Park Madison Perspectives

Outlook 2022

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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 advised on over $20 billion in private capital placements for a wide range of real estate vehicles including closed-end funds, open-end funds, separate accounts, programmatic joint ventures, and recapitalizations.

Park Madison Partners offers 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, sell-side, and consulting and we leverage this experience to provide a comprehensive approach to global real estate capital markets.

> "When you launch in a rocket, you're not really flying that rocket. You're just sort of hanging on."
>
> – Michael P. Anderson, U.S. astronaut

Heading into 2022 feels a bit like being strapped to a rocket. The first 20 months following the COVID-19 Recession could be considered the "booster stage." And much like the rockets of the Apollo Program, the U.S. economy has been propelled higher thanks to 1) rapid advances in science, 2) complex technological innovation, and 3) mountains of government financial support.

But now the booster stage is nearly over as the effects of fiscal and monetary stimulus fade. We're entering the "cut-off stage" when the rocket engines cease firing, and we anxiously await confirmation that the U.S. economy has reached escape velocity. We assume – or at least hope – that the people who designed, built, and fired the rocket are much smarter than we are, assuring our safe passage into the unknown. In the meantime, the best we can do is "just sort of hang on" and remember the lessons of prior cycles.

While no one can predict the future, it's our annual tradition to at least try. Last year we did pretty well, and you can see a full analysis in our "2021 Scorecard" at the end of this piece. But first, here are our top 10 predictions for 2022:

1.	Inflation will prove transitory and moderate by year-end	**4**
2.	The U.S. economy will expand at a moderate pace as Fed policy remains accommodative	**7**
3.	Real estate will remain attractive amid low interest rates and stable cap rates	**9**
4.	Big cities and downtowns will outperform	**11**
5.	Office valuations will stabilize, but fundamentals will remain challenged amid heated competition	**13**
6.	Residential segments will benefit from shifting demographics and favorable capital markets	**15**
7.	E-commerce and shifting supply chains will continue to propel industrial higher	**18**
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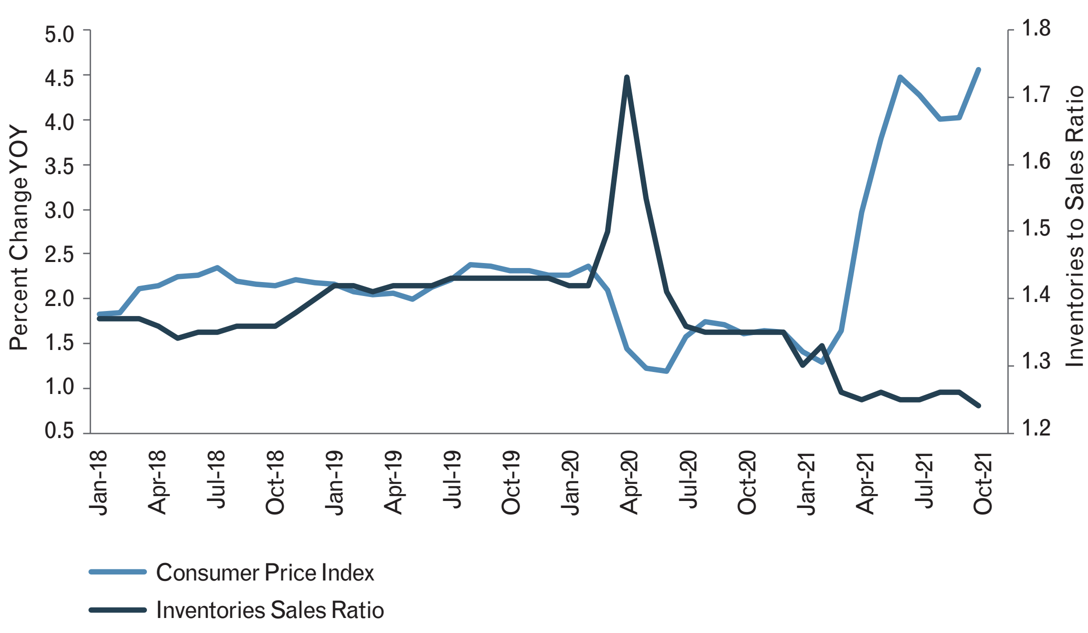
9.	Private capital flows into real estate will remain elevated as institutional investor allocations expand further	**22**
10.	Republicans will sweep the 2022 midterms	**24**

1 Inflation will prove transitory and begin to moderate by year-end

In the first months of the Covid-19 pandemic, the U.S. economy looked to be entering a deflationary downward spiral, with some economists even forecasting an "L-shaped" recovery. More than a year later, those dire warnings have been completely turned on their heads, with markets staging a V-shaped recovery amid surging inflation. Despite growing alarmism, we subscribe to the Federal Reserve's party line that higher inflation will ultimately prove to be transitory, rather than a harbinger of things to come.

We view today's inflationary environment as a classic supply-demand imbalance of "too much money chasing too few goods." On the demand side, consumer spending has ballooned amid unprecedented U.S. fiscal stimulus and elevated household savings. Low interest rates and excessive liquidity have also boosted expenditures on homes, durable goods, and other fixed assets. On the supply side, labor shortages have caused companies to boost wages to attract talent. Supply chain bottlenecks have resulted in skyrocketing freight costs, delayed delivery times, and low inventory levels. With no other market force available to correct these imbalances, inflation is the natural result.

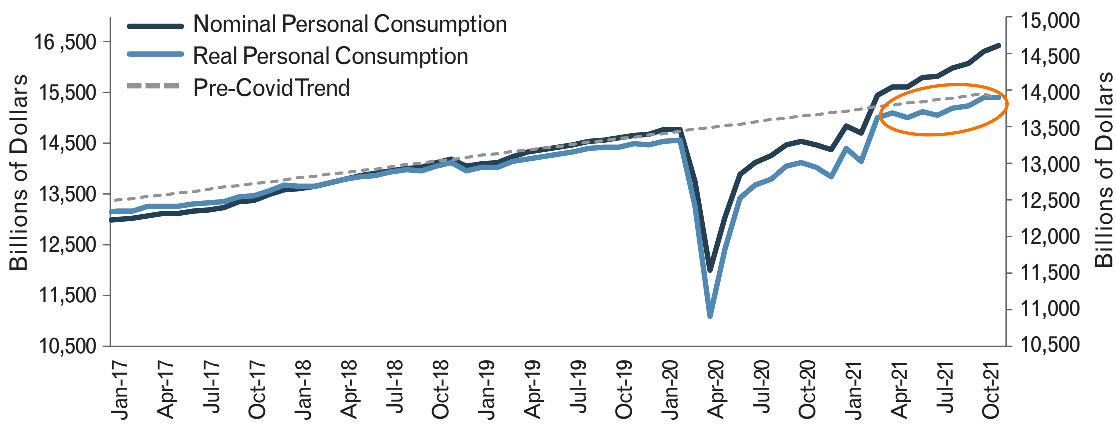
Too Much Money, Too Few Goods
Inventories to Sales Ratio vs. Consumer Price Index, Jan 2018 - Oct 2021



Source: Federal Reserve Economic Data

Far from heralding a new inflationary era, we believe these are extreme, pandemic-related market conditions that should gradually subside. Supply chain bottlenecks show early signs of easing. Household savings rates have already returned to pre-pandemic levels, and the effects of U.S. fiscal stimulus are starting to burn off. Likewise, while consumer spending remains elevated in nominal terms relative to the pre-pandemic trendline, in real terms the trend has already normalized. This suggests that there has not been a major paradigm shift in consumer behavior, but rather a temporary distortion in prices caused by supply and demand imbalances.

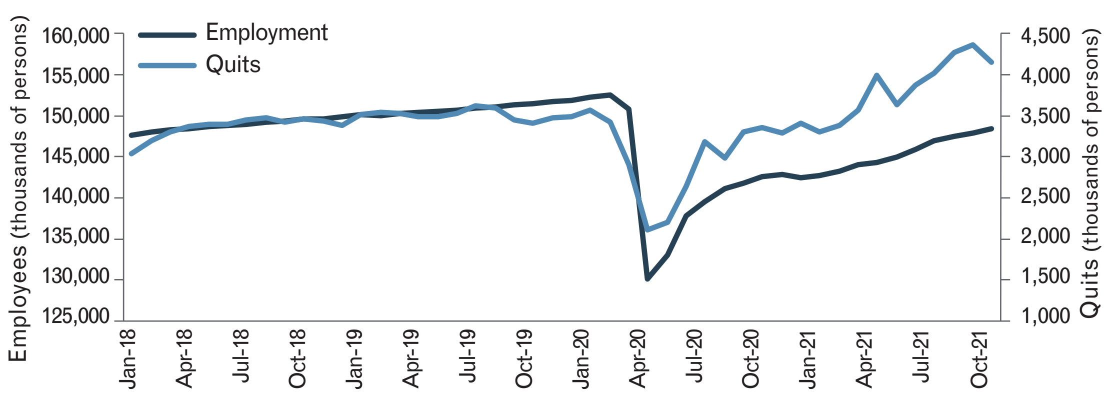
Distorted Reality
Nominal Personal Consumption vs. Real Personal Consumption, Jan 2017 - Oct 2021



Source: Federal Reserve Economic Data

Such imbalances are perhaps most acutely felt in the labor market, which we believe presents the biggest risk to our outlook. Several factors have disrupted the labor market, such as accelerated retirements, safety concerns keeping workers at home, and record high job openings providing workers with more career alternatives. For many workers, such career changes have been made easier by elevated personal savings throughout the pandemic. As a result, the quits ratio has vastly outpaced the jobs recovery overall, resulting in labor shortages across most industries.

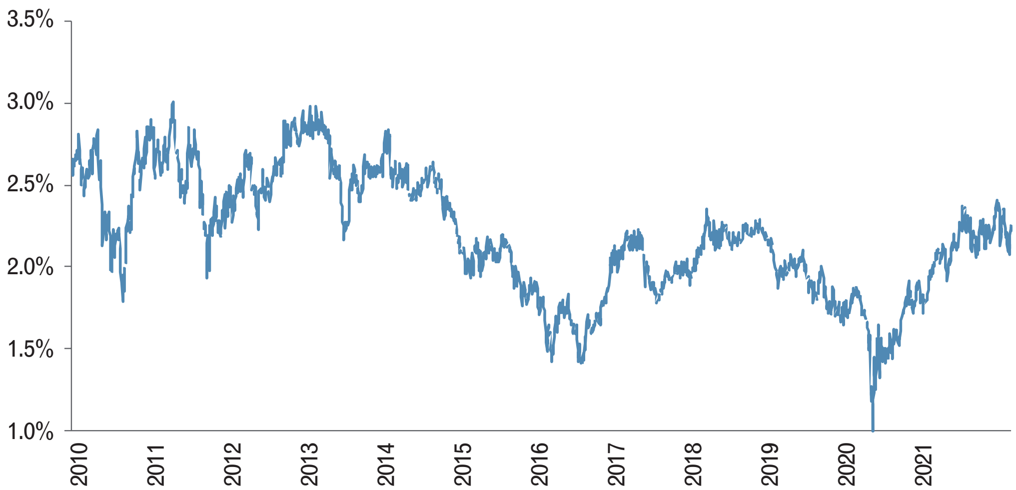
Help Wanted
Quits vs. Total Employment, Jan 2018 - Oct 2021



Source: Federal Reserve Economic Data

Businesses have reacted by increasing wages to attract and retain talent. Wages are sticky, and these pay increases are unlikely to be reversed. If wage pressures were to persist beyond the initial "re-opening phase" of the recovery, the resulting wage-price spiral could lead to elevated inflation for many years. But we believe this outcome is unlikely. The Fed has enough policy tools at its disposal to respond if inflation persists. Bond markets also remain sanguine, with 5-year forward inflation expectations firmly anchored near 2 percent – consistent with the Fed's view that elevated inflation is temporary and will revert to longer-term averages as market conditions normalize. And the bond market has a long history of getting it right.

Anchored Expectations
5 Year-5 Year Forward Inflation Rate, 2010-Present



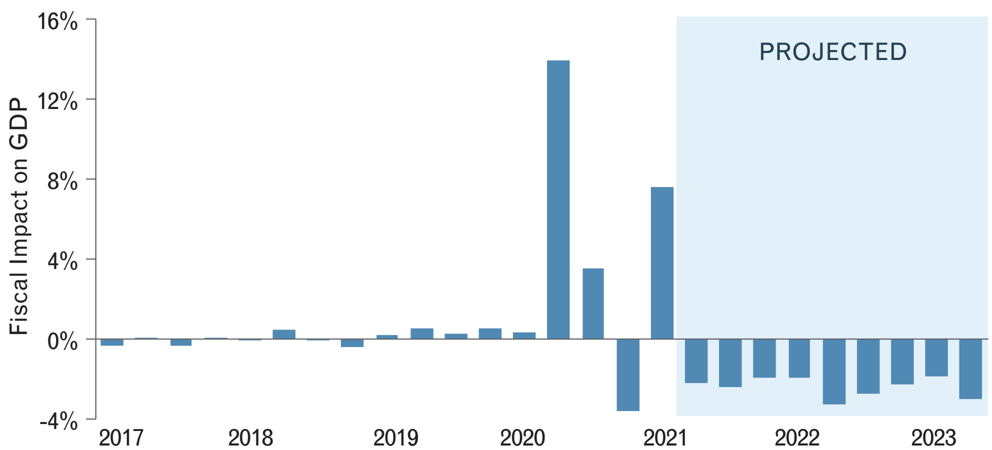
Source: Federal Reserve Economic Data

There are, of course, other longer-term inflationary risks for investors to monitor, such as increasing federal budget deficits or further debt monetization. Another pandemic flare-up could also prolong labor market and supply chain issues, with inflation persisting in tandem. Regardless of inflation's future direction, we believe U.S. real estate will continue to perform well so long as GDP – real or nominal – continues to expand.

2 The U.S. economy will expand at a moderate pace as Fed policy remains accommodative

Fueled by record stimulus, the strength of the U.S. economic recovery following the COVID-19 recession has stunned even the most optimistic forecasters. But we expect the next leg of the recovery will be a trickier balancing act for federal policymakers. Congress' $5 trillion stimulus barrage has largely run its course, and fiscal policy is now poised to turn sharply contractionary. The White House Office of Management and Budget estimates a -8.7 percent fiscal drag on growth in 2022, and another -2.3 percent in 2023. This represents the most contractionary fiscal policy since 1946, when sharp cuts in wartime spending reduced U.S. GDP by -14.1 percent.

What a Drag
Fiscal Impact on GDP, 2017 - 2023P

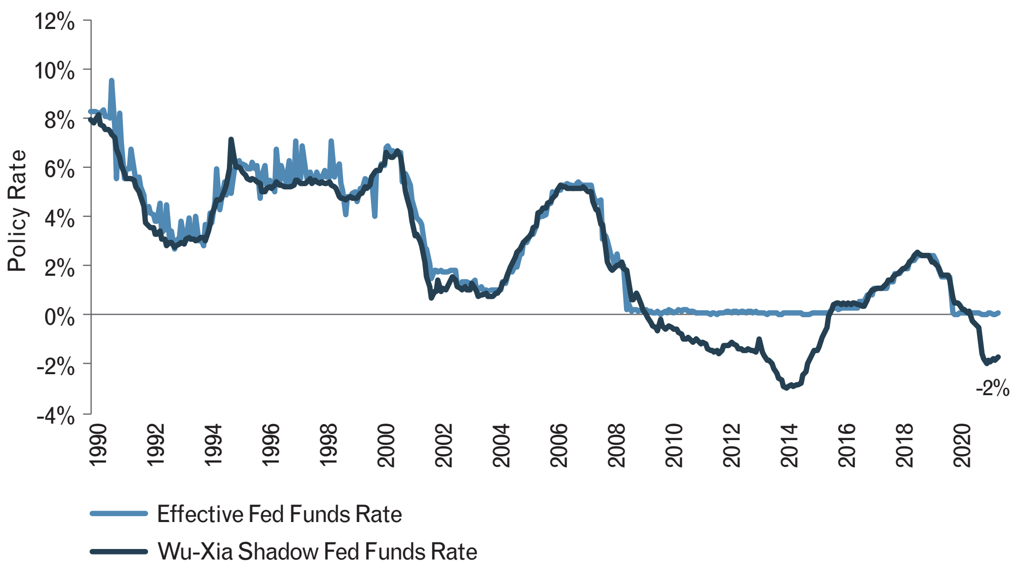


Source: Federal Reserve Economic Data, Congressional Budget Office

Monetary policy uncertainty adds yet another wrinkle to the economic outlook. Rising inflation has raised pressure on the Federal Reserve to turn more hawkish. The Fed has reacted by announcing an early end to quantitative easing, along with a forecast of 3 quarter-point rate hikes by year-end. But with growth and inflation both expected to slow in H2 2022, we would not be surprised to see a less hawkish pivot by mid-year. The Fed has plenty of tools in its arsenal to fight inflation, but fewer levers to pull to stimulate growth. As such, we believe the Fed will err on the side of keeping policy relatively accommodative.

Even if we're wrong and the Fed hikes more aggressively to stave off inflation, history suggests low interest rates are here to stay for the foreseeable future. In 15 rate hike cycles since 1954, the Fed has tightened policy by an average 494 basis points. Looking at more recent history since 1983, the average tightening cycle is a more modest 365 basis points. The Wu-Xia Shadow Fed Funds Rate, which considers the effects of quantitative easing, suggests that the effective Fed Funds Rate bottomed in May 2021 at -2 percent. So if history is any guide, the Fed Funds Rate appears unlikely to exceed 2 to 3 percent during this economic cycle.

Room for Maneuver
Fed Funds Rate vs. Wu-Xia Shadow Fed Funds Rate, 1990 - Present



Source: Federal Reserve Bank of Atlanta

Policy intrigue aside, the U.S. economy should continue to enjoy several tailwinds in 2022. Households boosted their savings by over $2 trillion during the pandemic, which should provide support for consumer spending. Further progress against the pandemic should help broaden the U.S. economic expansion as consumers shift more spending from goods to services. Record low business inventories should also keep manufacturers busy as a multi-year restocking cycle gathers pace. Assuming monetary policy remains supportive, we expect the U.S. economy to continue expanding at modest pace.

Real estate will remain attractive amid low interest rates and stable cap rates

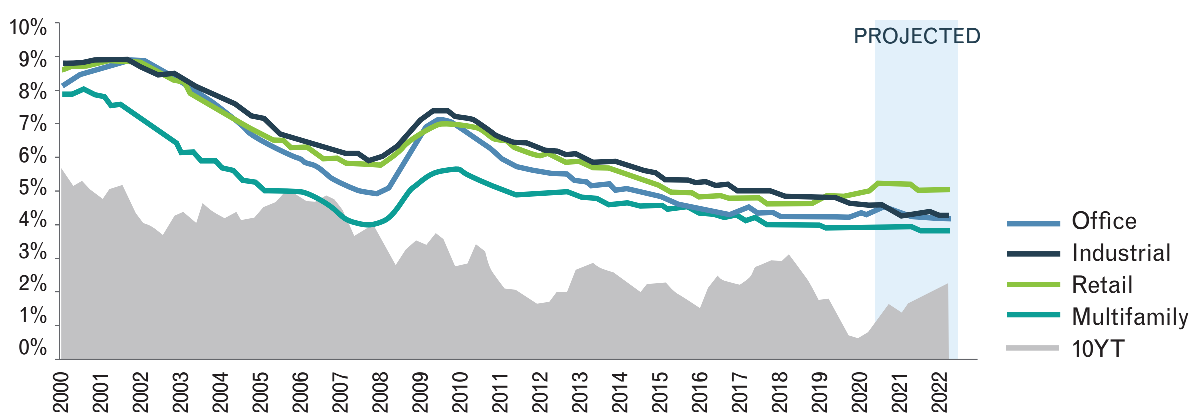
3

Real estate investment returns bounced back strongly in 2021, driven by a combination of recovering fundamentals, low borrowing costs, and ample liquidity. As of Q3 2021, the NCREIF Property Index was on pace to achieve an annualized unleveraged return of 12.1 percent, led by multifamily and industrial. Investment activity also picked up, with transaction volumes reaching a 16-year high according to CBRE. We expect U.S. real estate fundamentals to remain healthy throughout 2022.

Despite widespread expectations of financial distress from the pandemic, real estate valuations have mostly held firm as capital has remained plentiful. Investment managers are sitting on an estimated $393 billion mountain of dry powder, driving up competition for deals. Low interest rates also provide more opportunities to achieve positive leverage on stabilized assets, along with reduced carrying costs on transitional assets. We believe these dynamics will continue driving real estate values higher in 2022.

All this liquidity has driven cap rates to fresh lows, with stabilized properties in favored asset classes commanding cap rates as low as 3 to 4 percent. Cap rates at these levels present both challenges and opportunities for investors. Price convexity is steeper with cap rates in the low-to-mid single digits, resulting in more dramatic price swings if cap rates change. For example, a decrease in cap rate from 7 to 6 percent would result in a 17 percent rise in price, but a decrease from 4 to 3 percent would result in a 33 percent rise. This arithmetic has served investors well in recent years, with cap rate compression providing a steady tailwind for real estate performance since the GFC.

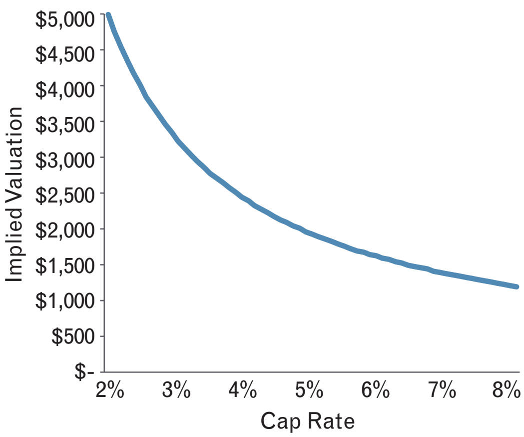
Low & Steady
Cap Rates vs. 10 Year Treasury, 2000 - 2022



Source: CBRE Econometric Advisors, Federal Reserve Economic Data

But price convexity is also a measure of risk: dramatic swings in price to the upside are magnified on the downside as well, especially with cap rates in the low-to-mid single digits. Investors must therefore be mindful of risk factors that could send cap rates higher, such as rising interest rates. Though cap rates and interest rates are not perfectly correlated, we believe the ability to achieve positive leverage has been a major driver of today's low cap rates. An uptick in borrowing costs could therefore lead to modest increases in cap rates. The downside risks are obviously highest for assets trading at the tightest cap rates, with more pronounced declines in value if rates rise. For example, assets priced at a 3 percent cap rate could decline in value by 33 percent if rates widened by just 100 basis points.

Higher Stakes
Capitalized Value of $1 of NOI



Source: Park Madison Partners

In this environment, we believe value-add and development strategies provide the best risk-reward for real estate investors. The overstated effects of price convexity mean greater financial rewards for stabilizing properties at yields representing a premium to market cap rates (i.e. stabilizing at a 6 percent cap and selling at 4.5 will generate more capital appreciation than stabilizing at a 7 and selling at a 5.5, etc). And positive real estate fundamentals should continue to support end-user demand growth across property types, which bodes well for value-add and development projects. With capital markets so hungry for core real estate, we expect managers that can deliver it will be well-rewarded.

All About Alpha

The NCREIF Property Index (NPI) and Open-End Diversified Core Equity (ODCE) Index are the primary industry benchmarks for U.S. core real estate performance, and many real estate managers and investors reference these indices for target returns and comparative performance. But beneath the headline performance numbers, return dispersion between different property types is the widest in NCREIF history dating back to 1977, ranging from +32.4 percent for industrial to -2.5% for hotels. Similarly wide dispersions exist at the individual asset level within each property type.

This creates nuances for benchmarking, but also leads to challenging questions on capital allocation. Office, retail, and hotel may be underperforming in aggregate, but they remain important components in a diversified real estate portfolio. Beta exposure to overall real estate performance is therefore insufficient, and manager selection is key. Even struggling property types will generate attractive investment opportunities, but it takes talent, skill, and keen local insight to source and execute the right deals. As such, in 2022 we expect investors to increasingly favor managers with a history of generating alpha within their respective property types.

NCREIF Property Index Performance, Q4 2020-Q3 2021

Period	Apartment	Hotel	Industrial	Office	Retail	All
4Q 2020	0.99%	-3.31%	4.68%	0.48%	-1.24%	**1.15%**
1Q 2021	1.69%	-1.61%	4.72%	0.99%	-0.45%	**1.72%**
2Q 2021	3.62%	-0.61%	8.88%	1.44%	0.90%	**3.59%**
3Q 2021	6.53%	1.83%	10.92%	1.87%	1.55%	**5.23%**
Annualized	**13.37%**	**-2.53%**	**32.38%**	**4.86%**	**0.74%**	**12.15%**

Source: NCREIF

4 Big cities and downtowns will outperform

After nearly two years, major cities and downtowns have still not fully recovered from the COVID-19 pandemic and 2020 lock-downs. One of cities' greatest economic strengths – density – became a crippling liability when residents sought the safety, comfort, and convenience of bigger living spaces. Smaller cities and suburbs have enjoyed booming population and job growth ever since, with real estate performance and capital flows responding in kind. While many of these dynamics will remain in place as the pandemic grinds on, we believe denser urban environments offer an attractive risk-reward going into 2022 – and significant potential for out-performance.

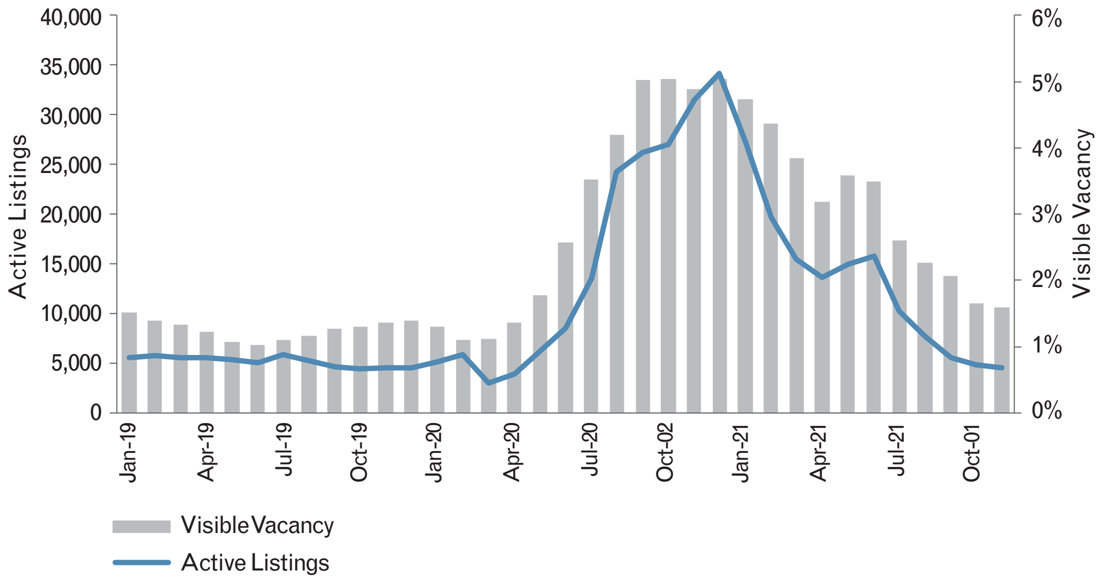
The challenges facing big cities are myriad and well-known. Work-from-home (WFH) taught many people that they could do their jobs from anywhere. The most socially mobile tend to be highly paid, highly educated workers from knowledge-based industries such as science, technology, engineering and mathematics (STEM). Studies suggest that every STEM job supports up to five additional jobs in other sectors of the economy, so permanently losing these jobs would be especially painful for urban economies.

While smaller cities are likely to continue benefiting from an influx of STEM jobs as America's knowledge economy matures and broadens, we believe fears of a mass exodus from major cities are overblown. 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, and we do not believe those efficiencies are easily replicated through virtual meetups.

Other pandemic-related challenges facing big cities should continue to moderate in 2022. The higher cost of living in cities makes little sense when urban amenities are shut down or feared to be unsafe. But thanks to the success of COVID-19 vaccines, such restrictions on urban lifestyles have largely disappeared. Fear of infection has also become less acute as vaccines reduce the risks of severe illness. As a result, urban cultural amenities – theaters, museums, concerts, events, college campuses, etc – have largely re-opened. In short, the vibrant "live, work, play" dynamic that makes urban life so appealing is on its way back.

We believe signs are already pointing to a strong recovery for major cities and downtowns. Downtown multifamily occupancy surged in Q2 and Q3 2021, with occupancy nearing pre-pandemic levels according to CBRE. Manhattan, one of the densest and hardest hit urban markets during the pandemic, provides an interesting case study. After falling over 14 percent through December 2020, multifamily rents have staged a near-full recovery across unit types as vacancies and inventory normalize. Tech and media tenants also continue to lease and acquire office space in anticipation of a longer-term presence. For example, Google recently paid $2.1 billion for a 1.7 million square foot office campus on Manhattan's West Side – a clear bet on the long-term importance of New York City as a technology and innovation hub.

And Just Like That
Manhattan Apartment Vacancy vs. Active Listings



Source: Corcoran Market Research. Figure reflects units actively listed as of the last day of the report month by any agency in Manhattan. Visible vacancy is a proprietary index reflecting a representative sample of properties throughout Manhattan in order for a known supply figure to be utilized when calculating unoccupied units. Real vacancy is unknown as not all vacant units are publicly listed. All material herein is intended for information purposes only and has been compiled from sources deemed reliable. Though information is believed to be correct, it is presented subject to errors, omissions, changes or withdrawal without notice.

While smaller cities and suburbs may continue to be viewed as lower risk in the near term, we believe they will also be lower returning due to heightened competition for deals. The higher returning opportunities are likely in high-density urban environments, and negative sentiment towards these markets could provide real estate investors with a window of opportunity to acquire well-located properties at a discount.

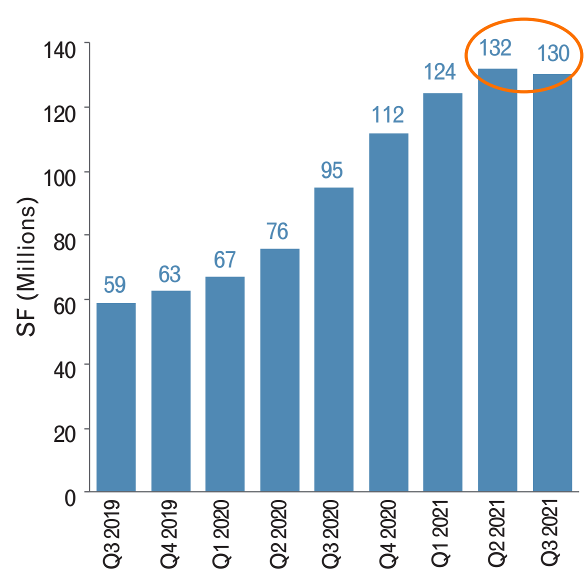
5 Office valuations will stabilize, but fundamentals will remain challenged amid heated competition

The secular shifts affecting the office market have led many to quip that "office is the new retail." Indeed, while the work-from-home (WFH) trend has faded somewhat, there is little doubt that the future of work is hybrid. Most employers recognize that some flexibility around WFH is necessary to retain top talent, and some workers will be allowed to WFH indefinitely. How much this reduces future office demand is still unclear, but consensus estimates generally point to a 10 to 20 percent reduction in occupancy.

Even amid such a contraction, we do not believe WFH's damage to the office market will be on par with e-commerce's impact on retail. Rather, we view WFH as a temporary setback in base-level office demand, with growth resuming as demand stabilizes. Already the office market is exhibiting green shoots that suggest the bottom is near. Net absorption has steadily improved from its Q4 2020 nadir and looks set to turn positive in 2022. Sublet inventory also appears to have peaked in Q2 2021; similar peaks in prior downturns (Q2 2002 following the Dotcom Crash, and Q4 2009 following the GFC) corresponded closely with cyclical bottoms in both office fundamentals and pricing.

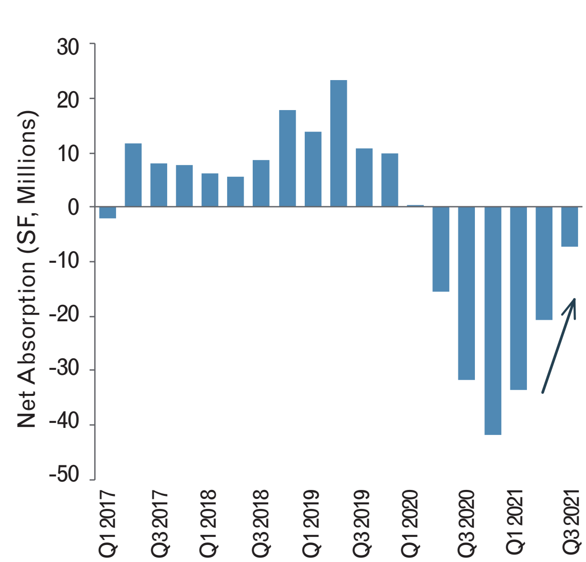
Turning Point

U.S. Office Sublet Inventory, Q3 2019 - Q3 2021



Source: Cushman & Wakefield

U.S. Office Net Absorption, Q3 2017 - Q3 2021



Source: JLL

As a recovering economy generates more jobs, particularly in knowledge-based industries, we believe office occupancy will improve. But the speed and scale of the office market's recovery will vary widely across properties and geographies. WFH taught business leaders that some employees can do their jobs from anywhere, and many are putting that lesson into practice by relocating away from high-cost, high-tax jurisdictions. With many employees still working remotely, the opportunity cost of switching office locations has never been lower. As such, we expect the office recovery in lower-cost, lower-tax markets such as Austin and Miami to continue leading more traditional gateway cities like New York and San Francisco.

The post-pandemic order is likely to produce winners and losers at the property-level as well. The U.S. Energy Information Administration estimates that the median U.S. office building is 40 years old. Older office buildings, particularly in the Class B and C segments, will face severe challenges versus newly built or recently retrofitted competitors. Tenants increasingly demand buildings with modern amenities and technology such as high-quality HVAC and air filtration systems, operable windows, natural light, water and energy efficiency, touch less entry, and attractive common space. Antiquated buildings will likely require expensive upgrades to remain competitive, or else face increased risk of deteriorating fundamentals and functional obsolescence.

Even among newer building stock, a renewed amenity war is likely to pressure office operating margins for the foreseeable future. Operating and capital expenses have increased as buildings strive to remain competitive and provide more tenant services. Tenants extract more concessions that drive down net effective rents, such as lavish TI outlays. Average lease terms are also getting shorter, leading to less stable income streams from office assets.

Despite these headwinds, we believe office remains an indispensable property type for institutional investors. NAREIT estimates that U.S. office stock exceeds 11 billion square feet, and office investments are the most efficient way to deploy large amounts of capital into real estate, especially for cross-border investors. The office sector's recovery and evolution in the wake of the pandemic will undoubtedly create opportunities across the risk spectrum, and we expect institutional capital flows to follow accordingly. Colliers data suggests that office investment volumes have already returned to pre-pandemic levels and look set to increase further in 2022. The office market dynamics have changed following the COVID-19 pandemic, but rumors of office's demise have been greatly exaggerated.

Living at the Office

Converting office buildings to residential apartments has gained newfound interest following the pandemic. From a highest and best use perspective, the idea makes sense: the U.S. has too much antiquated office stock and not enough homes. But such conversions are easier in theory than in practice. The right core and floor plates are crucial to accommodate unit sizes that make sense for residents. Rectangular and square shaped buildings with a single core are better candidates than buildings with odd shapes, and architecture firm Gensler estimates that 70 percent of office buildings won't make the cut. But for the right buildings in the right locations, particularly in the Class B and C segments, office-to-residential conversions could provide attractive redevelopment opportunities.

Office-to-Residential Indicative Post-Conversion Floor Plan and Unit Mix

Source: Gensler

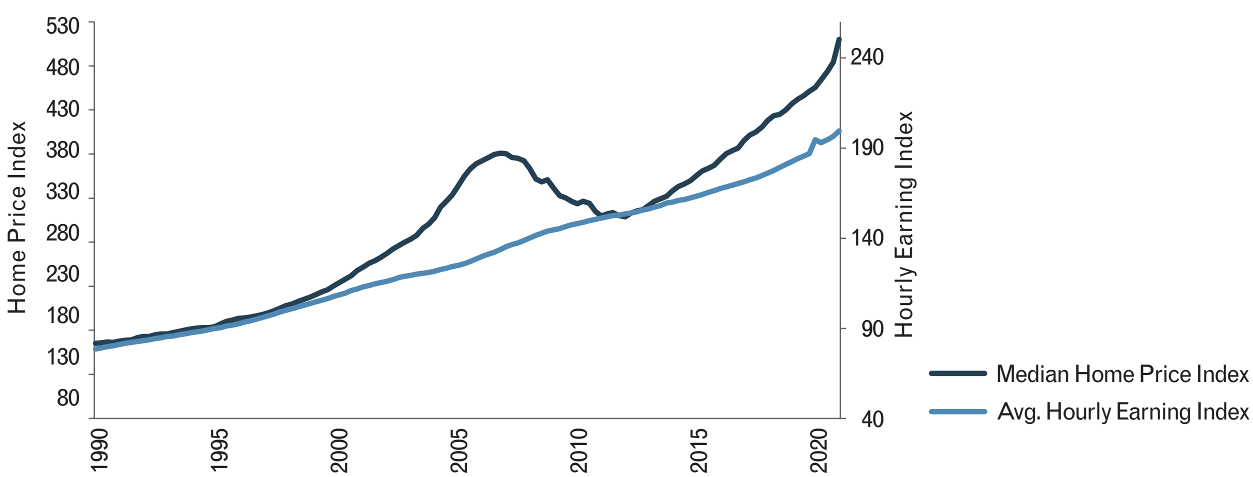
6 Residential segments will benefit from shifting demographics and favorable capital markets

Residential real estate – and multifamily in particular – continued to prove its cyclical resiliency throughout the pandemic, since there is no virtual alternative for a bed and a shower. Investors remain attracted to the residential sector's low volatility, stable cash flows, and secular growth story. Residential also provides an efficient inflation hedge due to shorter-term leases and rents that are closely correlated with nominal household incomes. We expect residential sectors to continue serving investors well in 2022.

The fundamentals underpinning residential real estate today have perhaps never been better. Net absorption outpaced new supply by over 2-to-1 throughout 2021. According to CBRE data, nationwide occupancy rates are at a record high 97 percent, providing rental landlords with considerable pricing power. Average rents were growing at an 8.4 percent annual pace as of Q3 2021, with rents eclipsing pre-pandemic levels in nearly every major market. An expanding economy, job growth, and rising wages should continue to support residential rents in 2022.

Barriers to homeownership should also provide steady demand for rentals. 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. Home prices' meteoric rise during the pandemic has exacerbated the problem, and the affordability gap between homes and wages is now wider than it was even at the height of the housing bubble.

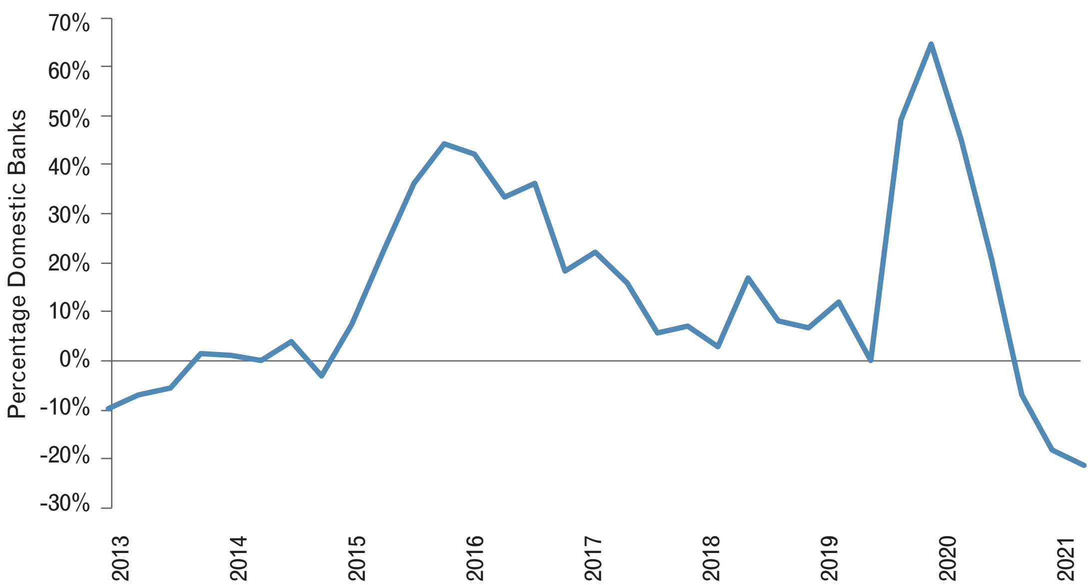
Affordability Problem
Home Prices vs. Wages, 1990 - Present



Source: Federal Reserve Economic Data

Of course, there are still plenty of reasons for investors to remain cautious and selective. More new supply is coming online, which will likely reduce pricing power and lead to slower rent growth than investors are enjoying today. Finding value in today's residential market is also a challenge amid high capital availability and low cap rates. Multifamily investment volume in 2021 far eclipsed prior records as investors piled in. Bank lending standards have also loosened considerably, and an influx of alternative lenders such as private debt funds have pushed down borrowing costs across the risk spectrum. All of this liquidity has led to excellent returns for investors, but it has also made new capital deployment more challenging as competition for deals heats up.

Take My Money
Net Percentage of U.S. Banks Tightening Standards for Multifamily Loans, 2013-Present



Source: Federal Reserve Economic Data

With such strong capital market demand for stabilized multifamily assets, we believe value-add multifamily strategies will continue to offer attractive risk-adjusted returns. Urban multifamily, for instance, is nearing a full recovery from the pandemic even in hard-hit markets like New York and San Francisco. Pandemic-induced changes in renter preferences such as larger unit sizes, healthier building systems, and outdoor common spaces could provide opportunities to redevelop and reposition antiquated properties. Experienced operators and developers should be able to capitalize on these trends.

But one of the best risk-reward opportunities in residential today may be the development of single-family built-to-rent (BTR). BTR properties offer renters many of the benefits of homeownership – space, privacy, yards, driveways, etc – but with no down payment and more flexibility to relocate. From a developer's perspective, BTR properties are typically less complicated to build than traditional multifamily, while commanding higher rents and quick lease-up times. Capital market appetite for stabilized BTR portfolios is also increasing, with market cap rates currently in the 4 to 5 percent range nationwide. Given the substantial yield-on-cost premiums developers can achieve in BTR projects, we expect additional investor interest in BTR development strategies over the next year.

Don't Say the B-word

Of all the market impacts from the pandemic, the white-hot U.S. housing market has been one of the most surprising. The Case-Schiller Home Price Index is recording annualized gains of over 19 percent, the highest levels in records stretching back to 1988. There are several legitimate fundamental drivers of home prices' rise, such as low inventory, high demand, elevated savings, and low interest rates. But housing prices have become completely untethered from median incomes, and disparities of today's magnitude have historically presaged prior housing market downturns: 1979-1982, 1990-1992, and 2006-2010.

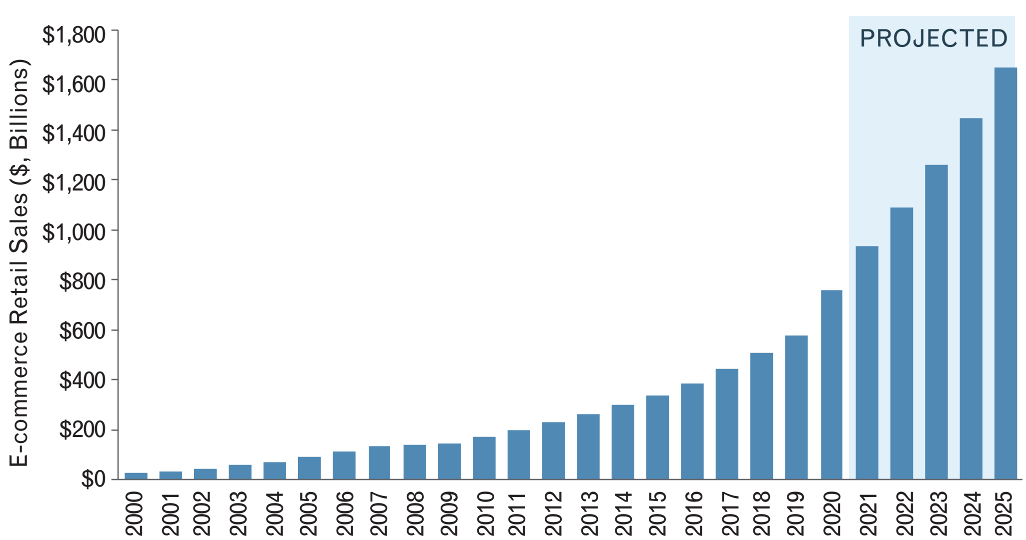
While few economists are worried about a housing bubble, we believe it's a risk worth monitoring. There are, of course, key differences between today's housing market and the 1998-2005 housing bubble. Bank underwriting standards are not nearly as lax, with thorough credit checks required to obtain a loan. There is also less systemic risk from asset-backed securities and derivatives. This makes a dramatic GFC-style crash unlikely. But a modest increase in mortgage rates could still send home prices down, and that would have ripple effects throughout the U.S. economy. Investors (and the Fed) should therefore be mindful of any signs that the housing market is cooling.

7 E-commerce and shifting supply chains will continue to propel industrial higher

Industrial continues to be one of the best performing sectors in real estate. Vacancies remain low despite record new supply, with net absorptions hitting a new record in every quarter of 2021. Rents continue to surge as tenants compete for strategic supply chain advantages. Rent growth has been so strong that rents are often 50 to 60 percent below market by the time a lease rolls.

The growth of e-commerce is of course the primary driver behind industrial real estate's recent out-performance. E-commerce sales growth continues to outpace the growth in consumer spending overall, as online sales steal market share from traditional brick-and-mortar retail. 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 are expected to grow by an additional $800 billion by 2025. This suggests an additional 1 billion square feet of industrial space needed within the next three to four years just to accommodate expected growth in e-commerce.

Tech Support
E-commerce Sales, 2000 - 2025P

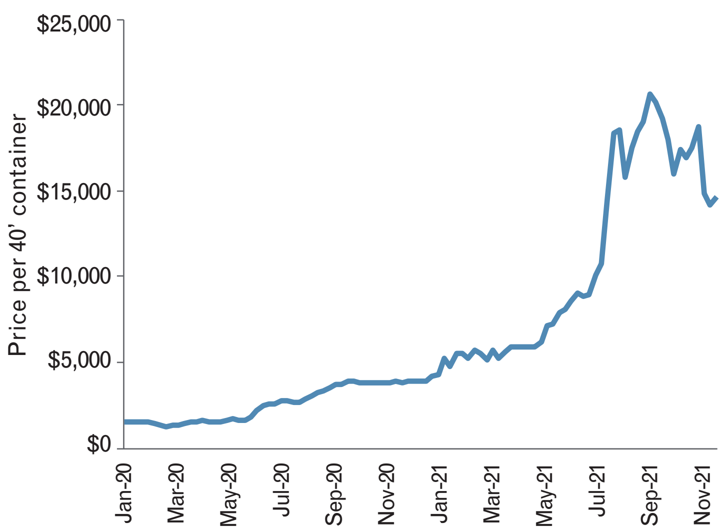


Source: Federal Reserve Economic Data, eMarketer

Beyond e-commerce, we expect several other macro factors will also contribute to strong industrial performance in the years ahead. As businesses compete for ever-shorter delivery times to consumers, industrial facilities located near population centers should experience strong rent growth. Such locations are often viewed as mission critical to a tenant's underlying businessThe higher rent is usually worth it: for logistics-focused industrial tenants, transportation and fuel costs typically compose 50 to 80 percent of total costs, while rent is less than 5 percent.This provides industrial landlords with considerable pricing power, particularly when space availability is low.

New commitments to supply chain resiliency provide yet another potential long-term demand driver for industrial real estate. Supply chain bottlenecks and elevated shipping costs have sparked renewed interest in "re-shoring" high-tech, strategically important manufacturing sectors such as semiconductors, pharmaceuticals, and metal alloys. More businesses are also pivoting away from "just-in-time" inventory management towards a "just-in-case" model, with more inventory held in reserve. Inventory levels are already at record lows and restocking to normal levels is likely to take several years, with demand for warehouse space rising in tandem.

Pandemic Shockwaves
East Asia-North America West Coast Sea Freight Prices, Jan 2020 - Nov 2021



Source: Freightos Baltic Index

With industrial out-performance showing no signs of slowing, capital markets have responded in kind. According to Real Capital Analytics, institutional investor allocations to industrial have risen by over 60 percent since 2016. Such strong investor demand creates opportunities in higher-returning investment strategies such as value-add and development. From a development perspective, industrial benefits from relatively short delivery times, predictable demand, and the ability to deliver at yields 75-150 bps above market cap rates. Industrial sectors characterized by smaller, less institutional properties such as last-mile and industrial outdoor storage may also provide portfolio aggregation opportunities that command yield premiums on exit. We believe these types of strategies offer some of the best risk-adjusted returns available in commercial real estate today.

8 Stabilizing fundamentals will draw more capital into the retail sector

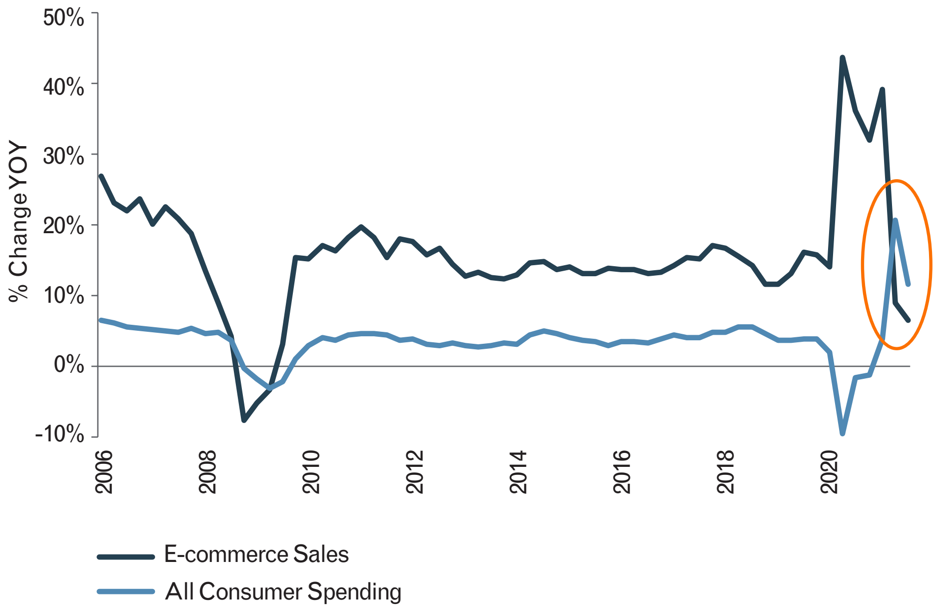
Retail continues to be one of the most challenging sectors in real estate. The last several years saw wave after wave of store closures, with the COVID-19 pandemic dealing the heaviest blow in 2020 with over 12,000 stores closing. The carnage has been so widespread and unrelenting that many real estate professionals have given up trying to call a bottom in retail. But one must assume (optimistically, perhaps) that retail's Darwinian evolution will eventually run its course, and the survivors will be stronger for it. Indeed, signs are emerging that the retail sector may finally be stabilizing, with increased investment activity perhaps not far behind.

The first hopeful sign comes from store openings: for the first time since 2017, more stores opened than closed, for a net gain of over 4,000 according to JLL. As of Q3 2021, the retail sector had recorded four consecutive quarters of positive net absorption, as well as three consecutive quarters of rising average asking rents. Even the beaten down mall sector saw positive net absorption for the first time in two years, with foot traffic exceeding pre-pandemic levels according to CBRE.

This turnaround in fundamentals occurs as retail has had to adapt more than perhaps any other real estate sector throughout the pandemic. Rapid transformations to retail business models, such as curbside pickup, more home delivery options, and compliance with various health and safety protocols, often required reconfigured store layouts. Retail landlords have also experimented with turnkey retail offerings for experiential pop-up shops and "test locations" for retailers considering a permanent store. While disruptive and expensive, these innovations have made retailers more economically efficient and improved sales-to-square footage ratios. As the saying goes, necessity is the mother of invention.

Retail is also benefiting from pent-up demand from consumers eager for live entertainment and in-person experiences. Tellingly, brick-and-mortar retailers have been gaining market share versus e-commerce since Q2 2020. In 2021, Cyber Monday sales even fell for the first time, while physical store traffic for Black Friday gained 61 percent compared to 2020. In the same way that more physical retailers now have omni-channel models, many digitally-native brands have also recognized the strategic advantages of a physical retail footprint, including increased online sales in the local vicinity. Colliers estimates that by 2025 approximately one third of all digital transactions will be fulfilled at a physical retail location. E-commerce will continue to provide stiff competition for physical stores, but recent trends suggest a more balanced duopoly between e-commerce and physical retail going forward.

A Brick-and-Mortar Moment?
E-commerce vs. All Consumer Spending, 2006 - Present



Source: Federal Reserve Economic Data

As retail's fundamentals stabilize, property values also appear to have found an appropriate risk-reward balance after a multi-year repricing. Some investors have started to take note of the out-sized yields available at properties with perceived tenant risk despite healthy foot traffic and sales. Certain malls could also provide interesting redevelopment plays, as they tend to be well-located near population centers. With mall vacancy still above 7 percent nationwide, we expect more big box anchors to close, thereby freeing up their space – and land – for other uses such as multifamily. And as more malls get redeveloped, mall fundamentals could find firmer footing due to reductions in overall supply.

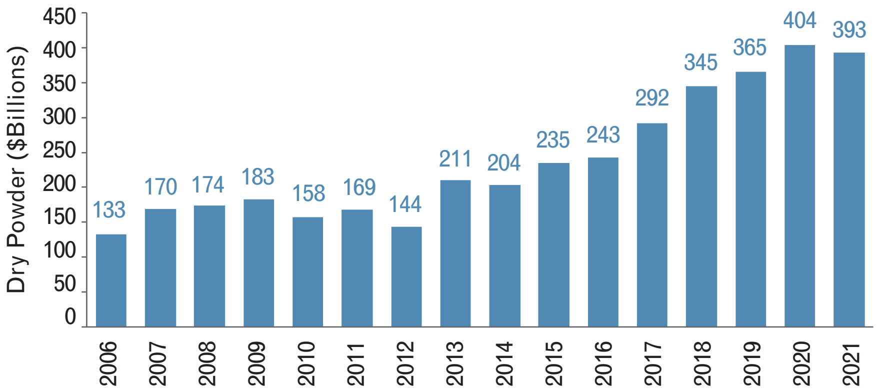
For real estate investors, retail's continued evolution will produce winners and losers. Creative destruction is far from over: e-commerce has lowered barriers to entry and will force brick-and-mortar incumbents to constantly adapt and improve. But retail is still a vital amenity within a broader mixed-use context. As retail's post-pandemic chapter unfolds, we expect that nimble managers with strong operating capabilities and creative foresight will uncover high alpha opportunities.

9

Private capital flows into real estate will remain elevated as institutional investor allocations expand further

Following a pandemic-induced slowdown in 2020, real estate transaction volumes came roaring back in 2021 as investors made up for lost time. According to CBRE, Q3 2021 investment volume of over $180 billion was the highest since at least 2005. This represents a +160 percent increase from pandemic lows, and an +18 percent increase from Q3 2019, before the pandemic hit. We expect transaction volumes to remain elevated in 2022 as real estate investors seek to put ever-higher sums to work.

Ready to Work
Dry Powder: Closed-End Private Real Estate Funds, 2006 - Present

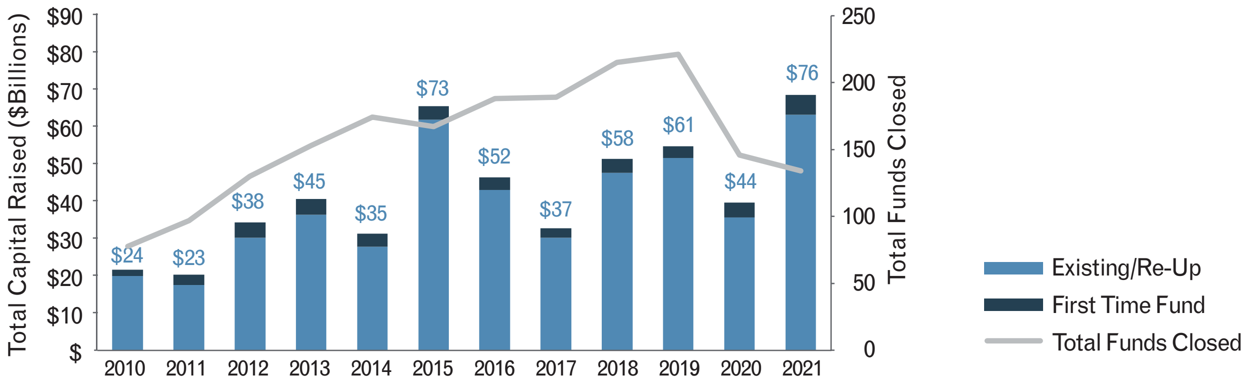


Source: Preqin

Institutional investors' average target allocations look set to surpass 11 percent in 2022 as real estate's strong performance, stable income stream, and portfolio diversification benefits remain attractive. The "denominator effect" is also driving new capital into real estate, as strong performance by public markets and slow capital deployment during the pandemic have caused many institutions to be under-allocated versus target. With investors remaining bullish on real estate's future prospects, we expect fundraising volumes to reclaim pre-pandemic highs in 2022.

Despite this favorable environment, private equity fundraising remains as competitive as ever. As alternative investment portfolios become more mature, institutional investors have increasingly defaulted to re-upping with existing managers. And the more established managers continue to raise larger funds, with fewer funds reaching final closes overall. Preqin data suggests that only 134 U.S. funds reached a final close in 2021, the lowest total since 2012, and the average fund size reached an all-time high of $570 million.

The Incumbency Effect
Re-Up vs. First Time Funds (Closed-End Commingled Value Add & Opportunistic), 2010 - Present

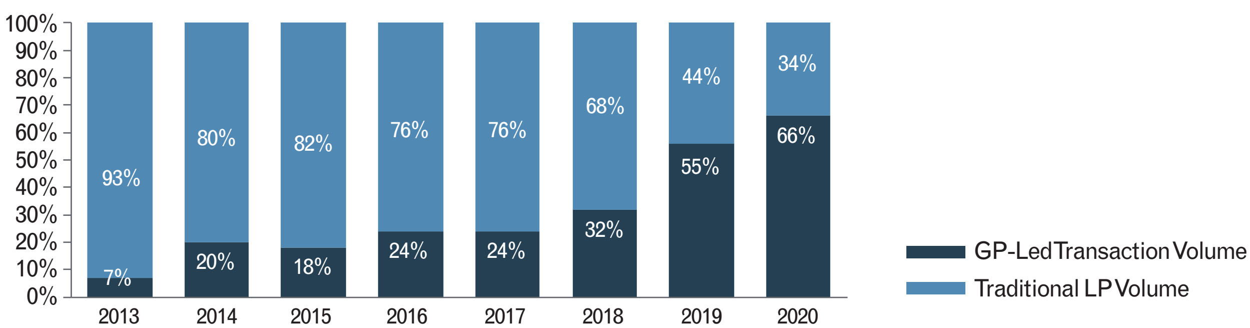


Source: Preqin

Manager differentiation and specific competitive advantages are therefore key to fundraising success. As the definition of "core" real estate expands beyond the major property types, managers focusing on niche sectors such as data centers, cell towers, medical office, or life sciences could succeed by offering investors further portfolio diversification. Unique sourcing angles or other expertise in favored property types such as industrial or multifamily are other potential avenues. Creative use of technology in the investment process is also a plus.

More real estate managers are also exploring alternatives to the typical 8-to-10-year private equity structure to raise capital. In particular, single-asset or portfolio secondaries have gained in popularity as a way for managers to secure new institutional capital partners, refresh business plans, restructure ownership, and form continuation vehicles. These types of GP-led recapitalizations now constitute the vast majority of real estate secondaries trades, and several investment managers have launched dedicated secondaries vehicles to capture this burgeoning new source of deal flow. Occasionally, a secondaries transaction can help an emerging manager jump-start a funds business through a "stapled primary" commitment from a reputable capital partner. We expect GP-led secondaries volume to increase further in 2022.

Paradigm Shift
Real Estate Secondaries Volume by Source, 2013 - 2020



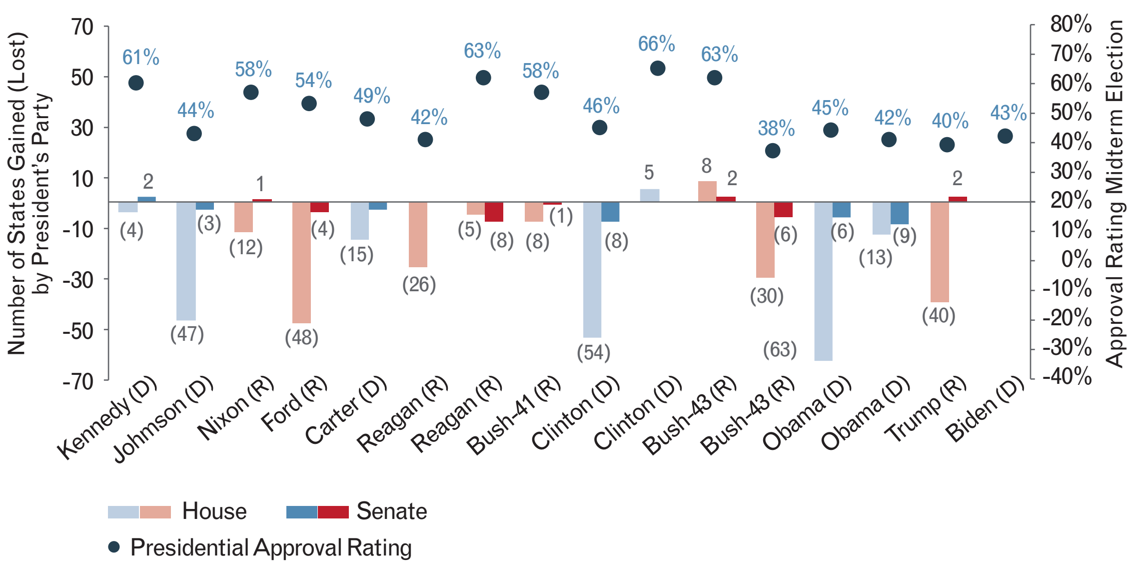
Source: Park Madison Partners

10 Republicans will sweep the 2022 midterms

Park Madison Partners has a lot of friends and we like to keep it that way, which means we tend to avoid political predictions that favor one side over the other. But politics defines policy and policy affects markets, so we think it's important to know which way the wind is blowing. As we enter the 2022 midterm election cycle, we believe all signs point to a Republican takeover of Congress.

First, political history is against the Democrats. Since the nation's founding, the incumbent President's party has lost seats in Congress in all but five U.S. midterm elections. The most recent exception to the rule was 2002, when Republicans under President George W. Bush's leadership benefited from a tidal wave of goodwill following the 9/11 terror attacks. But in most cases, presidents tend to lose seats during the midterms, and unpopular presidents fare much worse. At the time of this writing, President Biden's approval rating stands at just 43 percent according to Gallup Polling.

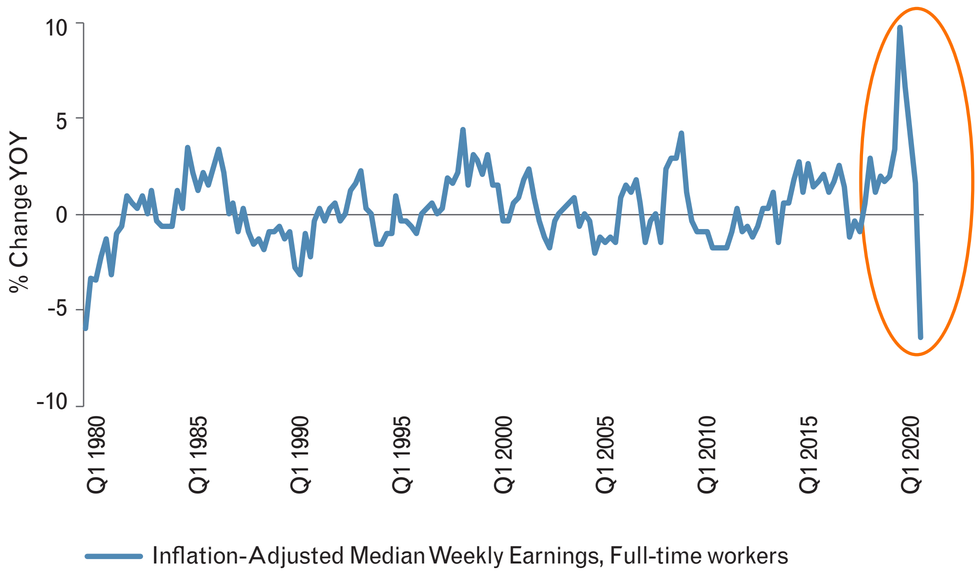
Routine Shellackings
Presidential Approval and Midterm Election Results, 1962 - Present



Source: Gallup, New York Times

Biden's low approval rating reflects a souring national mood on a number of issues, but inflation seems to be the biggest culprit. Despite rising wages across industries, inflation has eroded many of the gains. Consumers are now feeling the pinch of rising prices across most household staples from groceries to gasoline, and headline inflation numbers fail to capture the sheer magnitude of price gains in these categories. For example, as of November beef prices were up 20 percent year-over-year, and gas prices were up 59 percent. Such increases are forcing low- and middle-income consumers to change their shopping habits, and they aren't happy about it. Fair or not, voters tend to place blame on the party in charge. A November Washington Post/ABC News poll showed Republicans enjoying their largest generic ballot lead since the poll's inception in 1981.

Reversal of Fortune
Real Wage Growth, 1980 - Present



Source: Brookings Hutchins Center Fiscal Impact Measure

As such, we expect to see a Republican wave on par with 2010, with similar economic and policy implications. Following President Obama's "shellacking" in the 2010 midterms, Republicans ground his legislative agenda to a halt for the remainder of his time in office. Federal spending was curtailed, culminating with the 2013 budget sequestration which imposed severe automatic cuts to discretionary spending. As a result, the Federal Reserve was forced to remain accommodative for much longer than anticipated to keep the post-GFC recovery on track. We expect similar dynamics following the 2022 midterms.

For the U.S. economy and real estate investors, the near-term implications of Congressional gridlock are most likely lower growth, lower inflation – and therefore continued low interest rates. While low rates may be good news for asset prices, we worry about the effect of dysfunctional government on longer-term U.S. economic competitiveness, as well as the increased risk of partisan brinkmanship on issues such as the debt ceiling. But much like the U.S. economy, the U.S. political system is incredibly dynamic and typically provides the engine for its own renewal. We remain hopefully optimistic that despite today's polarized political environment, America's leaders and policymakers will rise to meet the challenges of the 21st Century – and ensure that the U.S. model remains a guiding light for the world.

2021 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 by acknowledging that COVID-19 will undoubtedly have a lasting impact on the global economy and real estate markets, but advising our readers to avoid the temptation to "fight yesterday's war" when positioning their portfolios. This mindset set the tone for most of our predictions. The pandemic's staying power caused us to miss in a few places, particularly calls related to office and senior housing. But most of our predictions appear to have aged quite well.

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

SCORE: **10/10**

Given the Congressional Budget Office's (CBO) July 2020 estimate that U.S. real GDP would not approach its pre-pandemic baseline until 2028, we predicted a continued barrage of fiscal and monetary stimulus to push the U.S. economy back to its pre-pandemic trajectory. Indeed, Congress passed the $1.9 trillion American Rescue Plan and the $1.2 trillion Investment in Infrastructure and Jobs Act, and the Fed kept monetary policy extraordinarily accommodative even in the face of rising inflation. Thanks in large part to these measures, the CBO now estimates that U.S. real GDP will exceed its pre-pandemic trajectory starting in early 2022. Maybe not our boldest prediction, but a 10/10 nonetheless.

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

SCORE: **10/10**

We predicted that institutional real estate allocations would continue expanding, and any pandemic-related financial distress would be relatively short-lived compared to the GFC due to capital market liquidity and low interest rates. We also suggested that capital flows would likely follow residents and corporations who are relocating to more business-friendly jurisdictions. Both of these calls largely played out as we expected. We also predicted that cap rates would remain low along with interest rates, and for some property types cap rates have compressed further.

2021 Scorecard

3 Urban environments will bounce back

SCORE: **8/10**

As a New York-based company, we were pretty fired up over proclamations that New York City was "dead," and our pushback against this narrative extended to all high-density urban environments. We discussed the vibrancy of urban mixed-use settings, the economic benefits of industry clustering, and the overall cultural experience that urban life brings. We conceded that the pandemic had temporarily impaired these attractions, but argued that they would recover strongly as the pandemic subsides. We feel vindicated by the progress we've seen over the last year. But we acknowledge that the pandemic has lingered longer than any of us would have hoped, which has caused certain "urban health indicators" such as office occupancy and mass transit usage to continue lagging pre-pandemic levels. So our 8/10 reflects the directional accuracy of our call, with a nod to our conviction that further improvement still lies ahead.

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

SCORE: **4/10**

After feeling burned out from 9 months of Zooms, we declared that early enthusiasm for WFH was overblown and that WFH would become less popular once the pandemic ends, while acknowledging that a "hybrid" model with 1-2 days per week spent remotely remained likely. An October 2021 Gallup poll suggested that 76 percent of U.S. workers expect their employers to retain a hybrid model going forward, so we feel good about that call. But the Delta and Omicron variants frustrated our Q3 2021 return-to-office timeline, and as a result office market fundamentals remain challenged. So we are taking our 4/10 with stride, but remain optimistic that this prediction will be closer to 10/10 by the end of 2022.

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

SCORE: **8/10**

We predicted that sustained secular tailwinds such as elevated home prices, household formation, and the growing prevalence of "renting-by-choice" would continue to support healthy multifamily demand in the years ahead. We also noted the increased market optimism for SFR development. Our one miss was in calling for a recovery in senior housing, which like several of our other calls was hindered by continued COVID-19 flare-ups (though the longer-term outlook remains positive). But we'll happily take our 8/10 on this one.

2021 Scorecard

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

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 have been fueling increased demand for industrial. Development even remained attractive, as rent growth has largely kept pace with increasing land prices.

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

SCORE: **10/10**

We chose our headline well on this one. Retail is by no means firing on all cylinders, but we correctly predicted that COVID-19 provided the sharp culling that the retail industry badly needed. The pandemic's survivors are now reaping the benefits of shoppers returning to physical stores. Even malls are experiencing higher foot traffic than before the pandemic according to data from several brokerage firms. That said, we predicted that overall retail square feet per capita was due to shrink in the coming years, which could lead to some attractive repositioning or redevelopment plays. We are starting to see more of these emerge, particularly in urban infill locations.

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

SCORE: **10/10**

We suggested that fundraising volumes would recover, but that the market would remain very competitive for emerging managers as investors stick with established, incumbent managers. Indeed, the pandemic continued to present an obstacle to travel and in-person meetings, making it more difficult for emerging managers to foster the necessary relationships to raise institutional capital. The largest, most established managers were clearly the net beneficiaries of this obstacle, 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 2021 appears to have been a watershed year for GP-led secondaries. We'll keep our day jobs for now.

2020 Scorecard

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

SCORE: **5/10**

We made essentially the same prediction on climate in both 2020 and 2021: the multitude of physical, financial, and regulatory threats from climate change will significantly impact real estate investment decision-making in the coming years. In 2021 we finally started to see more investors at least asking the hard questions, such as which locations' long-term viability was threatened by rising sea levels. We also witnessed a notable uptick in questions on climate-related risk from institutional investors during manager and fund due diligence. But so far the financial and regulatory penalties for climate-vulnerable locations have been limited. For instance, commercial real estate demand continues to rise in flood-prone South Florida, and even home prices in wildfire-ravaged Northern California show no signs of weakness. While we believe we'll be proven correct eventually, the transition to a more climate-conscious real estate industry may end up resembling climate change itself: gradual and indiscernible in the moment, but clearly visible on longer timescales.

10 The real estate industry will become more diverse and inclusive

SCORE: **TBD**

We predicted that the real estate industry would finally take redressive action on racial inequalities at investment managers and lending institutions. We certainly saw more firms focused on promoting diversity, either by changing their hiring practices or supporting organizations that promote real estate job opportunities for underserved demographics, such as Sponsors for Educational Opportunity (SEO) and the PREA Foundation. But there is still much work to do, and we anticipate it will take many years – perhaps decades – for the real estate industry to become truly representative of the population it serves. So with that, we give ourselves a hopeful and optimistic "TBD."

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 advised on over $20 billion in private capital placements 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 closed-end funds, open-end funds, separate accounts, programmatic joint ventures, and recapitalizations.

Park Madison Partners is a member of SIPC-FINRA and is certified with the Women's Business Enterprise National Council. For further information, please visit parkmadisonpartners.com.

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