Benchmarking the REIT Industry

Since 1960, REITs have changed the face of real estate investment by attracting a host of investors. REITs provide liquidity, a minimum dividend payout of 90% of the REIT's taxable income, diversification, and transparency that limited partnerships and direct investments lack. REITs have a low correlation to the overall stock market and deliver better risk-adjusted performance.

Q: What is the philosophy behind creating the NAREIT indexes?

A: The National Association of Real Estate Investment Trusts®, Inc. or NAREIT, is a nonprofit organization that conducts research, investor education and policy-related activities regarding REIT investment. Our indexes, which are managed and marketed by FTSE Group, provide a means of measuring the industry's performance. They also provide the basis for investment products, as well as benchmarks for investment managers.

Q: Why do you believe that REITs are superior to other forms of real estate investment?

A: REITs are in the business of owning and managing investment grade, commercial real estate assets and were established by Congress in 1960. The modern REIT era, though, dates back to the early 1990s. A flood of IPOs in the 1990s established the basis for the large, publicly traded industry we know today. It also created a market deep and liquid enough for large institutions to invest in REITs.

Large-scale investment in REITs by institutional investors in the 1990s and the current decade led to the emergence of a different pattern of investment returns that showed less correlation with the broader market and more correlation with direct real estate investment. Investors realized that, far from being just income producing stocks, REITs were a way of owning real estate. In fact, in the last 15 years the average correlation between REITs and the broad stock market has been only about 35%. Consequently, REITs are an excellent portfolio diversifier.

Over the past 15 years, REITs also have delivered risk-adjusted returns superior to bonds, commodities and other investments that also provide low correlation to the stock market. In fact, we have conducted research that demonstrates over the last 15 years there is no other type of investment that provides the same combination of both diversification power and risk-adjusted returns as REITs.

Large institutional investors historically have invested directly in commercial property, such as office buildings, shopping centers, apartment buildings and warehouse facilities. But academic research over several time periods shows REIT investments have outperformed direct investments by signifi-

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Over nearly 20 years Case has conducted academic research on various aspects of commercial and residential real estate markets, including the returns to investment in real estate through REITs.

Prior to joining NAREIT Case worked for the Federal Reserve Board of Governors in Washington, where he developed proposals for improved regulation of commercial and residential mortgage credit markets. Case earned his Ph.D. in Economics at Yale University.

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cant margins – up to 300 basis points – after adjusting for differences in property type mix, leverage and other measurement issues.

Q: What are the indexes that come under the NAREIT umbrella?
A: We have created several different REIT indexes that are managed and marketed for us by FTSE Group. We have the FTSE NAREIT All REIT Index, the most comprehensive index of the U.S. REIT market that includes approximately 150 REITs. The FTSE NAREIT Real Estate 50 Index comprises the 50 largest U.S. REITs.

The FTSE NAREIT Equity REIT Index is an index of publicly traded REITs that own commercial property. The FTSE NAREIT Mortgage REIT Index includes publicly traded REITs that own mortgage assets. A small group of REITs own both commercial properties and commercial mortgages and are included in the FTSE NAREIT Hybrid REIT index.

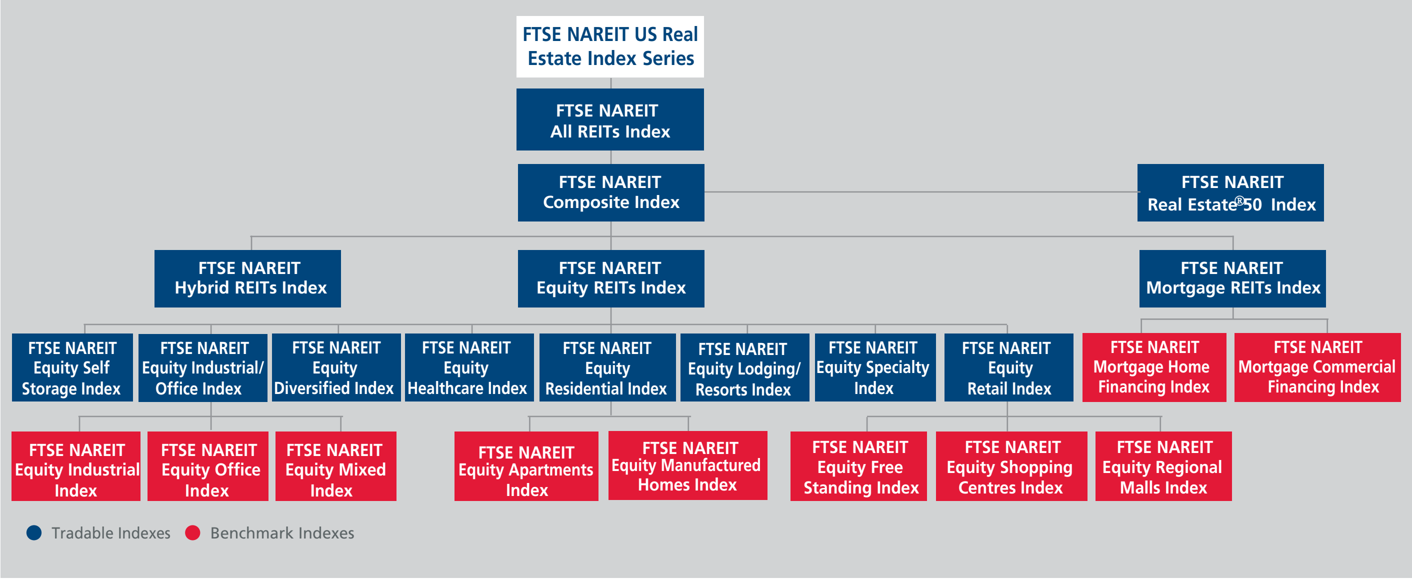
Most REITs tend to specialize by property type, so within our Equity REIT index, we have sub-indexes of REITs that invest only in retail malls, warehouses, offices or other specific property groups. For example, there are 27 REITs that are primarily retail and so they're all in the Retail REIT sub-index. Within that group, there are three sub-sectors with an index for each.

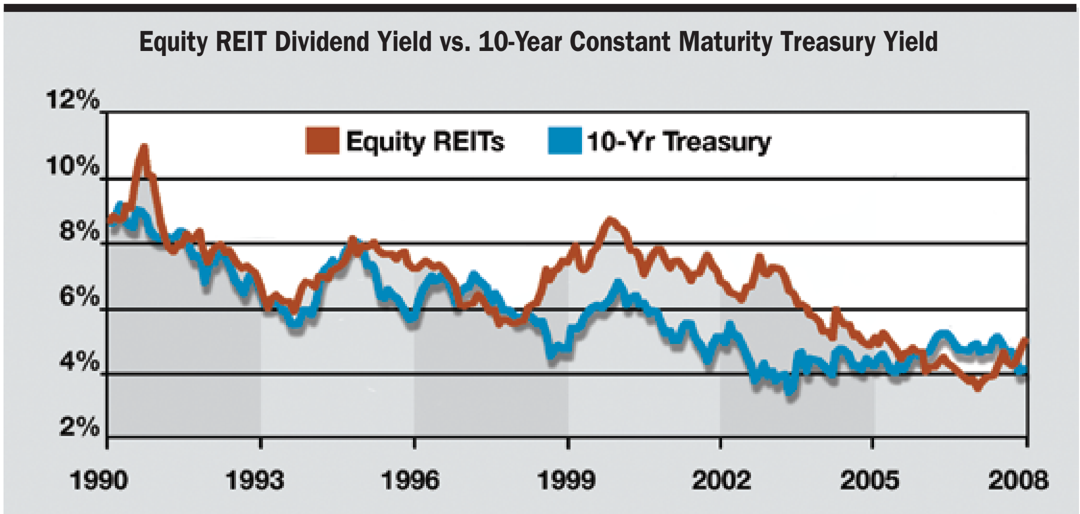
Because mortgage REITs tend to specialize in either single-family residential mortgages or commercial mortgages, there are sub-sector indexes within the FTSE NAREIT Mortgage REIT Index for both home financing and commercial financing REITs.

In addition, FTSE maintains the FTSE EPRA/NAREIT Global Real Estate Index Series, which is not restricted just to REITs but also includes non-REIT real estate companies worldwide. This index is divided into North American, Asian and European sub-indexes, and country-specific indexes, as well.

Q: How do investors go about investing in REITs?
A: All of the REITs in our indexes are publicly traded companies, mostly listed on the New York Stock Exchange that can be bought like any other stock. There also are many mutual funds and ETFs dedicated to REITs, a number of them based on our indexes.

FAMILY TREE





The advantage in REIT investment is access to the returns from commercial real estate investment without having to undertake the responsibilities of being a landlord. One also gets the benefit of active management that has produced such strong returns for REITs and access to a fully diversified portfolio rather than just one property and the investment is liquid. Selling an office or apartment building that you own directly is difficult, time consuming and expensive. REITs, however, are traded throughout the day on the major exchanges like any other stock.

Limited partnerships do not provide the liquidity of REITs or the investment efficiency, since they typically involve substantial management fees and may limit withdrawals. They also do not provide the same transparency. As publicly traded companies, REITs are subject to the same regulatory filing and disclosure requirements as any other publicly traded stocks.

Q: What percentage of REIT activity is in construction and development of real estate?

A: The proportion of REIT earnings derived from construction and development isn't a fixed number. Most equity REITs will develop properties if it is more economical to develop them than to buy existing properties. There may be more or less development at any given time, depending on market conditions. Low borrowing costs in 2005 and 2006 drove up prices for existing properties, making development more attractive for many REITs. The current slowdown in private equity activity may reduce some of that pricing pressure on existing properties and make acquisition more attractive than development.

Q: The REIT structure has been primarily used for commercial buildings. Why don't we see that in the residential housing market?

A: By definition, REITs are owners of commercial property that generates rent income. REITs are not owners of single family detached houses, but the U.S. REIT industry includes a very important segment of apartment REITs. It's important to recognize that there is no correlation between owner-occupied house values and REIT returns. A common, yet serious mistake made by investors and investment advisors is to think of a total amount of real estate that should be in any investor's portfolio and say, if that value is represented by the value of your house, then that is all the real estate you need.

Q: Do you see the dynamics changing in the shopping mall sector given that it is consumer spending that primarily drives their growth in the retail REITs sector?

A: The performance of the retail REIT sector has been extremely strong. Over the last ten years it has delivered a 16% average annual return I don't know if retail REITs are likely to deliver this same performance going forward, but they still are a strong investment.

It's important to recognize that consumer spending does not exclusively drive retail REIT returns. Retail REITs lease space to retailers. These leases typically are long-term – ten years is common – and the tenants typically represent a diversified group of retailers providing a variety of product types at various price points. Retail REITs also provide geographical diversification. A given REIT frequently owns dozens – or hundreds – of retail facilities around the United States, and often in other countries. These factors act to stabilize rent income.

Q: Any estimates on what percentage of the retail shopping malls and similar spaces are controlled by the retail REITs?

A: Retail REITs – especially regional mall REITs – own a greater proportion of properties in their market segment than other types of REITs do in their segments of the industry. This is a very large segment of the REIT industry, rep-

All REIT Index Performance

	RETURN COMPONENTS		DIVIDEND
Period	Total	Price	Yield
ANNUAL			
2001	15.50	7.05	7.38
2002	5.22	-2.15	7.32
2003	38.47	29.34	5.75
2004	30.41	22.87	4.97
2005	8.29	2.51	5.06
2006	34.35	28.31	4.06
2007	-17.83	-21.39	5.29

SOURCE: NAREIT

resenting more than a fourth of the total industry as measured by equity market capitalization. Retail REITs also typically control the best retail properties in the best locations. So, the fundamentals for retail REITs are very strong.

Q: In the last five years the real estate market has gone through some significant revaluations. From an economist's perspective has this impacted REITs ?

A: Commercial real estate property values have increased for a number of years, driven by steady economic growth, limited supply and, more recently, M&A activity, which was importantly fueled by very willing debt markets that provided low-cost financing. Obviously, the economy has slowed and the credit markets have become much tighter. It remains to be seen how these factors will develop in 2008 and how they will affect the commercial property market. The fundamentals for REITs, though, have remained strong. There has been no overdevelopment in the market. Occupancy rates and rents remain strong. The publicly traded equity REIT industry also is financially strong. The companies have continued to deliver solid earnings throughout 2007, and they have continued to maintain very conservative balance sheets. The average leverage in the publicly traded REIT industry remains at about 40 percent, which is conservative by the standards of almost any industry.

REITs will benefit from changing trends in institutional investment, as well. Major pension funds and endowments have recognized the benefits of REITs as a supplement for direct real estate investment, and have increased their REIT target allocations accordingly.

The U.S. pension industry's own statistics show that these institutions have boosted their target real estate allocations each year for the past six years. Yet, their actual investments are still below their targets. In the defined contribution plan arena, REITs also are being accepted as core components of lifecycle funds, which effectively are becoming the default investments in U.S. 401(k) plans.

These retirement plan professionals are long-term investors, and their recognition of the value of REITs in meeting their plans' liabilities represents an important trend.

Investor interest in REITs and other securitized real estate also has become increasingly global as the industry has grown around the globe, making it possible for large investors in the world's financial capitals to implement truly global real estate investment strategies through securitized real estate.

New index products like the FTSE EPRA/NAREIT Global Real Estate Index are providing the basis for expanded global securitized real estate investment as the benchmarks for institutional money managers and for a growing field of mutual funds and ETFs, which last year boasted more than $40 billion in assets. The equity market cap profile of this index provides the asset allocation map for these global investors: about 40% of it is in North America, another 40% is in the Asia/Pacific region and 20% is in Europe.

U.S. REIT Industry Evolution

ANNUAL EQUITY MARKET CAPITALIZATION (MILLIONS OF US$ AT YEAR END

	COMPOSITE	
Year	Number of REITs	Market Capitalization
ANNUAL		
1971	34	1,494.3
1972	46	1,880.9
1973	53	1,393.5
1974	53	712.4
1975	46	899.7
1976	62	1,308.0
1977	69	1,528.1
1978	71	1,412.4
1979	71	1,754.0
1980	75	2,298.6
1981	76	2,438.9
1982	66	3,298.6
1983	59	4,257.2
1984	59	5,085.3
1985	82	7,674.0
1986	96	9,923.6
1987	110	9,702.4
1988	117	11,435.2
1989	120	11,662.2
1990	119	8,737.1
1991	138	12,968.2
1992	142	15,912.0
1993	189	32,158.7
1994	226	44,306.0
1995	219	57,541.3
1996	199	88,776.3
1997	211	140,533.8
1998	210	138,301.4
1999	212	145,387.1
2000	189	138,715.4
2001	182	154,898.6
2002	176	161,937.3
2003	171	224,211.9
2004	190	305,025.1
2005	197	330,691.3

SOURCE: NAREIT