THE BENEFITS OF ACTIVE MANAGEMENT FOR REAL ESTATE SECURITIES

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EXECUTIVE SUMMARY

While the discussion of active management versus passive management in various asset classes may continue for some time, evidence suggests that active management wins out versus a passive approach when investing in listed real estate. As shown in this paper, active managers in listed real estate are shown to have out-performed a passive benchmark over 3, 5, 7, 10, and 15-year periods.

We believe the primary reason for the ability of active managers to out-perform is the asymmetry of information in the real estate industry, which is generally not found in other asset classes. The essential value of real estate is largely determined by the unique attributes of location and property type which active managers in listed real estate can exploit. Specifically,

- Real estate is defined inherently by its location; it is not a commodity.
- Real estate remains a local business and much of the critical information is local in nature.
- Property types can differ dramatically and carry with them contrasting financial attributes such as lease duration.
- Transparency across many real estate markets varies tremendously, depending on the market and property type.
- The listed real estate industry is not nearly as well-covered by the analyst community compared to broad equities.
- Active managers can identify higher quality real estate companies and tactically avoid lower quality companies.
- Active managers in listed real estate can access syndicate activity, including IPOs.

Lastly, a comparison of active management to a benchmark as the proxy for a passive approach is inherently flawed due to the principal limitation of such an exercise: the benchmark return is a theoretical construct and realistically unattainable. Benchmark returns omit the practical realities of transaction costs, taxes, and other frictional expenses. Thus, comparing the theoretical returns of a passive approach to the genuine returns of an active approach is not an "apples-to-apples" comparison.

REAL ESTATE SECURITIES ARE WELL-SUITED TO ACTIVE MANAGEMENT

There has been an on-going discussion among investors whether certain asset classes lend themselves to active investment management while others may be more suited to a passive management approach. Our view, as detailed throughout this paper, is that an active management approach in real estate securities can consistently out-perform a passive approach.[1] In general, arguments for a passive approach typically center on the belief that many markets are fairly efficient and, therefore, it is difficult for an investor to gain an informational advantage and thus an outsized profit. Large capitalization equities are frequently put forth as such a market, given the size and transparency of a large proportion of its constituents. Passive strategies typically have included index funds or exchange-traded funds (ETFs) which track widely-used benchmarks but increasingly are more specialized. While a passive approach has been around for a long time, such strategies have proliferated in recent years.[2]

Research and industry data have become more widely available in many asset classes (including listed real estate), thereby bolstering the argument that markets should be more efficient with respect to the dissemination of financial information. Nonetheless, we believe that real estate remains an asset class where active management is advantageous. Among the many reasons for this belief is that the real estate industry has a number of structural qualities which cause significant imperfect access to information. An active manager's ability to take advantage of imperfect information can add value in an actively managed portfolio.

THE EVIDENCE: ACTIVE REAL ESTATE MANAGERS OUTPERFORM OVER TIME

The most compelling evidence that active management makes sense for an allocation to listed real estate is the fact that active management has out-performed the benchmark over time. We analyzed the performance of active managers in the U.S. REIT market over various time periods--the U.S. is a suitable market to examine since it remains the deepest real estate securities market with a rich data set of active managers who have long track records.

Exhibit 1: Active Managers In Listed U.S. Real Estate Have Outperformed Over Time

The majority of active managers in U.S. REITs beat the benchmark over varying time periods, including trailing 3 year, 5 year, 7 year, 10 year, and 15 year periods. Over the longest of these time periods (15 years), 93% of active U.S. REIT managers beat the benchmark. Even in the trailing 3-year period, which arguably has been more challenging for many active managers, 71% of active U.S. REIT managers beat the benchmark, far exceeding the percentage achieved by large-cap core active managers (50%). The percentage of active U.S. REIT managers out-performing the benchmark is much higher than that for broad large-cap equities for all time periods.

	3 Year		5 Year		7 Year		10 Year		15 Year	
Active Managers	U.S. REITs	U.S. Large-Cap Core	U.S. REITs	U.S. Large-Cap Core	U.S. REITs	U.S. Large-Cap Core	U.S. REITs	U.S. Large-Cap Core	U.S. REITs	U.S. Large-Cap Core
Number of Managers	48	312	47	301	42	282	38	246	27	145
Number of Managers that Outperformed	34	156	39	135	37	180	34	188	25	123
Percentage of Managers that Outperformed	71%	50%	83%	45%	88%	64%	89%	76%	93%	85%
Average Outperformance	+162 bps	+170 bps	+133 bps	+140 bps	+204 bps	+147 bps	+175 bps	+142 bps	+179 bps	+259 bps

Source: CBRE Clarion as of 12/31/2014. Analysis based on classifications of managers in eVestment universe and monthly returns relative to the respective benchmark for each manager, which may differ from manager to manager. Past performance is no guarantee of future results.

[1] For the purposes of this discussion, "passive" refers to investing consistenly within the structure of a previously defined benchmark, net of any frictional costs associated with tracking the becnhmark.

[2] This has been due to a number of influencing factors including: (i) pressure on fees; (ii) the related desire for financial advisors to maintain a profitable business model; (iii) the creation of tailored products by large asset managers which create, produce and sell index funds or ETFs; (iv) frustration by some investors with active management; and (v) the chatter in the media regarding the growing number of passive investment vehicle alternatives.

THE INFORMATION EDGE – UNDERSTANDING LOCATION AND PROPERTY TYPE MEANS UNDERSTANDING VALUE

Real estate is defined inherently by its location; it is not a commodity. Unlike many industries that create products, all of which are identical, each real estate asset is unique, defined by its location. While properties can be similar in size, age and configuration, they fundamentally differ as a result of location and, therefore, require analysis which can evaluate the specific characteristics (such as access, parking, proximity to mass transit, orientation of the space to sunlight, amenities, floor plate size, elevators, and many other physical characteristics). This is even evident among big-box distribution warehouses, which would appear to a non-real estate analyst to be near commodities in nature. However, since approximately 50% of the cost of getting a product from the manufacturer to the retail store is transportation, the location of an otherwise identical warehouse is material to the tenant and, consequently, an investor.[3] Just as a prospective tenant would likely want to see the space before committing to a lease, a prospective investor similarly should want to see the space before investing in it. Analyzing a company with many properties can become complex given the sheer number of properties and differences among them. A real estate asset is not a commodity which can be easily extrapolated, such as with an automobile in the auto industry, an interest rate in the lending business, or other commodity-type products; it relies more on the build-up of specific underwriting of individual assets. An active manager of listed real estate with the resources and experience to analyze specific assets and real estate portfolios has the ability to underwrite companies individually.

Real estate remains a local business and much of the critical information is local in nature. Despite the significant improvement in the availability of information in recent decades, due to the growth of the listed property sector which reports frequently to investors, some of the most critical information is only available to those within that local market. For example, leasing agents spend a great deal of time identifying tenants which may have space requirements in the future, creating a competitive advantage with this proprietary knowledge that is otherwise unknown beyond the local market. Similarly, property asset managers operating properties for their customers (tenants, owners, and lenders) generally do so with a degree of privacy. This provides a competitive advantage to those players. Approximately 88% of the world's institutional quality property remains in private hands.[4] Developers, by nature, keep their plans private in order to gain a competitive advantage or else they might lose a market opportunity. For example, pricing discovery including market cap rates, information regarding market trends, and incremental demand/supply are typically known first by market players such as brokers or leasing agents located in each market, then only later made available to the wider market. An active manager with access to such market "agents" can potentially gain an information edge over others looking to invest in that market—an information edge which could lead to out-performance in an actively managed investment strategy.

While the dissemination of trends in real estate have improved dramatically with the growth of the real estate securities market and the REIT structure, information remains imperfect and uneven, thereby providing potential advantage to a careful underwriter of real estate trends who has access to information in both the listed and private markets.

Exhibit 2: Listed Real Estate is a Modest Portion of the Commerical Real Estate Market

A modest proportion of commercial real estate is held in the listed arena. Active managers with a view of the private and the listed real estate markets can formulate comprehensive views despite the complications of transparency and the scarcity of analyst coverage.

	Commercial Real Estate Assets (Direct & Listed Property)		Listed Real Estate Equity Market Capitalization		Implied Assets Owned by Listed Real Estate Companies[5]	
Country/Region	Value ($)	% of World	Value ($)	% of World	Value ($)	Implied Value as a % of Commercial Real Estate Value
Americas	10,479	36%	856	38%	1,468	14%
Europe	9,399	32%	299	13%	590	6%
Asia Pacific	8,182	28%	1,060	47%	1,422	17%
Middle East/Africa	1,080	4%	61	3%	70	7%
Total World	**$29,140**	**100%**	**$2,276**	**100%**	**$3,550**	**12%**

Source: CBRE Clarion, CBRE Global Investors, and EPRA. Dollar amounts expressed in Billions. Implied assets owned by listed real estate companies adjust the listed real estate equity market capitalization value for share price premium/discounts to NAV and include outstanding debt. Percentages may not add to 100% due to rounding. Information is the opinion of CBRE Clarion Securities, is subject to change and is not intended to be a forecast of future events, a guarantee of future results or investment advice. Any factors discussed are not indicative of future investment performance.

[3] CBRE Research.

[4] Refer to Exhibit 4.

[5] Implied assets owned by listed real estate companies adjust the listed real estate equity market capitalization value for share price premium/discounts to NAV and include outstanding debt.

ACTIVE MANAGERS CAN CAPITALIZE ON THE DISPERSION OF PERFORMANCE ACROSS PROPERTY SECTORS AND GEOGRAPHIES

Property types can differ dramatically and carry with them contrasting financial characteristics. The duration of cash flows generated by shorter lease length property types such as hotels and apartments, for example, contrasts with longer lease length anchors at malls or large users of office space. A big law firm, for example, might have a 10 or 15 year lease in a downtown skyscraper, with several five-year renewal options versus a small suburban office user who might be on a three-year lease or an apartment renter who is on a one-year lease. Development lead time can differ dramatically, too, causing certain property types to be more efficiently matched between incremental supply and demand. As such, the performance by sector can significantly vary depending on how "in synch" supply/demand is with the economic cycle. The ability to allocate capital to the right sectors at the right time carries with it the potential to add material value in an actively managed portfolio.

Exhibit 3: Active Managers can Add Value by Shifting Capital Among Property Sectors

The annual performance by U.S. REIT property sector going back to 2007 demonstrates the annual variability of returns by property sector of real estate trends who has access to information in both the listed and private markets.

Annual Returns (%) by U.S. Sector

	2007	2008	2009	2010	2011	2012	2013	2014
	Healthcare 2%	Self-Storage 5%	Hotels 67%	Apartments 47%	Self Storage 35%	Industrial 31%	Hotels 27%	Apartments 40%
	Industrial 0%	Healthcare -12%	Malls 63%	Hotels 43%	Malls 22%	Malls 28%	Self-Storage 9%	Healthcare 33%
	Malls -16%	Apartments -25%	Office 36%	Malls 35%	Apartments 15%	Shopping Centers 25%	Industrial 7%	Malls 33%
	Shopping Centers -18%	Shopping Centers -39%	Apartments 30%	Shopping Centers 31%	Healthcare 14%	Healthcare 20%	Office 6%	Hotels 33%
	Office -19%	Office -41%	Healthcare 25%	Self- Storage 29%	Shopping Centers -1%	Self-Storage 20%	Shopping Centers 5%	Self Storage 31%
	Hotels -22%	Hotels -60%	Industrial 12%	Healthcare 19%	Office -1%	Office 14%	Malls -1%	Shopping Centers 30%
	Self-Storage -25%	Malls -61%	Self-Storage 8%	Industrial 19%	Industrial -5%	Hotels 13%	Apartments -6%	Office 26%
	Apartments -25%	Industrial -67%	Shopping Centers -2%	Office 18%	Hotels -14%	Apartments 7%	Healthcare -7%	Industrial 21%
Range:	-25% to 2%	-67% to 5%	-2% to 67%	18% to 47%	-14% to 35%	7% to 31%	-7% to 27%	21% to 40%

Source: Morningstar Direct as of 12/31/2014. Annual property sector returns are based on the FTSE NAREIT Equity REIT Index. An index is unmanaged and not available for direct investment.

Transparency across many real estate markets varies tremendously, depending on the market and property type. In the U.S., penetration of listed property companies remains below 10% for most property types — for example, approximately 5% of self-storage facilities in the U.S. are in the listed market. Globally, while some markets are far along in developing consistent and thorough real estate operating metrics and research (such as the United States, United Kingdom and Australia), other geographies are significantly behind, including generally Asia ex-Japan, many countries in Continental Europe, and the emerging markets. These lagging markets are more fragmented, making it difficult to access reliable and deep data. Regulatory and reporting regimes can differ dramatically, creating yet another challenge to learn what is really going on. In many markets, financial reporting is conducted semi-annually instead of quarterly and the norms of reporting can vary significantly. Governance practices often fall below standards of those in more mature markets. In these types of markets, it takes people located locally to better identify and articulate fundamental trends which drive real estate values. An investor who can successfully navigate markets with a historically wide dispersion of returns has the potential to add value over time.

Exhibit 4: Insights into Local Markets Create Opportunities for Active Managers

The annual performance by major geography going back to 1994 reflects the tremendous variability of returns by geography.

Annual Returns (%) by Country/Region

	Australia	Hong Kong	Japan	United Kingdom	Continental Europe	North America	World Index
1995	16.2	**32.7**	10.0	13.8	10.4	22.3	19.6
1996	25.9	**56.0**	-18.2	27.0	14.6	42.8	31.0
1997	3.5	-37.8	-8.5	7.6	1.0	**25.1**	-7.4
1998	**22.6**	-5.2	-19.4	-13.1	15.5	-17.7	-8.2
1999	5.5	**51.4**	5.8	-3.1	-3.1	-4.4	8.9
2000	-0.1	1.1	19.8	13.2	6.2	**29.8**	13.8
2001	-1.9	-15.3	-25.9	-7.4	-4.5	**10.0**	-3.8
2002	14.6	-27.8	-0.9	11.6	**34.6**	2.4	2.8
2003	45.6	**49.2**	38.7	45.4	43.8	37.7	40.7
2004	39.8	35.1	37.2	**56.6**	48.6	33.5	38.0
2005	8.0	10.2	**53.2**	6.7	12.6	13.2	15.4
2006	43.1	38.8	24.6	**68.7**	65.1	36.3	42.4
2007	2.9	**58.5**	-6.4	-35.2	-14.4	-14.9	-7.0
2008	-64.4	-57.4	**-33.4**	-61.1	-44.2	-40.6	-47.7
2009	33.3	**88.7**	1.4	29.1	44.7	32.2	38.3
2010	14.4	11.9	**30.8**	1.8	13.5	28.7	20.4
2011	-2.0	-25.3	-22.1	-8.6	-14.4	**8.2**	-5.8
2012	33.8	43.7	**49.7**	35.9	27.9	18.1	28.7
2013	-8.1	-9.3	**32.0**	26.2	10.1	1.3	4.4
2014	27.3	13.3	-2.7	21.3	23.8	**29.0**	20.9

Returns are annual returns of regions of the FTSE EPRA/NAREIT Developed Proeprty Index, calculated in U.S. dollars, from December 31, 1994 through December 31, 2014.
Past results are not guarantee of future results.

LISTED REAL ESTATE STOCKS ARE NOT WELL-COVERED VERSUS OTHER SECTORS

The listed real estate industry is not well-covered by the analyst community compared to broad equities. Listed real estate companies have grown materially over the past decade in market capitalization but remain a relatively small industry relative to other asset classes. The size of the global real estate securities market is less than 1% that of the global equities market. As such, it does not lend itself to broad, consistent coverage by the analytical community, which among sell-side analysts in particular has high turnover and in many cases thin coverage. The broad equities market is characterized by deep coverage in the analytical community with twice as many analysts covering each S&P 500 company on average versus the number of analysts on average covering the constituents of the MSCI U.S. REIT Index (specifically, 24 analysts cover each S&P 500 company on average versus 12 analysts for each company in the MSCI U.S. REIT Index on average). The disparity in coverage widens for the smaller companies — for the smallest 20 companies in each benchmark, there are 17 analysts on average covering the S&P 500 versus five on average for the MSCI U.S. REIT Index.[6]

[6] Sourced from Bloomberg.

ACTIVE MANAGERS CAN STICK WITH QUALITY

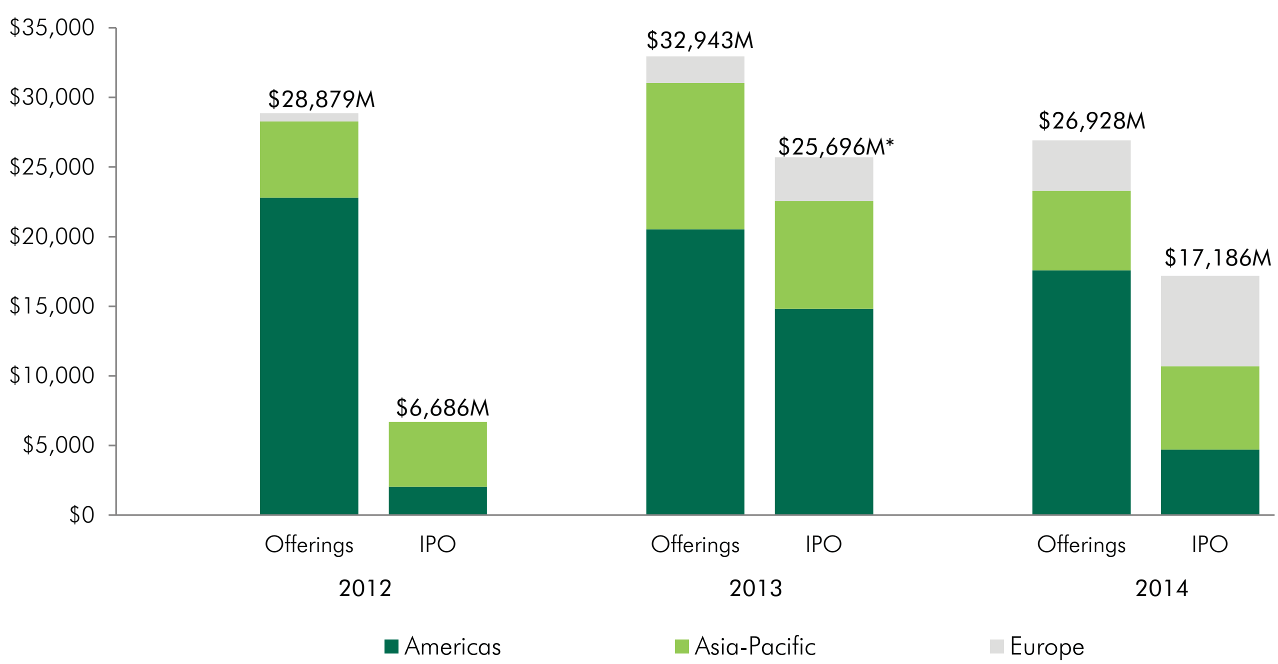
Active managers can identify higher quality companies and avoid lower quality companies. Active managers can screen for companies which are inferior, either by asset type, location, management, balance sheet, or strategy and do not have the obligation to own such companies in an active mandate. This becomes particularly important during the periodic bouts of market crisis, during which higher quality companies tend to out-perform. As a result, an active manager attempts to position a portfolio more conservatively to mitigate the downside. For example, in the Global Financial Crisis in 2008/2009, active portfolio managers could react by positioning the portfolio more defensively. Portfolio construction techniques during this time of crisis included raising cash, skewing towards "defensive" property types with more stable cash flows (such as regional malls, healthcare, and net lease) which are less cyclical (such as office and hotels), avoiding risky business models (such as developers or any company with a material level of development), shunning higher beta markets (such as many of the Asian markets), and favoring companies with strong and conservative balance sheets and well-covered dividend yields. A passive approach can do none of these things and is subject to the full impact of a falling market.

ACTIVE MANAGERS CAN ADD VALUE VIA SYNDICATE ACTIVITY

Active managers in listed real estate can access syndicate activity, including IPOs. Listed real estate companies are heavy users of capital given the capital intensive nature of the real estate business. As such, investors in listed real estate regularly invest in equity offerings, both initial public offerings and follow-on/secondary offerings. Many of these offerings remain difficult to access for the retail investor, particularly accelerated book builds which typically occur in under 24-hours on short notice. "Overnight" deals are particularly common in the U.S. for follow-on offerings. Purchasing equity on an offering has the advantages of being able to buy in scale with no frictional costs and generally at a discount to the previous market closing price. Active managers of real estate securities regularly participate in these deals, which have been significant in recent years.

Exhibit 5: Global Equity Issuance from Listed Real Estate Companies ($MM)

The magnitude of equity capital raised by real estate companies across the globe in recent years:



Source: CBRE Clarion as of 12/31/2014. *2013 includes the listing of COLE Real Estate Investments non-traded shares. Information is the opinion of CBRE Clarion as which is subject to change and is not intended to be a forecast of future events, a guarantee of future results, or invesment advice. Forecasts and any factors discussed are not indicative of future investment performance. Past performance is no guarantee of future results.

There have been nearly $13 billion of IPOs in the U.S. real estate securities market over the past two years, which have out-performed on average by 6.5% over the subsequent 10-days from the IPO date and nearly 8% over the subsequent 15 and 20 days from the IPO date. An investor who was able to participate materially in an IPO benefited from the out-performance versus the benchmark return over this time period. New companies are not typically included in the benchmark for at least a day following the IPO, and sometimes much longer, even if they are "fast tracked" into benchmark inclusion.

Exhibit 6: U.S. Real Estate IPO Activity in 2013 and 2014

The volume of IPOs compiled in 2013 and 2014 year-to-date and their performance post-IPO[7]:

Total U.S. IPOs: 19[8]	Offering Size ($MM)	10-Day Return	15-Day Return	20-Day Return
Average	$719	6.88%	8.23%	7.67%
Lowest	$120	-3.38%	-7.14%	-11.48%
Highest	$3,714	35.64%	29.45%	26.86%
MSCI U.S. REIT Index		0.39%	0.34%	-0.48%
IPO Outperformance[9]		6.49%	7.89%	8.15%

Source: CBRE Clarion as of 12/31/2014. Information is the opinion of CBRE Clarion as which is subject to change and is not intended to be a forecast of future events, a guarantee of fuure results, or investment advice. Forecasts and any factors discussed are not indicative of future invesement performance. Past performance is no guarantee of future results.

THE INHERENT FLAW IN PASSIVE COMPARISONS: THEORETICAL RETURNS ARE UNATTAINABLE

Passive strategies carry inherent costs which are perhaps underappreciated by investors, including transaction costs, costs related to turnover as a portfolio is rebalanced and, in the case of a global strategy, withholding and other taxes which can be significant to the investor. When added to transaction costs, and any management fee costs, total costs can become non-trivial for a "passive" approach – thus a passive strategy is not "free." Benchmark returns are thus theoretical in nature and not achievable without incurring costs. Any comparison of an active strategy to a passive strategy needs to be done after taking into account any expenses associated with running each strategy in order for it to be an "apples-to-apples" comparison. "Like a Unicorn, the benchmark Index is a mythical creature that only exists in our imaginations. Yet, the index is used as a point of comparison to berate investors into competing for a prize they cannot win." [10]

CONCLUSION: ACTIVE MANAGEMENT ADDS VALUE VERSUS A PASSIVE APPROACH IN LISTED REAL ESTATE

Real estate securities is an asset class which warrants active investment management, as validated by the evidence that the majority of active managers of U.S. real estate securities have out-performed the benchmark over the past 3, 5, 7, 10, and 15 years. The primary reason for the ability of active management to out-perform a passive strategy relates to the structural characteristics of the real estate sector which cause significant imperfect information. Structural characteristics include the fact that individual properties are unique as a result of their locations and, therefore, are difficult to commoditize, as well as the fact that some critical information in the real estate market is not readily available or transparent. Listed real estate also remains a small market relative to larger asset classes, less covered by the analytical community versus broad equities, thereby reducing the level of research data in the marketplace. In addition, active managers can take advantage of syndicate activity by taking material positions in real estate companies issuing equity, and can skew portfolios to companies of above average quality during times of crisis.

While the discussion contrasting the benefits of active management versus passive management may have merit with respect to some asset classes, it is clear that active management in listed real estate remains the prudent and superior approach.

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7 Excludes the IPO of William Lyons Homes (WLH) which had an outlier return of over 375% over the three time periods.

8 Includes 19 IPOs from REITs and real estate related companies in the U.S.; excludes WLH as an outlier.

9 Outperformance of Average IPO Return during the period as compared to the MSCI U.S. REIT Index.

10 The Many Errors of the "Active vs. Passive" Debate, Lance Roberts, Tuesday, May 20, 2014, STA Wealth Management

GLOSSARY:

FTSE NAREIT Equity Index is an unmanaged market cap weighted index comprised of equity REITs. The NAREIT Equity index is available daily. The NAREIT Equity index includes healthcare and net lease REITs, but excludes real estate operating companies. The requirement for inclusion in this index is for a company to be an exchange listed equity REIT. There is no minimum size or liquidity requirement for an equity REIT to be included in this index.

MSCI U.S. REIT Index (RMS): RMS is comprised of U.S. Real Estate Investment Trusts (REITs) of reasonable size and liquidity weighted by market capitalization and considered representative of U.S. equity REIT performance.

FTSE EPRA/NAREIT Developed Property Index is an unmanaged market-weighted index consisting of real estate companies from developed markets, where greater than 75% of their EBITDA (earnings before interest, taxes, depreciation, and amortization) is derived from relevant real estate activities.

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