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Spring time for real estate

- **If history is a guide, further cuts to interest rates in key economies could spur gains in real estate stocks.**
- **A shortage of high-quality space in some real estate sectors can potentially drive higher rents and capital values.**
- **Should spring time for real estate stocks turn into summer, this could prove an opportune time to invest.**
- **Please consider risk factors, including foreign currency risk and sector concentrations risk. Please refer to the KID and the Prospectus for other important information before investing.**

Introduction

It's spring time for real estate after a long winter. As policy rates edge lower in the United States, Europe and the UK, so financing costs are set to fall. What's more, supply of space is constrained in some commercial and residential areas just as demand is rising. This all suggests that the outlook for real estate investing is brightening.

Anticipating lower borrowing costs, stock prices have already started to rally. Yet our historical analysis suggests that, in fact, they tend to keep on rising for several years after central banks start cutting rates.

There's also good reason to expect brighter weather due to the dynamics of robust demand meeting constrained supply. Broadly speaking, since the COVID-19 pandemic higher costs and increased regulation have limited activity in both commercial and residential sectors. This has led to the scarcity of new, quality space.

Today's brighter outlook follows the harshest conditions for real estate since the 2008-2009 Global Financial Crisis. First, the pandemic in 2020 sparked an exodus from offices and kept people away from stores. Then, 2022's inflation spike forced some central banks to hike policy rates, driving up financing costs for a sector that typically depends on high leverage.

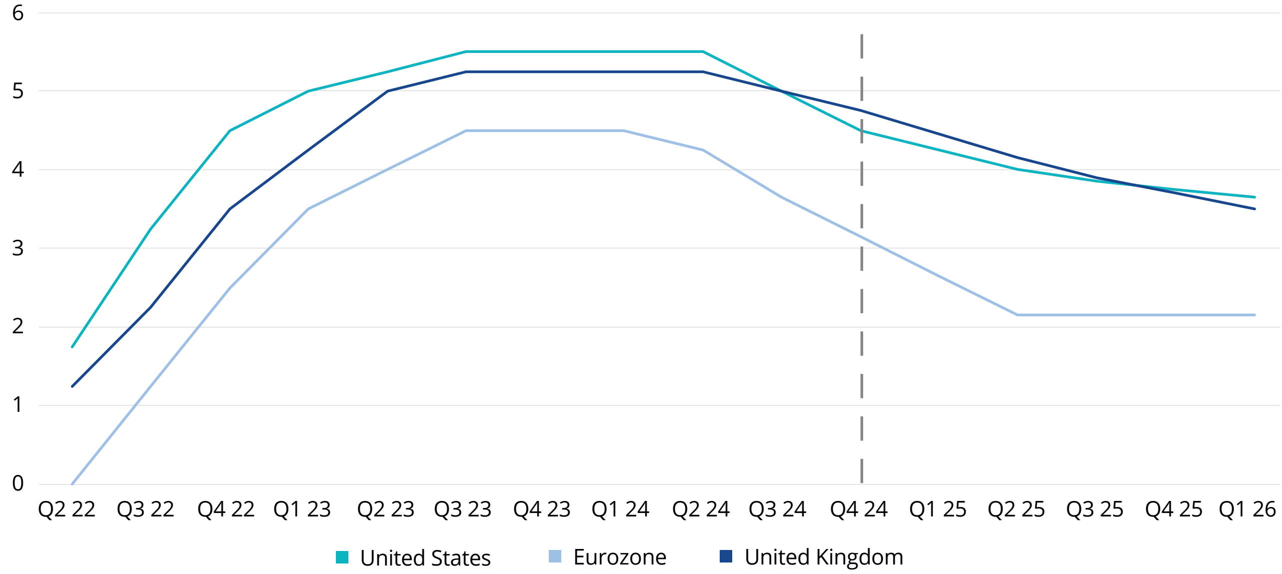
Generally, real estate appears set for a recovery. Looking to the longer term, it's also worth remembering that real estate is changing, becoming more diversified across a range of new sub-sectors including telecommunication towers and self-storage. As it does so, it may become less cyclical in future and more of an all-weather investment.

A history of rate cuts and stock price rallies

With inflation appearing relatively muted, interest rates are expected to fall over the next two years. Chart 1 shows the aggregate projections of analysts for policy rates, according to Bloomberg. At the time of the forecasts, they were expected to decline into 2026, although expectations often change. When interest rates fall, real estate stock prices tend to rise for an extended period of time, according to VanEck's research. We examined all periods of major rate cuts during the last 50 years and our analysis suggests that real estate stocks tend to perform well for several years after central banks start cutting interest rates in reaction to a slowing economy. In these cases, real estate stocks as measured by the FTSE Nareit All Equity REIT Index have typically risen by 50% to 100% or more from their lows.

Chart 1: Key interest rates keep falling

Aggregate analyst views for policy rates (December 2024)



Source: Bloomberg, data as of 20 December 2024.

For instance, charts 2 and 3 show how the FTSE Nareit All Equity REIT Index responded to US rate cuts in two periods: the Gulf War recession of the early 1990s and the 2008-2009 Global Financial Crisis.

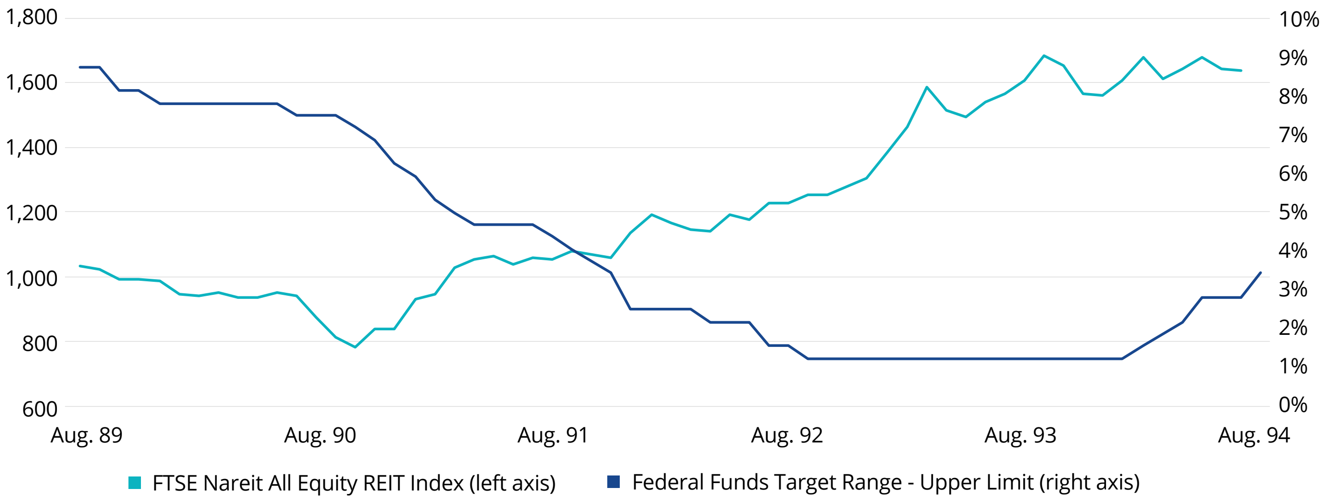
The race for quality space

Beyond rate cuts, a scarcity of high-quality real estate in some sectors is also likely to underpin stock prices. While conditions vary across the real estate market's many different geographies and sectors, broadly speaking robust demand is meeting constrained supply. Since COVID-19, new supply has been limited in both the commercial and residential sectors due to increased regulation and higher costs.

The result? As vibrant demand meets limited supply, decreasing vacancy rates, higher rents and increased real estate prices seem the inevitable outcome.

Chart 2: Gulf War recession

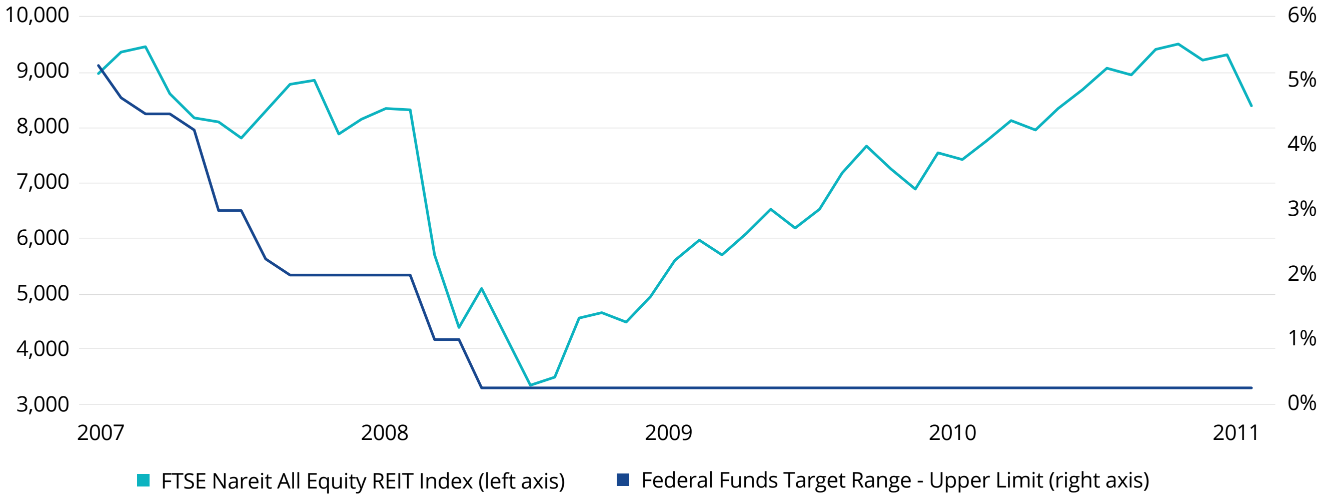
With US Fed funds rates falling, real estate stocks rise from 1990 to 1994



Source: Bloomberg

Chart 3: Global Financial Crisis

After reaching their lows in early 2009, real estate stocks recover through to 2011



Source: Bloomberg

Commercial

High growth in demand could be expected for logistics properties, data centers and telecommunications towers, which benefit from the growth of e-commerce and rapid adoption of generative AI. For instance, vacancy rates at data centers continue to decline across most countries due to strong demand, according to CBRE.[1] At the same time, artificial intelligence advances are projected to fuel future data center demand. There are even signs of life in the office market. In the third quarter of 2024, availability levels in the US office market began to decline for the first time in five years, according to JLL.[2] Encouraged by this long anticipated data, office stock prices have rallied (see chart 4).

Residential

In many countries there is a severe shortage of housing, especially in the cities. Take Europe, for instance, where high construction costs, lengthy planning procedures and financing challenges have limited supply at a time when demand has been growing exponentially. Chart 5 shows the fall in residential construction permits across the Eurozone and, more specifically, in Germany.

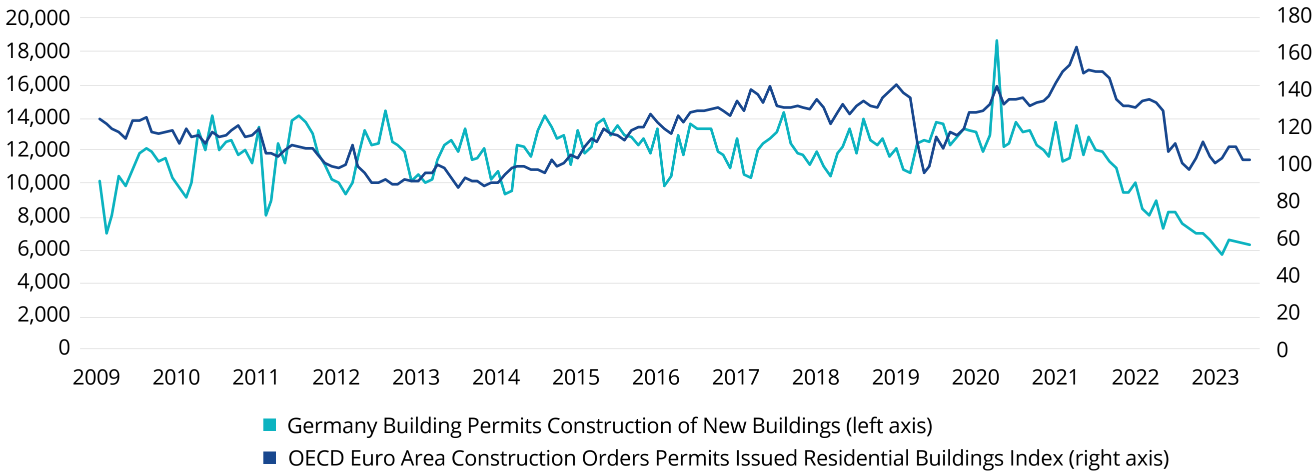
Chart 4: FTSE NAREIT Office Sub Sector Total Return Index

Source: Bloomberg

[1] Global Data Center Trends, 2024. CBRE. 24 June 2024.
[2] US Office Dynamics, Q3 2024. JLL. 8 October 2024.

Chart 5: Housing construction permits fall in Europe

Permits are down 37% from the peak in the Eurozone and 66% in Germany



Source: Bloomberg

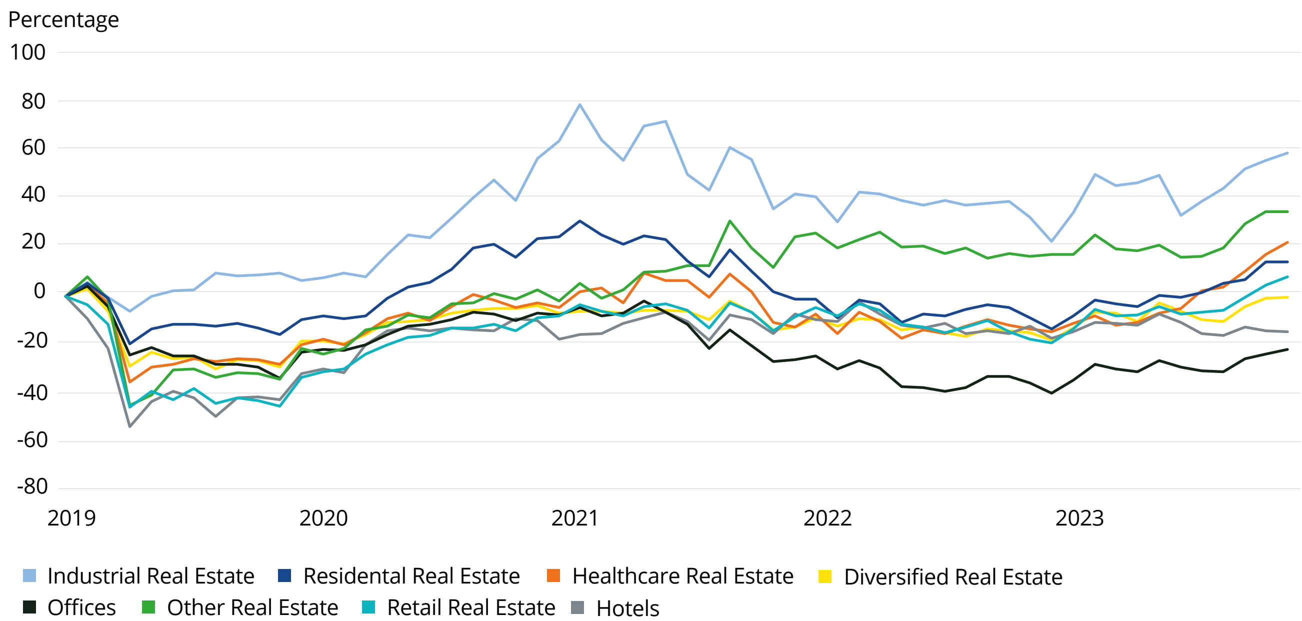
Greater diversification adds resilience

Beyond shortage of space, real estate's increasing diversification is changing the nature of investing in the sector and may smooth out the performance of real estate stocks in the future. The traditional four property sectors are retail, residential, office and industrial. But added to that are telecommunications towers, data centers, health care facilities, self-storage facilities, hotels, gaming facilities and others. This diversification brings different sensitivities, reducing the overall sector's exposure to events like spikes in interest rates and shifts in demand.

The five years from 2019 to 2024 – with Covid-19 followed by the inflation spike – were the ultimate stress test. Office REIT share prices fell as workers stayed at home (see chart 6). Yet industrial REITs proved more resilient, lifted by demand for warehouse space and e-commerce distribution centers.

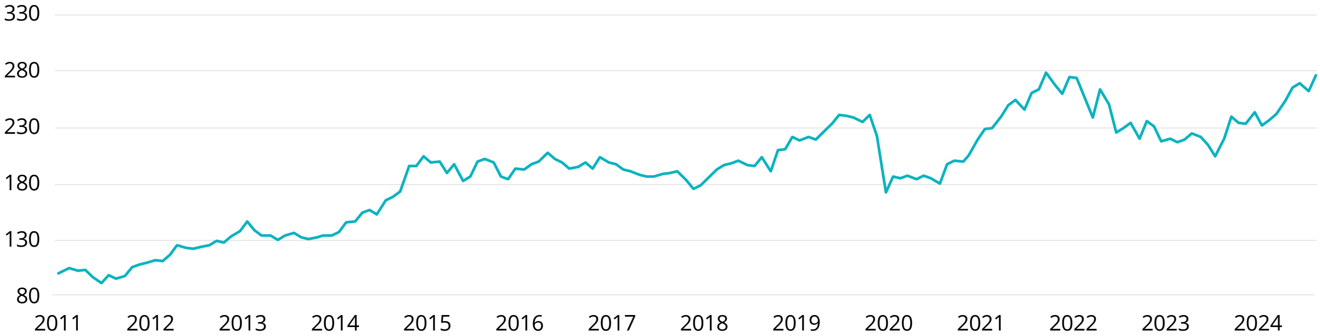
Why does this matter? Because for investors the increasing breadth of different types of real estate gives it greater resilience than was previously the case. Indeed, as the asset class caters to newer and fast-growing areas of the economy it is gaining natural diversification—a

Chart 6: Five years of polycrisis: the ultimate stress test (2019 – 2024)



Source: Solactive. Past performance does not predict future returns

Chart 7: Rise of the VanEck Global Real Estate UCITS ETF (April 2011 – November 2024)



Source: VanEck. Past performance does not predict future returns. Investing is subject to risk, including the possible loss of principal.

quality that Nobel laureate Harry Markowitz famously called the 'only free lunch in investing'.

From performance to portfolio diversification

Turning to performance, the real estate stocks listed on stock exchanges around the world have generated robust returns over the long term, although this has been subject to fluctuations. For instance, the VanEck Global Real Estate UCITS ETF, which tracks the top 100 real estate stocks globally, has generated an annualized return of 7.74% between inception in April 2011 and the time of writing – far exceeding inflation.[3] However, over five years it has only returned an annualized 2.97% and over 10 years an annualized 5.10% (see chart 7). Notably, the past five years included both the 2020 pandemic and 2022 inflation scare. In the spirit of Markowitz's words about diversification and free lunches, several institutional investors and family offices dedicate a proportion of their portfolios to real estate investments. For instance, Norway's respected government pension fund currently allocates about 5% of its portfolio to the asset class (see box). The correlation of real estate to equities varies as time goes by (see chart 8 of US real estate investment trusts (REITs)), with the periods of highest correlation appearing to be at times of general stress in financial markets.

Changing seasons

Returning to the present day, real estate appears to be enjoying the early days of its spring. With policy rates heading lower in several major economies, it seems reasonable to expect that the difficulties of the past five years are over and a more buoyant time may be ahead for stocks.

Norway's government pension's allocation to real estate

	30/06/2024
Equity	68.4%
Fixed Income	26.1%
Real Estate	5.3%
Other	0.1%

Source: Government Pension Fund Global, Norway.
https://www.nbim.no/en/investments/

[3] December 2024.

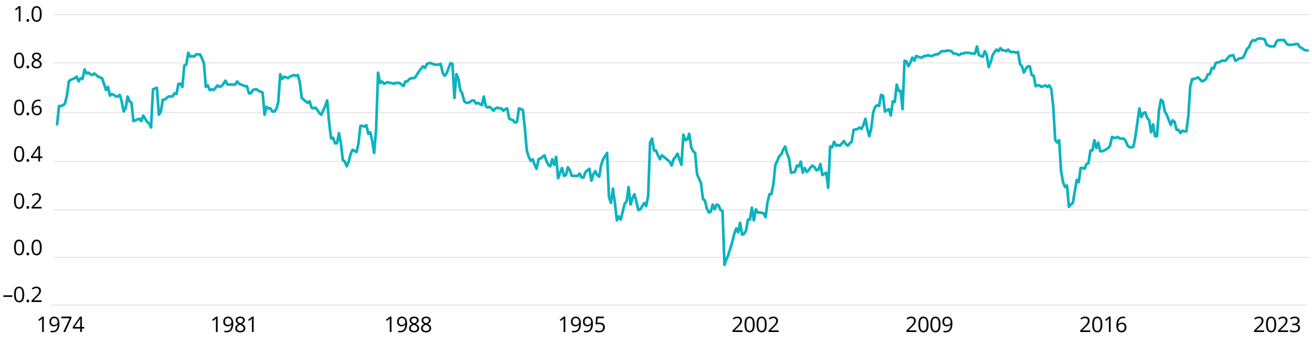
What's more, a shortage of high-quality space may put upward pressure on both rents and capital values. Of course, it's not just the next few years that matter as real estate stocks are usually intended as long-term investments. However, real estate's spring might turn to summer. And remember that financial markets are constantly changing and investing in equities is risky. Please refer to the KID and the Prospectus of the VanEck Global Real Estate UCITS ETF for all detailed information about the investment policy and related risks before investing.

Author

Dmitrii Ponomarev

Product Manager,
VanEck

Chart 8: Rolling correlation of US REITs against the US S&P 500 equity index (December 1974 – November 2024)

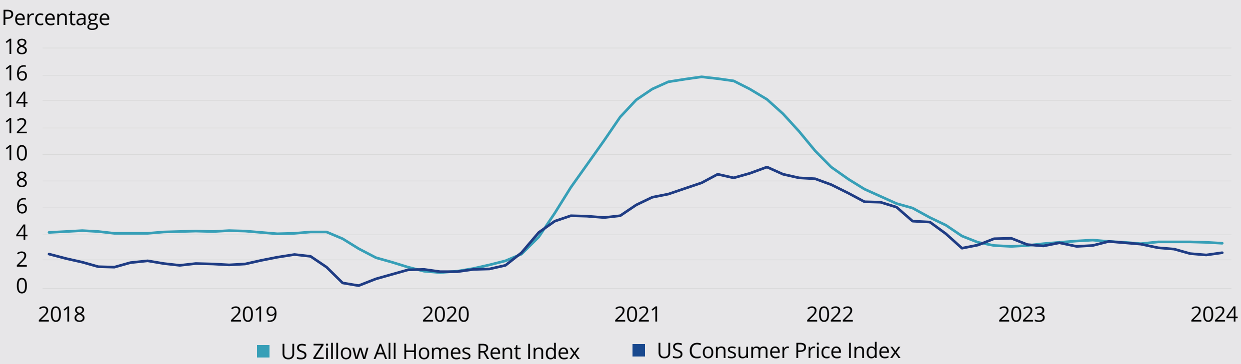


Source: Morningstar, 3 years rolling window correlation, US REITs are represented by the FTSE Nareit All Equity REITs Index.

Why inflation hedging is one of key reasons for investing in real estate

Real estate investing has stood the test of time for good reason. It's a store of value and a hedge against inflation – a quality that it has proved again and again. For instance, when inflation spiked in the US and Europe in 2021 and 2022, residential rents rose with them. The chart below compares the turquoise line of US rents rising, according to the Zillow Rent Index, against the blue line of consumer price inflation. While the exact form of inflation linking varies from one country to another, rents tend to rise in line with inflation. Many leases include clauses specifically linking rents to inflation – whether for commercial or residential property. In other cases, the link is less formal but nonetheless rents tend to move higher as prices rise. Capital values also tend to rise. As a physical asset, real estate's value tends to increase over time, particularly during periods of inflation when construction costs increase, whether due to labor or materials prices. This also means that replacement costs rise, boosting the prices of existing buildings.

US rents: real estate as a hedge against rising prices



Source: Bloomberg

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