INVESTING IN REITS

By Michael R. Grupe, Executive Vice President, Research & Investor Outreach, National Association of Real Estate Investment Trusts®

Over nearly half a century, the U.S. real estate investment trust (REIT) industry has evolved into important segments of the U.S. economy and investment markets. U.S. REITs have seen their equity market capitalization soar from $90 billion to more than $425 billion in just the past 10 years. In the process, that growth has set the stage for the adoption of the REIT approach to securitized real estate investment across the globe.

Congress created REITs in the U.S. in 1960 as a way to make investment in large-scale, income-producing real estate accessible to all investors in the same way they typically invest otherwise – through the purchase and sale of liquid securities. Prior to the creation of listed real estate equities, access to the investment returns of commercial real estate equity as a core asset was available only to institutions and wealthy individuals having the financial wherewithal to undertake direct real estate investment.

In its early years, the industry was dominated by mortgage REITs, which provide debt financing for commercial or residential properties through their investments in mortgages and mortgage-backed securities. The market's interest in equity REITs, which today usually both own and manage commercial properties, initially was limited because the ownership and management of assets were required to remain separate. That restriction changed with the passage of the Tax Reform Act of 1986, which permitted REITs to both own and manage their properties as vertically integrated companies and helped set the stage for a secular wave of equity REIT IPOs in the mid-1990s. Currently, more than 90 percent of the nearly 200 publicly traded U.S. REITs are equity REITs that own and most often manage commercial real estate and derive most of their revenue and income from rents. In aggregate, these companies own properties across all major property sectors and all major geographic regions.

In order for a company to qualify as a REIT in the U.S., it must comply with certain ground rules specified in the Internal Revenue Code. These include: investing at least 75 percent of total assets in real estate; deriving at least 75 percent of gross income as rents from real property or interest from mortgages on real property; and distributing annually at least 90 percent of taxable income to shareholders in the form of dividends.

REITs in the U.S. also have become widely recognized for the important roles they play in the real estate industry, in the broader economy and in diversified investment portfolios. Those roles were formally recognized in 2001, when Standard and Poor's admitted REITs to its primary benchmarks of U.S. equities, including the S&P 500 Index. Today, more than half of the total equity market capitalization of the REIT industry is captured by the S&P 400, S&P 500 and S&P 600 Indexes. Now, that same recognition is occurring on a global scale.

There are at least five reasons why the REIT approach to real estate investment has been embraced by policymakers and investors alike in the U.S., and increasingly around the world: diversification, dividends, liquidity, performance and transparency.

Commercial real estate, including REITs, has been widely recognized by leading pension investment professionals, academics and economists as a core asset in a diversified and well-balanced investment portfolio. More recently, that message has spread to a broader audience of investors, who increasingly are aware that commercial real estate investment through REITs provides a critical source of diversification in long-term investment portfolios. In short, REITs have been shown to deliver the key ingredients for successful investing: risk reduction together with enhancement of portfolio returns for long-term investors.

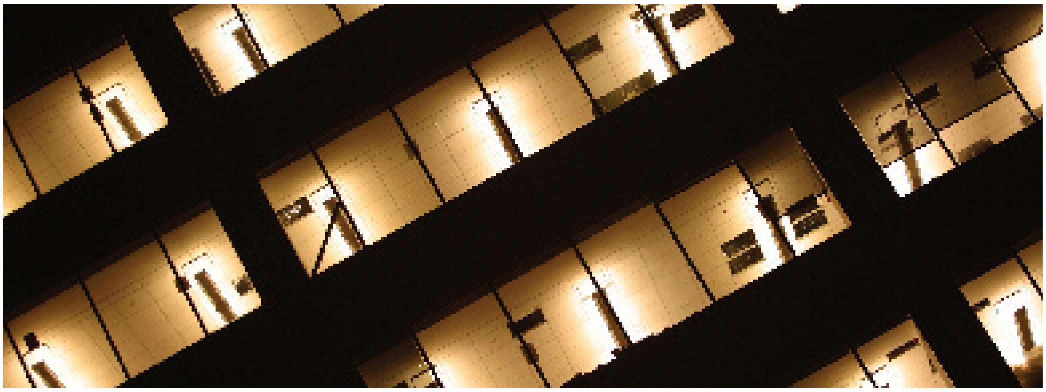
Groundbreaking analysis by asset allocation experts at Ibbotson Associates revealed how using REITs to add a commercial real estate allocation in a variety of risk-averse and risk-tolerant diversified investment portfolios would have increased portfolio return and reduced portfolio risk, and why they are likely to continue doing so in the future.

Risk-adjusted returns from balanced portfolios of U.S. stocks, U.S. bonds and international stocks over the 16-year period ended 2005 would have been higher with an allocation to global real estate securities than without such an allocation.

As investors worldwide look for income-oriented investments to help fund their retirement, the dividends associated with REITs put them at the top of the list, not just in the U.S., but around the world.

Currently, the 4.1 percent average dividend yield of U.S. REITs is more than twice as high as the 1.8 percent average dividend yield of other stocks in the S&P 500. Because REITs are required to distribute most of their taxable income to investors, U.S. equity REITs have delivered an average annual total return of 13.5 percent over the past 20 years, with 7.9 percentage points – or about 60 percent – of the total return owing to reinvested dividends.

Notably, that cash dividend has been in hand during good times and bad, providing a boost to total returns during periods of rising stock prices and a cushion during periods of falling stock prices, an investment attribute of real and tangible value to many investors.



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For many years, investors considered real estate the ultimate immovable, illiquid asset. However, U.S. REITs make real estate investing easy and efficient, thanks to their market liquidity. The equities of companies that own portfolios of properties or engage in real estate financing are bought and sold on major U.S. stock exchanges. As the investor base for listed real estate has grown over the past decade, average daily dollar trading volume in the U.S. has soared – from about $100 million in 1994 to approximately $3 billion today.

As a result of their liquidity, REIT and listed real estate equities have become the most efficient way for investors and investment managers across the globe to gain exposure to commercial real estate; an effective way for professional investment managers to manage their investment exposure to real estate; and a meaningful way to reduce the risk of illiquidity.

In terms of overall performance, the FTSE NAREIT Equity REIT Index of U.S. REITs outperformed all other major U.S. equity benchmarks in 2006 for the seventh consecutive year, posting a total return of 35.1 percent compared with a total return to the S&P 500 Index of 15.8 percent.

But more important for investors is the fact that REIT investment performance has been more than competitive with other equities over longer and more meaningful investment horizons. The FTSE NAREIT Equity REIT Index also has outperformed the S&P 500 Index as well as the MSCI EAFE Index over the past 35 years, delivering a compound annual total return of 14.0 percent, compared with a return of about 11.4 percent for the S&P 500 and 11.1 percent for the MSCI EAFE. REIT returns have consistently outpaced other equities over almost all other periods as well.

Globally, investment returns to REITs, when compared with other global equities and listed real estate companies, also have been strong. For the 15 years ended 2006, the FTSE EPRA/NAREIT Global Real Estate Index also has outpaced the S&P 500 and the MSCI EAFE.

Transparency is the final key element in the REIT story and can be thought of in two ways. REITs provide tax transparency, meaning that the REIT pays no corporate tax in exchange for paying out hefty dividends. Rather, taxes are paid only at the individual shareholder level. In addition, REITs provide market transparency, meaning that listed REITs are registered and regulated by the Securities and Exchange Commission and adhere to high and transparent standards of corporate governance, financial reporting and information disclosure.

In fact, the U.S. REIT industry's corporate governance has been recognized by Institutional Shareholder Services (ISS) as among the best in the country. In 2006, ISS ranked the REIT industry second only to the utility industry in the quality of its corporate governance. In an era when too many companies have been exposed for poor business practices, good governance wins investors' attention.

These five core attributes – diversification, dividends, liquidity, performance and transparency – have not been lost on policymakers or investors in the U.S. and around the globe. In particular, policymakers and investors in the U.S. and abroad increasingly are looking for more effective strategies to help individual investors manage the challenge of saving and investing for retirement.

It's clear that the world is shifting from traditional defined benefit pension plans to more contemporary defined contribution plans, in which the management of investment risk is transferred from professional managers to individual savers. Real estate investment long has been viewed by pension plans as a core asset in their opportunity set of investments to provide portfolio diversification and to meet future retirement obligations. There is no reason that employees investing for their own retirement should not have the same opportunity to invest in real estate. Today, about one in five plans offers its employees a REIT option, triple the proportion of plans offering such an option five years ago.

It is very clear that the future for REITs also is unfolding worldwide. The global opportunity in REITs will continue to grow as REIT legislation is adopted in more countries around the world. Today, some 20 countries outside the U.S. already have adopted REIT legislation, and the global REIT and real estate investment market is well positioned to equal the pace set by REITs in the U.S. The following table summarizes the salient features of REITs in some of these countries.

Country	Introduction	Payout	Leverage	Development
United States	1960	>90%	No limit	Restricted
Netherlands	1969	100%	<60%	No
Australia	1971	95%	No limit	Restricted
Canada	1995	>85%	No limit	Restricted
Belgium	1995	>80%	<50%	No
Japan	2000	>90%	No limit	Restricted
Singapore	2002	>90%	<60%	Restricted
France	2003	>85%	No limit	Restricted
Hong Kong	2003	>90%	<45%	No
United Kingdom	2007	>90%	>125%*	Restricted
Germany	2007	>90%	<60%	Restricted

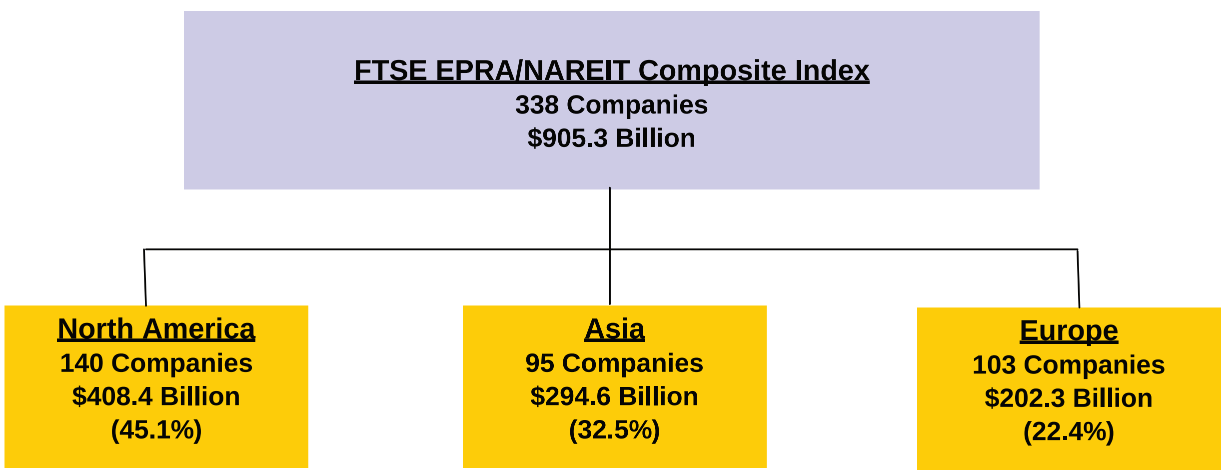
Increasingly, the countries establishing REIT legislation are following the U.S. model. As a result, REITs around the world are beginning to look and function very much the same. All of this activity points to the development of the REIT as a global brand for securitized real estate. That is a very positive development, because the growing uniformity and resulting acceptance of this brand is driving investment institutions around the world to add commercial real estate allocations through REIT investment to their portfolios. In addition, the establishment of this increasingly familiar brand is convincing more and more investment companies to add actively-managed and indexed REIT funds as well as exchange traded funds to their product lineups, including investment products linked to one of several global indexes.

This global growth of REITs will create the basis for exciting new financial products – products that will provide new opportunities for banks, brokerages and money management firms around the world – and generate value for REITs and their shareholders. One of these is the FTSE EPRA/NAREIT Global Real Estate Index. NAREIT and its partners, the FTSE Group and the European Public Real Estate Association, envision this index as a launching pad for a new generation of investment products aimed at improving and enhancing real estate investment opportunities around the world.

The global index at year end 2006 encompassed 338 companies representing $905 billion in equity market capitalization. Three regional sub-indexes comprise the global series. The North America Series included 140 companies that accounted for nearly half of the total market cap of the global index. The Asia Series included 95 companies that accounted for about 30 percent of the total, and the Europe Series included 103 companies and accounted for the remaining 20 percent of the global index.

The Global Opportunity Set

FTSE EPRA/NAREIT Global Real Estate Index



The development of a global REIT brand is creating a new generation of opportunities for investors across the globe. As a result, we are experiencing a very exciting and eventful time for securitized real estate worldwide. **N**

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