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Sector Alert

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Leveraging secular growth drivers in Real Estate

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Summary

Given our expectations for rangebound borrowing costs and a muted economic growth recovery in the second half of 2026, we think real estate investment trust (REIT) outperformance should hinge largely on exposure to secular growth drivers. We are making a number of sub-sector guidance changes in an effort to distinguish those sectors where we see significant tailwinds (favorable guidance) or significant headwinds (unfavorable guidance) from those where we anticipate mixed performance or a lack of meaningful near-term fundamental drivers (neutral guidance). We also see several shifts that merit revisiting our guidance, including an uptick in inflation expectations linked to recent geopolitical conflict, which should forestall stronger housing-market activity, and the aging of the baby boomer generation.

Real Estate sub-sector guidance

Favorable sub-sectors	Unfavorable sub-sectors
Data Center REITs, **Health Care REITs,** Industrial REITs	Timberland REITs

Source: Wells Fargo Investment Institute. Sub-sector guidance from Global Securities Research. Current as of May 28, 2026. Guidance changes announced in this report in bold text.

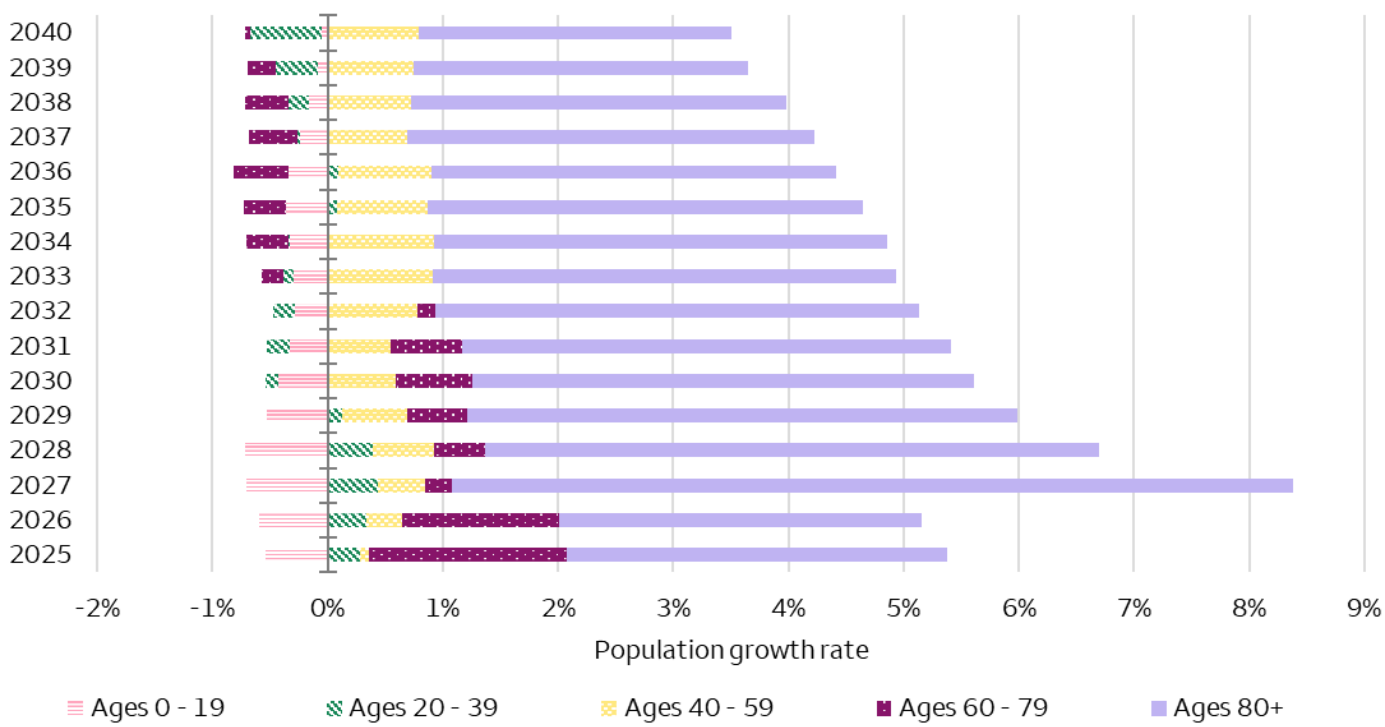
Favorable sub-sectors

Health Care REITs — Upgrading to favorable

We are upgrading the Health Care REITs sub-sector from neutral to favorable with a focus on senior-housing exposure, which has grown to represent a significant portion of the group's composition. While the sub-sector contains 20 companies, it is dominated by the two largest names, which account for nearly 70% of the total on a market-capitalization basis and generate the vast majority of their revenue (over 70% each) from their senior housing operating portfolios.[1] More broadly, senior housing accounts for approximately 50% of all assets within the sub-sector.

Our favorable view of senior housing is driven by an emerging demographic shift as the first baby boomers begin turning 80 this year. Growth of the 80+ population has accelerated and is estimated at a nearly 28% rate between 2025 and 2030, culminating in a supportive supply-demand backdrop. This potential supply shortage is further amplified by the fact that the younger generations are projected to account for a shrinking portion of the total population — while the 80+ cohort is expected to expand by 55% between 2025 and 2035, all other population groups are expected to grow by just under 6%. This divergence is shown in the chart below, with the vast majority of population growth arising from the 80+ group.

The demographic shift underlying expected growth in senior-housing demand



Sources: U.S. Census Bureau and Wells Fargo Investment Institute. Data as of May 21, 2026. Projections represent 2023 projections from the U.S. Census Bureau.

Meanwhile, senior-housing development slowed meaningfully following the pandemic amid an extremely difficult environment marked by staffing shortages, elevated labor costs, and challenges admitting new residents. Subsequently, supply growth averaged less than 1% per year from 2023 through 2025 as elevated construction costs as well as higher interest rates have been incremental headwinds. Though investor interest in the area has grown, development activity at the national level remains sluggish, and the development cycle from planning to completion often spans two or more years. Data tracked by NIC MAP (National Investment Center Market Analysis and Performance) through the first quarter of 2026 indicates downtrends across all phases of development, including new inventory growth, active construction volume, and construction starts. This is occurring even as average stabilized occupancy has increased to roughly 90%; absorption (the net increase in occupied units) has remained strong; and average rents have increased steadily.

1. Based on FactSet data and Health Care sub-sector as defined by the FTSE Nareit All REITs Index, as of May 19, 2026.

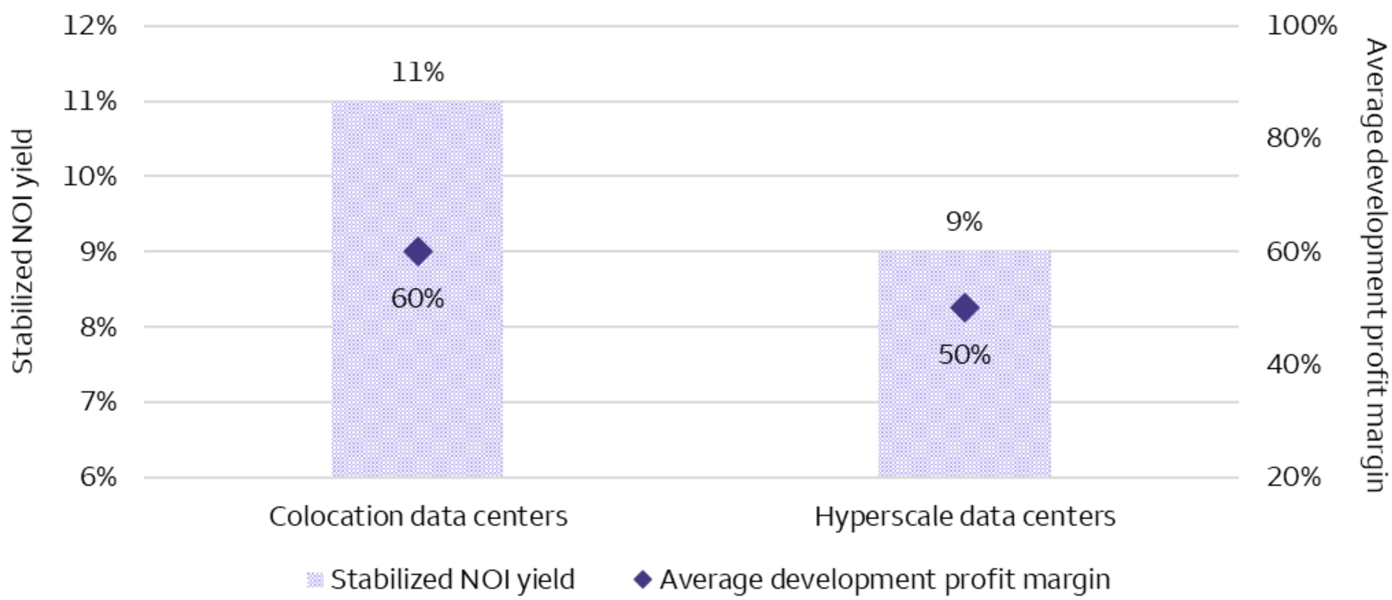
One distinguishing factor of senior housing is its payor mix, which is almost entirely private pay. In contrast, some other areas within health care depend primarily on either the government or private insurance for payment, adding a layer of policy-related uncertainty. Further, senior-housing affordability has improved notably in recent years (as represented by the percent of 75+ households that can cover the cost of senior housing from their income), and nearly half of seniors would be able to afford senior housing without using their savings according to Green Street.[2]

The Health Care REITs sub-sector also includes names focused on skilled-nursing facilities, outpatient medical properties, hospitals, and life-science properties. We have a less positive view of these areas for various reasons. At a high level, we do not see significant tailwinds for any of these areas in the near term. More specifically, skilled-nursing facilities are funded mainly by Medicare and Medicaid, which introduces policy-related risk through reimbursement rates and limits upside by constraining revenue and margin growth. Outpatient-medical properties tend to support relatively stable performance and operate under long-term (7 – 15 year) leases, but they have a limited growth opportunity in our view. Hospitals typically have even longer-term (15 – 20 year) triple-net leases with escalators, though we would note a risk of closure among lower-quality hospitals. Finally, demand for life-science properties tends to fluctuate with biotech funding cycles, and these highly specialized properties carry releasing risk.

Data Center REITs — Maintaining favorable guidance

We are maintaining favorable guidance on the Data Center REITs sub-sector. As artificial-intelligence (AI) investment and implementation have accelerated, the Data Center REITs sub-sector has experienced unprecedented demand. Offerings from these companies vary to include single-tenant and colocation data centers as well as data-center shells. Single-tenant data centers typically have long-term leases with hyperscalers or neocloud providers as tenants. Colocation data centers have multiple tenants and shorter-term leases, and this group includes a subset of network-dense data centers in which tenants can connect directly with cloud providers, carriers, and other enterprises through recurring, fee-based services offered by the REIT. Finally, shells are buildings that offer connections to power, cooling, and connectivity while the tenant installs and maintains their own data-center infrastructure.

Development economics for hyperscale versus colocation data centers in the U.S.



Sources: Green Street and Wells Fargo Investment Institute. Current as of February 28, 2026. Chart represents U.S. colocation and hyperscale estimates by Green Street. NOI = net operating income. Estimates can vary greatly based on market, operator, interconnection density (colocation only), and development budget. Stabilized NOI yields and development profit margins for powered-shell and triple-net leases would be lower.

2. "Senior Housing Outlook," Green Street, January 20, 2026.

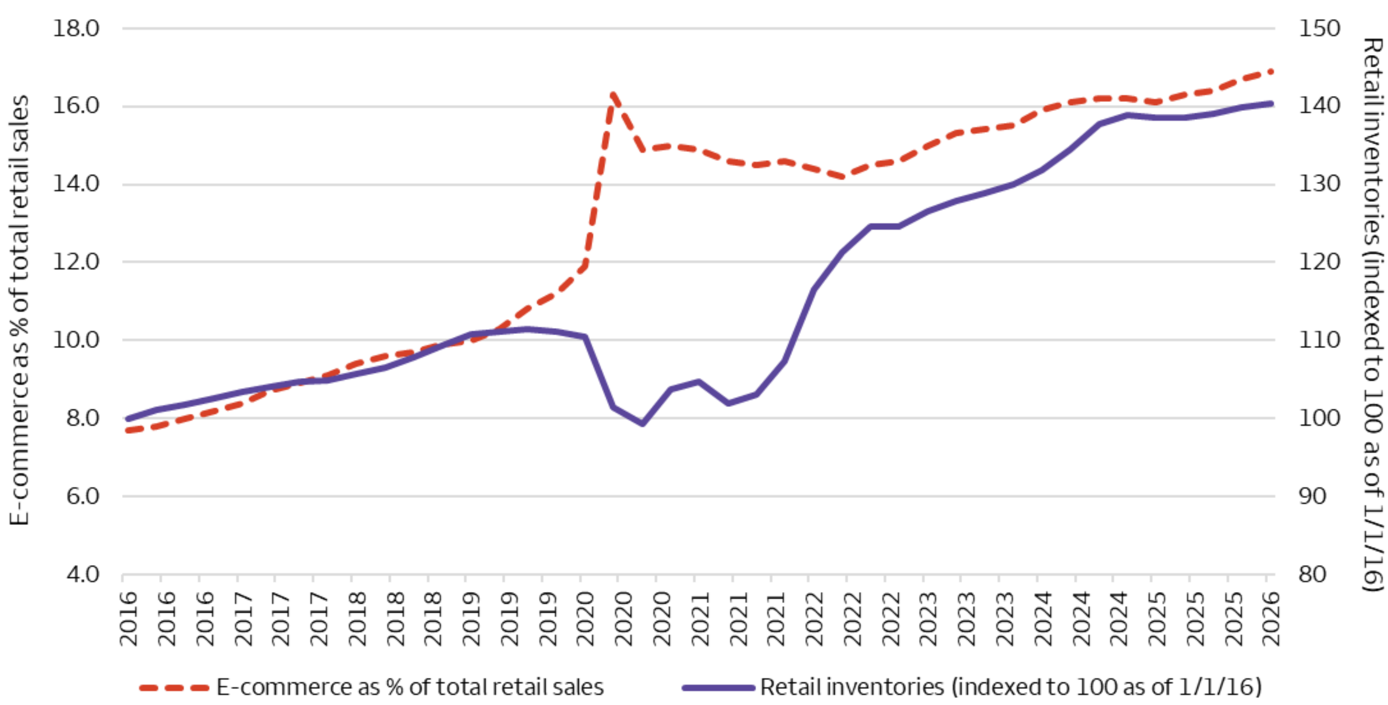
Larger data-center REITs' income sources are often diversified by this range of offerings, and we see colocation and interconnection as particularly notable features of the businesses. Colocation allows multiple tenants — ranging from hyperscalers to smaller enterprises — to operate within the same facility. On average, colocation data centers generate higher stabilized net operating income yields and represent higher average development profit margins compared to hyperscale data centers (as shown in the chart above). Meanwhile, interconnection enables lower-latency connections and translates to higher tenant retention. This stickiness, high switching costs, and shorter-term leases have together supported rent growth, and recurring fees for connections represent another source of revenue for the REIT. We view this sub-sector as an attractive route for gaining exposure to the AI theme within the Real Estate sector, particularly as AI use cases continue to expand and support sustained demand and pricing power.

Industrial REITs — Maintaining favorable guidance

We are maintaining favorable guidance on the Industrial REITs sub-sector. We expect supply chain reconfiguration and sustained e-commerce demand to support higher inventory levels, which should translate to greater demand among Industrial REITs.

E-commerce represents a notable demand driver for the sub-sector as it requires approximately three times the amount of warehouse space compared to brick-and-mortar locations. The coronavirus pandemic led to a sharp upswing in e-commerce retail sales as a percent of total sales, moderated somewhat in the intervening years, and has recently stabilized around 16% with a modest pace of growth. Retail inventories, on the other hand, declined during this period of pandemic-related recalibration before stabilizing at higher levels. In our view, the recent directional realignment between retail inventories and e-commerce's share of total sales (as shown in the chart below) suggests that retailers have adapted to structurally higher e-commerce sales, even as improved supply chain management technologies have enabled more efficient inventory management.

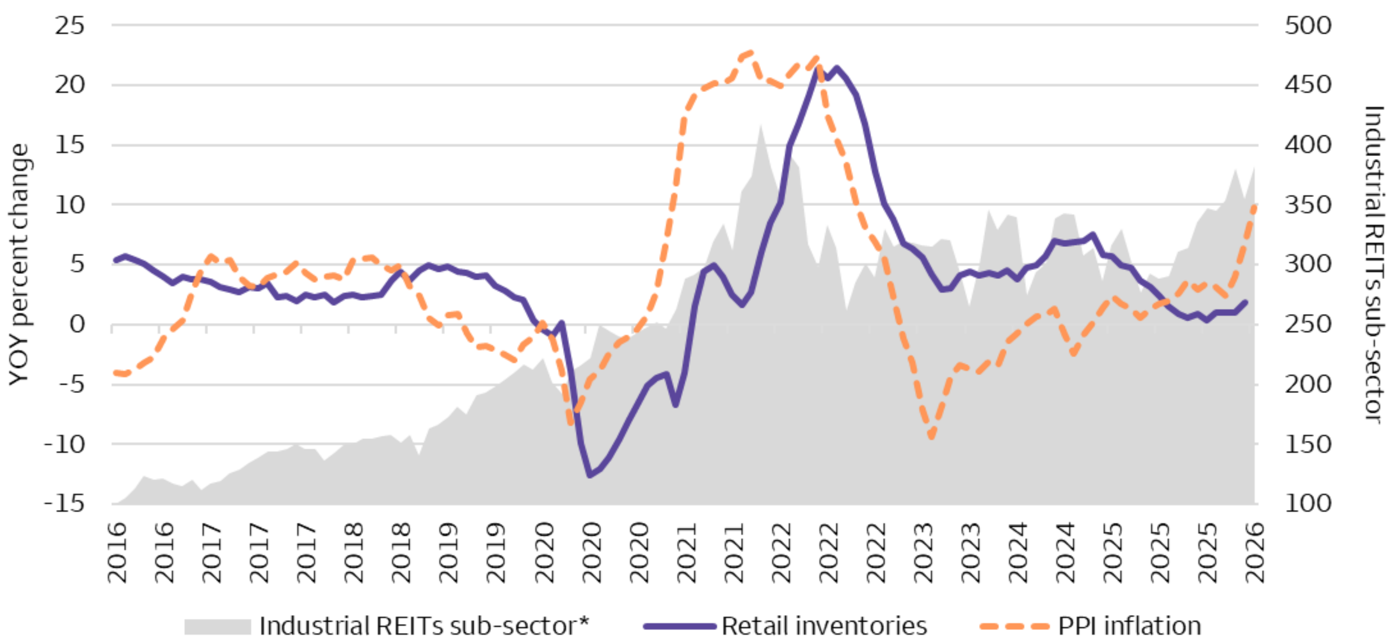
Post-pandemic stabilization indicates structurally higher e-commerce share and retail inventories



Sources: Federal Reserve Economic Data and Wells Fargo Investment Institute. Data through the first quarter of 2026.

Meanwhile, we see elevated goods inflation as well as higher-for-longer inflation expectations as potential tailwinds for the Industrial REITs sub-sector. The most recent Producer Price Index (PPI) inflation readings saw a notable year-over-year uptick, with a headline print of 6.0% and a core print of 4.4% for the month of April. As the chart below indicates, there has been a relationship between retail inventories and goods inflation in the past, with shifts in PPI inflation often preceding similar shifts in inventories during the time frame shown.[3] While we would acknowledge that numerous factors drive retail inventories, we do see accelerating PPI inflation as a sign of rising input-cost pressures that could, if tied to supply constraints or expected price increases, incentivize inventory building and support tenant demand for industrial space.

Accelerating input inflation may support retail inventories and demand for industrial space



Sources: Federal Reserve Economic Data, FactSet, and Wells Fargo Investment Institute. Data through April 2026. Producer Price Index (PPI) inflation reflects the Producer Price Index for all commodities. Producer Price Index (PPI) is a family of indexes that measures the average change in selling prices received by domestic producers of goods and services over time. An index is unmanaged and not available for direct investment. *Industrial REITs sub-sector represented by the S&P 1500 Industrial REITs Total Return Index; indexed to 100 as of April 2016.

Neutral sub-sectors

Diversified REITs — Upgrading to neutral

We are upgrading the Diversified REITs sub-sector from unfavorable to neutral. Companies in the sub-sector have exposure to various property types. For example, a company's portfolio may contain both office and industrial properties, resulting in potentially significant differences among the constituents of the sub-sector. We are not particularly constructive on the group as it is composed of a number of very small companies, some of which have experienced wide performance swings in recent years. However, we are not categorically averse to the sub-sector, would emphasize the importance of understanding a company's portfolio composition, and think a neutral rating is appropriate. We do not currently recommend any companies within the sub-sector.

Lodging/Resort REITs — Upgrading to neutral

We are upgrading the Lodging/Resort REITs sub-sector from unfavorable to neutral. This guidance change is driven by a reevaluation of our relative ranking system rather than any fundamental shifts in the market. We believe the sub-sector will continue to be pressured by muted economic growth, weaker consumer sentiment, and a decline in foreign travel to the

3. The chart shows PPI inflation for all commodities, which we view as a better proxy for input cost inflation than the more commonly monitored final demand PPI, which we view as a cleaner inflation measure.

U.S. We also remain cautious given structurally high levels of capital expenditures and the level of variability in revenues. However, REITs in this sub-sector mostly own assets on the upper end of the quality spectrum, and this tilt toward upper-income consumers represents a degree of relative resilience within a K-shaped economy. Limited new development is also a support for companies in the sub-sector. Ultimately, we believe neutral guidance is appropriate. We would caution investors on the sector's historical volatility relative to the broader Real Estate sector, its vulnerability to economic downturns, and the wide dispersion in performance among its constituents, but we do not anticipate sustained outperformance or underperformance over a tactical horizon at this time. We do not currently recommend any companies within the sub-sector.

Office REITs — Upgrading to neutral

We are upgrading the Office REITs sub-sector from unfavorable to neutral. The rationale here is similar to that of Lodging & Resort REITs, with the guidance change driven by a reevaluation of our relative ranking system rather than any fundamental shifts in the market. The sub-sector continues to face meaningful headwinds, including high capital expenditures, the growth of work-from-home optionality, and concerns about AI-related labor-market disruption. Fundamentals deteriorated meaningfully in recent years but have begun to show early signs of stabilization in 2026, supported in part by improved leasing activity and limited new supply on the horizon. Clarity around post-pandemic needs for office space has improved among tenants, supporting demand and contributing to expectations that occupancy has passed its nadir, though it does remain well below its pre-pandemic average. We would caution investors on possible volatility and emphasize the wide divergence in operating environments across different markets. However, at this time, we do not anticipate sustained outperformance or underperformance over a tactical horizon and believe a neutral rating to be appropriate. We do not currently recommend any companies within the sub-sector.

Self-Storage REITs — Downgrading to neutral

We are downgrading the Self-Storage REITs sub-sector from favorable to neutral. Amid a potentially elevated rate of inflation, the sub-sector does have the benefit of short-term leases (typically month to month) and the ability to adjust rental rates quickly. However, it is also closely tied to activity in the housing market, meaning that higher inflation weighs on demand by contributing to elevated borrowing costs and lower housing-market velocity.

The sub-sector started the year strong, with 16% total returns through April 30[4], and we see this as supportive of a downgrade to neutral as we expect further upside to be limited in the absence of meaningful near-term demand drivers along with tough year-over-year comps for move-in rents through the remainder of the year. High supply also remains a challenge in certain sub-markets; the sub-sector is trading at an elevated premium relative to other REITs; and the same-store revenue guidance for each self-storage REIT implies a deceleration through year end.

We do remain attracted to the sector's low overhead costs and broad customer base, especially as many younger individuals became first-time users during the pandemic. Companies have recently reported a solid ability to raise rents for existing customers, which has helped offset weakness from lower move-in rates. However, we think a forestalled housing-market recovery should represent a meaningful headwind to outperformance in the near term and believe a neutral rating is appropriate.

Specialty REITs — Upgrading to neutral

We are upgrading the Specialty REITs sub-sector from unfavorable to neutral. Companies in this sub-sector are focused on niche areas of the market that do not fit into existing sub-sectors, and according to Nareit[5], it often functions as an incubator for new property sectors. At various points, gaming, telecommunications, data-center, and timberland REITs, for

4. Self-Storage REITs sub-sector performance represented by FTSE Nareit Equity Self-Storage Index.
5. Nareit = National Association of Real Estate Investment Trusts.

example, all belonged in the Specialty REITs sub-sector. Given the dynamic nature of this area of the market, we are not categorically averse to it and believe a neutral rating to be appropriate. At this time, the sub-sector contains companies specialized in experiential properties, farmland, information storage and management, outdoor advertising, and ground leases. We do not currently recommend any companies in the sub-sector and believe caution is warranted given the mix of business models, portfolio characteristics, and company sizes.

Telecommunications REITs — Downgrading to neutral

We are downgrading the Telecommunications REITs sub-sector from favorable to neutral. The sub-sector has been facing several recent headwinds, including the default of a large wireless service carrier and subsequent lawsuits; merger-related decommissioning; and potentially subdued spending plans among U.S. wireless carriers. On the other hand, expectations for ongoing growth of mobile data usage (driven in part by AI); wireless-subscription growth; and the potential expansion of more advanced networks (5G in the U.S. and 3G through 5G internationally) represent potential tailwinds. The group possesses some of the highest margins within the Real Estate sector, and adding additional tenants to existing towers represents high-margin incremental revenue. The sub-sector currently contains three companies, and the largest by a substantial margin has gained exposure to data-center properties. Given the balance of headwinds and tailwinds, which we see as priced in, we are neutral on the sub-sector for the time being.

Equity recommendations

Recommended companies in our favored Real Estate sub-sectors

Ticker	Company name	Sub-sector/Sub-industry	Market cap (billions)	Price	Dividend	Dividend yield	Estimated NTM FFO/Share	NTM P/FFO	DSIP	Growth	Focus	High Yield	SMID
DLR	Digital Realty Trust, Inc.	Data Center REITs	$67.4	$191.71	$4.88	2.5%	$8.34	23.0x		X			
EQIX	Equinix, Inc.	Data Center REITs	$105.5	$1,070.22	$20.64	1.9%	$44.44	24.1x				X	
PLD	Prologis, Inc.	Industrial REITs	$136.6	$146.52	$4.28	2.9%	$6.37	23.0x	X		X		
STAG	STAG Industrial, Inc.	Industrial REITs	$7.3	$38.29	$1.55	4.0%	$2.69	14.2x				X	X
WELL	Welltower Inc.	Health Care REITs	$151.2	$214.18	$2.96	1.4%	$6.68	32.1x		X			

Sources: FactSet, Wells Fargo Investment Institute. Prices and data as of May 27, 2026. NTM = next twelve months. FFO = funds from operations. P/FFO = price to funds from operations.

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The **Diversified Stock Income Plan List (DSIP List)** focuses on companies that we believe will provide consistent annual dividend growth over a long-term investment horizon. Our objective is to provide a broad list of high-quality, industry-leading, dividend-growth companies from which an investor can assemble a well-diversified portfolio. Through consistent dividend growth, our goal is to help investors stay ahead of the wealth-eroding effects of inflation.

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