PERE Network

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North American real estate investors: commitments and strategies

Signs of recovery are emerging in North American real estate markets after two years of subdued transactions and fundraising. However, there are still manifold uncertainties for investors to navigate. Fundraising and survey data show continued interest in resilient sectors and locations, as well as a growing appetite for risk and for real estate debt.

This white paper examines fundraising for American real estate and the strategies and investments preferred by institutional investors, both at home and overseas.

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Stabilizing economy, uncertain geopolitical outlook

After two years of elevated interest rates, the US Federal Reserve Bank made its first cut for nearly four years in September. Fitch Ratings forecasts that the Fed will cut rates again this year, to 4.5 percent, and make further cuts in 2025, bringing them down to 3.5 percent and then further to a "neutral level" of 3 percent by June 2026.

The rate cut and the prospect of more to come has revitalized real estate investors in the US and further afield, with the prospect of cheaper borrowing and cap rate compression to come. Interest rate cuts also reflect concerns about the economy, the risk of a US recession is seen to be rising. For example, in August JP Morgan research raised the probability of a US recession this year to 35 percent.

However, the geopolitical environment remains disrupted with escalating conflict in the Middle East added to the ongoing war in Ukraine. US-China relations continue to be frosty. With all this as background, the US presidential election will be held on November 5th and, at the time of writing, the result looks too close to call.

The immediate impact of the election may be overstated, a September report from CBRE argues. It found "no material change in commercial real estate investment activity or values in the months just before and after federal elections, despite widespread belief to the contrary". The broker's research found that macroeconomic factor, particularly interest rates, had a far more significant effect on cap rates.

Nonetheless, CBRE notes that the new administration's decisions - on trade, taxes, regulations, government spending and the federal budget deficit - could affect real estate in the longer term.

The Investment Intentions Survey 2024, carried out by real estate bodies PREA, INREV and ANREV found that interest rate policy was the most significant factor affecting real estate investment, cited by 90 percent of North American investors. Meanwhile, geopolitical risk was cited by only 69 percent.

Investors look to higher risk/return and debt strategies

Capital-raising for real estate funds has fallen steadily since the peak of the fundraising market in 2021. PERE data show H1 2024 fundraising of $59 billion, down 43 percent from the $104.2 billion raised in the same period last year and the lowest half year total since 2012. The second half of 2023 was also relatively weak, so H2 2024 data are likely to give a clearer indication of whether fundraising has bottomed out. Anecdotal evidence suggests a change in sentiment following the Fed rate cut, but it will take time for this to be reflected in the data.

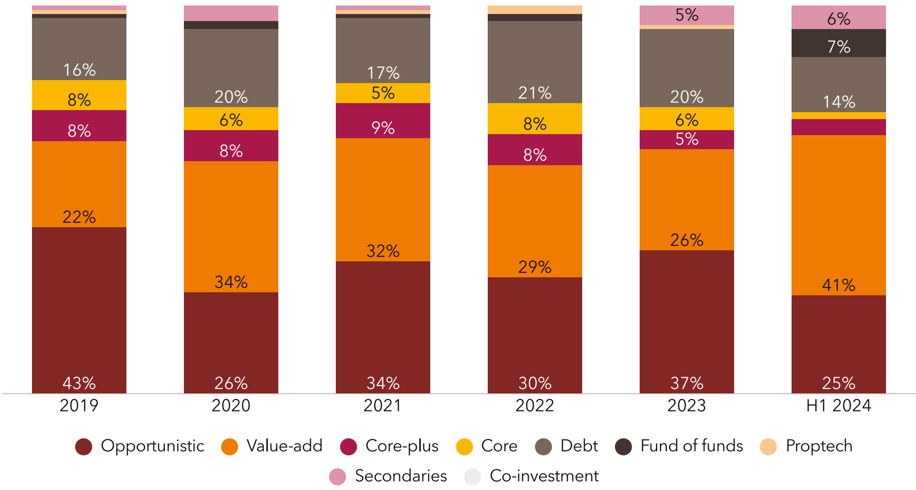
North American investors continue to have the highest allocation towards real estate, according to the PREA, INREV, ANREV survey, of 12.4 percent and are also slightly underweight their target allocation of 12.7 percent. PERE data show 45 percent of institutions underallocated as at June 30, 2024.

Investors' strategic preferences remain broadly similar to recent years, with significant capital allocated to value-add, opportunistic and debt strategies. These three strategies combined have accounted for around 80% of capital raising in the past five years. The first half of this year showed a strong preference for value-add strategies (41%), the highest level for five years.

Appropriately, the largest fund closed in the first half of 2024 was Blue Owl Capital's Blue Owl value-add Real Estate Capital Fund VI, which raised $5.16 billion. The second largest was Goldman Sachs Asset Management's West Street Real Estate Credit Partners IV. Of the top 10 largest funds closed, five have a value-add strategy.

Looking at the largest funds in the market today, six of the top 10 (including the three largest) are opportunistic vehicles. There are also two debt funds and one value-add strategy. This suggests a continuation of recent capital formation trends.

Year-on-year fundraising by strategy (%)



Home is where the heart is; regional investment strategies

More than half of the global investment institutions monitored by PERE are based in North America and North American strategies accounted for more than half the private real estate capital raised in the first half of this year. investments, PERE data show. Top of the list was the New York State Common Retirement Fund, which allocated $1.3 billion across four strategies.

PERE data show there are more funds in the market (by aggregate target capital) focused on North America than the rest of the world combined, if multi-regional funds are excluded. Furthermore PREA/INREV/ANREV data shows that North American investors have 75 percent of their real estate assets in their home region and another eight percent in the Americas ex-USA. Europe and Asia-Pacific combined make up less than one-tenth of their real estate holdings.

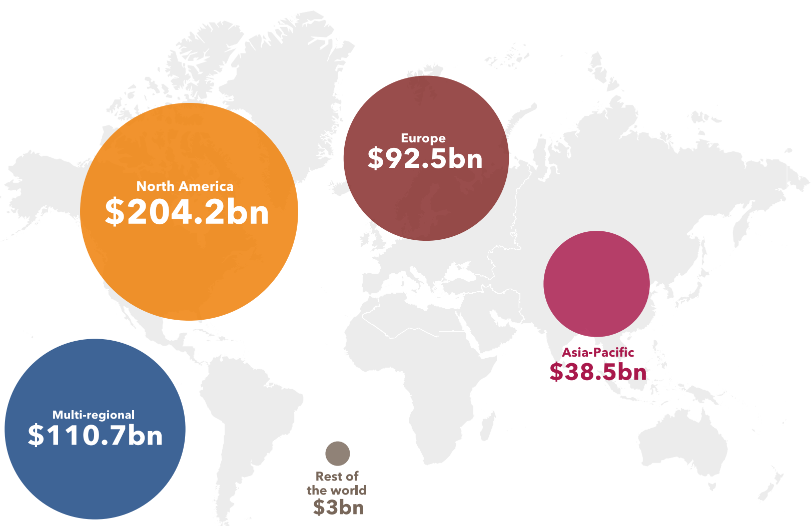
This demonstrates a strong home bias for North American investors and indicates where the bulk of their capital will be allocated. During the recent global real estate downturn, investors from all over the world were seen to reduce their activity in overseas markets. For example, MSCI data show cross-border activity in Asia Pacific fell to its lowest level for a decade in the first half of this year.

Nonetheless, there have been signs of interest from North American real estate investors in selective markets. Savills research found that US private equity investors have been very active in London's West End market in the first half of this year, acquiring assets with larger than average lot sizes. In the City of London, North American buyers accounted for 20 percent of purchases by value in the first half of this year.

Funds in market: by region

North America is the most popular region for funds in market, followed by multi-regional, targeting a total of $204.2 billion and $110.7 billion, respectively.

Having said that, only one of the top 10 biggest funds in market is targeting North America: Carlyle Realty Partners X. Meanwhile, six of the top 10 funds in the market h a multi-regional focus.

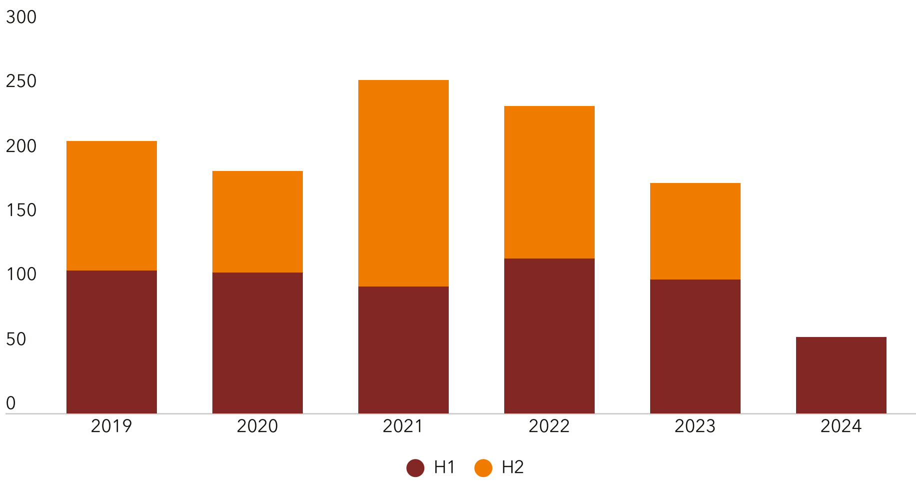


Investor action: where are the big checks going?

Following the trends outlined above, in the first half of 2024 North American investors were the dominant source of the largest known commitments to private real estate closed-end funds, accounting for 14 out of the top 15 investments, PERE data show. Top of the list was the New York State Common Retirement Fund, which allocated $1.3 billion across four strategies.

Of the top largest commitments made in the first half of this year, six were made to opportunistic funds and seven to strategies focusing entirely or partially on North America. However, the largest single commitment was the $343 million New York State Common Retirement Fund made to Ares European Property Enhancement Partners IV.

Year-on-year fundraising, capital raised ($bn)



Where to invest in the US?

According to JP Morgan Private Bank research, aggregate US real estate values have fallen 12 percent from their September 2022 peak. However, cashflows in that time have remained robust and vacancies are at "a near 25-year low". Even considering the travails of the US office market, the current downturn has been driven almost entirely by the interest rate environment.

A notable feature of this downturn is that it is not evenly spread. This is not just the case between sectors – logistics has been much more resilient than offices – but also within sectors and even cities. For example, despite office vacancies of around 18%, the One Vanderbilt office building in New York City is 99.4% leased.

As the JP Morgan report says: "The market is all over the place, and that could be where the opportunities lie." That seems to be what New York developer RXR and Ares Management believe, having plans to launch a $1 billion office fund. Meanwhile, Reven Capital and Mosaic Real Estate Investors have launched a new office real estate investment trust (REIT), while SL Green trailed plans for a $1 billion distressed debt fund for New York City real restate.

Indeed, MSCI transaction data suggest the office investment recovery has already started. US office transactions rose three percent year-on-year in the first half of 2024, making the sector the most improved on the previous period (most sectors fell), even though volumes were well behind the apartment and industrial sectors.

This tallies with the findings of CBRE's US investment intentions survey for 2024, launched at the beginning of this year, which revealed investors were still focused on the multifamily and logistics sectors nationwide. The most popular metros remained New York and the Sun Belt Cities. Meanwhile PERE data for the first half of this year show 87 percent of the capital raised was for residential or industrial strategies.

The rise of real estate debt & investment trends in debt

CBRE's investment intentions survey shows real estate debt as the preferred alternative sector for this year, ahead of sectors such as data centers, student housing and life sciences real estate.

Private debt accounts for a significant proportion of the North American real estate lending market and a smaller but growing proportion in Europe and Asia Pacific, with the charge often led by North American managers.

As banks continue to withdraw from real estate lending, there is a secular opportunity for private lenders to bridge the gap. A recent report from KKR pointed to a $300 billion financing gap, offering an outsized opportunity to real estate investors.

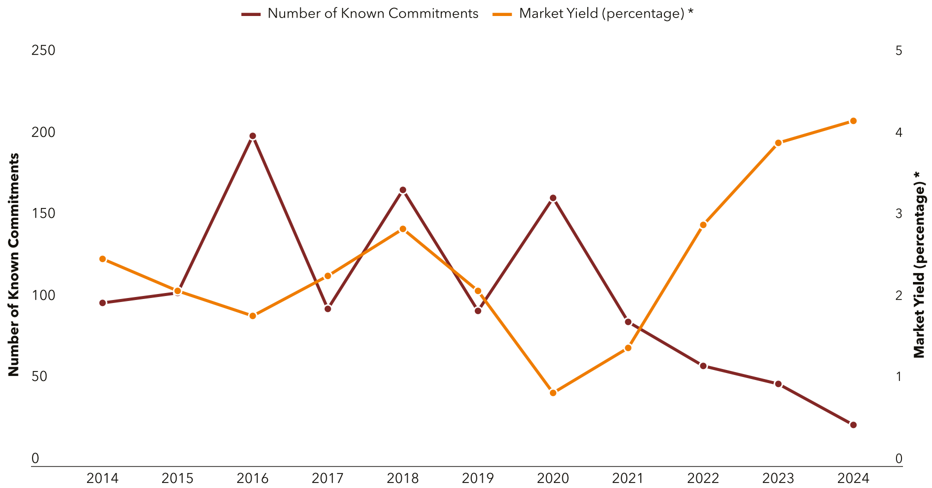
"We see real estate credit as a compelling, evergreen opportunity to diversify both real secured equity holdings and the credit component of a portfolio with a high-yielding asset backed by real property and benefiting from a structural decrease in the availability of capital," the report said.

Although recent debt capital-raising has been limited by higher interest rates and substantially reduced real estate transaction volumes, 2020 and 2021 saw a fundraising boom, with more than $57 billion raised for North American private real estate debt, according to data from PERE Credit.

North American institutional investors have been an important part of this fundraising. PERE Credit data show that the top 15 North American investors in American private real estate debt have committed close to $30 billion in equity since 2008.

Debt funds are also getting larger. The 20 largest debt funds which closed in the past five years have raised an average of just over $2 billion each, with the largest netting $4 billion. Today, the largest debt funds in the market are Blackstone Real Estate Debt Strategies V, targeting $8 billion and Cheyne Real Estate Holdings Fund VIII, targeting $6.41 billion.

Known real estate debt commitments by vintage year, compared with the 10-year treasury yield (2008-H1 2024)



*Source: Board of Governors of the Federal Reserve System (US)

Conclusion: preparing for the upturn

Despite uncertainty over the presidential election result, continued geopolitical upheaval and the risk of a US recession, real estate seems to have bottomed out. MSCI data shows prices rising in both the US industrial and retail real estate sectors and cap rate increases moderating across the board.

Despite subdued fundraising, a significant amount of opportunistic and value add capital has been raised and there is more to come as investors and managers position themselves for a recovery. Brokers are reporting more interest and more transactions, which should show up in the data soon.

North American real estate investors have a plethora of strategies to buy into, from resilient sector such as industrial and multifamily, through distressed assets at home and abroad to the huge opportunity in real estate debt.

PERE America is your unrivalled source of investment insight

In unsettled times, all intelligence is valuable and *PERE America* is the best place to exchange ideas with industry experts, either on the stage or in the networking events. The audience of investors and managers - 200 attending last year – is excellent, as is the quality of content. Leaders from Brookfield, Blackstone, CBRE Investment Management, Norges Bank and Oxford Properties will be on stage to discuss the state of the market and where to invest.

A full day of real estate debt content brings the opportunity to hear from pioneers in that sector and to meet both investors and managers who are either deep in the sector or looking to dive in. Senior executives from investors and managers such as Fortress Investment Group, Generali Real Estate and Kayne Anderson will take to the stage.

Taking place scarcely a week after the US presidential elections, the conference will be an early opportunity to hear considered judgement on the ramifications for real estate from some of the industry's biggest players.

PERE America takes place on November 13-14 2024, Convene at One Liberty Plaza, NYC. For more information and registration, contact Ben Moss, ben.m@pei.group.

For more details on the conference, agenda and participants, see: https://www.peievents.com/en/event/pere-america/home/