THE INSTITUTIONAL REAL ESTATE LETTER
ASIA PACIFIC

Volume 3, Number 9 | ISSN 1752-9417 | October 2011

FEATURES

Food for Thought
What questions do Asia Pacific property investors most want answered?
By Alex Eidlin **3**

Past, Present and Future
Debt offers another way to invest in Japanese real estate.
By Mikihisa Hirai **13**

Synthetic Benchmarks
Investors should consider a synthetic approach to benchmarking real estate funds in Asia.
By Dr. Kevin Swaddle **25**

Shop Talk: Lee Jun Ho
Lee Jun Ho, director of Real Estate Corea (REC), which represents real estate investors for the European Union Chamber of Commerce in Korea (EUCCK), discusses EUCCK's mission, the efforts of REC and Korean investor intentions.
With Alex Eidlin **31**

DEPARTMENTS

People 17

Investment News 19

Fund Activity Table 20

Calendar of Events 22

Investment Guide: Funds in the Market 34

Market Focus: Beijing 37

Transaction Analysis 38

Asia Pacific Transactions: July deals 39

REIT Markets Snapshot 40

Market Pulse 42

Asia Pacific REIT Roundup

Though Fundamentals Remain Strong, Asian REITs Backslide a Bit Amid Policy Restrictions and Inflation Fears

by Mard Naman

After posting tremendous gains both in 2009 and 2010, Asia Pacific REITs so far in 2011 have mostly stalled and retreated. Inflation fears, interest rate hikes, the Japanese earthquake and ongoing policy restrictions impacting the residential sector in Hong Kong, Singapore and China have all conspired to create mostly negative returns. Australia is the happy exception. Japanese REITs, though taking a strong hit immediately after the earthquake, staged a quick comeback. M&A activity and sponsor changes throughout the Asia Pacific region have strengthened the quality of Asian REITs, and economic growth will likely remain robust for the foreseeable future. The selective investor will find many attractive points of entry.

Listed real estate securities, including REITs, in the Asia Pacific region were generally laggards for the first half of 2011. They posted a negative total return in local currency and underperformed both their European and North American counterparts. Year-to-date through the end of June 2011, the FTSE EPRA/NAREIT Developed Asia Index recorded a return of –4.9 percent. The Developed North America Index, by contrast, came in with a 13.1 percent gain during the first six months of the year, and the Developed Europe Index showed an 8.0 percent gain (see graph, page 10). The worst performing market was Singapore (–10.5 percent in local currency), closely followed by Japan (–9.6 percent), obviously hurt by the earthquake/tsunami/nuclear meltdown triple disaster in March. The best performance in the Asia Pacific region came from Australia, where A-REITs put up a return of 2.9 percent for the first half of 2011. This is not great compared to North American and European REITs, but compared to the rest of Asia Pacific, Australia performed well.

As a global asset class, REITs and listed real estate securities performed heroically in 2009 and 2010. Coming off the bottom of the global financial crisis, they basically doubled between March 2009 and the end of the first half of 2010. The United States saw a total return of 129 percent, followed by Asian markets, which posted a 91 percent total return, and Europe with a 78 percent return. So their lackluster performance through the first half of this year looks better from a slightly longer-term perspective. They posted a 19.8 percent gain in third quarter 2010 (in U.S. dollar terms), then a 6.1 percent gain in fourth quarter 2010, followed by a 2.7 percent loss in first quarter 2011. As of 30 June 2011, Asia Pacific real estate securities were still up 22.8 percent from 30 June

2010. So it's not like they are tumbling in freefall, but their downward trend is unmistakable.

What has caused this REIT retreat? "Asia Pacific REITs and real estate companies were affected by fears of growing inflation and a restrictive policy environment," says Marc-André Flageole, portfolio manager, Asia Pacific, for Presima. China and several other central banks from Asia Pacific countries raised interest rates during the first half of 2011, which affects the financing costs of real estate companies. In China, the rate increases were combined with strong lending restrictions for real estate, further increasing the difficulty to access capital. The ongoing policies targeting the housing sector in Hong Kong, Singapore and China also have impacted on real estate companies. Starting in 2010, and continuing this year, these governments have attempted to cool down home price increases and limit the amount of leverage homebuyers can use.

"These measures seemed to have worked, at least partially," says Flageole. "They have slowed transaction volumes on the ground and certainly dampened investors' sentiment toward real estate securities exposed to the sector, particularly in Hong Kong and Singapore."

David Wharmby, portfolio manager, global real estate securities, for Cornerstone Real Estate Advisers, agrees. "We've seen a lot of policy risk, real activism on the part of Asia Pacific governments, particularly Hong Kong, Singapore and China," he says. "It's directly targeting the residential sector in those three countries, which is a good portion of the listed property securities. So it by relationship mutes the returns, and also the sentiment drags on the overall property sector. The commercial stuff sometimes gets cast in with the residential."

Still, a lot of real estate managers have focused more on commercial than residential companies in their stock selection. Singapore has some residential-only developers, but most companies tend to be more diversified. "It's really the degree to which they're exposed to the residential market," notes Wharmby. "Companies with less exposure to residential in their product mix probably have been perceived more favorably the last 18 months."

The restrictions have raised bank revenue requirements and increased equity requirements for homebuyers. There is uncertainty about how much longer the restrictions will be in place, and whether more are coming. All this has created volatility in the market.

"We do expect this kind of volatility and policy pressure to exist through the end of 2011," says Wharmby. Whether it continues into 2012 depends on how effectively these countries can get inflation under control. "Real estate is an important part of these countries' productivity, their GDP growth, so it's a delicate balancing act," adds Wharmby. "They can't afford to be too strong-handed and crush the real estate market fundamentals, but at the same time, there's a real eye toward controlling inflation."

UPSIDE DOWN UNDER

Australian REITs performed better than other Asia Pacific REITs, despite relatively high interest rates and inflationary concerns. Wharmby thinks it's because the Reserve Bank of Australia (RBA) took a break from its 2009 and 2010 tightening measures and has not raised interest rates in more than six months.

"There were some concerns about the economy slowing down, and the RBA looked at inflation and the economic growth balance, and made the decision to pause on tightening," says Wharmby. "That's helped real estate stocks, which are obviously capital intensive. Also, other than interest rates, the policy risk that exists in the rest of Asia doesn't exist in Australia."

Economic growth remains healthy in Australia. Flageole says office A-REITs have been clearly favored by investors, given the expectations that demand for space will exceed supply, paving the way for rent growth and more limited tenant incentives, particularly in Melbourne, Perth and Sydney.

Wharmby likes Australia for the rest of 2011, especially because he expects the returns from U.S and European REITs to trend down. "We think Australia will continue to perform as it has, putting up a steady 3 percent or 4 per-

THE INSTITUTIONAL REAL ESTATE LETTER – ASIA PACIFIC

PUBLISHER & EDITOR-IN-CHIEF
Geoffrey Dohrmann

CHIEF OPERATING OFFICER
Mark Dohrmann

ASSOCIATE PUBLISHER
& MANAGING DIRECTOR, ASIA
Alex Eidlin

MANAGING DIRECTOR, EUROPE
& SENIOR EDITOR
Sheila Hopkins

EDITORIAL DIRECTOR
Larry Gray

EDITOR
Jennifer Molloy

ART DIRECTOR
Susan Sharpe

CONTRIBUTING EDITORS
Drew Campbell
Loretta Clodfelter
Denise DeChaine
Richard Fleming
Andrea Waitrovich

RESEARCH MANAGER
Ashlee Lambrix

RESEARCH SERVICES
Justin Galicia
Karen Palma
Caterina Torres

VICE PRESIDENT, MARKETING
Sandy Terranova

MARKETING & CLIENT SERVICES
Suzanne Chaix
Elaine Daniels
Julia Feiner
Karen McLean
Brigite Thompson
Michelle Tiziani

CONFERENCE DIRECTOR
Michael Laffey

CONFERENCE SERVICES
Angel Howlett
John Hunt
Alessandra Mongardi
Dorian Taylor

CONFERENCE SPONSORSHIP
SALES MANAGER
Randy Schein

ADMINISTRATION
Melissa Benson
Terri Chang
Wendy Chen
Jennifer Guerrero
Lucero Jaramillo
Jennifer Vossoughi

cent total return per quarter. That will look attractive in comparison to the European and U.S. returns for the back half of the year," says Wharmby. While he still sees some value in U.S. and European stocks, Wharmby thinks that the rate at which they've been providing returns won't continue, making Australian returns competitive.

Volatility of A-REITs has been relatively low for the first half of the year. Presima's Flageole thinks the continued efforts of management teams to sell down noncore assets, focus their activities on Australian assets and improve balance sheets has had a positive impact on investors' interest. "The beta of A-REITs against the general equity market in Australia is now down to 0.7, while it was up to 1.4 during the global financial crisis, casting major doubts about the low-risk profile typically associated with the asset class," he says.

Vincent Felteau, also a portfolio manager, Asia Pacific, for Presima, says, "In Australia, leasing activity and transaction evidence both confirm our positive view of the office sector. At this point, we feel that stocks that have exposure to that sector will continue to outperform." He notes that leasing momentum is definitely picking up in major cities around the country. For example, more than 20 leases were signed in April alone for the Sydney central business district. And according to the Property Council of Australia, the vacancy rate in Sydney is only 3.1 percent for the premium office subsector. In addition, Colliers predicts that cap rate compressions and net rent growth of 5 percent to 10 percent are realistic estimates for this year. Felteau believes if that materializes, it will translate into higher share prices during the next 12 months. Another upside down under is that Australian listed office properties rate high on ESG (environmental, social and governance) issues.

"Companies owning office properties in Australia are, according to our internal ESG ratings, the most sustainable companies within the global universe of listed real estate," remarks Felteau. "Because an increasing amount of global pension fund money is invested in a sustainable way, and more and more large institutions consider ESG factors as part of their investment process, we believe that will ultimately benefit those companies."

J-REITS: A GOOD FLOOR, BUT A LOW CEILING

In the aftermath of the disastrous earthquake, tsunami and nuclear crisis, the Japanese listed real estate securities sector took a dive. Major developers owning high-quality assets, as well as stable J-REITs, tumbled in the days following the 11 March earthquake, but J-REITs staged a quick and strong rebound. The Tokyo Stock Exchange REIT Index plunged 22 percent in the immediate aftermath of the disaster but recovered to end the month with only a –5 percent dip. The Nikkei index lost about 17 percent of its value.

"This high volatility certainly seemed to hinder the already fragile confidence of local real estate investors in Japan, especially in the case of high-quality J-REITs that are meant to be stable investment vehicles," says Flageole. It therefore wasn't too surprising, just a few days after the earthquake, to see the Bank of Japan double the scope of its J-REIT purchasing program, from ¥50 billion to ¥100 billion (US$650.5 million to US$1.3 billion), in order to boost confidence in the sector.

The Japanese government views J-REITs as an important vehicle to support real estate prices in Japan, and it has taken several actions to nurse them back to health. One has been the inclusion of J-REITs in the Bank of Japan's asset purchase program. Another has been the implementation of the public/private fund during 2009, which provided refinancing for J-REITs when their bonds were due. Some companies had trouble accessing financing at the time, so this provided liquidity for them. Presima's Flageole believes J-REITs' volatility should come down in the year ahead and anticipates that earnings stability and trading patterns will revert to historical means.

Felteau notes that the direct impact of the earthquake and tsunami on most properties held by listed companies was minor. "Fortunately, the main listed real estate stocks in Japan generally have a very low exposure to the hardest-hit areas, and they have a heavy concentration of recently built assets with very strict earthquake-resistance standards," Felteau says. "Consequently, we saw a rapid comeback, with J-REIT share prices stabilizing at levels not too distant from their pre-earthquake levels."

However, J-REITs are not yet back to pre-earthquake levels. But at least they bounced back quickly, in contrast to Japanese public developers, which did not start to come back until late June.

Even before the earthquake, J-REITs were already trending downward, according to Masayuki Ozaki, equity research analyst – Asia for Cornerstone Real Estate Advisers. "2010 was a very strong year for the J-REIT market," he says. "They returned over 26 percent in local currency terms. So there was a little bit of profit-taking that was going on in the beginning of 2011, and there were concerns about equity raises earlier in the year. So they were trending downward when the earthquake hit."

Ozaki believes the earthquake has not scared off foreign investors from REITs in Japan, even though they have taken a wait-and-see attitude toward private real estate assets since the earthquake. "REIT activity has been somewhat subdued, not because of the earthquake but because their earnings growth prospect is muted for the time being," Ozaki says. "The developers' recent rise has been partly driven by foreign investors coming in, so I wouldn't say that the earthquake had a major negative impact on foreign investors investing in Japanese real estate securities."

Asked if the developers' recent surge is due to the post-earthquake reconstruction in Japan, Ozaki says it's more because the developers as a sector in Japan are known as a high-beta, cyclical play, so as expectations of an improvement in the economy take place and as the stimulus spending money gets poured into the economy, the improved sentiment drives the performance of the developers. As further evidence that foreign investors are not staying away, he points to the recent offering by the J-REIT Kenedix Realty Investment Corp., which had a very good response from foreign investors.

Another viewpoint is provided by Felteau, who says, "Even though most J-REITs haven't suffered any serious damage, the extreme volatility of share prices has negatively impacted an already fragile investor confidence toward the investment vehicle. Also, the fact that the Bank of Japan has had to artificially support the sector clearly demonstrates that the J-REIT market is not yet in a healthy condition."

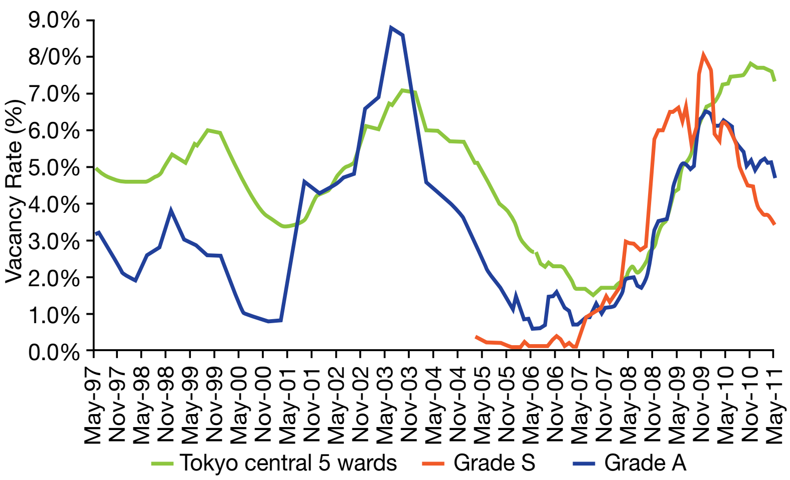
Looking ahead, Ozaki thinks J-REITs will be relatively stable over the short term. He believes the downside is protected by the Bank of Japan's asset purchasing program. That should provide a solid floor for J-REITs. But unfortunately, there also will be a low ceiling for now because the earnings growth prospects of J-REITs are quite limited going forward.

"Internal growth is going to be negative for a while for most J-REITs," Ozaki says. "It will be supplemented by external growth if companies can make accretive acquisitions, but that's a big 'if' for some companies. Overall, the earnings growth prospect is not very bright, putting a cap on the upside as well." But he is hopeful that by the end of the year some J-REITs will raise enough equity and make enough good acquisitions to provide positive sentiment. If the economy recovers as strongly as expected, that's going to translate into a better outlook for Japanese real estate fundamentals.

However, Ozaki says it will remain a relative call between REITs and the developers in Japan. "Currently the developers are cheaper and more attractive," he says. "We've seen a little adjustment in the developers' prices, but they have more upside for the time being."

Another concern is that the Japanese real estate securities market is dominated by the office sector, and most J-REITs have significant office exposure. Overall, office demand

Tokyo Office Vacancy Rate



Sources: CB Richard Ellis, Presima; June 2011 has not tapered off as much as predicted right after the earthquake. "Office demand is not robust, but it has not fallen off a cliff; it's been relatively stable," says Ozaki. But the Tokyo office market is expected to receive a large new supply at the end of 2011 and beginning of 2012. "That's going to dampen any pricing power landlords have," adds Ozaki. And even though market rents have now mostly stabilized, when rents that are now in-place roll over, they will have to be adjusted down to market. Generally the difference between market rents and in-place rents is about 10 percent less, so that will be a downside for landlords in the coming months. But once those adjustments are made, and if the economy continues to improve as expected, there's not going to be much more of a significant downside, Ozaki predicts.

Felteau is watching closely what happens with this surge of new supply. "The market absorption rate of this large amount of supply will have profound consequences on where the market is heading for the next few years, and the pace at which conditions improve," he says. "If more and more people realize the situation won't be as bad as expected, fair allocations to the Japanese real estate market could come back."

Felteau looks favorably upon Japan's future, anticipating mid- to long-term positive results for its real estate securities market. "Last year, we had a positive view on Japan; this year, our view is even more positive, especially for the major developers," he says. Not only have condominium sales rebounded significantly since the earthquake, but demand for office buildings has shifted to highly safe, earthquake-resistant buildings. And vacancy rates for the major developers have been improving. In fact, says Felteau, vacancy rates for top-quality office space, the so-called grade S buildings, have consistently been going down since the beginning of 2010. He says that as long as the rental-rate differential between the grade S buildings and the rest of the market doesn't widen significantly, he expects the downward vacancy trend to continue. Also, in another advantage the public developers have over the REITs, developers own a disproportionate amount of very high-quality space, mostly within the main 23 wards of Tokyo.

M&A ACTIVITY IS A GOOD THING

In Japan, there have been seven mergers and seven sponsor changes since 2008. Though still the largest REIT market in Asia Pacific by far, there are now 35 J-REITs, down from 42.

"The J-REIT sector did go through quite a transformation, and in my view that's been very healthy because it improved the overall quality of the J-REIT space," says Ozaki. And while the major M&A activity already has taken place, a few more could be coming. "There are still a few relatively weaker quality J-REITs, so we may see transactions involving those companies," he says.

Ozaki believes the sponsor changes are mostly done, and overall the quality of the sponsors has improved quite a bit. The benefits of the sponsor changes include better access to capital and more transparency. "There is also less risk that the sponsors abuse the REITs by selling assets at unreasonable prices. That risk is mitigated by a higher quality sponsor," says Ozaki.

Australia also has had a very active M&A market during the past two to three years, "A lot of that

Fundamentals Are Strong in Asia Pacific

Cohen & Steers, in its recent *Global Real Estate Securities Strategy Investment Commentary,* reports that property fundamentals are strong in Asia Pacific, but that inflation remains a big concern.

"We believe economic growth throughout most of Asia Pacific is likely to remain robust, driven largely by demand from China," the commentary notes. "However, as the inflation threat continues to rise, many governments are facing mounting pressure to enact further tightening measures, putting further pressure on developers' profit margins and dampening residential transaction volumes. As such we generally favor landlords [versus developers], who can raise rents as prices rise."

The exception to this is Japan, Cohen & Steers reports, where "we have increased our allocation to developers, given what we view as attractive points of entry." In Japan, developers have taken longer than REITs to bounce back after the earthquake, so there is now more upside.

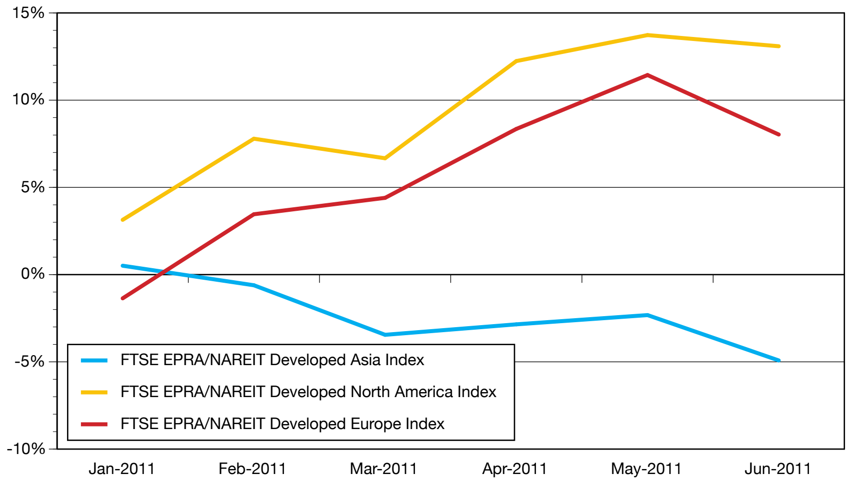
Cohen & Steers has reduced its allocation to Hong Kong, as the firm believes continued policy tightening, rising mortgage rates and inflation are likely to negatively affect the residential market. "Our focus remains on office and retail owners, which we believe are well positioned to benefit from solid economic growth and low unemployment," states the commentary.

In Singapore, Cohen & Steers believes strong economic growth will continue, but that developers will be hurt by tighter margins and decreased transaction volume due to tightening measures. The firm is positive about office demand in Singapore, but, "the constant stream of supply over the next few years may cause rental growth to be more gradual."

The Cohen & Steers investment commentary states that Australian real estate securities have so far benefited from the central bank's decision to hold interest rates steady month after month despite rising inflation pressures but, looking ahead, notes, "Australia's fortunes remain closely tied to the commodity cycle. We expect the economy to rebound from the [Queensland-area] flood-related contraction in the first quarter. However, rising inflation pressures are likely to accelerate the timeline for interest rate hikes."

— Mard Naman

FTSE EPRA/NAREIT Developed Index — 2011 Regional Performances (Local Currency)



Sources: CB Richard Ellis, Presima; June 2011

had to do with balance sheets and strategies that got pretty far afield from where they should have been going into the global financial crisis," says Cornerstone's Wharmby.

With regard to M&A activity in Australia, it has occurred since 2010 only at the small-cap level, says Peter Zabierek, global REITs senior portfolio manager for Urdang Securities Management. For example, Mirvac Group bought Mirvac Real Estate Investment Trust and Westpac Office Trust, Stockland bought Aveum, and Goodman Group bought ING Industrial Fund. Overall, "M&A activity has been more threat than reality," notes Zabierek.

He adds, "In the age of lower LTVs, it will be harder for companies to lever up to buy each other, not to mention that companies have all expressed very cautious views about the future of bank lending, relative to the rest of the globe."

Major Asian and Australian pension funds that have enough equity to buy companies have been buying direct assets instead. "The valuations are not nearly as attractive for M&A over direct property, given the companies at this point have pretty low growth profiles over the medium term," says Zabierek. As a result, Australian M&A activity is expected to remain slow.

Overall, Wharmby believes the M&A activity has been a very healthy thing for global REITs. "It's absolutely a positive," he says. "It's happened for different reasons at different points, and in each case it's been healthy in terms of re-establishing that the companies are unique and that there are bricks and sticks, there's something tangible underlying the stock price. It's effective at reminding the market of that every so often."

"The prospects for real estate securities around the globe are really quite sound."

— David Wharmby, portfolio manager, global real estate securities, Cornerstone Real Estate Advisers

A MOUNTAIN TOO HIGH?

As much as REITs have come back since the global financial crisis, they are still well off their record highs. The Tokyo Stock Exchange REIT Index reached its peak of more than 2500 in May 2007, says Urdang's Peter Zabierek. That fell to an all-time low of 705 in October 2008. The index is now at about 1000 points, much less than half its high point. Needless to say, the index won't be scaling the top of that mountain any time soon.

Globally, the FTSE EPRA/NAREIT Developed Index was 22.3 percent off its February 2007 peak, as of the end of the first half of 2011, in U.S. dollar terms, says Presima's Flageole. The Asian REITs and real estate companies were 32.1 percent off their peak, and the European index was 37.7 percent off. North American REITs were much closer to the top: only 15.9 percent away.

How long will it take for Asia Pacific, North American and European REITs to get back to those lofty highs, if ever?

"In Europe, we might be quite far away," says Flageole. "Broadly speaking, European REITs currently trade in line with the value of their underlying assets. While they may still go up slightly in the coming years, we believe that an increase of more than 35 percent in share prices would require significant rent and occupancy expansion, as well as accretive external growth. With the current European macroeconomic and fiscal backdrop, we are not expecting such high growth to occur for the next several years."

Flageole also believes it will take REITs in the Asia Pacific region a long time to get back to the peak levels. "While we are more positive on the growth prospects of the region, we believe that, for some sectors and countries, valuation levels achieved in 2007 were abnormally high," Flageole says. "At that time, optimism on Asian listed real estate companies, including those of Japan and Australia, was at a very elevated level, as investors were extremely bullish on potential earnings growth. The overall listed real estate asset class was also supported by strong inflows of money, and Asian REITs were certainly key beneficiaries of that trend."

North American REITs have the best chance of making a run in the medium term, Flageole says. "Given the very low prevailing interest rates, U.S. and Canadian REITs are generally supported by favorable financing costs and the current appetite of investors for higher-yielding assets," says Flageole. "In addition, balance sheets of North American REITs are in excellent shape, paving the way for more accretive acquisitions in the near term, which could propel net asset values of REITs higher."

It's a bit like comparing apples to oranges to compare today's indices to those of the peak in 2007. Speaking of Europe and Australia, Cornerstone's Wharmby says, "It was a fundamentally different market in 2007. Companies were very highly levered. Their equity was given quite a premium that was unwarranted. A lot of that equity and a lot of those companies don't exist anymore. So it would be hard to get back to that place."

WRAP-UP

Asia Pacific REITs have lagged in the first half of 2011 due to policy risk, interest rate increases, inflation fears and after-effects of the catastrophic events in Japan. For the remainder of 2011 and 2012, real estate companies exposed to residential development in Asia will likely remain volatile. The governments of China, Hong Kong and Singapore are trying to keep inflation down to avoid a housing bubble on the one hand and to maintain healthy fundamentals to avoid dramatically deflating home prices on the other hand.

"It is not an easy balance to achieve," says Flageole. "It is likely to remain a challenge for years to come and continue to be a source of uncertainty for investors." As a result, many investment managers are focusing on companies with more commercial and less residential in their mix. But residential real estate securities in Hong Kong and Singapore also present opportunities.

As Presima's most recent *Global Real Estate Securities Market Commentary* notes, "These stocks are now trading at historically attractive valuation levels in terms of discounts to their net market value and potentially represent a worthwhile opportunity from a long-term perspective." Elsewhere, Australia should continue on its positive trajectory, particularly the office sector, and demand for Singapore office should remain strong, although rental growth will slow due to upcoming supply. In the Asia Pacific region generally, landlords are favored over developers, except in Japan where the opposite is true.

Globally, real estate securities have done very well off the bottom of the global financial crisis. "The prospects for real estate securities around the globe are really quite sound," concludes Cornerstone's Wharmby. "It's just that we're not going to continue to put up the types of returns we have. Globally, in dollar-based returns, we're on pace to do 15 percent or 16 percent this year. You get a dividend of 3–4 percent, depending on where you invest globally, and you get some growth on top of that. That's what we see going forward." ❖

Mard Naman is a freelance writer based in Santa Cruz, Calif., USA.

Asia Pacific versus North America and Europe

Policy risk is the big difference between the U.S., European and Asia Pacific REIT markets, says David Wharmby, portfolio manager, global real estate securities, with Cornerstone Real Estate Advisers. Whereas much of the Asia Pacific region has seen policy tightening measures, the United States has seen a free-flowing stimulus, which he believes is now coming to an end. In Europe, the stimulus hasn't been as free-flowing, but the restrictive measures have been less severe than in Asia. Europe has major sovereign debt issues in Greece, Spain, Portugal and Italy, but, according to Wharmby, "most of the listed property in Europe avoids those markets," so the sovereign debt issue is a concern from a sentiment point of view, but not from an operational or fundamental point of view.

"U.S. and European REITs outperformed significantly in the first half of 2011, posting strong positive gains," says Marc-André Flageole, portfolio manager, Asia Pacific, for Presima. "While U.S. real estate fundamentals are not on a spectacular growth path, we certainly saw solid operational results from U.S. REITs." These results were driven both by major revenue growth and margin expansion resulting from cost-efficiency initiatives undertaken during the past two years.

"Following a deleveraging exercise, U.S. REITs' balance sheets are now, broadly speaking, in good shape with relatively limited leverage. Debt costs stand close to historical lows, particularly for good-quality REITs," Flageole says. Additionally, U.S. REITs typically have very good access to capital markets to increase their equity base via secondary offerings. In that respect, money can be very efficiently raised by U.S. REITs, while the process can be more complicated and take longer in markets such as Europe or Japan. Institutional and retail investors view U.S. REITs as a yielding vehicle with some potential for growth.

"With yields averaging close to 4 percent, U.S. REITs compare favorably to the S&P 500 companies, with average yields below 2 percent, and to the 10-year government bond yield, now hovering around 3 percent," notes Flageole.

In Europe, office landlords in the United Kingdom were particularly in favor, given a potential undersupply of space in the coming years. Overall, high-quality commercial real estate landlords in continental Europe were perceived as a safe haven in an uncertain economic and political environment. "Their relatively stable cash flow yields and conservative balance sheets attracted more risk-averse investors," says Flageole. However, the nice ride may be ending. "Given the appreciation in the price of shares, European real estate securities now trade in line with the net value of their assets, which might offer investors more limited upside for the rest of the year," he adds.

— Mard Naman