

REIT Preferred Securities

Opportunity and Risk in a Higher Inflation Environment

Real estate investment trust ("REIT") preferred securities currently offer a compelling yield opportunity among publicly traded income-oriented asset classes, in our opinion. Average current yields in the sector now stand at 8.2% as of May 2026, with an average upside to par of 32%. At the same time, commercial real estate operating results are stable and growing, the 10-year U.S. Treasury yield has risen to ~4.6% and inflation remains persistent. This backdrop thus offers elevated yields and discounted prices – and the potential for continued solid long-term returns in excess of most other fixed income asset classes. That said, one must also be on the alert for higher interest rates and the associated pressure resulting from a higher inflationary environment.

REIT Preferreds Look Attractive

1. High Income Levels

An 8.2% current yield represents a spread of nearly 400 basis points over the 10-year Treasury, a level that has historically offered compelling risk-adjusted returns for securities backed by institutional-quality real estate. For context, investment-grade and high-yield corporate credit spreads are near 25-year tight, meaning investors in those markets are receiving very little incremental compensation for credit risk. As such, REIT preferreds stand out as a high credit quality asset class with solidly high yields.

For income-focused investors, we believe this level of yield can provide:

- Significant cash flow
- Potential offset for inflation
- A cushion against moderate price volatility
- A competitive alternative to investment-grade fixed income

To note, REIT distributions also contain certain tax advantages, which serve to increase tax equivalent yields in the asset class.

2. Discount-to-Par Provides Embedded Appreciation Potential

REIT preferreds trade at discounts, embedding a 32% upside opportunity to their \$25 liquidation preference ("par value").

A preferred purchased near \$20 that ultimately returns to \$25 par can generate meaningful capital appreciation in addition to the coupon income stream. Unlike traditional bonds that mature on a fixed date, REIT preferreds are perpetual securities. As such, these securities can trade at discounts to par value for longer periods of time in lieu of a maturity event.

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3. Inflation Can Support Underlying Real Estate Cash Flows

REIT sectors such as apartments, self-storage, hotels, industrial, manufactured housing are among the best positioned to pass through inflation. They have generally delivered stronger rent growth over the past several years. Short lease structures allow for rapid repricing; Consumer Price Index - linked escalators in net lease and industrial portfolios have similarly provided revenue support. On the supply side, sharply higher construction costs have slowed new development, benefiting existing landlords.

For preferred shareholders, stronger underlying cash flow coverage can potentially improve dividend safety.

4. Public Market Liquidity and Transparency

Exchange-listed REIT preferreds are marked to market daily and governed under Securities and Exchange Commission reporting requirements. In an environment where portions of private credit carry valuations that are slow to reflect rate movements, the mark-to-market discipline is a meaningful structural differentiator. Investors can add or exit positions without navigating the illiquidity premiums or redemption gates that have characterized some private credit vehicles over the past two years.

REIT Preferreds Key Risks

1. Higher Inflation and Treasury Rates Pressure Preferred Valuations

REIT preferreds are interest rate-sensitive securities. As Treasury yields rise, fixed-income alternatives must become more competitive, causing preferred prices to decline. The rise in long-term interest rates since 2022 has been one of the primary reasons many REIT preferreds now trade at large discounts to par. If Treasury rates remain elevated for a prolonged period, preferred prices could remain discounted even if credit fundamentals for the asset class remain strong.

2. Higher Inflation Impinges Upon Real Estate Expenses and Costs of Capital

Higher interest costs: The combination of higher rates and tighter underwriting standards leads to higher interest expense for REITs carrying debt maturities. For those issuers, rolling maturing debt at rates 200–300 basis points higher than prior financings could pressure cash flow, reduce asset sale proceeds, reduce financing flexibility and compress investment spreads.

Lower asset values: Higher long-term interest rates generally drive real estate cap rates higher. As such, underlying REIT asset values could decline, thus pressuring the industry's capital raising capabilities.

Higher operating expenses: Commercial real estate operating expenses such as labor, insurance, property taxes, and capital expenditures generally rise in line with inflation. As such, it's incumbent upon REITs to drive up revenues in excess of these expenses in order to maintain profit margins and cash flow growth.

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There are several risks associated with investing in real estate of which investors must be aware, which may include, but are not limited to, fluctuations in the value of underlying properties, defaults by borrowers or tenants, market saturation, changes in general and local operating expenses, and other economic, political or regulatory occurrences affecting companies in the real estate industry. In addition to those in general, investing in REITs involves certain other risks related to their structure and focus, which can include, but are not limited to, dependency upon management skills, limited diversification, the risks of locating and managing financing for projects, heavy cash flow dependency, possible default by borrowers, the costs and potential losses of self-liquidation of one or more holdings, the risk of a possible lack of mortgage funds and associated interest rate risks, overbuilding, property vacancies, increases in property taxes and operating expenses, changes in zoning laws, losses due to environmental damages, changes in neighborhood values and appeal to purchasers, the possibility of failing to maintain exemptions from registration under the Investment Company Act of 1940 and, in many cases, relatively small market capitalization, which may result in less market liquidity and greater price volatility. REITs are also subject to the risk that the real estate market may experience an economic downturn generally, which may have a material effect on the real estate in which the REITs invest and their underlying portfolio securities. Investors should carefully consult all offering and legal documents to ensure suitability before investing.

Real Estate Investment Trust (REIT) - A company that purchases and manages real estate and/or real estate loans

Basis Point - One basis point equals one-hundredth of a percentage point, making it a precise way to discuss even very small rate movements.

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