

March 27, 2020

## Dear Clients and Colleagues:

Given the rapid evolution of COVID-19, the majority of us have been taking shelter and working from home as a result of the more stringent social distancing measures being put in place. While real estate is typically thought to be a safe place to shelter, the same cannot be said at this time.

The well-known qualities of real estate – steady rental income, diversification (in terms of multiple properties and multiple tenants), being an asset backed business that pays a higher than average dividend – have afforded it safe haven status in the past. However, the COVID-19 induced shutdown of non-essential enterprises in many regions has led to growing concerns that rents will not be paid, and at the same time credit markets are also being pressured. With the real estate sector being such a large consumer of debt, this is likely a reason why it has underperformed the broader market so far this year. Year to date, the total return for the MSCI World Small Cap Real Estate Index is -31.1% compared to the MSCI World Small Cap Index total return of -29.5%. Over the last month the difference in performance has been more pronounced with the Real Estate index underperforming its broader counterpart by 6.4%.

While some companies will undoubtedly be at risk, the sector has changed somewhat since the financial crisis in 2008 - 2009. Leverage in the space is lower now, and companies have taken advantage of the lower for longer interest rate environment to extend debt maturities and increase interest coverage. As we have seen recently, governments and central banks are reacting much faster and to a greater extent now.

Before the COVID-19 outbreak, it was estimated that global commercial real estate transaction volumes would decrease slightly this year, as the sector was facing some tough year-on-year comparisons, in addition to a general economic slowdown and a dearth of available targets. Now it is likely that the number of transactions will decrease significantly in the short-term as visibility remains low. This could lead to reported property values being questioned due to a lack of transactions. We have seen the suspension of some United Kingdom (UK) property funds due to “turbulent market conditions” making it problematic to accurately price properties. The lockdowns and movement restrictions limit due diligence and physical viewings.

As commercial rent is normally paid in advance on a quarterly basis, this week is when payments for the second quarter are due. Therefore we should start getting a better idea of how collection is going starting next week. In our discussions with holdings, so far the number of clients asking for a deferral or other mitigating factors such as monthly payments instead of quarterly is negligible. Rental growth

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is inherently tied to the broader economy so if we were to enter a recession, albeit expected to be a brief one, it should come as no surprise to see a material decline. For example, rental growth was down 13% from its peak in the 2008 - 2009 financial crisis.

That being said, cash preservation measures are being undertaken where necessary. The suspension of dividend payments and any outstanding share buyback programs is reasonable and should help minimize to some extent potential decreases in rental income. Growth capex spend can be postponed and maintenance capex kept to the absolute minimum. Banks are also likely to be accommodating given current circumstances, potentially offering initiatives such as short-term waivers for covenants or rolling up interest. A lack of access to capital had severe consequences in the previous financial crisis but given that banks are better capitalized now and are bound to receive more support, we believe they will likely be more accommodative.

We believe our diversified real estate exposure (outlined below) is well positioned to benefit from the current environment of interest rate cuts and stimulus packages to boost the economy.

Advance Residence Investment Corporation has the largest portfolio among residential J-REITs, with almost 200 properties located nationwide with a focus in seven Tokyo wards. As of now we do not foresee a disruption in rental payments.

Boardwalk Real Estate Investment Trust acquires and manages multi-family residential projects throughout Canada.

Community Healthcare Trust owns non-urban healthcare real estate that are leased to hospitals, doctors or other healthcare providers.

Farmland Partners owns and seeks to acquire farmland located in agricultural markets in North America. Its farms are used to grow primary crops (e.g. corn, soybeans, wheat, rice, and cotton) as well as some specialty crops.

IWG is the world's largest provider of workspace solutions. It offers workstations, office support services, and communication access through 3100 business centers across 100 different countries. While at first glance flexible workspace may appear a concern, the financial crisis showed income is more resilient than previously thought. IWG occupancy dropped 4% to 5% in the last recession and large enterprises (across many industries) account for a larger percentage of revenues than previous recessions.

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Patrizia AG is a real estate investment manager operating in commercial and residential real estate. The company offers the entire value chain and life cycle (i.e. due diligence, acquisition, development, management, sales and re-investment). Patrizia offers special funds, private funds and co-investment.

Rayonier is a leading timberland REIT with assets located in softwood timber growing regions in the US and New Zealand. Rayonier owns, leases or manages around 2.6 million acres of timberlands.

Rexford Industrial Realty is an industrial REIT focused on owning, operating and acquiring industrial properties in Southern California infill markets.

Safestore is the UK's largest self-storage provider by number of stores, with a portfolio in the UK, France, Spain and the Netherlands (via a joint venture). Self-storage facilities only need around 30% occupancy to break even.

Samhallsbyggnadsbolaget is a leading Nordic real estate company primarily operating in community service properties and regulated residential properties. The tenants are sovereign or state financed organizations which we consider a low risk source of income.

Savills is a real estate service provider offering transactional, consultancy, property and facilities management, funds management and financial services.

Urban&Civic is a UK based master developer. The company obtains planning permission and delivers community infrastructure which is then sold to house builders as a fully serviced land parcel.

Sincerely,

The Global Alpha team

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