THE BENEFITS OF DIVERSIFICATION OUTSIDE CANADA:

An Update on the Benefits of Investing in European Real Estate

APRIL 2007

Prepared in conjunction with:
CLAYTON RESEARCH
IPD

GWL REALTY ADVISORS

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The Benefits of Diversification Outside Canada: An Update on the Benefits of Investing in European Real Estate is the 12th in a continuing series of research publications by GWL Realty Advisors Inc.

Other recently-published reports include:

Dynamic Times in Food Retailing: Insight for Food-Anchored Shopping Centre Investors and Managers, November 2006
The Benefits of Diversification Outside Canada: Which U.S. Regions to Invest in to Improve Portfolio Returns, November 2006
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Data used in this report was obtained from Altus Clayton, Investment Property Databank Ltd. (IPD) and Jones Lang LaSalle.

PART ONE: EXECUTIVE SUMMARY

In 2004, GWL Realty Advisors Inc. commissioned Clayton Research and Investment Property Databank (IPD) to undertake an analysis of the potential benefits to Canadian institutional real estate investors of investing in real estate outside of Canada. The focus of the research was non-residential (office, retail, industrial) properties in five Western European countries (UK, Sweden, The Netherlands, Germany, France). The results were published by GWL Realty Advisors Inc. in a report entitled “Benefits of Investing in Real Estate in Europe”, released in April 2005[1].

The April 2005 study was based on data available through 2003. Since that time, global property markets exhibited dramatic increases in overall investment returns, particularly in terms of the amount of investment capital directed toward real estate; it is reported[2] that European real estate investment levels rose by 19% from 2003 to 2004, and then by another 48% in 2005.

With such dramatic changes since the completion of our original study, is it possible that the more-recent results could have a material impact on our investment conclusions? This April 2007 report, based upon updated research completed by Clayton and IPD, complements the prior study with data available through to the end of 2005, to determine whether the conclusions of the original study remain relevant.

The results of the updated research reaffirm that the benefits of a European diversification strategy identified the April 2005 study remain fundamentally the same:

- While only the UK has had higher property returns than Canada over the longer-term, The Netherlands and France show the potential to offer investors similar returns with a lower portfolio risk. Moreover, property returns in these two countries have been higher than returns on alternate investments (i.e. Canadian stocks and bonds).
- The United Kingdom stands out, warranting particular consideration:
  - Its larger market size, and higher rates of turnover, provides a larger base of potential properties to purchase compared to the other countries;
  - Based on the portfolio simulations runs, there appears to be potential to increase overall portfolio returns while also lowering overall portfolio risk; and,
  - Relatively low correlation of returns to those in Canada, which suggest potential benefits of portfolio diversification to include UK properties.

In the next section, we present the summary conclusions of the updated research. For those readers interested in further information, we then follow with three appendices which summarize:

(a) What’s New in Canada?
(b) Recent European Market Performance Compared to Canada
(c) What Recent Changes Have Occurred in the IPD Indices?

[1] Readers are encouraged to obtain copies of this report at www.gwlra.com, which contains more information pertaining to the methodologies and analysis referenced to herein.

[2] Source: Jones Lang LaSalle Research, as quoted in Emerging Trends in Real Estate® Europe 2007, Urban Land Institute and PricewaterhouseCoopers LLP, p.8.

PART TWO: INTRODUCTION

Canada's real estate investment market has matured over the past several years, and investors have been eager to participate in it. The relative attractiveness of property, in and of itself, and in relation to other asset classes, has created the current environment wherein many domestic investors already in the property market would like to increase their holdings and other domestic investors, who had not been active in the property sector, want to acquire product.

At the same time, some foreign investors (e.g., from Germany and Israel) have recently been viewing Canada in a more favourable light. This has led to increased interest for new acquisitions – but at a time when little is trading, as it is also attractive to investors to hold on to properties in their portfolios. Those investors wanting to increase their property holdings are thus faced with a limited number of options:

- Be willing to accept a lower return and therefore be able to acquire product;
- Look to developing their own new supply; or
- Look to opportunities outside Canada.

Several factors reinforce the notion that the time is perhaps more "right" now than in the past for institutional investors to consider real estate investment opportunities outside Canada – as summarized below:

Why Real Estate Investment Outside Canada Has Been Gaining Interest

Past Situation	Current Situation
Able to achieve investment goals within Canada – no need to look abroad	Small size of the Canadian market and increased interest/competition for properties that do become available have created a relative shortage of properties suitable for institutional investment
Diversification goals largely meant expanding to different urban markets or different property sectors within Canada, or into the U.S.	Next logical step is exploring potential diversification benefits of expanding outside North America
Lack of reliable information on property performance in foreign markets	Expansion of benchmarking services (e.g. IPD) has increased available information for many markets
Lack of familiarity with foreign markets	Globalization has increased information flows, international knowledge base and transparency
Difficulty in finding competent and compatible managers and/or partners	Globalization has improved international networks, ability to do business from abroad and cross-border experience of managers
Concerns about currency risk	Still a factor, but more developed hedging options

Please note that an analysis of tax differences pertaining to real estate investment amongst the countries examined is not included in the scope of this study.

PART THREE: UPDATE ON RISK/RETURN ANALYSIS AND PORTFOLIO MIX

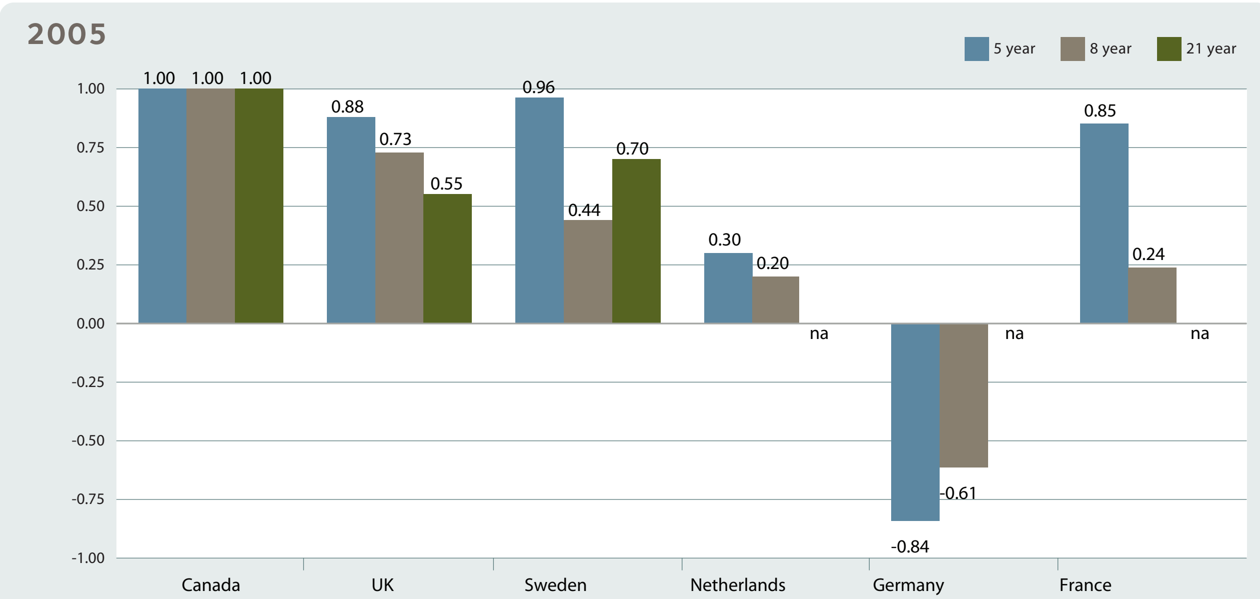
In this section, we directly compare the final results of the original Clayton/GWL Realty Advisors study with the update study results, to determine whether the most recent performance of each nations' real estate markets has had any substantive impact that would materially alter the conclusions of the original study.

Figure 1: Long-Term Growth/Volatility Relationship – Real GDP

Source: Clayton Research, based on data from OECD

- Looking at the growth/volatility relationship of the selected nations, the fundamental relationship amongst the selected nations remains the same. In other words, even though the most recent two years of additional market data (2004 and 2005) do vary somewhat from previous data, the long-term results were not materially affected.

Figure 2: Total Returns on Office, Retail and Industrial Property, Correlation with Canada (Nominal, Local Currency)



Source: IPD and Clayton Research

- Looking to the short (5 year) and medium (8 year) terms, for a number of the nations' commercial real estate markets, the correlation of their respective performance compared to Canada have measurably changed. (More details regarding recent market performance will be provided later in this report.)
- Looking beyond the medium term, however, the nations' correlations with the Canadian market still hold, although there has been some slight shifts.
  - Over the longer-term, returns on Office, Retail and Industrial ("ORI") property in the UK have only been moderately correlated with those in Canada, although in the past 5 years the UK's correlation with Canada has been relatively high.
  - Swedish returns have had a high correlation over the longer term, as well as in the past 5 years.
  - Returns in The Netherlands have had a low correlation with Canada in the past 5 years, and over the 8 year timeframe.
  - Returns in Germany have been negatively correlated, both in the past 5 years and over the past 8 years.
  - Returns in France for the past 5 years have been highly correlated with Canada, but not highly correlated over the past 8 years.

Table 1: Risk/Return Relationship and Correlation of Returns with Canada, Office, Retail & Industrial Property (Nominal, Local Currency)

2005	Canada	UK	Sweden	Netherlands	Germany	France
1985-2005 (21 years)						
Mean annual return (reward)*	9.5	11.6	10.5	na	na	na
Standard deviation (risk)	7.2	9.1	15.3	na	na	na
Correlation with Canada	1.00	0.55	0.70	na	na	na
Coefficient of variation**	0.76	0.78	1.45	na	na	na
1998-2005 (8 years)						
Mean annual return (reward)*	12.3	12.8	9.4	10.9	3.6	12.2
Standard deviation (risk)	3.9	4.3	8.6	2.8	2.1	4.3
Correlation with Canada	1.00	0.73	0.44	0.20	-0.61	0.24
Coefficient of variation**	0.32	0.34	0.92	0.26	0.58	0.35
2001-2005 (5 years)						
Mean annual return (reward)*	11.9	13.0	4.0	9.1	2.8	10.8
Standard deviation (risk)	4.7	5.5	5.1	1.7	2.2	3.1
Correlation with Canada	1.00	0.88	0.96	0.30	-0.84	0.85
Coefficient of variation**	0.39	0.42	1.26	0.18	0.80	0.29

*The mean annual return will vary slightly from the annualized return presented elsewhere in this report
** Ratio of risk to reward

Source: IPD and Clayton Research

- The table above summarizes in greater detail some of the information presented in the previous graph.
- Additionally, many investors like to monitor the risk-to-reward ratio, as measured by the coefficient of variation, which is the ratio of the standard deviation of the returns to the mean return for the given time period. A low ratio is more favourable, as it indicates less risk associated with a given level of return. The results varied by country:
  - In each period examined (5, 8, 21 years), the risk-to-reward ratio was similar in the UK and France to Canada.
  - For Sweden and Germany, the risk-to-reward ratio was higher than for Canada in each period.
  - For The Netherlands, the risk-to-reward ratio was lower than for Canada in each period.

Table 2: Impact of Adding European Real Estate to Canadian Real Estate Portfolio

2005	Original	Remixed 70% Canada; 30% specified country				
	100% Canada	UK	Sweden	Netherlands	Germany	France
Based on 21 year returns (1985-2005)						
Expected annual return	9.5	10.2	9.8	na	na	na
Expected risk (standard deviation)	7.2	6.9	8.9	na	na	na
Risk/return	0.76	0.68	0.90	na	na	na
Based on 8 year returns (1998-2005)						
Expected annual return	12.3	12.4	11.4	11.9	9.7	12.3
Expected risk (standard deviation)	3.9	3.8	4.5	3.0	2.4	3.3
Risk/return	0.32	0.30	0.39	0.25	0.25	0.27
Based on 5 year returns (2001-2005)						
Expected annual return	11.9	12.3	9.6	11.1	9.2	11.6
Expected risk (standard deviation)	4.7	4.8	4.8	3.5	2.8	4.1
Risk/return	0.39	0.39	0.50	0.31	0.30	0.36

Source: IPD and Clayton Research

- Some simple portfolio diversification simulations were run to explore the implications of adding European real estate to a Canadian property portfolio. The starting portfolio was 100% Canadian properties (composed of office, retail and industrial properties). For this report, the second scenario selected for a remixed portfolio contained 70% Canadian properties and 30% for the relevant European country.
- The results of the "remixed portfolio" simulation, in terms of the impact on the portfolio return and risk, include:
  - The remixing of the portfolio such that 30% of portfolio value was comprised of a typical mix of property in each country does not have any large impact – better or worse – in terms of the overall portfolio returns, risk and risk-to-return relationship.
  - The most positive contribution is made by UK property; regardless of the timeframe used for the analysis, the portfolio return for the Canadian investor is either unchanged or enhanced, and the portfolio risk is reduced. The relatively favourable UK returns, combined with the lower correlation of returns with those in Canada, contribute to the positive contribution.
  - The addition of Swedish property is the least favourable; depending on the timeframe used, it either reduces the portfolio average return or leaves it relatively unchanged, while the relative risk is increased.
  - Adding properties from The Netherlands, Germany and France does not improve the portfolio performance. However, the portfolio risk is reduced, and the risk/return ratios are lowered slightly.
- The conclusions here are based on the specific simulations run; other simulations (i.e. changing the mix of the base Canadian and/or the mix of the added European property) could produce different results.
- Even though the addition of some countries did not benefit the portfolio (i.e. in enhancing returns and/or reducing risk), the addition does not necessarily negate the potential desire to add European real estate to the portfolio. As discussed previously, an overall lower return and/or higher risk for the portfolio may be determined to be warranted, if the returns on the European properties are still favourable relative to investing in lower return/higher risk alternate assets in Canada.

In summary, our review of the results of the original April 2005 study and this April 2007 follow-up lead us to conclude that the over-arching conclusions of the original report remain valid:

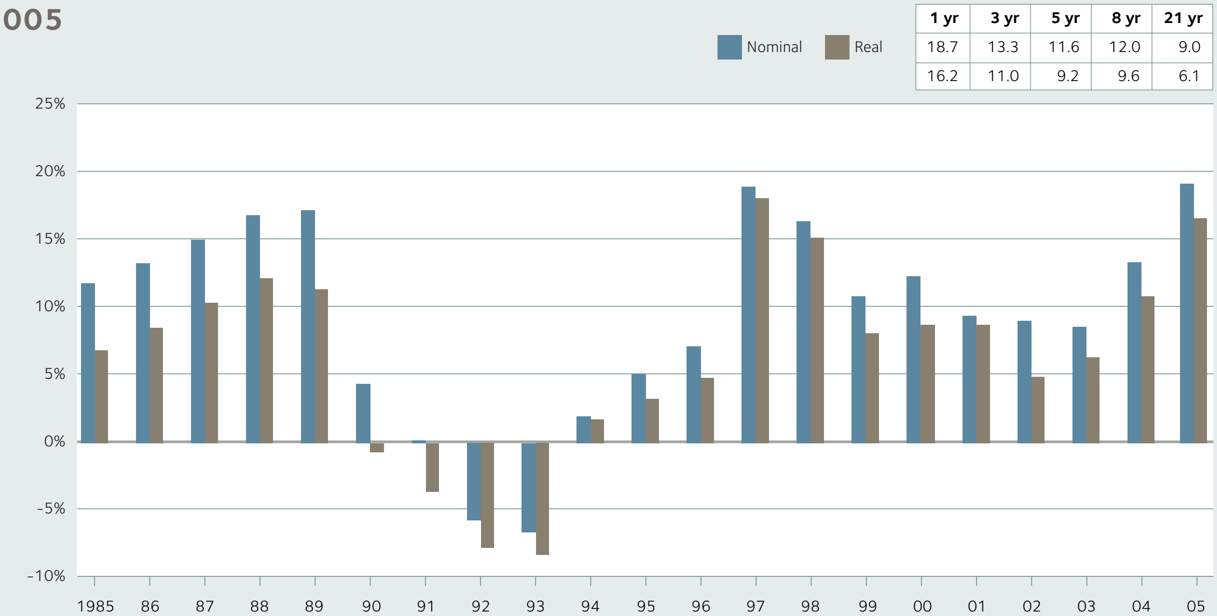
- The Netherlands and France show the potential to offer investors similar returns with a lower portfolio risk.
- The United Kingdom stands out as warranting particular consideration for diversification purposes:
  - It has relatively low correlation of returns to those in Canada, which suggest potential benefits of portfolio diversification to include UK properties; and,
  - there appears to be potential to increase overall portfolio returns, while also lowering overall portfolio risk.

APPENDIX A - WHAT'S NEW IN CANADA

Figure 3: Total Returns on Property, Canada

2005

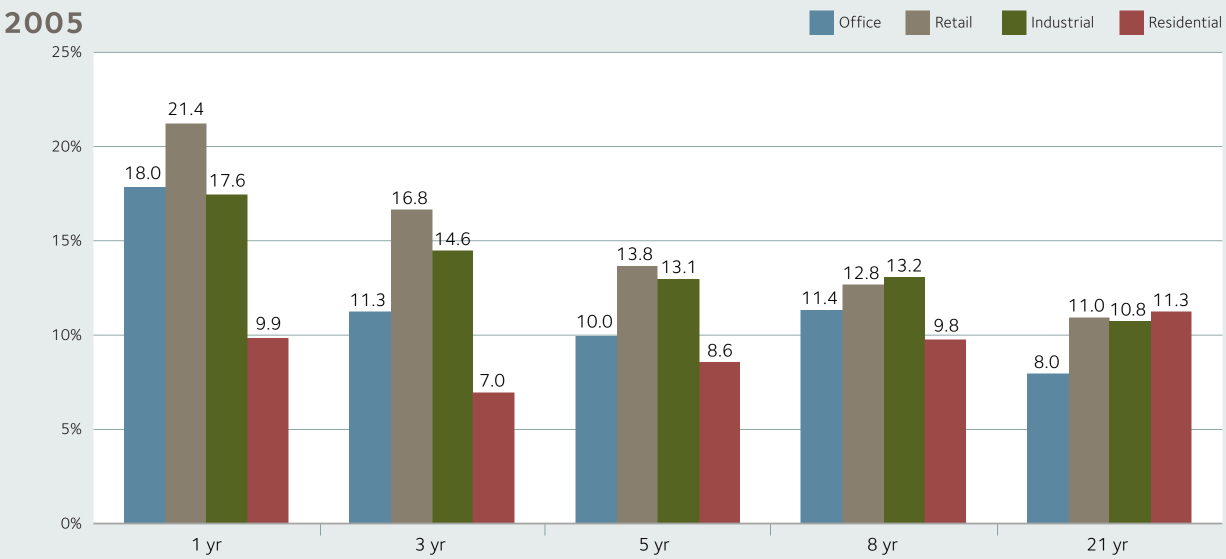
1 yr	3 yr	5 yr	8 yr	21 yr
18.7	13.3	11.6	12.0	9.0
16.2	11.0	9.2	9.6	6.1



Source: Clayton Research, based on IPD and Frank Russell Canada data

- As indicated above, as measured by IPD, Canadian real estate returns measurably increased in 2004 and 2005, largely as result of very strong investment capital-inflows that exerted downward pressure on cap rates. Measurably higher cross-border capital flows around the globe has also helped play a role in declining cap rates.
- By adding only two years to the long-term averages, the long-term return figure is measurably higher than before.

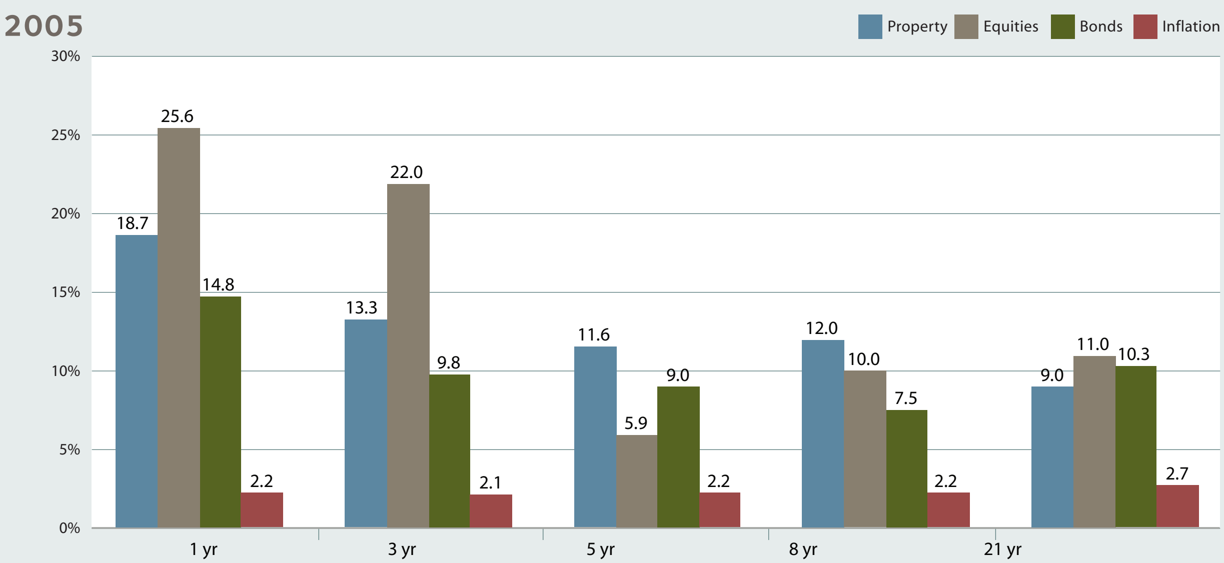
Figure 4: Annualized Returns on Property by Sector, Canada



Source: Clayton Research, based on IPD and Frank Russell Canada data

- Residential properties continued to lag the returns of other asset classes in 2004 and 2005. However, returns for the other asset classes were very strong, led by healthy capital gains in the retail sector, followed closely by industrial assets and a well-improved office sector.

Figure 5: Annualized Nominal Returns, Property vs. Other Assets, Canada

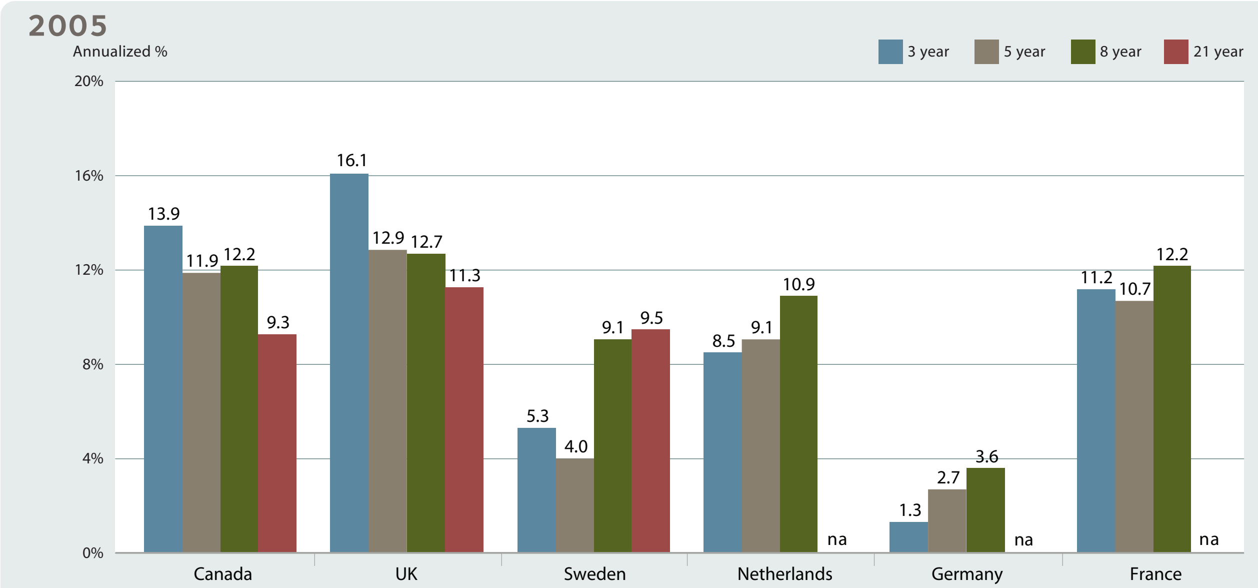


Source: Clayton Research based on IPD, Frank Russell Canada, Statistics Canada, Morgan Stanley, Solomon Smith Barney data

- Looking to long-term performance, the relationship between Property, Equities and Bonds remains largely the same, notwithstanding improved short-term performance by Property and Equities.

APPENDIX B - RECENT EUROPEAN MARKET PERFORMANCE COMPARED TO CANADA

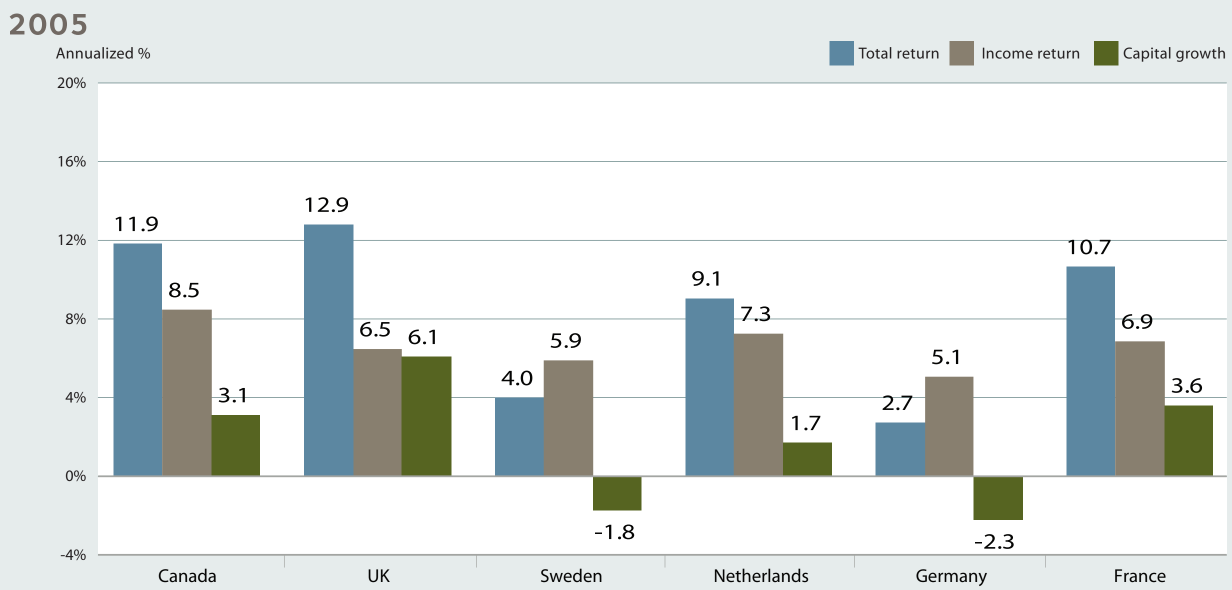
Figure 6: Total Returns on Office, Retail, Industrial Properties (Nominal, Local Currency)



Source: Clayton Research based on IPD and Frank Russell Canada data

- Comparatively, the long-term performance of each country is largely unchanged.
- Looking at just the last few years, while the UK's performance has held relatively steady, the other European countries have not fared as well:
  - The UK is the only market where property returns have been higher than Canada for all of the timeframes covered.
  - Property returns for France have been broadly similar to Canada.
  - Swedish property returns have underperformed relative to Canada in recent years, but are close to the Canadian performance over the longer term.
  - In The Netherlands, property returns have not kept pace with Canadian returns.
  - Returns in Germany have been very low relative to Canada and to the other European countries examined here.

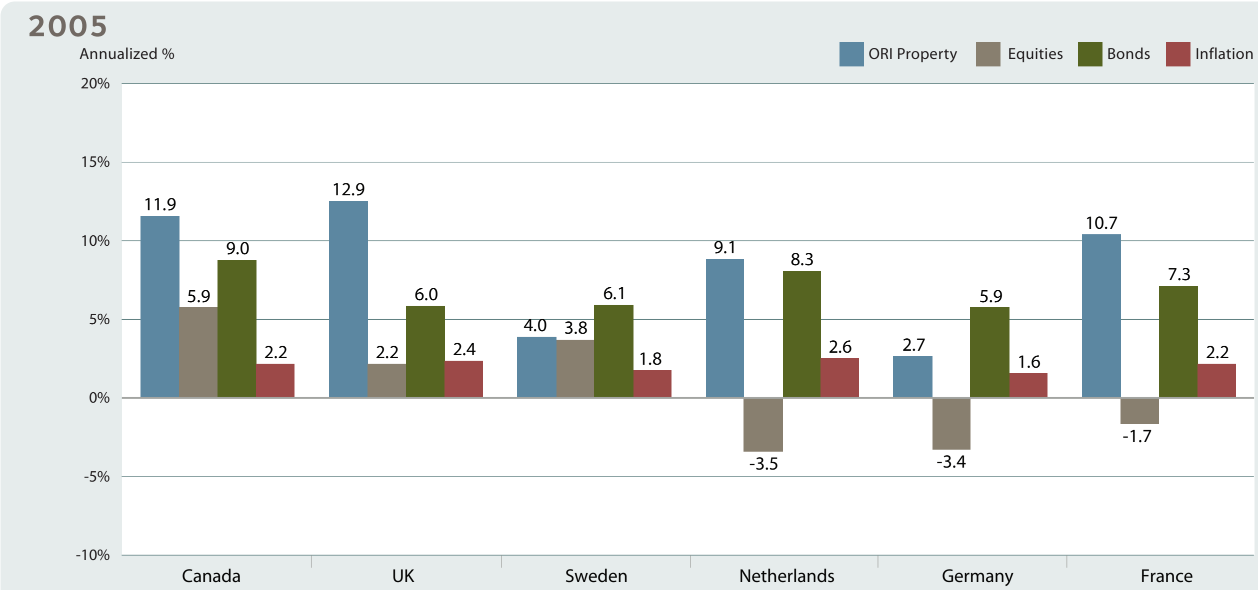
Figure 7: Five-Year Returns on Office, Retail, Industrial Property by Component (Nominal, Local Currency)



Source: IPD and Frank Russell Canada

- Five-year income return levels have remained largely the same, underscoring how income returns provide a stabilizing base for property returns.
- Conversely, the largest contributor to swings in total returns has to do with the capital return component. In this regard, Canada and the UK have recently fared well, whereas the other European nations have seen decreased capital growth (to the point of capital losses in Sweden and Germany).

Figure 8: Five-Year Returns on Office, Retail, Industrial Property Vs. Other Assets



Source: IPD

- Comparing other investment classes to real estate, bond returns were up measurably in all markets, but real estate still outperformed in most countries, even at a time when some countries recently saw lower performance in their real estate markets.

APPENDIX C - WHAT RECENT CHANGES HAVE OCCURRED IN THE EUROPEAN INDICES?

The purpose of this section is to advise what changes have occurred since 2003 to the IPD databanks that were used for preparing this report. As will be explained herein, while there have been some notable changes, it is understood that the changes have not distorted the analysis of returns in the respective countries.

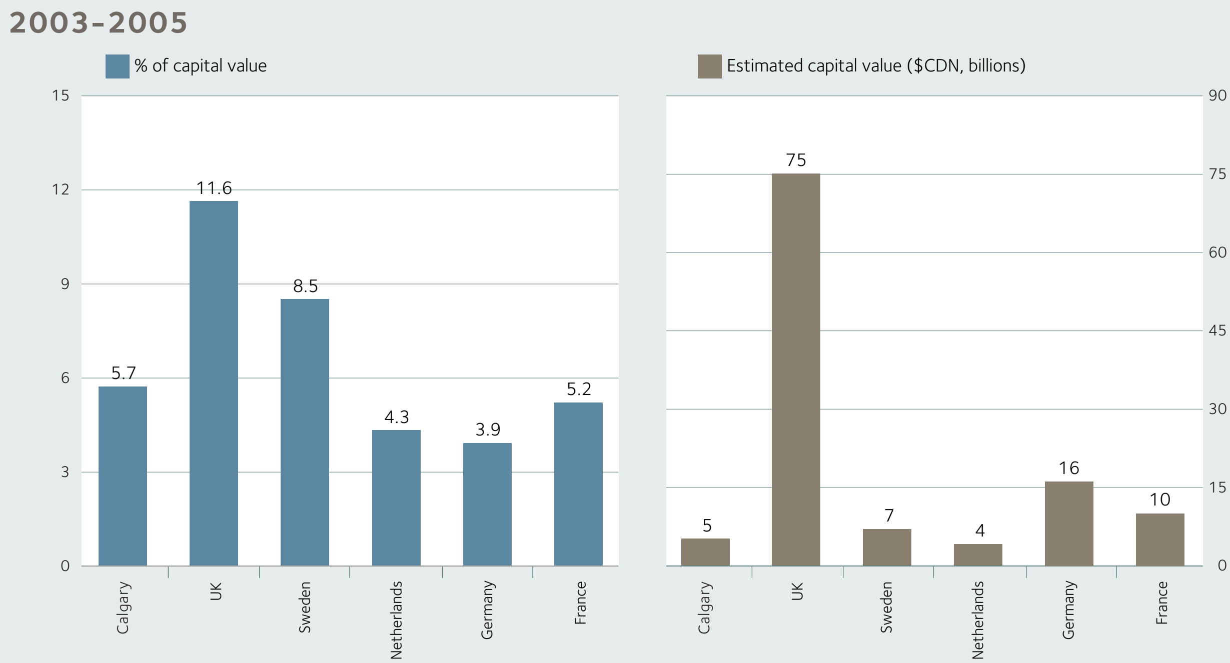
Table 3: Selected IPD databanks

End of 2005	IPD data starts end of	# of properties in IPD databank	Market value of properties in IPD databank (in $Cdn, billions)	IPD coverage as % of estimated total market*	Estimated size of total market ($Cdn, billions)*	Retail, office & industrial properties as % of IPD total value
Canada	1984**	1,827	58	50	116	90
UK	1971	11,010	325	45	722	97
Sweden	1984	851	26	30	87	84
Netherlands	1995	5,631	61	60	102	54
Germany	1996	3,427	90	23	391	71
France	1997***	6,622	113	54	209	78

*Institutional & public vehicles
** Data prior to 2000 is from Frank Russell Canada
*** Some limited information for the office and residential sectors only is available back to 1986

- It appears that there have been some measurable changes to the IPD databases in the countries analyzed herein.
  - For the German and French databanks, when new participants were added after 2003, for the most part historical data was also collected, and the historical return series was updated to reflect the additional historical data. Therefore, there is a comfort level that the IPD returns evidenced in 2004 and 2005 are primarily related to market forces, and not due to a change in the underlying database.
  - For Sweden, the reason for the sample decline was primarily related to previous IPD participants selling properties to owners that are not IPD participants (many being foreign investors). Given the very small size of Sweden's IPD database compared to other European nations, the impact on the overall findings in this study are considered nominal.

Figure 9: Average Annual Turnover (Property Availability) Past 3 Years, Office, Retail & Industrial Properties*



** Approximated by capital receipts (which is primarily sales receipts) as % of mid-year capital value*
Source: IPD and Clayton Research

- With regard to average annual turnover in percentage terms, figures are only slightly different between those originally reported and the more up-to-date research.
- The UK is up the most, especially in £ terms, mirroring the international trend of rising prices.

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