TH Real Estate

a nuveen company

THINK Global: 10 reasons to consider real estate in your portfolio

Introduction

Direct real estate is defined as 'private investments in institutional-quality commercial property'. It covers traditional sectors, such as office buildings, apartments, retail malls, and industrial space, as well as structural sectors, which are as diverse as healthcare, student housing and datacentres. Real estate can provide stable, bond-like cash flows, with the advantage of adding value through asset management - similar to equity. Regulated and contracted revenues, and long lease terms that deliver predictable return over time, provide a compelling option for investors with regular cash distribution requirements. A growing number of domestic and international investors are turning to real estate to increase diversification, and by making long-term commitments to the sector, they amplify what is a structural, not cyclical, re-allocation of capital.

Why real estate?

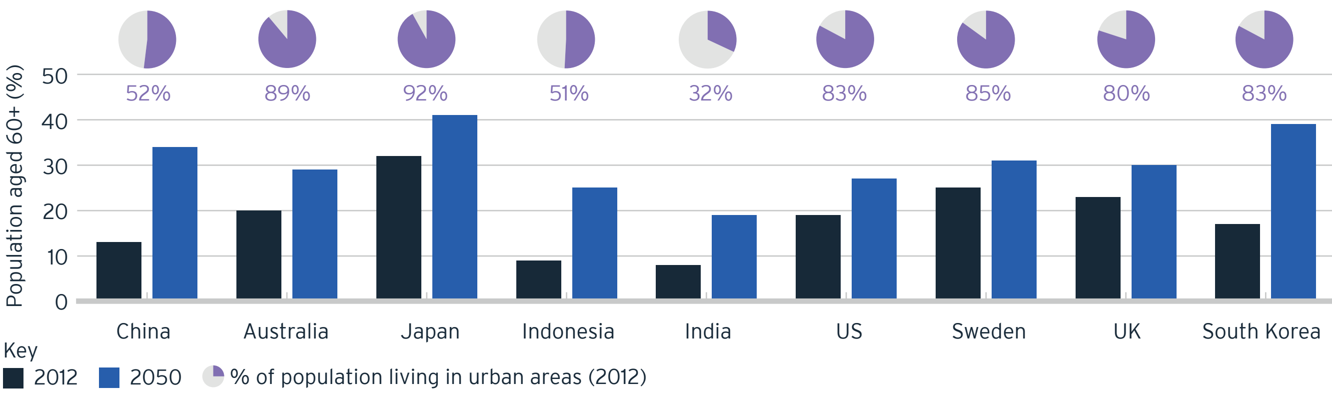
The growing realisation of a lower-for-longer global interest rate horizon, coupled with meagre bond and equity returns, have contributed to a secular shift to real assets. As investors contemplate the implications of political and economic uncertainty on capital markets, it seems a pertinent time to readdress the rationale for real estate in a multi-asset portfolio, and how to optimise performance in an evermore globalised economy.

Against a backdrop of sluggish economic growth, depressed interest rates and market instability, there has been a greater desire for investors to broaden their exposure outside traditional equity and fixed income positions, attracted by the attributes of real assets. For investors reappraising risk and reward, real estate can fulfil a need for stability, diversification, performance, and importantly yield, in a world starved of income. As some economic commentators debate whether a 'return to the old normal' is beyond the reach of Central Banks, one can expect allocations to real estate to continue to increase.

Optimising performance

Higher life and pension fund allocations, the evolution of sovereign wealth funds, legislative change, and socio-demographic developments, all imply an expansion in real estate capital allocations. Institutions in emerging markets are becoming increasingly active in the global market place, with a desire to find safe havens for their expanding pools of domestic savings; and traditionally have high allocations to real estate. In combination, these trends favour an international approach to real estate investment to enhance market return and reduced risk. We believe this investment mantra, borne out of our megatrends research, will drive long-term performance. Investment strategy must be aligned to evolving global trends as the world's population ages, migrates to cities, embraces technological advancements, and the developing nations grow richer and more influential. Megatrends, by definition, are multi-jurisdictional, but their impacts are local. Incorporating these developments, and understanding how they will impact at a city level, will be critical as real estate capital flows become more concentrated. Embedded within these trends is an appreciation that investor requirements are constantly changing, against a backdrop of challenging market conditions and heightened sustainability pressures. We believe the key to outperformance will be to identify those cities and industry sectors poised to benefit from ongoing structural change, and apply that insight alongside local expertise to benefit from an early-mover advantage. Long-term investors could enjoy above-average returns, lower-than-average volatility and modest downside risk, when following a city-based real estate strategy that is underpinned by long-term, structural trends. This approach strikes the right balance of risk and diversification, while taking advantage of short-term pricing opportunities.

Fig.1: Global population trends



Source: United Nations, World Bank, 2016

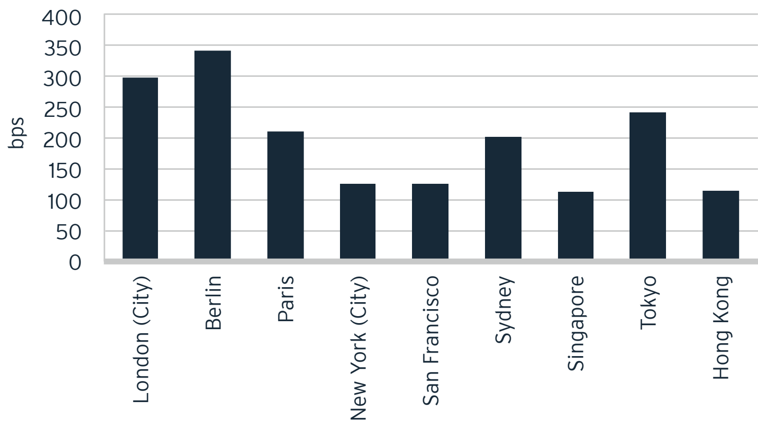
10 key reasons to invest in commercial real estate

1

Income

In the current and forecasted muted economic and inflationary environment, resilient levels of rental income underpin the attraction of commercial real estate. Against yields on traditional income-bearing products, such as government bonds, income that is distributed from property is very appealing. Fundamentally, while dividends from equity-based investments are discretionary, rental income from commercial property is contractually agreed, ranging globally from 3 to 15 years lease terms, this provides income security from a range of quality tenants.

Fig.2: Yield spread of prime offices vs. benchmark country 10-year government bond yield



Source: MacroBond, TH Real Estate, Oxford Economics, PMA, Macrobond, end-Q4 2016. Past performance is no guarantee of future results.

2

Stability

The income component of real estate may have the effect of tempering volatility. Traditionally, property cycles are less pronounced, with staggered long lease terms helping to mitigate the impact of economic fluctuations on income, which remains fairly consistent even during times of economic distress. Capital appreciation introduces volatility into returns, highlighting the importance of investment timing. History has shown that real estate exhibits much greater stability – more akin to bonds than to stocks, or even publicly traded REITs across most global real estate markets.

3

Diversification

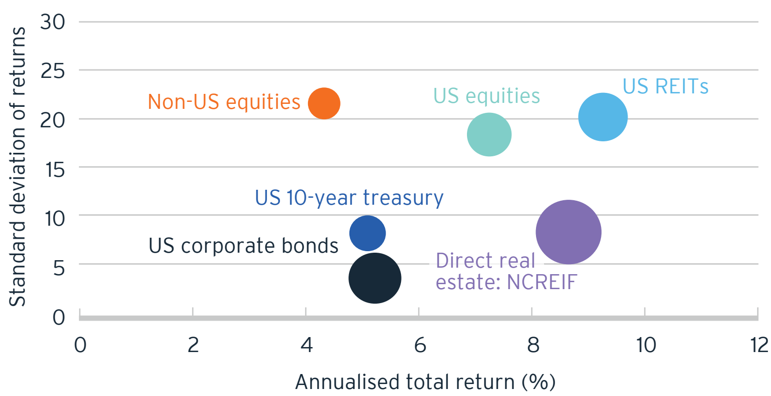
Low correlation of real estate returns with those for equities and fixed income products is one of the main arguments for including real estate in a mixed-asset portfolio. Commercial real estate is a longer-term investment with established, lengthy lease terms and sensitivity to development activity, as well as other factors giving commercial real estate a meaningful ability to reduce portfolio volatility through diversification. As property is an intricate part of the economic and social fabric of a city, geographical real estate investment diversification can be captured by structural socio-economic variables.

4

Return

Direct or private real estate has historically shown lower levels of volatility than other asset classes but also superior total returns over the longer term. Given a large component of performance results from its income, annualized returns have historically proven very healthy.

Fig.3: US risk and return, 20 years



Source: MSCI, MacroBond, Q4 2016
Note: It is not possible to invest in an index. Performance for indices does not reflect investment fees or transactions costs. The indices in the above chart are US equities: Russell 3000 US index; Non-US equities: MSCI ACWI-ex USA IMI; Direct real estate: NCREIF all property, US REITs: NAREIT all equity REITs index (REITs); US corporate bonds: Bloomberg Barclays US aggregate bond index; US 10-year treasury: Total return from yield (10-year).

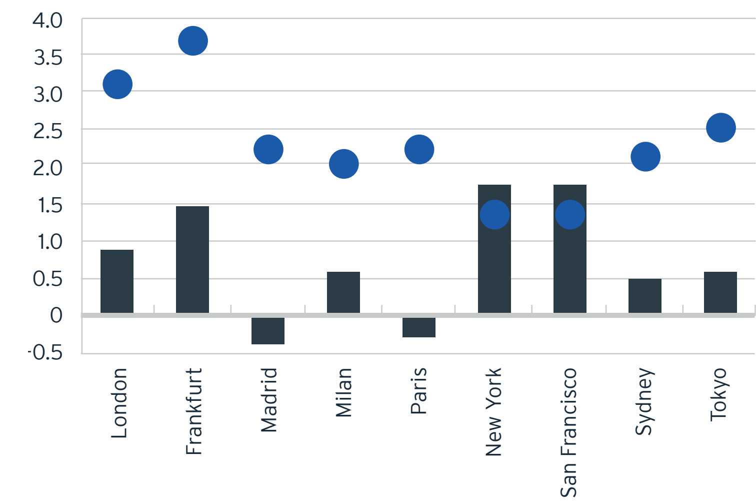
5 Value-add

Real estate can provide bond-like income with potential equity-like returns through opportunistic investment strategies and quality asset management. Real estate managers with good market relationships and partnerships with developers, agents, local authorities, private and institutional players, are essential to source attractive value-add opportunities. A sound knowledge of the planning system, coupled with business plans that extend, refurbish, and change the asset use, or improve the property's sustainability credentials, can all unlock and enhance value. An ability to reposition an asset and drive income expansion are defining components in delivering alpha.

6 Structural and cyclical

Real estate investment can incorporate short (cyclical) and long-term (structural) market strategies. A tactical, time-sensitive deployment of capital would typically represent a cyclical, possibly contrarian, investor approach, with a goal to achieve enhanced performance. A structural strategy implies a longer-term commitment to a market or sector, and a realisation of a solid, more defensive return profile. Investment strategies, combining both long-term structural trends and shorter- term cyclical opportunities, should continue to enjoy superior risk-adjusted returns.

Fig.4: Office property yield premium, %



Key

■ Spread over equity dividend yield ● Spread over 10-year bond

Source: MacroBond, TH Real Estate, PMA, end-Q4 2016

7 Tangible

Property is a real asset, with 'hard' credentials, which means it has intrinsic value. The structure has value, as well as the land upon which the asset resides. Well-chosen properties, in locations of long-term value which can benefit from favourable demand and supply dynamics, or infrastructure developments, provide security that some residual value will be retained even if the property or location does not reach its anticipated full potential. In short, the value of a tangible asset can rise and fall, but should not fully disappear.

8 Inflation protection

The potential for rental income to keep pace with, or outstrip, inflation strengthens the case for real estate as an asset class. Property assets normally feature leases with open market rent reviews, upward-only rent terms, or rental uplifts based upon inflation. Real estate returns are often considered as a natural inflation hedge, notably when inflation has resulted from strengthening economic demand. As prices of goods, services and profits increase in the broader economy, tenant demand and the prices they are willing to pay for space, move in tandem.

9 Liability matching

Market cycles are becoming shorter and harder to navigate, and the investment strategies of life, pension and sovereign wealth funds are responding to an expanding world population that is becoming more affluent and living for longer. This has prompted leading investment managers to form real assets groups in response to the structural shift of global portfolios rebalancing to asset classes, such as property, that deliver a high income component of return, offer a healthy relative risk-adjusted return, and a clear diversification benefit.

10 Macro-environment considerations

There will always be headwinds in the real estate industry. To focus solely on the risks, and not the attractive investment opportunities that market volatility can present, would be a mistake. Real estate is multi-dimensional, and investors should take comfort in the versatility of the sector, and the range of markets, deployment strategies and reward opportunities that are ever-present. Given wider global uncertainty and asset volatility, it is no surprise that allocations to global real estate are projected to continue increasing in the future.

About TH Real Estate

TH Real Estate, an affiliate of Nuveen, the investment manager of TIAA, is one of the largest real estate investment managers in the world with $109bn in AUM. Managing a suite of funds and mandates spanning both debt and equity across diverse geographies, sectors, investment styles and vehicle types, we provide access to every aspect of real estate investing. With over 80 years of investing experience, and more than 520 real estate professionals located across 22 cities throughout the US, Europe and Asia Pacific, the platform offers unparalleled geographic reach, which is married with deep sector expertise.

Our investment, asset management and corporate strategies grow from a deep understanding of the structural trends that we believe will shape the future of real estate and responsible investing beyond market cycles. This 'Tomorrow's World' approach sits at the core of our investment process and business operations, informing our long-term view of real estate investments for the enduring benefit of both clients and society.

AUM figures as at 31 December 2017

Contact us

Alice Breheny
Global Head of Research
T: +442037278122
E: alice.breheny@threalestate.com

Michael Keogh
Director of Research
T: +442037278160
E: michael.keogh@threalestate.com

contact@threalestate.com
threalestate.com
@THRealEstate14

Note: Real estate investments are subject to various risks, including fluctuations in property values, higher expenses or lower income than expected, and potential environmental problems and liability. Please consider all risks carefully prior to investing in any particular strategy. A portfolio's concentration in the real estate sector makes it subject to greater risk and volatility than other portfolios that are more diversified and its value may be substantially affected by economic events in the real estate industry. International investing involves risks, including risks related to foreign currency, limited liquidity particularly where the underlying asset comprises real estate, less government regulation in some jurisdictions, and the possibility of substantial volatility due to adverse political, economic or other developments.

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