

# AN ALTERNATIVE VIEW ON REAL ESTATE

Over the last 15 years, there has been more investment into new sectors, and increasingly innovative ways to make those investments. This broadening of our investment universe has defined the post-Financial-Crisis era. However, portraying this era as the rise of alternative real estate oversimplifies the structural changes seen in the market. In this paper, we consider the extent of change within institutional portfolios and what drove those changes. We also offer an alternative way to view real estate investments across a broad range of property types.

## STRUCTURAL CHANGE IN REAL ESTATE INVESTMENT

Real estate investors have changed the mix of property types within their portfolios with increasing freedom over the last 15 years. Offices and retail have lost global market share to industrial, residential and other property types in both the listed and unlisted sectors (Figure 1).

The listed sector saw greater change. The main four property types each have a similar market share, and

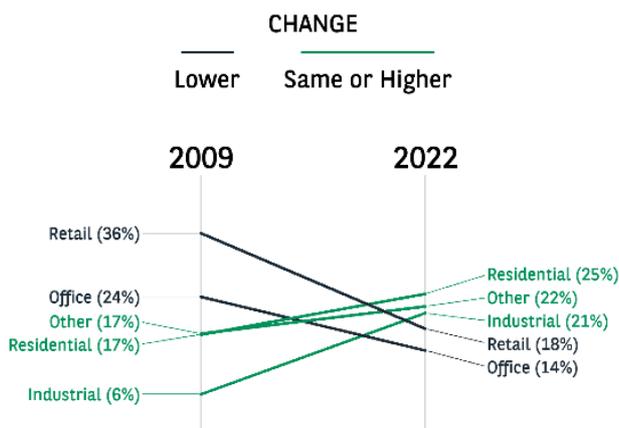
their rankings have changed compared to 2009. In addition, 22% of today's listed market is a mix of more niche property types.

The unlisted sector has differed in two ways: it has been slower to reduce its exposure to offices, and niche property types still only make up 6% of assets under management.

**FIGURE 1: THE CHANGE IN OWNERSHIP SHARE BY PROEPRTY TYPE**

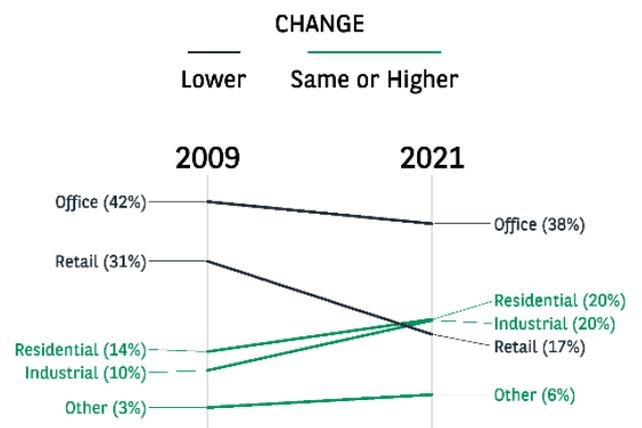
### GLOBAL LISTED REAL ESTATE

Global listed real estate by sector (% share of market cap, USD)



### GLOBAL UNLISTED REAL ESTATE

Global unlisted real estate by sector (% share of assets under management, USD)



Source: Macrobond, EPRA/NAREIT World Developed Indexes, MSCI Global Annual Property Index

## INVESTMENT MANAGEMENT

### THE DRIVERS OF STRUCTURAL CHANGE

After the Global Financial Crisis, there was an expectation among investors that the rise of “alternative” real estate – niche property types that are less liquid but fast growing – would define the current era of investment. In hindsight, this has been only part of the story.

It is true that growth in data usage, international travel and study, and the ageing of our populations have been instrumental in how investors are reshaping their real estate portfolios to include data centres, hotels, student accommodation and healthcare, for example, but progress has been slow.

However, changing fortunes in the main property types have also encouraged investors to evolve their strategies. Yields in offices, retail and industrial have declined, leases have shortened and the traditional landlord-tenant relationship has given way to a more customer-focused approach – one that meant partnerships with tenants, or operators, made more sense (Figure 2).

New property types often offered better solutions to those problems and more resilient demand-supply

fundamentals than an investor’s existing portfolio.

There have been other structural changes underway during this period. In response to the growth in e-commerce, many investors actively reduced their exposure to retail properties and increased their investment in logistics. In addition, the value losses in retail and strong value gains in logistics exacerbated the relative change in market share. When viewed together, investors were maintaining their exposure to households’ retail spending but diverting their investment to the part of the retailer supply chain that was undersupplied.

The way we work and use office space was changing before the pandemic began. However, the series of lockdowns in many countries revealed the good and the bad of sustained remote working. It has fast-tracked many companies’ adoption of hybrid working and often resulted in a need for less office space, but better office space (see our previous Living Thoughts article). Investors have begun their response by ensuring they focus on good quality, well-located offices but allowing their overall exposure to offices to drop.

FIGURE 2: THE DRIVERS BEHIND INVESTMENT TRENDS



#### LOW YIELDS

Look further afield to find suitable income returns



#### LEASE LENGTH

Wider search for long leases, including sale and leasebacks



#### OPERATORS

Desire to acquire, or partner with, operators for greater control



#### DEMOGRAPHY

Structural trends boost demand in a wide range of sectors

Source: BNP Paribas REIM

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# LIVING THOUGHTS

A BNP Paribas REIM Research Paper

SEPTEMBER 2022

## KEEPING A BROAD VIEW ON SECTORS

Finally, a word on the outlook. In light of the pandemic and the Ukraine-Russia War, some investors might stall their entry into new sectors. It might also be a time of higher capital expenditure at the expense of investment volumes – improve what you have today to ensure it is sustainable in the future. In that regard, we are strong advocates for sustainable investment and helping our industry contribute to reduced carbon emissions.

To some, now might not feel like the time to start investing in something new, but what we are describing is an investment market that should have a relatively narrow focus on quality, but a broad focus by property type. Further, with new buildings being increasingly multi-use, and investors often changing or adding uses to existing buildings,

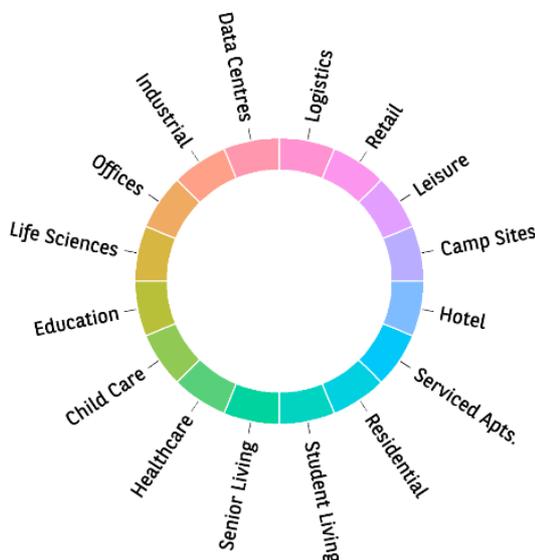
investors need a clear view on all sectors.

However, rather than thinking in terms of mainstream versus alternative real estate, or looking at retail or office trends in isolation, we will continue to look across a broad spectrum of property types and group them by their underlying drivers (Figure 3).

Here, logistics and retail are part of the same exposure to spending and entertainment. We can take long-term views on how households will spend their disposable incomes and invest accordingly. The Living sector is part of a wider belief that many demographic groups, from students to seniors, need more purpose-built accommodation. In addition, our interest in healthcare is part of a need to invest more in the infrastructure that our society depends on.

FIGURE 3: A NEW WAY TO VIEW REAL ESTATE

### THE SPECTRUM OF SECTORS



### SECTOR GROUPS

#### Spending & Entertainment

- Logistics
- Retail
- Leisure
- Camp Sites
- Hotel
- Serviced Apts.

#### Living

- Residential
- Student Living
- Senior Living

#### Social Infrastructure

- Healthcare
- Child Care
- Education

#### Services & Production

- Life Sciences
- Offices
- Industrial
- Data Centres

Source: BNP Paribas REIM (as at April 2022), Note: List is not exhaustive

Source: BNP Paribas REIM

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## UNDERSTANDING THE FUNDAMENTALS

We remain focused on expanding our residential and healthcare platforms across Europe. These property types should be an essential part of a real estate portfolio over the next decade, not because their status is changing from alternative to mainstream in the minds of some investors, but because they have positive fundamentals that can drive their growth and performance.

We can apply this framework to all real estate investments, and summarise them as:

- Investment should generate a positive social impact and have a minimal environmental impact
- Demographic trends should increase occupier demand over the long term
- Occupier demand for space should be resilient to online or virtual substitutes and automation
- Supply should be constrained or otherwise unlikely to meet demand over the long term

As well as the fundamentals, we also look at property types from the perspective of style factors: growth, yield and volatility, for example (as discussed in our

recent Lighthouse H1 2022 publication). A new property type could reduce the cyclicity of our portfolio, improve our income return or reduce the overall volatility of total returns. The interplay between the new property type and existing assets is important.

Finally, what are the entry points to the new sector? The capital market traits, or features as we call them, are important considerations. What is the average asset value and deal size? Are portfolios and entity-level deals common? These features vary greatly from one sector to the next and one must consider if you are well prepared to manage deals of this nature.

Overall, whether an investor is considering a new property type or reviewing their exposure to an existing one, looking at what drives the long-term fundamentals, how each investment changes the nature of the portfolio, and how each investment would be made, help us form a well-rounded view on all real estate investments, not just alternatives.

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