ElmTree Funds
PRIVATE EQUITY REAL ESTATE

ElmTree Funds TRACKER

2015 VOLUME 5

IN THIS ISSUE

2015 market**Outlook**

2014 marked another strong year for the U.S. Commercial Real Estate sector highlighted by strong returns in the equity market. The FTSE NAREIT Composite returned 27.23% for the year, continuing its upward trend evidenced by a 5-Year total return of 84.10%. However, going forward there are two factors that will critically impact the U.S. Commercial Real Estate landscape: First, increased capital inflow will continue to drive transactional volume. Second, a rising interest rate environment may force investors to consider a capital redeployment into other asset classes.

There have been several factors that have been driving demand throughout the U.S. Commercial Real Estate sector. First, strong returns have spurred investor interest within the sector. REITs have taken advantage of strong investor appetite by raising significant amounts of capital through several equity and debt issuances over the past three years. Second, global uncertainty has led foreign investors into the U.S. Commercial Real Estate sector in search for yield. With interest rates near all-time lows abroad, foreign investors are pouring capital into the U.S. real estate market.

These foreign investors are primarily focused on capital preservation and are willing to accept lower yields, particularly for trophy assets located in core markets such as New York, Chicago, and Washington, D.C. Lastly, real estate has become a more accepted asset class. More retail investors are allocating a larger portion of their investment portfolios to real estate. This has allowed new competitors, such as small private equity funds, to raise money from high net worth individuals and family offices to compete in the sector.

Year-on-Year Performance - Total Return

Index % (USD)	2010	2011	2012	2013	2014
FTSE NAREIT Composite	27.6	7.3	19.7	2.3	27.2
FTSE NAREIT All Equity REITs	27.9	8.3	19.7	2.9	28.0
FTSE NAREIT Mortgage REITs	22.6	-2.4	19.9	-2.0	17.9
FTSE NAREIT Real Estate 50	26.7	9.4	18.0	-0.5	28.7

2015 marketOutlook (continued)

Foreign Capital Pouring Into U.S. CRE

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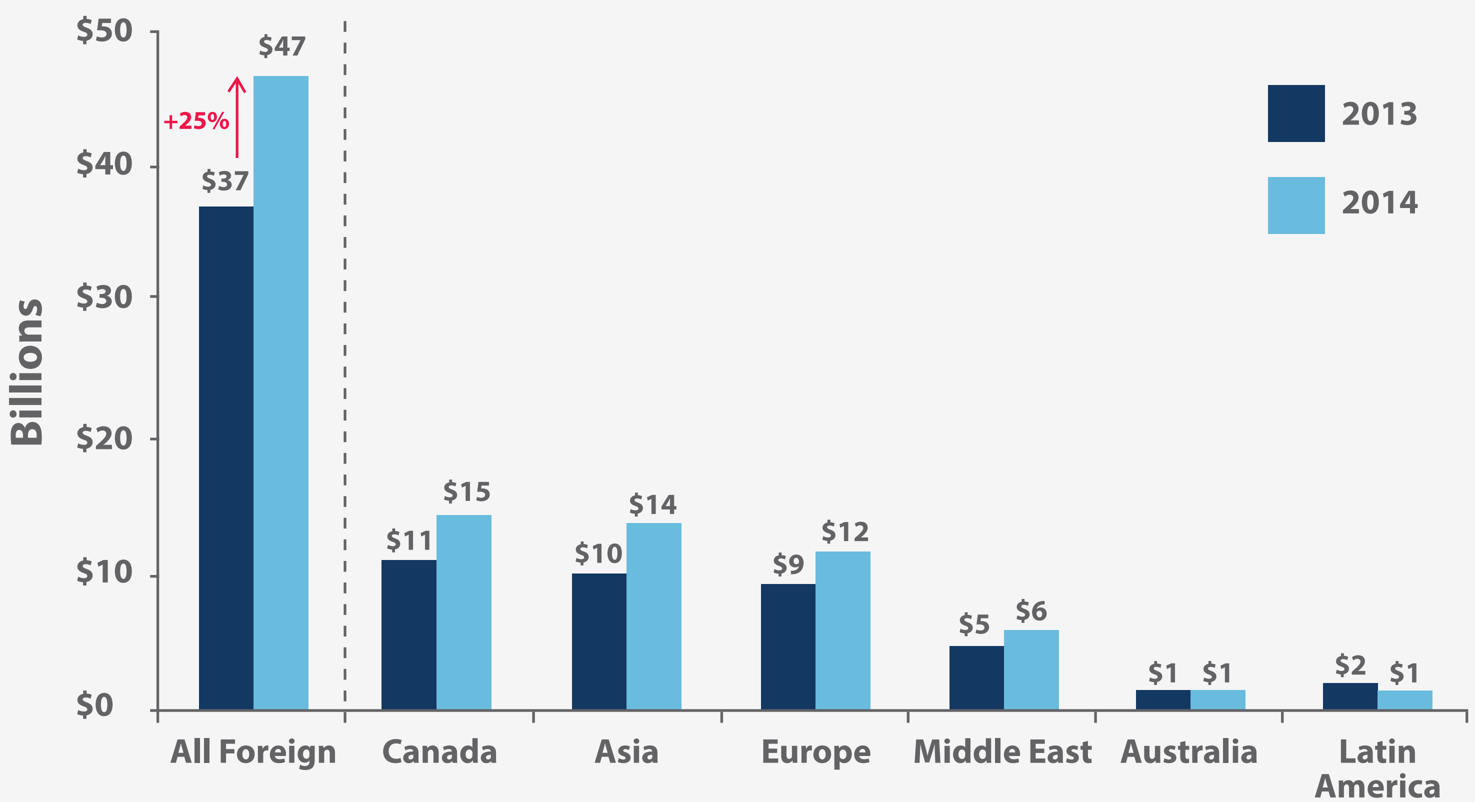


Increased capital inflow has driven competition for assets, fueled transaction volume, and compressed capitalization rates. Since the crater in 2009, known as the Great Depression, transaction volumes have steadily risen, nearly quintupling over a six year period. Currently, transaction volume is on pace to reach between $55B - $60B for fiscal year 2015, representing a 10%-20% increase year-over-year.

Consequently, cap rates have continued to compress and are currently just north of 6.0% - a marked contrast given that properties were trading just shy of 8.00% in 2009. With few alternatives in the market today, investors are more than ever willing to pay more for yield.

The major headwind facing the U.S. Commercial Real Estate sector today is a potential rising interest rate environment. Currently, the Fed seems likely to execute a short-term interest rate hike in September 2015. All else being equal, rising interest rates increase the cost of borrowing, ultimately requiring real estate investors to seek higher cap rates to generate returns. While that may be true in a vacuum, there is a caveat. Investors' ability to generate returns are predicated on the spread between cap rates and interest rates. Currently, the spread between cap rates and the 10 year U.S. treasury rate is high when compared to historical figures. As seen below, there is a nearly 400 bps gap between cap rates and interest rates. This is significant compared to 2006, often viewed as the height of the last real estate cycle, where the spread was roughly 200 bps.

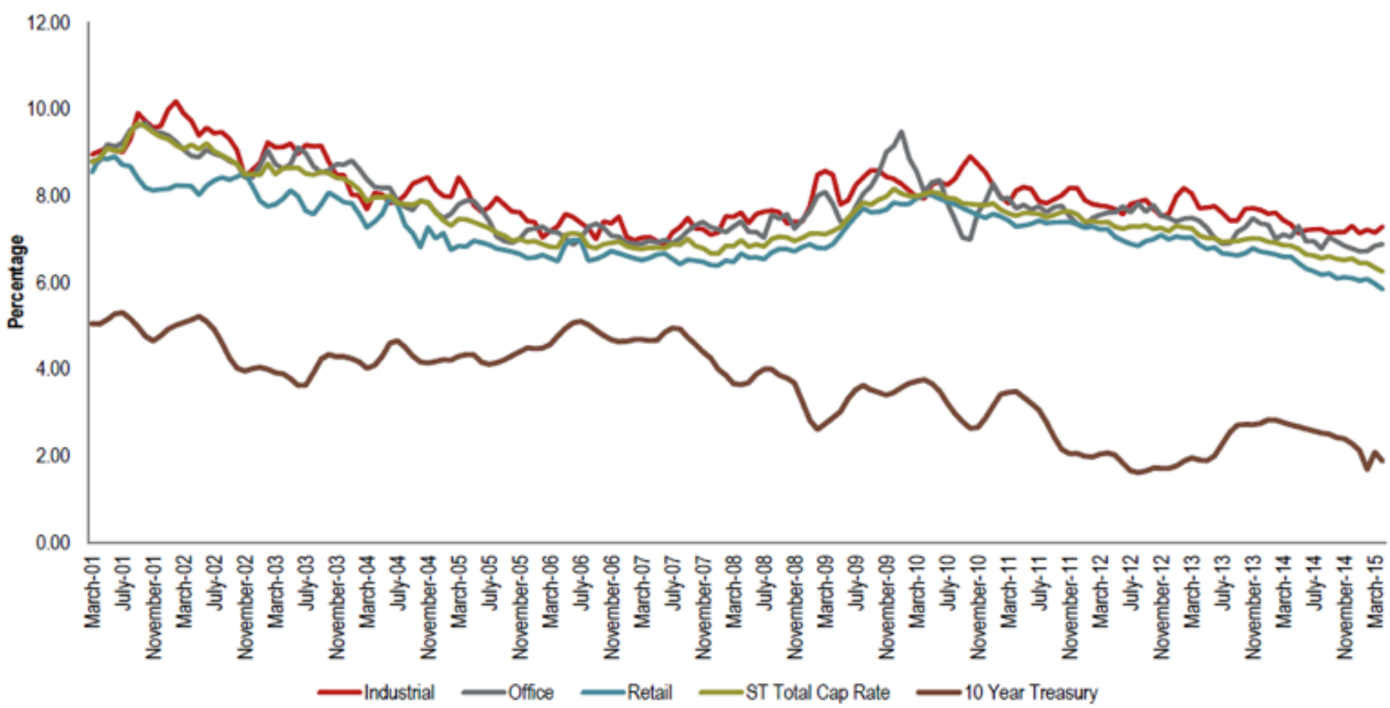
Transaction volumes, all property types – 2001 to Q12015

2015 market**Outlook** (continued)

Even with a Fed rate hike, there is enough "slack" in the spread for cap rates to continue to compress. Furthermore, the Fed has clearly indicated that any increase in interest rates will be based on economic data, particularly job growth and inflation targets. One would assume that any Fed rate hike would signal an improving economy, which would improve real estate fundamentals such as vacancy, net absorption, and market rental rates among others.

With strong domestic and foreign capital inflows and the acceptance of real estate as an asset class, it is clear that demand for real estate assets has increased significantly. This has led to increased competition within the sector, thereby driving transactional volume and property valuations while putting downward pressure on capitalization rates. Even with an imminent interest rate hike, there is still room for cap rate compression given the large historical spread between cap rates and interest rates, as well as the belief that such a rate hike would signal an improving economy, further improving real estate fundamentals.

Office, industrial & retail historical cap rate with 10 year treasury – 2001 to Q12015



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