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Real Estate Investment Trust Industry Report

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Introduction

About this Report

This *Real Estate Investment Trust (REIT) Industry Report* includes coverage of the residential, commercial, and industrial REITS industry. We decided to offer a report on the REITS industry due to its financial impact on the home building and financial services (mortgage) industry. This report has been prepared in an easy to use format for the reader to drill down to key sections. This report covers various macroeconomic as well as microeconomic issues that can impact the industry. There's also coverage of the hotel REITs, entertainment REITs, and hospital REITs, and how that industry can and will impact the overall REITs industry for better or worse. The main focus of this report is centered on commentary and analysis with supportive statistics and data that backs up our hypothesis on both the short-term and long-term outlook of the industry.

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Industry Environment.

Weakness Plagues the Outlook for the REIT Industry.

The real estate investment trust industry (REIT) has been dragging along in recent months due to the weak U.S. economy, declining real estate market, and a tight credit market which has hurt funding for expansion.

Many REITs are carrying excessively high debt levels and will need to repay or refinance these obligations over the next 12 months. In fact, General Growth Properties, Inc. has already been a casualty of the current economic environment by filing for bankruptcy in April 2009. General Growth Properties could not refinance its huge debt load. The company couldn't even find buyers for some of its properties which could have avoided Chapter 11 bankruptcy.

A key issue with many REITs is the large development pipelines which requires them to rely on banks to provide funds for construction. Many REITs need follow-on financial support to ensure their projects will be completed on time. When the credit markets crashed in the fall of 2008, many banks refused to support additional financing or would consider financing but at much higher and unfavorable borrowing rates. Thus, securing capital and/or capital at attractive rates will remain challenging throughout the end of 2010 at least.

The Harsh Reality from the U.S. Economic Recession.

The U.S. economic downturn has been the longest and deepest economic contraction since the Great Depression in the 1930's. There are very few positives in the blighted economic data. Gross domestic product (GDP) dipped 6.1% in the first quarter of 2009. Housing foreclosures are still at a very high levels. Credit markets have remained somewhat frozen for many borrowers. The \$787 billion federal economic stimulus plan has still failed to filter down to the core consumers of the economy. Consumer confidence has continued to plunge with elevated unemployment levels.

The economy has a major impact on the prospects of the real estate investment industry. Higher rates of unemployment reduces the need for new and existing office towers. This unemployment leads to reductions in consumer spending which hurts retailers. This ultimately impacts retail REITs. In 2008, U.S. payrolls plunged by 2.6 million jobs and 1.9 million during the last one-third (September 2008 through December 2008) of the year. The first quarter of 2009 witnessed an additional 2.1 million job losses. As of early June 2009, the unemployment rate is about 9.2% but the real unemployment rate could be as high as 17.5% since the Department of Labor does not include part timers, underemployed workers, inactive job seekers, and workers that may have received reduced work hours.

These harsh economic realities will cause significant problems for REITs who own apartment properties, retail properties, office properties, hotel properties and industrial space. Healthcare

REITs are less impacted by current economic woes because demand for health services and facilities has a tendency to be constant despite economic conditions.

High Debt Levels Trouble REITs.

The real estate investment trust industry is reeling from the adverse credit market crisis which has had an adverse impact on the entire industry. The credit crisis has reduced or eliminated credit financing which has made it very difficult to finance new projects or service existing debts. Many REITs that are highly leveraged with debt maturities in the near-term have been raising cash by issuing more shares (which is dilutive to shareholder value), obtaining more debt if available, and selling assets. These concerns began when the financial system nearly collapsed with the failure of Lehman Brothers and Merrill Lynch in September 2008. More lenders became concerned about the leverage and liquidity of many REITs.

Equity Markets are Unfavorable Too.

The falling stock market has crippled many industry players from raising capital. REITs with significantly reduced share prices will not be able to raise capital at attractive prices. This will also dilute existing shareholders equity stakes in the company. Some REITs have raised capital in the private equity markets. but even here, funds are drying up as financial pressures continue for many creditors. Many REITs are highly leveraged and the current credit-constrained environment will put added pressure on these companies.

Many REITs have suspended or reduced their dividend payments. This allows the company to save cash but at the expense of existing shareholders who will experience plunging share values. Some REITs have been attempting to sell non-core, non-strategic assets to raise cash to improve liquidity. But with dire global economic weakness, finding buyers could be much more difficult.

The Downtrodden Commercial Construction Market.

Commercial properties have buckled which has now followed the trend in the residential construction market. Most markets are down sharply with the exception of farmland and timberland properties which have reported some positive results. Commercial construction starts rose 4% in 2007 and dropped 26% in 2008.

A slowdown in new development could be a positive byproduct of the weak economy for existing landlords. Commercial real estate markets have not been as overbuilt as the residential sector. In addition, tight credit markets have made the availability of new construction loans scarce.

Financial markets are still constraining development in 2009 and should continue at least through the first half of 2010. Commercial construction loans are more expensive and much

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