

PCCP MARKET COMMENTARY

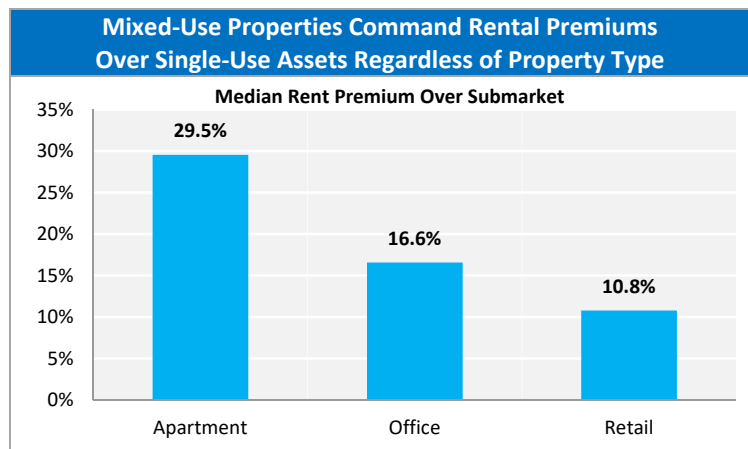
First Quarter 2020

Mixed-Use Investment: Evaluating Outcomes and Opportunities

As the desire for convenience and community has grown in recent years, mixed-use projects have spread rapidly across the United States. Mixed-use development, generally understood to mean pedestrian-friendly projects that include two or more uses, is now widely considered the ideal development model from a community planning perspective. The amenities and convenience of mixed-use projects appear to produce highly desired economic, environmental and health benefits, both for residents, and the community at large. The growing demand has resulted in a wave of new mixed-use projects ranging in proportion and scale, from middle market vertically-mixed assets, to expansive billion dollar mixed-use communities. To take advantage of investment opportunities in this growing area, PCCP recently commissioned our outside research firm to conduct a large-scale study examining mixed-use development. The results of this study and case studies of PCCP’s existing investments in mixed-use projects support the real estate industry consensus on the role of mixed-uses in rental rate and community outcomes. Our study also reveals some interesting middle-market investment opportunities.

To date, large-scale empirical research on mixed-use asset performance has been limited. This is primarily due to the difficulty in defining mixed-use, given nebulous ideas on the integration, proportion, and scale of mixed-use development.¹ For purposes of PCCP’s study, “mixed-use” is defined as projects having complementary uses that each comprise at least 10% of the net operating income of the property.² Using this definition we analyzed the performance and surrounding demographics of over 580 mixed-use projects across U.S. markets.³

When we compared the performance of single-use assets to comparable property types in mixed-use projects in the same submarkets, the study revealed significant rental rate premiums: 30% for multifamily assets, more than 15% for office assets, and more than 10% for retail assets. Our data indicate that the mixed-use rental premium over single-use assets is generally higher in urban areas than in suburban districts. However, the study also revealed significant rental premiums in suburban areas as well: 23% for mixed-use multifamily and 15% for office assets. Although the study supports rental premiums for mixed-use properties, our research does not show a material impact on mixed-use exit capitalization rates. This may be a result of limited buyer pools for mixed-use projects, which are typically large-scale.



Source: Costar Portfolio Strategy

Q3 2019

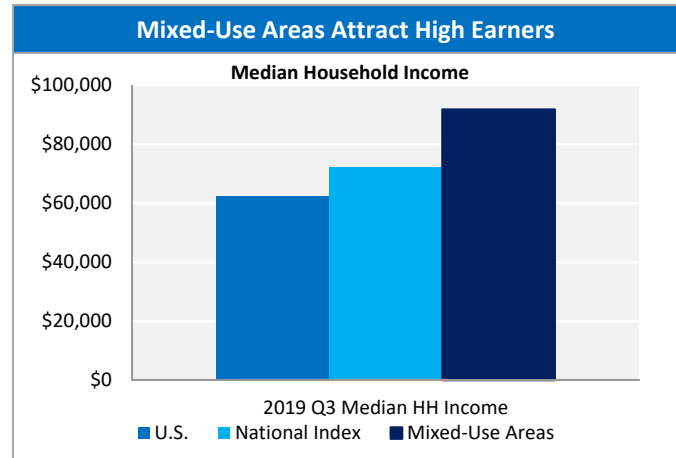
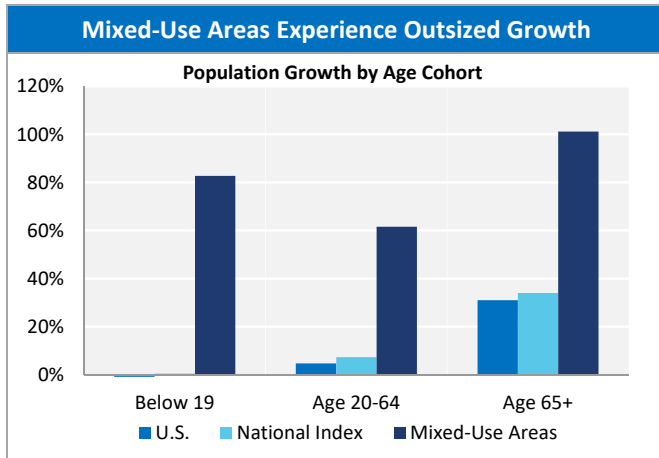
The data also demonstrated that the areas surrounding mixed-use projects experience favorable trends in population growth, labor participation, educational attainment, and household income relative to national performance. The study found that in areas within a three-minute walk of a mixed-use project (“mixed-use areas”), total population growth since 2010 was near 70%, or almost 10 times the national growth rate in the same period. This growth was well distributed across all age groups, supporting the proposition that walkable, amenitized communities are valued across the population. Mixed-use areas were also found to have lower unemployment rates and higher labor force participation relative to national benchmarks since 2010. These areas also support higher educational attainment rates, with near 60% of total residents holding a bachelor’s degree or higher compared to just 30% of residents across the U.S. In addition, the median household income growth in mixed-use areas outperforms the nation and the National Index Benchmark, growing over 40% since 2010 to more than \$90,000 as of Q3 2019.

¹ ICSC, BOMA, NAIOP, NMHC.

² Based on projects with two or more uses built in 2006 or later under one developer or plan. Includes properties within a 3-minute walking distance from the subject.

³ Mixed-Use Analysis. CoStar Portfolio Strategy, October 2019. “U.S. markets” includes all domestic markets tracked by CoStar Portfolio Strategy.

The data also indicate potential for middle-market investment opportunities. We found that the strength of mixed-use area demographics creates a material positive impact on the performance of single-use properties within a close radius of mixed-use projects, primarily for multifamily. Rental premiums in single-use assets located within mixed-use areas reached over 22% for multifamily properties and over 11% for office properties. These adjacency premiums are not limited to urban locations, as suburban office assets located near mixed-use projects achieved 15% rent premiums, and multifamily assets command an impressive 25% premium.



Source: Neustar; CoStar Portfolio Strategy

Q3 2019

Reflecting on our own mixed-use investment track record, the performance of PCCP’s mixed-use investments has been consistent with these trends. The immediate area surrounding PCCP’s Watter’s Creek, a mixed-use lifestyle center in Dallas, TX, has seen 224% population growth and 103% household income growth since 2010, compared to 38% and 27% across the entire submarket, respectively. Moreover, the multifamily rental units achieve a 41% rental premium over the submarket, and office and retail rents beat out single use assets in the market by near 10%. PCCP’s The GoodWynn, a multifamily asset in Atlanta’s Class A mixed-use community Town Brookhaven, leases at rents 32% above other assets in the submarket, and the premium for near 300,000 SF of retail at the property is 15%.

Cost data remains the missing piece of the puzzle. Quantifying the impact of an increase in uses on development cost is challenging given the inherent complexity of mixed-use development, and most research that accounts for cost data is limited to small data sets. As such, there is no rule of thumb for determining the financial feasibility of such developments. Mixed-use investors must, on a project by project basis, balance risk and return by prudently weighing the increased land, entitlement, planning, construction, financing and operational costs that result from multiple uses, against the expected premiums.

Still, our research results increase our understanding of macro trends in mixed-use asset performance. Bolstered by our research and case study results, and given that public demand for vibrant mixed-use communities is not expected to wane, PCCP seeks to capitalize on increased opportunities to achieve premiums in both single- and mixed-use asset investment.

Our thanks to PCCP’s Cierra Taylor for her help in drafting this quarterly newsletter.

Bryan Thornton
bthornton@pccpllc.com
 (415) 732-7649

Greg Eberhardt
geberhardt@pccpllc.com
 (310) 414-2004

Brian Heafey
bheafey@pccpllc.com
 (415) 732-7548

K.C. Kriegel
kkriegel@pccpllc.com
 (646) 308-2102

Legal Notice: The information contained herein is not to be construed as investment advice. Past performance is not an indication of future results. This information does not constitute an offer, or the solicitation of an offer, of any investment. Such offers are made only by the Private Placement Memorandum(s) related to such investment and only to persons and in circumstances in which such offers may legally be made without violation of U.S. federal or state securities laws or applicable laws and regulations. The views and statements expressed herein are those solely of PCCP. This commentary contains preliminary information only, is subject to change at any time and is not, and should not be assumed to be, complete or to constitute all the information necessary to adequately make an investment decision. No representation is made as to the accuracy or completeness of the information set forth herein. Certain information contained herein constitutes “forward-looking statements,” which can be identified by use of forward-looking terminology such as “may,” “will,” “should,” “expect,” “attempt,” “anticipate,” “project,” “estimate,” “intend,” “seek,” “target,” “continue,” or “believe,” or the negatives thereof or other variations thereon or comparable terminology. Due to the various risks and uncertainties, actual events or results in the actual performance of investments may differ materially from those reflected or contemplated in such forward-looking statements. PCCP, LLC is registered as an investment adviser under the Investment Advisers Act of 1940, as amended. The investment examples included herein are being provided for informational purposes only and were chosen to show recent, demonstrative transactions in PCCP’s portfolio with characteristics similar to the mixed-use definition set forth in this commentary. There can be no assurance that PCCP will be able to make investment similar to the examples included herein, including in terms of size, scope, and location. Past performance is no guarantee of future results. PCCP’s mixed-use investment track record is available upon request. Unless otherwise noted, all data cited herein is based on information provided by CoStar Portfolio Strategy as of October 2019.