COHEN & STEERS

Strong foundations: The case for real estate securities

Listed real estate offers access to high-quality assets with strong growth potential, providing an efficient, liquid vehicle for investors seeking the unique benefits of real assets.

by **Jason Yablon, Mathew Kirschner** and **Ji Zhang**

KEY TAKEAWAYS

A distinctive combination of attributes

Listed real estate has a history of strong returns, attractive and growing income, low long-term correlations with stocks, and outperformance in inflationary periods.

A diverse and growing global market

The $1.9 trillion listed real estate universe represents 21 developed economies and more than a dozen property types, providing scale and diversity for active managers to potentially add alpha.

A complement to private real estate

Allocating to both listed and private markets may allow investors to better diversify their real estate portfolios, access next-generation property types and pursue timely tactical opportunities.

The case for real estate securities

Listed real estate may offer access to high-quality assets in an efficient and diversified manner.

Real estate has long appealed to investors due to its history of attractive income, total return, diversification benefits and inflation sensitivity, resulting in sizeable allocations that have continued to grow. The annual Cornell–Hodes Weill survey of global institutional allocation trends showed that real estate commitments have steadily increased over the past decade, reaching an average of 10.7% in 2021.[(1)]

This large investment universe—ranking behind only stocks and bonds in market size—has experienced a significant shift of capital from private market investors to the public market in recent decades. As a result, the U.S. equity REIT market has grown from just $9 billion in 1991 to $1.3 trillion today, while global listed real estate is now valued at $1.9 trillion.[(2)]

Listed real estate enables investors to construct globally diversified portfolios of high-quality assets, and we believe it is a natural complement to private real estate. In our view, the listed market has matured to the point that it can support diverse investment approaches and deliver a variety of distinctive investor benefits.

Summary

Distinctive characteristics

- Strong historical returns, averaging 11.1% per year in the U.S. and 7.9% globally since 1991 (Ex. 1)
- Potential for attractive and growing dividend income, with current yields at about 4% (Ex. 2)
- Historical correlation vs. stocks of 0.26 over five-year rolling periods, indicating potential diversification benefits (Ex. 3)
- Historical outperformance in periods of unexpected inflation (Ex. 4)

A diverse and growing market

- A $1.9 trillion market spanning more than 350 companies in 21 developed economies (Ex. 5)
- Access to alternative sectors such as cell towers, data centers, self storage and health care, which make up more than half of the U.S. REIT market (Ex. 6)
- Wide historical dispersion of returns at the country, sector and security level (Ex. 7) creates opportunities for REIT managers to enhance potential returns
- Active real estate portfolio managers have a solid record of outperforming passive benchmarks (Ex. 8)

A complement to private real estate

- Historically an effective way to allocate to core/core-plus real estate, outperforming both open-end and closed-end core private real estate funds by wide margins annually over the past 20–30 years (Ex. 9)
- Offering higher potential returns compared with core/core-plus private, yet with similar risk (Ex. 10)
- Besides a strategic allocation, potential to take advantage of compelling and timely tactical opportunities over the course of market cycles (Ex. 11)

Past performance is no guarantee of future results. See individual exhibits for notes. See page 15 for index associations, definitions and additional disclosures.

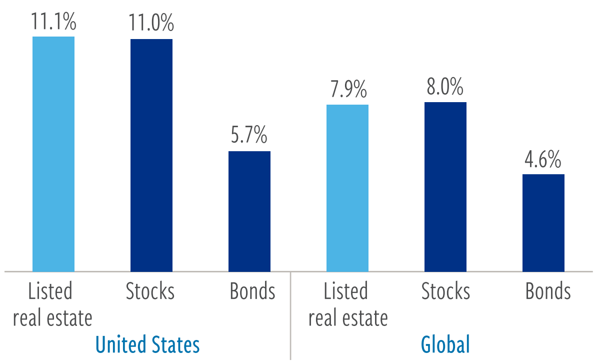
(1) November 21, 2021. Cornell and Hodes Weill & Associates Institutional Real Estate Allocations Monitor.
(2) **At June 30, 2022.** Listed real estate includes real estate investment trusts (REITs) and other real estate securities. For simplicity, we may refer to listed real estate simply as REITs.

A distinctive combination of attributes

Listed real estate has a history of investment attributes that may provide a potentially compelling reason for allocations—particularly in the current environment of general yield scarcity and persistent inflation.

EXHIBIT 1

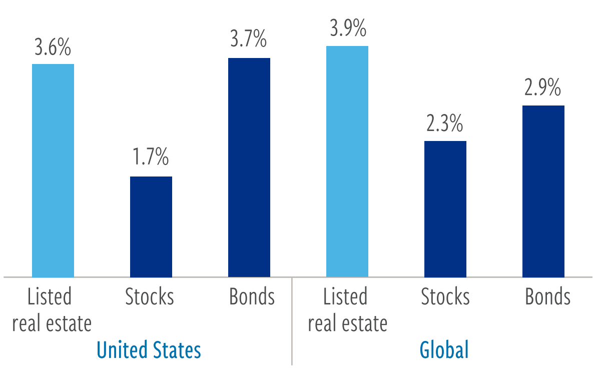
Annualized returns since 1991 (US$)



At June 30, 2022. Source: Morningstar, Cohen & Steers.

EXHIBIT 2

Current yields



At June 30, 2022. Source: Morningstar, Cohen & Steers.
Real estate and stocks represent dividend yield; bonds represent yield to maturity.

1. Strong historical returns

Since the start of the modern REIT era in 1991, listed real estate has delivered strong absolute and relative returns, averaging 11.1% per year in the U.S. and 7.9% globally (Exhibit 1). This track record has been underpinned by REITs' stable business models, which focus on acquiring and developing high-quality assets that generate recurring income tied to leases.

Furthermore, a process of natural selection over decades has prompted the adoption of best practices in investment strategy and corporate governance, generally to the benefit of shareholders. REIT management teams, unconstrained by a finite fund life, may focus on generating long-term shareholder value by investing in their platforms, which include people, process, data and culture. All of these, in our view, can help drive growth and improved financial returns.

2. Attractive income with growth potential

REITs tend to pay attractive dividends, with yields currently well above those of stocks and bonds globally (Exhibit 2). REITs are cash flow–oriented businesses and are required to pay out nearly all taxable income to shareholders. In the U.S., for example, REITs must distribute at least 90% of their annual net income.

By meeting this requirement, REITs gain exemption from corporate taxes, allowing them to efficiently pass through income to shareholders, who then pay taxes depending on their specific tax status.

Furthermore, REITs have an embedded mechanism for increasing dividends. For a REIT to remain above the minimum distribution threshold, it must typically raise its dividend concurrent with any growth in rents and net income. This dynamic has historically resulted in sustained dividend growth.

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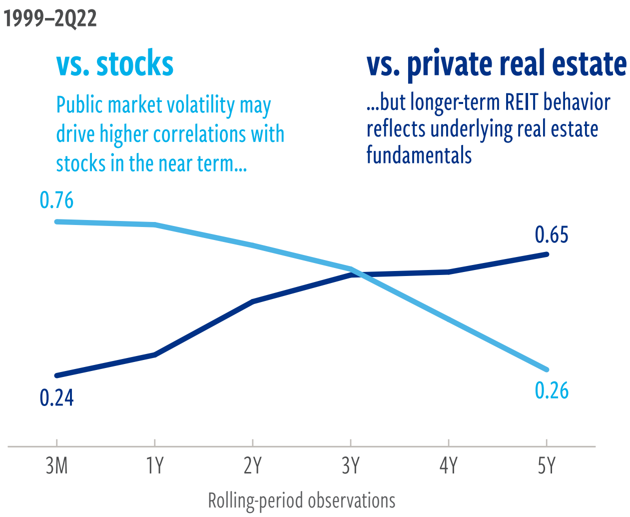
EXHIBIT 3

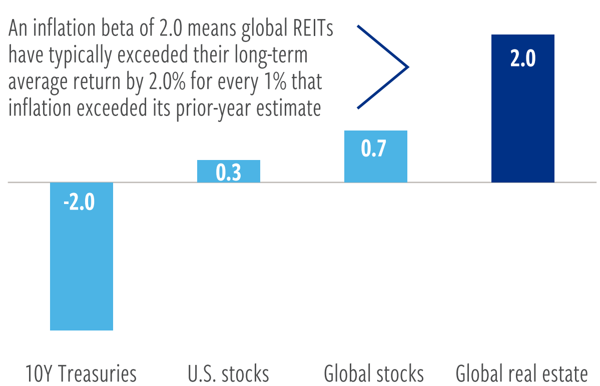
Listed real estate correlations by holding period



At June 30, 2022. Source: NCREIF, Bloomberg, Cohen & Steers.
Correlation based on rolling-period return time series calculated for U.S. REITs, U.S. stocks and private real estate using quarterly data. Correlation is a statistical measure of how two data series move in relation to each other.

EXHIBIT 4

Inflation beta, 1991–present



At June 30, 2022. Source: Bloomberg, Thomson Reuters Datastream, Cohen & Steers proprietary analysis.
Inflation beta calculates the linear regression beta of 1-year real returns to the difference between the year-over-year realized inflation rate and lagged 1-year-ahead expected inflation, including the level of the lagged expected inflation rate. Expected inflation as measured reflects median inflation expectation from University of Michigan's survey of forward-year inflation expectations. Realized inflation is measured by the U.S. Consumer Price Index (CPI) for All Urban Consumers, published by the U.S. Bureau of Labor Statistics. Linear regression is a statistical method that models the relationship between a dependent variable and one or more explanatory variables.

3. Diversifying correlations

Listed real estate may exhibit elevated correlations with stocks in the short term, influenced by market factors that affect publicly traded securities broadly. But in the long run, listed real estate's performance is largely driven by the underlying property markets.

Exhibit 3 shows this relationship through listed real estate correlations over different time horizons, from quarterly observations to rolling five-year periods. Historically, correlations with stocks decline dramatically as the holding period is extended, indicating that an allocation to REITs offers potential long-term diversification benefits within a traditional stock/bond portfolio.

By contrast, REITs exhibit little similarity to private real estate in the short term, as share prices are marked to market in real time, whereas private property values are based on slow-moving appraisals. Over longer observation periods, the performance patterns of listed and private real estate converge. In other words, REITs are, in fact, real estate.

4. Historical inflation protection

Listed real estate has historically performed well in inflationary environments, benefiting from attributes that impact both short-term and long-term performance:

Economic sensitivity	Shorter lease durations and/or greater economic sensitivity may better absorb rising overhead costs, benefiting from stronger demand in an improving economy.
High operating margins	Inflation hurts company profits when costs rise faster than revenues. REITs typically enjoy operating margins of around 60%, reducing the effect of higher costs.
Low commodity and labor price sensitivity	Most REITs have little connection to commodity prices, and onsite staff is usually minimal (except for hotels and health care). REITs' biggest costs are often property taxes, which tend to rise slowly.
Inflation-linked rents	Many commercial leases explicitly tie rent increases to a published inflation rate. (This is more common outside the U.S.)
Rising replacement costs	Higher costs for land, materials and labor can reduce the potential profits of development, raising the economic barriers to new supply and reducing potential competition for existing properties.

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A diverse and growing global market

The global listed REIT market has evolved substantially over the past several decades, providing access to new property types and new markets.

REITs are global

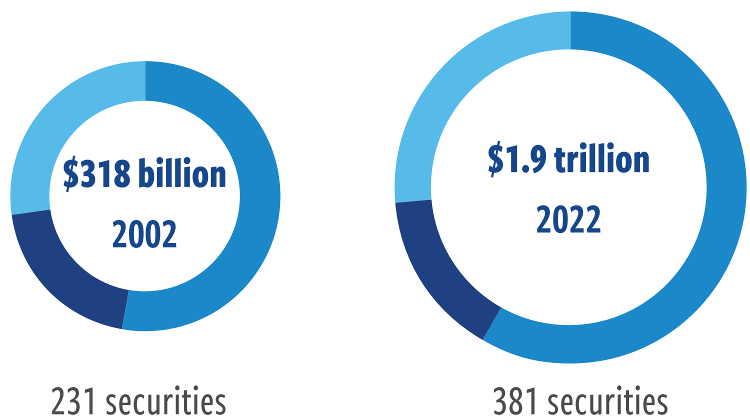
As capital has moved from private investors to the public market, global listed real estate has grown from a market capitalization of $300 billion in the early 2000s to $1.9 trillion today, representing 21 developed economies and more than 350 companies (Exhibit 5). Increasing adoption of the REIT structure has contributed to this growth, as governments have sought to expand access to real estate to a broader range of investors. Today, 38 countries have REIT-like securities, and more are at various stages of implementing REIT legislation. In addition to the $1.9 trillion developed market, emerging real estate markets account for an extra $140 billion in market capitalization.

EXHIBIT 5

Growth of the real estate securities market

Evolution of the global real estate market[a] over the last 20 years

Region	Annual Growth Rate 2002–2022[b]
North America	11.0%
EMEA	10.0%
Asia Pacific	9.9%



At June 30, 2022. Source: Nareit, FactSet, Cohen & Steers.

(a) The FTSE EPRA Nareit Developed Real Estate Index. (b) Shows compound annual growth rates of market capitalization by region for the past 20 years. See page 15 for index associations, definitions and additional disclosures.

Distinct regional characteristics

Each region's listed real estate market has evolved differently, resulting in meaningful structural differences.

United States

The U.S. REIT structure has evolved into the world's most efficient real estate operating model, in our view. The size and scope of the U.S. market has allowed REITs to develop dominant sector-specific platforms, allowing them to focus their business strategy, simplify their investment story and strengthen their negotiating position with tenants.

Europe

Many European and U.K. landlords have adopted reforms to improve corporate governance, business models and shareholder returns; these reforms include simplified sector strategies, less leverage and a greater emphasis on cash flow and active property management. Improvements in governance and board incentives are designed to drive better capital allocation discipline—an issue that has constrained external growth prospects in the past.

Asia Pacific

Asia Pacific has been the fastest-growing real estate market over the past few years, both in terms of its market capitalization and number of new listed companies. Initially dominated by developers, the region now has a substantial landlord presence. In the region, as in the U.S. and Europe, REITs have expanded into logistics, health care, data centers and hospitality.

Access to alternative property types

The modern listed REIT market has expanded into property types beyond the traditional sectors that dominated the market 20 years ago (and still dominate core private real estate funds).

The most notable change has been the growth of tech REITs. Over the past decade, many cell tower companies have converted into REITs, creating what is now the largest sector in the U.S. REIT market. Data center REITs have also grown alongside the demand for cloud computing and IT outsourcing. The industrial property sector now consists largely of smaller distribution centers for online retailers such as Amazon. These three sectors have been instrumental in providing the infrastructure for remote working, e-commerce and streaming entertainment.

Alternative property types now make up more than half of the U.S. REIT market and a quarter of the global listed real estate universe (Exhibit 6). We believe this has made the listed real estate market structurally less cyclical, driven more by secular trends such as the growth of e-commerce and the need for health care services and housing for aging populations.

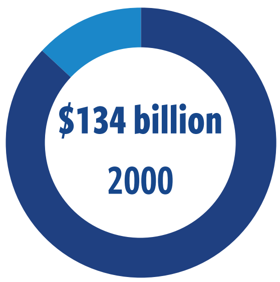
In addition, enhancements to REIT rules are creating new opportunities. For example, health care REITs that own senior housing are now allowed to operate properties with a third party, giving them a stake in the operating business and providing new avenues for growth.

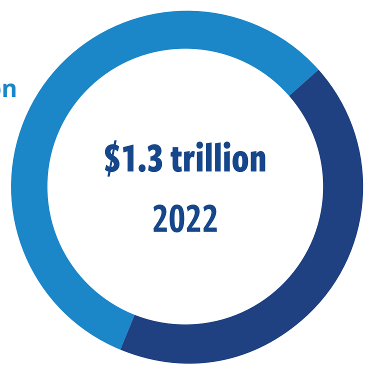
Next-generation property types have been critical to trends such as working from home and the fulfillment of e-commerce.

EXHIBIT 6

Next-generation real estate has driven growth of the U.S. REIT market

Market capitalization





U.S.	Index weight (%)
Traditional sectors	**43**
Industrial[1]	12
Apartments	11
Retail[2]	7
Offices	6
Net lease	6
Timber	3
Hotel	3
Diversified[3]	2
Next-generation	**57**
Cell towers	17
Health care	9
Data centers	7
Self storage	7
Manufactured homes	3
Single-family rental	3

		Company examples[4]		
Key growth sectors	**Drivers**	**North America**	**EMEA**	**Asia Pacific**
Cell towers	5G, HD video streaming, more connected devices	American Tower, Crown Castle, SBA Communications	Cellnex	
Data centers	Cloud computing, working from home, IT outsourcing	Equinix, Digital Realty Trust		GDS, NextDC
Health care	Life science research, patient care, assisted living, skilled nursing	Welltower, Ventas	Aedifica, Assura Group	Parkway Life REIT
Self storage	Need for space to store belongings, small business inventory	Public Storage, Extra Space Storage	Big Yellow, Safestore	National Storage REIT
Alternative housing	Single-family rental demand, age 55+ communities, student housing	Invitation Homes, Sun Communities, Equity Lifestyle Properties	Unite Group	Ingenia
Industrial	E-commerce logistics, last-mile delivery	Prologis, Duke Realty	Segro, Warehouses de Pauw	Goodman Group, Nippon Prologis, Ascendas REIT

At June 30, 2022. Source: UBS, Morningstar, Cohen & Steers.
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(1) Industrial also includes industrial office. (2) Retail includes regional malls and shopping centers. (3) Diversified (in the global market) also includes net lease and homebuilders. (4) Examples are the largest companies by market capitalization within a regional sector.

Regions and property types have distinct economic sensitivities and cycles that active managers can exploit to potentially enhance risk-adjusted returns.

Return dispersion creates opportunities for active managers

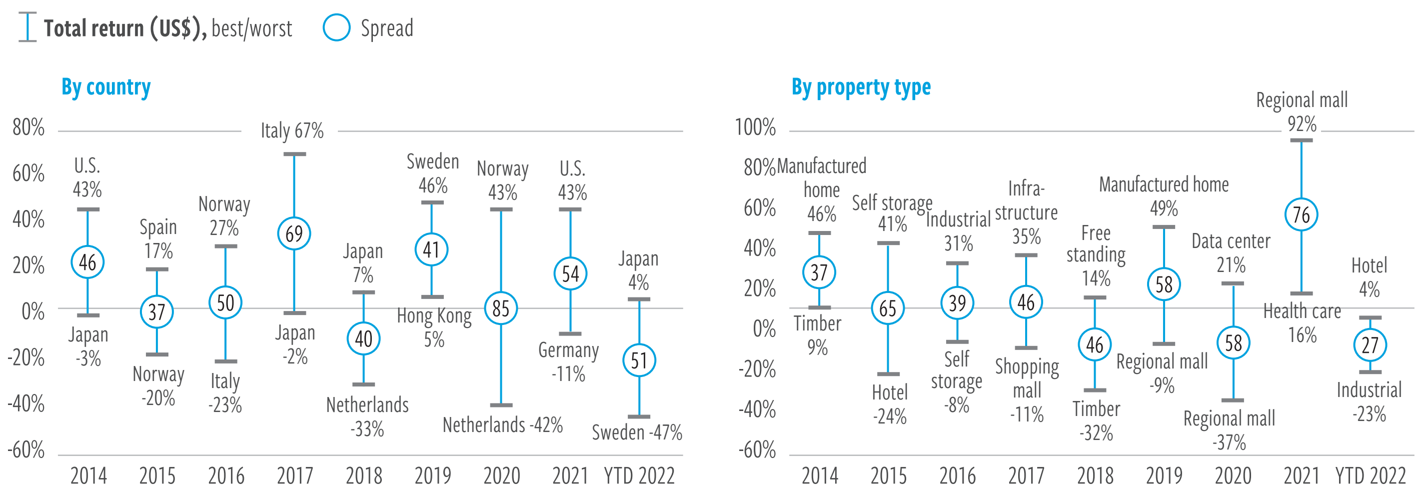
Across countries and continents, real estate performance may vary widely depending on differences in property cycles, macroeconomic conditions and interest rate policies. At the sector level, some companies are affected more by cyclical factors such as job growth, consumer spending and trade, while others are tied more to secular trends such as demographics and the growth of e-commerce. This diversity often results in a wide range of returns in any given period (Exhibit 7).

REIT specialists with the resources and experience to understand the market and position portfolios appropriately may enhance potential risk-adjusted returns. Indeed, active real estate portfolio managers have a solid record of outperforming passive benchmarks, as indicated in Exhibit 8.

EXHIBIT 7

Wide range of returns highlights opportunity

Active managers may exploit different conditions among countries and sectors to potentially enhance returns



At June 30, 2022. Source: Morningstar.
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EXHIBIT 8

Relative performance of global active listed real estate managers versus benchmark[(a)]

Annualized returns (%)	1 year	3 year	5 year	7 year	10 year
Top quartile	1.90	3.70	3.30	2.50	2.30
Median manager	0.80	2.60	2.40	1.60	1.50
Bottom quartile	-0.60	1.30	1.10	0.50	0.70

At June 30, 2022. Source: Morningstar, Cohen & Steers.
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(a) Manager preferred benchmark as detailed in eVestment.

A complement to private real estate

Though REITs may exhibit equity-like behavior in the short term, long-run performance is driven primarily by underlying real estate fundamentals (as reinforced by historical correlations shown in Exhibit 3). However, there are important differences between listed and private real estate which may present opportunities for investors who allocate across both markets. Notably, listed real estate offers the potential for:

- Outperformance relative to core private real estate funds, with added alpha potential from active management
- Broader diversification within a real estate allocation, including efficient access to international markets and alternative property types such as cell towers, data centers, self storage and health care
- Tactical allocation to different property types, and opportunistic arbitrage of dislocations in listed and private market values

Considering these attributes, we believe listed real estate can serve as an effective foundation for a comprehensive real estate strategy, complementing targeted opportunistic or value-add private real estate investments.

Listed real estate has historically delivered strong returns through investment strategies focused on high-quality assets using relatively modest leverage.

Historical outperformance relative to core private funds

For core real estate, many investors allocate to private funds to gain long-term exposure to commercial real estate. We believe 10-year periods generally provide an appropriate representation of the time horizon for these investors, and by looking at outcomes over rolling periods, investors may gain more useful insight into the consistency of total returns. Over rolling 10-year periods since 1993, which coincides with the beginning of the modern REIT era, REITs outperformed the NFI-ODCE[(1)] 76% of the time (60 of 79 quarterly observations) and delivered a similar range of returns to the NFI-ODCE (6.0–15.2% versus 5.0–12.9%, respectively, within the 5th to 95th percentiles), but with a median return about 270 basis points higher (Exhibit 9).

(1) NCREIF Fund Index–Open End Diversified Core Equity (NFI-ODCE) is a capitalization-weighted, time-weighted index of 36 private real estate funds pursuing a core investment strategy focused predominantly on U.S. assets.

The historical advantage is also evident when REITs are compared with private closed-end funds. (The private closed-end fund analysis carries the benefit of not relying upon an un-investible index of private real estate funds, comprising an often unknown mixture of funds of different vintages.) REITs have achieved these return premiums while providing daily liquidity and generally employing relatively low-risk core real estate investment strategies, with a focus on high-quality, stabilized assets. REITs also typically employ modest leverage of 30–40%, in line with many core private real estate funds.

EXHIBIT 9

A performance edge

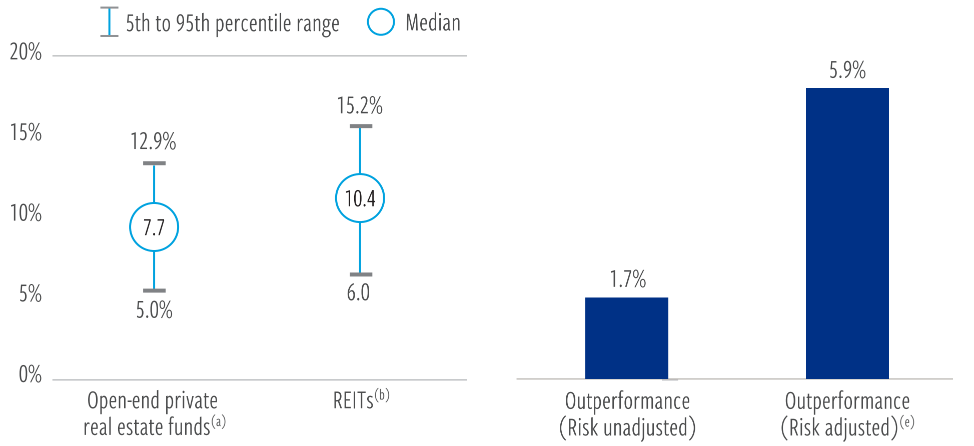
REITs have historically outperformed core private real estate

REITs vs. core private open-end funds

10-year rolling returns, Jan 1993–Jun 2022

REITs vs. core private closed-end funds

Time-matched REIT outperformance, Jan 2000–Dec 2019[c, d]



Frequency of REIT outperformance:	**76%**	**53%**	**68%**

At June 30, 2022. Source: Morningstar, Cohen & Steers and Warrington College of Business (Unversity of Florida).

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(a) Open-end private real estate funds are represented by the NCREIF Fund Index-Open End Diversified Core Equity (NFI-ODCE). (b) REITs are represented by the FTSE Nareit All Equity REITs Index. 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. (c) Thomas Arnold, David Ling and Andy Naranjo; Warrington College of Business, University of Florida. "Private equity real estate fund performance: A comparison to REITs and open-end core funds." *The Journal of Portfolio Management*, October 2021. (d) Closed-end private funds are represented by 375 seasoned funds; REITs are represented by the FTSE Nareit All Equity REITs Index. (e) Conservative adjustment for risk: illiquidity, additional leverage and the opportunity cost of keeping dry powder. See page 15 for index associations, definitions and additional disclosures.

What factors have potentially contributed to REITs' historical outperformance?

We believe structural advantages of the REIT business model likely account for the strong relative returns of listed real estate (which also benefits from increased liquidity) over core private funds.

- REIT management incentive compensation aligned with creating shareholder value
- Transparent accountability and public market oversight
- Ability to raise capital quickly and efficiently through public and private sources of equity and debt
- Exposure to historically strong-performing alternative property types such as cell towers, data centers, self storage and manufactured housing

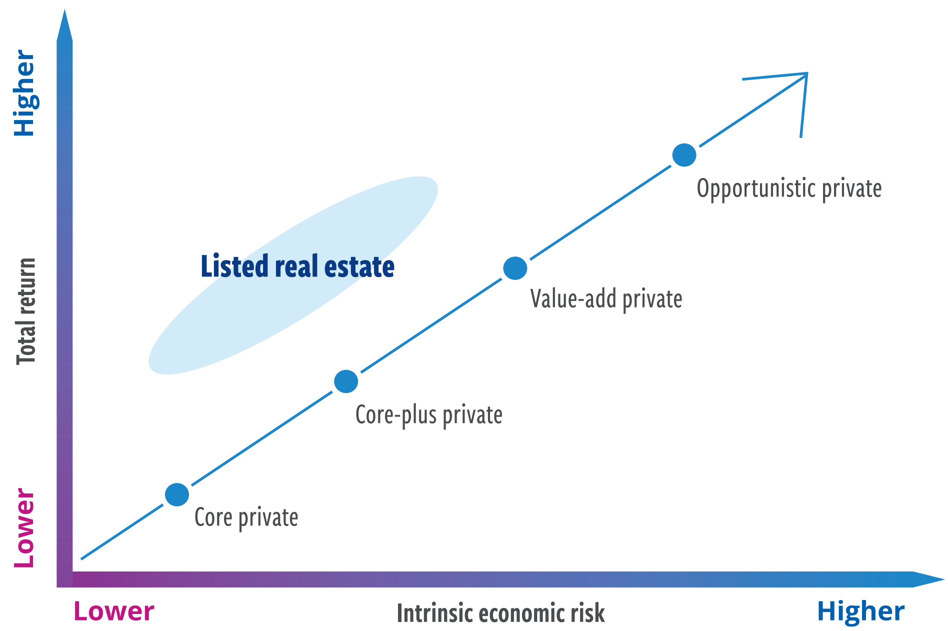
A compelling risk/reward profile versus private allocations

Allocating to private real estate may offer higher return potential as you move up the investment spectrum from core to value-added and opportunistic, but with greater macro risk as portfolios become more exposed to leverage and non-landlord development operations. However, a listed real estate allocation can offer higher potential returns compared with core/core-plus private, yet with similar risk, as REITs (like core private) tend to focus on lower-risk properties, typically with long-lease tenants (Exhibit 10).

EXHIBIT 10

REITs can occupy a sweet spot in the risk/reward profile

Illustrative potential returns and risk by real estate strategy



At June 30, 2022. Source: Cohen & Steers.
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Different response times may create tactical in-cycle opportunities

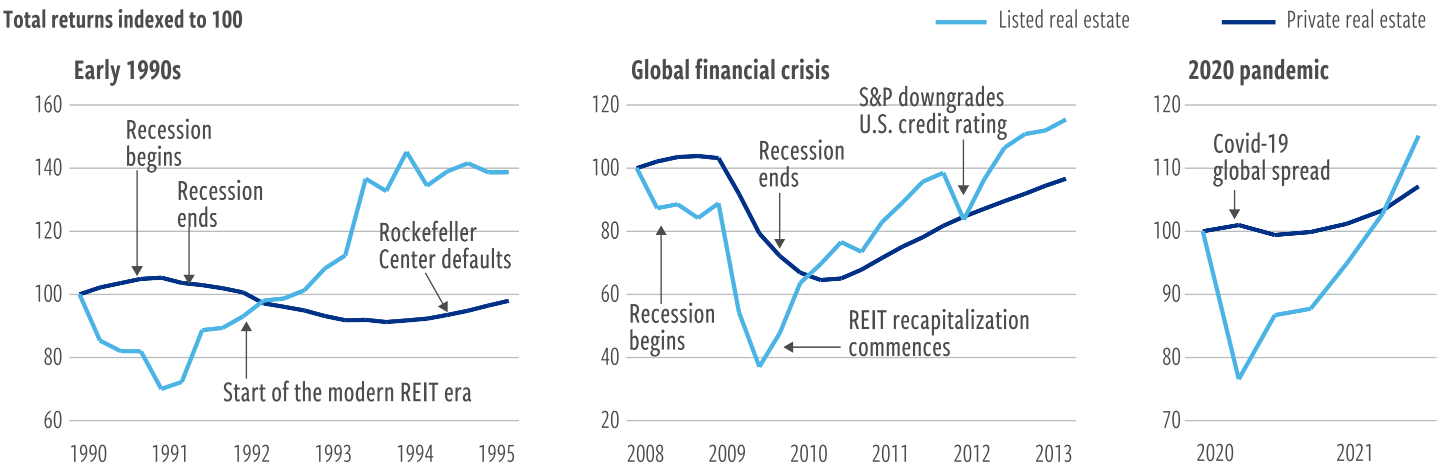
Differences between the real-time pricing of listed REITs and the typically slower-moving appraisal process used for valuing private real estate can create significant short-term dislocations, especially in periods of heightened uncertainty. Investors who understand this relationship and can allocate across both listed and private markets may be able to capture pricing arbitrage opportunities to enhance potential returns and diversification.

Historically, following market downturns, investors have been able to take advantage of the lag in private real estate values, investing incremental capital in listed markets (where markdowns may have already occurred) at potentially meaningful discounts to the securities' intrinsic value (Exhibit 11).

EXHIBIT 11

Dislocations create opportunity

Different trading dynamics of listed and private markets may create opportunities over market cycles



At June 30, 2021. Source: Morningstar, Cohen & Steers analysis.

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We believe pairing REITs with opportunistic or value-add private vehicles can provide an effective foundation for a comprehensive real estate strategy.

In the Covid-19 downturn of 2020, the REIT market's sudden, steep decline provided a short window to buy high-quality assets priced for opportunistic returns. However, considering the lasting implications for sector and geographic demand trends, we believe selective exposure, supported by fundamental research, is a better approach than a simple passive strategy.

Diversification through listed and private allocations

We believe both listed and private may deserve a place in a strategic allocation. The precise mix between listed and private will be driven by a series of investor-specific factors, including (but not limited to) the need for liquidity, preference for income versus total return, general risk tolerance, aversion to mark-to-market volatility and fee sensitivity. In addition to this strategic perspective on allocating to real estate, there may be cycle-specific reasons to invest in a certain manner.

Though many investors share a common set of priorities when making allocations, no single implementation offers a “silver bullet” solution that provides the best of each. Thus, investors must make trade-offs according to their individual preferences, and they may find that a diversified approach creates the best balance.

Outlined below are the relative strengths and weaknesses of different investments in listed and private real estate.

Potential full-cycle benefits and trade-offs of different real estate implementations

Investor priority	Relative strength in delivering on investor priorities: Strong		Weak
Total return	Opportunistic **Listed**	Value-Add	Core
Yield	Core	**Listed**	Value-Add Opportunistic
Liquidity	**Listed**	Core (open-end)	Private (closed-end)
Reported volatility	Private		**Listed**
Fees	**Listed**	Core	Value-Add Opportunistic
Asset quality	**Listed**	Core Value-Add	Opportunistic

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How institutions are allocating to listed real estate

As institutional investors have ramped up their use of listed real estate, we have observed a variety of implementations tailored to investors’ differing objectives. These have included:

Use case	Sample strategies
An entire real estate allocation	Global real estate securities U.S. real estate securities
A core real estate allocation, intended to be combined with private real estate opportunistic funds	
An opportunistic allocation (often in addition to long-term allocations) to tactically overweight real estate over the course of a market cycle	
A liquidity tool to be drawn down to fund capital calls on a private real estate strategy	
A tactical sleeve to provide an active allocation overlay to private investment	
A regional completion strategy for investors with large allocations to domestic assets seeking global exposure	Real estate securities domiciled in North America, Europe and/or Asia Pacific
A sectoral completion strategy for investors with poorly diversified private allocations (often concentrated in office and retail)	Custom strategy targeting specific sector exposures

About the authors

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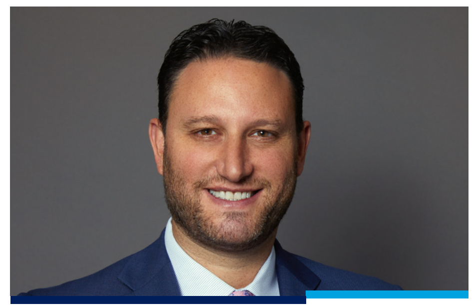

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Index definitions / important disclosures

An investor cannot invest directly in an index and index performance does not reflect the deduction of any fees, expenses or taxes. Index comparisons have limitations as volatility and other characteristics may differ from a particular investment.

Global listed real estate/REITs: FTSE EPRA Nareit Developed Index is an unmanaged market-capitalization-weighted total-return index consisting of publicly traded equity REITs and listed property companies from developed markets.

Global stocks: MSCI World Index, a free-float-adjusted index, measures the performance of large- and mid-capitalization companies representing developed market countries and is net of dividend withholding taxes.

Global bonds: Bloomberg Global Aggregate Bond Index provides a broad-based measure of the global investment-grade fixed-rate debt markets.

Private real estate: NCREIF Fund Index–Open End Diversified Core Equity (NFI-ODCE) is a capitalization-weighted, time-weighted index of 36 private real estate funds pursuing a core investment strategy focused predominantly on U.S. assets.

U.S. listed real estate/REITs: 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.

U.S. stocks: S&P 500 Index is an unmanaged index of 500 large-capitalization stocks that is frequently used as a general measure of U.S. stock market performance.

U.S. bonds: Bloomberg U.S. Aggregate Bond Index is a broad-market measure of the U.S. dollar-denominated investment-grade fixed-rate taxable bond market, and includes Treasuries, government-related and corporate securities, mortgage-backed securities, asset-backed securities, and commercial mortgage-backed securities.

10-year Treasuries: ICE BofA U.S. 7-10 Year Treasury Index is a subset of the ICE BofA US Treasury Index including all securities with a remaining term to final maturity greater than or equal to 7 years and less than 10 years.

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