REIT Preferreds An Attractive Entry Point?

As of 12/6/2023

L D R CAPITAL MANAGEMENT

Key Takeaways

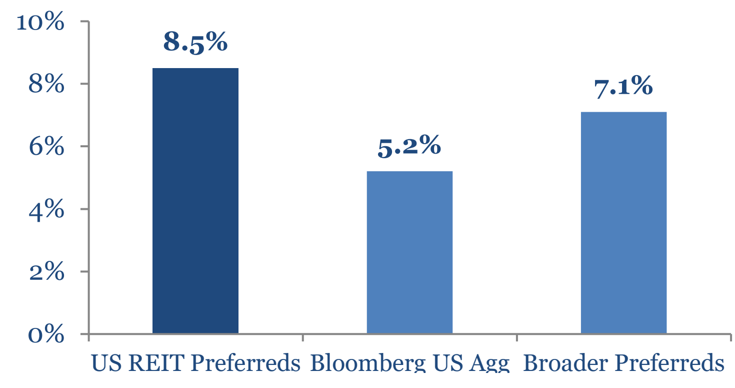
- *The U.S. Federal Reserve's higher-for-longer stance provides one of the most attractive entry points for REIT preferred investors in more than a decade.*
- *With the Fed nearing the end of its rate hike cycle, current valuation levels have increased future expected returns for the asset class.*
- *Credit quality remains solid with healthy balance sheets in addition to high preferred dividend coverage ratios.*
- *We also anticipate a more opportunistic outlook for REIT preferreds once greater price transparency and transaction activity materializes in private real estate.*

I. REIT Preferred Valuations Are Increasingly Favorable

Yield

- As of 11/21/23, we calculate that REIT preferreds traded at a weighted average yield of 8.5%.
- In comparison, we calculate the Bloomberg US Aggregate Bond Index traded at a yield-to-maturity of 5.2% and the broader preferred universe traded at a yield-to-maturity of 7.1%.

Yield Comparison (as of 11/21/2023)*



*Source: Bloomberg. "US REIT Preferreds" is based on LDR Capital Management's proprietary database of REIT preferreds, "Bloomberg US Agg" is the Bloomberg US Aggregate Bond Index, and "Broader Preferreds" is the ICE BofA Core plus Fixed Rate Preferred Securities Index.

Price to Par

- As of 11/21/23, we calculate that 99% of the asset class trades below par at an average price of $19.48 relative to a $25 par value, implying an average 37% upside to par.

II. Technical Environment Supportive

Supply Restricted

- New issuance has essentially ground to a halt in 2023. Year to date, we count just 3 new issuances of REIT preferreds totaling $224 million.
- That compares to redemptions and tender offers representing $1.1 billion in 2023.
- Companies are not deploying capital and growing their balance sheets, as private market valuations have not adjusted to the new regime in interest rates.

Demand

- We anticipate investors will begin to extend duration within their fixed income allocations once Treasury yields stabilize and the Fed starts easing monetary policy.
- Positive momentum in fund flows could push capital appreciation on top of high yields.
- We also anticipate a more opportunistic outlook for liquid real estate securities (including REIT preferreds) once greater price transparency and transaction activity materializes in the private market.

III. REIT Preferred Credit Quality Remains Solid

Defaults Have Historically Been Quite Low

- Over the past 25 years, we calculate the cumulative default rate in the asset class to be just 3.6%, or 14 bps per annum.

- We count that 9 REITs suspended their preferred dividends as a consequence of the COVID-19 pandemic. In each and every case, these issues were either completely cured or are now in the process of being cured.

- While economic uncertainty still exists, we do not expect REIT preferred defaults to become elevated, as the seniority of claims and structural attributes of the asset class should protect issues even in an economic downturn.

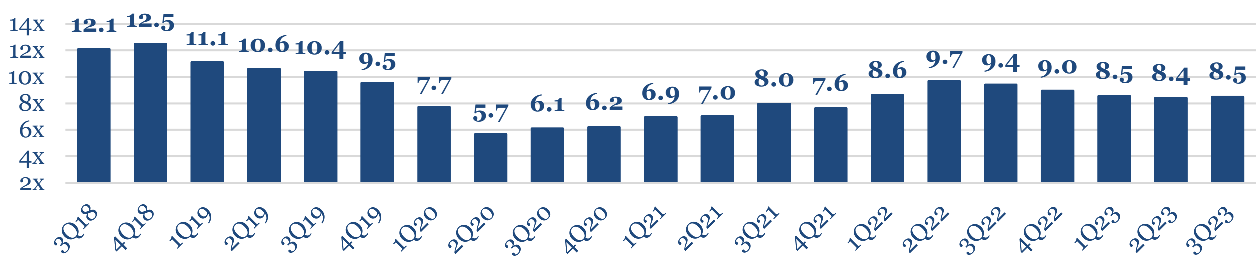
Balance Sheets and Credit Remains Solid

- Green Street Research calculates that debt-to-EBITDA for equity REITs stood at 5.8x in Q2.2023, versus a historical average of 6.0x.

- NAREIT calculates that leverage, as calculated by net debt to enterprise value, was 35% for equity REITs in Q2.2023, versus a historic average of 39%.

- We calculate that REIT preferred dividend coverage was a healthy 8.5x in Q3.2023.

REIT Preferred Universe Dividend Coverage*



*Source: LDR Capital Management proprietary database

- We calculate that REIT cash flows would have to decline 38% before coverage on their preferred dividends would fall to 1x, an unlikely prospect in our opinion.

- During periods of stress, REITs have multiple avenues to access capital, including paying common dividends in stock rather than cash, issuing additional equity or preferred shares and mortgaging unencumbered assets.

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LDR Database Definitions

LDR's calculations regarding REIT preferreds described herein are derived from its proprietary database, which strives to track the performance and valuation metrics for all currently outstanding publicly-traded REIT preferreds issued in North America (excluding $1000-par preferreds, as they are not exchange-listed). LDR's proprietary database does not include historical data, so references to historical yields and returns prior to 9/30/22 are based on relevant indices, as noted. Overall issuance data, where indicated, includes U.S. and Canada-issued fixed-rate and convertible REIT preferreds. Yield data consists only of U.S.-issued fixed-rate preferreds. All pricing and trading data for the database are derived from Bloomberg.

Use of Indices

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

Indices

REIT Preferreds is based on the LDR Capital Management proprietary database. Overall Preferreds are represented by the ICE BofA Core Plus Fixed Rate Preferred Securities Index, which tracks the performance of fixed U.S. dollar-denominated preferred securities issued in the U.S. domestic market. Municipal Bonds use the Bloomberg Municipal Bond Total Return Index, which covers the USD-denominated long-term tax-exempt bond market. High Yield Bonds are represented by the ICE BofA BB US High Yield Index which tracks the performance of the U.S. dollar-denominated below investment grade corporate debt rate BB1 through BB3 publicly issued in the U.S. domestic market. Investment Grade Bonds use the ICE BofA BBB US Corporate Index which tracks the performance of U.S. dollar-denominated investment grade corporate debt rates BBB1 through BBB3 publicly issued in the U.S. domestic market. The TNX Index represents the U.S. 10-Year Treasury. Qualified Dividend Income ("QDI") are ordinary dividends that meet specific criteria to be taxed at the lower long-term capital gains tax rate of 20% rather than at the higher tax rate for an individual's ordinary income.