The ElmTree Edge

March 2024

Smart, Savvy, and Strategic

Investor sentiment grows increasingly positive as signs point to a 2024 turnaround

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Fundraising for commercial real estate in 2023 proved to be challenging. Transaction volume was down, and a combination of factors made investors more conservative with their decision-making. Higher inflation, monetary policy (i.e., the Fed's quantitative tightening), limited distributions, and unpredictable pacing of future capital calls created an overall atmosphere of economic uncertainty as geopolitical instability further heightened investor caution. Overall fundraising totals dropped 34% in 2023 compared to 2022 and the number of funds that held a final close dropped to the lowest level since 2012[1].

The good news, however, is that the tide is clearly turning, especially for sectors that have demonstrable underlying macro trends and fundamentals that remain strong. We have observed that analysts, observers, and investors are increasingly confident that 2023 was a bump in the road rather than a complete detour for the industrial sector. The primary demand drivers shaping the industrial real estate marketplace include:

- **Strong conviction around e-commerce growth**
  E-commerce sales are projected to grow 8-9% per annum over the next five years[2]. As a result, consumer focused corporations are increasing their focus on mission critical industrial real estate to meet the persistent growth in demand from consumers.

- **Continued supply chain diversification**
  Companies continue to diversify their supply chain operations in response to pandemic pressures as ongoing geopolitical issues further highlight the fragility of global supply chains. As corporations look to de-risk their supply chain infrastructure and deglobalization progresses through reshoring, nearshoring, and friend-shoring, the U.S. is positioned to be the greatest beneficiary.

- **Mexican prosperity**
  As Mexico continues to benefit from increased nearshoring, exports to the U.S. are projected to grow to $90 billion over the next 5 years (an increase of approximately 25%[3]). This is particularly good news for southern border states including New Mexico, Arizona, and Texas.

- **Stateside tech boom**
  The U.S. is in the midst of a significant uptick in semiconductor and EV manufacturing, a market that has surged approximately $320B in the past two years alone[4]. Almost 60% of manufacturing mandates are expected to occur in the desirable sunbelt or "Smile States" markets, which remain a key focus of ElmTree's investments and comprise 40% of total tenant requirements in the U.S.[5]

Shifting Investor Sentiment

The combination of the factors outlined above is leading to a clear shift in investor sentiment, particularly for the industrial sector. Institutional investors are showing signs of increased activity, and the uncertainty and hesitations of 2023 are abating and giving way to a renewed outlook of optimism and opportunity.

Amidst the uncertainty plaguing 2023, investors adopted a "risk off" approach and focused on portfolio management and rebalancing, but now the sidelined capital is flowing back into the market with an increased appetite for value-add and opportunistic strategies. Capital shifted away from core and core-plus strategies in 2023, as evidenced by the heightened redemptions from open-ended vehicles, which reached their highest level of net outflows in the past 20 years[6], and are now prioritizing long-term value growth and capital appreciation over income generation. This trend is evidenced by institutional investors maintaining their private real estate target allocations at 10.8% on average for 2024[7].

The era of easily accessible capital and the advantages of a low-rate environment has passed. However, enduring demand drivers remain in place, leading investors to seek managers and strategies characterized by resilience and attractive risk-adjusted returns, which can perform in various market conditions.

Sources

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