Private Real Estate: Income that Drives Return

Establishing a strong income component in a portfolio is much more challenging than it used to be. The ultra-low interest rate environment that has bedeviled income investors for years shows little sign of abating, with the Fed signaling it is prepared to extend current policies.

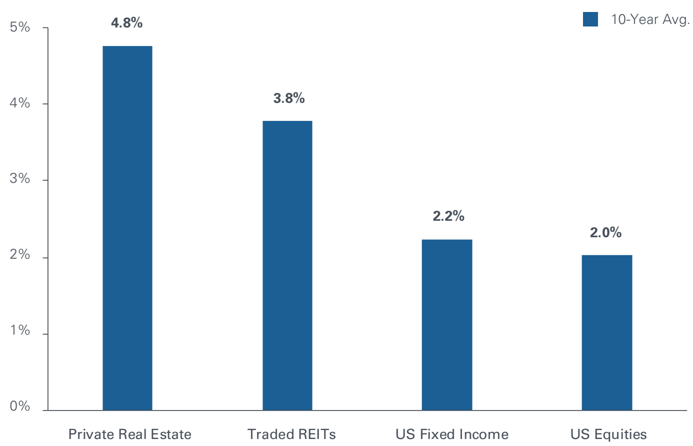
As a result, investors have little choice but to look beyond traditional fixed income investments for current yield. However, one important issue is the amount and type of risk that comes along with the higher yield ride. Will the level of income that's generated be steady or volatile? Is the underlying revenue stream robust? And what level of appreciation can the assets be reasonably expected to generate over time?

SEEKING YIELD THROUGH REAL ESTATE

Direct investment in privately held commercial real estate has historically provided attractive yields relative to other major asset classes.

Consider the 4.8% average yield generated by privately held real estate over the last 10 years. This is well above the 2.2% and 2.0% averaged by US fixed income and equities respectively over that period, as well as the 3.8% yield from traded REITs.

AVERAGE ONE-YEAR YIELD, 9/30/10 - 9/30/20



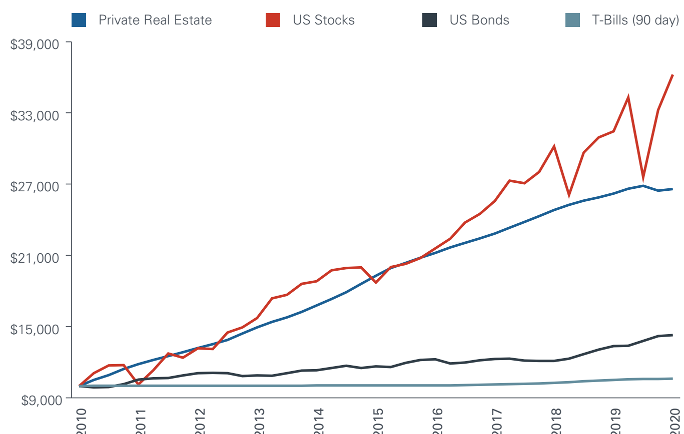
Source: Clarion Partners Investment Research, NCREIF, REIT.com, S&P, Bloomberg, as of Sept. 30, 2020. **Past performance is no guarantee of future return. Yields are not guaranteed and are subject to change.** Indexes are unmanaged, and not available for direct investment. Index returns do not include fees or sales charges. This information is provided for illustrative purposes only and does not reflect the performance of an actual investment. Private real estate investments are represented by the ODCE Index. REITs are represented by the NAREIT All-Equity Index. US Fixed income is represented by the Bloomberg Barclays US Aggregate Bond Index. US Equities are represented by the S&P 500 Index.

Of course, a long-term average doesn't take into account the volatility within asset classes, and investors would be right to ask how far the yields fluctuate over time. In the case of private real estate, the swings in yield are relatively narrow. During the past decade, annual average yields for the NFI-ODCE index ranged between 4.18% (2019) and 6.64% (2010). That's well below than the kind of volatility generally associated with equities.

The relative consistency of private real estate income is easy to explain. Commercial properties such as warehouses or office buildings derive revenue from long-term contractual leases. This generates a cash stream that tends not to change abruptly, given the costs involved in cancelling the lease and relocating business operations. Another stabilizing factor: many leases are indexed to inflation.

The durability of that income stream, in turn, has helped to support total return for private real estate as well. Indeed, over the past 10 years, private real estate delivered an average annual gain of more than 10%, substantially outperforming the broad US bond market in over the same period – as is evident in the chart below, which tracks the progress of a hypothetical $10,000 initial investment made in late 2010:

GROWTH OF $10,000 INVESTED (Q3 2010-Q3 2020)



Source: Clarion Partners Investment Research, NCREIF, REIT.com, S&P, Bloomberg, as of Sept. 30, 2020. **Past performance is no guarantee of future return.** Indexes are unmanaged, and not available for direct investment. Index returns do not include fees or sales charges. This information is provided for illustrative purposes only and does not reflect the performance of an actual investment. Private real estate investments are represented by the NFI-ODCE Index. US Fixed Income is represented by the Bloomberg Barclays US Aggregate Bond Index. US Equities are represented by the S&P 500 Index.

CLARION PARTNERS

KNOWING WHERE TO LOOK

While private real estate clearly has the potential to deliver relatively high income yields and lower return volatility than US stocks in general, a rigorous property selection process is critical for investors to actually achieve these results. The old saying that all real estate is local still holds true. Each property represents a distinct mix of market, financial and operational considerations.

To uncover suitable opportunities around the U.S. requires a high level of research expertise, as well as the scale to move on properties when appropriate. Our firm, Clarion Partners, exemplifies this type of approach. We have the scale as one of the largest pure-play real estate investment managers with over $55 billion in property investments – as well as the research expertise gained over a 37-year history of evaluating commercial properties. These strengths are critical to the success of the firm's various strategies, including CPREIF, which invests in private real estate with a focus on income.

DEFINITIONS

The NFI-ODCE Index is an index of investments returns (gross of fees) of the largest private real estate funds with core investment strategy characterized by low risk, low leverage and stable properties diversified across the US.

NAREIT All-Equity REITS Total Return Index (NAREIT Index) is free-float-adjusted market capitalization weighted index that includes all tax qualified REITS listed in the NYSE, AMEX and NASDAQ National Markets.

The **S&P 500 Index** is an unmanaged index of 500 stocks that is generally representative of the performance of larger companies in the U.S.

The **Bloomberg Barclays U.S. Aggregate Bond Index** is an unmanaged index that measures the performance of the investment grade universe of bonds issued in the United States. The index includes institutionally traded U.S. Treasury, government sponsored, mortgage and corporate securities.

All investments involve risks, including possible loss of principal. This material is intended to be of general interest only and should not be construed as individual investment advice or a recommendation or solicitation to buy, sell or hold any security or to adopt any investment strategy. It does not constitute legal or tax advice.

The value of investments and the income from them can go down as well as up and investors may not get back the amounts originally invested, and can be affected by changes in interest rates, in exchange rates, general market conditions, political, social and economic developments and other variable factors. Investment involves risks including but not limited to, possible delays in payments and loss of income or capital. Neither Franklin Templeton nor any of its investment managers guarantees any rate of return or the return of capital invested.

Real estate investments are subject to risks, including but not limited to local, state, national or international economic conditions; including market disruptions caused by regional concerns, political upheaval, sovereign debt crises and other factors.

Equity securities are subject to price fluctuation and possible loss of principal. Fixed-income securities involve interest rate, credit, inflation and reinvestment risks; and possible loss of principal. As interest rates rise, the value of fixed income securities falls.

The views expressed are those of the investment manager and the comments, opinions and analyses are rendered as at publication date and may change without notice. The information provided in this material is not intended as a complete analysis of every material fact regarding any country, region or market.

CLARION PARTNERS