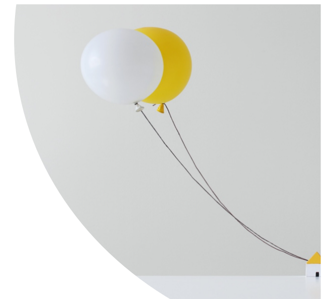
SILICON PRIVATE WEALTH

WEALTH MANAGEMENT SOLUTIONS

July 2020



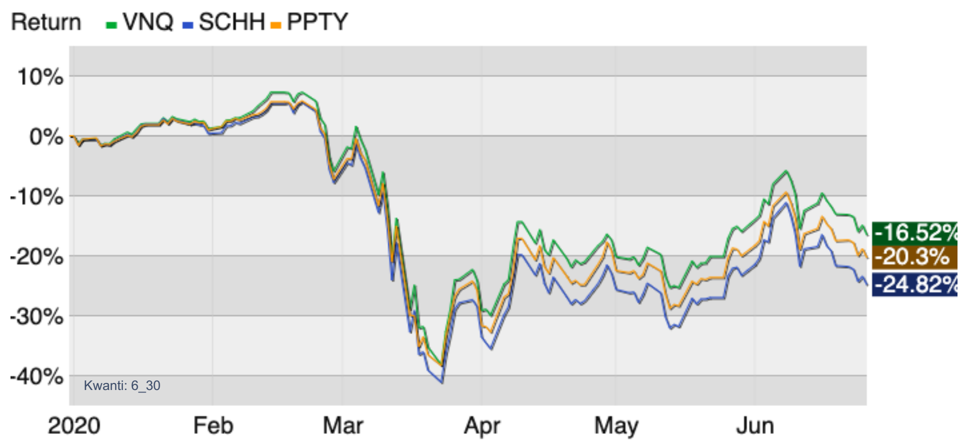
We Are Thinking about … Real Estate

Hard Asset's Renewed Allure

With the Fed blowing up its balance sheet, "hard assets," including real estate, have a renewed allure. REITs are one of the ways to participate, but as any savvy investor knows, REITs vary. REITs can be equity ("own" the asset), mortgage ("lend" against the asset) or a hybrid. Taking into account just the equity-based REITs, these are divided into further subclasses or sectors, such as office, hotel, retail, apartments, student housing, manufactured housing, self-storage, farming and more. Certain sectors post COVID may fare better than others.

Public vs. Private

Investors in publicly traded REITs are perceived to pay a premium for the liquidity; these REITs get priced by the market each trading day and there's no hiding in the market's bright light. Publicly traded REITs get swept up in a general market sell off. Any homeowner would be horrified to see the value of their property drop by 30% or more in a single month. The perception is that single family rental (SFR) real estate valuations just don't move that fast! But some well-known diversified REIT ETFs such as VNQ, PPTY, and SCHH did exactly that during the sweep of COVID this spring.

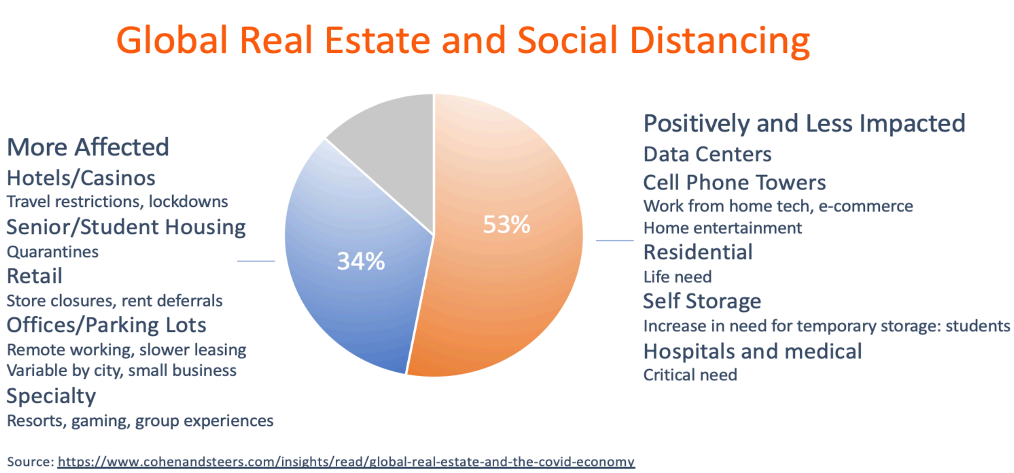


Close to lock step in diversified Real Estate ETFs

Our thought was to peel the onion back a bit and look at how social distancing and the shutdown were impacting commercial real estate short and longer term. REITs are required to "pass through", at least 90% of taxable income to realize their tax advantage, are generally regarded as income investments, and typically ranked by dividend income. But, if the market trading value diverges significantly from the value of the assets themselves, this could signal a value opportunity or conversely point to more unpleasant news to come.

The three diversified Real Estate ETFs, noted above, have very similar top holdings. Variations in the weightings contributed to a performance spread ..... but are diversified REITs in this COVID world working against the investor?

Global Real Estate and COVID Impact



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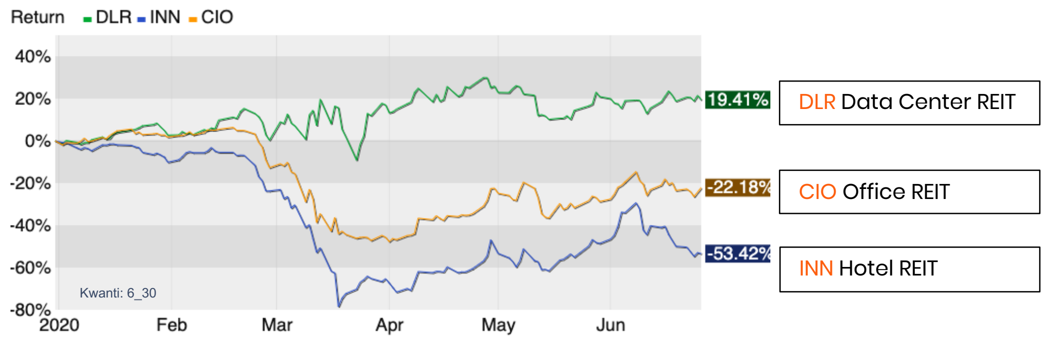
Global Real Estate and COVID Impact

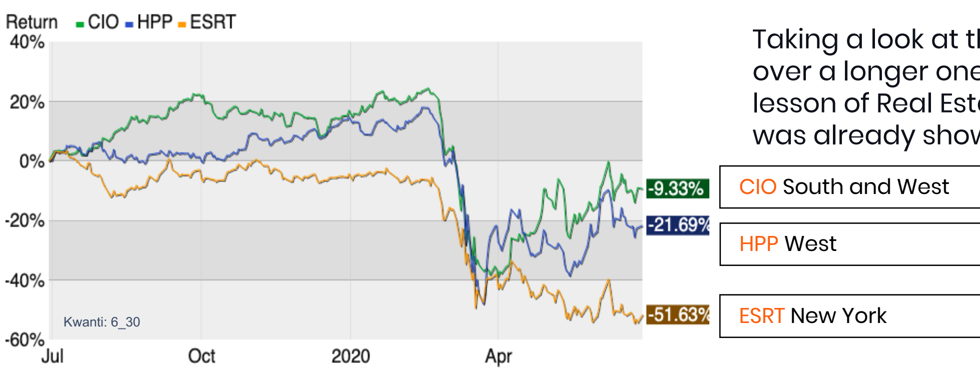
REITs typically specialize in a single sector and the economic fallout from the lockdown and social distancing set up some obvious winners and losers. The success of data center and failure of office and hotel REITs confirm investors' beliefs that COVID means more people will be working from home, using their smartphones, and traveling less.

Communications-infrastructure REIT AMT recovered quickly and data center REITs like DLR performed extremely well, with significantly less drawdown during the March meltdown -- stellar performance driven by an insatiable need for data infrastructure.



In stark contrast, REITs in the resort and hotel sector have been crippled by minimal travel and corporate event cancellations, with many moving to virtual events. Most hotel REITs have suspended their common dividend and have taken steps to maximize credit facilities through this triage process. Office REITs were already under some pressure before COVID with cloud internet computing enabling a greater remote work capability and there can be no doubt that debate is raging around what a post COVID office will look like. However, the differentiating factor about office REITs is that they collect rent from longer term contractual leases and that should act as a buffer to maintain a dividend distribution. But do all office REITs look the same?

East Coast vs. West Coast

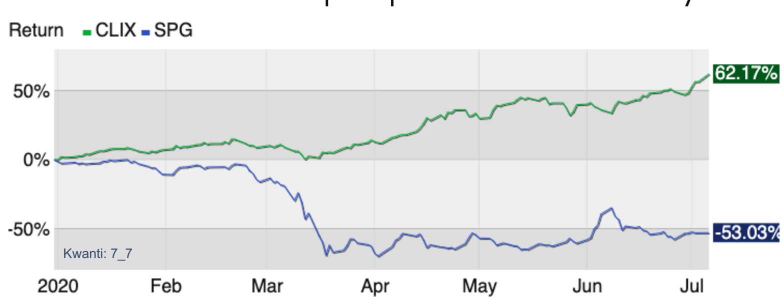


Taking a look at the market value of a few office REITs over a longer one-year time frame reveals the first lesson of Real Estate: location matters. New York ESRT was already showing stress in the office sector before COVID with factors as varied as the tax squeeze after the Jobs ACT in 2018 pushing more people out of NY and now work-from-home is sounding the gong.

Shopping Centers

Just as macro trends, such as working from home, impacted office REITs, retail shopping has undergone the sea change of more people doing on-line purchases; the phenomenon of COVID has coerced the participation of remaining late adopters. With retail companies, such as J.Crew, Neiman Marcus and J. C. Penny, declaring bankruptcy, a tidal wave of vacancies puts pressure on an already distressed sector. …

The market distress is reflected in this comparison of CLIX, an alternative investment that is long (online retailers) and short ("brick and mortar retail") versus SPG Simon Property Group. The exaggerated trend is painfully apparent.



COVID accelerating Online versus "Bricks and Mortar" dynamic

We Are Thinking about … Real Estate

Where to Look

We are making the case that selectivity in Real Estate is warranted and that the broad asset class is currently an underweight. Diversification in Real Estate is working against the investor. The trend evident in the publicly traded REIT sectors of office, shopping centers, and hotels is likely delayed, but lurking, in the non-traded private sector as it more slowly marks to this market.

A value play in retail and office REITs is debatable with future earnings forecast downward and likely increased pressure on continued dividend levels. In addition, if single-family residential REITs trade at higher premiums than their peers and, if California's anti-eviction trends and rent control trends are adopted by other states, the single-family rental (SFR) route could be a more expensive approach. Also, not forgetting the fact that mortgage REITs and hybrids can be burdened by interest rate and default risks.

Ticker	Annual Dividend	YTD	P/E	Forward P/E	Market Cap	Enterprise Value	Sector
SPG	7.54%	-53.0%	10.7	12.5	20.2B	45.5B	Retail
ESRT	5.95%	-48.1%	27.1	58.3	1.2B	3.4B	NY Office
CIO	6%	-23.0%	-	-	.46B	1.1B	South & West Office
AMT	1.65%	17.0%	62.2	54.7	117.9B	142.1B	Cell Phone
INN	-	-52.0%	15.5	-	.57B	1.7B	Hotel
AMH	0.73%	4.7%	92	136	8B	11.8B	Single Family Rental REIT

Source: Schwab Research as of 7/7/2020

Snapshot on Value and Premium

So, where to look indeed!

We are thinking ….. Investors looking for safer havens might take a closer look at suburban apartment, (sans California), manufactured housing, cell tower and data-center REITs.

Talk to Us

In this talking point piece we have laid out that, Real Estate investing, through the moving sweep of COVID, is a lot more complex than simply targeting an allocation to the asset class. We would very much like to start a conversation around how you are currently allocated to Real Estate, public or private, and if you are looking to take a deeper dive to assess risk.

You can contact us at (408)-645-6790. We look forward to hearing from you.

Sources: Cohen and Steers, JLL, Schwab Research, Land and Buildings, WSJ and NYT.
Graphs: Kwanti
Table: Schwab Research