iShares REIT ETFs

Portfolio Benefits and Implementation Guide

iShares REIT ETFs

iShares domestic real estate index funds

iShares Cohen & Steers Realty Majors Index Fund (ICF)
iShares Dow Jones U.S. Real Estate Index Fund (IYR)
iShares FTSE NAREIT Real Estate 50 Index Fund (FTY)
iShares FTSE NAREIT Industrial/Office Capped Index Fund (FNIO)
iShares FTSE NAREIT Mortgage Plus Capped Index Fund (REM)
iShares FTSE NAREIT Residential Plus Capped Index Fund (REZ)
iShares FTSE NAREIT Retail Capped Index Fund (RTL)

iShares international/global real estate index funds

iShares S&P Developed ex-U.S. Property Index Fund (WPS)
iShares FTSE EPRA/NAREIT Developed Real Estate ex-U.S. Index Fund (IFGL)
iShares FTSE EPRA/NAREIT Developed Asia Index Fund (IFAS)
iShares FTSE EPRA/NAREIT Developed Europe Index Fund (IFEU)
iShares FTSE EPRA/NAREIT North America Index Fund (IFNA)

Introduction

Real estate investments have long been viewed as an integral part of well-diversified investment portfolios, offering the potential for stable income and typically low correlations to traditional asset classes. Real estate has also been viewed as a potential hedge against unexpected inflation as increases in rent are expected to help protect against inflationary pressure and continue delivering strong cash flows.

Despite these distinctive advantages, until the advent of Real Estate Investment Trusts (REITs), the average investor or the small institution not equipped with the specific expertise required to buy, manage and operate large properties was unable to benefit. As publicly traded companies that own and operate commercial real estate, REITs opened the floodgates to simplified and tax-efficient property ownership.

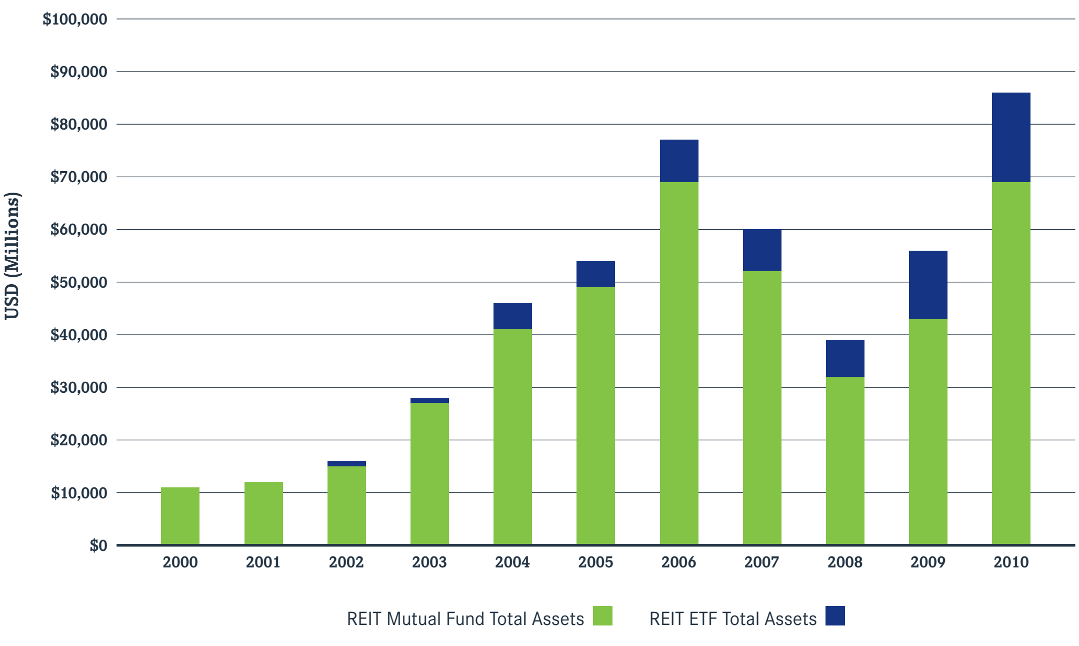
Spurred by low interest rates, loose lending and strong capital inflows, real estate prices in many developed markets surged so strongly from 2002 onwards that many investors came to believe they could not fall.

The financial crisis period of 2008–2009 quickly changed this notion. Property markets effectively fell apart as credit markets froze. Governments acted to stabilize credit markets and instill confidence in the markets with some success, but this period of turmoil serves as a reminder of investing risk.

Coming out of this period, many investors looking to maintain real estate allocations have moved towards alternatives such as REITs to complement their illiquid real estate portfolios. REITs accessed through diversified exchange traded funds (ETFs) have recently become especially popular among investors looking for more liquid access to real estate, particularly on a global basis. In this piece, we will touch on the following:

- REITs as an income-seeking investment
- REITs as a potential inflation hedge
- REITs as a diversification tool

Figure 1: Growth in REIT mutual fund and ETF assets



Sources: AMG, Citi Investment Research and Analysis, as of 12/31/10.

What are REITs?

Real Estate Investment Trusts are publicly traded companies that generate rental income through the ownership of commercial properties—from office skyscrapers and malls to industrial parks and storage facilities. For the individual investor, the cost of ownership of a REIT is generally quite low and much more liquid, simply purchasing traded shares compared to physical ownership. Favorable taxation benefits and typically high levels of dividend yield have made REITs an increasingly compelling complement and alternative to direct real estate investments.

The following characteristics generally apply:

- **Liquidity.** REITs offer investors the benefit of real estate investments, combined with the liquidity of publicly traded securities. Investors can expand the breadth of their portfolios rather quickly, compared to a more time consuming process of acquiring and managing properties.
- **Tax benefits** that produce potentially higher yield. REITs that meet listed requirements under each regulatory regime can qualify for favorable tax benefits. One such example is the availability of "flow-through taxes," resulting in exemptions that effectively afford REITs certain tax benefits as long as they distribute a certain level of its income to investors. By law, US REITs must pay out 90% of taxable income to investors, which provide the opportunity for likely higher yield.
- **Access to public markets.** As listed instruments, REITs can easily access public markets to raise equity and address immediate capital concerns. While the recent credit crunch caused financing to dry up for over-leveraged private property owners, US REITs were able to raise money through equity markets in 2010, with 173 offerings raising more than $47 billion.[1]
- **Real-time pricing.** Whereas physical property values are determined based on appraisals that are subject to revaluation lags, REITs offer pricing on a real-time basis.

Overview of REIT markets

According to FTSE, over 280 REITs globally create an approximately $825 billion market.[2] North America accounts for almost half of all listed REITs. The Asia-Pacific REIT market has matured quickly with a market share of 40%. The US was the first country to enact REIT regulations in 1960, with the intention of providing individual investors with the opportunity to invest in larger income-producing properties. While growth of publicly traded REITs has accelerated over the past two decades, the opportunity for further growth is substantial, as only 5.5% of commercial property in the world is owned by a publicly traded entity today, and just 22 developed countries offer REIT structures.[3]

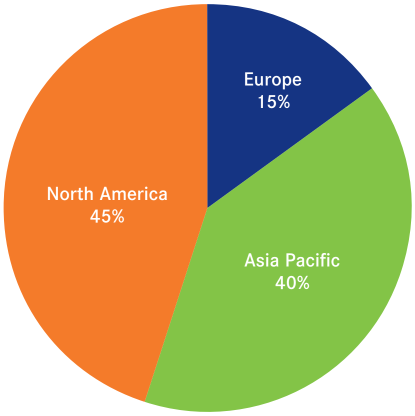
The REIT universe can be divided in a number of ways, but the most obvious is by operational focus. The majority of REITs own and manage a portfolio of properties for the purpose of generating rental income (equity REITs). Others focus on offering financing for commercial or private properties (mortgage REITs). Hybrid REITs engage in both activities.

Among equity REITs:

- **Retail REITs** include owners of malls and shopping centers, and benefit from higher barriers to entry and formidable construction costs.
- **Office REITs** are highly cyclical by nature, and office rents normally have longer lease terms than comparable properties in other sectors.
- **Industrial REITs** exhibit steadier and more predictable cash flows due to high renewal rates and low capital expenditure demands.
- **Residential REITs** typically invest in apartment buildings and multifamily complexes that are leased to individuals. Accordingly, they are exposed to the broad supply and demand dynamics of economic cycles with unemployment as a particularly important factor.

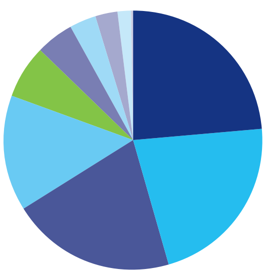
1. Source: NAREIT, as of 3/31/11; adjusted for free float. All dollar amounts in this document are in USD.
2. Source: FTSE, as of 12/31/10.
3. Source: NAREIT, as of 3/31/11. While there are some emerging markets that have approved REIT structures, the indices that iShares track include only developed countries.

Figure 2: Global REIT market capitalization



Sources: FTSE, BlackRock, as of 12/31/10.

Figure 3: Property sectors for Dow Jones US Real Estate Index (IYR)



Industrial & Office REITs	23.80%
Specialty REITs	21.88%
Retail REITs	20.56%
Residential REITs	14.44%
Mortgage REITs	6.73%
Hotel & Lodging REITs	4.78%
Real Estate Holding & Development	3.11%
Real Estate Services	2.85%
Diversified REITs	1.74%
Short-Term Securities	0.03%
Other/Undefined	0.07%

Source: iShares.com, as of 5/31/11.

Real estate's role in the recent financial crisis

While real estate was a significant factor in sparking the financial crisis, it is important to distinguish between residential real estate and publicly-traded REITs, which generally own and operate commercial property for both capital appreciation and generating rental income.

Brief review of some of the relevant causes of the crisis:

- Significant liquidity by the Fed, as well as other central banks, was poured into the economy post-tech-bubble burst and the 9/11/01 terrorist attacks through sustained low interest rates.
- With these lower rates and access to lending, there was heightened interest by investors to use leverage to get outsized returns, which led to more risk taking.

Lax lending standards and the proliferation of mortgage-backed securities led to the collapse of a residential housing market bubble and subsequent halt to lending in the fall of 2008.

It was a small subsection of REIT companies that actually experienced severe blows to their balance sheets—mainly those that invested in preexisting (and especially subprime) residential mortgages. While all REIT types struggled at varying degrees to weather the crisis as credit dried up, nervous investors shunned all things real estate—equity and mortgage REITs, US and international alike.

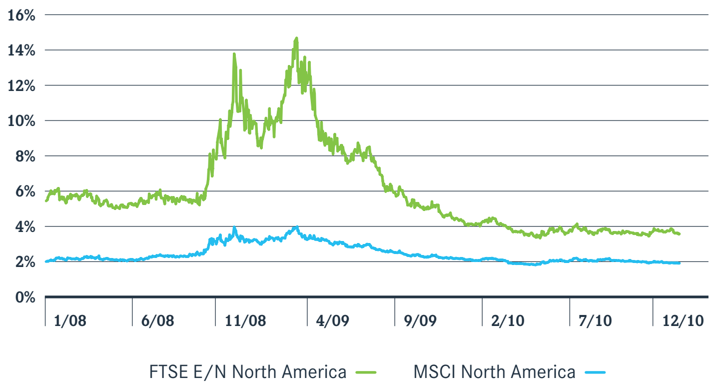
In fact, the financial crisis served to highlight one key advantage of investing in REITs over owning private property outright: liquidity. Despite the market volatility, investors were able to quickly liquidate positions if necessary, which could be quite difficult with other forms of real estate ownership.

REITs as an income-seeking investment

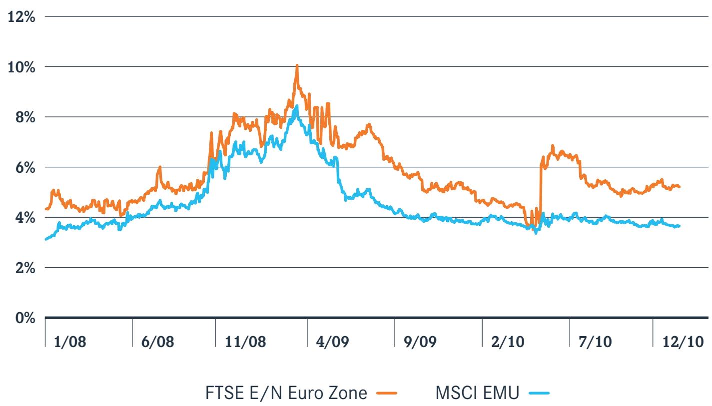
Due to unique regulatory requirements that dictate high levels of dividend distribution, as well as the consistent nature of typical rental income streams, REITs have been utilized as an income investment. Investors looking for steady income streams should also be aware that REIT dividends can be volatile. From 1993 to 2008, US REIT dividends grew rather steadily at a rate of 6% per year, before plummeting by 25% during the 2008–2009 financial crisis. REIT dividends bounced back quickly, and in 2010 alone they increased by 17% while the S&P 500 dividends only grew 1.5%. Expectations that these levels will return to historical averages, combined with higher indications of cash flow growth, have resulted in projected dividend growth rates for US REITs from 2011 to 2015 to be 9.5%.[4] While REIT investors tend to focus on the US due to the sheer size of the market and its dominance in the sector worldwide, dividend yields exhibit remarkable variation across geographic regions. Current yields, coupled with expectations of continued dividend growth, should arguably be considered when evaluating REIT investments globally.

Figure 4: Rolling 12-month dividend yields

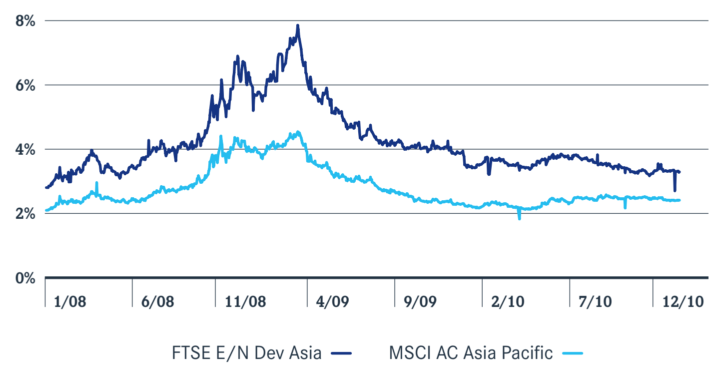
North America



Europe



Asia Pacific



Sources: Bloomberg, BlackRock, as of 12/31/10. **Past dividend yields are not indicative of future results.**

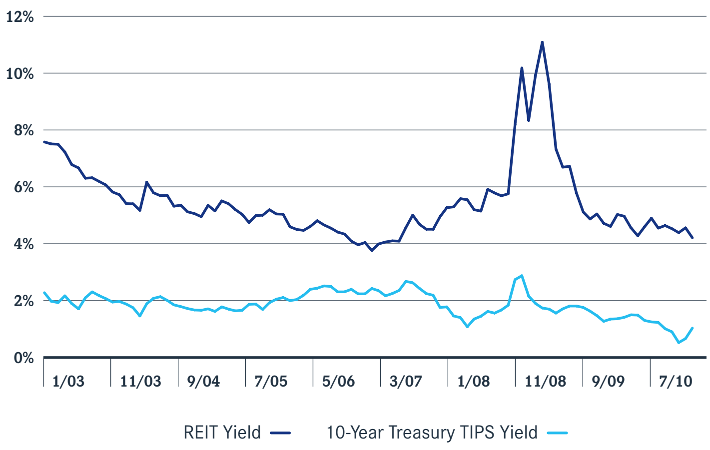
4. Sources: FTSE NAREIT, Cohen & Steers, as of 12/31/10. There is no guarantee that dividends will be paid.

REITs as a potential inflation hedge

REITs have historically paid steady streams of dividends over time, and impressively have done so at a pace faster than rising rates of inflation. Unlike fixed income instruments whose prices will fall with rising rates, due to the fact that REITs derive the majority of their incomes from rental streams, these payments tend to rise alongside inflation and consumer prices. Historically, a comparison of data from NAREIT and the Bureau of Labor Statistics reveals that US REIT dividend yields have indeed exceeded inflation as measured by the Consumer Price Index (CPI) every year since 1990 (see Figure 5).[5]

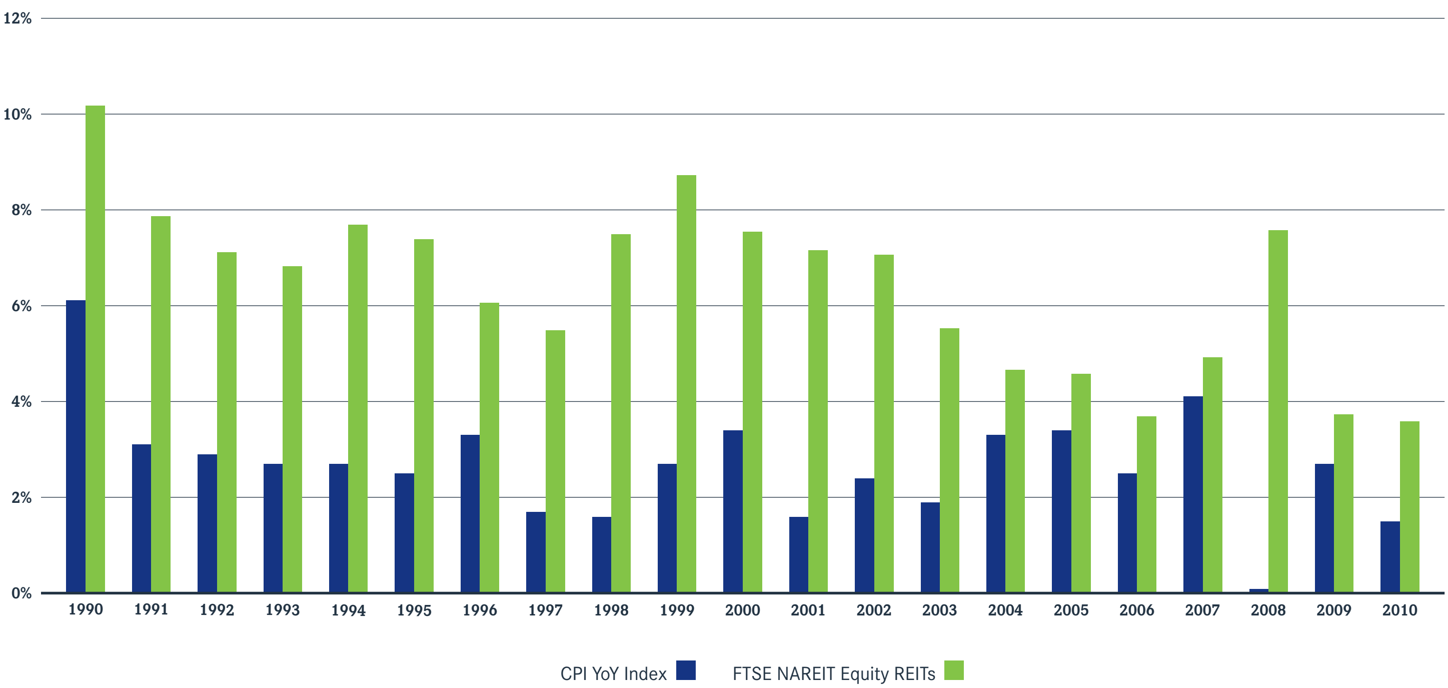
REIT dividend yields hit a high of 10.3% in January 2009, during a period when funding was badly needed by the REIT universe and REITs were willing to pay investors for equity capital. While REIT dividend yields are no longer at historic highs, they have been and still are well above 10-year Treasury TIPS, which are marketable US Treasury securities that have their principal values adjusted according to changes in the US CPI (see Figure 6).

Figure 6: US REIT dividend yield vs. TIPS yield



Sources: Bloomberg, NAREIT, BlackRock, as of 12/31/10. **Past dividend yields are not indicative of future results.**

Figure 5: Equity REIT dividend yields have outpaced CPI (1990–2010)



Sources: Bloomberg, NAREIT, BlackRock, as of 12/31/10. **Past dividend yields are not indicative of future results.**

5. Sources: NAREIT, Bureau of Labor Statistics, as of 2010. **Past dividend yields are not indicative of future results.**

REITs as a diversification tool

Real estate (and other real asset) investments are generally expected to act somewhat differently than other investments in a portfolio. An examination of historical correlations across asset classes and geographic regions indicates potential diversification benefits for REIT investors. Correlations measure essentially how much one asset class moves in proportion to another—ranging from 1.0 (moving in lock step) to –1.0 (moving in the complete opposite direction). REIT indices focused on North America (and dominated by US REITs) exhibit historical varying correlations to other asset classes, which could help in building a diversified portfolio. For example, compared to the fixed income benchmark, the correlation is quite low at only 0.13 (highlighted in Figure 7) versus the REIT index, but it is higher for other equity asset classes.

Further, the risk/profile of each geographic region is sufficiently distinctive that investors could reap additional benefits from diversifying geographically.

Figure 7: 10-year correlations based on monthly returns

	Dow Jones U.S. Real Estate Index	S&P 500 Index	Russell 2000 Index	Barclays Capital U.S. Aggregate Index	MSCI EAFE Index	MSCI Emerging Markets Index
Dow Jones U.S. Real Estate Index	1.00					
S&P 500 Index	0.68	1.00				
Russell 2000 Index	0.75	0.89	1.00			
Barclays Capital U.S. Aggregate Index	0.13	–0.08	–0.12	1.00		
MSCI EAFE Index	0.66	0.89	0.82	0.02	1.00	
MSCI Emerging Markets Index	0.58	0.82	0.79	0.02	0.89	1.00

Sources: Bloomberg, NAREIT, BlackRock, as of 12/31/10.

Figure 8: Correlations among regional REIT indices (July 2007–2010)

	FTSE EPRA/NAREIT Developed Europe Index	FTSE EPRA/NAREIT Developed Asia Index	FTSE EPRA/NAREIT Developed Real Estate ex-U.S. Index
FTSE EPRA/NAREIT North America Index	0.26	–0.02	0.11
Dow Jones U.S. Real Estate Index	0.31	0.01	–0.16

Sources: Bloomberg, BlackRock, as of 12/31/10.

Utilizing REITs in a portfolio

Given all of the reasons outlined above, many investors wonder how to employ REIT exposure in a diversified portfolio. There are a number of ways to and there are certainly active fund managers who can outperform REIT indices—even once fees and taxes are considered—but it is important to understand fund managers' philosophies and track records to assess their ability to consistently deliver outperformance to a benchmark index. Over multiple time windows for performance, the S&P BMI US REIT index outperformed the majority of active REIT funds.[6]

So, when finding a skilled fund manager is difficult or cost-prohibitive, a blended strategy featuring cost- and tax-efficient iShares® ETFs can help better track index performance and reduce active risk.

Know the differences

While iShares ETFs and mutual funds each hold a basket of securities and are obliged to distribute gains to shareholders, some key differences do exist.

iShares ETFs

- iShares ETFs trade on exchanges intraday at market price, which may be greater or less than net asset value.
- Shares of iShares ETFs are not individually redeemed from the fund.
- Transactions in shares of iShares ETFs result in brokerage commissions and generate tax consequences.
- Shares index ETFs are passively managed; they seek to track a market index, before fees and expenses, and do not attempt to outperform during rising markets or to take defensive positions in declining markets. Performance may diverge from the ETF's underlying index.

Mutual funds

- Accessed directly from the fund company or through a select broker.
- Pricing generally occurs once a day.
- Investors buy or redeem shares at the end-of-day net asset value, less any applicable fees.
- May charge sales loads or redemption fees.
- Most are actively managed, seeking to outperform market indexes.
- Active funds typically charge more than index-linked products for the increased trading and research expenses that may be incurred.

6. Source: SPIVA U.S. Year-End 2010 Report. **Past performance does not guarantee future results.**

Conclusion

REITs offer investors an innovative way to access real estate markets, and ETFs build upon this flexibility and liquidity by introducing an additional element of diversification. The main advantages of REITs for an investment portfolio include:

- **Potential income.** Due to the unique regulatory environments which make REIT industries possible in a given jurisdiction, REITs are generally required (or otherwise favorably treated) to distribute the vast majority of income in the form of dividends.
- **Potential inflation hedge.** REIT dividends have historically outpaced inflation because of their ability to raise rents as needed.
- **Diversification.** REITs have exhibited reasonably low historical correlations to traditional asset classes, and the characteristics of regions and sectors are sufficiently diverse such that investors have a reasonable selection of diverse markets to choose from.

Through targeted, index-tracking exposure, iShares ETFs can be effective tools to strategically hold and/or actively access specific real estate sectors or geographic exposures.

Figure 9: Strategic applications for iShares REIT ETFs

Market Exposure	Implement your outlook on	Potential iShares REIT Index Fund Solution
US Real Estate	▸ Interest rates ▸ Potential inflation hedge	IYR, ICF, FTY
US Real Estate Sectors		
Office/Industrial	▸ Economic growth	FNIO
Mortgage	▸ Mortgage interest rates	REM
Residential (Apartments)	▸ Unemployment ▸ Supply/building	REZ
North America	▸ Economic growth	IFNA
Global Real Estate	▸ Growth expectations globally are higher than in US (driven by demographics and/or infrastructure spend) ▸ Diversifying US dollar exposure	WPS, IFGL, IFAS, IFEU

For more information visit www.iShares.com or call 1-800-474-2737

Carefully consider the iShares Funds' investment objectives, risk factors, and charges and expenses before investing. This and other information can be found in the Funds' prospectuses, which may be obtained by calling 1-800-iShares (1-800-474-2737) or by visiting www.iShares.com. Read the prospectus carefully before investing.

Investing involves risk, including possible loss of principal.

In addition to the normal risks associated with investing, international investments may involve risk of capital loss from unfavorable fluctuation in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations. Narrowly focused investments typically exhibit higher volatility. REIT investments are subject to changes in economic conditions, credit risk and interest rate fluctuations. International real estate is subject to the status of its local economy. Diversification may not protect against market risk.

Investment comparisons are for illustrative purposes only and are not meant to be all-inclusive. To better understand the similarities and differences between investments, including investment objectives, risks, fees and expenses, it is important to read the products' prospectuses.

The strategies discussed are strictly for illustrative and educational purposes and should not be construed as a recommendation to purchase or sell, or an offer to sell or a solicitation of an offer to buy any security. There is no guarantee that any strategies discussed will be effective.

The iShares Funds ("Funds") are distributed by SEI Investments Distribution Co. ("SEI"). BlackRock Fund Advisors ("BFA") serves as the investment advisor to the Funds. BFA is a subsidiary of BlackRock Institutional Trust Company, N.A., neither of which is affiliated with SEI.

The iShares Funds are not sponsored, endorsed, issued, sold or promoted by Cohen & Steers Capital Management, Inc., Dow Jones Trademark Holdings, LLC, European Public Real Estate Association ("EPRA®"), FTSE International Limited ("FTSE") or Standard & Poor's. None of these companies make any representation regarding the advisability of investing in the Funds. Neither SEI, nor BlackRock Institutional Trust Company, N.A., nor any of their affiliates, are affiliated with the companies listed above.

Neither FTSE nor NAREIT makes any warranty regarding the FTSE NAREIT Real Estate 50/Residential/Retail/Mortgage or Industrial/Office Index; all rights vest in NAREIT. Neither FTSE nor NAREIT makes any warranty regarding the FTSE EPRA/NAREIT Developed Real Estate ex-US/North America/Europe/Asia Index; all rights vest in FTSE, NAREIT and EPRA. All rights in the FTSE Developed Small Cap ex-North America Index vest in FTSE. "FTSE®" is a trademark jointly owned by the London Stock Exchange Plc and The Financial Times Limited and is used by FTSE under license.

FOR FINANCIAL PROFESSIONAL USE ONLY— NOT FOR PUBLIC DISTRIBUTION

Not FDIC Insured • No Bank Guarantee • May Lose Value

iS-4642-0711