Ares Secondaries Group Provides Recap of 2023 Real Estate Secondaries Market Volume

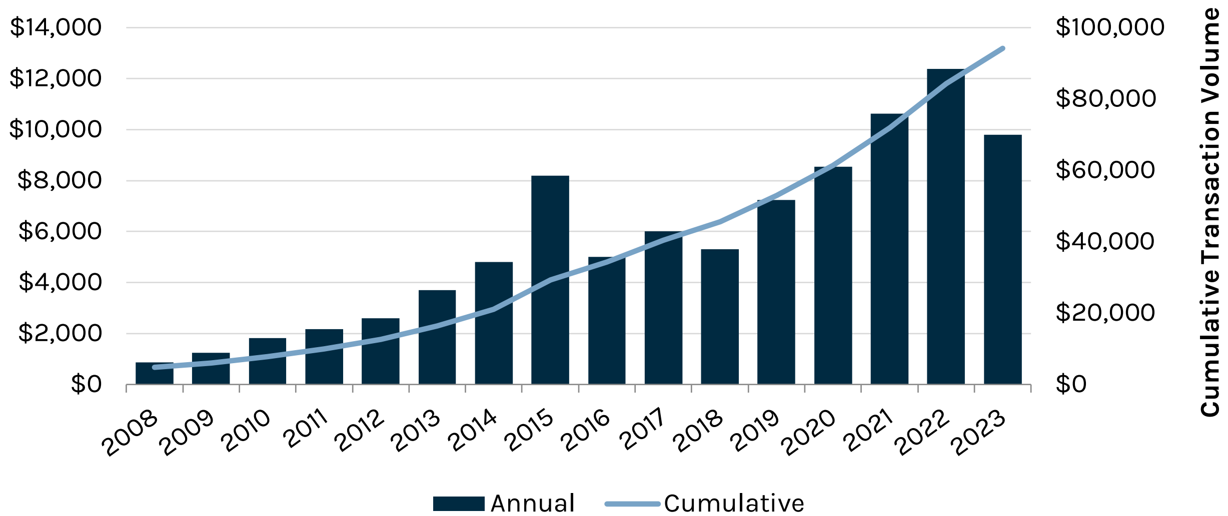
Following Record 2022, Real Estate Secondary Market Transaction Volume Down in 2023; Promising Outlook for 2024 and Beyond

The Ares Secondaries Group has been been tracking market data for nearly two decades in order to better understand past trends and anticipate future ones. Looking at real estate secondary market transaction volume for 2023, the overall decrease in volume relative to a record-setting 2022 was not surprising given the market environment. However, this has contributed to a greater pent-up need from both Limited Partners ("LPs") and General Partners ("GPs") to generate liquidity, which we believe creates an exciting opportunity for significant growth. The following provides a more detailed picture of what we saw and why we're optimistic about the outlook for real estate secondaries.

Against a backdrop of higher-for-longer interest rates and a broad correction of real estate values, real estate secondary transaction volumes, measured by Net Asset Value ("NAV"), declined to $9.8 billion in 2023, down 21% from the record $12.4 billion in 2022. The number of real estate secondary transactions in 2023, however, declined by only 4% to 154. This is down from the record high 161 transactions in 2022. While a decline in volume was expected given the market environment, it actually compares favorably to the direct real estate transaction market, which saw volume declines in the rang e of 50%+ globally per MSCI.

Real Estate Secondary Transaction Volume

(Millions, by Reported Value, Source: Ares Management)



Breaking this down a bit further, the GP-led and LP-led volumes tell two different stories.

GP-Led Transactions

In 2023, GP-led transactions declined to $6.2 billion, a 35% decrease from the record high volume achieved in 2022. Recall that the market saw several large scale transactions – including two valued at $1+ billion – that drove the strong year. There were no $1+ billion transactions in 2023, but instead a number of transactions in the $200 - $500 million range. Many of these were weighted toward more niche property sectors, including data centers, specialized industrial and storage, singe-family-rental and manufactured housing, all of which continue to enjoy healthy operating fundamentals. The sharp decline in the direct transaction market in 2023 only exacerbated the need for GPs to look for alternative ways to generate liquidity in their mature funds. Hence, many GPs could only get compelling pricing for their best performing assets. Overall, GP-led transactions accounted for 63% of the total volume, compared to the 77% in 2022, but generally consistent with the 66% seen in both 2020 and 2021.

LP-led Transactions

While GP-led transactions decreased in 2023, LP-led transactions grew to $3.6 billion – a 26% increase – from 2022.

Transactions in value-added and opportunistic funds totaled $1.2 billion in 2023, a 26% increase from the multi-year low volume seen in 2022. Despite this increase, volume was still meaningfully below the pre-COVID five-year average volume of $3.4 billion, implying the potential for significant growth ahead.[1] Pricing discounts for most closed-end funds traded in 2023 ranged from 25% to 50%+. The fact that value-added and opportunistic fund NAVs have only been marked down 6% from peak values in mid-2022, per Burgiss, was a key contributer to the higher pricing discounts. As private real estate funds work through appraisal lag, “optical” secondary market pricing discounts to reported NAV should improve, which we believe will bring an increasing number of LPs to the secondary market to re-balance and address liquidity needs.

After a slow start in the first half of 2023, the transaction volume of open-end core funds in the US and Europe recovered significantly in the second half and pushed the overall volume to a new high of $2.4 billion. As a result, open-end core funds comprised 66% of the total LP-led transaction volume in 2023. A catalyst for this increase in core fund volume was the large redemption queues, where, in many instances, it can take 18 - 24 months to fully pay out a redeeming investor. Another catalyst was the value adjustments experienced across most open-ended funds since the peak in 2022. In the US through Q4 2023, the NCREIF NPI index has now had six consecutive quarters of negative appreciation, recording a cumulative decline of 14% unlevered since the peak reached in Q2 2022. In Europe through Q3 2023, the INREV All Fund Index, comprising primarily core funds, registered 13% negative capital appreciation since the peak reached in Q2 2022. These value declines brought the optical discount of quality core funds to a level that sparked the sharp rebound of overall transaction volumes.

Overall during 2023, US-weighted partnerships accounted for 62% of total volume, European-weighted partnerships accounted for 32% and Asia-weighted partnerships accounted for 6%. Outside of fund and portfolio recapitalization transactions, non-US pension plans, insurance companies and US pension plans were the most active sellers in 2023, accounting for 18%, 12% and 4% of volume, respectively. US-based sellers continue to be the most active, generating 53% of total volume, followed by Europe at 40%, Asia at 6% and Other at 1%.

[1] Pre-COVID five-year refers to 2015 to 2019.

2024 and Beyond

Although overall secondary transaction volumes dropped in 2023, we expect to see significant growth in secondary transactions over the next few years. Based on Burgiss data, the amount of NAV held across closed-end real estate funds has grown to over $970 billion, with $180 billion of this held in funds over eight years old.[2] In addition, there is well over $1 trillion of NAV held in non-fund vehicles, such as joint ventures, separate accounts, etc. Many fund sponsors across their legacy vehicles are faced with mounting debt maturities and portfolios that need more time and/or more capital to finish business plans. In addition, fund distributions have substantially been reduced causing liquidity issues for some LPs. We believe the combination of these factors will likely drive significant growth in secondary transaction volumes as capital market conditions improve and real estate NAVs continue to adjust.

[2] Burgiss data as of September 30, 2023.