

# Why Global Change Could Yield Opportunities for Real Estate Investors

**Melissa Reagen, Head of Research at Nuveen Real Estate, explains why amid uncertainty real estate will play a key role in investor portfolios as the industry adapts**

**After the extraordinary events of 2020, what are your views on the viability of real estate as an asset class today?**

Numerous economic scenarios could arise in 2021 and the implications for real estate from each potential outcome are varied, so trying to peer into a crystal ball is ineffective. Real estate is facing a K-shaped recovery: certain property types, such as warehouses, life sciences, single-family rentals, and self-storage are facing rising values and rents, while other property types, such as malls and lodging, are facing plummeting values and rents. Still, the current spread between direct real estate cap rates and corporate bond yields is well above the historical average – signaling real estate’s strong relative value.

The pandemic has not caused a paradigm shift for real estate, but has accelerated already-present underlying trends. For example, we expect to continue to see strong e-commerce retail sales, more of a movement to the Sunbelt cities in the southern parts of the US, and an increasingly digital economy. Most of us who have endured previous cycles remain optimistic and believe that new opportunities emerging from current circumstances will strengthen portfolios in the long run. Agility and insight into tomorrow’s world are the two qualities I believe are most critical for managers and investors today.

**What opportunities do you believe will prove the most attractive?**

We believe there will be opportunities to acquire real estate assets at attractive prices as the pandemic endures. And we expect that the alternative property sectors are likely to become a mainstay in institutional investors’ portfolios during the next decade. Currently, most institutional investors, according to NFI-ODCE, have less than 15% exposure to the alternative property



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types. I suspect that to shift closer to a 50% allocation within the next decade.

Property types that can generate superior net operating income (NOI) growth are going to play a significant role and will dovetail with trends being driven by the pandemic: a continued shift toward renting, a

transformation of the US healthcare system, and a rise in the digital economy.

Specifically, medical office, senior housing development, self-storage, data centers, life sciences, and single-family rentals are the alternative subsectors we are currently focused on because their fundamental drivers are less tied to the economic factors that are so uncertain right now.

**But with institutional investors already deeply embedded in primary sectors like office and retail, how should they manage the portfolios they own today?**

Office and retail are certainly experiencing unprecedented challenges, yet they were under pressure to evolve pre-pandemic. I don't doubt the viability of these sectors in the future – it just may come down to the asset level and be a survival of the fittest scenario, making property management, technology, and competitive insights more crucial than ever. For instance, our office strategy embraces the growing demand for more flexible space and the wellbeing and health of the occupants. With retail, we are repositioning assets that can remain relevant and seeking to repurpose others.

An ideal portfolio today is a defensive portfolio, with long-term leases and high occupancy rates, along with low leverage to cushion volatility and downside risk. And yes, portfolios will need to shift over time to better balance retail and office exposure and avoid or limit exposure to hospitality, gaming, or leisure.

**Cities have always been a central focus of your investment philosophy. How have current circumstances affected that view?**

City life is certainly diminished due to restrictions on movement and travel, but as we are seeing with the current upsurge of the pandemic in more suburban areas in the US, the virus is a global issue and no location is immune. Therefore, we expect that over the medium to long term, the greater economic opportunities and the dynamism of cities will continue to make them attractive. The factors we've always considered – such as urbanization, shifts in middle classes, generational dynamics, and digital drivers – are still relevant, while factors such as wellbeing and sustainability may become more pertinent than ever. I suspect major cities will see rents and values reset in the near term, but this will also usher in a new, and perhaps more vibrant, era for major cities across the world.

**What are you transacting in now?**

Multi-family and industrial are the current darlings, but increased competition for the best assets may mute

overall performance in the medium term – again, asset selection and property management factors come into play. Multi-family rent collections and performance remain strong and while we've been investing in the industrial sector since 1953, we believe the sector is currently poised for the most outsized growth in history. We expect e-commerce retail sales could reach 20-25% of total retail sales in the medium term, driving demand for warehouse space. In 2020, these two property types accounted for half of all US transaction volumes, speaking to investor demand.

Our transactions since the pandemic began have spanned both the alternative space – the acquisition of student housing assets in Denmark, and a joint venture with Arizona-based Sparrow for U.S. single-family rentals – and more traditional sectors – industrial acquisitions in new markets such as the Netherlands and South Korea and a joint venture with Madrid-headquartered Kronos to develop 5,000 housing units in Spain.

We also believe that the pandemic is bringing about a change in priorities which is likely to increase demand for investment approaches that target positive social and environmental outcomes. For this reason, we have increased our focus on impact investing.

**How mainstream is impact investing today for institutional investors, and how do you see it as distinct from responsible investing?**

Traditional responsible investing aims to integrate a range of ESG factors that can mitigate risk and improve performance, while impact investing is a distinct approach that seeks specific positive environmental and social benefits in addition to attractive returns. The global pandemic has most likely accelerated this shift as good governance, balancing stakeholder needs, and a focus on long-term value generation have become even more important to investors and society.

The Global Impact Investing Network reported that pension funds and insurance companies invested \$7.2bn into impact investments in 2019 alone. And we see investor demand growing, particularly from European investors, as they seek to align their investment practices with their values.

Successful real estate impact strategies will take affordability, health/wellbeing, educational access, and climate change into consideration and clearly define what they want to achieve, how they plan to do that, how to measure success, and how success is preserved over time. We have a solid history in this area and are going to be introducing new impact strategies.