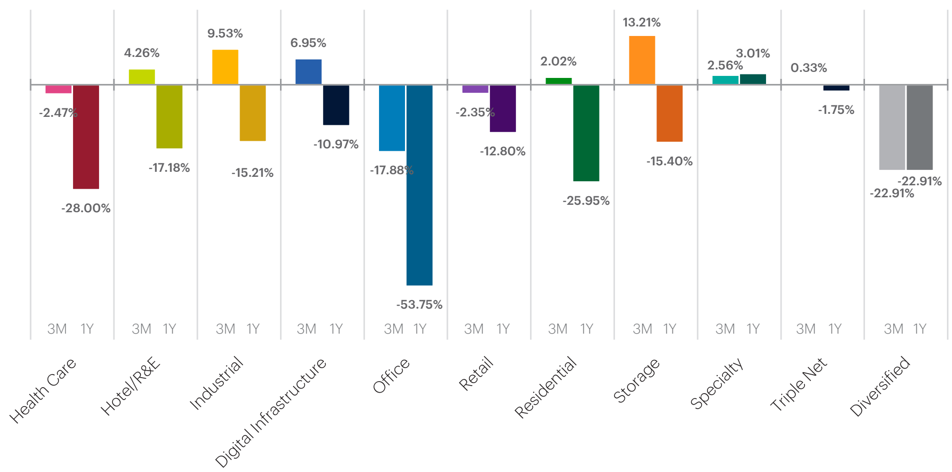
## March 2023 Market Overview

Over the first quarter of 2023, the FTSE NAREIT Equity Index gained 2.68.[1]

1 All performance is quoted in US Dollars.

**FTSE NAREIT EQUITY REITS PERFORMANCE AS OF 3/31/23**




Economic indicators released during early 2023 showed that the US economy held up better than expected, considering the Federal Reserves's ("the Fed") aggressive efforts to slow inflation through restrictive monetary policy, which has historically forced a recession.[2] At their most recent FOMC meeting, the Fed raised rates by another 25 basis points ("bps"), after the previous 25, 50, and 75 bps moves.[3]

In March 2023, a new risk emerged in the liquidation of Silvergate Capital Corp., followed by the receiverships of Silicon Valley Bank ("SVB") and Signature Bank, which roiled markets and raised questions about the possibility of contagion in the banking sector and financial markets.[4] The US federal government's response may allay immediate fears among a subset of investors. Still, the steep decline in regional bank equities and the more pronounced yield curve inversion suggests, in our view, a recession in 2023. As such, Heitman believes that the forecasted terminal Fed funds rate is lower since weaker financial conditions assist the Fed in its objective of reducing aggregate demand in the economy.

Most forecasters expect a mild recession in the second half of 2023, but risks are weighted to the downside

In response to the bank failures, the Fed, Treasury, and FDIC released a joint statement on March 12, 2023. The statement included the following key details: (1) the US government invoked a "systemic risk exception" for both SVB and Signature Bank; (2) the exception ensures that all depositors, insured and uninsured, at SVB and Signature Bank will be made whole; and (3) the government established a Bank Term Funding Program ("BTFP") to provide additional liquidity to eligible depository institutions. The Treasury Department will make available up to $25 billion from the Exchange Stabilization Fund to support the BTFP if needed, but the Fed stated that it does not anticipate drawing on these funds. While this response may have alleviated some initial fears, it did not prevent the extreme market volatility observed in the aftermath of the bank failures.

2 Barron's (February 24, 2023). What Everyone Got Wrong About the Economy – and the Ominous Implications for the Fed.
3 https://www.federalreserve.gov/newsevents/pressreleases/monetary20230322a.htm
4 https://www.fdic.gov/news/press-releases/2023/pr23016.html

While January and February 2023 inflation data have shown signs of easing, inflation remains stubbornly above the Fed's 2.0% target.[5] Headline PCE (the Fed's preferred measure of inflation) was up 5.0% year-over-year as of February, down 30 bps from the previous month.[6] Core PCE, which excludes food and energy, also decreased in February, down 10 bps from January to 4.6%.[7] In February, price increases remained largely driven by housing costs and prices tied to core services, up 9.1% and 5.0%, respectively.[8] Chairman Powell has indicated that the Fed views the labor market as the main channel by which inflation can be reined in, as the pace of wage growth and services inflation are directly related.[9]

The February 2023 jobs report showed slight moderation in the pace of nonfarm payroll growth as 311,000 jobs were added, down from January's robust 504,000 jobs.[10] However, this figure was, in our opinion, still stronger than anticipated, and we believe the Fed saw this pace of growth as too rapid, evident in their decision to raise rates by an additional 25 bps at the March FOMC meeting. The February Job Opening and Labor Turnover Survey ("JOLTS") report also signalled that the labor market is softening, as job openings were below 10 million for the first time since May 2021, which we think is a likely indication that businesses are growing wary of additional headcount.[11] Furthermore, the ratio of unemployed persons to open jobs, a metric the Fed watches closely, dipped to its lowest level since November 2021. Job openings will have to continue to trend downwards if they are to move closer to the pre-pandemic levels of roughly 7 million.[12] The March 2023 jobs report, scheduled to be released April 7, 2023, is anticipated to show further moderation of growth, with consensus expectations of an additional 240,000 nonfarm payrolls added in March.[13]

In our assessment, risks to the economy have grown considerably in light of the recent regional bank failures and concerns that they will create widespread contagion. Even if the fallout from the SVB and Signature Bank failures remains relatively contained, heightened volatility will likely persist for some time, in our opinion. While inflation remains above the Fed's long-term target, turmoil in the financial system, in our opinion, complicates its path regarding the magnitude of further rate increases. While Heitman believes the Fed will likely pause rate hikes after their next meeting in May 2023, we do not foresee rate cuts occurring this year. Most forecasters still expect a mild recession in the second half of 2023, but risks are weighted to the downside.[14]

Throughout this, the US 10-year bond rallied, from 3.52% at the end of December 2022 to 3.47% in March,[15] as SVB and other bank-induced volatility saw estimates for economic growth wound back, in our opinion.

According to Bloomberg data, REIT equity issuance in the first quarter of 2023 totalled just over $11 billion.[16] VICI Properties Inc tapped the market twice, raising $2.5 billion to fund further acquisitions.[17] The company closed its acquisition of the remaining 49.9% stake in a joint venture which owns MGM Grand Las Vegas and Mandalay Bay Resort from Blackstone Real Estate Income Triust, Inc. for $1.27 billion.[18] In other notable capital issuances, Healthpeak Properties Inc. raised $1.5 billion, Rexford Industrial Realty, Inc. raised $1.25 billion, National Health Investors, Inc. raised $500 million, and $300 million was raised by Sunstone Hotel Investors, Inc.

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5 https://www.bls.gov/cpi/
6 U.S. Bureau of Economic Analysis (February 2022). Personal Income and Outlays, February 2022
7 Id.
8 Moody's Analytics (March 31, 2023). Economic Roundup: All Eyes on "Supercore" Inflation.
9 Id.
10 Current Employment Statistics - CES (National) : U.S. Bureau of Labor Statistics (bls.gov)
11 Oxford Economics (April 4, 2023). US: Decline in job openings picks up pace in February
12 Oxford Economics (March 10, 2023). US: The labor market cools from blistering to just plain hot
13 Trading Economics (March 2023). United States Non Farm Payrolls
14 Oxford Economics (March 16, 2023). US: Economic strength delays the start of the recession
15 https://ycharts.com/indicators/10_year_treasury_rate#:~:text=10%20Year%20Treasury%20Rate%20is%20at %204.08%25%2C%20 compared%20to%204.01,long%20term%20average%20of%204.26%25.
16 Bloomberg, Inc. data retrieved 3 April 2023
17 VICI Properties - VICI Properties Inc. Announces Public Offering of Common Stock
18 VICI Properties buys Blackstone REIT's stake in MGM Grand, Mandalay Bay hotels | Seeking Alpha

The most significant news, however, was the $8.4 billion in redemptions from Blackstone's flagship REIT[19] and University of California Investments' $4.5 billion injection of capital with a guaranteed minimum return of 11.25% annualized over six years.[20] In our opinion, this transaction, announced in January 2023, countered some negative sentiment towards private REITs that had grown over 2022.

The asset transaction market, in our view, remains depressed as the bank lending market has slowed, and buyers and sellers wait for clarity on interest rates and economic conditions.

In contrast to bank financing markets, the corporate unsecured bond market remains open, with Rexford and Extra Space Storage Inc. recently issuing a combined $8 billion at rates of 5% and 5.7%, respectively.[21]

## Outlook

In Heitman's view, the outlook for real estate remains mixed, with direct real estate transactions, pointing to a downward trajectory. In our opinion, much of this has already been priced into the listed real estate markets.

The office sector continues to underperform due to continued headlines of hybrid work, negatively impacting vacancy levels and, more recently, causing the potential lack of financing following the failure of several banks. Fortunately for the REIT market, the office sector comprises only a small index component.

For storage, revenue rates are showing signs of stabilization in recent months, suggesting that core revenue growth will remain positive in 2023; a soft landing provided by the tremendous growth experienced through the COVID-19 pandemic.

While a recession scenario is likely to impact demand for the industrial sector negatively, in our view, recent leasing trends support Prologis Inc.'s 10% market rent growth forecast, which should sustain the attractive total portfolio rent mark-to-markets and high single digit internal growth.

Overall, Heitman remains focused on the opportunities presented in these volatile markets by focusing on stocks with identifiable catalysts and strong secular trends. We continue to focus on higher-quality assets and strong balance sheets while taking risks where lower-quality opportunities arise.

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19 Blackstone receives over $5bn in redemption requests in property fund (investmentweek.co.uk)
20 UC Investments Creates Strategic Venture with Blackstone to Invest $4 Billion in BREIT Common Shares | Business Wire
21 Company Announcements

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