2024 Real Estate Outlook

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Introduction

2023 presented several challenges for most real estate managers – a theme we expect to carry over into 2024 as higher interest rates, limited credit availability, and persistent inflation may continue to apply negative pressure to existing portfolios and limit the ability of managers to raise and invest new capital. While we expect many firms will be working to rebalance their portfolios, Blue Owl is well positioned to deploy over $5 billion in dry powder and to act on the best buying opportunity we have seen in two decades. In particular, there are three themes we anticipate being prevalent in private equity real estate throughout 2024.

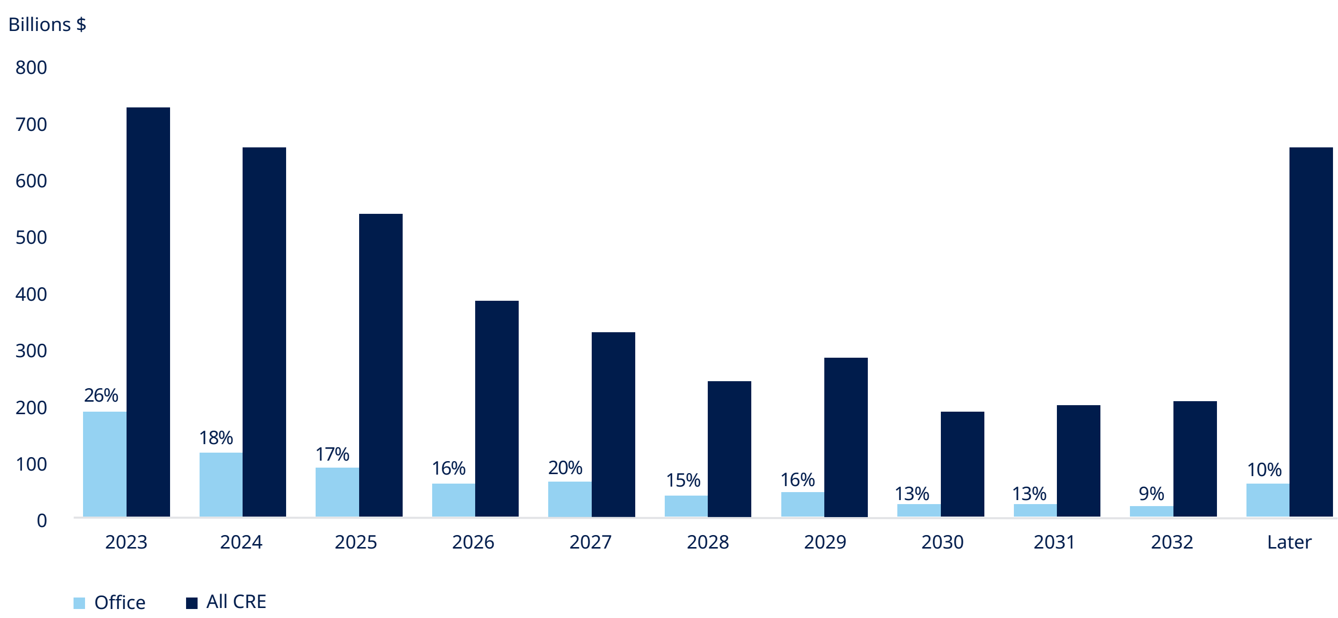
1. A perfect storm in sale leasebacks: attractive supply/demand dynamics continue
2. Opportunities at the top: scaled managers capitalizing on the onshoring trend
3. Net lease remains well-positioned in today's environment

1 A perfect storm in sale leasebacks: Attractive supply/demand dynamics continue

We believe real estate investors face a number of challenges in the current macro environment. Real estate transaction volume declined over 50% in 2023 and remains low as many investors are likely finding it increasingly difficult to successfully deploy capital in a high interest rate environment with fewer debt providers actively lending in this market.[1] At the same time, those lenders that are providing new capital have tightened their already stringent underwriting standards and are exercising caution over which deals they finance while simultaneously preparing for the mountain of looming debt maturities that will soon become reality.[1] In the next three years, an estimated $2 trillion of commercial real estate loans will reach maturity, causing many industry experts to conclude the worst has yet to come as room exists for portfolio deterioration to continue, especially for those with office space exposure.[2] Investors' hesitation to allocate new capital towards real estate investments is evidenced by the fact that 2023 is expected to be recorded as the lowest annual commercial real estate fundraising total since 2012.[3]

Figure 1

CRE loan maturities by year[4]



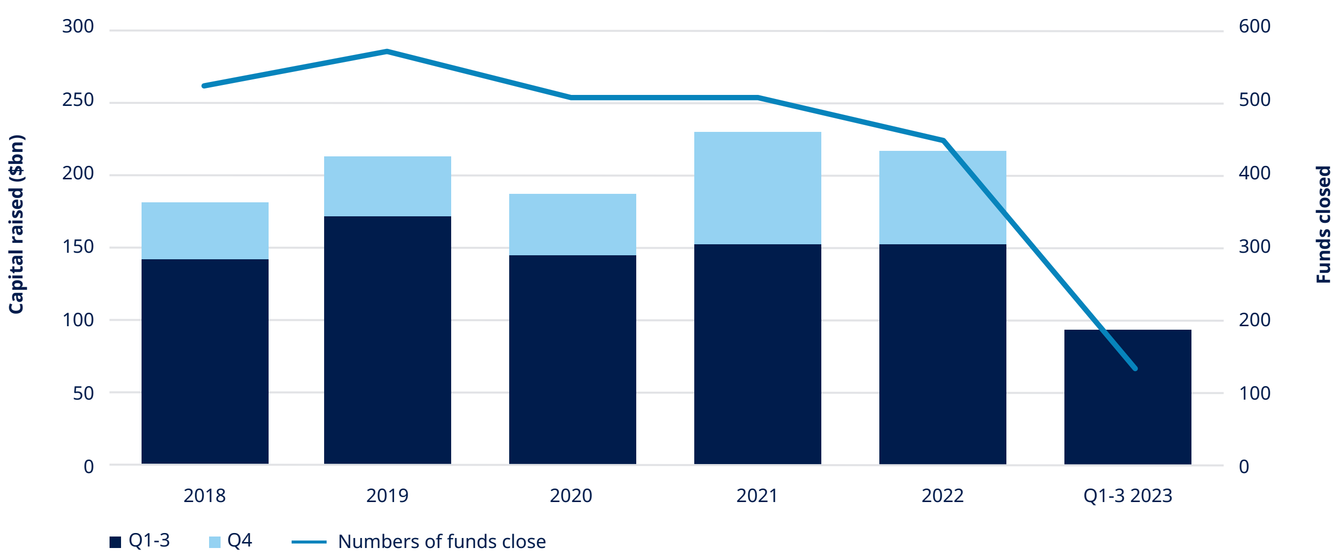
[1] Source: Wall Street Journal, "The Money Has Stopped Flowing in Commercial Real Estate" published October 31, 2023
[2] Source: CBRE: "Commercial Loan Losses to Create Short-Term Pain, Long-Term Opportunities" published July 13, 2023
[3] Source: Fortune "Commercial real estate valuations are so hard-hit that CBRE warns they could fall 'another 10%,' after saying earlier they 'may come down 15%, 20%'" published November 9, 2023
[4] Source: Mortgage Bankers Association, January 2023

Having acknowledged the current challenges and emerging distress in the market, we feel strongly this will present compelling investment opportunities for investors adopting Sam Zell's "gravedancer" mentality of reviving deteriorating investments. While others may be focusing on the problems in their existing portfolios, Blue Owl Real Estate is in the early innings of pursuing what we believe to be one of the best buying opportunities we have seen since our founding. We would argue that a corporation's need for liquidity is more crucial than ever in today's economy, and we are seeing many firms turning to sale-leaseback transactions to access capital and to finance their various business initiatives. We believe we have developed a niche for ourselves in the industry as a flexible and creative capital solutions provider that can transact at scale. Our proactive investment sourcing approach of developing direct relationships with companies and their most trusted advisors has created more unique and bespoke opportunities for Blue Owl Real Estate than one may see in the brokered market. Our expertise is centered around problem solving and presenting solutions to company decision-makers with the goal of helping them optimize their balance sheets and utilize their own capital more efficiently. Rather than just executing a standard real estate transaction, we are serving as a capital solutions provider to the company, which is how we have been able to meaningfully drive attractive pricing and deal terms. Our ability to buy assets at considerable spreads to the broader market has resulted in steady valuation growth in our existing portfolios and has also allowed for more opportunity to monetize assets with compression, even in this environment.

We believe that sentiment has resonated with investors as Blue Owl Real Estate has been able to raise over $7 billion of new capital in the last 18 months, notwithstanding an extremely difficult fundraising environment. Additionally, we have closed or placed under contract approximately $8 billion of real estate in the last 12 months and expect to continue that trajectory in 2024 given the increased need for capital and the significant amount of dry powder we have available.

Figure 2

Year-on-year fundraising – Private equity real estate[1]



[1] Source: PERE: Fundraising Report Q3 2023

2 Opportunities at the top: scaled managers capitalizing on the onshoring trend

As geopolitical tensions and supply chain issues continue to dominate headlines, we've noticed companies elevating "onshoring" to the top of their priority list. This trillion-dollar movement to bring manufacturing back to the U.S. from overseas should enable companies to reduce their exposure to and dependence on the global economy. Separate from the more publicized geopolitical conflicts happening around the world, there is another "war" happening in our own backyard – the so-called Chip War.[1]

Geopolitical power, measured in military and economic might and influence, is built upon a foundation of semiconductors and microchips which stand as arguably the world's most critical technologies. This trillion-dollar industry has been identified as a national security issue for the United States as only 12% of semiconductor chips are manufactured in the U.S.[1] Meanwhile, Taiwan is currently the center of gravity in the microchip ecosystem, producing over 60% of the world's semiconductors and over 90% of the most advanced semiconductors. Taiwan's outsized weighting as a producer of this critical technology, combined with China's political aggression in the region, may represent a critical risk for the United States and companies globally.[2]

The onshoring trend is not a brief investment opportunity or moment in time; it has the potential to be a transformational manufacturing renaissance in the United States. We believe we are entering an era of firms developing multi-billion-dollar facilities and investing significant dollars into infrastructure and supply chain improvements. The chip industry now produces in one year more transistors than the combined quantity of all goods produced by all other companies in all other industries in all of human history.[3]

Figure 3

Semiconductor market size, 2022 to 2032[4]

[1] Source: CNN Business "The US is spending billions to boost chip manufacturing. Will it be enough?" published October 18, 2022
[2] Source: The Economist "Taiwan's dominance of the chip industry makes it more important" published March 6, 2023
[3] Source: Nasdaq.com, "Global Chip Race: Everything Investors Need to Know" published October 26, 2023
[4] Source: Precedence Statistics as of June 2023

Leading technology companies such as Intel, Micron, and Samsung have been at the forefront of the movement as they look to create advanced semiconductor and chip manufacturing facilities. President Biden has announced multiple government incentives, including the Inflation Reduction Act, the Infrastructure Investment and Jobs Act and the CHIPS and Science Act, to encourage companies to "Invest in America".[1] However, we believe these incentives don't even scratch the surface of what may be required to build out leading edge chip fabrication facilities which can cost in excess of $25 billion.[2] A substantial amount of private capital is likely going to be needed to fill the gap.

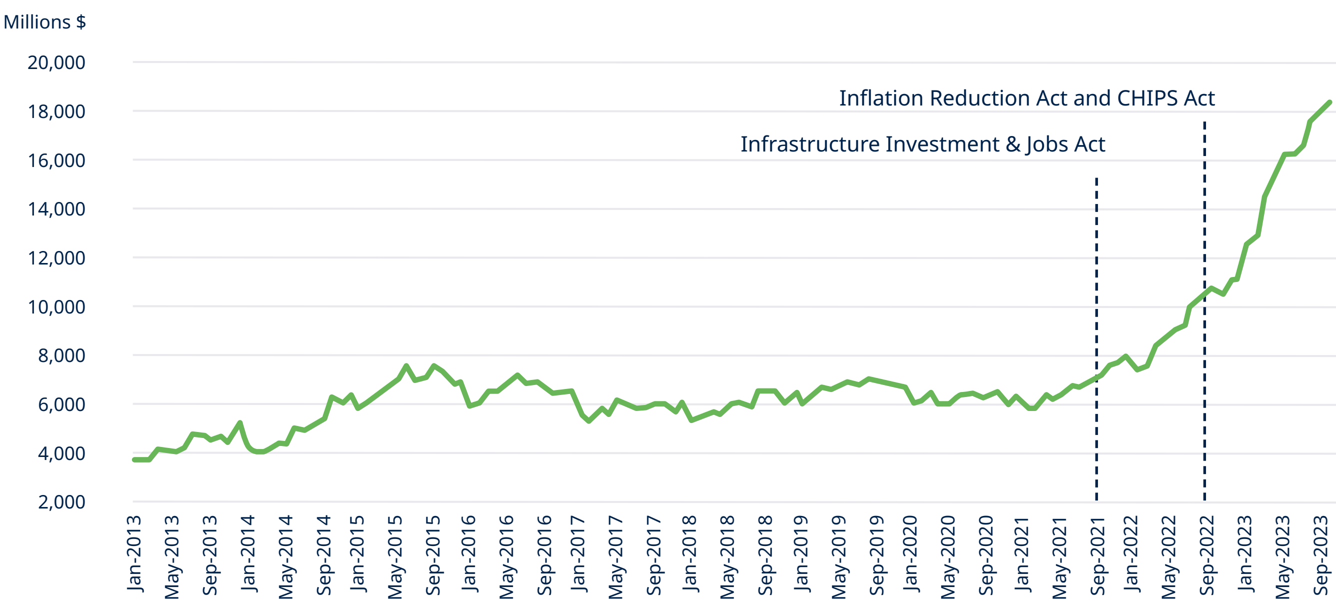
We believe the significant capital need has led companies to strongly consider sale-leaseback transactions to help finance the projects and this movement has created a significant pipeline of investment opportunities for Blue Owl Real Estate.

Considering the sheer scale of these developments, we believe there are very few groups that can provide the capital and depth of partnership for these types of transactions the way Blue Owl Real Estate's platform has proven to do. We have been able to establish ourselves as a knowledgeable, creative, and flexible capital solutions provider which we believe positions us as a partner of choice.

As such, these assets will not only be mission critical to the companies themselves, but more importantly, they are expected to be critical to the economy of the United States. This aligns well with the investment thesis that Blue Owl Real Estate has maintained since Day 1 of targeting a company's most mission critical assets. We believe our long-standing track record of success, coupled with billions in available investment capital, positions us to take advantage of these opportunities in the near term.

Figure 4

Total private construction spending: U.S. Manufacturing[3]



[1] Source: Precedence Statistics as of June 2023

[2] Source: Investors Business Daily, "Intel, TSM And Samsung Are Point Players In U.S. Construction Boom" published September 28, 2023

[3] Sources: FRED Economic Data, U.S. Census Bureau as of October 31, 2023

3 Net lease remains well-positioned in today's environment

As investors continue to face ongoing uncertainty, we believe net lease transactions should become more appealing to both buyers and sellers. From a seller's perspective, disposing of real estate can be a way to access liquidity to fuel growth or more efficiently utilize their capital. A substantial amount of value locked up in real estate may not be the highest or best use of capital. From a buyer's perspective, investors can access an income-generating asset with the potential for lower volatility and the potential for additional diversification. The net lease structure seeks to provide inflation protection through its insulation from operating expenses for the buyer, as expenses in a triple net structure are the responsibility of the tenant. The structure looks and feels very similar to a bond but seeks to provide additional capital preservation through the real estate serving as collateral.

Blue Owl Real Estate's sole focus since launching in 2009 has been pursuing net lease transactions. The structure of our triple net leases seeks to insulate us from rising expenses and delivers a predictable income stream to our investors. We believe stability and predictability of returns are top of mind for investors in today's market, which has translated to meaningful demand for net lease real estate investments. Blue Owl's net lease real estate strategy has maintained the singular focus of providing attractive risk-adjusted returns through long-term, contractual cash flow by acquiring mission-critical real estate backed by investment grade or creditworthy entities.[1] Our stringent investment criteria have allowed our strategy to perform well in varying economic environments, and we believe the strategy continues to be well positioned to pursue favorable yields and total returns for our investors for the foreseeable future.

Conclusion

Despite the noted macroeconomic and geopolitical disruptions, today's market may present one of the most attractive investment opportunities for net lease real estate strategies. Blue Owl's bespoke approach to origination and ability to transact in off-market deal flow enables us to act on opportunities that we believe are unavailable to most participants. We believe the need for flexible and reliable capital providers combined with our scale, speed and certainty of execution, make Blue Owl a partner of choice, attributes we look forward to continuing as we enter 2024.

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[1] Investment grade companies must have "BBB-" rating or higher by S&P or an equivalent rating from a nationally recognized statistical rating organization (NRSRO). Creditworthy refers to businesses that Blue Owl deems financially sound enough to justify an extension of credit or engage in a lease agreement.

Important information

Unless otherwise indicated, the information referenced herein is as of September 2023.

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