REAL ESTATE: A TIME TO BUY?

While REITs have enjoyed periods of significant investor interest over the past two decades, the current global economy has cast a pall over the entire sector. Interesting. Very interesting.

By Jennifer Popovec

For centuries, wealth creation has been achieved through the ownership of land and, more recently, commercial buildings—a physical ownership of the real estate, if you will. Today, investors don't have to own the deed—to pour money directly into land or buildings—to create wealth; instead, they can invest in real estate in a more abstract fashion. That is to say, obviously, via real estate investment trusts (REITs) and mutual funds that invest in both domestic and international REITs and listed property companies. By now, financial advisors are well versed in the "new" asset class.

Real estate, though a significant portion of the world's economy, still is considered an alternative investment. Yet smart and savvy investors, whether they're institutional or individual, are increasingly interested in allocating a portion of their portfolios to real estate, and REITs in particular.

REITs provide investors with access to real estate assets and markets that otherwise would be unavailable, according to Stephen Todd Walker, author of, *Wave Theory for Alternative Investments*. Most people, for example, don't have the funds to buy a 50-story office tower in Manhattan, yet investing in a REIT makes it possible for John and Jane Doe to partake in the returns generated by such quality property. Likewise, it usually is impossible for individuals to acquire properties in foreign markets such as China and Brazil. Global real estate funds, however, offer exposure to growth-oriented markets.

REITs are well-liked for their ability to provide diversification to investment portfolios. And, as more REITs are established, often in niche sectors such as student housing and data centers, that diversification is multiplied.

Moreover, REITs continue to serve as a hedge against inflation. Despite the fact that inflation has not been a concern for several years, financial experts warn that an inflationary environment is sure to occur in the near future. Although REITs have recently been tied to the movement of the overall market and broader economy—and therefore subject to much of the same volatility—they still maintain a low correlation with the broader equity markets, Walker points out.

While REITs have enjoyed periods of significant investor interest over the past two decades, the current global economy has cast a pall over the entire sector. Investors perceive REITs to be on the higher end of the risk-reward continuum, and as they seek a safe haven for their money, REITs have become less attractive.

Walker cautions investors to avoid overreacting to current market conditions. "A lot of investors have done very, very well by investing in REITs, and if you aren't examining REITs as an important part of your clients' portfolio, you are not helping them," he asserts. "The best time to go surfing is not when it's sunny and the waves are flat. The best time to surf is during a storm."

REIT Performance by **Sector**

Sector	Total Return - YTD	Total Return - 1 Year	Total Return - 3 Year	Total Return - 5 Year
Hotel	-32.39	-19.48	-13.96	-48.19
Office	-8.17	-3.98	-10.19	-23.3
Diversified	-3.27	-0.74	2.49	11.3
Industrial	-14.81	5.2	-37.39	-51.49
Multifamily	3.99	13.03	36.28	20.84
Retail	-2.43	5.39	-2.46	-10.77
Self-storage	13.81	15.47	38.28	44.43
Healthcare	1.11	1.19	24.12	61.69
Manufactured Homes	16.22	20.44	61.66	58.88
SNL Equity REIT Index	-2.54	5.15	-1.61	-5.68
S&P 500	-5.16	4.98	3.59	-2.18

As of Sept. 27, 2011 — Source: *SNL Financial*

CHECK-IN TIME

Battered lodging REITs offer bottom-feeders an opportunity to get in on the ground floor.

By Jennifer Popovec

It's obvious that investor sentiment toward lodging REITs is negative. Despite solid and improving operating fundamentals, stock prices have steadily drifted lower throughout 2011. Investors are spooked by the increasingly grim global economic outlook, and they believe—with good reason—the hospitality sector is particularly vulnerable. However, industry analysts say investors have overreacted to macroeconomic concerns and that it's one of best times to invest in lodging REITs.

"We met with 23 different groups at the NYU Lodging Conference in mid-September, and no one is seeing any sign of a slowdown," says David Loeb, a managing director covering lodging REITs for Robert W. Baird & Co. "Demand for hotels is still strong enough that there's occupancy growth, and we're at a point where occupancy is high enough that operators have some pricing power to increase room rates. Risk is already built into the stock prices, and we think investors should overweight the sector."

Lodging stocks fall into two main categories – operators such as **Marriott International** (Ticker: MAR) and hotel REITs such as **Host Hotels & Resorts** (HST). Lodging operators tend to own very few properties and generate the bulk of their income from franchise fees and operating agreements.

Lodging REITs, in contrast, own hotel properties and generate most of their income through leases with hotel operators and franchisees. In some cases, however, lodging REITs also operate their own properties. Lodging REITs own some of the highest quality hotel assets in the world. Host Hotels, for example, owns the St. Regis Houston, along with the W New York, while **Ashford Hospitality Trust** (AHT) owns the Ritz-Carlton Atlanta.

Today, there are 17 publically-traded lodging REITs with a total market cap of $19.2 billion. Host Hotels & Resorts is the largest with a market cap of roughly $7.9 billion, according to SNL Financial. On the non-traded REIT side, there are two hotel-focused REITs currently raising money: Apple REIT Ten and Carey Watermark Investors. A number of other non-traded REITs invest in hotels, albeit not exclusively.

Poor Performance

The past five years represent the worst operating environment for the lodging sector since the early 1930s. Occupancy peaked in 2006, while revenue per available room (RevPAR) and average daily rate (ADR) peaked in 2007, along with lodging REIT stocks. In fact, the Baird/STR Hotel Stock Index, which is comprised of 15 publicly traded lodging companies and hotel REITs, shed nearly 85 percent from July 5, 2007 to March 6, 2009. In contrast, the RMZ lost 65 percent and the S&P 500 lost 55 percent during the same period. The five-year total return for the SNL US REIT Hotel Index was a negative 48.19 percent—the worst performance of all REIT sectors. Year-to-date (as of Sept. 27, 2011), the index was down 32.39 percent—once again a laggard compared to other REIT sectors.

Indeed, most publicly traded lodging REITs have posted a negative total return so far this year. But the returns, as with any industry sector, are not uniform: **InnSuites Hospitality Trust** (IHT), for example, achieved the highest total return of 31.63 percent, and FelCor Lodging Trust (FCH) is getting punished, recording the lowest total return of a negative 60.6 percent, according to SNL Financial.

Perhaps the equities needed a little rest. Loeb points out that lodging REIT stocks nearly tripled from March 2009 to February 2011. But, from February 2011 to the present, stocks have decreased more than 30 percent. "Investors were clearly concerned that the recovery in hotel stocks happened a little too soon," he says. "It's been a pretty spectacular sell off."

The average dividend yield for the hotel REIT sector—2.34 percent—is relatively unimpressive compared to those offered by other sectors. However, there are several REITs within the space that didn't pay a dividend for the last quarter, which drags down the entire sector. Most of them offer a dividend yield in the 3 percent to 4 percent range, according to SNL Financial.

Most investors view hospitality as the riskiest of all commercial real estate sectors because of its close ties with the overall economy and the short-term nature of nightly rentals versus multi-year lease agreements like those seen in retail and office properties.

Future Improvement

While PwC's report forecasts that some people will shorten or cancel their trips during the remainder of 2011 and into 2012, the firm still expects that most leisure travel plans will remain unchanged and corporate and group travel will continue to expand. As a result, its outlook anticipates ADR gains of 3.6 percent in 2011 and 5.1 percent in 2012. Likewise, it predicts RevPAR increases of 7.5 percent this year and 6.2 percent next year.

"The economy is not in great shape, but the nature of the economic weakness has not led individuals to cut back on leisure travel or businesses to cut back on corporate travel," Loeb contends. "Groups are booking for the next three months to a year. These are indicators that things are pretty good."

Expecting the Worst

Although operating metrics, management commentary and supply/demand dynamics all point toward positive growth through 2012, the market is pricing hotel REIT stocks as if the world is ending. For example, current 2012 EV/EBITDA multiples for the REITs in Baird's coverage universe are trading at 11.2, essentially pricing in a 15 percent decline for the firm's 2012 EBITDA forecast. That decline corresponds to flat RevPAR growth in 2012, a scenario that Loeb finds unlikely.

"We believe it would take a substantial change in travel patterns, like the one seen following the 9/11 terrorist attacks or the sharp decline in business travel during and after the 2008 financial crisis for [RevPAR to be flat or negative]," Loeb says. "While the risks of such a change in travel patterns now appear to be higher than they seemed to be a few months ago, we still see that risk as low."

Loeb contends that current valuations are attractive for risk-tolerant investors. "When sentiment turns positive, we believe relative outperformance could be achieved, hence our overweight recommendation of hotel stocks," he says. "Investors willing to shoulder heightened economic risks have a buying opportunity in high-quality lodging stocks, given the potential for several years of occupancy gains."

Lodging & Hospitality REITs

Institution Name	Ticker	Market Capitalization ($M)	Total Return (%) - YTD	Total Return (%) - One Year	Total Return (%) - Three Year	Total Return (%) - Five Year	Dividend Yield (%) (Most Recent Quarter)
Host Hotels & Resorts, Inc.	HST	$7,901.70	-37.2%	-22.82%	-18.53%	-45.18%	0.71%
Hospitality Properties Trust	HPT	2,780.20	3.18	10.02	40.38	-22.55	7.42
LaSalle Hotel Properties	LHO	1,645.50	-26.13	-16.99	-13.52	-46.79	1.67
RLJ Lodging Trust	RLJ	1,384.30	NA	NA	NA	NA	3.45
DiamondRock Hospitality Company	DRH	1,193.50	-39.02	-25.41	-19.55	-49.96	2.98
Strategic Hotels & Resorts, Inc.	BEE	835.3	-14.93	8.7	-50	-74.72	0
Pebblebrook Hotel Trust	PEB	760.4	-25.61	-16.19	NA	NA	2.38
Sunstone Hotel Investors, Inc.	SHO	643.8	-47.34	-42.98	-59.97	-77.98	0
Hersha Hospitality Trust	HT	560.6	-49.03	-34.81	-41.4	-49.35	4.31
Ashford Hospitality Trust, Inc.	AHT	436.1	-32.43	-26.15	62.61	-30.99	3.21
Chesapeake Lodging Trust	CHSP	363.4	-38.48	-30.37	NA	NA	4.69
FelCor Lodging Trust Incorporated	FCH	266.6	-69.6	-52.23	-68.06	-87.56	0
Summit Hotel Properties, Inc.	INN	214.1	NA	NA	NA	NA	3.96
Chatham Lodging Trust	CLDT	135.2	-42.05	-41.51	NA	NA	4.35
MHI Hospitality Corporation	MDH	20.8	2.33	-14.99	-52.33	-71.48	0
Supertel Hospitality, Inc.	SPPR	17	-53.16	-40.76	-80.96	-86.23	0
InnSuites Hospitality Trust	IHT	17	31.63	59.84	70.56	73.28	0.58
Hotel REITs (Sum / Average)		**19,175.60**					**2.34**

As of Sept. 27, 2011

Source: SNL Financial

REIT RED FLAGS

Five things to watch out for when evaluating REITs

By Jennifer Popovec

When it comes to REIT investing, you likely have your own method for determining which REITs offer the best investment opportunity. Total return and dividend yield are certainly two of the most popular metrics used to identify those oh-so-desirable REITs.

But what tells you that a REIT might not be such a good bet for your clients? What pieces of information throw up a red flag, shouting out, "Wait a minute! Are you sure about that?!"

Here, *Registered Rep.* identifies five red flags that will help you evaluate REITs so you can make sure your clients get what they need to achieve the best investment results.

Red Flag #1: Consistent poor performance

REITs obviously own real estate, so their performance can be influenced not only by overall market ups and downs, but also by real estate cycles. Thankfully, there are so many different entities that track REIT performance, it's not difficult to figure out how well different REIT sectors are performing, as well as the performance of specific REITs.

When evaluating REITs, it's important to put REIT performance in the context of the broader market, in addition to the REIT industry and different property types. A REIT that performs poorly when the overall REIT industry is doing well or when its peer REITs are showing strength should be carefully evaluated. Moreover, REITs that pay dividend yields lower than the rest of the sector—or don't pay them at all—require a second thought. (It's worth noting that REITs cannot suspend dividends indefinitely or they will lose their REIT status with the IRS.)

Red Flag #2: Dangerous debt

Several years ago as I interviewed a prominent mortgage banker, he told me, somewhat tongue-in-cheek, that it is "un-American to not use debt." He was referring to commercial real estate investors who paid for properties using nothing but cold, hard cash. The sentiment today is that all debt is bad. The reality, for REITs at least, is somewhere in the middle.

High levels of debt, debt maturity exposure or expensive debt are all considered to be dangerous debt and should be considered red flags, according to John Sheehan, a REIT analyst with Edward Jones. He says most REITs have an average debt to market cap of 30 to 45 percent. "That level of debt doesn't make me uncomfortable as long as it's structured properly and staggered appropriately," he explains.

It's true that the recent credit crisis (some would say it's ongoing) forced a lot of REITs to the edge. Many had too much debt, or even worse, had too much debt due at one time.

Because REITs own property, the typical REIT had both corporate debt and property-specific debt (mortgage debt). In some cases, REITs had mortgages that were cross-collateralized—meaning that one mortgage was secured by several properties. For example, property A's mortgage would be secured by properties A, B and C. In this scenario, if the REIT didn't pay property A's mortgage, the lender could foreclose on properties A, B and C.

Over the past three years, REITs have deleveraged; in other words, they've reduced the amount of debt they have on their balance sheet. Most of them have also either paid off property-specific debt or refinanced it so mortgages don't all come due at once.

"The general rule is that REITs that have less leverage have provided better risk-adjusted returns," says Brad Case, senior vice president of research and industry information for the National Association of REITs. "But, low leverage is not a guarantee—you want to look at the kind of debt they use." (See Red Flag #3.)

Red Flag #3: Limited access to capital

I've renovated a 100-year-old home from top to bottom, and I can promise you that the best handyman is one who has multiple tools in his toolbox and the know-how to use each and every one. The same analogy is true for REITs—the strongest and most successful REITs are those that have multiple sources of capital and an executive team that knows when and how to use that capital.

Historically, REITs have relied primarily on mortgage debt to finance their growth. Increasingly, however, REITs are moving away from mortgage debt (see problems associated with mortgage debt in Red Flag #2) and focusing on accessing capital in other ways.

For example, more REITs are expanding their unsecured lines of credit with multiple capital sources. In addition, many REITs have pursued investment-grade credit so they can issue unsecured debt in the form of corporate bonds. While REIT analysts do not advocate one form of debt over another, they do prefer that REITs have access to capital through many different vehicles.

Red Flag #4: Shaky strategy

REITs are no different from any other business—in order to succeed, they must have a differentiated strategy and be able to execute that strategy consistently and effectively. The problem arises not when they stumble in the execution of their articulated strategy, but when their strategy is ill-defined or shaky. It's even worse when a REIT, faced with a challenging operating environment due to real estate cycles, veers off course.

"You don't want to penalize a company for trying new things and having new ideas," Sheehan says. "But, if they're changing their strategy every couple of years and chasing the

Bottom 25 REITs by **YTD** Total Return

Company (ticker)	Total Return
Pacific Office Properties Trust, Inc. (PCE)	-88.73
FelCor Lodging Trust Incorporated (FCH)	-69.6
Supertel Hospitality, Inc. (SPPR)	-53.16
Presidential Realty Corporation (PDNLB)	-49.08
Hersha Hospitality Trust (HT)	-49.03
Sunstone Hotel Investors, Inc. (SHO)	-47.34
Getty Realty Corp. (GTY)	-47.3
Cedar Shopping Centers, Inc. (CDR)	-46.01
Chatham Lodging Trust (CLDT)	-42.05
Sabra Health Care REIT, Inc. (SBRA)	-41.51
Pennsylvania Real Estate Investment Trust (PEI)	-40.05
HMG/Courtland Properties, Inc. (HMG)	-39.9
DiamondRock Hospitality Company (DRH)	-39.02
Chesapeake Lodging Trust (CHSP)	-38.48
Host Hotels & Resorts, Inc. (HST)	-37.2
USA Real Estate Investment Trust (USRE)	-35.83
CapLease, Inc. (LSE)	-33.8
Parkway Properties, Inc. (PKY)	-33.46
Gyrodyne Company of America, Inc. (GYRO)	-33.07
Ashford Hospitality Trust, Inc. (AHT)	-32.43
Cogdell Spencer Inc. (CSA)	-32.14
Corporate Office Properties Trust (OFC)	-31.76
Ramco-Gershenson Properties Trust (RPT)	-30.89
Kite Realty Group Trust (KRG)	-29.06
Saul Centers, Inc. (BFS)	-28.29

As of Sept. 26, 2011 Source: *SNL Financial*

Bottom 25 REITs by **1-Year** Total Return

Company (ticker)	Total Return
Pacific Office Properties Trust, Inc. (PCE)	-90.02
Presidential Realty Corporation (PDNLB)	-55.38
FelCor Lodging Trust Incorporated (FCH)	-52.23
Cedar Shopping Centers, Inc. (CDR)	-46.79
USA Real Estate Investment Trust (USRE)	-43.8
Sunstone Hotel Investors, Inc. (SHO)	-42.98
Chatham Lodging Trust (CLDT)	-41.51
Supertel Hospitality, Inc. (SPPR)	-40.76
Cogdell Spencer Inc. (CSA)	-37.87
Getty Realty Corp. (GTY)	-37.23
Hersha Hospitality Trust (HT)	-34.81
Corporate Office Properties Trust (OFC)	-34.27
Chesapeake Lodging Trust (CHSP)	-30.37
Brandywine Realty Trust (BDN)	-30.33
CapLease, Inc. (LSE)	-30.08
Gyrodyne Company of America, Inc. (GYRO)	-29.77
Pennsylvania Real Estate Investment Trust (PEI)	-29.44
Ashford Hospitality Trust, Inc. (AHT)	-26.15
Winthrop Realty Trust (FUR)	-25.56
DiamondRock Hospitality Company (DRH)	-25.41
Hudson Pacific Properties, Inc. (HPP)	-24.87
Ramco-Gershenson Properties Trust (RPT)	-22.84
Host Hotels & Resorts, Inc. (HST)	-22.82
Terreno Realty Corporation (TRNO)	-22.13
CommonWealth REIT (CWH)	-21.34

As of Sept. 26, 2011 Source: *SNL Financial*

Bottom 25 REITs by **3-Year** Total Return

Company (ticker)	Total Return
Pacific Office Properties Trust, Inc. (PCE)	-92.33
Presidential Realty Corporation (PDNLB)	-81.77
Supertel Hospitality, Inc. (SPPR)	-80.96
USA Real Estate Investment Trust (USRE)	-80.14
Cousins Properties Incorporated (CUZ)	-73.45
Cogdell Spencer Inc. (CSA)	-73.04
Cedar Shopping Centers, Inc. (CDR)	-72.59
First Industrial Realty Trust, Inc. (FR)	-70.34
FelCor Lodging Trust Incorporated (FCH)	-68.06
MPG Office Trust, Inc. (MPG)	-67.38
DDR Corp. (DDR)	-66.56
Parkway Properties, Inc. (PKY)	-66.24
Sunstone Hotel Investors, Inc. (SHO)	-59.97
Kite Realty Group Trust (KRG)	-56.13
Ramco-Gershenson Properties Trust (RPT)	-54.66
MHI Hospitality Corporation (MDH)	-52.33
Kimco Realty Corporation (KIM)	-51.4
Strategic Hotels & Resorts, Inc. (BEE)	-50
Duke Realty Corporation (DRE)	-48.66
Lexington Realty Trust (LXP)	-47.51
CapLease, Inc. (LSE)	-46.57
Winthrop Realty Trust (FUR)	-42.8
Pennsylvania Real Estate Investment Trust (PEI)	-41.97
Hersha Hospitality Trust (HT)	-41.4
Alexandria Real Estate Equities, Inc. (ARE)	-40.95

As of Sept. 26, 2011 Source: *SNL Financial*

Bottom 25 REITs by **5-Year** Total Return

Company (ticker)	Total Return
Feldman Mall Properties, Inc. (FMLP)	-98.83
MPG Office Trust, Inc. (MPG)	-93.85
FelCor Lodging Trust Incorporated (FCH)	-87.56
Supertel Hospitality, Inc. (SPPR)	-86.23
Pacific Office Properties Trust, Inc. (PCE)	-85
Presidential Realty Corporation (PDNLB)	-84.7
USA Real Estate Investment Trust (USRE)	-79.06
Sunstone Hotel Investors, Inc. (SHO)	-77.98
DDR Corp. (DDR)	-77.32
First Industrial Realty Trust, Inc. (FR)	-76.69
Cousins Properties Incorporated (CUZ)	-75.88
Strategic Hotels & Resorts, Inc. (BEE)	-74.72
Cogdell Spencer Inc. (CSA)	-73.55
Cedar Shopping Centers, Inc. (CDR)	-73.12
MHI Hospitality Corporation (MDH)	-71.48
HMG/Courtland Properties, Inc. (HMG)	-70
Kite Realty Group Trust (KRG)	-68.72
Pennsylvania Real Estate Investment Trust (PEI)	-68.08
Parkway Properties, Inc. (PKY)	-67.91
Brandywine Realty Trust (BDN)	-64.56
Ramco-Gershenson Properties Trust (RPT)	-62
Winthrop Realty Trust (FUR)	-60.34
Duke Realty Corporation (DRE)	-60.17
CBL & Associates Properties, Inc. (CBL)	-55.73
CapLease, Inc. (LSE)	-53.86

As of Sept. 26, 2011 Source: *SNL Financial*

Bottom 10 REITs by **Dividend Yield**

Company (ticker)	Dividend Yield (MRQ)
SL Green Realty Corp. (SLG)	0.48
InnSuites Hospitality Trust (IHT)	0.58
Host Hotels & Resorts, Inc. (HST)	0.71
DDR Corp. (DDR)	1.13
LaSalle Hotel Properties (LHO)	1.67
Parkway Properties, Inc. (PKY)	1.76
Apartment Investment and Management Company (AIV)	1.88
Boston Properties, Inc. (BXP)	1.88
DuPont Fabros Technology, Inc. (DFT)	1.9
Post Properties, Inc. (PPS)	1.96

As of Sept. 26, 2011 Source: *SNL Financial*

Top 10 REITs by **Total Debt/Total Equity**

Company (ticker)	Total Debt/ Total Equity
First Real Estate Investment Trust of New Jersey (FREVS)	8.8
InnSuites Hospitality Trust (IHT)	5.82
Apartment Investment and Management Company (AIV)	4.34
Alexander's, Inc. (ALX)	3.82
CapLease, Inc. (LSE)	3.71
Supertel Hospitality, Inc. (SPPR)	3.61
CBL & Associates Properties, Inc. (CBL)	3.46
Pennsylvania Real Estate Investment Trust (PEI)	3.31
MHI Hospitality Corporation (MDH)	3.12
Simon Property Group, Inc. (SPG)	3.06

As of Sept. 26, 2011 Source: *SNL Financial*

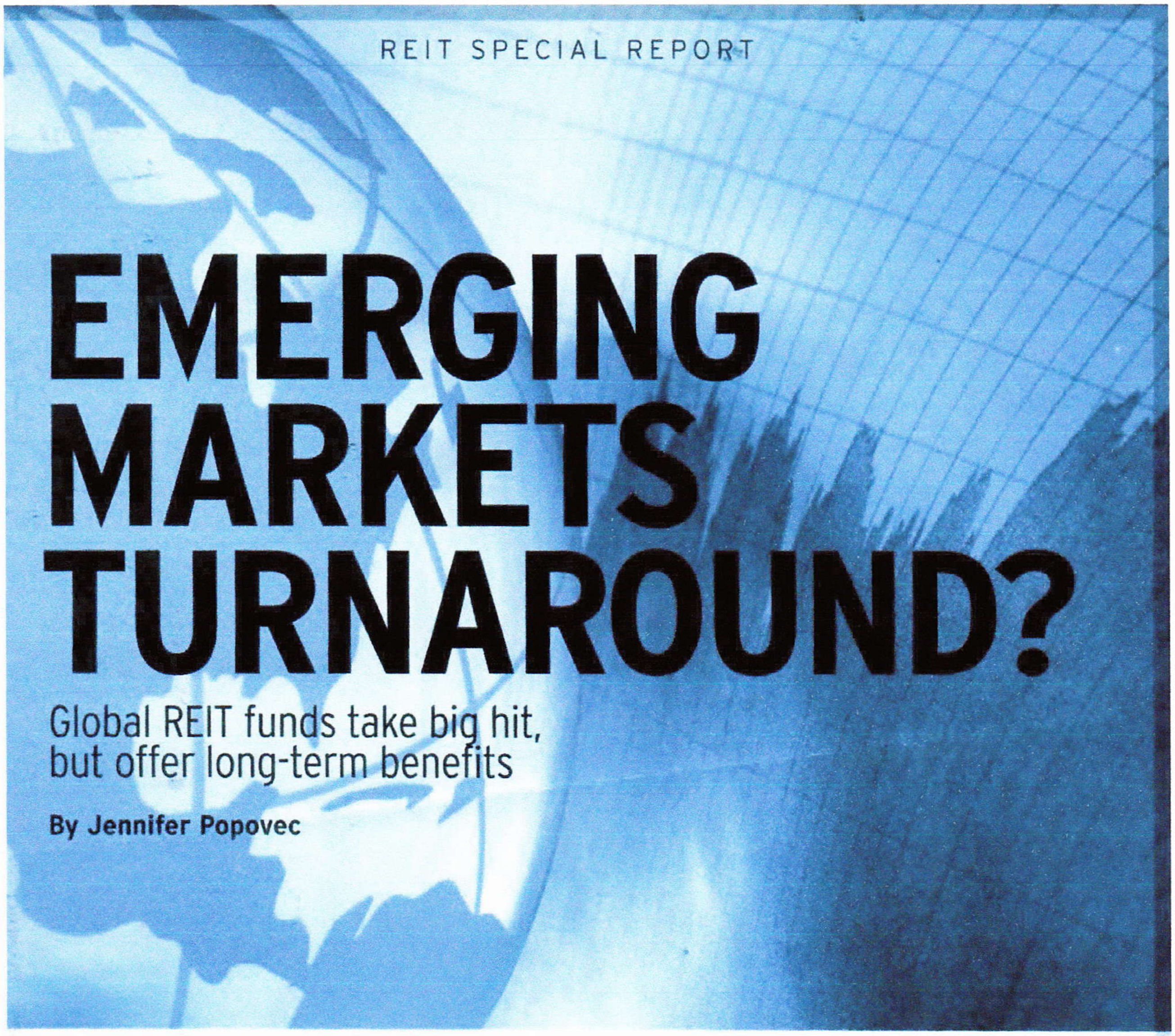
next fad—that's a red flag," he points out. "Most companies that have been successful have articulated a broad strategy and executed it. Those that haven't been successful have not found their core guiding light."

Red Flag #5: Excessive executive and board turnover

Unless someone is referring to the entrance of a building a REIT owns, you don't want the word "revolving door" to come up. In fact, when it comes to REITs, job-hopping executives and flighty board members are worse than a red flag, they're a red light, experts warn.

While excessive executive and board turnover can simply be bad timing or family illness, it's more than likely that it is the result of a failure to meet expectations or internal dysfunction. Either way, it's ugly. And, it causes the REIT to suffer from both a lack of quality leadership and continuity.

Without quality and consistent leadership, the REIT's performance could be compromised.



EMERGING MARKETS TURNAROUND?

Global REIT funds take big hit, but offer long-term benefits

By Jennifer Popovec

Global real estate funds have suffered several difficult years, posting negative returns and disappointing investors. With funds trading at least 20 percent off their peak pricing for 2011 and posting negative returns ranging from nearly 7 percent to more than 28 percent, industry experts suggest that investors who are looking to diversify their real estate portfolios and to position themselves for an improving global economy should consider investing in global real estate funds.

"If you look at future economic growth and real estate demand, the opportunities are better in emerging markets than here in the U.S.," says Tom Roseen, a research analyst with Lipper. "It makes sense that global real estate funds are an attractive place for investors over the long haul."

Relying on Development Activity

Obviously, global real estate fund performance varies based on the composition of the REITs and listed property companies within the fund. What may be less obvious is how REITs and listed property companies across the globe are impacted by regions in which they operate.

While each country has its own specific legislation regarding REIT structures and listed property companies, these companies also are differentiated by their investment strategies, which vary dramatically depending on whether they're based in the United States, Europe or Asia-Pacific. (With the exception of Brazil, there are few publically-traded real estate companies in South America.)

For example, U.S.-based REITs tend to generate the bulk of their income from existing properties with only a small portion of their investment activity focused on development. The reasons for this are two-fold: One, the U.S. is a relatively mature commercial property market with limited development opportunities; two, development is considered a risky endeavor, and investors tend to shy away from REITs that are overly focused on development.

In contrast, REITs and listed property companies based in Asia-Pacific are heavily focused on development. With robust population growth and a burgeoning middle class,

Better Days **Ahead**

These global funds have been increasing their equity allocations and moving away from bonds.

Fund	YTD Total Return	1-year total return	3-year total return	5-year total return	10-year total return
Global Real Estate Funds Average	-13.88	-6.69	-2.84	-5.41	8.45
International Real Estate Funds Average	-19.11	-12.52	-4.14	-6.26	8.89

Source: *Clipper*

opportunities for new development projects are plentiful and varied across multiple property types, from hotels to high-rise residential properties.

Since development tends to provide juicier returns, it makes sense that Asia-Pacific REITs and listed property companies posted better returns during the most recent real estate boom. The flip side is that when the regional and global economies are weak, development activity moderates, which significantly impacts the investment performance of the companies that rely on development.

European REITs and listed property companies traditionally have not focused on development, primarily because most Western European countries have little developable land and limited demand. The opposite is true for Eastern Europe, particularly Russia, the Czech Republic and other former Soviet bloc countries.

However, the risks of developing in these countries are significant. Although a handful of REITs and listed property companies have dipped a toe in these emerging European markets, most of them tend to shy away from countries that still operate under archaic and convoluted property laws. Moreover, opportunities to develop in Europe have been mitigated by the region's economic troubles, which seem to be escalating rather than waning. That translates into depressed returns for European REITs and listed property companies.

Exposure to Emerging Markets

Over the past decade, commercial property developers and owners have been buzzing about emerging markets like the "BRIC" nations of Brazil, Russia, India and China. These markets, with their burgeoning middle class, tend to be chronically underserved for both residential and commercial property.

Global real estate funds benefited from the excitement surrounding emerging markets. Lipper's data shows that global real estate funds posted a 10-year total return of 8.45 percent—outperforming most major indices.

A recent whitepaper by global fund manager Cohen & Steers, "Emerging Markets Real Estate Securities: Risk/Return Profile and Asset Allocation," found that adding emerging market (EM) real estate securities can enhance a portfolio's risk-adjusted return characteristics. Scott Crowe, global portfolio manager with Cohen & Steers and author of the whitepaper, calculated that a portfolio that included a 10 percent allocation to EM real estate securities would have returned 1.1 percent per annum more than a portfolio excluding this allocation over the 10-year period ended Dec. 31, 2010.

However, the global real estate funds have taken big hits since the global credit crisis and the subsequent global recession. The five-year total return for Lipper's global real estate funds was -5.41 percent.

10 **largest** global properties

Company Name	Country	Market Capitalization (€M)	YTD Total Return (%)	1-Yr Total Return (%)	3-Yr Total Return (%)	5-Yr Total Return (%)
Cheung Kong Holdings Limited	Hong Kong	€214,940.10	-20.6%	-22.44%	46.1%	23.5%
China Overseas Land & Investment Limited	Hong Kong	106,896.50	-7.1	-18.32	59.43	115.83
DLF Limited	India	382,164.30	-22.3	-38.93	-19.91	NA
Hang Lung Group Limited	Hong Kong	61,286.70	-9.5	-11.68	135.67	142.41
Hang Lung Properties Limited	Hong Kong	120,085.00	-24.2	-26.88	96.79	79.9
MTR Corporation Limited	Hong Kong	144,889.10	-9.2	-14.92	71.9	47.88
Sun Hung Kai Properties Limited	Hong Kong	266,513.10	-19.1	-21.15	83.85	38.46
Swire Pacific Limited	Hong Kong	137,824.80	-23.5	-13.28	119.83	35.86
Unitech Limited	India	69,855.20	-59.7	-70.59	-66.31	-85.89
Wharf (Holdings) Limited	Hong Kong	115,111.40	-35.2	-26.06	182.05	67.13

* as of 10.24.11

Source: *SNL Financial*

"The global markets have been crushed, particularly the real estate sector," Roseen says. "In addition to concerns about Europe's economy, investors also are discouraged by the lack of real estate activity in Asia."

In fact, fund performance throughout 2011 has been downright ugly. As of Sept. 22, global real estate funds had a total return of -13.88 percent, according to Lipper.

Even the best performing fund, **DFA Global Real Estate Securities Portfolio** (Ticker: DFGEX), still posted a negative total return of 6.94 percent. The worst performing fund, **Alpine Emerging Markets Rl Estate Fund** (AEMEX), posted a total return of -28.12.

Despite their less-than-stellar performance, global real estate funds still have managed to significantly outperform their international counterparts, primarily because of their exposure to domestic REITs and other real estate stocks, Roseen notes.

"Domestic exposure has mitigated losses for global funds versus pure international funds," Roseen explains, pointing out that international real estate funds posted a year-to-date loss of -19.11 percent (as of Sept. 22). Interestingly, the 10-year total return for international real estate funds—8.89 percent—is better than average return for global real estate funds for the same period.

Strong Earnings Potential

While the global economy continues to cause concern, most real estate experts agree that the worst is over. That means improving property fundamentals across the globe and better financial performance from listed property companies and REITs.

"There are many countries that are on the cusp of major wealth creation," says Brad Case, senior vice president of research and industry information for the National Association of REITs. "If you are confident that the economy will improve, you want to be investing in global real estate funds now when the price is low and strong earnings growth is in the future. You want to invest before that wealth creation takes place. The biggest mistake you can make is to wait until the recovery is already under way and miss out."

Crowe wrote in the Cohen & Steers whitepaper that "growth potential is higher for EM real estate securities than for either developed property or broad equity markets." He concluded that 10 percent to 20 percent of an investor's overall real estate investment portfolio should be allocated to EM real estate securities, subject to individual return and risk requirements.