nuveen
REAL ESTATE

RealAccess

Global insights for real estate investors

ISSUE NO. 04 | WHAT'S INSIDE

02 Sustainable real estate

06 The evolution of rental housing

10 Resurgence in the suburbs

12 Tax benefits and implications for REIT investors

16 Citywatch: Vienna

Building in a time of climate change

OPINION PIECE. PLEASE SEE IMPORTANT DISCLOSURES IN THE ENDNOTES.

Building a sustainable future

In this issue of *RealAccess*, our stories emphasize that while our changing environment presents risks for investors, it also creates new opportunities. As our economy changes, we see opportunity in new housing sectors. As our climate changes, we see opportunity in building a more resilient real estate portfolio.

Great investors envision the future and invest in that promise. Nuveen is making investments in real estate that are positioned for the future we want to help build. A future where people live in comfortable, convenient housing and have offices with the technology that makes workers healthy and keeps energy costs lower. A future where buildings not only withstand the changing climate, but also help mitigate the carbon emissions that contribute to climate change.

Nuveen Real Estate is committed to building the communities of the future, and we strive to protect the value of every property we own by enhancing sustainability.

Sincerely,

Carly Tripp
Global CIO, Nuveen Real Estate

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Building through climate change

Our investment teams consider climate change with every building they purchase. See how that process can impact value.

See "Sustainable real estate: Building in a time of climate change"

02

Suburban resurgence

The suburbs are cool again. With a lower cost of living, larger living spaces and good schools, more families are relocating. This trend is creating opportunities.

See "Resurgence in the suburbs"

10

New housing trends

As demographic trends shift, more Americans are seeking rental housing, both in traditional apartments and the growing single-family home rental market.

See "Gimme shelter: the evolution of rental housing"

06

Tax implications for real estate income

Some real estate income is passed through to the shareholders as a non-taxable return of capital. While it reduces the tax liability of the dividend, it also reduces the investor's per-share cost basis.

See "Tax benefits and implications for REIT investors"

12

A city of culture and connectivity

Vienna sits at a crossroads in Europe. With excellent transportation infrastructure, it offers a thriving real estate market for many sectors, especially fulfillment and logistics.

See "Citywatch: Vienna"

16

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Sustainable real estate:

Building in a time of climate change

While Nuveen's sustainability strategy encompasses a broad range of ESG issues, we believe the physical effects of climate change and the transition to the low carbon economy will have the most significant influence on real estate asset values. Climate change can also alter the demand for real estate in a particular region or location, which could have a detrimental impact on asset values. We continue to monitor what we believe are the key physical risks.

It is critical that our investment process analyzes how climate risk may affect real estate opportunities. Our strategy includes our top-down tomorrow's world investment strategy and a bottom-up assessment of individual investment opportunities. To identify investable cities, we screen for factors such as climate change vulnerability, air quality and electricity grid carbon intensity. We also assess the scale, growth and livability of a city. Scoring the sustainability of cities in this way helps us to incorporate resilience into our strategy.

When performing due diligence on building acquisitions, Nuveen's investment and sustainability teams underwrite for opportunities and risks associated with energy efficiency, occupant health and wellness, and climate change risk. We seek to integrate ESG throughout our real estate investment management process to help preserve and create value for our clients.

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Key physical risks of climate change

COASTAL FLOODING

causes business interruption, loss of revenue and repair costs, as well as impacting insurability and liquidity. Buildings can be designed or retrofitted to be more resilient, and municipalities can invest in resilience strategies like flood walls and restoring natural barriers. However, market pricing will also reflect the perceived future risk to the property and increasing insurance costs.

SEVERE STORMS

can lead to dangerous supercells, derechos and tornadoes. They are created by raw energy, which is determined by how warm, moist and buoyant the air is, as well as the wind shear. These storms can have both acute and chronic impacts on real estate, depending on their frequency and intensity.

HURRICANES AND TYPHOONS

are getting stronger and storm tracks are shifting, increasing extreme rainfall and storm surges. The water vapor feeding extra-tropical cyclones has increased, resulting in more extreme precipitation. The catastrophic impacts of hurricanes on real estate are difficult to predict.

WILDFIRES

have become larger and more intense, as temperatures increase and precipitation patterns change. They can damage commercial real estate, though most assets are located in urban areas with less exposure. However, soot and smoke can impact the surrounding infrastructure, and the long-term value of residential property is also at risk.

TEMPERATURE EXTREMES

are easier to plan for, but harder to insure against than other types of physical climate risk. For real estate, extreme heat brings increased cooling costs, landscaping challenges, and equipment and facade degradation. Other challenges include negative impacts to worker productivity, occupant comfort and overall quality of life.

DROUGHTS

can impact water quality, availability and price, with local jurisdictions restricting water use under extreme conditions. Many industrial and commercial processes use water as a solvent or coolant and are therefore sensitive to the cost and quality of the local supply.

Investing sustainably may drive value in real estate

The Nuveen real estate investment process addresses a range of environmental and social issues throughout the lifecycle of ownership. This helps us toward our goal of reducing energy intensity by 30% versus 2015 totals across all our properties by 2025.

Acquisition: assessing sustainability risk/opportunity as part of due diligence

Leasing: attracting tenants with sustainable buildings and managing legislative risk

Property management: improving the sustainability performance of buildings in operation

Capital improvements: incorporating sustainability into annual business plans and redevelopment

Disposition: managing the impact of sustainability risks on exit yield

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Gimme shelter: *the evolution of rental housing*

Demographic shifts in the United States over the next 10 years are reshaping the housing markets. The aging of millennials, changing income trends and migration away from cities are fueling demand for apartments and single-family rentals.

MILLENNIALS NEED THEIR SPACE

The older millennials, in their mid to late 30s, have largely married and are starting their families. We estimate approximately 60% of this cohort will opt for home ownership, leaving close to 40%, or one million families, looking for rental options.

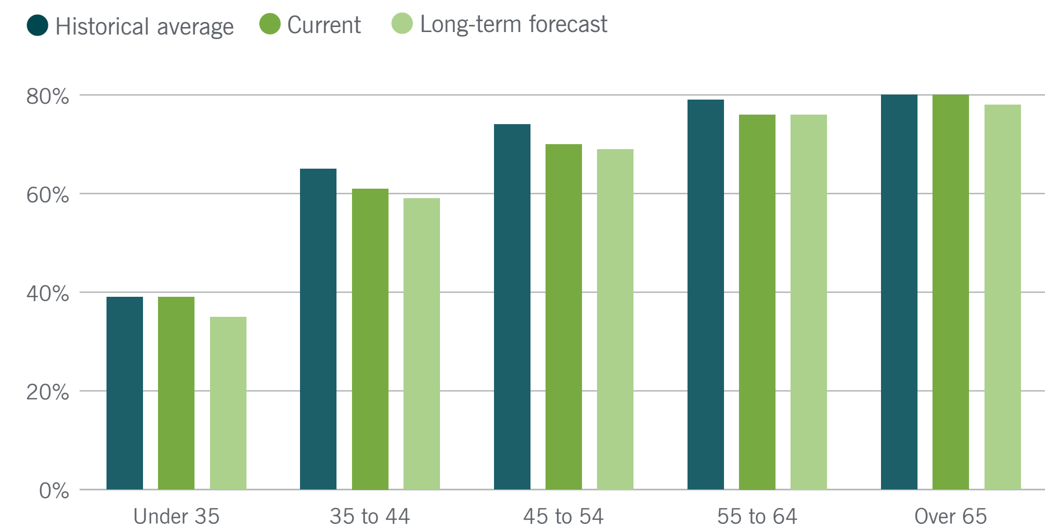
Meanwhile, younger millennials in their 20s will generate demand for rental apartments for at least another 7 to 10 years. This group is focused on cities offering tech hubs, high quality jobs and a lower cost of living, such as Charlotte, Austin, Minneapolis and Orlando.

Why this propensity to rent? Key factors include declining home affordability, record student loan debt, stricter lending requirements and delays in starting families.

U.S. homes have become increasingly unaffordable, with home prices exceeding 2006-peak levels. This pricing pressure is compounded by the spike in home prices in early 2021 due to a shortage of inventory amid rising demand.

MILLENNIALS ARE RESHAPING THE HOUSING MARKETS

Homeownership rates by age



Data source: U.S. Census Bureau, StratoDem Analytics (forecasted). The historical average spans 30 years and the long-term forecast extends through 2028.

FOCUS ON MIDDLE INCOME

Middle income households of all ages represent a long-term source of demand for apartments. Rental rates are significantly higher in more expensive metro areas like New York or San Francisco, but middle income groups also rent at rates outpacing the national average in more affordable metro areas like Dallas and Atlanta.

Across the country, cost-conscious renters typically avoid the more recently built higher-end rental units, increasing demand for value-oriented class-A and well-located class-B apartment communities. We believe exciting and emerging neighborhoods in select metro areas could prove particularly attractive to younger millennials for at least the next 10 years. Affordability is a key differentiator among the markets we have identified.

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RENTING THE FAMILY HOME

Both millennials and middle income households are also boosting a whole new housing subsector: the single family rental home. These rentals represent only 18% of total occupied U.S. single-family housing stock today, but we expect that percentage to grow.

In a post-COVID environment, many city dwellers have fled for the suburbs and Sun Belt cities. While it is unclear if this trend is secular or cyclical, single-family rentals represent an affordable option for millennial households seeking a permanent lifestyle change who cannot yet afford to own a home.

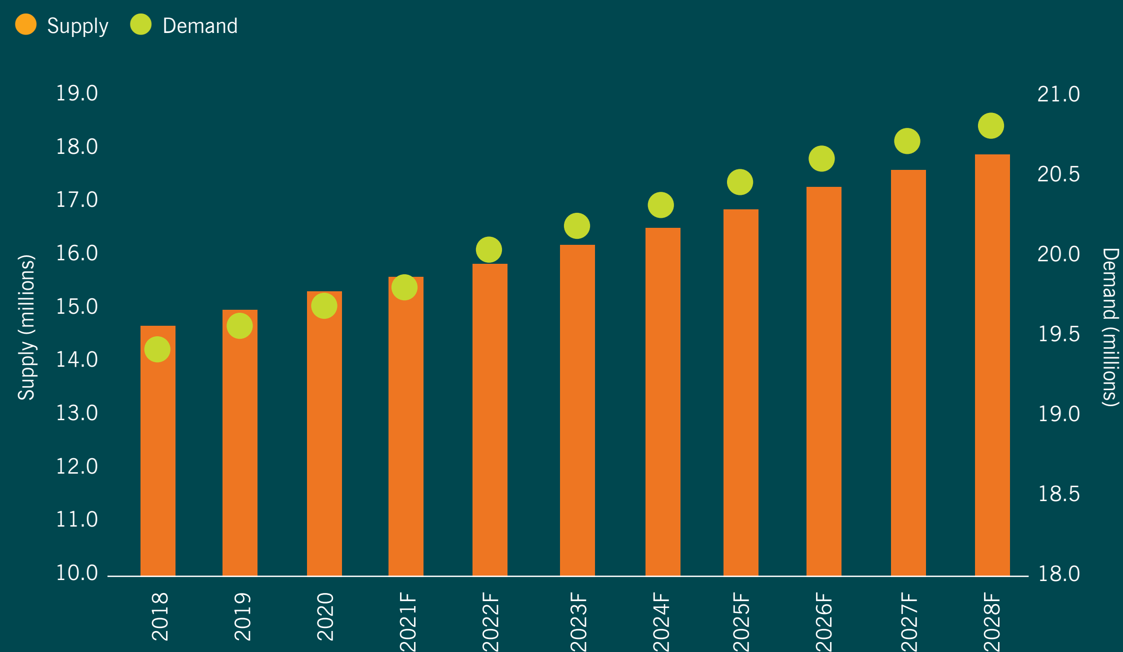
Further, the permanent adoption of flexible remote work policies could serve as a tailwind for single-family rentals. Home ownership rates have risen to 68%, near the 2008 level but below the 2006 peak. While rising homeownership rates could be seen as a headwind to the single family rental sector, home ownership removes inventory from the single-family rental market, which benefits the sector.

Ownership of these properties is also evolving. Today, the single-family rental market is 98% dominated by noninstitutional owners.[1] However, REITs and other investors have recently entered this market, increasing the institutionalization of this space.

Millennials in their 20s will generate demand for rental apartments for at least another 7 to 10 years.

DEMAND OUTSTRIPS SUPPLY FOR SINGLE-FAMILY RENTALS

Supply and demand

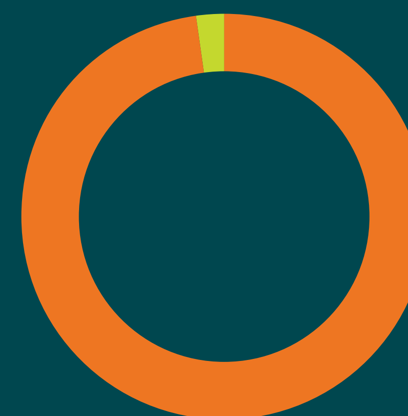


Data source: StratoDem Analytics, Nuveen Real Estate. Demand represents household count for ages 30 to 49 with renter status. F indicates forecasted.

CHANGING OWNERSHIP

Noninstitutional owners have dominated the single-family rental market. However, REITs and other investors have recently entered this market, increasing the institutionalization of this space.

Noninstitutional owners | Institutional owners



Data source: John Burns, September 2021.

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Resurgence in the suburbs

The suburban population has been quietly growing, primarily driven by older millennials seeking additional space for their young families. Last year, 53% of homes purchased by those in their 30s were located in the suburbs, with a life change being the main reason for their move.[2] The COVID-19 pandemic has supercharged this trend, as the work-from-home lifestyle means employees are less tied to cities.

In the Nashville metropolitan area, for example, the suburban net migration rate was two times that of the urban area in 2015. The suburbs more than doubled this relative outperformance in 2020, growing four times as fast as the urban area.[3] The majority of those migrating to Nashville came from Atlanta, Chicago, New York and Los Angeles.[4]

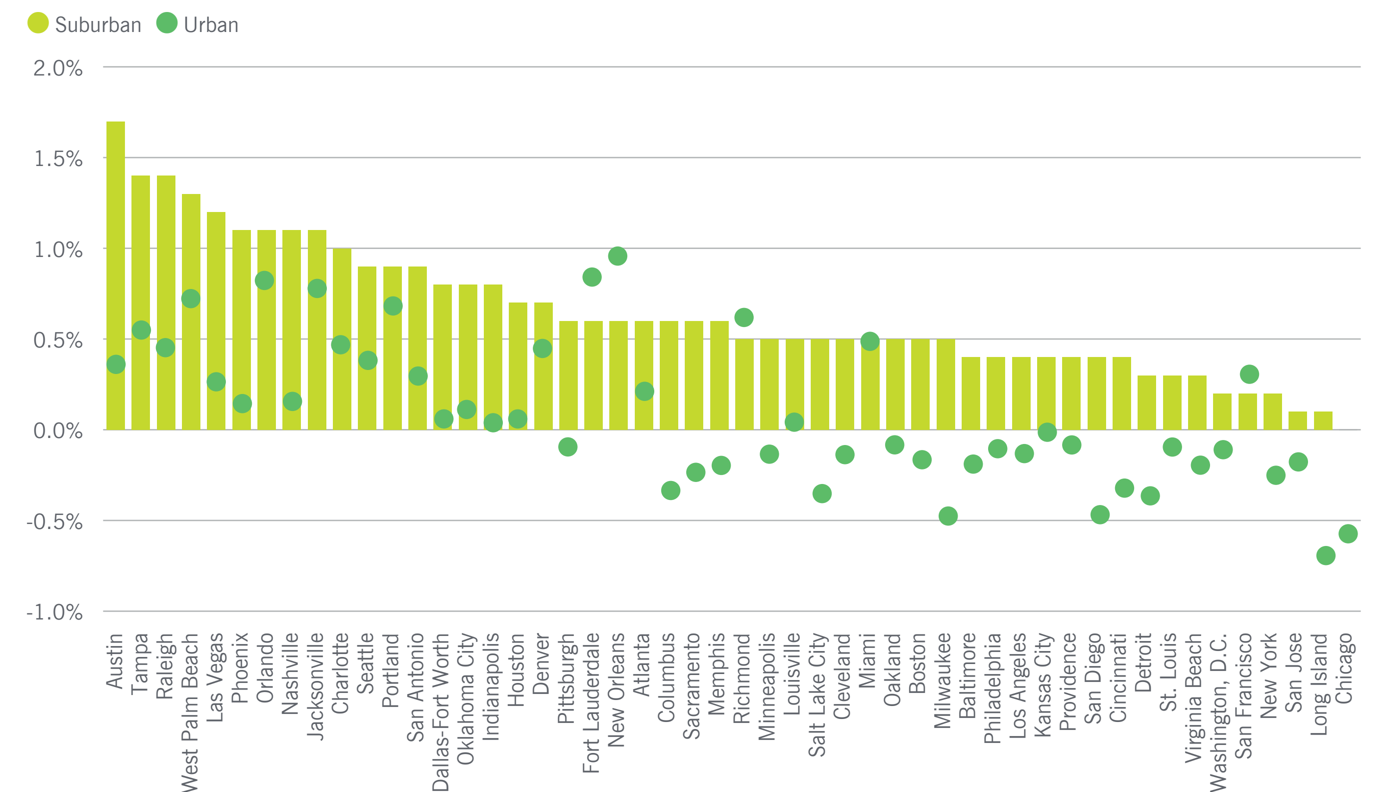
This migration trend goes beyond the nation's fastest growing cities. In the Boston metropolitan area, the relative growth of the suburbs increased from one times that of the urban area in 2015 to two times last year. In fact, most metropolitan areas saw stronger net migration rates in the suburbs than in urban areas last year. We expect this trend to continue as millennials form households and employers embrace a more flexible approach to work.

This population shift has created a number of opportunities in the suburbs for real estate investors, especially in alternative housing and specialized retail, like grocery-anchored shopping centers.

Ironically, opportunities are also developing in the major metro areas. As prices soften on class-A luxury apartments, valuations on those properties become more attractive. The potential dislocation in the luxury apartment market in high-demand cities like Los Angeles, New York, San Jose and San Francisco represents a cyclical, albeit short-lived, prospect for investors.

MIGRATION FAVORS THE SUBURBS

Net migration rates across the top 50 metro areas



Data source: StratoDem Analytics, 2021. Urban/suburban classifications are census tract level definitions as classified by HUD's 2017 *American Housing Survey Neighborhood Description Study.*

Tax benefits and implications for REIT investors

183 Clarence Street

Sydney, Australia

Real Estate Investment Trusts (REITs) have become an interesting option for income investors due to their income payouts and capital appreciation potential. Distributions from REITs can provide income flow, but the income is considered taxable in the eyes of the IRS. When the reduced tax rates are combined with an ROC tax shelter, the effective federal tax rate for REITs may be reduced considerably.

What is a Real Estate Investment Trust?

A REIT is an investment company that purchases and owns real estate for the purpose of generating current income. REITs invest in a wide scope of real estate property, such as corporate offices, warehouses, shopping malls and apartment complexes.

Generally, REITs provide income to shareholders in the form of dividends. Legally, the entity must pay out at least 90% of its taxable income as dividends. Since those dividends are actually the taxable portion of the income generated by the REIT-owned properties, the company is able to pass its tax burden to shareholders rather than pay federal taxes itself.

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Cube

Berlin, Germany

An overview of taxation at the individual level

The income tax liability faced by REIT shareholders can be complicated. Each distribution, or dividend payout, received by investors in taxable accounts is comprised of a combination of funds acquired by the REIT from a range of sources and categories, each with its own tax consequences.

Often, the bulk of REIT dividend payouts consists of the company's operating profit. As a proportional owner of the REIT company, this profit is passed through to the shareholder as ordinary income and will be taxed at the investor's marginal income tax rate as nonqualified dividends.

However, sometimes REIT dividends will include a portion of operating profit that was previously sheltered from tax due to depreciation of real estate assets. This portion of the payout is considered a nontaxable return of capital, sometimes referred to as the ROC. While it reduces the tax liability of the dividend, it also reduces the investor's per-share cost basis. A reduction in cost basis will not impact on the tax liability of current income generated by REIT dividends, but it will increase taxes due when the REIT shares are eventually sold. For individuals with a higher taxable income in the near term, this provision may present income planning opportunities, including the ability to smooth income over multiple years.

Another portion of REIT dividends may consist of capital gains. This occurs when the company sells one of its real estate assets and realizes a profit. Whether the capital gains are deemed short-term or long-term depends on the length of time the REIT company owned that particular asset before it was sold. If the asset was held for less than one year, the shareholder's short-term capital gains liability is the same as their marginal tax rate. If the REIT held the property for more than one year, long-term capital gains rates apply; investors in the 10% or 15% tax brackets pay no long-term capital gains taxes, while those in all but the highest income bracket will pay 15%. Shareholders who fall into the highest income tax bracket, currently 37%, will pay 20% for long-term capital gains.

HYPOTHETICAL REIT PORTFOLIO

Assumes $100,000 investment; 5% annualized pre-tax yield ($5,000 annualized distribution)

Return of capital scenarios	0%	60%	90%
Distributions	$5,000	$5,000	$5,000
Return of capital $	—	-$3,000	-$4,500
Taxable basis	$5,000	$2,000	$500
Tax rate with 20% deduction (highest bracket)	29.6%	29.6%	29.6%
Tax payable	-$1,480	-$592	-$148
After-tax distributions	**$3,520**	**$4,408**	**$4,852**
After-tax yield	**3.5%**	**4.4%**	**4.9%**
Effective federal tax rate	**29.6%**	**11.8%**	**3.0%**

Return of capital reduces the stockholder's tax basis in the year the dividend is received and generally defers taxes on that portion until the capital asset is sold. Certain non-cash deductions, such as depreciation and amortization, lower the taxable income for REIT distributions.

The 60% ROC scenario reflects the following: straight-line depreciation can account for approximately 50% of a REIT's distributions; assuming a 5% distribution and a 40-year depreciable life, depreciation would amount to 2.5% annually; including additional non-cash deductions, we estimate that 60% of distributions would be considered ROC. The illustrative example does not reflect the impact of increasing net operating income (NOI); an increasing NOI from higher rents would reduce the amount of ROC. While NOI for commercial real estate has historically increased, past performance does not guarantee future results. The illustrative example does not include state taxes. Investors could be subject to state income tax in their state of residence, which would lower the after-tax yield received by the investor. Distributions from Nuveen Global Cities REIT are not guaranteed and may be sourced from non-income items including, without limitation, the sale of assets, borrowings, return of capital or offering proceeds, and we have no limits on the amounts we may pay from such sources. After-tax distribution reflects the current tax year and does not consider other taxes that may be owed on an investment in Nuveen Global Cities REIT when the investor redeems their shares. Upon redemption, the investor may be subject to higher capital gains taxes as a result of a depreciating cost basis due to the return of capital portion of distributions.

Tax benefits of REITs

Current federal tax provisions allow for a 20% deduction on pass-through income through the end of 2025. Individual REIT shareholders can deduct 20% of the taxable REIT dividend income they receive (but not for dividends that qualify for the capital gains rates). There is no cap on the deduction, no wage restriction and itemized deductions are not required to receive this benefit. This provision (qualified business income) effectively lowers the federal tax rate on ordinary REIT dividends from 37% to 29.6% for a taxpayer in the highest bracket.

A word on current tax reform

The Biden administration outlined roughly $1.5 trillion in individual tax increases on April 28 to help offset the costs of a large family and economic infrastructure initiative. Many of the tax proposals echo tax rate increases for high-income-earning individuals outlined during the campaign.

Congress is currently considering the infrastructure plans and negotiating both structure and language for proposed legislation. This process will occupy much of the final months of 2021, and if enacted will very likely impact the tax rates of high-income individuals.

Closing thoughts

It is important to understand the potential benefits and requirements when exploring the world of REITs. The rules of REIT taxation are unique, and shareholders can face varying tax rates depending on the scenario. As always, you should consult with your own tax, legal and investment advisors, as every individual's situation will differ.

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CityWatch | Vienna

Culture and connectivity

Our innovative research approach captures structural megatrends and tactical real estate fundamentals to identify cities we believe are best positioned for investment. Vienna is one of these cities:

- ***Connected***
  As a key hub in Europe, Vienna's extensive transport system serves as a connection point for people and goods on their way to central, eastern and southeastern Europe.
- ***Growing population***
  One of the fastest-growing European capitals, Vienna boasts a population of 1.8 million. That number is predicted to grow to more than 2 million by 2029.
- ***Robust economy***
  Vienna is a global economic center and the seventh wealthiest city in Europe. Key industries include food and luxury commodities, mechanical engineering and steel construction, chemicals and vehicle manufacturing.
- ***Business opportunities***
  More international companies set up business in Vienna in 2019 than in all of Austria's other federal provinces combined. Vienna is a popular convention city, hosting organizations such as the United Nations and OPEC.
- ***Attractive lifestyle***
  Vienna was named the world's most livable city for the tenth consecutive time in 2019 by the Mercer Quality of Living Index. This historic center is rich in architecture, art and music culture.

Low unemployment (June 2021)
6.4%

Population growth (2014–2021)
250K

Green space in the city
50%

Source: City of Vienna, Mercer, EIU, Nuveen Real Estate estimates based on Oxford Economics, 2018.

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For more information, please visit nuveen.com.

Endnotes

Sources

1 Invitation Homes filings; Public company home counts from public filings; Private company home counts estimated using HouseCanary data.

2 National Association of Realtors: 2020 NAR Home Buyer and Seller Generational Trends.

3 StratoDem Analytics, August 2021.

4 Placer.AI, September 2021.

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A word on risk

Responsible investing incorporates Environmental Social Governance (ESG) factors that may affect exposure to issuers, sectors, industries, limiting the type and number of investment opportunities available, which could result in excluding investments that perform well. Real estate investments are subject to various risks, including fluctuations in property values, higher expenses or lower income than expected, and potential environmental problems and liability. Please consider all risks carefully prior to investing in any particular strategy. A portfolio's concentration in the real estate sector makes it subject to greater risk and volatility than other portfolios that are more diversified and its value may be substantially affected by economic events in the real estate industry. International investing involves risks, including risks related to foreign currency, limited liquidity particularly where the underlying asset comprises real estate, less government regulation in some jurisdictions, and the possibility of substantial volatility due to adverse political, economic or other developments.

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REAL ESTATE

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