



HOULIHAN LOKEY

REAL ESTATE MARKET UPDATE

SUMMER 2021



Houlihan Lokey's Real Estate Market Update

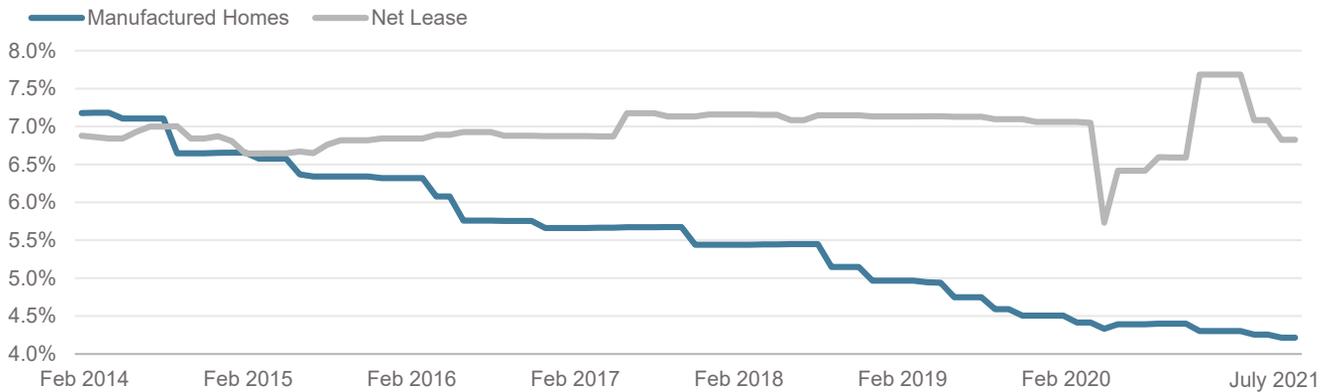
Summer 2021

Houlihan Lokey is pleased to present a summary of real estate industry observations from its M&A and valuation professionals based on real-time market insights.

1 Net lease is hot, but is it cooling?

- Net lease, once considered a specialized asset for certain institutional investors and 1031 investors, has increasingly become a household name. CBRE noted Q1 2021 single-tenant transactions topping \$14.3 billion, and Green Street's Fund Flows cited the net lease sector's \$2.3 billion in equity raised as the most of any sector.
- Consistent with the increased interest in the sector and corresponding decline in U.S. Treasury rates, cap rates have steadily declined from 7%–9% 10 years ago to 5%–7% (or lower) today, according to The Boulder Group's most recent National Net Lease Report.
- However, according to The Boulder Group, national cap rates of industrial and retail assets rose during Q2 2021, while office yields remained flat. With a potential rise in U.S. Treasury rates coming in 2022, and the apparent flattening or increasing required yields in the sector, the attractive historical risk adjusted spread may be tightening for net lease assets. Some, such as iStar, may benefit, which announced in July that it plans to dispose of its 19 million square-foot net lease portfolio.

Property Sector Nominal Cap Rates



Source: Green Street.

2 With housing undersupplied, SFR and manufactured housing show no sign of stopping.

- As we highlighted last quarter, the SFR market is hot—highlighted by the \$5 billion venture announced in June between Invesco Real Estate and Mynd Management to purchase 20,000 homes over the next three years.
- Blackstone, having limited its exposure to the sector with the 2017 IPO of Invitation Homes, is making a \$6 billion re-entry splash with Home Partners of America and its 17,000 home portfolio. Tricon Residential announced a new JV in July that will have approximately \$5 billion of purchase power with leverage, according to GlobeSt.
- Others are looking to benefit from the investor frenzy and increase in home prices. VineBrook Homes Trust announced in July that it is considering an IPO or other capital event, monetizing its nearly 12,000 homes, and GTIS Partners effected a \$300 million sale of its remaining 1,000 homes purchased during the Great Recession.
- That said, SFR cap rates may be stabilizing, with Chandan Economics reporting average cap rates of 6% in 1H2021, from a low of 5.9% in 2H2020. However, these are well below trailing five-year rates of 6.5%–8%.

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3 As SFR heats up, allocations to alternative housing assets increase.

- With the aforementioned interest in SFR and multifamily cap rates remaining stubbornly low, investors interested in housing are looking elsewhere (e.g., affordable and manufactured housing). For example, BREIT recently increased its affordable housing exposure with a \$5.1 billion purchase of AIG's U.S. portfolio.
- Others, such as The Carlyle Group, are continuing to increase their portfolios as they scale up and seek efficiencies from size. The increased investor demand, coupled with continued positive fundamentals (e.g., Marcus & Millichap reporting price appreciation across the country as rents continue to rise 3%–5%+ per year) is resulting in record-low cap rates. Investors indicated purchase yields as low as 2% compared to 4%–5% only a few years back, and Green Street reported an average implied cap rate of 3.5% for the REIT sector.

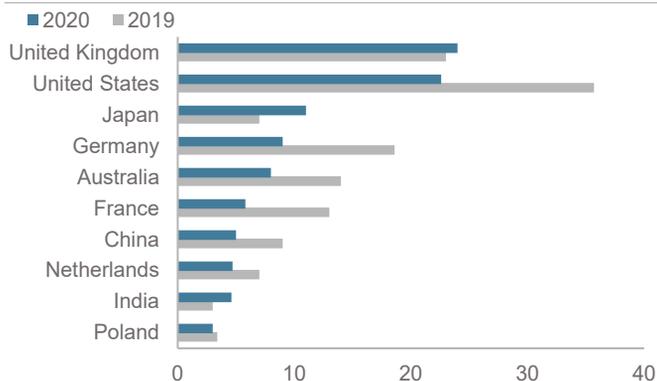
4 Investors get increasingly creative to capture yield and provide liquidity.

- With the continued broadening of the real estate investor world, investors are starting to seek liquidity events akin to those in other investment sectors.
- LPs in closed-end funds are looking to capitalize on the white-hot market, and GPs are looking to free up capital for continued investment. As a result, we are increasingly seeing transactions such as partial GP interest buyouts, LPs selling their fractional ownership to third parties, or end-of-life cross-fund traders among older and newer vintage funds from the same sponsor.
- We expect this to lead to new strategies in the real estate market, highlighted by one Dallas-based equity investor recently establishing a nine-figure fund targeting the purchase of minority LP interests in real estate funds.

5 Non-U.S. capital flows to the U.S., and U.S. capital seeks non-U.S. investments.

- Historically, the U.S. real estate market has been dominated by U.S.-based investors, with “foreign” capital buying principally in the “sexy six” markets, the coasts, and occasionally to other major metros such as Chicago.
- Despite record-low cap rates in the U.S., the relative safety of investment appears to continue to attract additional non-U.S. money to U.S. assets. The Arden Group, for example, recently closed on a \$500 million fund, exceeding its \$300 million target with money raised largely from the Gulf Cooperation Council.
- Meanwhile, U.S. investors may be starting to look elsewhere, primarily Western Europe—one example being Heitman's continued expansion of its U.K. self-storage platform.
- Some large investors, such as W.P. Carey, continue to focus on European expansion to capture greater yield than for similar U.S. based opportunities. Plus, as a signal of further interest, KKR recently raised \$2.2 billion for its second Europe real estate fund.

Top 10 Destinations of Capital 2020



Predicted Top 10 Capital Flows



Houlihan Lokey's Real Estate Expertise

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 We have deep **valuation expertise** in investment, financial reporting, and tax matters.

 We advise **boards of directors and special committees** as they navigate a range of strategic situations and challenges.

 We **value large portfolios** of real estate equity and debt positions for various investors and lenders across the United States.

 Leveraging our accounting and real estate expertise, we help clients with **transaction advisory services** related to real estate equity and debt investments.

 Our bench of experts includes **dispute resolution counselors** to advise on valuation matters involving disputes, mediation, arbitration, and litigation.

 We provide **fairness opinions, solvency opinions, and valuation opinions** to clients across a variety of property- and entity-level transactions.

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