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REAL ESTATE

Outlook for real estate

FIVE THEMES FOR 2021

1. Awash with cash
2. Rethinking urban centres and suburban life
3. Fast forward to the future
4. Identifying the winners and losers
5. Climate change

No one can deny how challenging 2020 has been. As coronavirus spread around the globe, life for many was put on hold. Unprecedented government-imposed measures curtailed social and economic activity to protect people's health and save lives.

Looking to 2021, the pandemic continues, but people continue to adapt, adjusting to the new normal as treatments for the disease improve and vaccine hopes are high.

While governments have restricted activities, they have also pumped cash into economies. This is one of our five themes for 2021 — global monetary conditions should buoy capital markets and asset values, supporting real estate investment.

Our second theme is the changing nature of cities. People are rethinking urban centres and suburban living during and after the pandemic.

Some of the fundamental changes that were already underway in the real estate market, driven by technology and demographics, are accelerating as a result of the virus. The reliance on e-commerce and flexible working practices are good examples. This fast forwarding to the future is our third theme.

Distinct winners and losers will emerge, with resilient assets in demand while others become obsolete. We look at the sectors and subsectors where those assets are likely to be in our fourth theme.

Our final theme is climate change — a key risk for all investors. We expect renewed focus on this in 2021, as the year begins with the new U.S. administration in January and culminates in the United Nations Climate Change Conference (COP26) in November.

The portfolio of the future

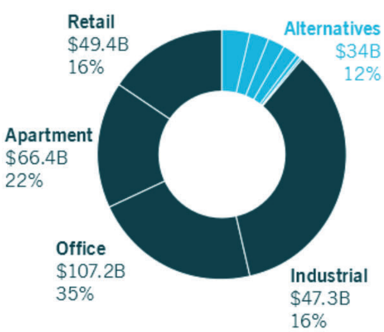
These five themes will shape the investment landscape over the coming years resulting in significant changes in the composition of real estate portfolios.

Portfolio exposure to traditional office and retail will shrink, making space for alternative sectors. Healthcare will grow as investors find opportunities in life science facilities, medical offices and senior housing increases. The focus on apartments in the residential sector will shift to alternatives such as self-storage, manufactured housing and single-family rental units. The growth of viable assets such as data centres and mobile towers will expand and establish the technology sector.

As these opportunities evolve over the coming decade, we anticipate the target for alternatives, within a typical real estate portfolio, growing from around 12% to more than 50%.

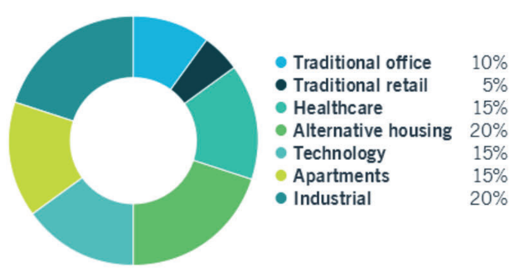
Figure 1: The future of real estate portfolios

Current real estate exposure*



Current exposure to Alternatives in real estate portfolios is ~12%

Representative real estate portfolio in 2030



In a decade, Alternatives will make up more than 50% of a real estate portfolio

Source: NCREIF, Q1 2020
*NFI-ODCE MV ($B) by property type. (Note: Alternative sectors market value NPI Plus)

1

Awash with cash

Central bank policies and capital flows will support real estate market conditions in 2021.

The coordinated quantitative easing action in 2020 dwarfed all previous QE, as figure 2 shows. This time, authorities have been much quicker to respond, creating a low-rate, easy-money environment, which is set to increase liquidity and capital flows into commercial real estate.

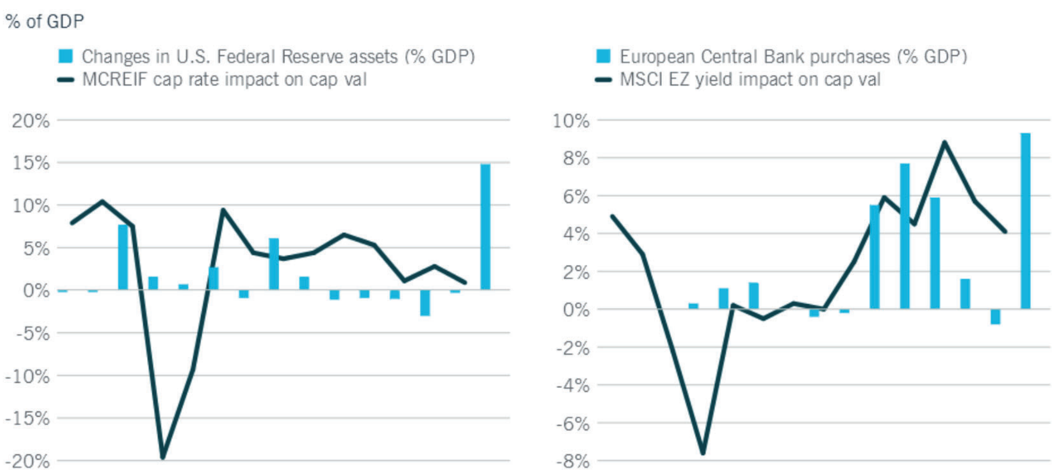
Fund raising activity, having stalled earlier in the pandemic, is picking up, as are transactions in some regions and sectors.

The potential for yield should also attract investors given how the asset class behaved during previous bouts of QE. Real estate yields ticked up significantly in the U.S. and UK following the cash injections of the global financial crisis and also in the eurozone with the European Central Bank's purchases in 2015, 2016 and 2017.

With such buoyant market conditions, we expect to see sector rotation in the U.S., Europe and Asia. Capital will likely target the logistics, alternatives and residential sectors. Retail will continue to struggle and has further to fall.

Commercial real estate debt (CRE) will benefit from capital market conditions. The relatively high current income return combined with the potential downside protection aspect of CRE debt is becoming increasingly sought after when rates are likely to remain low.

Figure 2: Monetary authorities' swift and large response creates supportive conditions for real estate



Source: CEIC, 2020

2

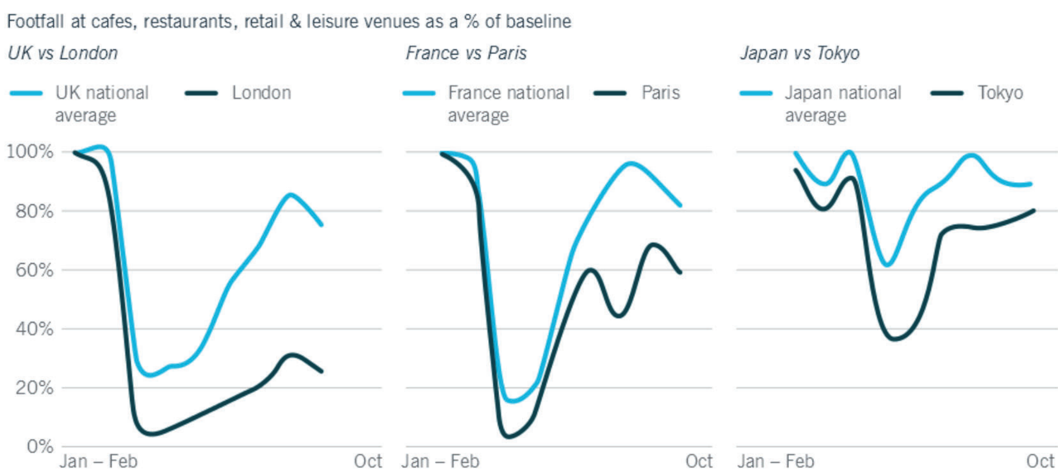
Rethinking urban centres and suburban life

Prompted by the pandemic, people are reassessing their living situations. Migration data from the U.S. shows many are seeking to escape from densely populated cities in pursuit of more space. This will favour suburbia and the sunbelt cities in the U.S. and it will fuel demand for alternative housing, such as single-family units and manufactured housing, rather than the traditional multi-family apartment blocks.

This shift in thinking will play out to a lesser degree in Europe and Asia Pacific. The outcomes will be more varied, driven by regional and national differences, such as language, culture, planning and transport, that support an urban way of life. Already the data is indicating a stronger resurgence in second-tier cities and towns, where footfall at restaurants, retailers and other leisure venues has had a stronger bounce back in locations outside capital cities figure 3.

The megatrends of demographics, technology and sustainability, which shape our tomorrow's world view of cities, will continue to drive demand for real estate globally, and we expect to see softer factors such as wellbeing, culture and leisure, play a greater role than previously. Identifying resilient cities that can adapt and thrive to these structural changes remains at the heart of our global cities approach.

Figure 3: Smaller towns and suburban locations see a stronger recovery in retail and hospitality



Source: Nuveen, Oxford Economics 2020

3

Fast forward to the future

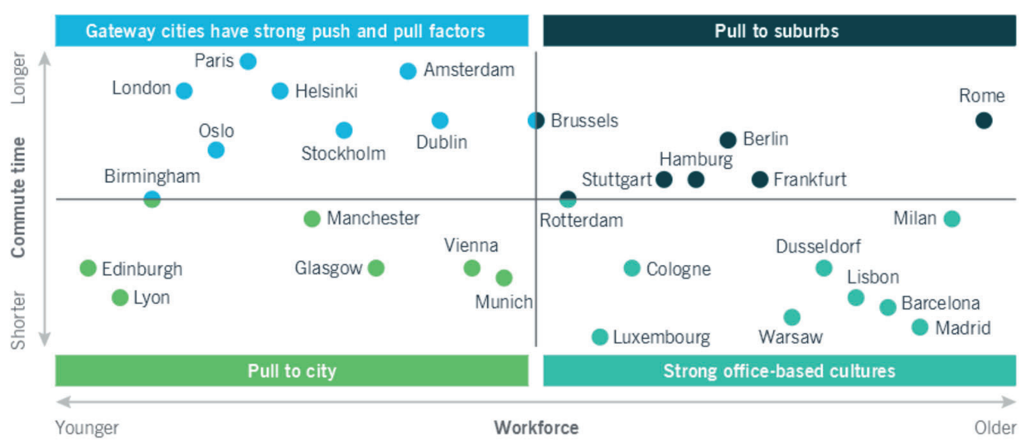
As people reassess where and how they live, they are also looking at how they work and how they shop. This is accelerating some of the fundamental changes that were already underway in the real estate market prior to the pandemic.

Over the last few years our research has explored the influence of technology and demographics on real estate. The rise of e-commerce has transformed shopping habits and the pandemic has increased its adoption across all age groups and in previously underpenetrated sectors such as grocery and health care. Logistics will continue to benefit from this, while further consolidation among retailers is expected.

Technology has also facilitated working from home during lockdowns, raising questions about the future of the office. We think the return to the office in many cities and towns will be a function of local demographics and infrastructure. In Europe, cities which have shorter commute times and younger working populations are likely to return to the office sooner, which favours lifestyle cities and second-tier cities. Large coastal U.S. cities are most at risk from home working, especially as people migrate to the sunbelt. Asian cities where space is always at a premium and people are used to high-rise living and working will likely be more defensive.

The momentum behind responsible investing and impact strategies will also accelerate. Given how real estate shapes home and working lives, and how the pandemic has sharpened the sense of community for many, we expect these strategies to grow in importance for real estate investors.

Figure 4: Influences on future home working



Source: Eurofound survey of commute times, PMA estimates for non-capital cities, Oxford Economics, Nuveen Real Estate.

4

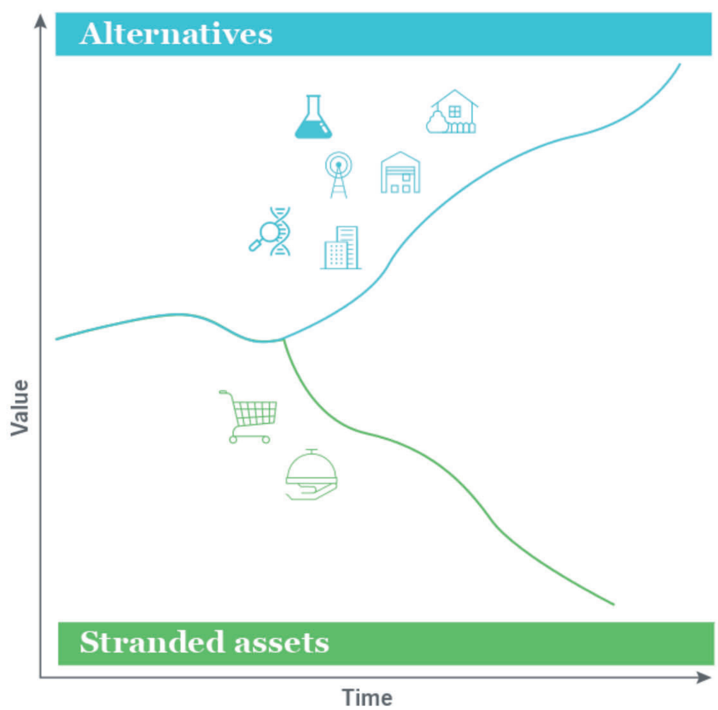
Winners and losers

As in any crisis situation and subsequent recovery, some assets will thrive while others become obsolete. Investors will reassess the lifecycle of assets in light of the new risks presented by the pandemic as well as from the longer-term structural shifts in demographics, technology and sustainability.

We see a K-shaped recovery in real estate. Values and rents for certain property types – notably within hospitality and retail – will likely plummet but rise for others, with few assets in the middle ground. Alternatives like life sciences, medical offices, self-storage, single-family housing, data centres and mobile towers, are likely to be sources of this outperformance. The fundamental drivers for these assets are less tied to the economic factors that are currently so uncertain. Disruptive technologies, such as driverless cars and innovations in food production and delivery, also present opportunities.

The wide range of opportunity and outcomes for real estate reinforces the need for diversification across property types which should spur the increased allocation to alternative property types.

Figure 5: A K-shaped recovery ahead



Source: Nuveen Real Estate

5

Climate change

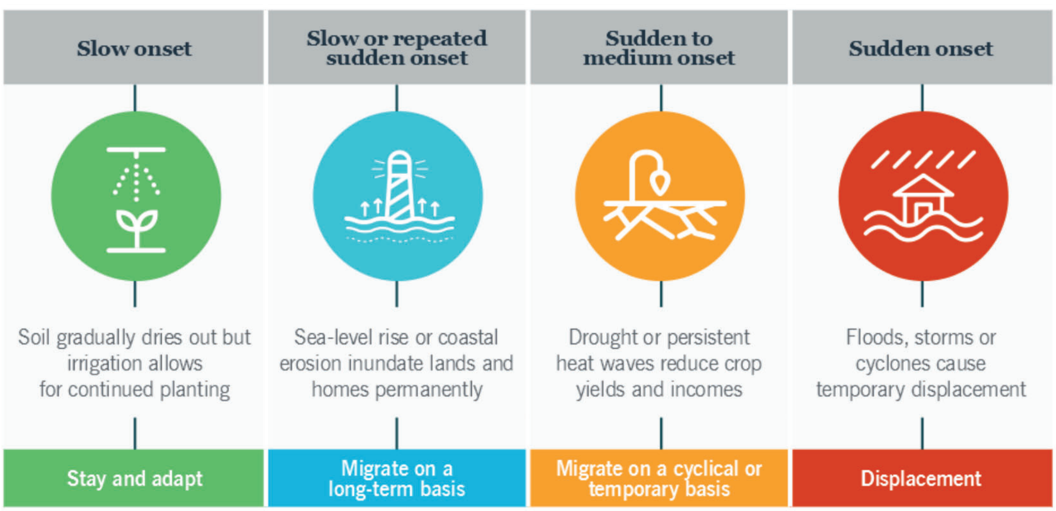
Climate change has significant implications for real estate assets and locations over the short, medium and long term.

In 2021, international efforts for mitigation and regulation are likely to find a new a new footing, but the strength of commitment varies among countries and regions. In Europe, regulations are stringent and plans ambitious with many countries committed to net zero carbon by 2050 or sooner, and some companies and investors committing to it by as soon as 2030 and 2035. In Asia Pacific, Japan and South Korea are aiming to be net zero carbon by 2050 and China by 2060. In the U.S., there has been a slew of recent state and city regulations and the incoming administration is expected to prioritise the issue more than the previous.

Legislation will not hold back all the physical effects of climate change. Extreme events (such as flood and wildfire) or slow-onset processes (e.g. heat, droughts, rising sea levels) will affect home prices, insurance, and mortgage pricing and availability. These factors will influence decisions about whether to stay or migrate, presenting investors with a range of scenarios and risks to consider.

Real estate needs to respond to the demands of investors by ensuring assets are managed responsibly and sustainably, and in keeping with the investors' values. We expect real estate assets will play a growing role in ESG and impact portfolios. Furthermore, we believe responsible investing will no longer be considered an additional, complementary strategy but integrated within traditional investment analysis and management.

Figure 6: The speed of climate change effects and its influence on migration



Source: Nuveen Real Estate, adapted from ODI and UNDP material.

For more information, please visit nuveen.com

Endnotes

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