IN PARTNERSHIP WITH BUSINESS TELEVISION

APRIL 10, 2023

THE CASE FOR ADDING REITS TO YOUR PORTFOLIO, WITH MIDDLEFIELD

Middlefield is an independent asset management company founded in 1979 and focused on equity income, with a very specific remit – to seek out dividend growth stocks that generate high levels of steady income for their clients. This has been the company's principal tenet for several decades.

Of all the different types of equities that generate income, Middlefield has seen the most success with Real Estate Investment Trusts, better known as REITs. REITs as an asset class are known for their stability due to the contractual nature and the modest but steady growth of their revenue streams.

Middlefield's CEO, Dean Orrico, joined the company in 1996, around the same time that REITs became a more common way for investors to own publicly listed real estate. With a career spent analyzing and advising on the REIT market, he has an impeccable pedigree. "When I got into this business, a lot of the current REITs that we have in the market today were IPO'ing", Orrico continues, "So I've known these companies and their management teams for over 25 years. As a result, we manage real estate and REIT portfolios with a strong foundation and have witnessed how they perform during various market cycles."

In addition to being company CEO, Orrico is also an active fund manager. The Middlefield Real Estate Dividend Class – which he oversees – was recently recognized with a prestigious Refinitiv Lipper Fund Award for Best Fund Over 5 Years – Real Estate Equity, for the second consecutive year.

In a recent chat, Orrico offered up a thorough overview of the most consequential real estate trends from the past year, as well as some of the sub-sectors of the REIT market that he predicts will perform well in the months to come.

According to Orrico, the year's biggest trend was the downturn in public real estate, which coincided with the overall economic uncertainty in the markets. Some publicly listed REITs were down 20% in Canada, and close to 30% in the US. This was somewhat surprising since REITs are generally thought to be able to weather the fluctuations of the stock market.

But in 2022, Orrico noticed something unusual with the REITs – they were trading down in price despite rising asset values and stable levels of income generation. Historically, REITs tend to outperform in high-inflation market environments. It seemed that interest rates were rising so fast, that investors were scared off and worried that high rates would push North America's economy into a recession. Orrico predicts that this trend will self-correct as he believes we are nearing the end of the recent rising interest rate cycle. "Investors will finally have a line of sight on where interest rates are going because up until this point, their view has been that rates are just nudging higher and we're falling into recession." Orrico said, "So at least now we have some visibility of what's happening with interest rates, and I think that's a plus." Orrico believes that one reason that we may see a pause in rate hikes is due to the current distress in the banking sector. With the recent collapse of the Silicon Valley Bank and Credit Suisse, it's likely that this will neutralize economic activity in the same way that a Fed sponsored interest rate hike would.

Another big trend in the real estate market last year was the unusual disconnect in the economic performance between public and private real estate. While public REITs were down significantly as the broader equity market sold off, private REITs were written up in value, which Orrico feels makes publicly listed REITs, the majority of real estate assets managed by Middlefield, that much more attractive to investors. And it's the main reason that Orrico feels like investing in public REITs right now is a wise strategy, "We have been telling our clients that if they want real estate exposure, publicly listed real estate funds are currently much more attractive given those recent market dynamics." He continues, "Even if you assume the economy is contracting, you're being more than compensated for that downside risk with many high-quality REITs priced at a 20% discount to NAV."

Looking ahead to the remainder of 2023, Orrico believes that there are three sub-sectors of the public real estate market that investors should be particularly interested in.

INDUSTRIAL REITs

Middlefield continue to be a strong advocate of Industrial REITs, singling out companies like Granite REIT, Dream Industrial REIT, and Prologis REIT in the US as being especially well positioned.

The high demand for industrial real estate exists for a couple of reasons. First, is that companies are increasingly interested in space for logistics and distribution to help support e-commerce.

Demand for industrial properties is also being driven by the concept of onshoring of operations. Orrico explains, "During the past 30 years, many North American companies looked to locate their facilities and plants in low-cost areas in Asia or India. We're now starting to see a lot of that manufacturing and distribution activity being brought back onshore, closer to their head offices and their customers."

Whether it's due to the lingering after effects of the Covid pandemic or the increase in geopolitical strife in Russia and other parts of east Asia, many links in the supply chains are returning home after a long period of being outsourced, which can only be good news for the industrial sector.

MULTI FAMILY REITs

Middlefield is also bullish on multi family, or apartment rental REITs, mainly due to the significant shortage of housing and continuing influx of new immigrants to Canada, which projects to see an average of half a million people coming into the country over the next several years. These high immigration levels are contributing to a national housing crisis in Canada, which – among other problems – has seen the cost of a new house skyrocket beyond reach for most new Canadians. As a result, a high percentage of these new immigrants will rent for years before becoming buyers, which drives up demand in the multifamily apartment sector.

RETAIL REITs

The third sub-sector of public real estate that Middlefield has great confidence in, maybe somewhat surprisingly, is the retail sector. While conventional wisdom tells us that the emergence of e-commerce has negatively affected retail, Orrico suggests that this isn't necessarily true for this multi-faceted market. He explains, "We've had a lot of challenges in retail, but most of our retail REITs in Canada are really very well positioned. They don't own shopping centers or enclosed malls, they own necessity-based grocery-anchored open-air centers that continue to do really well, despite the proliferation of e-commerce."

Orrico's savvy navigation of the public real estate market helps underscore the importance of choosing an active investment manager like Middlefield when investing in REITs. As we've seen, certain areas of the market are better positioned to perform. Buying into a passive index may unwittingly give that investor exposure to a corner of the market that's poised to underperform. Orrico points towards the office real estate market as one such area. He explains, "The office market is an area you really want to be underweighting right now. Lots of people are still working from home, and I don't think we'll have a good sense for how this trend will develop for at least another three or four years." An active manager would help an investor steer clear of this kind type of investment.

When it comes to finding a REIT-focused active asset manager focused on equity income, Orrico makes the case for Middlefield, "You want to consider a Middlefield fund right now because, given the type of environment we're in today, you need to be in more discrete parts of the market. You need to be able to get returns from different parts of your portfolio, and an active manager can really help navigate those waters. We've been focused on this since 1979. Real estate is really in our blood".

Read the full article at **www.middlefield.com**