
HINES THESIS

# Non-Traditional U.S. Sectors

February 2024

*Fenton Student Housing | Cary, NC*

Hines


*Levit Green Lab and Medical Office | Houston, TX*

# Introduction

In the U.S., real estate sectors such as Data Centers, Build-to-Rent (BTR), Student Housing, Medical Office, Self-Storage, and Life Science have been attracting increased interest and a larger share of commercial real estate transaction volume. As such, we believe there may be significant opportunities here going forward. Typically, these sectors have been the focus of real estate investment trusts, but in recent years some other sectors (such as Life Science and Self-Storage) have become a meaningful part of most core (NFI-ODCE) and core-plus portfolio allocations and continue to grow in exposure and liquidity. The following analysis represents the views of Hines Research on the demand drivers and investment outlook for these other sectors expected to generate attractive investment opportunities going forward.

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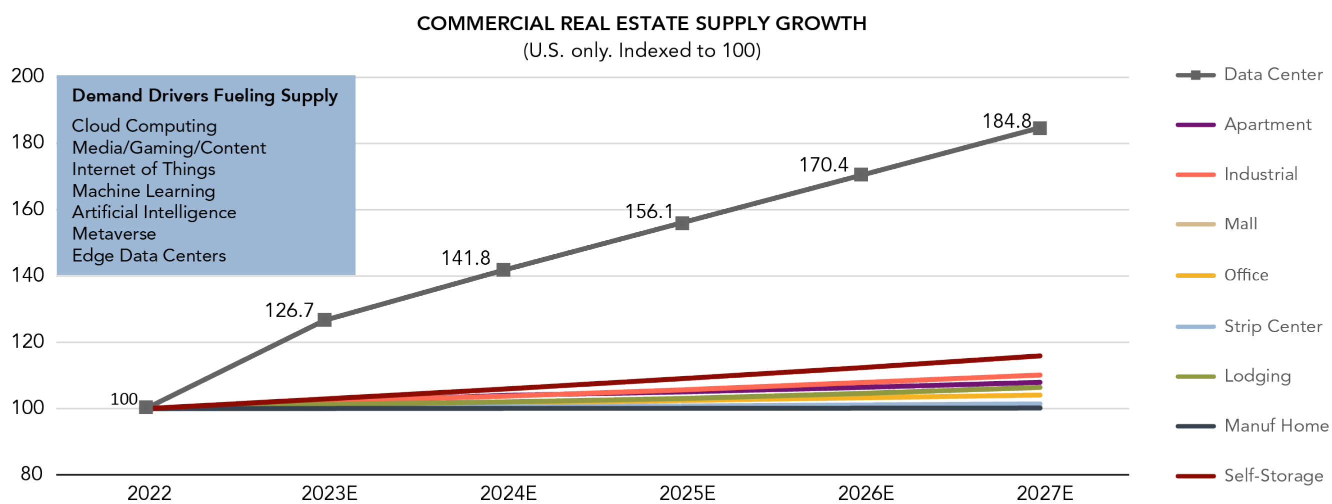
# Data Centers

The COVID-19 pandemic highlighted the importance of digital infrastructure across the globe. The demand for data storage and processing has been increasing rapidly with various drivers fueling growth. Per the graph below, Green Street estimates[1] that the data center sector will grow noticeably faster than other property types over the next five years.

There are several types of data centers, including:

- Powered shell data centers where the landlord owns the real estate (shell) and the tenant is responsible for building and maintaining the data center infrastructure (lease typically >5 years).
- Colocation data centers where multiple small-scale tenants can rent space to house servers and networking equipment (lease typically <5 years).
- Managed services data centers operated by third-party providers offering services such as server management and maintenance (lease typically >5 years).
- Enterprise data centers owned and operated by individual companies for their own use.
- Hyperscale data centers designed to support the infrastructure of large technology companies, such as Google or Meta (lease typically >5 years).

## New supply has not kept up with increased demand[1]




[1] Green Street Data Center Update as of August 25, 2023

Primary markets such as Northern Virginia have had difficulty adding power capacity, resulting in increased spillover to secondary and tertiary markets. This has also resulted in increased liquidity and a rebound in average rental rates[2] (14.5% year-over-year as of YE 2022). Northern Virginia is among the largest U.S. data center markets due in part to its proximity to major internet hubs, abundant power supply, and cool climate. Other primary markets are also attractive for a variety of reasons. For example, Phoenix and Dallas have a low cost of living and a skilled workforce, Silicon Valley is mission-critical to many tech companies, and the Portland market has low power costs (abundant hydro-generation) and is home to many undersea cable terminals.

The sector has historically featured stable cash flows, long-term growth potential and has been relatively recession-proof as data centers have become essential to virtually all businesses.

## Hines Focus:

Hines is focusing on top regional markets with ample access to power generation. Secondary markets with good power availability will also be investigated. These markets could provide good risk adjusted returns.

[2] CBRE Research, CBRE Data Center Solutions, YE 2022. Hines confirms that, to the best of its knowledge, more updated information is not available and the above remains materially accurate.

# Single-Family Rental (SFR)

Single-Family Rental fundamentals are expected to remain strong over the next decade, with revenue and NOI growth outpacing most commercial property types.

Demand for these properties is being driven by factors such as:[3]

- A growing and aging 35–44-year-old cohort (who more likely want the increased space and privacy)
- Increased adoption of work-from-home
- Surge in cost of homeownership (favoring renting)
- A shortage of U.S. housing combined with historically poor affordability for buyers

With strong demand predicted, new supply is likely to remain restrained due to higher interest rates and higher expenses (driven by inflation), limiting NOI growth in the near term. However, institutional presence has continued to grow, resulting in increased consolidation that appears to be building scale and boosting efficiencies. These factors combine for a positive long-term outlook.

Demographics also favor SFR. Over the next ten years (beginning in Q3 2022), the U.S. is expected to add more than 15 million net new households as individuals born in the 1980s and 1990s enter their family-forming years.[4] While this projection was made in 2022 and could certainly change, Hines Research believes this takeaway is key - supply is unlikely to catch up with the increased demand from household growth anytime soon.

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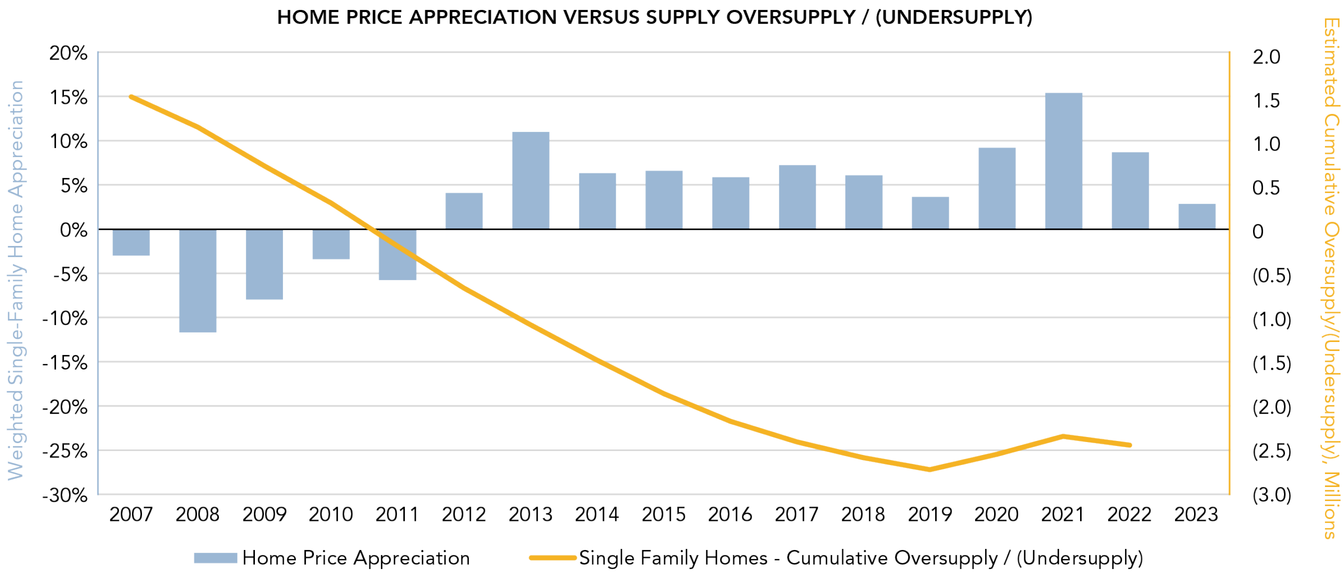
[3] Green Street. U.S. Single-Family Rental Outlook January 2023

[4] John Burns Consulting, Freddie Mac, July 2022 – Hines confirms that, to the best of its knowledge, more updated information is not available and the above remains materially accurate.

## Housing supply has not kept up with demand while prices continue to increase




Source: Zillow (home appreciation), Census Bureau/American Housing Survey & RealPage (cumulative housing oversupply/undersupply), Hines Research. As of December 31, 2023, though the cumulative housing surplus/deficit is annual and depends on a source that has not been produced for the calendar year 2023 yet. The home price appreciation is weighted by the total single-family housing stock for 54 major metros in the US. The cumulative housing oversupply/(undersupply is an estimate for the same sample. Note that oversupply is deemed a surplus of homes, whereas undersupply is a deficit.

Home price appreciation has also outpaced wage growth for over 20 years.[5] This is not surprising, given the chronic undersupply of SFRs which has persisted since 2013 and in our view, is unlikely to correct anytime soon due to (for example) higher interest rates and a shortage of construction workers. In addition to creating an affordability gap, this dynamic has also raised the down payment bar. A typical down payment (5%) for a first-time buyer has jumped over 135% from YE 2011 ($10,600) to YE 2023 ($25,000),[6] based on the median home price. This increased payment, along with high interest rates and lack of supply has helped create an increasingly large and sticky renter base.

## Hines Focus:

In the Single-Family Rental sector, Hines is focusing primarily on Build-To-Rent (BTR) communities located in markets with a growing population and strong long-term fundamentals. Location, liquidity, and highly rated schools are also key factors. The contiguous nature of BTR is optimal for management and leasing, enabling Hines to leverage its extensive living track record in seeking to add alpha to its investments.

5 Federal Reserve Bank of St. Louis, Median Sales Price of New Houses Sold in the United States, FRED Economic Data as of September 1, 2023

6 Moody's, Zillow, Hines Research as of YE 2023

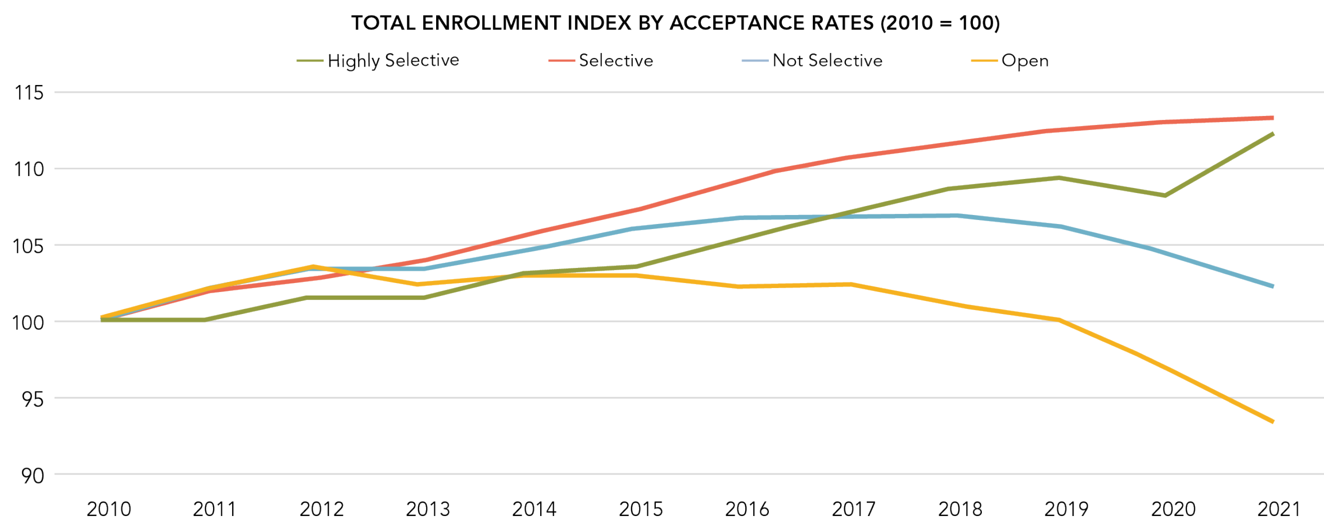
# Student Housing

Historically, Student Housing has offered an attractive yield spread of 50-75 basis points (bps) to traditional multifamily.[7] Several demand factors have increased the attractiveness of student housing, including:

- Student numbers have increased at a subset of universities, despite demographic trends indicating falling overall enrollment
- Countercyclical demand (enrollment is higher in periods of economic softness)
- Consolidation in higher education (expected to continue near term, benefitting the largest schools)

These factors should benefit this sector relative to conventional multifamily. The market for student housing has grown, which may potentially lead to continued capital appreciation. Data show the 50 largest schools are likely to have the strongest enrollment growth in the next five years (3.8% vs. 2.1% at the next largest 150 schools through 2028).[8] In fact, we have found direct evidence below that enrollment growth is focused on schools that are either considered highly-selective or selective.

## Rent growth is stronger in city and suburban campuses - performance is linked to multifamily fundamentals and strong enrollment[9]

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7 PERE, Student Housing Proves Recession-Resilient, June 1, 2022 - Hines confirms that, to the best of its knowledge, more updated information is not available and the above remains materially accurate.
8 Yardi Matrix. Student Housing National Outlook, Spring 2023
9 Yardi Matrix. Student Housing National Outlook, Spring 2023

There was a sharp decline in the U.S. birth rate between 2008 through 2011 and it is expected that – among the many implications of declining birth rates – college enrollments in certain regions of the U.S. will likely face a rapid drop starting in 2025. Not all schools will experience a decline and top-tier schools in the West Coast, Southeast, Texas, and the mountain states are expected to maintain strong demand and enrollment growth.

## Hines Focus:

Hines is focusing on student housing properties in areas with long-term enrollment growth in locations close to (or on) campus at universities that stand out on key factors such as acceptance rate (selectivity), quality, size, and student profile. These include Tier 1 Research Universities[10] and/or institutions within the Power 5 Conferences[11] with a sufficiently large student population (30,000+) and limited exposure to online classes or international students.

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[10] Hines equates the Tier 1 designation to the "R1" classification of the Carnegie Classification of Institutions of Higher Education – defined as "doctorate-granting universities with "very high research activity.""

[11] The Power 5 conferences are the five most prominent U.S. college football conferences and include the Atlantic Coast, Big 10, Big 12, Pac-12, and Southeastern conferences.

# Medical Office

Medical office buildings represent the largest percentage of healthcare real estate transactions.[12] Overall, this sector has been supported by robust secular drivers, including:

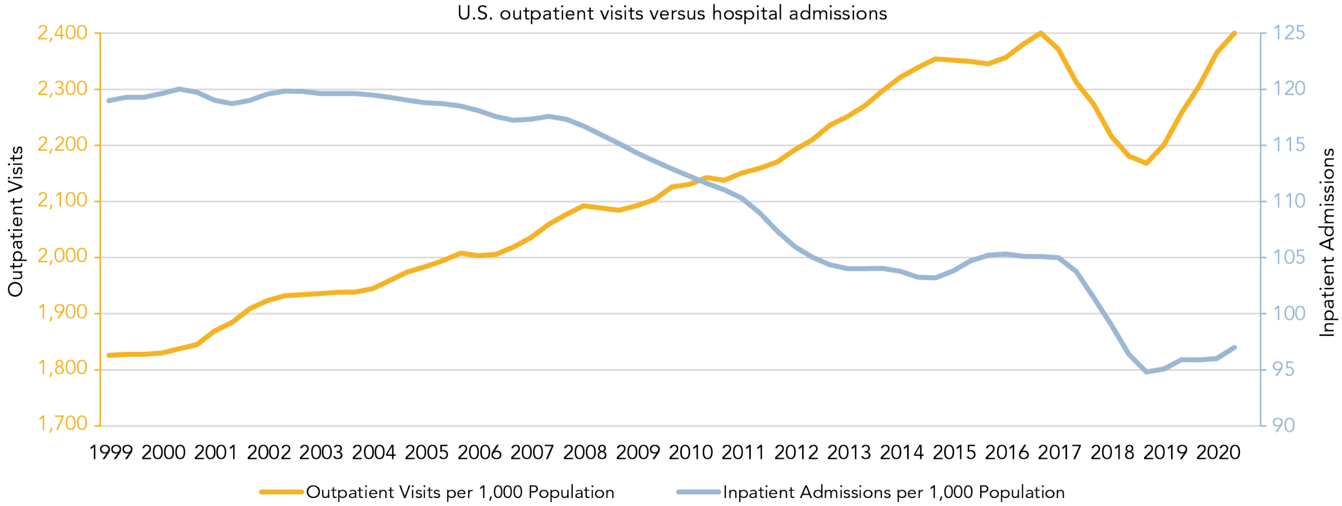
- Growth in the 65+ population
- Deferred demand for continuous care (post-pandemic)
- Advances in technology, changes in reimbursement and demand for convenient and flexible services

These factors have combined to shift more care delivery to outpatient settings, leading to continued strong fundamentals for medical office buildings going forward.

**Outpatient volumes increased significantly from 2016 to 2021 and are expected to grow by 7.3% in 2021-2026, while inpatient volumes are projected to continue declining**[13]

**OUTPATIENT SITES DOMINATE HEALTHCARE SERVICE DELIVERY**

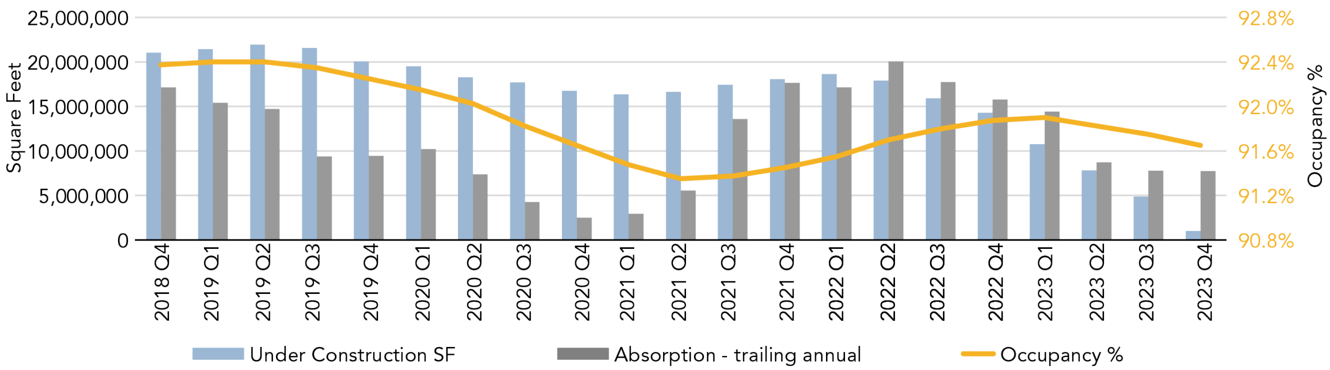
U.S. outpatient visits versus hospital admissions




[12] JLL, Healthcare Investor Survey and Trends Outlook, United States 2023
[13] JLL, Healthcare Advisory Board, June 20, 2023

## Occupancy rates set for recovery as demand stabilizes post-COVID and development drops sharply[14]

MEDICAL OFFICE OCCUPANCY TICKS DOWN AS ACCELERATION DURING COVID NORMALIZES BUT SUPPLY PLUMMETING




Strong growth has pushed up asking rents as well. Since YE 2007 (the earliest data available), medical office rent growth has averaged 1.4% annually across the top 54 national markets.[15] However, over the past decade (since YE 2013), this growth has accelerated, averaging 2.9% per year in these same markets[17]. Metros like Miami, Orlando, Boston, and Tampa have been able to pass through these increased costs to tenants.[16] Data also show medical offices adjacent to hospitals can command a rent premium of 50 to 100 bps.[17]

## Hines Focus:

Hines is focusing on high-quality outpatient and ambulatory surgical center facilities that are near and/or adjacent to good performing affiliated hospitals and boast high-quality tenants.

[14] CoStar, Hines Research as of Q4 2023
[15] CoStar, Hines Research as of YE 2023
[16] Revista as of February 28, 2023
[17] Revista as of February 28, 2023

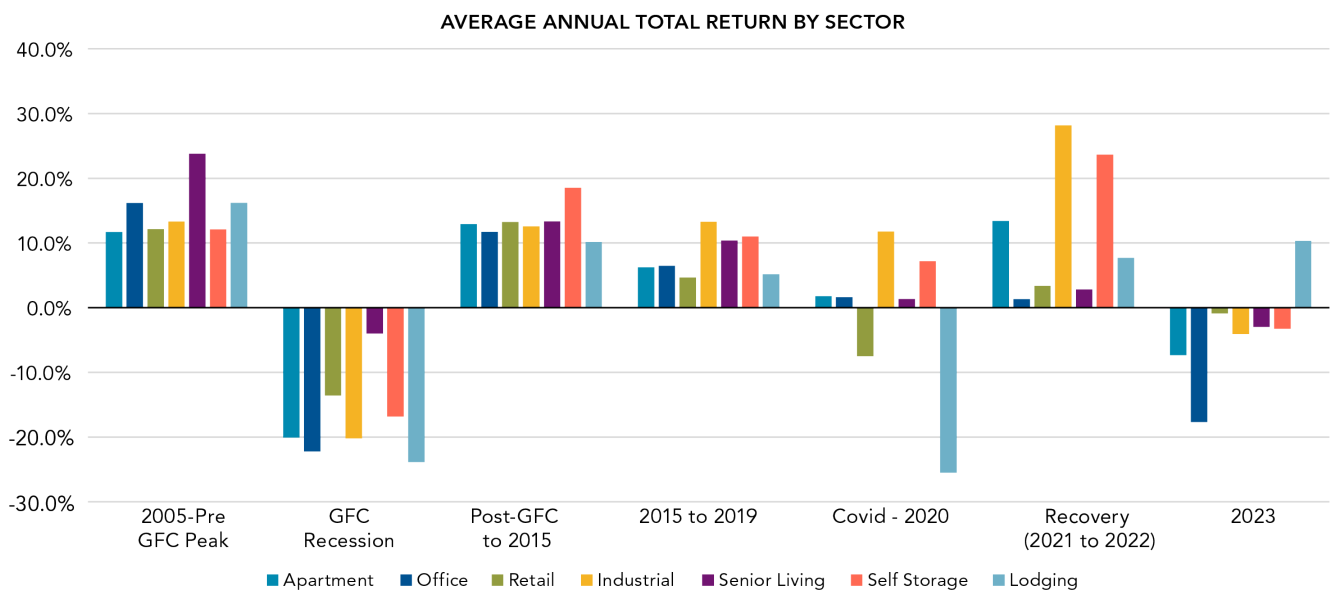
# Self-Storage

Demand for self-storage units saw growth post-COVID (2021-2022), driven by:

- The occurrence of "life events" (including renting, moving, death and disaster).
- Downsizing and decluttering trends.
- The pandemic, which led to people spending more time (and needing more space) at home.

These demand drivers, combined with relatively low operating costs, generally resulted in steady cash flow. Self-storage also performed well relative to other asset classes following the last two recessions (Global Financial Crisis and COVID pandemic).

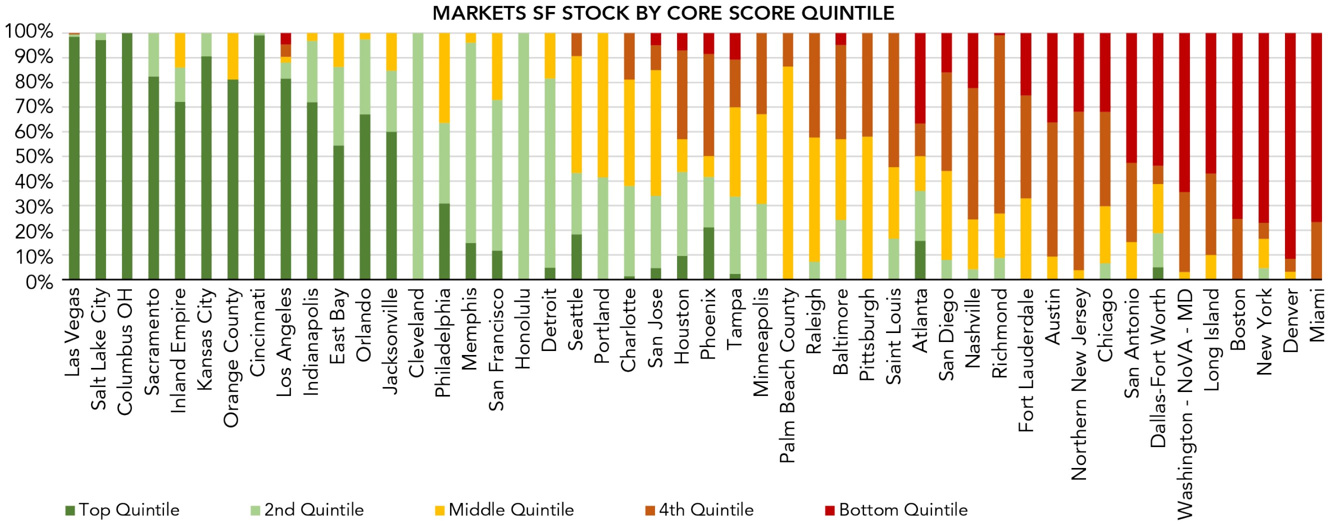
### Self-storage properties in NCREIF have had higher average total returns (2006 to June 30, 2023) than other sectors[18]




While performance has been strong, broad market fundamentals have recently softened, and market selection will be key going forward. Asking rents were down ~15% in 3Q23 and average occupancy down 2.0% YoY;[19] however, street rates are more resilient in the larger metros compared to most other markets.[20]

18 NCREIF as of June 30, 2023
19 Green Street. Self-Storage Sector Update as of Q2 2023
20 Yardi Matrix. National Self Storage Report July 2023.

## National street rates are normalizing after the pandemic-induced peak last summer[21,22]




# Hines Focus:

As noted, self-storage fundamentals softened during the second half of 2023. As such, Hines is focusing on assets in the top two quintiles with emphasis on locations boasting strong demographics within a three-mile radius, and puts particular focus on modern, climate-controlled assets.

21 Yardi Matrix. National Self Storage Report July 2023.

22 The Core score use a set of factors unique to each product type, as well as economic and demographic data to determine how "core" a city is. Higher scoring cities have been indicative of revenue growth over time and have outperformed the ODCE benchmark. For Self-Storage, supply constraints are critical, so the core scores may help investors identify markets where relative supply levels over time are below average, potentially supporting differentiated rent and capital growth over time.

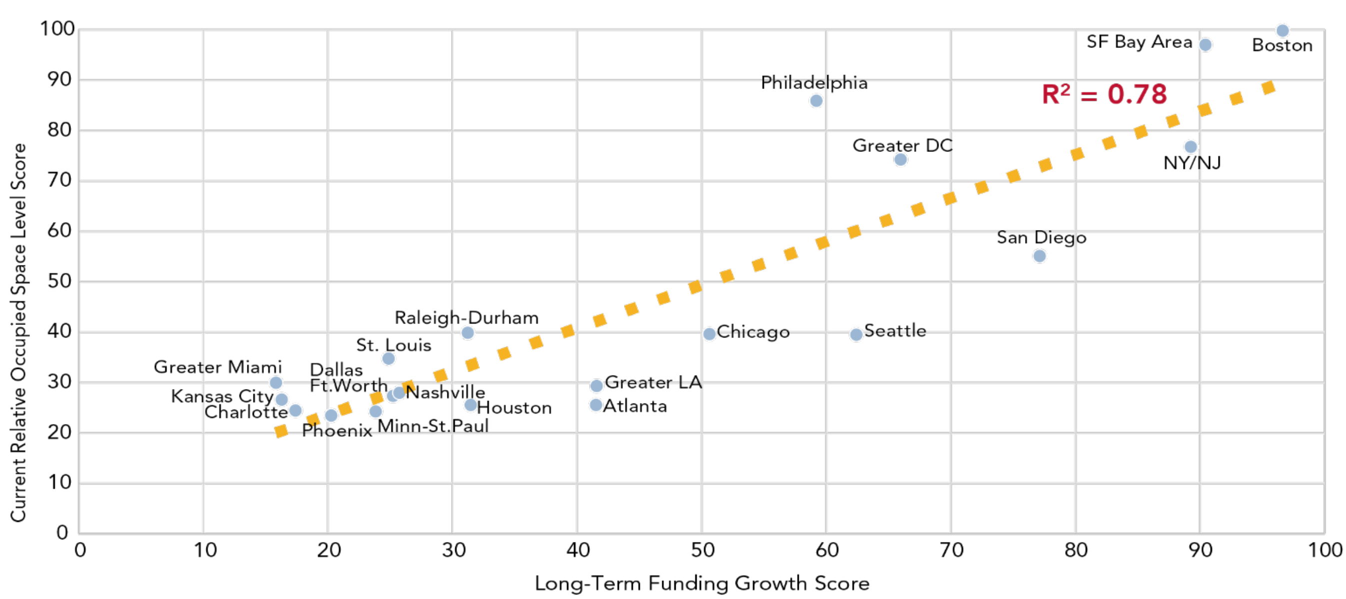
# Life Science

Life science fundamentals are expected to deliver differentiated growth over the next decade or longer, with revenue and net operating income[23] growth outpacing most commercial property types on the back of favorable demographic trends. Demand for research and development facilities, as well as manufacturing and distribution centers for pharmaceuticals and medical devices is being driven by several factors, including:[24]

- The aging population
- The rise of new technologies, such as gene editing and artificial intelligence
- The increasing demand for personalized medicine

A Hines Research model shows a strong link between life science funding levels and occupied life science office/lab space. Hines has found the absolute level of total funding has been a strong determinant of demand. This approach favors established life science markets but can also help identify where funding is showing signs of sustained increases, i.e., underpinning new development in emerging markets.

## U.S. life science demand performance versus long-term funding growth[25]




[23] Net operating income is defined as the total of all income generated from a property, minus all associated expenses.

[24] Straits Research, Healthcare Logistics Market as of YE 2022. Hines confirms that, to the best of its knowledge, more updated information is not available and the above remains materially accurate.

[25] CBRE, Hines Research as of Q22023 – The R2 is defined as the coefficient of determination (ranging as a value between o and 1) that reflects the percentage of the variation of the model. The higher the number, the more correlation, with a value of 1 representing a complete correlation.

After a period of growth in 2020 and 2021, the industry slowed in 2023, although the demand for lab/R&D space remained above pre-pandemic levels. As of Q4 2022, there was 181.7 million square feet of life sciences real estate inventory in the U.S. (up nearly 50% in five years.)[26]

While the long view for this sector is compelling, Hines Research sees the possibility of near-term cyclical weakness, as the domestic industry has been affected by short-term market headwinds and a slowdown in funding. Investors are looking for more validation before committing capital, causing uncertainty (and the postponing of real estate decisions) for younger startups and smaller firms. This contributes to the potential opportunity as valuations are down (per NCREIF[27]), offering better entry points in terms of pricing, which will likely enhance the investment case.

## Hines Focus:

Given the softness in this sector, Hines is focusing on high-quality (facilities and tenants) opportunities in established markets with a strong academic and medical institution presence. Additionally, there may be value in high-conviction subsectors like bio-manufacturing where supply is constrained, institutional investment is sparse, and spreads are higher.

[26] CBRE. 2023 U.S. Life Sciences Outlook as of Q4 2022 - Hines confirms that, to the best of its knowledge, more updated information is not available and the above remains materially accurate.

[27] NCREIF as of June 30, 2023

The NFI ODCE, short for NCREIF Fund Index Open End Diversified Core Equity, is a capitalization weighted, gross of fee, time weighted return index with an inception date of December 31, 1977. Other supplemental data such as equal weight and net of fee returns are also provided by NCREIF for information purposes and additional analysis. To be eligible for NFI ODCE membership, each member fund must be marketed as an open-end fund with a diversified core investment strategy primarily investing in private equity real estate. All members funds must adhere to the following index inclusion criteria: (1) At least 80 of market value of net assets must be invested in real estate 20 cap on cash and equivalents); (2) At least 80 of market value of real estate net assets must be invested in private equity real estate properties 20 cap on real estate assets invested in but not limited to, property debt, publica company equity/debt or private company equity/debt; (3 )At least 95 of real estate net assets must be located in U S markets; (4) At least 80 of market value of real estate net assets must be invested in office, industrial, apartment and retail property types; (5) No more than 65% (+/- for market force)s of market value of real estate net assets in one property type or region as defined by NCREIF Property Index; and (6 )No more than 40% leverage. Each member fund must also comply with the NCREIF PREA Reporting standards. A benchmark index is not professionally managed. Investors cannot invest directly in an index.

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