



INVESTING

INVESTING IN REAL ESTATE

Breaking Down the Bricks and Mortar

WHY INVEST IN REAL ESTATE?

Real estate investment can be an important component of any investment program. Real estate has many unique characteristics that may make it an attractive long-term investment.

Income

Real estate investments tend to have a significant income component. The income yield may be as high as 6 percent in some instances, which is very desirable for investors with income requirements.¹ While real estate investments are not immune to recessions, during economic downturns they can continue to provide cash flows. This is primarily due to the fact that real estate investments are supported by long-term lease contracts, which tend to provide a steady source of income regardless of the state of the economy.

Inflation Hedge

Real estate can also be viewed as an inflation hedge. Property sectors such as office, industrial and retail have multi-year lease contracts that may stipulate automatic rent adjustments to compensate for increases in the Consumer Price Index (CPI). Sectors with shorter-term leases change rents as the leases expire, to keep up with inflation. Apartment leases are typically one year in duration, offering the owners the ability to change rents as leases roll over annually. Hotels can change rental rates daily.

Historically, real estate has also performed well as an inflation hedge because the investment comprises physical assets, as opposed to monetary assets that lose value as inflation rises. There is also potential for real estate values to appreciate over longer periods of time. The table below shows correlations between the National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index (NPI) and inflation during high-inflation and low-inflation periods.

Real estate truly proves its value as an inflation hedge during high-inflationary periods. The strongest correlation between the NPI and CPI (0.80) was during high-inflation episodes in U.S. economic history.²

CHART 1: CORRELATION BETWEEN NPI & CPI

High-Inflation Period (1978 – 1982)	0.80
Low-Inflation Period (1983 – 2009)	0.16

Sources: NCREIF, RREEF Research

¹ Source: NCREIF

² Source: RREEF, the real estate investment management business of Deutsche Bank's Asset Management division.

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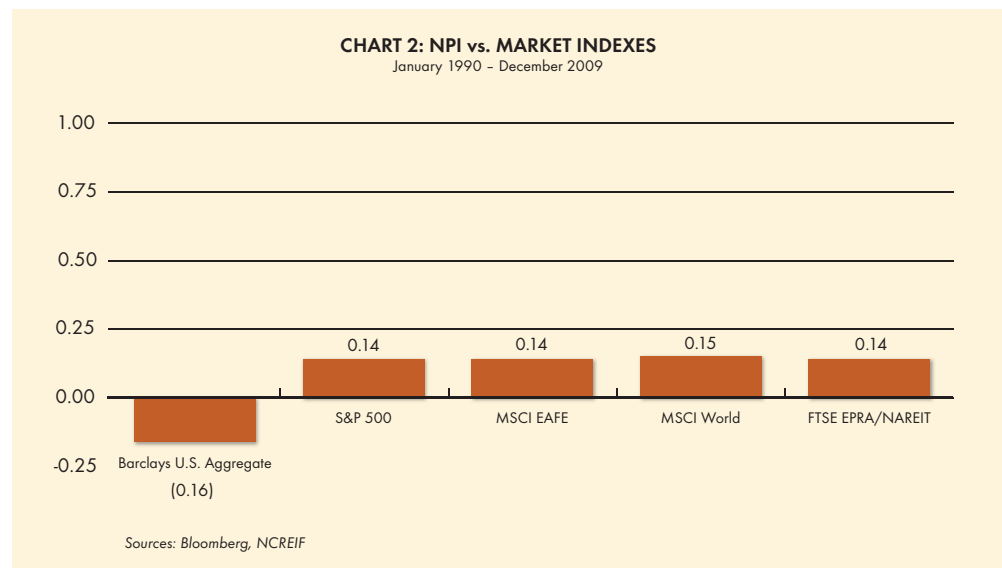


Returns from private, or direct real estate investments as measured by the NPI are largely uncorrelated with stock and bond market returns.

Diversification

Historically, real estate has also been known to offer attractive diversification benefits, given its relatively lower correlation to other asset classes. Returns from private, or direct real estate investments as measured by the NPI are largely uncorrelated with stock and bond market returns. Correlations between NPI and various market indexes from 1990 through 2009 are presented below.

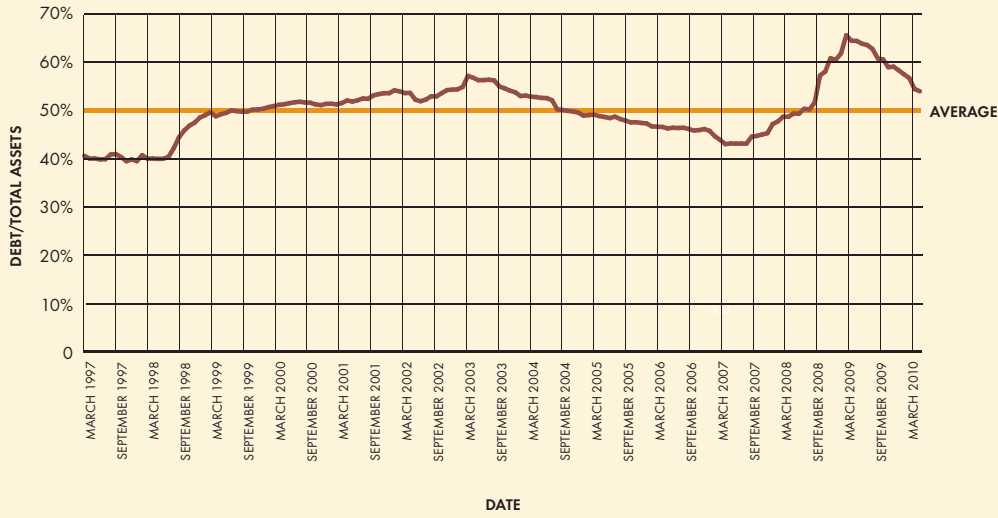
The imperfect correlation of real estate, equities and fixed income over the period suggests that, given the level of risk, if private real estate is added to a mixed-asset portfolio, there is a potential for return enhancement. As Chart 2 indicates, over the measurement period of 1990 to 2009, real estate had only a 0.14 correlation with common stocks and a negative 0.16 correlation with bonds. These diversification benefits may be enhanced when real estate investments are global in nature.



PRIVATE VS. PUBLIC

With private real estate, one can invest in a portfolio of predominantly (95 percent) core-stabilized assets, whereas REITs may have portfolios with a combination of core, core plus, value added and even some development. REITs also tend to have higher leverage than core open-end funds. The leverage, as measured by debt to total assets, for equity REITs has averaged 50 percent, while core funds typically have leverage below 30 percent (see Chart 3). Liquidity is one of the key benefits of publicly traded REITs, but it can also lead to increased volatility of returns, especially when combined with higher leverage. While real estate generally has a low correlation to other asset classes, REITs may be more highly correlated with equity markets over shorter periods.

CHART 3: REIT LEVERAGE (DEBT/TOTAL ASSETS)



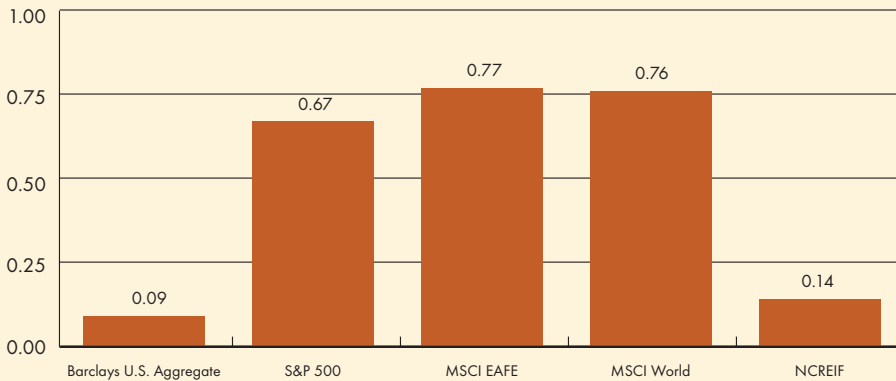
Source: Green Street Advisors

REITs tend to have higher leverage than core open-end funds.

Another key difference between private and public real estate investments is that public real estate tends to lead in the economic cycle while private real estate tends to lag. In the most recent cycle, quarterly returns for U.S. REITs peaked 18 months before NCREIF returns. According to correlation analysis conducted by Northern Trust, there is a very low correlation between core private real estate and REITs. The period of 2009 to 2010 is a good example of the potential dispersion in returns. In the 12 months ended March 31, 2010, U.S. REITs returned more than 100 percent, while the private real estate market was just beginning to trough. Correlations between real estate securities, private real estate, equities and bonds are shown in Chart 4. Actual historical returns are displayed in Chart 5.

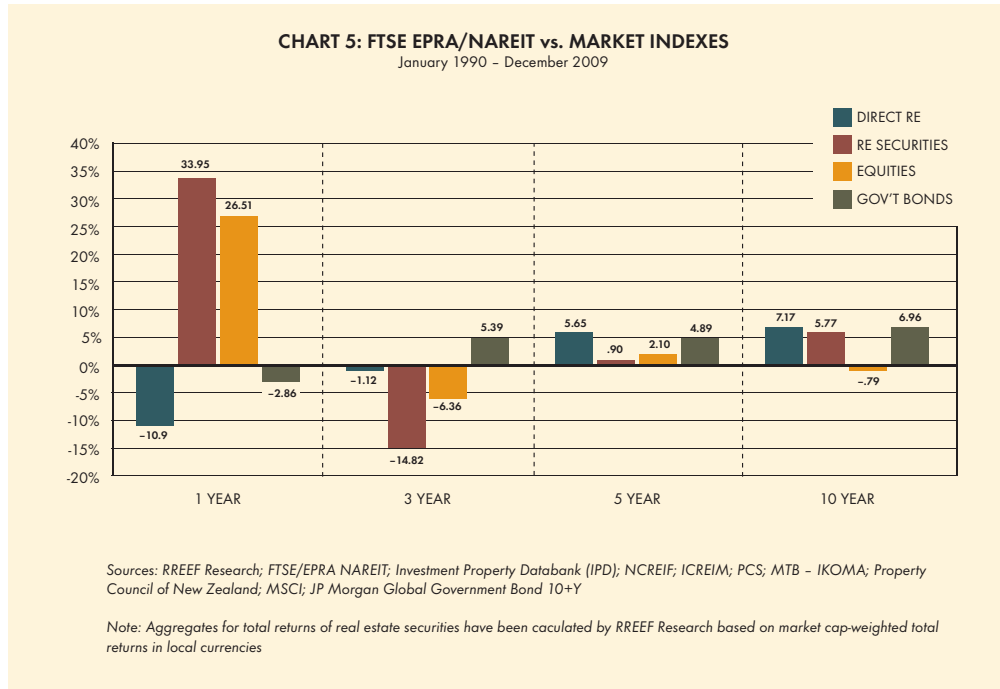
CHART 4: FTSE EPRA/NAREIT vs. MARKET INDEXES

January 1990 - December 2009

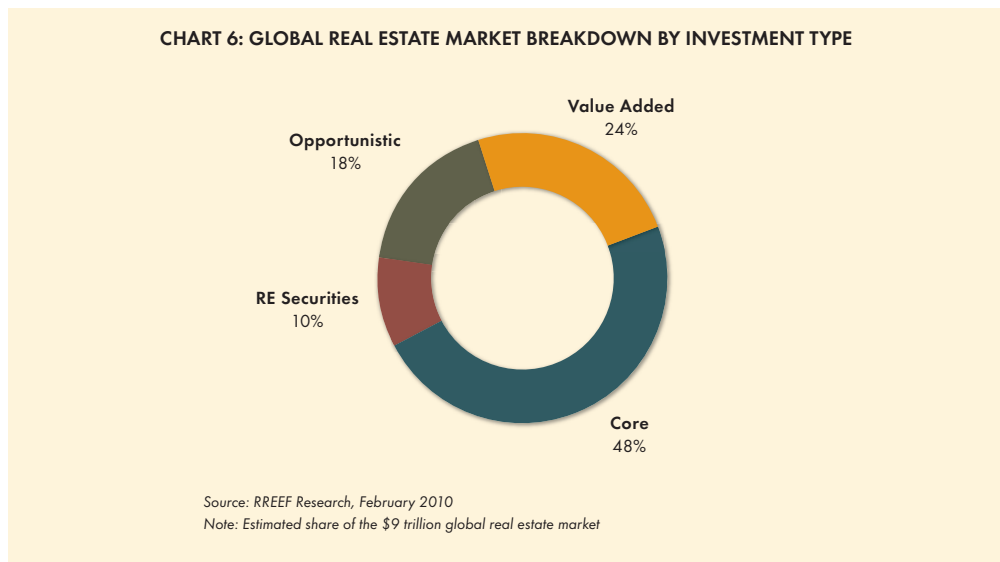


Sources: Bloomberg, NCREIF

Only 10 percent of the global real estate market is publicly traded.



Finally, according to RREEF, only approximately 10 percent of the global market is publicly traded equity, while the vast majority of the real estate market is private (see Chart 6). There are many advantages to investing in public real estate, but to ignore privately held real estate would be to ignore the lion's share of opportunities.



FOUR PRIVATE REAL ESTATE INVESTMENT STYLES

There are four key investment styles or types of investments in private real estate: core, core plus, value added and opportunistic. Although it is difficult to quantify, RREEF estimates that nearly half of the global real estate market (48 percent) is made up of less-risky core assets. The opportunistic segment makes up a relatively small portion (less than 20 percent) of the overall market, while value added represents approximately 25 percent. As noted, publicly traded real estate securities, at 10 percent, are the smallest segment of the market.

Core

Core real estate investments typically are characterized as high-quality, multi-tenant properties in major metropolitan areas. Tenant quality is high; lease expirations are staggered. Core properties are unleveraged or low-leveraged (0 to 30 percent) investments in income-producing office, apartment, industrial or retail properties. Healthcare, lodging, manufactured homes, self-storage, and specialty properties are generally considered non-core property types.

Core investments usually have a high income yield, accounting for approximately 70 to 80 percent of total return. These investments tend to have lower volatility and are the least correlated with other asset classes. U.S. core real estate has a well-established benchmark, the NCREIF Property Index (NPI), discussed later.

Core Plus

Core plus is similar to core with some modest upside in net operating income. These investments may be close to fully stabilized, with some moderate leasing upside. Leverage for core plus may also come in above 30 percent, which is the high end for core investments.

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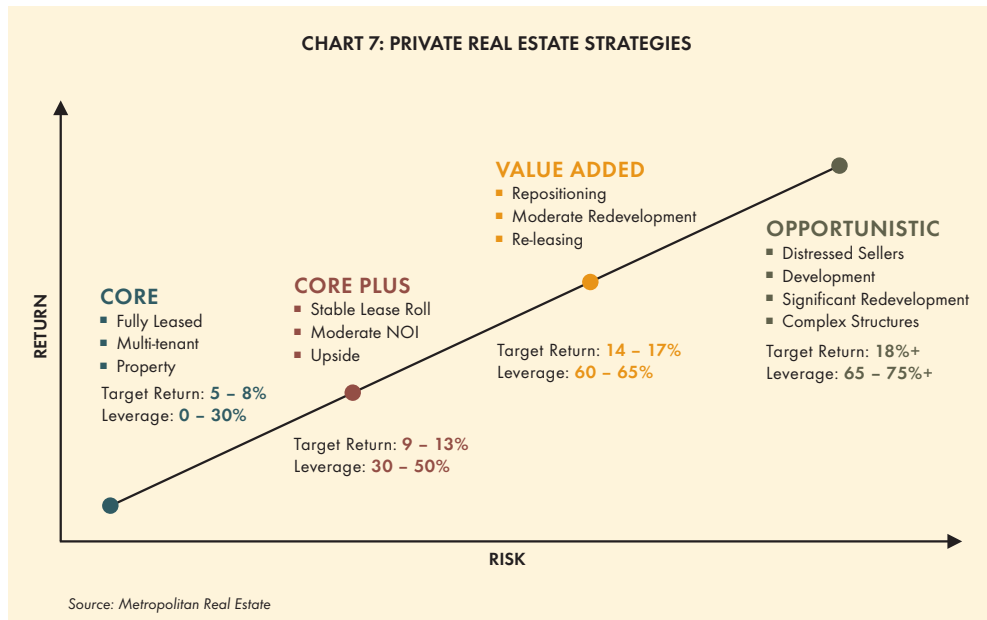


CHART 8: HISTORICAL RETURN PROFILE
ACROSS STRATEGIES

	GLOBAL
Core	6.9%
Value Added	9.1%
Opportunistic	14.8%
Real Estate Securities	9.3%
Global Aggregate	10.0%

Sources: RREEF Research, IPD, NCREIF, FTSE EPRA/NAREIT, Townsend, PERE, February 2010
Returns stated are gross of management fees, which would further reduce the above figures.

Value Added

Value added strategies tend to fall higher on the risk-return spectrum, and generally involve some repositioning of the assets. Moderate redevelopment may also be a part of the investment strategy. Investors may also add value through re-leasing the properties. Leverage in value added investments tends to be higher than core and core plus, at around 60 percent. Given the increased risk and leverage, value added strategies offer the potential for higher returns but these investments tend to be more volatile.

Opportunistic

Opportunistic investments tend to be riskiest because they have a higher proportion of return coming from value growth. These investments often have significant repositioning and redevelopment requirements. They tend to be more highly leveraged and may be located in less-established property markets.

Opportunistic investments include ground-up development, which carries its own risks including unique financing needs, timing of delivery and lease-up. Given the added risk, these properties have the highest return potential, but also tend to be the most volatile and have the greatest downside risk.

PRIVATE REAL ESTATE INVESTMENT OPTIONS

Open-End Funds

Open-end private real estate funds generally invest in a diversified portfolio of real estate assets. The underlying assets are typically core properties that are close to fully leased and do not require extensive renovations or redevelopment. These funds typically do not have exposure to ground-up development. They have no set lifespan; investors can generally invest and redeem units quarterly, subject to any existing queues.

These funds typically have lower leverage in the 0 to 30 percent range and lower risk, resulting in lower return potential. Open-end core funds have the longest track records, some dating back to 1970. The universe is currently made up of a limited number of funds. As of 12/31/2009, there were fewer than 20 open-end funds.

Closed-End Funds

Closed-end funds invest in a portfolio of real estate assets that may be either diversified or focused on a specific property type or geographic region. There are also funds specializing in debt investments. The underlying assets are typically value added and opportunistic, which may require renovations, lease-up and may also include development.

Closed-end funds have a finite investment period, during which capital is locked up. The average life of closed-end funds is 7 to 10 years. These funds typically employ higher levels of leverage and have higher risk, resulting in potentially higher returns. According to Preqin, an information provider of private equity, real estate, and hedge fund universe and performance data, there were approximately 350+ firms managing more than 1,500 closed-end real estate funds at the end of 2008.

Funds of Funds

Funds of funds invest in diversified portfolios of closed-end real estate funds, rather than investing in real estate directly. The fund of funds is responsible for hiring and firing the managers in the fund (typically 10 to 15). Funds of funds charge fees for their services, in addition to the underlying funds' management and performance fees.

These funds typically invest in value-added and opportunistic real estate, which can offer potentially higher returns. Leverage is generally not used at the fund of funds level and therefore can be similar to that of closed-end funds. The key advantages to fund of funds investments are improved access to private real estate managers and manager diversification. Preqin has identified fewer than 60 fund of funds firms in 2008, managing more than 90 real estate funds. Approximately half of these firms are located in the U.S.

UNDERSTANDING THE RISKS

There are risks tied to investing in real estate of which investors should be aware. Some of the most important risks to consider are:

- **Macroeconomic risk:** Real estate is cyclical and can be closely tied to what is going on in the economy. Real estate demand is often closely tied to job growth and consumer confidence, therefore deterioration in the overall economic outlook can have a negative impact on the demand for real estate, as well as rents and real estate values.
- **Leverage risk:** Access to debt markets is critical to investor demand for real estate and debt market challenges can spill over into real estate markets.
- **Liquidity risk:** Liquidity is a critical challenge with investing in direct, or private real estate. There are no perfectly liquid investments in private real estate, which by nature is illiquid. Private real estate investments do not have an available public market and therefore cannot be traded.

The most liquid vehicles in private real estate are open-end funds, which generally offer quarterly contributions and redemptions, but these vehicles can also face both investment and redemption queues, depending on the environment. Closed-end funds may also seek extensions to the life of the fund if the environment is not ideal for selling assets. Funds of funds are subject to the liquidity of their underlying fund investments.

Other risks in private real estate include tenant risk, leasing risk, development risk, and other investment-specific risks. It is critical to thoroughly read all fund documentation for an explanation of the risks.

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There are two key benchmarks for core private real estate established by NCREIF.

BENCHMARKS

There are two key benchmarks for core private real estate established by NCREIF, an association of institutional real estate professionals that addresses industry issues and promotes research. NCREIF produces several quarterly indexes that show real estate performance returns using data submitted by contributing members.

NPI

This quarterly, time-series composite tracks the total rate of return measure of the investment performance of a very large pool of individual commercial real estate properties acquired in the private market for investment purposes only. Though there are properties in the NPI that have leverage, investment returns are reported on a non-leveraged basis. NPI is often referred to as an “appraisal-based index.”

NFI-ODCE Index

The NCREIF Fund Index – Open-End Diversified Core Equity (NFI-ODCE Index) reports, on both a historical and current basis, the investment returns of open-end commingled funds pursuing a core investment strategy. The NFI-ODCE Index is capitalization-weighted and reported gross of fees. NCREIF calculates the overall aggregated index return.

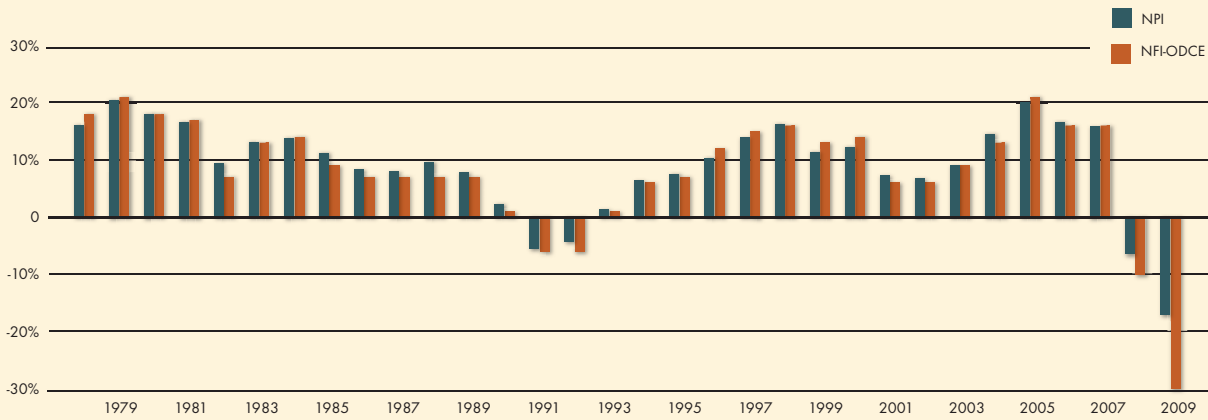
Performance of these indexes is calculated quarterly based on real estate appraisals, which are inherently backward-looking. This methodology results in a smoothing effect on returns. Chart 9 compares some of the key characteristics of the NPI and NFI-ODCE Indexes.

CHART 9: COMPARISON OF NPI AND NFI-ODCE INDEXES

	NCREIF PROPERTY INDEX	NCREIF FUND INDEX - ODCE
Inception Date	1977Q4	1978Q1
Market Value (2009Q4)	\$238.2 Billion	\$47.7 Billion (Net of Leverage)
Number of Core Properties (2009Q4)	6211	1565
Number of Funds (2009Q4)	N/A	14 (26 Legacy)
Current Leverage	N/A	33.60%
Occupancy	88.6%	88.1%
Joint Ventures	Reported on 100% Ownership Basis	Reported in Net Terms, Consistent with Reporting Standards
Percent of Joint Venture Assets Occupancy	39.2%	45.6%
Cash Balance	No Cash	Includes Cash Balances
Management Fees	Not Reported	Average Fee (i.e., Net to Gross Spread)
Average Spread between Net & Gross	N/A	100 BPS Annually

Source: NCREIF

CHART 10: PERFORMANCE OF NPI AND NFI-ODCE INDEXES



Source: NCREIF, As of December 31, 2009

Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index.

NCREIF Townsend Indexes

These indexes present the performance information of private equity real estate funds pursuing core, value added and opportunistic investment strategies using both open-end and closed-end structures. The performance data is comprised of both active investments as well as funds that have completed their full lifecycles or discontinued operations. Return information is represented both in the time-weighted format (which is most appropriate for open-end vehicles) and vintage-year descriptive statistics (which are most appropriate for closed-end vehicles that exhibit performance patterns dependent on their lifecycles). Inception dates are:

- **Core index** – 1978
- **Value added** – second quarter 1986
- **Opportunistic** – second quarter 1989

CHART 11: NCREIF TOWNSEND INDEXES

(TIME-WEIGHTED INDEX RETURNS)

		CORE			VALUE ADDED			OPPORTUNISTIC
GROSS OF FEE RETURNS		ALL CORE	OPEN-END	NFI-ODCE	ALL VALUE ADDED	OPEN-END	CLOSED-END	ALL OPPORTUNISTIC
QTR	INCOME	1.60%	1.60%	1.60%	1.30%	1.50%	1.10%	0.80%
	APPRECIATION	-5.20%	-5.20%	-5.10%	-14.90%	-10.70%	-18.50%	-4.90%
	TOTAL RETURN	-3.70%	-3.70%	-3.50%	-13.50%	-9.30%	-17.40%	-4.10%
	PRIOR QTR. TOTAL RETURN	-7.30%	-7.30%	-7.30%	-7.60%	-12.70%	-3.40%	-3.00%
4 QTR ROLL	2009Q1 - 2009Q4	-29.70%	-29.70%	-29.80%	-40.70%	-46.90%	-34.90%	-29.90%
	2008Q1 - 2008Q4	-10.00%	-10.00%	-10.00%	-19.40%	-19.30%	-19.50%	-36.10%
CALENDAR YEAR	2009	-29.70%	-29.70%	-29.80%	-40.70%	-46.90%	34.90%	-29.90%
	2008	-10.00%	-10.00%	-10.00%	-19.40%	-19.30%	-19.50%	-36.10%
	2007	15.90%	15.90%	16.00%	17.40%	17.40%	17.30%	26.00%
	2006	16.50%	16.50%	16.30%	19.50%	18.90%	20.00%	43.00%
	2005	21.20%	21.20%	21.40%	27.50%	24.80%	30.40%	44.50%
ANNUALIZED	3 YEAR	-9.80%	-9.80%	-9.80%	-17.50%	-20.50%	-15.00%	-17.30%
	5 YEAR	0.70%	0.70%	0.70%	-3.10%	-5.70%	-0.80%	3.10%
	5 YEAR STANDARD DEVIATION	11.84%	11.84%	11.91%	16.39%	17.88%	16.40%	21.74%
	5 YEAR SHARPE RATIO	(0.133)	(0.132)	(0.13)	(0.294)	(0.409)	(0.144)	0.125
	7 YEAR	3.70%	3.60%	3.60%	1.70%	-0.60%	3.70%	8.40%
	10 YEAR	5.00%	5.00%	5.00%	3.90%	2.30%	5.30%	8.90%

Sources: NCREIF & The Townsend Group

CONCLUSION

Real estate is an important asset class that should not be overlooked. Real estate investments can offer distinct advantages including attractive yields, diversification benefits and inflation protection. Investors can access real estate through both private market investments and publicly traded securities, but should consider the nuances of each investment.

Given the low correlation between public and private real estate, each may serve a valuable role in investors' portfolios. In private real estate, there are a variety of investment options including core, value added and opportunistic investments, each with a unique set of risk and return expectations.

There are also numerous vehicles allowing access to real estate including open-end funds, closed-end funds and funds of funds. The risks and liquidity constraints of the investor should be considered carefully before making allocations to real estate investments.



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