REAL ESTATE

# Global Approach Best Position

*Bullish or safety seeker? Global real estate can be part of a solution under either scenario*

BY: **TOM JOHNSTON & CATHERINE MARSHALL**

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Think the extended economic expansion can't go on much longer, taking the real estate market down with it? Or are you positive about a protracted period of synchronized global growth? Regardless of your outlook, a significant number of

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real estate investment professionals subscribe to the view that investing outside of Canada is the best way to position a real estate portfolio to outperform in the long-term.

### Smallest Market

While Canada has long been a strong, stable location for property investment, it is one of the smallest institutional-grade markets in the world – estimated to be two to three per cent of a $28 trillion institutional-grade global market.

Canada has also become an increasingly difficult place for new real estate investments because large institutions, such as Ontario Teachers' Pension Plan and OMERS, were early movers in the Canadian market and were able to tie up a significant portion of prime real estate in the country. They continue to hold these prime assets even as they in-

**Chart 1**

**ANNUAL CANADIAN RETURNS**

| Year | All Assets | Standard Investments | Non-operating Investments |
|---|---|---|---|
| YTD (September 2017) | 4.4 | 4.2 | 5.5 |
| 2016 | 6.1 | 5.7 | 10.1 |
| 2015 | 7.8 | 8.0 | 6.2 |
| 2014 | 7.0 | 7.2 | 4.7 |
| 2013 | 10.5 | 11.0 | 5.9 |
| 2012 | 14.0 | 14.0 | 13.2 |
| 2011 | 15.4 | 15.4 | 15.5 |
| 2010 | 10.7 | 11.1 | 6.8 |
| 2009 | -0.9 | -0.7 | -3.7 |
| 2008 | 3.4 | 3.7 | -0.1 |
| 2007 | 15.9 | 15.9 | 16.3 |

***Source:*** MSCI REALPAC/IPD Canada Property Index.

creasingly invest overseas. This creates a situation where many of the domestic properties for sale are small assets in secondary locations that are owned by non-institutional vendors.

After double-digit returns from 2010 to 2013, annual Canadian returns fell to seven per cent in 2014, 7.8 per cent in 2015, 6.1 per cent in 2016, and 4.4 per cent year-to-date as of September 2017 (See *Chart 1*).

By expanding beyond a domestic-only investment program and tapping into markets that are currently experiencing stronger economic growth and varying market cycles, an investor can increase the scope and quality of opportunities, contributing to higher absolute and risk-adjusted returns and increasing the potential to meet, or exceed, global performance in the long term. Moreover, the composition of the constituent real estate components often differs from country to country regarding underlying weights to office, retail, multi-residential, and industrial/logistics assets. *Chart 2* shows the range of annual returns by country with Canada represented by the light green dot.

In a February 2017 research paper, CBRE Global Investors produced a heat map (*See Figure 1*) showing correlations in local currency total returns for the major developed real estate markets over the period 1991 to 2015 to Canadian real estate. While markets like Japan, the U.S., Sweden, and Australia had correlations below 0.6 to the Canadian market, the correlations were even lower for the UK and the Eurozone.

## Wider Opportunity

Ivo de Wit, portfolio manager of CBRE Global Investment Partners' Global Alpha Fund, affirms the diversification and risk-and-return benefits of taking advantage of the wider opportunity set with a global approach to portfolio construction. Targeting investments among global cities that have the potential for above-average capital gains has been part of de Wit's portfolio strategy, aided by CBRE's worldwide market research team.

In the past two years, investments in institutional-grade office property have produced a 14 per cent annualized return. "These returns are coming from core properties in Sydney and Melbourne," he says. Other investments that have been top performers over the recent past have been office investments in Paris and Dublin, he adds.

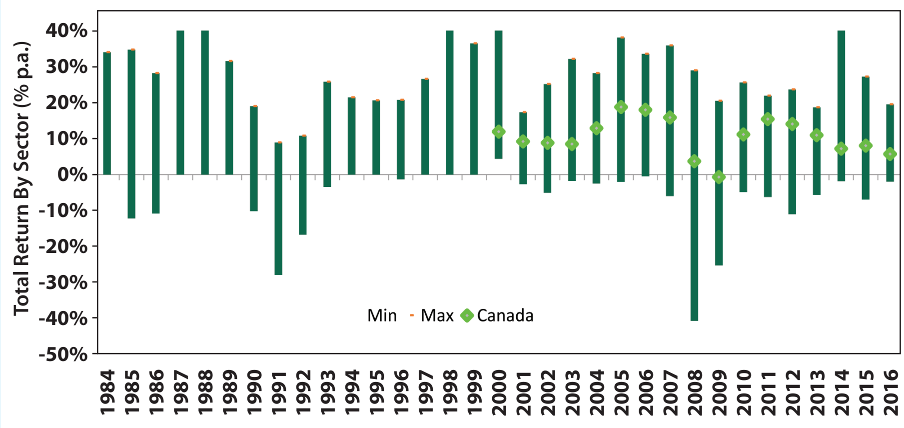
Following the Global Financial Crisis (GFC), CBRE's strategy was to nimbly buy in regions where the company forecast strong market returns and to sell in markets that were projected to cool down. But now, with a more synchronized global economic expansion where most regions are on the upswing of their real estate cycle, de Wit's strategy is to focus on property types that represent the best value, focusing on the relative demand for space by occupiers and rental growth to increase property revenues.

Included among his favoured property types are medical offices and seniors' housing. Although these are emerging as institution-grade investments in other parts of the world, Canada is not large enough to support these types of specialty private real estate funds.

Given expectations about rising interest rates, de Wit thinks it is prudent to focus new investments on properties offering greater income return and income

**Chart 2**

### ANNUAL RETURNS BY COUNTRY

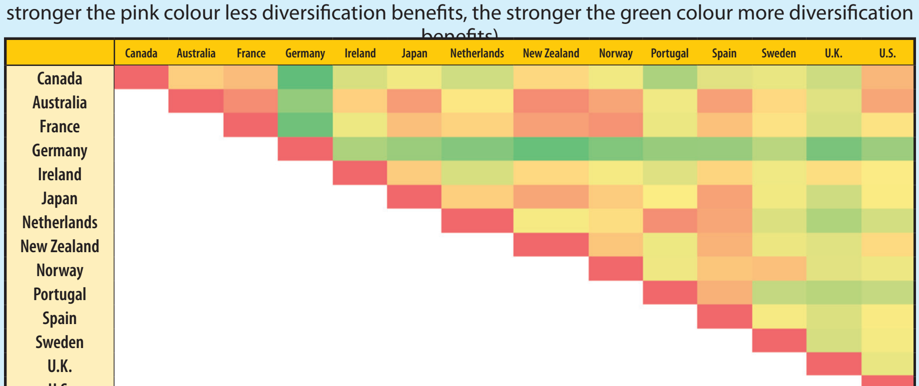



***Source:*** CBRE Global Investors.

**Figure 1**

### REAL ESTATE TOTAL RETURN CORRELATIONS 1991 TO 2016

The colours represent diversification potential (green – high, cream – medium, pink – low: the stronger the pink colour less diversification benefits, the stronger the green colour more diversification benefits)




***Source:*** CBRE-Ikoma, IPD, NCREIF, PMA, CBRE Global Investors, all underlying returns are local currency, all property, by country.

growth. But even by relying on this approach – treating real estate like a 'bricks and mortar bond' – de Wit anticipates that a portfolio can return a four to five per cent income return and three to four per cent growth over the medium term while employing modest (30 to 40 per cent) levels of leverage.

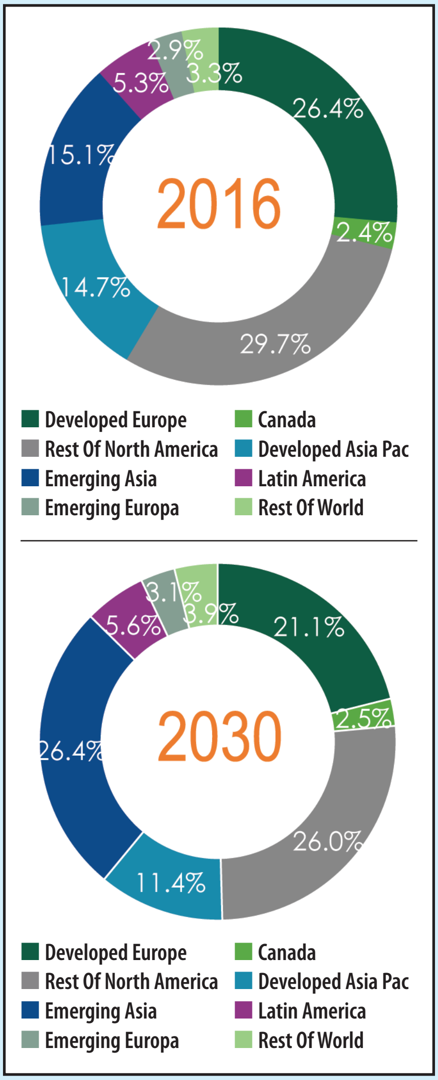
Rosemary Feenan, the director or global research at Jones Lang LaSalle, has seen the search for returns change the definition of a global destination for capital. "There are opportunities emerg-

**Figure 2**

## FTSE EPRA/NAREIT DEVELOPED MARKET INDEX (C$)


**Figure 3**

## GLOBAL REAL ESATE MARKET SHARE




*Source:* CBRE Global Investors

ing everywhere," she says. "We are in a new era of competition between cities for capital." Beyond the traditional capital magnets such as London and New York, many smaller cities – such as Melbourne, Munich, and Miami – are on the radar of global investors.

Higher up the risk curve, global investment firms are raising new closed-end opportunity funds on the heels of successful funds from vintage years 2009 to 2013. According to industry data and intelligence provider Preqin, opportunistic funds are garnering the largest share of capital raised in 2017. In a Preqin survey, 90 per cent of limited partnerships (LPs) said the performance from real estate private equity funds had exceeded their expectations over the last year. It is likely that much of the capital raised is coming from investors who are merely redeploying the proceeds from the previous fund.

One strategy that seems to be falling out of favour is investing in global real estate funds that closely track a benchmark such as the FTSE EPRA/NAREIT Global Real Estate Index Series (*See Figure 2*). Although passive strategies in equities and bonds are attracting massive inflows, there are no large, liquid funds that passively track the EPRA/NAREIT. In addition, the actively managed funds in the market are now fighting headwinds from broad market perceptions that these funds will be impacted by future interest rate increases.

### Asset Class Of Choice

Whether investors are seeking a bricks-and-mortar bond-like investment, or are bullish enough to going out the risk curve in the next global opportunity fund, 2018 looks set to make real estate the asset class of choice for many investors.

Based on a longer-term perspective, the stock of emerging market real estate is expected to grow significantly (as evidenced by *Figure 3*) from 27 per cent of the current investable universe in 2016 to 39 per cent in 2030. The case for a global approach caters to this continuing trend. **BPM**

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