

# REITs: Think Local, Invest Global

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## Highlights

- REITs could see increasing attention after widely underperforming in recent years, as we believe property fundamentals look healthy overall, and earnings multiples have contracted while those of broad equities are at their cycle highs. This is perhaps counter to perceptions of how quantitative easing has affected multiples.
- The U.S. represents just half of the \$1.7 trillion global real estate securities market, a diverse universe with distinct characteristics across countries and property sectors that fund managers may exploit to enhance return potential.
- While we believe business conditions remain generally favorable for U.S. REITs, some overseas property markets are seeing strong momentum and may have more runway for growth. We highlight opportunities in Europe, the U.K. and Japan.

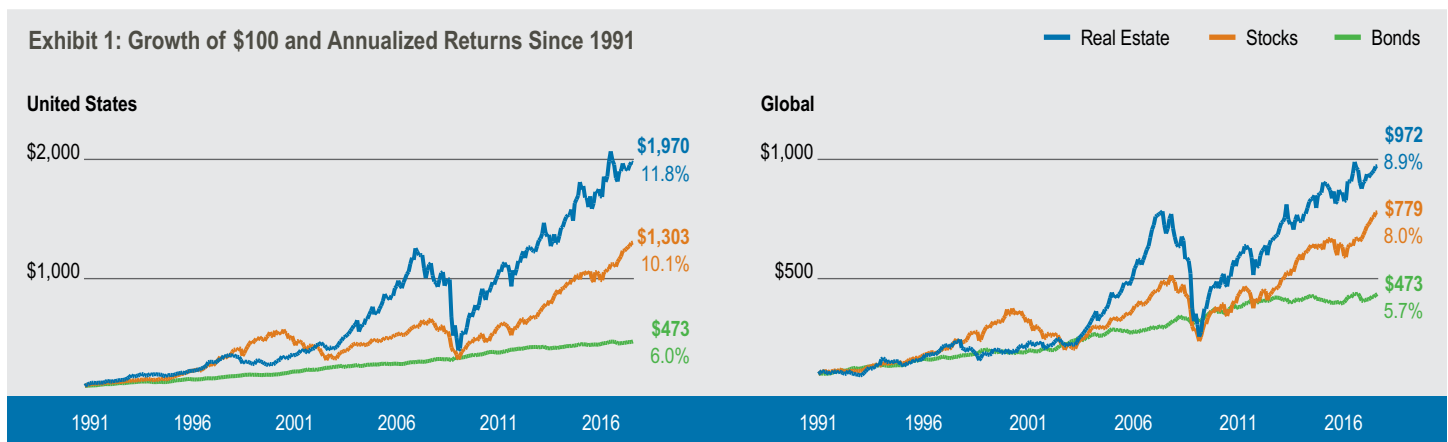
Since real estate is inherently local, what happens in New York generally has little impact on London, Berlin or Tokyo. By taking a global approach to real estate allocations, investors gain access to different property cycles, economic trends and interest-rate environments. We believe the flexibility to position portfolios globally is more important than ever amid a growing divergence in country and sector fundamentals.

## Real Estate Attractively Positioned

Over the long run, investing in commercial property through real estate investment trusts (REITs) has paid off handsomely, as REITs have prospered through their stable, cash-flow-oriented business models.

Since the beginning of the modern REIT era in 1991, U.S. REITs have delivered a return of almost 12% per year—about 2% more than the S&P 500, and twice that of U.S. bonds (Exhibit 1). The story is similar for global indexes, with REITs and other real estate securities outperforming broad equities 8.9% to 8.0%, respectively, over the same period.

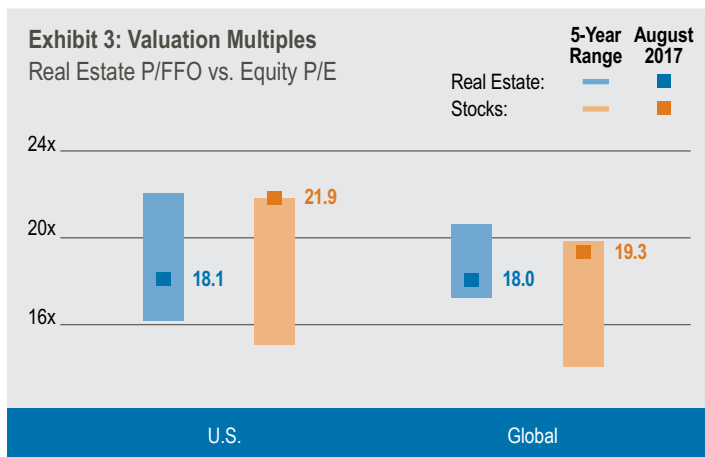
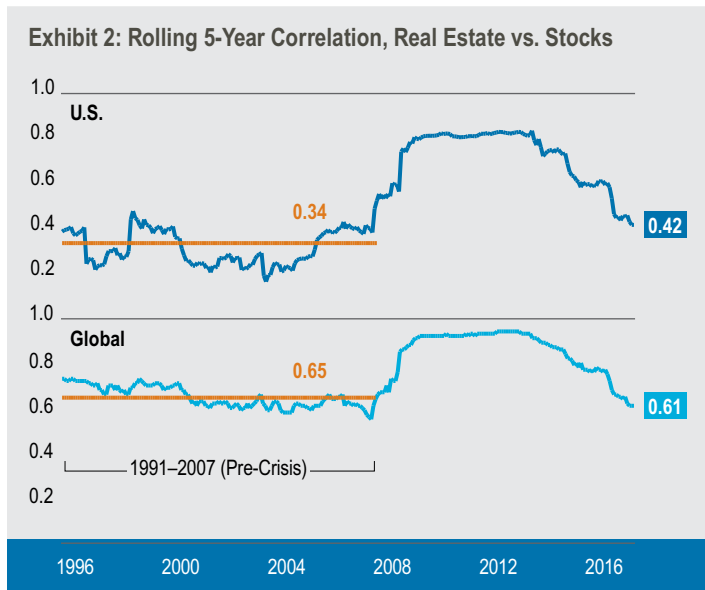
REITs have also generally paid higher yields than equities while providing diversification potential due to low long-term correlations with other asset classes. Importantly, correlations with equities have declined significantly since 2013 after a prolonged period of convergence. As of August 2017, global real estate securities had a rolling five-year correlation of 0.61 with global equities, while U.S. REITs had a 0.42 correlation with U.S. equities—both consistent with their respective levels prior to the financial crisis (Exhibit 2).



At August 31, 2017. Source: Morningstar, Cohen & Steers.

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Over the last five years, however, real estate securities have not kept pace with equities despite superior earnings growth and above-average dividends, underperforming by nearly 4% per year globally and by 5% in the U.S. We attribute this mostly to concerns over rising interest rates in the U.S. and the continued struggles of retail-focused properties. This has created an environment in which earnings multiples for both U.S. and global real estate companies have contracted, whereas multiples for equity markets have expanded to their cycle highs (Exhibit 3).



At August 31, 2017. Source: Morningstar, Cohen & Steers estimates based on proprietary qualitative and quantitative metrics.

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Peering ahead, we believe U.S. REITs are attractively positioned, as demand should continue to outpace new supply in aggregate. However, we believe it is critical to be selective in the current environment, considering the forced evolution of retail and increasing supply pressures in some areas of the market. At the same time, we see strong prospects in growth sectors such as data centers, cell towers, manufactured housing and single-family rentals. Demand for these properties is generally driven less by the economy and more by secular and demographic trends such as e-commerce, urbanization, aging populations and the entrance of millennials into the market.

Globally, we believe conditions remain favorable for landlords in most commercial real estate markets. Accelerating global growth, steady job creation, reasonable new supply levels and generally accommodative monetary policies are all pointing to steady improvement in cash flows.

**We believe healthy fundamentals and attractive valuations both in and outside the U.S. could draw increasing attention to an asset class that has widely underperformed global equities in recent years.**

For investors looking to build an allocation to real estate, we believe there are strong reasons to take a globally diversified approach.

## REITs Are a Global Opportunity

When investing in listed real estate, it is important to note that REITs are not limited to the United States. Originally created in the U.S. in 1960, REITs didn't see much traction until the early 1990s, when refinements to the REIT structure made it a more appealing vehicle for owning real estate.

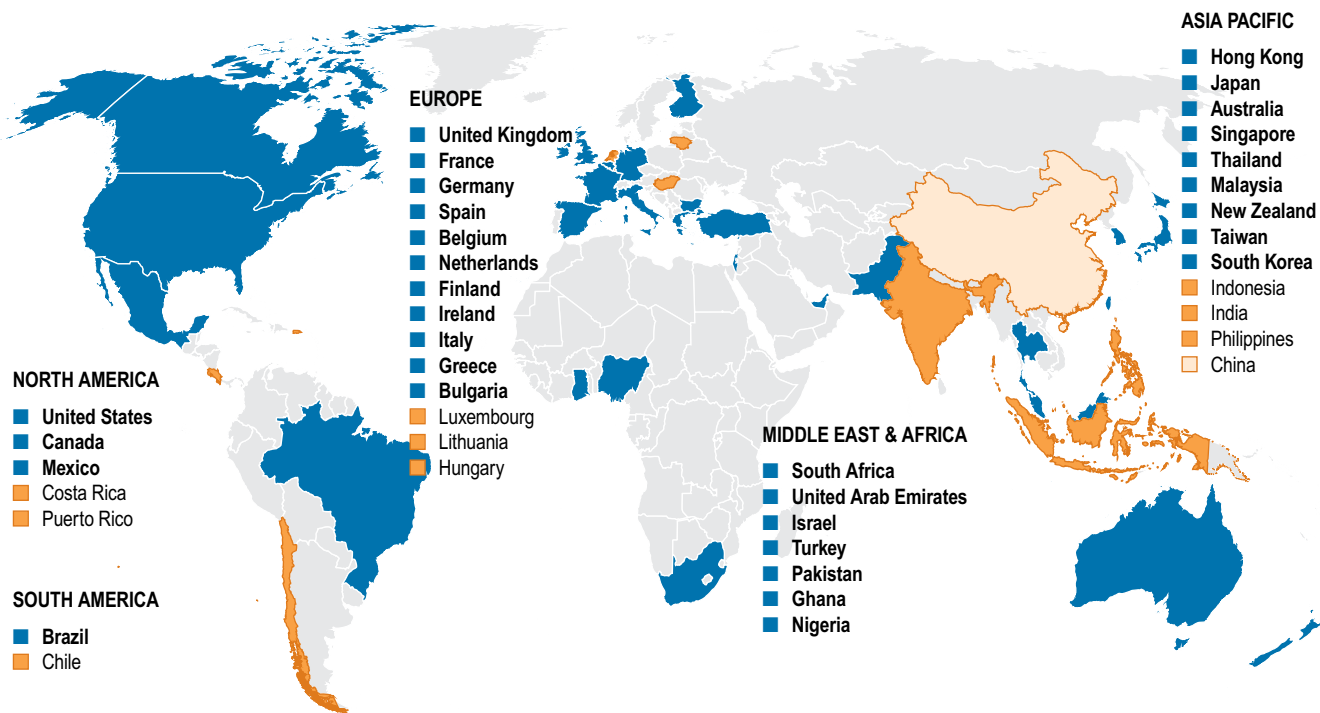
Encouraged by the success of the U.S. REIT market, other countries began to introduce their own versions of the REIT structure, providing investors broader access to commercial real estate and boosting local economies and banking systems by attracting foreign and domestic capital.

Today, 31 countries have REIT-like securities and several more are considering REIT legislation (Exhibit 4). The widespread adoption of the REIT structure has transformed the global real estate securities market, growing it from a \$320 billion market in 2002 to \$1.7 trillion in market capitalization today, comprising 335 REITs and other listed property companies (Exhibit 5).

**Exhibit 4: Global REIT Adoption**

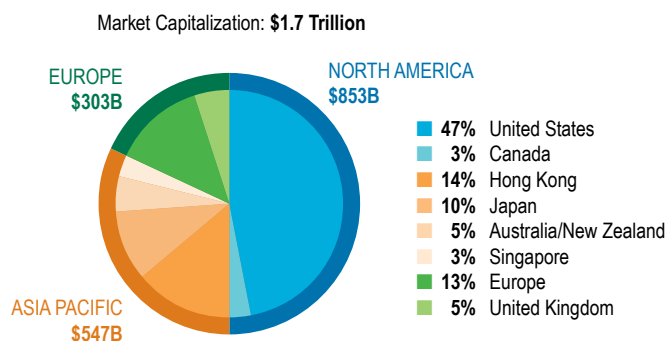
■ Listed REITs    ■ REIT Legislation in Progress    ■ REITs Under Consideration

31 countries have REIT-like structures and several more are in the process of implementing REIT legislation



At August 31, 2017. Source: UBS, Cohen & Steers. See page 7 for additional disclosures.

**Exhibit 5: The Global Real Estate Securities Market**



At August 31, 2017. Source: FactSet, Cohen & Steers. See page 7 for index associations, definitions and additional disclosures.

This geographic diversification creates a significant depth and breadth of opportunities for investors, providing access at any point in time to different property cycles, macroeconomic trends, political environments and interest-rate policies. These distinctions have historically resulted in low cross-correlations at the country level (Exhibit 6), helping to diversify the market and offering the potential for lower volatility relative to the U.S. REIT market alone.

Furthermore, each property sector in the global market has distinct characteristics that can affect their cash flows. Some real estate companies own properties that have short lease terms and tend to be more sensitive to economic cycles, while others have more predictable income and long lease durations that may be appealing in times of uncertainty.

Because of the differences among countries and property sectors, they will often perform very differently over any given period (Exhibit 7). This return dispersion creates opportunities for active portfolio managers to enhance return potential by concentrating a portfolio's assets in companies that may be better positioned to grow cash flows in a given market environment.

**Distinct characteristics among countries and sectors provide an opportunity for active portfolio managers to capitalize on different phases of each market's real estate cycle.**

In some ways, we believe the need to be selective is even more important in global portfolios. The REIT structure, and listed real estate in general, is still relatively new in many countries, so there has been less time for best practices to evolve compared to the more mature U.S. market. As a result, we often see significant variation across factors such as:

- Corporate structure and governance
- Portfolio focus and strategic planning
- Balance sheet management
- Financial reporting standards
- Land rights
- Approaches to capital raising

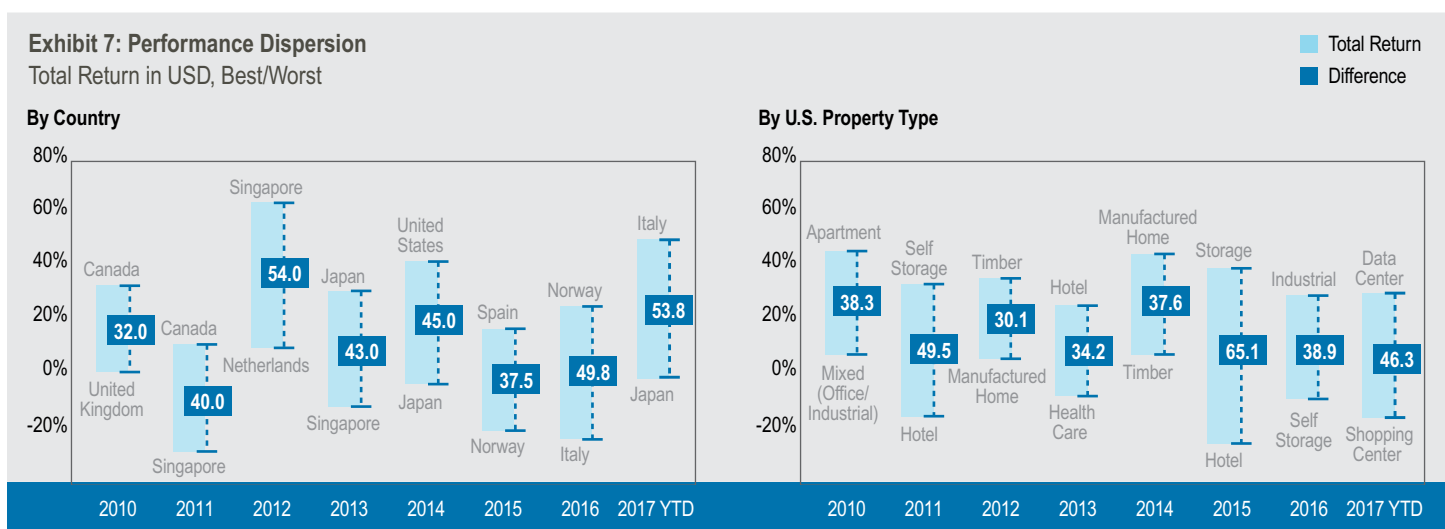
By paying attention to these factors, a skilled active manager may be able to differentiate companies that are more likely to be successful in delivering long-term shareholder returns.

**Exhibit 6: Global Real Estate Securities 5-Year Correlations by Country**

	NORTH AMERICA		EUROPE			ASIA PACIFIC		
	United States	Canada	United Kingdom	Germany	France	Australia	Japan	Hong Kong
<b>NORTH AMERICA</b>								
United States	<b>1.00</b>							
Canada	0.51	<b>1.00</b>						
<b>EUROPE</b>								
United Kingdom	0.39	0.29	<b>1.00</b>					
Germany	0.47	0.43	0.45	<b>1.00</b>				
France	0.49	0.55	0.65	0.69	<b>1.00</b>			
<b>ASIA PACIFIC</b>								
Australia	0.70	0.68	0.39	0.57	0.57	<b>1.00</b>		
Japan	0.26	0.48	0.15	0.07	0.25	0.44	<b>1.00</b>	
Hong Kong	0.39	0.54	0.31	0.46	0.43	0.57	0.28	<b>1.00</b>

At August 31, 2017. Source: Morningstar, Cohen & Steers.

Data quoted represents past performance, which is no guarantee of future results. Correlation is a statistical measure of how two data series move in relation to each other, with 1 representing perfect synchronization and 0 representing perfect randomness. Correlation analysis based on monthly data from 8/31/12 to 8/31/17. See page 7 for index associations, definitions and additional disclosures.



At August 31, 2017. Source: Morningstar, Cohen & Steers.

Data quoted represents past performance, which is no guarantee of future results. The information presented above does not reflect the performance of any fund or account managed or serviced by Cohen & Steers, and there is no guarantee that investors will experience the type of performance reflected above. Property sector returns based on FTSE NAREIT Equity REIT Index. Country returns based on FTSE EPRA/NAREIT Developed Real Estate Index. See page 7 for index definitions and additional disclosures.

## Shifting Tides

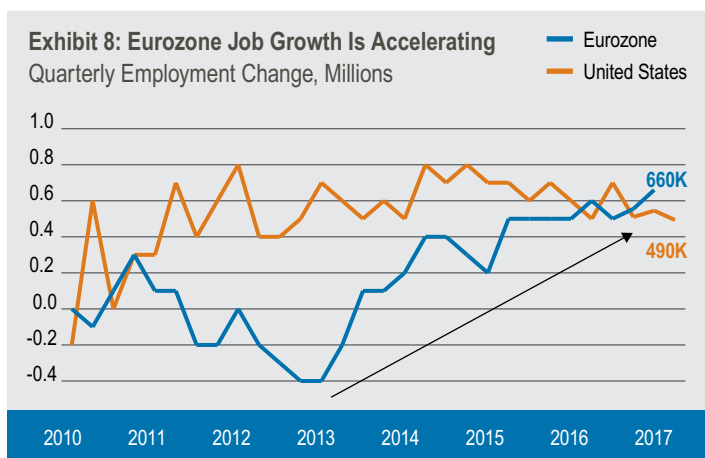
For the past decade, the U.S. has generally been in the driver's seat within the global real estate market. This advantage seems to have diminished, with Europe and Asia Pacific significantly outperforming the U.S. over the past year. While we continue to have a positive view of the U.S. REIT market overall, we believe it makes sense for investors to expand the pool of opportunities beyond U.S. borders into markets that may have more runway for growth.

Below are three markets we believe present particularly interesting opportunities today.

### European Stimulus Efforts Paying Off

After a prolonged period of anemic growth, Europe is now seeing the strongest acceleration of any developed economy. Eurozone GDP growth accelerated to 2.1% in the second quarter of 2017, its fastest pace in six years. Political concerns have largely dissipated since the victory of Emmanuel Macron—a strong advocate of the European Union (EU)—as France's president in May. Many consumer and business sentiment indicators are at multi-year highs, pointing to continued acceleration. And interest rates in Europe are likely to remain lower than in the U.S., as there is still significant economic slack.

Perhaps the strongest indicator of improving real estate demand in Europe is the surge in employment. As shown in Exhibit 8, Europe now exceeds the U.S. in job growth, adding 660,000 new jobs in the first quarter of 2017. Yet there is still considerable room for improvement, with the average unemployment rate in the euro area at 9.1% as of July 2017, down from 12% four years ago. Considering what job growth has done for the U.S. REIT market, we see similar potential for European property.



At August 31, 2017. Source: Morningstar, Cohen & Steers. Europe employment data generally reported about one quarter behind the U.S.

This strength is especially evident in Germany, the EU's economic gravity center. Thanks to a vibrant export economy, strong job growth and immigration, German household formations are running at the highest levels since the boom years following reunification. Nowhere is this more evident than in Berlin, which is quickly becoming the Silicon Valley of Europe. Although residential supply is increasing, it has not been nearly enough to meet demand. Quality office space in Berlin is also scarce, with demand fueled by job growth and the continued fallout from Brexit as more companies seek alternatives to London for their regional base of operations.

### Company Example: Deutsche Wohnen



Owns 160,000 residential and commercial units in Germany, mainly in Berlin and other major metropolitan regions. The company is enjoying strong fundamentals, with an occupancy rate in Berlin of more than 98% and average in-place rents up more than 9% from just two years ago. Funds from operations increased 26% year over year through June 2017 due to acquisitions and operational improvements. Despite these favorable metrics, the stock has been trading at a material discount to the private-market value of its properties.

### The U.K.'s Brexit Survivors

Although the U.K. economy has been on a weakening trend since the country's decision to leave the EU in 2016, we believe domestic-focused properties such as industrial, student housing and health care should be relatively insulated from Brexit fallout. For example, the industrial sector is benefiting from the decline in the pound due to the impact on exports, as well as growing demand for logistics services as retailers strive to improve product delivery times to customers. Despite the more defensive nature of these properties, many of these landlords are trading at compelling discounts to the value of their underlying assets.

Company Example: **SEGRO**



Owns 6.4 million square meters of urban and big box warehouses, as well as warehouses used as data centers, with assets concentrated in London, other parts of the U.K. and major distribution hubs in Europe. The company is enjoying significant e-commerce tailwinds as the growth of Internet retailing reshapes the U.K. and Continental Europe's high street. A shortage of warehouse supply has led to high occupancy rates and is driving rental growth expectations, with approximately half of SEGRO's assets serving the critical "last mile" of the e-commerce value chain.

### Japan Awakens

A similar story to Europe is playing out in Japan, where a stronger macro backdrop and continued monetary stimulus are providing favorable conditions for real estate developers.

After a long slumber, Japan's economy is seeing a meaningful improvement in growth. Real GDP grew at a 4% annualized rate in the second quarter of 2017, marking the sixth consecutive gain and the longest and strongest expansion in a decade. In July, the unemployment rate hit its lowest point since the mid-1990s at 2.8% as businesses benefited from a stronger global economy, a soft yen and—for the first time in years—a recovery in domestic consumption. This backdrop has created increasing demand for Tokyo office space, driving market rents and asset values higher.

Company Example: **Sumitomo Realty & Development**



One of Japan's leading developers and owners of office, residential and hotel properties. The company is benefiting from strong demand for modern, quake-resistant office space in Tokyo's central business district and recently reported its highest ever condo bookings. Sumitomo is also being recognized for its primarily domestic development pipeline at a time when some other developers have raised questions with large overseas acquisitions. As with other Japanese developers, persistent concerns over Japan's economy have depressed Sumitomo's share price well below the value of its assets, which could improve if inflation expectations rise.

### Going Global With REITs

While some investors may decide to remain focused on their home country, we believe there are important reasons to consider a global approach to real estate allocations, including the potential for:

- **Attractive long-term total returns that balance capital appreciation and income**
- **Low correlations with other asset classes**
- **Diversification on a global scale, with access to property markets at different points in their fundamental cycle**
- **Greater opportunities for added value through active portfolio management**
- **Participation in the long-term securitization of real estate**

Furthermore, for investors who may be under-allocated to international assets, global real estate securities can be an effective way to enhance geographic diversification. Most real estate companies own properties largely within their home territory, providing one of the most direct ways to participate in the growth of local economies.

## Investing With Cohen & Steers

With the growing divergence in country and sector fundamentals, we believe partnering with the right active manager will be critical in the coming years.

As the first investment manager to specialize in REITs, Cohen & Steers has built a 30-year track record of helping investors capitalize on opportunities in this unique asset class. We have been through the highs and lows of multiple real estate cycles, developing a deep perspective that has enabled us to deliver consistently superior results for our clients.

Despite our accomplishments, we know we must constantly strive to enhance our competitive advantage. To that end, we have assembled the world's largest team of portfolio managers, analysts and traders dedicated to real estate securities, with an average of 17 years of experience. Members of the team are placed in local markets, working closely together to identify trends and opportunities around the globe. We believe these insights give us an edge in navigating real estate markets that are constantly evolving in response to emerging technologies, changing spending behaviors and shifting demographics.

### The Cohen & Steers Global Real Estate Investment Team

	Number of Professionals			Total
	Portfolio Management	Research Analysts	Traders	
New York	5	6	6	17
London	2	3	1	6
Hong Kong	2	3	1	6
<b>Total</b>	<b>9</b>	<b>12</b>	<b>8</b>	<b>29</b>
<b>Average Years With CNS</b>	<b>13</b>	<b>7</b>	<b>9</b>	<b>9</b>
<b>Average Years of Experience</b>	<b>23</b>	<b>12</b>	<b>18</b>	<b>17</b>

At June 30, 2017. Source: Cohen & Steers.

For more information on how to invest with Cohen & Steers, talk to your financial advisor or visit us at [cohenandsteers.com](http://cohenandsteers.com)

**Index Associations and Definitions.** All returns and investment characteristics discussed in this report are based on the indexes below. An investor cannot invest directly in an index and index performance does not reflect the deduction of any fees, expenses or taxes.

Global bonds: Barclays Capital Global Aggregate Bond Index provides a broad-based measure of the global investment grade fixed-rate debt markets. Global real estate: FTSE EPRA/NAREIT Developed Real Estate Index (net) is an unmanaged market-capitalization-weighted total-return index, which consists of publicly traded equity REITs and listed property companies from developed markets. Global stocks: MSCI World Index consists of a wide selection of stocks traded in 24 developed countries. It is weighted for market capitalization and is considered an important benchmark of the state of global stock markets. U.S. bonds: Barclays Capital U.S. Aggregate Bond Index is a broad-market measure of the U.S. dollar-denominated investment-grade fixed-rate taxable bond market, and includes Treasuries, government-related and corporate securities, mortgage-backed securities, asset-backed securities, and commercial mortgage-backed securities. U.S. REITs: FTSE NAREIT Equity REIT Index contains all tax-qualified REITs, except timber and infrastructure REITs, with more than 50% of total assets in qualifying real estate assets other than mortgages secured by real property that also meet minimum size and liquidity criteria. U.S. stocks: The S&P 500 Index is an unmanaged index of 500 large-capitalization stocks that is frequently used as a general measure of U.S. stock market performance.

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This commentary must be accompanied by the most recent Cohen & Steers fund fact sheet(s) and summary prospectus if used in connection with the sale of mutual fund shares.

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We believe accessing investment opportunities around the world requires local knowledge and insight into specialized and regional markets. Cohen & Steers maintains a global presence through the following offices:

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