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Preqin Special Report - US Commercial Real Estate

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PREQIN SPECIAL
REPORT:
**US COMMERCIAL
REAL ESTATE**

July 2020

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Executive Summary

Nearly \$150bn waits in the wings as the pandemic creates challenges and uncertainty in the US commercial real estate market

COVID-19 has caused turmoil for US property owners. As consumers and businesses adapt to enforced distancing and lockdown measures, the way in which Americans use commercial property has abruptly changed.

Activity across the hospitality sector all but disappeared as lockdowns were introduced. Bars and restaurants shut, while travel restrictions, both international and domestic, led to empty hotels across the country. Many offices too were emptied as large parts of the US workforce started to work from home. Brick-and-mortar retail has long been threatened by the rise of e-commerce, and the pandemic has put further pressure on the high street as Q2 online sales in the US soared. The industrial sector – already a hot market supporting the growth in online shopping in recent years – is becoming ever more important.

Deal Activity Has Stalled

Private equity real estate (PERE) deal activity faltered in the second quarter of 2020. Just \$7.3bn of deals were completed in Q2 (as of 15 June), with retail and hotel sectors the most impacted. Prequin recorded only two PERE deals in the hotel sector in Q2 2020, while the \$500mn of investment in US retail highlights the pressures the sector was under even before COVID-19. Not only has the pandemic created difficulties in accurately valuing property, but with the US in lockdown, viewing property and completing the documentation required to transact it has become challenging.

The pandemic came at a time of strong activity in the US commercial real estate market. The year began with \$31bn of PERE deals completed in Q1, putting the sector on course to surpass \$100bn of annual PERE deals for the sixth consecutive year. Indeed, the 2019 total of \$180bn in PERE deals is an all-time high and almost double the total in 2014 (\$97bn).

A key driver behind the significant activity in 2019 was the growth of the industrial sector. The \$59bn of PERE deals completed for US industrial property in 2019 is a record total and increase of 63% on the previous year. The office sector, however, remains the destination for the majority of investment in US commercial real estate, attracting 55% of all capital invested in the market since 2014. Activity in the retail sector, on the other hand, had been declining with both aggregate deal value and average deal prices decreasing year on year since 2016: the average value of a US retail deal in 2019 (\$27mn) was 42% lower than in 2016 (\$47mn). Activity in the hotel sector has been consistent, with seven high-profile \$1bn+ deals completed over the past five years, including 2020.

The New Normal

Looking forward, the market is ready to return to action. US commercial real estate dry powder stands at a record \$147bn (as of December 2019), with fund managers poised to return to the market as it emerges from this crisis.

However, for activity to reach pre-COVID-19 levels a number of questions will need to be answered. Which new consumer habits will prevail in the 'new normal'? How long before we see a rebound in consumer spending and deal-making? What will be the pandemic's impact on valuations? The answers will shape how people live and work and the destination of private real estate capital in this new normal. The answers are as yet unclear, meaning that deal activity will likely remain muted throughout Q3.

How COVID-19 Is Changing Commercial Real Estate

For fund managers and investors alike, the pandemic presents short-term challenges, long-term opportunities, and lessons to be learned

How has the commercial real estate market fared so far in 2020?

We've seen a really challenging market for some property types in 2020, in particular retail and hospitality.

We're expecting the pandemic to accelerate the drive to e-commerce and omnichannel retail that we've seen in recent years. Grocers and essential-needs retailers have held relatively strong – we're seeing rent continue to be paid and consistent footfall. But outside of those sectors, rent collection rates in retail have been hovering around 25-30%, which is extremely low.

That said, there is some good news for retail. In June we saw consumer spend in the US spike up about 14% – or even higher in sectors like clothing retail – which shows that people still shop in brick-and-mortar stores. An indication that physical retail will still play a part in consumer habits in a 'new normal.'

Hospitality – and in particular upper-end hospitality that caters to conferences – has been decimated. And with travel bans continuing and conferences still being canceled, they're not seeing a rebound in occupancy. One area of strength within hospitality is in the lower-end hotels, those around 1-3 stars, which are exposed to key industries and the parts of the economy that have kept moving. Hotels along key trucking routes, for example, have kept their occupancy up and been able to keep their rates pretty steady.

The office sector has been fairly insulated. Yes, the offices have been empty, but many firms are successfully operating with a remote workforce, and continue to pay their rent. Going forward, we expect most people will still want at least a mix of office work and that the office will remain a crucial part of a company's culture.



Troy Merkel

Partner, Real Estate Senior Analyst
RSM US LLP

From an industrial standpoint, if you're a logistics center operating in the supply line of essential or e-commerce goods, you're probably doing quite well.

How has the pandemic shaped commercial real estate operations?

On the fundraising side, we've seen large players continue to close funds. Rockpoint Group closed its Rockpoint Real Estate Fund VI on \$3.82bn in June 2020, exceeding its target of \$3.25bn. So it's clear that there is still appetite for investment. I think we'll see a continuation of the consolidation trend of recent years as capital flock to the big names with track records.

On the deals side, there have been challenges. Working through the process of closing deals when the required parties can't get together to sign the necessary paperwork has caused issues. Off the back of this, we may see more technology in the deal-making process. Solutions like blockchain may help with deeding, online appraisal facilities, and electronic document submission, but not all state or local agencies utilize these solutions.

A lot of people see this as a great opportunity because it's an existential stressor that didn't really exist before – the pandemic is truly a black swan event. A lot of property will be fundamentally strong but the price of that property may have decreased. So if you have capital or if you're not tied to certain debt parameters, there will be opportunities out there.

The commercial real estate industry is saying we want to re-invest in these buildings, but we need this technological support to operate in a touchless or distanced market.

What lessons are emerging from COVID-19 for the industry?

We've seen fund managers reviewing their banking relationships. There were situations earlier in the pandemic timeline when GPs were trying to take on debt, but some of the banks – and this is some of the larger banks too – were not as accommodating as fund managers needed. So in order to add more resiliency in terms of accessing debt, fund managers are now seeing that operating with multiple banking partners is a better practice.

On the reporting and data side, real-time reporting has been shown to be really important. As an investor, if you receive quarterly reports from your investments, as is traditional, then from March to June – which is when we saw the real impact of the pandemic in the US – you didn't know how your investments were faring. Your last communication may have been in March or early April when rent was still coming in. So there were cases where LPs and GPs were in the dark and didn't know how badly they were impacted.

I think there's going to be a push for solutions that provide integrated information systems, investor portals, and monthly reporting.

Where are the best opportunities in the current market?

I think there's opportunity in suburban areas. In a general sense, and for a number of reasons – remote work, more space, improved hygiene – there seems to be a migration pattern emerging from cities toward suburban areas.

There are housing affordability issues in cities. If commutes can be cut to a couple of days a week as remote working becomes more commonplace, then we may see places 30-50 miles outside of the city become a bit more attractive. This trend will then play out across commercial real estate. There may be more demand for hospitality in the suburbs, and offices may downsize in the city or be turned into satellite spaces for remote workers to meet.

For example, suburban retail property tends to be in great locations with fantastic transportation connections, and this kind of property is ripe for increased foot traffic and mixed-use redevelopment.

There's also opportunity in the infill industrial market. As more firms focus on their online presence – and the recent Wal-Mart and Shopify partnership is a great example of this – there's going to be much more competition for infill industrial property and logistics property that serves urban market consumers.

A lot of these trends existed before the pandemic, but the outbreak of COVID-19 has accelerated and put more focus on these trends. Something perhaps being born out of the pandemic is 'clean investing' in commercial property. We'll see things like UV lighting, air filtration systems, and cleaning processes come into a lot of property as employees, shoppers, and consumers put more focus on their own health and safety at work and out on the high street.

About RSM

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rsmus.com/realestate

Seeking Alpha: The Next Frontier of Investment Management Software

Technology is enabling fund managers the ability to improve value for the investors they serve

To understand the state of commercial real estate investment management, specifically in relation to the role of technology, it's important take a step back and remember how much the industry has evolved over the past 20 or so years.

Since 2000, institutional investment in commercial real estate has increased dramatically. The private real estate market has grown from \$64bn in assets under management (AUM) in 2000 to \$1.10tn as of December 2019, making it just the second private capital asset class to reach the \$1tn mark – behind only private equity. This capital infusion, combined with tremendous economic growth, drove commercial real estate prices to all-time highs and capitalization rates to all-time lows, creating one of the most competitive markets in history.

With expectations for near-term market growth muted, many leading investment managers have turned their focus inward, exploring ways to improve investor value through select investments in technology.

The Challenge

Advancements in technology have played a key part in meeting the diverse needs of a growing industry – as referenced by thousands of start-ups and a wave of property-focused venture capital. Despite this, many leading managers still struggle with a fundamental reporting gap. Accessing even the most basic asset and portfolio data in a timely fashion can present a significant challenge.

Without this data, a number of processes become more difficult. Monitoring performance, identifying and managing risk, looking backward and forward in time, driving strategic decision-making, and leveraging internal and external data in a way that adds meaningful value to their teams and/or investors – all are impacted by the gap in communicating real estate data. And this gap has been especially apparent in recent months. Why? Because the information required to do so lives



Eric LaCoursiere

Industry Principal, Investment Management,
RealPage

in disparate point software applications used by key stakeholders who support the management process – e.g., platforms like ARGUS® for underwriting, forecasting, and valuations; a myriad of legacy accounting, budgeting, and property management solutions; VTS® for lease pipeline; Procore® for capital project management workflow; Chatham Financial® for debt; a myriad of point solutions used to track benchmarking/market data; plus, of course, Excel® mixed in along the way. Additionally, many investment managers outsource property management and accounting functions to third parties running on bespoke software instances with different types of accounting configurations.

Monitoring financial and operational performance and/or executing critical investment management functions requires constant aggregation and normalization of this information. Without timely and accurate data, business operations can suffer, particularly in these four key areas:

1. **Risk Management:** Limited visibility means an infinite number of days may pass before managers are aware of underperformance along the key metrics they track. Delayed awareness prolongs underperformance that could otherwise be a blip. A lack of centralized data makes modern capabilities like configurable search/navigation, dashboards,

alerts, and notifications impossible to deliver.

2. **Investor Transparency:** Many investment managers are actively working to improve how they communicate with investors, seeking platforms that enable investors to self-service more operational, financial, and performance data. However, most managers do not have the tools to give their investors more detailed and applicable real-time information because the underlying data is not captured.
3. **Business Planning & Reporting:** Intelligent business planning requires information from across the organization. Because this information lives in siloed systems, the process of creating and approving business plans is onerous. And measuring progress relative to plans is even more cumbersome. In addition, compiling ongoing asset and portfolio reports from multiple disparate platforms requires tremendous human resources, and typically results in a reporting process that is prone to errors, inconsistencies, and reconciliation.
4. **Market Data, Benchmarking, & Analytics:** Investment managers struggle to consolidate market data from the many internal and external sources that exist to serve the investment lifecycle. At the executive level, these challenges surface as bigger issues in various forms, such as holding the team accountable for performance, or onboarding AUM without adding headcount and costs.
5. **Modeling & Forecasting:** Real-time data modeling is simply not possible for most investment managers today due to limitations leading software providers in the space. However, many are exploring innovative new solutions to solve this gap.

A Way Forward

As part of a wider effort to solve these challenges and improve investor value, many leading investment managers have turned their focus from point solutions

used across the portfolio/enterprise, to modernizing the way they aggregate, normalize, and roll up relevant financial and operational performance data from those point solutions.

Working in partnership with a select group of leading investment managers, RealPage has assembled the industry's most comprehensive Investment Management Toolbox to solve these challenges, including a modern Data Warehouse that's designed specifically for real estate; an Asset & Portfolio Monitoring application to give users a consistent view of financial and operational performance; a customizable Integrated Modeling & Forecasting application enabling users to configure custom dashboards and reports; Market Research; and an Investor Management & Reporting application, so users can manage those relationships while elevating transparency throughout the process.

Leading investment managers are blazing a new trail – pushing outside traditional boundaries to work smarter, improve access to portfolio data, and challenge antiquated workflows adopted by prior generations.

To support their efforts, RealPage has developed an essential information management platform designed specifically to address the operational complexities involved with investing in real estate across a diverse set of property types and geographies. These products and services solve the problems associated with data consolidation (highlighted herein) and give investors the tools they need to effectively monitor portfolio performance, manage risk, make informed decisions, and derive the maximum value from their data.

Will investment managers who address these technology challenges head on be the same managers who deliver outsized returns in the increasingly competitive market ahead? You decide!

About Eric LaCoursiere

Eric LaCoursiere has spent his entire career in the real estate business, serving in leadership roles at a select group of real estate advisory and technology companies in New York City and Los Angeles. As Industry Principal at RealPage, Eric is responsible for guiding product strategy, messaging, and alignment with the global real estate investment management community. Prior to this role Eric built the Western US region at VTS, the commercial real estate industry's leading leasing platform, serving as a regional sales leader for several years. Eric started his real estate career at Cushman & Wakefield, advising clients on office projects in New York City.

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RealPage® Investment Management is an essential information management platform designed to address the operational complexities involved with investing in real estate across a diverse set of property types and geographies. These products and services solve the problems associated with data consolidation and give investors the tools they need to monitor portfolio performance, mitigate risk and make informed decisions.

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Overview



\$147^{bn}

North America-focused commercial real estate dry powder stands at a record high



\$38^{bn}

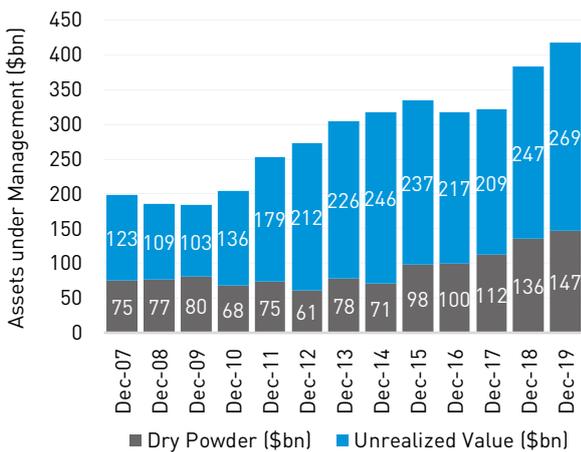
Total value of US commercial PERE deals completed in 2020 as of June



\$33^{bn}

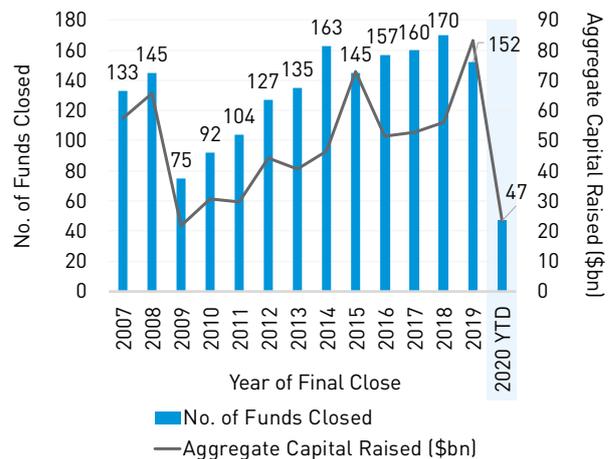
Total value of single-asset commercial PERE deals in California in 2019

Fig. 1: North America-Focused Commercial Real Estate Assets under Management, 2007 - 2019



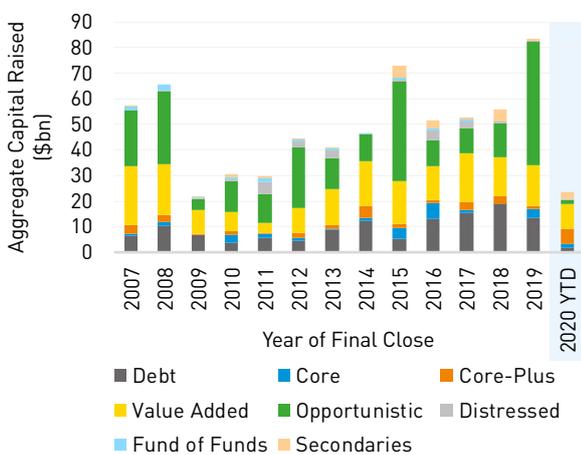
Source: Preqin Pro

Fig. 2: North America-Focused Commercial Real Estate Fundraising, 2007 - 2020 YTD



Source: Preqin Pro. Data as of June 2020

Fig. 3: Aggregate North America-Focused Commercial Real Estate Capital Raised by Primary Strategy, 2007 - 2020 YTD



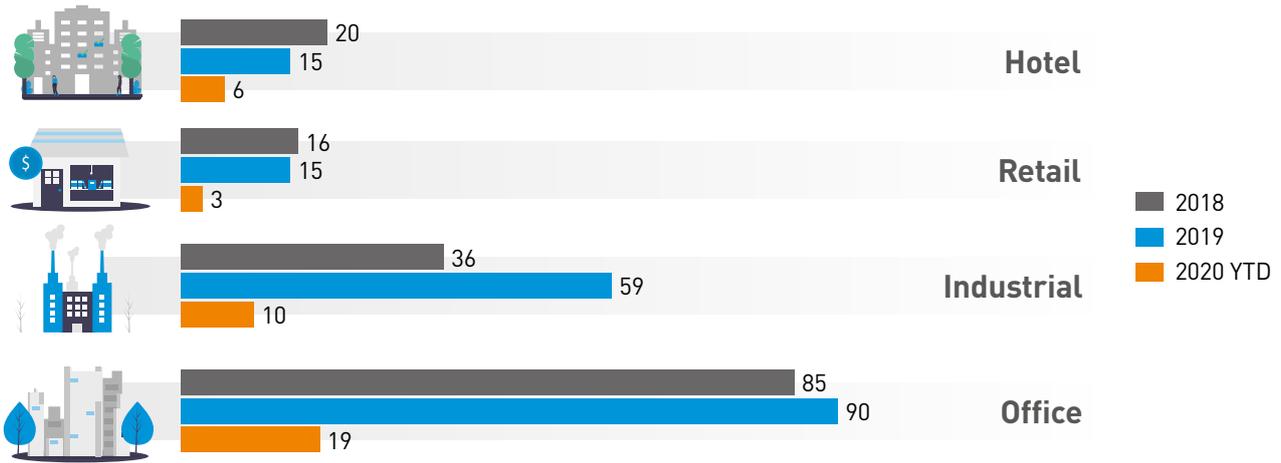
Source: Preqin Pro. Data as of June 2020

Fig. 4: US Commercial PERE Deals, 2014 - 2020 YTD



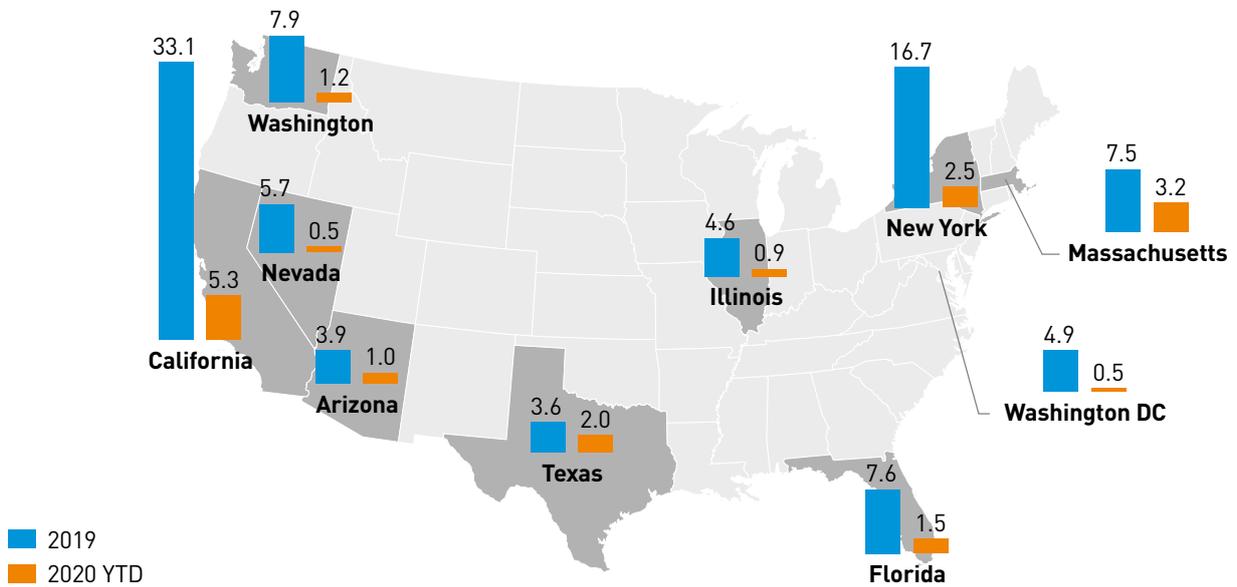
Source: Preqin Pro. Data as of June 2020

Fig. 5: Aggregate Value of US Commercial PERE Deals by Primary Property Type (\$bn), 2018 - 2020 YTD



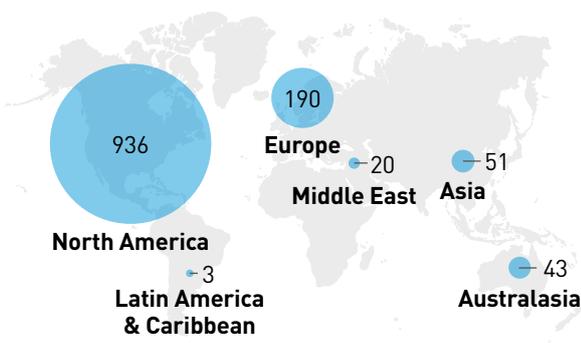
Source: Preqin Pro. Data as of June 2020

Fig. 6: Most Active US States by Aggregate Value of Single-Asset Commercial PERE Deals (\$bn), 2019 vs. 2020 YTD



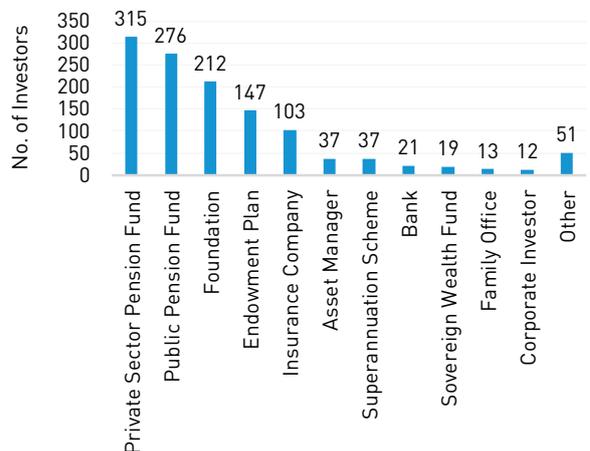
Source: Preqin Pro. Data as of June 2020

Fig. 7: Location of Investors Active in North American Commercial Real Estate



Source: Preqin Pro

Fig. 8: Investors Active in North American Commercial Real Estate by Type



Source: Preqin Pro

The Office vs. Remote Working

The US has seen a successful period of remote working, but the office will remain at a company's core

We have proven remote working is possible. Who would have guessed that we could tell Corporate America to go home for three months and almost everything would work? This experiment would not have been as successful just a few years ago without the robust technology and resilient home delivery supply chain. There is no doubt we are now able to accomplish much of what we need to from our homes.

Still, will we all want to continue doing this once the pandemic subsides?

Many people will embrace the flexibility of working remotely, but others will want to go back to a physical office. Employers will need to reassess how many workers to accommodate, and reconsider how much space per worker they will provide. The office sector has been under pressure to densify over the past 10 years. External shocks like COVID-19 either accelerate trends already in place or reverse them. This is an example of both: accelerating the trend toward remote working and reversing the trend of office densification.

For years, office users have been reducing their square footage per worker, with workstations getting smaller and spaces between employees shrinking. Will this now be considered a liability, and will social distancing be here to stay? Will employees be wary of crowding an elevator to work in large towers? Do employers and employees flee dense urban environments?



Mike Acton

Managing Director and Head of Research, AEW

Looking to Asia as an example, we do not believe this will be the case. Parts of China are reportedly largely back to normal operations, and our colleagues in Hong Kong have reported similar conditions. Office buildings, malls, restaurants, and parks have re-opened and social distancing guidelines have been relaxed. Temperature scans, face masks, and staggered shifts are ubiquitous; however, people are re-engaging in their pre-coronavirus life.

It is likely that some distancing measures will stay in place through 2020 and perhaps 2021. As more time passes, however, these restrictions may fade, particularly if a vaccine is developed and is widely available in 2021.

About AEW

Founded in 1981, AEW Capital Management, L.P. (AEW) provides real estate investment management services to investors worldwide. Grounded in research and experienced in the complexities of the real estate and capital markets, AEW actively manages portfolios in both the public and private property markets and across the risk/return spectrum.

www.aew.com

Office: Activity Slumps amid Questions over Sector's Future

Deal-making for office assets has declined dramatically after a record-breaking 2019, but long-term confidence remains despite the rise in remote work

Investment in office assets in the US has dropped off significantly amid the economic uncertainty caused by COVID-19. As of 15 June 2020, PERE deals completed for US office assets so far this year amount to just \$19bn, which represents only 21% of 2019's total (Fig. 9). Not only have travel restrictions made it difficult for fund managers to view properties and conduct business operations, but the widespread integration of remote working across the US means businesses are assessing the longevity of this trend and thus their approach to office space.

Some high-profile transactions however indicate the appeal of the US office sector, however, Amazon's \$1.15bn acquisition of the Lord & Taylor Building on Manhattan's Fifth Avenue was completed in March. CEO Jeff Bezos, the world's richest person, viewed three Manhattan properties before selecting the 10-story

building previously owned by WeWork to serve as the tech giant's New York City headquarters.¹ CBRE Global Investors have also been active in the US office market in 2020, acquiring 237 @ First Office Park for \$197mn in May 2020. The property is located in Silicon Valley and sits adjacent to the planned Google campus.

Office assets are a key destination for US commercial real estate capital. Home to world-leading business hubs such as New York, Chicago, and Los Angeles, as well as high-growth cities such as Austin and Seattle, the US offers investors a range of commercial real estate opportunities with varying risk/return profiles. Capital has flocked to the market in recent years, with office assets' share of annual US commercial PERE deal value ranging from 64% in 2014 to just over 50% in 2019.

¹ <https://therealdeal.com/2020/03/12/amazon-buying-lord-taylor-building-for-1-1b/>

Fig. 9: US Office PERE Deals, 2014 - 2020 YTD



Source: Preqin Pro. Data as of June 2020

Fig. 10: North America-Focused Office Private Real Estate Fundraising, 2014 - 2020 YTD



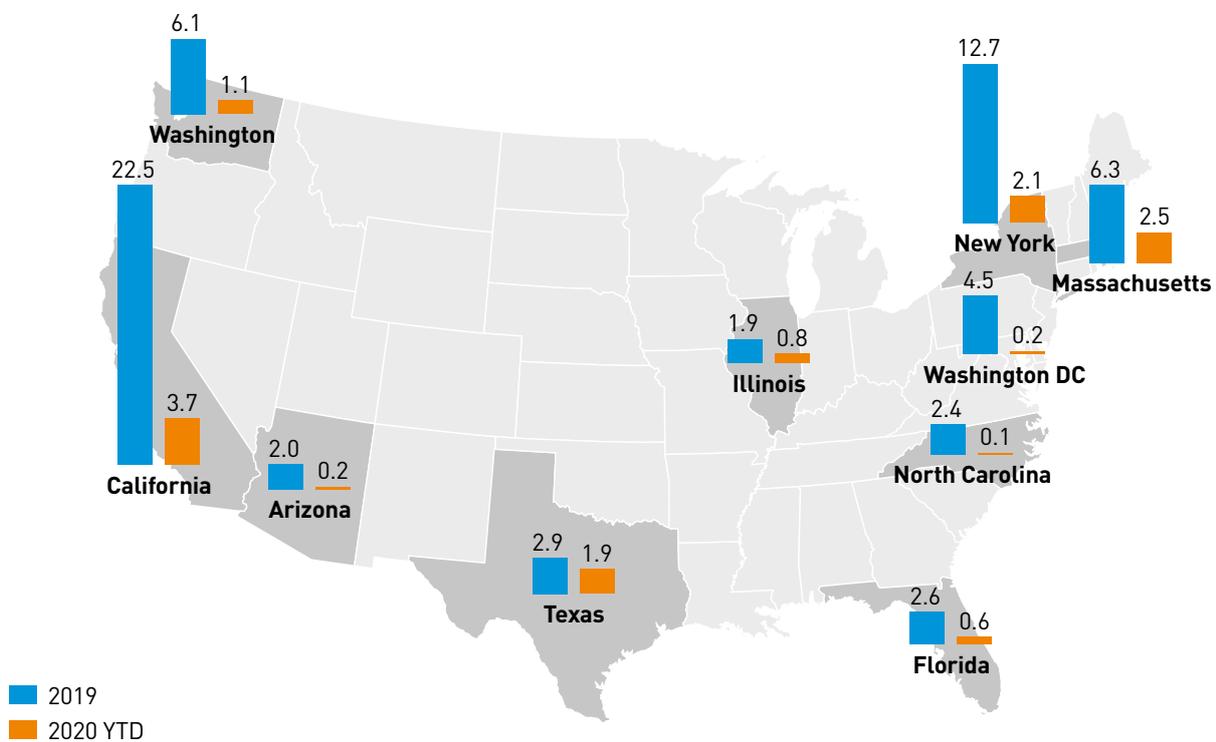
Source: Preqin Pro. Data as of June 2020

Before the disruption of 2020, the office sector had been enjoying particularly strong momentum in the US. PERE deals for office assets reached a total of \$90bn last year – the highest ever, up 50% from five years prior (\$60bn in 2014). California and New York collectively accounted for \$35bn (39%) of the total, with San Francisco’s financial district and Manhattan’s Fifth Avenue attracting a number of high-profile deals.

With this momentum now lost, the industry is asking what the office of the future will look like in a post-

pandemic era. The impact of increased remote working is yet to be fully understood, while in the new normal, new cleanliness and space requirements may change how office space is used. Both Troy Merkel of RSM (see page 4) and Mike Acton of AEW (see page 11) expect employees will want a mix of office working and remote working, rather than working from home becoming the norm. While a company’s approach to using office space may change in the future, we expect the office to remain critical to a company’s identity and for investment in the sector to continue.

Fig. 11: Most Active US States by Aggregate Value of Single-Asset Office PERE Deals (\$bn), 2019 vs. 2020 YTD



Source: Preqin Pro. Data as of June 2020

Fig. 12: Largest US Office PERE Deals in 2020 YTD

Asset	Deal Date	Deal Size (\$mn)	Transaction Type	Asset State(s)	Investor(s)/Buyer(s)	Bought from/Seller(s)
Lord & Taylor Building	Mar-20	1,150	Single Asset	New York	Amazon Property	WeWork, Rhône Group
245 Summer Street	Apr-20	729	Single Asset	Massachusetts	Fidelity Investments	Benderson Development
San Francisco, CA, Office Portfolio	Feb-20	700	Portfolio	California	Deutsche Finance America, Bayerische Versorgungskammer, Unidentified Buyer(s)	Transamerica, Aegon Asset Management
609 Main at Texas	Mar-20	675	Single Asset	Texas	KB Securities	CalPERS - California Public Employees' Retirement System, Hines
Menlo Park, CA, Office Portfolio	Jan-20	610	Portfolio	California	DivcoWest	Ford Land Company

Source: Preqin Pro. Data as of June 2020

Industrial: Capital Flows into Sector amid Retail Revolution

Capital flooded into US industrial property in 2019 and the accelerated rise of e-commerce may drive more investors to the space

The US industrial sector – the logistics segment in particular – is one of the most active real estate markets across the globe. As more consumers and businesses across the US turn to e-commerce, property that enables the delivery and service of America’s online shoppers is increasingly attractive.

Following a record-breaking \$59bn of PERE deals in 2019, activity has declined so far in 2020 as a result of the economic fallout from COVID-19. The US industrial space has recorded \$10bn of PERE deals so far in 2020 (as of 15 June), one-quarter (26%) of all PERE investment in US commercial property in 2020 (Fig. 13). While investment in the sector has stalled slightly, key deals have still been completed.

Several large deals have been completed for industrial property amid the economic turmoil. In fact, four of the 10 largest US commercial PERE deals in 2020 YTD have

been for industrial assets. These include Oak Street Real Estate Capital’s purchase/lease back transaction with discount retailer Big Lots. In June 2020, the real estate fund of funds manager completed a direct deal worth \$725mn for a portfolio of distribution centers.

Prior to the outbreak of COVID-19, the US industrial market has benefited from a consistent flow of institutional capital in recent years. The sector registered \$8.4bn of PERE deals in 2014, which grew to an annual record of \$59bn in 2019. Industrial real estate deals also accounted for one-third of all US commercial deal value in 2019, up from just 9% of the total in 2014.

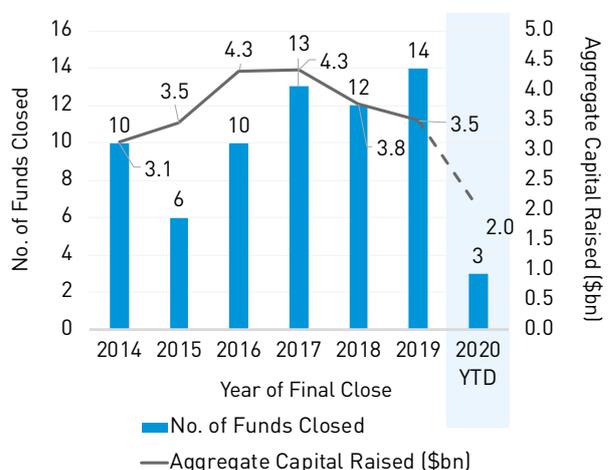
The largest-ever PERE deal was the key driver behind 2019’s record figures. Blackstone Group’s \$18.7bn acquisition of a portfolio of US logistics assets from GLP doubled the firm’s industrial exposure in the US.

Fig. 13: US Industrial PERE Deals, 2014 - 2020 YTD



Source: Preqin Pro. Data as of June 2020

Fig. 14: North America-Focused Industrial Private Real Estate Fundraising, 2014 - 2020 YTD



Source: Preqin Pro. Data as of June 2020

At the time of the acquisition in September 2019, Ken Caplan, Global Co-Head of Blackstone Real Estate, highlighted the importance of the sector to the firm: “Logistics is our highest conviction global investment theme today, and we look forward to building on our existing portfolio to meet the growing e-commerce demand.”¹

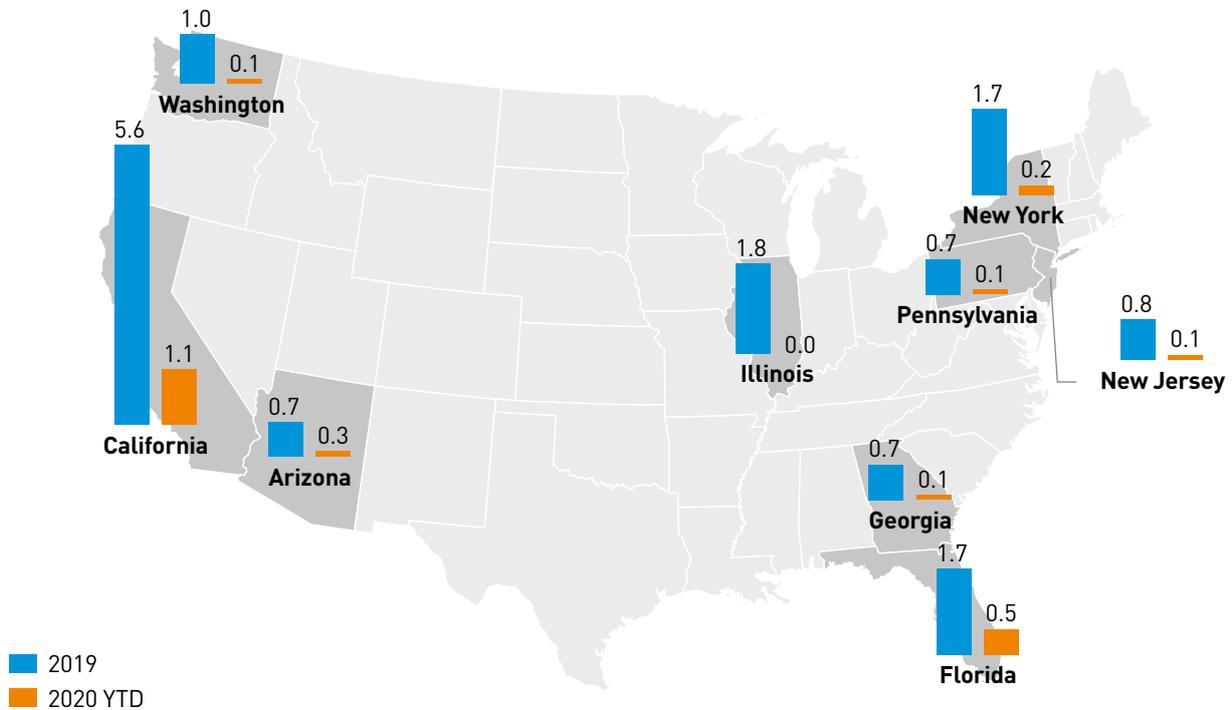
Fast-forward just a few months and the level of demand has indeed grown, with the pandemic greatly accelerating the rise of online retail (see

page 16). This change in consumer behavior has led many firms across the US to increase – or even begin – e-commerce operations, making retail’s pain industrial’s gain. In a June 2020 report, eMarketer forecast US e-commerce sales to increase 18% in 2020, while total US retail sales are expected to decline 10.5% as brick-and-mortar retail struggles.² Against this backdrop, we expect investors to look for increased exposure to the property assets supporting this retail evolution.

¹ [https://www.blackstone.com/the-firm/press-releases/article/blackstone-to-buy-u.s.-logistics-assets-from-glp-for-\\$18.7-billion](https://www.blackstone.com/the-firm/press-releases/article/blackstone-to-buy-u.s.-logistics-assets-from-glp-for-$18.7-billion)

² <https://www.emarketer.com/content/us-ecommerce-2020>

Fig. 15: Most Active US States by Aggregate Value of Single-Asset Industrial PERE Deals (\$bn), 2019 vs. 2020 YTD



Source: Preqin Pro. Data as of June 2020

Fig. 16: Largest US Industrial PERE Deals in 2020 YTD

Asset	Deal Date	Deal Size (\$mn)	Transaction Type	Asset State(s)	Investor(s)/ Buyer(s)	Bought from/ Seller(s)
US, Diversified Portfolio	Jan-20	900	Portfolio	Missouri, Texas	Guggenheim Investments	ElmTree Funds
US, Diversified Portfolio	Feb-20	730	Portfolio	California, Florida, Georgia, Illinois, Louisiana, New Jersey, North Carolina, Texas, North Carolina	WPT Industrial REIT	Pure Industrial Real Estate Trust
US, Industrial Portfolio	Apr-20	725	Portfolio	Alabama, Ohio, Oklahoma, Pennsylvania	Oak Street Real Estate Capital	Big Lots
US, Diversified Portfolio	Apr-20	650	Portfolio	Colorado, Minnesota, Colorado	Blackstone Group	CSM Corporation
135 American Legion Highway	Jan-20	355	Single Asset	Massachusetts	Clarion Partners	Atlantic Management

Source: Preqin Pro. Data as of June 2020

Retail: COVID-19 Compounds Brick and Mortar's Troubles

Retail real estate's assets and tenants are evolving as the pandemic accelerates the rise of e-commerce

The retail real estate market in the US has reached a critical juncture. The sector has long been under pressure from the rise of e-commerce, Amazon at the helm, but COVID-19-related closures have added to its woes. Aggregate deal value had been declining year on year, from \$23bn in 2016 to \$15bn in 2019, a drop of 33% (Fig. 17). In 2020 activity has fallen further still, with just \$3.4bn of deals completed up to 15 June.

Sales across a range of retail sectors declined in March 2020 compared with the previous month. Clothing and accessories retail were the hardest hit, with monthly sales down by 50.5%¹. Conversely, TechCrunch reported that US e-commerce sales were up 49% in April.² The relationship between online and brick-and-mortar retail will remain at the forefront of investors' minds and will drive the evolution of the retail property market.

One notable development within the retail sector is the growth of mixed-use retail assets. In a bid to ensure a consistent level of foot traffic and diversify tenant revenue streams, retail spaces across the US are incorporating aspects of the office, hospitality, and grocery sectors. This sub-sector has seen some of the biggest deals of 2020, such as the January acquisition of Garden City Center for \$181mn in a joint venture between WS Capital Partners and CrossHarbor Capital Partners, which is the largest PERE retail deal of the year so far (Fig. 20). The outdoor shopping center in Rhode Island houses a number of retailers and is anchored by supermarket chain Whole Foods. The Rainier Companies' January 2020 acquisition of The Plaza and The Village at Colony Place in Massachusetts for \$160mn is another example of a grocery-anchored retail property.

¹ <https://www.us.jll.com/content/dam/jll-com/documents/pdf/research/US-Retail-Outlook-Q1-2020.pdf>

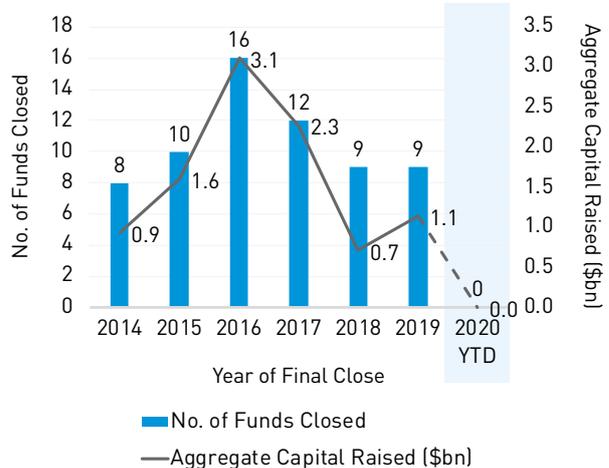
² <https://techcrunch.com/2020/05/12/us-e-commerce-sales-jump-49-in-april-led-by-online-grocery/>

Fig. 17: US Retail PERE Deals, 2014 - 2020 YTD



Source: Preqin Pro. Data as of June 2020

Fig. 18: North America-Focused Retail Private Real Estate Fundraising, 2014 - 2020 YTD



Source: Preqin Pro. Data as of June 2020

Activity in the second quarter was subdued, but investors will be attracted to the risk profile of mixed-use assets when investment picks up.

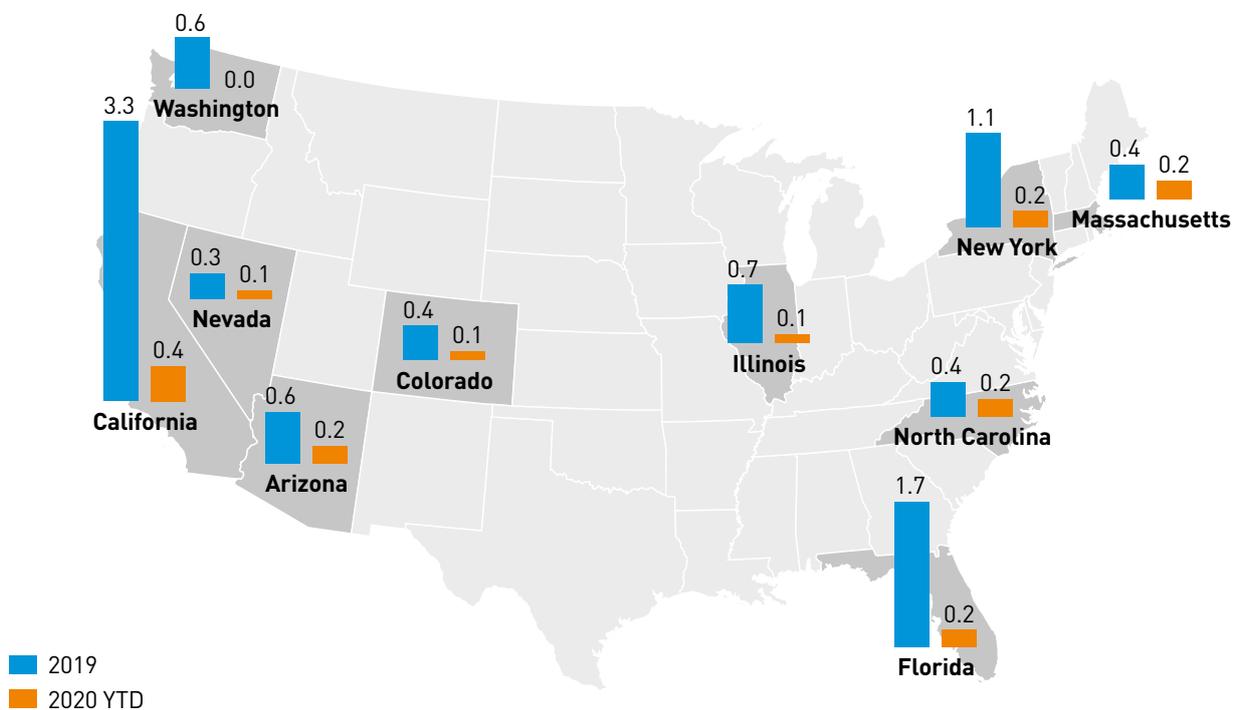
Another crucial trend is that of retail firms embracing e-commerce. Many retailers are opting for an omnichannel approach, pairing brick-and-mortar retail with e-commerce to avoid overreliance on foot traffic. It is those tenants that allow their consumers to shop

online, click and collect, and shop in physical stores that may prove attractive partners for property owners.

Looking forward, there are positives in the retail sector. While deal activity has declined in 2020, US retail sales saw a strong rebound in Q2, jumping 16.8% in May (excluding food sales).³ This rebound in sales and the continued evolution within the sector highlights that retail – and indeed brick-and-mortar retail – will play a role in the ‘new normal.’

³ <https://www.cnbc.com/2020/06/16/us-retail-sales-may-2020.html>

Fig. 19: Most Active US States by Aggregate Value of Single-Asset Retail PERE Deals (\$bn), 2019 vs. 2020 YTD



Source: Preqin Pro. Data as of June 2020

Fig. 20: Largest US Retail PERE Deals in 2020 YTD

Asset	Deal Date	Deal Size (\$mn)	Transaction Type	Asset State(s)	Investor(s)/Buyer(s)	Bought from/Seller(s)
Garden City Center	Jan-20	181	Single Asset	Rhode Island	WS Capital Partners, CrossHarbor Capital Partners	TA Realty
Colony Place	Jan-20	160	Single Asset	Massachusetts	The Rainier Companies	-
Mount Pleasant Towne Centre	Feb-20	147	Single Asset	South Carolina	Continental Realty Corporation	CalPERS - California Public Employees' Retirement System, Miller Capital Advisory
1075 Commercial Street	Apr-20	113	Single Asset	California	Alexandria Venture Investments	Unidentified Seller(s)
US, Retail Portfolio	Mar-20	107	Portfolio	Maryland, North Carolina, Virginia	Slate Asset Management	Unidentified Seller(s)

Source: Preqin Pro. Data as of June 2020

Hotels: Capital Checks out in Dramatic Decline

Hotel investment dries up as COVID-19 restrictions plunge the sector into uncertainty

The hospitality sector faced unprecedented challenges in 2020. The outbreak of COVID-19 has impacted all property sectors across the US, but perhaps none more than hospitality and hotels. With the US Government announcing travel restrictions throughout the year, tourism to the US – and indeed globally – plummeted.¹ Hotels relying on business travel and events also suffered as the lockdown forced Americans to stay at home and businesses to cancel physical meetings. Amid the uncertainty surrounding cash flow and the timeline of a potential rebound in travel and tourism, investment activity in the hotel sector ground to a halt.

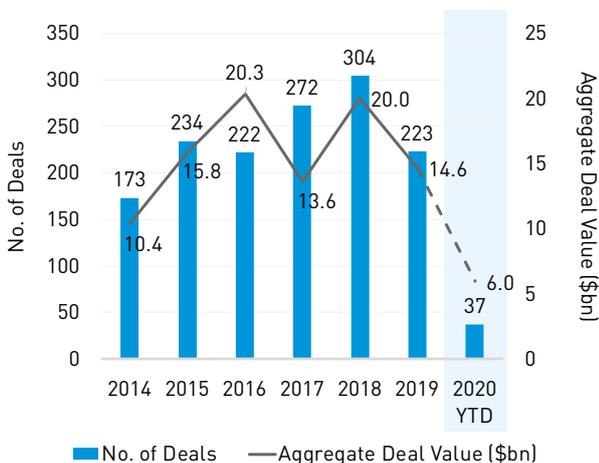
Investment in US hotels almost disappeared when travel restrictions were introduced. All but two of the 37 PERE deals completed for US hotels in 2020 YTD (as of 15 June) came in the first quarter of the year, largely

before the pandemic reached US shores (Fig. 21). In Q2 most managers were forced to turn their attention from sourcing new opportunities to monitoring any troubled assets.

Prior to the COVID-19 crisis, however, the hotel sector had been enjoying a period of strong activity. Total deal value amounted to \$14-20bn annually from 2014 to 2019. And the \$5.9bn worth of transactions in Q1 2020 put the year on course to exceed \$20bn. Blackstone Group’s continued focus on Las Vegas was a key driver of Q1 activity. After acquiring the Bellagio for \$4.25bn in 2019, the New York-based investment firm announced a \$4.6bn joint venture with MGM Growth Properties to purchase the MGM Grand and Mandalay Bay in January 2020.

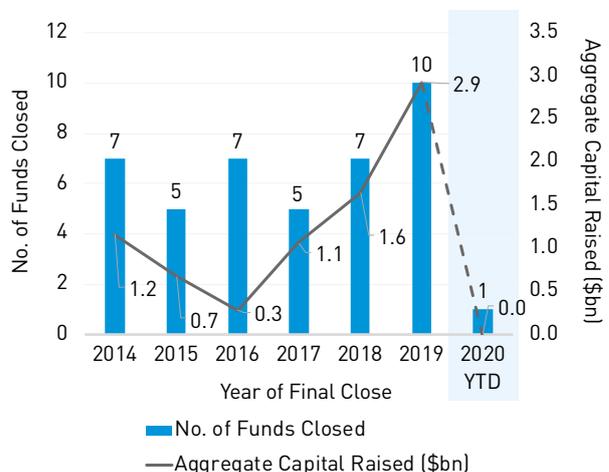
¹ <https://www.unwto.org/news/new-data-shows-impact-of-covid-19-on-tourism>

Fig. 21: US Hotel PERE Deals, 2014 - 2020 YTD



Source: Preqin Pro. Data as of June 2020

Fig. 22: North America-Focused Hotel Private Real Estate Fundraising, 2014 - 2020 YTD



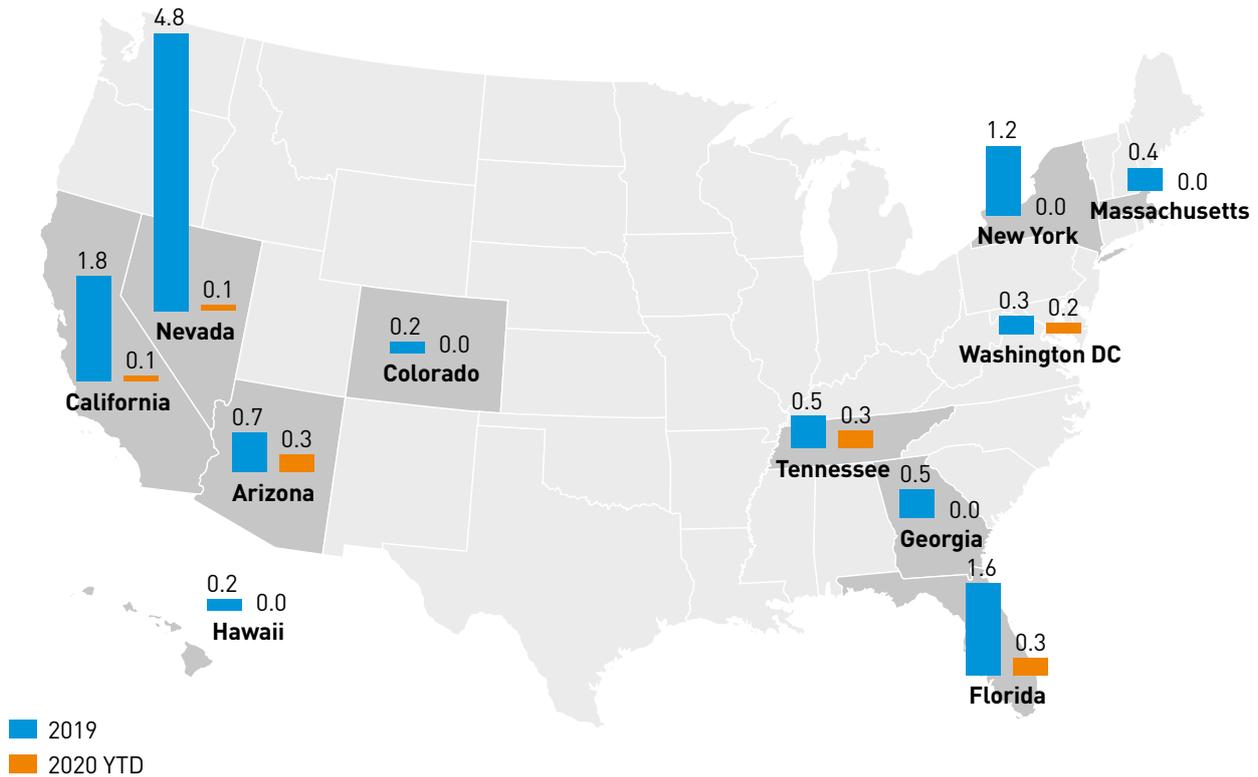
Source: Preqin Pro. Data as of June 2020

At this point it is difficult to predict when investment activity will resume. While any future repricing opportunities may attract investment back into the hotel sector, the ability of hotels to generate cash will depend on the return of consumer spending. The May 2020

US hotel forecast from STR and Tourism Economics projects a 57.5% decrease in revenue per available room (RevPAR) in 2020, followed by an increase of 63.1% in 2021.² The rate of recovery will vary across markets, but activity will likely remain low in the short term.

² <https://str.com/press-release/str-and-te-further-downgrade-us-hotel-forecast>

Fig. 23: Most Active US States by Aggregate Value of Single-Asset Hotel PERE Deals (\$bn), 2019 vs. 2020 YTD



Source: Preqin Pro. Data as of June 2020

Fig. 24: Largest US Hotel PERE Deals in 2020 YTD

Asset	Deal Date	Deal Size (\$mn)	Transaction Type	Asset State(s)	Investor(s)/Buyer(s)	Bought from/Seller(s)
Las Vegas, NV, Hotel Portfolio	Jan-20	4,600	Portfolio	Nevada	Blackstone Group, MGM Growth Properties	MGM Resorts International
Sheraton Grand Phoenix	Jan-20	268	Single Asset	Arizona	Blackstone Group	Marriott International, Inc, TLG Investment Partners, Concord Wilshire
DoubleTree by Hilton Hotel Nashville Downtown	Jan-20	139	Single Asset	Tennessee	AWH Partners, Spire Hospitality, Inland Institutional Capital	Walton Street Capital
Shelborne South Beach	Feb-20	120	Single Asset	Florida	King Street Properties, Westdale, Cedar Capital Partners	Unidentified Seller(s)
Thompson Washington D.C.	Jan-20	120	Single Asset	Washington DC	Union Investment Real Estate	Geolo Capital, JW Capital

Source: Preqin Pro. Data as of June 2020

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