LDR CAPITAL MANAGEMENT

April 2025 Flash Note

Higher Tariffs and Their Impact on REIT Preferreds

SUMMARY

- *A higher tariff regime has potential for far-reaching impact across all U.S. industries, including commercial real estate (CRE). We provide an analysis of the impact on REIT preferreds, REITs and CRE*
- ***Impact on REIT preferred shares:** The securities are fundamentally well-covered with a high dividend cushion, but may face short-term volatility and wider credit spreads; this presents a medium-term buying opportunity given the preferreds' historical resilience*
- ***Impact on REITs:** While REIT earnings are typically more stable than other sectors due to long-term leases, a slowing economy could still lead to downward earnings revisions—though likely less severe than for the broader market*

Impact on REIT preferred shares

Fundamentally: Negligible. In the fourth quarter of 2024, average REIT cash flows exceeded preferred dividend requirements by a high 8.4 times. That means cash flow levels would have to drop by a significant 31% for coverages to fall to 1:1. Given the high coverage levels and the senior status of REIT preferreds compared to common dividends, we do not foresee any significant asset class stress due to weaker conditions pursuing into a higher tariff regime.

Credit spreads: Wider. REIT preferreds are hybrid securities and correlate positively both with the equity and fixed income markets, though price performance at any moment in time depends upon the prevailing market environment. In the context of a higher tariff regime, REIT performance has and should correlate more closely over the short term with the equity markets. In fact, year to date as of April 11th, the MSCI REIT Preferred Index was down -6.38% vs. the S&P 500 Index was down -8.47% and the Bloomberg U.S. Agg Index was up +1.06%. Separately, with 10-year U.S. Treasury yield at 4.49%, we calculate that REIT preferred credit spreads have widened by 75 basis points thus far in 2025.

Intermediate term: Opportunity. To the extent that REIT preferred shares are negatively impacted in the short term by wider credit spreads and a correlation to the equity market, we would view that as an intermediate term buying opportunity. Historically, when the asset class has declined due to macroeconomic factors, it has rebounded. As long as the industry-wide preferred credit standing remains intact (which it has), eventually share price has historically responded positively. We suspect the same would hold true in this case as well—and thus view this volatile market as a buying opportunity.

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Impact on REITs

Impact on CRE supply: Reduce. Tariffs in general are expected to raise development and construction costs. New supply has already been dampened by a rise in interest rates. A concurrent rise in construction costs will likely cause developers to delay or cancel new projects - at least until such time that rents have increased to levels that justify appropriate returns on higher levels of capital outlay.

Impact on CRE demand: Dampen. General economic uncertainty and potentially higher inflationary conditions could dampen consumer sentiment and business investment spending. Commercial real estate is undoubtedly exposed to economic cycles and would be impacted over time by slowing growth in the form of lower rental rates and/or higher vacancy rates. That said, CRE is generally a lagging cyclical industry due to longer lease structures compared to front-end cyclical industries.

Impact on REIT earnings: Small reduction. Generally speaking, REIT earnings volatility is lower than the broader marketplace due to long-term lease structures. That said, few industry is immune to soft economic conditions. Specific to REITs, consensus estimates call for industry earnings to be about flat for 2025 but to accelerate in 2026. Looking ahead, were economic trends to slow in the U.S., we would expect that REIT earnings growth to be revised downward as well - but to a lesser degree than the broader marketplace.

Impact on Commercial Real Estate

Property sectors that are more insulated: Multifamily housing, data centers, self storage, net leased retail, and medical offices. Each of these sectors is generally less sensitive to trade directly, though somewhat vulnerable in a broader economic downturn. As well data centers and medical offices are driven more by technological advancement and healthcare trends than global trade. Self-storage has a long-standing reputation of being more recession resilient since tenant demand is driven more by life changes than the economy. Finally, the multifamily market should prove more resilient as a positive rent vs. buy equation, low cap-ex loads, and longer lease stays (during economically weak periods) are key positive business attributes.

Property sectors that are less well insulated: Retail, office and industrial. Retailers relying on imported goods face cost increases, lower margins, and softening consumer confidence. Higher

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tariffs should not generally treat the retail REITs well, but companies with more defensive, necessity-based portfolios should hold up better. Industrial REITs would be most impacted by supply chain disruptions, and higher tariffs could increase costs or cause delays for tenants, thereby impacting their ability to pay rent or expand. As a consequence, the industrial sector could face weakness from a combination of both a slower global economy and trade flow, especially in coastal markets. Finally, the office sector would normally be a category harder hit during a period of weaker economic conditions. However, the asset class is coming off a severe decline, supply has essentially ground to a halt, and the pace of leasing is still recovering from its COVID-related low. As such, we would expect office to come through the current environment relatively unscathed.

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LDR Database Definitions

LDR's calculations regarding REIT preferreds described herein are derived from its proprietary database, which strives to track the performance and valuation metrics for all currently outstanding publicly-traded REIT preferreds issued in North America (excluding $1000-par preferreds, as they are not exchange-listed). LDR's proprietary database does not include historical data, so references to historical yields and returns prior to 9/30/22 are based on relevant indices, as noted. Overall issuance data, where indicated, includes U.S. and Canada-issued fixed-rate and convertible REIT preferreds. Yield data consists only of U.S.-issued fixed-rate preferreds. All pricing and trading data for the database are derived from Bloomberg.

Use of Indexes

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Index Definitions

10-year U.S. Treasury yield, also known as the 10-year bond rate, represents the interest rate at which the U.S. government borrows money by issuing 10-year Treasury notes. It's a key indicator for financial markets and the broader economy, reflecting investor expectations about future interest rates and economic growth.

Bloomberg U.S. Aggregate Bond Index tracks the performance of investment grade, U.S. dollar-denominated, fixed-rate taxable bonds, including Treasuries, government-related and corporate securities, MBS, ABS and CMBS.

MSCI REIT Preferred Index is a preferred stock market capitalization-weighted total return index of certain exchange-traded perpetual preferred securities issued by U.S. Equity and U.S. Hybrid REITs.

S&P 500 Index is a market-capitalization-weighted index of 500 leading publicly traded companies in the US.