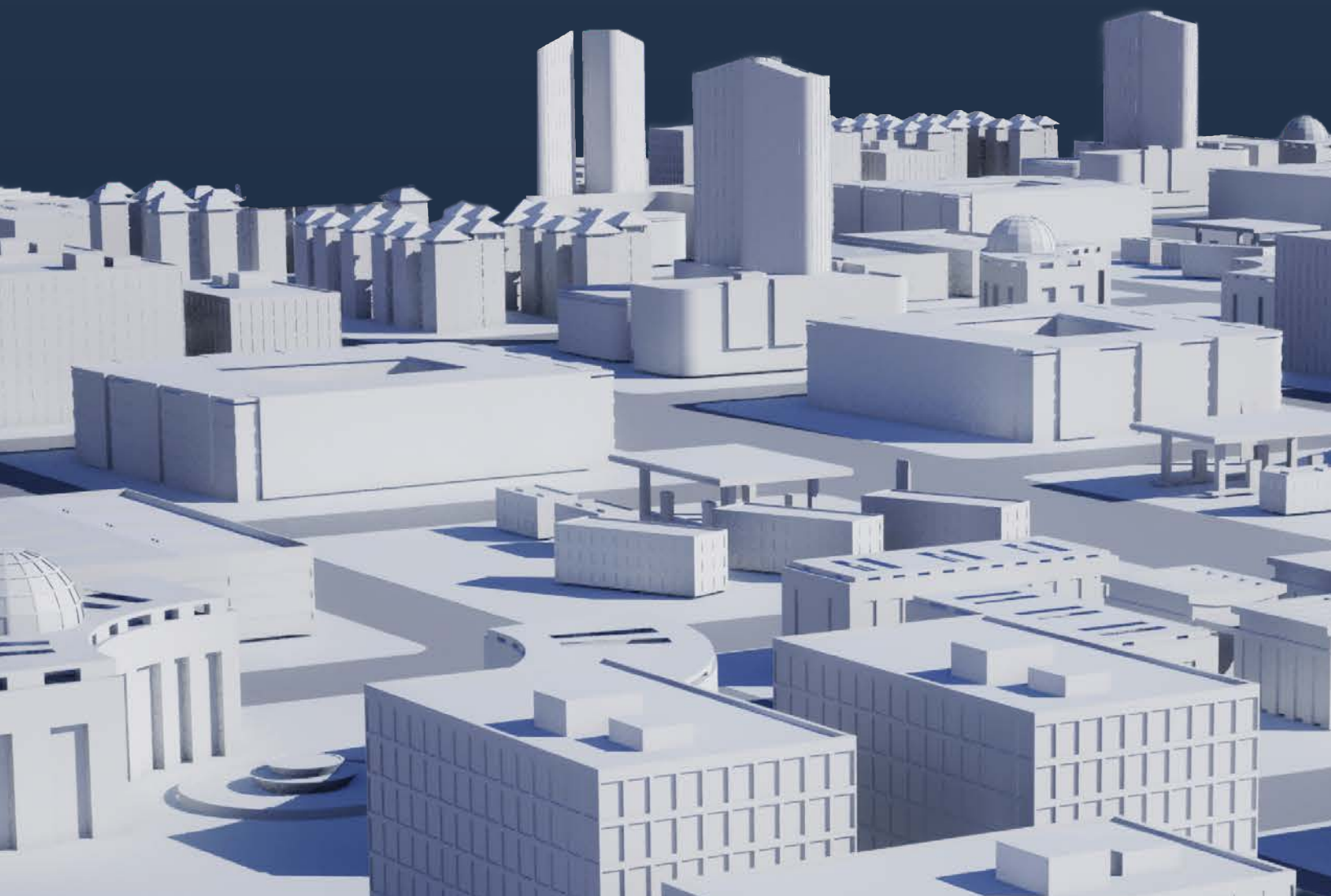
Yieldstreet

Growth & Income REIT

Q1 2023 Commentary



On the first anniversary of the Growth and Income REIT, we discuss the market dynamics in 2022 that shaped the real estate investment performance and take a closer look at the ongoing trends to form an investment thesis for 2023.

2022 Market Commentary

2022 was largely marked by a significant slowdown in investment activity as the Fed started raising interest rates at an unprecedented pace to tackle inflation. Given the uncertainty on how far the Fed would push interest rates, capital market participants (lenders and equity investors), for the most part, took to the sidelines as "value" became hard to determine. The bid-ask spread between buyer and seller became too wide which severely curtailed new acquisitions. Additionally, higher borrowing costs put a downward pressure on the value of the real estate.

The aforementioned volatility came at the heels of a two year period, post-Covid, which saw borrowing rates near zero, increased accessibility to credit, double digit rent growth, and increase in property values driven by large investor appetite. The trend was especially applicable to sun belt states like Texas, Florida, Atlanta, and Arizona which had strong in-migration patterns and job growth. Additionally, certain real estate asset classes like multifamily and industrial fared much better than the others given the strong sector tailwinds.

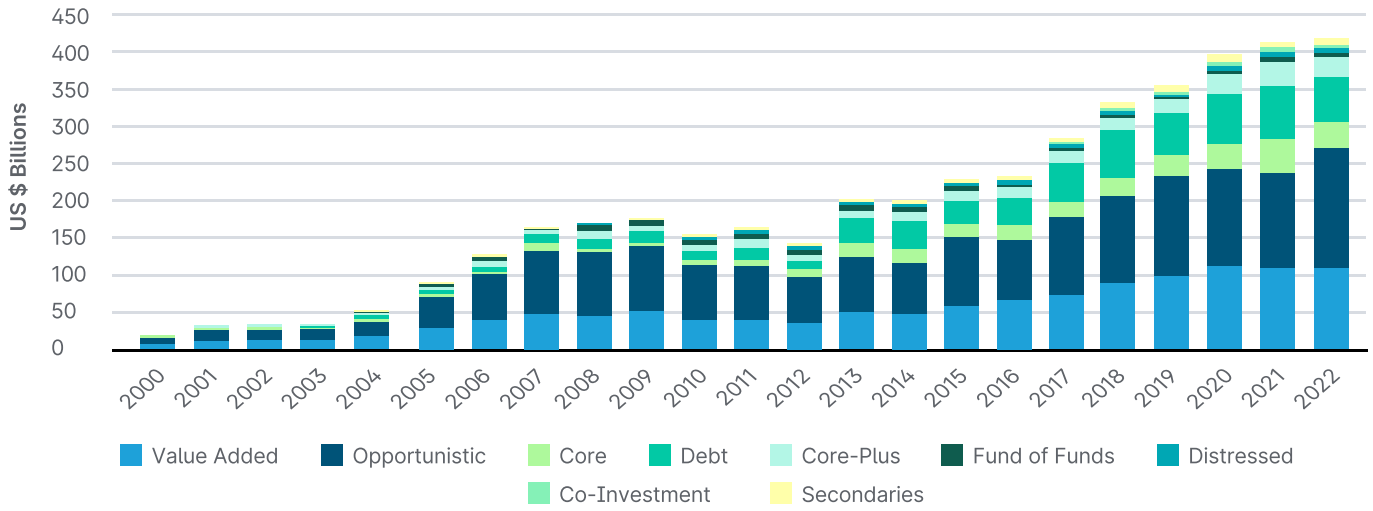
With the subsequent rise in the benchmark secured overnight financing rate (SOFR) rates from near zero to +4.5%, property owners saw free cash flow after debt service plummet to near zero or negative.

2022 Market Outlook

It's a new year but much has remained the same. Inflation has remained high, credit is tight, capital markets are volatile, and transaction volume remains muted. With the recent bank challenges, we expect credit to become much tighter. However, capital is available for the right deals, such as high-quality multifamily, industrial and grocery-anchored retail, or with established, creditworthy borrowers.

As shown in the chart below, there is a significant capital reserve to be deployed. This should support asset prices as capital is available to recapitalize the assets at the current market levels.

Global Dry Powder by Sector



Sources: Prequin, CBRE Research, October 2022

Update

The Growth & Income REIT invested in three multifamily assets and an industrial complex over the last year since inception. The properties, generally, have continued to perform in line with or above budget. However, in line with the market factors, the rise in interest rates limited free cash flow after payment of debt service, preventing distributions to investors. In saying this, the impact of the rate hikes on the Growth & Income REIT was relatively moderate because all deals have interest rate caps in place which were purchased at closing of each transaction or financed with fixed rate debt.

Tucson Multi-Family Equity	The property ended 2022 with higher in-place rents than projected at closing. Overall, the Sponsor increased in-place rents by 10% since taking ownership in March 2022. The higher rents are driving property level net operating income (NOI), which ended the year in-line with the 2022 budget from closing. View the full update here
Atlanta Multi-Family Equity	In 2022, the Sponsor achieved stabilization of the asset from its initial lease-up and began removing concessions from leases to increase net rental income. The property ended the year 93% occupied with an average occupancy rate of 88% (due to lower occupancy in the beginning of the year during lease-up). View the full update here
Norfolk Industrial Complex	The properties are 95% leased and current in-place rents are in-line with rents underwritten at closing. Accordingly, net operating income (NOI) is in-line with projections. View the full update here
Dallas Multi-Family Equity	The Sponsor increased in-place rents by ~15% in 2022 and has maintained occupancy of 94% which is in-line with projections and the competitive properties in the market. In Q4 the Sponsor was successful in reducing the property tax bill by ~19% which, in tandem with higher than anticipated revenue from rent growth, led to the property outperforming the 2022 budgeted net operating income by 13%. View the full update here

Areas of opportunity in the quarters to come

Providing credit to borrowers at very attractive rates

With the public markets undergoing a significant reaction to a challenging environment of scarce and higher cost of capital, many real estate borrowers are experiencing difficulty obtaining financing in the current restrictive climate. In this context, there is an appealing investment opportunity available for investors who can endure some anticipated short-term volatility in real estate equity prices, particularly on select credit opportunities. Investors willing and able to provide capital in the current stressed market can now identify opportunities to generate attractive, high-single-digit yields on an un-leveraged basis, particularly on deals with loan-to-value (LTV) ratios between 60% and 80%. The structure provides additional protection in such volatile times with the additional equity cushion subordinated to the investment.

Focusing on locations and asset classes with strong tailwinds:

We will focus on property sectors that exhibit secular trends and demand drivers that can provide long-term support. Such trends may arise from factors like demographics, socio-economic shifts, evolving consumer behavior, or technological advancements.

- **Multifamily and Single Family Rental ("SFR"):** The multifamily and SFR sector, for instance, is attracting a lot of attention due to demographic factors such as young adults delaying settling down and baby boomers downsizing, as well as the low supply of housing. However, the primary factor driving the demand for multifamily properties is affordability, which has become an issue in recent years due to the significant increase in home prices. Mortgage rates have almost doubled over the past year. This increase in rates has made housing even more costly for consumers, who already face high monthly expenses. As a result, renting has become an increasingly appealing option for many families.
- **Industrial:** The industrial sector is benefiting from long-term trends, as the rise of e-commerce is leading to a transformation of supply chains and a significant increase in demand for warehouses and distribution centers. To optimize their supply chains and reduce costs, businesses are focusing on acquiring modern, strategically located logistics facilities. CBRE Supply Chain Advisory has reported that transportation expenses make up 40% to 70% of a company's total logistics spending, while fixed facilities, including rent, account for only 3% to 6%.
- **Hotels**: The hotel industry has bounced back from the severe impact of the pandemic and is currently thriving, particularly leisure and drive-to hotels. Key performance indicators such as occupancy rates and average daily rates are hovering around their recent peak levels. Despite the high demand for hotel accommodations, we anticipate that there may be a challenge with their capital structure, and therefore, they may require additional capital. We perceive promising prospects in offering various types of financing, including gap financing, structured equity, or structured credit to hotels that possess sound operations but lack proper capital structures.

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