



IMAP Independent Thought Podcast

Episode 37: REITs in focus - why listed property matters

Join Mark Mazzarella (Dexus) & our host Emily Barlow (Perpetual Private) as they discuss:

- **Key differences between listed and unlisted property**
- **The role of REITs in balanced and income-focused portfolios**
- **Positioning AREITs & Global REITs vs bonds, hybrids, and unlisted trusts**
- **Value of diversifying across domestic and global exposures**
- **Impact of rates, macro trends, and why listed property looks attractive now**

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Emily Barlow – Perpetual Private

Welcome to the IMAP Independent Thought Series podcast, dedicated to helping managed account professionals stay up to date with views from a range of investment and advice experts.

My name is Emily Barlow, and I am an investment director at Perpetual and your podcast host. In today's episode, we'll be talking about listed REITs and why they might present a compelling opportunity for investors.

And joining me today for this discussion is Mark Mazzarella from Dexus. Mark is head of real estate securities and brings deep insights into the REIT sector and the broader landscape of real asset investing.

Hello, Mark.

Mark Mazzarella - Dexus

Hi, Emily. Thanks so much for having me on the podcast series.

Emily Barlow – Perpetual Private

So if we jump straight into it, and to start us off, beyond the fact that one can be traded on a stock exchange, could you highlight the key differences between listed and unlisted real estate?

Mark Mazzarella - Dexus

Sure. Well, of course, you mentioned that one can be traded readily on a stock exchange and the other can't. So that basically comes down to liquidity. And that's effectively one of the biggest differences. If not the biggest difference between both listed and unlisted real estate securities investing.

But if you just unpack that a little bit, it's important to understand exactly what that means.

Obviously, if you're in a structure that is illiquid or has redemption and application terms that are varied outside of daily, you're effectively taking some measure of risk associated with that.

And as me and my colleagues like to say in the listed world for our funds, when the facts change, we're able to change our mind and change our portfolio positioning and effectively steer the bus around corners.

So that's one big difference between the REITs in the listed space and unlisted securities.

The other though, of course, is volatility. That comes with that. So if you're an investor that can't stomach having a look at your unit price going up and down every day by whatever the fluctuations of the market pricing might be, then unlisted is perhaps the way to go for you.

It's also definitely worth mentioning that the big difference next to liquidity and everything that comes into it in terms of access, the ability to change your positioning when the facts change, it's also access and diversification. So if you're investing in an unlisted fund, real estate, typically you might be getting access to one portfolio with 20 to 100 individual assets.

Whereas if you're investing in a rate portfolio that's actively managed and in the A REIT space, you could get access to upwards of 3,500 or 5,000 individual properties. And indeed, when you're investing globally, and if you're investing in the global REITs, and perhaps have access to some REITs in North America that own apartment portfolios, you might get access to anywhere up to 100,000 individual apartment assets.

And by extension, 100,000 individual tenants. So much better diversification there in the listed space. Emily?

Emily Barlow – Perpetual Private

Great. Thanks, Mark. And I think you've sort of started to answer this question. But with that as a backdrop, where do you see REITs fitting into a typical balanced or income-focused portfolio? And how do you see their role evolving in the context of rising demands for alternative assets?

Mark Mazzarella - Dexus

So the listed REITs are effectively under the umbrella of a liquid real asset class. So a real asset is one that is typically used to maintain and grow the purchasing power

of capital because underlying drivers of value are tethered to items that are very good inflation hedges.

Mark Mazzarella - Dexus

So the CPI-linked rent reviews that often come along with a commercial property lease, as well as the inputs of the actual building, being labour and building materials that tend to be good proxies for inflation and good items to track inflation.

So the liquid real asset class and its properties for rates definitely hold themselves in that relatively defensive, but the ability to provide that maintenance and growth of purchasing power for a component of a portfolio.

Also, a real asset is a hard asset, a tangible asset, someone you can look, feel, and touch, very much rooted in that as a driver of value, not so much the intangible component of a business. You're basically buying into a portfolio or a hard asset that's use is inextricably linked to its ability to derive a return in the form of rent and rents that are growing.

With that, it can be a component of a portfolio that's the relatively defensive component, but that can also provide growth. It's a great diversifier. It's a relatively lower risk exposure. to the drivers of the surrounding economy or thematic. The REITs typically have a beta of about 0.7. And indeed, if you're implementing a relative value or growth at a reasonable price type investment philosophy that we do, you're also likely to get lower than peer and lower than benchmark volatility as a result of that.

There's also an ability to get access to some strong emerging and secular trends that aren't necessarily tethered to the traditional business cycle. So you might be able to get access to healthcare real estate, which is driven by demographics, as well as data centers and cell towers, which are driven by secular demand for data and its transmission.

So a really interesting asset class and one that can fulfil that defensive growth component of a portfolio.

In terms of that more defensive side, with listed real estate, we can see more equity-like properties to it. So what makes you more comfortable putting it in that more defensive bucket than the growth bucket?

Mark Mazzarella - Dexus

Well, look, simplistically, each of the tenants that might be considered growth tenants are Many of those ultimately tenant their commercial assets to undergo their actual function of their business and their outputs. And those businesses pay rent as per a lease contract or formal structure.

And the real estate owner gets the benefit of that. You're still taking an element of commercial risk, but you're getting access to the ability of that tenant to not only grow, and do so sustainably, but also pay rent in the immediate term.

We've got access to many a hyperscale data center tenant in our portfolio on a look-through basis, many of which wouldn't pay dividends to their underlying shareholders. But we get a look through that in the form of rents, simplistically, through the rate structure and investment in the commercial property that they ultimately utilize to undertake their core business.

Emily Barlow – Perpetual Private

Thanks, Mark. And for those investors focused on income, how would you position Aussie and global REITs relative to more traditional income generating assets that

you might see in an Australian portfolio like hybrids, bonds, or perhaps those unlisted properties?

Mark Mazzarella - Dexus

Look, it's an interesting question because over the probably post-COVID period, we've seen interest rates increase dramatically. We've seen term deposit rates increase. And There isn't so much of a spread between term deposit rates and other sources of yield as the REITs.

But an interesting stat is that over the longer term, and many people I speak to about the return of the A REITs tend to do a double take when I talk about this, is that The AREIT fund that we manage has been in the market for over 16 years, and its annualized total return CAGR over that period of time is around 9.8%.

Two-thirds of that is in income, and one-third of that broadly is in capital growth. So an income investor is not only getting a solid level of distribution yield, paid monthly, visible, highly visible cash flow, but you're also getting the growth of in terms of the total return, given it's a real asset and it's got a substantial ability to maintain and grow the purchasing power of capital. A REITs have a relatively high distribution yield.

They tend to pay out a larger amount of income, sometimes smoothed with capital. Relative to some REITs offshore that tend to provide lower yields and retain a bit more capital, but still are mandated to pay out, , let's say 90% plus of their income so that they can get the tax shield associated with the REIT structure.

So definitely the A REITs have a day one passing yield advantage over the global REITs, but what you forego in yield, you often make up in capital growth and the ability to get access to some strong thematics and trends and asset classes and markets that we obviously don't get access to here.

Emily Barlow – Perpetual Private

And would that s up why you would invest in both A REITs and G REITs, or is there anything else you'd add in terms of the benefit both of those sub-asset classes?

Mark Mazzarella - Dexus

It really comes down to what the investor's preference is. If you are comfortable with domestically derived commercial rental receipts as two thirds of your total return, and you don't want to take any currency risk or offshore risk, the A rates would be the investment choice for you. On the other end of the barbell, the global REITs provide a level of access and diversification which is unmatched by the A-REITs.

A sector that's far less concentrated and with much more scope to add value through active management. And the ability to get access to some powerful thematics. Yields, of course, are lower. So the AREIT index or the AREIT fund that we manage might be able to deliver a distribution yield of 5.5% to 6%.

And the global fund might deliver a yield closer to 4%. But through a cycle, you would expect relatively similar total returns of anywhere between 8%, 10% to 12% through cycle.

Emily Barlow – Perpetual Private

Okay. And in terms of some of those broader megatrends, so AI obviously being a big theme both positively and negatively, decarbonisation, automation, ageing population, is that something that you see through investing in REITs?

Mark Mazzarella - Dexus

Absolutely. I'll start with your last one there in ageing populations.

That's a profound trend and one that you can absolutely get behind as an investor in the global market. REIT space, but also the AREIT space where you're able to invest in portfolios that are specifically targeted to providing that retirement and post-retirement right into the assisted living and higher acuity care type living outcomes for a population that's forecast to really grow quite significantly right through to 2050 in terms of the age gap. disparity relative to what we've got today.

So you're investing with a strong tailwind behind you. You're also finding at the moment, indeed over the last year or so, probably 18 months actually, that in North America in particular, you've been able to get access to some REITs that own seniors housing at pretty attractive valuations reflected by the price. relative to the price.

When we went through COVID, we saw a heap of occupancy declines, cost increases, and that really hurt the seniors living operators. But now we're seeing that bounce back and you're also getting,

I think what's a really important trend across commercial property generally now is the difficulty of providing new supply to any market. That's extremely acute. seniors housing space, not only because of financing costs having increased, but construction costs.

So the ability to bring on new supplies is just tempered. So the existing landlords and the rates that are in our portfolios can benefit just by function of their operations. So that organic growth is really powerful, especially in the seniors housing space where you've got that demographic trend.

And of course you mentioned data centers, technology, AI. Look, it's a phenomenal space that requires a heap of capital and you only have to look at the financial results of the hyperscalers like your Meta, Amazon, Microsoft and what they're investing every quarter. It's eye-watering numbers and they're investing those in , the Nvidia chips that we've all seen, heard about, and they go and live in a data center.

And we have the ability to go buy that data center and derive the economics from the rent that's an output of that. So we're probably taking a relatively less of a risky exposure, (the pick and shovel approach).

What a cliché that is. That's been bandied around a lot. to the AI thematic, but it's effectively what it is. We're not betting on which large language model is going to win or which hyperscaler is going to be able to leverage their position the best.

We're betting on the thematic and the fact that those chips need to go into a data center and it's becoming increasingly expensive and longer dated to deliver these data centers. So the REITs that we own are those that have a great pathway to do that or already have high barrier to entry portfolios and networks.

Emily Barlow – Perpetual Private

So you mentioned pick and shovel and you've talked a little bit throughout about lower volatility.

Perhaps now would be a good time for you to touch on in a little bit more detail how DEXIS approaches these sectors.

Mark Mazzarella - Dexus

Sure. Well, our real estate securities team are made up of a diverse group of investors and a number of our senior members are real estate specialists, including myself as a former property valuer and real estate corporate finance professional.

Also, we've got senior portfolio managers that have worked in equities research and also private equity for real estate. And our analyst pool is extremely diverse with many that have worked in studies in parts of Asia and North America and even Europe.

So, with that well-rounded backdrop, we have a look at real estate fundamentals and market fundamentals first and foremost. Our approach is very much bottom-up, but we employed a pretty rigorous top-down overlay. So, we want to make sure that we're buying or effectively buying the best quality real estate we can and at a price that makes sense.

We don't want to pay too much for growth, but we're happy to pay a fair price for certain REITs that have an outsized ability to provide earnings growth.

What that means is we'll typically invest in the mid-cap space of the global REIT market.

And we found that over time, we've been able to minimize volatility as a byproduct of our relative valuation and investment philosophy. And that shows up in the numbers with relatively lower volatility than the market benchmark and peers. And indeed, that's one of the objectives of our fund's PDS, lower than market volatility.

We're also absolutely laser focused as fundamental investors. And real estate professionals are investing where we see the best prospects for rental tension. Because at the end of the day, rental tension is what drives income at the property level and value over time that ultimately flows to security holders and manifests in a share price of any listed rate.

Emily Barlow – Perpetual Private

Okay. Just one more to wrap up. Sure. timing. There's been a lot that's happened in markets, certainly this year for the last few years. How should advisors be framing this asset class with their clients? And what gives you confidence that now is a good time to be investing in listed property?

Mark Mazzarella - Dexus

There's no question that the global rates and rates generally have underperformed equities post-COVID. We've seen a sector afflicted by a rapid increase in inflation and interest rates versus an equities market that has been on an absolute bull run, driven by a handful of tech names globally, but also here in Australia, effectively one major bank and a couple of other growth stocks.

And the REITs have been left behind, and there's no shying away from that. But over the journey since we launched, say, the Global REIT Fund, in the depths of the pandemic, the total return CAGR has been in the mid 8% range. And I would argue that that's absolutely in the slot of what you should expect from a liquid real asset class in the listed REIT space.

If the sector's putting up numbers like the general equity sector, that's a cause for concern. Whereas in the AREIT space, as I mentioned, 16 years of 9 ½ % CAGR is a pretty good return and what you should expect from listed rates.

Mark Mazarella - Dexus

But there's no shying away from the fact that the one year return versus equities is globally a fair way behind.

The elastic band that I like to talk about for the equities return and the equities market performance versus the global rates has stretched really far. And it doesn't take much for that to come back to what's a more normalised level.

And we saw that earlier this year with the advent of deep seek impacting the tech names and also the tariff uncertainty. that persisted there for a little bit. And now the market's sort of forgotten about all of those and continues to go higher.

It just makes the rates look relatively more attractive, in my view, versus equities, given so many catalysts for outperformance, many of which I've touched on.

Operational resilience, we've got high occupancy rates, decent like-for-like growth at the property level.

And there's also extreme differences between supply and demand given construction costs and interest rates have hampered development in many select sectors. So really constructive for the outlook for rates from here versus equities.

Emily Barlow – Perpetual Private

I think that's a great note to end on. Mark, thank you so much for joining us today and sharing your insights. And thank you to our listeners for joining us for today's episode.

We've covered a lot from how REITs fit into diversified portfolios to some of the macro themes, driving opportunities and how advisors can approach listed property and client conversations.

If you found this discussion valuable, please subscribe, leave a review and share it with your network. We'll be back soon with more insights to help you navigate the ever evolving landscape of investment and advice.

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