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Real Estate Investments & Opportunities and the Asian Private Client

In July, Hubbis in partnership with Janus Henderson Investors and KATCH Investment Group hosted a virtual discussion focusing on the world of real estate investment opportunities. The mission was to scan the world of international property and identify the right access points through financial sector instruments, both public and private. Janus Henderson Investors was one of the sponsors and was represented by Xin Yan Low, Portfolio Manager based in Singapore. As a specialist in global property investing, she offered delegates some valuable insights into the markets, the opportunities and what investment avenues private clients might consider.

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XIN YAN LOW
Janus Henderson

Commercial real estate

investing can take many different forms, and there are many different levels at which investors can participate. The experts on the panel reviewed the potential avenues available, including via direct private market equity, or publicly traded REITs representing equity, they looked at how actively managed mutual and other funds are faring and where the best opportunities might be today, or in the years ahead. They touched on private property sector debt and public market fixed income that allow investors access to yield higher up the capital ladder than equity.

Global expertise

Xin Yan opened her commentary by noting that Janus Henderson has built its expertise in global property since 1997, and currently has a team with collectively more than 130 years of relevant investment experience managing about USD3.2 billion of assets across a suite of both global as well as regional funds, all in the listed space.

She said the reality is that the past 12 to 18 months had been challenging, with a macro narrative of rising rates impacting negatively on underlying real estate prices. She said the speed with which rate rises have piled one on another and the overall uncertainty in the air had, understandably, impacted the availability of credit, exacerbated by the tremors felt in the US banking industry this year.

Drilling down into the markets

"But we need to look beyond the headlines, and we see that some sectors of the commercial property markets continue to demonstrate very robust rental growth," she told guests. "There are many high-quality portfolios, which have been able to enjoy and sustain fairly high occupancy levels and demonstrate operational resilience. In short, in the listed space, the companies that we look at are still producing good earnings growth, indeed better than the wider markets."

She added that around mid-2022, the expectation was for broad-based S&P 500 earnings growth in 2023 to be in the high single digits, but that has reversed to an expectation of a mid-single digit decline now. "But real estate is rather resilient, and earnings visibility remains robust," she said.

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Pluses and minuses

She did however concede that on a relative basis, property yields look less attractive compared to risk-free rates from bonds, or compared to high-grade corporate paper. "Excepting Japan, the spread [of physical property] against 10-year bonds are now far below what they were for many years," she reported. "But that has been quickly reflected in the traded price of listed real estate, falling nearly a quarter in 2022 and today trading at roughly 20% below NAV."

She explained that this actually leaves certain REITs in selected markets at yields that are still above 10-year bonds. "For example," she elucidated, "dividend yields for Singapore, Hong Kong and Japan listed REITs are on average trading at a roughly 250 to 350 basis points positive spread. Investors are therefore able to buy in at deflated prices that already reflect the wider economic and financial concerns around."

Some segments shine bright

Moreover, she said there are certain sectors whereby top-line rental growth has actually been able to offset the significant rise

in the cap rate. “Across the board globally, we see most industrial logistics assets being able to buffer their cap rate expansion with top-line rental growth. That is an example of selective sectors where owners do actually have the requisite bargaining power to pass through their higher overall costs.”

As to the Janus Henderson strategies, Xin Yan explained that across their roughly USD3.2 billion property sector AUM, they cover the world and offer total return funds as well as income strategies, and also focus on both DM and EM assets. All their strategies are actively managed, including, she reports, a hybrid offering in the form of an ‘active’ ETF covering the US market.

Be selective

Xin Yan later turned her thoughts to the office sector, which since the pandemic has been deeply out of favour. She said the return to the office protocol was not at all challenging in some markets, especially not in Asia. “This region was the last to reopen globally, but we were amongst the first to return to offices, and we estimate that 90% or more of the traffic across the region is back to what it was. It is really in the US where we see real challenges with the return to office numbers stagnating at half of where they were pre pandemic.” She notes that while there are many concerns surrounding the office sector, it is a fairly US concentrated issue. “Across many major US cities, vacancy rates have spiked above where they were during the Global Financial Crisis to levels not seen since the early 90s.” She added “Selected markets like Paris or London West End continue to see rental growth in the prime market due to tightness of supply.”

Quality matters

In the listed space, she told guests that Janus Henderson has seen a lot of very high-quality office landlords dragged lower as the investment tides receded. “However, many vehicles can hold some of the best quality assets,” she reported. “For example, in Japan, the listed Japanese developers are winning over many tenants to their new projects, with those occupants in a flight to quality, moving away from the older grade B stock. In short, there are some very good pockets of assets if you dig a bit deeper.”

Headroom for rental rises

She expanded on the industrial logistics segment, which she said continues to enjoy what she called “extremely strong structural demand”. She explained the increasing penetration of E-commerce over the past decade had been exacerbated by the pandemic lockdowns and was returning gradually to more normal growth levels.

“You might have heard of potential weakness in previously very strong markets like California, but we do still expect that the high embedded rental reversionary potential will continue to support very attractive rent growth over the next few years,” she reported. “In fact, in the US, you have market rents today, which are 60% to 70% higher than existing portfolio rents. Accordingly, should headline market rents weaken slightly, there is still a lot of headway for strong rental growth. Moreover, the supply of new space will be more limited as funding costs are higher, scaling back capital deployment to new projects."

She added: "If we fast forward to this time next year, we could find ourselves actually back in extremely tight markets."

Valuations and smart allocation

Xin Yan then explained that taking more of a big-picture perspective, investors should be encouraged by listed valuations which have already priced in a lot of concerns around rate hikes and slowing macroeconomic growth and presents an attractive entry point. also It is important to be ahead of the game for the next growth opportunities that will be emerging in the coming 5 to 10 years.

"Generally, listed real estate companies are amongst the few buyers out there that are able to acquire," she said. "They generally have stronger balance sheets and also good access to capital, both on the corporate bond market as well as on the equity markets. We are seeing listed REITs taking the opportunity to buy up assets from private funds. In fact, there is the same sort of shift taking place after the real estate market collapse of the 1980s that led to banks being more reticent to lend to commercial real estate in the early 1990s, which in turn fuelled what has become the modern REIT sector today. It is the access to capital which is shifting the buying power from private to public markets."

She explained that in the US alone, there are numerous mature, very well-managed and well-capitalised public companies that can take advantage of distressed situations amongst other real estate owners.

It's important to be active

Xin Yan closed her commentary by pointing to the value of active management of property investments. "There are such different fundamentals across different segments of the property markets," she stated, "and many differences and nuances within each of those segments. If you were to invest in ETFs, you'll be owning all companies in the relevant index. But our approach in managing active funds is to select the best-in-class companies from the right sectors and in the right markets." ■