ZRP

ZIFF
REAL ESTATE
PARTNERS

2022 Year in Review & 2023 Outlook

February 8, 2023

Fellow Investors and Friends:

In this brief letter, we will provide an update on our operating performance and investment activities in 2022 and discuss where we see risk and opportunity in 2023.

If you are an active investor with ZRP, please note, updates for individual properties and our ZRP Storage Opportunity Fund will be distributed in the next few weeks; K-1s will be distributed in March.

2022 Real Estate Market Overview

From a macro perspective, the past year was dominated by inflation, higher interest rates and concerns about a potential recession, all of which contributed to lower prices for equities and fixed income instruments.

How did commercial real estate perform in this environment? The performance of a commercial real estate investment is driven by the change in the net operating income ("NOI") of the property, and the cap rate (multiple of NOI) at which it is valued. In 2021, it was the best of both worlds; NOI was growing thanks to rising occupancy and rents, and cap rates were coming down.

In 2022, most commercial real estate performed quite well from an operating standpoint, producing solid NOI growth, as occupancy and rent growth outpaced operating cost increases. However, as interest rates moved higher, so did cap rates and thus valuation multiples declined across all real estate sectors.

The net impact on any particular asset will of course depend on the amount of NOI growth and how much the cap rate moved up (which will be determined by the asset type, the quality of the specific asset and location) and where it had been valued previously.

As long-term value-add investors, we tend not to place much importance on short-term valuation fluctuations and instead focus primarily on executing the business plan and achieving our NOI targets for each property. We do, however, conduct an annual valuation process after we have final year-end financial statements and will distribute those to our investors with our Q1 updates.

Given our value-add approach, we are continually working to improve properties and drive higher occupancy, rents, and NOI, and in 2022, we were largely successful, **producing double-digit same-store NOI growth across all asset types**. This growth in NOI will, to some degree, offset declines in valuations from increasing cap rates as a result of higher interest rates. We look forward to sharing these updated valuations with our partners soon, however, we currently do not expect to report any material declines in asset values for the past year. This valuation exercise is of course hypothetical until we seek to exit an investment, but we, nonetheless, feel it is important to keep our partners abreast of the value of their investment along the way.

ZRP Operating Performance

In 2022, we successfully increased occupancy and rents and contained operating cost increases. Importantly, we did not suffer from the impact of higher debt service costs which hurt those who utilized floating rate debt; 88% of all ZRP credit facilities are fixed at an average of 4.07% with approximately 4 years of term remaining. For transactions in 2022 alone, **82% of the debt funds placed were fixed at an average rate of 4.4%, compared to current financing rates in excess of 6% today.**

This year's operating performance highlighted the benefit of having an in-house leasing and property management team to maximize rent growth and tenant retention and to control expenses, rather than relying on third parties.

Our **retail** properties saw **occupancy and total rents increase by 4.2% and 7.8%** on a same-store basis. The leasing team produced an average **increase in base rent of 32.3% for new leases and 22.7% for renewals**. The property management team effectively controlled expenses despite the inflationary environment and contributed to an 11.7% increase in NOI.

Our stabilized **flex industrial** properties performed well with **occupancy, rent and NOI increasing by 8.5%, 7.1% and 12.9%**. The average base rent increases for **new leases and renewals were 7.9% and 13.6%**, respectively. The more recently acquired Directors Row property in Indianapolis is early in its value-add transformation, and we have been investing to transform obsolete physical spaces which are now ready for an aggressive leasing campaign in 2023.

Launched in December of 2021, the **ZRP Storage Opportunity Fund** was in investment mode during 2022, and thus we do not have same-store 2021 data to compare year-over-year growth. For our storage assets acquired this year, it is typical to see occupancy decline once taking over ownership as our goal is to replace below-market rent tenants with higher rent payors, and this is reflected in the modest 0.5% occupancy increase since acquisition. Despite the flat occupancy, our acquired properties **performed well with rent growth of 11.2% and NOI increasing 13.8%** from the time of acquisition. The construction budgets of our development projects are, in aggregate, under budget to date with some projects slightly above budget and some slightly below.

ZIFF REAL ESTATE PARTNERS

ZRP Investment Activity

2022 Acquisitions

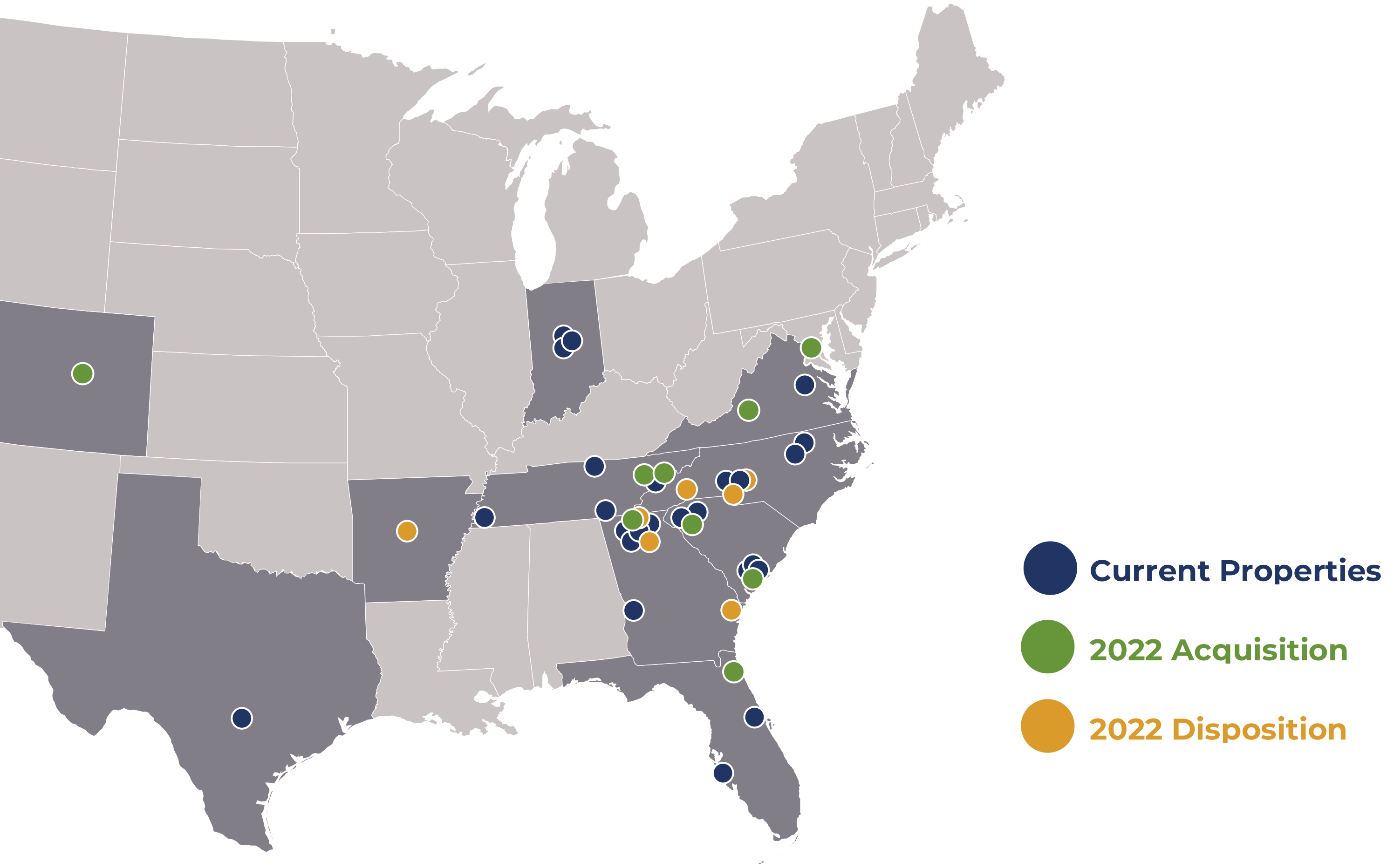
9	$85.4MM	18.4%	2.1x
Acquisitions	Acquisitions Volume	Average Pro Forma Base Scenario Net IRR	Average Pro Forma Base Scenario Net MOIC

2022 Dispositions

7	$62.1MM	35.1%	12.7x
Disposition Transactions	Sales Proceeds	Realized Net IRR	Realized Net MOIC

2022 Capital Transactions

$71.2M	$70.9M	82%	4.4%
Equity Under Management	Debt Financing Volume	Percentage of Fixed Rate Debt	Average Fixed Rate



ZRP Investment Activity (continued)

ZRP's investment strategy is centered on **acquiring** undermanaged properties in quality locations below replacement cost, **improving** operating performance and **selling** when our target valuation has been achieved. For the year, we were net buyers, mainly driven by identifying assets for the ZRP Storage Opportunity Fund. We closed on the purchase **of two neighborhood retail centers and seven storage opportunities** (two existing facilities, two existing facilities with an expansion component, two adaptive-reuse conversions and one ground-up development). These acquisitions totaled over $85 million including planned capital expenditures, and the projected base case net IRRs averaged 18.4%.

On the disposition side, we realized more than $62 million in sales proceeds from four neighborhood retail centers, one office building and two out parcel sales.

2022 brought two noteworthy sales transactions, one longer than average hold period and one shorter than average. First, the historic Manger Building in downtown Savannah, GA was sold to be redeveloped into its original use as a hotel. We owned and operated this historic office building for **27 years which generated a 38.7% net IRR and 34.9x net MOIC**.

Second, the sale of Galleria Commons, a neighborhood retail center in Charlotte, NC, was ZRP's first full cycle investment with outside investors. After only **13 months of ownership**, we leased the building to 82% occupancy, up from 60% at acquisition. We were approached by several unsolicited buyers and were able to sell the asset for 93% of our 5-year upside projected sales price, generating a **net IRR of 77.4% and an MOIC of 1.82x**.

Since first accepting capital from outside investors in late 2020, we have now **welcomed 195 external partners** from 31 US states with investment sizes ranging from $25,000 to ~$5,000,000. Our Equity Under Management ("EUM") is over $71 million, including unfunded commitments in the Storage Opportunity Fund.

Manger Building
Savannah, GA

Galleria Commons
Matthews (Charlotte), NC

2023 Outlook

Acquisition Opportunities:

As mentioned in our mid-year 2022 investor letter, the rapid rise in financing costs, tighter lending conditions and sellers reluctant to acknowledge the impact of higher cap rates on valuations, all contributed to decreased transaction volumes in 2022, and this reduced level of acquisition activity is continuing as we enter 2023.

Sellers of commercial real estate remain hopeful that the Fed will ease the pace of interest rate increases with rates plateauing and then beginning to decline over the next 12 months. Owners that don't have to sell are holding off, hoping for lower cap rates, however, all may not be able to hang on as many are exposed to floating rate debt and expiring interest rate caps.

Combined with record maturities of CMBS debt in 2023, some increase in "motivated" or "forced" sellers should materialize as the year progresses and expand the acquisition opportunity set for us. We have experience purchasing properties via the acquisition of non-performing loans, and we are actively seeking opportunities through this channel.

Crosspointe Plaza in Greenville, SC was acquired in May 2022.

Operating Outlook:

From an operating standpoint, we are coming off a very strong period for occupancy and rent growth but with the Fed intent on slowing the economy, we must expect moderation in these positive trends. The defensive nature of necessity-based neighborhood retail and self-storage, we believe, limits the potential downside in our NOI, and we continue to have leases come up for renewal that are well below market rates. While we are not immune to macro influences, our value-add approach gives us the ability to create incremental rental income, and thereby value, by investing to improve our properties and leasing up vacant spaces, in addition to renewing existing leases at higher rents.

Neighborhood Retail:

Trader Joe's grand opening at Stony Point Shopping Center in Richmond, VA

For many years, we have successfully invested in neighborhood retail centers and while retail (broadly defined - including malls and big box power centers) has gone in and out of favor, our neighborhood retail investments have consistently compounded our capital at over 20% annually for 30+ years, and we remain excited about this sector going forward. Necessity-based neighborhood retail performed well during and after the pandemic because of a fundamental supply/demand imbalance.

There is a shortage of well-located neighborhood centers in prime locations, and it is difficult to bring on new supply, given the cost of land, construction materials and labor. There is steady demand from a wide range of service-based small businesses for high quality, affordable space. As illustrated by our rent growth and reduction of operating expenses in a year marked by high inflation, our in-house property management and leasing capability is a major strategic advantage; most of our competitors are small-scale "Mom and Pop" landlords that utilize expensive and less attentive 3rd party management companies.

We are interested in allocating more of our own capital to this asset type and are contemplating raising a neighborhood retail fund, should the supply of acquisition opportunities improve as sellers become more realistic. The fund would intend to aggregate five to ten value-add neighborhood retail investments with the goal of creating a diversified portfolio that provides current cash flow as well as capital appreciation potential. If you are interested in learning more and possibly investing alongside us, **please click here**, and we will send you an overview of our neighborhood retail investment thesis.

Self-Storage:

StoreEase-managed facility in Anderson, SC with virtual management

We have a solid pipeline of acquisition prospects for our ZRP Storage Opportunity Fund and expect to close on the remaining investments that will complete the fund in the next several quarters. We will be calling most of the remaining capital to fund these acquisitions and development projects over the course of 2023 with a small amount remaining in Q1 2024.

While industry fundamentals are normalizing post the pandemic spike in occupancy and rent growth, we remain enthusiastic about the self-storage asset class given its less cyclical demand drivers, low capex requirements and attractive NOI margins. Our ability to execute value-add expansions of existing facilities, repurpose non-storage structures into Class A storage facilities, and build new, gives us numerous avenues to create value.

The industry also remains highly fragmented, and an ongoing opportunity exists to aggregate high quality portfolios of properties that can be ultimately sold to large consolidators, as we did in a $100mm portfolio sale in 2021. This activity continues as evidenced by the recent announcement by Public Storage (the largest public storage REIT) that they are seeking to acquire Life Storage in a transaction valued at over $11 billion. Given the solid operating fundamentals and attractive risk-adjusted returns, we intend to raise a second storage fund in the next several months. Our internal partners will be committing personal capital of ~ $15-$20mm to this next fund. Please let us know if you would be interested in reviewing the materials for our next storage fund by **clicking this link**.

Flex Industrial Business Parks:

Flex industrial properties (aka "business parks") serve a wide range of small-to-medium sized businesses and provide affordable warehouse and office space.

We continue to like this sector fundamentally because there is solid demand, but very limited new supply given the challenges of higher land, labor and construction costs. However, with the flood of capital into anything "industrial", valuations (from our value-add point of view) appear to be full and less attractive currently. We will continue to monitor the sector for potential one-off opportunities but are unlikely to commit material new capital to the sector in 2023.

Conclusion

We are very comfortable with the properties we own, and they remain on track to achieve their pro-forma returns. With moderate leverage and low-cost fixed-rate debt, we are well positioned for this higher interest rate environment and are hopeful that tighter financial market conditions will pressure those with floating rate debt and expiring interest rate caps to sell properties at attractive levels. We look forward to keeping you up to date as the year progresses and please feel free to schedule a call with us if you have any questions.

Tim Walter Curt Schade

If you are a prospective investor who would like additional information about Ziff or you would like to refer a friend, please contact our Partner, Sarah Brantley, Director of Investor Relations.

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Click below to keep up with us on social media!