COMMENTARY

Jul 3rd, 2009

Dear clients and colleagues,

This week we'd like to introduce the US multi-family REITs sector and profile our pick in the portfolio – Mid America Apartment (MAA US). We met its management last week.

The apartment REITs sector has a more defensive nature than the office or retail REITs. Recent market movements have clearly demonstrated so. Based on Bloomberg REIT indexes, we can see that from Jan 1st to March 6th the apartment REITs outperformed the office and retail, but have underperformed in the following months. However, thanks to strong fundamentals Mid-America has outperformed the above three sectors in both periods.

Sector Overview

US multi-family REITs are closely related to the apartment-rental market. There are approximately 40 million rental units available in the US, of which 18 million are multi-family houses with 6 or more units.

We believe the supply and demand factors play in favor of this sector. On the demand side, positive demographics such as immigration flows, eco boomers and retirees provide growing support. Mortgages delinquencies also force more people back for rental housing. Home ownership in the US peaked 69% in 2006, fell to 67.5% in early 2009, and is expected to return to 65%, a historically sustainable level. On the supply side, multi-family rental starts continue to drop each year, and are projected to set a post-WWII low till 2011.

Meanwhile, two key risks continue to weigh on the sector: High unemployment rate may cause more tenant turnover and lower pricing. Tight credit condition may squeeze profit margin and slow property development and re-development.

Industry experts have projected that due to weak employment trends the sector will see meaningful moderation in revenue growth in 2009 & 1H2010, but strong recovery (V shape) from 2H2010 into 2011.

This market is very fragmented with different regional players. Key competitors of Mid America are AvalonBay Communities, Camden Property, Equity Residentials, Essex Property Trust, Home Properties, and UDR.

Mid America Apartment

MAA is a self-administered and self-managed REIT, which acquires, develops, owns and operates exclusively multi-family apartment communities in the southeast and midwest US. It owns 100% of 144 properties representing 42,252 apartment units.

Market cap US$996M, dividend yield 6.9%, debt/capital 50%, dividend/FFO payout ratio 69%, P/FFO(12/2009e) 9.8x, www.maac.net

Competitive Advantages
Superior operating capability: MAA has a successful track record for property redevelopment and management. Its 10-year compounded annual FFO growth has been 3.5% vs. sector average of 0.9%. It has a sophisticated web-based system with high operation efficiency.

Outstanding management: The CEO and CFO are very experienced and well-known as the top management team in the sector. They have been managing the firm since MAA's IPO in 1994, owning 4% of stake.

Diversified portfolio: MAA operates in both high-growth primary market and less cyclical secondary markets, which ensures stable cash flows.

Strong balance sheet: MAA is not a developer like some competitors who require large capital. Instead, it buys value assets and redevelops. Its debt/capital is 50% vs. sector average of 55%. It has the lowest div/AFFO payout ratio 82% vs. sector average of 90%.

Growth Strategy
Focus on high-growing sunbelt region supported by positive migration, affordable housing and robust employment. MAA is in 7 of the top 10 projected "Echo Boom Household" markets, namely, Dallas, Houston, Atlanta, Phoenix, Austin, South FL, and Orlando.

Set up joint ventures: By combining forces with private equity, MAA aims to achieve higher return through property management and higher leverage with 33.3% ownership.

Investment Theme
A defensive play and industry leader well-positioned for the recovery in apartment leasing.

Very experienced management: In the last period of weak markets between 2002 and 2003, MAA outperformed its peers. We believe its stable management team is able to deliver superior and consistent results in the coming years.

Valuation
MAA's current EV/unit is $58,000 (about $58/sq ft). Recent comparable transactions are valued at $75-90 per sq ft. Using DCF model, our target price is $70, for a 100% expected return, based on 5% long-term growth rate and 5% risk premium.

Have a nice weekend.

The Global Alpha Team