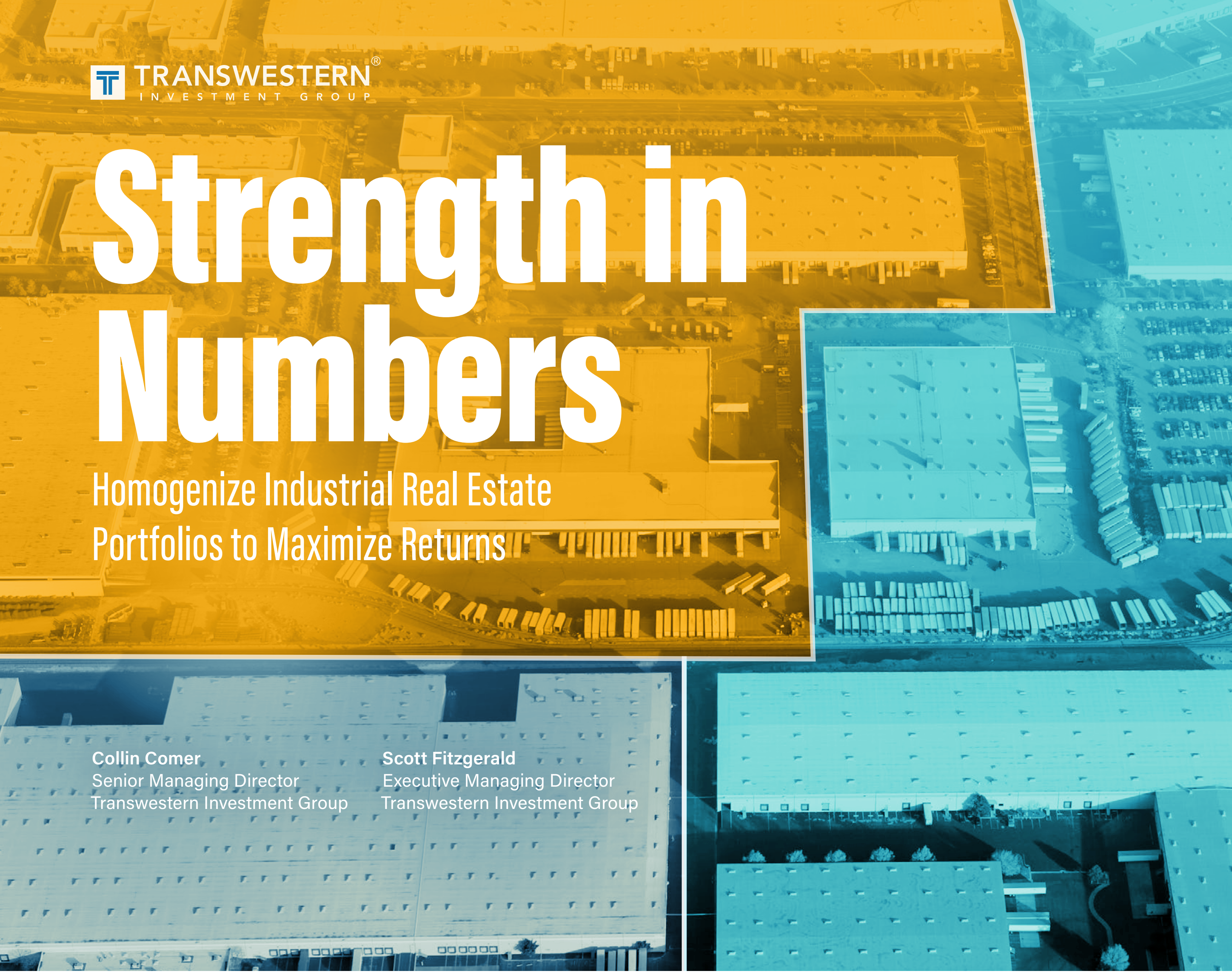


TRANSWESTERN® INVESTMENT GROUP

Strength in Numbers

Homogenize Industrial Real Estate Portfolios to Maximize Returns

Collin Comer
Senior Managing Director
Transwestern Investment Group

Scott Fitzgerald
Executive Managing Director
Transwestern Investment Group

As many investors will attest, few industrial portfolios available today will entirely dovetail with a buyer's needs. Real Capital Analytics data shows approximately 70% of industrial asset sales are one-off transactions, creating a fundamental mismatch between those offerings and the volume of capital that seeks large-scale placement in the sector.

This dynamic provides an opportunity for investors with properly positioned portfolios to achieve premium pricing. But to better appreciate that opportunity, it helps to understand the reasons for the incompatibility between buyer and seller requirements, one of which stems from the way fundraising has evolved since the Great Recession.

Larger funds, fewer managers

Targeting higher returns and lower volatility, pension plans have increased allocations to commercial real estate over the last 10 years. In the wake of the 2007-2008 global financial crisis, pensions consolidated external manager relationships to reduce expenses and demands on internal staff, with best-in-class managers benefitting from broader mandates. By 2013, more than 450 closed-end private real estate funds were targeting new commitments, according to Preqin, with 40% seeking capital for the first time.

Aiming to avoid the risk of investing with new management teams, pensions have opted to commit allocations to existing external managers, resulting in larger allocations to fewer

managers. By 2016, the 10 largest funds secured 36% of the total capital raised, according to Preqin. The average fund size in 2016 was $500 million, with many managers raising multibillion-dollar closed-end funds in record time.

The average investment in an industrial property is approximately $12 million, according to Real Capital Analytics. That amount is half the average value of office transactions and poses a challenge for some investors seeking to increase industrial exposure.

The larger funds that have emerged in recent years need large transactions to fully deploy their committed capital because the alternative – targeting smaller transactions – would require additional resources and staffing levels, elevating investment-execution risk while increasing cost and inefficiency.

Instead of engaging in one-off transactions, many larger firms have concentrated on gaining industrial asset exposure by pursuing portfolios and entity-level transactions. By 2018, annual portfolio and entity-level transactions for industrial properties totaled $45.6 billion, up more than 279% from $12.0 billion in 2012, per Real Capital Analytics.

Portfolio premium

Industrial market fundamentals are strong, with demand outpacing supply in most of the major markets. E-commerce tenants continue to drive demand for warehouse and distribution space, vacancy rates are at cycle-lows and rents are increasing. Investor demand for these assets has grown, and some large investment funds, which generally have the lowest cost of capital, will pay more for a large, multitenant, geographically diverse portfolio of similar vintage.

Lenders have increased their appetite for industrial as well. Although they remain cautious, debt providers have rewarded investors financing large, diverse portfolios with lower credit spreads and higher leverage ratios than can be achieved in alternative property types or lower mortgage balances. This trend produced liquidity that has enhanced larger portfolio transactions. Currently, demand from large investment funds can combine with enhanced liquidity to create a significant premium for a portfolio trade over a single-asset trade.

However, not all portfolios will trade the same. Industrial portfolio sales are highly dependent on the proper mix of assets and locations.

“A homogeneous portfolio of sufficient scale will garner a premium.”

For example, offering a portfolio that includes both high-throughput logistics assets as well as flex assets that are chiefly finished out as offices will limit investor interest because of the mismatch between investment strategies. The investor that focuses on the logistics assets will not want to invest in the flex assets and vice versa. This leads to a breakup of the portfolio into multiple transactions where the assets are allocated according to the proper strategy.

Homogeneous portfolio strategy

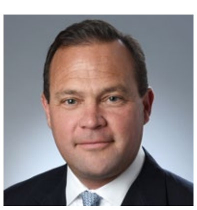
Conversely, a portfolio with similar assets in logistically related markets of comparable vintage will attract significant investor attention, given the uniform strategy that can fit within an investor's defined investment profile. A homogeneous portfolio of sufficient scale will garner the portfolio premium.

Transwestern Investment Group (TIG®) achieved premium pricing on a recent industrial portfolio sale by catering to the market's largest buyers, aggregating smaller acquisitions into a sizable industrial portfolio in TSP Value and Income Fund I, which delivered a net 17% internal rate of return to investors after fees, expenses and carried interest. The firm is continuing with the same strategy on its second and larger fund, combining narrow acquisition criteria with a value-add program.

As an experienced owner and operator, TIG acquired assets it could enhance through efficient operations. In addition to making needed capital improvements, TIG renewed tenants on long-term leases, reconfigured spaces to fill vacancies and maximized net operating income (NOI). Adding value is the principal strategy to reach targeted returns, and Fund I boosted NOI by almost 20% over an average weighted hold of 3.5 years.

Throughout the investment period for both funds, the team was laying groundwork to substantially outperform when monetizing those assets. The key to outperformance was aggregating a product that could participate in the significant transformation stemming from the proliferation of e-commerce, sized to garner the attention of the market's largest buyers.

Collin Comer
Collin.Comer@transwesterninvest.com
214.572.9810



Scott Fitzgerald
Scott.Fitzgerald@transwesterninvest.com
214.572.9813

TSP Value and Income Funds I and II

Transwestern Investment Group's industrial investments in both TSP Value and Income Funds I and II have positioned TIG to be a low-cost provider of functional, infill warehouse space.

The asset class already offers an attractive yield and has a strong tailwind as the growth of omnichannel retailing and e-commerce drive demand for fulfillment and distribution centers. TIG's portfolio aggregation strategy provides multimarket diversity with highly functional bulk warehouses containing a low ratio of office space in infill locations suited for order fulfilment and last-mile delivery to urban populations.

The firm drew upon its lengthy experience as an owner and operator to increase value, improving each asset's net operating income through leasing, improvements and efficient operations. Fund I boosted NOI by almost 20% over an average weighted hold of 3.5 years.

Fund I's 3.5 million-square-foot portfolio – including 21 logistics facilities in Illinois, Ohio, Indiana and Kentucky – provided a highly sought-after product type that met the size and quality requirements of the market's largest buyers. The portfolio was 91% occupied when it sold to an overseas institutional buyer whose low cost of capital gave the seller a premium on the fund's residual cap rate, boosting the net internal rate of return to 17%.

Fund II is using the same strategy at twice the scale, buying assets that coalesce to capture demand for large transactions. By midsummer 2019, Value and Income Fund II had approximately 4 million square feet in committed industrial acquisitions.