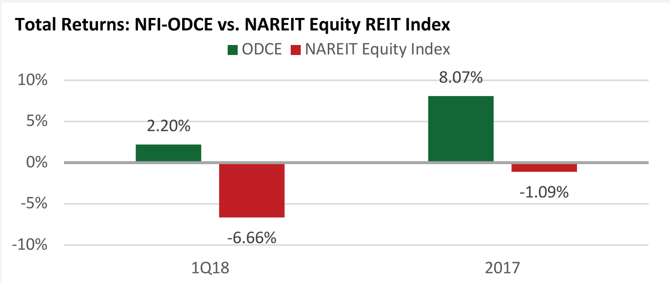
ODCE

REAL ESTATE IS ON SALE ON WALL STREET

The NFI-ODCE materially outperformed the NAREIT Equity REIT Index this past quarter and in 2017. The total gross quarterly return for the NFI-ODCE was 2.20% in 1Q18, comprised of 116 bps from appreciation and 104 bps from income, compared to -6.66% for the NAREIT Equity REIT Index. ODCE quarterly gross returns have been increasing for the past four quarters.



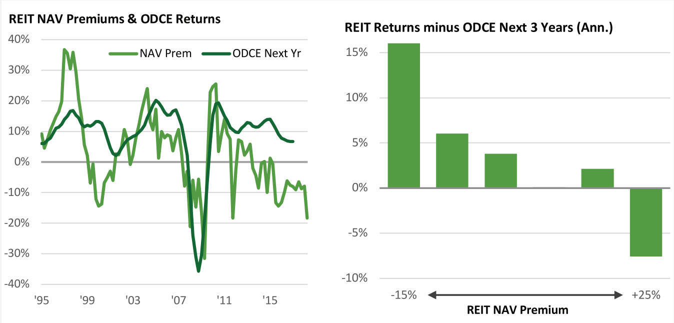
Institutional demand for private real estate remains high; net investor cash flows were positive in 1Q18, a significant turnaround from negative net flows throughout 2017. This was driven by positive $74 million of net investor contributions reflective of a greater balance in fund flows. Balance sheets remain healthy with leverage at 21.1%, cash balances at 3.2%, and occupancy at 92.4%.

The economy is doing well, and economic growth is expected to pick up this year and next as the twin engines of tax cuts and deficit spending take effect. On the supply side, low supply growth has been one of the defining positive attributes of this real estate recovery, and new supply has been problematic in only a few sectors and markets. With supply and demand roughly in balance, we can expect inflationary-type rent growth for the near future.

Overall, fundamentals are healthy, but slowing, and there are definite winners and losers between property sectors. Secular changes triggered by ecommerce are helping industrial real estate, especially infill properties, and hurting retail.

Commercial real estate pricing today continues to screen as fairly priced relative to corporate bonds, but the signal from the public REIT market indicates that private market real estate is expensive. Lackluster recent performance by listed REITs has resulted in big discounts to NAV in the public market at a time where investors have been climbing over each other to invest in private real estate.

The presence of dual – private and public – markets not only makes real estate an unusual asset class, it also creates opportunities for investors to substantially enhance returns by arbitraging between the two markets. This is made possible by the fact that future relative returns of private vs. public real estate can be predicted with a reasonable degree of accuracy. By way of example, when REITs have traded at NAV discounts in excess of 10%, they have subsequently outperformed the ODCE by more than 1200 bps per annum over the next three years. By contrast, they have underperformed by about 200 bps/yr after trading at large (>20%) premiums. Listed REITs in the major property sectors are trading at an 11% discount to NAV.



These signals can clearly be employed to boost returns, and today's heavily discounted REIT market provides an unusually ripe opportunity. Retail, office, and apartment properties comprise 78% of the holdings of the funds in the ODCE index, and the real estate owned by REITs in these sectors can currently be purchased on the NYSE for $0.85 on the dollar. Private-market vehicles designed to exploit that dynamic may well outperform their public peers.

The existence of dual real estate markets that often head in different directions provides investors an opportunity that is about as close to a free lunch as can be found anywhere in the investment arena.

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