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Off-Market Real Estate Deals Are on Rise as Sellers Seek Relief

Property owners are turning to private fund managers more directly than in the past to make moves on real estate assets facing pressure from high interest rates.

By Davide Mamone | July 17, 2024

Property owners struggling with the high interest rate environment are increasingly engaging directly with real estate fund managers to pursue off-market transactions rather than go to auction through deal brokers, market participants say.

Some estimate that at least one-third of current transactions and negotiations are off-market.

The off-market deals tend to be in the mid-sized range for the asset class, with some industry observers pegging the average size in the neighborhood of $30 million to $150 million.

A noticeable bump in off-market deals is coming from private sellers, developers and individuals across the Sun Belt states and the Northwest region, as well as Colorado and Utah, half a dozen managers, advisors and sellers told FundFire.

Among the active sellers for such deals are owners who bought or developed residential properties under the low-rate regime, which now are underperforming, said **Walker Williams**, chief market strategist on private wealth at **Lido Advisors**.

Until a few years ago, these owners could carry higher leverage on their properties because their underwriting largely depended on cost management, he said. But now the higher interest rate environment is forcing them to rethink how to handle the investments, he said.

"I have gotten more and more requests over the past six months to connect individuals and clients directly with developers to provide capital," he said.

The off-market sellers include owners who built real estate portfolios with plans to exit properties individually but now see it as "advantageous" to trade them all at once, Williams added.

Some sellers also seek to execute off-market deals of performing properties to make up for underperforming parts of their portfolio, said **Rajesh Agarwal**, head of mortgage strategies at **Napier Park Global Capital**.

"Let's say there was a flood in Florida: it is possible that I, as a property owner, could borrow from Peter to pay Paul by making a profit out of my own properties in Alabama, Texas and Georgia," he said.

A Matter of Trust
The trend is attracting larger and smaller fund managers as buyers.

Brookfield Asset Management's real estate income trust vehicle recently announced three separate acquisitions in Georgia, Tennessee and Alabama totaling more than $150 million. Two of them were off-market deals.

The $925 billion manager has a third major off-market deal in the pipeline, **Dana Petitto**, managing director at Brookfield's real estate group, told Fundfire.

Owners engaging directly with larger firms like Brookfield tend to look for a buyer who has the reputation of being a good operator and can transact quickly, she added.

"Some instances are developers that have completed a project, and they need capital to continue to fund their pipeline," Petitto said. "Others, perhaps they had a failed [broker-led] process, and so they're coming back with their investment and maybe want to try an off-market route because they had spent time on a process that ended up not working out."

Ares Management also cites off-market deal flow as one of the firm's main strategies to increase its residential portfolio, according to a recent presentation to investors.

Sometimes, the sellers are not individual owners but rather other fund managers, and some of the off-market deals involve high-profile assets.

For instance, **Rexford Industrial Realty**, a real estate investment trust, completed over $1 billion in real estate acquisitions, including "a large off-market portfolio purchase acquired from a combination of Blackstone-affiliated entities," said **Michael Frankel**, the firm's co-chief financial officer, during an earnings call in April.

And last week, two off-market trades in the San Francisco Bay area closed for over $60 million combined, marking the second and third largest sales in California's San Mateo County so far this year, according to the Real Deal.

On the buyer side, many large managers are well positioned to close off-market deals, in part because they can take on more risk in an individual transaction without compromising the value of their portfolio, said **CapStack Partners** CEO **David Blatt**.

"For smaller ones, every asset in the portfolio has a meaningful impact regardless of the surface," he said.

However, the required check size for deals can make it difficult for large managers to underwrite smaller off-market opportunities, said Lido Advisors's Williams.

"[T]he most action is kind of [in] the mid to the small managers," he said.

'Huge Demand'

Sellers often explore the off-market route because it can save time compared to a typical bidding process – and sometimes also allows them to get a higher price, said **Ruben Izgelov**, managing partner at **We Lend**, a New York City-based mortgage lender.

"There is also a huge demand in finding people that can help sell the properties off-market, because you, as a seller, may not have the network to be able to do that," he said. "Having the right people in the right places will definitely help you on that front."

Some off-market deals even involve the reverse model where a fund sells off properties out of its portfolio to individual buyers in order to free up capital to deploy in a better opportunity.

"We have seen those deals," Williams said. "This kind is more of a cash flow model than a growth model."