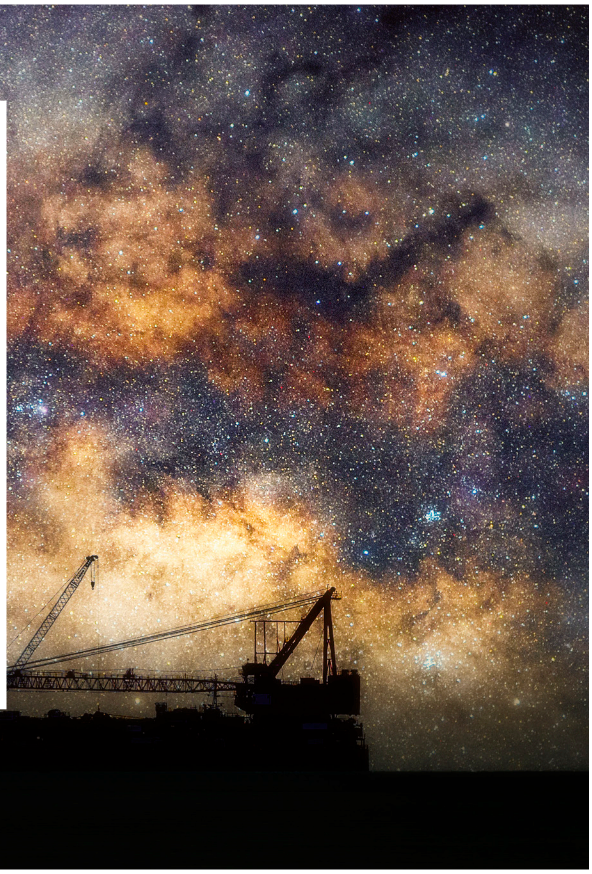

Real Estate: Expanding into the alternative universe

Market participants are discovering the universe is much more than just traditional property types.

It's estimated that the size of the overall global investable real estate market is $19.5 trillion, of which $13.3 trillion is professionally owned and managed[1]. As property markets have evolved through time alongside societal needs, investors are starting to grasp that the universe is as diverse as it is large. Up until the mid-2010s institutional investors had been almost exclusively focused on the four traditional property types – apartment, industrial, office and retail. Each of these property types has historically exhibited a moderate to high correlation with the business cycle (e.g. GDP, labor market) and thus provided less diversification benefits to a portfolio.

More recently, particularly in the post-COVID era amid the remote work trend plaguing the traditional office sector, institutional investors have turned their attention to the so-called "alternative" property types such as single-family rental, student housing, seniors housing, medical office, life science, self-storage and data center.

The attractiveness of these alternative property types is due to the less correlated demand drivers, enhanced diversification benefits and defensive profiles as fundamentals are broadly driven by non-cyclical growth trends (e.g. demographics, technology, healthcare, education).

The alternative sectors can generally be described as having fragmented ownership, less scalability, more operational intensity and offering higher yields vs. the traditional property types. However, each of the alternative sectors possess differing investable universe sizes, tenant types, lease structures and capital expenditure requirements. This makes them useful tools in building out a real estate portfolio that's focused on income and diversification. Although the US remains the market leader in terms of alternative property types, these sectors have also started to get more attention in other regions such as Europe, Canada and Australia.

At long last, alternatives are going mainstream

The public real estate market has led the way into the new and emerging categories of real estate. In the year 2000, alternative property types accounted for only 15% of the market vs. 52% as of March 31, 2024[2]. The private real estate market has lagged in this area. Non-traditional sectors make up less than 10% of the market right now, but we expect this number to continue to grow given the surge in capital markets interest among the investment community[3].

After years of advocating from market participants, starting in 1Q24, prominent private U.S. real estate data provider, the National Council of Real Estate Investment Fiduciaries (NCREIF), has rolled out new property type and subtype classifications for their often-cited property-level index, the NCREIF Property Index (NPI)[4], with the purpose of better reflecting the current real estate landscape, assisting with the growing demand for diversification and delivering much-needed transparency to this area of the market.

The newly launched "Expanded NPI" will add three new property types (self-storage, seniors housing and other (serving as a catch-all)) to the previous version of the NPI's (now referred to as "Classic NPI") existing five property types (which are apartment, hotel, industrial, office, retail). The "apartment" property type will be reclassified as "residential" to account for more subtypes such as student housing and single-family rental. Further, the Expanded NPI has introduced new as well as removed property subtypes. A full taxonomy of the Expanded NPI can be seen in Figure 1. NCREIF will keep releasing both the Classic and Expanded NPI data sets during a one-year transition period to allow for the industry to adjust. The old version will be retired following the transition period.

Additionally, to better align with the changes to the NPI, NCREIF has also made changes[5] to their flagship fund-level index, the Open-End Diversified Core Equity Index (ODCE).[3]

1. The "apartment" category changed to "residential" - meaning at least 75% of a fund's aggregate gross market value are required to be invested in the office, industrial, residential and retail property types
2. The six expanded property subtypes (single-family rental, manufactured housing, student housing, industrial life science, office life science, medical office) will count toward the 75% property type policy test above
3. A maximum of 25% of a fund's aggregate gross market value can be invested in the six expanded property subtypes

Figure 1: **Expanded NPI Property Type/Subtype Taxonomy**

1. **Residential**
    a. Apartment
    b. Student
    c. Manufactured Housing
    d. Single Family
2. **Hotel**
    a. Full Service
    b. Limited Service
3. **Industrial**
    a. Manufacturing
    b. Flex
    c. Warehouse
    d. Specialized
    e. Life Science
4. **Office**
    a. Medical
    b. Life Science
    c. CBD
    d. Urban
    e. Secondary Business District
    f. Suburban
5. **Retail**
    a. Street
    b. Strip
    c. Mall
6. **Seniors Housing**
    a. Independent Living
    b. Assisted Living
    c. Continuing Care
    d. Skilled Nursing
7. **Self-storage**
    a. No subtypes
8. **Other**
    a. Data Center
    b. Operating Land
    c. Entertainment
    d. Parking
    e. Other

Alternative real estate segments have been a major focus for WTW and our clients over the past decade. We recognize the potential challenges of lower transparency and liquidity as well as higher risk and fees versus traditional real estate segments. When invested thoughtfully these segments can also offer potential for higher income, diversification and return enhancement.

We saw the writing on the wall prior to the pandemic regarding the structural headwinds facing two of the traditional sectors, office and retail. With this knowledge, we've long advocated a strategic underweight to both property types. Consequently, we've advised clients to allocate a higher percentage of their real estate portfolios into alternative categories as a complement to their legacy ODCE exposure or even as a stand-alone building block. Amid the interest rate-induced repricing the entire asset class has experienced since mid-2022, this has proven beneficial from a diversification and relative performance perspective.

Similarly, over recent years, our delegated client portfolios have been early movers into numerous alternative sector-specific offerings. This has helped us create new strategies in many cases. For example, in 2018, our team identified U.S. single-family rental (SFR) as an attractive market segment due to favorable conditions. This was because there weren't enough units for rent, young people were starting families, and the fragmented sector was divided into many different types of ownership. Conversely, WTW viewed the opportunity set as an ideal buy-fix-hold strategy that focused on income. It became apparent after conducting a comprehensive market mapping that the universe was almost entirely comprised of strategies employing an opportunistic buy-fix-sell model. As such, we partnered with a high-conviction investment manager willing to launch a first-of-its-kind core+ open-ended U.S. Single-Family Rental Fund.[6]

Given our view on relative value and real estate cycle stage, we have had a recent selection bias tilted towards lower-risk income-orientated strategies. However, moving forward in a shifting landscape we remain diligent to uncovering unique opportunities within the demographically driven alternative sectors across the entire risk-return spectrum. We believe secular trends, such as aging populations driving healthcare expenditures and exponential data volume growth propelled by technological advances (e.g., AI, cloud computing), has major implications for the need of space in the coming decades. Except for the glaring near-term oversupply challenging the life science sector, current alternative sector supply-demand fundamentals broadly remain healthy from a historical standpoint. From a capital markets perspective, property valuations are close to fully adjusting to the higher interest rates. This is likely presenting an attractive entry point although that remains contingent on economic and interest rate stability. Nonetheless, the alternative property types will continue to serve as an important and growing piece of our clients' real estate portfolios to help them achieve their risk-return objectives.

1. MSCI Real Estate Market Size Report, July 2023
2. National Association of Real Estate Investment Trusts (NAREIT), FTSE NAREIT All Equity REIT Index, May 2024 (link)
3. The NCREIF Open-End Diversified Core Equity index (ODCE) is a fund-level capitalization weighted, time-weighted return index and includes property investments at ownership share, cash balances and leverage (i.e., returns reflect the fund's actual asset ownership positions and financing strategy). The ODCE fund count is 25 as of March 31, 2024.
4. The NCREIF Property Index (NPI) is a quarterly, unleveraged composite total return for private commercial real estate properties held for investment purposes only. All properties in the NPI have been acquired, at least in part, on behalf of tax-exempt institutional investors and held in a fiduciary environment.
5. The NCREIF board of directors will review the ODCE Inclusion Policy at a minimum of every three years to ensure industry alignment and adjust as necessary.
6. *This is a sample representation of our work with an investment manager. Outcomes will vary and there is no guarantee that we can achieve similar results with any particular manager in any particular asset class.

If you have any questions or would like to know more, please contact us here.

About WTW
At WTW (NASDAQ: WTW), we provide data-driven, insight-led solutions in the areas of people, risk and capital. Leveraging the global view and local expertise of our colleagues serving 140 countries and markets, we help you sharpen your strategy, enhance organizational resilience, motivate your workforce and maximize performance. Working shoulder to shoulder with you, we uncover opportunities for sustainable success — and provide perspective that moves you. Learn more at wtwco.com.

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