GUGGENHEIM

Innovative Solutions. **Enduring Values.**®

August 2019

REIT Industry Update

Commercial Real Estate Hits a Pause

After years of outperformance, REITs took a breather in 2018. Amidst expectations of rising rates, REITs finished down -4.64 percent as the 10-year closed at 2.68 percent by year-end.[1] Thus far in 2019, REITs have snapped back, rallying up 19.73 percent with the 10-year hitting 1.85 percent.[1] Meanwhile, private market valuations are holding firm, with Green Street Advisors' Commercial Property Price Index suggesting that values are up a modest 2 percent over the past 12 months. Their data shows commercial property has fully recovered from the 2009 lows, now surpassing the 2007 peak levels by 33 percent.[2] Providing support for real estate valuations are capital markets that remain robust with multiple financing alternatives open. Growth in real estate demand has been sufficient to stabilize occupancy levels in the mid-90 percent range.[3] Steady gains in leasing amidst low supply are translating into solid pricing power for landlords and stable-to-rising market rents for most subsectors. Overall property-level operating income is expected to grow at roughly a 3 percent annual pace. As a result of the positive fundamentals, REIT earnings should pace in the low-single digit range for 2019.[3] Dividend growth should parallel earnings growth, as current dividend payout ratios remain below historical norms.

Active in the Capital Markets

Good REIT management teams have generally added value throughout the cycle. This cycle is no different, as REIT managers have taken advantage of one of their core tools—capital management. Attractive capital market conditions allowed REITs to improve both overall leverage levels, as well as the quality of the balance sheet—lower debt spreads/rates, longer duration, etc. Along with attractive debt, REITs are also finding their equity well-priced. Total capital (debt, preferred equity, and common equity) raised thus far in 2019 equals $42Bn, compared to $52Bn in all of 2018.

Despite moderating fundamentals heading into the latter stages of this economic cycle, REITs remain well-positioned from a balance sheet perspective to both play defense, and, as the opportunity arises, offense.

The Case for REITs

During the second quarter of 2019 equity REITs delivered a 1.24 percent total return compared to 4.30 percent for the S&P 500 Index.[1] Guggenheim Investments, LLC feels public real estate offers several benefits for an individual investor's portfolio that are particularly relevant in today's environment:

- REITs may provide attractive current income with the potential for future dividend growth as underlying property cash flows grow over time.
- Real estate provides inflation hedging characteristics as underlying rents, property cash flows, and replacement costs have historically adjusted with inflation over the long run.
- REIT earnings should be relatively resilient during economic downturns as a large portion of rental revenues are derived from contractual lease obligations.

1 Bloomberg. REITs represented by the FTSE NAREIT Equity REITS Index (FNRE); **2** Green Street Advisors, Inc., Commercial Property Price Index, July 2019; **3** Citi Investment Research & Analysis, Weekly REIT and Lodging Strategy, August 2, 2019

For information on investment products offering REIT market exposure, please contact your financial advisor or visit GuggenheimInvestments.com.

Index Definitions (Each index is unmanaged and it is not possible to invest directly in any index.) **S&P 500 Index** is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. **Green Street Commercial Property Price Index** ("CPPI") is a time series of unleveraged U.S. commercial property values. CPPI captures the prices at which commercial real estate transactions are currently being negotiated and contracted.

Member FINRA/SIPC REITUPDT-0819 #39644