Global Property Securities
2021 outlook

First Sentier Investors

Macro backdrop for property securities

We believe real estate securities will be supported by a global economic recovery in 2021, underpinned by highly accommodative governments and central banks and the gradual normalisation of commercial and social activity as the world is progressively inoculated against COVID-19.

We expect official policy interest rates to remain near zero throughout 2021 at least. Central banks have also guided that they will continue to use all the tools at their disposal, including large asset purchase programmes, in order to stimulate domestic economies through the disruption. This should keep markets flush with liquidity and the cost of debt extraordinarily low for the foreseeable future, which will be very supportive of real estate valuations in our view. Furthermore, in this low rate environment where yield is scarce, the attractive recurring income offered by the global property securities sector - currently yielding around 3.8%[1] - is likely to underpin investor demand for property securities in 2021.

A continuation of extensive, globally coordinated fiscal stimulus by governments should also support households and businesses throughout 2021. Nevertheless, we believe as the current recession is ultimately a global health crisis at its core, the near-term outlook will be influenced by how the COVID-19 situation plays out. The pandemic remains a significant near-term risk, particularly for the first half of 2021, as record rates of infection and new strains of the virus has forced a number of regions back into lockdown, clouding the outlook for growth globally.

The persistence of the virus threatens to delay the 'return to normal', which has disproportionately impacted real estate tied to non-essential communal interaction and tourism, including hotels and resorts, shopping malls, gaming and leisure assets, hospitality venues and CBD office buildings to an extent.

Some of these sectors have experienced depressed rent collections, rising vacancies and higher levels of bad debt due to the pandemic, resulting in an elevated number of operator insolvencies during 2020. On the other hand, other sectors – like data centres, logistical warehouses, self-storage facilities, healthcare assets and residential properties – have been largely insulated from COVID-19 restrictions and have continued to benefit from strong ongoing structural tailwinds.

Nonetheless, as several effective vaccines are already being rolled out in a number of countries, with millions of inoculations already having been administered, we are optimistic on the prospects of a progressive normalisation of conditions by the second half of 2021. This should benefit the real estate sector as a whole, however, the greatest degree of relief will be felt by the aforementioned sectors that struggled most significantly during 2020, such as hotels, hospitality assets and shopping malls.

In any case, we are primarily focused on the medium to long term. A number of the themes affecting property markets that have emerged or accelerated during the COVID-19 recession are likely to persist through 2021 and beyond, irrespective of the timing and shape of the economic recovery. We believe that these 'mega trends' should be the greatest consideration for property investors, as real estate assets have very long economic lives.

Therefore, as a team a great deal of our time and energy is spent on trying to understand the implications of continued growth in e-commerce adoption, secular shifts towards more flexible working arrangements by corporates, the decentralisation of our cities, renewed attention on the fitness for purpose of healthcare systems, falling home ownership rates, ongoing demographic change including ageing populations, rising data consumption, and a number of other trends.

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The real estate to look out for in 2021

As we enter 2021, we are excited about a number of the opportunities across our investment universe and have conviction in a range of real estate sectors that are underpinned by solid tenant demand and structural growth tailwinds.

Industrial landlords are very well placed for the year ahead. The sector is set to continue to benefit from the accelerating e-commerce related demand. This should underpin a continuation of robust fundamentals for logistical distribution centres, which play a critical role in the fulfilment of goods purchased online.

Moreover, heightened investment from a range of industries into optimising supply chains should also support sector fundamentals. After widespread stock-outs in early 2020 saw customer demand for a range of goods being unmet, businesses in a range of industries are likely to invest capital into shoring up their supply chains, which should further support strong tenant demand in the near-term.

The residential-for-rent (RfR) sector, which includes apartments, detached housing and manufactured homes, is also positively

1. 12 month forward dividend yield of the FTSE EPRA/NAREIT Developed Index. Source: Factset as at 1 January 2021.

positioned for 2021. RfR assets have been largely insulated from the effects of the pandemic, as tenants have demonstrated a continued ability to meet their rental obligations with the support of government assistance. As housing is a basic social need, residential assets are inherently defensive and tend to deliver stable cash flows during economic downturns like the current recession. We believe the risk-adjusted returns currently offered by the sector are very compelling.

Looking ahead, tenant demand for institutionally owned RfR assets should continue to be underpinned by the defined long-term shift from home ownership to rental accommodation. Housing affordability is a major issue for younger generations that has been exacerbated by the pandemic and the aspiration to own a home continues to wane as priorities shift towards lifestyle and experiences.

Decentralisation is also likely to have a material impact on the sector in 2021. We expect people to continue to move from dense urban locations to less dense urban and suburban areas amidst the broader trend of working, living and playing local. This should support the fundamentals of detached housing, apartments and manufactured homes located in smaller towns, city fringes and in the suburbs, while we generally expect the fundamentals of apartments located in major urban centres to deteriorate.

This thematic is also likely to lead to higher vacancy rates and worsening rental levels for high rise office buildings located in dense urban centres; to the benefit of 'A grade' suburban and city fringe office buildings, as tenants increasingly seek out high quality work spaces at lower occupancy costs closer to where workers live, in the suburbs and city fringes.

In addition, we believe the healthcare sector is poised to deliver solid returns this calendar year. The pandemic has undoubtedly placed renewed attention on healthcare systems around the world as governments have worked to contain the spread of the virus and successfully treat the infected, while investing heavily into the development of vaccines, therapeutics and diagnostics in public-private partnerships.

We think that policy makers will be focussed on building further contingency into their healthcare systems and that they are likely to look to private capital to help fund these initiatives. Over the coming years this provides an enormous opportunity for investment into purpose built modern healthcare assets, including acute care hospitals, outpatient facilities and medical office buildings.

The massive amount of investment into pharmaceutical research and development in 2020, which has culminated in the development of several effective COVID-19 vaccines, is also expected to continue into 2021 and over the medium term and should underpin robust demand for bio-tech laboratories. We also expect ongoing demographic change such as ageing populations to fuel tenant demand for assets across the healthcare system, particularly aged care facilities and seniors housing.