Lazard Global Real Estate Securities
US Real Estate Indicators Report

NOV 2017

US real estate investment trusts (REITs) were essentially flat in October, returning 0.03%[1], and have been generally range bound for most of 2017 as the market has focused on higher-growth industries and concerns about a slowdown in the proverbial real estate "cycle". While this lackluster performance has caused the REIT sector to substantially underperform broader equities by in excess of 1,000 basis points (bps) for the year, REITs have still posted 5.9% year-to-date returns and are positioning to record a ninth straight year of positive total returns. In addition, over the last 15 years (in order to pick up the full impact of the financial crisis for comparison), equity REITs have annualized returns of 10.98% as compared to 10.04% for the S&P 500 Index and have also outperformed the S&P 500 Index over 20-, 30-, and 40-year time periods.

Most commercial real estate sectors are performing well, though after multiple years of recovery, property-level growth is slowing marginally. With the third quarter earnings season effectively complete, 2017 expectations have held steady with approximately 80% of REITs meeting or beating third quarter estimates and 57% raising 2017 guidance.[1] However, while many companies have not issued 2018 guidance, of those that did, the majority issued below current estimates and noted a more cautious stance on next year. To that end, the tough response to REITs during the earnings season suggests that investors remain skittish as performance gaps are widening between both sectors and regions as slack demand, new supply, and/or margin pressures are hitting some pockets of the real estate market. There has historically been a wide yearly performance gap between different sectors, but 2017 is proving to be excessive in this regard with distinct have and have-nots. On the "have" side, industrials, multifamily and diversified (namely technology-related REITs) have been the leading sectors. The "have nots" are primarily retail REITs which are battling negative sentiment and select erosion in some fundamentals due to underlying retail tenant health.

The results also suggest that we are in a mature phase of the cycle, (likely in the later stages of that phase). Most of the core sectors show slowing underlying property net operating income (NOI) growth with estimates for 2017 in the mid-to-low 3% range. Looking forward to 2018, the overall economic climate remains constructive to the real estate asset class with GDP and jobs growth bolstered by high consumer and business confidence and some cooling in construction levels in recent months that will ease new supply deliveries.

Finally, even though legislators are still working through the initial Republican tax plan proposal, it seems to us that the real estate industry will not be impacted negatively. To date, continuation of interest expense reductions, maintaining the 1031 exchange, and REIT dividends potentially taxed at 25% are supportive to real estate. In addition, any change to home mortgage deductibility would be an added tailwind to single-family rental and multifamily REITs.

US Real Estate Market Returns

(%; cumulative)	1 Month	3 Months	1 Year	3 Years	5 Years	YTD
SNL US REIT Equity	0.0	-0.2	8.2	22.7	62.0	5.9
MSCI US REIT (RMS)	-1.0	-1.3	5.6	18.7	57.7	2.6
S&P 500	2.3	4.7	23.6	35.9	102.7	16.9
Russell 3000	2.2	4.8	24.0	35.0	102.2	16.4

US Real Estate Market Returns by Property Type

(%; cumulative)	1 Month	3 Months	1 Year	3 Years	5 Years	YTD
Diversified/Other	-0.3	-0.5	11.9	19.0	45.6	9.2
Health Care	-3.8	-6.7	-1.6	5.9	31.7	2.0
Hotel	2.5	3.8	28.4	4.7	82.6	4.7
Industrials	1.8	5.4	24.2	62.4	117.4	21.5
Multifamily	1.3	-1.2	14.1	35.1	76.7	8.2
Office	-1.2	-1.0	6.4	14.9	53.6	-0.8
Regional Mall	-3.8	-6.1	-16.2	-11.9	14.0	-15.2
Community Retail	-4.3	-8.3	-18.9	-8.3	23.5	-18.3
Self-Storage	-1.3	5.3	5.5	30.9	95.5	-0.2

As of 31 October 2017

For illustrative purposes only. The performance quoted represents past performance. Past performance is not a reliable indicator of future results. This is not intended to represent any strategy or product managed by Lazard. The indices are unmanaged and have no fees. One cannot invest directly in an index.

Source: FTSE, NAREIT, Standard and Poor's

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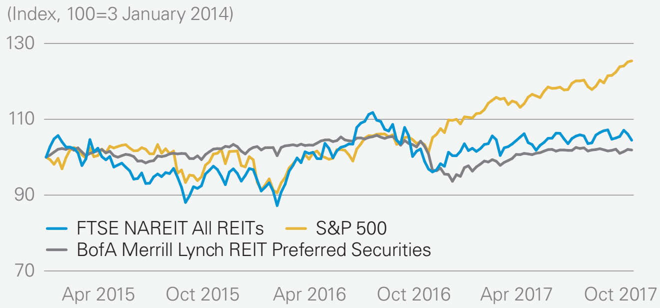
Listed Real Estate Market Performance

Cumulative Returns



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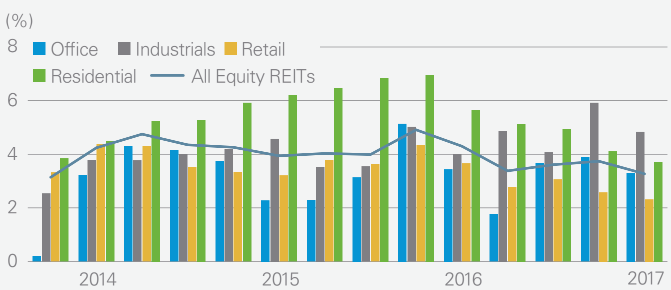
Source: Bloomberg

REITs continue to struggle as broader equities have not had a down month since Fall 2016, growth is favored over value (which is where REITs are generally catalogued), and real estate appears to be in a late mature phase of its cycle. Further, REIT trading behavior has been very range bound throughout the year, with the stock prices essentially oscillating between +/- 4%. However, the aggregate numbers do hide a wide discrepancy in sector performance with almost a 40-percentage point return difference between the best (industrials) and worst (regional mall) sectors. REIT preferred securities have benefited from the yield environment, gaining 7.4% this year.

Real Estate Fundamentals

Same-Store Net Operating Income (NOI) Growth



As of 31 October 2017

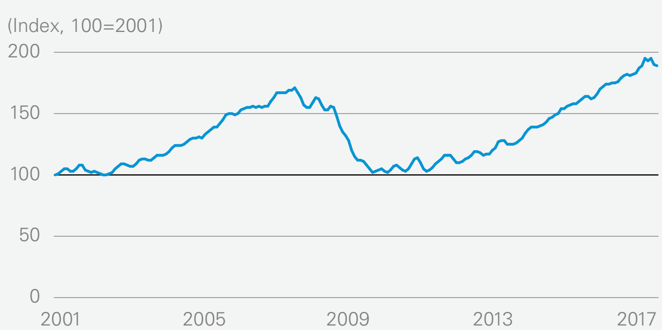
Forecasted or estimated results do not represent a promise or guarantee of future results and are subject to change.

Source: NAREIT 2017, S&P Global Market Intelligence

Property-level NOI growth is moderating, but continues to trend above inflation. A combination of solid economic growth and moderate levels of new construction can help NOI growth remain at a rate above inflation. After increasing by 3.8% in the first quarter, same-store NOI growth slowed in the second quarter with estimated growth of approximately 3.3%, which should be sustained. However, not all sectors are at the same point in the overall cycle. Business-orientated sectors are leading, the industrials sector is enjoying strong growth, and the office sector is accelerating slightly. In contrast, earlier recovering sectors such as apartments are moderating.

Underlying Property Values

US Investment Grade Composite Index — Equal Weighted



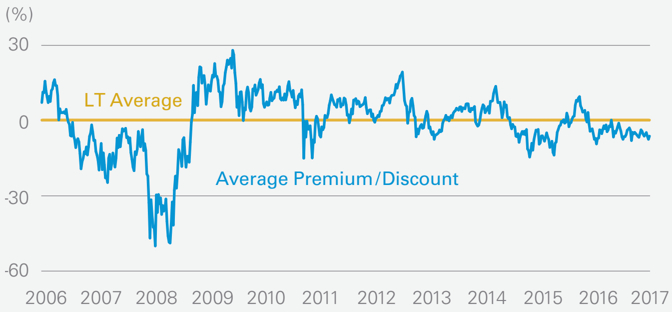
As of 31 October 2017

Source: Real Capital Analytics

US property prices fell from recent peak levels, down 2.9% over the last three months.[2] Prices are still up 4.5% for the year, and 11% above prior peak levels. Commercial real estate continues to benefit from increased allocations across most investor categories globally, which has led to significant amounts of "dry powder" for real estate investments with over 60% of institutions under-invested relative to target allocations.[3] Near term, there is a lack of product for sale, both on the individual and portfolio levels. On average, monthly sales volumes are down 11% from 2016 primarily due to a large decline in CBD office sales.

Listed Real Estate Valuations

Premium/Discount to Underlying Net Asset Value



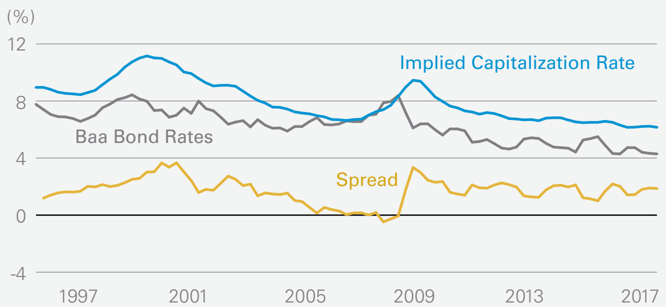
As of 31 October 2017

The REIT market as represented is a basket of 53 large and investable REITs across all sectors, as identified and selected by SNL Financial. The basket also includes companies that over time have gone private or merged in order to avoid survivor bias in the historical data.

Source: SNL Financial

REIT valuations have been trending at slight discounts since Fall 2016. This is below the sector's 2%–3% long-term average premium and its close-to-zero average premium since 2005. Property sales suggest that prices continue to creep higher.[4] The discount to NAV in late 2007 preceded a downturn in property prices, but in the three times (current time frame excluded) since then, when REITs traded at a NAV discount, a property price correction did not materialize. The combination of solid demand for US assets from both foreign and domestic investors and a steadily growing economy should support asset prices even with a moderate rise in yields. However, the recent geopolitical instability could affect inbound foreign capital.

REIT-Implied Capitalization Rate Spread to Baa-Rated Bonds



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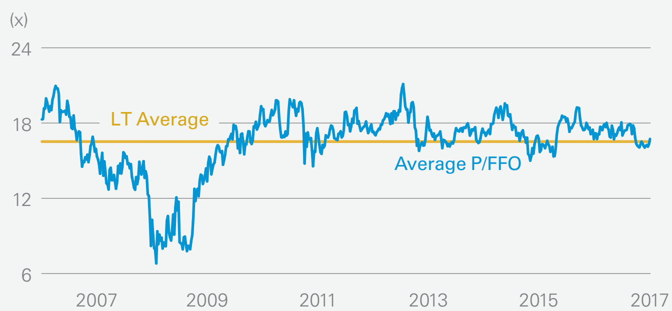
Source: SNL Financial

Corporate Baa bond yields have been generally flat for a few months as economic and inflation growth expectations have moderated from the initial election euphoria. Year to date, Baa bond yields have fallen by approximately 40 bps. This has caused the spread between REIT implied cap rates and the yield on Baa bonds to widen by approximately 40 bps. The current spread of 190 bps is 90 bps higher than at the beginning of 2016.

Further rate hikes can jeopardize this cushion, but for now suggest that **relative** value remains solid within the real estate space.

Price-to-Funds from Operations (P/FFO)



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Source: SNL Financial

REIT P/FFO valuations have moderated as earnings have been growing faster than price appreciation and are now trading at its long-term average of 16.5x P/FFO multiple. Third quarter earnings have been slightly better than expected, due partially to earnings guidance feeling overly conservative. REIT earnings remain very stable and have grown in the mid-to-single digits annually. With dividend payout ratios still low, this earnings growth should translate into comparable dividend growth. REIT 5%–7% earnings growth expectations in 2017 and 2018 are not that different than the 6% third quarter S&P 500 earnings growth, but is below the 10% growth expectations for 2018.

Note: P/FFO is the standard REIT equivalent of the price-to-earnings (P/E) ratio.

Notes

1 Source: S&P Global Intelligence

2 Source: CoStar Commercial Real Estate Investment Grade Index

3 Source: Hodes Weill 2017 Institutional Real Estate Allocations Monitor

4 Source: CoStar US Composite Index

Important Information

Published on 16 November 2017.

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Equity securities will fluctuate in price; the value of your investment will thus fluctuate, and this may result in a loss. Securities in certain non-domestic countries may be less liquid, more volatile, and less subject to governmental supervision than in one's home market. The values of these securities may be affected by changes in currency rates, application of a country's specific tax laws, changes in government administration, and economic and monetary policy. Small- and mid-capitalization stocks may be subject to higher degrees of risk, their earnings may be less predictable, their prices more volatile, and their liquidity less than that of large-capitalization or more established companies' securities. Emerging markets securities carry special risks, such as less developed or less efficient trading markets, a lack of company information, and differing auditing and legal standards. The securities markets of emerging markets countries can be extremely volatile; performance can also be influenced by political, social, and economic factors affecting companies in emerging markets countries.

Fixed income and preferred securities are subject to credit risk, interest rate risk, and call and reinvestment risk. The strategy's investments in lower-rated, higher-yielding securities are subject to greater credit risk than its higher-rated investments. Junk bonds tend to be more volatile, less liquid, and are considered speculative, and a strategy may not be able to sell certain securities at the time and price it would like.

Non-domestic securities carry special risks, such as exposure to currency fluctuations, less developed or less efficient trading markets, political instability, a lack of company information, differing auditing and legal standards, and, potentially, less liquidity. The strategy may invest in a smaller number of issuers than other, more diversified, investment portfolios, and therefore the strategy's net asset value may be more vulnerable to changes in the market value of a single issuer or group of issuers and may be relatively more susceptible to adverse effects from any single corporate, industry, economic, market, political, or regulatory occurrence.

Derivatives transactions may cause a strategy to experience losses greater than if the strategy had not engaged in such transactions. Investments in derivatives are subject to many of the risks of, and can be highly sensitive to changes in the value of, the related security or index. As such, a small commitment to derivatives could potentially have a relatively large impact on a strategy's performance.