Global Real Estate and the COVID Economy
Prepared for Challenging Times

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Overview

As the pandemic has redefined our daily lives and uprooted millions suddenly out of work, the shock to the economy has been severe. Share prices for global real estate securities, as with all asset classes, have been significantly impacted in a manner rivaled only by the global financial crisis.

Unlike the financial crisis, however, this recession is the result of an external shock rather than excesses and perceived abuses in the system. As a result, policymakers have taken aggressive actions to provide relief to affected businesses and households. Despite these efforts, we expect a return to full normalcy will be long and drawn out.

In this environment, some REITs with weaker balance sheets and/or exposure to retail and tourism will be tested. However, our research indicates that most listed real estate companies are very well prepared to manage through this challenging period, and some may even benefit from increased reliance on technology and necessary services.

In this report, we seek to help investors understand the dynamics at work in the global real estate securities market, the durability of the cash flows and balance sheets, how our views have shifted based on the new reality, and how to assess fundamental value to make informed investment decisions.

Highlights

1. How the economic shock is affecting global real estate

- Real estate's underperformance in the first quarter stemmed from concerns over rising credit spreads and exposure to some of the industries that have been most affected by virus containment efforts.
- However, REIT cash flows should be more resilient than most industries in this environment, and the majority of property sectors (such as data centers, cell towers, industrial and hospitals) either stand to benefit from or are less impacted by job losses and social distancing.
- Additionally, central bank actions have helped to reduce credit spreads and provide liquidity.

2. What we are doing in our portfolios

- We are focusing on financially strong, liquid companies, balancing defensive positions with deep-value cyclical companies that we believe have been overly punished and offer significant upside potential in a recovery.
- Based on valuations and fundamental prospects, we prefer Asia, followed by the U.S. and then Europe.
- At the sector level, we are focused on companies that provide e-commerce infrastructure, as well as residential, self storage and health care.

3. Assessing fundamentals and value

- REIT balance sheets are generally in stronger shape than at any point in history, and most companies continue to have access to financing at very low rates despite wider credit spreads.
- Reduced development and the emergence of new property types over the past decade have made the REIT market structurally less cyclical.
- With public REITs trading at meaningful discounts to their intrinsic values, we see potential opportunities emerging for long-term investors to take advantage of market dislocations.

How the economic shock is affecting global real estate

In typical recessions, REITs' lease-based revenues and attractive dividends often provide a defensive cushion against economic uncertainty. In the current crisis, however, REITs have exposure to industries that have shut down or are experiencing significant disruptions, such as hotels, casinos, retail and senior housing. In addition, rising credit spreads have raised questions about access to reasonably priced capital. These two issues contributed to the worst drawdown for global REITs in over a decade, with the market falling 27% in the first quarter, compared with a 20% decline for global equities.(1)

We believe markets are overlooking several key factors.

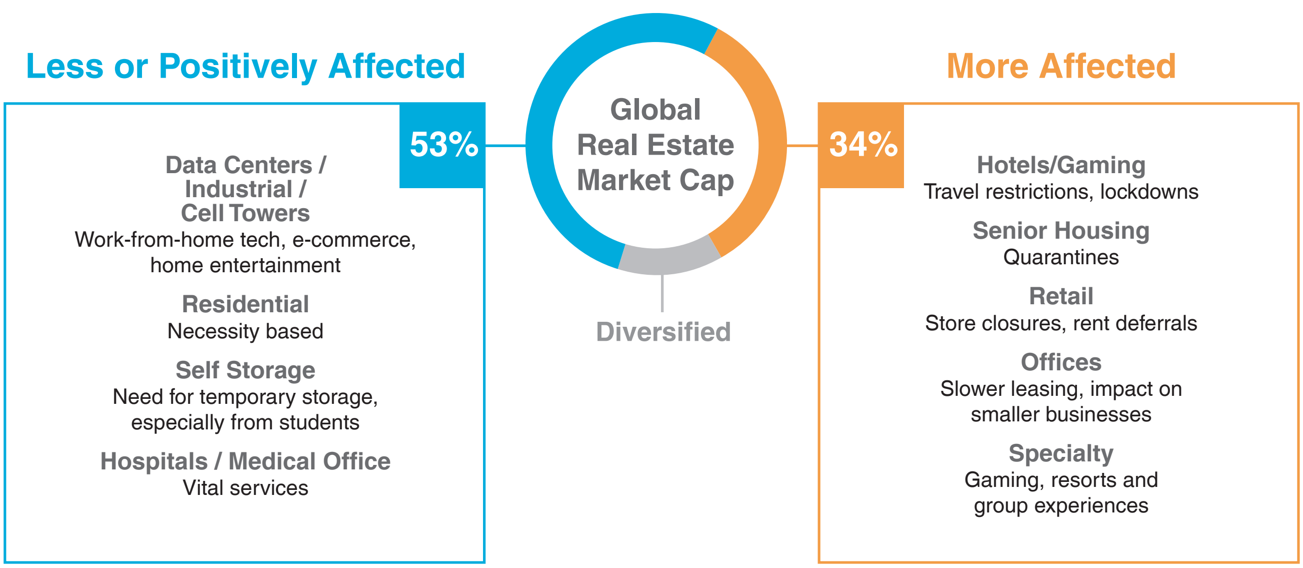
Certain REITs should see stronger demand in the crisis. Though some property sectors have been highly impacted, most areas of the market are experiencing either a positive or only modestly negative effect on demand, including data centers, cell towers, logistics and most health care properties (Ex. 1). Other REITs, such as offices, are being impacted in a manner consistent with most recessions.

REIT cash flows are still significantly more resilient than most equity investments. For our global REIT universe, we have reduced our 2020 earnings expectations from an initial outlook of 6% growth to a 4% contraction. While –4% earnings growth is a historically poor result for REITs, consider that earnings for broad equity indexes are consistently expected to decline by around 25% or more from 2019 levels.

Central bank actions should help keep credit flowing. Although we are in a recession—and recessions drive credit cycles—this is not a credit or financial crisis. The Federal Reserve cannot make people go to restaurants or travel, but it can be effective at supporting functioning credit markets, especially in the context of a significantly less levered financial system compared with 2008. As a result, high-quality companies may see a higher cost of capital (as is normal in recessions), but capital should be available.

Companies with high leverage going into the crisis and those with severe revenue disruptions will likely be challenged to manage their balance sheets over the next 12–18 months. However, average leverage for global REITs has declined significantly over the last decade and asset quality has generally improved. As a result, we believe public real estate companies are in a strong position in this challenging environment.

EXHIBIT 1: Global Real Estate and Social Distancing



At March 31, 2020. Source: FactSet, Cohen & Steers.

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(1) Returns quoted in local currencies.

E-commerce infrastructure vital to staying connected

Data centers are playing a critical role in helping sequestered populations connect to work and family. U.S. network carriers reported a 30% increase in virtual private network (VPN) traffic in a single week in March as companies instituted work-from-home policies. The shift of traffic from office to home is focusing companies on gaps in network capacity and security, which data center REITs are uniquely positioned to address.

Industrial properties continue to see strong demand amid the growing need for e-commerce fulfillment capabilities. Amazon announced plans to hire 100,000 warehouse and delivery workers amid the surge in online orders due to the coronavirus outbreak. Likewise, **cell towers** stand to benefit from increased carrier capital spending amid increasing wireless data usage. Verizon has already increased its capital guidance to accelerate the 5G rollout.

Health care and housing more necessary than ever

Hospitals and medical offices should continue to see strong demand through the crisis, while also featuring lease terms of 10 years or more that tend to provide a buffer against near-term economic swings.

Residential landlords in many countries entered 2020 with relatively healthy fundamentals. Layoffs and rent deferrals could impact near-term cash flows; however, in the medium term, we believe rental housing should hold up relatively well, as people increasingly value their home and their space, and may also be less inclined to move out and buy a home. Similarly, **self storage** companies in certain markets have been able to raise rents aggressively in response to strong demand, driven partly by students forced to vacate campuses.

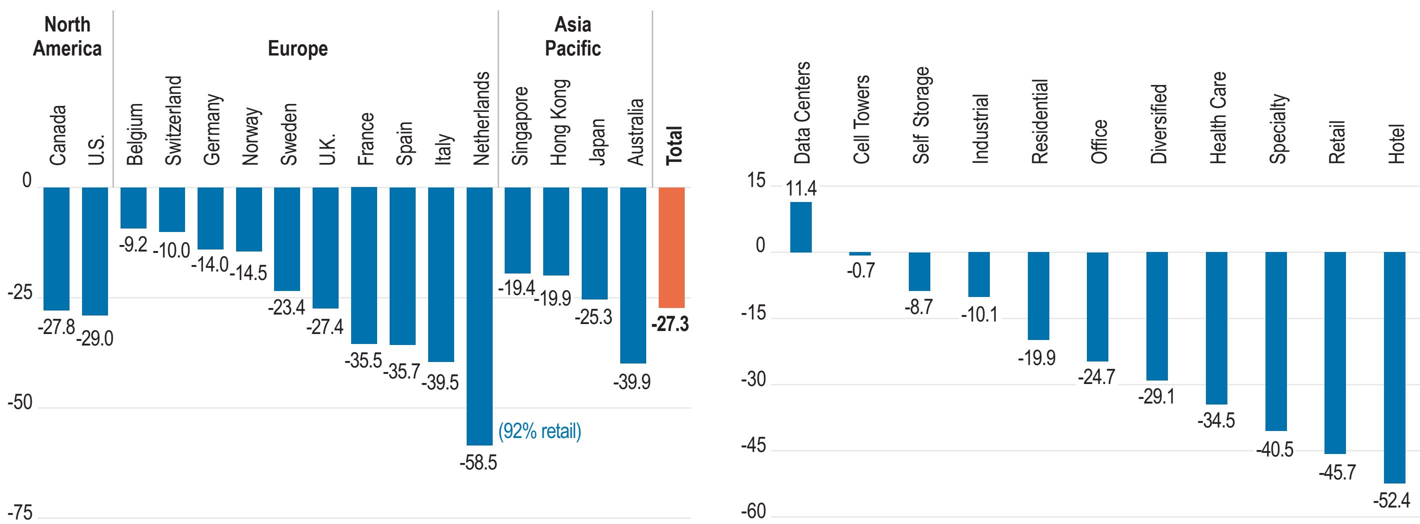
Hotels and retail severely impacted

The **hotel and gaming** industries have been devastated by the pandemic. Many properties have closed, while those able to remain open are seeing historic declines in occupancy and room rates as non-essential travel grinds to a halt. Also, restaurants tend to provide a significant portion of hotel and gaming revenue, and most have either shut down or are limited to takeout or delivery only. Europe and the U.S. are presently worse off (hotel occupancy in France has dropped as low as 3%[1]), whereas parts of Asia that are past the virus peak have begun to improve.

Retail landlords are working with tenants to offer rent deferrals or outright relief, as many retailers have closed stores or have cut back business hours. The crisis is also accelerating e-commerce adoption, as more consumers are being trained to shop online and could permanently shift certain spending away from physical stores. We anticipate lower-quality, higher-leveraged retail REITs—which have already been compromised by e-commerce—could face

EXHIBIT 2: Global Real Estate Securities Performance in 1Q 2020

Total Returns (%) in Local Currencies by Country and Global Property Sector



At March 31, 2020. Source: FactSet.

Data quoted represents past performance, which is no guarantee of future results. The charts above are for illustrative purposes only and do not reflect information about any fund or other account managed or serviced by Cohen & Steers. Represented by FTSE EPRA Nareit Developed Index, except cell towers (not in global index), represented by FTSE Nareit All Equity REITs Index. See back page for index definitions and additional disclosures.

(1) Source: SFR, March 2020.

solvency questions in the next few months. Nondiscretionary retail centers have been less affected, as grocery, pharmacy and discount stores have stayed open and are seeing a substantial increase in business.

Offices are likely to see slower leasing activity in the near term, and there could be more diversification of locations, including work-from-home arrangements. On the other hand, employers may be less prone to sitting workers as closely together in the future. Flex-office is likely to face material disruption, as these spaces operate with shorter lease terms, have dense working conditions and cater to smaller businesses that may be more vulnerable in a recession. This segment has been a large source of new demand in recent years, but disruption could eventually be a positive for office landlords, reversing the trend of workplace "densification."

Regional impact

U.S. REITs have seen a significant disparity among property types, with hotels and retail experiencing substantial declines and e-commerce REITs (data centers, cell towers and industrial) proving highly resilient. The divergence within health care has also been acute, depending largely on exposure to senior housing, which has been negatively impacted by increased mortality among elderly residents, reduced resident inflow due to quarantines and higher disinfectant expenses. Canada has been similarly affected by retail challenges, while its oil export industry in Western Canada has taken a severe hit from the rout in energy commodity prices.

Europe has generally held up better, with the exceptions of retail-heavy markets such as the Netherlands and France, as well as virus epicenters Italy and Spain. German apartments have continued to benefit from strong demand through the crisis despite uncertainty over Berlin rent freeze legislation. Office and retail specialists tend to be more cyclical and have struggled, whereas health care, storage and residential have remained consistently defensive.

Asia markets are seeing early signs of recovery despite China's severe economic downturn in the first quarter. We do not expect a quick "V-shaped" recovery, but the worst of the virus appears to be over in China. As with other markets, technology-focused properties were among the relative winners, while hotel and retail lagged. Australia has been a downside outlier, affected by its retail-heavy market and the impact of sharply lower commodity prices on resource exports.

What we are doing in our portfolios

Portfolio strategy

Our team in Hong Kong closely followed the potential impacts of the virus from the early stages of the outbreak, and we took swift measures to position more defensively in our portfolios. We have been in regular contact with REIT management teams, as well as with brokers, attorneys and tenants, to understand demand and market dynamics. Accordingly, we have ascribed conservative (and in some cases punitive) assumptions to our investment universe, marking down income growth expectations substantially.

With negative expectations now priced into the market, we are balancing defensive positions with deep-value cyclical companies that may offer significant upside in a recovery. We are also focusing on companies with the strongest balance sheets and high-quality tenants.

Regional preference ranking

1. **Asia:** We have added to China and other Asian markets, as economic activity is beginning to recover in markets where the virus threat is dissipating. We are focused on markets where the virus is more under control and where countries have fiscal and monetary capacity to support the economies.
2. **U.S.:** Virus containment measures are likely to increase in the weeks ahead, creating significant uncertainty. However, we see long-term fundamental value due to strong balance sheets, a domestic-focused economy and both the political will and capacity to enact further policy stimulus measures.
3. **Europe:** We have become more cautious on peripheral countries (especially Spain), although certain markets remain attractive. Governments and central banks are likely to provide significant social and financial support, but credit markets will be seriously tested, as some European banks remain undercapitalized. Europe's economy is particularly focused on tourism and trade, so may be more vulnerable in the medium term.
4. **Emerging markets:** EMs are the most vulnerable in our view, with lower health care capacity and more limited stimulus options, offset by younger demographics. We have little to no exposure to EMs in our global portfolios and are underweight in client portfolios that have the ability to invest in EMs.

Sector preferences

Positioning	Overweight	Underweight
Global	• Data centers and cell towers – e-commerce beneficiaries • Self storage – resilient in crisis • Industrial – demand for home delivery • Health care – part of the virus solution	• Retail – virus adds to challenging fundamentals • Office – reduced business confidence and denser tenant spaces
Changes	**Added**	**Reduced**
U.S.	• Cell towers – carriers accelerating spending to meet growing data needs • Health care – defensive and necessity based • Apartments – relatively healthy coastal markets • Hotels – strong franchises at deep discounts	• Office – slower leasing activity • Gaming – visitor traffic will be slow to resume • Retail – unrelenting pressure, but best operators positioned to gain market share
Europe	• German residential – defensive fundamentals and cash flows • Industrial – strong secular demand • Scandinavian specialists – attractive relative value and sound fundamentals	• Offices/retail – economically sensitive • Spanish offices – accelerating virus cases • Companies with potential balance sheet risks or dividend cuts
Asia Pacific	• China and Singapore residential – beneficiaries of stimulus • Japan REITs (apartments, logistics) – concerns largely priced in following recent underperformance	• Japan REITs (hotel, retail) – reducing cyclical exposure

Assessing fundamentals and value

With containment measures likely to become stricter in the coming weeks as infection rates escalate, we expect the hit to second-quarter growth will be on a scale without historical parallel. Since early March, our base case for global growth has shifted to a deeper contraction in the near term and a more gradual, U-shaped recovery starting late in the third quarter.

Despite the near-term challenges, we believe global REITs are in a much stronger position to manage through the current crisis than they were in 2008.

Balance sheets are stronger. Most real estate management teams have learned the lessons from the global financial crisis, strengthening their balance sheets, reducing leverage and laddering debt maturities to limit the risk of refinancing at a time of wide credit spreads. Certain hotel, gaming and retail companies, facing months without income, will likely see a liquidity crunch. However, we believe this is a non-issue for most property companies, including major franchises in troubled sectors such as hotels and retail.

Financing costs remain low. Many public real estate companies are able to raise debt capital at attractive levels due to low policy rates, healthy balance sheets and generally high-quality assets and tenants. We estimate the best REITs can raise 10-year debt at around 3.5% in the U.S., 2.5% in Europe and 1% in Japan.

The REIT universe is more diverse and less cyclical. The emergence of new specialty property types over the past decade has provided investors access to opportunities driven by secular themes, while also making the listed real estate market structurally less cyclical.

There is less development risk. A decade of less-than-dynamic economic growth has resulted in companies focusing more on operating properties than development, reducing the asset class's cyclicality.

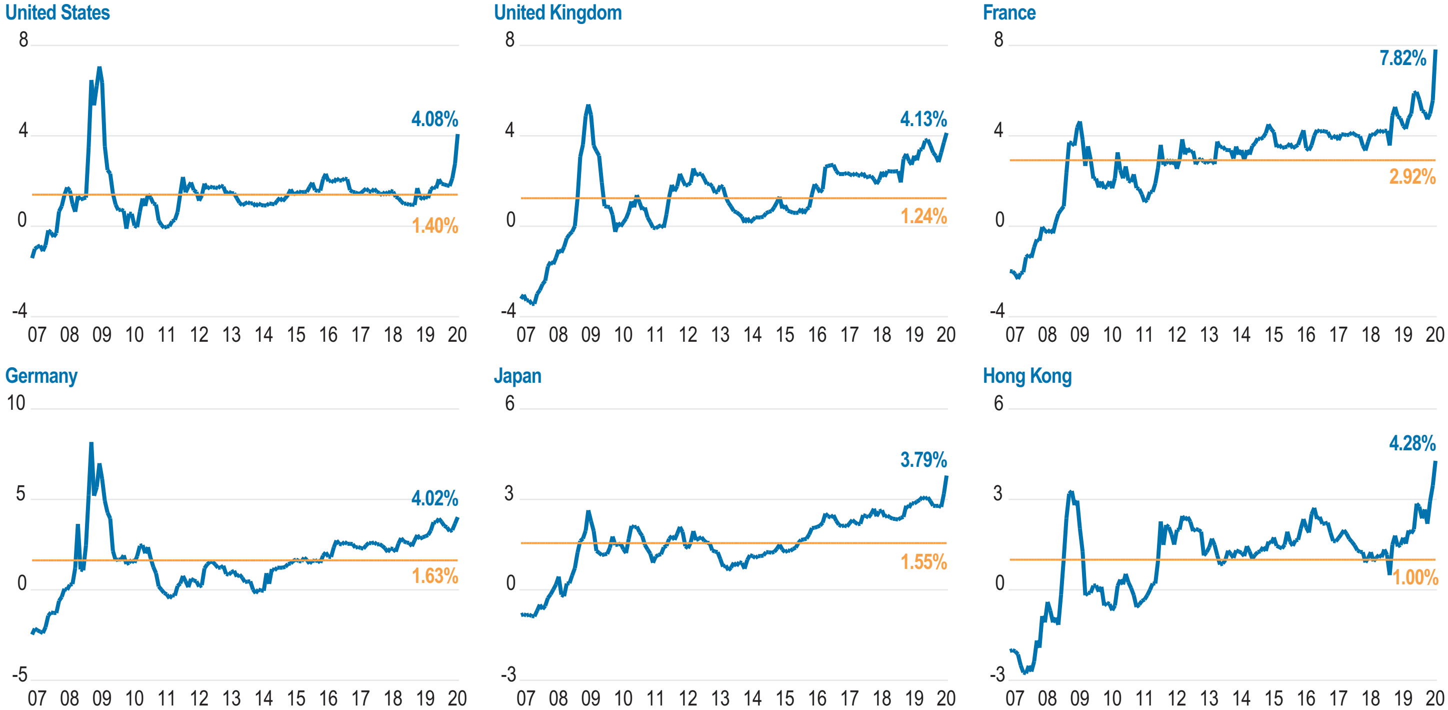
Policymakers are providing substantial relief. Governments and central banks have pulled out their playbooks from the global financial crisis, moving forcefully and quickly to provide liquidity, help companies avoid insolvency and provide relief to households and small businesses facing hardship. Once restrictions are relaxed, governments are prepared to pass additional fiscal measures to get economies moving again.

Valuations are at attractive levels relative to other asset classes. The spreads between REIT dividend yields and 10-year government bond rates are at historically wide levels across all major regions (Ex. 3). REIT earnings multiples are below those of broad equities (Ex. 4). And REITs are trading at 10–20% average discounts to the private-market value of their holdings (Ex. 5), as measured by our current net asset value (NAV) estimates.

EXHIBIT 3: REITs vs. Fixed Income[a]

Dividend Yield Spreads to 10Y Government Bond Rates

REITs are paying significant yield premiums relative to government bonds



At March 31, 2020. Source: Bloomberg, Nareit.

REIT earnings multiples are at multi-year lows and are below those of comparable broad equity indexes

REITs are trading at deep discounts to their private-market values

Exhibit 4: REITs vs. Equities[b]

Price to Funds from Operations vs. Price to Earnings

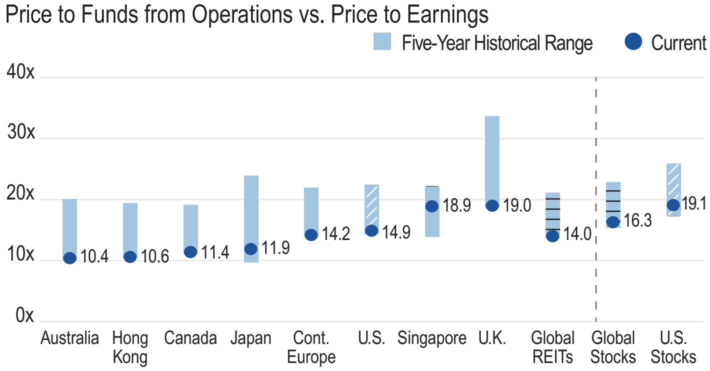
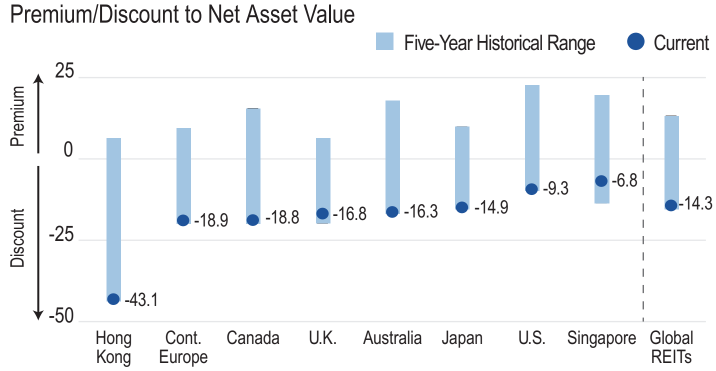


Exhibit 5: REITs vs. Private Real Estate[c]

Premium/Discount to Net Asset Value



At March 31, 2020. Source: Bloomberg, Nareit.

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(a) Weighted average dividend yield for all dividend paying stocks in the respective country as represented by the FTSE/EPRA Nareit Developed Index. 10-year government bond rates represented by each country's generic 10-year government bond yield. (b) Funds from operations (FFO) is the REIT industry's key earnings metric, calculated as GAAP net income, plus real estate gains (minus real estate losses), plus GAAP real estate depreciation and amortization. U.S. stocks represented by the weighted harmonic average P/E multiple of the Russell 3000 Index. Global stocks represented by the weighted harmonic average P/E multiple based on the MSCI World Index. (c) Net asset value seeks to calculate the net market value of a company's assets after subtracting liabilities. See back page for index definitions and additional disclosures.

Conclusion

We expect the global economy to remain in hibernation through the end of the second quarter and to reawaken over the second half of the year. While the shape and magnitude of the recovery in 2020 is uncertain, the commitment of policymakers gives us confidence that the economy will eventually come out of this shock with significant demand at a time of record easy monetary conditions.

No one can perfectly call a market bottom. However, we believe there are attractive discounted valuations in REITs. Additionally, the arbitrage opportunity versus private real estate is more pronounced than we have seen in many years.

For historical perspective, there have been three U.S. recession periods since the inception of the FTSE EPRA Nareit Developed Index. On average, global REITs recovered faster than broad global equities, benefiting from reaccelerating demand and low interest rates (Ex. 6). The U.S. REIT market shows similar results over an even longer history of data, spanning the past six recessions.

An arbitrage opportunity for private real estate investors

The historic decline in listed real estate share prices has resulted in NAV discounts not seen in years. Based on our marked-down estimates of private-market values, global REITs are trading at a 14% average discount and U.S. REITs are trading at a 9% average discount (Ex. 5). Prices of listed and private real estate may diverge in the short term, but prolonged dislocations tend to be unsustainable, as real estate companies and other investors may take advantage of arbitrage opportunities, buying assets in whichever market offers greater value.

Due to the lead-lag relationship between listed and private real estate valuations—resulting from delays in private-market appraisals—we expect private market NAVs to decline significantly over the next several quarters. For private real estate investors able to redeem funds, or those with liquidity reserves who intend to increase allocations to real estate, we strongly believe this represents a compelling opportunity to take advantage of the significant dislocation between listed and private market values.

EXHIBIT 6: Real Estate Performance Following Recessions

Global		Recession Performance			Returns 6 Months After Recession End			Returns 1 Year After Recession End		
Recession Start	Recession End	REITs	Stocks	*Difference*	REITs	Stocks	*Difference*	REITs	Stocks	*Difference*
Jul-90	Mar-91	-7.8%	-2.4%	*-5.4%*	0.6%	3.4%	*-2.8%*	-8.2%	-1.1%	*-7.1%*
Mar-01	Nov-01	-0.7%	-5.2%	*4.5%*	13.9%	-2.3%	*16.2%*	4.3%	-15.3%	*19.6%*
Dec-07	Jun-09	-44.6%	-36.9%	*-7.7%*	30.6%	22.2%	*8.4%*	25.1%	10.2%	*14.8%*
Average		**-17.7%**	**-14.8%**	***-2.9%***	**15.0%**	**7.8%**	***7.3%***	**7.1%**	**-2.1%**	***9.1%***

United States		Recession Performance			Returns 6 Months After Recession End			Returns 1 Year After Recession End		
Recession Start	Recession End	REITs	Stocks	*Difference*	REITs	Stocks	*Difference*	REITs	Stocks	*Difference*
Nov-73	Mar-75	-5.8%	-7.8%	*2.0%*	-2.2%	2.7%	*-4.9%*	18.9%	28.3%	*-9.4%*
Jan-80	Jul-80	7.4%	9.6%	*-2.2%*	9.9%	9.1%	*0.9%*	16.8%	13.0%	*3.8%*
Jul-81	Nov-82	15.9%	14.2%	*1.7%*	25.0%	19.9%	*5.1%*	29.1%	25.6%	*3.5%*
Jul-90	Mar-91	9.2%	8.0%	*1.2%*	4.9%	5.1%	*-0.2%*	11.3%	11.0%	*0.2%*
Mar-01	Nov-01	10.8%	-0.9%	*11.7%*	13.4%	-5.7%	*19.0%*	5.6%	-16.5%	*22.1%*
Dec-07	Jun-09	-45.3%	-35.0%	*-10.3%*	45.8%	22.6%	*23.2%*	53.9%	14.4%	*39.5%*
Average		**-1.3%**	**-2.0%**	***0.7%***	**16.1%**	**9.0%**	***7.2%***	**22.6%**	**12.6%**	***10.0%***

At March 31, 2020. Source: Bloomberg, Cohen & Steers.

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Index Definitions. *An investor cannot invest directly in an index and index performance does not reflect the deduction of any fees, expenses or taxes. Index comparisons have limitations as volatility and other characteristics may differ from a particular investment.*

Global REITs: FTSE EPRA Nareit Developed Index 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: The MSCI World Index is a free-float-adjusted index that measures performance of large- and mid-capitalization companies representing developed market countries and is net of dividend withholding taxes.

U.S. REITs: The FTSE NAREIT All Equity REITs Index contains all tax-qualified 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: Exhibit 6: 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. Exhibit 4: The Russell 3000 Index is a market capitalization weighted equity index maintained by the Russell Investment Group that encompasses the 3,000 largest U.S.-traded stocks, in which the underlying companies are all incorporated in the U.S.

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