For professional / qualified / Institutional clients and wholesale fund selectors investors only

Global real estate

UBS Asset Management | Viewpoints Market Outlook 2022

On November 30, **Charles Li,** Head of Global Wealth Management Client Coverage for APAC, spoke with **Nick Chukiat,** Co-Head of APAC, Multi-Manager Real Estate. They discussed how the outlook for global real estate has evolved with the pandemic.

Robust demand for high-quality real estate

- The pandemic demonstrated once again that the global unlisted real estate asset class exhibits lower volatility relative to other asset classes. This has been the case time and again across multiple market cycles.
- The pandemic magnified the risks and opportunities across various real estate sectors, and the Omicron variant has not changed this.
- In the office sector, we expect new COVID variants and the resulting government and corporate policies to delay a full-scale return to the office in the near term. Over the long term, we expect office footprints to shrink by about 10%.
- In the retail sector, we expect lingering COVID uncertainties to delay a return to normal foot traffic. We anticipate that retail spending will continue to be conducted mostly online.
- In Asia, markets like Japan, Hong Kong, Singapore and Australia still meaningfully trail Korea, the US and China in terms of e-commerce penetration.
- The industrial & logistics sector has been a direct beneficiary of increased online shopping habits. It should further be bolstered by increasing supply chain resiliency and a growing focus on domestic production of critical goods.
- In the residential & living sector, we have seen de-organization in certain markets, as well as a preference for larger homes, which are increasingly being used as flexible office space.
- We were not surprised to see residential real estate benefit from its essential non-discretionary aspects, as everyone needs a roof over their head. We believe this will help mitigate the risk of Omicron and future variants.

Sub-sector performance review

- During the pandemic, industrial & logistics was by far the best-performing sector, generating annual returns in excess of 20%.
- This was due to the acceleration of online shopping and increased investment in securing resilient supply chains.
- The sector also benefited from the recognition by the capital markets that modern, high-quality industrial and warehousing facilities belong in a long-term real estate portfolio.
- The residential & living sector also registered strong performance, with returns just below 10%.
- Rents provided stable income as people were forced to stay at home during lockdowns.
- The essential service that residential property provides has also translated into rental increases, which in turn have supported capital value appreciation.
- In the office sector, capital values tended to remain flat and stable despite mass work from home conditions.
- The resilience was due to the fact that office leases are contractual obligations, and corporates have generally been able to meet their rental obligations during the pandemic.
- The retail sector has been the hardest hit, registering double-digit capital value declines as lockdowns prevented people from going to shopping centers.
- The only exception was trips to buy daily essentials such as groceries and medicine.

Current portfolio positioning

- Our global real estate portfolios have been positioned to benefit from what we believe will be diverging sector performance as we emerge from the pandemic.
- At the start of the pandemic, we saw US real estate values decline marginally, driven primarily by weaker performance in the office and retail sectors.

- In 2021, we've seen a very strong recovery in US capital values.
- In Europe, we saw values decline in 2020. In 2021, the UK has posted a strong recovery, while the rest of Europe has only demonstrated a modest recovery to date.
- In Asia, we've seen a mix of performance, with Korea posting consistently strong returns, Japan demonstrating very stable performance, and Australia declining at the start of the pandemic, followed by a notably rapid recovery in 2021.
- With this wide range of outcomes at the various stages of the pandemic, being globally diversified would have protected the downside and left plenty of room for upside as the markets revert to normalization.
- We are expecting global real estate to deliver approximately 6% per annum over the next three to five years.

Fluctuating investor demand for real estate
- Just before the pandemic, global real estate transaction volumes had reached pre-Global Financial Crisis levels, at over USD 350 billion.
- At the start of pandemic, most investors took a cautious wait-and-see position. This resulted in real estate transaction volumes about halving in 2020.
- In the first three quarters of 2021, we can see that investor confidence in global real estate has returned. Transaction volumes have reached levels in line with 2018 so far.
- Depending on how transaction volumes pan out in the fourth quarter, it's possible that the market can recover to 2019 levels.
- The desire to invest in real estate is visible across investors in Asia, Europe and North America. Across the world, investors tend to target an allocation to real estate of about 10% to 11% of their portfolios.
- Investors in APAC are under-allocated to real estate, despite their target allocation.
- This can be explained by the relatively less-developed universe of income-generating properties in APAC versus the rest of the developed markets.
- A quick solution to remedy this under-allocation to real estate could be to invest in a multi-manager real estate fund.
- These funds allocate assets to a select number of managers and operators whose local expertise may provide an advantage in navigating constantly evolving market challenges, including local regulations, credit conditions and bespoke supply-demand conditions.

Future trends in real estate
- Pre-pandemic, we were already invested in senior housing, medical offices and life science laboratory spaces.
- These investments were made on the basis of the higher income they offer, their lower correlation to the broader economy, and the outperformance of a select group of specialists, operators and managers.
- We have further increased our exposure to health care-related real estate given the obvious near-term demand drivers, which include vaccine development and medical research, as well as the fact that health care companies tend to be more reliable occupiers of offices.
- Over the longer term, our original pre-pandemic rationale for investing in these health care-related subsectors remains intact.
- They are non-cyclical businesses that are supported by increased health care spending, aging populations, and in many cases, direct and indirect government subsidies.
- We have recently made our first investments into the APAC health care space via a couple of managers who focus on private hospitals in Australia, where the bulk of the rental income is paid by government tenants on long-term leases.
- Investments in this space align with our client and group focuses on impact investing, where we can demonstrate tangible improvements to health care access and quality of life.

Outlook for the retail sector
- During the pandemic, we've seen neighborhood retail centers, which are anchored by essential daily needs retailers such as grocery stores, pharmacies and discount retailers, demonstrate a surprising degree of resilience.
- We've also seen larger format, big box-anchored retailers thrive as consumers have been spending more time at, and working from home. These types of retail sub-sectors have seen their capital values hold steady.
- In contrast, large enclosed shopping centers, which are often anchored by obsolete department stores, have seen foot traffic and valuations decline.
- In Australia, neighborhood retail that is focused on daily needs has posted meaningful capital value recoveries.
- Our current House View forecasts that retail more broadly should see a capital value recovery from 2024 onward. But a lot can happen in two years.

Residential real estate in our portfolio

- We invest in income-producing residential properties, which include multi-family, single family, senior housing, student housing and affordable housing. These sub-sectors provide an essential service – namely a roof over their occupiers' heads – and thus tend to reliably generate consistent income.
- We invest with specialist operators and managers that can realize economies of scale and deliver high-quality dwellings, which is not easily replicable.
- The residential portfolios that we manage have exposure to the US, Japan, Europe and the UK, and target a diversified mix of occupiers through all parts of the human lifecycle, further limiting our concentration risk.

Global real estate in 2022

- There remains a lot of risk out there. Over the course of many market cycles, real estate has proven to be a resilient, stable, income-generating asset class.
- We've seen the benefits of that lower volatility versus other asset classes, and at the same time, we've been able to see capital value appreciation by investing into growth sectors.
- The coming year may be an opportune time to consider investing in global real estate.
- It may make sense to increase one's allocation to real estate from 5% to 10%, perhaps by reallocating assets from the more volatile equity asset class.
- That said, real estate is just one ingredient in a properly diversified portfolio. Diversification is key, especially given all the uncertainties that lie ahead of us.

For information purposes by UBS. For professional / qualified / institutional clients and investors only. Published December 2021.

This document does not replace portfolio and fund-specific materials. Commentary is at a macro or strategy level and is not with reference to any registered or other mutual fund. PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

Americas
The views expressed are a general guide to the views of UBS Asset Management as of December 2021. The information contained herein should not be considered a recommendation to purchase or sell securities or any particular strategy or fund. Commentary is at a macro level and is not with reference to any investment strategy, product or fund offered by UBS Asset Management. The information contained herein does not constitute investment research, has not been prepared in line with the requirements of any jurisdiction designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. The information and opinions contained in this document have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith. All such information and opinions are subject to change without notice. Care has been taken to ensure its accuracy but no responsibility is accepted for any errors or omissions herein. A number of the comments in this document are based on current expectations and are considered "forward-looking statements". Actual future results, however, may prove to be different from expectations. The opinions expressed are a reflection of UBS Asset Management's best judgment at the time this document was compiled, and any obligation to update or alter forward-looking statements as a result of new information, future events or otherwise is disclaimed. Furthermore, these views are not intended to predict or guarantee the future performance of any individual security, asset class or market generally, nor are they intended to predict the future performance of any UBS Asset Management account, portfolio or fund.

EMEA
The information and opinions contained in this document have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith, but is not guaranteed as being accurate, nor is it a complete statement or summary of the securities, markets or developments referred to in the document. UBS AG and / or other members of the UBS Group may have a position in and may make a purchase and / or sale of any of the securities or other financial instruments mentioned in this document.

Before investing in a product please read the latest prospectus carefully and thoroughly. Units of UBS funds mentioned herein may not be eligible for sale in all jurisdictions or to certain categories of investors and may not be offered, sold or delivered in the United States. The information mentioned herein is not intended to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. Past performance is not a reliable indicator of future results. The performance shown does not take account of any commissions and costs charged when subscribing to and redeeming units. Commissions and costs have a negative impact on performance. If the currency of a financial product or financial service is different from your reference currency, the return can increase or decrease as a result of currency fluctuations. This information pays no regard to the specific or future investment objectives, financial or tax situation or particular needs of any specific recipient.

The details and opinions contained in this document are provided by UBS without any guarantee or warranty and are for the recipient's personal use and information purposes only. This document may not be reproduced, redistributed or republished for any purpose without the written permission of UBS AG.

This document contains statements that constitute "forward-looking statements", including, but not limited to, statements relating to our future business development. While these forward-looking statements represent our judgments and future expectations concerning the development of our business, a number of risks, uncertainties and other important factors could cause actual developments and results to differ materially from our expectations.

UK
Issued in the UK by UBS Asset Management (UK) Ltd. Authorised and regulated by the Financial Conduct Authority.

APAC
This document and its contents have not been reviewed by, delivered to or registered with any regulatory or other relevant authority in APAC. This document is for informational purposes and should not be construed as an offer or invitation to the public, direct or indirect, to buy or sell securities. This document is intended for limited distribution and only to the extent permitted under applicable laws in your jurisdiction. No representations are made with respect to the eligibility of any recipients of this document to acquire interests in securities under the laws of your jurisdiction.

Using, copying, redistributing or republishing any part of this document without prior written permission from UBS Asset Management is prohibited. Any statements made regarding investment performance objectives, risk and/or return targets shall not constitute a representation or warranty that such objectives or expectations will be achieved or risks are fully disclosed. The information and opinions contained in this document is based upon information obtained from sources believed to be reliable and in good faith but no responsibility is accepted for any misrepresentation, errors or omissions. All such information and opinions are subject to change without notice. A number of comments in this document are based on current expectations and are considered "forward-looking statements". Actual future results may prove to be different from expectations and any unforeseen risk or event may arise in the future. The opinions expressed are a reflection of UBS Asset Management's judgment at the time this document is compiled and any obligation to update or alter forward-looking statements as a result of new information, future events, or otherwise is disclaimed.

You are advised to exercise caution in relation to this document. The information in this document does not constitute advice and does not take into consideration your investment objectives, legal, financial or tax situation or particular needs in any other respect. Investors should be aware that past performance of investment is not necessarily indicative of future performance. Potential for profit is accompanied by possibility of loss. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

Australia
This document is provided by UBS Asset Management (Australia) Ltd, ABN 31 003 146 290 and AFS License No. 222605.

Source for all data and charts (if not indicated otherwise): UBS Asset Management

AMT-1264 1/22
www.ubs.com/am

For professional / qualified / institutional clients and investors only.

UBS