Thinking about Real Estate? Building a Strong Portfolio with REITs

October 26, 2016

National Association of Real Estate Investment Trusts®
REITs: Building Dividends & Diversification®
1875 I St, NW Suite 600, Washington, DC 20006 • 202-739-9400
Commercial Real Estate is a Large Asset Class
Third Largest Asset in U.S. Investment Market Basket

U.S. Bonds
$35 Trillion
45%

Commercial Real Estate
$17 Trillion
21%

U.S. Equities
$27 Trillion
34%

Sources: Stock and Bond data from Financial Accounts of the United States; commercial real estate market data from NAREIT analysis based on Florance, Miller, Peng & Spivey, “Slicing, Dicing, and Scoping the Size of the U.S. Commercial Real Estate Market” (2010), adjusted using Moody’s/RCA CPPI, CoStar CRSI, and FTSE NAREIT PureProperty Index.
Real Estate: Recognized as a Core Asset Class by Large & Small Institutional Investors

![Share of Defined Benefit Plans with Real Estate Exposure](chart)

- Commercial real estate investment provides:
  - Hybrid investment returns with elements of both stocks and bonds
  - Investment grade real property assets provide a measure of inflation hedging
  - Real estate cycle does not coincide with the overall economic cycle
  - Moderate correlation with other assets over time provides potential diversification

Source: Money Market Directory (February 2016) and NAREIT calculations.
The Purpose

• The potential for U.S. REITs was created in 1960 by an act of Congress
  – Real Estate Investment Trust Act of 1960
  • Part of the Cigar Excise Tax Extension of 1960 signed by President Eisenhower September 14, 1960

• Allows all types of investors to benefit from real estate investment in the same manner as might be obtained by direct ownership, while also potentially diversifying their risks and obtaining professional management
Real Estate and REITs are Widely Used by Institutional Investors

Share of Public Pension Funds using Real Estate with REITs

- < $1B: 33.3% (Asset Weighted), 31.5% (Plan Count)
- $1B to $5B: 39.6% (Asset Weighted), 40.0% (Plan Count)
- $5B to $15B: 62.8% (Asset Weighted), 60.5% (Plan Count)
- $15B +: 58.1% (Asset Weighted), 60.7% (Plan Count)
- Total: 57.0% (Asset Weighted), 39.6% (Plan Count)

Source: NAREIT analysis of Preqin Real Estate Online and Money Market Directory (June 2016).
Real Estate Investment through Listed REITs

- REITs are *Real Estate* equities
- REITs deliver competitive long-term performance
- REITs provide portfolio diversification
- REITs are a complement to private investment in the real estate portfolio
- REITs are an efficient way to gain global real estate exposure
Listed REITs and Property Companies Contribute Solid Portfolio Performance

<table>
<thead>
<tr>
<th></th>
<th>FTSE NAREIT U.S. Equity REITs TR</th>
<th>FTSE EPRA/NAREIT Developed TR</th>
<th>Russell 3000 TR</th>
<th>MSCI EAFE TR</th>
<th>Barclays Capital U.S. Aggregate Bond Index</th>
<th>Barclays Capital Global Aggregate Bond Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-Year</td>
<td>20.94</td>
<td>15.85</td>
<td>14.96</td>
<td>6.52</td>
<td>5.19</td>
<td>8.83</td>
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<tr>
<td>3-Year</td>
<td>13.86</td>
<td>8.59</td>
<td>10.44</td>
<td>0.48</td>
<td>4.03</td>
<td>2.13</td>
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<tr>
<td>5-Year</td>
<td>15.97</td>
<td>13.16</td>
<td>16.36</td>
<td>7.39</td>
<td>3.08</td>
<td>1.74</td>
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<tr>
<td>10-Year</td>
<td>6.37</td>
<td>4.16</td>
<td>7.37</td>
<td>1.82</td>
<td>4.79</td>
<td>4.26</td>
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<tr>
<td>15-Year</td>
<td>11.40</td>
<td>10.67</td>
<td>7.61</td>
<td>5.81</td>
<td>4.80</td>
<td>5.13</td>
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<tr>
<td>20-Year</td>
<td>10.81</td>
<td>8.26</td>
<td>8.03</td>
<td>4.29</td>
<td>5.60</td>
<td>4.94</td>
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<tr>
<td>25-Year</td>
<td>11.51</td>
<td>9.05</td>
<td>9.47</td>
<td>5.05</td>
<td>5.97</td>
<td>5.73</td>
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<tr>
<td>30-Year</td>
<td>10.44</td>
<td>N/A</td>
<td>10.14</td>
<td>5.73</td>
<td>6.56</td>
<td>N/A</td>
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<tr>
<td>35-Year</td>
<td>12.33</td>
<td>N/A</td>
<td>11.44</td>
<td>8.89</td>
<td>8.39</td>
<td>N/A</td>
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<tr>
<td>40-Year</td>
<td>13.25</td>
<td>N/A</td>
<td>N/A</td>
<td>9.41</td>
<td>7.58</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Note: Monthly data as of September 2016
Sources: NAREIT® analysis of data from IDC accessed through FactSet.
CEM Study: REITs Outperformed All Other Asset Classes


Listed Equity REITs
Private Equity
U.S. Small Cap
Non-U.S. Equity
U.S. Long Bonds
Other Real Assets
U.S. Large Cap
Unlisted Real Estate
Non-U.S. Fixed Income
U.S. Broad Fixed Income
Hedge Funds/TAA
U.S. Other Fixed Income

Expense Impact %
Average Annual % Return Net of Fees

Source: CEM Benchmarking, 2016
### Listed Domestic Equity REIT Industry
#### Broad Diversification by Property Type and Geography

<table>
<thead>
<tr>
<th>Property Sector</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>13</td>
</tr>
<tr>
<td>Regional Malls</td>
<td>11</td>
</tr>
<tr>
<td>Health Care</td>
<td>11</td>
</tr>
<tr>
<td>Office Buildings</td>
<td>10</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>9</td>
</tr>
<tr>
<td>Shopping Centers</td>
<td>8</td>
</tr>
<tr>
<td>Industrial Facilities</td>
<td>6</td>
</tr>
<tr>
<td>Diversified</td>
<td>6</td>
</tr>
<tr>
<td>Self-Storage</td>
<td>6</td>
</tr>
<tr>
<td>Data Centers</td>
<td>5</td>
</tr>
<tr>
<td>Lodging/Resorts</td>
<td>4</td>
</tr>
<tr>
<td>Free Standing Retail</td>
<td>4</td>
</tr>
<tr>
<td>Specialty</td>
<td>3</td>
</tr>
<tr>
<td>Timber</td>
<td>3</td>
</tr>
</tbody>
</table>

**Total** 100

Data as of September 30, 2016
Source: NAREIT®
Real Estate Elevated to a Headline Sector in GICS

Changes to GICS

- On September 1, 2016, stock-exchange listed real estate companies (including listed equity REITs) will be reclassified under GICS, moving from under the Financials Sector and elevated to a new 11th headline Real Estate Sector.

- The change reflects the size and importance of listed real estate and underscores both that real estate is a separate and distinct asset class and stock exchange-listed equity REITs are an essential part of the real estate asset class.

Implications

- **Visibility and understanding:** Makes real estate a more visible asset class and will increase understanding of the asset class. Over time this should result in increased demand.

- **Increased demand:** U.S. equity funds have been underweight real estate. Analysts estimate that funds would need to buy as much as $100 billion in REITs to achieve a market-neutral position in the new real estate sector.*

- **Reduce volatility, improve diversification benefits:** The GICs change will separate REITs from the financial sector and increase liquidity, promote better understanding of the sector, and ultimately reduce volatility.

*Thomas Bohjalian, Cohen & Steers.*
Equity REITs are More Correlated with Private Real Estate, and Less with Stocks, over Longer Horizons

- Declining REIT-stock correlation over increasing investment horizons indicates that asset returns increasingly differ as spillover (mispricing) effects are corrected.
- Declining correlation as errors are corrected is a sign that underlying return drivers are fundamentally different—that is, REITs and non-REIT stocks represent different asset classes.
- Increasing Correlations of REITs and private real estate over lengthening investment horizons indicates that asset returns are more similar as appraisal errors and the illiquidity of private real estate are addressed.
- This correlation pattern is characteristic of indexes in the same asset class that are measured with “error”.

Source: NAREIT® analysis of monthly returns data for January 1990 through September 2016 from Interactive Data Pricing and Reference Data accessed through FactSet. NAREIT® analysis of data from FTSE NAREIT All Equity REITs Index, NCREIF Property Index, and NCREIF Open-End Diversified Core Equity (ODCE) Fund Index, 1978Q1-2016Q2; and from Cambridge Associates Real Estate Fund Index, 1986Q1-2016Q1.
REITs and Private Real Estate Funds in a Blended Portfolio
Optimal Allocations

Maximum Sharpe Ratio Portfolio
- 19.6% REITs, 43.3% ODCE, 37.1% Cambridge
- Average Net Return 8.17%/yr
- Volatility 7.2%/yr

Minimum-Volatility Portfolio
- 5.1% REITs, 94.9% ODCE
- Average Net Return 6.55%/yr
- Volatility 5.7%/yr

Note: Based on quarterly net total returns for NCREIF ODCE Fund Index, Cambridge Associates Real Estate Index and FTSE NAREIT Equity REITs Index for 1986q1–2015q2. Fees and expenses are assumed to be 50 bps per year for publicly traded equity REITs; fees and expenses for ODCE funds are as reported by NCREIF; CA Real Estate Index net of fees, expenses & carried interest. Source: NAREIT® analysis of data from NCREIF, Cambridge Associates, and FTSE NAREIT Equity REITs Index.
Source: NAREIT® and NCREIF (70% NPI – 30% FTSE NAREIT Equity REIT Index, 1978 – September 2008)

- REITs and core funds have similar, but not identical, long-term investment characteristics creating diversification within the asset class when combined

- This diversification creates the opportunity for the blended portfolio to earn higher returns while reducing the potential for negative or low returns

- Since 1977 there have been only two five-year investment periods during which a 70/30 private / public portfolio experienced negative net returns (-0.29% per year during 2006Q3-2011Q3 and -0.12% per year during 2006Q4-2011Q4).

Note: Based on quarterly net total returns of FTSE NAREIT All Equity REITs Index and NCREIF Open-End Diversified Core Equity (ODCE) Index, 1978Q1-2016Q2. Source: NAREIT analysis of data from NCREIF and IDP accessed through FactSet.
Global Expansion of the REIT Model
Increasing Investment Opportunity

Countries and Regions that Have Adopted the REIT Approach

G7 Countries
- Canada: 1993
- France: 2003
- Germany: 1997
- Italy: 2007
- Japan: 2006
- United Kingdom: 2007
- United States: 1960

Australia: 1971
Bahrain: 2015
Belgium: 1995
Brazil: 1993
Bulgaria: 2005
Costa Rica: 2009
Finland: 2009
Greece: 1999
Hong Kong: 2003
Hungary: 2011
India: 2014
Ireland: 2013

Countries Considering REITs
- China: 1969
- Indonesia: 1969
- Malta: 2010
- Nigeria: 2010
- Poland: 1999
- Saudi Arabia: 2005
- Sweden: 2006
- Tanzania: 2006

Source: NAREIT®
Date indicates adoption year of REIT rules.

As of October 5, 2016
Exchange Traded U.S. Equity REITS

• House the U.S. economy

• Historically have persistently outperformed other forms of commercial real estate investment while offering liquidity, transparency and comparatively low costs

• Provide access to the types of real estate and to the markets where you want to own

• Are owned by more than one-half of all pension, endowment and foundation funds investing in commercial real estate
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