

Quarterly Review

Second Quarter 2009

Quarter sees significant recovery in global real estate stocks

Global real estate stocks recovered significantly in the second quarter with strength in all markets, but particularly in the U.S., Hong Kong, and Singapore. Stocks in the UBS Investors Index produced a positive total return of 24.1% in the quarter while the MSCI World Equity Index of broad-market stocks rose 16.7%. (All returns are stated in local currencies.) Year-to-date, global real estate stocks have produced a negative return of 5.5% versus a positive return of 5.2% in the broad global equity market.

Global Performance Review¹

UBS Investors Indices	2Q09	YTD at 6/30/09	2008
Hong Kong	33.5	39.4	-41.1
United States	30.4	-16.2	-38.8
Singapore	28.8	30.9	-53.7
Canada	25.7	14.0	-40.1
Global Real Estate	24.1	-5.5	-42.6
United Kingdom	17.0	-17.2	-47.0
Continental Europe	16.6	6.0	-43.4
Australia	15.1	-12.6	-51.5
Japan	13.6	4.0	-43.6
MSCI World Index	16.7	5.2	-38.3

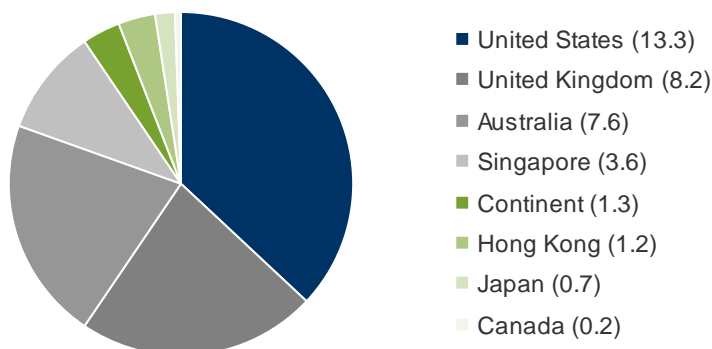
Capital markets have reopened to Global Real Estate Companies

Recent months have been marked by a somewhat improved investment and economic mood, and the opening of the capital markets to global real estate companies, particularly in Australia, Singapore, the U.S., and the U.K. More than \$35 billion USD of new equity shares have been issued by almost eighty public real estate companies since the first of the year. The credit markets have also become more liquid in the past few months, and credit spreads have narrowed materially for a broad spectrum of key industry benchmarks.

This new capital has gone a long way towards improving the ability of the capital-raising companies to avoid severe financial distress, and we believe positions the better-run companies to take advantage of opportunistic property sales which have been sparse to date but are likely to accelerate in the next several quarters.

¹ All Index returns for Global Real Estate Companies are expressed in the UBS Investors Index (local currency, gross dividends) or its sub-indices; Broad market returns are those of the MSCI World Index (local currency, gross dividends) or its sub-indices.

**New equity raised – First Half 2009
(\$ billion USD)**



New capital is of particular benefit to U.S. REITs

Renewed access to capital was the key factor in the strong performance of real estate stocks in the U.S. More than \$13 billion in equity has been raised by more than 35 U.S. real estate companies since the first of the year, with representation from every property category. U.S. REITs were up 30%; the broad U.S. stock market gained 16%.

Lodging and regional mall stocks dramatically outperformed in the second quarter, up 75% and nearly 60% respectively. These sectors benefited from new liquidity, and also from the perception that the economy and consumer spending, while not yet recovering, may be closer to a bottom than thought earlier in the year. Office, industrial, and shopping center stocks benefited to a lesser extent. The more recession-resistant apartment and health care stocks lagged in the period, after outperforming earlier in the year.

Real U.S. GDP, using updated forecasts and data developed by Global Insights, is expected to decline 3.0% in 2009, with consumption down 0.8%; both figures are favorable revisions from earlier estimates. A return to growth in the economy is currently projected for 2010. Fundamentals continue to deteriorate in most property types and markets, and should not recover until well after the economy has turned the corner.

And to property companies in the U.K.

Capital was important in other markets as well. Real estate companies in the U.K. and Continental Europe were each up 17%, as companies continued to strengthen their balance sheets through asset sales and stock issuance. More than a dozen companies in the U.K. have issued new capital in the last few months, raising more than \$8 billion USD. There was also an initial offering for a fund to make high-opportunity investments in Central London. Continental Europe was less active, with six companies raising \$1.2 billion USD.

Real GDP growth estimates in the Eurozone are projected to be negative 4.6% in 2009 and about break even in 2010. In the U.K., GDP is expected to be off 3.1% in 2009 and another 1.1% in 2010. Most companies reported first quarter results in line with expectations, with the recession resulting in first signs of operational weakness. In most European office markets vacancies increased and retail sales figures fell, but oftentimes the weaker top-line growth was offset by interest costs savings as a result of falling interest rates.

Sales included Hammerson's sale of interests in London and Paris office properties. A transaction was announced between Swiss Prime Site and Jelmoli Holding that will create the largest listed Swiss real estate portfolio. British Land sold two substantial office properties. The second quarter also marked a flurry of direct property transactions by U.K. REITs.

Asia-Pacific is not immune to the recession, but underlying conditions are more favorable

With a relatively strong economy today (with GDP down only 0.6% in 2009 and up 0.9% in 2010), Australian real estate stocks did not benefit as much by the more favorable capital markets in the quarter, and property shares were up 15% in the quarter. Ten companies have raised capital this year, with more than \$7 billion raised. Consumer spending is expected to be up 0.7% in 2009 (an improvement) and up 0.9% next year, and consumer sentiment was up

strongly late in the quarter. Business confidence is up as well, though still slightly negative, and housing is showing growth. Commercial property sales continue at a reasonable level.

Real estate stocks in Japan were the weakest in the group in the quarter, but still rose nearly 14%. Japan's economy continues to be very poor, with estimates for 2009 slightly worse than those of the last three months; real GDP is projected to decline almost 7% in 2009, the worst performance among large economies. Even so, there are some bright spots. Refinancing risk appears to be receding thanks to increased lending by the Development Bank of Japan, and several smaller J-REITs have recently announced or are expected to announce additional sponsorship to their advisors, thus enhancing their reputations and potentially improving their refinancing outlook in the next few months.

Hong Kong and Singapore - sector leaders

Hong Kong and Singapore real estate stocks lead the sector for the year and did somewhat better than the average in the quarter, up 34% and 29% respectively. While their recessions are sharp, recovery is expected to be rapid as well. Housing is surprisingly strong in the region and companies associated with housing have done better than traditional investors. Both retail spending and exports are up in Hong Kong, with exports almost reaching levels of a year ago. In Singapore, exports and manufacturing expanded towards the end of the quarter. Several major S-REITs have raised more than \$3 billion USD in capital in the past few months.

Economic recovery anticipated in 2010, with real estate recovery to follow

The world economy remains in recession, with a recovery anticipated in 2010. Recent estimates have improved for most economies compared with projections made earlier in the year. We now expect the global economy to decline by 2.6% in 2009, then recover most of the loss in 2010. Our company earnings estimates have stabilized, and we project declines in the earnings of global real estate companies of 6% or so this year, with a slightly smaller decrease in 2010. We emphasize that we expect most public real estate companies to continue to be profitable in absolute terms and have adequate financial flexibility during this period.

Investment Outlook

In today's environment, we are paying particular attention to balance sheet strength and the ability of companies to refinance their obligations and raise new capital. We favor companies that have strong balance sheets with moderate gearing and manageable debt maturity schedules. Companies with capital and astute management are likely to have lucrative acquisition opportunities over the next couple of years.

Although many global real estate companies have cut their current dividend payouts, Global Real Estate Companies as a group pay dividends today producing yields substantially higher than those offered by most investment alternatives. The prices of real estate stocks are in a comfortable relationship with our estimates of underlying asset values, with stocks selling at a mid-single digit premium today. While there is a risk that these values will decline further if distressed selling materializes, our estimates of property values have been adjusted to conservative levels relative to long-term norms and compared with capital market alternatives.

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