2021 INVESTOR OUTLOOK: WHERE DO WE GO FROM HERE?

MARKET COMMENTARY JANUARY 7, 2021

In 2020, Our Portfolio Shined As We Built Out Infrastructure For Future Growth

As We Head Into 2021, We Are Actively (But Patiently) Bidding Across Multiple Sectors

2020: THAT WAS SOME YEAR, BUT WE NAVIGATED SUCCESSFULLY THROUGH THE STORM

One year ago, we offered investors constructive advice on how to protect themselves against an economic downturn. We didn't predict a pandemic, of course, but we did stress the importance of investing in deals that avoided pitfalls like inflexible leverage and overly optimistic growth projections. When COVID-19 emerged domestically in February and then rapidly built momentum, that economic downturn was suddenly here overnight. What started off as a major international supply chain disruption quickly morphed into widespread shutdowns and a historic collapse in economic demand. There was a point in late March where we were concerned about collecting *any* rent from our portfolio. Fortunately, our management team had been through the Great Financial Crisis ("GFC") and multiple market cycles and took rapid and proactive measures to protect our assets and investors, such as stockpiling cash and negotiating aggressively with lenders and tenants. The best-laid plans cannot prevent disasters from happening, but experience and careful planning helped us navigate the crisis and return to pre-pandemic levels quickly. By the third quarter, we had resumed distributions at most of our assets and rent collections had recovered to greater than 90% portfolio-wide. Despite COVID-19's surge in the fourth quarter, we continue to see strong leasing activity and positive developments at our centers. Although the world has changed a lot over the past 12 months, our basic investment theses and principles continue to hold true. We saw metrics across our portfolio strengthen in 2020 and are primed for growth heading in 2021.

DESPITE A HISTORICALLY CHALLENGING YEAR, OUR PORTFOLIO METRICS ACTUALLY IMPROVED

	12/31/2019	12/31/2020	YoY Change
Occupancy	94.2%	96.1%	1.9%
Average Base Rent	$11.84	$12.22	$0.38 (+3.2%)
SF Leased	1,236,389	1,261,311	24,922 (Net Absorption)

Source: LBX Investments

WE PUT PIECES IN PLACE FOR EXTERNAL GROWTH

Growth was internal this past year as we did not make any asset acquisitions in 2020. This was largely due to a capital markets freeze in retail and a dearth of high-quality product on the market that met our risk/return requirements. REITs and other institutional retail owners – typically the primary source of our acquisitions – were in crisis management mode and opted, wherever possible, to delay selling underperforming assets into a depressed pricing environment. We used this time to take stock of market conditions and made several adjustments to our operating model in order to capitalize on the opportunities that we believe lie ahead over the next 12-24 months.

First and most importantly, we invested in our people. We expanded our in-house capabilities by making strategic and experienced hires in asset management, accounting, and property management. We also formally brought our leasing function in-house. These acquisitions enable us to vertically integrate most of our operations, improve our financial reporting and controls, and more effectively focus on strategic plan execution. As a best-in-class investment and asset manager, these improvements will better position us to control all of the detailed, day-to-day tasks that drive value and protect the equity at our properties. They will serve us well and improve our capabilities, operational performance and bottom line going forward.

Second, we expanded our investment partnerships and made the strategic decision to transform LBX Investments into a multi-sector company that will focus on acquiring shopping centers, apartments, and hotels. These are three sectors where we have deep professional experience – our partners have collectively run large public and private real estate companies and transacted several billion dollars of assets in these specific sectors. We believe that each of these strategies offers a compelling risk-return proposition in the current investment environment.

LBX VERTICALLY INTEGRATED IN 2020

- Brought leasing and a nationwide network of broker and retailer relationships in-house
- Internalized accounting for improved financial reporting and controls
- Hired a best-in-class asset manager to allow us to more effectively focus on strategic plan execution
- Added a top senior property manager to ensure we execute on the detailed, day-to-day activities that drive value and protect equity at our properties

- LBX Retail will continue to invest in neighborhood and community shopping centers. While our focus has predominantly been on Southeastern markets with this strategy, we have begun to look at opportunities outside of that footprint given our expanded internal capabilities. For example, we are currently bidding on grocery-anchored shopping centers in Missouri and Suburban Philadelphia that offer compelling risk-adjusted returns.

- LBX Residential (announced in September) is focused on investing in Class B multifamily assets in secondary and tertiary markets with attractive growth profiles. The entity is a partnership between LBX Acquisitions (Rob, Phil and Jason Post) and Arliga Capital, which is run by David Dowell. David is an experienced private equity professional who has led acquisitions and dispositions of more than $2.5 billion of commercial real estate over a 20-year career, including a significant focus on the multifamily space. LBX Residential will also leverage the capabilities of our partner, Post Investment Group, which has acquired more than $1.3 billion of multifamily since 2005 and has a tremendous track record of investing success over the past 15 years.

- LBX Lodging is being established to invest in distressed hospitality assets. We believe that the hotel space will begin to offer attractive investment opportunities this year, as owners and lenders are forced to either shed assets or seek rescue capital in order to continue operating through the next couple of years.

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NOTES ON THE GENERAL ACQUISITION ENVIRONMENT: REMAIN DISCIPLINED

Here are three themes we think investors should be considering as 2021 kicks off:

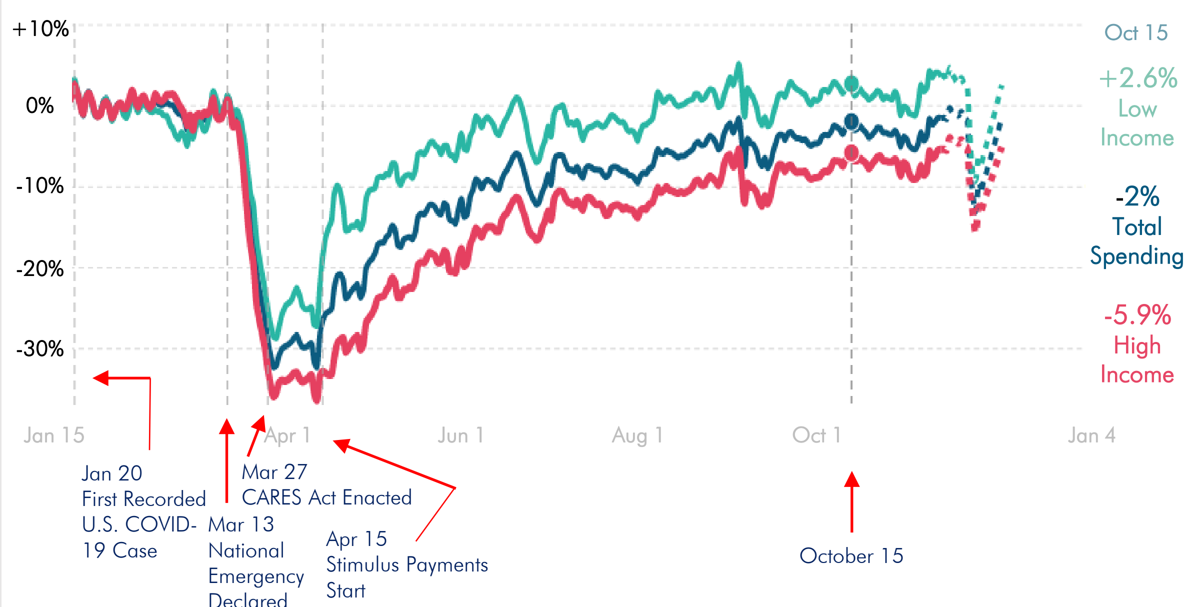
First, money is cheap and plentiful. There is liquidity everywhere, whether it is money sitting on the sidelines that is ready for investment, consumers propped up by stimulus, or historically low interest rates that are unlikely to move higher in the near-term. Lenders also returned to the fray in the second half of the year after mostly sitting the second quarter out. While lenders' underwriting standards have generally become more conservative, debt capital is now readily available across most sectors.

We believe this liquidity is creating opportunities for less disciplined investors to make bad decisions. We have not acquired any assets for 16 months, but have selectively bid on ~25 opportunities since the beginning of the pandemic (a far lower number of deals than we would typically pursue in any given year). We can't and won't chase deals simply to put capital out, and a consistent theme we have seen is that we have been outbid by fund investors who need to deploy capital – a dynamic we feel is leading to impatience and poor risk/return tradeoffs. For instance, while malls and the few hotels that have traded have seen price declines, multi-family and industrial pricing has strengthened over the past year and dominant grocery-anchored centers continue to command tight cap rates.
We expect this environment to persist in 2021 (and perhaps beyond), and encourage investors to remain disciplined as they evaluate investment opportunities in today's climate. Overly rosy underwriting can paint an attractive picture, but discipline is pivotal to making intelligent investment decisions.

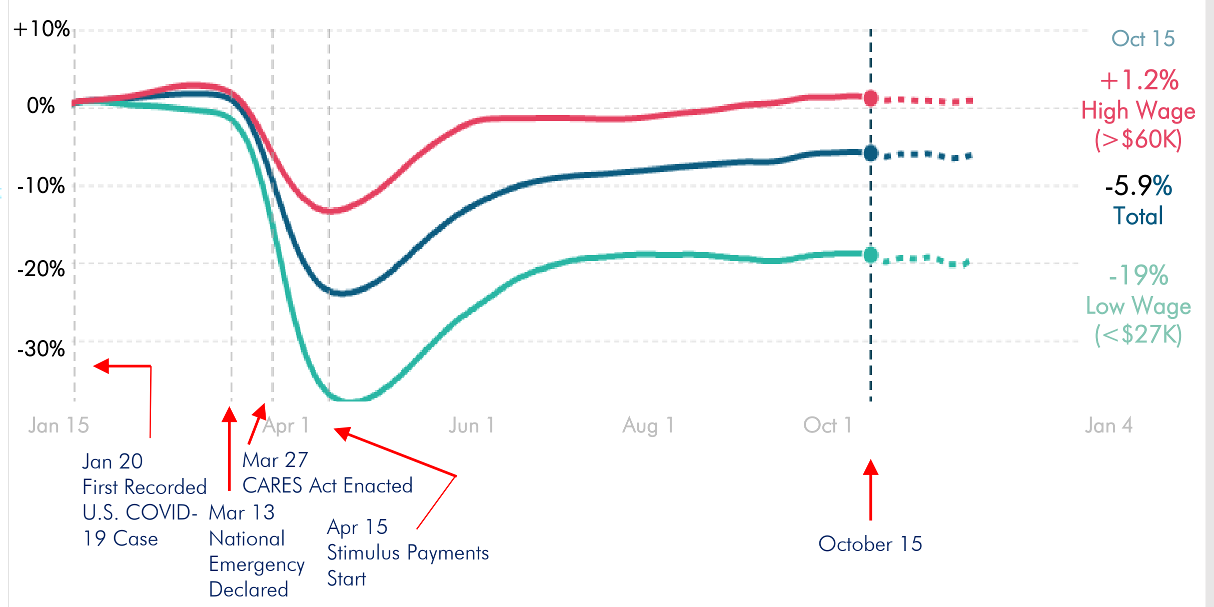
Second, there is still uncertainty around the pandemic and economic recovery, and underlying fundamentals are hard to evaluate. Therefore, in our view, making conservative assumptions when evaluating an investment opportunity and maintaining patience is more important than ever.

For example, the multi-family space is heavily correlated to the health of the consumer. Per the charts below, Class C multi-family renters saw very sharp job losses last year; as of October, low wage employment was down 19% from January. Despite terrible underlying fundamentals, low-income consumer spending was up 2.6% during this same timeframe and Class C multi-family rental collections stood at 87.8% nationally, down only 2.7% from a year earlier.

LOW INCOME CONSUMER SPENDING WAS UP 2.6% BETWEEN JANUARY AND OCTOBER 15th ...



... DESPITE EMPLOYMENT RATES DECLINING FOR THIS SAME COHORT BY 19% DURING THIS TIME PERIOD



Source: Track The Recovery (www.tracktherecovery.org)

While rapid government intervention helped prop up this segment of commercial real estate, this example is instructive. We have adopted very conservative measures when underwriting multifamily going forward because deals cannot rely on stimulus in order to make sense – we need to be prepared for the possibility that government intervention can lapse or reduce in size and breadth and therefore can have a significant impact deal performance. While we tend to focus on Class B multi-family, which attracts a higher-quality renter than Class C, we are still typically underwriting zero to minimal growth in the first year or two of a hold, widening cap rates at exit ~10 bps every year of ownership, and haircutting third-party rent growth estimates across the board. We also account for upticks in vacancy, turnover, and bad debt in the first few years of ownership in order to account for unknowns as COVID-19 runs its course. The multi-family acquisition environment is very competitive but we are staying disciplined and patient in our approach in order to ensure that any deal we win has ample downside protection.

Third, there has not been a lot of product on the market, but this should begin to change. While every economic downturn looks a little bit different, 2020's was characterized by a sudden, steep drop in demand and unprecedented uncertainty. This put a major damper on deal volume which, per Real Capital Analytics, through mid-November was 42% lower than through the same point in 2019. Multifamily investment sales volume did return with a flourish in the second half of the year, increasing +55.9% from 2Q to 3Q, and we have begun to see signs of life in the retail and hospitality sectors. On a sector-by-sector basis, here is a summary of market conditions that we are seeing for multi-family, retail and hospitality:

MULTI-FAMILY

We continue to look for value-add multi-family deals that have been undermanaged and under-capitalized in submarkets where we like the long-term fundamentals of multi-family. We have been actively bidding on deals but have thus far come up short on our pricing. That said, cap rates have stayed tight – in particular for suburban Class B product, which has benefited from a pandemic-induced flight from gateway cities. The agency lenders have continued to finance assets throughout the pandemic, debt capital is cheap and readily available, and market conditions are very competitive. We are remaining patient as we conservatively underwrite opportunities.

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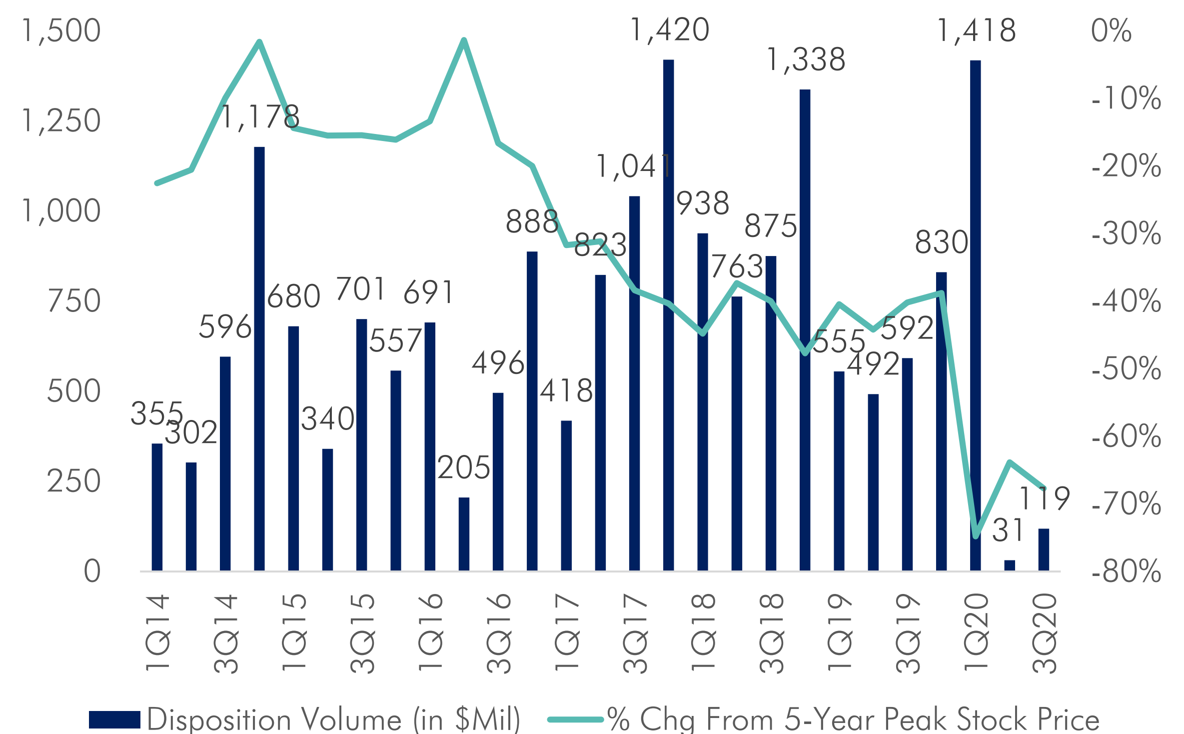
RETAIL

Our retail investment thesis has not changed despite COVID-19 accelerating structural trends like the rise of e-commerce. We believe that brick-and-mortar stores will continue to serve an important role for retailers for several reasons, foremost their profitability and ability to deliver a physical experience that the internet cannot match.

Our portfolio has performed well through the pandemic and our ability to underwrite tenants has only improved – we have a good grasp on which tenants weathered a challenging time successfully and which did not. The bulk of the problems and bankruptcies seen in the retail sector in 2020, outside of fitness and restaurant tenants, have been primarily mall-based. Grocers, essential tenants, discounters, and, surprisingly, many mom-and-pop businesses have been resilient.

The pandemic temporarily froze the capital markets for retail investments, impacting pricing and reducing the buyer pool. Additionally, lenders and borrowers have worked together to place loans into forbearance and temporarily defer tenant lease obligations in order to work through problems that arose earlier in the year. For these reasons, we have not seen an outflow of deals from shopping center owners yet.

HISTORICALLY, DECLINES IN SHOPPING CENTER REIT STOCK PRICES HAVE PRECEDED ASSET SALES



Source: LBX Investments and Company Reports

We do, however, expect to see an uptick in deal flow this year. First, we are hearing from many broker contacts that they are being asked for opinions of value, which generally is a leading indicator of sales activity. Second, REITs – which hardly sold any assets in 2020 and have accounted for more than half of our acquisitions – have come under considerable pressure from stock price declines (see chart above). REITs and other large institutions (which can only hold on to problematic retail for so long) were shedding billions in non-core retail assets prior to the pandemic as they repositioned their portfolios in the urban core, where cap rates have remained tight. We expect this trend to resurface – particularly for the REITs and large pension fund investors, as they need to raise capital for their portfolio activities through asset sales. We see many similarities between today's environment and the one that excited us when we started acquiring shopping centers in this strategy in 2016: (1) There is a supply-demand imbalance between buyers and sellers, and (2) the narrative around the retail sector is terrible, so good assets get thrown out with the bad.

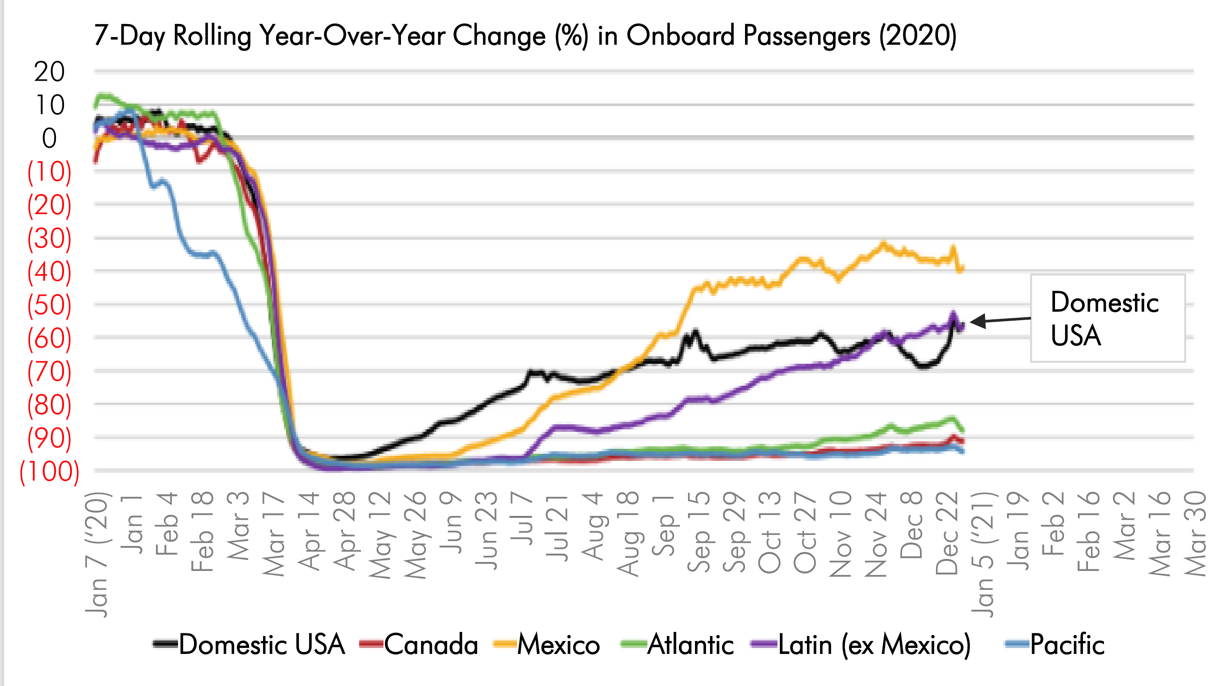
HOSPITALITY

Since the outbreak of the pandemic, the hospitality industry has been in a steep depression, with occupancy, RevPAR (revenue per available room), airline travel (see chart on right), tourism, and group business metrics all at historically low levels. While we have looked at equity opportunities in the hospitality space, much of the deal flow we expect to see in the coming months will likely fall into one of two categories: providing some form of rescue funding (e.g., preferred equity) to strong operators who need capital to manage through the recovery or acquiring discounted debt instruments from lenders who are seeking to minimize their exposure to the sector. We have been actively bidding on hotel investments (both equity and distressed notes), but the market has been somewhat thin, with minimal deal flow, but we believe 2021 will see a surge of opportunity.

Investors looking for more opportunistic returns in hospitality are probably looking in the right sector, but it is important to remember that peak loan defaults generally do not occur in the first year of a deep downturn. They can take several years to materialize, in fact, and quick actions taken by the FDIC, lenders, and borrowers early in the pandemic delayed widespread foreclosures and forced asset sales.

We have been bidding on both full and limited-service hotels that are newer builds and sit in well-trafficked locations. We have developed relationships with some of the most active hotel managers in the country, providing us with access to potential off-market opportunities and the ability to leverage their infrastructure to ensure we are underwriting risk appropriately. **The common trait we look for in all of the hotel opportunities we evaluate is the potential to own high quality real estate at a price below intrinsic value.** We do not intend to be long-term holders; rather, we are looking for opportunities to buy good assets cheap, manage them to profitability, and then sell into a recovering market. Industry forecasts vary but a recovery is broadly expected to coincide with widespread vaccinations, and the industry is expected to return to some sense of normalcy next year. We are generally underwriting to a more conservative outlook, assuming recovery to pre-pandemic levels in five years.

U.S. AIRLINE PASSENGER VOLUMES WERE 57% BELOW 2019 LEVELS IN THE WEEK LEADING UP TO CHRISTMAS



Source: Airlines For America

WHAT WILL 1Q21 HOLD?

Going forward, we will continue to carefully and prudently navigate our way through a complicated investment landscape while maintaining our conservative stance as we evaluate opportunities. We do ask our investors to be patient: 2021 should provide many intriguing investment opportunities, as stretched owners and lenders are forced to resolve outstanding issues with their assets.