

FROM GUGGENHEIM REAL ESTATE, LLC

# REIT Industry Update

JULY 2010

## SHIFTING TO OFFENSE

Encouraged by improving property fundamentals, financing conditions and balance sheet strength, Real Estate Investment Trusts (REITs) have begun to aggressively pursue property acquisitions, and to a lesser extent, new development opportunities. Contrary to expectations, real estate investors have yet to see the “wave of distressed opportunities” emerge. For high quality, well located real estate in particular, it is now common to see 20-30 bidders in heated auctions and surprisingly high sale prices. Commercial real estate values are now 20% off their May 2009 lows according to Green Street Advisors Commercial Property Price Index. Rising valuations have been a function of the stronger than expected rebound in fundamentals, declining return requirements by investors, and the lack of real estate product for sale.

## PROPERTY FUNDAMENTALS REBOUNDING EARLIER AND STRONGER

Property leasing fundamentals remain challenging with elevated vacancy levels, rent well off peak levels, and weak negotiating power for landlords overall. However, relative to expectations at the start of the year, fundamentals are recovering much sooner and stronger than expected, resulting in a slew of upward earnings guidance revisions by REIT management teams and Wall Street analysts. This is most visible in property sectors with short term leases such as apartments, hotels, and self storage. In all three cases, occupancy levels have been increasing throughout the year and landlords are beginning to push through rent or rate increases. The recovery for these property types has occurred about two quarters earlier than anticipated. Longer term lease sectors such as office and shopping malls will not see the immediate impact of improving fundamentals. However, they are likewise seeing rent and occupancy levels stabilize and leasing volumes improve.

## THE CASE FOR REITS

As of June 30, 2010, REITs, as represented by the FTSE NAREIT Equity REIT Index, have delivered an approximate 5.56% total return compared to the S&P 500 Index's (6.65%) total return,\* reflecting the better than expected real estate fundamentals and valuations.

We continue to believe public real estate offers several benefits for an individual investor's portfolio that are particularly relevant in the current low yield environment. These benefits include:

- REITs provide an attractive current income with potential for future dividend growth as underlying property cash flows recover.
- There is price appreciation potential in the underlying real estate portfolios. This is particularly relevant given that we are near a cyclical low in terms of underlying property cash flow and real estate valuation levels.
- Real estate provides inflation hedging characteristics as underlying rents, property cash flows, and replacement costs have adjusted with inflation over the long term.

\*Source: Bloomberg

**INDEX DEFINITIONS** (The indexes are unmanaged and it is not possible to invest directly in the indexes.) **FTSE NAREIT Equity REIT Index** is a free float adjusted index of REITs that own, manage and lease investment-grade commercial real estate. Specifically, a company is classified as an Equity REIT if 75% or more of its gross invested book assets is invested in real property. **S&P 500 Index** is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. **Green Street Commercial Property Price Index (“CPPI”)** is a time series of unleveraged U.S. commercial property values. CPPI captures the prices at which commercial real estate transactions are currently being negotiated and contracted.

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