Investment **INSIGHTS**

OPEN WINDOW OF OPPORTUNITY IN REAL ESTATE

Sara Queen
Managing Director, Head of Real Estate Equity, MetLife Investment Management

Between the empty-office conundrum resulting from the work-from-home model and the Federal Reserve's tightening regime — even if rates may be close to the top — just about everything in real estate may feel upside down. But as is the case with prior challenging markets, this may be an opportune time for institutional investors to enter or expand allocations in real estate, as long as they are willing to do deeper due diligence and take on a little risk.

"We see there are several opportunities in the equity market," said Sara Queen, managing director and head of real estate equity at MetLife Investment Management. "We think what we will find over the next several years is that many of the investments made now will be very accretive and strong performers for their owners."

While there are ebbs and flows in real estate, both in the overall asset class and within its many categories, "we see one of the things that real estate does very well is potentially provide a great hedge against inflation. Also, because of the long-term nature of the leases, for many of the subsectors, there's potential for a steady income stream," she said.

TAKE A DEEPER DIVE

Given the recent flood of macro and market news, the current environment is "one of the most challenging times in the real estate market in my career," Queen said. That necessitates real estate investors take a close look at everything from the nitty-gritty — "working your rent roll" and understanding tenants and their business needs — all the way up to strategic portfolio allocations, she said.

At the portfolio level, investors need to look at "at those broader demographic trends and understand where you will need to be in the near future: Which sectors are more resilient for the fluctuations in the economy, and what are some of those underlying tailwinds?" she said. MIM sees opportunities in sectors like industrial, including traditional logistics and cold storage, and housing, covering traditional multifamily, manufactured housing, build-to-rent single family housing, senior housing and everything in between. Additionally, "we see there continues to be strong opportunities for other segments of the capital stack like commercial mortgage loans, particularly as banks have pulled back from lending and mortgage yields have increased."

SUPPORTIVE FUNDAMENTALS

Looking at the logistics space, it continues to be buoyed by evolving shopping patterns, Queen said. "It used to be that you were thrilled if you could get something delivered in two weeks. But now, if you can't get it in four hours, you look elsewhere to buy it. Drive times have to come down to be able to meet those consumer needs," she said. "We expect to see a continual increase in logistics activity, and we're particularly bullish on those opportunities."

The U.S. housing sector continues to benefit from exceptionally strong demand that's currently heightened by severely constrained inventory. "Traditionally, institutional investors have focused on multifamily housing, but now they are looking at housing more broadly and expanding that definition to include single family rentals, student housing and senior housing," Queen said. U.S. population growth trends indicate there isn't adequate housing inventory to meet expected demand, "and we have to find ways to house people and to offer them a lot of different choices."

MIM has focused increasingly on single-family, build-to-rent homes. "We see there's a good deal of evidence that Americans still want to live in houses. But a number of headwinds, like student loan debt and higher interest rates, are keeping many of them from buying," Queen said. Manufactured homes may be another solution that addresses the lack of affordable housing, providing institutional investors with a nontraditional sector in which to invest.

DEMOGRAPHIC SHIFTS

"We believe post-pandemic demographic data have revealed structural changes in retail and office space that can offer investment opportunity as well," Queen said. "In general, the U.S. economy has been over-retailed, but limited new construction and selective demolitions have driven occupancy for a number of retail formats to the highest level on record. We see stronger fundamentals now than we have for the last several years."

On the office side, Queen believes that people will continue to return to the office, although slowly. "We need to make the office-user experience better than what employees have at home, through spaces that cultivate more collaboration and mentoring, particularly for newer employees."

Demographic and trend data support the storage sector, particularly self-storage and cold storage, she said, with the latter referencing the storing of perishable or sensitive foods. An interesting element of the MIM real estate equity team's approach in this space is finding synergies with the firm's strong agricultural-lending practice. "Our ag lending group provides a lot of intelligence, which creates some interesting opportunities," Queen said.

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ALL ABOUT LOCATION

Real estate investors need to think outside the box when it comes to geographic diversification. Geography is "very dependent on the type of product you're investing in, but the markets that we think are more favorable over the longer term could include Lexington, Ky.; Corpus Christi and El Paso in Texas; Knoxville, Tenn.; and Des Moines, Iowa, for instance," Queen said. Secondary markets that have gotten a lot of attention include Nashville, Tenn., and the Charlotte-Raleigh area of North Carolina, she noted.

Once-primary markets like New York and San Francisco have proved more resilient than many believed during the darkest hours of the pandemic, but that doesn't mean they're out of the woods yet. "You want to focus on the markets where you see the most long-term opportunity. Everybody's going to look at that differently," Queen said.

Investors might also do well to be cautious of areas that were attractive prior to COVID, and which became even more so over the pandemic, such as Texas and Florida. "Lots of people are moving to areas that are impacted by climate change," Queen said. But "those two states have both had significant climate events in the last few years," including significant hurricanes and an unexpected deep freeze. "I don't think people are leaving those areas because of climate change, but it is putting increased pressure on them. You're seeing it in rising insurance rates and increasing difficulty getting insurance coverage."

KNOW THE BUSINESSES

Even the most seasoned real estate asset managers need to analyze the business aspects of sectors whose performance is contingent on the operating businesses that occupy them, Queen said. That includes, for example, senior living facilities with a health-care component. "One of the things about any of the businesses that have a strong operating component is you need to understand how that piece works," which is separate from the real estate component, she pointed out.

For that reason, data storage may give pause to some investors. "What do the increases in computer power and quantum computing look like in 10 or 15 years?" in light of the rapid pace of artificial intelligence, for instance, she posed. "It means more and more computing and larger and larger facilities. But that does not take into account the possibility that there could be a fundamental shift in how data is stored and its power needs."

PARTNERSHIP AND OWNERSHIP

More asset owners today are looking for an asset manager with whom they can partner to help navigate challenging markets. "When you hire an asset manager, you're looking for a thought partner who is not only thinking strategically for you but is also deeply committed to driving performance in your assets day in and day out," Queen said.

"How we deliver that starts with our boots on the ground," she said, with the real estate equity team offering a deep understanding of their markets by being embedded in the field, close to the assets. "Every morning they think about how they are going to drive returns in those assets, and they meet with tenants and potential tenants to deliver on that goal."

MIM's proprietary analytical tool, the Property Type Scorecard, helps clients with allocation decisions, and where they should be over- and under-weighted. "It enables us to have deep and meaningful conversations about which property sectors clients should be investing in to help maximize returns, mitigate risk, and balance their overall portfolios," Queen said.

"We believe real estate investing is about finding a partnership with an asset manager who has the same overall philosophy as the client and is deeply committed to driving that return on assets," Queen said. For an asset manager, "it means maximizing the client's investment and thinking about every dollar you manage as your own." For 150-odd years, MIM has invested in real estate as an owner, "and that is part of our process, how we look at every decision we're making." ■

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