BLUE OWL

Real Estate Outlook

JANUARY 2025

Introduction

Investors appear to be entering a new era of optimism for commercial real estate following a challenging few years of declining valuations, persistent inflation, and higher interest rates and credit spreads paired with lower credit availability.

For the limited number of real estate managers and investors who are fortunate enough to have access to dry powder, they will be able to take advantage of what many believe to be a once-in-a-generation buying opportunity.

The economic headwinds of the recent past have created increased interest from investors who are eager to invest their capital in net lease strategies that may deliver contractual, predictable income in an unpredictable environment. Blue Owl Real Estate's all-weather net lease strategy was intentionally designed just for this need: Our net lease strategy is focused on partnering with high quality investment grade and creditworthy firms to help them unlock capital through acquiring their most mission-critical real estate assets. Since our tenants assume the expense risk in a net lease structure, we can target consistent cash flow to our investors along with downside protection.

Our stringent investment criteria have resulted in Blue Owl Real Estate's net lease strategy outperforming the broader real estate market.[i] We have several billion of dry powder to deploy and believe we are well positioned to take advantage of this unique investment opportunity in 2025 and beyond.[ii]

What value creation looks like in a "higher for longer" interest rate environment

Our view

Net lease strategies have grown and evolved in recent years. What was once considered a niche sector has now become a mainstream option for investors who are drawn to its compelling characteristics of stability, predictability of cash flow, downside protection, and if executed properly, the potential for opportunistic returns. The triple net lease structure seeks to provide inflation protection for investors through its insulation from operating expenses as the tenant bears responsibility for expenses (i.e., real estate taxes, maintenance, insurance, etc.).

Net lease transactions have become equally appealing to corporations that own real estate. As higher interest rates have impacted companies of all sizes and capital structures, sale-leaseback activity has accelerated materially over the past few years.[iii] Many firms are now looking to optimize their balance sheets through the monetization of their real estate, and they are utilizing those proceeds to fuel growth or finance various initiatives. Companies have shown a preference to partners that can provide scale, speed, and certainty of execution as they are more inclined to pursue a large, single solution in the private markets that offers a greater level of assurance.

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The net lease advantage

Tenant

Responsible for expenses such as:

- Repairs
- Maintenance
- Insurance
- Real estate tax

Net Cash Flow / Rent →

Blue Owl

- Landlord receives rent, net of all expenses
- Long-term lease obligations mitigate vacancy risk
- Target contractual 2% annual rent escalations provide clarity on future cash flows

Our strategy

When you examine the evolution of our net lease strategy dating back to the inception of the predecessor to Blue Owl Real Estate in 2009, our strategy and investment criteria have remained largely consistent, year over year and vintage over vintage. Having launched the business on the heels of the 2007-2008 Global Financial Crisis, our team sought to create an investment thesis that could stand the test of various market cycles and perform regardless of the economic environment. We are proud to say our strategy has continuously delivered attractive, risk-adjusted returns to investors over the past 15+ years regardless of the market or interest rate environment.

A key focus of our investment strategy is to maintain an attractive spread between our all-in cost of financing and our entry cap rates, which results in positive leverage for our investments. While the cost of our financing has risen, we have been able to maintain our cash yield by deploying at some of the most attractive valuations observed historically. The entry cap rates we have been able to achieve have meaningfully increased in the current market as a result of corporations seeking alternative and bespoke capital solutions. Our team's ability to structure a flexible and creative solution to meet the unique needs of these corporate counterparties allows Blue Owl Real Estate to drive attractive pricing and better terms. Our strategy focuses on securing fixed-rate debt which provides our investors with certainty of cash flow throughout the investment hold period. Furthermore, our portfolio of real estate assets carries annual net rent growth of approximately 2% on average, providing a compelling hedge against inflation throughout a range of long-term economic cycles.

Companies utilize our capital for many reasons, whether it is paying down debt, pursuing M&A activity, or solving for capital expenditure needs with sale-leaseback proceeds. Looking ahead, we expect organic and inorganic growth to be a key theme for firms in 2025. With corporate M&A activity expected to increase in the coming months, we expect companies will be searching for partners that can help them scale to drive earnings and growth.

We believe these dynamics will allow Blue Owl Real Estate to put considerable dollars to work in pursuit of delivering favorable yields and risk adjusted total returns for our investors.

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The opportunity set in private capital solutions is rapidly expanding

Our view

Private markets have historically been dominated by institutional capital such as public pension funds and endowments, but the past few decades have brought a meaningful shift in those markets' underlying investor bases, as private wealth demand for private market investment opportunities has increased substantially.[iv] Investment managers have provided greater access to their private funds to high-net-worth investors who are in search of higher yielding investments and diversification.

Simultaneously, the expansion of the private markets, coupled with evolving economic conditions, have enabled investment managers to continue to innovate and offer investors new private capital solutions. Within private real estate, we observe three major investment opportunities we believe will have tremendous tailwinds for years to come: European sale-leaseback transactions, Real Estate Credit, and Digital Infrastructure.

Our strategy

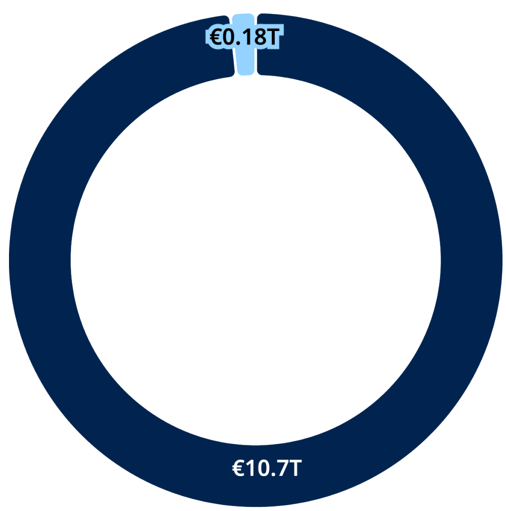
Over the past two years, Blue Owl Real Estate has raised over $6 billion of high-net-worth private capital, which has allowed us to scale our business and capitalize on the unique and attractive buying opportunity in today's market.

The first opportunity we have been actively pursuing is executing sale-leaseback transactions in Europe. The Blue Owl Real Estate net lease strategy in Europe is a replica of the net lease strategy Blue Owl has successfully executed in the United States for over 15 years. We believe the European real estate market is experiencing similar cyclical distress we have experienced in the United States – one driven by macroeconomic uncertainty, capital markets volatility, and the lack of liquidity available in the market today. Historically, we have also seen cap rates trade much more tightly in Europe compared to the US, making the opportunity set less appealing to our team relative to the opportunities we have been pursuing domestically for over a decade. However, as a result of lower cap rates in Europe, the liquidity challenges and rising rates in Europe have created even more distress compared to what we have seen in the US, which has removed many of the historical sale-leaseback market constituents out of the business as they manage their troubled portfolios.[v] This has catalyzed an incredible entry point for Blue Owl Real Estate to enter the market with less competition.

Europe presents a vast addressable market with the potential sale-leaseback investment universe representing, according to our estimates, approximately €10.7 trillion while annual transaction volume is only approximately €18 billion, which is less than 1% of the market size. Additionally, there is now notably less competition in Europe compared to the US, giving us strong conviction our deal pipeline will remain incredibly robust for the foreseeable future. Our team has spent the past 15 years developing deep relationships with investment grade corporations and their most trusted advisors. Going forward, Blue Owl Real Estate plans to expand its partnerships with many of these same firms who have an international presence and have expressed a strong desire to monetize their assets overseas, while also developing new relationships with the many investment grade rated companies domiciled in Europe.

Europe's opportunity

Sale-leaseback investable universe vs. annual transaction volume



Source: Jones Lang Lasalle Incorporated — "Raising Capital From Corporate Real Estate" — April 2024

The second opportunity we are enthusiastic about is Real Estate Credit. We believe the lack of credit availability in the market today, coupled with higher interest rates, has created a unique opportunity for private lenders such as Blue Owl Real Estate to fill the void. Historically, banks have been the largest lenders in the commercial real estate industry, but those firms have pulled back in recent years due to market volatility. Additionally, the higher-for-longer interest rate environment has made it challenging for borrowers to find alternative sources of capital to refinance their existing lenders. It is estimated nearly $3 trillion of mortgage loans will come to maturity in the next four years[vi], causing industry experts to believe portfolio deterioration will continue and lead to a significant need for private debt capital moving forward.[vii]

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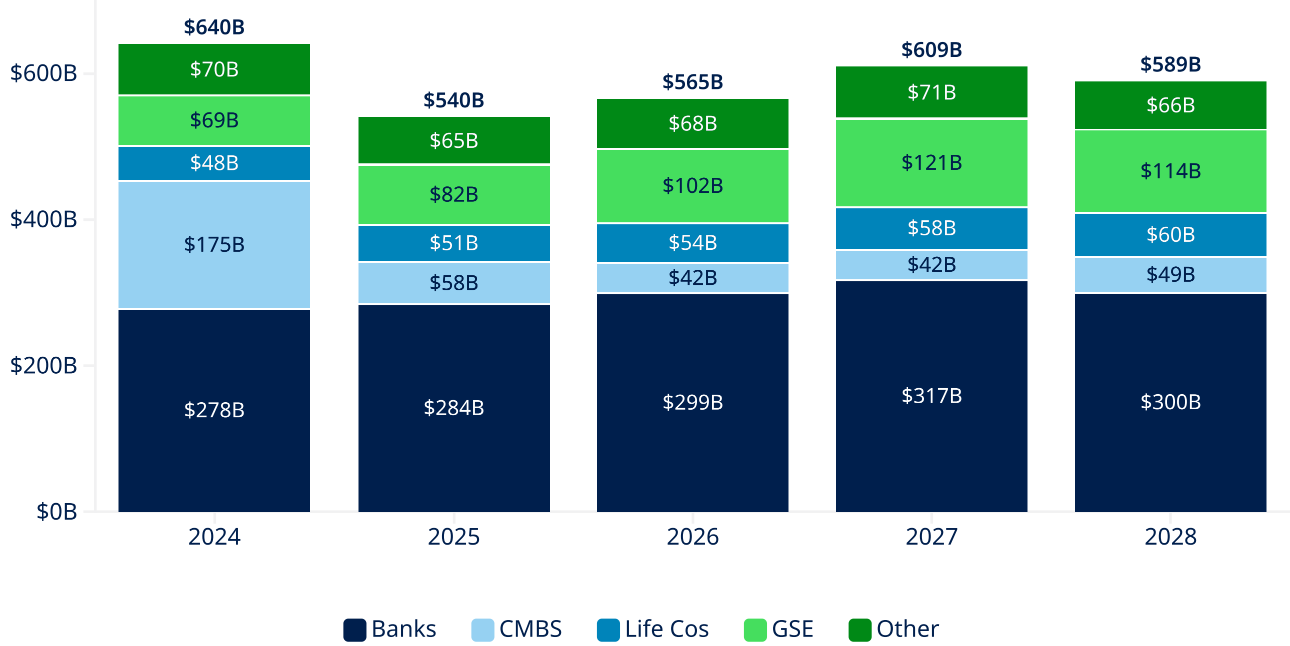
The $3 trillion wave

Commercial real estate debt maturities by year



Source: Trepp, Inc. based on Federal Reserve flow of funds data

Investor appetite for private real estate debt is robust, as evidenced by PERE's Real Estate Debt 50 ranking which shows a 3% increase in fundraising in 2024, a notable statistic despite overall real estate capital raising falling to its lowest level in 11 years. We have observed commercial real estate lending strategies delivering higher returns at lower leverage levels in today's market compared to recent years. This is due to higher interest rates and credit spreads coupled with lower loan to value ratios driven by re-priced assets and a more conservative lender underwriting environment. As such, we believe our Real Estate Credit strategy is well positioned for upcoming market volatility.

The third opportunity we are incredibly excited about, digital infrastructure, also overlaps with our third theme—the importance of scale, which we will now examine in the next section.

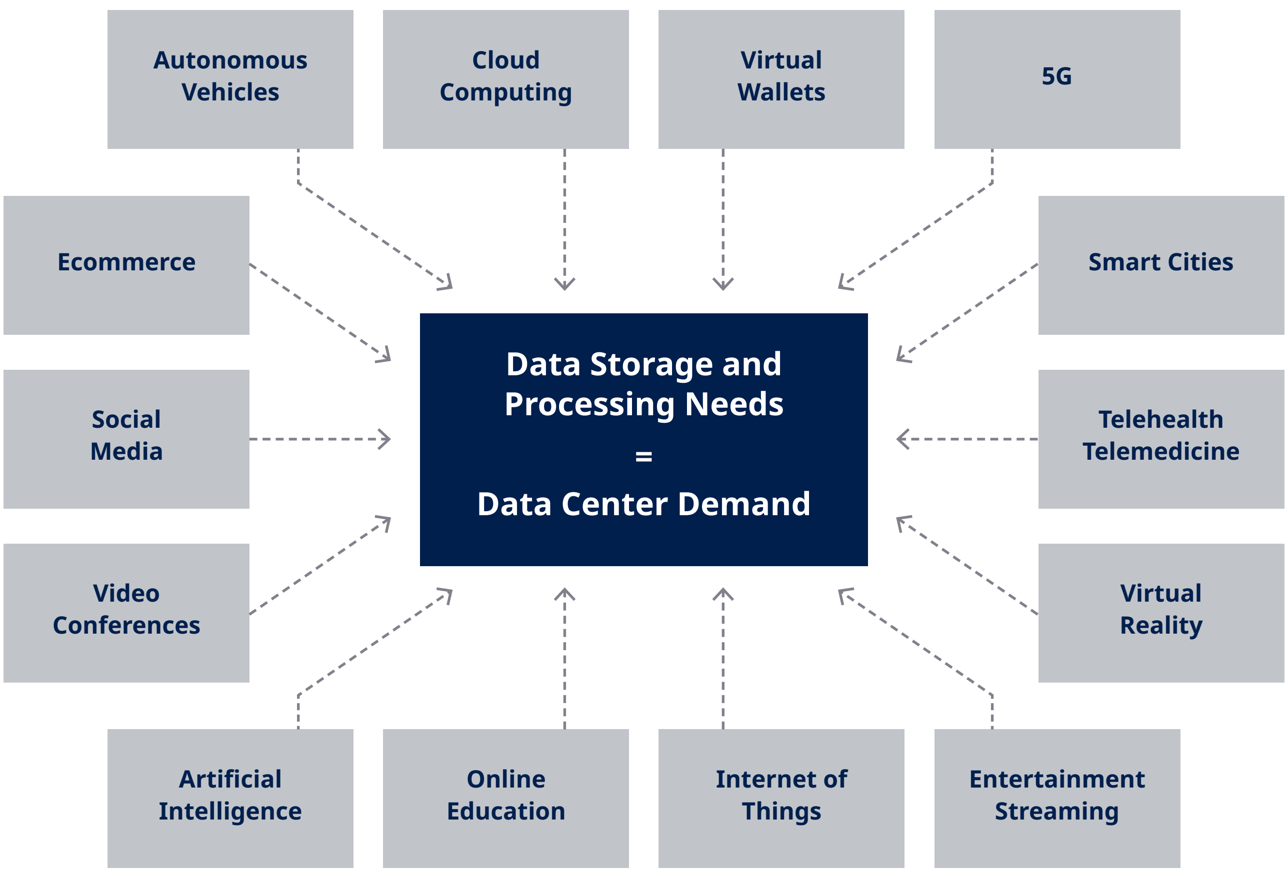
The competitive advantage afforded by scale is only now being amplified

Our view

We believe the opportunity for growth within the net lease industry has never been larger than it is today. It is clear an increasing number of corporations are seeking alternative forms of liquidity and, as a result, transaction volumes have increased accordingly. Corporations are now prioritizing capital partners who can provide them with greater scale, increased speed, and deep experience in structuring bespoke solutions as they look to grow their business.

These factors are most evident in digital infrastructure. The explosive growth of cloud services and proliferation of artificial intelligence has led to an increased need within the technology sector to meet the heightened demand for expanded data and latency capabilities. Cloud service providers are encountering a massive supply/demand imbalance and are desperately searching for capital partners that can provide scale. Firms appear to be moving toward custom-built facilities they control so they can efficiently build these assets to meet the needs of end-users. As such, hyper-scalers, including some of the world's largest technology companies, will be looking for partners to fund the expansion of their data center footprint by providing cost efficient and scaled financing solutions.

The data center ecosystem



Our strategy

These conditions have allowed Blue Owl Real Estate to put significant capital to work, as we can provide the exact solution firms are seeking. We have been fortunate to raise approximately $11 billion over the past 24 months, making Blue Owl Real Estate one of the largest capital raisers in private real estate, which has created an opportunity for us to provide companies sizeable and scalable solutions that can have a significant impact on their strategic initiatives and overall business growth. As such, our pipeline of opportunities is greater than it has ever been and shows no signs of slowing down.

Due to the limited number of pure-play data center owners and managers with meaningful size, our team is optimally positioned to leverage our corporate infrastructure expertise and creative capital solutions in an ever-growing sector. Blue Owl Real Estate currently has over $27 billion worth of data center deals in the pipeline with over $15 billion closed or under contract.

Considering the magnitude of these developments, often in the billions of dollars, we believe there are few market participants capable of providing the capital and depth of partnership to compete with Blue Owl's Real Estate platform.

Expanding on these advantages, Blue Owl recently announced the closing of its acquisition of IPI Partners, a leading digital infrastructure manager. IPI's team is focused on transacting with large, high quality hyperscale and enterprise datacenter users and has grown to become one of the largest US-based data center owners and operators. This acquisition will further expand Blue Owl Real Estate's existing digital infrastructure strategy and provide immediate and scaled expansion into a multi-trillion-dollar (and growing) data center market. We believe IPI's investment strategy complements our existing net lease real estate platform and positions us well within the largest and fastest growing part of the global real assets landscape.

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> There is one industry in particular where the ability to scale has become the number-one criteria when evaluating capital partners: digital infrastructure.

Conclusion

Today's buying opportunity has the potential to yield some of the best performing vintages for real estate investments we have seen in more than a decade. Our differentiated sourcing and ability to transact off-market will allow us to take advantage of these rare opportunities. The increased need for partners who can provide scale and creative capital solutions will continue to distinguish us from our peers and make Blue Owl a partner of choice for companies seeking firms who can provide certainty of execution and assist them in their growth. Our strategy was purposefully designed to perform in varying economic environments, and we believe we are well positioned to continue delivering consistent current income and attractive risk-adjusted returns as we enter the new year.

Author

Marc Zahr
Co-President and Head of the Real Estate platform

Endnotes

i. Preqin; Blue Owl RE data as of September 30, 2024 (Preqin data as of Most-up-to-Date)

ii. Blue Owl Pulse Check: 2024 Market Outlook

iii. PERE – "Net Lease Report" – May 2024

iv. Private Banker International – "Private markets: the new frontier for private wealth investors" – October 28, 2024

v. CBRE - "The Case for European Real Estate"

vi. Trepp - CRE Mortgage Maturities and Debt Outstanding" - May 202

vii. PERE "Red 50 Managers shrug off market woes" – May 2024

Important information

Unless otherwise indicated, the information referenced herein is as of December 31, 2024.

Past performance is not a guarantee of future results.

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