Beds, sheds and meds

INDUSTRY EXPERTS OFFER THEIR VIEWS ON THE REAL ESTATE MARKET'S RESILIENCE, DISCUSS ITS MAIN CHALLENGES AND IDENTIFY WHICH SUBSECTORS ARE GAINING MOMENTUM.

SAM STEELE
INVESTMENT RESEARCH DIRECTOR, PRIVATE MARKETS, RUSSELL INVESTMENTS

Beds, sheds and meds: Like every other asset class, the real estate market has been impacted by the economic fallout from Covid-19. However, some sectors within real estate have arguably benefited as a result of the pandemic, and trends that were emerging have accelerated.

The logistics sector will continue to be a winner, with a strong demand picture driven by ecommerce and supported by supply chain reconfiguration. Urban logistics and site repositioning plays provide new investment opportunities, acting as a quasi-proxy for the retail sector.

In addition to logistics, the focus for 2021 will be on 'beds, sheds and meds' as the logistics and alternative sectors (healthcare, life science, residential) increase in importance to future-proof investors' portfolios to the detriment of retail and office.

Defensive real estate: We currently do not hold a strong regional allocation preference, but in the near-term, Asian countries that have been able to contain Covid-19 may prove more resilient. Overall, during this uncertain period, we think that manager, sector and asset selection will hold greater weight on investment performance than regional allocations. As 2020 has highlighted, portfolio diversification is important to create a defensive real estate portfolio.

MARC BERTRAND
CEO, AMUNDI REAL ESTATE

Bonds versus real estate: While real estate assets are not a substitute for bonds, they can be used in addition to bonds as part of a portfolio. Along with its diversification impact, real estate can be attractive to investors looking for income, in particular as many leases are indexed to inflation and today the gap between prime yields and ten-year government bonds is high. We have observed that real estate portfolios that are diversified both geographically and by asset type have displayed resilience in the income distribution in 2020, despite the Covid context.

"WHILE THE COVID PANDEMIC HAS BROUGHT INTO FOCUS ASSET CLASSES LIKE LOGISTICS OR HOUSING, WE WOULD CAUTION INVESTORS NOT TO THROW THE OFFICE OUT WITH THE COVID BATHWATER!."

Marc Bertrand

One major difference with bonds is that real estate assets have no face value, though they do have an intrinsic land value.

Office vacancies: While the Covid pandemic has brought into focus asset classes like logistics or housing, we would caution investors not to throw the office out with the Covid bathwater! We believe offices will remain key for investors' allocation looking ahead.

Historically offices are the number-one real estate asset in terms of investment turnover in Europe. The Covid crisis strengthens existing trends, with offices responding and adapting to occupier demand which includes flexibility, services, and high IT and technological standards. This should lead to the office market becoming more segmented.

TOM WALKER
CO-HEAD OF GLOBAL REAL ESTATE SECURITIES, SCHRODERS

The challenges for Shanghai and Shenzhen: They are no different to most global cities. There is intense competition for land use driven by increasing levels of urbanisation. The key disruptive trends in all real estate markets at present are e-commerce and working from home.

"THE KEY DISRUPTIVE TRENDS IN ALL REAL ESTATE MARKETS AT PRESENT ARE E-COMMERCE AND WORKING FROM HOME."

Tom Walker

China has the highest e-commerce penetration anywhere in the world. This is leading to strong demand for 'last mile' distribution facilities and data centres. There is also a significant focus on sustainability. This is exemplified by Shenzhen, which used to generate high levels of pollution and is now arguably one of the 'greenest' cities in the world.

Superior Covid response: The way that the majority of the large Asian cities have dealt with the pandemic is superior to Western cities. Therefore, we have more confidence in the 'return to normal' in these markets and are expecting stronger returns in the short term.

Covid-19 has not introduced any new trends to real estate markets: we were already positioned for greater levels of e-commerce, working from home and the exponential growth of data creation and storage. Prior to the pandemic, we were most excited about the key cities in China and the growth that they will deliver. What has taken place over the last 12 months or so has only increased our conviction.

PAUL JAYASINGHA
HEAD OF REAL ASSETS, WILLIS TOWERS WATSON

Secure income from leases: We continue to like the "secure income" space – real estate characterised by long-term, inflation-linked leases to high-quality counterparties. Here we focus on the set of characteristics that make the most sense for our pension fund clients' liabilities.

A great example here is UK specialist social housing, where we can find initial yields in the 5% area, with contractual inflation linkages, let to counterparties which are directly funded by local authorities. Rent collection has been solid throughout Covid-19 and the societal benefits of the strategy are compelling. In an environment where gilt yields are low and there are increasing concerns about higher inflation as a result of government stimulus, the strategy appears attractive.

No dramatic changes to asset allocation: To date we haven't seen dramatic changes from our clients, which makes sense given the illiquidity of the asset class and long-term strategic views taken by clients. Prior to Covid-19, we had been advocating a shift towards 'alternative', more defensive property sectors such as healthcare, student, data centres and residential – especially those with compelling sustainability credentials. Given the ongoing challenges in office and retail, we expect this trend to continue.

TRULS NERGAARD
HEAD OF NORDIC REAL ESTATE, STOREBRAND ASSET MANAGEMENT

No denying sustainability surge: The momentum around sustainability is undeniable. Climate change, population growth and urbanisation are all issues shifting the landscape and expectations on the industry. The real estate business is maturing quickly as we see increasing pressure from both public and private [investors] to address issues related to sustainability and climate. A sustainable approach in real estate is important for the wellbeing of individuals and healthy communities – but also for increasing the value of the real estate.

Sustainability in general has had a strong focus for many years in the Nordics and both investors and tenants increasingly demand that the offering is sustainable. We see a clear and increased demand for green buildings, both in transactions among investors and on the tenant market as more stakeholders realise that it is not just about safeguarding our future, it also increases the appeal and value of the communities, the real estates, and the investments.

As a consequence, there is more scrutinising on sustainability, due diligence and demand for information on practices and performance. This requires increased collaboration with the tenants to integrate environmental issues and make green practices part of the business plan and in some ways to rethink the business. The EU taxonomy will most probably contribute further to accelerating development on a larger scale.

The challenges and the opportunities are many in the real estate space. Properties in general provide an attractive risk-adjusted return, but the demand is greater than the supply. When you add the sustainability dimension, the range becomes even smaller.

DANNY PHUAN
HEAD OF ACQUISITIONS ASIA-PACIFIC, ALLIANZ REAL ESTATE

Asia's fundamentals are still in place: Asia-Pacific's long-term macroeconomic fundamentals remain, despite Covid-19. Demographics, high levels of savings and infrastructure investment will see Asia-Pacific GDP outpace US and EU growth over the next five years.

Real estate liquidity has remained high, resulting in competition and increasing capital value across most sectors. With Covid-19, pockets of dislocation are emerging, mostly in the US and Europe. However, Asian property owners remain well capitalised and regional institutional interest remains high, driving mega-trends and negative risk-free rates, which provide real estate yield support.

> **"ASIAN PROPERTY OWNERS REMAIN WELL CAPITALISED AND REGIONAL INSTITUTIONAL INTEREST REMAINS HIGH, DRIVING MEGA-TRENDS AND NEGATIVE RISK-FREE RATES, WHICH PROVIDE REAL ESTATE YIELD SUPPORT."**
>
> *Danny Phuan*

In Asia-Pacific, we align our investments with secular macro trends including urbanisation, infrastructure and digitisation. Covid-19 has accelerated these mega-trends and validated our investment strategy. In 2020 we expanded our offices to Tokyo and Shanghai to support our growth.

Furthermore, we capitalise individual country and sector cycles to build a diversified, long-term portfolio with income-producing assets, offering investors stable returns.

Our focus remains on Japan, Australia, Singapore, China, India, South Korea and Hong Kong, and we seek attractive risk adjusted investment opportunities across office, logistics, multi-family, student housing and data centres.

JOSÉ-LUIS PELLICER
HEAD OF INVESTMENT STRATEGY AND RESEARCH, M&G REAL ESTATE

The UK's recovery from Brexit: UK real estate pricing has been penalised by Brexit uncertainty since 2016. However, we believe the pricing differential between London and other major European cities will now begin to erode, reinforced by structural strengths such as the London market's size, deep pools of liquidity and low cyclical supply risk, following the UK's orderly departure from the European Union.

While the future regulatory framework for financial services is yet to be determined, we believe there remains strong justification for a large share of the industry to retain roots in the UK. Crucially, London reflects a strong source of human capital, with a long history of innovation in financial services. It also represents a powerhouse in business services, technology and biotech, and it is important to consider that the UK is one of the most business-friendly countries in Europe.

Although pricing of UK real estate now appears an outlier when compared to other major European cities, we expect investors to capitalise on this differential as it begins to normalise, reinforced by reduced political and Covid-19-related uncertainty, which may well encourage some investors to increase their risk tolerance.

RAYMOND JACOBS
MANAGING DIRECTOR, FRANKLIN REAL ASSET ADVISORS

Governments can't go it alone: The pandemic has revealed a lot about the world. It drew the curtain back on our ability to deal with a significant global crisis, laying bare systemic weaknesses and exposing structural failures.

One such failure pertains to social infrastructure. The pandemic highlighted that many communities around the world lack the necessary facilities, such as accessible healthcare facilities and affordable housing, to combat threats like Covid-19 effectively.

The lack of necessary real estate infrastructure certainly existed prior to the outbreak of Covid-19, and the pandemic has emphasised the need for increased investment.

While governments have implemented a range of fiscal and quantitative measures to cope with many aspects of the pandemic, social infrastructure funding has not been a priority. Governments alone cannot respond effectively to the crisis on behalf of vulnerable communities; public investments are not sufficient to fill the social infrastructure investment gap. The support of the private sector is needed now more than ever.

AXEL DRWENSKI
HEAD OF RESEARCH, KGAL

Business travel's comeback: In the current market cycle, the majority of investors are seeking out opportunities which are low-risk and provide greater stability. As a result, we have found that the appetite for residential and logistic assets in core European markets are high, whereas the demand for sectors affected by the measures to contain coronavirus remain very limited – for example, hotels and shopping centres.

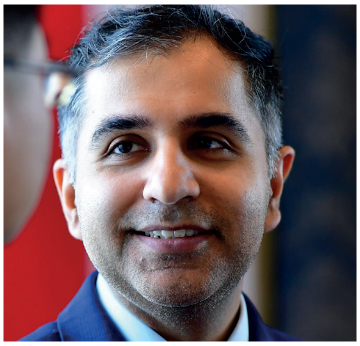
The previous downturns have taught us that the moment for contra-cyclical investments will soon return, and subsequently, we are anticipating a comeback of business hotels and selected core retail locations.

"PREVIOUS DOWNTURNS HAVE TAUGHT US THAT THE MOMENT FOR CONTRA-CYCLICAL INVESTMENTS WILL SOON RETURN."

Axel Drwenski

Acceleration of trends: We have witnessed a strong shift of the demand from value-added and opportunistic investments to less risky ones. However, the pandemic should not have an impact for the long term. Apart from the downturn in the hotel sector, the development we have seen in 2020 (the increase in online trade, remote working, and the shift of the housing demand from the cities to the city fringes), is just the acceleration of trends investors should have already anticipated in their pre-Covid investment strategies. Furthermore, if you are looking for a stable cash flow, the last year has shown how important the diversification by sectors and countries is.

Cities worth watching: I would keep an eye out for London and Belfast. After years of uncertainty, there are many opportunities in London; and because of the special status of Northern Ireland, the region might become an attractive link between the European Union and the UK.



VARUN MALIK
EXECUTIVE DIRECTOR, APAC CLIENT COVERAGE, MSCI

Office vacancies increase: Asia-Pacific real estate was not immune to the impact of Covid-19. Struggling asset classes such as retail suffered acutely across the region. However, they have also recovered sharply based on strong policy and support provided by government such as in Singapore, according to MSCI Private Real Estate Indexes.

"DESPITE THE SHORT-TERM CHALLENGES FACED BY REAL ESTATE INVESTORS, THE MARKET DOESN'T SEEM DISTRACTED FROM ANOTHER MAJOR CHALLENGE: CLIMATE CHANGE."

Varun Malik

Logistics has bucked the trend and paradoxically has garnered even more capital, addressing the gap left within the consumption/retail segment. Office vacancies continue to increase across the board and, with valuation season upon us, it remains to be seen what adverse impact this would have on property prices looking into 2021 and beyond.

Despite the short-term challenges faced by real estate investors, the market doesn't seem distracted from another major challenge: climate change. Especially in markets such as Japan, Australia and Singapore.

In fact, the pandemic has highlighted the wide-reaching impacts that seemingly nonfinancial and difficult-to-quantify risks have and can have on a portfolio.

STEFAN WUNDRAK
HEAD OF EUROPE RESEARCH, NUVEEN

The bond/real estate yield gap: European real estate allocations have been rising since the early 2000s and have continued to rise globally since zero-interest-rate policies have taken hold across the developed world. According to the Hodes Weill 2020 survey, target allocations to real estate

"UNSURPRISINGLY, IT IS REAL ESTATE DEBT WHICH IS GAINING A BIGGER MARKET SHARE WITHIN PROPERTY ALLOCATIONS."

Stefan Wundrak

have even accelerated again in the last year. Despite record low property yields, the yield gap to bonds is still not seriously squeezed in most markets; real estate remains relatively good value, which drives up allocations. Equity investments in real estate also offer the opportunity to create alpha, which is much harder in fixed income. However, valuations for real estate are high on an absolute basis compared to historical levels.

Unsurprisingly, it is real estate debt which is gaining a bigger market share within property allocations. While debt investments lack the upside of equity, predictable income streams and downside risk mitigation are making this form of real estate investment mainstream in a period of very low equity yields. Rent collection issues and the fallout of the pandemic on tenants, in particular in the retail and hospitality space, has further shifted allocation into debt in 2020.

With under $10 trillion (€8.2 trillion) of professionally managed global real estate according to MSCI, real estate allocation is still more than a magnitude smaller than the global bond markets, estimated at just under $130 trillion (ICMA) total outstanding volume. Real estate's share will continue to rise as long as interest rates are so low, but it won't rival the bond market in the foreseeable future.

JASON ORAM
PARTNER, FUND MANAGER, EUROPA CAPITAL

Profound changes: It is stating the obvious, but the pandemic has had a negative impact on real estate investment in Europe, with volumes for the year projected to be around 15-20% lower than in 2019, but still similar to 2016. This is only a superficial impact on the market and masks what are more profound changes.

The cause of the reduction in real estate investment in Europe is not simply due to the restrictions in mobility that frustrate capital movements in what is now an increasingly internationalised industry, but may be more substantially attributed to the undermining of capital market confidence in occupier markets and not just in the short term, but more importantly into the long term.

Although important, this isn't just about confidence in occupier covenant strength as a result of the financial strain of the pandemic, but rather it is to do with the manner in which the pandemic is revolutionising the way in which we occupy real estate.

> "TRENDS THAT WERE EVIDENT PRE-PANDEMIC ARE BEING ACCELERATED BOTH FOR GOOD AND BAD. THIS APPLIES TO THE FUTURE USE OF OFFICES AND EVEN HOMES."
>
> *Jason Oram*

Trends that were evident pre-pandemic are being accelerated both for good and bad. This might be most evident in the trauma being experienced in the retail sector and the contrasting exuberance of the industrial sector, but it also applies to the future use of offices and even the homes within which we live, indeed the entire built environment is being rethought.

As occupiers, we are social beings, and ultimately, successful real estate has always been about creating social environments. Urban areas have been capable of demonstrating the best qualities of a social environment and must strive to continue to do so and meet our changing needs.

AMÉLIE DELAUNAY
DIRECTOR OF RESEARCH AND PROFESSIONAL STANDARDS, ANREV

No change of plan in APAC: The great majority of institutional investors globally plan to stick firm to their future investment plans for non-listed real estate in the Asia-Pacific region in the coming year, according to our annual Investment Intentions Survey.

Despite the turbulence of 2020, 77% of respondents said that the coronavirus pandemic had not changed their investment plans in Asia-Pacific. In fact, more investors reported plans to increase allocations to real estate than to reduce them because of Covid-19, which was particularly the case with Asia-Pacific investments, as 22% said the crisis urged them to increase their planned investments in the region.

This is not only driven by investors outside the region looking to increase their real estate allocation to the region in a search for international diversification, but also from Asia-Pacific investors: 72% of investors expect their allocation to Asia-Pacific to increase over the next two years, far higher than the proportion expecting an increase in allocation to the other regions, as indicated by the survey.

This year, the top main investment destinations are the same as in previous years – Sydney, Melbourne and Tokyo – but for the first time, investors indicated that the industrial and logistics sector in Australia is their most preferred destination/sector combination for 2021, ahead of offices in the country which have long dominated the rankings. This was followed by the residential sector in Tokyo.

The region should see another influx of capital in 2021.

RACHEL TONG
MANAGING DIRECTOR AND HEAD OF REAL ESTATE PRIVATE EQUITY, VALUE PARTNERS

A taste for Tokyo: We see Tokyo as the most preferred city for investment in 2021. The city has ranked in the top-three most popular destinations since 2018 owing to its availability of high-quality assets and strong liquidity. Secondly, although CBD [central business district] office rents in Singapore declined in 2020, rents are forecasted to register growth over the next three years, supported by low vacancy and strong demand. Singapore remains an important hub for foreign corporations looking to access Southeast Asia and is also emerging as a viable alternative to Hong Kong among companies establishing Asia-Pacific headquarters.

The Korean market is also an area to pay attention to and the investors retain a strong appetite for modern logistics properties in Greater Seoul.

For the challenges, as many government support programmes come to an end in 2021, the commercial real estate market is expected to receive significant amounts of stressed or distressed assets to be released. In Asia-Pacific, government funding to support local economies put commercial real estate transactions on hold as asset owners had yet to feel the pressure to sell and buyers were taking a wait-and-see attitude.

In China, as the government continues to tighten bank financing, both large and small developers are looking to all assets to meet debt obligations or to fund new land acquisitions. China's residential sector is most vulnerable to distress selling as oversupply has surfaced in some areas. However, the demand for residential assets remained strong during the 'Golden Week' in October, [when] residential developers can avoid a credit shortage if they are willing to cut the sales prices.

The impact of the pandemic has added another layer of stress to India's developers on top of the 2019 crackdown of developer-finance irregularities. It is estimated that about 95% of Indian developers are facing potential cash and liquidity shortages.

Popularity contest: We always liked the logistic centres and data centres, even before the pandemic period. With the pandemic boosting demand for industrial and logistics property over the course of 2020, the sector was named the most popular for investment in 2021. Data centres were the subject of stronger interest as a surge in demand for video-conferencing and other platforms to support remote working led to increasing requirements for data storage. As data centres require considerable expertise to secure and operate suitable sites, partnering with

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Rachel Tong

experienced operators remains the preferred entry route for investors.

We should see an increasing opportunity for investors to partner with second-tier data centre operators in need of equity investment to expand their capacity and footprint.

Separately, there continues to be strong interest in real estate debt, with this year likely to bring a host of opportunities, particularly in China, where the government recently imposed new caps on bank lending to developers. This is likely to force developers to utilise private debt.

PAUL BASHIR
CEO EUROPE, HARRISON STREET

Life sciences: The European life-science sector is in its infancy and there is structural undersupply which cannot keep pace with the increasing demand from occupiers. Our investment strategy in life sciences is across the risk spectrum, and we are seeing assets for acquisitions at attractive pricing

"WHILE WE IDENTIFIED THE LIFE-SCIENCE OPPORTUNITY LONG BEFORE COVID-19, THE PANDEMIC HAS HIGHLIGHTED THE RISING NEED FOR INVESTMENT IN THIS SPACE FOR MANY OTHER LONG-TERM CHALLENGES."

Paul Bashir

and with value-add opportunities. Although our initial investment was in the UK market, we are also exploring opportunities in Ireland and the Netherlands and will target Switzerland in the future.

While we identified the life-science opportunity long before Covid-19, the pandemic has highlighted the rising need for investment in this space, not just in relation to this crisis, but also for many other long-term challenges. For instance, chronic illnesses such as heart disease, asthma, cancer and diabetes are more prevalent, as life expectancy is increasing globally. **f**e