Invesco Real Estate

Considerations for investing in global real estate

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In the past, real estate investors around the world have tended to be domestically focused but, increasingly, many are now investing in non-domestic or even global real estate. Large institutional investors and sovereign wealth funds have been at the forefront of the shift, driven by the generally stable income component that comes from real estate and the potential for diversification benefits, risk reduction and the possibility of return enhancement.[1] Likewise, a lack of domestic investment opportunities has also played a role in investors' increasing appetite for an international portfolio as a way to significantly broaden their opportunity set.

Admittedly, assessing the global real estate market and the different means of gaining exposure through listed, unlisted, equity and debt vehicles can be a daunting task. Investors must assess various factors before making an allocation, including the impact of currency fluctuations and foreign tax laws. They must also assess their own internal capabilities for evaluating such an allocation.

Ways to invest in global real estate

While global public real estate markets have long been accessible to investors, it is only recently that pan-regional, open-ended core funds have become available globally, offering access to global unlisted real estate. Prior to that, unlisted real estate was accessible primarily through closed-end, higher-return strategies or through management-intensive direct ownership.

This enhancement to the composition of available investment vehicles is providing investors with greater opportunities for diversification by adding unlisted global real estate to their portfolios. Does it matter? It is noteworthy that while listed and unlisted real estate tend to have similar characteristics in the long term, they have varying characteristics in the short term, driven in large part by the liquidity component of each. Listed real estate offers daily liquidity, but this comes with higher volatility, whereas unlisted real estate generally offers only periodic liquidity, which underscores generally greater stability under normal market conditions. This is beginning to change. Increasingly, a range of unlisted vehicles is evolving that provides greater liquidity than the traditional closed-end and open-ended funds, often through a blend of direct and listed real estate.

In addition to choosing an investment vehicle, various real estate strategies exist across the risk-return spectrum that may warrant consideration depending on an investor's goals and risk tolerance. The options include core, core plus, value-add and opportunistic approaches. Core assets are generally stable, cash-flow producing assets with stable occupancy, while opportunistic assets represent the riskiest real estate approach, wherein investors look to achieve higher returns by tackling assets with structural or financial obstacles.

The role of global real estate within a mixed-asset portfolio

According to the 2018 *Institutional Real Estate Allocations Monitor,* which tracks 208 institutional investors representing over $11.0 trillion in total assets and real estate assets of approximately $1.0 trillion, investors' target allocations to real estate have increased 150 bps since 2013, reaching 10.4 percent in 2018. Approximately 61 percent of institutions surveyed have a target allocation greater than 10.0 percent.[2]

To help to visualize the impact of adding real estate, Fig. 1 shows the efficient frontiers for two hypothetical portfolios during the period 2005-17. The first is a "traditional" equities/bonds portfolio constrained to a maximum allocation of 60 percent to either equities or bonds (dark blue). The second is a portfolio enhanced with global real estate constrained to a maximum 20 percent weighting over the 2005-2017 period (light green). It shows clearly that by adding global real estate, a portfolio would have had the potential to achieve either a higher return or the same level of return at lower risk.

Another way to look at this topic is to consider the effect of adding a given percentage of global real estate to a portfolio, say 10 percent, 20 percent or 30 percent (Fig. 2). What would

WHY GLOBAL REAL ESTATE?

Investors have different motivations for considering international real estate —

Size and performance

- Size of the real estate asset class
- Lack of domestic real estate opportunities
- Markets comparable in transparency
- Income orientation
- Strong relative historical return performance

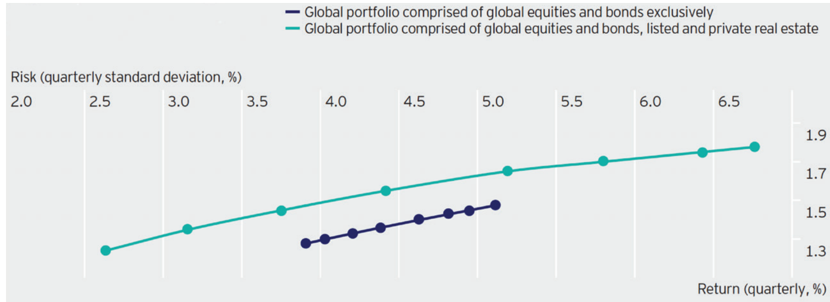
Characteristics and portfolio contribution

- Different growth drivers
- Diversification with traditional asset classes
- Diversification with domestic real estate market
- Inflation hedging
- Portfolio risk reduction and return enhancement

have been the impact on a traditional global stocks and global bonds portfolio in the post-GFC period? Four conclusions are clear:

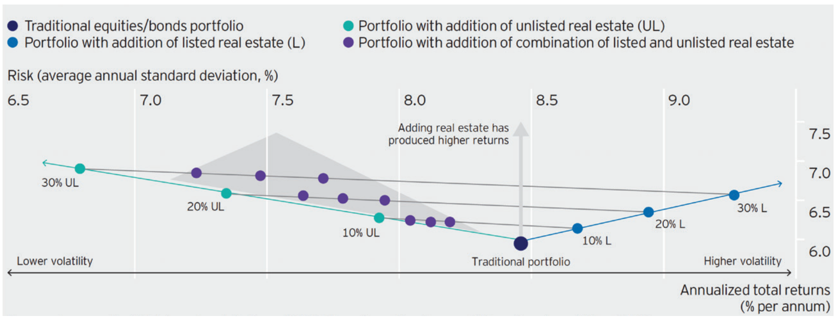
– Adding global real estate, unlisted or listed, would have enhanced the total return of the portfolio from approximately 20–30 bps per annum at the 10 percent allocation level for real estate to 60–80 bps at the 30 percent level.
– If the real estate was exclusively in the unlisted form, it would also have lowered the portfolio volatility from 8.5 percent standard deviations by 50-150 bps to 6.8-7.9 percent — but at the expense of adding a degree of illiquidity to the portfolio.
– If the real estate was exclusively in listed form, it would have enhanced the return by 25-75 bps without sacrificing liquidity, but at the expense of higher volatility (up by 25-100 bps).
– Finally, within the real estate allocation, a blend of 10-30 percent listed and 70-90 percent unlisted real estate would have both enhanced portfolio returns and lowered volatility, without sacrificing much liquidity. This cone of improved risk-adjusted returns is highlighted in grey in Fig. 2.

Fig. 1: Global indices efficient frontier 2005-17



Sources: Invesco Real Estate using data from Macrobond, Barclays and MSCI Global Property Index as of July 2018.

Fig. 2: Diversification risk and return profile of different portfolios since the GFC (Q1 2010–Q4 2018, in US$) [3]



Sources: Invesco Real Estate using data from MSCI, Bloomberg Barclays and Macrobond as of May 2019.

This exercise exhibits some of the benefits of real estate in a global portfolio, however it should be acknowledged that in practice most investors will begin with a portfolio that already has a component of domestic real estate and then consider the addition of global real estate.

Conclusion

While there are a number of potential motivations for investing in global real estate, an investor may want to assess various other factors before making an allocation such as the impact of currency, tax, liquidity and pricing, as well as an assessment of internal capabilities. Analyzing global real estate markets and the different ways to invest can be a large task. An investor may need to assess what resources and capabilities they have to execute a global real estate allocation.

Most investors may choose to participate via listed real estate, separate accounts, unlisted commingled funds or fund of funds in order to gain access to global real estate without the extensive time required to build out dedicated internal resources, much less the lead time to deploy capital at scale.

For investors considering expanding their exposure beyond their home country, listed and unlisted global real estate can offer attractive returns derived from generally stable income streams, while simultaneously having the potential to lower portfolio volatility. The depth and transparency of many international markets make cross-border investment increasingly accessible, while historical low correlations to other countries and alternative asset classes makes it a useful tool for diversification. For many, time in the market, rather than market timing may be the simpler, better way to achieve the portfolio benefits.

OVERVIEW

Invesco Real Estate is a global leader in the real estate investment management business with $81.3 billion in real estate assets under management, approximately 534 employees and 21 regional offices across the U.S., Europe and Asia (as of 09/30/2019). Invesco Real Estate has been actively investing in core, value-add and opportunistic real estate strategies since 1992. Invesco Real Estate is a business name of Invesco Advisers, Inc., an indirect, wholly owned subsidiary of Invesco. Ltd

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1 CBRE Research, Global Investor Intentions Survey 2018
2 Hodes Weill & Associates, 2018 Institutional Real Estate Allocations Monitor
3 Global equity performance is calculated based on the MSCI World Index. Global bond performance is calculated based on the Bloomberg Barclays Global Aggregate Index. Global private real estate is calculated based on the MSCI IPD Global Property Fund Index. Global public real estate is calculated based on the FTSE EPRA/NAREIT Developed Index.