

# A Modern Perspective on REITs

## Looking Ahead to '21 and Beyond

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As REITs emerge from the Great Shutdown of 2020, Cohen & Steers is finding attractive opportunities across the market—from cyclical property sectors that should benefit from economic reopening, to REITs that own the buildings that make e-commerce and cloud computing possible.

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### Two sides to REITs in the pandemic

Though many headlines have focused on properties severely affected by the shutdown, other sectors have benefited from the acceleration of e-commerce and remote computing. Rent collections have remained above 90% in most REIT sectors, and earnings have been far more resilient than those of the broader market.

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### What could drive a recovery?

REITs have historically delivered their best returns in the early stages of a recovery and are coming off a period of material underperformance. We believe greater clarity on a vaccine and a path toward economic reopening could be strong catalysts for REIT share prices.

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### Positioning REIT portfolios post-2020

We have organized opportunities into four categories: vaccine-driven recovery (apartments, health care, gaming, student housing), economic-driven recovery (self storage, homebuilders, timber), secular beneficiaries (industrial, data centers, cell towers, single-family rental), and structural challenges (offices, retail, hotels).

## Two sides to REITs in the pandemic

### Not all property types have been hurt by the shutdown

REITs had disappointing returns through the majority of 2020, as certain real estate businesses were among the most negatively affected by the economic shutdown. However, the impact was far from uniform, and hardest-hit REIT sectors could perform especially well as vaccines become available.

Hotels felt the effects of social distancing immediately, with occupancy rates falling below 20% globally. Retail tenants, already dealing with oversupply and the incursion of e-commerce, had to curtail business hours. Office leasing has slowed as companies reassess their future needs. Senior housing facilities have been especially vulnerable to contagion. Even apartments, especially in major gateway cities, experienced increasing vacancy rates as residents flocked to the suburbs and cohabitated with family.

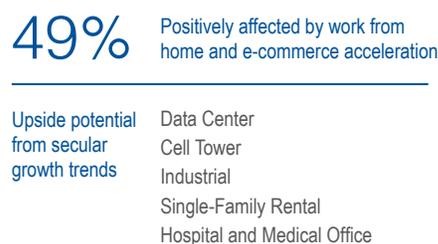
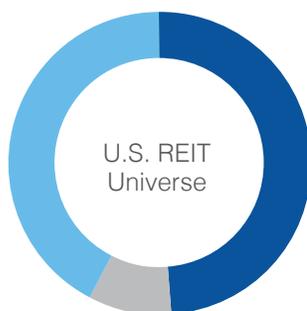
Other areas of real estate have seen increasing demand, benefiting from remote working and the acceleration of e-commerce. The growth of online shopping, video streaming and data networking is driving demand for data centers, while cell towers are working with wireless carriers to roll out 5G networks. Industrial warehouses are at the center of online commerce, enabling fulfillment of home delivery. And the urban exodus that has hurt apartments has been positive for single-family rentals, which are attracting residents seeking more space.

### Rent collections and earnings have remained resilient

Despite the positive impact on certain REIT sectors, headlines about empty offices, deserted malls and quarantined senior housing facilities contributed to a generally cautious view of real estate. There was also a misperception that many landlords were unable to collect rent during the crisis. The truth is that rent collections remained above 90% for most REIT sectors throughout the year, including offices and apartments.<sup>1</sup> Retail landlords experienced a temporary drop in rent collections early in the pandemic, but most tenants resumed rent payments as lockdowns were lifted in favor of “safe reopenings.”

Fortunately, REITs entered 2020 in healthy financial shape overall, while the Federal Reserve’s emergency measures have kept credit flowing, providing both landlords and tenants critical access to capital. REIT earnings have also been relatively resilient, projected to decline less than 10% in 2020, compared with a decline of more than 20% for the S&P 500, helped by resilient cash flows tied to leases.<sup>2</sup>

### Pandemic effect on REIT sectors: % of total market capitalization



At September 30, 2020. Source: Cohen & Steers, FactSet.

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<sup>1</sup>Source: Nareit, October 2020.  
<sup>2</sup>Source: Citigroup estimates, September 2020.

# What could drive a recovery?

The potential silver lining for investors is that U.S. REITs have historically delivered their strongest returns—both in absolute terms and relative to broader equities—in the early stages of economic recoveries. Since the early 1990s, U.S. REITs have averaged about a 23% annual return in such periods, compared with just over 11% for the S&P 500. Furthermore, U.S. REITs are coming off a period of meaningful underperformance, potentially giving them more room to run. We believe two likely catalysts for REIT share prices are the prospect of a widely distributed vaccine and a path toward economic reopening.

## Getting healthy

Before the economy can fully reopen, the virus needs to be brought under control. Vaccine trials are already showing success, and markets have responded enthusiastically to news of progress. Wide availability may take months, with vaccinations prioritized for front-line health workers, then at-risk individuals and the elderly, followed by the general population. However, if investors are confident a solution is on the way, they may look through near-term spikes in virus cases.

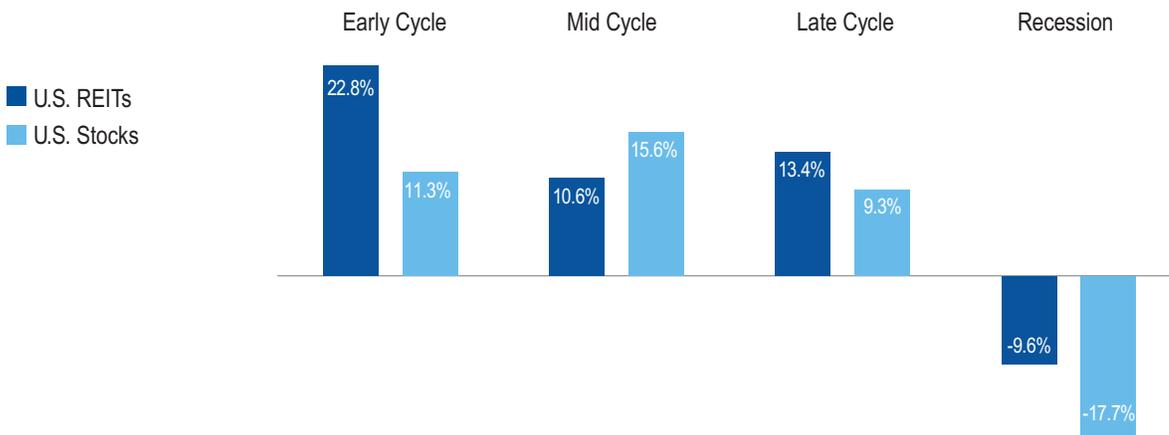
## Reopening the economy

A viable vaccine will potentially pave the way for businesses to gradually resume onsite operations at full capacity. Employees will be able to return to offices, stores and factories under safe

conditions. Businesses will need to rehire workers to meet demand. Consumers will start to feel more comfortable going into shops, restaurants and theaters. Eventually, hotels should see business and leisure travel start to pick up. And because the elderly are likely to receive vaccines early, that could boost senior housing and skilled nursing demand. However, a return to normalcy is just the beginning—a broader economic recovery will likely take time, as many businesses were forced to shut down, and individuals that were unemployed for an extended period may find it difficult to quickly re-enter the workforce. A strong fiscal response from governments could help accelerate this process significantly.

## U.S. REITs have outperformed in early economic expansions

Average annualized returns, 1991–2019



At December 31, 2019 (end of most recent full economic cycle). Source: The Conference Board, National Bureau of Economic Research, Morningstar, Cohen & Steers.

**Data quoted represents past performance, which is no guarantee of future results.** This chart is for illustrative purposes only and does not reflect information about any fund or other account managed or serviced by Cohen & Steers. There is no guarantee that any historical trend illustrated above will be repeated in the future, and there is no way to predict precisely when such a trend will begin. 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. Average of annualized monthly returns (348 total periods), grouped by phase. Expansion subdivisions determined by Cohen & Steers based on major trends in the Conference Board Coincident Index (CBCI): Early cycle—CBCI accelerating (104 months); Mid cycle—CBCI stable (180 months); Late cycle—CBCI decelerating (36 months). Recessions as reported by NBER (28 months). Analysis focuses on post-1991 period—considered the “modern REIT era” due to evolution of the REIT structure, breadth and size of the market and overall liquidity, which we believe is representative of the current U.S. REIT investment universe and characteristics. See page 7 for index associations, definitions and additional disclosures.

## Positioning REIT portfolios post-2020

As the process above moves forward, we believe property sectors that were most negatively affected by the pandemic may see the greatest benefit from a vaccine and an economic recovery. The pandemic has also accelerated existing secular trends such as the growth of e-commerce. Other real estate businesses are likely to see lasting structural challenges, although certain companies may be in a strong position to capture market share.

### Secular beneficiaries



#### Industrial warehouses

##### Surge in online retail

E-commerce sales, which had been growing at about 15% per year through much of the 2010s, jumped to a 44% annual pace in mid-2020, spurring demand for modern logistics facilities to manage the flow of inventory. The push by online retailers to provide next-day delivery has further intensified demand for better inventory management and fulfillment.

##### Cold storage, a new frontier

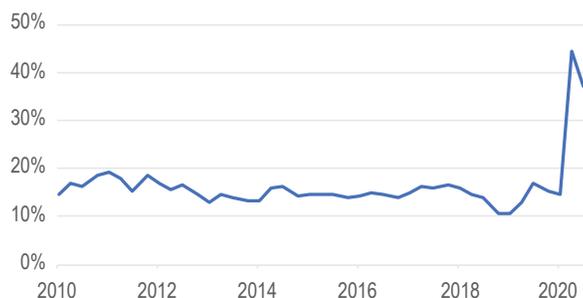
The pandemic also put a spotlight on specialized refrigerated storage facilities as more people began cooking at home and stocking up on staples. We see this as a long-term growth opportunity as consumers become more accustomed to the safety and convenience of online grocery shopping, potentially driving e-commerce disruption in yet another market.

##### Industrial long-term growth

Leading industrial landlords have reported that lease rates are now exceeding pre-COVID levels in most

major markets. Reflecting strong fundamentals and demand prospects, we have raised our industrial property value estimates by about 20% on average since early 2020.

##### U.S. e-commerce sales growth tripled in 2020



At September 30, 2020. Source: U.S. Census Bureau. There is no guarantee that any historical trend illustrated above will be repeated in the future, and there is no way to predict precisely when such a trend will begin. See page 7 for additional disclosures.



#### Data centers and cell towers

##### Video streaming and conferencing

The growing reliance on digital platforms to manage remote work, education, entertainment and social interactions during the pandemic is driving the need for secure exchanges where service providers can connect on neutral territory—something data center REITs are uniquely positioned to provide.

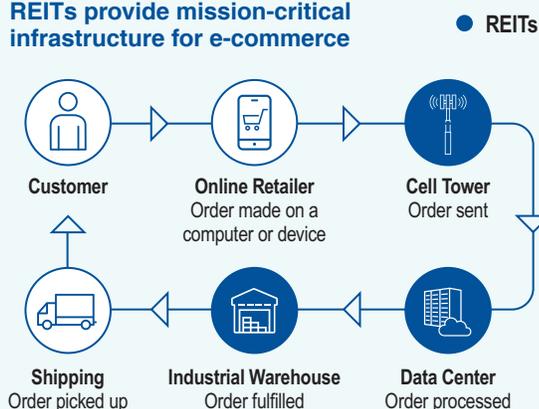
##### The race to build 5G infrastructure

We believe towers are at an inflection point for increasing demand amid a multi-year investment cycle in wireless infrastructure. Despite a temporary decline in wireless data usage (as more users access data over their home WiFi), network providers are ramping up spending for 5G, requiring more leased space from cell tower companies to house communications equipment.

##### Room to run

These two sectors make up a third of the U.S. REIT market and have been strong performers over the past year. Though our positioning at any given time reflects our view of relative value, we continue to have conviction in the long-term growth story.

#### REITs provide mission-critical infrastructure for e-commerce



Every online purchase sets a sequence in motion that travels through a network of communications, data and industrial facilities, many of which are owned by REITs

At October 30, 2020. Source: Cohen & Steers. This chart is for illustrative purposes only. See page 7 for additional disclosures.

## Vaccine-driven recovery

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### Health care

#### Rebuilding senior housing occupancy

Senior housing centers lost significant occupancy during quarantine and therefore could be early beneficiaries of a vaccine, which should enable operators to accept new occupants. Top senior housing REITs are now collecting nearly 100% of rents on their net lease assets, the vast majority of properties have reopened, and aggressive (and costly) cleaning protocols have been highly successful at limiting new virus cases.

#### Medical research takes center stage

Life science companies, which were doing well before the pandemic, have since seen accelerated demand.

Financial backing is strong, with more money raised for life science research in 2020 than in any previous year. We believe these trends will continue amid greater awareness of the vital role of biotech research.

#### Increasing our allocation

After a decade of being underweight health care REITs, the sector has become one of our largest allocations based on attractive relative values and the prospect of long-term, needs-based demand: the growth rate of the 80+ age group is projected to double in the next three years.<sup>3</sup>



### Apartments

#### The great migration

The pandemic has caused many to migrate from cities to the suburbs in search of more space. Job losses have had an uneven effect on occupancies: higher-income markets such as certain sunbelt suburban areas have fared better, while tourism- and energy-focused cities have been severely affected.

#### Returning to work

A vaccine could be a major catalyst for both job growth and household formation (emerging from pandemic

cohabitation), potentially benefiting apartment REITs. We also expect single-family rentals to benefit from a continued flight to suburbia.

#### Favorable demographics

Total housing supply remains well below historical averages at a time when the Millennial generation is forming families, which should eventually restore occupancy rates and support steady rent growth.

## Economic-driven recovery

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### Self storage

#### Freeing up living space

After initially seeing a hit to rents during the shutdown, self storage companies experienced a significant rise in demand, due in part to quarantined dwellers anticipating the need to create usable living space. Our proprietary “web scraping” tool shows that storage unit rates increased by high single-digit percentages in the third quarter versus the prior year.

#### Work-from-home beneficiaries

We expect demand to continue, particularly in coastal markets, as residents relocate outside of major cities and work from home becomes more prevalent.

#### Defensive cash flows

These businesses tend to be relatively less cyclical, as people tend to sacrifice other expenses before giving up belongings kept in storage. However, an economic recovery could accelerate demand due to increased moving activity as job growth improves.

<sup>3</sup> Source: Green Street, September 2020.

## Structural challenges

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### Offices

#### **Out of the office, into the home**

The work-from-home experiment of the shutdown has shown many companies they can operate with little or no impact on productivity. This, in addition to the economic fallout from the pandemic, has resulted in extremely low levels of new leasing activity as managements consider reducing their office space in the future.

#### **A long-term headwind**

We estimate a growing remote workforce could reduce office demand by 5–10% over time. Preference for enhanced cleaning and safety measures and more space per employee will likely push demand towards

newer buildings, potentially forcing older buildings to upgrade their facilities to remain competitive.

#### **Focusing on TAMI tenants**

We see value in select office companies with more modern buildings; while it is unclear how work-from-home trends will affect specific industries, markets with greater exposure to technology, advertising, media and information (TAMI) companies may be well positioned. These sectors have benefited from increased technology adoption, which could lead to outsized job growth compared with other office-using industries.

### Retail

#### **Near-term boost, but long-term challenges**

Economic reopening and a widely distributed vaccine should benefit retail owners considerably, in our view. However, the industry remains challenged by losses to e-commerce, retailer bankruptcies and shifting consumer spending from goods to experiences, services and media subscriptions. In shopping centers, grocery businesses are contending with the growing popularity of web-based grocers and waning profitability.

#### **The Class A advantage**

Mall owners with high-quality assets in prime markets are seeing better rent collections and have the capital to repurpose vacated space to create lifestyle

destinations featuring upscale restaurants, movie theaters, health care services and other attractions. By contrast, we expect many weaker malls will be forced to shut down in the coming years, helping to reduce retail oversupply.

#### **Select value opportunities**

Following severe share price declines, we believe weak retail fundamentals are largely reflected in valuations, creating opportunities to enter strong, well-run companies at attractive levels.

### Hotels

#### **A heavy toll**

No sector has been more impacted by COVID than hotels, as the industry relies heavily on business travel and convention business, which have essentially come to a halt. Occupancies have risen to just below 50% globally, but smaller companies with limited liquidity continue to face severe cash flow issues.

#### **A prolonged recovery**

We believe a return to normal will take much longer for hotels than for other businesses, as many companies may continue to limit non-essential business travel due to lingering safety concerns and cost savings from virtual meetings.

#### **Opportunities in major brands and gaming**

We are finding value in large companies that we believe have the financial strength to weather an extended period of reduced revenues. We also favor gaming companies, which are more tied to leisure travel and which could rebound much faster with the distribution of a vaccine.

# An attractive opportunity for long-term investors

Taking a broad view on REITs, we believe the group is in a strong position for 2021. Just as COVID upended the REIT market in 2020, we believe it could be a prime beneficiary of a vaccine and a potential economic recovery. REITs also provide access to dynamic secular investment themes, including infrastructure that supports the growth of e-commerce.

After a disappointing year, REITs appear to offer historic relative value compared with a broader equity market that has set record highs. Though there may be further volatility in the near term, we believe that two or three years from now, investors will likely look back on this time as an attractive entry point for REITs.



**Potential catalysts from a vaccine, economic recovery and long-term secular growth trends**



**Historic value in REITs after a year of material underperformance**



**Low interest rates and increasing fiscal spending globally**



**Relatively durable earnings and dividends**



**Healthy balance sheets and access to low-cost financing**

## 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.*

**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:** 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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