Global Real Estate Securities Market Update

Third Quarter 2024

October 9, 2024

Darling Quarter commercial street art installation
Sydney, Australia

Before we get started

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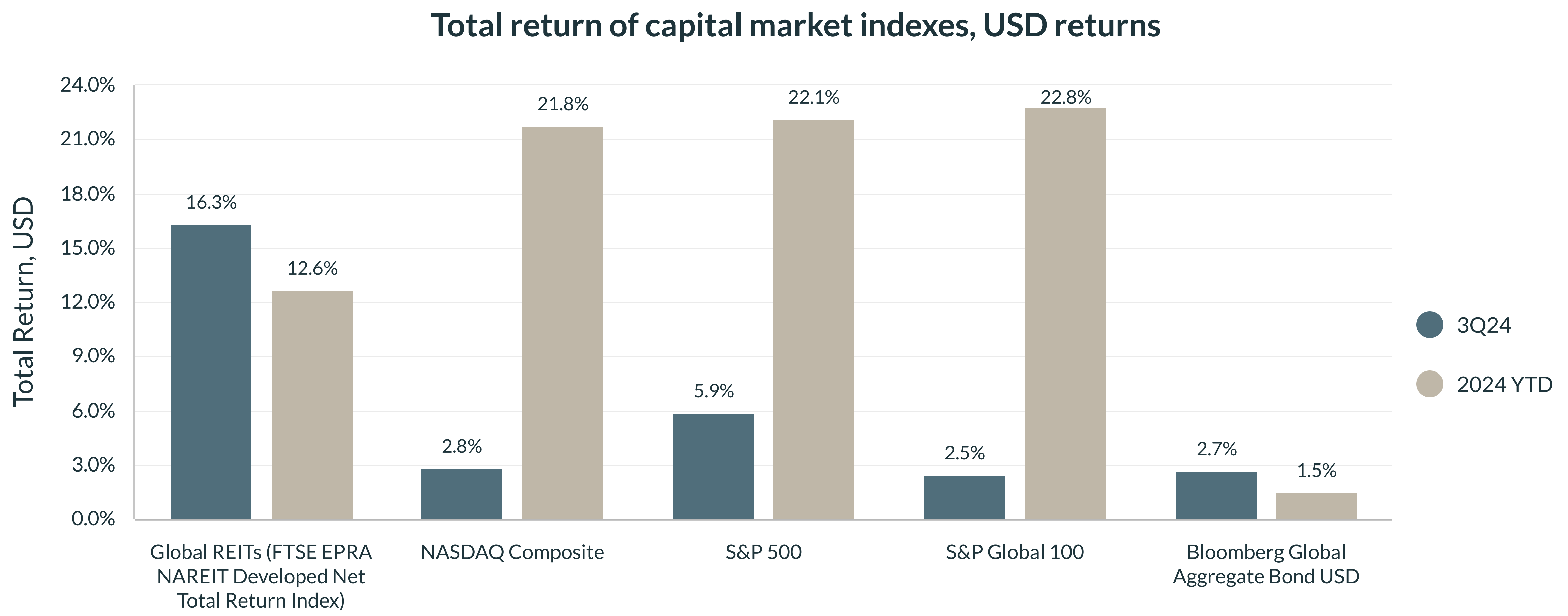
Global REIT Market Performance

REITs win the third quarter

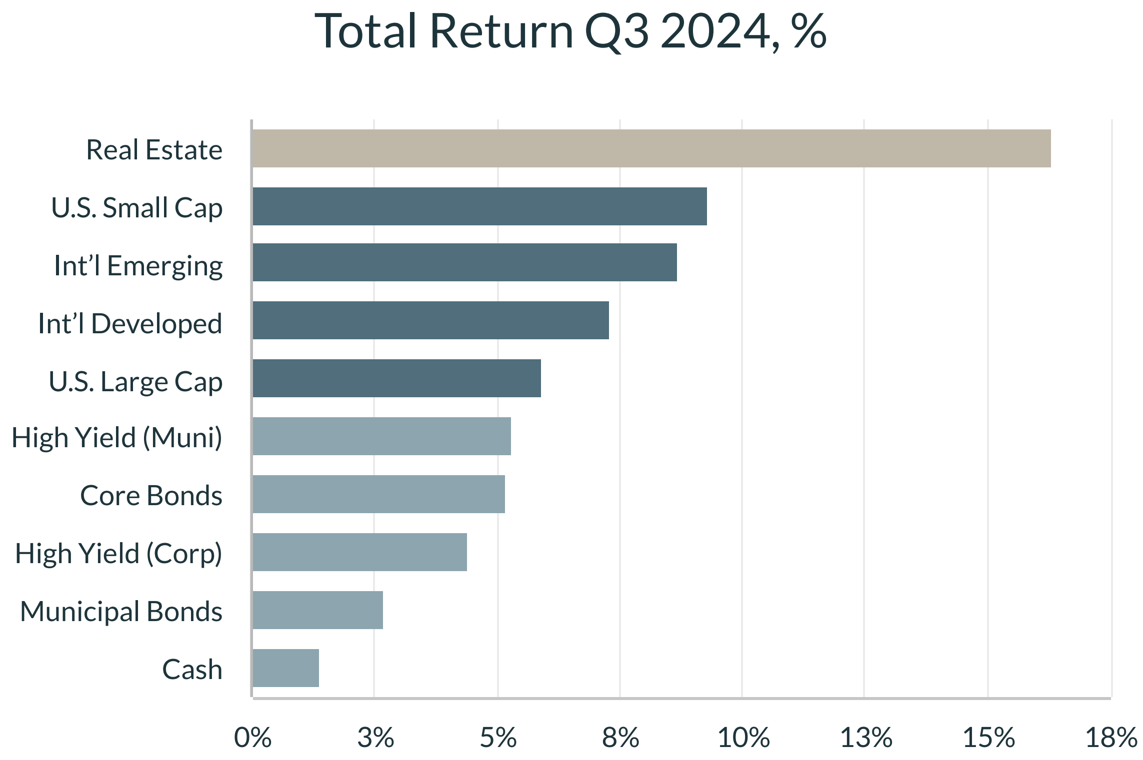
Global REITs made a dramatic run in 3Q24, pounding equities and bonds

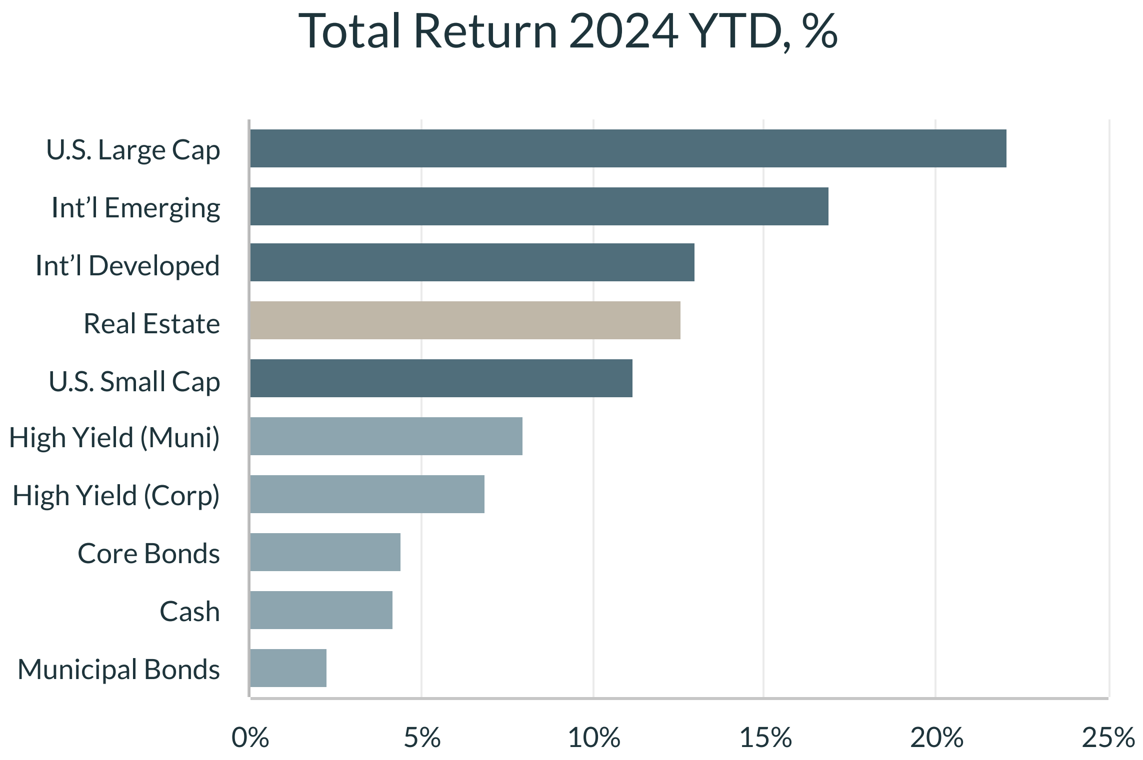


Sources: FTSE Russell and Bloomberg, LLC, October1, 2024

Major asset classes positive in 2024, but with a notable rotation into real estate in Q3

Several out-of-favor portions of the market like REITs, small caps and value stocks outperformed. Interest rates fell, leading to solid total returns for bonds across the credit spectrum





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Sources: FTSE Russell and Bloomberg, LLC, October1, 2024

Key broad market trends in 3Q favor REITs

Whether the REITs were the tail or the dog, the market saw one of its best quarters ever. Current trends favor the real estate market

The Fed Finally Cut Rates (!)

Lower borrowing costs improve REIT profitability and property values if long-term rates follow the Fed. Economic concerns could offset gains, though

Employment Weakened (Sahm Rule Triggered)

Weakened employment reduces demand for certain real estate, but employment remains at high levels

Inflation Cooled Enough To Reassure The Fed

Lower inflation stabilizes borrowing costs and operating expenses, boosting REIT appeal net-net

Bad News Became Bad; Good News Became Good

Strong fundamentals in most REIT sectors now shining through

Positioning Reconverged As Policy Starts Normalizing

A positive for REITs, as they had underperformed dramatically since 2022

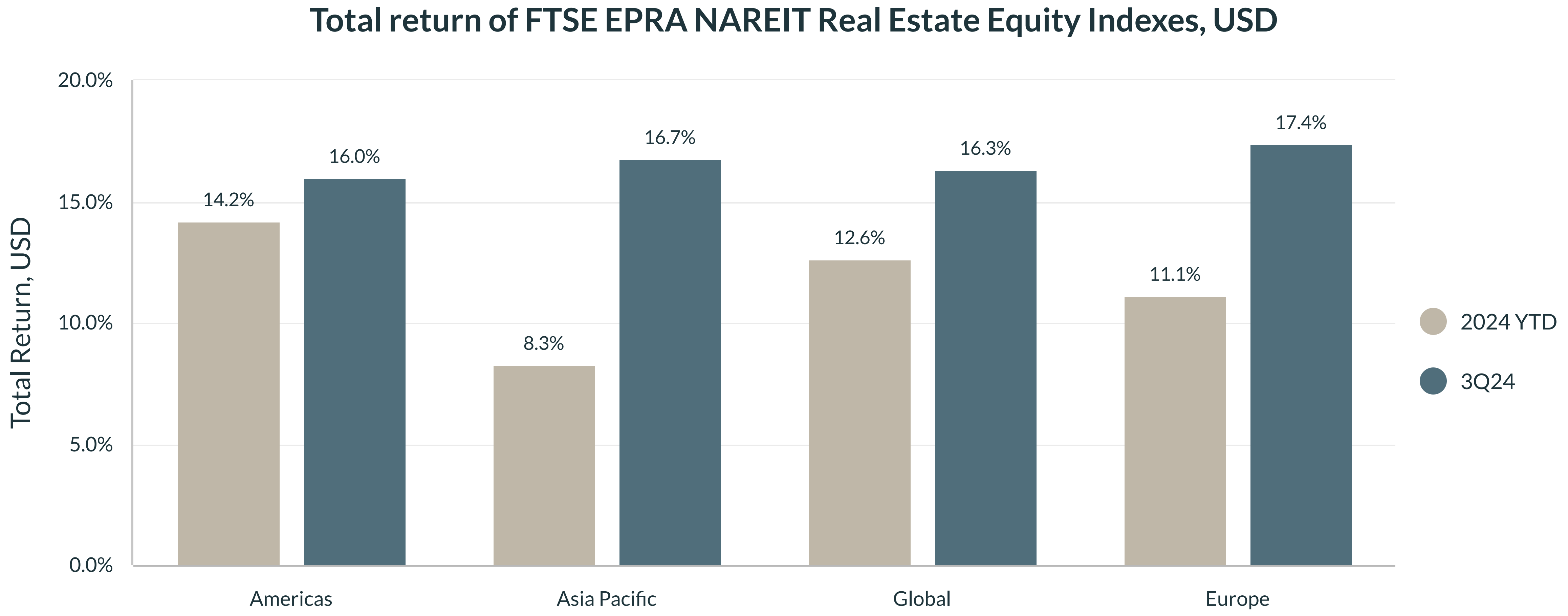
Volatility Spiked As The Yen Carry Trade Unwound

Volatility was short-lived, though, defying many market prognosticators

Sources: PSC Macro and Sugi Capital Management, October 1, 2024

Rising tide lifted all REIT regions

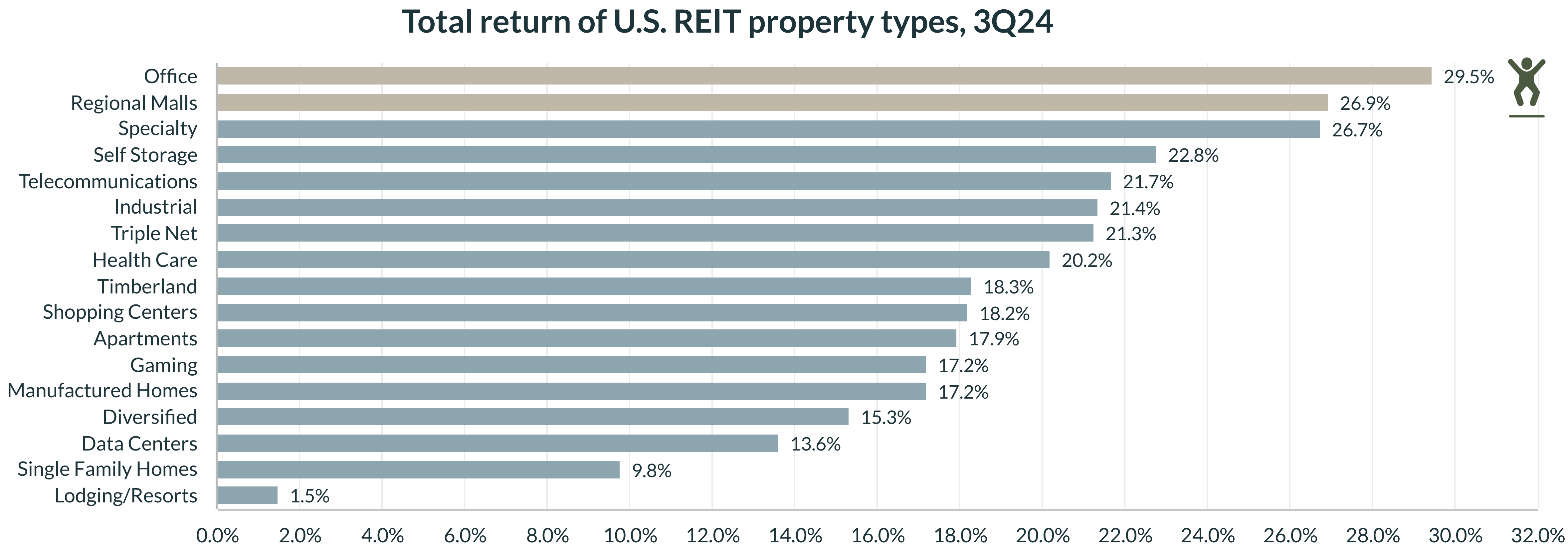
Not much differentiation amongst regions as only 140 bp separated the top (Europe, +17.4%) from the bottom (Americas, +16.0%)



Source: FTSE Russell, October 1, 2024

Office and malls: the comeback kids

In what probably surprised many REIT investors, **office** and **retail malls** topped the chart in the third quarter, with nearly 30% returns. Self storage also defied expectations, at +23%. Market darlings data centers (+14%) and single family homes (+10%) were up, but lagged. **Lodging** (+1%) was at the bottom



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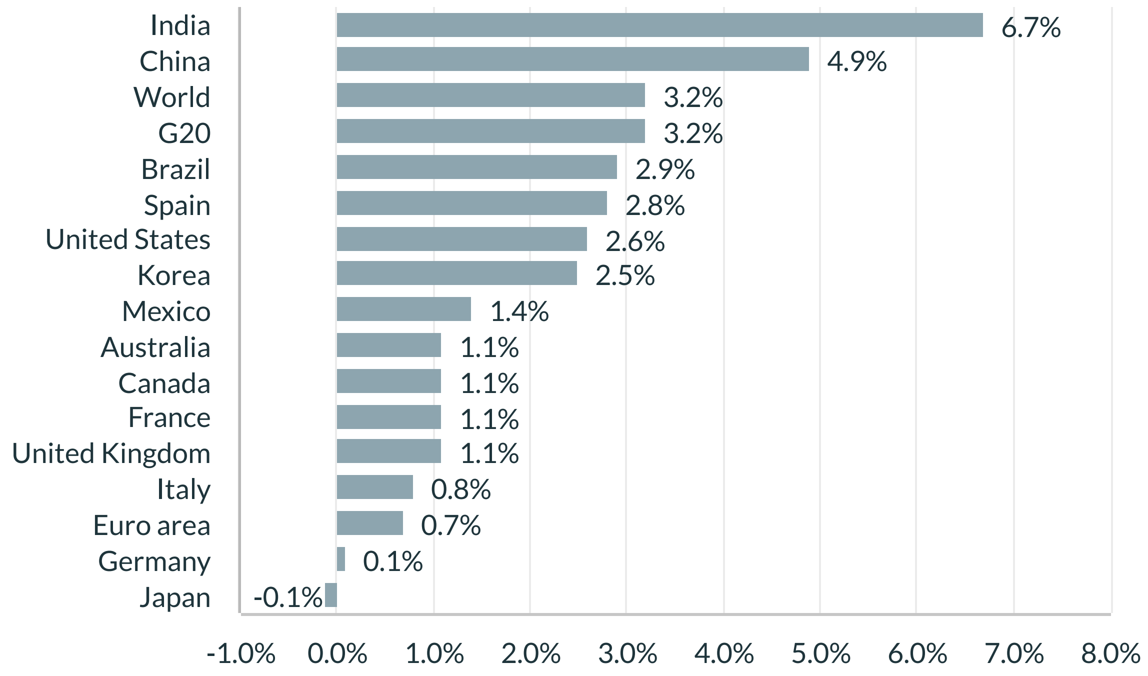
Source: NAREIT, market data as of September 30, 2024

Investment Backdrop

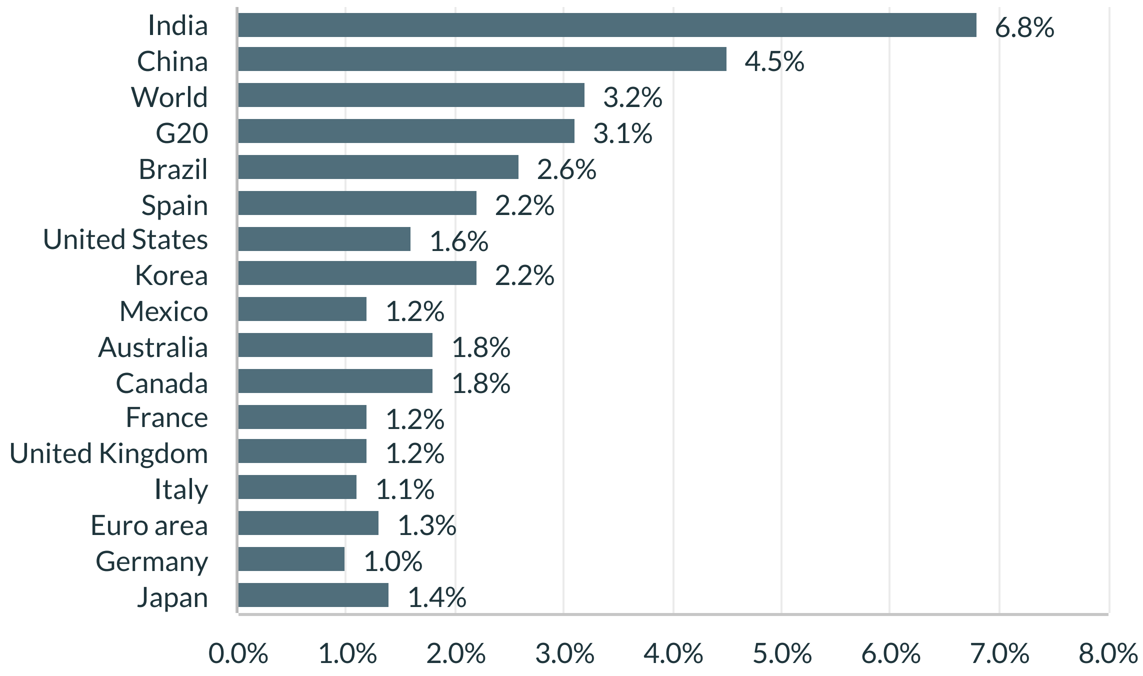
Global growth stabilizing

The global economy is steadying, with projected growth rates of 3.2% in 2024 and 2025, closely mirroring the solid pace seen in the first half of the year. Strong domestic demand has bolstered activity in key markets like the US, Canada, Spain, Brazil, and India

Projected Real GDP Growth, 2024E



Projected Real GDP Growth, 2025E



Source: OECD (2024), *OECD Economic Outlook, Interim Report September 2024: Turning the Corner*, OECD Publishing, Paris, https://doi.org/10.1787/1517c196-en

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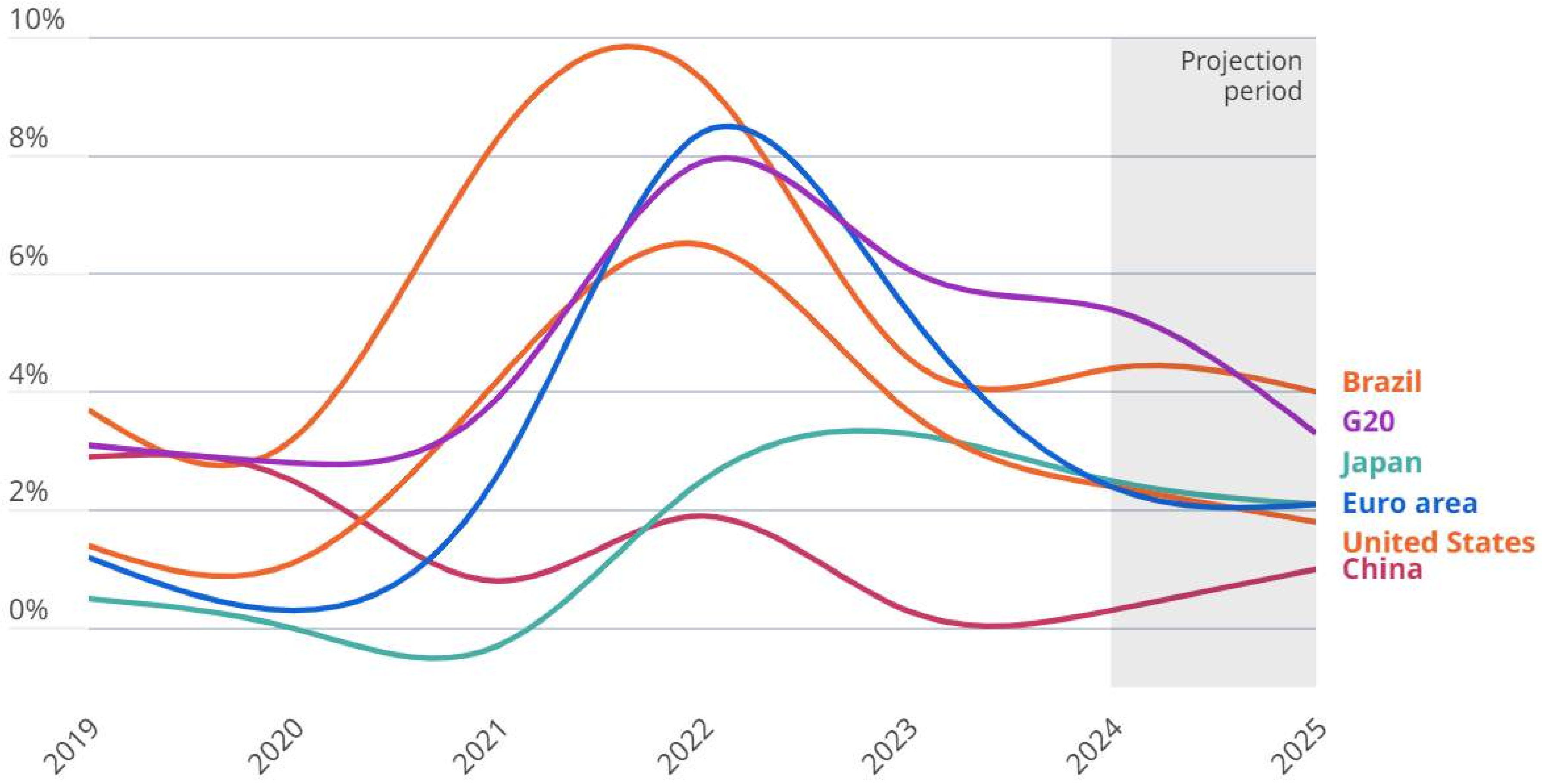
Inflation is projected to return to target in most economies

- Headline inflation in the G20 is projected to fall from 6.1% in 2023, to 5.4% in 2024, and 3.3% in 2025
- Core inflation in the G20 advanced economies is anticipated to ease from 4.2% in 2023 to 2.7% in 2024 and 2.1% in 2025
- Inflation in the emerging-market economies is projected to remain generally higher than in the advanced economies, while also easing gradually, however with exceptions



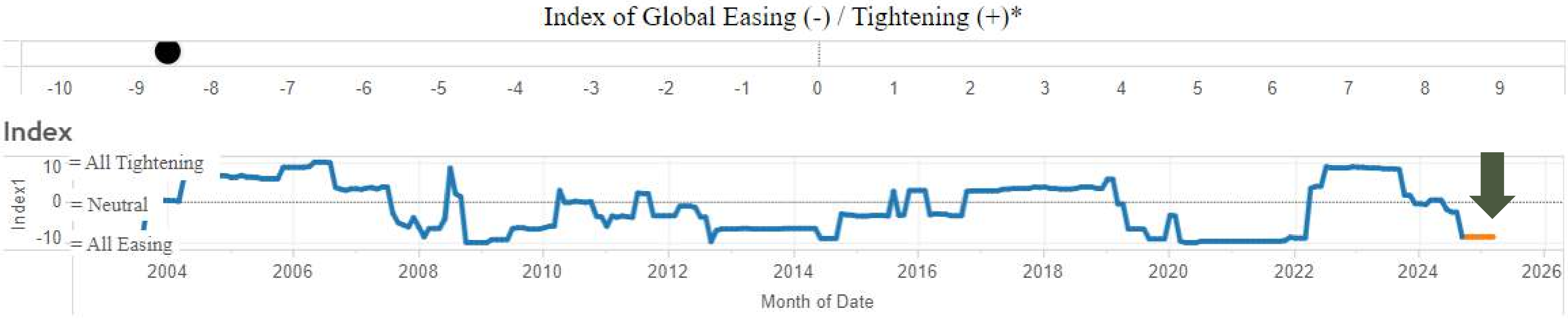
Source: OECD (2024), *OECD Economic Outlook, Interim Report September 2024: Turning the Corner*, OECD Publishing, Paris, https://doi.org/10.1787/1517c196-en.

Central banks move from tight to loose

Global central banks have moved from a **tightening** bias in September 2022 to an **easing** bias by September 2023

The ECB, the Fed, and the BoE believe they are prevailing in the fight against rising prices, adopting more accommodative policy stances

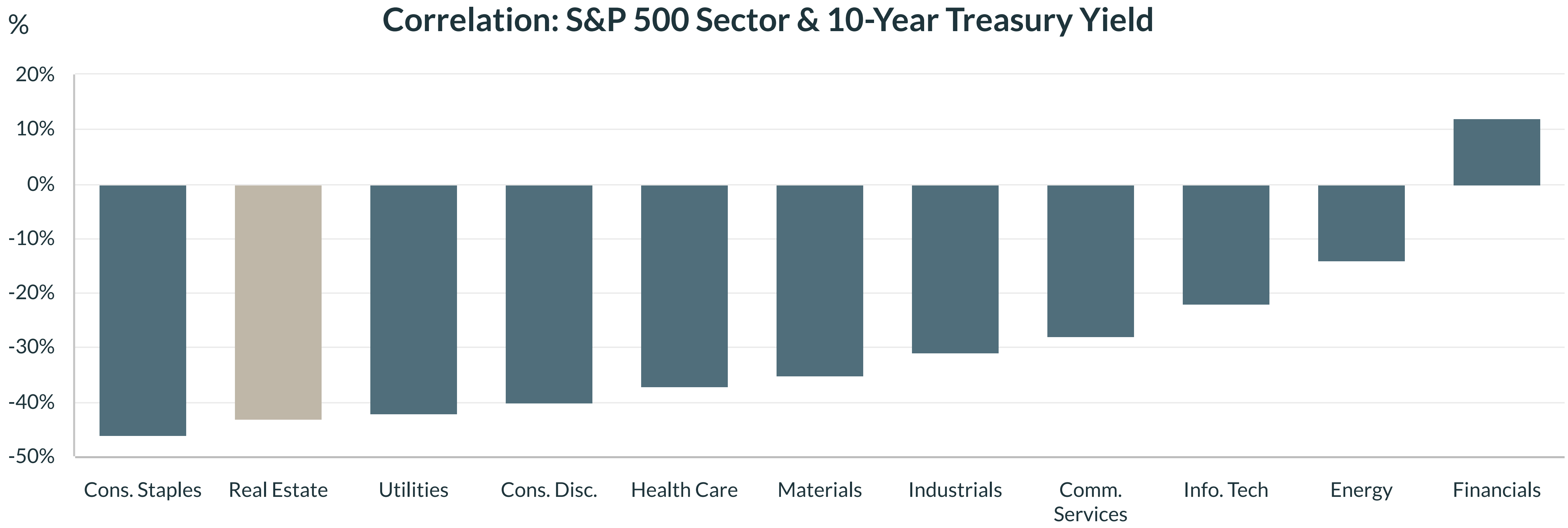
The Fed's latest forecasts indicate an additional 50 basis points in cuts by the end of this year, with another 100 basis points projected for 2025



Source: CFR's Global Monetary Policy Tracker, https://www.cfr.org/global/global-monetary-policy-tracker/p37726#!/p37726

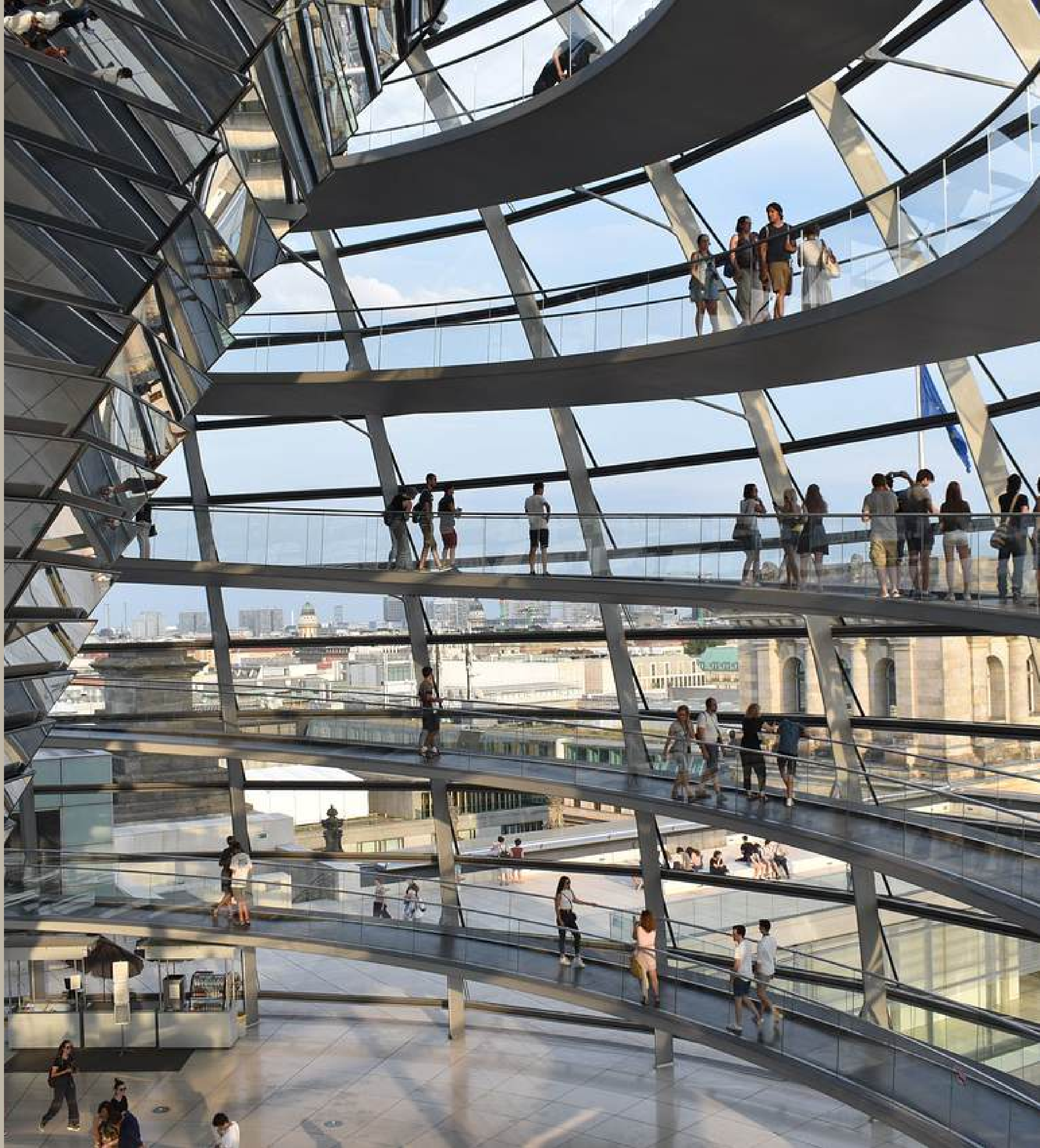
REITs responsive to lower yields

The real estate sector's performance is second-most negatively correlated to the 10-year Treasury yield. The impact of yields on REITs are transmitted primarily via three mediums: 1) funding costs, 2) cap rates, and 3) opportunity cost, or relative valuation



Source: © Alpine Macro 2024

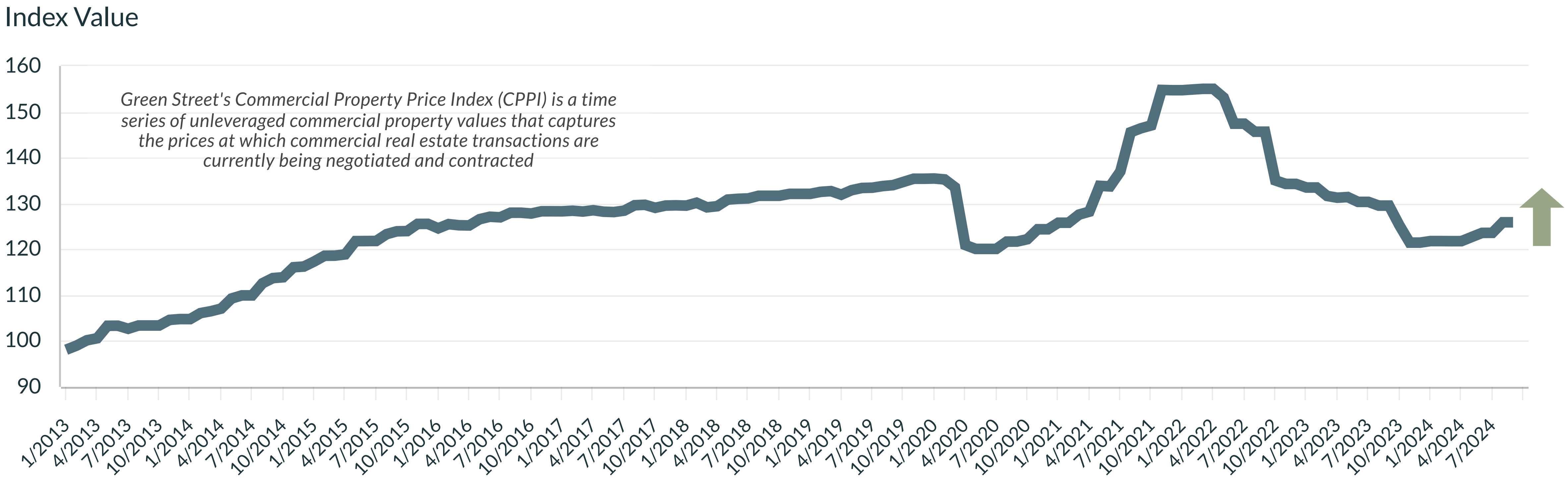
Global Real Estate Markets



Commercial property prices up 3% this year

The Green Street Commercial Property Price Index rose 1.9% in 3Q24. "Property prices have increased this year, and we expect further appreciation" said Green Street

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



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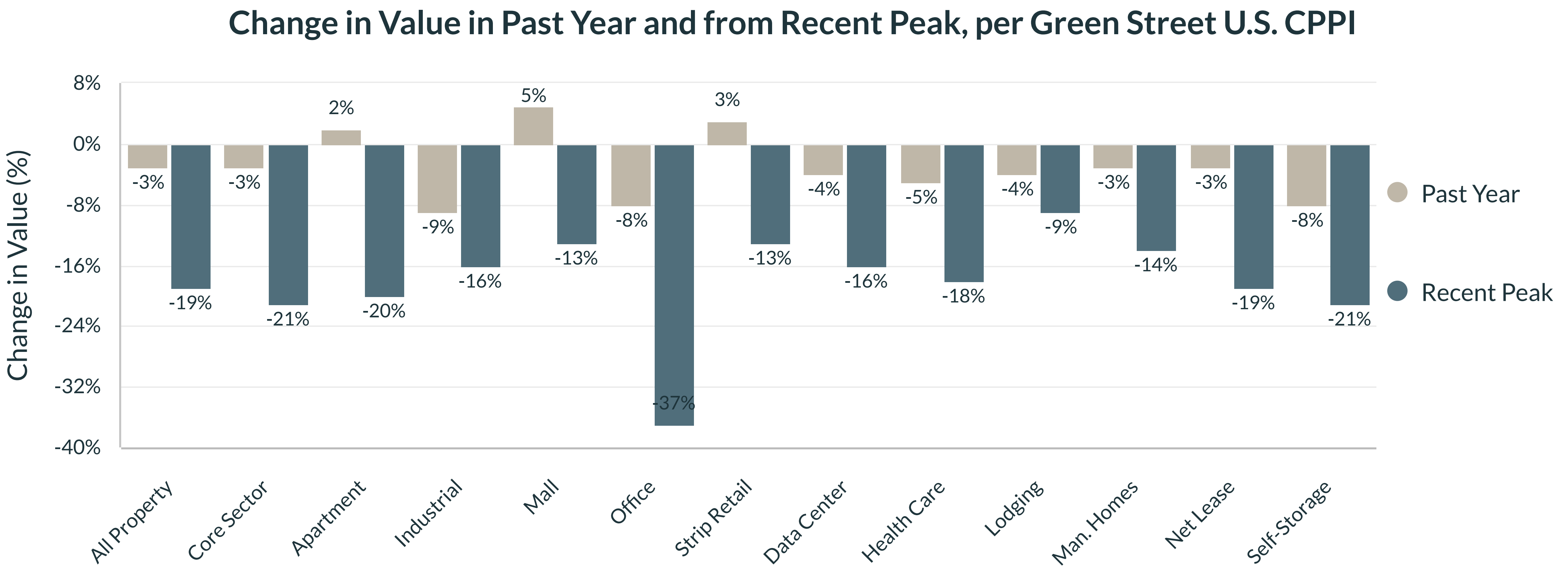
Source: Green Street Advisors, LLC, October 4, 2024

Retail and apartments leading the pack

In the past year, **malls** are up 5%, **strip retail** is up 3%, and **apartments** are up 2%. Every other sector is down, with **industrial** (-9%), **office** (-8%), and **self storage** (-8%) falling the most

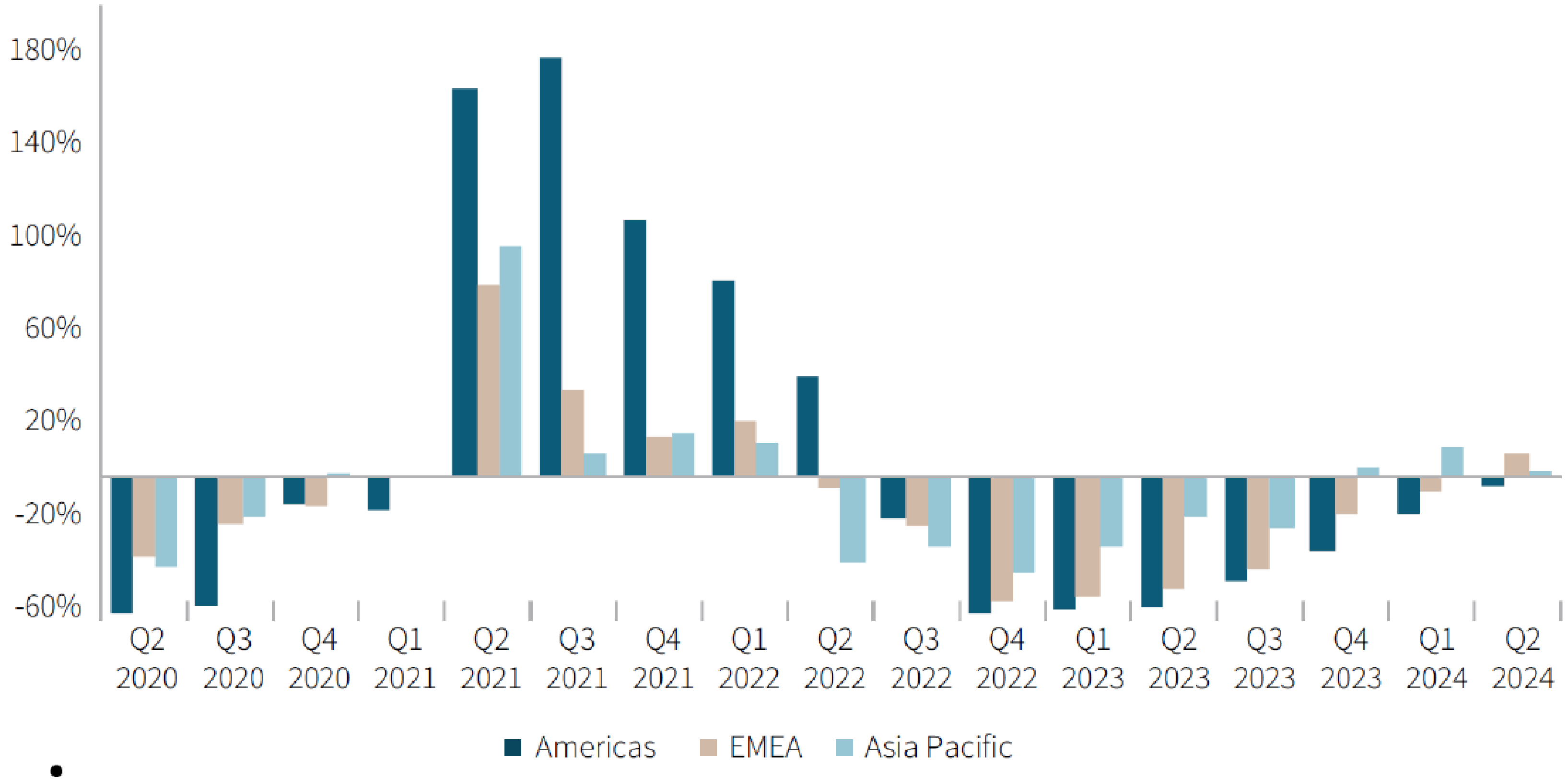


Source: Green Street Advisors, LLC, October 4, 2024

Transaction volumes bottoming out

Improved market sentiment was reflected in the stable year-over-year global direct investment volumes, which reached US$155 billion in 2Q24, resulting in a moderate 4% year-to-date decrease in first-half volumes at US$287 billion

Investment volumes annual change by region, 1Q20 – 2Q24



Investment volumes in the Americas declined 4% year-over-year, but EMEA and Asia Pacific saw modest gains, indicating early growth

Strategic transactions, including large-scale deals, are resurfacing globally, particularly in living strategies and logistics/data centers, spurring further market activity

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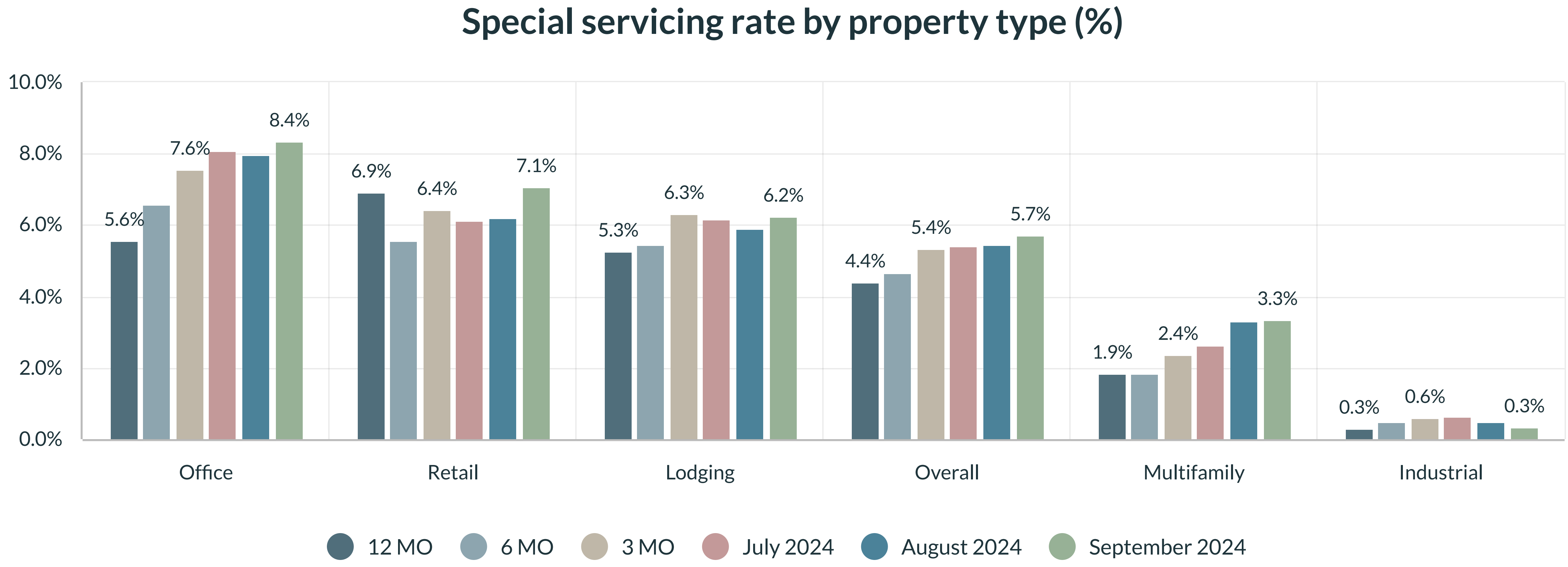
Source: JLL Global Real Estate Perspective - Highlights, August 2024

CMBS delinquency rate jumps, led by retail

The **retail** delinquency rate soared by 86 basis points to 7.07% in September, contributing 50% to the overall rise. The **office** sector made up 37% of the $2 billion increase, with its rate rising 39 basis points to 8.36%

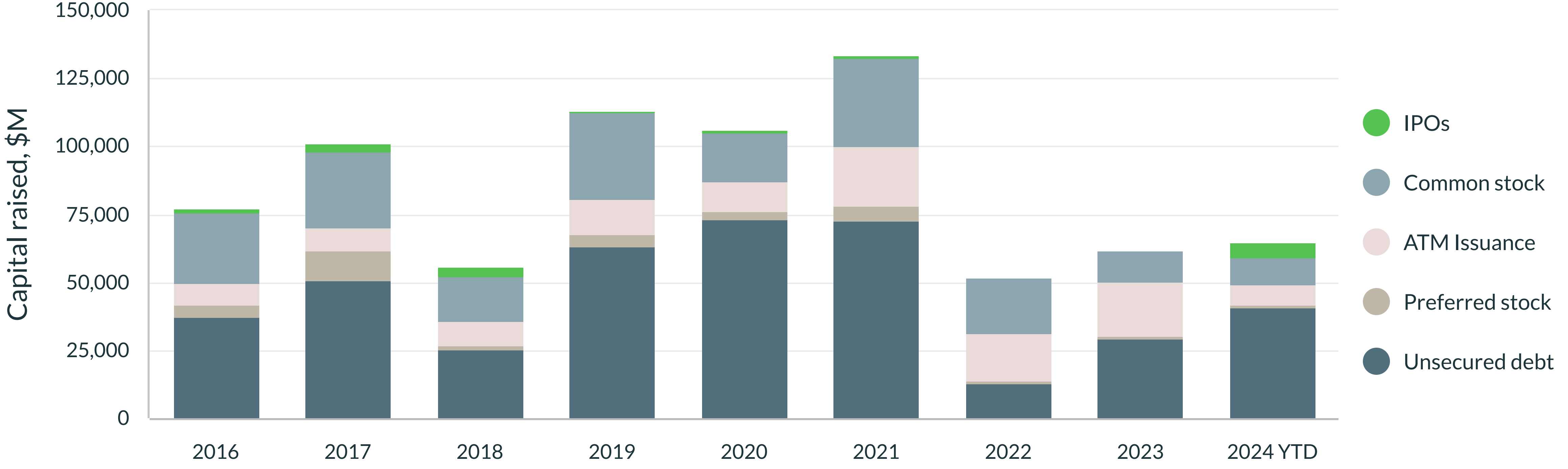


Source: Trepp CMBS Research, October 2024

REIT capital raising accelerating

The data shows a steady increase in REIT capital raising, indicating growing investor confidence. **Lineage REIT** made headlines with the largest IPO of 2024, raising $4.44 billion in July. **FrontView REIT** completed its IPO in October, raising approximately $250.8 million. The unsecured debt market continued to be quite active

US equity REIT capital market activity, 2016 - 2024 YTD

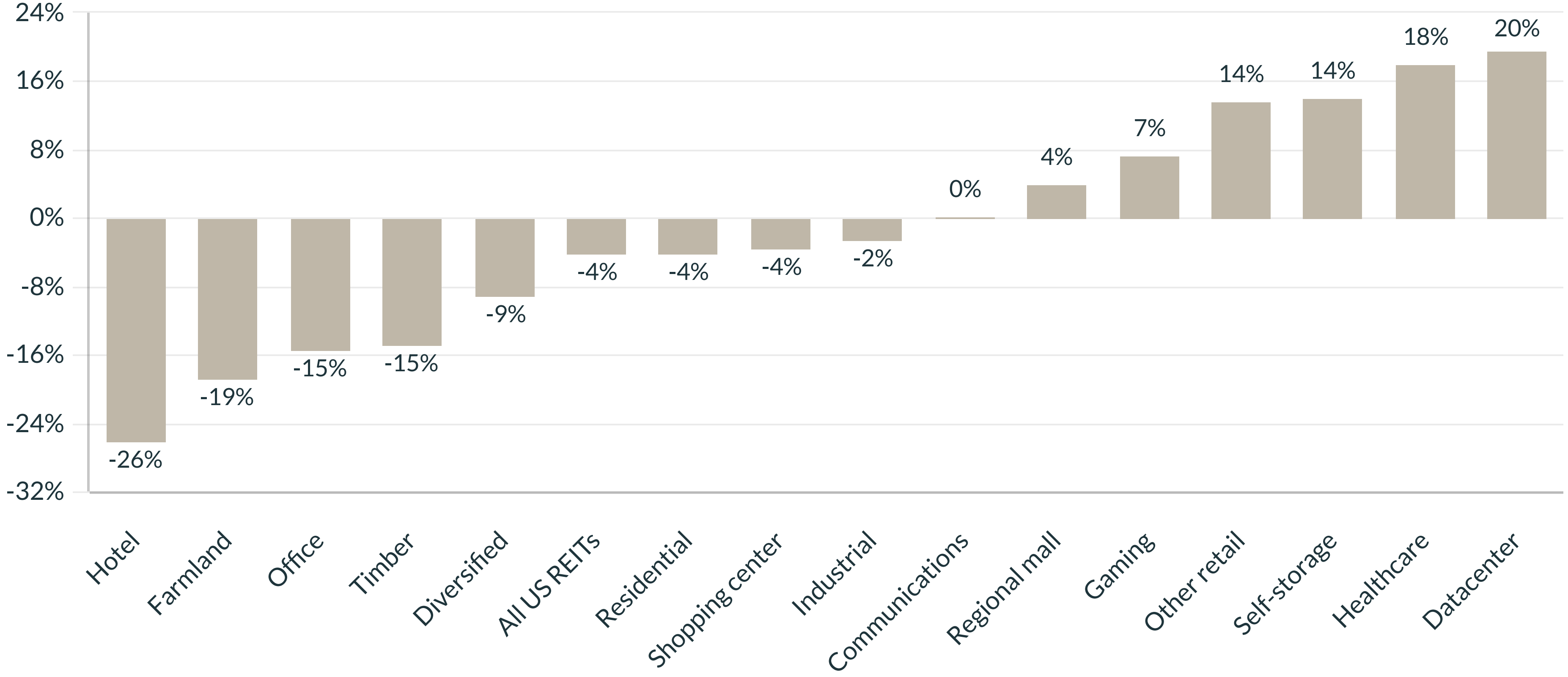


Source: Nareit, S&P Global Market Intelligence, October 2024

REITs approaching par to NAV

Data centers, health care, self storage, triple net, gaming, and malls trade at a premium to NAV in the public market. Offices are at a 15% discount and hotels are at -26%

Premiums / discounts to REIT NAV by U.S. sector



-4%

U.S. REITS TRADE AT A 4% DISCOUNT TO PRIVATE MARKET VALUES

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Source: S&P Global Market Intelligence LLC, September 30, 2024

Positioning: greater selectivity after strong 3Q run

Last quarter, we suggested that "the time is ripe for a REIT comeback after two and a half years of underperformance." It seems REITs took note, as Q3 2024 was one of their strongest in recent memory. Looking ahead, we expect recovery to continue, supported by a potential "Goldilocks" macro environment of easing monetary policy and improving profit growth. Segments like senior housing, data centers, and high-quality office spaces are seeing demand outpace supply, while sectors like self-storage and hotels face challenges. Valuations, though no longer so attractive after recent gains, still offer opportunities in sectors that haven't fully rebounded. Lower or steadier long-term bond yields could provide another boost. Overall, the outlook for REITs remains positive, with strong potential in well-positioned sectors.

- **Valuation**
  - REIT Price/FFO multiples (19x) are trading below the S&P 500 P/E multiple (28x).
  - Price/NAV -14% globally and -4% in the U.S.
  - Small caps trading at notable discounts to larger peers
  - Sectors have gapped out
- **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; self storage remains an exception; office coming back, especially at the high end
  - Industrial is seeing an inflection point downward, with net absorption falling
  - Senior housing is super strong
- **Growth**
  - Consensus REIT FFO estimates remain at ~4-5% earnings growth in 2025
  - The U.S. appears on track to achieve a "soft landing," which is the Goldilocks environment that the REITs thrive in
- **Capital**
  - Borrowing rates fell this quarter as spreads compressed along with base rates
  - Fed cutting overnight rate by 50 bp has boosted sentiment and activity
  - REIT balance sheets in the best shape in recent memory, with average leverage ~33%
  - Large recent JVs like Plymouth REIT's demonstrate private capital demand for REIT assets
  - REIT capital raising in 2024 through nine monthshas already surpassing that of 2023
  - Strong balance sheets will put REITs in the drivers seat
  - We expect more M&A in 2024 and 2025
- **Portfolio preferences**
  - **Data centers**: Robust demand persists for data centers, exceeding supply
  - **Health Care**: The healthcare industry is experiencing robust growth, driven by thriving senior living facilities and skilled nursing centers
  - **Net Lease**: Lower long-term rates could drive net lease REIT growth and acquisitions, supported by attractive valuations and inflation-linked rents
  - **Industrial**: The industrial REIT market is stabilizing despite rising vacancies and subdued demand; investors return to key markets
  - **Digital infrastructure (e.g. billboards)**: Digital billboard stocks are attractively priced, with the industry poised for transformative growth
  - **Residential**: Residential REITs flourish as multifamily, manufactured housing, and single-family rentals see demand amid affordability issues
  - **Shopping Centers**: Shopping centers boast resilient tenants, pricing sway, and robust leasing despite bankruptcies. Valuations are still appealing

Sector Outlooks

Industrial: mixed messages

The industrial REIT sector is stabilizing as interest rate pressures ease, though vacancy rates are rising due to new supply. Demand is subdued, but institutional investors are returning to key markets like L.A.

- ## Market overview
  - The industrial sector has seen more stability in valuations as interest rate pressures ease
  - U.S. industrial vacancy stands at 5.7%, with ongoing new supply expected to push vacancy rates higher into mid-2025
  - Demand is unlikely to accelerate significantly toward the end of the year due to broader macroeconomic uncertainties, including election-related factors

- ## Leasing and occupancy
  - Rents rose 4% annually in Q2 2024, but leasing demand fell 70%, and net absorption declined
  - Vacancy rates have increased by 30 basis points quarter-over-quarter and 190 basis points year-over-year. This is primarily driven by new deliveries and declining net absorption

- ## Investment market warming up
  - **Capital Market Trends**: Industrial REITs are seeing a resurgence of institutional capital, particularly in high-demand markets like Los Angeles. Limited investment activity in other sectors could drive more interest in the industrial space
  - **Dry Powder**: There is significant capital waiting to be deployed into industrial assets, creating opportunities for investments in discounted names like First Industrial (FR) and Plymouth (PLYM)

- ## Valuation
  - Industrial REITs are trading at a 5.00% implied cap rate. The sector's price per square foot is around $190
  - The 2025 estimated AFFO multiple for industrial REITs is 21x, while the FFO multiple stands at 18x

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Sources: Company reports, Baird Research, Sugi Capital Management

Residential: firm investor and renter demand

The residential REITs remains strong, with high demand in multifamily and single-family rentals due to affordability challenges and rising mortgage rates. Leasing and occupancy are stable, particularly in coastal and Midwest markets, while manufactured housing continues to show steady demand and low turnover

- ## Market overview
  - **Single-family rentals** are benefiting from housing affordability challenges
  - **Multifamily** properties are absorbing elevated supply
  - **Manufactured housing** showing stable demand
  - The residential sector is facing a favorable multi-year setup with elevated demand absorbing peak supply
- ## Leasing and occupancy
  - **Single-family rentals**: Demand is strong as homeownership becomes less affordable, keeping turnover rates low
  - **Multifamily**: Leasing activity remains robust, especially in coastal and Midwest markets, with Sunbelt regions expected to recover from high supply pressures
  - **Manufactured housing**: This sector maintains steady demand due to its affordability, with low tenant turnover and consistent rent growth
- ## Investment market
  - Investment interest varies across all three sectors, with institutional capital particularly active in multifamily and single-family rentals
  - Manufactured housing is also attracting capital due to its resilience and growth potential. The sector's lower capital intensity and resilience during economic downturns make it a desirable long-term investment
- ## Valuation
  - **Single-Family Rentals**: Implied cap rates are ~5.2%, with 2025E AFFO multiple of 22x
  - **Multifamily**: Implied cap rates are ~5.4%, with 2025E AFFO multiple of 22x
  - **Manufactured Housing**: The sector is trading at lower cap rates, ~4.8%, with a higher 2025E AFFO multiple of 24x

Sources: Company reports, Morgan Stanley Research, AlphaWise Data, CBRE Research, NAREIT Data, Sugi Capital Management

Shopping centers: the secret is out

Shopping center REITs exhibit strong tenant retention and pricing power, with robust leasing despite retail bankruptcies. Demand from omni-channel and medical tenants absorbs available space; stock valuations are still appealing

- ## Market overview
  - The sector is benefiting from strong pricing power, with elevated tenant retention and high leasing spreads
  - Leading retailers are expanding into spaces vacated by weaker tenants, absorbing the impact of bankruptcies
  - Medical and omni-channel retailers are increasing demand for shopping center spaces

- ## Leasing and occupancy
  - The resilient consumer and limited new supply sustain solid leasing demand, despite pressures on low-end and softening luxury sales
  - Retention rates are high
  - Physical stores continue to play a crucial role in supporting online sales, driving leasing

- ## Investment market
  - The market remains attractive to private capital, with stable fundamentals supporting continued investment
  - Redevelopment and mixed-use projects are key growth strategies beyond traditional leasing
  - As private capital flows into the sector, there is potential for cap rate compression due to improving fundamentals

- ## Valuation
  - Shopping centers are trading at a low- to mid-6% implied cap rate
  - The 2025E FFO multiple for shopping center REITs is 14x
  - The AFFO multiple is 19x

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Sources: Company reports, BMO Research, Sugi Capital Management

Regional malls: back to the future

The mall sector has recovered from its post-GFC struggles, with top-tier malls performing well, benefiting from higher foot traffic and occupancy rates now exceeding pre-pandemic levels. However, lower-tier malls continue to face challenges, with ongoing vacancy issues and refinancing risks

- **Market overview**
  - Regional malls faced challenges similar to the office sector post-GFC, but the sector has recovered, partly due to a reduction in supply
  - High-end malls excel, but lower-tier struggle amid weak demand
  - Mall visits are up 3% in 2024 compared to 2019, showing recovery from the pandemic nadir when visits were down by over 20%
- **Leasing and occupancy**
  - Overall occupancy at mall properties has increased to 89.6%, with top-tier malls at 95.1% occupancy and lower-tier malls at 89.1%
  - Mall visitors' median income returned to pre-pandemic levels of $87,000, sustaining stable leasing
- **Investment market**
  - Investors are focusing on top-tier malls, which continue to attract capital due to their strong fundamentals and performance
  - Lower-tier malls are being considered for mixed-use redevelopment as they struggle to retain retail tenants
  - Around $11.93 billion in CMBS loans maturing soon; lower-yield loans may struggle to refinance
- **Valuation**
  - Malls are trading at a ~7% implied cap rate
  - The 2025E FFO multiple for mall REITs is 14x
  - The AFFO multiple is 16x

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Sources: Company reports, JP Morgan, Sugi Capital Management

Office: bargain basement

The office sector faces significant challenges, with vacancy rates remaining high and demand subdued by the shift toward remote and hybrid work models. That said, top-tier office properties in prime locations are still thriving

- **Market overview**
  - Sunbelt and East Coast office markets are outperforming, while West Coast properties are lagging
  - Large companies announcing return-to-office (RTO) policies are expected to help stabilize demand
  - Employees are in the office an average of three days per week, showing that the office is not dead, though absorption trends are still negative

- **Leasing and occupancy**
  - Well-capitalized REITs thrive as tenants seek quality
  - While sublease vacancy remains high (~100 million square feet), it contracted slightly in Q2 2024
  - Occupancies are expected to bottom out in 2024, providing better visibility into future cash flows

- **Investment market**
  - Capital markets remain constrained, but there are select opportunities, particularly in higher-quality assets
  - As volatility decreases, capital market conditions are expected to improve, creating more external growth opportunities
  - Some opportunities in distressed assets and residential conversions

- **Valuation**
  - Implied cap rates are at 8.2%
  - Office REITs are trading at a 10x 2025E FFO multiple and a 15X AFFO multiple
  - Office stocks performed very well in 3Q, up nearly 30%

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Sources: Company reports, JPM Morgan, Sugi Capital Management

Healthcare: the gray wave

Healthcare REITs are gaining from aging demographics, boosting demand in senior housing and skilled nursing. Occupancy is improving post-pandemic, and operators are seeing more stability. With rising capital deployment and strong private interest, healthcare REITs are set for growth, backed by solid valuations and investor confidence

- **Market overview**
  - The aging population continues to drive demand, especially in senior housing and skilled nursing facilities (SNFs)
  - The healthcare sector is recovering from pandemic disruptions, with occupancy rates improving across senior housing and SNFs
  - Operators are benefiting from a more stable operating environment, with expense growth moderating.
- **Leasing and occupancy**
  - Senior housing portfolios are experiencing outsized growth due to increased move-ins and lower turnover
  - Occupancy trending higher in independent and assisted living, with year-over-year gains of ~250 basis points
  - Outpatient medical visits continue to grow, but tenant retention is becoming a key focus due to higher lease expirations
- **Investment market**
  - Capital deployment is accelerating, especially in SNFs, as REITs benefit from a cost-of-capital advantage and stabilizing operations
  - Healthcare REITs are positioned for external growth, though competition for acquisitions is increasing
  - Strong demand from private capital is helping support valuations and creating growth opportunities in high-quality assets
- **Valuation**
  - Healthcare REITs are trading at wide range of implied cap rates, 4-7%, with senior housing stocks at the low end
  - Healthcare REITs are trading at a 15x 2025E FFO multiple on average, 17x on an AFFO basis
  - Some healthcare REITs are trading at premiums to NAV, especially in the skilled nursing and senior housing segments, reflecting their strong growth outlook

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

Self storage: long way back to the top

Despite a tough operating environment, self-storage REITs are maintaining strong investor interest, with assets trading at cap rates in the mid-5% range. While NOI growth is expected to be modest in 2025, the sector's stability and potential for recovery, especially with lower interest rates, is buoying the stocks

- **Market overview**
  - The self-storage sector maintains stability, but demand recovery remains elusive, with fierce pricing competition
  - Optimism for 2025 demand grows, despite consumer weakness risks
  - The market is watching for green shoots of recovery, especially in the context of lower interest rates potentially stimulating housing activity
- **Leasing and occupancy**
  - For August, Extra Space Storage (EXR) reported occupancy at 94.3%, a slight improvement year-over-year but down from the prior month due to seasonality
  - Street rates for new customers are down significantly year-over-year, with EXR reporting a 15% decline in August, further deteriorating from July
  - Despite new customer pricing declines, vacates have remained stable, indicating steady tenant retention
- **Investment market**
  - REITs, particularly Public Storage (PSA), are re-engaging in acquisitions, with larger portfolios expected to come to market as bid-ask spreads narrow
  - Stabilized self-storage in prime markets sees cap rates around 5%, larger portfolios discounted
  - REITs are benefiting from an improved cost of capital, which may drive more aggressive acquisition activity in the near term
- **Valuations**
  - Implied cap rates are at 5%
  - The 2025E FFO multiple for storage REITs is 20x
  - The AFFO multiple is 21x

Sources: Company reports, BMO Research, Sugi Capital Management

Net lease: waiting for rates to come in

Net lease REITs are poised for growth if long-term interest rates fall, with acquisition activity expected to rise due to improved capital costs. Valuations remain attractive while inflation-linked rents provide further stability

- **Market overview**
  - Falling interest rates have improved sentiment in the net lease sector, leading to renewed excitement about external growth opportunities
  - While the overall outlook is positive, there are pockets of weakness among certain tenants, particularly in sectors facing above-trend inflation
  - Low annual rent escalators present a potential long-term challenge for net lease REITs
- **Leasing and occupancy**
  - Leasing activity remains stable, though organic growth is limited due to the nature of long-term leases
  - Some deterioration in tenant credit has been observed, with particular caution around investment-grade (IG) and non-IG tenants
  - Some REITs, such as VICI, are benefiting from inflation-linked rent increases, providing protection against rising costs
- **Investment market**
  - Acquisition volume is expected to increase as the cost of capital improves and lending conditions ease
  - Demand for sale-leasebacks may moderate as capital becomes more readily available, but remains a key growth driver
  - Net lease REITs are well-positioned for external growth as financing becomes cheaper, allowing them to pursue acquisitions more aggressively
- **Valuation**
  - Implied cap rates for net lease REITs are around mid-6%
  - Larger net lease REITs, such as Realty Income (O) and National Retail Properties (NNN), trade at ~14x 2025E FFO multiples. Most smaller companies trade at lower multiples, 12x on average

Sources: Company reports, Sugi Capital Management, Sugi NAREIT meetings

Data centers: derivative AI play

Data center REITs continue to experience strong demand driven by digital transformation and cloud adoption, with near-full occupancy and ongoing leasing growth. Valuations remain high, with FFO multiples on the high end of the sector

- **Market overview**
  - Data centers continue to see robust demand, driven by digital transformation and cloud adoption
  - Even amidst rising costs, data centers have remained resilient, supported by strong tenant demand
  - Investors view data centers as critical infrastructure for the growing digital economy, with the ascendance of AI a further tailwind
- **Leasing and occupancy**
  - Data center REITs report near-full occupancy, reflecting strong demand from cloud and enterprise tenants
  - New leasing continues at a strong pace, with expansions from major tech companies driving growth
  - Supply constraints around power availability and planning restrictions in certain markets are further supporting occupancy and rental rate growth
- **Leverage and growth**
  - As cost of capital improves, data center REITs are well-positioned for further acquisition activity
  - Cap rates for stabilized data centers remain low, reflecting the sector's strong demand
  - Institutional investors continue to show interest, particularly in core markets with stable long-term growth potential
- **Valuation**
  - Data center REITs trade at implied cap rates of around 6%
  - Data center REITs trade at ~27x 2025E FFO multiples
  - Trading at notable premiums to NAV

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Sources: Company reports, Sugi Capital Management

Cell towers: steady but slow

Tower REITs are benefiting from lower interest rates and stable long-term demand, though carrier spending remains muted in the short term. Despite flat leasing expectations, the sector can grow through international expansion, strategic acquisitions, and continued 5G deployment

- **Market overview**
  - Lower interest rates are benefiting tower REITs despite muted carrier spending
  - The demand for towers remains durable with 5G deployed on more than 50% of sites
- **Leasing and occupancy**
  - Carrier spending remains slow, leading to flat leasing expectations for next year, but the underlying long-term demand for towers remains steady
  - Despite lower spending, organic growth net of churn remains durable, providing stability in leasing operations
  - The rollout of 5G continues to support leasing growth in the long term
- **Investment market**
  - Tower REITs, particularly SBA Communications, are leveraging international opportunities to drive growth
  - Tower REITs are benefiting from low leverage, positioning them well for future investment
  - Tower REITs are poised for potential M&A opportunities as the cost of capital improves
- **Valuation**
  - Tower REITs are trading at 17x-21x 2025 AFFO multiples
  - Crown Castle and SBA Communications trade at discounts, while American Tower commands a premium

Sources: BMO Research, Sugi Capital Management

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