GLOBAL REAL ESTATE SECURITIES
MARKET COMMENTARY
Q3 2014

EXECUTIVE SUMMARY

REAL ESTATE SHARE PERFORMANCE TAKES A PAUSE

Global real estate share performance paused in September resulting in negative performance for the third quarter, an arguably healthy consolidation following a very strong run since January of this year. Real estate stocks have generated favorable returns over the past nine months as the result of low bond yields, accommodative capital markets, and improving fundamental demand for real estate space with limited new supply. Despite this pullback in performance in Q3, the factors driving the positive performance year-to-date remain in place and property share valuations are now more attractive.

MACRO ENVIRONMENT CONTINUES TO PROVIDE A POSITIVE BACKDROP FOR REAL ESTATE SECURITIES

The current shape of the yield curve is good for property companies and reflects a low inflationary environment. While the yield curve is expected to steepen over the next twelve months, forward markets indicate that the increase will be modest. Our macro-economic view continues to be one that sees global economic conditions improving over time and bond yields commensurately moving higher, although gradual in pace and change in trajectory. Real estate shares should benefit from the current environment which has historically proven favorable for performance.

FUNDAMENTALS FOR REAL ESTATE IMPROVING

We underwrite property companies to generate earnings growth in 2014 and 2015 in the +6-7% range, following a steady +6.3% in 2013, as the economic recovery in most developed economies begins to gain further traction, and positively affect real estate cash flows. Given that the majority of the cash flows are largely contractual in nature, there is a fairly high degree of visibility to these projections, with any potential revisions likely to be positive ones not negative. (See Exhibits 3.)

VALUATIONS REMAIN ATTRACTIVE

We estimate that listed property companies are trading at an average discount of 8% to NAV, a discount below the long term average. The discount to NAV provides a "cushion" for REIT pricing should interest rates move higher. In effect, the market has already built into its pricing higher cap rates should interest rates rise, cap rates which are conservatively higher than transactional evidence than what CBRE underwrites. In a world of gradual economic improvement, listed real estate trading at discounted valuations should offer investors attractive total return potential over time anchored by current income via the dividend. (See Exhibit 6.)

Exhibit 1: FTSE EPRA/NAREIT Developed Index Performance as of September 30, 2014

Period	Return
Q3 2014	-4.4%
YTD	7.2%
1 Year	6.7%
3 Year	15.6%
5 Year	11.3%
7 Year	0.8%
10 Year	7.8%

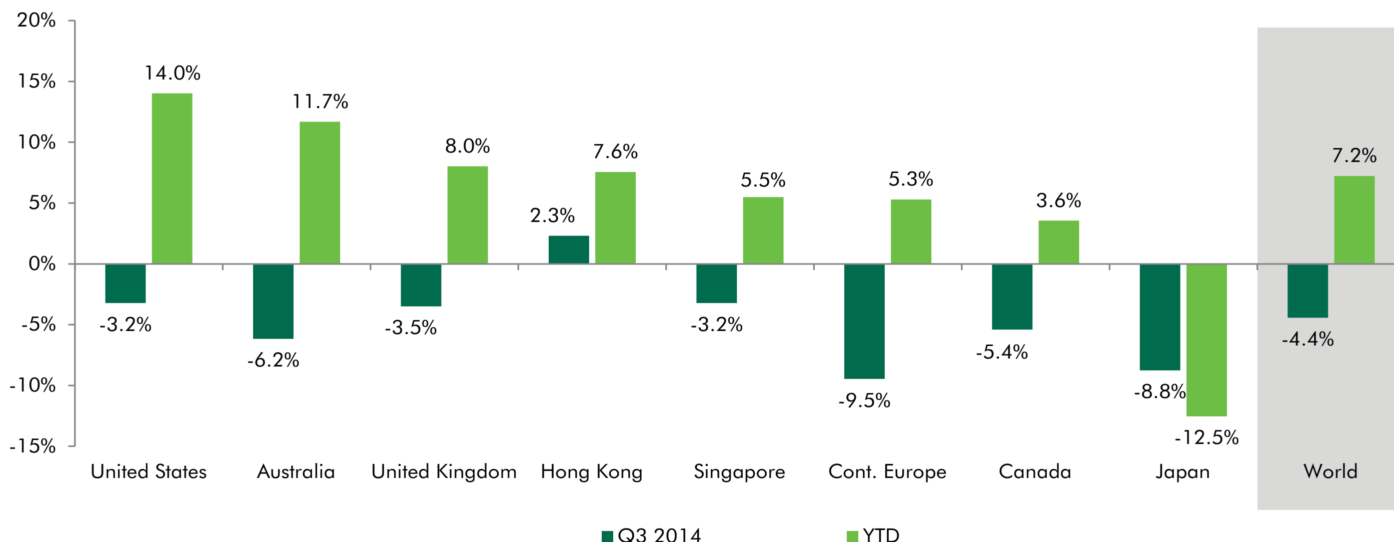
Source: FTSE EPRA/NAREIT Developed Index in USD as of 09/30/2014.
An index is unmanaged and not available for direct investment.
Past performance is no guarantee of future results.

CBRE CLARION SECURITIES

MARKET PERFORMANCE REVIEW

While global real estate shares generated a high single digit total return over the first nine months of the year, the positive performance paused in September, resulting in negative performance for the quarter. Property share performance was weakest in Continental Europe and Japan. European returns were negative amidst increasing evidence that economic recovery in the eurozone remains fragile, and that the European Central Bank is perhaps being excessively deliberate in providing quantitative easing. Japanese property shares were lackluster, possibly as a result of the lack of immediate catalysts, as investors await further potential action by the BOJ and Japanese government, with potential movement in the fourth quarter. Bucking the trend was the positive performance recorded in Hong Kong, which was driven in part by a series of easing measures by the Chinese government, which have the intent of stimulating demand for residential housing and overall economic growth. While these measures supported positive performance in Q3, it remains unclear how effective these policies will be. Overall, we believe the Q3 pullback to be a natural consolidation as the market once again digests the prospects for higher interest rates and post a strong run since January of this year. The pullback is a reminder that listed shares do not always go up and is arguably healthy for a sector which has recorded strong total return year-to-date. Despite this pullback in performance, the factors driving the positive performance year-to-date remain in place with property share valuations that are increasingly attractive.

Exhibit 2: Global Real Estate Total Returns as of September 30, 2014



Source: FTSE EPRA/NAREIT Developed Index in USD as of 09/30/2014. Please refer to the last page for index performance in other major currencies. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

MACRO ENVIRONMENT CONTINUES TO PROVIDE A POSITIVE BACKDROP FOR REAL ESTATE SECURITIES

The combination of gradually improving economic growth but scant evidence of inflation provides the framework for continued potential outperformance for real estate companies, which provide attractive current yield and steady earnings growth. The current shape of the yield curve is good for property companies and reflects a low inflationary environment. While forward markets indicate a higher bond yield on the U.S. 10-year Treasury in twelve months, the upward shift in the yield curve should prove to be modest. Longer-term yields (US 10-year Treasury) in the near term have settled in to a more benign level, closing at 2.49% at quarter end. This has arguably been the result of mixed economic data, particularly in the euro zone, where yields on bonds trended lower during the quarter, thereby putting indirect pressure on yields in other capital markets, including the U.S. More recent employment data in the U.S., however, supports an economic scenario of improving employment, housing, consumer confidence, all of which underpin improving demand for commercial property including office space, apartments and shopping centers via higher retail spending. Economic recovery is less consistent outside the U.S., where the U.K. looks more resilient than the Continent, and the Asia-Pacific region remains fragmented, ranging from a stimulus fueled Japan, to a government managed slowdown in China, which indirectly affects the entire region, including commodity dependent Australia. Our macro-economic view continues to be one that sees global economic conditions improving over time and bond yields commensurately moving higher, although gradual in pace and change in trajectory. Real estate shares should benefit from the current environment which has historically proven favorable for performance.

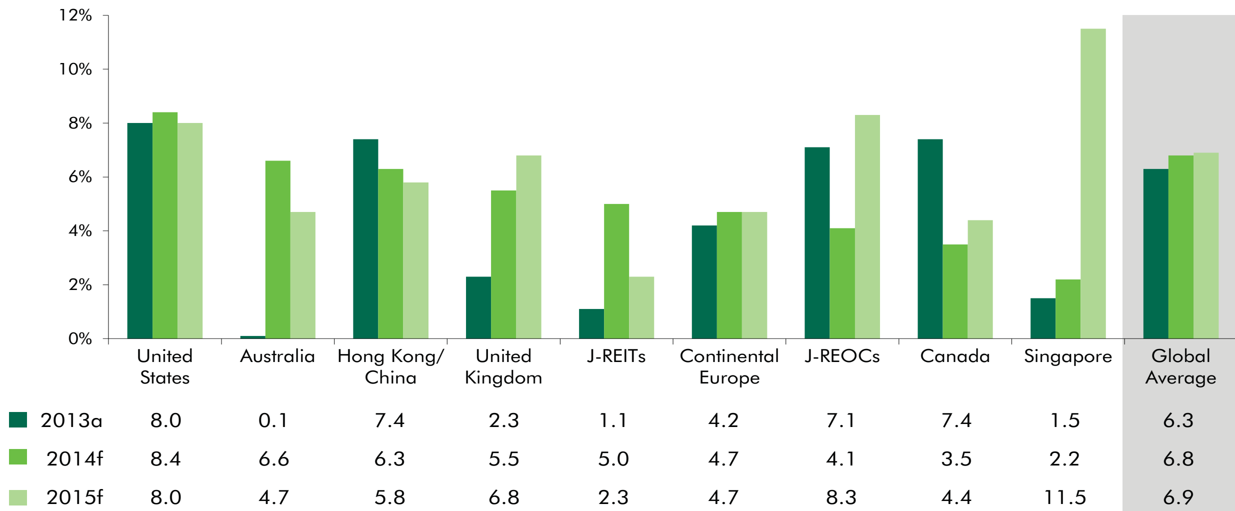
OUTLOOK

FUNDAMENTALS FOR REAL ESTATE IMPROVING

Property companies are achieving internal cash flow growth (primarily the lease-up of currently vacant space, mark-to-market of expiring leases, and embedded rental rate growth through contractual annual rate increases), as evidenced by decreasing vacancy rates in major asset classes, ranging from U.S. apartments, global industrial, office markets in London, Tokyo, New York, San Francisco and Los Angeles, and lodging in global gateway cities. With this, landlords increasingly are exercising pricing power by pushing rental growth and limiting tenant concessions such as free rent or tenant improvements, thereby increasing net effective rents. Witness the office vacancy in central Tokyo currently at 5.65% versus 9.40% just over two years ago, and in the U.S. through year-end 2014, CBRE Econometric Advisors expects average annual rent growth in the U.S. to outpace inflation, at 3.4%, and top 4% per year by 2016.

Property companies are growing cash flow per share additionally via "external" growth of acquisitions and value added recycling of capital. Property values continue to rise as cap rates hold firm and even decrease further, as the spread to bonds remains wide. Real estate companies have been actively raising fresh equity, with U.S. property companies raising $3.7 billion in September alone; to help fund growth while keeping leverage levels fairly constant, in what represents a value-added sourcing and investing of capital.

Exhibit 3: Regional Earnings Growth



	United States	Australia	Hong Kong/ China	United Kingdom	J-REITs	Continental Europe	J-REOCs	Canada	Singapore	Global Average
2013a	8.0	0.1	7.4	2.3	1.1	4.2	7.1	7.4	1.5	6.3
2014f	8.4	6.6	6.3	5.5	5.0	4.7	4.1	3.5	2.2	6.8
2015f	8.0	4.7	5.8	6.8	2.3	4.7	8.3	4.4	11.5	6.9

Source: CBRE Clarion as of 09/30/2014.
Information is the opinion of CBRE Clarion , which is subject to change and is not intended to be a forecast of future events, a guarantee of future results, or investment advice. "a" refers to actual, "f" refers to "forecasts". **Forecasts and the factors noted are not indicative of future investment performance.**

GROWING EARNINGS SUPPORT ATTRACTIVE YIELDS AND MAY LEAD TO EXPANDING DIVIDEND PAYOUTS

Current income generated by listed property's dividend yield remains a defining investment characteristic of the sector. Listed property companies' dividend yield currently averages nearly 4% globally and is growing at a very healthy rate. We project average dividend growth to equal earnings growth in 2014 and 2015 at nearly 7%, driven by a combination of improving company cash flows as well as an expansion of dividend pay-out policies which remain conservative.

The spread between dividend yields and bonds also continues to be above-average as shown in the chart below, suggesting good relative value versus fixed income investment alternatives, and a buffer of sorts as interest rates potentially and eventually rise.

Exhibit 4: Regional Dividend Growth

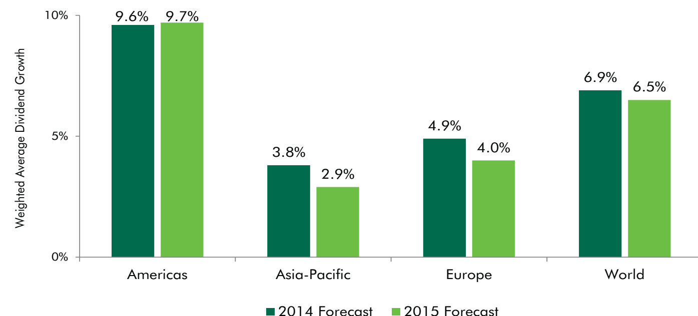


Exhibit 5: Regional Dividend Yield

Source: Source: CBRE Clarion, FactSet and Bloomberg as of 09/30/2014. Not all countries included. **Past performance is no guarantee of future results. Forecasts and any factors discussed are not indicative of future investment performance.** Yields fluctuate and are not guaranteed. This information is subject to change and should not be construed as investment advice.

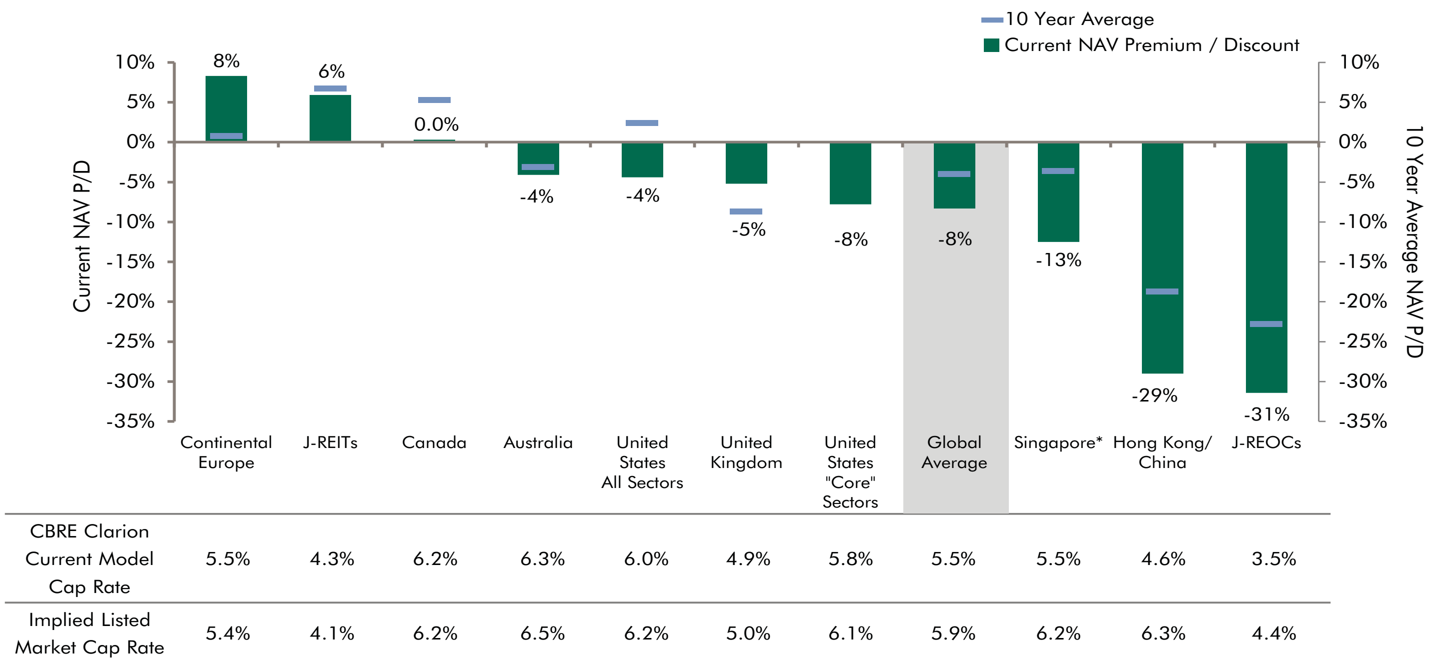
ATTRACTIVE VALUATIONS OF LISTED PROPERTY WHILE PRIVATE MARKET PRICING

We estimate that listed property companies are trading at an average discount of 8% to NAV, a discount also below the long term average. As shown in the Exhibit 6, real estate is trading near par or at a discount in many major markets around the world. The discount to NAV provides a "cushion" for REIT pricing should interest rates move higher. In effect, the market has already built into its pricing higher cap rates should interest rates rise, cap rates which are conservatively higher than transactional evidence than what CBRE underwrites. This provides some additional upside, as the year unfolds, to the returns expected from a growing dividend stream and higher earnings which should lift stock prices. Transaction volumes also remain elevated, as investors including private equity, sovereign wealth, pension funds, other institutional capital, and listed companies all vie for potential deals, putting continued downward pressure on cap rates.

There is an increasing disconnect with private market transactions and implied pricing in the listed markets, witness the September announcement by U.S. office REIT Boston Properties that it will sell a 45% stake in three high-quality core assets to Norges Bank Investment Management for approximately $1.5 billion in cash, or $1,073 per sf which is an estimated 3.9% cap rate on 2015 net operating income. The three assets included in the transaction were 601 Lexington Avenue in Midtown Manhattan and 100 Federal Street and Atlantic Wharf in Boston. This compares to an implied cap rate on Boston Properties shares at quarter end of ~5%.

Separately in September, Hilton Hotels announced the $1.95 billion sale of the Waldorf Astoria to Chinese insurance company, Anbang Insurance Company, which equates to $1.4 million/room and in the range of a 3% implied yield, versus an implied yield on Hilton's shares of 6.1%. While all of Hilton's properties are not iconic such as the Waldorf, there nonetheless is a glaring difference between pricing in the private market versus implied pricing in the listed market. Hilton will retain a long-term management contract on the hotel.

Exhibit 6: NAV Premium/Discount



	Continental Europe	J-REITs	Canada	Australia	United States All Sectors	United Kingdom	United States "Core" Sectors	Global Average	Singapore*	Hong Kong/ China	J-REOCs
CBRE Clarion Current Model Cap Rate	5.5%	4.3%	6.2%	6.3%	6.0%	4.9%	5.8%	5.5%	5.5%	4.6%	3.5%
Implied Listed Market Cap Rate	5.4%	4.1%	6.2%	6.5%	6.2%	5.0%	6.1%	5.9%	6.2%	6.3%	4.4%

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REGIONAL PROPERTY MARKET REVIEW

In the U.S., we remain favorable on the industrial, apartment and lodging sectors as well as coastal CBD office and high-end mall companies, and are more cautious on the storage, net lease and healthcare sectors. Portfolio positioning emphasizes property types which can benefit the most from improving economic conditions and companies with management teams that can take advantage of their market positioning, either via local expertise, balance sheet strength and/or if warranted development activities. By geography, this includes many of the gateway cities located in the northeast and in California, including New York, San Francisco and Los Angeles. We remain cautious on the more bond-like sectors of net lease and healthcare but take into account potential syndicate activity and takeover possibilities in our portfolio positioning.

In Europe, U.K. property fundamentals are improving more visibly than on the Continent. Investments in Europe are focused on companies with higher growth characteristics, such as London office companies and German residential. Elsewhere on the Continent, we favor select value names which offer a high level of cash flow and dividend yield. We also believe that there may be more merger and acquisition activity involving euro zone property companies.

In the Asia-Pacific region we like the prospects for Japan and Australia, but are very selective elsewhere in the region. Positioning in the Asia-Pacific region continues to tread carefully around decelerating economic growth in mainland China and ever-changing government policies aimed at limiting price appreciation for the residential sectors in Hong Kong, Singapore and mainland China. We are more positive on the office and retail property types in these markets than on residential. We also continue to see value in the Tokyo office market, which is showing improved occupancies and accelerating rental growth after years of stagnation. Land values in Tokyo have recently improved and office vacancy has tightened, with vacancy in the five central wards now in the mid-5% range versus the mid 8% range just a year ago. While gradual, improvement in Tokyo office rents is steady and visible.

We believe that global property stocks offer investors an attractive investment option, anchored by current yield via a growing dividend and underpinned by increasing real estate cash flows derived from improving economic and commercial property fundamentals.

IMPORTANT DISCLOSURES AND RISK INFORMATION

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The FTSE EPRA/ NAREIT Developed Index is an unmanaged market-weighted index consisting of real estate companies from developed markets, where greater than 75% of their EBITA (earnings before interest, taxes, depreciation, and amortization) is derived from relevant real estate activities. Investors cannot invest directly in an index.

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