

nuveen **When tactical real estate investing becomes strategic**

REAL ESTATE

Nuveen Real Estate argues that ignoring structural trends could undermine a cyclical value-add real estate strategy. The firm outlines a different approach, highlighting some of the opportunities in the logistics, office, retail and living sectors.

Value-add strategies are considered a cyclical play. They seek discounted assets in a downturn in the hope of making a profit when the cycle swings up. But will this strategy pay off in our rapidly changing world?

The megatrends shaping tomorrow's world

Many of the trends that are shaping our world did not exist in previous real estate cycles — the ubiquity of technology, the quest for sustainability and the changing demands of different generations.

Understanding these structural megatrends will not only help to identify the turning points of the cycle but, more importantly, help to identify the locations and real estate assets that will be best positioned when the upturn comes.

The pace of technological and social change over the past decade means the demand drivers for real estate have evolved significantly. At the peak of the last cycle, tablets, ride-hailing, peer-to-peer business platforms and fast 4G

mobile data were not available. We've also seen supply-chain technology, artificial intelligence and the advancements in industrial robotics reshape business models, while demands for sustainability have grown exponentially.

Expectations about the physical environment are not confined to environmentally sound practices about energy and resource efficiency. People, young and old, are looking for living and working spaces that provide a sense of community and satisfy health and well-being considerations.

These profound structural trends have dramatically altered consumer and corporate behaviour around the world and, as a result, real estate needs.

At Nuveen Real Estate, we believe a successful value-add strategy needs more than timing the cycle and finding mis-priced opportunities. It needs to select assets that can be optimised or are well positioned for the global megatrends shaping tomorrow's world (illustrated in Figure 1).

Logistics — More than just big boxes

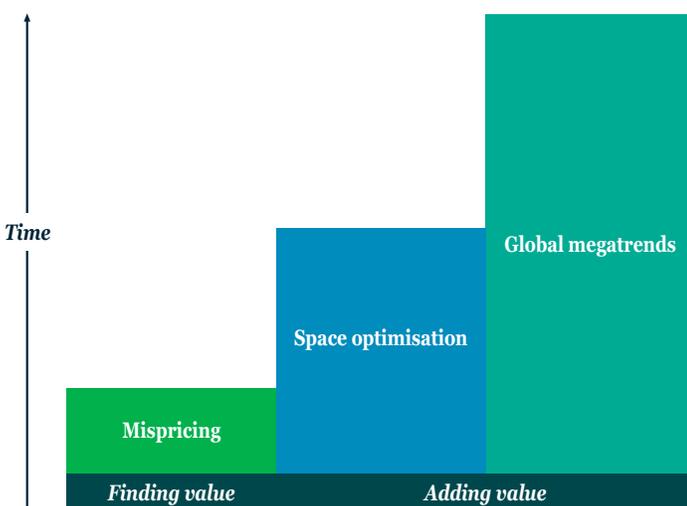
The logistics sector's rapid rise is a prime example of how megatrends can profoundly reshape a sector in just a few years.

Until 2014, logistics was merely a subcategory of the generally unloved industrial sector. Six years later, well in the time frame of a value-add fund, logistics is the most sought-after real estate sector. Former illiquid asset types, such as cross-docks, chilled space, compromised urban buildings and multi-storey constructions, are now at the forefront of investor and occupier demand.

The unfolding e-commerce revolution, new manufacturing technology and the overarching theme of digitalisation are transforming how logistics operate. We believe these trends will continue to shape the sector in a way most investors continue to underestimate.

The same can be said of sustainability, an area in which the extremely cost-conscious logistics industry has generally lagged behind other sectors. But this is likely to change quickly, given the growing public, political and regulatory pressure on retailers, manufacturers and transport

Figure 1. A fresh approach to value-add investing
Short-term strategy with a longer-term filter



Source: Nuveen Real Estate.

companies. Acting ahead of the curve, the value-creating potential is significant, starting with income-enhancing measures, such as solar panels and energy-saving technology, all the way to anticipating the electrification of deliveries by providing fast lorry-charging points.

Offices — Becoming agile and social

Technology and demographics are changing work habitats and worker preferences. Compared with previous cycles, more organisations and companies now operate on short-term planning horizons, relying on the ability to adjust staff as demand fluctuates.

Along with leaner and flatter structures, businesses are focusing on talent and workforce productivity. This means satisfying social drivers, including employee expectations about health and well-being, community, sustainability and flexible working.

Value-add opportunities in the office market should look to replace obsolete office space. Creating the right product to satisfy the proliferation of flexible space operators, at least until traditional landlords acquire the skills to compete, is one strategy to ensure assets are in demand after the cycle turns.

Retail — Disruption favours the brave

New technologies are influencing consumer culture from the decision-making process to accessing the product. This structural, rather than cyclical, shift is driving repricing in retail. The bounce back in price is, therefore, not guaranteed, nor will it be uniform.

In our view, value-add strategies for consumer-led real estate should focus on three areas. One is accessible spaces that are convenient, food-led spaces focused on efficiency. Experience spaces is the second group in which the purchase of goods is no longer the sole reason for the visit. These spaces blur the lines between retail, leisure, restaurants and gaming. The final group is lifestyle spaces that connect and

integrate the spaces where people want to live, shop, work and play, traditionally known as mixed use.

Living — Generation Rent needs a new home

The plight of forced renters is well documented, but it should be remembered that renting is a tenure favoured by many who do not want the commitment that comes with ownership. Many of Europe's major cities have a much more international and transient population than 20 years ago, with a material decline in home ownership, especially among people under 30.

This age cohort, labelled "generation rent", is displaying a preference for flexibility, location and quality modern offerings that are close to work or to attractive amenities. Many prefer to spend on a lifestyle rather than save for a down payment on an increasingly expensive property.

Urban residential and student accommodation, in which consumers are willing to sacrifice personal space for location, affordability and access to amenities, offer opportunities for value-add investors. This is most evident in residential, with the growing interest in co-living, a concept centered around community, collaboration, communal and connected living.

Why a short-term strategy needs a long-term philosophy

These examples highlight the range of opportunities available to value-add real estate investors. In today's fast-changing world, successful value-add strategies will need to do more than seek cyclically mispriced and short-term optimisation opportunities.

A longer-term philosophy is required to adapt real estate assets for the evolving requirements of sustainability, technology and demographics. Reconfiguring or repositioning assets for these structural megatrends will create assets that will be in demand not only in the upswing, but also in any market environment, as investors increasingly discriminate for resilience.

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