

A LOOK UNDER THE HOOD:

Inside Equity Resource Investment's Multi-Strategy Approach to Uncover Where Opportunities Exist in the Market Today

"We believe our focus on the lower middle market continues to provide us with an attractive competitive advantage: the ability to create highly diversified commercial real estate portfolios for our investors..." says Kurt Spring, ERI Managing Partner, Head of Asset Management



How does ERI define its investment approach and why did the firm adopt a multi-strategy model?

ERI has always been acutely focused on value investing and seeking to identify often unique, compelling opportunities, rather than specific asset classes or geographies. We believe our focus on the lower middle market - which dates to our roots in the 1980's - has provided, and continues to provide us, with an attractive competitive advantage: the ability to create highly diversified commercial real estate portfolios for our investors with the goal of achieving favorable returns while managing risk and volatility. Over the past decade, we have refined the approach into a data-driven, high-conviction strategy centered on three investment themes where we believe our experience gives us an edge. These investment themes include affordable housing, workforce multifamily housing, and value-add industrial, with optionality and flexibility to also allocate capital to more opportunistic, sponsor-driven investments outside these three target asset classes.

In our view, the key advantages of this multi-strategy approach for investors are potential access to diversification, stability and liquidity. By capitalizing real estate across a wide range of assets, markets, and partners - and often targeting smaller transactions that we believe go overlooked by larger peers - we seek to create a portfolio with reduced concentration risk that can weather a variety of market conditions and return capital to clients more frequently than may otherwise be possible through less diversified portfolios of larger investments. Because our core investment themes have different return profiles and timelines - affordable housing investments typically require a longer hold to realize their full potential, while industrial and workforce housing investments often turn over in three-to-five years - we have the potential to create a cadence of realizations which can provide more regular liquidity for investors while helping them gain confidence in the strength of our portfolio.

What is the importance of sponsor relationships to ERI's investment strategy?

ERI is very much a partner-driven organization, with our sponsor relationships being central to our investment strategy. We recognize that we alone cannot be experts in every market across the country, which is where our partners bring tremendous value. We seek to identify operating partners with deep expertise in our focus areas, and whose interests and investment philosophy are aligned with our own. They bring on-the-ground knowledge and operational expertise, while we bring investment-level expertise, relationships and experience. We believe that combination is powerful.

We take the process of identifying the right partners – and building those partnerships into strong, longstanding relationships – quite seriously. We believe that approach has paid off: on average, about 60% of each of our fund's investments are executed alongside repeat sponsor relationships, which we believe is beneficial to investment success. We know how to work together, we trust each other's judgment, and we tend to share the same perspective on when to acquire, refinance, or exit an asset.

How does ERI manage risk across such a diversified portfolio?

We believe at the heart of risk management is portfolio construction, and core to ERI's approach is our intentional focus on portfolio diversification. We aim to create combinations of assets that avoid outsized exposure. We believe that discipline helps protect the portfolio from risk and is a key driver in our long-term consistency across market cycles.

We are also very hands-on. Once an acquisition closes, our team takes over the asset management process and becomes deeply involved in ongoing decision-making from sales and refinancings to property management changes and renovation strategies. We review financials and performance for most deals monthly, and re-underwrite every investment as part of our valuation process each quarter. That is no easy task when you are managing dozens of investments across hundreds of underlying assets. It means updating cash flow projections, revisiting growth and exit assumptions, and running a discounted cash flow analysis, not just applying a cap rate to property NOI.

While labor intensive, we believe these processes are critical to effective portfolio management. We find they give us a sharper picture of portfolio health, allow us to identify risks early, stay ahead of potential opportunities and provide investors with an accurate and realistic view of NAV. Based on these monthly and quarterly findings, we also prioritize where to focus our time to allocate our resources where they can be most value additive for our investors long-term.

ERI has a defined niche in affordable housing. How does that serve as a differentiator and inform your approach to other essential housing assets?

Our history in affordable housing investment also dates to the 1980's, when our precursor firm began providing liquidity to investors that often owned affordable or Section 8 housing. At that time, affordable housing was a complex, non-institutional asset class. As that liquidity strategy grew over time, so did ERI's access to significant data and a deep network of relationships with general partners active in affordable housing nationwide. We were fortunate to receive the valuable early experience required to develop the expertise to navigate affordable housing's complexity. Today, with the sector more institutionalized, we believe our deep understanding given our decades of work in the space is a significant differentiator.

Our experience in affordable housing also informs how we approach other essential real estate assets. In both affordable and workforce housing, for example, we believe there's a persistent supply-demand imbalance – millions of units short of what is needed. These properties are often acquired below replacement cost, which insulates them from new supply pressures and supports strong fundamentals. The same principle applies to industrial real estate, where we focus on smaller, single and multi-tenant properties that see steady demand but are often overlooked by larger investors. We believe by focusing on under-the-radar opportunities and where we can apply skills we have honed for decades, we are able to target results which may be more compelling than our peers in the market.

How are today's market conditions shaping ERI's opportunity set?

We are finding compelling opportunities to deploy capital and create value across our high-conviction strategies.

In value-add industrial, we continue to identify smaller assets – often off-market and likely overlooked by larger buyers – from long-time owners who have yet to fully capitalize on the rent growth in the market over the last five-to-ten years. By collaborating closely with operating partners who have deep expertise in specific geographies, we believe we are uniquely positioned to acquire these properties, optimize rents and improve tenancy, before bringing them back to market to capture the value we created. In industrial, we are presently finding attractive opportunities in the Midwest and in port cities along the East Coast. A recent example of our value-add strategy that we believe demonstrates not only the geographic opportunity, but also our approach to value creation is our 2022 investment in an industrial portfolio. Earlier in the year, that investment was taken full cycle after aggregating seven distinct properties with a single partner, bringing most of the tenants up to market rents and exiting to an institutional wealth manager.

We are also seeing compelling opportunities to put capital to work on the essential housing side, where pricing has adjusted meaningfully since the 2021–2022 peak. As an example, we recently acquired an affordable, subsidized (Section 8) portfolio with ~600 units in the Midwest, where contractual rent increases from the federal government were secured prior to closing. The in-place, unlevered yield on cost prior to acquisition was about 6% however, with the rent increases locked in prior to closing, the pro forma yield moved closer to 8% – a level we have not consistently seen in many years for these assets. That yield and the ability to create positive leverage, even at today's interest rates, made it a particularly compelling opportunity for us.