April 2014

REIT Preferreds: Attractive Liquid Alternative For Real Estate Investors

L D R CAPITAL MANAGEMENT

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REIT PREFERRED SHARES ADD VALUE TO INSTITUTIONAL REAL ESTATE ALLOCATIONS

EXECUTIVE SUMMARY

REIT preferred shares offer institutional investors three critical advantages: 1) Attractive liquid alternative to core real estate, 2) Superior current income as compared to most other real estate products, and 3) Low volatility.

- Institutional investors seeking an attractive liquid alternative to core real estate can look to REIT preferreds. Historically, REIT preferreds have generated similar returns and volatility as core real estate investments. This comes with enhanced liquidity and daily price transparency.

- REIT preferreds offer superior current income to most other real estate product types. At present, the asset class provides an average 7.3% current yield, which stands almost twice the level of REIT equities in the public market and at a healthy premium to Class A cap rates in the private market.

- REIT preferreds have historically exhibited about 1/3rd the volatility level of REIT equities.

- Institutions can combine REIT preferred investments with existing REIT common stock allocations in order to achieve attractive risk-adjusted returns.

We therefore suggest institutional investors utilize REIT preferreds to: 1) provide a liquid complement to existing direct real estate investments, 2) temporarily fill core real estate allocations in advance of future capital calls, and/or, 3) augment existing REIT equity allocations in a way that produces attractive investment returns while at the same time dampening volatility levels.

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SECTION 1: REIT PREFERREDS AS AN ATTRACTIVE LIQUID ALTERNATIVE TO CORE REAL ESTATE

- **Medium and long term returns of REIT preferreds have been consistently strong both on an absolute basis and on a relative basis.**
- **REIT preferreds generated 10-year and 15-year returns of 7.2% and 7.5% respectively, consistent with the asset class's fundamental and structural underpinnings.**
- **REIT preferred long-term absolute returns have historically been consistent with the returns of core real estate and core real estate funds.**
- **Note we utilize the NCREIF Index to represent unleveraged core real estate returns and NCREIF-ODCE Index to represent core real estate fund returns.**

Figure 1: REIT Preferreds Have Produced Competitive Long-Term Returns

	Annualized returns*				
	1-year	3-year	5-year	10-year	15-year
REIT Preferreds	**6.3%**	**10.8%**	**11.9%**	**7.2%**	**7.5%**
NCREIF	11.0%	11.9%	5.7%	8.6%	8.9%
NCREIF-ODCE	14.0%	13.6%	3.7%	7.2%	7.9%
REIT Equity	19.7%	18.4%	5.7%	11.8%	8.9%
REIT Debt	11.7%	11.0%	10.0%	7.2%	NA

** See page 12 for explanation of REIT preferred, NCREIF, and equity indices. REIT preferreds based on Bank of America Merrill Lynch (BAML) REIT Preferred Securities Index. NCREIF tracks private real estate total returns. NCREIF-ODCE (Open End Diversified Core Equity) Index represents total returns of investments funds invested in core commercial real estate. REIT equity based on FTSE NAREIT All Equity REITs Total Return index. REIT debt based on JPMorgan's U.S. Liquid Index (JULI) for REITs. Data calculated as the compound annualized returns from 1Q13, 1Q10, 1Q08, 1Q03 and 1Q98 through 4Q13, for 1-year, 3-year, 5-year, 10-year and 15-year, respectively. <u>REIT preferred, equity and debt returns are lagged by 4 quarters.</u>*
Source: NCREIF, JPMorgan, Bloomberg, LDR Capital Management

Leverage levels have played a critical role in the above return series. As an example, REIT equities carry the highest leverage levels of the above asset categories (about 50%), and in turn they have generated the highest total returns over the past 1 and 3 years during a robust investment environment. However, that same leverage factor hindered the 5-year annualized returns rate of REIT equities, as higher debt levels created a substantial 40% downdraft in 2008. Similarly, private fund vehicles that represent the NCREIF-ODCE Index carry an average ~25% debt level while the NCREIF Index measures unlevered core real estate returns. As such, the NCREIF-ODCE Index contained slightly more return volatility than NCREIF over time, with higher 1 and 3 year returns during the recent recovery but lower 5-year annualized returns including the 2008 downturn. **All the while, REIT preferreds have generated consistent and stable returns over all holding periods listed above.**

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Over a 5-year average rolling hold period:

- **REIT preferreds generated slightly lower returns than core real estate, but on a risk adjusted basis, REIT preferreds produced consistent results.**
- **REIT preferreds generated higher returns with lower volatility as compared to core real estate funds.**
- **REIT preferreds produced lower returns than REIT equities, but on a risk-adjusted basis, the asset class substantially outperformed equities.**

Over a 7-year average rolling hold period:

- **REIT preferred returns fell a bit short of core real estate and REIT equity returns.**
- **REIT preferreds actually performed quite well on a risk-adjusted basis, substantially outperforming REIT equities and core real estate funds.**

In order to represent intermediate and longer term investment horizons agnostic to starting date, we selected rolling 3, 5 and 7 year periods to replicate various investment horizons of different institutional platforms. The data clearly shows that REIT preferreds have produced solid comparative returns—and with substantially lower volatility than core real estate, core real estate funds and REIT equities. And on a volatility-adjusted basis, REIT preferreds have historically produced superior results over essentially every time period. As such, buy-and-hold strategies with REIT preferreds have historically rewarded investors.

Figure 2: REIT Preferreds Have Generated Attractive Volatility-Adjusted Results

	Average Rolling Annualized Return*			Average Rolling Volatility			Average Rolling Return / Volatility		
	Over 3 years	Over 5 years	Over 7 years	Over 3 years	Over 5 years	Over 7 years	Over 3 years	Over 5 years	Over 7 years
REIT Preferreds	**7.4%**	**6.7%**	**6.9%**	**7.2%**	**3.6%**	**2.2%**	**1.0**	**1.8**	**3.1**
NCREIF	8.5%	8.0%	9.1%	8.1%	4.8%	2.7%	1.1	1.7	3.4
NCREIF-ODCE	6.9%	6.0%	7.6%	10.8%	6.4%	3.8%	0.6	0.9	2.0
REIT Equity	11.4%	10.5%	11.3%	16.4%	9.9%	5.8%	0.7	1.1	2.0

**See page 12 for explanation of REIT preferred, NCREIF, and equity indices. REIT preferreds based on BAML REIT Preferred Securities Index. NCREIF tracks private real estate total returns. NCREIF-ODCE (Open End Diversified Core Equity) Index represents total returns of investments funds invested in core commercial real estate. REIT equity based on FTSE NAREIT All Equity REITs Total Return index. Returns and volatility based on prior 3, 5, and 7 year rolling returns, from 2004 to 2013. <u>REIT preferred and equity returns are lagged by 4 quarters</u>. Source: NCREIF, Bloomberg, LDR Capital Management*

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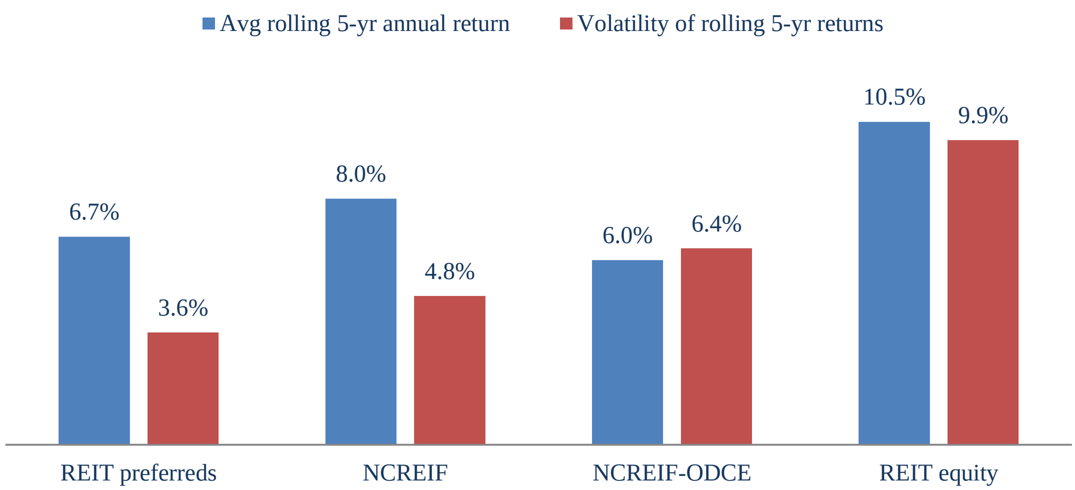
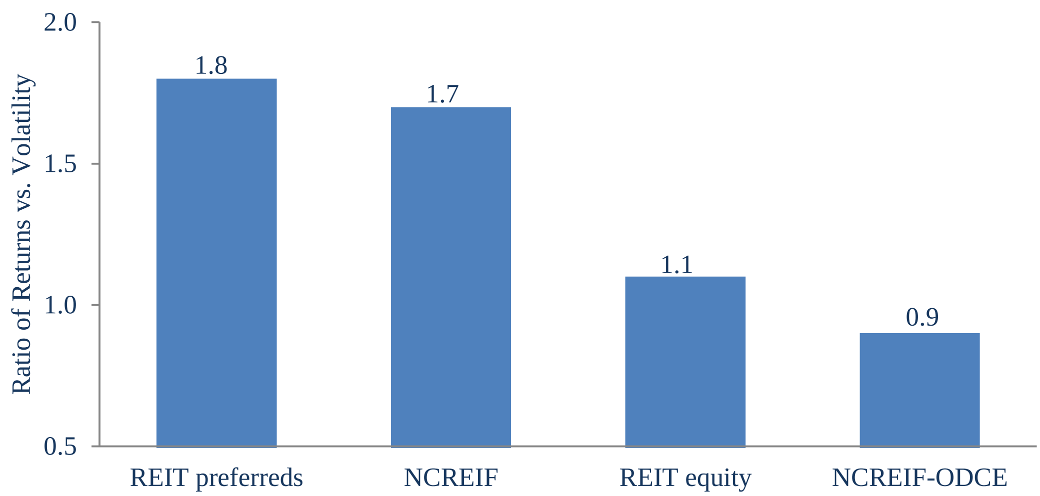
Figure 3: REIT Preferreds Have Performed Well Over Longer Hold Periods…

Comparative Average 5-yr Rolling Returns and Volatility*



…and Delivered Superior "Risk-Adjusted" Returns Relative to Other Real Estate Classes

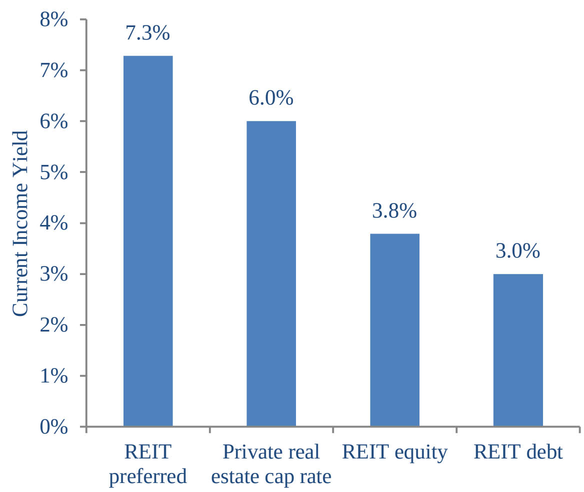


**See page 12 for explanation of REIT peferred, NCREIF, and equity indices. REIT preferreds based on BAML REIT Preferred Securities Index. NCREIF tracks private real estate total returns. NCREIF-ODCE Index represents total returns of investments funds invested in core commercial real estate. REIT equity based on FTSE NAREIT All Equity REITs Total Return index. Returns and volatility based on prior 5-year rolling returns from 2003 to 2013. REIT preferred, equity and debt returns are lagged by 4 quarters. Source: NCREIF, Bloomberg, LDR Capital Management*

SECTION 2: REIT PREFERREDS OFFER SUPERIOR INCOME YIELDS

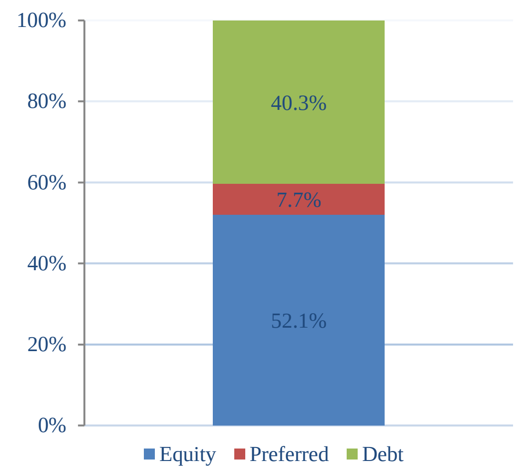
REIT preferreds offer current yields well in excess of REIT common stocks, REIT debt, and most real estate cap rates in the private market. At the same time, preferred shares carry senior claims on underlying REIT cash flows as compared to equity investments, and stand junior only to debt obligations. Further, REIT preferreds distribute this relatively high income in cash on a consistent, quarterly basis. As such, we believe REIT preferreds offer a high quality, well collateralized real estate-based income alternative for institutional investors.

Figure 4: REIT Preferreds Offer Superior Current Yields …



REIT preferreds based on proprietary database of REIT preferred universe. Private real estate cap rate based on NCREIF transaction cap rate. REIT equity based on the MSCI US REIT Index (RMZ). REIT debt based on weighted average of REIT corporate bonds. Source: CBRE, Wells Fargo, Bloomberg, LDR Capital Management. As of 2/28/14.

… at a solid position within the REIT capital stack.



Based on company reports as of 4Q13 of 68 REIT preferred issuers.
Source: Company reports, LDR Capital Management

We calculate that REIT preferreds now stand on average between 52% and 60% in the REIT capital stack, thereby providing a 52% equity cushion for stability. Hence, REIT preferreds provide attractive risk-adjusted returns through superior quarterly income yields combined with a priority claim on cash flows.

SECTION 3: CLOSE CORRELATION BETWEEN REIT PREFERREDS AND CORE REAL ESTATE

- **REIT preferreds are the liquid alternative with the closest correlation to core real estate and core real estate funds.**
- **Correlation between REIT preferreds and core real estate has actually grown much tighter over the past several years.**
- **REIT equity returns have grown more closely correlated with the S&P 500 Index than with core real estate over the past several years.**
- **REIT debt returns are consistently more correlated with corporate debt than with core real estate.**

Among all liquid alternatives, the REIT preferred asset class is the most correlated with core real estate and core real estate funds over the past 5, 10 and 15 years. In fact, the correlation between REIT preferreds and direct real estate has grown stronger over the past 5 years, reaching 62% in the time period between 2008 to 2013. In comparison, REIT debt and REIT equity have consistently maintained correlations with the NCREIF and NCREIF-ODCE indexes below 50%.

Figure 5: Tight Correlation Exists Between REIT Preferreds and Core Real Estate

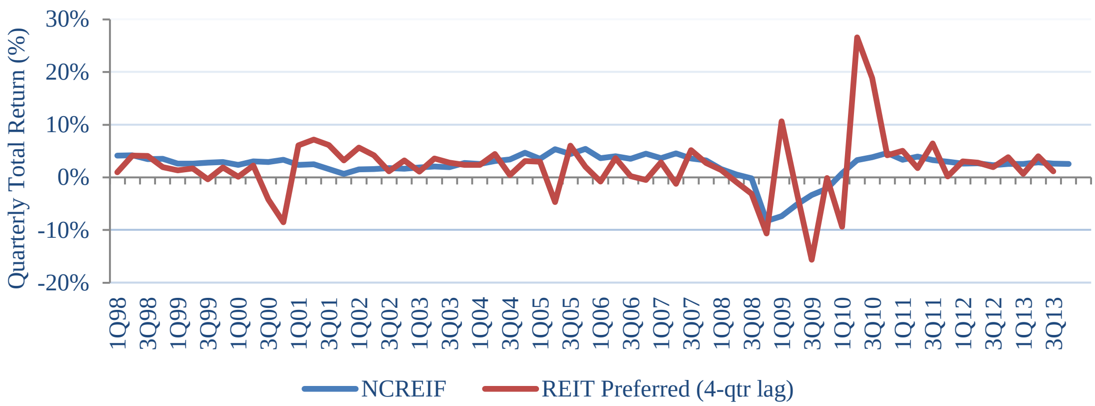
	Correlation with NCREIF		
	1998-2013	2003-2013	2008-2013
REIT Preferreds	**43%**	**50%**	**62%**
REIT Equity	41%	46%	48%
REIT Debt	NA	22%	35%

	Correlation with NCREIF-ODCE		
	1998-2013	2003-2013	2008-2013
REIT Preferreds	**48%**	**57%**	**65%**
REIT Equity	39%	44%	45%
REIT Debt	NA	28%	38%

See page 12 for explanation of REIT peferred, NCREIF, and REIT equity and debt indices. REIT preferreds based on BAML REIT Preferred Securities Index. REIT equity based on FTSE NAREIT All Equity REITs Total Return index. REIT debt based on JPMorgan's U.S. Liquid Index (JULI) for REITs. Correlations are based on quarterly returns with a 4-quarter lag. Data exclude 1Q09 return, as we view that quarter as an outlier that distorts correlations.
Source: NCREIF, JPMorgan, Bloomberg, LDR Capital Management

The chart on the next page graphically depicts the historic return series of REIT preferreds compared to core real estate (assuming a 4-quarter lag for REIT preferreds). Aside from the financial and economic declines in 2008-2009, wherein all asset classes became disjointed, REIT preferred shares visibly track the NCREIF Index quite closely.

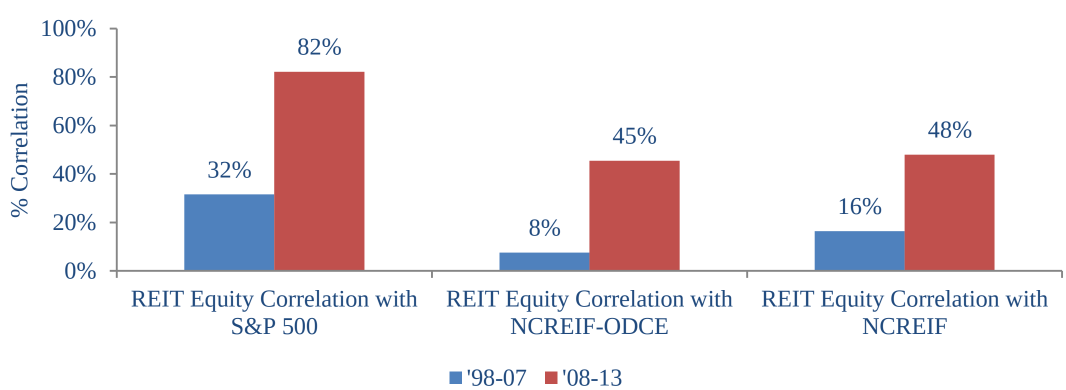
Figure 6: REIT Preferred Returns Similar to Direct Real Estate Returns



REIT preferred based on BAML REIT Preferred Securities index, graphed on a 4-quarter lag.
Source: NCREIF, Bloomberg, LDR Capital Management

In contrast, REIT equity returns have grown more tightly correlated with the S&P 500 than with core real estate over the past several years. In the 10 years between 1998 to 2007, REIT equities had a 16% correlation with the NCREIF Index—but a higher 32% correlation with the S&P 500 Index. More importantly, the correlation between REIT equities and the S&P 500 has risen to 82% over the past five years (versus 48% with the NCREIF Index over that same time period). Further, REIT equity measurement of beta (measure of a security's volatility in relation to the market) averaged 0.61 from 1998 to 2007, but has risen to 1.18 since 2008.

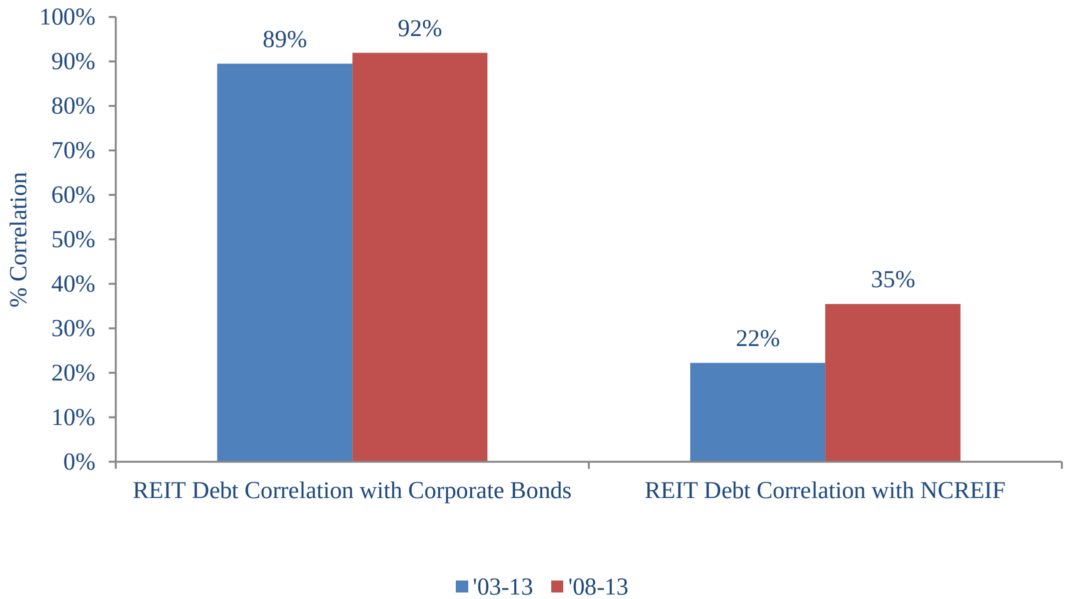
Figure 7: REIT Equities Have Grown More Tightly Correlated with the S&P 500 Index than with Core Real Estate



REIT equity based on FTSE NAREIT All Equity REITs Total Return index. Data based on 4-quarter lag between NCREIF and REIT equity, concurrent between REIT equity and S&P 500. Source: NCREIF, Bloomberg, LDR Capital Management

REIT debt returns are consistently more correlated to corporate debt than to core real estate. As seen below, the correlation between REIT debt and BB-rated corporate bond index is extremely close while the correlation between REIT debt and NCREIF is quite low. Thus, we conclude that REIT debt trades more like corporate debt than it does like direct real estate.

Figure 8: REIT Debt More Tightly Correlated with Corporate Bonds than with Direct Real Estate



REIT debt based on JPMorgan U.S. Liquid Index for REITs, corporate bonds based on Credit Suisse BB-rated Corporate Bond Index. Correlation between NCREIF and real estate debt is lagged 4 quarters, concurrent between corporate bonds and real estate debt. Source: NCREIF, JPMorgan, Credit Suisse, LDR Capital Management

SECTION 4: BLENDING REIT PREFERREDS INTO REIT COMMON STOCK ALLOCATIONS OFFERS ATTRACTIVE RISK-ADJUSTED RESULTS

- **Adding REIT preferreds to a pre-existing REIT common stock allocation has historically improved risk-adjusted returns.**
- **REIT preferreds can serve to dampen the volatility of a pre-existing REIT equity positions.**

Institutions can combine REIT preferred investments with existing REIT equity allocations in order to achieve attractive risk-adjusted returns. As seen below, since January 2000 the average of 5-year rolling return for REIT equities has been 9.8%. In contrast, over that same time period, average rolling return for REIT preferred shares has been 8.1%. However, the volatility in returns for REIT equities has been 9.6% while the volatility in returns for REIT preferreds has been just 5.4%.

History reveals that an institutional allocation to both REIT equities and REIT preferreds has produced solid absolute returns and improved risk adjusted returns. By adding in a mix of REIT preferreds to a pre-existing REIT equity allocation, institutional investors can maintain attractive absolute returns while at the same time substantially reducing volatility levels – and in doing so actually improve overall risk-adjusted results.

Figure 9: Mixing REIT Preferreds Into An Existing REIT Equity Allocation…

	Average of Rolling 5-Year Annual Return	Average of Rolling 5-Year Volatility	Return/Volatility 5-Year Rolling Average
REIT Preferred	**8.1%**	**5.4%**	**1.5**
REIT Equity	9.8%	9.6%	1.0
5% Pref + 95% Equity	9.8%	9.2%	1.1
10% Pref + 90% Equity	9.8%	8.8%	1.1
20% Pref + 80% Equity	9.7%	8.1%	1.2

REIT Preferreds based on Wells Fargo Hybrid & Preferred Securities REIT Index. REIT equity based on FTSE NAREIT All Equity REITs Index. Data calculated as annualized 5-year rolling monthly returns since from January 2000 to January 2014. Source: Bloomberg, LDR Capital Management.

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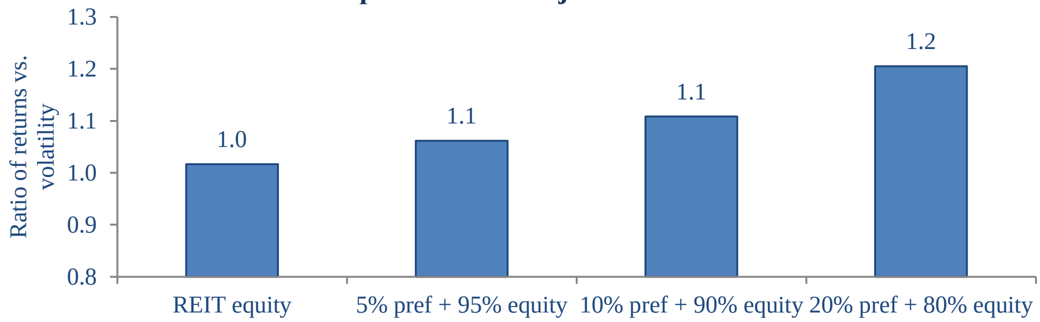
…Has Improved Risk-Adjusted Returns to Investors

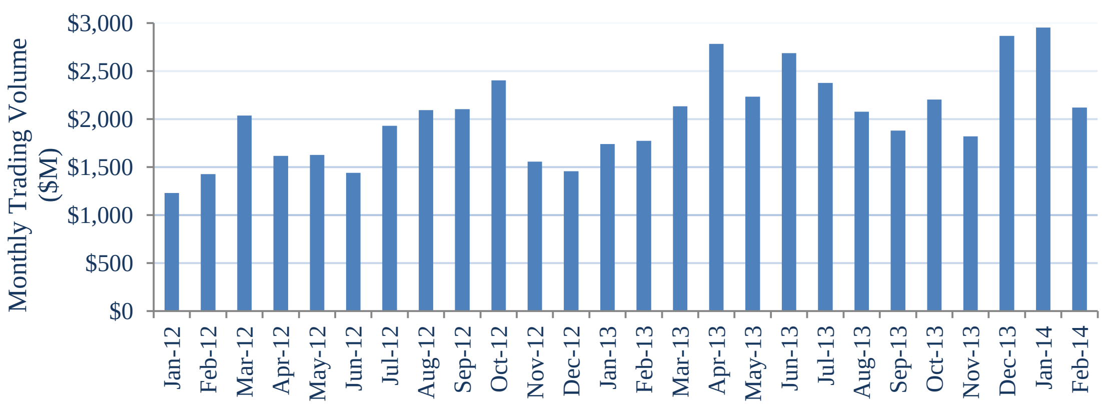


REIT Preferreds based on Wells Fargo Hybrid & Preferred Securities REIT Index. REIT equity based on FTSE NAREIT All Equity REITs Index. Data calculated as annualized 5-year rolling monthly returns since from January 2000 to January 2014. Source: Bloomberg, LDR Capital Management.

SECTION 5: REIT PREFERREDS PROVIDE REQUISITE LIQUIDITY FOR INSTITUTIONAL INVESTORS

The REIT preferred asset class totals $28 billion of par value outstanding, represented by 213 issues from 112 issuers. Including Canadian REIT preferreds, convertible preferreds and other real estate related preferreds, the overall preferred universe represents about $36 billion of par value outstanding. We calculate an average $2 billion of preferred shares trade on a monthly basis, or about $100 million par value on a daily basis. An institutional allocation to REIT preferreds of $100 million would thus only represent up to one day's trading. Hence, institutions seeking investment in REIT preferreds can feel comfortable of adequate liquidity in the event of a desired reallocation of capital.

Figure 10: Monthly Dollar Volume of Trading in REIT Preferred Stocks



Volume based on LDR proprietary database on all REIT preferreds outstanding.
Source: Bloomberg, LDR Capital Management, as of 2/28/14.

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CONCLUSION: REIT PREFERREDS STAND AS A HIGH QUALITY LIQUID PRODUCT FOR INSTITUTIONAL INVESTORS SEEKING LIQUID ALTERNATIVES TO CORE REAL ESTATE

Institutions seeking a liquid vehicle as an adjacency to direct real estate investments are well served to look toward REIT preferred shares. Over any holding period, 3-year, 5-year, 7-year or longer, REIT preferred shares have served as the best liquid proxy for both the NCREIF index and the core real estate fund index.

In fact, the case for REIT preferred shares in institutional real estate portfolios has grown even more pronounced in the past few years as compared to both REIT equity and REIT debt. Among these other liquid alternatives, REIT preferreds offer institutional investors a combination of: 1) Similar return series to direct real estate, 2) Close correlation to direct real estate, 3) Higher current income, and 4) Similar volatility levels to direct real estate. Further, institutions can combine REIT preferred investments with existing REIT common stock allocations in order to dampen volatility while still achieving attractive risk-adjusted returns.

Institutional investors can look to REIT preferreds to: 1) Provide a liquid complement to existing direct real estate investments, 2) Temporarily fill core real estate allocations in advance of future capital calls, and/or, 3) Augment existing REIT equity allocations in a way that produces attractive investment results.

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Basis of Analysis

This report analyzes historical returns for privately held real estate based on the National Council of Real Estate Investment Fiduciaries (NCREIF) Property Index. This index provides unlevered total returns on institutional-owned commercial real estate properties, composed of income and changes in appraised value.

According to NCREIF, "appraisals tend to lag transaction price due to the nature of the appraisal process". The average time between re-evaluation of properties in the index is approximately 3-4 quarters. As such, when comparing market-based returns (such as REIT preferreds, equity and debt) with appraisal-based returns, we lag market-driven returns by 4 quarters to account for this delay.

In addition to the NCREIF Property Index, we also include the NCREIF Open End Diversified Core Equity Index (NCREIF–ODCE Index), which tracks the returns of 31 open-end commingled funds investing core real estate. We view this index as representative of the returns an institution would receive through an allocation to funds investing in core real estate rather than investing in individual properties outright. NCREIF–ODCE Index returns are levered and gross of fees.

In section 1 and section 3 of this report, we compare the performance of NCREIF index and NCREIF-ODCE index with Bank of America Merrill Lynch (BAML) REIT Preferred Securities Index. This index was launched in 1997 and consists of 31 investment grade-rated REIT preferred securities. We also refer to the Wells Fargo Hybrid & Preferred Securities REIT (WHPSR) Index in Section 4 of this report. The WHPSR was launched in January 2000 and consists of 131 investment grade, non-investment grade and un-rated REIT preferred securities.

In addition to comparing returns over the past 3, 5, 7 and 10 years, we also analyze performance over rolling 3, 5 and 7-year periods. We believe this better mirrors real estate investors' typically longer-term holding periods, and is agnostic as to when this investment began.

For example, the average return and volatility of rolling 5-year period measures the mean and standard deviation of annualized returns over the prior 5 years starting in Q4.2003 – this includes 36 observations, or 9 years' data.

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Risks of investing in REIT preferred securities include (but are not limited to): fundamental risk (exposure to economic recession, whereby REITs' underlying cash flow and dividend paying capability could be impaired); interest rate risk (REIT preferreds may experience mark-to-market losses in the event of rising interest rates, though their par value would remain unchanged); takeover risk (corporate events that add significant senior leverage that can impact the credit standing of preferreds); and liquidity risk.