

News release

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REITs leading real estate out of global financial downturn

Asian REITs significantly outperformed other regions

London & Sydney, 9 March 2010: Real estate investment trusts (REIT) are leading other property investments out of the global economic downturn largely thanks to the resiliency of the REIT model, according to a report released today by Ernst & Young.

The report, *Against all odds: Ernst & Young's Global REIT Report 2010* covers 16 of the world's largest REIT markets and includes analysis of total rates of return, market capitalization and debt loads as well as an outlook for the global REIT sector.

“The nature of real estate has typically been that it takes time for investors to identify and select investments but REITs were created chiefly to provide a market for investors to be able to buy and sell real estate – through securities rather than bricks and mortar – more efficiently,” said Howard Roth, Global Leader of the Real Estate sector for Ernst & Young.

“Our analysis shows that during the recent global downturn, REITs did what they were intended to do: give investors – albeit at a price – an opportunity to quickly adjust their exposure to real estate by selling REIT stocks. Now, REITs are providing investors with a way to capture the market rebound by adding real estate stocks back into their portfolios,” added Roth.

Double digit positive returns for REITs

Since March 2009, many REIT markets around the world have seen significant increases in share prices and REITs have raised billions of dollars by going back to the stock market for secondary (or follow-on) equity offerings to reduce debt, recapitalize their balance sheets and prepare their businesses for the next wave of growth.

“The turnaround in the global REIT market in 2009 is best shown by the fact that all REIT markets – except Japan -- saw double digit positive returns for the year,” said Robert Lehman, Global Leader of Ernst & Young’s Real Estate Investment Trust practice. Returns for Japan’s REITs grew just 6.68%, with Australia’s REITs performing slightly better at 10.4% growth in returns in the same full year period. The largest single REIT market in the world, the United States, witnessed almost 28% returns.

Ernst & Young’s report reveals a compelling story for Asia where REITs as a group have outperformed other regions of the world in terms of total returns. Singapore and Hong Kong REITs posted 85.6% and 64.5% returns respectively in 2009 with Malaysia (38.6%) and South Korea (28.4%) also showing strongly. South Korea, Malaysia and Hong Kong all recorded positive rates of return in their REIT markets over the last three years, despite the global downturn.

Some challenges for the UK and A-REIT markets

On the other side of the coin, the United Kingdom and Australian REIT (A-REIT) markets recorded poor performance over the last three years, both exceeding negative 20% returns. According to Chris Lawton, Leader of Ernst & Young’s Australian Real Estate practice, the poor performance of Australian REITs is on one level surprising, given that the economy ultimately proved to be far more robust through the downturn than the UK economy.

“Our report indicates that the main reason REIT markets in the UK and Australia have performed poorly in the last few years is that they have moved furthest from the traditional “passive” REIT model – where REITs purchase existing properties and capture revenue by managing those properties – and moved much further up the risk/return curve into high risk development activities,” said Lehman.

Weaknesses in the REIT model

The report also outlines weaknesses in the REIT model exposed by the global financial downturn most notably that requirements placed on REITs to distribute a large percentage of their income to investors made it very difficult for most to conserve cash at a time when they most needed to. Also, restrictions on REIT debt levels in many countries – designed to prevent REITs from over-leveraging during a period of market growth – had potentially serious tax implications for REITs during the downturn.

“A lesson from the downturn is that governments need to take a look at REIT distribution rules – whereby a high proportion of REITs’ income (typically 95 percent) has to be distributed to investors via dividend payments - because the ability to conserve cash could be critical to the survival of some REIT businesses in the next global financial crisis,” said Lehman.

The report also suggests that investors can play a role in creating greater stability for REITs during market downturns. For example, during the last phase of growth, investors seeking higher returns were, in effect, pushing A-REITs to diversify into riskier ventures such as development and offshore assets in order to boost returns. Many A-REITs did diversify but this ultimately made them much more vulnerable during the downturn.

“Investors need to do some soul searching and ask themselves what part do they want REITs to play in their portfolios? Do they want stable income or returns? A clear message will help REIT managers run their businesses appropriately,” Lehman added.

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