PRESIMA April 28, 2020

The Bulletin

Into the Storm: The Outlook for Global REITs

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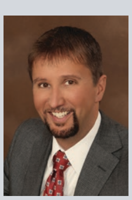

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THIS GLOBAL PANDEMIC HAS CREATED SIGNIFICANT DISRUPTIONS AROUND THE WORLD.

Volatility in the financial markets has increased, with share prices for global stocks, including REITs, changing dramatically from week to week.

The underlying revenue streams for REITs are backed by leases, and for most property sectors these leases are long term, providing REITs with stronger downside risk protection relative to traditional equities. Moreover, since the last downturn in 2008 and 2009, the REIT sector is better protected. With that said we believe that not all REITs and not all property types are equal. In this paper we will examine current REIT performance, analyze the state of the REIT sector in terms of balance sheets, capital markets, and valuations, and we will look at historical periods of significant dislocations to see how REITs performed during and after those periods relative to traditional stocks and bonds.

Once the virus began to spread outside China, global stocks began to react with significant volatility. As evidenced from Exhibit 1, stock prices changed dramatically from week to week for both traditional equities as well as REITs. Year-to-date as of April 17, 2020 both U.S. and global REITs have underperformed the broader equity markets. Based on current valuations and historical trends we believe REITs may be poised to outperform broader equities and bonds coming out of this downturn.

UNLIKE PRIOR TO THE GFC, SECTOR FUNDAMENTALS WERE STRONG GOING INTO THE PANDEMIC

Unlike in previous downturns, including the Global Financial Crisis of 2008 and 2009, most REITs appear better positioned this time around. Balance sheets are, on average, stronger (with Debt to EV of 32% as of 1Q 2020 versus 41% in 4Q 2007)[1], the REIT universe is more diverse (with exposure to data centers, cell towers, and health care), development exposure is low, capital markets remain open and borrowing costs remain low, governments around the world are providing liquidity, and valuations are attractive.

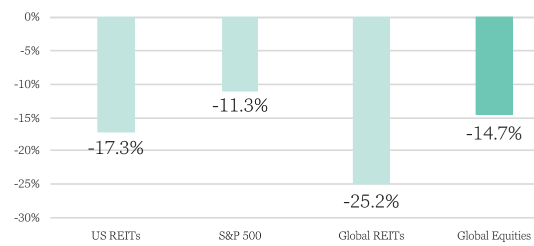
REIT OPPORTUNITY TO PRIVATE REAL ESTATE: VALUATIONS ARE VERY ATTRACTIVE

Whether looking at price to NAV or spreads to 10-year bonds, REIT valuations look attractive, even cheap. Exhibit 2 illustrates price to NAV relationships around the globe versus the past 5-year average in these countries. Net asset values calculate the underlying value of the real estate held by companies. Investors have come to accept that a company should trade at a slight premium to its underlying real estate because of professional management and the value of liquidity. Because of the massive dislocation in the marketplace today, resulting from the global pandemic, Global REITs are selling at an estimated 20.4% discount to NAV versus a 5-year average discount of 1.4%. Hong Kong, which over the past five years has sold at a 24.9% discount is now selling at a 44.8% discount to its NAV. Australia, which over its past 5-year history has sold at a modest premium, is now selling at a 31.7% discount. REITs in the U.S., Europe and Japan are selling at high ten to mid-20% discounts[2]. The takeaway from this analysis is twofold. First, there is a significant gap in pricing between private and public real estate. For investors who are looking at a play between the two, the public real estate market currently provides an attractive pricing opportunity. Second, the public real estate market is likely foreshadowing a revaluation of private real estate in the months ahead. Although capital has been flowing into private equity over the past many years, this foreshadowing of a repricing may redirect those flows from private into public, at least in the short term given arbitrage pricing opportunities.

Exhibit 1: Increased Volatility for REITs and Traditional Stocks

Week ending	US REITs	S&P 500	Global REITs	Global Equities
February 28, 2020	-12.3%	-11.5%	-11.0%	-11.0%
March 6, 2020	4.1%	0.6%	2.9%	0.4%
March 13, 2020	-11.7%	-8.8%	-16.5%	-12.5%
March 20, 2020	-24.3%	-15.0%	-22.7%	-12.3%
March 27, 2020	16.5%	10.3%	15.7%	10.7%
April 3, 2020	-8.0%	-2.1%	-8.5%	-2.8%
April 10, 2020	22.0%	12.1%	18.5%	11.0%
April 17, 2020	-3.8%	3.0%	-3.2%	2.3%

Year to Date through April 17, 2020



Note: Indices presented are the SNL U.S. REIT Equity index, the FTSE/EPRA NAREIT Developed Index, the S&P 500 Index and the MSCI World index.
Source: SNL.

Exhibit 2: Price to NAV Relationships (NAV Estimates as of March 31, 2020)

	Price to NAV	5 Year Average
Global	-20.4%	-1.4%
U.S.	-17.5%	-5.2%
Europe	-18.0%	-9.0%
Japan	-24.9%	-8.2%
Australia	-31.7%	+5.6%
Hong Kong	-44.8%	-24.9%

Note: Price to NAV are Presima's estimates as of March 31, 2020.
Source: Presima Inc..

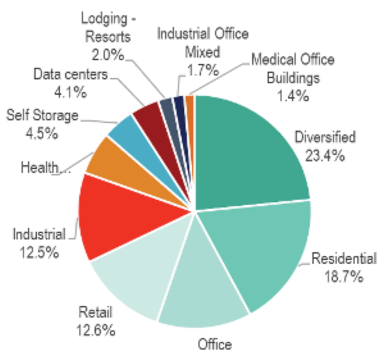
We believe this foreshadowing of a repricing may redirect flows from private into public, at least in the short term given arbitrage pricing opportunities.

Exhibit 3: REIT Dividend Yield Spreads to 10 Year Government Bonds

	As of April 17, 2020	10-Year Average	13-Year Avg (Includes the GFC)
Europe	544	258	242
U.S.	366	140	139
Australia	454	188	215
Japan	371	196	169
Hong Kong	379	137	95

Note: Bloomberg Treasury Yields are those of, Europe: GECU10YR Index (EU Govt 10 Year Yield); US: USGG10YR Index (US Govt 10 Year Yield); Australia: GACGB10 Index (AUS Govt 10 Year Yield); Japan: GJGB10 Index (JAP Govt 10 Year Yield); Hong Kong: (HK Govt 10 Year Yield) HKGG10Y Index. SNL Dividend Yields are those of Europe: SNL Europe RE Index; US: SNL US REIT Equity Index; Australia: SNL Australia RE Index; Japan : SNL Japan RE Index; Hong Kong : SNL Hong Kong RE Index.
Sources: Bloomberg L.P.; SNL.

Exhibit 4: Global REIT Index Property Type



Source: Presima Inc.

We believe that a more active approach to property type selection may result in a portfolio which is more resilient to this downturn.

REIT OPPORTUNITY TO 10-YEAR TREASURIES: REITS APPEAR VERY ATTRACTIVE

When examining yield spreads between REIT dividend yields and their corresponding 10-year government bonds, we find these spreads are at historical highs. These spreads have more than doubled their 10-year historical averages in Europe, the U.S., Hong Kong, and Australia. While we acknowledge that some companies are temporarily reducing dividends to retain cash flows, the current yield spreads remain attractive.

Finally, when comparing REIT earnings multiples (FFO) to broader equities, REITs look fairly valued. The current price to FFO multiple for the global index of REITs is 21[3] versus an 18 price to earnings multiple for the MSCI Global Index[4] for traditional equities (as of April 17, 2020).

NOT ALL REAL ESTATE IS THE SAME…PASSIVE INVESTING MAY NOT BE THE ANSWER

Within the REIT sector there is broad diversification not only by geography but also by property type (Exhibit 4). Because of this diversity, there are property types that will likely be more resilient to this downturn and those that will be harder hit. Overall, we find three categories of property types, ranging from most resilient to least resilient.

In the first category, the most resilient category, are sectors that might see revenue impacts that offset each other or that will even benefit from changes in user habits. These properties could see a little dip in their operations short term, but they should recover quickly and may even see additional growth. In our view, datacenters, industrial and self-storage are in this category.

In the second category, the more resilient category, are sectors that will likely see an impact on cash flows that could affect short term dividend payouts, but that will also see a rebound once the situation stabilizes. These assets should not be impacted by significant secular changes to their usage, but nonetheless see earnings come down due to the economic slowdown. We see multifamily, manufactured housing, student housing, single family rental, and office being in this category.

In the third category, the least resilient category, are sectors that will likely experience a significant hit to operations and financial conditions. Some of these sectors were already experiencing headwinds, with companies potentially in financial distress. User habits may change longer term and a recovery in cash flows, when it happens, will take a prolonged period of time. We see retail (mostly malls), hotels and senior housing in this category.

When we aggregate those sectors that are either most or more resilient, we find that about 67.5% of the index falls into this category. A more active approach to property type selection may result in a portfolio which is more resilient to this downturn.

REIT OPPORTUNITY: HISTORICALLY, REITS HAVE OUTPERFORMED STOCKS AND BONDS COMING OUT OF A DOWNTURN

If we use U.S. REITs as a proxy for global REITs, we can look at 4 historical time periods of significant dislocation in the financial markets over the past 40 years to see how REITs performed immediately following these dislocations relative to traditional stocks and bonds. While every crisis is different, on average U.S. REITs outperformed traditional U.S. equities and bonds 12 and 24-months following these downturns (Exhibit 5). The case for REITs is particularly strong following the past two recessions in 2001 and 2008/2009. It is less meaningful to use the downturns prior to 1991 as the Modern REIT era did not begin until 1991 and in those years prior to 1991 REITs were still in their infancy, the universe was small, the sector was working through governance issues, and there was a lack of liquidity in the sector.

Although this study does not posit that REITs will outperform stocks or bonds or that an investor can time the market, this study does suggest that REITs have performed well on a relative basis to traditional equities and bonds coming out of previous market downturns.

> REITs look fairly valued relative to traditional equities. With that said, research demonstrates that on a historical basis, REITs have outperformed traditional equities, and bonds, 12- and 24-months after a downturn.

CONCLUSION

Unlike the 2008 and 2009 downturn, this downturn has not been caused by a credit or financial crisis. Given the actions of governments around the globe, particularly in the U.S., credit should continue to be made available through stimulus packages as well as through the Federal Reserve providing trillions in loans and bond purchases. These actions should also buoy the American economy through this pandemic.

From a valuation perspective REITs look very attractive relative to the value of private equity. They are trading at steep discounts to their NAVs. REIT dividend to bond yield spreads also look very attractive relative to 10-year government bonds. The spreads between REIT dividend yields and 10-year government bonds have more than doubled in many countries from long-term historical averages, including in the U.S., Europe, Hong Kong, and Australia. REITs look fairly valued relative to traditional equities. With that said, research demonstrates that on a historical basis, REITs have outperformed traditional equities, and bonds, 12- and 24-months after a downturn.

Although it is difficult to know how this pandemic plays out, we expect the U.S. government to try to restart its economic engine in May. What we know and see is the commitment of governments around the globe to stimulate their economies through fiscal policy and to use all the levers of monetary policy to lift their economies as they re-emerge from their sleep. We believe real estate, particularly, global REITs, will benefit from these policy measures.

Exhibit 5: REITs Have Performed Better than Stocks and Bonds Coming out of Past Downturns

	12 months after				
Crisis	S&P 500 (%)	REIT (%)	Difference (%)	Bonds (%)	Difference (%)
3/1980 U.S. Recession	40.1	37.4	-2.7	13.2	24.2
9/1990 U.S. Recession	31.1	32.8	1.7	17.0	15.8
9/2001 U.S. Recession	-11.1	14.3	25.4	7.9	6.4
3/2009 GFC & Great Recession	70.3	134.7	64.4	23.4	111.3
Average Relative Performance			+22.2		+39.4

	24 months after				
Crisis	S&P 500 (%)	REIT (%)	Difference (%)	Bonds (%)	Difference (%)
3/1980 U.S. Recession	21.8	14.3	-7.5	21.6	-7.3
9/1990 U.S. Recession	45.6	24.3	-21.3	33.6	-9.3
9/2001 U.S. Recession	10.9	38.8	27.9	18.5	20.3
3/2009 GFC & Great Recession	101.5	203.8	102.3	33.0	170.8
Average Relative Performance			+22.2		+43.6

Note: Indices used are; S&P 500: SPX Index; REIT: BBREIT Index; Bonds: LUACTRUU Index.
Source: Bloomberg L.P.

REFERENCES
1. Bloomberg L.P.
2. Historical NAVs are Presima Inc's estimates.
3. SNL.
4. Bloomberg L.P.

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