Insights
Sector

June 2021

Global Real Estate: Growth, Stability and Value Opportunities Amid Reopening

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- In 2021, global real estate has joined the risk-on rally, although looking at pre-pandemic levels the sector has still room to catch up to the broader market.
- Relative to global equities, global real estate remains undervalued both on a P/B and EV/EBITDA basis.
- Global Real Estate offers attractive mix of longer-term growth, stability and value opportunities that can be extracted as reopening continues in the developed world.

Still Plenty of Room to Catch Up with Broader Market

In 2021, global real estate has joined the risk-on rally after a challenging 2020. The pandemic triggered a large sell-off across shopping malls and then elevated uncertainty about the future of office space weighed on the exposure. Meanwhile, logistics assets flourished as they benefited from accelerated online and e-commerce megatrends during lockdowns.

Performance year to date may suggest that real estate has recovered even faster than broad equity markets. However, looking at pre-pandemic levels, global equities have returned nearly 28% since the end of 2019 while global real estate equities barely recovered (+1.9% above the end of 2019 level). As a result, there may still be room for a catch-up if the progress on vaccination, reopening and recovery continues in 2021 across major developed markets, as expected by State Street Global Advisors. (State Street Global Advisors full-year GDP forecasts as of March 2021: +5.3% for the US, +4.7% for Germany, +5.7% for France, +6.2% for the UK, +3.1% for Japan +3.8% for Australia and +7.7% for China.)

Figure 1

Total Return Year to Date

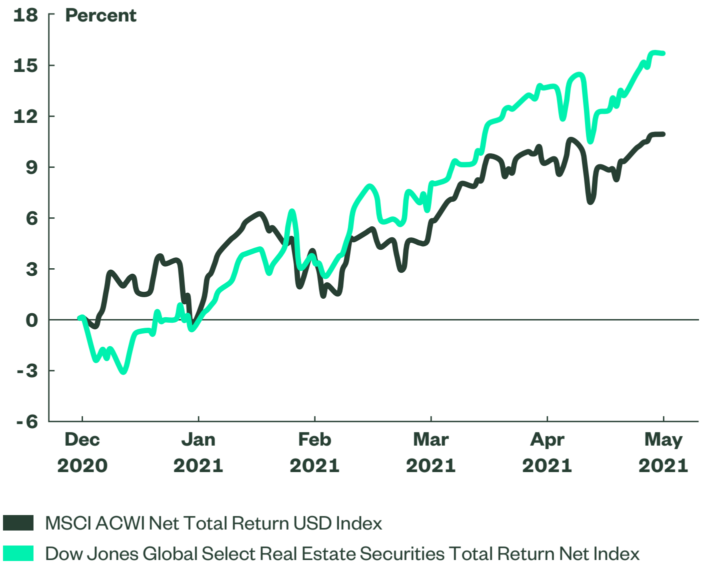
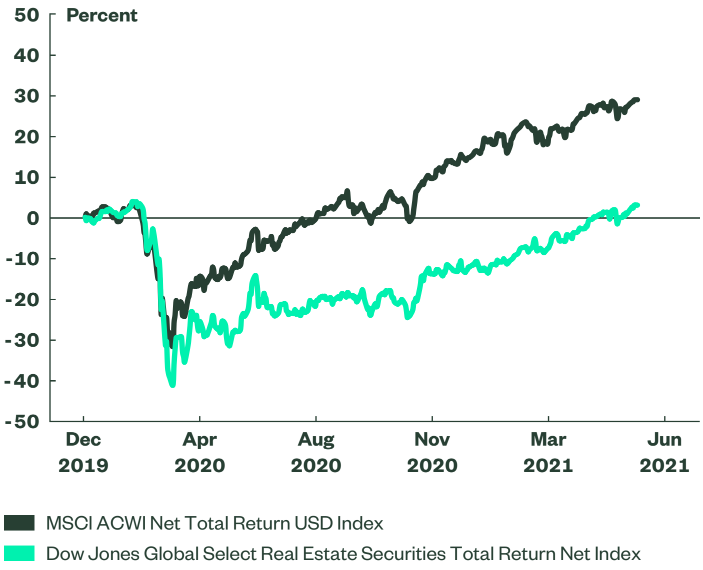


Figure 2

Total Return Since 1 Jan 2020



Source: Bloomberg Finance L.P., as of 31 May 2021. Performance in USD. Past performance is no guarantee of future results.

Undervalued Relative to Global Equities

Despite the recovery, global real estate still offers an attractive valuation relative to global equities. In particular, the relative EV/EBITDA and Price to Book (both 1-year forward) remain below their long-term average.

Figure 3

EV to EBITDA — Global Real Estate Relative to Global Equities

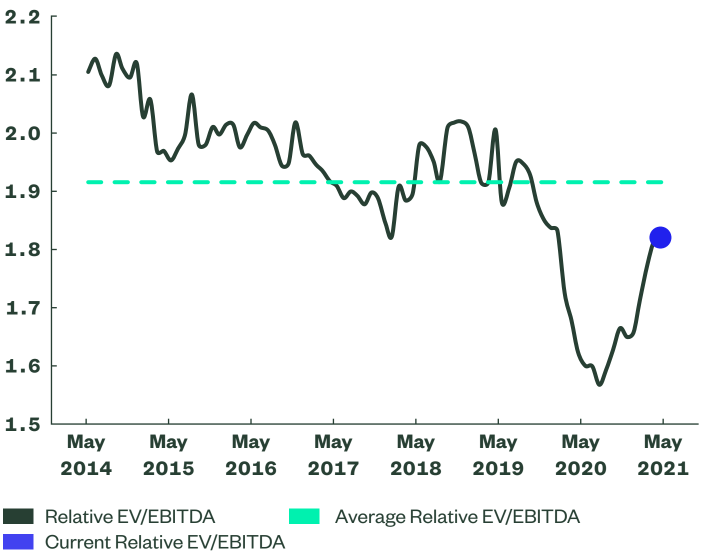
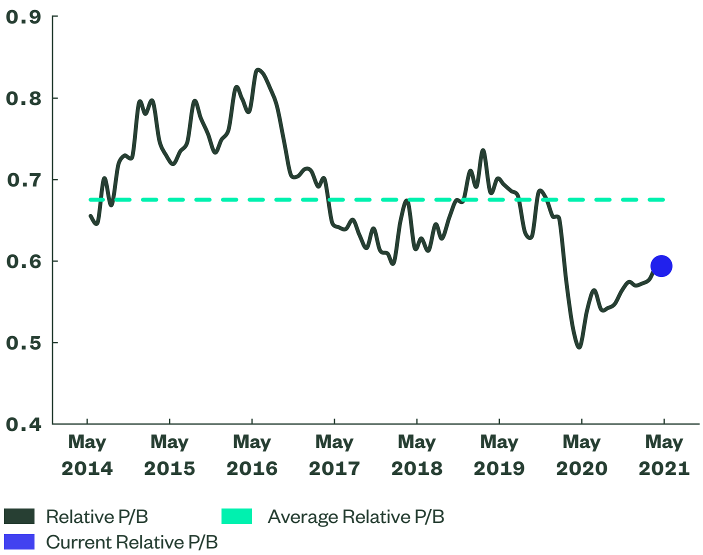


Figure 4

Price to Book — Global Real Estate Relative to Global Equities



Source: Bloomberg Finance L.P. as of 31 May 2021. EV/EBITDA is 12m forward BEST_CUR_EV_TO_EBITDA while P/B is 12m forward BEST_PX_BPS_RATIO. Global Real Estate is represented by Dow Jones Global Select Real Estate Securities Total Return Net Index while Global Equities is MSCI ACWI Net Total Return USD Index.

Diverse and Relatively Attractive Components[1]

Real estate is a diverse sector with components offering a mix of longer-term growth, stability and pockets of value that can still be extracted as reopening and recovery continue.

- **Industrial REITs (17.2%)** Dominated by **logistics real estate, which is fueled by e-commerce acceleration.** This shift is structural and is expected to continue beyond the pandemic as demand for warehouses remains robust. Supply response is not obvious as end customers expect short delivery time for products they purchase. This demand puts existing landlords with well-located logistic warehouses in a relatively favourable position. This logistics component, while neglected in the past, has become the largest subsector within global listed real estate.

- **Retail REITs (16.9%)** The most visible scar of COVID and its continuous lockdowns. Retail real estate businesses faced challenges around cash flow collection from tenants and lower property valuations. These issues may lead to covenant activation or simply an inability to service debt. However, companies that thrived through the crisis are now well positioned to enjoy the recovery. As vaccination and reopening progress, particularly in the developed countries, **retail REITs may be the most evident beneficiary,** especially given the fact that **this part of the market has not yet rerated** to pre-pandemic levels.

- **Residential REITs (15.0%)** Segment that rose in recent years as the **urbanisation megatrend keeps demand high.** Residential companies in the US felt the impact of the pandemic but, with the reopening, occupancy rates should climb back. As such, the timing to enter the market may be worth considering. At the same time, supply remains in check as the cost of building materials such as steel and timber have skyrocketed.

- **Office REITs (11.8%)** The future of the office remains uncertain, and investors may be reluctant to invest given the narrative around lower demand for space in the future as employees around the world are more accustomed to working from home. However, **offices are likely to remain an important part of businesses, enabling improved collaboration, relationship management and, importantly, talent retention.** Offices are likely to evolve and the future demand may not be as weak as often reported in headlines. Companies (tenants) often view their offices as a way to attract talent and this may be the key factor for office real estate to thrive. In addition, safety measures ensuring appropriate distance between employees create a natural barrier to cutting a real estate footprint too aggressively.

- **Specialised REITs (9.2%)** 60–70% of specialised REIT in the DJ Global Real Estate Index relate to **self-storage** companies that are **set to benefit from increased mobility,** particularly in the US. The remaining 30%–40% relates largely to **datacenters** that **enjoy structural tailwinds as businesses transition to cloud computing and data storage.**

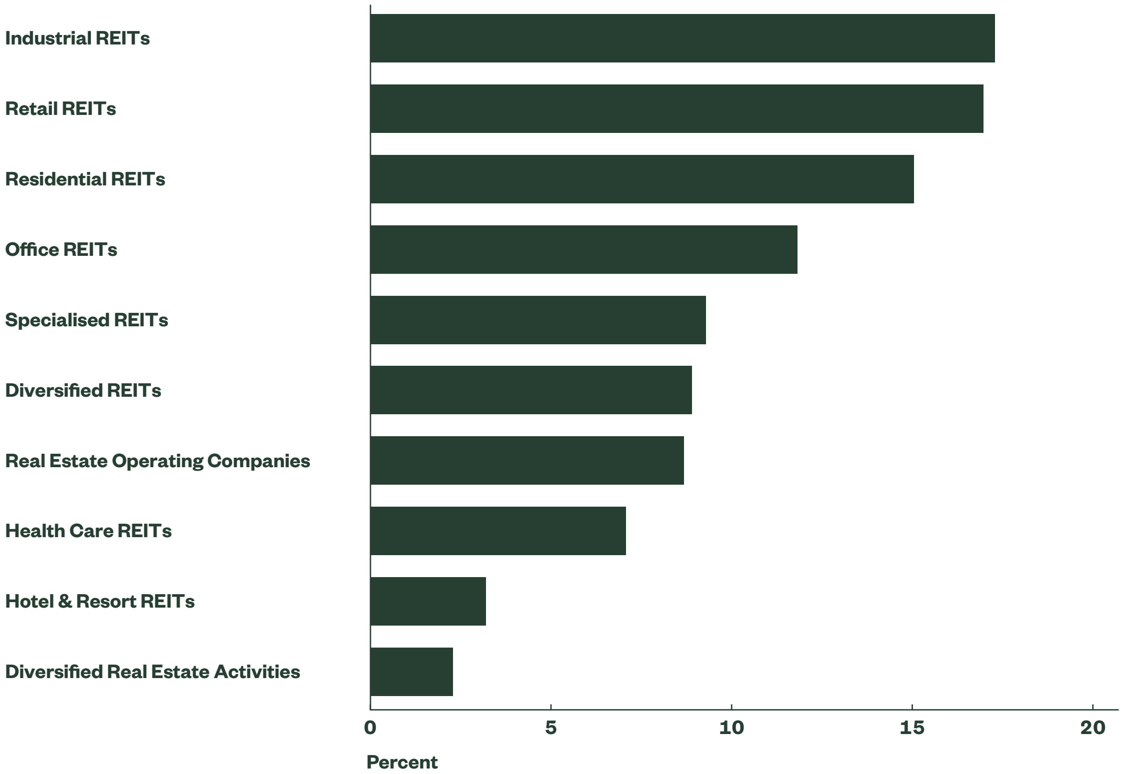
- **Diversified REITs (8.9%)** Companies investing in various types of real estate. These entities are a bit **more elastic and can adapt their portfolios** faster to a changing environment. One example is Merlin Properties,[2] a Spanish diversified REIT increasing its logistics footprint in recent years.

- **Real Estate Operating Companies (8.6%)** REOC represents a type of vehicle rather than economic exposure to an asset or tenant type. It offers greater flexibility around capital reinvestments but does not enjoy the tax benefits that REITs do. REOCs in the DJ Global Real Estate Index include **German residential companies benefitting from structural supply-demand imbalance** as well as Swiss and Nordic companies.

- **Health Care REITs (7.0%)** Include senior living, where an ageing population drives increasing demand. Occupancy rates dropped due to the pandemic but started moving up as vaccination rapidly progressed among the elder part of the population. Health care facilities stand to benefit from increased focus on health following COVID, as well as the management of a backlog of surgeries postponed due to the pandemic.

- **Hotel and Resort REITs (3.2%)** Hotels are reopening, although it may take time to reach full capacity. Hotels always have been, and are now more than ever, a high risk/high reward part of real estate sector. Nevertheless, the worst appears to be behind us and hotel owners who made it through the pandemic may be well positioned to enjoy the return of customers both in resorts and city hotels.

Figure 5
Dow Jones Global Select Real Estate Securities Index Subsector Split

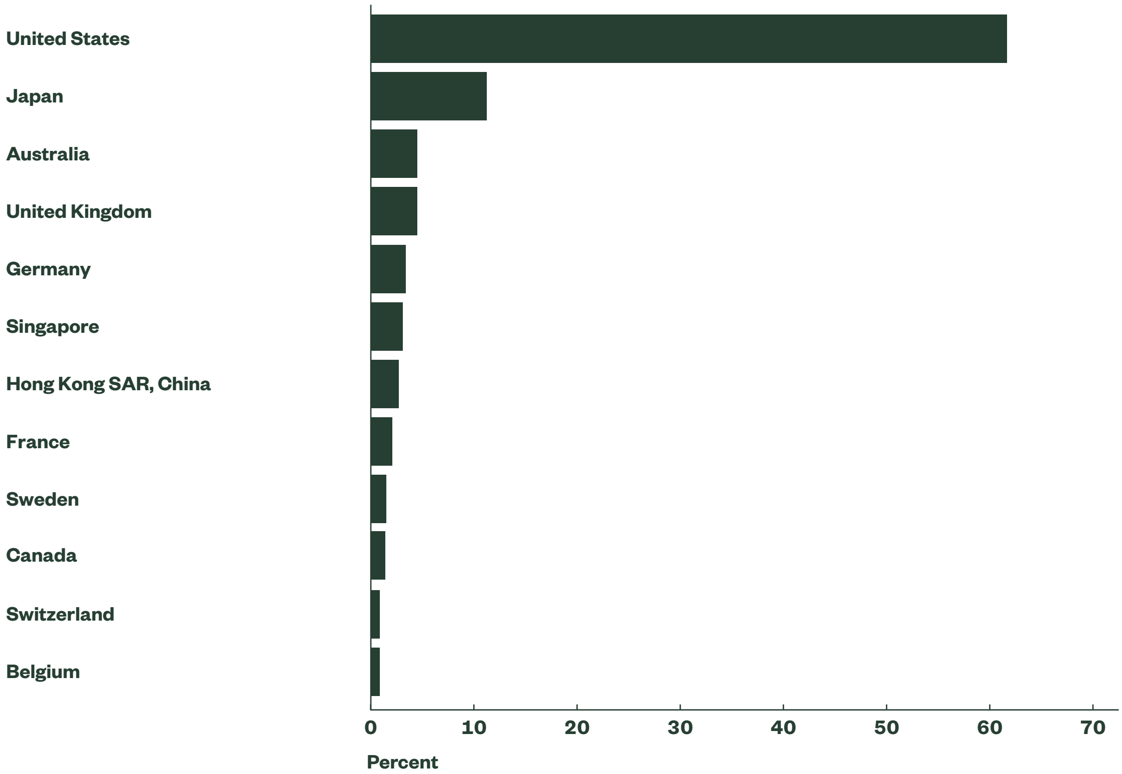


Source: FactSet, as of 31 May 2021. Weights are as of the date indicated and should not be relied upon as current thereafter.

A Focus on Developed Markets

Listed real estate naturally skews heavily toward developed markets, with more than 60% in the US, which enjoyed recovery to its pre pandemic levels in a majority of sectors as investors started pricing in future growth. There is no reason why real estate in the US should not fully join that recovery. Other parts of developed world (except for Japan) should also benefit from rapid vaccination and reopening. Vaccination is important as it determines reopening, increased mobility and other "back to normal" aspects that are crucial for real estate recovery.

Figure 6
Dow Jones Global Select Real Estate Securities Index Breakdown by Region



Source: S&P Dow Jones Indices LLC, as of 31 May 2021. Country breakdowns are as of the date indicated and should not be relied upon as current thereafter.

Endnotes

1 Subsector split in this section based on Dow Jones Global Select Real Estate Securities Index, as of 31 May 2021. Source: FactSet.

2 This information should not be treated as an investment recommendation.

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