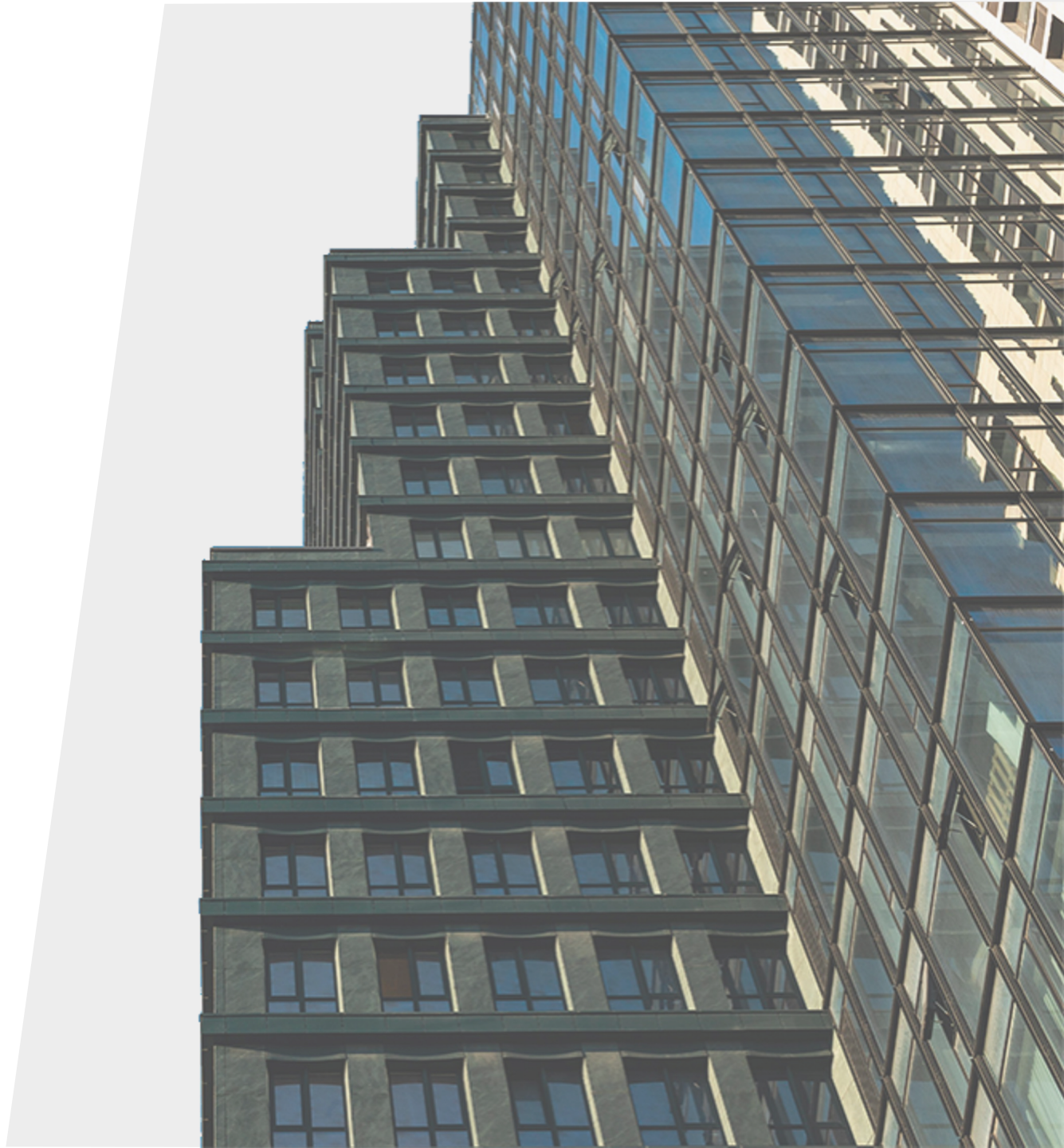


# USA Real Estate Market Outlook

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Macroeconomic and strategic view of  
the Real Estate market in the U.S.

FEBRUARY, 24





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# Executive Summary

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## USA Real Estate Market Outlook

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## The biggest risk is missing the opportunities created by the current turbulence and the shift in the FED's monetary policy

Property prices are adjusting to high interest rates, having fallen 22% since the peak in 2022. With the start of the Fed's monetary easing period expected in 2024 ("dovish pivot"), prices are likely bottoming out at their lowest levels and starting to recover in late 2025. Investments made at stages equivalent to the current one in previous cycles generated exceptional returns.

Despite the decline in property prices, rental income remains resilient, due to an imbalance between supply and demand, especially in the residential and necessity-retail segments. This has been the price-downturn cycle in which the increase in property revenues, in these segments, most offset the negative impact of interest rates on their prices, demonstrating their strong structural robustness.

In 2024/2025 the best opportunities should be in:

- ▶ **Opportunistic – Distressed Properties:** One trillion dollars in debt maturing between 2024 and 2025 is expected to open a window of opportunity for opportunistic acquisitions of properties with distressed leverage structures that need to refinance their loans, at a time when interest rates are historically high.
- ▶ **Private real estate credit:** High interest rates and scarce credit will continue to contrast with strong demand for financing, favoring investment in private credit.
- ▶ **Build-to-rent:** The "dovish pivot" by the Fed should start a new cycle of reducing interest rates in 2024. Construction projects started in 2024/25 will be completed at the end of this cycle and should benefit from higher spreads when taking out long-term financing, and from capital gains derived from the expected compression in cap rates.

# Macro Scenario

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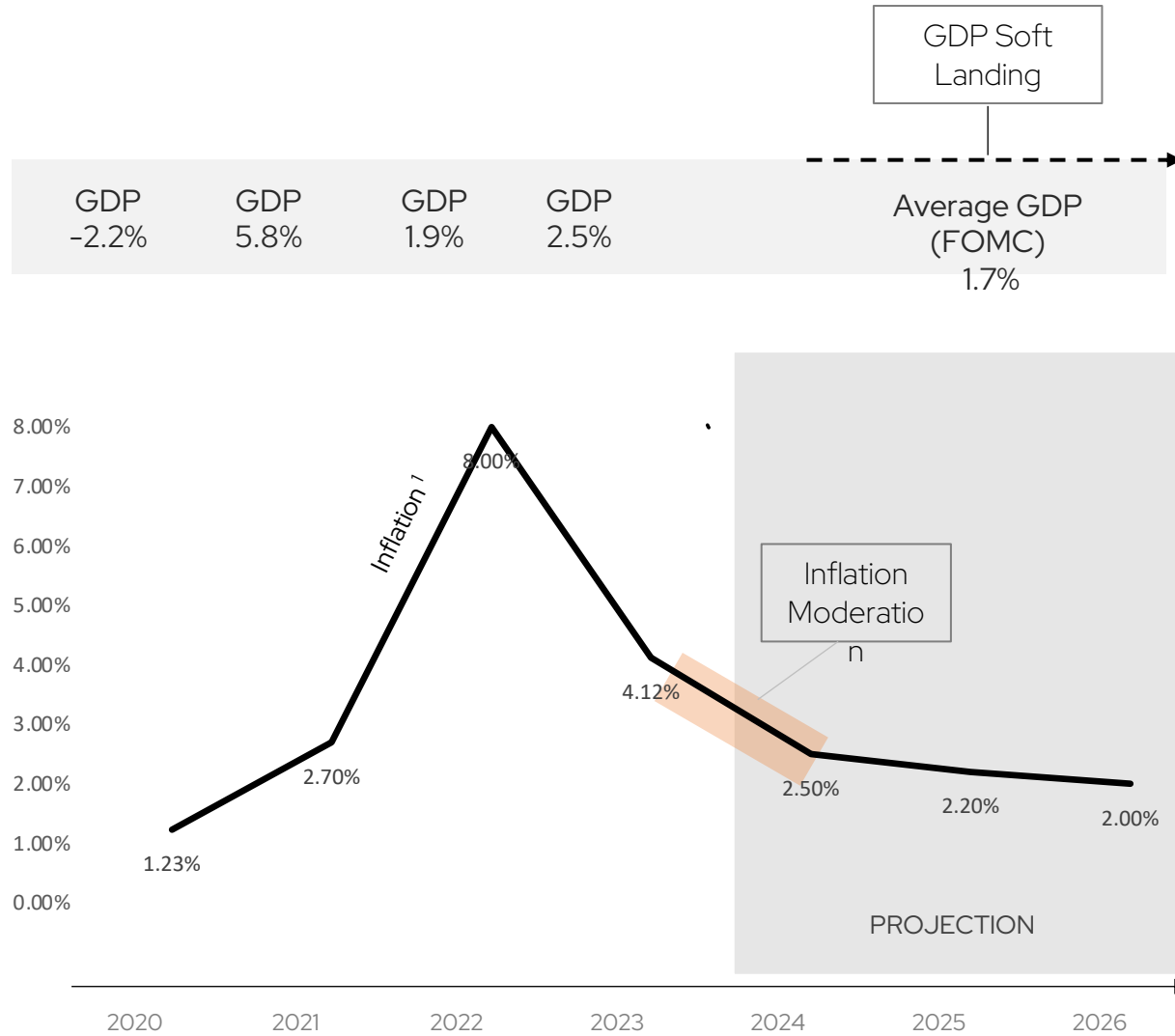
## USA Real Estate Market Outlook

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# Forecast of **soft landing** and **declining inflation**



1 Historic: US Bureau of Labor Statistics; Estimate based on FOMC projections in Dec-23 for the FFR.

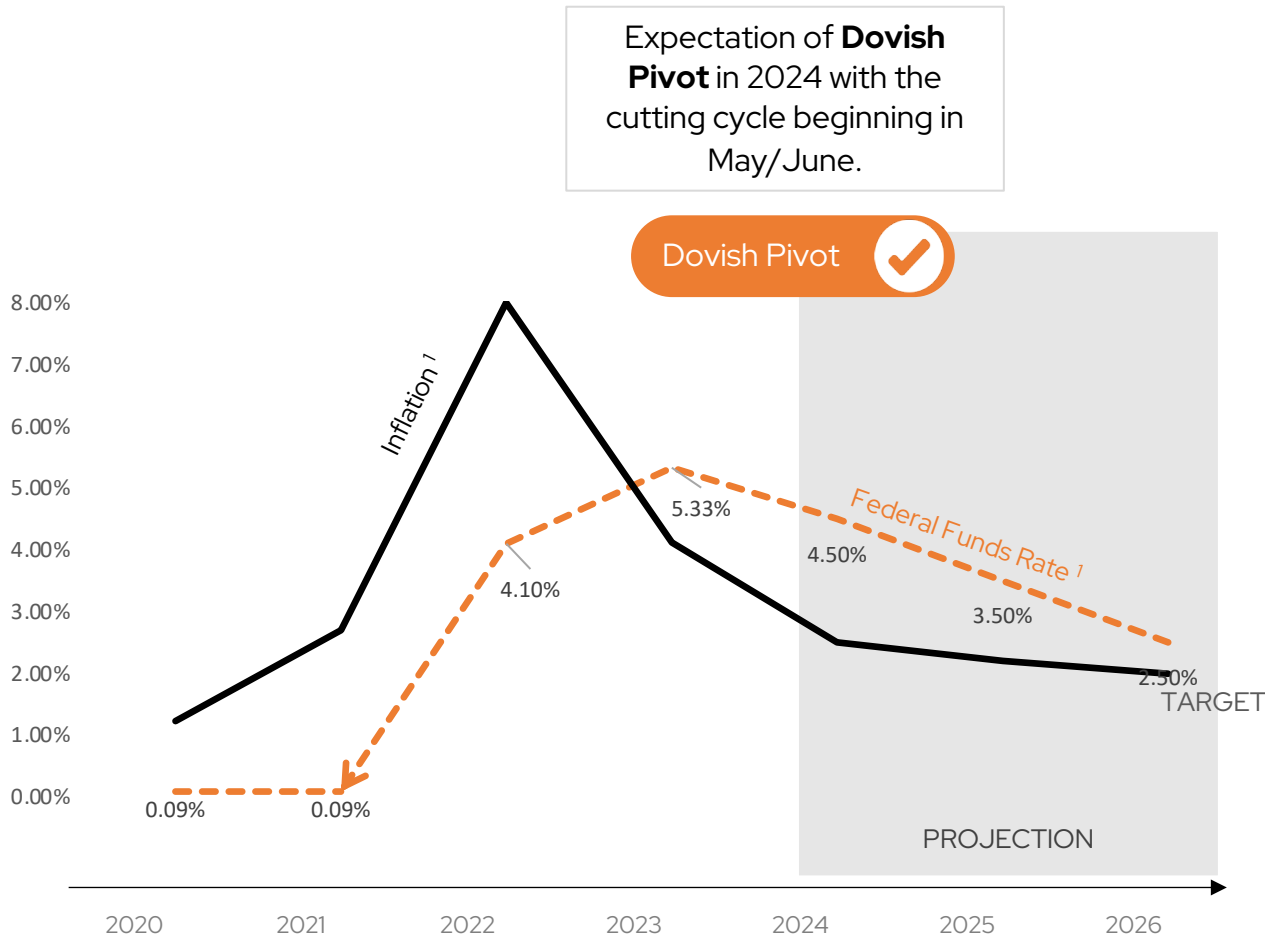
U.S. core inflation measures have peaked, and Fed officials expect them to continue falling toward the 2% target in 2026.

The FOMC base case forecasts a reduction in average GDP growth to 1.7% p.a. over the next 3 years and a slight increase in the unemployment rate to 4.3%. However, no recessionary scenario is forecast.

## Risks

Labor markets remain hot and less progress has been made in moderating inflation in wage-sensitive core services, signaling a risk of a slower-than-expected decline in inflation indicators.

# The historic tightening of U.S. monetary policy appears to be coming to an end, with a **“dovish pivot”** expected in **2024**



<sup>1</sup>Historic: Board of Governors of the Federal Reserve System (US); Estimate based on FOMC projections in Dec-23 for the FFR.

The Fed kept the Federal Funds rate stable in the 5.25% - 5.5% range in January, the highest in the last 23 years. Since December, the Fed has signaled that this historic tightening is coming to an end.

Based on the more cautious statements after the January meeting and considering the stronger-than-expected labor market, the rate-cutting cycle is estimated to begin only in May or June.

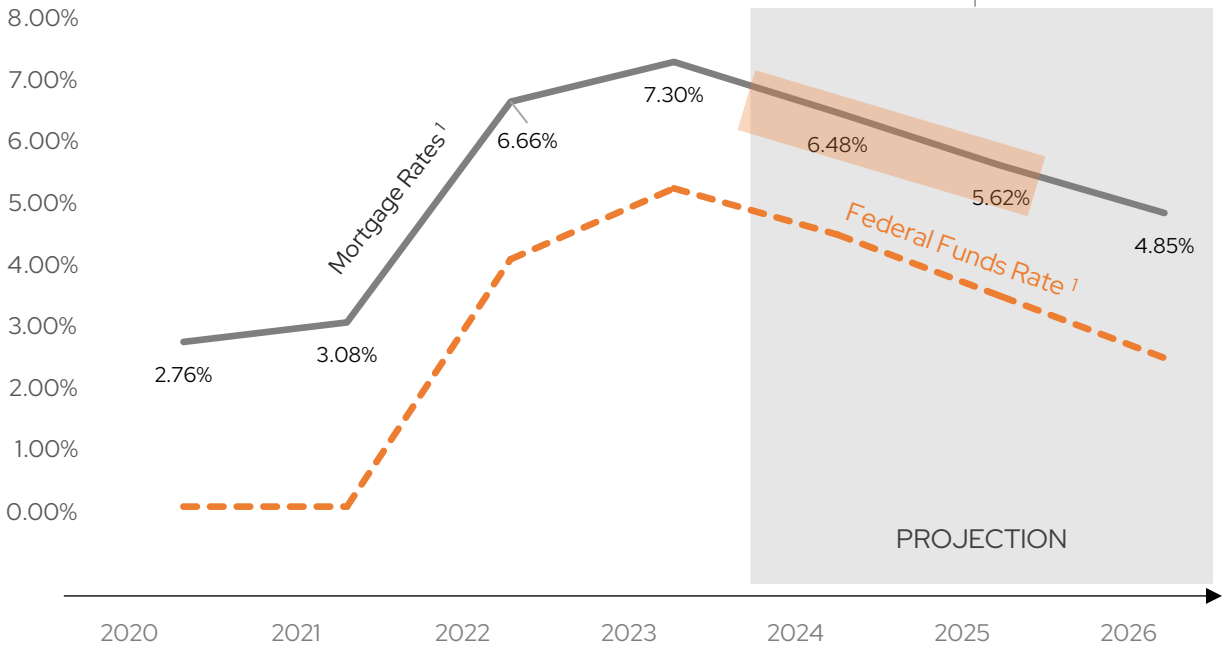
## Risks

If the labor market remains resilient it should continue pressuring inflation, forcing the Fed to keep interest rates high for longer to avoid the risk of resurgent inflation.

# Mortgage rates should start to fall, but will remain high until 2025, negatively impacting borrowers whose loans are about to mature

More than US\$ 1 trillion in commercial real estate loans mature in 2024 and 2025, when rates are still very high

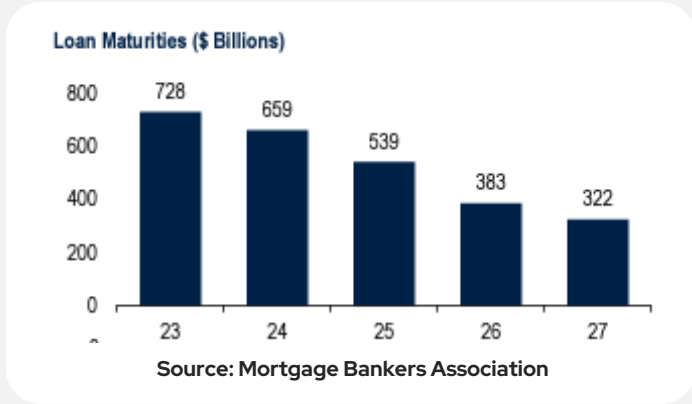
Mortgage rates begin to fall, but remain high until 2025



1 Historic 30-Year Fixed Rate Mortgage Average, Freddie Mac from FRED; Projection: Estimates by Ativore based on FOMC projections in Dec-23 for the FFR.  
 2 Historic: Board of Governors of the Federal Reserve System (US); Estimate based on FOMC projections in Dec-23 for the FFR.

From the second half of 2024, mortgage rates should start to fall, tracking the movement of the Federal Funds, but the pace of decline will not be as fast.

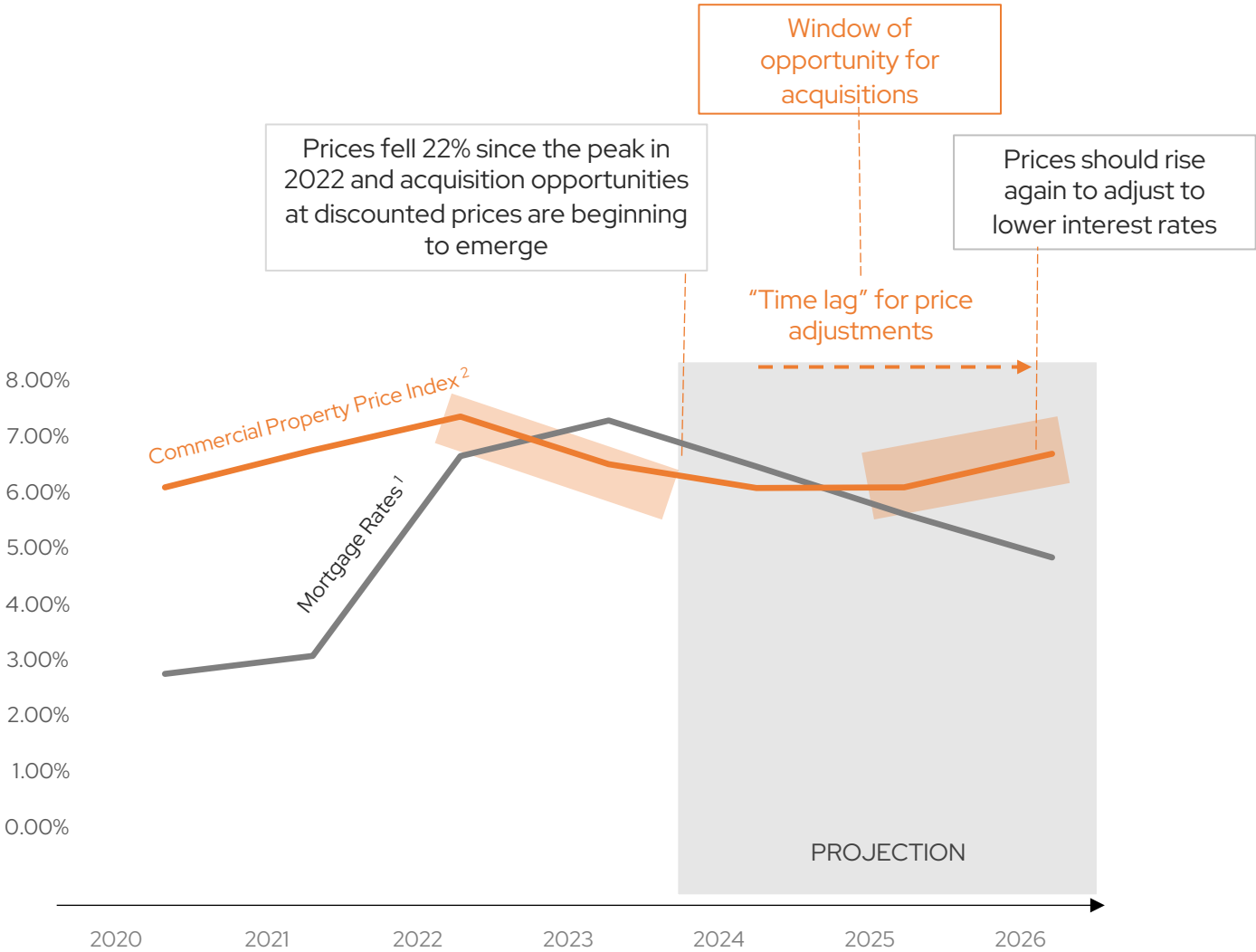
More than US\$ 1 trillion in real estate loans mature in 2024 and 2025, at a time when mortgage rates are still high, which should create stress in more leveraged properties that need to renegotiate their debts.



## Risks

Despite a market and Fed consensus on a high probability of a soft landing for the economy, there has never been a cycle in which rates remained so high for so long without causing collateral damage to the economy. This could create a more widespread stress situation than expected in the real estate market.

# Property prices have already fallen 22%: in 2024, opportunistic acquisitions of properties with distressed leverage at discounted prices begin to emerge



According to the January report by GreenStreet, property prices have already fallen 22% since the peak in 2022. Property prices are likely reaching the lowest levels of this cycle, should the FED's monetary tightening come to an end in 2024, as expected.

There is a gap of 1-2 years between the “dovish pivot” and the start of the recovery in property prices. Investments made during stages equivalent to the current one in previous cycles generated exceptional returns.

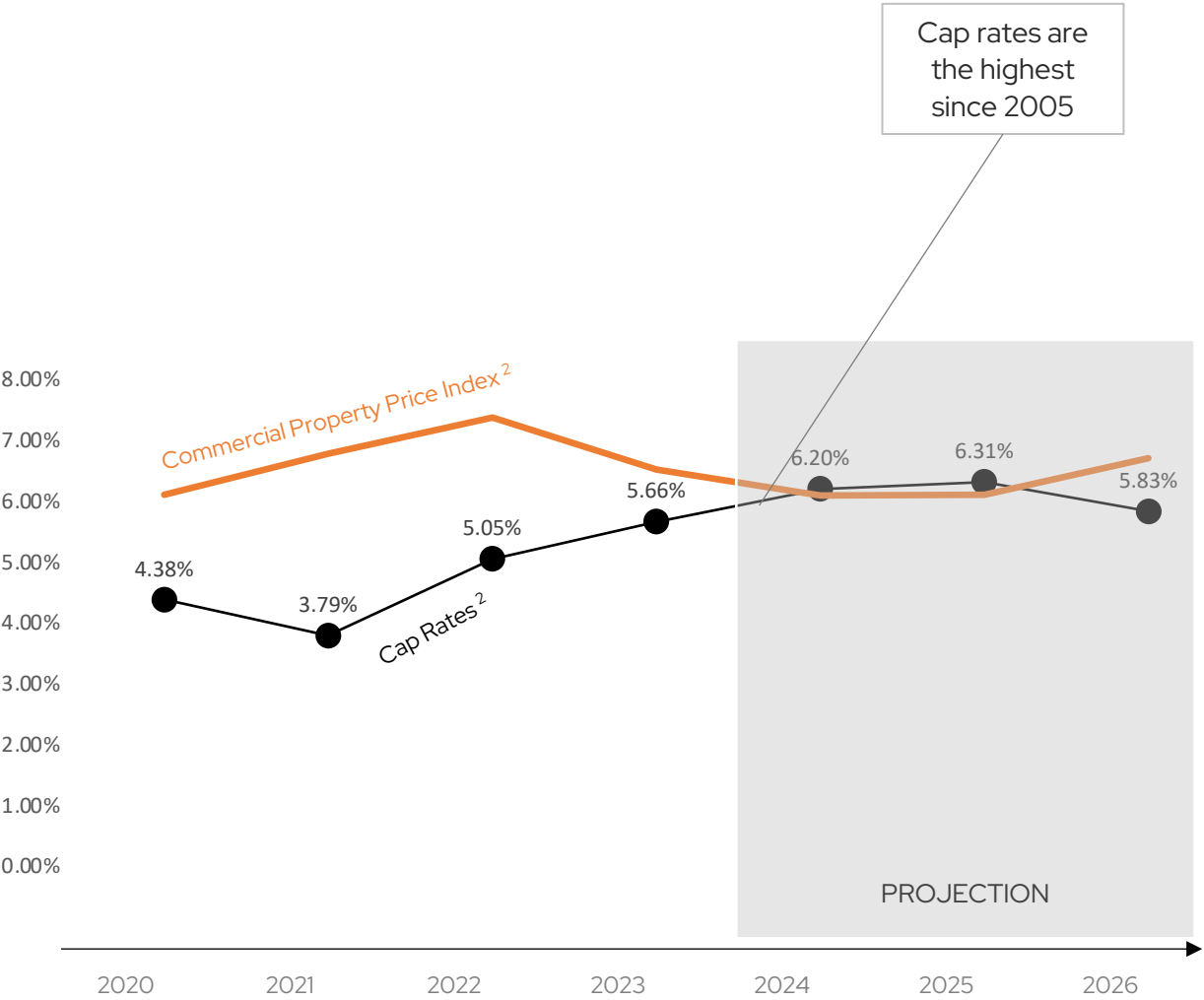
Acquisitions at opportunistic prices of properties with distressed financing structures are already beginning to emerge, and the pipeline of acquisition opportunities at discounted prices should grow throughout 2024.

## Risks

An unforeseen event (black swan) or a worsening of the economic situation, as a result of the current extremely restrictive policy, could extend the recovery time for property prices.

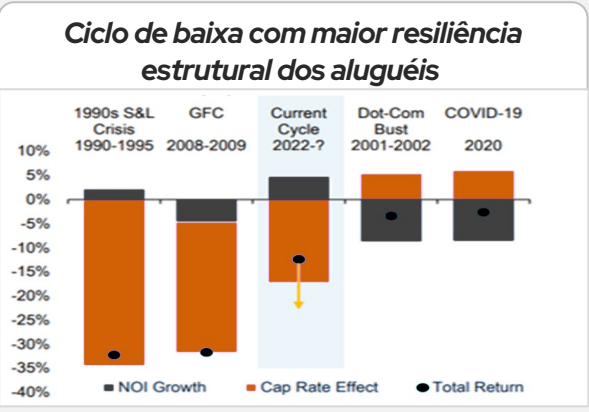
1 Historic 30-Year Fixed Rate Mortgage Average, Freddie Mac from FRED; Projection: Estimates by Ativore based on FOMC projections in Dec-23 for the FFR.  
 2 Historic: Census, Hud: Median Sales Price of Houses Sold for the United States; Estimate based on FOMC projections in Dec-23 for the FFR.

With the decline in property prices and the structural resilience of revenue in some segments, **the average rental yield (cap rates) is already the highest since 2005**



Despite the decline in property prices, rents in several segments continue to rise, due to a structural shortage in property supply. This phenomenon has had a positive impact on the average rental yield (cap rates), which is already the highest since 2005.

This has been the historic downturn cycle in which the rise in property revenues has most offset the negative impact of high interest rates on property prices, demonstrating the strong structural resilience of some segments, such as residential.



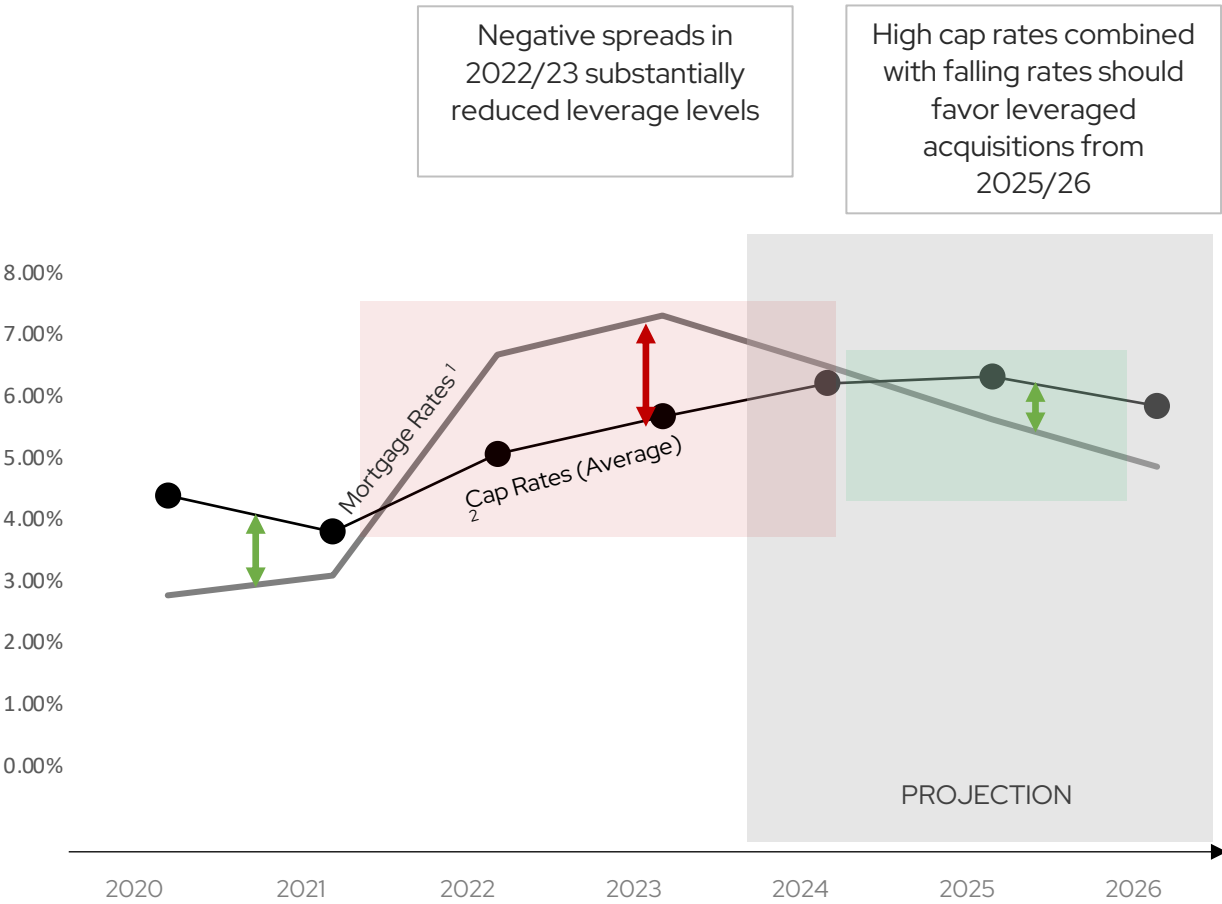
Sources: Green Street Advisors, NCREIF, PGIM Real Estate; as of November 2023.

**Risks**

If the economy enters a recession, contrary to soft-landing forecasts, rents may not hold up, even for the most resilient segments.

1 Historic: Commercial Property Price Index (CPPI) by Greenstreet; Projection: Estimates by Ativore based on projected rental growth and cap rates.  
 2 Historic: Market Cap Rates Weighted Average for Apartments, GreenStreet Advisors.; Projection: Estimates by Ativore based on FOMC projections in Dec-23 for the FFR.

# With falling interest rates and the projected rise in cap rates, **spreads on property acquisitions should start to rise**



1Historic 30-Year Fixed Rate Mortgage Average, Freddie Mac from FRED; Projection: Estimates by Ativore based on FOMC projections in Dec-23 for the FFR.  
 2Historic: Average Cap Rates for Apartments, GreenStreet Advisors.; Projection: Estimates by Ativore based on FOMC projections in Dec-23 for the FFR.

The sharp rise in interest rates has made leverage-based investment strategies unviable and substantially reduced credit supply. Leverage levels in the most recent real estate investments are among the lowest (most conservative) in decades.

The structural robustness of some segments will continue to support rising rents. Due to the expected two-year “time lag” between the expected fall in interest rates and the recovery in property prices, a substantial increase in rental yields (cap rates) may occur from 2025, once again benefiting leveraged acquisition strategies.

### Risks

If rents in the most resilient segments do not hold up due to a potential recessionary scenario (less likely, but possible) or, on the other hand, the economy stays hot preventing the start of the rate-cutting cycle, spreads could remain compressed.

# Tactical Opportunities from the Economic Cycle

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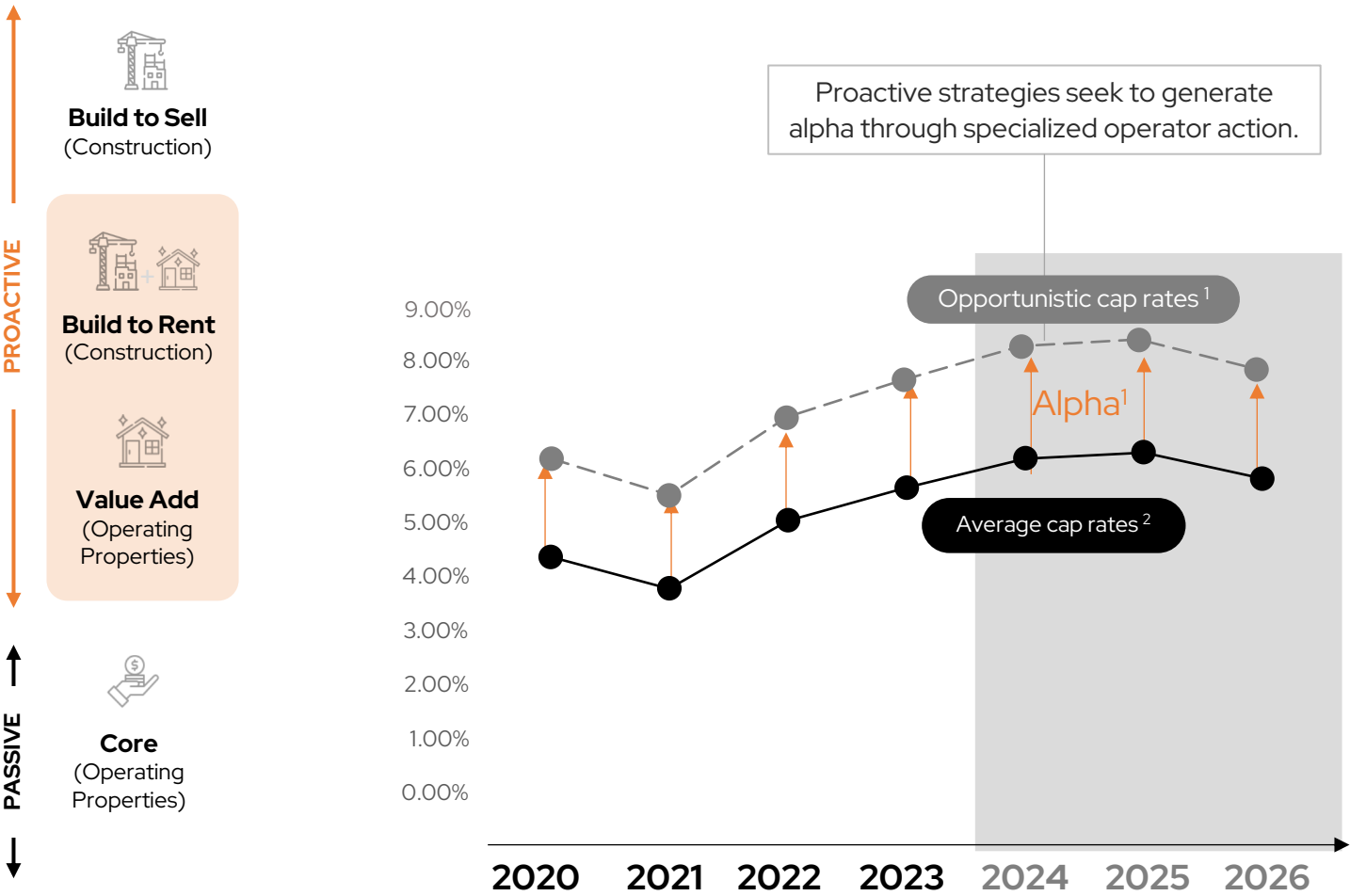
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# Focus on **PROACTIVE STRATEGIES** anchored in the generation of cash flows that present opportunities to **create alpha through the action of local specialists**



Proactive strategies have greater alpha-generation potential than passive strategies, as they involve specialized operator action to increase cash flow and appreciate assets.

In addition, we prefer strategies with the potential to generate rental cash flow, since they do not depend on capital gains and short sale cycles to create value for investors. Our focus for 2024/25 is on the following strategies:

## **VALUE ADD (Operating Properties)**

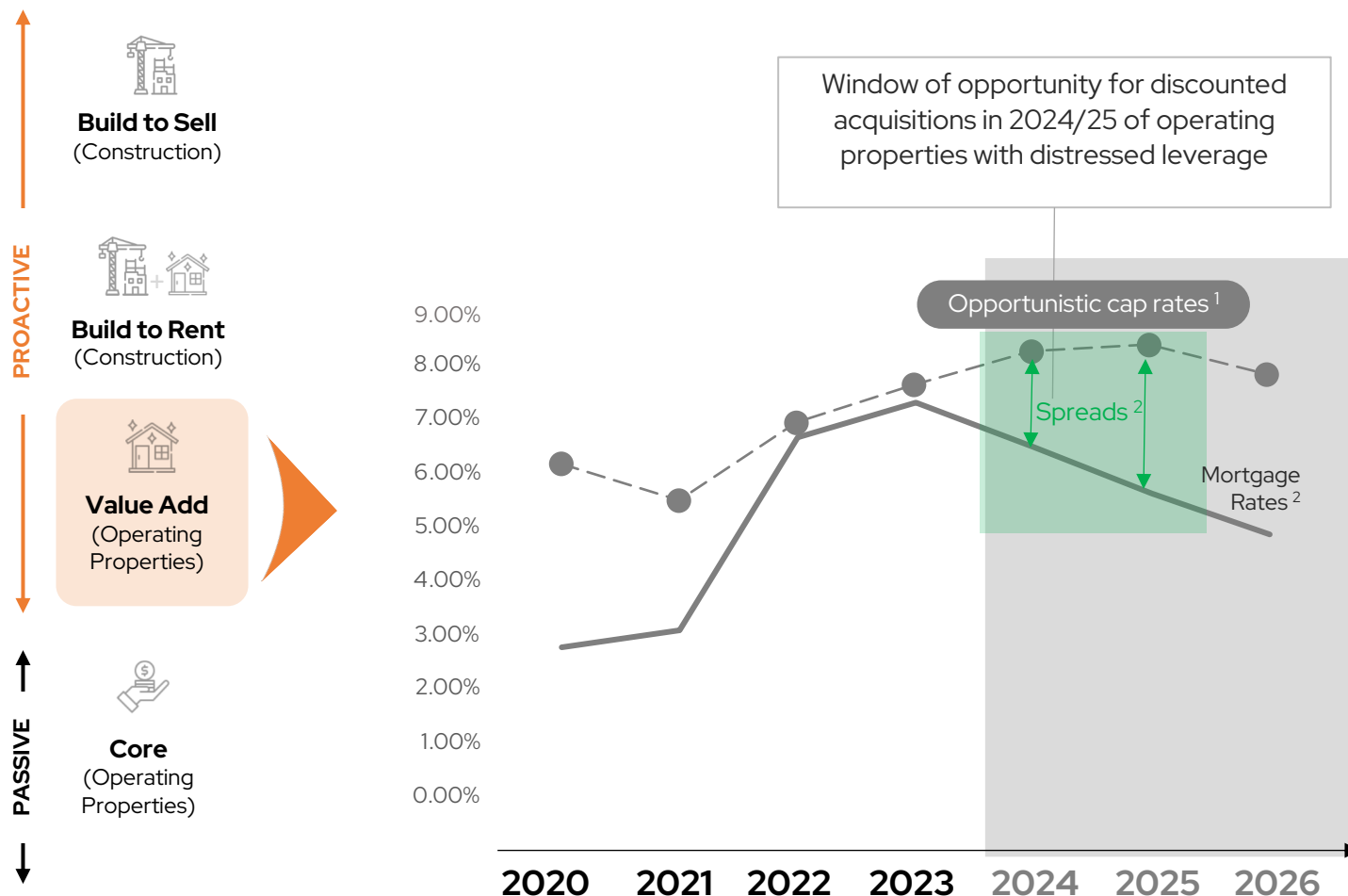
Discounted acquisitions and/or cash-flow improvements of operating properties, through cost reduction or revenue growth, to raise cap rates and generate capital gains.

## **BUILD TO RENT (Construction)**

Capture of the developer's margin in the construction of properties designed specifically for rental.

1. Purely illustrative estimate. Presented based on empirical knowledge, with no quantitative basis. 2. Historic 30-Year Fixed Rate Mortgage Average, Freddie Mac from FRED; Projection: Estimates by Ativore based on FOMC projections in Dec-23 for the FFR

# OPPORTUNISTIC VALUE ADD: Window of opportunities in 2024/25 to acquire **operating properties with distressed leverage** in structurally robust segments

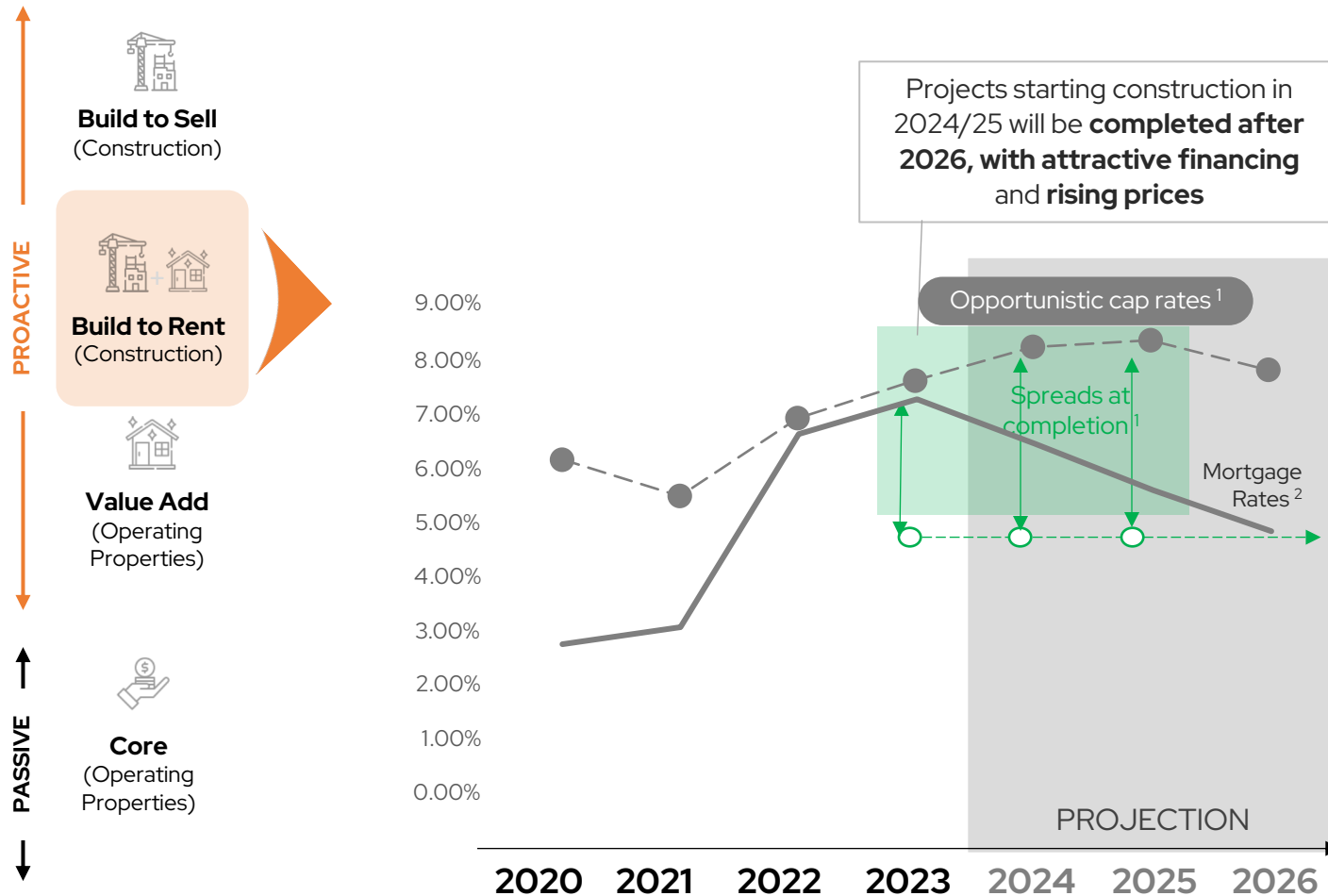


A trillion in debt maturing between 2024 and 2025 is expected to enable opportunistic acquisition strategies (at discounted prices) of operating properties with robust fundamentals but distressed leverage structures (balance sheet distressed Properties).

As interest rates decline, properties are expected to start rising in late 2025, creating the possibility of future exits with strong capital gains for those who seize this window.

1. Purely illustrative estimate. Presented based on empirical knowledge, with no quantitative basis. 2. Historic 30-Year Fixed Rate Mortgage Average, Freddie Mac from FRED; Projection: Estimates by Ativore based on FOMC projections in Dec-23 for the FFR

# BUILD TO RENT: Properties under construction expected to be completed and stabilized after 2026 will benefit from **lower long-term interest rates** and **appreciation** from cap rate compression



After construction and stabilization, within 2-3 years, the construction loan is replaced by long-term mortgage financing (+10 years).

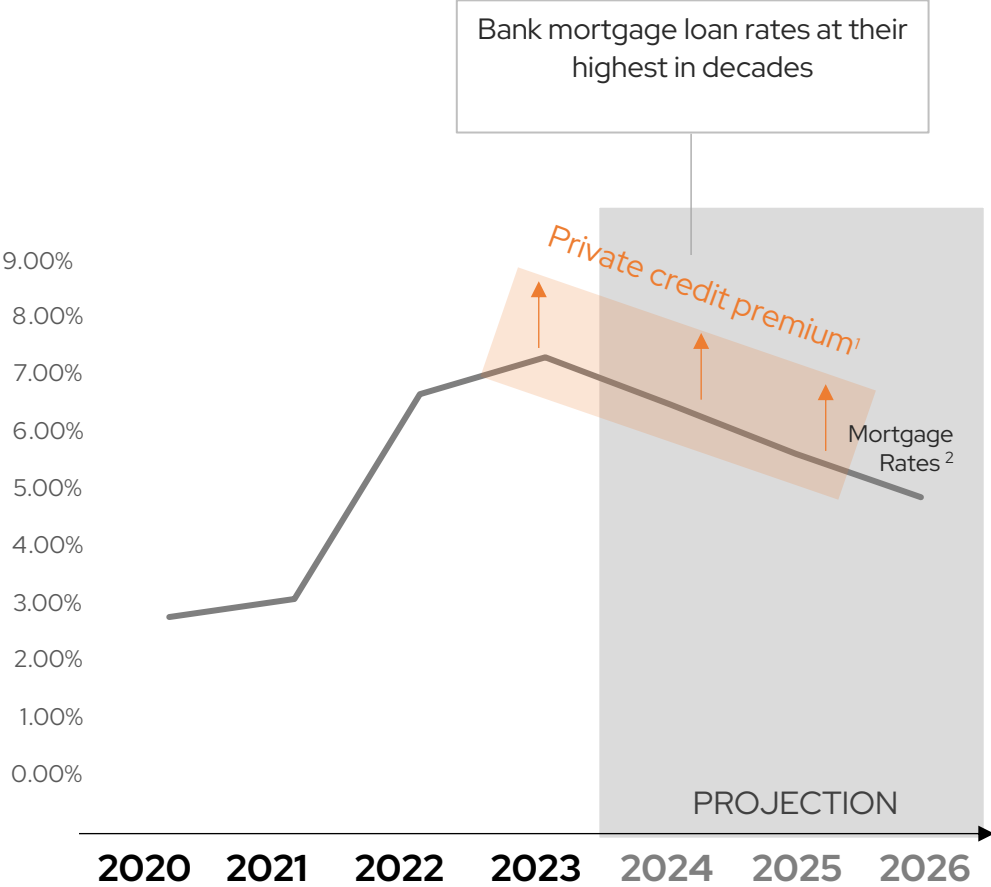
The timing for this strategy was poor in 2020/2021, as properties would be completed and refinanced now with very high interest rates, but it started to become attractive from 2023, due to the expected start of the rate-cutting period.

Projects starting construction in 2023/25 will be completed after 2026, when interest rates are expected to be much lower and property prices will already have begun to rise, enabling the lock-up of mortgage loans at attractive rates and potential capital gains generated by cap rate compression after 2026.

Of course, alpha generation through construction assumes the market is structurally robust and has no oversupply of properties.

1. Purely illustrative values. Presented based on empirical knowledge and without a quantitative basis. 2. Historic 30-Year Fixed Rate Mortgage Average Rate from Freddie Mac from FRED; Projection: Estimates by Ativore based on FOMC projections in Dec-23 for the FFR.

**PRIVATE CREDIT: Scarce real estate credit and still-high interest rates** will favor investment in debt with excellent risk-return profiles in 2024/25



With mortgage rates rising more than 300 basis points since the start of the Fed's "Hawk" cycle, we believe private real estate credit will continue to offer, at least until mid-2025, a very attractive risk-adjusted return.

The reduction in credit origination due to stricter standards adopted by banks will contrast with strong demand for credit, heightened by the need to refinance maturing debt over the next two years, even if transaction volume is lower.

1. Purely illustrative figures. Presented based on empirical knowledge, with no quantitative basis. 2. Historic 30-Year Fixed Rate Mortgage Average, Freddie Mac from FRED; Projection: Estimates by Ativore based on FOMC projections in Dec-23 for the FFR.

# Structural Opportunities Derived from Real Estate Fundamentals

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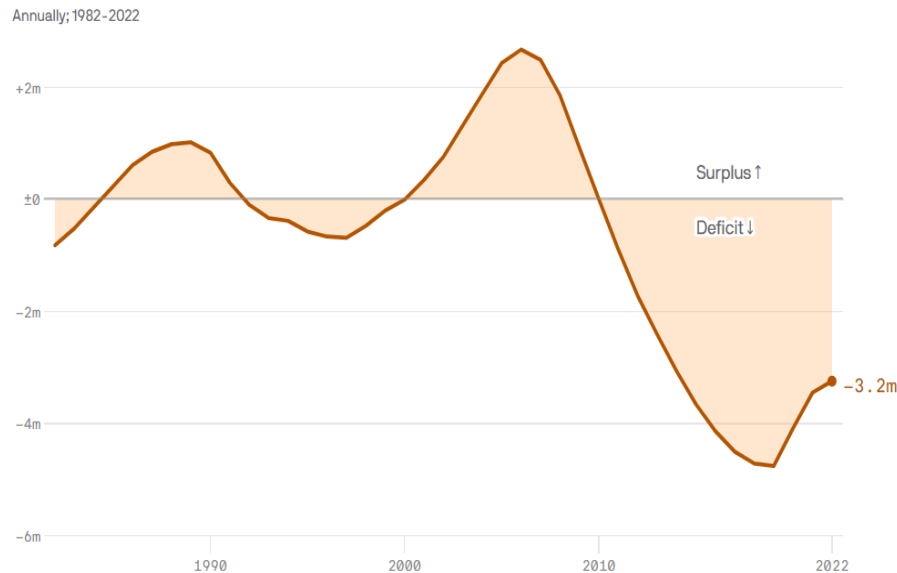


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# RESIDENTIAL FOR RENT: Housing deficit will be worsened by strong demographic fundamentals and a reduction in new construction projects due to the rise in interest rates

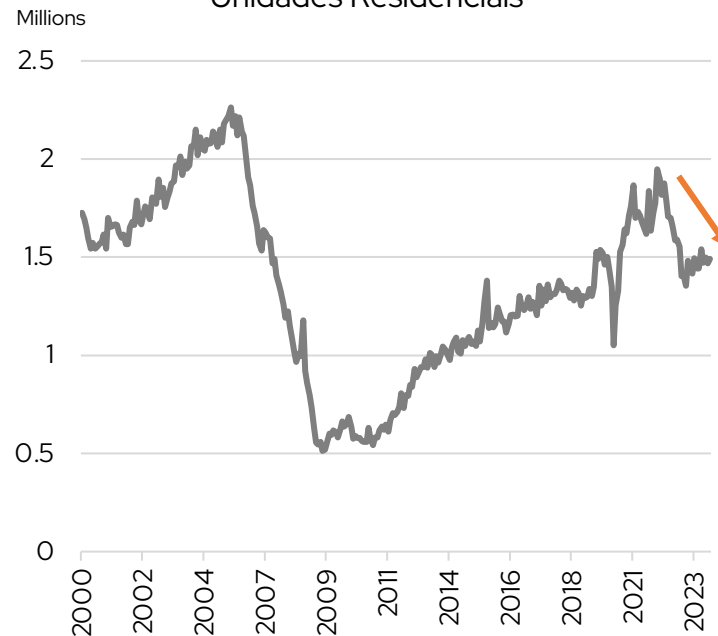
About 15 million housing units will need to be added over the next decade due to population growth and obsolescence.

*Housing deficit of 3.2 M units formed over the last decade<sup>1</sup>*



The 23% drop from the peak should worsen the deficit between 2025-2027

*Licenças para Construção de Novas Unidades Residenciais<sup>2</sup>*



There is a deficit of approximately 3.2 million homes in the U.S. In addition, about 15 million housing units will need to be added over the next decade, due to demographic factors and obsolescence.

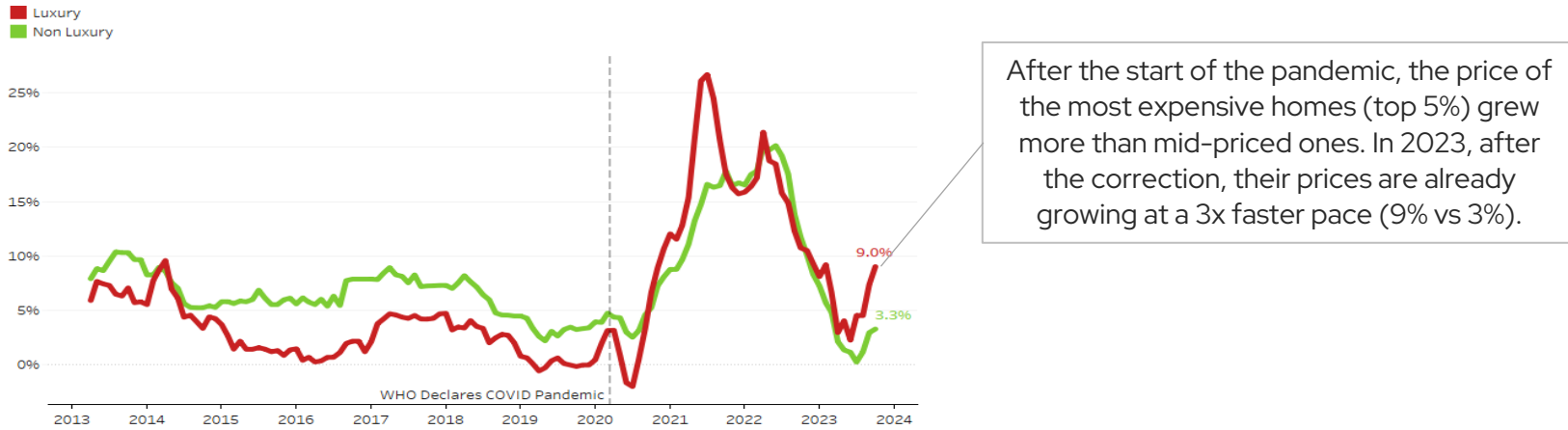
Since the start of monetary tightening, there has been a 23% drop in permits for new construction projects, a reversal of the trend seen between 2020 and 2021. An acceleration in construction over the next 2 years is unlikely due to high interest rates, which will result in significantly reduced deliveries of new properties between 2025 and 2027, worsening the deficit and strengthening residential sector fundamentals in this period.

1. Analysis by Hines of data from the Census Bureau and Moody's; Note: Population demand is a theoretical housing-demand metric based on long-term household formation and homeownership rates by age group; Chart: Axios Visuals.

2. FRED St Louis; CBRE Research, CBRE Econometric Advisors, Freddie Mac, U.S. Census Bureau, Realtor.com, FHFA, Q2 2023.. Compiled by: Ativore

# LUXURY RESIDENTIAL: a consumer less susceptible to market volatility who pays a premium for location and exclusivity

## High growth in luxury home prices

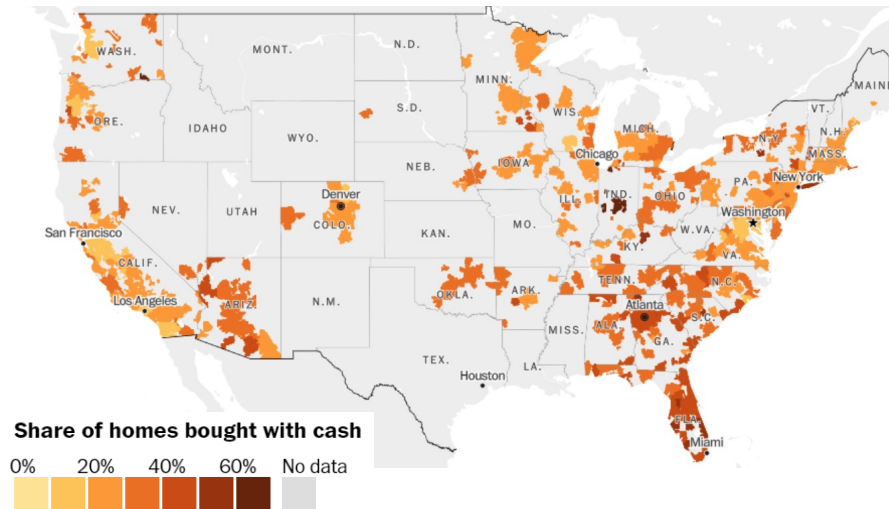


Since 2020, the most expensive end of the real estate market has outperformed the rest of the market. Explanations include more time spent at home after the pandemic, the need for more space, the desire to treat oneself, excess liquidity, and the growing concentration of income in the U.S.

With rising interest rates, the percentage of “all-cash” acquisitions, without financing, rose to 35% on the national average, reaching the highest level since 2014. Naturally, in premium markets, where buyers have high net worth, this figure reaches 90%, reinforcing the idea that the luxury market is less susceptible to economic volatility.

## Record number of all-cash transactions

2023 was a record year for acquisitions without financing (“all-cash”). In premium markets (West Palm Beach, Naples, Long Island etc.) between 60% and 90% of acquisitions are all-cash and do not depend on the level of interest rates.



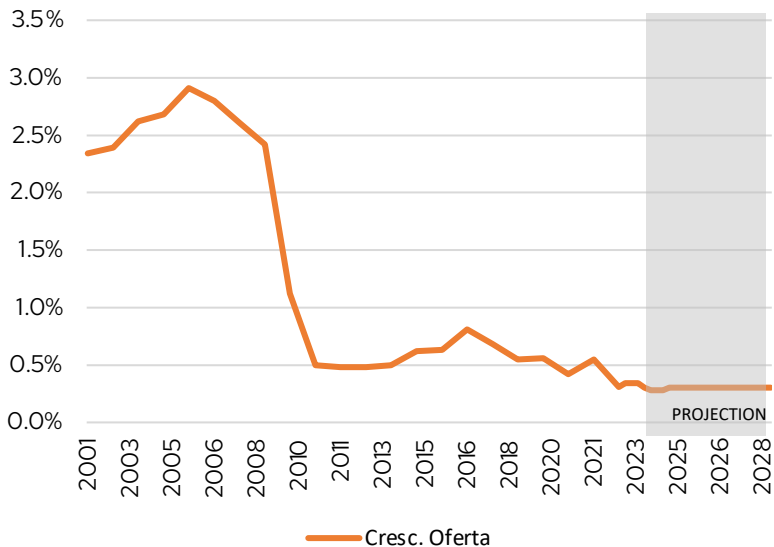
In addition, a 57% growth is projected in *High Net Worth Individuals* (HNWI) and 28% in *Ultra High Net Worth Individuals* (UHNWI) by 2027.

Sources: RedFin, KnightFrank, Washington Post.

# NECESSITY AND EXPERIENCE RETAIL: : “bad press”, supply shortage and rising consumer spending favor the segment, especially the part that does not compete with e-commerce

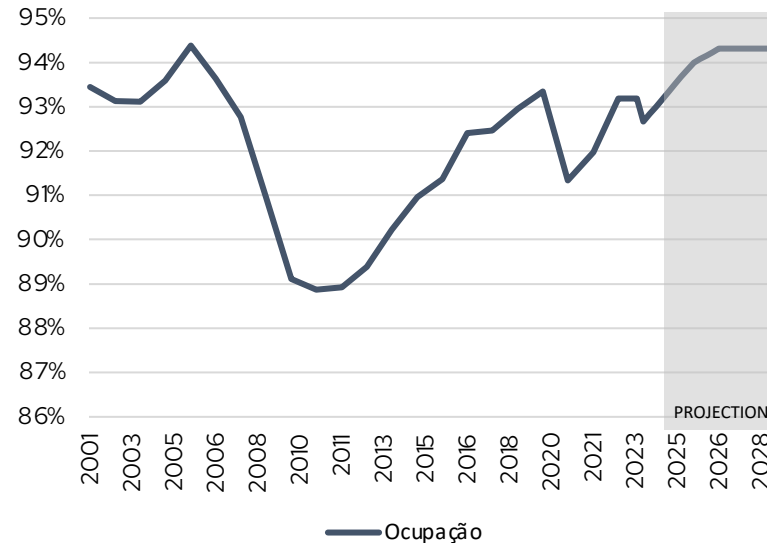
“Strip malls”: new construction near zero, demolitions and conversions, restricting the supply of space.

**Baixíssima expansão de oferta**



Growing demand has driven occupancy and rents in street retail, especially those geared toward essential services and “experience consumption” (e.g. luxury “high street”).

**Ocupação estável na última década**



Since the e-commerce boom, retail has faced distrust from investors. Several shopping centers and department stores succumbed in this process. But street retail reinvented itself and began to seek complementarity with online retail. Since then, occupancy has returned to healthy levels, above 93%, with an upward trend, and rents have also seen positive adjustments.

Many tenants offer services with no direct competition, such as supermarkets, restaurants, and gyms, while others seek to enhance the shopping experience. Another growing trend in the U.S. is “luxury retail”.

In parallel, there was a sharp drop in supply, due to high construction costs, zoning restrictions, and lack of adequate space. This, combined with strong consumer spending, made street retail (“Strip mall”) re-emerge as a good investment option, after the initial uncertainty brought by the pandemic.

Source: Green Street Data for Strip Center.

# Investment Strategies 2024-25

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**2024/25 STRATEGIES:** The biggest risk is missing the opportunities generated by the economic turbulence of the current high interest rates and the “dovish pivot” by the Fed

### 01 STRUCTURAL (Long Term)

Segments with strong structural fundamentals, demonstrated by the resilience of rents despite the sharp monetary tightening of the last two years

Luxury Residential

Residential for Rent

Necessity and Experience Retail  
(including luxury)

### 02 TACTICAL (2024-2025)

Strategies that benefit from the current high interest rates and the “dovish pivot” by the Fed in 2024.

Build to Rent

Private Credit

Opportunistic Distressed Properties

2nd Half of 2024 - 2025

“Dovish Pivot” Distressed properties

2025+

Stabilization and recovery

#### 1 - Structural factors (Long Term)

Residential and necessity-retail sectors have robust fundamentals, demonstrated by the resilience of rents in a context of historic monetary tightening.

#### 2 - Tactical factors (2024-2025)

##### Build to Rent

The “Dovish Pivot” by the Fed should lead to interest rate cuts over the next two years, when construction projects started in 2024 will be completed, benefiting from higher spreads and capital gains from cap rate compression.

##### Private Credit

High interest rates and scarce credit contrast with strong demand for loans, favoring investment in private credit.

##### Opportunistic – Distressed Properties

One trillion in debt maturing between 2024 and 2025 is expected to open a window for opportunistic acquisitions of properties with distressed leverage structures.

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