Q1 2024 Market Overview

In Heitman's view, during Q1 2024, investors became more measured in the view that US and European Central Banks would be successful in reaching target inflation levels in the near term. Economic reports continue to suggest that the US economy is growing and may avoid a recession. Real Gross Domestic Product ("GDP") for Q4 2023 was reported in January 2024 and showed growth of 3.3%, above the Bloomberg survey amount of 2.0% but lower than the previous quarter release of 4.9%.[1] Job growth has proved to be resilient with January, February, and March 2024 jobs totaling 829,000 after revisions. Finally, year-over-year the Consumer Price Index ("CPI") for February 2024, less food and energy, surprised the market by coming in higher than anticipated at 3.8%.[2] The expectation was that inflation would continue to abate more quickly, but instead it was only 10 basis points ("bps") lower than the previous month.

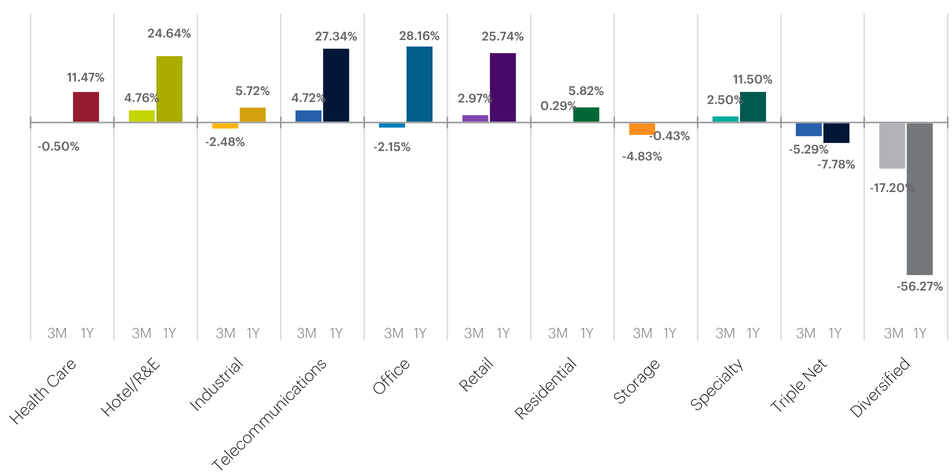
The Federal Open Market Committee ("FOMC") continued to signal that rate increases are likely over, and cuts will begin in 2024.[3] During the late January 2024 FOMC meeting, the Federal Reserve (the "Fed") Funds rate remained unchanged but the FOMC replaced its previous hiking bias statements.[4] During the March 2024 meeting, the overnight rate was again left unchanged and the FOMC continued to project that there will be three rate cuts in 2024. We believe that this release and subsequent press conference was dovish, as Fed Chairman Powell indicated that he was not concerned about the firmer January and February 2024 inflation data.[5] Also during the press conference, Powell noted that although the FOMC raised its 2024 GDP forecast, it is not a concern for inflation since recent faster growth in the labor supply eases pressures. By the end of Q1 2024, the number of Fed Fund cuts expected by the market in 2024 declined to less than three, compared to the greater than six expected at the beginning of the quarter.[6]

Economic reports continue to suggest that the US economy is growing and may avoid a recession

REIT Market Review – Q1 2024

During Q1 2024, the FTSE NAREIT Equity Index returned negative 0.20%.[7] In Heitman's view, during the quarter, investors became more meausred that US and European Central Banks would be successful in reaching target inflation levels in the near term.[2]

FTSE NAREIT EQUITY REITS PERFORMANCE AS OF 3/31/24



1. Bloomberg Attachments.doc
2. Bloomberg Attachments.doc
3. Bloomberg Attachments.doc
4. https://www.federalreserve.gov/newsevents/pressreleases/monetary20240131a.htm
5. Goldman Fed Note – Mar24.pdf
6. Bloomberg Eco Charts – Mar24.docx
7. All performance is quoted in US Dollars.

According to Bloomberg data, $2.6 billion of equity issuance was announced during Q1 2024.[8] We continue to believe that public REITs' more diverse access to capital along with 32.2% debt to asset value[9] will continue to provide the opportunity to take advantage of external growth opportunities, which may emerge in the difficult bank lending environment. For example, the largest equity raise was Rexford Industrial's $840 million equty offering to a current shareholder used to fund a $1 billion portfolio from Blackstone, which resulted in immediate earnings accretion.[10] Terreno Realty Corporation followed with a $392 million offering used to fund two portfolio acquisitions, which was also immediately accretive to earnings.[11] Q1 2024 also included American Healthcare REIT, Inc. $773 million IPO.[12] Privitzations and public-to-public mergers and acquisitions were quiet during the quarter.

The best-performing sectors for Q1 2024 included data centers (up 4.72%) and hotels (up 4.76%). The triple net sector lagged the most, down 5.3%, followed by self-storage, which was down 4.83%.

The data center sector outperformance was driven by the continued theme of record demand with the potential to grow further due to the increasing use of artificial intelligence and continued power availabilities limiting supply.[13] The reason for the hotel sector outperformance is less clear in our view. However, we believe conference or "group" hotel demand remains strong from pent-up demand due to COVID-19, as well as from the work-from-home environment creating the increased need for in-person team and industry gatherings.

The self-storage sector underperformance is driven by the continued theme of lower demand from life normalization post-COVID-19. However, any decline in home mortgage rates may result in an improved home sales market and increase mobility.[14] We believe the triple net sector underperformance is driven by the slower acquisition market due to interest rate and bank financing market uncertainty, as well as the more bond-like nature of the triple net business model that is negatively impacted by higher rates.

Outlook

In line with previous quarters, the outlook for US REITs remains mixed. In our view, valuations are attractive compared to private real estate appraisals, broad equities, and fixed income. We believe the market will continue to be data dependent in assessing the effectiveness of the restrictive monetary policy in maintaining the improved inflation readings and to the extent the policy damages economic growth.

Regarding sectors, we believe data centers, single-family rental, manufactured housing, open-air retail, and senior housing remain fundamental bright spots. Data center space demand is positioned to grow due to the increasing use of artificial intelligence and continued power availabilities limiting supply.[15] Open-air retail REITs continue to experience strong leasing given the shortage of high-quality infill shopping centers with additional demand from curbside pickup required for omni-channel e-commerce.[16] Senior housing will likely remain the sector with the highest growth due to continued age demographic-driven demand accompanied by low supply.[17]

The North American REITs outlook remains mixed as we view valuations as attractive compared to private real estate appraisals, broad equities, and fixed income

8. Bloomberg, Inc. data retrieved 7 April 2024
9. Heitman estimates as of 31 December 31 2023
10. Scotia Research report 1 April 2024
11. Scotia Research report 26 March 2024
12. Company press release 29 January 2024
13. Green Street Advisors Research 30 November 2023
14. Green Street Advisors Research 5 December 2023
15. Green Street Advisors Research 30 November 2023
16. Green Street Advisors Research 4 December 2023
17. Green Street Advisors Research 1 December 2023

We believe larger industrial tenants have slowed leasing decisions due to lower goods consumption and recession fears. Additionally, outsized rent growth in recent years has caused rent affordability issues. However, the market remains strong by historical standards, with the exceptions of a few submarkets, in our view. The slowdown in the self-storage sector is also being closely watched as home sales velocity slows and lives normalize post-COVID-19. However, the decline in home mortgage rates may result in an improved home sales market and increase mobility.[18] The residential sector is mixed, with Sunbelt apartment markets facing supply pressure and experiencing the impact of weakening age demographics, which currently favor the single-family rental and manufactured housing sub-sectors.[19] The office sector remains the weakest sector, in our view, given the continued increases in market availability due to weak tenant demand and difficult debt financing markets, but the office sector comprises less than 5% of the Index.

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

18. Green Street Advisors Research 5 December 2023
19. Green Street Advisors Research 1 December 2023

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