REIT *VIEW* - DOMESTIC

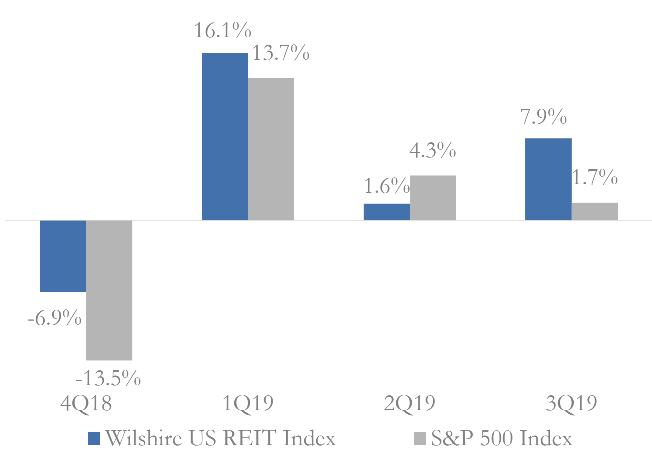
Third Quarter 2019

Stall speed. The third estimate of Second Quarter GDP growth was 2.0% and the Federal Reserve Bank of Atlanta projects Third Quarter GDP growth to decelerate further to 1.8%. According to the Bureau of Labor Statistics ("BLS"), changes in total nonfarm payroll in the past three months were 166,000, 168,000 and 136,000, respectively, an average of 156,667 and a deceleration from 187,083 for the 12 months prior. Additionally, the BLS revised downward by 501,000, jobs created in the US between March 2018 and March 2019. Due to the slowing GDP and job growth (albeit, both still positive), the long end of the yield curve continues to decline as the yield on the 10-Year Treasury Note dropped from 2.000% on June 30 to 1.675% on September 30; the spread between the 3 Month Treasury Bill and the 10 Year Treasury Note was inverted for the entire Third Quarter.

The Wilshire US REIT Index ("Index") was up 7.9% in Third Quarter, significantly better than the S&P 500 and Russell 2000 Indices with total returns of 1.7% and -2.4%, respectively. In Third Quarter, out of the 107 constituents of the Index, 90 securities produced positive returns; the best performing company was CyrusOne, Inc. (up 37.9%), a data center REIT subject to M&A rumors which surfaced during the quarter, and the worst performing stock was Pennsylvania REIT (down 8.4%), a B-mall company which continues to suffer from declining fundamentals and tenant bankruptcies.

REITs vs. S&P 500 Index

Total Return



Sector Performance of the Wilshire US REIT Index

Ranked by Third Quarter 2019 Performance

Sector	3Q19	Trailing 1-Year	Current Yield
Mfd. Housing	11.9%	45.7%	1.7%
Health Care	11.4	33.5	4.5
Industrial	10.6	28.0	2.5
Apartments	9.8	28.2	2.8
Retail-Local	9.3	13.5	4.5
Wilshire US REIT	**7.9**	**18.4**	**3.5**
Diversified	7.2	12.9	3.8
Storage	6.4	28.3	3.3
Industrial Mixed	5.7	28.9	3.4
Office	5.1	8.1	3.2
Hotels	-0.3	-11.0	5.8
Retail-Regional	-1.0	-12.5	5.9
Factory Outlets	-2.4	-27.4	9.2

Source: Wilshire Associates.

The Good, the Bad and the Ugly. A macro environment in which a quiescent monetary authority is helping risk assets off the sugar highs induced by the 2017 fiscal stimulus seems to be positive for REITs on both an absolute and relative basis (the Wilshire US REIT Index returned 18.4% for the trailing year vs. 4.3% and -8.9% for the S&P 500 and Russell 2000 Indices, respectively) but, underneath the surface, there was significant dispersion in property type performances consistent with stalling economic data. In the Clint Eastwood category are Shelter (Manufactured Housing, Apartments and Storage) and Secular Growth (Health Care, Industrial and Data Centers). In the Lee Van Cleef category are Retail-Local and (West Coast) Office and in the Eli Wallach category are Hotels, Retail-Regional and (NYC) Office. Investors don't seem to be particularly concerned about the price to be paid to cavort with Clint while no amount of returns are enticing them to break bread with Eli.

In September, there was a shocking, albeit brief, reversal of that trend which coincided with a shocking, albeit brief, steepening of the yield curve. The magnitude of the growth/value reversal was breath-taking which suggests that positioning among global investors is very one-sided; on the other hand, the brevity of the reversal suggests that an enduring outperformance by value stocks (both REITs and general equities) is contingent on real growth as signified by a sustained steepening of the yield curve.

WeDelay our IPO. WeWork is the most prominent of the global flex office operators who are essentially glorified middlemen renting space from landlords on a longer-term basis and, in turn, leasing that space to co-working or enterprise tenants on a shorter-term basis. From raising $2 billion at a $47 billion valuation on January 8 to the initial S-1 filing on August 14 to its founder Adam Neumann stepping down as CEO on September 24 to the formal withdrawal of its IPO plans on September 30, this year has certainly been eventful for the putative unicorn, part failed effort at capital raising in the public markets and part car wreck on the highway.

Unfortunately, the recent news of a delay in WeWork's IPO and the salacious details of the company's practices that have emerged from its S-1 filing has cast a pall on office REITs by extension. While actual exposure to WeWork as a tenant is not overly concerning for the office REITs, ranging from a high of 2.6% for JBG Smith Properties to around 1.0% for the likes of Boston Properties and SL Green, the unpleasant fact of the matter is that leasing in a number of gateway markets has been buoyed for the past few years by an uneconomic participant who has been careening around like a drunken sailor (e.g. paying as much as 5x the normal broker commission in order to woo tenants from competitors in some markets) in a madcap effort to give proof to its TAM or total addressable market. On the one hand, flex operators, as a whole, represent less than 2% of the national office tenancy; on the other hand, they have comprised an outsized proportion of recent net absorption, estimated by brokers to be 25 – 30%. Not surprisingly, gateway cities San Francisco, Seattle, Boston and New York City have the greatest exposure to flex operators and WeWork but they (at least the West Coast) also have the most robust localized business fundamentals. Certainly, retrenchment by the biggest flex operator is a short to intermediate-term negative for the office landlords, particularly in markets like Manhattan where investors are concerned that anemic operating fundamentals can get even more so (punching more holes into the NAV estimates for NYC office REITs).

Taking a step back, flex office operators offer intermediation to an unwieldy tenant/landlord relationship. If enterprise continues to favor a flexible workforce (contractor workers now outnumber full-time employees at some Silicon Valley firms), why wouldn't they look for flexible solutions for their space needs as well? Whatever the eventual outcome for Adam Neumann and WeWork, for better or for worse, expect flex to become a bigger and bigger part of the office landscape.

Blue Bottle Coffee anyone?

Observations from the Field – Suzanne Sorkin, CFA

We recently toured the Phoenix market, an MSA with nearly 5 million people that has been growing at almost twice the national average and, as a result, becoming an increasingly important market for REITs. We toured properties in various "shelter" asset classes including apartments owned by Camden Property Trust ("CPT"), single family rentals owned by Invitation Homes ("INVH") and American Homes 4 Rent ("AMH"), student housing developed by American Campus Communities ("ACC") at Arizona State University in Tempe, and manufactured housing ("MH") owned by Equity Lifestyle Properties ("ELS") and Sun Communities ("SUI"). While each of the property types were located in different submarkets of the city (Scottsdale, Phoenix, Mesa, Tempe and Casa Grande), the common theme was good underlying demand based on above-average job growth over the past 5 years, driven by lower taxes and affordable housing.

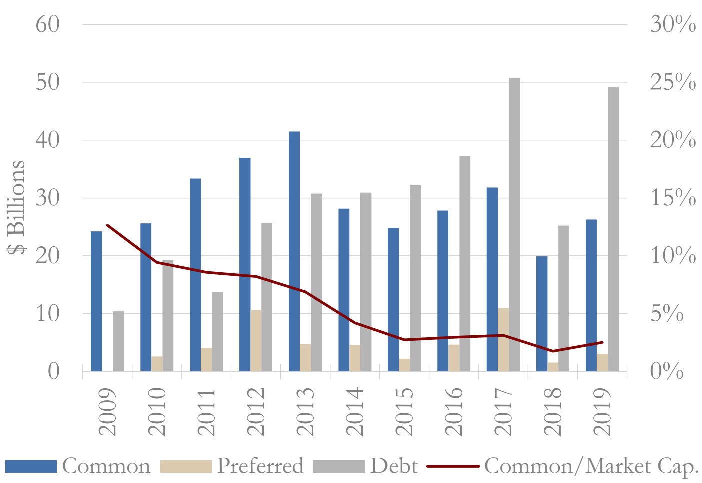
The Phoenix MSA has been one of the strongest apartment markets over the past few years, with any new apartment supply easily absorbed. New supply is expected to decline from ~9,000-10,000 units in 2019 to ~6,000 units in 2020 so Phoenix should continue to be a bright spot for the apartment REITs who have exposure. The single-family rental REITs are also enjoying strong rental rate growth (above 7%) and high occupancy levels (~97%) in the MSA; while they would both like to increase their exposure to the market, bidding tents remain competitive (in the first half of the year, INVH and AMH added only ~100 and ~30 homes in Phoenix, respectively). For the age-restricted MH owners, Phoenix remains a robust market, with little to no new supply and strong demand from the 55+ aged population who wants to spend at least part of the year in sunny Phoenix in highly amenitized resort-style communities; with higher levels of acuity in an aging population, perhaps MH could present a more viable option for investors hoping to capitalize on the highly anticipated "Silver Tsunami" than assisted living facilities (there is certainly less supply). In student housing, we toured Arizona State University ("ASU") with ACC which has worked hand in hand with the school to help deliver a housing solution compatible with the university's strategic vision. ASU is an important NOI contributor for ACC (~9%) and has served as a model for other schools across the nation creating similar partnerships with ACC.

From students in their teens to retirees in their 70's, Phoenix represents an attractive destination; while it has been a shallow and volatile real estate market in the past, continued inbound migration of jobs and workers suggest that REITs with exposure to Phoenix should reap future benefits.

Capital issuance follows share price appreciation. According to NAREIT, $34.2 billion in capital was raised in Third Quarter 2019, significantly more than the $24.7 billion raised in the prior quarter and the $14.6 billion raised a year ago in Third Quarter 2018. Most of the capital activity took place in the issuance of unsecured bonds (there were 50 offerings totaling $25.8 billion during the quarter, more than double the $12.0 billion issued in the prior quarter and 4x the $6.3 billion issued a year ago). There were 22 secondary equity offerings totaling $7.0 billion during the quarter, less than the $11.9 billion issued in the prior quarter and on par with the $7.9 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

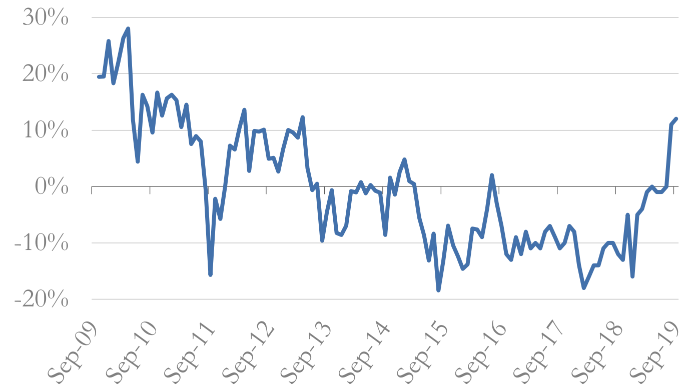


Sources: S&P Global Market Intelligence, NAREIT 2019.

Stemming the tide. According to AMG Data Services, net flows out of dedicated real estate funds, excluding ETFs, totaled $4.0 billion in Third Quarter 2019, double the outflows of $2.0 billion in Third Quarter 2018. REIT ETFs saw inflows of $1.3 billion in Third Quarter 2019 and total $4.0 billion for the year, mostly offsetting the YTD flows out of dedicated real estate funds.

Flows in US and Global mutual funds registered in Japan were modestly positive at $0.1 billion in Third Quarter 2019 compared to outflows of $1.7 billion in Third Quarter 2018.

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

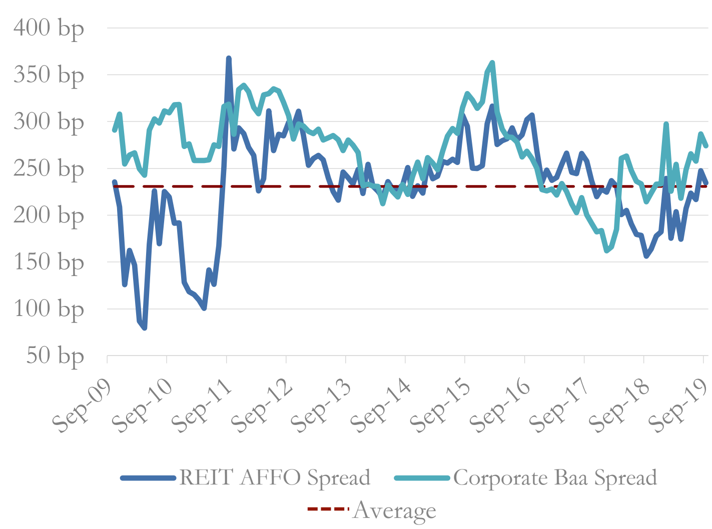


Sources: Adelante Capital Management and Green Street Advisors.

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 231 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 11 bps sequentially from last quarter to 235 bps. Despite the strong performance of REITs in the first three quarters of 2019, investors are still being properly compensated.

In Third Quarter, the Corporate Baa spread increased 9 bps to 274 bps, also on par with the 10-year average of 267 bps.

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



Sources: Adelante Capital Management and Green Street Advisors.

Outlook

Quid pro quo. The biggest political news, at least in the past month, has been the impeachment inquiry launched by House Speaker Pelosi into the actions of President Trump, specifically those surrounding his conversation with Ukrainian President Zelensky on July 25. The news had very little effect on risk assets as investors reminded themselves of the 28% return on the S&P 500 Index and the 64% return on the Nasdaq Composite from the start of impeachment proceedings for President Clinton in October 1998 to his acquittal by the Senate in February 1999. Even from a political perspective, while President Trump's impeachment odds soared from mid-20% to 70% on PredictIt (the go-to political betting website started by a group of New Zealand researchers), he is still the front-runner for the 2020 Presidential Election at around 40%, reinforcing the consensus view that (i) the House of Representatives will approve one or more articles of impeachment, (ii) the Senate will acquit President Trump, and (iii) President Trump will be the front-runner going into the 2020 elections (Eric Trump tweeted that they raised "almost $15 million in small dollar donations (including 50,000 NEW donors) since Speaker Pelosi started this impeachment charade 72 hrs ago!").

An unintended consequence of these recent political developments that the markets may not yet have factored, however, is that Elizabeth Warren is now second on PredictIt for the 2020 Presidential Election at 33%, perhaps due to the controversy surrounding Joe Biden and health issues for Bernie Sanders. The S&P 500 Index has advanced 47.4% since the election of President Trump; assuming that it advances 50% under four more years of President Trump and assuming that the market craters 50% under a very anti-Wall Street President Warren (ignoring the fact that equity markets have generally done better under Democratic Presidents) and assuming that they both have an equal shot at the Presidency in 2020, probability math would suggest that the S&P 500 would be flat from 2020 – 2024 but the real outcome could be far different, one way or the other, making underwriting the next six years virtually impossible. **A sideways arrow for politics with significant volatility longer term.**

"Big day of negotiations with China. They want to make a deal, do I? (@realDonaldTrump, October 10)" On October 1, the Institute for Supply Management ("ISM") reported that their US Manufacturing Purchasing Managers' Index came in at 47.8% in September, the second consecutive month of contraction and the lowest reading since June 2009. More surprisingly, on October 3, ISM reported that their US Non-Manufacturing Index came in at 52.6% in September, well below expectations of 55.3% and a sharp sequential decline from 56.4% in August. Per CNBC, "though the reading still indicated expansion for the services sector, it showed that weakness from manufacturing is bleeding into the broader economy." Following a mixed jobs report for September (missed estimates but upward revisions to past gains and an unemployment rate of 3.5%, lowest since December 1969), investors were subsequently disappointed by the release of the Jobs Openings and Labor Turnover Survey ("JOLTS") from the BLS; job openings declined for the third consecutive month to 7.051 million - historically, job openings fall sharply prior to a recession (admittedly, there are only a few data points).

Clearly the effects of the Tax Cuts and Jobs Act of 2017 are waning, and the economy is getting buffeted by the US/China conflict. Manufacturing took the initial hit but now weakness is assailing the broader services sectors leading to a lower pace of job creation and a potential slowdown in that bastion of the American economy, consumer spending. Another bout of fiscal stimulus would certainly help but with a divided legislature and the Democrats loath to do anything to help the incumbent President, that does not seem very likely. Something positive out of the US/China brouhaha would also be helpful but with systemic imbalances between the two countries (Ray Dalio points out in a LinkedIn article that "there is a rising power (China) challenging the existing world power (the US), which will lead to more conflicts between them about many different issues"), détente is the most investors can probably hope for; a return to the unfettered globalism of the recent past seems unlikely. **A downward pointing arrow for fiscal and trade with significant volatility shorter term.**

"My only question is, who is our bigger enemy, Jay Powel or Chairman Xi? (@realDonaldTrump, August 23)" With the current Federal Funds rate 32.5 bps above the yield on the 10-Year Treasury Note (as of September 30), there is no question that the FOMC is behind the curve. Chairman Powell came close to admitting that their last rate hike in December 2018 was a mistake when he said in July, "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 thought, so monetary policy hasn't been as accommodative as we had thought." But, while there is always the possibility of policy error and miscommunication (mid-cycle adjustment?!?!?!) there is no way that Jerome Powell and the other hard-working members of the FOMC want the country to enter a recession on their watch. Admittedly, there is a lag to monetary policy but… **an upward pointing arrow for monetary policy with very little volatility** (the FOMC clearly wants to help).

Disclosure:

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