WHITE OAK
PARTNERS

A BETTER HEDGE AGAINST VOLATILITY:

PUBLIC VS. PRIVATE MARKETS

White Oak Partners Research Team | August 2023

- *Private real estate makes for a compelling investment compared to public REITs due to less volatility throughout economic cycles.*
- *Unlike private real estate, the market value of Real Estate Investment Trusts (REITs) is often disconnected from the underlying real estate performance, including distributable cash flow, and instead mirrors market sentiment and movements in interest rates.*
- *The risk profile of REITs does not adequately compensate investors for the additional risk of market volatility as private real estate has outperformed public REITs over the past 10 years with less than half the volatility. (NCREIF)*
- *Investors in public REITS are paying for liquidity and accepting the risk of market volatility. During a market downturn, strong correlation to the overall market will likely impact the price of REITs as well, limiting the benefits of faster transaction speed.*

Although implied cap rates of publicly traded REITs are currently higher than private real estate cap rates, White Oak Partners Research Team's analysis suggests that the arbitrage between public and private going in yields may not make for a compelling trade going forward. Resilient fundamentals, including migration trends and a widespread housing shortage, continue to drive strong multifamily performance. In today's environment, Real Estate Investment Trusts (REITs), which are publicly traded like stock and represent shares in an underlying real estate portfolio, are perceived to be relatively inexpensive compared to private real estate. The White Oak Research Team used multiple data points from publicly available sources to assess the relative value between the two investment vehicles. The following analysis will incorporate income return potential, historical performance, and risk profiles between public and private real estate markets.

METHODOLOGY

Investors often compare property values using cap rates. Public markets do not provide a direct comparison, but many institutional investors like public pension funds will compare implied cap rates of public REITs with cap rates of private real estate. The following analysis is an example of how investors can incorporate a wider view of various metrics to determine the value of an arbitrage opportunity.

PRIVATE CAP RATE	IMPLIED PUBLIC CAP RATE
= Net Operating Income (NOI) / Property Value	= Funds From Operations / Market Capitalization

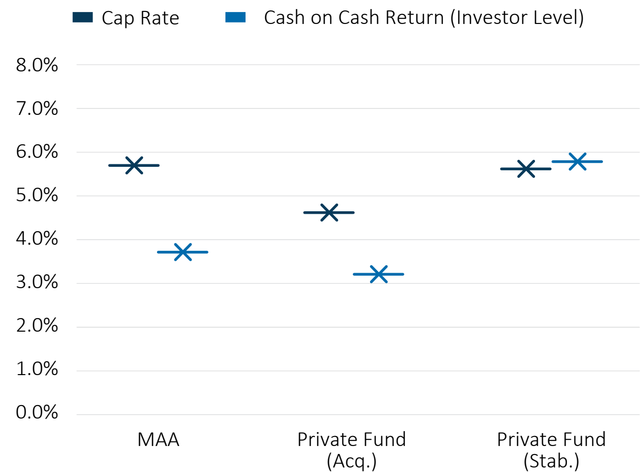
For additional perspective beyond the cap rate comparison, investor income return can also be analyzed to provide another view of the risk-adjusted returns of public REITs and private real estate.

- For private real estate, the investor cash return is calculated by taking the average annual investor level cash flow and dividing it by total equity invested, which results in a figure comparable to the dividend yield of a REIT.
- The Research Team then compared these yields to the cap rates of each investment vehicle. See Investment Comparison Analysis.
- White Oak used data from a Class A private real estate portfolio focused on the Sunbelt that consisted of both stabilized and pre-stabilized core assets.
- Mid-American Apartment Communities (MAA) and Camden Property Trust (CPT) are publicly traded REITs that were selected for this analysis due to geographical similarities to the private portfolio.
- NCREIF NPI transaction cap rates were used to provide information on private transactions. See Relative Value vs. Volatility.

INVESTMENT COMPARISON ANALYSIS

The data suggests that on a go-forward basis private real estate offers more compelling income returns at a similar value upon stabilization. The private fund includes five stabilized assets and five pre-stabilized assets. Attractive fixed rate debt supports strong year one income returns of 5.2% on the stabilized assets. Although the blend of pre-stabilized and stabilized assets provides a cash yield of 3.2% at acquisition, the cash-on-cash return grows to 5.8% (net of all fees) in year two as all assets in the fund reach stabilization. For comparison, MAA's dividend yield as of Q1 2023 was 3.7%.[1] Upon stabilization, the private fund cap rate expands to be more in line with its cash return and similar to the cap rate of MAA. In contrast, MAA's cash yield is 200 basis points

FIGURE 1
Investor-Level Cash Flow



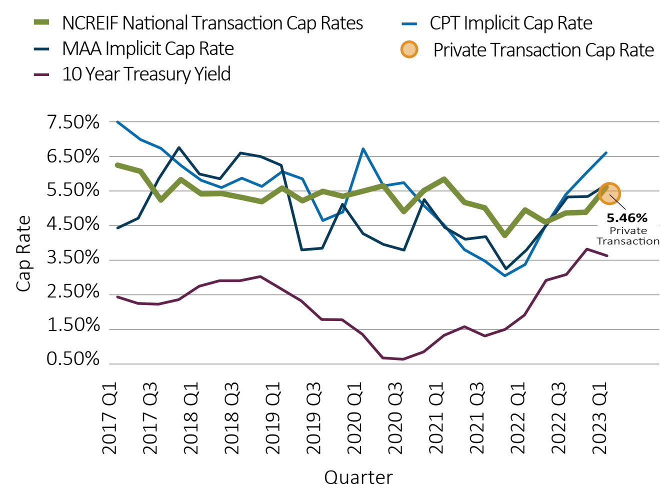
Sources: White Oak Partners Research

FIGURE 2
Portfolio Comparison

	PRIVATE FUND	MAA
Markets	Sunbelt	Sunbelt
Submarkets	Suburban	Urban, Suburban
Average Vintage	2020	2003
Construction Style	Midrise, Garden	Highrise, Midrise, Garden
Amenities	Superior	Inferior
Cash Yield	5.8% (Year 2)	3.7%

Source: White Oak Partners Research

FIGURE 3
Q1 2023 Public Vs. Private Cap Rates



Sources: NCREIF, CPT, MAA [1,2,3]

lower than its cap rate. To illustrate, ***Figure 1*** shows how the cap rate approaches the investor level cash-on-cash return between acquisition and stabilization of the portfolio. This expansion is a result of NOI growth as the pre-stabilized properties increase occupancy while the denominator, the purchase price, stays the same.

The difference in risk profiles between the public REITs and private funds can partially be explained by examining portfolio construction. MAA is a stabilized portfolio with vintages ranging from 1970 to 2023. The older, stabilized portfolio results in muted growth expectations and much higher capital expenditures than the brand-new assets within the private portfolio. In the coming years, MAA's capex is likely to increase due to the wide range of property vintages, impacting their ability to maintain or raise their dividend as more cash goes to maintaining or upgrading older products. MAA's dividend would have to increase by 53% to match the private fund's investor-level stabilized net cash-on-cash return.

RELATIVE VALUE VS VOLATILITY

When looking at ***Figure 3***, the volatility of REITs is immediately apparent when compared to the NPI private cap rates despite both REITs representing stabilized portfolios. Both MAA and CPT are highly correlated to the overall market, with betas of 0.78 and 0.77 respectively.[4] Additionally, both REITs proved highly sensitive to recent interest rate fluctuations despite both portfolios holding more than 80% of their debt at fixed rates. This results in much larger swings in cap rates in public REITs than seen in private markets. Currently, NPI properties have been transacting at a 5.42% cap rate on average through Q1 2023[3] compared to the 5.74% implicit cap rate of MAA as of Q1 2023.[1] A recent relationship transaction is also charted for comparison.

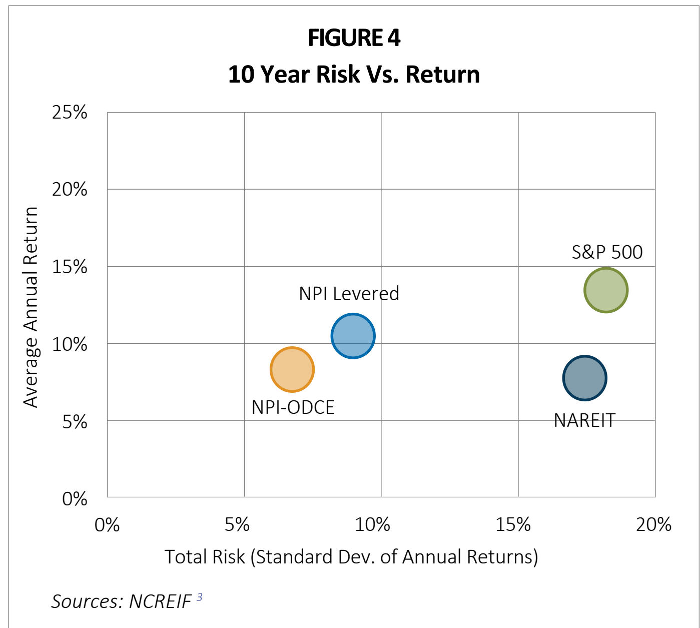
HISTORICAL RISK ADJUSTED PERFORMANCE

While REITs provide portfolio diversification, historically their risk profile more in line with traditional equities. REITs are exposed to short-term market fluctuations that often results in the share price fluctuating independent of the value of the underlying real estate. ***Figure 4*** is a comparison of the average return and average variability of returns for public and private real estate indexes. The S&P 500 was included to represent typical market volatility. Additionally, the strong correlation between REITs and the stock market eliminates much of the liquidity benefit they provide. Any market downturn is likely to impact the price of REITs regardless of the performance of the underlying real estate portfolio, which then potentially results in selling at an inopportune price.

Figure 5 further illustrates the diversification benefits private real estate has over REITs. This matrix shows the correlation between the ODCE index, NPI, NAREIT and the S&P 500. Movements in both the ODCE index and NPI are less than 20% correlated with the S&P 500. NAREIT , by comparison, is 63% correlated with the S&P 500.[3] As a result, private real estate offers more of a diversification advantage than publicly traded REITs.

CONCLUSION

Private real estate makes for a compelling investment compared to public REITs due to less volatility throughout economic cycles. The investment structure of private real estate allows investors to generate attractive risk adjusted returns due to private market returns being tied directly to the performance and value of the underlying assets. Conversely, the perceived liquidity advantage of REITs is offset by the highly correlated nature of their returns to the overall market. A private investor can selectively identify opportunities within the multifamily market that provide relative stability combined with strong cash yields uniquely position private real estate's risk adjusted return relative to other assets.



Sources: NCREIF [3]

FIGURE 5
Correlation Matrix

	NFI-ODCE	NPI LEVERED	NAREIT	S&P 500
NFI-ODCE	100%	99%	-2%	16%
NPI Levered	99%	100%	-1%	13%
NAREIT	-2%	-1%	100%	63%
S&P 500	16%	13%	63%	100%

Source: NCREIF [3]

Sources:
1. *Corporate Profile MAA | Luxury Apartment Rentals*
2. *Camden Property Trust - Investor Relations*
3. *NCREIF*
4. *NYSE*

CONTACT US

MICHAEL MENZER
Chief Executive Officer
mmenzer@whiteoakpartners.com
614-741-7790

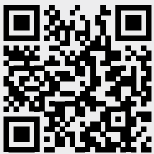
JAMES CRAMER
Partner, President
jcramer@whiteoakpartners.com
614-741-7797

LUKE ROTTMANN
Managing Director, Capital Markets
lrottmann@whiteoakpartners.com
415-417-9233

BENJAMIN BARNES
Partner, Chief Investment Officer
bbarnes@whiteoakpartners.com
614-741-7628

ANDREW CARR
Partner, Head of Capital Markets
acarr@whiteoakpartners.com
614-741-7736

STEVE PRIBONIC
Director, Capital Markets
spribonic@whiteoakpartners.com
614-741-7724



TO LEARN MORE

White Oak Partners is an experienced owner-operator specializing in institutional-quality multifamily housing. Based in Columbus, Ohio, White Oak has acquired over 18,500 multifamily units, with a market value in excess of $4.3 billion, since inception under the direction of its leadership team, which averages over 25 years of experience. White Oak builds on the track record of its Founder, Michael J. Menzer, who owned and managed approximately 100,000 multifamily units in 47 states while building his prior multifamily firm, Paramount Financial Group, from 1987-2004.

Certain information contained herein includes forward-looking statements. Such statements can generally be identified by terminology such as "except," "may," "should," "anticipate," "project," "target," "believe," or "intend" or the negative thereof or comparable terminology. These statements are based on certain assumptions made by White Oak Partners, LLC and information obtained from sources we believe to be accurate and reliable. Some or all forward-looking statements may prove to be inaccurate and/or incorrect. The opinions expressed and the material provided are for general information and should not be considered a solicitation for the purchase or sale of any security. Brokerage Services are provided by WOBD, LLC, a registered broker-dealer with the SEC and a member of FINRA and SIPC. WOBD, LLC and White Oak Partners Investment Advisor, LLC, a registered investment advisor with the SEC, are both affiliated entities of White Oak Partners, LLC.