



Record Wide NAV discounts: Time to buy listed real estate?

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Discounts in European listed real estate have rarely been this wide. Long-term investors should take note.

Investors have multiple choices when deciding to invest in real estate: They can buy buildings directly; they can give money to mutual funds that invest in buildings; or they can invest in listed stocks, via companies that develop, own and manage large commercial and residential real estate portfolios in closed-ended, publicly listed vehicles.

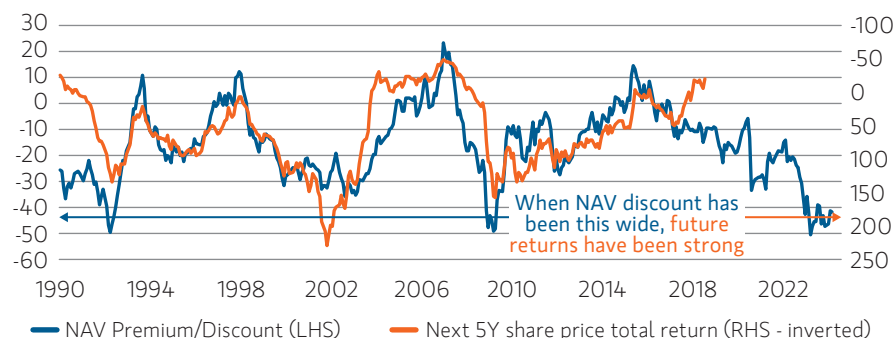
Despite challenges from higher interest rates, we note that public **real estate stocks' discounts** to underlying independent appraisal values in Europe are **close to historically wide levels**, looking back over the last 30 years. We also show that, on average, for listed real estate, **future returns increase the wider this discount is**. This is particularly relevant on a five-year view and/or when discounts are very extreme.

As can be seen in *Display 1*, the discount to last-reported net asset value (NAV) of the larger European listed real estate companies has expanded to over 40% as at August 2023. These depressed levels are witnessed only occasionally, such as during the global financial crisis of 2008-2009 and the European Exchange Rate Mechanism (ERM) debacle in 1992. Other, less extreme lows, occurred

DISPLAY 1

Historical NAV valuation vs. next 5Y share price return

European listed real estate NAV valuation vs. next 5Y share price return (%)



Source: August 2023 Bloomberg, Datastream, Company data, Morgan Stanley

Data is provided for informational use only. Forecasts/estimates are based on current market conditions, subject to change, and may not necessarily come to pass. Past performance is no guarantee of future results.

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when traditional real estate was out of favour during the tech stock boom of the early 2000s, and, of course, during the COVID-19 pandemic.

These moments of significant uncertainty have offered highly beneficial entry points. Indeed, the earlier examples provided the bases for between 100%-200% (Display 2) cumulative returns over the following five years, as the listed markets typically priced in forward-looking direct real estate market valuation declines and more.

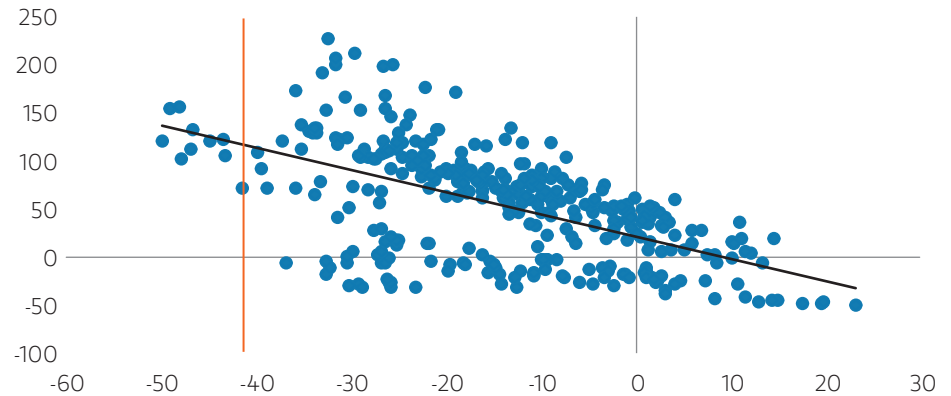
At the discount witnessed at August 2023, historical data suggests that an almost 120% cumulative return over the next five years may be achievable, a compound annual growth rate (CAGR) of over 17% (Display 3).

Between December 1989 and February 2023, there was a 100% hit rate of positive five-year total returns when the opening discount to NAV has been between 40% and 50%. While these are extremes, the trend is consistent at lower levels of discount. When the discount has been between 30% and 40%, the hit

DISPLAY 2

NAV valuation and long-term share price return are correlated. At current discount levels, returns have been strong

Pan-Europe NAV valuation (horizontal axis) vs. next 5Y share price total return (vertical), monthly since 1990



Source: August 2023 Bloomberg, Datastream, Company data, Morgan Stanley
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rate was still a high 82% over five years and 69% over one year (see Display 4).

There are some caveats. Normally, wide discounts signal sharp valuation declines in underlying real estate markets, that take some time to feed through, and current dislocation has largely been driven by higher interest rates. Some

companies' balance sheets may not survive this stress and require dilutive capital raisings. But time is a healer; and as our analysis shows, backtesting returns suggests attractive returns may be on offer, particularly for investors with a medium-term time horizon.

DISPLAY 3

Listed European real estate index average share price return for different NAV valuation ranges

NAV PREMIUM/DISCOUNT (PERCENTAGE POINT)	3 MOS	6 MOS	1 YR	2 YR	5 YR
20 – 30	2.0	-10.4	-31.9	-65.0	-49.6
10 – 20	-2.3	-7.3	-13.7	-28.8	-12.9
0 – 10	2.4	5.7	8.8	11.4	10.5
-10 – 0	2.0	4.2	10.5	18.1	32.2
-20 – -10	2.6	4.8	7.2	22.8	58.9
-30 – -20	0.5	0.7	3.6	14.2	80.0
-40 – -30	1.0	4.0	13.0	30.0	99.0
-50 – -40	0.1	10.2	36.0	60.0	121.0
Average return total period	1.5	3.4	7.6	17.8	53.7

Data range: December 1989 to August 2023

Source: Bloomberg, Datastream, Company data, Morgan Stanley.
Note on shading: green = above average returns, red = negative returns
The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. Past performance is no guarantee of future results.

DISPLAY 4

Listed European real estate hit ratio for different NAV valuation ranges

NAV PREMIUM/DISCOUNT (PERCENTAGE POINT)	3 MOS	6 MOS	1 YR	2 YR	5 YR
20 – 30	100	0	0	0	0
10 – 20	35	35	6	18	47
0 – 10	65	67	70	70	63
-10 – 0	67	68	68	82	68
-20 – -10	71	77	75	85	80
-30 – -20	57	59	59	64	87
-40 – -30	56	49	69	78	82
-50 – -40	50	67	83	100	100
Total hit ratio%*	62	64	66	75	76

Data range: December 1989 to August 2023

Source: Bloomberg, Datastream, Company data, Morgan Stanley.
*Note: hit ratio: % of positive monthly returns over total number of returns for each range
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