COHEN & STEERS

REIT investing and the active advantage

by Jon Cheigh and Jason Yablon

Managers who specialize in REITs have historically had high success rates delivering excess returns, capitalizing on the diversity and complexity of the listed real estate universe.

Listed real estate has historically been well suited for generating alpha

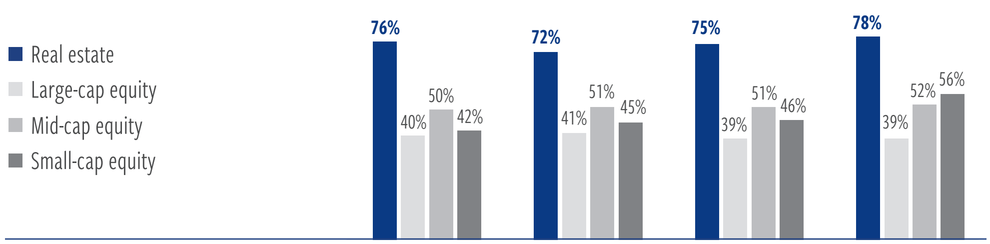
Over the past 10 years, global and U.S. real estate managers have outperformed their benchmarks at nearly twice the rate of large-cap equity managers, and the magnitude of excess returns versus passive real estate strategies has often been significant (Exhibit 1). For example, in 2020, the median global REIT manager outperformed the market by 4.2%, helping to mitigate the challenging effects of the pandemic on certain types of real estate.

We believe this advantage stems from the time and resources REIT managers devote to understanding current real estate fundamentals and the factors that may affect listed equity performance. This focus creates the potential for better-quality information, more accurate forecasts and faster implementation of investment ideas, achieved simply because these managers are more attuned to shifting market trends. By contrast, real estate tends to receive little attention from generalist managers, accounting for just 3% of the MSCI World Index.

EXHIBIT 1

REIT managers have a track record of delivering value

% of global and U.S. managers that outperformed their benchmark



	Annualized total return (%)	1 year	3 years	5 years	10 years
Global real estate	Global real estate index	-8.2	2.5	4.7	6.3
	Active manager median	-4.0	4.3	5.5	7.0
	CNS Global Realty Total Return	-2.0	6.1	7.4	7.6
	CNS Global Realty Focus	-0.5	8.3	10.7	10.0
U.S. real estate	U.S. real estate index	-5.1	5.3	5.9	8.9
	Active manager median	-3.5	5.8	6.4	9.4
	CNS U.S. Realty Total Return	-2.0	8.6	8.1	10.4
	CNS U.S. Realty Focus	1.9	9.0	10.2	12.0

At December 31, 2020. Source: eVestment Alliance, Cohen & Steers analysis. **Data represents past performance, which is no guarantee of future results.** There is no guarantee that investors will experience the type of performance reflected above. Data includes current managers with performance records spanning the full period in question. Managers represented in respective eVestment categories: global and U.S. real estate active managers: 1Y (161); 3Y (153); 5Y (144); 10Y (102); global real estate active managers: 1Y (97); 3Y (92); 5Y (86); 10Y (55); global real estate passive managers: 1Y (7); 3Y (7); 5Y (6); 10Y (3); U.S. real estate active managers: 1Y (64); 3Y (61); 5Y (58); 10Y (47); U.S. real estate passive managers: 1Y (8); 3Y (8); 5Y (8); 10Y (5); large-cap equity: 1Y (1085); 3Y (1063); 5Y (996); 10Y (842); mid-cap equity: 1Y (279); 3Y (274); 5Y (262); 10Y (234); small-cap equity 1Y (621); 3Y (607); 5Y (579); 10Y (507). See page 4 for benchmark associations, definitions and additional disclosures.

KEY TAKEAWAYS

Over the past decade, 78% of REIT managers have exceeded their benchmarks, delivering a measurable advantage over passive strategies, on average.

Distinct characteristics across 17 property types and dozens of countries provide opportunities for active managers to potentially add value.

Fundamental research is the foundation for active management, incorporating macro-economic, sector and security-level inputs into portfolio construction.

Capitalizing on sector and country performance dispersion

Distinct characteristics often produce divergent returns

The listed real estate universe encompasses 17 major property types, spanning dozens of developed and emerging markets. Each sector has distinct characteristics, including lease durations, types of tenants, economic drivers and supply cycles. Countries and regions may also have different property cycles, monetary policies and business practices. These factors typically result in a wide dispersion of returns in any given period (Exhibit 2). By understanding the characteristics of various real estate markets, active managers may emphasize areas they believe are most likely to perform well in the current market environment.

For example, in 2020, retail, offices and hotels experienced significant disruption due to the pandemic, whereas data centers and industrial warehouses benefited from increasing reliance on e-commerce and digital platforms. Over a typical market cycle, more economically sensitive sectors with short lease terms, such as hotels or self storage, may outperform in periods of accelerating demand, as they can adjust rents relatively quickly. By contrast, longer-lease sectors like net lease and health care may be more resilient during economic downturns due to their more defensive cash flows.

Because of the diversity of listed real estate, specialist managers are often able to take advantage of economic and sector growth opportunities.

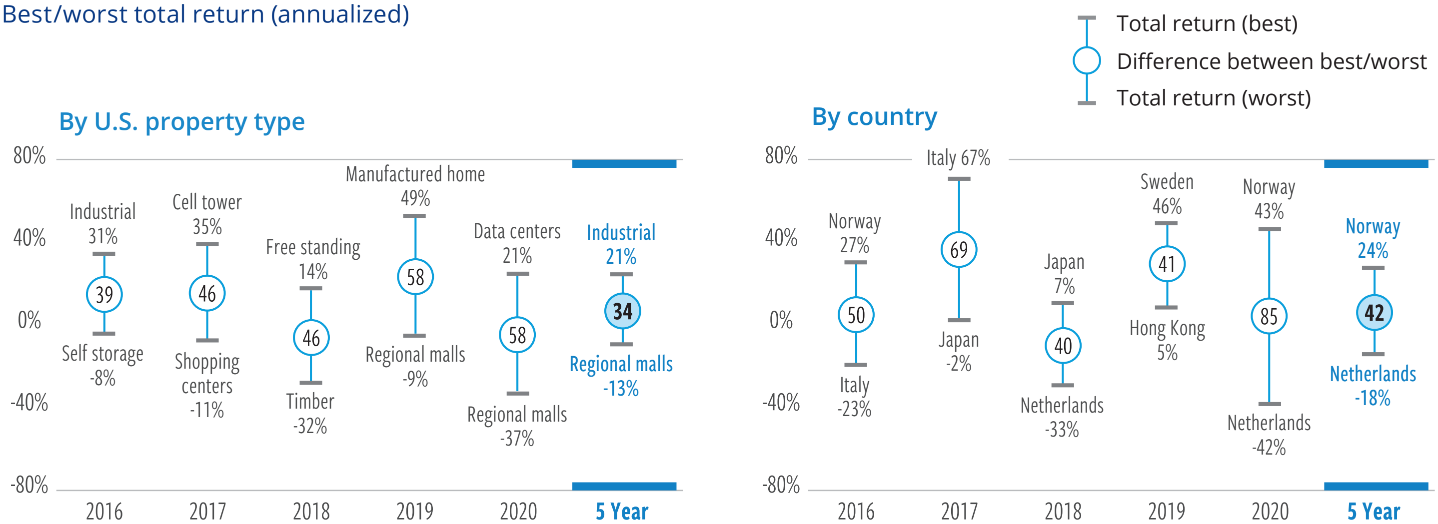
Positioning for secular growth and avoiding structural challenges

Over the past five years, technology-related REITs—including industrial, data centers and cell towers—have outperformed regional malls by more than 30% on average, due largely to the growing impact of e-commerce. Real estate investors will likely face other tectonic shifts in the coming years—changes in office utilization due to the impact of work-from-home policies, residents moving from apartments in dense cities to suburban markets or lower-cost states, and the need for digital infrastructure to meet the demands of growing data traffic. By design, passive portfolios are not able to allocate assets to benefit from potential secular growth opportunities, nor can they sidestep potential sector calamities.

EXHIBIT 2

Performance dispersion creates potential for active managers to add value

Best/worst total return (annualized)



At December 31, 2020. Source: Morningstar, Cohen & Steers.

Data quoted represents past performance, which is no guarantee of future results. Sector returns based on FTSE Nareit All Equity REITs Index; country returns based on FTSE EPRA Nareit Developed Index. 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. See page 4 for index associations, definitions and additional disclosures.

Identifying potential value through fundamental research

Fundamental analysis is often the foundation of active management

Understanding the many drivers that may affect a real estate company's financial performance requires a commitment to fundamental research. For example, in a typical year, Cohen & Steers may conduct 300 property visits and 1,300 meetings with management teams, seek local perspective from independent brokers, and leverage proprietary data sets, such as web scraping tools that provide unit pricing information in real time. Using inputs such as these, plus a view on future supply and demand, a REIT manager can often take a differentiated view on where cash flow and asset values are pointing to in the future. They can then identify securities that may be underpriced relative to the value of their property holdings (net asset value) and cash flow growth prospects (using a dividend discount model).

The listed real estate market is historically inefficient, as generalist and passive investors can collectively dominate ownership. As such, specialist managers can seek to leverage the information advantage they hold—their deeper insights into factors that drive sector and company performance—to uncover unique opportunities.

Integrating ESG factors into investment decisions

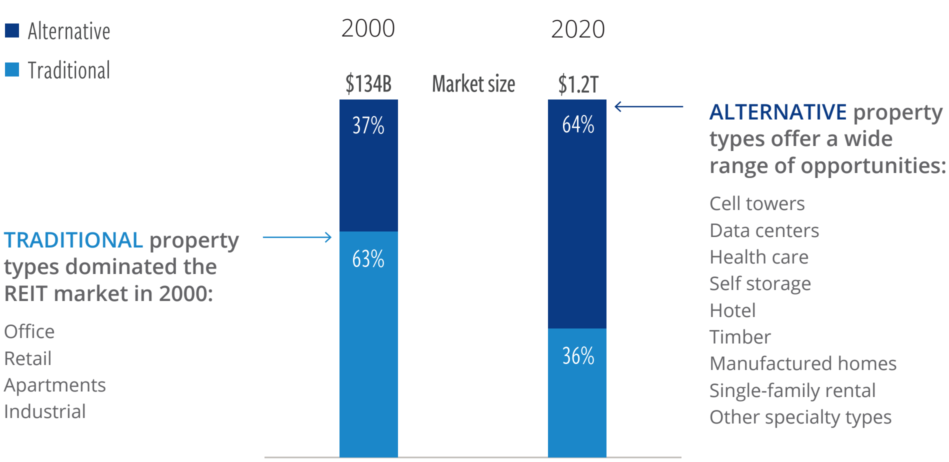
Some managers seek to understand environmental, social and governance (ESG) factors that may affect a company's ability to enhance long-term shareholder value and mitigate potential risks. Each manager approaches this process differently. At Cohen & Steers, we develop proprietary ESG scores for individual companies, incorporating them into valuation calculations that drive portfolio construction decisions. Learn about ESG investment integration at Cohen & Steers.

Growth of the listed real estate market, combined with the evolution of alternative property types, has given specialist managers more opportunities to find potential value.

EXHIBIT 3

More REIT sectors require more resources to provide depth of coverage

U.S. REIT market composition by sector



At December 31, 2020. Source: FTSE Nareit, Cohen & Steers.

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Current market dynamics benefit active management

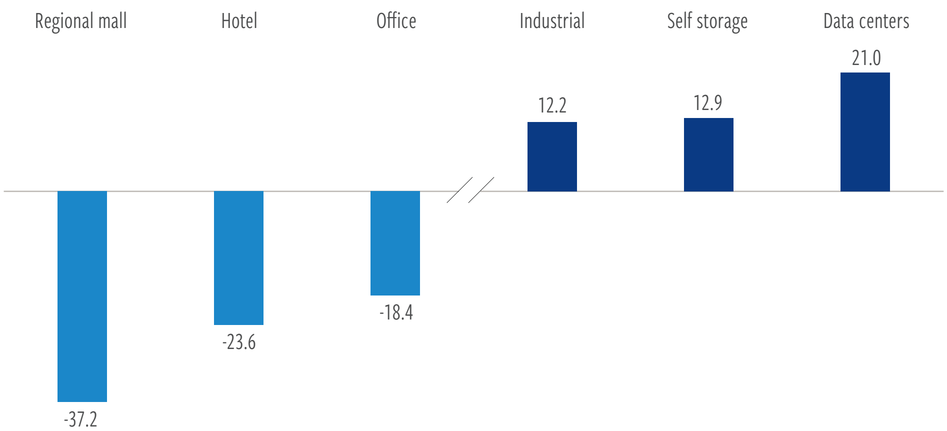
The wide dispersion in REIT performance in 2020, illustrated below, shows how the pandemic has impacted areas of the market in different ways (Exhibit 4). We believe different property types are likely to have varying experiences through the economic recovery, especially in an environment of rising interest rates and inflation. In addition, many sectors and cities may feel lasting effects from shifting trends in consumer preferences, demographics and workplace practices. The analysis required to understand these dynamics should not be underestimated, underscoring the importance of fundamental research—the foundation of active management.

As economies recover from the pandemic, different property types are likely to respond in various ways, putting a focus on the value of fundamental research.

EXHIBIT 4

Today's divergent sector dynamics highlight the need for well-designed portfolios

2020 performance (%), selected U.S. REIT sectors



At December 31, 2020. Source: Morningstar, Cohen & Steers.
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