1Q24 REIT Review/Outlook

Executive Summary

REITs underperformed the broader market during the quarter. Publicly traded REITs continue to trade at a substantial discount to their net asset value (NAV) versus the private market values of their portfolios. It is our forecast that these discounts are bottoming and will begin to narrow as REIT valuations move up and private market values adjust to the generally higher cost of capital and lower leverage environment. Recent transactions, such as Blackstone's acquisition of apartment owner AIRC at a 25% premium to its prior closing price support this thesis. We have been firmly in the 'higher for longer' camp as it relates to the Federal Reserve ("Fed"). As the higher for longer macro eases, arguably later this year, we expect the REITs to attract greater interest from both general investors looking for durable and growing income streams and private buyers, like Blackstone (BX), looking to deploy the record level of capital they have recently raised.

REITs Post Slight 1Q Losses
Underperform vs the Overall Market, 1Q

REITs (Primary Benchmark Index[1]) generated a -1.3% Total Return over 1Q. The equity market (SPX) ended 1Q24 at 5,254.4, generating 10.6% Total Return over the quarter. The UST10Y yield closed at 4.20%, up 32bps over 1Q, the UST2Y yield closed at 4.59%, up 35bps. These broader market moves reflect a change in the narrative over 1Q from modest economic/corporate earnings growth and several cuts in interest rates to higher economic/earnings growth and three or less rate reductions.

Equity performance continued to be led by mega-cap tech stocks – arguably reduced to the Fabulous 4 (AMZN, NVDA, META, MSFT) from the Magnificent 7 (Fab 4 plus AAPL, GOOG, TSLA). The SPX and NASDAQ Indices both hit all-time highs late in 1Q. Though AI enthusiasm continued unabated, there was some encouraging widening (non-tech, smaller companies) of the bull market in stocks.

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[1] Primary Benchmark Index: Prior to 12/31/2023, the benchmark index was the FTSE NAREIT All Equity Index; thereafter, a custom benchmark that uses the 150 largest market capitalization companies. In creating a custom benchmark Uniplan applies a screening tool utilizing a KPI REIT universe. From there, Uniplan uses the 150 largest market capitalization companies. Basic exclusions from this universe include Commercial Real estate services & brokerage, real estate investment & services, and all Mortgage REITs. Uniplan reserves the right to remove a company from the custom benchmark for any or no reason at all. The Primary Benchmark is rebalanced quarterly and includes the reinvestment of dividends. It is not possible to invest directly in an index. The index figures do not reflect any deduction for fees, expenses or taxes.

Markets have embraced hopes of an economic 'soft/no landing'. The Fed with its most recent Statement of Economic Projections (March 2024) raised its Y24 expectations of economic growth, employment, inflation at the same time as reiterating its 3 times, 25bps rate cuts this year. UST yields have increased while the Yield Curve has flattened/partially dis-inverted, Break-evens remained little changed with the US10Y Real Yield that has been around 200bps for much of 1Q.

Inflation and the Labor Market have remained points of focus over 1Q24. Inflation as measured by CPI (Headline) has declined from 6.5% in Dec 2022 (9.1% peak June 2022) to 3.5% in March 2024 with Core PCE down to 2.8% Y/Y in February but has shown signs of being 'sticky' rather than declining this year. The jobs market has shown little signs of cooling with 829k jobs gained over 1Q (276K average per month) with unemployment at 3.8% at the end of March and Y/Y Wage gains of 4.1%. There were 1.4 openings per unemployed as per the March BLS Monthly data and February JOLTs report. The Fed has been on 'pause' with FFR at 5.25-5.50% since Sept 2023.

Concern about the stability of the medium sized banks and the availability of credit flared up again with New York Community Bank (NYCB). Worries have focused on the smaller-mid sized banks – generically called Regional Banks – which are disproportionally important to property lending. Regionals own two-thirds of CRE loans and 38% of all loans. There are ~$500bn of mortgages maturing each year over the next 3yrs. The cost of borrowing has doubled from levels a year or two ago and for many, loans will be harder, if not impossible to obtain. The office sector has been the most negatively impacted, other property categories less so. Offices comprise less than 5% of the Primary Benchmark Index of public REITs by equity market cap.

Investors have remained cautious about investing in REITs over 1Q24 with worries about their sensitivity to interest rates and bank lending to the sector. The challenged state of the CBD office market has continued to generate plenty of news headlines and the increase of multifamily unit development has been noted. There is uncertainty about the extent property prices have adjusted to market clearance level. While the physical asset market does take time to reset, the public markets react much more in real time. **It is reasonable to think that since the Fed started raising rates two years ago and now seems likely to hold/reduce rates in the near-medium term, much of the property price corrections are behind us.** Over time, we think investors will re-focus on REITs' steady earnings/dividend growth potential. We believe overall REIT Y/Y earnings/dividend growth in Y24 should be in the 3-5% range allowing room for dividend increases.

Looking ahead, we believe there are risks that markets may not have fully adjusted to a 'higher/high for longer' rate environment and corporate earnings estimates for Y24 might be too optimistic. Over the current quarter and rest of the year, we think the Fed will

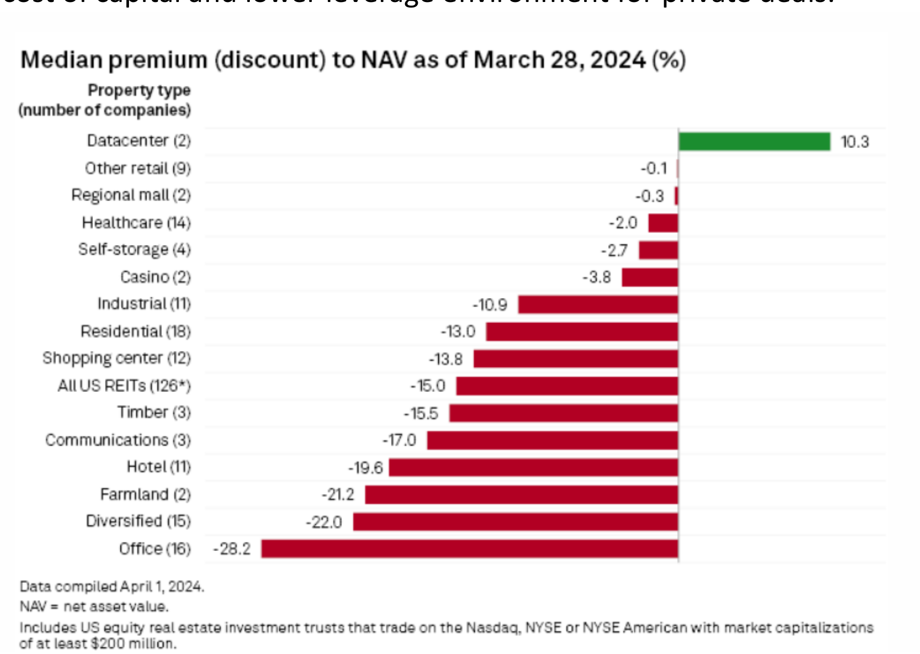
reduce rates maybe 1-2 times as inflation proves to be 'sticky' and the economic growth continues to be solid. Against this background, we think the REIT sector may start to attract greater support. And as always, the appeal of REITs' high, relatively secure dividend yield will be attractive to income seekers.

Property/REIT Markets

Property fundamentals – space supply and demand - over 1Q24 have remained generally positive. There are in general limited signs of oversupply and space demand has remained fairly solid for most property types as the economy has continued to grow and add jobs. Increased supply of multifamily and weak office space demand are two areas that contrast with the overall state of the property market. The investment market continues to be subdued though there has been some recent pick up in transaction volume providing some price discovery. The rapid increase in interest rates over 2022/23 (FFR close to zero to the mid-5%'s) has raised the cost of capital, pushed cap rates up and reduced many property values. We think the stabilization of interest rates/prospect of rate reduction in near-medium term should support an improvement in the cost/availability of debt which should facilitate a firming of property investment markets.

Valuation

Publicly traded REITs continue to trade at a substantial discount to their net asset value (NAV) versus the private market value for similar commercial real estate. Data from S&P suggest that the consensus sell-side discount of public REITs is about 15% as of quarter end. It is our forecast that these discounts are bottoming and will begin to narrow as REIT valuations move up and private market values adjust lower as a result of the generally higher cost of capital and lower leverage environment for private deals.



Source: S&P Global, Inc.

Sector Notes

The stock performance of **Datacenters and Cell Towers (23%/Primary Benchmark Index by equity market capitalization at end March 2024)** has continued to show a wide gap over 1Q24. Investor enthusiasm for all things related to AI has propelled Datacenters to be the best performing REIT sub-sector YTD, a furtherance of their performance over Y23. By contrast, reduced capex by the big carriers has weighed on the Towers and left them below average sub-sector performers. We are inclined to think some AI optimism is early for the Datacenters and to believe 5G adoption will underpin tenant increased demand for space in the medium-longer term for the Towers. **Industrial/Distribution space** (14%/Primary Benchmark Index) demand led by e-commerce and modest new supply continues to support positive fundamentals. **Collectively, the tech-related, Cell Towers, Datacenters and Industrial/Distribution companies had a weighting of 37%/Primary Benchmark Index**.

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

Residential rental property with a **15% weighting in the Primary Benchmark Index** continues to be regarded as a relatively stable and resilient property type. Limited supply of existing homes for sale has underpinned price gains and pushed reduced ownership affordability for many. Higher mortgage rates have 'locked-in' place many owners deterring movement. As labor markets and personal incomes have remained solid, renter demand has remained resilient. In some locations, mainly in the Sunbelt, there is increased new supply which has suppressed rental growth. The current dearth of construction loan finance from the regional banks seems near certain to mean more limited supply shortage over the next 2-3 years.

Other sub-sectors of note that individually represent 10% or less of the Primary Benchmark Index include: **Healthcare** properties continue to represent 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 remained generally positive, albeit with some new supply concerns, Hospitals to a lesser extent. **Self Storage** has proved to be a cyclically resilient property type. Current operational/earnings performance is decelerating back towards longer-term trends after a Covid spurt. **Offices** have been negatively impacted by a slow Return-to-Office/tenant space demand and by concerns about debt refinancing. There is good demand for the very best properties, but the broad challenges faced by offices are unlikely to be resolved any time soon. 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.

The **property investment markets** continue to be subdued with participants (particularly sellers) taking time to adjust to lower prices reflecting a higher cost of capital. As we transit towards a more stable financing environment, we would expect investment activity will move to higher levels. The public REITs, seeing this as being an opportune time, have been among the more active buyers over 1Q. Notable deals include Welltower's (WELL) purchase of 3,900 Senior Housing units for $1bn; debt related deals taking out joint venture partners in New York City offices by Boston Properties (BXP) and SL Green (SLG); and Essex Property (ESS) buying out its 50% partner on 1,500 apartment units in California for $505m. Notably, there have been a number of sponsors including Ares, RXR and SL Green (SLG) seeking to raise funds to invest in New York City offices.

Property capital markets – Through the end of February 2024, REITs have raised only $2.6bn (compared to $55bn over Y23) as per NAREIT. Equity issuance has been very limited: over 1Q there have been Equity Forward deals (not counted by NAREIT ahead of issuance) by Triple Net, Retail orientated, Realty Income (O) – $6.5bn, and Agree Realty (ADC) - $1bn. Both are expected to be active buyers of properties this year. Terreno (TRNO) raised $340m equity at the end of Mar to help fund acquisitions. Unsecured debt issuance has been more active with several companies happy to raise 10Y debt in the 5%'s. Many of these companies are typically paying 2x over the rates on expiring debt. Notable issuance includes: American Tower (AMT) $1.3bn, 5 & 10Y at 5.3% blended; Alexandria (ARE) $1bn, 12Y and 30Y at 5.5% blended; Extra Space (EXR) $600m, 7Y at 5.9%; American Homes 4 Rent (AMH) $600m 10Y at 5.5%; and Essex Property (ESS) $350m, 10Y at 5.5%.

Many REITs have locked in low rates and extended maturities and reduced variable debt over recent years giving them some protection against higher interest rates in the near-medium term. In the secured (mortgage) debt market, there are worries 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. Unsurprisingly, office loans 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 will mean more forbearance agreements with both lenders and borrowers sharing some pain. New issuance in the CMBS market has largely dried up and while loans with special services/delinquencies have been on the rise from low levels with particular concern around office properties.

The **Non-Traded REITs** (BREIT, SREIT and others) enjoyed considerable support from retail investor inflows a few years back. They have however 'gated' (limited) investors from selling their stock over the last couple of years as redemption requests exceeded capped limits. 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), will need to adapt if they are to generate attractive returns in a higher rate environment. Institutional investors in PERE funds appear to harbor few doubts about CRE's prospects – Blackstone (BX) recently raised $30bn equity for BREP X to invest globally across property sectors.

Most REITs provided Y24 **earnings guidance** with their 4Q/Y23 earnings releases in Jan/Feb. Most REITs have fairly predictable businesses with many noting growth expectations tempered by headwinds from increased operational costs and higher debt charges. Notably strong earnings were reported by Industrial and Datacenter REITs; there were down earnings from the Office companies. We continue we think overall Y/Y FFO/sh REIT growth for Y24 will be in the low-mid single digit range assuming modest growth in GDP over the year.

Notwithstanding a lackluster start to the year, we remain cautiously constructive on the outlook for the performance prospects of REIT stocks over the remainder of the year. The sector has underperformed the tech-driven overall market (measured by the SPX) YTD though underperformance versus non-tech sectors has been less marked. Interest rate concerns have weighed heavily on sentiment. Looking ahead, assuming some rate cuts are coming and there is continued economic growth, we think investors may continue to widen their interest in stocks beyond big tech. Lower rates and economic growth should provide some support for property investment and space demand while new supply generally remains limited. In a more stable environment, the appeal of property/REITs with inflation hedge characteristics, that offer a relatively secure dividend (4.1% at 1Q24 end) that will grow over time and today is approximately 3x the yield of the SPX and slightly below the UST 10Y, remains strong.

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The views in this letter were as of April 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 viewers to understand the strategy's methodology and do not constitute investment advice or recommendations.

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.