"These two factors are helping offset the expected reduced demand for office space. Although London office headline rents are not materially changed, increased rent-free periods are lowering the net effective rents that tenants pay. Rent collections in city offices have generally been more resilient than that from the retail and leisure property sectors," he says.

All this has caused a re-think for pension schemes; speaking at a recent Irish Association of Pension Funds (IAPF) conference, Nest CEO Mark Fawcett, says: "Given what has happened in the pandemic we have been a bit cautious about property, both debt and equity, and have really scaled back our commitments to those."

Expanding on this, Nest head of manager selection, Anders Lundgren, says: "Although the property market has stabilised we remain cautious. Leisure and hospitality have still far from recovered and with further lockdown measures being announced we're concerned about the short-term outlook for this sector. We've therefore underweighted property in our portfolio in anticipation of some structural changes, in areas such as retail.

"However, we expect leisure and hospitality to recover over the longer term and that there'll be opportunities in sectors like logistics. In general we continue to view property as a yield enhancement and diversification benefit."

Long-term focus

Pension schemes are long-term investors, however, so CBRE Global Investors chief investment officer EMEA direct real estate strategies, Paul Gibson, recommends they focus on "properties that are best placed to benefit from, rather than be disrupted by, structural trends and evolving occupier requirements". He favours logistics and residential sectors where demographic and technological changes continue to provide tailwinds for customer demand.

In regards to offices, Border to Coast portfolio manager (property), Paul Campbell, says: "For office assets, increased working from home/reduced office demand is, to some extent, offset by the reversal of the long-term trend of increased employee densification and the continued need for employee training and coaching which has been successfully achieved in an office-based environment.

"As a result, pension funds need to be as close as possible to their tenants to understand their requirements from office space in the medium to long term in order to form a view of the scale of the impact and plan accordingly."

Furthermore, Jayasingha notes that UK property is "expensive to trade" and takes time to invest and divest. Therefore, he advises that pension schemes continue to focus on their longer-term overall risk and return objectives and consider (and in some cases re-consider) how best property can play a part in achieving these objectives alongside other asset classes.

"We believe it is important to continually re-assess how society is using real estate and what this may mean for a pension fund's property allocation. For example, the rise in online retailing has increased the demand for logistics and reduced the demand for certain types of retail. Longer-term lifestyle, demographic and technology trends may be supportive for residential, healthcare and data centres," he states.

Despite these structural changes taking place within the property market, Kohalmi expects that property will still draw interest from pension schemes over the coming years. "We are entering a world of universally low rates, very likely coupled with a higher degree of volatility in the equity markets," he says.

"For pension plans that want to diversify their holdings to a degree from listed equities to products with lower volatility, but still an ability to produce alpha, value add real estate funds should prove to be one of the more attractive solutions. For pension plans looking to diversify away from low to negative yielding bonds, more core real estate exposure providing real cash on cash income will be a strong draw. Hence overall I expect real estate to be a net benefactor in terms of interest from pensions plans in the coming years."

Debt or equity

When it comes to property, investors can choose to invest in debt or equity real estate but which one should pension funds consider? Jayasingha says this depends on a pension funds preference for specific risk and return opportunities. "Senior real estate debt, given its priority position, is more defensive to a downturn in property values.

"That said, certain ungeared real estate equity strategies like commercial ground rents or long lease property, can be similarly defensive but also offer long-term inflation linkages, which debt strategies typically don't offer. These longer-term inflation linkages are attractive characteristics to pension funds."

Kohalmi, however, is less inclined to lean towards real estate debt: "One can argue that by investing into real estate debt one gains a more conservative exposure given where one sits in the capital stack.

"The key issue I see for pension plans is that they are mostly keen on long-term capital flows. The problem with debt is that it regularly gets refinanced, and hence the debt book needs to turn over regularly in order to remain invested. This in turn does mean that when cycles heat up – as was the case in 2018/19 – debt providers have to consider lending to slightly more cyclical assets.

"Hence for most pension plans I would suggest that holding very high quality core real estate investments over the long term would be at least as attractive as debt funds exposure that rolls often. Value add funds are of course different altogether, aiming to create more alpha, albeit admittedly with the higher volatility of returns."

Written by Natalie Tuck