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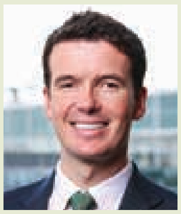
REAL ESTATE

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

CONTRIBUTOR



Austin Mitchell
Managing Director
Global Head of Strategy, Product and Solutions

Austin Mitchell is responsible for leading the corporate strategy and development of all new funds, joint ventures and client solutions for Nuveen Real Estate (Nuveen is the investment management arm of TIAA). He is a member of the global leadership team and the chair of the product design group, which evaluates all new real estate client solutions and products. Additionally, he chairs the Strategic Advisory Council, which brings together the firm's regional CIOs, and global research, innovation and sustainability functions to identify and execute new strategic initiatives.

As one of the largest real estate investment managers in the world, how are you responding to investors' needs for varying outcomes?

We work closely with our clients to develop longstanding strategic relationships, to understand their goals and meet their requirements.

We combine long-term structural trends and top-down forecasts of global markets and economies, with local market forecasts and thematic recommendations. Our aim is to deliver unique investment solutions today, by focusing on the structural trends that will shape real estate tomorrow. With that in mind, we have developed a range of real estate solutions to offer clients a spectrum of outcomes focused on potential growth, diversification, income and downside protection. These solutions are our resilient, enhanced and debt series.

Your focus is on core strategies, correct?

Yes, the majority of our platform's focus and foundation is core, open-end. Then, alongside these core, open-end strategies, in each region we launch a 'best idea,' closed-end, value-add strategy 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 strategies.

The strategies are designed to provide a comprehensive, cohesive and customisable core real estate solution for investors focused on diversification, income and long-term capital growth. Leveraging our unique combination of global reach and local execution capabilities, we offer six open-ended strategies — two diversified pan-regional strategies investing in Europe and Asia Pacific, and four sector-specific strategies in the United States. They 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, urbanisation 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 customisation offered by your four sector-specific strategies 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 customisation 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 customise 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 strategy 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 buildto-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. One of our 'best ideas' 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 neighbourhoods. 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 strategies target an investment universe of just over 90 cities that we refer to as 'tomorrow's world cities.' Our global research team analysed 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 urbanisation 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 global gateway cities, but can you make cases for some other secondary or tertiary cities?

Of the 90 global cities, several are global gateway cities, such as New York, Paris or Sydney, but there are many cities on our list that would be considered as non-gateway, secondary cities that exhibit resilience. For example, among the 42 'tomorrow's world cities' in Europe, we have identified non-gateway cities such as Bologna, Rotterdam and Cologne that score exceptionally well on our mega-trend filter. Global gateway cities should of course form a component of a resilient city-based strategy, but one should be wary of how diversified their portfolio might appear versus the reality. Many of these cities are closely correlated and, while investing across different sectors and submarkets will help lower volatility of performance, bringing different city personalities and skill sets into the mix might enhance outcomes further.

Our research shows that regionally and domestically driven cities tend to be better diversifiers and should be included alongside global gateway cities in a portfolio. Balancing investments in financial- and business-services-driven cities with energy or education-based markets, for example, ought to have good results in lowering volatility. Or adding structurally driven markets to highly cyclical cities should have similar benefits. This is the approach that we are taking in our resilient series.

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 strategies under one umbrella with synchronised 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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