



Secondary transactions are transforming the real estate market

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Summary

The cyclical tailwind of rising interest rates has been a catalyst for the increase in real estate secondary transactions, but the asset class has its own engine powering secular growth. Several structural factors are expanding and evolving the secondary market in ways that will drive long-term growth and transform the broader real estate market—even when interest rates eventually start to fall.

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For buyers, secondaries offer an attractive entry basis vs. primary real estate investments and can often be purchased at a further discount to intrinsic value. Equally important, secondary transactions tend to be less risky because buyers are often entering an investment during the harvesting period; this mitigates the J curve, offers income from day one and limits blind pool risk.

Sellers include both limited partners (LPs) and general partners (GPs). LP sellers have come to the secondary markets over the past few years to meet liquidity requirements, rebalance portfolios that have become overweight private market assets due to declines in public market valuations, or implement a change in strategy. GPs have used secondaries to meet capital shortfalls during disruption in the debt and equity capital markets and provide term extensions when delayed business plans become misaligned with the existing capital structure and/or expectations of equity investors.

Increasingly, however, GPs have become savvier about using the secondary market to maintain control of their best assets through recapitalizations. GP-led transactions have driven significant increases in annual transaction volume over the past five years, which was previously dominated by LP transactions.

Reflecting this shift over the past decade, CBRE IM uses a purposefully broad definition for secondaries that includes any transaction where equity is exchanged in the capital stack, but the operator or sponsor stays in place and maintains control over the real estate.



Classifying more types of transactions as secondaries offers a more realistic picture of the breadth and depth of the real estate secondary market, yet accurately estimating the market's size is challenging: there is no comprehensive data set and many transactions are off market. While some sources estimate annual global transaction volume at \$10-15 billion, we think the market is 2-3x the size, considering the volume of recapitalizations that go uncaptured.

That range could increase if the path is similar to private equity, where secondary market activity has increased with the growth of the primary market and now has a turnover rate of about 2%-3% of global private equity assets under management. Real estate secondary transaction volume—which we estimate at 1%-2% of the market—could realistically grow to 2%-3% of the \$1,026 billion in unrealized value in private real estate funds and the more than \$816 billion in non-fund structures.¹

The secondary market is not just expanding, it's also changing the entire real estate market. In addition to valuable use cases, such as liquidity, portfolio management and risk management, secondaries are also becoming an important way to access high-quality assets. As GPs realize they can continue to create value in some of their best assets by holding onto them and recapitalizing, investors cannot ignore the secondary markets when looking for opportunities in their preferred sectors. In fact, some prime assets may never trade in the primary market again.

This evolution in the real estate secondaries market coincides with the highest interest rates in a decade across many regions. CBRE IM forecasts suggest that interest rates may have peaked, but may not come down as quickly as they went up or return to near-zero levels—a supportive backdrop for the secondary market. Furthermore, with increasing use cases and acceptance, secondary transactions may be less impacted by falling interest rates than in previous cycles.

¹ National Council of Real Estate Investment Fiduciaries (NCREIF), as of March 2024.



At present, private real estate valuations are still adjusting downward to reflect the current high interest rate environment because the fall-off in transaction volume has limited price discovery. At this point in the cycle, only the higher-quality assets in more liquid markets, such as logistics, storage and residential, will transact—and typically at meaningful discounts. At the same time, underwriting is more challenging, so experienced operators may be able to get better access to preferred assets.

Valuations are likely to further support real estate secondaries. As the real estate market bottoms, which comes roughly as interest rates peak, secondary investments actually look increasingly attractive: current discounts to primary investments enable secondary investors to get today's real estate at tomorrow's prices. Historically, these secondary vintages, when valuations are approaching a trough, have produced strong returns.

However, investing in secondaries around an inflection point requires two competitive advantages: access to high-quality assets via strong relationships with experienced operators in local markets and a deep understanding of the fundamentals and complex nuances of the real estate market. Investors need to be able to evaluate the price discount to real intrinsic value—not just the current valuation; they also must be able to ensure that the transaction aligns with their strategy, determine an eventual exit strategy and in some cases, take advantage of the ability to recast the governance. Opportunities often come up with a short window to execute, requiring a local team that can mobilize immediately.

The secondary market is increasingly providing access to some of the highest-quality assets in the broader real estate market—and at discounted prices with less risk. Investors will want to pay careful attention to this growing area of the market, at all points of the cycle.

