REIT 2024 Review & 2025 Outlook

REIT Outlook 2025 – A Stable Environment for Steady Returns

Executive Summary:

- **2025 Return expectations** –We expect REITs will generate 8-10% total returns in 2025, approximately half comprising of a cash dividend yield of ~4%. REITs are on track to generate about 12% total returns over 2024. This is ahead of our forecast of +8-10% for Y24 a year ago. For 2025, we assume economic growth will grow at ~2.0-2.25%, similar to Y24 growth. We expect inflation may remain 'sticky' and constrain the Fed from reducing rates below 3.5-4.0%. (See "Key Macro-Economic, Stock Market Assumptions" in the Appendix below). We believe REITs will produce Y/Y earnings growth of 4-6%, pay a ~3.5-4.0% cash dividend yield and that the earnings multiple will remain largely unchanged/possibly expand a little Y/Y to reflect lower interest rates.
- **Earnings growth –** Over 2025, we assume earnings for most REITs will be largely supported by modest income increases derived from space demand and little new supply. As an offset, there will continue to be upward pressure on operating expenses and from increased debt costs. Some REITs may generate incremental gains from acquisitions. Development gains are likely to be limited.
- **Dividends** – The current 3.5% REIT sector dividend yield is 3x the yield of the S&P 500 Index (1.2%) and roughly 85% of the current 10Y UST yield. We continue to believe REITs over the medium-longer term, will raise their dividends at 5% per annum, broadly consistent with our cash flow growth expectations for the sector. All while raising return and lowering volatility in the typical stock and bond portfolio.
- **Fund Flow** – REITs are on track to raise ~$85bn of capital in 2024, roughly 40% more than the $62bn they raised in 2023. Approx two-thirds of the capital raised YTD has been debt while soft share prices have suppressed equity issuance. Private Equity Real Estate funds have attracted reduced inflows but retain 'dry powder' (untapped money) to spend. We think many long-term investors will maintain CRE investment.
- **Principal Assumptions and Risks** – We assume Y25 GDP Y/Y growth will be ~2.0-2.25%, unemployment will remain in the low/mid-4%'s, PCE Core inflation will decline to ~2.5-3.00% by YE25 and the Fed will reduce FFR to 3.75-4.25% by YE25. We regard the major risks to sector stock performance to include **inflation** that persists at elevated levels and

the Fed may maintain **restrictive monetary conditions** (interest rates and bond sales); and the availability/price of **debt** could be a limiting factor. A **recession** seems unlikely but would depress space demand. **CRE/REIT stock valuations** (specifically cap rates) may be perceived as not being reflective of 'true' market conditions. Excessive new development is commonly a cause of cyclical property risk but is a low probability at present.

Comment:

Property markets over 2024 have been supported by positive fundamentals. New supply has been limited while space demand for most property types has reflected the growth of the economy/job gains. By contrast, there has been an increase in Sunbelt apartments construction and a slow office Return-To-Work which has keep office rental demand generally depressed. Investment activity has increased from low levels over recent years as the prospect of lower interest rates has induced some optimism. The still relatively modest number of investment transactions means it can still be quite challenging to peg property valuations, but it does appear that cap rates have largely stabilized at least for better quality properties. The Fed has reduced FFR by 75bps since September 2024 and has indicated they could reduce further rates over 2025. **If our macro prediction for 2025 of solid economic growth with modest easing of monetary policy is right, then a reasonable case for improved space demand (and hence property income) and higher property/REIT valuations can be made.**

Ten Big REIT Themes for 2025

- **Economic Growth, Inflation and Interest Rates** will continue to be dominant themes for all investors. There is unusual uncertainty about the economic outlook for the next year ranging from higher growth, declining inflation and lower rates to stagflation. REITs are sensitive to macro-economic factors, in particular interest rates (cap rates – asset prices and the cost of capital) and interest rates are reflective of inflation. Lower inflation, absent a recession/slow-down, would be a general positive for REIT stocks and conversely, higher inflation would mean higher rates and would be a general negative.

- **Property Debt Markets to Open Further** – Unsecured debt and CMBS markets have been open and active over 2024 while Regional Banks and other typical whole loan mortgage lenders have been subdued. Further improvement in the economy should boost the appetite for risk and help to broaden lender participation in CRE.

- **Space Demand** from growth in employment should1 be the principal focus in the absence of much new supply for most property types in most markets. The much

unloved office sector should see some modest improvement as ~50% Return-to-Office numbers slowly go higher. We do believe in a solid recovery over time, but no one should be holding their breath.

- **Sub-sector Divergence.** The medium-longer term performance dispersion between the REIT sub-sectors continues to be marked. We think the rate of change of earnings has become a big factor. Economic growth will drive additional space demand that should benefit all landlords, with shorter lease owners seeing revenue/earnings gains first.

- **More REIT IPO's** - Lineage (LINE) $4.4bn IPO was the biggest yet in REIT-land – it will encourage others to contemplate 'going public' if stock prices stay up.

- **Acquisitions/Development** – Given a favorable cost of capital, REITs are well placed to pursue accretive acquisitions. Development activity by the REITs appears likely to gradually increase.

- **M&A Activity** appears likely to continue albeit at reduced levels while debt markets remain tighter than the pre-2021 era. The appeal of consolidation - scale considerations among the public companies will continue.

- **Insurance and Climate Risks Gain Even More Prominence** – Insurance costs have been rising and appear likely to escalate further. Greater attention will be paid to areas of greatest risk to climatic events. Properties in states including Florida, Texas and California which have enjoyed long-term boom property market conditions, look most at risk.

- **Cash Flow Growth** (not Net Asset Value) we believe will remain the principal driver of stock performance with the incremental buyer/seller of REITs being the general investor versus the REIT dedicated crowd.

- **Private Equity RE/Non-Traded REITs 'Past Peak'** A higher rate environment has seriously challenged these business models that were significant beneficiaries of the ultra-low rate/low cap rate environment of the 2010's. We think they need to build up their operational abilities and lower return expectations. Questions about valuations, leverage, risk, high fees, and lack of liquidity remain. *Modest debt levels and management with strong operational and redevelopment abilities are more commonly found in public REITs.*

REIT Earnings

In 2024 REITs produced modest earnings growth from rents and solid occupancy offset by increased operating expenses and higher interest costs. REIT earnings growth over 2024 are on track to be 3-5% Y/Y. The best growth has come from Industrial and Shopping Centers and the weakest from the Office and Cell Tower companies. Looking into 2025, subject to generally positive macro conditions, Y/Y earnings growth could match/modestly exceed 2024. We believe, Industrial and Datacenter earnings should be solid as should Retail while growth for Apartments and Storage will likely be more modest though still positive, both should offer better growth prospects in 2026. Offices, a small sub-sector in the REIT market, looks likely to produce further negative earnings change. Cell Towers seem likely to be flat pending an improvement in 2026. **At this time, we think overall Y/Y REIT earnings growth in 2025 will be 4-6%.**

Dividends

Given the REIT pay-out rules, dividends will largely grow at the rate of earnings growth (or higher). As we expect earnings to grow in 2025, dividends can be expected to increase at least at a broadly similar pace. Over the medium-long term, we think overall REIT earnings growth will be of the order of ~5% and we can expect dividends will grow at a similar/slightly higher rate. Some REITs have racked up some notable dividend payment records over many years: Realty Income (O) has paid a monthly dividend without a break 653 times (that's over 54 years), Federal Realty (FRT) has increased its quarterly dividends every year for the last 57 years and more recently over the last decade, sector giants Prologis (PLD) has raised its dividend on an 11% CAGR and American Tower (AMT) 20%. We note, that at **5% the long-term REIT dividend growth is double the rate of annual expected inflation that many economists forecast.**

Fund Flow into Property

The performance of public debt and equity markets in 2024 seems likely to prompt many institutional investors to look to rebalance their portfolio asset allocations (aka the denominator effect) for next year. It seems likely that higher yields from UST and IG debt will attract increased allocations. We think investors should be cautious about investing in Alternative/Private investments where valuations/future returns are questionable, and liquidity is frequently limited. CRE/PERE falls into the Alternative bucket for many investors, and we expect some will curb their new commitments and others to actively sell. That said, CRE's 'inflation hedging' characteristics may gain broader recognition. Over the longer term, we expect institutional allocations to CRE (both equity and debt in REITs, PERE, Direct) to remain steady at around 10-12%.

Capital raised by REITs in 2024 through the end of September, has totaled $65bn - on track for ~$85bn for FY24 which would be 40% above that raised in 2023 and the highest total since 2021. Quarter end September 2024, there has been $41bn of unsecured debt raised and $24bn equity. REIT's have typically been seeking long term, fixed rate unsecured debt with the rate in

the 5%'s, approximately 200bps above expiring debt. Some notable issuance includes: Realty Income (O) $1.25bn blended 8.3 years at 4.99%, Alexandria (ARE) $1bn blended 23Y at 5.5%, Boston Props (BXP) $850m 10Y at 5.75%, Simon (SPG) $1bn 10Y at 4.75% and American Tower (AMT) $1.2bn, blended 7.5Y at 5.2%. New issuance in the CMBS market has picked up - $42bn was raised 1H24 (80% Floating Rate), higher than that raised over Y23. Loans with special services/delinquencies have moved up a little and there have been some specific problems with Single Asset/Single Borrower office deals.

In the secured (mortgage) debt market, there continue to be some concerns related to the price and availability of new loans with high volume of debt maturing annually over the next few years and the regional banks being big lenders. Office loans unsurprisingly have been the most problematic. There have been some instances of borrowers 'handing back the keys' but with many banks reluctant to take back the properties, this has meant forbearance. There is $500bn/year of property debt maturing over the next three (3) years so the challenge will not go away. It seems likely there will need to be debt 'work-outs' involving write-downs, extensions, cash injections and distressed sales over the next few years. This may be an area of acquisition opportunity for well-funded REITs.

Prudently, many REITs had taken advantage of the years of low rates to lock in much of their debt at fixed rates for extended duration. Many REITs have locked in low rates with extended maturities and reduced variable debt over recent years which gave them some protection against the rise in interest rates experienced over recent times. REIT balance sheets are at comparatively low leverage levels with ample 'dry powder' to do deals.

New institutional commitments to North American **Private Equity Real Estate (PERE**) funds have declined YTD to $77bn approximately half the historic high of $155bn in 2021 according to Preqin. At 1Q24, there was $1tr US PERE AUM including $345bn/quarter of 'dry powder' (assuming leverage of 60% implies they have in excess of $750bn of spending power). We think a greater portion of future investment may be directed more towards debt. We have expressed the view that we believe PERE is 'Past Peak' (see Uniplan Whitepapers – June 2022) meaning that future returns are very unlikely to approach the returns generated by many PERE funds over the last decade.

Non-Traded REITs (BREIT, SREIT and others) as an alternative to publicly traded REITs have enjoyed considerable support from retail investor inflows over recent years. They 'gated' (limited) investors from selling their stock over 2023/24 as redemption requests exceeded monthly limits. BREIT has lifted the limit; SREIT has left its limit in place. Retail investors have been learning of the value of stock liquidity the hard way. These investment vehicles, like **Private Equity Real Estate (PERE),** thrived during the 'free money' era (2008-2021) but are likely to be challenged in a higher rate environment. Their business models look less likely to generate attractive risk-adjusted returns in the future than they did in the past. We largely attribute the continued support from some institutional investors for PERE fund investment to the forces of inertia and lack of diligence and the sales prowess of large private equity platforms.

Mergers & Acquisitions/CRE Transactional Activity

Transactional activity including M&A has increased over 2024 from subdued 2021-23 levels. This reflected some improvement in debt availability/cost and CRE price stabilization. That said, there were few Public-to-Public deals and only a handful of Public-to-Private transactions as public REIT Boards and PERE funds remained generally cautious. Most public consolidation deals are driven by access/cost of capital, elimination of G&A of one of the companies and maybe some scale benefits. We anticipate there will be more M&A merger activity in the sector in 2025. PERE can be expected to be more active as debt markets improve. Blackstone (BX) has been active both buying and selling portfolios/companies: it acquired two public companies – national apartment company AIR Communities (AIRC) for $10bn and West Coast shopping center company Retail Opportunity (ROIC) for $4bn. They sold a $1bn So CA warehouse portfolio to Rexford (REXR) and a $1bn sunbelt apartment portfolio to Equity Residential (EQR). Additionally, we note KKR's acquisition of a Single-Family Residential portfolio for $2.1bn from Lennar (LEN).

Acquisitions by the REITs have picked up over 2024 as sellers have adjusted down their prior price expectations and the REIT's cost of capital has made them competitive buyers. There have been limited 'distressed selling' this cycle with arguably more opportunities on the debt rather than on the equity side. The Triple-net REITs have continued to be active acquirers and have maintained impressive discipline on pricing. The EQR and REXR deals are referenced above, and we also note Welltower (WELL) purchase of a $1bn Senior Housing portfolio. The REITs look well placed to be active buyers in 2025 assuming their cost of capital remains favorable.

Development activity has been at a low level with few projects penciling out with current rents and increased costs. Obtaining debt finance has been challenging. Looking into 2025, we think some REITs will begin to increase their development programs based on improved optimism about the outlook in 2026/27. We continue to think selected redevelopment activities from their existing portfolios will continue and generally offer attractive returns for those companies with the ability to manage the activity.

Some large investors with a long term perspective continue to selectively show an interest in partnering on development/investment deals – SL Green (SLG) and Japan's Mori Trust have an office JV at 245 Park Ave (total $2bn/$1,200psf), Boston Properties (BXP) and unnamed institution in 343 Madison Ave (~1m sf office by Grand Central), Digital Realty (DLR) has formed a number of JV's to develop datacenters, and American Homes 4 Rent (AMH), Invitation Homes (INVH) and UDR (UDR) for residential investment ventures.

Leading Sub-Sector Commentary

The stock performance of **Datacenters and Cell Towers (21%/Index by equity market capitalization at end Sept, '24)** has seen both perform generally in line with the sector YTD. This follows a notably strong performance by Datacenters over 2023. General investor enthusiasm for all things related to AI, Datacenters included, has persisted albeit at a slightly less frenzied pitch while Towers have been regarded as rather oversold. There are some hopes that the telephone carriers will increase capex spending – related to 5G build-out – which

should help push up Tower's growth prospects over the medium term. **Industrial/Distribution space** (13%/Index) demand led by e-commerce and generally modest new supply continues to support positive fundamentals. There have been some concerns about decelerating demand/rent growth from elevated levels and specifically softness in the big Southern California market. **Collectively, the tech-related, Cell Towers, Datacenters and Industrial/Distribution companies had a weighting of 34%/Index**.

Retail (15%/Index) property has continued to experience a solid rebound from the Covid induced woes of 2020. Consumer spending has been brisk and there has been a return to the physical stores. With virtually no new supply of new properties over recent years, retailer demand for space in the better performing properties has been strong for quality shopping centers, malls and stand-alone/triple-net properties. We think competition from e-commerce will continue to increase: on-line sales currently represents about 15-16% of total retail sales and has been growing at approximately 3x the rate of overall sales. Many retailers have adapted to 'omni-channel' models combining e-commerce and physical stores. We think the best retail properties will do well but pressure will persist on many tertiary and secondary quality properties.

Residential rental property with a **14% Index weighting** continues to be regarded as a stable and resilient property type. We continue to think overall residential supply (New Starts approximately 1.3m annualized and limited supply of Pre-Owned For Sale) falls far below need/demand. Strong Home Price gains (>5%/Y) and mortgage rates (>6%) continue to pressure affordability which has supported solid renter demand. Growth in labor markets and personal incomes have also boosted demand. In some locations, mainly in the sunbelt, there has been increased new supply which has been largely absorbed. The current dearth of construction loan finance from the regional banks would suggest it is likely there will remain a shortage of new supply over the next 2-3 years.

Other sub-sectors of note that individually represent less than 12% of the Index include: **Healthcare** properties continue to present a somewhat mixed picture: Senior Housing has continued to rebound from its over-supplied/Covid period. It does have the locked-in demographic tailwind driving long term demand. Life-science/ Medical Offices Buildings have seen a softening of demand and some new supply concerns. **Self-Storage** has proved to be a cyclically resilient property type. Current operational/earnings performance is decelerating back towards longer-term trends after the Covid-related spurt. **Offices** have been negatively impacted by a slow Return-to-Office/tenant space demand and by worries about debt refinancing. There is good demand for the very best highly amenitized properties, but the broader challenges faced by offices seem likely to persist for some time. Many **Lodging** properties have recovered from Covid setbacks with rebounding leisure travel. Business travel has been slower to recover. The **Gaming REITs** which have been included in the Specialty sub-sector, continue to attract investor support. These companies have been among the most

active deal makers over recent times. Their activities including some interesting development funding/option to buy agreements with entertainment/leisure operators.

Conclusion

We have a relatively positive stance on the performance prospects of REIT stocks over 2025. Looking to next year and assuming solid economic growth, modestly lower inflation and interest rates, the outlook for REITs appears favorable. REIT income should increase driven by space demand and property pricing should stabilize/improve with lower rates. New supply of properties can be assumed to be limited in most cases. The long-term appeal of REIT's secure dividend yield and their diversification characteristics may generate more investor interest. REITs are on track to turn in a solid, high single-digit total return over 2024 which would be a marked improvement over the prior couple of years. We assume they can deliver much the same over 2025 and possibly better.

December 2024

David Harris
Richard Imperiale

Appendix

Key Macro-Economic, Stock Market Assumptions

US economy GDP 2.0-2.25%. Consumer spending remains solid.

Unemployment - low-mid 4%'s.

Inflation does decline but slower than some expect (Core PCE 2.5-3.0% by YE24) & the Fed will be limited to a shallow rather than deep reduction of FFR (we expect ~3.75-4.25% by YE25).

UST/Bonds Real yields remain positive supporting yield orientated investments. Nominal yields stabilize. Normalization of the US Yield Curve driving the UST10Y yield higher over 1H.

Corporate (SPX EPS) earnings growth after ~10% Y/Y growth in Y24 to repeat at ~10%. Other than tech, sales/revenue growth is largely positive but higher operating costs and interest rates pressurize margins and there are FX headwinds.

Stock market valuations remain historically elevated but increased visibility and confidence about growth prospects into 2026 should help validate prices later in year. Uncertainty on fiscal/regulatory policy should dissipate. Much attention will be focused on Big Tech (Mag-7,

Fab-5, etc) but stretched valuations and potential growth concerns may mean more volatility. Boring old Cyclicals, Manufacturing, Energy (and REITs) should catch a bid.

CRE regains more attention as total return/higher yield options are limited. There is little new development and the prospect of better tenant space demand in 2025/2026. REIT earnings growth is relatively modest in 2025 but should accelerate in 2026.

The views in this letter were as of December 2024 and may not necessarily reflect the same views on the date this letter is first published or any time thereafter. These views are intended to help shareholders in understanding the fund's investment methodology and do not constitute investment advice.

All references to debt issuance, deals, etc., by individual REITs are sourced from Company Reports (typically press releases available on corporate websites and filings such as 10-K, 10-Q, and 8-K).

All investments carry a certain degree of risk, including possible loss of principal. Past performance does not guarantee future results. REITs are subject to illiquidity, credit and interest rate risks, as well as risks associated with small and mid-cap investments. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style. Value style investing presents the risk that the holdings or securities may never reach their full market value because the market fails to recognize what the portfolio management team considers the true business value or because the portfolio management team has misjudged those values. In addition, value style investing may fall out of favor and underperform growth or other style investing during given periods. Real estate poses certain risks related to overall and specific economic conditions as well as risks related to individual property, credit an interest rate fluctuation. Real estate companies and REITS may be leveraged, which increases risk. REIT performance depends on the strength of the real estate markets, REIT management and property management which can be affected by many factors, including national and regional economic conditions.

Uniplan Investment Counsel, Inc. ("Uniplan") is an independent investment adviser registered under the Investment Advisers Act of 1940, as amended. Registration does not imply a certain level of skill or training. More information about Uniplan including our investment strategies, fees and objectives can be found in our ADV Part 2 which is available upon request. The views expressed contain certain forward-looking statements which can be speculative in nature. Uniplan believes these forward-looking statements to be reasonable, although they are forecasts and actual results may be meaningfully different. This material represents an assessment of the market at a particular time and is not a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding any particular security and is subject to change without notice. Prices, quotes and other statistics have been obtained from sources we believe to be reliable, but Uniplan cannot guarantee their accuracy or completeness. All expressions of opinion are subject to change without notice. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of this security. This information is not an offer to buy or sell a security nor does it constitute investment advice or an offer to provide investment advisory or other services. All information is subject to correction or change. A list of securities purchased and sold in the portfolio during the past year, including the purchase or sale price and the current market price, is available upon request by calling 262-534-3000.