Presima

Investing in real estate securities

Recently, **Jonathan A. Schein,** managing director of global business development at Institutional Real Estate, Inc., spoke with **Peter Zabierek** and **Marc-André Flageole** of Presima. The following is an excerpt of that conversation.

What have been the most important trends in the global real estate securities market over the past year or two?

Zabierek: Nearly all measures of investor, consumer and business confidence have surged over the past two years. Global REITs have performed somewhere in between global stocks and bonds, as the market tried to anticipate where the private real estate market was going. While prices appear relatively high on the private side, recent transactions in the listed market seem to suggest that commercial real estate is actually relatively *cheap* in the REIT market. While global real estate transaction volumes were down during the first half of 2017, the rate of decline has slowed and sits at only slightly below 2016 levels. We have seen private capital start to be more aggressive with two recent REIT privatizations and numerous asset and portfolio deals. When we speak with REIT management teams, we often hear about significant dry powder for future investment. We see optimism in the market and expect an active end to 2017.

Flageole: REIT mergers and acquisition activity has picked up during the second quarter of 2017, with seven deals for a total value of US$16.8 billion, the highest level in many quarters. Most of these transactions have resulted in positive performance for shareholders of the acquired companies, with take-out prices at an estimated 6 percent to 24 percent premium over the pre-deal share prices. With several other U.S. REITs trading at a discount to underlying asset value, we would not be surprised to see more M&A activity by the end of this year.

There's been a large shift from active investing to passive investing over the past few years. What effect has this had on the global REIT market?

Zabierek: It has had a more profound effect than most investors expected. The flows from actively managed products to passive ones have been considerable. This has come as a disappointment to businesses engaged in active REIT management, but has created opportunities (and challenges) for those who pick stocks for a living. With increased capital now flowing into market-cap, weighted index funds, we see more momentum in real estate stocks than we have ever seen. As a result, we see wide dispersions in sectors' performance — some sectors trading at high premiums and some trading at significant discounts. Certainly fundamentals play a part in those differences, but we believe that many of the spreads have gone too far. Therein, we believe, lies the opportunity for value-based investors.

How do you characterize your investment philosophy?

Flageole: There are five tenets of our investment philosophy. First, we believe that **REITs are real estate.** While they may be correlated to stocks in the short term, they tend to perform like real estate over the medium to long term. Second, **mispricings do occur.** The nature of the listed market leads to divergences between stock prices and intrinsic value. Third, we **focus on fundamental analysis.** There are no shortcuts to a disciplined underwriting process. Fourth, **be different.** We believe we need to be different from the market to beat the market. And fifth, **stay nimble.** We must remain small to retain our liquidity advantage.

CONTRIBUTORS

Peter Zabierek, CEO, joined Presima in 2013. He oversees the strategic development, corporate management and promotion of Presima's global investment and business activities. Zabierek has 27 years of professional experience. Prior to joining Presima, he was managing director and co-head of global real estate securities at CenterSquare (formerly Urdang Capital Management).

Marc-André Flageole serves as a Global Portfolio Manager for Presima. He joined the team in 2006. His role involves investment decision making and portfolio construction for Presima's global real estate securities strategies, as well as stock coverage within the Asia Pacific region. He is also responsible for overseeing the team's research efforts and managing the investment team.

What is "active share" and why do you think that it is important?

Zabierek: Active share measures how individual stock weights in a portfolio differ from the weights in a benchmark and ranges from zero percent (an index fund) to 100 percent. The higher a fund's active share, the more an investment portfolio differs from its benchmark. Research shows that higher active-share levels are generally associated with higher levels of outperformance.[1] The corollary is that funds with low active-share ratings appear to be, in essence, closet index funds that underperform after fees. Active share is not a new concept to the Presima portfolio managers. Since the late 1990s, our active share has been one of the highest in the industry, and right now it stands at 75 percent (active share of the Presima Concentrated Strategy as of June 30, 2017). This is higher than the typical active share in our assessed competitive set. We believe that this approach, combined with an experienced investment team and a commitment to stay small, will yield good results for our clients.

Tell us about Presima's commitment to remain a small boutique.

Zabierek: As a small firm, we often find ourselves cast in the role of "David" versus the industry's "Goliaths." As we have grown threefold over the last four years, like David, we seem to have been successful when we go toe-to-toe with the giants. We believe our people, process and performance compare favorably with the industry behemoths, but we offer the liquidity advantage and client-service edge found in a small boutique. While we would certainly like to grow a bit more, we want to retain the ability to add value for our clients. We currently manage C$1.9 billion (as of August 31, 2017), and have committed to our clients to put a hard cap on AUM at one-half percent of the global real estate securities market, which would infer a cap of about C$5 billion to C$7 billion. Listed real estate is a relatively small, niche market, and liquidity and nimbleness are keys to success. And on the client side, the one-size-fits-all approach to client service no longer works, and clients expect more from their managers. We feel the pathway to success is deeper relationships with a manageable number of clients.

What products does Presima currently offer?

Zabierek: We have now three main strategies. Our flagship is our **Concentrated** strategy, with a track record that goes back to 1999. It is benchmark-aware with high active share, has 30 to 40 stocks, and is available in a number of different vehicles, from separate accounts to funds. Second, we have our **Enhanced Yield** strategy that focuses on income-producing global real estate stocks. The strategy focuses on stocks that generate high dividend yields, and includes option strategies to manage volatility and deliver additional income. Third, our **Global Value** strategy, launched last year, is a total-return strategy, which seeks to take advantage of pricing discrepancies between public and private real estate markets. Our strategies complement one another and provide a range of risk-return outcomes for clients. We also offer customized investment strategies, assuming the strategy fits within our research envelope.

Many of your competitors boast that they have "boots on the ground" around the globe, and you have one office in Montreal. What is the advantage of a single location?

Zabierek: We believe that the operational model for an investment firm must match its investment philosophy and process. Given that we run concentrated portfolios with large individual bets, a single location makes most sense. We think that a single location gives us the advantage of eschewing the market noise and allows our investment team to step back and focus on the most critical trends and details. We decided to create a virtual global footprint. Rather than establish satellite offices in top financial centers, our team of portfolio managers and analysts have, over the years, created networks of information flow from local real estate brokers, sell-side brokers, private equity contacts, economists, demographers, etc. This operational model works quite well for us.

Flageole: I would also add that we travel the world extensively, with around 500 management meetings each year. In addition, being in one location gives us advantages in terms of team communication, portfolio construction and risk management. The challenge when managing a portfolio resides in the ability to synthesize the market information and make decisions with it efficiently. Being all located in Montreal allows us to exchange views and developments, and ensure the consistency of our philosophy and process. Our portfolios are constructed as single global portfolios and not assemblies of regional portfolios. These portfolios reflect our best investment ideas within a risk-management framework, so risk is managed at the overall portfolio level as opposed to on a regional basis. It is a lot simpler to have the investment team, trading team, operations team and compliance team all working within 100 feet of one another.

What else can you tell us about your investment culture?

Zabierek: We do not want to create a bureaucratic process that is so rule-based that we lose our ability to think outside the box. We have a strong investment culture, and we encourage creativity. So to start, everything we do is founded in respect and trust. If you start with trust, conversation has a tendency to go in a positive direction. The second element is accountability and responsibility. We have clear guidelines about who is responsible for what, who will be rewarded for what, and that has created a very solid sense of accountability. The third element is an attitude of honesty, candor and curiosity. Presima is a very direct place. When we need to cross-examine our investment ideas or question the consensus, we feel very comfortable doing so. Honesty, candor and curiosity allow us to question the market consensus and identify mispricings on an ongoing basis.

How has Presima evolved since its founding?

Flageole: Presima was launched in 1998 as a group within the real estate division of the *Caisse de dépôt et placement du Québec* (Caisse). Its mission was to build on the Caisse's foundation as a direct real estate investor to add value in global listed real estate markets. In 2004, Presima incorporated and organized as an independent entity, and we started raising external money. In 2010, National Australia Bank (NAB) bought Presima from the Caisse. They wanted a global listed real estate investor for their asset management arm, which is now called NAB Asset Management. So we are an independent shop, but we are owned by one of the top global banks.

Zabierek: On a day-to-day basis, we operate as a true boutique, with decision making based here in Montreal. Our parent wants us to operate as a boutique and keep our approach to investing as out-of-the-box as it has always been. NAB understands how to ensure that a boutique enjoys independence from an investment standpoint, yet offers the support a larger institution can provide.

[1]"Active Share and Mutual Fund Performance" by Antti Petajisto, Financial Analysts Journal Volume 69 · Number 4 2013 CFA Institute; and "Go Active or Go Home" by Ryan Leggio, Morningstar Inc, September 6, 2010.

CORPORATE OVERVIEW

Presima is a specialist boutique focused exclusively on global real estate securities. The firm constructs concentrated, high active-share portfolios for its clients. Presima has established a hard capacity limit so the firm can remain small and nimble, and continue to outperform for its clients. Presima believes the firm's "one team, one location" approach ensures consistency in the investment process and that only the best ideas make it in the portfolios. Presima is focused on serving an institutional client base and is proud to count as clients some of the most sophisticated institutions in Australia, the United States and Canada.

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