The Growing Opportunity in Alternative Real Estate

March 2022

OVERVIEW

- **Alternative real estate property types are a growing area of interest due to their strong historical returns and diversification benefits**
- **These sectors tend to have attractive demographic tailwinds, but also come with unique risks**
- **Most diversified real estate strategies are now allocating to non-traditional sectors and should benefit from their inclusion**

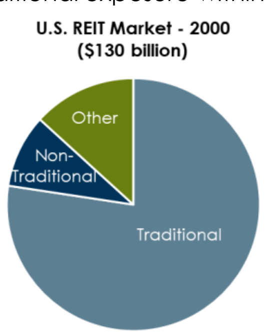
Background

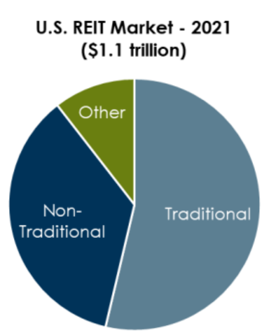
Until recently, institutional real estate investors tended to focus on the four primary property types – Office, Apartments, Industrial, and Retail. However, as the market for more niche "non-traditional" property types continue to develop, investors have broadened the scope of their strategies to include additional sectors, like Alternative Housing, Storage & Logistics, and Technology. These non-traditional property types have demonstrated the ability to outperform while also providing attractive diversification benefits. However, these property types also come with unique challenges that require specialized expertise to effectively operate and manage.

Alternative Housing	Storage/Logistics	Technology
Single Family Rentals	Self-Storage	Data Centers
Student Housing	Cold Storage	Towers
Senior Housing	Industrial Service Facilities	Life Sciences
Manufactured Housing		Medical Office

A Growing Opportunity

Non-traditional property types are a growing area of interest to both private and public real estate investors, but the public REIT market was quickest to embrace these niche property sectors. The market cap for non-traditional listed REITs has grown from close to $10 billion in 2000 to nearly $400 billion in 2021, far outpacing the growth of traditional REITs. While non-traditional REITs account for over 1/3 of the public real estate market, they only comprise 5-6% of the NCREIF ODCE Index, most of which is in Self-Storage. The strong public market expanded the opportunity set for private real estate managers and should act as a catalyst for increasing non-traditional exposure within the private market.

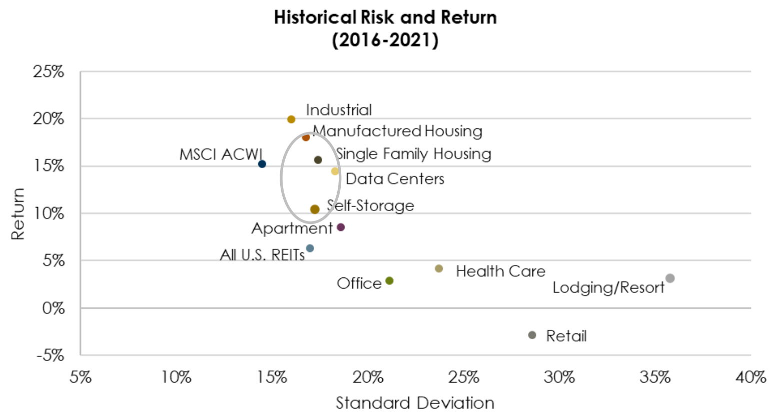




Source: Nareit, ACG Research

Evaluating Performance

Non-traditional sectors have recently outperformed traditional property types and done so with a lower level of risk. Part of this outperformance was driven by strong flows into these sectors which put downward pressure on yields. However, investors remain bullish on sectors like Self-Storage, Single Family Rentals, and Manufactured Housing due to their strong secular tailwinds, attractive rent growth potential and lower capex requirements compared to Office and Retail.



Source: Nareit, ACG Research

In terms of diversification, non-traditional property types can further reduce volatility of a portfolio due to their lower correlations to traditional property types and equities.

Correlations by REIT Sector (2016-2021)

	MSCI ACWI	All U.S. REITs	Health Care	S.F. Rentals	Man. Housing	Self-Storage	Data Centers
All U.S. REITs	0.81	1.00					
Health Care	0.71	0.91	1.00				
S.F. Rentals	0.85	0.90	0.81	1.00			
Man. Housing	0.66	0.85	0.81	0.81	1.00		
Self-Storage	0.24	0.57	0.46	0.47	0.42	1.00	
Data Centers	0.27	0.35	0.23	0.51	0.46	0.30	1.00

Source: Nareit, ACG Research

Risks

One reason that private real estate managers have been slower to move into alternative sectors is the higher level of operational intensity associated with these assets. For example, the resources required to lease and manage a 100-unit apartment building are much different than those required to manage a portfolio of 100 rental houses. Unexpected capital expenditures can also pose a risk to an investment's cash flow, requiring scale and experience to better underwrite and mitigate those factors.

ACG's Position

An allocation to non-traditional property types can increase diversification and return potential within a real estate portfolio over the long term. Portfolios with exposure to traditional property types may consider adding strategies dedicated to non-traditional property types or to mixed strategies that have the ability to invest some capital in these sectors. It is especially important to identify managers with the scale and expertise to source opportunities in these fragmented markets and that have the resources to best manage expenses and drive income growth.

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