June 30, 2020

REIT Preferreds in the Pandemic

L D R CAPITAL MANAGEMENT

FOUR QUESTIONS FOR REIT PREFERREDS IN THE COVID-19 PANDEMIC

As of May 31st, 2020, we calculated that 80% of REIT preferred issues traded at or below par value. We also calculated the asset class weighted discount to par to be -16.3% with the universe trading at a weighted average strip yield of 7.5%. We believe that these discounted pricing metrics present an opportunity, but also engender questions about risk. To that end, we offer our views regarding the impact of COVID-19 on REIT preferreds by answering four critical questions.

As of 5/31/2020	%
Trading < Par	76%
Trading at Par	4%
Trading > Par	20%

Source: Proprietary database (LDR Capital Management), Bloomberg as of 5/31/2020. Based on price less accrued dividend.
See Disclaimers and Disclosures for further information.

1. IS THE CURRENT DOWNDRAFT IN THE REIT PREFERRED SECTOR AN ABRUPT MARK-TO-MARKET OR A PERMANENT DISPLACEMENT OF CAPITAL?

We believe the recent downdraft experienced in the REIT preferred sector to be an abrupt and temporary mark-to-market rather than a permanent displacement of capital. It is our belief that the vast majority of REITs will survive this challenging period, continue to operate, continue to pay their cumulative preferred dividends, and ultimately have minimal, if any, credit impairments on their preferred shares.

As background, REITs began issuing preferreds almost 25 years ago. Over that time, the asset class has withstood several wars, economic downturns and financial crises. Despite these events, the REIT preferred universe as a whole was able to bounce back, pay continuous income, and recover par value. As of May 31st, 2020, the REIT industry* now has an aggregate equity market capitalization of approximately $800 billion, and distributes approximately $37.5 billion of annual dividends to common shareholders. Preferred shareholders sit senior to the entire equity stack and also sit senior to all common distributions. Further in our view, the REIT industry generally owns quality commercial real estate, often with long leases, and went into this crisis with the healthiest balance sheets and liquidity in over a decade. Thus, we believe broad-based asset class credit impairment is unlikely.

* Represented by the MSCI US REIT Index (RMZ). Annual dividend distribution calculated by using 12-month trailing dividend yield.

REIT Preferreds in the Pandemic

We calculate the historical cumulative credit loss experienced by the entire REIT preferred asset class over the past 23 years to be just 2.64%* (see table below). Cumulative credit loss is defined as the sum of total credit loss (where preferred shareholders receive $0 for shares) and partial credit loss (where preferred share holders are only paid back a portion of par) as a percentage of total par value of preferreds issued. That loss is an aggregated tally over 23 years, not an annual amount, thus suggesting minimal historic credit losses in the universe. Diving a little more deeply, we calculate that equity REITs have experienced a historical cumulative credit loss of just 0.81%* over the past 23-years (earliest data available). Separately, we calculate that mortgage REIT preferreds, which comprise approximately 16% of total REIT preferred issuances, experienced 12.44%* in cumulative credit loss. Note, one mortgage REIT issuer represented approximately 53% of total mortgage REIT credit loss. Taken in total, the REIT preferred asset class has historically experienced a small number of credit issues. Even the mortgage REIT preferred area, aside from one issuer, has experienced relatively few credit issues.

Historical Credit Loss of REIT Preferreds

	Partial Credit Loss		Total Credit Loss		Cumulative
	# of Issuers	Loss as a % of Total Par Value of Preferred Issued	# of Issuers	Loss as a % of Total Par Value of Preferred Issued	Loss as a % of Total Par Value of Preferred Issued
Equity REIT Preferreds	3	0.41%	4	0.40%	**0.81%**
Mortgage REIT Preferreds	2	0.96%	8	11.48%	**12.44%**
Total REIT Preferreds	5	0.50%	12	2.14%	**2.64%**

Source: Proprietary database (LDR Capital Management) as of 12/31/2019.
* Loss is calculated as the amount of the loss as a percentage of total par value of preferred issued.
Past performance is not indicative of future results. See Disclaimers and Disclosures for further information.

Please note we are by no means anticipating a V shaped recovery for REITs from this pandemic. Landlords will have to work through numerous tenant issues, re-staff their properties, increase health and cleanliness practices across their portfolios, catch up on any deferred maintenance issues, and rebuild the financial liquidity spent during this crisis. The recovery for commercial real estate and REITs will most certainly take some time.

That said, as stated herein, REIT preferreds are cumulative dividend securities that sit senior to underlying equity capital. Any diminution in cash flow or capital value has to completely wipe all the underlying equity before credit impairment occurs at the preferred level. With what we view as substantial equity capital and available liquidity, the vast majority of REIT preferreds should experience minimal, if any, credit issues and should be able to withstand this severe economic crisis.

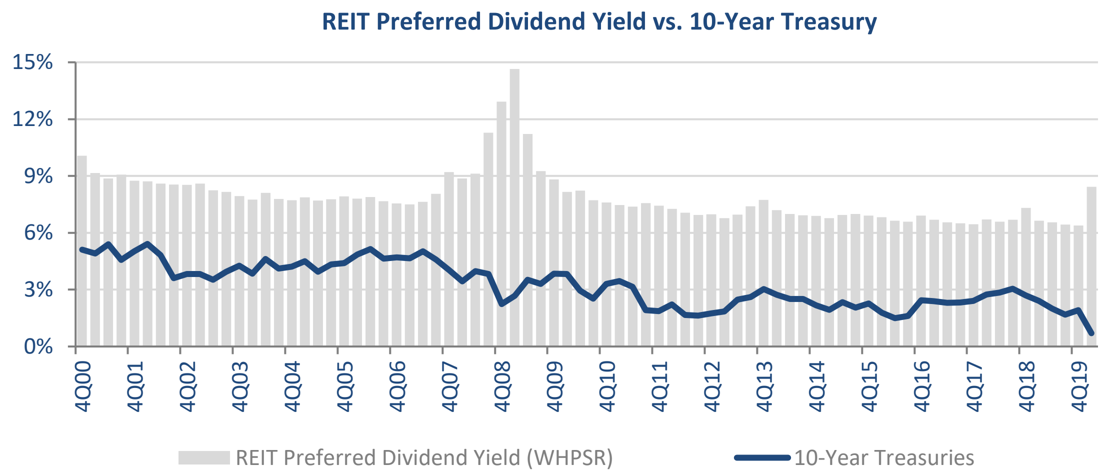
We thus believe that the current downdraft in the REIT preferred sector will prove to be a temporary mark-to-market issue rather than a permanent displacement of capital.

2. What are your views regarding the sustainability of REIT preferred dividends given the current pandemic?

Simply stated, we believe REIT preferred dividends have proven in the past, and will yet again prove, sustainable during this pandemic.

The REIT preferred universe has a long and well-documented history of paying sustained dividends. As seen below, REIT preferreds have been paying consistent dividends with a healthy spread over 10-year Treasury rates for decades. We calculate REIT preferred dividend yields have on average exceeded 10-year Treasury yields by 460 bps since 2000.

The Average Yield Advantage for REIT Preferreds Over 10-Year Treasuries Has Been 460 bps Since 2000



Source: Bloomberg. Quarterly data as of 3/31/2020. REIT preferred universe represented by the Wells Fargo Hybrid & Preferred Securities REIT Index (WHPSR), which has an inception date of 1/3/2000.
See Disclaimers and Disclosures for more information on indexes.

During the 2007-2009 financial crisis, which had a large impact on real estate, we count that 18 REITs suspended their preferred dividends (specifically 7 equity REITs and 11 mortgage REITs). Of these companies, 7 reinstated their preferred dividends, with investors being paid back in full (5 equity REITs and 2 mortgage REITs). In totality, just 2 equity REITs experienced a credit loss as a consequence of the 2007-2009 financial crisis, both of which were lodging REITs that were taken private. Of note, subsequent to 2009, the majority of REIT preferred issues now contain change of control provisions, which would preclude the type of credit loss experienced by the two hotel preferreds that sustained a loss through privatization transactions.

Underpinning the dividends of REIT preferreds are a few main characteristics. From a structural perspective, REIT preferred dividends are cumulative in nature, meaning preferred holders must be paid in full before common shareholders receive any dividends. Any unpaid and accrued preferred dividends are accounted for as an accruing liability on REIT balance sheets. As of this year, cash strapped REITs are allowed to pay up to 90% of their common dividend in stock in lieu of cash, which provides even further support for preferred shareholders during stressed time periods. It's for those reasons that many REITs have recently publicly expressed the view that their preferred shares are senior securities, and the underlying dividends to be part of their recurring fixed charges.

From a financial perspective, we calculate that an average 35% decline in cash earnings must occur before dividend coverages on the universe of REIT preferreds fall to 1.0x (where free cash flow after debt service and capital expenditures are just enough to cover preferred dividends). Further, conservatively assuming no operating income from properties at all, we calculate that the average REIT preferred issuer (aside from hotel and mortgage REITs) has enough financial liquidity to continue to pay all their overhead costs, including preferred dividends, for almost 2 years. This liquidity assumes REITs continue to pay all corporate expenses, debt service, preferred dividends, and capital expenditures while all their buildings are completely empty, a scenario which we believe is extremely remote. Both of these financial metrics indicate substantial resiliency and liquidity for REITs and their preferred dividends. As such, we find it no surprise that while 61 REITs have thus far either eliminated or reduced common dividends during this crisis, just 6 have suspended their preferred dividends. In less than 3 months, 2 REIT preferreds have already reinstated the preferred dividends.

We therefore believe REIT preferred dividends will prove sustainable through (and coming out) of this pandemic period.

3. How has the COVID-19 pandemic fundamentally impacted the various REIT property sectors?

The COVID-19 pandemic has most definitely impacted fundamentals within the commercial real estate marketplace. While we discuss the impact of this crisis on each of the major REIT property sectors below, our bottom line conclusions are as follows: 1) Across the board, earnings from REITs will be dramatically lower in 2020, with expected improvements in 2021, but a return to prior levels not likely until 2022, 2) Major dispersion of results within property sectors, with certain parts of the universe holding up relatively well while others more severely impacted, and 3) Aside from an acceleration of the secular decline in retail, we see little permanent displacement of capital value over time.

In our view, the sectors least impacted by COVID-19 pandemic include:

- *Data centers and tower REITs:* Both sectors being driven by strong demand for increased data transmission, bandwidth, and storage. The COVID-19 pandemic appears to only increase that demand.

- *Industrial REITs:* This pandemic likely improves demand for industrial real estate as it serves the ever-more important supply chain in the United States.

- *Self-storage REITs:* This property sector is driven by movement and change in peoples' lives, and the COVID-19 pandemic, unfortunately, is causing household change, and increased migration – all of which in our view help bolster demand for self storage facilities.

- *Multi-family and single-family rental REITs:* Higher unemployment levels unfortunately create lower affordability rates for households, which offers stability and lower moveout volumes for the rental housing industry. As such, we believe this pandemic offers stability of demand for both multi-family and single-family rental REITs.

In our view, the sectors most impacted by the COVID-19 pandemic include:

- *Hotel REITs:* A cessation of domestic and global travel has severely impacted the lodging industry. No REIT sector has been as negatively impacted as the lodging sector. We believe the lodging industry will return to its former levels, but this may take considerable time to occur. We do not believe the lodging sector will be fundamentally impaired over the long run, but instead will have extremely negative cash flow implications over a near to intermediate timeframe.

- *Retail REITs:* The shopping center and regional mall industries have been in a secular decline for several years. The COVID-19 pandemic has certainly accelerated this process. We expect these secular trends to continue.

- *Office REITs:* Technological advancement has clearly enabled office tenants to increase work from home initiatives. As well, office landlords must incur expenditures to improve cleanliness within properties. Urban areas as well must contend with significant commutation issues for office workers. Consequently, while we believe the office market will absolutely survive this crisis, future operating margins will likely be lower.

- *Healthcare REITs:* Certainly, healthcare REITs have been at the epicenter of this pandemic. Near term demand, particularly in the senior housing arena, will likely be substantially lower. Over the long run, though, we believe the demand for healthcare facilities across the spectrum will recover.

We believe the COVID-19 pandemic has absolutely hindered near term operating and financial results within the REIT universe. That said, we feel that many property sectors should emerge from this crisis in relatively short order, while others will likely take longer to re-emerge from this crisis. In our view, only the retail sector will experience a long-term permanent impairment of capital value from the COVID-19 pandemic.

4. CAN YOU DISCUSS THE RECENT COVID-19 RELATED VOLATILITY OF THE REIT PREFERRED ASSET CLASS?

Broader market volatility has certainly picked up markedly this year. We calculated that as of May 31st, 24% of trading days closed with a ±3% or more price change in the S&P 500* compared to the full-year 2008 where the S&P 500 exhibited a similar move just 17% of the time. Even more dramatically, we calculate a S&P 500 price change of ±5% or more occurred on 9% of trading days this year, which is already higher than the entire 2008 year where the S&P 500 exhibited a similar price change on just 7% of trading days. We believe that the confluence of increased market volatility, negative fund flows, and concerns about the resiliency of commercial real estate has caused the REIT preferred asset class to exhibit a strong reaction to the COVID-19 crisis. We expect this extreme asset class volatility to subside as the U.S. economy reopens and visibility on future REIT operating fundamental trends emerges.

Over the past 20 years, volatility within the REIT preferred asset class has been just 12%. As well, the asset class has carried a 68% correlation with REIT equities and a 51% correlation with the S&P 500*. However, since February 1st, those metrics have gapped up. We calculate that asset class correlation with the broader market has risen to approximately 100% and volatility has risen by a factor of 5.5x, to close to 66%.

Annualized Standard Deviations**	ITD	Since February 1, 2020
Wells Fargo Hybrid and Preferred Securities Index (WHPSR)	12%***	66%

Data as of 5/31/2020.
**Annualized standard deviation calculated from daily standard deviation calculation.
***Inception date of Wells Fargo Hybrid and Preferred Securities Index (WHPSR) is 1/3/2000.

In the past, the REIT preferred class has lived through periods of extraordinary market conditions, during which volatility and correlations have spiked. In addition to the reasons mentioned above, relatively thin trading liquidity of the REIT preferreds have caused correlations with the broader market to gap up and volatility to soar in times of severe crisis. That said, after each and every instance of market disruption in the past, this asset class has eventually settled in to more stable conditions, volatility has subsided, and correlations with the broader market have reduced.

We therefore believe that while the recent COVID-19 crisis has clearly caused a spike in volatility in REIT preferreds, a return to better economic and operating conditions will trigger a settling of the asset class back to more normal trading patterns.

* FTSE NAREIT All Equity REITS Total Return Index (FNERTR) used to represent REIT equities and the S&P 500 Total Return Index (SPXT) to represent the S&P 500. Data as of 5/31/2020. Inception date of Wells Fargo Hybrid and Preferred Securities Index (WHPSR) is 1/3/2000.

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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 6/18/20 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.

MSCI US REIT Index (RMZ) is a free float-adjusted market capitalization weighted index that is comprised of equity Real Estate Investment Trusts (REITs).

DISCLAIMERS AND DISCLOSURES CONTINUED

Coronavirus and Other Global Health Events Risk

Epidemics, pandemics and other widespread public health problems could adversely affect the Fund's performance. 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 Fund's performance or the duration of any potential business disruption 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 the Fund 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, all of which are beyond the Fund's control.