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Real Estate Securities Update

We have just witnessed the quickest pullback in the listed real estate space during the modern REIT era. This pullback has driven REITs to discounts to NAV we have not seen in decades. As of Tuesday March 24th, 2020, the benchmark returns for U.S. REITs (as represented by the FTSE NAREIT Equity Index) and Global Real Estate Securities (as represented by the FTSE EPRA NAREIT Developed Index) were both down about -35%. Duff & Phelps has outperformed its benchmark in both strategies thus far this year through active management. Much of the negative performance within the sector has occurred in the current month (March) as the U.S. benchmark declined -30.4% and the Global benchmark declined -30.1%. Listed real estate across the globe are in the eye of the COVID-19 storm as major cities, states, and in some cases entire countries, stepped up to halt the spread of the dangerous virus, shutting down all economic activities except essential services. Combining this historic action with elevated emotions and an appropriate level of caution has created an environment of inefficiency, and thus far a disproportionately negative effect on REITs relative to many other GICs sectors this month.

Some examples of the pullback by property sector. Regional Malls, Shopping Centers and Lodging/Gaming REITs have declined in the vicinity of 50% year-to-date as of March 24th, as they have virtually shut down operations per governmental authorities in the best markets of the world, where listed REITs own properties, temporarily impacting their tenants. Data Centers and Industrial (logistics facilities/warehouses), sectors we have identified and invested in as secular growers, have done relatively well. Data Center companies have declined approximately -7% YTD, continuing to benefit on a secular basis as data and video traffic has significantly increased as a result of work from home policies. Industrial has declined -21% YTD, still outperforming. Increased on-line shopping drives strong demand for well- located industrial space which is close to the consumer. Self-storage, declined -22.9% YTD as the sector is viewed as defensive and has low capital expenditure needs.

As of this writing, the market is rallying as we await the details of a massive U.S. stimulus program aimed at helping both individuals and businesses bridge the cash flow gap until the world returns to a more normal state. Europe is also contemplating similar fiscal actions. These programs could potentially have a profound effect on people's lives as well as businesses severely hurt by COVID-19. In the REIT world, it could provide assistance to tenants in numerous property sectors. Across the globe, high-quality REITs are selling at deep discounts to historical net asset values. In many cases dividend yields are very attractive relative to other investment alternatives. As of the close on Tuesday, March 24th, U.S. REITs were selling at a 35% discount to their NAV (EvercoreISI). History has shown us that well-structured stimulus programs over time can help heal an economic crisis and close the valuation gap between an asset's deeply discounted share price and its intrinsic value.

Sources: Bloomberg Finance L.P., FTSE, EvercoreISI.