

REIT-Update: USA



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National Association of
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Following a strong rebound in July, U.S. REIT returns continue to significantly outperform the broader U.S. stock market in 2008. After posting a double-digit decline in June, the FTSE NAREIT All REIT Index was up 2.8 percent in July, while the FTSE NAREIT Equity REIT Index was up 3.5 percent for the month.

Through the first seven months of 2008, the FTSE NAREIT All REIT Index was down 2.9 percent, while the FTSE NAREIT Equity REIT Index was essentially flat. In contrast, other U.S. market benchmarks remained deeper in negative territory for the year (the Dow Jones Industrials down 14.2 percent, the S&P 500 down 12.7 percent, the NASDAQ Composite down 12.3 percent, and the Russell 2000 down 6.0 percent).

In its review of U.S. REIT earnings calls, Citi reported management teams continued to stress caution when forecasting second half performance due in large part to broader economic uncertainty.

Residential and Self Storage REITs continue to lead the U.S. REIT market with double-digit total returns for the year. Sparked by strong fundamentals in the rental market, Residential REITs were up 16 percent for the year, through July 31. In July, Residential REITs gained 11.6 percent. Despite flat returns in July, the Self Storage sector continued to be a top performer for the year, up 12.6 percent.

Housing Bill Includes Important REIT Provisions: Major U.S. housing legislation signed into law by President George W. Bush on July 30 features long-awaited revisions to the rules governing U.S. REITs.

The bill—dubbed the "Housing and Economic Recovery Act of 2008"—incorporates virtually all of the REIT Investment Diversification and Empowerment Act (RIDEA) provisions. NAREIT staff members have worked with Capitol Hill and the Administration for the past three years to adopt RIDEA.

The new law's REIT-related provisions include:

- Reducing the holding period under the “dealer” sales safe harbor test from four years to two years;
- Changing the measurement of the 10 percent of sales permitted under the safe harbor test from current tax basis to either tax basis or fair market value (at the REIT’s annual option);
- Increasing the size ceiling for taxable REIT subsidiaries from 20 percent to 25 percent of assets;
- Permitting health care REITs to use taxable subsidiaries in the same manner as hotel REITs;
- Excluding most real estate-related foreign currency gains from the computation of the REIT income tests; and,
- Providing the Treasury Department with clear authority to rule on whether a variety of items are “good” REIT income.

“The new rules provide more flexibility for REITs to more efficiently manage their property portfolios, which is critical in today’s market,” said Tony Edwards, NAREIT’s executive vice president and general counsel

OECD Approves Long-Awaited REIT Provisions: The Organization for Economic Cooperation and Development (OECD) on July 18 approved the latest round of updates to its Model Tax Convention (MTC), which includes measures governing taxation of cross-border REIT investment.

Jeffrey Owens, director of the OECD Center for Tax Policy and Administration, said the growing popularity of securitized real estate investment had spurred the organization’s interest in putting a finer point on its proposed REIT tax regulations.

“The use of real estate investment trusts has significantly expanded worldwide and more and more countries are introducing rules to facilitate the use of these vehicles,” Owens wrote in a report on the new measures.

The MTC is intended to serve as a blueprint to create comity among international tax treaties. NAREIT and its foreign partners in the Real Estate Equity Securitization Alliance (REESA) have been working collaboratively with the OECD to modify the convention’s REIT-related provisions for the past two years.

The approved revisions to the MTC’s REIT provisions bear no major differences from the proposals circulated by the OECD since October 2007. Among them, the model suggests that REIT dividends to portfolio investors based in other countries should be taxed at a lower rate, usually 15 percent. The OECD also examined investments by foreign REITs, as well as REIT-to-REIT investments, but the commentary on its new model tax treaty did not reach conclusions on those issues.

“NAREIT greatly appreciated the OECD’s cooperative spirit in designing rules that remove barriers to cross-border REIT investments. The OECD’s acknowledgment of REITs around the world confirms the status of

income-producing real estate as one of the four major asset classes necessary for investors to achieve true diversification in their portfolios," said Tony Edwards, NAREIT's executive vice president and general counsel.

In addition to NAREIT, REESA's membership consists of the Asian Public Real Estate Association (APREA); The Association of Real Estate Securitization (ARES); the British Property Federation (BPF); the European Public Real Estate Association (EPRA); the Property Council of Australia (PCA); and the Real Property Association of Canada (REALpac).

CFTC Approves Futures Contracts: On July 14, the Commodity Futures Trading Commission's (CFTC) Office of General Counsel announced its approval of the offer and sale of Euronext Paris' futures contracts in the U.S., based on the FTSE EPRA/NAREIT Indexes.

"The CFTC's decision permitting the offer and sale of Euronext Paris' FTSE EPRA/NAREIT listed real estate futures contracts is another meaningful step in the full development of the market for publicly traded real estate securities and risk management products," says Mike Grupe, NAREIT's executive vice president, research and investor outreach.

The FTSE EPRA/NAREIT Europe Index and the FTSE EPRA/NAREIT Euro Zone Index are composed of real estate securities that are listed and traded in Europe. They are broad-based, free-float-market-capitalization-weighted, total-return security indexes. According to Euronext Paris, the total adjusted market capitalization of the FTSE EPRA/NAREIT Euro Zone Index is approximately \$82 billion, while the FTSE EPRA/NAREIT Europe Index is approximately \$179 billion.

"These new contracts provide investors with more effective and transparent tools for efficiently managing the risks of their European real estate investments," Grupe says.

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