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Real Estate: Keeping with the Times

Real estate is seemingly the easiest investment asset class in the world for investors to understand, as property may be the only asset class that every person on earth uses all the time. It's therefore unsurprising that real estate, a ~$USD 230 trillion industry, is the world's largest asset class, more than doubling the size of the global bond market.[1]

The changing value of real estate

Real estate value is determined by the demand for its use and the supply of its inventory. Historically, we've also seen dramatic changes as primary functions of real estate have altered over time. As early as 12,000 years ago, fixed real estate was valued for the fertility of its land, enabling people to farm and sustain a family. As settlements and communities grew, so did the need for fixed buildings such as homes and commercial space. This was largely enabled by what are known as the First and Second Industrial Revolutions of the past couple of centuries, which were marked first by the rise of production, then mass production, that led to the creation of larger cities. In the past several decades, real estate as we know it stayed relatively consistent. This predictability of demand meant that owners were able to reasonably forecast their cash flows, making certain types of real estate generally a very stable, secure, and consequently valuable asset class. Cyclicality was generally understood; one could reasonably expect that in a weak economic environment, fewer people travel and spend money in hotels, or companies shrink and need less office space. But the prevailing (and correct) assumption was that structural demand would remain generally intact.

However, there have certainly been various longer-term changes that have impacted real estate values. For example, the rise of the suburbs in the U.S. beginning in the 1950s that made suburban homes and neighbourhood shopping centres valuable for several decades. Or the urbanization trend of the 2000s that drew populations back to cities and made urban commercial and residential real estate more valuable. There was no real need or purpose to invest in technological innovation for a property to help protect it against these changes, because the cost would be too high and the return on invested capital too low. The investor lived and died by the external forces of supply and demand.

Changes in the market

Today, while real estate remains a strong investment choice, evolution is impacting the values of different types of real estate. This is largely influenced by the technology-enabled Third (Digital Revolution) and Fourth Industrial Revolutions, which, on the latter, the World Economic

Forum says "represents a fundamental change in the way we live, work and relate to one another."[2] The recent COVID-19 pandemic has caused a potential eruption of factors, the most immediate being the impact on retail real estate caused by the acceleration of e-commerce and the impact on office real estate caused by remote working. As malls and offices are two of the most familiar types of real estate, some investors associate these negatively changing trends (real or perceived) as the demise of all commercial real estate and a reason to avoid this asset class. Doing so, however, would risk missing out on many very attractive risk-adjusted opportunities. Malls are being pressured by e-commerce, but goods don't get manufactured and delivered to customers out of nowhere, which makes warehouse space more valuable than ever and puts warehouse owners in an enviable position. If companies opt to work more from home, this could change the perceived value of a home as more time will be spent there. More remote working places greater demand for data traffic and data servers and as a result, creates more demand for many cellular towers and data centres, which many investors don't realize are considered real estate.

Real Estate Investment Trusts (REITs)

These changes in value have been reflected in public REIT market capitalizations. Where in 2010, technology REITs were non-existent, today they represent 30% of the FTSE Nareit All REITs Index.[3] Malls, on the other hand in 2010 represented 14.5% of the U.S. REIT index, and today they represent only 3.2%. These changes in real estate trends, however, do not happen overnight, and the passive nature of REIT indices ensures that they will not be nimble enough to manage these changes. The index will almost never be early investing in good ideas and will almost always be late shedding bad ideas. By the end of 2019, U.S. index weightings in malls, hotels, and mortgage REITs were around 14%. In our Signature Global REIT mandate this number was virtually zero. Year-to-date those sectors are down between 47% and 60% and have been a significant drag on the performance of the index. This is one of the reasons why the Signature Global REIT mandate, while down, is outperforming its global benchmark by over 700 basis points year-to-date and by over 1,000 basis points over the last 12 months. Active management matters.[4]

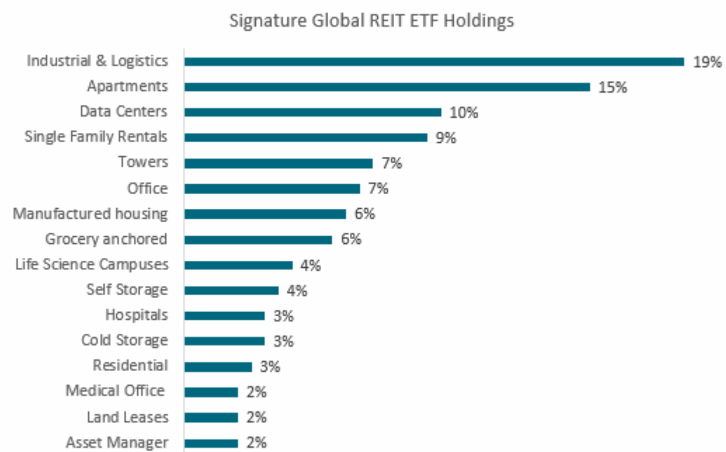
Signature's focus

But the key for us is not just to avoid problem areas. We want to focus on the advantages in our ever-changing environment. With the deep, collaborative team of asset and sector specialists at Signature, we're well-equipped to act on evolving trends on a global basis. This has led us to sectors like life sciences campuses as early investors in new emerging sectors, like cold storage facilities, and to be among the largest investors in the world in the IPOs of India's first ever REIT and Asia Pacific's largest focused e-commerce warehouse platform. This is why the warehouse

company Prologis is one of the largest positions we hold. It allows us to sort through the noise of things like short-term rent collections through the pandemic and focus on established property types whose businesses will remain intact, like residential rentals. It has emboldened our focus on well-capitalized companies with conservative payout ratios to mitigate downside risk. As our Signature team's expertise and network grows, so does our ability to access attractive and unique opportunities.

There are over 20 subsectors in listed global real estate, and we can actively tailor the strategy to meet our evolving view of the world. This chart shows the investable public real estate subsectors with our positioning:

Investable property types
Apartments
Single-Family Rentals
Manufactured Homes
Retirement Homes
Nursing Homes
Office
Life Science Campuses
Industrial & Logistics
Cold storage
Malls
Strip Centers
Data Centers
Cell Towers
Hotels
Timberlands
Self-Storage
Triple-net REITs
Land leases
Asset Manager
Developer



Source: Signature Global Asset Management
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Sources:
1https://internationalservices.hsbc.com/content/dam/hsbcis/pdf/HSBC_Global_Real_Estate_Report_July2017.pdf
2 https://www.weforum.org/focus/fourth-industrial-revolution?page=120&source=post_page
3 https://www.reit.com/data-research/reit-indexes/monthly-index-constituents
4 Subsector returns (Malls, Hotel, Mortgage REITs) as per Bloomberg: Bloomberg Real Estate Investment Trust Mortgage Index,

Bloomberg REIT Regional Mall Index, Bloomberg REIT Hotels Index
Performance data May 17,2019-May 19,2020 and YTD to May 19, 2020
F Class returns as per Bloomberg Finance L.P.
Index used is FTSE EPRA Nareit CAD
Data on holdings expected for REIT ETF/Pool based on initial indicative portfolio.

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