CBRE CLARION SECURITIES

MARKET INSIGHT

REIT MARKET ROUNDTABLE Q&A

HOW ARE REITS POSITIONED IN A RISING INTEREST RATE ENVIRONMENT?

JULY 2015

What was the catalyst for the sell-off in U.S. property stocks YTD?

Since January, U.S. property stocks corrected by -13.4%. The primary catalyst for this poor performance was concern that the U.S. Federal Reserve would begin to raise interest rates later this year. This rattled both equity and debt markets as the U.S. 10-year Treasury yield ultimately climbed by 71 basis points from January to the end of June.

How have real estate stocks historically performed during periods of rising interest rates?

Based on our analysis, there have been seven periods during which REITs have corrected by approximately 10% or more due solely to a material interest rate movement and not a change in real estate fundamentals or a change in access to capital.

Key Highlights

- The recent interest rate related "taper tantrum" sell-off in U.S. REITs may present a buying opportunity for long-term investors
- Real estate fundamentals are strengthening and REITs' valuations are attractive
- U.S. REITs have historically delivered a 26% return, on average, over the 12-month period following stock price corrections related to rising interest rate concerns

Exhibit 1: Real Estate Stock Returns During and After Periods of Rising Interest Rates

				Acute Periods of Interest Rate Fears			Subsequent REIT Returns Post Sell-Off Period[1]		Subsequent S&P 500 Index Returns Post Sell-Off Period	
Sell-Off Period		Days	Rate Rise During Sell-Off	REITs Return	S&P 500 Return	REITs vs. S&P	180 days	1 Year	180 days	1 Year
Jun-94	Nov-94	159	0.93%	-11.1%	-1.4%	-9.7%	8.8%	24.1%	7.8%	36.5%
May-99	Dec-99	157	0.72%	-18.6%	4.8%	-23.4%	23.8%	33.9%	3.8%	-6.5%
May-04	May-04	26	0.70%	-14.4%	-1.5%	-12.9%	24.4%	33.5%	5.6%	7.0%
Mar-06	May-06	48	0.37%	-10.1%	-3.6%	-6.5%	27.6%	27.1%	11.0%	23.4%
Nov-10	Nov-10	8	0.31%	-9.1%	-3.8%	-5.4%	18.5%	11.2%	13.9%	7.2%
May-13	Aug-13	74	1.11%	-16.0%	1.5%	-17.4%	16.9%	26.3%	14.8%	22.9%
Jan-15	Jun-15	108	0.71%	-13.4%	3.0%	-16.5%	--	--	--	--
Averages		**83**	**0.69%**	**-13.2%**	**-0.1%**	**-13.1%**	**20.0%**	**26.0%**	**9.5%**	**15.1%**

[1]FTSE NAREIT Equity REIT Index
Source: FactSet, S&P 500 Index and FTSE NAREIT Equity REIT Index as of June 2015. An index is unmanaged and not available for direct investment.
Past performance is no guarantee of future results.

In each of these periods, REIT total returns underperformed equity market returns short-term but, thereafter, delivered subsequent periods of strong absolute returns, and generally outperformed the broader equity market. Over the next 12 months following an interest rate driven correction, the U.S. REIT Market had an average return of 26%, roughly 11% greater than the broader equity market return. These conclusions are based on the U.S. REIT and S&P equity indices data shown in Exhibit 1.

We believe the impact of rising interest rates on property stocks has largely played out, thus creating a buying opportunity that has historically been advantageous to investors following short-term corrections, as the economy is improving and real estate fundamentals are strengthening.

What market conditions would be positive for REITs?

Increasing interest rates are often a sign of an improving economic environment. Commercial real estate is generally a direct beneficiary of economic growth since improving economic conditions ultimately translate to rising occupancy levels, rental rates, net operating income, and potentially capital values. In an environment where interest rates are increasing as a result of improving economic vitality, listed REIT fundamentals may improve as a result of an increase in demand for commercial real estate. This would particularly be true within a framework of muted new construction supply, which in the U.S. and globally generally holds true at present. These dynamics would potentially lead to rising revenues, earnings, dividends and net asset values.

More broadly, a steepening yield curve typically reflects an improvement in economic conditions which later generally translates to increased demand for commercial real estate and rising real estate cash flows.

What type of environment are REITs in today?

While further changes in interest rates will, as always, depend on future economic data and central bank actions, we believe it is likely that rates will move higher over time in tandem with improving economic conditions. This is being reflected in a steepening yield curve.

Market volatility and related investor worries have arguably set up a "buying opportunity," since we believe that real estate values will remain static if not increase further, given continued high investor demand and the low interest rate environment we expect to live in over the next few years. We expect cap rates to continue to remain low by historical standards despite the recent upward shift in interest rates.

Demand for real estate remains high, given the desire for yield and the significant capital seeking commercial real estate from sources including institutional investors, sovereign wealth funds, private equity and listed property. Additionally, lower cap rates in a historical context are completely rational given the lower trajectory of the yield curve and related benign inflationary pressures. Following the recent sell-off, we estimate that U.S. listed property companies trade at valuations which are at an 8% discount to our estimates of the private market value of the real estate they own versus a long-term average of a 2% premium, an attractive value proposition versus estimated private market value.

U.S. REITs' performance for the month of July (through July 16th) has generated a strong 5.4% return as interest rate jitters have abated and solid fundamentals and attractive valuations are again rewarding investors who have begun capitalizing on the "taper tantrum" correction.

IMPORTANT DISCLOSURES

Index Descriptions

Standard & Poor's 500 Index is an unmanaged capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. **The FTSE NAREIT Equity REIT Index** is an unmanaged market cap weighted index comprised of approximately 139 equity REITs. The FTSE NAREIT Equity REIT Index is available daily. The FTSE NAREIT Equity REIT Index includes healthcare and net lease REITs, but excludes real estate operating companies. The requirement for inclusion in this index is for a company to be an exchange listed equity REIT. There is no minimum size or liquidity requirement for an equity REIT to be included in this index. PA2015