GLOBAL REAL ESTATE MARKET NEWSLETTER

AUGUST 2015

GLOBAL REAL ESTATE MARKET OVERVIEW

Welcome to the inaugural issue of the RVK Global Real Estate Market Newsletter. The intent of this letter is to efficiently and concisely communicate what's on our mind. This may include current opportunities and where we view attractive relative value, real estate strategies we find overhyped and "running on fumes," thoughts on investment structures or market trends, or a host of other topics. We should emphasize that our views are NOT blanket recommendations. We firmly understand that circumstances differ for each portfolio, which is what makes customized client solutions the true hallmark of RVK's real estate consulting philosophy. Topics for the first issue include (i) portfolio aggregation opportunities in senior housing, (ii) "bricks and sticks" retail opportunities in the internet era, and (iii) our differentiated view on the apartment sector.

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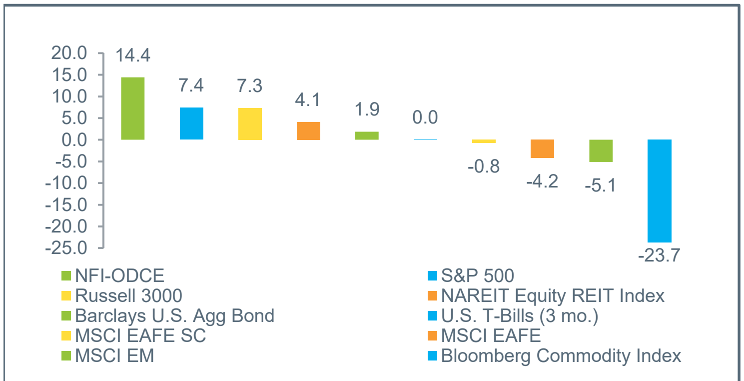
About RVK Real Estate

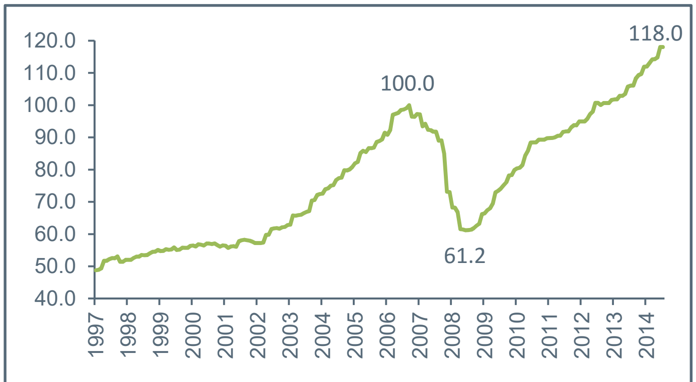
As shown below in **Figure 1**, private core U.S. real estate (as measured by the NFI – ODCE index) has significantly outperformed other asset classes over the past year. As one may expect, strong recent performance coupled with a global search for yield has led to significant capital flowing into the sector. Private real estate investment reached an all-time high in 2014, and uncalled capital levels continue to grow. Fundamentals in the U.S. remain strong as absorption continues to outpace supply in virtually all sectors. Private fundraising levels in Europe last year were more than double the amount raised during 2013, which demonstrates the growing appetite for European real estate. Despite this good news (or in light of it), we remain generally cautious on the current entry point, particularly in the core space. **Figure 2** demonstrates how capital inflows have compressed cap rates and driven values above prior peak levels in gateway markets, leading to unsustainable appreciation returns for core assets. We believe real estate will remain attractive vis-à-vis other asset classes as long as global rates remain low, and we encourage real estate investors to maintain a long-term view. Select opportunities remain, but manager selection and disciplined underwriting is especially crucial at this stage of the cycle, and vintage year diversification is of utmost importance.

Figure 1: TRAILING 1YR MARKET PERFORMANCE (%) (AS OF 6/30/2015)



Data Source: NCREIF, Bloomberg

Figure 2: COMMERCIAL PROPERTY PRICE INDEX (INDEXED TO 100 IN AUGUST 2007)



Data Source: Green Street Advisors

About RVK – *RVK was founded in 1985 to focus exclusively on investment consulting and today employs over 100 professionals. The firm derives 100% of its revenue from investment consulting services and is headquartered in Portland, Oregon, with regional offices in Chicago and New York City. Based in Chicago, the RVK Real Estate Consulting Group advises a wide array of governmental, corporate, endowment, and foundation clients on both a retainer and project basis. Services include real estate policy development, strategic planning, portfolio construction and risk mitigation, real estate manager sourcing and due diligence, portfolio monitoring, performance reporting, secondary sales advisory, and co-investment and direct asset reviews, among others.*

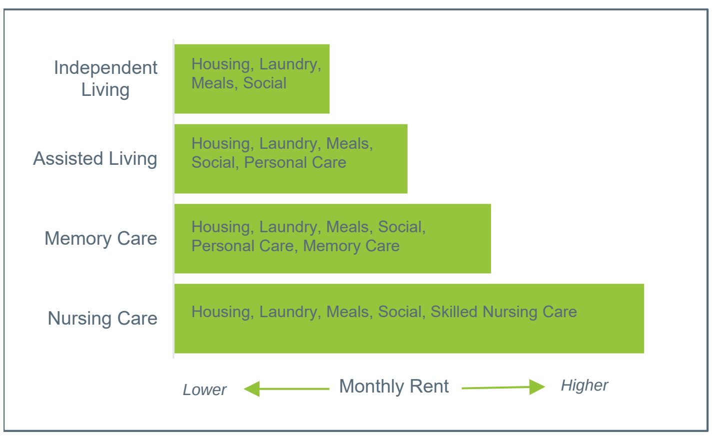
CURRENT REAL ESTATE INSIGHTS AND OPPORTUNITIES

Reposition or Expand Senior Housing Stock

RVK Real Estate Consulting Group has identified the senior housing sector as an attractive investment opportunity to generate strong risk-adjusted returns through (i) the acquisition of individual assets or small portfolios, (ii) the implementation of a value-added business plan through amenities upgrades and the construction or conversion of existing units into additional care segments, and (iii) the disposition of the portfolio to an institutional buyer seeking scale in the industry. RVK has identified this specific strategy due to the cap rate spread generated on larger portfolio transactions relative to individual asset or small portfolio sales, the functional obsolescence of the current stock, and the desire for residents to "age in place."

The senior housing and care industry provides housing and an array of services to seniors, with care segments commonly divided into the four (4) categories noted in **Figure 3**. This diagram represents the continuum of care spectrum and services rendered, relative to rents.

Figure 3: SENIOR HOUSING SERVICES SPECTRUM

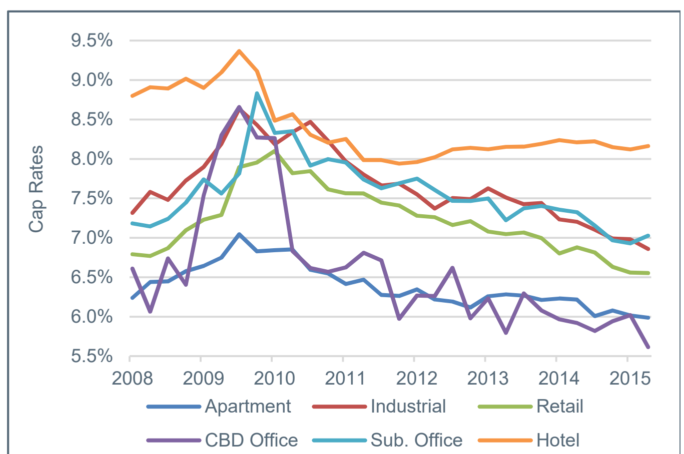


According to NCREIF and AEW Research, the senior housing sector has outperformed the traditional property types across 1-, 3-, 5-, and 10-year periods. In addition, the sector has proven to be the most stable property type, having lost only approximately 200 bps in occupancy through the most recent real estate cycle. Further, senior housing was the only real estate sector to demonstrate continued positive rent growth through the Global Financial Crisis.

While inventory has steadily increased since 2007, absorption has consistently outpaced new supply, resulting in steady occupancy growth since 2010. This supports the demographic trend that senior citizens are among the fastest growing segments of the U.S. population. Further, Alzheimer's and dementia-related diseases are growing at rapid rates, leading to an increased need for more advanced care services. As a result, the current supply of inventory is unable to meet demand, while much of the existing stock is nearing functional obsolescence. Finally, since turnover tends to increase in tandem with the acuity spectrum and residents prefer a facility which offers the ability to "age in place," demand for assets offering multiple care segments has increased, thus leading to development and/or redevelopment opportunities of existing assets that currently focus on one level of care.

Given the search for yield and cap rate compression trends found in the more traditional sectors, institutional investors have begun to identify the senior housing sector as an attractive opportunity, leading to a significant increase in transaction volume dating back to 2011. However, despite this inflow of capital, capitalization rates of senior housing properties have remained steady at approximately 8.0%, and according to Real Capital Analytics represent a premium to cap rates of most traditional property types, which have compressed significantly following the financial crisis as shown in **Figure 4**.

Figure 4: CAP RATE TRENDS BY SECTOR



Data Source: Real Capital Analytics (RCA)

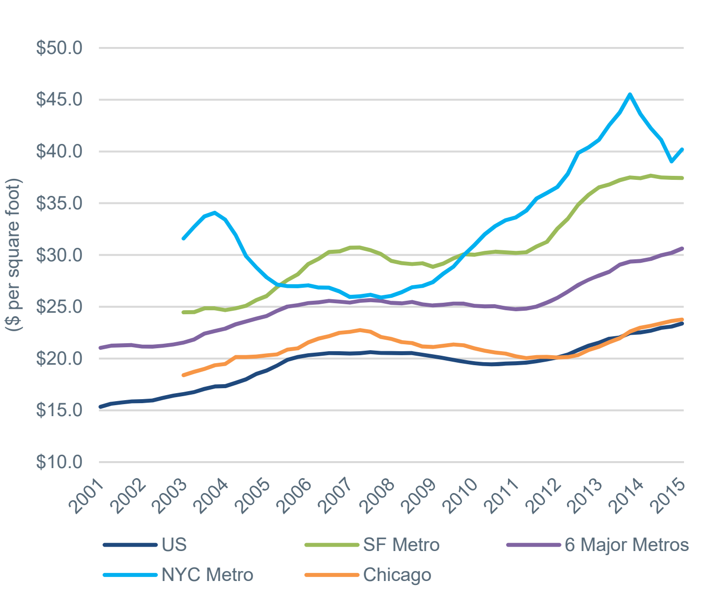
CURRENT REAL ESTATE INSIGHTS AND OPPORTUNITIES

Repurpose or Develop Urban Retail in Strategic Locations

Shoppers flock to Fifth Avenue in NYC or the Champs-Élysées in Paris not only to *purchase*, but to *shop*, and retailers are starting to appreciate the marketing value of a high-street retail location in addition to its relative stability. This is especially true internationally (Asia and South America), where creating brand awareness for the burgeoning middle class is increasingly important.

In the wake of the Global Financial Crisis, domestic and institutional capital identified prime retail as a "safe haven" and thus demand drove pricing ahead of fundamentals. Natural constraints limit new supply in this sub-sector, and there has been a general trend towards renovating or expanding key locations rather than opening new stores across markets. As a result, valuations are now driven by the tenant rather than investor demand. According to Real Capital Analytics, 83% of retail markets saw rents rise or remain unchanged year-over year. Prime markets have done particularly well with rents up 10% year-over-year, as illustrated in **Figure 5** below, while some super-prime submarkets (e.g., Union Square in San Francisco) have seen considerably higher rental increases.

Figure 5: RETAIL INSTITUTIONAL EFFECTIVE RENTAL REVENUE

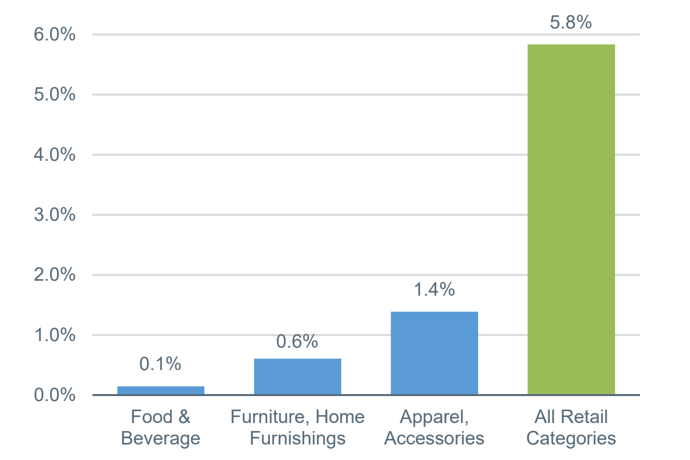


Data Source: Real Capital Analytics (RCA)

E-Commerce

Much has been written about the demise of the bricks and mortar retail store and, in truth, the internet has had a material impact on the retail industry. However, customers are proving reluctant to buy certain products (e.g. apparel, food, home furnishings) on-line, as illustrated in **Figure 6** below, and retailers are adapting to the e-commerce trend.

Figure 6: E-COMMERCE SALES AS % OF TOTAL RETAIL SALES, BY CATEGORY (2013)



Data Source: U.S. Census Bureau

Leading retailers have invested heavily in technology to enhance store and online synergies and have found that "Reserve in Store" programs have increased customer traffic, sales conversion rates, and average customer spending because of cross-selling opportunities. According to the U.S. Bureau of the Census, total E-commerce sales still only account for just 5.8% of total retail sales. "Omni-channel" strategies seek to tightly integrate their online and physical stores. In the case of Gap, for example, customers can reserve items online, have them shipped to the store closest to them, and be held for pickup, presenting "up-sell" opportunities which often results in additional purchases.

While leading retailers are growing their on-line presence, the adoption of omni-channel strategies coupled with "necessity" goods that consumers still prefer to buy in-person dictates that a network of physical stores is still required. We believe stores in main street, high traffic retail corridors or top malls serve key selling and advertising functions that can be leveraged along with retailers' online sales channels.

CURRENT REAL ESTATE INSIGHTS AND OPPORTUNITIES

Cautious View on Multifamily Valuations

One of the most popular current discussion topics in commercial real estate centers on when the strong growth in rents, valuations, and apartment construction will eventually slow down. Apartment valuations have rebounded sharply since the end of the Great Recession of 2008-2010, with REIS reporting national vacancies declining from 8.0% during the depth of the downturn, to a current rate of 4.2%. During much of that recovery, while demand strengthened, new supply remained fairly muted. However, that supply/demand imbalance is beginning to shift dramatically.

According to REIS, approximately 240,000 new institutional-quality apartments will come online in 2015. That's 43 percent more than 2014, and well above the average of 132,000 units per year delivered between 1999 and 2008. As of January 2015, construction starts on multifamily structures with five or more units increased to 372,000, up more than 12% from December 2014, and a 24.5% increase year-over-year. However, real estate brokerage firm Marcus and Millichap estimates 2015 incremental demand for apartments of only 186,000 units, which would cause vacancy rates to actually increase year-over-year. REIS forecasts a 70 to 80 basis point increase in the national vacancy rate in 2015. As a result, effective rent growth has begun to slow across the U.S., recently dipping below 3% year-over-year in Major Metros, as illustrated in **Figure 7** below.

Figure 7: DECLINING EFFECTIVE RENT GROWTH

Data Source: Real Capital Analytics (RCA)

What About the Millennial Effect?

At 87 million strong, Millennials are now America's largest demographic cohort, overtaking the Baby Boomers (76 million). Millennials are more likely to be college educated as compared to Baby Boomers, more mobile, and more likely to rent than own their primary residence. In addition, they are getting married later and having children later, increasing demand for rental housing relative to single family homes. Is this a structural shift in how America views the idea of homeownership, or is it a transitory phenomenon related to the timing of the Great Recession and the resulting impact on employment prospects and household formation of the Millennial generation? We believe it is the latter.

U.S. News & World Report published a report in April 2015 titled "A Suburban Place to Call Their Own," which demonstrated that the Millennial generation is not much different from prior generations in viewing homeownership as a key part of the American Dream. The report showed that 90% of young apartment renters were likely to buy a home in the future, while only 7% stated they would always rent. Perhaps more surprisingly, 76% of renters stated that they believed owning a home was the more sensible financial choice over the long-term. Despite the impressive growth in urban, "live-work-play" apartment communities, the data indicated the vast majority (approximately 2/3) of Millennials prefer living in the suburbs. While the "Millennial Effect" has fueled much of the growth in apartment construction over the past several years, we believe this trend will not continue at the same pace going forward.

As a result, RVK believes that while opportunity remains in the multifamily space, strict adherence to prudent underwriting standards has become increasingly important. We have observed investors "stretching" assumptions to justify increasing purchase prices in certain markets. We caution our clients that in this market, it is often the "incremental" buyer, or buyer most willing to aggressively underwrite an apartment asset, that is winning deals and setting the market. While multifamily real estate should always remain a part of any institutional investor's portfolio due to the consistent nature of rental streams and cash flows, we encourage clients to proceed with caution in the current environment.

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