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Q2 2019

Completion Strategies for Real Estate

ALTERNATIVE PROPERTY TYPES AND PORTFOLIO ALLOCATIONS

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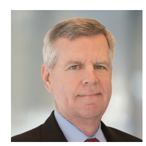

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Filling in the Gaps in a Real Estate Portfolio

The largest institutional investors access core real estate through private investments — typically separate accounts or comingled funds. In most of the world, private real estate investment strategies have typically focused on major property sectors, such as office, retail, and industrial, with residential and hotel assets also included in core portfolios in some countries. Consequently, institutional investors often have little exposure to less traditional or niche property sectors.

In recent years, there has been a significant growth in the universe of niche property types as well as increased investor interest. Both the private and public real estate sectors have benefited from this trend, although it has been more pronounced in the publicly traded real estate universe. Returns of niche property types have been strong in both the public and private sectors, generally exceeding overall property indices over the past decade. Many of the niche sectors also out-performed traditional property types during the Global Financial Crisis (GFC) due to factors such as counter-cyclical demand drivers and/or limited supply due to fewer qualified developers.

Management of niche property types often requires specialized knowledge and resources, differing from typical core real estate investment and management practices. While there are qualified and experienced managers for privately held niche sectors, gaining access to these private operators and managers is typically difficult due to fewer options and smaller funds. Conversely, the opportunity set to access these niche property sectors in the public real estate securities universe is significantly larger and more available, while also offering some of the best in class operators in these property types.

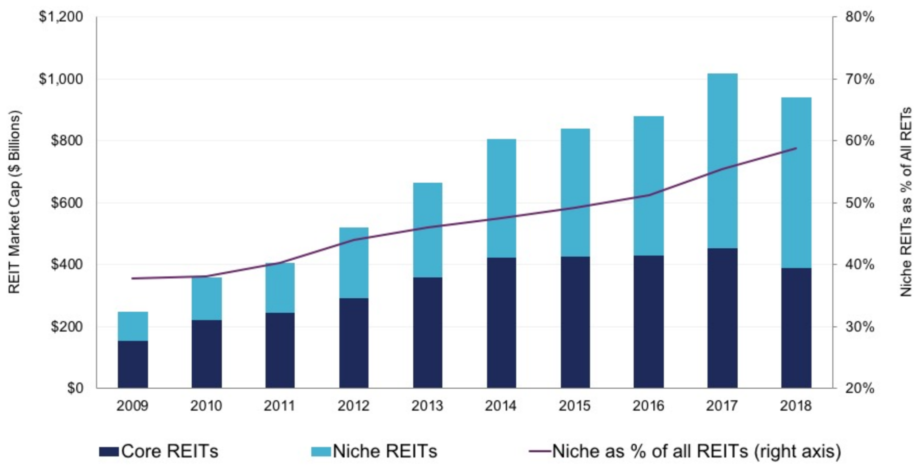
As we discuss below, niche property sectors have become an increasingly significant component of the investment universe, putting most institutions in an underweight position relative to those sectors. Therefore, institutional investors should consider publicly traded real estate securities as an efficient means to “complete” their real estate allocations and help align the property type weightings with the true investable universe.

Growth of Niche Property Sectors

The number of companies and the market capitalization of niche sectors (e.g., healthcare, data centers, self-storage, student housing, etc.) have rapidly expanded over the past decade and now constitute a significant portion of the publicly traded (and overall) real estate universe. In the United States, where growth has been fastest, niche sectors account for more than half of the public real estate market capitalization. The prevalence of niche properties is lower globally, but continues to steadily expand. The growth of the niche portion of the U.S. real estate market over the past decade is shown in the chart entitled Evolution of the U.S. Public Real Estate Market. As shown, the niche sector has grown to $550 billion of equity capitalization, accounting for 59% of the total U.S. real estate securities market (as measured by the FTSE Nareit All Equity REITs Index).

Evolution of the U.S. Public Real Estate Market

GROWTH THROUGH INCLUSION OF MORE NICHE PROPERTY TYPES



Note: Core REITs are office, retail, apartments, industrial and mixed.
Niche REITs include self-storage, healthcare, infrastructure, and data centers, among others.

Source: FTSE Nareit All Equity REITs Index as of December 31, 2018.

In addition to its rapid growth in size, the niche portion of the U.S. public real estate market has become quite diverse. As of year-end 2018, there were 85 niche REITs spread across 12 sectors, with a market capitalization of over $550 billion in the FTSE Nareit All Equity REITs Index. These 12 sectors provide a wide array of investment opportunities with varying demand drivers, both cyclical and secular in nature. The largest niche sector is infrastructure, which includes companies that own cell towers and other infrastructure that supports mobile data transmission. The two largest companies in this category, American Tower and Crown Castle, have a combined equity market capitalization of over $100 billion, and American Tower recently surpassed Simon Property Group as the largest REIT in the world.

Property Type and Country Drivers

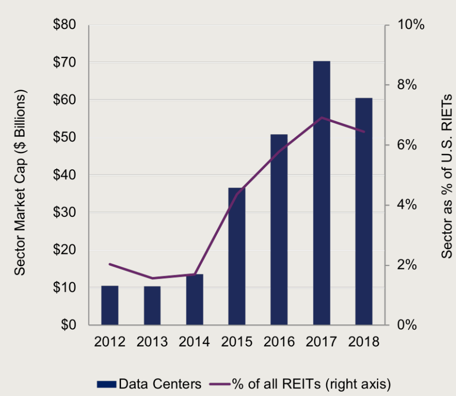
Varying Demand Drivers Add Diversification Benefits and Potential Protection from Cycles

Niche sectors have diverse business models and have a wide range of demand drivers. Demand drivers can be both cyclical and secular in nature, and can differ materially from the more traditional sectors. These diverse demand drivers offer additional diversification to a core real estate allocation and may help to insulate real estate allocations from volatility in the economic and real estate cycles. The structure and demand drivers of several niche sectors are detailed below:

DATA CENTERS AND CELL TOWERS

Growth in these sectors is driven by technological advancement and data consumption, making the sector less dependent on typical real estate demand drivers such as job or income growth. Demand for both cell towers and data centers has stemmed from the rapid global increase in data consumption, the shift to cloud based technology and the growing consumer need to always be “connected”. These drivers are likely to continue for many years as new technologies such as autonomous vehicles and streaming devices become more widespread. While the majority of companies within both sectors are based in the U.S., these companies are expanding their footprints globally, adding an additional level of diversification and widening their opportunity set moving forward.

Growth of Data Center REITs[2]



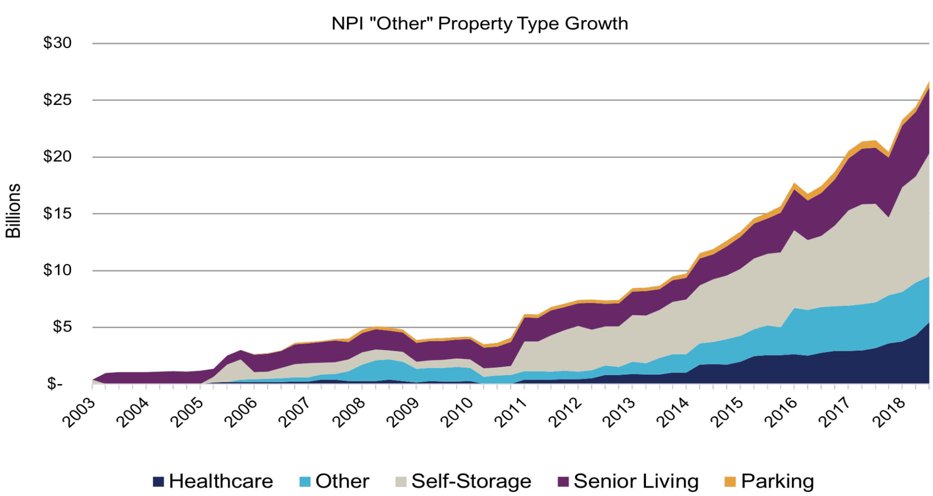
Universe of U.S. Niche Property Sectors

	Number of Companies	Market Capitalization ($000)	% of Nareit
DATA CENTERS	5	60,556	6.4%
HEALTH CARE	18	97,932	10.4%
INFRASTRUCTURE	6	136,628	14.5%
LIFE SCIENCES	1	12,106	1.3%
LODGING AND RESORT	17	45,660	4.9%
MANUFACTURED HOMES	3	17,098	1.8%
SELF STORAGE	5	51,996	5.5%
SINGLE FAMILY HOMES	3	11,490	1.2%
SPECIALTY	12	43,148	4.6%
STUDENT HOUSING	1	5,596	0.6%
TIMBER	4	22,325	2.4%
TRIPLE NET LEASE	10	47,121	5.0%
NICHE SECTORS	**85**	**551,654**	**58.7%**
FTSE Nareit All Equity REITs	**171**	**939,991**	

Source: FTSE Nareit All Equity REITs Index (As of December 31, 2018), LaSalle Securities. Data based on FTSE Nareit All Equity REIT Index using LaSalle Securities' property sector classifications.

In contrast to the public real estate market, niche properties have much lower representation in U.S. core indices and funds. As shown below, the combined value of niche sectors in the NPI Plus Index have growth from less than $5 billion in 2010 to over $26 billion at the end of 2018. This is only 4% of the total NPI Plus Index. Representation is slightly higher in the NCREIF Open-End Diversified Core Equity Index (NFI-ODCE), with 6% of total assets invested in niche sectors. For both indices, self-storage is the most popular property type. In the United Kingdom, the share of "other" sectors has grown to 11% of the MSCI UK Quarterly Property Index, consisting mainly of student housing, self-storage, and residential (which is considered a niche sector in the UK)[1].

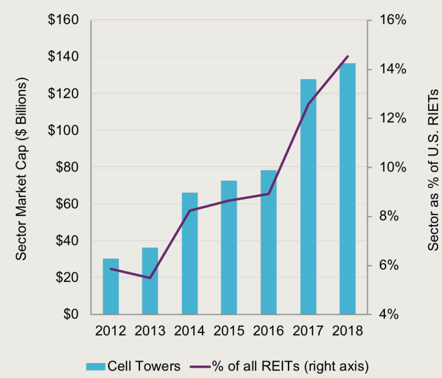
Growth of Niche Properties in NPI Plus



Source: NCREIF Property Index Plus (NPI-Plus), as of fourth quarter 2018.

[1] Source: MSCI as of 2018.

Growth of Cell Tower REITs[2]



SELF-STORAGE

This sector is primarily driven by population growth, percentage of renter-occupied housing units, and average household size, all of which are long term secular trends with limited impact from to the ups and downs of economic cycles. Self-storage demand remained strong during the GFC, although the housing bust was a material factor.

STUDENT HOUSING

Demand for this sector is dictated by demographics, mobility and college enrollment, rather than by macroeconomic conditions. Higher enrollment in education has resulted in colleges seeking institutional funding to modernize outdated housing and provide additional student living accommodations.

SENIOR HOUSING AND HEALTHCARE

Demographic changes create more demand for retirement living and healthcare. In the U.S., healthcare spending is projected to grow one percentage point faster than GDP growth per year over the 2017-2026 period. This means the healthcare share of GDP is projected to rise from about 18% in 2016 to nearly 20% in 2026[3].

[2] Determined by market capitalization according to the FTSE Nareit All Equity REITs Index.

[3] Projected National Health Expenditure Fact Sheet 2017-2026, Centers for Medicare and Medicaid Services.

In addition, Green Street Advisors has recently added niche sectors to its U.S. Commercial Property Price Index (CPPI) to better reflect their prevalence in the real estate universe, offering further validation for these niche sectors as a significant portion of the real estate universe.

Competitive Returns

While an expanding investable universe and diversification benefits are good reasons to consider niche property sectors, returns have also been competitive over the short term and have outperformed over the long term. As shown in the chart entitled Public Niche Universe Has Outperformed Over the Long Term, niche-focused companies in the U.S. public real estate universe have offered superior or competitive returns compared to both the broader U.S. public universe (FTSE Nareit All Equity REITs Index) and U.S. private core real estate (NFI-ODCE) over the past fifteen years. This outperformance has been due to yield compression as niche sectors have become more accepted, but also due to strong operating fundamentals.

Public Niche Universe Has Outperformed Over the Long Term

AS OF DECEMBER 31, 2018

Sources: Nareit, NCREIF (ODCE), and LaSalle Securities.
Data as of 12/31/2018.
Past performance is not necessarily indicative of future results.

Combining Listed Niche Sectors with Private Core Strategies

Niche sectors represent a significant and growing component of the real estate investment universe. The specialized knowledge and resources required to manage these properties can make them difficult to access in the private market. Public markets have fully embraced these property types, as they offer a broad range of demand drivers, and provide diversification and potential protection in economic downturns. Despite their prevalence and strong returns, niche properties are under-represented in most core institutional real estate portfolios, including core open-ended funds.

Given the growing importance of niche sectors, their inclusion in widely-accepted real estate indices, and the competitive return profile, institutional investors would be well served to consider a “completion” strategy that combines publicly traded niche properties with existing core real estate allocations. Based on past performance, potential benefits include higher returns, greater diversification, and better alignment with the evolving real estate universe.

Global Markets

While the U.S. real estate securities market has led in the expansion of these niche property types, this trend is also occurring in other regions across the globe. Other countries are generally in the beginning stages of niche property sector growth, which offers the opportunities to benefit as the sector expands. Certain sectors have been quicker to progress in other parts of the globe, as discussed below:

UNITED KINGDOM

Student housing and self-storage have led the overall growth of niche sectors in the U.K. Higher enrollment has spurred colleges into seeking institutional funding to provide student residential facilities that conform with modern-day functional and aesthetic designs[4].

JAPAN

Demand for healthcare in Japan is expected to increase rapidly as the 75-years-or-older population segment increases from 16 million to 22 million between 2017 and 2025[5]. The healthcare focused real estate companies in Japan have long-term leases with healthcare operators, which secure cash flow growth and take advantage of favorable government policies towards this key demographic.

[4] “Funds invest in student housing as prospects brighten”, JLL – The Investor, David Houck, March 27, 2017.

[5] “Spotlight - 2017 review and 2018 prospects, Savills Japan, January 2018.

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FTSE Nareit All Equity REIT Index

The FTSE Nareit All Equity REITs Index is a free-float adjusted, market capitalization-weighted index of U.S. equity REITs. Constituents of the index include all tax-qualified REITs with more than 50 percent of total assets in qualifying real estate assets other than mortgages secured by real property. For more information, please visit http://www.ftserussell.com/.

NCREIF

The NCREIF Property Index Plus (NPI-Plus) 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. Property types include apartment, hotel, industrial, office and retail plus non-traditional investment properties including student housing, self-storage and senior living. The composition of the NPI-Plus can change over time. The number of properties changes as Data Contributing Members buy and sell properties and new Data Contributing Members are added. Properties exit the NPI when assets are sold or otherwise leave the database. All historical data remains in the database and in the Index. The Index represents investment returns from a single class of investor. As such, the NPI-Plus may not be representative of the market as a whole. For more information, please visit https://www.ncreif.org/.

The NFI-ODCE, short for NCREIF Fund Index - Open End Diversified Core Equity, is the first of the NCREIF Fund Database products and is an index of investment returns reporting on both a historical and current basis the results of 36 open-end commingled funds pursuing a core investment strategy, some of which have performance histories dating back to the 1970s. The NFI-ODCE Index is capitalization-weighted and is reported gross of fees. Measurement is time-weighted. NCREIF will calculate the overall aggregated Index return.

MSCI UK Quarterly Property Index

The MSCI UK Quarterly Property Index measures unlevered total returns of directly held standing property investments from one valuation to the next. The index tracks performance of 9,034 property investments, with a total capital value of GBP 163.1 billion as at December 2018.

The securities of issuers that are principally engaged in the real estate sector may be subject to risks similar to those associated with the direct ownership of real estate. These include: declines in real estate values, defaults by mortgagors or other borrowers and tenants, increases in property taxes and operating expenses, overbuilding, fluctuations in rental income, changes in interest rates, possible lack of availability of mortgage funds or financing, extended vacancies of properties, changes in tax and regulatory requirements (including zoning laws and environmental restrictions), losses due to costs resulting from the clean-up of environmental problems, liability to third parties for damages resulting from environmental problems, and casualty or condemnation losses. In addition, the performance of the local economy in each of the regions in which the real estate owned by a portfolio company is located affects occupancy, market rental rates and expenses and, consequently, has an impact on the income from such properties and their underlying values.

The forecasts contained in this publication are generated from a range of statistical techniques, including econometric models. They are subject to errors stemming from three main sources: measurement and statistical error which relate to raw data and the econometric model, as well as error arising from assumptions regarding the future behavior of explanatory variables. As a result, we place greater emphasis on trends and turning points than on precise values. Please note that the forecasts do not include the impact of any commissions, fees or other charges that may be payable.

Past performance is not necessarily indicative of future results. In addition, the price and/or value of and income derived from any particular investment may vary because of changes in interest rates, foreign exchange rates, operational or financial conditions. Investors may therefore get back less than originally invested. Furthermore, these investments may not be eligible for sale in all jurisdictions or to certain categories of investors.

There is no guarantee the trends identified in the following graphs will herein continue: “Evolution of the U.S. Public Real Estate Market”, “Growth of Data Center REITs”, “Growth of Cell Tower REITs”, “Growth of Niche Properties in NPI Plus”.

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