TRINITY SMF

STUDENT MANAGED FUND

Real Estate Sector Report
2023-2024

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Table of Contents

Sector Overview

Real Estate Investment Trusts (REITs) are companies modelled after mutual funds, in which capital is pooled from investors and then used to operate and finance income-generating property. REITs can be appealing to investors as they present an opportunity to diversify their portfolio without making the large, lump-sum investment into purchasing real estate, or exposing themselves to the direct risks and burdens of owning and operating property. When buying a share of a REIT, one is essentially purchasing a claim to ownership of a physical asset, with a long-expected life span and potential for income through either rent or property appreciation. To qualify as a REIT, companies are required to pay-out 90% of their profits as dividends. In addition, 75% of its gross income must be from real property-related sources.

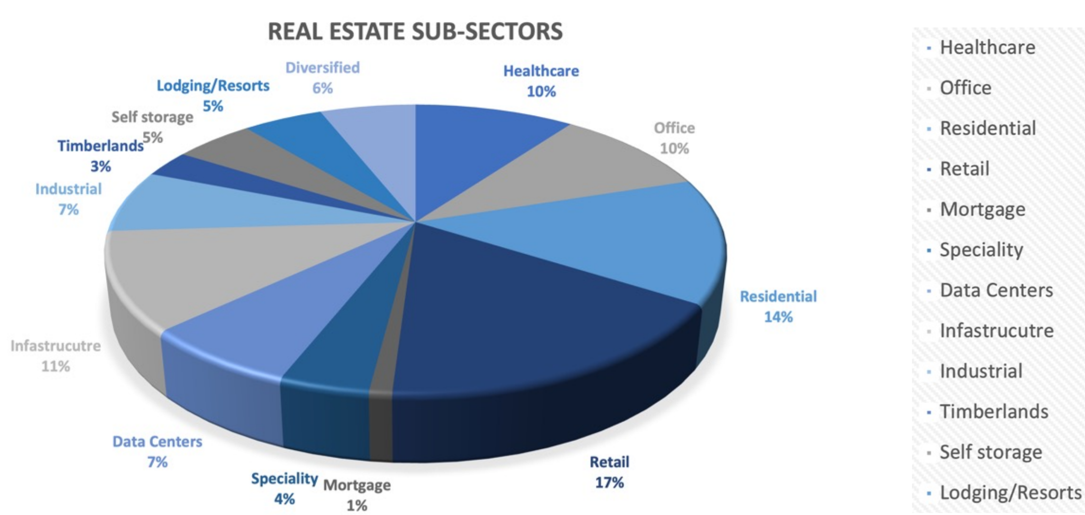
3 Types of REITs

Equity REITs: This type of REIT owns and manages income-generating real estate and generates income primarily through rents.

Mortgage REITs: Also known as mREITs, this type of REIT lends money to real estate owners and operators either directly through mortgages, or indirectly through a mortgage-backed security (MBS). Their earnings come from the net interest margin – which is the spread between the interest they earn on mortgage loans and the cost of funding these loans. Due to this earning model they are particularly sensitive to interest rate hikes.

Hybrid REITs: These REITs use investment strategies from both equity and mortgage REITs.

The global Real Estate market size was valued at $3.69 trillion in 2021 and is positioned to grow to USD $6.13 trillion by 2030, growing at a CAGR of 5.2% in the forecast period. The sector has historically been regarded as a hedge against inflation, with at least one commercial real estate (CRE) sector - multifamily, office, retail, or industrial – beating inflation in every period. This especially rings true for residential properties, as rental income usually rises in line with, or faster than, inflation.



Sector Overview

Types of Key Leases

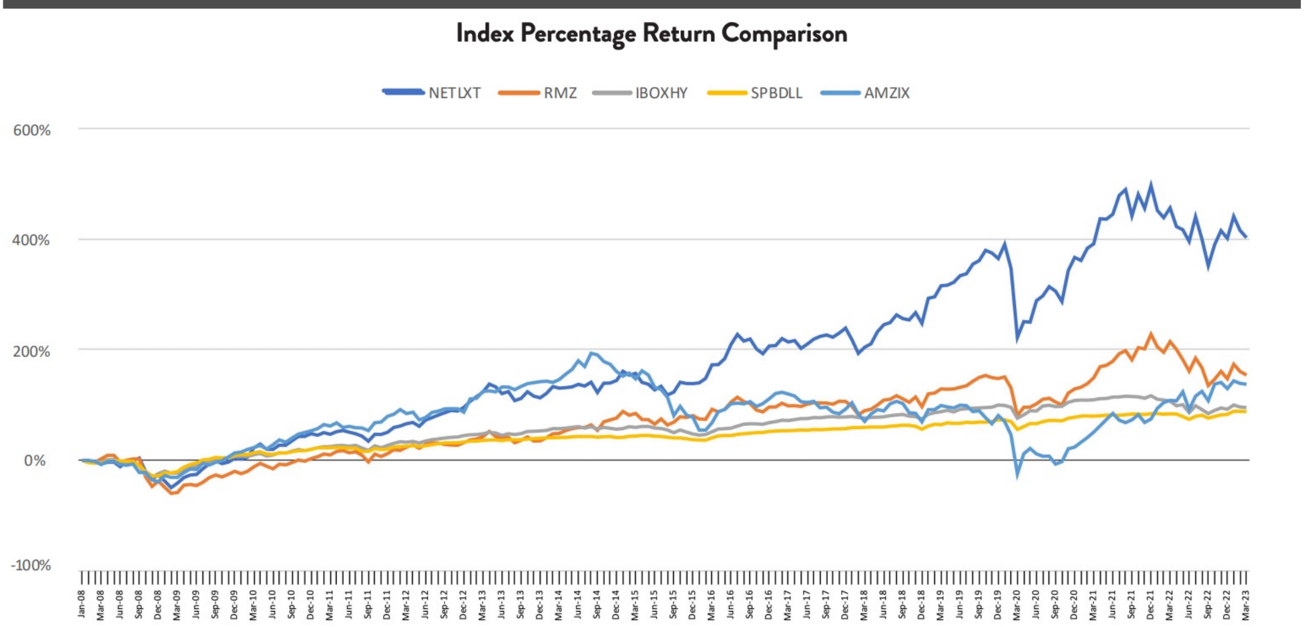
Understanding types of leases can help identify which REITs would perform better in different market conditions. For instance, leases with variable rental rates would lead a REIT to be exposed to the fluctuations within a market, making them more vulnerable in volatile market conditions and economic downturns. Three of the most common leases you'll see when analysing a REIT will be the following:

Single Net Lease: This a commercial real estate lease agreement in which the tenant agrees to pay property taxes in addition to rent.

Triple Net Lease: Also known as an NNN lease, tenants are required to pay the monthly rate alongside a portion of the 3 major expense categories; usually taxes, insurance and maintenance.

Absolute Net Lease: The tenant is required to pay the monthly rent and all of the property's operating expenses.

PERFORMANCE CHART



CAGR - Compound Annual Growth %

TICKER	INDEX NAME	YTD	1 YEAR	3 YEAR	5 YEAR	10 YEAR	JAN 2008 - Dec 2022
NETLXT	Fundamental Income Net Lease Real Estate Index	1.1%	-9.6%	16.0%	10.5%	8.4%	11.2%
RMZ	MSCI US REIT I	11.4%	-19.2%	12.0%	6.0%	5.9%	6.3%
IBOXHY	iBoxx USD Liquid High Yield Index	6.5%	-5.5%	3.5%	2.1%	2.8%	4.5%
SPBDLL	S&P/LSTA U.S. Leveraged Loan 100	12.1%	2.4%	6.5%	3.4%	3.3%	4.2%
AMZIX	Alerian MLP Infrastructure Index	14.4%	13.9%	46.3%	6.8%	0.6%	5.8%

Key Players & Performance Indicators

REIT Valuation Differences

REITs are often valued differently compared to regular companies. Most firms' assets, like vehicles and machinery, depreciate in value overtime because of continuous wear and tear. Whereas, for the vast majority of REITs' assets consist of land & property. As land never depreciates in value but rather appreciates over time, we must utilise a valuation method which takes this into account.

The most common way to compensate for this is through using a Price to Funds From Operations ratio (P/FFO), instead of the commonly used Price to Earnings ratio (P/E). The main difference and benefit of P/FFO is:

- P/FFO adds back depreciation and amortization
- P/FFO also subtracts any profits made from the one-off sale of an asset (as it doesn't reflect regular business operations of a REIT).

FFO = Net Income + Depreciation Expense + Amortization Expense + Losses on sale of assets)
- (Gains on Sale of Assets + Interest Income)

Building Permits

A building permit is the legal authorization given by a government to commence construction. The U.S. Census Bureau reports the total number of building permits issued monthly. This can be viewed as an indicator of growth or stagnation in particular segments of the economy. For example, if there is an increase in retail building permits (shopping centres, high street properties) this could indicate that there is an upsurge in consumer spending and retail companies are willing to expand to meet demand.

Housing Starts

A housing start refers to the start of construction on a new residential housing unit. Similar to building permits the number of housing starts are published monthly. As new housing results in additional consumer spending on goods such as furniture and appliances, it is a key economic indicator.

Housing start estimates are also seasonally adjusted as factors like weather can have seasonal effects on those numbers. Overall, month-to-month numbers can be volatile and are subject to large error margins, thus requires months of data to establish the underlying trend.

PMI

The PMI (also known as the Purchasing Managers Index) is a 'survey-based' index which aims to be a representative model of the industry through managers' inputs on purchase and supply trends. The PMI covers 18 sectors including all aspects of the manufacturing sector. Due to the timeliness of the reports, economic trends can be identified quicker before they reflect onto the whole economy. As this index can be utilised to view economic trends and peaks in purchases (or consumer behaviour), it is a key indicator for overall economic conditions.

Key Players & Performance Indicators

Non-farm payrolls

The non-farm payroll measures the number of workers in the US except for those working in the following sectors: farming, non-profit organisations and the military. Data on non-farm payrolls is collected and reported monthly. This data can reflect the state of the economy assessing the employment situation. Based on this data, government action may be taken to adjust unemployment rates. For example, the Fed may decrease interest rates to combat unemployment, leading to lower borrowing costs and increased activity in the real estate market.

Credit Conditions

Credit is the action or contractual agreement of providing finance to another party, and getting it back later with interest. Credit conditions, or rather lending practices among banks and other financial institutions, greatly affect the real estate market. Acquiring properties often requires loans and tightening on lending practices, or a shift in credit conditions, can affect the sentiment to do so.

Equinix
Market Cap: $73.97 Billion
Is a data centre REIT which is noted to have the largest portfolio concerning data centres.

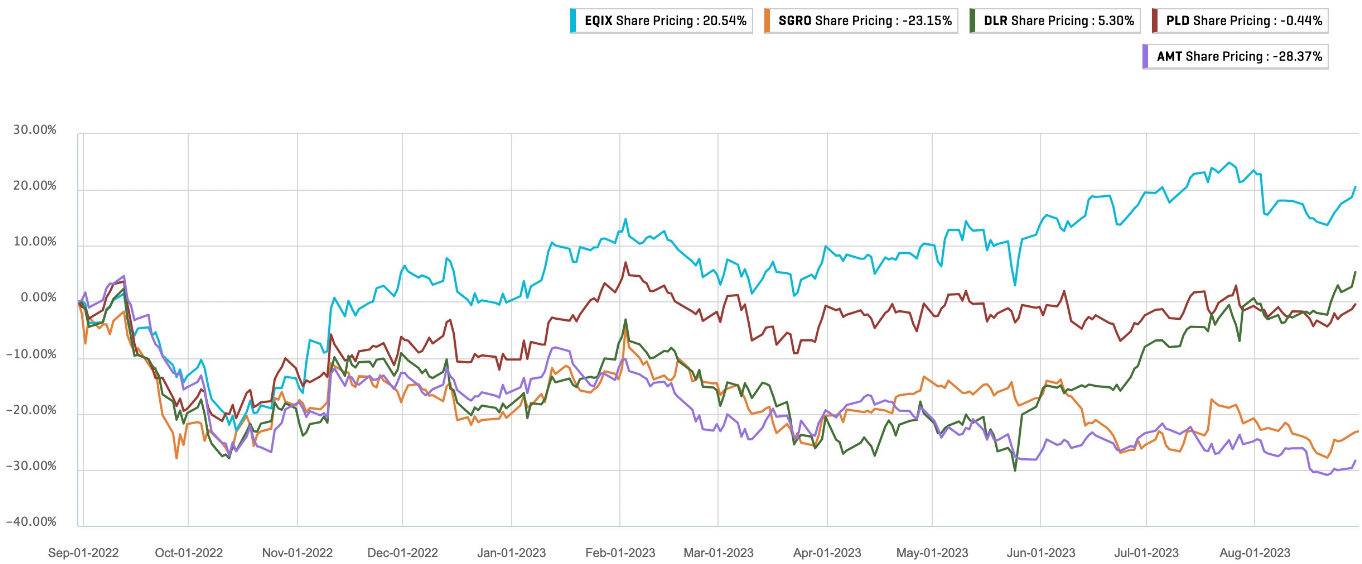
American Tower Corp.
Market Cap: $84.61 Billion
Operates a variety of different properties mostly in relation to the infrastructure and data centre sub-sectors. Properties include: data centres, cell and radio towers.

Prologis
Market Cap: $115.58 Billion
Operates logistics facilities which include warehouses and distribution facilities.

SEGRO
Market Cap: £9.06 Billion
A leading owner of warehouses and industrial property in the UK and wider Europe.

Digital Realty Trust
Market Cap: $39.46 Billion
A fast growing REIT focusing on network neutral data centers.

Current Climate



Real Estate is a cyclical sector making it susceptible to risk and volatility derived from the overall economic market. The sector within itself is also a crucial indicator of the overall economy's health as property prices and rent affect consumer spending.

The commercial real estate market (CRE), which groups properties that are used for business purposes, has recently seen a negative impact on the offices industry. The trend to move to remote working has kept offices vacant and have led to many companies terminating their leases. This presents the issue of companies and owners of office properties not being able to generate enough income to pay back loans, and ultimately damaging banks' stability. Big concerns about the commercial real estate market have especially arisen after the collapse of Silicon Valley Bank and the regional banking crisis. Morgan Stanley has stated that there is a global 10-15% office property over-supply.

Bank failures which occurred in March 2023 has led to restrictions on lending practices, creating difficulty for individuals to acquire mortgage loans. This issue has persisted particularly in the UK, as banks have increased mortgage rates after the Bank of England hiked its own borrowing costs to cool down inflation. Bloomberg reported that the average rate for fixed two-year home loans rose to 6.66% in July - the highest since August 2008 and just 0.28% shy of the rate of that time.

Key Player Performance

1) Equinix: 20.54%
2) Digital Realty Trust: 5.30%
3) Prologis: -0.44%
4) SEGRO: -23.15%
5) American Tower Corp: -28.37%

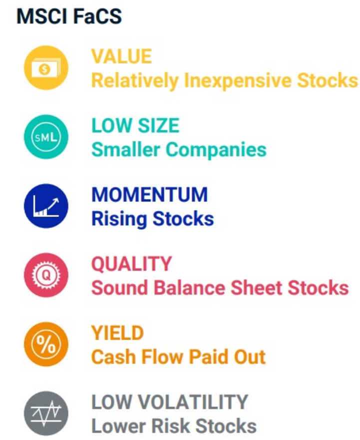
Current Climate

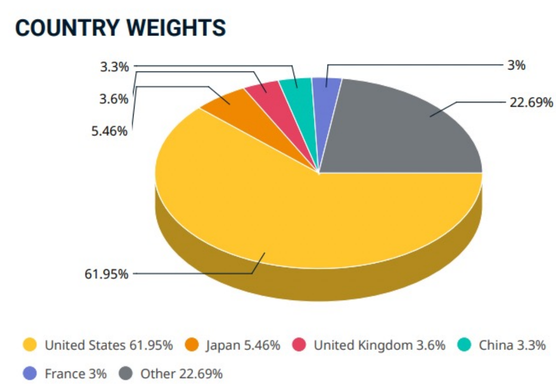
Rising interest rates have added uncertainty to the market as it drives down incentive to finance property. In doing so, it also makes other assets, namely bonds, more attractive and thus pulling away investors from the sector.

The FTSE Nareit Index Series categorises REITs based on type and location, providing a comprehensive benchmark of REIT stocks. MSCI ACWI represents the performance of large and mid-cap stocks across 23 developed markets and 24 emerging markets which covers nearly 3,000 stocks. Real Estate makes up 2.34% of the MSCI ACWI.

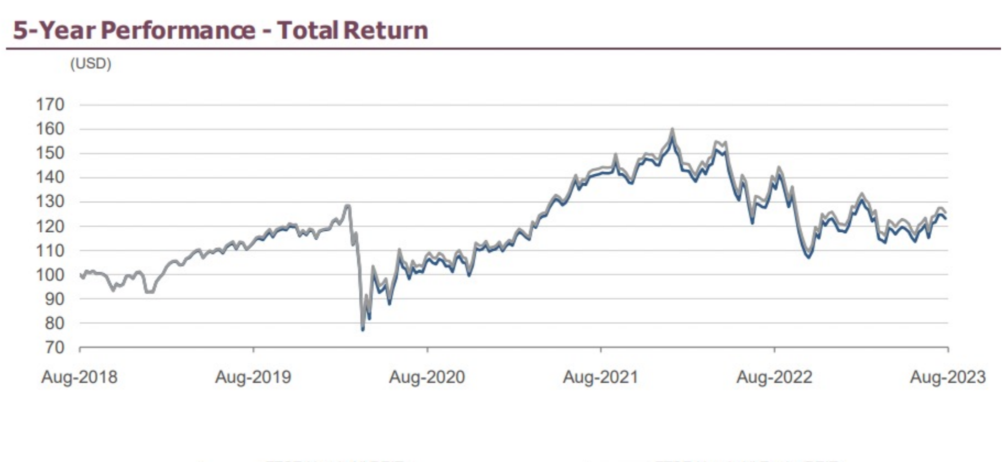
As of the 31st of July, FTSE Nareit All REITs reported a 5.3% return YTD in comparison to the MSCI ACWI 12.91%.

- MSCI ACWI -





- FTSE Nareit All REITs Index -



TOP DATA CENTER MARKETS BY NEW CONSTRUCTION (MW)

Source: Global X ETFs with information derived from: Albers, J. (2022, March 24). Americas data center update: Second half of 2021. Cushman & Wakefield.; Cushman & Wakefield. (2021, October 18). APAC data center update.; Fray, A. (2021, November 29). EMEA data centre update. Cushman & Wakefield.

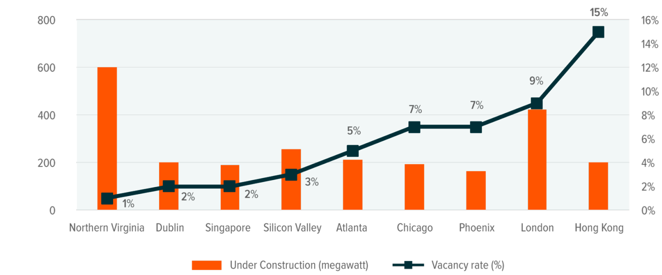


Chart 7: The RICS New Buyer Enquiries series is signalling a renewed fall in mortgage activity over the coming months

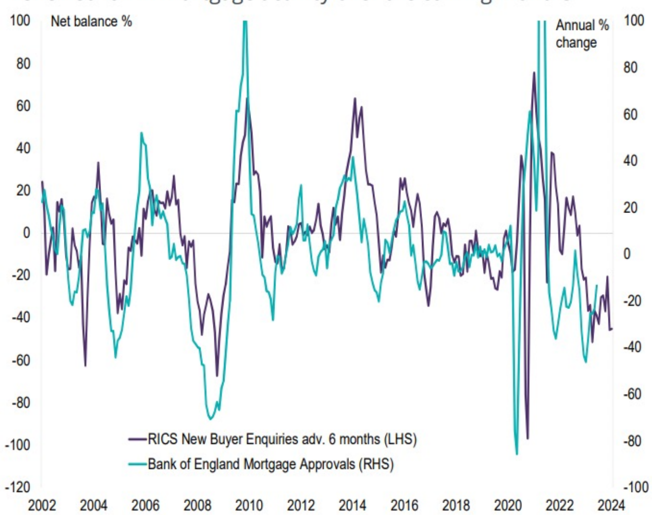
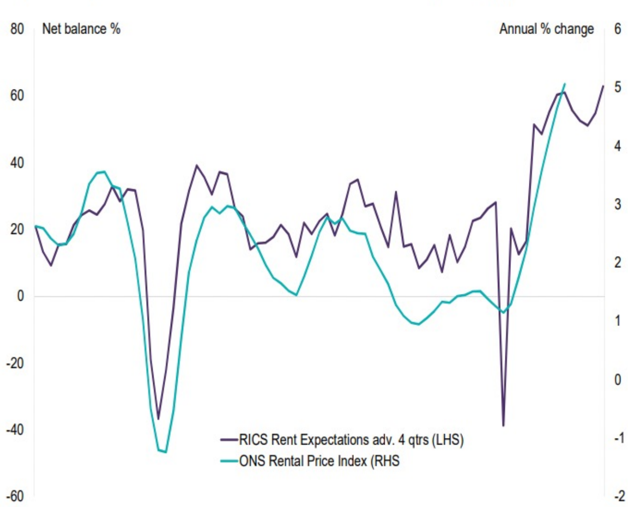


Chart 9: The RICS metric on rental expectations points to further upward pressure on rents as demand outstrips supply



Real estate is extremely diverse and flexible, as it can gain exposure to all other industries through subsectors. For instance, during the pandemic the healthcare industry experienced a peak in demand; this correlated to the resilience of healthcare REITs (operating hospitals etc.) during a time of wider downturn for the rest of the market. Growth within other sectors present opportunities for REITs which appeal to those property groups.

Digital Infrastructure

With new developments in technology and recent advances in AI, digital infrastructure has been noted to be a crucial sub-sector. Property types include data centres, cell towers and wireless infrastructure. 5G has been mainly driving the telecom industry similarly to how AI has sparked a new wave of interest in data centres.

The top graph to the left indicates new construction of data centres in a variety of regions including Hong Kong. As Asia presents to be a global hub for innovation and development, digital infrastructure developments in those areas will be crucial for growth.

Rental Property Demand

Interest rate hikes have made mortgages unappealing to many, as borrowing rates have become costly. This phenomenon has driven people to rent instead of outright buying, property. This situation is most severe in the UK. The two graphs to the left signal consumer sentiment towards the mortgage and rental markets. The first graph indicates a perpetuated fall in interest towards mortgages whereas the graph below affirms the current lack in supply for rental homes as demand heightens.

Current supply of rental homes within the UK cannot meet demand. This presents as an area for growth within the rental/residential REIT market.

Priced in Sector Drivers

Interest Rates

Interest rates have a major impact on the real estate market as it is a decisive element in consumer's ability to purchase property. This is due to the correlation between interest rate hikes and lending rates. Lower interest rates allow for lower mortgages, increasing consumer incentive to enter the market. In return, this trend can lead to heightened demand leading to higher property prices. As interest rates rise, the cost of a mortgage increases, thus lowering demand and real estate prices.
Interest rates and REITs' market appeal are highly correlated. When rates decrease, REITs' high yields become more appealing and their prices go up. When interest rates increase, the yield on a REIT becomes less attractive, thus investors are incentivized to put their money in other higher-yielding bonds. This transfer of capital from real estate to government bonds can also push the price of REITs down.

Global banks have increased interest rates this past year to combat inflation; however in doing so this has created mass uncertainty for the real estate market. With UK interest rates increasing to 5% in June, the cost of borrowing hasn't been this high since 2009. Specialty and to some extent healthcare REITs have become more favorable as they are more resilient against the economic cycle and perform better during economic uncertainty. One example of such a company would be Healthpeak Properties (NYSE:PEAK), which although has slightly underperformed the industry, maintained favorable ratios against their peers and industry (19.7x PE ratio and 11.5x PFFO ratio).

Euro Area Bank Interest Rate Hikes

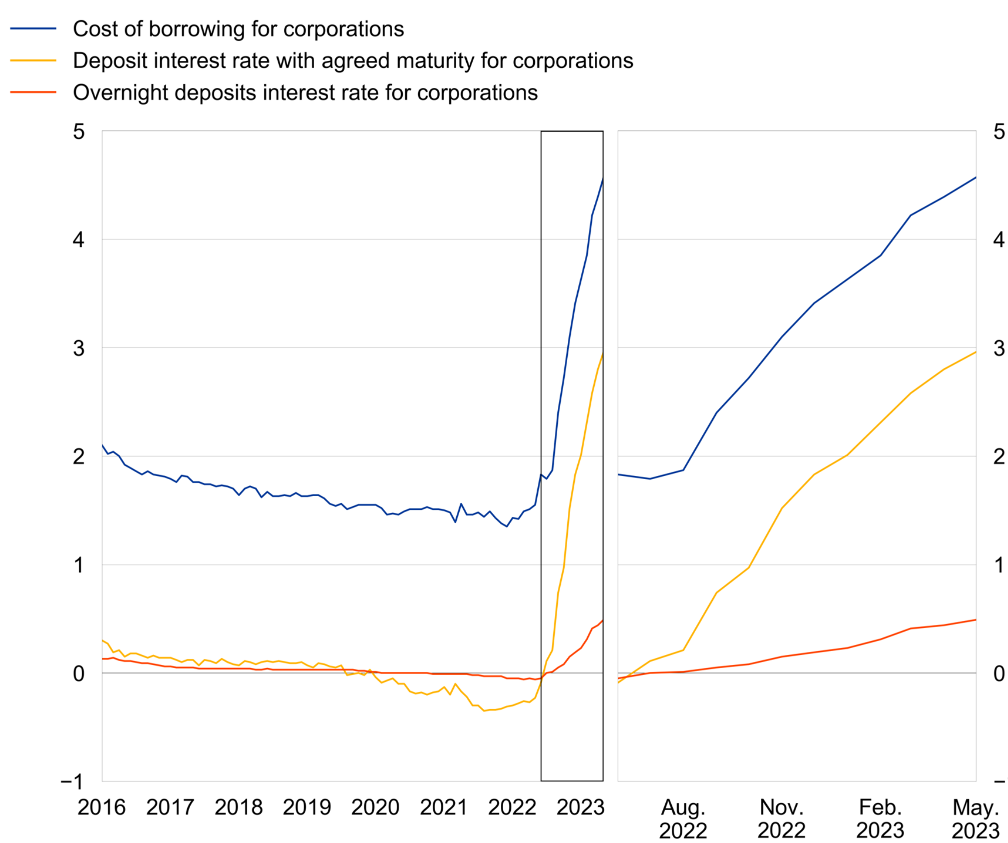
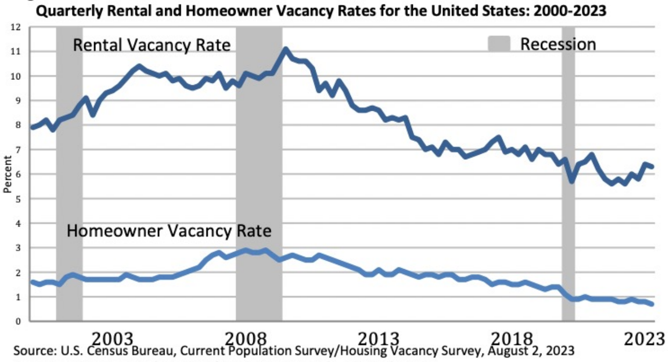
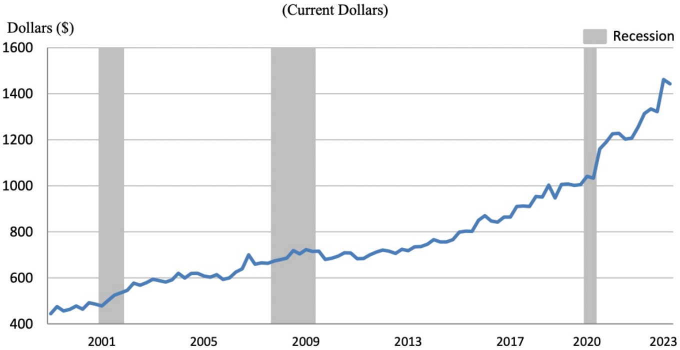


Figure 1
Quarterly Rental and Homeowner Vacancy Rates for the United States: 2000-2023



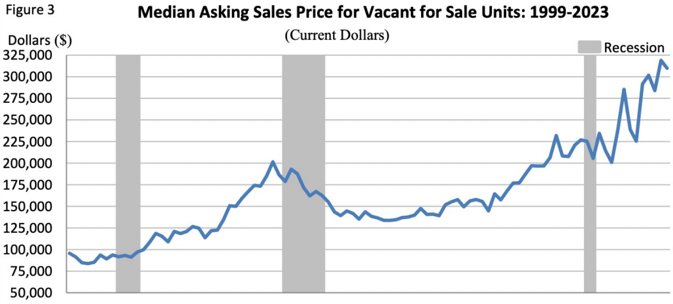
Source: U.S. Census Bureau, Current Population Survey/Housing Vacancy Survey, August 2, 2023
Recession data: National Bureau of Economic Research, <www.nber.org>

Figure 2 **Median Asking Rent for Vacant for Rent Units: 1999-2023**
(Current Dollars)



Source: U.S. Census Bureau, Current Population Survey/Housing Vacancy Survey, August 2, 2023

Figure 3 **Median Asking Sales Price for Vacant for Sale Units: 1999-2023**
(Current Dollars)



Source: U.S. Census Bureau, Current Population Survey/Housing Vacancy, August 2, 2023

Rental Vacancy & Occupancy Rates

The rental vacancy rate measures the degree to which a building space goes unused and is primarily used as a metric in the US.
Occupancy rates are essentially the inverse of vacancy rates, as a low vacancy rate indicates that the occupancy rate is high. Low vacancy rates reflect strong demand for construction operators in the industry, especially for commercial REITs.
The graphs to the left depicts US Vacancy rates as well as rent pricing.

Consumer Confidence

Overall economic conditions often affect consumer confidence which subsequently determines the consumer's perception of job security, financial stability and influence financial decision making such as home ownership.
The public confidence in the Bank of England is at a record low as they struggle to manage inflation, which has led to more uncertainty. This economic climate combined with a decreasing need for commercial space with an added push for remote working has caused commercial and residential REITs to underperform.

Labour Market

The labour market and real estate sector present a tight correlation as negative employment rates often results in government interference through rise of interest rates. Rate hikes ultimately drive consumer spending directed at properties. Additionally, growth in sub-sectors, namely commercial (CRE) presents new job opportunities for the region. For instance, the construction of a shopping mall ultimately results in new job positions being generated. Stability in the job market also indicates consistent income which generates potential for higher priced property sales.

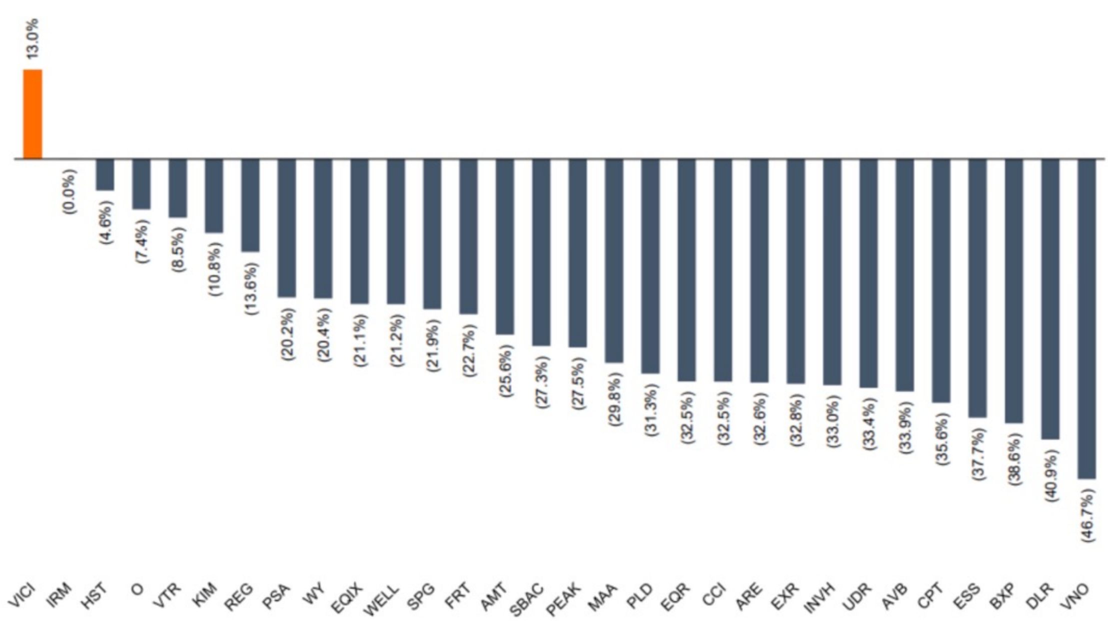
Case Study

VICI Properties (NYSE: VICI)

VICI Properties Inc. is an S&P 500 real estate investment trust that owns one of the largest portfolios of market-leading gaming, hospitality and entertainment destinations. VICI Properties' geographically diverse portfolio consists of 50 gaming facilities across both the United States and Canada comprising approximately 124 million square feet. Its properties are occupied by industry leading gaming and hospitality operators under long-term, triple-net lease agreements, occupying a great portion of the Las Vegas Strip.

VICI falls under the category of 'Specialty REITs' for owning and managing a unique mix of property types. It has demonstrated exceptional resilience through all major world events throughout the recent years, even outperforming the entire REIT sector and all S&P 500 REITs in 2022 by being the only one to generate positive returns (13%). They have also released a Q2 report, showing total revenues and Adjusted FFO per share increasing 35.5% and 12% year-over-year respectively (AFFO is an improved version of the previously mentioned P/FFO ratio, because it takes costs into consideration). These strong performance results, coupled with the promising start of VICI's international operations, makes it why VICI has become a Moderate-Strong buy among analysts.

Several risks still stand, such as the barrage of interest rate hikes in the past few months, inflation, and its over-dependence on some of its larger tenants, such as Caesars Entertainment and MGM Resorts who each account for 40% and 36% of its annualised cash rent respectively. Although VICI may be heavily dependent on these property's tenants, it is crucial to note that the tenants are also dependent on the property. As these properties are entertainment based the property itself is an element of what attracts customers to the hotels and casinos. The property has its own personality as seen on the Las Vegas Strip; for the company to preserve their brand they must also preserve the property thus making them an ideal tenant for longevity.



VICI outperformed all other S&P 500 REITs in 2022 on a Total Stock Return Basis

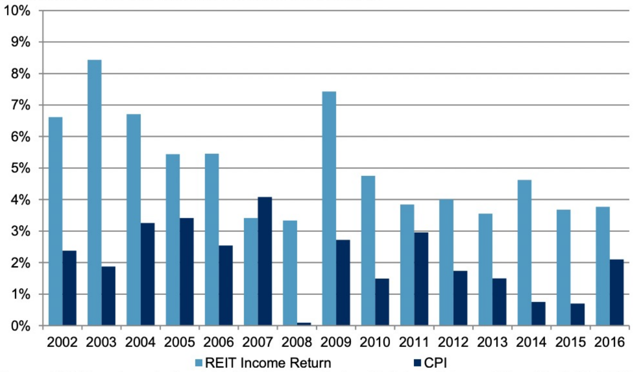
Risks

Inflation

Inflation is a decrease in the purchasing power of money, reflected in a general increase in the price of goods and services in an economy. This phenomenon obviously affects all subsectors in some way, whether it be decrease in rents, increase in defaults on loans, or increasing maintenance costs.

Historically however, real estate has always been considered as a safe harbour against inflation, as property value often appreciates along with inflationary trends. This allows for investors to benefit from property investments during inflation. The most inflation-resistant REITs will also often have rent escalations built into their leases, meaning rents automatically rise with inflation.

Exhibit 3: REIT Income Has Outpaced Inflation

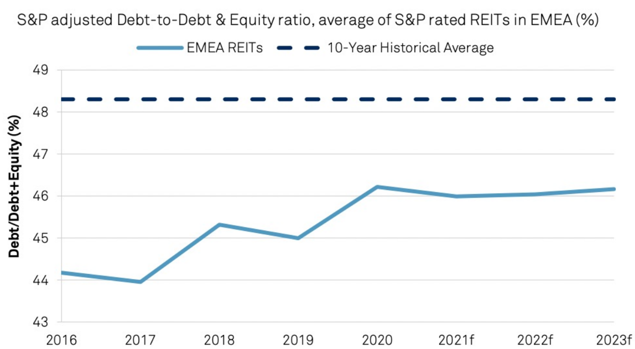


Source: S&P Dow Jones Indices LLC; The Bureau of Labor Statistics. Data as of Dec. 30, 2016. REIT Income Return is calculated as the annual difference in return between the Dow Jones U.S. Select REIT Index (PR) and Dow Jones U.S. Select REIT Index (TR). Past performance is no guarantee of future results. Chart is provided for illustrative purposes.

Debt

As REITs are required to pay out 90% of their taxable income there doesn't leave much to be utilised for growth. Thus, REITs take on large amounts of debt, often a bigger amount than other companies, in order to facilitate the acquisition of new properties and overall grow the company. In times of economic downturn or a tightening in lending practices, this can significantly damage a REITs finances if they are heavily dependent on bank loans. Additionally, if the loan does not have a fixed interest rate (known as floating rate debt) the company becomes highly susceptible to risks concerning rate hikes.

Debt-to-Debt And Equity Should See Limited Decline Potential In 2022-2023



Interest Rates

In most cases, REITs utilise a combination of both debt and equity to finance the purchase of new properties. Because of this, they are far more sensitive than other asset classes to changes in interest rates, particularly those that use variable rate debt.

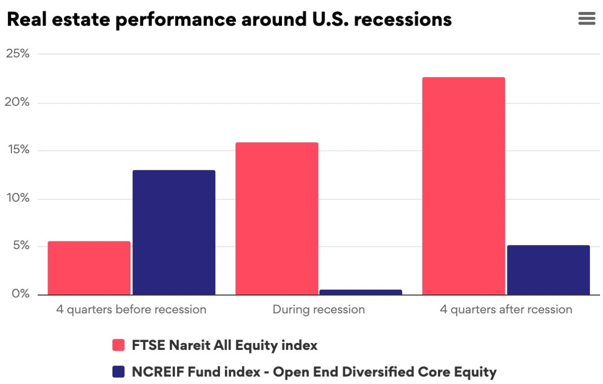
As depicted in the table to the right; since the early 1970s, there have been six periods during which 10-Year U.S. Treasury Bond yields rose significantly. In four of those six periods, U.S. REITs earned positive total returns, and in half of those periods, U.S REITs outperformed the S&P 500. The S&P 500 outperformed U.S. REITs in only two of these periods.

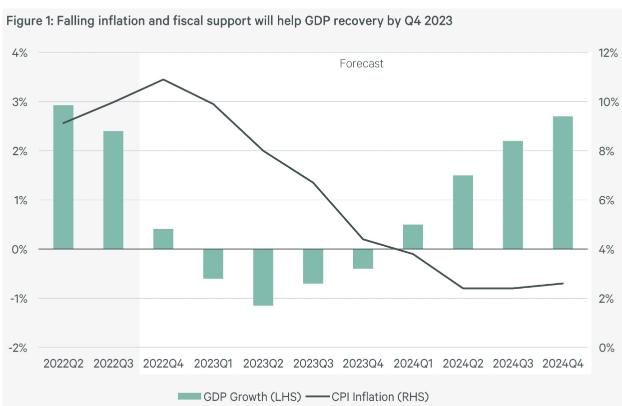
Exhibit 2: REIT Performance During Sustained Periods of Rising Interest Rates

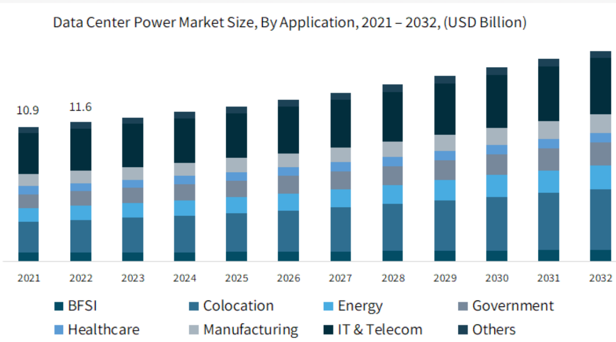
TIME PERIOD	U.S. 10-YEAR TREASURY YIELD			CUMULATIVE TOTAL RETURN OVER PERIOD		
	BEGINNING YIELD (%)	ENDING YIELD (%)	CHANGE (%)	REITS (%)	STOCKS (%)	DIFFERENCE (%)
December 1976-September 1981	6.9	15.3	8.5	137.4	46.0	91.4
January 1983-June 1984	10.5	13.6	3.1	35.6	16.5	19.1
August 1986-October 1987	7.2	9.5	2.4	-10.1	10.9	-21.0
October 1993-November 1994	5.3	8.0	2.6	-10.3	0.1	-10.3
October 1998-January 2001	4.5	6.7	2.1	27.4	27.8	-0.4
June 2003-June 2006	3.3	5.1	1.8	108.2	37.6	70.6

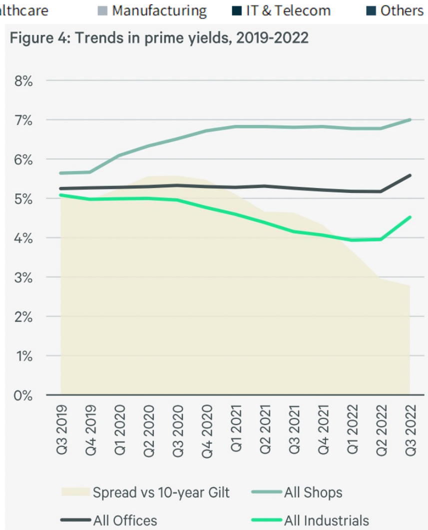
Source: S&P Dow Jones Indices LLC, Bloomberg, The Federal Reserve. REIT total returns are based on the FTSE/NAREIT Equity Index from Dec. 31, 1971, to Dec. 31, 1986, and they are based on the Dow Jones U.S. Select REIT Index after Dec. 31, 1986. Stock total returns are based on the S&P 500. Past performance is no guarantee of future results. Table is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

Strategy for the Year Ahead









Real estate has historically been an outperforming sector in times following a recessionary period, which shows potential for the sector in the coming months.

Within the US Economy inflation has cooled down to 3% however it is still above the Fed's target of 2%. With rate hikes on a 'pause' this economic situation perpetuates uncertainty for the real estate market. Analysis of the EU's PMI has seen a contraction in the region's economy. Growth within the eurozone was recorded to be 0.3% for Q2 and 0.1% for Q1. Sluggish growth is expected to persist in both regions however as inflation eases overall predictions suggests a pick-up in growth entering 2024.

Data centre REITs accounted for 8.8% of equity market capitalisation of the FTSE Nareit All Equity Index as of June 30, 2023. Data centre T-Tracker stats have also shown that, on average, both funds from operations and net operating income experienced 15.0% year-over-year gains. Alongside pushes from AI, the data centre market has become increasingly attractive as many REITs within the sector also expand to APAC.

As inflation slows and the labour market remains tight, these economic conditions foster an environment for **retail REITs** to thrive. Barclays has presented a bullish stance on the sector for 2024 when a soft landing of the US economy has been predicted.

The single biggest component of the Consumer Price Index - housing costs - continues to be the main driver of inflation, rising twice as fast as other components as of August 2023. While high rates have cooled the housing market - sales of existing homes were down 20% in May in comparison to the previous year. Home prices have remained stubborn due to a lack of supply. As we are observing a higher renting youth population, **residential REITs** pose to be a key player within the next year. Moreover, Single-Family Rental REITs (SFR REITs) are of high appeal as rental rates steady and rent growth cools.

Looking forward the data centre, retail and residential sub-sectors have potential for growth in the coming months which our sector will be focusing on.