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The Growing Case for Global REITs

Many REITs investors still think of REITs as a predominantly U.S. market, or else they assume that U.S. REITs assets are sufficiently international that it is unnecessary to go elsewhere for global exposure. In this paper, we argue that non-U.S. markets can deliver real diversification benefits and are growing too fast to ignore—with the potentially huge Chinese and Indian markets only just taking off.

Listed real estate, in the form of Real Estate Investment Trusts (REITs), remains untested territory for many investors, particularly outside the U.S.

Awareness is rising. In the U.K., especially, where investors and regulators have started to recognize the liquidity risks associated with open-ended direct property funds, there is growing interest in REITs. More and more investors see that REITs are not just another equity sector, like consumer staples or health care, but deliver a genuinely diversifying, real estate flavor[1] of cash flow and return profile. They are also increasingly aware that this doesn't have to mean a dull collection of offices and shopping malls that may not survive in the post-coronavirus world. More and more listed real estate assets, such as datacenters, cellphone towers and last-mile fulfilment storage spaces, stand to benefit from technology and e-commerce growth themes.[2]

But even some of the most enthusiastic and knowledgeable REITs investors still tend to think of it as a predominantly U.S. market—or assume that U.S. REITs assets are sufficiently international that it is unnecessary to go elsewhere for global exposure.

Both of those assumptions are true to some extent. The U.S. accounts for around half of global listed real estate market capitalization. Major names such as Prologis and American Tower, for example, are certainly not just U.S. businesses. The latter has half of its assets outside the U.S., from Mexico, Brazil and India, where it owns more sites than it does at home, to Burkina Faso. But the U.S. market is still only part of the global real estate story. Local-market listings are growing fast around the world, particularly in emerging markets, and we believe that they can offer more exposure to idiosyncratic, localized real estate trends and cycles than a U.S.-only allocation.

Furthermore, we would argue that there is no better way to get genuinely global real estate exposure than via REITs. Few institutional investors attempt to manage in-house portfolios with assets in territories across the world, but it's also true that there are very few credible global direct real estate funds.

That is not surprising: it is very difficult to amass, cost-effectively, the local expertise required to manage assets in dozens of idiosyncratic towns and cities across the world. The fund-of-funds route is one viable (but expensive) option, and even that does not quite give investors the sort of instant access to established experience that comes with buying a REIT or other listed real estate company. That experience not only covers asset management but also, in many cases, development; and it can also be very granular—there are REITs for holiday homes in Germany, supermarkets in the U.K. and health care facilities in Japan, to name but three. Granularity helps with diversification and, when combined with the liquidity of REITs, it can also enable an investor to add value by changing sector exposure tactically, which has been a big advantage during the COVID-19 crisis. Add the simplicity of investment, the generally low leverage and the potential tax advantages, and we believe it is clear why investors seeking to build a global portfolio tend to turn to listed real estate.

Given that convenience and potential, unless an investor is consciously focusing on a single market, we think it would be unfortunate not to take full advantage of the growth opportunities and diversity on offer via a global allocation.

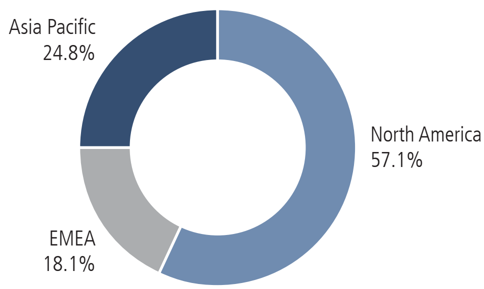
Growth

By the end of June 2020, the market capitalization of indexed global real estate securities was more than $1.9 trillion. Even when we exclude the fast-growing emerging markets, there is almost $1.4 trillion of market capitalization represented in the FTSE EPRA/NAREIT Developed Index, and 43% of that is now listed outside North America.

[1] Gillian Tiltman, "REITS: The Real Thing" (Sep 2017) at https://www.nb.com/_layouts/www/transfer.aspx?URL=/insights/reits-the-real-thing.
[2] Steve S. Shigekawa and Brian Jones, "Digital Drivers of Real Estate Opportunity" (May 2020) at https://www.nb.com/_layouts/www/transfer.aspx?URL=/insights/digital-drivers-of-real-estate-opportunity.

FIGURE 1. THE REITS MARKET IS NOW SUBSTANTIALLY GLOBAL

Even without emerging markets, 43% of index market capitalization is outside North America…



North America
54.2% U.S.
2.9% Canada

EMEA (Europe, Middle East and Africa)
13.3% Continental Europe
4.6% U.K.
0.2% Israel

Asia Pacific
11.5% Japan
9.8% Hong Kong and Singapore
3.5% Australia and New Zeland

… and regulatory approval of REITs and REIT-like structures is spreading worldwide

Region	Country	Listed REITs
North America	United States	1960
	Canada	1994
	Mexico	2011
	Puerto Rico	Legislation in Place
Europe	The Netherlands	1969
	Belgium	1995
	Turkey	1999
	Greece	1999
	France	2003
	Bulgaria	2005
	Germany	2007
	United Kingdom	2007
	Italy	2007
	Finland	2013
	Ireland	2013
	Spain	2014
	Hungary	2011

Region	Country	Listed REITs
Asia Pacific	Australia	1971
	Japan	2001
	Korea	2004
	Singapore	2002
	Taiwan	2004
	Hong Kong	2005
	Malaysia	2005
	New Zeland	2007
	Thailand	2013
	Indonesia	Under Consideration
	Philippines	2010
	China	Under Consideration
Other	Ghana	1994
	Brazil	1995
	Israel	2006
	Nigeria	Under Consideration
	Pakistan	2015
	South Africa	2013
	Dubia	2010
	Costa Rica	2009
	India	2014

Source: FactSet. UBS. Data as at June 30, 2020. For illustrative purposes only.

Five years ago we wrote about how fast the European REITs market was growing, for example, following the value opportunity that opened up following the eurozone crisis.[3] In just three years, there had been 45 Initial Public Offerings raising more than €13 billion—and, just as important, these listings had greatly diversified the European market beyond the dominant U.K. and French names.

While the European IPO market has been quiet for the past 18 months, European Public Real Estate Association (EPRA) data show that during 2017 and 2018 a further 28 listings were made, raising almost €8 billion. These covered Germany, Ireland, Finland,

[3] Gillian Tiltman, "Europe's Listed real Estate Revolution" (September 2015).

Spain, Sweden, the Netherlands and Belgium, as well as the U.K., with a tilt toward residential but also a number of new additions in alternative sectors such as holiday properties, e-commerce logistics and infrastructure. Since 2013, the total raised by European REIT IPOs now stands at €22.7 billion.

When we include emerging markets in our universe, there is still more potential for growth. As figure 1 shows, many emerging stock markets have rules in place to list REITS or REIT-like structures—and in some cases they have had them since the mid-1990s. But some of the largest and most important equity markets have come to the opportunity only recently, suggesting that there is a lot of growth to come.

India is a good example. REITs were approved in 2014 and the regulations came into effect in 2017, but the first security, Embassy, was listed only in 2019. There are still only two REITs and three public Infrastructure Investment Trusts on the market. Similarly, the Philippines has had legislation in place for a decade, but has only recently listed its first security, AREIT, sponsored by Ayala Land.

And then there is China. China started a formal trial into the viability of REITs in April this year, and there are plans to list around 10 infrastructure-based trusts before the end of 2020. Traditional real estate-based trusts are likely to follow later. If the U.S. is a guide to how big China REITs could become as a proportion of GDP, it could potentially grow into a market worth more than $1 trillion.

Similarly new Asian REITS markets, such as Singapore's and Japan's, have exhibited attractive relative returns. According to Bloomberg, between March 2003 and December 2019, Singapore REITs returned 13.2% and Japan REITs 9.8%, annualized, versus 10.2% and 7.2% for the broader Straits Times Index and TOPIX Index, respectively.

Furthermore, while the first listings in China and India have tended to be infrastructure- rather than traditional real estate-based, this is not yet true for Asia as a whole. If we exclude the $260bn China Tower, only 5% of Asia's REITs exposure is to non-traditional sectors such as technology and social infrastructure. In the U.S., these sectors have grown very quickly, to account for more than 55% of the market.

The current leading names in datacenters and cell towers, such as NextDC, KeppelDC, Keihanshin Building, Tower Bersama Group and Sunevision, and in specialty infrastructure, such as Parkway Life, Arena, National Storage and HC&M, are in our view the vanguard of a coming wave of Asian non-traditional REITs. As we have set out many times in the past, this is also where we see the most attractive earnings growth potential as global real estate reflects new digital and demographic realities.

Diversification

Going global with REITs is not only about seeking out growing markets, however. It is also about benefitting from diversified exposure to idiosyncratic, local real estate cycles. While many U.S. REITs have long had a global footprint, and real estate in general is becoming more globalized, we believe these idiosyncratic cycles are nonetheless quite clear and they do feed through into listed-security performance.

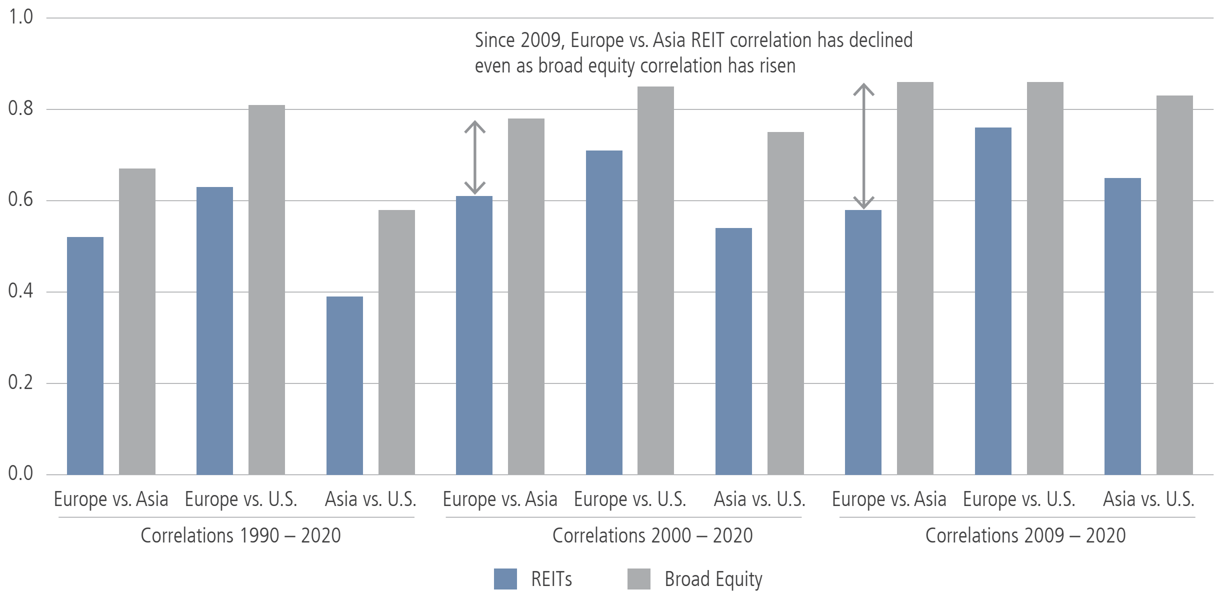
One might reasonably expect emerging market REITs to offer the greatest diversification benefits, but only developed markets have a performance history long enough for meaningful analysis. As figure 2 shows, even here the historical diversification has been significant.

FIGURE 2. DIVERSIFICATION BETWEEN REGIONAL REITS MARKETS

Long-term REIT index correlations between three developed market regions

	Correlations 1990 – 2020	Correlations 2000 – 2020	Correlations 2009 – 2020
Europe vs. U.S.	0.63	0.71	0.76
Asia vs. U.S.	0.39	0.54	0.65
Europe vs. Asia	0.52	0.61	0.58

Regional REIT index correlations have been lower than similar regional Broad Equity index correlations



Source: FactSet, Neuberger Berman. Data as at August 31, 2020. Correlations are derived from monthly total returns in USD to the FTSE EPRA/NAREIT Developed Europe, Developed Asia and USA Indices and the MSCI Europe, Pacific and USA Indices, between January 1990 and August 2020. For illustrative purposes only.

While the European and Asian markets have both become more like the U.S. REIT market over time, they have maintained a steady and relative low correlation with one another. This appears to reflect the fact that they have both been growing at the same time as the U.S. market has been globalizing its exposures, while at the same time all three markets have retained their idiosyncratic characteristics.

Moreover, this history shows us that correlations have often dipped lower during crises that we think of as large, systemic, global events, such as the Asia crisis starting in 1997, the eurozone crisis starting in 2010 and the China, commodities and emerging markets downturn of 2015 – 18.

These global events in financial risk have remained relatively localized in REITs markets because while certain real estate companies may have a genuinely global set of assets, real estate remains a fundamentally local business.

We can see that effect when we compare the correlations exhibited between our regional REITs indices with the correlations of broad-equity MSCI indices that cover a similar set of countries (figure 2). Inter-regional correlations have been lower in REITs for all market pairs across all the time periods selected. Perhaps most striking, however, is that Europe-to-Asia REITs correlation has declined during the post-2008 period even as broad equity market correlation has risen, likely driven by synchronous easing of monetary policy by the U.S. Federal Reserve, the European Central Bank and the Bank of Japan. We think it is remarkable to see these listed real estate markets assert their idiosyncrasies against such an unprecedented homogenizing force.

The Full Flavor of Global Real Estate

In short, we do not believe that a U.S.-only REITs allocation delivers the full flavor of the global real estate universe, notwithstanding the increasingly global set of assets owned by many U.S. real estate companies.

Historical returns suggest that even developed regional markets move according to idiosyncratic cycles, and this local effect is more pronounced than it is for other industrial sectors and the broad equity market. We might expect emerging markets real estate to exhibit still greater diversification benefits: this is an asset class that is only just beginning to take off, but we believe the growth potential of markets such as China and India is clearly huge.

In the absence of credible global direct real estate funds, we argue that a global REITs strategy is the only way to gain exposure to these two substantial benefits of growth potential and diversification.

Index Definitions

The **FTSE EPRA/Nareit Global Real Estate Index** Series and its subset, the **FTSE EPRA/Nareit Developed Index** Series, are designed to represent general trends in eligible real estate equities worldwide. Relevant activities are defined as the ownership, trading and development of income-producing real estate. The F**TSE EPRA/Nareit USA Index, FTSE EPRA/Nareit Developed Europe Index** and **FTSE EPRA/Nareit Developed Asia Index** are subsets of the **FTSE EPRA Nareit Developed Index**.

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