Global Real Estate Securities

2020 Market Outlook
Executive SUMMARY

The Opportunity in 2020

As we enter the start of a new decade, global economic activity has shifted to a slower but steady pace compared to the past few years and Central banks stand ready to intervene to support economic activity by holding interest rates lower for longer until both growth AND inflation recover.

In an environment where economic growth is harder to come by, we believe Global REITs are positioned to deliver another year of double-digit total returns (10% to 12%) anchored by attractive earnings growth and supported by secular demand trends and accommodative financial conditions.

REITs benefit from predictable income BUT with growth in earnings far more resilient than other sectors of the economy, liquidity far more abundant than private real estate and yields far higher than many fixed income alternatives.

While the current cycle is long by historical standards, strong global labour trends and consumption are positively influencing commercial real estate fundamentals and demand for residential housing. We believe this bodes well for REIT cash flow growth and share prices over the next 12 months. Our view is premised on five key factors:

1. REIT outperformance typically grows in magnitude and frequency in a modestly growing economy
2. REIT earnings growth potential in 2020 is attractive on an absolute basis and resilient on a relative basis
3. REITs solve the yield conundrum in a lower for longer interest rate environment
4. Relative valuations have room to expand
5. Large unfunded commitments will support real estate valuations

We believe investors will be best served focusing on companies and property types that can deliver superior earnings growth through a combination of positive secular demand trends, higher internal growth, attractive external growth opportunities like development and acquisitions, and finally margin expansion through expense controls. Based on this, please find below Timbercreek’s top investment opportunities in 2020.

Top Investment Opportunities in 2020

United States:
• Growing cell tower demand driven by the 5G wireless revolution
• Strong fundamentals from Class B residential housing
• Life sciences benefiting from innovation and advancement of human health

Canada:
• High levels of immigration driving robust demand for multifamily communities
• Industrial REITs benefiting from rising e-commerce penetration

Europe:
• Attractively priced opportunities in high-quality Class A bricks and mortar retail centres on the Continent
• Industrial markets delivering strong growth and valuation gains

Asia:
• Japan lodging poised to shine from Tokyo Olympics and inbound foreign travel
• Hong Kong residential housing benefitting from demand outstripping supply
• Singapore data centres positioned to take advantage of growth in Asia

Australia:
• Self-storage is mispriced, offering attractive yield and total return potential

For further details on our top investment ideas for 2020 please refer to each regional market outlook.
Global Real Estate Securities – 2020 Market Outlook

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2019 MARKET OVERVIEW

Equity markets around the world soared in 2019, as a global shift in monetary policy and progress in the U.S. and China trade negotiations drove equity prices higher throughout the year. 2019 marked the beginning of another global easing cycle. Central banks came to the rescue—just like they did in 2012 and 2016—flipping the switch from tightening to loosening, resuming balance sheet expansion, cutting interest rates 140 times (bringing the total to 1,355 times since the start of the global financial crisis) and engineering a recovery in asset values with the goal of stabilizing the global economy (albeit in a slower gear). Despite the drag from manufacturing and trade, global labour markets and consumption showed impressive resilience. As markets recovered, fears of an imminent recession receded, extremely bearish investor sentiment improved, credit spreads narrowed, and volatility collapsed by nearly 50%. Amid all this, how did REITs fare and what does this mean for the asset class going forward?

In 2019, global real estate securities gained 23.1%² in USD and 17.2%³ in CAD, exceeding our expectations for the year driven by a combination of multiple expansions, stronger earnings growth and rising dividends. Anecdotally, earnings provided a boost to share prices in 2019 with more REITs beating or meeting consensus expectations compared to historical averages and those REITs that outperformed on the day of their earnings release did so by a larger amount than the historical average, all of which led to increased demand for REITs given the sector’s resiliency in earnings, culminating in multiple expansion.

In terms of specific market performance in 2019 (Figure 1), every region save Hong Kong and Australia gained more than 20% with the U.K. leading the pack driven by a favourable Brexit outcome which propelled shares higher towards the end of the year. In the five years prior to 2019, the range of returns across the regions was 35% per year, creating opportunity to add alpha via country selection. This was less the case in 2019 as regional performance fell into a narrower band.

In Continental Europe, Sweden earned gold-star status in 2019 generating a total return of over 50% (SEK), driven by strong property fundamentals that propelled share prices higher. On the other end of the spectrum, ongoing protests in Hong Kong hampered economic activity negatively, impacting restaurants, tourism, retail sales and share prices.

2020 GLOBAL REAL ESTATE SECURITIES FORECASTS

2019 marks the end of the decade and as we turn the page to 2020, it’s incredible to think that a full 10 years have passed since the global financial crisis ended when many of us on the Timbercreek team either worked together or in REIT investing. The events that unfolded 10+ years ago have acutely influenced how we think about investing today. Quality, location, transparency, cash flow and yield remain driving forces in our investment process.

Over the past 10 years, Global REITs have generated a strong track record with an annualized total return of +9.2%, nearly similar to global equities (+10.1%)⁴ and far superior than global bonds (+2.4%)⁵ which REITs are traditionally viewed as being tied to, a stigma that we strongly disagree with.

REITs benefit from predictable income BUT with growth in earnings far more resilient than other sectors of the economy, liquidity far more abundant than private real estate and yields far higher than many fixed income alternatives.

What does this indicate for 2020?

As we enter the start of a new decade, the deceleration in global economic growth experienced throughout 2019 is showing glimpses of stabilizing (as indicated by global manufacturing output PMI’s, Chinese industrial product and U.S. business activity) at a slower but steady pace compared to the past few years. Yet, economic activity across most of the rest of the world is lacklustre with Europe, Canada, Japan and some emerging market countries like Brazil growing at uninspiring levels. Central banks stand ready to intervene to support economic activity by holding interest rates lower for longer until both growth AND inflation recover.

In an environment where economic growth is harder to come by, we believe investors need to focus on companies and property types that can deliver superior earnings growth through a combination of positive secular demand trends, higher internal growth, attractive external growth opportunities like development and acquisitions, and finally margin expansion through expense controls.

We believe there is strong empirical evidence linking earnings growth and share price performance. Our view is that REITs which consistently grow earnings, dividends and NAV, will generate sector leading performance over time.

Figure 1: 2019 Total Return by Market

Source: Bloomberg, Timbercreek. As of December 31, 2019. Total returns are in local currency.

¹Source: Bloomberg. Represents the Gave Volatility Index.
²Source: Bloomberg. Represents the FTSE EPRA NAREIT Developed Total Return Index.
³Source: Bloomberg. Represents the FTSE EPRA NAREIT Developed Europe ex U.K. Index.
⁴Source: Bloomberg. Represents the FTSE EPRA NAREIT Developed Total Return Index.
⁵Source: Bloomberg. Represents the FTSE EPRA NAREIT Canada Index.
⁶Source: Bloomberg. Represents the MSCI World Index.
⁷Source: Bloomberg Barclays Global Aggregate Total Return Index Value Unhedged USD.
As we enter 2020, we believe in a global economy that’s modestly growing, REITs are positioned to deliver another year of double-digit total returns anchored by attractive earnings growth and supported by secular demand trends and accommodative financial conditions. Our view is premised on five key factors:

1. REIT outperformance typically grows in magnitude and frequency in a modestly growing economy.
2. REIT earnings growth potential in 2020 is attractive on an absolute basis and resilient on a relative basis.
3. REITs solve the yield conundrum in a lower for longer interest rate environment.
4. Relative valuations have room to expand.
5. Large unfunded commitments will support real estate valuations.

Let’s delve a little deeper into each of these factors:

**REIT outperformance typically grows in magnitude and frequency in a modestly growing economy.**

Over the past year we have spoken to many investors about how REITs fit in a slower economic growth environment. Using the U.S. as an example, consensus estimates call for U.S. Real GDP growth of 1.8% in 2020, that is down from 2.9% in 2018, a ~38% deceleration in economic growth in the past 24 months. As highlighted in Figure 2, over the past 45+ years, when U.S. Real GDP growth averages between 1% and 2%, REITs outperform the S&P 500 Index 62% of the time and by over 600 basis points annually generating an average annual absolute return of +18%. We see similar trends in other markets too, such as Canada. Consensus estimates for global developed market Real GDP growth (i.e. excluding emerging markets) in 2020 is 1.4%, that is down from 2.2% in 2018. Including emerging markets, consensus estimates for 2020 global Real GDP growth of 2.5% is better but still slow, putting REITs in a favourable position around the world to deliver growth superior to current economic conditions.

**Figure 2: U.S. REIT Performance vs. Equities**

<table>
<thead>
<tr>
<th>Year</th>
<th>Global Real Estate</th>
<th>Global Equities</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>8.1%</td>
<td>4.7%</td>
</tr>
<tr>
<td>2015</td>
<td>8.0%</td>
<td>3.0%</td>
</tr>
<tr>
<td>2016</td>
<td>6.7%</td>
<td>2.1%</td>
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<td>5.2%</td>
<td>16.5%</td>
</tr>
<tr>
<td>2018</td>
<td>5.8%</td>
<td>14.5%</td>
</tr>
<tr>
<td>2019E</td>
<td>4.4%</td>
<td>0.1%</td>
</tr>
<tr>
<td>2020E</td>
<td>4.8%</td>
<td>5.0%</td>
</tr>
</tbody>
</table>

Source: UBS, JP Morgan, BofA Merrill Lynch Global Research

**REIT earnings growth potential in 2020 is attractive on an absolute basis and resilient on a relative basis.**

The rate of earnings growth for equities declined materially in 2019 from double-digit increases in 2017 and 2018 due to a slowing global economy. REITs, on the other hand, delivered stronger absolute earnings growth in 2019 as REIT cash flows tend to be more predictable because they are tied to contractual leases that hold up better to changes in economic conditions. If we use the Q3 2019 reporting season in the U.S. as a guide for global activity, more REITs beat (60%) or met (25%) consensus estimates with greater frequency than historical averages. As mentioned earlier, we believe there is strong empirical evidence linking earnings growth and share price performance and as we look toward 2020, we anticipate REITs will deliver ~5% earnings growth, attractive on an absolute basis (on par with global equities as shown in Figure 3) and resilient on a relative basis should the global economy experience further hiccups.

**Figure 3: Earnings Growth Expectations**

**REITs solve the yield conundrum in a lower for longer interest rate environment.**

In 2017 and 2018, rising interest rates served as a headwind for the REIT industry in so far as investors re-allocated nearly US$40 billion of capital away from REITs to other sectors of the economy with a more cyclical growth profile. That changed in 2019 with nearly US$167 billion of capital flowing out of equities almost none of which came from REITs. We believe it is unlikely that Central banks will raise rates again until they see a clear-cut return to growth AND inflation, making it unlikely that REIT fund flows will serve as a similar headwind in 2020 as it did in 2017 and 2018.

With interest rates expected to remain lower for longer, investors face the unpleasant choice of either taking on more risk or lowering their long-term return expectations. Over $11 trillion in government debt globally now has negative yields, meaning investors are paying for the opportunity to invest their capital. This has created a yield-conundrum and we believe REITs are a solution.
Today, the global REIT market is yielding nearly 4%, far higher than what can be earned from other industries and dividends are growing at the pace of earnings (~5%) and in some cases even higher (circa 10% to 20% per annum) like with technology-focused REITs, such as cell towers and data centres.

**Relative valuations have room to expand.**

Valuation multiples have expanded over the past 12 to 15 months as investors have put greater emphasis on sectors with better earnings resiliency. During this time period (Q4 2018 thru Q4 2019), global REITs outperformed global equities by ~500 basis points*. As highlighted in Figure 4, despite the recent outperformance, REIT relative price-to-cash flow multiples are still slightly below its long-term average. We believe that in a more modest growth environment, REITs can trade at premium multiples to their long-term average, like the 2009 to 2013 time period.

Looking at valuations through a private real estate lens, (see Figure 5), real estate risk premiums have not compressed to levels seen prior to the global financial crisis, suggesting further cap rate compression is possible (particularly in Europe, Australia, Japan and the U.S.) if interest rates remain lower for longer, with the caveat being we would only expect to see cap rates compress in those property types and geographies where rents are growing or where yield spreads over fixed income investments are above the long-term average. From an underwriting perspective, we are **NOT** assuming additional cap rate compression, however, it is comforting to see that a buffer exists between where cap rates currently are and where bond yields trade suggesting that if bond yields do rise, there is room for cap rates to absorb such an increase.

Globally, REITs are trading at a ~4.8% discount to NAV, roughly in-line with the average discount over the past 15 years (i.e. ~5.6%). We are seeing wider variations in discounts to NAV by region and property type which is why we believe country and security selection will play an even more important role in creating alpha in 2020.

**Figure 5: Private Real Estate Cap Rates vs. Bond Yields**

Large unfunded commitments will support real estate valuations.

The amount of cash available for real estate transactions continue to rise, recently surpassing the US$300 billion threshold for the first time. When levered 50%, that creates over US$650 billion of purchasing power which we believe will serve as an anchor for private market asset values. In addition, there are currently ~800 funds in the process of raising capital with a cumulative targeted raise of just over US$250 billion. We believe a portion of this capital will make its way back into the global REIT market through M&A, the acquisition of REIT assets or joint ventures that lead to additional growth opportunities for REITs.

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*Source: Bloomberg*
2020 RETURN EXPECTATIONS

Global economic activity has shifted to a slower but steady pace compared to the past few years and Central banks stand ready to intervene to support economic activity by holding interest rates lower for longer until both growth AND inflation recover.

Lower interest rates are having a positive impact on housing and corporate bond markets (volume is up, and credit spreads are tighter) while strength in the services sector is helping to cushion the blow from a slowdown in manufacturing and waning business confidence. The services sector makes up ~80% of global GDP so the impact from slower trade and manufacturing activity is less meaningful on a relative basis, but not inconsequential, which is why Central banks are loosening monetary conditions.

We believe that in a global economy that’s modestly growing, global REITs are positioned to deliver an attractive total return of 10% to 12%, consistent with the industry’s average over the past 10 years.

This return consists of a 4.0% to 4.5% cash flow yield, 5.0% cash flow growth and very modest growth in valuations. Our confidence in the industry’s 5.0% cash flow growth potential is driven by:

- Positive releasing spreads on lease rollovers relative to in-place rent;
- Annual contractual rent increases;
- Accretive acquisitions; and
- Completion of redevelopment and development projects currently underway.

We believe politics pose the biggest risk in 2020 ranging from the completion of a Phase I trade deal between China and the U.S. along with subsequent negotiations to rollback existing tariffs, Brexit and achieving the milestones necessary for an orderly exit, ongoing protests in Hong Kong and the U.S. Presidential election. Having said that, if we look at historical elections going back to 1992, global REITs have outperformed global equities\(^1\), on average, by over 850 basis points, in years where there was a U.S. Presidential election.

Other risks include an unexpected spike in interest rates due to inflation without corresponding growth in GDP and jobs. Any of these events, should they go awry, can have an exogenous impact on financial and economic conditions, throwing markets off-course in 2020.

REITs are the landlord of the global economy and while the current cycle is long by historical standards, strong global labour trends and consumption are positively influencing commercial real estate fundamentals and demand for residential housing. We believe this bodes well for REIT cash flow growth and share prices over the next 12 months.

TOP INVESTMENT OPPORTUNITIES IN 2020

We have identified a number of investment opportunities – across geographies and property types – for the year ahead:

**United States**

- Growing cell tower demand driven by the 5G wireless revolution
- Strong fundamentals from Class B residential housing
- Life sciences benefiting from innovation and advancement of human health

**Canada**

- High levels of immigration driving robust demand for multifamily communities
- Industrial REITs benefiting from rising e-commerce penetration

**Europe**

- Attractively priced opportunities in high-quality Class A bricks and mortar retail centres in Continental Europe
- Industrial markets delivering strong growth and valuation gains

**Asia**

- **Japan** - Lodging poised to shine from Tokyo Olympics and inbound foreign travel
- **Hong Kong** – Residential housing benefiting from demand outstripping supply
- **Singapore** - Data centres positioned to take advantage of growth in Asia

**Australia**

- Self-Storage is mispriced, offering attractive yield and total return potential

For further details on our top investment ideas for 2020 please refer to the following sections.

\(^1\)Source: Bloomberg. Represents the FTSE EPRA NAREIT Developed Total Return Index.

\(^2\)Source: Bloomberg. Represents the MSCI World Index
REGIONAL MARKET OUTLOOKS

As highlighted in Figure 6, we believe most markets are in equilibrium as indicated by the green and yellow dots with several regions showing good demand and growth potential despite a global economy that is growing at a slower but steady pace relative to past years. Strong global labour trends and consumption are positively influencing commercial real estate fundamentals and demand for residential housing, which we believe bodes well for REIT share prices and cash flow growth in the year ahead.

<table>
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<th>Supply</th>
<th>Growth</th>
<th>Public Market Valuation</th>
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<tr>
<td>Continental Europe</td>
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Positive Neutral Negative


United States

The 5G wireless revolution is creating robust demand for wireless tower space on macro cell towers, making cell tower REITs one of our top investment opportunities for 2020. According to Cisco, mobile data consumption in the U.S. is expected to increase by more than 30% per year through at least 2024 as a result of more devices in service and higher usage per device (Figure 7). Today, the average U.S. smartphone user consumes ~10 GB per month, which has doubled in less than 3 years. By 2028, industry estimates suggest that total U.S. mobile data usage will be approximately 6X 2018 levels. To keep up with this demand, wireless carriers are adding significant equipment to existing macro cell towers, expanding their networks to new macro cell towers and adding additional spectrum deployments to support today’s 4G network. Additionally, according to CTIA, the number of small cells, whose primary purpose is to propagate the 5G signal, is expected to increase nearly tenfold by 2026, further enhancing growth opportunities for cell tower REITs. Wireless carrier capex budgets are anticipated to reach US $32 billion in 2020. We believe 5G will only accelerate this growth trend, leading to a sustained period of robust organic same store net operating income growth for cell tower REITs, resulting in double-digit earnings growth in 2020. We expect robust earnings growth to translate to higher share prices and relative outperformance over the next 12 months.

One of the more attractive sectors in the traditional real estate space heading into 2020 is the residential sector. We believe Class B properties in the single-family rental, apartment, and manufactured home segments of the housing market are likely to experience strong fundamentals as a result of a very favourable supply and demand dynamic. The demand side of the equation is being driven by household formation, which is supported by continued job growth, and the continued unaffordability of home ownership, swelling the pool of renters. On the supply side, rising land prices and construction costs have made it economically challenging to construct Class B residences. The only new supply arriving to the market is at the Class A price point, which does not address the demand within the Class B segment. We believe that the market is not properly reflecting this fundamental strength in the valuation of residential REITs that own assets in the mid-price segment.

Lastly, we are favourable on the life science sector in 2020. We believe tenant demand for life science lab and office space is strong, particularly in major markets such as Cambridge, South San Francisco / Mission Bay and San Diego. These three markets, along with others that are near major research institutions, funding sources, and university talent pipelines provide the intellectual capital necessary for research, innovation and advances in the treatment of diseases impacting human health. R&D spend from global bio-pharma firms stood at $179 billion in 2018 and is expected to grow at a 5% CAGR through 2024.
This is further aided by robust venture capital commitments, funding from the National Institutes of Health and a more accommodative governmental (FDA) regime that is increasing the number of drugs approved, which stood at a record 59 in 2018. We believe all these demand drivers are adding to new company formation and will increase demand for lab and office space in 2020. Further, life science leases are typically constituted in a triple-net structure which mitigates the recurring capex burden for landlords, resulting in higher gross margins and ultimately cash flow growth. Rental costs as a percent of R&D and G&A budgets for major bio-pharma firms are small, which we believe provides a long runway for future rental growth. The benefit to firms of being in the top locations far outweighs the nominal rental cost.

Canada

In 2020, we believe that the Canadian apartment sector will continue to exhibit strong operating performance as a result of the market’s supply and demand situation. Demand in Canada is robust, supported by high levels of immigration. As shown in Figure 9, Canada is one of the top immigration destinations due to the country’s healthy economy and open-door immigration policy. Despite strains that the growing population is placing on the country’s housing market and infrastructure, policymakers plan to increase immigration over the coming years. The supply side of the equation continues to be constrained as well, especially in Ontario. Greenbelts, cumbersome permitting processes, and richly priced land have made development of new apartments challenging. Supply is coming online but it is not expected to be high enough to meet demand.

Europe

In 2019, negative interest rates and slower economic growth increased demand for higher sustainable cash flowing assets causing valuations to expand and REIT share prices to rise, benefiting Europe’s real estate market. Operating conditions were better than expected as most sectors faced a lack of new supply which led to attractive rental growth while refinancing costs hit an all-time low further enhancing cash flows.

Looking forward to 2020, although rental growth is likely to slow compared to prior years, we believe pockets of opportunity exist in sectors and countries with secular growth stories or value-driven opportunities where cash flows are highly durable. We expect trends such as urbanization, residential rent cap policies and ESG to play a bigger role in the year ahead.

One of our favourite investment ideas in 2020 is owning high-quality Class A Continental European retail shopping centres. We believe public retail REIT share prices have been painted with a broad brush of negativity causing stock prices to trade at overly discounted levels across the board (~15%). In 2019, like-for-like rental growth in the Class A segment was over 3%, driven by retail sales growth of over 1.5%.

Figure 11 (next page) illustrates that while the overall industry is in decline, if you isolate the high-quality retail assets, the performance of these well-positioned centres have stabilized and continue to deliver positive growth.
Despite the slowdown in manufacturing in 2019, Germany’s office market experienced one of the highest rates of rent growth driven by historically low vacancy rates. We see this trend continuing in 2020 as average rent levels across Germany’s top five cities are still very affordable compared to other prime European cities. Blackstone’s acquisition of Dream Global REIT (consisting of mainly German office properties) at a premium to its share price showcases a shared favourable view on office markets in Germany. Other countries where we see continued growth and attractive total return potential is in the Belgium-Netherlands-Luxembourg region which is benefiting from the EU government’s presence of multiple agencies and ministries, a dense population centre and land shortages influencing supply. London’s west-end market is another pocket of opportunity where a favourable Brexit outcome can result in property yields staying lower for longer and vacancy rates remaining stable supporting higher rents that will help offset elevated concession packages.

In 2019, the multi-residential sector experienced political instability, with Berlin and Ireland proposing a 5-year and 3-year rent freeze respectively. Continued job growth is driving steady demand for housing and the lack of supply in urban locations is driving up rental rates. In Ireland, for example, strong job growth driven by large global technology firms is causing demand for multifamily housing to outpace new supply. Going into 2020, we believe public markets have priced in a considerable amount of political uncertainty downside into share prices such that we view current valuations as an opportunity to generate attractive total returns. In the U.K., we prefer student housing rather than traditional multifamily housing driven by strong growth in enrollment with more and more students coming from outside the European Union. The U.K. is doing a good job of commercializing education and we anticipate steady demand for student housing in 2020.

The opposite is true in the U.K. where landlords have cut rents quicker than anticipated with more retailers electing to enter CVA (i.e. bankruptcy) as a result of changing consumer behaviour. According to the Centre for Retail Research, 16,337 stores in the U.K. closed since the start of 2019 through the end of October. While our expectation for 2020 is that the pace of store closures will slow, it will take several years and significant amounts of capex to improve the rental income of these centres.

On the Continent, we also have a favourable view on the logistics sector in 2020, as growing demand for industrial space driven by growth in e-commerce will likely result in rising rents and value creation opportunities from REITs that can capitalize on value-add acquisitions and/or development opportunities. We think Sweden offers an outstanding risk-return profile as the country continues to deliver above trend economic growth and is behind the curve with respect to omnichannel retail. Like other parts of Europe, the switch from old assets to new highly automated warehouses will garner greater demand and higher rent growth potential. In addition, increasing land use regulations give REITs with development expertise and access to capital a structural advantage.

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**Figure 11: Like-for-Like Rental Growth of Continental European REITs**

[Graph showing rental growth trends from 2011 to 2019.]

**Source: Timbercreek Investment Management and Company Reports**

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**Figure 12: Nationality of U.K. Student Population**

[Pie chart showing nationality distribution with 86% U.K., 6% EU Excluding U.K., and 8% Non-EU.]

**Source: UCAS**
Japan

In 2019, office supply fears quickly diminished as record low vacancy rates and healthy preleasing levels led to very strong market rent growth. Corporate governance improved further, enhanced by significant share buyback announcements, the removal of poison pills and M&A takeover attempts with the J-REIT market experiencing its first ever hostile takeover. The Bank of Japan (BOJ) continued to acquire Japanese REIT shares in 2019 through their ¥90 billion purchasing program, which helped support share prices and contributed to J-REIT outperformance versus Japanese C-corps.

In 2020, we are most enthusiastic about Japan’s hotel sector. As highlighted in Figure 13, inbound foreign travel is forecasted to grow to 40 million tourists in 2020, representing over 30% growth from 2018 levels. Japan’s hotel industry is benefiting from an easing of Japanese / South Korean tensions, the upcoming Tokyo Olympic and Paralympic games plus the 2021 World Masters Games in Kansai, all of which will drive considerable demand for hotel rooms. Although hotel room supply is higher in Tokyo, Osaka and Kyoto in anticipation of these city-wide events, over 85% of the new supply is in the limited-service segment. This is why we believe the best opportunity in 2020 is where the supply isn’t, such as the full-service, upscale/upper upscale category. Compared to other countries, Japan has a significant lack of upper-class and full-service hotel offerings and we expect to see attractive RevPAR growth from these two categories in 2020 driven by both occupancy and ADR increases.

Hong Kong

Hong Kong is undergoing one of the worst economic crises in history which saw the nation sink into recession for the first time in a decade in the third quarter of 2019. The ongoing social unrest that began in June led to a steep reduction in; tourism arrivals (-43.7% YoY as of October 2019), overall retail sales (-24.3% YoY as of October 2019), the closure of 200 restaurants and an increase in the unemployment rate to 3.1%.

In 2020, we favour Hong Kong’s housing sector which should benefit from the government’s acute focus of making housing more affordable, addressing part of the reason why there is social unrest in the first place, therefore making housing a more resilient property type in a highly uncertain political environment. We believe there is significant domestic pent-up demand for housing and the supply of new homes is trending below its historical average predominantly as a result of a land shortage (Figure 14). This demand-supply imbalance has distorted affordability levels, causing market prices to rise and is challenging the government to provide solutions like easing mortgage policies to new first-time home buyers. As the government unlocks new land sites, we expect to see an increase in new residential projects, leading to significant revenue growth and margin expansion for those Hong Kong companies positioned to take advantage of the pent-up demand. In 2020, we believe there is a significant re-rating potential for property developers with residential businesses whose share prices have been sold-off due to the ongoing social unrest, trading at or above a 50% discount to current net asset value which is at the low end of its historical trading range.

We also have a favourable view of the office sector in 2020. Healthy net absorption of additional Grade S office space in Tokyo will keep the overall vacancy rate low resulting in continued growth in asking rents. We believe cap rates will most likely remain stable, but we wouldn’t be surprised to see additional cap rate compression given the spread between property yields and fixed income yields are historically high at over 400 basis points and office fundamentals remain strong driven by urbanization trends.
Despite historically low public market valuations, we remain cautious on the discretionary retail sector in 2020 which has been the hardest hit by recent social unrest. We believe rental concessions, additional rent-free periods and increased vacancy will continue to negatively impact landlords’ over the next 12 months (Figure 15) with JLL forecasting a 15% to 20% decline in street level shop rents. In contrast, we are favourable on non-discretionary retail centres given spending is more resilient to ongoing social unrest and typically located in high footfall catchment areas with access to direct transportation. We believe that in 2020, rents will continue to grow in the single digit range for this format type. Should the social unrest subside, we believe inbound tourism will improve and retail stocks could be poised to rebound which is why we will keep a close ear to the ground as developments unfold throughout 2020.

![Figure 15: Hong Kong Price Index](source: Savills Research & Consultancy)

The office sector has also been negatively impacted with vacancy rates increasing to 5.6%. Ongoing protests are causing weaker leasing interest from Chinese companies and prolonging leasing decisions from domestic customers, causing Central office rents to decline 7% in November. As we enter 2020, we believe office demand continues to remain soft with expectations of a further drop in Central office rents. However, we anticipate the Island East submarket will be more resilient thanks to favourable leasing terms and improved infrastructure over the last several years that makes this submarket a more attractive destination for tenants.

**Singapore**

In 2020, we believe Singapore will continue to build upon its position as a regional data centre powerhouse (Figure 16). Singapore remains the best-connected Tier I data centre market in the Asia-Pacific region with the highest number of subsea cable landings and data centres operated by global hyperscale customers. Singapore’s success as a data centre hub has been attributed to the country’s low risk of natural disasters, stable political environment, reliable power grid, and robust international network connectivity. In addition, Singapore’s proximity to neighbouring countries such as Malaysia, Indonesia, and Thailand allow the island-nation to serve as a gateway to SE Asia. Hyperscale customers such as Amazon, Microsoft, Facebook and others are keen to tap into the rapid digitalization and surge in demand for cloud-based services within the region.

Globally, SE Asia is expected to be the fastest growing colocation market by size over the next 5 years with a CAGR of +13%. This trend is supported by SE Asia’s high population base, consumer data consumption habits, and the introduction of new technologies such as 5G. We believe Singapore’s data centre market will continue to experience strong secular growth in 2020 as rising data usage per user will lead to strong demand for data centre space.

![Figure 16: Total Capacity and Future Supply in Asia-Pacific](source: CBRE)

**Australia**

In 2020, we see an opportunity to generate outsized returns in the self-storage sector supported by attractive valuations and favourable demographic trends in urbanization, population growth, and lower home ownership rates. Self-storage assets in Australia trade at higher cap rates (6%-7% range) in comparison to their European and U.S. counterparts (5%-6%). We believe there is potential for cap rate compression in 2020, due to the large spread between cap rates and financing costs. As highlighted in Figure 17, the self-storage market in Australia is highly fragmented, which gives institutional investors (like REITs) the opportunity to buy properties from mom and pop operators at a 7% cap rate with the ability to raise that yield to 8%-9% over the subsequent 12 to 24 months. REITs drive operational efficiencies through an internalized revenue management system, customer acquisition tools (e.g. Google keyword-search), and economies of scale. In our view, Australia’s self-storage market lags the trends we’ve seen in North America over the past decade providing a long runway for growth in occupancy rates and market rents as utilization levels increase.

![Figure 17: Australia’s Fragmented Self Storage Ownership Profile](source: National Storage REIT)
The Timbercreek Approach

Founded in 1999, Timbercreek (together with its affiliates) is a global alternative asset class manager with over $10 billion (CAD) in assets under management*. Timbercreek employs a value-oriented investment philosophy and specializes in providing conservatively managed, risk-averse alternative asset class investment opportunities to investors.

Our core competency is our ability to accurately value cash flows based on a comprehensive analysis of the quality and sustainability of a property’s current and future revenue streams. This fundamental ‘bricks-and-mortar’ approach is critical to identifying attractive investment opportunities across our three key business lines:

• global real estate securities,
• private equity investing and
• customized mortgage solutions and other debt secured by real estate.

By combining these strategies Timbercreek is able to deliver an integrated approach to real estate investing.

Global Real Estate Securities Investing

Timbercreek invests in publicly listed real estate companies that own investment-grade real estate around the world. We focus on achieving a superior risk-adjusted return through investments that own high-quality real estate across all asset types that we assess to be undervalued. Our investment objective is to deliver stable distribution and a compelling total return while limiting volatility and protecting capital.

Timbercreek has cultivated an experienced and proven team of real estate professionals strategically located in key global markets including Canada, the United States, Europe and Hong Kong. We believe our comprehensive ‘feet on the ground’ presence allows for a deep understanding of local markets, enabling us to accurately and efficiently source, underwrite and monitor global real estate investments. Our key investment strategies include Core and Income and are offered to both institutional and retail audiences through a range of public and private vehicles.

* Includes syndicated debt under administration. As of September 30, 2019.

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Corrado Russo is responsible for managing the global securities platform including the Timbercreek Global Real Estate Income Fund and the Timbercreek Four Quadrant Global Real Estate Partnership. Mr. Russo has over 20 years experience in the investment management field, having held positions in portfolio management, equity research and direct real estate investments. Mr. Russo holds an MBA from the Schulich School of Business at York University in Toronto and holds the Chartered Financial Analyst designation.

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