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From niche to norm: The mainstreaming of alternative property sectors

In an evolving and growing commercial real estate universe, we believe alternatives are becoming mainstream and deserve a material allocation from institutional investors. This assertion is predicated on:

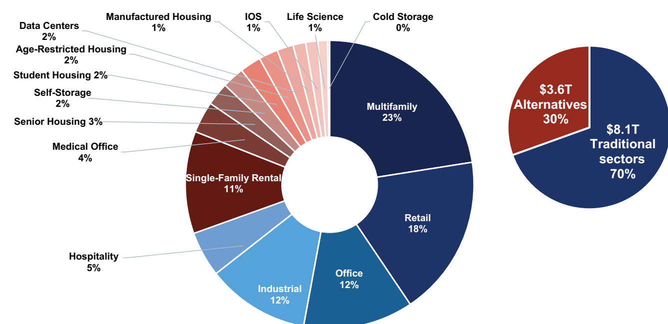
- The growth of alternative property types within the institutional real estate universe
- The structural underpinnings of demand that provide alternative property types long-term tailwinds and resilience through economic cycles
- Competitive performance
- Compelling portfolio attributes that provide diversification benefits to a traditional-only real estate allocation

A growing opportunity to scale within alternatives

Structural tailwinds and robust capital flows have propelled alternative property sectors to a material proportion of the commercial real estate industry. According to a recent analysis by Clarion Partners and Rosen Consulting Group, alternative properties account for approximately 30 percent of the $11.7 trillion[1] institutional commercial real estate universe (Exhibit 1). The alternative subsegment of the institutional universe includes single-family rentals, student housing, age-restricted housing, manufactured housing, self-storage, life sciences, medical office, senior housing, data centers, industrial outdoor storage (IOS) and cold storage.

Exhibit 1. A sizable and scalable opportunity set

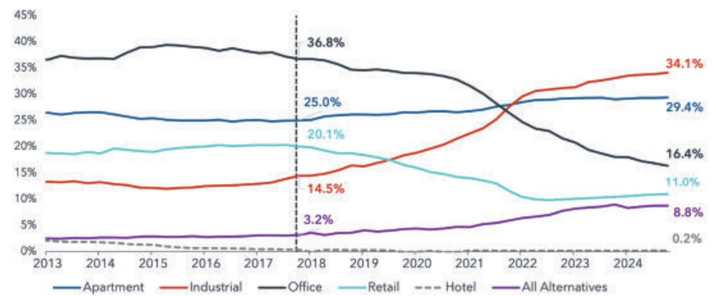
Share of institutional investable universe by sector



Source: Clarion Partners Global Research, November 2024

Institutional investor allocations to alternative property types have risen steadily in recent cycles. Historical barriers to entry for institutional investors into alternative property sectors – including concerns regarding the ability to scale, dearth of "institutional quality" assets, and limited transparency into historical operations and performance – remain a challenge in select sectors but have seen marked improvement in recent cycles. As a share of the NCREIF Open-End Diversified Core Equity (ODCE) universe, alternative property types account for 8.8 percent of the $278 billion gross asset value (GAV) as of fourth quarter 2024[2] (Exhibit 2). This is up from less than 3 percent a decade prior and is likely an underestimate of ODCE's allocation to alternatives, considering that several alternative sectors are grouped within traditional property types (i.e., life sciences is a subtype within office). Recent updates to the treatment of alternative property types in ODCE-qualified funds will allow fund managers to allocate up to 50 percent of their portfolio to sectors outside of the traditional "big four" property sectors. This evolution in the ODCE is in line with increasing diversification within core real estate portfolios and should further bolster institutional investment in alternative property sectors going forward.

Exhibit 2. Institutional pivot toward alternatives

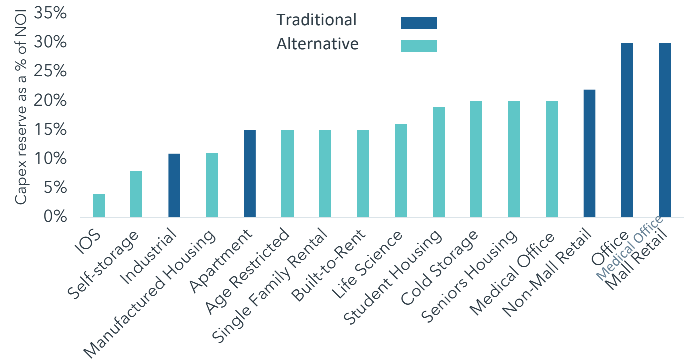


Source: NCREIF – NFI-ODCE, as of Q4 2024

Lower capital expenditures and structural demand fundamentals have contributed to reduced volatility

Alternative property types have generated lower total return volatility across economic cycles – a product of the sector's lower required capex reserves[3] (Exhibit 3), counter-cyclical demand drivers and ties to longer-term structural trends. These characteristics have contributed to the sector's relatively stable NOI growth and solid performance across economic cycles. The lower volatility of alternatives has been extremely important in reducing overall portfolio beta.

Exhibit 3. Lower capex reserves support longer-term outperformance



Sources: Green Street Advisors, NCREIF, Clarion Partners Global Research, as of January 2025

Compelling structural tailwinds, which include shifts in demographic age cohorts, the chronic housing shortage, maturation of new technologies and industries, and shifting globalization, are positive demand drivers for alternative property sectors (Exhibit 4). These secular trends highlight the alternative

sector's need-based, counter-cyclical demand drivers, which have contributed to its reduced volatility and relatively strong performance across economic cycles.

Exhibit 4. Secular tailwinds drive alternative property performance

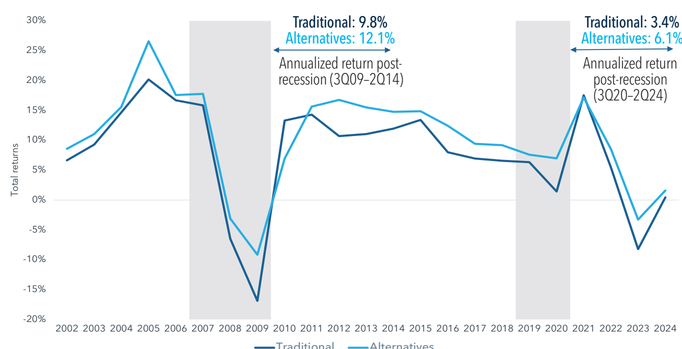
Structural theme	Trends	Alternative sectors impacted
Demographics	Aging baby boomers Maturing millennials Sizable college-age cohort	Senior housing, single-family rentals, student housing, active-adult housing, medical office, life sciences, self-storage
Chronic housing shortage	Declining affordability Delayed homeownership Widening own-to-rent ratio	Single-family rentals, manufactured housing
Innovation/Technology	Digital economy Artificial intelligence Healthcare innovation	Data centers, life sciences
Shifting globalization/ infrastructure	Regionalization Ecommerce Resilient supply chains	IOS, cold storage

Source: Clarion Partners Global Research

Alternative property sectors have produced attractive returns across economic cycles

Alternative properties have performed well historically, both on an absolute and risk-adjusted basis. An indication of the sector's resilience, counter-cycle demand drivers and lower sensitivity to the shifts in the economic cycle is demonstrated in performance: alternatives outperformed traditional property types during and following down periods in the economic cycle. During the two most recent recessions, the global financial crisis (fourth quarter 2007 to second quarter 2009) and COVID-19 (fourth quarter 2019 to second quarter 2020), alternatives outperformed traditional property sectors, generating cumulative total returns of –7.8 percent versus –15.3 percent, respectively, during the GFC and 4.3 percent versus 1.2 percent during the COVID-19 recession[4] (Exhibit 5). Alternatives also outperformed traditional property types in the immediate aftermath of the previous two recessions.

Exhibit 5. Alternatives have outperformed coming out of recessions



Sources: NCREIF – Expanded NPI, Clarion Partners Global Research, as of Q4 2024

During the five-year period following the GFC, alternative properties generated an annualized return of 12.1 percent versus 9.8 percent for traditional properties, according to NCREIF. More recently, during the 18 quarters following the post-pandemic recession ending in fourth quarter 2024, alternatives again outperformed, generating a 6.1 percent return versus 3.4 percent by traditional property sectors. This performance was driven by both strong market fundamentals, as well as cap rate compression driven by growing investor interest.

Low correlation to traditional property sectors and reduced volatility improve risk-adjusted portfolio returns

Considering the alternatives sector's comparatively strong historical returns and reduced volatility, the addition of alternative property types to a traditional real estate portfolio can provide added diversification and enhance risk-adjusted performance. Total returns for alternative property sectors have historically shown a low correlation with the performance of traditional property sectors,[5] thereby making the case for diversification.

There is a growing and sizable opportunity to invest and scale within the alternative property space. Alternatives' share of the institutional universe should continue to grow as investors increase exposure to alternative property types to capitalize on the sectors' healthy historical returns, lower volatility and proven resilience through economic cycles. Considering these characteristics and the sector's historical, relative performance, the addition of alternative property types to a traditional commercial real estate portfolio has generated improved risk-adjusted returns, reducing portfolio volatility and bolstering returns[6] (Exhibit 6). As such, we expect that an allocation to alternative property types will continue to evolve into a central element within a core commercial real estate investment strategy.

Exhibit 6. Addition of alternatives to a traditional property portfolio enhances risk-adjusted returns

2007–2024	100% Alternatives	100% Traditional	60% Traditional/ 40% Alternative	50% Traditional/ 50% Alternative	40% Traditional/ 60% Alternative
Annualized total return	8.9%	6.2%	7.3%	7.5%	7.8%
Standard deviation	7.9%	9.2%	8.4%	8.3%	8.2%
Sharpe Ratio	0.78	0.38	0.54	0.58	0.62

Sources: Moody's Analytics, NCREIF – Expanded NPI, Clarion Partners Global Research, as of Q4 2024

Notes: [1] Rosen Consulting Group, Clarion Partners Global Research, as of 1H 2024; [2] NCREIF – NFI-ODCE, as of Q4 2024; [3] Green Street Advisors, NCREIF, Clarion Partners Global Research, as of January 2025; [4] NCREIF – Expanded NPI, Clarion Partners Global Research, as of Q4 2024; [5] NCREIF – Expanded NPI, Clarion Partners Global Research, as of Q4 2024; [6] Moody's Analytics, NCREIF – Expanded NPI, Clarion Partners Global Research, as of Q4 2024

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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 $72.5 billion in total assets under management as of Dec. 31, 2024, 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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