LaSalle

January 2021

Research & Strategy

lasalle.com/research

Why Global Real Estate? A Canadian Perspective

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The rise of global real estate investment has been a feature of the market since the Global Financial Crisis. Elsewhere[1], we make the case for global real estate investment generally. Here we detail why we believe that the rationale underpinning the globalisation of real estate portfolios is particularly salient for Canadian investors, and how global indirect real estate investment could unlock many of these benefits.

One of the principal benefits of going global is that investors gain access to an enlarged opportunity set. For instance, we estimate that the entire Canadian institutional investible universe amounts to roughly US$ 303bn[2]. By extending their investible horizon's outside of Canada, they would expand their opportunity set by a multiple of 33.6. We expect that this multiple is likely to rise over the coming decade, as countries in earlier stages of their development path are likely to display greater rates of urbanisation and economic growth than developed ones, thus channeling investment towards productive investment uses like real estate. Moreover, the larger opportunity set also allows for an investors' portfolio to be tilted towards areas of stronger real estate performance through the cycle.

Table 1: Size of the Institutional Real Estate Investible Universe

	Institutional Investible Universe (US$ Bn)	Size Relative to the Canadian Universe
Canada	303	1x
Global Total	10,200	33.6x

Source: LaSalle (2021). Figures correct as at mid-2020.

Access to non-Canadian markets could also help enhance the benefits of diversification, improving the risk/return profile of investors' real estate portfolios. We have argued that differences in macroeconomic structures and cycles, as well asynchronies in the local drivers of real estate markets mean that real estate returns in different parts of the world tend not to be perfectly correlated. Table 2 below highlights that Canadian real estate returns display low correlations with a large sample of countries, particularly European and Asian markets. Even returns in markets with greater geographic, institutional and market structure similarities - such as the US, France or Australia - are less than perfectly correlated with Canadian real estate returns. A more granular assessment of city-level return correlations highlights that the five markets that display the greatest potential diversification benefits

[1] "Why global Real Estate?" LaSalle (2021)
[2] "Accessing the Real Estate Investment Universe in 2021", LaSalle (2021)

relative to Canadian cities are in Germany[3], whilst the five most correlated markets are concentrated in the US, France, and in resources-driven markets in Australia[4]. The opportunity is that including non-Canadian assets in their portfolios, Canadian investors could unlock higher levels of returns for a given level of risk.

Moreover, diversification can be enhanced by investing across the four quadrants of real estate, namely, public and private, debt and equity. Differences in liquidity, volatility and the position in the capital stack mean that the returns in the different quadrants are not highly correlated with each other over the short to medium term and likely to enhance risk-adjusted returns for a real estate portfolio.

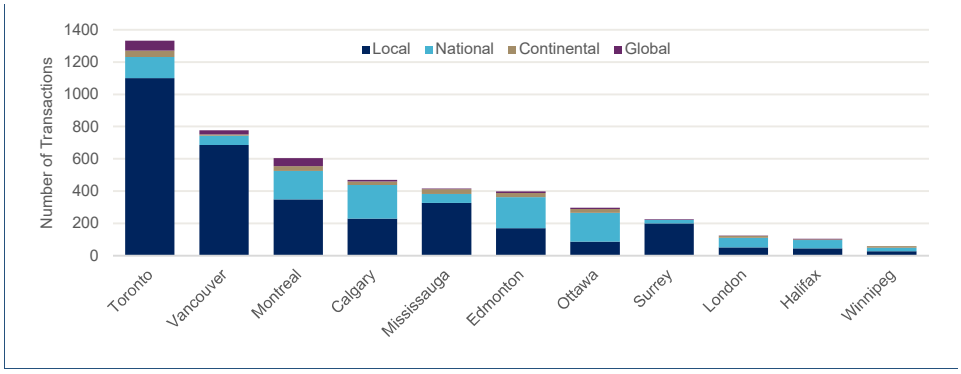
Table 2: Correlation Coefficients of Real Estate Returns (2001-2019)

	AUT	BEL	SWI	GER	NED	FRA	NOR	DEN	SWE	ITA	SPA	POR	IRE	UK	NZ	AUS	JPN	SKO	US	CAN
AUT	1.0																			
BEL	0.4	1.0																		
SWI	0.2	0.1	1.0																	
GER	0.4	0.3	0.1	1.0																
NED	0.5	0.7	0.1	0.6	1.0															
FRA	0.6	0.8	0.3	0.0	0.6	1.0														
NOR	0.5	0.8	0.2	0.2	0.6	0.9	1.0													
DEN	0.5	0.8	0.0	0.0	0.7	0.8	0.8	1.0												
SWE	0.7	0.8	0.2	0.3	0.7	0.9	0.9	0.7	1.0											
ITA	0.3	0.9	0.2	0.1	0.7	0.8	0.8	0.8	0.7	1.0										
SPA	0.5	0.9	0.0	0.5	0.8	0.8	0.8	0.7	0.9	0.7	1.0									
POR	0.3	0.9	-0.1	0.4	0.9	0.7	0.8	0.7	0.7	0.8	0.9	1.0								
IRE	0.5	0.6	-0.2	0.3	0.4	0.6	0.7	0.5	0.8	0.3	0.8	0.6	1.0							
UK	0.5	0.2	-0.3	0.0	0.1	0.4	0.5	0.3	0.6	0.0	0.4	0.2	0.8	1.0						
NZ	0.6	0.8	0.1	0.1	0.6	0.9	0.8	0.8	0.9	0.7	0.8	0.7	0.8	0.5	1.0					
AUS	0.6	0.8	0.3	0.2	0.6	0.9	0.9	0.7	0.9	0.7	0.9	0.7	0.8	0.5	1.0	1.0				
JPN	0.6	0.8	0.1	0.4	0.7	0.8	0.8	0.7	0.8	0.6	0.9	0.7	0.8	0.4	0.9	0.9	1.0			
SKO	0.1	0.7	0.3	-0.1	0.3	0.7	0.8	0.6	0.6	0.8	0.4	0.5	0.4	0.1	0.6	0.6	0.5	1.0		
US	0.6	0.5	0.3	0.2	0.4	0.7	0.6	0.4	0.8	0.4	0.6	0.3	0.7	0.6	0.8	0.9	0.8	0.3	1.0	
CAN	0.5	0.5	0.6	-0.2	0.2	0.8	0.6	0.5	0.6	0.5	0.4	0.2	0.4	0.4	0.8	0.8	0.6	0.5	0.8	1.0
Region	Europe														Asia Pacific				NA	

Source: MSCI Global Index (2019), based on annual total returns in local currency.

Canada's real estate market is notoriously competitive for domestic investors. Canadian pension funds are amongst the world's largest with some of those having spent years building and acquiring many of Canada's trophy real estate assets, while others have been more comfortable investing in their home market. According to OECD estimates[5] and assuming that that Canadian pension funds hold a real estate allocation of around 10.1%[6], that would translate to demand for US$ 150bn of real estate assets by these pension funds, or roughly equivalent to half of the institutional real estate stock in Canada. In this kind of environment, competition from domestic institutions for the best assets is likely to be high. In aggregate terms, cross-border transactions for Canadian assets has ranged between 5-20% over the last five years, a comparatively low level by developed market standards[7]. More granular data suggests that local and national investors have accounted for the vast majority of transaction activity in the largest Canadian metros (Chart 1). Going global could help mitigate the risk of overpaying for prime assets.

Chart 1: Transactions in Key Canadian Cities by Investor Domicile (2015-2019)

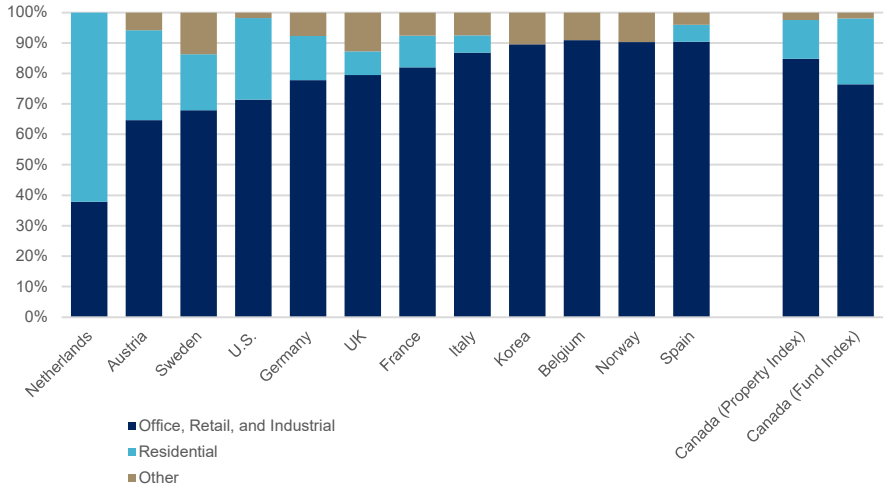


Source: RCA (12/20)

[3] Lowest return correlations are recorded for Berlin, Munich, Frankfurt, Dusseldorf and Hamburg. MSCI (2020)
[4] Canadian cities display the highest correlation coefficients in relation to Perth, Toulouse, Adelaide, Brisbane, and Washington DC. MSCI (2020)
[5] In 2019 the size of the Canadian pension fund market stood at around US$ 1.5tr. https://www.oecd.org/pensions/Pension-Funds-in-Figures-2020.pdf
[6] In line the target allocation to real estate reported by North American pension funds to the Hodes Weill Allocation Monitor. Hodes Weill (2020)
[7] RCA (12/20)

Access to niche/emerging property sectors that are larger and more developed in other parts of the world could provide an additional benefit for Canadian investors. It is noteworthy that the makeup of the Canadian real estate inventory, as well as the holdings of Canadian real estate funds are both largely skewed towards the traditional office, retail, industrial and residential sectors. Put differently, Canadian investors have more limited access to niche/alternative real estate sectors domestically. This is in stark contrast to the composition of the non-Canadian opportunity set (Chart 2).

Chart 2: Sector Composition by Country (%)



Source: MSCI (2020). Data as at end-2019.

Investing globally and only reflecting the composition of the global opportunity set could naturally increase Canadian investor's exposure to these nascent or specialist sectors. Moreover, the secular headwinds faced by at least two of the traditional sectors, retail and office, are well documented. As detailed in our Investment Strategy Annual for 2021, we believe that tilting investors' portfolios towards sectors driven by secular changes in demographics, urbanisation, technology and environmental change is one way to improve portfolio's resiliency. Investing globally is one way to help Canadian investors gain exposure to niche sectors.

Building the skills and know-how to execute strategies can be a significant barrier to enter for investors in specialist or niche sectors. Indeed, these sectors tend to require experience and expertise in highly unique and operational assets. Specialist managers often focus on raising capital via specialist REITs as well as open-end and closed-end fund structures. Therefore, an indirect approach is a good alternative for investors trying to access niche real estate sectors internationally all the while minimising asset-level idiosyncratic risks by investing in portfolios of these assets[8] .

In summary, Canadian investors can enhance the risk-adjusted return profile of their real estate investments by investing in a wider set of global investments. On the enhanced return side of the equation, they could access niche investments that would otherwise be difficult to access.

[8] For more details see "Accessing the Real Estate Investment Universe in 2021", LaSalle (2021)