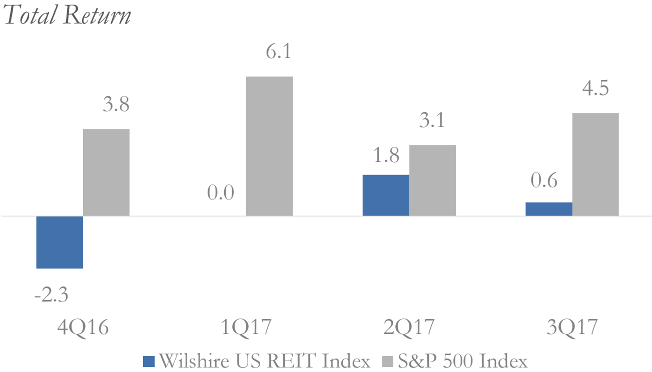
Risk On. "Global synchronous recovery" seems to be the financial community's mantra for 2017, used to ward off evil spirits associated with a tightening monetary policy, especially in the US. Although Balkanization and climate change across the globe pose great long-term threats, their symptoms, Charlottesville, Catalonia and (possibly) the severity of Hurricanes Hugo and Irma, resulted in only short-term market volatility and, thus far, prospects for tax cuts has certainly trumped (pun intended) the threat of a nuclear strike from North Korea.

Economic data released during the quarter was mixed. The third estimate of Second Quarter GDP growth came in at 3.1%, compared to 1.2% for First Quarter 2017 and average GDP growth of 1.9% and 2.0% in 2016 and 2015, respectively. According to the Bureau of Labor Statistics, changes in total nonfarm payroll in the past three months were 138,000, 169,000 and -33,000 (hurricane impacted), respectively, an average of 91,000 compared to an average of 185,000 for the 12 months prior. The yield on the 10-Year Treasury Note rose from 2.302% to 2.326%.

The Wilshire US REIT Index ("Index") was up 0.6% in Third Quarter, lagging both the S&P 500 and Russell 2000 Indices which advanced 4.5% and 5.7%, respectively; this is the fifth consecutive quarter of REIT underperformance. The majority of the constituents in the Index produced positive returns (67 out of the 115 constituents). The best performing REIT, Cedar Realty Trust, was up 17.0% and the worst, Taubman Centers, was down 15.6%.

REITs vs. S&P 500 Index (%)

Total Return



Source: Bloomberg and Wilshire Associates.

Sector Performance of the Wilshire US REIT Index

Ranked by Third Quarter 2017 Performance

Sector	3Q17	Trailing 1-Year	Current Yield
Industrial	7.2%	21.7%	2.9%
Storage	4.7	0.6	3.9
Retail-Local	3.8	-21.7	4.6
Hotels	2.4	21.0	5.3
Industrial Mixed	2.2	24.6	3.0
Diversified	2.0	1.7	2.0
Wilshire US REIT	**0.6**	**0.1**	**3.7**
Office	-0.6	1.8	3.0
Apartments	-0.8	7.0	3.2
Mfd. Housing	-1.9	12.7	2.2
Retail-Regional	-2.2	-21.2	4.8
Factory Outlets	-4.8	-34.6	5.6
Health Care	-5.7	-4.7	5.2

Source: Wilshire Associates.

More of the Same. In terms of relative performance by sectors, as in Fourth Quarter 2016 when investors first became enamored with prospects for "Trumpflation," the length of the lease term was influential as landlords with shorter duration leases like Storage and Hotels outperformed the more interest rate sensitive sectors like Health Care. Property types with secular demand drivers like Industrial and data centers continued to outperform while all three shelter categories lagged: Apartments, Manufactured Housing and Single Family.

Many market commentators are suggesting that with an improvement in economic activity and positive fourth quarter seasonality, risk-on factors like Value might start to outperform defensive factors like Price Momentum. Is the burgeoning outperformance of Retail a sign of reversion to the mean for the beleaguered sectors? Since the 2008 financial crisis, Retail REITs have had a tendency to underperform in the fourth quarter, perhaps as a result of investors' concerns about the health of the consumer going into each holiday season. However, expectations are very low currently and store closings should abate until January. With the pace of economic activity rising amidst a tight labor market (4.2% unemployment rate), doesn't wage growth (2.9% for the past 12 months) lead to increased consumption as the wealth effect finally spreads?

More M&A. On August 10, Invitation Homes ("INVH") and Starwood Waypoint Homes ("SFR") announced a stock-for-stock merger of equals, creating the largest REIT focused on owning and operating single family homes for rent. The merger was apparently initiated by overtures from SFR's founder Barry Sternlicht to Jonathan Gray, the real estate chief of the Blackstone Group which owns 70.6% of INVH. Subsequent to the merger, shareholders of INVH will own 59% of the combined entity. The new management team will be a mix of the two with SFR's Fred Tuomi leading the new company as CEO. The combined board will have 11 members with six from INVH and five from SFR. For investors looking for immediate gratification, synergies from the merger will result in immediate cost savings of $45 to $50 million, 5% of the combined EBITDA. Perhaps more importantly, the two companies have 83% overlap in markets; going forward, the company will average 4,800 homes in its top seven markets leading to greater operating efficiencies. Finally, the combined entity will be the 20th largest REIT by enterprise value, potentially leading to a significant lowering of its cost of capital in both debt and equity. Subsequent to the deal being announced, SFR has outperformed American Homes For Rent, its largest competitor in the sector, by more than 1,000 bps and the Index by 800 bps through quarter-end.

Assessing Hurricane Damage. Commercial real estate seems to have weathered Hurricanes Harvey and Irma reasonably well. Anecdotes are trickling in through Third Quarter earnings with sector specific themes. LaSalle Hotel Properties had two resorts in Key West which were closed during Hurricane Irma, negatively impacting RevPAR by 110 bps; there was some water intrusion but no significant structural damage and both resorts will reopen in Fourth Quarter. LaSalle maintains full insurance at both properties, including business interruption with a combined $5 million deductible. On EastGroup Properties' earnings call, management noted new leases/increased activity with homebuilders and home improvement retailers subsequent to Hurricane Harvey. EastGroup did opine that Apartment and Storage REITs in Houston should see an immediate uptick in business. Equity LifeStyle Properties mentioned that their Florida mainland properties resumed normal operations shortly after Hurricane Irma and that two RV resorts in the Keys will reopen in Fourth Quarter; they too had adequate insurance, subject to a deductible. Most likely, investors will look through the Third Quarter noise; sadly, the only takeaway may be the conversion in investors' minds of Houston exposure from a liability (oversupply) to an asset (increased demand subsequent to Harvey).

Observations from the Field – Suzanne Sorkin, CFA

The last few months have been quite notable for the public REITs that own medical office buildings ("MOBs"). Since May, we have seen a flood of transaction activity in the space with three high profile transactions (totaling over $4 billion) all pricing at sub 5% cap rates. Many investors were skeptical when HTA announced its acquisition of DRE's $2.75 billion portfolio (6.1 million sf) at an initial 4.75% cap rate; most believed that there was too high a premium paid for the DRE platform. However, in the months following, we have now seen DOC purchase the Baylor Cancer Center in Dallas and four other high quality MOBs in Atlanta and Indianapolis (1.1 million sf) for a combined $580 million at a 4.7% cap rate and HR announce a $613 million purchase of a 15 asset MOB portfolio (1.3 million sf) in Atlanta at a 4.9% cap rate (though ultimately closing on only 8 buildings for $194 million). Are sub 5% cap rates for MOBs the new norm?

We recently toured the Dallas MOB market which has been at the center of many of these recent high profile deals. Dallas is an important market for the three stand-alone MOB public players (HTA, HR and DOC) as well as HCP among "The Big Three" Health Care REITs; HTA, HR, DOC and HCP generate 12%, 16%, 8% and 12% of their MOB NOI from Dallas, respectively. The tour highlighted the growing trend of hospital systems establishing outposts away from their main campuses; we toured several facilities in Plano and Frisco that are associated with Baylor and Medical City Dallas, two major systems with their main campuses in Downtown Dallas. We continue to believe in the importance of close proximity to a hospital campus; if MOBs are located off-campus, being affiliated with a major hospital system seems paramount.

The tour also offered a glimpse into a market that could see a wave of new supply over the next few years. While most MOB investors are not concerned about supply risk with only 1.9% of existing stock to be delivered in 2018 nationwide, it is important to note pockets of oversupply that may pose risks for single markets. Dallas could be an example of this with 5.7% construction vs. inventory (according to Revista); there are currently 21 MOBs under construction there for ~$685MM. Ironically, one of the other major MSAs with looming supply is Atlanta at 7.0% construction vs. inventory ($785MM of deals), the second largest market (after Dallas) in the recent spate of "expensive" MOB deals. Are public REIT investors effectively encouraging MOB construction by paying increasingly lower cap rates and, by doing so, creating the beginnings of a supply bubble in certain key markets? Stay tuned.

Capital issuance is down slightly. According to NAREIT, $29.8 billion in capital was raised in Third Quarter 2017, significantly more than both the $21.1 billion raised in the prior quarter and the $21.3 billion raised a year ago in Third Quarter 2016.

The capital activity took place primarily in the issuance of unsecured bonds (there were 33 offerings totaling $15.6 billion during the quarter, significantly more than both the $10.2 billion issued in the prior quarter and the $10.9 billion issued a year ago); perhaps companies are trying to front-run balance sheet normalization by the FOMC. There were 14 offerings of secondary issuance of equity totaling $7.7 billion during the quarter, slightly less than the $8.8 billion issued in the prior quarter and the $9.1 billion issued a year ago and 23 offerings of preferred equity totaling $6.3 million, a big jump from $1.3 billion issued in the prior quarter and $1.0 billion issued a year ago. There were two small IPOs totaling $0.3 billion.

Funds flow out. According to AMG Data Services, net flows out of dedicated real estate funds, excluding ETFs, totaled $1.7 billion in Third Quarter 2017 compared to inflows of $1.0 billion in Third Quarter 2016. Year-to-date, flows out of dedicated real estate funds totaled $6.0 billion compared to inflows of $2.2 billion for REIT ETFs; dedicated real estate funds saw outflows of $5.5 billion and $6.1 billion in 2016 and 2015, respectively, compared to flows of $2.2 billion and -$0.2 billion for REIT ETFs. According to Bloomberg, almost a quarter of all REITs are owned passively, the most of any sector.

Flows out of US and global mutual funds registered in Japan are estimated to be $2.1 billion in Third Quarter 2017 compared to inflows of $6.4 billion in Third Quarter 2016.

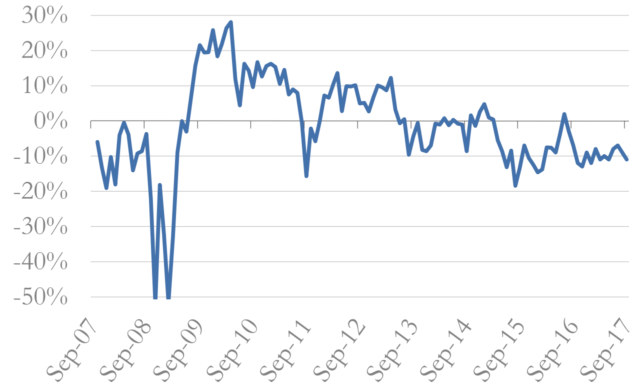
Transactions are down. According to Real Capital Analytics ("RCA"), sale of commercial properties in Third Quarter totaled $114.2 billion, down 9%. Per RCA, "Commercial property sales dropped in Q3 '17, the fourth consecutive quarter of declining year-over-year activity. While overall trends are down, the market is not collapsing. With prices at record high levels, as the RCA CPPI show, underwriting acquisition is simply more difficult." Technology is having an equally disruptive impact on private markets with Industrial being the only property type experiencing an increase in transactions.

In terms of markets, Manhattan is experiencing the greatest decline in sales volume, however, there are $4.8 billion of deals with contracts pending so all hope should not be lost; year-to-date, Los Angeles and Dallas lead transaction activity nationwide.

Premium/Discount to Net Asset Value

REIT Universe

September 30, 2007 to September 30, 2017



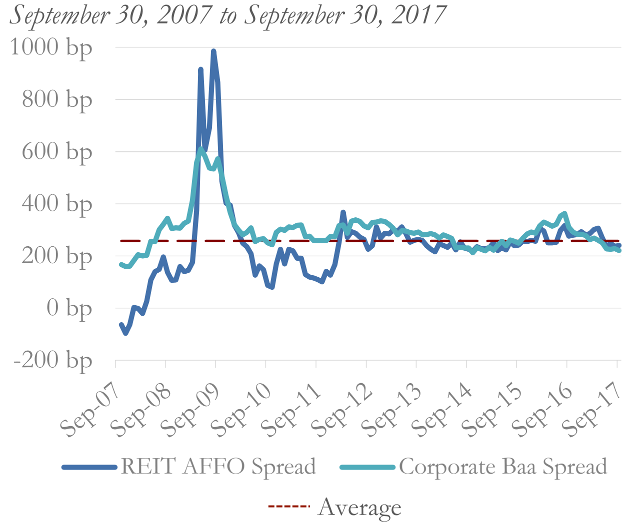
Source: Adelante Capital Management and Green Street Advisors.

Risk premium is in-line with the ten-year average. The risk premium for owning commercial real estate, as represented by the spread between REIT cash flow yields and the riskless rate of return, effectively trades on par with the 10-year average of 258 bps. The cash flow yield for REITs rose 14 bps to 4.90%, outpacing the 2 bps rise on the yield on the 10-Year Treasury Note and, as a consequence, the spread between REIT cash flow yields and the 10-Year Treasury Note yield increased slightly from 246 bps to 258 bps. As of September 30, there was still a healthy yield premium for taking the risk of owning commercial real estate via REITs. In Third Quarter, the Corporate Baa spread ticked down to 200 bps, well below the 10-year average of 298 bps; bond markets are also favoring tenants over landlords, underwriting an improving credit profile as the economy improves.

Spread Comparison

REIT Cash Flow and Corporate Baa Yields vs. 10-Year Treasury Note Yield

September 30, 2007 to September 30, 2017



Source: Adelante Capital Management and Green Street Advisors.

Outlook

Participants raised a number of important considerations about the implications of persistently low inflation for the path of the federal funds rate over the medium run. Several expressed concern that the persistence of low rates of inflation might imply that the underlying trend was running below 2 percent, risking a decline in inflation expectations. If so, the appropriate policy path should take into account the need to bolster inflation expectations in order to ensure that inflation returned to 2 percent and to prevent erosion in the credibility of the Committee's objective. It was also noted that the persistence of low inflation might result in the federal funds rate staying uncomfortably close to its effective lower bound. However, a few others pointed out the need to consider the lags in the response of inflation to tightening resource utilization and, thus, increasing upside risks to inflation as the labor market tightened further.

On balance, participants continued to forecast that PCE price inflation would stabilize around the Committee's 2 percent objective over the medium term. However, several noted that in preparing their projections for this meeting, they had taken on board the likelihood that convergence to the Committee's symmetric 2 percent inflation objective might take somewhat longer than they anticipated earlier. Participants generally agreed it would be important to monitor inflation developments closely. Several of them noted that interpreting the next few inflation reports would likely be complicated by the temporary run-up in energy costs and in the prices of other items affected by storm-related disruptions and rebuilding.

Minutes of the Federal Open Market Committee ("FOMC"), September 19-20, 2017

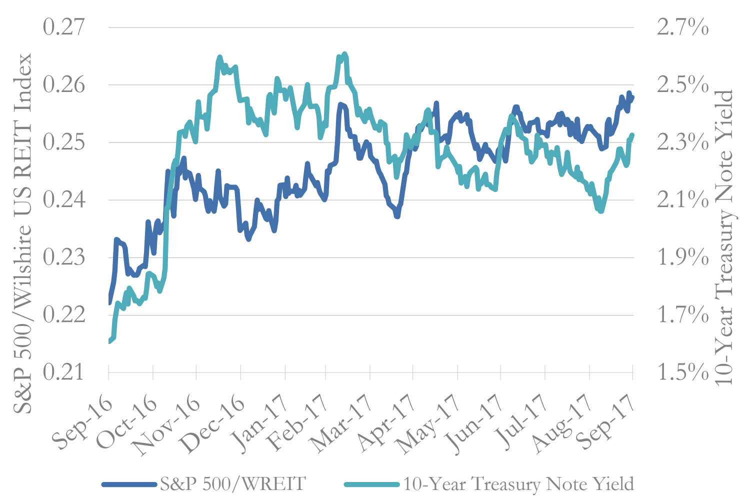
Third Quarter 2017 is the fifth in a row that the Wilshire US REIT Index has underperformed the S&P 500 Index, an unprecedented losing streak based primarily on the assumption that deregulation and tax cuts at home and a broad based economic recovery abroad will jump start an economy in its eighth year of expansion, leading to outsized benefits for the tenants vis a vis the landlords. The sharp rally in the S&P 500 Index is somewhat surprising in the face of geopolitical turmoil and dysfunction in Washington D.C.; when interviewed on Bloomberg Television, the newly minted Nobel Laureate in Economics, Richard Thaler, stated, "we seem to be living in the riskiest moment of our lives, and yet the stock market seems to be napping; I admit to not understanding it."

Most likely, bond investors are having trouble understanding the equity market rally as well. Once the euphoria of the 2016 election wore off, the yield curve has actually been flattening steadily with the spread in yield between the 10-Year Treasury Note to the 2-Year going from a high of 135.5 bps on December 22, 2016 to a low of 74.9 bps on October 17, 2017.

Despite these signals from the bond market and a lack of a clear consensus among the members of the Federal Open Market Committee on their own inflation expectations, Chair Yellen and her cohort seem determined to begin the long path to balance sheet normalization and the removal of monetary accommodation; current odds of a rate hike in December stand at 83.6%. Certainly the hawks on the Committee were emboldened by the October Employment Situation Summary released by the Bureau of Labor Statistics which showed another tick down on the unemployment rate to 4.2% and a 2.9% increase in average hourly earnings for the past 12 months.

Given the intention of the FOMC to normalize its balance sheet and to tighten policy, albeit gradually, it is surprising to see the yield on the 10-Year Treasury Note remain stubbornly low. Perhaps some caution on the equity market euphoria is in order. While the 2.4% return on the Wilshire REIT Index pales in comparison to the 14.2% delivered by the S&P 500 Index year-to-date, the underperformance has made REITs more attractive in terms of relative valuation. REITs are still projected to deliver solid same-store NOI growth for 2017 and aggregate construction as a percentage of total stock remains well below the historical average. Trading at double digit discounts to private market valuations (and thus attractive to private equity investors who are flush with cash), what is not to like about REITs except for potentially misplaced concerns about interest rate sensitivity? Doesn't an improving economy mean higher occupancy and rents for the landlords?

Relative Performance (REITs vs S&P 500) vs. 10-Year Treasury Note Yield
September 30, 2016 to September 30, 2017



Source: Bloomberg and Wilshire Associates.