Lazard Asset Management

Jay Leupp is a managing director and portfolio manager at Lazard Asset Management, responsible for U.S., international and global real estate investment strategies. Leupp founded Alesco Global Advisors in 2006 as president and CEO and was the senior portfolio manager of Alesco's real estate mutual funds. He was previously a real estate equity research analyst for 12 years, first at Robertson Stephens & Co. and then at RBC Capital Markets. Earlier in his career, he worked at the Staubach Co.

Christopher Hartung is a director in Lazard Asset Management's global real estate securities group and is responsible for investment strategy, research and product development. Previously, he was a senior adviser to Grubb & Ellis Alesco Advisors. Hartung was also a managing director covering the real estate industry at both Wells Fargo/Eastdil Secured and Banc of America Securities. He also serves as a director of FelCor Lodging Trust and as an advisory board member for Maier Siebel Baber.

Recently, ***Geoffrey Dohrmann,*** *publisher and editor-in-chief of* The Institutional Real Estate Letter – Americas, *spoke with* ***Jay Leupp*** *and* ***Christopher Hartung*** *of Lazard Asset Management. The following is an excerpt of that conversation.*

Can you briefly describe the Lazard platform?

Jay Leupp: Lazard is a global platform, which was attractive and interesting to us, with portfolio managers and research analysts that are located all over the world. It is an organization with a rich investment culture and a history of global sector expertise. We are the first team devoted to public real estate securities to join the Lazard platform, but there are over a half dozen analysts and portfolio managers in other offices around the world — New York City, London, Sydney, Tokyo — that have property sector exposure, and that has a very synergistic effect on our investment process.

Christopher Hartung: If we step back a bit, Lazard is over 165 years old. It is an organization that focuses exclusively on providing fiduciary advice to clients, either in the form of investment management, which is where we sit, and investment banking, which is the other half of Lazard. On the Lazard asset management side, the firm currently manages approximately $160 billion of AUM that is divided primarily amongst an institutional client base and, importantly, over two-thirds of the assets are managed in global strategies. So the firm has been investing globally for decades, and we think that combined with the reach that Jay is talking about, is a fairly attractive piece.

Your team has been investing for over five years, but you launched the Lazard Global Real Estate Investment Group last year. What brought you to Lazard in the first place?

Leupp: We decided to partner with Lazard for a number of following reasons: Lazard has built a successful investment management business globally based upon a foundation that is characterized by high business and ethical standards, which was very important to us. Additionally, we sought an organization that has a rich investment culture and a history of deep global sector expertise. These are two areas in which Lazard has historically excelled.

Hartung: We also found compelling the fact that Lazard has been a pioneer in the evolution of the investment management industry, particularly around certain areas such as incorporating ESG issues into investment analysis and decision making. Bottom line, we are thrilled to be part of an organization that we believe is truly committed to investment management and wherein we can leverage extensive expertise to build a highly successful real estate investment management business.

What are some of the other issues that distinguish Lazard in your mind from other real estate investment managers?

Hartung: We believe our team and investment approach is differentiated from other real estate investment managers. Our team specifically has a multi-faceted real estate experience set in a number of critical areas, including real estate development, tenant brokerage, credit, investment banking and direct industry involvement with industry groups such ULI. We believe that this multi-faceted experience set allows us to better understand nuances that drive underlying real estate values and cycles, and this then becomes the baseline for our conviction weighted approach to portfolio construction.

Leupp: Additionally, we believe a key area of differentiation is the fact that our investment approach combines both top-down and bottom-up components. While we evaluate each individual investment on its own merits, we also are mindful that real estate is cyclical and that there can be significant trends that can favor one sector or geography over another. It is critical that we maintain a balanced focus on both the forest and the trees. And lastly, the ability to leverage Lazard's global investment research, which I described earlier, and differentiated insight provides us with a tremendous market depth and sector expertise.

One of the concerns that a lot of people have had about investment bank–sponsored investment management operations is that the bank too often is using its own capital as a principal.

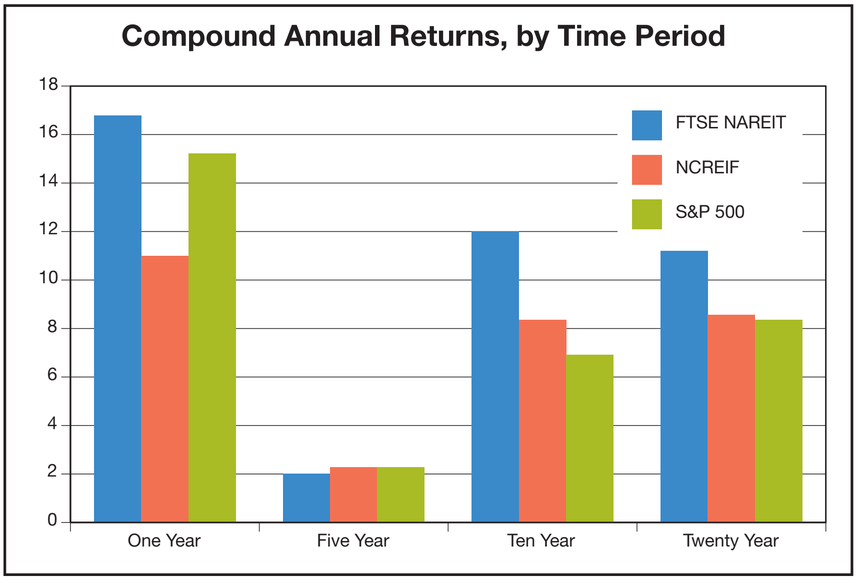
Hartung: That is something that we feel very strongly about as a firm and is why the firm focuses on advisory services and an investment management business, which at its essence is around fiduciary advice to the client. Further, the firm does not engage in proprietary trading.

You are not doing any proprietary trading?

Leupp: No. We do have a portion of seed capital that was used when we were first acquired by Lazard to seed our funds, but that is commingled with other investor capital in the mutual funds. There is some seed capital to help give the funds critical mass, but that is not traded separately.

Where do you see listed real estate fitting into an investment portfolio? What role does listed real estate play in an institutional investment portfolio from your perspective?

Hartung: With our team having over two decades of public real estate market experience and observation during this period of time, we think the performance record for public real estate securities speaks for itself. Whether you look over a five-year, 10-year, 20-year, 30-year or 40-year period, public real estate has outperformed general equities and has performed either ahead or in line with private real estate. If you take that track record and combine it with the substantial body of research that exists on the topic, it suggests that a 15 percent to 20 percent allocation to the real estate asset class may enhance investor risk-adjusted returns. We believe it has a fairly significant place. What is interesting is that, based on that 15 percent to 20 percent number, most investors are under-allocated to the asset class, and in particular within that allocation if they choose to invest in real estate, many investors implement that exposure through direct real estate investments only. If you look at that track record for public real estate securities, we believe that diversifying some of that direct investment exposure into public real estate is not only prudent, but in addition to helping enhance returns, it also adds additional diversification and liquidity, which should be important to investors.



Source: NAREIT
Data as of October 31, 2012

"The REIT model certainly has been a great success story in the U.S. … and we believe it has contributed to the maturation of the entire real estate industry here."

There has been no doubt that in the U.S. the REIT model is here to stay. It has proven itself over the past 50 years. What can we expect globally from securitized real estate over the next decade?

Leupp: Yes, the REIT model has been a great success story in the U.S. since the legislation was first enacted in 1960, and we believe it has contributed to the maturation of the entire real estate industry here in the United States. This coupled with the growth of securitized products, such as CMBS, has led to more transparency with respect to fundamentals, as well as governance. We think that this transparency has helped broaden real estate's appeal as an asset class. We have begun to see similar changes occurring in markets across the globe, particularly in Asia. And as countries adopt REIT-like structures, investors are more easily able to invest in real estate growth markets. Importantly, global growth is now shifting to emerging markets, and we think the next decade will see an acceleration in global REIT structures and investing.

We've seen a lot of change around the way capital is being formed around the globe, most particularly the move to define contribution pension plans away from defined benefit. How is that impacting your business?

Hartung: That is a very important question because, as we all know, the real estate industry has been hit quite hard during the past five years, and not only from the asset side. Corporations and governments are rapidly changing how they structure their safety nets, and this is resulting in a responsibility shift from the entity to the individual. Moreover, this shift is now shaping the type of investment strategies that are created and delivered to the defined contribution plan participant.

Leupp: Because of this, risk, or lack thereof, matters even more. Income matters even more. Liquidity matters even more. We believe this plays to our favor as public real estate exposure can help achieve these investor needs. This phenomenon is not isolated to the United States; it is also happening in Australia, the United Kingdom and we think it will eventually happen in the E.U.

So what are the biggest challenges facing the investors that are running these funds right now as they make these shifts?

Hartung: We look at the challenges facing investors, which are certainly numerous, and we think they fall into three broad categories. One is a structural change, which we just discussed, and relates to the shifting of retirement responsibility to the individual and then the resultant need for certain investment outcomes. In addition, investors are facing liability/deficit gaps and the need for global access. Now interestingly, some of the same investment characteristics that are being sought out as a result of structural change — namely, income and lower risk — are also being sought out to help deal with large liability-funding deficits.

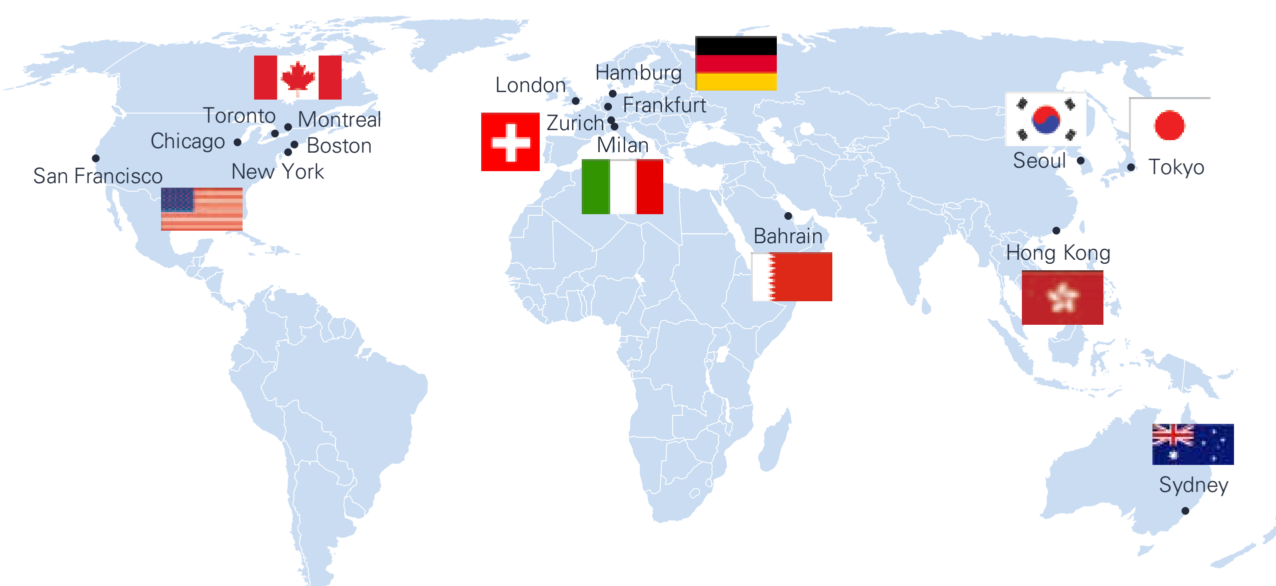
Leupp: With respect to global access, investors have realized that more than half of global GDP growth occurs outside of the G7 countries, and in order to participate in this growth story, one needs to invest globally. Lazard has tremendous experience in providing clients and prospects with customized global solutions that help investors meet their challenges. In addition, we believe the tangible nature of real estate combined with its inherent income characteristics is very well suited for today's investor needs of long-term income generation, capital preservation and also inflation protection.

Looking out over the next couple of years, looking around the globe at the various alternatives, where do you guys see the best investment opportunities?

Leupp: The global recovery in public real estate prices has been impressive during the past three years as investors have pushed up asset values in the face of an ultra-low interest rate environment. As a result, while deep value opportunities are tougher to come by, we think the market is now more normalized where investors' expectations should be more aligned with real estate's long-term performance experience. Specifically, return expectations are likely to revert to historical norms of a high single-digit to low double-digit range, and furthermore, a good percentage of this expected return is likely to come from current income. As such, we are focused on a barbell approach: On one end we look for companies that are discounted to underlying net asset value, really value investments, and have sufficient asset quality and market stability to help sustain current net asset value. On the other end of the barbell, we are looking for companies that, while maybe trading at, or near, net asset value, have stronger than normal growth prospects and, therefore, in our view, should show solid asset-level operating income growth going forward.

Hartung: For us, the currently attractive markets for growth are Asia, excluding the mature markets of Japan and Australia, as well as Brazil. These

Lazard Global Footprint



markets are attractive due to long-term powerful drivers such as the emergent middle class and the urbanization and general modernization that is going on in those societies. Now, investors certainly need to assess government risk more closely in these markets, but the beauty of real estate is that even in a Brazilian or Chinese secondary city, industrial or retail assets will be leased to global corporations, and this provides credit support to the asset. And because they are well-located assets built to international standards, investors can gain access to the market's long-term potential. Europe is on the other end of the spectrum, so even though there are good reasons behind the negative headline concerns, there are some great opportunities to buy companies at discounts to sustainable net asset value. However, in Europe investors need to look for idiosyncratic ideas. One may not get the growth that one could realize in Asia, but the discounted pricing combined with current yield may end up being an attractive risk-adjusted return opportunity.

Leupp: Due to the maturity and size of the U.S. markets, we view our home market slightly differently. Investors need to look at sectors separately, as any national average obscures valuation and growth differentials across these sectors. Even though multifamily has been in recovery mode for a few years, we think it is a mistake to ignore the fundamentals that will continue to drive growth in multifamily. On the flip side, we are cautious of a value trap as investors chase yields into assets with marginal quality or location. The initial income may look nice, but we view the risk of income erosion as high.

Hartung: Finally, you need to look on a very macro basis, and the big question there is: What is the impact of higher rates on the industry? We can't fully protect against this, nor can anyone, but due to our focus on global listed real estate and, therefore, our ability to quickly shift portfolio composition — whether by sector or geography — we believe that this allows us to be among the better positioned real estate managers to help manage to that potential risk, if and when it occurs.

You are operating in a global environment. How do you analyze and manage all the risks that you have to address in the portfolio? What is your approach to risk management?

Leupp: Yes, risk assessment is an incredibly important component of real estate investing. As a hard asset, one can look to tangible value; however, one cannot move the asset or easily or inexpensively change the asset. Therefore, if demand drivers change, if the political/regulatory environment changes, or if space patterns change, what once was a strong, growing income generator can become a dying, almost self-liquidating asset. We spend a lot of time trying to understand a company's underlying portfolio, its quality, its tenants and its competitive positioning. In addition, we also are cognizant of our overall portfolio composition to ensure that the portfolio is balanced by sector and geographic risk. You know, we are lucky to be a part of a truly global organization with more than 280 investment professionals located across the globe. This reach allows us to understand this risk from both a global and local perspective and is likely to help us result in a more consistent pattern of performance.

> *"We are a highly collaborative, interactive global investment culture."*

How do you tap into that? It is one thing having a network out there, but how do you tap into it and harvest the knowledge base that is out there?

Leupp: One approach is constant communication. Within our own internal network, we are in constant communication with our research analysts and portfolio managers who have property exposure across the globe. We travel extensively and oftentimes do company meetings and conferences jointly with our colleagues, whether in London, Tokyo, or Sydney. We are a highly collaborative, interactive global investment culture.

Hartung: What it boils down to is you need to have an organization that has a culture of both communication and collaboration. Lazard has been investing globally for decades. We have in place systems to support that collaboration and communication, whether it is real-time intranets, internal blogging systems, consolidated research databases, all on a global basis. What one team member does is available to other members of the investment team, and that in and of itself then creates a virtuous circle where we have a continual feedback loop globally. ❖

CORPORATE OVERVIEW

Lazard Asset Management is known for its global perspective on investing and years of experience with global, regional and domestic portfolios. With more than 280 investment personnel worldwide, the firm offers investors of all types an array of equity, fixed income and alternative investment solutions from its network of local offices in 10 different countries. With approximately $160 billion in assets under management at September 30, 2012, Lazard has offices located throughout the world in Bahrain, Boston, Frankfurt, Hong Kong, London, Milan, Montreal, New York City, San Francisco, Seoul, Sydney, Tokyo, Toronto and Zurich.

CORPORATE CONTACTS

Judi Mackey, Director, Global Communications
+1 212-632-6000
judi.mackey@lazard.com
www.lazard.com