

# The Bulletin

---

## Coronavirus: what next for REITs?

**AUTHOR**

Chris Blanchard, CFA  
Portfolio Manager

Chris Blanchard is one of the portfolio managers responsible for Presima's investment strategies. He oversees the coverage of European stock for the investment team.

Since our first thought piece on the Coronavirus at the end of January 2020<sup>1</sup>, the world has changed dramatically. At the time there were 6,065 cases which had been identified and largely contained within China. A month and a half later the virus has spread to over 187 countries with more than 737,929 cases and 35,019 deaths as of March 30, 2020<sup>2</sup>. Western governments are now racing to lock down cities and limit human movement as the number of infected grows exponentially. No longer are comparisons being made to SARS, which we referenced in the first report, but instead to the global pandemics of the late 1800s and early 1900s<sup>3</sup>.

### MARKETS ARE STRUGGLING

In addition to the toll on human lives, the virus has also sent financial markets into a tailspin.

---

Since the end of January 2020, major equity markets have fallen ~25–35% as financial liquidity dries up and economists rapidly downgrade growth forecasts. In just over a month, a Bloomberg survey of economists has seen US GDP growth fall from an earlier forecast of 1.8% for 2020 to 1.4% today and with the range of estimates going from -9% to 2.4%. The economic situation is equally devastating in Europe as major countries such as France, Italy and Spain, have enacted strict stay at home rules with the City of London closing all non-essential businesses as of last week. Financial rescue packages grow by the day as Central Banks do their best to head off another global financial crisis.

The events of the past few weeks have also left their mark on real estate with the Global REIT index<sup>4</sup> having fallen 29% in US\$, from the end of January 2020 to March 27, 2020. Shoppers, movie goers, workers and respective landlords are feeling the negative impacts of shutdowns and social distancing. Hotel bookings have evaporated and even perceived safe haven assets such as senior care facilities are impacted as older populations remain highly susceptible to the virus' impact.

### ARE REITS BECOMING ATTRACTIVE?

The public markets have quickly priced in the risks inherent to the different real estate asset classes. The table below shows US REIT asset class returns since the end of January 2020. Not surprisingly hotel and retail landlords have suffered most while sectors which rely less on human interactions such as self storage or industrial have fared better. From a valuation standpoint, looking at our conservative estimates, we see that almost all sub-sectors now trade at a discount to the net value of their assets values in private markets.

This discount is by far the largest we have seen over the last several years. Generally speaking, this either signals that a significant correction is looming for private real estate, or that REITs have over-reacted to the current crisis.

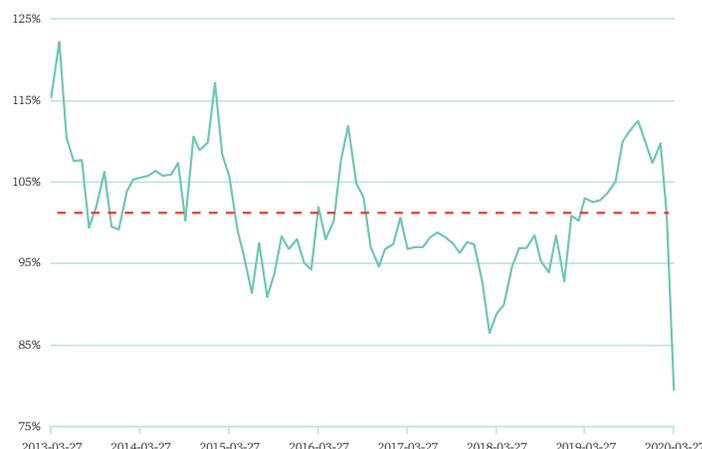
#### US REIT Sectors Returns since January 2020 (in US\$)

US REIT sectors	Returns (%) from 01/31/2020 to 03/27/2020	Price / NAV (%)
Datacenters	-4.9	114.7
Healthcare	-35.6	84.7
Industrial	-15.1	93.0
Lodging	-46.8	46.9
Malls	-52.4	51.7
Office	-28.7	69.3
Residential	-25.2	81.0
Storage	-14.2	99.3
Strip Centers	-43.3	51.4
Triple Net	-38.4	89.7
US REITs (all sectors)	-29.3	82.6

Notes: Based off the constituents of the FTSE EPRA Nareit US Index. NAVs are Presima Estimates as at March 27, 2020.

Sources: Bloomberg L.P.; Presima Inc.

#### US REITs Price/Net Asset Value



Note: Net Asset Values (NAV) are Presima estimates as at March 27, 2020.

Sources: Presima Inc.; Bloomberg L.P.

As such, what's been surprising in this very rapid downfall, is that even sectors that we would consider resilient in the current context have suffered significantly. We believe this creates opportunities for investors focused on the long-term, particularly those who believe in the merits of private real estate as an asset class.

We believe this creates opportunities for investors focused on the long-term, particularly those who believe in the merits of private real estate as an asset class.

#### VALUATION MATTERS

Looking more closely at valuation metrics and cash flows, we see that many of these US REITs are now offering outsized implied cap rates and dividend yields, especially compared to current bond yields.

## WITH GENERALLY LIMITED LEVERAGE,

We view that some more defensive sectors should navigate the crisis with only a small to moderate impact to their Funds from Operations (FFO) as evidenced in the below table.

Demand for datacenters, industrial, residential, self-storage and office should not be dramatically impacted by Covid-19, unless the crisis lasts for years. The relatively resilient nature of their tenant base and/or the relatively long leases should protect most of their cash flows which, to us, puts their current discount to private values in the spotlight.

While the outlook appears bleak at best, with the virus currently ravaging through Europe and only now starting to be felt in North America, at one point, Covid-19 will work its way through society. The progress in some Asian countries, which were forced to shut down many cities in the first wave of Covid-19 infections earlier in the year, gives us some hope that an end to this pandemic is possible. While we can't claim victory in these countries, as highlighted by a recent second wave of contamination, some Asian cities and countries are slowly coming back to life. As containment progresses and global medical teams get nearer to a vaccine and other alleviating measures, life will resume.

While there will certainly be long-lasting financial scars left behind by this virus, we believe real estate will continue to be a source of stable income and returns for investors in the future. And while some sectors will fare better than others, the current indiscriminate sell-off has created distressed valuations in the listed markets which will provide an attractive entry point into the asset class.

### Presima Valuation Estimates as at March 27<sup>th</sup>, 2020

US Sector	Implied Cap Rate (%)	ICR Spread to 10Yr Yield (%)	Dividend Yield (%)	AFFO Payout (%)	Debt to Assets (%)	Occupancy Rate (%)	Pre-Covid 3Yr FFO Growth (%)	Estimated Impact to 2020-2021 FFO (%)
Datacenters	5.8	5.2	3.3	75.6	37.0	88.2	8.0	Small
Healthcare	7.3	6.6	7.5	97.0	38.3	96.1	3.0	Moderate
Industrial	5.0	4.4	2.9	65.0	22.9	95.1	6.8	Moderate
Lodging	13.2	12.6	11.9	83.8	36.1	76.0	-3.4	Large
Malls	9.9	9.2	14.6	89.1	49.4	89.2	2.9	Large
Office	7.1	6.4	4.2	74.1	33.4	93.0	5.5	Small
Residential	5.6	5.0	3.4	68.4	26.0	96.0	6.2	Moderate
Storage	5.6	4.9	4.2	81.8	22.9	90.2	1.6	Small
Strip Center	8.9	8.2	8.4	94.4	35.5	93.1	3.9	Large
Triple Net	11.8	11.2	7.3	82.5	36.8	97.8	5.4	Moderate
US REITs	7.1	6.5	5.4	78.0	31.9	91.8	4.9	Moderate

Note: Numbers are Presima Inc estimates, weighted average based on the constituents of the FTSE EPRA/NAREIT US Index as of March 27, 2020.

Sources: Bloomberg L.P.; Presima Inc.; Companies filings.

Furthermore, direct real estate assets have not yet been re-valued since the beginning of this crisis, but we expect this to happen in the coming months. In our opinion, these are two very compelling arguments for investing into listed real estate markets.

On our end, we remain focused on identifying these opportunities and any emerging thematic for our clients. We believe that specific companies and sectors are better positioned to weather out the crisis and that others will be better positioned when the situation returns to "normal."

As a result, we remain firm believers in active management rather than a passive or ETF exposure in listed real estate.

We believe that specific companies and sectors are better positioned to weather out the crisis and that others will be better positioned when the situation returns to "normal."



#### REFERENCES

1. Blanchard, Chris. "Are REITs Coronavirus-Immune?" *Presima Inc.*, January 30, 2020.
2. John Hopkins University and Medicine. "[Coronavirus Resource Center](#)" 2020.
3. Hunt, Darren. "[Coronavirus WARNING: Deadly virus 'like 1918 Spanish flu pandemic' which killed 50 million](#)" *Express*, March 3, 2020.
4. FTSE EPRA/NAREIT Developed Index.

#### GENERAL DISCLAIMER

Presima Inc. declines any responsibility with respect to direct or indirect damages or consequences of the inaccuracy of the information reproduced in this document, or for any actions taken in reliance thereon. No information or data contained herein may be reproduced by any process whatsoever without written consent. Certain statements made in this document may be forward-looking statements. These forward-looking statements are based upon current assumptions and beliefs in light of the information currently available but involve known and unknown risks and uncertainties. Our actual actions or results may differ materially from those discussed in the forward-looking statements, and we undertake no obligation to publicly update any forward-looking statement. Presima Inc., a wholly owned subsidiary of the National Australia Bank Group (NAB Group), conducts its business and investment activities on a separate basis from the NAB Group and its affiliates. Consequently, in accordance with National Instrument 62-103 Respecting The Early Warning System and Related Take-Over Bid and Insider Reporting Issues and the Aggregation Relief described in Part 5.1 of such Regulation, Presima Inc. treats securities it controls separately from securities owned or controlled by the NAB Group or by its other affiliates. An investment in a financial product issued, managed or distributed by Presima Inc. does not represent a deposit with or a liability of the National Australia Bank Limited nor any of its affiliates and is subject to investment risk including possible delays in repayment and loss of income and capital invested. Neither the National Australia Bank Limited nor its affiliates guarantees the capital value, payment of income or performance of Presima Inc. For Australian wholesale clients, Presima Inc. has been granted relief from holding an Australian financial services licence for the provision of certain financial services to wholesale clients in Australia. Presima is registered as an SEC Investment Advisor and subject to the U.S. regulatory requirements and laws which differ from Australian laws.



#### CONTACT

Amina Si Chalb,  
Senior Associate,  
Client Service & Marketing  
[asichaib@presima.com](mailto:asichaib@presima.com)  
(514) 673-1224