# When Tough Times Offer Good Timing

## ARA Research

AMERICAN
REALTY ADVISORS
INSTITUTIONAL CAPITAL MANAGEMENT

It is no secret that real estate performance has been challenged in recent quarters. A classic supply-demand imbalance has added pressures to already-strained capital markets, spurring some investors to seek a reduction in their exposure to the asset class.

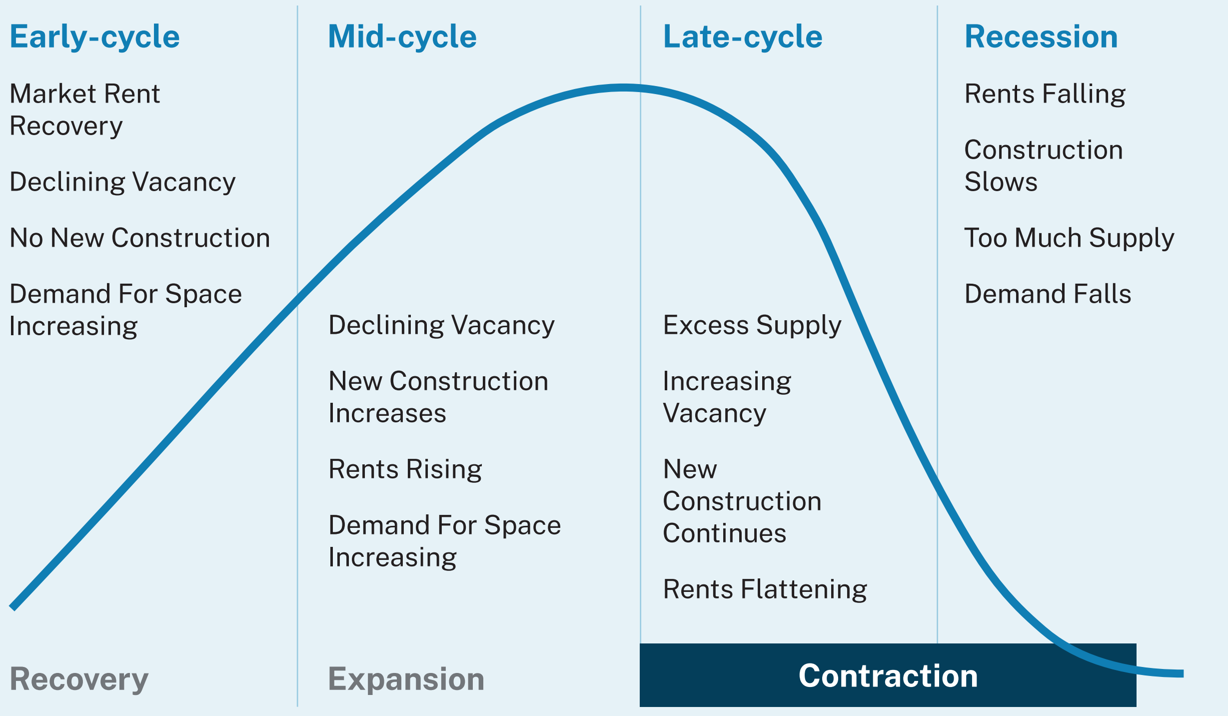
While there may be larger policy-related reasons to rebalance, we think now is an opportune time to start thinking now about *increasing* allocations to gear up for the early stages of the next cycle. Hindsight is often 20/20, and investors may end up wishing they had "gotten back in sooner" when looking back to today's buying opportunities.

## Cyclical Opportunity

The saying goes "history may not repeat itself, but it often rhymes." For real estate, that has tended to show itself in a logical set of phases (Figure 1). Today, most would probably agree we are in the trough. Whether we are at the beginning or end is more hotly debated and depends on how much further you think values need to fall before reaching a bottom and how long it will take before they start their climb back up.

FIGURE 1

**Real Estate Cycle Stages**

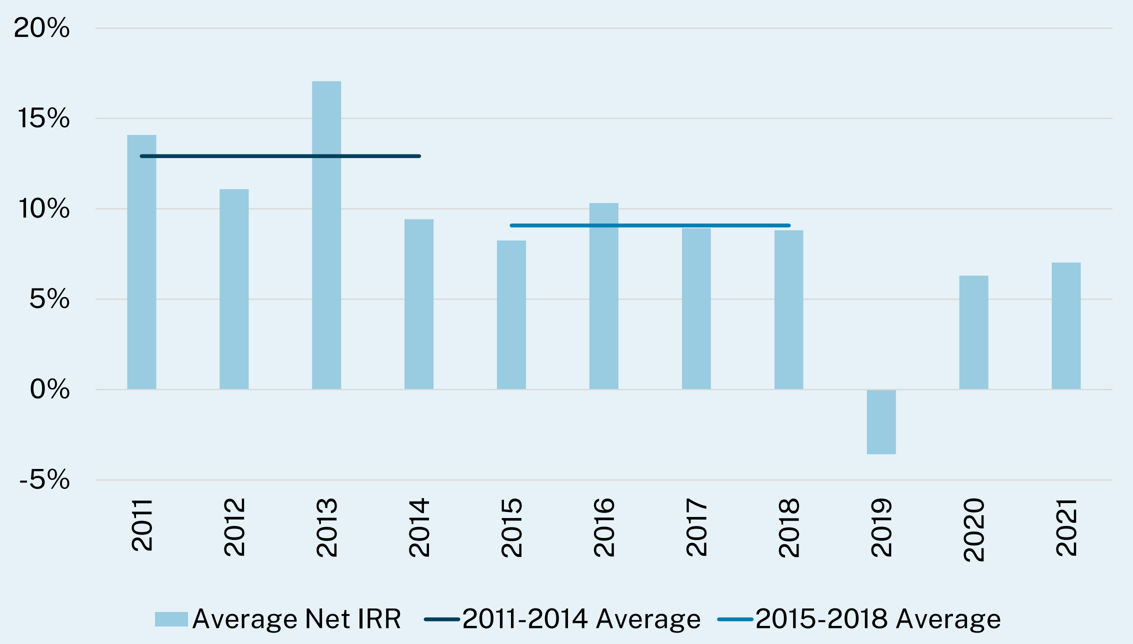



History suggests that it is in the early quarters of the recovery where the highest returns may be achieved. We need only look back to what was arguably one of the worst real estate downturns in modern history during the Global Financial Crisis to see this play out.

Though the recession ended in 2009, real estate fundamentals did not begin to turn the corner until 2010. Investors who anticipated and identified these turning points and got out of the gates earlier in the recovery (in this case, 2011 through 2014) achieved stronger returns than those whose deployment didn't start until improvement was well under way and generally firmer (2015-2018) (Figure 2).

FIGURE 2

**Average IRR, Vintage-Year Value-Add Funds**

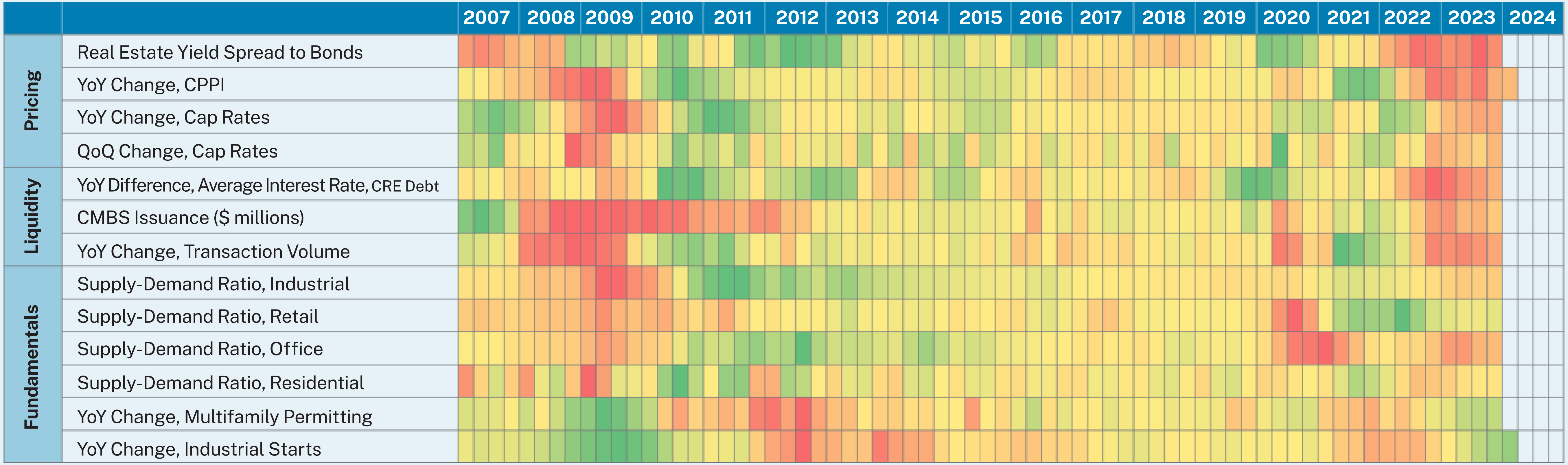



Source: American Realty Advisors based on data from NCREIF as of September 30, 2023, the latest the series was available. Value-add real estate performance reflects the NCREIF Fund Index - Closed-End Equity Value-Add Strategies (NFI-CEVA) equally weighted as of the reporting date.

As Figure 2 shows, investing earlier has yielded stronger returns. Those funds with investor capital to put to work earlier were able to acquire properties at their reset values, providing a more attractive basis from which to ride the wave up as fundamentals strengthened. Purchase price is important when it comes to returns –buying low and selling high is generally regarded as sound advice.

FIGURE 3

**Recovery Indicators Dashboard**




## How Do We Know We're Recovering?

There is a lot to consider when trying to identify cyclical turning points in real estate. At ARA, we believe there are three key areas (covering 13 unique metrics) that provide a barometer of the state of the market at any given time. These three categories are pricing, liquidity, and fundamentals.

Comparing today's conditions relative to those in the early quarters coming out of the GFC shows that these metrics are beginning to come up from their bottom, just as they did in late 2009.

While the natural inclination is to "wait for the bottom" before investing, it is extremely difficult to time when that is and getting commitments approved and funded afterwards takes time. A more practical and advantageous approach may be to start exploring new and add-on commitments when things move into their last leg down, so that when fundamentals and capital markets start to turn, funds can be invested earlier. Since indications are that we may be nearing the end of repricing and approaching the beginning of a new cycle, that time may be sooner than you think.

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