

# Balancing Forces

*“Of everything that moves, the space which it acquires is as great as that which it leaves.”*

Leonardo da Vinci

January 2019

## Dear Fellow Shareholders,

Welcome to Monmouth Real Estate Investment Corporation’s Fiscal 2018 Annual Report. As I reflect upon our outstanding year gone by, and contemplate our very bright future, I think it is appropriate to begin with a reality check of sorts, to better understand where we fit within the grand scheme of things.

We are living in an age of widespread disruption. Today, reality distortion fields can be seen in abundance. For while the best way to predict the future may indeed be to invent it yourself, a newly created future can only truly endure if it remains in harmony with the balancing forces of nature.

Whether the subject is art, science, commerce, or value creation itself, fundamental adherence to these laws will be tested again and again, revealing for all to see that which is of lasting value, and that which is not.

Fiscal 2018 marked our 51st year as a public REIT. Our longevity is a testament to our conservative principles and our sound business model. It has been ten years since the global markets witnessed the end of The Great Moderation and experienced the biggest downturn since The Great Depression. The decades of stability from the mid-80’s through 2007 ultimately transitioned into The Global Financial Crisis. “Stability is destabilizing,” observed the late economist Hyman Minsky. People are all too willing to go further and further out on a limb, blinded to their own blindness, in search of alpha. To state the painfully obvious, human nature cannot help itself from exhibiting irrational behavior at times. Because it is impossible to say with complete certainty what the future will bring, we have always positioned Monmouth to be a conservative company, one that will endure and prosper in good times and in bad, and prosper we have.

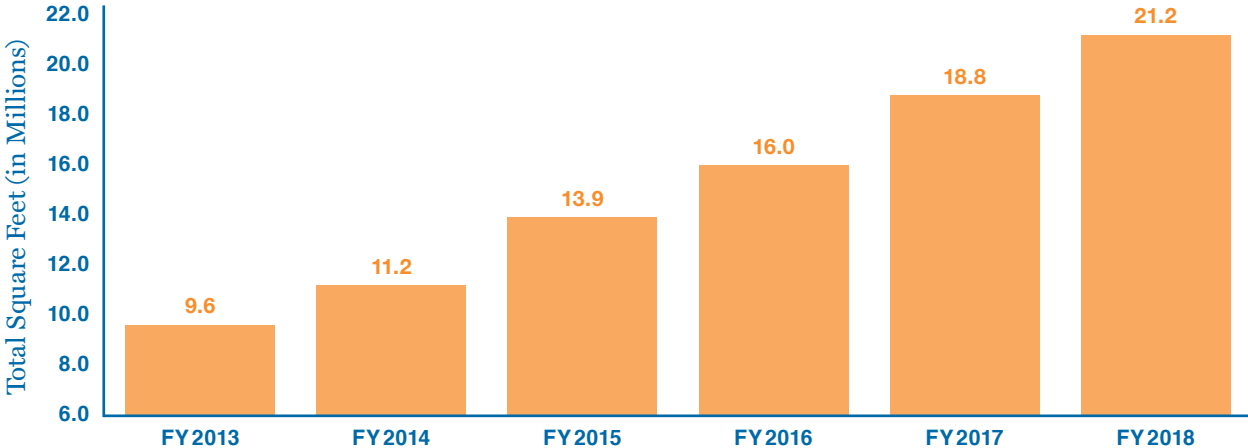
## During Fiscal 2018, the Company's many accomplishments include the following:

- Increased our common stock dividend by 6.3% to \$0.68,
- Generated FFO per share growth of 18.7% to \$0.89,
- Generated AFFO per share growth of 14.5% to \$0.87,
- Increased our Gross Revenue by 23.5% to \$152.3 million,
- Increased our Net Operating Income by 19.3% to \$114.8 million,
- Acquired 2.7 million square feet of high-quality industrial space for \$282.3 million, comprising seven brand-new Class A properties, all leased long-term, of which 85% is leased to investment-grade tenants,
- Completed two expansions for approximately \$3.5 million, resulting in ten-year lease extensions for both properties,
- Generated 13% year-over-year growth in our Gross Leasable Area to 21.2 million rentable square feet,
- Entered into commitments to purchase three Class A, build-to-suit properties comprising approximately 745,000 square feet, all leased long-term to investment-grade tenants,
- Renewed 11 of the 16 leases comprising 1.1 million square feet that were scheduled to expire in fiscal 2018,
- Excluding one short term renewal, the ten renewals resulted in a weighted-average lease term of 6.8 years, and rental increases of 4.1% on a GAAP basis and 2.8% on a cash basis,
- Maintained a sector-leading occupancy rate of 99.6% at fiscal yearend, representing our third consecutive year with above 99% occupancy,
- Extended our weighted-average lease maturity from 7.9 years to 8.1 years,
- Achieved an 8% total shareholder return for fiscal 2018, versus a 4% total return for the MSCI US REIT Index,
- Increased our total market capitalization by 17% to \$2.5 billion at fiscal yearend,
- Raised approximately \$90.0 million in equity through our Dividend Reinvestment and Stock Purchase Plan,
- Raised approximately \$41.0 million in gross proceeds through our Preferred Stock ATM Program,
- Extended our weighted-average debt maturity to 11.7 years at fiscal yearend,
- Reduced our weighted-average interest rate on our fixed-rate debt from 4.2% to 4.1%,
- Subsequent to yearend, completed an offering of 9.2 million shares of common stock, generating gross proceeds of \$138.0 million, and
- Subsequent to yearend, purchased two new Class A built-to-suit properties, comprising 474,000 square feet for \$113.1 million.

The past few years have seen unprecedented demand for industrial property portfolios. At the turn of the century we predicted that with the widespread growth of ecommerce our property type would gain market share from the traditional retail sector. Since that time, our prophecy has been coming true, and today the industrial real estate sector is on fire. In our admittedly biased opinion, Monmouth’s high-quality industrial portfolio is second to none. There are several factors that bear this out. First and foremost is our highly specialized focus. We invest solely in single-tenant industrial properties, subject to long-term net leases of ten years or more, to investment-grade tenants. Our all-star tenant roster currently includes: Amazon, Anheuser-Busch, Beam Suntory, Coca-Cola, FedEx, GE, Home Depot, International Paper, National Oilwell Varco, Shaw Industries, Sherwin-Williams, Siemens, ULTA Cosmetics, United Technologies, and other high-quality companies. To take our investment criteria to an even higher level, these properties must be well-located, the building construction needs to be Class A, and the acreage needs to be ample. Given such a stringent focus, it is no wonder that we have never been able to acquire a portfolio ourselves. The reason being our portfolio is the only one in existence that meets all these requirements. Built one high-quality asset at a time, our property portfolio comprises 113 properties totaling 21.6 million square feet, geographically diversified across 30 states.

There is irony in the fact that Monmouth, as one of the oldest REITs in the world, should still be one of the smaller companies. But this is simply because with a clear preference for quality over quantity, we march at our own tempo. We do not strive to be the biggest company, simply a better one. We have been able to achieve transformative growth over the past six years by more than doubling our Gross Leasable Area, without sacrificing our high-quality standards. Because this growth was accomplished through the acquisition of brand-new Class A, built-to-suit properties, today Monmouth owns the youngest and most state-of-the-art property portfolio in the industrial REIT sector. This year our acquisition volume totaled \$282.3 million, consisting of seven brand-new Class A, built-to-suit properties comprising 2.7 million square feet, with 85% of the total square footage leased to investment-grade tenants. We have assembled a modern industrial property portfolio that contains large amounts of excess land to accommodate future growth. Our tenants have made substantial investments in the infrastructure of these buildings. These are smart, highly automated industrial assets that are mission-critical to our tenants’ operations.

## Portfolio Growth



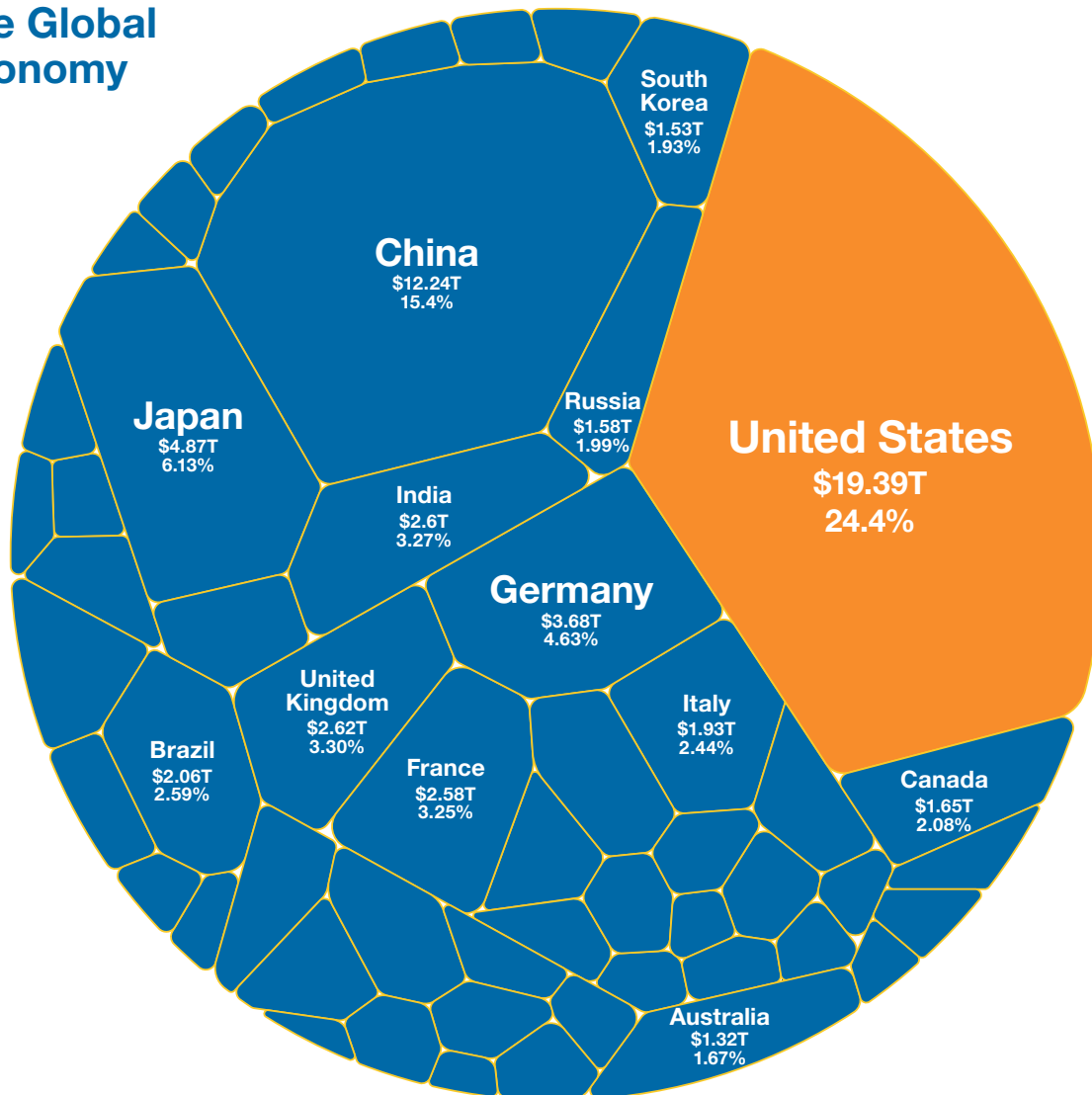
With 80% of our total rental revenue derived from investment-grade tenants, and the remaining 20% also generated from very strong companies, Monmouth provides some of the highest-quality earnings around. Our tenants deliver resilient income streams day after day, week after week, and year after year. But no one on earth delivers quite like our largest tenant, FedEx. Ever since the acquisition of our first property leased to FedEx in Richland, Mississippi, back in 1994, we have been amazed at the caliber of this company. While they still reside in our Richland facility, we now own 61 properties leased to FedEx, comprising 10.5 million total square feet, representing 48% of our gross leasable area. People were once concerned that the invention of the facsimile machine would curtail FedEx's growth. Then it was the advent of the high-speed scanner that would supposedly slow them down. These concerns were unwarranted. FedEx's growth continued unabated because these devices needed to be delivered as well. Today, all of the goods on Planet Earth can be ordered from a device sitting right in your pocket, and no one can get them to you as fast and reliably as FedEx can.



# Location...

In making real estate investment decisions, three of the primary considerations should always be location, location, location. One hundred percent of Monmouth's portfolio is based right here in the continental United States. America has by far the largest and most dynamic economy in the world. The rest of the world greatly desires access to our markets, and we have no intention of allowing our focus to stray elsewhere. We have the world's reserve currency, the most reliable rule of law, and the best higher-education institutions. Our population growth and real GDP growth are consistently among the highest in the developed world. Extraordinary real estate investments are hard to find. It is best to look in extraordinary locations.

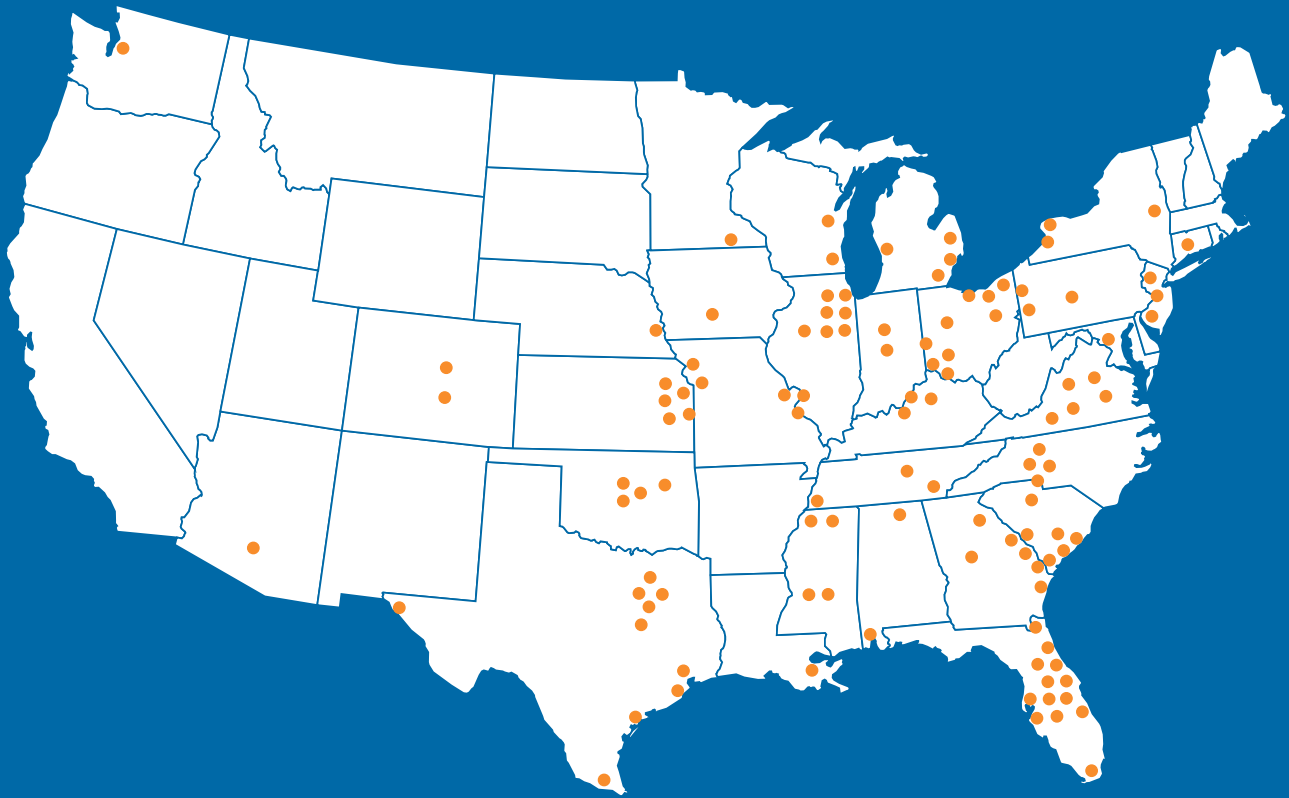
## The Global Economy



# Location Location...

The growth in global trade has created efficiencies of scale that have steadily reduced shipping costs for decades, despite the increased costs of fuel, labor, environmental compliance, and terminal fees. Fifty years ago, the cost of ocean shipping was approximately 15% of the value of shipped goods. Today, it's less than 1%. As a result, imports plus exports in the U.S. have grown exponentially and now represent over a \$4 trillion market. Surrounded by two peaceful neighbors and two great oceans, America's location is ideal. However, there was a severe bottleneck for goods coming in through the West Coast ports that caused expensive disruptions to the global supply chain. The recent completion of the Panama Canal expansion in June of 2016 has resulted in diverting in-bound traffic from the West Coast ports to those on the East Coast. Tonnage moving through the expanded Panama Canal is up over 30%. Accordingly, Monmouth has been building up a large presence along the Gulf and Eastern seaports. We have assets in Houston, Corpus Christi, New Orleans, Mobile, Tampa, Fort Myers, Miami, Jacksonville, Savannah, Charleston, and Newark. Today, as a result of the recently completed Panama Canal expansion, these are among the fastest-growing ports in the world.





# Location Location Location!

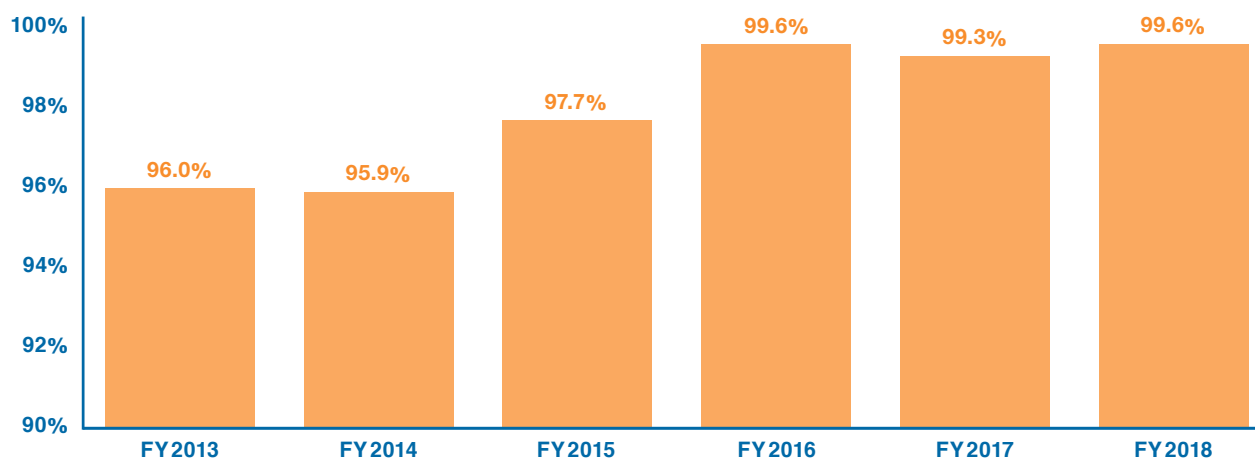
As you can see, Monmouth has put together a portfolio of very well-located industrial assets that are poised to benefit for decades to come. With over 70% of the U.S. population residing east of the Mississippi River, coupled with shipping container growth on the East Coast ports solidly outpacing that on the West Coast ports, our assets are clearly on the path of future progress. Zooming in closer on our strategic locations, you will find that our assets are positioned near major seaports, major intermodal ports that help serve these seaports, interstate highways, international airports, and manufacturing plants that are integral to our

tenants' operations. We also focus on investing in business-friendly states. Florida and Texas consistently rank as two of the most business-friendly states in the nation, and it is no coincidence that these states represent two of our largest concentrations. Our occupancy rate continues to rank as the highest in the industrial REIT sector. In fact, we are now enjoying our fourth consecutive year with above 99% occupancy. Location, location, location is the time-tested mantra, and our virtually fully-occupied portfolio best illustrates the mission-critical nature of our ideally positioned assets.

Monmouth's Funds from Operations (FFO) for fiscal 2018 were \$69.8 million, or \$0.89 per diluted share, as compared to \$54.4 million, or \$0.75 per diluted share, a year ago, representing an 18.7% increase in FFO per share. A primary focus of ours is on growing our recurring earnings, or what is commonly referred to as Adjusted Funds from Operations (AFFO). AFFO excludes gains or losses on the sale of real estate and gains or losses on the sale of REIT securities, as well as lease termination income and the effects of straight-lined rent adjustments. Therefore, we believe AFFO serves as the best proxy for recurring cash earnings. Over the past three-year period, our AFFO per share growth has averaged 14%. This year, our AFFO per diluted share increased to \$0.87 from \$0.76 in the prior year, representing a 14.5% increase. This strong and consistent AFFO per share growth has allowed us to raise our common stock dividend twice in the last three years. Our AFFO dividend payout ratio this year was 78%. Given our high-quality tenant base, coupled with our 8.1 year weighted-average lease maturity, and our net-lease structure, this 22% cushion provides for a very safe, well-protected dividend.

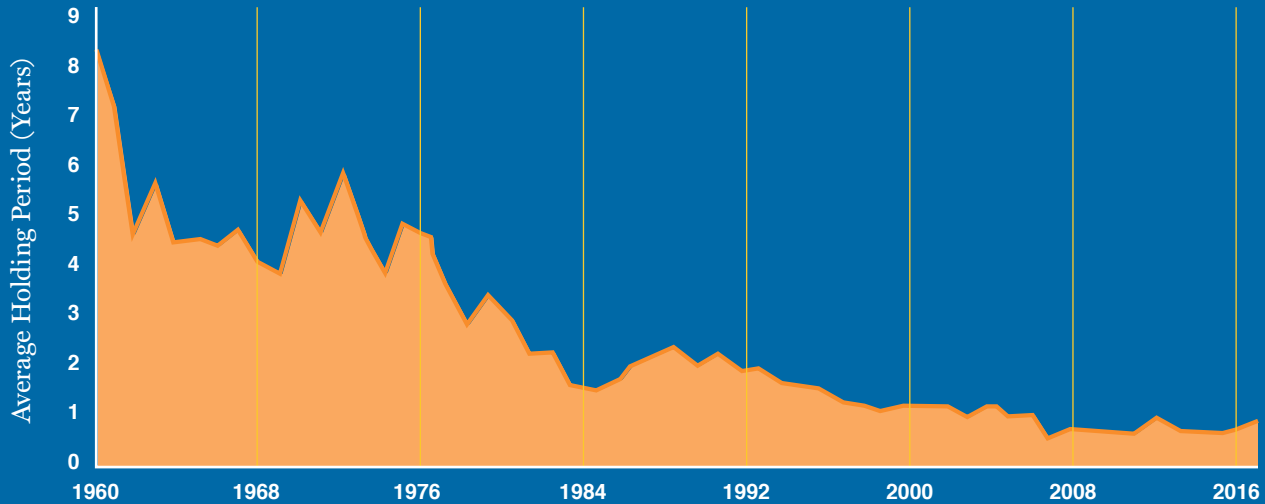
In fiscal 2018, 8% of our gross leasable area, representing 16 leases totaling approximately 1.5 million square feet, was scheduled to expire. Eleven of the 16 leases were renewed this year, representing 1.1 million total square feet, giving us a 69% tenant retention rate. Excluding one short-term renewal, these ten renewals have an average term of 6.8 years and resulted in an increase in our weighted-average lease rate of 4.1% on a GAAP basis and 2.8% on a cash basis. Of the remaining five properties scheduled to expire this past year, three were sold, generating substantial gains; one was re-tenanted; and one is currently vacant. The overall U.S. industrial market continues to perform exceptionally well. It has now enjoyed 9.5 consecutive years of positive net absorption and counting. Both occupancy rates and rental rates have risen to record levels.

## Occupancy



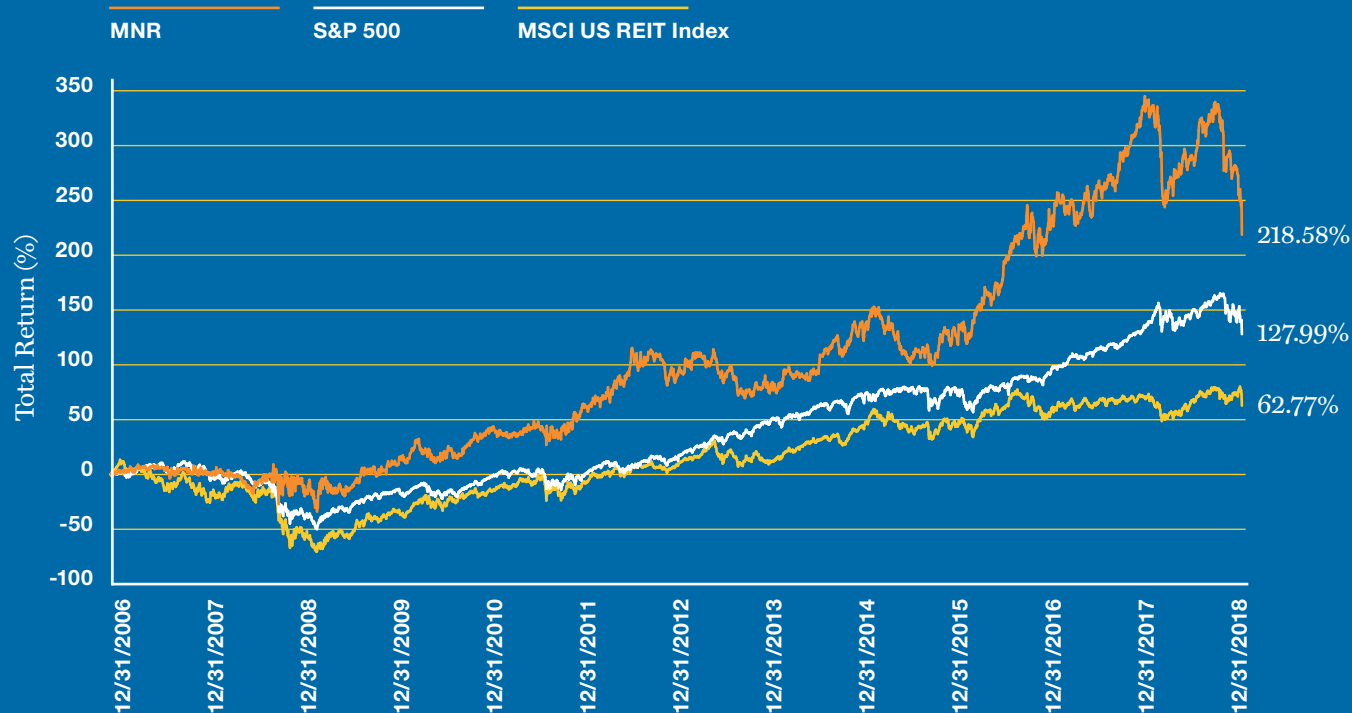


## NYSE Average Holding Period 1960–2016



The pace of change in our world has been accelerating rapidly. One negative side effect from the public market standpoint is that the average investment time horizon for stock ownership has been decreasing dramatically, from over eight years in 1960 to less than eight months currently. The hyperactive trading patterns brought on by the advent of computers replacing humans in investment decision-making has represented a turn for the worse. As the adjacent chart clearly illustrates, an investment in Monmouth's common stock 12 years ago, assuming the reinvestment of dividends, has generated a total return of 218.58%. These excellent results represent outperformance of over 3x versus the REIT index. Because real estate is a cyclical asset class with cycles that run for many years, I encourage all REIT investors to slow down, take a long-term view, and never underestimate the power of compound earnings.

## Total Return Performance



For Monmouth to survive and thrive these past 51 years, maintaining a strong balance sheet has been essential. Because we have used this protracted period of historically low interest rates to reduce our cost of capital throughout our capital structure and to extend our debt maturities as far out as possible, our balance sheet today is stronger than ever before. Our total market capitalization was \$2.5 billion at fiscal yearend, representing a 17% increase over the prior year. Our capital structure at fiscal yearend is composed of \$1.36 billion in equity capitalization, \$898 million in debt, and \$287 million in perpetual preferred capital. Eighty percent of our total debt is fixed-rate, with a weighted-average interest rate of 4.1% and a weighted-average maturity of 11.7 years. This represents one of the longest debt maturity schedules in the entire REIT sector, and coupled with our \$287 million in 6.125% preferred equity going out in perpetuity, our long-term debt

maturities are very well-balanced with our long-term assets. Additionally, at fiscal yearend we held \$154.9 million in marketable REIT securities, or liquid real estate as we like to think of it, representing 8% of our undepreciated assets.

In fiscal 2018, we raised approximately \$90 million in equity capital through our Dividend Reinvestment and Stock Purchase Plan (DRIP). Of this amount, a total of \$12.9 million in dividends was reinvested this year, representing a 24% participation rate in our dividend reinvestment plan. Investors who participate in our DRIP can enhance their returns by reinvesting their dividends and achieving a compounded return. This has historically proven to be a very reliable program to help fund our growth. During the year we also raised \$41.0 million in gross proceeds through our 6.125% Series C Perpetual Preferred Stock ATM program.

Real Estate is a long-term asset class and financing it with perpetual preferred stock is as long-term as it gets. Subsequent to our fiscal yearend, we completed our first common stock offering since 2014. This offering generated \$138 million in gross proceeds. Looking ahead, Monmouth is very well capitalized to continue to execute our qualitative growth strategy.

The Digital Revolution has produced many advancements for society at large, perhaps none greater than the globalization of trade. Total trade, imports plus exports, has grown in the U.S. from \$50 billion annually in the late 1960's to over \$4 trillion today. Because imports require more long-term warehouse and distribution space than exports, one could argue that industrial real estate investors don't mind, or perhaps even prefer, large trade deficits. However, that would be missing the bigger picture. Reciprocal trade agreements beget more trade, which translates into more jobs, more prosperity, and peace. Overt mercantilism is a problem. Unfair trade policies are counter-productive and disruptive. Whether it's Japan in the 1990's or our \$300 billion trade deficit with China today, balancing forces will ultimately prevail by moving the global supply chain to regions that are more willing to conduct commerce in a reciprocal manner.

A major balancing force that has recently emerged is the widespread use of hydraulic fracturing. This technological breakthrough has allowed the U.S. to become the largest producer of natural gas and one of the largest producers of oil in the world. Given the energy-rich nature of our country, it now makes sense to increase the amount of domestic manufacturing. However, one need not fear that we will be moving backward from a globalized economy to an isolated one. The technological advancements brought on by the Digital Revolution have been far too great for that to happen. The Internet has connected billions of people throughout our planet in real time. In the future, billions more will have access. Globalization has become our manifest destiny.

Basically, there are only two kinds of investors: Those that don't know, and those that don't know they don't know. And then, in a group all to himself, there's Jim Grant, the interest-rate yogi. Given the uncertainty in attempting to predict the future, it all comes down to probabilistic judgments that separate the gifted from the rest. Disruptive forces, caused by trillions of dollars conjured out of thin air and pumped into the system globally, will be with us for many years to come. Nobody seemed to mind this free money when it created a bull market in virtually everything. Surely you still remember the Orwellian days when people cheered bad economic reports and fretted over strong data. The fear being that good news might induce the Fed to stop holding the pedal to the metal. However, Jim wisely cautions that, "It is hoping for an asymmetric miracle to assume that the forces of Quantitative Tightening will be substantially weaker than the forces of Quantitative Easing." Increased inflation appears to be the endgame that our Central Bank desires. The problem is that we may end up with much more inflation than they wish for. As we have seen throughout many cycles, real estate investment is one of the few safe harbors from this cruelest tax of all. In an inflationary environment, rents will reset higher, as rising land values and increased construction costs will require it. This is precisely what is taking place in the industrial real estate sector today, and I suspect that it will spread to other property types in the not-too-distant future.

Ecommerce sales continue to grow rapidly, averaging a 15% compound annual growth rate since the turn of the century. While Monmouth was early in seeing the benefits that Internet sales would bring to the industrial property sector, this year I'd like to focus on what has become for the Digital Retail Sector, the most highly unprofitable part of the supply chain, "The Last Mile." In the good old days, the last mile was represented by the brick-and-mortar retail shopping centers, and consumers would have to make this leg of the journey themselves. Today, "free shipping" has become the norm, and not just for getting the goods to the end consumer, but also for picking up and processing the costly returns. As ecommerce market



share has increased, currently representing 19% of total retail sales (excluding food, fuel, and autos), the difficulties in dealing with these mounting returns has become very disruptive for Amazon and the other giant retailers. It is not unusual to see product returns in excess of 30% for goods such as apparel, and this is driving fulfillment costs through the roof. Thus far, investors have been valuing growth over profitability for these giant digital disruptors. However, at some point something will have to give. We have invariably seen that balancing forces will ultimately appear, and someone will have to pick up the tab. For there can never be a free lunch for everyone.

Speaking of free lunch, legend has it that Nobel Prize-winning economist Milton Friedman was giving a presentation when some heckler yelled out, "Hey Milton, if you're so smart, why aren't you rich?" Without missing a beat, Milton responded, "If you're so rich, why aren't you smart?" This story reminds me of our public markets today. The widespread proliferation of Exchange Traded Funds and Index Funds has resulted in just a handful of institutions owning a large percentage of the publicly-traded universe. By replacing the more expensive human brainpower with low-cost computers, these institutions have been able to attract trillions of dollars of hard-earned capital. Today, the scales are tilted far in the direction of passive investment strategies. Will balancing forces emerge and tilt these scales back in the direction of human decision-making? Do opportunities still abound for active, old-school value investors?

A major highlight for me this past year, and a great honor that I will always cherish for the rest of my life, occurred when I got to meet the one and only Warren Buffett at a small real estate gathering in Omaha. I was able to speak with him one-on-one for a bit, and later he fielded questions from the audience. He was incredibly gracious and as you can imagine his wisdom runs deep. Someone asked Mr. Buffett if he ever considered retiring. The Oracle responded that he sees his life's work as a canvas upon which he is painting a picture that can never be completed. He said that he enjoys looking at it, and that he is always trying to improve and perfect it. His poetic answer reminded me of two people.

One of them is the great Renaissance artist and inventor Leonardo da Vinci. For it was Da Vinci who said:

*"Art is never finished,  
only abandoned."*

Leonardo da Vinci would carry his great works with him constantly and refine them whenever he felt truly inspired.

The other person is my father, Eugene Landy, our Founder and Chairman. Eugene Landy formed this Company over 50 years ago when I was just six years old, and he is still going strong today. All my life I have watched him working tirelessly, concentrating carefully, successfully creating tremendous value from the most meager origins. Monmouth is his canvas, his masterpiece, and I can assure you that it will never be abandoned, for he is our inspiration.

To my teammates, I am truly honored to be a part of this hardworking, industrious group. It is so rewarding to observe the growth in our individual and collective talents year after year. Our game plan was executed so well this past year. For this to happen, requires a complete trust in one another. Everyone upheld their end of the bargain, performed their role with great focus, and left it all out there on the proverbial field. So, thank you once again for sharing the vision and making it so.

To our directors, thank you for your strong oversight. As you know, good decisions compound over time into extraordinary results. Your understanding and appreciation of our simple business model and our time-tested philosophy have resulted in a long-term track record that we should all be very proud of. Thank you for looking after Monmouth with such care and for being a balancing force throughout.

To our shareholders, the irreplaceable nature of savings and the sanctity of capital have our utmost respect. We are eternally grateful to you, our loyal long-term shareholders, for the faith that you have shown in us. Your continued faith is increasingly rare in this ordinary world of ours, and it is something that we will never take for granted. Thank you for being an integral part of Monmouth.



Lastly, the seas of change have recently been swirling away from President Calvin Coolidge's ideal that: "The business of America is business," toward new ideals in which societal concerns take precedence. Because of everything that moves, even that which moves from our collective minds to our collective hearts, the space that is vacated is as great as that which is acquired. We must be careful to understand the ramifications of not only the newly created space, but of the newly created void as well. I believe that Coolidge fully understood the most direct and effective path for lifting society up to a higher standard of living. And, of course, that was what he was trying to create all along.

Here's to prosperity and peace in the New Year.

Sincerely,

A handwritten signature in blue ink that reads "Michael Landy".

**Michael P. Landy**

President and Chief Executive Officer