# IMAP Webinar Series

## Property and Infrastructure: Do they offer defence in uncertain times?

## **Property Update**

Damon Mumford – Dexus
Mary Power – JANA Investment Advisers
Moderated by
David McDonald, CFA – IMAP

# Upcoming webinars

Wednesday 18th October – Infrastructure Update
Mark Murray, Mercer
Justin Lannen, Maple-Brown Abbott

Friday 20th October – Allocating to Property and Infrastructure
Matthew Swieconek, Findex
William Morgan, Atrium Investment Management

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# How to ask a Question

# Property Update

Damon Mumford
Dexus

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## IMAP Webinar

# Property – defence in uncertain times?

16 October 2023

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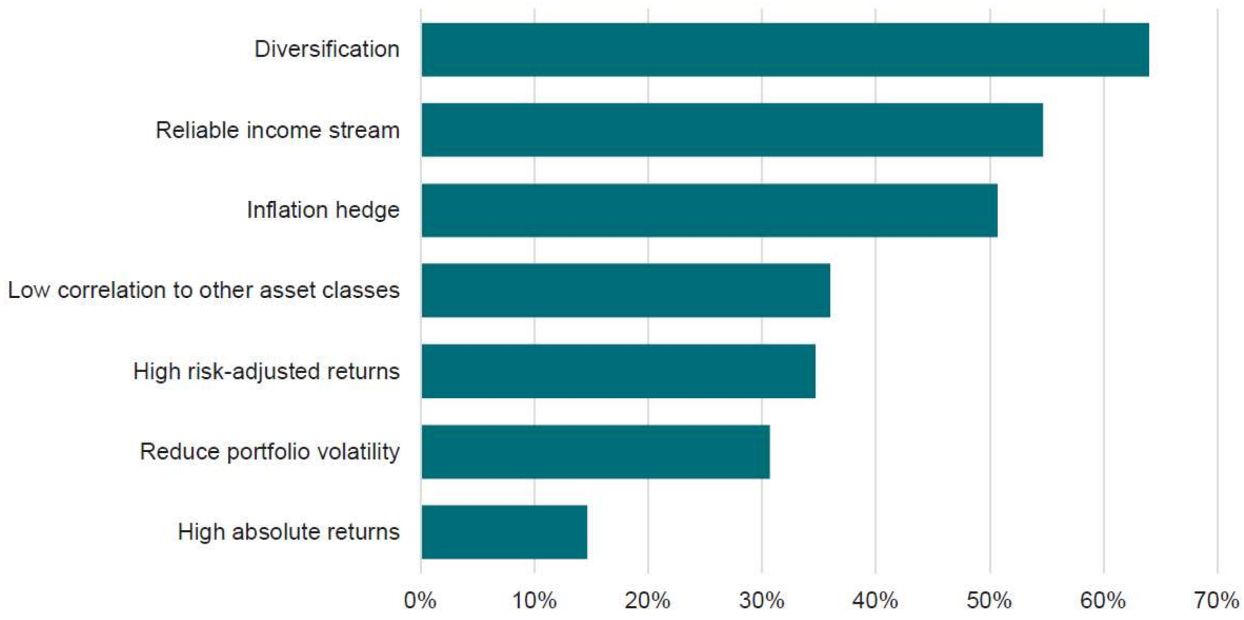
# Investors: reasons to invest in real estate

## Main benefits

- Stable income returns from rents collected and often with fixed rent escalations.
- Attractive yields relative to fixed income.
- Strong diversification benefit for a mixed portfolio and diverse range of assets within real estate.
- Good risk adjusted returns with less volatility than equities.
- Provides a hedge against inflation.
- Positive contribution to ESG goals

## Preqin global survey: Investors' main reasons for investing in real estate




Source: Preqin Investor Survey 2023

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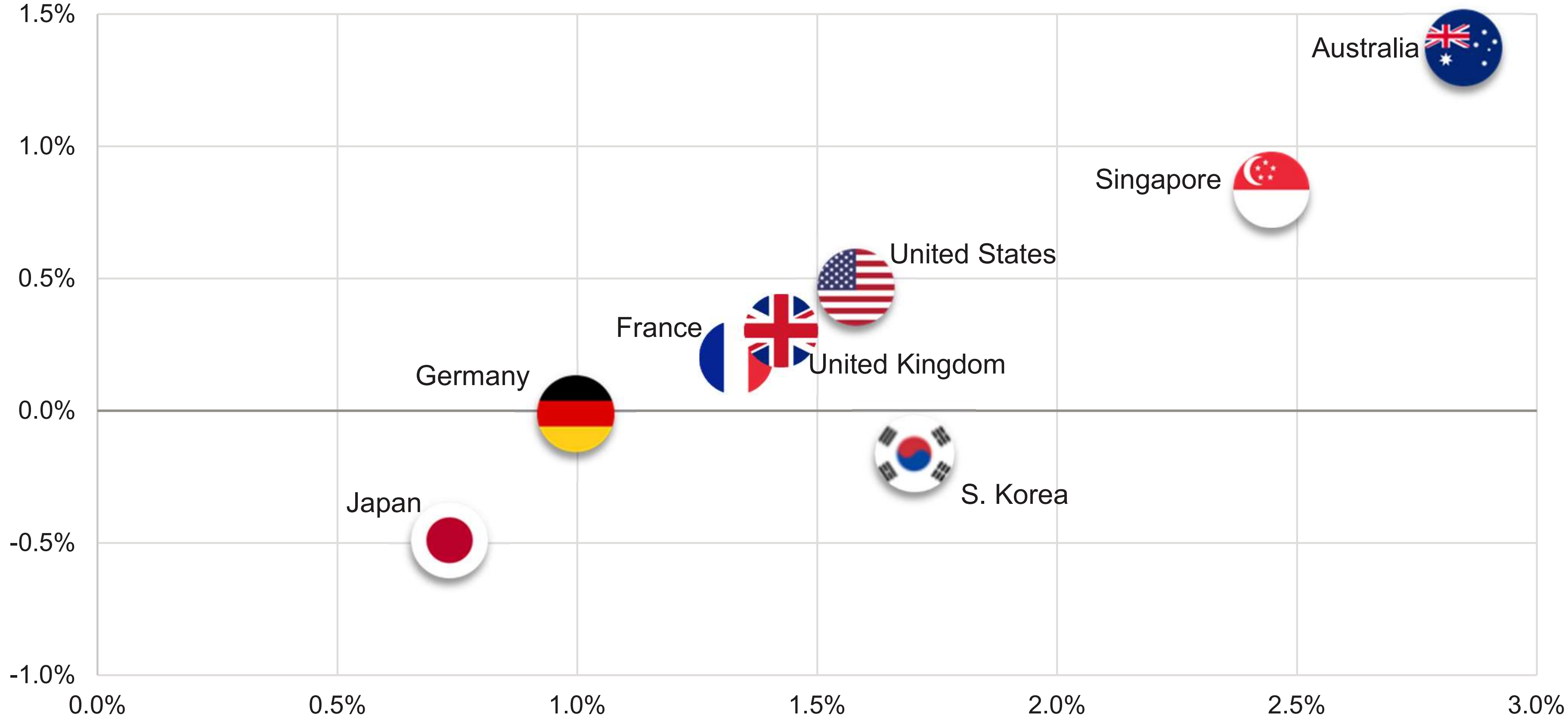
# Real estate underpinned by fundamentals

## Advanced economies - GDP & population growth 2022 to 2032

Population growth %pa




GDP Growth %pa

Source: Oxford Economics, Dexus Research

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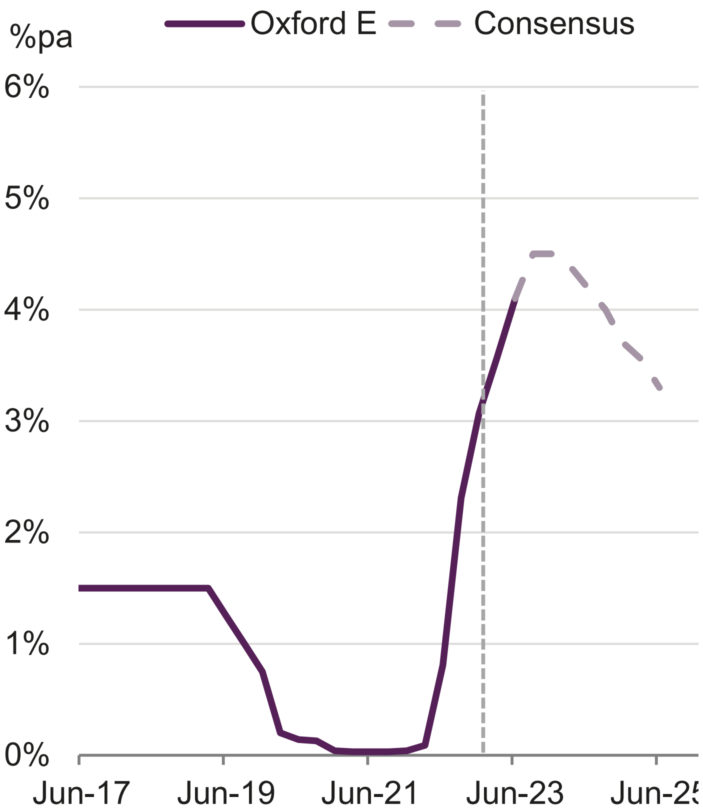
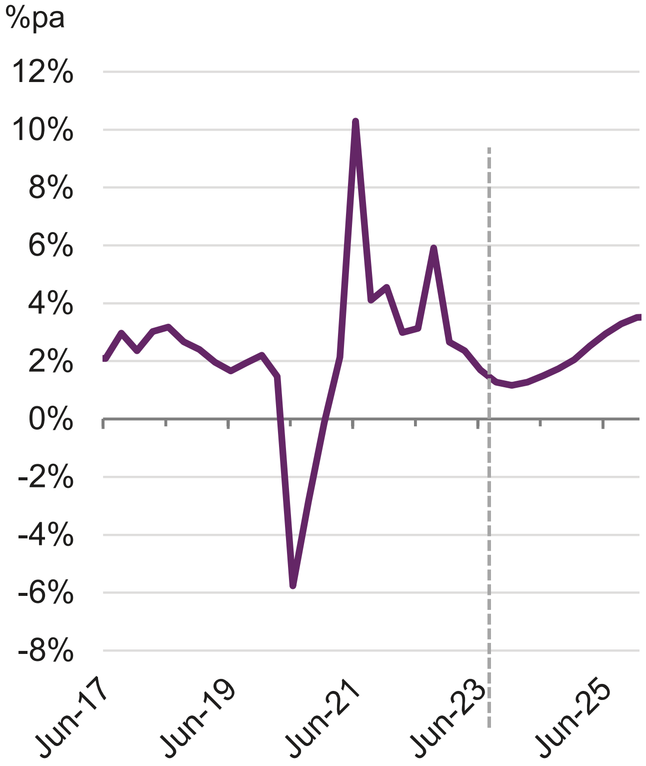
# Inflation, interest rates and growth forecast

## Inflation


## Cash rate




## GDP Growth




Source: Oxford Economics, Dexus

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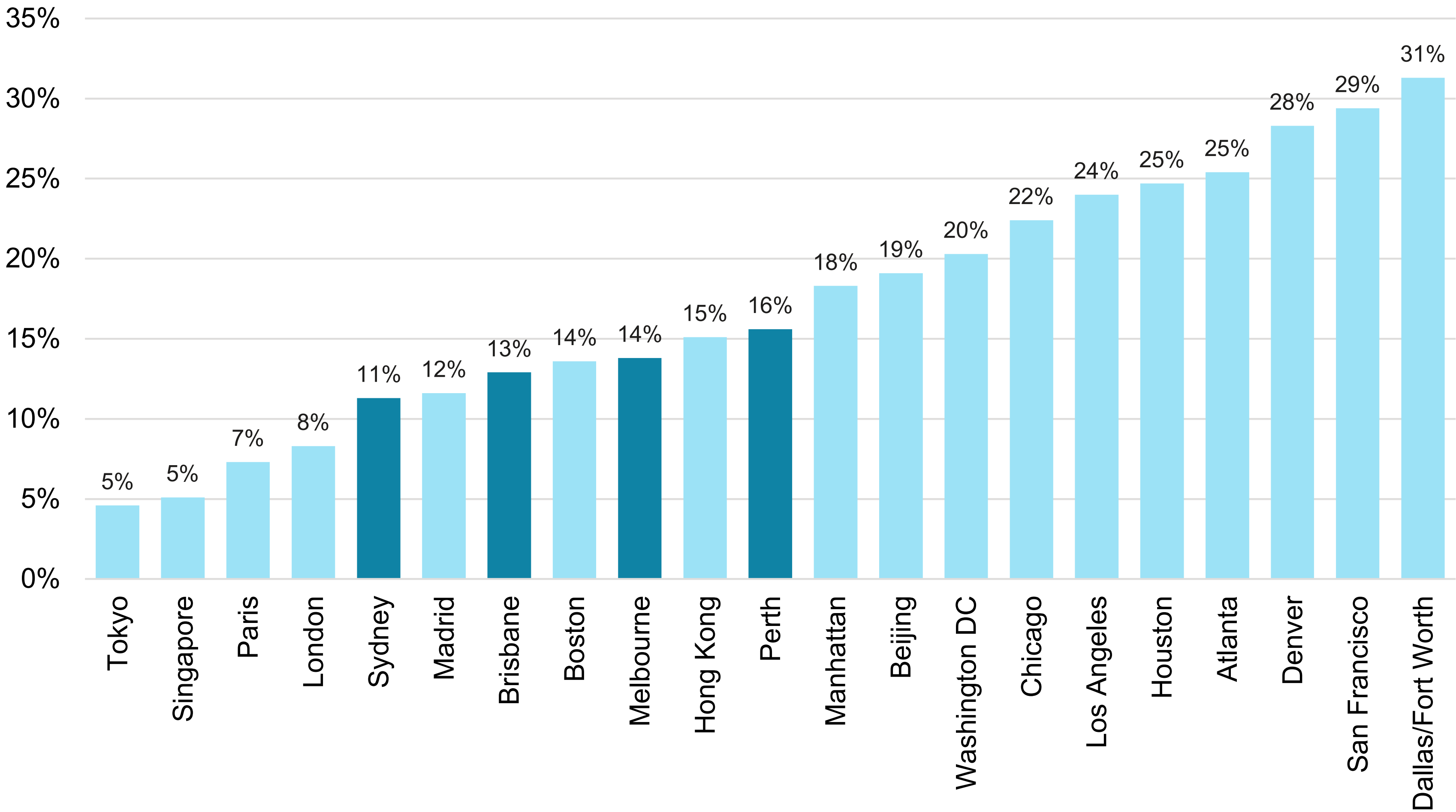
# Office: vacancy rates Australia vs global

## Total vacancy rate for major office markets




Source: CBRE, Dexus Research

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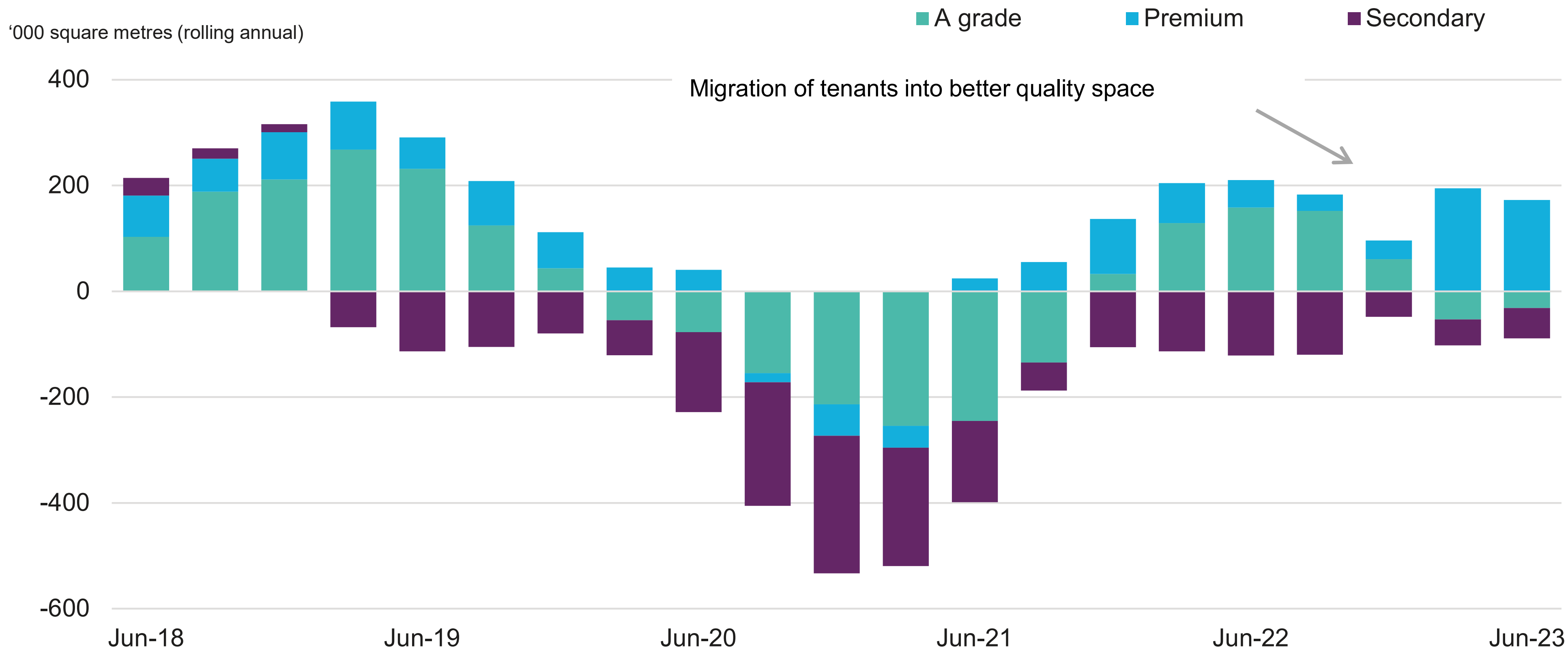
# Office: flight to quality and core

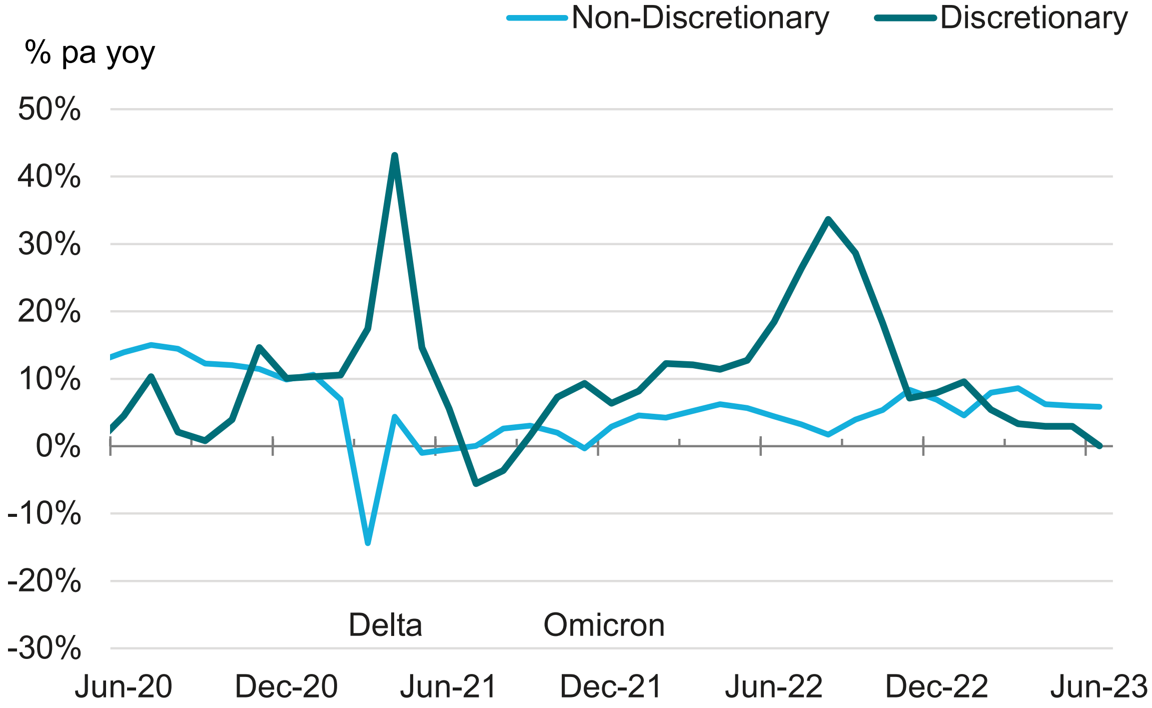
## Net absorption by grade (Melbourne, Sydney, Perth, Brisbane CBDs )



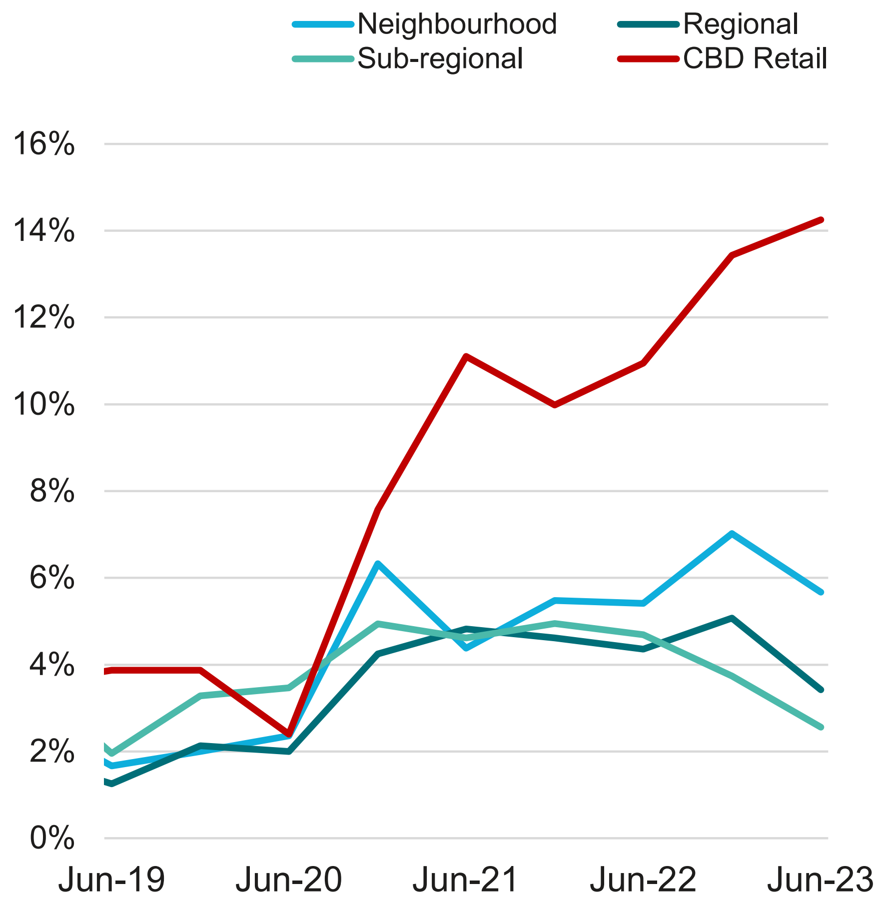

Source: JLL Research

# Retail: shopping centre occupancy improving

### Retail spending by type



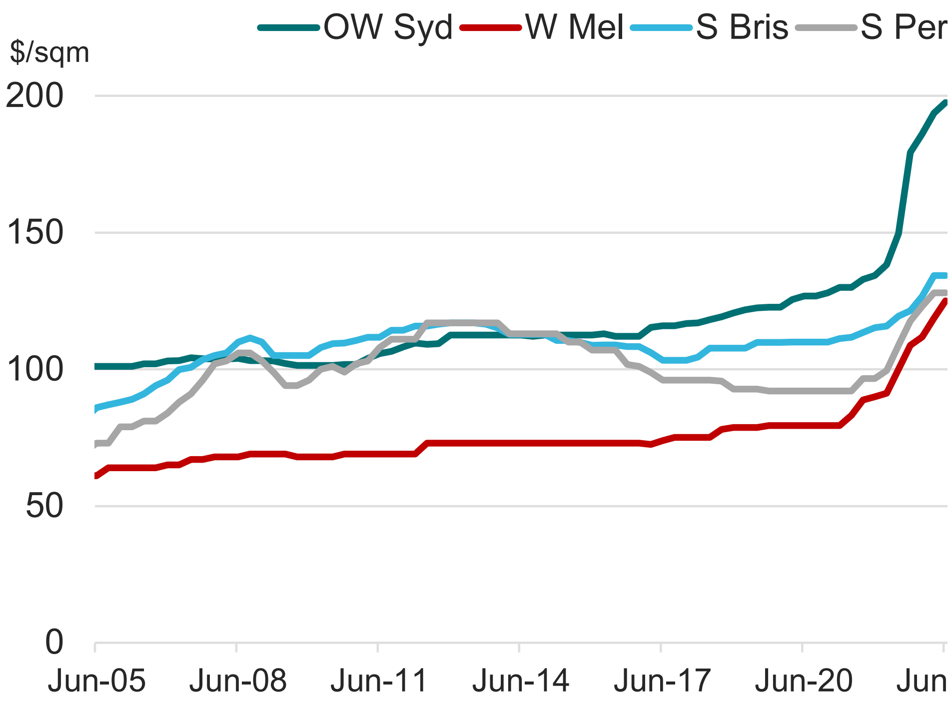

### Specialty shop vacancy rates by type



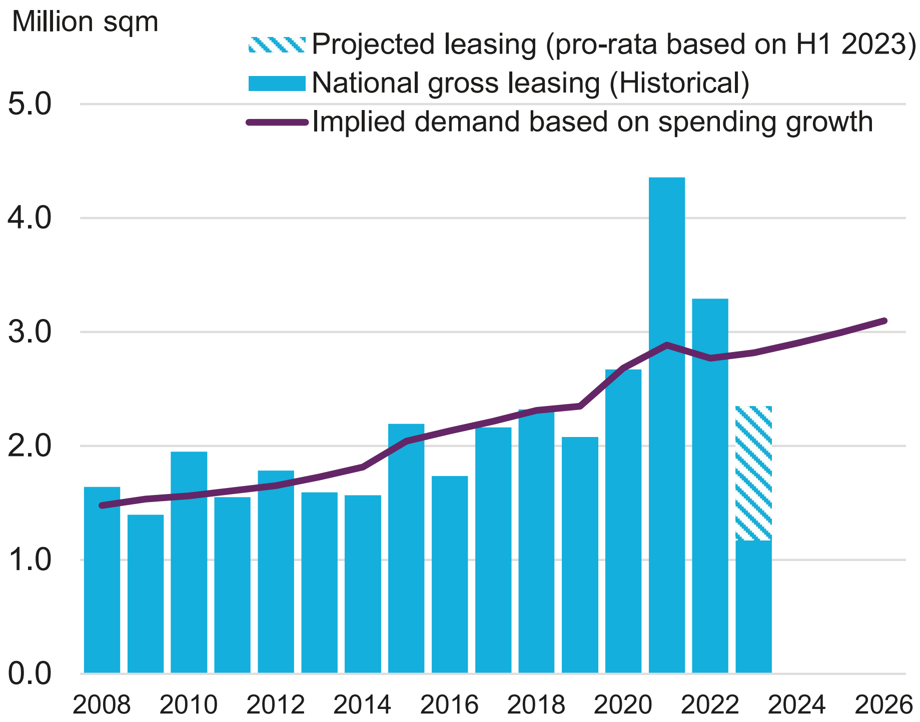

Source: ABS, JLL Research

# Industrial: market normalising after a strong run

## Rents by key market




## Projected levels of demand




Source: JLL Research, Dexus Research, NAB, ABS

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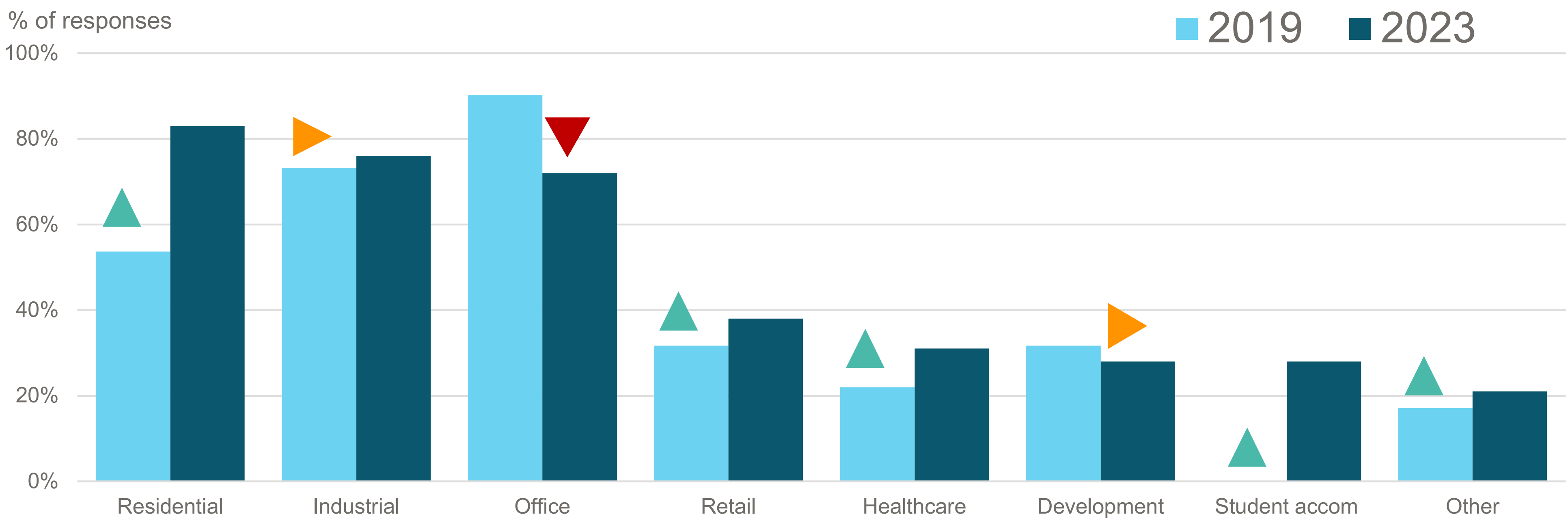
# Investor sentiment: seeking diversification

## Preferred sector for investment – AsiaPac investors




Source: ANREV 2023

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# Property Update

Mary Power
JANA Investment Advisers

Institute of Managed Account Professionals

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# Property Research Trip

August 2023

**Mary Power**, Principal Consultant

**Chris Cawson,** Senior Consultant

# JANA Property Research Trip

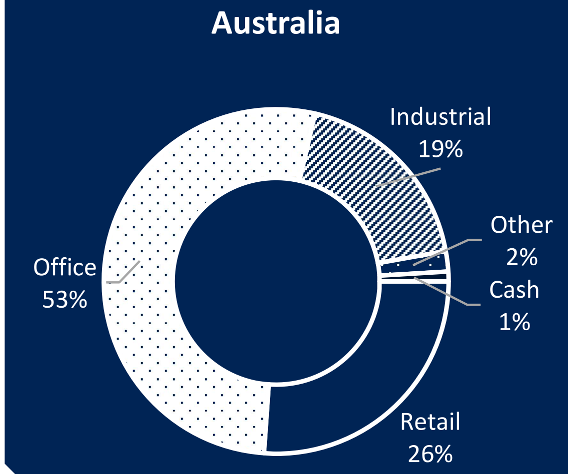
- ► **The JANA Property Research Team undertook a research trip to the UK and US, covering 32 meetings and 52 strategies across 25 asset managers, general partners and listed investments managers.**
- ► Given the dislocation in the market, the key purpose of the research trip was to assess the impact of capital markets, interest rates and leverage on valuations, market pricing, and capital flows across the various regions. Additionally, we conducted extensive research on the sustainability theme within the UK and US. We inspected life science, multifamily, medical office and industrial assets in both New York and Dallas and identified "best idea" opportunities that merit consideration.

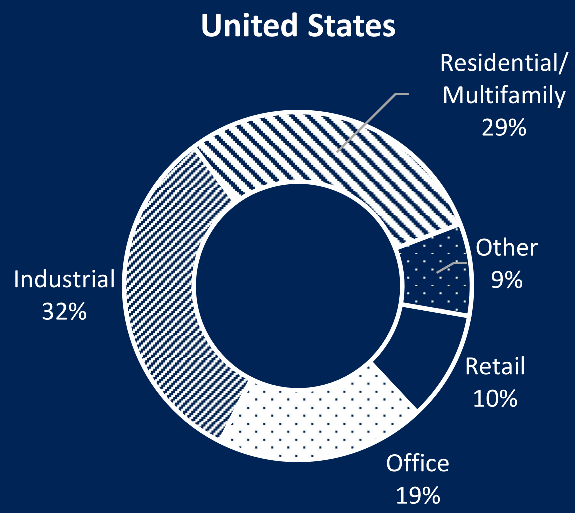
# Market Overview – Australia, UK & US

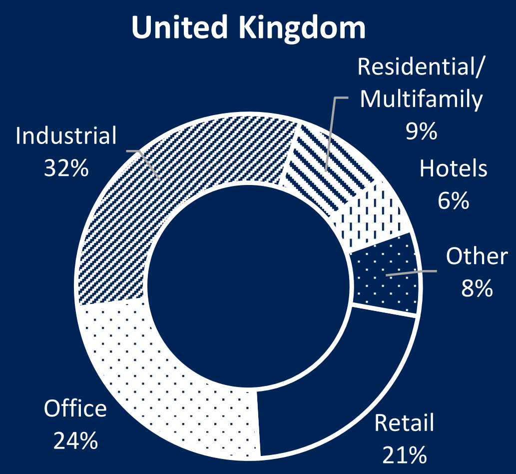
**Performance between each market was varied, with both the US and UK markets underperforming Australia during the last 12 months.**

| Local Fund-level Benchmarks (30 June 2023) | Country | Total Returns (p.a./%) | | | |
|---|---|---|---|---|---|
| | | 1 Yr. | 3 Yrs. | 5 Yrs | 10 Yrs |
| MSCI/Mercer Core Wholesale Australia Monthly Property Fund Index (AUD) | Australia | -1.3 | 6.1 | 4.5 | 7.7 |
| NCREIF Fund Index - Open Diversified Core Equity (USD) | United States | -10.7 | 7.0 | 5.6 | 7.8 |
| MSCI/AREF UK Quarterly Property Fund Index (All Property) (GBP) | United Kingdom | -17.1 | 2.3 | 1.1 | 5.5 |

## Local Benchmarks – Sector Composition



# Observations from Offshore

**Capital Markets**

- Global capital flows have been disrupted by the **volatility in interest rates** and **weak credit conditions leading to**
- **declining valuations** and a **lack of transactional activity.**
- Notably, variations in interest rates and leverage across different regions is exhibiting some stress particularly given weaker credit conditions.
- **UK and US with higher leverage levels (up to 65%)** has experienced **greater refinancing stress** in comparison to Australia.
- For example, in the UK industrial sector, capitalization rates have increased from sub 3% to >5%, leading to substantial valuation corrections (-30%) in certain locations. **Industrial has corrected more so than the Office sector in the UK**.

**Indices Correction**

- Rapid changes in capital markets and interest rates have been **key contributors** to the ongoing **repricing of real estate** over the last 12 months.
- As of June 30, 2023, key property market indices tell the story: Australia has seen a decline of -1.3%, while the UK has experienced a more substantial drop of -17.1%, and the US has declined by -10.7%.
- **Interest rates** and **leverage** have been **significant drivers of the extent of negative returns** across these regions with UK and US property markets experiencing higher interest rates and being significantly more levered than Australia.
- It is recognised that the **US is yet to reach the bottom** of its correction cycle.

**Valuation Practices**

- In the UK, the valuation process has adapted to reflect the current market reality, characterised by a scarcity of transactional evidence. The Royal Institution of Chartered Surveyors (RICS) has issued guidance that permits valuers to **consider market sentiment when substantial market data is lacking**.
- Given the usual quarterly valuation cycle, this adjustment has resulted in **valuations swiftly aligning with prevailing market conditions**. The UK market is notably ahead of Europe in terms of asset repricing, with the logistics sector witnessing more pronounced declines compared to other sectors.
- In contrast, **the US lags the UK** in terms of this revaluation process.

# Observations from Offshore

### Financing

- Alternative lenders, such as insurance companies have entered the UK and European markets, gaining market share at the expense of traditional banks.
- The UK has adapted rapidly to this change, with **35-40% of lending now originating from alternative lenders**. The UK's credit-friendly environment provides an advantage in promptly addressing issues, including resetting valuations.

### ESG / Sustainability

- Environmental, Social, and Governance **(ESG) considerations are significantly important to real estate investors and tenants**. All major stakeholders are now obligated to report on ESG outcomes and future plans. Market consensus is that buildings with **strong ESG credentials will outperform**, both in terms of occupancy rates and investor returns.
- Investors are actively targeting new investments with high ESG standards and restructuring their portfolios accordingly.
- Evidence from surveys involving **250 asset managers** across the UK, Germany, France, Spain, and Italy support the thesis that green buildings command higher rental growth. The **real estate market is actively bifurcating from a sustainability perspective.**

### Strategies

- True core investment strategies are limited with Investors **leaning towards Core-Plus, Value-Add, and/or Opportunistic strategies,** with the objective to "**buy the best and avoid over-leveraging**."
- Larger players, like Blackstone in the UK, anticipate strong fundamentals over a sustained period. Sectors such as logistics, self-storage, data centres, and hospitality are a key focus; particularly targeting larger lot sizes where there is little competition.
- Unlevered return targets in the UK are at a 15% net Internal Rate of Return (IRR) driven by market dislocation and a lower cost basis.
- Blackstone is underwriting **net leveraged returns of 20-25% IRR for deals based on 50% LTV.** This manager is adopting a "**sharp-shooter" approach,** capitalising on the current lack of competition – favouring their investment style and capabilities.

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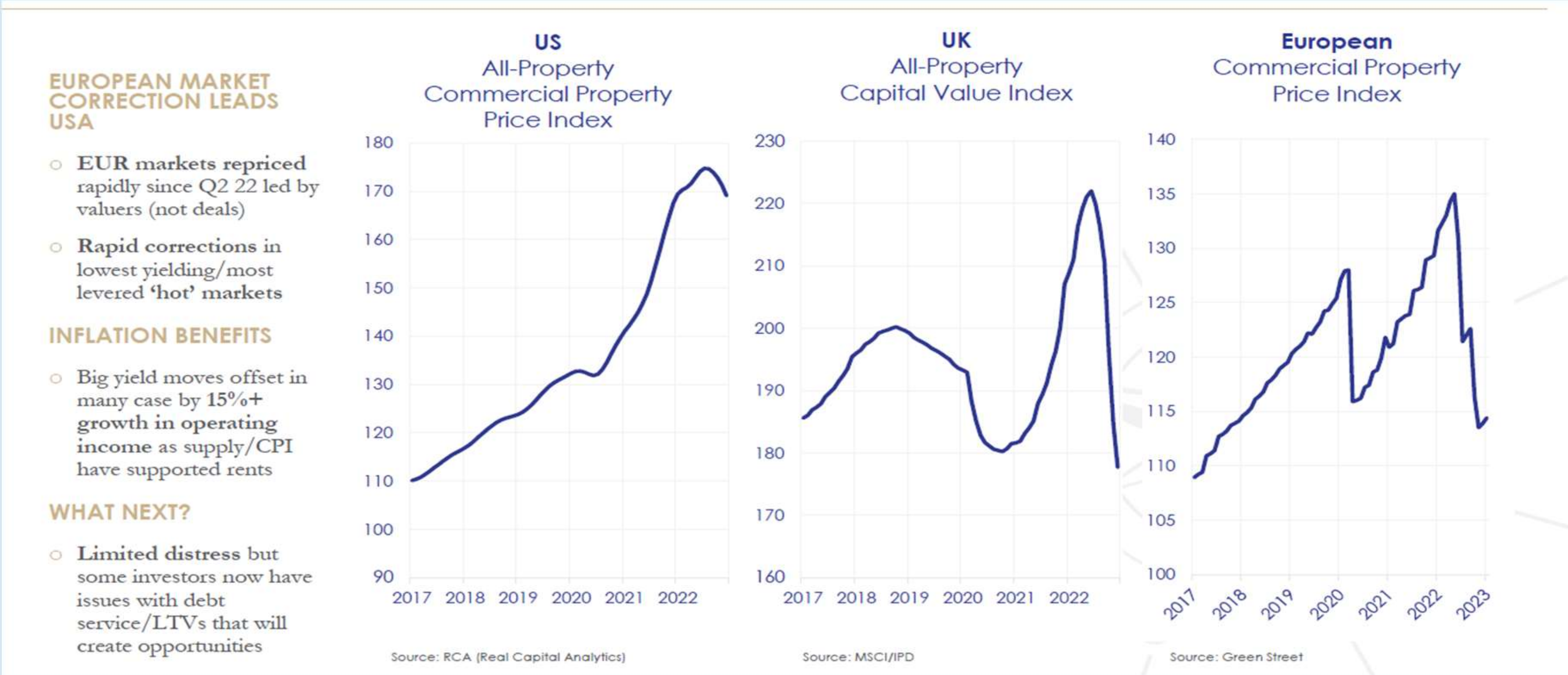
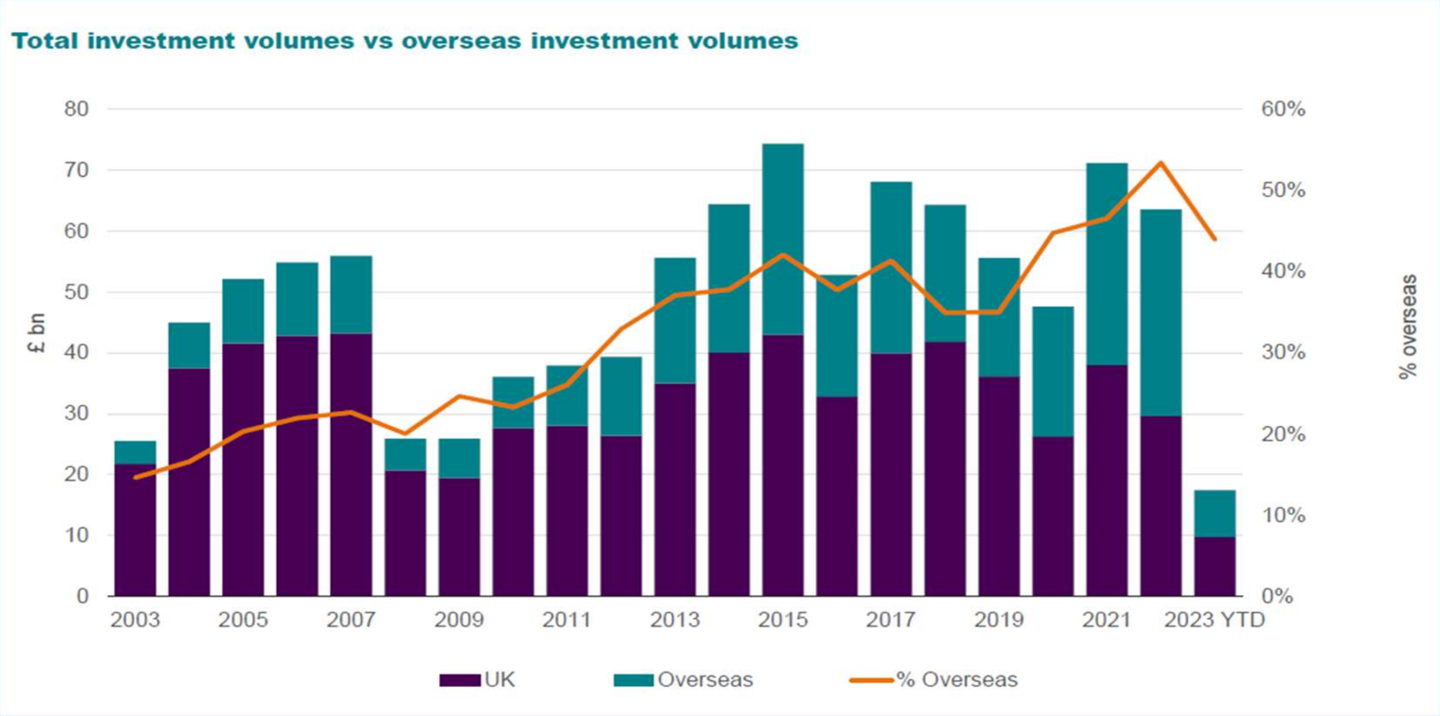
# UK, Europe & US Market Overview

Private Real Estate prices have rebased sharply in the UK; and in the US to a lesser extent.



# Reduced transaction activity, volatile interest rates and a weak credit environment.

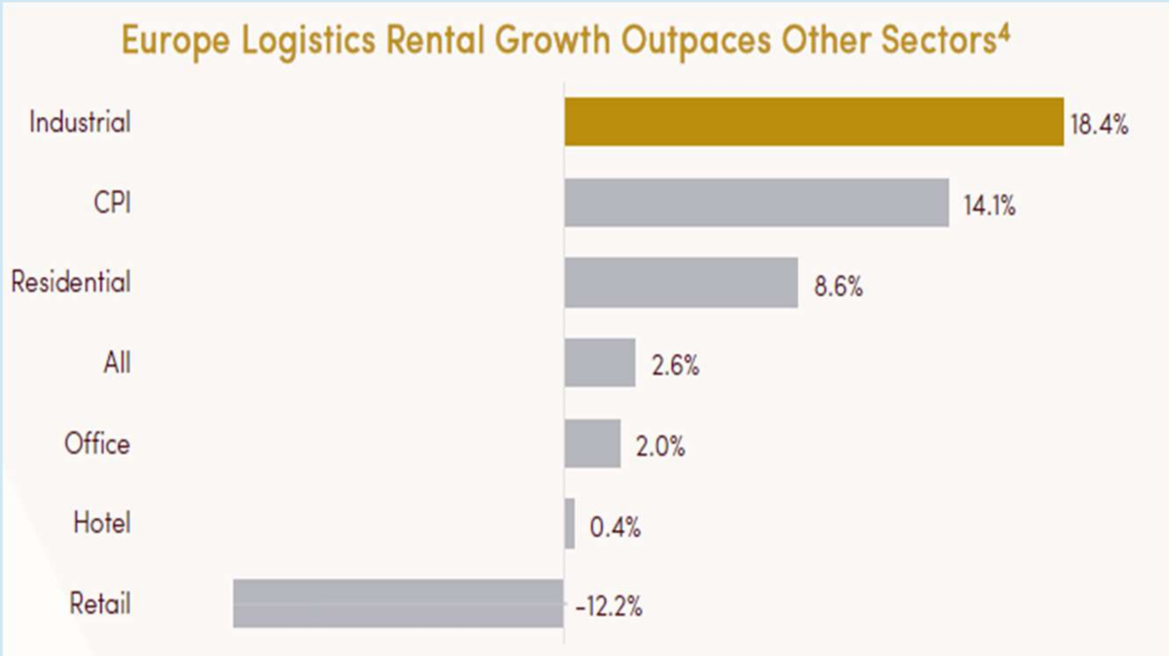
Year-to-date transaction volumes (July 2023) in the UK are materially down, trending near total yearly volumes throughout the GFC.




***Source:*** *Royal London/MSCI*

# Logistics remains a key sector for many investment managers.

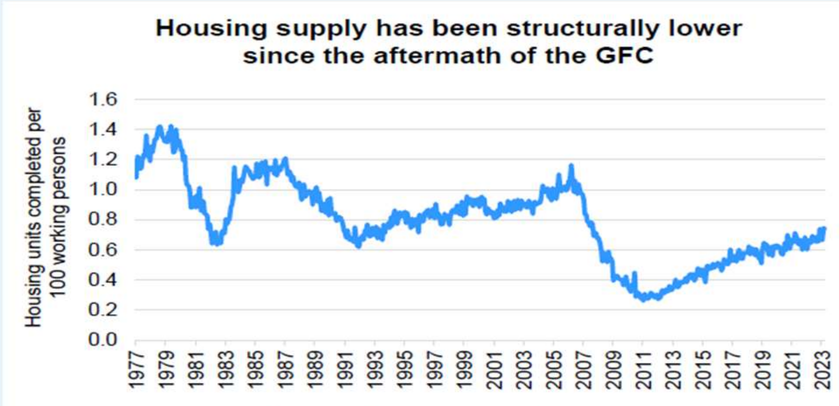
- The Industrial sector continues to benefit from a backdrop of positive fundamentals; entry pricing is now significantly lower.
- The UK has the highest e-commerce uptake globally, with parts of Europe showing similar levels of growth to the US, with little evidence of slowing. Continued growth of e-commerce is expected to drive tenant demand.
- Vacancy remains at historic lows across UK/EU, currently at sub-3%.
- Cost escalation, declining bank funding for construction loans and weaker investment sentiment are indicative of lower-than-expected completion rates for 2023; despite positive demand.
- Industrial has been the strongest performing sector in terms of rental growth in comparison to traditional (and some alternative) sectors. In the UK, leases have 5 yearly market rent reviews and nearly all Continental European countries have CPI-linked leases, providing an inflation hedge and NOI growth for long-leased assets.
- European logistics real estate is projected to deliver highest returns compared to other real estate sectors.



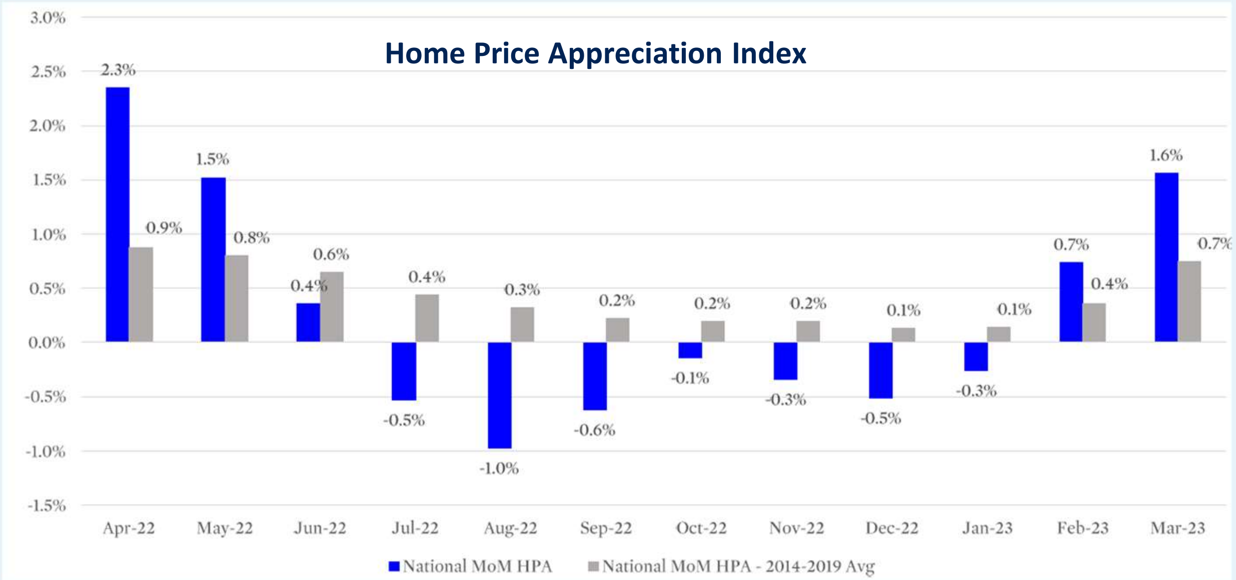

*4: as per EQT/ Oxford Economics, March 2023*

# Single Family Housing remains a key investment focus.

- **There is a chronic undersupply of housing in the US.** Pretium and Invitation Homes are both reporting a current national undersupply of an estimated 4 million homes built annually.
- The millennial cohort is maturing into a 'family phase', driving single family housing demand.
- At the start of the US interest rate cycle, home prices from July to January 2023 started to depreciate.
- While interest rates have increased, housing has appreciated in value due to reduced stock levels. Record home prices, high mortgage rates and limited sales are pushing homeownership beyond many Americans' reach, while supporting the single-family housing thematic.
- Construction costs have moderated, though were elevated throughout 2022. Alongside labour and supply issues, these factors slowed the pace of completions, further driving demand for existing products.



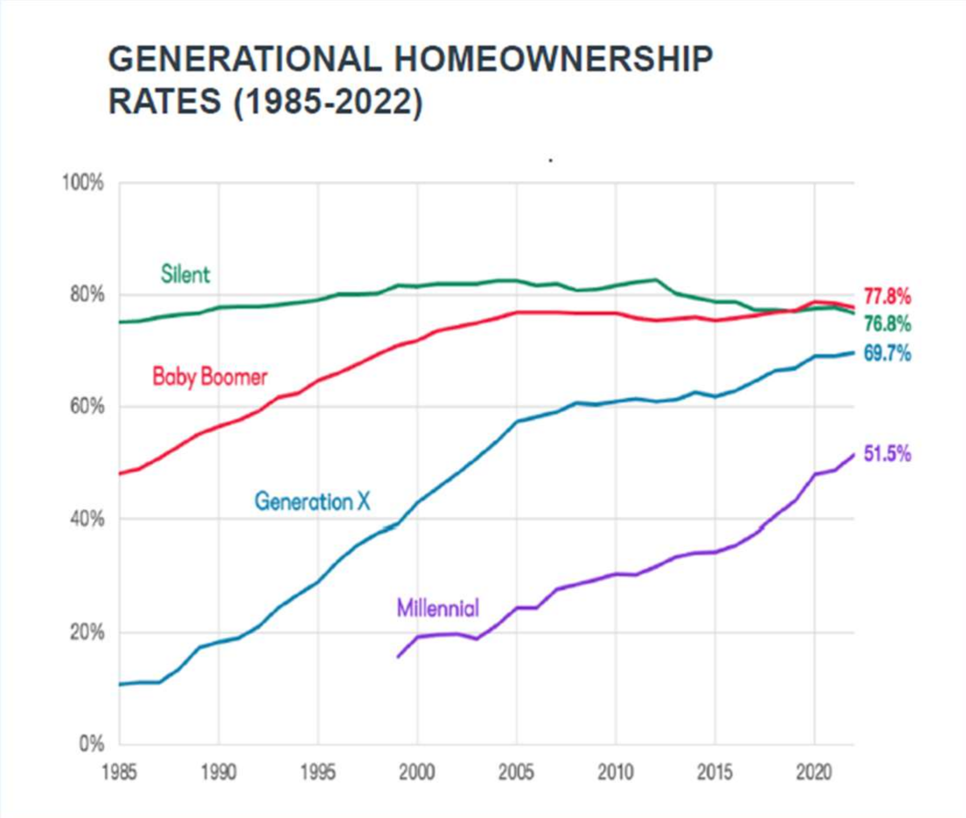

Source: Federal Reserve Data, FRB St. Louis, March 1, 2023.




***Source:*** *Pretium (HPA = Home Price Appreciation)*

# Multifamily remains attractive. However, there is a short-term supply imbalance in select markets.

- **The Housing Affordability index in the US has materially declined post-COVID.**
- The issue of housing affordability (or lack thereof) continues to drive a greater proportion of younger generations preferring to rent as an alternative to home ownership.
- Rising debt and borrowing costs, alongside deposit requirements are keeping prospective home buyers in the renter pool for an extended period of time.
- Multifamily vacancies have risen nationally in the face of increased supply becoming available throughout 2023 and 2024.
- 75-80% of supply being developed is Class A multi-family, with some of the supply expected to be withdrawn due to lack of debt financing.
- Rising construction costs and lack of construction debt will result in a sharp decline in available stock post 2025.

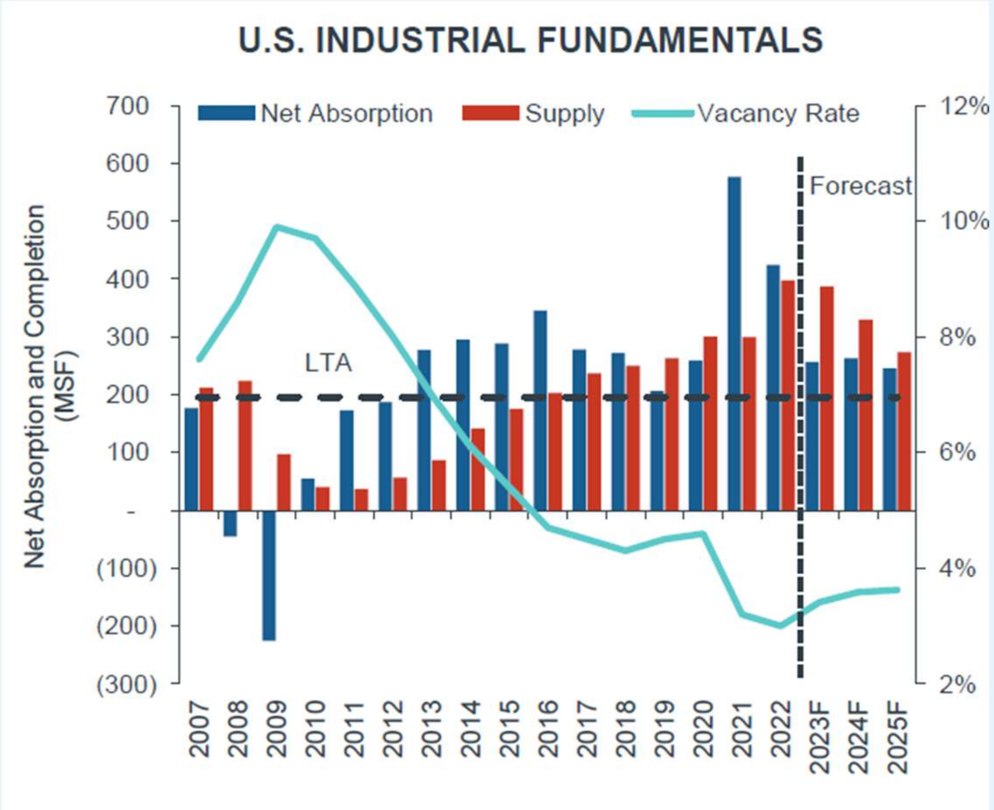



***Source:*** *Clarion Partners*

## Market Insights: US

# Industrial remains attractive.

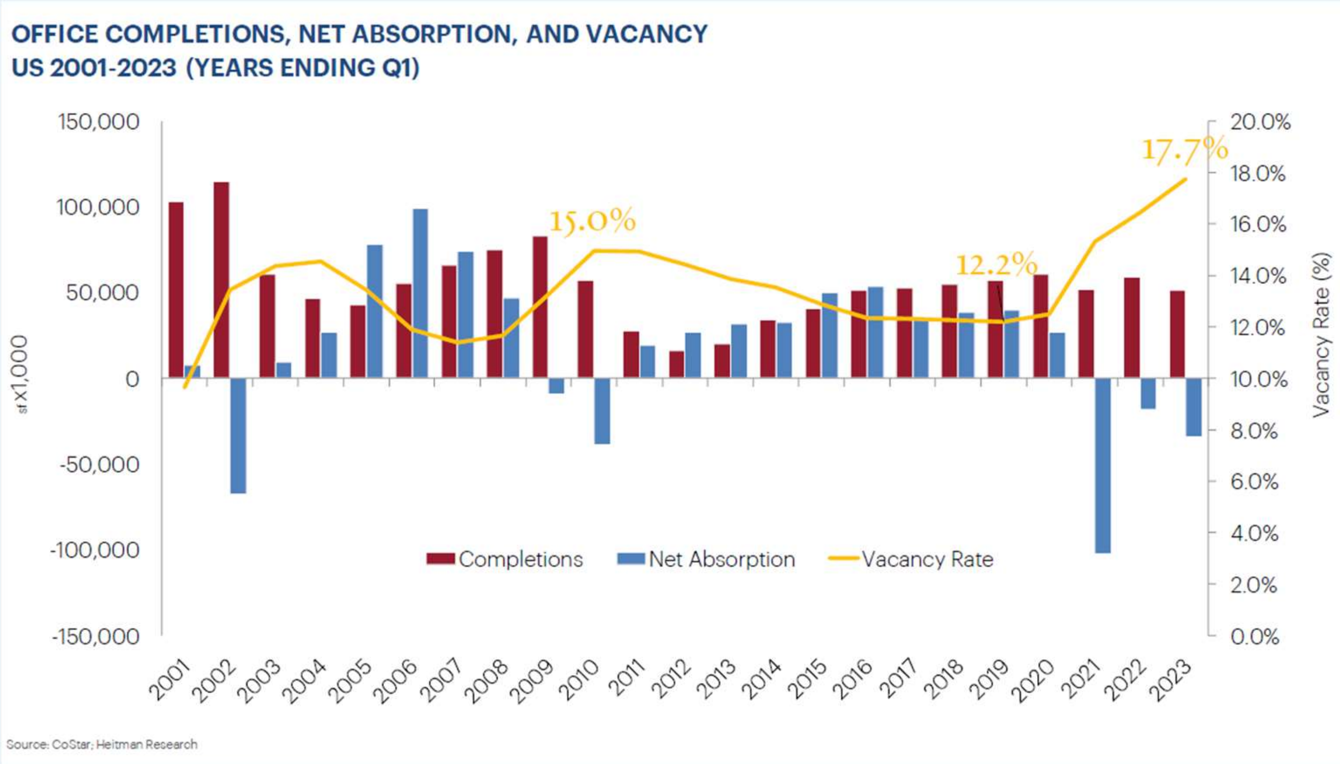
- **Industrial has outperformed every property type throughout the cycle,** benefiting from the longest expansion in history for the US (ecommerce growth). This cycle, industrial investors have generally been more disciplined, utilising lower leverage.
- Vacancy is 3.7%, while the long-term average is 7%. If only 20% of the stock being developed today is leased upon completion, vacancy will only increase to 6.6%.
- **Going forward, supply is not expected to keep up with demand.** The market is moving back to a normalised absorption rate, after experiencing an all-time high through the COVID period.
- The most significant headwind to industrial is working through the current oversupply in some sub-markets. Clarion is of the view absorption will take 1.5-2 years, after which there will be no supply coming into the market.
- **Tenant demand remains strong;** however, there are some recession fears. Amazon and FedEx are pausing expansion plans.




***Source:*** *Clarion Partners*

# Office remains challenged due to quality of stock and declining fundamentals.

- **Office vacancy and tenancy absorption (net absorption) are poor compared to long-term averages, even when compared to previous 'distress' periods.**
- Vacancy is expected to remain at elevated levels, with Clarion Partners forecasting net effective rental growth of -4.5% in 2023, -3.0% in 2024, and -0.1% in 2025.
- National completions are at near long-term averages. Construction of new office buildings is focused on high quality, sustainable buildings which are still in demand from tenants.
- Investor sentiment towards office remains negative, primarily due to concerns of weakening fundamentals and pending loan maturities.
- While hybrid and remote work preferences have hampered a fuller return to office, weakening over the past three quarters also reflects the impact of elevated interest rates and the threat of recession.



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# QUESTIONS

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