REIT Preferred Dividends During the COVID-19 Pandemic

REIT preferred dividend distributions have thus far held up well during the COVID-19 pandemic. To be specific, 5 REITs have preferred dividends that are currently suspended, and no REIT has reduced preferred dividends. Interestingly, 9 REITs had originally suspended their preferred dividends, but 4 of those companies have already reinstated these distributions. In comparison, 79 REITs have announced some sort of downward adjustment to their common stock dividends as of 7/31/20. In total, we calculate that Q2.2020 REIT preferred stock dividends were down just 5% from Q4.2019. That compares favorably to REIT equities, with Q2.2020 common stock dividends down a more significant 22% from Q4.2019. Overall, we believe the REIT preferreds have thus far exhibited solid resiliency from an income perspective during the COVID-19 pandemic.

As of 7/31/2020	# of REITs
Suspended Preferred Dividends	**5**
Reduced or Suspended Common Dividends	**79**

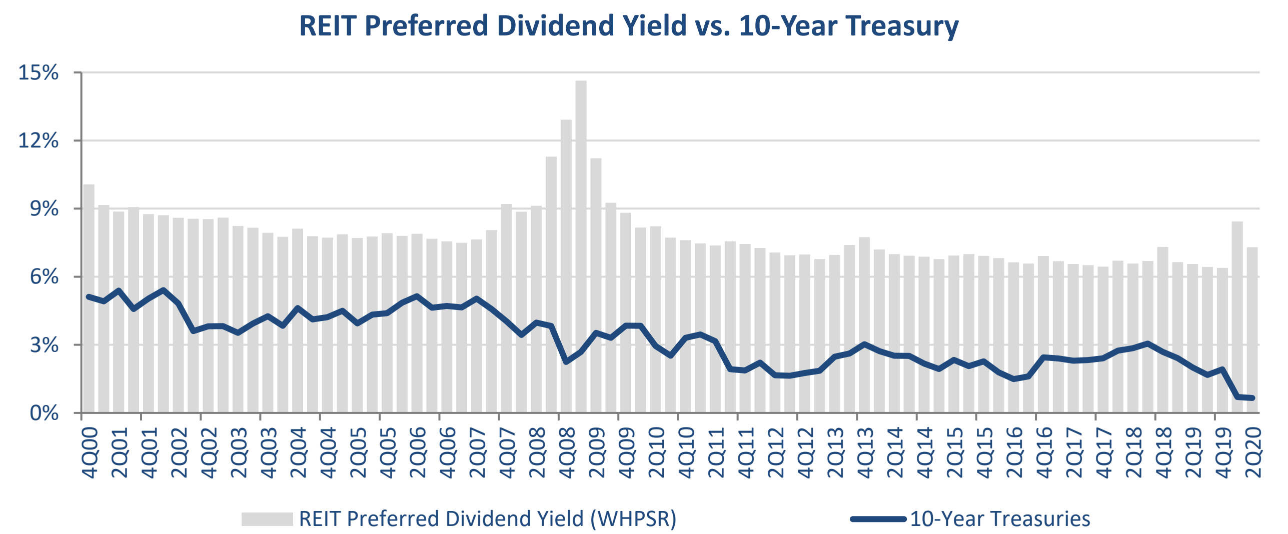
Source: Proprietary database (LDR Capital Management) as of 7/31/2020.

The REIT preferred asset class has provided generally consistent distributions over its 20+ year history, as seen in the chart on the next page. Importantly, these income distributions have held up relatively well during times of financial and economic stress. For example, during the global financial crisis from 2007-2009, we calculate that distribution levels for REIT preferreds fell by 9% while REIT common stock* distributions fell by a more significant 37%. So far in this pandemic, REIT preferred distributions have held up even better (down just 5% as mentioned earlier), as REITs generally went into this crisis with strong balance sheets.

Underpinning the quality of REIT preferred dividends are a few main characteristics. From a structural perspective, REIT preferred dividends are cumulative in nature, and must be paid in full before common shareholders receive any dividends. This cumulative feature and seniority to the common carry significant weight. Further, cumulative preferred dividends must be declared each quarter and paid in cash. If not, any unpaid preferred dividends will be accounted for as a growing liability on a REIT's balance sheet. Preferred dividends can also be counted against REIT distribution requirements for tax purposes (they must pay out 90% of taxable income each year), and thereby help to fulfill an important basic mandate for this industry. Lastly, cash strapped REITs are now allowed to pay up to 90% of their common dividend in stock in lieu of

* Represented by the FTSE NAREIT All REITs Index (FNAR). Annual dividend distribution calculated by using 12-month trailing dividend yield.

cash, which provides additional support to preferred dividends during stressed time periods. For those reasons, many REIT management teams view their preferred shares as senior securities, and consider the preferred dividends as part of their recurring fixed charges (even though technically, they are not part of their fixed charge covenants).



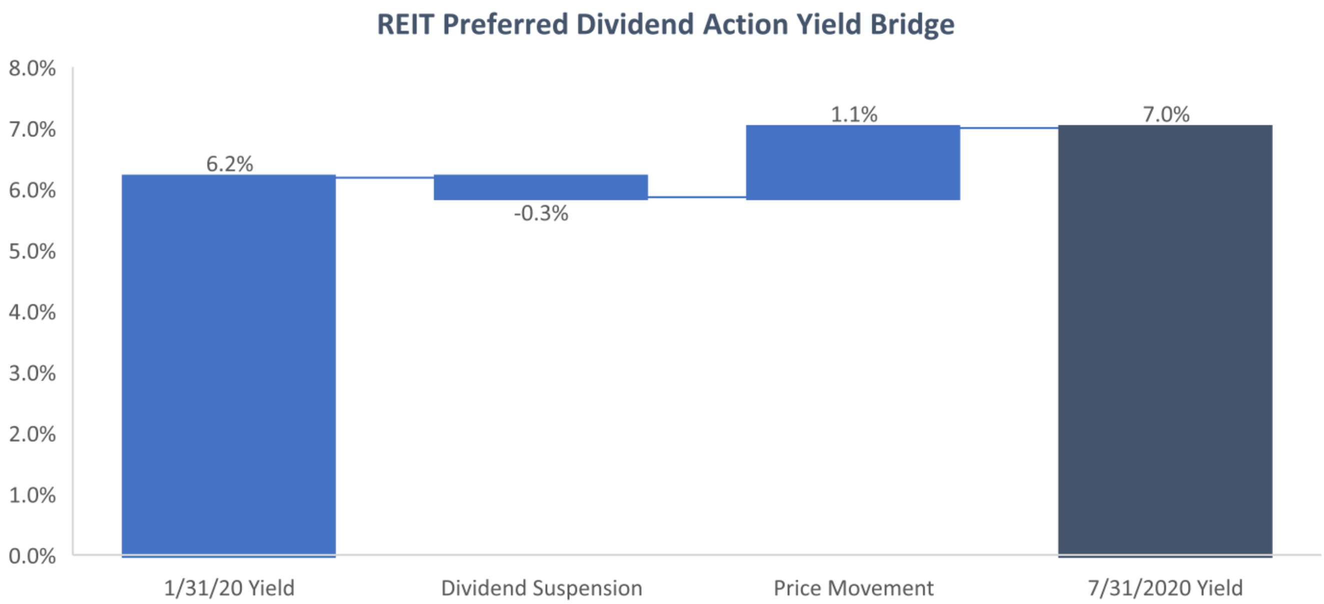
Source: Wells Fargo Hybrid and Preferred Securities REIT Index. As of 2Q20.

From a financial perspective, we calculate REIT preferreds, aside from mortgage REITs, sit senior to an approximate 45-50% equity cushion (conservatively calculated based on the original cost basis of their assets, not market value of their assets). As such, we calculate that REITs must experience an average 46% decline in cash earnings before dividend coverage on their preferreds falls to 1.0x. Further, conservatively assuming all their properties are closed and generating zero operating income (a scenario which we certainly consider to be extremely remote), we calculate that the average REIT preferred issuer aside from mortgage REITs currently has enough financial liquidity to continue to pay all their overhead costs including preferred dividends for over 1 year. Finally, J.P. Morgan Research noted in a recent report that REIT balance sheets entered this pandemic with the strongest set of credit metrics in over a decade, thereby providing added downside support to the preferred asset class during this crisis. It's for this entire set of structural and financial reasons that we believe REIT preferred dividend distributions have proven, and will continue to prove, sustainable through (and coming out) of the COVID-19 pandemic.

From a property sector perspective, the 5 remaining REITs that are still deferring their preferred dividends pursuant to the pandemic are concentrated in the mortgage and hotel sectors - two areas most clearly in a direct path of this crisis. No REIT issuer in any other property sector has announced a suspension of preferred dividends - another metric that we believe demonstrates the resiliency of income within the broader REIT preferred asset class.

REIT Preferred Dividends During the COVID-19 Pandemic

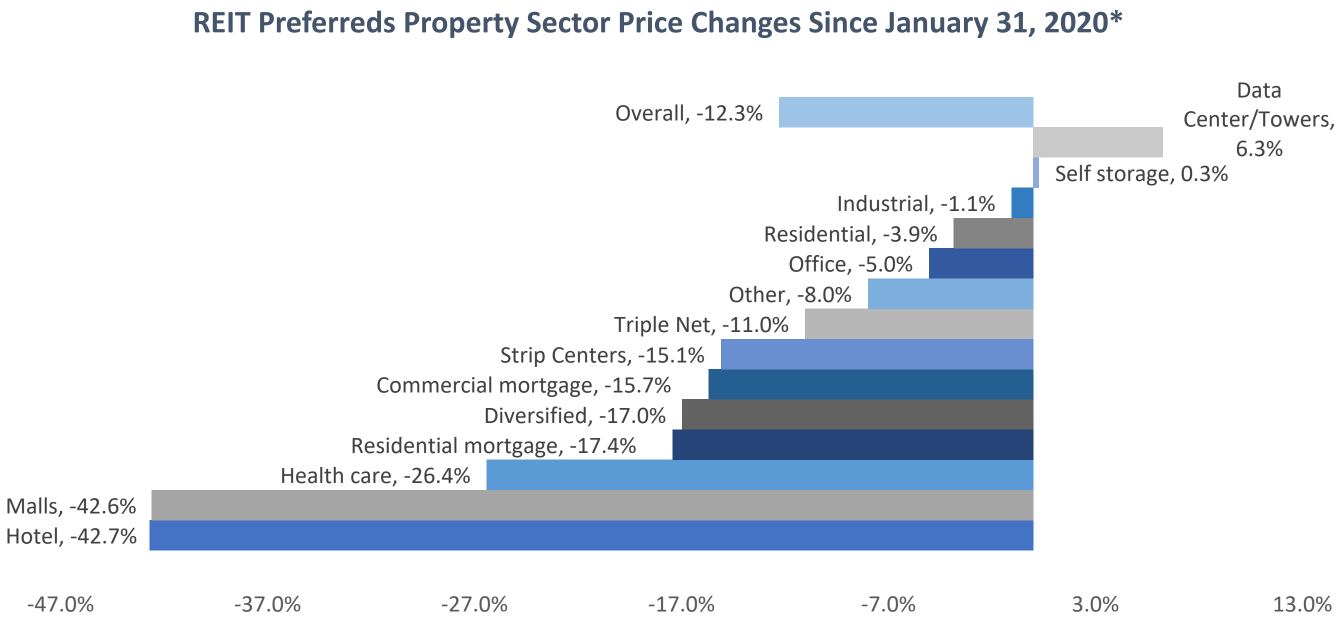
Despite generally demonstrating resiliency in income, we calculate that share prices in the REIT preferred asset class declined by 12% from January 31, 2020 to July 31, 2020. As such, price action in this asset class has demonstrably diverged from underlying distribution sustainability. As seen below, we calculate that the asset class yield stood at 6.2% at the end of January, and now stands at 7.0%, with the minimal decline in distributions more than offset by a more dramatic decline in share prices.



Source: Proprietary database (LDR Capital Management) as of 7/31/2020.

Digging a little more deeply, we note some striking dispersions in performance from a property sector vantage point, with several REIT preferred property sectors having sold off markedly despite zero preferred dividend adjustments, while others having held up quite well. Specifically, we calculate the weighted average price of regional mall and hotel preferreds are both down 43%, and health care preferreds are down 26% since the end of January. To the contrary, we calculate data center and tower preferreds are up on average 6%, self-storage preferreds are flat, and industrial preferreds are down just 1% over the same time period.

We attribute this significant dispersion to three reasons: 1) Investor flight to defensive and recession-proof sectors, especially those with minimal human interaction; 2) Uncertainty regarding REIT rent collection levels and the re-opening of non-essential businesses; and 3) Concerns surrounding the longer term impacts on commercial real estate from the growth in ecommerce and work from home initiatives.



Source: Proprietary database (LDR Capital Management), Bloomberg as of 7/31/2020

Over the short run, it's quite natural for the share prices of preferred stocks to be impacted by various factors such as the performance of their underlying equities and all the other drivers mentioned above. However, over the long run, we believe that the primary determinant of REIT preferred share prices has been, and should continue to be, income distributions: preferreds that have continuously distributed dividends should preserve value in the form of share prices, while preferreds that have impaired dividends should eventually see their share prices decline. Looking ahead, it is for this principal reason that we believe the disconnect between income distributions and share price performance will eventually come back in sync.

Conclusion

We believe the worst may be over for suspensions to REIT preferred dividends, and in fact may see more re-instatements of preferred dividends over the next 12-24 months. Our views are based, in part, on the fact that some of the industry's largest issuers have already addressed their preferred dividends in the past few months by raising capital, cutting costs (including common dividends), and reaching agreements with their lenders. In addition, looking to year-end, we believe there may be some REITs that make year-end true-up preferred/common distributions to maintain their REIT status. As such, we think the current average 7.0% dividend yield for REIT preferreds will prove to be sustainable. And more importantly, the REIT preferred asset class should demonstrate solid resiliency during (and coming out of) the current COVID-19 pandemic.

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Index Definitions

LDR Database Definitions
LDR's calculations regarding REIT preferreds that are described in this letter are derived from its proprietary database of REIT preferreds, which is described in this paragraph. LDR seeks to track performance and various valuation metrics for all REIT publicly-traded preferreds issued in North America that are currently outstanding. This database does not include $1000-par preferreds, as they are not exchange listed. Otherwise, LDR believes that its database captures the universe of publicly-traded REIT preferreds in North America that are currently outstanding. However, the LDR proprietary database does not include historical data, so references to historical yields and returns prior to 7/31/2020 are based on relevant indices as noted. Overall issuance data, where noted, includes U.S. and Canada-issued fixed-rate and convertible REIT preferreds. Yield data includes only U.S.-issued fixed-rate preferreds. All pricing and trading data for the database are derived from Bloomberg.

Use of Indices
Market index information shown herein is for illustrative purposes only and is included to show relative market performance and other metrics for the periods indicated. The indices presented herein are not representative of any LDR account and no such account will seek to replicate an index. Market participants cannot invest directly in an index, the index is not actively managed, not subject to management fees, broker commissions or other expenses, and investors should not rely on them as accurate means of comparison.

Index Definitions
Wells Fargo Hybrid and Preferred Securities Index (WHPSR) tracks the performance of preferred securities issued in the US market by Real Estate Investment Trusts. The index is composed of preferred stock and securities that, in Wells Fargo's judgment, are functionally equivalent to preferred stock including, but not limited to, depositary preferred securities, perpetual subordinated debt and certain capital securities.

FTSE NAREIT All REITs Index (FNAR) tracks the performance of all publicly traded US REIT stocks. The index is market capitalization weighted and includes all tax qualified REITs listed on the NYSE, AMEX and NASDQ.

DISCLAIMERS AND DISCLOSURES CONTINUED

Coronavirus and Other Global Health Events Risk

Epidemics, pandemics and other widespread public health problems could adversely affect the performance of REIT preferreds. For example, in late 2019, a novel virus started causing a disease ("COVID-19") with severe acute respiratory syndromes in humans, at times with serious health complications that sometimes result in death. What began as a local outbreak in Wuhan, China, spread globally over the course of weeks, stressing advanced healthcare systems of Western countries and resulting in financial disruptions to an extent that remains unclear. On March 11, 2020, the World Health Organization assessed that the outbreak can be characterized as a pandemic. Many countries imposed restrictions on travel and strict measures of social distancing.

As the potential impact on global markets from COVID-19, or future epidemics, pandemics or other health crises, is impossible to predict, the extent to which any such crisis may negatively affect the performance of REIT preferreds is uncertain. Precautions or restrictions imposed by governmental authorities and public health departments related to this pandemic are expected to result in indeterminate periods of decreased economic activity throughout the U.S. and globally, including reduced or ceased business operations, decline in international trade and shortages of supplies, goods and services. An outbreak such as COVID-19, and the reactions to such an outbreak, are expected to cause uncertainty in the markets and businesses and are generally expected to adversely affect the performance of the U.S. and global economy, including due to market volatility, market and business uncertainty and closures, supply chain and travel interruptions, the need for employees to work at external locations and extensive medical absences among the workforce. As a reaction to such an outbreak, it is possible that governmental fiscal and economic measures will lead to an increase in spending and other forms of financial stimuli, and it is difficult to predict what effect such measures will have on the U.S. and global economies.

The impact that pandemics and other public health events will have on the performance of REIT preferreds in particular is uncertain, and it will depend to a large extent on future developments and new information that may emerge regarding the duration and severity of the coronavirus or other health crisis, and the actions taken by authorities and other entities to contain such crisis or treat its impact.