ERER Presentation
Problems and Opportunities in
Commercial Real Estate
November 10th, 2016
Marcel Bio

- Started ice cream and yoghurt company (Mountain High)
  - Went public (1981)
  - Sold to Beatrice (1983)

- Started real estate investment company 1984 (Colorado & Santa Fe)
  - Investing in distressed commercial property
  - Substantial condo conversion business (1995-2005)

- Foresaw the housing bubble and downturn
  - Stopped condo buying (2005)
  - Shorted housing and financial stocks (2005-2006)
  - Sold off 80%+ of real estate portfolio (2007-2009)
  - Accumulated substantial cash >$100MM

- Foresaw the housing recovery
  - Bought public homebuilding stock (2008 - Lennar)
Housing And Real Estate Expertise & Presentations

- Housing expertise
  - Bloomberg
  - TV
  - Time (2x)
  - CFA magazine (2x)

- Recent interviews
  - Inc.

- Published in “Journal of Real Estate Finance and Economics”
- Housing cycle presentation to MDC/Richmond Board of Directors
- Talks at numerous conferences and several universities
RCS Commercial Real Estate Strategy – BUY SELECTIVELY
Is real estate getting over-valued?

- Not yet, BUT…
- Why not?
Are lenders over-extending credit YET?

Lender liquidity is not “out of control”
This suggests no bubble is being formed YET
MUST PAY ATTENTION to lender liquidity (mortgages)
• Over-building kills real estate values
  • A recession is a “flesh wound”
  • Over-building is a “head shot”
RCS’ Commercial Real Estate Clock Cycle – **Still Time To Invest**

Observations

1. Job growth remains strong = creates demand
2. Supply is constrained = rents are rising
3. RCS focuses on value-add = higher IRR (~20% net to our investors)

Conclusion: “All-in” until RCS office clock indicators become negative.

Strategy: Buy partially vacant, lease-up then sell (3-4 years)
A Typical RCS Deal – Germantown Office

**Project Name:** Germantown Parkway  
**Location:** Memphis, TN  
**Collateral Type:** 6 Class A Office Buildings  
**Rentable SF / Spaces:** 534,809  
**Current Occupancy:** 78.03%  
**Year Built:** 1987-1999  
**Deal Type:** Value-Add  
**Acquisition Closing Date:** 12/1/2016  
**Projected Investment Period:** 60  
**Going-In Cap Rate:** 9.34%  
**Exit Cap Rate:** 8.50%  

**PROJECTED LEVERAGED CASH FLOWS AND RETURNS**

<table>
<thead>
<tr>
<th></th>
<th>Project Company¹</th>
<th>Limited Partner²</th>
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</thead>
<tbody>
<tr>
<td>Initial Capital Call:</td>
<td>$9,765,748</td>
<td>$4,882,874</td>
</tr>
<tr>
<td>Subsequent Capital Calls:</td>
<td>2,518,280</td>
<td>1,259,140</td>
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<tr>
<td><strong>Total Equity Commitment:</strong></td>
<td>$12,284,028</td>
<td>$6,142,014</td>
</tr>
<tr>
<td>Profit:</td>
<td>$10,087,807</td>
<td>$4,028,750</td>
</tr>
<tr>
<td>Multiple³:</td>
<td>2.03 x</td>
<td>1.83 x</td>
</tr>
<tr>
<td>XIRR:</td>
<td>21.29%</td>
<td>18.35%</td>
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RCS’ Denver Apartment Investment Clock

The "Investment Clock" is a registered trademark, and related buying signals are proprietary.

Real Capital Solutions
Denver Apartment "Investment Clock"

Total Apartment Score = 8:00
as of 3/13/2016

12:00 - 2020
Exit & Hedge

9:00 - 2017
Hold

6:00 - 2014
Qualified buy 2016
All-in buy

3:00 - 2011
Next few years multifamily can stay over trend

Eventually, when the recession hits (2019?) apartments are hit by a "Negative Trifecta":
1. Accumulated over-building (2017-2019)
2. Renters converting to SF owners
3. Recession (2019?)
When and how does the Negative Trifecta hit?

1. We need 1-3 more years of over-building
   • At ~9,000 per year, it would take about 3 years
   • At ~10,000 per year, it would take about 2 years
   • 2019?

2. Entry-level mortgages and housing accelerates
   • Builders need to furnish supply of entry-level
   • Banks and regulators need to ease mortgage lending
   • Over the next 3-5 years, millennials can start flooding into housing
   • 2019-2021?

3. A recession always weakens demand
   • Interest rates typically rise
   • Job growth goes negative
   • For Colorado, this may be starting for Oil & Gas?
   • We project a recession in 2019? +/-

Conclusion: Because of lags, apartment values will deteriorate ~2020 +/-
RCS Value-Add Strategy
Cycle Timing Matters

www.realcapitalsolutions.com
RCS’ track record has exceeded median private equity RE returns (by ~70%) This is because of:

1. We harvest profits near the cyclical highs
2. Banks offer us better leverage and terms (Marcel’s guaranty)
3. The entire RCS shop has been trained to “think like owners”
RCS Strategy: High Expertise = Higher Returns

- Development: ~35% IRR (HCS, CCS, DEV, Spain)
- Value Add: ~25% IRR (ACS, CRE)
- Institutional RE Investor: ~12% IRR
Is Real Estate Still Worth Investing In?

• **Yes…but selectively**

• Real Estate values have already recovered, but;
  • Many markets still offer good future returns
  • Many product types still offer good future returns

• Other investment alternatives are very exposed and dangerous
  • Stocks are volatile near all-time highs
    • Future stock returns will be very low (3% to 7%)
  • Bonds are volatile near all-time highs
    • Future bond returns will be very low to negative (-3% to 3%)

• **Conclusion: Real Estate remains an superior alternative**
Where is RCS heading?

Projected MA-related AUM ($MM)

Average growth rate = 13.9%

- Real estate
- Cash & equivalents
- Private equity/other

(500)


1,569 1,853 2,074 2,194 2,722 3,281 3,682 4,146 4,567 5,048

Recession
People & partners matter

- Success is not about real estate
- Success is not about capital
- Success is about people

- In a value-add shop (RCS)
  - People drive results - execution
  - Strategy drives results
  - Cycle drives results – timing
  - Bank leverage enhances results
Over 35 Years, RCS Has Built An Extraordinary Team

• RCS has proven capability of acquiring and managing investments
  • RCS has an active pipeline of promising opportunities
  • RCS will accomplish ~$280MM of new acquisitions in 2016

• Senior RCS employees have been with us for 10-30 years
  • We all want to scale our success

• The RCS team is capable of adding other family offices
  • Hans Herrmann invested >$40MM with RCS
  • RCS can handle the Real Estate needs of additional family offices

• Our objective is to build long-term relationships with family offices
• Our approach is;
  • Start with single deal investments
  • Prove our capability
  • Expand the relationship
Recommendations & Conclusions (Safety & Success)

1. Understanding and acting on the real estate cycle is critical
   a) It’s getting late in the cycle for apartments
   b) Know your assets perform when a recession hits
2. Sponsorship matters
   a) Invest with knowledgeable and driven partners
   b) Invest with partners that exhibit entrepreneurial focus
3. Demand a high co-investment 20-50%, not 1-2% (OPM)
   a) Stay away from PE Real Estate funds (especially 2017-2020)
   b) High co-investment ensures alignment of interests
4. Taxes matter: when you sell, defer your taxes (do 1031 exchanges)
   a) RCS has accomplished $500MM in 1031 exchanges
   b) This has saved our principals ~$100MM in deferred taxes
We know and love real estate.

If you have real estate investments that you’re concerned about, call us
If you are interested in how we approach real estate, call us

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