UNIPLAN
A BETTER ALTERNATIVE

The outlook for returns from Private Equity Real Estate (PERE) has materially declined which, we believe, leaves Public REITs looking relatively attractive.

- Higher inflation (8.2% Y/Y CPI in May) has forced the Fed to raise interest rates (FFR +75bps in June to 1.25%) with expectations of several more increases to come. This has increased the Cost of Capital (immediately so regarding debt) and put downward pressure on asset prices. For Commercial Real Estate (CRE) this meant upward pressure on Cap Rates (lower income multiples).

- Over the last 10-15yrs, an exceptional, extended period of low inflation/low interest rates enabled PERE to produce attractive returns – many funds providing annual returns to investors in the mid-teens. PERE funds typically used elevated leverage (~65% Loan-To-Value) and held their assets for several years while cap rates declined (and property values increased). Returns benefited disproportionately from cap rate compression and leverage and less from property income growth, in many cases.

- Looking ahead, it seems likely that inflation will take some time to be reduced, interest rates will remain elevated by comparison with the last decade and there is a non-trivial risk of a recession/stagflationary environment prevailing. Against that background, it is difficult to believe that property cap rates will decline – cap rates for the most sought after residential and industrial properties are at historic lows of 3.5-4.0% (Alternatively said 25-30x EBITDA). Rather, it seems prudent to think cap rates will rise and put downward pressure on property values that would translate into much weaker returns from PERE. Moreover, it is likely that operational growth/improvements will be a larger driver of future returns compared to capital gains from cap rate compression.

- We believe Public REITs offer an increasingly attractive option to institutional and individual investors versus PERE funds and Non-Traded REITs (which have similar characteristics to PERE funds but are aimed at individuals). Most Public REITs operate with lower financial risk (LTV's ~35-40%), are focused on one property type (apartments, retail, self-storage, etc.) and have full-time, internal management that have specialized experience. We think this offers investors a superior play on operations than the PERE model of high leverage, multiple property types and external management arrangement with notably higher fees.

- An investment in public REITs is volatile (like any public equity stock) but they offer daily liquidity, pricing and high levels of transparency into their businesses. By contrast, PERE funds and Non-Traded REITs offer limited liquidity, less frequent pricing, typically less transparency and usually operate with higher financial risks.

David Harris
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All investments carry a certain degree of risk, including possible loss of principal. REITs are subject to illiquidity, credit and interest rate risks, as well as risks associated with small and mid-cap investments. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style. Value style investing presents the risk that the holdings or securities may never reach their full market value because the market fails to recognize what the portfolio management team considers the true business value or because the portfolio management team has misjudged those values. In addition, value style investing may fall out of favor and underperform growth or other style investing during given periods.

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