REAL ESTATE SECURITIES THE SUSTAINABLE WAY

INVESTING IN GREEN RE SECURITIES WITH AN ESG APPROACH

October 2016 - La Francaise Forum Securities & Inflection Point

The first three quarters of the year 2016 are over.

It has been a bumpy ride and volatility will continue, as we remain concerned about the strength of the global economic recovery and the outcomes of political events around world. As we start to look for return generating opportunities in the final quarter of 2016, it is important to examine the performance of different asset classes, the behavior of real estate securities over the past nine months and the outlook on yields and total return.

This paper introduces investors to the topic of green / sustainable investing in the real estate securities sector. Readers will better apprehend the notion of "green" & "sustainable" as it applies to real estate equities. Furthermore, we will present empirical evidence that companies with a strong sustainability orientation do experience better financial performance. We will also argue that the future of real estate securities investing is in green real estate securities products – that are still hard to come by in the investment community. Undoubtedly, we would like to be considered as innovators with a cutting-edge approach to the real estate securities asset class.

First, a few basic questions:

1) **What is a real estate security and a REIT?**

People often use the term real estate security and REIT interchangeably.

We do not think that it is correct but understand the simplicity of using the term REIT for its brevity rather than real estate securities. In fact, the REIT is a subcategory of real estate security.

REIT is an acronym that stands for "real estate investment trust". There is no single definition for a REIT. Rather, they are defined by the legislation of the country of registration. However, REITs (regardless of country of origin) do share some commonalities – majority of net profits have to be distributed in the form of dividends to shareholders in exchange for tax transparency. The different legal systems may further impose other constraints such as external management, limitation on the degree of leverage, limitation vis-à-vis green field development activity, etc. Roughly, two-thirds of the global real estate securities universe can be characterized as REITs.

Companies that do not enjoy tax transparency and do not have any specific obligations regarding distribution are not REITs, but rather real estate operating companies. They are not subject to any specific regulation vis-à-vis leverage, development activity or distribution; hence, as a result, their dividend payout ratios tend to be lower and their engagement into development activity higher. Japanese, Singaporean, Hong Kong and many European companies tend to fall into this category.

The real estate securities universe is not limited to REITs and real estate operating companies. There are other types of real estate instruments that are eligible for inclusion and investment: real estate bonds and real estate preferred equity.

In conclusion, public real estate securities can be categorized as follows:

REITs
(Real Estate Investment Trusts)

- Tax transparent
- Obligatory high dividend pay-out ratio (min. 80-90%)
- Little or no development exposure, cash flow focus as a result
- Specific limits may apply with respect to leverage and management structure
- Approximately 65% of developed world universe and 15% of emerging markets universe are REITs

REOCs
(Real Estate Operating Companies)

- No tax transparency
- Dividend pay-out is discretionary
- No limitations with regards to use of cash or development activity
- Exist where REITs are not eligible or where company's business model is not suitable for REIT structure
- Prevalent in emerging markets, in homebuilding in the developed world, and hotel and niche sectors

Preferred Equity
(issued by listed RE companies)

- Hybrid instrument, senior to equity and junior to bonds
- Priority over common equity holder in dividend payment and in liquidation process
- Typically preferred equity is non-voting and can be called by issuer
- Liquidity of preferred equity may not be as readily available
- Typically less volatile than common equity

Debt Securities
(issued by listed RE companies)

- Attractive when market dislocation occurs and risk adjusted returns are more favorable in corporate debt instruments vs. equity
- No limitations on senior, junior, investment grade, high yield, secured or unsecured – function of risk/return characteristics
- Typically seeking opportunistic exposure if sufficient liquidity can be sourced

Geographically speaking, the real estate securities universe – as defined by the most recognized global real estate securities index, FTSE EPRA/NAREIT Global Developed Index – consists of 330+ real estate securities, spread across North America, Europe and Asia.

This is the universe that we will consider for our analysis:

Country / Region	No. of companies	Market Cap. (US$ Bn)	Global Weight (%)
Asia-Pacific	**80**	**386**	**27.0**
Japan	*40*	*156*	*10.9*
Hong Kong & China	*14*	*110*	*7.7*
Australia	*14*	*87*	*6.1*
Singapore	*12*	*33*	*2.3*
Europe	**103**	**232**	**16.2**
Western Europe	*66*	*160*	*11.2*
United Kingdom	*34*	*67*	*4.7*
CEE & South Africa	*3*	*5*	*0.3*
North America	**150**	**814**	**56.8**
United States	*132*	*776*	*54.2*
Canada	*18*	*38*	*2.7*
Total FTSE EPRA / NAREIT Developed Index	**333**	**1,432**	**100.0**

Source: La Française Forum Securities. As at September 30, 2016.

2) What is a green real estate securities strategy?

A "green real estate equity" is a listed company with underlying property holdings or investments that display above average environmental, social, and governance ("ESG") sustainability characteristics.

A green real estate securities *strategy* is thus an investment platform where the "sustainability" of the underlying holdings dictates their inclusion in the strategy, in addition to an analysis of the securities' risk-adjusted financial return prospects. The sustainability characteristics that would typically be examined are as follows:

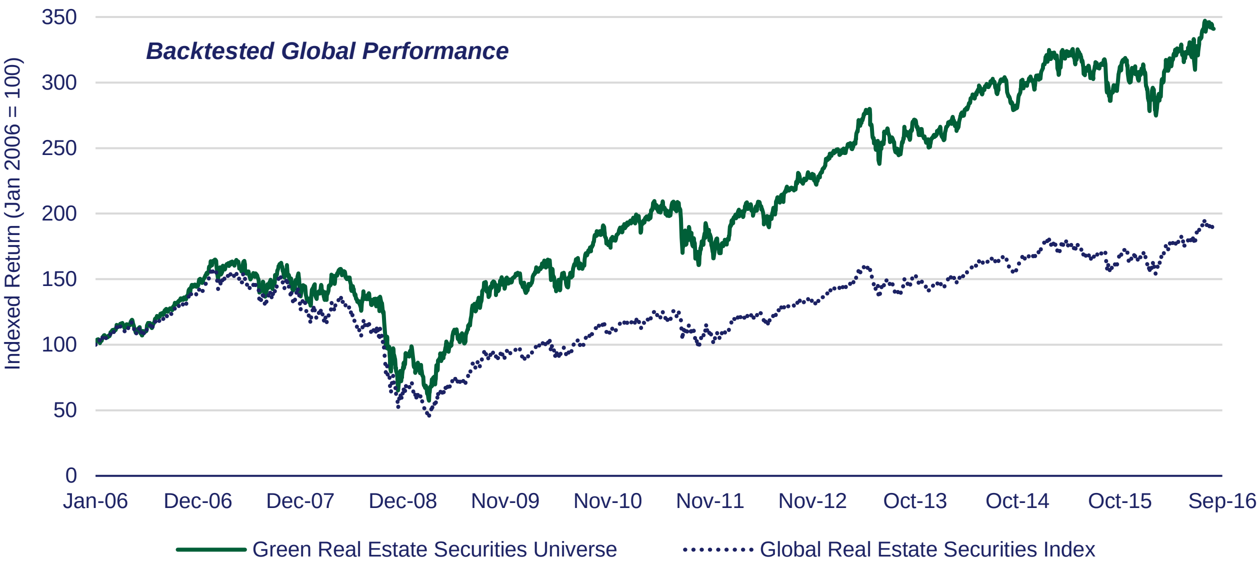
- → Energy efficiency
- → Carbon (climate) efficiency
- → Water use efficiency
- → Materials use efficiency
- → Health and safety quality for tenants
- → Proximity to public transit

Making a thorough assessment of these characteristics requires a great deal of in-depth company research. However, there are compelling reasons, both financial and sustainability-wise, for conducting such research. On the pure economic side, buildings with superior "eco-efficiency" or sustainability can demand higher rents (approximately 20%, BREEAM), achieve superior transaction values (approximately 11% on average for new buildings, LEED) and incur lower operating costs (aggregate reduction of 19%, LEED). They tend to generate greater tenant satisfaction and loyalty, as well as better productivity (typically around 16% on average, LEED). This in turn leads to higher occupancy rates (10%, Energy Star) and, consequently, lower turnover and transition costs.

The pure sustainability benefits include significant reductions in energy use (typically around 25% on average, LEED), carbon emissions (typically around 5-55%, BREEAM) and water use (typically around 11% on average, LEED).Other benefits include the savings resulting from fewer tenant/worker sick days. But for investors, the bottom line is this: real estate securities with underlying holdings that are superior to their peers in terms of sustainability are, quite simply, better-managed companies. This is in turn a strong, leading indicator that they will be superior financial investments, both in terms of accounting-based indicators and share price performance.

Inflection Point Capital Management has been able to rank over 250 of the largest securities from the global real estate universe based on its own proprietary "ESG" model. La Francaise Forum Securities carried out a back test to research whether the hypothesis of outperformance of "greener" companies holds.

The backtest takes into account the upper half of the IPCM-ranked global real estate securities universe, i.e. companies with above average ESG scores. The performance of this "ESG/green" universe is weighted based on individual security market capitalizations.



	Total Return	Mean Annual Return	Volatility	Sharpe Ratio	Mean Excess Annual Return	Beta
Green Real Estate Securities Universe	237.5%	12.0%	21.5%	0.56	5.6%	1.051
Global Real Estate Securities	87.6%	6.0%	20.0%	0.30		

Source: Bloomberg, La Française Forum Securities. As at September 30, 2016.
Note: Global Real Estate Securities Index = FTSE EPRA/NAREIT Developed Index USD (Bloomberg Ticker = RUGL Index). All index performance figures are quoted in USD GROSS OF FEES. All figures are reflective of a proprietary backtest. Backtested performance does not represent actual results. Actual results can differ significantly from the backtested returns being presented. Methodology includes daily rebalancing and excludes foreign exchange hedging and transaction costs.

This annualized gap of 600 basis points (6%) could be called a "sustainability alpha premium", and it is clearly one of significant size. But what is even more important, is what is likely to happen to that alpha premium going forward: it will most probably increase. That potential increase will be driven by at least three major trends:

- → Tightening "green" regulations for buildings in virtually every region in the world
- → Accelerating growth in tenant appetite for greener buildings
- → And, a dramatic increase in investor demand.

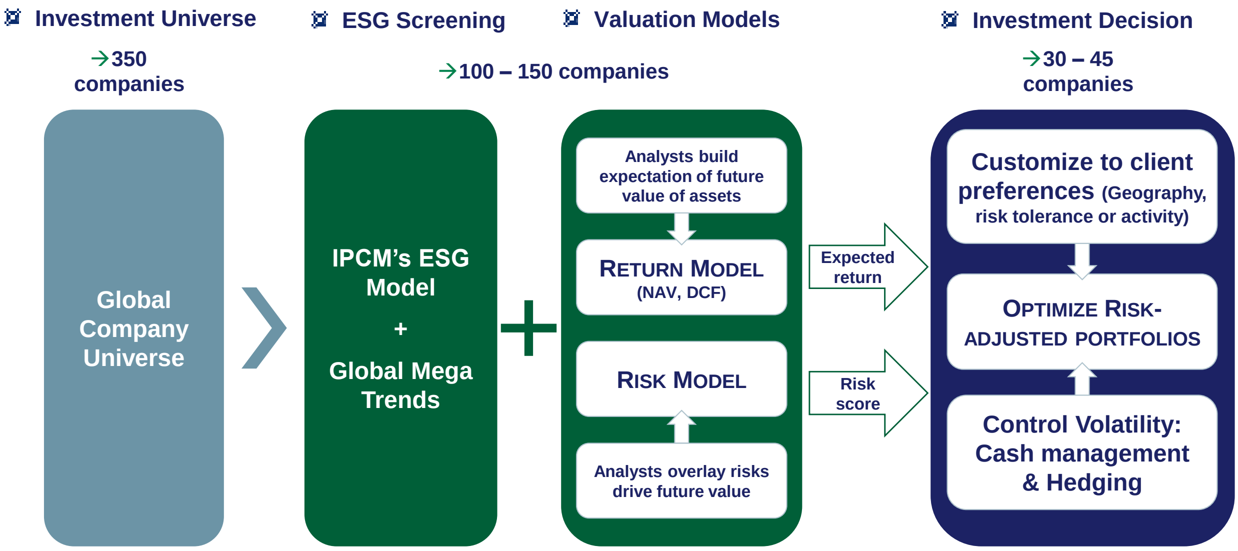
As further evidence, the UN Principles for Responsible Investment, a coalition of asset owners and managers dedicated to improved sustainability, has grown in signatory assets from US$6.5 trillion to US$62 trillion, in only 10 years (Source: PRI Association).

Real estate securities in general are an increasingly important and attractive asset class. But *green* real estate equities are the future, and the future is already here!

Our Solution

La Francaise Forum Securities and Inflection Point are pleased to propose a green real estate strategy designed for institutional investors. The strategy focuses on active portfolio management within a predefined ESG-compliant universe, i.e. subset of global real estate securities universe where companies have an above-average green score. The actively managed strategy goes one step further and focuses on the stock selection of real estate securities that are not only well positioned in the ESG ranking (i.e. above-average) but that offer an attractive investment proposition as far as the financial analysis of risk and return is concerned. This financial analysis includes the assessment of potential risk-adjusted returns based on standard valuation methods used in the real estate asset class - net asset value and discounted cash flow – with a forward-looking view over the next two to three years. The projection of macroeconomic drivers and real estate realities, both quantitative and qualitative, are reflected in individual models, which serve as the basis for stock selection in the ultimate portfolio. We believe that such a concentrated portfolio can deliver a higher performance than the real estate securities benchmark.

ESG INVESTMENT PROCESS
Portfolio construction



The investment process and skill set described above reflect the extensive global experience and talent of two La Française subsidiaries, La Française Forum Securities and Inflection Point.

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Associated risks: Real estate securities risk, investment in small and mid-caps, liquidity risk, exchange rate risk, credit risk relating to issuers of debt securities, discretionary risk, risk of capital loss, interest rate risk, non-diversification risk.

Important Backtest Disclosures: Backtested performance is NOT an indicator of future actual results. The backtested performance results referenced in this paper do NOT represent returns that any investor actually attained. The backtested performance referenced in this paper does NOT reflect the deduction of advisory fees, brokerage or other commissions, or any other expenses that a client would have paid. Backtested results are calculated by the retroactive application of a model constructed on the basis of historical data and based on assumptions integral to the model, which may or may not be testable and are subject to losses.

General assumptions include: LFFS would have been able to purchase the securities recommended by the model and the markets were sufficiently liquid to permit all trading. Changes in these assumptions may have a material impact on the backtested returns presented. Certain assumptions have been made for modelling purposes and are unlikely to be realized. No representations and warranties are made as to the reasonableness of the assumptions. This information is provided for illustrative purposes only.

Backtested performance is developed with the benefit of hindsight and has inherent limitations. Specifically, backtested results do not reflect actual trading or the effect of material economic and market factors on the decision-making process. Since trades have not actually been executed, results may have under or over compensated for the impact, if any, of certain market factors, such as lack of liquidity, and may not reflect the impact that certain economic or market factors may have had on the decision-making process. Further, backtesting allows the security selection methodology to be adjusted until past returns are maximized. Actual performance may differ significantly from backtested performance.

Backtested results are adjusted to reflect the reinvestment of dividends and other income and, except where otherwise indicated, are presented gross-of fees and do not include the effect of backtested transaction costs, management fees, performance fees or expenses, if applicable.

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