Park Madison Perspectives

Outlook 2021

PARKMADISONPARTNERS

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About Park Madison Partners

Park Madison Partners is a boutique New York-based capital markets and advisory firm for global real estate alternative investments. Since its formation in 2006, Park Madison has participated in the placement of over $17 billion in private equity capital for a wide range of real estate vehicles and strategies.

Park Madison Partners was founded to offer clients capital raising and strategic consulting services with a high degree of customization, integrity and accountability. Our team comprises professionals with backgrounds across the buy-side and sell-side, and we leverage this experience to provide a thoughtful approach to global real estate capital markets. Our unique expertise allows us to offer a variety of highly customized capital solutions to real estate managers, including commingled funds, separate accounts, programmatic joint ventures, and recapitalizations.


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> "It used to be said that war was the locomotive of history, with its power to accelerate change. The coronavirus crisis has that same power."
>
> **– Caroline Lucas, British politician**

The scale and shock of the COVID-19 pandemic has naturally drawn comparisons to other cataclysmic, history-shaping events: 9/11, the Global Financial Crisis, and even World War II. Perhaps the most common parallel between these events and COVID-19 is their ability to split history into pre- and post- eras. But while COVID-19 will certainly have a lasting impact on the global economy and real estate markets, we would avoid the temptation to expect major paradigm shifts as a result of the pandemic. As the scornful military proverb goes, "Armies are always preparing to fight yesterday's war."

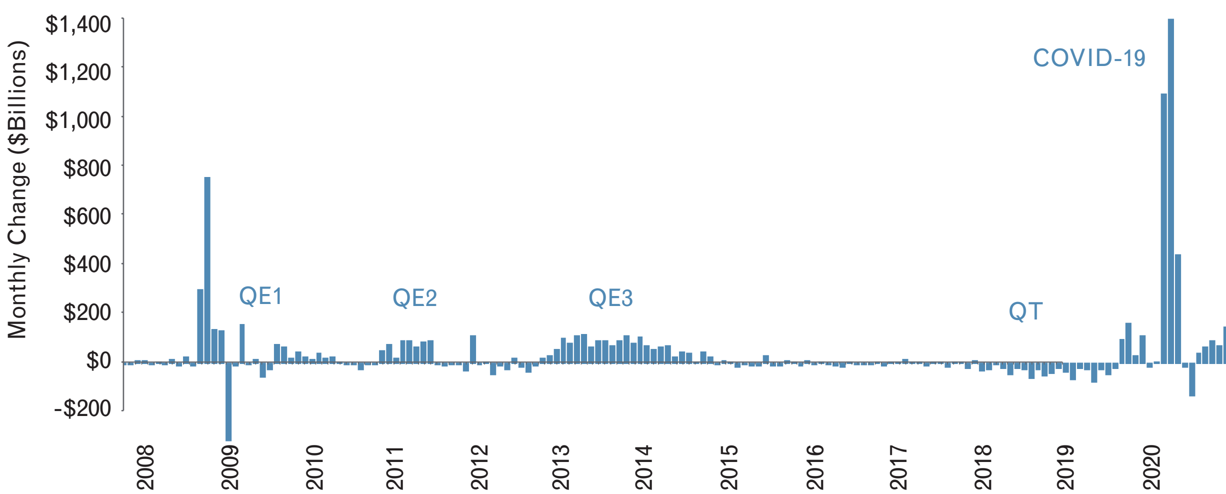
Indeed, the most disruptive forces facing the global economy were already in play before COVID-19: shifting geopolitics, urbanization, accelerating technological advances, aging populations, increasing global connectivity, and climate change. The pandemic may have temporarily slowed some of these trends while accelerating others. But they all remain in place, and we believe each of these factors alone will have more long-term impact on real estate markets over the next decade than COVID-19. So with that context, here are our top 10 predictions for 2021:

1 The U.S. economy will continue its V-shaped recovery, driven by fiscal stimulus and easy monetary policy

The COVID-19 recession is unlike any prior downturn any of us have ever lived through, both in terms of its sharpness and its severity. By all accounts it was the fastest economic contraction on record, wiping out virtually all jobs gained in the 10 years following the Global Financial Crisis ("GFC") and causing U.S. GDP to fall at a dizzying 31.4 percent annual rate in Q2 2020.

But the speed and scope of the public policy response to this downturn has also been exceptional. Fiscal stimulus has totaled nearly $3 trillion or 14 percent of GDP, more than double the fiscal firepower used to combat the GFC. The Federal Reserve also eclipsed all prior episodes of quantitative easing, slashing interest rates to zero and purchasing over $3 trillion of securities between March and June. Indeed, the combination of debt-fueled stimulus (including direct payments to households) and aggressive debt monetization is basically the textbook definition of Milton Friedman's "helicopter money."[1] As stimulus continues and the pandemic subsides, we expect the U.S. economy's "V-shaped" recovery to gather steam in 2021, at least on a macro level.

Quantitative Firehose
Monthly Change in Federal Reserve Balance Sheet, 2008-Present

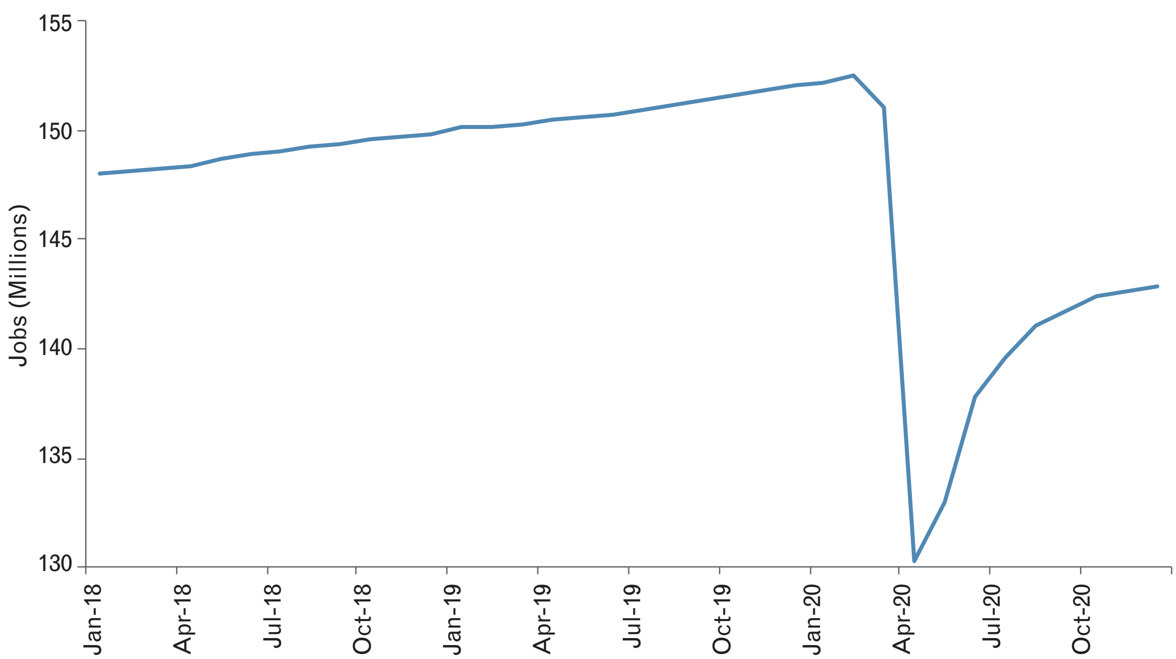


Source: Federal Reserve Economic Data

1 "Helicopter money" is a term first coined by Milton Friedman in 1969 to describe the effects of monetary expansion, using the analogy of dropping money from a helicopter to the general public. Economists later revived the term to refer to unconventional monetary policies such as quantitative easing, including Ben Bernanke who famously earned the nickname "Helicopter Ben" due to his own policies and rhetoric as Fed Chairman. The most direct form of helicopter money would involve central banks transferring newly created money directly to the private sector to stimulate aggregate demand. Presumably this would be a simple way to alleviate a "liquidity trap." The U.S. federal government arguably came close to the helicopter money approach during the initial months of COVID-19, albeit in an indirect fashion. When the U.S. Treasury issues new debt to finance stimulus checks to households, and the Fed buys a near equivalent amount of treasuries in the open market, that's just one step removed from the Fed making direct money transfers to households.

At a micro level, post-recession recoveries almost always follow a "K" shape. There are always winners and losers, and current stimulus measures will not be enough to fully contain the pandemic's economic fallout. Millions of jobs have been destroyed permanently. In December, the Fed confirmed that it would continue to purchase at least $120 billion of bonds per month "until substantial further progress has been made toward the Committee's maximum employment and price stability goals." And despite the sharp economic rebound in Q3 2020, the U.S. is still a long way from maximum employment: nearly 10 million fewer jobs than before the pandemic. For perspective, that's more jobs than the U.S. lost in the entire GFC, and the pace of job gains has been slowing. As such, we believe a full economic recovery will require several years of easy monetary policy.

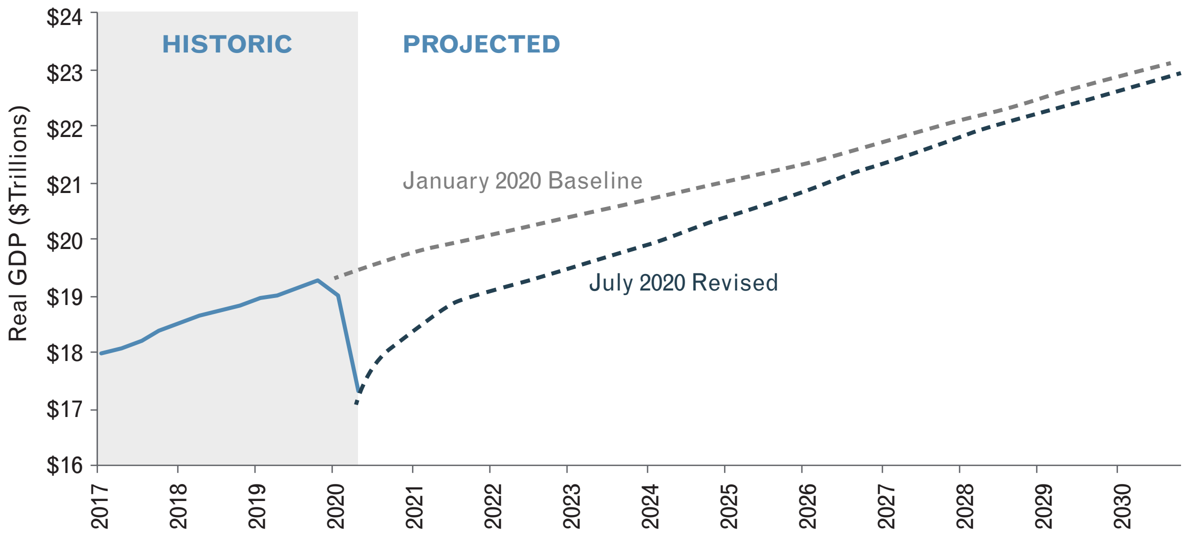
The Saxophone-Shaped Recovery
U.S. Employment, 2018-Present



Source: Federal Reserve Economic Data

Unified Democratic control of Washington, DC does raise the likelihood of more fiscal stimulus from Congress, which could cause the Fed to tighten policy earlier than expected to keep inflation in check. For example, President-Elect Biden has suggested that an infrastructure spending bill will be an early legislative priority. However, based on the latest estimates from the Congressional Budget Office, U.S. real GDP will not approach its pre-pandemic baseline until 2028 (assuming there are no recessions in the interim). With this much slack in the economy, the Fed should have ample room to maneuver without stoking inflation. We expect near-zero interest rates until at least 2023.

Long Road Ahead
U.S. Real GDP, Baseline vs. Actual (Forecast)



Source: Congressional Budget Office

Inflated Unease

With the Fed and Congress resorting to unprecedented levels of monetary stimulus, there is a growing fear that excessive "money printing" could send inflation spiraling higher. While we share the cautionary sentiment, we remain confident that the Fed will maintain control and keep a lid on prices. For one, central bankers have a stronger information advantage than in the past thanks to modern technology. With so many transactions occurring electronically, the Fed can monitor the velocity of money practically in real time, and either press the accelerator or tap the brakes as needed.

The theory that inflation is a "monetary phenomenon" is also challenged by recent experience. In the years following the GFC, the Fed created trillions of dollars through quantitative easing with little inflationary consequence. U.S. inflation eventually did tick mildly higher, but it was primarily due to less slack in the economy: lower unemployment, higher wage growth, and more aggregate demand. Even then, inflation struggled to stay above the Fed's 2 percent target, and a short-lived attempt to shrink the Fed's balance sheet had to be quickly reversed in H2 2019 as growth stalled.

At most, we expect a significant – yet transitory – uptick in inflation in 2021 as the pandemic subsides and consumers make up for lost time. Longer-term inflationary risks include sustained federal budget deficits, further debt monetization, and excess demand as Millennials ramp up their spending. Real estate offers an attractive hedge against rising inflation, providing current income at a premium over market interest rates as well as the ability to pass price increases to tenants in the form of higher rents.

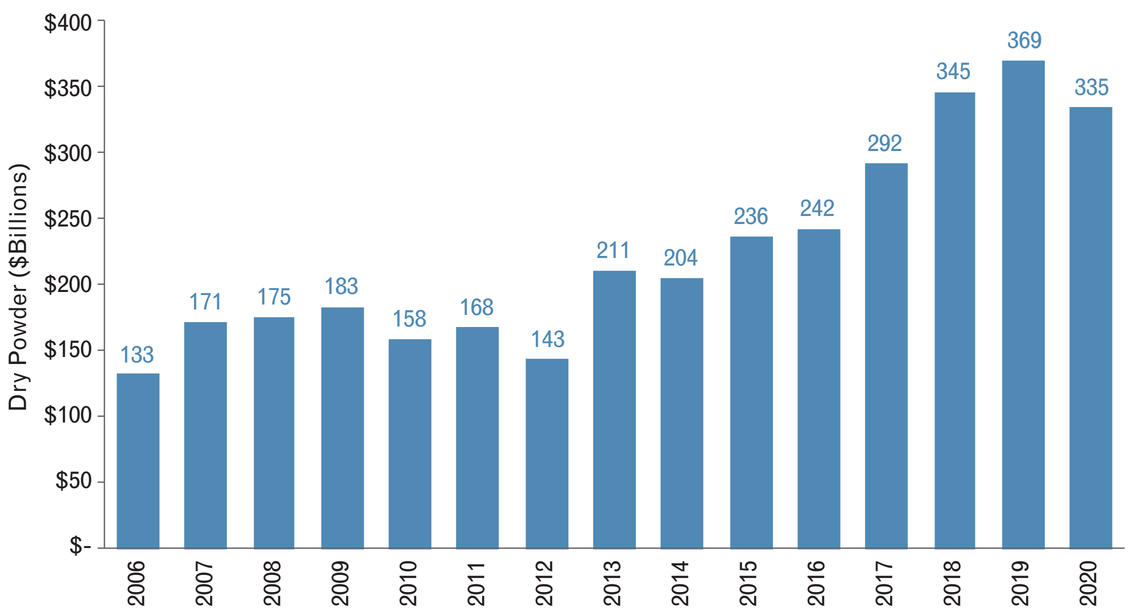
Real estate will remain attractive amid low interest rates, ample liquidity, and a recovering economy

2

The pandemic's impact on U.S. real estate fundamentals and capital flows will undoubtedly reverberate into 2021 and beyond. According to CBRE, U.S. transaction volumes fell by 44 percent in Q1-Q3 2020 versus the same period in 2019. Tenant delinquencies and rising vacancies have caused upticks in financial distress across property sectors, with the pain being most pronounced in hotels and retail. Mortgage forbearance has kept the financial damage in check so far, but we expect to see default rates pick up as more forbearance agreements expire in early 2021.

Despite the rising risk of defaults, we believe pandemic-related financial distress will be relatively short-lived and milder when compared to the GFC. Unlike the GFC, capital market liquidity has not been a serious issue during the COVID-19 downturn. Debt markets are deeper, more sophisticated, and other than a brief seizure in March and April have remained open throughout the pandemic. Real estate investment managers are also sitting on $335 billion of dry powder, keeping the hunt for deals competitive and limiting the prospects for pricing dislocations.

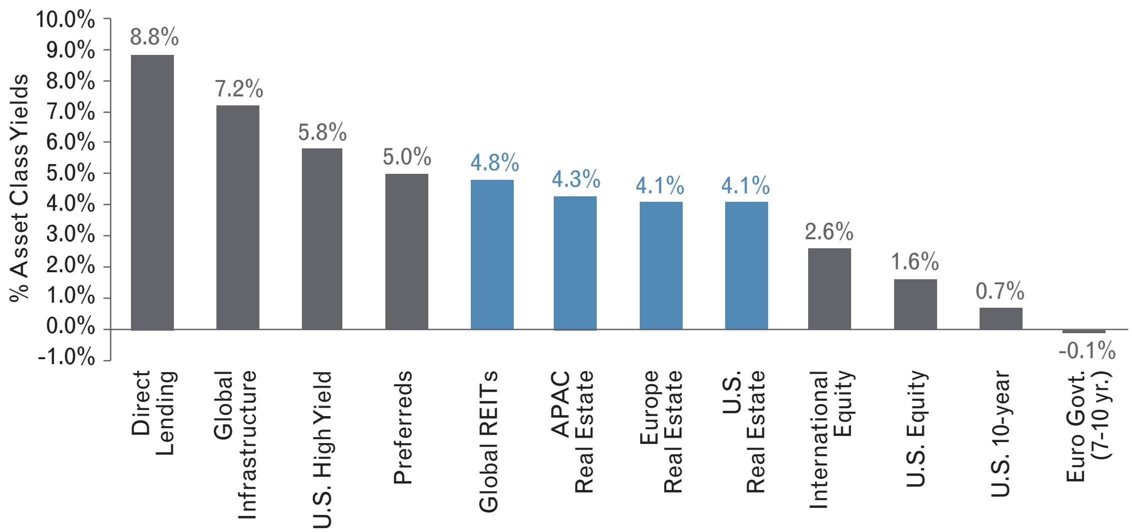
$335 Billion Safety Net
Real Estate Private Equity Dry Powder, 2006-Present



Source: Preqin, as of December 22, 2020

As the U.S. economy recovers and interest rates remain stubbornly low, the income and diversification benefits provided by real estate become more attractive, and we expect the asset class will continue to enjoy strong investor demand. Additionally, while capitalization rates and interest rates are not perfectly correlated, we expect low interest rates will result in relatively low cap rates for core assets over the long term as more investors seek out real estate as a yield alternative. As a result, institutional investors' target allocations should continue to expand further above the 10 percent threshold.

Happy Hunting Grounds
Yields Across Asset Classes, November 2020



Source: BAML, Barclays, Bloomberg, Clarkson, Cliffwater, Federal Reserve, FTSE, MSCI, NCREIF, FactSet, J.P. Morgan Asset Management. Data is based on availability as of November 30, 2020.

Chart originally published in J.P. Morgan Asset Management's *Q4 2020 Guide to Alternatives.*

Allocating capital wisely will remain a challenge in 2021 as the dust from the pandemic settles. We expect that continued growth in America's "knowledge economy" will create attractive opportunities across property types, particularly in markets that host a large number of jobs focused on science, technology, engineering and mathematics ("STEM"). But the question of corporate relocations will add to the post-pandemic fog that investors must navigate. Studies suggest that every STEM job supports up to five additional jobs in other sectors of the economy. With so many STEM employees working remotely – particularly in the technology sector – the opportunity cost of switching office locations has never been lower. Any company that wishes to relocate to a more business-friendly jurisdiction is more likely to do so within the next year than at any other time.

The supply and demand impacts of such relocations will ripple across property types, including office, retail, residential, and industrial. Markets on the receiving end of uprooted STEM jobs could see tremendous investment opportunities, but potentially at the expense of the markets being exited. This dynamic could set up a competitive new chapter in the growth of America's knowledge economy, with broad implications for real estate investment strategy and market selection.

3 Urban environments will bounce back

Despite the pandemic and this year's social unrest, we believe the rumored demise of America's cities has been greatly exaggerated. We can understand why stories of boarded up store fronts, rising crime, and fleeing residents evoked comparisons to the 1970s. Pandemic-induced agoraphobia certainly didn't help; crowded buildings and mass transit are not exactly conducive to social distancing. But cities have faced worse calamities in the past – fires, plagues, natural disasters, and even nuclear weapons – and most have bounced back. We expect another strong recovery for urban environments as the COVID-19 pandemic subsides.

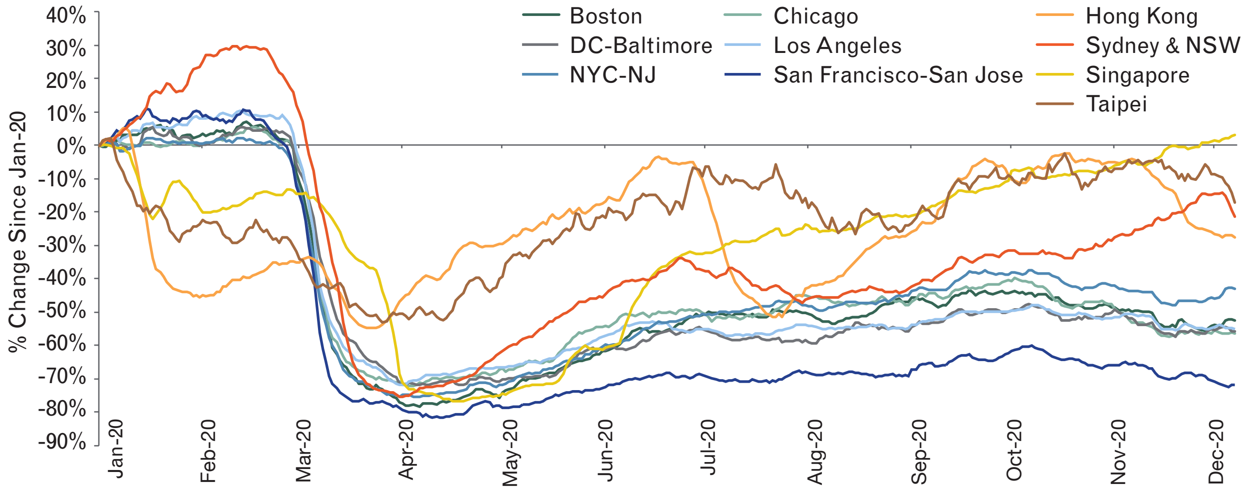
Throughout history, cities have been the ultimate crucibles of economic activity, innovation, culture, and human progress. The economic efficiencies gained from the clustering of industries and workers are the primary reason that cities exist in the first place. To quote Jerry Seinfeld, "Real, live, inspiring human energy exists when we coagulate together in crazy places like New York City." The pandemic may have reduced the attraction of high-density urban environments, but only temporarily.

We expect that young, educated professionals that have formed the backbone of America's knowledge economy will continue to find urban life appealing. The vibrant "live, work, play" dynamic that characterized mixed-use environments before COVID-19 should be in higher demand as people emerge from a period of relative isolation and boredom. Urban streetscapes will likely see improvements as well, with certain pandemic-induced features like curbside dining, dedicated bike lanes, and green outdoor gathering spaces becoming permanent. The hollowing out of the retail base (while causing serious economic damage) also provides urban planners a once-in-a-generation opportunity to reconfigure neighborhoods in a more deliberate and equitable fashion, creating "15-minute cities" where most of life's needs are within a short walk or bike ride from home.

Even mass transit could be a source of strength for urban environments in the post-pandemic era. People often cite the lack of a commute as the primary advantage of working from home. But as people return to work in physical offices, it is likely that the prospect of shorter commutes will encourage people to live closer to mass transit nodes. We may already be seeing signs of this in the Asia-Pacific region where ridership is approaching or surpassing pre-pandemic levels as infection rates subside.

Certain cities will of course continue to face challenges from pre-existing trends that the pandemic merely accelerated. For instance, we expect to see additional high-profile business relocations out of heavily taxed places like New York and San Francisco towards more business-friendly jurisdictions like Austin and Nashville. Millennials, the largest generational cohort, will also continue their gradual migration to smaller cities and suburbs as they form families, just as the Baby Boomers did in the 1980s.

Light at the End of the Tunnel
Public Transit Ridership in Select Cities, January 2020-Present



Source: moovit
Moovit Public Transit Index

But what's good for Austin and Nashville does not constitute an existential threat to New York and San Francisco. High income STEM jobs are booming across the U.S., with dozens of cities emerging as new centers of the knowledge economy. As America's knowledge economy continues to expand, the benefits of clustering and collaboration suggest that STEM jobs will continue to concentrate within cities. The pandemic may have urban centers down, but they are far from out.

Fiscal Awareness

A fiscal reckoning that has been brewing for decades has likely been accelerated by COVID-19. In certain states and municipalities, a combination of high taxes, bloated balance sheets, and underfunded pensions has caused a steady exodus of workers and businesses seeking more business-friendly environments. These issues started to receive additional attention following the passage of the 2017 Tax Cuts and Jobs Act ("TCJA"), which increased the overall tax burden in these areas by capping state and local income tax deductions. New York and California, for instance, both experienced notable upticks in net outmigration following the TCJA's passage.

The COVID-19 pandemic and ensuing lockdowns exacerbated the problem. Business closures and a general curtailment of commercial activity blew a hole in state and local budgets. Many residents, particularly the wealthiest, fled the cities for less dense areas; how many return once the pandemic is over remains an open question.

This places many states and municipalities in a fiscal quandary. Reducing public services or slashing employees would save money in the interim, but the resulting drop in living standards may foment a broader or more permanent exodus. Raising taxes from an already stressed tax base could be similarly disastrous. Federal aid (i.e. a bailout) is therefore the best option to prevent a fiscal death spiral, but such relief has so far been a tough sell in Congress. With so much institutional capital invested in higher tax "gateway markets," we expect the real estate industry to pay close attention to the actions of the 117th Congress.

4 Office market fundamentals will recover as the "work from home" trend fades

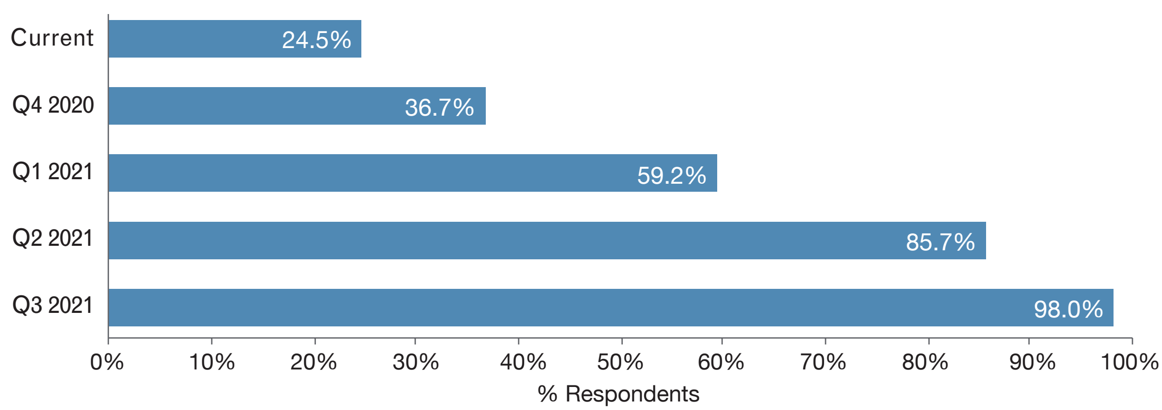
The early success of work from home ("WFH") led many CEOs to declare that a significant portion of their employees would stay remote indefinitely. According to S&P Global Market Intelligence, 64 percent of companies plan to retain expanded WFH policies after the pandemic, and 32 percent say they will reduce their office footprint. This obviously begets questions about the future of the office sector.

But the early enthusiasm for WFH now appears to be overblown, and we believe WFH will become less popular once the pandemic ends. Keeping workers remote certainly reduces real estate expenses and saves time on commuting. But the benefits largely end there, and the downsides are numerous.

Perhaps the most obvious casualty of WFH is the lack of connection among colleagues. Communication and the formation of relationships are stifled without in-person interaction. Psychologists believe that between 70 and 90 percent of all communication is non-verbal, and those vital social cues are largely missed over Zoom. Zoom also eliminates the opportunity for "chance encounters," which modern office designs seek to encourage. Putting everyone in virtual silos is 180 degrees in the other direction, with negative outcomes for efficiency, production, collaboration, innovation, training, and company culture.

As such, we do not believe that a full-time WFH model has much staying power beyond the pandemic. With vaccines expected to be widely available by March, we expect most office workers to begin returning to the office in late Q2 2021. By Q3 2021, we expect almost everyone who wants to return to the office to have done so.

Cabin Fever
CBRE Survey of Office Re-Entry Plans



Source: CBRE Occupier Sentiment Survey, September 2020
Chart originally published in CBRE's *2021 Outlook.*

Will companies adopt a hybrid model, with some employees in the office and others staying remote? Certain jobs functions – particularly back office and administrative tasks – could probably be performed remotely without much consequence. Additionally, the occasional WFH for other employees (perhaps 1-2 days per week) is also likely to remain a permanent feature of office culture following the pandemic. A whopping 96 percent of real estate professionals recently surveyed by EY and ULI expect more use of WFH after the pandemic.

As such, we expect continued uncertainty over the future of WFH will send a chill through most office markets in 2021. This further compounds a problem that existed pre-COVID: office is the largest property sector in terms of stock, but it is increasingly difficult for investors to navigate. Operating and capital expenses have increased, tenants are more demanding, and lease terms are shorter leading to less surety of income in the long run. The pandemic also underscores the growing appeal of newer buildings outfitted with modern technology to promote indoor air quality, putting owners of aging office buildings at a steeper disadvantage. Antiquated buildings may require expensive upgrades to remain competitive.

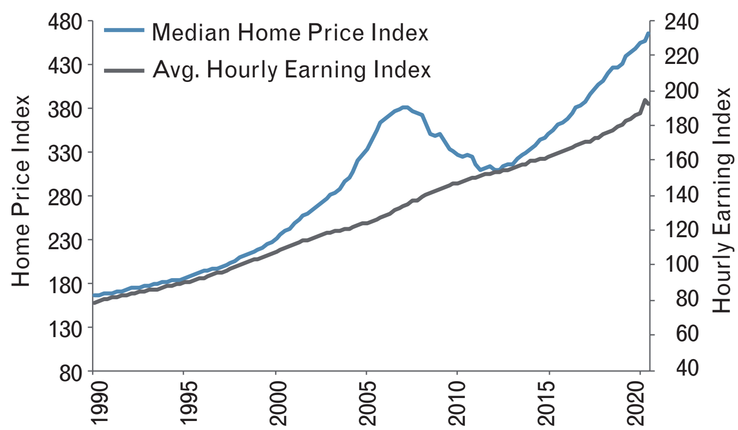
Despite this, office remains an indispensable property type for institutional investors. Office investments are the most efficient way to deploy large amounts of capital into real estate, especially for foreign investors. And we expect office to ultimately perform well as the U.S. economy recovers. Unlike prior recessions where urban CBD offices led the recovery, we would not be surprised to see CBD locations lag due to a prolonged return to normalcy in denser urban environments. For real estate investors, that should mean a longer window of opportunity to acquire high-quality office properties at discounts to their intrinsic value.

5

Shifting demographics and migration patterns will create attractive opportunities across residential segments

Multifamily has once again proven its cyclical resiliency, performing better than most property sectors throughout 2020 despite a rise in tenant delinquencies and vacancy. We believe sustained secular tailwinds should continue to support healthy demand in the years ahead. Home price appreciation has outpaced wage growth on a national basis for several years, creating affordability issues and freezing many aspiring homeowners out of the market. Additionally, a growing number of tenants are renters by choice, preferring the financial flexibility and geographic mobility that renting provides – advantages that were further reinforced by the pandemic.

Defying Gravity
Housing Prices vs. Median Wages, 1990-Present



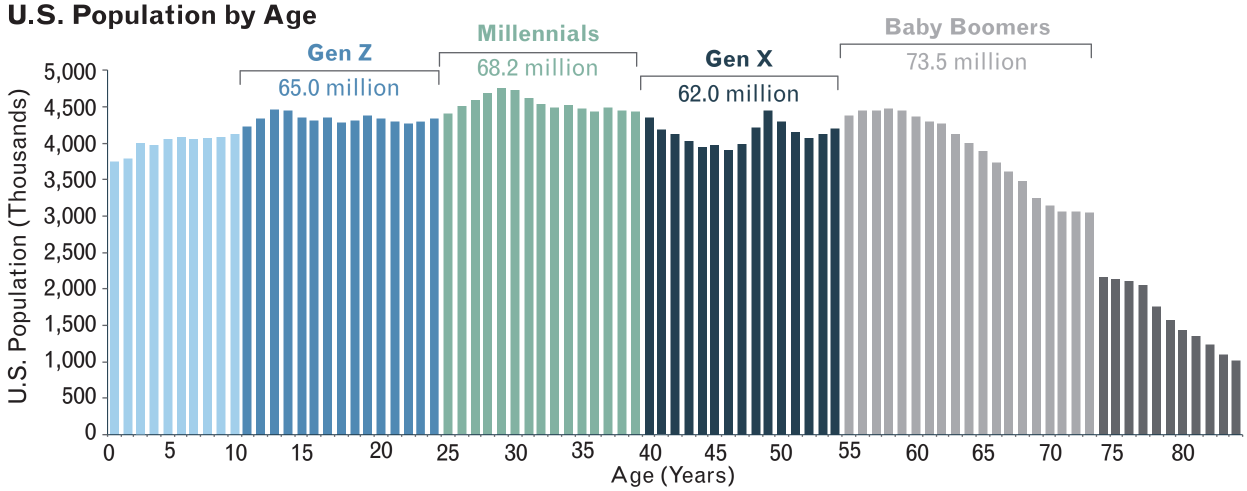
Source: Federal Reserve Economic Data

The predictable progression of U.S. demographics also provides clues on what to expect across residential property types in the years ahead. For instance, Millennials should continue to gradually migrate to smaller cities and suburbs as they form families. We expect many of these young families will be renters by choice, due to both affordability constraints and personal mobility considerations. As a result, investors have become increasingly bullish on the single-family rental ("SFR") segment. ULI's 2021 Emerging Trends survey ranks SFR as the third most attractive development opportunity, behind only Fulfillment (industrial) and Warehouse (also industrial). RCLCO estimates that at least 2.5 million additional SFR units are needed over the next decade to meet the growth in demand.

Favorable demographics should also boost senior housing, and we believe 2021 could provide the most attractive long-term entry point that senior housing investors will see for decades. Vacancies were already elevated pre-pandemic due to several years of oversupply. The pandemic further exacerbated the situation, pushing vacancies higher and inflating operating expenses. But we expect these headwinds to be transitory. Senior housing communities will receive priority distribution of the COVID-19 vaccine, alleviating a major source of concern for residents and their families. New deliveries and construction starts have slowed, which should help to ease oversupply concerns in the next 3-5 years. And the U.S. population continues to age: according to the U.S. Census Bureau, the 65+ population will grow by more than 50 percent in the next 20 years, and the 85+ population is expected to grow by 177 percent. As such, we expect to see an uptick of institutional investor interest in senior housing in the coming years.

Finally, we believe traditional multifamily will continue to experience healthy long-term demand. The steady migration of Millennials to smaller cities and suburbs should generate attractive value-add and development opportunities. Many of these markets are already seeing multifamily prices surpass their pre-pandemic levels, particularly in the Sunbelt. Urban multifamily should also remain attractive in the long-term despite setbacks following the pandemic. Millennial migration from the cities will be gradual, with the Generation Z cohort absorbing much of the excess inventory as they make their debut into the workforce. But in the near term we expect to see more distress in urban multifamily as it lags the broader recovery, with corresponding price discounts.

Demographic Crystal Ball
U.S. Population by Age



Source: U.S. Census Bureau, Park Madison Partners
*Note: Excludes ages 85+, which at the time of this writing totals approximately 6 million people. Generational definitions vary by source.

Homework

While the eviction moratorium has provided relief to U.S. renters throughout the pandemic, the thornier problem of affordability across the U.S. housing market continues unabated. Despite the clear need for more affordable housing, new multifamily deliveries have been disproportionately weighted towards high-end product. Meanwhile, low- and middle-income housing continues to be in tight supply amidst strong demand. With raw materials prices rising across the board, we expect that elevated construction costs will provide further headwinds to affordable housing development in 2021.

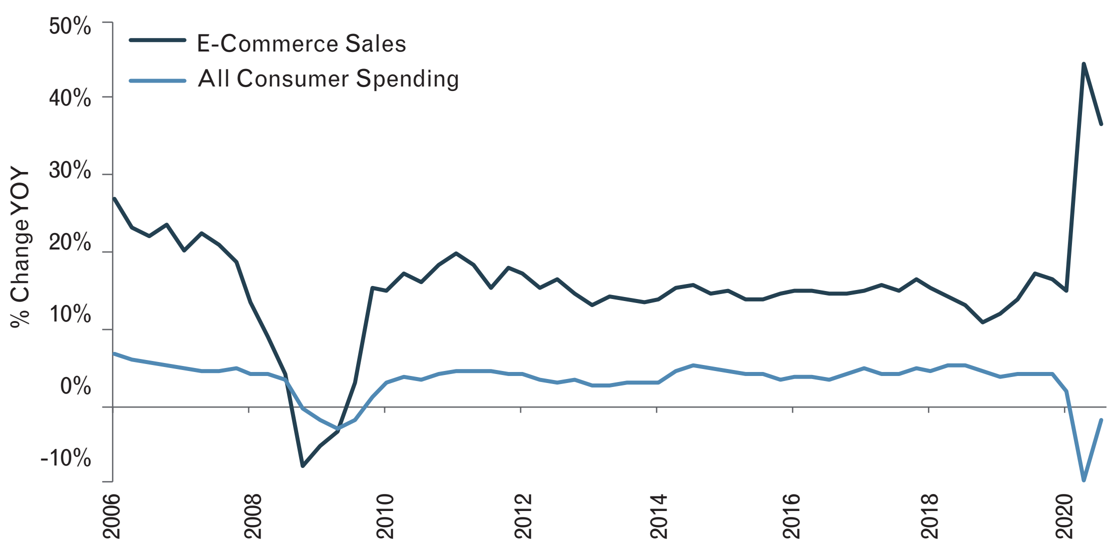
We remain hopeful that advances in construction technology will help alleviate America's housing affordability crisis in the longer term. Innovations such as modular construction and off-site manufacturing have the potential to reduce hard costs and improve delivery times, allowing affordable housing product to be delivered more economically. More public sector support is also needed through tax incentives, subsidized financing, and less restrictive zoning to encourage development. The profit-seeking motives of America's private sector can be harnessed to solve the affordable housing problem effectively, but only once we make the math work.

6 Industrial will continue to benefit from changing delivery preferences and supply chains

Industrial was once again the best performing sector in real estate in 2020. Despite a decline in investment sales volume, pricing remained stable throughout the pandemic. Cap rates compressed further as rent collections held up during the lockdowns. Rents grew at a 6.4 percent annual rate according to CBRE, outpacing their 5-year average and further underscoring the industrial sector's strength in the era of e-commerce. We expect net absorption and rent growth to continue to exceed historical averages in 2021.

The rapid growth of e-commerce continues to be the dominant theme driving industrial demand. CBRE estimates that every $1 billion increase in online sales translates to an incremental 1.25 million square feet of industrial warehouse demand, and online sales exploded in 2020 amid lockdown orders. Millions of people tried new shopping methods for the first time, such as online grocery orders, and many of these habits will endure after the pandemic ends. Consulting firm McKinsey & Co. estimates that COVID-19 collapsed 10 years' worth of e-commerce adoption into the span of only three months.

Diverging Fortunes
E-Commerce Sales Growth vs. Annual Growth of All U.S. Consumer Spending, 2006 - Present



Source: Federal Reserve Economic Data

In addition to traditional distribution centers, we expect e-commerce growth to continue fueling demand for "last mile" industrial facilities, which are in high demand as companies seek ever-shorter delivery times to consumers. While the small size (typically 50,000 to 300,000 square feet) and infill locations create sourcing difficulties, local operators that can assemble large portfolios stand to benefit from institutional capital demand. Additionally, due to their infill locations, last mile facilities often compete on highest-and-best-use with other property types such as residential and office, making them attractive long-term covered land plays.

New commitments to supply chain resiliency provide yet another potential long-term demand driver for industrial real estate. Global supply chain disruptions from COVID-19 compelled many retailers to increase their levels of inventory on-hand and invest more in e-commerce strategy, which bodes well for warehouse assets. There has also been speculation that the pandemic will catalyze a new wave of production "onshoring" by U.S.-based manufacturers, and we expect to see a fair amount of this in higher-tech sectors such as electronics, pharmaceuticals, and medical supplies. In less technologically advanced manufacturing processes, relatively high unit labor costs render the U.S. less competitive than most emerging economies. But overall, we agree that corporate investments in supply chain resiliency should generate attractive opportunities throughout the industrial sector in the years ahead.

For investors seeking to deploy capital in industrial real estate, we believe speculative ground-up development continues to be an attractive long-term bet. With the big box industrial market now picked over as capital has flooded into the sector, there are fewer opportunities for value-add strategies other than niche sectors such as last-mile. From a development perspective, industrial benefits from relatively short delivery times, the ability to deliver at yields 75-150 bps above market cap rates, and steadily expanding tenant demand. As such, we believe well-located industrial development offers one of the best risk-adjusted returns in real estate today.

7

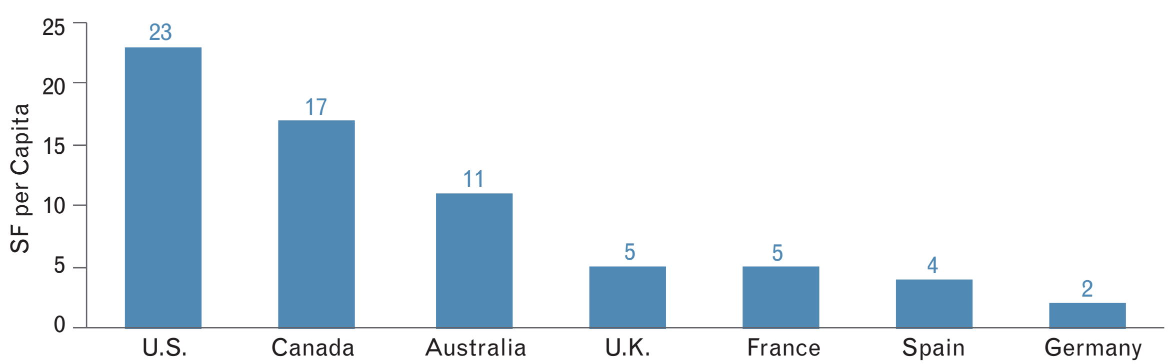
Retail's survivors will benefit from pent-up consumer demand

As the so-called "Retail Apocalypse" continues, COVID-19 is perhaps its Fourth Horseman. The ICSC expects 20,000 to 25,000 store closures in 2020, following a record 9,800 in 2019. Smaller stores and restaurants, particularly those that are not part of a national chain, have been especially hard hit by the pandemic and resulting lockdown orders. Many of these smaller "mom and pop" businesses had no more than a few months' worth of cash reserves on hand, and unfortunately thousands of them will be forced to close permanently. Unsurprisingly, COVID-19 also accelerated the demise of several mall-centric brands such as J.C. Penney, Lord and Taylor, Neiman Marcus, Brooks Brothers, Payless, and Pier 1, which joined the long list of retailers filing for bankruptcy in 2020.

For the jobs and businesses destroyed, the losses are very personal and tragic. But for the retail sector as a whole, COVID-19 may have provided the sharp culling that the retail industry badly needed. The pandemic is a classic Darwinian stress test: only the strong will survive. We believe the retailers that remain standing after the pandemic will be poised to perform much better, as pent-up consumer demand for entertainment and in-person experiences benefit brick-and-mortar retailers. Newer entrants, including digitally native brands, will also be able to expand into the vacuum that failing stores leave behind.

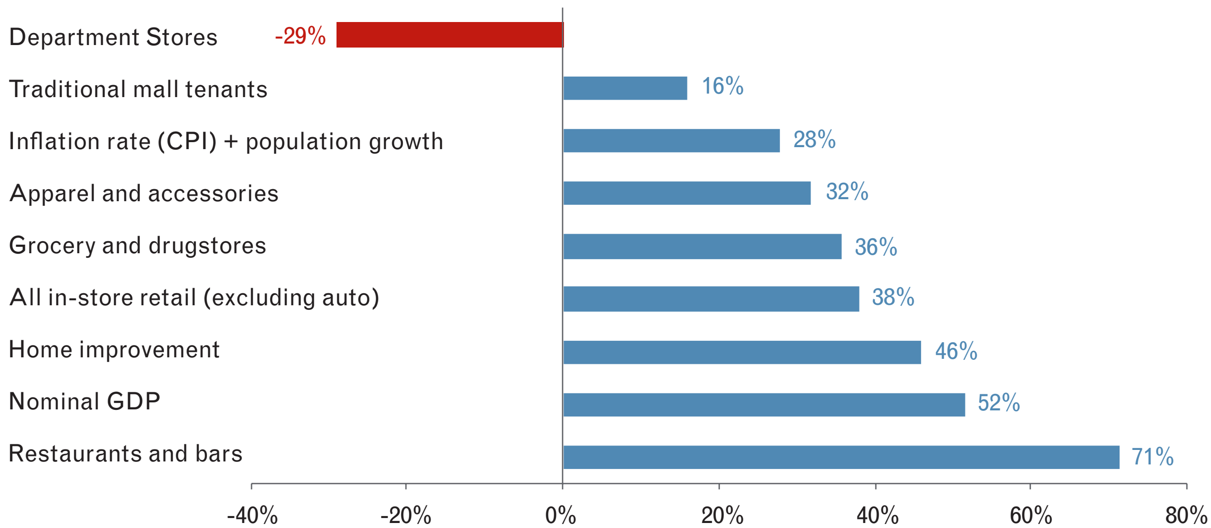
Still, the U.S. remains grossly over-retailed, and many retail properties likely need to be either repurposed or demolished. Department stores in particular appear to be a broken model in the age of e-commerce, and by extension so are most malls. CBRE forecasts a 20 percent reduction in retail square feet per capita by 2025, and we expect much of that reduction to come in the form of closing or repurposing underperforming malls. Municipalities may resist efforts to convert mall properties to other uses (industrial, for instance) due to the potential loss of sales tax revenue. But some form of conversion or redevelopment will be unavoidable in the long term.

Burden of Choice
Retail Square Feet per Capita, Select Countries, 2019



Source: Business Insider; Next Gen Personal Finance

Miracle Needed on 34th Street
Retail Sales by Store Type: Percentage Change since GFC, 2Q 2009 to 4Q 2019



Source: U.S. Census Bureau, U.S. Bureau of Labor Statistics, Nelson Economics, Urban Land Institute
Chart originally published in Urban Land Institute's *2021 Emerging Trends in Real Estate.*

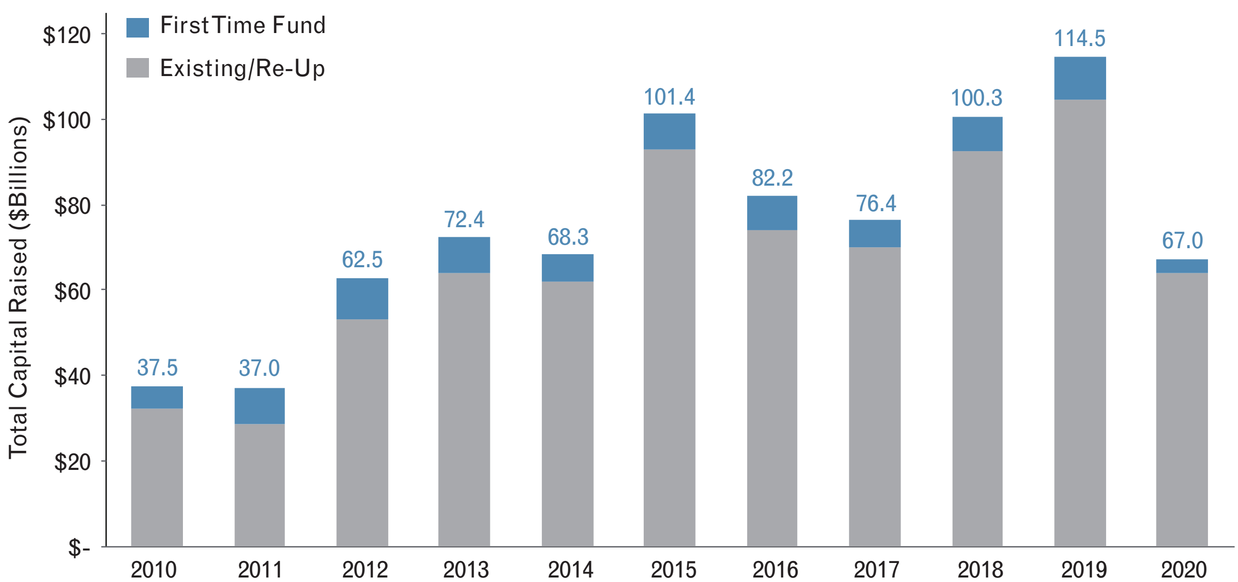
Investing wisely in a shrinking property sector is obviously quite difficult, and so we expect retail to see limited capital flows in 2021 and potentially for many years hence. But attractive investment opportunities will still emerge as retail's evolution continues, and the dearth of capital may lead to outsized returns for enterprising investors. Additionally, in retail centers that experience significant distress, redevelopment or adding other uses could yield opportunistic returns at the right cost basis. Many of the open-end funds with significant retail exposure are finally marking down or selling underperforming retail assets, and at a certain price point some of these properties may look attractive as repositioning or redevelopment plays.

8

Real estate private fundraising will pick up, with recapitalizations and longer-life vehicles gaining in popularity

After a steep decline in 2020, we expect real estate private equity fundraising to rebound in 2021 as the asset class retains its long-term institutional investment appeal. The decline in overall fundraising in 2020 should come as no surprise. In addition to general economic uncertainty, real estate private equity is a relationship-driven business. In the absence of a pre-existing dialogue, raising capital without being able to travel or have in-person meetings is exceptionally difficult. As a result, institutional investors have mostly defaulted to re-upping with existing managers throughout the pandemic. As of late December, Preqin data suggests that just over $3 billion of equity was raised by first-time funds, and if those numbers hold, they will represent the lowest fundraising haul from first-time funds since 2003.

Fortune Favors the Old
Re-Up vs. First Time Managers, U.S. Value-Add and Opportunistic Funds, 2010-2020



Source: Preqin, as of December 22, 2020

While this was a major obstacle for emerging managers in 2020, the fundraising environment has favored incumbents for many years. According to an analysis by GCM Grosvenor, only 34 percent of emerging manager funds reach a final close. Manager differentiation and specific competitive advantages have therefore been key to fundraising success for emerging managers as institutional investment portfolios mature. Creative use of technology in the investment process is one potential avenue. Managers focusing on niche property types, such as data centers, medical office, or life sciences often succeed by offering investors diversification that complements their existing portfolios. Managers with a unique sourcing angle or other competitive advantage in favored property types such as industrial also stand to benefit.

In a fundraising landscape where differentiation is key, one notable exception has been the growing standardization of fund terms. Most closed-end funds in the value-add and opportunistic space have a 1.5 percent management fee, 20 percent promote, 8-9 percent preferred return hurdle, and a 50/50 catch-up. Exceptions to this standard combination are increasingly rare, and institutional investors are quick to correct any managers who deviate. Co-investment terms are also highly standardized, with most investors expecting to be offered their pro-rata share in any co-investment opportunity on a half-fee, half-promote basis.

This standard closed-end fund structure was designed assuming a 3-year investment period and a 4-7 year hold period, but of course this framework is not appropriate for all real estate deals or strategies. For instance, the forced wind down at the end of a fund's life limits managers that seek to buy, stabilize, and hold properties long term for cash flow. Asset business plans that require more time to achieve maximum value, such as development, leaseholds, or covered land plays, are also often precluded from a closed-end fund's capacities. As a result, longer-term fund vehicles are increasingly on managers' wish lists, but remain difficult to raise.

One possible path to raising a longer-life vehicle is through a GP-led recapitalization ("recap"). Recaps can be a useful tool for managers to avoid parting with irreplaceable assets, return equity to investors, or inject fresh capital for the next phase of a business plan. On the LP side, more institutional investors have become interested in recaps as an alternative to blind-pool fund investments, providing an opportunity to underwrite both the manager and a specified portfolio of assets. For example, a manager could choose to recap a closed-end fund with a new strategic capital partner that shares the manager's longer-term business plan and vision for the portfolio. We expect GP-led recaps to grow more popular in the years ahead, and for fund documents to begin addressing the conditions and process required for these types of exits going forward.

9

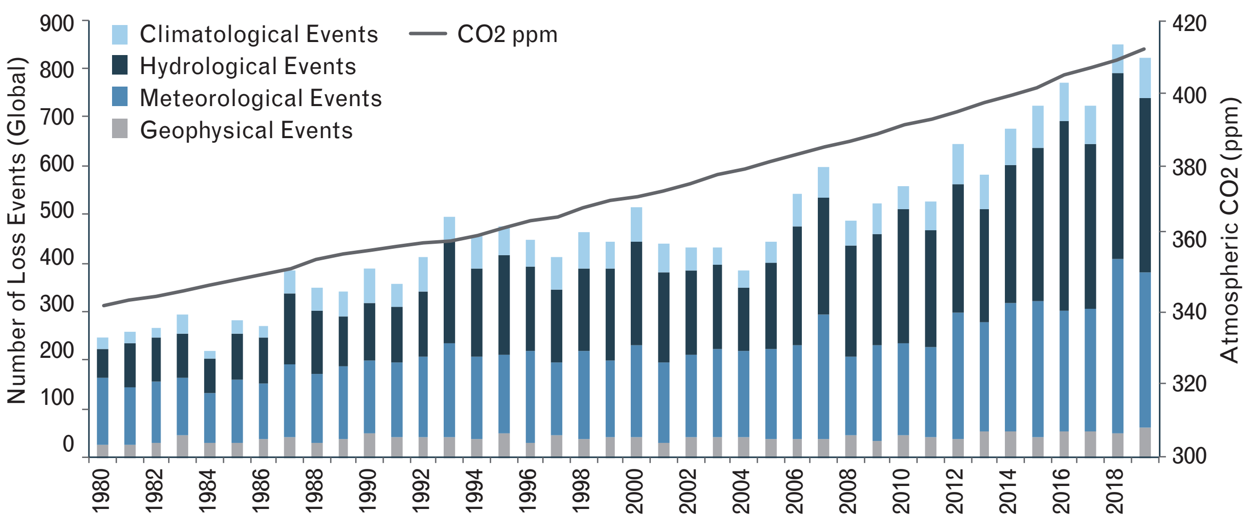
Climate risk will become a focal point in real estate investment decisions

An important lesson from the pandemic will be the long-term threats posed by what actuaries call "global catastrophic risk." Catastrophic risk involves infrequent fat-tail events like global war, supervolcanoes, solar storms, and pandemics. Climate change is another example, but with an important distinction: it's already here. Unlike a pandemic that strikes suddenly without warning, we can already observe the impacts of global climate change, and also predict future consequences within a reasonable confidence interval. Such forward-looking information can be invaluable to investors if used appropriately.

For the real estate industry, the implications of rising sea levels and extreme weather are abundantly clear. Most urban economic hubs are located on the coast, and approximately 40 percent of Americans live on the coast. And sea levels are currently rising just over three millimeters per year. Such small changes are barely discernible from a year-to-year basis, but on a geologic timescale this pace of change is rapid and will lead to more frequent coastal flooding as time goes on.

The threat to real estate from climate change is not only physical, but also financial and regulatory. In the past, real estate investors may have shrugged off the threat of coastal flooding as an insurable risk. But with insurance rates escalating, the realization is slowly setting in that some properties may not be insurable indefinitely.

This Trend is Not Your Friend
Extreme Weather Events vs. Atmospheric CO2, 1980-Present



Source: Munich Re, National Oceanic and Atmospheric Administration

Fannie Mae and Freddie Mac are already beginning to acknowledge the risk climate change poses to U.S. taxpayers. These agencies' obligation to buy loans from private lenders creates some climate-related moral hazard. As insurance costs rise for at-risk homes – or insurers shun them altogether – there's a growing motivation for bankers to offload mortgages on flood-prone homes to the agencies. Private lenders should be wary of a federal policy change to prevent this type of outcome.

Indeed, there's already evidence of changing attitudes at the federal level. In August 2020, both FEMA and HUD announced programs to aid the relocation of entire communities from flood-prone areas nationwide. These moves followed an ultimatum from the Army Corps of Engineers, which effectively threatened to withhold federal flood protection funding unless certain flood-prone areas were forcibly evacuated. Areas more prone to other ecological calamities linked to global warming, such as wildfires, could see similar measures.

As extreme weather events become more common, we expect the physical, financial, and regulatory impacts of climate change to increasingly weigh on real estate decision-making. Investors, lenders, and tenants will be focused on the environmental impact of buildings within the context of their own ESG policies. Some will demand new data, benchmarks, and reporting to demonstrate measurable progress towards reducing carbon emissions and waste. Less physically resilient properties and locations will likely face heavier scrutiny and pricing discounts. There's an old saying that "money talks," and when it comes to climate change, the crescendo in money's voice is likely to become much more discernible in the coming years.

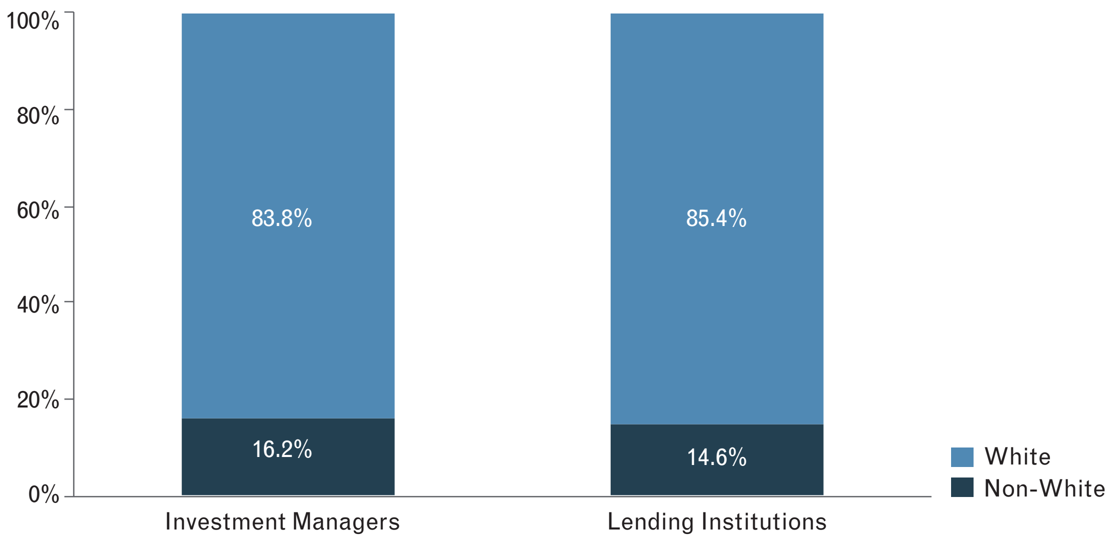
10 The real estate industry will become more diverse and inclusive

From an ESG perspective, the environmental "E" has traditionally attracted the most attention in a real estate context. But last summer's Black Lives Matter protests have placed a renewed spotlight on the social "S," particularly as it relates to diversity and inclusion. The focus is warranted, and long overdue.

Despite real estate's integral position within our social fabric, the real estate industry has done a lackluster job of reflecting the diversity of the society it's meant to serve. This lack of diversity is perhaps most conspicuous within industry leadership. While the population of the U.S. is 60 percent white, nearly 84 percent of the leaders across commercial real estate investment firms are white according to a survey by Bisnow. Within the commercial real estate lending industry

– including banks, insurance companies, pensions, and private lenders that control trillions of dollars of loans – over 85 percent of the leaders are white. According to the 2018 Diverse Asset Management Firm Assessment, only 2 percent of the firms surveyed were more than 50 percent minority-owned, and less than 2 percent were majority women-owned.

A Look in the Mirror
Racial Diversity of Commercial Real Estate Leaders



Source: 2020 Bisnow Survey

The racial disparity between America's leaders and American society has been glaringly obvious for decades, but now the desire to take redressive action is gaining momentum. In a recent study by Willis Towers Watson, 73 percent of North American companies surveyed have adopted plans to promote diversity in their organizations. Some companies have gone so far as to tie diversity recruitment quotas to executive compensation.

Within the real estate investment management industry, we expect manager diversity to become a more important component in fundraising. An increasing number of institutions – particularly public pensions, endowments, and foundations – are taking new steps to support managers that have a demonstrated commitment to diversity and inclusion. More firms are also joining organizations that promote real estate job opportunities for underserved demographics, such as Sponsors for Educational Opportunity (SEO) and the PREA Foundation. For all the pain wrought by 2020, if we can emerge from it with a newfound resolve to create a more just and equal society, then that's reason enough for optimism and hope for the future.

2020 Scorecard

In the spirit of staying honest with our readers, we continue our tradition of providing a short "scorecard" on the previous year's Outlook. Each of our market calls is scored on a scale of 1 to 10, with 10 meaning "nailed it" and 1 meaning "not even close." We also include some brief (highly subjective) commentary to explain why we scored ourselves the way we did.

We opened last year's Outlook with a quote from Erik Hoffer: "In times of change, learners inherit the earth, while the learned find themselves beautifully equipped to deal with a world that no longer exists." This set the tone for most of our 2020 predictions, with a focus on the growing pace of change and the real estate industry's ability to adapt. So far, they seem to have aged quite well.

1. The U.S. economy will keep expanding thanks to supportive monetary policy

Score: 7/10

When Warren Buffett gives forecasts to Berkshire Hathaway shareholders, he's been known to throw in the disclaimer, "In the case of nuclear war, disregard this message." As it turns out, a pandemic is sufficient. We predicted that the Fed's "mid-cycle adjustment" would reset the business cycle and propel the U.S. economy forward for another year, while also giving the Fed further room to raise interest rates in the years ahead. We further predicted that despite the Fed's increased abilities to hike rates, they were likely to stay relatively low for the foreseeable future. While the continued economic expansion was an obvious miss due to COVID-19 (which no one could have predicted), the underlying theme of our argument actually held up quite well: the Fed's determination to use all tools available to prevent a recession. And indeed, interest rates are expected to stay low for quite a long time. So given the circumstances, we think we did pretty well and are giving ourselves a 7/10.

2. In a lower-for-longer interest rate world, U.S. real estate will remain attractive

Score: 8/10

We predicted that technology would continue to transform the global economy and real estate markets at an increasingly rapid pace, and that the proliferation of STEM jobs would help the U.S. "knowledge economy" expand to more cities beyond the traditional tech hubs of New York, Boston, Los Angeles, and the Bay Area. We saw this play out on a grand scale with several high-profile corporate relocations announced throughout the pandemic. We also predicted that cap rates would remain low thanks to continued investment demand for real estate. Indeed, cap rates for certain sectors have remained relatively stable throughout the pandemic (or even compressed further, as in the industrial sector). Though we lost points due to rising cap rates in property types experiencing more distress due to COVID-19. Finally, we warned about the possibility of a late-cycle correction, but stipulated that any dip in real estate prices would likely be mild and short-lived due to the amount of real estate dry powder on the sidelines. Any investor looking for distressed pricing today would likely corroborate this assertion. We'll take our 8/10 on this one.

2020 Scorecard

3. Strong multifamily fundamentals will continue to drive steady performance

Score: 9/10

We said that favorable demographics and strong underlying demand would cause multifamily to continue performing well. Of course, our prediction was aided by nearly $3 trillion of fiscal stimulus, which included expanded unemployment benefits and direct payments to American families. Our one miss was the suggestion that elevated home prices would keep Millennials in the rental market, and by most accounts it appears Millennials purchased homes in droves as the pandemic hit. We'll settle for 9/10.

4. Industrial will offer the best risk/reward of all major property types

Score: 10/10

No need to belabor the point here. Industrial had another very good year, driven by e-commerce growth and investment in supply chains, which is what we expected. Far from being a hindrance, the pandemic actually accelerated most of the trends that were fueling increased demand for industrial. So while it wasn't the boldest prediction, we'll still take our 10/10.

5. Retail will continue to experience significant change driven by technology

Score: 10/10

This was also not our boldest prediction of 2020. However, far from predicting a retail apocalypse, we were balanced in our view between retail's winners and losers. We said that more struggling brick and mortar retailers would close, along with a significant percentage of existing malls, but that digitally native retailers would partially offset this loss by expanding their physical footprints. Indeed, as the pandemic has taken its toll on retail tenants, there are already signs that newer retail players – including several digitally native brands – are filling part of the void. We also mentioned Gen Z's affinity for physical stores as a break from screen time, or "retail therapy." We expect this idea has some staying power.

6. The office amenity war will pressure operating margins

Score: 10/10

We said that office operating margins would face increasing pressure due to rising capex requirements and TI expenses as owners seek to keep up with changing technology and tenant preferences. The extra focus on health and wellness in the wake of COVID-19 (while not part of our prediction) certainly led to increased operating expenses for most office landlords in 2020. Our prediction that changing tenant preferences on space configuration would keep expenses high was also (unfortunately) significantly aided by the pandemic. Finally, we predicted that office proptech would become more widely adopted as a way to monitor light, temperature, and indoor air quality. As has been stated innumerable times, the pandemic accelerated many pre-existing trends.

2020 Scorecard

7. Private real estate equity capital will flow primarily to the largest managers

Score: 10/10

We predicted that institutional real estate allocations would continue to expand above the 10 percent threshold, and indeed they have pushed higher over the last year. We suggested that fundraising would remain very competitive for emerging managers as investors stuck with established, incumbent managers. Again, we did not anticipate a pandemic that would prevent most travel and in-person meetings, making it nearly impossible for emerging managers to foster the necessary relationships to raise institutional capital. The largest, most established managers were clearly the net beneficiaries of this restriction, though we expect the largest managers would have done well regardless. Finally, we predicted rising interest in recapitalizations and a subsequent increase in recap transaction volume in the years ahead, and the pandemic seems to have given that call a boost as well. We'll keep our day jobs for now.

8. Climate risks will increasingly affect real estate investment decisions

Score: TBD

This prediction was substantially the same as our 2021 prediction on climate: the multitude of physical, financial, and regulatory threats from climate change will significantly impact real estate investment decision-making in the coming years. But in 2020, climate change likely took a back seat to the pandemic on most people's lists of pressing concerns. Longer term we believe we'll be proven correct.

9. ESG considerations will become a higher priority across the real estate industry

Score: 10/10

We predicted that more real estate managers would be pressured by their investors to adopt ESG standards, with ESG questionnaires becoming a more common element of institutional due diligence processes. In particular, we said that rhetorical "check the box" answers on ESG would no longer be sufficient, and that investors would be focused on concrete data (e.g. a building's environmental scores, manager diversity, etc) to substantiate their ESG goals. Based on our own recent experience, this call appears to be right on the mark.

2020 Scorecard

10. The 2020 U.S. Presidential Election will be a close contest

Score: 5/10

Based on the headline alone, we did well on this one. The 2020 Presidential Election was a nail-biter all the way to the end (even as we publish this outlook, some still insist it isn't over). But we missed on several of the details. We made a strong case for a brokered Democratic convention, with a crowded primary field fracturing voters along ideological fault lines and producing no clear winner. After an inconclusive Iowa Caucus and a virtual tie between Bernie Sanders and Pete Buttigieg in New Hampshire, along with Bloomberg staging an 11th hour surge in national polls, we thought our prediction was looking pretty solid. But Joe Biden's decisive win in South Carolina was a game-changer, and from then on it wasn't a close contest. However, we also made the point that the 2020 Election would see at least one political paradigm broken: 1) no sitting president has ever won re-election with an approval rating below 50 percent on Election Day, and 2) no sitting president has lost re-election when unemployment is below 7.4 percent. The first paradigm held: President Trump's approval rating was about 46 percent on Election Day according to an average of polls on RealClearPolitics, suggesting he would lose. However, the October unemployment rate was 6.9 percent, suggesting Trump should have won. He did not, so at least one historical precedent was broken during the 2020 Election. If pressed, we could probably list others.

About Park Madison Partners

Park Madison Partners is a boutique New York-based capital markets and advisory firm for global real estate alternative investments. Since its formation in 2006, Park Madison has participated in the placement of over $17 billion in private equity capital for a wide range of real estate vehicles and strategies.

Park Madison Partners was founded to offer clients capital raising and strategic consulting services with a high degree of customization, integrity and accountability. Our team comprises professionals with backgrounds across the buy-side and sell-side, and we leverage this experience to provide a thoughtful approach to global real estate capital markets. Our unique expertise allows us to offer a variety of highly customized capital solutions to real estate managers, including commingled funds, separate accounts, programmatic joint ventures, and recapitalizations.

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