asset management

Global Property Market Review & Outlook

1Q 2022

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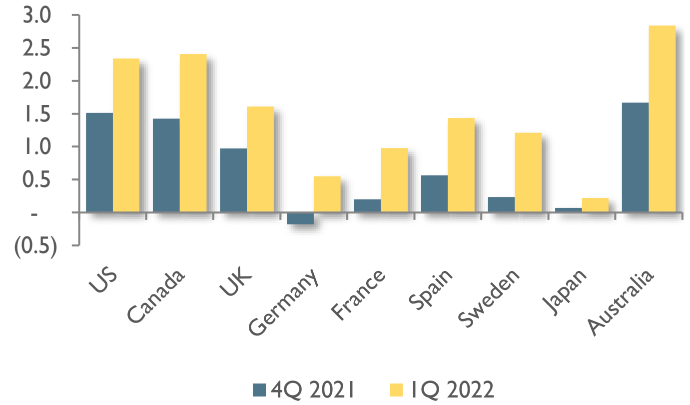
Global Slowdown?

Market Overview

The impediments to growth are starting to stack up at the same time the Central Banks are trying to stem rising prices which could ultimately result in a further reduction in growth rates – or even a recession. China has recognized that its economy needs stimulus after implementing a variety of measures aimed at slowing growth, the combination of which has proven to be far more deleterious than President Xi might have expected. US bond investors experienced their worst quarter in 40 years (WSJ 4/1) as the rate of increase in interest rates apparently surprised the markets, amplified by comments from the US Fed Chair Powell to fight in the inflationary trends more aggressively – looks like the "Powell Put" is going away. In Europe, the Russia/Ukraine war has escalated and what originally looked to be another land grab by Putin similar to the Crimea takeover now seems to be a more expansive and destructive situation. The energy and food crisis that the conflict has spawned also appears to be having a deeper impact on the EU economy just as it was emerging from lockdowns related to Covid. Germany and the Netherlands depend on Russian energy for a substantial percentage of their requirements and while they might want to eliminate this supplier there is not yet a viable replacement. Despite the inflationary trend in Europe the ECB seems hesitant to tighten as the impact of the Ukraine conflict on supply chains, soaring energy costs and overall economic data for the region suggest that a slowdown may be imminent.

10-Year Government Bond Yields
4Q 2021 vs. 1Q 2022
(% per annum)



Data from Bloomberg as of 3/31/2022. Bonds analyzed: US (USGG10YR Index), Canada (GCAN10Y Index), UK (GUKG10 Index), Germany (GDBR10 Index), France (GFRN10 Index), Spain (GSPG10YR Index), Sweden (GSGB10YR Index), Japan (GJGB10 Index) and Australia (GACGB10 Index).

In essence, the Developed markets seem to be breaking down into three different stages based on developing trends:

- Hot. Markets that are running a bit hotter than normal due largely to stimulative measures by the governments and Central Banks. This trend is manifest most clearly in the Anglo-Saxon markets – US, UK, Canada and Australia. The publicly listed real estate valuations tend to reflect the potential for rising rates in their share prices much more quickly than the underlying property market valuations which remain robust in these markets.

- Warm. Stimulus measures still in effect but could be pulled back. In these markets, notably the EU, property share prices are volatile as investors try to gauge the extent of the potential for interest rate increases.

- Cooling. Stimulus measures needed and interest rates/inflation are receding from recent peaks as best exemplified by China. The discounts to NAV for the publicly listed real estate companies are the highest in the world (50-70%), reflecting uncertainty as to the pace of additions to stimulus and economic recovery.

At the end of the quarter more information became available in the US regarding consumer loan levels that reached $15 trillion for the first time (US Government data). Consumers with low credit scores are being squeezed by both rising interest rates and inflation and this has become clear in the rising delinquencies for sub-prime auto loans and credit cards. Further evidence of potential credit trauma has become apparent in the 75% decline in share prices for Fintech companies like Affirm and Upstart which focus on this sector (WSJ 4/11). This trend could result in declining consumer demand in the future which could slow the rate of recovery that we would expect from re-opening.

Global Real Estate Market Trends

The Economist (4/15) recently described the global markets as creating "A New Atlas" where the future centers of economic activity are characterized as "agglomeration economies" where "clustering" is the driving force. These cities are characterized by the aggregation of the following important criteria that could drive economic growth for the foreseeable future:

- Universities that attract high quality talent. Bangalaru (India) has 70 engineering colleges alone that encourage economic activity.

- Internet access/cloud computing. Key ingredients for a successful future.

- Abundance of risk capital. While India may have clusters of engineering schools, it is lacking in risk capital unlike Silicon Valley. For example, in 2011, the San Francisco area had 20 "unicorns" (75% of the US total), it now has 220 – although we will see how any actually make it to the finish line.

- Openness to Foreigners – investors and company management. Japan struggles in this category as well as the lack of English speakers (only 8% of the population speak English).

Another market dynamic that could change markets long-term is the trend toward energy conservation and the global need for the commodities/rare earth elements that facilitate this change. This puts countries like Brazil, Australia, and China in the spotlight for future investment as the alternative energy and technology industries expand, which seems inevitable, while encouraging a review of those markets that are reliant on fossil fuels for growth. The Economist (3/28) also notes that supply chains in general are undergoing a review to determine political risk for outsourced materials as highlighted by the conflict in the Ukraine that has affected the availability of not only energy supplies but also grains.

Real estate markets are generally not homogeneous due to an abundance of local market idiosyncrasies, but there are some trends that seem to be consistent in many major markets. In these cases, we have noticed similar market trends for publicly listed companies which we are reflecting in our analysis and portfolio construction:

- Rising production costs – land, materials, and labor – are starting to limit development of new buildings of virtually all types while demand remains above current supply levels. This bodes well for owners of real estate today as the future additions to supply may remain below long-term levels, allowing from more pricing power.

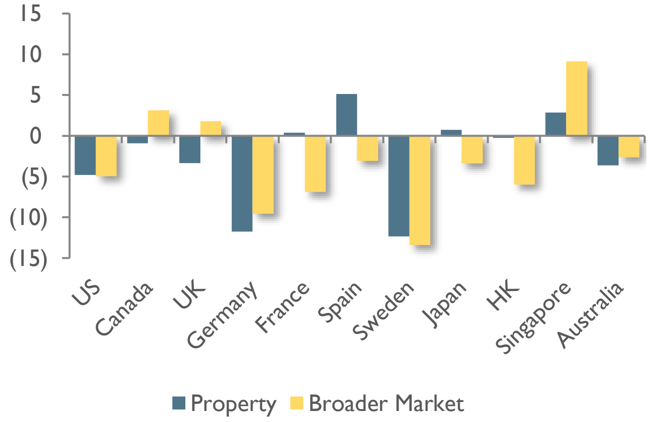
• Obsolescence risk. This has not been much of an issue for many property types, particularly office buildings in prime locations that can be refurbished periodically. However, there have been some major developments that could alter investors' views on obsolescence due to the recent impact of Covid, rising concerns about environmental and energy impacts of real estate on the local community – not to mention climate change which we will leave for another time. London recently passed legislation requiring a certain level of energy efficiency for rental apartments which must be in place by 2028 or they cannot be rented, resulting in many buildings which could become obsolete as the retrofit may not be possible, either physically or economically.

• "Supply Chain Chaos is Great for Warehouse Stocks". This article in the WSJ (4/11) notes the increasing tendency for companies to build in a buffer for future supply chain shocks and hold greater inventories than in the past. We believe that this will continue to be the preferred alternative to "onshoring" as a means of securing the supply chain and the customer base. Vacancy rates for logistics/warehouse facilities globally are at historically low levels and opposition to increased supply is meeting local neighborhood resistance.

• Sluggish Return to Office trend. With the exception of the major Asian cities, office workers in urban areas are showing some reluctance to return. JPMorgan's CEO Jamie Dimon has been one of the key proponents of getting his employees back to the office but recently admitted that the occupancy rate may stay below 50% - at least for the coming year (Economist 4/8). This also affects the surrounding business community as restaurants and shops depend on office workers.

While the real estate sector has been proving to be more resilient than other sectors and the broader equity markets in general as shown below, first quarter performance was negative for most companies, in particular those that were most popular with investors in 2021. Despite the trend to reduce or eliminate mobility restrictions in most countries and markets, the increased economic activity expected from this re-opening has not been fully manifest in many markets. Shoppers are starting to return to stores and in some cases at the same pace as pre-pandemic, but this has not been universally the case.

1Q22 Performance - Property Sector vs. Broader Equity Market[1] (price return/local currency in %)



Data from Bloomberg as of 3/31/22.

Q1 Real Estate Market Highlights

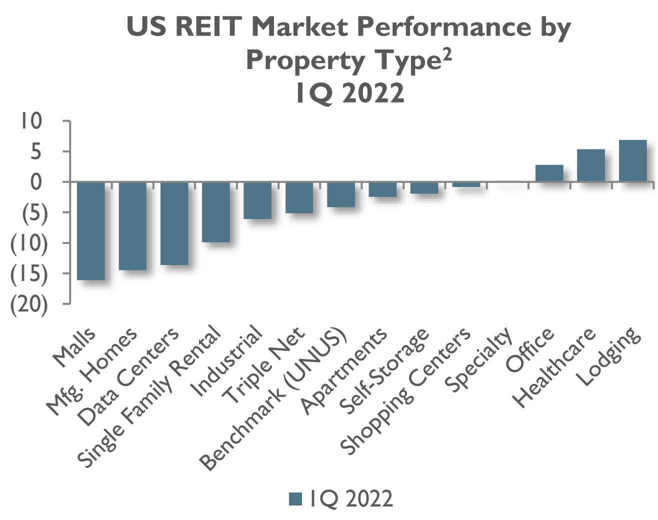
US

Notwithstanding some of the challenges noted above, the US REITs are reporting solid operating conditions and rental growth for most property types. As we noted above, some of last year's winners struggled during the first quarter, the logistics/warehouse companies reported some astoundingly strong numbers and we would expect this group in particular to rebound. One of the "last mile" focused companies noted in its Q1 report that its rental rates on renewals are up over 50% and that there is more to come as demand remains strong and supply is limited. The company also noted that it essentially has no space available and is having difficulties increasing supply to meet demand, which could slow the company's growth rate at some point. The world's largest logistics/warehouse company, Prologis, with over $130 billion assets worldwide, noted that the US vacancy rate is 3.5% in its recent quarterly report.

Another sector that continues to surprise investors with the pace of rental growth is residential rental properties of virtually all types – single family, multifamily, manufactured housing. The research firm Yardi Matrix reported that the average US multifamily apartment raised asking rents nearly 15% in March 2022 as compared to March 2021. Obviously, this will be a major factor in the inflation data but also demonstrates the strength of the rental housing market which should continue given the strong demand and the challenges of buying a house due to rising mortgage rates and low supply. A large number of cities throughout the US reported rent increases well in excess of 15% led by Miami and Orlando (Florida) – up over 25%. Some of the apartment REITs had held rental rate increases to 15% to mollify local politicians but have been forced to raise their upper limit to 25% due to strong demand and low supply.

Office markets appear to be recovering although the pace of "return to office" (RTO) is slower than expected for the larger urban centers. Adding to the challenges for landlords, JLL reports that this year will mark the greatest amount of lease expirations in the US since 2015 – 243 million sf, or 11% of the total available amount. Blackstone ended up handing back the keys to the lenders to a midtown NY office building when the largest tenant, L Brands terminated its lease. Offsetting some of this negativity was the announcement by Google at the end of the quarter that it would spend $9.5 billion in 2022 on office space and data centers and Facebook is taking another 300k sf in Manhattan.

The US hotel sector appears to be on the mend as exemplified by unusually strong investor demand for hotels as over $12 billion of hotel properties were sold during the quarter, the most transactions for any quarter since 2016 as reported by Costar. With more markets opening to business travel, we would expect a solid recovery in this sector throughout the coming months. Hotel REITs were among the top performers for the quarter despite challenges from low occupancies and staffing issues. As these markets re-open, a new challenge is arising in the restaurant sector where more restaurants are opening more quickly than expected, straining supplies of both labor and food/drink.



Data from Bloomberg as of 3/31/22.

UK

London's office market has experienced a slower pace of RTW than we expected as the UK relaxed Covid restrictions ahead of all others. After the end of the quarter, the accounting/consulting firm, Deloitte, announced that it was relinquishing 50k sf of Central London office space and is adopting a more flexible work from home plan than in the past. The office developer Great Portland is expanding its flex office space offer from around 10% currently to 25% in the future as demand has increased substantially since the onset of Covid and is expected to continue. Difficult to say whether these trends are long-term and if they are, the effect these short-term leases may have on valuations. Student housing and logistics have been our main focus in this market, and we are monitoring developments in the office and retail sectors for better signs of recovery as the discounts to NAV remain sizable.

Germany

Obviously, this market has been directly affected by the onset of war in the Ukraine and sharp spike in energy prices. Even so, we have been mystified by the declines in German residential company share prices during the quarter of more than 10% despite the robust investment and rental environment. Demand for rental housing is strong and investors are willing to pay prices that suggest that the public market discounts/NAV of 30% or more are misguided based on our analysis. Given this unprecedentedly large gap between public and private market pricing, we would expect M&A activity in this sector over the near term, especially assuming that interest rates will rise which should accelerate the activity.

HK/China

The lockdown/quarantine approach to stemming the spread of the virus is having a significant impact on these markets and in the case of HK, there have been examples of companies relocating staff to Singapore. While we have reduced exposure to the China residential market, the 60-70% discounts to NAV remain compelling, especially if the Chinese government develops a better plan for handling the pandemic than full out lockdowns. At the end of the quarter, auto makers BMW and Tesla reported improving conditions for their factories in Shanghai and there appear to be more workarounds given the latest version of "Dynamic Covid Zero". As noted previously, one of the benefits of lockdowns is to dramatically slow the pace of new development to below the pre-pandemic supply/demand equilibrium point.

One of the major HK developers, Wheelock, reported that it was offering a 12% discount on new apartment sales which is highly unusual for this market. The challenge for residential developers throughout the region is to operate without the benefit of showrooms (closed due to Covid) and property tours. For HK, the lockdowns and quarantine requirements also directly affect HK's ability to function as a regional financial center and tourist attraction. For the moment, the discounts to NAV at 50-70% seem reasonable given these uncertainties but the reversal could be quite strong as the companies in HK are financially stable and able to endure the current instability.

Japan

Japan took a softer touch on restricting businesses to deal with COVID and declared a quasi-state of emergency in January which lasted through to 21st March. It has since seen COVID cases stabilize as Japan like other countries learn to live with the pandemic. Although borders remain closed to tourists, retail sales at JREITs and developers are generally seeing recovery close to or exceeding pre-pandemic levels. March office vacancy of 6.37% in Tokyo continue to weigh on rents as March market rents saw decline of -5.5% yoy. While most developers have better occupancies at their higher quality portfolios, demand for large office spaces continue to be slow as companies continue to ponder what post pandemic office requirements will be. Japan's inflation is seeing its highest levels in 2 years (headline inflation of 1.2% in March). However, Bank of Japan has been steadfast in keeping to their yield curve control of 0% for 10 yr JGB, the result of which has brought yen to a 20-year low. Investment market on the other hand is still buoyant and developers are still able to pass cost increases to customers and continues to enjoy strong capital gains.

Singapore

At the end of the quarter, Singapore announced that it is now open to all travelers and free from quarantine restrictions. Unlike China which is really suffering from the low vaccination rate for the elderly (20% for those 80 and over), Singapore is 96% vaccinated for all eligible citizens. As we noted in our last Outlook, the re-opening of the office market and the shortage of supply is resulting in rising rental rates, one of the few markets where this is occurring. As of April 26, essentially all restrictions and vaccine checks will be ended and the government is referring to this as "Happy Day" – we expect a surge of economic activity as a result.

Australia

As tightening prospects increased in this market, along with long-term bond yields, most Aussie REITs declined during the quarter with only a few companies achieving positive returns led by one of the shopping center companies, Vicinity Centers, which rose over 17%. Housing-related companies declined across the board although the range was wide, from -1% to -20% for a manufactured housing company.

Market Outlook/Positioning

Although it is very tempting from a valuation perspective to increase allocations to the cheaper Asian markets where multiples are a third to a half of the US market, the ongoing threat of lockdowns and the disruptions that have resulted give us pause. Europe is also challenging due to the Ukraine crisis while the US is under pressure from the Fed's efforts to dampen inflation. Consequently, we are focusing on companies with solid balance sheets and growth prospects as well as more opportunistic investments where the impact of re-opening will be more directly transmitted – gateway cities, hotels, and in certain select markets, office companies. This trend is supported by the latest data for US airlines "expecting a record quarter (Q2)" (WSJ 4/22) as more businesses start traveling.

As noted previously, the longer-term prospects for the real estate industry as a whole are very promising given the impediments to expansion and the already moderate supply levels relative to demand. A trend that has taken on global significance is the shift from home ownership to rental and we are tracking this development as it seems to be more enduring than we originally thought. The retail sector will likely continue to be challenged, but with public market valuations well-below fundamentals and recent trades, this is currently a major focus for our team. In the meantime, we expect more company acquisitions by private equity firms and sovereign wealth funds seeking immediate market exposure and increased scale.

JLP Global Investment Team, March 2022.

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[1]**Property Sector includes:** US: RMZ Index, Canada: ELCA Index, UK: ELUK Index, Germany: EPGR Index, France: EPFR Index, Spain: EPSP Index, Sweden: ELSD Index, Japan: ELJP Index, HK: ELHK Index, Singapore: ELSI Index, and Australia: ELAU Index.

Broader Equity Market includes: US: SPX Index, Canada: SPTSX Index, UK: UKX Index, Germany: DAXK Index, France: CAC Index, Spain: IBEX Index, Sweden: OMX Index, Japan: NKY Index, HK: HSI Index, Singapore: FSSTI Index, and Australia: RDAU Index.

[2]**Property Type includes:** Triple Net Index (FNFRETR), Healthcare Index (FNHEATR), Lodging Index (FNLODTR), Office Index (FNOFFTR), Data Centers Index (FNDCTR), Specialty Index (FNSPTR), FTSE EPRA/NAREIT United States Index (UNUS), Malls Index (FNMALTR), Shopping Centers Index (FNSHOTR), Single Family Rental Index (FNFHTR), Self-Storage Index (FNSELTR), Industrial Index (FNINDTR), Mfg. Homes Index (FNMANTR) and Apartments Index (FNAPTTR). JLP defines all companies listed above in the relevant sector based on NAREIT's categorization of companies in the sector.