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REAL ESTATE

# Core real estate investing in 'tomorrow's world cities'



## CONTRIBUTOR

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Managing Director, Global Chief Operating Officer and Head of Portfolio Management, Americas

Rahul Idnani is responsible for leading global strategy and corporate development for Nuveen Real Estate (Nuveen is the investment management arm of TIAA). In the Americas, Idnani manages a \$90 billion real estate portfolio across all property types and risk styles for global institutional and retail clients. As a member of the Global Executive Leadership Team, he leads corporate strategy, joint venture and M&A efforts, partnering with teams across sectors and regions to design and execute on strategic initiatives. He is also a voting member of the investment and operating committees in the Americas.

Recently, **Jonathan A. Schein**, senior vice president and managing director of global business development for Institutional Real Estate, Inc., spoke with **Rahul Idnani**, managing director, global chief operating officer and head of portfolio management, Americas. Following is an excerpt of that conversation.

*You manage a \$90 billion real estate portfolio across all property types and risk — how do you do that?*

I have a talented team of 10 portfolio managers with deep acquisitions and asset management experience, six of whom are sector specialists and four of whom are diversified portfolio managers. Day to day, the portfolio managers are focused on a variety of activities, such as discussing investment performance with their clients, evaluating new deals in the pipeline, or making capital expenditure decisions with our asset management team. As for me, my responsibility is to ensure our portfolios meet or exceed their respective benchmarks, as well as achieve client expectations.

*Your focus is core funds, correct?*

Yes, the majority of our platform's focus and foundation is core, open-end funds. Then, alongside these core, open-end funds, here in the United States we launch a 'best idea,' closed-end, value-add fund every 12 to 18 months, which is typically a thematic investment strategy complemented by a niche, sharp-shooter execution approach.

*Tell us about the core funds, or what you are now calling the Global Resilient Series.*

Our Global Resilient Series is designed to provide a comprehensive, cohesive and customizable core real estate solution

for investors focused on diversification, income and long-term capital growth. The Series leverages our unique combination of global reach and local execution capabilities and comprises a suite of six open-ended products — two diversified pan-regional funds investing in Europe and Asia Pacific, and four sector-specific strategies in the United States. These funds focus on investing in high-quality assets in leading cities that are well positioned to benefit from long-term structural mega trends, including shifting demographics, urbanization and technology.

*For your purposes, how do you define 'resilience'?*

We define resilience as the capacity to cope and remain defensive during an economic downturn or volatility but also adapt and thrive through an expansionary cycle. In determining whether a city exhibits resilience, we consider several factors, such as hard factors (income per capita, youthfulness), soft factors (innovation index, quality of life) and growth factors (economic growth, population growth). Sustainability is another critical lens in evaluating resilience. For example, what is the quality of air in a given city, or is local government supportive of sustainability initiatives?

*Why do you think the customization offered by your four sector-specific funds makes sense now?*

If you look at the NFI-ODCE [NCREIF Fund Index – Open End Diversified Core Equity], which is how most institutional investors access core real estate today, the index is composed of 24 ODCE funds that have historically been overweight to the office and retail sector and underweight to industrial and multifamily. We believe it may be possible to achieve a better investment outcome via our four sector-specific funds rather than through ODCE funds. The reason we think customization makes sense is to enable flexibility to take advantage of varying sector performance. For instance, one-year core industrial performed over 13 percent, but institutional investors invested in an ODCE fund were underweight the highest performing sector and relatively overweight retail, which in the last year returned 0 percent. But if you are able to customize and able to migrate from office and retail, for example, to multifamily and industrial, not only may investments outperform the ODCE benchmark, but we think you will be more nimble and better able to potentially take advantage of headwinds and tailwinds in each property type over time.

*Upfront, you mentioned you intend to launch a closed-end, value-add fund every 12 to 18 months. Can you give us an example of one?*

Sure. About 18 months ago, we launched the Strategic Industrial Fund, a value-add industrial fund, which is a build-to-core and repositioning play. The strategy of that fund is to take

advantage of the robust core industrial performance we are seeing in the market, given e-commerce tailwinds and constrained supply in certain markets. We launched the fund with \$330 million of equity, and it is already delivering property performance two to three times in excess of core industrial. Simply put, if core is returning a low double-digit return, then value-add or development in industrial should return significantly higher. Our “best idea” today is a New York City strategy focused on taking advantage of the secular shift in space use and tenant demand by acquiring, developing or redeveloping assets across established and emerging neighborhoods. New York City office space has typically been dominated by FIRE [Finance, Insurance and Real Estate] tenants, but there is a huge opportunity in redeveloping legacy, obsolete office stock for both FIRE and TAMI [Technology, Advertising, Media and Information] tenants that want amenity-rich environments and modern formats. If you can execute on this strategy, we believe the redeveloped or developed office stock should see rent premiums and high-quality tenant interest.

*Your investment universe is limited to certain cities. How did you select those cities?*

Our six core, open-end funds target an investment universe of just over 90 cities that we refer to as ‘tomorrow’s world cities.’ Our global research team analyzed more than 4,000 cities around the world and identified the top 2 percent of cities that we believe are best positioned in light of global mega trends. This proprietary research process involves a four-stage filtering and scoring system. We begin with *scale* as our first filter to identify cities with a metropolitan area population of at least 150,000 as a proxy for density, which is roughly over 4,000 cities. Then we look at *transparency* as our second filter to identify cities with liquidity, transparency of data, property rights, good transaction processes — and that brings the investible universe from 4,000 to 900 cities. Our third filter, *stability*, identifies cities in countries with adequate political and economic stability, which takes us to 200 investible cities. Finally, we look at a mega-trend filter, which is the *resilience* element we discussed earlier — cities that score well on soft factors like quality of life and technology scores, and hard factors such as urbanization and youth population and growth — both in terms of discretionary spending and population growth. This top-down process is how we got from 4,000 to just over 90 cities that we believe are best placed to benefit from long-term growth in demand for real estate.

*Generally speaking, those cities are coastal cities, but can you make cases for some other secondary or tertiary cities?*

Of the 90 global cities, several are coastal cities, such as New York, Lisbon or Perth, but there are many cities on our list that would be considered as non-gateway, secondary cities that exhibit resilience. For example, among the 35 ‘tomorrow’s world cities’ in the United States, we have identified non-coastal cities such as Denver, Minneapolis and Nashville that score exceptionally well on our mega-trend filter. Although, from time to time, we may see investment stock in cities that are not part of the 35 target cities, where there is some kind of pricing arbitrage to achieve attractive risk-adjusted returns, the funds will have the discretion to migrate outside of those 35 cities, but it will have

to be something very compelling. For example, there’s our U.S. Cities Retail Fund, which has a target universe of 36 cities, because one of our seed investments is in Naples, Fla., an excellent retail node serving the surrounding residential and golf communities of South Naples. So we do have discretion to migrate outside those 35 U.S. cities, but it is on a case-by-case basis.

*When you do make that compelling case, do investors see a mission creep? Or is it well within the bounds of your mission, and the investors are fine with that?*

Imagine if we applied our filtering process 60 or 70 years ago in the United States. Without a doubt, cities like Detroit and Cleveland would have been perceived as resilient economies and potentially fertile ground for real estate investing. Our research team reviews the ‘tomorrow’s world cities’ list annually and underwrites cities to see if they should remain on the list or if there are any additions. Ultimately, when we speak with our investors, we emphasize that our primary objective for the four U.S. sector-specific funds is to outperform their respective property-sector benchmarks. If we do just that, then we are executing well toward our mission.

*What are the benefits of offering these funds in a series?*

The suite of products is designed to provide clients instant access to a high-quality global portfolio diversified by geography, sector and scale, with the ability to leverage our asset-management capabilities and local market expertise. It is an offering of six funds under one umbrella with synchronized terms — and that’s important. It provides investors with the ultimate flexibility to suit portfolio allocation needs and is a unique proposition in the marketplace, so the series also represents a shift away from the smaller, specialist products and is designed to meet investor needs across the board for capital growth, income and diversification. Finally, I think the series is also designed to facilitate efficient global allocations to core real estate, so terms and governance, price, and liquidity are consistent across the series. Investors can combine products to seamlessly adjust for bespoke portfolio exposure based on the existing underweight/overweight positions and sector/location preferences. If you look at a client who has a core real estate portfolio that is significantly overweight in core office, that investor may ask, ‘Can you help me increase multifamily and industrial exposure only?’ You don’t have to invest in all six funds. We can provide access to specific sectors to help institutional investors balance their portfolios.

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