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### Favorable Backdrop for Real Estate

- REITs in traditional property types are trading at an average 15% discount to net asset value in the public markets. Since the interest rate fever has broken and real estate fundamentals remain solid, REIT shares will likely trade up towards NAV over the next 12 months.
- Public market valuations have remained disconnected from the private market for nearly half a year now. If this temporary phenomenon persists, a continued acceleration of M&A in the REIT sector should occur.
- REITs have risen 12% on average since 1994 during 12 periods of 10-year treasury yield increases of at least 60 bps for a sustained period. REITs have seen stronger returns at 18% on average when the economy is in an early expansion, as we are today.
- The Land and Buildings' "must own" property stocks mentioned in last quarter's outlook were up 6% in the third quarter, outperforming the REIT index which was down 3%. The current list of "must own" stocks are: BRE Properties, CoreSite, DiamondRock Hospitality, General Growth Properties, Kilroy Realty, Las Vegas Sands, Prologis and SBA Communications.

### Attractive Buying Opportunity for REITs

REIT and real estate related share prices remain at discounts to net asset value following "taper" talk by the Fed. Dovish comments from Fed Chairman Ben Bernanke and a lack of QE tapering in September have pushed the United States 10-year treasury yield down ~40 bps from its September 5th, 2013 peak. The dysfunctional political environment in Washington, already tighter financial conditions (i.e. higher interest rates), a lack of meaningful acceleration in near-term economic growth, and the Fed's strong commitment to lower rates likely mean the 10-year has seen its highs for the year.

With that backdrop in mind, there appears to be an attractive buying opportunity for REITs and real estate related equities given:

- REITs in traditional property types trade at a 15% discount to NAV
- Private market valuations for core assets are unchanged despite higher treasury yields
- M&A is accelerating given disconnect between private and public markets
- REITs are not bonds; REITs have growing cash flows and dividends
- REITs typically have strong positive returns during prolonged periods of rising interest rates
- REIT implied cap rates remain at a wide spread relative to BBB bond yields

**Public Real Estate Trading at a Substantial Discount to Private Market Value**

Traditional real estate property types (regional malls, apartments, office and lodging) are trading at an average 15% discount to net asset value in the public markets, with both malls and apartments at approximately 20% discounts. Since the interest rate fever has broken and real estate fundamentals remain solid, REIT shares will likely trade up towards NAV over the next 12 months.

Discussions with public REITs, private real estate owners/operators/developers, real estate brokers, and other industry contacts as well as real-time transaction data points all confirm that real estate valuations in the private market are largely unchanged since interest rates started rising in early May. Real estate buyers never priced in the ultra-low 10-year yields seen earlier in 2013.

Furthermore, real estate cash flows are leveraged to improving global growth prospects, causing buyers to underwrite higher future cash flow, enhancing unlevered return expectations.

**M&A is Accelerating Given Disconnect Between Private and Public Markets**

Public market valuations have remained disconnected from the private market for nearly half a year now. If this temporary phenomenon persists, a continued acceleration of M&A in the REIT sector should occur. Thus far in 2013, Colonial Properties Trust (NYSE: CLP; Apartments), Brookfield Office Properties (NYSE: BPO; Office) and Archstone (Apartments) were all acquired. Furthermore, BRE Properties (NYSE: BRE; Apartments), CommonWealth REIT (NYSE: CWH), and Strategic Hotels and Resorts (NYSE: BEE; Hotels) are all currently subject to investor activism attempting to immediately rectify discounted public market valuations through strategic alternatives.

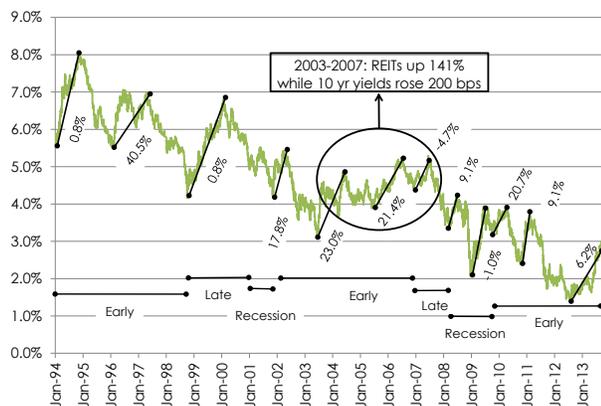
**REITs Are Not Bonds, They Are Better**

Real estate fundamentals are robust and continuing to improve with steadily growing demand and low levels of new construction providing excellent prospects for continued growth in cash flows, dividends and net asset value. Unlike bonds, REITs typically have strong positive returns during prolonged periods of rising interest rates.

REITs have risen 12% on average since 1994 during 12 periods of 10-year treasury yield increases of at least 60 bps for a sustained period. REITs have seen stronger returns at 18% on average when the economy is in an early expansion, as we are today. A 200 basis point rise in rates from 2003 to 2007 saw REITs return 141%. (Figure 1)

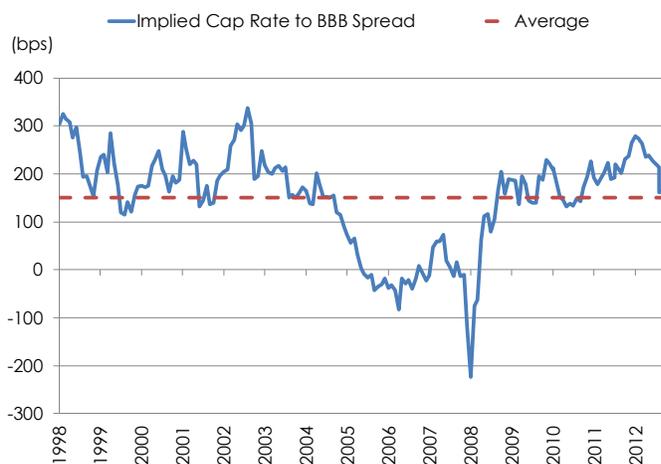
Not only do REITs provide a growing cash flow stream and a store of value during inflationary periods that bonds do not, REITs are also currently priced "cheap" relative to bonds. The implied cap rate of the REIT sector is 180 bps higher than BBB bond yields, an above average spread relative to the past 15 years, especially when considering that the spread should compress as economic growth accelerates. (Figure 2)

**Figure 1: REITs Have Generated Strong Returns as 10-Year Rates Rise During Early Economic Expansions**



Note: Figures are REIT returns during each interest rate rise  
Source: Land and Buildings, Bloomberg, NAREIT

**Figure 2: Implied Cap Rates Wide to BBB Bond Yields**



Source: Land and Buildings, Bloomberg, Citi

**4Q13 “Must Own” Property Stocks**

The Land and Buildings’ “must own” property stocks mentioned in last quarter’s outlook were up 6% in the third quarter, outperforming the REIT index which was down 3%. See below for our current “must own” stocks for the last quarter of the year.

Three stocks have been added to the fourth quarter “must own” list: DiamondRock Hospitality (NYSE: DRH; Lodging), ProLogis (NYSE: PLD; Industrial) and SBA Communications (NASDAQ: SBAC; Cellular Towers), while Host Hotels (NYSE: HST; Lodging) has been removed, though it remains an attractive investment opportunity. All year-to-date returns are as of 9/30/2013.

- **BRE Properties (NYSE: BRE; Apartments) Up 2% in 3Q13, Up 2% YTD**—BRE Properties is an owner, operator and developer of apartment communities throughout the supply-constrained markets on the West Coast, including San Francisco, Los Angeles, Orange County, San Diego and Seattle.

BRE Properties trades at a ~30% discount to the private market value of its assets. This discount is likely to narrow one of two ways: the company’s operating fundamentals will improve and come in well ahead of expectations or BRE will seek strategic alternatives, including selling the entire company.

On July 31<sup>st</sup>, 2013, [Land and Buildings sent a letter to BRE Chairman Bud Lyons](#) expressing our disappointment that BRE did not seriously consider our June offer, on behalf of a consortium that would include Land and Buildings, to purchase BRE Properties for \$60 per share.

- **CoreSite (NYSE: COR; Datacenters) Up 8% in 3Q13; Up 26% YTD**—CoreSite is a national provider of datacenter products and interconnection services with 14 datacenter across nine major U.S. markets including Los Angeles, San Francisco, Chicago, Washington DC and New York City.

The CoreSite story remains compelling as the company has robust core internal growth, significant external growth value creation and a discounted valuation.

COR has among the best organic growth profiles in the REIT universe. Double-digit same-store NOI growth, driven by both increasing occupancy and rents, is likely. Leasing activity in the retail/colocation datacenter segment remains at a high level and cloud computing providers are particularly active according to our industry contacts.

The company's development value creation engine is in its early phases as the company has enough land and buildings currently on the balance sheet to double its size in a few years' time. And at an implied cap rate of 8%, the company has significant valuation upside potential as well.

- **DiamondRock Hospitality (NYSE: DRH; Lodging) Up 15% in 3Q13, Up 22% YTD—***DiamondRock Hospitality owns 27 hotels across major gateway and destination markets primarily in the United States.*

DiamondRock is well positioned to generate high single digit RevPAR growth in 2014 and EBITDA growth in excess of 20% as the company is now set to benefit from \$140 million of renovations that resulted in \$12-\$15 million of less EBITDA in 2013 versus 2012 and was a 3% drag on overall portfolio RevPAR. Going forward DRH should get this lost EBITDA back plus a return on its investments, leading to upside to current consensus EBITDA estimates. The stock is trading at 12x 2014 EBITDA, a discount to peers and the private market despite further renovation tailwinds to boost growth beyond next year.

The company has prudently managed its balance sheet with low leverage, positioning the company to take advantage of acquisition opportunities as they present themselves, but currently the focus is inwards through its renovation program and other asset management initiatives to drive down expenses and take advantage of incremental revenue opportunities. The company's forward group bookings are strong, with the combination of higher rates and higher number of rooms booked translating into a pace of over 10% RevPAR growth for the group segment in 2014.

- **General Growth Properties (NYSE: GGP; Regional Malls) Down 2% in 3Q13, Down 2% YTD—***General Growth Properties owns and operates 123 high-quality regional malls across the United States.*

General Growth's clear focus on leasing up the portfolio and improving the tenant base is paying off, with 6.8% same store net operating income growth in the second quarter, the highest in the mall sector. The company's malls are gaining share of the consumer's wallet, with 5.1% sales growth in the malls over the past year, outpacing its peers and national retail sales. Strong operating results should continue, with the company expecting in excess of 4% annual net operating income growth over the next several years

The company recently bought back over \$550 million of stock, removing an overhang and reducing Pershing Square's stake to less than 4% of the company. This was an attractive use of capital from the sale of its Brazilian investment, further simplifying the company and focusing attention on sector-leading core trends.

The stock is trading at an attractive relative valuation to its class A mall peers and is likely trading at more than a 20% discount to net asset value based on the private market values of its assets.

- **Kilroy Realty Trust (NYSE: KRC; Office) Down 5% in 3Q13, Up 8% YTD**—Kilroy owns, operates and develops high quality office properties that span top coastal market locations from Seattle to San Diego. The Company's portfolio totals approximately 13.5 million square feet.

Multiple meetings with senior management as well as channel checks across the industry confirmed that office leasing activity and rental growth are picking up in San Diego, are reaccelerating in San Francisco, and remain at a high level in Seattle. A resumption of robust growth in the Bay Area in particular does not appear well understood by the markets. Continued occupancy and rental rates increases should cause KRC to deliver annual same store NOI growth of at least 4% for the next several years.

Kilroy has been relatively quiet on the external growth front the past several months, but the savvy KRC management team should continue to unearth attractive acquisition and development opportunities across its core markets and that additional value creation is likely imminent. The company is currently underway on over \$800 million of fully leased developments with over \$1 billion of additional developments either in the pipeline or currently being evaluated. With development yields of 7-8% and market cap rates of sub-5%, the company is creating over 20% net asset value growth with the current active and shadow pipeline combined.

- **Las Vegas Sands (NYSE: LVS; Gaming) Up 26% in 3Q13, Up 47% YTD**—Las Vegas Sands is the pre-eminent operator and developer of integrated casino resorts predominantly located in Macao and Singapore, featuring a combination of gaming, lodging, entertainment and retail facilities.

Macao gross gaming revenues continue to beat expectations, up 17% year to date through September. Las Vegas Sands is particularly well positioned for growth with assets located on the Cotai strip and a focus on the mass market. Infrastructure improvements such as rail lines and expanded border gates are driving increased visitation from mainland China.

Last summer Land and Buildings highlighted the significant discounted sum of the parts valuation of the company's retail, hotel and gaming businesses embedded in its integrated resorts. Fair value of the company's assets were estimated at \$85 per share at the time, while the stock traded in the low \$40s, which could be unlocked through a strategic transaction (e.g. REIT conversion) or a resumption of strong trends in Macao gaming revenue. The stock continues to trade at a discounted valuation today despite making meaningful progress in closing the gap: LVS now trades at ~\$70 including last year's special dividend. For Land and Buildings' full analysis, please see our September 2012 presentation, [\*\*Las Vegas Sands: Unleashing The Best Mall and Lodging REITs in the World \(And Why the Stock Can DOUBLE\).\*\*](#)

- **Prologis (NYSE: PLD; Industrial) Flat in 3Q13, Up 5% YTD**—Prologis is an owner, manager and developer of industrial real estate globally.

Prologis has the leading global platform in the industrial sector and is well positioned to capitalize on strong fundamentals in the industry through rent increases and external growth from development. The portfolio should generate in excess of 4% annual same store NOI growth as an improving global economy is driving incremental tenant demand and there is limited new supply competing with the company's high barrier to entry portfolio that is focused in key gateway markets.

The company is in position to go on offense with the balance sheet now in solid position following the merger with AMB Property in 2011. Development should be accretive to earnings and net asset value with \$2 billion of development starts annually to help drive earnings growth of near 10%. The valuation near a high 5% implied cap rate is attractive based on the growth potential of the portfolio and private market value of the assets.

- **SBA Communications (NASDAQ: SBAC; Cellular Towers) Up 9% in 3Q13, Up 13% YTD**—SBA Communications owns and leases 17,500 multi-tenant cellular towers across North and South America.

SBAC's second quarter earnings came in ahead of analyst estimates and the company raised 2013 revenue and cash flow guidance. Robust organic leasing and a high level of accretive acquisitions were the primary drivers of the better than expected results.

Industry contacts have described current tower leasing fundamentals as the "strongest ever" with strong prospects for 2014 and 2015 underappreciated by the market. As the major wireless carriers, such as AT&T and Verizon, achieve nationwide 4G/LTE coverage, a second phase of tower leasing begins in earnest where the networks are densified. Carriers slow down lease amendments on existing towers and accelerate higher value leases on new towers. This process of infill leasing and "cell-splitting" should continue for several years, allowing SBAC to likely grow same store EBITDA above market expectations at 12%+ annually over the next 3 years.

Year-to-date, SBAC is outperforming the REITs by 1,000 bps and cellular tower peers by 1,200 bps on average. Outperformance should continue given the stock trades at a 10% discount to REIT cash flow multiples and SBAC is growing cash flow per share more than twice as fast as traditional real estate.

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