Is it time **to rethink property?**

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Calls may be recorded

The investment merits of property aren't up for debate. It's an asset class that warrants its position in a well-diversified portfolio, complementing the likes of equities and bonds, and providing scope for attractive returns – both income and growth – in its own right.

Some of its characteristics – most notably liquidity – however, have recently led to questions, reassessment and uncertainty. The FCA's review of illiquid assets in open-ended structures has been ongoing since last summer and isn't expected to be finalised until at least the third quarter of 2021. In the meantime, investors are left in limbo, aware of property's potential but concerned about soft closures and the future liquidity of existing funds. Will they be required to give advance notice of redemptions? And what role will new fund categories – such as the proposed Long-Term Asset Fund – play?

A 'hybrid' could be the answer you're looking for...

The uncertain mood is evidenced by negative property fund flows and closures, as well as asset sales as managers seek to meet redemptions. At BMO GAM, however, we remain firm proponents of property and offer a suite of client-focused solutions drawing on capabilities in both physical and securitised real estate investing. Among our range is an innovatively structured 'hybrid' that blends physical and real estate securities, which was launched in 2005 and has been run by the same team ever since. For many, especially those seeking enhanced liquidity, we believe a hybrid approach can offer property's best attributes, gaining exposure to a broad range of property sub-sectors through real estate equities whilst avoiding the liquidity issues around pure physical only portfolios.

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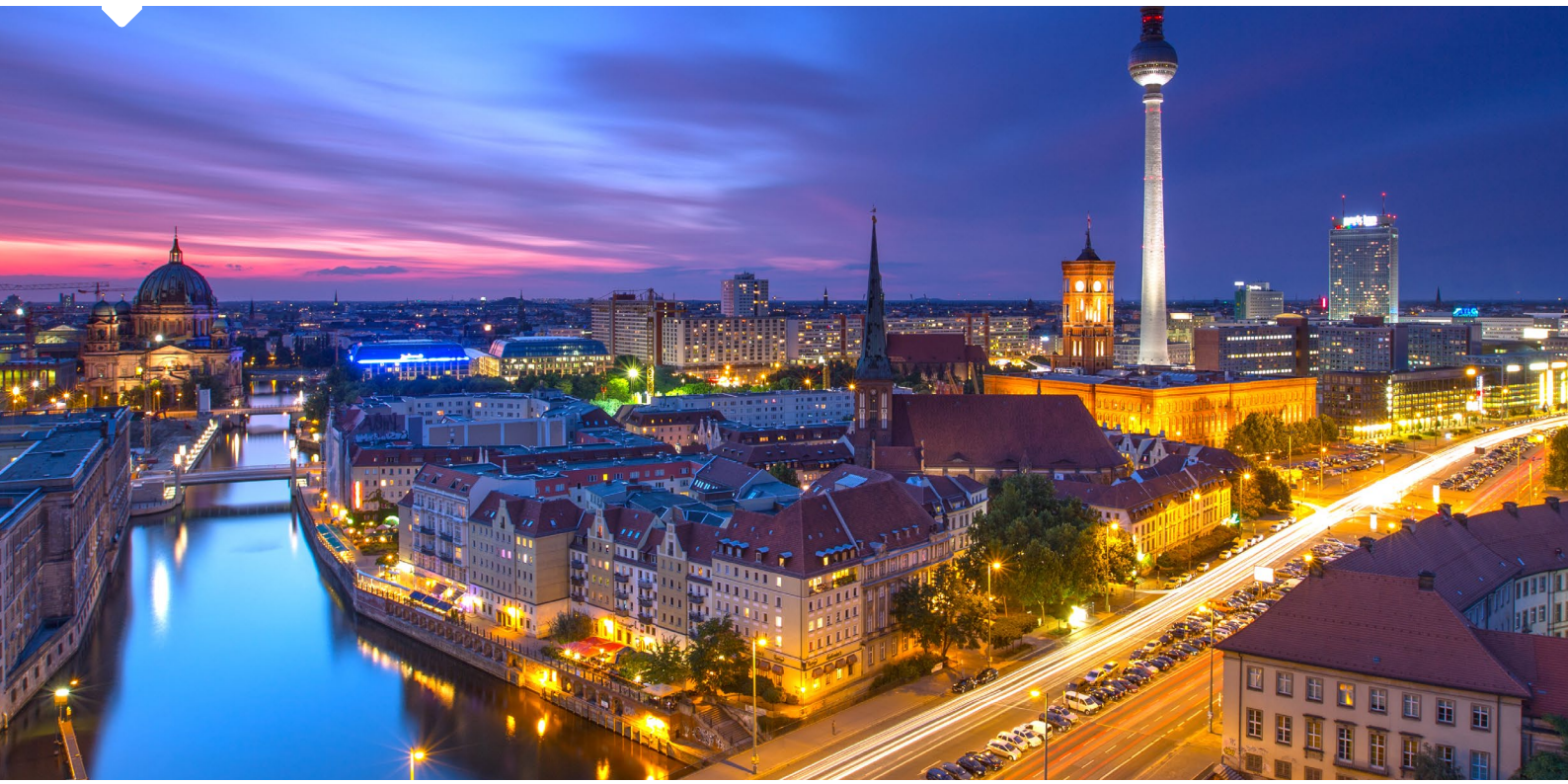

Benefits of blending physical and listed property

1 **Avoid the liquidity trap** – physical property is an illiquid asset. It takes a long time to transact and costs are high, particularly in periods of market stress. Real estate securities, meanwhile, can be easily and swiftly traded, enabling ongoing active management and providing investors with daily liquidity. Equities may be more volatile over shorter timescales but holding physical property alongside them can serve to dampen the effect of near-term fluctuations.

2 **Mind the cash drag** – buildings aren't cheap and together with the practical realities of transacting in bricks & mortar, cash balances within a physical property fund can be large. This can have implications for returns, investors' broader asset allocations and raise questions over the value of management fees. Complementing physical property with real estate securities can counter potential cash drag because the portfolio can remain more fully invested.

3 **More active benefits** – active property investing is multi-faceted, encompassing a host of techniques, each aiming to maximise income and growth, or manage risk. A hybrid structure – assuming the right skill sets are in place – can bring more active tools into play. These range from the purchase/sale, redevelopment and lease management of physical assets, as well as stock selection and sector/geographic positioning within the equity component.

4 **Location, location, location** – it makes sense to diversify any property portfolio across a range of geographies, sectors and individual property assets. Real estate securities can dramatically enhance investment reach and potential through select positions in quality property businesses across a broad range of sectors and locations. This diversification is just not available in traditional physical only portfolios. As an example, at the moment German residential, UK healthcare, industrials and supermarket sectors all look particularly attractive.

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Why invest in property now

There are lots of negative property headlines but it's important to remember that real estate is an exceptionally diverse asset class. The UK high street's problems are well known but many other sectors are enjoying rental growth thanks to stable tenant demand and tight supply. These conditions serve to support property's yield (and growth) advantage over fixed income.

The diverse range of listed property companies allow managers to target their exposure towards focused sub-markets which are experiencing positive demand/supply characteristics. Logistics and light industrial rents across all of Europe are rising as a combination of more online shopping, shortened supply chains and less reliance on 'just in time' delivery has driven a huge increase in demand for storage space. Other macro trends such as the solid demand for better quality working environments – with a focus on sustainability – is driving new office rents and exposure can be obtained through a raft of development businesses. Affordable housing and rents is a global theme which again can be accessed through listed property companies particularly in Germany and the Nordics.

These and other themes serve to illustrate that property has the potential to play an important role in a broader portfolio. What should be carefully considered however, is the way real estate is accessed. We believe that a hybrid approach is potentially ideal for those mindful of the implications of a pure physical approach yet keen to tap into a diversified pool of real estate assets.

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The value of investments and any income derived from them can go down as well as up as a result of market or currency movements and investors may not get back the original amount invested.

The value of directly-held property reflects the opinion of valuers and is reviewed periodically. These assets can also be illiquid and significant or persistent redemptions may require the manager to sell properties at a lower market value adversely affecting the value of your investment.

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