H1 2022

GLOBAL

Real Estate Report

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Key takeaways

Private real estate fundraising looks to be on the decline based on data from the first half of 2022, which is a surprising development given investors' tendency to gravitate toward the asset class during inflationary times. Only 123 funds were raised in the first half of the year compared to 230 in H2 2021. While our data collection efforts typically capture more funds over time, larger funds tend to be recorded first, so capital raised may not increase substantially when all is said and done. With just $63.2 billion raised in H1 2022 compared to $104.0 billion in H2 2021, there is a good chance that we will not see real estate fundraising climb as many had expected for 2022 as a whole.

A few macroeconomic factors are currently top of mind for real estate investors. With a recession and/or real estate market correction potentially on the horizon and the bid-ask spread between buyers and sellers reportedly growing, some investors may be waiting on a reset in the economic cycle before allocating. In addition, while real estate is broadly considered an inflation hedge, climbing interest rates and high inflation are more harmful to some real estate strategies and sectors compared to others, so investors must be selective to increase their chances of achieving attractive returns in the current environment.

Private real estate's one-year horizon IRR of 24.8% through the end of 2021 was its best performance in a decade and not far below the asset class' highest return of 25.4% in the year through Q1 2011. Quarterly IRR figures for Q4 2021 were similarly robust but preliminary numbers from Q1 2022 indicate a potential shift back to normal for returns. This is supported by REIT performance, which began a sustained decline across sectors in Q1 2022 and through the end of Q2. Even if not record breaking, the outlook is still favorable for performance through the end of the year, especially compared to other asset classes.

Real estate fund type definitions

Core: Core investments target the lowest-risk forms of real estate investing, typically in strong markets and desirable locations. They seek high-quality properties with low vacancy rates. Core investment funds usually have a buy-and-hold strategy and include an income stream from property leasing and management activities. Because of the longer-term holding periods of the investments, core strategies often use open-ended rather than closed-end funds.

Core plus: Core plus investments are similar to core investments in that they target stable and fundamentally sound properties; they differ in that they seek assets with an opportunity to add value or enhance returns while holding and collecting rents. Core plus investments may possess a slightly higher risk profile due to exposure points such as upcoming lease expirations, minor renovation requirements, or positioning in a suburb or secondary market. Core plus strategies also often utilize open-ended rather than closed-end funds.

Value-add: Value-add investments pursue higher returns by targeting properties that require more involved additive efforts such as major renovation, repositioning, or reduction of vacancy rates through marketing, for example. Value-add investments may require a longer holding period of seven to 10 years in order to fully execute additive efforts and make returns, largely through the sale of the property at exit.

Opportunistic: Opportunistic investments tend to be made in properties that require substantial additive efforts due to a need for renovation, repurposing, high vacancy rates, or shifting supply-demand dynamics in a market. This category also includes new property development such as greenfield and brownfield projects.

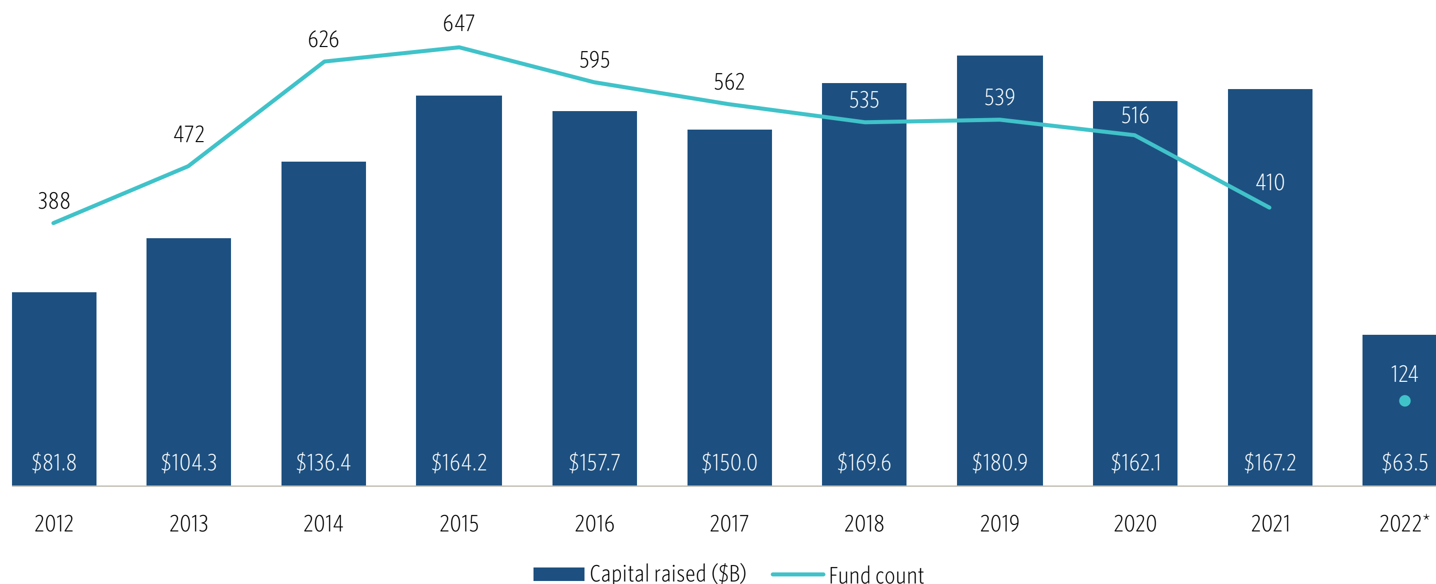
Distressed: Distressed investments target properties and/or mortgages wherein the current ownership is in or near default. In addition, if lenders cannot sell foreclosed-upon properties at auction, the property—also considered a distressed asset—may be sold at a reduced rate on the market.

Debt: Debt funds provide short- to medium-term capital for real estate borrowers, often for development or redevelopment projects. Real estate debt investors can invest in either performing or nonperforming (distressed) debt.

Note: For more on what characterizes various real estate fund strategies and sectors, check out our Analyst Note: Private Markets Real Estate Fundamentals.

Overview

Real estate fundraising activity



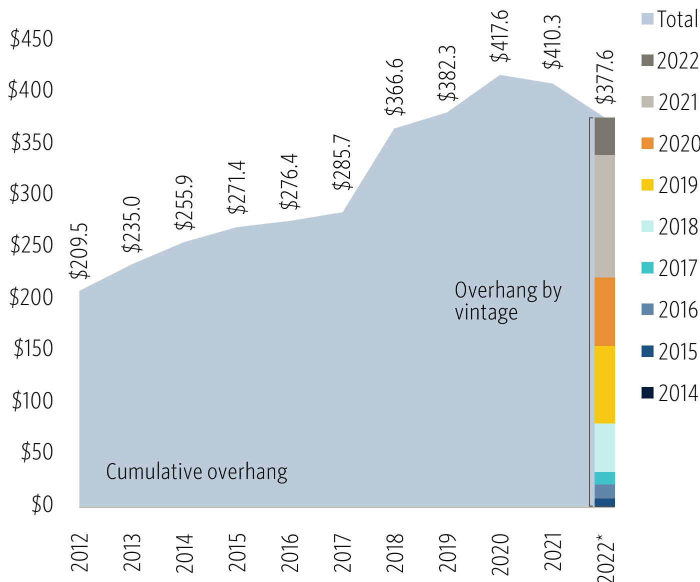
Source: PitchBook | **Geography:** Global
*As of June 30, 2022

In the first half of 2022, real estate made up a smaller proportion of overall private market capital raised than in any of the prior calendar years.[1] The asset class comprised just 7.3%, down from 10.8% in 2021, which is an unexpected development given investor proclivity toward real estate when inflation is high and expected to remain aloft. In part, this is due to rising interest rates, but it also appears that the investor interest that would have been directed to real estate was shifted instead to real assets funds. Their share increased from 9.9% in 2021 to 14.5% in H1 2022.[2] Of the portion that went to real assets, 96.2% went to infrastructure, which shares many investment characteristics with real estate. To name a few, both are thought to be stable, offer inflation protection, are often income-producing, and utilize a spectrum of strategies from lower-effort and low-risk core to higher-effort and high-risk opportunistic. Yet, infrastructure's more steadfast performance during the COVID-19 pandemic may be drawing those in search of an investment capable of weathering macroeconomic turmoil away from real estate. There are a few other factors at play as well, which will be discussed throughout this report.

Not only are some LPs pulling back on real estate commitments, but GPs may be holding off on deploying the dry powder they already have. While dry powder decreased from 2020's high of $417.6 billion to $377.6 billion at the close of H1 2022, older funds have a bigger share. Compared to 2020, when overhang from funds ages three to five was 16.3% of all dry powder and from funds ages six to seven was 2.1%, considerably more of 2022's dry powder is controlled by older funds. As of the close of H1 2022, 35.9% of dry powder sat in funds ages three to five and 5.4% in those ages six to seven. The difference between 2020 and 2022 numbers is likely influenced, in part, by our data not yet capturing all of the newest funds; however, it may also be indicative of investor outlook on the economy. Should there be a reset in the economic cycle, investors could purchase high-quality assets at depressed prices and sell high later, which may be incentivizing those anticipating one to wait on utilizing dry powder.

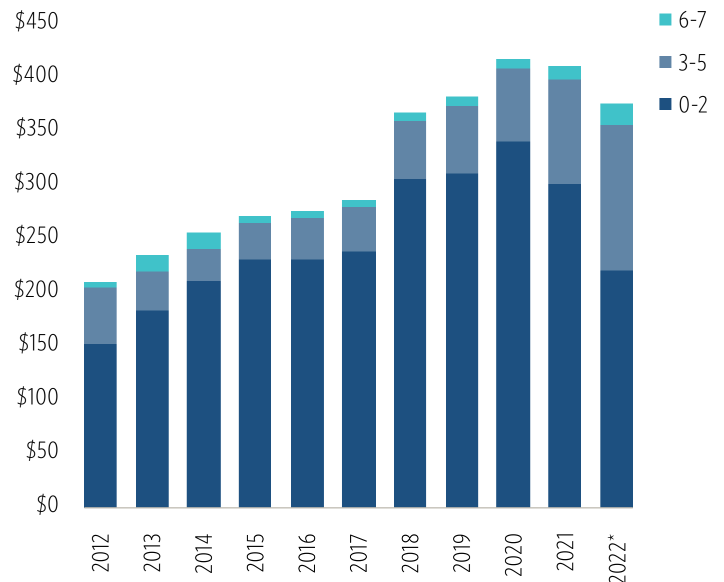
1: Read our Q2 2022 Global Private Markets Fundraising Report for more on this topic.
2: Note: These figures exclude debt.

Real estate dry powder ($B)



Source: PitchBook | **Geography:** Global
*As of June 30, 2022

Real estate dry powder ($B) by age cohort



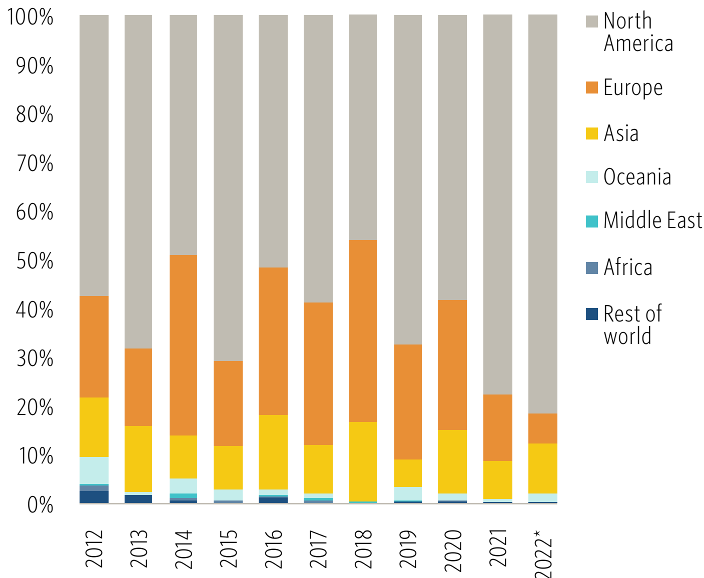
Source: PitchBook | **Geography:** Global
*As of June 30, 2022

Overall, closed-end real estate funds raised $63.2 billion across 123 vehicles in H1 2022. Of that capital, 81.7% was raised by funds based in North America, up from 77.7% in 2021. While these funds may invest globally, this is still considerable given it is the highest percentage of real estate capital raised by any single region we have on record. The percentage that went to Europe shriveled to 7.3% from 13.7% in 2021, while Asia's share rose to 10.3% from 7.7% in 2021. Asia appears to be the only major region for real estate fundraising keeping pace with previous years, having raised $6.5 billion thus far in 2022 compared to $12.9 billion in 2021. Even North America does not appear to be tracking to hit 2021 numbers despite its massive share, with $51.9 billion raised compared to $129.8 billion in 2021.

Rolling 12-month real estate fundraising activity

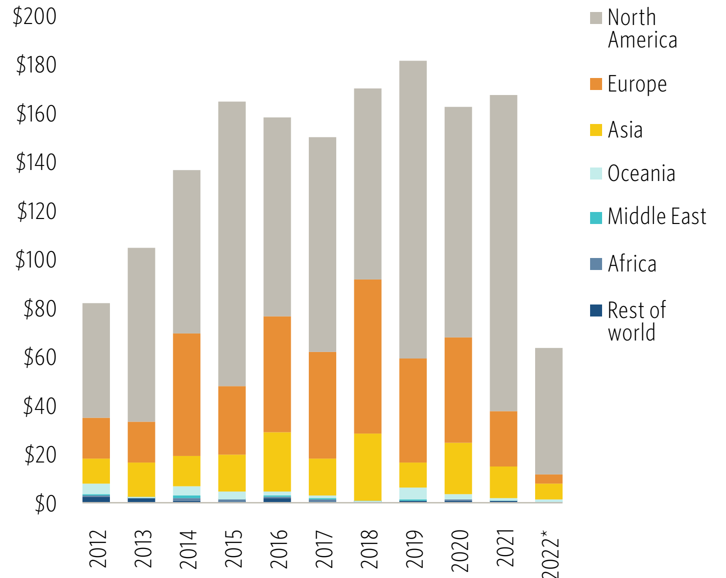
Source: PitchBook | **Geography:** Global
*As of June 30, 2022

Share of real estate capital raised by region



Source: PitchBook | **Geography:** Global
*As of June 30, 2022

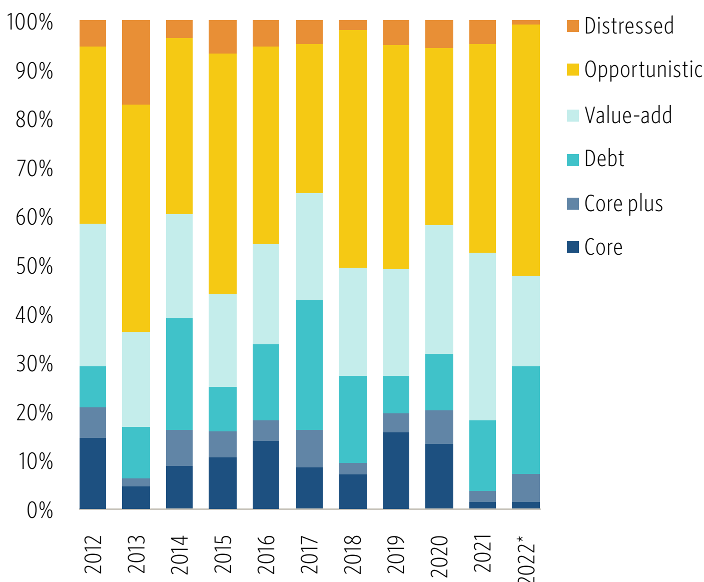
Real estate capital raised ($B) by region



Source: PitchBook | **Geography:** Global
*As of June 30, 2022

As far as fundraising by strategy, opportunistic vehicles continued to dominate, making up 51.1% of raised capital in H1 2022. Debt funds had a good showing as well, comprising 21.9% of capital raised and keeping up with 2021 fundraising rates. Core and core plus funds received a higher share of capital in H1 2022 than in 2021 and are on track to exceed 2021's $6.4 billion raised with $4.5 billion in H1 2022. However, together they still only comprise 7.1% of capital raised. Value-add's share shrank to 18.5%, likely taken up by opportunistic, and distressed's fell to 1.0%. The fact that distressed vehicles now make up the smallest proportion of raised capital we have on record may seem surprising given recessionary fears. Yet, our data shows less correlation between economic recessions and distressed fundraising than might be expected. For more on this, read on to the Distressed and Opportunistic section.

Share of real estate capital raised by type



Source: PitchBook | **Geography:** Global
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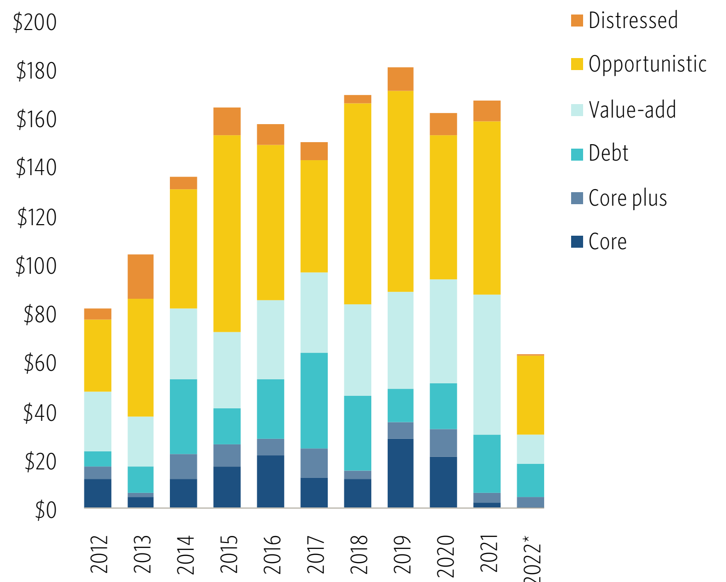
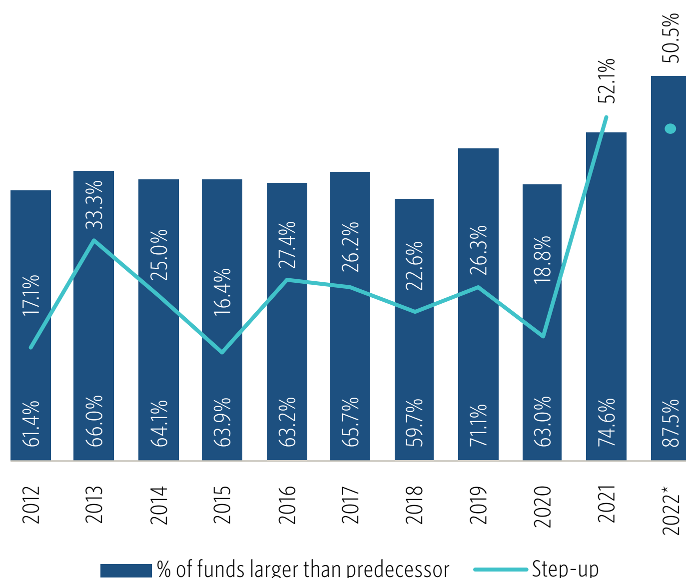
Real estate capital raised ($B) by type



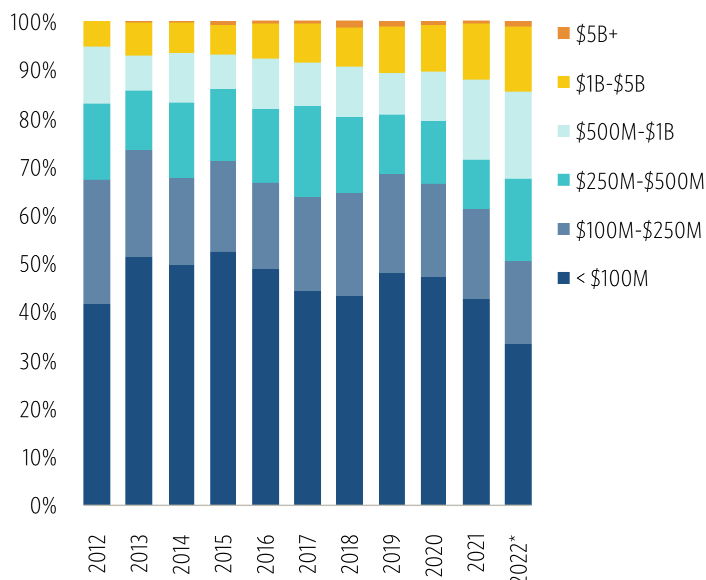
Source: PitchBook | **Geography:** Global
*As of June 30, 2022

Median step-up from previous real estate fund in fund family



Source: PitchBook | **Geography:** Global
*As of June 30, 2022

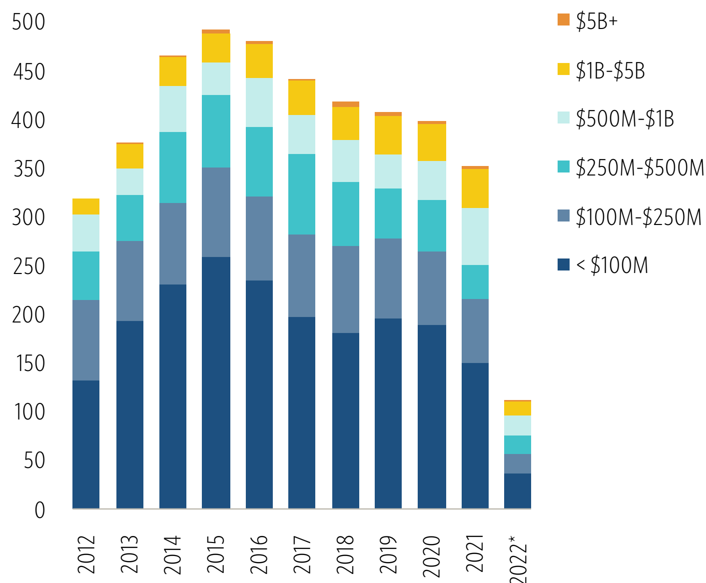
Share of real estate fund count by size bucket



Source: PitchBook | **Geography:** Global
*As of June 30, 2022

Median step-ups remained lofty at 50.5%, with an all-time high of 87.5% of funds raised being larger than their predecessor. As we capture more of the smaller funds raised in the first half of the year, these numbers may soften slightly but will likely still be elevated compared to historical data. Movement toward larger fund sizes in real estate is in line with broader private market trends of recent years. During the pandemic and associated macroeconomic turmoil, investors have increasingly turned to more experienced brand-name managers raising progressively larger funds, resulting, in part, in record sizes. There is some evidence of this in real estate, as the percentage of capital raised by emerging managers has been decreasing over the past couple years.[3] In 2020, 17.6% of capital went to emerging managers, in 2021 it was 16.7%, and in H1 2022 it was 14.8%, although this proportion may increase as news about emerging and small managers makes it to our datasets.

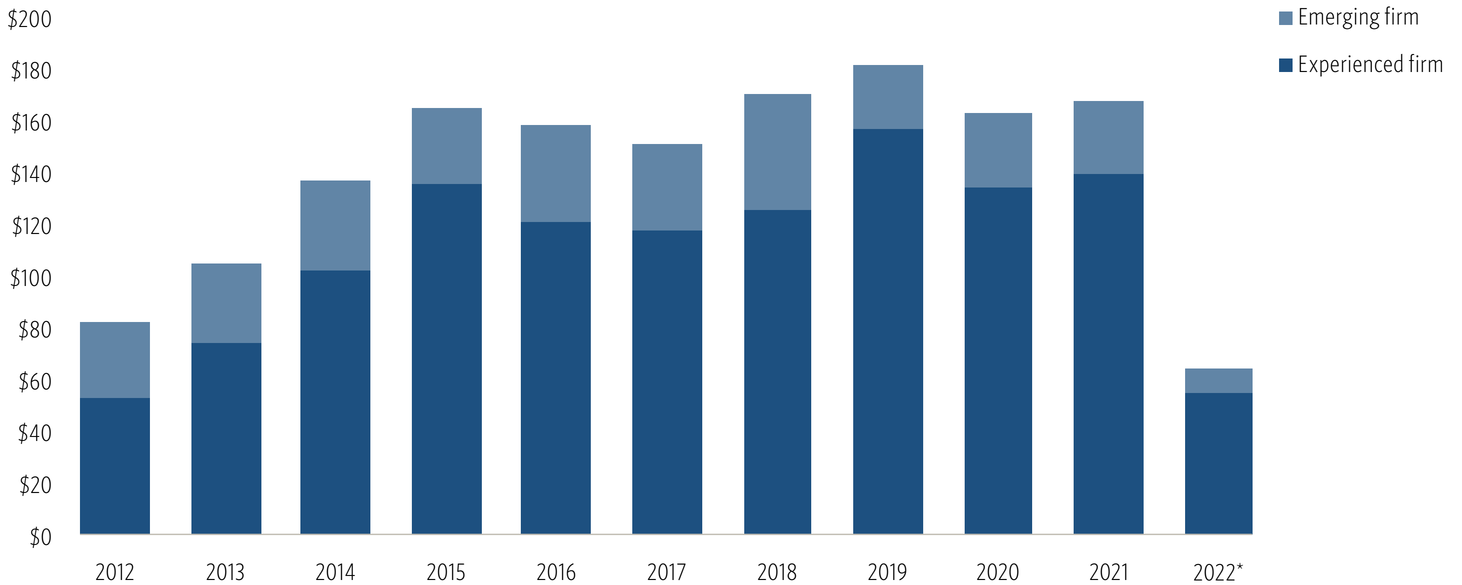
Real estate capital raised ($B) by size



Source: PitchBook | **Geography:** Global
*As of June 30, 2022

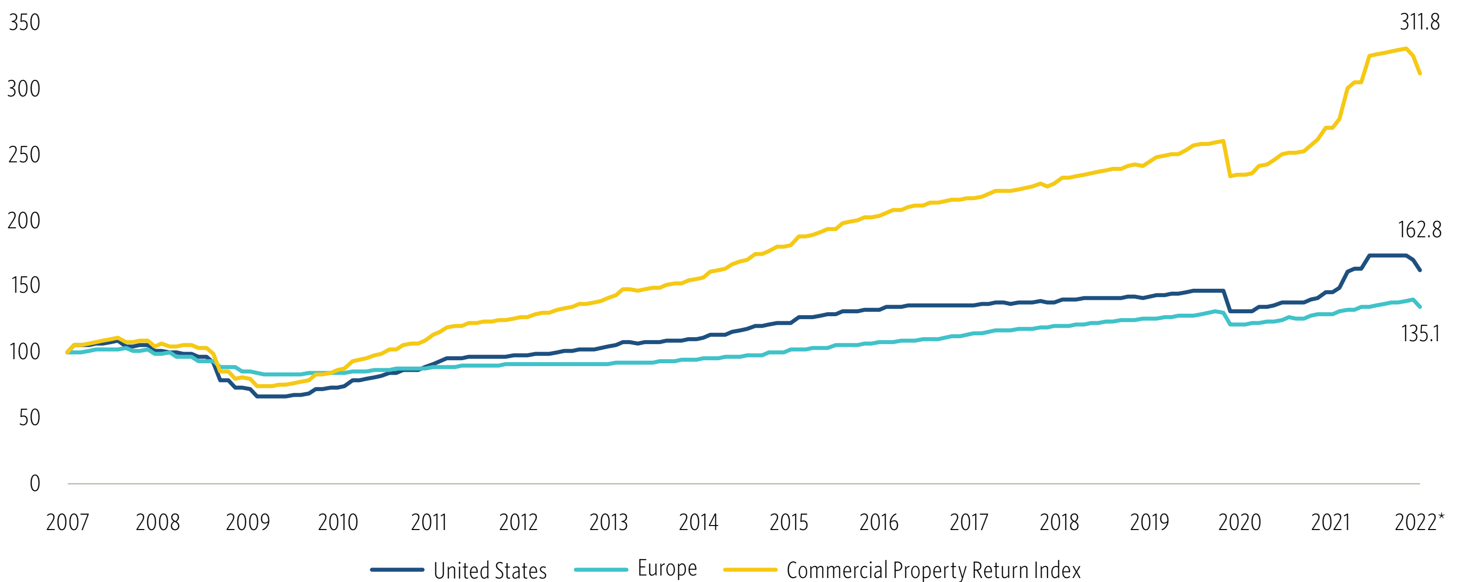
3: Note: The proportion that went to emerging managers in 2019 was anomalously low at 13.7%; this metric had hovered around 20% or higher in previous years.

Real estate capital raised ($B) by manager experience



Source: PitchBook | **Geography:** Global
*As of June 30, 2022

Green Street US and European commercial property price indexes



Source: Green Street | **Geography:** US & Europe
*As of June 30, 2022

Green Street's Commercial Property Price Index, indexed to 100 in 2007, provides some insight into the dynamics informing investor behavior in the space. After the US index climbed back up to 173.6 in Q1 2022 after Q2 2020's drop to 131.4, it seemed to be experiencing another retraction in Q2 2022, dropping 6.2% to 162.8.[4] Europe saw a more toned-down version of that drop, going from a high of 139.4 at the beginning of Q2 2022 to 135.1 at the quarter's end. This is occurring alongside reports of an increase in the bid-ask spread between buyers and sellers, as seller behavior is informed by a surfeit of demand in some sectors and buyers seek prices more compatible with a higher cost of capital.[5] Together, these factors could fuel uncertainty about the near-term future of real estate, especially when combined with fears of a potential recession.

Another metric that adds color to the overall picture of the real estate market is the capitalization rate (cap rate) spread to the 10-year Treasury. Cap rates are calculated by dividing the annual net operating income—essentially rent collected minus operating expenses—by the current market value of a property. The spread tends to be higher in periods of economic distress and lower in times of economic growth, as it represents the compensation investors must receive in order to take on the additional risk associated with real estate investments compared to government bonds.[6] According to J.P. Morgan Asset Management, cap rate spreads have been dropping since their pandemic peak, even reaching below the 2.9% historical average to 2.8% as of March 2022.[7] These numbers will remain important to watch as the effects of the Fed's aggressive counter-inflationary measures are seen more acutely in the data.

US vacancy rates had also been on a decline going into 2022, following the pandemic's highs, with office experiencing the least dramatic recovery of the sectors with respect to this metric. However, office, retail, and apartment vacancies in early 2022 experienced a small uptick.[8] Competition for employee talent has meant increased adoption of remote and hybrid work, causing companies to rethink what their optimal office space and usage should look like. It also has created a need to incentivize in-office time for the companies committed to a full return to pre-pandemic norms by offering new and better amenities.[9] For retail properties, it's a mixed bag, with the highest-quality assets doing well but those in less populous and desirable locations suffering. And for multifamily properties, there is a shortage of affordable housing as rental costs have scaled with inflation and reflect the seller's market. Industrial was left unscathed for the time being, supported by robust e-commerce activity and associated logistics property demand.

4: All Property CPPI weights: retail (20%), office (17.5%), apartment (15%), healthcare (15%), industrial (10%), lodging (7.5%), net lease (5%), self-storage (5%), manufactured home park (2.5%), and student housing (2.5%).
5: "Q2 2022 Private Markets Investment Briefs," Hamilton Lane, Q2 2022.
6: "Cap Rate Spread in Commercial Real Estate Explained," First National Realty Partners, August 16, 2021.
7: "Guide to Alternatives 2Q 2022," J.P. Morgan Asset Management, David Lebovitz, Meera Pandit and Nimish Vyas, May 31, 2022.
8: Ibid.
9: "2022 Midyear Commercial Real Estate Outlook," J.P. Morgan, Al Brooks, June 27, 2022.

A WORD FROM BAKER TILLY

Can real estate investors sustain growth in the current market and looking ahead?

What are your thoughts on the current real estate market, and where do you see things heading in 2022?

While the cost of capital is increasing, a large supply of capital is also chasing opportunities, looking for yield. Where this capital gets deployed depends on where interest rates go, whether we enter a recession, and, if so, whether it will be a V- or U-shaped recession. The outlook is different for every type of real estate.

The office market, for example, has not been resolved. People are largely working from home versus going back to an office.

Many investors are pursuing necessity-based retail opportunities, but if we fall into a recession, how will that impact an industry that depends on disposable income?

Clients investing in lodging are seeing some softening in the market but not a sharp downturn.

With industrial real estate, downside predictions include stagnating market rent growth or plateauing—or at least slowing—value growth.

Even though the immediate multifamily outlook is favorable, if there is a deep and drawn out recession, household formation will likely decrease as will the number of households. Historical trends say people will double up on housing or move back with their parents. Rising interest rates, however, may help multifamily because rising rates make home ownership prohibitive for many people, forcing them to rent instead of buy in the near term.

Another change related to multifamily is location. Pre-pandemic, the suburbs were not as desirable, except for those with easy access to downtown via mass transit. Now, things have shifted. The suburbs are in demand as people are hesitant to go downtown. In some cities, we will likely see the office space repositioned as residential units or other alternate uses as a result of companies not needing the same space they did three years ago.

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With more than 15 years of experience, Mike leads the firm's real estate practice. From real estate PE firms to REITs, Mike specializes in audit, financial reporting, real estate transactions and due diligence for various real estate professionals and asset classes.

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Brent provides valuation and transaction advisory services for real estate entities, property portfolios, and complex single-asset properties to investors, owners, and users. He has advised on numerous assignments of large portfolios for multi-national and global engagements across the world.

What questions or concerns are your clients raising at the moment? How are you advising them?

Deal flow is top of mind as well as opportunities to deploy committed capital. Many clients who were focused in a particular geography or property type are refocusing, for example, from urban office space to industrial or exploring new geographies. Everyone is trying to anticipate where the market and the economy are going.

Also, a lender's idea of value right now is far different from equity holders', so matching that up is tricky. When an equity investor is selling a piece of real estate, they have a buyer, but when the buyer goes for a loan, the pricing may not match because lenders don't always agree with the valuation. Deals will always get done, but it's getting harder because yields don't always match up.

Valuation is more important and challenging than ever with variables moving in different directions at different paces.

Do you believe inflation or looming interest rate increases are starting to show up in investment levels?

Simply put, if interest rates go up, pricing for real estate assets goes down. If pricing pulls back, the only way to make the math work is to increase the operating performance of a real estate asset and lower return expectations. Recently, we've seen deals fall apart or be delayed because the cost of debt increased to the point where it didn't meet return expectations or couldn't get through bank underwriting. This is especially true in the office sector, where underwriting is more speculative and not as transparent.

How high can rents go? How low can operating costs go? If debt costs 6%, but we're paying a 4% cap rate for a multifamily asset, the math doesn't work unless you can increase operating performance, or if cap rates compress, neither of which is the case. Conversely, some large private equity funds can hold real estate assets for the long term. There's a lot of money chasing US real estate, so some funds are willing to make those deals knowing they can hold property through a down cycle.

Also, because interest rates are high, we will likely see property owners get creative to improve performance and generate more income, such as adding experiential retail rather than just increasing rents.

Another challenge is the poor performance of equity markets, which has driven up bond yields, pushing investors toward safer investments, such as bonds. Because equities decreased, investors may find themselves over-allocated into real estate, potentially forcing them to divest real estate positions at prices lower than they would like to get their balance back in order.

How have project life cycles changed over the past few years?

Developers are still having issues with underwriting deals, as projects take longer to complete largely because of supply chain and labor challenges. So a project they thought would be done six months ago may be extended several months. With increasing interest rates and construction costs, a project that looked good on paper 12 months ago may not in today's environment.

Many investor decisions will be based on where they are in the debt life cycle. Someone looking to refinance tomorrow or in six months will experience much different pricing than they would have a year ago. Certain buyers with capital will have interesting opportunities because investors for whom refinance options are not attractive or obtainable will have to sell. If someone has long-term, fixed-rate debt maturing in 10 years, these uncertain times are just a small hiccup.

Have you seen increased focus on environmental, social, and governance (ESG) initiatives from your clients?

Yes. Our clients want to be good stewards of each of those initiatives. The environmental piece is most relevant to our business and ability to assist clients in achieving their goals. When it comes to target properties, clients are interested in equipment and whether they are adding solar or highly efficient HVAC units, lighting, windows, doors, etc. This doesn't necessarily affect the underwriting on every investment we're seeing, but more sophisticated investors are adding environmental concerns to their underwriting as a differentiator. If we do enter a recession, firms will look for efficiency advantages, and many of these environmental initiatives will help the bottom line after their initial capital cost.

That said, not only are real estate organizations incorporating ESG into their businesses, but investors are as well. So, an investor that incorporates ESG elements into their business will be attracted to a real estate owner or developer that does the same.

For commercial properties, has the recovery from peak pandemic vacancies progressed as expected?

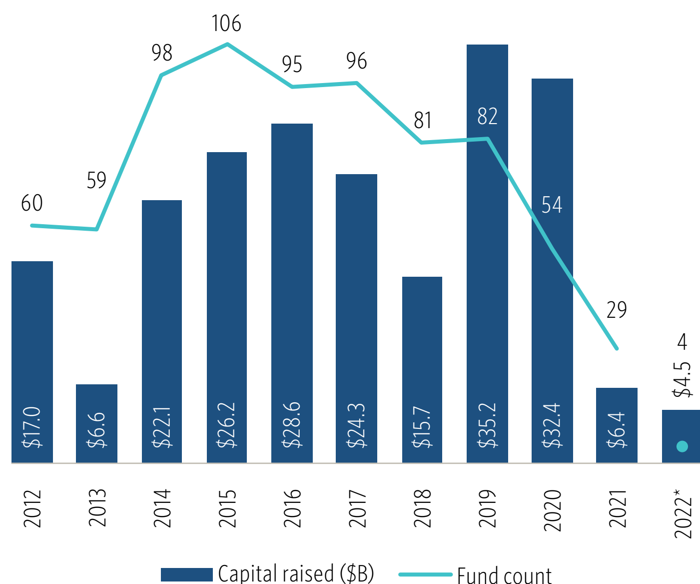
At the beginning of the pandemic, investors were trying to determine what was expected. The vacancy impact in the retail and industrial sectors was accelerated from a trend that started pre-pandemic, while the impact on office and lodging was unexpected at the very beginning of the pandemic. Lodging has experienced a recovery of sorts but has work to do. Investors are taking a hard look at lodging. Multifamily will continue to see vacancies that are below the historical average given the national housing shortage—unless we experience a deep recession. Office vacancies are difficult to assess given the work-from-home shift and employees' reluctance to return to the office. A recession could move the pendulum to employers, however, so we may see employees return to the office.

Which service areas are seeing the most traction recently? In which areas do you expect to see a rise in activity in the next few years?

Our valuation team has been busy assisting investors and owners with underwriting transactions and evaluating portfolio value for various reasons. Many situations are driven by tax changes circulating Congress; others are driven by the markets and difficulty in determining today's value.

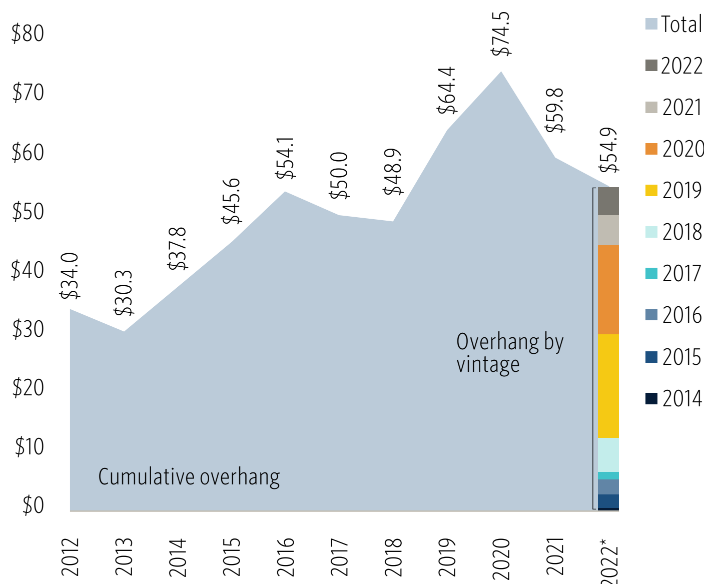
Core and core plus

Core and core plus fundraising activity



Source: PitchBook | **Geography:** Global
*As of June 30, 2022

Core and core plus dry powder ($B)



Source: PitchBook | **Geography:** Global
*As of June 30, 2022

Core and core plus funds raised $4.5 billion across just four vehicles in H1 2022. While the pace of fundraising by capital amount has picked up marginally compared to 2021's 12-year nadir of $6.4 billion and 29 funds, the number of funds raised is miniscule. It is likely that 2022 will be a below-average fundraising year for these strategies compared to historical numbers—from 2007 to 2021, core and core plus funds averaged $18.7 billion raised. While there are a few reasons why fundraising among these strategies is waning, one major factor influencing the data is the exclusion of evergreen funds from this reporting, which are used more frequently by core and core plus strategies. Especially as the economic cycle and the real estate market are less predictable, GPs may be leaning into the flexibility that evergreen fund structures provide. Given that, our data likely offers a significantly downsized representation of the overall core and core plus fund universe.

In terms of what is impacting fundraising itself, the economic landscape in H1 2022 and through the rest of the year has created opposing forces on the space. For one—as mentioned in our Private Markets Real Estate Fundamentals Report—rising interest rates make strategies with less leverage use more attractive, and core and core plus are on the lower end of the spectrum for real estate, with core typically ranging from 40% to 45% and core plus from 45% to 60%. Assets are often financed using long-term fixed rate loans, which is beneficial when interest rates are rising and expected to continue to do so. Plus, with minimal capital improvements, if any, involved in these strategies, they are impacted less by profit margin narrowing from inflation-related cost increases. While those forces make core and core plus strategies more attractive in the current environment, the funds implementing them do tend to provide lower returns overall alongside their

Top core and core plus funds to close in 2022*

Fund name	Investor name	Fund size ($M)	Close date (2022)	Fund type	Fund location
West Street Real Estate Investment Partners	Goldman Sachs Asset Management	$3,500.0	April 27	Core plus	New York, US
Bell Core Fund I	Bell Partners	$930.0	February 15	Core	Greensboro, US
CapitaLand Innovation Fund	CapitaLand	$36.7	January 6	Core	Singapore, Singapore
Morrocroft Neighborhood Fund III	Gorelick Brothers Capital	$34.4	January 26	Core plus	Charlotte, US

Source: PitchBook | **Geography:** Global
*As of June 30, 2022

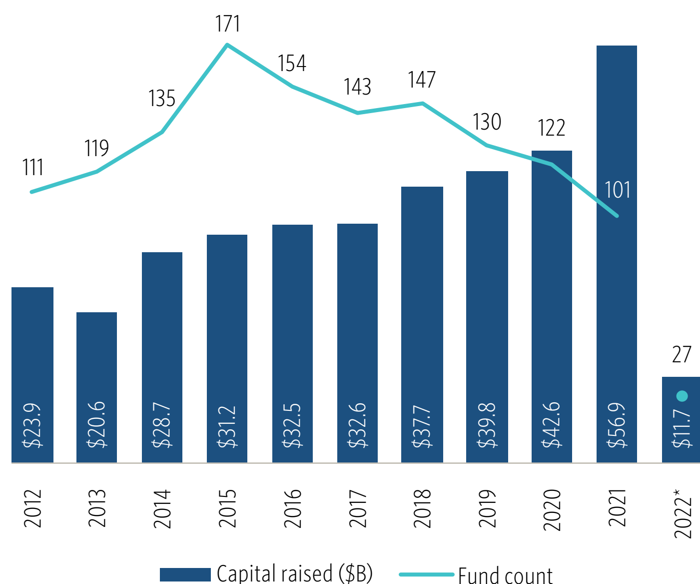
lower risk profile. Of note, the two-month recession in 2020 does not appear to have resulted in a full economic reset. As such, property prices have not become sufficiently depressed to offer a significant capital appreciation component to core and core plus' income-based returns, potentially making them less appealing to LPs that need to hit return targets.

Of the four funds to close in the first half of 2022, West Street Real Estate Investment Partners from Goldman Sachs Asset Management (NYSE: GS) was by far the largest at $3.5 billion. It is a US-based core plus fund investing globally, with investments in residential, logistics, and office properties thus far.[10] The next largest was Bell Partners' Bell Core Fund I at $930.0 million. It focuses specifically on multifamily properties, having already invested in several on the West Coast and a few in the South and on the East Coast of the US.[11] The third largest was CapitaLand Innovation Fund at $36.7 million, a core fund based in Singapore. This fund is unusual in that it focuses on offering a real estate platform for testing sustainability-related innovations in the built environment.[12] Lastly, Morrocroft Neighborhood Fund III from Gorelick Brothers Capital in the US closed at $34.4 million using a core plus strategy.

10: "Goldman Sachs Raises $3.5 Billion for Global Real Estate Bets," *Bloomberg*, Gillian Tan, April 21, 2022.
11: "Bell Partners Closes $930 Million Core Venture," Bell Partners, February 16, 2022.
12: "Capitaland Unveils S$50 Million Innovation Fund and Crowns Winners of First Capitaland Sustainability X Challenge," CapitaLand, June 11, 2021.

Value-add

Value-add fundraising activity



Source: PitchBook | **Geography:** Global
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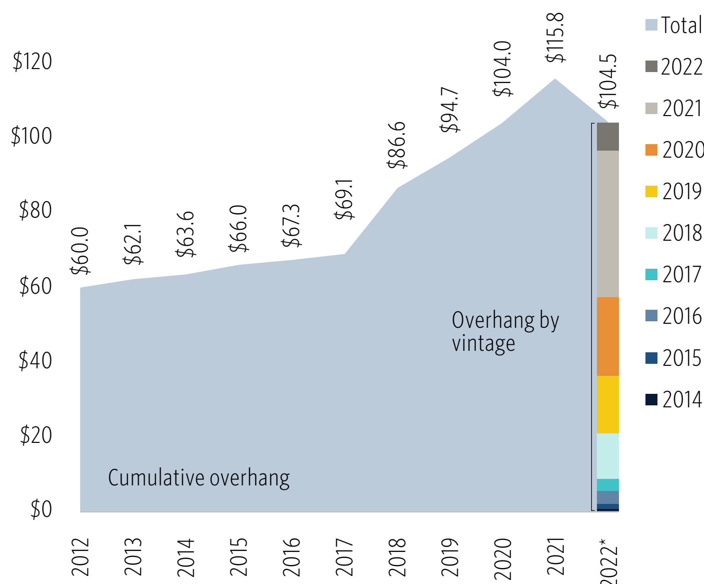
Value-add dry powder ($B)



Source: PitchBook | **Geography:** Global
*As of June 30, 2022

Fundraising for vehicles using a value-add strategy fell off in H1 2022 after an uncharacteristically active 2021. Compared to the $56.9 billion and 101 funds raised last year, this year is tracking to meet under half of the previous year's amount with $11.7 billion raised across 27 funds in H1. At its current rate, value-add will hit just above two thirds of the annual average going back to 2007. This is especially surprising given the context of eight years of consecutive increases in raised capital for this strategy, going back to 2013. One reason we might be seeing hesitation in committing to value-add funds this year is leverage usage. Value-add funds typically use 60% to 75% leverage through short-term floating rate loans, which work out in favor of the lender when interest rates increase. In contrast, opportunistic funds use variable levels of leverage, often depending on access, but range from 50% to 70%-plus. This variability could be what is drawing investors away from value-add strategies and toward opportunistic.

Leverage may not be the only way that value-add strategies are the less happy medium between two extremes. While core and core plus funds do not implement any substantial capital improvements and as such are largely untouched by increased costs during inflation, value-add funds do. This strategy frequently involves major renovation, repositioning, or reduction of vacancy rates, though not to the same degree as opportunistic funds. With less implementation risk, returns are generally anticipated to be lower in value-add. In the current macro environment, it is possible investors are implementing a barbell approach, making big opportunistic bets and/or playing it safe with evergreen core and core plus or debt funds.

Top value-add funds to close in 2022*

Fund name	Investor name	Fund size ($M)	Close date (2022)	Fund step-up	Fund location
Asana Partners Fund III	Asana Partners	$1,500.0	March 16	1.9x	Charlotte, US
FPA Apartment Opportunity Fund VIII	FPA Multifamily	$1,450.0	March 14	1.5x	San Francisco, US
BC Partners European Real Estate I	BC Partners	$1,316.2	June 7	N/A	London, UK
Real Estate Partners 4	Lendlease	$1,078.7	January 9	1.5x	Barangaroo, Australia
H.I.G. Realty Partners IV	H.I.G. Capital	$838.0	March 1	1.4x	Los Angeles, US
Hammes Partners IV	Hammes Partners	$739.0	March 31	1.1x	Milwaukee, US
Realterm Logistics Fund IV	Realterm Global	$610.0	May 17	1.6x	Annapolis, US
Alterra IOS Venture II	Alterra Property Group	$524.0	March 18	1.7x	Philadelphia, US
Peakside Real Estate Fund IV	Peakside Capital	$470.8	January 18	2.1x	Frankfurt, Germany
IEC Institutional Fund V	Interstate Equities	$445.0	March 18	1.5x	Los Altos, US

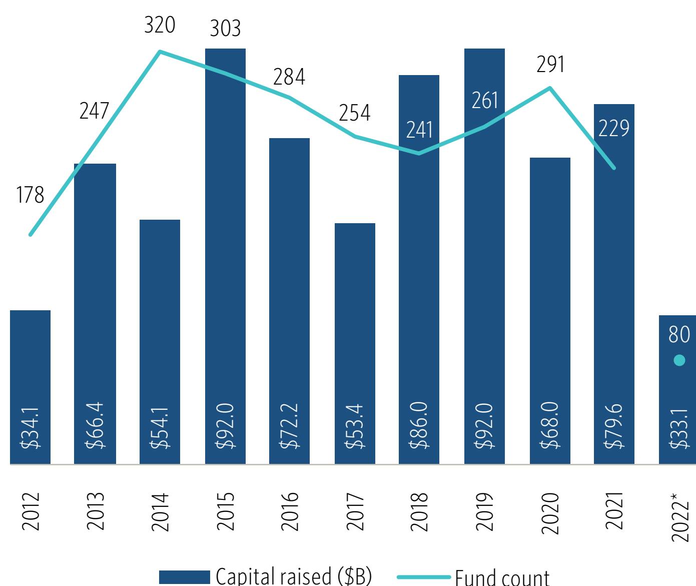
Source: PitchBook | **Geography:** Global
*As of June 30, 2022

Among the top value-add funds to close in the first half, sector focuses and strategies were varied, but residential and logistics themes were particularly prevalent. The largest fund to close was US-based Asana Partners Fund III at $1.5 billion. In line with the fund manager's area of expertise, it will target mixed-use properties in urban and near-urban areas of the US and reposition them.[13] Recent funds investing in the residential space include FPA Apartment Opportunity Fund VIII at $1.5 billion,[14] IEC Institutional Fund V at $445.0 million,[15] and Drake Real Estate Partners IV at $410.0 million.[16] Those with logistics-inclusive strategies include Realterm Logistics Fund IV at $610.0 million,[17] Alterra IOS Venture II at $524.0 million,[18] and Peakside Real Estate Fund IV at $470.8 million, which also invests in residential.[19]

13: "Asana Partners Closes Third Value-Add Fund at $1.5 Billion," Asana Partners, March 16, 2022.
14: "Strategies," FPA Multifamily, n.d., accessed August 18, 2022.
15: "IEC Closes 5th Institutional Fund at $445M," *Multi-Housing News*, Olivia Bunescu, March 18, 2022.
16: "Drake Real Estate Partners Announces Final Close of DREP Fund IV Exceeding Target at $410+ Million," *Cision PR Newswire*, January 4, 2022.
17: "Realterm Raises $630 Million in LP Commitments for Realterm Logistics Fund IV," Realterm, August 9, 2022.
18: "Alterra IOS Venture II, LP Reaches $500 Million Hard Cap," *Globe Newswire*, March 18, 2022.
19: "Peakside Raises €415M for Value-Add German Real Estate Fund," *IPE Real Assets*, IPE Staff, January 19, 2022.

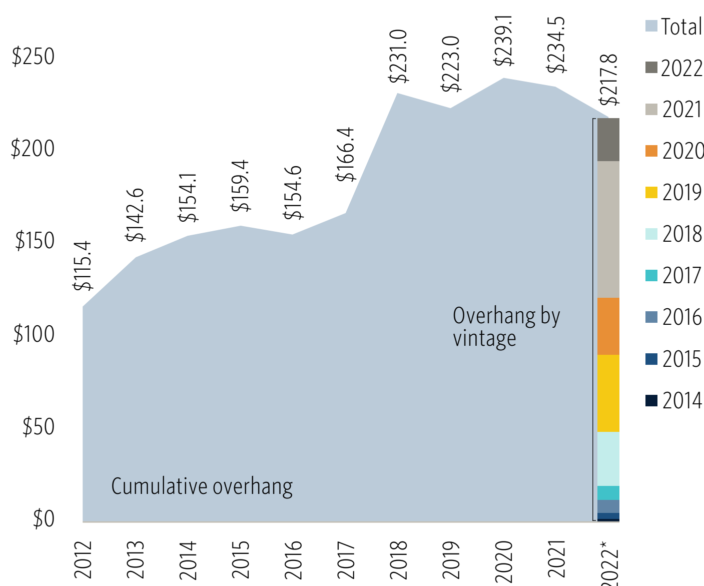
Distressed and opportunistic

Distressed and opportunistic fundraising activity



Source: PitchBook | Geography: Global
*As of June 30, 2022

Distressed and opportunistic dry powder ($B)



Source: PitchBook | Geography: Global
*As of June 30, 2022

Distressed and opportunistic fundraising slowed in H1 2022 but is still on track to keep up with historical averages from 2007 onward. The strategies raised $33.1 billion across 80 funds compared to the full-year mean of $63.5 billion and 229 funds. Beneath the H1 2022 fundraising numbers for this 'bucket,' 98.2% of dollars and 97.5% of funds belonged to opportunistic strategies. While the higher cost of capital from rising interest rates may erode profit margins when leverage is used, LPs may find it worth the risk to allocate to opportunistic funds in order to meet return targets. This is especially relevant when asset prices have been bid up in real estate. Although opportunistic strategies have always been one of the major real estate strategies, this year shows a more exaggerated split than we have seen previously, in part due to distressed strategies raising a minute amount of capital. At just $0.6 billion across two funds, the strategy gathered its smallest proportion of commitments on record.

Economists and market participants have been fervently debating whether there is a recession ahead, so the near-lack of distressed fundraising may raise some eyebrows. However, strong fundraising years for distressed strategies don't always correspond with recessions. Yes, the strategy raised its second-largest proportion of capital in 2009 at 13.9%, and its third-largest in 2011 at 11.6%, but its largest year was 2013 at 17.3%. That year also saw the greatest amount of capital raised by the strategy at $18.1 billion, followed by 2015 at $11.3 billion, and 2019 at $9.2 billion. Distressed funds may have a broader range of potential investable opportunities available to them during national or global economic contractions, yet the age-old real estate axiom also holds true: When it comes to distressed investments, opportunity may be dependent on location, location, location—or, in other words, some geographies may be more distressed than others.

Top distressed and opportunistic funds to close in 2022*

Fund name	Investor name	Fund size ($M)	Close date (2022)	Fund type	Fund step-up	Fund location
Blackstone Real Estate Partners Asia III	Blackstone	$7,502.3	January 1	Opportunistic	1.0x	New York, US
GLP Japan Development Partners IV	GLP	$3,700.0	January 19	Opportunistic	1.6x	Singapore, Singapore
Breakthrough Life Science Property Fund	Breakthrough Properties	$3,000.0	April 29	Opportunistic	N/A	Los Angeles, US
Rockpoint-ADIA Investment Vehicle	Rockpoint Group	$2,000.0	January 1	Opportunistic	N/A	Boston, US
Bridge Opportunity Zone Fund IV	Bridge Investment Group	$1,505.2	March 3	Opportunistic	1.5x	Salt Lake City, US
GLP Vietnam Development Partners I	GLP	$1,100.0	January 24	Opportunistic	N/A	Shanghai, China
Harrison Street European Property Partners III	Harrison Street Real Estate Capital	$907.2	February 10	Opportunistic	1.6x	Chicago, US
Crow Holdings Development Opportunities Fund I	Crow Holdings Capital - Real Estate	$750.0	March 28	Opportunistic	N/A	Dallas, US
Phoenix Real Estate Fund X	Phoenix Capital Partners	$715.0	May 26	Opportunistic	2.5x	Dallas, US
Actis Asia Real Estate 2	Actis	$700.0	April 6	Opportunistic	1.2x	Singapore, Singapore

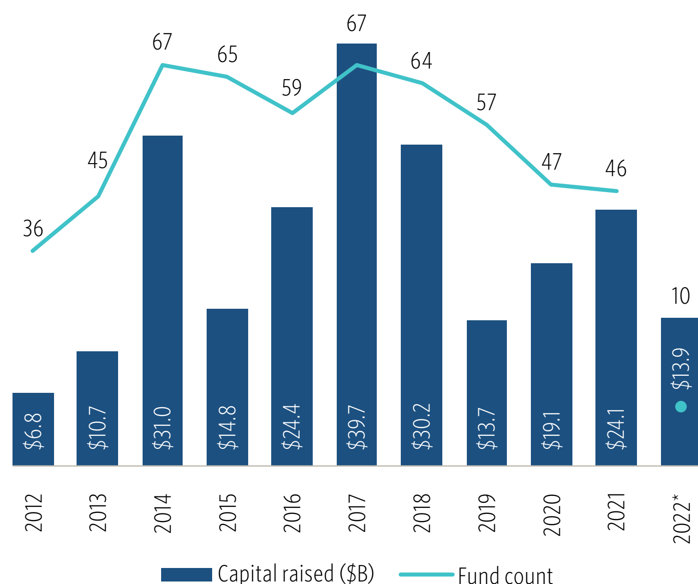
Source: PitchBook | **Geography:** Global
*As of June 30, 2022

As one might expect, opportunistic funds filled the top ten list of vehicles in this 'bucket' closed in H1 2022. Similarly unsurprising was the fact that the predominant geographical focus was the US. However, there was also very strong representation of funds domiciled or investing in Asia. The top fund, Blackstone Real Estate Partners Asia III, is one of these, and also exemplifies a common sector-related trend among the funds. Coming in at $7.5 billion, the pan-Asia fund invests across logistics and life sciences, among other sectors.[20] Several other vehicles in the top 10 invest in the logistics and life sciences sectors, including GLP Japan Development Partners IV at $3.7 billion,[21] Breakthrough Life Science Property Fund at $3.0 billion, GLP Vietnam Development Partners I at $1.1 billion, and more.[22]

20: "Blackstone Raised $1.1B for Third Asia Real Estate Fund Amid 'Challenging' First Quarter," *Mingtiandi*, Christopher Caillavet, April 23, 2022.
21: "GLP Reaches Final Close for Japan Logistics Development Fund, Targeting $9 Billion in AUM," GLP, January 19, 2022.
22: "GLP Launches $1.1 Billion Maiden Vietnam Logistics Development Fund," GLP, January 21, 2022.

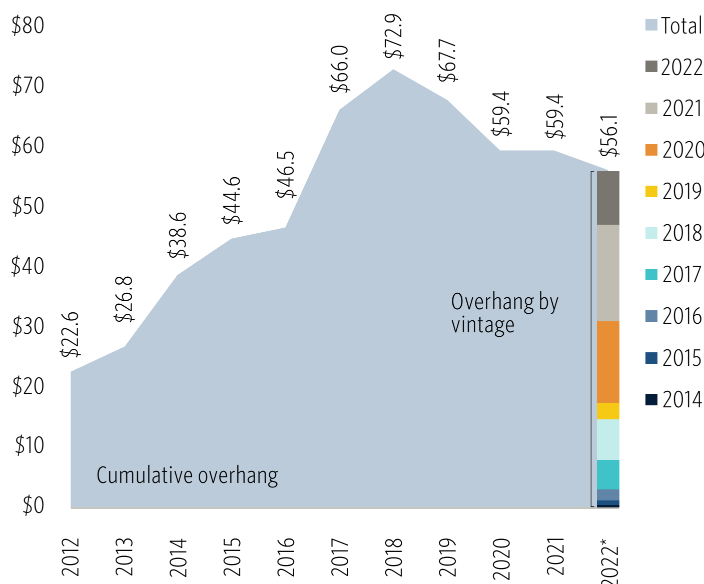
Debt

Real estate debt fundraising activity



Source: PitchBook | **Geography:** Global
*As of June 30, 2022

Real estate debt dry powder ($B)



Source: PitchBook | **Geography:** Global
*As of June 30, 2022

Fundraising for real estate debt vehicles was off to a solid start in H1 2022. With 10 funds garnering $13.9 billion, the strategy looks like it may exceed both 2021's numbers and historical averages by the end of the year. As debt issuers gain a clearer view of the macroeconomic landscape, they can use that perspective to better inform whether they make bets on floating or fixed rate loans. Still, with real estate fundraising as a whole slowing, lenders in this space may need to offer more competitive rates in the future, especially as private real estate has traditionally been less reliant on funds for their debt financing compared to other asset classes. The impact of this will likely not be felt in 2022 though, as there is still plenty of older dry powder that GPs must put to work.

Outside the private market funds universe, the net percentage of US banks tightening standards for commercial real estate loans with construction and land development purposes has been positive and increasing since Q2 2022.[23] As of Q3 2022, that metric reached 48.4%. This indicates some reticence around the future performance of new developments, which in the private markets would translate to concern around lending to opportunistic and some value-add funds. To slice it another way, the net percentage of domestic banks tightening standards for commercial real estate loans secured by nonfarm nonresidential structures in Q3 2022 was 41.5%,[24] and the same metric for loans secured by multifamily residential structures was 30.3%.[25] These numbers speak

23: "Net Percentage of Domestic Banks Tightening Standards for Commercial Real Estate Loans with Construction and Land Development Purposes," FRED, n.d., accessed August 18, 2022.
24: "Net Percentage of Domestic Banks Tightening Standards for Commercial Real Estate Loans Secured by Nonfarm Nonresidential Structures," FRED, n.d., accessed August 18, 2022.
25: "Net Percentage of Domestic Banks Tightening Standards for Commercial Real Estate Loans Secured by Multifamily Residential Structures," FRED, n.d., accessed August 18, 2022.

Top real estate debt funds to close in 2022*

Fund name	Investor name	Fund size ($M)	Close date (2022)	Fund step-up	Fund location
Oaktree Real Estate Debt Fund III	Oaktree Capital Management	$3,000.0	February 6	1.4x	Los Angeles, US
Bridge Debt Strategies Fund IV	Bridge Investment Group	$2,900.0	June 23	1.8x	Salt Lake City, US
Madison Realty Capital Debt Fund V	Madison Realty Capital	$2,080.5	January 10	1.8x	New York, US
Kayne Anderson Real Estate Debt IV	Kayne Anderson Capital Advisors	$1,875.0	May 11	1.4x	Los Angeles, US
Pretium Residential Credit Fund II	Pretium (Asset Management)	$1,700.0	April 6	N/A	New York, US
Related Real Estate Debt Fund	The Related Companies	$792.0	January 4	N/A	New York, US
European Real Estate Debt Fund IV	DRC Capital	$676.5	February 15	0.8x	London, UK
H/2 Special Opportunities V	H/2 Capital Partners	$661.5	April 21	0.4x	Stamford, US
Atalaya Commercial Real Estate Fund I	Atalaya Capital Management	$120.0	January 10	N/A	New York, US
Fairview Investment Fund V	Fairview Partners	$82.0	February 17	14.2x	Seattle, US

Source: PitchBook | **Geography:** Global
*As of June 30, 2022

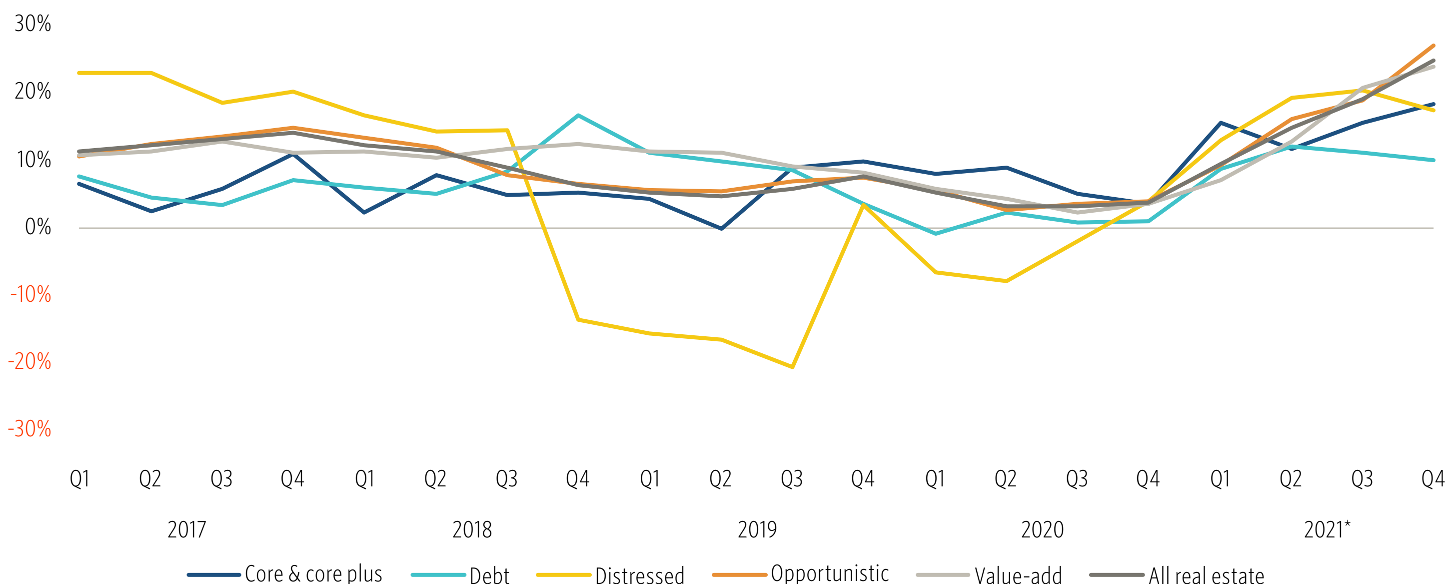
more to the potential implications of lending to core, core plus, and some value-add and distressed funds in the private markets. Tightening standards from banks mean opportunity for private debt funds. Those willing to take on more risk by lending where banks will not can charge higher rates because they have less competition.

All but one of the top debt funds to close in H1 2022 were US-based, with the exception being European Real Estate Debt Fund IV from DRC Capital at $676.5 million. The strategies cited by many vehicles seemed fairly sector-agnostic, lending across areas like retail, office, industrial, and hospitality, with most having a primary or secondary focus on residential. This is interesting considering the percentage of domestic banks tightening standards for multifamily residential structures was the lowest of the three discussed but is not a significant departure from what would be expected of these funds. Beyond the residential basics, lending for student and senior housing was mentioned by a few funds, including Bridge Debt Strategies Fund IV at $2.9 billion,[26] Kayne Anderson Real Estate Debt IV at $1.9 billion,[27] and European Real Estate Debt IV.

26: "Bridge Investment Group Raises $2.9 Billion for Bridge Debt Strategies Fund IV," Bridge Investment Group, June 22, 2022.
27: "Kayne Anderson Real Estate Closes Latest Debt Fund Above Target at $1.875 Billion," *Cision PR Newswire*, May 11, 2022.

Public and private performance

Real estate rolling one-year horizon IRRs by strategy*



Source: PitchBook | **Geography:** Global
*As of December 31, 2021

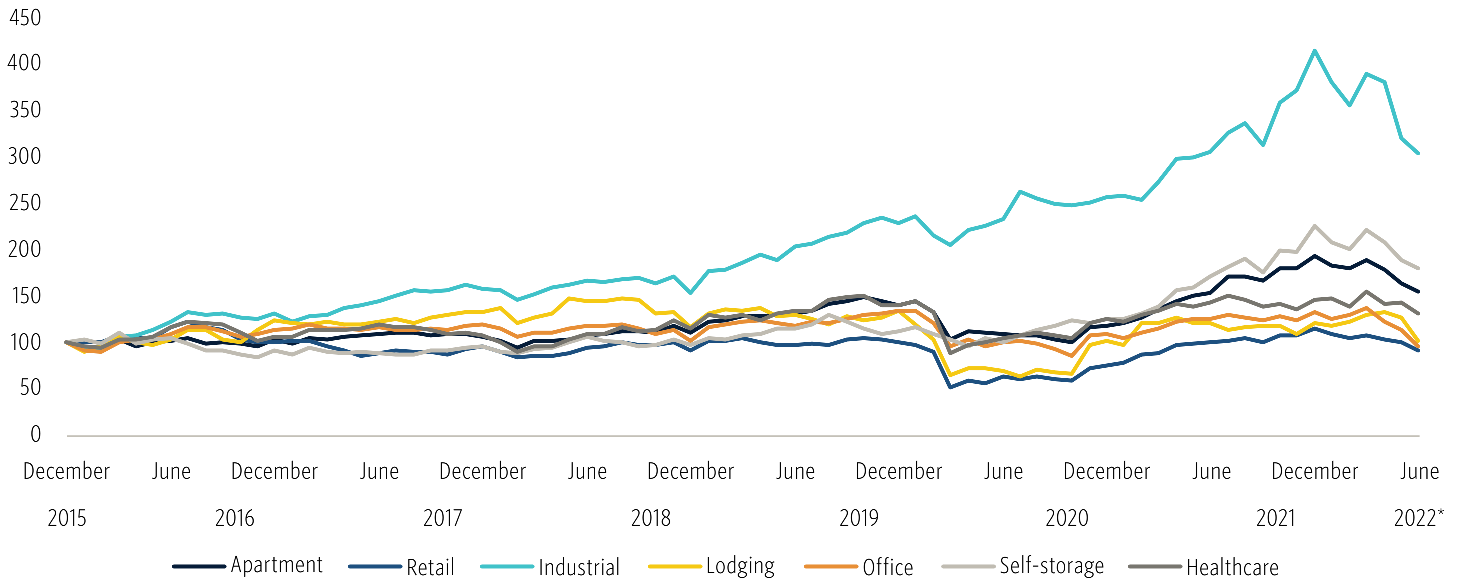
Private real estate fund performance through the end of 2021 was very robust. Across the asset class as a whole, the rolling one-year horizon IRR hit 24.8%, its best performance in a decade and a hair away from its all-time high of 25.4% from Q1 2011. All of the strategies except distressed and debt had IRRs that were near-term or long-term highs. Core and core plus funds posted an 18.4% return, their highest since Q2 2016. Opportunistic fund returns hit 27.0%, their best since Q2 2011. And value-added funds registered a 23.8% return, the highest we have on record for that strategy. Even distressed posted a 17.4% return, while debt marked a 10.0% return, the lowest of any strategy. Yet, this run of good fortune may not last. According to our 2022 Global Fund Performance Report, the preliminary Q1 2022 quarterly IRR for real estate looks like it will end 2021's streak of continuously climbing IRRs, although it is far from a bad result at 7.6% compared to 8.3%.

More tempered expectations around returns going forward are supported by public market performance. For REITs, Q1 2022 marked the beginning of a sustained decline across sectors, with industrial and self-storage hit the hardest as they had the furthest to fall. In addition, Green Street's Commercial Property Return Index, indexed to 100 in 2007, shows a notable drop from its highest point of 330.6 at the end of April 2022 to 311.8 at the end of June.[28] The plunge is comparable in magnitude to that which occurred in 2020 associated with the pandemic. While REIT indexes tend to move with stocks rather than real estate in the short-term, the private markets typically are not fully insulated against the broad market forces that impact publicly traded instruments. As such, we can expect that private real estate funds will face similar inflation- and interest-rate-related headwinds to their public counterparts, even if quarterly returns are not impacted to the same magnitude.

As referenced in our Analyst Note: Private Markets Real Estate Fundamentals, harm linked to inflation is typically associated with two factors in real estate investments: capital improvements and operating costs. Capital improvements are physical changes made to a property to increase its value, including renovations, repositioning, and greenfield development. As previously mentioned, value-add and opportunistic strategies use these most

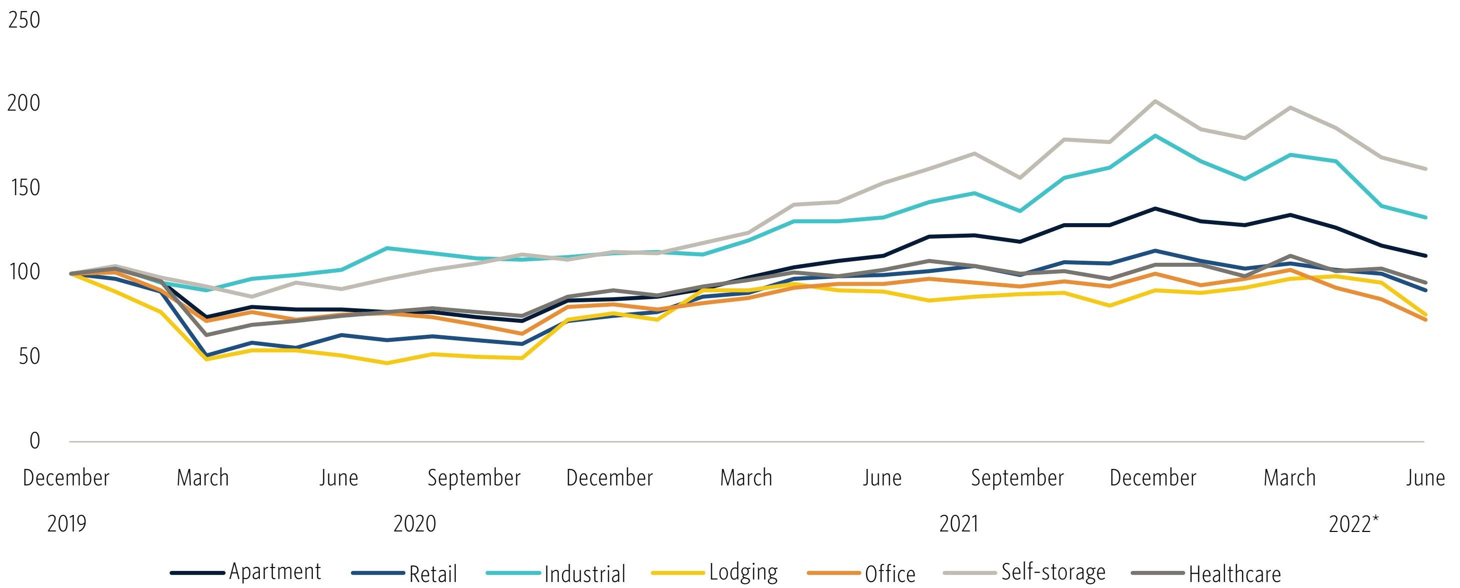
28: All Property CPPI weights: retail (20%), office (17.5%), apartment (15%), healthcare (15%), industrial (10%), lodging (7.5%), net lease (5%), self-storage (5%), manufactured home park (2.5%), and student housing (2.5%).

Six-and-a-half year total return for select REIT indexes by sector



Source: Nareit | **Geography:** US
*As of June 30, 2022

Two-and-a-half year total return for select REIT indexes by sector



Source: Nareit | **Geography:** US
*As of June 30, 2022

frequently compared to other strategies. When inflation is high, investors are paying more for the labor and materials associated with these improvements, narrowing profit margins and lowering performance expectations. In terms of operating costs, strategies like core and core plus that involve long holding periods while the property is operational—and rely more on income rather than appreciation for returns—may be more sensitive to inflation due to associated operating cost increases. However, value-add, opportunistic, and distressed strategies may be impacted as well. It is worth noting that the magnitude of harm due to inflationary impact on operating costs is considerably less than that tied to capital improvements.

Inflation sensitivity through operating costs will also vary depending on the sector, with some—including multifamily, residential, or hospitality & recreation—much more exposed than others, such as self-storage. The variability comes mostly from the operational intensity of the property. The more property management and administration, marketing and advertising, maintenance and repairs, and utilities the property owner is responsible for, the more impactful it will be to returns when those costs increase with inflation. This is certainly not the only factor at play though, as is visible in the comparable downward movement of self-storage and apartment REITS in the first half of 2022. It should additionally be acknowledged that while inflation provides headwinds to real estate, it also delivers tailwinds, offering some insulation from its negative effects. Property managers can often raise rents during inflationary times, passing along heightened costs to tenants. This is part of the reason that real estate is widely considered an inflation hedge, although not all real estate assets will provide a full or even partial hedge.

With respect to interest rates, the explanation for how real estate returns could be dampened is more intuitive. The strategies that require more leverage to execute, like value-add and opportunistic, will experience the most detriment due to higher cost of capital when rates rise. Those that utilize less leverage, like core and core plus, will be less effected. However, there is a more complex calculus to how GPs weigh the risks and rewards associated with each strategy and its necessary or optimal amount of leverage, as employing leverage and the strategies that use more of it can result in much higher returns. In debt, portfolios with more floating-rate loans will have an advantage, while those with more fixed-rate loans will suffer. Private debt funds also have the option to take on more risk so that they can potentially achieve better returns when banks tighten their standards.

So, what are some of the other current factors that will contribute to performance going forward? With respect to public health, a resumption of normalcy began for many in the West after multiple COVID-19 vaccine doses, with a return to offices, holiday travel, and metropolitan living in late 2021 and early 2022. This supported the apartment, lodging, and office sectors. Despite cases spiking as a result of this and new virus variants, much of the world seemed to decide it was done with the pandemic, so attempts to return to life as it once was continued into 2022.[29] Personal consumption expenditures per capita in the US continued to climb in the back half of 2021 and front half of 2022, fueling the industrial sector as it tried to keep up with the demand for goods.[30] The re-shoring or consolidation of portions of supply chains because of 2021's disruptions, demand for logistics properties due to strong e-commerce activity, and resuscitation of in-person retail are also impacting the attractiveness of real estate.

29: "United States: Coronavirus Pandemic Country Profile," Our World in Data, Hannah Ritchie, et al., n.d., accessed August 18, 2022.
30: "Personal Consumption Expenditures per Capita," FRED, n.d., accessed August 18, 2022.

Additional research

Private markets

Q1 2022 Global Real Assets Report

Download the report here

2022 PitchBook Benchmarks as of Q4 2021 with preliminary Q1 2022 data

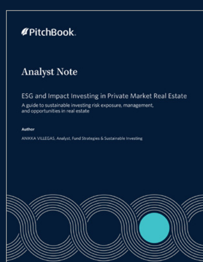
Download the report here

Q2 2022 Global Private Markets Fundraising Report

Download the report here

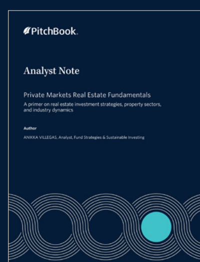
Global Fund Performance Report as of Q4 2021 with preliminary Q1 2022 data

Download the report here



Analyst Note: ESG and Impact Investing in Private Market Real Estate

Download the report here



Analyst Note: Private Markets Real Estate Fundamentals

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