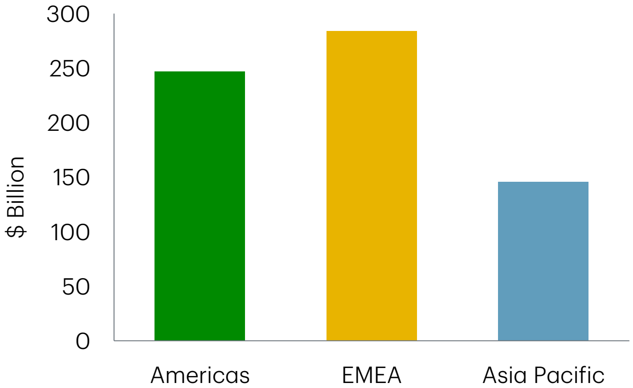
Why Global Real Estate?

More institutional investors are recognizing the benefits of an allocation to commercial real estate. These benefits include an attractive income yield, inflation hedging ability, improved asset/liability matching, enhanced diversification and the potential for capital appreciation. Some institutional investors have sought these benefits through an allocation to a domestic real estate market (i.e. Canada), given the ability to better match liabilities. At TD Asset Management Inc. (TDAM), we believe there are benefits to adding a global real estate allocation to complement an existing Canadian real estate mandate, including:

Greater Opportunity Set

The professionally managed global real estate market is estimated to be slightly over US$8.5 trillion.[1] Canada represents approximately 3% of the total global market. Global investment volume for 2018 was estimated to be US$733 billion,[2] while the Canadian investment volume represents C$49 billion.[3] Going global provides a large opportunity set and increases the ability to strategically position a portfolio and deploy capital efficiently into high-quality, long-term assets. The greater opportunity set also allows investors to compare investment opportunities in multiple geographies, and invest in assets with the most attractive risk-adjusted returns.

Chart 1 - 2018 Investment Activity



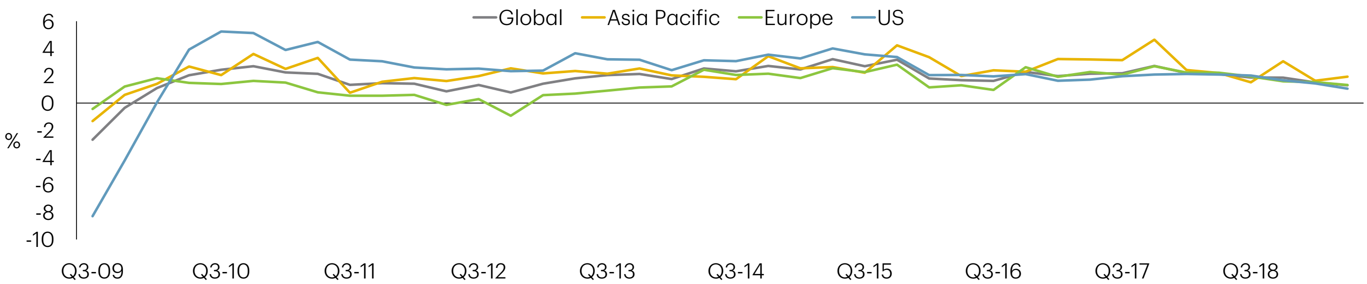
Source: JLL, 2018.

[1] MSCI. As at December 2017.
[2] JLL. As at December 2018.
[3] 2018 Investment volumes include allocations from M&A activity. CBRE Limited.

Potential to Enhance Risk-Adjusted Performance and Achieve Attractive Income Yields

There is a wide dispersion of returns that investors can access through a global real estate mandate. This dispersion allows investment managers to enhance the overall performance of a real estate portfolio and increase exposure to markets that are growing at a faster pace. Additionally, national economies are not always synchronized. Markets and different regions do not always trend in the same direction, as they can be influenced by local factors. Active management can take advantage of these regional differences within global markets by increasing exposure to regions that have the most attractive risk and return profiles.

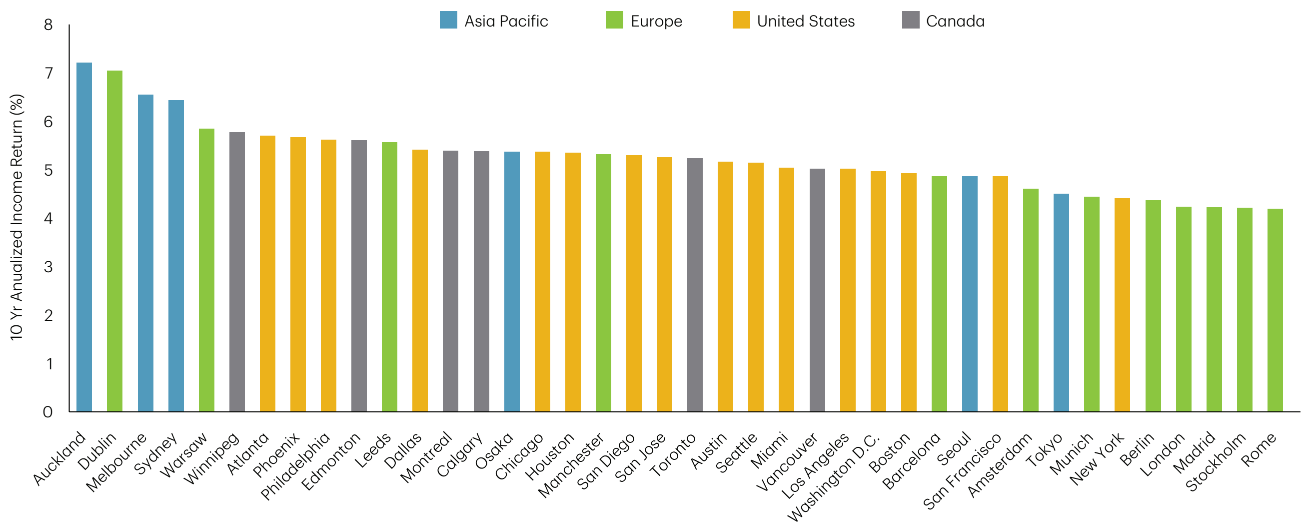
Chart 2 - Quarterly Performance by Region



Source: Global Real Estate Fund Index, Q3-2009 to Q2-2019 (local currency).

Historically, income has been the largest contributor to total returns. By having access to multiple markets, investors should be able to generate long-term sustainable income streams by seeking exposure to properties that are accretive on a risk-adjusted basis.

Chart 3 - 10-Year Annualized Income Return



Source: MSCI Global Property Index. Dec 2018.

Figure 1: Correlation	Asia Pacific	Europe	U.S.
Asia Pacific	1.00		
Europe	0.50	1.00	
U.S.	0.63	0.27	1.00

Source: Global Real Estate Fund Index. Q3 2009 - Q2 2019. Local currency.

Additional Diversification Benefits

Canada's stable political and economic environment makes it a strong market for investors. However, there are compelling opportunities to diversify into other countries. Performance of a property is driven by local supply and demand factors (i.e. GDP, population growth, employment, retail sales, etc.) as well as geopolitical risk. As a result, correlations across global markets tend to be lower than within a domestic market. This diversification benefit helps reduce the overall volatility of a portfolio. A global portfolio tends to be more insulated from local country risk such as Brexit or trade wars.

Determining the Allocation Between Domestic (Canadian) and Global Commercial Real Estate

Canadian and global real estate markets have similar attributes, which include long-term contractual cash flows, inflation hedging, liquidity premium, and diversification benefits relative to other asset classes. The optimal allocation to domestic real estate, global real estate or both depends on a combination of three factors:

1. Size of real asset exposure
2. Objective of a real asset allocation
3. Source of funding real asset exposure

The size of the real asset exposure will dictate the degree of diversification needed within real estate. We believe that domestic real estate is appropriate for Canadian investors due to its greater correlation to Canadian obligations, the diversified nature of the Canadian real estate market and the stable Canadian political environment. However, as real estate allocations grow, global real estate can diversify potential concentration risk. In our experience, investors tend to seek further real asset diversification when their allocation to Canadian real estate grows beyond 5 - 10%.

Canadian real estate exhibits a higher correlation to long-term Canadian bonds and to inflation-linked (real return) bonds. For many Canadian investors, we believe this makes a strong case for a core exposure to Canadian real estate as an initial investment. If the objective is to further enhance diversification or achieve higher risk-adjusted returns, then we believe a global real estate allocation best meets these objectives.

The source of funding real asset exposure will also influence the optimal split between Canadian and global real estate. Exposure sourced from fixed income portfolios tends to better align with domestic real estate given its liability matching and fixed income characteristics. Conversely, sourcing from equities tends to be better aligned with global real estate for return seeking investors.

At TDAM, we believe that both Canadian and global real estate can play strong roles as core real asset exposures for most investors. As real estate exposure grows, global markets and sectors provide further diversification and can potentially improve risk-adjusted returns. An allocation towards a global real estate mandate can enhance the set of investable opportunities, and better enable investors to access assets at attractive valuations. Overall, global and domestic real estate portfolios are expected to reduce risk, improve risk-adjusted returns and deliver long-term sustainable income.

Contact us to find out how TDAM can bring new thinking to your most important challenges.

1-888-834-6339 | inst.info@tdam.com | tdaminstitutional.com