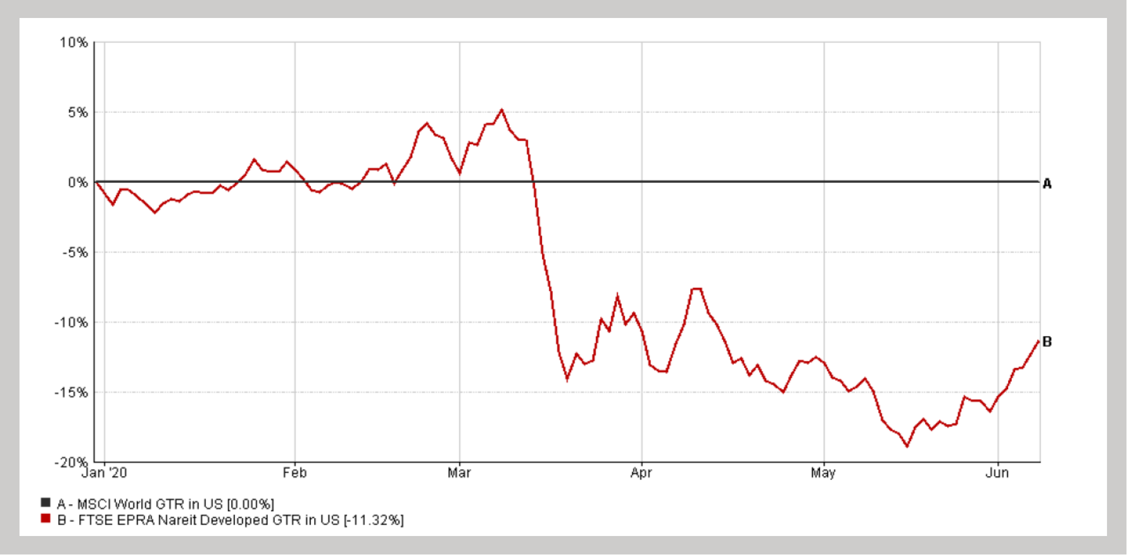
ANOTHER HEADWIND FOR LISTED REAL ESTATE?

In terms of "post-virus" portfolio activity, the only change that we have made at an asset allocation level in response to this year's events has been to remove exposure to listed property from our models. At the time of that decision – late March – we reasoned that downward pressure on rent rolls resulting from the abrupt slowdown across global economies, in combination with prevailing levels of balance sheet leverage, was likely to create funding pressures for real estate companies that would lead to capital calls across the sector. We reasoned that REITs (Real Estate Investment Trusts) were particularly vulnerable, since the requirement to distribute at least 90% of their taxable income as dividends in order to qualify for tax-advantageous REIT status left them very little in the way of a cashflow buffer when their income stream takes a hit. As the cornerstone of many an income portfolio, our view was that market demand for REITs was also likely to suffer disproportionately from the exit of yield-oriented investors as and when their dividends were reduced or cut completely.

Although one could argue the timing could have been a little better, based on subsequent market movements, our decision looks to have been a prudent one. As shown by the relative performance chart below, developed world listed real estate companies have lagged the broad global equity benchmark by a meaningful margin since the Q1 sell-off in risk-assets (REITS have lagged further still).

Developed market real estate vs global equities



31/12/2019 – 08/06/2020
Source: FE Analytics

With no known current active COVID-19 cases and none having been reported for 40 days, Guernsey is further down the road back to normality than most other western jurisdictions. Though that doesn't necessarily mean that we're best placed to get a feel for what's happening out in the big wide world, changes to the way that businesses are operating in our sheltered little island provide at least some clues as to the shape of the post-lockdown environment.

In this regard, one of the more notable aspects of the phased unwinding of isolation and distancing measures underway here is the considerable number of staff from a variety of business sectors who are choosing to continue working from home, rather than return to the office. While only time can provide any certainty as to whether this represents a structural shift or is merely a temporary phenomenon, one thing of which our collective experiences of the past three months gives a high degree of confidence is that technology is not an impediment to working remotely.

Indeed, at our local level, there is anecdotal evidence to suggest that working patterns are changing on a more permanent basis. By way of example, plans for the configuration of a refurbished building next to ours have been put on hold pending feedback on expectation of a reduced office-based headcount. Since there is no reason to think this won't be replicated elsewhere (why spend three hours of your day commuting in and out of London when you can work effectively from home?), we can now add changes to the usage of and demand for office space to the list of challenges facing the real estate sector over and above the suffering already visited upon it by the effects of the COVID-19 pandemic.

That being the case, a return to the listed property asset class within our asset allocation models looks unlikely for the time being.

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