Asian Real Estate – A Rare Combination of Higher Yield, Growth and Diversifications

Central Banks are expected to continue at a time when yield orientated assets are under yet more pressure, investors would be wise to re-assess the case for Asian real estate securities. Real Estate Investment Trusts (REITs) are well established in US and Europe, however are at an earlier stage of development in Asia. Asia's demographic, social and economic circumstances are supportive of continued development of the real estate sector in this region.

Yield: A Key Component of Total Return

Typically, Asia's real estate companies focussed on high profile development opportunities. The risk and return characteristics of building and selling properties are although quite different from property management, a business for which REITs are specifically designed. REITs vary across jurisdictions however the core concept is a listed and regulated entity that's obliged to distribute a significant proportion of its rental income.

Although REITS are often categorised as if they are equity securities, a deeper examination demonstrates a number of distinctive and compelling characteristics.

Dividends have historically represented around one-third of the total return from equity securities. For REITs dividend yields make up a greater proportion of total return, historically around two-thirds. This higher yield is partly attributable to REIT's legal and regulatory structure, with most jurisdictions requiring distribution of at least 90% of profits. With a higher proportion of total returns distributed as dividends, investors receive more of the total return in regular cash flows and less as capital gains.

Risk Managed Property Exposure

The question of whether investors in REITs experience returns similar to physical property is hotly debated. It is often argued that the REIT wrapper dilutes the fundamental characteristics of physical property investments. What is not disputed is other key characteristics are very different, such as liquidity, ease of diversification, cost of investment and the investment/divestment timescale, all of which can be important in managing risks.

Academic studies observe that physical property and REITs are affected by the same influences, identifying integrated characteristics across the respective markets. Studies have found over the short term the two types of investment can behave differently, with the more liquid REITs tending to anticipate physical property prices. However, as investment timescales increase the relationship strengthens so that over the long-term returns are comparable. The correlation between the two tends to change in response to extreme market conditions and varies over discrete periods, however most academic studies conclude over the long term the two are substitutable.

The relationship between REITs and equity securities also vary over time, being similarly influenced by the market environment. Academic studies indicate that in recent decades sensitivity to equity price changes has declined, explained by the growth in the number of REITs, their asset base and growing sector maturity.

Putting together higher regular yield, return characteristics in line with physical property but with superior risk management characteristics and low sensitivity to equities, REITs can play a valuable role in multi asset portfolios. Academics examining REITs in mixed asset portfolios note their contribution varies across the efficient frontier; at the lower risk end REITs effectively increase returns, while at higher risk levels the risk reduction effect is greater. This can be explained by REITs' characteristics sitting in between equities and bonds, increasing returns in a bond portfolio and reducing risk in an equity portfolio.

Asia: Populous, Urban, Diverse

Asia's listed real estate market is notable for is breadth and diversity. Across Tokyo, Hong Kong, Singapore and Sydney the cities reflect each country's distinct culture, illustrating the region's heterogeneous nature.

Asia is home to 4.6bn people, representing 60% of the world's population who live in just 30% of the world's land area. The region contains 6 out of the ten largest cities such as Tokyo and Delhi. Furthermore the region benefits from higher growth rates, in 2019 almost double the global growth rate of 2.5%.

REITs are well established in its developed markets; Japan has the largest number and total capitalisation value, followed by Australia and Singapore. In Australia and Singapore REIT assets represent around 40% of all managed real estate, in Japan and HK the proportion is lower. Rental yields in Hong Kong are the highest and Japan the lowest.

In addition to this geographic diversity, REITs service a range of business sectors exposed to different parts of these economies. Japan has the most office REITs, Australia the most retail, while Singapore and Japan have the most industrial REITs. Sector diversified portfolios represent the largest group, REITS focused on office, retail and industrial are the largest dedicated sectors, while specialist sectors such as hotels and healthcare are smaller by number and total capitalisation.

The Asia Pacific developing countries are tentatively embracing domestically listed REITs. In India the first REIT was launched in 2019, while China is now trialling domestic listings of infrastructure assets in a limited and controlled manner. While onshore listed REIT exposure to Chinese property is not yet available, it is possible to obtain exposure through Singapore listings, which include a number of dedicated China, and Hong Kong REITS.

The dynamism and diversity across Asian real estate markets provides an exciting range of opportunities and scope for diversification that is well suited to actively managed REITs strategies.

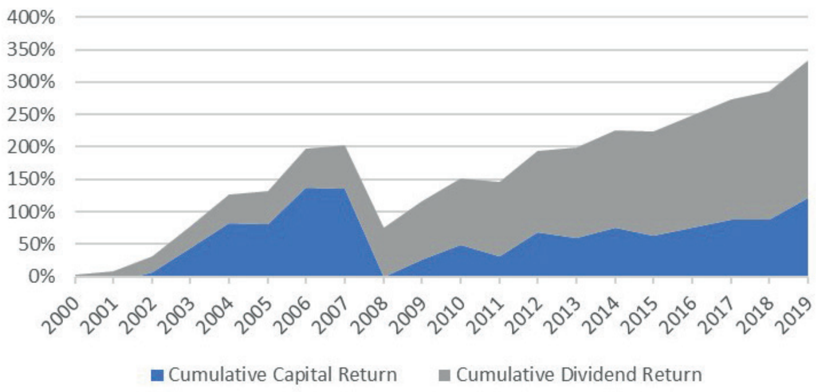
2020 Outlook

In line with other equity related assets, in the first quarter of 2020 REIT markets across the globe were adversely impacted by the COVID-19 pandemic. Australia was worst effected, while Japan and Singapore proved more resilient than US REITs. The second quarter saw a modest recovery across Asian markets, with the exception of Hong Kong where increased political tensions effected confidence.

The investment team view the Retail sector as being most exposed to COVID-19 risks, favouring Industrials. Logistics properties have benefitted from increased e-commerce activities, as have managers of specialist Data Facilities. Their sector preference results in an overweight to Japan which has a large Industrial sector, and underweight Retail orientated Australia.

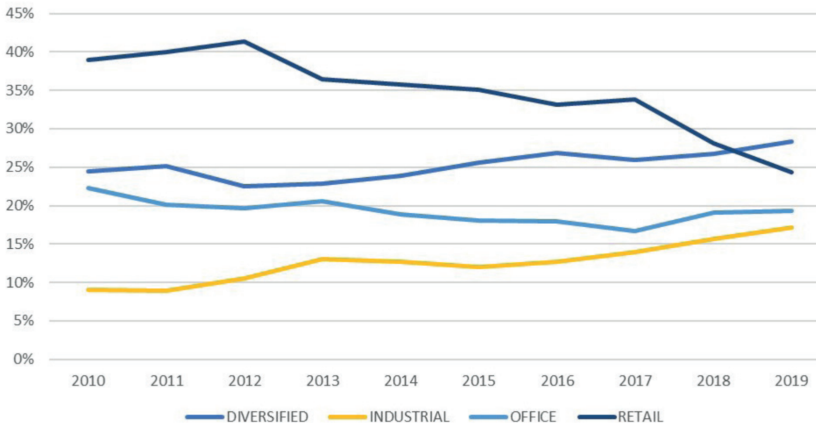
The investment team believe real estate in Asia will not be adversely impacted by the pandemic to such an extent as in western countries, as COVID-19 has been more effectively controlled with a less significant economic impact. Combined with Asia's higher growth rate real estate prices are likely to recover more rapidly in Asia than in other regions.

S&P Asia Pacific REIT Index 2000-2019



Source: S&P Asia Pacific REIT Index, USD

S&P REIT Index Sector Weights 2010-2019



Source: S&P Asia Pacific REIT Index, USD