



DIMEO
SCHNEIDER
& ASSOCIATES, L.L.C.

White Paper

DiMeo Schneider & Associates, L.L.C.

By: Chad A Tischer, CFP™

With Contribution From: Matthew Rice, CFA & Geoff Strotman, CFA

► OCTOBER 2006

International REITs

With only 5% of the estimated \$14.5 trillion of the global real estate market currently securitized, U.S. investors have the opportunity to participate in the growth of global real estate securities in the coming decade¹. Driving much of the growth is the adoption of REIT – like structures throughout the world. This paper addresses the shift of privately held real estate to the public markets and discusses how U.S. investors could position the asset class within diversified portfolios.

History:

In various forms, real estate has been used to diversify portfolios for decades. As recently as 1960, domestic real estate investments were only available to wealthy individuals or corporations with the financial resources to invest in shopping malls, office buildings, raw land, hotels and health care facilities. Congress passed the Real Estate Investment Trust Act of 1960 which exempted real estate companies from corporate income tax if certain criteria were met². This legislation was intended to encourage investors to pool their resources by forming real estate companies, providing investment opportunities to the average American. The Tax Reform Act of 1986 lifted additional restrictions which prompted the proliferation of the modern REIT structure.

Requirements for REIT status in the United States

U.S. REITs must pass four tests in order to retain their special tax status³:

1. *REITs must distribute at least 90 percent of their taxable income, excluding capital gains, as dividends to its shareholders.*
2. *REITs must have at least 75 percent of their assets invested in real estate, mortgage loans, shares of other REITs, cash, or government securities.*
3. *REITs must derive at least 75 percent of their gross income from rents, mortgage interest, or gains from the sale of real property. At least 95 percent must come from these sources, together with dividends, interest and gains from security sales.*
4. *REITs must have at least 100 shareholders with less than 50 percent of outstanding shares concentrated in the hands of five or fewer shareholders.*










Over the past 20 years, the commercial real estate market in the U.S. has undergone dramatic transformation due to significant capital flows into publicly traded real estate securities. Much of the growth has been fueled by the transfer from private to public ownership. The publicly traded U.S. REIT market has grown to approximately 200 companies with a market capitalization totaling \$363 billion¹. The growth of the U.S. REIT market has been driven by investor demand for high current income, diversification and attractive total returns. REITs are now widely used in institutional and high net worth portfolios.

REIT - Like Investment Structures:

While REIT structures differ across borders, the advantages of meeting certain uniform requirements are numerous. For investors, the benefits of incorporating REITs into a portfolio include:

- Avoidance of double taxation (no corporate income tax, allowing pass through of income to individuals).
- Professional management teams responsible for the day-to-day operations.
- Unlike direct real estate, publicly traded REITs are a liquid asset.
- Relatively small investors are able to diversify their holdings between various geographic areas and property specializations.
- REITs can tap the debt and equity markets to raise funds when opportunities arise.
- REITs have had low correlation to stocks and bonds providing portfolio diversification benefits.
- High cash dividends can limit steep declines.

Comparison of Global REIT-like Securities

										
	US	Australia	Netherlands	Canada	Belgium	Singapore	Japan	France	Hong Kong	UK
Management	Internal or External	Internal or External	Internal	Internal	Internal or External	External	External	Internal or External	Internal or External	Internal or External
Restrictions										
Real Estate Investments	75%+	>50% of revenue from rent ¹	100%	80%+	100%	70%+	75%+	Flexible	100%	75%+
Overseas Investments	OK	OK	OK	OK	Prohibited	OK	OK	OK	Prohibited	OK
Development	OK	OK	Minimal	OK	Minimal	20% of total assets	OK but >50% of assets must be income producing	OK	Prohibited	OK
Gearing Limit	No limit	No limit	80% of property assets	No limit	50% of total assets	35% of total assets ³	No limit	No limit	35% of total assets	Possible limit
Payout	>90% of taxable income (post depreciation)	100% of taxable income (post depreciation)	100% of fiscal earnings	85% of distributable cash (pre depreciation)	80% of taxable income and net debt pay down	100% of taxable income (no depreciation)	>90% of taxable income (post depreciation)	85% of taxable income from rentals, 50% of capital gains	>90% of net income after tax (no depreciation)	95% of rental asset income (post allowable deductions) ⁶
Closed Ended⁴	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Closed likely
Listed/ Unlisted⁵	Both	Both	Both	Listed	Listed	Listed	Listed	Listed	Listed	Listed likely, Unlisted possible
Tax Transparency	Yes	Yes	Yes ⁴	Yes	Yes ⁴	Yes	Yes	Yes ⁴	No ²	Yes

Notes:

¹ this is a condition of entry into the LPT index, not a regulatory requirement

² no tax on dividends at the investor level

³ with >35% with an A rating

⁴ taxed at source on overseas income and non-exempt activities such as development (France only)

⁵ currently Germany is the only country with a tax transparent option that is unlisted and open ended that is available to both paying and tax exempt investors

⁶ capital gains from the tax exempt portion can be distributed in line with tax treatment of rent

Source: UBS, June 2005

Since December 2003, the global real estate securities market has more than doubled to over \$733 billion. The international real estate market appears poised to experience a conversion from private, non-traded entities to

publicly traded securities. Institutional grade real estate assets total approximately \$14.5 trillion worldwide, but only about 5% is securitized, leaving considerable growth potential. The U.S. market represents only a third of the global institutional grade real estate market, of which 47% is already securitized⁵.

	PROPERTY MARKET		EQUITY MARKET	
	Size (US\$B)	Share of global market	Equity Market Capitalization (US\$B)	Securitization level %
United States	4,991	34%	345	47%
Europe	4,553	31%	73	10%
Japan	1,967	13%	88	12%
United Kingdom	1,043	7%	66	9%
Other Asia-Pacific *	667	5%	15	2%
Latin America	445	3%	-	0%
Canada	395	3%	22	3%
Hong Kong / China	289	2%	59	8%
Australia	232	2%	66	9%
TOTAL	\$14,582	100%	\$733	5%

The growth in global real estate securities has been driven by the adoption of Real Estate Investment Trusts or REIT – like structures. Prior to 1990, only 4 developed countries had such a structure, including the United States, Netherlands, Australia and Luxembourg⁶. Today, over 17 countries have adopted them. UBS Securities estimates that the market capitalization for global REIT securities will double in the next 5 – 7 years to \$1 trillion, driven primarily by the adoption of REIT - like structures¹. Given current legislation, Europe and Asia offer the most immediate potential growth for the REIT securitization market.

* Other Asia-Pacific includes Singapore, Malaysia, Taiwan, Philippines, Thailand, New Zealand, Indonesia, South Korea, India and Vietnam

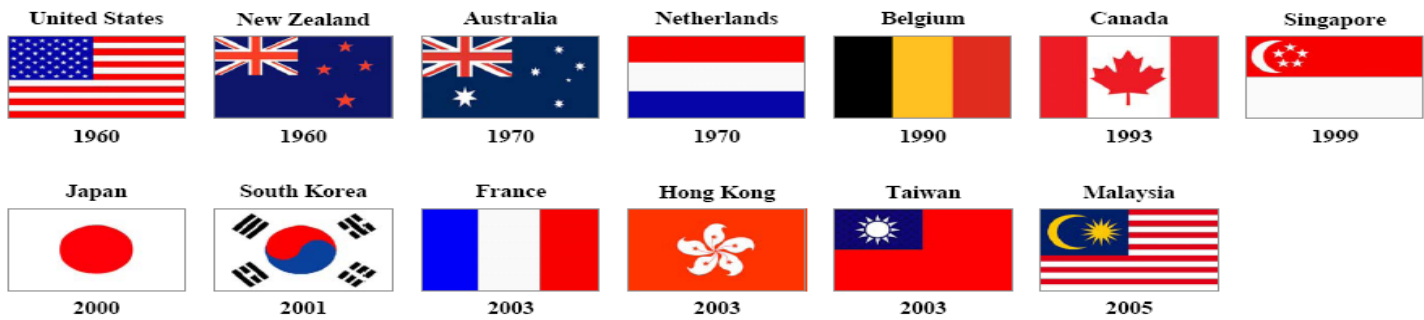
Source: FTSE, Citigroup and Kensington Investment Group. Equity Market Capitalization and Securitization Level represented by the FTSE EPRA/NAREIT Global Real Estate Index. Latin America not included in FTSE EPRA/NAREIT Global Real Estate Index

* Other Asia-Pacific includes Singapore, Malaysia, Taiwan, Philippines, Thailand, New Zealand, Indonesia, South Korea, India and Vietnam.

Source: FTSE, Citigroup and Kensington Investment Group. Equity Market Capitalization and Securitization Level represented by the FTSE EPRA/NAREIT Global Real Estate Index. Latin America not included in FTSE EPRA/NAREIT Global Real Estate Index.

**While the general size of the "Property Markets" vary widely across data sources, the "Share of Global Market" remain fairly constant.

Countries with existing REIT-like structures



Countries considering REIT-like structures



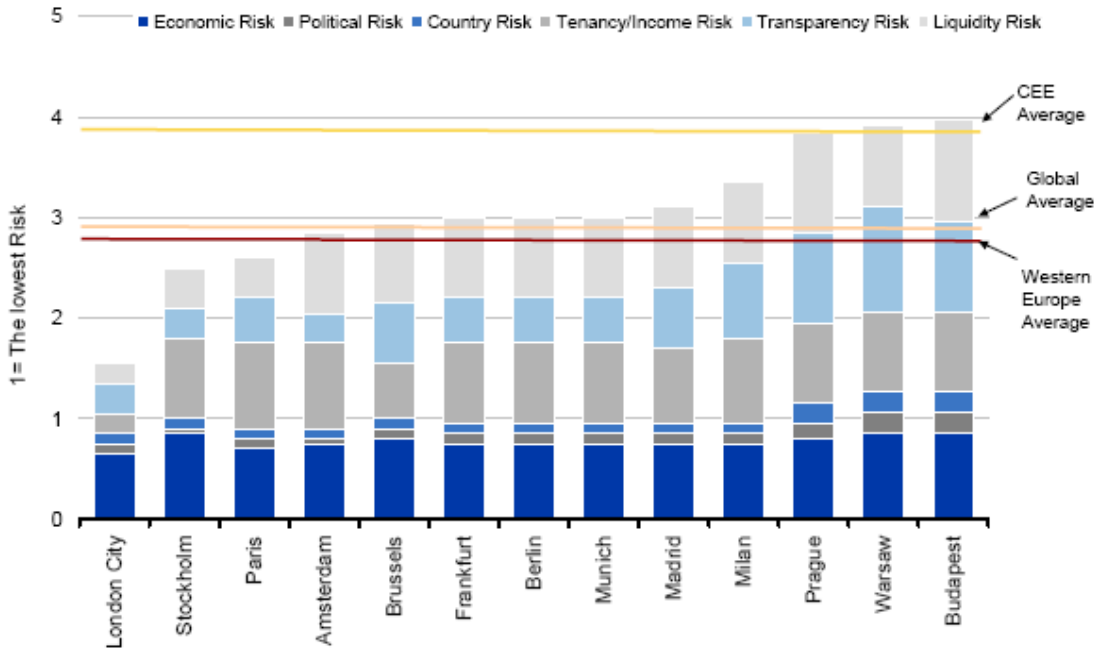
Europe

The United Kingdom will adopt a REIT structure in January 2007. Upon the passage of the REIT legislation in March of 2006, the S&P/Citigroup U.K. BMI Property Index indicated that real estate property companies (non REITs) jumped 10% in value the next month. Due to the removal of tax leakage and the relatively low conversion charge, many UK listed property companies are expected to convert to the REIT - like structure in the next 24 months⁵. Germany is anticipated to follow suit by adopting a G-REIT structure in early 2007. Germany has the largest real estate market in Europe. The Initiative Finanzplatz Deutschland (IFD), a lobbying group for the creation of G-REITs estimates that listed property in Germany could reach \$158 billion before the end of the decade if the G-REIT is adopted in 2007^{5,8}. REIT legislation is also under consideration in Italy, Finland and Spain.

Country	Total Invested Real Estate US\$ Bn	Total Listed US\$ Bn	Listed as % of Total Real Estate	Tax Exempt (REIT-type) Listed
Germany	605	8	1%	No
UK	662	63	10%	No (Yes in 2007)
France	242	24	10%	Yes
Italy	152	6	4%	No
Netherlands	125	16	13%	Yes
Switzerland	108	5	5%	No
Spain	85	18	21%	No
Sweden	81	16	20%	No
Belgium	46	4	9%	Yes
Austria	40	9	23%	No

Source: RREEF Research, EPRA/NAREIT

Most countries in Europe have relatively mature real estate markets. The rating system (developed by RREEF Research⁵) outlined below is based on a series of factors such as the level of establishment, liquidity and leasing environment (e.g., length of leases and upward only rent review). RREEF Research indicates that Western Europe provides ample opportunity for current investment potential with a market driven by sale and leaseback activity⁴. Sale and leaseback activity was estimated at \$70 billion in 2005, with 90% from Germany, UK and Netherlands⁵. In contrast, the rising affluence of Eastern European countries has resulted in higher growth rates with a relative shortage of high quality real estate. This growth develops strong potential for the continued creation of new residential, retail and commercial real estate across the region.



Source: RREEF Research

Note: 1 indicates the lowest structural risk and 5 represents the highest structural risk, Also see RREEF Research (2005), Opportunities in Global Office Markets, 19th August 2005.

Asia

While the prospects for Asia's expanding REIT market appears strong, it is also volatile due to its "emerging" nature. Structural developments throughout the 1990's, such as relaxation of restrictions on foreign direct investment (including land) and increased liquidity and transparency throughout the region have helped drive

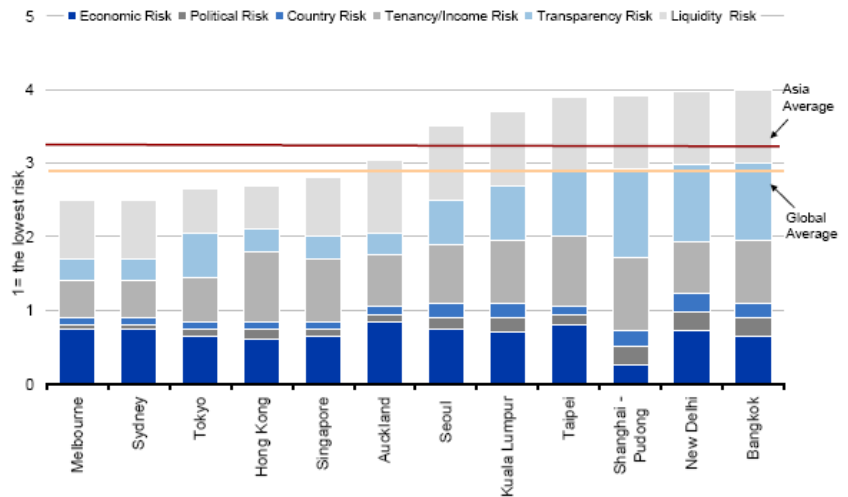
recent growth. Strong economic growth and a shortage of modern real estate have driven the Asian-Pacific real estate market growth. The market has grown 800% in Singapore, 500% in Japan and over 1,000% in Hong Kong in the last 3 years alone⁵. While Singapore and Hong Kong real estate markets are relatively small, both are beneficiaries of strong demand for cross-border activity for investors wanting close proximity to mainland China and India.

Country	Total Invested Real Estate US\$ Bn	Total Listed US\$ Bn	Listed as % of Total Real Estate	Tax Exempt (REIT-type) Listed
Japan	900	116	13%	Yes
Hong Kong/China	180	74	39%	Yes in HK
Australia	144	83	58%	Yes
S Korea	77	1	1%	Yes
Singapore	36	22	61%	Yes
India	25	1	2%	No
Taiwan	16	5	21%	Yes
Malaysia	11	7	65%	Yes

2.853.1000

While Asian markets continue to evolve, Australia has had a REIT – like market for years, currently in excess of \$80 billion⁵. By the middle of 2006, REIT – like structures in Japan, Singapore, South Korea, Taiwan, Malaysia and Thailand only had a market capitalization of \$40 billion⁵. The Asian market continues to be dominated in Japan which accounts for over 70% of the total market. Japan alone has 32 J-REITs with a total market capitalization of \$29.5B¹. By comparison it took the U.S. 34 years to reach \$30 billion in market capitalization⁸.

While Australia has one of the world’s most developed real estate markets, RREEF Research indicates that nearby Asia is still a work in progress. Japan, Hong Kong, Singapore and South Korea have made considerable progress in recent years, but liquidity and transparency risks are still significant. China and India have far more significant risk. Regulatory and political risks are high, while short commercial leases and volatile rental rates add additional risks. The potential for sale and leaseback activity remains strong across Asia. Recent trends of privatization of government owned property and corporate restructuring involving the disposition of real estate are driving this activity.



Source: RREEF Research

Note: 1 indicates the lowest structural risk and 5 represents the highest structural risk. Also see RREEF Research (2005), Opportunities in Global Office Markets, 19th August 2005.

Performance

International real estate securities have demonstrated a similar risk and return profile to domestic real estate stocks over the past 1, 3 & 5 years. Historically, they have offered attractive yields and modest capital

Performance

	1 Year	3 Year	5 Year	10 Year
S&P Citigroup World Property ex. US Index	32.65%	33.66%	22.30%	9.51%
S&P 500 Index	8.88%	10.95%	4.65%	8.91%
MSCI EAFE Index	24.78%	23.99%	12.25%	7.44%
Lehman US Aggregate Bond Index	1.70%	3.98%	4.87%	6.51%
Dow Jones Wilshire REIT Index	26.19%	28.10%	21.40%	16.49%

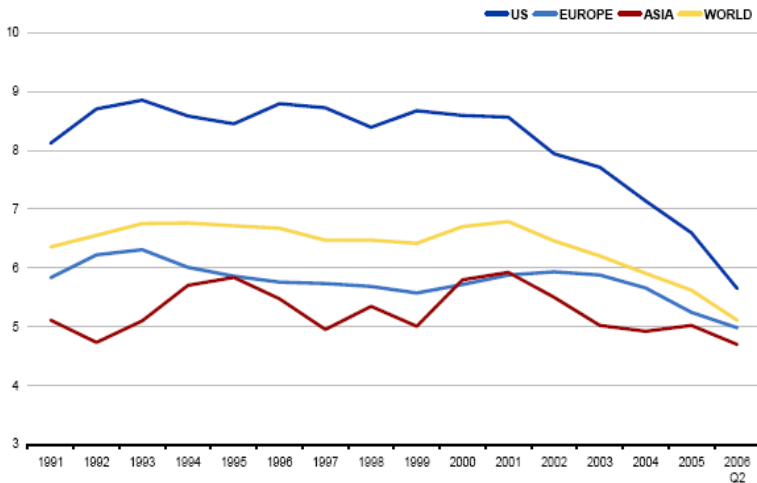
Source: S&P Citigroup World Property ex. US Index, S&P 500 Index, MSCI EAFE International Index, Lehman US Aggregate Bond Index, Dow Jones Wilshire REIT (Full Cap) Index. Monthly date through August 2006. U.S. Dollars

appreciation. International real estate securities have outperformed both domestic and global equities over the past 1, 3, 5 & 10 years. The world’s strong appetite for real estate over this period has led to significant cap rate compression, particularly in the U.S. and Europe. This compression has been the primary driver of above average performance in recent years. While history is not destiny, the data highlights that international real estate securities are capable of

outperforming other major asset classes through full economic cycles.

The most mature markets like Australia, United Kingdom and the United States have averaged strong double digit returns over the past decade. The same environment does not exist today. Recent research conducted by RREEF, indicates world wide office cap rates are currently around 5, sliding from historical averages of 6.5 – 7⁵. Cap rates have fallen dramatically, leaving investors less opportunity for future capital appreciation.

Chart 7: World and Regional Office Cap Rates, 1991-06, (% year end)



The Cap Rate is a ratio used to estimate the value of income properties. It is the net operating income (NOI) divided by the sales price or value of the property expressed as a percentage.

Example:

A property has an NOI of \$500,000 and an asking price of \$6,250,000.

$$\text{Cap Rate} = \$500,000 / \$6,250,000 = .08 \text{ or } 8$$

Source: RREEF Research; CB Richard Ellis; National Real Estate Index; JLL Real Estate Intelligence Service

Note: Unweighted aggregate performance based on twenty-four global markets – 10 in US, 10 in Western Europe and 4 in Asia-Pacific

Correlation

International real estate securities can offer diversification benefits when combined with stocks and bonds. Over the past 10 years, international real estate securities have had low correlation to domestic bonds (.05), equities (.55), international equities (.68) and even U.S. REITs (.42).

Correlation of Global Real Estate Securities to Select Asset Classes

	S&P 500	MSCI EAFE	Lehman US Aggregate Bond	Dow Jones Wilshire REIT
3 Year	0.60	0.80	0.36	0.62
5 Year	0.60	0.80	0.06	0.57
10 Year	0.55	0.68	0.05	0.42

Source: S&P Citigroup World Property ex. US Index, S&P 500 Index, MSCI EAFE International Index, Lehman US Aggregate Bond Index, Dow Jones Wilshire REIT (Full Cap) Index. Monthly date through August 2006. U.S. Dollars

Correlations among countries has also generally been low, indicating that the business of real estate is still a “local market” with each region subject to its own demographic trends, land constraints, zoning regulations, supply/demand needs and tenant credit-worthiness⁶.

Correlation Across Property Regions - Past 10 Years

	United Kingdom	Germany	United States	Australia	Japan	Hong Kong
United Kingdom	1.00					
Germany	0.20	1.00				
United States	0.42	0.10	1.00			
Australia	0.40	0.16	0.35	1.00		
Japan	0.18	0.15	0.07	0.25	1.00	
Hong Kong	0.24	0.14	0.32	0.40	0.27	1.00

Source: S&P Citigroup BMI Property Indices. Monthly date through August 2006. U.S. Dollars

This “dual” layer of diversification could make international REITs an attractive emerging asset class. Combined with competitive risk-adjusted returns versus broader equity markets and relatively stable income, this asset class appears to be an attractive diversifier for global portfolios.

Investment Alternatives

With the emergence of this market, the number of global REIT managers has grown over the past 18 months. According to Morningstar, currently 13 international or global REIT funds exist, most created during the last 3 years. Including known global REIT strategies outside of the mutual fund industry (e.g., separate accounts and commingled funds), the number is north of 25 and growing.

Conclusion

While real estate property companies have been included in international equity portfolios for many years, the emergence of global REIT-like structures appear to offer investors a new opportunity. The U.S. REIT market represents only the “tip of the iceberg.” With the current and proposed expansion of REIT-like structures worldwide, the market could be poised for a dramatic change similar to what the U.S. market experienced in the early 1990s. The potential for equity-like returns with low correlation to other asset classes makes international REITs an attractive alternative asset class that warrants consideration in a diversified portfolio.

About the Firm:

Based in downtown Chicago, DiMeo Schneider & Associates, L.L.C. provides impartial investment consulting services to retirement plan sponsors, institutions, nonprofit organizations and high net worth individuals. As of March 31, 2006, assets under advisement are approximately \$17 billion.

About the author:

Chad Tischer, CFP™: *Chad is a Senior Consultant for The Wealth Office, advising high net worth clients, family offices, and endowments & foundations. He is a member of the DiMeo Schneider & Associates, LLC Asset Allocation committee, an internal advisory group which researches broad investment ideas and theories. Chad co-heads the firm’s Disciplined Portfolio Advisor Group, responsible for the group’s marketing and business development efforts. Prior to working at DiMeo Schneider & Associates, Chad worked at Envestnet Asset Management, a Registered Investment Advisor that specializes in providing investment advice to independent investment advisors. Chad received his MBA in Finance from the Kellstadt Graduate School of Business at DePaul University, is a Certified Financial Planner (CFP™) and a Level II candidate in the Chartered Financial Analyst (CFA) program.*

Research Contributors:

Matthew Rice, CFA, CIMA: *Matt is the firm's Chief Research Officer and a Senior Consultant. As Chief Research Officer, Matt spearheads the firm's research efforts in the areas of capital market analysis & forecasts, investment strategy, asset allocation & portfolio rebalancing modeling and alternative investments. He is a member of the DiMeo Schneider & Associates, L.L.C.'s investment committee which sets investment policy, establishes the framework for asset allocation and approves investment managers. In 2004, he co-authored *The Practical Guide to Managing Nonprofit Assets* (John Wiley & Sons). Matt received a BA in Economics from Northwestern University, is CFA Charter holder (Chartered Financial Analyst), a CIMA (Certified Investment Management Analyst), a CIMC (Certified Investment Management Consultant), and earned an Alternative Investment Certificate from the Wharton School of Business & IMCA. Prior to joining DiMeo Schneider & Associates, L.L.C., Matt was a Trust Officer in the institutional investment services group at Fifth Third Bank (formerly Old Kent Bank), worked as a Corporate Retirement Plan Consultant for First Business Investment Services, and was an Investment Consultant at AXA Advisors.*

Geoff Strotman, CFA: *Geoff is the firm's Manager of Investment Research and heads the investment search efforts for the firm. He provides both qualitative and quantitative research on investment managers/funds for the firm's institutional and high net worth clients with a focus on providing appropriate investment options for client selection. As a member of the firm's Investment Committee, Geoff helps set investment policies for the firm, establishes the framework for asset allocation, and approves investment managers. Geoff received a MBA, Finance, Economics, and International Business from University of Chicago, and a BA in Accounting from the University of Notre Dame. Geoff is a CFA Charter holder (Chartered Financial Analyst).*

References

1. "Globalization of REITs: The Case for International Real Estate Securities." Kensington Investment Group. April 2006.
2. Kennon, Joshua. "Real Estate Investing Through REITs." Investing for Beginners. About.com. <http://beginnersinvest.about.com/od/reit/a/aa101404.htm>.
3. Block, Ralph L. Investing in REITs: Real Estate Investment Trusts. Princeton: Bloomberg Press, 1998.
4. "Fidelity Funds Global Property Fund Sales Presentation." Fidelity International. March 2006.
5. Chin, Henry (Wei)., Stephen Newbold, Ermina Topintzi, and Peter Hobbs. "Global Real Estate Insights." RREEF Research. August 2006.
6. "A Case For: Global Real Estate Securities." State Street Global Advisors. 2005
7. "REITs: A Global Perspective." Cohen & Steers. 2006.
8. "International Real Estate Securities as an Enhancement to an Existing US Real Estate Strategy." ING Clarion Real Estate Securities. Spring 2006.
9. Bigman, Ted, Christina Chiu. "The Case for a Strategic Allocation to Global Real Estate Securities." Morgan Stanley. Fall 2005.
10. "Global Real Estate Investable Universe Continues to Expand." UBS Global Asset Management Investment Brief. Spring 2006.