

ELMTREE FUNDS TRACKER

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Foreign Capital Influx Benefits the Net Lease Sector

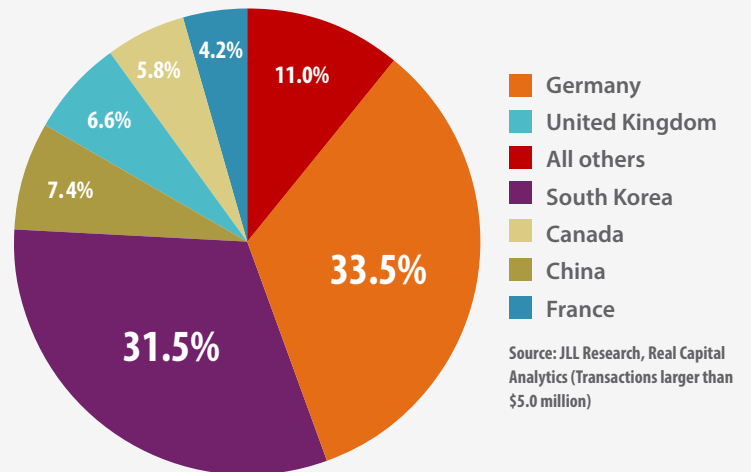
Introduction and Overview

Amid global market volatility and weakened economic conditions in various foreign nations, commercial real estate markets in the U.S. have experienced a significant influx of foreign capital. Many foreign investors see the U.S. real estate market as a safe haven for their capital amongst global uncertainty, especially given the strength of the U.S. economy relative to various economies abroad. Furthermore, foreign investors are dealing with a structural issue of excess savings and a limited number of investment opportunities that offer both manageable risk and desirable yields. Accordingly, with significant amounts of capital to invest and a lack of attractive investment options in their domestic countries, foreign investors' appetite for U.S. commercial real estate has increased significantly.

In like manner, the net lease sector has been brought to the forefront of foreign investors' attention given the attractive yields and strong preservation of capital the space offers. In particular, net leased assets offer foreign investors a predictable and passive income stream as the tenant in a net leased asset is responsible for paying all operating expenses including capital repairs and maintenance. As such, the net lease sector is an ideal vehicle for foreign investors to meet their investment objectives of preservation of capital and strong risk-adjusted returns. Moving forward, a continued increase in foreign participation in the U.S. net lease sector is expected given the desirable income stability and wealth preservation the sector provides, especially considering the level of volatility in global markets. This increased investment from foreign investors will lead to both increased liquidity in the net lease sector and increased recognition for the sector from various types of institutional investors.

Foreign Investment Trends

Through the first nine months of 2016, foreign investment in the net lease sector has reached approximately \$2.9 billion, according to JLL Research. Germany and South Korea have led foreign activity as they accounted for 65.0% of net lease acquisitions over the period, as shown in the following chart:



Additionally, foreign investors focused heavily on net leased office assets. In the first nine months of 2016, foreign investment in net leased office assets reached \$2.2 billion, an increase of 27.2% year-over-year. Foreign investors are also becoming increasingly interested in net leased industrial assets. More specifically, in the third quarter approximately one-third of all industrial acquisitions completed by foreign buyers were net leased assets, according to JLL Research. Foreign investors particularly like the growing demand for net leased industrial assets, which has primarily been driven by the e-commerce boom in the United States. As e-commerce sales continue to grow rapidly, demand for warehouses and distribution facilities is expected to grow as businesses will need to lease additional facilities and invest in supply chain infrastructure in order to provide competitive and quick delivery times for their customers. Additionally, e-commerce businesses need to increase investment in their infrastructure to support an ever-increasing selection of merchandise and growing levels of inventory. Companies that increase their real estate footprint and build out their distribution network in an efficient and cost effective manner will be most successful in this type of environment.

Foreign Capital Influx Benefits the Net Lease Sector (continued)

Increased Investment in Secondary Markets

Foreign investors have also increased their appetite for net leased assets in secondary markets. According to JLL Research, foreign investment in secondary markets was up 171.7% quarter-over-quarter in the second quarter of 2016 and reached \$752.3 million through the first six months of 2016. Given the heightened level of competition in primary markets, a record number of investors have increased their focus on secondary markets as they search for additional yield that isn't offered within primary markets. Additionally, companies are locating more mission critical assets, such as office headquarters and major industrial facilities, in secondary and tertiary markets as these markets allow companies to reduce labor costs and benefit from more business friendly environments relative to primary markets. Foreign investors are targeting investments in these mission critical facilities as these assets provide stable cash flow and long term capital preservation as tenants typically remain in these buildings for a significant amount of time, which is usually until the facilities become obsolete. Furthermore, as

mentioned prior, e-commerce growth in the U.S. has driven demand growth for net leased industrial assets, particularly in secondary markets, and foreign investors have looked to secondary markets to capitalize on this trend.

Foreign Investors Seek Partnerships with Best-in-Class Operators

As the demand for U.S. real estate assets has continued to increase, so has the competition from foreign investors to partner with the best-in-class operators in the real estate industry. Foreign investors are looking to identify the best-in-class operators to lock up relationships that benefit both parties over a long term horizon. With that said, the number of operators that meet foreign investors' stringent criteria is limited. Thus, the platforms with unique strategies, proven track records, and experienced management teams capable of producing the best risk adjusted returns will benefit the most from this influx of foreign capital which, in turn, should spur organic growth and drive increased liquidity in the net lease sector.

Recent Notable Net Lease Acquisitions by Foreign Investors



Source: CoStar

On July 8, 2016, South Korea's Mirae Asset Financial purchased the **Amazon Headquarters Phase VIII** office building for **\$246.8 million**. The building is located in Seattle, Washington, and the cap rate on the transaction was 4.3%. The 317,804 SF, Class A office building is 12-stories, steel framed with glass, and houses a small amount of retail space on the first level as well as four underground levels of parking. The office space is 100% leased to Amazon.com, Inc., and the lease had approximately 15 years remaining at the time of the sale.

(Source: RCA & CoStar)

Foreign Capital Influx Benefits the Net Lease Sector (continued)



Source: The Sheward Partnership

Recent Notable Net Lease Acquisitions by Foreign Investors (continued)

On February 23, 2016, Britain's 90 North Group, through a joint venture with Kuwait's Arzan Financial Group, purchased **Saint-Gobain's North American headquarters in Philadelphia, PA** for **\$123.0 million**. The headquarters consists of two buildings, one being a four story 277,335 SF office building and the other a two story 43,891 SF office building with research and development lab space. The cap rate on the transaction was 5.8%. Saint-Gobain had approximately 14 years remaining on its lease at the time of the sale. (Source: RCA & CoStar)

On October 6, 2016, Britain's 90 North Group, through a joint venture with Kuwait's KAMCO Investment Company, purchased **General Electric's Global Operations Center (The Banks) in Cincinnati, Ohio** for **\$107.3 million**. The cap rate on the transaction was 5.6%. The building is a 340,000 SF Class A office building located in the central business district of Cincinnati, Ohio. General Electric had approximately 15 years remaining on its lease at the time of the sale. (Source: RCA & CoStar)



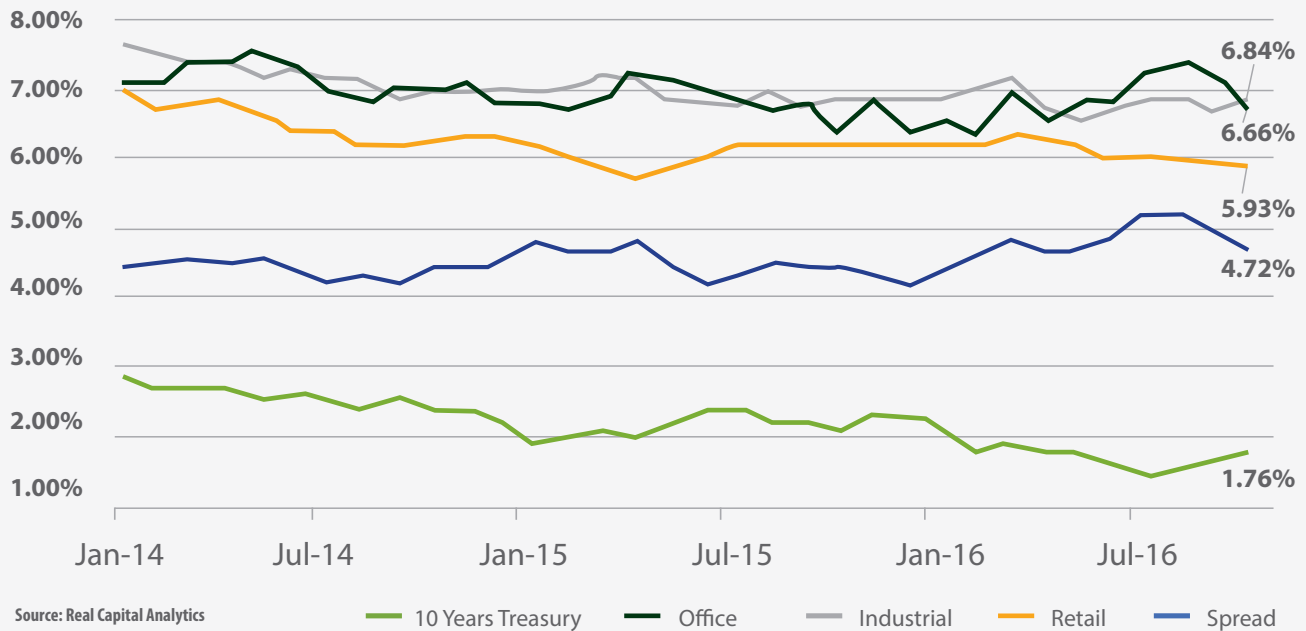
Source: General Electric

Net Lease Market Update

Single-Tenant Sector Cap Rates



Single-Tenant Cap Rates vs. 10-Year Treasury Yield



Source: Real Capital Analytics

10 Years Treasury Office Industrial Retail Spread

For more information regarding this newsletter or other related net lease matters, please contact Wes Walker or Jason Ridgway at: 8027 Forsyth Blvd, St. Louis, MO 63105 | p: 314.828.4200 f: 314.828.4220 | www.elmtreefunds.com

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