Timbercreek
Asset Management

The Opportunity of REITs: Thinking Beyond Stocks and Bonds

Real Estate Investment Trusts (REITs) add diversification and can reduce volatility in investment portfolios, complementing traditional assets while capturing the benefits unique to real estate.

The Opportunity in 2016:

REITs are set to attract more attention and more capital in 2016 given the upcoming reclassification of real estate stocks within the Global Industry Classification System (GICS). REITs will finally leave the shadows of the financials umbrella and become a stand-alone sector, raising the industry's visibility and driving new inflows by generalists that are currently underweight REITs. According to J.P. Morgan, the current average weight to REITs across all long-only 40 Act mutual funds in the United States is 2.3% versus over 4% for the various benchmarks. The aggregate assets under management ("AUM") across these funds is approximately USD 5 trillion. If the weight to REITs is increased to benchmark levels, that would imply over USD 100 billion in new inflows to the sector, equating to almost 5% of the market capitalization of the developed world.

REITs perform through diverse market cycles:

Today's investors have multiple goals: preserve capital, generate stable income, achieve an attractive total return, protect against market volatility and the potential longer-term impact of rising interest rates and inflation. REITs can provide superior risk-adjusted investment returns while preserving capital. In particular, REITs allow investors to:

- Add high-quality securities to a portfolio that can deliver stable income and consistent performance over the long term through diverse market cycles.
- Benefit from real estate's low correlation across borders and with other asset classes, leading to more stable returns when markets falter.
- Reap the rewards from an asset class that holds value in an environment of rising interest rates (contrary to public perception) and inflation.
- Access the global real estate market efficiently and directly, allowing investors to profit from pockets of regional and economic growth around the world.

In this paper we discuss how and why REITs bring the advantages of diversification to individual investment portfolios across a range of market scenarios. We also provide background and context on the global real estate market, including our insights on how this market has developed over time.

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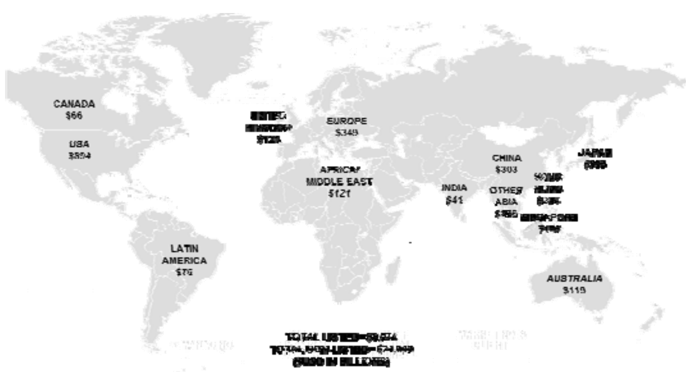
The World of Global Real Estate

Real Estate Investment Trusts provide an accessible and efficient mechanism for investors to invest in real estate globally. REITs are a tax efficient structure and while the specific regulatory framework may differ by country, the unifying characteristic of all REITs is that their revenue is derived from the collection of rent from owning or managing properties. REITs function as a proxy for the real estate market as a whole, providing investors the benefits of investing in the asset class while overcoming the barriers that often stand in the way, such as the lack of financial wherewithal and expertise to own and manage commercial real estate on one's own. REITs allow individual investors to easily and readily add the real estate asset class to a portfolio versus relying on the direct real estate market, which is typically reserved for large investors.

Today, the value of the global real estate universe is estimated at approximately USD 27 trillion. Of that total, an estimated USD 3 trillion – or slightly more than 11% – of the world's available real estate is securitized in the publicly-listed real estate market. Approximately 56% of the listed real estate market is located in North America, with 17% in continental Europe, roughly 21% across Asia and 6% in Australia and New Zealand.[1]



Source: UBS Research. As of May 2015.

> ***The continued adoption of REIT-like structures around the world will further promote the securitization of real estate – and lead to further opportunities for investors.***

REITs in a Global Context: Exploring Correlation and Diversification

Real estate is fundamentally a local business and its performance is primarily influenced by local supply and demand dynamics. Real estate operating income, cash flows and valuation are ultimately driven by local economic and business conditions. For example, why are residential real estate prices rising in Sydney, Australia but falling in Hong Kong? Or why are office market rents declining in Calgary, Canada but rising in London, England?

Low correlations across borders

The local nature of real estate means the performance of one (local or regional) real estate market has a low influence on the performance of another real estate market. When investing in real estate on a global scale, we believe the low correlation of real estate markets around the world provides the benefits of diversification and decreases volatility and risk of a portfolio.

Global Real Estate Regional Correlations

Region	U.S.	Canada	Europe	Hong Kong	Japan	Singapore	Australia
U.S.	1.00	0.55	0.60	0.30	0.34	0.33	0.52
Canada		1.00	0.53	0.34	0.29	0.40	0.52
Europe			1.00	0.33	0.33	0.31	0.48
Hong Kong				1.00	0.21	0.76	0.25
Japan					1.00	0.27	0.27
Singapore						1.00	0.27
Australia							1.00

Source: Bloomberg. Data as of December 31, 1992 to January 31, 2016.

Low correlations to broader equity markets

Real estate also exhibits low correlations to broader equity markets. Unlike most industries around the world, real estate cash flows are contractual in nature – and payable over a fixed time frame.

The fixed rent obligation of real estate creates a high level of transparency resulting in real estate cash flows being more stable and less susceptible to the ebbs and flows of traditional business and market cycles.

Real Estate / Equity Regional Correlations

Region	U.S.	Canada	Europe	Hong Kong	Japan	Singapore	Australia
U.S.	0.55	0.43	0.46	0.37	0.33	0.47	0.50
Canada	0.50	0.52	0.40	0.36	0.30	0.48	0.44
Europe	0.53	0.43	0.57	0.39	0.41	0.53	0.53
Hong Kong	0.61	0.55	0.44	0.89	0.31	0.73	0.53
Japan	0.34	0.27	0.34	0.25	0.75	0.32	0.40
Singapore	0.53	0.52	0.45	0.70	0.34	0.85	0.50
Australia	0.43	0.39	0.42	0.35	0.30	0.38	0.27

Source: Bloomberg. Data as of December 31, 1992 to January 31, 2016.

Low correlations to other asset classes

Finally, as an asset class, global real estate securities exhibit low correlation to other asset classes, such as Canadian equities, global bonds, and gold. We believe introducing real estate securities into a broader portfolio of stocks and bonds enhances diversification – which leads to more stable investment performance over time.

Global Asset Class Correlations

	Global Real Estate	Global Equities	Global Bonds	Gold
Global Real Estate	1.00	0.77	0.35	0.19
Global Equities		1.00	0.23	0.11
Global Bonds			1.00	0.41
Gold				1.00

Source: Bloomberg. Data as of December 31, 1992 to January 31, 2016 except for Gold which is as of December 31, 1994 to December 31, 2015. Indices include FTSE EPRA NAREIT Developed Global Real Estate Index, S&P/TSX Composite Index, JP Morgan Global Aggregate Bond Index and the Bloomberg Gold Index.

[1] Data is as of November 30, 2015

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Real Estate and Economic Growth

A focus on interest rates

One factor that concerns investors about investing in real estate is the threat of rising long term interest rates and the impact that may have on the performance of listed real estate. Rising interest rates are typically accompanied by either stronger economic growth, acceleration in inflation, or both. Our conclusion based on our experience and research is that real estate performs well in either environment.

Real estate and economic growth

From an economic growth perspective, stronger economic growth leads to higher levels of demand for commercial real estate space as companies grow and expand. Higher demand for space leads to higher occupancy rates and greater pricing power, resulting in increases in market rents. Higher market rents and occupancy rates lead to higher revenue growth, which results in stronger earnings growth and typically higher stock prices and positive returns.

Real estate and rising inflation

If interest rates rise due to an acceleration in inflation, real estate acts as a protector of purchasing power owing to the fact that annual rent increases are tied to inflation. Moreover, as inflation rises so do construction costs, which in turn makes existing properties more valuable as replacement costs rise. Landlords are able to pass through the impact of higher inflation to tenants in the form of higher rents.

REIT Performance Through Rising Interest Rates: The Results of Our Research

Our research demonstrates that publicly-listed REITs perform well in a rising interest rate environment. Using the U.S. market as a barometer, since 1975 we have identified eight time periods where interest rates have meaningfully increased. As the table below shows, in seven of those time periods, REITs have generated strong absolute returns: on average, 14% annualized.

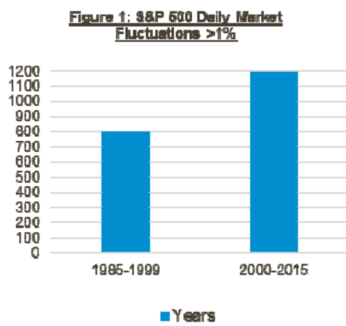
We believe the strong absolute performance of publicly-listed REITs in a rising interest rate environment is a by-product of strong economic growth, earnings growth and dividend growth, all of which positively benefit commercial real estate. The combination of all of these factors typically lead to rising share prices.

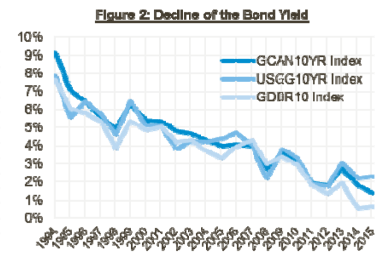
Time Period	Length of Increase	Change in Fed Policy[1]	REIT Performance[2]
Apr. 2004 – Jun. 2007	3 years	+425 bps	+17%
Apr. 1999 – Dec. 2000	~2 years	+175 bps	+14%
Jan. 1994 – Jun. 1995	1.5 years	+300 bps	+6%
Apr. 1988 – Apr. 1989	1 year	+300 bps	+6%
Apr. 1987 – Sept. 1987	6 months	+125 bps	-5%
Apr. 1983 – Sept. 1984	1.5 years	+325 bps	+20%
Jun. 1980 – Dec. 1980	6 months	+850 bps	+35%
Apr. 1976 – Apr. 1980	4 years	+1525 bps	+21%

[1] Federal Funds Target Rate. [2] MSCI U.S. REIT Total Return Index. Represents annualized returns. Source: Bloomberg. As at March 31, 2015.

REITs in Your Investment Portfolio: Reducing Risk While Enhancing Returns

The contemporary challenge for the individual investor is solving for income, volatility and inflation protection, while maximizing return in an environment where fixed income returns are at historical lows and macro-economic news headlines create pockets of unwelcomed risk. The charts we provide below in Figures 1 and 2 illustrate how current market conditions deviate from the recent past, with daily market fluctuations increasing over the past 15 years and bond yields falling to all-time lows.





Bloomberg. December 31, 2015

Markets are becoming increasingly volatile.

Fixed income returns are diminishing to historical lows.

We believe that adding REITs to a portfolio of stocks and bonds can help investors and advisors overcome the challenges of investing in today's environment, namely reducing risk while enhancing income and returns.

The low correlation of real estate markets around the world provides the benefits of diversification while lowering the volatility and risk of a portfolio.

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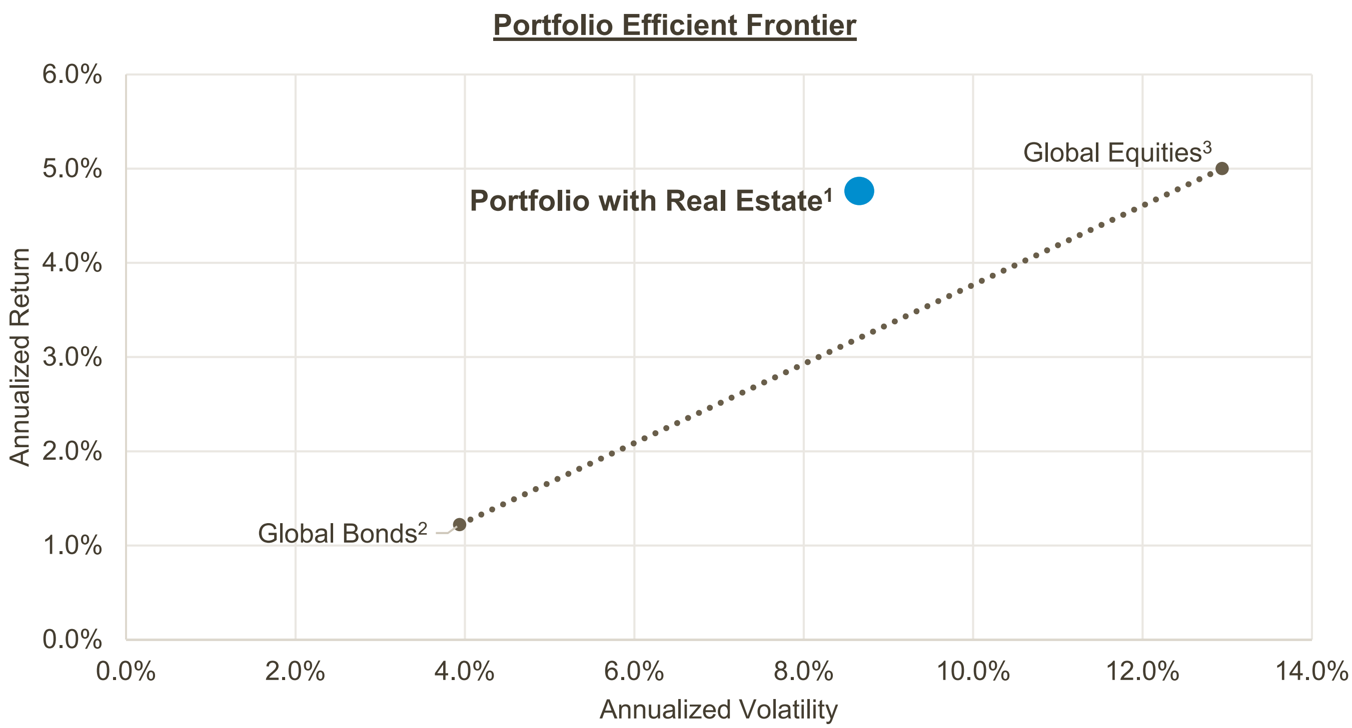
Building a Better Portfolio

Below, we provide an illustration that shows how including global REITs in a portfolio of global equities and bonds can be more efficient than portfolios which exclude exposure to real estate. There is a distinct positive impact when low correlated assets are combined in a single portfolio. A portfolio with an allocation to real estate delivers a superior annualized return and sharpe ratio, quantitatively demonstrating the benefits of adding REITs as an investment asset class as part of an investor's overall asset allocation mix.



[1]Represented by 40% MSCI World Index, 40% JPM Global Aggregate Bond Index – Total Return Unhedged and 20% FTSE EPRA NAREIT Developed Total Return Index.
[2]JPM Global Aggregate Bond Index – Total Return Unhedged.
[3]MSCI World Index.
All performance returns are in USD. Source: Bloomberg. All data as at December 31, 2015, unless stated otherwise.

In Summary

Today's investors have multiple goals: preserve capital, generate stable income, achieve an attractive total return, protect against market volatility and protect against the potential impact of rising interest rates.

This paper provides an overview of how adding REITs to a portfolio can help meet these goals, allowing investors to benefit from "thinking beyond stocks and bonds".

Global REITs add diversification while reducing volatility, complementing traditional assets while capturing the benefits unique to real estate. REITs also allow investors to access the global real estate market efficiently and directly, delivering stable income while consistently generating strong performance over the long term through diverse market cycles.

The power of combining assets with low correlations in a single portfolio is critical to delivering successful investment performance and we believe global REITs are an essential element to an investors asset allocation mix.

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The Timbercreek Approach

Founded in 1999, Timbercreek Asset Management is a global alternative asset class manager with CAD 5.5 billion in AUM. Timbercreek employs a value-oriented investment philosophy and specializes in providing conservatively managed, risk-averse alternative asset class investment opportunities to investors.

Our core competency is our ability to accurately value cash flows based on a comprehensive analysis of the quality and sustainability of a property's current and future revenue streams. This fundamental 'bricks-and-mortar' approach is critical to identifying attractive investment opportunities across our three key business lines:

- global real estate securities,
- private equity investing and
- customized mortgage solutions and other debt secured by real estate.

By combining these strategies Timbercreek is able to deliver an integrated approach to real estate investing.

Global Real Estate Securities Investing

Timbercreek invests in publicly-listed real estate companies that own investment-grade real estate around the world. We focus on achieving a superior risk-adjusted return through investments that own high quality real estate across all asset types that we assess to be undervalued. Our investment objective is to deliver stable distribution and a compelling total return while limiting volatility and protecting capital.

Timbercreek has cultivated an experienced and proven team of real estate professionals strategically located in key global markets including Canada, the United States, Europe and Hong Kong. We believe our comprehensive 'feet on the ground' presence allows for a deep understanding of local markets, enabling us to accurately and efficiently source, underwrite and monitor global real estate investments. Key investment strategies include Core, Income and Balanced and are offered to both institutional and retail audiences through a range of public and private vehicles.

About the Author

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Corrado Russo is responsible for managing the global securities platform. Mr. Russo has an extensive background in the investment management field, having held positions in portfolio management, equity research and direct real estate investments. Mr. Russo holds an MBA from the Schulich School of Business at York University in Toronto and holds the Chartered Financial Analyst designation.

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