For professional investors only.
In Switzerland for qualified investors only.
Not for Americas distribution

Global real estate strategies

The case for a broader perspective

abrdn.com

Executive summary

- The global real estate market is substantial and offers a vastly broader opportunity set than any individual country.
- Diversification is the primary objective – and by allocating across various sectors and geographies, overall portfolio risk can be reduced.
- Accessing higher asset-level returns is also possible, but this should not be the primary expected outcome for investors.
- The mechanics of returns are different between markets, with income risk and growth derived through differing lease structures from one country to the next.
- Thematic opportunities are emerging because of demographic shifts, technology and behavioural change, which offer differing risk and reward potential for investors. Taking a global perspective offers investors the best opportunity to capture these structural trends.
- Accessing all corners of the global direct market can be a challenge. By having an allocation to more liquid forms of global real estate, investors will not miss out on the chance to capture an opportunity when it arises.
- Global investment strategies face some specific challenges, though. These can often be mitigated, managed, avoided, or converted into positives by a reliable Houseview and investment process.

The cornerstone of a global investment approach has always been diversification. The thesis is that by spreading investment beyond single assets in single jurisdictions, overall portfolio volatility can be reduced. This improves risk-adjusted returns for investors. This remains one of the primary benefits of global investment strategies.

But this is evolving. Diversification is also supplemented by other benefits of going beyond domestic investing. The size of the global investible real estate universe is substantial. By taking a global perspective, investors can capture the best of what real estate has to offer. No two markets offer the same opportunities at the same time and in the same volume.

In this paper we consider the merits and challenges of global investment strategies, the range of opportunities that exist, and the various ways to access all corners of the global real estate market.

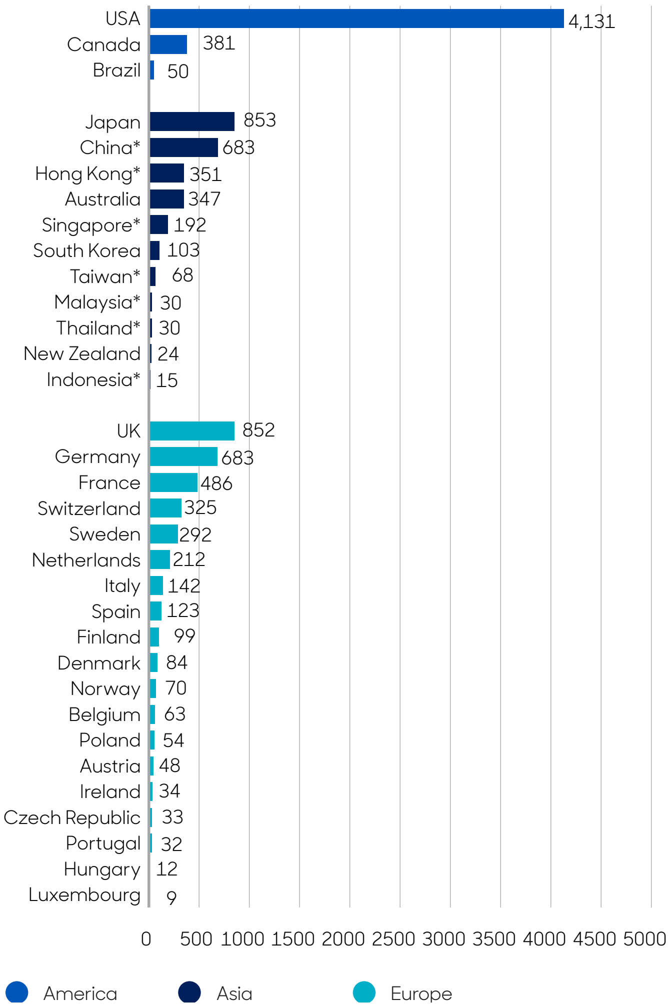
01

More opportunities

For most investors, moving outside their domestic real estate market rapidly expands the opportunities. An investor's local market typically represents a fraction of the overall real estate universe. The total global investible universe is estimated to be around $11 trillion in size. For UK investors, the domestic market is worth roughly $852 billion, which is just 8% of the global investment market. By increasing the scope of the investment universe, the opportunities to find good assets in good locations increases dramatically. A global strategy could complement an existing domestic allocation.

Chart 1: Estimated investible market size

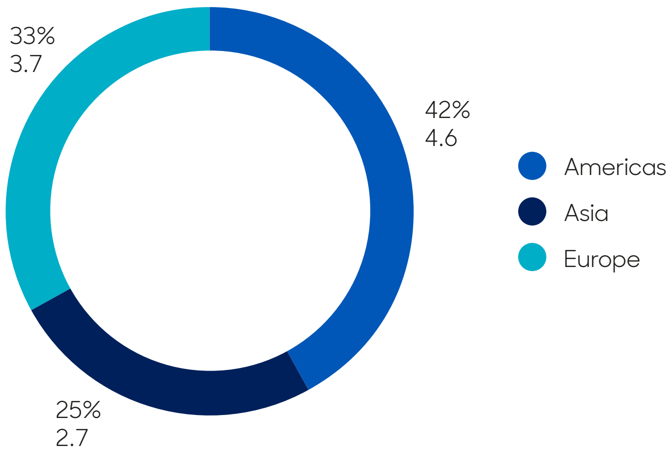
USD $ bn



Source: MSCI / IPD estimated market size December 2021, abrdn December 2022.

Chart 2: Estimated investible market size

USD $ bn



Source: MSCI / IPD estimated market size December 2021, abrdn December 2022.

02

Diversification benefits

Diversification is a very important aspect of investment management. By investing in multiple assets with different characteristics, the overall risk of your portfolio falls. Instead of investing all capital in a single asset, allocating across different assets puts you at less risk of losing capital compared with a single-asset strategy. By layering investments across a larger number of assets, and across a wide range of sectors and locations, both property-specific and market risks can be reduced.

$11.0 Trillion

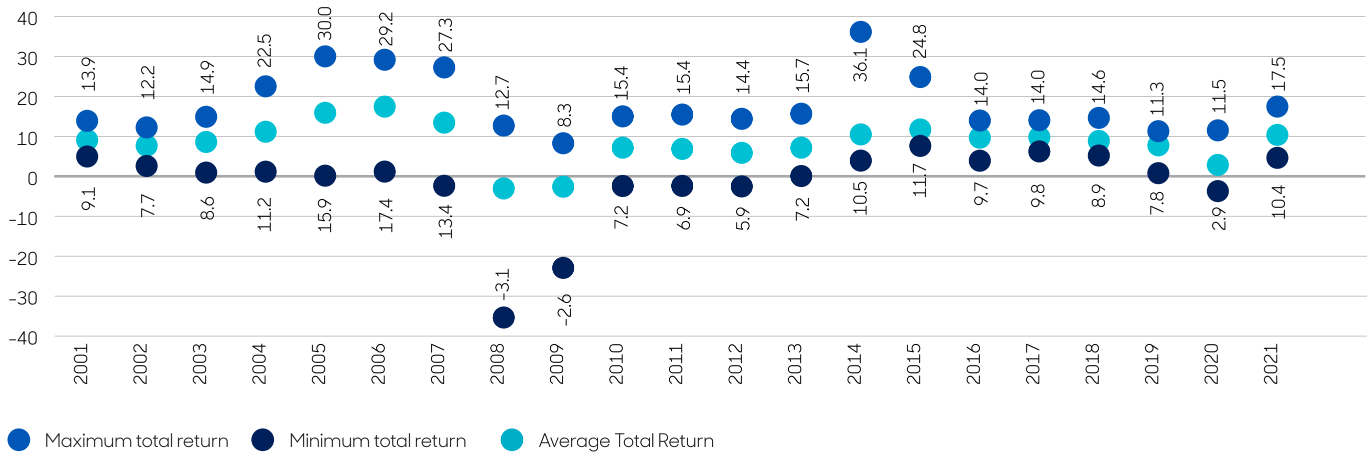
Domestic Portfolio + Globally Diversifed Portfolio = Balanced strategy, diversified by country, sector and asset type

By taking a global view, investors can access different real estate cycles and benefit from the strongest thematic trends. They can also generate higher return potential, access different sectors and sub-sectors, and thus improve overall diversification.

Increased diversification can also help to provide an element of downside protection in volatile market conditions. If we take the global financial crisis (GFC) as an example, it is clear from the range of returns shown in Chart 5 that single country-specific risks are higher in any given year. The total returns ranged between +12.7 (for South Africa) and -35.3% (for Ireland). The total return for a globally diversified portfolio of assets would have been closer to -7.7% in 2009, compared with -21.8% for the UK market over this period.

Chart 3: Global direct market returns by country range

Total retuurn % p.a.



Source: MSCI/IPD, abrdn November 2022.

The synchronicity of market returns varies through the cycle. Country spreads have fallen over the last few years, with the recent stronger correlation due to more synchronised monetary policy, stimulus and low interest rates across almost all markets since the GFC. However, history tells us that periods of higher inflation or volatility tend to result in a broader dispersion of returns. Indeed, the pandemic and the Russian invasion of Ukraine have had distorting effects on global economies, which mean that the spread is expected to grow.

In terms of longer-term trends, there has been more discussion around the forces behind de-globalisation. This includes the shortening of supply chains, an increased focus on energy security, political pressure to promote domestic policy over international policy, and the shock from the global pandemic. While this might suggest a less supportive environment for global investing, it conversely suggests that there are to be fewer economic ties internationally. Therefore, diversification should increase as economies become more driven by local factors and less by global trade flows.

03

Market mechanics and ESG

Diversification can also come from the mechanics of returns, too. This could be lease duration or the local market lease convention for scaling income growth. Rents can move either from being marked to market or by indexation to inflation. The strength and growth potential of each cashflow varies and is often determined by the legislative framework in each jurisdiction.

In the UK, for example, rental levels are most typically reviewed at pre-determined intervals and move in line with the market rent as determined by an independent valuer. Lease lengths can vary from under three years to 25 years and beyond. On the continent, rents typically grow annually at the rate of consumer price inflation (CPI) or a blended index with breaks at three- or five-year intervals. Often leases move to a year-on-year rolling basis, unless an agreement is reached to renegotiate the terms.

With inflation having surged in most corners of the world, the mechanics behind income growth have never been more important. Indexation clauses – where contractual rents move in-line with a form of inflation, be it CPI or an alternative measure – can be found in most institutional markets, but it is not standard convention everywhere except in continental Europe. For UK or liquidity-driven investors, allocating some of your investment to cashflows that have a stronger year-on-year relationship with inflation could be a valid consideration. Global strategies allow greater flexibility to blend exposure to markets that can harness market growth more quickly.

Lastly, one of the most important considerations for investors will be decarbonisation and environmental, social and governance (ESG) implications. This can affect performance in two ways: transition risks and physical risks. Chart xx highlights the two risks. In terms of transition risks, global markets will move at different speeds and markets will price ESG shortfalls differently depending on the maturity of financial markets and local regulation. In terms of physical risks, investors' exposure to drought, floods, extreme weather patterns, or the cost of energy will also drive differences in risk and performance. Global investment strategies will be able to diversify or manage exposure to these different risks more easily than a single-market domestic strategies.

Components of climate risk on real estate performance

ESG factor	Climate trasition risk		Climate physical risk
External pressures	Regulation/ carbon pricing	Changing market expectations	Exposure to hazards/ temperature increase
Potential impacts on assets	Upgrade cost to meet regulations and decarbonisation pathway		Increased energy consumption and cost for cooling and adaptation measures if required
	Market sentiment/ liquidity		Disruption/ loss of income
	Impact on valuation		

Source: abrdn, November 2022.

Thematic evolution

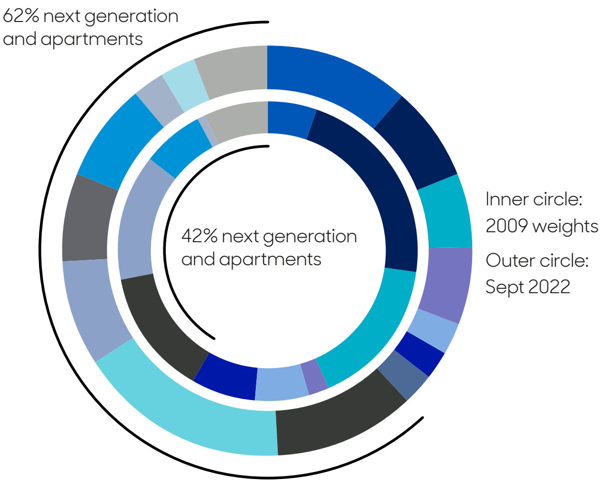
Human behaviour and the use of the built environment is changing at a varied pace across global markets. This is driven by geographically uneven demographic trends, technological advancement, and social and economic needs.

Despite today's economic challenges (a widespread slowdown worsened by rising interest rates), it is critical for investors to remain focused on the individual and fundamental drivers that underpin cashflows in each market.

In the US, for example, the evolution of the sector capitalisation of the NAREIT index shows just how substantial these pressures have been in recent years. In 2009, around 42% of the US real estate investment trust (REIT) market was invested in 'next generation' real estate, including healthcare, self-storage, data centres and apartments. By September 2022, this share had expanded rapidly to 62%. Apartments (17%) now account for around 2.5 times more than retail (7%) as a weight in the index.

Chart 5: US listed market capitalisation by sector

%



	2009	2022		2009	2022
Industrial	5	12	Infrastructure	0	17
Retail	22	7	Health care	14	8
Office	16	6	Data Center	0	7
Net Lease	2	6	Self Storage	7	8
Lodging	6	3	Manufactured Homes	1	2
Diversified	7	2	Single Family Rental	0	3
Timber	0	3	Specialty	7	6
Apartments	14	11			

Source: NAREIT, abrdn September 2022.

Not all domestic real estate markets are alike. In some countries, institutional investment in specific real estate sectors is possible, whereas in other countries it is not.

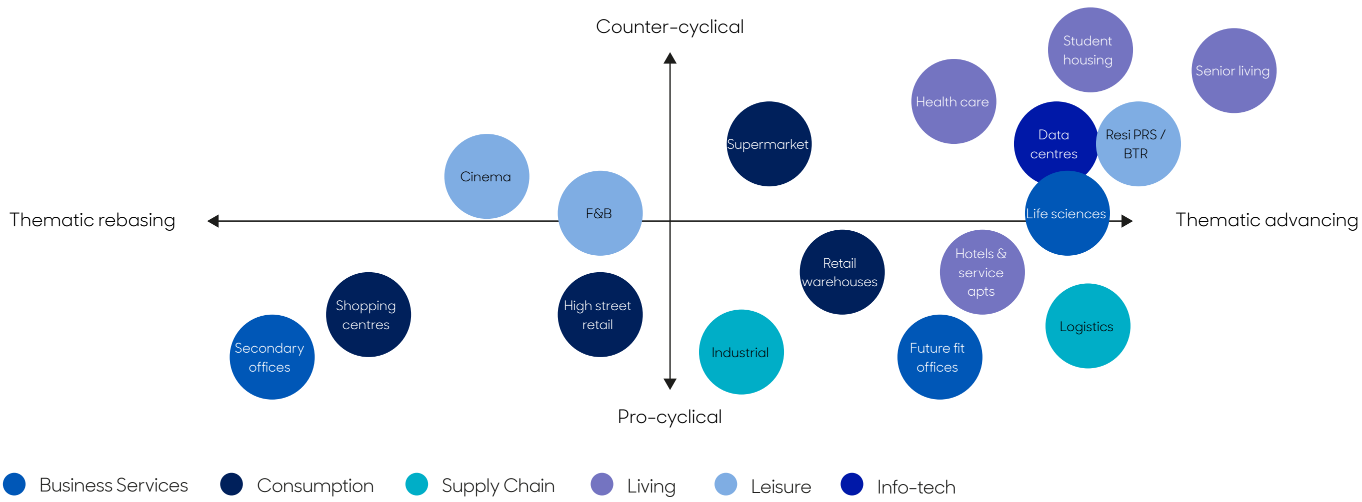
The US model is more mature than other markets and arguably offers the most opportunity to capture emerging themes across the board. Even in the UK, which is considered a relatively mature market, private rented residential (PRS) is relatively small due to the higher share of home ownership as a form of tenure (over 60% of homes are owned and not rented). In Germany, which has a roughly comparable population to the UK, the PRS market is many times the size of the UK residential market – it even has various listed residential property companies offering investors more liquid access to the underlying residential assets.

However, there are further intricacies and nuances when it comes to targeted investment. If an investor wishes to target the purpose-built student accommodation segment (PBSA) of the residential market, the UK opportunity set is far greater than that in Germany. Similarly, opportunities to invest in healthcare are more prevalent in France and Spain, while senior living in Japan is more prevalent in accordance with the ageing demographic.

The same can be said for the logistics sector, which is at various stages of its evolution across the world. Ecommerce sales are expected to account for a quarter of total retail sales globally by the end of 2022. There is a large range between countries, with the UK and China near the top of the list at around 25% of total retail sales – the former having peaked at over 35% during the Covid-19 pandemic lockdowns. The rise of ecommerce is creating significant growth in demand for modern logistics properties within wider metropolitan areas. While some markets are more advanced along this transition to demand-driven supply chains, it is expected to grow across most cities in the world.

Chart 6: Looking ahead – portfolio construction themes

Long term thematic plays and cyclical timings: managing portfolio evolution



Source: abrdn November 2022.

05

Accessing global markets goes beyond direct allocations

Investors need to consider how they intend to access real estate markets. This will determine whether an international or domestic solution makes the most sense, or if a blend of the two is more appropriate. The real estate portfolio's risk-adjusted returns and volatility will be dependent on portfolio size.

This has implications for how investors should gain exposure to different markets. Should they invest directly in non-domestic properties or gain exposure to indirect real estate investments? Investment size is not the only variable that plays a role when thinking about non-domestic investments; there are a series of trade-offs between risk, return and liquidity.

Assuming an investor wishes to diversify risk across countries and real estate sectors, a global or regional portfolio (using the direct investment route) is restricted to all but the very largest investors, given the volume of capital required. For example, assembling a global portfolio of around 20 assets with an average lot size of 40 million would require a fund size of 800 million. Managing this portfolio across a variety of different regions would also incur significant costs in terms of accessing local knowledge, globally integrated systems for managing the assets, and expertise in tax and structuring across the different regions.

Indirect real estate investments can provide a more efficient solution, enhancing diversification by country, sector and asset type. Indirect real estate investments access properties through public or private unitised vehicles. Public vehicles include real estate investment trusts (REITs); private vehicles include unlisted real estate funds or funds of funds. REITs have a high, short-term correlation with the stock market, but the medium-term return tends to be correlated with the underlying real estate market. This reflects the relatively high dividends REITs pay to investors and their focus on income-producing assets. Unlisted funds, or funds of funds, tend to behave more like the underlying real estate market, with a lower correlation to listed stocks when looking at performance.

Strategy, challenges, risks, and costs associated with global strategies

Not only do the characteristics of the underlying real estate markets determine the optimal non-domestic allocation, but the choice of how and when to enter these markets is not a trivial one. Several key factors need to be assessed when considering a global real estate allocation.

1. Global Houseview, implementation and liquidity risk

We believe the most important starting point for a global strategy is to have an established and collaborative real estate Houseview. Extensive knowledge of global markets and the ability to contextualise local trends enable better decision-making and stronger portfolio construction. Without this, it is difficult to know if opportunities or investment decisions are as good as they look in isolation.

Houseviews have traditionally involved forecasting markets or relative-value approaches. Increasingly, they also require an understanding of our changing consumer behaviour, demographic shifts, use of technology, and ESG. A comprehensive Houseview will assess all these drivers and risks to performance. A local presence in key locations and the ability to draw from information and opinions across different business lines (economists, asset managers, finance, ESG, fund managers and those involved in indirect investments) forms the bedrock of a collaborative approach.

Given that non-domestic markets will differ in terms of their transparency, levels of corruption, and ease of doing business, the need for local investment expertise should not be underestimated. These pitfalls demonstrate the importance of teaming-up with a seasoned global operator who has a significant local presence. Similarly, the level of liquidity in a market can also be key in realising investment goals. If liquidity in a particular market is relatively limited, can a sale be implemented at the end of a defined hold period?

2. Taxation (and its impact on return)

In some instances, going global is likely to mean that the returns available to domestic investors are not always available to non-domestic investors. While vehicles can be structured to minimise the leakage from punitive tax regimes, it is not possible to completely eliminate this drag on return. This is important because as the return on the global portfolio falls, its relative attractiveness falls too. Specialist advice on tax structuring to minimise tax leakage is key for global investors.

3. Currencies (and their impact on risks or returns)

Investing in non-domestic real estate adds another layer of volatility in terms of currency risk, whereby the returns made in a non-domestic market may change when translated into the home currency. Risks can be hedged, to some extent, but that will come with a cost and hence the cost/benefit must be analysed by the end-investor.

Note that different tax leakages vary significantly between investors, markets and legislations, and must be investigated on a case-by-case basis.

What then does this mean for investors?

The logic of investing globally is well understood in other asset classes and the logic is no different for real estate – access to more opportunities, higher potential returns, risk reduction through diversification, and access to a broader range of specialist sectors.

- The opportunity set for investing globally has advanced considerably in recent times and now offers a much broader number (and sophistication) of opportunities and managers.
- A solely domestic portfolio will deny investors access to around 92% of the global universe.
- Our research demonstrates that an investor with a solely domestic portfolio should consider the advantages of an allocation to global markets. They should also recognise the need for technical expertise to help with the challenges associated with implementing strategies in unfamiliar jurisdictions.
- Scale is an important factor and will be significant in determining whether a non-domestic allocation is obtained directly, indirectly or a combination of the two.
- Understanding global investment risk starts with an effective Houseview process. However, it is also imperative that the challenges and costs of investing globally are fully understood and mitigated where possible.

Important Information

This communication constitutes marketing, and is available in the following countries/regions and issued by the respective abrdn group members detailed below. abrdn group comprises abrdn plc and its subsidiaries:

(entities as at 28 November 2022)

United Kingdom (UK)

abrdn Investment Management Limited registered in Scotland (SC123321) at 1 George Street, Edinburgh EH2 2LL. Authorised and regulated in the UK by the Financial Conduct Authority.

Europe[1], Middle East and Africa

[1] In EU/EEA for Professional Investors, in Switzerland for Qualified Investors - not authorised for distribution to retail investors in these regions

Belgium, Cyprus, Denmark, Finland, France, Gibraltar, Greece, Iceland, Ireland, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, and Sweden: Produced by abrdn Investment Management Limited which is registered in Scotland (SC123321) at 1 George Street, Edinburgh EH2 2LL and authorised and regulated by the Financial Conduct Authority in the UK. Unless otherwise indicated, this content refers only to the market views, analysis and investment capabilities of the foregoing entity as at the date of publication. Issued by abrdn Investments Ireland Limited. Registered in Republic of Ireland (Company No.621721) at 2-4 Merrion Row, Dublin D02 WP23. Regulated by the Central Bank of Ireland. **Austria, Germany**: abrdn Investment Management Limited registered in Scotland (SC123321) at 1 George Street, Edinburgh EH2 2LL. Authorised and regulated by the Financial Conduct Authority in the UK. **Switzerland**: abrdn Investments Switzerland AG. Registered in Switzerland (CHE-114.943.983) at Schweizergasse 14, 8001 Zürich. **Abu Dhabi Global Market ("ADGM")**: Aberdeen Asset Middle East Limited, 6th floor, Al Khatem Tower, Abu Dhabi Global Market Square, Al Maryah Island, P.O. Box 764605, Abu Dhabi, United Arab Emirates. Regulated by the ADGM Financial Services Regulatory Authority. For Professional Clients and Market Counterparties only. **South Africa**: abrdn Investments Limited ("abrdnIL"). Registered in Scotland (SC108419) at 10 Queen's Terrace, Aberdeen AB10 1XL. abrdnIL is not a registered Financial Service Provider and is exempt from the Financial Advisory And Intermediary Services Act, 2002. abrdnIL operates in South Africa under an exemption granted by the Financial Sector Conduct Authority (FSCA FAIS Notice 3 of 2022) and can render financial services to the classes of clients specified therein.

Asia-Pacific

Australia and New Zealand: abrdn Australia Limited ABN 59 002 123 364, AFSL No. 240263. In New Zealand to wholesale investors only as defined in the Financial Markets Conduct Act 2013 (New Zealand). **Hong Kong**: abrdn Hong Kong Limited. This document has not been reviewed by the Securities and Futures Commission. **Malaysia**: abrdn Malaysia Sdn Bhd, Company Number: 200501013266 (690313-D). This document has not been reviewed by the Securities Commission of Malaysia. **Thailand**: Aberdeen Asset Management (Thailand) Limited. **Singapore**: abrdn Asia Limited, Registration Number 199105448E.

For more information visit abrdn.com

GB-100123-186271-1