Global Real Estate Securities Market Update

First Quarter 2024

Sugi Capital Management

April 9, 2024

Before we get started

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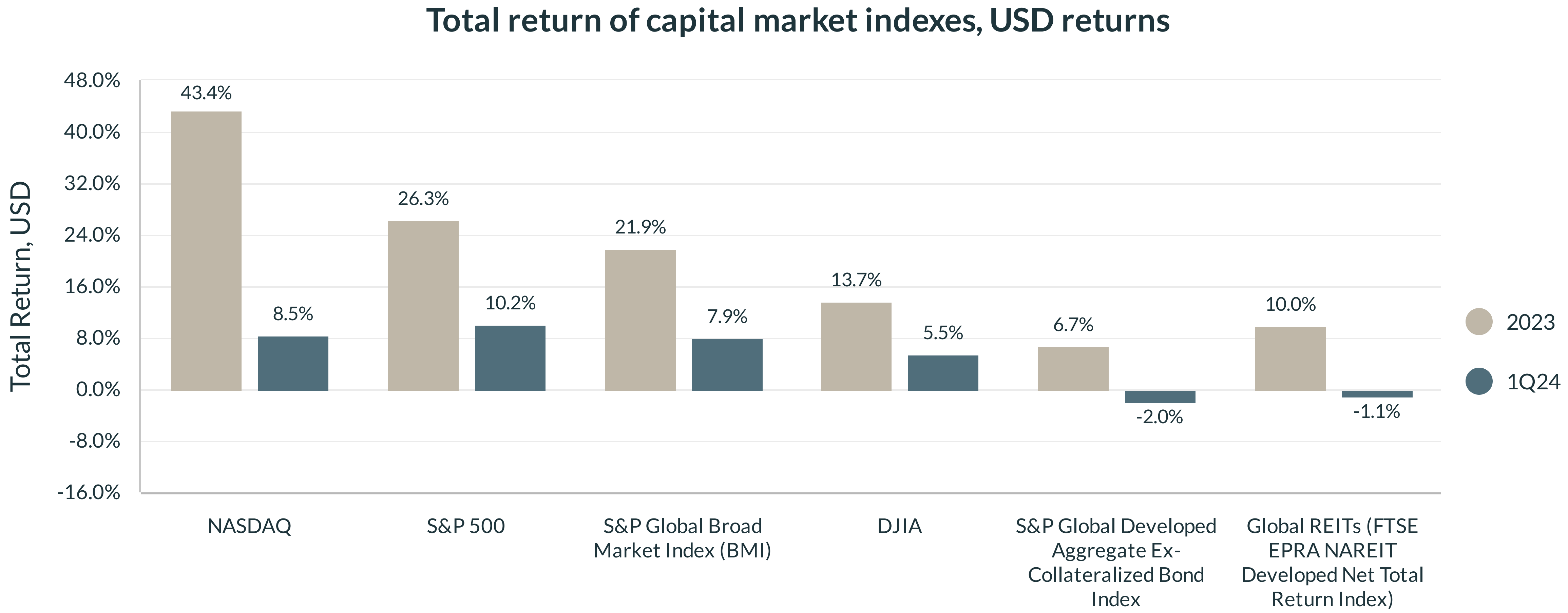
Global REIT Market Performance

REITs continued to lag equities in 1Q24

Global REITs have underperformed broader equities but have beaten bonds over the last two years

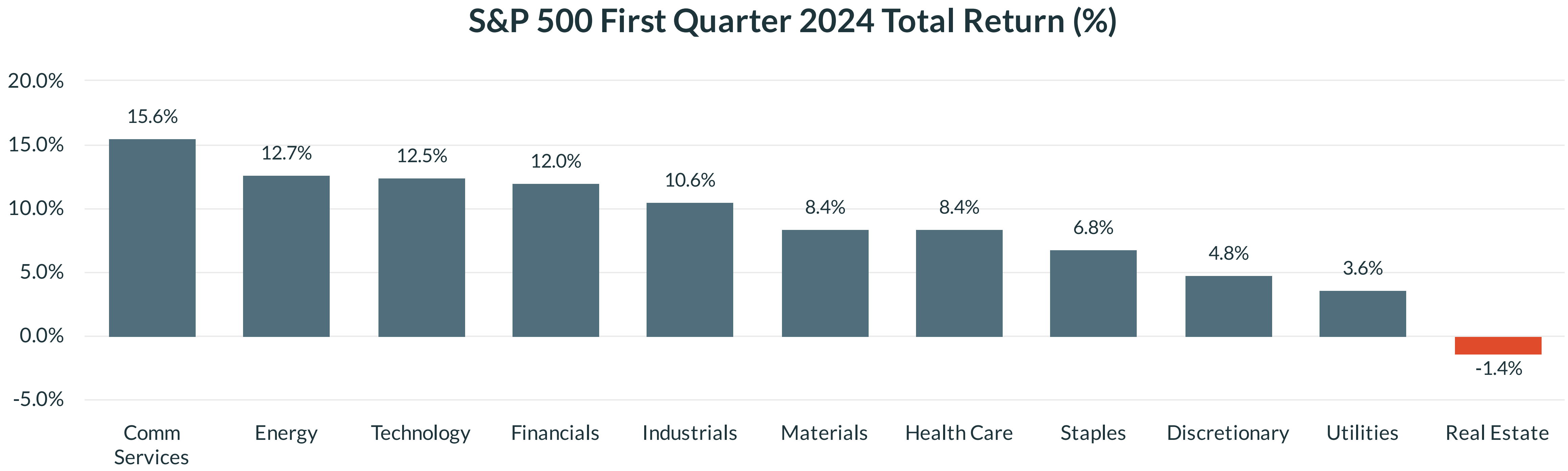


Source: FTSE Russell and Bloomberg, LLC, April 1, 2024

Another great quarter for S&P 500; sideways slog for real estate

The S&P 500 was up 10.2% in 1Q24. The main themes that outperformed last year in 2023 continued to be top performers in 2024 (large > small, growth > value, quality > risk, etc.)

At the sector level, **Tech** and **Comm Services** (the biggest winners in in 2023) outperformed again in 1Q24. Defensive sectors (**Utilities, Staples, Real Estate)** continued their string of underperformance



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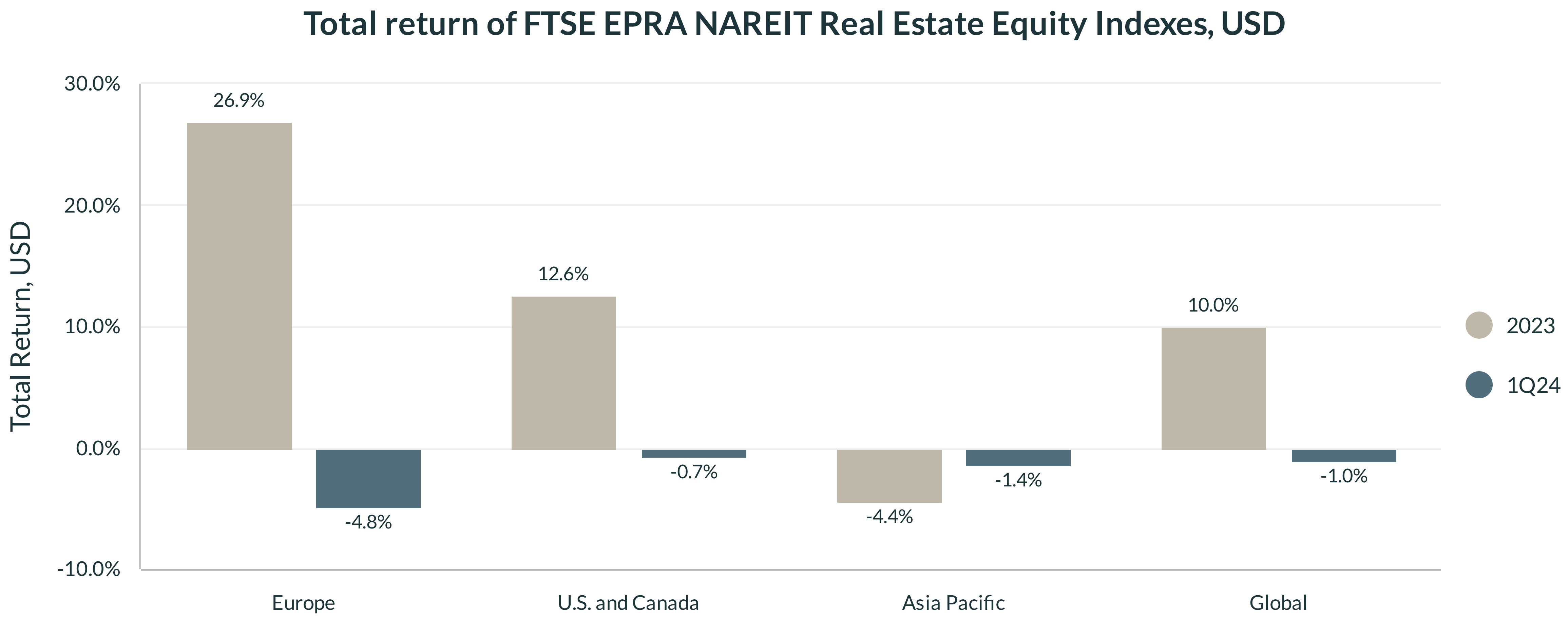
Source: Bloomberg LLC

All REIT regions dipped

U.S. and Canada REITs outperformed but only slightly in the first quarter

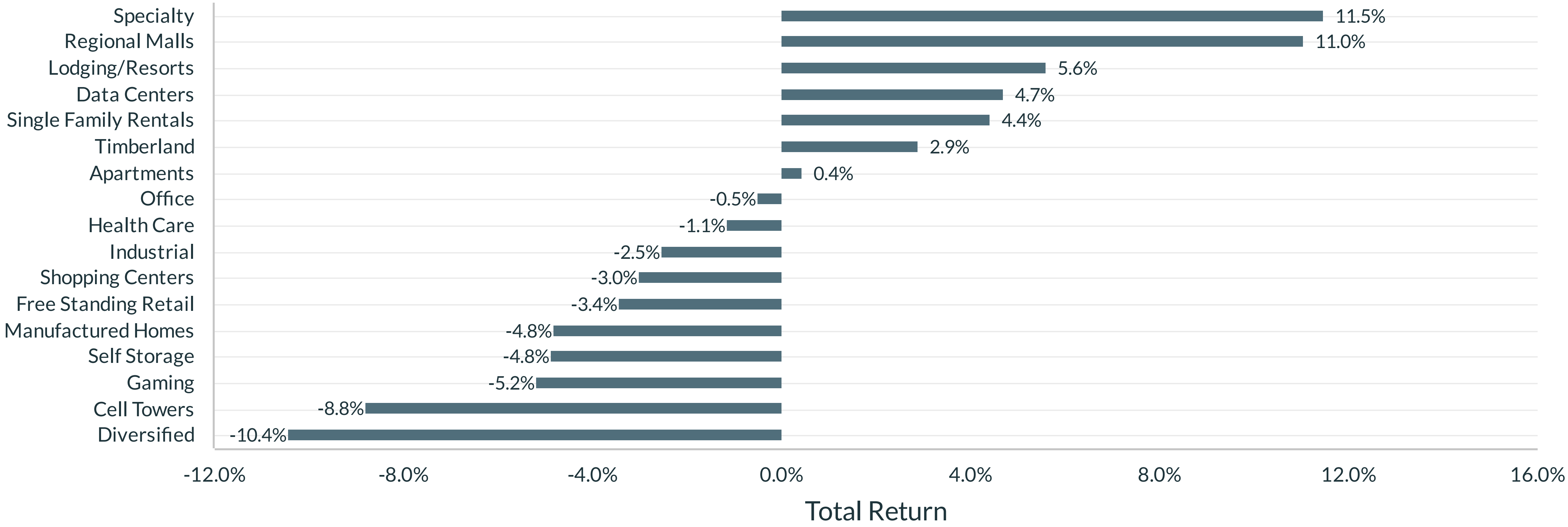


Source: FTSE Russell, April 1, 2024

"Defensive" REIT sectors underperformed

In the U.S.,, **Specialty REITs,** including **outdoor advertising sites**, topped the charts. **Malls, Lodging, SFRs, and Industrial,** outperformed. **Cell Towers, Diversified, Self Storage,** and **Gaming** fared worst

Total return of U.S. REIT property types, 1Q24



Source: NAREIT, market data as of March 28, 2024

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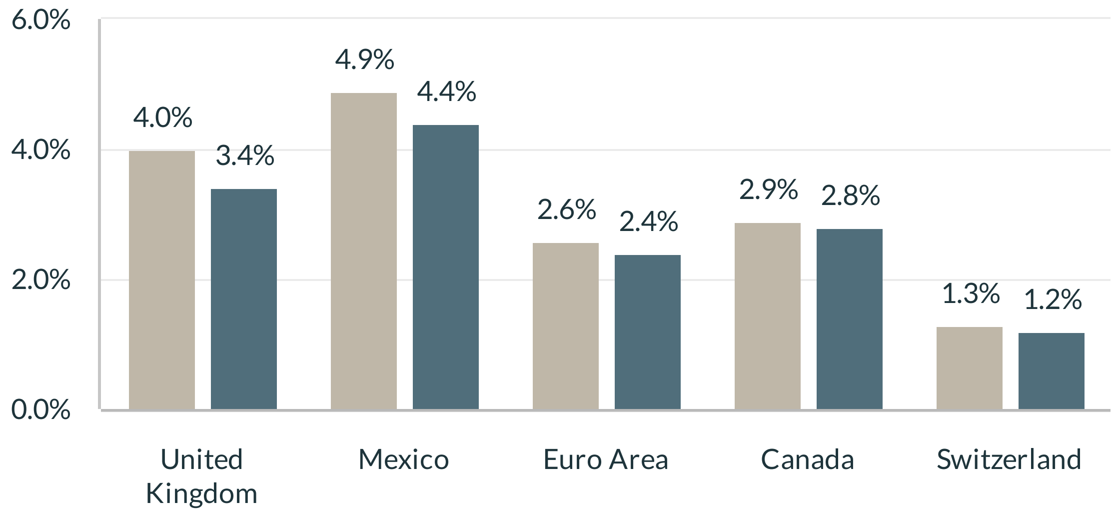
Investment Backdrop

Inflation: not tamed yet

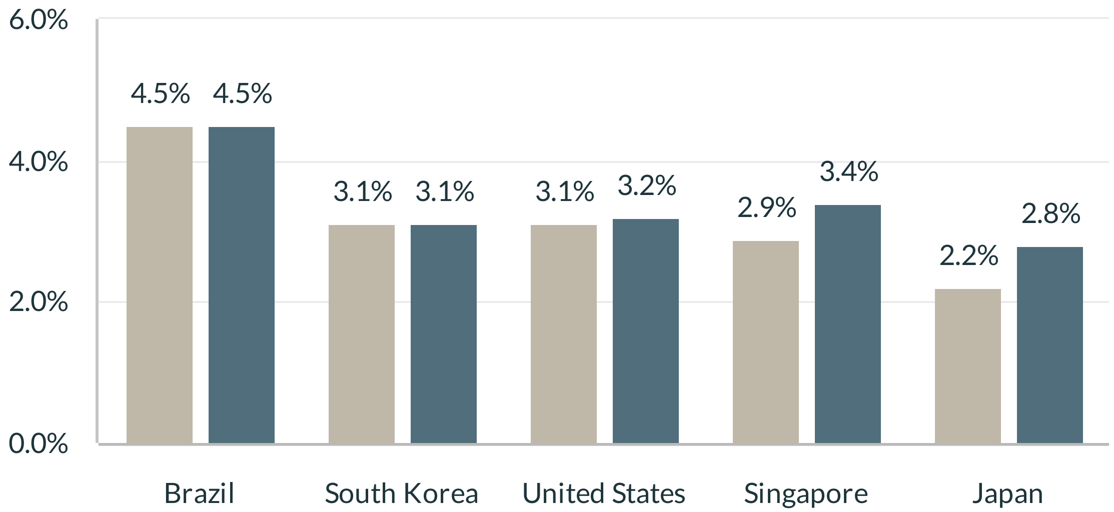
Across the globe, the road to lower inflation following a pandemic-induced spike continues to be bumpy

In the U.S., gasoline costs kept inflation high in February, offsetting flat food prices. Overall prices rose 3.2% from a year earlier, up from 3.1% in January

Countries where annual inflation is DOWN



Countries where annual inflation is FLAT or UP



"Most Recent Month" is February 2024 for all geographies except for Euro Area and South Korea, which is March 2024

Previous Month   Most Recent Month

Previous Month   Most Recent Month

Source: Trading Economics, https://tradingeconomics.com/country-list/inflation-rate-, data pulled April 3, 2024

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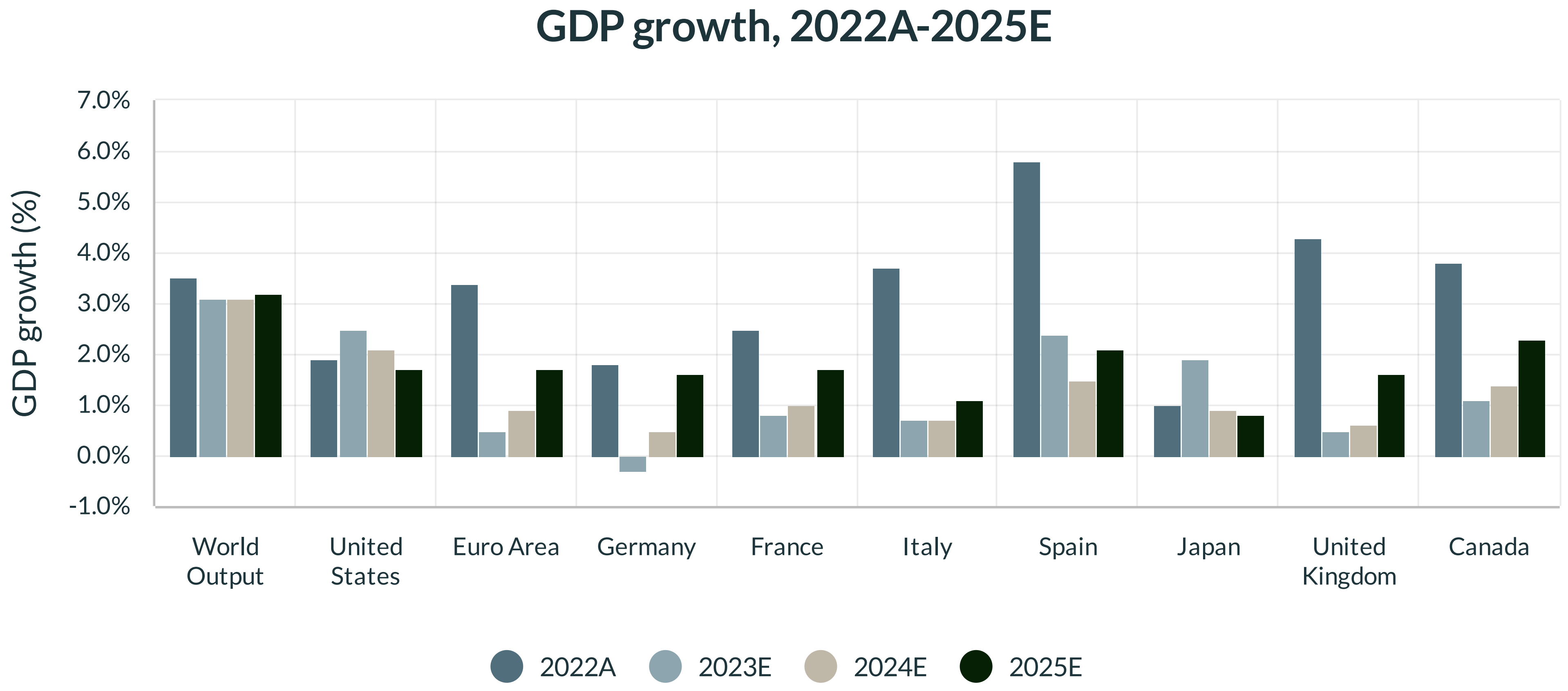
Recession fears continue to subside

Global growth is projected at 3.1% in 2024 and 3.2% in 2025, with the 2024 forecast 0.2% higher than that in the October 2023 World Economic Outlook (WEO)



The forecast for 2024–25 is, however, below the historical (2000–19) average of 3.8%, with elevated central bank policy rates to fight inflation, a withdrawal of fiscal support amid high debt weighing on economic activity, and low underlying productivity growth

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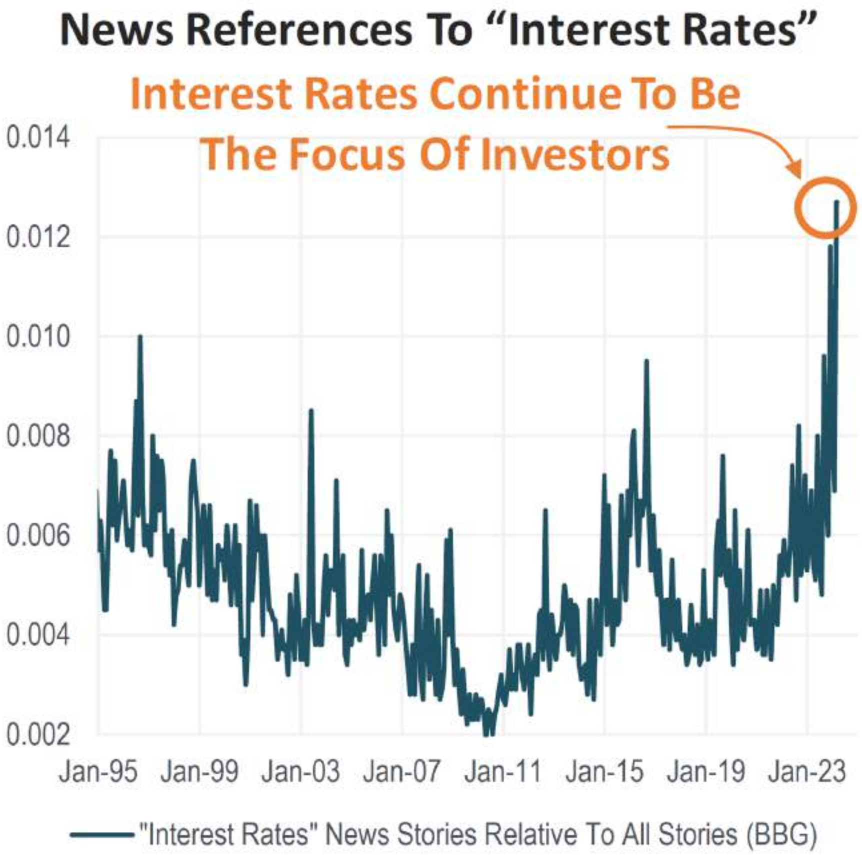
Source: IMF, https://www.imf.org/en/Publications/WEO/Issues/2024/01/30/world-economic-outlook-update-january-2024, data pulled April 4, 2024

What happened to rates and Fed expectations in 1Q24?

The Federal Reserve has been closely watched for the first interest rate cut. Rate cut expectations for 2024 fell from 6 to 3 according to Fed Funds futures. At the March meeting, the Fed's median dot plot showed rate cuts of 3 in 2024 and 3 in 2025, down from 4



How Did Fed Fund Futures and the Dot Plots Change In 1Q24?

WIRP
Dec 2023

Meeting	#Hikes/Cuts
01/31/2024	-0.160
03/20/2024	-1.003
05/01/2024	-2.075
06/12/2024	-3.118
07/31/2024	-3.960
09/18/2024	-4.918
11/07/2024	-5.630
12/18/2024	-6.303
01/29/2025	-6.950

WIRP
End Of Q1

Meeting	#Hikes/Cuts
05/01/2024	-0.098
06/12/2024	-0.667
07/31/2024	-1.055
09/18/2024	-1.755
11/07/2024	-2.212
12/18/2024	-2.903
01/29/2025	-3.375

Fed Fund Futures Went From Expecting ~6 Cuts To 3 Cuts in 2024

FOMC Dots Median

As Of Meeting	2024	2025	2026	Longer Term
12/13/2023	4.625	3.625	2.875	2.5
3/20/2024	4.625	3.875	3.125	2.562
Chg	0	0.25	0.25	0.062

March Fed Meeting Median Dots: No Change For 2024 (3 Cuts Expected); Expectations For 2025 Was Revised Down To 3 Cuts From 4 Cuts

Source: PSC Macro, *What In The World Happened To Markets In 1Q?!?!*, 4/1/2024

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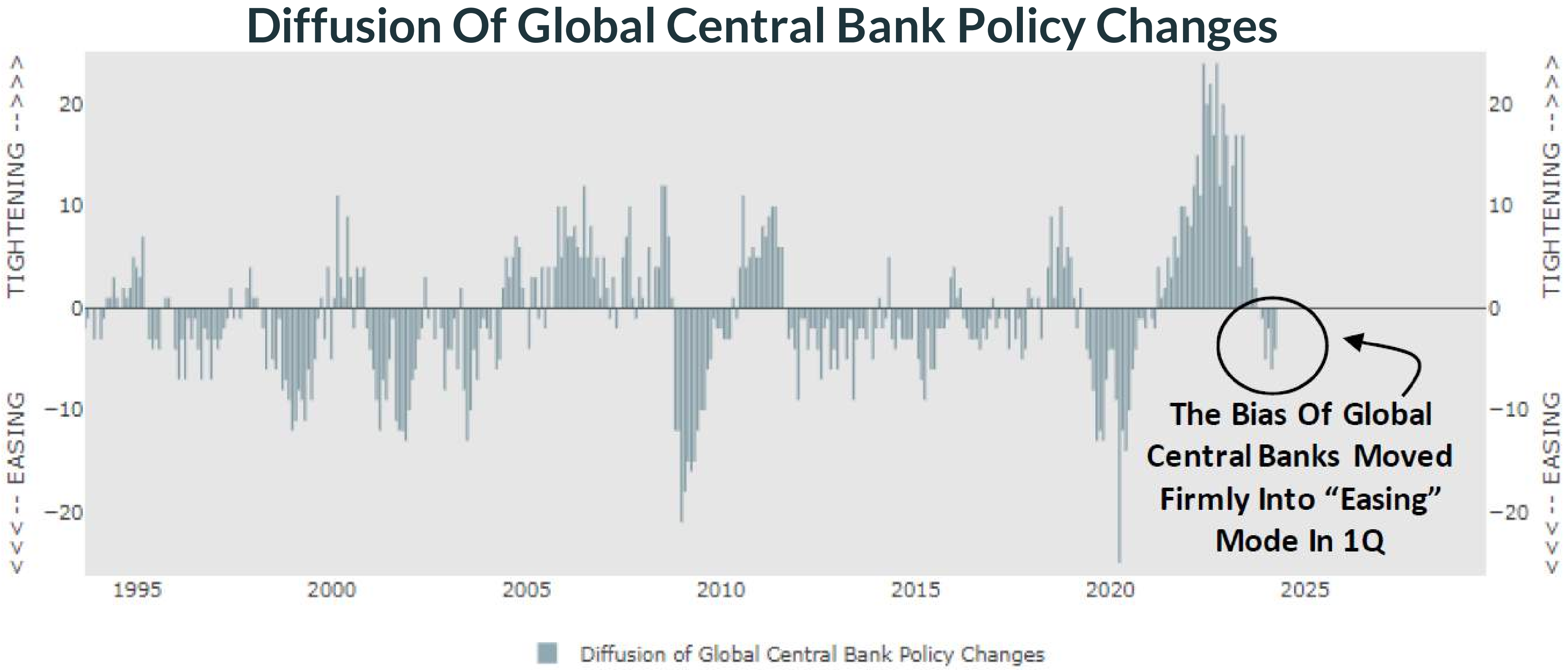
More global central banks eased than tightened

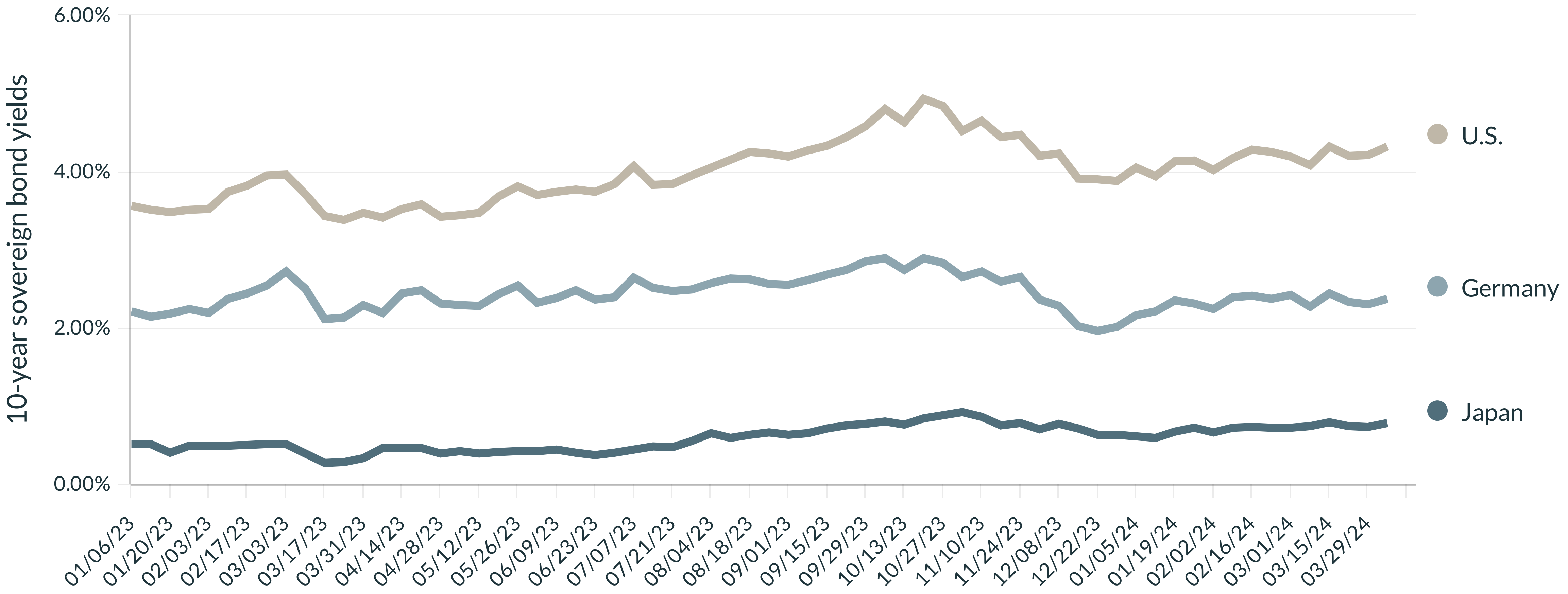
China cut bank reserves in February to defend markets and spur growth, while Japan ended an eight-year stretch of negative interest rates at the end of March



Source: PSC Macro, *What In The World Happened To Markets In 1Q?!?!*, 4/1/2024

10-year sovereign bond yields rose in 1Q24

The start of 2024 saw 10-year yields rise again after dropping at the tail end of 2023. In 1Q24, U.S. yields rose 44 bp, Germany rose 36 bp, and Japan rose 15 bp



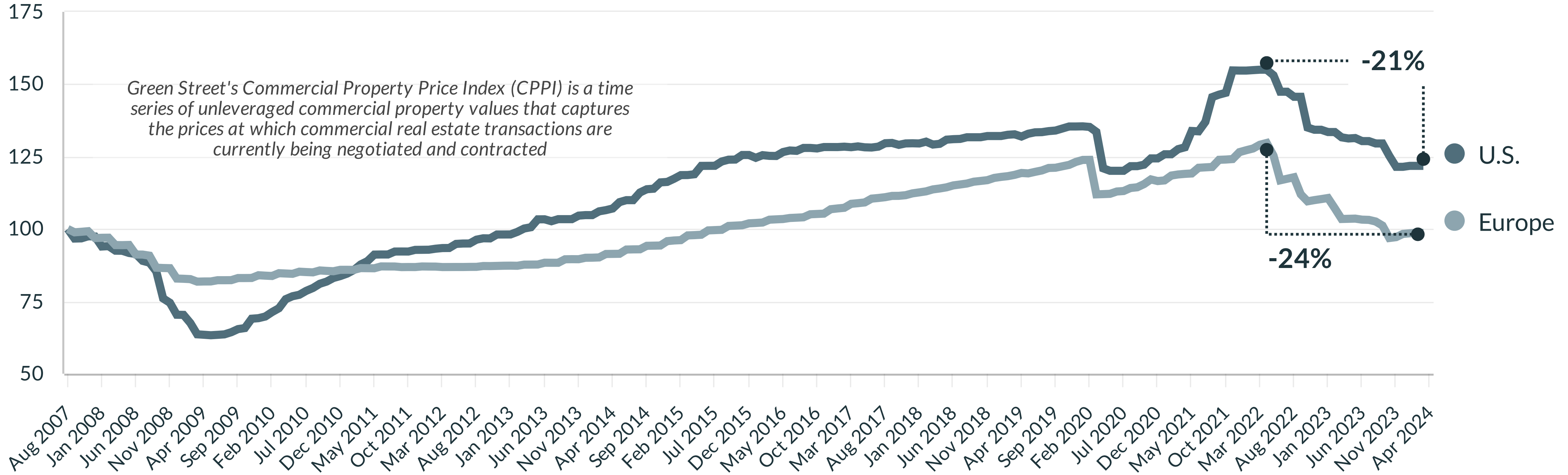
Source: Market Watch, https://www.marketwatch.com/investing/bond/tmbmkjp-10y/download-data, April 5, 2024

Global Real Estate Markets

Property prices have regained their footing

After back-to-back years of significant declines, **property prices have stabilized**. The U.S. CPPI is down 7% over the past year and 21% since its March '22 peak. In Europe, where the market is off 24% from its peak, sector fortunes have diverged. Residential and industrial were up +1.4% each, while the office sector was down -1.1%

Green Street U.S. and European Commercial Property Price Index (CPPI)



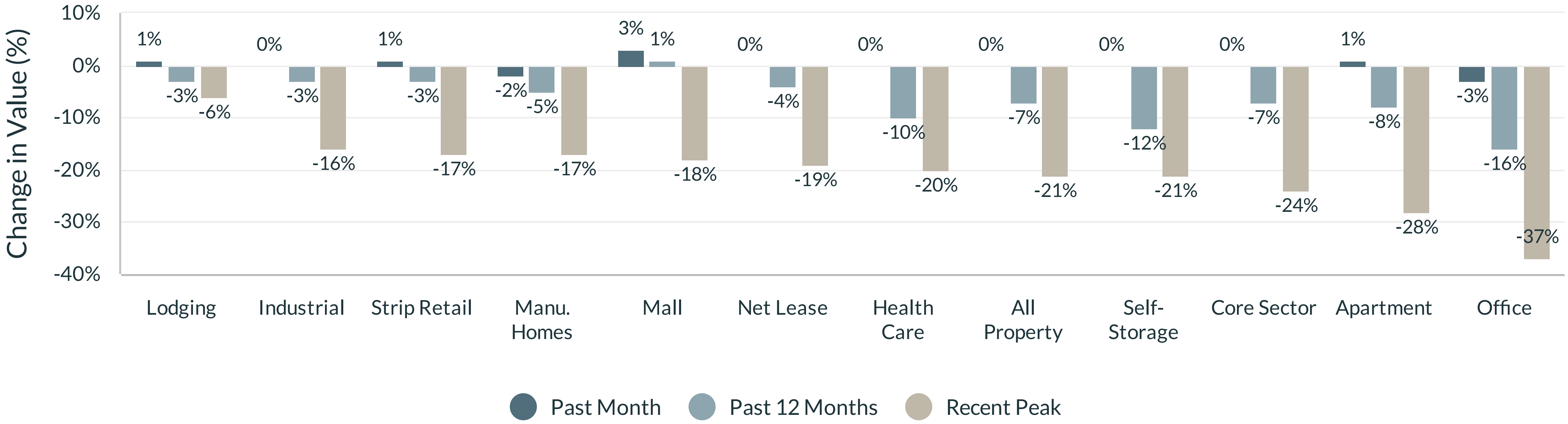
Source: Green Street Advisors, LLC, April 4, 2024

Some private property sectors have begun to turn up

In March 2024, **lodging, strip retail, malls, and apartments rose**, while **office and manufactured homes fell**

Since the 2022 peak, office and apartments have fared the worst, while lodging, industrial, and strip retail have held up best (but still down overall)

Change in Value in Past Month, Past 12 Months and from Recent 2022 Peak, per Green Street CPPI



Source: Green Street Advisors, LLC, April 4, 2024

Transaction activity still down, but less so

Annual transaction volumes reached the lowest level in a decade in 2023, but some renewed momentum emerged in late 4Q

Global investment volumes declined in Q4 to US$166 billion, down 23% year-over-year as pressures facing markets during the first nine months of 2023 persisted into the final quarter. On a full-year basis, volumes totaled US$594 billion in 2023, a drop of 44% compared to 2022

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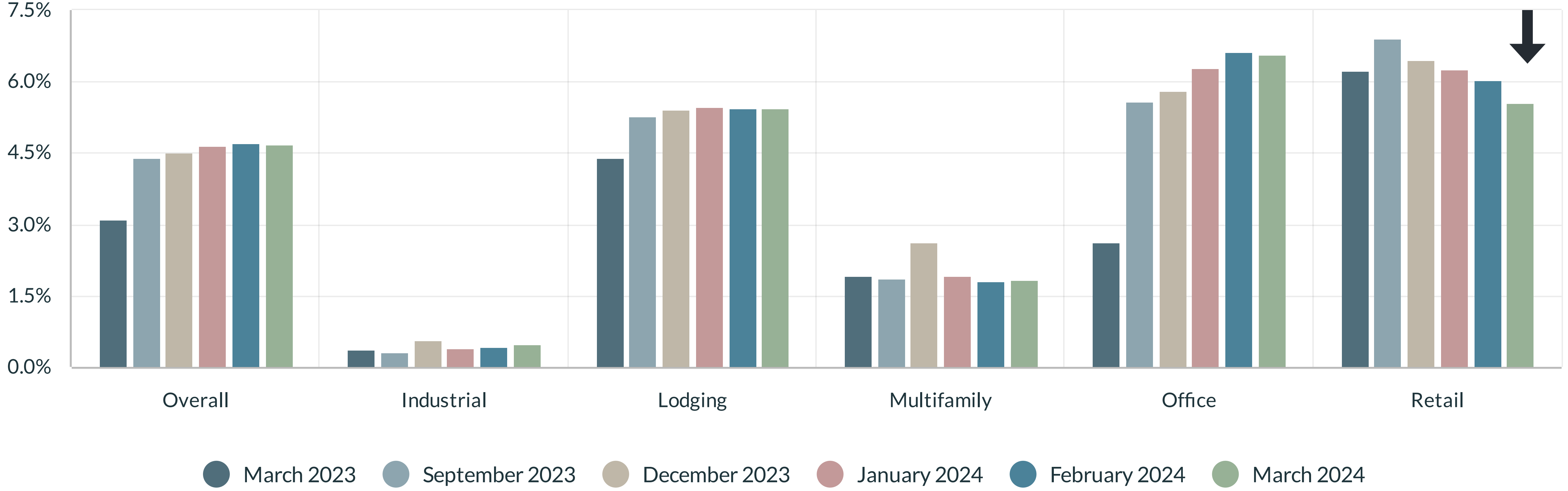
Source: JLL Global Real Estate Perspective - Highlights, February 2024

CMBS delinquency rate dropped slightly in March

Overall, the Trepp CMBS delinquency rate declined 4 basis points to 4.67%. The decline was almost exclusively due to the **continued improvement in the retail sector** as it notched its fourth consecutive monthly decline. The retail delinquency rate declined 47 basis points in March to 5.56%.

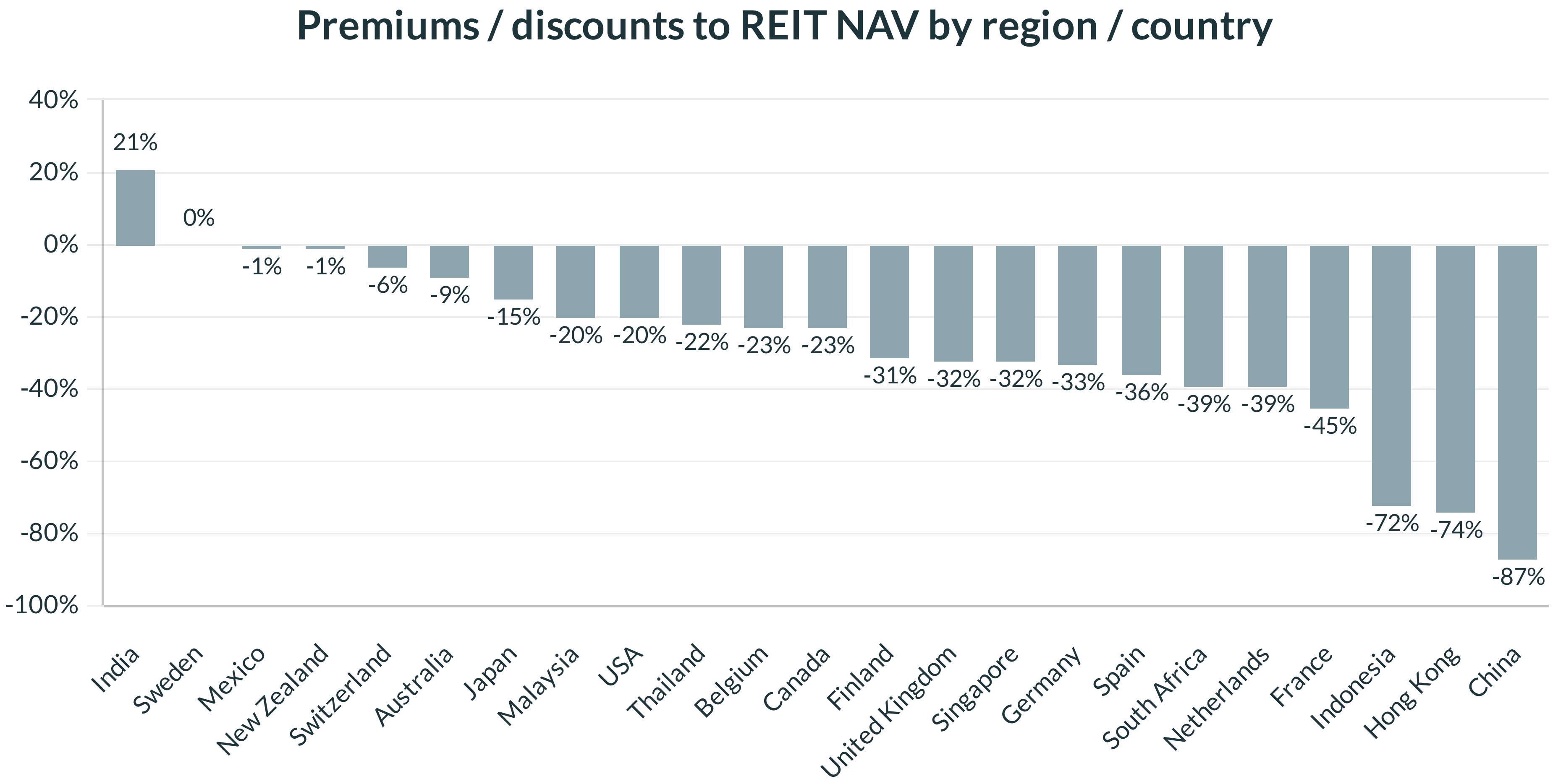
Special servicing rate (%)



Source: Trepp CMBS Research, April 2024

Global REITs show wide deviations from NAV

Global discounts expanded slightly from 26% at the end of 2023



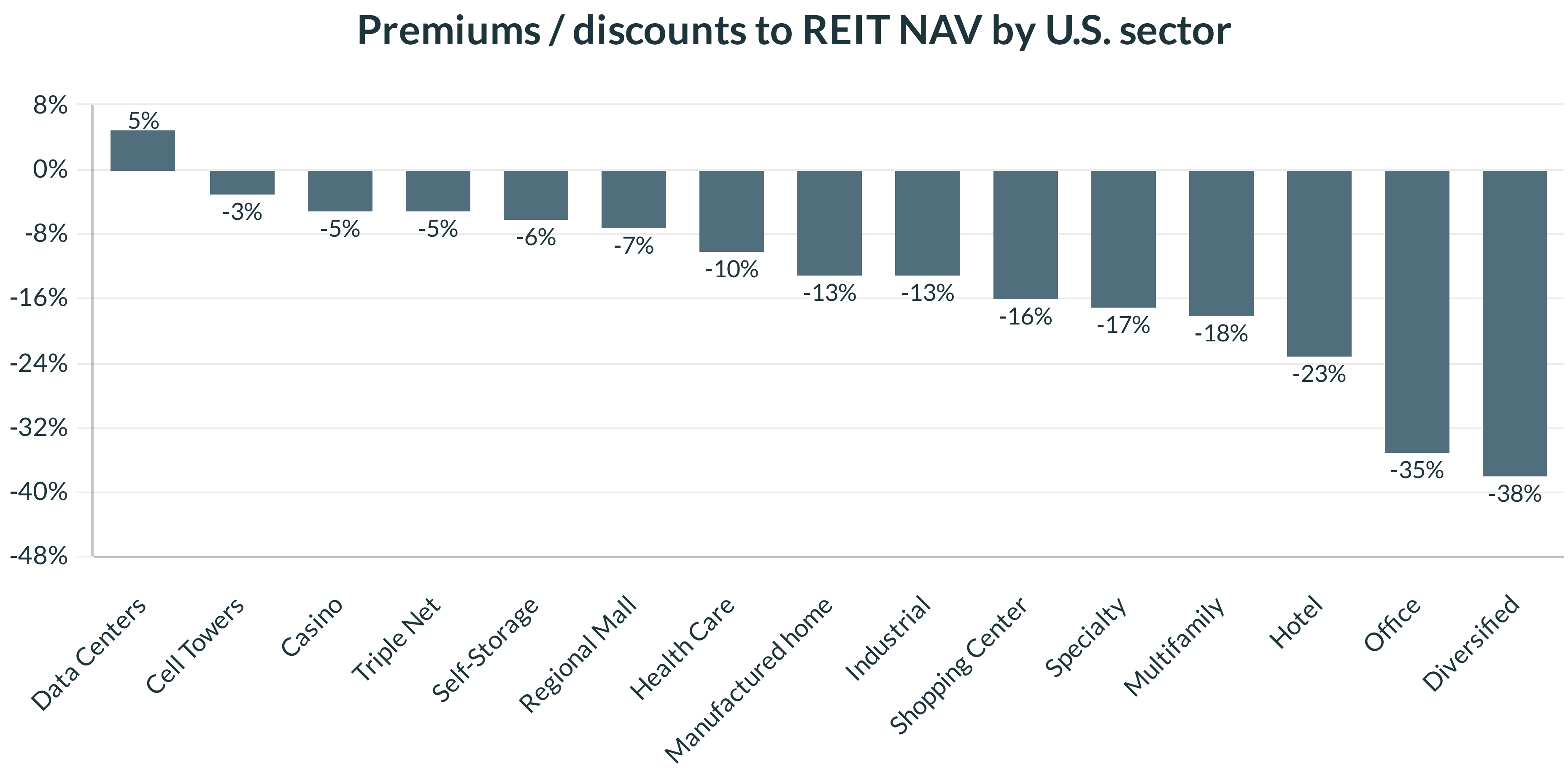
Source: S&P Global Market Intelligence LLC, April 4, 2024

-29%

AVERAGE GLOBAL REIT NAV DISCOUNT TO PRIVATE MARKET VALUES IS DEEP

Most U.S. sectors are trading at discounts

Data center REITs are now the only sector to trade at a premium to NAV in the public market. Offices are at a 35% discount



Source: S&P Global Market Intelligence LLC, April 4, 2024

-20%

U.S. REITS TRADE AT A 20% DISCOUNT TO PRIVATE MARKET VALUES

Positioning: leaning into digital infrastructure, growth

*REITs have underperformed broader equities (especially the "Magnificent 7") dramatically over the last nine quarters. Is now the time for the comeback to begin? The valuation case is there, with stocks trading at discounts to broader equities and to private market values. But what is the catalyst? Could it be the Fed cutting rates? Maybe, but what if that doesn't happen fast enough? Our portfolio is a barbell, with **growth** in digital infrastructure and health care, and **value** in net lease, residential, and shopping centers*

- ## Valuation
  - REIT Price/FFO multiples (19x) are trading below the S&P 500 P/E multiple (21x).
  - Price/NAV -29% globally and -20% in the U.S.
  - Small caps trading at notable discounts to larger peers

- ## Fundamentals
  - REITs should generate ~2-3% NOI growth in 2024
  - Supply remains below average levels, except for pockets such as Sunbelt multifamily and industrial
  - Demand for most property types remains steady; office remains the exception
  - Industrial is seeing an inflection point downward, but that may reverse later this year

- ## Growth
  - Consensus REIT FFO estimates remain at +4-5% earnings growth in 2024
  - Though the U.S. appears on track to achieve a "soft landing," global post-pandemic economic disruptions are driving investor caution

- ## Capital
  - Borrowing rates are back up and the REITs have reacted negaively
  - Fed's actions have negatively impacted asset pricing, the financing market, and transaction volumes
  - Fed’s inflation-fighting efforts have created some stress in the banking system and have led to increased capital costs
  - REIT balance sheets still in great shape, with average leverage ~35%, despite decrease in asset values
  - Large recent JVs demonstrate private capital demand for REIT assets

- ## Portfolio preferences
  - **Data centers**: Demand, leasing and development are strong while supply is tight
  - **Health Care**: The health care sector is seeing favorable conditions, including improved senior housing and skilled nursing fundamentals, stable medical office fundamentals, and increased leasing demand for life science
  - **Net Lease**: Net lease REITs have solid balance sheets and attractive valuations - plus growth!
  - **Industrial**: The sector faces current supply challenges but has strong embedded growth. Rent increases may slow but new supply is likely to fall
  - **Digital infrastructure (e.g. billboards)**: The stocks are cheap and the sector is in the early innings of digital adoption
  - **Residential**: The residential sector shows contrasting conditions among multifamily, manufactured housing, and single-family rentals (SFRs). We prefer SFR
  - **Shopping Centers**: We see a solid operating environment but slower FFO growth in 2024
  - Strong balance sheets haven't gone out of style
  - We expect more M&A in 2024

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Sector Outlooks

Industrial: tempered growth expectations

Industrial REITs are navigating a complex environment marked by solid SSNOI growth but tempered expectations for FFO growth. Strategic positioning and management of development pipelines will be critical for maintaining growth and managing the anticipated softening in market rental growth

- **SSNOI growth softening**

  REITs saw strong SSNOI growth for Q4 2023. However, projections for 2024 FFO guidance fell short of expectations. The sector's mark-to-market earnings buffer is expected to shrink as net absorption turns negative for the first time since 2010

- **Focus on strategy**

  The industrial REITs are leaning into long-term strategy in this time of declining fundamentals. Prologis, for instance, is highlighting their resilience and multiple value drivers despite the broader sector's challenges

- **Supply peaking**

  Market rental growth is expected to slow to the lowest in 11 years as demand falls and vacancies rise to a 10-year high. However, supply growth is forecast to drop sharply from 2.8% in 2023 to 0.9% in 2025, which may improve the market

- **Valuation rich, but...**

  Industrial REITs trade at a premium, with an average AFFO multiple of 27x, above the REIT average. The forecast for 2025 anticipates a rebound with +10% y/y FFO growth, though

Sources: Company reports, BMO, Sugi Capital Management

Residential: contrasting conditions

The residential rental market is showing a divergence among multifamily, manufactured housing, and SFR's, and between Sunbelt and Coastal areas. Some REITs are shifting focus to occupancy over rent increases

- **Jobs-to-supply ratio concerns**

  The new-jobs-to-supply ratio, an indicator of market health, is forecasted to be lower in 2024-25 across the board, with a particularly stark difference between Coastal (3.5x) and Sunbelt (1.8x) markets

- **Sunbelt vs. coastal**

  There's a notable difference between Sunbelt and Coastal apartment markets, with Sunbelt multifamily rents showing a year-over-year decrease (-2.2%) in asking effective rents, contrasting with a slight increase (+0.4%) in Coastal areas

- **SFR and MH better than apartments**

  Single-family rentals likely to increase rents significantly due to less affordable options and limited inventory. Projected net income growth for 2024 averages 4%. Manufactured home rates should rise steadily, with a forecasted average 5% net income growth from strong pricing leverage and solid collections

- **Impact of new supply**

  The apartment market is experiencing a significant influx of new supply, especially in the Sunbelt region, where it's expected to grow by +4.3% in 2024. This compares to a more moderate increase of +1.7% in major Coastal markets

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Sources: Company reports, BMO, Sugi Capital Management

Shopping centers: solid but uninspiring

Despite what the strip retail REITs call one of the best operating environments in years, those good tidings are only translating to roughly 2% growth for 2024

- **4Q23 earnings were good**

  Shopping center REITs reported robust 4Q23 results, hinting at resilience amid macro uncertainties. However, concerns are rising due to signs of consumer strain at the lower end and an uptick in bankruptcies potentially affecting short-term earnings growth

- **Growth challenged**

  The main challenge for shopping centers is limited expected 2024 FFO growth (~+2%) in what seems to be the best operating environment in years

- **Growing watch list**

  A slight increase in the watch list of tenants and average REIT exposure suggests growing risks, particularly among certain shopping centers more vulnerable to downturns. Despite ongoing store openings, driven mainly by discounters and fitness/wellness sectors, a pick-up in bankruptcies is anticipated for 2024, which could pressure earnings

- **Valuation**

  Despite an attractive average implied cap rate of 6.9%, shopping center REITs trade at a premium FFO multiple relative to history, putting some investors on the sidelines

Sources: Company reports, BMO Research, Sugi Capital Management

Regional malls: charting a new course

The best performing sector of the last five quarters, malls REITs proved that the mall is **NOT** dead. But the stocks are are not so cheap, while the sector grapples with lingering structural challenges, including declining foot traffic and tenant struggles

- ## Mall tenant challenges
  The fading mall traffic and struggles of mall tenants persist despite omnichannel efforts. This suggests structural issues make reversing declines in traffic and performance hard

- ## Diverging strategies and performance
  - **Simon Property Group** displayed flat core earnings, reflecting broader sector challenges
  - A management change at **Macerich** hinted at potential strategic shifts within the sector, possibly affecting future consolidation and restructuring efforts
  - **Tanger Outlet Centers** have shown some positive signals by stabilizing their lease expiration schedules and diversifying their portfolio with non-outlet acquisitions. However, significant near-term lease expirations loom

- ## Market rally and acquisition opportunities
  Despite a market rally over the last year-plus, mall and outlet REITs like SPG, MAC, and SKT face the challenge of utilizing their inflated stock valuations to diversify away from traditional malls or outlets. Accretive acquisitions are crucial for sustaining growth amid the sector's challenges

- ## Valuation - not so cheap any more
  The mall REIT stocks trade at a 14x multiple on 2024 earnings but only a 7% discount to NAV. In other words, the stocks appear cheap on an earnings multiple basis but expensive on an NAV basis

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Sources: Company reports, Sugi Capital Management

Office: long waiting game

The office sector continues to battle back. Most office REITs have increased debt load (not as severe as in the private sector, but high relative to other REITs). And with the timeframe to sign contracts, invest in capital expenditures, and work through rent free periods, it could be 2026/2027 before we see cash flow improve

- **Occupancy trends**
  We anticipate occupancy rates for office REITs to hit their lowest in 2025, with a near-term trend of declining cash flow. However, our updated models and leasing momentum hint at a modest recovery

- **Opportunity knocks?**
  We are beginning to see some opportunities in office REITs, but are focused on ones with strong balance sheets, quality portfolios, and Sunbelt exposure

- **Outlook and valuations**
  Office REITs are navigating through weak cash flow trends, with AFFO growth rates at -7% to -8% for 2024 and flat to -3% to -4% for 2025. That said, many office REITs are trading at single digit AFFO multiples

- **Heavy capex coming**
  If and when leasing volume eventually increases, we see substantial capital expenditure loads, potentially exceeding 25% of cash NOI. This could continue to pressure cash flows into 2026/2027

Sources: Company reports, JPM Morgan, Sugi Capital Management

Health care: tailwinds

Healthcare REITs are seeing improved senior housing and skilled nursing fundamentals, favorable government reimbursement for skilled nursing, early signs of increased leasing demand for life sciences though softer pricing, stable medical office fundamentals, and improved acquisition opportunities for those with cost advantages

- **Skilled Nursing**

  We anticipate a 4.1% rise in Medicare Part A payments for FY25, the largest in 15 years. Watch for pressures from Medicare Advantage, with its lower reimbursement rates and shorter stays

- **Senior Housing**

  We are observing occupancy gains and solid revenue per occupied room (REVPOR) in Q1 2024. Despite labor costs, occupancy near pre-pandemic levels promises higher net operating income (NOI) margins

- **Life Science**

  We see rebound with a growing leasing pipeline and positive capital market trends, though soft pricing persists due to supply in major markets

- **Medical Office**

  We see steady demand and rent increases for medical offices, though high cap rates slow acquisitions. Healthcare real estate looks promising for accretive buys, amid scrutiny of private equity's health sector involvement

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Sources: Company reports, Deutsche Bank Research, Sugi Capital Management

Self storage: not yet at an inflection point

Although visibility remains low, there has been a deceleration in the pace of rate declines. Supply should also continue to slow, which may position storage for a '25 recovery

- **Multiple challenges**

  The sector faces headwinds from new customer price competition, substantial negative releasing spreads, and uncertainty in housing and macroeconomic conditions

- **Real-time demand data less bad**

  Early 2024 shows a seasonal uptick in demand, as indicated by improvements in web traffic and foot traffic through mid-March. This aligns with a general anticipation of easing street rate pressures and a better leasing season ahead

- **Recovery in 2025?**

  The self storage sector showed some resilience in Q4 2023, outperforming expectations despite softer initial guidance for 2024. Signs of stabilization in rate declines and seasonal improvements in demand indicators maintain a cautiously optimistic outlook for a recovery in 2025

- **Valuations reasonable**

  Self storage REITs trade at a 17x AFFO multiple on 2024 earnings, versus 19x for the sector as a whole. They trade at a 6% discount to NAV

Sources: Company reports, BMO Research, Sugi Capital Management

Net lease: growth at reasonable price

At current valuations, we believe the triple net REIT sector includes many good risk-adjusted opportunities. The subsector has underperfomed as rates have ticked up again. But in parallel, capitalization rates have increased, providing potential fuel for the companies' external growth

- ## Growth - without dilution?

  Given the volatility in the cost of capital over the past few months, a key focus point for triple net management teams has been how much growth they can deliver in 2024 -- **without** having to issue incremental equity

- ## Leveraged to lower rates

  The triple net sector has historically traded with a high inverse correlation to bond yields, given clear cost of capital implications. While we still believe that the triple net REITs can rebound even with interest rates in the current range, we see outsized performance from triple net if rates fall

- ## Tenant concerns manageable

  Although certain tenants across the properties may face challenges (e.g. At Home, Big Lots, and Party City), we view the overall health of the tenants as fairly robust and do not foresee meaningful tenant bankruptcies during the current fiscal year.

- ## Valuation is "GARP"-y

  Triple Net REITs are trading ~5x turns inside REITs overall and ~4x turns inside their 5-year trailing average spread, while offering 4% AFFO/sh growth into 2024 (consensus estimates). This growth profile is more attractive than retail, which trades at a higher multiple, and in line with the broader REIT index, while trading at a significant discount

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Sources: Company reports, Mizuho Securities, Sugi Capital Management

Data centers: in high demand

Strong leasing demand is driving growth in development opportunities, while landlords are benefiting from tight supply. Long-term demand coupled with natural supply constraints will drive higher returns on investment as landlords are in prime position to capture value

- **High development yields**

  North American development yields averaged 10.2% in FY23, up >200 bps from FY22

- **Superpowered demand**

  FY23 net absorption of 5 GW was up from 3 GW in FY22, and 4Q23 net absorption of 1,600 MW was more than double the 750 MW figure from 4Q22

- **Hyperscale capex growth**

  Generative AI continues to drive accelerating spend, which should continue to push lease rates higher and keep vacancy rates low

- **Premium REIT valuations**

  Data centers are one of the few sectors trading at a premium to NAV (~5%), and at a 22.5X AFFO multiple (versus the sector average of 19.2X)

Sources: Company reports, Citi Research, Sugi Capital Management

Cell tower REITs: relative value

Towers continued to de-rate into 1Q24, as concerns about slower carrier investment persist. With the impact of elevated churn lapping in 2025 and significant negative sentiment already priced in, the outlook should improve, especially as AI advancements fuel demand for 5G

- **Carrier capex headwind**

  REITs expecting ~25% lower spend than average in FY24, while forecasting spending trends to inflect in 2H24

- **Weak FY24 guidance**

  Elevated churn from lower carrier spend and the ongoing consolidation from the Sprint/T-Mobile merger weighed on the sector

- **International growth potential**

  Growth potential outside of the US (with exception of Latin America) is greater in the short term as leasing demand has farther to go to catch up

- **Cheap-ish valuations**

  Currently, tower stocks trade at attractive ~17x NTM P/AFFO, below REIT universe at 19x

Sources: Company reports, Citi Research, Sugi Capital Management

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