CenterSquare

INVESTMENT MANAGEMENT

Entrepreneurial Culture, Institutional Strength.

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ASSESSING LATE CYCLE REAL ESTATE INVESTING

The term "late cycle" has increasingly been used to describe the current real estate market. Often ill-defined, however, are the potential benefits of this characterization in helping to set investment policy. Four factors are of primary importance when positioning our portfolios at this point in the cycle: 1. the position of the underlying economy; 2. identifying and understanding secular demand drivers; 3. paying attention to where this demand is being met with supply; and, 4. understanding how these dynamics are priced into underlying real estate markets and the valuation offered by REITs. An analysis of our preferred macroeconomic indicators— 10-year and 2-year Treasury spreads, emerging markets, commodities, and credit spreads— reaffirms our view that the end of this cycle will likely be measured in years, not weeks or months.

THE UNDERLYING ECONOMIC CYCLE

The yield curve remains positive, although the Federal Reserve's (Fed) rate increases have caused a flattening, leading to a still-positive but more moderate outlook. This leads us to believe that the Fed will likely chart a moderate course forward, especially as it measures the impact of the expected reduction in balance sheet. Additionally, emerging markets have recovered from their 2016 slowdown, primarily due to supply rationalization, enabling weaker but not panicked markets. The sum of these factors is seen in the behavior of credit spreads, which remain at their post-Great Financial Crisis (GFC) lows, demonstrating lender confidence in the economic outlook.

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.

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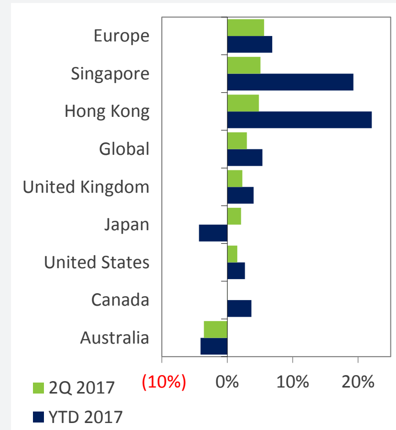
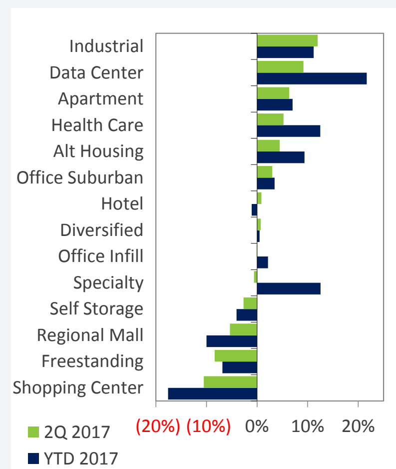
2Q17 PERFORMANCE REVIEW

FTSE EPRA/NAREIT DEVELOPED INDEX



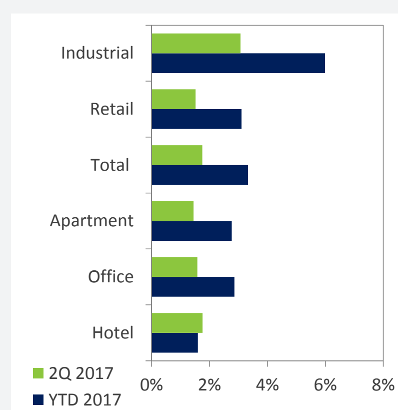
All returns in local currency.
Source: Bloomberg, FTSE, July 2017

FTSE NAREIT EQUITY REITS INDEX



Source: Bloomberg, FTSE July 2017

NCREIF PROPERTY INDEX



Source: NCREIF, July 2017

Assessing Late Cycle Real Estate Investing

1. Understand the economic cycle

- Following a mid-cycle slow down at the beginning of 2016, the economic cycle continues to move forward at a moderate pace globally

2. Identify secular demand drivers

- Identifying shifting demand patterns from changing demographics, technology and preferences is key to selecting the right real estate investments

3. Be mindful of supply

- Supply has increased but markets remain in balance, with pent up demand meeting new deliveries and a plateau in forward supply

4. Assess valuation

- Underlying property market valuations appear rational and REITs are inexpensive

DEMAND DRIVERS CREATE OPPORTUNITIES

We believe the best opportunities can be found by identifying strong secular demand drivers. Focusing on shifting patterns from changing demographics, technology, and preferences is key to selecting the right real estate investments. For example, a review of the REIT implied cap rates of industrial and retail assets—two sides of the same coin of e-commerce growth—make it clear that real estate values are likely to make a significant and potentially permanent shift for these asset classes. Similarly, datacenters, the physical manifestation of e-commerce and the cloud, are as much driven by technology trends as they are by REIT market influences. This is important given that cap rate compression is largely over, as highlighted by the flattening of REIT implied cap rates over the last two years. Therefore, relying on continued momentum through the pricing of real estate is a tough strategy; investors are better advised to identify and anticipate real estate repricing in response to the changing use of such assets in the new economy.

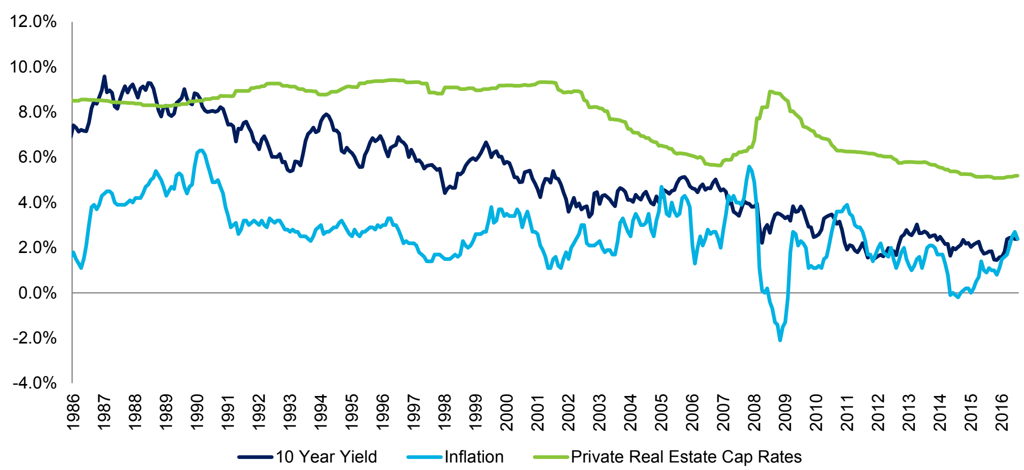
SUPPLY MEETS DEMAND

Late cycle investing requires paying attention to the extent that supply is catching up with demand. This supply response is late compared to prior cycles, allowing real estate owners a long period of strong cash flow growth despite a tepid economic recovery and risk-averse barriers for capital funding of new development. However, this dynamic has shifted in the last two years, and gains from occupancy and rent increases have moderated due to new supply. Supply has followed capital flows and is most acute in gateway markets and property types benefitting from secular demand tailwinds. Our focus, therefore, includes not only identifying secular demand trends, but also identifying where new supply is leading to moderating cash flow growth as well as what has already been priced into the REIT market.

THE VALUE OF VALUATION

The final important factor in this equation is valuation. CenterSquare's investment teams attempt to answer this question daily: To what extent are demand shifts priced in? As of now, we think underlying property market valuations appear rational and REITs are inexpensive. Real estate yields remain at a very comfortable cushion relative to debt costs, and the lack of inflation negates the consensus concern that we will soon see an upshot in 10-year bond yields to push interest rates and real estate cap rates higher.

Real Estate Yields



Source: CenterSquare, GreenStreet Advisors, as of April 2017

REIT PERFORMANCE

Fed in part by relative foreign currency appreciation, Global REITs were up 2.74%[1] during the second quarter with returns varying significantly by country. Europe performed strongly, with roughly half of its performance due to currency

[1] *Source: FTSE EPRA/NAREIT Developed Index as of June 30, 2017.*

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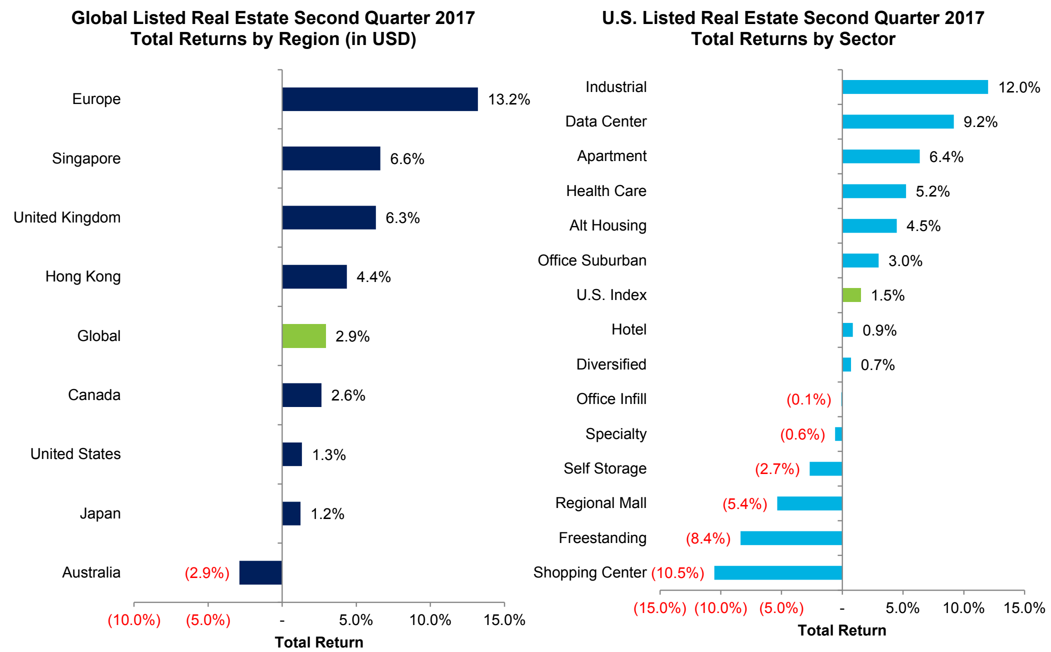
appreciation following the French elections. The United Kingdom also benefitted from its relative currency strength. Singapore and Hong Kong continued their recent rally, with both REITs and developers faring well. Australia was the only detractor, as the market sold off at the end of the quarter due to rising bond yields and a negative market reaction to a perceived extravagant REIT purchase. At the end of the quarter, the market appeared fair in valuation overall, slightly below net asset value (NAV). Hong Kong remained cheap, and Australia and Japan no longer appear expensive.

Second Quarter in Review: REIT Returns by Region and Sector



Source: Source: FTSE EPRA/NAREIT Developed Index, FTSE NAREIT Equity REITs Index, as of June 30, 2017. Please see definition of indices at the end of this document.

NORTH AMERICA

The U.S. REIT market rose 1.52% for the second quarter,[2] in part due to a solid demand for commercial space, as new construction has begun to materially increase in some sectors but is currently being met by pent-up demand. Data centers, industrial, and infill office continue to benefit from technological disruption, while low-quality commodity retail is languishing in a changing retail landscape.

U.S. REITs remained relatively inexpensive in the second quarter: 1. trading near NAV; 2. with a higher than average yield spread to the 10-year U.S. government bond; and, 3. an in-line multiple relative to the Standard and Poor's 500 Index, representing a significant discount to the relative multiple witnessed over the past decade.

One of the more interesting stories of the quarter may be alternate housing, particularly single family residential, one of the few areas of affordable housing and a much needed option as apartment development has largely focused on high-end, expensive units in major markets. New alternate housing supply is at historically low levels, particularly for entry-level price points. Paired with this is a higher propensity to rent among all age groups—whether through choice or necessity—which is likely to buoy this sector going forward. In addition, urbanization is expected to plateau, with suburban housing likely garnering a larger market share as Millennials age and a generational tailwind begins in urban cores. Continuing cost synergies in select REITs should also benefit this asset class. We expect single-family residential will remain a viable and healthy REIT sector, as the need for affordable housing grows and is insufficiently met with new supply.

Conversely, healthcare and net lease offer more bond-like returns. Healthcare presents little upside in an improving economy and strong downside if headwinds continue such as oversupply in senior housing, which has appeared years ahead of a demographic shift in the Baby Boomer generation, and tenant survivability issues in skilled nursing facilities due to bundled payments and Medicaid cuts.

Apartment and industrial REITs will likely continue to create a favorable spread to their cost of capital as growing demand both inside and outside overdeveloped, expensive major urban markets is outpacing supply. REITs in the non-traditional sectors will likely continue to trade at premiums to NAV, making spread investing accretive. However, accretive acquisitions in the traditional sector are rarer, forcing this space to shed assets to fund development. Finally, we will continue to watch signs of inflation acceleration as this may impact construction costs and rents in the United States.

EUROPE

The United Kingdom

Following an election that backfired for the majority party, consumer confidence and growth expectations for the United Kingdom eroded during the quarter, diminishing the country's

[2] *Source: FTSE NAREIT Equity REITs Index, as of June 30, 2017.*

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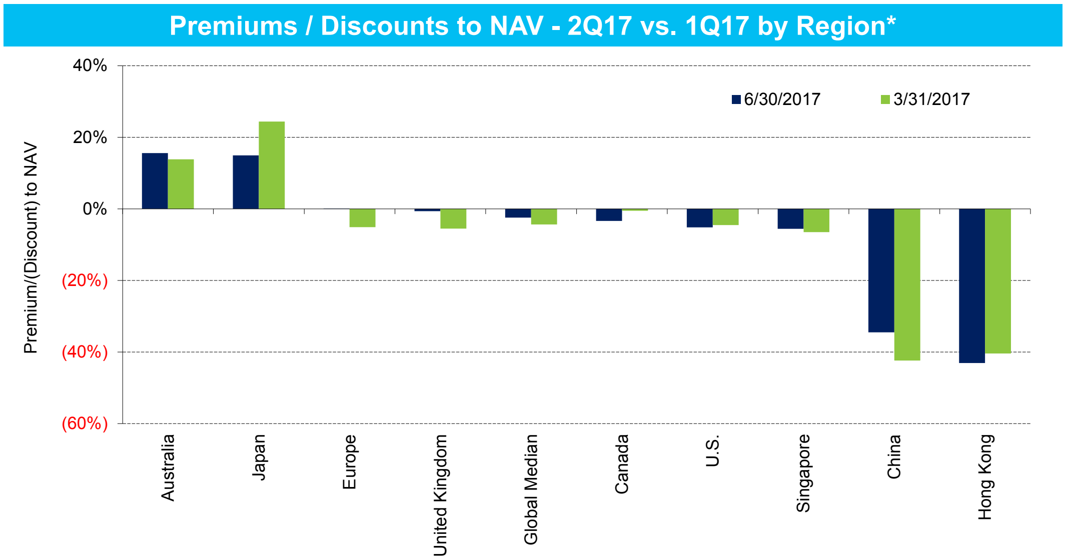
negotiating power in the formal Brexit talks that commenced post-election. Risk of another U.K. election before discussions conclude in early 2019 is high, and may further dilute the British government's power. Additionally, waning consumer confidence, rising inflation, and faltering wage growth added pressure to the economy as a whole, as incomes are likely to be squeezed. However, despite this backdrop, corporate earning generally beat expectations but with no significant re-rating.



Source: SNL Financial, July 2017. 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.*

Moving into the third quarter, U.K. industrials should remain strong and office values firm, as Brexit uncertainties have restricted new developments but not curtailed foreign investment. Alternately, the U.K. retail and residential spaces appear unwise investments, due to decreased consumer confidence and restricted incomes.

European Union

With the French electing pro-EU president Emmanuel Macron in May, political uncertainty was assuaged. Economic confidence and growth expectations broadly rose for the Eurozone, in some cases to pre-recession highs. Muted inflation and a likely re-election of Germany's incumbent Christian Democratic Union later this year kept the region's monetary policy on track.

We remain broadly neutral to Europe but still expect capital to continue to be attracted to prime European assets. German residential, Spanish office, and the Nordic countries are likely to continue providing positive performance, with the latter two offering the most attractive opportunities.

ASIA-PACIFIC

Hong Kong, China and Singapore

Hong Kong's economic outlook remained stable, and although sentiment surrounding its residential market peaked ahead of a traditionally slower second half, this is not expected to be detrimental. Residential volumes have slowed and discount pricing has grown, however, a large increase in stamp duty earlier this year has provided encouraging signs. Office remains strong, Hong Kong's retail is recovering, and its condominium market appears stable.

Singapore continues to see expectations improve as a trough in most sectors appears to have already been priced in. However, equity markets moved ahead of an expected direct market recovery, which may limit the near-term upside in the country's stocks. Office rents have begun to rise, but retail remains weak. Condominium volumes were boosted by new supply and prices continue to fall, although at a more moderate trajectory than previously.

Japan

During the second quarter, healthy economic growth laid a hopeful backdrop in Japan. After much anticipation by the Bank of Japan, wage inflation materialized. However, continuing economic growth expectations will benefit developers over JREITs. JREITs are finding it increasingly challenging to generate earnings growth, and saw material selling during the quarter due to increased regulatory scrutiny of investment funds. In addition, industrial overdevelopment may soon produce a headwind, and the condominium market also remains weak, particularly outside of prime areas. Meanwhile, Japan's office conditions continue to surprise to the upside.

Australia

Although Australian office remains strong, retail and housing were weak due to diluted consumption, rising energy prices, anemic wage growth, and out-of-cycle mortgage hikes. Rising bond yields affected the country's REIT performance as well. Interest rates remain on hold and will likely remain flat over the next year as Australia remains one of the few markets more likely to enact quantitative easing than tightening. The high-profile purchase of an office asset at peak pricing by a prominent Australian REIT also negatively impacted the country's performance as the move was unwelcomed by the market.

MINDFUL DURING MODERATION

Halfway into 2017, the global economic cycle continued to move forward at a moderate pace. We believe the market is behaving rationally and is defensively positioned for the inevitable next recession. Supply being delivered is being met with pent-up demand, and although this has led to a moderation in growth, it has not led to a detriment in rents or values on average. Current leverage levels versus 2007 are low, a reflection of the risk aversion discipline imposed on the market as a consequence of the last cycle. Underlying economic growth should continue at a fair pace until the Federal Reserve is forced to flatten the yield curve as we enter what is likely to be a more normal recession in which real estate is not the headliner.

Rather than trying to bet on predictions of swings in economic growth, we believe that a more appropriate focus is identifying strong underlying secular demand drivers, being mindful of supply, and critically assessing valuation, all of which are paramount to understanding the cycle and how to most beneficially position our portfolios in anticipation of its coming stages.

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 US Real Estate Index Series is designed to provide the most comprehensive assessment of overall industry performance, and includes all tax-qualified real estate investment trusts (REITs) that are listed on the New York Stock Exchange, the American Stock Exchange and the NASDAQ National Market List. The index constituents span the commercial real estate space across the US economy and provides investors with exposure to all investment and property sectors.

FTSE EPRA/NAREIT Developed Index (and FTSE EPRA/NAREIT Developed Net Index)
The FTSE EPRA/NAREIT Developed Real Estate Index Series covers both the FTSE EPRA/NAREIT Equity REITs 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 Gross benchmark presented is based on total return calculations which add the income a stock's dividend provides to the performance of the index. The Gross benchmark is presented is gross of withholding taxes and investment management fees. The Net benchmark presented is calculated as a total return net of foreign withholding taxes on dividends from an U.S. investor perspective, and gross of 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.

S&P 500
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.

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 the fund may be considerably more volatile than and have material differences from the performance of any of the referenced indices. Unlike these benchmarks, the portfolios of each of the funds portrayed herein are actively managed. Furthermore, the fund invests 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 fund comprise these benchmarks. Also, performance results for benchmarks may not reflect payment of investment management/incentive fees and other fund expenses. Because of these differences, benchmarks should not be relied upon as an accurate measure of comparison.

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