Unlocking the Potentials: Listed Property v Direct Property

First Sentier Investors

For professional investors only

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The case for having listed property as a part of real asset portfolios should be considered on the basis of longer term returns, liquidity and ability to offer a strong inflationary hedge. In this paper, we examine these elements and highlight the investment opportunity in listed property as a complement to real asset portfolios.

Property characteristics

There are three main routes for investors to gain exposure to real estate: **listed property (Real Estate Investment Trusts (REITs)), private property (unlisted property funds) and/or direct investment**. There are some nuanced differences between these options primarily related to liquidity, cost and asset type. The key characteristics are:

Private property and direct investment

- Lower correlation with equities and REITs in the short term, but higher correlation to REITs in the long term
- Valuations based on net asset value rather than the stock market
- Very little demonstration of an inflationary hedge in recent times
- Liquidity:
  - Closed end private property funds: Inflexible and illiquid, with liquidity windows pressured during downturns as assets need to be sold to realise investments
  - Direct investment: Inflexible and illiquid, as the asset or joint venture interest needs to be sold to raise liquidity
- Typically invested in traditional property types such as office, industrial and retail, with office and retail being more exposed to disruption
- Very high transaction costs for direct investment and high fees for exit on private property funds
- Performance fees can be excessive

Risk factors

This is a financial promotion for The First Sentier Global Property Securities Strategy. This information is for professional clients only in the UK and EEA and elsewhere where lawful. Investing involves certain risks including:

- **The value of investments and any income from them may go down as well as up and are not guaranteed. Investors may get back significantly less than the original amount invested.**
- **Currency risk:** the Fund invests in assets which are denominated in other currencies; changes in exchange rates will affect the value of the Fund and could create losses. Currency control decisions made by governments could affect the value of the Fund's investments and could cause the Fund to global bond defer or suspend redemptions of its shares.
- **Single sector risk:** investing in a single economic sector may be riskier than investing in a number of different sectors. Investing in a larger number of sectors helps to spread risk.
- **Single country/specific region risk:** investing in a single country or specific region may be riskier than investing in a number of different countries or regions. Investing in a larger number of countries or regions helps spread risk.
- **Property securities risk:** the Fund invests in the shares of companies that are involved in property (such as real estate investment trusts) rather than in property itself. The value of these investments may fluctuate more than the underlying property assets.
- **Emerging market risk:** Emerging markets tend to be more sensitive to economic and political conditions than developed markets. Other factors include greater liquidity risk, restrictions on investment or transfer of assets, failed/delayed settlement and difficulties valuing securities.

For details of the firms issuing this information and any funds referred to, please see Terms and Conditions and Important Information.

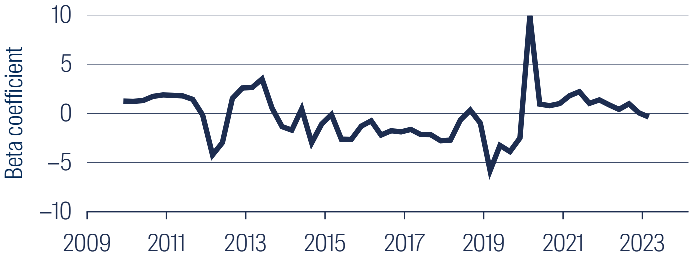
For a full description of the terms of investment and the risks please see the Prospectus and Key Investor Information Document for each Fund.

If you are in any doubt as to the suitability of our funds for your investment needs, please seek investment advice.

Listed property

- Liquid alternative to direct property investment, REITs are listed on equity markets
- Natural inflation hedge with stable cash flows and pricing power
- Flexibility to move into different real estate sectors and regions
- Less volatile than equities but more volatile than direct property funds (see Chart 1). It's important to note that the long term trend beta is near 1. For long term investors, listed property offers the luxury of liquidity with a similar return profile. The rarer cyclical volatile events do create large pricing anomalies offering active investors excess return opportunities
- Assets within the REIT universe provide access to alternative property sectors such as data centres, healthcare, residential, life science and self-storage facilities (see Chart 2)
- De minimis transaction costs

Chart 1: 1 year rolling beta listed property versus direct property



Disclaimer: First Sentier Global Property Securities Strategy vs INREV Global Real Estate Fund Index. All data in USD. Past performance is not indicative of future performance. Source: Factset and inrev.org. 31st December 2023.

Chart 2: Asset types of listed property and direct property

Listed property	Private property
• Medical Office Buildings	• CBD Office Buildings
• Private Hospitals	• Suburban Office Buildings
• Seniors Housing Assets	• Shopping Malls
• Life Science Assets	• Retail Shopping Centres
• Apartments for Rent	• Logistical Centres
• Detached Housing for Rent	• Industrial Warehousing
• Land Lease Communities	• Student Accommodation
• Student Accommodation	
• Hotels and Leisure Assets	
• Logistical Centres	
• Industrial Warehousing	
• Data Centres	
• Self-Storage Facilities	
• Shopping Malls	
• Retail Shopping Centres	
• Suburban Office Buildings	
• CBD Office Buildings	

Listed property

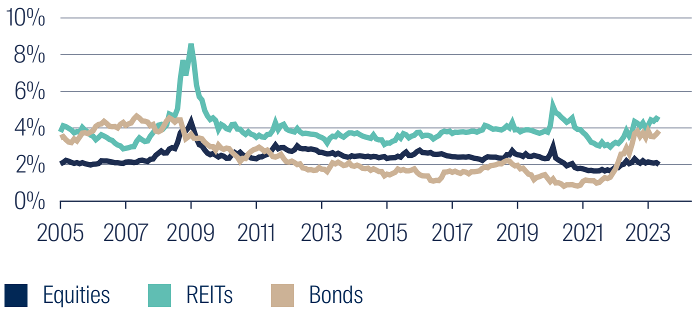
With listed property offering investor liquid exposure to high quality assets across various property subsectors, there are several other core characteristics of listed property that reinforce the aim to deliver resilient cash flows together with long-term capital appreciation:

Dependable cash flow

We believe REITs generate stable cash flows as their revenues come from contracted rental income streams across a diverse range of property types. The listed property universe includes asset types such as biotech laboratories, data centres, student accommodation, residential assets, self-storage facilities and logistics warehouses, which offer exposure to structural growth themes. These assets are usually less economically sensitive and their operating fundamentals are driven by factors such as societal change, technology adoption, data consumption growth and demographic shifts etc. The stable cash flows allow REITs to consistently provide attractive dividends to shareholders throughout economic cycles. Chart 3 demonstrates that global REITs have historically offered higher dividend yields compared to global bonds and equities.

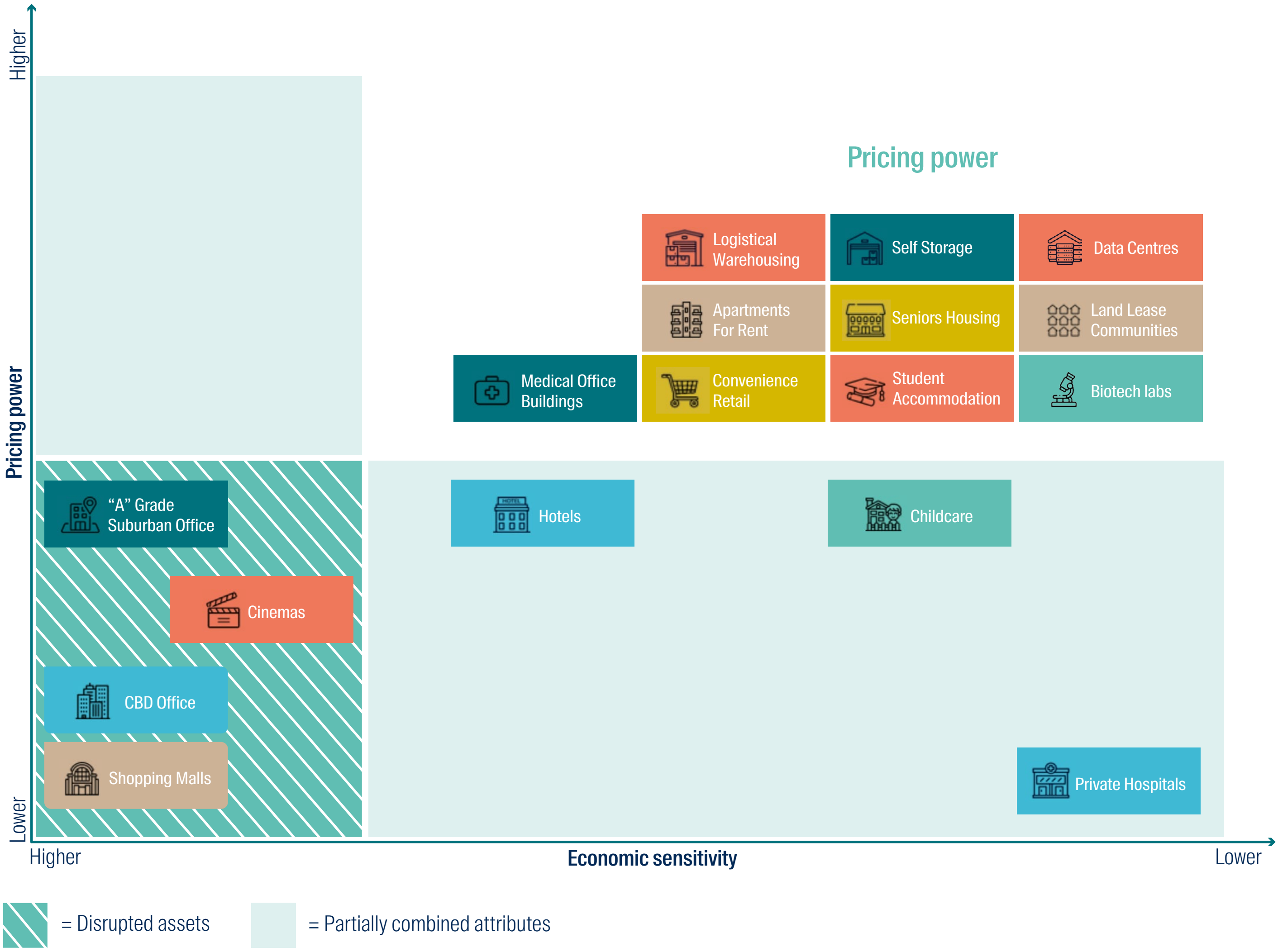
Many property types offer an inflation hedge to investors. Some property types have rental contracts with built-in clauses that automatically increase rents annually. These clauses can be fixed (typically around 2-3%), or tied to a published inflation rate, or a combination of both, which may take pricing floors or caps into consideration. In the short term, these lease clauses help pass higher landlord costs to tenants. However, for the inflationary hedge to be sustainable, the property must have pricing power. Without pricing power, the inflationary hedge may not be sustainable and could lead to tenant default and/or material falls in rents at the end of the lease. Assets that can maintain 'pricing power' (see Chart 4) are able to pass through inflationary pressures to tenants, providing a natural sustainable inflationary hedge that drives revenue growth. Rising inflation also increases the replacement cost of property assets and increases barriers-to-entry, reducing supply. This limited supply further supports market rental growth and property valuations.

Chart 3: Dividend yield



Disclaimer: Data as at 31 March 2024. Global REITs as represented by the FTSE EPRA Nareit Developed Index. Global Equities as represented by the MSCI World index. Global Bonds as represented by Bloomberg Global Aggregate Bond Index. All data is in USD.

Chart 4: Pricing power within listed property universe by asset type



Source: First Sentier Investors, for illustrative purposes only.

As shown in Chart 4, the majority of the listed property sector assets are positioned in the top right quadrant. These assets exhibit strong pricing power, which drives the inflationary hedge with low economic sensitivity.

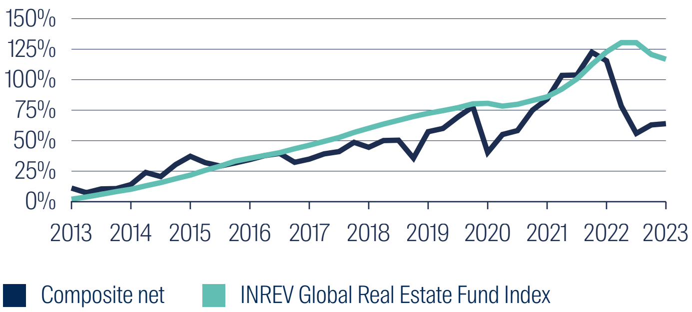
Understanding liquidity

For private investing, liquidity has been a core issue, especially during periods of volatility when Private Real Estate Funds have 'gated', preventing or delaying investor redemptions. For direct investment, capital market conditions may cause direct property markets to freeze, preventing asset sales.

In contrast, for listed property, whilst volatility may cause implied stock prices to fall below net asset values, liquidity is also available which allows for more efficient asset allocation. Volatility provides the flexibility to move between property segments, which may have different supply and demand dynamics. The appealing valuations in listed property also make a compelling argument, particularly for active management.

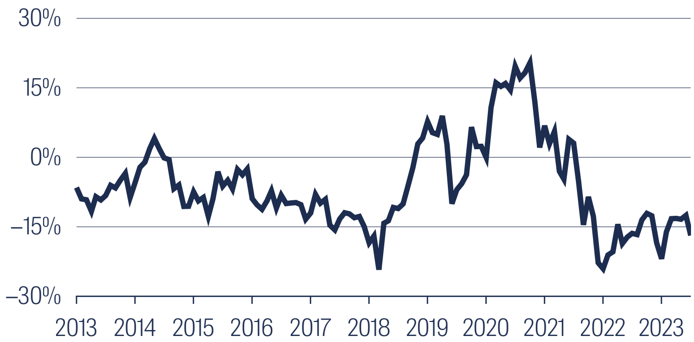
Chart 5 demonstrates that listed property and direct property have delivered similar long term returns until central banks began tightening monetary policy and increasing interest rates. The direct property valuation lag effect is very evident here, whereas listed property was revalued with immediacy. This lag effect in direct property valuation can create significant pricing dislocations in the short and medium term, as is the case today. We believe a further decline is expected in direct property valuations, listed property offers a distinct pricing anomaly with much higher total return expectations over the medium term.

Chart 5: Listed Property vs Direct Property performance (10 Years)



Disclaimer: Metrics are for the First Sentier Global Property Securities Strategy (USD) and the INREV Global Real Estate Fund Index. The First Sentier Global Property Securities Strategy is net of fees and the INREV Global Real Estate Fund Index is net of fees (assumption is 40 basis points). Past performance is not indicative of future performance. Data as at 31 December 2023.

Chart 6: First Sentier Global Property Securities Strategy Net Asset Value



Disclaimer: Metrics are for the First Sentier Global Property Securities Strategy (OEIC). NAV (Net Asset Value) is our assessed value of property assets owned plus the value of other businesses operated. Past performance is not indicative of future performance. Data as at 31 March 2024. Source: First Sentier Investors.

Conclusion

With investors having the ability to gain exposure to real assets via differing avenues, the decision to choose one over another can be challenging. It is clear that both listed and direct property have historically delivered similar returns over the longer term, which makes a strong case for owning both as they complement each other. However, in our view, listed property is expected to offer higher returns over the medium term given the current pricing anomalies. There is also an argument for listed property to deliver higher returns over the longer term, given its sector make up primarily invested in alternative property types with a stronger inflationary hedge. Essentially, liquidity should not be overlooked – it isn't important until it is. Combining higher return expectations and liquidity makes a compelling case for including listed property as an important part of real assets portfolios.

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