MARKET COMMENTARY

November 2017

CenterSquare
INVESTMENT MANAGEMENT

Entrepreneurial Culture, Institutional Strength.

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THE FUTURE OF RETAIL REAL ESTATE

During our quarterly webinar we discussed "The Purpose of Real Estate in New Economy Retailing." The comments below are a summary - our full analysis will be presented in an upcoming paper of the same title that we look forward to sending to you shortly.

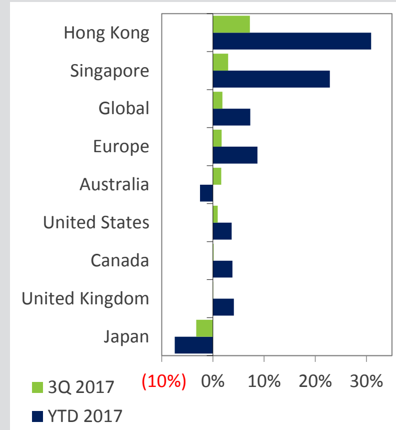
In the new economy, the value of retail real estate will be defined by its ability to meet the needs of a retailer's omni-channel sales strategy. The implication for landlords is the need for significant repositioning of existing assets and lower demand for physical real estate. The consequence for investors is that while certain real estate will face obsolescence risk, the best assets will benefit from extremely high demand, especially as physical real estate availability rationalizes. Real estate assets that will win in the future of retail are either a destination or offer extreme convenience.

CenterSquare has estimated that we will see "peak ecommerce" in the next 5-7 years at nearly 28% of sales. This is more than double today's level. Ecommerce penetration will differ among consumption items based on their "ecommerce-ability", which we assess along four categories: the homogeneity of the product, the cost of the product, the time spent to purchase the product, and the type of information required to guide the purchase decision. We expect significant saturation in categories such as electronics, material growth in apparel and merchandise, and lower penetration in food and groceries.

What does ecommerce's encroachment mean for physical retail assets? Malls are vulnerable primarily due to their apparel exposure. However, the ecommerce threat is

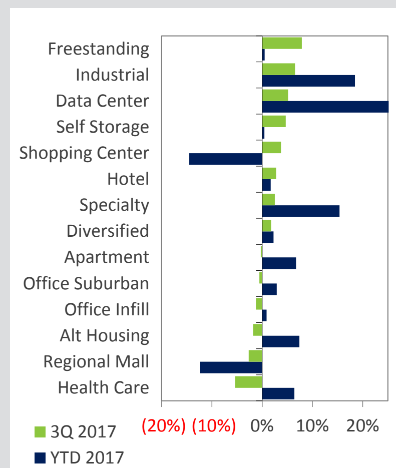
3Q17 PERFORMANCE REVIEW

FTSE EPRA/NAREIT DEVELOPED INDEX



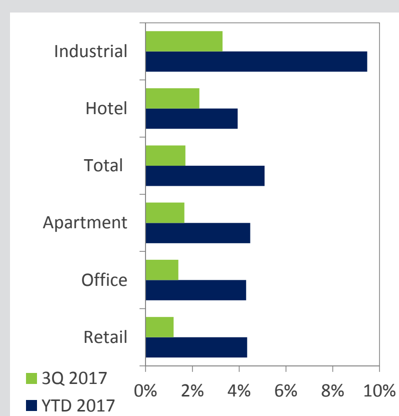
All returns in local currency.
Source: Bloomberg, FTSE, September 2017

FTSE NAREIT EQUITY REITS INDEX



Source: Bloomberg, FTSE September 2017

NCREIF PROPERTY INDEX



Source: NCREIF, September 2017

Peak Ecommerce Penetration and Mall Retail Footprint

Malls	Total Retail Spend (%)	Peak Ecommerce Penetration	Equilibrium Physical Retail Share
Apparel & Merchandise	50%	50%	50%
Electronics	10%	70%	30%
Food	10%	5%	95%
Other	30%	13%	87%
Total	**100%**	**36%**	**64%**

Mall Breakdown by Quality

Mall Quality	Number of Malls	Sales/Sqft	Mall % by Retail Spend	Mall % by Value	Mall % by Sqft
A	1-200	$635+	45%	65%	37%
B	201-600	$385+	37%	28%	37%
C	601-1000	<$385	18%	7%	26%
Total	1,000		100%	100%	100%

Current and Future Mall Sqft Needs

	Current Sqft		Future Sqft	
Mall Quality	Ecommerce Penetration	Current Physical Retail Share	Peak Ecommerce Penetration	Equilibrium Physical Retail Share
A	8%	92%	18%	82%
B	18%	82%	50%	50%
C	28%	72%	100%	0%
Total	**15%**	**85%**	**44%**	**56%**

Sources: Retail spend and mall data from Green Street Advisors, as of May 2017. Future sqft and peak values are projections based on estimates by CenterSquare Investment Management. Actual results may differ substantially from projections presented.

not consistent across all retail assets. Under our assumptions, 36% of sales in malls are susceptible to poaching by ecommerce, leading to our belief that 44% of retail square footage (or 30% of overall mall value), located primarily in B and C malls, may be shuttered or repurposed over the next five to seven years. As a result, we believe capitalization rates for malls may materially change. Pricing is expected to be more akin to office assets, which exhibit a significant bifurcation between well-located assets with inelastic demand and lower-quality assets with higher capex. High-quality, core mall assets should be more valuable than ever in new economy retailing, attracting very low cap rates as they provide retailers with a valuable and unique format to interact face-to-face with customers.

We believe we are at the beginning stages of the rationalization and repurposing of physical retail, which, once complete, will lead to a new equilibrium between the amount of physical retail and new economy consumption. Only thereafter will be an opportunity for assets to appreciate in value, particularly the higher-quality ones. As it stands today, we advise clients to be cautious when hunting for value in a sector likely to be dominated by creative destruction as these trends evolve.

REIT PERFORMANCE

Global REITs were up 1.8% for the quarter and 7.3% year to date, with nearly half of the return for both timeframes owed to foreign currency appreciation relative to the U.S. dollar.[1] Hong Kong continued as the strongest performer, up 7.2% in local currency, with developers again leading the charge. Europe and Singapore also fared well in both local returns and currency. However, Japanese stocks continued to be the primary poor performer, with developers taking the lion's share of the losses this quarter. Additionally, the United States continued its weak trend witnessed throughout 2017.

The Asia-Pacific region populated both ends of the Premium / Discount to net asset value (NAV) spectrum, as Hong Kong and China remained cheap despite strong performance, while Australia posted a slight premium to NAV. All other primary regions remained slightly discounted to NAV, with the United Kingdom cheapest due to uncertainty surrounding Brexit.

THE UNITED STATES

The The U.S. REIT market was up 0.9% for the third quarter of 2017, underperforming the Dow Jones Industrial Average (Dow) and Standard & Poor's 500 (S&P 500) Indices, which rose 5.6% and 4.5%, respectively.[2] Year-to-date returns paralleled the quarter, with REITs up only 3.7% versus 15.5% and 14.2% for the Dow and S&P 500, respectively.[2]

U.S. REITs remain inexpensive as of the end of the quarter, (1) trading at a discount to NAV, (2) retaining a much higher than average yield spread to the 10-year U.S. government bond, and (3) possessing an in-line multiple relative to the S&P 500, that represents a significant discount to what has been witnessed over the past decade.

Freestanding U.S. retail was the best performer during the period, while industrials and data centers continued to fortify their positive trend as the largest technology winners. Conversely, despite shopping centers' rebound from a weak first half, retail weighed heavily as malls moved lower during the quarter.

The Hurricane's Impact

The late-summer hurricanes that hit Texas and Florida had a reverberating effect on the performance of some sectors operating in these regions. For example, self storage rose after a weak start to 2017 as demand increased in the wake of the destructive storms. The hurricanes also lifted Houston apartments, which reversed course virtually overnight, moving from one of the worst markets in the country with little chance of recovery to the highest performing. Conversely, alternate housing was battered, undoing the sector's robust start to the year, including Houston's single-family residential and South Florida's manufactured homes.

[1] *Source: FTSE EPRA/NAREIT Developed Index as of September 30, 2017. Return cited is gross fees.*
[2] *Source: FTSE NAREIT Equity REITs Index, as of September 30, 2017.*

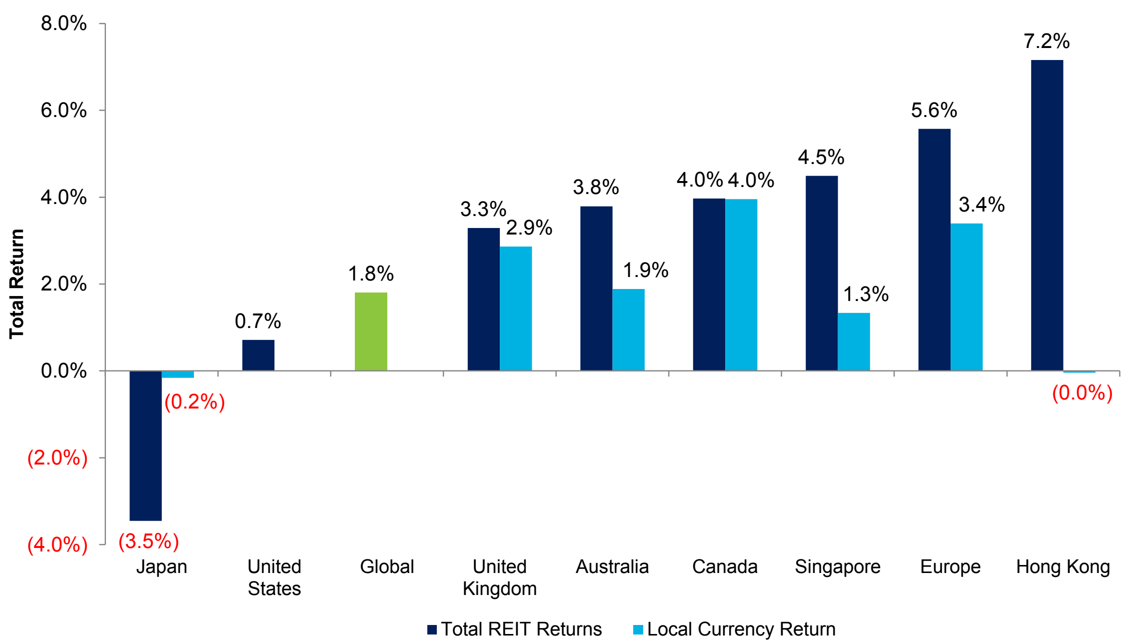
Waiting for the Baby Boomers

Healthcare, a traditionally defensive sector, saw fundamentals weaken during the quarter. Senior housing demand is expected to rise significantly by 2025 due to aging Baby Boomers, however, developers are building too much supply too soon. Occupancy is moving lower with rates only inching up, pressuring revenues. While future supply appears to be slowing down, it will take 18 to 24 months to satisfy the excess deliveries through mid-2018. On the expense side, supply is impacting labor costs materially, as Millennials shun jobs in this industry. And, because senior housing is a low-margin business, these wage pressures are more than offsetting slightly positive revenue growth.

Skilled nursing facilities (SNFs) have been under even greater pressure. Operators have been hamstrung by fines incurred by the Department of Justice for service overbilling as well as bundled payments that have reduced stays and total charges. In addition, SNFs have low margins, partially due to rent overpayment, and face similar expense issues as senior housing.

Across the U.S. REIT portfolio, we continue to maintain our preference toward quality real estate, secular demand patterns, and value-add development. Single-family residential, West Coast office, and industrials appear healthy moving into the fourth quarter of the year, while we believe net lease, healthcare, and select specialty stocks do not present beneficial opportunities.

Global Listed Real Estate 3Q 2017 Total Returns by Region (in USD)



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

THE UNITED KINGDOM AND EUROPE

The United Kingdom continued to struggle with uncertainty surrounding Brexit, and consumer confidence remained tepid, further pressuring the economy. However, U.K. industrials and London office provided performance relief in an otherwise anemic region. Retail and residential spaces in this region still appear unwise due to economic pressures on consumers.

With all major European elections now in the books, political uncertainty on the Continent is lessened, providing potentially better footing moving into 2018. Prime European assets such as German residential, Spanish office, and assets in the Nordic countries are expected to continue providing strong performance, while European retail, like its U.S. counterpart, struggles to find equilibrium in the evolving retail economy.

ASIA-PACIFIC

Hong Kong, China, Singapore, and Japan

Singapore industrial and hotels again posted strong returns for the quarter. Japanese stocks, however, wore on the region's performance, as JREITs and office continued to appear sluggish on a slow-to-reboot economy.

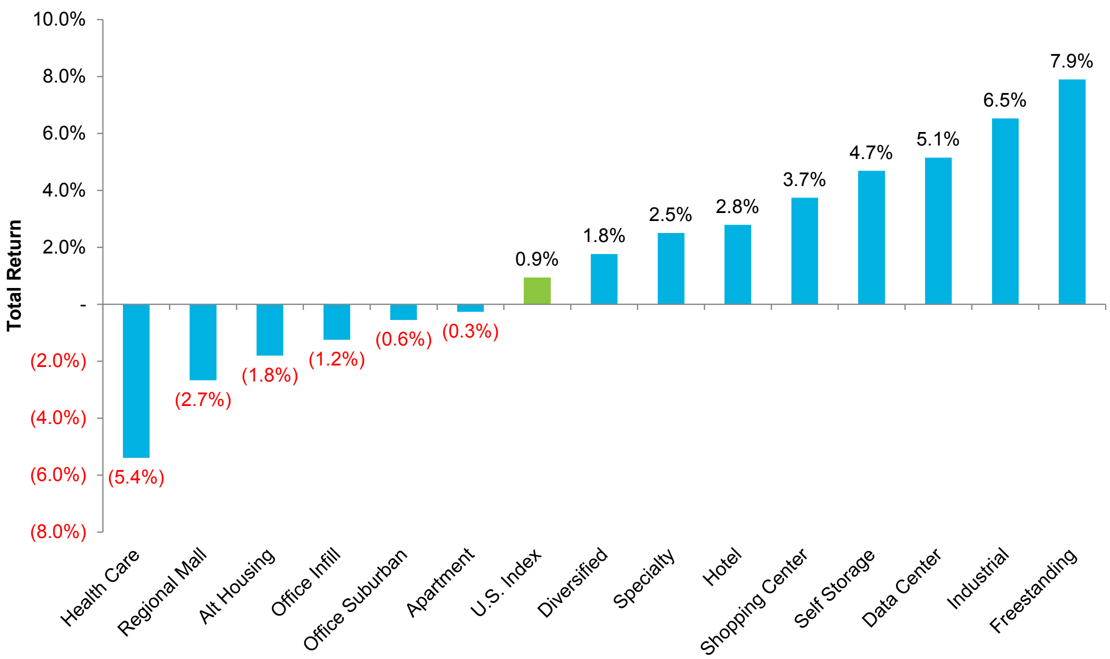
Australia

When evaluating Australian office supply-and-demand drivers from a top-down perspective, both Sydney and Melbourne have seen strong population growth over the past decades. Buoyed by both inter-state migration as well as overseas immigration, this trend is forecasted to endure, driving office demand higher. But what makes the current office cycle stand out is the supply side of the equation. Melbourne and Sydney saw a glut of office developments come to market from 2014 to 2016, leading to a sharp fall in net effective rents and a subsequent dearth in construction. From 2015 onwards, both cities also witnessed increased conversion of older office buildings into condominiums to meet rising demand for urban living. This mixture of

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.

strong underlying demand, a reduction in new office developments, and the removal of older office stock led to a sharp reversal in fortunes, with net effective rents in both cities rising from 2016 onwards. While office supply will eventually rise again, limited land availability in both central business districts, as well as prolonged planning regimes, provides opportunity of at least two more years of outsized rent growth.

U.S. Listed Real Estate 3Q 2017 Total Returns by Sector



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

FINDING THE EQUILIBRIUM

In the new economy, the value of retail real estate will be defined by its ability to meet the needs of retailers' omni-channel sales strategy. The consequence for landlords will be a significant reduction and/or repositioning of existing assets. For investors, the implications are that while certain real estate faces risk of obsolescence, the best assets will benefit from extremely high demand via experiential destinations or extreme convenience offerings.

In summary, we believe that we are at the beginning stages of the rationalization and repurposing of retail assets, which, once complete, will lead to a new equilibrium where physical space is in line with the demand for new economy consumption. When this point is reached, opportunity for asset appreciation will arise, particularly those of higher quality. However, as it stands today, we advise clients to be careful when hunting for value in a sector which is likely to be dominated by creative destruction as these trends play out.

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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.

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