April 2017

Investing in U.S. Real Estate Equity

- While we are now almost eight years into the current economic expansion, our market indicators remain positive for investing in U.S. real estate.
- The market is competitive; however, we continue to see compelling opportunities to acquire properties in growth markets and increase cash flow, physically improve these assets to create value, and generate attractive risk-adjusted returns.
- We favor creating durable and diversified cash flows, rather than acquiring capital intensive assets.
- We see significantly greater opportunity in "18-Hour Cities" with lower costs of living, high job growth and more balanced supply compared to traditional gateway markets.
- Real estate markets can be inefficient, and experienced investors with access to information across geographies, property types and tenant credits can have an advantage across cycles.
- With transaction volume and pricing returning to near prior-peak levels in certain markets, asset selectivity, sourcing expertise and investment discipline are critical factors for success.
- The upcoming wave of commercial real estate loan maturities presents further attractive acquisition and recapitalization opportunities for experienced managers to provide capital to restructure assets as well as create value through renovation, repositioning and leasing.
- Real estate can provide attractive and stable cash flows for investors seeking yield.
- Hard assets like real estate tend to hold value, generate more stable returns and therefore provide more stability amidst uncertainty.
- If inflation emerges as we progress through this market cycle, real estate can act as a hedge given historical trends.

HEADQUARTERS
Ares Management, L.P.
2000 Avenue of the Stars
12th Floor
Los Angeles, CA 90067
www.aresmgmt.com

Company Locations
U.S. Los Angeles, New York, Chicago, Boston, Atlanta, Washington D.C., Dallas, San Francisco
Europe/Middle East London, Paris, Frankfurt, Stockholm, Luxembourg, Dubai
Asia/Australia Shanghai, Hong Kong, Chengdu, Sydney

Please see the Endnotes and Legal Notice and Disclaimers beginning on page 8.

Our View of Today's U.S. Real Estate Market

The U.S. real estate market remains competitive and in an expansionary phase across most markets, with rising asset values, supportive fundamentals, supply and demand imbalance, and a diverse lender universe, underpinned by strength in the labor market. Commercial real estate has remained highly attractive to institutional investors and has delivered strong returns, leading to record distributions over the past years. The U.S. economy continues to be viewed as an attractive environment given its growth forecast and higher yield relative to other developed global markets. While U.S. property valuations are above prior peaks in many areas, we believe that underlying cash flows generally support these valuations and pricing is at a level that enables equity to earn meaningfully positive leverage, particularly in non-gateway markets. Importantly, we believe that the market recovery has been uneven, varying by geographic market, property type and asset condition. As uncertainty remains around the new administration and the pace of future increases in interest rates, we believe that any near-term changes to valuations are likely to be driven primarily by underlying property fundamentals. We see the most compelling opportunities in growth markets outside of the gateway cities and in property types that benefit from the confluence of positive fundamentals, healthy capital markets, supply and demand dynamics, as well as demographic and financing trends.

Strong Fundamentals

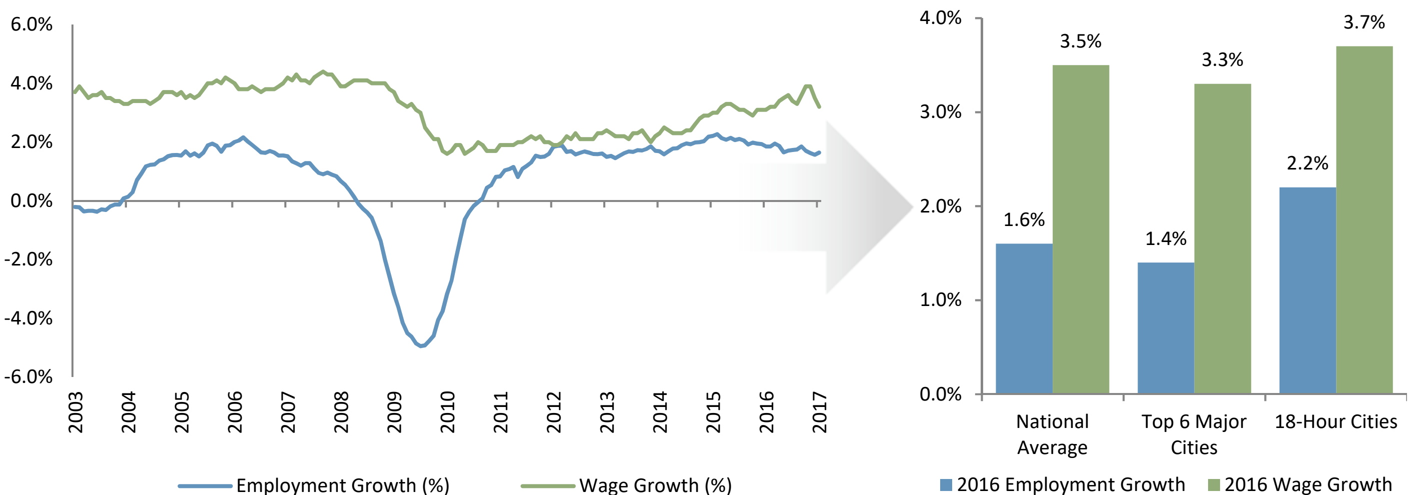
Population, employment and wage growth continue to drive demand for real estate, and, as depicted in Figure 1, these metrics have recovered well from the Global Financial Crisis. We believe the most compelling opportunities generally exist within the 50+ markets with populations exceeding one million that exhibit strong, diversified economies and good quality of life, often exceeding the national averages for these metrics.

Demand and Supply Dynamics

Demand fundamentals remain positive, supported by the continued improvement of the U.S. economy with generally strong labor market conditions, which we expect will continue to drive demand growth. The past decade has seen significant changes in the way space is consumed, which has changed the distribution of demand. For instance, while we still see certain population cohorts moving to gateway cities, affordability concerns have moderated this trend and have increased migration to and development of secondary markets ("18-Hour Cities"), such as Philadelphia, Atlanta, Austin, Dallas and San Diego. Additionally, the desire for efficiency and a balanced work-life-play lifestyle, as well as changes from increased e-commerce and technological advances, continue to have impacts across all major property types.

On the supply side, while the availability of certain product types is slowly rising in the major gateway markets and we see moderate levels of supply additions in the non-gateway major markets, disciplined lending practices have kept development

Figure 1: U.S. Employment and Wage Growth (%)



U.S. National Employment Growth Source: Bureau of Labor Statistics through January 31, 2017.
U.S. National Wage Growth Source: Federal Reserve Bank of Atlanta through January 31, 2017.
Top 6 Major Metros and 18-Hour Cities: Bureau of Labor Statistics and Rosen Consulting Group for the period from December 31, 2015 to December 31, 2016.

largely in check.[i] Underwriting standards have tightened, and there continues to be an undersupply of debt funding for new development. Banks are expected to continue to favor preferred sponsors with development projects in primary and select secondary cities, ensuring development activity remains in moderation.[ii] We believe there is still additional capacity in the system, with supply forecasted to remain below historical averages across most property types in the coming years.[ii] As such, we believe that the current supply and demand dynamics create a supportive and a desirable operating landscape to acquire assets and execute property-level business plans.

Interest Rates

In comparison to 2006/2007 conditions, interest rates today are substantially below going-in cap rates, generating positive leverage.[iii]

Figure 2. Positive and Less Leverage in the System

Metric	2007	2016
Nominal Cap Rate (major sectors)	6.6%	6.2%
10Y UST	4.1%	2.5%
Baa Corporate Yield	6.5%	4.7%
Average LTV	70.5%	69.6%
Dry Powder	$168bn	$246bn

Source: Green Street Advisors for Baa Corporate Yields as of January 1, 2008 and January 1, 2017.

Source: Real Capital Analytics for 10Y UST as of December 2007 and December 2016.

Source: Real Capital Analytics for Average LTV as of February 2007 and August 2016.

Source: Preqin for Dry Powder as of December 31, 2007 and December 31, 2016.

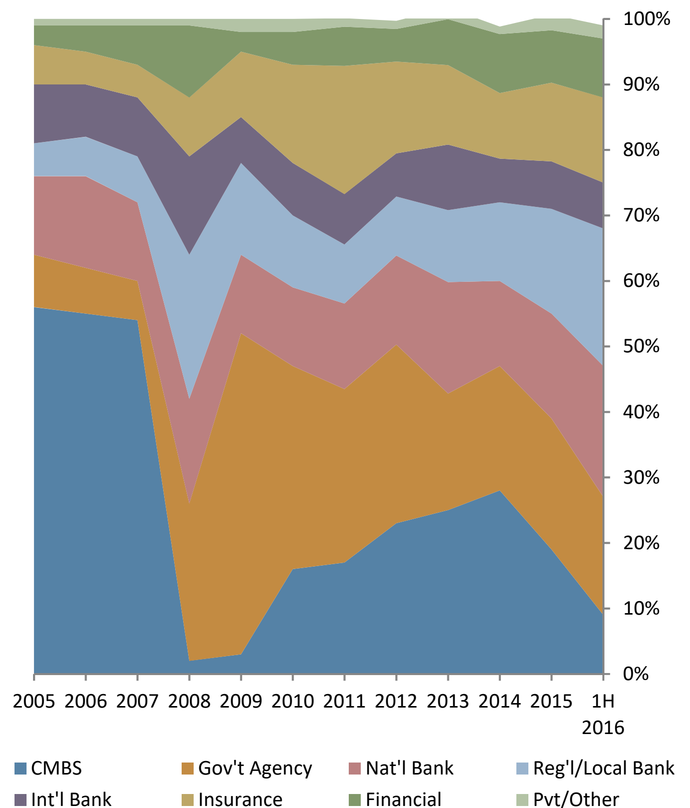
Source: Real Capital Analytics for nominal cap rates as of December 2007 and December 2016.

We expect interest rates to continue to move upward as economic expansion continues, but the consensus economic outlook is for only moderate increases in the federal funds rate and 10-year notes through the end of 2018. In short, we believe that "low for longer" will remain the governing approach for the coming years, as the Federal Reserve takes a slow, measured approach to increasing interest rates while still fostering healthy growth levels.

Balanced Lender Universe

Compared to ten years ago, real estate capital markets have a significantly more diversified lender universe today, with much less leverage in the system compared to 2006/2007 levels.[iv] Multiple types of lenders remain eager to lend on quality real estate assets with strong sponsorship. Importantly, we continue to see more disciplined lending standards than in the 2006/2007 pre-recession period, both in terms of quality of the collateral and loan-to-value ratios.[v] Life companies, commercial banks, agencies and CMBS have continued to fight for market share throughout the recovery, which has kept spreads attractive and loan terms competitive.

Figure 3: U.S. Commercial Real Estate Lending by Lender Type



Source: Real Capital Analytics through 1H 2016.

Attractive Liquidity

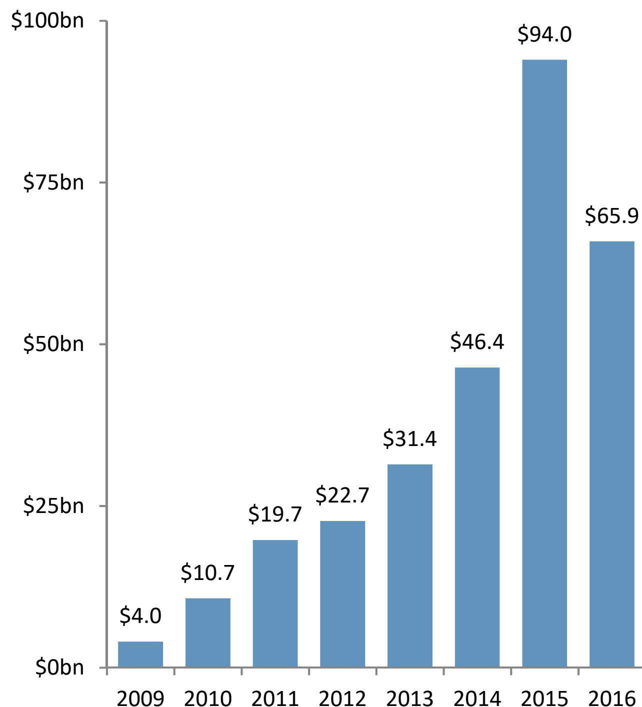
We anticipate that both debt and equity capital market conditions will remain fluid in the near term, providing ample capital flows to maintain liquidity across major U.S. markets and property types. In markets that offer favorable economic, demographic and investment market fundamentals, occupancy activity is less volatile and disposition markets are more liquid. The financing environment remains very efficient and supportive of low-leverage equity strategies to execute property-level business plans. The bank financing market has recently tightened for sponsors and developers in need of more customization or greater proceeds, often requiring transitional or alternative lenders who are able to provide more tailored financing solutions.

Increased Investor Appetite

In a quest for yield, investors' real estate allocations remain on the rise, and 2017 represents the first time that global real estate allocations have surpassed 10%.[v] We have seen continuous and positive momentum in U.S. real estate fundraising, with 156 U.S. real estate private equity funds closed in 2016 totaling approximately $71.5 billion in aggregate capital raised.[vi]

Cross-border investment activity into the U.S. ended 2016 at a volume of $65.9 billion.[vii] Despite a year-over-year decline compared to a record-breaking 2015, foreign activity remains high across a number of markets, particularly in certain non-gateway cities.

Figure 4: Foreign Capital Supporting the Sector



Source: Real Capital Analytics from January 1, 2009 through December 31, 2016.

European investors show significant upticks in their aggregate real estate allocations, on average having increased their allocations by 40 bps in the past year to 10.9%.[viii] Additionally, recent reforms to the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA") went into effect in December 2015, which is expected to attract additional foreign investments to U.S. real estate investment opportunities. The FIRPTA reforms significantly benefitted Qualified Foreign Pension Funds ("QFPFs"), as QPFPs no longer incur U.S. tax on capital gain of U.S. real estate sales if the investments are held through a REIT. This is particularly attractive as higher after-tax returns may make U.S. real estate investments more attractive to foreign investors than the risk-adjusted returns available from U.S. and off-shore non-real estate investment opportunities.

Foreign investment into U.S. real estate has previously tended to flow toward core properties in the major gateway markets, such as New York, Washington, D.C., and Boston; however, with prices for 'trophy' real estate assets in these major gateway cities at record levels, foreign investors are looking towards secondary markets and the "18-Hour Cities" to meet their return requirements. This trend has also affected the primary core strategies of some U.S. real estate investment managers and funds. In the current environment, some managers are stretching past their principal competency areas to pursue core-plus and value-add strategies in order to seek higher yields and are looking at transactions in secondary markets where they do not have an established track record or the requisite local knowledge to understand the submarket dynamics.

Investment Themes

As stated, we believe that the current market environment is attractive for selective real estate equity investment opportunities. Themes driving attractive investment areas include the confluence of demographic trends, property value and yield disparities, and assets that have been previously overleveraged and in need of improvements.

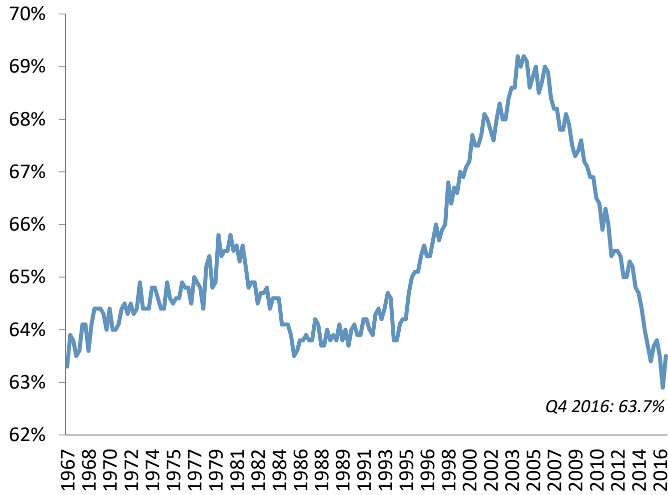
Demographic Tailwinds Create Multifamily Opportunities

In the past several years, we have seen rapid population growth in the "18-Hour Cities" outside of the major U.S. gateway markets.[ix] These cities tend to offer an appealing mix of a lower cost of living and doing business, high job growth, strong underlying infrastructure, and recreation and entertainment offerings that attract newcomers. Changes in how people live, work, travel and shop, largely influenced by technological advancements, have further supported this trend. Population demographics have largely been influenced by the millennial generation,[x] which has surpassed the baby boomers as the nation's largest living generation, and are spurning the suburbs for urban living in these "18-Hour Cities." Meanwhile, homeownership trends support the multifamily sector, as the U.S. homeownership rate fell in Q2 2016 to 62.9%.[xi]

Figure 5 below illustrates that, despite steadily increasing U.S. homeownership rates from 1995 to 2005, the recession has left a lasting mark, with homeownership reverting and falling past

levels last experienced in the late 1960's. We believe that the increase in renter households will persist as low levels of inventory, affordability concerns, and a preference to lead a balanced work-life-play lifestyle will continue to suppress homeownership rates.

Figure 5: U.S. Homeownership Rates



Source: U.S. Census Bureau as of December 31, 2016

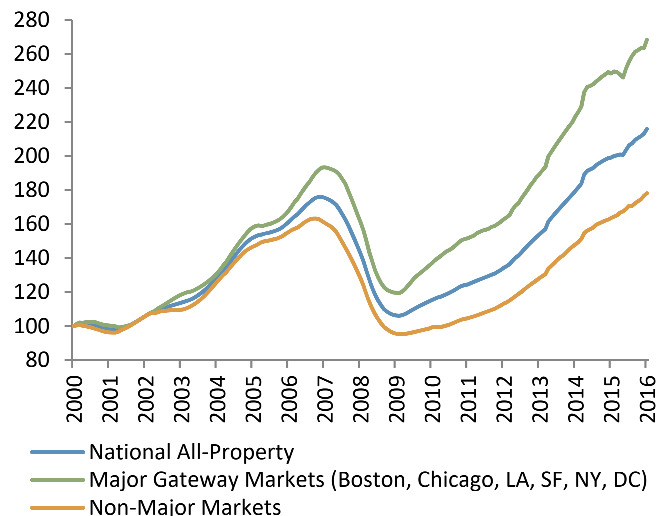
Across major property types, including multifamily, retail and office, we believe that the best submarkets are often situated near useful amenities, such as parks, shopping, entertainment and restaurants, with strong transportation access, proximity to employment and good-quality public schools. Additional support for both population and employment growth in a particular submarket may be attributed to strong quality of life and proximity to major knowledge hubs, such as educational or research institutions. We believe that many "18-Hour Cities" have a wide spread between the cost of renting and homeownership, which helps ensure a continuous, large pool of quality renters. More companies are relocating to these lower cost locations, which often exhibit strong multifamily demand as the skilled workforce prefers to live in close proximity to employers. Examples include Atlanta, which serves as the North American headquarters of Mercedes and a major regional center for State Farm Insurance, and Raleigh, which serves as the headquarters for global technology companies, including Citrix ShareFile, Lenovo, Bandwidth, Red Hat, and SAS, as well as major operations for Metlife's Global Technology Center and Cisco Systems. These non-gateway growth markets additionally tend to face lower-than-average supply pressure, creating an attractive set of real estate equity investment opportunities for knowledgeable managers. We believe there are attractive opportunities in these markets to acquire 10- to 30-year-old multifamily assets with repositioning potential and achieve outsized returns through current income and capital appreciation. Investors can create value through property enhancements, optimal leasing and a disciplined exit. This type of business plan helps to fill the void between the cost of new apartment deliveries and antiquated properties with obsolete, outdated floorplans, finishes, and amenities.

Despite increased focus on growth markets, we believe that there is also still value in de-risked Class A development in the major markets, such as Chicago and Boston, where exit prices and rental rates remain attractive, although affordability concerns in central business districts may counsel toward focusing on more walkable and transit-oriented suburban development that is more likely to appeal to millennials. We additionally see investment potential in recapitalizing and redeveloping distressed or overleveraged assets in these markets.

Enhanced Risk-Adjusted Yields: Gateway Versus "18-Hour Cities"

Further supporting the value proposition in the "18-Hour Cities," we continue to see significant differentials in prices and cap rates between gateway and non-major markets, which we believe have been largely fueled by investors' post-recessionary flight-to-safety, particularly from foreign capital sources.

Figure 6: Moody's/RCA US Commercial Property Indices

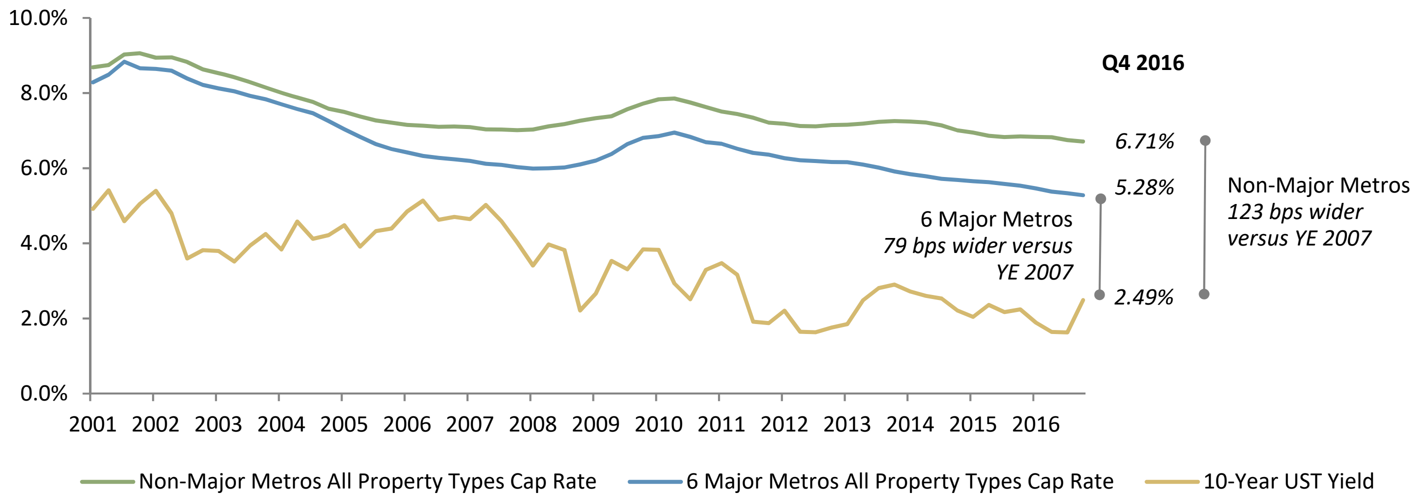


Source: Moody's/RCA Commercial Property Price Indices, published by Real Capital Analytic through December 31, 2016. [xii]

While arguably much of the value has been priced in across the gateway markets, we believe that significant pockets of opportunity remain in secondary markets.

Specifically, this presents attractive acquisition and recapitalization opportunities, as the majority of the maturing loans were 10-year loans originated at the height of the last cycle that will require either additional equity infusion and/or greater demand for flexible capital that will be required to fill the refinance gap. There are many opportunities for qualified owners/operators to exploit broken capital structures, provide capital to restructure assets with imbalanced debt levels, as well as to step in where owners are forced to sell to repatriate equity and create value through renovation, repositioning or leasing. This is particularly the case given the fluid capital markets for qualified sponsors, who can acquire assets with moderate levels of low-cost debt.

Figure 7. Cap Rate Spread Between Market Segments

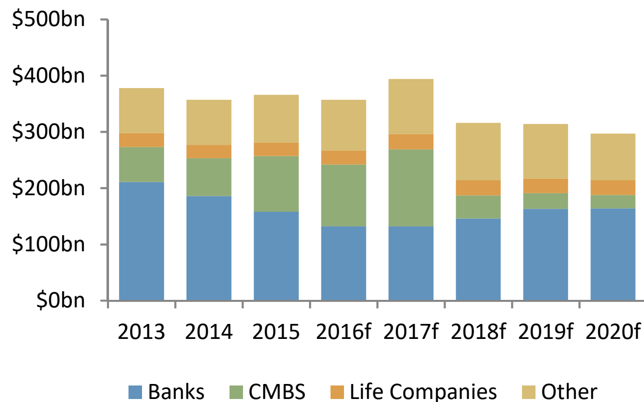


Source: Real Capital Analytics and Bloomberg through December 31, 2016.

Debt and Equity Opportunities Due to Refinancings

The current real estate lending and securitization landscape provides additional opportunities for real estate investors. A sizable wall of commercial real estate loan maturities is coming due in the near term based on the loans executed prior to the Global Financial Crisis, with over $170 billion of U.S. CMBS loans maturing through the end of 2018.[xiii] Many loans executed prior to the Global Financial Crisis are now maturing, which will create opportunities beyond 2017 for sophisticated investors.

Figure 8. Commercial Mortgage Maturities



Source: RCG, MBA, Morgan Stanley, SNL, Intex, Trepp as of December 31, 2016

Capitalizing on Ineffective Ownership

Even as property and capital market conditions have improved in recent years, a number of property owners still lack the time horizon, capital requirements, and/or operating expertise to effectively own, manage, and improve assets across major property sectors and high growth markets. Informational insights and flexible capital structures present compelling opportunities for well-capitalized managers with strong industry relationships and local market knowledge to step in, create value, and generate strong returns on a risk-adjusted basis. This is particularly the case in some of the growth markets outside of the major gateway cities, where less experienced investors have attempted to assemble portfolios without requisite knowledge of the local economy or how to optimally improve and reposition these properties.

Active Management, Strong Industry Networks, Deep Property Expertise and Cross Asset-Class Research Can Help Investors Maximize Returns

With transaction volume and pricing returning to near prior-peak levels in certain markets, asset selectivity, sourcing expertise, and investment discipline remain critical across all stages of the real estate investment lifecycle. In this environment, cycle-tested investors that have deep experience across multiple economic and real estate cycles have an edge that is not replicable. Investors need strong industry networks, including longstanding relationships with property owners, leasing and management professionals and transaction intermediaries to help source and maximize return for portfolio investments. Larger-scaled managers often have access to broad, cross-asset class investment platforms, which can provide a research edge to ascertain industry trends, local market conditions and tenant credit health. Due to significant regional distinctions, it is critical to understand the nuances of local markets. Experienced, active investors understand how to improve properties in an ROI-effective manner and can accurately assess tenant income profiles and the capacity to raise rents. Increasingly, real estate investors are also paying attention to risk management best practices, looking to invest across property types and navigate across sectors as conditions change to adapt to market cycles. A focus on capital preservation, portfolio diversification and prudent leverage levels are important features of a sound active management approach.

Conclusion

In short, we believe that the current market environment provides compelling opportunities for real estate equity investments to improve existing properties in the “18-Hour Cities”, given cap rate compression in the gateway markets and demographic shifts across major property types. The opportunity set is further enhanced by the current wave of commercial real estate debt maturities, which presents attractive acquisition and recapitalization opportunities for experienced managers to fix broken capital structures and create value through renovation, repositioning and releasing. Moreover, we believe there is still room for further improvement in property fundamentals in these growth markets, with opportunities for rent increases as assets are physically changed to create value and attractive exit opportunities once business plans are achieved.

About Ares Management, L.P.

Ares Management, L.P. is a publicly traded, leading global alternative asset manager with approximately $99 billion of assets under management as of December 31, 2016, including approximately $3.6 billion of AUM pro forma for Ares Capital Corporation’s acquisition of American Capital, Ltd., which closed on January 3, 2017, and more than 15 offices in the United States, Europe and Asia. Since its inception in 1997, Ares has adhered to a disciplined investment philosophy that focuses on delivering strong risk-adjusted investment returns throughout market cycles. Ares believes each of its three distinct but complementary investment groups in Credit, Private Equity and Real Estate is a market leader based on assets under management and investment performance. Ares was built upon the fundamental principle that each group benefits from being part of the greater whole. For more information, visit www.aresmgmt.com.

Legal Notice and Disclaimers

This document contains the current, good faith opinions of Ares Management, L.P. (“Ares”). The document is meant for information purposes only and is not intended to present and should not be construed as any investment advice and is neither a recommendation of an investment nor an offer to sell or a solicitation of an offer to purchase (or any marketing in connection therewith) any interest in any investment vehicles managed by Ares or its affiliates, the offer and/or sale of which can only be made by definitive offering documentation.

There is no guarantee that any projection, forecast or opinion in these materials will be realized. Past performance is neither indicative of, nor a guarantee of, future results. The views expressed herein may change at any time subsequent to the date of issue hereof. The information contained herein does not take into account any particular investment objectives, financial situations or needs and individual circumstances should be considered with investment professionals before making any decisions.

Alternative investments can be highly illiquid, are speculative and may not be suitable for all investors. Investing in alternative investments is only intended for experienced and sophisticated investors who are willing to bear the high economic risks associated with such an investment. Investors should carefully review and consider potential risks before investing. Certain of these risks include the following: loss of all or a substantial portion of the investment due to leverage; lack of liquidity in that there may be no secondary market for a fund; volatility of returns; restrictions on transferring of interests in a fund; potential lack of diversification and resulting higher risk due to investment concentration and/or concentration of trading authority when a single advisor is utilized; complex tax structures; less regulation and higher fees than mutual funds.

This document may contain forward-looking statements. These are based upon a number of assumptions concerning future conditions that ultimately may prove to be inaccurate. Such forward-looking statements are subject to risks and uncertainties and may be affected by various factors that may cause actual results to differ materially from those in the forward-looking statements. Any forward-looking statements speak only as of the date they are made and Ares assumes no duty to and does not undertake to update forward-looking statements or any other information contained herein.

Ares may make investment recommendations and decisions that are contrary to the views expressed herein and may sponsor and hold interests in investment vehicles that have holdings that are inconsistent with the views expressed herein.

Interests in alternative investment vehicles are offered and sold only pursuant to specific offering memoranda. Prospective investors of any alternative investment should refer to the specific fund’s offering memorandum and operative and governing documents.

The document may not be copied, quoted, or referenced without Ares’ prior written consent.

Benchmark (index) performance does not reflect the deduction of transaction costs, management fees, or other costs which would reduce returns. References to market or composite indexes, benchmarks or other measures of relative performance are for comparison purposes only. An investor cannot invest directly in an index.

This may contain information obtained from third parties, including ratings from credit ratings agencies such as Standard & Poor’s. Reproduction and distribution of third party content in any form is prohibited except with the prior written permission of the applicable third party. Third party content providers do not guarantee the accuracy, completeness, timeliness or availability of any information, including ratings, and are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, or for the results obtained from the use of such content. THIRD PARTY CONTENT PROVIDERS GIVE NO EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. THIRD PARTY CONTENT PROVIDERS SHALL NOT BE LIABLE FOR ANY DIRECT, INDIRECT, INCIDENTAL, EXEMPLARY, COMPENSATORY, PUNITIVE, SPECIAL OR CONSEQUENTIAL DAMAGES, COSTS, EXPENSES, LEGAL FEES, OR LOSSES (INCLUDING LOST INCOME OR PROFITS AND OPPORTUNITY COSTS OR LOSSES CAUSED BY NEGLIGENCE) IN CONNECTION WITH ANY USE OF THEIR CONTENT, INCLUDING RATINGS.

Endnotes

[i] Source: REIS as of December 2016.

[ii] Source: Cox Castle Nicholson, January 2017.

[iii] Metrics represent market capitalization weighted averages per Green Street Advisors as of January 2016. Leverage ratio defined as total liabilities (including preferred shares) net of cash as a percentage of current value of assets.

[iv] Source: Barclays, SNL Financial, Bloomberg, Association of Foreign Investors in Real Estate, and Green Street Advisors.

[v] Source: Ernst & Young, 2017 Global Market Outlook.

[vi] Source: Prequin, 2016.

[vii] Source: Real Capital Analytics, as of December 31, 2016.

[viii] Source: Pension and Investments, “Real Estate Allocations Up as Investors Seek Security,” November 28, 2016.

[ix] Source: Urban Land Institute, Emerging Trends in Real Estate, United States and Canada 2017.

[x] Source: Pew Research Center tabulations of the US Census Bureau population projections released December 2014 and 2015 population estimates.

[xi] Source: U.S. Census Bureau, as of December 31, 2016.

[xii] Notes on Moody’s/RCA CPPI methodology: The Moody’s/RCA CPPI Index is calculated on a monthly basis and includes office, industrial, retail, apartment, and hotel properties for transactions of all investors, both domestic and foreign as well as institutional and private. RCA records commercial properties valued at over $2.5 million that have sold at least twice from 1988 to the current period.

[xiii] Source: Rosen Consulting Group, Capital Markets as of December 2016.