STEPSTONE

Real Estate Liquidity Insights

An Analysis of Fund-Level Cash Flows

OCTOBER 2024

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All data is as of October 2024, unless noted otherwise.

Executive Summary

Interest rate surge driving overleveraged balance sheets	Interest rate spike beginning mid 22 led to value declines, resulting in a need for capital to de-lever
Trading volume low	Appraisal-based carrying values have not fully corrected; managers holding assets longer to avoid recognizing losses
Distributions low	Low sales volume translates to low distributions
Capital calls keep coming	Non-core fund capital calls back in-line with long-term averages, driven by deleveraging and longer hold periods
Assets need more time and more money	Low values, reduced transaction activity, and longer hold periods mean assets need more time and more money
Funds struggle to raise capital	Fundraising is taking much longer, proceeds are lower, and capital is favoring larger managers

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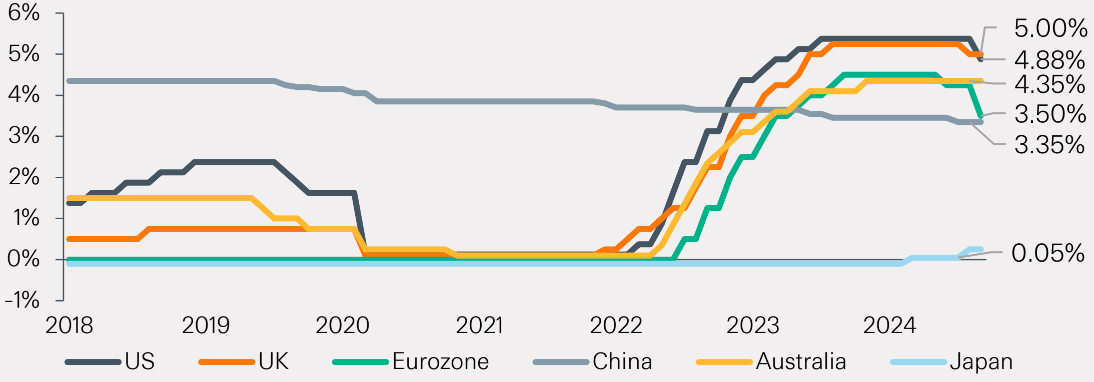
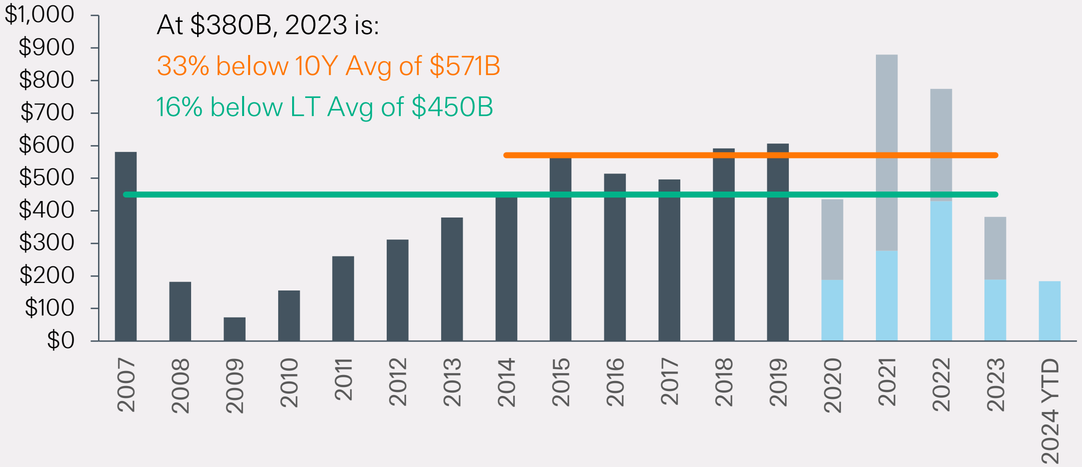
Marks remain above trading prices, suppressing volume

- Interest rates likely to remain well above pre-2022 levels, even as central banks ease
- A large bid-ask gap, with sellers not motivated to take losses, is depressing trading volume
- Fund valuations have lagged asset trading prices in both timing (normal) and amount. Leverage implies fund valuations should drop further than the unlevered Green Street trading price data

Global base rates easing, but still elevated

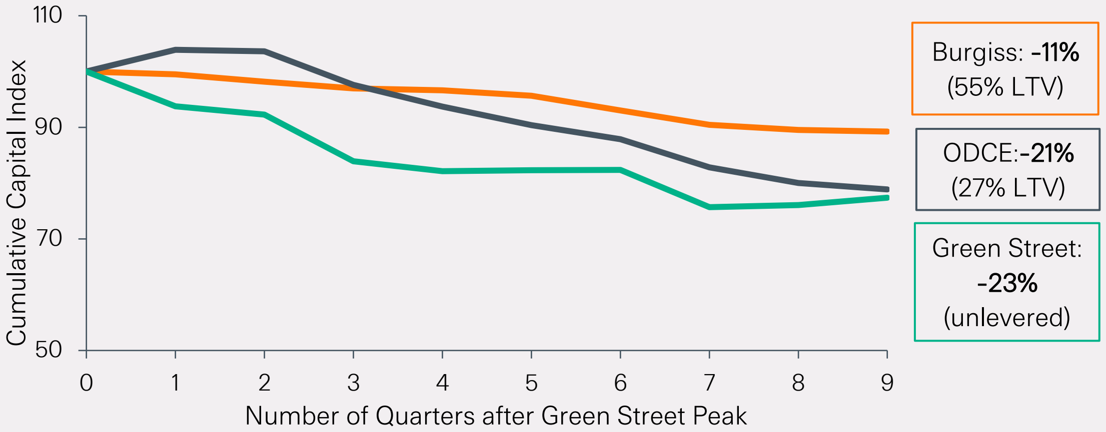


US annual transaction volume, $ in billions



Private real estate fund valuations lag drop in trading prices[1]

Green Street: trading prices, ODCE: core fund index, Burgiss: non-core fund index



Sources: Green Street, NCREIF ODCE, Burgiss, Bank for International Settlements, MSCI RCA ,October 2024.

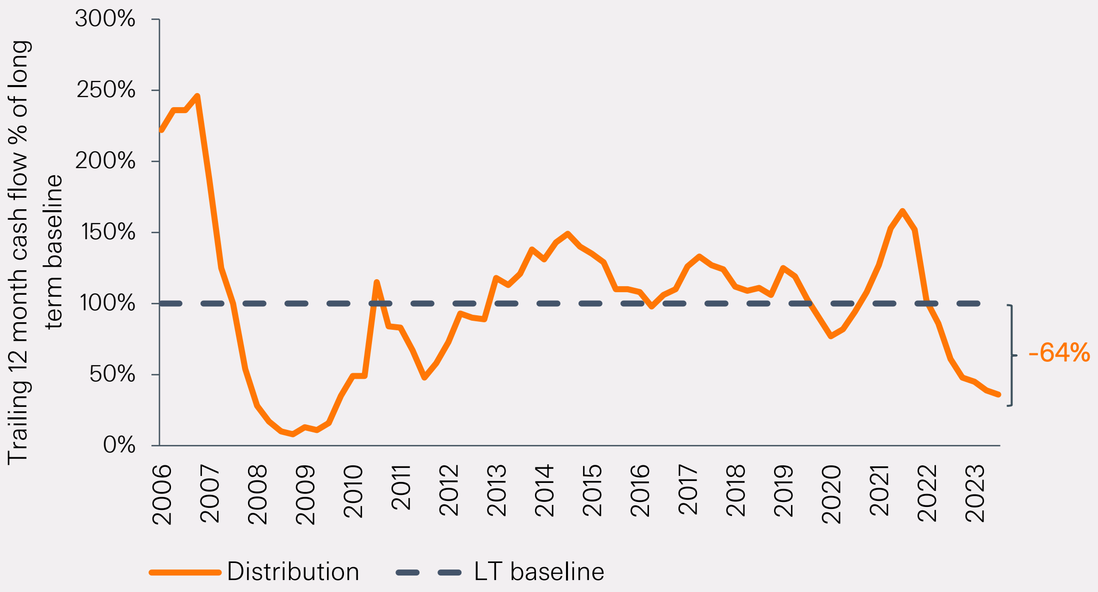
1. Green Street CPPI's latest peak quarter is Q1 2022.

Fund distributions are down

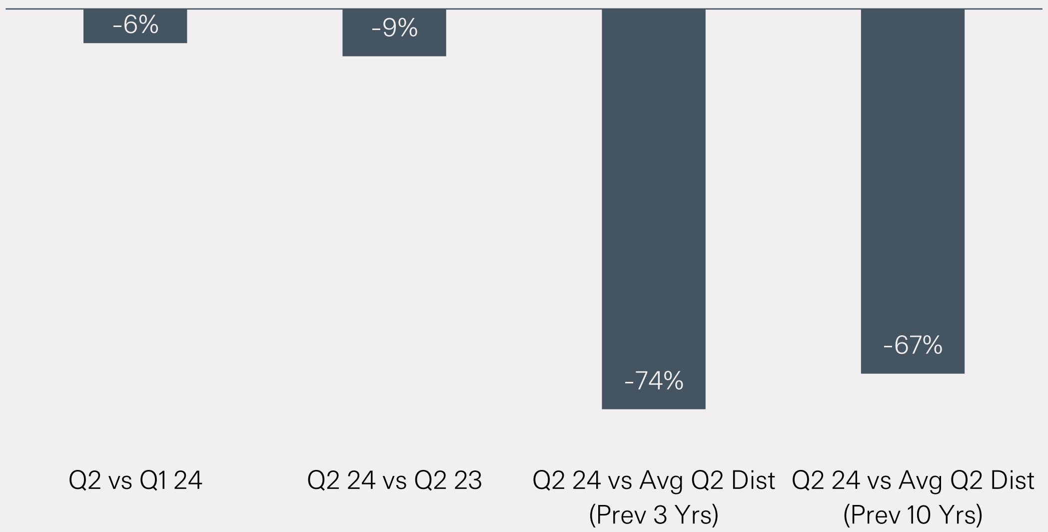
Lower trading volume translating to sharp drop in non-core fund distributions

- Distributions over 12 months ending Q2 24 are 64% below the long-term average
- When accounting for seasonality, Q2 24 distribution is 67% below the average Q2 distribution of the last 10 years

Fund-level distribution, TTM vs long-term average[1]



Distribution change in Q2 24[2]



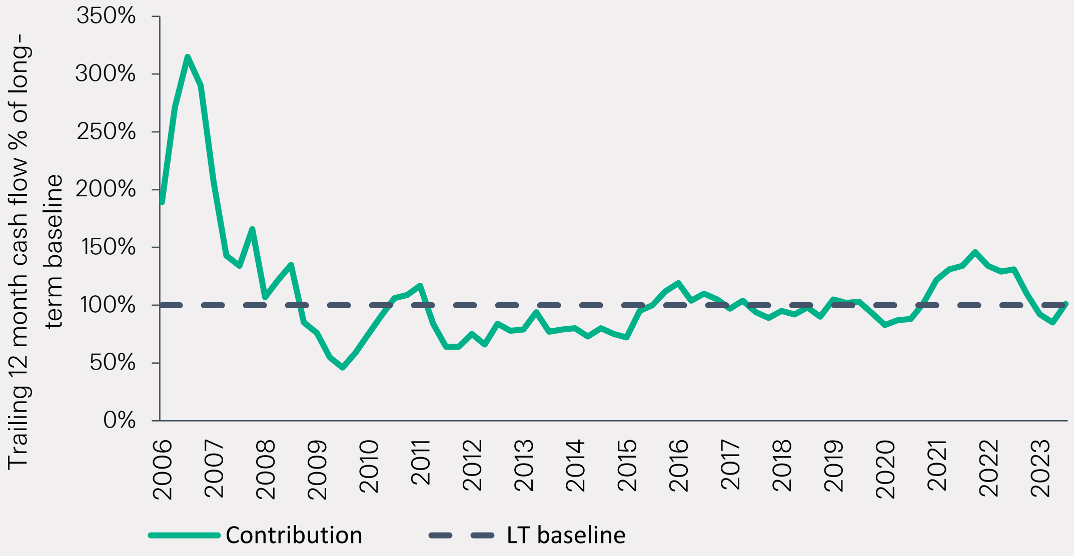
Source: SPI Research and Reporting, Oct 2024.

Capital calls back to long term averages

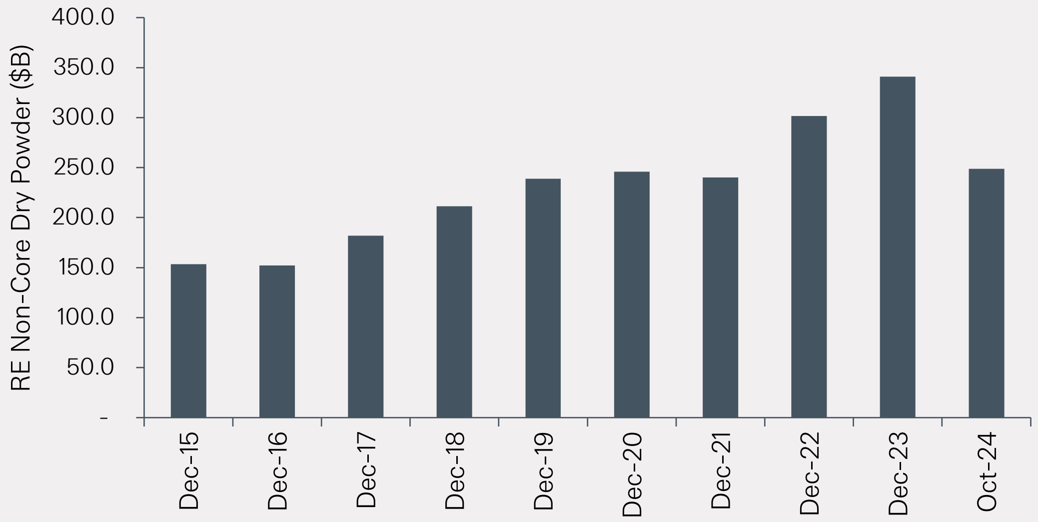
Unplanned investment in existing assets likely key driver for non-core funds that made acquisitions before mid '22. Capital calls:

- Fill funding gaps caused by higher interest rates. Non-core funds are on average 55% leveraged[1] and are heavy users of floating rate debt to match their buy-fix-sell strategies
- Cover inflated cap ex budgets and carry transitional assets longer amid weaker leasing

Fund-level contribution, TTM vs long-term average[2]



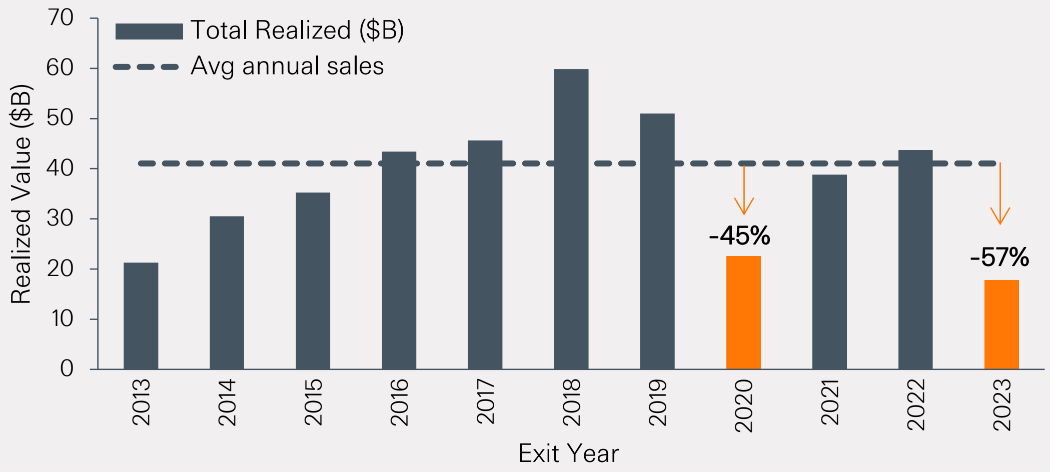
RE Non-Core dry powder now declining[3]



1. Sourced from StepStone SPI Reporting as of Q2 2024.
2. Sourced from SPI Research and Reporting, October 2024.
3. Sourced from Preqin Pro, RE value-add and opportunistic, October 2024.

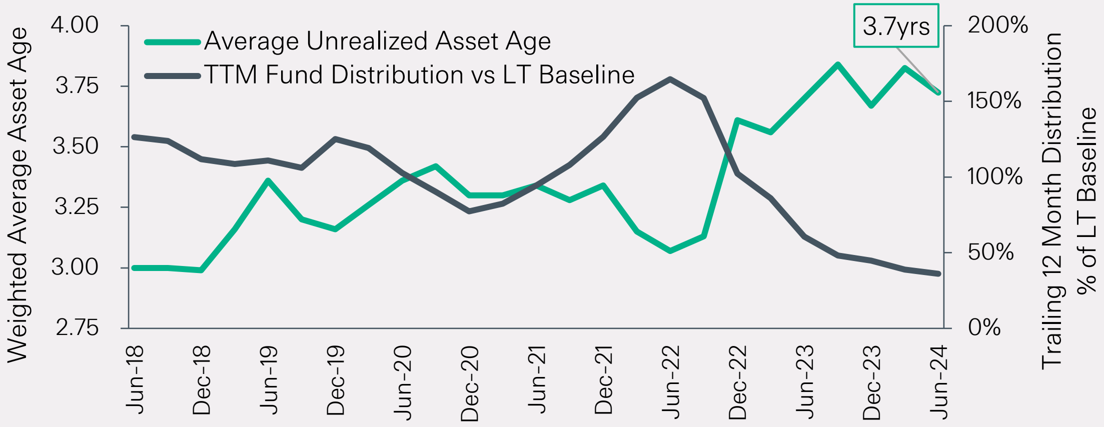
Less sales, longer holds, more losses

Annual asset sale proceeds ($B) fell in 2020 and 2023

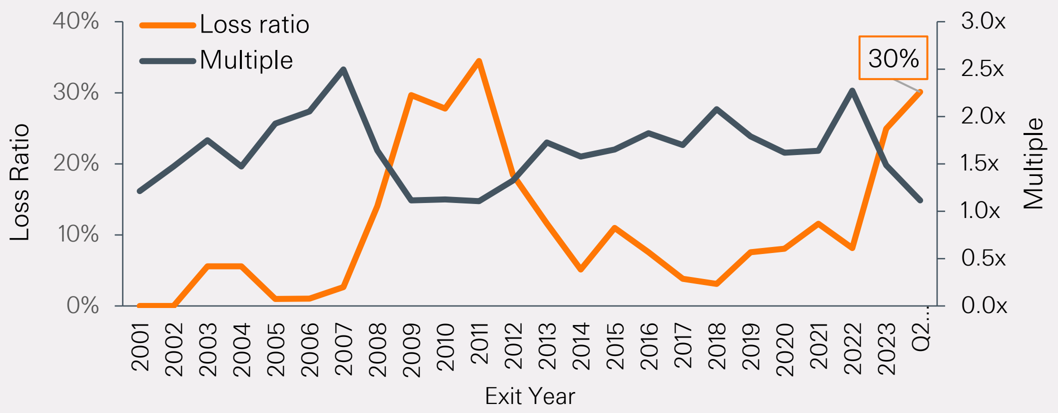


- Asset sales are 57% below the 10-year average from 2013 to 2022, excluding disruptive year of 2020
- This leaves more unrealized assets, increasing the average asset age
- Many recent sales are likely forced, with realized loss ratio hitting 30%
  - Appraised carrying values above trading prices also drives losses on assets sold at market value
  - Aggregate asset sales by funds dropped more than sales for the market as a whole, likely due to transitional asset strategies

Average age of unrealized assets rising from 3.25 to 4.0 years



Realized loss ratio surged in 2023 and 2024

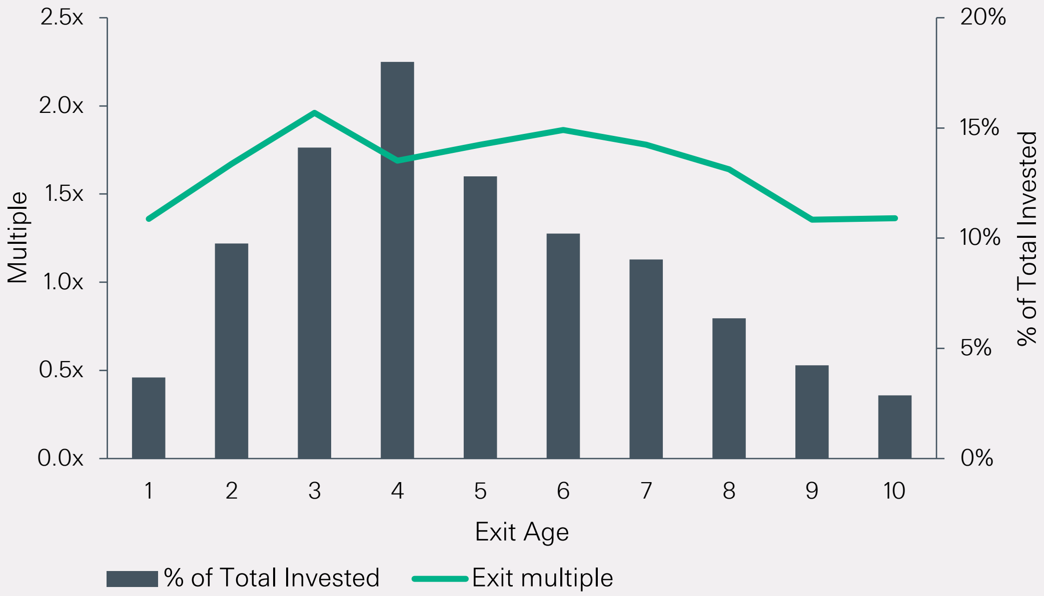


Sources: SPI Research and Reporting, October 2024.

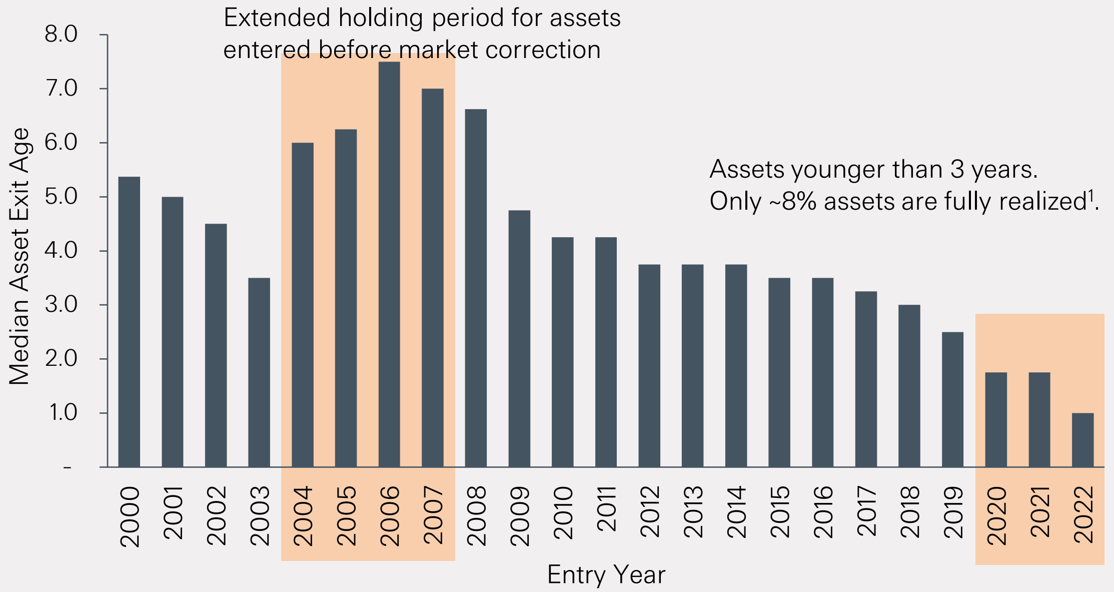
Holds are longer in distressed periods

- The median holding period of a real estate investment is 3.75 years
- Market dislocation significantly extends holding periods. Assets entered right before the GFC had a median holding period of 7 years
- Assets entered 2020-2022 are younger than the median holding period; only 8.4% of the assets are realized

Longer hold periods mean lower multiples



Median exit age by entry year

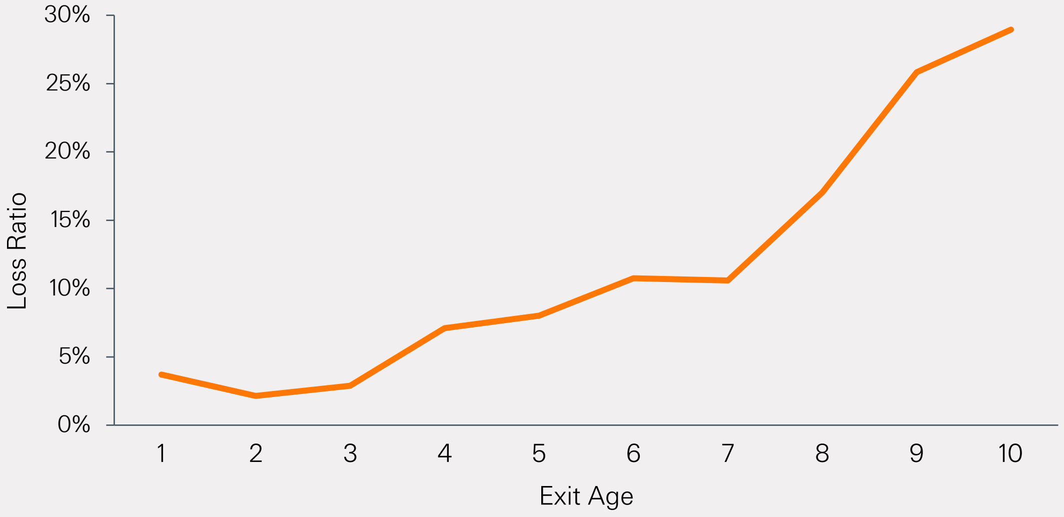


Sources: SPI Research and Reporting, October 2024. 1. Percentage calculated by invested capital.

Longer hold periods mean higher losses

- The average loss ratio for all assets realized after year 6 is more than 10%, double the average loss ratio for assets exited between years 4 and 6
- Assets entered right before GFC (2004 -08) reported materially higher loss ratios across all holding periods. Flat multiples over extended holding periods mean IRRs fall. Assets exited 6-10 years after the GFC enjoyed the benefit of falling interest rates, which tended to lift exit prices
- 2018-20 acquisitions lag the historical realization pattern, which implies higher losses
- 2021-22 acquisitions have more risk of loss since they were likely bought at cyclic peak pricing and may be exited in a higher interest rate environment

Exit age & loss ratio



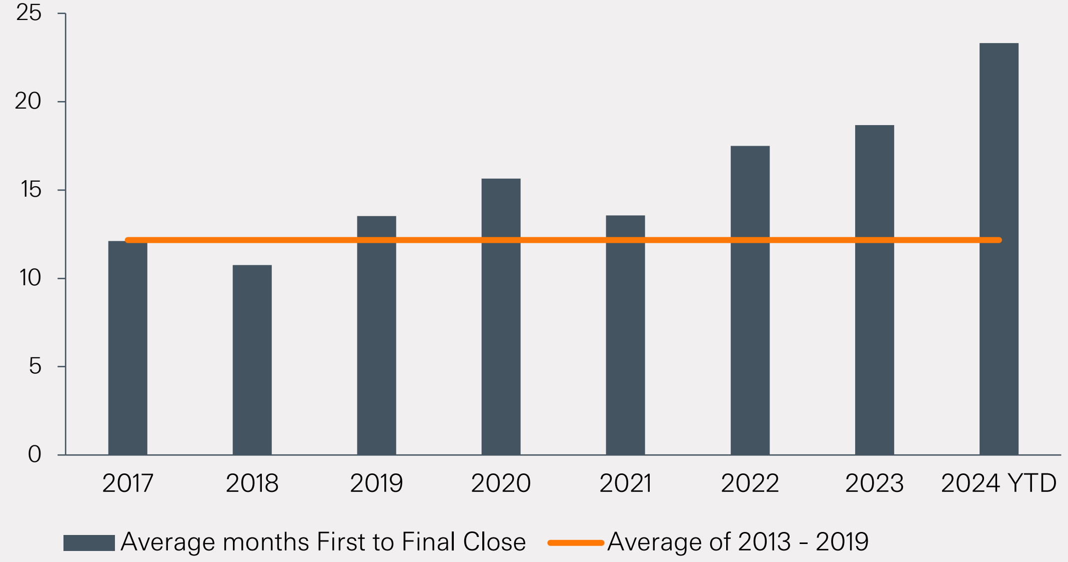
Bear years vs others

Sources: SPI Research and Reporting, October 2024.

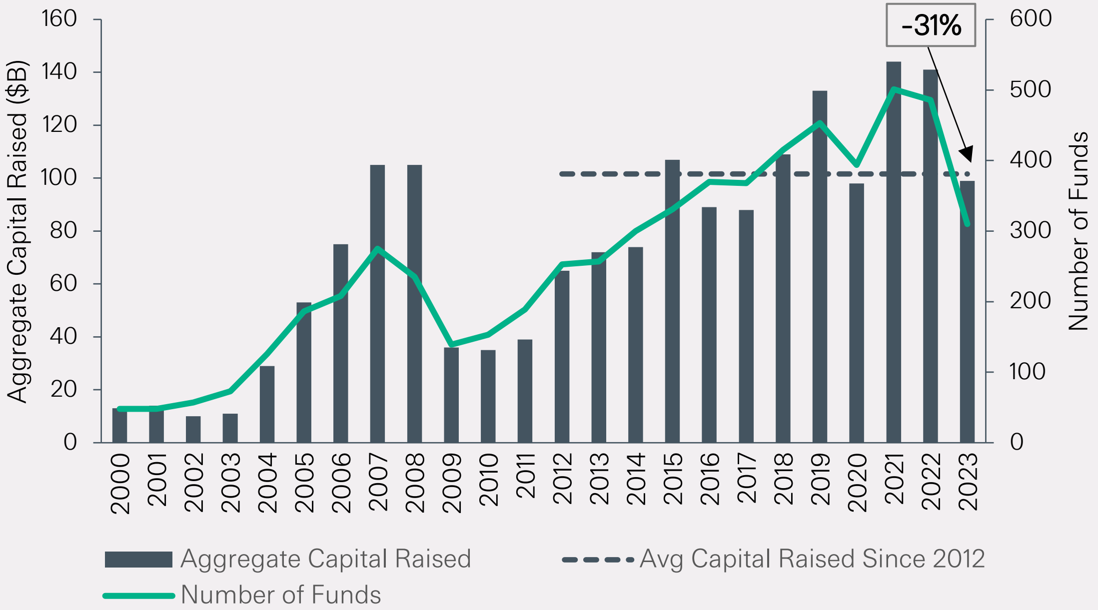
Fundraise periods doubled, proceeds well below peak

- Fundraising periods have been increasing, with time between first close and final close nearly doubled since 2017.
- Larger funds (over $1.5B) took approximately 2 months less than small funds from first to final close (22 months vs 24 months)
- Amount raised is cyclic and growing. Recent fundraising is down 31% versus post GFC peak, yet it is close to the post GFC average (since 2012)
- Since 2017, average fund size grew from $300M to $432M, with large funds (over $1.5B) raising 42% of total non-core capital

Funds now taking longer to close



Total Fundraising, $billions



Sources: StepStone Research, Preqin Pro, Oct 2024. Data refers only to closed funds so may understate the recent slowdown. There is no data available on time from launch to first close.

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