Heard on the Beach

Casino Royale

April 23, 2021

Green Street

Executive Summary

It used to be easy for US-based REIT investors to ignore the challenges confronting global investors. Listed property markets elsewhere were generally small and/or poorly developed. That is no longer the case, and many investors previously tasked with identifying cheap U.S. REITs/property types now also need to consider the appropriateness of cross-border valuations.

In 2015, Green Street introduced the *Global Property Allocator (GPA)*, a monthly report that ranks property sectors in the US, UK, and Continental Europe based on the unlevered long-term returns they are expected to deliver. Those return forecasts are paramount, but an additional important step involves making returns comparable by backing out the relevant risk-free rate. Consistent with economic theory, investments in countries with higher interest rates need to generate higher returns.

A review of the report's track record highlights that proper property type and/or country selection can lead to superior results. A portfolio of sectors that garnered a top-tercile ranking (rebalanced monthly) outperformed by over 500 bp/year and results were positive in 85% of 12-month periods. The logic underpinning the analysis is also useful when assessing cross-border acquisitions by REITs.

Past performance is no guarantee of future performance, but the consistent outperformance by GPA shows that new challenges can also be new opportunities.

RMZ: **1300** | DJIA: **33,815** | 10-Year T-Note: **1.53%** | Baa Yield: **3.56%**

Important disclosure on pages 6-7

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Casino Royale: There are many ways for active investors to generate alpha in the REIT space. Individual stock selection sits at the "micro" end of the spectrum, while interest rates, the economic outlook, and pandemics comprise the "macro" end. Property sector selection, geographic allocation within continents, and cross-continent positioning reside somewhere in the middle. For many years, Green Street's forte was at the micro end: our track record in successfully separating winning REITs from losing REITs (on a sector-neutral basis) stretches back decades. On the flip side, we have been proponents of avoiding macro bets: hardly anyone is talented enough to consistently outsmart the market in this area.

Opportunities abound in the middle of the spectrum, however, and there is ample reason to believe that savvy investors can gain advantages. Indeed, the tools we've introduced over the last decade to help with sector selection have added as much value as superior stock selection in the US, and sizable resources are being dedicated toward geographic calls within the US. To help with the cross-continent valuation question, Green Street introduced the *Global Property Allocator (GPA)* five-and-a-half years ago.

GPA is a monthly report that ranks the attractiveness of property sectors in the US, UK, and Continental Europe. The investment logic is built on Green Street's approach towards sector allocation. Instead of choosing sectors based on an anticipated reaction to economic/other surprises, REIT sectors are ranked by the long-term unlevered return they are expected to generate at current pricing.

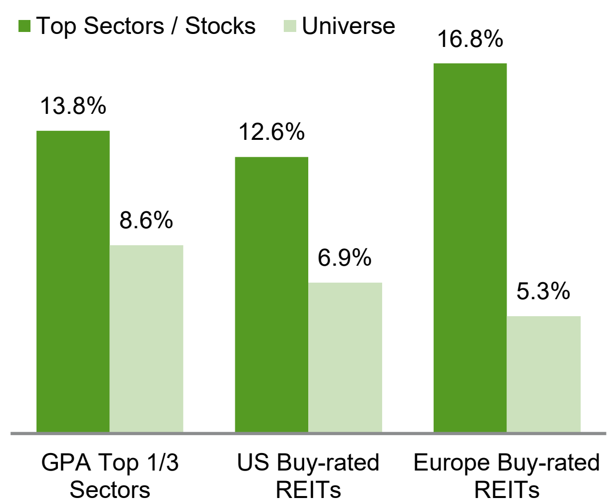
Those returns are a function of starting yields (i.e., implied cap rates), growth expectations, and the amount of capitalized (i.e., hidden) expenses required to achieve that growth. Adjustments are made for property-type risk (e.g., volatility of lodging vs. student housing), strong/weak balance sheets, G&A efficiency, and external growth prospects. Internal property growth is a critical input. Demand and supply imbalances (and their persistence) are a key driver within a country and differences in inflation are important across countries. Large assumptions are an inherent shortcoming of the endeavor. Nevertheless, the return forecasts represent the collective wisdom of Green Street's 54-person cross-continent research team.

But not all returns are created equal. A 6% USD expected return is less desirable than a 6% EUR expected return. The GPA's approach to account for different countries/currencies should be familiar to global investors. Interest rate parity dictates that the currency of a country with a *lower* interest rate will be priced to *appreciate* by an amount equal to the difference in interest rates between the countries. Therefore, any comparison of returns that does not adjust for the interest rate environment effectively contains an undesired bet on currency moves. The GPA takes this into account by subtracting the local 10-year government bond yield from expected returns. Based on prevailing yields, that means that investors should be neutral between a 6% return in the US and a 4.5% return in France.

The importance of the sovereign rate adjustment is highlighted by a recent bond-market anecdote. Two months ago, Prologis issued EUR notes at a yield of 0.5% and then three days later issued USD notes with a similar tenor at 1.625%. That begs the question, "if they can borrow that cheap, shouldn't cap rates in Europe be lower?" Yes, they should.

With a five-year track record under its belt, the performance of the GPA can now be measured. REIT property sectors ranked in the top one-third of the GPA analysis returned 13.8%/year from Oct 5, 2015 to April 15, 2021, which is 520 bp more than the 8.6%/year return of all sectors (equally wtd.). Top sectors outperformed the all-sector average in 2/3rds of monthly periods and 85% of the time when performance is viewed over rolling 12-month periods. Those results are almost as good as Green Street's individual stock recommendations.[1]

Annualized total return over past 5 1/2 years



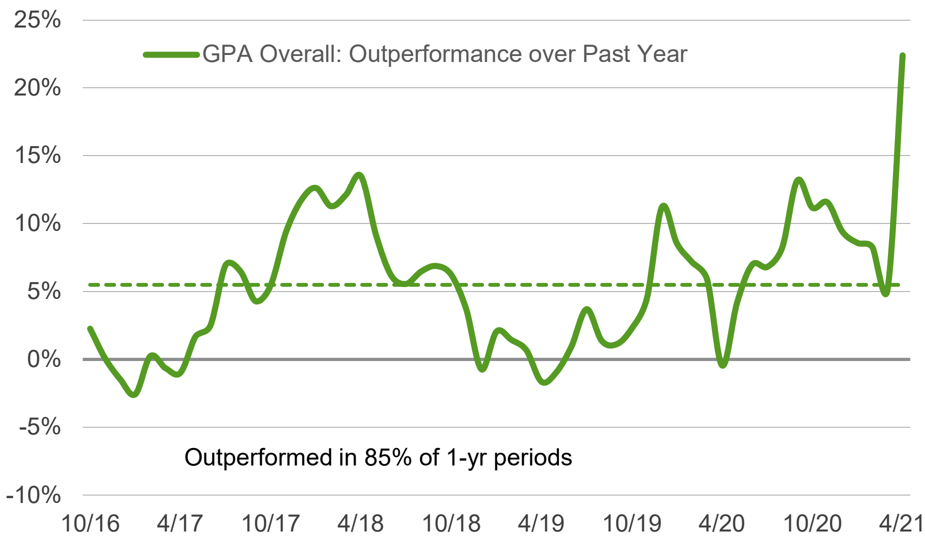
Country selection is important, but attribution analysis shows that the ability to identify intra-region mispricing (e.g., UK Self-Storage vs. other UK sectors) was responsible for most of GPA's success. Viewed on an intra-region basis, outperformance by top-ranked sectors was sizable for the UK and US though barely positive for Continental Europe. When combined, those intra-region results account for 80% of GPA's outperformance. Ecommerce and non-core vs. core were two trends that contributed to the outsized role of property type over the past five years. Going forward, the importance of the two GPA components—property type and country selection—is likely to be more balanced.

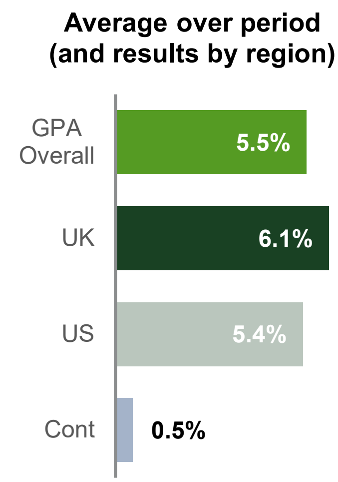
The standardization of expected returns that is at the heart of the GPA, is also useful when analyzing acquisitions by REITs outside of their home country. Global expansion presents a relatively unfamiliar analytical challenge for REIT investors

[1] GPA returns in USD. Sectors are given an equal weighting and terciles rebalanced with each report. Return of middle and third terciles was 4.3% and 6.7%, respectively. US and European buy-rated stock returns from Oct 1, 2015 to March 31, 2021. Securities are equally weighted. European returns presented in local currency (i.e., no conversion). Past performance does not guarantee future performance.

A Good Track Record: Green Street's *Global Property Allocator* identifies property types across the US, UK, and Continental Europe poised to deliver the highest/lowest risk-adjusted returns. Since the product's introduction 5 1/2 years ago, the top 1/3 of sectors identified by the GPA bested the average return of all sectors by 5.5%/year (measured over rolling 12-month periods). The tool has delivered positive outperformance 85% of the time and it has been most effective highlighting mispricing within the UK and US.

Outperformance of Highest Ranked GPA Sectors (vs. All Sector Average)

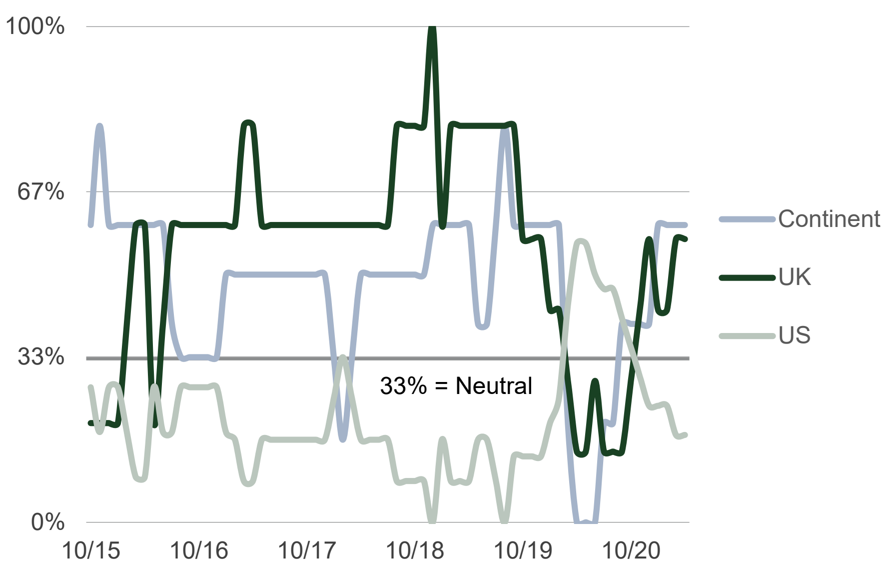




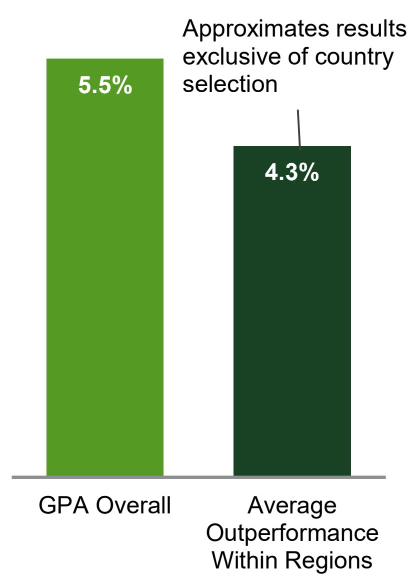
Highest is best 1/3 rd based on rank in Global Property Allocator report. Returns in USD. All sectors given equal weighting. Results by region is highest 1/3 rd in region vs. avg of all sectors in region. Methodology is different than presented on page 2 (avg of rolling 12-month periods vs. annualized return for entire period).

Assisted by Country Selection: Continent and UK property sectors garnered a disproportionate share of top rankings, largely because risk-free rates in those regions have been lower than those in the US. That European tilt added roughly 120 bp to the GPA track record. Most of the tool's outperformance came from identifying attractively priced property types, not from country selection.

% of Sectors in Region included in Highest Ranking



GPA Track Record



Average of three regions is 25% Continent, 25% UK, and 50% US which approximates number of sectors in each region.

and managers, and the GPA framework is insightful. American Tower's €7.7 billion acquisition earlier this year of Telefonica assets in Germany, Spain, Argentina, and Brazil (plus other countries) highlights the wide range of appropriate hurdle rates:

- Discount rates for sites in Germany and Spain are significantly lower than those for sites in the US. Long-term growth rates are also lower due to lower inflation, but the difference is not as large as the gap in discount rates. Market-derived breakeven inflation expectations, when available, should be used.

- Discount rates for Argentina and Brazil are much higher. But so is inflation, and real growth is likely to be as well. The combination equals much higher nominal growth rates. Cap rates in those markets need not be as high (vis-à-vis the US) as first appears.

The deal's high-3% cap rate speaks to the growth potential of towers, and the sector's popularity. Even at that yield, if sites were located entirely in Germany and Spain, pricing would have been attractive…in line with AMT's implied cap rate despite lower discount rates in the Eurozone. The Latin America exposure (20% of portfolio and higher warranted cap rate) muddies any conclusion, but perhaps the market's initial negative reaction should have been more upbeat.

For the active investor, risk and opportunity go hand in hand. Nobody outperforms the benchmark by holding the benchmark, and selective bets predicated on approaches that have proven to be helpful provide a path to outperformance. Cross-continent bets may feel a bit too risky/macro, but opportunities are sometimes large enough to warrant placing chips at that table. Property investors with a global mandate should put *Global Property Allocator* high on the reading list.

Peter Rothemund, CFA
Mike Kirby

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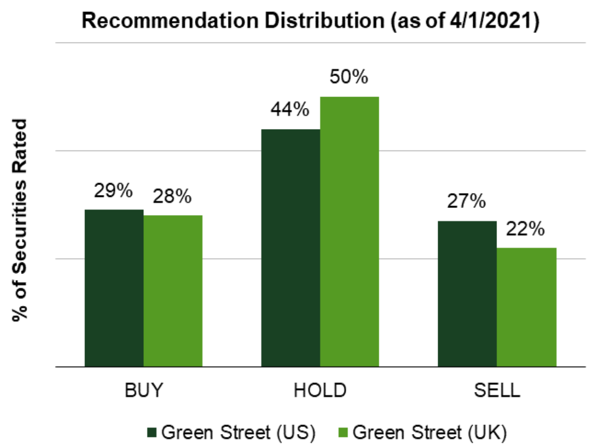

Green Street's "BUYs" have historically achieved far higher total returns than its "HOLDs", which, in turn, have outperformed its "SELLs".

Total Return of Green Street's Recommendations[1,2]

Year[3]	Buy	Hold	Sell	Universe
2021 YTD	12.2%	12.3%	10.2%	11.8%
2020	3.3%	-13.0%	-22.5%	-10.7%
2019	31.6%	22.4%	17.8%	24.0%
2018	-5.1%	-6.6%	-9.2%	-7.0%
2017	6.4%	0.2%	2.1%	2.6%
2016	14.9%	14.7%	13.1%	14.4%
2015	8.3%	0.9%	-1.7%	2.4%
2014	41.6%	31.5%	27.3%	33.3%
2013	4.1%	0.6%	1.7%	2.2%
2012	24.5%	24.7%	18.9%	23.0%
2011	18.9%	7.6%	-4.7%	7.6%
2010	43.3%	32.8%	26.6%	33.8%
2009	59.0%	47.7%	6.0%	37.9%
2008	-28.1%	-30.9%	-52.6%	-37.3%
2007	-6.9%	-22.4%	-27.8%	-19.7%
2006	45.8%	29.6%	19.5%	31.6%
2005	26.3%	18.5%	-1.8%	15.9%
2004	42.8%	28.7%	16.4%	29.4%
2003	43.3%	37.4%	21.8%	34.8%
2002	17.3%	2.8%	2.6%	5.4%
2001	34.9%	19.1%	13.0%	21.1%
2000	53.4%	28.9%	5.9%	29.6%
1999	12.3%	-9.0%	-20.5%	-6.9%
1998	-1.6%	-15.1%	-15.5%	-12.1%
1997	36.7%	14.8%	7.2%	18.3%
1996	47.6%	30.7%	18.9%	32.1%
1995	22.9%	13.9%	0.5%	13.5%
1994	20.8%	-0.8%	-8.7%	3.1%
1993	27.3%	4.7%	8.1%	12.1%
Cumulative Total Return	**24497.8%**	**1320.1%**	**21.3%**	**1613.4%**
Annualized	**21.6%**	**9.9%**	**0.7%**	**10.6%**

The results shown above are hypothetical; they do not represent the actual trading of securities. Actual performance will vary from the hypothetical performance shown above due to, but not limited to 1) advisory fees and other expenses that one would pay; 2) transaction costs; 3) the inability to execute trades at the last published price (the hypothetical returns assume execution at the last closing price); 4) the inability to maintain an equally-weighted portfolio in size (the returns above assume an equal weighting); and 5) market and economic factors will almost certainly cause one to invest differently than projected by the model that simulated the above returns. All returns include the reinvestment of dividends. Past performance, particularly hypothetical performance, cannot be used to predict future performance. Investing involves risk and possible loss of principal capital.

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(2) Beginning July 5, 2017, all companies in Green Street's North American coverage universe are included in the performance calculation. Previously, inclusion in the calculation of total return had been based on whether the companies were listed in the primary exhibit of Green Street's "Real Estate Securities Monthly" and had a rating other than "Not Rated".

(3) From 1993 until July 3, 2017, the returns for each year cover the period following the first RESM issued in the respective year through the first RESM issued in the following year and are not based on a calendar year. Subsequent to July 5, 2017, returns are based on calendar months.

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