

SPRING
2025

REDEFINING THE CORE: THE INSTITUTIONAL PIVOT TOWARD ALTERNATIVES



In our view, alternative property sectors are becoming mainstream and deserve a material allocation from institutional investors.



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Alternative property sectors have become a sizable and growing segment of the commercial real estate (CRE) sector. Alternatives have generally been characterized as property types with more fragmented ownership, greater operational intensity, unconventional lease structures, and less scalability relative to traditional property sectors. Historically, this has translated into a perception of higher risk, which has contributed to the alternative sector’s higher yields relative to those of traditional property types. Despite accounting for less than 10% of institutional investor CRE portfolios, alternatives account for a sizable and expanding share of the CRE investable universe and have been a longtime staple within the listed REIT sector, representing more than half the market cap in the FTSE Nareit All Equity REITs Index.



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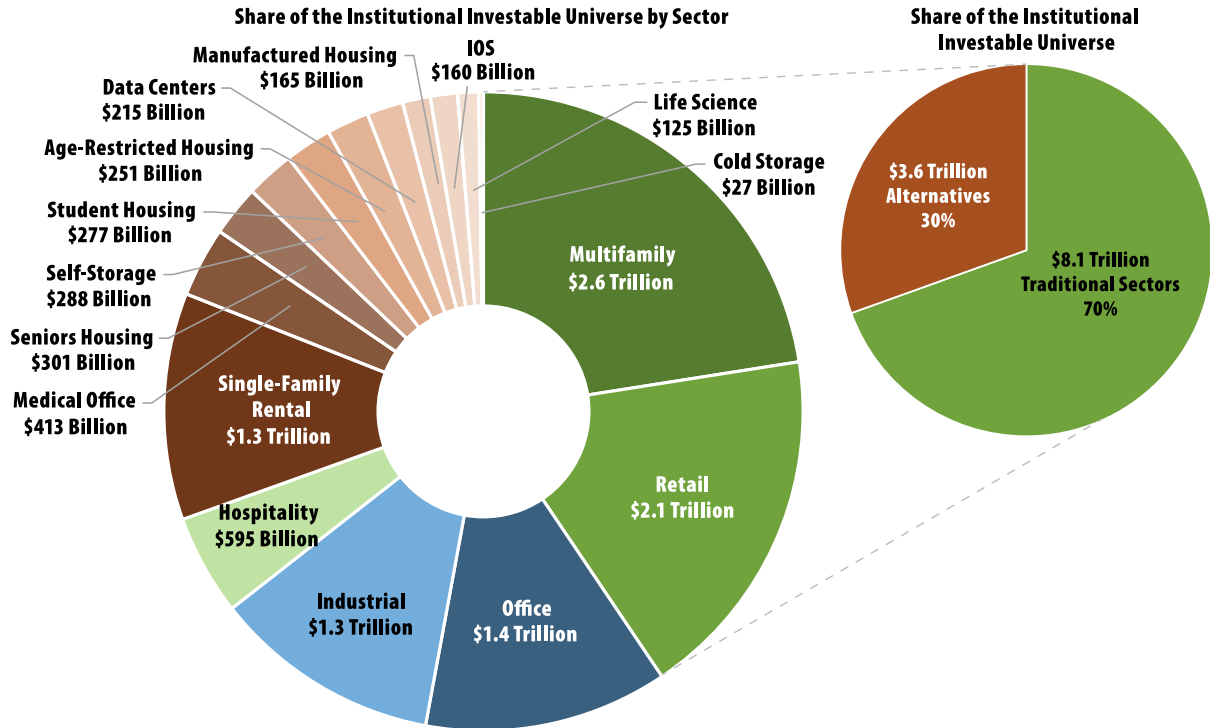
The continued institutionalization and growing investor interest in alternatives stems from both recent underperformance (and, therefore, a pivot away) from several traditional property types and strong demand for many alternative property types (seniors housing, data centers, self-storage, industrial outdoor storage, etc.) because of their outperformance. Select secular trends—namely, demographic shifts, the expansion of e-commerce, the persistence of both low housing availability and affordability, and the permanence of hybrid work (aided by technological innovation)—have benefited many alternative sectors at the expense of segments within office and retail. These broader secular trends in demographics, housing, and innovation are expected to strongly influence CRE demand and performance in the decades ahead, and

allocations to alternative property sectors should allow investors to more directly capitalize on these structural growth trends. Consequently, these characteristics also contribute to alternatives’ low correlation to traditional property sectors, providing added diversification benefits to real estate portfolios.

Given the growing awareness of the benefits of investing in alternatives—the strong relative performance, added diversification, countercyclical demand drivers, opportunities to scale, and continued institutionalization—investment activity into alternative property types is expected to rise as a share of total CRE investment activity going forward. In our view, alternative property sectors deserve a material allocation from institutional investors. This assertion is predicated on

- the growth of alternative property types within the institutional real estate universe
- the structural underpinnings of demand that result in long-term tailwinds and resilience throughout economic cycles
- competitive fundamentals and return performance
- compelling portfolio diversification benefits over a “traditional”-only real estate allocation

Exhibit 1: A Sizable and Scalable Opportunity Set



Source: Clarion Partners Global Research; November 2024

A Growing and Sizable Opportunity to Scale Within Alternatives

Investors have largely limited their investments in commercial real estate to the “big-four” property types: office, industrial, retail, and multifamily, with hotels appearing in some portfolios. However, recent analysis by Clarion Partners and Rosen Consulting Group suggests that alternative property sectors accounted for approximately 30% of the \$11.7 trillion institutional CRE universe as of the first half of 2024 (Exhibit 1). The alternative subsegment of the institutional universe includes single-family rentals, student housing, age-restricted housing, manufactured housing, self-storage, life science, medical office, seniors housing, data centers, industrial outdoor storage (IOS), and cold storage.

Institutional investor allocations to alternative property types have risen only slowly in recent cycles, although the pace has accelerated recently. Historical barriers to entry for institutional investors into alternative property sectors, including concerns

regarding the ability to scale, the dearth of “institutional-quality” assets, and limited transparency into historical operations and performance, remain a challenge in select sectors but have seen marked improvement in recent years. As a share of the NCREIF Fund Index—Open-End Diversified Core Equity (ODCE) universe, alternative property types accounted for 8.8% of the \$278 billion gross asset value as of 4Q2024. This is up from less than 3% a decade prior. Recent updates to the treatment of alternative property types in ODCE-qualified funds should allow fund managers to allocate a greater percentage of their portfolios to sectors outside the traditional big-four property sectors. This evolution in the ODCE is in line with increasing diversification within core real estate portfolios and should further bolster institutional investment in alternative property sectors going forward.

Alternatives have also accounted for a growing share of total CRE transaction volume in the US, with the alternatives’ share of total CRE deal flow surpassing 20% in

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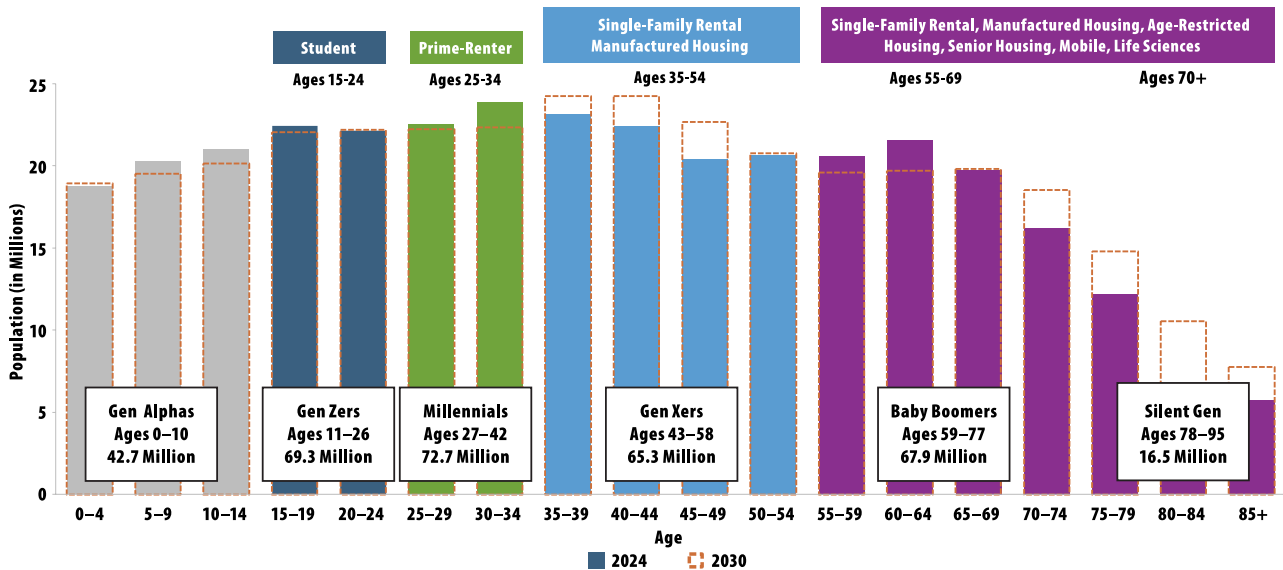
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1
FOCUS

39
YEARS

\$41B
ACQUIRED

Exhibit 2: Aging Baby Boomers and Maturing Millennials—US Population by Age Cohort



Sources: US Census Bureau, Moody’s Analytics, Clarion Partners Global Research; as of December 2024

recent quarters and maintaining an upward trend over the prior decade, according to MSCI / Real Capital Analytics. Annual transaction volume for alternative property sectors has averaged \$72 billion annually since 2015.

Structural Demand Drivers Have Contributed to Reduced Volatility

Alternative property types have generated relatively stable net operating income growth and lower total return volatility across economic cycles, driven in large part by countercyclical demand drivers and ties to longer-term structural trends. The lower volatility of alternatives has been substantially important in reducing overall portfolio beta.

Total returns for alternatives in aggregate have demonstrated less sensitivity to changes in GDP, mitigating historical volatility relative to the broader commercial real estate market. In response to a 1% change in GDP growth, total returns for alternatives have historically increased or decreased 1.6% versus 2.1% for traditional property sectors.¹ This lower sensitivity to GDP growth is likely a function of the alternative sector’s need-based, countercyclical demand drivers and connection to secular trends.

Structural Tailwinds Propel Alternative Sector Performance

The positive outlook for alternative property sectors is bolstered by compelling structural tailwinds—the shifts in demographic age cohorts, the chronic housing shortage, and maturation of new technologies and industries. In addition to broader cyclical trends, these longer-term, secular trends should heavily influence CRE demand fundamentals and be particularly impactful on demand for alternative property sectors.

Demographics: Shifts in the size of age cohorts influence consumer behavior, mobility, and household movement, and the US is undergoing significant changes to its population profile. With the oldest baby boomers entering their 80s in 2026² (Exhibit 2), this massive age cohort is expected to generate elevated demand for seniors housing into the coming decade. This will also aid in driving health-care spending growth, which, in turn, will bolster demand for medical office space and investment in drug discovery and therapeutics,

1. US Bureau of Economic Analysis, Moody’s Analytics, NCREIF, Clarion Partners Global Research; as of 4Q2024. The Expanded NPI includes all NPI properties and all qualified alternative assets.
2. Moody’s Analytics forecast; as of February 2025.

For real estate investors, this prolonged housing imbalance should present opportunities to address a fundamental issue that will likely extend into future real estate cycles.



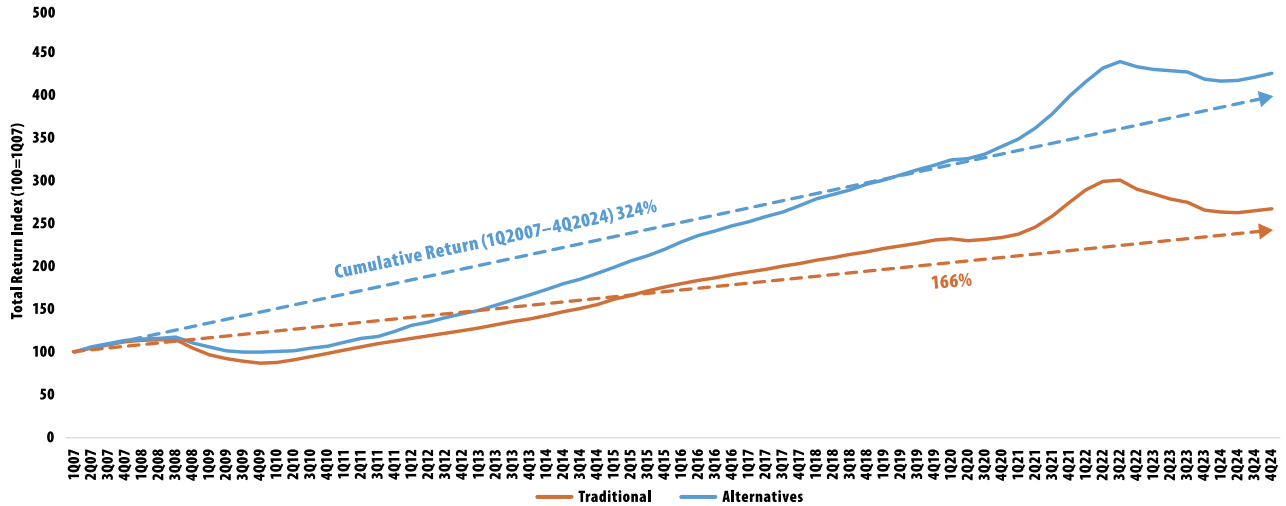
incentivizing investment in life science research. Additionally, millennials are entering their prime earning years, starting families, and generating outside demand for larger homes. Considering the heightened competition for housing of all types and the inaccessibility of the for-sale market, this enlarged rental pool is expected to bolster housing demand across residential subtypes. The college-age population is expected to remain at elevated levels, supporting demand for purpose-built student housing units at major universities.

Housing Shortage: The various demographic shifts outlined above and the different housing demands these shifts generate have not been met with adequate stock. In fact, the lack of housing has created a shortage surpassing three million units³ that, ultimately, should lead to long-term structural tailwinds. These tailwinds support demand across the residential spectrum, from manufactured housing and build-to-rent homes to student housing, and influence housing decision-making across all age cohorts. With no immediate solution in sight, this structural housing deficit is anticipated to remain through the coming decade, creating opportunities for investors to capitalize on a prolonged period of solid demand and pricing as a result of the sustained supply-demand imbalance. For real estate investors, this prolonged housing imbalance should present opportunities to address a fundamental issue that will likely extend into future real estate cycles.

Innovation Industries: The US has continued to shift toward a knowledge-based economy since the 1980s. Its economy increasingly relies on, and is driven by, innovation-driven industries that span life sciences to high-tech manufacturing, generating a variety of real estate needs from complex laboratories to advanced manufacturing and distribution space.

3. US Census Bureau, Moody's Analytics, Clarion Partners Global Research; as of April 2025.

Exhibit 3: Alternatives Have Outperformed Across Recent Economic Cycles



Sources: NCREIF Property Index Expanded, Clarion Partners Global Research; as of 4Q2024

With artificial intelligence (AI) still in its infancy, the continued maturation of AI and commercialization of this technology will result in the emergence of new companies and industries, generating demand across a diverse range of alternative property types, including life science space, data centers, and logistics infrastructure. Importantly, the knowledge economy in the US is widespread geographically and offers a far deeper and more diverse set of investment opportunities than even two decades ago.

Alternative Property Sectors Have Produced Attractive Returns Across Economic Cycles

Alternative properties have performed well historically, both on an absolute and a risk-adjusted basis. Since 2007, total returns for the alternative property sector grouping have greatly outpaced those of the traditional sector grouping, with alternatives generating a cumulative total return that is nearly double that of the traditional sectors. This outperformance has been driven in large part by both strong market fundamentals and cap rate compression (Exhibit 3). Additionally, the alternative sector’s countercyclical demand drivers and lower sensitivity to the shifts in the economic cycle are evident in its performance during and following economic downturns. During the

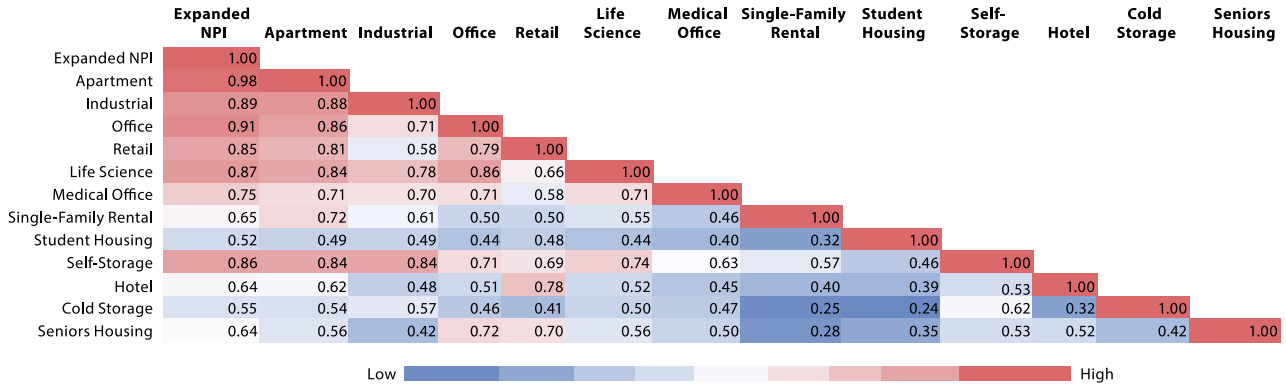
two most recent recessions, alternatives outperformed traditional property sectors. During the global financial crisis, alternatives generated a cumulative total return of -7.8% versus -15.3% for traditional sectors, and during the COVID recession, alternatives again outperformed, 4.3% versus 1.2%, respectively.⁴ Alternatives also outperformed traditional property types in the immediate aftermath of the past two recessions. During the five-year period following the financial crisis, alternative properties generated an average annualized return of 12.1% compared with 9.8% for traditional properties, according to NCREIF. More recently, during the 18 quarters following the post-pandemic recession, alternatives again outperformed, generating a 6.1% return compared with 3.4% by traditional property sectors.

Low Correlation to Traditional Property Sectors and Reduced Volatility Improve Risk-Adjusted Portfolio Returns

Considering the alternative sector’s comparatively strong historical returns and low volatility, the addition of alternative property types to a traditional real estate

4. Expanded NCREIF Property Index, Clarion Partners Global Research; as of 4Q2024.

Exhibit 4: Low Correlation to Traditional Property Types, 1Q2007–4Q2024



Sources: Expanded NCREIF Property Index, Clarion Partners Global Research; as of 4Q2024

Exhibit 5: Addition of Alternatives to a Traditional Property Portfolio Enhanced Risk-Adjusted Returns

2007–2024	100% Alternatives	100% Traditional	60% Traditional/ 40% Alternatives	50% Traditional/ 50% Alternatives	40% Traditional/ 60% Alternatives
Annualized Total Return	8.9%	6.2%	7.3%	7.5%	7.8%
Standard Deviation	7.9%	9.2%	8.4%	8.3%	8.2%
Sharpe Ratio	0.78	0.38	0.54	0.58	0.62

Sources: Moody’s Analytics, NCREIF Property Index Expanded, Clarion Partners Global Research; as of 4Q2024

portfolio should enhance risk-adjusted performance. Additionally, total returns for alternative property sectors have historically had a low correlation with the performance of traditional property sectors (Exhibit 4), demonstrating the diversification benefits of this sector cohort as well. This low correlation to traditional property sectors reflects the operationally intensive nature of many alternative property types and highlights the importance of asset, market, and partner selection.

There is a growing and sizable opportunity to invest and scale within the alternative property space. Alternatives’ share of the institutional universe should continue to grow as investors increase exposure to alternative property types to capitalize on the sector’s healthy historical returns, lower volatility, and proven resilience through economic cycles. The addition of alternative property types to a traditional commercial real estate portfolio has and should continue to improve risk-adjusted returns, reduce portfolio volatility, and

bolster returns (Exhibit 5). As such, we expect that an allocation to alternative property types should continue to evolve into a central element within a core, commercial real estate investment strategy. ■

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