Top 10 with…

Unlocking real estate opportunities

Interview with **Paul Guest**

UBS

Opportune timing

With the market correction unlocking attractive possibilities, unlisted real estate – an asset class offering stable returns and good protection against inflation – can witness a unique growth opportunity in 2023 and 2024.

In this top 10 interview with **Paul Guest**, Senior Portfolio Manager, we'll uncover insights into what makes the current investment environment unique, including trends within the real estate sector, the importance of sustainability within private markets, and benefits investors can find within this space.

Key facts[1]

2007	29.4bn	20+	60
establishment of Multi-Managers Real Estate	invested equity	unique comingled strategies and single client accounts	real estate professionals

1

Why is private markets investing particularly now so attractive?

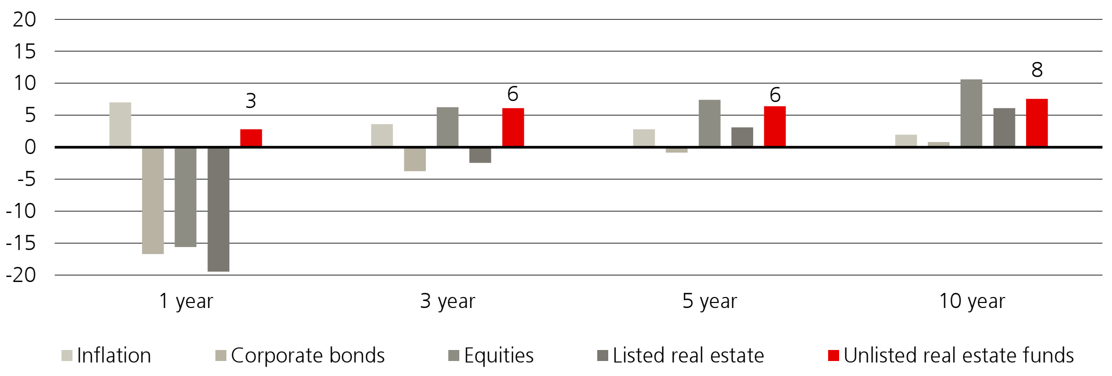
Private markets offer diversification, lower volatility, and exposure to market structures that positively impact the risk / return equation. In today's environment, investors face the challenge of optimizing portfolio allocations for appreciation potential and income generation, while mitigating volatility and broader issues such as climate change. While institutional investors have long embraced private markets allocations, these opportunities are becoming increasingly appealing also for non-institutional investors due to their higher return-potential, lower correlation with public equity markets, inflation protection, and access to otherwise inaccessible markets and strategies.

Private markets provide the ability to trade liquidity for higher returns at comparable risk levels, while granting investors greater asset control and the opportunity to benefit from skill and illiquidity premiums. In addition, private markets serve as a gateway to sustainable investments in high-growth sectors, aligning with the increasing focus on sustainability for many investors. However, sustainability is a complex and rapidly evolving field with challenges such as increasing regulations, stakeholders' transparency expectations and the lack of standardizations in reporting and scoring. The private markets industry knows these challenges and our approach to face them focuses on expanding the diversity and scale of our activities.

2

Why investing in real estate over the next few years? Where do challenges and opportunities lie?

Figure 1: Unlisted real estate also provides stable returns and can be considered as good inflation protection (4Q22, % p.a.)



Source: MSCI, Oxford Economics, NCREIF, Refinitiv Datastream. UBS, Real Estate & Private Markets (REPM); May 2023. Inflation = Advanced Economies; global corporate bonds = Bank of America Merrill Lynch Global Broad Corporate (USD, data only available from 1997); global equities = MSCI World Index (local currency); global listed real estate = FTSE EPRA / NAREIT Developed (EUR); global unlisted real estate funds = ANREV / INREV / NCREIF Global Real Estate Fund Index core funds with performance pre-2005 estimated by UBS (local currency). Past / expected performance is no guarantee for future results.

Unlisted real estate sits between bonds and equities in terms of its risk-return characteristics. Historically it has offered higher returns than bonds, but lower risk than equities and listed real estate. Real estate also has a low correlation with bonds, while at the same time delivering higher returns with only slightly higher volatility. As such, it is often used as a portfolio diversifier. The favorable risk-adjusted performance is the result of the high proportion of the total return which is derived from the contractual rents paid by tenants, the income return. Over the long-term core real estate, the lowest risk profile form of real estate investment, is expected to deliver the majority of its total return from income (70-80%), with the remainder coming from capital growth.

Real estate is holding up relatively well, with 2022 witnessing the second highest global deal volume (USD 1,135)[2], and we see both short and long-term benefits for those who explore this asset class. The current re-pricing, distressed investment opportunities, and fresh equity providing a considerable negotiating power all add to the short-term benefits. We think now is an opportune timing to consider investments for several reasons.

Firstly, the recent adjustments in prices due to higher interest rates have created an attractive entry point. Such opportunities arise only once in a cycle, making it a unique chance to capitalize on favorable market conditions.

Secondly, investing in quality real estate with a promising outlook, especially when its value has adapted to the prevailing higher discount rate environment, can yield significant future returns. Therefore, taking advantage of this opportune time to invest in real estate is likely to prove highly advantageous, as it aligns with the potential for growth and improved returns in the future.

It is also important to note that real estate is a less liquid asset class compared to the daily traded public markets in equities and investors need to take this into consideration. In downturns it may not be possible to sell real estate investments, or only at a significant discount. As such, real estate investors typically have long term investment horizons and do not require the high levels of liquidity provided by public markets.

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What benefits can private markets, particularly real estate, bring to a portfolio?

There are many benefits investors can be excited about when choosing real estate. First, diversification, which is key to achieving stable performance. We find low correlations between real estate and bonds and equities. This means adding real estate to a portfolio can improve the risk-return balance and enable investors to achieve desired returns with reduced risk. Second, real estate provides income through rents paid by occupants leasing properties. Third, real estate presents the potential for capital appreciation, including through active asset management.

Finally, real estate can serve as a protection against inflation, as rental income typically grows around in line with inflation. Moreover, in an actively-managed and unique portfolio that would be impossible to replicate in the open market. Our privileged position as a leading provider of unlisted real estate solutions means that investors can benefit from our scale and network, to unlock investment opportunities which are typically only available to institutional investors.

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How do you think property values will develop across key real estate markets?

The private equity real estate market is, like other asset classes, adjusting to the higher interest rates environment. This has necessitated a valuation adjustment as the discount rate on future cash flows has shown strong growth. However, this is offset at least in some sectors by particularly robust tenant markets and therefore stable, high occupancy rates and healthy rental growth. As a result, though the loss in capital value has temporarily exceeded the stable income return, this opens a window of opportunity to acquire good quality assets. As interest rates stabilize, the negative pressure on values will ease and income returns will once again start to dominate.

Of course, this will not happen at the same pace across sectors and geographies, and tenant demand is not as robust in all places and all times. This underlines the importance of expertise and an actively managed portfolio – to be able to take advantage of timing and seize the opportunity where asset values will rebound soonest and most strongly. We work closely with our in-house Research & Strategy team to anticipate market movements and position portfolios ahead of the movement in asset values.

We are looking for real estate markets broadly to stabilize in the second half of this year, with leading sectors such as logistics, living assets, and life sciences/healthcare to provide the most compelling rebound.

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How can investors gain exposure to global real estate?

The global real estate market has experienced remarkable growth, providing investors with many avenues to tap into its potential. Traditionally, investors would directly acquire real estate assets, granting them complete control over their investments, including the choice of asset types, locations, sectors, and unique characteristics. However, this approach offers limited diversification opportunities, particularly for those with more modest resources, as they could only afford a handful of properties. To counter this, an alternative approach are club deals, where investors pool their resources. These exclusive arrangements typically involve two to four institutional investors, exposing them to a broader array of assets while maintaining control and targeted exposure.

Unlisted real estate funds present an attractive option for investors seeking diversification benefits on a larger scale. By pooling funds from multiple investors, these funds invest in various underlying properties, offering substantial diversification advantages. They can either provide broad market exposure or focus on specialized sectors. These funds may have varying degrees of liquidity, with full liquidity potentially being limited during periods of market volatility.

Another unlisted fund structure, multi-manager, combines investments from multiple investors and allocates capital across various single unlisted real estate funds, co-investments, and joint ventures in specific assets or portfolios. Multi-manager offer unparalleled diversification benefits, granting exposure to many individual assets. Wealthier investors may opt for a separate managed account (SMA) multi-manager, enabling a tailored portfolio that aligns with their specific needs, preferred portfolio construction, and investment criteria.

Furthermore, investors can explore real estate investment opportunities through listed markets and publicly listed real estate companies. This can be achieved through Real Estate Investment Trusts (REITs), which are publicly traded property companies listed on stock exchanges, allowing for trading their shares. In Switzerland, listed real estate funds are also accessible to investors. This exposure to real estate historically has higher volatility in values, albeit with higher liquidity. REITs typically have volatility equal to or even in excess of broader equity markets.

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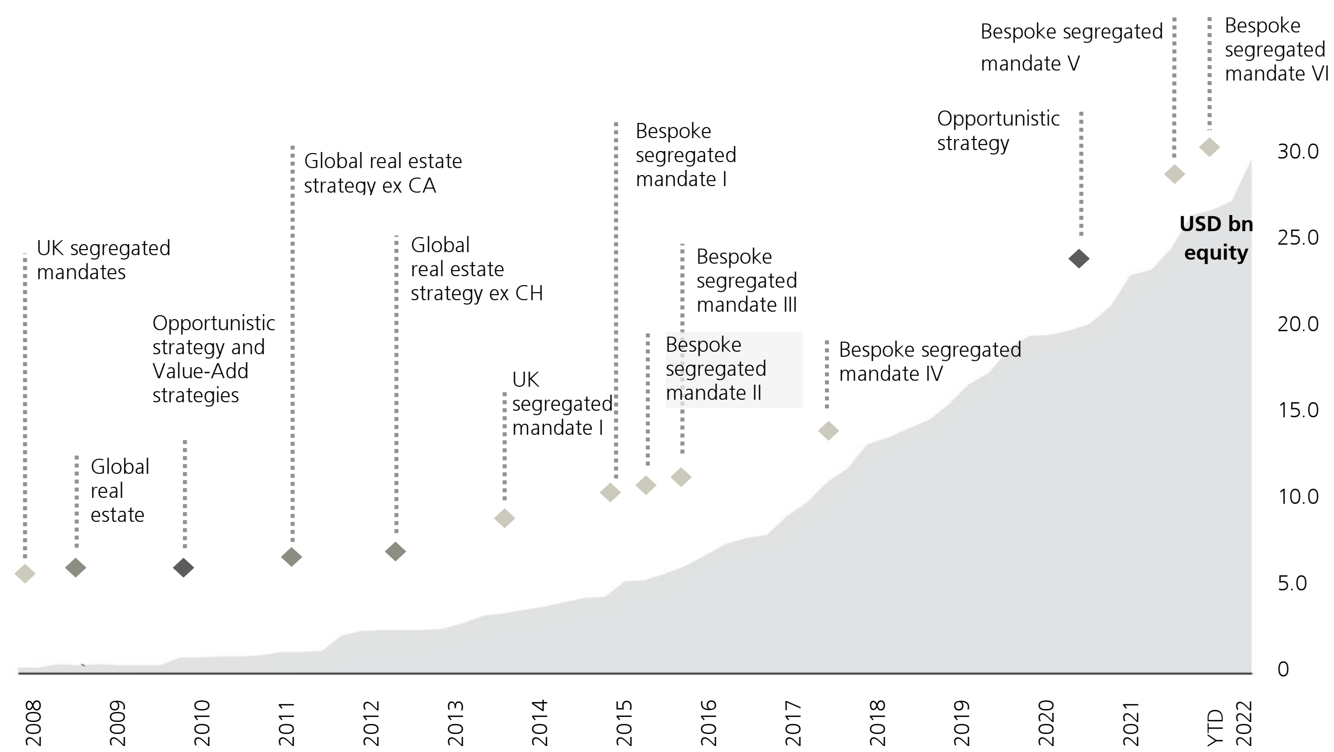
What is your experience and track record in real estate investing?

UBS Asset Management (UBS-AM) has been active in this industry since the Global Financial Crisis and is one of the largest multi-managers in this space to date. My team, UBS Multi-Managers Real Estate (MMRE) has a track record which goes back to 2007.

Over the past decade, our business witnessed an impressive growth, with a cumulative growth rate of 30% since the foundation of the business. Although this is concentrated in the low risk, core end of the strategy spectrum, we also invest in higher risk funds, emerging markets, and debt, with an increasing focus in value-add and opportunistic in recent years.

I personally have more than 20 years of experience in this industry, and I am currently Senior Portfolio Manager for our two largest comingled multi-manager strategies, geared towards institutional investors. In addition, I am responsible for top-down analysis and allocations across products and mandates, while looking to enhance efficiency and coordination of processes and tools. Prior to joining UBS, my career focused on strategy and research focused on commercial real estate investment in both Europe and Asia-Pacific.

Track record – MMRE equity history



Source: UBS Asset Management, Real Estate & Private Markets (REPM); March 2022.
Notes: All data as at 31 December 2022, unless otherwise stated

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How do you differentiate from your competitors?

There are several reasons that our firm is an attractive choice when it comes to real estate solutions. We have a long track record and an established presence in the industry. Our team is made up of highly experienced investment managers, and our reach spans 5 regions. With more than USD 29 billion of assets under management in our multi-managers business invested across 150+[3] globally diversified real estate funds with leading managers, we offer a wide platform with deals usually inaccessible for non-institutional investors. Our scale also translates into reduced fees and savings directly passed to our investors.

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How do you pool likeminded investors and ensure alignment of interest with investment managers?

We have the ability to negotiate enhanced investment conditions via pooling similar investments rather than investing solely on an individual fund basis. This is the case with investments into existing funds, or when we act as cornerstone investors in newly launched funds. We are regularly able to negotiate amongst the best terms for all our clients.

Examples of the benefits of pooled investments include but are not limited to: reduced fee loads for both primary and bespoke investments; enhanced transparency and removal of unfavorable terms, executed via our strong side-letter negotiation; or verifiable sustainability impacts - we are able to share best practices amongst GPs in addition to obtaining further information from managers.

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How do private markets play into the trend of semi-liquid solutions?

There has been increasing interest in private markets from a wide range of investors. Historically, because of scale, access, and information asymmetries, private market assets were typically only available to institutional investors and while these investors have steadily increased their exposure to private market assets over the last two decades, and are projected to continue doing so, liquidity and other structural and regulatory still constraints limited access to these products for a wider range of investors. This is changing.

Improvements in transparency and the availability of data has led regulators, within certain important limits, to define investment structures giving non-institutional investors access to private market assets. The characteristics of these asset types, in particular their relative illiquidity, needs to be properly understood by investors. But with that in mind, the semi-liquid solutions now proposed do bring all the portfolio benefits of what an institutional asset class to a much wider universe of investors has so far been.

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What's your view on integrating sustainability factors into real estate solutions?

Sustainability is something we can no longer ignore, and if we look at what is happening to our planet, it is not difficult to understand that this topic has become urgent. The link between climate change and real estate is stronger than we might think. Indeed, as natural disasters increase, so do the physical risks faced by our buildings, which results in growing premiums. That's why integrating risk analysis is a crucial component to assess the possible financial risks of our assets, and is an embedded practice into our transaction and monitoring processes.

Although estimates might differ, the real estate industry accounts for approximately 39%[4] of total emissions. This means that we, as real estate proprietors and investors, have a significant responsibility to ensure that our assets are managed in accordance with science-based net zero goals. It is also our belief that integrating sustainability into our whole investment process improves performance and adds benefits to the whole business.
Green real estate assets generally exhibit higher value due to factors such as shorter vacancy periods, lower obsolescence, decreased depreciation, reduced operating costs, shorter tenant agreements, and improved tenant retention – which is not the same for brown assets, or, assets not taking into account sustainability.
Investors are on the same page, as they are increasingly asking for accountability and transparency when it comes to sustainable investments.

Source: **1** UBS Asset Management, Real Estate & Private Markets (REPM), May 2023. **2** McKinsey Global Private Markets Review 2023, McKinsey & Company, March 2023. **3** UBS Asset Management, Real Estate & Private Markets (REPM), May 2023. Note: All data as of December 2022. **4** World Green Building Council, https://worldgbc.org/advancing-net-zero/embodied-carbon/, 2019.

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