

# On the lookout for where to go

Higher return opportunities in real estate | White paper

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For real estate investors, higher return strategies can be complementary to existing core holdings. In this paper, we look at current opportunities in the higher return space and factors which investors must consider to manage risk.

We think there are three ways investors can earn higher returns from real estate. First, from traditional value-add and opportunistic investments, second from opportunities arising due to market dislocation and third from specialist and thematic investments which deliver outsized returns as they benefit from megatrends and changes in the economy.

# We believe there are three roads to higher returns for real estate investors

As has always been the case, value-add and opportunistic strategies are avenues for higher returns – and risk – for real estate investors. In addition to these market priced strategies, we think that market dislocation and specialist investments can also offer opportunities for higher returns to investors.

## **The real estate investment opportunity set**

A central tenet of modern finance is the so-called Mean-Variance Model of investment. It states that higher investment returns should go hand-in-hand with higher risk, as measured by the volatility of returns. Interactions between assets and their impact on risk at the portfolio level must also be taken into account. Closely related to this is the Capital Asset Pricing Model, which looks at the returns an investor can expect to receive on an individual asset given its risk characteristics, and relates them to the overall market return. Private real estate can be analyzed within this framework too and typically sits between bonds and equities on the risk-return spectrum.

In this paper, we will look at ways for investors to generate higher returns from real estate and current opportunities for doing so. Overall, we see broadly three ways of generating higher returns. The first is from traditional value-add and opportunistic investments which the market prices correctly and hence higher returns can only be achieved by taking on additional risk. The second is when market dislocation and stress generates opportunities to earn outsized returns relative to the risk of the investment. The third and final way is from specialist investments which will benefit from wider trends in the economy which will cause them to deliver excess returns. Specialist investments based on asymmetric information are akin to an active strategy in the context of equities.

## **Traditional value-add and opportunistic investments**

Historically, real estate investments have been lumped into three buckets: core, value-add and opportunistic, with risk and returns increasing moving from core to opportunistic. Ultimately, how the market prices an investment and its implied return depends both on broader capital markets

factors, such as interest rates and the economy, and those specific to the investment, such as the risk and size of its projected cash flows. Whether the actual returns achieved match those underwritten, will only be seen with the passage of time. Other things being equal, we would expect there to be more variation in achieved returns versus underwritten returns for investments which are higher up the risk curve and have higher return expectations at the time of the investment. By definition these should be higher risk investments.

It is important to understand what factors the market takes into account when pricing investments. A key characteristic of traditional value-add investing is taking on leasing risk. A building which is currently unlet entails more risk than one which is fully let on a long lease. There is uncertainty over when the building will be let and on what terms with regard to the rent level and lease length. This means that the investment is riskier and that investors will require higher returns. There may also be an element of refurbishment or repositioning of the asset, which will also add to the level of risk.

Moving higher up the risk-return spectrum is opportunistic investment. This often involves developing a new building, which will entail a range of risk factors that investors will require compensation for. These include managing architects and builders, acquiring planning approval, liaising with local government and complying with its requirements and finally letting or selling the building on completion. All this leads to a broad, uncertain range of return outcomes for the investor. They must be compensated for this additional risk with higher returns.

Emerging market investments are another area of higher return and higher risk investment. Exposure to emerging markets requires expert knowledge of those markets. They will likely be operationally more challenging and opaquer, and hence more risky too. Moreover, effective investment will probably mean partnering with a local operator. Emerging market economies also tend to be more volatile and the political climate more uncertain than in advanced economies, although arguably populist movements have narrowed the gap. Emerging markets also entail currency risk, although hedging can help to reduce this. All these factors mean investors typically require higher returns from emerging market investments.

Illiquidity is the final factor which investors normally require higher returns for. However, we would argue that liquidity is a binary concept and that an investor either needs it or they don't. If they are investing for the long-term it may make little difference to them if two investments have similar return prospects, but one is less liquid than the other. In contrast, a short-term investor who needs quick access to their money may be willing to pay a premium for liquidity. Hence the market pricing of liquidity will depend upon the balance of investors with short-term investment horizons, who require liquidity, and those with long term horizons, who do not.

Returns can also be boosted by leverage, and typically this has been a cornerstone of value-add and opportunistic investment. Provided equity returns are higher than interest costs, then adding debt to an investment will be accretive to returns. Debt must be properly managed in terms of the level of servicing costs, covenants and leverage, but it will increase risk compared to the unleveraged investment. Higher returns can be mechanically generated simply by adding leverage to core investments. Indeed, it has been argued that leveraged core is a more cost efficient way of generating higher returns than a pure real estate strategy alone<sup>1</sup>. We acknowledge this argument, but believe that pure real estate strategies can also generate higher returns, particularly given the wide variation in post-investment performance for value-add and opportunistic investments, which we will discuss later.

### Higher returns arising due to market dislocation

So far, we have looked at strategies in which the market explicitly prices in higher expected returns for higher risk. However, as noted earlier, we think that opportunities can arise for excess returns relative to an investment's risk. The first area of opportunity arises due to dislocation and stress in the market.

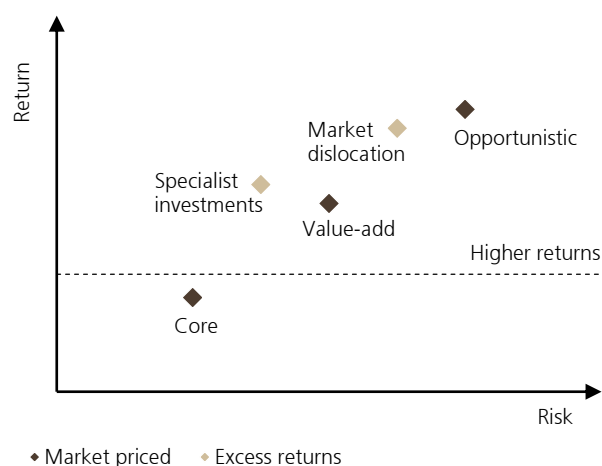
For example, when an owner must sell quickly because they have breached loan covenants or they need liquidity for other reasons. In such instances, they may be willing or forced to sell at below market price. Another example is a co-investment in a large portfolio deal which offers a discount to secure the final equity needed.

### Specialist investments can generate higher returns

The second area of generating excess returns relative to risk is specialist investments. Real estate markets can be opaque and subject to differing opinions on valuations and prospects. Asymmetric information and good market intelligence can generate excess returns for investors. For example, the existing owner of an asset may fail to appreciate what broader trends in the economy mean for its income growth prospects and factor in expectations that are too low. As such, they will under-value the asset relative to its true worth. Past examples of outsized returns include the Berlin office market, which has benefited from a booming tech sector which has driven very strong rental growth; and the logistics sector in general in recent years, which has benefited from the online sales boom.

Asymmetric information can generate alpha and excess returns purely at the equity level, without the need for adding leverage or any of the other facets associated with traditional value-add and opportunistic investing. Overall, we see three areas of opportunity for higher returns from real estate. The first is from traditional higher risk, higher return value-add and opportunistic investments. The second is from instances of market dislocation and stress. The final area is specialist and thematic investments when asymmetric information can lead to outsized returns. It is the latter which have the potential to be of most interest to investors and particularly profitable for them relative to the risk they are taking on (see Figure 1).

**Figure 1: Stylized real estate risk-return opportunity set**



<sup>1</sup> Another Look at Private Real Estate Returns by Strategy, Mitchell A. Bollinger and Joseph L. Pagliari Jr., 2019

Source: UBS Asset Management, Real Estate & Private Markets (REPM), November 2020. Actual returns may vary materially from forecast returns.

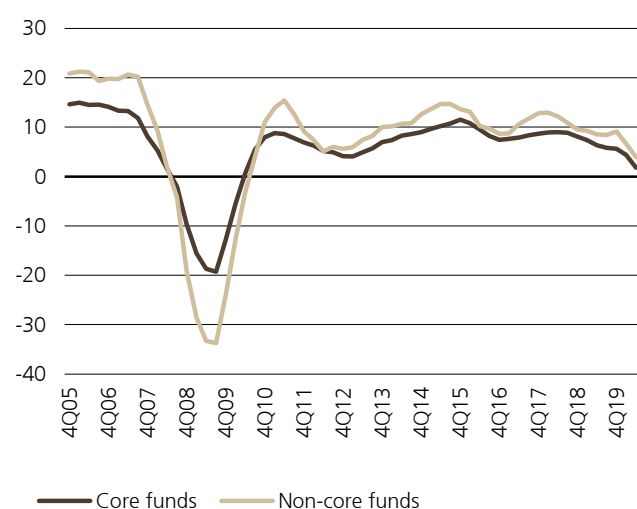
### Routes and vehicles for accessing higher returns

As for core real estate, investors have several routes by which they can access higher return strategies. At the most basic level, they can directly purchase real estate assets which have higher return expectations, whether they are market priced or excess return opportunities. This is most likely inadvisable though, particularly in the higher risk space, since investing in one or even a small number of assets will entail a large amount of idiosyncratic and concentration risk. Alternatively, for risk management purposes, investors could invest in either a fund or a multi-manager fund targeting this strategy. Either route would give the investor a small stake in a large number of investments, thus diversifying away a lot of the concentration risk and giving them the best chance for good performance.

### Non-core funds have exhibited higher returns and risk

Now briefly we turn to look at the historical performance of higher return strategies. Following our earlier discussion, we would expect higher returns to go hand-in-hand with higher risk. On the basis of fund return data, this has indeed been the case. The ANREV/INREV/NCREIF Global Real Estate Fund Index measures the performance of private market real estate funds around the world, and is split into both core and non-core buckets. Non-core funds have on average delivered higher returns than core funds, but also been subject to greater volatility and higher risk, as can be seen in the period around the Global Financial Crisis (GFC) (see Figure 2). Overall, we think that risk-adjusted returns in the non-core space have been fair.

**Figure 2: Fund returns – Global Real Estate Fund Index**  
(local currency, YoY% to 2Q20)



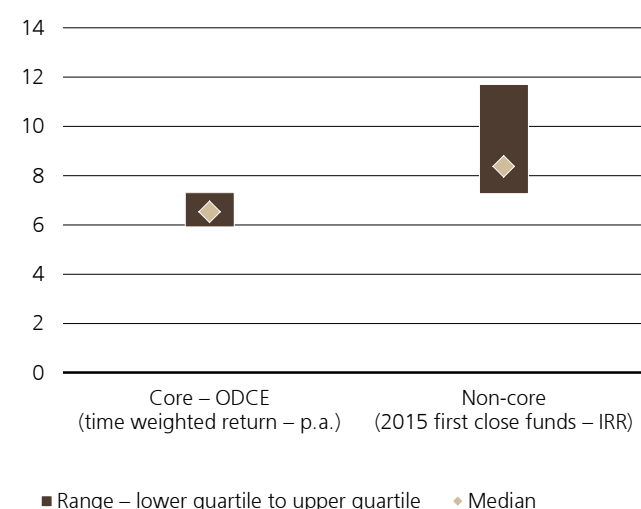
Source: ANREV/INREV/NCREIF GREFI; 2Q20. Past performance is not a guarantee for future results.

In the higher risk space most funds are closed-end. As such, historical performance must be assessed on internal rates of return (IRR). The ANREV/INREV/NCREIF Global Real Estate IRR Index measures the IRRs for funds by vintage year (see Figure 4 on next page). The data lead to two observations. First, that funds launched in the immediate wake of the GFC have achieved higher IRRs than those launched before it, since they were not subject to the capital value losses incurred during the GFC period. Second, for each vintage there is typically a wide variation in performance outcomes.

For example, for funds that had their first close in 2013, the median IRR was 14.9% to 2Q20 net of fees, while IRRs ranged from 11.7% for the lower quartile to 26.4% for the upper quartile. Therefore, in the non-core space, good manager and strategy selection, for the proper management of leverage, are crucial for investment success and mitigating risks.

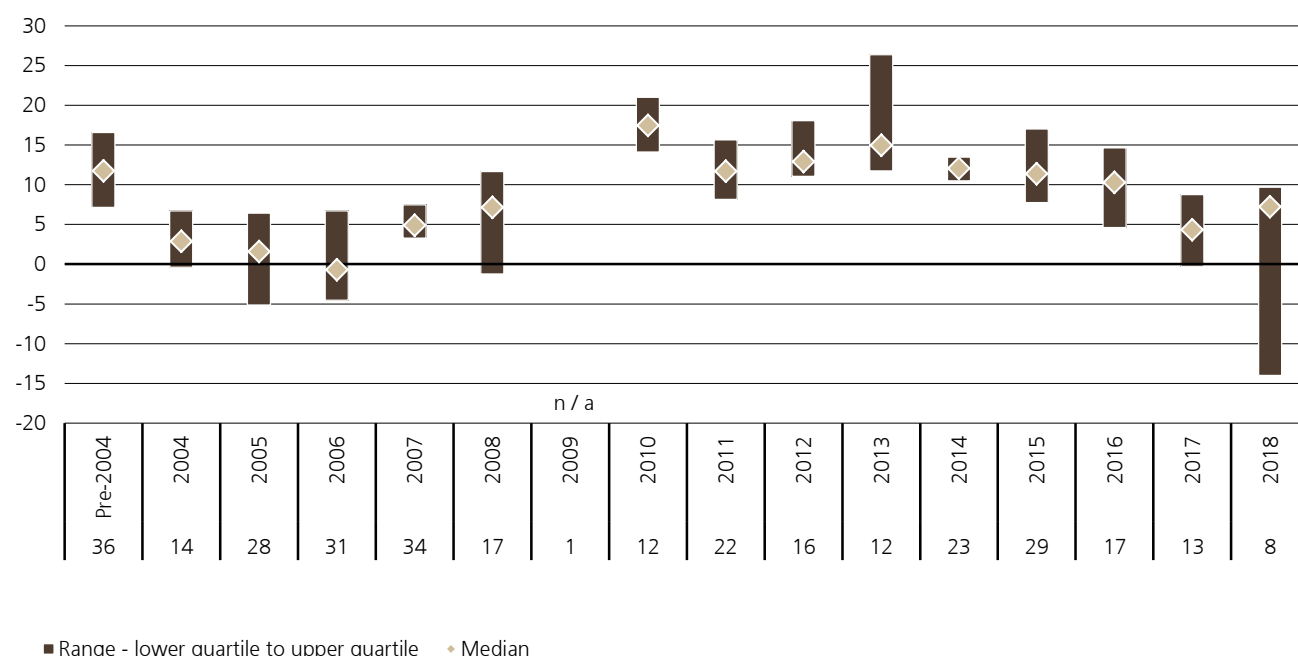
Data from the US provides additional evidence that the dispersion of returns is greater in the non-core space than in the core space. For example, the median IRR to 2Q20 for non-core funds which had their first close in 2015 was 8.4% net of fees, while the range from the lower quartile fund IRR to the upper quartile fund IRR was 443bps. By contrast, the return on the median core (ODCE) fund for the five years since 2Q15 was 6.5% p.a. net of fees and the range between the lower quartile fund and the upper quartile fund was lower, at 139 bps (see Figure 3).

**Figure 3: US fund returns 5 years to 2Q20**  
(local currency net of fees, %)



Source: NCREIF; 2Q20. Past performance is not a guarantee for future results.

**Figure 4: Distribution of IRRs for non-core funds since inception**  
(% by vintage year to 2Q20, with number of funds per vintage)



Source: ANREV/INREV/NCREIF, 2Q20. Past performance is not a guarantee for future results.

### The window for higher return strategies is open

As the period around the GFC demonstrates, non-core strategies have historically performed better for early cycle vintages than late cycle vintages which, by virtue of timing, incorporate a downturn. 2019 marked the tenth annual increase in global real estate values. However, we expect a small fall in values in 2020 due to the impact of COVID-19. In the higher return space, we think that the market correction and fall in values will potentially create an attractive window of opportunity for investment. Low interest rates and debt costs also mean that leverage is accretive to returns.

Moreover, we think that exposure in the higher return space is complementary to any existing core holdings which an investor might have. Core property yields are low, and we expect unleveraged returns in the region of 6% p.a. for the three years 2021-23. We think that higher returns can be achieved in the non-core space. Entering the non-core space also opens up deal-flow for investors, which would otherwise not be available to them.

### Opportunities in traditional value-add and opportunistic

We think that attractive investment opportunities do exist in the traditional value-add and opportunistic space, although limited availability of debt and its cost can be a restriction on executing these strategies. However, this has been partially offset by the private credit market. The first opportunity is traditional value-add investments in European office markets (see *European offices value-add* box on next page). We think there are also value-add and opportunistic investments available in the retail sector. The retail sector is highly challenged and struggling with the shift to online and lower footfall due to the COVID-19 pandemic. However, if executed carefully, we think there is the potential opportunity to buy retail assets and convert them to alternative uses.

Many of these conversion strategies are centered on the idea of densification, with retail not being removed entirely, but the space being utilized more efficiently by combining it with other uses, typically residential and leisure. This has the impact of creating a more pleasant and diverse retail environment, as well as creating a catchment for convenience retail operators. In addition, retail parks located relatively close to urban centers can be repurposed to last mile logistics facilities. This is a compelling opportunity for investors since it has the benefit of offering an initial income, and also that the reconfiguration of the structure is not very expensive in terms of capex.

### European offices value-add

The uncertainty of the economic fallout from COVID-19, the unknown path of the virus and the potential for major structural shifts towards home working will discourage occupiers from making long-term real estate commitments in the short-term. However, we believe in the future of the office as an essential, albeit shifting, part of the corporate function. When occupational demand does return, after some of the uncertainties dissipate, we expect it to be heavily focused towards the best quality office buildings in core city center locations, which can add real value to the workplace environment.

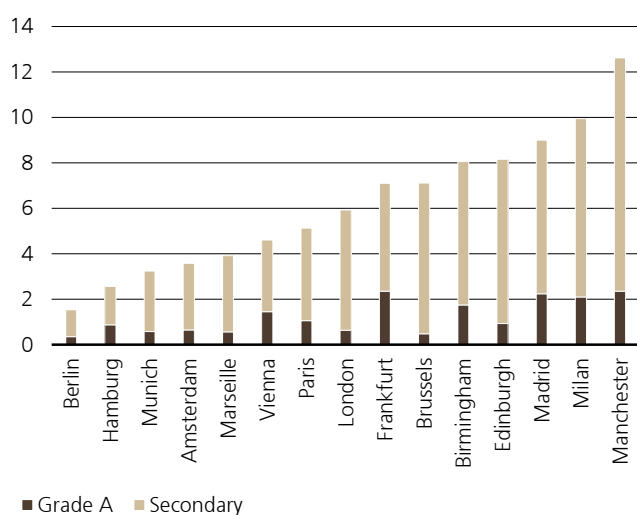
However, grade A supply in the vast majority of European markets is at extremely low levels (see Figure 5). And with the uncertainties facing the market, we expect development pipelines to remain subdued for the foreseeable future. This presents an opportunity to benefit from some of the market disruption caused by COVID-19 to acquire value-add assets in strong locations at a discount, driven by weak sentiment towards assets with short-dated income. Once vacant possession has been achieved, these assets can be repurposed to create office space environments to match the changing occupier requirements we expect to see in the post-COVID-19 world. Moreover, they will come back to the market at a time when supply of this quality of space is likely to be extremely stretched.

### Opportunities arising due to market dislocation

The most immediate opportunities arising are those due to market dislocation and stress brought on by the pandemic. Unlike the GFC, the COVID-19 crisis has originated outside of the economy and so far not resulted in the high levels of stress and forced sales we saw back then. During the GFC, it took some time for distress in the market to work its way through to asset sales, which peaked in 2011 (see Figure 6). However, we still think that there will be opportunities to buy assets at reduced prices from sellers who need liquidity. For example, corporates looking to shore up balance sheets, borrowers who are struggling to refinance assets due to tighter debt markets and operating partners who need equity quickly to complete a large deal and are willing to offer it at a discount. Other potential opportunities include funds reaching the end of their lives or being recapitalized. In the fund space, there may be opportunities to buy units on the secondary market at a discount to a fund's published net asset values.

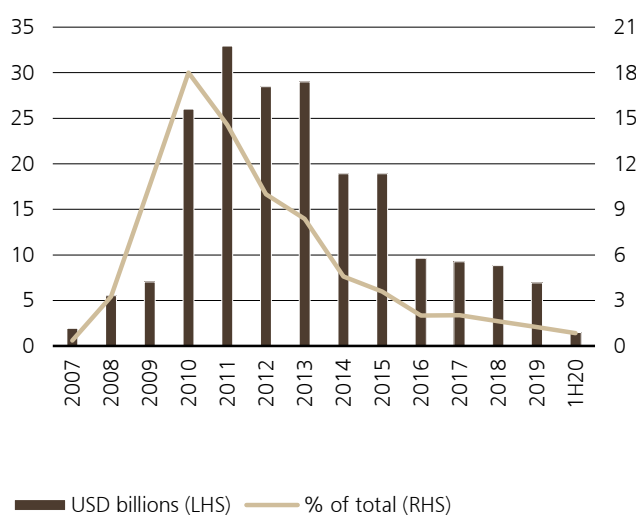
Another area of market stress which can present attractive opportunities is when listed markets over-react or value real estate assets at below the level at which private markets would value them at. Possibilities might exist for taking public real estate companies into private ownership. An example of this is back in 2016 when a Blackstone fund bought the BioMed REIT for USD 8.0 billion. Blackstone also privately sold its Logicon portfolio in 2017 to China Investment Corporation for USD 14.6 billion, reportedly preferring a private sale rather than a public offering because it was faster and could yield a higher price. The price would have made it an above-average size REIT in the US. Conversely, investors could buy large numbers of individual properties from smaller, private investors and aggregate them into a portfolio which incorporates economies of scale and is more highly valued.

**Figure 5: Office vacancy rates by grade (% , 2Q20)**



Source: CBRE, September 2020

**Figure 6: US distressed asset sales (USD and % of total)**



Source: RCA, 2Q20

### Opportunities for specialist investments

We think that identifying the dominant themes in the economy is key for finding specialist investments, since ultimately these trends should drive stronger growth in rental income, which can contribute to outsized returns. In its recent Q-Series report, UBS Investment Bank identified seven key

megatrends for the future (see Figure 7). We would add demographics as a key driver for real estate demand and investment performance as well, and think that real estate which is closely aligned to these megatrends has the best potential to generate excess returns.

**Figure 7: The megatrends of the future**

Area	Megatrend	Direction	Positively impacted sectors
Economy	From material to intellectual <i>A shift in economic focus further away from the material towards the intellectual and intangible</i>	Accelerating	E-commerce, education, technology, media and telecom
Trade	From globalization to stasis <i>A rotation away from globalization as value chains are shortened and become more domestic-oriented</i>	Accelerating	Media, pharma, food retail
Automation	From the factory to the mainstream <i>A broadening of automation to use in more general areas such as food, healthcare, consumer goods and e-commerce</i>	Accelerating	Capital goods, e-commerce, technology software
Policy	From whatever it takes to whatever is left <i>Policymakers having to use whatever policies are left to support the economy, with high public debt possibly leading to a loss of confidence and weak countercyclical fiscal policy</i>	Accelerating	Education, real estate
Sustainability	From shareholder to stakeholder <i>Strong interest in sustainability factors from investors, governments and consumers. Strong flows to sustainable funds for equities</i>	Accelerating	Not included in sector assessment, but affects all sectors
Distribution	From hypercapitalism to higher taxes <i>A move to higher taxes to pay for the debts accumulated during the crisis and a potentially flatter income distribution</i>	Emerging	Pharma, utilities
Health	From pandemic to higher life expectancy <i>Higher life expectancy after the pandemic due to health tech and greater consumer engagement</i>	Surprising	Real estate, e-commerce, medical technology

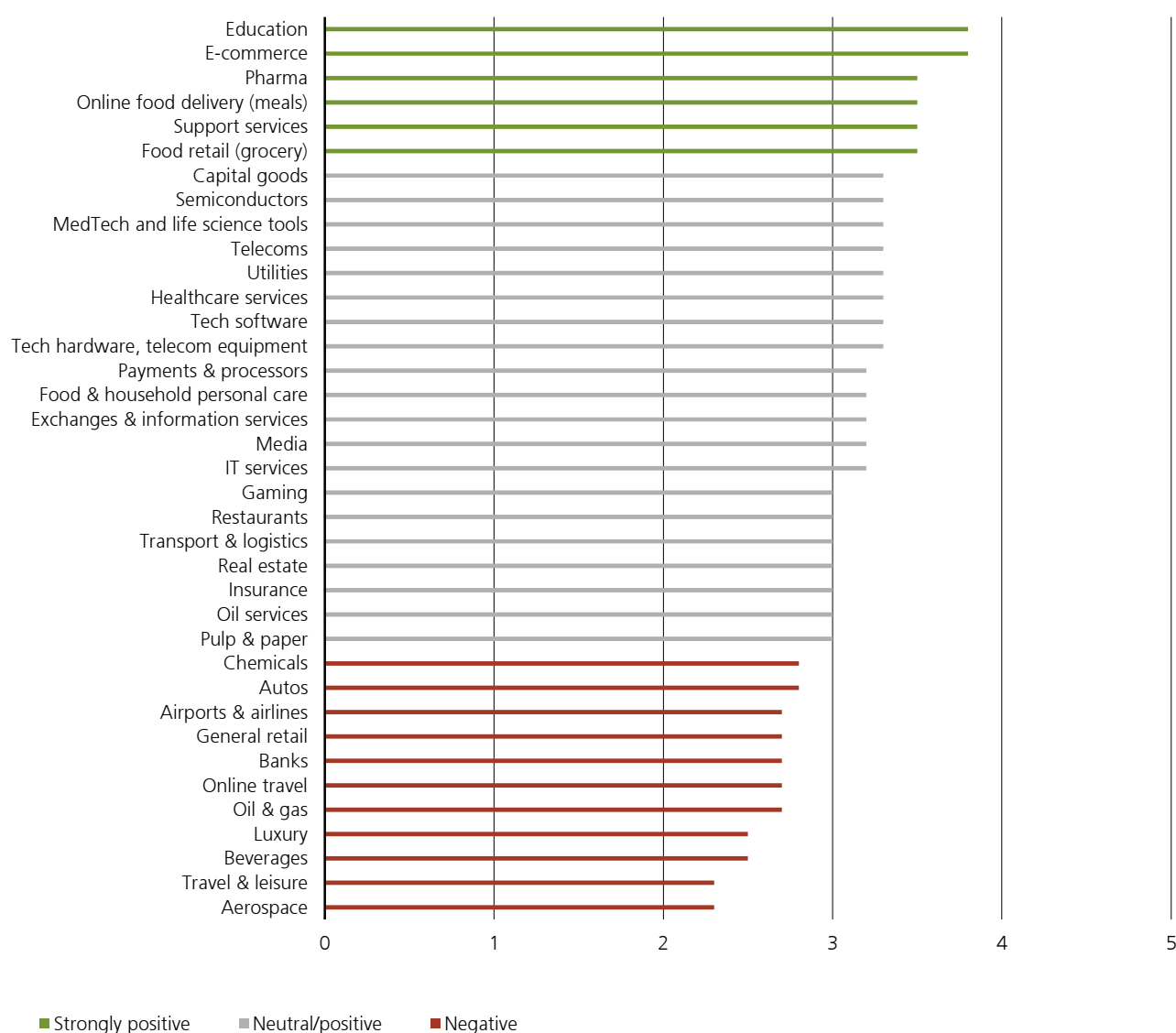
Source: Q-Series, Future Reimagined: Propelled to The Thinking Economy, UBS Investment Bank, June 2020

The report examines how the megatrends identified will affect different industry groups (see Figure 8). The most positively impacted industries will likely be the most profitable and grow in size. As such, they will also likely exhibit the strongest demand for the real estate they use, creating the potential for stronger rental growth, particularly in markets which are supply constrained in some way, such as due to a lack of land.

The two industries expected to be most positively impacted by the megatrends are education and e-commerce. They are followed by pharma, online food delivery (meals), support services and food retail (grocery). At the bottom of the list, unsurprisingly, are the likes of aerospace, travel and leisure, airports and airlines and general retail.

**Figure 8: Impact of megatrends across industry groups**

(5 represents the most positive and 1 the most negative)



Source: Q-Series, Future Reimagined: Propelled to The Thinking Economy, UBS Investment Bank, June 2020



## **Specialist investments with alpha potential**

We now move on to look at some specialist and thematic investments which we think will benefit from the megatrends identified and other changes taking place in the economy and society at large. We think that real estate investments in the 12 areas listed below, in no specific order, have the potential to deliver excess returns and be alpha investments.

### *1. Consumer focused logistics*

Real estate investors are well versed in the e-commerce story and the impact it has had on logistics and distribution. E-commerce is the sector expected to be most positively impacted by megatrends. The new online customers from during the lockdown period are expected to be sticky and the share of online retail sales is predicted to rise even further as e-commerce broadens to previously underpenetrated sectors, such as luxury and to the older population. Over the longer-term, online market places are expected to benefit more than online retailers. Overall, this supports demand for consumer-focused logistics, such as last-mile, urban delivery facilities, parcel pick-up sites and warehouses. The main risk to this sector is supply, though this is often constrained for facilities in city centers. The opportunities are most likely in markets which are lagging in online and have scope for catch-up, such as some of the continental European countries.

### *2. Real estate linked to pharma and life sciences*

Pharma is ranked three in terms of the positive impact of megatrends on the sector and is expected to benefit from an increased focus on vaccine development. Medical technology and life sciences should also be supported by the underlying demographic of aging populations which demand new health care treatments. Meanwhile, advances in genomics are spurring innovation in testing and therapeutics. Also worth noting is an increase in telemedicine and remote patient monitoring. In general, we expect real estate aligned to the health sector such as medical offices, laboratories and out-patient clinics, to perform well. One risk to be monitored in the US is any changes to drug pricing policy which could occur following the Democratic presidential election victory in November 2020.

### *3. Affordable housing*

In most advanced economies housing is both in short supply, particularly in cities, and unaffordable, especially for those on low incomes. This presents an investment opportunity as governments look to partner with institutional investors to help deliver affordable housing at scale for their populations to improve living conditions and social welfare. We think that the sector could also benefit from a shift in government policy towards a leveling of the income distribution. Affordable housing also gives investors an opportunity to participate in socially beneficial investment.

### *4. Real estate supporting the tech and digital world*

The COVID-19 pandemic has hastened the shift from the physical to the digital across all parts of the economy, from communications and teleworking to online shopping. We think real estate which is aligned to and supports the growing digital infrastructure needed will see strong demand. This means data centers and real estate in existing and emerging tech hubs. Given the rotation towards home working and uncertainty over the outlook for the office sector, strong demand for offices in tech hubs is not assured, but should provide a tailwind for these markets, such as Nashville in the US.

Education is ranked number one in terms of megatrend impact, reflecting a rotation towards online teaching and courses. Hence the potential for education lies in the technological ecosystem that facilitates online learning. As an aside, we think that traditional student accommodation will be underpinned by university social interaction and the fact that some courses, such as medicine and natural sciences, will still require a significant amount of practical laboratory work. However, we think that some lower ranked institutions could be at risk and we will closely monitor developments.

### *5. Facilities supporting online grocery*

Online grocery is expected to benefit from megatrends and projected to be another growth area. Online grocery sales accelerated during the COVID-19 lockdown, though it has been a challenging area for operators, who have struggled to meet volume demands and contain costs. For the time being, physical supermarket chains are mostly fulfilling online orders from their existing physical stores rather than dedicated facilities. However, this could change and in the long-term operators will likely become more efficient as higher levels of demand spur innovation. This could see a rotation towards specialist facilities focused on fulfilling online grocery orders only and more pure-play online operators may emerge. An example of this is Ocado, a UK online supermarket operator. It should be noted that Ocado does partner with traditional supermarkets. Evidence of growth in the sector comes from the UK grocer Tesco, which announced in August 2020 that it will generate 16,000 new jobs to support its online business. This follows its online share of sales rising to 16% over the pandemic from 9% before.

### *6. Dark kitchens for online meal delivery*

Online food and meal delivery is another area which is expected to be positively impacted by megatrends. Currently, online food delivery services are mostly fulfilled via existing restaurants. However, as the sector evolves we are seeing greater interest in and use of *dark kitchens* (delivery-only restaurants), which cater solely to the online market. Such facilities will need to be located near or within urban centers and residential areas with high population densities. We think alpha opportunities may arise in this area as the sector grows and innovates.

### 7. Multifamily

We think the multifamily sector offers alpha investment potential in countries where it is less developed. Populations have become more transient and mobile, family formation is being delayed and the shortage of housing is a constraint on purchasing mid-market homes. However, the pandemic is prompting a rotation towards home-based work arrangements and we think that investors should start to consider larger units that are located in suburban areas as well as renters start to prioritize living space efficiency over commuting time. Before the pandemic, the focus had often been on multifamily assets that comprised small unit layouts and were within walking distance to train stations. Investors with a track record in countries with mature multifamily segments, such as Japan and the US, can enlarge their geographical coverage by looking at other maturing and developing multifamily markets in Australia, China and European countries.

We think that real estate which is closely aligned to megatrends has the best alpha potential

### 8. Senior living

We think that senior living and retirement communities have the potential for excess returns, supported by the strong tailwind of aging populations. This should see rising demand for independent living, assisted living and accommodation for people with memory difficulties. The COVID-19 pandemic has hit the sector hard and is bringing about operational changes in the short-term, which we expect to last into the future. However, we think that in the long-term strong demand for this type of property has the potential to drive outsized investment performance, particularly for markets where this type of product is less common and has scope to grow in line with the desires and needs of the aging population, such as in some of the Nordic countries.

### 9. Vertical farming and urban agriculture

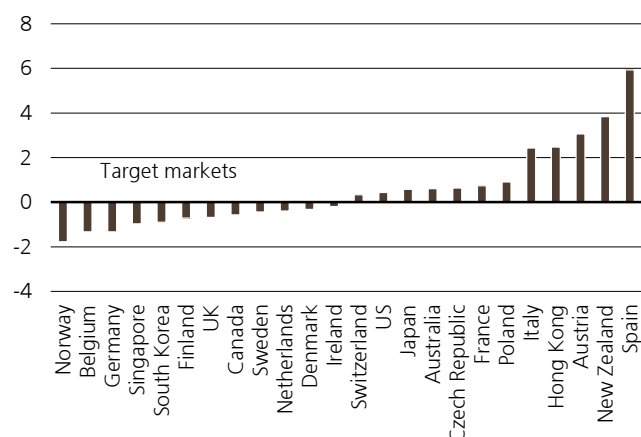
Vertical farming is a new and innovative way of providing locally sourced produce to city dwellers. Crops are grown in a controlled environment in vertical towers. The process also has the advantage of being viable in climates where standard agricultural production is not possible, such as in hot climates like the Middle East. Also, consumers are becoming more focused on where their food comes from and how it is produced. There has been a rotation towards domestic supply following interruption during the pandemic. This sector is unlikely to replace conventional farming, but we think that it is a disrupter and growth area worth monitoring. It may present good investment opportunities as it grows in size.

### 10. Domestic market focused hotels in developed economies

Travel and leisure are expected to be adversely affected by megatrends. However, we think that hotels serving their domestic markets in developed economies could present opportunities. Before the COVID-19 pandemic, we saw three key forces acting on international travel and hotels. In developed economies aging populations meant a gradual rotation towards domestic travel was likely as foreign trips became unfeasible or undesirable for older travelers. At the same time, increased awareness of the impact of carbon emissions and a desire to reduce carbon footprints (*flight shaming*) was likely to have a cooling impact on foreign travel in the medium-term. Moreover, ultimately government intervention in the form of taxes might also have been used to curb demand. Countering these forces on international travel was a rising affluence in developing economies, which was fueling an increase in the number of middle-income households with the desire and now financial resources to travel.

In the near-term, COVID-19 has severely disrupted international travel and leisure. Many people have taken vacations domestically as international travel restrictions have remained widespread and they have been concerned about contracting the virus. A full recovery looks unlikely for some time. Overall, we think that hotels in developed economies, particularly in northern European countries which had tourism trade deficits prior to COVID-19, will likely see increasing demand, both in the short and medium-term, and will benefit from more domestic travelers (see Figure 9). They will also potentially see an increase in international travelers from developing markets once the pandemic has passed due to rising incomes in these countries. However, it should be noted that demand and location from these different types of travelers does vary.

**Figure 9: International tourism trade balances**  
(% of GDP, 2018)



Source: World Bank, September 2020

### 11. Cold chain facilities

Following trade tensions in 2019 and the outbreak of COVID-19 in 2020, countries have become more convinced about accelerating the re-shoring of food production and stockpiling essential resources for national security. This implies that there will be a greater need for specialized logistics assets for storing and moving perishable produce and pharmaceutical products across domestic markets. In emerging markets such as China, across Southeast Asia and in Eastern Europe, food consumption patterns have evolved and the demand for protein has increased exponentially.

Along with greater awareness of food safety, this creates a real need for modern cold chain facilities. In most instances cold chain facilities are purpose built and it is unusual to find normal warehouses being converted to them. While not as energy intensive as data centers, cold chain facilities require uninterrupted and reliable power grids, which make it a rather unique asset class to create and operate. This also makes the supply of cold storage warehouses less susceptible to speculative development and supports the growth story in most markets. Moreover, an efficient food distribution network also helps to reduce food waste, which is desirable from an environmental perspective.

### 12. Farmland

Farmland is a less well-known asset class. However, we believe it has the potential to deliver good performance due to the long-term trends supporting demand for it. Growing global population and falling supply mean that demand for agricultural land will likely rise over time and generate upward pressure on prices.

### Strong ESG credentials crucial for all investments

We have highlighted a number of areas which we think have the potential to be higher return, alpha investments. ESG factors need to be taken into consideration across all investments. Investors, consumers and governments are placing increased value and emphasis on ESG factors in the real estate space and we think that this focus will rise further going forward. Moreover, we believe that strong ESG credentials are a prerequisite for good investment performance and go hand-in-hand with good stewardship and responsibilities to society at large.

In the real estate sphere carbon emissions, water usage, exposure to climate risk, social impact and governance are all factors of great importance<sup>1</sup>. For example, office tenants are demanding greener and more flexible workspaces. As previously mentioned, some of the specialist investments we have outlined in this paper also have specific ESG attributes. For example, affordable housing can bring about positive social impact and an efficient cold storage chain can reduce food waste. Overall, we believe strong ESG credentials are essential for investment success. In equities, there is also evidence that higher-rated ESG companies have yielded alpha over the past five years<sup>2</sup>.

### Conclusion

In this paper we have looked at ways to generate higher and attractive risk-adjusted returns from real estate investment, which can be complementary to any core holdings. First are the traditional higher risk value-add and opportunistic investment strategies, which are normally accompanied by leverage to boost returns. Second, are opportunities arising due to market dislocation. Finally, we think there are opportunities for excess returns from specialist investments, driven by megatrends and changes in the economy. Asymmetric information means that the market does not always price in the full potential of these investments.

We currently see investment opportunities across all these areas, which we have detailed in this paper. We think that closely monitoring the trends which will impact the wider economy and real estate markets will give investors the best chance of achieving higher returns, while at the same time balancing the risks. We have outlined a number of specialist investment areas which we think have the potential to be alpha investments and deliver excess returns. Doubtless others exist as well and more will surface in the future as the world we live in continues to change and evolve. We will be vigilantly monitoring for these opportunities as they arise.

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<sup>1</sup> See our White Paper: Going green, real estate sustainability in APAC, April 2020

<sup>2</sup> Source: Q-Series, Future Reimagined: Propelled to The Thinking Economy, UBS Investment Bank, June 2020

For more information, please contact:

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