



CRE
ANALYST

November 30, 2022

**No more easy
money, but
widespread
distressed sales
seem unlikely.**



Largest Active Real Estate Funds

Top 10 Commercial Real Estate Funds: Closed in 2021-2022, Closed-end

Fund Vehicle	Strategy	\$ Bil
Blackstone Real Estate Partners IX	Opportunistic Equity	20.5
Brookfield Strategic Real Estate Partners IV	Opportunistic Equity	15.0
Starwood Distressed Opportunity Fund XII	Opportunistic Equity	10.0
Digital Colony Partners II	Value Added Equity	8.3
Blackstone Real Estate Debt Strategies IV	High Yield Debt	8.0
Carlyle Realty Partners IX	Opportunistic Equity	8.0
Oaktree Real Estate Opportunities Fund XIII	Value Added Equity	4.8
Lone Star Real Estate Fund XI	High Yield Debt	4.6
KKR Real Estate Partners Americas III	Opportunistic Equity	4.3
Brookfield Real Estate Finance XI	High Yield Debt	4.0

\$40B+ of "dry powder" but stuck between a rock and a hard place...



Brookfield



digitalcolony

CARLYLE



OAKTREE



LONE STAR FUNDS

KKR

Largest Real Estate Core Funds



Top 10 Commercial Real Estate Core Funds, Open-end:

Fund Vehicle	Sponsor	Founded	\$ Bil (est)
Strategic Property Fund	JP Morgan	1970	47.5
Prime Property Fund	Morgan Stanley	1973	39.0
PRISA	Prudential Real Estate Investors	1970	31.6
UBS Trumbull Property Fund	UBS Realty Advisors	1978	20.7
Lion Properties Fund	Clarion Partners	2000	19.2
Invesco Core Real estate	Invesco Real Estate	2004	16.8
RREEF America REIT II	Deutsche Bank	1998	16.5
Heitman America Real Estate Trust	Heitman Capital Management	2007	13.4
Principal US Property Account	Principal Real Estate Investors	1982	12.0
Multi-Employer Property Trust	BentallGreenOak	1982	11.7

4% of the CRE market drives property values, but these funds are sidelined for now.



J.P.Morgan

BentallGreenOak



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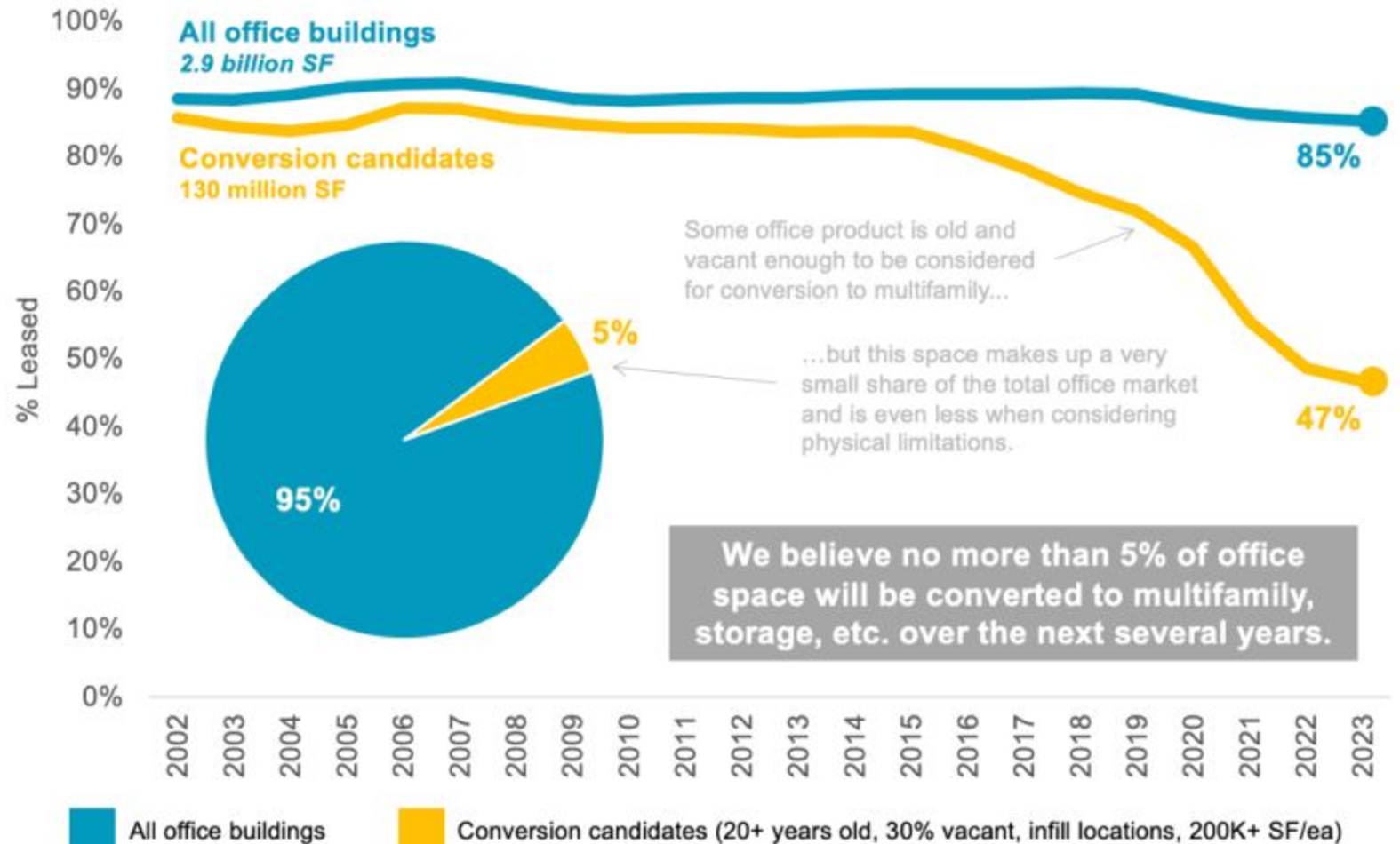
Source: Los Angeles County Employees Retirement Association



Office Conversions in Perspective



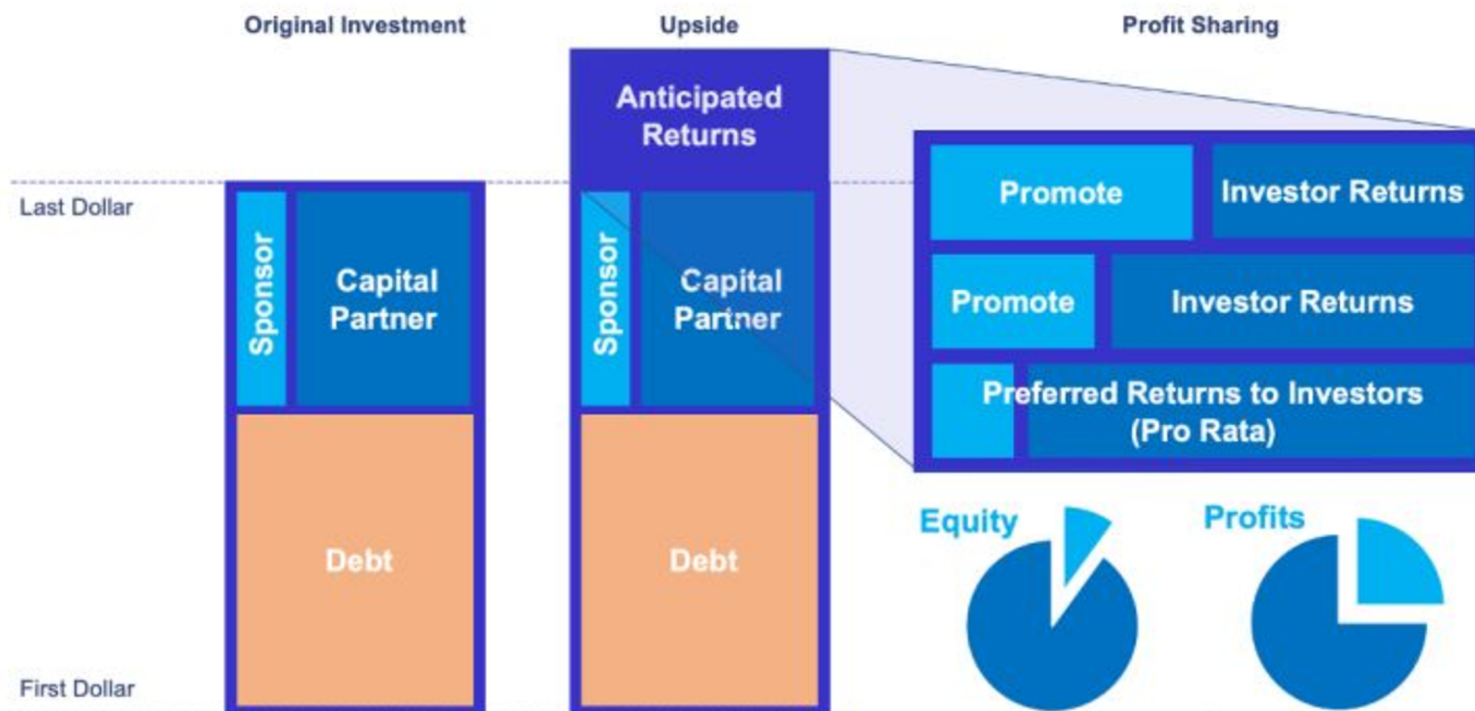
Office Space in The Five Largest U.S. Markets



Converting office space to other uses is more hype than reality.

We know hundreds of industry leaders who are great thinkers and "ehh" modelers, but we don't know a single industry leader who is a great modeler but an "ehh" thinker.

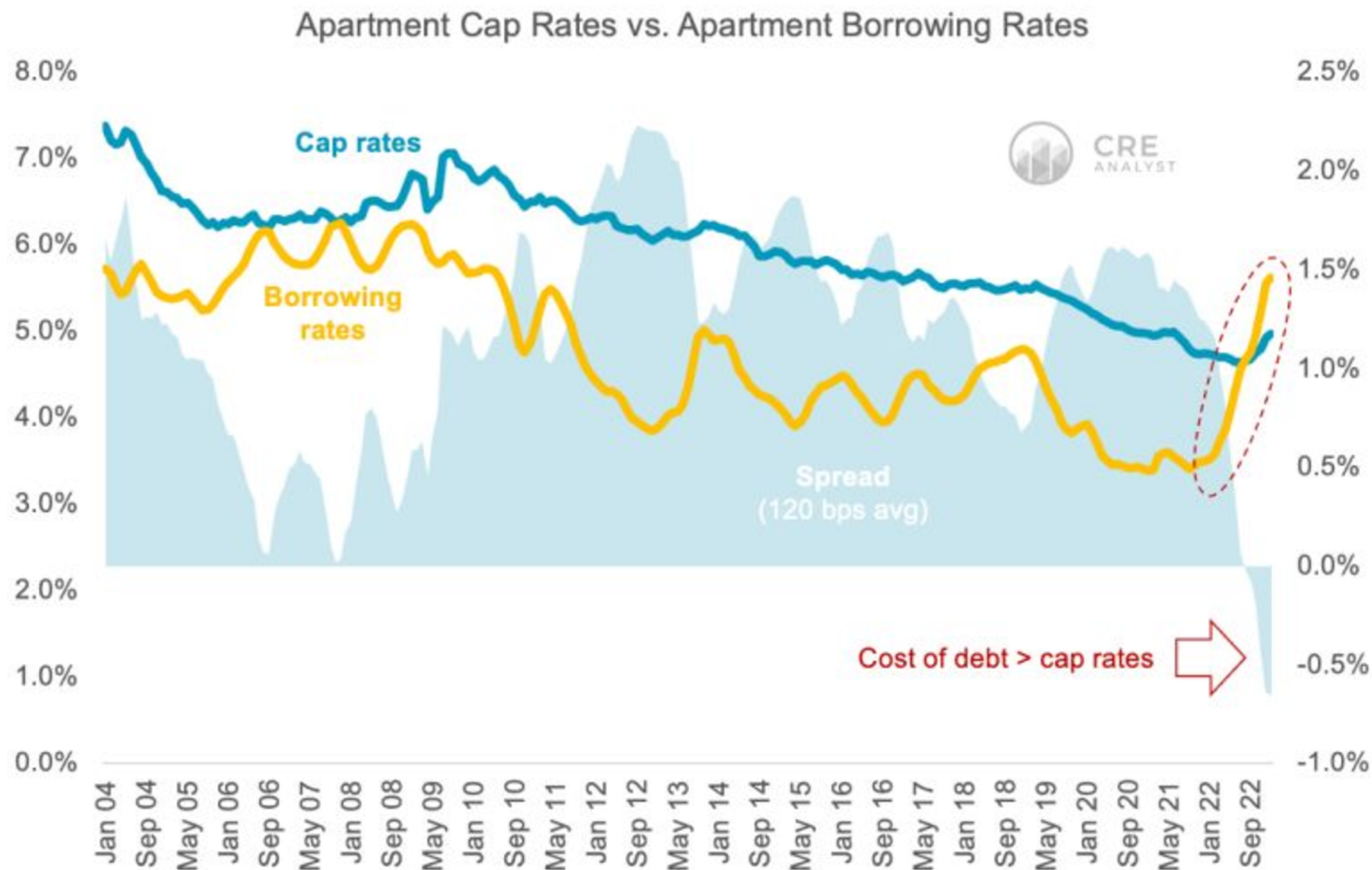
JV Waterfalls: Preferred Returns and Promotes





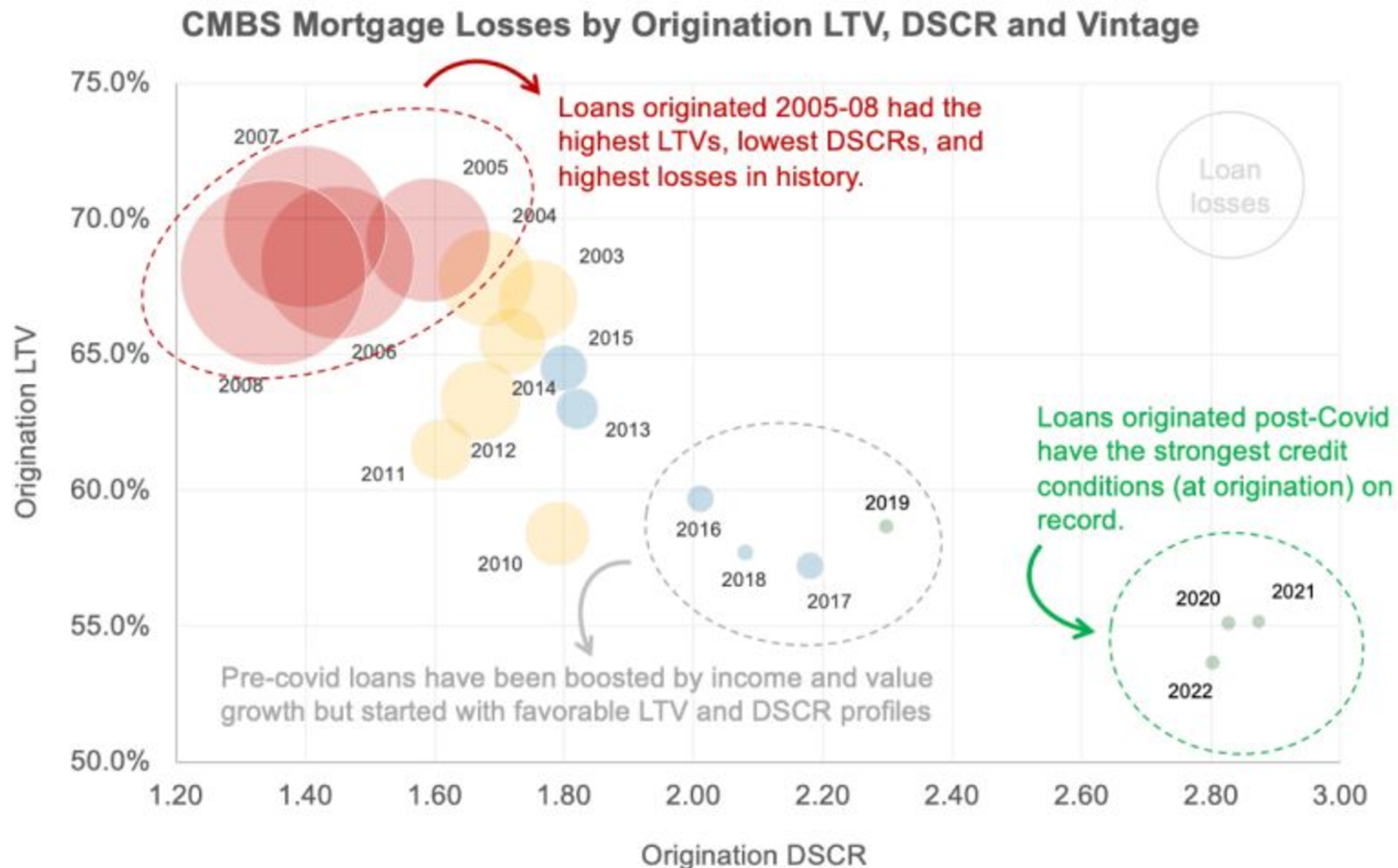
**For the first time in
20 years, cap rates
are lower than
interest rates.**

CRE Debt: That Escalated Quickly



Don't bet on S&L crisis 2.0

There will almost certainly be a spike in delinquencies and defaults ...but this time is different for banks, insurance companies, and CMBS...



CMBS Loan Case Study: Willis Tower

Willis Tower could be a decent barometer for the rest of the office market: lower values with more income than you think, which leads to murky outcomes that play out over many years.

Loan Details	
Collateral	Willis Tower
Loan amount	\$1.325 billion
Square feet	3.9 msf
Metro area	Chicago, IL
% Leased	86.0%
Maturity date	March 2024
Final maturity	March 2025
LTV (orig)	74.4%
DSCR (orig)	2.42x
Debt yield (est)	8.5%
Borrower	Blackstone (BREP VII)
Status	Special servicing



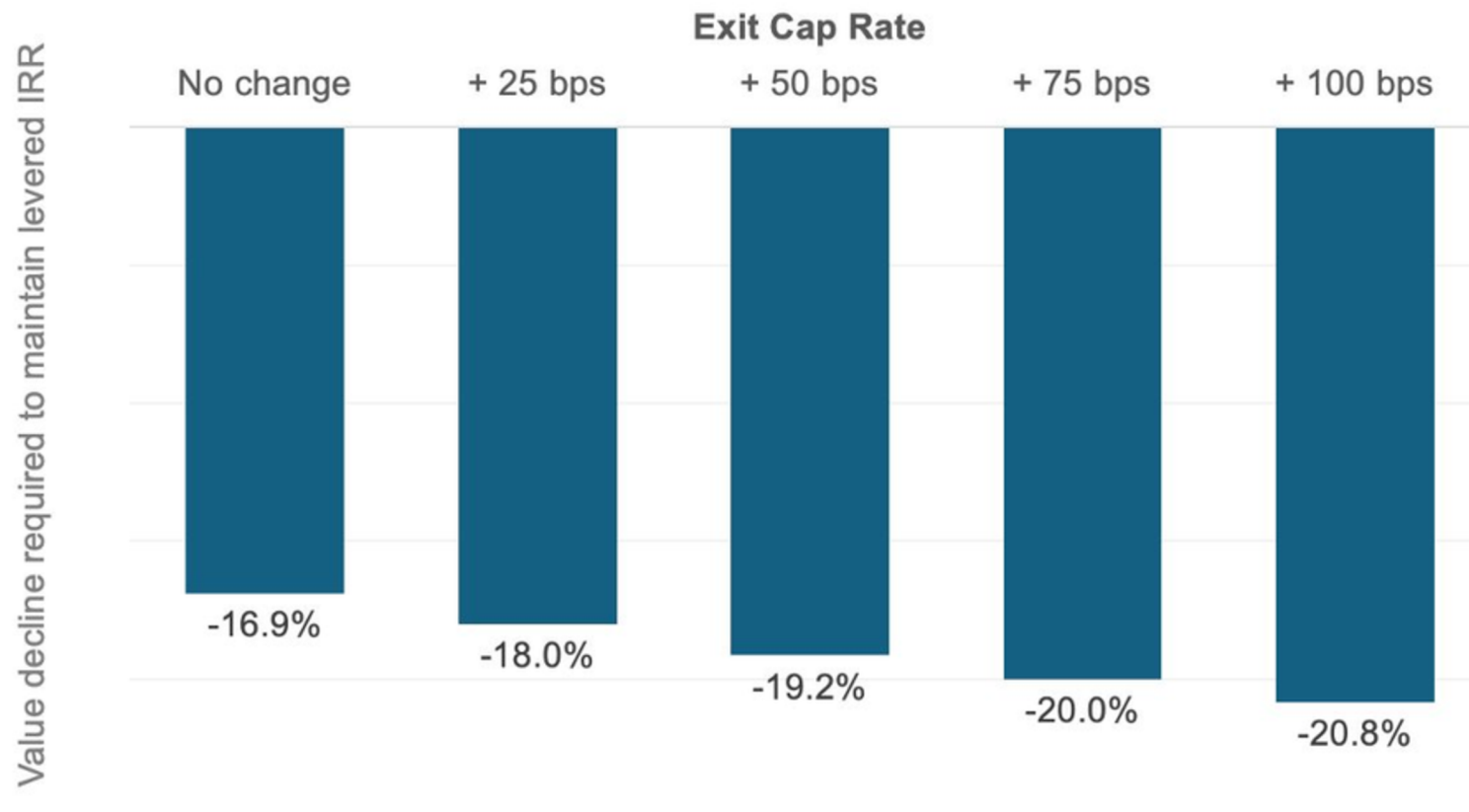
Scenario	Assumptions			Loan Metrics			Estimated Outcome
	NOI Chg	Cap Rate	Coupon	LTV	DSCR	Debt Yield	
Upside	0%	7.5%	7.0%	89%	1.21	8.47%	2025 payoff
Base Case	-5%	8.5%	8.0%	106%	1.01	8.05%	???
Downside	-10%	10.0%	9.0%	131%	0.85	7.62%	2024 default

Want to maintain IRR with higher rates?

Effect of higher interest rates on an office property's value



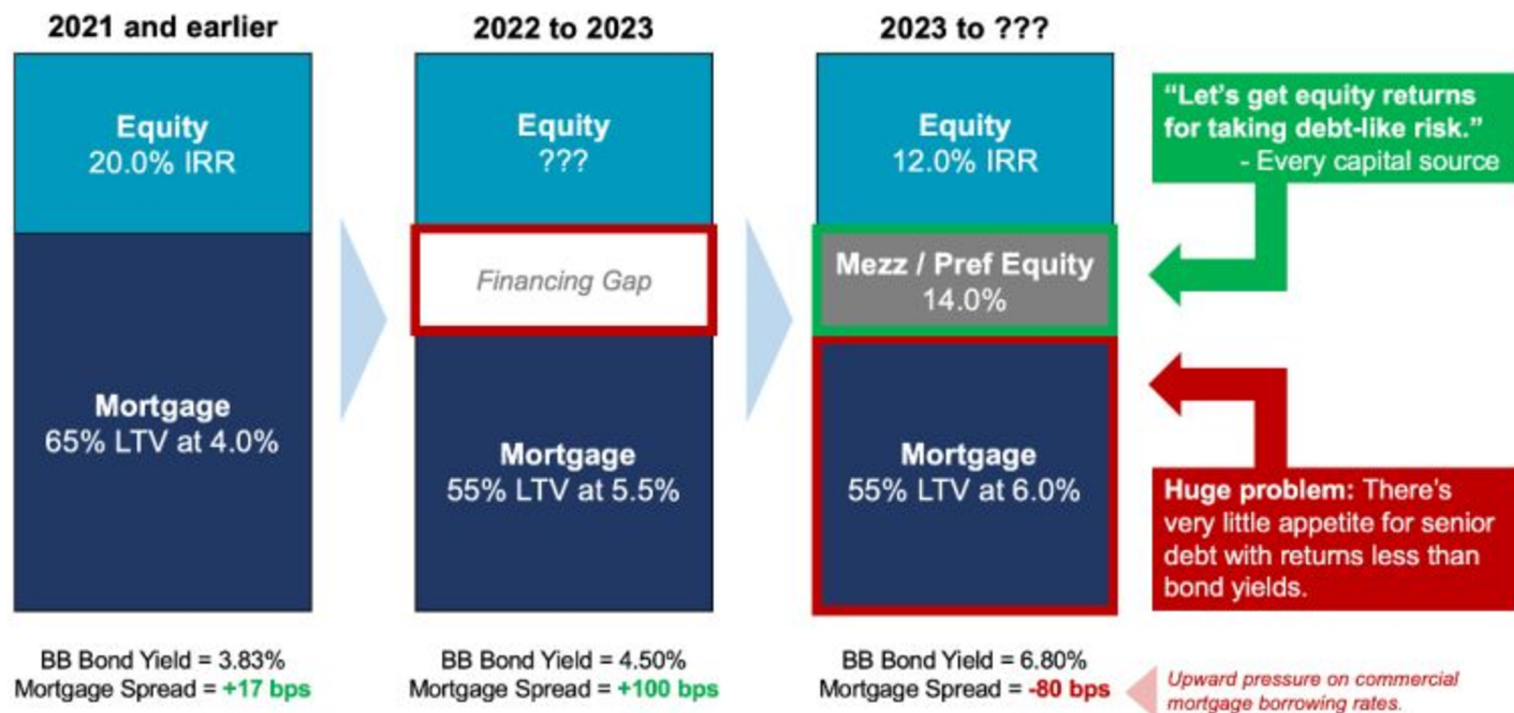
Here's why "dry powder" is the most overplayed real estate term of 2023...



Takeaway: 15-20% value declines before considering erosion in rents, occupancy, NOI, etc.

Preferred equity may get the headlines, but we think the absence of senior debt is the real story; if negative relative value vs. corporate bonds remains, CRE borrowing costs will certainly increase.

Mind the Gap: CRE Debt Challenges



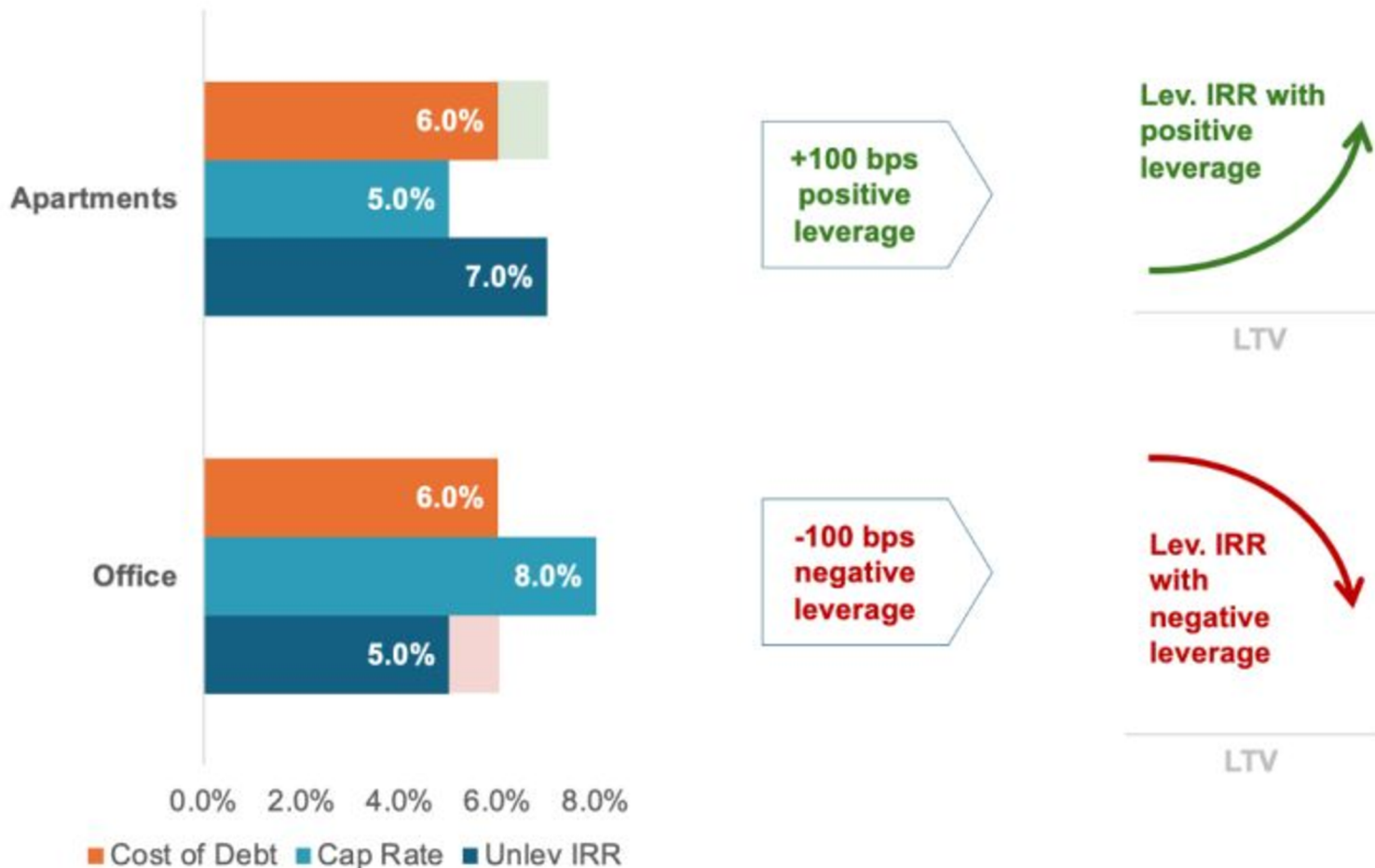
“Negative Leverage” vs. Negative Leverage

Cap Rate and Unlev. IRR vs. Cost of Debt

Debt

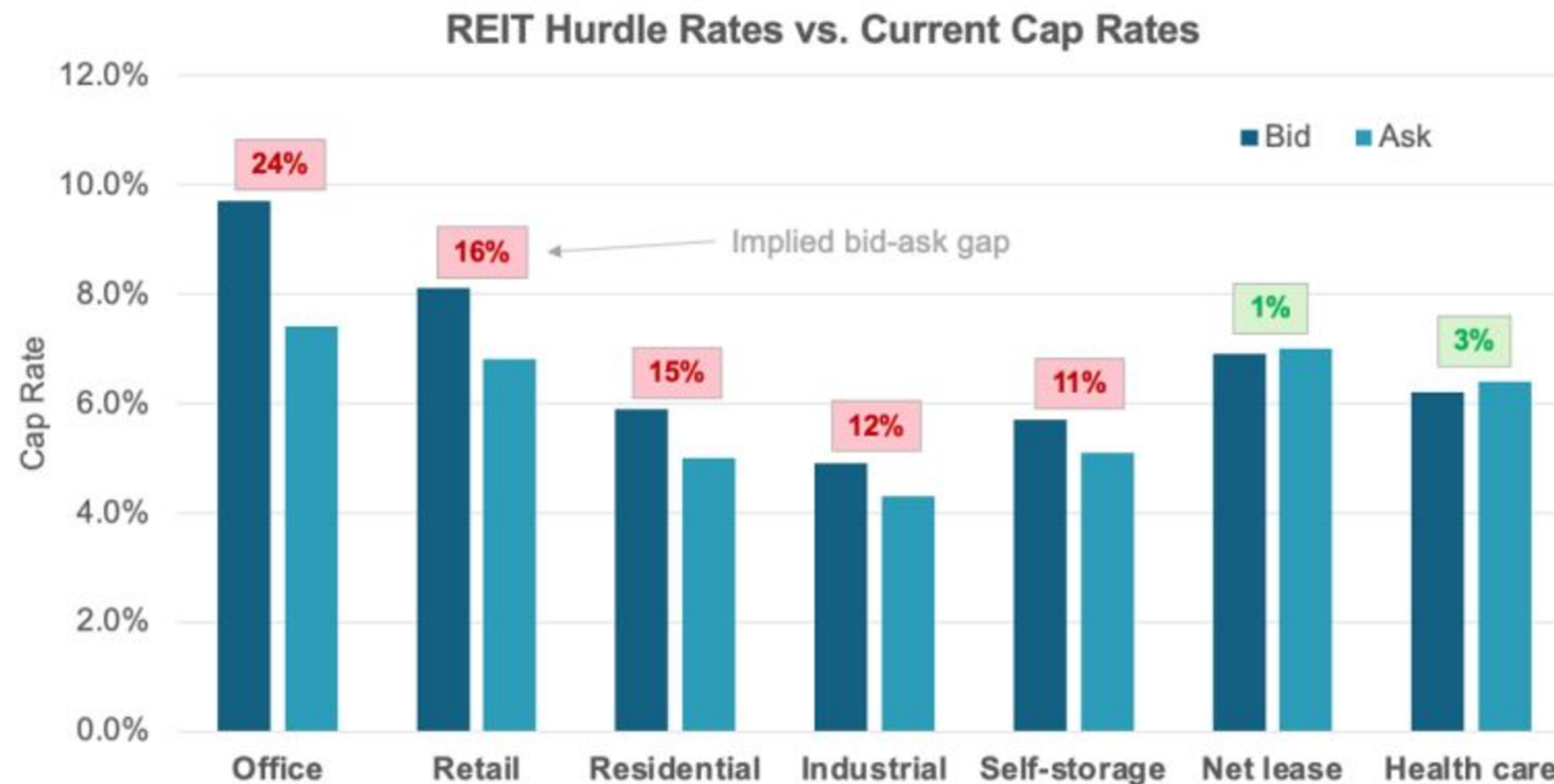
Lev. IRR

Can we have an honest discussion about "negative leverage?"



Mind the Gap: Cap Rates

This 11% bid-ask gap varies substantially by sector. Assuming REITs set a pricing floor, here's how far values would fall from recent peaks...









Public REITs typically lead private real estate markets; therefore, REITs' cost of capital can be indicative of private asset values. With REIT values down 30% and relative clarity around REIT earnings yields and debt costs, we can estimate an implied hurdle rate. i.e., the cap rates where REITs would be buyers, which provide insight into bid-ask gaps vs. current cap rates.

Where are the CRE buyers?



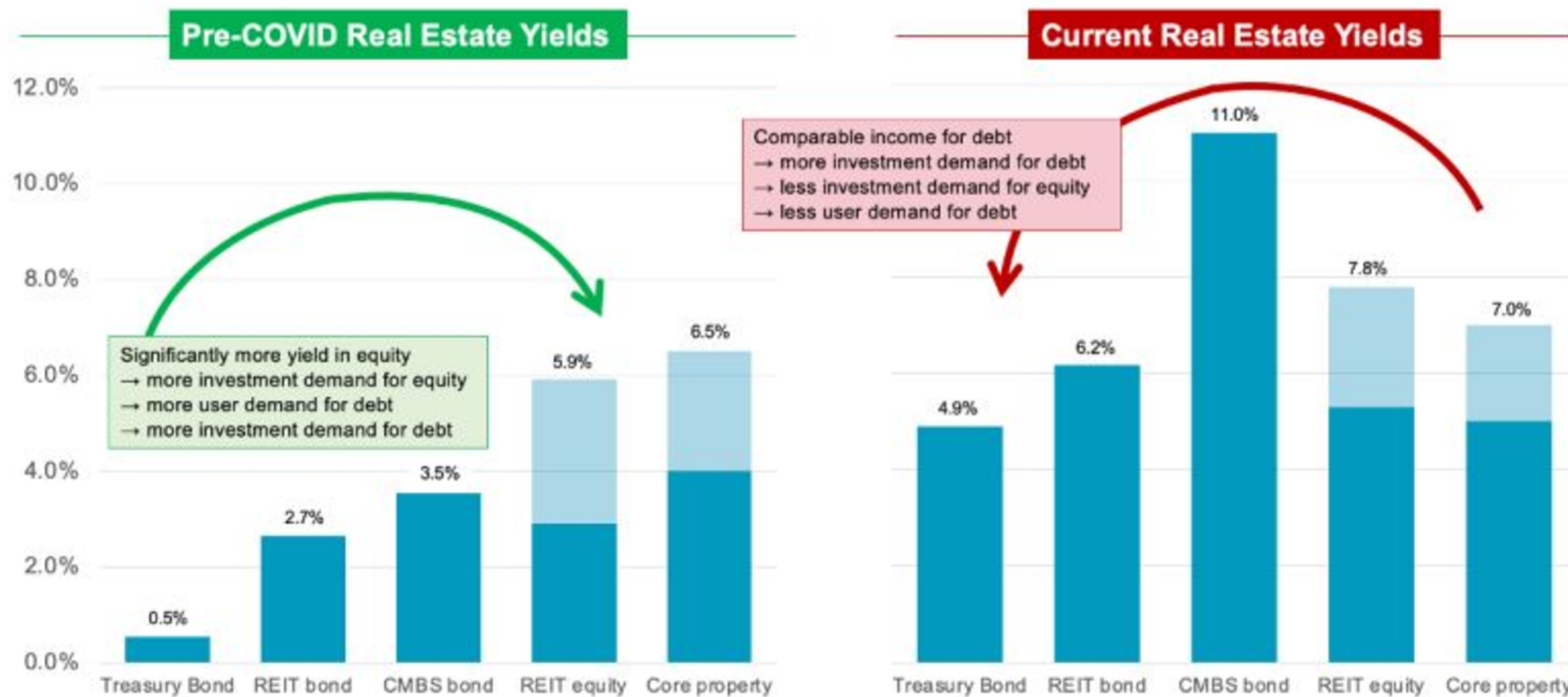
Real Estate Equity Appetite and Challenges by Vehicle

	Core funds	Core plus funds	Public REITs	Private REITs	Value add funds	Opportunistic funds
Fund Structure	Perpetual	Perpetual	Perpetual	Perpetual	Closed end	Closed end
Example Fund	JPM Strategic Property Fund	Blackstone Property Partners	ProLogis	Blackstone Real Estate Income Trust (BREIT)	CBRE Strategic Partners U.S. Value Fund 9	Blackstone Real Estate Partners (BREP)
Approx. Return to Investors	8%	9%	9%	11%	11%	15%
Current Appetite						
Dominant Challenge	Appraisal lag, redemption queues	Appraisal lag, redemption queues	Discounts to NAV	Appraisal lag, redemption queues	Prohibitive borrowing costs	Prohibitive borrowing costs
Prerequisite for Recovery	Stable values, economic clarity	Stable values, economic clarity	Stable values	Stable values, economic clarity	Debt market recovery	Debt market recovery

Nearly all buyers are currently on the sidelines. No green shoots...

Why would an investor buy a property with a 5% cap rate when the investor could be a real estate lender and get 6% yields?

CRE Capital Markets: A Painful Pivot



Notes: Returns estimates are based on 10Y Treasury, UDR bonds and equity, BBB CMBS bonds, and ODCE returns



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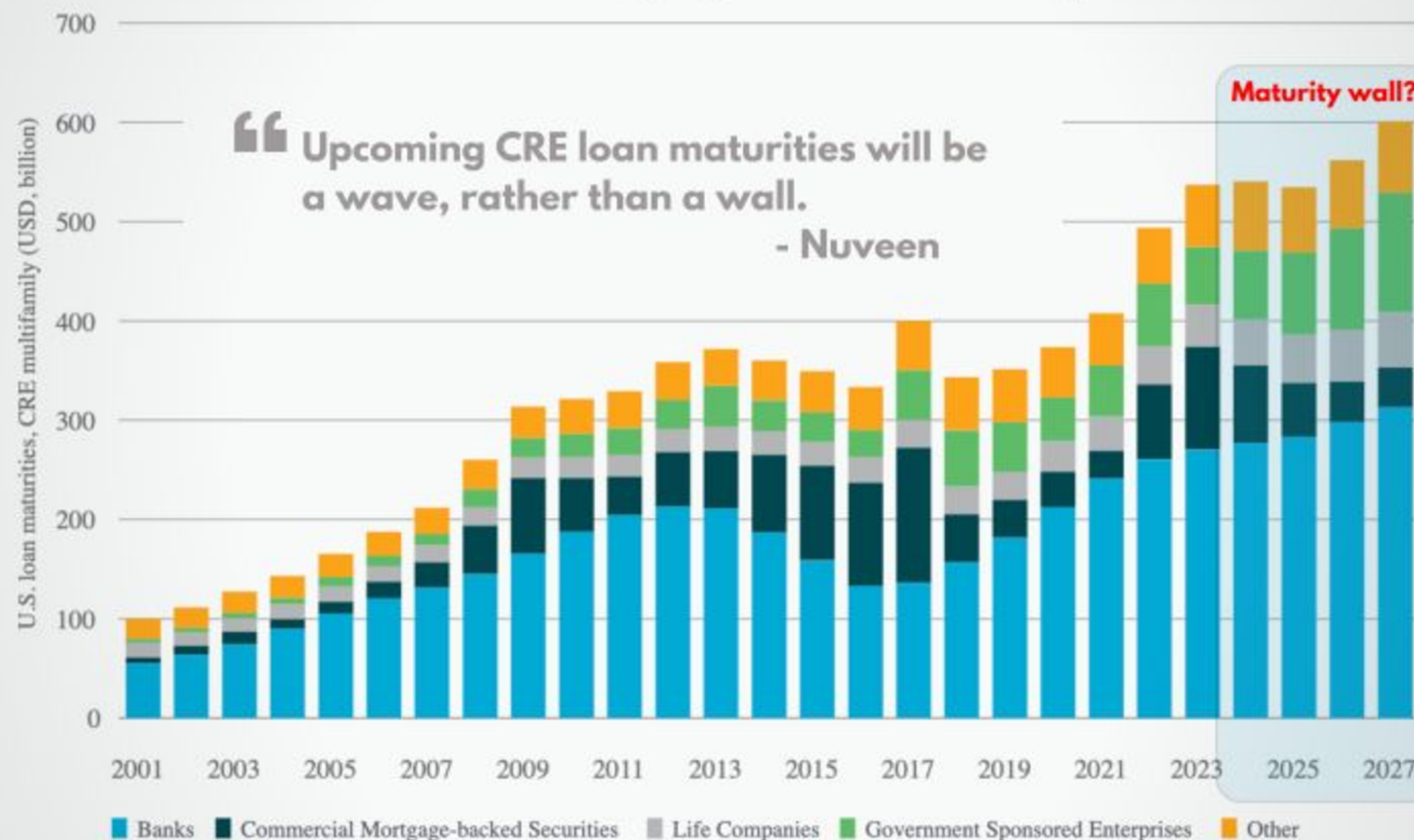
January 4, 2024

CRE pundits love a good boogeyman narrative, but CRE credit risk is nuanced, facts matter, and the risks of fear mongering are real.

The maturity wall myth?



Commercial Mortgage Maturities by Year

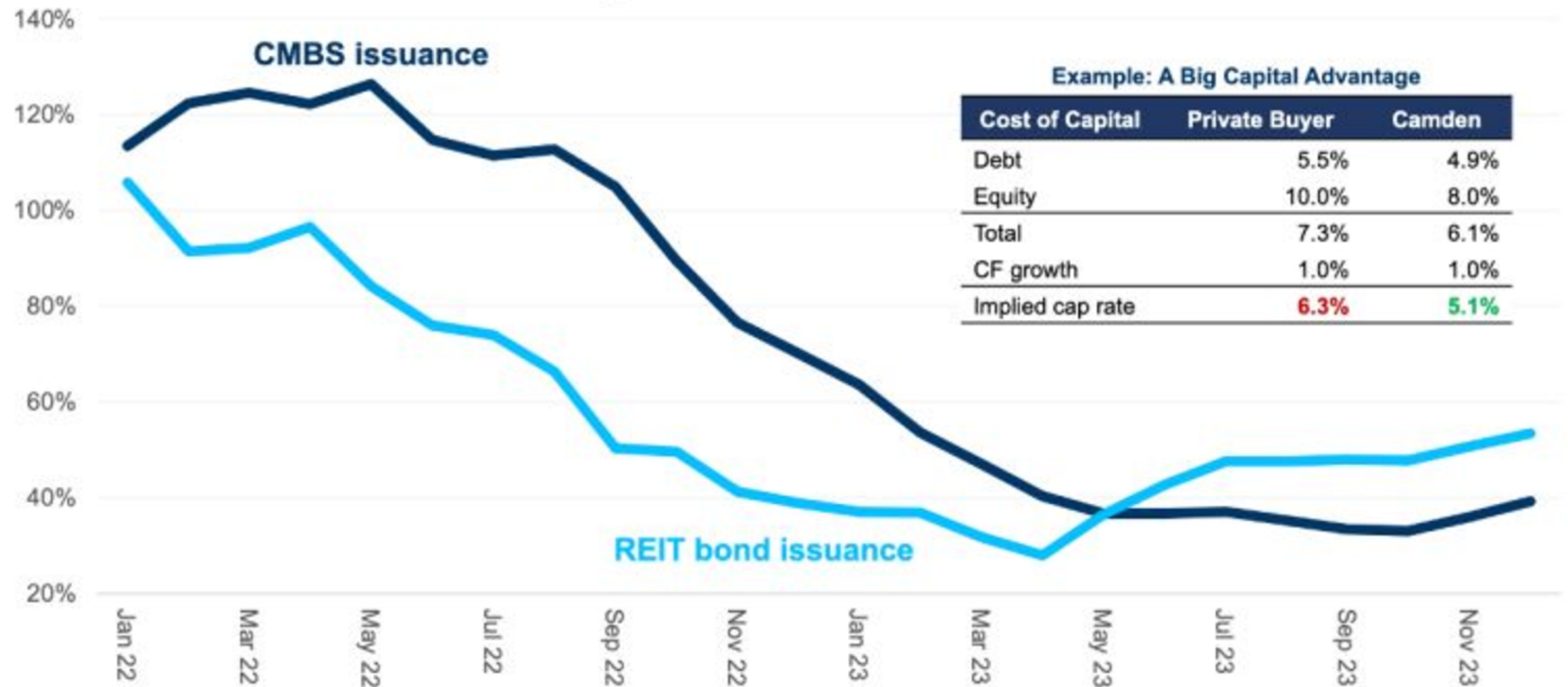


Source: Nuveen, Trepp

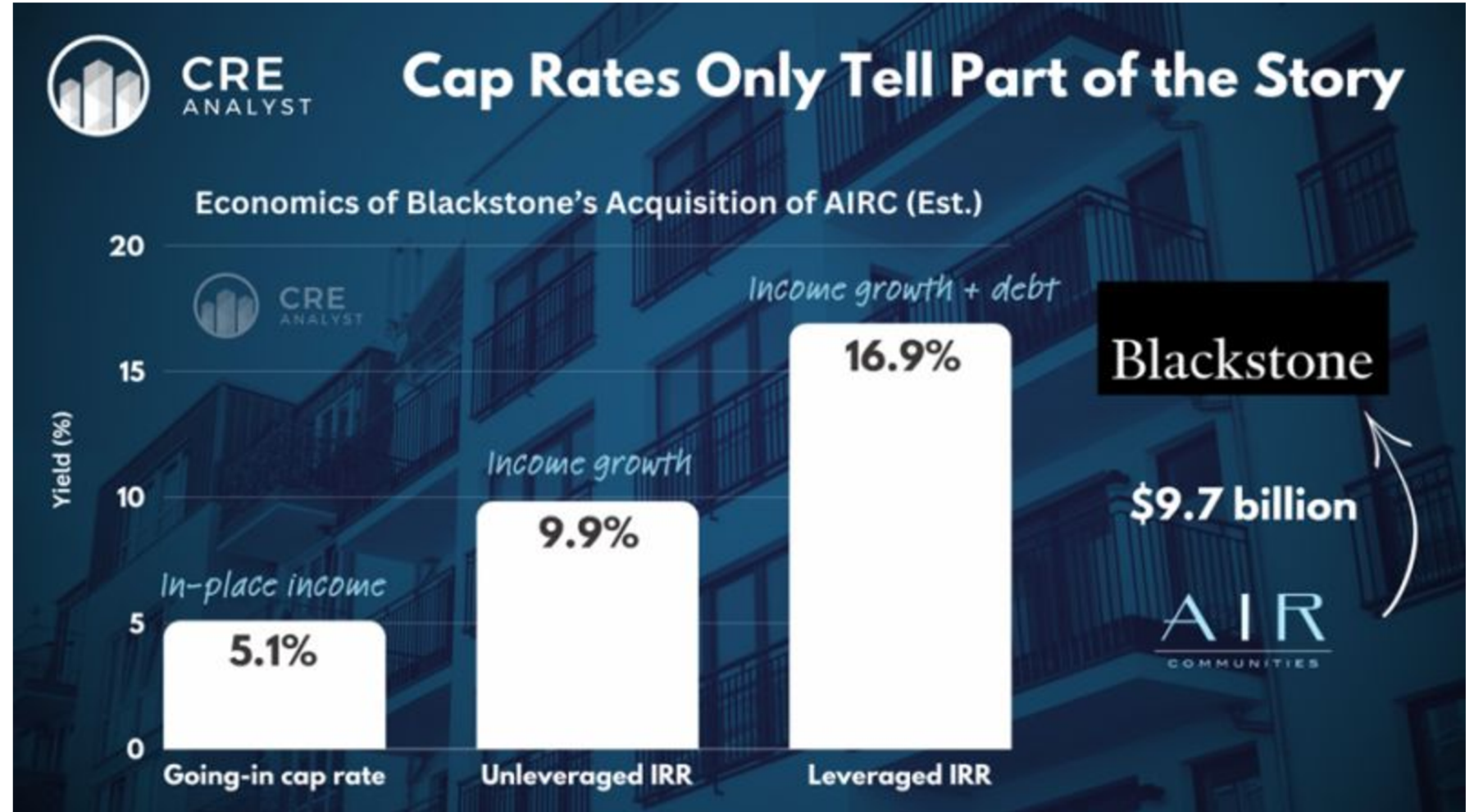
REITs, with their relatively conservative approach and near-constant access to debt and equity, give us examples of this at play. Perhaps this is a turning point...

Winners vs. Losers = Access to Capital

Debt Originations as % of Pre-Covid Levels



Trigger warning:
Cap rates are
bullsh*t



A big step toward the industry's new normal? We think these trades suggest a new watermark for higher-quality apartments between 5% and 5.5% cap rates.


Are Apartments Fairly Priced Again?



Apartment REIT FFO Yield (AVB) vs. Primary Market Cap Rates










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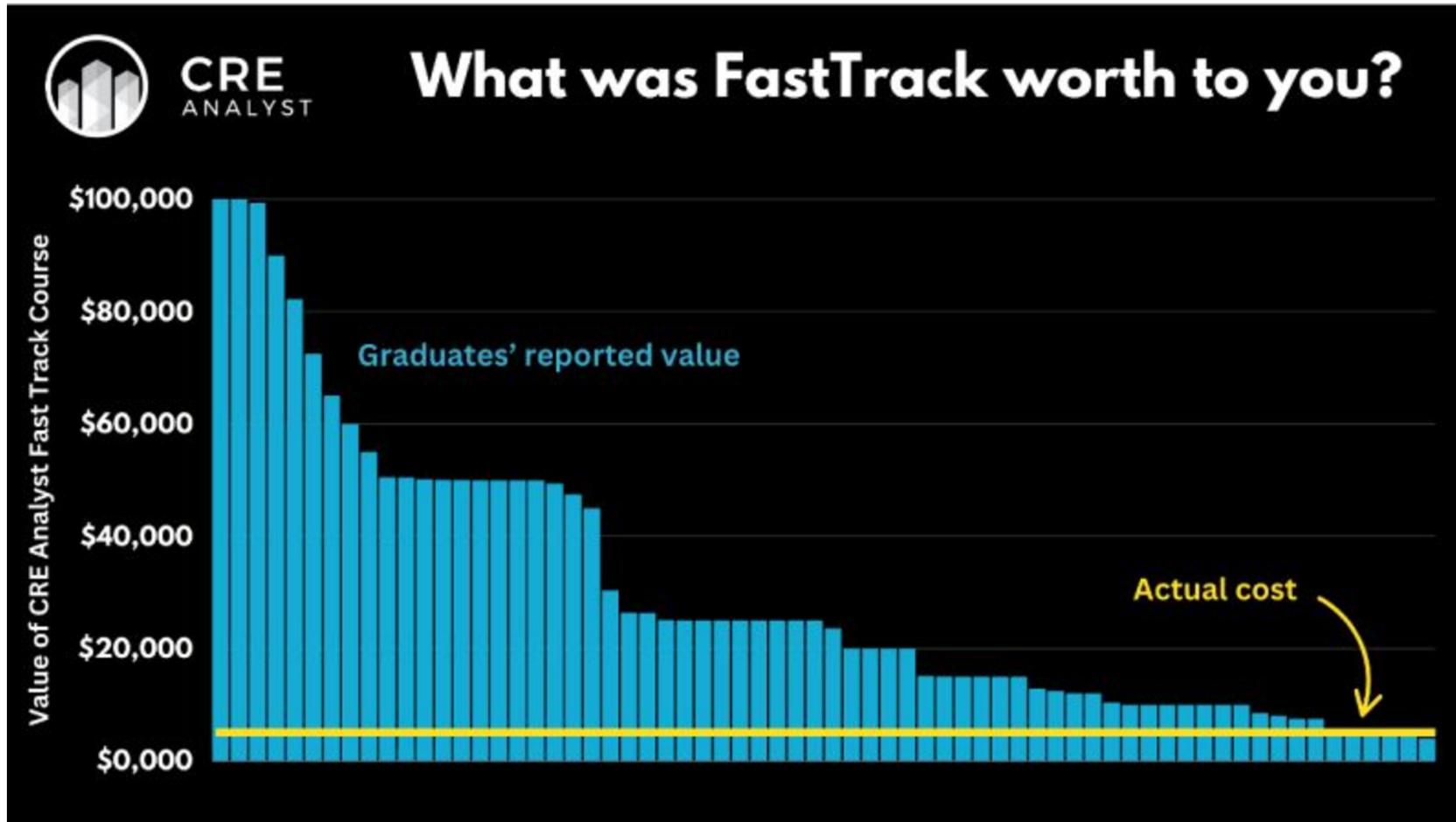
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DM us if you want to learn about the critical CRE frameworks that define our analysis.

Enrollment for next FastTrack cohort ends this week.