December 2004

HSBC Trinkaus & Burkhardt

German Real Estate

Germany

A German REIT (G-REIT) structure to leverage the importance of real estate into the listed sector

- **Despite the success of other real estate investment vehicles in Germany, the listed sector is still negligible**
- **Underperformance of German real estate set to continue…**
- **…making the potential introduction of a REIT structure the most obvious trigger for the listed sector**

German property stocks likely to continue to underperform

We have looked at the development of various real estate categories in five countries, and have found that, over the past 10 years, Germany has underpeformed its international peers in each category. Furthermore, we think German property will continue to lag the European and US recovery cycle. Therefore, the long-awaited catalyst for the listed sector is unlikely to come from the performance of the private property market.

G-REIT, the long-awaited saviour

In Germany, there is heated debate around the launch of a German REIT structure. A REIT (Real Estate Investment Trust) is a listed property stock that is taxed, not at the corporate but at the investor level, which can lead to tax advantages. REITs were first implemented in the US in 1960, since when the total market cap has sky-rocketed to cUSD275bn, or 2.5% of US GDP. The REIT discussions in Germany have reached a critical stage. Although there are still some hurdles and there may be some pitfalls in the legislation process, we think a G-REIT structure could be in place by 2006. The final shape of the G-REIT structure is still undecided, but German property stocks have already started to react.

Fundamental analysis and valuation

We have analysed our peer group of property companies using a rating approach comprising five elements. We have looked at the companies' country and category exposures; we have examined rent expiry profiles and tried to analyse the impact of a G-REIT structure; and have added a miscellaneous element. We then weighted our rating results (please find details on our analysis in the relevant section of the report), to finish with a score between 1 and 5, where 5 is good and 1 is poor. Based on our fundamental rating, DES comes out best with an overall rating of 3.36, followed by IVG at 2.98. AIG comes close behind with a rating of 2.93. Vivacon is slightly discriminated against in our rating results – its overall rating is just 2.61 – as our approach is not perfectly suited to it owing to its strong focus on project development.

Looking at valuation, we find that IVG trades on the highest discount to NAV of 20%, followed by DES, trading at a discount of 16% to NAV. AIG trades on the lowest discount to NAV of 12%. We value Vivacon on a PE basis (trading at 9.9x, based on 2005 estimates) representing a significant discount to its European developer peers, which trade at an average of 17.7x.

Relative index level

Source: Thomson Financial Datastream

Sector report

Sector	Real Estate
Index	E300 Real Estate

Companies mentioned

Name	RIC
AIG International Real Estate	IREG.DE
Deutsche EuroShop	DEQGn.DE
IVG Immobilien	IVGG.DE
Vivacon	VIVG.DE

Disclaimer & disclosures

This report must be read with the disclaimer, disclosures and analyst certifications on p186 that form part of it.

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Despite its significant underperformance vs European peers during the past 10 years, real estate has been the most popular investment theme of the past three years in Germany, with open-end funds receiving almost all money inflows. The listed sector, however, is still insignificant, both in terms of size and liquidity, and is in desperate need of a catalyst. We expect the sector to continue to underperform, and see the introduction of a G-REIT structure as potentially the long-awaited saviour that could transfer the importance of German real estate into the listed sector.

The truth about listed real estate – a story in eight chapters

As the listed German property sector lacks size and weight, the capital market has not given it a lot of attention. Therefore, we consider it useful to look at the basics of property stock investing and have made the following conclusions:

1 There is no general evidence that property stocks have underperformed the equity market

2 The European property sector generally offers below-average trading liquidity, while German property stocks can be considered to be actually illiquid

3 Both in terms of absolute and relative volatility, property stocks can be considered as defensive investments

4 Property stocks generate higher dividend yields than the overall market

5 Property stocks seem to constitute its own asset class

6 Property stock performance is dependent on the private real estate market

7 Property stocks do not seem to be interest-rate sensitive

8 German property stocks seem to have a tax disadvantage to property funds, but this can be reversed by decreasing the pay-out ratio

German property stocks likely to continue to underperform

We have looked at the development of various real estate categories in five countries, and have found that over the past 10 years, Germany has underpeformed its international peers in each category. Furthermore, we think German property will continue to lag the European and US recovery cycle. Therefore, the long-awaited catalyst for the listed sector is unlikely to come from the performance of the private property market. Overall, we consider the UK and the US to be the most attractive countries for property stocks, and our preferred categories are hotel and industrial, with office representing the bottom of the league.

Investment summary

The G-REIT as the long-awaited saviour

In Germany, there is heated debate around the launch of a German REIT structure. A REIT (Real Estate Investment Trust) is a listed property stock that is taxed, not at the corporate but at the investor level, which can lead to tax advantages. REITs were first implemented in the US in 1960, since when the total market cap has sky-rocketed to cUSD275bn, or 2.5% of US GDP. Their more recent introduction in Australia, France and Japan has also been extremely successful, lifting average stock prices and the market cap of the sector tremendously.

The REIT discussions in Germany have reached a serious stage, with all the most-involved parties seemingly agreed about the usefulness of a REIT structure. In addition, the finance ministry has commissioned a feasibility study (including the possible tax impact), which is due at the end of the year. Although there are still some hurdles and there may be some pitfalls in the legislative process, we think a G-REIT structure could be in place by 2006. Although the final shape of the G-REIT structure is still undecided, German property stocks have already started to react. Based on US figures, ie a market size of 2.5% of total market cap, or 2.5% of GDP, the G-REIT market has a potential size of cEUR20bn or EUR52bn, respectively.

Bearing in mind that these are only hypothetical numbers and we are unsure about the exact G-REIT structure, it seems sensible to expect a market volume in double-digit billions of euros.

Fundamental analysis and valuation

We have analysed our peer group of property companies using a rating approach comprising five elements. We have looked at the companies' country and category exposures; we have analysed rent expiry profiles and tried to analyse the impact of a G-REIT structure; and, as this approach is quite crude and does not really account for individual stocks' special features, we have added a miscellaneous element. We have then weighed our rating results (please find details on our analysis in the relevant section of the report), finishing with a score between 1 and 5, where 5 is good and 1 is poor.

Based on our fundamental rating, DES comes out best with an overall rating of 3.36, followed by IVG at 2.98. AIG comes close behind with a rating of 2.93. We highlight that our rating approach is not perfectly suited to Vivacon, due to its strong focus on project development. Thus, we think Vivacon is slightly discriminated against in our rating results – its overall rating is only 2.61.

Looking at valuation, we find that IVG trades on the highest discount to NAV of 20%, followed by DES, trading at a discount of 16% to NAV. AIG trades on the lowest discount to NAV of 12%. We think it is inappropriate to value property developers such as Vivacon on a P/NAV basis and would therefore encourage investors to look at PE ratios. Vivacon trades at a PE of 9.9x, based on 2005 estimates, representing a significant discount to its European developer peers, which trade at an average of 17.7x.

German real estate market

Importance of real estate in Germany

In a survey in October 2003, IFD Allensbach asked Germans to reveal the investment asset classes they would favour for retirement. The Germans clearly showed a preference for investing in conservative assets. Real estate was the most popular category, favoured by 82% of respondents. Traditionally, real estate has been a very popular asset class in Germany. For many Germans, owning their own house or apartment is the favoured insurance method of planning for retirement.

82% of Germans believe real estate to be good insurance for retirement...

Popularity of asset classes

Asset class	%
Real estate	82
Life insurance	76
Time deposits	64
Fixed Income	62
Building society service	59
Saving plan	42
Investment funds	40
Equity funds	38
Workers asset formation funds	36
Savings account	29
Stocks	23

*Note: * as of October 2003*
Source: IFD Allensbach, FAZ

According to *Rat der Immobilienweisen*, the current size of the German real estate market is cEUR7,100bn. Given 2003 GDP of EUR2,138bn, it means that real estate assets are worth 3.3x annual GDP, excluding public real estate. The real estate market is therefore by far the biggest asset class in Germany.

The estimated value of real estate of EUR7,100bn in can be roughly spilt up by category and holders. The bulk of the EUR7,100bn is residential property held by individuals and households, and accounts for 47% of all real estate assets. The second group is residential in the hands of corporates and the government. This subgroup amounts to EUR2,100bn or 30%. The rest of EUR1,600bn, or 23% is commercial real estate, owned by corporates.

Despite this enormous market size, investors are more interested in the stock market than real estate – a fact reflected by the lack of press coverage and statistical data from official sources on the latter. One reason is that a large amount of real estate is privately owned with only a very small part owned through the capital markets. Real estate is not perceived as an exciting area, as the average holding period for buildings is estimated to be c50 years. However, despite only 2% of real estate assets being turned over every year, there is EUR140bn of real estate transactions pa, which is still an impressive number.

...even though media exposure of real estate is poor compared to stocks

The real estate market also interacts strongly with the financial sector. The banking sector has a high exposure to the real estate market in terms of financing, with most properties financed to a large extent with loans. Lending by German banks was on an upward and unbroken trend from 1968 to 2000. However, in 2001, as a result of more restrictive lending activity by banks, loans outstanding came to a halt.

Accompanying this increase was a rise in lending to the real estate sector. Measuring the relative importance of real estate lending, we calculated total real estate loans as a percentage of total loans outstanding. The result is that in the past almost 50% of all loans went into real estate, by far the biggest category. In the period 1968-04, between 35% and 48% of loans were directed to the real estate sector. Furthermore, their share has increased constantly since 1992 and is at its highest level since statistics began.

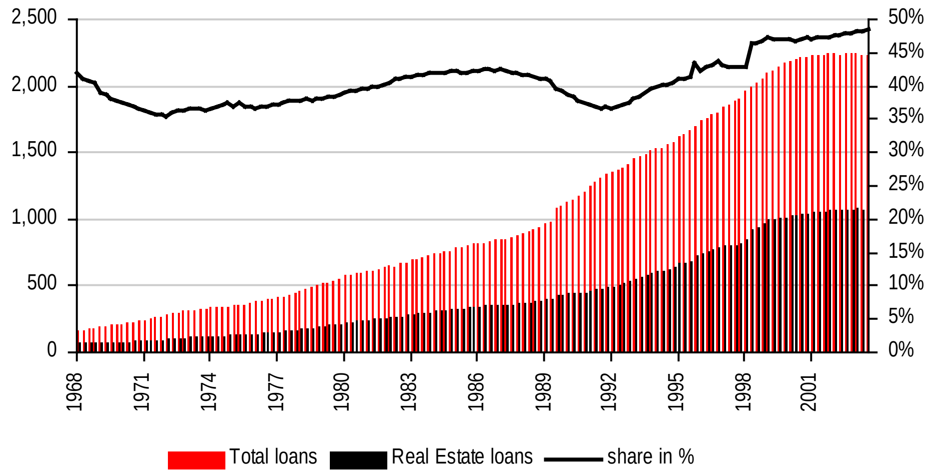
German real estate universe

Total (EUR1,000bn)	7.1
Individuals/households	3.4
Corporates, government residential	2.1
Corporates, commercial	1.6

Source: Rat der Immobilienwerisen 2003

German real estate market

Loans from banks (in EUR bn)



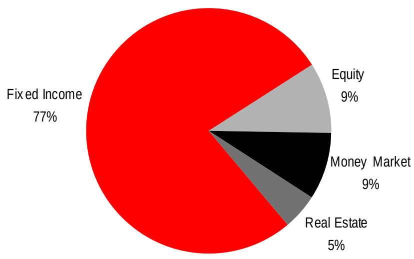
Note: as of 30 June 2004
Source: Bundesbank, HSBC Trinkaus & Burkhardt

Real estate is under-represented in portfolios of institutional investors

Despite the huge importance of real estate for bank lending and the economy as a whole, regarding the asset allocation of institutional investors, real estate seems a less favoured asset class. Most institutional investment money goes into fixed income, amounting to 77% of all assets, followed by equities and the money market each accounting for 9%. Real estate amounts to just 5% of institutional assets. In conclusion, real estate is underrepresented in the portfolios of institutional investors relative to its size within the economy. In a further chart we illustrate the split of real estate assets held by institutional investors. It reveals that closed-end property funds account for the largest part. Their 39% stake is followed by open-end property funds' stake of 18%, leasing companies of 17%, pension funds and foreign investors of 16% and 6%, respectively. Surprisingly, real estate companies account for just 4%. This shows that the public real estate sector is highly underrepresented, especially compared to open-end property or closed-end property funds, although the same is true in other countries.

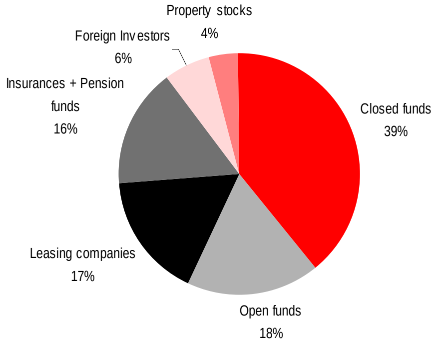
German real estate market

Institutional investors asset allocation



Source: Feri, HSBC Trinkaus & Burkhardt

Real estate assets by institutional investors



Source: BulwienGesa, BVI, BAV, Bundesverband Deutscher Leasinggesellschaften, Deutsche Bundesbank, DID, HSBC Trinkaus & Burkhardt

The most important German real estate investment vehicles

Open-end property funds

Managing volatile money flows

Open-end funds are regulated by the Bafin

As we saw in the previous section, open-end property funds are an important pillar in the German market. These funds are regulated and audited by the 'Bundesanstalt für Finanzdienstleistungsaufsicht' (BaFin).

Open-end funds have to manage inflows and outflows of money, resulting in a fluctuating capital base...

Theoretically, open end property funds provide the investor with stable yields from property ownership combined with liquidity due to daily availability of the money invested. The fund takes new investors' capital (there is no legal obligation to do so, but we have not seen a fund rejecting inflows in the past) and issues new shares in the fund in exchange for it. On the other hand, the fund is obliged to take back shares at any time. There is the possibility at any time that this so-called redemption right may cease temporarily. However, this has never happened, as it would mean a huge loss of reputation for the open fund industry. In effect, this means investors may buy and sell their shares directly through the fund and not through the stock exchange at any time. The result is inflows and outflows which are largely driven by factors beyond the control of the fund (manager).

...which is beyond control of the funds' management

The price of a share in an open-end property fund is its current net asset value. If investors want to get their money back, shares in the fund are reduced again and the fund has to pay out to the investor. As a result, open-end property funds' capital is fluctuating constantly. Open-end property funds in Germany are subject to many regulations. Generally they are obliged to split their investments geographically in order to achieve a certain diversification. Prior to 2002, they were not allowed to invest more than 20% of assets outside EU countries. This restriction was lifted and at present there is no limit.

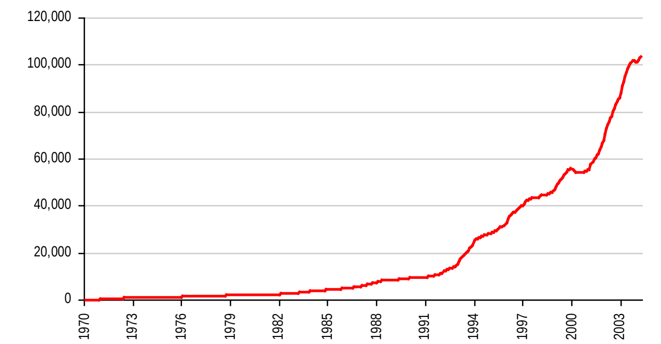
German real estate market

Strong recent asset growth due to collapse of equity markets

The fund market in Germany has grown enormously – in the past 10 years open-end fund volumes increased from EUR23bn to EUR105bn. More recently, inflows have been strong since 2001, when slumping stock prices made the stock markets increasingly unattractive. As we can see, inflows and outflows may fluctuate very strongly.

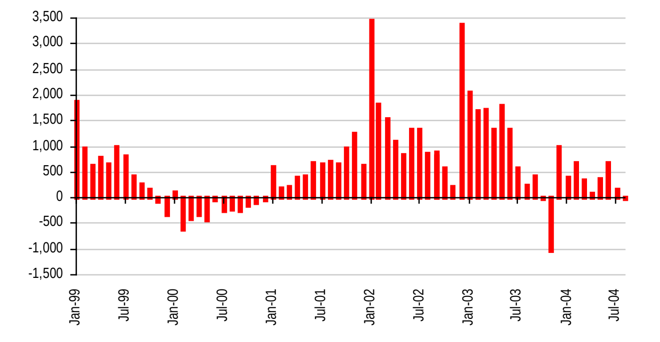
Open-ended funds grew from EUR23bn in 1995, to EUR105bn in 2004

Open-end fund volume (in EURbn)*



*Note: * including specialty funds*
Source: BVI, HSBC Trinkaus & Burkhardt

Open-end inflows/outflows (in EURm)*



*Note: * including specialty funds*
Source:BVI, HSBC Trinkaus & Burkhardt

International funds perform much better than their domestic counterparts

Returns from open-end property funds have differed in the past. Despite the time range 1989-1994, average returns never exceeded 6%. From 1989-1994, the reunification boom caused returns to rise but since then, returns have declined constantly to the current low level of 3.1%. As previously mentioned, open-end property funds are also invested abroad. When we split German incorporated open-end property funds into those primarily invested domestically and those focussing on investments abroad, we see that open-end property funds investing locally have delivered a much worse performance than funds investing abroad. Moreover, their performance has been lower for all periods in the past 10 years. Domestic-oriented funds delivered a disappointing total return of less than 2% for the past 12 months. The difference would be even larger if we were to take different tax burdens into consideration. Open-end funds investing and operating properties abroad pay taxes for rents and disposals of properties in the foreign country. Rents however are tax exempt at investor level. Domestically investing open-end funds are not taxed at fund level and taxation takes entirely place at investor level. These differences in tax charges are not accounted for when performance at fund level is measured. As a rule of thumb, we can say that the positive net effect of tax performance at investor level is even higher in international funds.

Open-end funds have never delivered more than 6% pa on average…

…within which domestic funds performed badly

…while international funds performed much better…

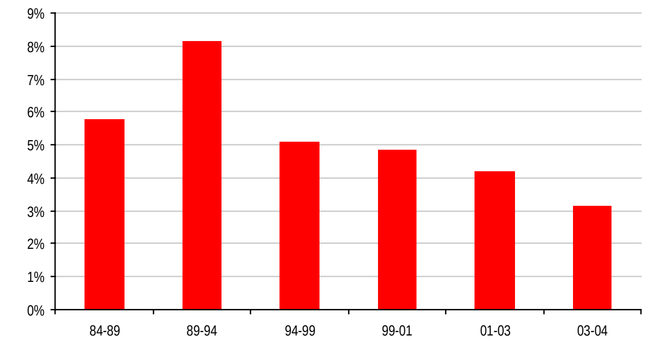
One reason domestic funds' performance has been so bad was the struggling German real estate market which led to an increase in vacancy rates and decrease in rents. According to our analysis, based on data provided by fund manager KanAm, the average vacancy rate of domestic funds is 8.7%, compared to 3% for international funds. This is a surprising result, as the overall level of vacancy is not much higher than in other European capitals, despite the strong rise in vacancies in Germany. As a lot of international property funds were launched much later than their domestic counterparts, we think they might still be benefiting

…partly due to much lower vacancy rates

German real estate market

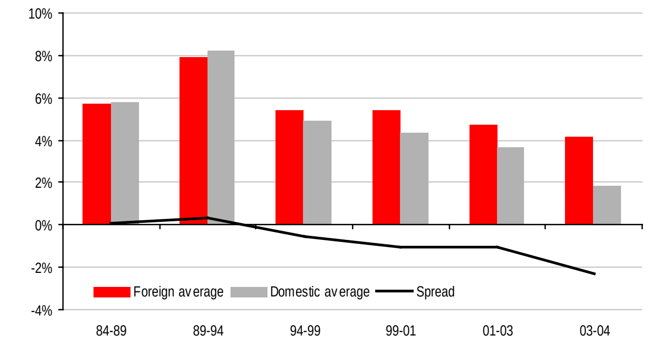
from long-term initial rent agreements of acquired properties. Against this background, they seem highly over-rented, which might pose a risk to future performance.

Average annual performance of open-end property funds...



Note: as of 31 Aug 2004
Source: BVI, HSBC Trinkaus & Burkhardt

...additionally split by asset allocation focus



Note: as of 31 Aug 2004
Source: BVI, FAZ, HSBC Trinkaus & Burkhardt

Illiquid asset and redemption guarantee can cause liquidity problems

Property funds are more constrained in their liquidity management than equity funds

Open-end property funds are at a huge disadvantage compared to equity open-end funds. Equity funds can react to redemption pressure by selling assets in the market. If the stocks are sufficiently liquid, the fund can easily meet redemption pressure. If the equity fund is subject to large-scale inflows, it is also able to invest the funds quickly. This may drive stock prices up and down, with detrimental impact on the fund's performance, especially when selling illiquid stocks in the market. The development of the Neuer Markt index is a good example of the impact of open fund money on equity prices. Fund inflows first led to an accelerated rise in Neuer Markt equity prices and then to an accelerated decline. Nevertheless, it is difficult to see an equity fund facing a big liquidity problem. The same holds true for funds investing in other exchange-traded and liquid assets such as bonds and commodities.

The Dutch open-fund crisis in the early 1990s is an example of liquidity risk...

...and DEKA a more recent example

Property investment funds, however, are invested in a highly illiquid asset class. Once funds are forced to sell properties, the number of buyers is very limited as each property is unique. In addition, disposals usually take time and if they are done under pressure, can result in lower proceeds. This can easily lead to a liquidity issue in times of massive money outflows. Furthermore, open-end property funds are usually not allowed to sell properties far below the property's net asset value. The Dutch open-end funds markets experienced this in the early 1990s. Dutch REIT Rodamco was at the brink of collapse at that time. Another more recent example is DEKA's Immobilien Fonds, which experienced a massive outflow of cEUR1.5bn in 2004 after negative press comments on one of its general managers being involved in a huge property scandal. Its parent company, DEKA Bank, took a large part of the funds onto its own book to secure the liquidity of the fund.

Properties need to be examined prudently prior to an investment and disposals are difficult due to the illiquid property market

When property funds experience high inflows as happened in 2002 and 2003, they cannot invest the funds immediately, simply because properties have to be investigated first. Therefore, both high inflows and high outflows are unfavourable for property funds, forcing them to react pro cyclically. In other words, in times of rising property prices, investors put

German real estate market

money into open-end funds, forcing them to invest at even higher prices and lower yields. When property prices decline, yields rise but investors take money out of open-end funds, forcing them to sell properties at even lower prices. This has a negative impact on their performance and, due to their enormous purchasing power, on the property sector.

Open-end funds have investment ratios of c69-78%

Indeed, property funds are obliged to hold at least 5% of liquid assets and often hold more, however, this might not be enough to stand outflow pressure if this ratio is low and hurts returns if it is too high. The later happens because liquid assets are invested in financial instruments, usually yielding less than property. German fund analyst, Stephan Loipfinger, is currently putting open-end funds on a watch list, when they are more than 85% invested in properties. As we can see from the table below, German open-end property funds had investment ratios of c69-78% in the past four years. In a cross-sectional consideration, ratios varied widely from a low of 27% to high 137%. A number greater than 100% means that some of the assets are financed with debt. At present, funds still have high liquidity, represented by a low ratio of invested assets. Liquidity has surprisingly even increased (due to some funds selling property assets) in 2004, but we think the picture is distorted by at least two factors:

- DEKA's theoretical outflows are not considered as they are transferred on its parent book
- At present, we are seeing money flowing out of domestically investing funds into higher-yielding international funds (see our performance analysis below)

Nevertheless, it looks like the DEKA case is a one-off. The stream of negative newsflow surrounding the disappointing returns of German properties compared to its European counterparts, the Frankfurt property scandal and DEKA's liquidity issue might, however, have a negative impact on money flows in the future. September money flow actually turned negative for the first time in 2004.

Ratio of invested assets vs net fund volume*

Year	2001	2002	2003	2004**
Invested assets	78%	71%	76%	69%
Minimum	27%	31%	38%	38%
Maximum***	108%	112%	137%	133%

*Note: * assets weighted,** as of 30 Sep 2004, *** ratios >100% result due to loans deducted from gross assets*
Source: BVI, HSBC Trinkaus & Burkhardt

Transparency of open funds has room for improvement

Open-end funds have a low transparency,...

...priced always at their NAV...

...and suffering from a lack of unbiased market prices

Another main problem concerning open-end property funds is their often-criticised lack of transparency regarding information provision. Open-end property funds present so-called statement of accounts on an annual basis. The scope of that statement differs from one fund to another. For instance, most open-end property funds do not disclose net asset values for single properties of their portfolio so investors do not really know what they are investing in. As mentioned before, investors can buy and sell shares in open-end property funds at the fund's net asset value. Since the NAV is not a quote but a number calculated by property advisors mostly only once a year, it is not necessarily representative of latest market trends. Market quotes are the most efficient signal of the value of an investment in our view. Due to a lack of market prices, investors buying an open-end fund, and therefore relying on the

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NAV number, can never be sure if this NAV is 'correct'. German independent fund research house, Scope, has recently publicly raised the issue that fund properties are systematically overvalued in times of market downturns as they are based on normalised rents which are unachievable at that time. A recent example of this is Deka's "Immobilien Fonds", one of the largest property funds in Germany. Deka Immobilien calculated internally that it will have to write off EUR400m over the next five years. However, an external advisor (Deloitte & Touche) estimated a number of EUR530m based on their own calculations. Management had to resign because it concealed the need for the write-off. Similar events at other funds, especially those investing domestically, cannot be ruled out.

Efforts to increase transparency are underway

There have been efforts to increase transparency by ranking open-end property funds. In September this year, Scope published ratings which were all but favourable for open-end property funds. Only two of them received a 'very good' rating and most of them were rated much worse. Unfortunately, even this rating agency had mostly to rely on publicly available information because the bulk of those funds refused to provide this research agency with additional information. BVI members are currently working on their own rating approach which will be done by Fitch and Feri.

Recently, four of the major open-end funds providers (CGI, DEKA, Difa, Degi) declared they had increased transparency in a first step by publishing more relevant information eg rent contribution of the total return of a fund etc. They don't intend to publish additional data such as market prices of properties, rents, occupancy rates etc but they will at least be provided to rating agencies.

Cost structure allows only a long-term strategy

Also, open-end property funds are very costly for an investor. The usual up-front cost is 5% of face value and annual fund management fee is about 0.75%. External property management consumes another 0.75%. The recent performance of open-end property funds means investors have had to wait for over two years before the fund has increased enough to earn the fees. Such a fee structure only permits a mid to long-term strategy when investing in real estate. For private investors who want to ride the property cycle, open-end property funds are not optimal.

Institutionals seem to have parked short-term money in open-end funds

Nevertheless, we assume a lot of institutional money has gone into open end funds. These investors typically do not have to pay front-load fees and therefore can park money for a short time in property funds. This adds significantly to the volatility of money flows. This has been publicly criticised by fund researchers and fund managers alike. Why the latter took the money in the first place remains unclear however.

Closed-end property funds

Closed-end funds are not yet regulated…

…but this will change effective July 2005

In contrast to open end property funds which are regulated, closed end property funds are not yet subject to strict regulations. With the passing of the EU abuse directive into German law in July 2004 this will, however, change in July 2005. From then on, closed end fund managers (irrespective of asset class) will be obliged to issue a prospectus for each fund that is marketed. The prospectus has to be approved by the BaFin before marketing starts. Although this is definitely a step in the right direction, we would caution against expecting too much improvement in transparency. BaFin only checks formal criteria (which are not yet presented in detail) and does not perform economic due diligence.

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Closed funds are limited partnerships in a legal sense...

Usually, closed end property funds are unlimited partnerships or limited partnerships (GmbH Co. KG). Also, closed end property funds do not need to be diversified geographically nor by sector. They are usually created to invest in one single or very few properties. In order to market the funds, the property is usually already owned by the initiator. Thus, money usually follows the real estate, unlike open funds, which tend to invest when money is on the table already.

...and were used as a tax shelter vehicle in the past

In the past investors participated in closed end property funds to generate tax losses which could offset income from other sources and thus could lower their tax charge. As a fully 'tax transparent' vehicle, taxation does not take place at fund level but only at the investor level.

Many funds suffered losses from their East German investments, which were mainly tax driven

Now tax shelter opportunities have been cut...

In order to 'generate' tax losses, a high degree of leverage (currently still c50%) and high tax depreciation rates were needed. The latter reduced the value of the property in the tax balance sheet without reflecting changes in the market value of the estate. This led to book losses, which in many cases can (hopefully) be compensated when the property is sold. Capital gains are also tax exempt after a 10-year holding period. These tax incentives made investors invest almost blindly in properties, driving prices up and yields down. A recent example of this was closed-end property funds eagerly investing in East Germany following the re-unification. Thus, in the 1990s huge tax incentives for East Germany caused the amount invested to jump from one height to another. Currently, there is more than EUR170bn outstanding. As many closed-end property funds burned money in East Germany owing to the collapse of the market, we can assume that the real value of funds volume is much lower. The tax loss argument has, however, run out of steam in recent years. With a change in German tax legislation, the possibility of closed fund-induced tax losses has been reduced in the past to currently between 20-30% of invested capital. Also, many investors were unable to recover their investments when selling property.

...and investors have shifted their focus to international markets, which deliver higher returns

Therefore, closed-end fund investors' focus turned towards foreign and away from domestic estates. The reasons are generally higher expected returns and lower taxation in foreign countries compared to Germany. As a tax-transparent vehicle, international profits do not get double-taxed at investor level under most tax treaties, so the investor benefits from properties in low-tax environments. The treatment of international profits is similar to open-end funds but differs from the treatment of property stock dividends, which are double taxed. As a consequence, domestic funds lost ground constantly while the market as a whole was still growing as can be see in the left chart below. Because many domestic oriented closed-end property funds invested in East Germany, their vacancy rates must be high and returns from closed-end property funds should be depressed. Therefore, we think that in the future we will see a continuing focus on foreign properties funds reflecting a similar development to open-end funds. Scope estimates that 40% of the equity raised in 2004 will be invested in the US and Canada alone.

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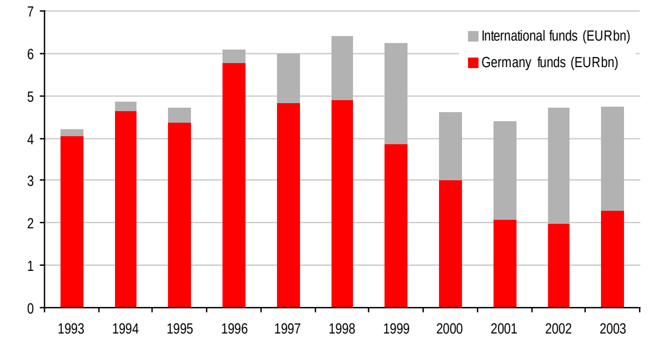
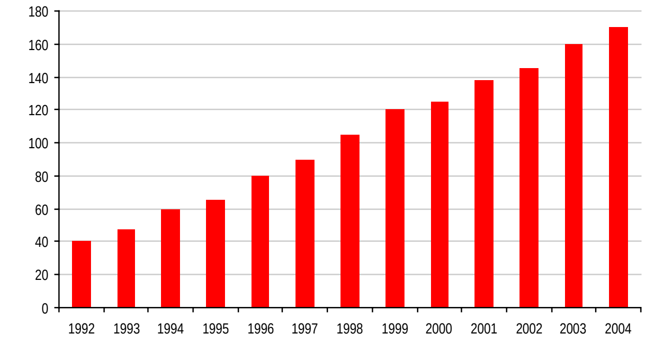
Fund raising of closed-end property funds (in EURbn)



Source: Stefan Loipfinger research, HSBC Trinkaus & Burkhardt

Total assets in closed-end property funds (in EURbn)



Source: Stefan Loipfinger Research, HSBC Trinkaus & Burkhardt

Closed end funds are even less transparent than open-end funds…

If we see open-end property funds as not transparent regarding the provision of information (not to be confused with full tax transparency!) closed-end property funds are even less so. At present, there is no established regulated market for closed-end property funds. Therefore, once an investment is made it is difficult to get one's money back before the termination of the fund, which can take over 10 years. The only way to reclaim part of the investment is to sell one's own stake in the fund over the counter. There have been numerous attempts to establish organised markets for all kinds of closed-end funds (media, ships, property etc.). Due to the diversity of products and difficulty of valuing closed-end funds externally, success has been extremely limited so far. Recently there have been two initiatives to launch trading segments for closed-end funds at the regional exchanges of Düsseldorf (Gefox) and Hamburg (DAI). Whereas the latter has c800 funds listed, Gefox is less successful, comprising only a handful of listed funds. Overall exchange trading of closed funds does not guarantee fair prices; the German Association of Closed End Funds (VGI) states that just 10-30% of the fund value seeming priced realistically. Furthermore, buyers of closed-end funds are difficult to find, as they cannot take the advantage of all tax loss carry-forwards anymore. There still seems a long way to go before the funds achieve the status and liquidity of listed pooled property funds in the UK.

…and very illiquid

Regulated markets for closed-end funds are not yet a success

Early sales depend on fund managers organising them

Currently, fund initiators are the main source to organise a sales process of 'old' fund shares within their own customer network. Discounts to market values can, however, be huge. The VGI is currently pushing towards requiring fund managers to take back fund shares up to a certain volume. This discussion, however, is in its very early stages and success is far from certain.

Real estate companies

Real estate companies can be categorised as 'owners' or 'developers'

Real estate companies are another indirect property investment vehicle. Usually one can split real estate companies into two groups those primarily owning properties and those developing them. 'Owners' are less risky as their primary income is rents. Owners buy existing properties with established rental contracts. In contrast, 'developers' are exposed to high risk as they first construct properties and sell them afterwards or keep them in their own books. Most companies operate in both areas. Compared to the market capitalisation of real estate companies, EUR6bn represent less than 1% of total market capitalisation. Compared

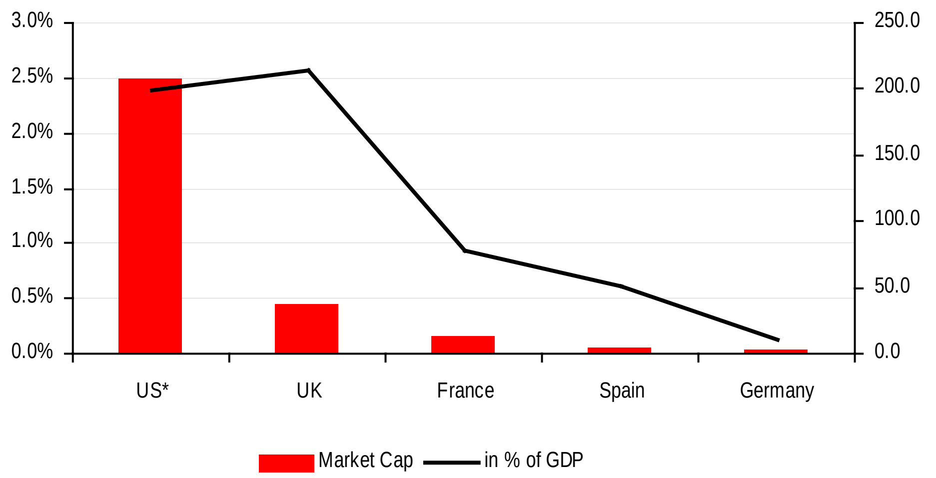
German real estate companies are few and small…

German real estate market

...whereas US companies are many and big

to an estimated size of the real estate market of EUR7,100bn, the EUR6bn market capitalisation of domestic real estate stocks is negligible and for sure has potential to grow. Other countries such as the US have been extremely successful in developing a listed real estate sector. In the US, property stocks represent a market value of cUSD275bn, 35x the German sector value. When you consider US GDP, of cUSD11,000bn, is only c4.1x German GDP, the underrepresentation of the listed real estate sector in Germany becomes obvious. In the following section, we discuss some characteristics of (listed) real estate companies. As we fear that the German sector is not representative and might deliver heavily distorted results, we have also taken other markets into consideration to round the picture.

Market cap of EPRA stocks of big five countries (EURbn)



*Note: * Market cap of US-REITs in the NAREIT index, not EPRA*
Source: Bloomberg, destatis, EPRA, Federal Reserve Bank, Bank of England, OECD, HSBC Trinkaus & Burkhardt

Characteristics of real estate stocks

Thesis 1: Real estate stocks perform poorly

Public real estate companies and private real estate are not the same

Public real estate must also be compared to other debt and equity indices

Real Estate is sometimes seen as a boring low-performing investment without the flair of more exciting stocks. Real estate stocks are often lumped in with direct investments in real estate. However, they are publicly traded companies and therefore should be regarded as such. An important benchmark for the development of public-traded companies involved in the real estate business is the European EPRA Index. The EPRA Index also includes non-euro countries like Sweden, Switzerland, Denmark and UK. It is remarkable that UK companies account for c50% of the market capitalisation of the index. To qualify for the EPRA Index, companies must meet certain organisational, market capitalisation and free float conditions. We compared the performance of EPRA stocks to the broad European market measured by the Dow Jones STOXX 50 index. European real estate companies surged as much as the overall stock market. Despite a large difference in performance in the late 1990s for the whole period, they actually did slightly better. We also use the REX Performance Index for German government bonds as a proxy for European bonds. German bonds are the ultimate benchmark for European bonds and therefore the use of the REX Index is justifiable. Up to 2003, real estate performed as well as bonds and only afterwards did they did do significantly better.

The European real estate industry is tracked by the European Public Real Estate Association Index (EPRA)

Only three German real estate companies qualify for the EPRA Index

There are just three German companies in the EPRA Index, too few to use it as a benchmark, so we have used another index for the German market. The Stuttgart-based private bank, Ellwanger & Geiger (E&G), provides time series for German real estate stocks since the end of 1988. The E&G DIMAX Index contains all German real estate companies which generate at least 75% of revenues and 75% of income with real estate investments. At present, there are 51 companies in the index of which the largest six amount for 50% of its value. Many of these companies are very small and all 51 members have a total market capitalisation of just EUR6.3bn. Adjusted for free float, this number would be below EUR3bn. Probably the best-known company IVG amounts to almost 18% of its value. Although DIMAX depends strongly on the development of few stocks, due to a relatively undeveloped market in Germany, DIMAX is the best available source to serve as a benchmark.

The German real estate industry is tracked by the DIMAX Index of Ellwanger & Geiger

On average since 1992, European real estate stocks gained a remarkable 11.2% pa, while the DJ STOXX 50 increased by 10.9% pa. and bonds gained 7.4% pa. For shorter time periods, however, there have been large differences in performance returns between the three. Real Estate and bonds performed more steadily than stocks, which experienced excessive positive and excessive negative returns for certain time periods. This year has been very favourable to real estate stocks, pushing the EPRA Index to new heights. All in all, European real estate and blue chips have not been unexciting assets. More importantly, we cannot conclude that European real estate stocks have generally underperformed.

Characteristics of real estate stocks

Comparing the historical returns of DIMAX stocks with other asset classes eg DAX for blue chips, MDAX for mid caps or REX for the bond market, we can assert that in Germany real estate stocks have performed barely in line with REX and DAX. Following German reunification, real estate in Germany boomed in 1989/90. Eastern Germany was the main driver in that development, as tax benefits and the requirement of huge initial investments made real estate in East Germany a booming sector. DIMAX doubled within the first two years and remained quite stable until 1997. In 1998 real estate stocks began to catch up with the bull market in equities. However, even if the rise in real estate stocks was not as strong as in equities, in the aftermath of the bubble burst real estate also experienced a softer landing.

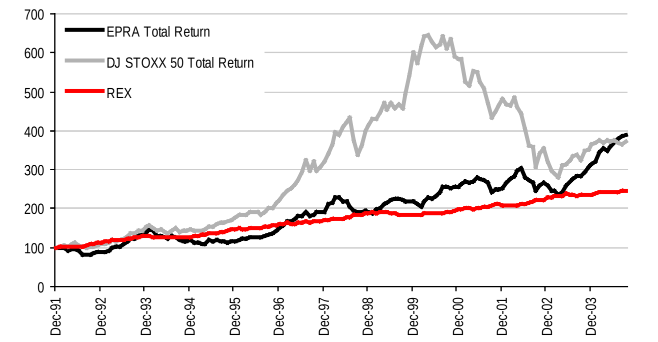
Average annual total returns – Europe (%)

	EPRA	DJ STOXX 50	REX
1 year	38.7	14.8	4.3
5 years	12.1	-4.0	6.0
10 years	12.6	10.3	7.0
since 1992	11.3	10.9	7.4

Source: Bloomberg, EPRA, HSBC Trinkaus & Burkhardt

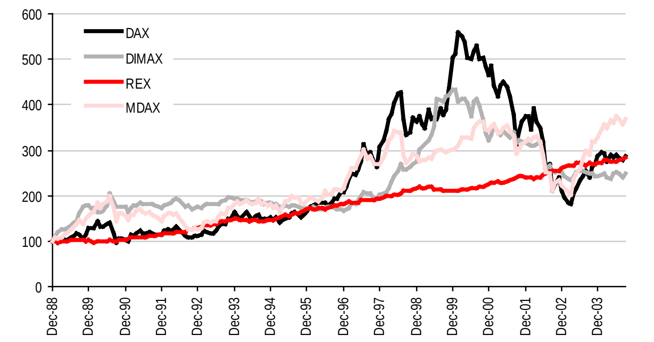
Throughout the consideration period German real estate stocks underperformed all three benchmark indices. As mentioned above, this result is unlikely to be representative for an average real estate stock, as market capitalisation is unequal and few companies have a big share within the index. Nevertheless, German real estate stocks disappointed in their performance, even if European stocks did not, due to weak real estate market in Germany. Moreover, DIMAX has been outpaced by both stocks and bonds in all considered periods. On average, DIMAX stocks yielded 6.0% pa, which is poor compared to the DAX and MDAX. DIMAX has been outpaced even by bonds. Underperformance was not the result of the period chosen, because DIMAX performed worst in all considered periods.

Total return of EPRA Composite vs DJ STOXX 50*



Note: as of 30 September 2004*
Source: Bloomberg, EPRA, HSBC Trinkaus & Burkhardt

Total return of DIMAX vs DAX/MDAX/REX indices*



*Note: * as of 30 September 2004*
Source: Bloomberg, Ellwanger & Geiger, HSBC Trinkaus & Burkhardt

Considering one single time period might be misleading. Therefore we have also looked at single periods to identify periods of out- and underperformance. The data chart below indicates in which periods it proved to be valuable to be invested in real estate. A data point of 10% for example, indicates that for the six months until the shown date real estate stocks performed 10% better than the DJ STOXX 50. Two major under- and two major outperformance periods can be identified. In times when the stock market has been strong, ie 1997/1998 and 1999/2000 real estate has underperformed; in times where the stock market was stumbling, real estate outperformed. Over the rolling six-month period, differences have been big (up to 35%). An important exception is the upswing in stock prices which started in 2003. Both real estate stocks and the DJ STOXX 50 appreciated. Real estate stocks, however, did far better, driven by improving real estate market sentiment

Average annual total returns – Germany (%)

	DIMAX	DAX	MDAX	REX
1 year	0.4	19.1	26.6	4.3
5 years	-9.4	-5.2	4.2	6.0
10 years	2.9	7.0	7.3	7.0
since 1989	6.0	7.0	8.8	6.9

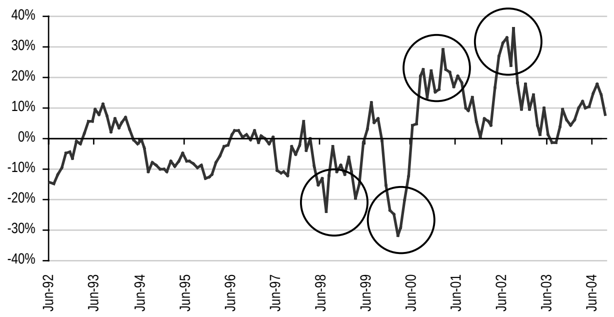
Source: Bloomberg, Ellwanger & Geiger, HSBC Trinkaus & Burkhardt

Characteristics of real estate stocks

particularly in the retail and industrial sectors. However, due to the size and strength of the increase, we believe it's an exception rather than a new rule. Thus, generally favourable stock market conditions have led to an outperformance of the DJ STOXX 50 over EPRA.

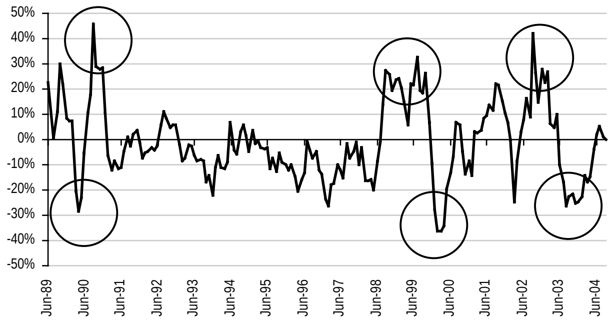
Despite the overall underperformance, there have been shorter periods of outperformance of DIMAX stocks compared to DAX stocks for example. We highlighted periods in which the DAX had an outstanding performance. We observed that in bull market periods DIMAX stocks consistently lagged DAX stocks in a range up to 35%. In times of stock market consolidation ie in the current year, real estate stocks were usually able to catch up. Generally speaking, 'bad times' for large caps means 'good times' for real estate stocks.

Relative six-month performance of EPRA Composite vs DJ STOXX 50*



Source: Bloomberg, HSBC Trinkaus & Burkhardt

Relative six-month performance of DIMAX vs DAX*



Source: Bloomberg, Ellwanger & Geiger, HSBC Trinkaus & Burkhardt

Characteristics of real estate stocks

Thesis 2: Real estate stocks are illiquid

A second commonly-heard statement about real estate stocks is that they are relatively illiquid compared to other stocks. We examined this issue by looking at the trading activity of EPRA and DJ STOXX 50 members. We measured the capitalisation-weighted total volume traded with month-end stock prices and monthly volumes and compared the results with the average market capitalisation for the six months considered. The chart reveals that in fact real estate stocks have been less liquid than the big blue chips. This is not surprising as the EPRA stocks are much smaller and are not included in major European indices like many DJ STOXX 50 companies. On average in the past four years, 53% of the market cap in DJ STOXX 50 companies has been traded on exchanges in six months, while the respective number for real estate stocks has been 30%. Even if the difference is big, in our view the calculated number of c30% is still favourable as it indicated that institutional investors are provided with enough liquidity.

Real estate stocks are less liquid than the broad market

Six months trading activity in % of market cap:

...53% for DJ Euro 50 stocks

...30% for EPRA stocks

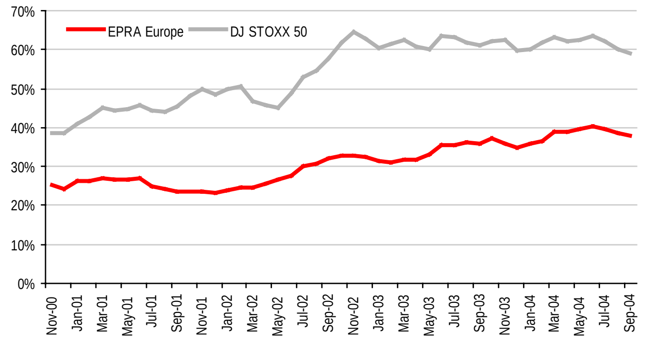
Repeating the procedure for the German markets leads to different results. We examined the difference in liquidity between DIMAX and DAX and include the MDAX and SDAX for comparison purposes. Unlike European real estate stocks, DIMAX members had a far lower liquidity ratio. While DAX and MDAX stocks came to 65% and 18% respectively, during the past four years it averaged only 7% for DIMAX stocks. For comparison, the biggest member IVG, which is also a member in the EPRA Index, had a liquidity ratio of 10%. This reveals that even the biggest German real estate company is not very liquid. DIMAX liquidity only recently increased, reaching levels similar to SDAX. While institutional investors may perceive SDAX stocks as being too small and illiquid, for an investment in DIMAX stocks it is certainly true. An important reason for this low liquidity ratio is the low free float of real estate stocks. In a cross-sectional consideration the equal weighted actual free float for DIMAX companies is c36%. In addition to the low free float, the small size of an average real estate company is another main reason institutional investors stay out of the market.

...65% for DAX stocks

...18% for MDAX stocks

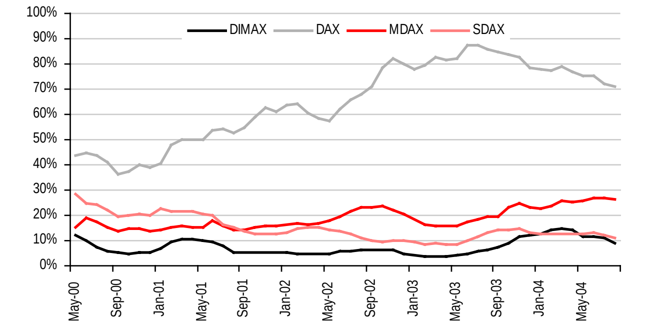
...and only 7% for DIMAX stocks

Six-month turnover in % of average market capitalisation* (Europe)



*Note: * as of 30 September 2004*
Source: Bloomberg, EPRA, HSBC Trinkaus & Burkhardt

Six-month turnover in % of average market capitalisation* (Germany)



*Note: * as of 30 September 2004*
Source: Bloomberg, Ellwanger & Geiger, HSBC Trinkaus & Burkhardt

Characteristics of real estate stocks

Thesis 3: Real estate stocks are defensive investments

Real estate stocks are higher leveraged…

…with gearing ratios of 105% for EPRA compared to…

…83% for DJ STOXX 50

In this section we consider whether an investment in real estate stocks represents a defensive play. A first indication of a defensive company is a high portion of equity financing omitting too strong a leverage effect on earnings and thus reducing earnings volatility. We have calculated year-end debt/equity ratios for the EPRA and the DJ STOXX 50 indices excluding financial institutions from the sample. Our gearing is defined as book value of debt to book value of equity. On average, the gearing ratios have been 105% for EPRA and 83% for DJ STOXX 50 stocks. This shows that real estate stocks are leveraged more aggressively than blue chips. However, the difference from blue chips is not large. Thus, we consider this result rather as a first tendency than as a strong evidence of higher risk.

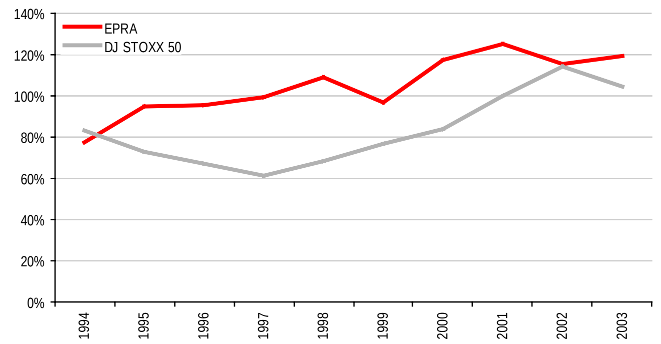
…and 81% for the DAX

…78% for the MDAX

…and 184% for Dimax

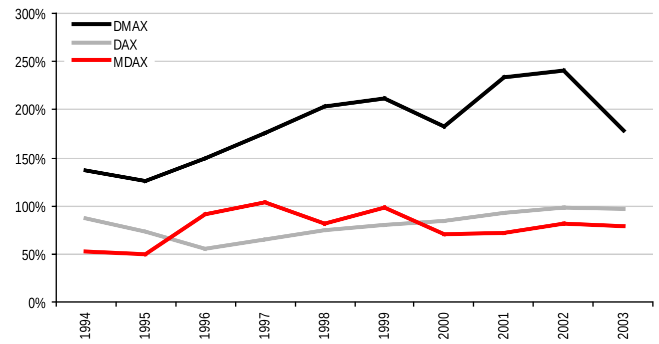
Turning our view to the German market, we again compare gearing ratios first. Again, in our sample, banks and other financial institutions are excluded. Generally, gearing ratios have risen slightly over the past decade. For DAX and MDAX companies, gearing ratios have been very similar to those of the DJ STOXX 50. The average equal-weighted gearing has been 81% and 78%, respectively. DIMAX stocks had much higher leverage ratios, averaging 184% over the 10-year period. Following the bubble bursting in 2000/01, many companies were supposed to lower their debt. Our findings do not support that. Whether market weighted gearing ratios or those calculated differently, increased or not, does not matter so much. What counts is that real estate stocks are much more leveraged than blue chips and mid caps.

Equal weighted gearing*/ (Europe)**



*Note: total debt/ total equity, ** based on book values*
Source: Bloomberg, EPRA, HSBC Trinkaus & Burkhardt

Equal weighted gearing*/ (Germany)**



*Note: total debt/ total equity, ** based on book values*
Source: Bloomberg, Ellwanger & Geiger, HSBC Trinkaus & Burkhardt

Volatility of real estate is lower than that of the general stock market

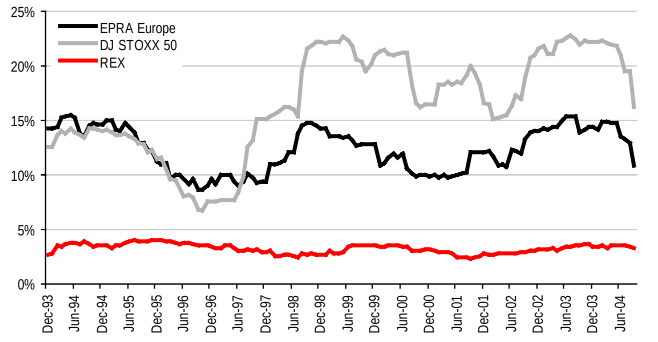
The real risk to which an investor is exposed is measured by volatility numbers of the investment. In the chart below, we present the rolling 24-month volatility of monthly returns for both indices. In the three-year period leading up to 1997, EPRA stocks had almost the same volatility as the DJ STOXX 50 blue chips. Later on, their volatility graphs diverged. Volatility for DJ STOXX 50 members averaged 16.6%. The risk in real estate stocks rarely exceeded 15%, while the volatility of DJ STOXX 50 exceeded 20% for longer periods. In comparison, REX volatility averaged 3.2%. REX volatility has been far below both equity indices. This is to be expected, however, as bonds are much more defensive than stocks.

Characteristics of real estate stocks

Volatility for EPRA averaged 12.3%. From this perspective, real estate stocks are less volatile and less risky and can therefore be regarded as defensive.

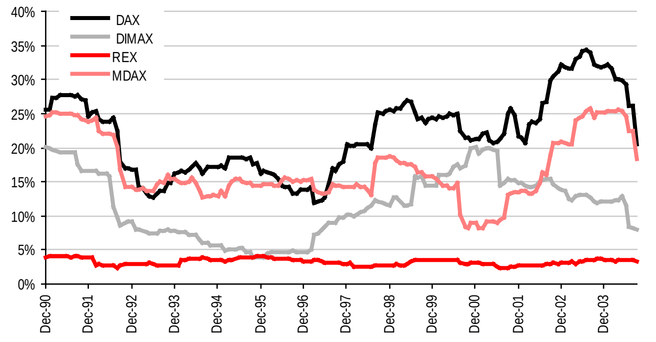
Simple volatility measures indicate that, on average, German real estate stocks have been more defensive than other stocks. The rolling two-year volatility on a monthly basis averaged 11.6% and ranged from a low 5% to 20% since 1991. In comparison, the average DAX and MDAX volatility has been 21.8% and 16.4%, respectively. However, compared with German bonds measured by the REX index, real estate stocks had a substantially higher volatility. Roughly speaking, real estate stocks are in fact less risky. This is the same result we already presented for the European stocks. Volatility has never really exceeded 20%. For all periods, DIMAX volatility has always been lower than that of DAX and for most of the time also lower than that of MDAX.

24-month rolling volatility (Europe)



*Note: * as of 30 September 2004*
Source: Bloomberg, HSBC Trinkaus & Burkhardt

24-month rolling volatility (Germany)



*Note: * as of 30 September 2004*
Source: Bloomberg, Ellwanger & Geiger, HSBC Trinkaus & Burkhardt

Risk sensitivity of European real estate measured by beta averaged 0.45

Measuring the betas of EPRA stocks compared to blue chips shows that when EPRA and DJ STOXX 50 had almost the same volatility, beta was high at between 0.8 and 1. Later, beta factors decreased strongly, moving between 0 and 0.5 for the rest of the time period. On average, beta factors have moved around 0.45, which is very low. This result supports our previous findings that real estate stocks tend to underperform blue chips when stock markets rise and outperform when they decline. Regarding the REX Index, because of its low volatility, beta tends to overshoot in both directions, depending on the correlation between REX and EPRA. Therefore, attention should be paid not to the intensity, but rather on the direction of the swing. As beta numbers swing from positive to negative and vice versa, we can conclude that in the long term, bond and real estate is more or less uncorrelated. This raises the question of whether real estate stocks are influenced by interest rates at all. We will discuss this topic later in the paper.

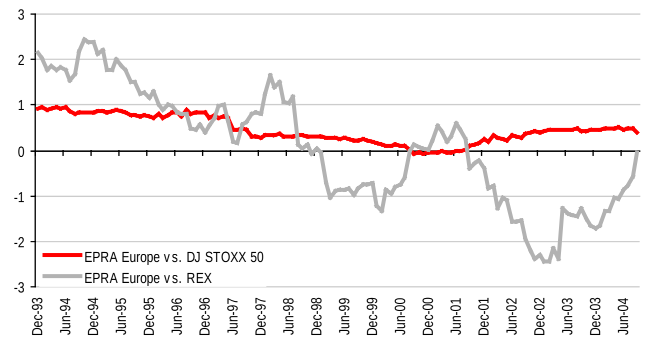
...and 0.22 for German real estate stocks

Given the moderate correlation between the DAX and the DIMAX and a lower volatility in real estate stocks, beta has been very low in the past, ranging between 0.03 and 0.43. With an average of 0.22, it was half as big as the beta of EPRA vs DJ STOXX 50. The beta risk measure vs MDAX has been in a range of 0.1 to 1.2, averaging 0.37. This abnormal beta range does not provide guidelines on future beta; however, except in 2001, the MDAX-DIMAX beta was very close to the DAX-DIMAX beta. The abnormally high MDAX-DIMAX

Characteristics of real estate stocks

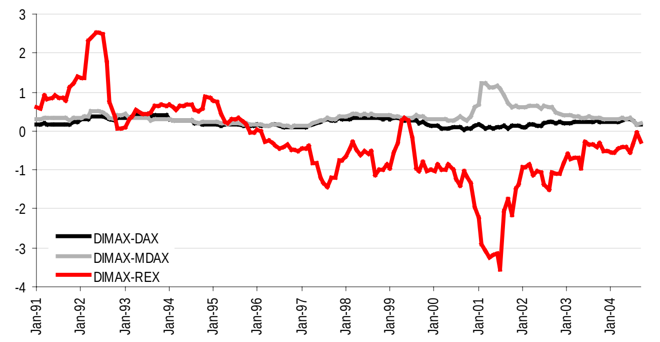
beta in 2001 emanated from all three factors: low volatility of the MDAX, high volatility of DIMAX, and a suddenly increased correlation of these two indices. Again REX beta was highly volatile, jumping from +2,5 to -3,5. From these results we do not see any connection between DIMAX and REX indices. In Germany, as in Europe, bonds and real estate stocks did not tend to track the same return pattern in the long run. We can conclude that real estate stocks are a defensive vehicle compared to the stock market.

24-month rolling beta factors* (Europe)



*Note: * as of 30 September 2004*
Source: Bloomberg, HSBC Trinkaus & Burkhardt

24-month rolling beta factors* (Germany)



*Note: * as of 30 September 2004*
Source: Bloomberg, Ellwanger & Geiger, HSBC Trinkaus & Burkhardt

Thesis 4: Real estate stocks generate high dividend yields

Real estate stock have high dividend yields…

The next thesis we examine is that real estate stocks have higher dividend yields than the average market. On a European basis we observe a significant dividend yield pick-up for real estate companies. EPRA dividend yields averaged 4.5%, while European blue chips generated just 3.0%. Except for a short period in 1990, real estate stocks have always yielded more. Besides, dividend yields have never been below 3%, which we regard as an attractive level for investors seeking a steady income stream. The average current payout ratio for EPRA companies has been c64% in the period between 1990 and 2003.

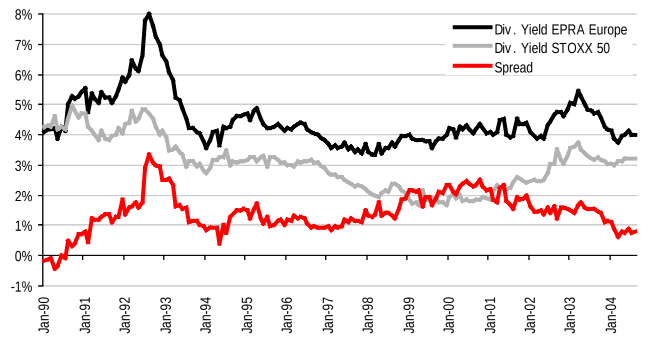
…4.5% for EPRA vs 3.0% for DJ Stoxx 50

…and 2.8% for DIMAX vs 2.1% for the DAX

As a result of poor data prior to 2000 for comparing dividend yields in the German market, we have concentrated on the later period. We have observed rising dividend yields in the past few years for both the DAX and the DIMAX. This is hardly surprising as a downturn in stock prices usually means an increase in dividend yields because dividends tend to lag operating performance and the latter tends to lag stock price movements (assuming a reaction of prices owing to a change of fundamentals). The average dividend yield for DIMAX stocks since 2000 has been 2.8% and for DAX stocks 2.1%. Consequently, the average dividend yield pick-up investors could earn from an investment in real estate stocks was just 0.7%. For an investor seeking stable and high income from investments, a 0.7% pick-up might seem a lot. However, on an absolute basis, a 2.8% dividend yield for DIMAX stocks looks very poor compared with 4.5% for EPRA stocks. German real estate companies suffered from the domestic sluggish real estate market and this was one of the main reasons they could not offer investors the same level of returns as their European counterparts.

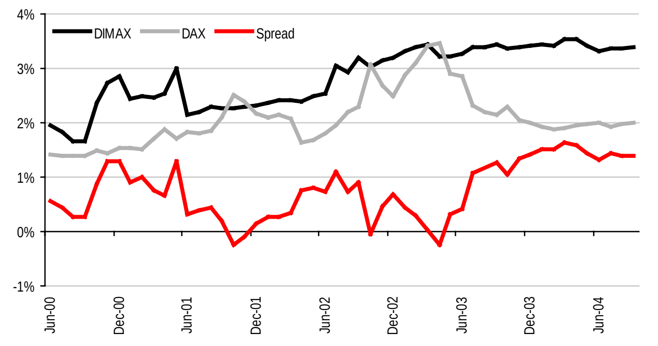
Characteristics of real estate stocks

Dividend yield EPRA vs DJ STOXX 50*



*Note: * as of 30 September 2004*
Source: Bloomberg, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Dividend yield DIMAX vs DAX/ MDAX*



*Note: * as of 30 September 2004*
Source: Bloomberg, Company data, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Thesis 5: Real estate stocks are an individual asset class

Significant size/liquidity

To qualify as an own-asset class real estate stocks need (1) significant size and liquidity

The first criterion for real estate stocks to be recognised as an individual asset class is their significant size. We think that European real estate stocks have a significant market value to be regarded as a real investment opportunity by investors. Real estate stocks included in the EPRA Index have an average market cap of EUR1.1bn. Total market cap of the companies included in the EPRA Index is cEUR80bn. The situation in Germany is different because the public real estate market is small. All DIMAX stocks have a market cap of little more than EUR6bn. As we have shown in a previous section, on a European basis, trading activity is sufficiently high. Taking this into account, our size/liquidity criterion seems fulfilled.

...which European real estate stocks have

..and German counterparts do not, and...

Lack of substitution

...(2) a lack of substitution opportunities to other assets...

The second criterion is, in our view, the lack of substitution possibilities for real estate stocks. Properties generate stable income in the form of rental income (investor) or gains/losses from property disposals (developers). Particularly in Germany, open-end property funds are already a capital market vehicle that generates income in the same way. Although these funds operate in the same field as real estate stocks, open-end property funds are not priced frequently. Because the price is derived from an actual NAV price, fluctuations are very small and do not reflect supply and demand for the funds. Instead, equity capital of open-end property investment funds fluctuates daily, bearing the risk of an erosion of capital base. This is because of the obligation of the funds to issue and redeem shares in the fund. As a result, open-end property investment funds cannot realistically replace real estate stocks as a vehicle. Direct investment cannot be a substitute as that market is highly atomised.

Special risk/return characteristics

...(3) as well as special risk/ return characteristics

Combing the risk/return finding of the indices examined in the previous sections reveals that real estate stocks differ substantially from their counterparts. To underpin our findings, we also

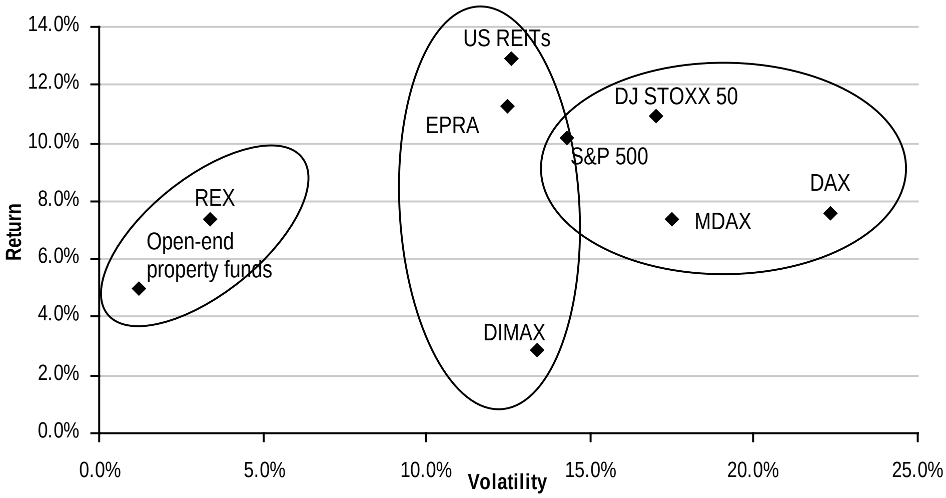
Characteristics of real estate stocks

take here the US market into consideration. The chart below shows the risk/return characteristics for the indices examined. Four main conclusions can be drawn from the chart.

European and US real estate and the corresponding stock markets performed far better than German blue chips and real estate

First, as we have seen earlier, European real estate and European blue chip stocks have performed better than their German counterparts over 1992-2004. US REITs and US blue chips also delivered a better performance. Second, risk of real estate stocks has been smaller than for the broad markets in Europe and Germany and the US. Third, returns of real estate companies have reached levels that stock markets also achieved. The only exception is Germany with DIMAX performing poorly. Fourth, compared to the bond market (measured here by the REX index), DIMAX stocks have not proved to be a superior investment. The German property market has been hit hard by the downturn. Moreover, one has to bear in mind that the past 12 years have been marked by a low inflation environment and accordingly an environment of declining interest rates. REX yielded 7.4%, also driven by capital gains.

Risk/return diagram Europe (1992-2004)



*Note: * as of 30 September 2004*
Source: Bloomberg, BVI, Ellwanger & Geiger, HSBC Trinkaus & Burkhardt

Bonds are not likely to repeat their strong past performance

The latter is unlikely to occur again in the same intensity as interest rates are historically low and capital gains are limited, particularly in the short term. Long term, it is unclear whether capital may be reinvested at higher rates that would overcompensate the lack of future capital gains. Assuming that risk and returns for equities are similar in the future, real estate stocks should partly fill the gap between blue chips and bonds.

Real estate stocks uncorrelated to bonds and modestly correlated to stocks

According to Markowitz, in a risk/return chart at least two assets can be combined to form efficient portfolios with higher risk or lower return. The necessary condition is an existing correlation between these assets that is less than perfect. The lower the correlation, the

Characteristics of real estate stocks

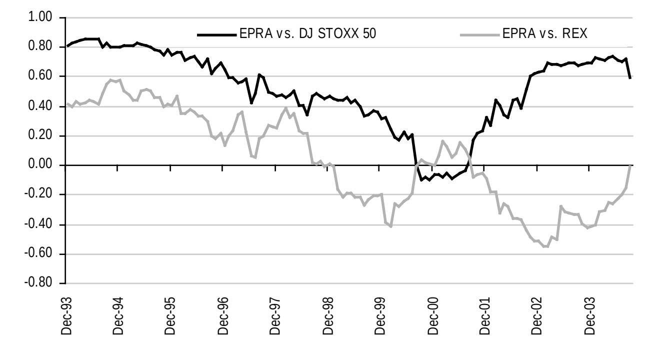
better the diversification. In the chart below, correlation between EPRA stocks, REX and DJ STOXX 50 is shown. Interestingly, correlation between DJ STOXX 50 and EPRA was very high at the beginning and declined constantly. In 2000, correlation slumped below zero, turning positive a year later. Currently, correlation is around 0.59, having averaged 0.52 for the whole period. Comparing EPRA stock returns to the REX correlation averaged 0.04. Thus, both assets were almost uncorrelated. From these findings, we can state that real estate stocks have offered a good diversification opportunity. Real estate stocks offer valuable diversification potential to portfolios through their correlations with respect to their special risk/return characteristics.

Correlation between DIMAX vs DAX and MDAX, respectively, was surprisingly very similar for a long time. Only between 2001 and 2002 did DIMAX demonstrated a stronger correlation with MDAX compared with DAX. Generally, correlation factors to MDAX ranged between 0.3 and 0.7, excluding some periods that we define as exceptional (ie 2000). In terms of DAX correlation, factors ranged between 0.05 and 0.75 and were thus slightly more volatile. Correlation with DAX was the lowest between 2000 and 2003 – a period when stock prices declined significantly. Therefore, an investment in real estate stocks represented a good diversification vehicle during that period for a blue chip position in Germany. Concerning the bond market (measured here by the REX index), we calculated correlation factors of -0.6 to 0.6. Much like the European market, bonds and real estate stocks have been largely uncorrelated in Germany.

DAX-DIMAX correlation ranged between 0.05 and 0.75

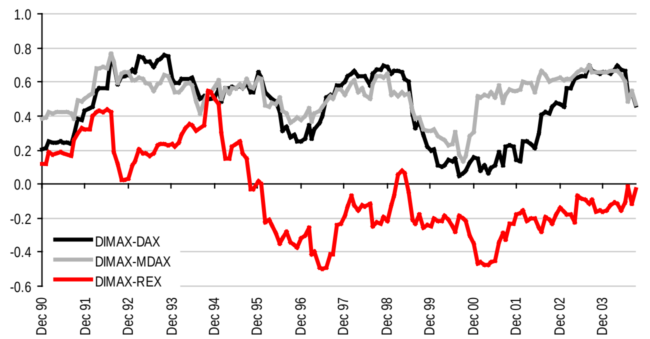
MDAX-DIMAX correlation ranged between 0.15 and 0.70

24-month rolling correlation EPRA vs DJ STOXX 50/REX



*Note: * as of 30 September 2004*
Source: Bloomberg, EPRA, HSBC Trinkaus & Burkhardt

24-month rolling correlation DIMAX vs DAX/MDAX/REX



*Note: * as of 30 September 2004*
Source: Bloomberg, EPRA, HSBC Trinkaus & Burkhardt

Thesis 6: RE stock performance depends on private RE

Which markets are really comparable?

In terms of size, the private real estate market plays David to the public real estate market's Goliath. The public market can be considered as an early indicator of private real estate. As the private and public markets operate in the same field, their respective performances should broadly correlate. However, this only holds true for the long term. In the short term, returns can differ substantially, as public real estate is affected by the capital markets, which are exposed

Long-term returns of private and public real estate move in the same direction, but there can be huge short-term differences

Characteristics of real estate stocks

to large fluctuations in sentiment or capital flows. In addition, it would be unrealistic to expect a perfect alignment as publicly traded real estate reacts almost immediately to macro changes such as GDP, inflation, interest rates, or micro changes such as bankruptcy of a tenant, etc. Moreover, public real estate companies are more volatile than private real estate, as market prices are available on a daily basis while private values are not.

Reliable private real estate price or yield data is difficult to obtain for many markets. Therefore, is it not possible to derive absolutely correct results from these figures when doing a comparison between public and private markets. We have concentrated on the US and the UK, representing the private real estate markets for which most reliable data rows exist in our view. For the US private real estate market, we use time series data of National Council of Real Estate Investment Fiduciaries (NCREIF), and for the UK, time series data from the Investment Property Databank (IPD).

Public real estate returns are leveraged, private real estate returns are not

There are two main problems concerning the comparability of private and public real estate markets. The first is that public real estate companies use debt financing to make use of the leverage effect in order to increase RoEs. This is possible if the total return on property exceeds the long-term cost of debt financing, which has historically been the case for most markets including the US and UK. In contrast, private real estate returns are unleveraged. Everything else being equal, this difference will result in too positive a view on real estate companies' performance. From that perspective, public real estate is almost 'obliged' to generate higher returns, only to justify the additional risk taken on by higher leverage.

UK public real estate companies have a tax disadvantage compared with private real estate companies

The second problem occurs if public real estate companies have a tax disadvantage compared with private real estate. Private real estate returns time rows are always net of tax. Thus, when real estate companies are taxed at a company level, the returns they can deliver are automatically compared with private real estate. Corporate taxation takes place in all countries without a REIT structure (including the UK). As a result, we consider that the US delivers the fairest view when comparing private and public real estate performance.

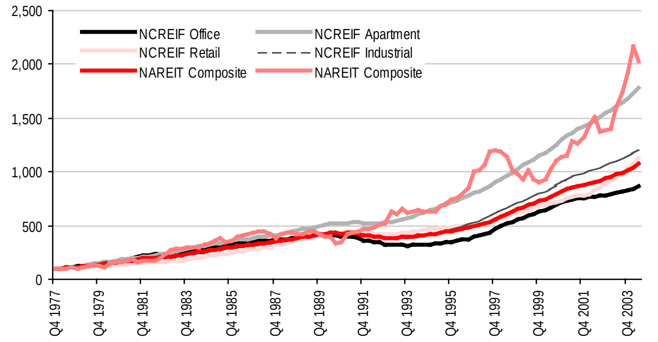
US market performed strongly and better than the private market

US REITs have performed better than the private real estate market in the past

The US real estate market has performed very strongly since 1978. The data we use is provided by NCREIF. We regard NCREIF data as a good approximation of the real estate market in the US although the NCREIF data does not perfectly represent the reality in terms of property category weightings. The public real estate companies are represented by the NAREIT Composite index which tracks the performance of real estate investment trusts (REITs) in the US. From the table below, we see that REITs have outperformed all private property markets since 1978. On average they yielded 12% pa while the private market delivered average returns of 9.4% pa since 1978. The outperformance of 2.6% can be partly explained by the positive leverage effect, which we have described above. Nevertheless, the 12% annual return is remarkable for publicly listed companies.

Characteristics of real estate stocks

Public vs private real estate US market performance



Source: Bloomberg, NAREIT, NCREIF, HSBC Trinkaus & Burkhardt

Average annual returns in the US

	Total return pa
NCREIF Office	8.5%
NCREIF Apartment	11.5%
NCREIF Retail	9.6%
NCREIF Industrial	9.9%
NCREIF Composite	**6.5%**
NAREIT Composite	**12.0%**

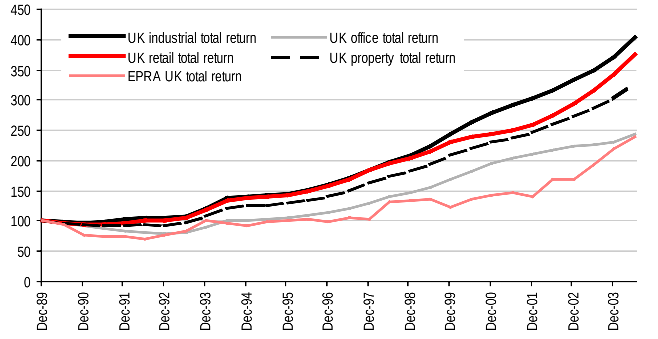
Source: Bloomberg, NAREIT, NCREIF, HSBC Trinkaus & Burkhardt

UK: EPRA Index really lagging?

UK real estate companies lagged the private market because of their high office exposure – the worst-performing sector

In the UK, all private property markets performed better than EPRA UK. In particular, industrial and retail performed very well. Office was left behind as the sector suffered a deep recession in early 1990s. Public real estate represented by the EPRA Index lagged the other indices for almost the whole time period. Only recently has public real estate experienced a huge gain in stock prices in 2002 and 2003. On average they were in line with the private office sector over the period. This makes sense because most companies operate in that sector. Thus we cannot conclude that public real estate is generally worse than its private counterpart. In contrast, we can conclude that public and private move roughly in line.

Public vs private real estate UK market performance



Source: Bloomberg, EPRA, IPD, HSBC Trinkaus & Burkhardt

Average annual returns in the UK

	total return p.a.
UK retail	9.6%
UK office	6.4%
UK industrial	10.1%
UK all property	**8.6%**
EPRA UK	**6.5%**

Source: Bloomberg, EPRA, IPD, HSBC Trinkaus & Burkhardt

Characteristics of real estate stocks

Thesis 7: Real estate stocks are interest rate sensitive

Interest rate increases are bad for real estate, but are usually accompanied by economic growth, which in turn can dampen interest rate effects

The second factor we examine is interest rates. In theory, real estate should be adversely affected by a rise in interest rates because real estate is usually financed with a high degree of debt. When interest rates rise, debt financing becomes more expensive. In order to achieve a given RoE, real estate values have to come down at constant rents. Economic activity, ie growth, usually affects interest rates. Thus, interest rates usually rise when an economy is growing due to a higher demand for capital, increased investment or inflation expectations. In this case, growth causes interest rate increases and lowers real estate prices. On the other hand, growth directly increases the value for real estate, in particular by shrinking vacancy rates and increasing rents. The overall impact of these two effects is highly dependent on the funding conditions (short versus long term) as well as the demand sensitivity for property space according to economic growth.

No significant correlation between rising interest rates and falling real estate stock prices in Europe

In Europe we found a slightly negative correlation between interest rates and real estate stock returns for the 10-year rate (-0.1). On the contrary, the two-year interest rate seemed to have a small positive effect on real estate (0.05). Both correlation factors are insignificant, so we cannot state that interest rates had any influence on property stocks performance.

Significant interest rate effects in the UK

In the UK markets, both correlation factors are negative. Correlation between real estate and the two-year and 10-year yields have been -0.19 and -0.27, respectively. Both correlation factors are significantly different from zero, thus a decrease in interest rates *ceteris paribus* led to a positive return in real estate.

Also In Germany, no significant effects

Unlike the UK and Europe, both results for Germany show a small positive correlation factor. The correlation factor with two-year rates is 0.12; for 10-year rates it is 0.08. Again, both factors are small and we would not consider them significant.

Different borrowing practices in continental Europe and UK might be the reason for significant interest rate influence in the UK

How can different results be explained? One explanation could be the difference in mortgage lending practices between the UK and most other European countries. While fixed rate mortgage lending is generally the standard in Europe floating mortgage rates dominate in the UK. As a result, UK interest rate fluctuations have a stronger impact on real estate markets. Nevertheless, our findings do not fit perfectly with the correlation factors we calculated. We would expect a stronger correlation for the two-year rates and not for the 10-year ones. Even if this was not the case, both correlation factors are close to each other in value, so the important finding is that significance existed at all. If we recall our findings for the gearing ratios of DIMAX and EPRA stocks, DIMAX companies should be more sensitive to interest rates than they in fact are. Our non-significant interest correlation for DIMAX countries is in contrast to this. A possible explanation could be the very weak state of the German real estate market which overcompensated the interest rate effect.

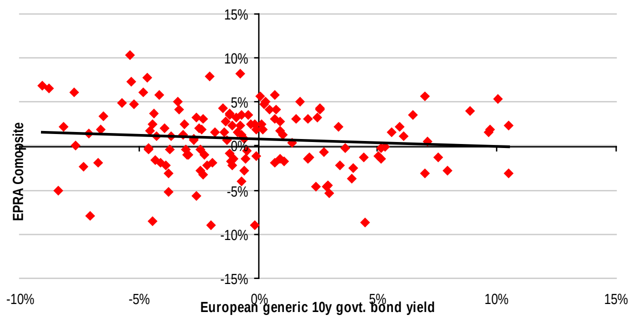
Residential real estate category is more affected by interest rate changes

In our examination, we implicitly excluded the interest rate impact on residential real estate stocks as real estate companies seldom invest in this sector (with the notable exception of AIG International Real Estate). For private investors, however, interest rates and debt repayment burdens play a major role in investment decisions. Thus, results for residential-oriented real estate stocks might be different. In general we would expect residential real estate to react more strongly to interest rate changes. The level of debt taken on by homebuyers is usually

Characteristics of real estate stocks

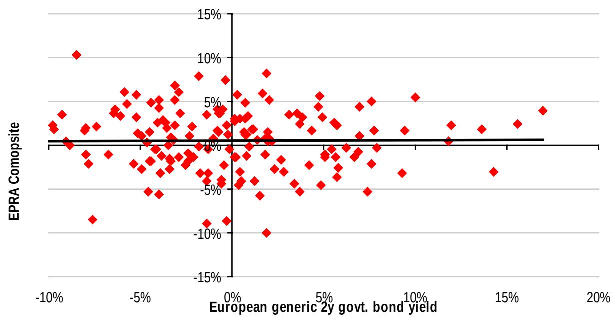
high and the overall demand for living space is more dependent on demographic development and migration trends than on short-term changes in economic activity.

European real estate interest rate sensitivity (long-term rate 10y)



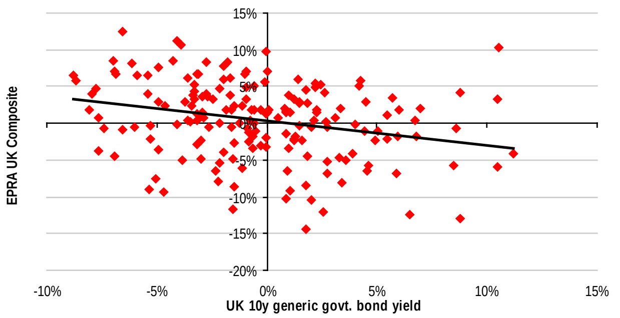
Source: Bloomberg, HSBC Trinkaus & Burkhardt

European real estate interest rate sensitivity (short-term rate 2y)



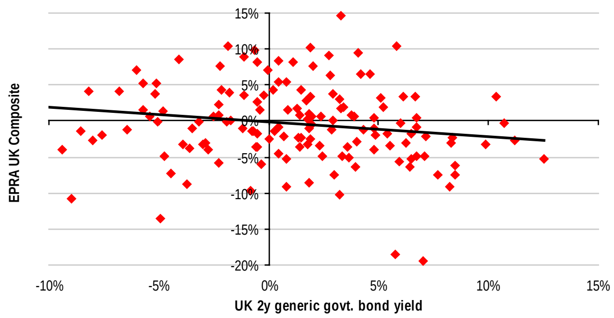
Source: Bloomberg, HSBC Trinkaus & Burkhardt

UK real estate interest rate sensitivity (long-term rate 10y)



Source: Bloomberg, HSBC Trinkaus & Burkhardt

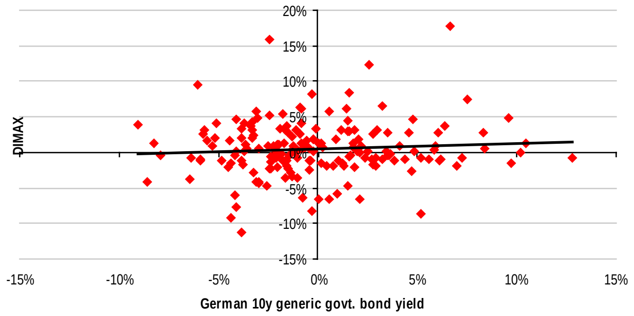
UK real estate interest rate sensitivity (short-term rate 2y)



Source: Bloomberg, HSBC Trinkaus & Burkhardt

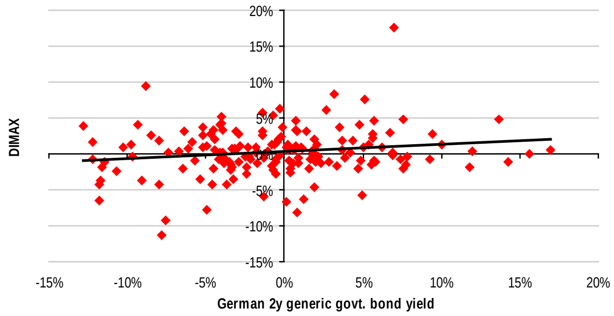
Characteristics of real estate stocks

German real estate interest rate sensitivity (long-term rate 10y)



Source: Bloomberg, HSBC Trinkaus & Burkhardt

German real estate interest rate sensitivity (short-term rate 10y)



Source: Bloomberg, HSBC Trinkaus & Burkhardt

Thesis 8: Property funds enjoy a tax privilege

Common wisdom: property funds are tax privileged

The tax treatment of property investments has always been a point of major interest for German investors. Property investments currently enjoy numerous tax advantages in Germany. These range from the tax exemption of capital gains after a 10-year holding period to special depreciation rules for listed buildings, with the latter being a cornerstone of Vivacon's business model. Germany is a high tax environment for corporates and individuals alike. The marginal income tax rate currently stands at 45% (declining to 42% in 2005). This makes retail investors in particular extremely keen to seek out tax-optimised investment possibilities. A notable example for the success of tax subsidies on the placement of property investments is the special depreciation rates for Eastern German real estate. The related investment inflow was so high that it first inflated property prices in Eastern Germany and later led to their collapse.

Taxation is a focal point of (retail) property investors, as evidenced by the tax-induced distortions on the Eastern German property market

Due to the manifold loopholes in German real estate taxation, we are of the opinion that the sector cannot be analysed without a sound grasp of tax implication on investments. It is widely accepted that property funds (be they open or closed) enjoy tax benefits over listed property stocks as an investment vehicle. The most common argument is that property stocks are subject to double taxation at corporate and investor level, leading to an overall higher tax charge. Open- and closed end funds, on the other hand, are tax transparent, meaning that taxation only takes place at the investor level.

General wisdom is that property stocks are double taxed. Thus, open and closed end funds enjoy a tax advantage

Putting the double taxation thesis to the test

Structure of analysis

In order to understand the tax treatment of property investments, we have executed the following analysis:

Two-layered analysis process

Characteristics of real estate stocks

- We have set up a tax model simulating the taxation of property stocks, open- and closed end funds as the main competitors for indirect property investment money. The tax treatment of property investment vehicles is anything but simple (at least in Germany). Even after attending a KPMG workshop on the issue, we still had to sit down with our own tax department several times in order to ensure that our model works consistently and produces correct results. In this context, we would like to thank Joachim Zimmermann as the head of our tax department for his ongoing support and patience.

1. HSBC T&B model simulating taxation

- As a second step, we look at real life tax rates of the nine leading German listed property stocks in order to double check our model's results.

2. Model results double-checked with real life data

HSBC T&B property investment vehicle tax model

As we have alluded to above, the tax treatment of property investment vehicles is complex, if not chaotic. We have had to make numerous assumptions regarding the location of profits, investment shares, foreign tax rate, scope of trade taxation, etc. To list all our assumptions in detail would go beyond the scope of this paper, but we list the major ones in combination with their assumed impact in the table below.

Main assumptions of HSBC T&B RE investment vehicle tax model

Assumption	Comment
100% payout ratio	Retaining earnings would improve tax situation of private investors in Immo AG*; if held more than one year and reflected in share price capital gains tax exempt; corporate investors would have to pay corporate tax and SolZ on 5% of capital gain irrespective of holding period
Private investor holds less than 1% of Immo AG	Otherwise 50% of capital gains are subject to personal income tax
Income tax progression effect of international income at private investor not considered	Marginally higher income tax charge of fund investments (open/closed)
Corporate investor holding less than 10% of Immo AG	Share of >10% would improve tax situation of corporate investor as no trade tax to be paid
Corporate and private investor treated equally regarding international taxation	Private investors may have lower tax charges and/or tax allowances in many countries
Real estate trade tax preference applicable at Immo AG	If not applicable tax situation of Immo AG investors would be worse
Closed end fund is asset manager only	Not meaningful
Trade tax multiple of 490%	Seems high end of locally differing multiples at present
Other income of corporate investor > trade tax	Leads to positive corporate tax and German SolZ charge at corporate investor level

*Note: * Immo AG is a private or public limited property company*
Source: HSBC Trinkaus & Burkhardt

We have assumed an even split of pre-tax profit regarding domestic and international generation. Furthermore, we have factored in a 4:1 split regarding rental income and capital gains. We have assumed that none of the latter will be tax exempt for any vehicle. Foreign corporate tax is modelled at 30% – lower than in France at 33% but higher than in the Netherlands at c20% (the exact tax rate in the Netherlands is hard to quantify given the standard approach to base profits on 4% of property net market values). In the table below, we list our profit and tax rate assumptions in detail.

Model outcome highly dependent on assumptions

Characteristics of real estate stocks

Tax and revenue assumptions HSBC T&B RE investment vehicle tax model (EURm)

Domestic profit before tax	50	Domestic tax	Rate
Rental income	40	Corporate tax	25.0%
Disposal gains	10	Trade tax	19.7%
o/w tax exempt (>10y holding period)	0	SolZ	5.5%
International profit before tax	**50**	Personal Income tax	45.0%
Rental income	40	**International tax**	**Rate**
Disposal gains	10	Corporate tax	30.0%
o/w tax exempt*	0	Trade tax	0.0%
Total profit before tax	**100**		

*Note: * Required holding period is dependent on country*
Source: EStG, GewStG, KöStG, OECD double taxation treatment model, SolZG, HSBC Trinkaus & Burkhardt

Our base-case assumptions prove the thesis right

The above assumptions seem to prove the thesis that the total tax charge for investors in real estate companies is higher than for fund investments. The total tax charge for a private investor investing in a property stock (which we call Immo AG in the table below) is c6pp higher than an investment in an open- or closed end fund. Under the same assumptions, a corporate investor has a 4pp higher tax charge than an open end fund investment. The tax disadvantage even increases to c11pp compared with a closed end fund investment.

Results of HSBC T&B RE investment vehicle tax model (EURm)

Taxation/investment vehicle	Immo AG*	Open fund	Closed fund
International tax	-15.00	-15.00	-15.00
German trade tax	-	-	-
German corporate Tax	-12.50	-	-
German SolZ	-0.69	-	-
Total taxation	-28.19	-15.00	-15.00
Total tax rate	-28.19%	-15.00%	-15.00%
Distributable profit	71.81	85.00	85.00
Private investor			
Income tax	-16.16	-22.50	-22.50
SolZ	-0.89	-1.24	-1.24
Total taxation private level	-17.05	-23.74	-23.74
Net income	**54.77**	**61.26**	**61.26**
Total taxation	-45.23	-38.74	-38.74
Total tax rate	-45.23%	-38.74%	-38.74%
Corporate investor			
German trade tax	-14.15	-9.85	-
German corporate Tax	2.64	-10.04	-12.50
German SolZ	0.15	-0.55	-0.69
Total taxation corp level	-11.36	-20.44	-13.19
Net income	**60.45**	**64.56**	**71.81**
Total taxation	-39.55	-35.44	-28.19
Total tax rate	-39.55%	-35.44%	-28.19%

*Note: * assuming 100% pay out ratio*
Source: EStG, GewStG, KöStG, OECD double taxation treatment model, SolZG, HSBC Trinkaus & Burkhardt

Life, however, is rarely as simple as a crude model might indicate. The above results depend on the assumption of a 100% payout ratio of Immo AG. If we change this, the picture differs

Characteristics of real estate stocks

completely from the one drawn up above. For the following analysis we assume that 100% of the profits are retained by Immo AG and that retained earnings are 1:1 reflected in the stock price. The latter assumption might be too aggressive short term (especially given that German property stocks are trading at discounts to their NAVs at present) but long term is not unreasonable in our view. Furthermore, we assume that capital gains of the stock are tax-exempt for the private investor, implying a holding period of more than one year. Corporate investors have to tax 5% of capital gains with corporate and trade tax.

Our changed assumptions lead to a tax advantage for property companies compared with open and closed funds, which seems to contradict the double-taxation thesis. The detailed results are shown in the table below.

Results of HSBC T&B RE investment vehicle tax model (EURm)

Taxation/investment vehicle	Immo AG*	Open end fund	Closed end fund
International tax	-15.00	-15.00	-15.00
German trade tax	-	-	-
German corporate Tax	-12.50	-	-
German SolZ	-0.69	-	-
Total taxation	-28.19	-15.00	-15.00
Total tax rate	-28.19%	-15.00%	-15.00%
Distributable profit	71.81	85.00	85.00
Private investor			
Income tax		-22.50	-22.50
SolZ	-	-1.24	-1.24
Total taxation private level	-	-23.74	-23.74
Net income	**71.81**	**61.26**	**61.26**
Total taxation	-28.19	-38.74	-38.74
Total tax rate	-28.19%	-38.74%	-38.74%
Corporate investor			
German trade tax	-0.71	-9.85	-
German corporate Tax	-0.72	-10.04	-12.50
German SolZ	-0.04	-0.55	-0.69
Total taxation corp level	-1.47	-20.44	-13.19
Net income	**70.34**	**64.56**	**71.81**
Total taxation	-29.66	-35.44	-28.19
Total tax rate	-29.66%	-35.44%	-28.19%

*Note: * assuming 0% payout ratio*
Source: EStG, GewStG, KöStG, OECD double taxation treatment model, SolZG, HSBC Trinkaus & Burkhardt

Characteristics of real estate stocks

A glance at real life taxation

Overview of RE company tax rates 2003 (EURm)

Company	PBT	Income tax	Other tax	Total tax	Income tax/PBT	Total tax/PBT
B&L Immobilien	N/M	N/M	N/M	N/M	N/M	N/M
Deutsche Euroshop	6.5	-7.8	-0.9	-8.7	120.0%	133.8%
Deutsche Wohnen	19.9	-9.2	-	-9.2	46.2%	46.2%
DIB	18.9	-0.3	-2.8	-3.1	1.6%	16.4%
GBW	16.5	-1.2	-0.9	-2.1	7.3%	12.7%
GBH	13.2	-0.9	-1.0	-1.9	6.8%	14.4%
Harpen	23.9	-0.6	-	-0.6	2.5%	2.5%
IVG	99.8	-20.8	-12.6	33.4	20.8%	33.5%
RSE	148.5	0.6	-3.9	-3.3	-0.4%	2.2%
Total/average*	**347.2**	**-40.2**	**-22.2**	**-62.4**	**11.6%**	**18.0%**

*Note: * We have excluded companies with negative pbt from our analysis*
Source: Company data, HSBC Trinkaus & Burkhardt

Tax rates of property vary substantially…

In order to double-check the above results, we have also looked at the tax charges of leading listed property companies for 2002 and 2003. We found that tax charges vary substantially ranging from 2.2% for RSE to 140% for Deutsche Euroshop. The latter is, however, predominantly driven by the build-up of deferred taxes on capital gains within its group accounts. The effective tax rate is practically zero according to company. The average tax charge stood at 12% in 2003 and 23% in 2002. Both numbers are substantially below the tax rate of 28% calculated by our model.

Obviously real estate companies already operate with a high degree of tax optimisation measures. We consider the investment via investment holding companies as one of the more important tax measures. This would in effect mean that capital gains from selling the investment vehicle instead of the property itself would be 95% exempt from corporate and trade tax.

Overview of RE company tax rates 2002 (EURm)

Company	PBT	Income tax	Other tax	Total tax	Income tax/PBT	Total tax/PBT
B&L Immobilien	5.4	-0.7	0.0	-0.7	13.0%	12.9%
Deutsche Euroshop	4.8	-6.9	-0.8	-7.7	143.8%	160.4%
Deutsche Wohnen	19.4	-6.0	-	-6.0	30.9%	30.9%
DIB Industriebau	25.2	-0.3	-2.9	-3.2	1.2%	12.7%
GBW-	6.2	-0.1	-1.1	-1.2	1.3%	19.0%
GBH	11.3	-0.8	-1.0	-1.8	7.1%	15.9%
Harpen	38.7	-10.9	-	-10.9	28.2%	28.2%
IVG	111.0	-26.2	-14.5	-40.7	23.5%	36.6%
RSE	N/M	N/M	N/M	N/M	N/M	N/M
Total/average*	**222.1**	**-51.9**	**-20.4**	**-72.3**	**23.4%**	**32.5%**

*Note: * We have excluded companies with negative pbt from our analysis*
Source: Company data, HSBC Trinkaus & Burkhardt

…but are on average much lower than the average for DAX and MDAX stocks

The tax rates of listed real estate stocks also compare very favourably with the average for listed German companies of 32% and 33% for 2002/03 (see table below). The ‘Five Economy Sages’, an advisory committee to the German government, have even calculated

Characteristics of real estate stocks

a tax rate of 36% for German companies in 2003/04. Thus, real estate stocks already seem to enjoy a certain degree of tax benefits compared with the average German stock.

Tax rates* of DAX and MDAX stocks

	2001	2002	2003
DAX	33.6%	34.8%	31.0%
MDAX	29.5%	31.9%	35.9%
DAX + MDAX**	**29.5%**	**32.3%**	**33.4%**

*Note: * Calculated as median, ** unweighted average*
Source: JCF, HSBC Trinkaus & Burkhardt

Conclusions of our tax model

Our base case supports the general wisdom that open and closed funds enjoy tax advantage over (listed) real estate companies. Among other things the tax advantage of funds increases with:

- Rising payout ratio of the property stock (Immo AG),
- Rising share of (lower taxed) foreign profits, and
- Rising share of tax-exempt profits, eg capital gains, (at the funds)

Tax disadvantage reverses if Immo AG retains profits

The above result is, however, crucially dependent on the assumption of a high payout ratio of the property stock. For most cases, the tax disadvantage can be converted in a tax advantage if profits of the Immo AG are retained.

Real life tax rates indicate tax advantage over other industries

As our tax model does not consider a number of tax-optimisation measures, it generates tax rates that are higher than tax rates we found for leading listed property stocks. As the latter are much lower than the average DAX and MDAX rates, the listed property sector already enjoys a tax privilege with other industries.

Public real estate companies compared with funds

Characteristics of public real estate, private real estate and property funds are very different

So far, we have described real estate companies in detail. It is interesting to compare them with other indirect investment vehicles like closed-end and open-end property funds. Since there are so many differences, we prefer to focus on what we believe to be the most important factors. We summarise our findings in the following table.

Characteristics of real estate stocks

Overview of main indirect real estate investment vehicles

Category	Direct investment	Closed-end fund	Open-end fund**	Listed real estate company
Legal vehicle	N/A	GbR, KG	Separate estate	plc (AG)
Legal basis	N/A	N/A	InvG, KWG, KAGG	AktG, HGB, IAS
Valuation of property	Not required	Not required	At least annually	Annually/quarterly/monthly
Fees*	c10% (agent, lawyers, transfer tax)	c5% front load plus up to 10% additional soft costs	5% front load + c0.75% management fee	c1% per transaction, lower at direct banks, IPO costs reduce NAV
Regulator	N/A	Na/BaFin from July 2005	BaFin	BaFin, Deutsche Börse
Legal (tax) income type	Rental income	Rental income	Capital income	Capital income
Minimum investment	High	Medium	Low	Low
Market size	Very large	Large	Large	Small
Investors	Private, institutional	Private, institutional	Private, institutional	Private, institutional
Diversification requirements	Not required	Not required	Required	Not required
Investment time horizon	Long term	Long term	Mid to long term	Short to mid term
Risk	Very high, only one property	High, limited number of properties	Low, diversification possible and frequent	Medium, diversification possible but higher volatility due to listing
Liquidity	Extremely low	Low/stake in financing can be sold, fund managers often help but high discounts is usual	High (but artificial), funds can be returned anytime	Medium to low (for German real estate stocks) increases with market cap
Quotation	N/A	No quotation, sometimes 'grey market'	Daily bid/ask quotes	Continuously on stock market
Income generation at vehicle	Rents and capital gain final sale of property	Rents and capital gain final sale of property	Rents, capital gains on sale of properties	Development, rents, capital gains on sales
Taxation	Full transparency, taxed at investor level, losses can be netted against other income	Full transparency, tax exempt on fund level/losses can be netted against personal income at investor level	Transparency, tax exempt on fund level, taxation at investor level, losses cannot be netted	No transparency, taxation at corporate and investor level
Gearing	Limited by overall credit worthiness of investor	No limit, usually 50%	50%	Limited by credit worthiness of company
External (analyst) coverage	No	Extremely limited	Limited but increasing	Yes
Regular reporting	N/A	Depending on fund manager, only for investors	Low, annual report	High (quarterly and audited annual report)
Investment object	Individual real estate	Stake in a partnership	Stake in a fund	Stake in a corporation
Liability	Unlimited	KG: limited to capital contribution, GbR: jointly and severally liable	Limited to participation value	Limited to market value
Co-determination	Full decision competence	Limited regarding investors' meeting	None	Limited regarding AGM
Typical investment for...	Tax-driven real estate investors who want to invest much and have real estate know-how	Tax-driven real estate investors seeking a long-term investment in real estate	Payout-oriented investor interested in stable performance	Risk-conscious investor interested in real estate

*Note: * HSBC estimates, ** not covering specialty funds*
Source: div., HSBC Trinkaus & Burkhardt

Real estate investment trusts

Real estate investment trusts worldwide

REIT structures have similarities concerning taxation and dividend payout

Real estate investment trusts (REITs) are established in many countries across the world, with more countries expected to introduce such structures in the near future. Although REIT legislation differs from one country to another, some elements of legislation are similar or even identical. The introduction of REITs is generally driven by a number of fairly standard goals: (1) to boost the real estate market, (2) to allow small individuals to participate in real estate investments, or (3) to increase capital gains tax income from property transactions.

All REIT structures worldwide are subject to regulations for which they are compensated with benefits. This can be best described as 'carrot and stick' legislation. The 'carrot' is that corporates that become REITs or similar entities enjoy tax advantages over other corporates. This can manifest itself in one of two ways: either through a general tax exemption for the REIT or a deductibility of dividends from taxable income of the REIT – both on a company level. The intention behind this is to only tax investors' dividend income.

Worldwide REIT structures

Established	Under consideration
Australia	Finland
Belgium	Germany
Canada	Greece
France	Italy
Hong Kong	Philippines
Japan	UK
Malaysia	
Netherlands	
New Zealand	
Singapore	
South Korea	
Taiwan	
Thailand	
Turkey	
USA	

Source: EPRA, HSBC Trinkaus & Burkhardt

There are more sticks than carrots in this scenario, with many unique to their respective jurisdictions. However, similarities do exist. For instance, the main business activity of a company wishing to be awarded REIT status is usually ownership and operation of real estate properties. A second similarity of REIT structures is a high dividend payout ratio. It is usually the case that a REIT is obliged to pay out a high share of earnings in the form of dividends to its shareholders.

Unfortunately, similarities are few and differences many. For example, an activity permitted by one country's REIT legislation may be prohibited in another country. Development operations are such an activity: some countries allow them (eg France), some limit them (eg Belgium) and others completely prohibit them (eg the Netherlands). Another difference is the ratio of leverage REITs are allowed to have. Some governments (eg Hong Kong) reveal their desire for safety with relatively strict leverage constraints, while others (eg France) focus on flexibility, resulting in an unregulated leverage ratio. In some countries (eg the US) capital gains may be taxed, in others (eg Australia) they are subject to partial taxation, while in others (eg Hong Kong) they are not taxed at all. A further difference is the requirement of an exit tax that a REIT has to pay in most countries on real estate reserves.

Differences concern shareholder structure, pay-out, and foreign activity restrictions

Other differences include the type of management (internal versus external) required, shareholder structure, minimum payout levels (how much pay out on what?), and foreign activities restrictions. As the description of all differences is beyond the scope of this paper, we summarise the most relevant factors of selected REIT structures in the tables below.

Real estate investment trusts

Worldwide REIT structures

	Netherlands	Belgium	France	US	Canada
Name	BI	SICAFI	SIIC	REIT	MFT
Introduction	1969	1995	2003	1960	1994
Tax law	Article 28 Corporate Tax Act	Royal Decree	2003 Budget Law	IRC §§856-860	Income Tax Act
Legal form	Public limited (liability) company (NV), private company with limited liability (BV) or a unit trust/mutual funds, entity must be resident in the Netherlands	Limited liability company or a limited partnership, company must be resident in Belgium	SA (corporation) and SCA (limited partnership by shares). Must be listed in France	Corporate (67%) or business trust (33%)	Mutual fund trusts
Share capital	Minimum share capital for a BV is EUR18,000 and for an NV is EUR 45,000	Minimum share capital is EUR1.25m	Minimum share capital is EUR15m	N/A	N/A
Treatment of domestic shareholders (max/min of shareholders)	Max 45% of the share capital may be held by a single entity, Max 25% may be held directly by a single non-resident share-holder and max 25% indirectly by resident shareholders through non-resident entities	No restrictions	No restrictions	Min 100 shareholders, have no more than 50% of its shares held by five or fewer individuals during the last half of the taxable year	>150 unit holders each having a stake with a fair market value of >CAD500, for residents only
Mandatory listing on stock exchange	None	Mandatory listing, IPO must include a 30% public offering	Parent company must be listed on a French stock exchange	None	Must be listed to avoid having the units redeemable at the demand of the holder
Asset level/ activity test	The exclusive activity must be passive investment in real estate	Main activity must be (passive) investment in real estate, <20% of assets can be invested in one project, by-laws may provide that SICAFI can additionally invest in securities and hold cash	Passive investment in real estate is a must, other activities allowed, but <50% of company's gross assets, development, brokerage, etc allowed but < 20% of assets.	>75% of assets in real estate*, cash and government securities, >75% of income from real estate property rents or interest on mortgages, >95% of income from above + passive sources (non-mortgage interest and dividends), < 20% of assets in TRS**	Must invest funds in property, the acquiring, holding, maintaining, improving, leasing or managing of any real property (or interest in real property) that is capital property of the trust, or any combination of the foregoing activities
Leverage	60% of fiscal book value of real property and 20% of fiscal book value of all other	50% of assets at the time when the loan agreement is concluded	Unlimited	Unlimited	Unlimited
Distribution on operative income (profit distribution obligations)	100% of taxable profit	80% of net profit	85% of the profit resulting from leasing of real estate, 100% of dividends received from a SIIC subsidiary	At least 90% of taxable income (in form of dividends)	if 100% then tax free
Distribution on capital gain on disposed investments (profit distribution obligations)	Capital gains/losses are allocated to a tax-free reserve, not a part of the taxable profit	Capital gains remain tax-free and are not included in the distribution obligation, provided capital gains are reinvested within four years	50% of capital gains from the disposal of either real estate or shares in real estate partnerships or subsidiary	Not required but to the extent the capital gains are not distributed corporate income tax is due	100%
Timing (profit distribution obligations)	Within eight months after the close of the financial year	Distribution must take place annually	Rents within 12 months, capital gains within 24 months	Distribution must take place annually	All income must be paid or payable in the taxation year of the MFT

*Note: * Real Estate; ** Taxable REIT subsidiary*
Source: EPRA Global REIT Survey, Ernst & Young, KPMG, NAREIT, National Jurisdictions, HSBC Trinkaus & Burkhardt

Real estate investment trusts

Worldwide REIT structures (cont'd)

	Netherlands	Belgium	France	US	Canada
Income (tax treatment at REIT level)	Real property income forms part of the taxable profit and is taxed at 0%	In principle subject to the standard corporation tax rate (33.99%), but the qualifying real property income is excluded from the taxable basis	Exemption from CIT for eligible activities. Non-eligible activities are taxed at the rate of 33.33% increased to 35.43% by surcharges	Dividends are deductible from taxable income. A REIT pays corporate income tax to the extent it retains income	Taxed as individual on its worldwide income from all sources (capital and gains), dividends deductible from income
Capital gain (tax treatment at REIT level)	Capital gains/losses are allocated to a tax-free reserve and are thus exempt from tax	Capital gains are not included in the taxable profit provided they are at arm's length	Capital gains belonging to the eligible activities and duly distributed are exempt from CIT	To the extent the capital gains are distributed to the REIT's shareholders in the form of dividends, these may be deducted from taxable income	50% of capital gains are included in income and 50% of a capital loss can be applied to offset taxable capital gains
Withholding tax (tax treatment at REIT level)	25%, which may be reduced pursuant to a double taxation treaty	15% dividend withholding tax, which may be reduced pursuant to the application of tax treaties	25% dividend withholding tax which may be reduced pursuant to tax treaties to 15%, 5% or 0%	No withholding to US shareholders. 30% to non-US shareholders, 35% withholding rate on REIT capital gain distributions to non-US shareholders	None for residents of Canada, 25% tax on non-resident income
Exit tax (conversion into REIT status)	Step-up of all assets/ liabilities to market value. The 'built-in' capital gain is subject to CIT at normal rate. Tax-free reserves also taxable	All unrealised capital gains of normal real estate will be taxed at a reduced corporate tax rate (20.085%)	16.5% exit tax on unrealised gains, paid over four years, tax losses carried forward are deductible from the exit tax basis	CIT on the excess of the assets' fair market value over their tax basis. Tax is eliminated if the REIT holds the property for >10 years, all accumulated profits generated before it becomes a REIT must be distributed to the shareholders no later than the end of the REIT's first taxable year	For a trust no tax payable
Registration duties	0.55% on capital contributions, taxable basis is the higher of fair market value and the nominal value, 6% real property transfer tax if the BI itself acquires or disposes of real property and/or shares in real property companies	10% or 12.5% real property transfer tax if the SICAFI itself buys real estate. 10% or 12.5% apply for the buyer if the SICAFI sells real estate	No proportional capital duty on capital contributions. Transfer tax at 4.80% on acquisition of real estate or acquisition of share in an unlisted real estate oriented company	Most states apply transfer taxes on acquisitions of real estate	Some provinces impose a transfer tax on the acquisition of real estate payable by the purchaser, for instance, the rate in Ontario is 1.5% of the value of the consideration
Overseas assets	Allowed	Not allowed	Allowed	Allowed	Allowed
Development	Prohibited	Developments are allowed, but cannot be sold within five years of completion	Allowed	Allowed for own portfolio, development for 3rd parties taxed in the TRS	Allowed
Management type	Internal & external	Internal & external	Internal	Internal & external	Internal
REIT status for foreign investors in domestic market	No	No	Yes	Yes	N/A

Source: EPRA Global REIT Survey, Ernst & Young, KPMG, NAREIT, National Jurisdictions, HSBC Trinkaus & Burkhardt

Real estate investment trusts

Worldwide REIT structures (cont'd)

	Australia	Hong Kong	Japan	Singapore
Name	(Public) Unit Trust, Equity Law, Public Trading Trust Regime	REIT	REIT	SREIT
Introduction	1985	2003	2000	2002
Tax law	Income Tax Assessment Act		Investment Trust Law	N/A
Legal form	Resident/non-resident (public) unit trust	Unit trust domiciled in Hong Kong	Trust or corporation	Trust or corporation
Share capital	No minimum capital requirements	No minimum capital requirements	Minimum capital required for corporate type is JPY100m	N/A
Treatment of domestic shareholders (max/min of shareholders)	No restrictions	No restrictions	At least 1,000 shareholders before listing	At least 500 shareholders
Mandatory listing on stock exchange	No	Yes	No, if desired then listing requires: >JPY5bn assets, >1,000 investors, >75% assets invested in real estate, >50% in income-generating assets	Yes
Asset level/ activity test	Public unit trusts investing in land must do so for the purpose, or primarily for the purpose, of deriving rent, public unit trusts that carry on a trading business are not accorded 'flow through' treatment	Investment in Hong Kong real estate only, real estate must generally be income-generating, the REIT is required to hold each property (or the property holding SPVs) for a period of at least two years	Investments only in 'qualified assets', including negotiable securities, real estate, monetary debts, trust beneficiary rights, interest in silent partnerships (tokumei kumiai)	>70% of funds should be invested in real estate and real estate related assets
Leverage	Unlimited, subject to general principles (eg thin capitalisation rules)	Aggregate borrowings shall not exceed 35% of the total gross assets	Unlimited	Total borrowings should not exceed 35% of deposited property
Distribution on operative income (profit distribution obligations)	Distribution of 100% of trust's income	90% of its audited annual net income after tax	More than 90% of distributable income	90% of taxable income
Distribution on capital gain on disposed investments (profit distribution obligations)	Distribution of 100% of capital gains realised on disposal of property, 50% CGT discount may be available	90% of its audited annual net income after tax, trustee has discretion if capital gains to account for net income or not	More than 90% of distributable income	No requirement
Timing (profit distribution obligations)	Beneficiaries must be presently entitled to the trust's income at year-end, ie distribution must occur annually	Annual distributions	Business year	Semi-annually (in practice)

Source: EPRA Global REIT Survey, Ernst & Young, KPMG, NAREIT, National Jurisdictions, HSBC Trinkaus & Burkhardt

Real estate investment trusts

Worldwide REIT structures (cont'd)

	Australia	Hong Kong	Japan	Singapore
Income (tax treatment at REIT level)	Certain types of income may be subject to tax in the hands of the trustee where the income is attributable to non-resident unit holders and is Australian sourced	REIT is ordinarily subject to property tax for property held directly, dividend income from SPVs is tax exempt from profits tax	J-REIT is subject to tax but distributions are deductible	Not taxable at trustee level to the extent of taxable income distributed
Capital gain (tax treatment at REIT level)	Like ordinary income, 50% CGT discount may be available	No CGT	Tax treatment similar to current income	No CGT
Withholding tax (tax treatment at REIT level)	Dividend and interest paid to non-resident unit holders is subject to withholding tax	None	General 7%, local tax rate 3%	70% on distributions to non-qualifying unit holders, eg non-resident corporate unit holders
Exit tax (conversion into REIT status)	N/A	There is no specific transition regulation in Hong Kong governing the transformation of a corporation to a REIT	If appreciation in the assets prior to the transfer to the J-REIT, gains are taxable	The transferor is subject to normal tax treatment on gains realised from the transfer, ie they are taxed as ordinary income if determined to be trading gains and not taxed if they are capital gains
Registration duties	No duty on capital contributions, stamp duty of up to 6.75% of the higher of market value or consideration paid on the transfer of property or transfer of units in unlisted property trusts, listed trusts – no duty on transfers of units	Transfer of real estate into a REIT subject to stamp duty at a max of 3.75% if >HKD6,720,000, if the REIT acquires the shares in an SPV holding the real estate, the transfer of the shares, if they are regarded as Hong Kong stock, will be subject to stamp duty at the rate of 0.2%	Registration tax is imposed on the increase of capital in J-REIT regardless of the amount of capital increase, acquisition tax, registration tax, and various surtaxes are levied	There is no capital duty on capital contributions into an S-REIT. However, an S-REIT has to pay stamp duty at c3% of the consideration for acquisition of real estate
Overseas assets	Allowed	Prohibited	Allowed	Allowed
Development	Allowed	Prohibited	OK (but >50% of assets must be income producing)	20% of total assets
Management type	External (internal through stapled structure)	External	Internal	External
REIT status for foreign investors in domestic market	N/A	N/A	N/A	N/A

Source: EPRA Global REIT Survey, Ernst & Young, KPMG, NAREIT, National Jurisdictions, HSBC Trinkaus & Burkhardt

Real estate investment trusts

The US real estate investment trust regime

The US – the leading REIT market

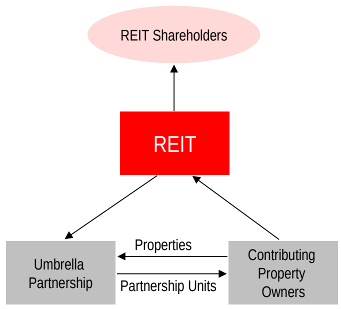
The US REIT market is the oldest in the world

The well-established US market is the oldest REIT market in the world. For this reason, below we provide an overview of its structure, development and performance. Put simply, a US REIT is an entity involved in real estate activities subject to special regulations and requirements that enable it to benefit from favourable taxation regulations.

The conditions that a corporate has to meet in order to receive REIT status in the US are many. First, the company must be a limited company (listed or private) or a similar association. Second, its shares must be fully transferable. Third, a REIT is obliged to prove it has more than 100 shareholders at the beginning of its second taxable year. This condition is the so-called 'shareholder test'. Another test is the '5/50' test whereby a company must prove that the five largest individual shareholders do not hold more than 50% of the shares in the second half of its fiscal year. In terms of a REIT's management, it can be managed internally by a board of directors or externally by trustees.

A company must be involved mainly in real estate operations. At least 75% of its assets have to be invested in real estate or real estate related forms such as property ownership or mortgage-backed loan lending, and 75% of its gross income must be generated from these activities. In addition, only up to 20% of the assets may be invested in taxable REIT subsidiaries (TRS). A TRS is a subsidiary of a REIT involved in operations such as third-party management and development. Such activities do not qualify as REIT activities and are therefore fully taxed at the subsidiary level. The final, and for investors the most relevant, restriction is the obligation to distribute at least 90% of the REIT's taxable income.

Up-REIT structure

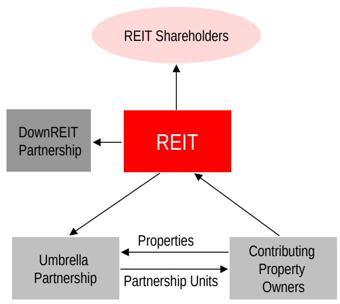


Source: NAREIT, HSBC Trinkaus & Burkhardt

A company meeting all these requirements may become a REIT (or preserve its REIT status), a structure that allows it to deduct dividends paid to its shareholders from usually taxable income. For instance, a REIT paying out 90% of its taxable income may deduct this amount from the tax base and only pay corporate taxes on the remaining 10%. As a result, many REITs pay out as much as they can in dividends and lower the tax base to zero.

According to the National Association of Real Estate Investment Trusts (NAREIT), three different REIT structures exist. The traditional structure is a REIT, which directly owns the property. The second structure is called an 'Up-REIT'. Up-REITs are limited partnerships in which the REIT acts as the general partner. An operating partnership is formed out of the existing partnerships and the REIT. For their respective interests in the operating partnership, the partners bring in the properties and the REIT the proceeds from the IPO. The REIT is typically the majority owner of the operating partnership. The third structure is the so-called "Down-REIT". A Down-REIT differs from an Up-REIT in that the REIT holds properties directly in addition to having an interest in the partnership.

Down-REIT structure



Source: NAREIT, HSBC Trinkaus & Burkhardt

Real estate investment trusts

History and characteristics of US REITs

Strong growth of REITs since 1993 for a number of reasons

REITs were launched as a new investment vehicle in the US in 1960. Until 1986, when Congress passed the Tax Reform Act, the market for REITs had been small with a total market cap of less than USD10bn. However, since 1993, REITs have grown significantly. Below we outline the main reasons for the growing success of REITs in the era after the Tax Reform Act in 1986.

(1) Disappearance of tax shelter for private real estate

- Prior to 1986, private real estate had been used as a tax shelter. The Tax Reform Act almost abolished this opportunity and investors began to focus on the income generation ability of real estate. REITs were the main vehicle to profit from this because they offered attractive income prospects

(2) Tax Reform Act of 1986

- The Tax Reform Act also allowed REITs to manage their assets internally. Prior to 1986, REITs had been owners of properties but had to rely on external management operating them. The management of the properties internally was the key point of an efficient managed property portfolio

(3) Depression in the real estate sector in early 1990s

- The depression in the real estate industry in early 1990s forced banks and financial institutions to shrink debt financing to the real estate industry. As a result, REITs had to turn their focus to the capital markets. In addition, REITs traded at a premium to NAV in 1993, which facilitated equity financing

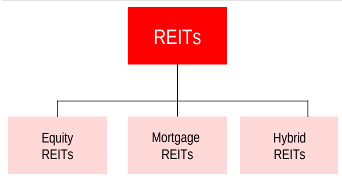
(4) Inception of Up-REIT structure

- The inception of the Up-REIT structure in 1993 allowed a tax-free transfer of property into a REIT, enforcing the growth in REITs. Unlike a cash sale of property (attracting capital gains tax), the transfer of property into a REIT allowed property holders to postpone paying capital gain taxes

(5) Approval of pension funds to invest in REITs

- Since 1993 pension funds have been allowed to invest in REITs

REIT structures



Source: NAREIT, HSBC Trinkaus & Burkhardt

REITs can be split into public, non-exchange traded, and private REITs. Basically, public REITs do not differ from other listed companies in terms of reporting obligations and other requirements. The publicly traded REITs file with the SEC, publish reports quarterly and are usually self-advised and managed. Non-exchange traded REITs are required to have a majority of independent members and also report to the SEC, albeit to a more limited extent. They are usually managed externally. Finally, private REITs are unregulated and are neither forced to report to the SEC nor required to be run by independent directors. At present, there are around 187 publicly traded REITs, 20 listed non-exchange traded REITs, and 800 private REITs.

Publicly-listed REITS: equity, mortgage and hybrid

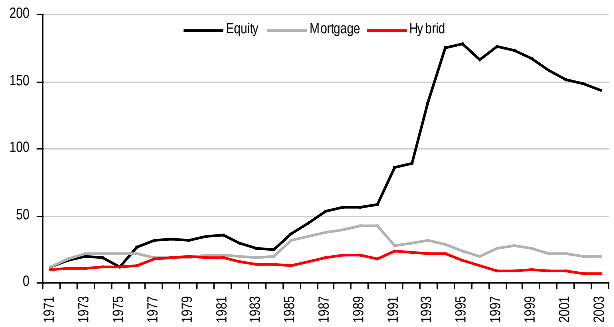
Given that availability of data for the public sector is much better than for the private sector, we concentrate on the first one. The public (ie publicly listed REIT universe) can be split into three main groups: equity, mortgage and hybrid. While equity REITs manage real estate assets by generating rent income form tenants, mortgage REITs are involved in commercial and home financing. Mortgage REITs finance real estate investments and earn interest income. Combining these two styles, hybrid REITs are involved in either owning and managing property and commercial and home financing.

Real estate investment trusts

Market dominated by equity REITs

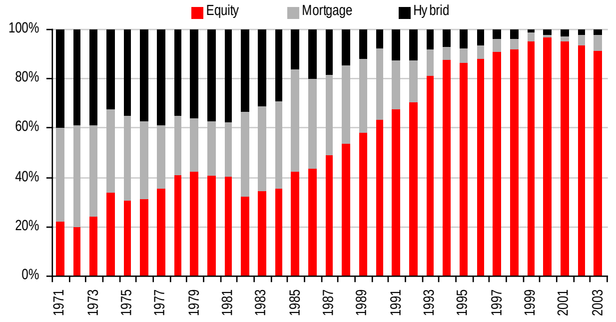
While in the 1970s, the composition of these three groups was more or less well balanced, the dominance of equity REITs in numbers and market cap outpaced the others in the 1980s and outnumbered mortgage and hybrid structures fivefold last year. During the 1980s, the relevance of hybrid REITs shrank. The same happened to mortgage REITs a decade later. Among all the REIT copycats internationally that followed the US model, we are not aware of any that has included mortgage or hybrid REITs.

No. of REITs by segment



Source: NAREIT, HSBC Trinkaus & Burkhardt

Market cap by segment in %



Source: NAREIT, HSBC Trinkaus & Burkhardt

Total REITs market cap of USD275bn by end-September 2004, with an average market cap of USD1.5bn

Splitting the three sub-sections of equity, mortgage and hybrid into industry groups reveals some interesting findings about the numbers and market caps within the publicly listed REIT universe. By 30 September 2004, there were 187 REITs listed in the US with a total market cap of USD275bn (ie average market cap per REIT of USD1.5bn). Thus, the US real estate companies are much bigger than their German counterparts like IVG, which as the biggest real estate company has a market cap of only EUR1.0bn.

US REITs are big and liquid enough to meet investors demand

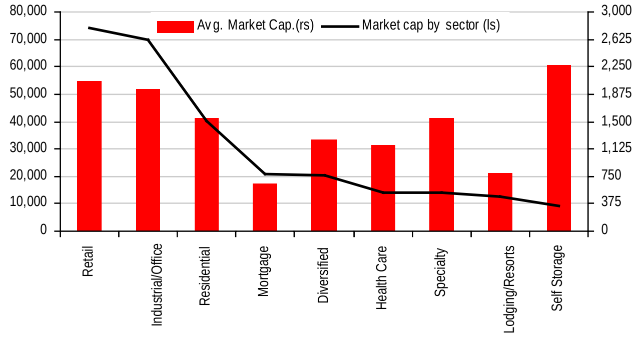
Within the REIT universe, retail and office REITs were the most important in the industry, with an average size of USD2bn. Although these two groups account for only 58 of 178 of all publicly traded REITs, a market cap of over USD126bn equates to more than 40% of the total market. Unlike German real estate companies, US REITs are big and liquid enough to meet investors demand. The fact that REIT market cap has grown steadily over the past 10 years while the number of REITs has fallen by c30% can be explained by M&A activity and capital offerings. In addition, favourable development of real estate prices and appreciation of REIT stock prices compared to their net asset value have played a major role.

REITs usually specialise in a single property category

Over the years, REITs have built out different investment strategies. Most commonly, REITs specialise in a single property category. In this respect, most REITs can be categorised into those investing in office, industrial, residential, retail or other property types. In addition, most REITs restrict their activities to certain regions. Thus, most REITs are highly geared to one category and a certain region, leaving portfolio decisions to the investor. A select group of REITs is however seeking scale advantages by aggressive acquisitions and growth. The most prominent example is the largest US REIT, Equity Office Properties Trust. As this group of REITs is moving across the country, it is also geographically more diversified. Scale advantages are targeted to come from improved procurement conditions for building supply, refurbishment, development, etc.

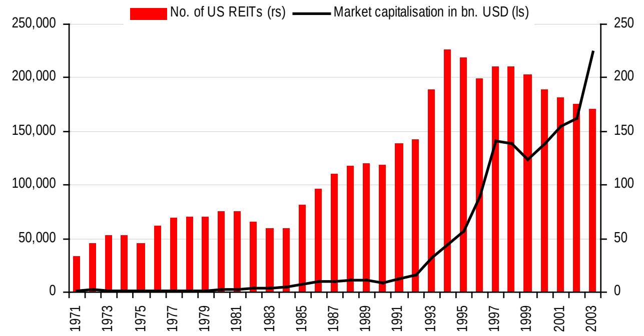
Real estate investment trusts

US REITs split by sector (in USDm)*



*Note: * as of 30 September 2004*
Source: NAREIT, HSBC Trinkaus & Burkhardt

Market cap and no. of US REITs



Note: as of 31 December 2003*
Source: NAREIT, HSBC Trinkaus & Burkhardt

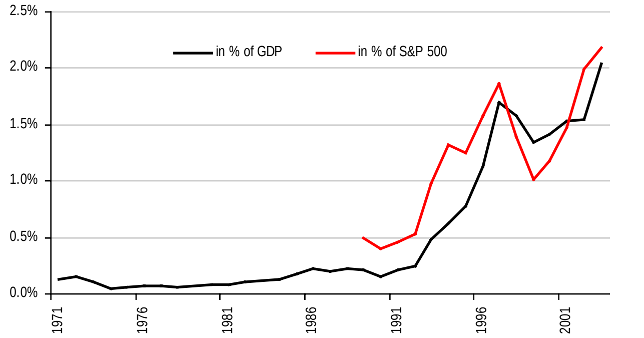
Long-term underperformance of REITs since 1972 to the S&P 500 but outperformed since 1993

A look at the historical performance of REITs reveals an underperformance compared with the S&P 500 on a total return basis starting on 1 January 1972. On this basis, the NAREIT Composite lagged the S&P 500 yielding 10.3% pa vs the S&P on 11.2% pa. If we exclude the pre-1993 period from the sample and concentrate on the development since 1993, REITs returned an average of 12.9% pa vs the S&P 500 with 10.4%. In terms of the evolution of both indices, the NAREIT Composite performed in line with the S&P 500 until 1988, but as the stock market continued to rally, REITs were unable to keep up.

REIT market cap stands at c2.5% of GDP and S&P 500 market cap

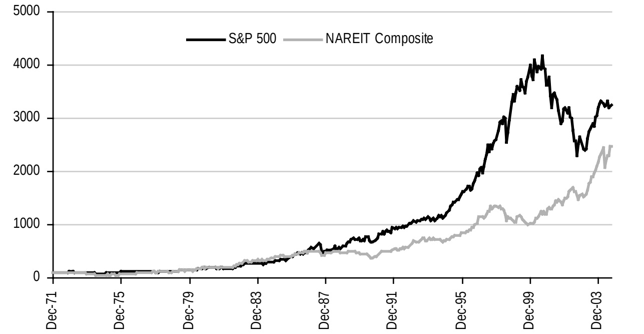
Comparing REIT market cap to figures like GDP or the market cap of the S&P 500 reveals that the importance of REITs has risen significantly over the past 10 years. At present, it amounts to c2.5% of GDP and S&P 500, respectively. During recent years, REITs have sometimes developed contrarian to other equities. In the period 1998/99, REITs suffered losses whereas the S&P rose. In 2000-03, REITs doubled their market cap, whereas the S&P 500 suffered massive losses.

Market cap of US REITs vs GDP/S&P*



*Note: * as of 31 December 2003*
Source: Bloomberg, NAREIT, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Performance of US REITs vs S&P 500*/**



*Note: * total return indices, ** as of 30 September 2004*
Source: NAREIT, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

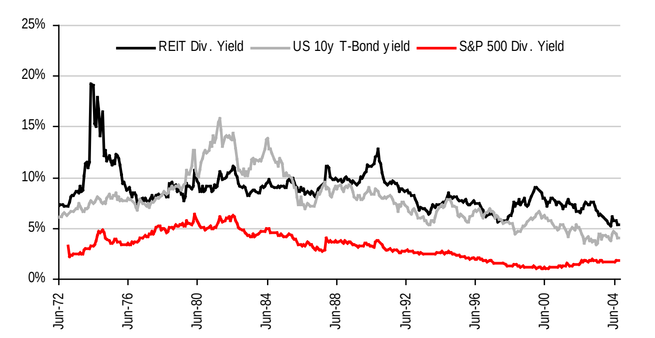
Real estate investment trusts

High dividend yields of REITs are not a free lunch

REITs pay very high dividends

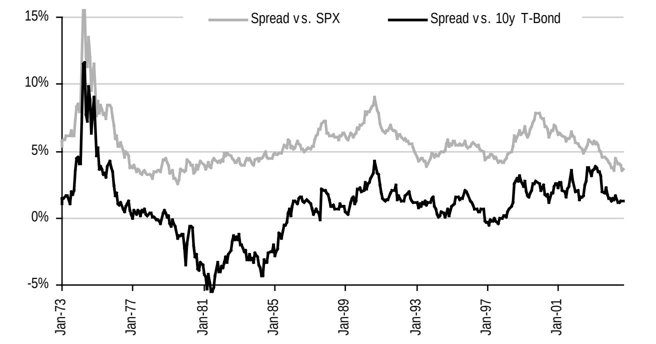
A major advantage of REITs is supposed to be their earnings generation power, which manifests in high dividends. Due to the obligation of REITs to distribute at least 90% of their income, REITs in fact belong to vehicles with the highest dividend yields. The comparison of REIT dividend yields and T-bond yields or dividend yields of the S&P 500 reveals that, for most of the consideration period, REITs have provided investors with a substantially higher income than other equity stocks and a slightly higher yield than bonds. In the high inflation and oil prices environment of the 1970s, for a short period REITs offered a dividend yield in high double-digit numbers. However, this was only due to a slump in REIT stock prices. Compared with 10-year US Treasuries, dividend yields were also higher (albeit to a smaller extent). Yields declined towards 10% in the 1990s and now range between 6% and 9%.

Dividend-/ bond yield comparison*



*Note: * as of 30 September 2004*
Source: Bloomberg, NAREIT, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Yield spread of US REITs*



*Note: * as of 30 September 2004*
Source: Bloomberg, NAREIT, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

REITs dividends yielded an average of 8.6% pa since 1972 vs the S&P 500 with 3.2% pa

Comparing REIT dividend yields to the average dividend yield of the S&P 500 reveals that REITs lured investors with much higher dividend yields than the S&P 500 for the whole consideration period. The S&P 500 never yielded more than 6% with a long-term average of 3.2%. Over the past 15 years, dividend yields for the S&P 500 have ranged between 1% and 3%. On average, 10-year T-bonds yielded 7.9% since 1972, while REITs yielded 8.6%. Until the mid-1980s T-bonds and REITs generated similar yields, but REITs have subsequently outpaced T-bonds. Investors looking for cash cows (ie stable and high income flows) were well served by their REIT investments. The recent dividend taxation act (lowering tax rates on dividends to 15%) does not affect REITs. Most of the dividend income from REITs (except TRS income) is subject to the individual's personal tax rate. This is because REITs are already tax exempt at the corporate level and therefore do not qualify for the 15% rate. This disadvantage reduces the benefits from higher dividend yields.

However, price appreciation must be considered

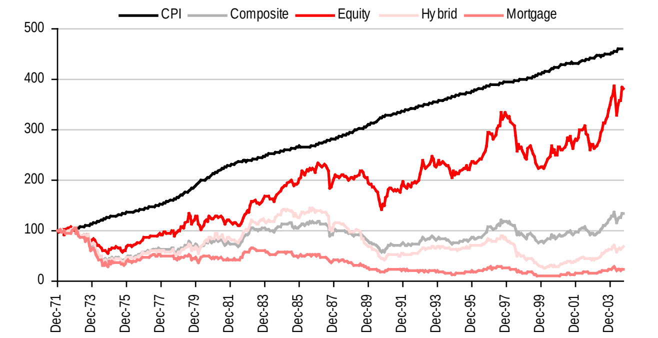
Either pre-tax and post-tax dividend yields are just one side of the coin. High dividend yields do not mean that capital preservation is warranted. On the contrary, the higher the dividends, the less capital can be accumulated because the less retained capital can serve as the base for further accumulation. Therefore a breakdown of total return of REITs into an income (dividends) part and a capital gain part is essential in order to derive the exact characteristics of total return generation. As our findings for equity REITs differ substantially from those for mortgage and hybrid REITs, we examine all three categories below.

Real estate investment trusts

Price appreciation: unfavourable for mortgage and hybrid REITs

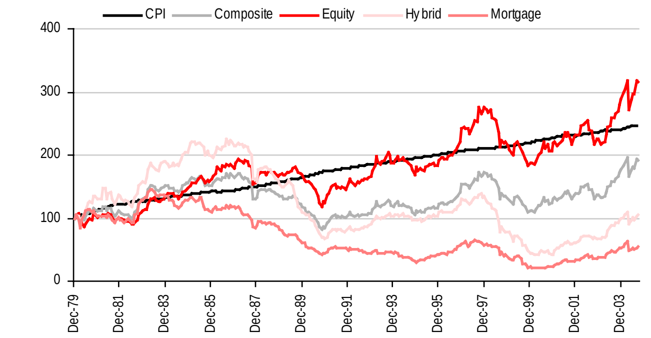
In nominal terms, mortgage and hybrid REITs lost value since 1972. Due to high price returns of equity REITs, the composite index could preserve its value, ending above its 1972 level. Excluding REITs' worst years in the early 1970s and starting in 1975 does not change the view a lot. Still, mortgage REITs lost in value even if hybrids did appreciate slightly.

Price indices & CPI since 1972*



*Note: * as of 30 September 2004*
Source: Bloomberg, NAREIT, HSBC Trinkaus & Burkhardt

Price indices & CPI since 1975*



*Note: * as of 30 September 2004*
Source: Bloomberg, NAREIT, HSBC Trinkaus & Burkhardt

Equity REITs could appreciate in accordance with the CPI, but mortgage and hybrid REITs lost most of their value in real terms

Comparing these results on a real capital basis adjusted for inflation reveals some interesting facts. A basket of REITs bought on 31 December 1971 delivered real capital losses on average. All REIT categories were worth less taking the US Consumer Price Index (CPI) into consideration. The two time frames reveal that REITs are not the vehicle investors should hold looking for capital gains. Usually, REITs have difficulties preserving their value. In real terms since 1972, equity REITs lost 16%, mortgages 95%, and hybrids 86% of their value. In real terms, REITs lost 73% on average. This result is disappointing, as REITs ought to at least preserve investors' capital. One reason is that payout ratios of some REITs exceeded 100% of taxable income. Excluding the 1970s and starting the consideration period in 1980 leads to a better outcome for REITs. During the 24 years since then, the NAREIT Composite lost 21%. Equity REITs gained 23%, hybrids lost 58%, while mortgages (again the worst performing class) lost 78%.

Total returns of hybrid and mortgage REITs have been higher than equity REITs in the short run...

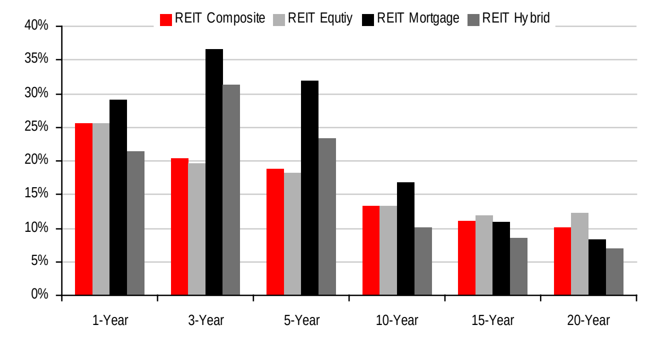
Can we conclude that mortgage or hybrid REITs have been a worse choice than equity REITs? Short term, no. Long term, yes. Even if in the past five years mortgage and hybrid REITs' total returns have been higher than those for equity REITs on a time horizon of 15-20 years, equity REITs have performed better. Thus, even if dividend yields of mortgage and hybrid REITs have been higher since 1972, the capital contraction has been too strong to compensate this. In conclusion, high dividend ratios are not an automatic cash generation vehicle for investors. Regarding the higher long-term dividend yield of mortgage REITs compared with equity REITs, this underperformance in price returns means that what an investor wins on the swings, he loses on the roundabouts.

...but much lower in the long run

Given that in recent years the bulk of total return came from price acceleration and not dividends, we view this as a one-off and unsustainable and unlikely to recur.

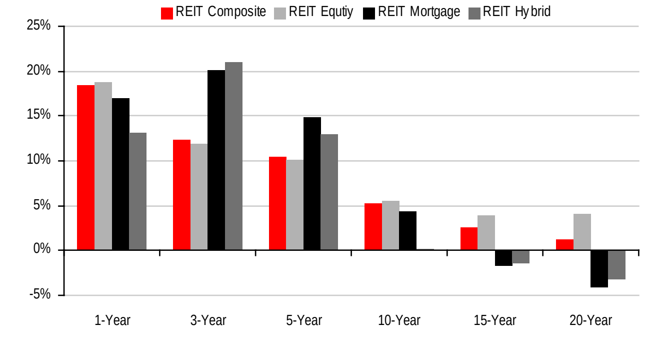
Real estate investment trusts

US REITs annual total return*



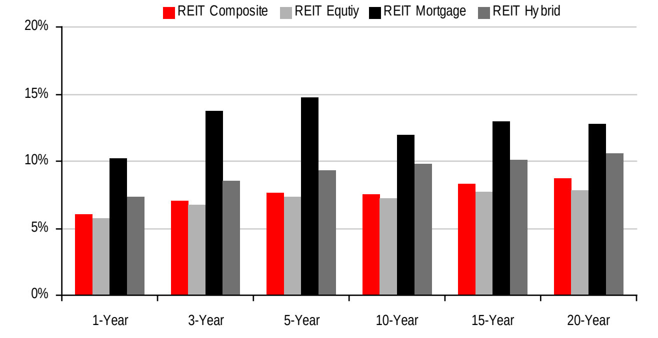
*Note: * as of 30 June 2004*
Source: NAREIT, HSBC Trinkaus & Burkhardt

US REITs annual price return*



*Note: * as of 30 June 2004*
Source: NAREIT, HSBC Trinkaus & Burkhardt

US REITs annual dividend yields



*Note: * as of 30 June 2004*
Source: NAREIT, HSBC Trinkaus & Burkhardt

REITs have been less risky than other stocks

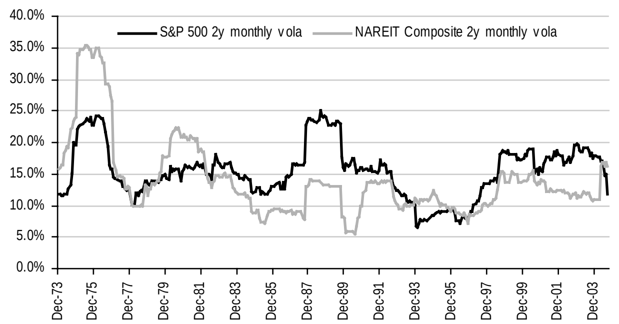
Risk measures of REITs are very favourable. In the period 1972-2004, the real estate industry went through several business cycles. This enables us to draw some general conclusions about the risk characteristics of REITs. In the mid-1970s, REITs had a higher volatility than the biggest 500 American stocks. Later on, volatilities were similar until the mid-1980s. Since then, REITs have had a lower volatility measure. With lower risk and much higher returns at that time, investors were well advised keeping REITs in their portfolios.

Correlation and beta around 0.5

From a risk/return perspective, REITs show similar characteristics to the broad market measured by S&P 500. However, there is a big diversification gain for investors that mix their portfolios with REITs in order to reduce overall portfolio risk. Volatilities of REITs have been below those of the S&P 500 index over recent years. Measuring correlation in a two-year trailing period on monthly basis reveals that, between 1973 and 1980, correlation was between 0.4 and 0.8, averaging 0.67. Between 1979 and 2004, it averaged 0.54 and therefore offered good diversification potential. As a result, beta is also in the 0.5 region, indicating that the US REIT sector is defensive compared with the broad market.

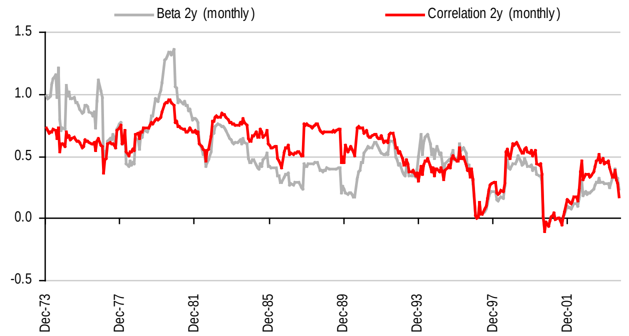
Real estate investment trusts

Risk of US REITs vs S&P 500*



*Note: * as of 30 September 2004*
Source: Bloomberg, NAREIT, HSBC Trinkaus & Burkhardt

Beta & correlation of US REITs vs S&P 500*



*Note: * as of 30 September 2004*
Source: Bloomberg, NAREIT, HSBC Trinkaus & Burkhardt

REITs are poorly internally funded and need capital markets to finance growth

REITs, even those earning above-industry averages, face the general problem of a lack of internal funding sources for new projects. This is because REITs are obliged to distribute at least 90% of the income they generate and therefore suffer from a lack of internal funding almost by definition. The only way to gather additional funds is to tap either the equity or the bond market. Thus, capital raising is a standard feature of the REIT sector.

Strong issuance activity on the equity side in times of premiums to NAV

IPOs and secondary issues as well as secured and unsecured debt offerings have been a major growth driver of the REIT market, although issuance volumes have fluctuated significantly since 1988. Generally, issuance has been more volatile on the equity side than on the bond side. This is not surprising and reflects the overall market's experience. Equity offerings issuance volatility depends mostly on market conditions. A main driver of issuance volume has been the performance of REITs and their pricing (premium/discount) compared with the sector's net asset value. IPOs and secondary offerings have been high in years when REITs performed well. This was the case in the 1993/94 and 1997/98 when REITs traded at attractive premiums to their NAVs. When REITs trade above their respective NAVs, it is attractive to pool private real estate and to go public. If the IPO is priced in line with traded peers, which means at a premium to NAV, the seller doing the IPO makes a gain equal to the difference of the IPO price and the NAV. When REITs trade below NAV due to the same consideration, value is destroyed by initial and secondary offerings and this is an important reason why IPO activity has been so volatile so far. By way of example, in 2000 and 2001 (when REITs traded at significant discounts to NAV), there was not a single IPO in the US market simply because the prices for REITs were unattractive.

Historically, REITs traded at a slight premium to their NAVs of 3.5%

Since 1990, the average difference between REITs prices and their NAV has been c3.5%. In other words, REITs have traded at a slight premium to NAV. Theoretically, REITs should trade at, or close to, NAV – as they have done (on average) for the past 14 years. However, single REIT stocks may trade significantly above or below their respective NAVs. One has to bear in mind that valuation and price of REITs is always based on expectations that can differ through time or change quickly. Optimistic expectations of future developments in the real estate sector lead to prices at premiums as well as positive expectations about qualitative improvements of assets or increases in rents.

Real estate investment trusts

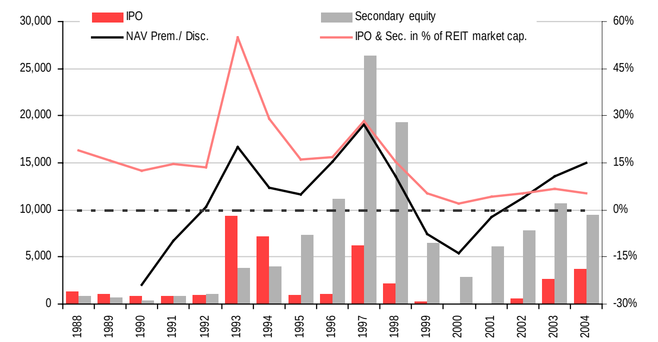
In 1993, IPOs amounted to 50% of total market cap

In 1993, the year when favourable conditions for REITs appeared, REIT equity offerings amounted to over 50% of total market cap. With a grown total capitalisation of REITs, these numbers have declined to c5% at present.

Debt issuance has been more stable than equity issuance

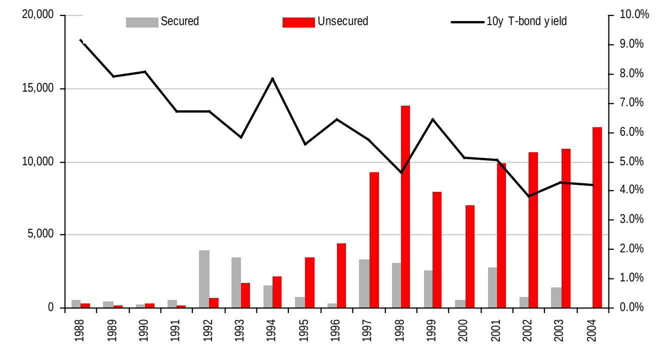
In absolute terms, debt offerings increased steadily between 1990 and 1997, reaching a record high of USD13bn. Since then, they have stabilised at levels of cUSD7-11bn. While secured debt issues dominated until 1993, the trend changed with more and more unsecured debt issues tapping the market. It is more difficult to conclude a rising debt issuance activity due to declining interest rates. While we would still support that fact, we acknowledge that the connection between these events is loose.

Historical equity offerings in USDbn (equity/debt)*



*Note: *as of 30 September 2004*
Source: © Green Street Advisors, NAREIT, HSBC Trinkaus & Burkhardt

Historical debt offerings in USDbn (equity/debt)*



*Note: *as of 30 September 2004*
Source: Bloomberg, NAREIT, HSBC Trinkaus & Burkhardt

Debt issuance can only partly compensate difficult environment for equity raising

In conclusion, the willingness to raise equity capital is very dependent on market conditions, ie the current premium or discount to NAV. The latter in turn may also depend on factors such as market expectations or economical developments. In times of distressed REIT prices (ie when REITs are priced below NAV), they will find it hard to raise funds. This might be partly compensated by higher issuance of debt. In countries in which governments have set limits for leverage, however, increased debt issuance as a compensation for a lack of investor appetite for equity capital might be strongly restrained. Therefore, from time to time, those REITs might suffer from a lack of funds needed to expand operations. Thus, differing restrictions across countries regarding leverage might matter a lot in respect of the operating flexibility of REITs.

The G-REIT discussion

How could a G-REIT act be introduced?

REIT legislation in Germany very likely

At present, there is a debate in Germany about the introduction of G-REITs. While we can say it is very likely that REIT legislation will be introduced, it is unclear when this will happen, how it will be designed and what kind of advantages and disadvantages will result for real estate investors, real estate companies and the government. The following discussion only considers equity REITs, ie there are no plans at present to introduce mortgage REITs.

Two possibilities: a new REIT law (favoured by the industry)...

There are two ways in which G-REIT legislation could be introduced: by creating a separate G-REIT law completely outside the existing regulations, or by extending the German Investment Act. Under the first scenario, a G-REIT would be subject to the same regulatory requirements as a normal corporation. The financial industry, which is pushing for the introduction of REITs in Germany, favours this approach because it expects an unregulated G-REIT structure in a separate law. However, the financial industry has to put up with the fact that the creation of a separate G-REIT act will take time. It is possible that a G-REIT law could be finalised in 2005 and become effective in 2006. However, if a decision about the introduction were not taken in 2005 (due to elections in 2006), the next probable introduction date would be 2007, effective from 2008.

...or an extension of German Investment Act (favoured by BVI and its members)

A much quicker way would be the extension of the German Investment Act. This would allow REITs to be introduced as early as mid-2005. However, under such legislation, REITs would be supervised by the Bafin, which also supervises open end funds. It is unlikely REITs would have as much flexibility as they could expect under a separate act. The Bundesverband Investment und Asset Management (BVI) and its members favour this approach.

Postulations of the Initiative Finanzstandort Deutschland (IFD)

IFD has a single committee concerned with the introduction of REITs

Initiative Finanzstandort Deutschland is an organisation founded in 2003 by politicians and members of the German finance sector. Within IFD, a special committee consisting of 12 people is considering and pushing the introduction of a G-REIT in Germany. In this sense, one goal is to mobilise the real estate assets of German companies. These assets are currently held not for operating purposes but rather for tax purposes. Due to high taxation on capital gains in Germany, companies tend to shy away from selling properties with book gains because of the high taxes that would have to be paid as a result. The committee proposes the following criteria for the introduction of a German REIT:

- Transparency of a German REIT on company level similar to open-end funds. G-REITs should be exempt from business and corporate taxes
- The REIT's main activity should be the operation of properties
- A corporate structure (AG)
- Mandatory listing on a stock exchange
- At least 75% of company's assets to be directly/indirectly linked to property investments
- Payout to shareholders of 80% of the cash flow measured by earnings before depreciation and amortisation (EBDA)
- IAS as the accounting standard

The G-REIT discussion

Proposal that G-REITs should be tax exempt on company level

In exchange, taxation at the company level would be abolished or strongly reduced. Moreover, the committee would like to see changes to several existing acts to facilitate lower transaction and taxation costs of property sales, to enable open-end funds to invest in G-REITs and account for them as real estate investments, and to enable insurance companies to treat G-REITs as real estate assets and not equity investments for accounting purposes. Although there is no statement about an imposition of a REIT free of any leverage regulations, we think investors would favour an unregulated leverage.

IFD estimates the G-REIT market to grow to EUR37-86bn by 2010

IFD estimates that the adoption of its recommendations would lead to a market size of G-REITs of cEUR37-86bn by 2010 – some 6-12x the current market cap of publicly listed companies in Germany.

Motivation of the government

Government will introduce REITs if they are likely to improve returns of real estate and if tax effects are positive

In contrast to the motivation of IFD to push for a rather unregulated and flexible G-REIT structure, we think that the Federal Ministry of Finance (BMF) will only support the REIT issue if an introduction of REITs will also be favourable for the government. In other words, the BMF has made it clear that REITs would not be introduced if tax income would be likely to shrink as a result. In addition, we think that the BMF aspires to a vehicle that generates higher yields than open-end funds. To avoid tax losses, the introduction of an exit tax is being considered. The BMF has commissioned a study by the European Business School to examine the tax effects of REIT introductions in Europe. We expect the results of this study by the end of 2004 and hope the findings will be published. By then, we should also know whether G-REIT legislation is to be introduced or not.

Government is likely to limit non-passive activities

Furthermore, we imagine that the BMF may intend to limit non-passive property activities such as development or holding of securities. Concerning leverage, we consider it more likely that only a few restrictions will be imposed, with the BMF leaving the decision about leverage ratios to the capital markets.

In terms of managing structure, we think the BMF has a preference towards internally managed structures. The BMF has not signalled to the market its views on payout ratios (ie percentage of profits).

A REIT structure similar to other European countries seems likely

Based on comments from the BMF at events we have attended, we believe the ministry has examined closely REIT legislation in other European countries. That is because a pan-European harmonisation of REIT laws is possible or likely in the long run and the BMF will want to be positioned for that. Thus, we think that G-REIT legislation might be similar to that in France (the most recent to be introduced in Europe).

We would like to highlight again, that the G-REIT introduction process is very dynamic at present and that the above descriptions and opinions are based on at least as much gut feeling as fact.

Where would REIT assets come from?

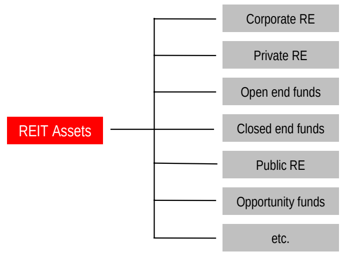
Amount of properties flowing into REITs will be crucial for their success

A successful introduction of G-REITs will depend crucially on the amount of properties as well as the capital flowing into this vehicle. We have made a number of assumptions as to where the properties and capital could come from.

The G-REIT discussion

In our view, the main supply channel of properties to G-REITs will be German companies. There are estimates that all properties held by all companies are worth cEUR1,500bn or even more. The very biggest German companies have properties with book values of cEUR132bn. Because the historical costs have been much higher, at cEUR193bn, and because it is unlikely that these historical costs reflect current market values as many have been held for decades, we assume that the real market value is far beyond EUR193bn. In the US, companies own just 25% of the properties they occupy. The UK percentage is 54%. In Germany, however, companies own 73% of properties they occupy.

REIT asset sources



Source: HSBC Trinkaus & Burkhardt

Should G-REITs be introduced, companies would finally be able to dispose of some of their properties via true sale or sale and leaseback transactions. This would unlock capital tied into these properties and make it possible to direct it to more efficient core operations. In France, after an initial period with new SIICs, euphoria seemed to disappear and market participants started to question the success of the introduction. At the moment, based on our discussion with international real estate agents, we again see a rising interest coming from corporates, of which more and more consider transferring their real estate properties into SIICs. This is exactly what we expect to happen in Germany.

Real estate investments of major German companies

Company	Book value (EURbn)	Historical cost (EURbn)	Housing units	Company	Book value (EURbn)	Historical cost (EURbn)	Housing units
Allianz	14.4	18.4	36,000	Henkel	1.1	1.9	1,200
BASF	2.9	6.7	11,000	Karstadt-Quelle	2.3	5.9	N/A
Bayer	3.9	7.5	12,000	Linde	0.7	1.3	N/A
HVB	1.9	2.6	N/A	Metro	2.6	3.7	N/A
BMW	3.1	5.0	N/A	Munich Re	6.4	8.0	6,500
Commerzbank	0.7	0.8	N/A	Preussag	1.4	2.1	N/A
Daimler-Chrysler	11.1	20.2	N/A	RAG	2.4	5.0	70,000
Degussa- Hüls	1.0	2.1	1,800	RWE	7.1	11.7	2,600
Deutsche Bahn	13.1	7.3	N/A	Schering	0.7	1.3	N/A
Deutsche Bank	4.2	4.8	N/A	Siemens	5.8	9.1	7,500
Deutsche Lufthansa	0.2	0.5	N/A	Thyssen-Krupp	4.9	7.2	53,000
Deutsche Post	5.9	7.2	N/A	TUI	N/A	N/A	23,000
Deutsche Telekom	14.4	20.2	N/A	VW	5.1	10.7	12,200
Eon/Viterra	14.0	21.7	160,000	Other	N/A	N/A	513,200
				Total	**131.8**	**192.9**	**910,000**

Source: University of Regensburg, Manager Magazin, HSBC Trinkaus & Burkhardt

Properties may come from open-end funds, insurance companies or public authorities

A second channel feeding new G-REITs with properties could theoretically be open end funds that would consider a conversion. We think this is unlikely to happen in the initial stage because the upfront fee of 5% charged at the time of investment into an open-end fund is too lucrative for the initiators to give up. It is more likely that open-end funds will converge in the event of large money outflows and the pressure resulting from it. In terms of closed-end funds, which are much smaller than open-end funds, we think that only pools and not single closed-end funds will be candidates for a G-REIT. The potential from this channel is limited in our view. Other sources of asset could be properties held by insurance companies.

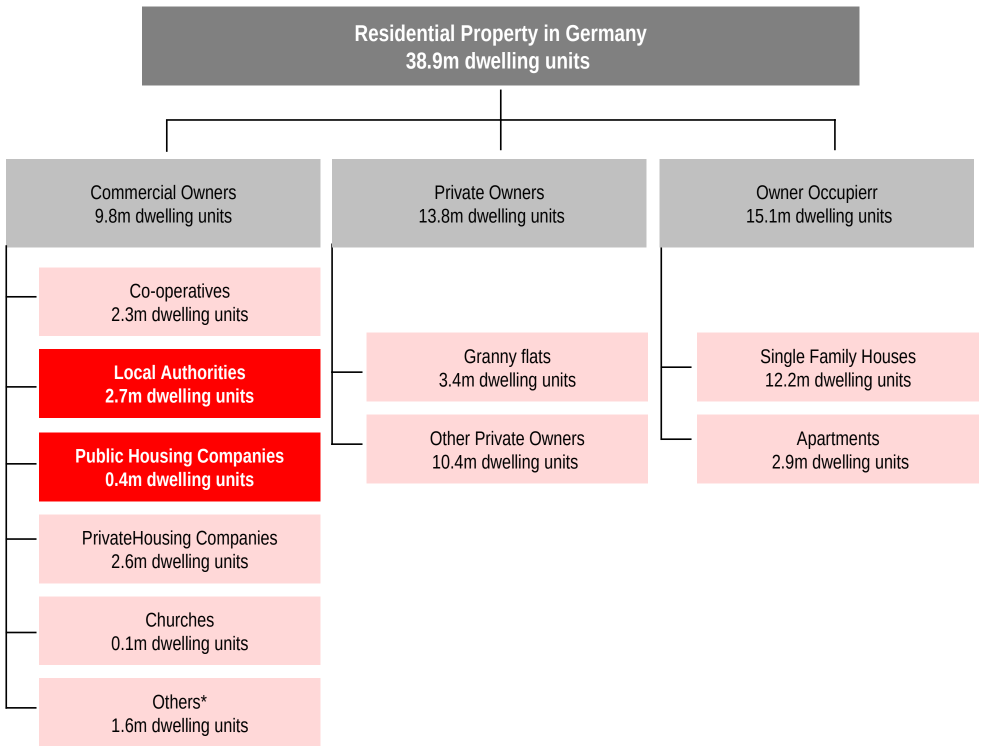
The G-REIT discussion

Public real estate could also be an important source of real estate investment. The Bund and local authorities own many properties, particularly residential ones (see chart below). Like the model of Deutsche Wohnen, a residential property spin-off of Deutsche Bank, the government might dispose of its properties via the capital market. There have been quite a few examples of public real estate assets being privatised in the past. Hessen recently disposed of office space via a sale and leaseback transaction worth EUR275m, and has announced further sales totalling EUR800m for 2005. Advisors close to its initial transaction mentioned a full privatisation pipeline with Hessen's transaction serving as a role model. In addition, the Bund recently restructured its real estate privatisation unit in order to ramp up privatisation proceeds.

Opportunity funds are active buyers in Germany

Real estate opportunity funds have been very active buyers in the recent past in Germany and thus could be considered possible suppliers of properties seeking to exit acquired portfolios via G-REITs.

German residential property assets



*Note: * Banks, Insurances, RE Funds, etc*
Source: Stat BA Microzensus 2002,GdW, HSBC Trinkaus & Burkhardt

Where would REIT money come from?

REIT money could come from a number of sources including mutual funds and pension funds...

Mutual funds could benefit from an untaxed dividend payment of REITs. In the US for instance, some 70-80 mutual funds invest in REITs. Likewise, we expect the number of funds interested in REITs in Germany to be high due to the advantages REIT dividends offer

The G-REIT discussion

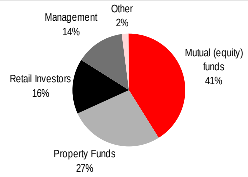
in terms of higher performance disclosures. Pension funds might also favour G-REITs over fixed income instruments. Pension funds in a mature stage have low inflows and high outflows and need high and stable income streams. As the German population is ageing, more and more pension funds will mature and be likely to invest in G-REITs. The switch from fixed income instruments to G-REITs will become increasingly attractive when the real estate market starts to pick up again.

...as well as insurance companies

Further, insurance companies are shifting their focus towards real estate and we expect their target asset allocations to be increased in the near future. In particular, as real estate currently represents only 5% of institutional investors' target asset allocation, there is much room for growth. Given the possibility that REITs will account for real estate portion and not for equity portion as one of the stipulations of the IFD, this might be a major driver.

In addition, money which today flows into closed end or open end funds might be absorbed to a significant amount by G-REITs. When G-REITs will be flexible, transparent, liquid vehicles and prove to deliver equal or even superior returns over open-end funds, G-REIT are likely grow at the cost of those. Retail investors below their tax-exempt capital income limits would benefit from a G-REIT that invests domestically, whereas high net worth individuals would rather benefit from internationally oriented REITs whose foreign dividends would not be taxed in Germany again.

US REIT investors by type



Source: Maximum Advisors, HSBC Trinkaus & Burkhardt

What is likely to happen?

If the G-REIT structure favours investors as in the US or France, we believe the size of the German market for REITs could be similar to that of the US market. Based on US figures, ie a market size of 2.5% of total market cap, the G-REIT market has a potential size of cEUR20bn. Based on a US comparable of 2.5% of GDP, its potential is EUR52bn. Bear in mind that these are only hypothetical numbers. As we do not know what the exact structure will be, it seems sensible to expect a market volume of solid double-digit billions of euros.

We estimate a market cap of >EUR20bn for REITs in Germany long term

There is uniform lobbying on the part of BVI, asset managers, banks and real estate companies for the introduction of REITs. We think that the standpoints of the industry and the government are close to each other to manifest in a favourable REIT legislation for both parties. We also suggest that concerns about shrinking taxation income are excessive because, looking at the actual tax payments of, for example, real estate companies in Germany, reveals that tax collections are much less than in theory. As companies will have incentives to restructure their property portfolios due to lowered capital gains taxes, despite the lower tax rates, the volume of taxes should rise significantly. So far tax rates are high but actual tax collections poor. Therefore, a G-REIT would be beneficial for both the real estate industry and the government. The advantages for the real estate industry would be a more liquid real estate market, greater transparency due to higher reporting requirements for G-REITs, increased attention of equity analysts covering REITs, a liquid REIT market and last but not least improved efficiency in companies able to redirect equity capital into their core operations.

BVI, fund managers, banks & real estate companies pushing for introduction of REITs

We further believe that the G-REIT might be similar to the SIIC, the French REIT. Because the French REIT is relatively flexible, the outcome for the industry is likely to be very positive. We also assume that a separate G-REIT act will be created and that G-REIT

We expect a G-REIT law to be passed in 2005, similar in structure to the French SIIC, becoming effective in 2006

The G-REIT discussion

legislation is unlikely to be considered as a part of the German Investment Act. However, we see a number of challenges given the involvement of so many parties. A G-REIT act would have to pass the Bundesrat and therefore the opposition would be involved. Real estate taxes touch on all layers of the German federal structure with income and corporate tax predominantly going to the Bund, business tax remaining at the community, and transfer tax going to German states. Nevertheless, owing to the current stage of procedures, the first REITs could appear in 2006 (with possibly IVG being an early G-REIT bird).

REIT structure must be flexible and favourable to be successful

The US market has demonstrated that a REIT structure by itself will not be successful if it does not meet the demands of the market. The higher the flexibility for REITs, the greater the success can be expected. US REITs made the market more professional, liquid and transparent – in our view, three major handicaps of the current German real estate market.

Real estate dynamics and market outlook

The phenomenon of real estate cycles

Why is real estate cyclical?

Regulatory cycles

Regulatory intervention can cause individual cycles

Fluctuations in real estate values can have a significant impact on the development or health of economies. In recent times, this effect has probably been best illustrated by the bursting of the real estate bubble in Japan in the 1990s. At the height of the bubble, the Japanese Emperor's palace in Tokyo was considered more valuable than the entire US state of California. The collapse of Japanese real estate values had a tremendous effect on equity markets, the banking system (which had heavily underwritten real estate investments) and the economy as a whole, and showed how important it is to monitor the real estate cycle. With other economies suffering similar experiences, many regulators reacted by strengthening industry guidelines, particularly for lending. The Bank of Canada, for example, temporarily limited real estate lending volumes to 70% of regulatory capital.

However, at other times, governments have actively encouraged real estate investment – one example is the tax incentives that were introduced to promote real estate investments in Eastern Germany. This intervention created a separate real estate cycle, leading to a period of overbuild and the subsequent collapse of real estate values at the beginning of the 1990s, which has yet to abate. Many emerging economies (including Singapore, the Philippines and Malaysia) have periodically relaxed and restricted rules on real estate lending, in many cases leading to regulatory property cycles. A non-fiscal measure that caused the London office cycle to overheat was the loosening of planning regulations for the Docklands area in the 1970s.

Interestingly, the most heavily affected economies, such as Japan, have yet to clamp down heavily on (commercial) real estate lending and investment.

Economic cycles

Some market participants have called the end of the cycle

Some market participants believe that the intensity of the 1991 real estate downturn will not recur, given the improvements in market transparency, and lending and investment policies. In the US, the situation was complicated by the deregulation of the savings & loans sector, which, as a result of structural problems in the market, led to a shrinkage of lending volumes. Some voices even called the end of the real estate cycle – reminiscent of those that believed they had seen the end of the equity risk premium when the equity capital markets overheated.

Long time rows of real estate market data hard to obtain

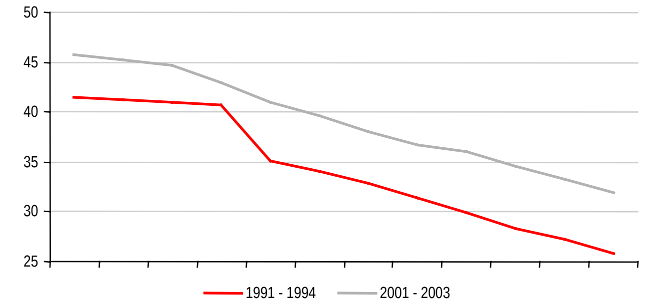
While we agree that transparency in the real estate market has increased in the past, we believe it is still insufficient. Data on properties will never be as comprehensive and precise as that for the capital markets because properties are not commodities and are therefore only comparable to a certain degree, while transactions are much less frequent than on exchanges. In addition, market data, particularly for Germany, is incomplete (especially for retail, industrial and hotels) and time rows do not go back very far. Data from official sources is essentially limited to residential real estate, with commercial real estate statistics mostly coming from estate agents that generally do not make them publicly available. In this context, we would like to thank CB Richard Ellis and Jones Lang LaSalle for their support and the provision of their proprietary market statistics which were of great help for our report.

Real estate dynamics and market outlook

The debate over whether the real estate cycle has become smoother, or even flattened altogether, came to an abrupt end with the downturn in 2000/01, which, in the US at least, saw an even sharper correction in rents than in the 1990s (residential and retail real estate in some countries managed to escape unscathed).

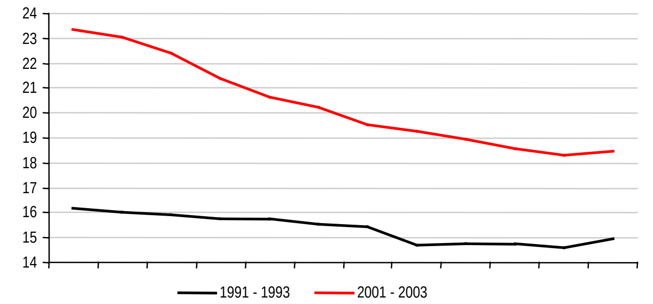
Abrupt market correction disproved smoothed-cycle thesis

The 1990s vs the 2001 downturn* in Europe (EUR)...



*Note: * Office real estate effective prime rent development of 16 largest European cities.*
Source: Atis Real, JLL, CBRE, C&W H&B, HSBC Trinkaus & Burkhardt

...and the US* (USD)



*Note: * Office real estate effective average rent development US aggregate.*
Source: TWR, HSBC Trinkaus & Burkhardt

Real estate cycles – observed since 1628 at least

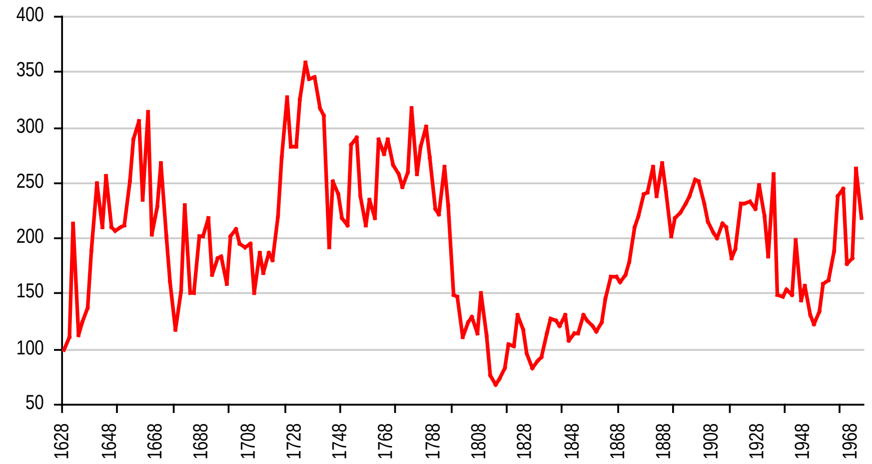
Real estate cycles have probably existed since the acknowledgement of property rights. The longest time row on inflation-adjusted property prices we have been able to unearth is for the Amsterdam housing market (the so-called Herengracht index), which dates back to 1628 and ends in 1973. This index is based on transactions of the buildings on the Herengracht, one of the canals in Amsterdam. Since its development, the quality of the buildings on this canal has remained at a constantly high level, which makes the Herengracht a unique sample on which to base a long-run house price index.

Real estate cycles have probably existed since the acknowledgement of property rights

The Herengracht index shows that the only constant in price movements is that cycles are at least as old as statistics (another finding is that that real estate values have not materially outperformed inflation over the course of more than 300 years).

Real estate dynamics and market outlook

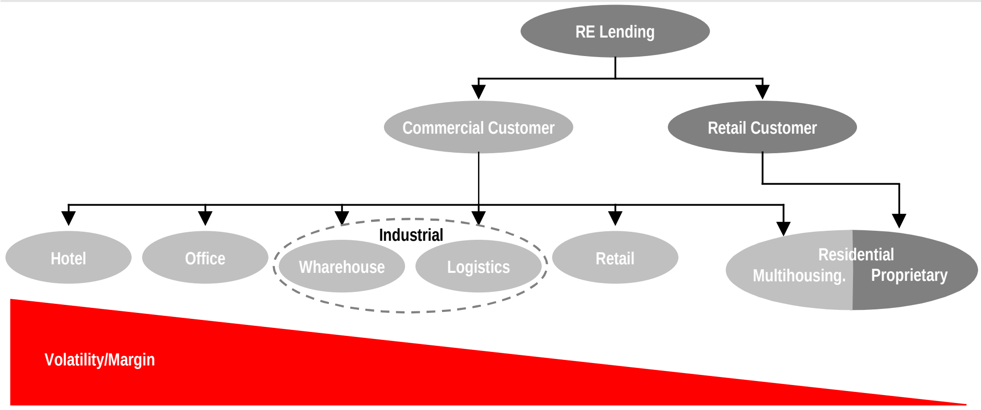
The Herengracht Index – a 'short' history of real estate cycles*



*Note: * Biennial development of real property prices.*
Source: University of Limburg 'Herengracht Index', HSBC Trinkaus & Burkhardt

The fundamentals of real estate cycles

Overview of main real estate categories



Source: HSBC Trinkaus & Burkhardt

Five real estate categories account for more than 90% of loan exposure

The five most significant real estate categories – ie office, retail, industrial, residential and hotels – account for almost the entire exposure of our peer group of German property stocks. The first two alone account for more than 70%. Other real estate categories such as leisure centres, ski centres, arenas, etc, may gain in importance in the future, but are currently marginal to the activities of our peer group.

Real estate dynamics and market outlook

Each real estate category follows a separate cycle

Although most real estate categories rose and then collapsed in the early 1990s and in the early 2000s, there are differences between the categories and it is therefore incorrect to talk of one real estate cycle. Property categories fluctuate for various reasons. Some property types are closely related to GDP growth, indicating the importance of the demand side for the cycle. These categories – retail, office and, to a lesser degree, industrial – echo the economic cycles, with time lags.

Volatility varies substantially according to…

Other real estate categories appear to show little correlation to the economy, following much longer swings that seem to have a life of their own. These include residential and, to a lesser extent, hotel property types.

In general, the volatility of real estate categories appears to depend on three main factors:

…the tendency to overbuild…

- **The tendency to overbuild** – ie, the building up of excess real estate capacity. Sectors with a high tendency to overbuild tend to be driven by the supply side. The construction pipeline typically expands capacity in line with increases in rents, which is interpreted as a signal of rising demand. Nevertheless, there is typically no direct supply-demand relationship. So-called speculative schemes are typical in the office and hotel sectors (almost by definition in the latter because of the very short rental periods, which typically cover only a few days)

…the extent of supply time lags and…

- **Extent of supply time lags** – as we have indicated above, rising rents are typically the main driver of new construction projects in sectors where supply leads demand. The volatility of a real estate asset category typically rises with the time it takes to convert price signals into new supply. This is particularly evident in the office sector where new construction has only recently begun to peter out in Europe and the US, despite the fact that the market entered recession in 2001. In a downturn, when supply is in excess of demand, vacancy rates rise strongly and rents collapse. This is a particular problem in Germany, where planning and authorisation can take an extremely long time

…volatility of demand

- **Volatility of demand** – the third major driver of real estate volatility is fluctuations in demand. Whereas demand for residential and retail real estate is relatively stable (particularly for prime retail locations), demand patterns in office and hotel space are relatively short term, adding to volatility

Real estate values are also affected by factors such as funding conditions, interest rates and rental agreements

Other factors that can have a significant impact on the volatility of real estate values are changes in funding conditions, the length of refinancing and rental agreements and the volume of investment available for real estate.

We set out below an analysis of the volatility of the most important asset classes.

Overview of real estate categories by cyclicality

Real estate category	Tendency to overbuild	Supply time lag	Demand volatility	Cyclicality
Hotel	High – supply leads demand	High	Very high	Very high
Office	High – supply leads demand	High	High	High
Industrial	Low – demand leads supply	N/A	Medium	Medium
Retail	Medium – supply leads demand	Medium	Low	Low
Residential	Low – demand leads supply	N/A	Low	Low

Source: HSBC Trinkaus & Burkhardt

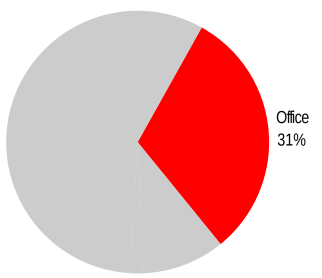
Real estate dynamics and market outlook

Different categories, different cycles

The office cycle – a limbo dancing elephant

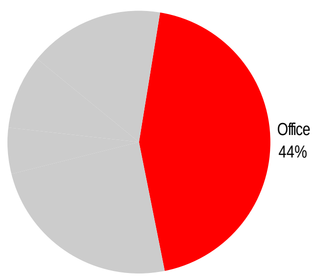
The most significant asset class

Office share of German commercial real estate*



Note: *We estimate total German commercial RE represented value of EUR1.63bn in 2003.
Source: BulwienGesa, HSBC Trinkaus & Burkhardt

Office share of European real estate investments*



Note: * In 2003.
Source: JLL, HSBC Trinkaus & Burkhardt

c44% of European investments flows into office

Office real estate is by far the most important commercial real estate category, accounting for 31% of German commercial real estate. Due to the relatively high liquidity of office property in major metropolitan areas, its share of European real estate investments is even higher. In 2003, office investments represented 44% of total European property investments.

Numerous sources of short-term statistics

The importance of the office sector means that there are numerous sources – such as real estate agents, real estate asset managers, research houses and industry groups – publishing the most recent market trends. The most important parameters tracked by these sources are vacancy rates, prime rents, and the prime yield development of real estate in the leading European capitals. Future supply pipelines and other types of information are also tracked.

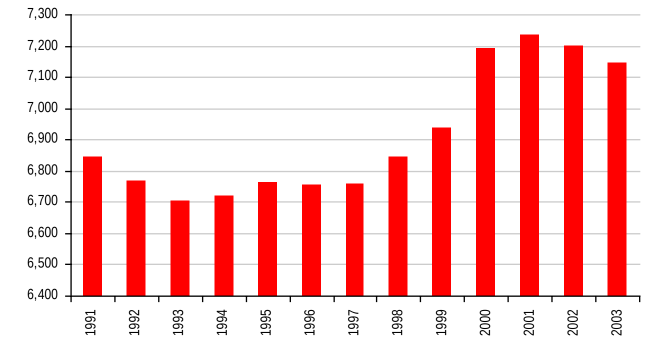
Tough times in the past but selective bottoming out

Office employment is the key demand driver

Demand for office space is driven by the number of office workers and the average space per office worker. In general, the percentage of office workers globally has increased over a long period of time. In the medium term, however, wide variations are unlikely. If we assume that the average office space per employee is relatively constant (we acknowledge that there are short-term fluctuations as it is usually easier to shed workforce than to reduce rented office space), the main short-term demand driver is the level of employment. We consider the latter to be a function of economic growth, although in some countries (such as the US) there has been recent economic growth without a corresponding rise in (office) jobs.

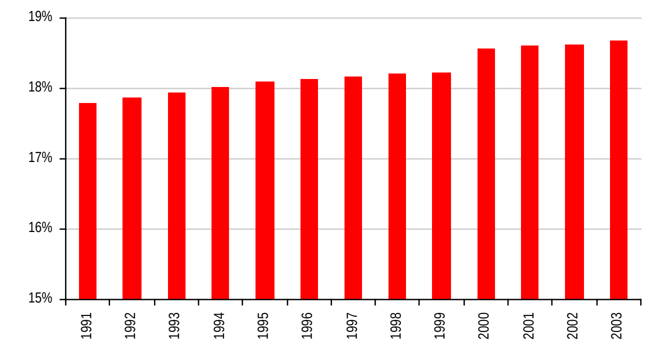
Real estate dynamics and market outlook

Development of office workers in Germany (m)...



Source: Bundesbank, HSBC Trinkaus & Burkhardt

...and as a percentage of total employment



Source: Bundesbank, HSBC Trinkaus & Burkhardt

Demand collapsed just as substantial new space hit the market

The recent downturn in the European economy has had a severe impact on the office sector. Demand, particularly from office-intensive sectors such as telecommunications, financial services and (new) media collapsed at the same time as new development pipelines were reaching record highs, driven by the preceding economic growth. As a consequence, vacancy rates and rents for new offices deteriorated across most European markets (with the exception of Brussels and Copenhagen, which are traditionally very stable; Paris, Vienna and Athens also held up quite well).

Incentives have reached a record high, particularly in cities with a high degree of available sublet space

	Supply		Occupier demand		Incentives	
	Postponed development schemes?	Sublet space	New companies in town?	Business sectors expanding?	Typical rent-free period (months)	Trend h-o-h
London City	No	c4% of office space	No	Professional services, lawyers, public sector	27-30 (10-year lease)	Up
London West End	No	c3.6% of office space	No	Technology, media, financial	18 (10-year lease)	Down
Paris	No. First signs of interest in schemes for completion 2006/007	<1% of office space	No	No	6-9 (6-year lease)	Flat
Madrid	Planned schemes are being postponed	Negligible	No	No	1-4 (5-year lease)	Up
Barcelona	No	Negligible	No	No	1-2 (5-year lease)	Flat
Düsseldorf	Negligible	c2% of office space	No	No	3-4 (5-year lease)	Up
Frankfurt	Negligible	c6% of office space	No	No	6 (5-year lease) 12 (10-year lease)	Flat
Hamburg	Negligible	c1% of office space	No	No	6 (5-year lease)	Flat
Munich	Large quantity of speculative development postponed to 2005+	c1% of office space	No	No	3-6 (5-year lease)	Flat

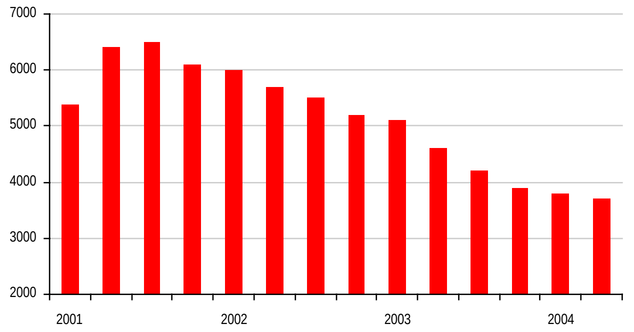
Source: JLL, HSBC Trinkaus & Burkhardt

Real estate dynamics and market outlook

Between the beginning of 2000 and mid-2004, the average prime rent for the 16 European cities we are looking at fell by c31%, while the average vacancy rate increased from 2% at to 9.9% over the same period. Low rents and high vacancy rates are, however, only part of the picture, as incentives such as rent-free periods have increased significantly, as can be see in the table above. In some markets, the reported prime rent can therefore only be considered as a theoretical number; the actual office market climate is likely to be far worse. In Germany in particular, renting activity was so low in some cities between mid-2003 and mid-2004 that market statistics can only be seen as rough estimates.

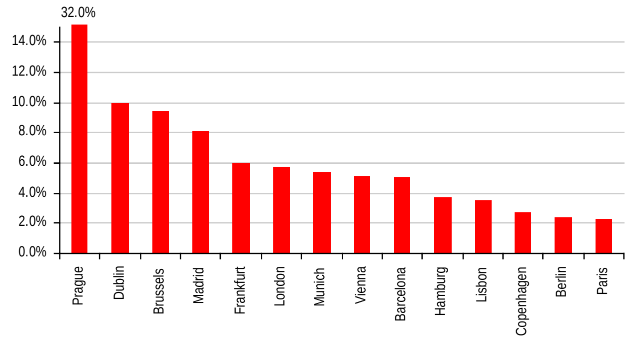
As incentives have risen tremendously, situation is likely to be worse than statistics imply

New supply* pressure continues to ease off on a European level (000 sq m)...



*Note: * 12-month supply pipeline based on 16 largest European cities.*
Source: CBRE, JLL, HSBC Trinkaus & Burkhardt

...but future supply pressure* varies significantly from city to city



*Note: * 24-month supply pipeline as % of total existing office space stock at the end of 2003.*
Source: CBRE, JLL, HSBC Trinkaus & Burkhardt

In this cycle, new office supply has been in decline for 11 quarters. This could suggest that the bottom of the cycle is approaching. European economic growth seems to be picking up, which should increase demand and lift some pressure from office supply. Thus, the deterioration in the European office market has begun to slow, and some European markets (such as London, Brussels, etc) have shown a positive swing in vacancy rates and rents.

New office supply is levelling off as economic recovery picks up

However, a further improvement will be far from even across Europe in our view, given the huge difference in the 24-month future supply pipelines of individual European cities. We have little faith in the convergence theory – that European markets are moving towards one cycle – which has been put forward in the past, and believe that this was based on the more or less uniform decline in the real estate markets in recent years. The recovery is likely to prove the convergence theory incorrect: we expect demand trends to vary across European capitals, driven by country variations in GDP growth and future supply moving into the market.

Deterioration has begun to slow, with some cities already starting to bottom out

We would caution, however, that the recovery will not be swift. The table below shows that average space per office worker has increased significantly on the German market over the past two years. As a consequence, even if companies begin to re-hire in the near future, initially the additional staff will be moved into the empty space, reducing average office space per employees, but not creating additional demand. However, this should reduce the amount of space available to sublet, as sublet space is a significant driver of prime rent deterioration, and may well have a stabilising impact on the rent level. We would expect one of the first signs of improvement to be a withdrawal of sublet space from the market.

Recovery is likely to be far from swift, with a reduction of sublet space as the first positive sign

Real estate dynamics and market outlook

Space per office worker* has risen substantially on the German market

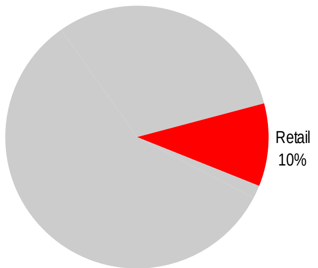
Sq m/employee	2001	y-o-y	2002	y-o-y	2003	y-o-y
Berlin	26.9	N/A	28.8	7%	30.0	4%
Düsseldorf	26.7	N/A	32.0	20%	35.7	12%
Frankfurt	33.0	N/A	32.2	-2%	34.3	7%
Hamburg	28.8	N/A	29.2	1%	33.9	16%
Munich	26.0	N/A	31.0	19%	31.7	2%
Average	**28.9**	**N/A**	**31.1**	**8%**	**33.1**	**6%**

*Note: * Based on a survey of 246 large companies.*
Source: JLL, HSBC Trinkaus & Burkhardt

The retail cycle – the most recent highflier

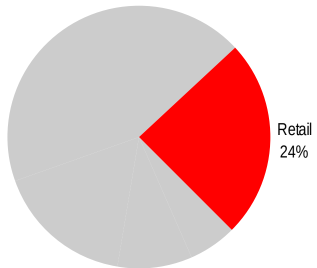
High significance of retail real estate for investors and lenders alike

Retail share of German commercial real estate*



*Note: * We estimate total German commercial RE represented value of EUR1.63bn in 2003.*
Source: BulwienGesa, HSBC Trinkaus & Burkhardt

Retail share of European real estate investments*



*Note: * In 2003.*
Source: JLL, HSBC Trinkaus & Burkhardt

Small real estate asset class attracts high share of property investments

Although a relatively small real estate asset class (representing c10% of German commercial real estate), the retail category has a strong appeal for investors. In 2003, 24% of all real estate investments in Europe went into the retail category. A strong performance during the downturn protected the retail investment share. Again, statistical data for the US market is abundant, whereas European statistics are limited to high street top rents, yields and, in some cases, vacancy rates.

Stellar performance during the downturn

Only real estate category to show improvement in values, but rents flat during the downturn

Retail real estate is the least cyclical commercial asset class, in line with retail sales being among the least cyclical components of macroeconomic demand. In times of declining real estate markets, investors increasingly put money into this conservative asset class, driving values up and yields down. In the most recent economic downswing, the retail sector benefited from its resilient nature in terms of rent generation and values. In the 16 European cities we looked at, values increased by 26% and rents by 22% between Q1 2001 and mid-2004. Germany was the notable exception: rents remained flat and there was a 6% drop in values over the same period.

Real estate dynamics and market outlook

As a rule of thumb, prime locations hold their values far more constantly, even in a downturn, than second or third tier locations. Top locations also tend to be much more liquid and can be sold far more easily in cases of distress. In the most recent period, shopping centres became a focus for a high amount of investment, even outperforming the general retail segment.

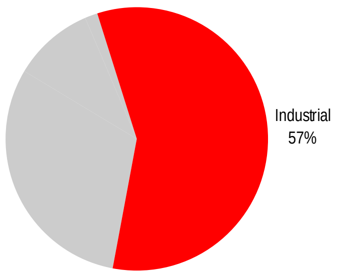
Early benefits from economic recovery expected

We expect the category to benefit relatively quickly from the expected economic recovery and improved consumer confidence. The main macro indicators for the retail segment are, of course, consumer spending and increased consumer confidence.

The industrial cycle – a volatile class

The largest asset class

Industrial share of German commercial real estate*



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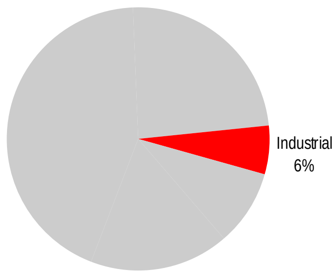
Source: BulwienGesa, HSBC Trinkaus & Burkhardt

Industrial share of European real estate investments*



*Note: * In 2003.*
Source: JLL, HSBC Trinkaus & Burkhardt

A giant asset class, but with little importance for investors

Industrial real estate is a miscellaneous category, comprising warehouses, production facilities, R&D facilities and distribution/logistics space. It is by far the largest subcategory of German commercial property, representing an estimated 57% (versus 33% for the more important office category). Nevertheless, its significance for real estate investors is relatively low, despite its high value, for a number of reasons. Industrial companies, for example, tend to own their production facilities, meaning there is little scope for investors. The latter have been willing to increase investments but past complaints about the scarcity of investment formats in Europe continue to be an issue.

Statistical data more limited in Europe than in the US

Although statistical data for the US market is relatively complete and even covers sub-categories, information on the European, and particularly the German, market is sparse, and is mainly restricted to prime rent and yield development. This is a result of the diversity of the category and the fact that most properties are tailor-made to demand, making the collection and comparison of aggregate industrial data challenging.

Early recovery expected

Industrial rents and values held up relatively well in recent downturn

The industrial sector is, in our opinion, less cyclical than other categories such as hotel or office, as supply typically reacts much faster in the ups and downs of a cycle than in the office category and, in some cases, even leads demand. Dormant space is also much more frequent in the industrial category (eg for warehouses), and has less impact on rents. This is

Real estate dynamics and market outlook

confirmed by the average decline in industrial rent of only c4% for the 16 European cities in our analysis of the current cycle. Values have also held up relatively well, declining by only 7%. Whereas rents seem to have bottomed out, remaining flat for six quarters in a row, yields have already started to compress.

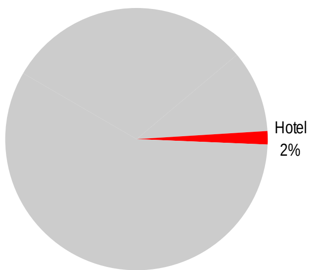
Industrial real estate to benefit quickly from economic recovery

We expect the industrial sector to benefit relatively fast from accelerating economic growth in the EU, with the warehouse sub-segment, in particular, tending to recover early. As diverse as the nature of the category is the number of indicators driving its performance: these include industrial production, retail sales, international trade, and capacity utilisation. In our opinion, industrial production growth (which is in turn a function of GDP growth) and the development of the business climate are the most important (lead) indicators.

The hotel cycle – early bird of economic recovery

More significant than you might think

Hotel share of German commercial real estate*



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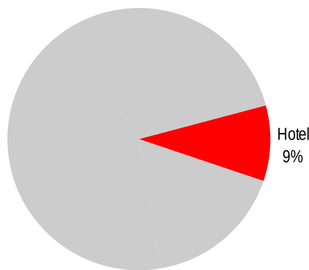
Source: BulwienGesa, HSBC Trinkaus & Burkhardt

Hotel share of European real estate investments*



*Note: * In 2003.*
Source: JLL, HSBC Trinkaus & Burkhardt

A commercial real estate dwarf with relatively high importance for investors

Despite representing only a negligible share of European commercial real estate (c2% of German commercial real estate), hotel real estate is an important category for investors. In the investment market, hotels have benefited from positioning within the cycle (with investors betting on economic recovery) and a maturing market (with more sophisticated investment vehicles). In 2003, c9% of European real estate investment was directed into the hotel segment. However, the extreme scarcity of data on a global scale for this category is probably the greatest impediment to further growth in both investments and lending. Among the globally leading real estate agents, only Jones Lang LaSalle provides some data on the market by its dedicated hotel unit (which is the clear market leader in the hotel segment). The latter provides yield ranges and trends for certain regions of the world on a regular basis.

The first to recover

Hotels are highly vulnerable to external shocks

Hotel real estate reacts very quickly to external shocks because of the short-term inflexibility of supply and the extreme volatility of the demand side. Unlike office properties, which are rented for time spans of two (Asia and the US) to seven or more years (Europe), hotels are typically rented on a weekly, if not daily, basis. The only exception is high-grade tourist hotels in top and safe locations, which have relatively constant occupation rates. They will

Real estate dynamics and market outlook

also typically be a much more liquid investment than lower-grade tourist hotels, which can be difficult to sell when the economy contracts.

Although tourism in general appeared to be a stable and growing market, events such as 9/11 have changed the structure of the sector significantly. It remains to be seen whether the current weakness in the market is a standard or a temporary feature. In general, the low end of the tourist segment displays a higher level of volatility depending on consumer confidence and trends. An investment in this segment is only suitable for investors who are prepared to live with a high degree of risk.

Hotels are the high beta play of commercial real estate...

Hotels targeting business clients are typically the first to suffer in an economic downturn, as cuts in company travel budgets lead almost immediately to lower occupation levels. On the other hand, a recovery in the economy leads to increased travel activity and a relatively short-term rise in occupation rates and room prices (hotels tend to talk about average daily rates or ADRs). Combining both effects leads to a powerful recovery of revenue per available room (RevPAR). Again, we see GDP growth and the development of business climate as the leading indicators for this category.

...as they are first to suffer and first to recover

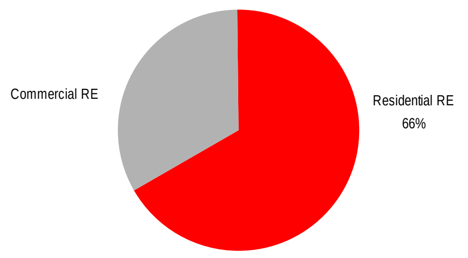
Hotels tend to lead the downswing within the real estate cycle, but are also expected to be the first category to recover. It is widely believed that office and hotel vacancies/occupation rates move in the same direction at the same time. However, we would argue that hotel real estate shows greater peaks and troughs. As a further complication, the management team is crucially important for any investment in hotel real estate. Lenders and investors tend to focus on people rather than real estate when investing in hotels.

Real estate dynamics and market outlook

The residential cycle – overshooting!

Huge markets

Residential real estate share of total German property*

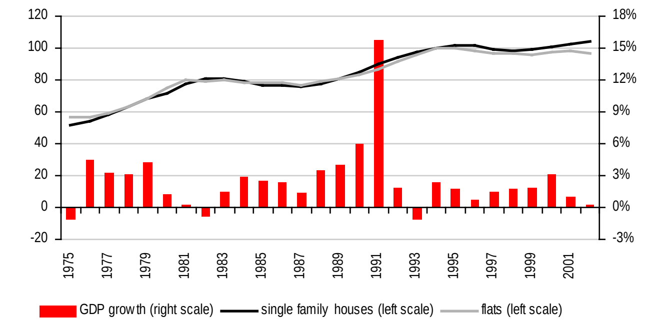


*Note: * We estimate total German commercial real estate to represent a value of EUR1.63bn in 2003. According to destatis residential real estate was valued at EUR3.21bn in 2003.*
Source: BulwienGesa, destatis, HSBC Trinkaus & Burkhardt

Residential real estate category is not clearly defined in many countries. It comprises the retail segment of individuals financing mainly self-occupied apartments or single properties or funding tax-optimised property investments, and commercial investors overseeing multi-housing real estate. In most countries, with the notable exception of the US, statistics do not differentiate between the two sub-categories. This makes analysis of data difficult.

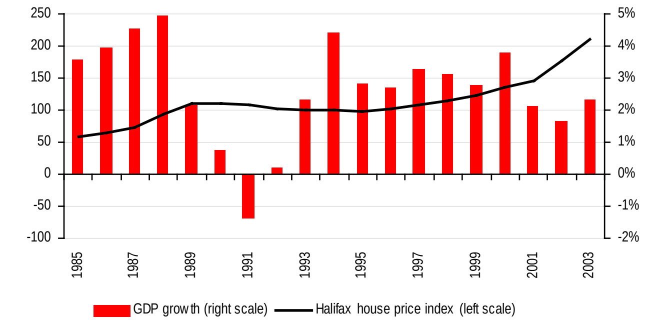
The German market moves sideways

House and flat prices* in Germany remained flat…



*Note: * Rebased to 1994.*
Source: Deutsche Bundesbank, BulwienGesa, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

…whereas the UK* experienced strong growth



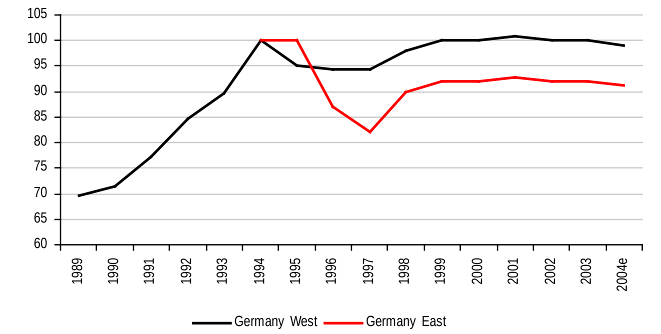
*Note: * Halifax House Price Index.*
Source: Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Residential real estate in Germany is the clear underperformer in Europe

The value development of German residential real estate has not echoed the strong surge in other European countries, notably Spain and the UK. In addition, the significant level of tax-induced investment has led to further problems in the eastern states of the country, where house prices have collapsed. This, combined with a surge in forced sales of properties as insolvencies have risen, has led to a high level of defaults in this category for real estate lenders in Germany.

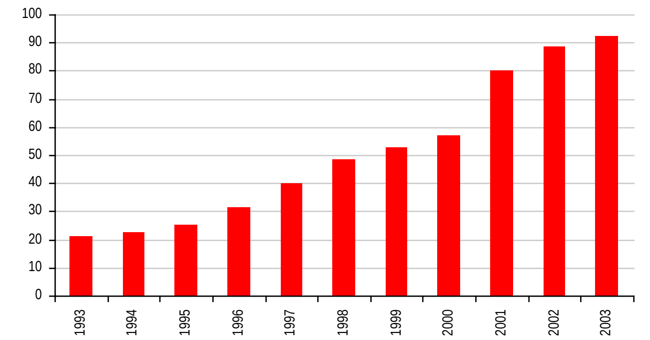
Real estate dynamics and market outlook

German house prices: the regional divide



*Note: * Rebased to 1994.*
Source: Deutsche Bundesbank, BulwienGesa, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Surge in forced sales* ('000 transactions)



Source: Argetra, HSBC Trinkaus & Burkhardt

Eastern Germany continues to cause headaches

While the slow economic recovery, combined with sustained low interest rates, is likely to have a slight positive impact in the western part of Germany, the eastern states face far more structural problems.

The sky is the limit for international markets

Sky rocketing house prices in Europe and the US have led to many warning voices

Flat prices for German residential real estate over the past 10 years contrast sharply with the price development in almost all other European countries and the US. Spanish house prices have more than doubled since end-2000, recording double-digit growth rates for five consecutive years. The Spanish Sociedad de Tasación is still upbeat on house price development. In the UK, house prices increased by 25% in 2003 alone. In the US, house prices have increased by an average of 8% over the past your years. Due to the interest rate sensitivity of residential real estate, record low mortgage rates in many countries have been a major driver of price increases.

The above development is seen as an alarming sign by many institutions:

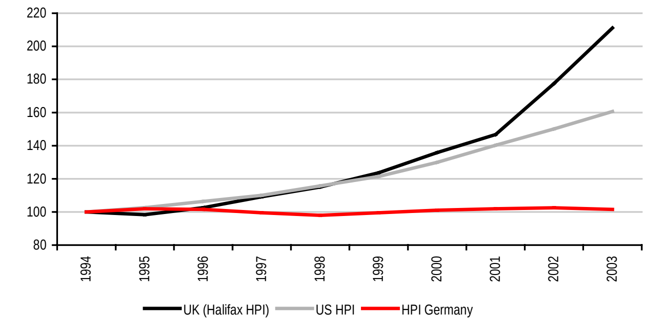
- The IMF recently reported the possibility of a sharp correction in house prices if mortgage rates (continue to) increase
- The ECB has cautioned about a possible overshooting of house prices in Europe

Short-term house financing makes countries vulnerable when interest rates rise

HSBC has already cautioned about the impact of monetary tightening on US house prices (see our report *The US Housing Bubble*, June 2004). In general, the risk of lower house prices is relatively high in countries with a high degree of mortgage financing at variable rates or with short-term maturities such as the UK, when interest rates are rising. In the UK, house price increases have slowed significantly and turned negative in summer. Although Spain is also characterised by short-term mortgage lending, we are less concerned about the situation here, as economic growth is relatively strong at present, foreign demand should also continue to be strong, and we are also less concerned about rate hikes.

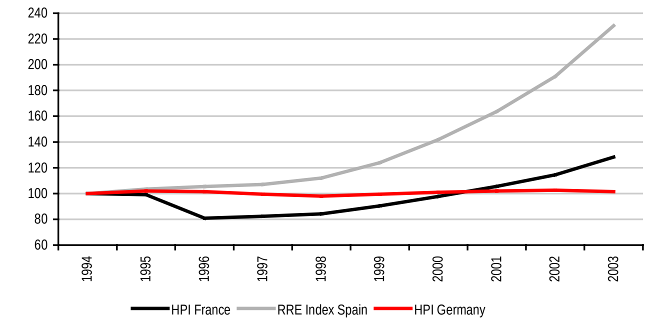
Real estate dynamics and market outlook

House price development in the UK and US…



Source: BulwienGesa, Deutsche Bundesbank, Halifax House Price Index, Office of Federal Housing Enterprise Oversight, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

…as well as Spain and France



Source: BulwienGesa, Deutsche Bundesbank, Compagnie des Notaires de Paris, Instituto de Tasación, HSBC Trinkaus & Burkhardt

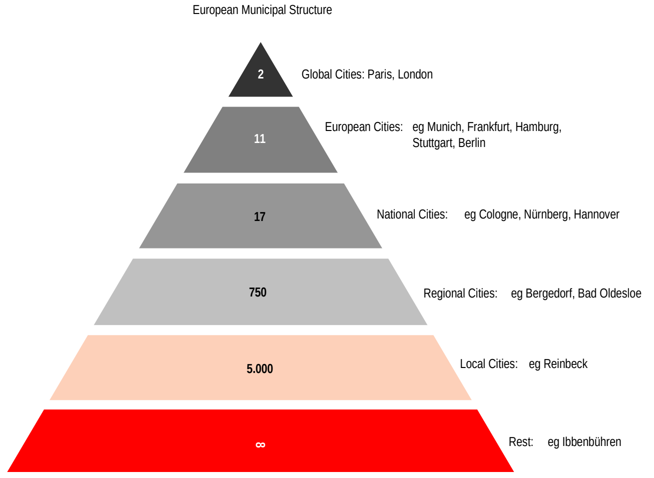
Real estate dynamics and market outlook

Country cycles – the beauty of diversity

German cycles – it's all different from here

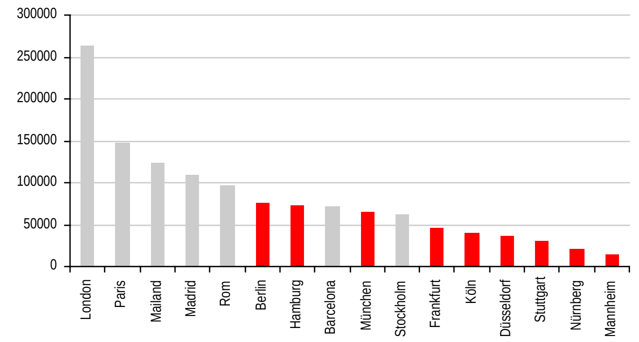
The German market is different for many reasons

No global…



Source: BulwienGesa, HSBC Trinkaus & Burkhardt

…but a handful of European cities* in Germany



*Note: * GDP 2002 (EURm).*
Source: Eurostat, HSBC Trinkaus & Burkhardt

German market differs from international market for a number of reasons

In addition to its recent underperformance across all real estate categories, the German market differs from the international market in a number of ways, including:

- The domestic real estate market is fairly evenly spread across a number of German cities. This contrasts with other countries, such as the UK and France, where focus tends to be on the relevant capital. Thus, investors and lenders alike need to have a much broader understanding of the development of different areas within Germany
- The German market is divided into East and West. As a result of massive overbuilding of real estate following reunification, real estate values in the eastern states have been in a state of continuous decline ever since
- The German market is characterised by low real estate yields due to a high degree of tax subsidies. This has also led to relatively little activity of international real estate investors
- With the possible exception of Frankfurt, the German market has, in the past, been characterised by relatively low volatility
- Germany does not have a REIT structure (although we hope it will have one soon) and real estate companies on exchanges are of relatively little importance. The only exception to this is IVG
- For some time, Germany has been characterised as a low-growth economy, representing the low end of all European countries

Real estate dynamics and market outlook

- Germany is still by far the most important market for our peer group of property companies in terms of country exposure

Office real estate sector

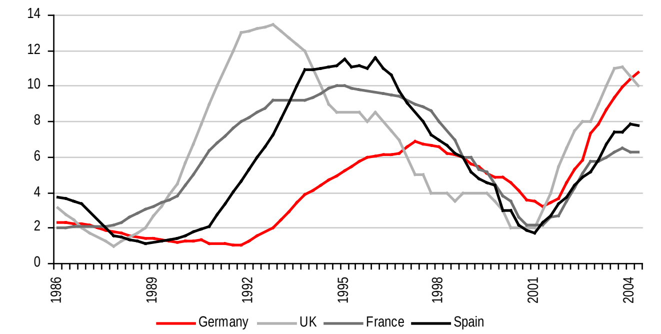
The German office real estate sector was, for many years, more stable than its European counterparts. Unfortunately, this trend has reversed in recent years, with the vacancy rate far higher than the European average. The main reason for this is widely acknowledged: the German economy, which had been growing at the low end of European countries for some years, turned negative in 2003.

What was once a relatively stable market has become increasingly volatile and weak

Although we think that economic growth will continue to accelerate in 2004 (remaining at the low end of European economies), there is little hope for substantial short-term relief. Thus, we think that effective rents in most German office markets will continue to deteriorate (though at a slower pace) in 2004/05. We expect the market to bottom out in late 2005 or early 2006 (at the earliest). Against this scenario, it seems realistic to expect a higher bottom level of vacancy rates in Germany than in the past for the time being.

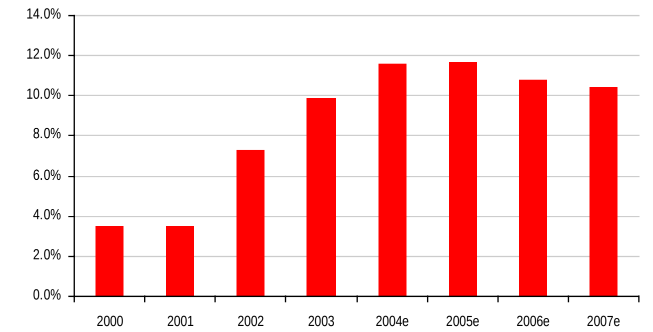
Situation not expected to improve until 2005 at the earliest

German office vacancy rate* reached European high…



*Note: * Vacancy rate excluding sublet space.*
Source: Aengevelt , Atis Müller, BulwienGesa, CBRE, C&W H&B, DEGI, DIP, dr lübke, DTZ, Eureal, Feri, gif, IVG, JLL, HSBC Trinkaus & Burkhardt

…and there is little hope for short-term improvement*



*Note: * Vacancy rate including sublet space.*
Source: Aengevelt , Atis Müller, BulwienGesa, CBRE, C&W H&B, DEGI, DIP,dr lübke, DTZ, Eureal, Feri, gif, IVG, JLL, HSBC Trinkaus & Burkhardt

Retail real estate sector

The German retail category has experienced a similar fate of underperformance on a European level. European retail had been the star performer of the German real estate market but, in recent years, values here have declined – mainly driven by disappointing retail sales due to euro irritation as well as uncertainty regarding the future development of the economy. Going forward, we expect prime rents to remain flat and lower quality locations to continue to suffer. We have some hope of an improvement in prime rents in 2005.

Strong underperformance, but bottoming out in 2004 and improvement in 2005 expected in retail…

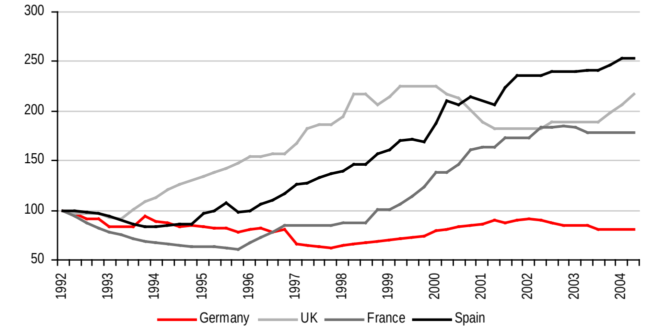
Industrial real estate sector

In line with other German real estate categories, we have observed an underperformance of the industrial category in recent years. In 2004, we expect rents in the logistics and warehouse segment to stabilise. In 2005 we expect rents to improve.

…and industrial real estate

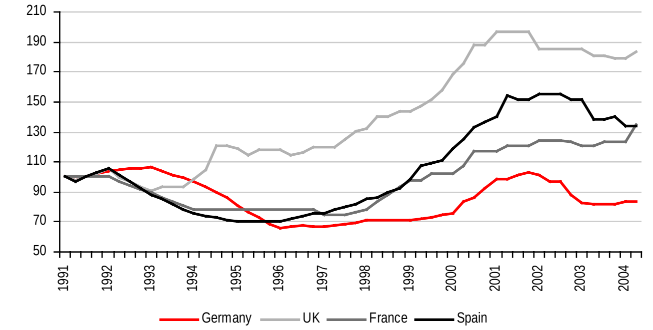
Real estate dynamics and market outlook

German retail real estate values* have not increased over the past 10 years



*Note: * All values rebased to Q1 1992.*
Source: Atis Müller, Brockhoff & Partner, BulwienGesa, CBRE, C&W H&B, DIP, DTZ, Eureal, Feri, GfK Prisma, JLL, Kempers, HSBC Trinkaus & Burkhardt

German industrial real estate values* have not increased over the past 10 years



*Note: * All values rebased to Q1 1991.*
Source: Aengevelt , Atis Müller, BulwienGesa, CBRE, C&W H&B, DEGI, DIP, dr lübke, DTZ, Eureal, Feri, gif, IVG, JLL, HSBC Trinkaus & Burkhardt

UK – a bet on finance

Office real estate sector – recovery led by West End

The UK real estate sector mainly consists of the London markets (City, West End). Unsurprisingly, these markets have been weak over recent years, with prime rents declining by c30% since the top of the cycle. However, demand has picked up recently, particularly in the West End, resulting in prime rent increases compared to a flat City market. The West End price increase in Q2 was, however, basically driven by one property – the Mayflower building. We expect further improvement on the demand side for the remainder of 2004, largely driven by a reviving financial industry. With speculative development schemes running out in 2004, prime rents should continue to increase in the West End. For the City market, we expect steady but unspectacular demand growth for the next 12-18 months, with only slightly positive impact on rents. Thus, the West End segment is still expected to be slightly ahead of the City curve in terms of recovery due to a lower vacancy rate combined with lower new supply pressure.

Office: weak recent development reversed in Q1 2004, with the West End leading the City

Retail real estate sector – rents further up

Retail prime rents were flat for prime locations in London in 2003, a trend that continued in 2004. Nevertheless, we would expect rents to show growth in 2004, benefiting from an uplift in the economy and also reviving tourism following a slow year in 2003.

Retail: flat rents in 2003 should grow in 2004

Industrial real estate sector – short-term recovery

Industrial rents have declined by only c5% since the peak of the cycle, essentially remaining flat in 2003 and H1 2004. Short term, we expect rents to benefit from an uplift in the economy. Thus, in H2 2004, rents should increase.

Industrial: rent recovery expected short term

Real estate dynamics and market outlook

France – first to recover?

Office real estate sector – recovery to be tested by landmark transactions

The French office sector (essentially the Paris market) has held up very well for a long time, with prime rents only declining by 19% between the peak in 2000/01 and end-2003. Vacancy rates stood at a moderate 6.4% – one of the lowest levels of the European markets we monitor – at end-2003. In H1 2004, messages on rent development were contradictory, with JLL reporting a stabilisation, whereas CBRE reported an accelerated decline. Vacancy rates were essentially flat. With new office supply set to ease substantially for the remainder of 2004, lower availability is likely to result in higher rent prices. We still expect the French office market to be one of the first to recover in Europe and see rents improving towards the end of this year. A lot will depend on a few landmark rental transactions: these are expected in H2 2004/H1 2005 and will effectively represent an acid test for the Paris office market.

Office: extremely resilient rents, making Paris one of the first markets likely to recover

Retail real estate sector – recovery delayed to 2005

Retail rents were flat for prime locations in Paris in 2003 as some retailers put their expansion plans on hold. The trend of soft consumer confidence continued in H1 2004. On the other hand, there is little scope for expansion of retail space in Paris. Thus, there has been little movement in rents this year. We think that prime retail rents should increase in 2005, benefiting from higher retail spending.

Retail: rent recovery in 2005

Industrial real estate sector – recovery accelerating

Paris is a major European logistics centre. Thus, industrial demand was strong in 2003 and at record levels the year before, resulting in small rent increases. Supply was lower at the beginning of 2004 making small rent increases possible. This trend should continue at an accelerated pace.

Industrial: accelerated rent growth in 2004/05

Spain – where are we heading?

Office real estate sector – strong demand and supply

The Spanish office market (comprising Madrid and Barcelona) had the lowest vacancy rates in Europe in 2000. As a result, Spanish office markets peaked relatively late in Q4 2001. Low vacancy rates also resulted in one of the strongest development pipelines in Europe, which began coming to the market just as demand began to decline again. Thus, Madrid and Barcelona were weak in 2002/03 with prime rents falling by 25%, although demand was relatively stable. New supply pressure is expected to continue in 2004 and so will prime rent declines. Nevertheless, net absorption turned positive in Q1 and Q2 due to strong job creation. Thus, rents seem close to bottoming out and we expect them to grow in 2005 due to relatively strong economic growth on the Spanish peninsula.

Office: strong new supply sent rents down in 2002/03 with recovery expected in 2005

Retail real estate sector – rents further up

Retail markets benefited from buoyant consumer spending in 2002/03 both in Barcelona and Madrid. Rent growth was slow but steady, being more pronounced in Barcelona. We would expect prime rents to continue to grow in 2004/05.

Retail: prime rent growth expected to accelerate in 2004

Real estate dynamics and market outlook

Industrial real estate sector – at the brink of recovery

Industrial space is relatively scarce in both Spanish metropolitan areas. Nevertheless, rents declined slightly in 2003. Rents bottomed out in H1 2004 and the negative price trend is expected to reverse in H2 2004 due to an accelerating economy.

Industrial: rent recovery starting in 2004

US cycles – benefiting from the global growth engine

Office real estate sector – on the brink of recovery

Unlike most European countries, the US real estate market is highly diverse with a number of extremely liquid cities. Thus, our analysis can only focus on an aggregate nationwide level that might be misleading for particular regions or cities. US office rents declined in 2003 in line with contracting employment. But the trend did reverse in the final quarter of the year, with both vacancy rates and rents showing a slight positive development. In H1 2004, rents continued to bottom out, while direct and indirect vacancy rates continued to decline.

Office: bottoming out since Q4 2003

New supply is expected to fall for the next two years in line with vacancy rates. Demand has been more moderate than expected so far, with corporates squeezing efficiency out of existing office space. Fuelled by strong economic growth, office space demand should pick up more strongly, driven rather by the services sector than the financial industrial. This is unfortunate, as the latter consumes c30% more office space per capita. Overall, we expect recovery to pick up in H2 2004, albeit at a slower pace than in the mid-1990s.

Rents expected to accelerate by end-2004, but at a lower pace than in the mid-1990s

Retail real estate sector – continuous rent increases

Retail rents have been steadily improving at an average of 2% pa over the past few years, despite slightly rising vacancy rates. We expect this trend of steady improvement to continue, with rising retail sales compensated by a relatively strong new supply pipeline. Prime locations stand to be the main beneficiaries of this trend, possibly driving rents up higher.

Retail: steady rent increase expected to continue

Industrial real estate sector – still way too much empty space

Since the collapse in demand for industrial real estate in 2000, the vacancy rate has shot up from 6.3% to currently 11.6%, sending rents down an average of 10% until the end of 2003. Q2 saw the first improvement in availability after 14 quarters of deterioration. In addition, the supply pipeline is still relatively strong. Thus, industrial hiring must be substantial to make up for what has been lost before. In a nutshell, we do not expect rents to start to recover until H2 2005.

Industrial: strong increase in vacancy and future supply will lead to a late recovery in H2 2005

Real estate dynamics and market outlook

The HSBC T&B Real Estate Matrix

Our short- to medium-term view: UK and US most favourable countries...

...hotel and industrial most attractive real estate categories

In the table below, we give an overview of the expected short- to mid-term development of the respective real estate categories and countries in terms of prime rents and investment market (prime yield). We consider the UK and the US to be the most attractive countries (with Germany bringing up the rear). Our preferred categories are hotel and industrial, with office representing the bottom of the league.

Short- to mid-term* development of real estate categories and markets**

	Office	Retail	Industrial	Hotel	Residential	Average	Inv market	Overall
Germany	2.0	3.0	2.0	3.0	2.0	**2.3**	2.0	**2.2**
UK	4.0	4.0	4.0	5.0	2.0	**4.1**	4.0	**4.1**
France	3.0	3.0	4.0	4.0	3.0	**3.2**	3.0	**3.1**
Spain	3.0	4.0	4.0	5.0	3.0	**3.6**	3.0	**3.3**
US	4.0	4.0	3.0	4.0	2.0	**3.9**	3.0	**3.5**
Average* **	**3.2**	**3.6**	**3.4**	**4.2**	**2.0**	**3.4**	**3.0**	**3.2**
Inv market	3.0	3.0	4.0	4.0	2.0	N/M	N/M	N/M
Overall	**3.1**	**3.3**	**3.7**	**4.1**	**2.0**	N/M	N/M	N/M

*Note: * 12 to 18 months development of prime rent and prime yield. ** Rent development 1: Strong decline; 3: Flat; 5: Strong improvement; Investment market 1: Strong yield widening; 3: Flat yield; 5: Strong yield compression. *** Averages weighted with category share of European investments in 2003 and equal weighted for countries.*
Source: HSBC Trinkaus & Burkhardt

Company analysis

Company analysis: our rating approach

We analyse our peer group of property companies using a rating approach. First, we look at each company's country and category exposure. Second, we analyse the rent expiry profiles of our peer group and try to analyse the impact of a G-REIT structure. As this approach is quite crude and does not really take into account a stock's individual elements, we add a 'miscellaneous' category. Finally, we assign weightings to our rating results according to the table below. In our rating approach, 5 is good and 1 is weak.

Rating summary

	Country exposure	Category exposure	Rent expiry	G-REIT factor	Other	Total
Weightings	25%	25%	15%	15%	20%	100%

Source: HSBC Trinkaus & Burkhardt

Company analysis against country cycles

AIG has best country exposure according to our rating

	AIG		DES		IVG		Vivacon		Average*	
	Country share	Country rating	Country share	Country rating	Country share	Country rating	Country share	Country rating	Country share	Country rating
Germany	4.6%	2.17	78.0%	2.17	39.9%	2.17	100.0%	2.17	55.6%	2.17
UK	0.0%	4.05	0.0%	4.05	5.1%	4.05	0.0%	4.05	1.3%	4.05
France	1.2%	3.09	6.0%	3.09	9.4%	3.09	0.0%	3.09	4.2%	3.09
Spain	0.0%	3.58	0.0%	3.58	0.0%	3.58	0.0%	3.58	0.0%	3.58
US	35.6%	3.46	0.0%	3.46	0.0%	3.46	0.0%	3.46	8.9%	3.46
Other	58.6%	3.00	16.0%	3.00	45.6%	3.00	0.0%	3.00	30.1%	3.00
Total	**100.0%**	**3.13**	**100.0%**	**2.36**	**100.0%**	**2.73**	**100.0%**	**2.17**	**100.0%**	**2.60**

*Note: *Equal weighted*
Source: Company data, HSBC Trinkaus & Burkhardt

AIG has best country exposure due to low German share

The above table is a result of applying our peer group's country exposure to the result of our HSBC T&B cycles matrix. As a result of the table above, we draw the following conclusions:

- Germany is by far the most important country for our peer group, representing an average exposure of 56%
- AIG has the best country exposure according to our analysis, as a result of its very low German exposure
- AIG also owns the most diversified portfolio

Company analysis

Company analysis against category cycles

DtES has best category exposure*

	AIG		DES		IVG		Vivacon		Average**	
	Cat share	Cat rating	Cat share	Cat rating	Cat share	Cat rating	Cat share	Cat rating	Cat share	Cat rating
Office	22.0%	3.10	1.4%	3.10	80.8%	3.10	5.0%	3.10	27.3%	3.10
Retail***	3.5%	3.30	98.6%	3.50	4.4%	3.30	5.0%	3.30	27.9%	3.30
Industrial	29.4%	3.70	0.0%	3.70	10.9%	3.70	0.0%	3.70	10.1%	3.70
Residential	45.1%	2.00	0.0%	2.00	0.0%	2.00	90.0%	2.00	33.8%	2.00
Other	0.0%	3.00	0.0%	3.00	3.9%	3.00	0.0%	3.00	1.0%	3.00
Total	**100.0%**	**2.79**	**100.0%**	**3.49**	**100.0%**	**3.17**	**100.0%**	**2.12**	**100.0%**	**2.84**

*Note: *5 is good, 1 is weak, ** Equal weighted, ***We have increased the category rating for DtES due to more favourable shopping centre exposure*
Source: Company data, HSBC Trinkaus & Burkhardt

DES has best category exposure due to strong retail focus

The above table is a result of applying our peer group's category exposure to the result of our HSBC T&B cycles matrix. We have increased the retail category weighting for DES from 3.3 to 3.5 as we continue to believe that the shopping centre format will outperform other retail formats. We draw the following conclusions from the table above:

- Our peer group has an almost even split between office, retail and residential. Industrial property is under-represented, explained by the often-cited lack of investible formats
- DES has by far the best category exposure according to our analysis
- Our peer group allows investors to play recovery cycles of different property categories: IVG for office, DES for retail, and AIG and Vivacon for residential. We acknowledge that the latter is a developer and thus less dependent on recovery cycles than investors

Company analysis against expiry profiles

Peer group rent expiry profiles

	2003	2004e	2005e	2006e	2007e	2008e*	total
AIG**	N/A	4.5%	24.4%	20.7%	3.8%	46.6%	100.0%
DES	2.0%	3.0%	2.0%	5.0%	3.0%	87.0%	100.0%
IVG	13.0%	18.2%	10.4%	10.9%	15.6%	44.9%	100.0%
Open funds	8.9%	11.1%	8.8%	9.5%	8.4%	62.2%	100.0%

*Note: *5 is good, 1 is weak and beyond, ** based on properties representing 81% of investment value*
Source: Company data, BVI, HSBC Trinkaus & Burkhardt

DES has best rent expiry profile

In the table above, we give an overview of the rent expiry profiles of DES and IVG. AIG does not provide expiry data on all properties, stating that data would be of limited value given the company's extreme 'Buy and Sell' approach. We have included data for 81% of AIG's portfolio. As Vivacon is a developer and has only one property, investment rent expiry profiles do not make sense in our view. As a source of reference, we have included rent expiries of German open-end funds. A high share of rent expiries in any given year can be considered good or bad according to the state of the property market. The latter converts in upside or downside pressure to the average rent level of a property stock. At present, we

Company analysis

consider a low share of rent expiries for the near future to be advantageous as property markets near the bottom of the cycle. Thus, the possibility of a negative impact on rents does still exist in our view. Thus, DES, with expiry rates of 2-3% for the next few years, is in a much better position than, say, IVG with double-digit expiry rates. AIG has an extremely high number of expiries in 2005/06, but these are mainly related to US multi-housing properties. The latter market is still in very good shape in terms of rental conditions, meaning that expiries could even present an opportunity for AIG.

DES has best rent expiry profile

Company	Rent expiry rating
AIG	4
DES	5
IVG	2
Vivacon	N/M

*Note: *5 is good, 1 is weak*
Source: HSBC Trinkaus & Burkhardt

Company analysis based on potential G-REIT impact

How large is the G-REIT tax advantage really?

In theory simple, in practice difficult

Calculating the tax advantage of a G-REIT structure is simple in theory. The positive impact for a property stock is the (positive) difference between the NPV of the tax advantage and the exit or conversion tax paid. The latter is simple to calculate when latent capital gains and exit rate are fixed (unfortunately, they are far from being fixed at present). Deriving the NPV of the tax advantage is more difficult. It is a no-brainer that on company level the tax impact is always positive when the property company is generating profits. The NPV at company level is then simply taken as being the (old) tax rate applied to future profits discounted back to today. Simple so far. Carrying out this exercise for IVG generates NPVs far higher than exit tax payments under all scenarios. This implies that a G-REIT structure would have a massively positive impact on the company's valuation. This procedure is also in line with our approach to company valuation, ie we simply ignore the degree of taxation at investor level.

We see, however, a difference between a REIT and a 'normal' company. The tax transparency at REIT level will certainly come at the expense of a higher taxation at investor level. This, however, is highly dependent on the investor structure (private, corporate, fund, etc) and where the investor is based (ie domestic or international). Thus, we fear that investor taxation levels will be much more heterogeneous within a REIT structure. We think that the total taxation level will range from normal levels compared with a current property stock to effectively zero. If tax differences prove as substantial as we expect, the launch of a G-REIT structure is likely to have a tremendous impact on the shareholder structure of property stocks in Germany. In the table below, we compare the shareholder structure of US REITs, NYSE listed stocks and German stocks, and find that funds are the dominant shareholders at 68%.

Company analysis

Individual and fund investors dominate REIT market

	German stocks	US REITs	NYSE	Diff REIT/ German	Diff REIT/ NYSE
Funds	19%	68%	31%	49%	37%
Individual investors	13%	16%	37%	3%	-21%
Other	68%	16%	32%	-52%	-16%
Total	**100%**	**100%**	**100%**	**0%**	**0%**

Source: DAI factbook 2003, Maximus advisors, NYSE factbook 2003, HSBC Trinkaus & Burkhardt

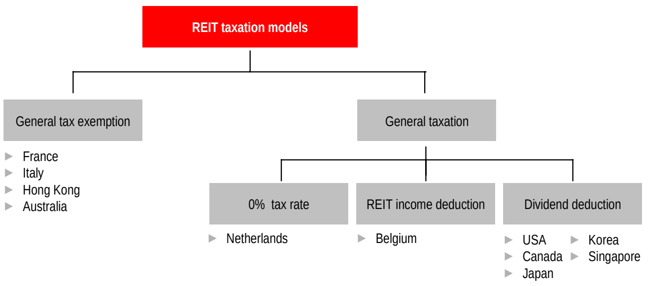
Different kinds of tax transparency

Tax transparency models

Transparency models			
Transparency model	REIT transparency	Partial transparency	Full transparency
Vehicle*	US REIT	German Open Fund	German Closed Fund
Income	Dividend	Rental income capital gains	Rental income capital gains
Taxation	Investor as dividend income	Investor as rental income/capital gains	Investor as commercial income
Losses	Not passed through to investor	Not passed through to investor	Passed through to investor

*Note: * Examples*
Source: HSBC Trinkaus & Burkhardt

REIT taxation models



Source: EPRA, Ernst & Young, KPMG, National Jurisdictions, HSBC Trinkaus & Burkhardt

Different REIT structures offer varying tax options

The introduction of a G-REIT structure also involves the question how REITs will actually be taxed. Unfortunately, it is not simply the case that G-REITs will not be subject to any form of taxation of that they will all be tax-transparent vehicles. We distinguish between different types of tax transparencies (full for German closed funds, partial for German open funds and REIT tax transparency). The latter again is far from being homogenous, with models ranging from general tax exemption to general taxation models. We provide an overview in the chart above.

The REIT role model in the US requires an annual REIT compliance test, which then results in dividends being tax deductible. This would mean that, in the event of a 100% payout ratio of taxable income, the REIT would effectively not pay any tax. The minimum requirement to obtain/maintain a REIT status is a 90% payout ratio. In practice, REITs tend to pay out more than the legal minimum, in some cases even exceeding 100% temporarily. REITs also tend to pay out more 100% of taxable income and therefore owe no corporate tax in practice. Shareholders pay 35% tax on dividends received compared with 15% on taxed dividends from non-REIT companies. In addition, most states honour this federal treatment and also do not require REITs to pay state income tax. Like other businesses, but unlike partnerships, REITs cannot pass tax losses through onto investors.

Preliminary results of our tax model

G-REIT taxation likely to require further tax changes

We think that the possible tax treatment is even more uncertain at present than the launch of G-REIT legislation in general. This raises a number of questions:

Company analysis

- The half-income taxation cannot be maintained in our view. It would lead to substantially lower overall tax charge on domestic profits. Given tight public budgets at present, we think it is unlikely that the regulator will give away money this way.
- If G-REIT dividends are fully taxed at investor level, international profits will be penalised quite substantially by being subject to full double taxation. Thus, it would be preferable to make international profits tax exempt at (private) investor level.
- Withholding tax on dividends distributed to foreign investors is likely to have to change. Withholding tax currently ranges from 0% to 15% depending on double-taxation agreements. Most foreign (European) institutional investors are not charged withholding tax due to the parent-subsidiary (EU) directive. This would mean that G-REIT dividends for foreign investors would effectively not get taxed domestically at all. As this would mean the loss of tax money, withholding tax on G-REIT dividends would be likely to rise. We acknowledge that this will depend on the legal treatment of REIT dividends within existing tax treaties. Tax treaties are bilateral agreements and changing them is a long-lasting political process, which, in practice, would prove difficult. The US REIT regime includes a 30% withholding tax on dividends and 35% on capital gains. In Canada and France, withholding tax is 25%. These tax rates can, however, be reduced pursuant to the application of tax treaties. The US recently significantly reduced hurdles for the application of tax treaties on REIT dividends.
- How will non G-REIT profits be taxed? Which tax rate will be applied?

Nevertheless, we have applied tax transparency to our tax model to simulate G-REIT taxation. We have left all revenue and tax assumptions of our base case (presented on page 30) unchanged. For simplicity reasons, we have opted for the partial tax transparency model of German open funds. In doing so, the tax treatment of a G-REIT is exactly equal to an open end fund (this is not to say that we favour a REIT status among the InvG). Compared with current taxation of a listed property company, the G-REIT is advantageous when the former pays out full profit as dividends. We arrive at a tax advantage of the G-REIT structure of 6% for private investors and 4% for corporate investors. If dividends are retained by Immo AG, the G-REIT structure can also lead to a (substantially) higher tax charge compared with open end funds. In general, the tax advantage of the G-REIT increases the higher the share of lower taxed international profits and the higher the degree of tax-free profits. For private and corporate investors, the case for a G-REIT is therefore highly dependent on the investor's preference for high payout ratios.

In addition, we have included funds in our analysis, as they are the largest REIT investor group in the US. As funds are generally not taxed, they would receive the untaxed dividend, which would lead to substantial performance advantages. Thus, funds appear to be the main beneficiaries of REIT legislation.

Company analysis

Possible G-REIT taxation comparison (EURm)

Taxation/investment vehicle	Immo AG*	Immo AG**	G-REIT	Open fund
International tax	-15.00	-15.00	-15.00	-15.00
German trade tax	-	-	-	-
German corporate tax	-12.50	-12.50	-	-
German SolZ	-0.69	-0.69	-	-
Total taxation	-28.19	-28.19	-15.00	-15.00
Total tax rate	-28.19%	-28.19%	-15.00%	-15.0%
Distributable profit	**71.81**	**71.81**	**85.00**	**85.00**
Private investor				
Income tax	-16.16	-	-22.50	-22.50
SolZ	-0.89	-	-1.24	-1.24
Total taxation private level	-17.05	-	-23.74	-23.74
Net income	**54.77**	**71.81**	**61.26**	**61.26**
Total taxation	-45.23	-28.19	-38.74	-38.74
Total tax rate	-45.23%	-28.19%	-38.74%	-38.74%
Corporate investor				
German trade tax	-14.15	-0.71	-9.85	-9.85
German corporate tax	2.64	-0.72	-10.04	-10.04
German SolZ	0.15	-0.04	-0.55	-0.55
Total taxation corp level	-11.36	-1.47	-20.44	-20.44
Net Income	**60.45**	**70.34**	**64.56**	**64.56**
Total taxation	-39.55	-29.66	-35.44	-35.44
Total tax rate	-39.55%	-29.66%	-35.44%	-35.44%
Fund*		***No taxation at fund level***		
Net income	**71.81**	**71.81**	**85.00**	**N/M**
Total taxation	-28.19	-28.19	-15.00	N/M
Total tax rate	-28.19%	-28.19%	-15.00%	N/M

*Note: * assuming pay out ratio of 100%, ** assuming pay out ratio of 0%, *** not considering the taxation at fund investor level*
Source: EStG, GewStG, KöStG, OECD double taxation treatment model, SolZG, HSBC Trinkaus & Burkhardt

We expect a strong clientele effect

Open-end equity and mutual funds likely to be a winner of G-REIT taxation

In view of the results above, we would reiterate our thesis that the introduction of G-REIT legislation should have a significant impact on the current shareholder structure of property stocks in Germany. Assuming that the taxation regime turns out to be somewhere close to our assumptions above, we would expect the following:

- G-REITs with a high degree of domestic profits should attract public open-end equity or mutual funds as their most important investor group, as the latter benefit from tax-free gross dividends. We think this will be different with specialty funds. Due to the limited number of investors in a specialty fund, they will have a much higher degree of influence on the fund manager. Thus, their tax situation and its impact on post-tax performance is more likely to be considered by the fund manager.
- G-REITs with a high degree of domestic profits will also be very attractive to private investors with a low tax rate.
- G-REITs with a high degree of international profits (assuming international activities are allowed) will find corporate and private investors with a high tax rate as their most

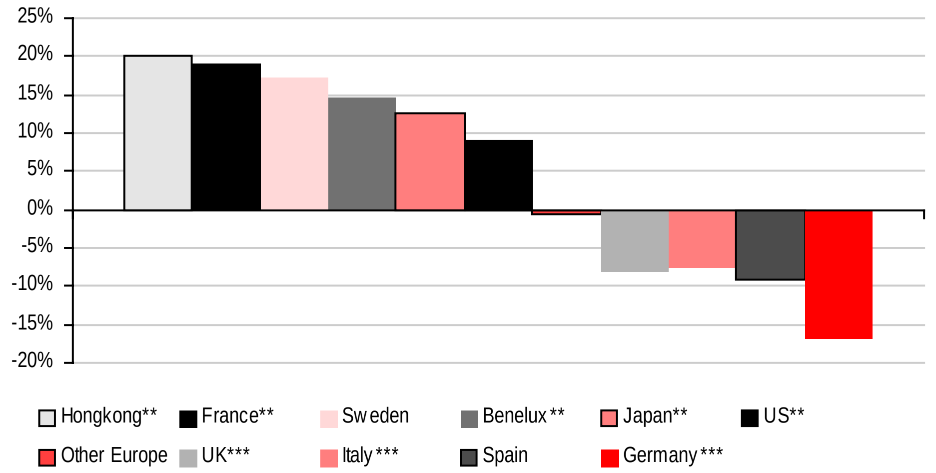
Company analysis

important investor groups, as the latter benefit from lower international taxation levels and tax exemption at investor level.

- The existing shareholder structure of property stocks would be likely to have a significant impact on the decision to convert into a G-REIT. We would expect large shareholders to definitely discuss the conversion issue with their holdings.

Will a G-REIT structure close the gap to NAV?

The conventional wisdom is: REIT countries trade at higher values*



*Note: *discount/premium to NAV, ** Country has a REIT structure, *** REIT structure under consideration*
Source: Green Street Advisors, JCF, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

German property stocks trade at a strong discount to NAV…

The chart above is currently displayed in almost any panel discussion tackling the introduction of a G-REIT structure in Germany and its benefits. The generally drawn conclusions are:

- REIT countries trade at higher valuations, therefore the introduction of REIT adds value
- Poorly performing German property stocks will close the gap to NAV by the introduction of a G-REIT structure

Company analysis

...but the missing REIT structure is not the only reason for this...

We find this leap of logic too simplistic. We have shown earlier that the listed property sector performs in line with the private real estate sector. It is therefore logical to assume that the poor performance of the German real estate market in the past had a major impact on the development of German property stocks and on German property investment vehicles in general. In order to verify this, we have compared the annual performance of different property investment vehicles in REIT and non-REIT countries from 1998 to 2003. The time span and country selection was basically a function of the data available for the private real estate market, where (total) return statistics do not reach far back for many locations. The notable exceptions are the UK where the IPD discloses data going back to 1980 (on a monthly basis) and the US where NCREIF started disclosing return data in 1978. We have summarised the results in the chart below. Taxation is a distorting factor, with some performance data (IPD, NPI, German open-end funds investing in domestic properties, PPFs and REITs) not considering taxation, while others do partly (German property stocks and German open-end funds investing in international properties). Leverage is another distorting element as total returns of private real estate assume an unleveraged property, whereas stocks are geared.

...as underperformance went across all investment vehicles

Nevertheless, we think the following conclusions can be drawn:

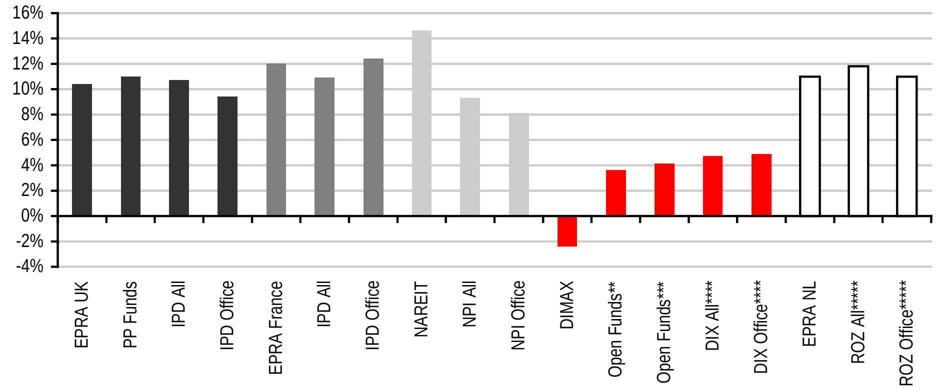
- Performance of German property stocks has been poor, indeed weaker than open-end funds and the underlying property market. The performance gap to open-end might be partly explained by a tax disadvantage depending on payout strategy of the company. More importantly, we think that higher gearing of stocks compared with usually unleveraged open end funds has had a negative impact as total returns of properties were lower than cost of funding.

- German property stocks have performed much worse than their European and US peers, but the underperformance went across all German property investment vehicles. While we think that a missing G-REIT structure might be one reason for property stocks' sad performance, the disappointing performance of the German private property sector was a main driver of underperformance in our view.

- Listed property stocks in REIT countries performed in line (Netherlands) or better (US and France) than the underlying property markets, partly due to a positive leverage effect (annual total return of the property higher than cost of funding). In the US in particular as the most mature REIT market, the outperformance was substantial at around five percentage points a year. Thus, it seems that a REIT structure can add value for property investors.

Company analysis

Performance* of different property investment vehicles in Germany, France, Netherlands, UK and the US



*Note: * annual performance 1998 until 2003, ** domestic investments, *** domestic and international investments, ****IPD Germany is a joint venture with DID and called DIX, ***** IPD Netherlands is a joint venture called ROZ*
Source: Bloomberg, BVI, CBRE, DID, EPRA, Ellwanger & Geiger, IPD, JLL, NCREIF, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

In a next step, we have taken through the cycle (total) performance data of private real estate from different countries and modelled discounts to NAV for idealised property companies. Therefore, we have assumed identical gearing ratios and identical tax rates for all countries in order to arrive at comparable results. Note that the NAV discounts and premiums used are not intended to be an indication of where property stocks of different countries should trade. This exercise only tells us which underlying property markets laid the foundation of value generation for an identical company operating in an identical tax environment.

Ceteris paribus modelled NAV valuation (discounts and premiums) last cycle*

	Office	Retail	Industrial**	Residential	All property
Germany	-70.0%	-52.0%	-70.0%	-86.0%	**-72.0%**
UK	22.7%	44.7%	61.2%	90.6%	**41.0%**
France***	56.4%	139.1%	52.5%	-32.2%	**30.8%**
Netherlands****	55.0%	47.0%	67.0%	93.0%	**73.0%**
US	37.9%	34.9%	45.7%	34.9%	**27.7%**
Total category***	**20.4%**	**42.7%**	**31.3%**	**20.1%**	**20.1%**

*Note: * Average of 1996-2003, **Industrial represents the category 'other' of DID for Germany, *** comprises only six performance years, **** comprises nine years of performance, *****equal weighted*
Source: DID, Halifax House Price Index, IPD, NCREIF, OFHEO, ROZ, Thomson Financial Datastream, IPD, HSBC Trinkaus & Burkhardt

The result of this exercise is very interesting. Whereas international property markets were highly value generative, the German market was a disaster. Even stripping out a possible tax disadvantage compared to REITs in other countries (in assuming identical tax rates), our idealised German property company massively destroyed value. Again, the reason was the disappointing development of the German real estate market, leading to a negative leverage effect (ie total property returns were much lower than cost of funding).

Company analysis

In another exercise, we applied a tax exemption to our base scenario above in order to simulate the positive tax advantage a REIT structure might have. We have not considered a possible exit tax charge as this would require too many assumptions on latent capital gains and exit tax rate, etc. Our calculations show that the impact on valuations of the German property would have been low at only 8% of NAV, whereas other countries yield valuation upside of 37-49% of NAV. Again, this exercise does not account for a higher taxation at investor level. Recalling that a tax rate cut becomes more valuable the more profits are generated, the result is unsurprising as our German model company's profitability was way below average.

REIT impact last cycle* assuming tax exemption (not considering exit tax and higher taxation at investor level!)

	Office	Retail	Industrial**	Residential	All property
Germany	8.6%	13.7%	8.6%	4.0%	**8.0%**
UK	35.0%	41.3%	46.1%	54.4%	**40.3%**
France***	44.7%	68.3%	43.6%	19.4%	**37.4%**
Netherlands****	44.3%	42.0%	47.7%	55.1%	**49.4%**
US	39.4%	38.5%	41.6%	38.5%	**36.5%**
Total category***	**34.4%**	**40.8%**	**37.5%**	**34.3%**	**34.3%**

*Note: * Average of 1996-2003, **Industrial represents the category 'other' of DID for Germany, *** comprises only six performance years, **** comprises nine years of performance, *****equal weighted*
Source: DID, Halifax House Price Index, IPD, NCREIF, OFHEO, ROZ, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

The above analysis indicates that a REIT structure can have a positive impact on valuation. However, the underlying property market is an equally important driver. With the outlook for German real estate being dull or at least below average, we think that a valuation discount compared with other countries will remain and we are unsure whether the gap to NAV will be closed by the introduction of a G-REIT alone. Nevertheless, should the outlook for the German property market turn more bullish, the NAV gap could diminish.

Our G-REIT rating

IVG likely to be the largest winner of a G-REIT structure

We have analysed the potential impact of a G-REIT structure on individual stocks in the company divisions of this report. We have only looked at the direct impact on the company's financials and have not considered the general positive impact on the whole sector (ie higher interest from investors, better analyst coverage, increase in liquidity, etc). Although the shape of the G-REIT structure is still uncertain, our initial findings are as follows:

- We think that IVG is most likely to be the largest beneficiary of our peer group, due to relatively large exposure in Germany
- AIG could be a beneficiary if the G-REIT structure is flexible in terms of geographic reach
- DES is unlikely to benefit from a G-REIT structure medium to long term as the company is already better than a REIT paying almost no corporate tax and tax-free dividends
- Vivacon is unlikely to benefit from a G-REIT structure as it has a very high property development exposure

Company analysis

IVG has highest G-REIT factor

Company	G-REIT factor*
AIG	3
DES	1
IVG	4
Vivacon	1

*Note: *5 is good, 1 is weak*
Source: HSBC Trinkaus & Burkhardt

Summary of rating approach

DES ranks best on our rating approach

In the table below we summarise the results of our rating approach. Based on our fundamental company analysis, DES ranks first with an overall rating of 3.36 followed by IVG with a rating of 2.98. AIG comes third with a rating of 2.93. Note that Vivacon only met four of the five criteria needed for our rating approach due to its strong focus on project development. As our rating approach is more suitable for investors, we feel that property developers such as Vivacon could be penalised, leading to a lower rating than deserved.

Rating summary

	Country exposure	Category exposure	Rent expiry	G-REIT factor	Other	Rating
Weightings	25%	25%	15%	15%	20%	**100%**
AIG	3.13	2.79	4.00	3.00	2.00	**2.93**
DES	2.36	3.49	5.00	1.00	5.00	**3.36**
IVG	2.73	3.17	2.00	4.00	3.00	**2.98**
Vivacon*	2.17	2.12	nm	1.00	5.00	**2.61**
Average	**2.60**	**2.89**	**3.67**	**2.25**	**3.75**	**3.01**

*Note: * Vivacon's rating is based on only four criteria which are extrapolated to 100%*
Source: HSBC Trinkaus & Burkhardt

Standard valuation metrics

IVG trades at highest discount to NAV

In the table below we give an overview of standard valuation metrics of our companies and its European peer group. IVG trades at the highest discount of 20% to NAV followed by DES trading at a discount of 16%. AIG trades on the lowest discount to NAV of 12%.

Company analysis

Property investor peer group

	PE			Price/Book			RoE			NAV	Price/NAV	Premium	EV/EBITDA		
Germany* **	**2004e**	**2005e**	**2006e**	**2004e**	**2005e**	**2006e**	**2004e**	**2005e**	**2006e**				**2004e**	**2005e**	**2006e**
AIG	12.74	12.58	11.85	0.87	0.79	0.72	7.10%	6.60%	6.30%	28.46	0.88	-12.2%	14.03	8.84	8.07
Deutsche Euroshop	113.43	89.82	66.68	0.82	0.79	0.76	1.04%	1.31%	1.82%	43.56	0.84	-16.0%	18.44	16.54	15.74
IVG	18.71	16.23	13.04	0.83	0.80	0.77	8.52%	9.46%	11.11%	14.41	0.80	-20.3%	16.59	15.06	13.55
Mean	48.29	39.54	30.52	0.84	0.79	0.75	5.55%	5.79%	6.41%	28.81	0.84	-16.1%	16.35	13.48	12.45
Median	18.71	16.23	13.04	0.83	0.79	0.76	7.10%	6.60%	6.30%	28.46	0.84	-16.0%	16.59	15.06	13.55
UK* **	**2004e**	**2005e**	**2006e**	**2004e**	**2005e**	**2006e**	**2004e**	**2005e**	**2006e**				**2004e**	**2005e**	**2006e**
British Land	28.14	25.37	24.96	0.76	0.71	0.65	2.02%	2.17%	2.31%	14.3	0.78	-22.1%	17.79	18.04	19.64
Hammerson	27.78	25.60	23.57	0.90	0.84	0.78	2.32%	2.47%	2.56%	12.3	0.91	-9.4%	20.68	21.77	22.02
Land Securities	22.23	20.13	19.02	0.96	0.90	0.84	3.17%	3.37%	3.44%	18.3	0.96	-3.7%	15.65	14.82	16.96
Liberty International	30.85	27.79	24.52	0.93	0.89	0.84	3.03%	3.33%	3.53%	13.9	0.89	-10.9%	19.38	19.35	18.36
Slough Estates	17.65	15.99	14.76	0.86	0.82	0.78	3.45%	3.68%	3.92%	7.6	0.87	-13.3%	15.02	15.09	15.05
Ashtenne Holdings	58.97	45.65	28.53	1.63	1.44	1.31	2.70%	2.93%	3.26%	5.2	1.04	4.0%	40.84	278.74	117.53
Brixton Estates	22.06	19.70	19.03	0.86	0.82	0.77	3.88%	3.94%	4.00%	5.0	0.86	-13.8%	21.30	17.52	17.70
Mucklow	23.63	22.29	17.65	0.87	0.83	0.78	3.77%	4.04%	4.37%	5.4	0.89	-11.4%	13.66	12.78	11.12
Workspace	33.01	29.39	22.02	0.99	0.89	0.75	1.68%	1.85%	2.03%	27.6	1.05	5.0%	20.37	19.08	18.36
Grainger Trust	16.03	17.22	19.60	2.39	2.09	1.88	1.10%	1.26%		38.0	0.64	-35.7%	12.44	13.81	14.74
Pillar Property Group	87.44	84.36	59.37	0.98	0.90	0.82	1.25%	1.32%	1.38%	9.7	1.05	4.6%	40.69	49.73	50.12
Nhp	21.68	20.49	19.45	1.61	1.60	1.56	3.48%	3.72%	3.69%	3.0	1.24	24.2%	15.60	14.15	13.65
Unite Group	high	96.59	34.36	0.77	0.69	0.58	0.99%	1.03%	1.06%	4.6	0.78	-21.5%	24.12	21.45	19.68
Mean	32.46	34.66	25.14	1.12	1.03	0.95	2.53%	2.70%	2.96%	12.7	0.92	-8.0%	21.35	39.72	27.30
Median	25.70	25.37	22.02	0.93	0.89	0.78	2.70%	2.93%	3.35%	9.7	0.89	-10.9%	19.38	18.04	18.36
France **	**2004e**	**2005e**	**2006e**	**2004e**	**2005e**	**2006e**	**2004e**	**2005e**	**2006e**				**2004e**	**2005e**	**2006e**
Gecina	23.17	20.28	18.33	0.97	0.91	0.88	4.32%	4.29%	4.69%	71.5	0.99	-1.5%	20.08	19.32	17.27
Klepierre	24.50	21.39	19.30	1.39	1.34	1.32	4.03%	4.14%	5.20%	49.5	1.27	27.2%	17.31	15.92	13.95
Silic	30.65	29.69	29.04	1.13	1.02	0.92	4.68%	5.14%	5.44%	55.0	1.20	20.4%	15.77	15.36	15.05
Unibail	27.52	26.60	22.68	1.50	1.55	1.50	3.44%	3.72%	3.85%	83.0	1.30	29.9%	17.87	18.28	16.46
Mean	26.46	24.49	22.33	1.25	1.21	1.15	4.12%	4.32%	4.79%	64.8	1.19	19.0%	17.76	17.22	15.68
Median	26.01	23.99	20.99	1.26	1.18	1.12	4.18%	4.21%	4.94%	63.3	1.24	23.8%	17.59	17.10	15.75
Benelux **	**2004e**	**2005e**	**2006e**	**2004e**	**2005e**	**2006e**	**2004e**	**2005e**	**2006e**				**2004e**	**2005e**	**2006e**
Cofinimmo	14.62	13.95	13.73	1.10	1.07	1.07	6.29%	6.34%	6.33%	104.0	1.12	12.4%	21.09	18.58	17.88
Corio	14.21	14.15	13.25	1.19	1.14	1.10	5.84%	5.82%	6.01%	32.2	1.28	27.6%	17.41	17.57	17.56
Eurocommercial	16.06	15.31	16.05	1.08	1.03	1.10	6.22%	6.50%	6.40%	21.7	1.15	15.2%	17.44	16.94	15.59
Rodamco Europe	14.66	13.73	12.18	1.13	1.08	1.03	5.27%	5.46%	5.66%	47.5	1.17	16.6%	17.95	18.36	16.60
Vastned Retail	13.33	13.35	12.40	1.09	1.06	1.04	7.51%	7.89%	7.95%	43.0	1.16	16.1%	13.80	14.35	13.84
Vastned O/I	10.27	11.41	11.98	0.88	0.95	0.97	9.79%	8.69%	8.35%	22.7	0.96	-3.7%	12.81	12.97	13.26
Wereldhave	12.46	11.86	11.53	1.12	1.09	0.99	6.19%	6.47%	6.75%	62.8	1.18	17.6%	15.08	14.46	13.59
Mean	13.66	13.39	13.02	1.08	1.06	1.04	6.73%	6.74%	6.78%	47.7	1.15	14.6%	16.51	16.18	15.47
Median	14.21	13.73	12.40	1.10	1.07	1.04	6.22%	6.47%	6.40%	43.0	1.16	16.1%	17.41	16.94	15.59

Source: JCF, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Company analysis

Property investor peer group

	P/E			Price/Book			RoE			NAV	Price/NAV	Premium	EV/EBITDA		
Sweden	**2004e**	**2005e**	**2006e**	**2004e**	**2005e**	**2006e**	**2004e**	**2005e**	**2006e**				**2004e**	**2005e**	**2006e**
Castellum	19.39	20.30	21.13	2.03	2.00	1.97	3.91%	4.12%	4.12%	23.0	1.19	18.6%	15.40	15.98	15.32
Fabege	12.96	18.10	19.78	1.05	1.05	1.02	4.59%	4.86%	5.66%	13.4	0.88	-11.6%	12.82	16.58	15.56
Hufvudstaden	19.40	22.77	22.88	1.90	1.85	1.81	2.71%	2.92%	2.92%	4.9	1.09	8.9%	14.63	15.66	15.09
Kungsleden	13.33	13.41	13.03	1.67	1.60	1.54	5.10%	5.29%	5.29%	19.5	1.52	52.1%	15.28	15.39	14.92
Wihlborgs	20.26	20.35	18.55	1.15	1.14	1.14	4.69%	4.80%	5.01%	12.4	1.19	18.5%	22.24	16.28	15.39
Mean	17.07	18.99	19.07	1.56	1.53	1.50	4.20%	4.40%	4.60%	14.7	1.17	17.3%	16.08	15.98	15.26
Median	19.39	20.30	19.78	1.67	1.60	1.54	4.59%	4.80%	5.01%	13.4	1.19	18.5%	15.28	15.98	15.32
Italy* **	**2004e**	**2005e**	**2006e**	**2004e**	**2005e**	**2006e**	**2004e**	**2005e**	**2006e**				**2004e**	**2005e**	**2006e**
Aedes	20.41	19.28	18.26	0.46	0.44	0.97	1.06%	1.10%	3.46%	5.6	0.62	-38.0%	10.72	5.56	
Beni Stabili	26.99	31.41	27.04	1.10	1.09	1.05	2.59%	2.35%	1.18%	1.0	0.70	-29.5%	13.5	13.6	14.5
Risanamento										2.7	0.68	-32.4%			
Pirelli RE	11.45	10.06	9.16	3.11	2.67	2.33	4.57%	5.31%	6.30%	20.7	1.70	70.0%	18.8	15.4	14.7
Mean	19.62	20.25	18.15	1.56	1.40	1.45	2.74%	2.92%	3.64%	7.5	0.93	-7.5%	14.34	11.52	14.58
Median	20.41	19.28	18.26	1.10	1.09	1.05	2.59%	2.35%	3.46%	4.2	0.69	-31.0%	13.54	13.60	14.58
Spain	**2004e**	**2005e**	**2006e**	**2004e**	**2005e**	**2006e**	**2004e**	**2005e**	**2006e**				**2004e**	**2005e**	**2006e**
Colonial	16.66	15.88	14.28	1.73	2.04	1.93	3.18%	3.54%	4.17%	31.5	0.94	-5.7%	19.65	15.67	14.48
Metrovacesa	11.85	11.69	11.21	3.98	3.18	2.71	3.45%	3.39%	3.79%	35.5	1.00	0.3%	14.75	14.09	13.72
Urbis	10.89	10.22	9.77	1.48	1.56	1.36	3.05%	3.31%	2.86%	13.0	0.78	-22.1%	10.42	10.18	9.49
Mean	13.13	12.59	11.75	2.40	2.26	2.00	3.23%	3.42%	3.61%	26.7	0.91	-9.2%	14.94	13.32	12.56
Median	11.85	11.69	11.21	1.73	2.04	1.93	3.18%	3.39%	3.79%	31.5	0.94	-5.7%	14.75	14.09	13.72
Other Europe	**2004e**	**2005e**	**2006e**	**2004e**	**2005e**	**2006e**	**2004e**	**2005e**	**2006e**				**2004e**	**2005e**	**2006e**
Sponda	16.72	19.59	19.74	1.02	1.09	1.10	4.82%	4.39%	4.82%	8.1	0.87	-12.6%	14.67	16.20	16.34
JM	17.94	13.23	11.51	1.40	1.33	1.26	4.37%	4.57%	4.66%	17.4	1.11	10.7%	11.45	9.78	8.56
PSP Swiss Prop	15.10	17.10	16.13	0.94	0.91	0.89	3.73%	3.88%	4.00%	35.0	0.92	-8.0%	21.78	20.24	20.93
Swiss Prime Site	18.88	18.37	17.52	1.08	1.06	1.04	4.52%	4.70%	4.76%	174.3	1.07	7.4%	23.90	23.11	20.40
Mean	17.16	17.07	16.23	1.11	1.10	1.07	4.36%	4.38%	4.56%	58.7	0.99	-0.6%	17.95	17.33	16.56
Median	17.33	17.73	16.82	1.05	1.07	1.07	4.45%	4.48%	4.71%	26.2	1.00	-0.3%	18.23	18.22	18.37

Source: JCF, Thomson Financial Datastream, HSBC Trinkaus & 'Burkhardt

We think it is inappropriate to value Vivacon on P/NAV and would thus advise investors look at PE ratios. Vivacon trades at a PE of 9.9 based on 2005 estimates.

Property developer peer group

	P/E			Price/Book			RoE			NAV	Price/NAV	Premium	EV/EBITDA		
Developers	**2004e**	**2005e**	**2006e**	**2004e**	**2005e**	**2006e**	**2004e**	**2005e**	**2006e**				**2004e**	**2005e**	**2006e**
Development Securities	136.67	17.73	15.49	0.90	0.85	0.80	1.52%	1.69%	1.91%	6.3	0.89	-0.11	64.81	16.61	10.13
Helical Bar	24.69	21.86	15.63	1.07	0.97	0.87	1.70%	1.86%	1.67%	13.0	1.17	0.17	16.71	16.21	17.00
Quintain Estates & Dev	103.77	97.49	45.25	1.06	0.96	0.87	2.02%	2.23%	2.47%	6.1	1.12	0.12	42.09	64.97	51.04
St Modwen Properties	13.49	11.08					2.39%	2.62%		3.1	1.39	0.39			
Vivacon	19.60	9.90	9.30	1.65	1.54	1.28	6.21%	9.76%	9.84%	3.55	1.77	0.77	10.23	7.04	4.87
Mean	59.64	31.61	21.42	1.17	1.08	0.95	2.77%	3.63%	3.97%	6.4	1.27	0.27	33.46	26.21	20.76
Median	24.69	17.73	15.56	1.06	0.96	0.87	2.02%	2.23%	2.19%	6.1	1.17	0.17	29.40	16.41	13.56

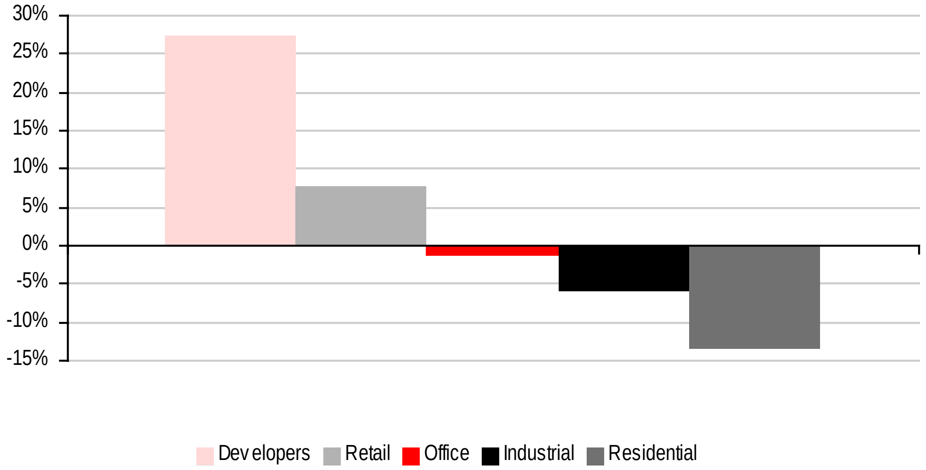
Source: JCF, HSBC Trinkaus & 'Burkhardt

Company analysis

Property developers trade on highest NAV multiples

In the chart below we have grouped our pan-European peer group according to category exposure. We have treated developers as a separate category. We find that developers trade on the highest NAV multiples (+27%), followed by retail (+8%), office (-1%) and industrial (-6%) real estate stocks. On the other hand, residential real estate stocks trade on the lowest multiples (-13%).

Peer group valuation by category*



*Note: *discount/premium to NAV*
Source: HSBC Trinkaus & Burkhardt

Company profiles

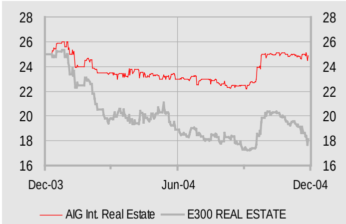
Initiating coverage

AIG Int. Real Estate

An opportunity f(o)und

Year to	Revenue (EURm)	EBITDA (EURm)	Reported PBT (EURm)	HSBC PBT (EURm)	HSBC Net profit (EURm)	HSBC EPS (EUR)	HSBC EPS gwth (%)	PE (HSBC) (x)	PE rel	Yield (%)	EV/ EBITDA (x)	EV/IC (x)	ROIC (%)	REP (x)
12/2003a	4.9	0.6	2.0	2.0	2.0	0.54		46.7	172.4	0.0	121.5	0.9	1.2	4.9
12/2004e	10.4	7.3	6.2	6.4	7.5	1.98	269.9	12.6	48.6	0.0	13.9	0.9	8.8	0.6
12/2005e	10.6	11.0	10.1	10.1	7.6	2.00	1.3	12.5	52.1	0.0	8.8	0.8	6.8	0.7
12/2006e	11.1	11.6	10.7	10.7	8.0	2.13	6.2	11.7	55.0	0.0	8.0	0.7	6.7	0.7

Relative price



Source: HSBC

Company report

Country	Germany
Sector	Real Estate
Reuters	IREG.DE
Mkt cap (EURm)	94.4
Mkt cap (USDm)	126.2
Free float (%)	70

Price

	1M	3M	12M
Absolute	24.80	22.50	25.05
Absolute (%)	0.8	11.2	-0.2
Relative (%)	-5.9	4.9	-27.4

Relative to	E300 Real Estate
Index level	1015.1

Current (EUR)	Target (EUR)
25.01	

- **AIG acts like a real estate opportunity fund**
- **Tax-efficient company due to a special holding structure**
- **HSBC T&B fundamental analysis approach gives rating of 2.93**

HSBC T&B fundamental rating approach

As outlined in the *Company Analysis and Valuation* section of this report, we have analysed our peer group of German real estate companies along five main weighted criteria (country and category exposure, rent expiry profile, G-REIT potential and a miscellaneous position comprising other relevant factors).

AIG International Real Estate's (AIRE) rating of 2.93 (5 is good) is slightly lower than the average rating of 3.01. The good country rating resulting from AIRE's high US exposure and its solid rent expiry rating were not sufficient to offset the lower ratings in category and other. At 2.79, the category rating is negatively affected by the company's very strong focus on the residential sector, which we view as risky. The category other, which serves as a proxy for company-specific issues, is hit by a high unhedged currency exposure of AIRE to the dollar and the yen. A G-REIT rating of 3 reveals the uncertainty of a potential G-REIT advantage.

Potential to benefit from G-REIT

In our opinion, AIRE will only benefit from the introduction of a G-REIT structure if such a regime both allows and exempts international profits from German taxation at the investor level. At present, due its special company structure with almost all investments held as international SPVs or holding companies, AIRE is already very tax efficient. Rental income is usually taxed in foreign countries at lower tax rates than in Germany. Also, this income is usually used to pay down debt or reinvested directly. It is not paid out as dividends to AIRE and therefore not taxed again in Germany. When AIRE exits its international investments, it does not sell the properties directly, but rather its stake in the SPV or holding company. The resulting capital gains are almost completely tax exempt for AIRE in most countries. Only a minor share (of 5%) is taxed in Germany. This results in a low taxation for the AIG group as a whole. In addition, AIRE is still benefiting from an IPO cost related tax loss carry forward of EUR8m for its German operations. These costs are also the reason why dividends cannot be paid out at present. Having gained the impression that its investors would favour the payment of dividends, a G-REIT structure would be likely to be beneficial. With respect to

Research team*

Analysts

Peter Barkow	DE	49 211 910 3276
Ireneus Stanislawek	DE	49 211 910 3017

*HSBC legal entities are listed on page 188

AIG Int. Real Estate

dividend payments under REIT legislation, further corporate restructuring could be required. Thus, we attribute a REIT rating of 3.0 to the stock.

Conclusion

Our rating approach assigns a rating of 2.93 to AIG international Real Estate, slightly below the peer group average. While the G-REIT advantage is difficult to quantify, it is a very important consideration. The company trades at the lowest discount to NAV (of 12%) of our peer group. We initiate coverage of AIRE with this report.

Group structure & strategy

Short history as a (public) company

AIG International Real Estate (AIRE) is a publicly- listed real estate firm...

AIG International Real Estate GmbH & Co KGaA (AIRE) is a public listed company investing in real estate worldwide. Management follows an active buy and sell strategy in order to generate superior returns. AIRE is involved in development activities to a lesser extent (20% of investments). The company was listed in Germany on 8 July 2002. Before the IPO, the company was practically non-existent. The IPO was initiated by AIG Private Bank, a subsidiary of AIG International Group. The latter is now AIRE's largest shareholder. Although IPO proceeds of EUR250-500m had been expected, due to a weak capital market environment, they were only EUR107m.

...with a short history (starting 2002)

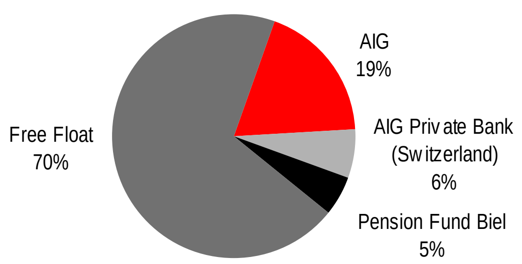
Intention behind the IPO was to attract new investors

AIG's intention behind the IPO was to attract new German and international investors to participate in real estate investments of AIG. AIRE was designed to offer not only institutional investors but also retail investors diversification opportunities through investments worldwide. So far, looking at the current shareholder structure and disregarding AIG's stake, the investor base is fragmented and meets the objective of a broad investor base. This, however, comes at some expense of low stock liquidity. The average daily volume traded in the past six months averaged 1,300 shares, equalling EUR35k a day. The critical issue for management is to increase trading volume to much higher levels, otherwise institutional investors look to invest their money elsewhere in more liquid stocks.

AIG Group is the major shareholder...

...of a company whose stocks are very illiquid

Shareholder structure



Source: Company data, HSBC Trinkaus & Burkhardt

AIG Int. Real Estate

Benefiting from insurance giant AIG's expertise and deal flow

A key feature of AIG International Real Estate is its unique company structure. Structured as a GmbH & Co KGaA, AIRE itself does not have any employees. AIRE's management activities are run by the 'General Partner' – AIG International Real Estate Geschäfts- und Verwaltungs GmbH – which consists of five executives.

AIRE's management is outsourced to AIG International Real Estate Geschäfts-und Verwaltungs GmbH

The company's primary objective is to invest in properties globally and generate an average return before taxes on its investments of at least 15% on IRR basis. Its second main objective is a prudent geographical diversification of investments. The company's geographical focus is split into North America (40-50%), Europe (25-35%) and Asia (25-35%).

AIRE's goals: worldwide investments with an IRR of >15%

In order to identify and undertake investments, management relies on the expertise of AIG Real Property Advisors Ltd, Bermuda. AIG Real Property Advisors has a sub-advisory agreement with AIG Global Investment Corp (New Jersey, US). Under the agreement, the advisor is obliged to identify and offer investment opportunities to AIRE, whose management decides whether or not to participate in the investments. In addition, the advisors and AIRE management reach agreement on target asset allocation on an annual basis. The advisor evaluates the investments and takes care of their management after the investment has been made. Generally, AIRE management will accept investment opportunities if projected IRR is 15% or above, if the investment is consistent with the geographical target asset allocation, and if it does not bear unacceptable risks for the portfolio. Investments with a projected IRR of less than 15% will only be made if they meet special cash flow or asset allocation needs. AIRE may also reject proposed investments with an IRR above 15% pa if such investments would be unfavourable for AIRE in any manner.

Management consults AIG advisors on investment opportunities…

On one hand, AIRE has limited own expertise and has to rely on the quality of the advisors. On the other hand, it reaps the benefits of the expertise of 350 AIG's analysts examining real estate investment opportunities worldwide. Every month, up to 10 new investment opportunities are presented to management. Few financial institutions have such extensive expertise in the sector. Usually when investment opportunities are discussed, AIRE and its advisors decide altogether about whether or not to invest. The advisory agreement is valid until 2014 and until then AIRE is not allowed to use the expertise of any other advisor.

…and relies on the expertise of >350 real estate analysts

Advisory and performance fees replace personal expenses

AIRE does not have any explicit personal costs. Instead it pays advisory and performance fees. The pre-fee NAV is the basis for the calculation of both fees. As a fixed compensation, AIRE pays a quarterly advisory fee of 0.5% of its pre-fee NAV in any given quarter. A performance fee is also charged on a quarterly basis in the event of favourable pre-fee NAV development. The performance fee is only charged if the pre-fee NAV breaches a specified watermark, calculated by taking the higher of the highest pre-fee NAV achieved in any of all previous quarters plus a 3% increase pa and the watermark from the quarter before plus a 3% increase pa. Should the pre-fee NAV of AIRE in a given quarter rise above the set watermark, 20% of the difference between it and that current watermark will be charged by the advisor as a performance fee. It can happen that the pre-fee NAV is higher than the watermark while the NAV (the regularly reported NAV after deduction of both fees) is lower. Even in that case, a performance fee is charged.

Quarterly NAV linked fees serve as compensation for management and advisory costs…

…consisting of a fixed fee and a performance-linked fee

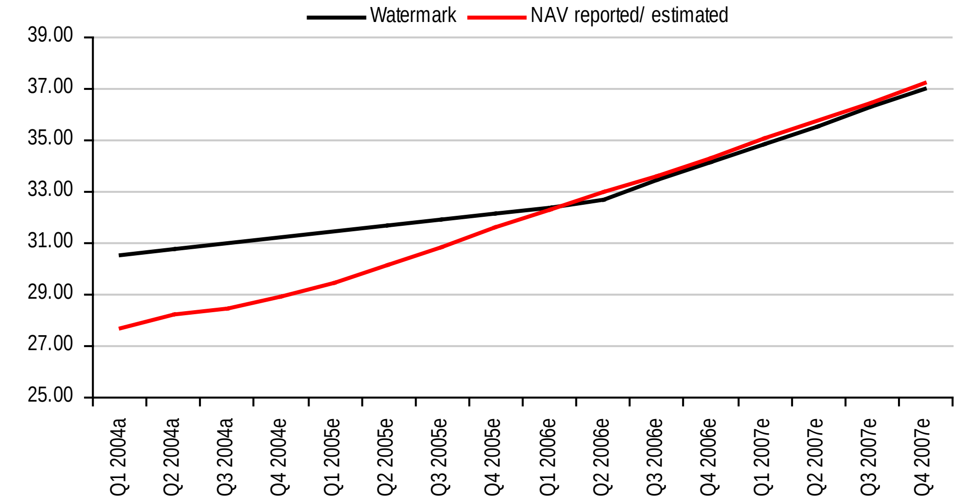
Performance fee is charged only if AIRE's NAV exceeds a special watermark…

AIG Int. Real Estate

...which we expect to happen in Q1 2006 for the first time

Because of the IPO when the stock went public at a price of EUR29, the current watermark is set at cEUR31.00 a share – far above the latest reported NAV of EUR28.46. Therefore, so far, no performance fee has been paid. At a first glance, the performance fee structure does not seem ambitious, as management should easily be able to achieve a much higher NAV growth than the growth of the watermark of 3% pa – a number that more or less equals inflation and is much lower than net rent yield of all property categories. However, because of frequent adjustments of the watermark (ie quarterly), even in the event of rapid NAV growth, we would not expect the performance fee to exceed the fixed fee. Nevertheless, in some quarters, this possibility cannot be ruled out. In our calculations, we expect the watermark to be reached and performance fees to be paid from Q1 2006. Based on the assumption that the IRR on AIG's projects will average c13% between 2005 and 2007, the performance fee is likely to be c50% of the fixed fee, ie cEUR1.3m in 2007 and beyond. Therefore, the sum of total fees charged to the company would amount to c0.75% in a quarter or c3% pa in 2007 and subsequent years. Adjusting the gross 13% IRR on single projects due to costs (including fees), the pre-tax NAV growth of AIRE as a whole is expected to average c9% pa.

NAV and watermark development (in EUR/share)



Source: Company data, HSBC Trinkaus & Burkhardt

AIRE's investment strategy

AIRE is allowed to participate in real estate projects undertaken by AIG Group...

In addition to the advisory agreement, the company is somewhat unusual in that it has a deal-sharing agreement with AIG Global Real Estate Investment Corp (AIGGRE) based in Delaware, US. AIG Global Real Estate Investment is a wholly owned subsidiary of AIG Global Investment Corp. The latter and its subsidiaries are financing investments of AIG Group in the real estate sector in co-operation with local third parties. The deal-sharing agreement obliges AIGGRE to offer AIRE a stake of 10% in every investment AIGGRE or its subsidiaries identify. In the past when AIRE's share of assets invested has been less than 80%, the stakes offered have had to be at least 25%.

AIG Int. Real Estate

...under the same terms and conditions

Normally, AIRE will not participate in an investment unless AIGGRE or another subsidiary of AIG does. AIGGRE always co-operates with a local partner, so that usually one and sometimes two third parties are involved in a single investment. AIRE invests on the same terms and conditions as all other parties involved. Generally, it can also accept less favourable conditions in return for a guaranteed specific return or other benefits. So far, AIRE has not participated in deals with non-equal conditions to all parties.

...even if influence on exit timing is very limited

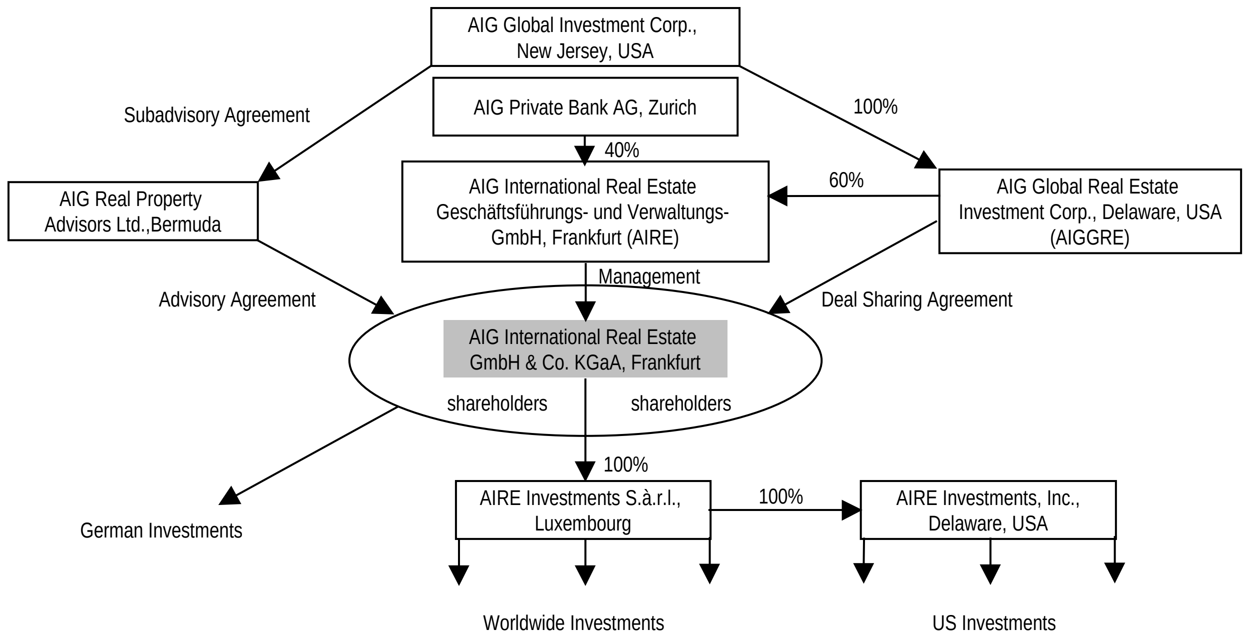
Prior to an investment, two exit strategies from investments are considered by the advisor/ sub-advisor. The exit can occur through a sale to an open-end fund, an opportunity fund, pension fund, REIT or other financial institution. AIRE may influence the exit date with its votes equal to the stake in the investment. This means that, in reality, it will seldom be able to determine the time of the exit and here also has to rely on the expertise of the advisors. In addition to this main investment channel, AIRE is able to invest in pools managed by subsidiaries of AIG Global Real Investment Corp. Participation in such pools involves a commitment of a certain amount of funding for a certain time horizon. Once a commitment has been made, AIRE has no influence over separate investments made by the fund.

The main investment strategy is the purchase of low occupied properties, refurbishment and disposal within three to seven years

AIRE follows an active buy and sell strategy. The intention is to invest in relatively cheap properties with occupancy rates of c80% or below. Once a single investment has been made in the second step the property is usually refurbished and tenant structure is optimised. This should normally lead to an increase in the occupancy rate and have a positive impact on rent levels. With occupancy rates and rents rising, the value of the property rises too. At the end of the process, the property is sold to investors. AIRE is also involved in new developments under the same terms and conditions as any other investment. The investment horizon of the company is between three and seven years. Generally, it can be expected that investments sold earlier will prove to be more profitable than properties held for longer periods. Active buy and sell strategies demand short holding periods, otherwise the annual gain is likely to converge more and more to the long-term average for the whole industry. Therefore, the crucial issue for management will be time in which buying, restructuring, development and disposal can be accomplished.

AIG Int. Real Estate

Organisational structure of AIG International Real Estate



Source: Company data, HSBC Trinkaus & Burkhardt

Portfolio analysis

Allocation of assets and investment constraints

Management has set the following targets and limits for the allocation of assets:

Asset allocation targets:

- No single investment may exceed 20% of net assets, unless approved by the supervisory board (only exception is Auto Parts Park investment which exceeds the 20% mark)

Each investment to be <20% of net assets

- Less than 50% of net assets may be allocated in the US

<50% US share

- Less than 30% of net assets may be located in a single country (except for the US)

<30% in any other single country

- The company will not undertake a single investment in a region which would increase the asset allocation by more than 10% compared with the previous level

New investments to be <10% of net asset volume

- LTV ratio of any investments must be below 80%

LTV ratios of <80%

- At most, 10% of assets may be allocated in real estate companies except for short-term fixed income investments or publicly traded securities subject to a lock-up or transfer restriction held by the company as a result of an earlier private transaction

Short term investment restrictions

AIG Int. Real Estate

- Property investments will not be made without approval of the supervisory board if their projected IRR is less than 10%
- Investments with projected IRR of less than 15% will not exceed 30% of total investments made in 2004 or thereafter

Approval of the board required for investments with estimated IRR <10%

investments with IRR <15% will not exceed 30% of investments made in 2004 or thereafter

Portfolio consists of 28 investments...

Currently, the company participates in 28 different investments spread throughout 10 countries. Of these, 15 are directly held by AIRE Investments S.à.r.l., Luxembourg, 12 by AIRE Investments, Inc, Delaware US and one directly by AIG International Real Estate GmbH & Co KGaA, Frankfurt. Altogether, the investments' fair value was EUR81.1m on 30 September 2004. Management acts opportunistically because diversification is done in a way disregarding the sectoral asset allocation. For instance, currently almost all US investments are in the residential sector, while almost all Japanese investments are in the office sector. The company seeks risk mitigation through regional diversification and to a minor degree by property categories. The company may also at any time consider the granting of loans for economic or tax reasons. AIRE grants loans under the same terms and conditions within the deal-sharing agreement as any other equity investment.

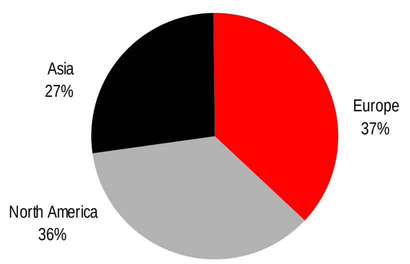
...in the industrial, office, residential and retail sector

EUR28m in current cash may be used for commitments and new investments

Since the company started activities without any investments and only with cash from the IPO, pre-IPO costs, NAV/share equalled the IPO price of EUR29 per share and the first post-IPO cost NAV was EUR26.80. To date, most of the capital has been invested even if it has taken management longer than expected to allocate it. Due to capital inflows from rents, interests and disposals in Q4, we estimate the company still has cEUR26m in cash and equivalents.

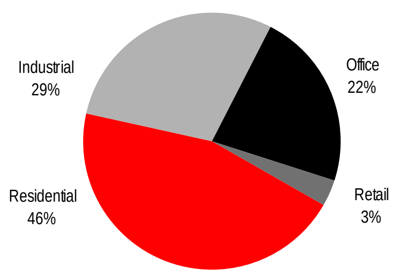
Management intends to devote a further cEUR8-9m to the US residential sector over the next three years. Foreseeable European investments within the next three years will be done via the commitments to the pool 'European Real Estate Partners'. Despite the new planned residential investments in the US, we very much welcome management's intention to move US focus towards other sectors such as industrials. This should do two things. First, it should reduce what we view as the company's risky residential exposure in North America. Second, it should allow AIRE to participate in the US industrial recovery (although we do not expect this to occur before H2 2005).

Invested assets by region*



*Note: *as of 30 September 2004*
Source: Company data, HSBC Trinkaus & Burkhardt

Invested assets by property type*



*Note: *as of 30 September 2004*
Source: Company data, HSBC Trinkaus & Burkhardt

AIG Int. Real Estate

AIRE's worldwide investments

Slovakian Auto Parts Park is AIRE's biggest investment

The biggest investment is the Auto Parts Park (APP) in Slovakia. AIRE holds a 100% stake in APP which in turn owns the properties. The investment has a fair value of EUR23.9m and can be considered the 'cash cow' of AIRE, yielding c15% and generating cEUR3.6m net income pa. Cash flows from APP are backed by long-term contracts and guarantees with tenants (until 2016) and an occupancy rate of 100%. Even if the stake in APP exceeds 20% of assets invested and represents the whole industrial share in the portfolio, we view APP as a main pillar of AIRE's profits. APP's risk for AIRE is limited to the amount of EUR23.9m invested in it as recourse rights on AIRE's other assets are ruled out. At present, c20% of investments are developments.

AIG Int. Real Estate

Investments by property*

Investment	Year	Location	Type	Costs	Fair value	Difference
Europe						
Polish Retail Rollout	2004	Poland	Retail	0.0	0.0	0.0
Auto Parts Park, Bratislava	2003	Slovakia	Industrial	23.7	23.9	0.2
Brescia Retail Center, Brescia	2003	Italy	Retail	0.3	0.3	0.0
Marques Avenue	2003	France	Retail	0.9	1.0	0.1
Metropole, Copenhagen	2003	Denmark	Retail	1.0	1.0	0.0
Edison Höfe, Berlin	2002	Germany	Office	3.7	3.7	0.0
Total investments Europe				**29.6**	**29.9**	**0.3**
North America						
Lovejoy, Boston	2004	US	Residential	1.3	1.3	0.0
CHW Portfolio	2004	US	Office	1.1	1.1	0.0
Alta at Courthouse Square, Stafford	2004	US	Residential	2.2	2.2	0.0
Lomas de Arena, Palm Desert	2004	US	Residential	0.8	0.8	0.0
Neptune Marina, Marina del Rey	2004	US	Residential	0.6	0.6	0.0
Watchtower, Brooklyn	2004	US	Residential	5.9	5.8	-0.1
Easton on Henderson, Dallas	2003	US	Residential	0.0	0.0	0.0
Seabridge Villas, Huntington Beach	2003	US	Residential	0.0	0.5	0.5
St. John's Plantation, Jacksonville	2003	US	Residential	2.0	1.7	-0.3
Terrabrook	2003	US	Residential	8.6	8.3	-0.3
Trivest	2003	US	Residential	4.0	3.9	-0.1
Alexan Piney Point, Houston	2002	US	Residential	2.8	2.8	0.0
Total investments North America				**29.3**	**28.9**	**-0.4**
Asia						
Chayamachi, Osaka	2004	Japan	Retail	0.6	0.5	-0.1
Aozora Regional Portfolio	2003	Japan	Office	2.5	2.1	-0.4
Forest Green	2003	Japan	Office	3.3	3.4	0.1
Oyamacho, Tokyo	2003	Japan	Office	0.5	0.5	0.0
Shinanen Canalside, Tokyo	2003	Japan	Office	6.9	6.1	-0.8
Tachibana Annex Building, Tokyo	2003	Japan	Office	0.6	1.0	0.4
Draycott Drive	2003	Singapore	Residential	0.3	0.3	0.0
Lengkong Gardens	2003	Singapore	Residential	0.7	0.6	-0.1
Marina Boulevard	2002	Singapore	Residential	6.8	6.3	-0.5
Repulse Bay Road & Peak Road	2002	Hong Kong	Residential	1.1	1.6	0.5
Total investments Asia				**23.1**	**22.3**	**-0.8**
Total of all investments				**81.9**	**81.1**	**-0.8**

*Note: * as of 30 September 2004*
Source: Company data, HSBC Trinkaus & Burkhardt; as of 30 September 2004

Regarding the residential investments, one has to note that AIRE does not invest in single housing properties. Instead, only multi-housing investments are made as management considers multi-housing investments as less risky than single housing ones.

AIG Int. Real Estate

Short but respectable track record

Company has a good but short track record

Measuring average total return figures for US private property, we estimate a number of c9% pa. European markets performed worse; therefore, management's 15% IRR target on a single project basis seems ambitious. Despite this, four transactions to date have been completed and the results have been impressive. However, this limited number of completed deals is not enough to be seen as a reliable and solid track record for management. The future will show if management, with the support of its advisors, is able to generate superior and sustainable returns.

Investment performance

Investment	Investment date	Disposal/ completion date	Holding period (years)	Profit (EURm)	IRR (local ccy)	IRR (EUR)	Disposal status
Shugard Self Storage S.C.A.	11/2002	07/2003	0.7	3.1	76%	76%	Completed
Mureau Road*	12/2002	09/2003	0.8	0.2	N/A	N/A	Completed
Beacon Station, Miami*	12/2002	11/2003	0.9	0.2	N/A	N/A	Completed
Repulse Bay Road & Peak Road	12/2002	Early 2005	1.5	c0.0	c30%	c0%	Ongoing
Seabridge	05/2003	Early 2005	>1.5	c1.5	c40%	c40%	Ongoing

Source: Company data, HSBC Trinkaus & Burkhardt

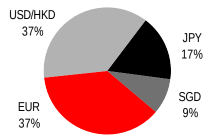
Financials are exposed to high volatility

We expect the company's financial results to be volatile. This is to be expected given that its buy and sell strategy should generate fluctuating capital gains or even losses. Furthermore, AIRE adds risk to its financials by a large foreign exchange exposure. For instance, the current USD exposure of the invested portfolio is c37%. Long term, it is likely to exceed 40%. The currency-induced volatility results from the fact that management imposes no hedges.

Management consciously takes this currency risk and expects currency gains and losses to compensate each other in the long run. In the short term, that might materialise in painful losses due to exchange rate movements as we have seen in, eg, the sale of properties at Repulse Bay Road & Peak Road in Hong Kong. These properties were sold this year with a high IRR in local currency; however, the proceeds collected by AIRE until now have been hurt by very unfavourable currency losses. In local currency terms, the IRR was 30% but after currency adjustments only more or less a black zero. In AIRE's history, a total of EUR2.9m or 2.7% of current NAV in currency losses has been booked already. A further risk relates to a potential conflict of interest with AIG group which accounts in US dollars and not euros like AIRE. As we expect AIG to have a greater influence on exit dates of investments than AIRE, the latter might be tempted to sell a property in times of a weak dollar. This would mean the realisation of currency losses to AIRE.

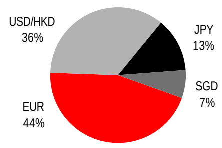
The following table and chart show the sensitivity of NAV to exchange rate movements. The total foreign exchange rate exposure compared with total NAV is c55%. Therefore, an appreciation (devaluation) of the euro to US dollar, HK dollar, Singapore dollar and Japanese yen of each 10% would result in a decrease (increase) in NAV of 5.5%. For instance, a devaluation of the euro of 10% to these currencies would push NAV from EUR28.46 to EUR30.02. In addition, we calculated US dollar and yen changes separately. A devaluation of the euro vs the US dollar and the yen of 10% would result in an NAV increase of 3.6% and 1.3%, respectively.

Currency breakdown of invested portfolio



Source: Company data, HSBC Trinkaus & Burkhardt

Currency breakdown of net assets



*Note: * rounding errors do not exceed 1%*
Source: Company data, HSBC Trinkaus & Burkhardt

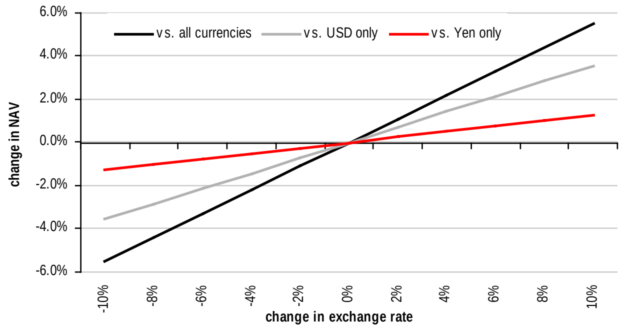
AIG Int. Real Estate

Currency changes impact on NAV (1) (%)

	Appreciation of EUR					*	Devaluation of EUR				
NAV (EURm)	26.9	27.2	27.5	27.8	28.1	28.5	28.8	29.1	29.4	29.7	30.0
Change of EUR	-10.0	-8.0	-6.0	-4.0	-2.0	0.0	2.0	4.0	6.0	8.0	10.0
Loss/gain in NAV vs											
All currencies	-5.5	-4.4	-3.3	-2.2	-1.1	0.0	1.1	1.2	3.3	4.4	5.5
USD only	-3.6	-2.8	-2.1	-1.4	-0.7	0.0	0.7	1.4	2.1	2.8	3.6
JPY only	-1.3	-1.0	-0.8	-0.5	-0.3	0.0	0.3	0.5	0.8	1.0	1.3

*Note: *grey shading = status quo*
Source: Company data, HSBC Trinkaus & Burkhardt

Currency changes impact on NAV (2)



Source: Company data, HSBC Trinkaus & Burkhardt

Financial liquidity at high levels of cEUR28m

Liquidity on corporate level is high and should be invested as soon as possible. We believe that a significant share of liquid assets will be invested in the coming months. For the first time in this fiscal year, a steady income stream from rents and interest is covering operating costs (including fees), meaning that no liquidity pressure exists from this side. The only risk could be commitments for investment pools over whose due date, unlike single investments, management has no influence. We estimate that effective commitments total cEUR32m, of which cEUR2.5m is due within the next six months and much more later. We estimate a current cash position of cEUR26m and because of an additional credit line in a bank of EUR10m, liquidity risk does not exist at present.

Due to LTV ratios of up to 80%, no significant leverage on group level

Progressed property investments are leveraged with a maximum loan to value ratio of 80%. Leverage ratios of most investments are not visible in AIRE's books because the investments are accounted for as financial investments. The only exception is an interest-paying debt position entered in the books together with the acquisition of APP, which is currently EUR33m. As AIRE is a 100% owner of APP, the latter is consolidated in AIRE's accounts. Basically, the company does not intend to increase leverage on group level. We think this is prudent strategy and an LTV ratio of 80% puts enough debt on AIG's investments.

AIRE reports NAV figures monthly

Although the leverage and the risk resulting from the LTV ratios is not fully visible at group level, the financial position of the company can be tracked very comfortable due to monthly reporting of NAV. In addition, all investments are valued at their respective NAVs in the financial reports. We view this as very positive as it enables a timely valuation of the company.

AIG Int. Real Estate

G-REIT impact

AIRE could benefit from a G-REIT structure

AIG is very interested in the current REIT discussion in Germany. Management is expected to consider a change to a REIT status if suitable for AIRE. Given that almost all profits come from international investments, a G-REIT structure will only be favourable if these profits are:

- *Allowed* as well as...
- ...*exempt* from German taxation at investor level within a G-REIT regime.

If international profits are tax exempt at investor level AIRE is already very tax efficient...

We think that both conditions are likely as the BMF is currently looking at flexible REIT structures (such as the French REIT) as role models for a German REIT legislation. Nevertheless, visibility of the certain aspects of the German REIT legislation is fairly limited at present.

...due to (indirect) holding of stakes in holding companies...

AIRE is already relatively 'tax efficient', as 27 of its 28 investments are international, most of which are stakes in SPVs or holding companies. When AIRE wants to exit these investments, it does not sell the properties directly, but rather disposes of its stake in the relevant SPV or holding company. As a result, capital gains are almost completely tax exempt for AIRE in most countries. Note that in Germany only 5% of capital gains are taxed at present. Also, rental income is usually taxed in foreign countries at a lower tax rate than in Germany. As this income is usually not paid out to AIRE (instead it is used to pay down debt), it is not taxed (again) in Germany. This results in a low taxation for the AIG group as a whole.

...and a high share of international profits

IPO expenses lead to de facto tax exemption of profits...

In addition to this, AIRE benefits from an IPO cost related tax loss carry forward of EUR8m. Thus, the effective tax rate in Germany will be zero for the time being. The IPO expenses at AIRE holding level are also the reason why regular dividends cannot be paid at present. AIRE has no free reserves (a prerequisite for dividend payments under German AktG). In its current group structure, AIRE does not envisage dividend payments and instead intends to retain earnings in order to avoid taxation at investor level. AIRE has, however, gained the impression that its investors would favour the payment of dividends. For this reason, a G-REIT structure would be likely to be beneficial. We would, however, not rule out the need for additional corporate restructuring to enable the company to pay meaningful dividends under a G-REIT regime.

...but also inhibit a dividend for the time being

AIG – summary financials

Current price (EUR)	25.01	Market cap (EURm)	94.4		
		Enterprise value (EURm)	101.9	Reuter RIC	IREG.DE

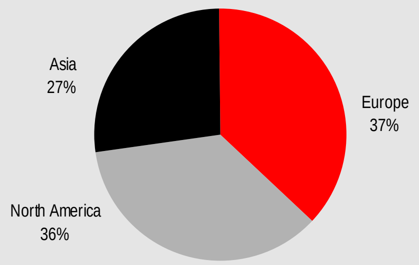
Year to	12/2003a	12/2004e	12/2005e	12/2006e
Per share data (EUR)				
Reported EPS	0.54	1.92	2.00	2.13
HSBC EPS	0.54	1.98	2.00	2.13
CEPS	0.54	2.03	2.00	2.13
DPS	0.00	0.00	0.00	0.00
NAV	26.49	28.97	32.00	35.11
P&L summary (EURm)				
Revenue	4.9	10.4	10.6	11.1
EBITDA	0.6	7.3	11.0	11.6
EBIT	0.6	7.1	11.0	11.6
Net interest	1.4	-0.9	-1.0	-0.9
PBT	2.0	6.2	10.1	10.7
HSBC PBT	2.0	6.4	10.1	10.7
Taxation	0.0	1.1	-2.5	-2.7
Reported net profit	2.0	7.3	7.6	8.0
HSBC Net profit	2.0	7.5	7.6	8.0
NOPLAT	0.6	8.6	8.3	8.7
Cash flow summary (EURm)				
Op free cash flow	-56.4	4.3	-1.1	-0.5
HSBC cash flow	2.4	7.4	8.3	8.8
Capital expenditure	-53.0	-10.0	-10.0	-10.0
Cash earnings	2.0	7.7	7.6	8.0
Change in net debt	59.6	30.4	-5.1	-3.8
Balance sheet summary (EURm)				
Intangible fixed assets	0.0	4.1	4.1	4.1
Tangible fixed assets	73.4	116.0	123.0	131.7
Cash	22.8	25.4	28.5	30.5
Current assets	27.5	26.2	29.3	31.3
Operating liabilities	0.7	2.2	2.1	2.2
Gross debt	0.0	33.0	30.9	29.2
Net debt	-22.8	7.5	2.4	-1.3
Shareholders funds	100.0	109.4	120.8	132.5
Invested capital	77.4	118.6	125.7	134.4

Year to	12/2003a	12/2004e	12/2005e	12/2006e
Ratios (%)				
Revenue/IC (x)	0.1	0.1	0.1	0.1
NOPLAT margin	12.1	82.9	77.8	78.7
ROIC	1.2	8.8	6.8	6.7
ROE	2.0	7.1	6.6	6.3
ROA	2.0	7.1	5.6	5.5
ROCE	2.0	7.4	5.9	5.8
ROIC/Cost of capital	0.2	1.3	1.0	1.0
Cost of capital	6.5	6.5	6.5	6.5
EBITDA margin	12.1	70.4	103.8	104.9
EBIT margin	12.1	68.4	103.8	104.9
PAT margin	41.6	69.8	71.1	72.5
Interest Cover	-0.4	7.5	11.6	12.8
Net debt/equity	-22.8	6.9	2.0	-1.0
Net debt/EBITDA	-38.8	1.0	0.2	-0.1
Growth (%)				
Revenue		114.5	2.3	4.1
EBITDA		1143.3	50.8	5.3
EBIT		1108.0	55.2	5.3
PBT		205.3	63.6	6.2
HSBC Net profit		269.9	1.3	6.2
HSBC NOPLAT		1364.5	-4.0	5.3
HSBC EPS		269.9	1.3	6.2
Valuation (x)				
PE	46.7	12.6	12.5	11.7
PNAV	0.9	0.9	0.8	0.7
PCE	46.7	12.3	12.5	11.7
Yield (%)	0.0	0.0	0.0	0.0
EV/Revenue	14.8	9.8	9.1	8.4
EV/EBITDA	121.5	13.9	8.8	8.0
EV/IC	0.9	0.9	0.8	0.7
ROIC/Cost of capital	0.2	1.3	1.0	1.0
HSBC REP	4.9	0.6	0.7	0.7

Business description

AIG International Real Estate (AIRE) invests in properties worldwide. It pursues an active buy and sell strategy resulting in a holding period of three to seven years. It buys units for refurbishment and sale and also builds properties. AIG's main objective is to generate an average return before taxes on its investments of at least 15% on an IRR basis. Special agreements allow AIRE to participate in property investments of AIG Group.

NAV by region



Initiating coverage

Deutsche EuroShop

Better than a REIT

Year to	Revenue (EURm)	EBITDA (EURm)	Reported PBT (EURm)	HSBC PBT (EURm)	HSBC Net profit (EURm)	HSBC EPS (EUR)	HSBC EPS gwth (%)	PE (HSBC) (x)	PE rel	Yield (%)	EV/ EBITDA (x)	EV/IC (x)	ROIC (%)	REP (x)
12/2003a	49.3	36.4	6.5	6.5	-0.5	-0.03				5.3	20.1	1.0	-0.7	
12/2004e	50.5	39.7	12.5	12.5	5.0	0.32		113.4	436.2	5.3	18.4	1.1	0.3	21.1
12/2005e	56.8	44.0	18.2	18.2	6.3	0.40	26.4	89.8	375.1	5.5	16.5	1.1	0.8	8.2
12/2006e	58.8	45.8	21.6	21.6	8.5	0.54	34.5	66.7	312.4	5.5	15.7	1.1	1.2	5.4

- **Pure play on German shopping centre real estate**
- **Efficient tax structure makes DES 'better than a REIT' at present**
- **HSBC T&B fundamental analysis approach gives rating of 3.36**

HSBC T&B fundamental rating approach

As outlined in the *Company Analysis and Valuation* section, we have analysed our peer group of German real estate companies according to five main weighted criteria – country and category exposure, rent expiry profile, G-REIT potential and a miscellaneous position comprising other relevant factors.

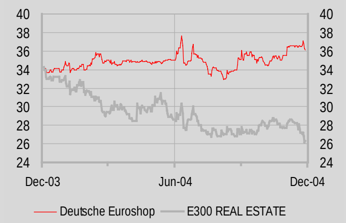
As DES concentrates strongly on the German market, which is in fact our least preferred market, within our peer group its rating is unfavourable at 2.36 (5 is good). Due to its focus on the retail segment, with a particular concentration on shopping centres, DES' category exposure is very favourable – a rating of 3.49, effectively the highest category rating in our peer group. Due to a very low level of rent expiries in the coming years, we have awarded DES the highest possible rating of 5.0 in this criterion. Among other factors, we have accounted for the extremely favourable tax structure of DES, which makes the company unique in our peer group, so we have awarded DES a miscellaneous rating of 5.0.

Below we describe DES' potential to benefit from a G-REIT structure other than increased investor interest, analyst coverage etc.

Potential to benefit from G-REIT

Given its portfolio and strategy, we think DES would make a perfect G-REIT under almost all possible scenarios. DES has expressed its intention to become a G-REIT at some point in the future, but we believe there is little need to rush the process. Currently the company effectively pays no tax at a corporate level, due to existing tax loss carry-forwards of more than EUR60m, putting the company in a situation comparable to REITs, which are tax-exempt at corporate level. In addition, DES' dividends are tax exempt for investors due to a special tax structure, which is more favourable than the full taxation that we would expect for G-REIT dividends. Thus, converting DES into a G-REIT would currently be a change for the worse, warranting a low rating of only 1.0.

Relative price



Source: HSBC

Company report

Country	Germany
Sector	Real Estate
Bloomberg	DEQ GR
Reuters	DEQGn.DE
Mkt cap (EURm)	565.6
Mkt cap (USDm)	756.3
Free float (%)	79

Price

	1M	3M	12M
Absolute	35.55	36.02	34.10
Absolute (%)	1.8	0.5	6.2
Relative (%)	-5.0	-5.2	-22.8

Relative to	E300 Real Estate
Index level	1015.1

Current (EUR)
36.20

Research team*

Analysts

Peter Barkow	DE	49 211 910 3276
Irineus Stanislawek	DE	49 211 910 3017

*HSBC legal entities are listed on page 188

Deutsche EuroShop

Conclusion

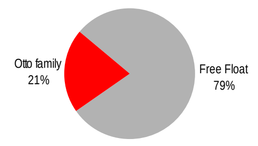
Our fundamental analysis approach gives an overall rating of 3.36 for DES, the best rating within our peer group. At the same time, the company trades at a discount to NAV of c15%. We initiate coverage on DES with this report.

Group strategy

A pure play shopping centre investor

Deutsche EuroShop (DES) is a real estate investment company exclusively focused on shopping centres that are predominantly located in Germany. Its investment strategy profile makes DES a unique play of the German shopping centre sector. The company was founded in 2000 by DB Real Estate, a subsidiary of Deutsche Bank, which injected its shopping centre portfolio into DES. DES then went public in January 2001. In the meantime, Deutsche Bank has sold down its remaining stake, so that the Otto family is the only remaining large shareholder with a combined holding of 21%. DES estimates that of the 79% free float, c55% belong to private investors with only c24% being institutional investors. Such a high concentration of private investors is quite unusual for an MDAX company (DES joined the German Mid-cap Index in September 2004) but can be explained by the history of the company. The company was set up as a tax-optimised dividend pay-out model, a structure from which the company is still benefiting at present. This structure is highly attractive for private investors as dividends are free of tax payments. DES's c6% net of tax dividend yield in the past was therefore much more attractive than yields of open-ended real estate funds (average total performance of 3.9% for the last three years), which were seen as an investment alternative.

DES shareholder structure



Source: Company data, HSBC Trinkaus & Burkhardt

All lateral processes outsourced

DES is structured very efficiently, as all lateral processes such as property development, financial feasibility studies for investments (although due diligence is undertaken and decisions are taken by DES's management), centre management etc. are outsourced so that the company is currently run by five employees (please see following pages for the special relation and dependence on ECE in this regard).

Ambitious growth plans require rights issue…

In the past, DES has mentioned ambitious growth plans, intending to become the no.5 retail RE investor in Europe. The gap between it and current no.5 listed retail property stock, Eurocommercial, is cEUR250m, or 36% of DES' market cap; we think closing this gap will require a rights issue. The company has already stated it intends to increase its capital base if suitable investments are found and It plans to present three specific projects for raising equity capital to investors. In its most recent conference call at the release of the Q3 figures in November, however, it became much more cautious on near-term growth perspectives postponing the utilisation of its EUR30m war chest into 2005. We attribute this to the high competition for shopping centre investments currently. The timing of a rights issue therefore seems elusive at present.

…but timing is elusive

The staff situation at DES is quite tight, with the company stating that it can handle only two to three investment projects annually. We therefore believe DES will need until the end of 2005 to fill its project pipeline in preparation for the SPO.

Deutsche EuroShop

Structured as a dividend pay-out model, DES' financials are optimised in order to prevent tax payments. As a consequence, the company is aggressively using all tax accounting measures available in order to minimise reported profits. In turn the company is maximising its free cash flow, which is also the basis for dividend payments. The change to IAS, which is expected for the FY 2004 figures, should lift the company's revenues and profits (without affecting cash flows of course). IAS will mean that the five properties, which are currently held as joint ventures and accounted for at cost, will have to be consolidated on a pro rata basis. This is likely to lead to higher group sales but reduce the financial result. The net impact on the company's bottom line is difficult to forecast given the lack of information on individual property's financials. On the other hand, IAS requires that a higher share of development expenses will have to be capitalised relieving the group P&L. This is unlikely to have any impact on effective tax payments, as these are contingent to DES's tax balance sheet which will not be affected.

Change over to IAS scheduled for FY 2004 figures…

…should have positive impact on revenues and profits…

…but no impact on cash flows and tax payments

Clear investment criteria

DES invests according to concrete investment criteria, of which we have listed the most important in the table below. DES tries to invest in shopping centres at an early stage – significantly before the opening of the centre. Thus, DES is exposed to development risk, which is alleviated by a required pre-let rate of more than 50%. The company stated that the main reason for this is to avoid buying from property developers, who in order to maximise their profits, try to build cheap and maximise rents at the time of the sale. DES is acting as a majority or minority investor (the latter predominantly in order to increase diversification but also to reduce development risk). At present the equity stakes range from 33-100%.

Precisely formulated investment approach

Regionally DES invests in so called regional centres, avoiding the high competition for real estate and related low yields of leading German cities. In order to increase revenues, DES is also investing in international properties (currently five out of 14 centres representing 22% of invested equity), which typically offer net rent yields ranging from 6.5-8%, compared to 5.5-6% for Germany. We see the point to spicing up revenues by adding international properties, nevertheless, we would caution that the international experience and market expertise of a company consisting of only five people is limited almost by definition. The dependence on the centre manager is therefore even higher than in DES's domestic market. We would therefore regard it as a better strategy if the company restricted itself to countries where its trusted centre management partner ECE has a proven track record.

Prime retail in second-tier German cities

DES is currently in the process of re-aligning its portfolio (a process that started with the disposal of its stake in the centre in Udine). This process is likely to continue with the sale of its French and Italian assets, which are still a legacy of the initial portfolio injected by DB Real Estate. The company already stated that these centres would not match its current strategy anymore (with a high tax rate being one of the reasons). Coincidentially (or not) these centres are the only ones not being managed by ECE, which would underline our above-stated view. Additional non-domestic investments are likely to be within the CEE area, according to the company's CEO, which matches the countries that ECE currently covers. Despite the above-mentioned strategy to sell assets, DES considers itself as a Buy and Hold investor, as disposals are driven by portfolio optimisation efforts.

International portfolio to be aligned:

CEE investments to replace Southern Europe

Overall strategy remains 'Buy and Hold'

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Deutsche EuroShop main investment criteria

Investment only in shopping centres (predominantly in Germany but also abroad)
>10,000 lettable space, of which no more than 15% office space or non-retail usage*
Shopping centre in development only with pre-let rate > 50%
Trading area >100,000 inhabitants
Shopping centre feasibility studies have to be audited by external real estate agents/advisors (eg Feri and GfK Prisma for Germany)
Well-established contractor

*Note: * eg cinemas*
Source: Company data, HSBC Trinkaus & Burkhardt

Development and Centre Management outsourced to ECE

Centre management outsourced to market leader ECE

DES is increasingly co-operating with ECE in terms of shopping centre development and management. ECE is also one of the main providers of new investments for DES. ECE is owned by DES' largest shareholder group, the Otto family. With 77 shopping centres under management, ECE is the German and European market leader in shopping centre management. Geographically it covers Germany, Austria, Hungary, the Czech Republic, Poland, Turkey and Quatar. Some 12 of 14 shopping centres currently owned by DES are managed by ECE (only the centres in Tuscia and Annemasse are managed 'externally').

DES/ECE revenue agreement

Centre Management Phase	Revenue agreement*
Development phase	15-20% of investment volume
Initial letting phase	40% of annual gross rents
Management phase	8% of annual gross rents

*Note: * HSBC estimates*
Source: Company data, HSBC Trinkaus & Burkhardt

ECE tenants outperform...

The success of ECE can be seen not only in its market dominance, but also in the sales development of its tenants. The chart on the following page (top left) indicates that shopping centres managed by ECE consistently outperformed the German retail market in terms of revenue development per square metre.

Although we do not question the success and professionality of ECE, we are, however, of the opinion that an analysis of the revenue development of ECE's tenants has to be treated with caution for the following reasons:

...partly due to success of shopping centre format...

- Shopping centres have been the customer's retail format of choice. Thus, a large part of the outperformance can be attributed to the shopping centre format and not to excellent centre management

...but degree of outperformance has declined...

- The degree of outperformance has declined continuously over time (as shown in the top right chart on the following page)

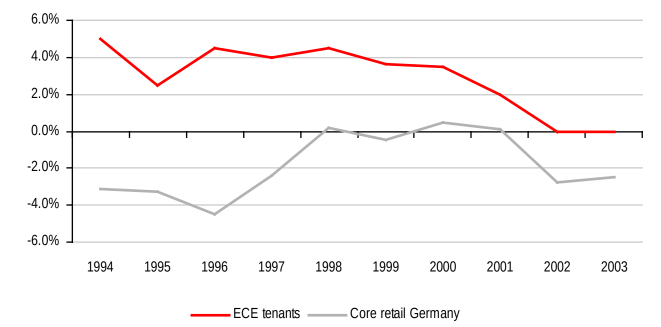
...and launch of new centres might distort the picture

- The revenue development of ECE tenants is hugely dependent on the launch of new centres that have a strongly positive revenue impact in the second and third year after opening. This is the time usually required by a shopping centre to establish itself as a retail centre. The large number of shopping centres run by ECE may be compensating for

Deutsche EuroShop

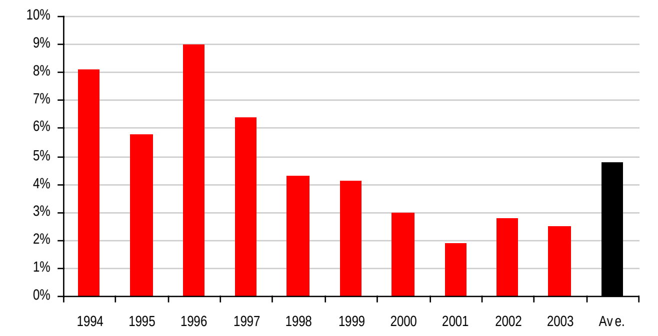
this distortion at present, but we are unsure about what the effect would have been 10 years ago.

ECE tenants outperformed German retail market*...



*Note: * sq m adjusted sales development*
Source: BAG, ECE, GfK Prisma, HSBC Trinkaus & Burkhardt

...but outperformance declined continuously*



*Note: * sq m adjusted sales development*
Source: BAG, ECE, GfK Prisma, HSBC Trinkaus & Burkhardt

We think the tight co-operation with ECE is beneficial for DES, but note two points as a caveat:

Otto family is main shareholder of ECE and DES

- The Otto family is a dominant shareholder in both DES and ECE. In addition, Alexander Otto is a member of DES's supervisory board. This could potentially lead to a conflict of interest, with the natural inclination of the Otto family being to allocate profits in ECE, which is a 100% holding. We have given an overview of the DES/ECE revenue agreement (on previous page) but are admittedly unable to check whether conditions are at arms length. The conditions do not seem completely unrealistic to us

DES dependence on ECE higher than vice versa in our view

- We think the DES dependence on ECE is higher than vice versa. DES is one of ECE's largest, if not the largest, customers (remember that 12 out of 77 shopping centres run by ECE are DES investments). On the other hand, we cannot see how DES could run its business model without ECE

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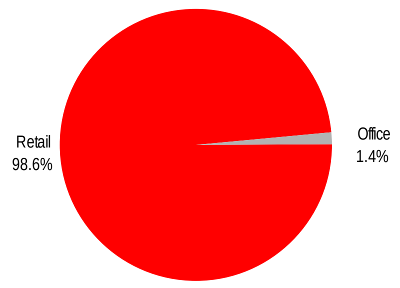
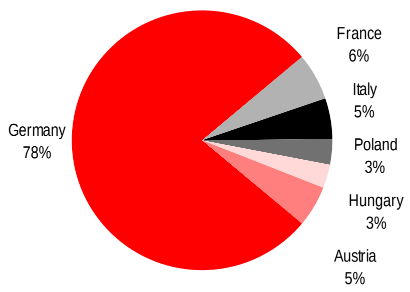
Portfolio analysis

Portfolio by real estate category*...



Note: * as percent of invested equity at end-2003
Source: Company data, HSBC Trinkaus & Burkhardt

...and by country*



Note: * as percent of invested equity at end-2003
Source: Company data, HSBC Trinkaus & Burkhardt

Focus on German retail estate reflected in portfolio

The initial capital donation is almost entirely invested at present and the current structure of the portfolio has a strong focus on Germany and retail estate. The company has announced one additional investment in 2004, to replace the sold Udine shopping centre (in Q3). The property is more likely to be located in Germany, according to the management, as a targeted international shopping centre has been swallowed up by a German open-ended fund.

We estimate a net rent yield of 5.4% for the portfolio

The occupancy rate is excellent at a 99% occupancy rate – excluding the centres that are still at a development stage – indicating the quality of DES shopping centres, as well as of the work done by ECE. According to our estimates, the total portfolio generates a net rent yield of 5.4%, with international properties generating higher yields than the German locations. The Rhein-Neckar centre, as well as Wuppertal, are generating disappointing returns at present. The latter has been suffering from two consecutive large insolvencies. As the situation has now been resolved, rental income should rise from H1 2005 onwards.

Portfolio externally rated and valued

The entire portfolio has been rated by GfK Prisma and Feri in 2003 with an average A rating. We think this is a decent outcome given the overall sluggish condition of the German real estate market. Furthermore, DES published an NAV for the portfolio for the first time in March 2004. Market values have been provided by locally leading real state agents (eg Feri and GfK Prisma for Germany). The NAV (before deferred taxes and sales costs) has been calculated at cEUR680m for the portfolio (compared to equity investments of cEUR600m at the time).

Portfolio makes DES an attractive takeover target, in our view

We think that DES's clear investment focus in terms of real estate category and country makes the company an attractive takeover target if large property investors want to play the recovery of German consumer spending.

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DES rent expiry profile*

	2003	2004e	2005e	2006e	2007e	2008e	2009e and beyond
Expiry	2%	3%	2%	5%	3%	2%	85%

*Note: * Still including Udine, not including Pécs, Klagenfurt, Hamburg and Wetzlar as at end-2003*
Source: Company data, HSBC Trinkaus & Burkhardt

At present, favourable rent expiry structure

DES's rent expiry structure looks favourable at present, with expiries totalling 3% in 2004 and 2% in 2005. This reflects the relatively young portfolio in combination with long-lasting rental contracts (c10-15 years). Expiries will accelerate beyond 2009 to above 10% annually. The expiry figures do not include bankruptcies, which the company states range between 1-2% of lettable space annually.

DES' top 10 tenants account for 26% of rental revenues*

	Tenant	Category	Exposure
1	Metro Group	Food & non food retail	6.3%
2	Douglas Group	Personal care and miscellaneous	4.6%
3	P&C	Fashion	2.6%
4	Karstadt Group	Food & non food retail	2.2%
5	Engelhorn	Fashion	2.0%
6	H&M	Fashion	2.0%
7	Palastbetriebe	Cinema	1.7%
8	Ipercoop	Food retail	1.6%
9	Bauhaus	Do-it-yourself	1.5%
10	New Yorker	Fashion	1.4%
Total			**25.9%**

*Note: * Still including Udine, not including Pécs, Klagenfurt, Hamburg and Wetzlar as at end-2003*
Source: Company data, HSBC Trinkaus & Burkhardt

Top 10 tenants account for 26% of rents...

...KarstadtQuelle for 2.2% (3.1% including the Phoenix centre)...

...but overall KQ risk seems limited at present

The table above shows that DES's top tenants account for 26% of rental revenues. The KarstadtQuelle (KQ) exposure at 2.2% (3.1% including the Phoenix centre) is striking. The German retail giant has embarked upon an extensive turnaround programme, putting all of its business units to the test. KQ has decided to exit its small- to medium-sized retail outlets with less than 8,000sq m. In addition, KQ subsidiaries Runnerspoint (running equipment) and Sinn Leffers (fashion) are up for sale. KQ currently rents major retail space from DES in Dresden, as well as in the newly-launched Phoenix centre in Hamburg/Harburg. The latter is not yet included in the table above. In addition, KQ acts as co-investor in Kassel (50%) and owns real estate in the Rhein-Neckar centre. Should these real estates be sold, we think DES would be a logical buyer. Given the pressure mounting on KQ, we think that these properties might represent attractive buying opportunities for DES in the medium term. In a first step, we would, however, assume that KQ would sell its real estate to an opportunity fund in one shot. The fund will then later repackage and sell the acquired portfolio. The rented retail outlets are partly large and/or quite successful, fitting KQ's current strategy. In addition they are subject to long rental agreements (thus exiting them would be costly for KQ). As our retail research team does not see a high risk of insolvency for the KQ group, we think that related rental income seems safe at present. ECE might, however, face the challenge of finding a new anchor tenant for the Phoenix centre in the medium term. Overall, we think that KQ risk is quite limited at present.

Deutsche EuroShop

DES becoming a G-REIT? At present a change for the worse

DES: currently better than a REIT...

DES is strongly in favour of German REIT legislation. Given the companies portfolio and strategy, we think DES would make a perfect REIT under almost all possible scenarios (low gearing, relatively passive portfolio management, limited development exposure, etc). DES has also expressed its intention to become a REIT at some time in the future. We are of the opinion that there is little need to rush this. The company is effectively not paying any taxes at corporate level (the tax charge at group level almost exclusively consists of deferred taxes). The existing tax loss carry-forward of above EUR60m ensures that this will remain so for the foreseeable future (at least seven years according to our estimates). This puts the company in a situation that is comparable to a REIT, which is also tax exempt at corporate level.

...as almost no taxes are paid at corporate level...

...and dividends are tax exempt at investor level

In addition, DES's tax strategy involves one other element that makes the company superior to a REIT. Dividends paid out by the company are effectively taken out of DES's reserves and due to a special tax structure are effectively treated as capital repayments for investors. Thus, the investor does not have to pay taxes for DES's dividends, which is a clear advantage over a REIT structure. Whether this concept could be maintained if DES opted for a REIT structure seems uncertain at present. Peer Deutsche Wohnen, which operates with the same tax optimisation model, has already mentioned the likely loss of its tax status when converting to a REIT.

G-REIT conversion could mean loss of tax status

Deutsche EuroShop – summary financials

Current price (EUR)	**36.20**	**Market cap (EURm)**	**565.6**	**Bloomberg code**	**DEQ GR**
		Enterprise value (EURm)	**729.6**	**Reuter RIC**	**DEQGn.DE**

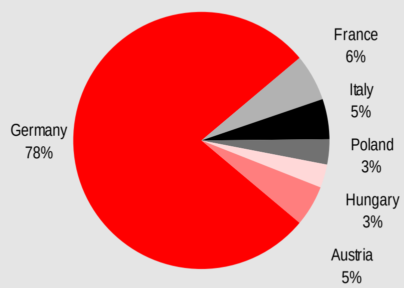
Year to	**12/2003a**	**12/2004e**	**12/2005e**	**12/2006e**
Per share data (EUR)				
Reported EPS	-0.03	0.32	0.40	0.54
HSBC EPS	-0.03	0.32	0.40	0.54
CEPS	1.40	1.75	1.87	2.05
DPS	1.92	1.92	2.00	2.00
NAV	43.56	44.65	46.13	47.66
P&L summary (EURm)				
Revenue	49.3	50.5	56.8	58.8
EBITDA	36.4	39.7	44.0	45.8
EBIT	14.0	17.3	21.0	22.3
Net interest	-14.1	-15.1	-15.0	-14.8
PBT	6.5	12.5	18.2	21.6
HSBC PBT	6.5	12.5	18.2	21.6
Taxation	-8.7	-11.0	-13.6	-13.8
Reported net profit	-0.5	5.0	6.3	8.5
HSBC Net profit	-0.5	5.0	6.3	8.5
NOPLAT	-4.9	2.1	5.3	8.0
Cash flow summary (EURm)				
Op free cash flow	-9.7	31.1	33.4	40.1
HSBC cash flow	17.7	21.4	24.7	28.4
Capital expenditure	-23.9	0.0	0.0	0.0
Cash earnings	21.9	27.4	29.3	32.0
Change in net debt	57.5	-2.1	-2.5	-7.4
Balance sheet summary (EURm)				
Intangible fixed assets	0.4	0.3	0.3	0.2
Tangible fixed assets	691.6	670.2	648.3	625.7
Cash	88.6	88.6	88.6	88.6
Current assets	106.2	106.6	108.9	109.6
Operating liabilities	8.8	8.8	9.1	9.1
Gross debt	408.6	406.5	404.0	396.6
Net debt	320.0	317.9	315.4	308.0
Shareholders funds	535.7	510.7	487.0	464.2
Invested capital	700.8	679.7	659.7	637.8

Year to	**12/2003a**	**12/2004e**	**12/2005e**	**12/2006e**
Ratios (%)				
Revenue/IC (x)	0.1	0.1	0.1	0.1
NOPLAT margin	-9.9	4.1	9.3	13.5
ROIC	-0.7	0.3	0.8	1.2
ROE	-0.1	1.0	1.3	1.8
ROA	-0.9	0.4	1.0	1.6
ROCE	-0.9	0.4	1.0	1.6
ROIC/Cost of capital	-0.1	0.1	0.1	0.2
Cost of capital	5.9	5.9	5.9	5.9
EBITDA margin	73.9	78.7	77.4	77.8
EBIT margin	28.5	34.3	37.0	37.8
PAT margin	-4.6	2.9	8.0	13.1
Interest Cover	1.0	1.1	1.4	1.5
Net debt/equity	59.7	62.3	64.8	66.3
Net debt/EBITDA	8.8	8.0	7.2	6.7
Growth (%)				
Revenue	6.0	2.4	12.6	3.5
EBITDA	9.1	9.0	10.8	4.1
EBIT	19.1	23.4	21.6	5.8
PBT	32.2	93.1	45.6	18.6
HSBC Net profit			26.4	34.5
HSBC NOPLAT			155.8	51.3
HSBC EPS			26.4	34.5
Valuation (x)				
PE		113.4	89.8	66.7
PNAV	0.8	0.8	0.8	0.8
PCE	25.9	20.7	19.3	17.7
Yield (%)	5.3	5.3	5.5	5.5
EV/Revenue	14.9	14.5	12.8	12.2
EV/EBITDA	20.1	18.4	16.5	15.7
EV/IC	1.0	1.1	1.1	1.1
ROIC/Cost of capital	-0.1	0.1	0.1	0.2
HSBC REP		21.1	8.2	5.4

Business description

Founded in 1997 as a dividend pay-out model by Deutsche Bank, DES went public in 2001 and has been internally managed since July 2003. The company is a real estate investor that focuses on shopping centres (98% of portfolio), which are predominantly based in second-tier cities in Germany (78% of portfolio). The company structure is extremely lean, comprising five professionals, with centre management and development outsourced to European market leader ECE. DES' dividend yield net of tax is c5% at present.

Equity exposure by region



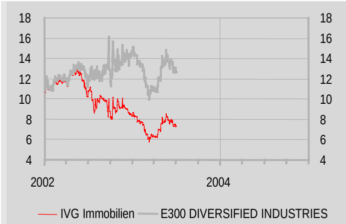
Initiating coverage

IVG Immobilien

Playing pan-European office cycles

Year to	Revenue (EURm)	EBITDA (EURm)	Reported PBT (EURm)	HSBC PBT (EURm)	HSBC Net profit (EURm)	HSBC EPS (EUR)	HSBC EPS gwth (%)	PE (HSBC) (x)	PE rel	Yield (%)	EV/ EBITDA (x)	EV/IC (x)	ROIC (%)	REP (x)
12/2003a	411.5	227.7	99.9	102.2	61.6	0.53	-13.3	23.0	209.4	2.8	13.9	1.1	4.4	1.5
12/2004e	440.1	215.5	111.1	111.1	75.9	0.65	23.1	18.7	194.1	3.3	16.6	1.0	3.9	1.6
12/2005e	486.3	243.7	130.7	130.7	87.5	0.75	15.3	16.2	191.4	3.3	15.1	1.0	3.9	1.5
12/2006e	537.4	275.7	162.6	162.6	108.8	0.94	24.4	13.0	162.7	3.7	13.5	0.9	4.2	1.3

Relative price



Source: HSBC

Company report

Country	Germany
Sector	Real Estate
Bloomberg	IVG GR
Reuters	IVGG.DE
Mkt cap (EURm)	1419.3
Mkt cap (USDm)	1897.6
Free float (%)	50

Price

	1M	3M	12M
Absolute	10.77	9.40	9.18
Absolute (%)	13.6	30.2	33.3
Relative (%)	13.6	30.2	33.3

Relative to E300 Diversified Industries
Index level 559.72

Current (EUR)
12.23

- **Leading office property investor across Europe**
- **G-REIT structure might deliver upside**
- **HSBC T&B fundamental analysis approach gives rating of 2.98; initiation of coverage**

HSBC T&B fundamental rating approach

As outlined in the *Company Analysis and Valuation* section of this report, we have analysed our peer group of German real estate companies along five main weighted criteria (country and category exposure, rent expiry profile, G-REIT potential, and a miscellaneous position comprising other relevant factors).

IVG's country rating benefits from its relatively large international exposure (c60% of NAV), giving a rating of 2.73 (out of a total score of 5), second only to AIG on 3.13. The company's category rating is slightly above average at 3.17, benefiting from the bottoming out of the office cycle in selected European cities. IVG has relatively high rent expiries in 2004/05, making the company vulnerable to high vacancy rates across Europe and especially in Germany. Thus, we have attributed a below-average rent-expiry rating of 2.0. We have attributed a neutral rating of 3.0 in the other category.

Below we describe IVG's potential to benefit from a G-REIT structure other than increased investor interest, analyst coverage, etc.

Potential to benefit from G-REIT

IVG would benefit from a G-REIT structure one way or another. However, given the lack of visibility regarding the shape of G-REIT legislation, it is unclear to what extent this would be. IVG already operates with a relatively tax efficient group structure, and its international operations alone have a tax loss carry-forward of cEUR400m. Of its total tax charge of EUR21m in 2003, the German IVG AG paid only EUR9.2m.

In addition, IVG is considering additional listings in order to obtain REIT status for its foreign portfolios. An example of this is the UK real estate company, Hammerson, which has a French listing and has therefore obtained SIIC status for its French portfolio. Dutch property company Wereldhave even has a triple REIT status (including France and Belgium). We estimate IVG's

Research team*

Analyst

Peter Barkow DE 49 211 910 3276
Irineus Stanislawek DE 49 211 910 3017

*HSBC legal entities are listed on page 188

IVG Immobilien

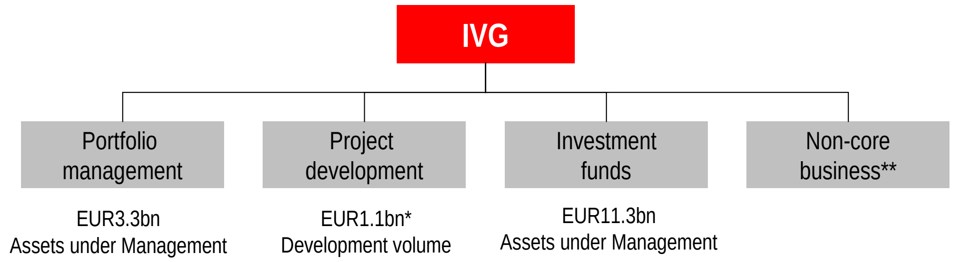
French exposure to be cEUR200m. Thus, we doubt whether French REIT benefits would exceed additional costs for IVG. In our view, the only regional portfolios qualifying for REIT listings are Germany and Belgium, with EUR1.3bn and EUR0.9bn of assets, respectively (both excluding debt). Overall, we attribute a G-REIT rating of 4.0 to IVG.

Conclusion

Our fundamental analysis approach gives an overall rating of 2.98 for IVG, which is the second best rating we have attributed within our peer group. At the same time, the company trades at the highest discount to NAV of c20% within our peer group. We initiate coverage on IVG with this report.

Group strategy

IVG business model



*Note: *The total development pipeline in worth some EUR2.1bn, of which IVG's exposure is EUR1.1bn, ** in the process of being run down*
Source: Company data, HSBC Trinkaus & Burkhardt

A leading investor in European office property

IVG is a leading European office property investor, with EUR15.7bn of real estate assets under management (including the company's fund management operations). IVG is (almost) a pure play on the European office sector, comprising 81% of the company's real estate exposure. Portfolio diversification is achieved by spreading risk across different European property locations. By pursuing an active 'Buy and Sell' strategy, IVG is trying to maximise returns by making use of different office cycles in Europe. Contrary to open-ended funds, IVG focuses on the acquisition of large property portfolios at huge discounts. The value of these portfolios is then lifted by upgrading them in quality and tenancy. Once the value enhancement is finalised, IVG tries to profitably exit its investments.

Property development pipeline of EUR1.1bn

The company is also running a relatively large property development business for third parties, as well as for its own portfolio. The development pipeline currently comprises EUR2.1bn (of which EUR1.1bn relates to IVG) and an equity exposure of cEUR400m for IVG. According to IVG, development activities are needed to reach attractive returns required by capital markets.

Quantum leap for asset management through acquisition of OIK

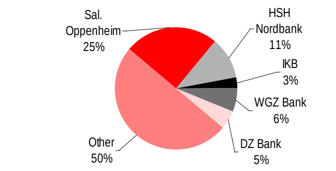
IVG's third business line is the management of property funds (open and closed), which has only recently been started. The business has not added substantial revenues and profits in the past, but this should change with the consolidation of OIK (Oppenheim Immobilien-Kapitalanlagegesellschaft); 50.1% of the latter was acquired in April 2004 for EUR125m.

IVG Immobilien

With EUR 8.3bn of gross assets under management, OIK covers c40% of the strongly growing German specialty property funds market.

IVG has a free float of 50%, making it by far the most liquid German real estate stock. A major event for the company was the purchase of its major shareholder WCM's stake in IVG by Sal Oppenheim, HSH Nordbank and three other financiers. The change in the company's shareholder structure had a positive impact, as the uncertainty about WCM was detrimental for IVG's management and for funding purposes. Sal Oppenheim and HSH Nordbank have clearly stated that they would be strategic investors in IVG. Nevertheless, the issue of a stock overhang remains, especially as DZ and WGZ bank do not appear to be strategic investors with a combined share of 11% in the company. We also think that IKB and HSH Nordbank would be willing to sell their stakes, if offered an attractive price.

IVG shareholder structure

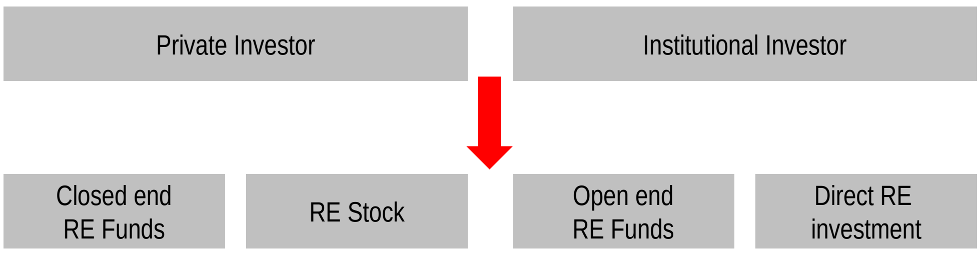


Source: Company data, HSBC Trinkaus & Burkhardt

IVG: a one-stop shop for property investors

IVG also considers itself a one-stop shop for real estate investors offering closed and open ended funds and RE stock, as well as direct property investments (the latter via sales from its portfolio).

IVG the one stop real estate investment shop



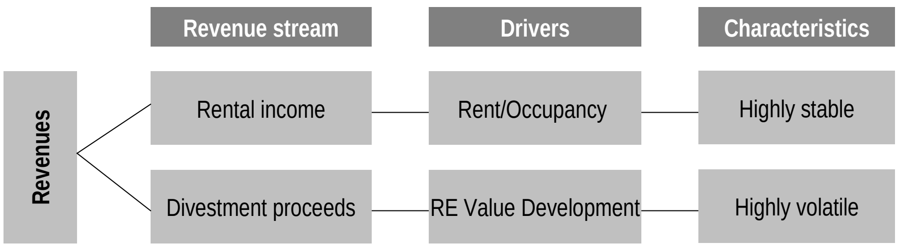
Source: Company data, HSBC Trinkaus & Burkhardt

Business segments

Portfolio management

Business segment strategy

Portfolio management revenue model



Source: HSBC Trinkaus & Burkhardt

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A leading office investor...

IVG concentrates mainly on office property spread across European locations. This sets it apart from other listed European real estate companies, which usually focus on one market (their home market). IVG's pan European strategy started in 1997, with the acquisition of a Paris-based real estate, putting IVG at the forefront of the internationalisation of German real estate companies. Since then, international exposure has continuously increased, although IVG still has a concentration on the German (office) real estate market. Despite the almost uniform decline of European office markets (with the notable exception of Brussels benefiting from the EU administration, which always seem to grow) we believe that real estate is predominantly a local business. We also think that recovery patterns will diverge sharply across European real estate locations in the current cycle. Thus, local management and presence means competitive advantage and, in our view, is a prerequisite for success. IVG accounts for this by maintaining offices with local staff in each of the major European real estate centres. In addition, one of the strategic ideas behind the OIK acquisition was to increase market penetration in selected European real estate centres. Nevertheless, the multi-local approach can be a disadvantage in terms of the potential investor base for real estate stocks. Some investors still prefer to take portfolio decisions themselves and do not favour outsourcing this process to holding companies investing in different countries.

...diversifying risk by geographical expansion

IVG buys, upgrades and finally sells properties...

IVG manages its portfolio by actively pursuing a 'buy and sell' approach. In this sense, IVG focuses on buying large real estate portfolios either directly, or via the acquisition of entire companies (such as Asticus or Polar real estate) at large discounts. Portfolios are then upgraded in quality and tenancy and IVG resells the properties piece by piece at retail prices, realising their increased value. Using this investment approach, IVG avoids the competition from open-ended funds, which mostly invest in single fully-let properties that are not in need of refurbishing. The trading element in IVG's portfolio management strategy potentially adds to earnings volatility. Furthermore, earnings can be managed by timing transactions. However, we focus on the positive impact on the company's NAV, rather than looking at the earnings impact of transactions.

...making the portfolio a moving target

Focus on high-quality tenants

IVG focuses on high net-worth tenants (the largest three are triple-A rated tenants) largely avoiding counter-party risk. We give an overview in the table below:

IVG tenant overview

Top 10 sectors	Rent share	Top 10 tenants (location)	Rent share
Public institutions	22.5%	Régie des Batiments (BRU)	7.9%
Wholesale and retail	11.1%	EBV Erdölbevorratungsverband (HAM)	6.9%
Financial services	9.5%	European Union (BRU)	3.9%
Electronic, micro-/optoelectronic	7.3%	Kesko Qyj (HEL)	3.8%
Other services	6.9%	Lucent Technologies Network (MUC)	3.5%
Telecoms	6.5%	COVA Central Orgaan Voraadvorming (HAM)	2.0%
Real estate	6.0%	EPCOS (MUC)	1.7%
Energy, gas and water	5.9%	PwC (BRU)	1.6%
Media	5.0%	Statoil Germany (HAM)	1.6%
Transport, Storage, Aviation, Automobiles	4.8%	Segafredo Zanetti (HEL)	1.5%
Total Top 10	**85.5%**	**Total top 10**	**34.4%**

Source: Company data HSBC Trinkaus & Burkhardt

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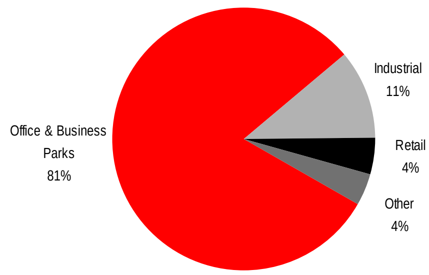
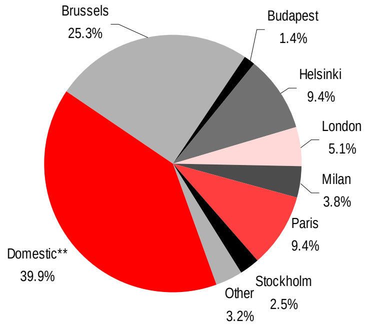
Portfolio analysis

Real estate portfolio by category*...



*Note: * Percentage of NAV at end-2003*
Source: Company data, HSBC Trinkaus & Burkhardt

...and region*



*Note: * Percentage of NAV at end-2003, ** containing 4% of taverns business*
Source: Company data, HSBC Trinkaus & Burkhardt

IVG property exposure: mainly office, mainly Germany

Looking at IVG's portfolio split, two aspects are apparent:

- Office real estate (and business parks) is the largest category at 81%
- Germany still accounts for c40% of regional exposure

1a locations internationally

1b locations in Germany

Value generation by 'Buy and Sell' strategy

The international portfolio solely comprises 1a locations, whereas locations in Germany are typically 1b. The latter are often industry parks on the way from the airport to the city that IVG has converted into office space and luxurious lofts. A notable exception to this is Berlin, where properties are closer to the centre. IVG is constantly optimising its portfolio, and because of this 'buy and sell' strategy, its portfolio is indeed a moving target. Nevertheless, IVG has successfully generated value through this strategy in the past. We give an overview of IVG's most recent portfolio transactions in the following table:

Overview of recent IVG property transactions

Month	Location	Category	Transaction	Value* (EURm)	Gross rent (EURm)	sqm	Vacancy	Value*/sq m (EUR)	NAV/sq m** (EUR)	Diff
8.2004	London	Office/Retail	Divestment	32.5	2.0	2,560	0%	12,695	12,635	0.5%
9.2004	Helsinki	Office	Acquisition	63.0	7.9	63,000	7%	1,000	1,042	-4.0%
10.2004	Paris	Office	Divestment	100.0	7.5	10,600	0%	9,434	9,083	3.9%

*Note: *of transaction, **average of IVG location*
Source: Company data, HSBC Trinkaus & Burkhardt

Rental contracts mature in five to 7.5 years on average

The average maturity of rental agreements is between five and 7.5 years, with substantial deviations according to the company. Typical lease length in the UK is c20 years, whereas in Finland, it is reportedly (source: IVG) very short (although the duration of rental agreements in the latter are much longer on average). In 2004e, expiries are quite high at 18.2%, which is unfortunate given the current weakness of the office real estate market in Europe. Nevertheless, the average top office rent for the European markets we cover were still 15% higher at end-Q2 2004 than six years ago. The average office top rent in Germany has increased by only 3% during the same time.

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High degree of rent expiries in 2004

	2003a	2004e	2005e	2006e	2007e	2008e*
Rent expiry**	13.0%	18.2%	10.4%	10.9%	15.6%	44.9%
Change y-o-y		40.0%	-42.9%	4.8%	43.1%	nm

*Note: * and beyond, ** as percentage of rents*
Source: Company data, HSBC Trinkaus & Burkhardt

Risk on average rent level from rising vacancy rates…

…but IVG has successfully maintained or increased rents in the current downturn

We expect the vacancy rate to increase at the end of 2004, but average rent to rise

Our calculation on top rent development indicates that IVG should have little downward pressure produced by the rent level of renewed contracts. We admit that this calculation does not account for any downside risk on rents arising from built-in rent increases for some IVG contracts. Automatic rent increases are based on the cost of living index in Germany, for example, and are included in c75% of IVG's lease agreements. The downside risk to IVG's average rent level stems from a much higher vacancy rate at end-Q2 2004, compared to six years ago. While on the European level the increase in vacancy was only 2%, the ratio increased by 4.6% in Germany for the six-year period. Nevertheless, IVG has a track record of maintaining, or even raising rents in difficult markets (as the following table shows). Note, however, that in 2003, revenues benefited from EUR6m one-off payments, because of the early termination of lease contracts. In its Q3 report, IVG states that an equivalent of 115,000 sq m of office space, or 7% of the portfolio, is already let. This, however leaves c190,000 sq m of expiring space still in the loop. At its November analyst meeting, IVG also mentioned that new lease contracts would have an average rent of EUR11.03, compared to expiring contract rents of EUR8.75. Based on this, we would expect the average vacancy rate of the portfolio to rise, and average rent to increase.

Development of average monthly rent per sq m

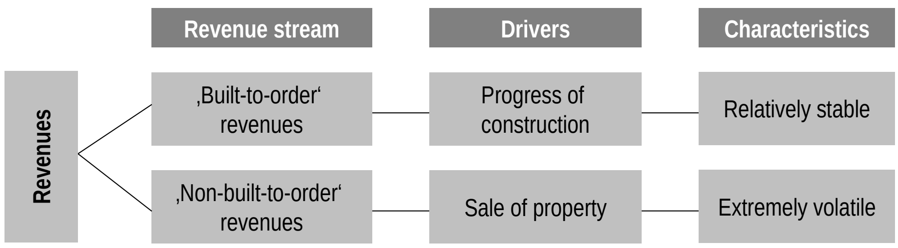
EUR	1995	1996	1997	1998	1999	2000	2001	2002	2003
Ave rent /sq m	5.23	5.27	5.55	7.92	9.2	9.22	11.16	11.19	11.09
change y-o-y		0.8%	5.3%	42.7%	16.2%	0.2%	21.0%	0.3%	-0.9%

Source: Company data, HSBC Trinkaus & Burkhardt

Project development

Business segment strategy

Revenue model



Source: HSBC Trinkaus & Burkhardt

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IVG is also active in project development not only for its own property portfolio (HSBCe c85%), but also for third parties. On a Pan European basis, IVG prefers to engage in joint ventures in order to minimise risk, and to add local expertise as well as credibility in some locations such as Paris, where IVG reported nine ongoing projects with joint venture partner AXA at end-2003. Other joint venture partners include blue chip names such as Bilfinger and Berger and Pazini Group. The former has, however, in the meantime stopped property development for its own account due to heavy losses. In some international locations such as Brussels and London, IVG has garnered a sufficient track record to develop properties individually.

Development activities for third parties and own portfolio

Partner approach for international activities

Project development volatility is high, as earnings are only booked upon finalisation and sale of the project according to German GAAP (either gross as revenues or net as other operating income). Projects developed for IVG's own portfolio do not have an impact on group accounts. JV project costs and revenues do not appear in IVG's accounts until the sale of the property (they then appear in the financial results as other financial income). The JV typically implies the set-up of a special purpose vehicle, which is not consolidated but admittedly is booked at cost in the balance sheet. In the case of an adverse development of the project, IVG would have to impair value for this and reduce the balance sheet accordingly. In 2003, external revenues for the division were down 46% y-o-y, underlining the segments high volatility. However, 2002, was a strong year due to the finalisation of IVG's largest-ever project in London.

Majority of development revenues are booked at finalisation of project...

...leading to high earnings volatility

The changeover to IAS at end-2004 will lead to substantial changes in the way development projects are accounted. Properties that have already been sold to external parties (unfortunately the minor part as we have mentioned previously) will be accounted for according to 'percentage of completion' method. Thus, earnings contribution will be attributed to development progress leading to more P&L stability. The accounting of properties developed for IVG's own portfolio remains unchanged, so that earnings volatility is likely to persist.

IAS will change treatment of 'pre sold' development projects...

...reducing earnings volatility a little

To minimise risk from the development business, IVG has set up the following guidelines for project development:

- Total project development volume may not exceed one-third of IVG's property portfolio
- Development projects have to comply with the same strict investment criteria as portfolio properties. IVG's pan European research, as well as the company's local real estate experts, execute a financial due diligence on the economic viability of each development project
- IVG exclusively hires blue-chip contractors for the building phase
- Gross margins have to range between 10% and 20% according to the project risk profile
- IVG's central controlling unit is to monitor each project on a continuous basis

IVG has set up a number of criteria to reduce development risk

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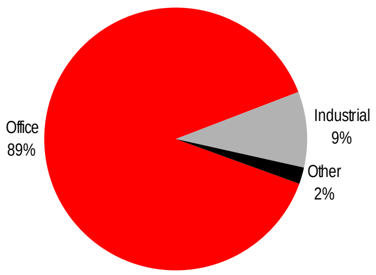
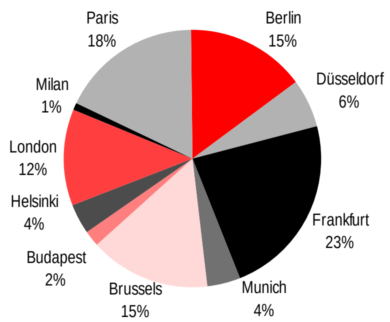
Attractive development pipeline

Real estate development pipeline by category*...



*Note: * Percentage of IVG exposure end 2003*
Source: Company data, HSBC Trinkaus & Burkhardt

...and region*



*Note: * Percentage of IVG exposure end 2003*
Source: Company data, HSBC Trinkaus & Burkhardt

EUR1.1bn development pipeline...

At end-2003, the total development pipeline was worth cEUR2.1bn, of which EUR1.1m belonged to IVG. Of this, IVG reported an equity exposure of cEUR400m. Given that developed properties currently have a 42% pre-let rate, one could argue that IVG's risk position can be considered less than the EUR400m equity exposure. Developments are realised by individual development companies. Although IVG does not formally guarantee their debt, we see a moral obligation for it to take over debt in the case of an adverse development that could lead to potential reputation loss. This would avoid future difficulty in funding IVG's development activities. Nevertheless, it also adds to the division's risk exposure.

...with EUR400m equity invested

Development pipeline reflects portfolio structure

Frankfurt exposure of 33% seems worrying...

...but the estate already has a 33% pre-let rate...

...and will not come to the market before 2007...

...and might even end if no new partner is found

The structure of the development pipeline pretty much mirrors the structure of IVG's property portfolio. Thus, in terms of country exposure, Germany is the largest individual country (at 48%), whereas office is the most important category at 89%. Frankfurt's huge share at 23% instantly strikes us. It has by far the highest availability rate (defined as direct vacancy, plus sub-let space, plus short-term speculative development space) on the German market at 15.5%, at end-Q2. Furthermore, Frankfurt is by far the most cyclical office property location in Germany, because of its dependence on the financial services industry. It is the only German city that has shown a significant decline of top rents in 2004, which we regard as a negative. IVG's Frankfurt exposure represents only the AIRRAIL property, which is close to the airport and combines 115,000sq m of office, retail and hotel space. According to IVG, the estate had a pre-let rate of 33% at end-2003, underlining much better rental conditions near the airport than in Frankfurt city. The project should be finalised in 2007, giving the Frankfurt property market some time to recover, and reducing IVG's development risk. In addition, IVG has mentioned that the future of the project is not certain, as joint venture partner Bilfinger & Berger intends to exit the development business. IVG has also stated it will only continue the project if another development partner takes over from Bilfinger & Berger. Further, IVG noted that abandoning the project would not require substantial costs, and that the company is confident of finding a new development partner in due course.

We think that 2005 will be a strong year for project development

Unfortunately, IVG does not give guidance on individual business segments. Therefore, we have to rely on data published in its annual report in order to get a feel for the current development pipeline. We think that the development pipeline looks fairly attractive,

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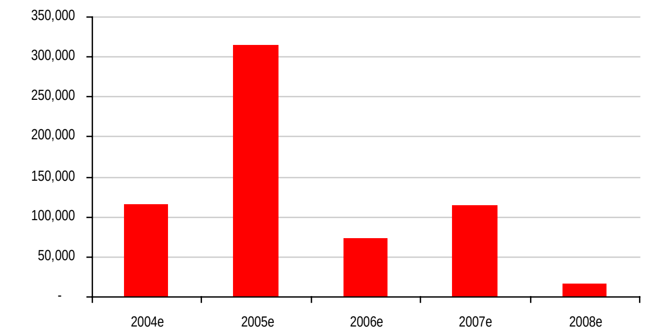
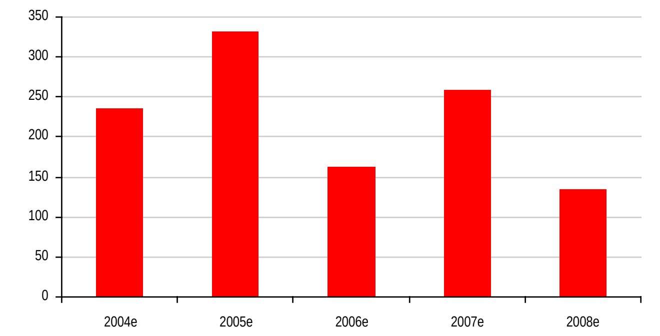
especially for 2005. We expect that up to six projects can be sold in 2005. We have, however, included the Madou Plaza and Terwuren Plaza projects in the portfolio management segment, as it is not certain whether they will be sold. Should this be the case, we expect a significant earnings impact in 2005.

IVG's development pipeline per year in sq m*...



*Note: *at end-2003*
Source: Company data, HSBC Trinkaus & Burkhardt

...and volume* (EURm)

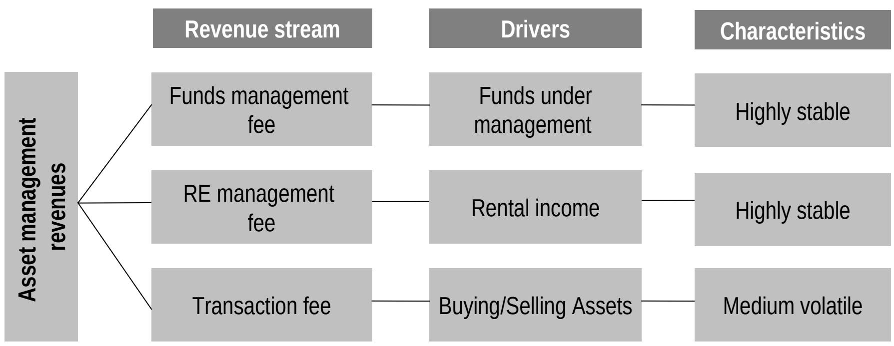


*Note: *at end-2003*
Source: Company data, HSBC Trinkaus & Burkhardt

Investment funds

Business segment strategy

Asset management revenue model



Source: HSBC Trinkaus & Burkhardt

IVG's fund management was not significant...

At end-2003, IVG had managed EUR3bn of real estate assets for third parties – mainly open-ended funds for institutional investors such as insurance companies and pension funds.

...until leading specialty funds manager was acquired in 2004

IVG acquired a 40% stake in Wert-Konzept in 2000. Wert-Konzept was completely taken over in April 2003 and recently renamed IVG Immobilien-Fonds. The company is a marketer of closed-end funds. Wert-Konzept raised EUR46m of equity in 2003 and targets EUR100m in 2004. In the past, revenue and profit contribution from the business segment was negligible (c3% of revenues and EUR1m of EBIT in FY 2003), but IVG's fund management operations entered a new dimension after the acquisition of OIK (Oppenheim Immobilien-

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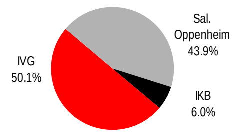
Kapitalanlagegesellschaft). With this deal, which combined OIK's and IVG's real estate assets, IVG became a global top 10 real estate asset manager.

The OIK deal

In April 2004, IVG acquired a 50.1% share in OIK for EUR125m, representing an EBIT multiple of 10. According to IVG, OIK is effectively almost debt free, so that the EV of the transaction can be calculated at EUR250m, putting FY 2003 EBIT at cEUR25m. OIK is a manager of open-ended specialty RE funds, with EUR8.3bn of gross assets under management at end-2003. Assets were spread across 26 funds (of which 18 are single investor funds) and invested in c520 properties located in 10 different countries. Total lettable space amounts to 3.2m sq m. OIK has c100 investors and holds a 10% stake in New York-based Real Estate Capital Partners.

OIK shareholder structure



Source: Company data, HSBC Trinkaus & Burkhardt

OIK's asset growth was cEUR800m, or 11% y-o-y in 2003. The company expects average fund inflows of EUR1bn annually. Growth, however, has slowed in 2004, as net assets reported by the BVI were flat in H1 2004. Thus, the EUR1bn asset inflow target seems stretched for 2004.

OIK dominates the specialty RE funds market in Germany (EURm)

Asset Manager	Exposure	Volume*
OIK	37.8%	5,271.0
III	16.4%	2,288.9
Hansa Invest	8.3%	1,156.4
Deka	6.1%	853.4
Aachener Investment	5.9%	827.1
AXA Investment	4.9%	678.0
MEAG	4.7%	654.6
APO immobilien	4.0%	553.3
Other	12.0%	1,667.3
Total	**100.0%**	**13,950.0**

*Note: * Net assets (deducting debt) as per June 2004*
Source: BVI, Deutsche Bundesbank, HSBC Trinkaus & Burkhardt

The specialty RE funds market has grown fast in the past...

OIK is the clear market leader in the German special real estate funds business, with a market share of close to 40%. The German market for real estate specialty funds has experienced strong growth in the past. Cumulated annual growth has been 40% for the last five years. In 2003, net assets under management grew 13.6% y-o-y. Growth in 2004 has, however, slowed substantially, with total net assets under management standing at EUR14bn (see chart below to the left) in June 2004. OIK's management has mentioned a shortage of suitable properties as the main reason for a slower growth pace in 2004.

...but the market slowed in 2004

Assuming revenues of 1.2% on net assets, the specialty real estate funds market represents a revenue pool of cEUR160m annually, while growing at double-digit rates. Without doubt, this, in our view, is an attractive market.

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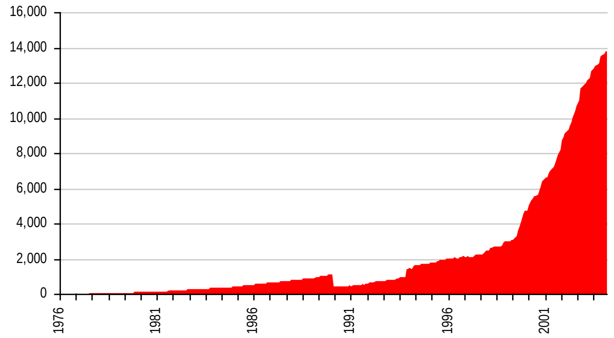
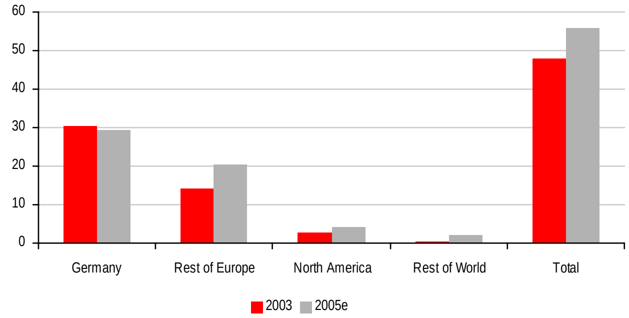
Specialty RE fund market is growing fast (EURm)



Source: Deutsche Bundesbank, HSBC Trinkaus & Burkhardt

Institutional investors still want to increase RE portfolio share (EURm)



Source: Feri, HSBC Trinkaus & Burkhardt

A number of macro trends continue to support the specialty funds business

There have been a number of macro trends supporting indirect investments in real estate. Institutional investors realised they were lacking research, as well as management expertise on real estate investments. At the same time, institutional investors increased their share of real estate investments in order to diversify their portfolios. In addition, institutional investors tried to manage their portfolios more actively, which is easier with open funds than with direct RE investments. At present we do not see an end to these macro drivers, despite slowing growth in 2004. Institutional investors are still in the process of increasing their RE investments. At the same time they continue to increase their international RE exposure (see bottom right chart on previous page). The impact of IFRS (OIK stated in the press that only eight of its c100 customers would be affected) and the introduction of a G-REIT structure on sector growth are difficult to assess at present.

...but G-REIT and IFRS impact remain unclear

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IVG and OIK office locations show some overlap

Location	IVG	OIK
Germany		
Berlin	✓	–
Düsseldorf	✓	–
Frankfurt/Wiesbaden	✓	✓
Hamburg	✓	–
Munich	✓	–
International		
Amsterdam	–	✓
Brussels	✓	✓
Budapest	✓	–
Helsinki	✓	–
Lisbon	–	✓
London	✓	✓
Madrid	✓	✓
Milan	✓	✓
New York	–	✓
Paris	✓	✓
Stockholm	–	–

Source: Company data, HSBC Trinkaus & Burkhardt

Some geographical overlap between IVG and OIK

There is some geographic overlap of IVG and OIK's European office network, which might result in minor cost synergies given the combination of offices in some locations. Nevertheless, the transaction's strategic rationale is not cost driven. We think it is plausible that both entities, combined, will have a better market penetration, making them a more important player in key European locations. We think that size matters in the real estate industry owing to...

Deal delivers size advantage

- An improved perception by property vendors leading to superior deal pipeline
- Increasing inside market know-how as IVG/OIK sees all or at least most deals
- Being a top priority account for real estate agents leading to superior occupancy
- (Some) cost advantages because of economies of scale

OIK can use IVG's letting experience

In addition, OIK can use IVG services in terms of letting properties, etc, which have been successful in the past. On the other hand, IVG has permanently been underfunded, missing out on attractive transactions the past. OIK with its (equity) funding power can, hopefully, make use of these opportunities.

Potential conflict of interest...

...but several levels of control

We would think it natural that investors consider corporate governance issues as relevant with respect to the above combination. Potential conflicts of interest could, for example, arise when a property is offered to IVG or OIK, as well as when IVG sells a portfolio property to OIK. IVG counters these arguments by stating that:

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- IVG and OIK follow different investment styles. Whereas IVG acquires whole property portfolios and tries to upgrade them, in terms of quality and occupancy, OIK purchases single properties with a total value from EUR15-50m, which are fully rented and are not in need of development. Thus, the potential overlap is minimal

IVG and OIK follow different investment styles

- Each OIK fund has an investment committee exclusively consisting of its investors, which has the final say on property transactions

OIK investors have final say on acquisitions

- OIK is run as an independent company (although it has first rights to purchase properties from IVG's portfolio that are up for sale) with Chinese walls in place.

Internal transactions double-checked by external value audits

- All IVG/OIK transactions are at arms length, with values double-checked by external audits

OIK's revenue model

OIK generates three types of revenues, which we estimate as follows:

OIK has three revenue streams:

- A fund management fee of c50bp on real estate assets under management

1. Fund management fees

- A property management fee (for maintenance) of c4-6% of annual net rents

2. Property management fees

- A transaction fee of 100bp for properties required for setting up a new fund, as well as portfolio optimisation

3. Property transaction fees

We think that performance-related fees are still an exception for specialty property funds, but might represent a future opportunity. With the above assumptions, we have set up the following revenue model for OIK. It can be seen that with 4% annual net asset growth and an annual cost improvement of 1%, net income growth of OIK equates to 6-7% annually. Discounting the revenue stream with a CoE of 7.2% (equalling a beta of 0.8) gives a fair value of cEUR260m, supporting the acquisition price paid by IVG. OIK was consolidated in Q3 with three months of revenues, according to IVG. OIK's goodwill amortisation was cEUR2m in Q3, but in FY 2004 figures, regular goodwill amortisation will fall out as IVG moves to IFRS. First-time IFRS users may not amortise goodwill on a regular basis, even when starting in 2004. This should lead to a cEUR4m net income improvement in Q4 for IVG.

We think OIK profits can grow by 6-7% annually medium to long term...

...justifying a transaction value of EUR250m

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OIK revenue model

EURm	2003a*	2004e	y-o-y	2005e	y-o-y	2006e	y-o-y	2007e	y-o-y
Assets	8,300	8,300	0.0%	8,632	4.0%	8,977	4.0%	9,336	4.0%
Asset turn factor	na	12.0%	na	7.5%	-4.5%	7.5%	0.0%	7.5%	0.0%
Property transactions	800	1,000	25.0%	955	-4.6%	993	4.0%	1,032	4.0%
Fee margins									
Asset management	0.50%	0.50%	0.0%	0.50%	0.0%	0.50%	0.0%	0.50%	0.0%
Transactions	1.00%	1.00%	0.0%	1.00%	0.0%	1.00%	0.0%	1.00%	0.0%
Property management	0.20%	0.20%	0.0%	0.20%	0.0%	0.20%	0.0%	0.20%	0.0%
Fee revenues									
Asset management	41.50	41.50	0.0%	43.16	4.0%	44.89	4.0%	46.68	4.0%
Transactions	8.00	10.00	25.0%	9.55	-4.6%	9.93	4.0%	10.32	4.0%
Property management	16.60	16.60	0.0%	17.26	4.0%	17.95	4.0%	18.67	4.0%
Total revenues	**66.10**	**68.10**	**3.0%**	**69.97**	**2.7%**	**72.77**	**4.0%**	**75.68**	**4.0%**
CIR	66%	65%	-1.0%	64%	-1.0%	63%	-1.0%	62%	-1.0%
PbT	**22.47**	**23.84**	**6.1%**	**25.19**	**5.7%**	**26.92**	**6.9%**	**28.76**	**6.8%**
Tax rate	40%	40%	0.0%	40%	0.0%	40%	0.0%	40%	0.0%
Net Income	**13.48**	**14.30**	**6.1%**	**15.11**	**5.7%**	**16.15**	**6.9%**	**17.25**	**6.8%**

Note: HSBC estimates based on public statements and transaction details
Source: Company data, HSBC Trinkaus & Burkhardt

Some potential to benefit from G-REIT structure

IVG is a strong proponent of a flexible G-REIT legislation…

…being itself a main beneficiary

IVG is an active player in the lobbying campaign for a G-REIT structure. The company is a strong proponent of a flexible G-REIT structure on international activities, the possibility of development activities, active real estate portfolio management ('Buy and Sell'), gearing and pay-out ratios, etc. IVG supports the view that a flexible REIT structure, such as in France or the US, has been the most successful in the past. At the same time, IVG would be a main beneficiary of flexible G-REIT legislation, given its corporate strategy and structure.

IVG tax overview (EURm)

	2002	2003	H1 200a
IVG Group			
PbT	96.6	87.3	17.1
Income tax charge	-26.2	-20.8	-2.9
Income tax rate	-27.1%	-23.8%	-17.0%
IVG AG			
PbT	50.7	49.0	na
Income tax charge	-7.8	-9.2	na
Income tax rate	-15.4%	-18.8%	na

Source: Company data, HSBC Trinkaus & Burkhardt

IVG's ideal scenario is to convert full company into a G-REIT…

IVG's ideal scenario is to convert the whole company into a G-REIT. Given the lack of visibility regarding the shape of G-REIT legislation it is, however, unclear, whether this will be possible or not. Even in the case of a flexible G-REIT structure, it is difficult to assess how much IVG will actually benefit, with so many essential parts of the G-REIT structure being completely uncertain (exit tax, taxation of capital gains, taxation of development

IVG Immobilien

activities, taxation at investor level etc.) at present. In general, IVG is already operating with a relatively tax efficient group structure. We understand that the volume of tax loss carry-forwards from IVGs international operations is cEUR400m alone (of which cEUR240m was added by the acquisition of Polar). This results in group tax rates of 27% and 24%, for 2002/03, which is much lower than the average listed German company (see tax chapter within the sector part for details). Of its total tax charge of EUR21m in 2003, the German IVG AG paid only EUR9.2m. We think it is plausible to assume that the difference between group and AG tax payments refers to taxes paid on international profits, which would not be affected by any G-REIT legislation. At present we think it would be challenging to quantify how much of the German tax bill would potentially relate to G-REIT income. Nevertheless, we have undertaken some scenario calculations below, resulting in NPVs of the tax advantage ranging from cEUR90-180m at IVG level. This advantage, however, comes at the expense of a potentially higher taxation at investor level.

...but IVG is already quite tax efficient

Potential benefit difficult to assess

In addition, IVG would have to pay an unknown amount of exit tax on the valuation reserves in the German part of its portfolio. The difference between IVG's NAV and book values was some EUR750m at end-2003, of which we estimate that maybe one-third relates to the German portfolio. The German portfolio accounted for 40% of the NAV at the same time, but we think it is reasonable to assume that its valuation reserves have developed less favourably then the international portfolio. This is in line with the underperformance of the German real estate markets compared to its European peers in recent years. In the table below, we have calculated the potential tax charge, with tax ratios ranging from 12.5-25% on the valuation reserve of IVG's German portfolio (see calculation to the right). This gives an exit tax range of EUR31-62m.

Capital gain of German portfolio (EURm)

NAV	**1,671**
Equity book value	917
Latent capital gain	**754**
German share	33%
Taxable capital gain	**251**

Source: Company data, HSBC Trinkaus & Burkhardt

IVG REIT impact (EURm)

	Lo case	Base case	Hi case
Exit tax payment			
Tax rate	12.5%	18.8%	25.0%
Exit tax	31.4	47.1	62.8
NPV tax advantage			
Share REIT profit	50.0%	75.0%	100.0%
Annual tax advantage	4.6	6.9	9.2
NPV tax advantage*	88.5	132.7	176.9
REIT impact**	**57.1**	**85.6**	**114.1**

*Note: Discounted at a COE of 7.2%, assuming 2% eternal growth of the tax advantage, *not considering higher tax charge at investor level Source: HSBC Trinkaus & Burkhardt*

IVG Immobilien

IVG's fall-back scenario is to list separate portfolios as REITS in other countries

In addition to a conversion into a German REIT, IVG is also considering additional listings in order to obtain REIT status for its foreign portfolios. An example of this is the UK real estate company Hammerson, which has a French listing and has therefore obtained SIIC status for its French portfolio. Dutch property company Wereldhave, even has triple-REIT status (including France and Belgium). We would not view this strategy as ideal, as it would further spread the liquidity of the stock, and restructuring c300 legal entities will probably not be an easy task (not to mention the incurred costs). We estimate IVG's French exposure to be cEUR200m (excluding debt), after the sale of a French property for cEUR100m in October 2004. Thus, we would be sceptical if the French REIT benefits exceed additional costs. The only regional portfolios qualifying for REIT listings, in our view, are Germany and Belgium, with EUR1.3bn and EUR0.9bn of assets, respectively (both excluding debt).

We think that excluding Germany. only Belgian exposure has critical mass

G-REITs could hamper growth expectations at OIK...

Another drawback of the G-REIT regime for IVG could be a possible negative impact on OIK's specialty funds business. Should the G-REIT segment prove to be extremely successful, institutional investors could, at some stage, decide to withdraw money from specialty funds and redirect it into G-REITs. The latter offers higher liquidity and thus better portfolio optimisation possibilities. Such a development would have a negative impact on OIK's business. The described scenario, however, remains somewhat speculative at present, and is also dependent on the treatment of G-REITs at insurance companies (counted as real estate or counted as property). Interestingly, OIK's other large shareholder (Sal Oppenheim) announced the launch of a REIT fund in October 2004.

...but it is too early to say

IVG – summary financials

Current price (EUR)	**12.23**	**Market cap (EURm)**	**1419.3**	**Bloomberg code**	**IVG GR**
		Enterprise value (EURm)	**3576.7**	**Reuter RIC**	**IVGG.DE**

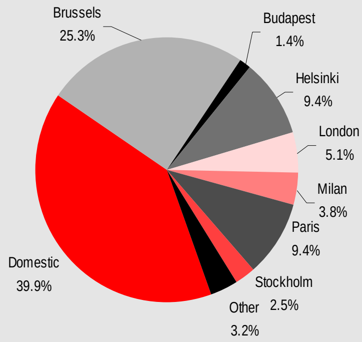
Year to	**12/2003a**	**12/2004e**	**12/2005e**	**12/2006e**
Per share data (EUR)				
Reported EPS	0.51	0.65	0.75	0.94
HSBC EPS	0.53	0.65	0.75	0.94
CEPS	0.94	1.04	1.15	1.35
DPS	0.34	0.40	0.40	0.45
NAV	14.41	14.66	15.32	15.83
P&L summary (EURm)				
Revenue	411.5	440.1	486.3	537.4
EBITDA	227.7	215.5	243.7	275.7
EBIT	180.1	170.6	197.5	227.8
Net interest	-91.2	-102.9	-111.4	-110.8
PBT	99.9	111.1	130.7	162.6
HSBC PBT	102.2	111.1	130.7	162.6
Taxation	-33.4	-30.1	-36.7	-47.1
Reported net profit	59.3	75.9	87.5	108.8
HSBC Net profit	61.6	75.9	87.5	108.8
NOPLAT	121.9	125.4	143.7	164.3
Cash flow summary (EURm)				
Op free cash flow	-112.3	-268.2	-14.5	12.3
HSBC cash flow	108.8	252.5	279.3	316.3
Capital expenditure	-266.0	-266.0	-266.0	-266.0
Cash earnings	109.3	120.8	133.6	156.8
Change in net debt	57.6	384.0	69.3	41.4
Balance sheet summary (EURm)				
Intangible fixed assets	26.3	105.8	110.3	114.8
Tangible fixed assets	2659.5	2836.5	3012.3	3186.4
Cash	54.4	54.4	54.4	54.4
Current assets	713.3	983.8	1081.3	1189.2
Operating liabilities	411.5	335.3	338.5	342.0
Gross debt	1911.9	2295.9	2365.2	2406.6
Net debt	1857.5	2241.5	2310.8	2352.2
Shareholders funds	917.0	953.5	994.5	1056.9
Invested capital	2933.2	3536.4	3811.0	4094.0

Year to	**12/2003a**	**12/2004e**	**12/2005e**	**12/2006e**
Ratios (%)				
Revenue/IC (x)	0.1	0.1	0.1	0.1
NOPLAT margin	29.6	28.5	29.5	30.6
ROIC	4.4	3.9	3.9	4.2
ROE	7.5	8.5	9.4	11.1
ROA	4.3	4.7	4.8	5.0
ROCE	5.4	5.9	6.1	6.6
ROIC/Cost of capital	0.7	0.6	0.6	0.7
Cost of capital	6.1	6.1	6.1	6.1
EBITDA margin	55.3	49.0	50.1	51.3
EBIT margin	43.8	38.8	40.6	42.4
PAT margin	16.2	18.4	19.3	21.5
Interest Cover	2.0	1.7	1.8	2.1
Net debt/equity	202.6	235.1	232.4	222.6
Net debt/EBITDA	8.2	10.4	9.5	8.5
Growth (%)				
Revenue	-12.7	7.0	10.5	10.5
EBITDA	-36.7	-5.3	13.0	13.1
EBIT	-10.9	-5.3	15.8	15.3
PBT	-10.1	11.3	17.6	24.4
HSBC Net profit	-13.3	23.1	15.3	24.4
HSBC NOPLAT	-5.8	2.8	14.6	14.3
HSBC EPS	-13.3	23.1	15.3	24.4
Valuation (x)				
PE	23.0	18.7	16.2	13.0
PNAV	0.8	0.8	0.8	0.8
PCE	13.0	11.7	10.6	9.1
Yield (%)	2.8	3.3	3.3	3.7
EV/Revenue	7.7	8.1	7.5	7.0
EV/EBITDA	13.9	16.6	15.1	13.5
EV/IC	1.1	1.0	1.0	0.9
ROIC/Cost of capital	0.7	0.6	0.6	0.7
HSBC REP	1.5	1.6	1.5	1.3

Business description

IVG is the largest listed German RE investor, managing a real estate portfolio of EUR15.7bn, including third-party funds. IVG's own portfolio is largely focused on Offices and Business Parks (c80% of NAV). Since 1997, IVG has increasingly internationalised its portfolio so that only 40% of real estate assets are still domestic. IVG's active 'Buy and Sell' portfolio strategy aims to maximise value by riding out real estate cycles. Through the acquisition of OIK, IVG has become one of the world's leading RE asset managers, with a particular strength in special funds. IVG also develops properties for its own portfolio and third parties.

NAV by location



Vivacon

Expanding into closed-end funds

Year to	Revenue (EURm)	EBITDA (EURm)	Reported PBT (EURm)	HSBC PBT (EURm)	HSBC Net profit (EURm)	HSBC EPS (EUR)	HSBC EPS gwth (%)	PE (HSBC) (x)	PE rel	Yield (%)	EV/ EBITDA (x)	EV/IC (x)	ROIC (%)	REP (x)
12/2003a	43.3	8.7	5.7	5.7	3.4	0.26	22.9	24.2	89.1	0.0	12.7	1.7	8.4	1.7
12/2004e	53.2	10.0	7.0	7.0	4.2	0.32	23.5	19.6	75.2	0.0	10.2	1.3	8.1	1.4
12/2005e	151.3	20.5	16.1	16.1	8.3	0.63	98.6	9.9	41.2	0.0	7.0	1.1	11.7	0.8
12/2006e	94.8	22.5	17.6	17.6	8.9	0.67	6.4	9.3	43.3	0.0	4.9	1.0	11.4	0.8

- **Highly specialised German property developer…**
- **…that has successfully expanded its business in the past**
- **HSBC T&B fundamental analysis approach gives rating of 2.61**

HSBC T&B fundamental rating approach

As outlined in the *Company Analysis and Valuation* section we have analysed our peer group of German real estate companies according to five main weighted criteria – country and category exposure, rent expiry profile, G-REIT potential and a miscellaneous position comprising other relevant factors.

As Vivacon exclusively operates in the German market, which is in fact our least preferred market, within our peer group its rating is unfavourable at 2.17 (5 is good). Due to its concentration of the residential segment, IVG's category exposure is also unfavourable at 2.12. Due to its focus on property development, rent expiries are not relevant for Vivacon so we have not attributed a rating. We feel that our rating approach is not ideal for property developers as puts them at a disadvantage to other Real Estate companies. We have tried to compensate for this by awarding a 5.0 for miscellaneous.

Below we describe IVG's potential to benefit from a G-REIT structure, other than increased investor interest, analyst coverage etc.

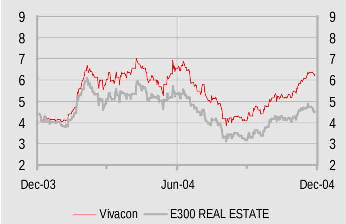
Potential to benefit from G-REIT

Vivacon is unlikely to benefit from potential German legislation in our view. As we have outlined above, Vivacon's main business activity is property development, with real estate investments limited to one property in Berlin. A certain degree of property development is allowed by some REIT legislations (eg US and France). Development exposure is, however, subject to strict limitation. Thus, we think it is unlikely that Vivacon will qualify for a G-REIT.

Conclusion

We would like to reiterate that our rating approach is not ideal for a property developer such as Vivacon. We have tried to compensate for this by attributing a very high rating under the miscellaneous heading, but still feel that an overall rating of 2.61 is lower than Vivacon deserves.

Relative price



Source: HSBC

Company report

Country	Germany
Sector	Real Estate
Bloomberg	VIA GR
Reuters	VIVG.DE
Mkt cap (EURm)	82.3
Mkt cap (USDm)	110.0
Free float (%)	58.8

Price

	1M	3M	12M
Absolute	5.19	4.10	4.34
Absolute (%)	19.5	51.2	43.0
Relative (%)	11.2	43.0	6.1

Relative to	E300 Real Estate
Index level	1015.1

Current (EUR)
6.20

Research team*

Analysts

Peter Barkow	DE	49 211 910 3276
Irineus Stanislawek	DE	49 211 910 3017

*HSBC legal entities are listed on page 188

Vivacon

We have argued in the past that property developers should not be valued on a P/NAV basis, instead encouraging investors to look at PE ratios. Vivacon is trading at a PE of 9.9x on 2005 numbers. This represents a discount of more than 40% to its peer group of European property developers.

A three-pronged business model

Still dependent on tax incentives...

In previous research we have said that Vivacon's business model depends to a certain degree on tax incentives. Among the various tax incentives for real estate investments in Germany, we have identified two that are of particular importance for Vivacon's business model:

Vivacon's business model benefits from tax advantages...

...for listed buildings...

- **Shortened depreciation period for listed properties.** According to the German income tax act, maintenance expenses for listed buildings are tax deductible over 12 years (up to 9% for the first 8 years and up to 7% for the next 4 years) compared to a linear depreciation over a period of 50 years for unlisted buildings. These rules are valid for investors (§7i EStG) and owner occupiers (§10f EStG) alike and especially interesting for real estate owners with above-average income, due to the progression of the German income tax

...and premia for low-income home buyers...

- **Owner-occupier home premium.** Persons below a specific income threshold are entitled to receive annual premiums of EUR1,250 plus an additional EUR800 per child annually for eight years. This incentive programme is only valid for low-income segments of the population

...both of which were reduced in 2003...

Both these benefits were reduced in 2003, in particular the owner-occupier premium, which was halved. Nevertheless, there is continued discussion about further reduction of tax incentives as the pressure on the public purse continues. The idea of abolishing the home owner premium completely has resurfaced in recent days. Whereas the German government intends to cut the home owner premium, the opposition would like to keep it. Predicting an outcome seems difficult at present.

...the latter still at risk of being abolished

Tax subsidies for listed building seem relatively safe in the medium term...

The subsidies for listed buildings, which we consider crucial to Vivacon's present business model, were lowered only slightly in 2004. We continue to think the regulations are relatively safe in the medium term as two attempts to abolish them in the past have already failed due to massive protests from the listed buildings lobby. We also continue to think that subsidies for the maintenance of historic buildings meet with a higher level of public acceptance than other more controversial areas of subvention.

...but risk from long-term trend towards reduced tax advantages

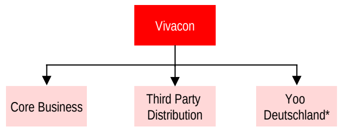
Nevertheless, tax subsidies are on a reducing trend and we cannot assume that the special regulations regarding listed building are safe in the long term. In the short term however, the discussions about further reduction or abolition of the home-owner premium may even lead to an acceleration of Vivacon sales in both the core business and third-party distribution.

Vivacon

...but two additional divisions will increase diversification

Establishing alternative lines of business is therefore important for Vivacon and the company has been busy in this area. The company launched two new business lines in 2003, namely the sale of residential property for third parties and the joint venture with London-based Yoo Ltd, the real estate activities of star French designer Philippe Starck. Vivacon's current business model therefore consists of three divisions (see chart to right).

Vivacon: A three-pronged business model



**joint venture with Philippe Starck*
Source: HSBC Trinkaus & Burkhardt

The three legs

1) Core business focused on listed buildings with 'freehold' titles

Overview of core business properties

Property	Acquisition/ listed building	Refurbished	Housing units	Average m²/unit	Ave. price/ unit (EUR)	Ave. price/ m² (EUR)	Sales volume (EURm)
Gartenstadt am Weinberg, Plauen	January 1997/listed	06/1997 - 12/1998	288	60.4	74,653	1,236	21.5
Wuhletalterassen, Berlin	July 1998	01/1999 - 12/1999	319	65.5	48,589	742	15.5
Stadtwaldstudios, Berlin	May 1999	04/2000 - 12/2000	176	39.5	38,352	970	6.8
Historical BMW housing estate, Eisenach	January 2000/listed	08/2000 - 12/2001	319	68.9	94,044	1,365	30.0
Kontorhaus Remberti, Bremen	September 2000/listed	09/2002 - 08/2003	82	115.4	170,732	1,479	14.0
Gartenstadt Kreuzkampe, Hannover/Buchholz	August 2001/listed	06/2002 - 12/2003	741	54.1	74,224	1,371	55.0
Grand Hotel Bad Nauheim, Bad Nauheim	February 2002/listed	09/2003 - 12/2004	121	91.1	198,347	2,177	24.0
Hochpfortenhaus, Cologne	July 2003/listed	07/2004 - 12/2004	50	85.3	210,000	2,461	10.5
Villa St. Gertraudt, Berlin	November 2003/listed	10/2004 - 12/2005	105	100.0	200,000	2,000	21.0
Albertus Magnus Kolleg, Königstein	September 2004/listed	03/2005 - 03/2006	68	75.0	285,714	3,196	16.3
Grazer Damm, Berlin*	October 2004/listed	na	1,529	63,1	58.862	933	90,0
Total			**4.030**	**76,4**	**134.678**	**1.655**	**327,6**

*Note: * Sale via closed end property fund, only light refurbishing required*
Source: Company data, HSBC Trinkaus & Burkhardt

Vivacon buys and sells (listed) residential properties...

Vivacon AG's main line of business is the acquisition, refurbishment and subsequent sale of residential properties. It deals mainly in large properties and residential complexes – ideally with 200-300 residential units and, if possible, listed buildings. Many of these properties are sold by public sector bodies or companies that have accumulated extensive real estate portfolios over the years and wish to dispose of them due to budget constraints or focus on their core business activities. As a further part of its business strategy, Vivacon separates the title to the plot of land and the building (see our company report 19 August 2003 for explanation) facilitating the finance for buyers of the housing unit (in this model, up to 100% can be financed relatively easily). The apartments are then renovated and sold to private investors for owner occupation (c25%) or as an investment (c75%). Since 1997, the company has sold more than 2,200 such residential units.

...splitting title to building and land...

...retaining the latter

In the future, properties will also be sold via closed-end funds...

In the past Vivacon exclusively relied on the direct sale of properties to investors and owner occupiers. This will, however, change in the future as Vivacon announced the launch of a closed-end fund in October 2004. Vivacon's sales partners are therefore able to offer its customers an indirect property investment vehicle. At the same time, Vivacon announced the acquisition of a property for its first fund comprising c1,500 dwelling units, making it by far the largest transaction in Vivacon's history.

Vivacon

The closed-end funds is a new business area for Vivacon and therefore implies a certain degree of execution risk. Nevertheless, we think it is likely to succeed due to the following:

...being a new business area for Vivacon...

- Vivacon's sales channel might be suitable to place closed-end funds, as it has placed apartments as financial products in the past. We consider closed funds to be a good substitute for this. Unsurprisingly, Vivacon mentioned very positive initial feedback from selected sales partners

...but Vivacon has a suitable sales channel,...

- Vivacon has a solid track record in finding attractive properties with appeal for tax-driven retail investors

...a track record of finding attractive properties...

- Although closed-end funds are mainly invested in office or industrial real estate, the special depreciation of listed apartments might offer appeal to investors. We estimate that the currently very successful closed-end foreign funds are generating post-tax margins ranging from 6-8%. Confronted with this figure, Vivacon said its product would be competitive

...and a product with competitive margins

Placement of the fund is targeted to start as soon as Q4. We regard the placement progress as an important indicator of a proof of the business concept. The German closed-end fund market comprises cEUR160bn of assets (including leverage, which we estimate at c55% on average). EUR4.7bn of equity was raised in 2003 with a similar number expected for 2004.

Fund placement to start in Q4; progress expected to be a major catalyst for the stock

Despite being focused on its core business, Vivacon occasionally makes opportunistic purchases. For example, the company bought, and still owns, a property in Berlin for tax optimisation reasons, which it lets out. Last year, Vivacon bought a property from Viterra Real Estate, which does not require refurbishing and Vivacon intends to sell it .

Vivacon also makes opportunistic purchases

Vivacon makes use of market opportunities, besides its core business, if they occur

Property	Acquisition/ listed building	Housing units	Average m²/unit	Average price/unit (EUR)	Average price/m² (EUR)	Sales volume (EURm)
Wuhletal-Karree, Berlin	Portfolio property/ let out	432	62	na	na	na
Viterra housing estate, Essen/Kamen	September 2003	249	48	40,161	844	10.0
Total		**681**	**55**	**40,161**	**844**	**10.0**

Source: Company data, HSBC Trinkaus & Burkhardt

2) Third-party distribution

Vivacon's sales partner network has grown continuously

	2000	y-o-y	2001	y-o-y	2002	y-o-y	2003	y-o-y
Sales partners	200	na	350	75%	500	43%	550	10%

Source: Company data, HSBC Trinkaus & Burkhardt

The second part of Vivacon's business model is the sale of housing units for third parties. With this strategy, Vivacon leverages its network of c550 sales partners without putting additional debt on its balance sheet. The company does not have its own sales organisation so external sales partners (small or medium-sized independent financial advisor networks) are commissioned to sell the properties. Vivacon's internal sales co-ordination team prepares sales materials in advance and provides information to the sales teams. Vivacon

Distribution of third-party properties...

...leverages sales network

Vivacon

estimates that the range of its sales network gives it a c2-3 year advantage over potential competitors ie the time it would take to set up a similar network.

Two third-party distribution deals already signed

Property	Acquisition/ listed building	Housing units	Average m²/unit	Average price/unit (EUR)	Average price/m² (EUR)	Sales volume (EURm)
Wuhletal-Karree, Berlin	Portfolio property/ let out	432	62	na	na	na
Viterra housing estate, Essen/Kamen	September 2003	249	48	40,161	844	10.0
Total		**681**	**55**	**40,161**	**844**	**10.0**

Source: company data, HSBC Trinkaus & Burkhardt

Two deals already signed

Since the launch of the division in 2003, Vivacon has signed distribution agreements with two developers, Renum GmbH (October 2003) and Tecklenburg GmbH (March 2004). There is a total of 129 housing units in the two projects in listed buildings and Vivacon will also retain the title to the land. Total sales volume is projected to be cEUR17m, of which EUR1.9m of the Renum project had already been sold in 2003.

Moving beyond listed buildings would be welcome to diversify business model risk

Although margins on total sales volumes are lower than in Vivacon's core business, we welcome the launch of this additional business segment as it leverages the company's distribution capacity while consuming little capital. Vivacon is only booking received fees as revenues and not total sales volume. We would welcome Vivacon expanding further into third-party distribution of non-listed properties to decrease its dependency on German tax law.

3) The Yoo joint venture

Yoo Deutschland: a joint venture with the famous designer, Philippe Starck…

…to market designer apartments in Germany

In May 2003, Vivacon set up Yoo Deutschland as a joint venture with the London-based Yoo Ltd, which concentrates on the real estate activities of star French designer, Philippe Starck. Both companies contributed an equal share of Yoo Deutschland's original capital (though Vivacon manages the company). Yoo Deutschland holds an exclusive license for the construction and marketing of Philippe Starck properties, exclusive designer apartments at top locations in German cities. The joint venture will benefit from Vivacon's expertise in the selection of properties and, if necessary, their renovation. Yoo Ltd will focus on the interior design, including sanitary facilities, and shared space, such as elevators and entrance halls.

Logical expansion of the Vivacon business model…

…to include middle to high-income earners

In our opinion, the Yoo Deutschland joint venture is a logical extension of the Vivacon business model. Yoo Deutschland will also buy and resell properties. Vivacon's expertise in the field of listed buildings and property renovation could prove to be an additional asset for the joint venture. To date, Vivacon has catered to customers in the lower income brackets who purchase the apartments as owner-occupiers and people in the middle to high income brackets who want to reduce their tax liability by investing in property. Yoo Deutschland's customers will also come from the higher and top income brackets.

Vivacon

Although it is a new marketing concept for Vivacon, it has already been successfully implemented in many major cities, such as Hong Kong, London, Melbourne and Miami so we assume it will be popular among German buyers. The apartments are positioned 25-30% above local market prices. There is considerable residual risk associated with the project as it is still at a relatively early stage of development. However, we also believe that the exclusivity of the projects requires first-rate property locations, which means that the number of units that can be developed is limited. This is for 2 reasons: 1) the number of prime locations is naturally restricted and 2) demand will wane if exclusivity is impaired by excessive supply. At the present time, it is difficult to pinpoint the demand ceiling for Starck designer apartments in Germany.

The Yoo concept has already proven successful in many major cities

Exclusivity imposes natural constraints on demand

Vivacon announced two measures taken recently, relevant to Yoo:

- Vivacon increased its equity capital by cEUR15m (net) through a successful rights issue at the end of June. Applying a debt leverage of 3:1, Vivacon will now, in our view, be able to take on additional projects worth cEUR60m. We think this comfortably covers Yoo Deutschland's funding requirements

cEUR15m of capital increase covers Yoo Deutschland's funding needs

- The company has also bought the land for its first development, in Hamburg, with expected sales volume of EUR29m. The plot is in Hafen City, Europe's largest development, right beside the planned yacht harbour on the Elbe river. Apartments are expected to be sold for EUR4,800 per sq m, reflecting the unique location in Germany's most beautiful city and classy design by Philippe Starck. The area, which is 30 minutes walk from the city centre, will suffer from construction activity for at least another five years, traffic infrastructure has still to be built and it remains to be seen whether a cultural infrastructure (eg restaurants) will develop. Nevertheless, we think the location and design will enable the apartments to be sold easily. The company has already received enthusiastic feedback from potential buyers via emails and telephone calls

First development in beautiful city of Hamburg

Yoo Property: Hafen City, Hamburg

Property	Acquisition/listed building	Refurbishing	Housing units	Average m²/unit	Ave. price/unit (EUR)	Ave. price/m² (EUR)	Sales volume (EURm)
Hafen-City (Yoo), Hamburg	June 2004/not listed	No refurbishing required	60	100	450,000	4,500	29.00

Source:Company data, HSBC Trinkaus & Burkhardt

Vivacon unlikely to benefit from REIT structure

Vivacon is unlikely to benefit from potential German legislation in our view. As we have outlined above, Vivacon's main business activity is property development, with real estate investments being limited to one property in Berlin. A certain degree of property development is allowed among some REIT legislations (eg US and France). Development exposure is, however, subject to strict limitation. Thus, we think it is unlikely that Vivacon will qualify for a G-REIT.

Vivacon – summary financials

Current price (EUR)	6.20	Market cap (EURm)	82.3	Bloomberg code	VIA GR
		Enterprise value (EURm)	102.2	Reuter RIC	VIVG.DE

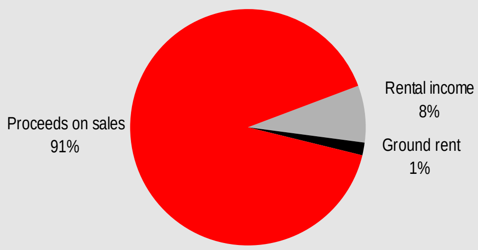
Year to	12/2003a	12/2004e	12/2005e	12/2006e
Per share data (EUR)				
Reported EPS	0.26	0.32	0.63	0.67
HSBC EPS	0.26	0.32	0.63	0.67
CEPS	0.27	0.33	0.64	0.69
DPS	0.00	0.00	0.00	0.00
NAV	3.76	3.55	4.17	4.84
P&L summary (EURm)				
Revenue	43.3	53.2	151.3	94.8
EBITDA	8.7	10.0	20.5	22.5
EBIT	8.5	9.9	20.3	22.3
Net interest	-2.9	-2.9	-4.2	-4.7
PBT	5.7	7.0	16.1	17.6
HSBC PBT	5.7	7.0	16.1	17.6
Taxation	-2.3	-2.8	-6.3	-6.7
Reported net profit	3.4	4.2	8.3	8.9
HSBC Net profit	3.4	4.2	8.3	8.9
NOPLAT	5.0	5.9	12.4	13.8
Cash flow summary (EURm)				
Op free cash flow	-5.5	-4.7	-38.0	38.6
HSBC cash flow	4.5	5.5	13.3	13.1
Capital expenditure	-6.4	-6.4	-6.4	-6.4
Cash earnings	3.5	4.4	8.5	9.1
Change in net debt	4.0	-8.2	37.3	-33.4
Balance sheet summary (EURm)				
Intangible fixed assets	0.3	0.5	0.7	0.9
Tangible fixed assets	43.5	49.7	55.8	62.0
Cash	36.9	36.9	36.9	36.9
Current assets	72.7	80.9	154.6	110.6
Operating liabilities	12.8	15.4	41.5	26.5
Gross debt	65.1	56.9	94.3	60.8
Net debt	28.2	20.1	57.4	24.0
Shareholders funds	28.0	47.0	60.4	69.3
Invested capital	66.8	78.8	132.7	110.1

Year to	12/2003a	12/2004e	12/2005e	12/2006e
Ratios (%)				
Revenue/IC (x)	0.7	0.7	1.4	0.8
NOPLAT margin	11.7	11.1	8.2	14.6
ROIC	8.4	8.1	11.7	11.4
ROE	13.6	11.2	16.3	14.9
ROA	5.1	4.9	7.4	7.3
ROCE	6.0	6.2	9.8	9.8
ROIC/Cost of capital	1.0	0.9	1.4	1.3
Cost of capital	8.7	8.7	8.7	8.7
EBITDA margin	20.1	18.9	13.6	23.7
EBIT margin	19.8	18.5	13.4	23.5
PAT margin	7.7	7.9	6.5	11.5
Interest Cover	3.0	3.5	4.8	4.7
Net debt/equity	100.7	42.6	95.1	34.6
Net debt/EBITDA	3.2	2.0	2.8	1.1
Growth (%)				
Revenue	30.0	23.0	184.4	-37.3
EBITDA	25.6	15.6	104.6	9.4
EBIT	26.3	15.4	106.3	9.4
PBT	35.5	23.8	130.4	8.7
HSBC Net profit	22.9	23.5	98.6	6.4
HSBC NOPLAT	12.3	17.4	109.7	11.2
HSBC EPS	22.9	23.5	98.6	6.4
Valuation (x)				
PE	24.2	19.6	9.9	9.3
PNAV	1.6	1.7	1.5	1.3
PCE	23.2	18.8	9.6	9.0
Yield (%)	0.0	0.0	0.0	0.0
EV/Revenue	2.6	1.9	1.0	1.2
EV/EBITDA	12.7	10.2	7.0	4.9
EV/IC	1.7	1.3	1.1	1.0
ROIC/Cost of capital	1.0	0.9	1.4	1.3
HSBC REP	1.7	1.4	0.8	0.8

Business description

Vivacon is a real-estate company focusing on buying and selling properties. Unlike other listed companies, Vivacon generates the bulk (90%) of its revenue from sales, only retaining a few properties in its portfolio. The company's main focus is the acquisition of large, mainly listed properties from the public sector and industrial enterprises. The properties are then refurbished, Vivacon retains title to the land and they are sold to, mainly, financial investors. In 2003, Vivacon entered into a joint venture with French designer Philippe Starck to sell designer apartments in Germany. The company also began acting as agent in the sale of property for real estate developers.

Revenue split



Country profiles

Germany

Macro data

Macro data Germany

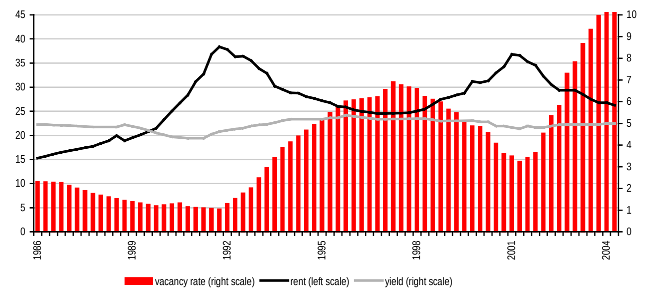
		1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004e	2005e
Inflation	%	4,41%	2,67%	1,73%	1,49%	1,89%	0,93%	0,51%	1,52%	2,00%	1,37%	1,06%	1,40%	0,70%
Real GDP	EURbn	1.727	1.769	1.801	1.815	1.842	1.874	1.909	1.968	1.988	1.990	1.988	2.385	2.624
GDP growth	%	-1,10%	2,40%	1,80%	0,81%	1,48%	1,71%	1,89%	3,11%	0,99%	0,12%	-0,14%	1,20%	1,10%
Long term yield	%	6,11%	7,71%	6,55%	6,04%	5,47%	3,76%	5,20%	5,24%	4,67%	4,36%	4,11%	4,11%	3,90%
Employees	000	37.368	37.297	37.377	37.271	37.208	37.611	38.073	38.749	38.914	38.670	38.288	38.221	na
of which office	000	6.708	6.723	6.765	6.757	6.761	6.845	6.941	7.196	7.238	7.204	7.148	7.144	na
Office worker	%	17,95%	18,03%	18,10%	18,13%	18,17%	18,20%	18,23%	18,57%	18,60%	18,63%	18,67%	18,69%	na
Unemployment (Bundesbank)	%	8,95%	9,60%	9,45%	10,39%	11,48%	11,06%	10,53%	9,62%	9,37%	9,80%	10,53%	10,45%	10,20%
Unemployment (EUROSTAT)	%	7,70%	8,20%	8,00%	8,70%	9,70%	9,10%	8,40%	7,80%	7,80%	8,70%	9,60%	na	na
Consumer spendings	EURbn	992	1.003	1.026	1.035	1.042	1.059	1.097	1.121	1.142	1.133	1.133	1.134	1.142
Consumer confidence	Points	-25,3	-10,9	-6,0	-19,9	-18,0	-5,1	-1,6	2,9	-3,3	-11,4	-18,6	na	na
Major purchase index	Points	-27,0	-25,0	-25,0	-27,0	-27,0	-25,0	-23,0	-23,0	-25,0	-33,0	-35,0	na	na
Population	000	80.975	81.338	81.539	81.818	82.012	82.057	82.037	82.164	82.260	82.440	82.537	82.539	na
Households	000	36.230	36.695	36.938	37.281	37.457	37.532	37.795	38.124	38.456	38.720	38.944	na	na
Ave. householdsize	-	2,25	2,23	2,22	2,20	2,20	2,19	2,18	2,16	2,15	2,14	2,13	na	na
House prices (1994 rebased)	EURbn	97,5	100,0	102,0	101,5	99,5	98,0	99,5	101,0	102,0	102,5	101,5	na	na
Flat prices (1994 rebased)	EURbn	96,1	100,0	100,0	98,5	96,6	96,6	96,1	97,6	97,6	96,6	95,6	na	na
Building land price	EURbn	50,2	56,6	57,8	59,7	62,2	67,2	70,3	72,9	72,9	78,0	74,0	72,8	na
Construction output	EURbn	264,9	292,1	298,5	286,7	280,1	278,1	278,4	272,6	258,1	250,8	242,3	234,0	226,1
Industrial production index	Points	96,5	100,0	100,3	99,9	102,3	105,5	106,6	111,7	111,3	110,0	110,1	112,8	114,2
ifo index	Points	88,3	97,4	95,6	91,6	96,9	97,3	95,1	100,0	92,1	89,4	91,7	na	na
PEX rate 5 years	%	6,25%	6,58%	6,37%	5,40%	4,93%	4,38%	4,19%	5,46%	4,72%	4,57%	3,54%	3,62%	na
PEX rate 10 years	%	6,70%	7,21%	7,12%	6,48%	5,88%	4,92%	4,90%	5,81%	5,25%	5,10%	4,33%	4,38%	na
Mortgage rate 10 years	%	7,80%	8,21%	8,16%	7,46%	6,83%	5,87%	5,73%	6,66%	6,08%	5,96%	5,14%	na	na
Mortgage rate 5 years	%	7,52%	7,61%	7,49%	6,44%	5,90%	5,41%	5,14%	6,36%	5,68%	5,53%	4,47%	na	na
Residential Real Estate lending volume	EURbn	554,8	614,3	666,6	733,0	789,4	846,1	991,3	1.030,8	1.053,9	1.068,7	1.083,3	na	na
Commercial Real Estate lending volume	EURbn	445,6	484,4	503,1	554,4	593,2	630,9	630,0	648,3	657,2	660,4	656,8	na	na
Open ended Real Estate funds inflows	EURbn	8,143	4,176	3,745	7,307	3,476	3,059	9,056	-1,486	12,432	17,791	15,204	na	na
Open ended Real Estate funds under management	EURbn	20,262	27,047	30,389	37,760	42,842	45,329	52,544	54,663	61,555	79,279	97,439	na	na
Closed end funds inflows	EURbn	na	na	na	na	na	na	3,867	3,008	2,061	1,982	2,302	na	na
Main Equity Index: DAX	Points	2.267	2.107	2.254	2.889	4.250	5.002	6.958	6.434	5.160	2.893	3.965	na	na
EPRA Germany	Points	na	719.3	709.2	407.9	423.6	633.2	1000.0	933.5	840.4	660.0	643.7	682.5*	na
% y-o-y	Points	na	na	-1.4%	-42.5%	3.9%	49.5%	57.9%	-6.7%	-10.0%	-21.5%	-2.5%	6.0%	na
DIMAX	Points	184.2	187.7	177.4	172.5	190.6	242.0	367.8	398.0	332.5	286.2	246.5	na	na
% y-o-y	Points	na	1.9%	-5.5%	-2.8%	10.5%	27.0%	52.0%	8.2%	-16.5%	-13.9%	-13.9%	na	na

*Source: BulwienGesa, BVI, Deutsche Börse, Deutsche Bundesbank, Destatis, DETR, Euroconstruct, EUROSTAT, VDH, Stefan Loipfinger Research, Thomson Financial Datstream, HSBC Trinkaus & Burkhardt, * Index value on 30/09/04*

Germany

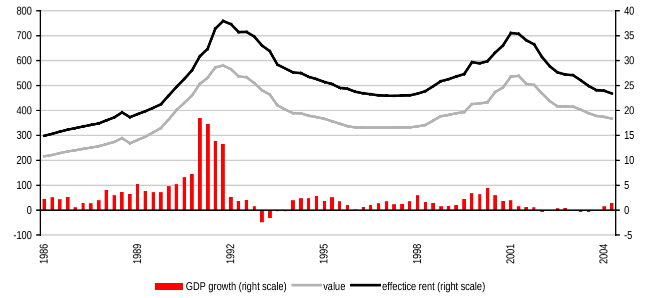
Office real estate development (five major German cities)

Prime rent (EUR), prime yield (%) and vacancy rate (%)



Source: Aengevelt , Atis Müller, BulwienGesa, CBRE, C&W H&B, DEGI, DIP, dr lübke, DTZ, Eureal, Feri, gif, IVG, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

GDP growth (%), value (EUR/sq m), effective rent (EUR)



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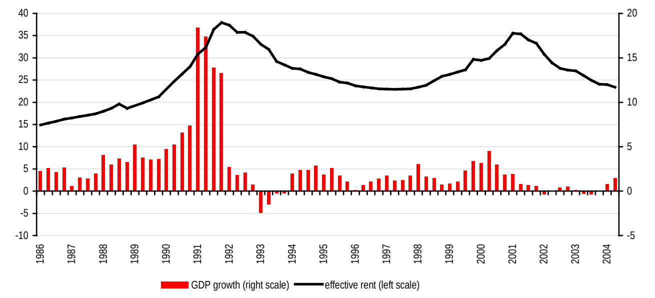
GDP growth (%), effective rent (EUR)



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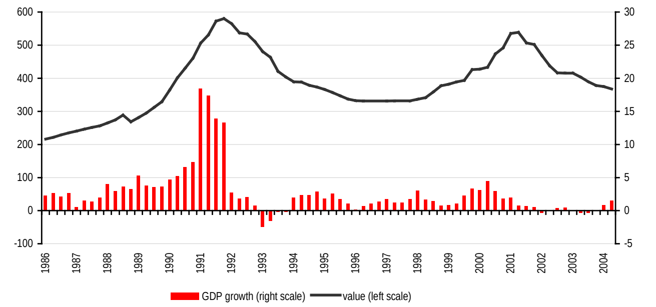
GDP growth (%), value (EUR/sq m)



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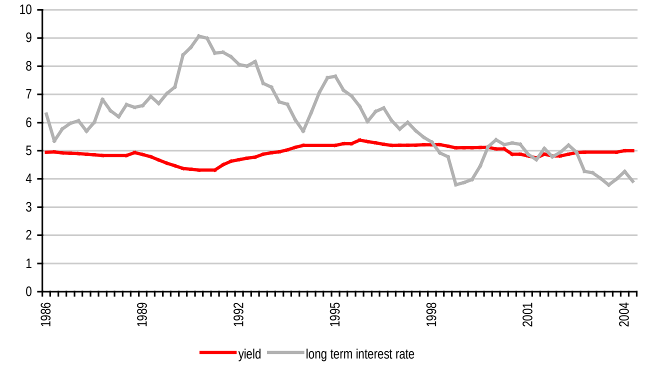
Prime yield (%), long-term interest rate (%)



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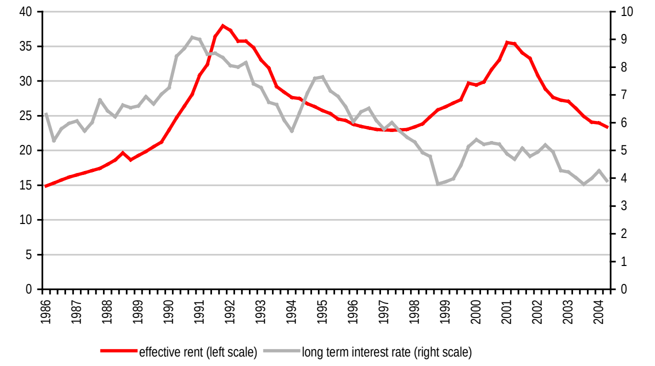
Long-term interest rate vs prime yield (%)

Source: Aengevelt , Atis Müller, BulwienGesa, CBRE, C&W H&B, DEGI, DIP, dr lübke, DTZ, Eureal, Feri, gif, IVG, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Germany

Effective rent (EUR), long-term interest rate (%)



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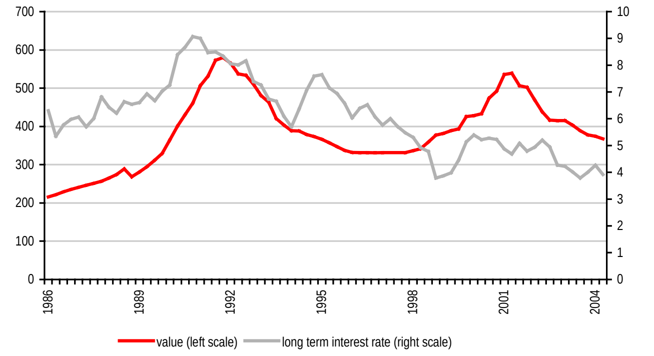
Value (EUR/sq m), long-term interest rate (%)



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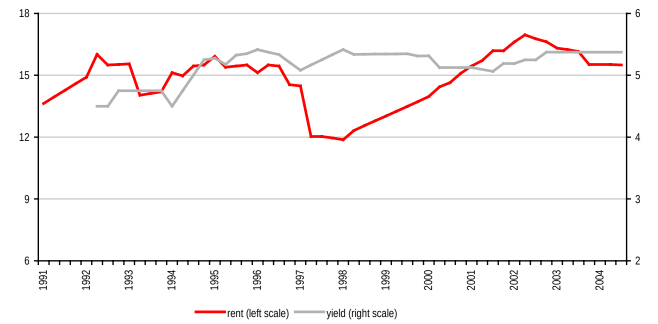
Germany

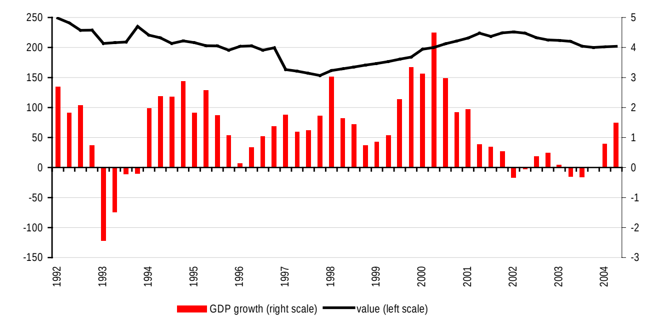
Retail real estate development (five major German cities)

Prime rent (EUR), prime yield (%)



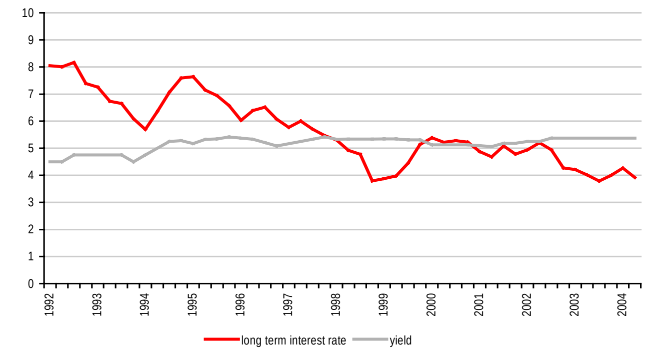
Source: Atis Müller, Brockhoff & Partner, BulwienGesa, CBRE, C&W H&B, DIP, DTZ, Eureal, Feri, GfK Prisma, JLL, Kempers, HSBC Trinkaus & Burkhardt

GDP growth (%), value (EUR/sq m)



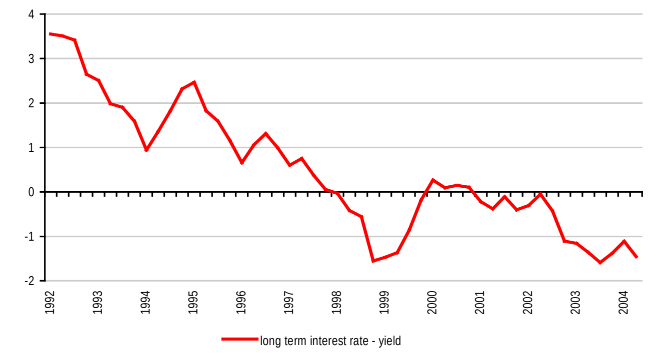
Source: Atis Müller, Brockhoff & Partner, BulwienGesa, CBRE, C&W H&B, DIP, DTZ, Eureal, Feri, GfK Prisma, JLL, Kempers, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Prime yield (%), long-term interest rate (%)



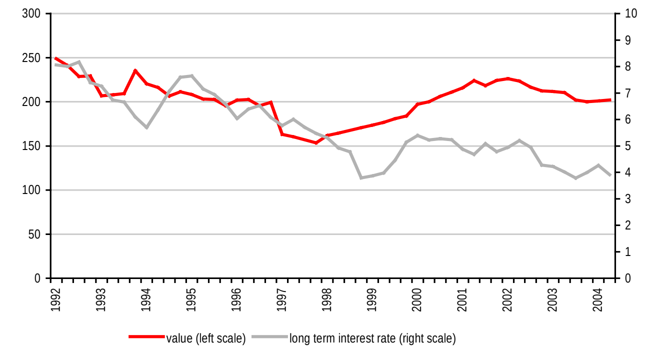
Source: Atis Müller, Brockhoff & Partner, BulwienGesa, CBRE, C&W H&B, DIP, DTZ, Eureal, Feri, GfK Prisma, JLL, Kempers, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Long term rate vs prime yield (%)



Source: Atis Müller, Brockhoff & Partner, BulwienGesa, CBRE, C&W H&B, DIP, DTZ, Eureal, Feri, GfK Prisma, JLL, Kempers, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Value (EUR/sq m), long-term interest rate (%)



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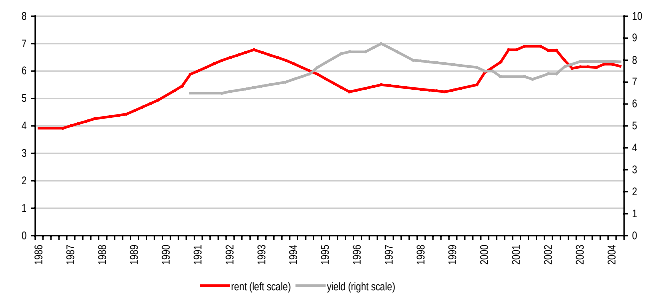
Germany

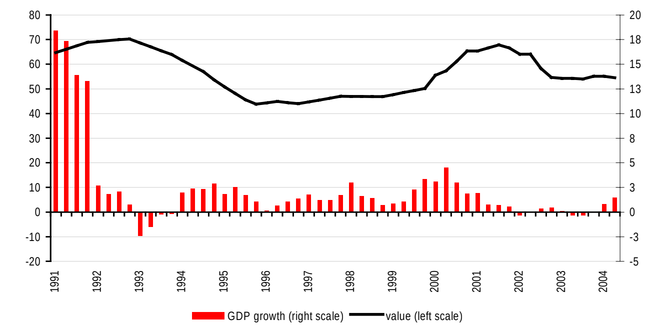
Industrial real estate development (five major German cities)

Prime rent (EUR), yield (%)



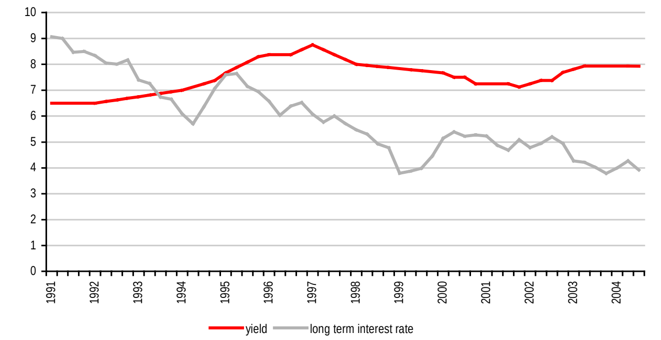
Source: Atis Müller, BulwienGesa, CBRE, DIP, JLL, HSBC Trinkaus & Burkhardt

GDP growth (%), value (EUR



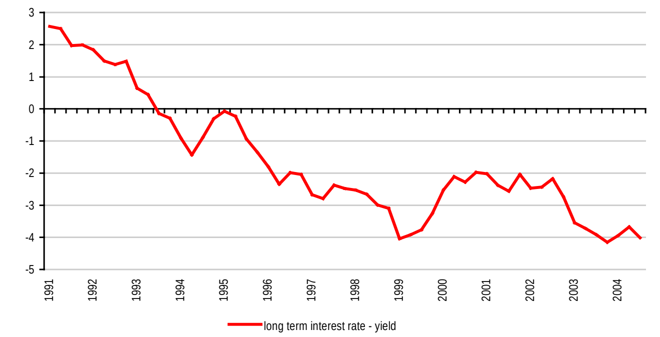
Source: Atis Müller, BulwienGesa, CBRE, DIP, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Prime yield (%), long-term interest rate (%)



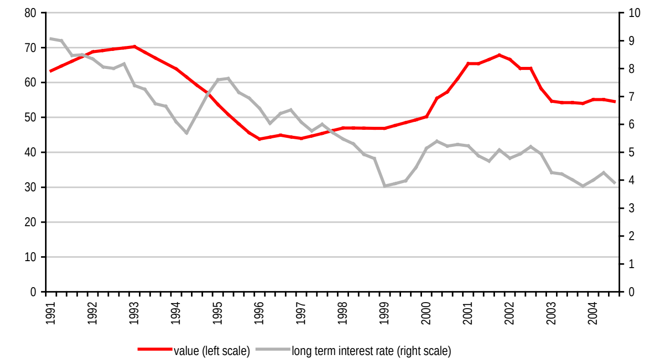
Source: Atis Müller, BulwienGesa, CBRE, DIP, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Long-term interest rate vs prime yield (%)



Source: Atis Müller, BulwienGesa, CBRE, DIP, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Value (EUR/sq m), long-term interest rate (%)

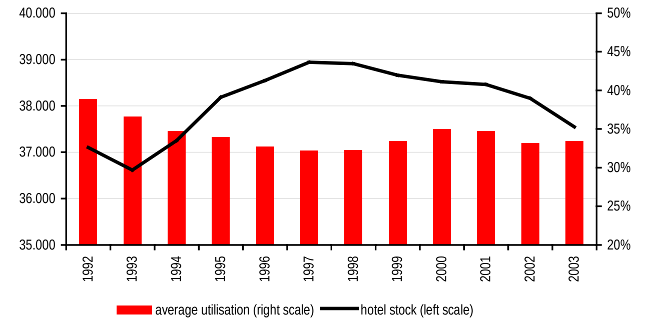


Source: Atis Müller, BulwienGesa, CBRE, DIP, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Germany

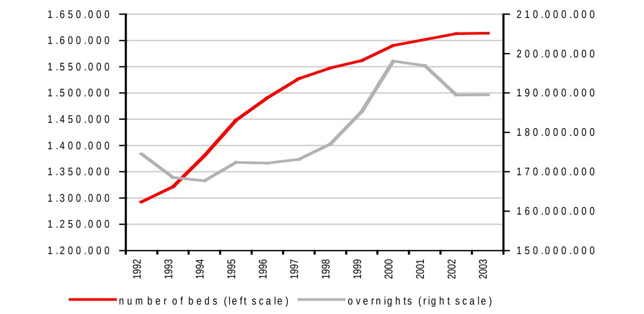
Hotel real estate development

Average utilisation (%) and hotel stock



Source:Destatis, HSBC Trinkaus & Burkhardt

Number of beds, overnights

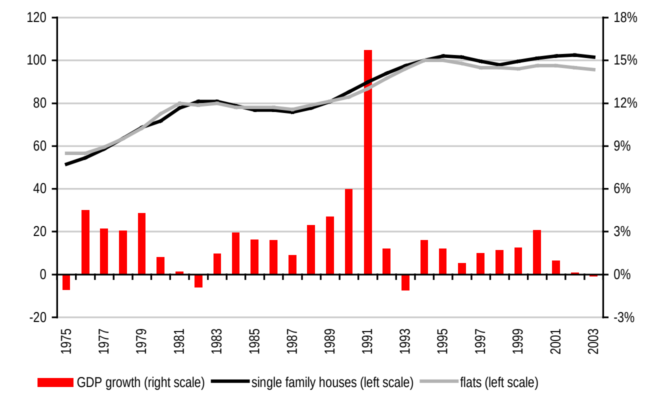


Source: Destatis, HSBC Trinkaus & Burkhardt

Germany

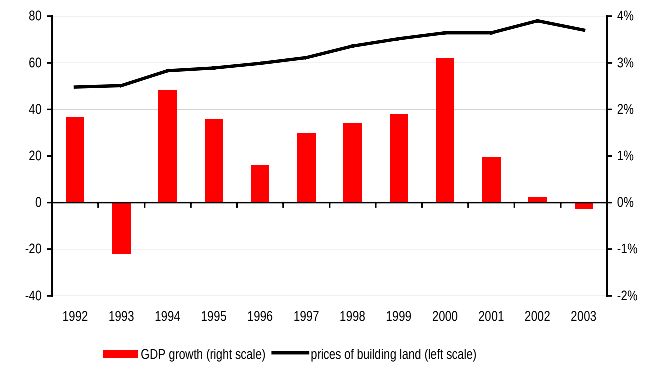
Residential real estate development

House and flat prices, 1994 rebased, GDP growth (%)



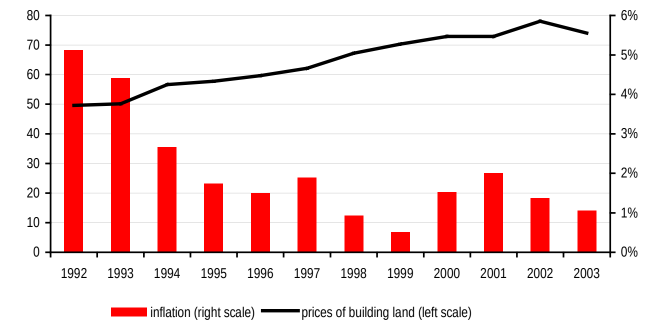
Source: Deutsche Bundesbank, BulwienGesa, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Prices of building land (EUR), GDP growth (%)



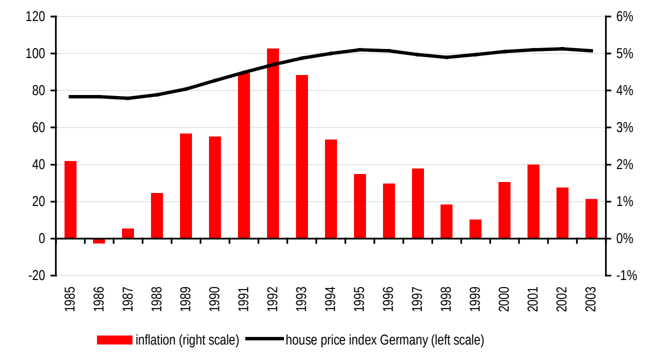
Source: Destatis, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Prices of building land (EUR), inflation (%)



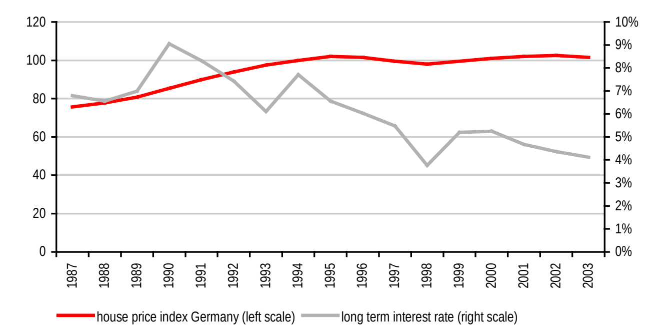
Source: Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

German house price index, inflation (%)



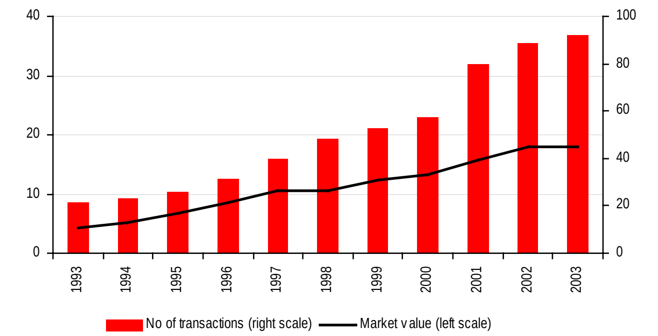
Source: Deutsche Bundesbank, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

German house price index, long-term interest rate (%)



Source: HSBC Trinkaus & Burkhardt

Forced sales of residential property (EURbn; '000)



Source: Argetra, HSBC Trinkaus & Burkhardt

UK

Macro data

Macro data UK

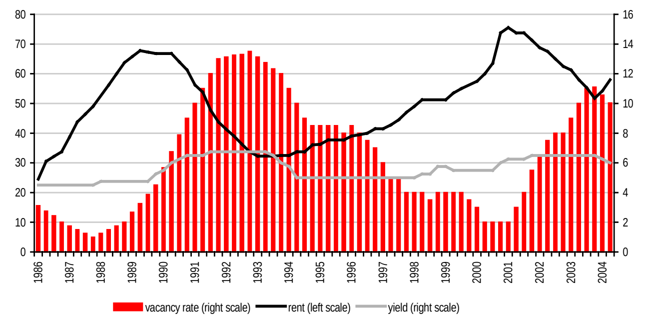
		1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004e	2005e
Inflation	%	1.57%	2.47%	3.41%	2.45%	3.13%	3.42%	1.56%	2.93%	1.82%	1.63%	2.92%	1.40%	1.90%
Real GDP	EURbn	773.8	808.1	831.1	854.5	882.5	909.8	935.8	971.9	994.3	1,011.9	1,034.6	1,068.8	1,090.1
GDP growth	%	2.33%	4.43%	2.85%	2.82%	3.28%	3.09%	2.86%	3.86%	2.30%	1.77%	2.25%	3.30%	2.00%
Long term yield	%	6.88%	8.86%	8.00%	7.38%	6.20%	4.62%	5.69%	5.21%	4.79%	4.50%	4.73%	5.10%	4.90%
Unemployment rate: EUROSTAT	%	10.00%	9.30%	8.50%	8.00%	6.90%	6.20%	5.90%	5.40%	5.00%	5.10%	5.00%	2.80%	3.00%
Consumer spendings	EURbn	502.2	517.8	526.3	545.4	565.3	587.5	613.4	641.4	659.9	681.7	697.6	719.2	733.6
Consumer confidence	Points	-17.83	-15.83	-10.42	-5.5	3.17	-1.75	-3.58	-3.75	-4.58	-3.75	-6.25	na	na
Major purchase index	Points	-19.0	-18.0	-15.0	-9.0	-5.0	-7.0	-5.0	-2.0	-2.0	-6.0	-13.0	na	na
Population	000	58,909	58,293	58,500	58,704	58,905	59,090	59,391	59,623	59,863	69,140	59,329	59,516	na
Households	000	24,545	24,289	24,375	24,460	24,544	24,621	24,746	24,843	24,943	30,061	25,795	na	na
Ave. householdsize	-	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.3	2.3	na	na
House price index (1994 rebased)	Points	99.46	100.00	98.37	102.57	109.13	115.05	123.73	135.82	146.82	177.55	211.20	0.00	na
Construction output	EURbn	51.0	52.7	52.6	53.9	55.5	56.4	57.2	58.1	60.1	64.9	67.9	68.3	69.8
Industrial Production	Points	88.5	93.3	94.9	96.2	97.5	98.5	99.7	101.6	100	97.5	97.4	na	na
Mortgage rates	%	5.92%	5.48%	6.69%	5.96%	6.58%	7.21%	5.33%	5.98%	5.08%	4.00%	3.69%	na	na
Main Equity Index: FTSE 100	Points	3,418	3,066	3,689	4,119	5,136	5,883	6,930	6,222	5,217	3,940	4,477	na	na
EPRA UK	EURbn	na	603.3	634.0	845.9	1,059.7	860.8	1,000.0	1,226.6	1,171.8	1,176.4	1,539.7	1,890.3*	na
% y-o-y	Points	na	na	5.1%	33.4%	25.3%	-18.8%	16.2%	22.7%	-4.5%	0.4%	30.9%	22.8%	na
GBP / EUR		0.80	0.79	0.83	0.83	0.69	0.67	0.66	0.61	0.62	0.63	0.69	0.69	0.75

*Source: BMP, DETR, Euroconstruct, Eurostat, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt, *Index value on 30/09/04*

UK

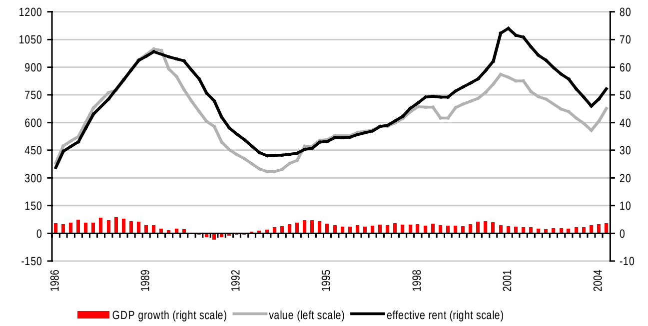
Office real estate development (London markets)

Prime rent (EUR), prime yield (%) and vacancy rate (%)



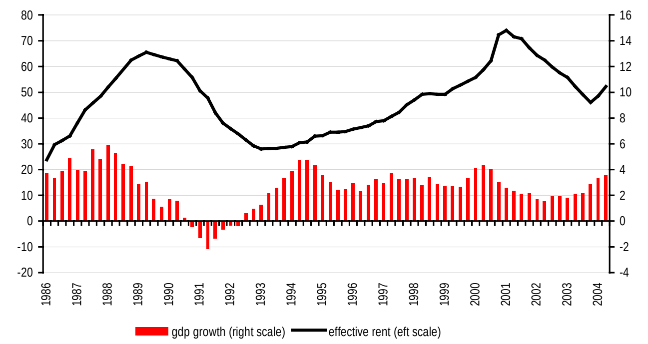
Source: ATIS REAL, CBRE, JLL, HSBC Trinkaus & Burkhardt

GDP growth (%), value (EUR/sq m), effective rent (EUR)



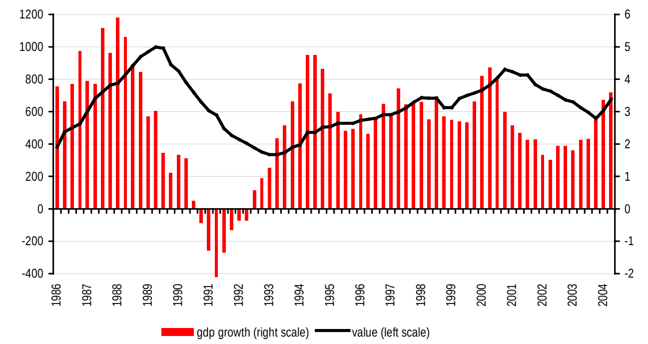
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

GDP growth (%), effective rent (EUR)



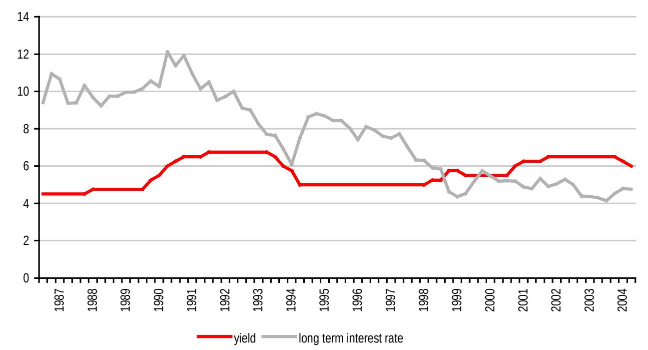
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

GDP growth (%), value (EUR/sq m)



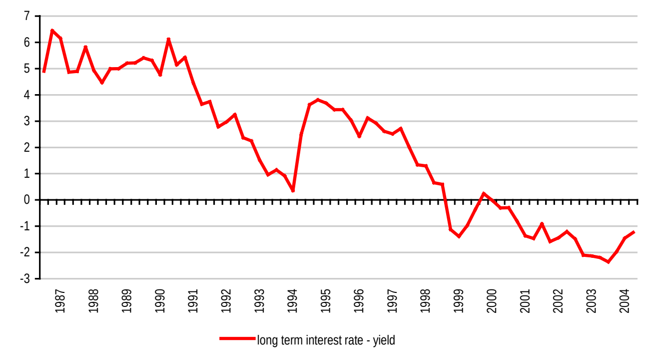
Source: CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Prime yield (%), long-term interest rate (%)



Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

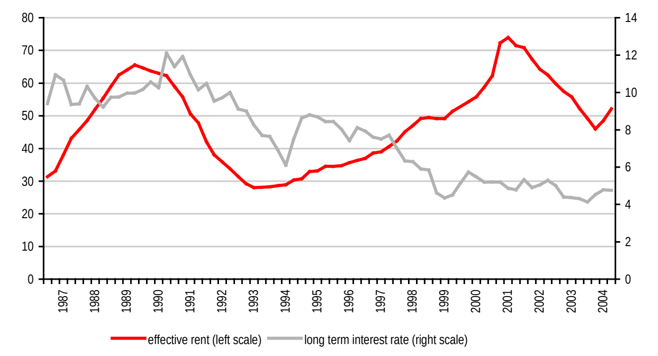
Long-term interest rate vs prime yield (%)



Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

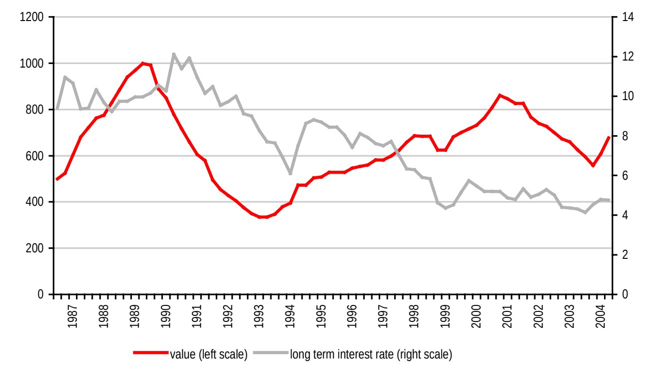
UK

Effective rent (EUR), long-term interest rate (%)



Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Value (EUR/sq m), long-term interest rate (%)

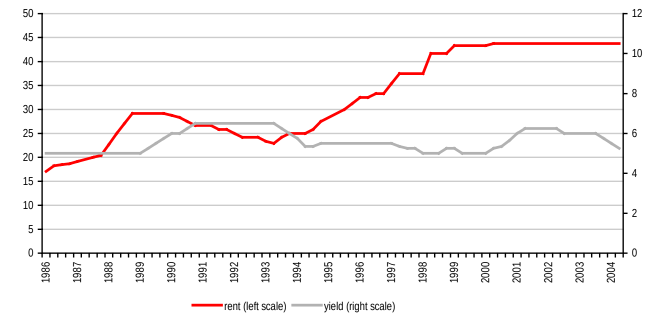


Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

UK

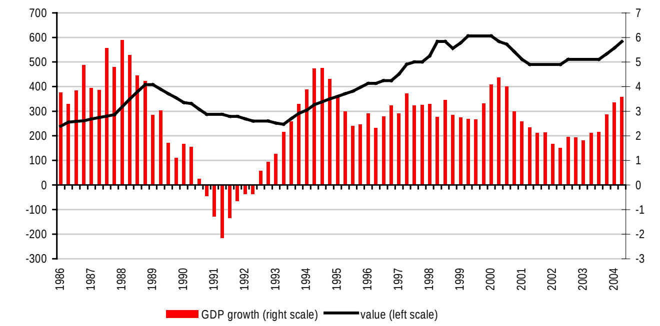
Retail real estate development (London markets)

Prime rent (EUR), prime yield (%)



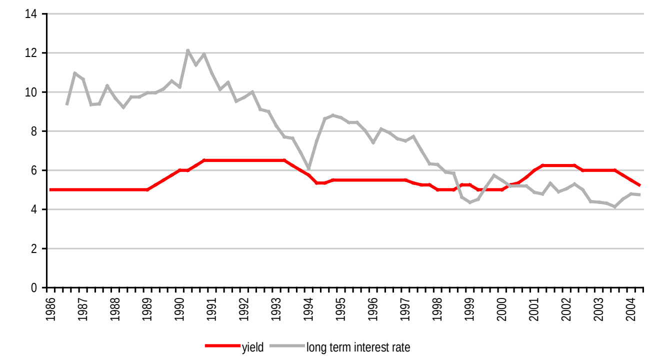
Source: ATIS REAL, CBRE, JLL, HSBC Trinkaus & Burkhardt

GDP growth (%), value (EUR/sq m)



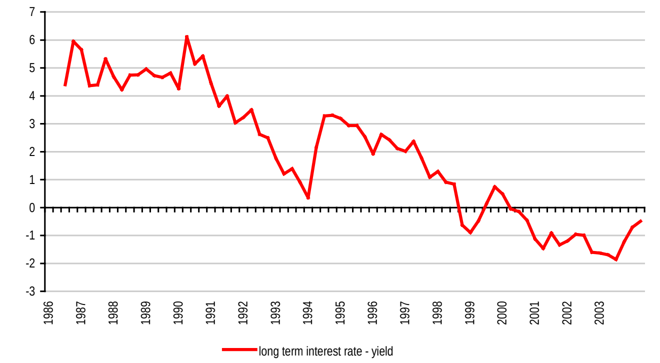
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Prime yield (%), long-term interest rate (%)



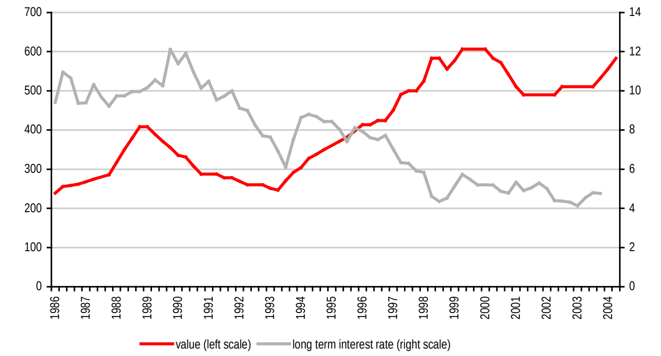
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Long-term rate vs prime yield (%)



Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Value (EUR/sq m), long-term interest rate (%)

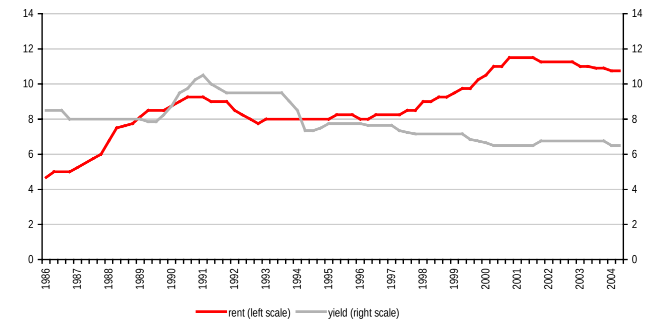


Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

UK

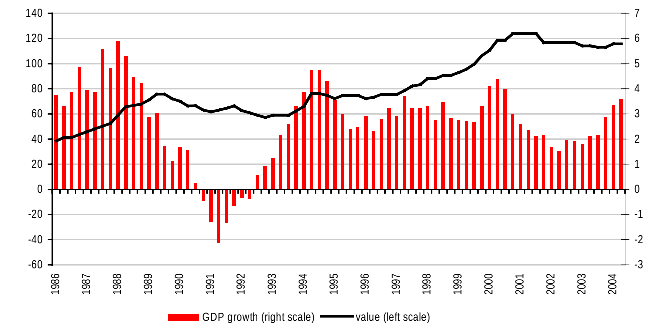
Industrial real estate development (London markets)

Prime rent (EUR), prime yield (%)



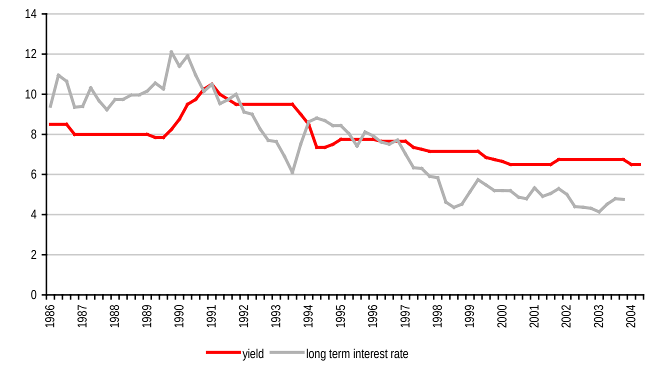
Source: ATIS REAL, CBRE, JLL, HSBC Trinkaus & Burkhardt

GDP growth (%), value (EUR



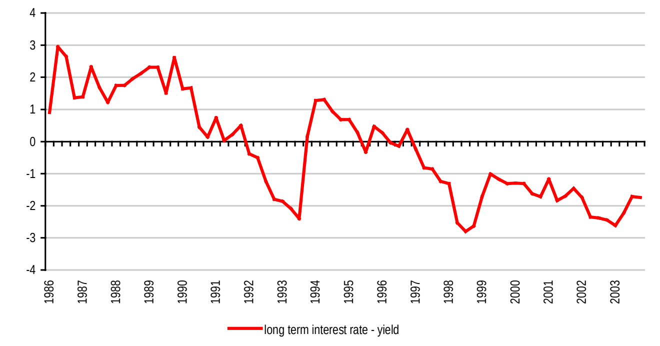
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Prime yield (%), long-term interest rate (%)



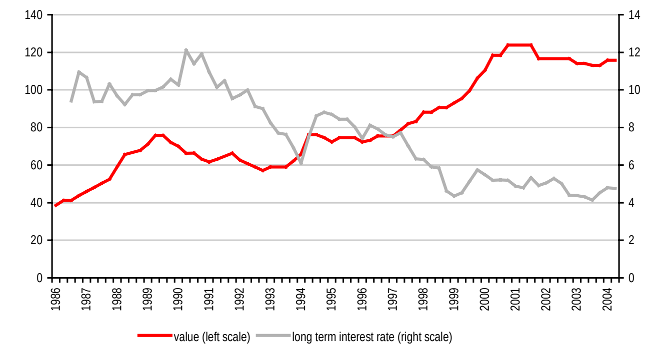
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Long-term interest rate vs prime yield (%)



Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Value (EUR/sq m), long-term interest rate (%)

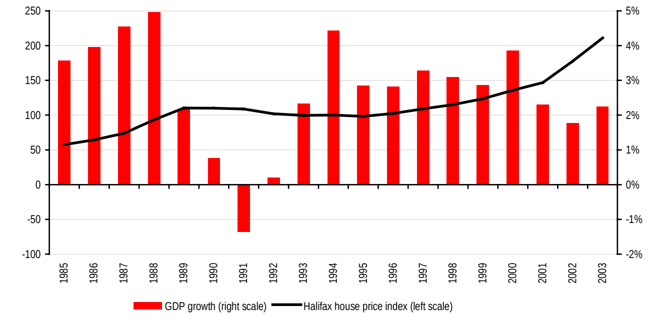


Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

UK

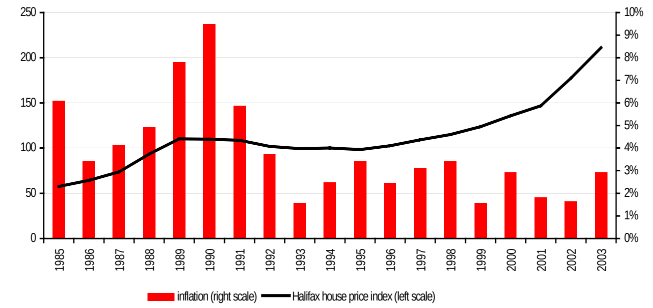
Residential real estate

UK Halifax house price index, GDP growth (%)



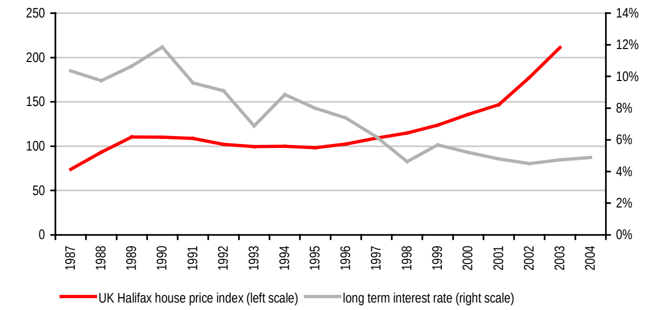
Source: Halifax House Price Index, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

UK Halifax house price index, inflation (%)



Source: Halifax House Price Index, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

UK Halifax house price index, long-term interest rate (%)



Source: Halifax House Price Index, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

France

Macro data

Macro data France

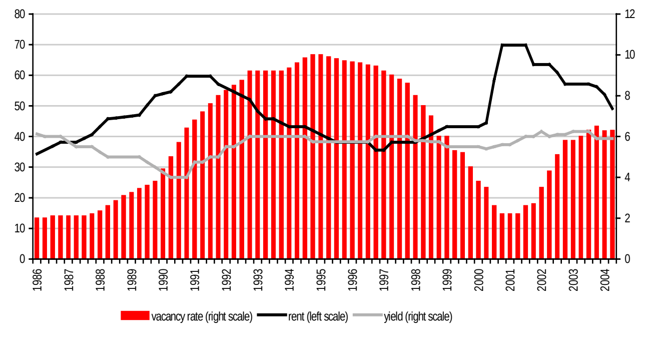
		1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004e	2005e
Inflation	%	1.57	2.47	3.41	2.45	3.13	3.42	1.56	2.93	1.82	1.63	2.92	1.50	1.00
Real GDP	EURbn	1139.9	1161.5	1182.8	1195	1217.4	1261.1	1301.9	1356.7	1385	1402	1407.1	1432.4	1455.3
GDP growth	%	-1.00	1.90	1.80	1.00	1.90	3.60	3.20	4.20	2.10	1.20	0.40	1.80	1.60
Long term yield	%	7.81	5.62	8.11	6.27	5.60	5.07	3.79	5.81	4.99	4.94	4.25	4.30	4.10
Unemployment rate: EUROSTAT	%	11.30	11.80	11.30	11.90	11.80	11.40	10.70	9.30	8.50	8.80	9.30	9.90	10.00
Consumer spendings	EURbn	641	647	656	665	666	689	713	734	755	766	779	794	810
Consumer confidence	Points	-32.17	-21.17	-23.42	-34.75	-25.08	-14.25	-6.42	-1.17	-6.75	-15.58	-27.58	na	na
Major purchase index	Points	0	0	0	0	0	0	0	1	0	0	0	na	na
Population	000	57,369	57,565	57,752	57,936	58,116	58,299	58,496	58,748	59,038	59,337	59,625	na	na
Households	000	22,948	23,026	23,101	24,140	24,215	24,291	24,373	24,478	24,599	24,724	na	na	na
Ave. householdsize	-	2.5	2.5	2.5	2.4	2.4	2.4	2.4	2.4	2.4	2.4	na	na	na
House price index	Points	na	100	99.15	99.125	101.05	103.525	108.725	118.075	127.525	138.35	151.5	na	na
Construction output	EURbn	114.6	116.7	119	115.9	116.3	128.2	135.3	144.9	146.8	144.6	142.1	143.8	146.5
Industrial production index	Points	82.3	85.5	87.5	87.1	90.9	94	96.1	100.1	101.2	100	na	na	na
Mortgage rates	%	8.60	8.70	8.50	7.30	6.50	5.60	5.90	6.40	6.20	na	na	na	na
Main Equity Index: CAC40	Points	2,268	1,881	1,872	2,315	2,998	3,942	5,958	5,926	4,624	3,063	3,557	4,100	4,380
EPRA France	EURbn	na	482.6	513.8	599.1	651.4	881.9	1,000.0	1,079.3	1,104.8	1,317.4	1,551.7	2,000.2*	na
% change	Points	na	na	6.5%	16.6%	8.7%	35.4%	13.4%	7.9%	2.4%	19.2%	17.8%	28.9%	na

*Source: Thomson Financial Datastream, Eurostat, HSBC Trinkaus & Burkhardt, * Index value on 30/09/04*

France

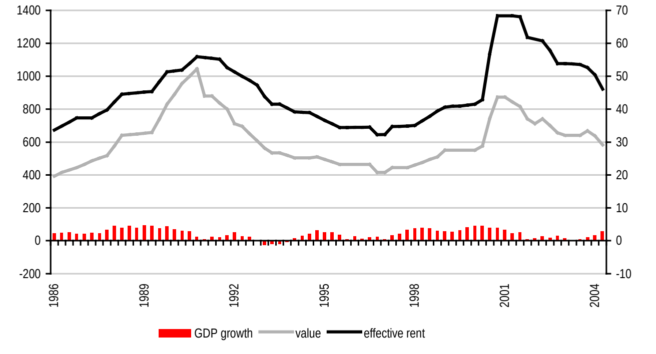
Office real estate development (Isle de France)

Prime rent (EUR), prime yield (%) and vacancy rate (%)



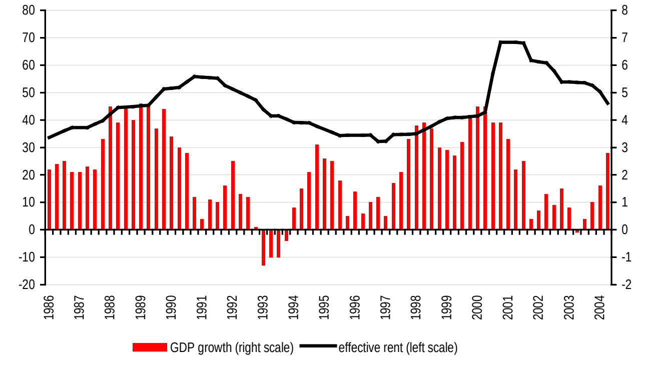
Source: ATIS REAL, CBRE, JLL, HSBC Trinkaus & Burkhardt

GDP growth (%), value (EUR/sq m), effective rent (EUR)



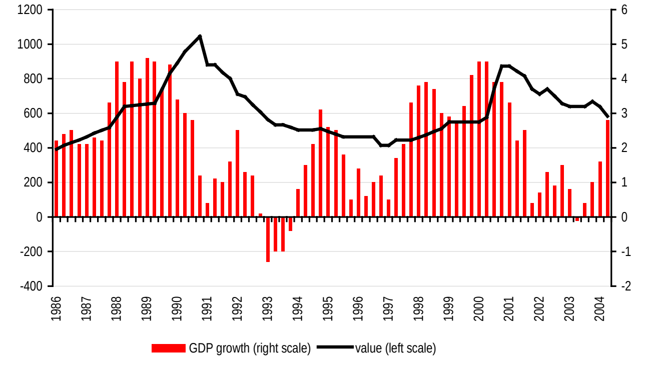
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

GDP growth (%), effective rent (EUR)



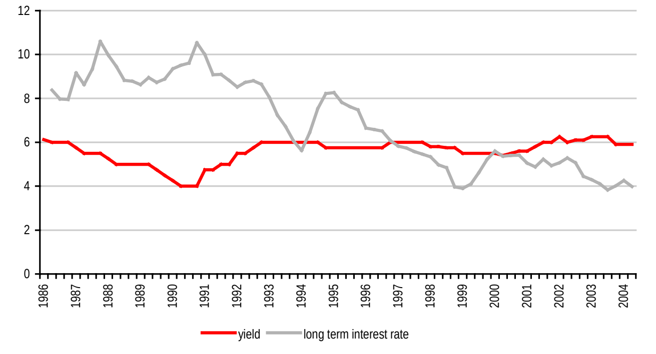
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

GDP growth (%), value (EUR/sq m)



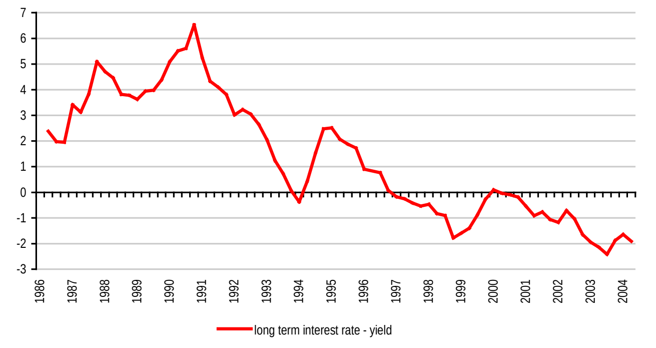
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Yield (%), long-term interest rate (%)



Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

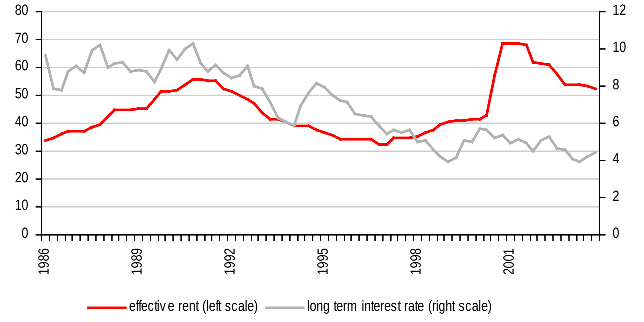
Long-term interest rate vs yield (%)



Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

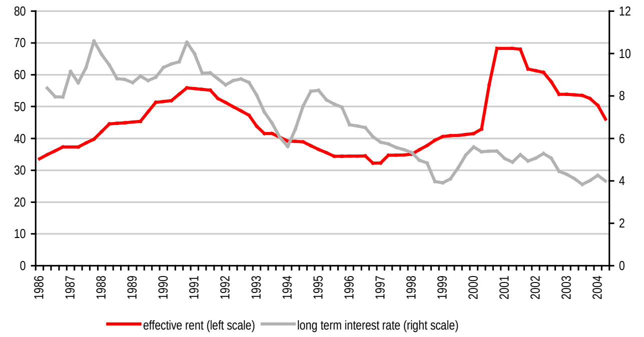
France

Effective rent (EUR), long-term interest rate (%)



Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Value (EUR/sq m), long-term interest rate (%)

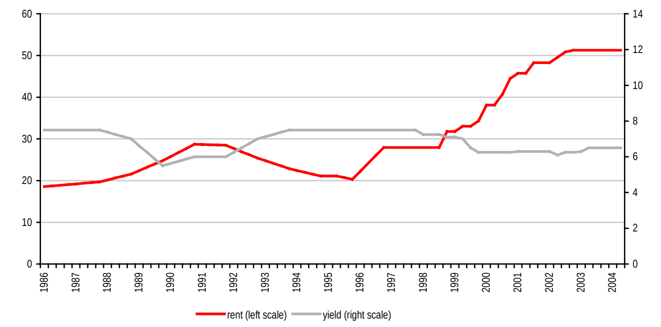


Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

France

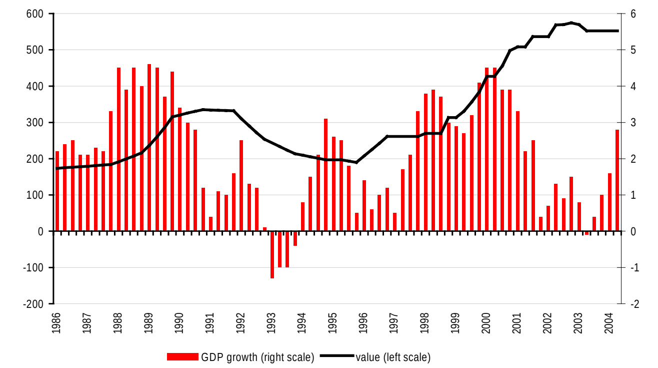
Retail real estate development (Isle de France)

Prime rent (EUR), prime yield (%)



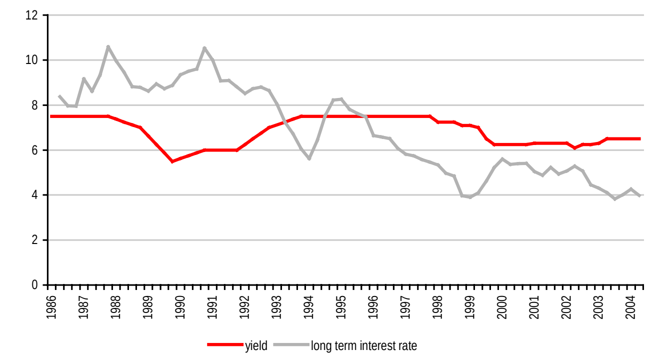
Source: ATIS REAL, CBRE, JLL, HSBC Trinkaus & Burkhardt

GDP growth (%), value (EUR/sq m)



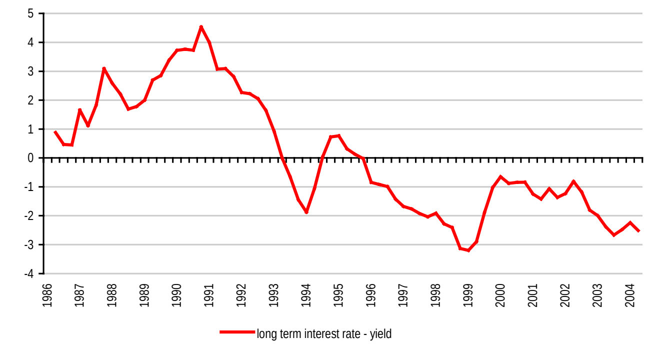
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Prime yield (%), long-term interest rate (%)



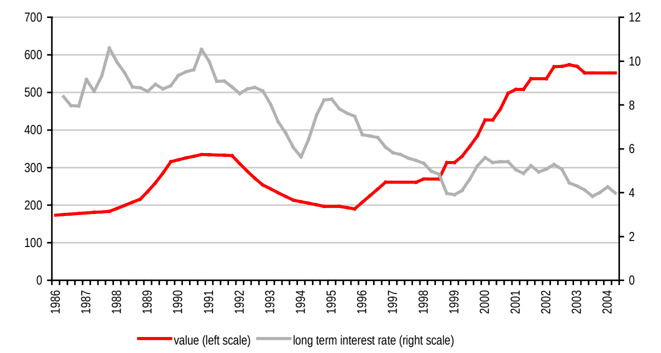
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Long term rate vs prime yield (%)



Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Value (EUR/sq m), long-term interest rate (%)

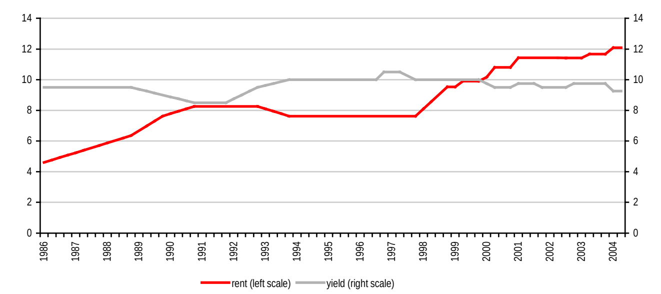


Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

France

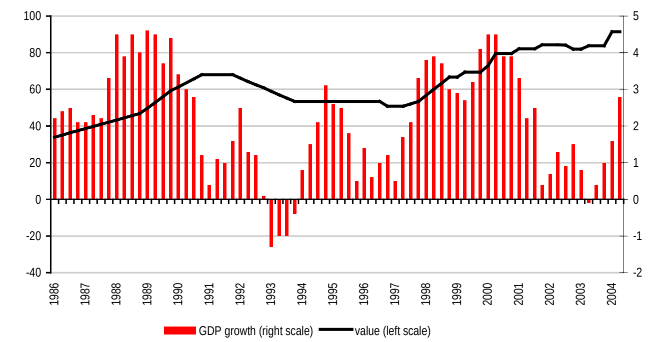
Industrial real estate development (Isle de France)

Prime rent (EUR), prime yield (%)



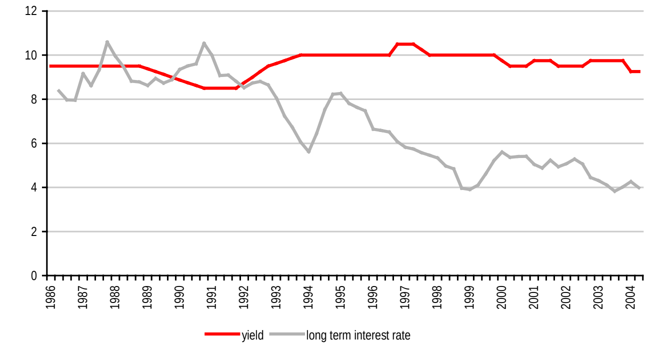
Source: ATIS REAL, CBRE, JLL, HSBC Trinkaus & Burkhardt

GDP growth (%), value (EUR



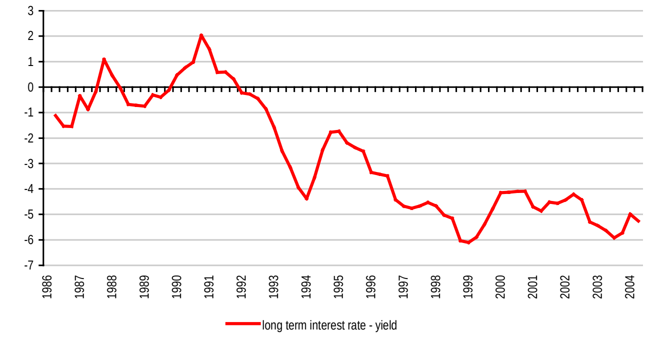
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Prime yield (%), long term interest rate (%)



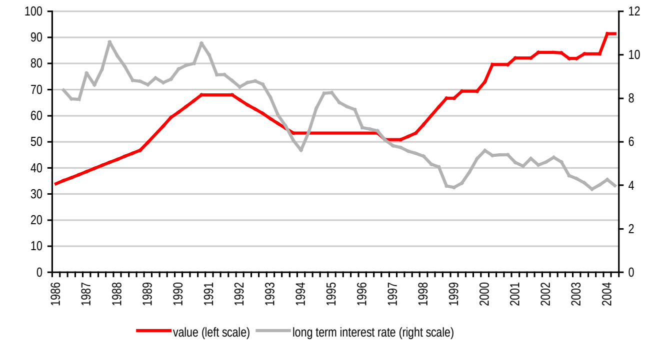
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Difference long term interest rate vs. prime yield (%)



Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Value (EUR/sq m), long-term interest rate (%)

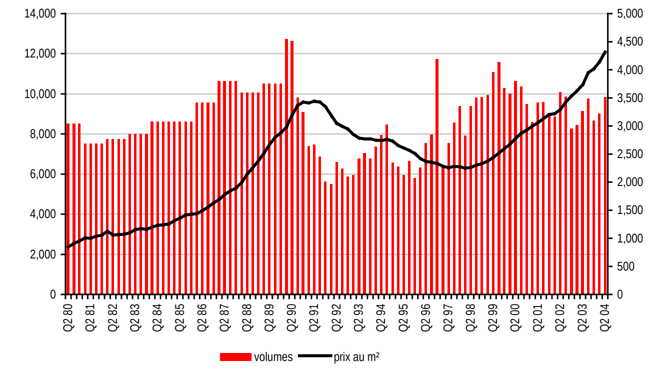


Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

France

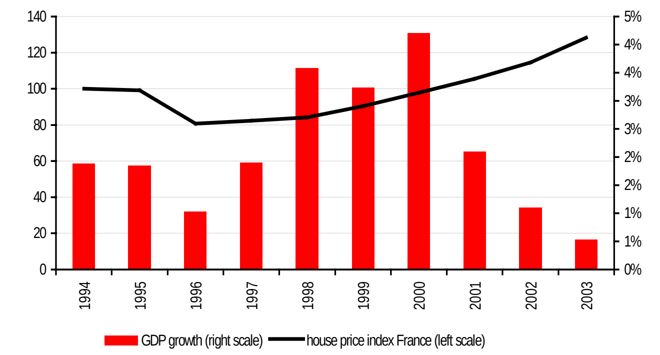
Residential real estate development

Prices of apartments in Paris, number of transactions



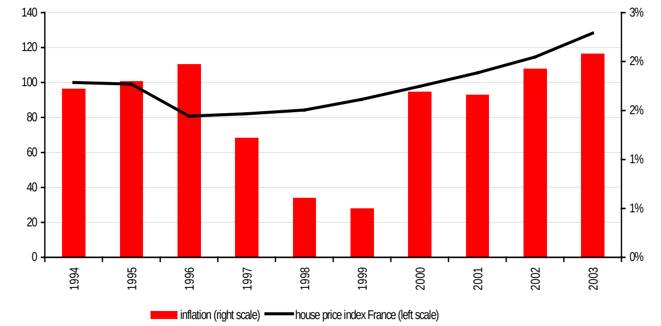
Source: Compagnie des Notaires de Paris, HSBC Trinkaus & Burkhardt

HPI France (1994 rebased), GDP growth (%)



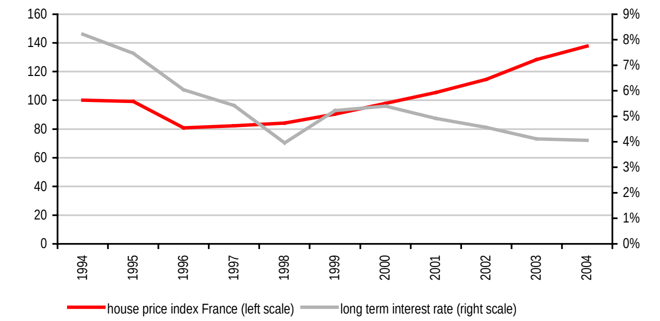
Source: Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

HPI France (1994 rebased), inflation (%)



Source: Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

HPI France (1994 rebased), long-term interest rate (%)



Source: HSBC Trinkaus & Burkhardt

Spain

Macro data

Macro data Spain

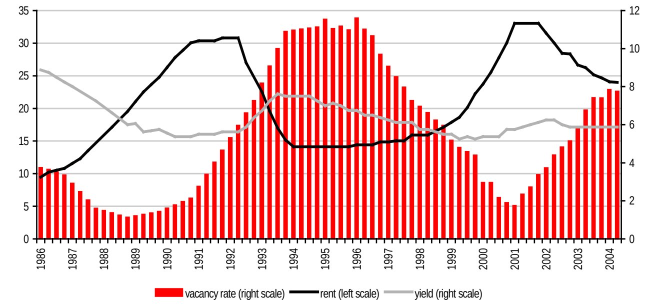
		1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004e	2005e
Inflation	%	4.56%	4.72%	4.68%	3.56%	1.97%	1.83%	2.31%	3.43%	3.59%	3.07%	3.03%	2.40%	2.00%
Real GDP	EURbn	416.1	426.0	437.8	448.5	466.5	486.8	507.3	529.7	544.5	556.7	570.6	582.0	592.4
GDP growth	%	-1.03%	2.38%	2.76%	2.44%	4.03%	4.35%	4.22%	4.40%	2.80%	2.23%	2.50%	2.00%	1.80%
Long term yield	%	9.09%	11.20%	10.85%	7.79%	5.84%	4.19%	5.42%	5.52%	4.96%	4.52%	4.17%	4.20%	4.50%
Unemployment rate: EUROSTAT	%	18.60%	19.80%	18.80%	18.10%	17.00%	15.20%	12.80%	11.30%	10.60%	11.30%	11.30%	11.00%	10.70%
Consumer Spendings)	EURbn	251.9	254.3	258.6	264.2	272.6	284.5	297.7	309.9	318.6	327.7	337.0	348.2	359.3
Consumer confidence	Points	-30.92	-16.33	-12.83	-9.42	-2.92	0.08	1.67	2.17	-4	-11.58	-13.67	na	na
Major purchase index	Points	-40	-36	-32	-30	-21	-14	-14	-15	-16	-18	-20	na	na
Population	000	39,114	39,219	39,305	39,383	39,468	39,571	39,724	39,961	40,376	40,851	41,551	42,198	na
Households	000	11,853	11,884	12,283	12,307	12,334	12,765	12,814	13,320	13,459	13,617	14,328	na	na
Ave. householdsize	-	3.3	3.3	3.2	3.2	3.2	3.1	3.1	3.0	3.0	3.0	2.9	na	na
RRE Index (1994 rebased)	Points	99.30	100.00	103.46	105.39	107.06	112.04	123.87	141.83	163.67	190.88	230.33	301.89	na
Industrial Production	Points	93.97	100.00	105.02	103.61	109.88	116.92	121.69	127.82	129.07	131.35	134.12	na	na
Mortgage rates	%	12.78%	8.95%	10.05%	8.50%	6.08%	5.01%	3.94%	5.18%	5.16%	4.31%	3.68%	na	na
Main Equity Index: IBEX35	Points	3,615	3,088	3,631	5,155	7,255	9,837	11,641	9,110	8,398	6,037	7,737	na	na
EPRA Spain	EURbn	na	468.1	463.6	580.7	931.5	1,214.1	1,000.0	1,086.6	1,077.3	1,499.1	1,947.3	2,788.5*	na
% y-o-y	Points	na	na	-1.0%	25.3%	60.4%	30.3%	-17.6%	8.7%	-0.9%	39.1%	29.9%	43.2%	na

*Source Thomson Financial Datastream. Eurostat, HSBC Trinkaus & Burkhardt, * Index value on 30/09/07*

Spain

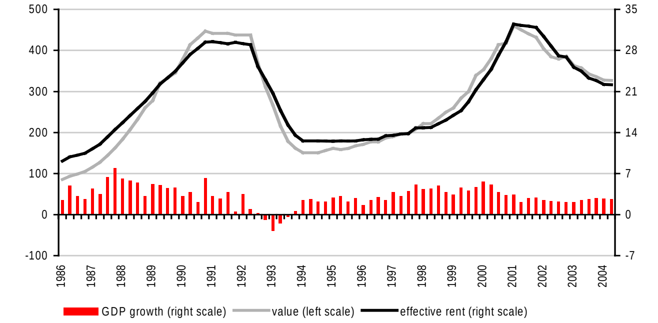
Office real estate development (Madrid, Barcelona)

Prime rent (EUR), prime yield (%) and vacancy rate (%)



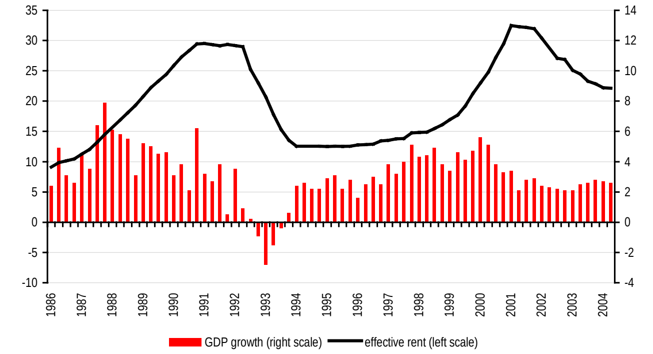
Source: ATIS REAL, CBRE, JLL, HSBC Trinkaus & Burkhardt

GDP growth (%), value (EUR/sq m), effective rent (EUR)



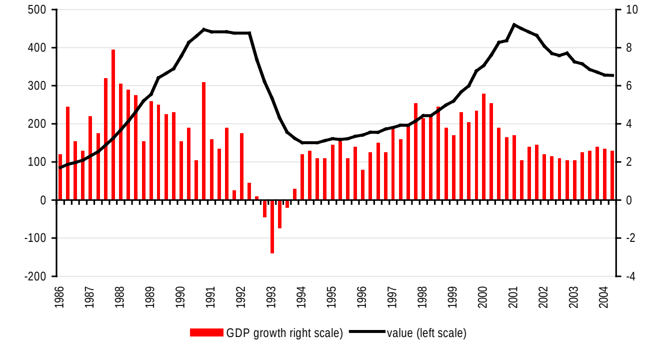
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

GDP growth (%), effective rent (EUR)



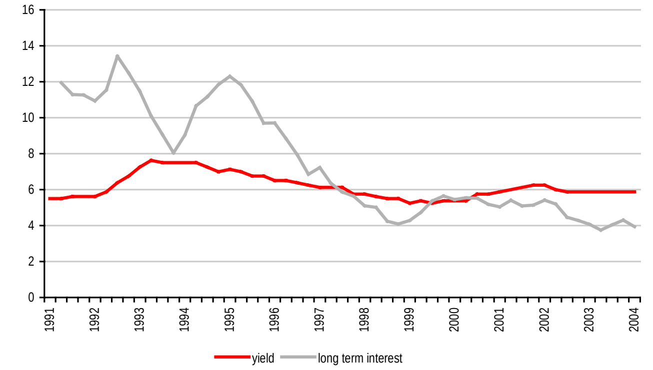
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

GDP growth (%), value (EUR/sq m)



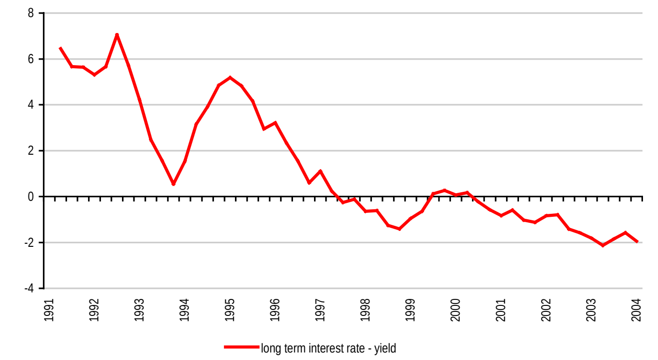
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Prime yield (%), long-term interest rate (%)



Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

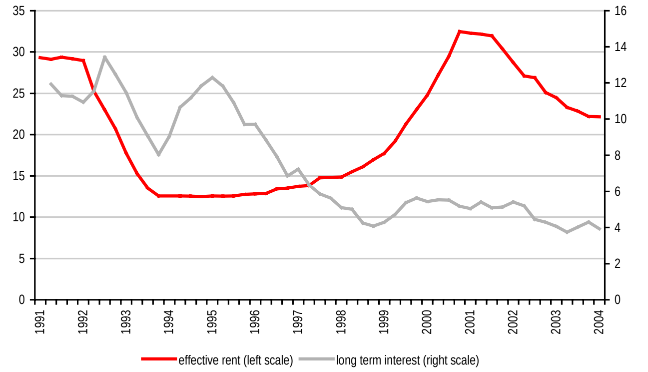
Long-term interest rate vs prime yield (%)



Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Spain

Effective rent (EUR), long-term interest rate (%)



Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

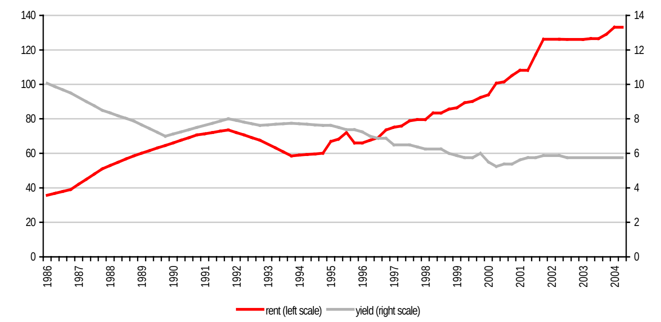
Value (EUR/sq m), long-term interest rate (%)

Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Spain

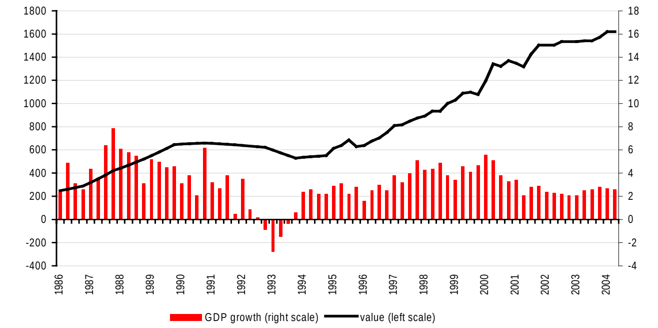
Retail real estate

Prime rent (EUR), prime yield (%)



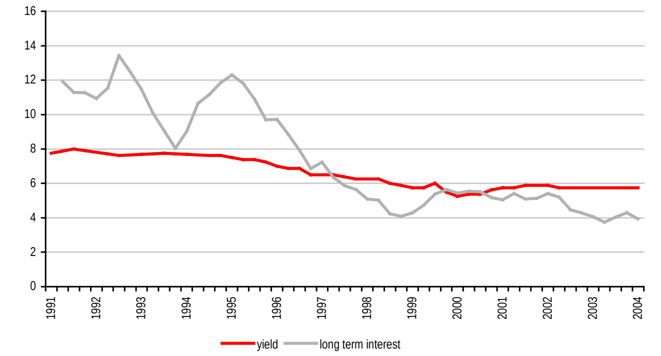
Source: ATIS REAL, CBRE, JLL, HSBC Trinkaus & Burkhardt

GDP growth (%), value (EUR/sq m)



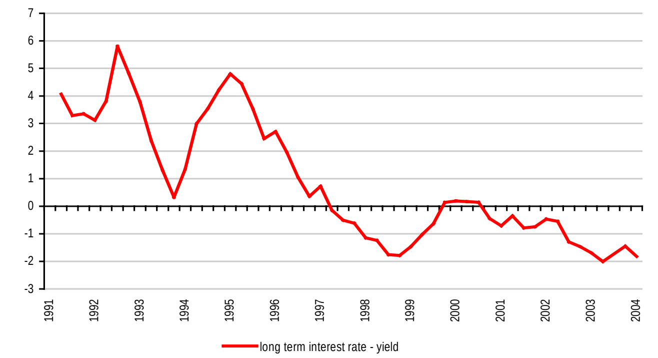
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Prime yield (%), long-term interest rate (%)



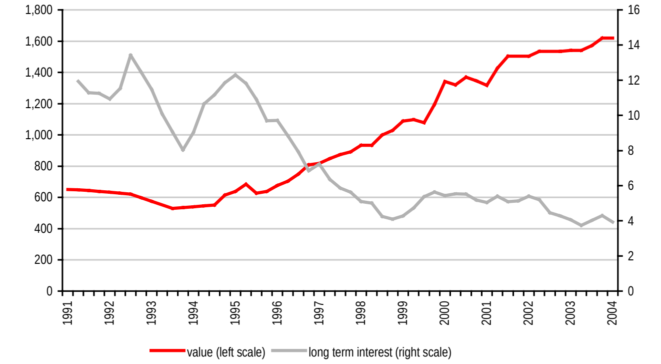
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Long-term rate vs prime yield (%)



Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Value (EUR/sq m), long-term interest rate (%)

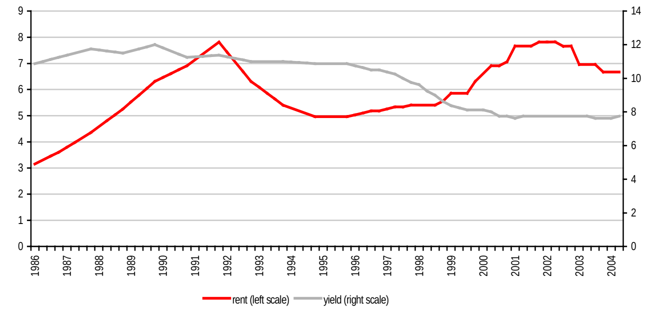


Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Spain

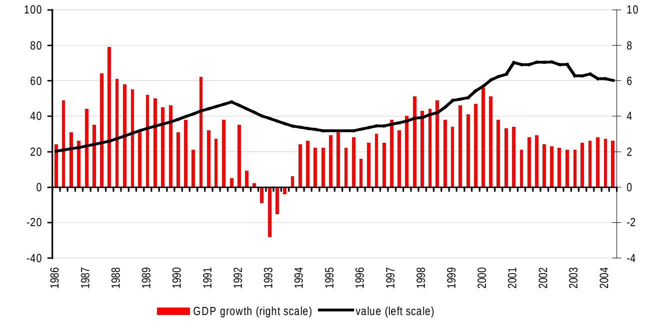
Industrial real estate

Prime rent (EUR), prime yield (%)



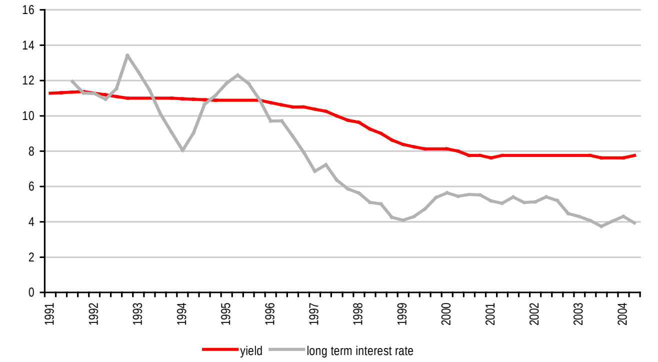
Source: ATIS REAL, CBRE, JLL, HSBC Trinkaus & Burkhardt

GDP growth (%), value (EUR)



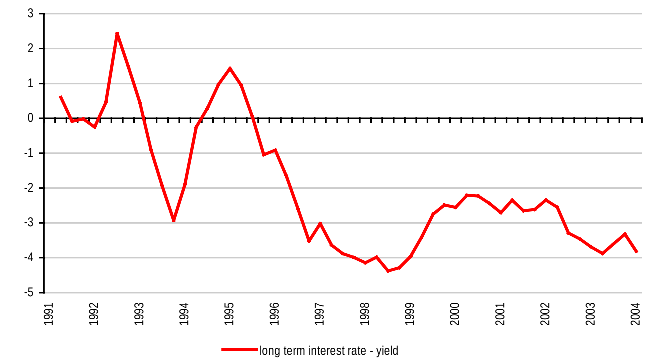
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Prime yield (%), long-term interest rate (%)



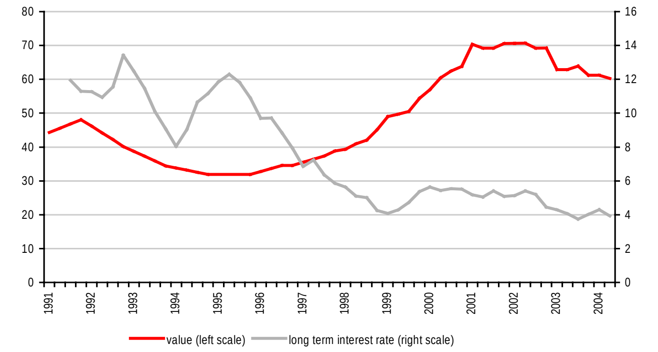
Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Long-term interest rate vs prime yield (%)



Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Value (EUR/sq m), long-term interest rate (%)

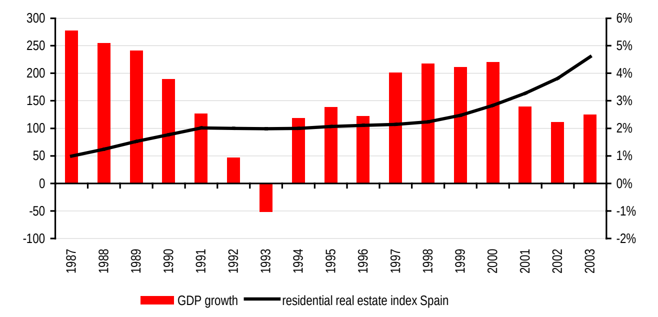


Source: ATIS REAL, CBRE, JLL, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Spain

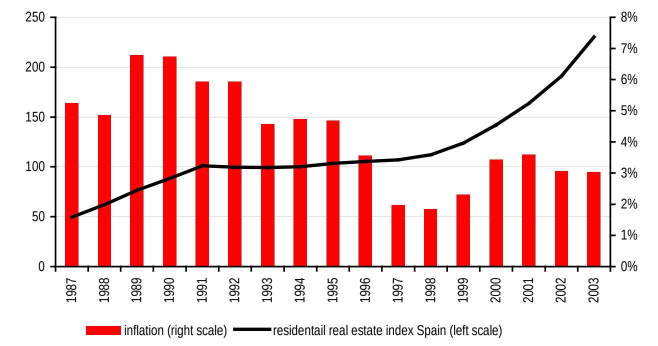
Residential real estate

Residential real estate index Spain



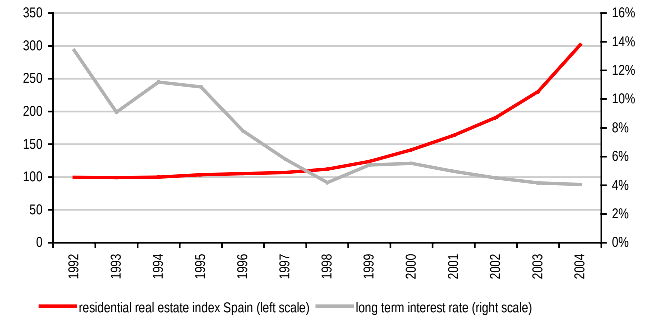
Source: Ministerio de Fomento, HSBC Trinkaus & Burkhardt

Residential real estate index Spain, inflation (%)



Source: Ministerio de Fomento, HSBC Trinkaus & Burkhardt

Residential real estate index Spain, long-term interest rate (%)



Source: Ministerio de Fomento, HSBC Trinkaus & Burkhardt

USA

Macro data

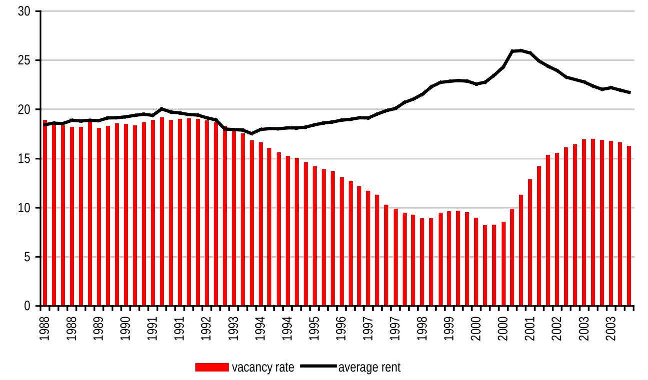
Macro data USA

		1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004e	2005e
Inflation	%	2.99%	2.56%	2.83%	2.89%	2.36%	1.56%	2.21%	3.36%	2.85%	1.58%	2.28%	2.70%	2.30%
GDP growth	USDbn	2.67%	4.02%	2.50%	3.70%	4.50%	4.18%	4.45%	3.66%	0.75%	1.86%	3.04%	4.20%	3.20%
Real GDP	%	7,533	7,836	8,032	8,329	8,704	9,067	9,470	9,817	9,891	10,075	10,381	10,817	11,163
Long term yield	%	5.99%	7.88%	6.44%	6.73%	6.30%	4.85%	6.10%	5.95%	5.30%	4.73%	5.10%	4.70%	5.20%
Unemployment rate: EUROSTAT	%	6.80%	6.10%	5.60%	5.40%	4.90%	4.50%	4.20%	4.00%	4.80%	5.80%	6.00%	5.70%	5.70%
Consumer Spendings	USDbn	5,100	5,291	5,433	5,619	5,832	6,126	6,439	6,739	6,910	7,123	7,356	7,635	7,887
Consumer confidence	Points	65.9	90.6	100	104.6	125.3	131.7	135.3	139	106.6	96.6	79.8	na	na
Population	000	260,255	263,436	266,557	269,667	272,912	276,115	279,295	282,339	285,024	287,676	290,343	293,030	na
Households	000	98,395	99,640	100,417	101,361	102,392	104,175	105,214	106,754	107,798	105,387	106,014	na	na
Ave. householdsize	-	2.65	2.64	2.65	2.66	2.67	2.65	2.65	2.64	2.64	2.73	2.74	na	na
House price index (1994 rebased)	Points	98.20	100.00	102.67	106.28	110.00	115.65	121.48	129.92	140.25	150.14	160.66	171.27	na
Construction output	USDbn	544.3	574.3	570.2	615.8	632.7	665.2	694.1	711.3	704.2	692.7	676.0	686.6	703.3
Industrial Production	Points	80.8	85.2	89.3	93.1	100.0	105.9	110.6	115.4	111.5	110.9	111.2	117.2	121.7
Mortgage rates	%	8.40%	8.03%	8.25%	8.02%	7.97%	7.71%	7.47%	7.59%	7.40%	7.01%	6.42%	4.70%	5.20%
NAREIT (total return)	Points	703.6	709.2	839.1	1,139.1	1,353.9	1,099.1	1,027.9	1,294.0	1,494.7	1,572.6	2,177.5	na	na
NAREIT (price)	Points	82.7	77.4	84.4	106.8	119.5	91.0	78.2	90.7	97.1	95.0	122.8	na	na
Main Equity Index: S&P 500	Points	466.5	459.3	615.9	740.7	970.4	1,229.2	1,469.3	1,320.3	1,148.1	879.8	1,111.9	na	na
USD/EUR		1.20	1.20	1.32	1.29	1.13	1.11	1.07	0.92	0.90	0.95	1.13	1.28	1.35

Source Thomson Financial Datastream, Eurostat, HSBC Trinkaus & Burkhardt

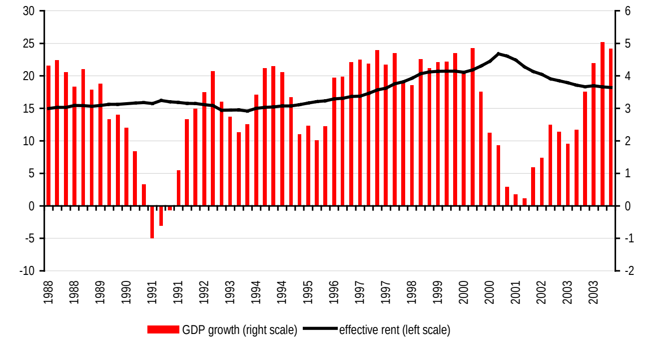
Office Real Estate USA

Vacancy rate (%), average rent (USD)



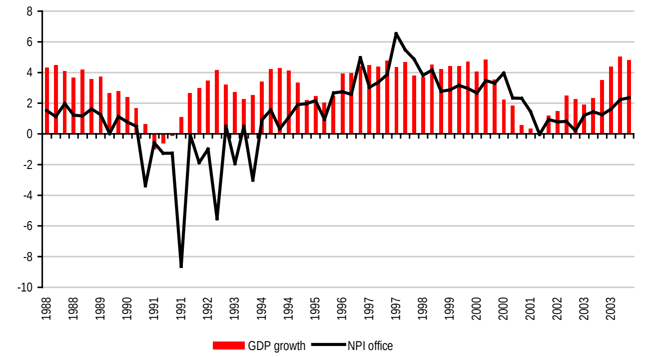
Source: TWR, HSBC Trinkaus & Burkhardt

GDP growth (%), effective rent (USD)



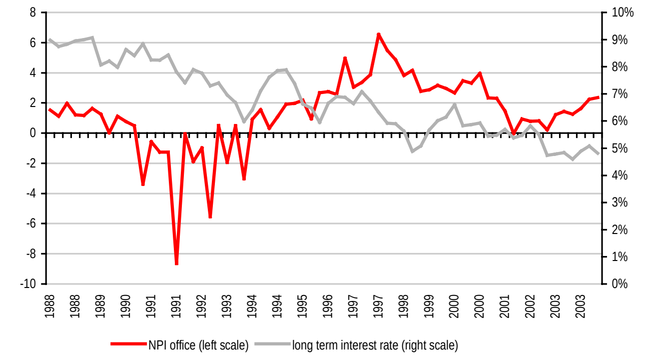
Source: TWR, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

GDP growth (%), NPI* office value growth (%)



**) NPI total return representing the sum of capital growth and income return for any given period*
Source: NCREIF, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

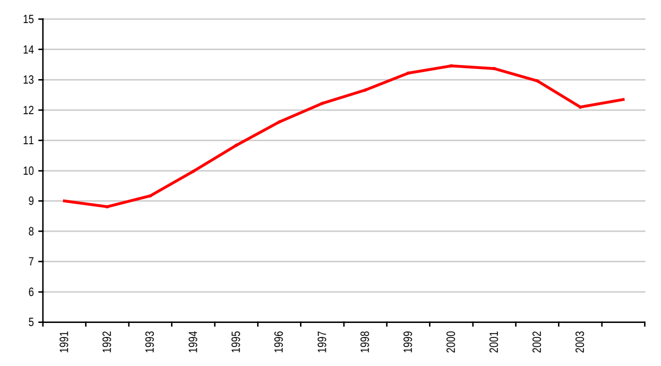
NPI* office value growth (%), long term interest rate (%)



**) NPI total return representing the sum of capital growth and income return for any given period*
Source: NCREIF, Thomson Financial Datastream,HSBC Trinkaus & Burkhardt

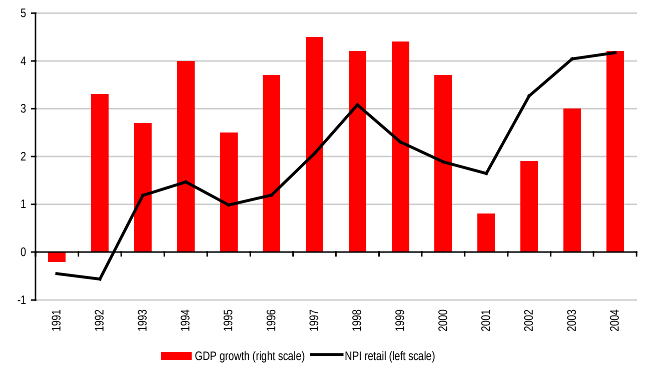
Retail Real Estate

Rents (USD)



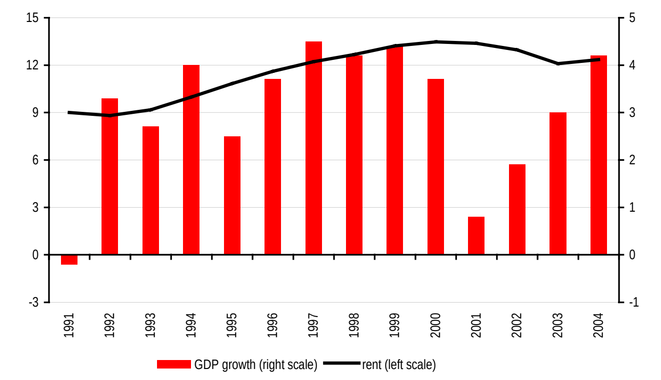
Source: TWR, HSBC Trinkaus & Burkhardt

GDP growth (%), NPI* retail value growth (%)



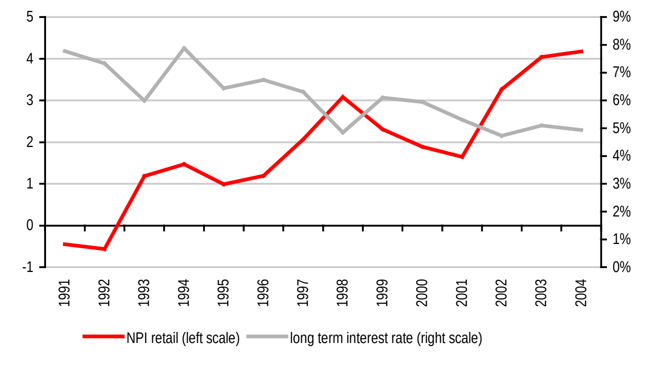
**) NPI total return representing the sum of capital growth and income return for any given period*
Source: NCREIF, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

GDP growth (%), rent (USD)



Source: TWR, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

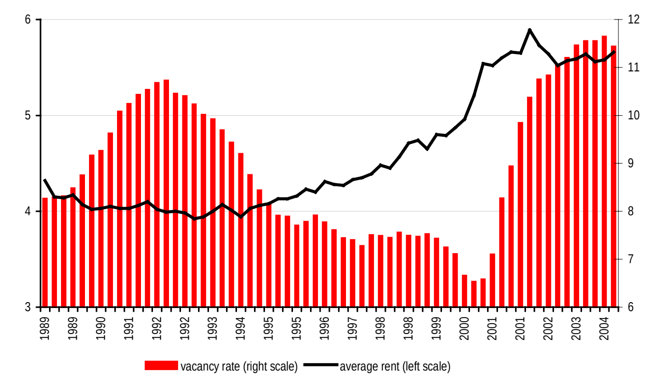
NPI retail value growth (%), long term interest rate (%)



**) NPI total return representing the sum of capital growth and income return for any given period*
Source: NCREIF, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

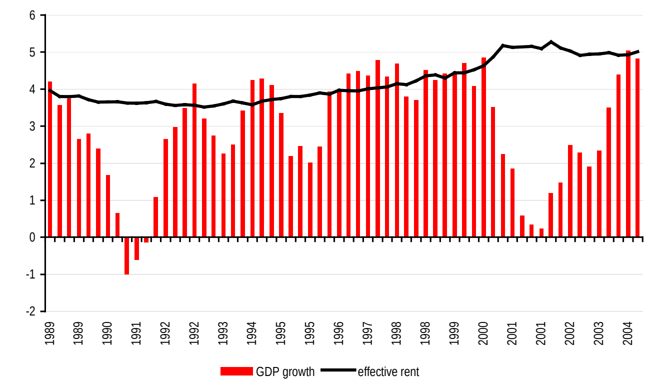
Industrial Real Estate

Vacancy rate (%), average rent (USD)



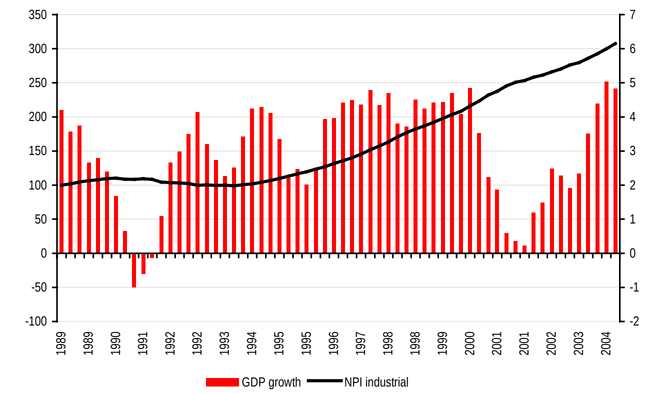
Source: TWR, HSBC Trinkaus & Burkhardt

GDP growth (%), effective rent (USD)



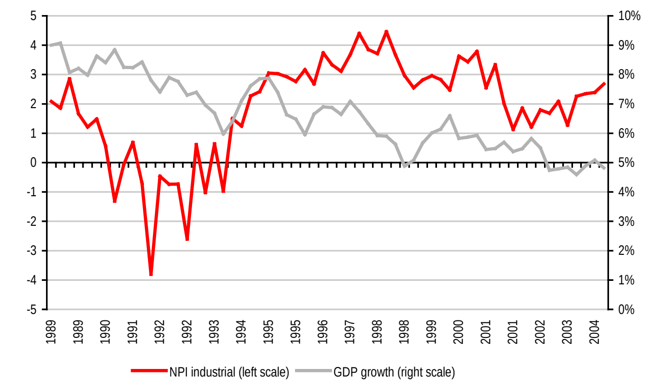
Source: TWR, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

GDP growth (%), NPI* industrial value growth



**) NPI total return representing the sum of capital growth and income return for any given period*
Source: NCREIF, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

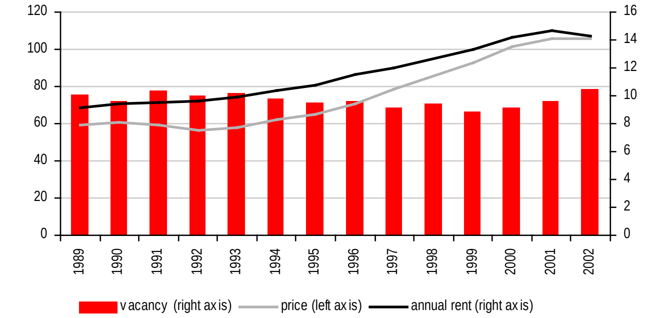
NPI* industrial value growth, long term interest rate (%)



**) NPI total return representing the sum of capital growth and income return for any given period*
Source: NCREIF, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

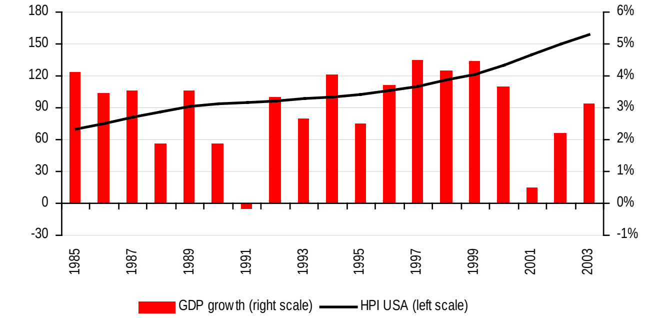
Residential Real Estate

Vacancy (%), price (USD per sq. ft.), annual rent (USD per sq. ft.)



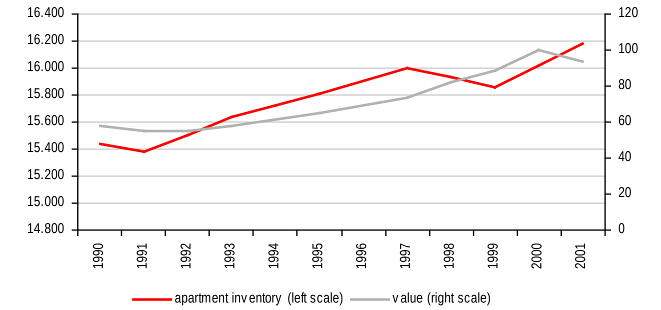
Source: NMHC, HSBC Trinkaus & Burkhardt

US house price index (1994 rebased), GDP growth (%)



Source: Office of Federal Housing Enterprise Oversight, HSBC Trinkaus & Burkhardt

Apartment inventory, value per square foot (USD)

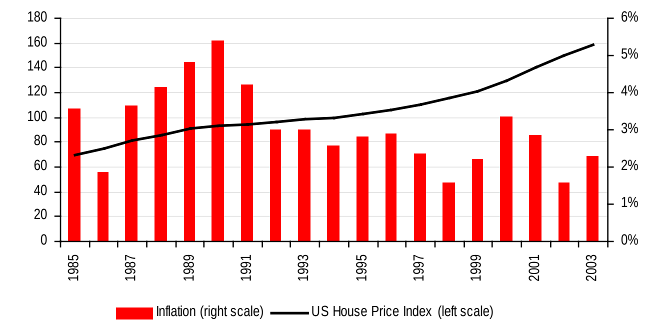


Source: NMHC, HSBC Trinkaus & Burkhardt

Development of inventory and value

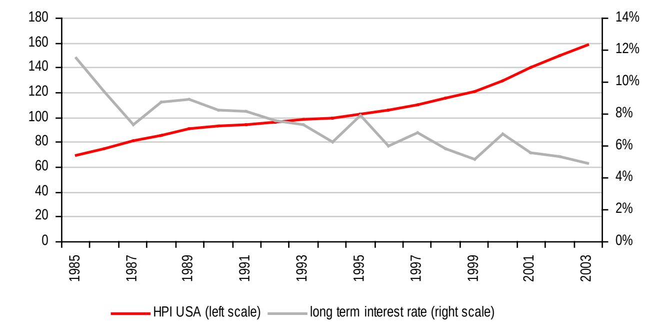
Source: NMHC, HSBC Trinkaus & Burkhardt

US house price index, inflation (%)



Source: Office of Federal Housing Enterprise Oversight, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

US house price index (1994 rebased), long term interest rate (%)



Source: Office of Federal Housing Enterprise Oversight, Thomson Financial Datastream, HSBC Trinkaus & Burkhardt

Glossary

Absorption rate
An estimate of the rate at which a particular classification of space – eg new office space, new housing, new condominium units, etc – will be sold or occupied each year.

ACLI (American Council of Life Insurers)
The ACLI is a Washington-based trade association with a membership of 383 financial institutions providing insurance and financial products. It provides comprehensive US real estate lending statistics including new commitments, margins, LTVs, etc.

Aengevelt
A leading German commercial real estate agent, Aengevelt is a member of DIP.

AFIRE (Association of Foreign Investors in Real Estate)
US association for foreign and US institutional investors in international real estate. AFIRE provides investment statistics, runs surveys, represents the interest of its members, etc.

Atis Müller
Leading German commercial real estate agent that also provides quarterly commercial real estate market statistics for Germany and Europe via co-operation partners.

Average daily rate (ADR)
Average price of a hotel room calculated per day.

Availability
The availability rate comprises direct vacant space, sublet space and the speculative development pipeline.

BaFin
Bundesaufsichtsamt für Finanzwesen – the German Federal Financial Supervisory Authority.

BI (fiscale beleggingsinstelling)
The Dutch REIT structure. The regime for the fiscal investment institution (fiscale beleggingsinstelling (BI)) in the Netherlands was introduced in the Dutch Corporate Income Tax Act of 1969.

BMF (Bundesministerium fuer Finanzen)
German Federal Ministry of Finance.

BVI (Bundesverband Investment und Asset Management e.V.)
The Bundesverband Investment und Asset Management e.V. is the central association representing the interests of the German investment fund industry.

Glossary

BulwienGesa
Leading German real estate market research house that sells comprehensive market statistics and forecasts based on proprietary databases.

Cap rate (capitalisation rate)
The percentage rate of return estimated from the net income of a piece of property (similar to net yield). The term is predominantly used in the US.

CB Richard Ellis (CBRE)
Leading global real estate agent formed by the merger of CB Hillier Parker and Insignia Richard Ellis that also provides quarterly commercial real estate market statistics.

Closed-ended property funds
A fund tailored for a limited number of private investors. Unlike open-ended property funds, shares in the fund cannot be issued or redeemed after the initial issue.

Commercial mortgage backed security (CMBS)
Debt instrument secured by commercial real estate mortgages.

Commercial property
A classification of real estate which includes income-producing property such as office buildings, gasoline stations, restaurants, shopping centres, hotels and motels, parking lots and stores, etc.

Commission
The compensation paid to a real estate broker (usually by the seller) for services rendered in connection with the sale or exchange of real property.

CR-REIT (Corporate Restructuring REIT)
One of the two REIT regimes in South Korea.

Cushman & Wakefield Healey & Baker (C&W H&B)
Leading global real estate agent formed by the merger Cushman & Wakefield and Healey & Baker that also provides quarterly commercial real estate market statistics.

Debt (service) coverage ratio (DSCR)
Ratio of funds available to required loan payments (principal and interest).

DEKA Immobilien Fond
Major German open- ended funds.

DEGI
German asset management company investing in real estate publishing reports on the German real estate market.

Glossary

Developer
A company or investor who attempts to put land to its most profitable use by the construction or improvement of real estate.

Deutscher Immobilien Index (DIX)
German real estate index provided by IPD since 1996. The annual index is available free of charge on IPD's website www.ipdindex.co.uk.

Deutsche Immobilien Partner (DIP)
Co-operation of four commercial real estate agents in Germany including the market leader, Aengevelt, that also provides the most comprehensive biannual real estate statistics on the German office market.

Down-REITt
Limited partnership in which the REIT acts as a general partner. Besides its interest in the limited partnership the REIT holds properties directly.

DTZ
A leading global real estate agent that also provides quarterly commercial real estate market statistics.

Effective rent
The effective rent is a figure calculated by HSBC Trinkaus & Burkhardt to summarise the real estate cycle in a single number. It is calculated by taking the real rent level and multiplying it by the occupancy rate. The effective rent represents the average gross cash flow generated by a square metre of real estate space.

EPRA (European Public Real Estate Association)/ EPRA indices
EPRA publishes indices for publicly listed real estate companies around the world and develops policies concerning standards of reporting disclosure, ethics and industry practices. EPRA also publishes research and analysis.

Equity REIT
A REIT which owns or has an 'equity interest' in rental real estate (rather than making loans secured by real estate collateral).

Eureal Catella
European real estate agent formed by the merger Eureal and Catella with a strong focus on Scandinavia and Benelux. Eureal Catella also provides quarterly commercial real estate market statistics.

Feri
Feri Finance provides financial consulting, wealth management, economic research and rating services with one business segment focusing on real estate investments.

Glossary

GbR (Gesellschaft des buergerlichen Rechts)
Non trading partnership.

gif e.V. (Gesellschaft für Immobilienwirtschaftliche Forschung)
Association of currently c650 members dedicated to real estate market research combining theory and practice. gif has standardised real estate guidelines and definitions.

GPR (Global Property Research)
GPR is an independent research company providing its customers with self-calculated and maintained property indices.

Hybrid REIT
A REIT combining the investment strategies of both Equity and Mortgage REITs.

IFD (Initiative Finanzstandort Deutschland)
Action group set up by the finance sector with the cooperation of the Federal Ministry of Finance with the aim of strengthening Germany as a base for finance business.

IPD (Investment Property Database)
IPD is an independent research company providing investors, occupiers, advisors and researchers with objective, reliable property benchmarks and indices for the UK, Canada, Denmark, France, Germany, Ireland, Italy, the Netherlands, Norway, Portugal, South Africa, Spain and Sweden. Annual indices are available free of charge on www.ipdindex.co.uk.

Jones Lang LaSalle (JLL)
Leading global real estate agent that also provides quarterly commercial real estate market statistics.

Junior mortgage
A mortgage that is subordinate in right or lien priority to an existing mortgage on the same realty, such as a second mortgage.

KG (Kommanditgesellschaft)
Limited partnership.

Leasehold
A less-than-freehold estate which a tenant possesses in real property.

Loan-to-value ratio
The ratio that the amount of the loan bears to the appraised value of the property or the sales price, whichever is lower.

Glossary

Maintenance
The care and work put into a building to keep it in operation and productive use; the general repair and upkeep of a building. If maintenance is deferred, the building will suffer a loss in value.

MFT(mutual fund trust)
Canadian REITs qualify as 'mutual fund trusts' (MFTs) under the Canadian Income Tax Act (ITA) for which there are comprehensive and detailed rules.

Mortgage
A legal document used to secure the performance of an obligation. In effect, the mortgage states that the lender can look to the property in the event the borrower defaults in payment of the note.

Mortgage REIT
A REIT that makes or owns loans and other obligations that are secured by real estate collateral.

National Association of Realtors
Formerly known as the National Association of Real Estate Boards (NAREB), the National Association of Realtors is the largest real estate organisation in the world.

NAV (Net Asset Value)
Funds: value of a single mutual fund share, based on the value of the underlying assets of the fund minus its liabilities.

Company: value of assets minus liabilities. Assets and liabilities are measured at their market, not book values.

Net rentable area (NAR)
NAR is the total of net rentable square feet in each building in the submarket.

NCREIF (National Council of Real Estate Investment Fiduciaries)
Association of US institutional real estate professionals providing statistical data such as NPI returns on real estate categories and US regions. NPI focuses on investment grade properties only. NCREIF also produces a Timberland Index and a Farmland Index, both of which contain properties held in a tax-exempt, fiduciary setting.

NMHC (National Multi Housing Council)
NMHC is a national association representing the interests of the nation's larger and most prominent apartment firms. NMHC advocates on behalf of rental housing, conducts apartment-related research (vacancy and absorption rates, prices, rents and capitalisation rates), encourages the exchange of strategic business information, and promotes the desirability of apartment living.

Glossary

NPI
Russell/NCREIF Property Index published by NCREIF covering leveraged and unleveraged real estate property. The leveraged properties are reported on an unleveraged basis. So, the index is completely unleveraged.

NREI (National Real Estate Index)
US provider of real estate data and analysis. The NREI is owned, produced and published by San Francisco-based Global Real Analytics.

Occupancy rate
The occupancy rate is the ratio between the number of occupied units and the total number of units in a specified project, city, country, etc. The occupancy rate is the reciprocal value of the vacancy rate.

Offsite costs
Costs such as for sewers, streets, utilities, etc, which are incurred in the development of raw land, but are not connected with the actual construction of the buildings (onsite costs).

OFHEO
Office of Federal Housing Enterprise Oversight, OFHEO's primary mission is ensuring the capital adequacy and financial safety and soundness of two government-sponsored enterprises (GSEs) – the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). It also provides real estate data (eg House Price Index) and some analysis (not much).

Open-ended property fund
Mutual funds designed for private investors investing in properties.

PEX (German Pfandbrief Index)
The PEX is a synthetic index based on the notional-bond-concept. The index portfolio consists of 30 synthetic Pfandbrief bonds with maturities ranging from 1 to 10 years and three coupon classes of 6%, 7.5% and 9%. The index is calculated on a daily basis.

Pre-let
A construction scheme by a condominium developer who is required to let a certain percentage of units or a certain share of space before a lender will commit to finance construction of the project.

Pre-sale
A pre-construction sale programme by a condominium developer who is required to sell a certain percentage of units before a lender will commit to finance construction of the project.

Prime rent
Average rent paid for top locations in the office, industrial, retail or residential real estate sector. Usually applies to a market share of 3% to 5%.

Glossary

Rat der Immobilienweisen
Committee of German Real Estate experts.

REIS
US real estate research house providing comprehensive research, statistics and forecasts on all major real estate categories.

REIT (real estate investment trust)
A special arrangement under federal and state law whereby investors may pool funds for investments in real estate and mortgages and yet escape corporation taxes in the US. Requires one hundred persons or more. REITs are based in the US but there are similar investment vehicles in other countries such as France (established in 2003). The UK plans a similar structure for 2005.

REOC (real estate operating company)
US property company that is taxed and does not fulfil REIT status. Consequently, REOCs are much less restricted than REITs.

RETF (Real Estate Trust Fund)
In 2004 the Korean government introduced a new structure for indirect real estate investment, the Real Estate Trust Fund ("RETF"). RETFs have many advantages over both General REITs and CR-REITS, (i.e., lower initial investment amounts, ability to leverage investment, less regulatory red-tape to create, possibility of perpetual existence).

REX
Index measuring the performance of the German bond market.

Residential mortgage backed security (RMBS)
Debt instrument secured by residential real estate mortgages.

Revenue per available room (RevPAR)
A figure describing the total revenue an average hotel room generates.

Second mortgage
A mortgage which is junior or subordinate to a first mortgage; typically, an additional loan imposed on top of the first mortgage, which is taken out when the borrower needs more money.

Secondary mortgage market
A market for the purchase and sale of existing mortgages, designed to provide greater liquidity for mortgages; also called secondary money market.

Glossary

SICAFI (société d'investissement à capital fixe en immobilière)
Belgian REIT structure. The SICAFI is a listed property fund with a fixed amount of corporate share capital whose role is to provide tax neutrality for collecting and distributing the rental income.

SIIC (Société d'investissement immobilier cotée)
French tax-efficient publicly listed real estate investment company, similar to REITs in the US.

Specialty funds
Open-ended property funds designed for few, institutional investors

SREIT (Singapore REIT)
The first Singapore REIT to be listed on the Singapore Exchange was launched in July 2002

Sublet space
Sublet space is space where the tenant of record actively intends to re-lease to another party. Sublet space can be occupied (and thus sublet available) or vacant.

Sublet vacancy
Sublet Vacancy represents space that is not occupied and being actively marketed, yet the tenant of record still has lease obligations to the property owner.

Take up
Amount of rented space in a given period measure in square metres.

Tax Reform Act of 1986
Federal law that substantially altered the real estate investment landscape by permitting REITs not only to own, but also to operate and manage most types of income-producing commercial properties. It also stopped real estate 'tax shelters' that had attracted capital from investors based on the amount of losses that could be created.

Torto Wheaton Research (TWR)
A subsidiary of CB Richard Ellis, TWR is a US real estate research house providing comprehensive research, statistics and forecasts on all major real estate categories. TWR statistics focus on an average property representing a broader approach than of real estate agents or NCREIF.

TRS (Taxable REIT subsidiary)
REIT subsidiary involved in 'non-REIT qualifying' operations, such as third-party management or development. Unlike the REIT, the subsidiary is taxed.

Up-REIT
In the typical Up-REIT, a newly formed REIT in combination with the partners in one or more existing partnerships become partners in a new partnership, termed the Operating

Glossary

Partnership. For their respective interests in the Operating Partnership ('OP Units'), the partners contribute the properties from the existing partnerships and the REIT contributes the cash proceeds from its public offering. The REIT is typically the general partner and the majority owner of the Operating Partnership.

Vacancy factor
An allowance or discount for estimated vacancies (unrented units) in a rental project.

Vacancy rate
The vacancy rate is the ratio between the number of vacant units and the total number of units in a specified project or area.

Yield (prime yield)
The prime yield represents the best (ie the highest) yield estimated to be achievable for a notional property of the highest quality and specification in the best location. The yield is calculated by dividing the prime rent net of operating costs (usually c30%) by the total purchase price including acquisition costs and transfer taxes.

Notes

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Notes

Important disclosures

Basis for financial analysis

HSBC does not seek to value companies in order to provide a target price or recommendation. Instead, the principal aim of HSBC's sector and company research is to show how a particular theme or idea may affect the future earnings or cash flow of a company. To this aim we provide earnings and cash flow forecasts, including an illustrative discounted cash flow analysis, and present standard valuation metrics to help clients in their investment decisions.

Issuer & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Disclosure
Deutsche Post	DPWGn.DE	16.2	1, 2, 6, 7
TUI	TUIG.DE	16.755	2, 7
Vivacon	VIVG.DE	6.145	1, 3, 5

Source: HSBC

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