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THE WEEKLY UPDATE ON THE INSTITUTIONAL MARKETPLACE

Analysis Sees Steep Losses at Property Funds

Cumulative losses on commercial real estate are expected to reach double digits in the second quarter for fund managers, according to a **Hodes Weill & Associates** analysis of a sampling of top firms.

The New York advisory firm found first-quarter gross returns reported by four of the biggest public companies in the sector ranged from negative-1% to negative-8.8%. Given that the economic effects of the coronavirus pandemic only began in mid-March, the expectation is that those managers will have to write down their real estate holdings further by the end of June, said co-founder **Doug Weill.**

"It's hard to see anything other than at least a double-digit decline cumulatively," he said. The first quarter, he added, was just "the beginning of a series of potential write-downs. This is an indication of what's to come. But the losses we're likely going to see in coming quarters should come as no surprise, given the ongoing uncertainty created by the pandemic."

Weill noted that the recognition of declines in portfolio values could drag into the third and fourth quarters — particularly if investment-sales volume continues to be so thin that market pros have few comparable sales to use as a baseline.

Hodes Weill's review analyzed the publicly announced commercial real estate returns of **Apollo Global, Ares Management, Blackstone** and **KKR.** Many large public firms don't disclose those returns in filings, including **Brookfield, Carlyle Group** and **Colony Capital.**

To be sure, the review is just a sampling and excludes some of the industry's heaviest hitters. But the four firms have some $377 billion of real estate assets under management, the bulk of which are in the U.S., and Weill said their "reported quarterly returns are increasingly important benchmarks for the industry." He noted that one institutional investor he spoke with recently said that "Blackstone, given its scale, is essentially an index for the industry."

The largest reported decline was on Blackstone's $58.5 billion of global opportunistic assets. The 8.8% first-quarter drop was in stark contrast to the platform's 2019 gross return of 17.6%.

Blackstone also reported a 3.9% loss on its global core-plus assets, which total some $36.9 billion. That portfolio generated a 9.2% return last year.

The next-largest reported drop, of 6.5%, was on Apollo's $29.4 billion global real assets portfolio. It had been up 16.2% last year.

Real Estate Fund Performance

	AUM ($Bil.)	Gross Return (%) 2019	Gross Return (%) 1Q-20
Apollo Global Real Assets	$29.4	16.2	-6.5
Ares European Real Estate Equity	3.9	12.7	-3.5
Ares U.S. Real Estate Equity	3.4	16.8	-4.2
Blackstone Global Core+	36.9	9.2	-3.9
Blackstone Global Opportunistic	58.5	17.6	-8.8
KKR Global Opportunistic	7.7	24.0	-1.0
MSCI/PREA U.S. Core OEF Index	237.4	5.9	1.2

Source: Hodes Weill & Associates

The smallest loss in the group was at KKR, whose $7.7 billion global opportunistic portfolio reported a negative-1% return — after a 2019 gain of 24%.

Weill said he would expect to continue seeing a disparity in reported losses, as different firms will have varying approaches to writing down the value of their real estate assets. Each firm's leverage and the risk profile of its holdings will also factor into its losses.

But Weill added that — unlike during the Great Recession in 2008-2010 — he expects investment firms to report losses sooner rather than later. He pointed to Blackstone president **Jon Gray's** comment during the firm's April 23 earnings call: "We have to remain clear-eyed about the uncertainties in the world, and underwrite a slow recovery."

After the 2008 crash, Weill said, "some managers took their medicine really quickly and some dribbled it out over 4-6 quarters. That frustrated LPs . . . They were holding out too much hope. If there's a lesson learned from the Great Financial Crisis, it's take your medicine earlier."

Weill said that even as negative returns continue, the overall outlook for real estate remains strong in whatever recovery follows. He noted that Blackstone chief executive **Stephen Schwarzman** referred to his firm's initial write-downs as "unrealized marks . . . a point-in-time valuation, and not an estimate of the value we ultimately expect to realize."

Weill added: "Commercial real estate remains a large and growing part of global institutions' investment strategies. And we do not expect that to change." ❖