CenterSquare INVESTMENT MANAGEMENT

Entrepreneurial Culture, Institutional Strength.

E. Todd Briddell, CFA, Chief Executive Officer and Chief Investment Officer

COMMERCIAL REAL ESTATE: GAME OVER, GAME ON

Norwalk Data Center, Norwalk, CT
Photo Credit: CyrusOne

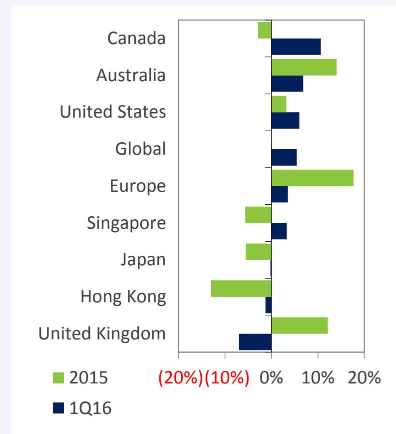
Despite the accommodative position of most major central banks around the world, the U.S. Federal Reserve raised interest rates in December 2015 and plotted a path of tightening monetary policy via planned additional rate hikes in 2016. Thankfully, the Fed stepped back from this position, taking a more dovish stance during the first quarter, as concern shifted from inflation to growth. Credit spreads widened early in the period, although they narrowed somewhat again as the quarter progressed. Oil rebounded from its 2015 lows and some energy debt and bankruptcy restructuring emerged. The currencies of many oil-exporting countries such as Russia, Canada, and Norway strengthened, as did the Japanese yen, while the U.S. dollar's strong start to the year subsided by the period's end.

The two largest emerging markets, China and Brazil, provoked trepidation in the first quarter. Despite already significant leverage in its state-owned enterprises (SOEs), China is relaxing policies to add even more leverage, a sizeable red flag to investors. The upcoming Olympics in Brazil agitated its political crisis to a boiling point, creating concern about the nation's stability. In addition, Saudi Arabia surfaced as a new area of concern during the quarter as current burn rate estimates put the kingdom's sovereign wealth fund near depletion in two to three years, significantly shorter than recent International Monetary Fund (IMF) reports.

From an investment perspective, the theme of low yield and low growth continued. Capital markets remained readily available for REIT and infrastructure companies, and investors were attracted to the stable cash flow growth of real assets in this environment. We believe it is important to be cautious, however, and not to extrapolate past years of strong returns and fundamentals into the future of these markets. Although we believe real assets are well positioned and that real estate values should remain firm, pockets of vulnerability exist.

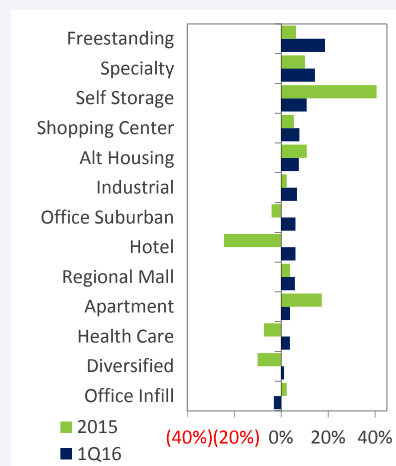
1Q16 PERFORMANCE REVIEW

FTSE EPRA/NAREIT DEVELOPED INDEX



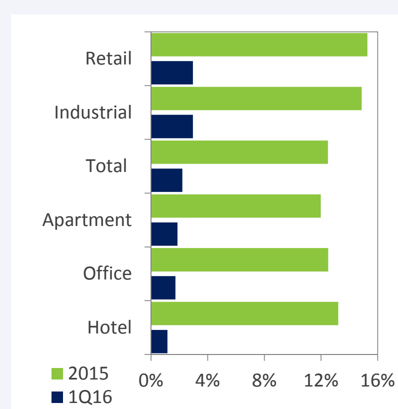
All returns in local currency.
Source: Bloomberg, FTSE, April 2016

FTSE NAREIT EQUITY REITS INDEX



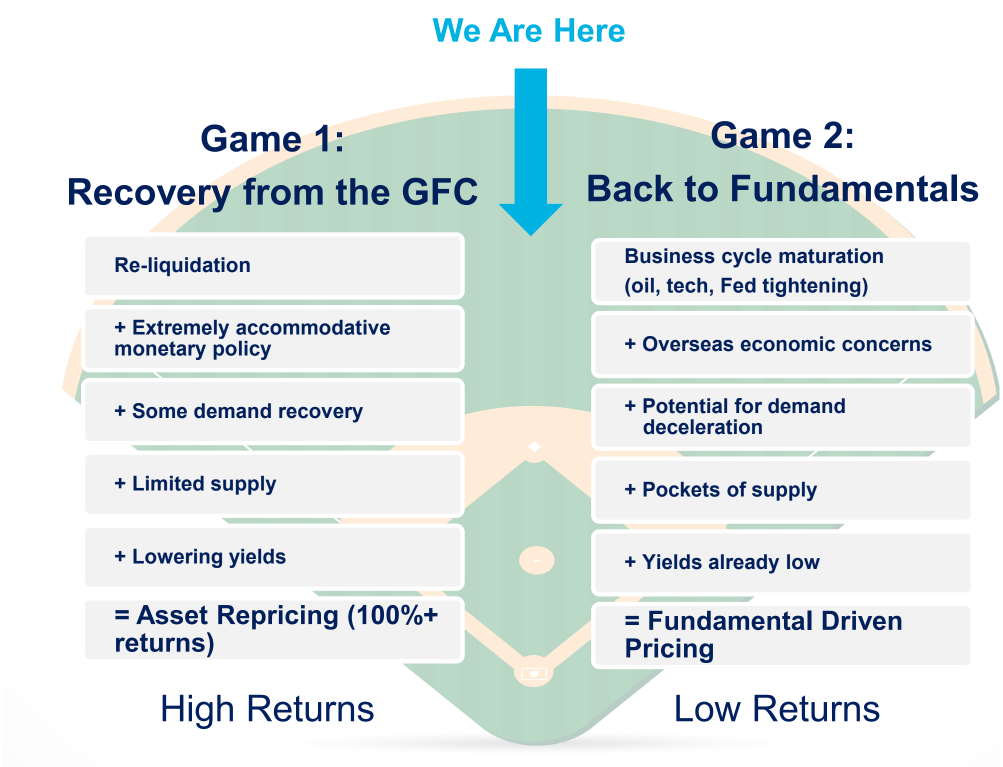
Source: Bloomberg, FTSE April 2016

NCREIF PROPERTY INDEX



Source: NCREIF, April 2016

The Commercial Real Estate Double Header



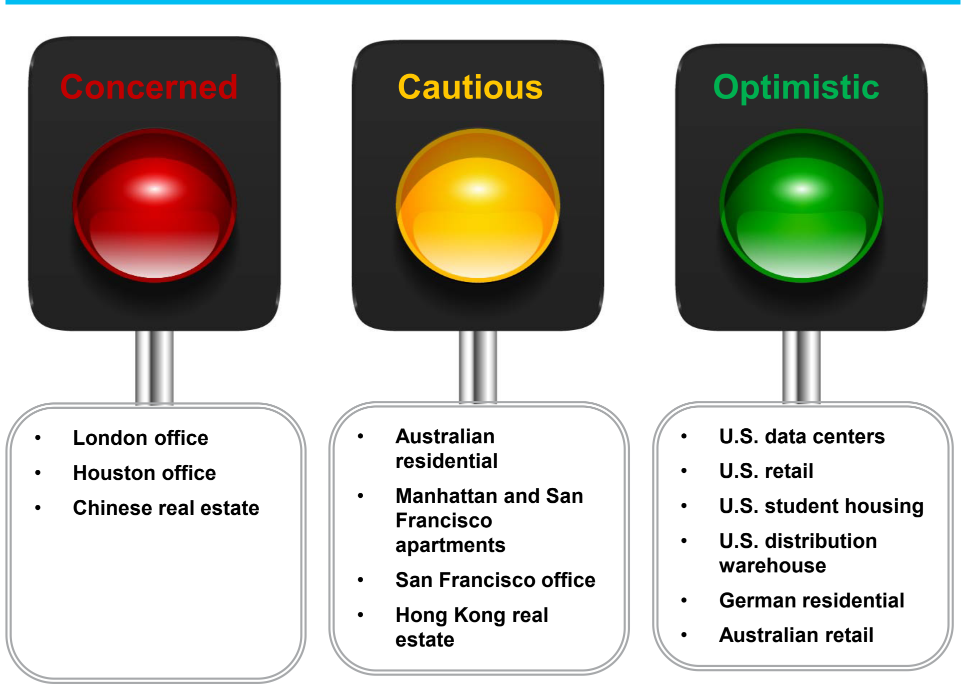
THE INTERMISSION OF THE DOUBLE HEADER

Recently, much speculation—often phrased analogously to baseball—has been made about where we are in the commercial real estate cycle. Equity Residential chief Sam Zell was quoted saying that we are now in the ninth inning of the cycle[1], and others including Kevin Shannon at Newmark Grubb Knight Frank put the market in the sixth or seventh Inning[2], while others still are more optimistic about gains to come in 2016. In keeping with this baseball metaphor, it is our view that the cycle currently rests in the intermission of a double header.

Game 1 began with the recovery from the depths of the Great Financial Crisis ("GFC"), characterized primarily by a massive re-liquidation in the markets, modest demand, limited supply, lowering yields, and extremely accommodative monetary policy. Those factors contributed to a high scoring game - effectively over 100% returns from the bottom of the GFC[3]. But Game 1 is now over. At this point, markets have fully recapitalized since the GFC, erasing the problem of liquidity, and demand has been steadily increasing. We expect the score of Game 2 to be significantly lower than Game 1 as market conditions have shifted meaningfully. The business cycle is maturing and the Federal Reserve's policy tightening, albeit at an incremental level, has begun. The energy industry, which had been a source of growth, has cooled, and overseas economic concerns that did not exist four or five years ago such as Brexit and a significant slowdown in emerging markets are at the forefront. Demand growth for new real estate is likely to decelerate and we are observing pockets of supply in traditionally supply-constrained core markets. Although we do not anticipate any meaningful increase in cap rates from higher bond yields, cap rates are already starting at a very low level and further significant cap rate compression is unlikely. These characteristics imply that the next part of the cycle will be focused more on fundamentally-driven pricing.

To that end, we are focusing our investment strategy thematically, emphasizing secular trends as well as cyclical drivers. For example, the trend toward urbanization will likely continue, and demographics are extremely important to real

REIT Market Risk Check



[1] *Sam Zell, Equity Residential Chair and Real Estate Investor, April 2016*
[2] *Kevin Shannon, Newmark Grubb Knight Frank, February 2016*
[3] *Source: FTSE NAREIT Equity REITs Index, total return from market bottom in May 2009 to December 31, 2015*

The statements made and the conclusions drawn in this newsletter are not guarantees and are merely the opinion of CenterSquare and its employees. Please refer to disclosures and definition of indices at the end of this document.

estate and infrastructure. Also, advances in technology are reshaping the way business is conducted. Exponentially better and faster technology and information are making business cycles much shorter. These are themes that we expect to have a meaningful impact on the future of real assets.

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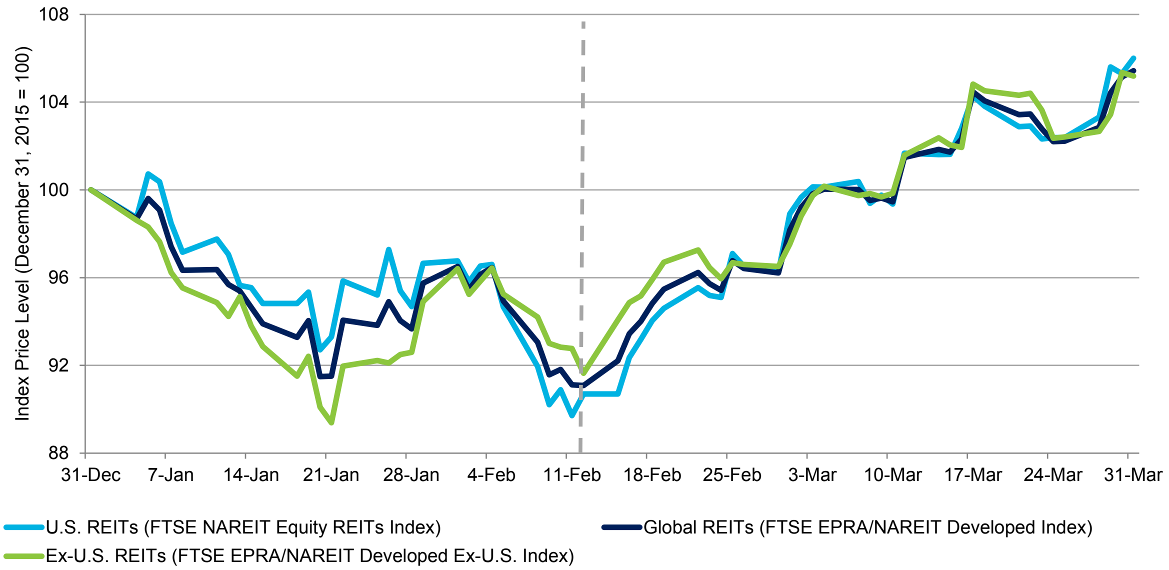
PRIVATE VS. PUBLIC REAL ESTATE

What matters most now to the real estate market is not what mattered a year or two ago. Interest rates and monetary policy were the focus in Game 1. Today, we believe supply, demand and growth of cash flow will be the key drivers going forward. The effects of movements in these factors are already driving the prices of private real estate both for major and non-major markets, all of which seem to have peaked at the end of 2015 and into the beginning of 2016. Although we don't believe prices will fall more than 5-7%, we also do not anticipate further private real estate appreciation unless stronger demand improves operating fundamentals.

A Tale of Two Markets

- First Half of the Quarter: Risk Off
  - Concern over China and
  - Concern over U.S. growth and rates
  - Oil prices plunge
- Second Half of the Quarter: Risk Off
  - China concerns ease
  - Oil prices rebound



Source: Bloomberg, FTSE, April 2016.

History has shown that it is not uncommon for private real estate prices to peak concurrent with the bottoming of public REIT prices. In this sense, the current discount to net asset value (NAV) in the U.S. REIT market of approximately 7-10%[4] may be a bullish indicator, as we believe it portends improved returns for REITs going forward, unlike the flat returns experienced over the last 12 to 18 months.

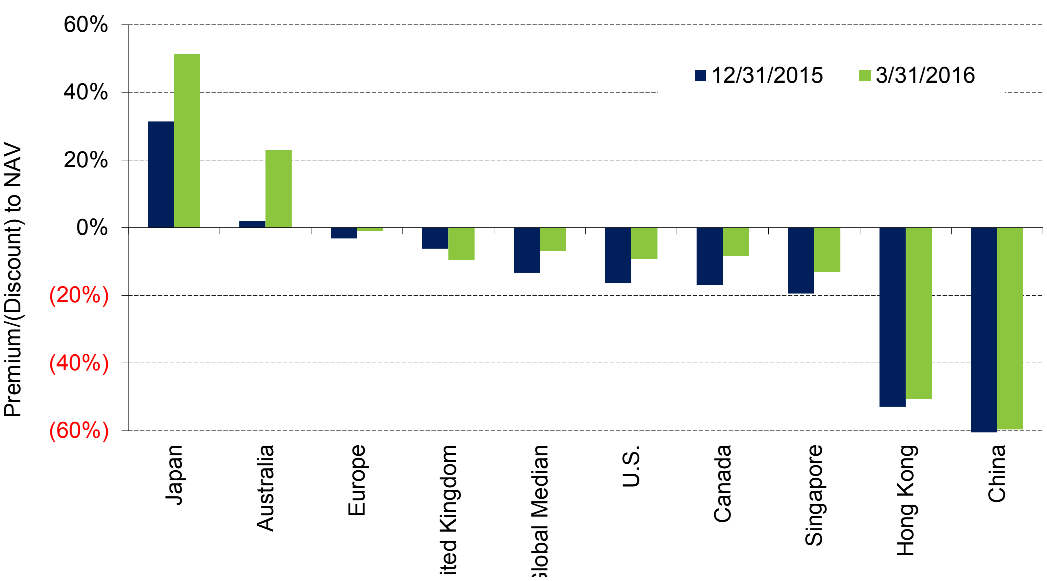
REIT PERFORMANCE

The first quarter of 2016 can be thought of in two parts – risk off and risk on - though in spite of market volatility, Global REITs produced a 5.39% total return for the first three months of 2016.[5] In the first half of the quarter, persistent concerns over China, plummeting oil prices, and a temporary soft patch in U.S. growth caused riskier assets to see price declines when investors flocked to safety and yield. In the real estate securities market, sectors more exposed to an economic slowdown and highly levered companies fared poorly during the first half of the quarter. Japan, Hong Kong, and Singapore developers produced a drag, as did U.S. prime office and apartments. Surprisingly, U.S. health care REITs, historically considered one of the most defensive sectors, were poor performers, though this was due to some idiosyncratic tenant issues as well as impacts from changes in Medicare reimbursements. U.S. freestanding retail companies performed well, and Singapore, Australia, Japan, and U.S. data center REITS also produced positive results.

The second half of the quarter brought a market reversal, as oil rebounded sharply off its lows, fears over Chinese and U.S. growth retreated, and concerns surrounding the velocity of the U.S. rate hikes subsided. U.S. data center REITs remained a standout performer in the second half, but developers in Singapore and Japan recovered less than average. The U.S. dollar remained strong through the end

[4]Source: SNL Financial, as of March 31, 2016
[5]Source: FTSE EPRA/NAREIT Developed Index

Premiums / Discounts to NAV - 4Q15 vs 1Q16 by Regions*



Source: SNL Financial, April 2016. The companies comprising each country shown are based on SNL Financial's universe of real estate securities domiciled in each country.
** Calculated using company-reported NAV with the exception of the U.S. and Canada, which are calculated using an average of consensus NAV estimates.*

of January but weakened toward the end of March, whereas currency recoveries in Brazil, Russia, Canada, Japan and Norway were notable.

NORTH AMERICA

United States

U.S. real estate fundamentals remain on stable footing but continue to trend to more normal growth levels as the cycle matures. Niche sectors such as prisons, gaming and paper storage produced positive results, as did U.S. office markets, hotel, freestanding retail, and shopping center sectors. Data centers and industrial assets were also major outperformers during the quarter.

As of March 31, U.S. REITs traded at a slight discount to NAV, a significant yield spread to the 10-year Treasury relative to history, and a slightly discounted multiple relative to the Standard & Poor's 500. Given the yield-starved environment that exists globally, we are surprised REITs are not expensive, but in fact, look cheap.

Moving forward, investor focus will likely be on the pace of future rate hikes and the U.S. economy's ability to weather slower global growth. While we are constructive on U.S. growth right now, supply in the urban gateway markets for apartments and hotels continues to rise, leaving the risk versus reward of those sectors less appealing. Job growth continues to be strong, but after multiple years of above-trend growth, a slight slide for urban gateway apartments appears likely. We continue to favor data centers, as demand is on a strong upward trajectory. Freestanding retail is another bright spot, and shopping centers remain strong, with appropriate exposure to the cycle yet the lowest supply growth of the core sectors. We expect U.S. companies with superior organic growth and well-positioned balance sheets to outperform strategies that rely heavily on accretive acquisition for growth.

Canada

Canada outperformed in U.S. dollar terms as the country's economy has proven more resilient than anticipated. However, low growth and uncertainty remain as the Canadian economy continues to adjust and reposition in the aftermath of the commodity price plummet.

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EUROPE

Growth and inflation remained subdued in the Eurozone as the European Central Bank extended quantitative easing in efforts to stimulate the economy. In local currency, the Eurozone continued its strong performance from 2015 into the first quarter of 2016. In the United Kingdom, preoccupation with the Brexit vote dominated policy and produced a general sell-off as Britain's departure from the European Union appeared increasingly likely.

For real estate markets, there was little progress in rental growth or other improvements in the occupier markets outside of the United Kingdom, the Nordics and Germany; valuations have been primarily cap-rate led. We expect the London office and residential markets to slow with Brexit uncertainty, but prime London retail to continue its strong trajectory. Finally, we expect political instability to remain while risks of further terrorist attacks increase, leading to more hesitation in the market.

ASIA-PACIFIC

China

Volatility in the Greater China region continues, following uncertainty over numerous economic issues and the complicated interactions of the region's many countries. Consensus gross domestic product (GDP) growth for China is forecasted at around 6.5% for 2016 and 6.3% for 2017; the government has inferred it does not want to expedite reform at the expense of slowing growth. Chinese developers' industry consolidation will likely hasten, and while China's property sector policy will remain supportive overall, select tier-1 and tier-2 cities will face polarized plans to cope with increasing speculative demand.

Hong Kong

Residential prices in Hong Kong have declined 13% from the peak[6], with price cuts in both the primary and secondary markets. However, transaction volume rebounded following these reductions; primary market competition should intensify as more units are launched and developers compete on volume.

Singapore

Concerns over stagnating Chinese growth and Singapore's local oversupply issues will continue to be a drag on the country's real estate investments. Residential prices remain under pressure and office rents continue to fall.

Japan

The Japanese economy is growing albeit slowly, with GDP estimates for 2016 at 1.4%, well below the official target of 2%[7]. The country's negative interest rate environment has aided the property market, but has had some unintended negative consequences. Corporations are not confident that Japan will hit its growth target this year, and are therefore sitting on significant cash balances. Conversely, strong tourism is driving the positive operating performance in the country's hospitality sector.

Australia

Australia's economy is steady and should persist throughout 2016, as the Royal Bank of Australia is ready to enact additional quantitative easing measures if necessary. Retail will likely remain resilient with discretionary outperforming non-discretionary. Infrastructure and housing construction should continue to feed the economy as well. However, a major upcoming election will prompt the double dissolution of Parliament, which may spur policy repercussions in real estate and pension or superannuation-type savings.

CONCLUSION

Despite the inning or game of the commercial real estate cycle, we harbor both concerns and optimism regarding the global economy. China continues to cause significant trepidation, but we believe that consensus has caught up with reality and policy makers have begun to respond. We are less concerned about a U.S. recession and missteps by the Federal Reserve as low growth and low inflation have forced the Fed to temper its rate hike outlook. From a political perspective, the U.S. presidential election continues to create and dominate headlines and news viewership, but also creates risk. Globally, terrorism and the refugee crisis persist, but are increasingly being accepted as the new way of life. We believe there is significantly more work to be done in the energy sector via either restructurings or bankruptcy filings, and expect major banks to take significant write-offs on their balance sheets.

We believe that, overall, real estate and real assets are well positioned, particularly if the low-yield environment continues, but there will likely be short-lived pockets of weakness that will emerge. Our 2016 investment strategy will continue to be designed to enhance the performance and resiliency of our clients' portfolios with research focused on identifying mispriced investment opportunities around the world.

[6] *Source: Centaline, as of March 2016*
[7] *Source: Economic and Social Research Institute, Government of Japan*

(continued on next page)

DEFINITION OF INDICES

The following indices were included in the commentary for illustrative purposes only and have been selected as they are well known and are easily recognizable by investors. The indices have volatility and other material characteristics that may differ from actual investments, are unmanaged, are not available for direct investment, and are not subject to management fees. Because of these differences, benchmarks should not be relied upon as an accurate measure of comparison.

FTSE NAREIT Equity REITs Index
The FTSE NAREIT Equity REITs Index is a free float market capitalization-weighted index measuring equity tax-qualified real estate investments trusts which meet minimum size and liquidity criteria and are traded on the New York Stock Exchange, the American Stock Exchange, and the NASDAQ National Market System. The performance presented is based on total return calculations which add the income a stock's dividend provides to the performance of the index and is gross of investment management fees. The FTSE NAREIT Equity REITs Index is part of the FTSE NAREIT U.S. Real Estate Index Series.

FTSE EPRA/NAREIT Developed Index and Developed ex-U.S. Index
The FTSE EPRA/NAREIT Developed Real Estate Index Series covers both the FTSE EPRA/NAREIT Equity Index and the FTSE EPRA/NAREIT Developed ex-U.S. Index. Designed to track the performance of listed real estate companies and REITs worldwide, the series acts as a performance measure of the overall market. The performance presented is based on total return calculations which add the income a stock's dividend provides to the performance of the index, and is gross of withholding taxes and investment management fees. The index changed names on March 23, 2009, and was formerly known as the FTSE EPRA/NAREIT Global Real Estate Index.

NCREIF Property Index
The National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index is a quarterly time series composite total return measure of investment performance of a very large pool of individual commercial real estate properties (apartments, hotels, industrial properties, office buildings and retail only) acquired in the private market for investment purposes.

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