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Five structural themes driving real estate investment demand

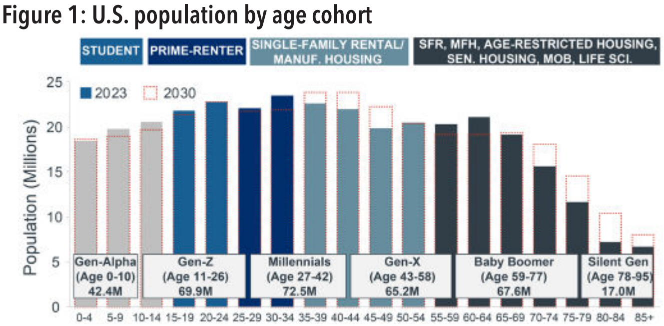
Commercial real estate demand and performance are driven by cyclical and structural factors. Cyclical factors, such as interest rates, consumer spending and employment, vary with economic cycles. Structural factors are long term, have a lasting impact on economic trends and offer real estate enduring opportunities for growth.

Clarion Partners has identified demographics, innovation, globalization, housing and resilience as five discernable structural themes that investors should consider in their approach toward building long-term real estate portfolios. These themes are powerful long-term catalysts for real estate demand and can offer investors a multitude of opportunities across different risk and return horizons.

Demographics is a fundamental driver for real estate

Demographics — population growth, age cohorts, migration patterns — are important to the development of communities and economies. Analyzing trends in population growth by age cohort allows real estate investors to identify markets and property types with strong tenant demand. The most influential U.S. generations, for present real estate investment purposes, are Generation Z, millennials, Gen X, and the aging baby boomers (Figure 1). By breaking the U.S. population into cohorts, we can create an investment opportunity set to identify generational live, play and work preferences.

Figure 1: U.S. population by age cohort



Sources: U.S. Census Bureau, Moody's Analytics, Clarion Partners Investment Research, April 2024

In the United States, the Sun Belt markets have experienced outsized population and employment growth due to several factors, including the cost of living, ability to work remotely and overall quality of life, which is expected to continue in the decade ahead. Forecasts estimate the U.S. population will grow by 79 million people, or 19 percent, from 2020 to 2060, reaching 404 million by the end of the period. This growth is driven by both natural increase and immigration.

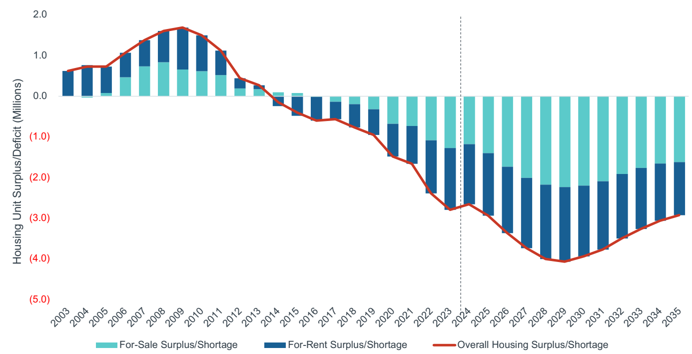
Housing shortage and affordability

The U.S. faces a structural housing shortage

Housing shortages have long been a discussion in the nation's largest cities, but shifting demographics and migration patterns have become more widespread. Several factors account for the U.S. housing deficiency: (1) population growth outpacing new supply, (2) regulatory barriers and zoning restrictions, (3) lack of public investment in infrastructure and housing, and (4) continued household formation.

By our estimate, the housing gap (comprising single-family and multifamily housing) is 3 million units in 2024 (Figure 2).[1] We expect this to worsen and peak at 4 million units by 2029 and that new demand will continue to outpace the volume of new deliveries. The housing shortage offers investors multiple opportunities to address the challenges the sector faces. A key driver of the housing gap is increasingly unaffordable single-family homeownership. In the past decade, the median U.S. home price has risen by 84 percent.

Figure 2: U.S. housing surplus/shortage (2024F–2035F)



Note: Historical housing shortfall/surplus calculates the difference between the current number of vacant units and the total number of vacant units that would exist under "normal" market conditions, which is based on the long-term housing vacancy rate. *Sources: U.S. Census Bureau, Moody's Analytics, Clarion Partners Investment Research, as of April 2024*

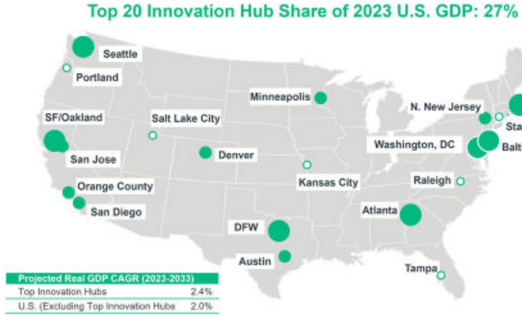
The innovation economy is the future of growth

Our third theme focuses on innovation and the substantial growth it has generated, as well as the enormous influence it will wield, going forward. This sector encompasses industries that heavily rely on research and development (R&D), creativity and intellectual capital, such as technology, biotechnology, pharmaceuticals, advanced manufacturing and renewable energy. Globally, the United States ranks No. 3 out of the Organization for Economic Co-operation and Development (OECD) countries for R&D spending as a share of national GDP.[2] During recent years, public and private investment in R&D has risen to record highs, reaching a combined $415 billion.

Artificial intelligence (AI), green technology and sustainability, digital health, cloud computing, precision agriculture, and cybersecurity are just a few high-growth segments that will continue to generate long-term demand for a variety of real estate sectors, such as life sciences, data centers and cold storage.

Innovation "clusters" have strengthened many regional economies. Many dominant and emerging hubs have disproportionately high employment, income, GDP per capita and home appreciation growth over the long term. We estimate there are about 20 such "innovation clusters," which accounted for 27 percent of U.S. GDP in 2023 and are set to remain a powerful economic force nationwide (Figure 3).[3]

Figure 3: Map of top 20 U.S. innovation clusters



Note: Innovation hubs are major markets, with the 20 highest high-tech employment location quotients. Bubble size corresponds with the market's 2023 gross metro product (GMP). All GMP data are chained to 2017 dollars. *Sources: U.S. Bureau of Labor Statistics, Bureau of Economic Analysis, Moody's Analytics, Clarion Partners Investment Research, Q4 2023*

Shifting globalization

Recently, globalization patterns have shifted due to evolving geopolitical dynamics. For the United States, it has meant growing trade levels with Mexico, Canada and Southeast Asia in recent years, while China has declined. Shifting gears of global trade can reshape the key routes and markets that are involved in trade and impact demand for industrial properties, which are vital to the global supply-chain infrastructure.

In the case of the United States, some implications for logistics and warehouse real estate are:

- **Globalization patterns are shifting, not declining, due to supply-chain disruptions.** Forecasts indicate global trade levels will continue to rise. All else being equal, a 1 percent rise in U.S. imports is associated with an approximately 5 percent rise in warehouse net absorption.[4]

- **Growing demand in U.S. border industrial markets in Texas, Arizona and California, as trade with Mexico increases.** The greater Southern California area, Dallas-Fort Worth and Phoenix will remain top distribution hubs for goods crossing the southern border.[5] At the same time, Houston; Charleston, S.C.; Savannah, Ga.; and Virginia have reported significant growth in cargo volumes, as well, which is likely to continue.[6]

- **A domestic manufacturing recovery.** The federal government and corporations are investing heavily (more than $700 billion) in more domestic factory production to reduce U.S. supply-chain dependence on China.[7] We anticipate near-term manufacturing space demand could tally approximately 100 million square feet nationally.[8]

- **Last-mile distribution properties.** As U.S. import and export volumes continue to rise, ecommerce growth will benefit, along with last-mile properties. It is estimated ecommerce users typically require about three times as much warehouse space as traditional retailers, and every $1 billion of new ecommerce sales growth requires 1.0 million square feet of additional warehouse space.[9] Therefore, an estimated 340 million square feet of new space will be needed over the next five years.

Resiliency: Building durable, long-term real estate portfolios

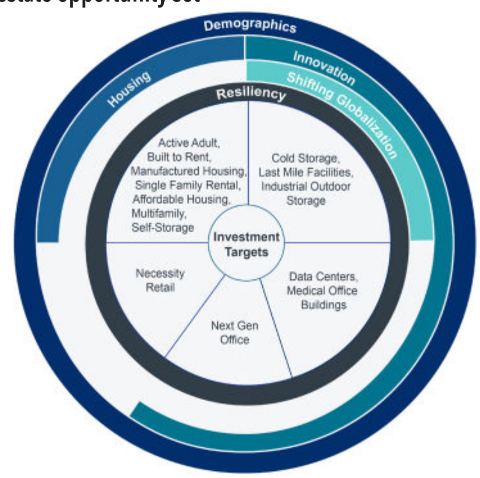
Figure 4: Resiliency underpins market and asset selection

Source: Clarion Partners Investment Research, April 2024

Market and asset-level resiliency are now viewed as integral to real estate investment strategy. Economic, operational and environmental factors are critical to providing consistent and repeatable cash flows through economic cycles to investors (Figure 4). Environmental, social and governance (ESG) considerations have also been proven to have significant financial benefits as well.[10]

Our investment themes allow investors to build durable strategies

Figure 5: Long-term themes can identify a wide real estate opportunity set



In an evolving world economy, investors need to focus on long-term strategies to ultimately deliver sustainable investment performance. As Figure 5 shows, our themes have direct applicability to a large and growing set of property types, which can be pursued by investors in their long-term investment strategies.

Institutional investor allocations will continue to shift by property type to reflect these powerful forces, which we believe will remain instrumental in driving long-term demand. We expect so-called "alternative" property sectors are going to be material beneficiaries of our themes, and we expect them to be a growing part of the investment landscape.

Notes: [1] Clarion Partners Investment Research, April 2024; [2] OECD, *OECD Science, Technology, & Innovation Outlook 2023,* 2023; [3] Ibid; [4] Clarion Partners Investment Research, Q4 2023; [5] U.S. DOT, BTS, FHWA, Clarion Partners Investment Research; August 2023. Note: Southern Border includes El Paso, Laredo, San Diego, Tucson; [6] Pacific Merchant Shipping Association, Individual Ports, Clarion Partners Investment Research; March 2024; [7] The White House, Clarion Partners Investment Research, Cushman & Wakefield; August 2023; [8] Moody's Analytics, CBRE-EA, Clarion Partners Investment Research; March 2024; [9] CBRE, Clarion Partners Investment Research; Q4 2023; [10] GRESB, 2024

CONTRIBUTORS

Indraneel Karlekar
Managing Director, Global Head of Investment Research

Jeb Belford
Managing Director, Chief Investment Officer

CORPORATE CONTACT

Hugh Macdonnell, Head of Client Capital Management

clarionpartners@clarionpartners.com | +1 212-883-2500 | www.clarionpartners.com

CORPORATE OVERVIEW

Clarion Partners has been a leading U.S. real estate investment manager for more than 40 years. Headquartered in New York City, the firm has offices in major markets throughout the United States and Europe. With $76.6 billion in total assets under management as of Dec. 31, 2023, Clarion Partners offers a broad range of both debt and equity real estate strategies across the risk/return spectrum to its approximately 500 domestic and international institutional investors.

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