Alternative real estate sectors lure investors for stable returns as traditional sectors come under pressure

Key points

- *Alternative real estate (commonly referred to as Niche or non-traditional sectors) is a $US1.5 trillion sector offshore and is set to benefit from secular tailwinds driven by needs-based demographic changes and technology.*
- *These sectors such as senior and workforce housing, as well as data centres and life sciences, typically provide more attractive, returns and diversification and are less sensitive to macro-economic volatility.*
- *With traditional real estate facing structural and cyclical headwinds, Australian investors could benefit from exposure to property types that are needs-based and underpinned by growing demand over the next few decades.*

Non-traditional real estate offers potentially higher returns than traditional sectors, which are expected to underperform as the coronavirus pandemic and technological shifts combine to impair demand for office and retail.

However, Australian investors remain overweight to traditional core Australian real estate, with relatively limited exposure to an emerging array of property types.

Frontier Advisors Principal Consultant, Jennifer Johnstone-Kaiser, highlighted that niche real estate sectors with strong secular tailwinds related to housing, healthcare, and technology represent a more than $US1.5 trillion offshore opportunity.

"In this environment where we expect returns to be lower for longer, historically defensive sectors are undergoing accelerated disruption. We are encouraging clients to focus on the niche sectors as a complementary allocation. The US clearly is the biggest, deepest market. We're also looking towards Europe which is emerging as an opportunity set."

Frontier prefers private real estate strategies, which offer more stable returns and lower volatility, but Global REITs can also provide an efficient way to complete a real estate portfolio, while also benefitting from enhanced liquidity.

Geoff Regnery, Senior Managing Director at alternative real estate specialist Harrison Street, said private real estate that caters to education, seniors, healthcare and storage, have delivered resilient returns through the GFC and now COVID-19.

"The sectors we target are needs-based, with demand driven by long term demographics, such as the aging population, increasing enrolments, the need for healthcare pharmaceutical innovation and development. That's very different than often what we see in traditional real estate, which is very highly linked to GDP and to job growth, so very cyclical in nature."

Traditional core real estate is expected to deliver total returns of 4-6% over the next 10 years, while non-traditional real estate, which benefits from higher cash yields and higher expected income growth, can deliver total returns of 8-10%, according to Frontier.

AMP Capital Head of Global Listed Real Estate, James Maydew, discussed "manufactured housing" – a type of prefabricated home located in self-contained residential communities – as an attractive niche opportunity.

Focused in sunbelt and coastal locations, more than 22 million Americans live in manufactured housing, which tends to deliver steady, predictable free cashflow across economic cycles.

"The demand drivers have been supportive, historically, and we now expect to see a huge wave of demand as the baby boomers move into retirement," he said.

Another area with strong potential is data centres, which are benefiting from the transition to a digital economy.

Key questions the panellists answered

- *(47.00m) Is it really a case of mispriced risk in these niche real estate sectors that drives a yield premium or are there other risks such as reputational risk behind it?*
- *(49.00m) How does the Australian market compare to the US for manufactured housing and how is it different than senior housing or retirement villages?*
- *(51.00m) Are Australian institutional investors investing in alternative real estate and if not, have they missed the opportunity?*
- *(53.20m) How has COVID-19 impacted valuations in the second quarter?*