

CANTOR PERSPECTIVES

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Seizing the Opportunity

Strategic Entry Points in the Commercial Real Estate Market

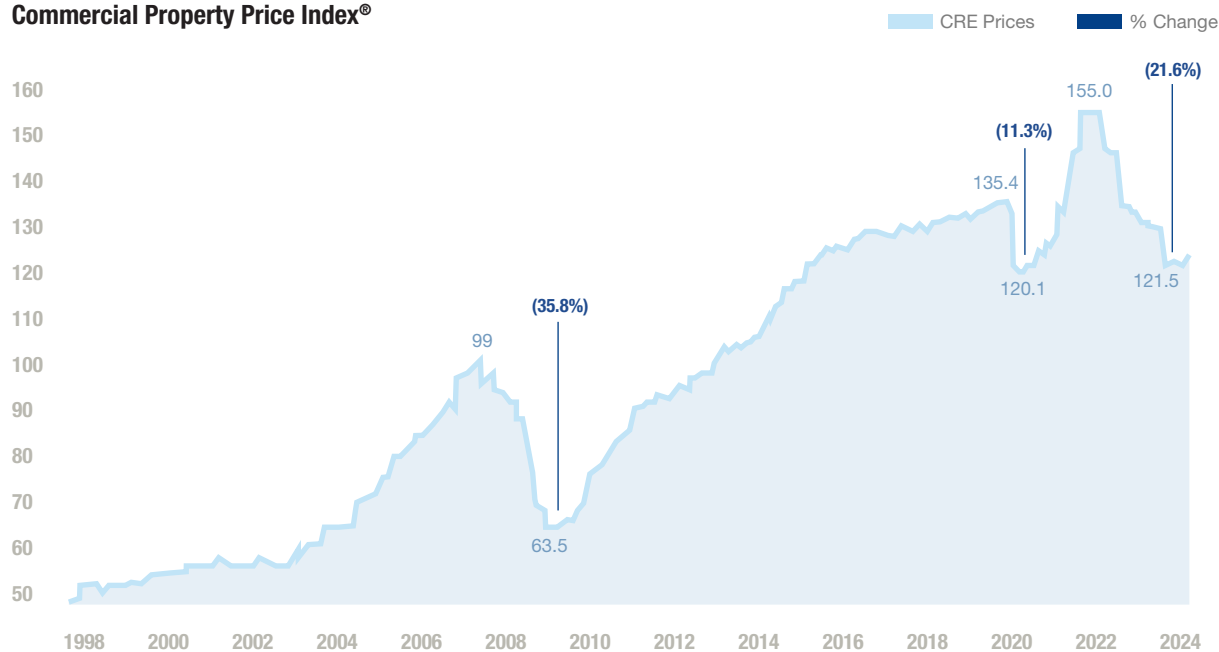
Economic conditions have battered Commercial Real Estate (CRE) prices over the last two years since reaching their peak in April-May 2022. Green Street Commercial Property Price Index® (CPPI) data shows as much as a 21.6% drop during that period.

However, since reaching a bottom in January 2024, CPPI movement has trended slightly upward, which, alongside other leading indicators, suggests that the CRE market is at or near its bottom for the current economic cycle.

These conditions highlight the strategic opportunity of entering the CRE market through vehicles with high-quality assets, balance sheet integrity, and appropriate valuations. The second half of 2024 may be the beginning of an attractive entry point for core and core-plus allocations.

FIGURE 1

Commercial Property Price Index®



Source: Green Street Commercial Property Price Index®, July 2024.

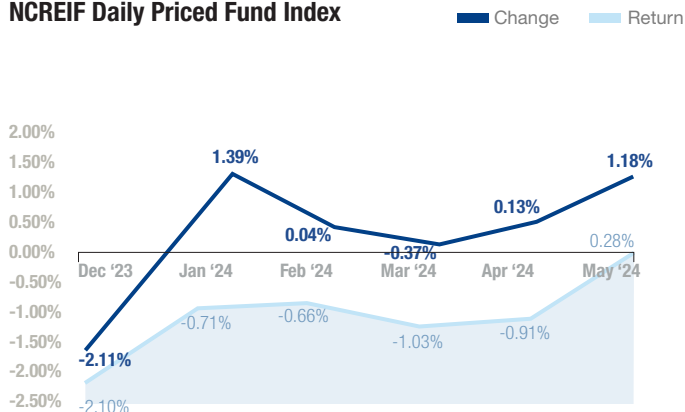
The Current State of the CRE Market

Inflationary pressures and interest rate hikes have played a large part in driving CRE price declines. Social changes such as hybrid work and relocation have added to the turbulence for specific markets, asset types, and certain individual properties.

However, data since January 2024 may indicate that the CRE market correction is leveling.

FIGURE 2

NCREIF Daily Priced Fund Index

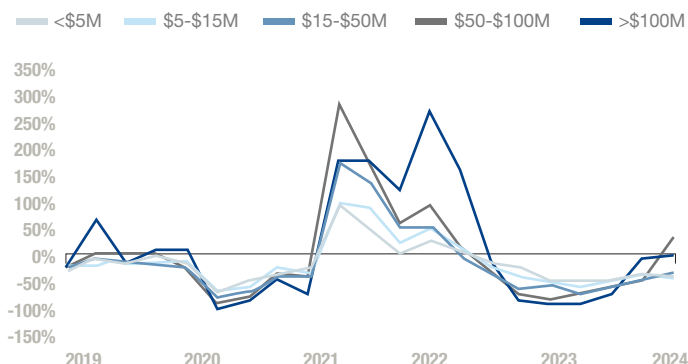


Source: NCREIF Month-End Press Releases. December 2023 – June 2024.

In May 2024, the National Council of Real Estate Investment Fiduciaries (NCREIF) Daily Priced Fund Index Data saw its first positive monthly return since the beginning of the year on the back of improving month-to-month conditions—73% of industrial markets and 58% of retail markets generated positive and rising total returns in 1Q 2024. (See Figure 2)

FIGURE 3

Year-over-Year Sale Growth (Transaction Volumes) by Sale Size

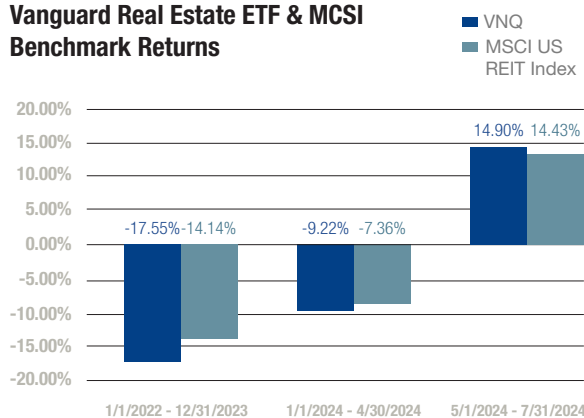


Source: Moody's CRE. 1Q 2024.

Increased transaction volumes indicate a growing confidence among investors and a potential stabilization in property prices. Moreover, the market's liquidity for transactions between \$50 million and \$100 million have significantly increased, signaling sustained investor interest and activity. (See Figure 3)

FIGURE 4

Vanguard Real Estate ETF & MCSI Benchmark Returns



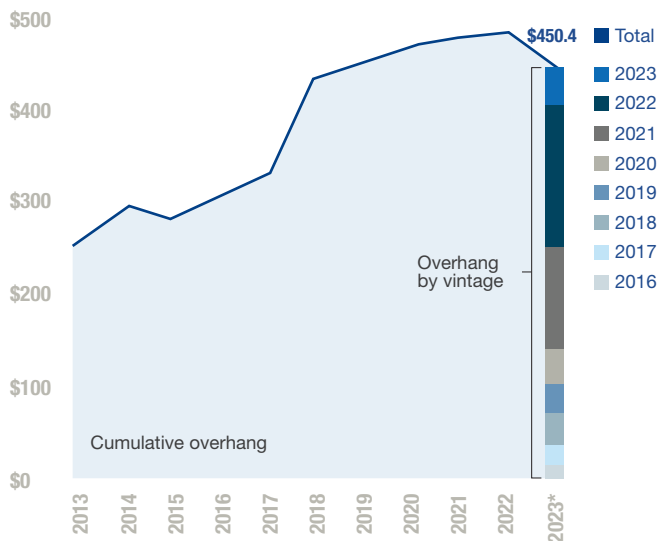
Source: Vanguard. July 2024.

Publicly traded U.S. REITs have historically been a leading indicator for private market pricing and recently have shown signs of recovery. (See Figure 4)



FIGURE 5

Real Estate Dry Power (\$B) by Vintage

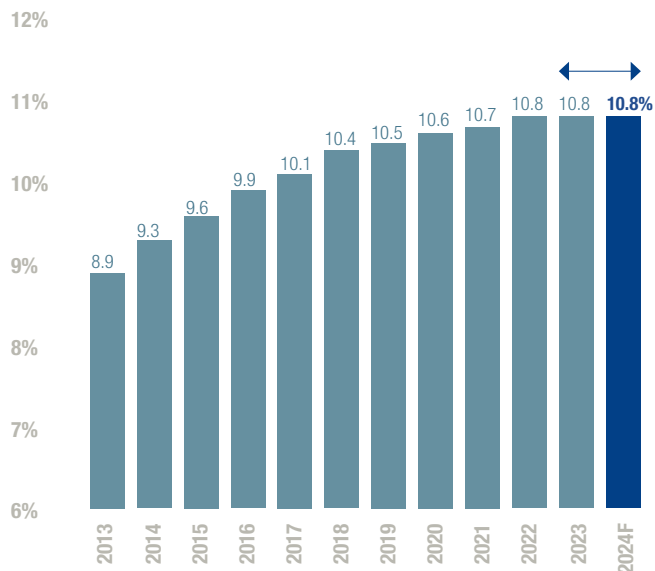


Source: Global Real Estate Report, Pitchbook. H2 2023.

Dry powder for private real estate investments equates to a leveraged purchasing power of \$475 billion as of April 2024 (per PitchBook data, based on a 55% loan-to-value ratio), suggesting pent-up demand and potential pricing support. (See Figure 5)

FIGURE 6

Target Allocation to Real Estate, All Institutions



Source: Hodes-Weill Institutional Real Estate Allocations Monitor. November 2023.

Institutional investors have not backed off on CRE allocations, which remained at 10.8% in 2022 and 2023 and are expected to continue at that level in 2024. (See Figure 6)

The combination of increased transaction volumes, stabilizing asset valuations, expectations for interest rate cuts from the Fed, and emerging positive sentiment within the industry provide reasons for optimism that the CRE market is poised for a recovery.

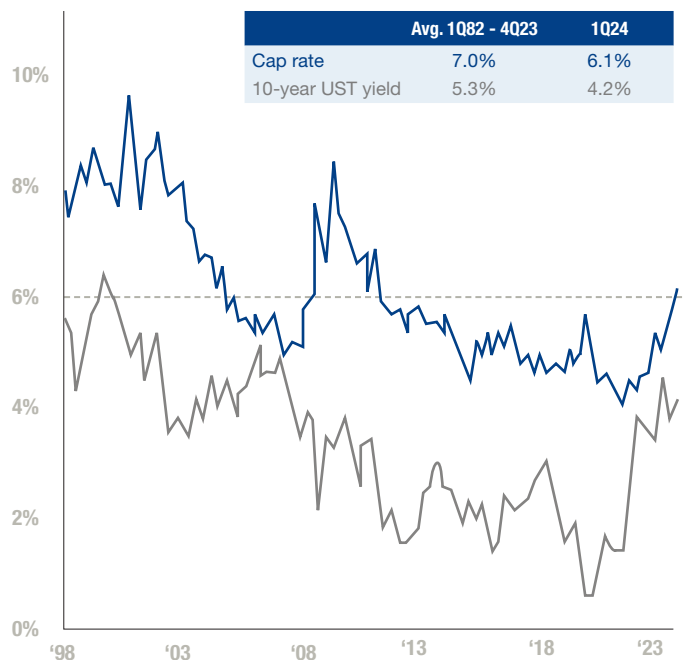
Under such conditions, investors can capitalize by targeting fundamentally sound assets with strong balance sheets and realistic valuations to be ready for the market transition out of its correction phase. On the upside, strategic investments during this period may yield substantial returns as the CRE market regains momentum.

Although some investors may be tempted to wait until seeing the exact bottom of the market, doing so is difficult. Instead, recent data as seen in Figure 7 on the right shows that CRE properties can be acquired at attractive valuations and a healthy spread of 190 basis points to 10-year Treasury yields. This is the first time in over a decade we have seen transaction cap rates exceed 6%. The key for long-term investors is to recognize attractive relative valuations. This approach minimizes the risk associated with market timing while maximizing the potential for long-term outperformance.

FIGURE 7

U.S. Real Estate Cap Rates and Interest Rates

Transaction based, 10-year U.S. Treasury yield



Source: J.P. Morgan Guide to Alternatives, May 31, 2024.

Means of Entry: Vehicles and Due Diligence

Not all CRE assets are created equal, however, so due diligence is paramount. While some news headlines about individual property sector stress, such as multi-tenant office buildings, might distort perceptions, investors looking for an entry point can find well-constructed vehicles focusing on asset, sector, and geographic quality with appropriate valuations.

Asset Quality

Investors should look to vehicles with attractively valued assets that reflect the impact of recent market conditions but possess strong fundamentals. These assets are likely to outperform as the market recovers. Emphasis should also be placed on properties with resilient traits, such as fully occupied buildings with long-term net leases to strong credit tenants delivering stable Net Operating Income (NOI).

Balance Sheet Analysis

Investors should prioritize funds with strong balance sheets, moderate leverage, and long-term fixed-rate debt to insulate against poorly timed maturities. This financial stability helps funds weather the current challenging CRE lending environment, brought on by higher interest rates and more restrictive bank lending, in order to capitalize on the recovery and growth phases of the cycle.

Sector Positioning

Certain regions and sectors are expected to outperform others in the recovery phase. For instance, in the multifamily sector, the cost of purchasing a home relative to renting an apartment has never been more expensive, resulting in a larger and longer-term renter pool. In addition, in some markets, primarily in the Sun Belt, we expect a housing shortage to lead to significant increases in NOI, yielding attractive returns to patient investors. Identifying these macroeconomic conditions can yield higher returns than more volatile sectors.

Valuation

Assessing the valuations of existing real estate funds is critical. Investors should ensure the funds are priced according to current market conditions rather than outdated valuations. Valuations from 2022 and early 2023 will not reflect the realities of today's market. Proper due diligence helps to avoid overpayment and maximize upside by ensuring that one's entry point reflects current market value.

CRE in Portfolio Construction

Provided investors conduct rigorous due diligence, CRE remains a compelling strategic investment in a balanced portfolio despite the current choppy economic climate. The market resilience of CRE, particularly in sectors like multifamily, net lease, and industrial, supports stable cash flows even during economic downturns.

Factors such as demographic trends, remote and hybrid working conditions, the historic relative affordability of renting versus owning a home, and the increasing demand for specialized property types such as warehouses, logistics, and data centers make it a robust addition to any diversified investment portfolio. Post-COVID macro conditions, which have adversely impacted the multi-tenant office sub-sector, do not negate the overall strengths of the CRE asset class overall, which is much broader than office.

In addition, CRE provides several structural advantages. It offers an effective inflation hedge as rents and replacement costs often increase with inflation, protecting purchasing power. Moreover, CRE offers significant diversification benefits, reducing portfolio volatility by providing exposure to a less-correlated asset class. Finally, CRE investments typically generate highly tax-efficient income through depreciation and other tax advantages, enhancing after-tax returns.



Vehicle Structures

Real Estate Investment Trusts (REITs) provide a straightforward path for accessing CRE. However, REITs come in different structures. Publicly traded REITs and publicly registered non-traded REITs, two types of REITs, have different characteristics that are important to consider.

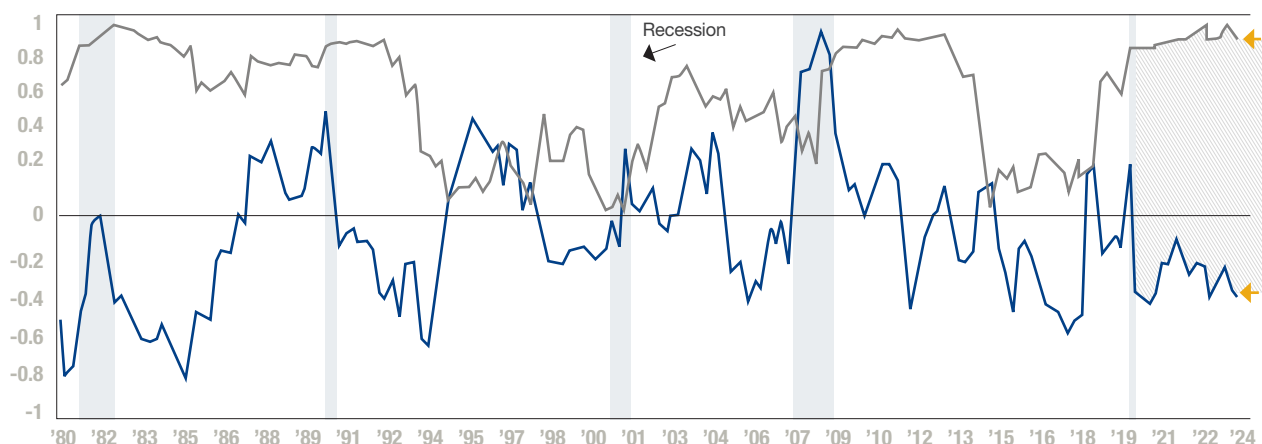
	Publicly Traded REITs	Publicly Registered, Non-Traded REITs
Accessibility	No minimum investment amounts	Higher minimum investment
	Easy access for retail investors	Greater suitability thresholds for investors
Transparency & Governance	Published real-time share prices	Periodic pricing and valuation, typically monthly
	Subject to stringent SEC governance, financial reporting, and disclosure requirements	Subject to stringent SEC governance, financial reporting, and disclosure requirements
Liquidity	Listed on major exchanges	Typically, semi-liquid vehicles with periodic liquidity
	Easy to enter and exit positions	Required holding periods and exit approval conditions
Correlation & Volatility	Highly correlated to the broader stock market	Low correlation to the broader stock market
	Significant price volatility	Less price volatility, often valued at net asset value (NAV)

Because of these characteristics, publicly traded REITs are more closely correlated to equity indexes as can be seen in Figure 8 below. Broad index funds already include exposure to real estate via traded REITs, with 25 REITs in the S&P 500 and 75 in the Russell 2000. As a result, non-traded REITs or other private real estate funds are essential for diversification.

FIGURE 8

U.S. REITs, Direct Real Estate and Equities 12-quarter rolling correlations, total return

	Avg. 4Q80 - 1Q24	1Q24
Direct real estate/S&P 500 correlation	-0.1	-0.4
Traded REITs/S&P 500 correlation	0.6	0.9



Source: J.P. Morgan Guide to Alternatives, May 31, 2024.

By leveraging multiple investment structures and conducting diligent analysis, investors can effectively navigate the current economic climate and capitalize on CRE's historically attractive return attributes with an attractive entry point for long-term value creation.

Takeaways

CRE presents a strategic opportunity for long-term-minded investors.

Waiting for a bottom is challenging and may ultimately lead to disappointment.

With its potential advantages, such as acting as an inflation hedge, providing diversification benefits, generating tax-efficient income, and demonstrating market resilience, CRE commands an important role in portfolio construction.

Real Estate Investment Trusts (REITs) offer an accessible pathway to CRE, with publicly traded REITs providing enhanced liquidity accompanied by higher volatility and stock market correlation. By contrast, publicly registered non-traded REITs, while not daily liquid, offer the potential for increased stability, lower correlations, and diversification.



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