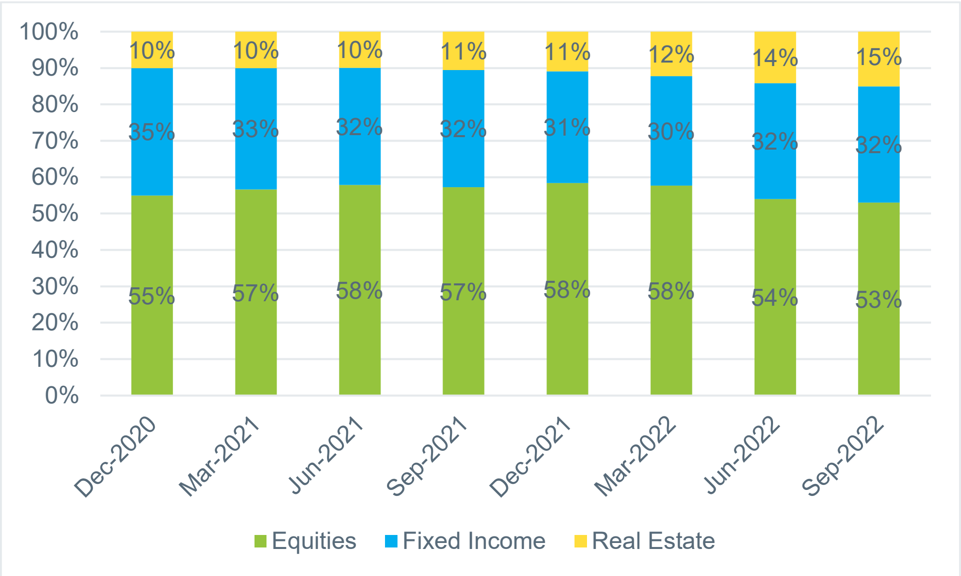
Open-Ended Real Estate Queue Update

The following is an overview of recent economic and broad market events that may lead to disruptive expected cash flow patterns in our client's open-ended real estate funds. In 2022, the public equity and debt markets experienced elevated levels of volatility and weakness. Year to date, private real estate markets have performed modestly well outside of a small group of sectors. Going forward, the asset class faces increasing illiquidity from higher borrowing costs, which leads to reduced buyer pools, further restricting liquidity to an already less-liquid asset class.

This series of events leads to what is often referred to as the "denominator effect." This occurs when private real estate appreciates while at the same time public markets depreciate. This creates a scenario where private real estate is above target allocation and public market assets are below target as a percentage of investors' total assets. As a result, investors look to rebalance their portfolio by selling private real estate and reinvesting the proceeds into public market assets.

Figure 1 shows a hypothetical investor asset allocation with 55% to global equities (MSCI ACWI), 35% to fixed income (Bloomberg US Aggregate) and 10% to real estate (NCREIF-ODCE) beginning December 31, 2020. If the investor earned these index returns and did not rebalance their portfolio over the next 7 quarters, their real estate allocation would have grown to 15% as of September 30, 2022, well above their target allocation. Conversely, both equity and fixed income allocations would now be underweight. This dislocation would most likely call for the investor to rebalance their overweight real estate portfolio.

Figure 1: The Denominator Effect
Asset Allocation Changes Over Time (No Rebalancing)

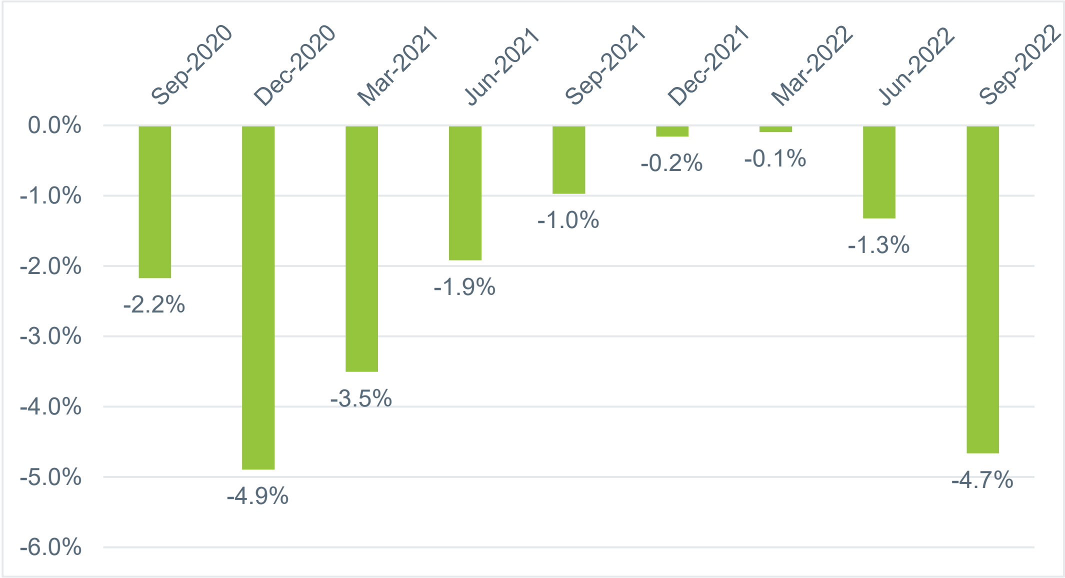


Performance proxies used: Equtiies = MSCI ACWI (Net), Fixed Income = Bloomberg US Aggregate Bond Index, and Real Estate = NCREIF ODCE Index (Net) (AWA).

This "denominator effect" is leading to elevated levels of investor redemption requests and causing investment managers to make conservative forward-looking cash flow decisions based on the potential needs of their funds. In some instances, managers are not fully redeeming all investors in each quarter or have put in place redemption queues, creating a more orderly return of capital to investors, while at the same time meeting fund investment objectives.

A common theme we are seeing throughout the industry is managers taking steps to shore up their fund's balance sheets in the near term, while at the same time looking to deploy capital in the most prudent manner. This is similar to the second quarter of 2020 when the pandemic created uncertainty in the market and managers felt it was prudent and necessary to restrict fund outflows and enacted redemption queues.

Figure 2: RVK Manager Survey
Net Queue as a Percentage of Gross Asset Value



Queue data is gathered quarterly by an RVK survey of over 20 open-ended real estate managers that we follow closely. Not all ODCE members are included in this survey.

The issues highlighted above—along with the market-related challenges of cap rate expansion, widening bid-ask spreads, and higher borrowing costs leading to reduced transaction activity—are no longer specific to any single fund. We are seeing similar trends across the industry and within the NFI-ODCE peer group. There are top-performing funds that have taken similar steps in anticipation of near-term liquidity constraints on their respective funds. Other fund managers have indicated that they are seeing elevated redemption requests from investors taking this opportunity to consolidate their manager rosters.

RVK recommends that clients remain invested and avoid submitting redemption requests at the current time unless cash flow shortfalls or investment policy guidelines necessitate a redemption. In times of market dislocations such as this, the "semi-liquid" nature of open-ended funds turn to illiquid and can remain that way for an extended period.

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