

SAMPLE NOTE

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PLRA Weekly REIT Note

March 31st, 2025

| | # | Total returns | | | | Yield | Price/'25... | | Impl. cap | NAV prem/(disc) | |
|----------------------|-----------|---------------|---------------|--------------|------------|------------|--------------|-------------|------------|-----------------|--------------|
| | | WTD | ↓QTD | YTD | LTM | | FFO | AFFO | | basic | unlev. |
| | | % | % | % | % | | x | x | | % | % |
| Net Lease | 7 | 1.7 | 9.2 | 9.2 | 21.1 | 5.2 | 14.3 | 13.7 | 6.5 | 9.1 | 6.3 |
| Health Care | 8 | 2.1 | 7.2 | 7.2 | 33.4 | 5.4 | 15.9 | 16.2 | 6.2 | 28.8 | 20.1 |
| Industrial | 6 | 1.7 | 6.2 | 6.2 | (5.6) | 3.6 | 18.6 | 21.0 | 5.5 | (8.3) | (6.2) |
| Residential | 10 | 1.7 | 4.0 | 4.0 | 16.1 | 3.4 | 19.0 | 20.7 | 5.3 | (4.9) | (3.8) |
| Self-Storage | 4 | 1.2 | 0.2 | 0.2 | 2.3 | 4.8 | 17.1 | 17.0 | 5.8 | (7.8) | (5.6) |
| Retail | 12 | 1.5 | (6.8) | (7.1) | 11.0 | 4.1 | 14.2 | 16.9 | 6.9 | (10.3) | (6.5) |
| Office | 14 | (0.2) | (11.7) | (11.7) | 2.5 | 4.7 | 9.5 | 14.5 | 8.9 | (30.6) | (14.2) |
| Hotels | 9 | (3.1) | (18.9) | (18.9) | (23.1) | 5.3 | 7.7 | 8.6 | 9.6 | (38.4) | (24.2) |
| PLRA Coverage | 70 | 0.7 | (3.1) | (3.1) | 7.3 | 4.5 | 13.9 | 15.9 | 7.1 | (10.5) | (5.5) |

| | 3/28 | | | | |
|------------------------|------|-------|---------------|--------|-------|
| MSCI US REIT Index | 1297 | 0.8 | 0.1 | 0.1 | 9.2 |
| Russell 2000 | 2023 | (1.6) | (9.0) | (9.0) | (3.5) |
| S&P 500 | 5581 | (1.5) | (4.8) | (4.8) | 7.6 |
| 10-Year Treasury (pts) | 4.25 | 0.00 | (0.32) | (0.32) | 0.05 |

2025 Sector Outlook

OW: industrial, residential
UW: office, retail, health care

Retailer earnings have been rough, but that is far from my only source of conviction in my retail underweight. As we transition from retailers into Q1 REIT earnings, I'll use this weekly note and the next one to review the core drivers of the above sector ratings — and in this one, I'll focus on some of the medium-term PLRA themes that are only just beginning to play out.

We'll start with a basic point about the market environment, and I'll use current Sun Belt trends as a cross-sector example. This is convenience-store giant **Couche-Tard**:

Our geographic mix in the US is hurting us a bit. Our largest states are Florida, Texas and Arizona, [and] **we've seen really heavy inflation and cost of living increases in FL and AZ. As a result, we're [also] seeing fewer snowbirds** — I think we're seeing that in our [positive] Canadian volumes. That's been a trend for a couple years, to be frank. And with the administration change, we are seeing softness along the border in TX and AZ. [But] in the middle of the country, we're performing quite well, [and] this too shall pass...

Here's homebuilder **Lennar**:

Homebuyers in Florida and Texas, our two highest-volume states, needed more help... we needed more incentives in FL and TX to [help] buyers achieve mortgage payments they can afford, as well as to offset a slowing in-migration environment and increased inventory.

[But] all markets around the country require incentives [in] the current environment...

And hotel REIT **DiamondRock**, a couple weeks earlier:

Florida continues to see headwinds, owing to what can best be characterized as a hangover from the pandemic. Heavy visitation, price inflation, Florida fans relocating to Florida, etc. But we're hopeful the market finds its footing in 2025. Our Florida resorts collectively saw a 5.8% decline in RevPAR...

See the pattern? Everyone's acknowledging this ongoing reversion from the Covid Sun Belt binge, everyone's ready to move on to the next themes, but reality is not cooperating. Even as a Sun Belt skeptic who likes to say I told you so as much as anyone, I've been starting to wonder if I moved on too fast. This is me in early February, during apartment REIT earnings:

For all the attention on Sun Belt supply, there's still not enough concern on Sun Belt demand and affordability. As long as questions [about a 2026 "snapback"] are even being asked, I'm going to wonder if **there's still a bit too much bubble logic in MAA and CPT... but it was 10x worse in 2021-22, right?**

After all, I've never had a dramatic bear case for the actual Sun Belt. My problem was more with the crowded Sun Belt "thesis" on spreadsheets here in New York — where the CRE investment themes that have replaced it seem just as crowded, lazy and (already) overpriced.

You could say these are just the standard calibration problems of a late and overripe bull market; everything looks expensive, no one has any new ideas, and we're all tired of rehashing the old ones. But on the public side, that's exactly the time to start digging into downside scenarios instead, especially as the macro outlook deteriorates.

So what are some other slow-moving post-Covid reversions that can't quite seem to find a bottom? Conversely, what are the *non*-reversions (i.e. pandemic regime shifts) that investors are still in denial about? And even where these themes don't look investable yet in their primary property type, where can they give us short/UW conviction in other property types?

1. LABOR MOBILITY (RESIDENTIAL & OFFICE)

Let's go back to that LEN call. You know the high-level housing story:

Rates have remained higher for longer, which has left the overall housing market weaker for longer. Across the housing landscape, actionable demand has slowed materially...

You've seen how it keeps getting worse:

Most recently, **even where HHI indicates an approvable mortgage qualification, elevated personal debt levels have often presented as an additional impediment...**

Additionally, until recently, consumers have been generally confident that they will remain employed, and that their compensation is safe. But more recently, even that safety has been called into question. [And] as we move past the beginning of February, we do not see the seasonal pickup typically associated with the beginning of the Spring selling season...

If you follow the public builders or do business with them, then you also know about their long and winding road to more of an "even flow" production model, with LEN's recent MRP spinoff as the most recent milestone:

We are much closer to the completion of the strategic rework of our operating platform, [and] the Millrose spin completed the backbone structure of that rework... we now have a strong complement of land bank partners [to] enable just-in-time delivery...

And you can guess why it's not helping their stock yet. If the pitch is lower margins but faster turns and less cyclical, and you're not getting the turns, and no one believes in the current cycle...

Q: How have you've determined the sales pace that you want your platform to deliver? [Because] you've expressed the view that demand is ultimately going to normalize higher, [but] an alternative view might be that this is the normal level. So I'm curious how long Lennar is going to tolerate subpar margins...

A: Well, interesting question. [But] we've been underproducing any notion of normalized production for 10–15 years... with rates where they are, and inflation having affected affordability, we think that the market is undersupplied, [and] that's what we're solving to.

Might we change our mind [as] immigration questions come up, and other questions come up? We'll have to wait and see.

Not exactly our problem on the REIT side, right? We've seen how this asset-light shift has dovetailed with the rise of the single-family rental boom, and I've also written about how it could ripple through longer-term supply trends. But set that aside, and just think about this locked-up housing market on its own terms. What are the most logical impacts that are not being discussed?

During Covid, I often framed this kind of question in terms of “escape valves,” and one that I keep coming back to lately is remote work. In other words, geographic labor mobility was *not* much of an escape valve for the initial Covid housing boom, but my concern was that it was being suppressed into a “slow bleed,” with an incremental ~1% of office workers relocating every year for another decade or two.

Now, it's harder than it sounds to have a differentiated and investable view on where they're going. On the public side, it's even more difficult to isolate that kind of bet, without just sliding back into the same crowded Sun Belt thesis.

But on the office side, you don't have to know where they're going, or even whether they have a dedicated desk in an office when they arrive. You just have to know *that* they're still going — i.e. that the current situation remains unstable — in order to see that there's more pain ahead for the office market.

If that sounds like a non sequitur, I've walked through more of the connection in some thematic office notes, like this one on Amazon's current RTO struggles. The main thing is to forget this idea of a struggle of will or “leverage” between employees and CEOs, which is no longer the core problem for large corporate employers. Rather, it's their inability to bring functional teams back together in the same office. And they can't solve that problem with turnover, because housing costs around their office footprint are simply too high.

Think of it this way: the more that the housing market tracks wealth over income, the harder it will be to maintain *any* large vertically-integrated office work force in the same location. We were already seeing this pre-Covid, of course, with mid- and back-office functions being relocated, and now it's stretching deeper into front-office functions as well.

This is the core of why the RTO investment theme has become another frustrating slog, like the attempts to reboot the Sun Belt thesis. In a broader sense, it's a reminder that the returns on residential real estate are partly a tax on other property types. And what you're hearing on this LEN call — or take your pick of housing indicators — is that there's no relief in sight.

2. E-COMMERCE BIFURCATION (INDUSTRIAL & RETAIL)

Another guidance cut at FedEx reinforces my framework of higher e-commerce volumes at bifurcating speeds. Remember, the problem for FDX (and UPS) is that they were built for the last cycle, to extract premium rates from sellers trying to keep up with a two-day Prime target. They doubled down on these investments during the pandemic, but Amazon doubled down on even faster speeds. Which has created a serious mix problem for the third-party networks:

| Delivery/Shipping Demand | | (Representative) Winners & Losers | | |
|--------------------------|----|-----------------------------------|-----|---------|
| On-demand / courier | ↑↑ | DASH | | |
| Same-day / next-day | ↑ | | WMT | AMZN |
| 2-3 days | ↓ | | | FDX/UPS |
| 3-5 days | ↑ | | | |
| 5+ days | ↑↑ | Temu | | |
| Total | ↑ | | | |

If you don't start with this framework, or something like it, then the story is getting harder to follow. There are moving pieces at the market level (e.g. with USPS and Amazon contracts) and FedEx has also rearranged their divisional disclosure. Everyone has different levers to pull in maximizing their network utilization; in FDX's case, some of this overlaps with their international business, and their ongoing Express/Ground restructuring. So it's no surprise to see them taking share in this slower segment, since they're essentially overbuilt for it...

FedEx Ground Economy [is] very well-positioned compared to the USPS's ground advantage product. We are being selective, but I will say that some of the pricing and honestly, some of the service challenges in the market from our competitors are helping us from an acquisition perspective, certainly.

...and it's no surprise that this is still not a good outcome for FDX shareholders...

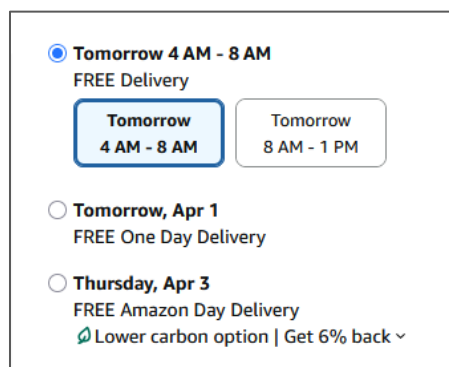
Q: On the shift to economy, can you talk about how you adjust the cost structure to meet the significantly lower yield on those products?

A: We're trying to sort off-cycle, [and] we are absolutely increasing our trucking vs. flying...

...but from our perspective, the point is that this new e-commerce market structure is beginning to settle into place. As with the first Prime era, it could be the backdrop for years to come. As with the residential REITs in the prior section, it's not so easy to bet on this yet with the industrial REITs, and many of the associated headwinds and tailwinds for the warehouse market are still emerging. But on the retail side, there's no question it's a net negative vs. the pre-Covid environment, and this is arguably already playing out.

In other words, we should expect e-commerce penetration to accelerate, simply because this bimodal shipping landscape is addressing more of the demand curve. Particularly the "convenience" occasion on the faster end of the spectrum, and particularly for the more affluent demographics that REITs target.

Just look at how Walmart shocked the Street last year (see [my Q2 note](#)) with the rapid growth of their 1-3 hour delivery offerings. Or look at how fast Amazon is moving (below) with more detailed A/B testing across their same-day/one-day schedule, and a widening assortment in every one of those buckets. Look at how DoorDash is getting more focused on fill rates and service quality, as the app landscape consolidates...



In fact, you don't have to read my notes on WMT/AMZN/DASH (or anyone else's notes) to see where this is going. Just think back to 2019, and consider how much easier it is already to avoid a trip to the store by ordering delivery — in terms of price, selection and (especially) reliability. Then consider the pitch from strip REITs (or specialty grocers, et al.) about being “insulated” by selling “convenience” to wealthy suburbanites.

You're about to hear even more of that on the Q1 calls, and the basic story is not wrong; if we're heading into a recession, these are the demos/locations/categories that you'd expect to be most defensive. Rather, the problem is that these tech/delivery giants are targeting the same customer that we're trying to draw into the store (or at least to a drive-thru or curbside pickup) and they're beginning to succeed at offering them even more convenience. They could just be getting started.

3. WINNER-TAKE-ALL DYNAMICS (RETAIL & NET LEASE)

From the **Darden** call last week:

During [our] fiscal Q3 [Dec/Jan/Feb] average same-restaurant sales for the industry grew 0.9%, and average same-restaurant guest counts decreased 1.2%. Additionally, due to a **significant divergence between average and median results**, we are sharing that the median same-restaurant sales for the industry decreased 2.3%, and median same-restaurant guest counts decreased 4.2%...

Q: What's your read through on the divergence?

A: It's really driven by an outlier; I think you probably all know what we're referring to. But going back at least three, four years, the median and average were within 50bps...

Whenever we talk about the benchmarks, we talk about the benchmarks excluding Darden. In times that Darden was way outperforming, you would have seen that same kind of divergence... so it's not like it's just one brand that can ever do it...

I assume this positive outlier is **Chili's**, which we discussed [in February](#) [p5-7] when their parent EAT reported. But for our purposes here, EAT and DRI are both in the winners column...

Q: If we set aside the impact of the big outlier, do you think we're also seeing a broader widening between the winners and losers in the category?

And if so, I'm curious what you'd attribute that to... are the benefits of consistently delivering a good experience sort of snowballing with the consumer, or is there any evidence that the underperforming players are cutting even deeper?

A: I think we've always said the chains that execute well continue to win. [And] yeah, there is a bifurcation. Some brands are executing really well... the ones that are not executing as well are the ones that are probably not winning as much, and **there is probably more divergence over the last few quarters, as consumers becoming even more discerning.**

I hesitate to even call this one a “PLRA theme,” because it’s more of an inconvenient truth that no one else seems to write about: winner-take-all dynamics are a long-term negative for landlords. The losers can’t pay more rent, and the winners don’t have to. So in the long term, occupancy cost is a ceiling, not a floor; competition among tenants is what determines competition for space.

This is a fractal rule at every level, down to the shop space in a single mall. As I put it [in 2019](#):

The key difference between retail and other types of commercial real estate is that you’re selling cotenancy and traffic, not just space. You probably don’t care who else is in your office building, but every retailer knows exactly who they want as neighbors.

This is why a single mall can make the developer a billionaire: success in retail compounds much faster than it does for other real estate. Better malls can attract better stores, which attract more shoppers, which attract even better stores, which pay higher rents, which the landlord can use to expand, which attracts more shoppers, and so on.

But this is a high wire act that depends on low vacancy and a not-too-lopsided distribution of sales, so that tenants feel they’re each getting at least as much benefit from the center as they’re giving back. And **even at a mall where total sales and traffic are not declining, a larger share going to the hottest tenants (like Apple or Tesla) can start that feedback loop working in the other direction.**

The version that I’ve been focused on since reopening is the pent-up advantage of market leaders who invested in labor, inventory and tech during the pandemic. When the reopening boom created an apparent “comeback” for the lower-credit chains who were skimping on reinvestment (and pushing their luck on pricing) I wrote about an “Empire Strikes Back” dynamic where the dominant blue chip tenants would storm back.

Which is more or less exactly what we’ve seen — and once again, there’s no obvious reason for it to stop anytime soon. It’s the market-level version of that mall dynamic above, with even more elements of positive feedback. So the Red Lobster bankruptcy is not independent of this strong performance at DRI, just as the liquidations of JOAN/PRTY/BIG are not independent of the resilience of HD/LOW, or the boom at WMT. As long as the higher-credit winners are still rolling, we should expect the lower-credit tenant fallout to keep coming.

4. WAGE/RATE SPREADS (NET LEASE & HEALTH CARE)

KinderCare is down over 30% on the 2025 guidance they introduced a couple weeks ago, and already trading 50% below their October IPO price...

For FY25, we expect occupancy to be relatively flat year-over-year, [and] **tuition for the year will land toward the low end of our 3–5% long-term growth target...**

Q: Why is tuition at the low end? Are you seeing family pushback, or competitive pressure?

A: Look, as we've talked about in the past, **we really start [with] our costs**, the biggest one obviously being teacher wages... then obviously that's coupled with how retention is going, [and] competition, engagement at our centers, all those sorts of factors. [But] we are confident we could be at the lower end of the range this year, and still drive a great margin between our wage rates and our tuition rate...

Q: Could you talk about how fall enrollment trended versus your expectations? I think previously you had talked about expecting some improvement...

A: We had a good enrollment path through Q4, largely in line with everything we talked to you [about] in August, and through the IPO. So that turned out the way we expected...

In terms of direct exposure for the net lease REITs, KLC and their peers are not quite at the top of my worry list. But they're a good way to think about wage/rate spreads, which I've been writing about more lately in health care, because child care providers tend to discuss them more directly. And despite the opposite demographic trends, there are many relevant parallels between child care and senior care — including the overlap with those stalled-out RTO policies, and the broader employment market.

From the REIT side, this is the most complex of our secular themes in this note, but one of the most actionable this year — especially in the second half — and I'll state it as bluntly as I can. When you're providing long-term sale/leaseback financing to a heavily labor-dependent business, and trying to project labor and rates separately, without thinking enough about the interaction between them, you are asking to lose money.

So this is apparently what just happened to some equity investors in this KLC IPO. It's been happening to health care REIT investors for over a decade now, and they just keep lining up for more. Even in more standard net lease categories, there are plenty of signs that the current “return” to pre-Covid labor market conditions has been drastically overstated — like this aside from **Dollar Tree** last week:

One of the biggest findings we had from 2024 is that you can't just muscle your way through a store and convert it, because it just goes back to its poor performance. It must be ready to receive. So **you can't have a store manager vacancy. You've got to have a strong assistant manager** [in] the back room. When we do those things well, the results are incredible. When we don't do those things well, we're disappointed.

Remember, dollar stores were already talking about heavy investments in labor (and corresponding margin pressure) during 2023. Remember that they were a Covid/shutdown beneficiary, without the widespread firings and furloughs in so many other sectors. They are not a straightforward bet

on wage/rate spreads, and they don't have anything *close* to the structural labor shortage of the child care and senior housing sectors, or the same dependence on an immigrant workforce.

But notice that wherever you look across retail and health care, the relative winners tend to be the ones who have focused the most on labor in this new post-Covid regime — whether that's HCA's nursing schools, or the script on the last WELL call, or Walmart and Darden earlier in this report, or KLC and BFAM in child care, or Mister Car Wash, Home Depot, on and on and on.

And remember that when it comes to immigration crackdowns, most of the investors who think this is not a needle-mover were saying the same thing about tariffs. I was too sanguine on tariffs myself, and I won't wait to admit that I was wrong; even if they're all rolled back tomorrow, they will have done serious economic damage.

Which is the way that investors should be thinking about immigration policy. Even if you believe the ultimate deportation count will be no higher than under Biden — and I'm still not convinced that it will be — there's still a lot of economic risk in the way it's done.

5. VACATION TRAVEL (CRUISE LINES & HOTELS)

The cruise stocks have stalled out a bit on macro fears, but their revenue trends are still impressive. This is **Carnival** last week:

Q: Is there any evidence [for] consumers trading down? We assume that there is some trading down to the value of a cruise versus the much more expensive hotels, particularly domestically...

A: [This] concept of trading down to a cruise — I'd look at it differently. I'd say that we have a tremendous price-to-experience ratio compared to land, and people recognize that value more [when] they're looking to make the dollar go further. So even though it pisses me off when we look at the price gap... in these types of times, that is a huge strength. [And] we're carrying more new-to-cruise [passengers] than we ever have...

It may be obvious why I don't quote these companies as often as airlines and other hotel-adjacent sectors. They can be interesting on their own terms, but they're usually not leading indicators of anything we care about — and as with ABNB/vacation rentals, this trade-down risk to hotel demand is often overstated.

But at times like now when it's really kicking in, it's worth spelling out a few second-order effects. First, a longer booking window means they're locking up demand further out...

Q: I'm just trying to triangulate what the visibility looks like now relative to the past. I think historically, it used to be that you guys were booked 50–70% for Q2, and maybe 30–50% for Q3. Has that decoupled a little bit, and moved a little bit higher?

A: Yeah, all of those numbers that I used to give for the current quarter and the next three, we are above the top end of all of those ranges. We're about 80% booked for the remainder of this year, [and] if you took the top end of all the ranges, you'd be [at] 70% for the rest of the year...

...which means that even in an economic upside case where consumers look to trade back up to hotels, we should expect more of a lag.

Second: there is already some overlap between the cruise and resort experiences, and that line is already moving. CCL has a half-dozen of their own destinations in the Caribbean, and they're opening another big one this summer:

Q: When would you expect Celebration Key to be peak noticeability in your booking surge, in light of the opening and awareness of the island?

A: I think it's pretty fascinating. We're still a make-believe land, right? So everything we're putting out on the marketing side really is in the imagination. And [since] the primary tenant there is going to be Carnival [as opposed to their other banners], a huge amount of which is short cruises, 3, 4, 5-nighters that have a much shorter window than booking on the 7s and 8s... **by any stretch of the imagination, we haven't seen the full impact...**

We easily see a path where by the end of the decade, what was about 6.5M guests going to our Caribbean footprint in 2024 could be upwards of 11M, which is a phenomenal thing. And I think **the thing that we're learning, which we haven't really benefited from in full, is how we brand and position our destinations themselves**, to make them part of the consideration set of the consumer. Historically, it's been very much about just the cruise and the brand, and then delight them when they're in our destination. But we have the ability to make it a driver for taking the cruise to begin with. So we're starting to lean into that, obviously, with Celebration Key, and we're going to do more of that...

So in this case, the high-level reversion dynamic is another one that I've been banging on about for a while: "supply risk" at US resorts is worse than it looks, because it's not just about the local comp set. It's nothing against Key West or Napa to say that the product is an experience rather than a location per se, and *no* vacation experience is so unique that it's completely immune to substitution at the margin. For investors who still haven't figured that out, this could be another one of those negative "surprises" that keeps happening every year for the next decade — and every year it will feel like a different idiosyncratic risk, and they'll never know quite how to discount it.

Now, the real bitter pill to swallow is that the urban-to-resort rotation could still have been a net positive for the early rotators (like DRH in the intro section) even if their ultimate returns on the resort investments are not great... because the demand destruction in high-rated business travel will make the returns even worse on the hotels they sold. In other words, if leisure demand is resetting 5-10% higher post Covid, and McKinsey is traveling 20% less... that offsets a lot of incremental supply risk on the leisure side, however we're defining supply.

But we'll save that for the next note. I'm only mentioning it here to show why I've focused my criticism on the "trophy collector" REITs who pushed the resort thesis into the red zone after Covid, and the investors who still think of the luxury segment as more "insulated" from these dynamics. There are multiple counterexamples on the cruise side, including the recent Viking IPO, but I liked this data point from the CCL call...

Q: The sale of the Seabourn ship at a gain, can you just elaborate on the reasoning?

A: I mean, it's actually pretty simple. We got a cash offer that [was] in the best interests of shareholders. It's as simple as that. Nothing is for sale, [but] if people are approaching us unsolicited, I'll listen. [It] doesn't happen very often, but that was one of these cases.

[And] Seabourn is a phenomenal brand. We are talking about one of the youngest fleets around the world, ultra-luxury, and they are going gangbusters, the yields are up nicely like there is nothing wrong other than the fact that somebody made us an offer that we couldn't refuse

...because the Japanese buyer (Mitsui) is **repositioning** the ship for their domestic market, which is a reminder of the Japanese tourists who still aren't fully back at REIT hotels in Hawaii.

Anyway, I don't know whether Mitsui is targeting the same high end customer, and I'm certainly not suggesting that the cruise lines will run away with this segment either. The luxury customer is a tough customer for everyone, and some of these macro fears may be warranted:

Q: [But] you have Seabourn, you have Cunard, [and] in the last few weeks we've had mixed commentary from other cruise companies about luxury...

But again, this isn't like airlines, where I'm writing about tricky hotel read-throughs that an airline analyst wouldn't care about. Cruise lines and other vacation alternatives are pretty well-covered by other research — often cross-covered with hotels — and the ways that they're competing for our customer are pretty obvious. For REIT investors with plenty of other reasons to worry about hotels this year, it feels like one more of these fuzzy, inconvenient risk factors that's just easier not to think about — which, unfortunately, doesn't make it any less real.

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