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SPRING 2017
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# PErspective in REAL ESTATE

A FEATURE EXAMINING THE ROLE OF PRIVATE EQUITY IN THE REAL ESTATE SECTOR.

## REITs, Private Equity Look Beyond Core Properties in 2017

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Private equity (PE) fund managers are growing bullish on the real estate industry. PE funds have already raised a combined $237 billion globally to invest in commercial real estate in 2017, outpacing the 2016 total of $202 billion, according to Preqin. With the Federal Reserve expected to introduce at least three interest rate increases in the year ahead, returns on real estate investments may decline. Investors face steeper competition for office, hotel and multi-family properties, and the dip in returns could lead many fund managers to embrace alternative real estate assets. REITs and private equity real estate funds are already sharpening their focus on non-traditional real estate assets.

Single-family rentals (SFR) is one niche area that has already shown hints of growth in 2017. In a deal that created the largest SFR REIT to date, private equity giant Blackstone raised $1.54 billion in a January IPO of its SFR portfolio, Invitation Homes. As of mid-February, the shares were trading at $20.88. PE and REIT interest in SFR took off during the housing crisis, with both investment vehicles buying up distressed homes. According to Hoya Capital Real Estate, the SFR sector performed well in 2016, with a 26 percent rate of return. Now that the housing market has stabilized, more fund managers are looking to exit and the momentum is likely to continue, perhaps with activity from strategic buyers picking up.

Another attractive investment option is data warehouses. The explosion of wireless connectivity, cloud computing and data has led to more demand for storage space. An IDC study found the total amount of stored data is doubling approximately every two years. Data warehouses or data centers are one way investors can capitalize on the network of facilities sustaining the growth of the Internet of Things. This year, data center acquisitions amounted to $1.7 billion, and investment activity is forecast to ramp up in 2017. Data Center REIT Equinix's $3.6 billion deal to acquire Verizon's data center businesses, which include 24 facilities, is expected to close in mid-2017.

Although PE interest in real estate is expected to increase, the bulk of investments this year will likely stem from the larger players. Carlyle Group is in the early stage of raising $5 billion for its eighth real estate fund. Consistent with the sector-wide trend, Carlyle Group plans to focus on niche property types with this fund—specifically, senior housing investments and rental properties.

### FUTURE PERSPECTIVES:
### WHAT'S NEXT FOR REAL ESTATE INVESTORS?

In response to President Donald Trump's pledge to invest heavily in nationwide infrastructure initiatives, PE and REITs are unsurprisingly bullish on infrastructure. In the president's first week in office alone, his administration announced infrastructure projects totaling more than $137.5 billion.

As PE and sovereign wealth funds explore adding infrastructure assets to their portfolio, we may see them leverage public-private partnerships (P3s). Through P3s, private sector companies partner with government agencies to finance and implement some or all aspects of public projects, including infrastructure, such as transportation and municipal buildings. Already in 2017, the Los Angeles County Metrorail is reportedly considering leveraging P3s to fast-track a transportation initiative.

Fiscal stimulus, such as investment in infrastructure, is likely to drive economic growth and reflect positively upon real estate fundamentals. While the full extent of the new administration's infrastructure priorities has yet to take shape, the real estate industry is keeping a close eye on opportunities as they evolve.

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In addition to increased investment in niche properties, private equity has also moved into the debt financing space. Private equity firms and other non-bank lenders are increasingly raising debt funds, providing loans as an alternative to or in conjunction with traditional banks for construction projects and property renovations. Investing in real estate debt could become a more prevalent strategy for PE firms as interest rates rise.

While PE consistently attracts interest from institutional investors, pension and endowment fund managers have historically had some concerns with REITs' volatility and ties to the stock market. But as real estate investing becomes more common, some institutional investors have started to take a closer look at REITs. South Carolina Retirement System Investment Commission, for example, made its first investment in REITs in 2016 by allocating about $728 million. As the types of investors funneling capital into PE and REITs converge, REIT fund managers would be wise to watch how PE interest develops in the sector and how it could spur more competition for assets.

This article has been adapted from a piece appearing in *Commercial Property Executive.* Access the article here.

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