

Overview

- Performance during June was hampered by macro-economic concerns which have brought into question the trajectory of the economic rebound. This has caused a general ratcheting down of expectations regarding global economic growth in the foreseeable future.
- Compounding these economic concerns are the related regulatory actions which might further constrain growth. Political decision making across major developed economies has increased, perhaps redefining the regulatory environment and calling into question the extent to which government will be involved with the private sector during the next economic cycle.
- Despite these issues property fundamentals are improving. Listed property companies globally are exhibiting occupancy rates, in general, at around 90%, market rents are generally bottoming/or improving, balance sheets are healthy and transaction volumes are increasing.

June 2010

FOR PROFESSIONAL INVESTORS ONLY

ING INVESTMENT MANAGEMENT

Global Property Securities Update



MARKET REVIEW

Global Property Securities Performance – 30 June 2010

Region	Index Weight %	Monthly Return %	Quarterly Return %
Americas	64.3	-4.6	-3.4
Asia Pacific	13.8	0.7	-3.3
Europe	21.9	-0.4	-9.8
TOTAL	100.0	-3.0	-5.0

Returns are UBS Global Investors Ex-Australia Total Return Index (Gross) and hedged to AUD. Note: Asia Pacific excludes Australia.

Global property companies generated a negative return in June, thus extending weak performance which began in May as investors over this time period increasingly looked at the economic glass as “half empty.” Performance was hampered by macro-economic concerns which bring into question the trajectory of the economic rebound, which is now over a year in the making.

Specific worries included the European sovereign debt crisis and associated tepid response by the European Central Bank (ECB); disappointing economic numbers from the US including employment and home sales; and concerns regarding the ultimate effect of the increased reach of politicians into the private sector via regulatory announcements or legislation.

These concerns have caused a general ratcheting down of expectations regarding future global economic growth. Investors have come to learn that patience will be required with this recovery.

Macro-economic headwinds increase.

The deleveraging process that began over a year ago will continue to weigh on the pace and strength of the economic recovery.

Europe has been the focus of much attention as concerns have shifted from the relatively small economy of Greece to the larger one of Spain, which has a banking system that remains extended and potentially vulnerable to refinancing risk over the near term. Investors worry that credit issues in “peripheral” European countries could spark a wider credit crisis and that the ECB will not be sufficiently proactive in providing a safety net should this occur. This is despite the successful repayment of €442 billion of one-year loans extended by the ECB to European banks which came due July 1, €242 billion of which was refinanced with a three-month term.

US economic statistics of late have been below consensus expectations and indicate that the pace of economic recovery is slowing. In its final reading of Q1/ 10 US GDP, the Commerce Department reported that GDP grew by 2.7%, less than the previously estimated reading of 3% and well below the 5.6% growth rate in the previous quarter (Q4/09). The final reading was lower primarily due to slower than originally reported consumer spending activity, which although healthy at 3.0% was below original expectations for 3.5% growth. Sales of existing homes were down 2.2% in May after two consecutive monthly increases and despite support from the federal government tax-incentive program.

Non-farm payrolls in May and June also disappointed on the realisation that many of the jobs added were via temporary census workers as private sector hires remain anaemic and that a lower unemployment rate of 9.5% (from 9.7% in May) is largely the result of workers leaving the workforce rather than becoming employed.

The Asian region by contrast has demonstrated robust economic growth, notably in Singapore, but remains subject to a potentially decelerating Chinese economy as the government in Beijing attempts to cool demand, including residential property demand. China's official manufacturing PMI in June came in at 52.1, lower than the May reading of 53.9 and below market expectations of 53 to 54, providing a reminder that Chinese economic growth may indeed be slowing at a sharper than expected pace.

Political meddling increasingly weighs on the economic recovery

Compounding economic concerns are the related regulatory actions which might further constrain growth. Political rhetoric and legislation in each of the major regions of the world have increased as of late, perhaps redefining the regulatory environment and calling into question the extent to which government will be involved with the private sector during the next economic cycle.

In Europe, which has received much of the attention, the European Union and the International Monetary Fund announced on May 10 an emergency rescue package of up to €750 billion ostensibly to keep Greece's debt crisis from spreading through the euro zone, but in principle available to any euro zone country in need. Questions remain regarding whether this action is sufficient to solve the problem of significant debt coming due over the coming year.

In the US, banking reform legislation was passed by the Senate and now needs to be merged with a bill passed by the House last December. With prospective passage imminent, the bill would increase capital requirements among financial institutions and more closely regulate derivative and mortgage products.

In China, the central government continues to remind its provinces that housing prices remain too high. The announcement of potential property taxes, perhaps first in Shanghai and Chongqing, plus the acceleration of the collection of Land Appreciation Taxes, which are payments made by developers to the government, are intended to slow growth in property prices. This follows a raft of announcements made in mid-April which increased down payment requirements for mortgages and otherwise narrowed the definition of how many mortgages a family can obtain, as the government attempts to rein in lending to the property sector.

Japan has installed a new prime minister as voters in Japan, too, increasingly voice frustration partly because of their government's inability to effectively address economic challenges.

One silver lining - low policy rates for the foreseeable future

One positive outcome of soft economic news is increased clarity that central bank policy will remain generally accommodative.

The US Federal Reserve maintained its all-time low interest rates in its June meeting and re-stated its intention to keep rates very low for an "extended period". Fed leaders left the Federal Funds rate in a range of 0% to 0.25%, where it has been since December 2008.

The Bank of England and ECB have also kept policy rates on hold, although some of the healthier Scandinavian countries have raised rates during 2Q10 (Norway by 25 basis points to 2.0% and Sweden by 25 basis points to 0.5%).

The recent upward bias to policy rates in the Asia-Pacific region ex-Japan has paused as the Reserve Bank of Australia kept rates on hold in its June meeting after having increased rates by an aggregate 150 basis points over the past nine months.

A delicate balance remains between Western markets (plus Japan) which are attempting to nurse growth back to a self-sustaining pace and Asian markets, which are attempting to cool economic growth in a globally dynamic market with economic regions that are increasingly interdependent.

Property fundamentals begin to reflect improving underlying markets

From a bottom-up standpoint, property fundamentals are gradually improving. With the second quarter earnings season upon us, themes thus far this year include:

- (1) improving operating numbers which are either "less bad" than comparable numbers or even positive;
- (2) improving expectations;
- (3) yield compression, albeit decelerating; and
- (4) continued capital raising, both equity and debt.

Evidence of a rebound in property fundamentals differs by property type, lease length and geography but there is little doubt that the marginal trend is one of improvement looking forward. Among listed property companies globally, occupancy rates are generally at 90%, market rents are generally bottoming/or improving, balance sheets are healthy with an average loan-to-value of 40% (versus mid-50% range at the nadir of the credit crisis), transaction volumes are increasing and confidence is growing.

Capital markets remain wide open

Property companies globally have raised approximately US\$100 billion in equity and debt capital over the past year and a half. During the quarter, a number of unsecured debt deals were completed in the US such as Boston Properties' US\$700 million issuance of 5.625% senior unsecured notes due in 2020 and Healthcare REIT's US\$300 million of 6.125% senior notes also due in 2020.

In Europe, French shopping centre company, Klepierre, raised €700 million through a 7-year bond offering at a coupon of 4.0%, a 125 basis point spread above the swap rate.

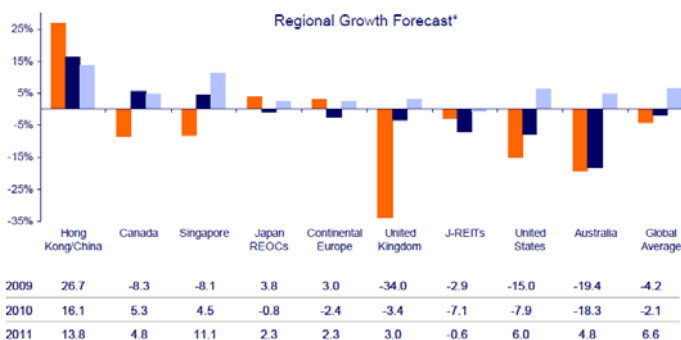
Equity raisings include Macerich's US\$1.2 billion raise of equity in the largest US REIT follow-on ever as the deal size doubled from its original size as the result of high demand. Pan-European shopping centre company, Corio, completed a €600 million equity issuance to help it fund acquisitions.

US REITs saw an IPO during the month of June as Hudson Pacific Properties went public with proceeds of US\$210 million. Hudson Pacific is an owner and operator of six office assets primarily located in Southern California, as well as two media and entertainment campuses located in Hollywood, California.

Capital markets remain supportive of capital formation, which remains critical to the listed sector.

Earnings suggest improving economic conditions

Despite the travails of recent macro-economic worries, we continue to see a rebound of property company earnings as we look out to 2011. While patience is clearly required, our most recent projections show a mid single-digit growth in cash flow per share in 2010/2011:

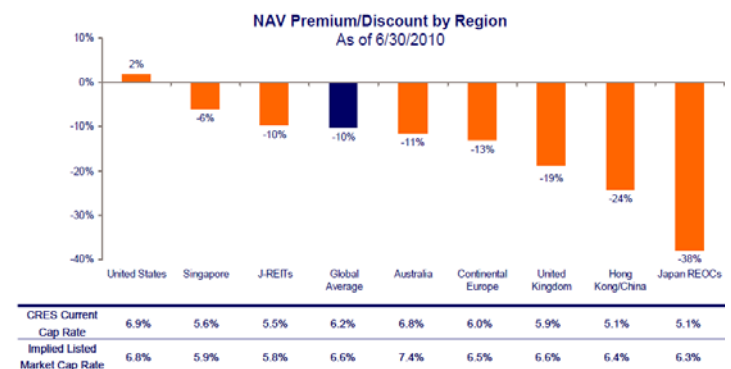


Valuations have been "re-set" to an attractive discount

The recent sell-off has improved the valuation of listed companies relative to what we believe the underlying real estate value to be, or NAV. While debate has continued regarding appropriate multiples and NAV relationships of real estate companies coming out of a recessionary environment using trough earnings, it clearly has become easier to make a case for listed property valuations following the recent correction. We estimate global property companies are trading at an average 10% discount to NAV on a weighted average basis.

In the US, we estimate property companies are trading in-line with NAV. We believe yield compression to have largely run its course from trough levels, although current yields should generally hold as capital returns to the property sector and as property fundamentals continue to improve, however gradual.

While the returns looking forward for a listed strategy likely cannot maintain the sharp pace of the last year, we believe the sell-off during 2Q10 supports positive expectations for property companies on the back of gradually improving economic conditions and an associated improvement in property fundamentals.



OUTLOOK

Expect returns of 5% to 15%

As put forth at the beginning of this year, we expect total REITs returns will be in the 5% to 15% range in 2010, driven by steady and growing dividends yielding approximately 4% combined with mid single-digit earning growth out to 2011. Given that first half returns were negative, this suggests that second half returns will be even better than the range provided.

The backdrop as we stand mid-year 2010 is significantly better than six months or even a year ago, but still remains fragile. We expect real estate fundamentals to continue to improve during the year but acknowledge that patience will be required. Though occupancies and rents will take time to improve, with increasing demand and low levels of new construction, fundamentals should inevitably firm going into 2011.

In a world of sluggish economic growth, the cash component of total return via the dividend yield we believe will be increasingly appreciated. Current yield via the dividend remains a hallmark of investing in the REIT sector.

Sector biases remain across regions

We remain positive on regions and property types which are more responsive to improving economic conditions. We are maintaining the outlook we have held since the beginning of the year despite recent market setbacks which we believe are temporary in nature.

We currently favour North America and much of the Asian region as well as malls, apartments, industrial and certain office markets, many of which are in Asia. More specifically, we like malls and apartments in the US and office markets in the UK, Hong Kong and Singapore.

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We remain cautious on Continental Europe, Japan and property types which tend to lag economic recovery (such as healthcare as well as many office markets in the West). We prefer companies with above average dividend yields to those with lower yields and have a bias towards quality as measured by property type, management, balance sheet, geography and business strategy.

About the Author

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