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Trending themes in real estate securities and carbon reduction

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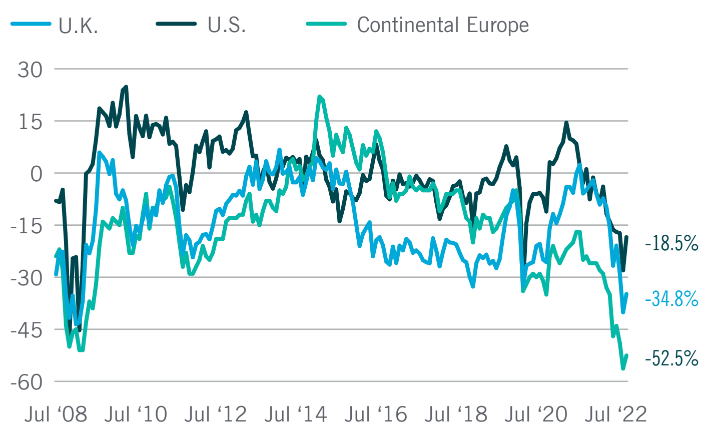
We believe the intersection of investments in real estate securities and carbon reduction policy provides a long runway of investment opportunities and growth. Cyclical asset class positives also exist, including favorable valuations and healthy fundamentals, along with solid earnings and dividend growth. Meanwhile, the need for forceful action to combat climate change has fueled worldwide demand for investments focused on decarbonization, potentially providing long-term support for the asset class. In our view, these tailwinds help make the case that now is the time to add global real estate securities to a diversified portfolio.

LOWER VALUATIONS ENHANCE THE APPEAL OF REITS

Fueled by the worldwide reopening from the COVID pandemic, REITs enjoyed robust returns in 2021 but gave back gains in 2022 amid aggressive interest rate hikes by central banks and generationally high inflation. This year, we are constructive on global REITs, as they trade at a significant discount to the underlying net asset value (NAV) of their property portfolios (see Figure 1). Global REITs also offer compelling multiples compared to private real estate and broad equity indexes.

Figure 1: Global real estate trades at a deep discount to NAV

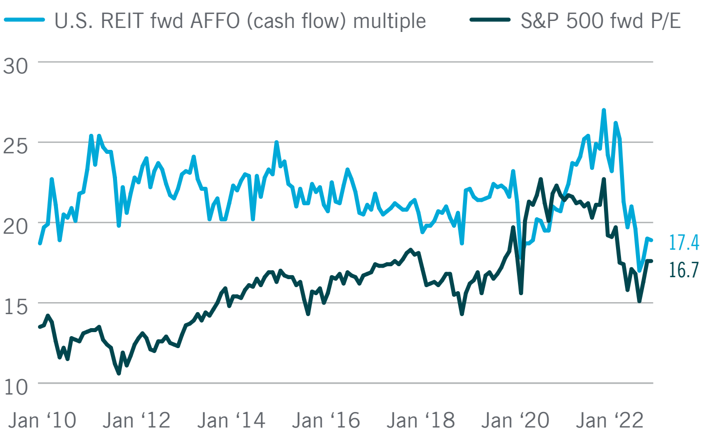
Premium/discount to NAV



Data source: Green Street, Morgan Stanley, Refinitiv Datastream as of 31 Oct 2022. **Performance data shown represents past performance and does not predict or guarantee future results.** The performance shown is for illustrative purposes only and does not replicate any of Nuveen's investment strategies.

Since 2010, U.S. REITs have consistently traded at a premium relative to the S&P 500 Index — 20x-25x cash flow, far higher than the S&P 500's P/E multiple, as shown in Figure 2. Over the past year, these REITs have become more attractively priced relative not only to their own trading range, but also to the S&P 500, as their adjusted funds from operations (AFFO), a measure of financial performance, have fallen below 20x. In fact, that premium has largely disappeared, converging to near parity and providing a potentially beneficial entry point for investors.

Figure 2: U.S. REIT cash flow multiples are attractive versus the S&P 500 Index



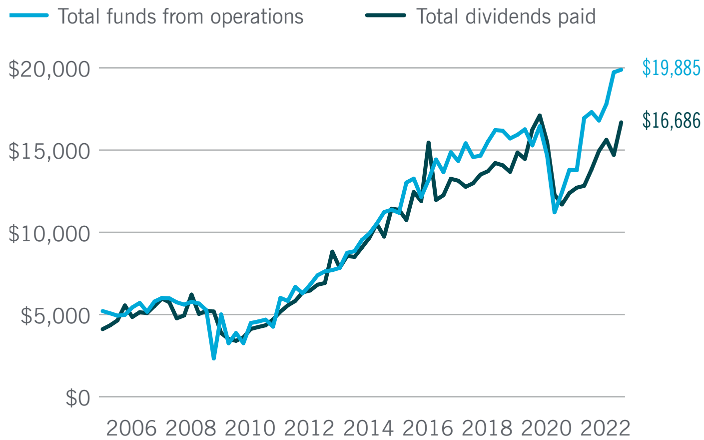
Data source: Evercore ISI as of 31 Dec 2022. **Performance data shown represents past performance and does not predict or guarantee future results** The performance shown is for illustrative purposes only and does not replicate any of Nuveen's investment strategies.

FUNDAMENTALS LOOK FAVORABLE

Attractive valuations are not the only potential green light we see. The strength in underlying fundamentals across many sub-property types should provide tailwinds as well, in our view. Occupancy rates remain high in nearly all markets, while supply is still constrained by regulations and soaring construction costs. Taken together, these factors have led to solid expected earnings and dividend growth for REITs in 2023.

Moreover, earnings growth for REITs has begun to outpace dividend growth after the two have historically been aligned (see Figure 3). For example, from 2019-2022, earnings increased at a 4% compounded annual growth rate (CAGR) compared to a 3% CAGR for dividends. But in 2023 and 2024, we believe dividend growth for REITs will accelerate to 9% per year versus earnings growth of 7%.

Figure 3: Earnings growth for REITs has outpaced dividend growth



Data source: NAREIT, Bloomberg as of 30 Sep 2022. **Performance data shown represents past performance and does not predict or guarantee future results.** The performance shown is for illustrative purposes only and does not replicate any of Nuveen's investment strategies. Other methods and market conditions may result in significantly different outcomes.

A MORE SUPPORTIVE INTEREST RATE ENVIRONMENT BECKONS

While rising inflation and low interest rates boosted total returns for REITs in 2021, a pivot toward more restrictive monetary policy and rising real rates (i.e., after inflation) became a headwind in 2022. From our perspective, 2023 will be a year of transition away from higher rates as inflation subsides and monetary policy globally approaches the end of its tightening cycle, allowing valuations and the strength of underlying fundamentals to drive results for REITs.

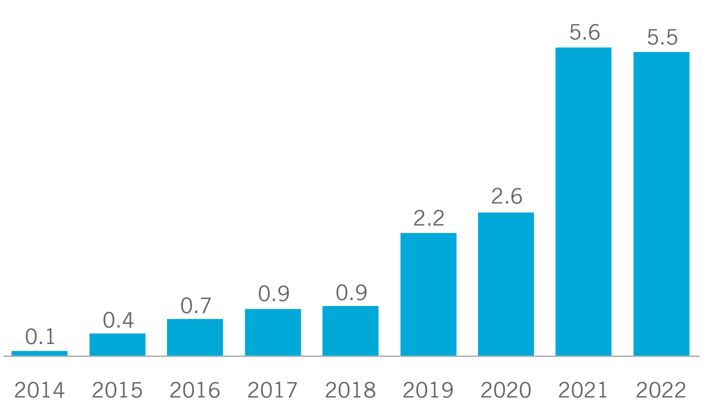
Real estate cash flows are generally protected from inflation through fixed percentage escalators or rent escalators tied to the Consumer Price Index (CPI) that specify how often and by how much rent will increase over time.[1] Therefore, REITs tend to deliver relatively better returns when inflation rises. However, real interest rates have been a more meaningful driver of REIT returns than inflation given the extended duration of contractual cash flows for most REITs and the financial leverage used to drive external growth. As real interest rates rise, the net present value of these contractual cash flows falls, and higher debt costs make it more difficult to create value via real estate acquisitions and development.

CARBON REDUCTION: SECULAR GROWTH AND INVESTMENT

From a longer-term strategic perspective, we believe there are several key reasons that property decarbonization, a major factor in minimizing global warming, will benefit investments in real estate securities.

Lower cost of capital – Companies prioritizing decarbonization should have superior access to, and better pricing for, equity capital and debt relative to their peers. Transparency has been rewarded in this regard. Studies have shown companies that disclose Scope 3 carbon emissions enjoy a lower cost of capital (20 basis points) versus those that do not disclose.[2] Real estate businesses focused on carbon reduction also have access to the green bond market — another important source of capital, as shown in Figure 4.

Figure 4: Labeled bond share of total investment grade corporate supply has soared (%)



Data source: Bof A Global Research as of 31 Dec 2022. Labeled bonds (sometimes referred to as impact bonds) are bonds that have specific environmental, social or governance (ESG) or sustainability objectives.

Hedge against future liabilities - Regulators are currently imposing carbon taxes or other penalties, including an inability to sign leases, on landlords who surpass global greenhouse gas thresholds or own buildings that do not conform to minimum energy efficiency standards. In Canada, for example, a carbon tax of Can$65/ton is set to increase to Can$170/ton by 2030.[3]

Looking ahead, failing to comply will become more costly, so companies that proactively implement a carbon emission reduction plan will likely deliver superior long-term risk-adjusted returns compared with peers ignoring this structural trend.

"First mover" advantage on new revenue sources – Creating lower emissions can produce attractive sources of financial return for real estate companies, often augmented by government subsidies. The best example is installing solar panels on roofs, which generally need repairing every 15 to 20 years. Doing so turns what was once a liability into an asset with an income stream from electricity generation. We believe employing emission reduction strategies can translate to returns above the cost of capital. Companies have demonstrated unlevered internal rates of return exceeding 10%, which in our view is a healthy balance of risk and reward.[4]

Preferred partner of public investment – Even without a regulatory push toward lower emissions, making assets more energy efficient can pay off for real estate companies and even for tenants, many of whom must meet their own corporate emissions reduction or net-zero targets. Operating from real estate with the lowest carbon footprint is a key method for their reaching these goals.

Investing in real estate companies that are leaders in their industry in terms of reducing overall carbon footprints is compelling from both an environmental and an economic standpoint. Meanwhile, investors can potentially benefit from the lower valuations, good earnings, robust dividend growth and healthy fundamentals offered by REITs.

CONCLUSION

Investing in real estate companies that are leaders in their industry in terms of reducing overall carbon footprints is compelling from both an environmental and an economic standpoint. To illustrate, decarbonizing is a major factor in minimizing global warming, while creating lower emissions, such as by installing solar panels, can produce attractive sources of financial return for real estate companies. For investors, we believe the lower valuations, good earnings, robust dividend growth and healthy fundamentals offered by REITs can make it a solid addition to a long-term, diversified portfolio.

For more information, please visit us at nuveen.com.

Endnotes

1 Data source: commercialrealestateloans.com

2 Data source: Ahyan Panjwani, Lionel Melin, Benoit Mercereau, "Do Scope 3 Carbon Emissions Impact Firms' Cost of Debt?" 17 Oct 2022

As defined by www.nationalgrid.com, Scope 3 encompasses emissions that are not produced by a company itself, nor by activities from assets it owns or controls. Instead, the emissions are produced by activities the company is indirectly responsible for, up and down its value chain.

3 Data source: Nuveen via the Government of Canada, Update to the Pan-Canadian Approach to Carbon Pollution Pricing 2023-2030.

4 Catena AB 2022 earnings call (22 FEB 2023) and Nuveen.

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