

FOLLOWING THE FLOWS

WHERE CAPITAL
IS HEADED IN 2024

WHAT TYPES OF ACTIVITY ARE LIKELY TO DRIVE THE MARKET THROUGHOUT 2024?

TYPES OF ACTIVITY WILL TAKE THE FORM OF:



DIRECT ASSET PURCHASES/SALES

In the near-term, this period of illiquidity is affording private capital the opportunity to step into a significantly less competitive market today to directly acquire assets.



RECAPITALIZATIONS

This period is also offering a significant opportunity for equity to come in and recapitalize assets where existing ownership doesn't want to part with the asset entirely.



LENDER-FACILITATED NOTE SALES

Private equity capital can also come in and purchase the distressed loans/note sales.



DIVERSIFICATION OF DEBT SOURCES

Finally, private debt funds can also step into an illiquid market today and effectively take advantage of the distress throughout the marketplace as opposed to distress of a given asset.



WHERE DO YOU THINK WE WILL SEE ACTIVE CAPITAL FLOWS ON THE SELL SIDE? **WHO WILL BE SELLERS?**

- » **Owners facing necessity-based conditions who are finally coming to terms with the higher-cost of capital environment.**
- » **Sellers facing debt maturities—particularly those that bought at the peak with shorter-term, bridge loan financing.**
 - Maturities are peaking in '24 and '25 (\$600B in 2024 and \$487B in 2025), and while it depends greatly on the situation and the loan, some owners are not going to be able to stomach new debt costs along with the new equity infusions required to meet more restrictive lending terms. It doesn't require a Fed pivot for sellers to acknowledge that rates aren't going back down to zero. The more that sellers now realize the new, higher-rate paradigm that we are in, the more likely they will be to accept what their debt will need to reset to. Depending on how long they've owned the asset, and how much accrued equity they have, they may choose to try to sell or to default. **There's a ton of equity capital that has built up, and near-term maturities will help catalyze existing owners into actualizing/crystallizing accrued profits so that they can recycle and deploy that capital into new ventures.**
- » **ODCE funds and non-traded REITs facing elevated redemption and withdrawal requests.**
 - Liquidity constraints gradually compel private funds to cherry-pick high-quality properties within their portfolios that have achieved business plan and that would receive strong interest/liquidity on the buy side. **Institutional product is selling, there is a ton of buyer interest and capital out there, but the sellers must be ready to meet the market—it's a matter of finding those sellers willing to accept that going-in yields must expand (i.e., that most buyers won't accept significant negative leverage anymore) and then it's a matter of deal teams shifting through those marketed/off-market assets.**
- » **Even private funds that aren't experiencing elevated redemptions; they might still decide to meet the market if they are experiencing declining portfolio cash flows and property valuations.**
- » **Closed-end funds and separate accounts with assets that have achieved business plans, looking to liquidate and get their promotes.**

WHERE DO YOU THINK WE WILL SEE ACTIVE CAPITAL FLOWS ON THE BUY SIDE?

WHO WILL BE BUYERS?

» **Private capital (unlevered) buyers that are seeking to capitalize on this “window” of dislocation.**

- A lot of the private capital buyers are investors (in Office, for example) that don’t necessarily have to answer to an LP and that can make decisions based on long-term conviction and because they don’t have return thresholds/mandates to follow.

» **Investors that are still interested in balancing (and rebalancing) their portfolios into higher-growth or different sectors or markets to ensure diversification.**

- These investors might be looking to balance sector- or market-level exposure, whether that be over- or under-exposure. The recent rally in the stock market underscores the fact that we are likely to see the denominator effect reverse in the period ahead, which means that you’ll have funds and portfolios suddenly under-allocated to CRE again.

» **Investors that recognize downturns, periods of illiquidity and dislocation create attractive vintage years for investment.**

» **Opportunistic and value-add investors who have enough conviction and do not want to wait until there is a clear inflection.**

- After waiting on the sidelines for over a year now, many buyers are eager to deploy capital and to take advantage of this window of dislocation ahead of a full inflection in capital flows and values. We’ve already seen a meaningful bounce back in public REIT markets, which serves as a helpful leading indicator towards demonstrating the direction private markets are headed as private valuation adjustments continue to register.

» **REITs that will continue to exercise their advantageous access (unsecured capital) to grow their portfolios and businesses strategically.**

- REIT investment activity is down compared to peak years, but many are still selectively acquiring assets that meet their target strategies. REITs have been particularly active in acquisitions in the Retail, Healthcare, Industrial, Residential and Self-Storage sectors. Looking forward, REIT’s broader access to financing, generally higher liquidity and generally lower average leverage ratios suggests that they could be positioned to acquire private assets at compelling terms. We might also see an inflow of capital into the public REIT space as investors recognize that the space has more fully reset and has already come off a few years of weak returns, making the valuations more appealing (and as they wait for the private side to reset more fully). These investor inflows to REITs could position REITs to be a more active buyer in the chapter ahead.

» **Entity-level merger and acquisition activity.**

- We’ve seen a few recent examples of take-privates (i.e., Blackstone’s \$10B acquisition of AIR Communities), which reflects the prevailing pricing differential between public and private markets. M&A activity is likely to continue as private equity players seek to deploy capital in large-scale and investors identify advantages toward operating large portfolios at scale.

» **Private capital buyers active in smaller deals.**

- With many of the very large funds still on the sidelines, deals that are getting done are smaller in nature because these smaller family offices and smaller investment managers can’t buy a \$100B asset when it would skew their portfolio exposure so much; they are generally more interested in smaller deals to blend with their portfolio.

» **Holders of note sales, not just asset sales, because they are likely to drive improvements in price discovery and aid the distress process overall.**



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