REIT *VIEW* - DOMESTIC

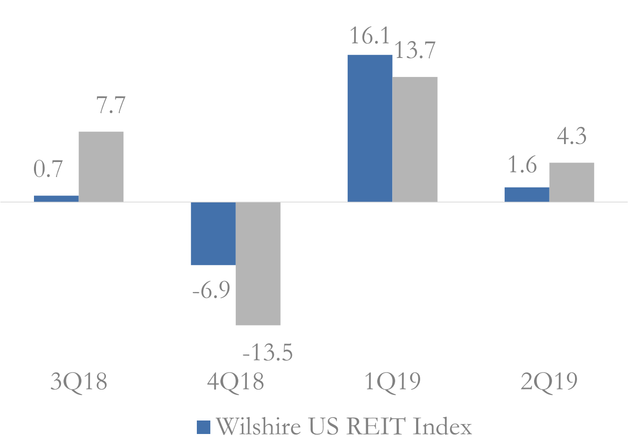
Second Quarter 2019

Behind the curve. The third estimate of First Quarter GDP growth was 3.1% but the Federal Reserve Bank of Atlanta projects Second Quarter GDP growth to drop sharply to 1.6%. According to the Bureau of Labor Statistics, changes in total nonfarm payroll in the past three months were 216,000, 72,000 and 224,000, respectively, an average of 170,667 and a deceleration from 209,750 for the 12 months prior**.** Due to the slowing GDP and job growth (albeit, both still positive), the long end of the yield curve continued to decline as the yield on the 10-Year Treasury Note dropped from 2.414% on March 31 to 2.000% on June 30; the spread between the 3 Month Treasury Bill and the 10 Year Treasury Note ("3M-10Yr") inverted in Second Quarter from 1 bps to -9 bps (the 3M-10Yr spread was negative for the entire month of June).

The Wilshire US REIT Index ("Index") was up 1.6% in Second Quarter, lagging both the S&P 500 and Russell 2000 Indices which advanced 4.3% and 2.1%, respectively. In Second Quarter, out of the 108 constituents of the Index, 51 securities produced positive returns; the best performing company was Terreno Realty Corporation (up 16.7%), an industrial REIT focused on infill locations in six major coastal markets and the worst performing stock was Ashford Hospitality Trust (down 36.2%), whose announcement of a dividend cut during the quarter highlighted deteriorating operating fundamentals for Hotel landlords.

REITs vs. S&P 500 Index (%)

Total Return



Sources: Bloomberg and Wilshire Associates.

Sector Performance of the Wilshire US REIT Index

Ranked by Second Quarter 2019 Performance

Sector	1Q19	Trailing 1-Year	Current Yield
Industrial	8.4%	23.2%	2.8%
Mfd. Housing	8.2	34.7	1.9
Storage	7.5	8.2	3.5
Health Care	3.5	22.5	4.9
Apartments	2.1	21.8	3.0
Wilshire US REIT	**1.6**	**10.5**	**3.8**
Diversified	0.5	7.9	4.0
Industrial Mixed	0.1	15.1	3.5
Retail-Local	-1.9	4.6	4.8
Hotels	-2.6	-10.5	5.7
Office	-3.0	0.2	3.3
Retail-Regional	-12.4	-8.3	5.8
Factory Outlets	-21.2	-26.4	8.8

Source: Wilshire Associates.

The Song Remains the Same. For Second Quarter (and for the trailing 1-year), cyclical property types: Hotels, Office, and Retail, all underperformed the Index while property types which are insulated from the vagaries of the economy: Health Care, Storage, Apartments and Manufactured Housing, and/or property types which offer secular growth: Industrial and Data Centers, all outperformed. REIT investors seem to be taking their cue from the bond market, eschewing property types which are dependent on a cyclical uptick and gravitating toward sectors that offer secular growth, allowing their shareholders to "safely" benefit from the asset inflation afforded by low interest rates.

Interestingly, many of the secular growth stories trade at hefty premiums to break-up values while high quality Hotel, Office (primarily NYC) and Regional Retail portfolios lie embedded in REITs like Diamondrock Hospitality, SL Green Realty ("SLG") and Macerich, unloved and unwanted. At a recent investor conference, Marc Holiday, CEO of SLG, suggested that stocks like his continue to trade at discounts because there are not a lot of $7.0 billion checks lying around. Unfortunately, Blackstone's subsequent announcement of a $18.7 billion acquisition of GLP's US Industrial portfolio seems to undermine Holiday's thesis; it may not be the size of the check but the type of merchandize that is deterring private (and public) market interest in REITs like SLG.

M&A. On May 6, Park Hotels & Resorts announced that it has entered into a definitive merger agreement with Chesapeake Lodging Trust in a transaction valued at $2.7 billion. Chesapeake shareholders will receive a combination of approximately two-thirds Park shares and one-third cash in consideration; the implied price of $31.71/share represented a modest 8.2% premium to the $29.31/share closing price prior to the announcement; with Chesapeake long rumored to be for sale, much of the take-out premium seems to have already been reflected in its share price.

From a real estate perspective, the merger makes sense; both Park and Chesapeake own branded full-service hotels in major markets. The transaction also improves portfolio quality ($195 revenue per available room "REVPAR" for Chesapeake vs. $176 for Park) as well brand and geographic diversification; from a pricing perspective, it seems like Park is paying for that privilege.

With four hotel REITs acquired in recent memory, all the chatter about M&A in the sector has subsided, especially given the penalty of underperformance imposed on the acquirers. Of course, Anbang Insurance Group's woes can't be sourced to their acquisition of the Strategic Hotel portfolio (Blackstone escapes unscathed once again…) but RLJ Lodging Trust, Pebblebrook Hotel Trust and now Park Hotels & Resorts have all underperformed the Bloomberg REIT Hotel Index since the announcement of their deals by 13.3%, 10.7% and 4.7%, respectively, through June 30. With such underwhelming results, and with the two hotel REITs who have the cost of capital advantage in mid-process of absorbing recent acquisitions, it is unlikely that public to public combinations will be tried again in the near future. Public to private is probably another story since there is still robust private market demand for hotels assets, particularly resorts.

On June 2, Blackstone announced that it has entered into an agreement to acquire GLP's US Industrial portfolio for $18.7 billion, nearly doubling the size of its warehouse footprint. Commenting on the deal, Ken Caplan, Global Co-Head of Blackstone Real Estate, said: "Logistics is our highest conviction global investment theme today, and we look forward to building on our existing portfolio to meet the growing e-commerce demand. Our global scale and ability to leverage differentiated investment strategies allowed us to provide a one-stop solution for GLP's high quality portfolio." GLP is itself a global investment manager with $64 billion assets under management in real estate and private equity funds.

Observations from the Field – Ben Yang

The annual International Council of Shopping Centers (ICSC) "RECon" convention offered important insights into the plans (and psyches) of retailers, public and private property owners, brokers, investors and others that comprised the estimated 30,000 attendees this past May. The overall tenor from our 20+ meetings was mixed with optimists (mainly the public REITs) pointing to the higher number of leasing meetings on the agenda this year (with expectations that signed leases will ensue), and pessimists pointing to just about everything else.

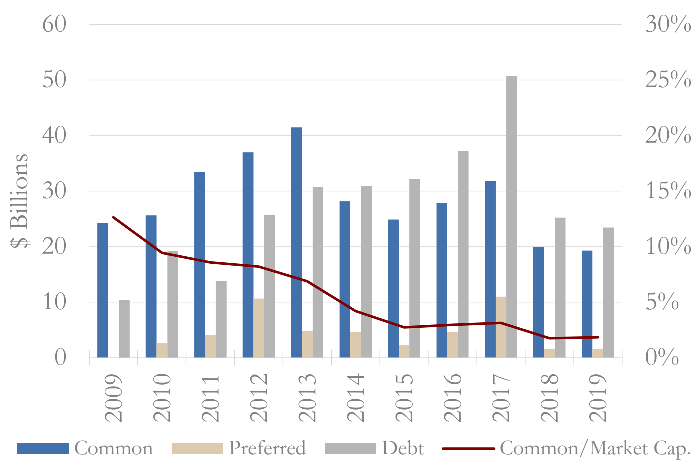
Specialty retail owner Ascena Retail Group unofficially and ignominiously kicked off the convention by announcing "plans to commence a wind down of Dressbarn's operations;" since updated to shutting down all 650 stores by 2020. Bed Bath & Beyond and Pier 1 were also in heavy rotation on the watchlist/playlist track, with another "major retailer" rumored to be in trouble; since revealed to be Forever 21, there are reports that this privately-owned fast fashion retailer with over 500 locations in the US is on the brink of bankruptcy. Announced store closures in 2019 have already surpassed the total from last year (>7,000 at mid-year vs. ~5,900 in 2018), with forecasts as high as a financial-crisis-topping 12,000 announced closures by year end. While store openings are also tracking higher than last year (~3,000 at mid-year vs. nearly 3,300 in 2018), there is inarguably still too much retail space in the US (~24 square feet per capita vs. Canada at 16, Australia at 11 and Europe at <5), particularly as e-commerce increasingly takes share from the overall retail pie.

Capital expenditures are also rising for all retail property types, affirmed by our meetings with private shopping center owners and leasing brokers (though not noticeably apparent in public company disclosures), partly resulting from (i) increasing store closures/reconfigurations and (ii) certain retailers finally realizing that they are the key tenants ("new anchors") and commanding significantly higher tenant improvement dollars to open stores. Consequently, retailers are becoming increasingly sensitive to sponsors when signing new and renewal leases as not all retail landlords have sufficient capital that is continuously needed to reinvest in their properties. The bifurcation between higher and lower quality retail portfolios has been a persistent theme since the financial crisis, as reflected in operating results and share performance, based on greater facility to re-tenant spaces and push rents higher. Bifurcation based on balance sheets and free cash flows could be the next key differentiator going forward, based on rising capex, with retail REITs that own the highest quality properties also possessing the most fortified balance sheets.

Capital issuance follows share price appreciation. According to NAREIT, $24.7 billion in capital was raised in Second Quarter 2019, significantly more than the $19.6 billion raised in the prior quarter and the $7.9 billion raised a year ago in Second Quarter 2018. About half the capital activity took place in the issuance of unsecured bonds (there were 24 offerings totaling $12.0 billion during the quarter, on par with the $11.4 billion issued in the prior quarter and way more than the $5.6 billion issued a year ago). Joining the fray, there were 24 secondary equity offerings totaling $11.9 billion during the quarter, significantly more than the $7.3 billion issued in the prior quarter and the $1.5 billion issued a year ago.

Note that the above data does not take into account equity issuance by at-the-market ("ATM") programs, a low-cost alternative; now that more REITs are trading above NAV, expect heightened activity on the ATM front, although, with leverage levels already low across the group, use of proceeds will be a point of emphasis for investors.

Historical Offering of Securities
2009 – 2019YTD

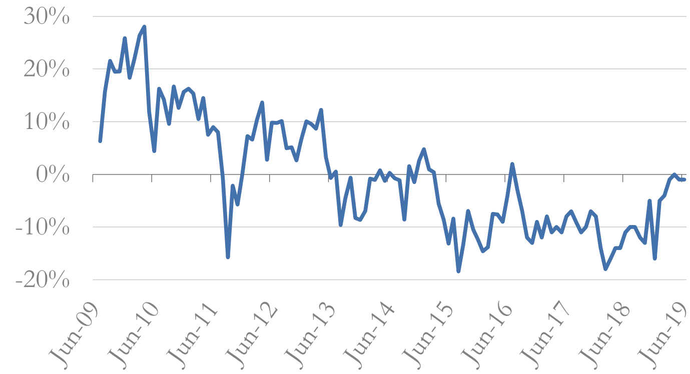


Sources: S&P Global Market Intelligence, NAREIT 2019.

Stemming the tide. According to AMG Data Services, net flows out of dedicated real estate funds, excluding ETFs, totaled $0.5 billion in Second Quarter 2019, significantly less than the outflows in excess of $3.3 billion in Second Quarter 2018. REIT ETFs saw modest outflows of $0.3 billion in Second Quarter 2019 but flows into ETFs are still positive $2.7 billion for the year.

Flows out of US and Global mutual funds registered in Japan also slowed to $0.4 billion in Second Quarter 2019 compared to outflows of $2.2 billion in Second Quarter 2018.

Premium/Discount to Net Asset Value
REIT Universe
June 30, 2009 to June 30, 2019

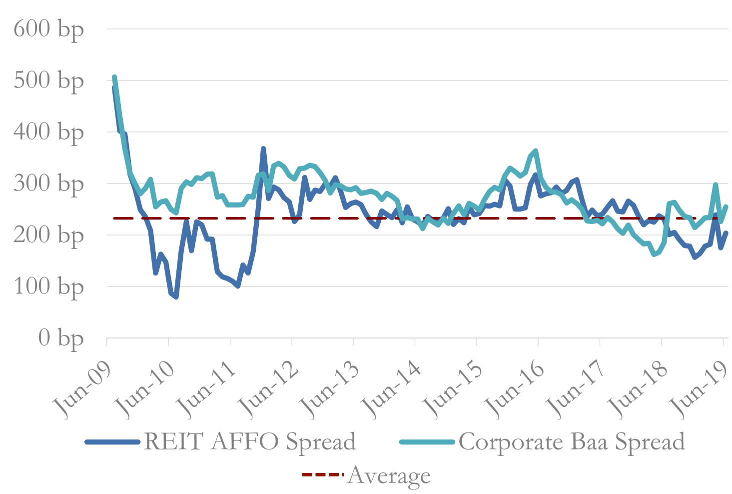


Sources: Adelante Capital Management and Green Street Advisors.

Risk premium on par 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, trades on par with the 10-year average of 232 bps. While the cash flow yield for REITs continues to decline due to share price appreciation, the yield on the 10-Year Treasury Note has also decreased and, as a consequence, the spread between REIT cash flow yields and the 10-Year Treasury Note yield has actually gone up 20 bps to 224 bps. Despite the strong performance of REITs in the first half of 2019, investors are still being properly compensated.

In Second Quarter, the Corporate Baa spread increased 11 bps to 265 bps, also on par with the 10-year average of 268 bps.

Spread Comparison
REIT Cash Flow and Corporate Baa Yields vs.
10-Year Treasury Note Yield
June 30, 2009 to June 30, 2019



Sources: Adelante Capital Management and Green Street Advisors.

OUTLOOK

Markets are partying like it's 1995. Bond yields are down, stocks are up, and the Fed is expected to cut rates soon. The current economic and market conditions look a lot like 1995. Back then, Alan Greenspan reacted to an economic slowdown by slashing the key interest rate a total of 75 bps in eight months. It was the famous soft landing. The economy picked up a year later, and by November Bill Clinton would win reelection as president. In his book "The Age of Turbulence," Greenspan wrote: "…in hindsight the soft landing of 1995 was one of the Fed's proudest accomplishments during my tenure."

The stock market rallied before and during the rate cut in 1995-1996. And the current equities rally suggest that investors are positioning for a repeat of the "Rate-Cut 101" trades; buy stocks, bonds and gold. In the bond market, the swap curve bears resemblance to the one in 1995. The 3m/2y curve is inverted, but 2y/10y is steepening, suggesting investors are expecting the Fed to lower rates soon, which could eventually drag the economy out of the soft patch.

But when the Fed starts cutting rates, it's difficult to know whether it's heading for recession or soft landing. As Greenspan recounted in the book: "It didn't feel like 'Oh, let's execute a soft landing,' it felt more like 'let's jump out this sixty-story building and try to land on our feet.'" Powell and Co. are certainly hoping that they're jumping from a lower building.

Bloomberg Markets Live Blog, Ye Xie – June 13, 2019

Lacking the ability and authority to address directly the structural challenges holding back growth, the Fed has had to rely on using the financial channel to promote consumption, investment and economic growth – that is, the view that loose financial conditions and the prospect of continued easy money will boost asset prices and trigger a pro-consumption "wealth effect" and pro-investment "animal spirits." Yet the Fed's success here has been patchy and partial. Moreover, the examples of other central banks having adopted more aggressive policies, including prolonged negative policy rates by the European Central bank and an interest rate cap on a benchmark market rate by the Bank of Japan, are not particularly reassuring…

The stronger performance of the U.S. economy – in absolute terms and especially relative to other advanced countries – should serve as a reminder of its sensitivity to pro-growth measures that lie outside the direct purview of the Fed (e.g., deregulation and tax reform). Meanwhile, the experiences of central banks in Europe and Japan illustrate that the effectiveness of monetary policy – and the institutional credibility and standing that come with that – depends more and more on other economic policymakers (and the politicians that must enable them to do so) stepping up to their policy responsibilities to boost productivity and remove obstacles to growth.

Bloomberg Opinion, Mohamed A. El-Erian – June 5, 2019

Just a fleeting glance at one's Coinbase account ("Oh, you don't own any Bitcoin?!?!") is enough to reinforce the notion that we've just experienced a "Buy Everything Rally" since Chairman Jerome Powell signaled a willingness to "act as appropriate to sustain the expansion" in a June 4 speech at a conference sponsored by the Federal Reserve Bank of Chicago. The S&P 500 Index jumped 2.1% on the day and has never really looked back. Of course there was the usual handwringing about whether Powell would actually go ahead with a July cut (isn't this "the greatest economy in the history of this country?") – the why, when and by how much – but in the end, the "soft landing" analogue to 1995 took hold of investors' imagination and risk assets of every cloth were off to the races for the summer.

Interestingly, the Maestro's "soft landing," effectuated by a total of 75 bps of interest rate cuts in eight months, was preceded by a doubling of the Federal funds rate from 3% to 6% in an effort to stem the inflationary excesses of an overheated economy. In the same vein, the prospective cut in July will have been preceded by a combination of seven hikes in the Federal funds rate since 2017 as well as quantitative tightening estimated by the Council on Foreign Relations to be the equivalent to another ~70 bps of hikes. In his most recent testimony before the Senate, Jerome Powell admitted, "We're learning that interest rates – that the neutral interest rate – is lower than we had thought and I think we're learning that the natural rate of unemployment is lower than we had thought, so monetary policy hasn't been as accommodative as we had thought."

The question of whether monetary authorities worldwide will work toward aiding and abetting economic growth and financial stability is really a red herring. Of course they will. The real question is whether they will have the puissance to offset a relatively dysfunctional global economy and splintered polities. As Mohamed A. El-Erian suggests in a June 5 opinion piece in Bloomberg, the experiences of Europe and Japan suggest that they do not. Declining GDP forecasts and PMIs (Purchasing Managers Index) certainly don't paint a particularly rosy economic picture in the US, Jerome Powell or no Jerome Powell. In this environment, there is a distinct possibility that a number of REITs could start offering better top and bottom line growth than their non-REIT counterparts in the equity markets in the not too distant future, drawing interest from generalist investors. As for value, with significant commercial real estate portfolios embedded at discounts in a group of laggards, a case can be made that private equity interest will eventually be piqued. Something for everyone…

Disclosure:

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