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Real Estate



The Decisive Eye

A strategic bulletin on issues and opportunities
in European real assets

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A photograph of a server room with rows of black server racks. The racks are filled with equipment, and many small lights are visible, creating a blue-toned, high-tech atmosphere.

Non-traditional property types
are no longer niche. Are they the
future of commercial real estate?



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D.I.G.I.T.A.L.


 Demographics

 Innovation

 Globalisation


 Infrastructure

 Technology

 Active over the Long-term

Long-term market outperformance



In this edition, we will examine the following issues: 

- ▶ Europe stands on the cusp of significant changes to its private real estate investment universe.
- ▶ We expect the expansion of non-traditional or niche property types to be one of the defining features of European real estate in the next decade.

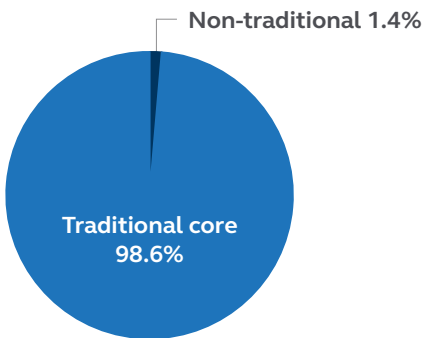
Introduction

Europe stands on the cusp of significant changes to its private real estate investment universe. DIGITAL and structural trends, catalyzed by the COVID-19 pandemic, are expanding and enhancing the real estate investment universe. Notably, we expect the expansion of non-traditional or niche property types to be one of the defining features of European real estate in the next decade and beyond. The DIGITAL trends that have so profoundly impacted the U.S. and listed real estate markets are starting to exert their influence on Europe and it is our expectation that non-traditional property types could constitute as much as 10% of the unlisted real estate universe in Europe by 2025.

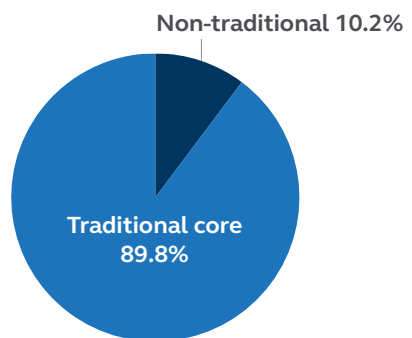
Listed markets have led the way in non-traditional property types. In the U.S., the listed real estate market has embraced non-traditional property types which now constitute 65% of the entire index. While the scale of adoption in European listed markets is smaller, we expect it to show material expansion in years ahead as investors embrace the secular themes underpinning their growth. In the last 10 years alone, the listed real estate market in Europe for non-traditional property types has gone from an insignificant amount (under 1%) to more than 10% of market capitalisation.

EXHIBIT 1: REITs spearhead growth of non-traditional property types in Europe

REIT index composition 2011



REIT index composition 2021



Source: MSCI, Principal Real Estate, September 2021. REIT index represents the FTSE EPRA Nareit Developed Europe Index.

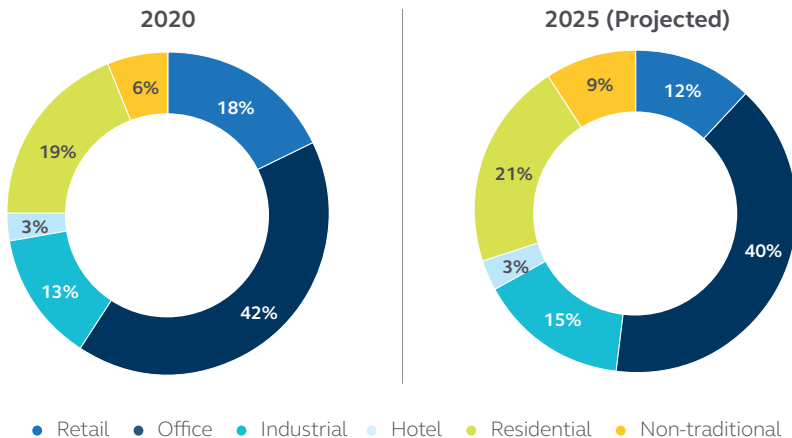
Non-traditional sectors: Self-storage, student housing, healthcare, homebuilder, hotels, realty services, and single-family rental.



Non-traditional property types will be an integral part of real estate

Although well behind both the REIT market and the U.S. in terms of scale and adoption, we are seeing clear signs of institutional investor appetite for non-traditional property types in Europe. Property types such as data centres, cold storage, medical offices, and senior housing have gained significant traction in the past 24 months, helping broaden the size of the investment universe. In fact, we anticipate that by 2025, non-traditional property types could comprise nearly 9% of the MSCI index, a substantial increase from the current levels.

EXHIBIT 2: Forecasted increase in non-traditional property types in the MSCI Index







Source: MSCI, Principal Real Estate, September 2021

Non-traditional property types capture DIGITAL drivers of growth

The structural and DIGITAL drivers which we have identified for real estate demand have been given a powerful catalyst by the pandemic. While it is too early to tell if some of the changes in human behavior are structural or cyclical, we feel confident that demand for non-traditional property types will stick. In our view, non-traditional property types reflect a structural shift within the economy wherein DIGITAL drivers have become the dominant drivers of growth and demand.

Our key DIGITAL drivers of demand—demographics, infrastructure, globalisation, innovation, and technology—have a clear impact on the growth of non-traditional (and traditional) property types given their sheer scale. But diving a little deeper, there are specific sub-themes within our broader DIGITAL framework that tie directly to the rise of non-traditional property types and their increasing importance, which we spotlight in Exhibit 3.

EXHIBIT 3: DIGITAL drivers of demand

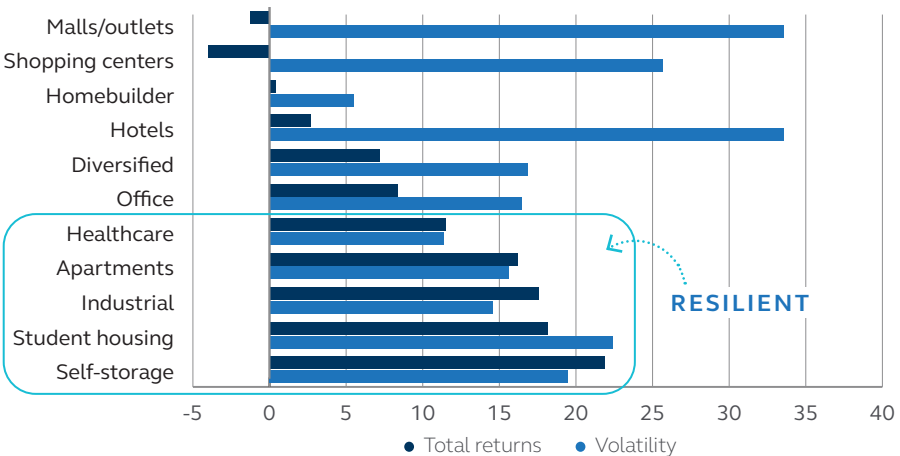
 Demographics	 Innovation & tech	 Globalisation	 Infrastructure
<ul style="list-style-type: none"> • Ageing population • Shifting migration patterns • Housing affordability • Inequality and cost of living 	<ul style="list-style-type: none"> • AI/Big data and a circular economy • Flexible working/ Working from home • Innovation “hubs” • Retail disruption • ESG prioritisation 	<ul style="list-style-type: none"> • Secular increase in trade & capital flows • Global technology supply chains • Mobile human capital and remote workforces • Satellite towers 	<ul style="list-style-type: none"> • Communication • Physical assets • Transportation • Energy and utilities • Social infrastructure • Seaports • Tunnels
<p>↓</p> <ul style="list-style-type: none"> Suburban housing Single-family rentals Manufactured housing Self-storage Senior living/care homes Grocers, discounters, DIYs 	<p>↓</p> <ul style="list-style-type: none"> Life sciences Lab space/MOB Data centres Cold storage Self-storage New format retailers 	<p>↓</p> <ul style="list-style-type: none"> Data centres Warehouse/ Logistics Last mile facilities 	<p>↓</p> <ul style="list-style-type: none"> Data centres Warehouse Affordable housing Care homes, medical office ESG focus



Data from REITs demonstrates benefits to a real estate portfolio

While non-traditional property types are still relatively young in the private markets, listed European stocks have a deeper history that can help identify the potential benefits to a portfolio of traditional real estate. Starting with performance, listed REIT data reveals that the strongest absolute returns over the past 10 years have been delivered by non-traditional property types (Exhibit 4). Self-storage and student housing are the strongest performing property types but are also compelling from a risk-adjusted basis.

EXHIBIT 4: Historical performance and volatility of select listed sectors
Average annualised performance past 10 years, percent



Source: MSCI, Principal Real Estate, September 2021

For investors, enhanced risk-adjusted performance should also lead to portfolio benefits, and indeed, correlation analysis from the listed market further demonstrates the diversification benefit of adding non-traditional property types. (Exhibit 5). Perhaps also helping is that many non-traditional REITs are operating entities with a build-to-core element that add diversification to pure-play REITs.

EXHIBIT 5: Non-traditional property types are portfolio diversifiers
8/31/2001 - 8/31/2021

10 year correlations	Traditional property types							Non-traditional property types			
	Apartments	Office	Industrial	Diversified	Hotels	Shopping centers	Mall/outlets	Self-storage	Healthcare	Student housing	Homebuilders
Apartments	1.00	0.54	0.53	0.57	0.19	0.37	0.34	0.35	0.34	0.45	0.01
Office	0.54	1.00	0.79	1.00	0.53	0.79	0.65	0.67	0.60	0.80	0.11
Industrial	0.53	0.79	1.00	0.74	0.25	0.55	0.43	0.68	0.53	0.70	0.15
Diversified	0.57	0.93	0.74	1.00	0.65	0.84	0.75	0.63	0.54	0.79	0.10
Hotels	0.19	0.53	0.25	0.65	1.00	0.72	0.67	0.22	0.27	0.50	0.01
Shopping centers	0.37	0.79	0.55	0.84	0.72	1.00	0.84	0.51	0.39	0.73	0.04
Mall/outlets	0.34	0.65	0.43	0.75	0.67	0.84	1.00	0.37	0.25	0.60	0.02
Self-storage	0.35	0.67	0.68	0.63	0.22	0.51	0.37	1.00	0.46	0.64	0.19
Healthcare	0.34	0.60	0.53	0.54	0.27	0.39	0.25	0.46	1.00	0.50	0.10
Student housing	0.45	0.80	0.70	0.79	0.50	0.73	0.60	0.64	0.50	1.00	0.03
Homebuilders	0.01	0.11	0.15	0.10	0.01	0.04	0.02	0.19	0.10	0.03	1.00

Source: NAREIT, Principal Real Estate, September 2021.



Europe's investors will stand to benefit as non-traditional properties expand the investment universe

The future of Europe's commercial property universe is set to expand materially as non-traditional sectors make their way into the mix. In our view, this is an undeniably promising development that deepens and enhances the investment universe and creates structural growth opportunities. The listed real estate market has already demonstrated the many benefits of non-traditional real estate for investors in the form of strong risk-adjusted performance driven in part by the structural DIGITAL changes the European economy is undergoing. It is our expectation that private real estate investors will make deep inroads into these growing property types enhancing and expanding the universe and allowing the potential to generate additional alpha.

About Principal Real Estate

Principal Real Estate is the dedicated real estate investment group within Principal Global Investors. Our real estate capabilities span the spectrum of public and private equity and debt investments. Our specialised market knowledge, dedicated and experienced teams around the globe, and extensive connections across all four real estate quadrants support our efforts to maximize opportunities and find the best relative value on behalf of our clients.

Top 10

global real estate manager¹

\$96 billion

in real estate assets under management²

More than

60 years

of real estate experience³

¹ Managers ranked by total worldwide assets (net of leverage), as of 30 June 2020. "Largest Real Estate Managers," Pensions & Investments, 5 October 2020.

² As of 30 June 2021.

³ Experience includes investment activities beginning in the real estate investment area of Principal Life Insurance Company and continuing through the firm to present.

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