PARTNERS CAPITAL

Asset Class Investment Strategies

Real Estate

This is a financial promotion. Your capital is at risk, the value of investments may fall and rise and you may not get back the full amount you invested. Past performance is not indicative of future returns.

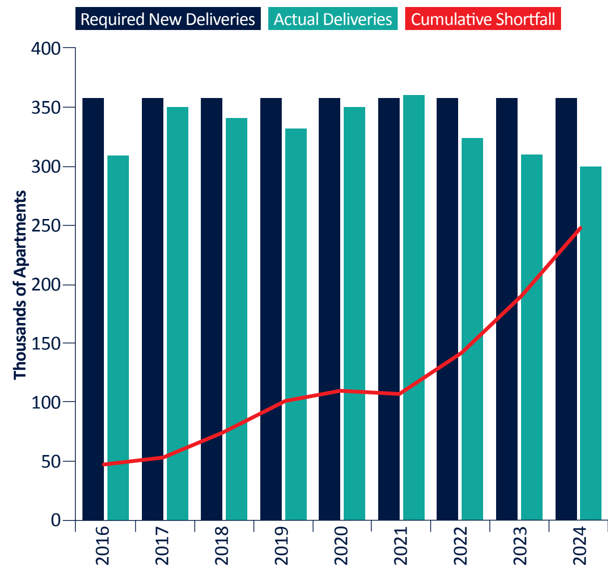
Major Trends

Accelerating shift to online shopping driving demand for logistics: E-commerce sales roughly doubled from 2016 to 2021 ($400-$770B) and are expected to double again by 2026[1] ($1.4T). Benefits last-mile logistics properties to the detriment of retail stores. JLL estimates every $1B of additional e-commerce sales creates demand for 1.25M square feet of industrial space, driving record low vacancy (c.4%) and accelerating rent growth.

Shortfall in apartment development: Favourable supply demand dynamics have driven vacancy close to all-time lows at c.4.0%[2]. Demographics are driving demand with younger consumers showing a preference for renting over buying: home ownership has declined from 69% to 65%[3] and is projected to fall to 60%[4], increasing the number of renters. On the supply side, most new development is skewed towards high-end product resulting in a shortfall of affordable 'Class B' apartments. More than 60% of existing rental apartments were built before 1980[5], creating opportunity for value-add refurbishments.

Exhibit 2

US multifamily: new construction falling behind required deliveries, creating shortfall

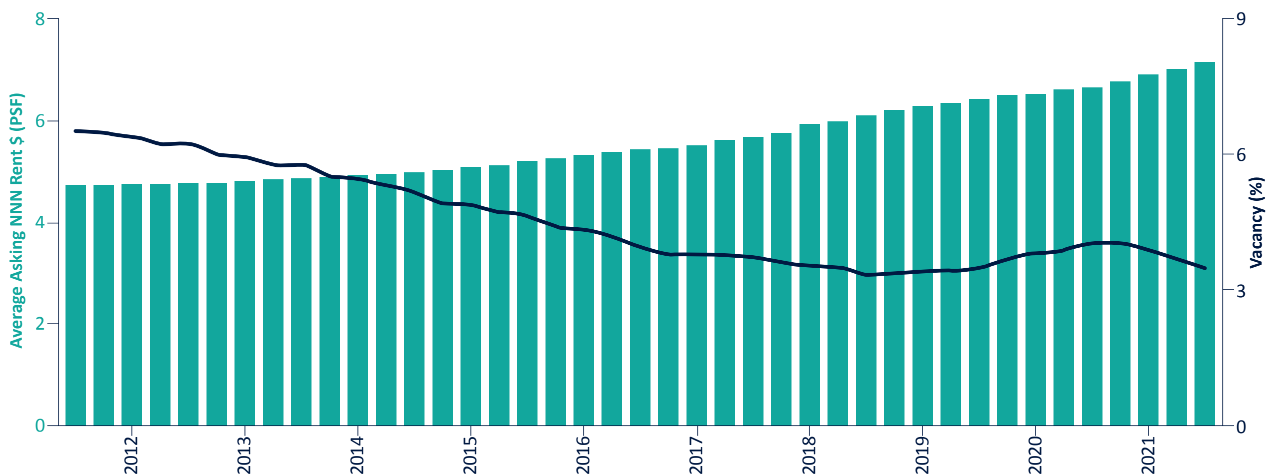


Source: *National Multifamily Housing Council*

1. Source: Statist.
2. Source: JLL, CBRE, as at 31 December 2021.
3. Source: US Census, as at 30 September 2021.
4. Source: Freddie Mac, as at 31 December 2020.
5. Source: Urban Institute, Q1 2020.

Exhibit 1

US industrials vacancy and rent growth



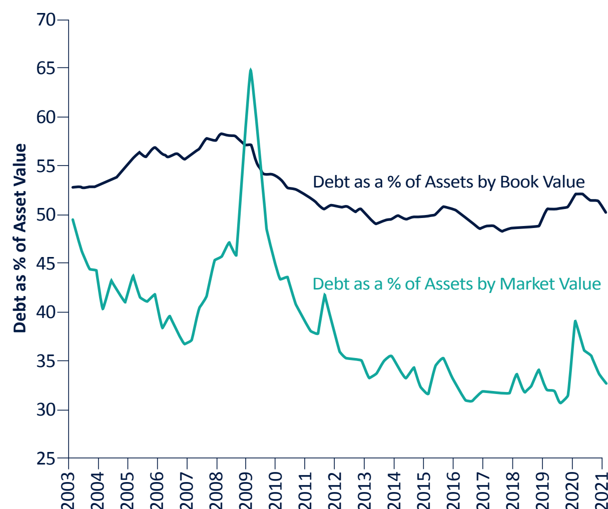
Source: *Newman Knight Frank*

Not yet sufficient return to compensate for higher risk in Covid-impacted sectors such as hospitality and retail: Clear cash flow challenges in hospitality and retail. Uncertainty surrounding future of office, but corporate tenants remain broadly healthy and continue paying rents. We do not yet see evidence of sufficiently distressed pricing or outsized returns to compensate for the risk in these sectors.

Lending and new construction (late cycle indicators) remain in check: Leverage levels meaningfully lower for US REITs since GFC: 30-35% LTV today vs. 40-50% pre-GFC[6]. This is consistent with CMBS data: 47% of CMBS loans made in 2008 had LTVs in excess of 70% vs. 10% today[7]. Adjusted for construction cost inflation, US real estate development remains in line with 25-year averages[8].

Exhibit 3

US REITs: Debt to Total Assets



Source: *NAREIT*

6. Source: NAREIT
7. Trepp Commercial Real Estate
8. US Census Bureau, Turner Construction Cost Index
9. Commodities measured by S&P Goldman Sachs Commodity Index; Real Estate measured by FTSE NAREIT All Equity REITs Index; Equities measured by S&P 500; TIPS measured by Barclays Capital U.S. Treasury TIPS Index; Gold measured by S&P GSCI Gold Index. Returns are shown annualised for the relevant periods which meet the defined criteria

Golden Rules

- Partner with vertically integrated managers with excellent operational capabilities and local knowledge
- Focus on "Buy, Fix, Sell" approach within PERE. For core-plus, "Buy, Fix, Hold" approach in high-conviction markets
- Be prudent in level and structure of leverage
- Maintain diversification, but skew towards markets with the strongest fundamentals
- Focus on liquid markets, be wary of tertiary and emerging markets
- Consider taxes – benefits or disadvantages depending on investor type and market.

Sub-Strategy Attractiveness

Industrial – Favourable view of portfolio aggregation strategies in "last-mile" logistics. Acquire small assets off-market, exit at a portfolio premium in sale to institutional buyer.

Multifamily – Favourable for sector specialists executing buy-fix-sell. Strong fundamentals in most markets and repeatable value-add playbook

Office – Neutral. Tenant demand accelerating into Class A, energy efficient properties. Avoid traditional "commodity" office. May be select opportunities to upgrade assets in growth markets.

Non-Traditional – Neutral. Favourable view of self-storage aggregation plays with experienced GPs, due to market fragmentation. Data centres and life science difficult to access without taking development risk.

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Real Estate
continued

Hospitality – Neutral. Despite cash flow challenges, lenders mostly forbearing. Combined with dry powder on the sidelines, this has prevented widespread distress in the sector.

Retail – Negative. Challenging sector with declining tenant demand and oversupply. Rents remain higher than alternative use value in many major markets, suggesting floor not yet reached.

2022 Strategic Priorities

- Focus incremental capital in sectors with supply demand imbalances, including logistics, residential, and select other sectors depending on geography.
- Access these opportunities via established and emerging manager partnerships who can source underdeveloped and undermanaged properties and drive excess returns via acquisition discounts, operational improvements, and net income growth.
- Certain types of real estate can be a good inflation hedge as replacement value increases with rising construction cost and rent. Overweight real estate exposures towards sectors that offer strong inflation hedging characteristics – e.g., residential (short leases, rents are reset every 12 months) and logistics (where landlords have pricing power and leases are structured as triple net, i.e., expenses passed to tenants).
- Increase investable options in real estate through semi-liquid core-plus property funds. These structures provide investors access to an existing portfolio of assets, allowing us to be highly selective with respect to sector and geographic exposures. In core-plus, scale is important to establish diversification and to ensure meaningful liquidity for investors in the vehicle. Our focus is on partnering with high quality managers and securing attractive terms for our clients.

Exhibit 4
Real estate has been a good inflation hedge

Inflation Hedge Effectiveness: 1978-2011 (c.400 Monthly Observations)

Description	Success Rate as Inflation Hedge	High Inflation Scenarios	Moderate Inflation Scenarios
Inflation		6.1%	1.8%
Commodities	70.4%	19.2%	-2.4%
Real Estate	65.8%	12.3%	12.3%
Global Equities	60.8%	10.2%	10.2%
TIPS	53.8%	6.9%	6.9%
Gold	43.2%	6.0%	6.0%

Source: *"Inflation and Real Estate Investments", March 2017. Susan M. Wachter, Richard B. Worley Professor of Financial Management, The Wharton School of the University of Pennsylvania, and Brad Case, Senior Vice President, NAREIT.*

- Generate co-investments through our manager relationships to scale into high conviction investments. In past 12 months, our clients have co-invested in US multifamily and European logistics opportunities.

Expected 12-Month Returns

Exhibit 5
Expected returns by scenario

	Recovery Falters (10%)	Stagflation (10%)	Gradual Normalisation (60%)	Reflation 2.0 (20%)	Expected Value
Core Property	-1.0%	5.0%	6.5%	7.5%	**5.8%**
PERE	-3.6%	7.9%	11.1%	13.1%	**9.7%**
Notes	Base case return comprised of rental income (c.5%) plus capital gains (c.2.0%), less expenses (c.1.0%). Manager alpha adds a further 1%. PERE assumes 2x core property beta, less 1.0x cash yield as a proxy for cost of leverage, plus a 4% illiquidity premium.				

Return assumptions are for the 12 months from 31 January 2022. Hypothetical return expectations are based on simulations with forward looking assumptions, which have inherent limitations. Such forecasts are not a reliable indicator of future performance.

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