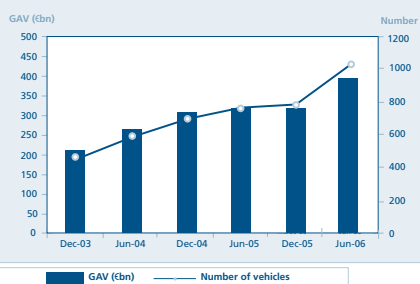


Property Funds Intelligence universe tops 1000 vehicles

It is two and a half years since Oxford Property Consultants (OPC) published its first bi-annual report, *The Indirect Property Market in Europe*. In June 2006, the research and information side of OPC was re-launched as Property Funds Intelligence (see back page) and our universe of non-listed private property vehicles (PPVs) reached a total of 1021 vehicles.

The number of PPVs has increased by 250% since December 2003, while total gross asset value (GAV) has almost doubled over this period, reaching €391 billion in June 2006 (Figure 1).

Figure 1: Growth of the Property Funds Intelligence Universe



Source: Property Funds Intelligence, June 2006

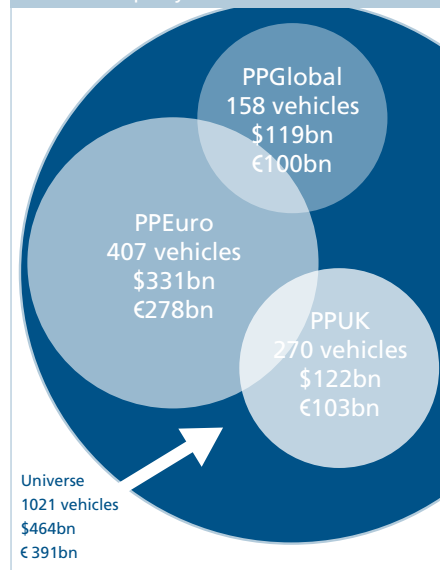
The Property Funds Intelligence universe is described in three products: Private Property UK (PPUK), Private Property Europe (PPEuro) and Private Property Global (PPGlobal), which is currently being developed in response to the growing interest from UK and other European fund managers in investment opportunities in other parts of the world.

PPUK has 270 vehicles and total GAV of €103 billion. PPEuro has 407 vehicles and total GAV of €331 billion. This

compares with €118 billion market capitalisation for European listed property companies (FTSE EPRA/NAREIT Global Real Estate Index Series, June 2006). At the moment, PPGlobal comprises 158 vehicles in North America, Asia and emerging markets with a total GAV of €100 billion. This is not yet a complete picture of global PPVs, and the product has not yet been launched; but Property Funds Intelligence is actively incorporating global vehicles as information becomes available.

Figure 2 shows that our universe contains more vehicles than those which are available in PPUK, PPEuro and PPGlobal. The difference is owing to the process of obtaining and verifying data for vehicles which we know to exist, but for which the details are sketchy or unreliable. This is particularly challenging in the case of global vehicles.

Figure 2: The Universe and the Private Property Products



Source: Property Funds Intelligence, June 2006

When is a property fund a hedge fund?

Details emerged in June 2006 of the FTSEpx Fund, a property fund whose performance was to be measured on a daily basis in order to produce a new FTSE property (as opposed to property share) index – the FTSE UK Commercial Property Index Series. FTSEpx is currently a fund of funds, but has an ambition to add direct property. Some of its current assets are geared but the fund can hold cash against that gearing. It will be daily priced because the underlying funds and properties will report valuations and NAVs at different times, and (given growth in the fund) there will eventually be true daily activity.

This is interesting in itself. A daily property index to be set alongside equity, gilt, hedge fund and other indices will be a very welcome innovation which will allow property to continue along its path of ever-closer integration into the mainstream investment world. Given the growth in interest and volume in the UK property derivatives market, and flutterings of property derivative activity elsewhere, this is big news for another reason.

Derivative markets are driven by speculators and hedgers, and if both groups develop a serious interest in the instrument volumes can become greater than in the underlying market. Speculators need price volatility: so a daily property index is good for them. Hedgers need to be confident that they can really hedge their position. Derivatives based on property market indices limit the investor's ability to do this, because the index is not itself investable. A long position in the underlying asset, property, cannot be perfectly matched by a short position in the indexed derivative because it is not possible to 'buy the index'. This introduces 'basis risk' and makes the derivative less attractive. It also complicates pricing of the derivative. If, on the other hand, perfect hedging is possible – without basis risk – then the derivative can be priced in line with theory using a risk free rate, because investors can produce a riskless portfolio.

So a daily priced investable property fund which can be used as the basis of a derivative will increase interest from speculators and hedgers alike as well as increase the value of derivative instruments. It could represent a huge step forward. No doubt conservative elements in the property world will point out the imperfections in the concept and in its execution, and there are several, but this is an exciting development.

And here is a third reason why this is interesting. The fund has been launched not by Prudential or Insight or Land Securities but by a manager that also manages a hedge fund, MSS Capital. While the FTSEpx Fund will not be able to use derivatives if it wishes to continue as the basis for the FTSE property index, another fund easily could. The FTSEpx Fund is the foundation for a daily FTSE property index, and if this becomes the basis of accepted property derivatives, we will inhabit a world where the property fund manager can go long and short in the same fund, playing games with alpha and beta exposure. Who will launch the first true property hedge fund?

German open-ended funds: liquidity and valuation issues

By Professor Neil Crosby, The University of Reading

German open-ended fund managers have been facing a reality check. In December 2005, outflows from open-ended funds reached over €3 billion according to the German Investment and Asset Management Association (BVI), up from €108 million in November; and in January, jittery investors tried to pull out of the Grundinvest fund. Grundinvest's manager, KanAm Grund KAG, was obliged to freeze the fund, indicating that it had insufficient funds to meet withdrawals.

The BVI has reacted swiftly, suggesting a series of measures which include an increase in the liquidity reserve requirement for retail funds from 5% to 10% and a 12-month notice period for withdrawals exceeding €1 million. The BVI's position is that the crux of the issue is liquidity. This is undoubtedly true in the sense that any fund which takes on short-term liabilities in order to acquire illiquid property assets takes the risk that this 'liquidity mismatch' may cause problems if there is a sudden loss of confidence.

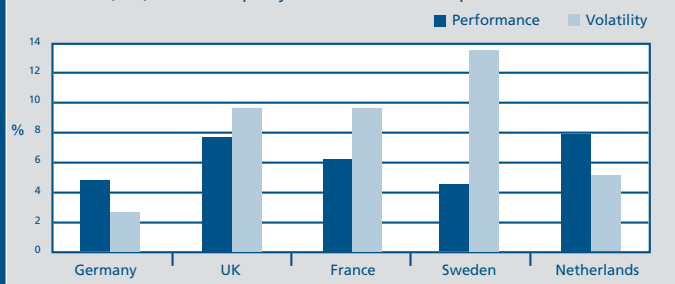
However, the BVI is sceptical about another concern of investors: the way in which property assets are valued. It has dismissed public criticism of the open-ended funds' property valuation methods as "unjustified". Unfortunately, no one appears convinced by this – and perception is important in all capital markets, especially those with illiquid assets and an instant call on their funds.

There are a number of concerns about property valuation methods in Germany. First, whereas most countries use valuation models which attempt to establish the exchange price of a property in prevailing market conditions, Germany is the birthplace of sustainable value concepts for lending valuations, and there is a suspicion that this mentality may lead to some smoothing of the peaks and troughs in market cycles, even when market valuations are being undertaken. This leads to under- and over-valuation when markets are above or below longer term trends. Where valuations are used to price units this is an accident waiting to happen, especially after a long term bear market.

Second, there are concerns about valuers being susceptible to pressure from clients. German valuers are allowed to earn a substantial element of their fees from one fund (and an even higher proportion of their total income from a single fund manager who manages several funds). There is plenty of evidence from around the world of client pressure being applied to fund or asset managers. The pressure is typically to alter performance measurement valuations for a number of reasons, primarily to support performance but also to ease a sale where there are internal or external rules concerning the relationship of price and prior valuations.

It has also been suggested that German open-ended fund managers may try to manipulate valuations to match their overall strategy, which is based on a commitment to offer a product that has very low risk and volatility. It is possible to create low volatility property funds by exerting pressure on valuers to smooth away the ups and downs of market cycles. It is interesting to note that German property indices are much less volatile than those of most other European countries, so there does appear to be a valuation issue to answer, as illustrated in Figure 3.

Figure 3: Annualised Performance and Volatility of Investment Property Databank (IPD) Office Property Indices in Five European Countries



Source: Adapted from Kurzrock, BM (2006) Extending the Index Time Series: The Performance of the German Property Market from 1989 to 2005.

Indirect property investment in Asia

Indirect property investment in Asia has increased rapidly in the past 18 months. In June 2006, the Property Funds Intelligence database had information on 59 PPVs investing in Asia, including a handful of vehicles which are due to be launched later this year. Of the 59 vehicles, 60% had been launched since the beginning of 2005.

At present India is located in the 'emerging markets' section of the Property Funds Intelligence database, but the data for India can be included with the data for other Asian countries if this makes more sense for a particular analysis. Here, India is included.

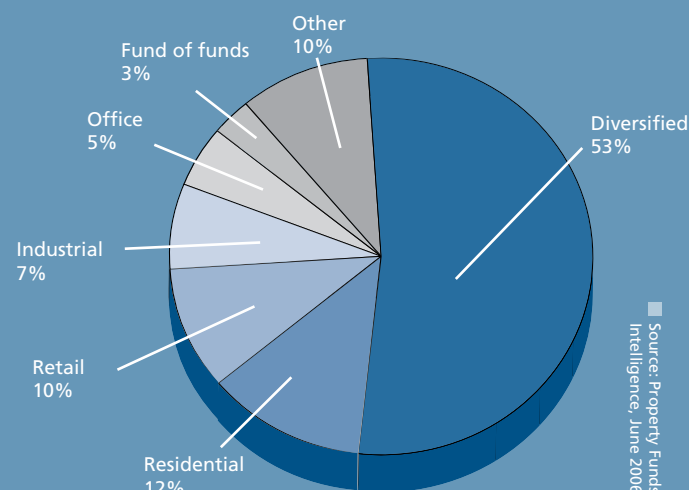
Just under one-third of PPVs in our database invest in more than one country (Table 1), while Japan is the largest single-country target for PPV investment. In 2005, launch activity was dominated by vehicles focusing on multi-country portfolios and on Japan, and average target GAV for vehicles launched was US\$1.5 billion. This year the focus of new launches has shifted to India and China, and average target GAV has fallen to US\$1.3 billion.

Table 1: Asia vehicles – target locations	Number of vehicles
Multi-country	19
Single-country	
Japan	22
India	7
China	6
Korea	3
Singapore	2
Asia (total)	59

Source: Property Funds Intelligence, June 2006

The style of choice for Asian vehicles is opportunity: this covers 62% of all funds for which we have information, compared with 30% classified as value added and 8% as core. More than half of fund managers favour investment in a diversified portfolio of properties, while 12% of funds focus on residential properties and 10% on the retail sector (Figure 4). There are two funds of funds: the Netherlands-based Composition Capital Asia Fund, launched in April 2005, and Luxembourg-domiciled Aberdeen Indirect Property Partners Asia, which will be launched later in 2006.

Figure 4: Asia vehicles - sectors targeted for investment



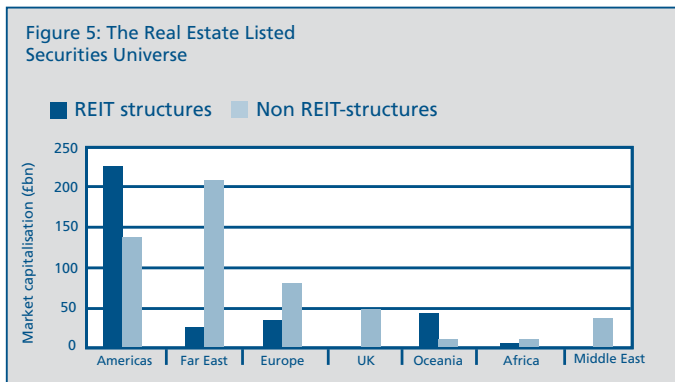
Source: Property Funds Intelligence, June 2006

Real estate securities: a global view

By Alex Moss, AME Capital

AME Capital has developed a Global Real Estate Analysis System (GREEAS) to monitor listed real estate companies worldwide. The global database currently holds data on some 1800 companies in 50 countries. The system allows companies to be analysed and categorised by financial criteria such as total returns, market capitalisation and gearing, as well as by property criteria such as sector type, country location and company style. It allows users to search for underlying asset exposure regardless of listing region. The analysis system has been designed for use by equity fund managers, fund of fund managers and all investors seeking an exposure to the global listed real estate securities market.

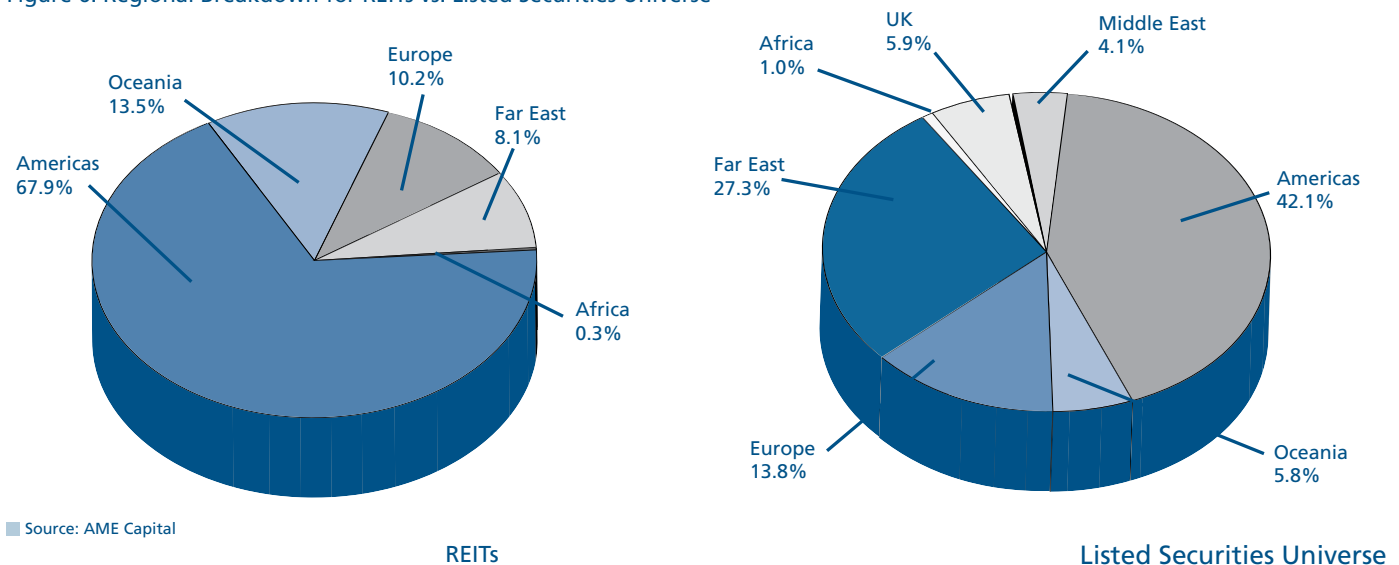
The database classifies companies as either Real Estate Investment Trusts (REITs) or non-REIT structures. The universe of all listed securities is currently worth £864 billion, of which 38% is made up of REITs and 62% of non-REIT structures. AME Capital produces a series of Global REIT indices on Bloomberg. It also produces securitised style indices for UK West End, UK Industrial and UK Retail (non-REIT structures).



Source: AME Capital

Figure 5 shows the breakdown of the global real estate listed securities market on 30 June 2006 (REITs and non-REIT structures). The most established REIT markets are in the US and Australia (which accounts for most of Oceania). As REIT legislation is introduced elsewhere, AME Capital expects the market to grow in the Far East and Europe (including the UK), shifting the regional breakdown of REIT markets closer to that of the global real estate securities market as a whole (Figure 6).

Figure 6: Regional Breakdown for REITs vs. Listed Securities Universe



Source: AME Capital

Table 2 shows the breakdown of the global REIT market on 30 June and changes in the market in the second quarter of 2006. The size of the North American market declined as a number of REITs were taken private and as underlying share prices performed poorly. There was also a decline in Europe, where the strong performance in the first quarter was reversed due to concerns over potential interest rate increases, with Turkey suffering the greatest decline. Oceania was the only region to show an increase in the size of the market in the second quarter. Australia, with market capitalisation of £43 billion, remains the largest REIT market after the US (£211 billion).

Table 2: The Global REIT Market

	Market Capitalisation (£m)	Change in Q2 (£m)	Number of REITs	Change in Q2 (number)
North America ¹	224,246	-4,847	239	-2
Europe ²	33,676	-3,511	62	+3
Oceania ³	44,617	+2,162	74	+3
Far East ⁴	26,708	-366	81	+17
Africa ⁵	863	-539	4	n/c

¹ US and Canada. ² France, Netherlands, Belgium, Greece, Turkey and Bulgaria. ³ Australia and New Zealand. ⁴ Japan, Singapore, Hong Kong, Taiwan, South Korea, Malaysia and Thailand. ⁵ South Africa.

Source: AME Capital

The main story of the last six months has been the dramatic increase in the number of Initial Public Offerings (IPOs) in the Far East. All countries in the region have shown an increase in the number of REITs, although weak market conditions have led to a decline in overall market capitalisation. Over the last 18 months the number of Japanese REITs has more than doubled, although this increase in supply has constrained performance. For the year to 30 June 2006, the weighted average return of J REITs was just 7.3%, compared to 81% for Japanese property companies in the comparable period.

Looking ahead, a number of UK companies have indicated that they are likely to convert to REIT status when legislation allowing them to do so comes into effect on 1 January 2007. Pakistan is also expected to have draft legislation in place later this year. In Germany, however, legislation is likely to be further delayed. Most commentators expect that the highest level of activity will remain in the Far East, with Singapore competing with Hong Kong to provide REIT structures with portfolios located in mainland China.

Emerging markets: an analysis of the news

As the market grows the universe of acceptable international property investment locations continues to expand. The first half of 2006 saw a number of new fund launches in the emerging markets of India and the UAE, while new fund activities in areas such as Russia, Africa and South America were also prominent.

Early 2006 brought the launch of the Chatterjee Group's new €372 million fund investing in Indian offices, while the Chicago Public School Teachers' Pension and Retirement Fund included India in its plans to invest in real estate.

The Al Mada'en fund, investing in North Africa and the Middle East, was launched by Abu Dhabi Commercial Bank in April, while firms such as the Hinduja Group, HDFC Real Estate Venture Fund and Trinity Capital also set up new Indian funds. In addition, RREEF announced plans to focus on investments in countries including India and Russia. CalPERS (the California Public Employees' Retirement System) invested in Indian funds during April, while Emirates Financial Services launched the €16 million Carnelian I fund for investments in the UAE.

The announcement that new property laws in the UAE were expected to lure more foreign investment into the country's real estate sector was backed up by CB Richard Ellis, which estimated that indirect vehicles could

invest as much as €5 billion in Dubai in the following 12 months.

May saw the launch of three new funds with Dubai as a target location: Al Mal Real Estate Fund, Dubai Property Fund, and a hotel development fund also targeting Saudi Arabia and India from KM Properties. Moreover, Unicorn Investment Bank launched Gulf Springs, a €118 million fund targeting North Africa and the Middle East. In the same month, a number of Indian funds were announced, including the Carlyle Group's €237 million fund and Stargate Capital's €147 million fund, while Indian property fund manager Saffron voiced its plans to launch three new funds to invest in India. Some €388 million was raised by IL&FS Investment Managers for its Indian Realty Fund and Dawney Day announced that it expects to launch a new Indian fund before the end of the year.



Property Funds Intelligence looks to the future

Oxford Property Consultants (OPC), the property research and investment business which established the first European and global dataset of unlisted property vehicles and became investment advisor to one of the first European fund of funds vehicles, announced in June that it had agreed a full de-merger of these two divisions through the sale of its investment management business.

A new company, Property Funds Intelligence Limited, has acquired the research and information business of OPC. OPC's fund management business has at the same time been sold to CBRE Investors to launch a new business, CBRE Global Multi Manager.

Property Funds Intelligence Limited will be majority owned by the existing management of the OPC research and information business. Jane Fear has been appointed Managing Director, and Andrew Baum will continue as Chairman. Property Funds Intelligence will

continue to operate from the former OPC office in Reading. This de-merger preserves the independence of the unique Property Funds Intelligence datasets, and will provide more resources for further investment in the interactive Private Property group of products (Private Property UK, Private Property Europe and Private Property Global) and for new product development.

Andrew Baum said: "OPC's successful move into fund management means that it is a natural development to separate these businesses for the benefit of our staff, and our customers and clients. We look forward to energetically pursuing Property Funds Intelligence's objective to be the leading provider of high quality data and research describing the major sources of capital, investment vehicles, managers and advisors which together largely define the UK, European and global institutional property markets."

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