Investment Strategy Summary

Preferred Equity

July 2023

Preferred Equity Investment Thesis

In todays challenging market, investing preferred equity in well-located multi-family assets provides a unique opportunity to earn compelling risk-adjusted returns. Several factors have contributed to this window of opportunity that can be broken out into 3 categories:

1. **Interest Rates** – In April of 2020 the Fed Funds Effective Rate dropped to 0.05%. The ensuing all-time low interest rate environment drove a flurry of multi-family development and acquisitions based on the assumption that these rates would not significantly increase. Today the Fed Funds Effective Rate is at 5.08%. This dramatic increase has pushed floating rate debt well above where many operators projected, pushing both financing costs and cap rates upward.
2. **Supply & Demand** – Despite pandemic related challenges, many markets saw continued or increased rent growth during and coming out of the pandemic. Driving this was the first significant wage growth in decades coupled with significant government stimulus. Additionally, with much of the workforce able to work from home, we saw large migration from urban centers to the smaller cities and suburbs. In many key gateway markets, municipalities have failed to keep up with housing demand even with negative net migration. Today we are seeing rents in many of these high-growth areas stagnate or decline due to the tremendous amount of supply coming online.
3. **Cost Overruns** – Many projects have been hit with significant cost overruns caused by a multitude of factors including raw material price increases, supply chain delays for key products, labor shortages, and increased carry costs.

This convergence of factors has created an environment where many operators are refinancing at lower valuations than originally anticipated. With capital markets pulling back, operators are forced to turn to private equity groups to bridge this funding gap. First position lenders prefer and often require in the entity documents that any investors stepping into this gap are able and willing to execute the business plan should the sponsor fail. Because of this, qualified preferred equity investors willing to invest can achieve mid-teens returns while mitigating downside risk with their preferred position and attractive last dollar basis.

REALM Strike Zone

Annual Rate	13%-16% (5-7% paid current)
Costs	All closing costs paid by operator
Fees	2% of equity in
Assets	Multi-family, Value Add & New Development
Equity	$2M to $10M, maximum ~75% of property value
Markets	TX (Austin, DFW, San Antonio, Houston), FL (Tampa, Miami), TN (Nashville, Knoxville), AL (Huntsville), CA (San Diego, Los Angeles), WA (Seattle), UT (Salt Lake City), CO (Denver, Boulder, Colorado Springs)

REALM

Case Study

Grace Townhomes

Grace Townhomes was completed in 2022 and consists of 32 4BR/ 3.5BA units in Miami-Dade, Florida. Each unit was completed with high-end fixtures and has a private rooftop deck. The project is fully leased and is located within a rapidly growing submarket. The operator is purchasing the asset from the developer and pushing rents to market from the current discounted lease rate. The last dollar basis for the Preferred Equity position on this transaction is well below replacement cost and other comparable properties within the market.

Property Description	
Address	26201 SW 138th Court, Naranja, FL
Units	32 Units
Leasable Area	43,612 SF
Avg. SF per Unit	1,363
Built	2022
Occupancy	100%

Return Metrics	
Investment Period	16 Months-Refinance
Total Profit	$520,000
Equity Multiple	1.2x
Preferred Return-Paid Current	6.0%
Preferred Return-Accruing	9.0%
Total Annual Rate of Return	**15.0%**

Capital Stack	Amount	Last Dollar Basis	$/PSF	
1st Position Debt (Agency)	$7,700,000	$240,625/ Unit	$177	56%
Preferred Equity	**$2,600,000**	**$321,875/ Unit**	**$236**	**75%**
Equity	$3,444,000			
Total	**$13,744,000**	**$429,500/ Unit**	**$315**	**100%**

Debt Yield			
Year 1 Net Operating Income	$787,000	Year 2 Net Operating Income	$851,000
Blended Debt Yield (Yr. 1)	7.6%	Blended Debt Yield (Yr. 2)	8.3%
Blended DSCR (Year 1)	1.2x		

Case Study

Oak Hills Village

Oak Hills Village is a vintage project with a heavy value-add renovation. The property is located adjacent to the Methodist Hospital, a highly desirable location in the heart of San Antonio. The operator was refinancing with attractive agency debt but had a gap in their capital stack. Operator has a proven improvement plan and has renovated 80 of the 121 units for ~$10,000/ unit achieving a $250/ month rent increase on those units. Preferred equity last dollar basis remains well below comparable product and replacement cost with a significant equity cushion.

Property Description	
Address	1847 Babcock Road, San Antonio, TX
Units	121 Units
Leasable Area	89,825 SF
Avg. SF per Unit	972
Built	1965
Occupancy	91%

Return Metrics	
Investment Period	48 Months-Refinance
Total Profit	$2,310,000
Equity Multiple	1.6x
Preferred Return-Paid Current	6.0%
Preferred Return-Accruing	9.0%
Total Annual Rate of Return	**15.0%**

Capital Stack	Amount	Last Dollar Basis	$/PSF	
1st Position Debt (Agency)	$7,000,000	$57,851/ Unit	$78	41%
Preferred Equity	**$3,850,000**	**$89,669/ Unit**	**$121**	**63%**
Equity	$6,380,000			
Total	**$17.230,000**	**$142,000/ Unit**	**$192**	**100%**

Debt Yield			
Year 1 Net Operating Income	$708,000	Stabilized Net Operating Income (Yr. 3)	$961,000
Blended Debt Yield (Yr. 1)	6.5%	Blended Debt Yield (Yr. 3)	8.9%
Blended DSCR	1.1x