



North America
United States
Financial
REITs

Industry
**US REIT 3Q16
Earnings Preview**

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Results

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REIT pullback & low bar could spark 3Q rallies, but don't get too excited

House view remains constructive for REITs as fundamentals moderate
Following a strong start to 2016 the REITs have traded off 10% since 8/1. The decline coincides with a 30bps rise in the 10-year yield and increasing probabilities of a Dec rate hike. While painful, the move has reset valuations, which now appear much healthier. As we have stated in the past, we think the REITs remain in macro limbo, with expectations regarding yields and overall risk appetites trumping bottom up trends. Given the DB house view, which calls for muted GDP growth, a stable 10-year environment, and no recession through 2017, combined with less aggressive REIT valuations, we think the stocks have a little room to run if 3Q can exceed low expectations.

Data Centers remain our focus, despite expected leasing volume decline
Following several Q's of record leasing we think the Data Centers could be poised to see some moderation in 3Q as activity naturally ebbs and flows. There are some concerns that public cloud players may take a pause in leasing activity following a rapid period of expansion, but with penetration of cloud workloads still low, we think any such pause would be temporary. Also, with the 10% and 14% drops in DLR and CONE, respectively since 8/1, we think expectations are low, making for an interesting setup for 2 names with secular demand drivers and above average growth prospects over the next few years.

Strip valuations looking better, but Sports Authority optics could be a challenge
Last Q we got less positive on the Strips as valuations had gotten ahead of fundamentals. With the markets seemingly feeling less risk averse, the Strips have pulled back by 11%, easing valuation concerns. 3Q could be optically challenging, however, as the impact from the Sports Authority bankruptcy, as flagged as it has been, finally hits reported SS NOI results. We will be more focused on how much progress has been made on releasing these boxes and who else might be next, with Golfsmith's bankruptcy a much smaller impact on the space. With still substantial relative value discounts in the space, we remain constructive on Buy-rated RPT, RPAI, and BRX.

Slowing trends expected in the Apartments, Malls, and Office sectors...
We are looking for moderating fundamentals for the Apartments and Office as supply in gateway markets remains elevated and job growth has slowed. While the issues in S.F. and NYC have been making headlines for some time, we will be focused on L.A. where job growth has decelerated for the past 2 months and D.C. where trends have improved. SLG, however, appears to have had another good leasing Q, with 2.3msf of YTD activity as of mid-September suggesting over 800ksf of deals signed with a couple of weeks left in 3Q.

...Healthcare fundamentals healthy, but investment volumes remain soft
Health care operating trends were positive in the Q per data from NIC, as occupancy was up and rent growth improved versus last Q. Although we have been concerned about pending supply, demand appears to be healthy. Concerns about the acquisition environment, however, remain; with Sr. Housing transaction volume continuing to fall in 3Q and VTR's recent acquisitions in the life sciences and hospital segments also suggesting fewer opportunities in traditional Sr. Housing.

Estimates, valuations, and risks
Our target prices are based on our forward NAV estimates and earnings multiples. Risks are supply/demand imbalances and capital market conditions. See pgs 54-55 for a summary of our target price and estimate changes.

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| Key Changes | | |
|-------------|--------------|--------|
| Company | Target Price | Rating |
| CIO.N | 15.00 to | - |
| | 15.50(USD) | |
| CONE.OQ | 60.00 to | - |
| | 59.00(USD) | |
| DLR.N | 112.00 to | - |
| | 108.00(USD) | |

Source: Deutsche Bank

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