EVOLVE ETFs

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Why REITs Now?

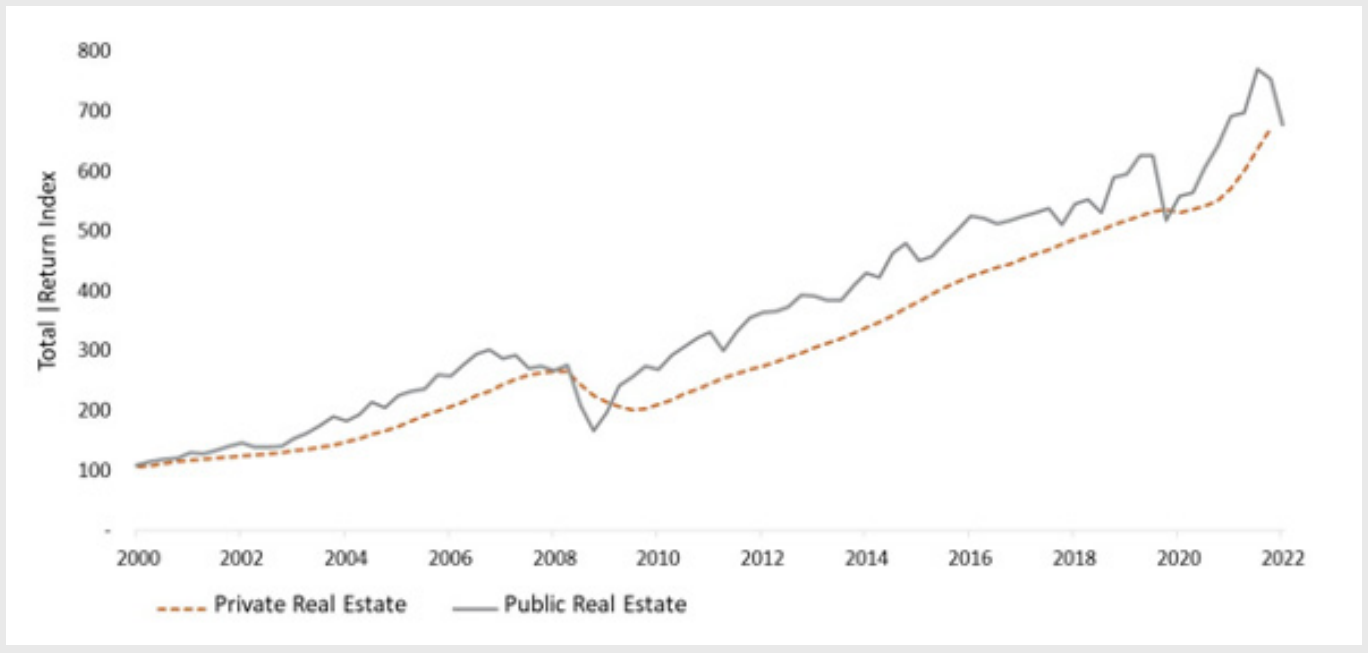
October/November 2022

REITs Are Real Estate

While over 90% of global real estate assets are privately held, the listed nature of REITs leads to an outsized contribution of information about the overall real estate market. This transparency allows investors to form a dynamic view on holdings, rental metrics, financials, market outlook and valuation between publicly listed and private real estate. REITs react in real time to market conditions and tend to trade at a premium or a discount to the intrinsic value of their property portfolio on the private market. While REITs behave like stocks in the short-term, they behave like real estate with a clear "lag effect" in the long-term (Exhibit 1). Ultimately, they provide stable and growing income from real estate properties and exposure to very diversified sectors and geographies but with the advantage of liquidity provided via the public markets.

REITs and direct Real Estate are almost the same...with a clear "lag effect"

Exhibit 1: Public vs Private Real Estate – "Lag Effect"



As of June 30, 2022. Sources: Bloomberg. Public real estate is represented by the Financial Times Stock Exchange National Association of Real Estate Investment Trusts ("FTSE NAREIT") Equity REIT Index and private real estate by the National Council of Real Estate Investment Fiduciaries ("NCREIF") Property Index.

REIT Valuations Appear Attractive

The relationship between REIT stock prices and the value of their assets in the private market is called the price to net asset value ratio (P/NAV). Today's rapid change in inflation and interest rate increases have made for a challenging investment environment while private real estate values have yet to correct. REIT prices, however, have adjusted quickly and are currently trading at a significant P/NAV discount, the cheapest seen in over a decade. The current P/NAV dislocation has only happened on three other occasions in the past 23 years: in 2000, 2008/2009 and March 2020 (Exhibit 2).

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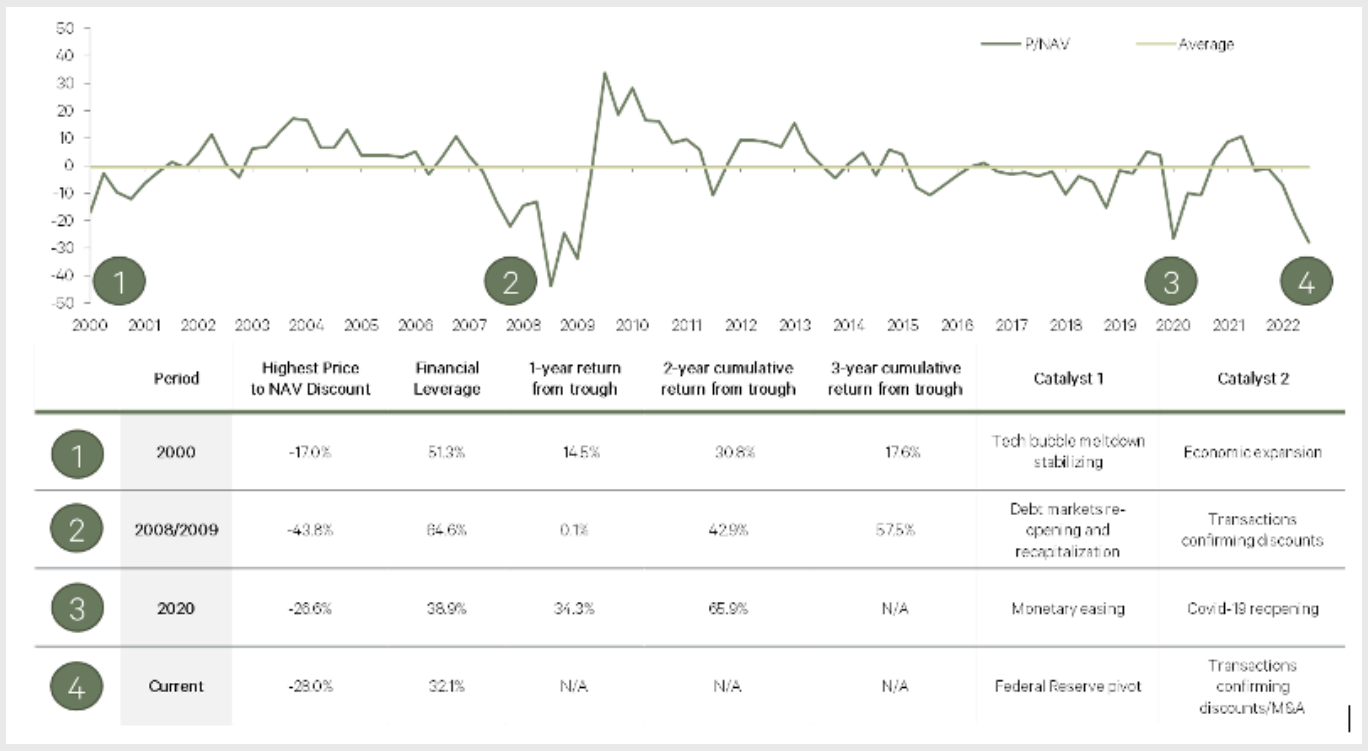
Exhibit 2: Price to NAV Premium/Discount – U.S. REITs Example



	Period	Highest Price to NAV Discount	Financial Leverage	1-year return from trough	2-year cumulative return from trough	3-year cumulative return from trough	Catalyst 1	Catalyst 2
1	2000	-17.0%	51.3%	14.5%	30.8%	17.6%	Tech bubble meltdown stabilizing	Economic expansion
2	2008/2009	-43.8%	64.6%	0.1%	42.9%	57.5%	Debt markets re-opening and recapitalization	Transactions confirming discounts
3	2020	-26.6%	38.9%	34.3%	65.9%	N/A	Monetary easing	Covid-19 reopening
4	Current	-28.0%	32.1%	N/A	N/A	N/A	Federal Reserve pivot	Transactions confirming discounts/M&A

Source: S&P Capital IQ, Nareit T-Tracker, Green Street Advisors. Data as of September 30, 2022. U.S. REIT returns represented by FTSE NAREIT All Equity REITs Index

Having access to REITs on a global basis allows for exposure to many different sectors that have significantly different operating fundamentals and P/NAV values. Active management is required to choose where to take advantage of dislocations. For example, multi-residential is at its cheapest level in more than a decade, as investors digest the impact of slowing growth rates, government regulation, and cost of debt. Our models indicate embedded revenue growth of mid single digit for 2023, without any additional market rent increases, which should sustain above average growth. Same for industrials, which was a very expensive sector over the last few years but traded down in April over news from Amazon slowing down their expansion. Given that Amazon is only a part of the story, there are many opportunities in this sector as stocks are at the cheapest level in the past decade.

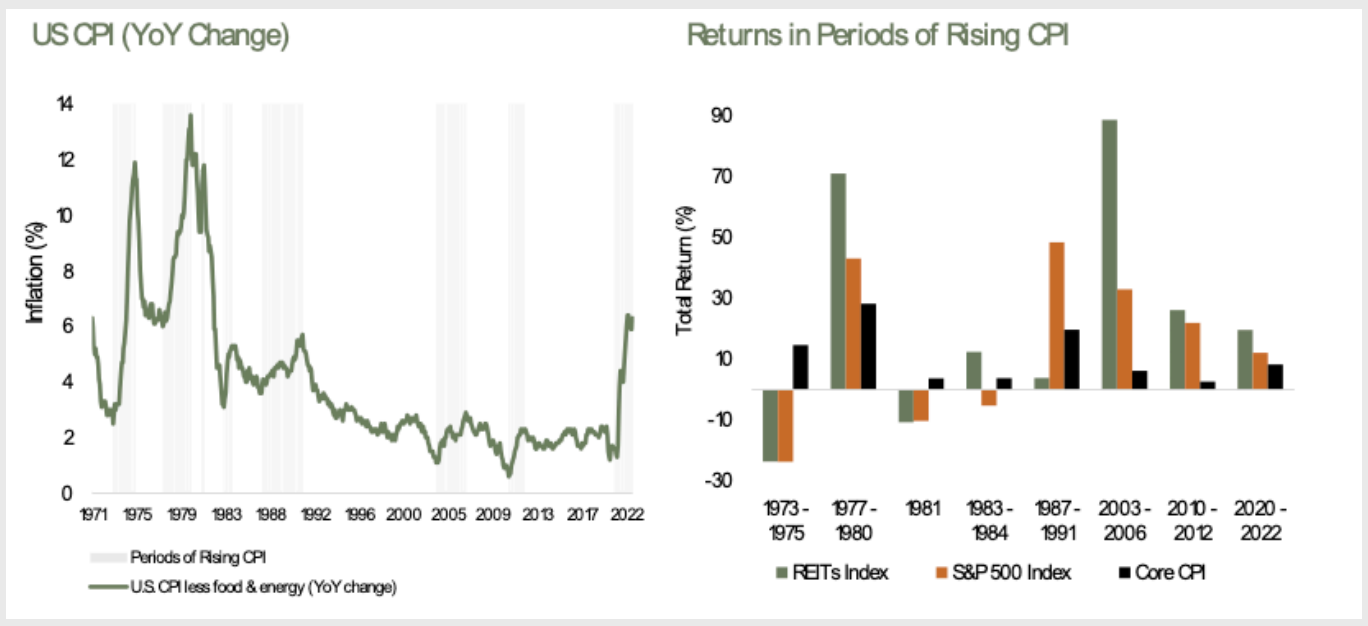
Additionally, REITs trading at discounts to NAV make attractive takeover targets. M&A activity becomes a strong mechanism to bring values back towards private markets. As a result, there have been several transactions this year. For instance, GIC (Singapore's sovereign wealth fund) and Dream Industrial REIT have announced in November that they will acquire Summit Industrial Income REIT in a transaction valued at C$5.9 billion. The premium offered was 31.1% above the last share price. It is expected that large private investors such as Blackstone, Brookfield and others will continue to take advantage of existing dislocations, which is ultimately a natural hedge and opportunity for upside in the price of global REITs in general.

REITs Are a Shield From Inflation

The recent spike in reported YoY inflation is one of only eight such moves in the last 50 years

REITs provide a natural protection from inflation as rents tend to increase when prices do. While REITs have historically fared well during inflationary periods, most of the time delivering positive returns and outperforming equities, not all real estate sectors offer the same level of inflation protection (Exhibit 3). Most REIT sectors currently show a positive leasing spread to market meaning that the market rent is above the level of maturing in place rent. As an example, this is the case for healthcare, multi-family, industrial and manufactured housing in the US where market rent levels are higher than in place rents. In addition, the market rent trend is still positive in many of these sectors which should help support income growth for a period. Another benefit to REIT shareholders is that earnings income growth is largely passed on in the form of growing dividends.

Exhibit 3: U.S REITs Fare Well During Inflation



Note: REITs Index is represented by the FTSE NA/REIT All Equity REITs Total Return Index as of September 30, 2022. Source: GreenStreet, Heard on the Beach, An Inflation Refuge, June 2021.; Bloomberg L.P.

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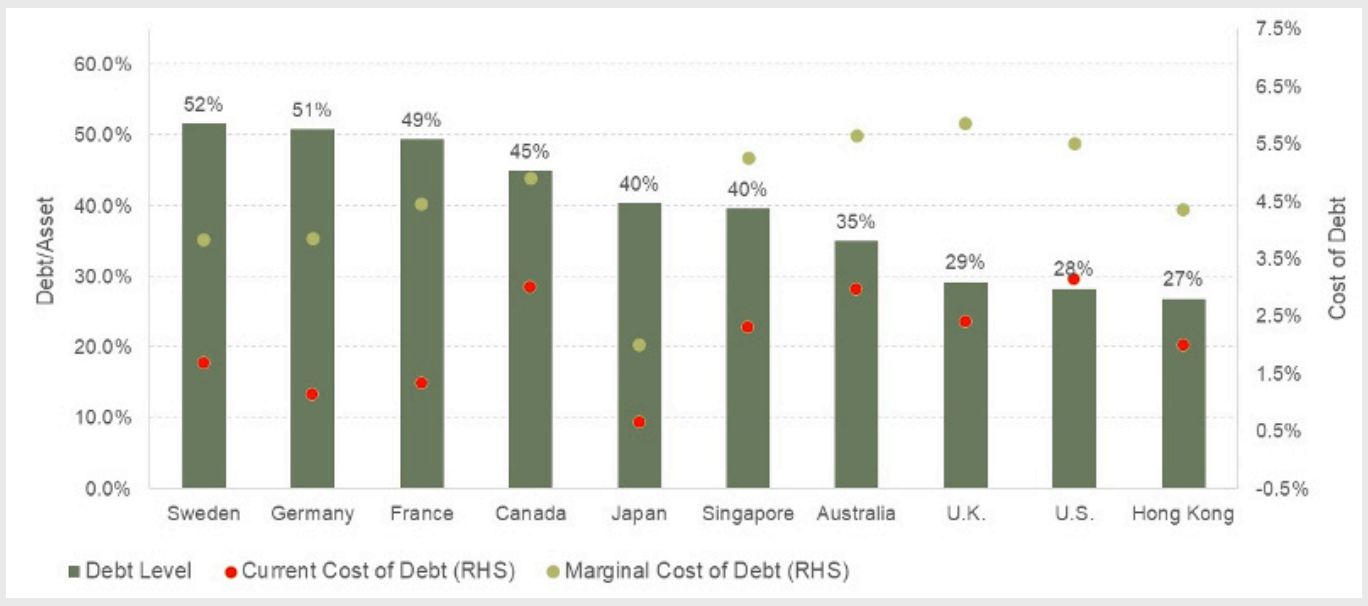
REITs, Leverage and Rising Interest Rates

Rising rates have been an obvious concern for markets in general and leverage is a very important topic in real estate. Public REITs currently have better flexibility to deal with the new interest rate environment due to generally lower leverage levels than private markets. Additionally, as debt levels vary globally, it is important to be selective as countries like France, Germany, Sweden or even Canada have quite high leverage (above 45%). However, large REIT markets like the US, UK or Australia are much more reasonable (Exhibit 4). Lastly, understanding debt maturities and the importance of these maturities being staggered over time is important to mitigating the impact of rising rates on a particular REIT.

- US and UK REITs have stronger balance sheets
- European REITs have much higher debt levels
- Monitor Canadian REIT debt levels closely

Exhibit 4: Leverage Not Excessive in Most Markets

Global REITs Financial Leverage[1]



Note: As of September18, 2022. 1 The Financial Times Stock Exchange European Public Real Estate Association/National Association of Real Estate Investment Trusts ("FTSE EPRA/NAREIT") Developed Index is a free-float adjusted, market capitalization-weighted index designed to track the performance of listed real estate companies in developed countries worldwide. Source: Presima estimates

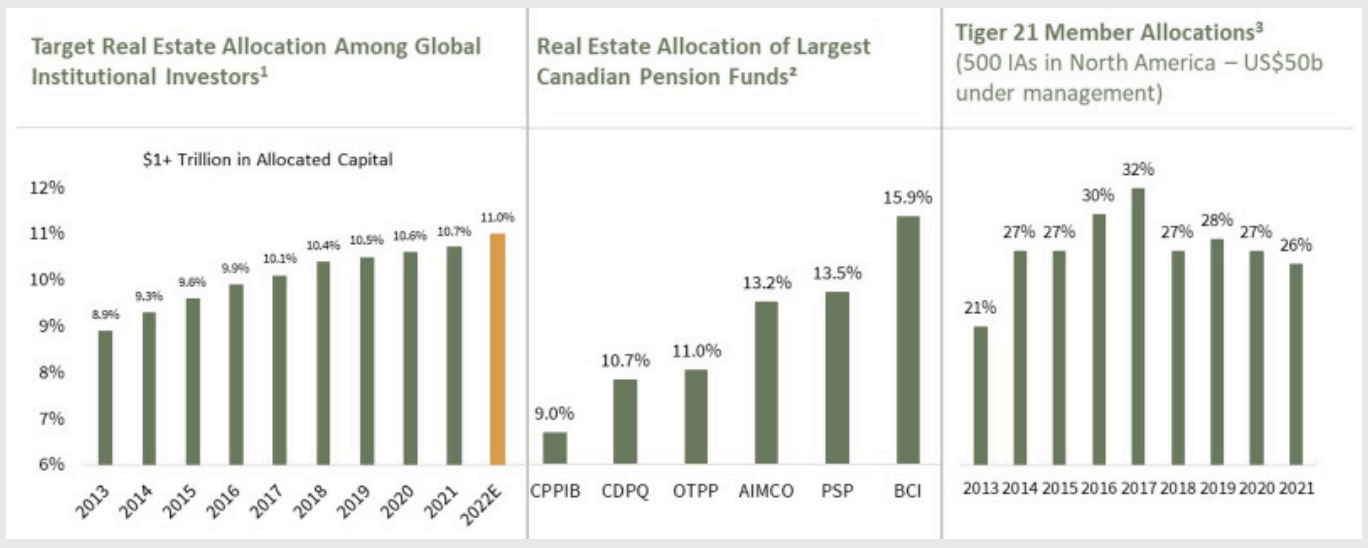
In terms of growth, fundamentals do remain sound in most countries and sectors, with REITs seeing growth today compared to the end of 2021. We are also seeing a few markets re-accelerating despite the turmoil. This is the case for Singapore, Hong Kong and Japan as these countries are just now reopening from COVID restrictions, with better earnings and expectations than last year.

Allocation to REITs

Where do REITs and real estate fit in a portfolio? There has been an increase in real estate allocation over the last several years both from ultra high-net-worth (UHNW) private clients and pension funds, which look at REITs as part of their real estate bucket. Examples are the Canada Pension Plan Investment Board (CPPIB), which has built out an internal team now focused specifically on REITs and dislocations between public and private markets, Caisse de dépôt et placement du Québec (CDPQ) through Ivanhoe Cambridge and, more recently British Columbia Investment Management Corporation (BCIMC) through QuadReal, purchasing an investment manager in the United States that focuses on REITs (Exhibit 5).

Institutions and UHNW are allocating between 10%–30% to real estate

Exhibit 5: Portfolio Real Estate Allocation



[1] Source: Hodes Well estimate of ~100 trillion of global AUM based on various public disclosures, research reports, and publications.
[2] Source: Latest publicly available annual reports as of September 19, 2022.
[3] Source: Tiger 21.

Why REITs Now?

In conclusion, REITs are real estate and over time reflect the values of their underlying assets. Periods of stock market volatility, however, impact short term price movements in REITs which in turn leads to temporary value dislocations. Today's geopolitical tensions, high inflation, and sharply higher bond yields have created such an uncertain environment resulting in a dislocation in REIT values observed only three other times during the last 23 years (Exhibit 3). Given that fundamentals for several real estate asset classes remains strong it is not surprising to see an increase in REIT M&A activity as opportunistic real estate capital privatizing assets at below market pricing. REITs may only represent a small portion of the total global real estate universe but at the right time can represent outsized investment opportunities given their liquidity and price efficiency.

Access REITs Through an Experienced Portfolio Manager

Capitalize on the Global Expertise of Slate Securities L.P.

The Evolve Slate Global Real Estate Enhanced Yield Fund (TSX: BILT) is an actively managed ETF that aims to provide a recurring income from the underlying rental income derived from publicly listed real estate issuers. Through BILT, investors may benefit from the real estate investing experience of Slate Securities L.P., with the added value of an active covered call strategy applied on up to 33% of the portfolio.

TSX **BILT** Evolve Slate Global Real Estate Enhanced Yield Fund

- REITs have generally outperformed the S&P 500 in periods of rising interest rates
- Stable and growing income from real estate properties with liquidity from public equity markets
- Broad geographic and sector diversification that improves risk/return of multi-asset class portfolios

About Slate Securities L.P.

Slate Securities is an investment management platform specializing in real estate investing, across the public and private real estate markets. As a wholly owned subsidiary of Slate Asset Management, a global investment and asset management platform focused on real assets, Slate Securities benefits from deep expertise, insights and Slate investment opportunities. Slate Securities was founded with the objective of being the real estate solution for allocators.

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With over $3.7 billion in assets under management (as at November 30, 2022), Evolve is one of Canada's fastest growing ETF providers since launching its first ETF in September 2017. Evolve is a leader in thematic ETFs and specializes in bringing innovative ETFs to Canadian investors. Evolve's suite of ETFs provide investors with access to: (i) long term investment themes; (ii) index-based income strategies; and (iii) some of the world's leading investment managers. Established by a team of industry veterans with a proven track record of success, Evolve creates investment products that make a difference.

For more information, please visit www.evolveetfs.com.

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