The Global Real Estate Environment

What to expect from a traditional inflation hedge

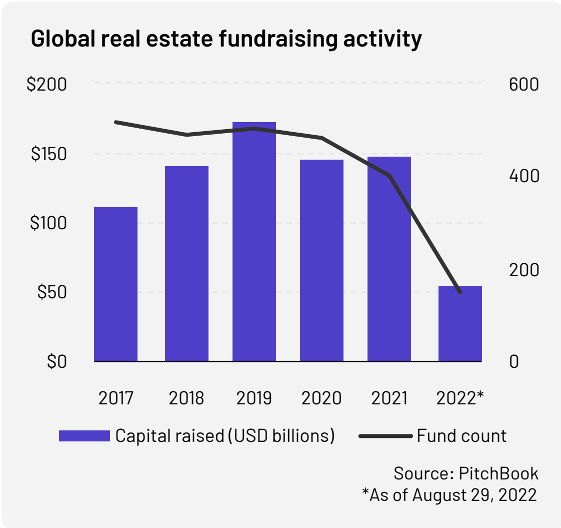
Data provided by PitchBook

Contents

Introduction

Real estate investing has been a staple of diversified portfolios for investors seeking assets with appreciating values and predictable cash flows. However, the COVID-19 pandemic dramatically changed the way people interact with different properties. Offices were shuttered during lockdowns, while apartments became cramped for residents who needed space for remote work and schooling. Hospitals filled with COVID-19 patients, while other healthcare facilities grew quiet as elective procedures were postponed. Fundamental assumptions about the real estate market were tested.

In 2022, real estate funds are slowing fundraising in anticipation of more challenging dealmaking conditions. Global issues, including supply-chain obstructions and high inflation, are taking a toll on planned construction projects, and some investors have grown wary of what is typically considered a safe investment when other asset classes decline in value. This report breaks down fundraising trends to examine recent changes and long-term prospects for real estate funds.



Market Trends

On a global scale, real estate fundraising has slowed in 2022 in response to macroeconomic pressures. Year-to-date (YTD) capital raised represents just over one-third of the annual total for 2021 and lags the elevated levels seen over the past 10 years.[1] First-time fundraising activity took an earlier hit in 2021, experiencing a 43.4 percent decline from 2020. These funds are feeling further downward pressure in 2022, with capital raised YTD representing just 19 percent of 2021's total. Overall median step-up between funds lost some momentum after a notable 39-percentage-point rise in 2021.

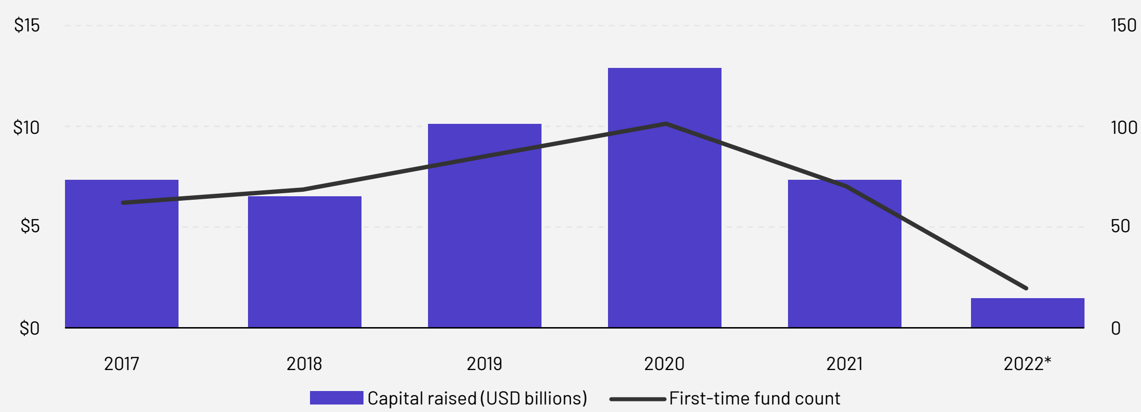
Once the initial economic shocks of the pandemic subsided in late 2020, many investors flocked back to Real Estate to take advantage of low interest rates and put dry powder to use. Residential home buyers had a similar idea, bolstered by new geographical flexibility provided by remote work. Demand for homes surged during this time while suppliers struggled to keep pace with the growing appetite, driving competition and prices upward.[2]

1: YTD data collected through August 29, 2022.

2: Anenberg, Elliot, and Daniel Ringo. 2022. "Volatility in Home Sales and Prices: Supply or Demand?" Finance and Economics Discussion Series 2022-041. Washington: Board of Governors of the Federal Reserve System.

Stock markets rebounded quickly from the onset of the pandemic, but stronger and more prolonged turbulence began in early 2022 as conflict broke out in Ukraine and logistics disruptions became more widespread. Supply challenges persisted, and inflation reached its highest level in decades for several nations. In response, central banks began rapidly and significantly increasing interest rates, creating a period of simultaneous rising mortgage

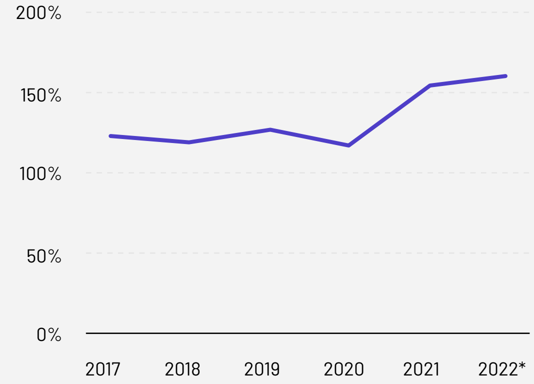
Global real estate first-time fundraising activity



Source: PitchBook | *As of August 29, 2022 rates and stubborn inflation. Investors are still waiting for the intended impact of higher rates to materialize. Real estate assets are traditionally used as a hedge against inflation as property values rise simultaneously, and in most cases, owners have pricing power to increase income and offset rising costs. However, the performance of different real estate asset classes fundamentally varied during the pandemic, and a confluence of macroeconomic factors worked against investors looking for a safe bet. Rapid shifts in migration trends and moratoriums on evictions, for example, disproportionately impacted residential owners. Many office and retail spaces were abandoned at the start of the pandemic, and lockdown policies and remote-work practices still vary widely by region. Supply-chain bottlenecks prevented or delayed capital improvements across the board, cutting into returns on projects that otherwise would have provided greater shelter from inflation and performed well even as stocks tumbled. These factors contributed to the slowing of new fundraising in 2022.

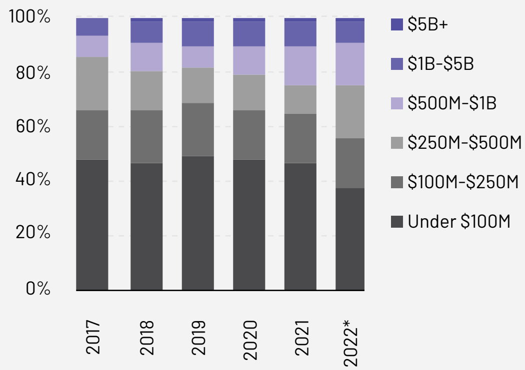
Unsurprisingly, a greater number of experienced real estate firms are raising capital YTD compared with emerging firms as investors look to mitigate risk and focus on efficiency. Between 2010 and 2013, more emerging managers were fundraising as the real estate market began recovering from the global financial crisis. This changed in 2014, and since then, most funds raising capital are those of experienced firms. The gap between

Median global real estate fund step-ups



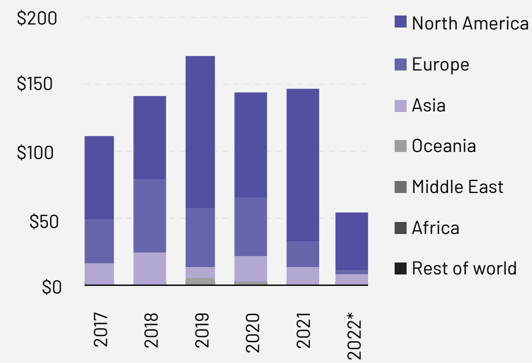
Source: PitchBook
*As of August 29, 2022

Share of global real estate fund count by size bucket



Source: PitchBook
*As of August 29, 2022

Global real estate capital raised (USD billions) by region

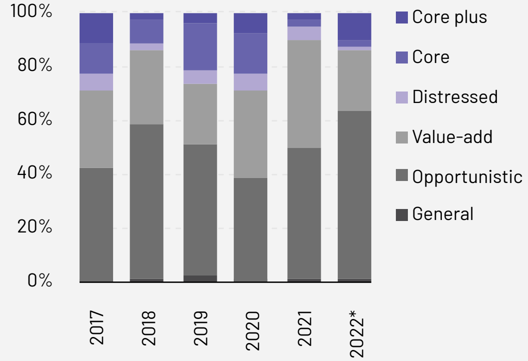


Source: PitchBook
*As of August 29, 2022

the two widened significantly in 2020 and has yet to shrink again.

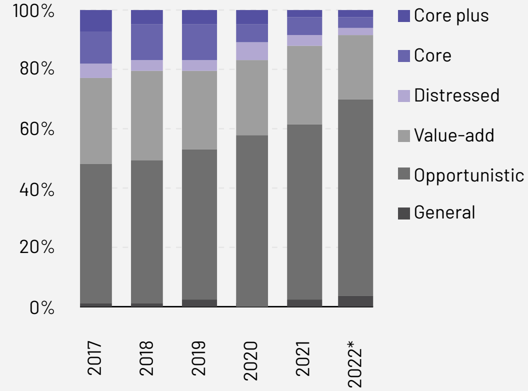
A slightly higher proportion of total fundraising YTD is attributed to opportunistic properties[3] in comparison with previous years, suggesting that investors still have an appetite for risk despite the higher leverage involved in these projects and the rising cost of debt. Larger firms that benefit from economies of scale remain committed, with five of the six largest funds closed YTD dedicated to this strategy. Short-term expectations for real estate funds may have declined, but long-term prospects remain largely sound. Fundraising has declined YTD, but funds are still sitting on significant stockpiles of dry powder and investors are eager to take advantage of an expected decline in home prices in the near term. Opportunities also exist for retail and office properties as large portions of the population return to in-person work and activities.

Share of global real estate capital raised (USD billions) by type



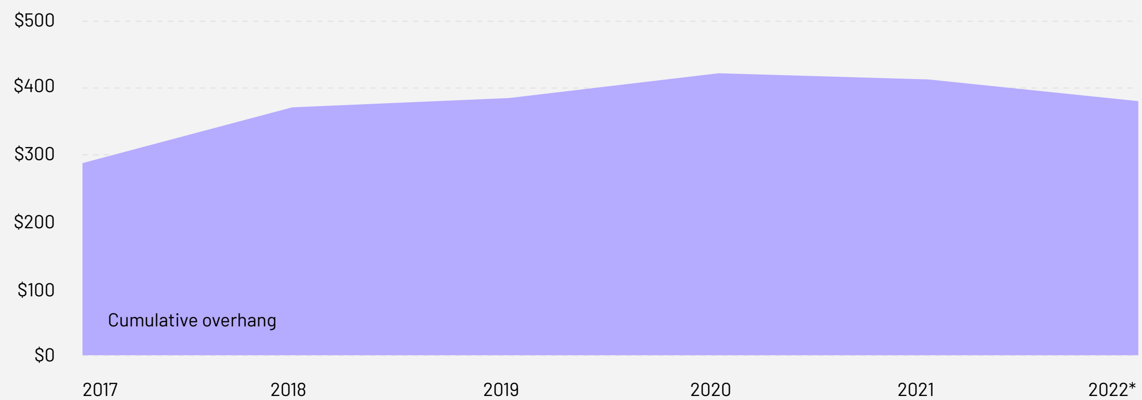
Source: PitchBook
*As of August 29, 2022

Share of global real estate fund count by type



Source: PitchBook
*As of August 29, 2022

Global real estate dry powder (USD billions)



Source: PitchBook | *As of August 29, 2022

3: Opportunistic investments tend to be made in properties that require substantial additive efforts due to a need for renovation, repurposing, high vacancy rates, or shifting supply-demand dynamics in a market. This category also includes new property development such as greenfield and brownfield projects.

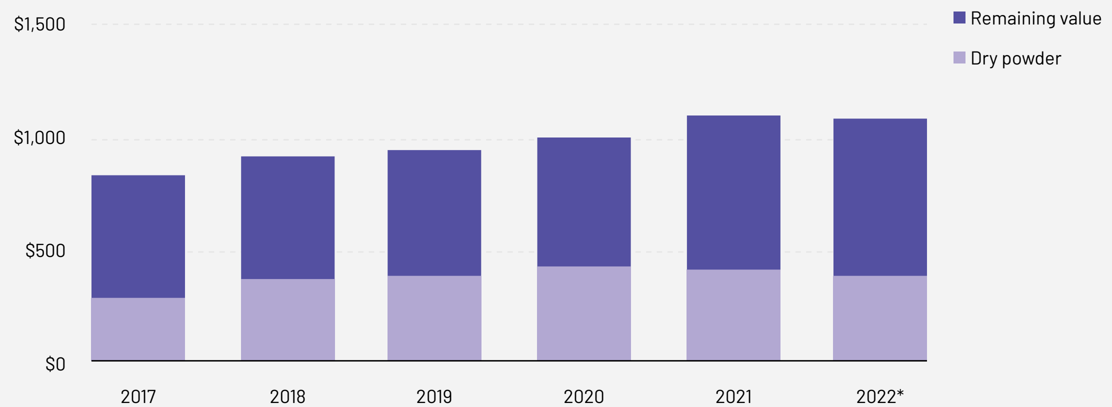
Industry Performance

Dry powder declined slightly because of slower fundraising YTD, but aggregate AUM remains elevated after exceeding USD one trillion for the first time in 2021. With the level of capital available for deployment, funds maintain the ability to drive returns with disciplined investments. Real estate funds exhibited strong performance in 2021, with a rolling one-year horizon IRR of 24.8 percent in Q4 compared with 3.8 percent the year prior, though recency can account for some skew. Conditions that could change that in 2022 include higher lending and input costs depending on the size and pace of further interest rate increases. Recession and economic concerns could soften growth expectations for shorter-term projects as well. Lower-leveraged investments that are less reliant on significant capital improvements may fare better in this sense, but these lower-risk projects yield lower returns as a result.

The initial rapid rise in fuel prices caused by the conflict in Ukraine has subsided, providing some at least temporary relief for real estate developers. The Baltic Exchange Dry Index, which tracks the cost of shipping goods globally, has dropped more than 50 percent YTD.[4] Continued central bank rate increases will drive down prices, but the question of timing remains. Public markets have not found their footing yet, and REIT indexes are following suit, sustaining aggregate losses YTD. Most segments regained the losses suffered at the onset of the pandemic, however, with Self-storage, Industrials and Apartments gaining momentum between 2020 and 2022.

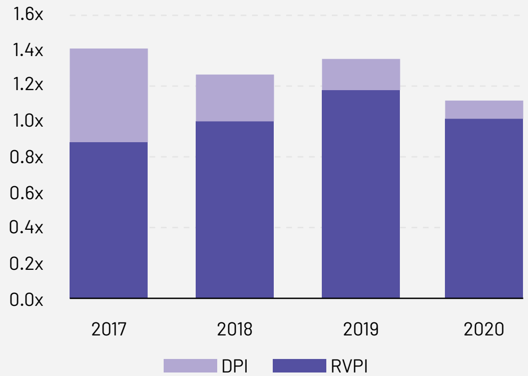
4: "Baltic Dry Exchange Index," Trading Economics, n.d., accessed September 16, 2022.

Global real estate AUM (USD billions)



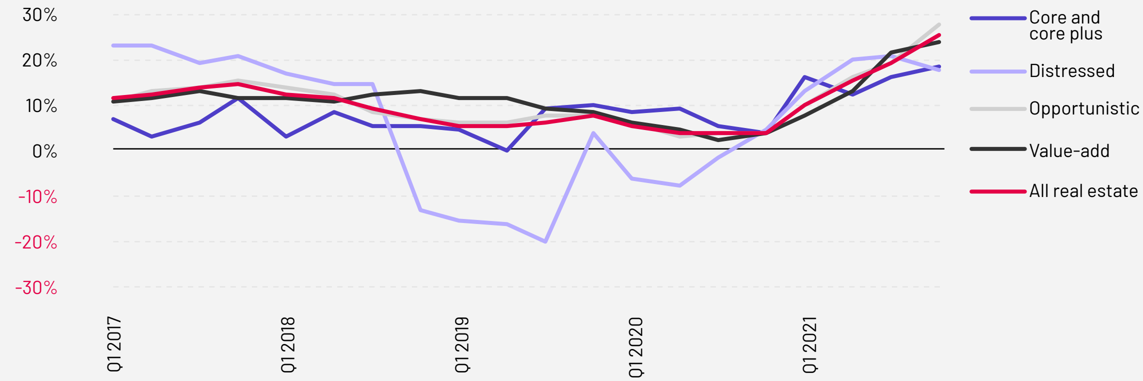
Source: PitchBook | *As of August 29, 2022

Global real estate pooled multiples by vintage*



Source: PitchBook
*As of December 31, 2021

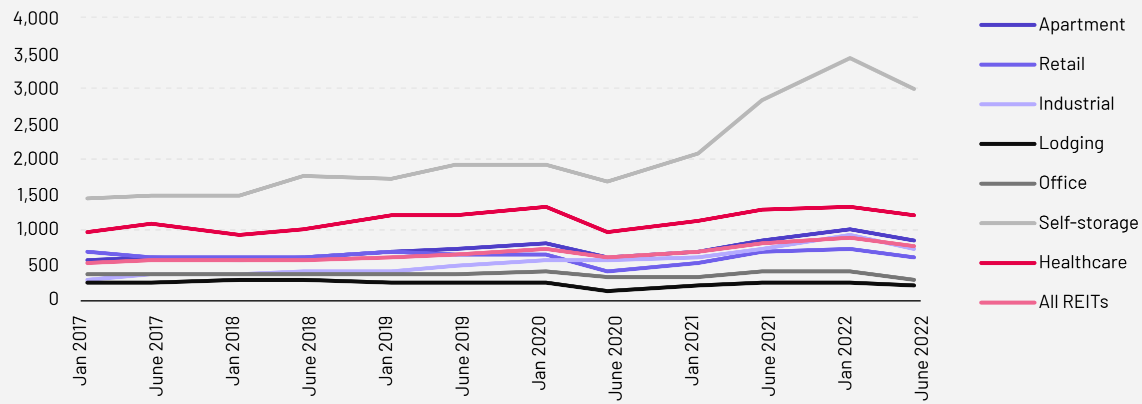
Global real estate rolling one-year horizon IRRs*



Source: PitchBook
*As of December 31, 2021

At the end of last year, the pooled multiples for 2020 fund vintages trailed those of prior vintages. The self-storage REIT index achieved breakaway returns in 2021 but was not immune to corrections felt by all sectors in the first half of 2022. Real estate funds may experience lagging impacts of public market turbulence in the form of further fundraising deceleration, but that will likely be insulated from much of the noise as asset fundamentals anchor long-term returns.

Total returns of select REIT property sector indexes*



Source: PitchBook | *As of June 30, 2022

Looking Forward

Despite short-term pullbacks in fundraising, Real Estate is still widely considered a safe bet in times of tumult for other asset classes. The transformation in property use that took place during the pandemic will undoubtedly require flexibility in fund strategies to adapt to a new normal. Residential properties still provide pricing power, allowing rental income to partially offset rising input costs, but investors will need to adjust to new regional hotspots that have emerged following pandemic migration. Commercial properties can bet on a return of foot traffic for retail and office properties, while logistics and warehouse properties will likely experience some cooling as pandemic-era e-commerce trends subside. Institutional investments managed by experienced firms with sufficient capital will be more insulated than individual property purchases until prices and mortgage rates level out. Large rate increases by central banks have yet to ease prices to the desired extent in most markets, so many firms may take a wait-and-see approach to new investments. In this case, new fundraising would remain level or further decelerate due to lower capital replenishment needs. Supply constraints may be the most significant catalyst for fund activity in the coming years. Once inputs normalize, project bottlenecks will subside and investor interest will rise again. While recent challenges have impacted dealmaking conditions and fundraising levels, the broader opinion of Real Estate's long-term viability for portfolios will likely remain favorable.

Intralinks **Deal**Centre™ for Real Estate

Your blueprint for real estate success.

LEARN MORE

SS&C Intralinks is a leading financial technology provider for the global banking, dealmaking and capital markets communities. As pioneers of the virtual data room, our technology enables and secures the flow of information, empowering our customers to work more productively and with complete confidence. **For more information, visit** intralinks.com.