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U.S. Real Estate: All Grown Up

The U.S. stock market is made up of many different types of companies across a multitude of industries. To assist investors, Standard & Poor's and MSCI have grouped individual stocks into sectors, with each sector representing one slice of the stock market pie. Historically, the classification system was divided into 10 sectors (consumer discretionary, consumer staples, energy, financials, health care, industrials, information technology, materials, telecommunication services and utilities) but starting next month, real estate will officially become its own distinct sector. The U.S. stock market pie will still be the same size—it will now just be divided into 11 instead of 10 slices.

Predominantly, the new real estate sector will be comprised of equity real estate investment trusts (REITs), but will also include some real estate development companies. For those who may be unfamiliar with them, equity REITs own physical properties such as apartment buildings, skyscrapers and shopping malls (*Note: Mortgage REITs, which own mortgages instead of physical buildings, will remain in the financials sector*).

Why the change? In part due to the growing influence of real estate assets on the economy. Consider that 15 years ago, REITs made up less than 1% of the financial sector (which represented nearly 18% of the broader S&P 500®). Today they constitute nearly 20% of the sector—second only to Diversified Banks (*see adjacent chart*). By breaking them out as a standalone sector, REITs will now account for 3% of the S&P 500 (similar to the weighting of telecoms, materials, and utilities) while financials will represent a smaller percentage of the overall S&P (more comparable to the weightings of consumer discretionary, consumer staples and industrials).

Exhibit 2: Composition of Financials including and excluding Real Estate
as of August 18, 2016

Financials industry	Mkt cap ($ bil)	% of Financials	% of Financials ex-Real Estate
Diversified Banks	$862	27 %	**33 %**
Multi-Sector Holdings	374	12	**14**
Asset Management & Custody Banks	225	7	**9**
Regional Banks	185	6	**7**
Investment Banking & Brokerage	175	5	**7**
Property & Casualty Insurance	161	5	**6**
Consumer Finance	149	5	**6**
Life & Health Insurance	148	5	**6**
Specialized Finance	133	4	**5**
Multi-line Insurance	101	3	**4**
Insurance Brokers	90	3	**3**
Financials ex-Real Estate	**$2,604**	**81 %**	**100 %**
Real Estate	605	19	**NA**
Financials	**$3,209**	**100 %**	**NA**

Source: FactSet and Goldman Sachs Global Investment Research.

The new real estate sector will span an array of industries through the inclusion of real estate tied to healthcare facilities, hotels, corporate offices, residential apartments, retail and mall properties, cell phone towers, personal storage, and real estate services and brokerage.

THE NEW SECTOR'S 10 LARGEST REITS

At the time of writing, the top 10 largest REITs (based on market capitalization) which will be included in the new sector are each worth in excess of $20 billion. The following provides a brief overview of each of those firms:

Simon Property Group	**SPG**	Owns, develops and manages retail real estate properties including malls, outlets and community & lifestyle centers. It's one of the largest owners of shopping centers in the world. As of December 31, 2015, SPG owned or held an interest in 209 income producing properties in the U.S. consisting of 108 malls, 71 premium outlets, four community/lifestyle centers, 14 regional malls and 12 other shopping centers or outlet centers across 37 states and Puerto Rico. In May of 2014, SPG completed the spin off all of its strip center business and smaller enclosed malls into an independent, publicly traded REIT called Washington Prime Group (WPG).
Public Storage	**PSA**	Invests in self-service storage facilities across the United States and Western Europe. In the U.S., the firm is the largest owner and operator of storage space, with direct and indirect equity investments in 2,277 self-storage facilities representing a total of about 148 million net rentable square feet of space located throughout 38 states (as of December 31, 2015). In Western Europe, operating under the "Shurgard Storage Centers" name, the firm owns 217 self-storage facilities containing 12 million net rentable square feet of space in seven countries (as of December 31, 2015).
Prologis	**PLD**	Owns and operates industrial distribution facilities in North America, Europe and Asia. The trust's business strategy is to integrate international scope and expertise with a strong local presence in its markets, thereby becoming an attractive choice for its target customer base, the largest global users of distribution space, while achieving long-term sustainable growth in cash flow. The trust's operating strategy includes the location of properties near key passenger and cargo airports, highway systems, and ports in major metropolitan areas. PLD's properties are often a critical component in the operations of its major customers including Amazon.com, Deutsche Post World Net/DHL, Kuehne + Nagel, Home Geodis and CEVA Logistics.
Welltower	**HCN**	Invests in health care facilities offering skilled nursing, assisted living, independent living and specialty care services, as well as medical office buildings. HCN's investments are primarily real estate properties leased to operators under long-term operating leases or financed with operators under long-term mortgages. HCN changed its name from Health Care REIT to Welltower Inc. on September 30, 2015. As of December 31, 2015, HCN had real estate investments totaling $26.1 billion, consisting of 1,405 properties in 46 states, the UK and Canada. HCN invests mainly in long-term care facilities managed by experienced operators, and diversifies its investment portfolio by operator and by geographic location.
Equinix	**EQIX**	Data center operator that provides physical connection locations for thousands of companies to directly connect with their own customers and exchange data. EQIX provides power, floor space, security and cooling for its customers, which place their own equipment inside EQIX facilities. EQIX does not sell equipment or network services, and thus does not compete with its clients. The data centers are all connected by fiber routes built by telecommunications services providers that pay EQIX monthly fees to house points of presence within EQIX facilities so they can sell network services to other EQIX customers. Customers also pay for each megabit (Mbp) of traffic exchanged within the data centers through cross connects or exchange ports.
General Growth Properties	GGP	Owns, develops, acquires and leases U.S. regional mall and community shopping centers. As of June 30, 2016, GGP's portfolio consisted of ownership interests in 129 retail properties throughout the United States comprising more than 121 million square feet of gross leasable area (GLA).
Ventas	VTR	Specializes in acquiring, financing and owning senior housing and health care properties, and leasing those properties to third parties or operating them through independent third-party managers. At the end of 2015, its portfolio consisted of interests in 1,282 properties in the United States and Canada, including senior housing communities, skilled nursing facilities, hospitals and medical office buildings (MOBs) in 46 states, the District of Columbia and two Canadian provinces.
AvalonBay Communities	AVB	Specializes in the ownership of multi-family apartment communities. As of December 31, 2015, AVB owned or held an interest in 51,134 apartment homes in 11 states and the District of Columbia. The average occupancy rate was 95% in 2015 and the average rental rate was $2,404 monthly. Geographic markets in which AVB has concentrations of apartments include

		Southern California, Metro NY/NJ, Mid-Atlantic, New England, Northern California, and the Pacific Northwest
Equity Residential	EQR	One of the largest publicly-held owners of multi-family properties, EQR has in recent years sold a majority of its ranch-style properties to focus on garden and mid-rise/high-rise assets. Garden-style properties have two or three floors, while mid-rise/high-rise properties have more than three floors. At the end of December 2015, the trust's largest geographic markets/metro areas as a percentage of net operating income were: New York (17.6%), Washington, DC (17.0%), San Francisco (15.1%), Los Angeles (12.3%), Boston (9.5%), South Seattle (7.6%), Florida (7.2%), Denver (4.6%), San Diego (3.1%) and Orange County, CA (3.1%). Average occupancy during 2015 was 96.0%, flat with 2015 and ahead of 95.4% for 2013.
Boston Properties	BXP	Develops, acquires, manages and operates commercial real estate. It is one of the largest U.S. owners of high-end Class A office properties. BXP conducts substantially all of its business through a limited partnership of which it is the sole general partner. As of December 31, 2015, the company's portfolio consisted of 154 properties, totaling 41.1 million rentable square feet along with structured parking facilities for vehicles. Total space available at year-end 2015 was 3.2 million square feet for office properties, and 171,135 square feet for office/technical. At the end of 2015, properties were concentrated in four core markets: greater Boston, New York metro area, greater Washington, DC and greater San Francisco.

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