Adviser Letter

accordant

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Executive Summary

We are pleased to present the Accordant Adviser Letter, dedicated to exploring the latest topics impacting the private real estate industry and our firm's outlook. The following highlights the key topics discussed below:

1. **Know what you own.** Private Real Estate is a strategic investment for financial advisers to utilize in client portfolios. However, it is important to understand the characteristics of the actual real estate you are buying, as highlighted in recently published articles about areas of concern related to non-traded REITs. Our mission is to bring transparency to the asset class and to highlight important questions advisers should be asking their managers to ensure they understand their investments.

2. **Find opportunity.** High interest rates and a sharp decline in property transactions have created challenges in price discovery in private real estate but this also creates areas of opportunity. We see immediate opportunities in growth areas like data centers and believe that multifamily and industrial are property types that have strong long-term supply and demand fundamentals. Investing opportunistically, given current market stress, can lead to attractive returns with a higher margin of safety due to the ability to potentially buy multifamily at prices below replacement cost.

3. **Own what you need.** We are scrutinizing every opportunity and investing selectively to build portfolios to accomplish the specific needs of our partners. We remain patient in deploying capital, moving forward with select opportunities that we believe have the potential to provide highly attractive risk-adjusted returns and above-average performance in this part of the cycle.

Private Real Estate Retail Offerings – Buyer Beware

While we believe in the importance of including private real estate in a comprehensive portfolio strategy, we also acknowledge the challenges advisers face in today's market environment. Doing the right due diligence is key. These are the main factors we believe all advisers and investors should be focused on: investment structure, manager alignment, fund size, and transparency.

Recently published articles have raised concerns about large non-traded REITs and their lack of transparency to investors and regulators around the processes they use to calculate net asset values ("NAV"). Managers often use the quarterly or annual NAV to calculate management and performance fees, which represent an important part of a firm's revenue. This has introduced concern around conflicts of interest when the investment manager is responsible for calculating the NAV that they then use to calculate their fees. In our view, a better approach is the one taken by many institutional funds, such as those in the NFI-ODCE Index, which requires managers to utilize a third-party valuation firm to calculate NAV, thus mitigating potential conflicts.

Another item of concern is the source of cash flow used to pay future dividends, which can include borrowing (leverage), selling assets, or raising capital from new investors. These levers should not be viewed as self-sustaining and should be compared to the more common practice for core real estate where the dividend is most often covered by the underlying properties. Furthermore, leverage plays a key role in affecting the performance of real estate investments, and while it can enhance returns, it also magnifies losses. Today, non-traded REITs often use more than 2x the leverage of the ODCE Index.

Lastly, it is our view that there comes a point where size hinders performance, which is a negative for funds charging high management and incentive fees. Investment funds managed by large public companies can often let the importance of gathering assets for higher revenue growth overshadow the importance of generating the highest possible returns for their investors.

Prominent Themes in Private Real Estate

Price Discovery. From a top-down perspective, the greatest challenge facing private real estate is price discovery. The sharp rise in interest rates and subsequent volatility in fixed-income markets negatively impacted real estate valuations and has created a more challenging refinancing environment. This has caused the number of real estate transactions to decline, making it more difficult to have confidence in current property valuations. With interest rates expected to be higher for longer, there is some evidence that transaction volume has begun to pick up as property owners recognize they will not be bailed out by lower interest rates anytime soon. Investors or investment vehicles with large exposure to recent vintages may suffer as they likely overpaid during the low-rate environment and are now saddled with higher financing costs. As a result, we are beginning to see potential discounts on assets, presenting an opportunity to those that are deploying capital to take advantage of the current market environment. In some cases, we are also seeing the sales price of assets begin to align with the portfolio valuations in ODCE.

Data Centers. Artificial intelligence (AI) and machine learning are in the early stages of their development, but they appear likely to impact every sector of the economy. This has the potential to positively impact productivity and drive GDP growth. From an investment perspective, there is a tremendous gap between current supply and the surging demand for data centers, and we are excited to participate in this specialized area of the real estate market through our access to a vertically integrated developer. From a fundamentally driven return perspective, we believe this is the most compelling prospect for equity investors today, and we look forward to sharing our latest opportunities in this sector with you.

Housing. Multifamily housing remains crucial given the country's chronic and sustained shortage of available units. This shortage may become even more pronounced owing to the high interest rate environment which acts as a barrier to (1) would-be home buyers that are priced out of purchasing, and (2) developers who cannot make economic sense of new product given higher costs. In our view, this phenomenon where investors can purchase properties below what it would cost to construct them occurs only once every 15-20 years. As the supply/demand fundamentals improve, it will once again become a more attractive time for development. While we expect to participate in both buy and build strategies, buying appears especially attractive at this stage of the cycle.

Industrial. The shift toward onshoring/nearshoring in the U.S. will continue to impact the industrial sector. We expect the growth of manufacturing in the U.S. and Mexico to result in greater demand for logistics in both countries. Based on recent data, we also see an acceleration in e-commerce in both the U.S. and Europe.

Debt. Private credit has become one of the more popular investment strategies as banks have continued to cede market share to private lenders given the regulatory and balance sheet pressures they face. We believe this is a structural shift versus previous cycles, and private capital will play an increasing role in areas like construction and core first mortgage lending. Further, there is a wave of refinancings headed our way over the next few years, given the number of floating-rate mortgages and properties that will need to be recapitalized. This is shaping up to be one of the more attractive real estate lending environments to generate high risk-adjusted returns and echoes what took place post-GFC. However, competition is fierce, and spreads are already beginning to narrow.

Conclusion

Balancing patience and opportunities in capital deployment. While we navigate a challenging environment for real estate investing, it is often during times such as these that some of the best opportunities arise to selectively increase exposure to the asset class. The challenges around key factors such as interest rates, growth, and valuations have led to increased volatility. That said, short-term fears should not overshadow the more important decision to invest for long-term portfolio diversification and prudent asset allocation, of which real estate should be considered a fundamental building block to client portfolios.

In the near term, we are identifying investment opportunities that have the potential to offer opportunistic returns, while at the same time providing downside protection. Specifically, our primary focus is on data center development, housing acquisition, and credit. For investors with available capital, we believe now is an excellent time to selectively increase exposure to private real estate with the objective of building a long-term, diversified portfolio. More broadly for the asset class, as transactions pick up, we are nearing more accurate and stable valuations that will create an attractive entry point for diversified core real estate exposure in the medium term.

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Important Disclosures