

CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Containing concern in commercial real estate

Bottom line up top

Rate hikes: One (more) and done? Markets continue to search for signs of rate stabilization, with the latest round of clues coming from last week's release of Consumer Price Index data for March and the minutes from the Federal Reserve's most recent meeting. Unfortunately, neither inspired much more than lukewarm optimism that red-hot restrictive monetary policy would cool off soon. The CPI report did show some incremental easing of inflation, but not enough to cement expectations for one more Fed hike before a pause-and-pivot by year-end — an outcome investors were hoping would be a foregone conclusion given lingering concerns about contagion from last month's banking turmoil. Although such contagion fears may be justified, Fed Chair Jerome Powell and his colleagues don't seem inclined to change course on that basis. Instead, the Fed is choosing to remain data-dependent when it comes to policy.

Contagion fears in commercial real estate may be overstated.

Policy trajectory isn't the only case markets are trying to crack. Since witnessing two of the largest bank failures in history last month, investors have focused on potential contagion across the global financial system. Topping the list for many is commercial real estate, and in particular, the commercial mortgage-backed securities market. Given the odds of increased regulation, tighter lending standards and shrinking deposit bases among regional banks, fears of direct negative impacts on this asset class aren't misplaced. But while we may see an uptick in distressed assets and defaults as the world heads toward a



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On behalf of Nuveen's Global Investment Committee

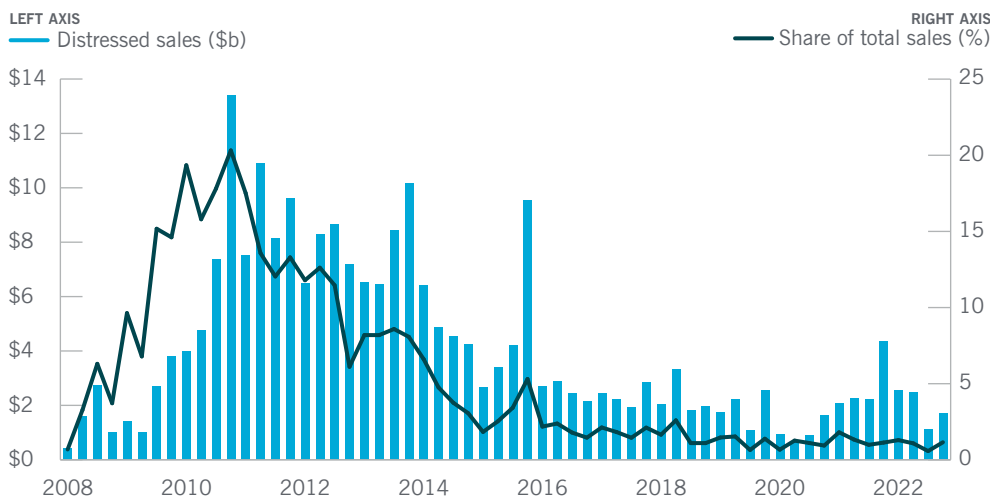
As Nuveen's CIO and leader of our Global Investment Committee, Saira drives market and investment insights, delivers client asset allocation views and brings together the firm's most senior investment leaders to deliver our best thinking and actionable investment ideas. In addition, she chairs Nuveen's Equities Investment Council and is a portfolio manager for several key investment strategies.

potential recession, distressed sales remain near all-time lows and we're not anticipating the massive scope of dislocation that occurred during the Global Financial Crisis in 2007-2008 (Figure 1). Today, CMBS represent less than 20% of the U.S. mortgage market and are of far better quality than mortgage securities and their corresponding derivatives were during that crisis. In fact, we expect to see improving confidence in the U.S. financial system, with widely available commercial real estate investment opportunities in both U.S. and non-U.S. markets.

The banking crisis could continue to spark some volatility, but we think broad contagion will be limited.

FIGURE 1: COMMERCIAL REAL ESTATE MARKET HEALTH HAS IMPROVED SIGNIFICANTLY

Real estate distressed sales levels



Data source: MSCI Real Capital Analytics. Based on quarterly reports of properties \$2.5 million and greater from 1Q 2007 through 4Q 2022.

Portfolio considerations

In the wake of the banking crisis, commercial real estate has been under the microscope because of risks from its exposure to regional banks. We believe further regulatory steps to boost capital requirements of regional banks to mitigate these risks are on the horizon, and will likely result in reduced real estate lending from these institutions. But this should benefit non-bank lenders, who'll be able to charge higher interest rates.

Opportunities across commercial property types: Globally, the industrial and residential property sectors have long-term tailwinds, and we see pockets of offer compelling opportunities across retail and office sectors. E-commerce-related real estate looks particularly attractive. As online shopping rates continue to rise (Figure 2), additional warehouse and

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distribution space is required to fulfill orders. Meanwhile, shorter expected delivery times from consumers requires additional distribution facilities, creating new demand for space. There are variances by region, but overall this dynamic continues to create opportunities.

In the residential sector, Japanese senior housing and Australian student housing look attractive, while scarce supply and favorable demographics boost the outlook across the residential spectrum in Europe. Demand for U.S. rental units has decelerated, but fundamentals look healthy across most markets.

The office sector remains broadly challenged by hybrid working models, but select areas warrant consideration (e.g., Seoul is seeing rising demand and rent levels). Offices in Europe enjoy higher occupancy rates than those in the U.S., while U.S. medical office and life science buildings benefit from strong demand as health care needs increase.

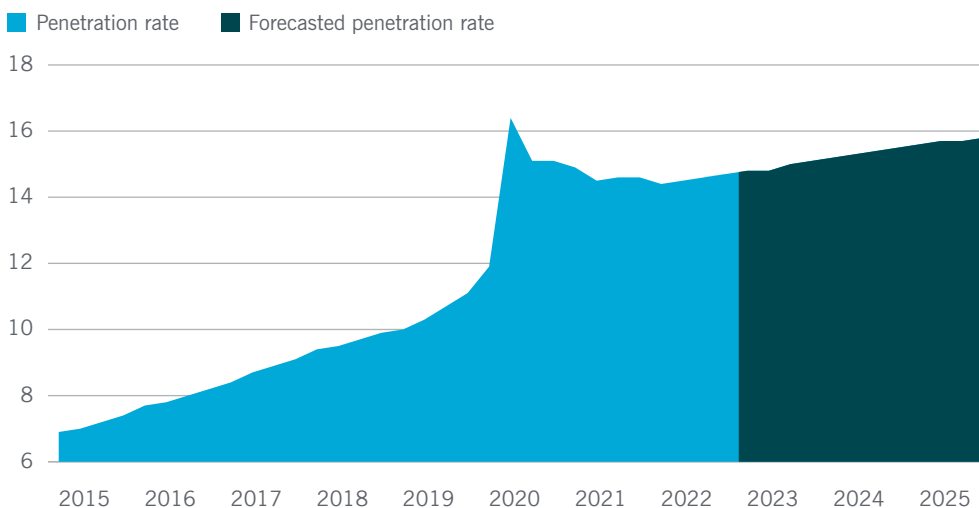
We see potential across the retail sector as well. Locally-oriented neighborhood retail in the U.S. and U.K., for example, offer sturdy fundamentals with low vacancies, almost no supply risk, resilient pandemic-tested demand, and higher yields.

Finally, we would point to nontraditional areas such as self-storage, which offers recession-resistant demand and opportunities to add value through professional management and flexible scale.

Despite concerns around commercial real estate, we think the sector offers attractive investment opportunities.

FIGURE 2: E-COMMERCE-FOCUSED REAL ESTATE OFFERS ROOM FOR GROWTH

E-commerce share of total U.S. retail sales (%)



Data source: Moody's Analytics. Quarterly readings from 2015 through 2022; quarterly forecasts from Moody's through 2025.

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Regular meetings of the GIC lead to published outlooks that offer:

- macro and asset class views that gain consensus among our investors
- insights from thematic “deep dive” discussions by the GIC and guest experts (markets, risk, geopolitics, demographics, etc.)
- guidance on how to turn our insights into action via regular commentary and communications

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Endnotes

Sources

All market and economic data from Bloomberg, FactSet and Morningstar.

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