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AN REIT REBOUND: WHY ORRICO THINKS THEY'RE BACK IN 2024

CEO of Middlefield, Dean Orrico, on the dichotomy of growth and challenges in the real estate sector, from stagnant offices to booming industrial and data centre markets

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For this CEO, the blood is still running hot in the real estate sector, just not in every vein. Dean Orrico, president and chief executive officer of Middlefield, says, "You've had really negative sentiment towards real estate. But again, that's sentiment."

The seasoned executive is optimistic about the firm's real estate solutions, maintaining, "When we consider the property sectors beyond the office realm, the fundamentals in most of these areas are arguably as robust as they have been in decades. Non-office markets are demonstrating strong performance and resilience, showcasing some of the best conditions we've observed in a long time."

The challenges in the office sector have been influenced by significant changes in workplace dynamics, such as the increase in remote work and the corresponding decline in demand for office space as well as an increase in supply in major centres like Toronto. The pressures facing Canada's residential sector, encompassing both single-family homes and condominiums, stem from multiple causes.

Orrico recalls 2022 and 2023 as particularly difficult years for public REITs, marked by negative returns and year-end rallies. The major culprits were rising interest rates and the regional banking crisis of 2023, largely impacting the US commercial real estate sector. He notes the significant influence of regional banks as lenders and the potential repercussions of bank failures, like Silicon Valley Bank, on the commercial real estate sector.

Why Should Investors Add REITs Now?

Near-term performance drivers
Inflation is subsiding and rate cuts expected in 2024
Prices trading at excessive discounts to NAV
Volatility has historically subsided after peak rates
Inflows coming from cash and near-cash alternatives
Portfolio companies are fundamentally solid
Rising rents and increasing cash flows across focus areas
Economic soft-landing scenario is coming into view

Medium & long-term tailwinds
Active management 25+ year history with intimate knowledge of the REIT sector evidenced by long-term outperformance vs. peers and benchmark
Strong REIT balance sheets REITs have solid balance sheets, access to debt, and ample liquidity
Built-in growth for high-quality assets Market rents are above in-place rents for many of our portfolio companies
Limited supply coming to market New supply, especially in Canada, is down significantly due to high development costs and interest rates

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It's difficult to underestimate the impact that interest rate volatility has had on REIT prices. While the year-end rally in 2022 turned out to be a head-fake due to continued interest rate increases in the first half of 2023, Orrico thinks central bankers have finally slayed inflation and is expecting a gradual decline in both short and long rates throughout 2024. This is causing investor sentiment to finally turn higher with the sector outflows of 2022 and 2023 turning into inflows in 2024.

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> **Dean Orrico, President & CEO**
> **Middlefield**

A blend of old and new

Optimistic about the industrial REIT market in Canada, Orrico finds it buoyed by strong fundamentals. A key factor is the limited supply of new industrial properties, creating a favourable supply-demand dynamic. While the US saw some increase in supply in 2023, which now appears to be peaking, Canada is experiencing very little new supply, a positive trend for property owners.

This supply constraint in Canada provides leverage for rental rates. For example, over the past eight to 10 years, industrial rental rates in Canada have escalated from around $5 or $6 per square foot to approximately $20 per square foot. Currently, while these rates are starting to plateau, cash flows are growing as landlords are renewing leases at significantly higher rates than their previous contracts.

Historically, this growth has been driven by the expansion of e-commerce. The increase in online shopping necessitates more logistics and distribution facilities, sustaining demand for industrial properties. Additionally, in the past two to three years, there's been a noticeable shift toward supply chain resilience and onshoring. Companies are bringing manufacturing and logistics back to North America, reversing previous trends of outsourcing to Asia. This change, aimed at enhancing supply chain reliability, especially evident during the pandemic, is further boosting demand for industrial properties and ensuring healthy cash flows in this sector.

Total Real Estate AUM: $450 million

MIDDLEFIELD
REAL ESTATE DIVIDEND
CLASS (MUTUAL FUND)

FUND CODES	YIELD	AUM
MID600 | MID601	5.5% | 4.6%	$48 million

MIDDLEFIELD
REAL ESTATE DIVIDEND
ETF

TSX TICKER	YIELD	AUM
MREL	7.5%	$106 million

Middlefield Global Real Estate Dividend ETF 2023 Fundata A+ Award

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ACHIEVED FOR THE YEAR 2023

Rising stars: Data centres and cell towers

Orrico is decidedly in favor of data centres, identifying them as a burgeoning frontier in the real estate sector.

He says, "Our focus spans North America, Europe, and, to a lesser extent, Asia. While in Canada we have access to a variety of REITs, including retail and industrial sectors, there are specific areas where the Canadian market doesn't offer direct access, notably data centre and cell tower REITs."

Data centre REITs essentially operate sophisticated industrial facilities equipped with advanced cooling systems, housing rows upon rows of high-powered computer servers. They are integral to what is commonly referred to as "the cloud," hosting data for a range of companies from major players like Amazon AWS to local firms like Bell Canada. As the trend of off-premises data storage grows, along with the ever-increasing volume of data generation, data centre REITs are poised for significant growth. In the Canadian market, we don't have direct access to these REITs, but we can invest in high-quality data centre REITs based in the US that have global operations.

Similarly, cell tower REITs present a unique investment opportunity. Unlike in Canada, where most cell tower assets are owned by large telecommunications companies, in the US, these assets often trade as separate entities. These REITs own the physical towers and lease space on them to various telecom operators.

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Orrico highlights, "Our top choice is Equinix. This company stands out in the sector due to its robust infrastructure and strategic global presence. As for cell towers, we favour investments in companies like SBA Communications and American Tower. These firms are notable for their extensive network of cell towers and their strategic leasing arrangements, positioning them well in the growing telecommunications infrastructure market."

A year of measured optimism

The Middlefield CEO envisions 2024 as a year of balanced growth, steered by strategic interest rate adjustments. He says, "Opinions vary regarding potential interest rate cuts. Some anticipate two or three cuts, while others expect as many as five or six. In my view, a scenario with five or six cuts likely indicates a struggling economy.

"I believe that two or three cuts would be more appropriate, suggesting an economy that is stable, neither surging forward nor declining. This would be a 'Goldilocks' situation, not too hot, not too cold, which I find ideal. Therefore, I'm optimistic about avoiding a severe economic downturn and do not align with the viewpoint that anticipates a need for five or six cuts."

Orrico's insights encapsulate the essence of the real estate sector, ever evolving, yet steadfast at its core.

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