COHEN & STEERS

REITs well positioned for a Grand Reopening

by Jon Cheigh and Jason Yablon

Vaccines, policy and consumer trends are uniting to create opportunities across the real estate landscape, setting up 2021 as a potentially strong "vintage year" for REITs.

Looking to a vaccine-driven recovery

Just as the pandemic upended certain types of real estate in 2020, we believe progress in vaccine distribution and fiscal stimulus are creating the potential for a Grand Reopening that could directly benefit some of the most impacted REIT sectors.

The U.S. is vaccinating around 2 million people per day, and more Americans have now had their second vaccine dose than have been diagnosed with COVID-19 since the start of the pandemic, prompting officials to begin lifting restrictions.(1) Extraordinary fiscal relief measures are adding to economic recovery expectations, including nearly $2 trillion in new U.S. COVID relief on top of $3 trillion approved in 2020. With other developed economies also ramping up vaccine distributions, we believe 2021 could offer attractive entry points for allocating to real estate.

KEY TAKEAWAYS

Vaccination progress and fiscal relief stand to directly benefit sectors impacted by the pandemic

REITs appear attractively valued relative to stocks entering what has historically been a favorable early-cycle environment

We see opportunities in cyclical/value plays, e-commerce infrastructure and work-from-home beneficiaries

EXHIBIT 1

REITs are coming off historical lows versus stocks

Earnings multiple spread

At February 28, 2021. Source: UBS Investment Research, Cohen & Steers calculation.
Earnings multiple spread is the difference in the average ratio of per-share REIT price to funds from operations (FFO) and stock price to earnings. 2021 multiples based on current-year earnings estimates. FFO is the key earnings metric for the REIT industry, calculated as GAAP net income, plus real estate gains (minus real estate losses), plus GAAP real estate depreciation and amortization. U.S. real estate represented by UBS coverage universe of U.S. real estate companies from 10/2002 to 12/2010, and Cohen & Steers coverage universe thereafter. Global real estate represented by UBS coverage universe of global real estate companies.
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(1) At March 8, 2021. Source: U.S. Centers for Disease Control and Prevention.

Attractive value entering an early-cycle environment

REITs appear cheaply valued relative to stocks

After trailing equities by 25% in 2020, global REITs ended the year at their largest relative discounts since the global financial crisis. Although the value gap has narrowed in the early months of 2021, it remains below the historical average (Exhibit 1). At a time when growth stock valuations are near historical highs, we believe REITs represent an attractive opportunity to diversify portfolios with undervalued, low-correlated assets.

Early-cycle environments tend to favor REITs

Post-recession periods have historically been positive for REIT returns, as these are generally times of accelerating economic growth and supportive monetary and fiscal policies. Since 1991, REITs have outperformed equities in early-cycle expansions on average, both globally and in the United States (Exhibit 2).

An improving economic outlook may drive long-term bond yields higher, raising questions about REITs' interest-rate sensitivity. Although rising interest rates may create volatility in the short term, we have found that over time, the benefits of stronger real estate demand in an improving economy have outweighed the effects of higher interest rates. We believe REITs today have the added benefit of wide yield spreads to bonds and staggered maturities, which may further cushion the effects of rising rates.

REITs currently offer value, attractive income potential and inflation sensitivity, enhanced by the prospect of a sustained economic recovery

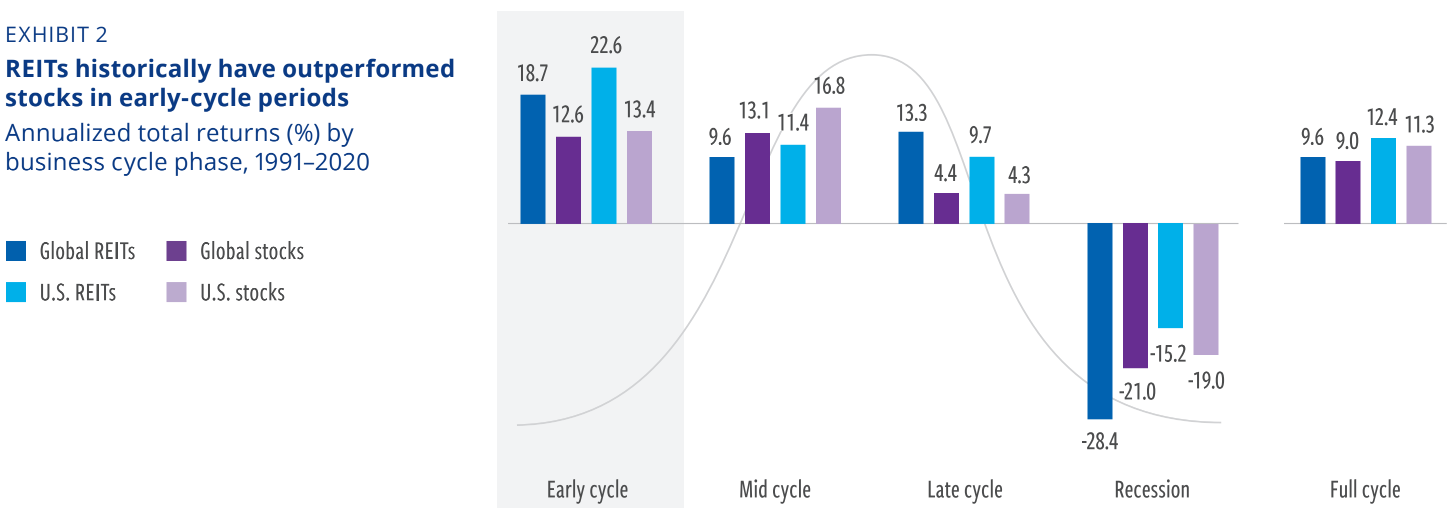
REITs may help defend portfolios against unexpected inflation

For investors concerned about the inflationary effects of large-scale government spending and quantitative easing, real estate offers potential inflation-hedging characteristics. Rising prices for labor, land and materials used in construction can increase the economic threshold for new development. This, in turn, may constrain new supply, supporting higher occupancies and giving landlords greater power to raise rents. As a result, REIT prices have historically responded positively to inflation surprises, compared with the negative impact on stocks and bonds.

EXHIBIT 2

REITs historically have outperformed stocks in early-cycle periods

Annualized total returns (%) by business cycle phase, 1991–2020



At December 31, 2020. Source: The Conference Board, U.S. National Bureau of Economic Research (NBER), Morningstar Direct, Cohen & Steers proprietary analysis.
Average of annualized monthly returns (360 total periods), grouped by phase, based on U.S. economic data. Expansion subdivisions determined by Cohen & Steers based on major trends in the Conference Board Coincident Index (CBCI): Early cycle—CBCI accelerating (112 months); Mid cycle—CBCI stable (176 months); Late cycle—CBCI decelerating (41 months). Recessions as reported by NBER (31 months).
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Compelling investment themes in the "new-economy normal"

Although shopping malls and offices have been getting most of the headlines during the pandemic, these sectors make up only a small portion of the modern REIT market (Exhibit 3). Today, we are seeing multiple sources of opportunity.

Beneficiaries of a Grand Reopening

Vaccines and fiscal stimulus may directly benefit property types impacted by social distancing, business interruptions and economic contraction.

Health care
Vaccinations and safety protocols are supporting a recovery in senior housing occupancy, while longer-term growth will likely be driven by an aging population of Baby Boomers.

Hotels and gaming
Gaming and leisure travel should recover relatively quickly, whereas business travel is likely to lag as companies look to save time and money with virtual meetings.

Retail
An economic reopening may overpower headwinds from e-commerce in the near term, potentially reducing the risk of tenant bankruptcies and unleashing pent-up consumer demand.

REITs at the center of the digital economy

Growing reliance on digital platforms is helping drive demand for properties that provide the infrastructure for data networks and e-commerce logistics.

Cell towers
5G-enabled smartphones are setting sales records globally, and the rollout of ultra-fast networks is just beginning, setting up a potential multi-year investment cycle in wireless infrastructure.

Data centers
Businesses are investing to migrate to the cloud and enhance online platforms, while the rise of HD video streaming is helping drive demand for data networking and storage.

Industrial warehouses
The giant leap forward in e-commerce during the pandemic is helping drive strong demand for logistics facilities to support rapid delivery, adding to an improving economic outlook.

The lasting work-from-home (WFH) impact

Many companies may allow for more flexible work policies post-pandemic, potentially shifting demand from urban centers to the suburbs and lower-cost states.

Offices
WFH could reduce office demand by 3–15% over the next several years[1], with U.S. and European financial and technology centers more impacted than Asian cities (where smaller living spaces make WFH less appealing).

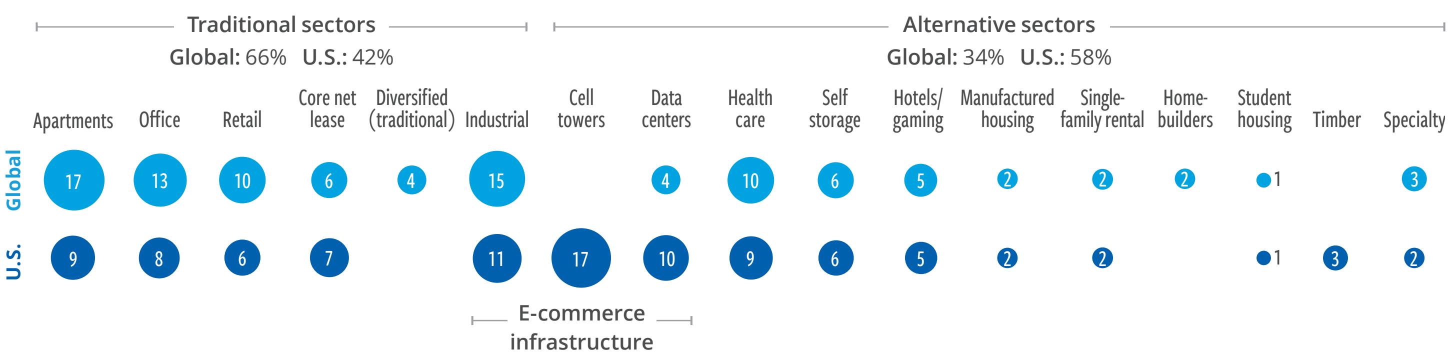
Self storage
U.S. storage unit rates rose 13% in 2020[2], driven by an increase in moving and the need for space while working from home—trends we expect to support strong demand globally in 2021.

Single-family rental
Detached housing is seeing record occupancies and twice the applications per home versus 2019[3] as city residents move to the suburbs and as millennials start moving into homes.

EXHIBIT 3

The modern REIT market offers a diverse opportunity set

REIT index sector weights (%)



At December 31, 2020. Source: FTSE Nareit, Cohen & Steers categorization of traditional and alternative sectors. Totals may not sum due to rounding.
The mention of specific sectors is not a recommendation or solicitation to buy, sell or hold a particular security and should not be relied upon as investment advice. See page 4 for index associations, definitions and additional disclosures.

(1) Cohen & Steers estimates, 2/28/2021. (2) Cohen & Steers proprietary analysis, 12/31/2020. (3) Company reports, 12/31/2020.

Summary

Vaccines

Safer interactions and easing business restrictions should directly benefit certain REIT sectors impacted by the pandemic, while extraordinary fiscal and monetary policy measures are driving expectations for a sustained economic recovery.

Value

REIT earnings multiples remain attractive compared with broad equities entering what has historically been the most favorable phase of the business cycle for REITs. The value proposition is further enhanced by real estate's inflation-hedging potential.

Variety of opportunity

The modern REIT market offers access to both secular growth themes and cyclical beneficiaries, enhancing the potential for active managers to add value. This is illustrated by the 45% performance gap in 2020 between the global REIT market's top sector (data centers +18%) and bottom sector (retail –27%) based on the FTSE EPRA Nareit Developed Index.

For more detail, see our full report, ***Vaccines and value setting up a strong vintage year for REITs,*** available at cohenandsteers.com.

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Index Definitions / Important Disclosures

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Global REITs: The FTSE EPRA Nareit Developed Index is a capitalization-weighted, time-weighted index of companies domiciled in developed markets that derive more than half their revenue from property-related activities. Source: London Stock Exchange Group plc and its group undertakings, including FTSE International Limited (collectively, the "LSE Group"), European Public Real Estate Association (EPRA), and the National Association of Real Estate Investments Trusts (Nareit) (and together the "Licensor Parties"). © LSE Group 2021. FTSE Russell is a trading name of certain LSE Group companies. FTSE® and Russell® are trademarks of the relevant LSE Group companies and are used by any other LSE Group company under license. Nareit® is a trademark of Nareit, EPRA® is a trademark of EPRA and all are used by the LSE Group under license. All rights in the FTSE EPRA Nareit Index series or data vest in the Licensor Parties. The Licensor Parties do not accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. No further distribution of data from the LSE Group is permitted without the relevant LSE Group company's express written consent. The Licensor Parties do not promote, sponsor or endorse the content of this communication. **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. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indexes or any securities or financial products. This report is not approved, endorsed, reviewed or produced by MSCI. None of the MSCI data is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such. **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. "FTSE®" is a trademark of the LSE Group and is used by FTSE International Limited (FTSE) under license. All rights in The FTSE Nareit All Equity REITs Index vest in FTSE and Nareit. Neither FTSE, nor the LSE Group, nor Nareit accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. No further distribution of data from the FTSE or Nareit is permitted without the relevant FTSE's express written consent. FTSE, the LSE Group, and Nareit do not promote, sponsor or endorse the content of this communication. **U.S. stocks:** The Russell 3000 Index (Exhibit 1) is a capitalization-weighted stock market index, maintained by FTSE Russell, that seeks to be a benchmark of the entire U.S. stock market. It measures the performance of the 3,000 largest publicly held companies incorporated in America as measured by total market capitalization and represents approximately 98% of the American public equity market. The S&P 500 Index (Exhibit 2) is an unmanaged index of 500 large-capitalization stocks that is frequently used as a general measure of U.S. stock market performance. London Stock Exchange Group plc and its group undertakings (collectively, the "LSE Group"). © LSE Group 2021. FTSE Russell is a trading name of certain of the LSE Group companies. FTSE®, Russell® and FTSE Russell® are trademarks of the relevant LSE Group companies and are used by any other LSE Group company under license. All rights in the FTSE Russell indexes or data vest in the relevant LSE Group company which owns the index or the data. Neither LSE Group nor its licensors accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. No further distribution of data from the LSE Group is permitted without the relevant LSE Group company's express written consent. The LSE Group does not promote, sponsor or endorse the content of this communication.

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