

REIT Revival

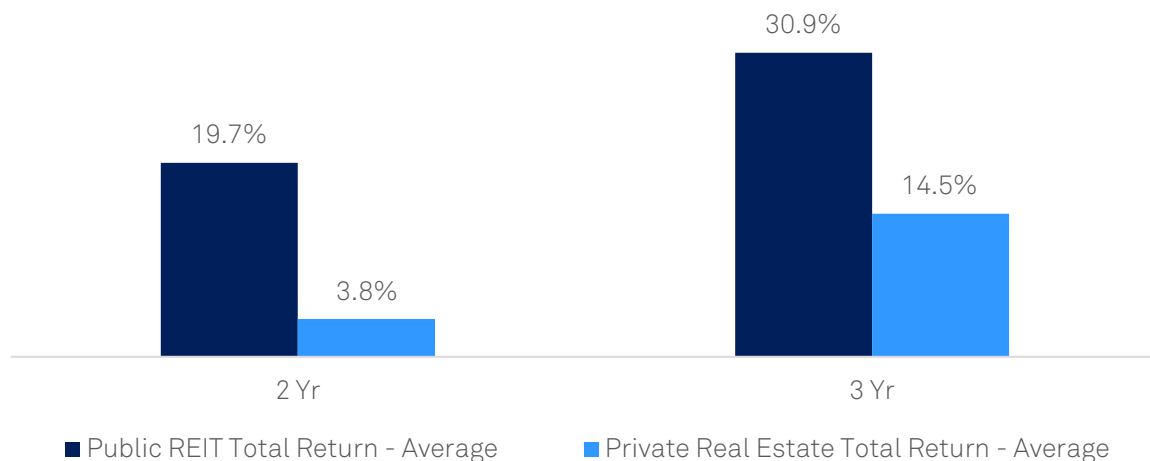
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As we approach what feels like the most widely anticipated Federal Reserve interest rate cut this month, we are looking ahead to the REIT revival likely to accompany the upcoming rate-cutting cycle. Our optimism is based on two considerations: 1) policy rate cuts have historically been a catalyst for REIT performance and 2) REITs offer a compelling opportunity for real estate investors versus core private real estate funds, and for all investors versus broader equities.

Rate relief catalyst

Given the interest rate sensitivity of the real estate asset class, it's no surprise that the aggressive, inflation-fighting monetary tightening around the world has been a drag on real estate performance across public and private markets. However, interest rate cuts have historically been a catalyst for REIT performance, especially when compared to private real estate. In fact, REITs tend to outperform private real estate in the three years following the first rate cut from the U.S. Federal Reserve at the beginning of a rate cutting cycle (Figure 1).

Figure 1: Average total returns following first rate cut in prior cycles in public and private real estate markets¹



¹ Average of returns beginning 6/30/1990, 6/30/1995, 9/30/1998, 12/31/2000, 9/30/2007, 9/30/2008, 6/30/2019 and 3/31/2020. The closest quarter-end relative to the Fed rate cut is used as the start date for the analysis. Private real estate = NFI-ODCE Index; REITs = FTSE Nareit All Equity REITs Index (FNER). Source: CenterSquare, Bloomberg, NCREIF as of 9/6/2024.

A compelling opportunity for real estate investors

Both public and private real estate investors have wrestled with the repricing of real estate due to the shifting interest rate regime – not just on the short end of the curve based on the actions of central banks globally, but also on the more permanent impacts for the longer end of the curve that more directly influence real estate pricing, as we wrote in our 2024 outlook piece ([A Reset Entry Point for Real Estate – 2024 Global Market Outlook](#)). This repricing, however, occurred much more swiftly across the public markets and has yet to be fully realized across private markets. The result is a much more attractive valuation for real estate investors in the public market versus the private market (Figure 2).

Figure 2: REIT implied cap rates versus private market appraisal cap rates

	Private Real Estate	Public Real Estate	Discount
Apartment	4.33%	5.61%	-23%
Industrial	3.71%	4.53%	-18%
Office	6.46%	8.01%	-19%
Retail	5.24%	6.80%	-23%

Sources: CenterSquare REIT Cap Rate data and ODCE data are as of June 30, 2024. Private real estate = NFI-ODCE Index; and Public real estate = FTSE Nareit All Equity REITs Index (FNER). Please refer to the cap rate methodology at the end of this paper.

Additionally, as the private market works through the dislocation associated with resetting valuations alongside mounting debt maturities, REITs are poised to emerge as a capital solution for the real estate industry. With lowly levered balance sheets and unparalleled access to capital across public equity markets and the unsecured bond market, REITs have a material cost of capital advantage versus more traditional private market investors. REITs have historically capitalized market dislocation to accretively acquire assets in periods that have proven to be strong vintage years for real estate (Figure 3) and are positioned for strong external growth in the coming years.

Figure 3: REITs' net acquisitions through prior cycles

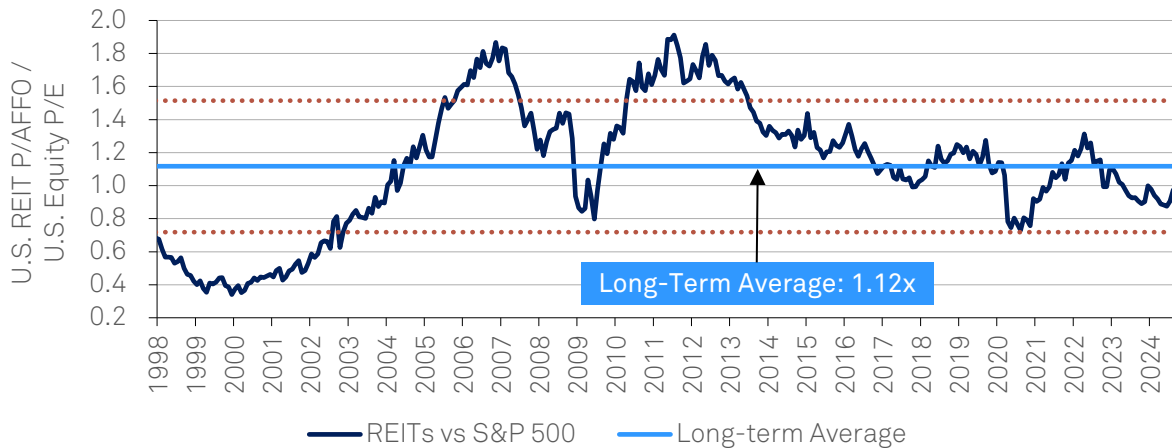


Source: Nareit as of 9/30/2023.

A compelling opportunity for equity investors

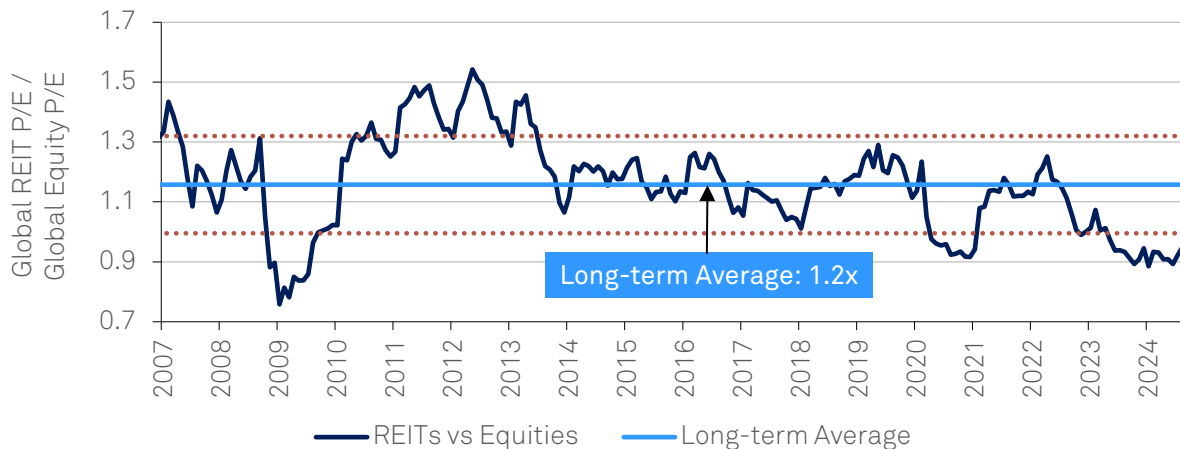
The latest rate hiking cycle has dampened returns for REITs more meaningfully versus other parts of the equity market, most notably, the technology sector, which has benefitted from the investor exuberance associated with generative artificial intelligence. The result has been a dislocation in the earnings multiples for the broader market versus REITs. Compared to historical averages, REITs – across both U.S. and global markets – are trading at a meaningfully discounted multiple compared to broader equities (Figures 4 & 5). Especially as we sit at the precipice of slowing economic growth, the defensive qualities of REITs (i.e., higher dividend yield and steady cash flows underpinned by long-term leases) versus other sectors further underscore the attractiveness of REITs within broader equity allocations today.

Figure 4: U.S. REIT P/AFFO versus S&P 500 P/E



Sources: CenterSquare, Bloomberg, Evercore ISI, Bank of America, Citi, NAREIT as of 8/31/2024. REITs = FTSE Nareit All Equity REITs Index (FNER); and S&P 500 Index.

Figure 5: Global REIT P/E versus MSCI Index P/E



Sources: CenterSquare, Bloomberg, UBS as 8/31/2024. Global REITs = FTSE EPRA Nareit Developed Total Return Index; and Global Equities = MSCI World Index.

The much-anticipated rate cut combined with the lag in private market repricing and defensive nature of REITs have fueled our optimism in the asset class. We believe the upcoming rate-cutting cycle will ultimately benefit public real estate investors, particularly when compared to private real estate and other equity investments.

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CenterSquare REIT Cap Rate Perspective Methodology

CenterSquare REIT Cap Rate Perspective Methodology
CenterSquare REIT Implied Cap Rates are based on a proprietary calculation that divides a company’s reporting net operating income (“NOI”) adjusted for non-recurring items by the value of its equity and debt less the value of non-income producing assets. The figures above are based on Q2 2024 earnings reported in June 2024.

The universe of stocks used to aggregate the data presented is based on CenterSquare’s coverage universe of approximately 200 U.S. listed real estate companies. Sector cap rates are market cap weighted. Sectors and market classifications are defined by the following:

Apartment: REITs that own and manage multifamily residential rental properties; Industrial: REITs that own and manage industrial facilities (i.e. warehouses, distribution centers); Office – REITs that own and manage commercial office properties; Retail – REITs that own and manage retail properties (i.e. malls, shopping centers); Hotel – REITs that own and manage lodging properties; Healthcare – REITs that own properties used by healthcare service tenants (i.e. hospitals, medical office buildings); Gateway – REITs with

portfolios primarily in the Boston, Chicago, LA, NYC, SF, and DC markets; Non-Gateway – REITs without a presence in the gateway markets.

The REIT ODCE Proxy is a universe of REIT stocks built to resemble the NCREIF Fund Index – Open End Diversified Core Equity (ODCE). The ODCE, short for NCREIF Fund Index - Open End Diversified Core Equity, is the first of the NCREIF Fund Database products and is an index of investment returns reporting on both a historical and current basis the results of 36 open-end commingled funds pursuing a core investment strategy, some of which have performance histories dating back to the 1970s. The REIT ODCE Proxy is proprietary to CenterSquare and uses gateway/infill names in apartments, retail, industrial and office, and then weights them according to the ODCE index to create a proxy.

Private Market Cap Rates represent the cap rate achievable in the private market for the property portfolio owned by each company, and are based on estimates produced by CenterSquare’s investment team informed by various market sources including broker estimates.

Definition of Indices

FTSE Nareit All Equity REITs Index “FNER”

The FTSE Nareit All Equity REITs Index is a free-float adjusted, market capitalization-weighted index of U.S. equity REITs. Constituents of the index include all tax-qualified REITs with more than 50 percent of total assets in qualifying real estate assets other than mortgages secured by real property.

FTSE EPRA Nareit Developed Total Return Index

The FTSE EPRA Nareit Developed Total Return Index is designed to measure the performance of publicly listed real estate companies and REITs from developed markets around the globe. It represents the total return of these constituents, meaning it accounts for both price appreciation and dividends, assuming they are reinvested. This index is part of the broader FTSE EPRA Nareit Global Real Estate Index Series and follows the classification and nationality rules as defined by FTSE Russell for the inclusion of eligible companies from developed markets.

S&P 500 Index

The S&P 500 is an index that is considered to be a gauge of the U.S. equities market. The index includes 500 leading companies spread across the major sectors of the U.S. economy. The index focuses on the larger cap segment of the U.S. market and represents approximately 75% of the market capitalization of U.S. securities. The index is the most notable of the many indices owned and maintained by Standard & Poor's, a division of McGraw-Hill Companies.

MSCI World Index

The MSCI World Index captures large and mid-cap representation across 23 Developed Markets (DM) countries*. With 1,480 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

NCREIF Open End Diversified Core Equity Index

The ODCE, short for NCREIF Fund Index - Open End Diversified Core Equity (NFI-ODCE), is the first of the NFI-ODCE Fund Database products and is an index of investment returns reporting on both a historical and current basis the results of 38 open-end commingled funds pursuing a core investment strategy, some of which have performance histories dating back to the 1970s.

These benchmarks are broad-based indices which are used for illustrative purposes only and have been selected as they are well known and are easily recognizable by investors. However, the investment activities and performance of an actual portfolio may be considerably more volatile than and have material differences from the performance of any of the referenced indices. Unlike these benchmarks, the portfolios portrayed herein are actively managed. Furthermore, the portfolios invest in substantially fewer securities than the number of securities comprising each of these benchmarks. There is no guarantee that any of the securities invested in by the portfolios comprise these benchmarks. Also, performance results for benchmarks may not reflect payment of investment management/incentive fees and other expenses. Because of these differences, benchmarks should not be relied upon as an accurate measure of comparison. A direct investment in an index is not possible.

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Uma Moriarity is the Senior Investment Strategist and Global ESG Lead for CenterSquare Investment Management LLC. She focuses on investment strategy and leads thought leadership across the Firm's public and private real estate platforms. She is part of the listed real estate investment team and serves on CenterSquare's Private Real Estate Debt Investment Committee. Uma leads the Firm's Environmental, Social, and Governance (ESG) strategy to incorporate ESG into the decision-making and management of listed and private real estate investments to create long-term value, reduce risk, and generate superior risk-adjusted investment returns. Prior to joining CenterSquare, she spent three years in corporate strategy and planning at ExxonMobil in Houston.

Uma graduated from The Pennsylvania State University with Interdisciplinary Honors and High Distinction and holds a B.S. in Finance with a minor in International Business, B.S. in Accounting, and Master of Accountancy. She is a CFA charterholder and member of the CFA Institute, and a LEED Green Associate. She currently serves on the Board of Directors for Green Building United, the Penn State Smeal Sustainability Advisory Board, and the FTSE EPRA Nareit Americas Regional Advisory Committee.

About CenterSquare

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