

Real Estate Investing at an Inflation Inflection Point

We believe it's critical for investors to consider whether their portfolios are positioned for persistent inflationary pressures, higher interest rates, and market volatility.

The Drivers of Elevated Inflation and Rising Rates



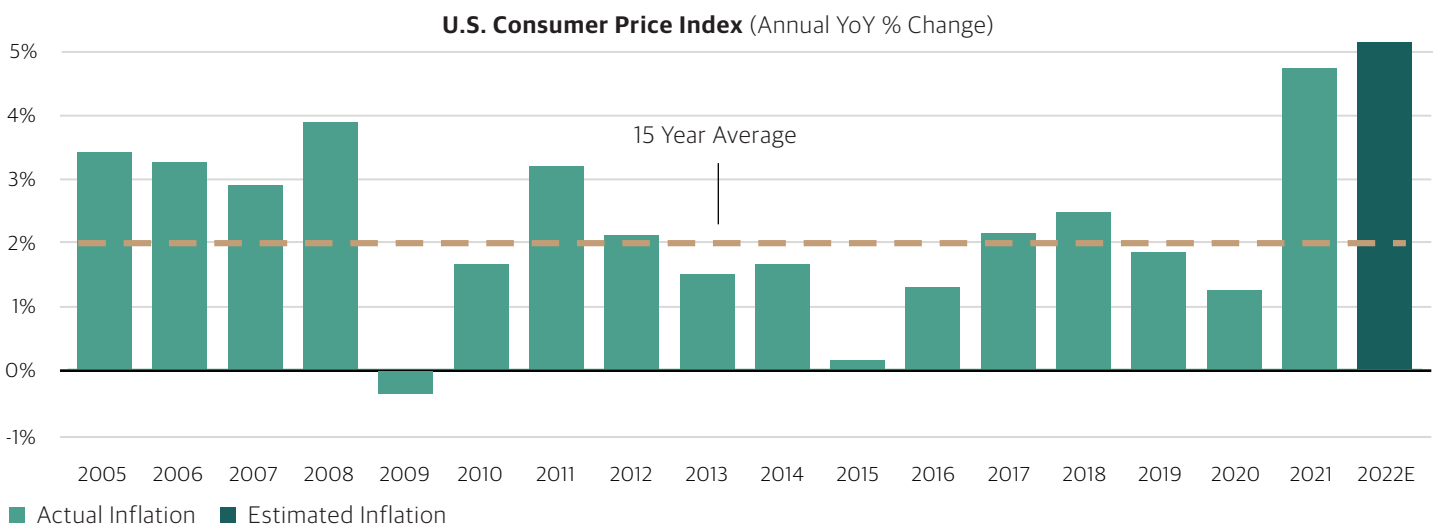
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- Inflation remains elevated due to stubborn supply chain bottlenecks, energy shortages, and rising commodity costs
- In the U.S., "sticky" components of inflation continue to accelerate, including shelter prices and wages
- Given the strength of the economy and the likelihood of persistent inflation, it's likely that the Fed will tighten monetary policy significantly
- Historically, periods of inflationary upturns suggest a higher 10-year Treasury yield¹

To counter the prevailing headwinds that are likely to challenge market returns, investors may want to consider the potential benefits of shorter-duration assets, industries with secular growth and thematic investing.

Inflation on the Rise

Consensus forecast is for inflation in 2022 to reach the highest level since 1990, significantly greater than the 15 year average



Source: The Consumer Price Index (CPI) measure referenced is the Consumer Price Index for All Urban Consumers: All Items in U.S. City Average. Bureau of Labor Statistics, as of 12/31/2021. Estimate for 2022 CPI represents the median consensus economic forecast, as compiled by Bloomberg, as of 2/28/2022.

1. Blackstone Investment Strategy calculations of Bureau of Labor Statistics and Bloomberg data, as of 12/31/2021.

What does inflation mean for real estate?

For the right assets, in the right markets, real estate historically has performed well in a rising-rate environment, particularly when economic growth is strong. Within certain sectors, real estate can provide cash flow yield and growth, with the potential downside protection that hard assets provide.



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Real estate can offer dynamic cash flows

- Unlike traditional bonds that generate fixed cash flows, the income streams from real estate can rise over time
- Prioritizing assets with shorter lease durations in sectors with strong underlying growth fundamentals can provide the opportunity to regularly reset rents to prevailing market rates in an inflationary environment. Hotels effectively have one-night leases. Other sectors, such as residential and industrial, also tend to have shorter-duration leases
- Certain assets with longer duration leases, such as net lease properties, often include contractual rent escalators to mitigate inflationary risks

Sector selection matters

- Residential and industrial are two of the strongest performing sectors where growth is outpacing inflation. Rent growth in these sectors has accelerated, and both are seeing growing demand¹
- Bond-like assets that have long-term leases with limited rent resets are more susceptible as rates rise
- Sectors facing tenant demand headwinds, such as U.S. regional malls and urban office buildings, may not be able to command near-term rent increases that can keep up with inflation

Cap rates have room for interest rates to rise

- Today, real estate trades at a historically high premium to 10-year Treasuries, with the major sectors cap rate spread significantly wider than the historical average^{2,3}
- Given this starting point, rising interest rates may not necessarily result in a commensurate increase in cap rates or decline in real estate values

Limited supply generally supports valuations

- Supply, even within in-demand sectors like industrial,⁴ remains in check
- In an inflationary environment, increases in the cost of land, construction, and labor are likely to make new supply less financially feasible, which is generally supportive of higher occupancies and stronger pricing power for existing assets

1. Two of the best performing sectors based on performance of residential and industrial listed REITs in 2021 represented by FTSE Nareit Equity REITs as of December 31, 2021. Inflation figures provided by the Bureau of Labor Statistics' Consumer Price Index which can be found at <https://fred.stlouisfed.org/series/CPIAUCSL>. Rent growth represents year-over-year net asking rents weighted by net absorption for the year.
2. Green Street Advisors, as of 1/1/22. Major sectors include apartments, industrial, mall, office, and strip centers. **Past performance is not indicative of future results.** There is no guarantee that any of these trends will continue or will not reverse. Past events and trends do not imply, predict or guarantee, and are not necessarily indicative of, future events or results. There is no guarantee that any risk can be mitigated in whole or in part. Real Estate products are subject to the risk of capital loss and investors may not get back the amount originally invested.
3. Major sectors real estate cap rate was 4.8% as of December 31, 2021. 10-Yr UST was 1.5% as of December 31, 2021. The "long-term average" reflects the period between December 1986 to December 2021. "Major Sectors" is sourced from Green Street Advisors and reflects the equal weighted average of the asset weighted averages for the five major property sectors (apartments, industrial, mall, office, and strip center).
4. CBRE-EA, as of 12/31/21. A copy of the source material of such data can be provided upon request.

Key Risk Factors

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