



Blue Owl

Providing private capital solutions with both income and growth

Net-lease real estate, real estate credit and digital infrastructure

Chase McWhorter, Institutional Real Estate, Inc.'s managing director, Americas, recently spoke with **Jesse Hom**, CIO of real estate and head of real estate credit with Blue Owl, about the market dynamics bolstering net-lease, real estate credit and digital infrastructure investment opportunities. Following is an excerpt of that conversation.

Real estate market and opportunity

What is Blue Owl's view of the real estate market today? Can you talk about the growth of the firm's real estate business?

Real estate today is a large market with a variety of ways to play it, from traditional property sectors to niche property sectors. Blue Owl does not seek to be everything to everyone. We focus on segments of the market where we see large and persistent mismatches between demand for capital and supply of capital, where returns are less correlated to traditional real estate and our strategies can provide diversification and accretion to existing portfolios, and where we can act as specialists leveraging the competitive advantages we have built relative to the broader market. These strategies – net lease, real estate credit and digital infrastructure – have been able to produce very attractive relative risk-returns and high cash yields, which have enabled us to invest in downside-protected positions.

We think about our net-lease business as supporting corporate infrastructure. Our customers are typically investment-grade, corporate credit tenants, where we provide capital to acquire, develop and improve mission-critical real estate infrastructure while entering into long-term lease contracts. Our capital is flexible, and we have been able to help these corporations achieve their strategic initiatives in a manner where traditional banks or corporate loans could not. The total addressable market is massive, at more than \$10 trillion in both the United States, where we have focused the past 15 years, and Europe, where we are in the process of closing our first fund.

Real estate credit is a \$5 trillion market, with \$3 trillion of loans maturing in the next five years. Almost half of that market was traditionally provided by the banking sector, which receded after the global financial crisis. We launched our real estate credit strategy last year seeking to capitalize on this opportunity; already at more than \$15 billion of assets under management, we have flexible costs of capital that can invest up and down the capital structure in both public and private debt instruments.

Lastly, digital infrastructure involves building out the critical infrastructure needed for the explosive growth in data storage and compute power needs. Data centers, in particular, are highly aligned with the principles of our core net-lease strategy, which is serving investment-grade corporate customers to capitalize their mission-critical real estate infrastructure needs, where secular imbalances in demand and supply for capital are expected to exist over the long term. We expect to close on our acquisition of IPI, a vertically integrated data center investment manager, operator and developer, in first quarter 2025, which will anchor this strategic vertical.

What market dynamics are driving opportunities?

We believe the opportunity for net lease is very attractive, given companies' increasing needs for capital to fund onshoring of supply chains, advanced manufacturing and R&D, regular-way business expansion, or plan against the long-term requirements of climate and energy transitions. Combined with the continued constraints from bank and traditional corporate debt capital, entering into net-lease and sale-leaseback arrangements, which allows companies to monetize owned real estate that is otherwise a non-earning asset on their balance sheet tying up capital, can be an attractive option. It can give them long-term certainty of control over that real estate through very long-term lease contracts, as well as ancillary tax and accounting benefits, which can be attractive to the company's broader financial and accounting goals. Given today's higher-rate environment, we feel the prospects for the business are as strong as ever, and our investment team is looking forward to taking advantage of future buying opportunities.

With real estate credit, we believe the current lending market is highly attractive, with the ability to generate strong returns investing at material discounts to property value. The opportunity is being driven by a combination of continued structural pullback in the banking complex reducing overall capital availability; property valuations falling due to higher rates or fundamental decline for certain sectors, such as office; and higher borrowing costs, making it more difficult to refinance those \$3 trillion of loans maturing during the next five years. As a result, there is a greater need for flexible, innovative, unregulated capital to help provide solutions to rebalance capital structures and address the refinancing gap. Blue Owl has a strong reputation playing this role in its net-lease and private credit strategies and has built out its real estate credit investment capabilities to meet this opportunity, as well.

Finally, we feel the data center opportunity today is as compelling as it has ever been, driven by the massive increase in demand for compute power globally, which has been accelerated by the roll out of cloud adoption, AI and machine learning. High energy requirements and capital intensity of data center projects have helped limit supply and create real moats around the business, creating what we believe to be compelling investment opportunities. As a credit-focused real estate investor, we think opportunities to provide strategic capital alongside some of the highest-quality firms in the world are unmatched anywhere else in real estate.

The last two to three years have been challenging for real estate. How would you position net-lease opportunities in the evolving market we are experiencing today?

Most real estate portfolios today are struggling with uncertain valuations in traditional property sectors, elevated borrowing costs and margin pressure due to expense inflation. In net lease, there is the dual benefit of investing in high-quality critical real estate, while also having the long-term income certainty through a net-lease contract, where the tenant pays rent and all expenses,

with an investment-grade corporate guarantor. The net-lease buying opportunity during the past two years has been as attractive as we've seen in our careers, as net-lease assets have been trading at cap rates as wide as any other asset class, with the ability to still borrow accretively and generate an attractive cash yield. Today we are finding opportunities to invest in net-lease assets that produce 8 percent to 10 percent cash-on-cash, which grow during a 15- to 20-year lease term, with the ability to generate value-added or better equity returns in attractive property types, mainly essential retail, industrial and data centers. We feel these opportunities provide a strong risk-return profile and portfolio allocation benefits relative to anything else we are seeing across the real estate space.

Strategy and approach

How is Blue Owl's approach in net lease different from your competitors?

Blue Owl has a very rigid and disciplined investment strategy. We focus on investment-grade tenants with long-term net leases – targeting 15 years at cap rates of 7 percent or higher. We have been able to find these opportunities because of our strong origination network. Our team has deep relationships with CFOs and treasury departments at many companies. We also leverage the broader Blue Owl platform, which has a more than \$100 billion corporate direct lending business. Our teams are having bilateral conversations with corporate CFOs and treasuries all the time. Being able to source attractive investments at cap rates wider than the market and structure rents that are below market is highly attractive. As a valued banking client, Blue Owl has access to leading liabilities and a demonstrated track record of discipline in monetizing assets when the market opportunity allows for us to sell to other buyers – whether private investors, private equity funds or public REITs – at a price that has allowed us to generate favorable realized returns to our investors.

For an investor, what are the key benefits of net-lease real estate, and what role does it play in a broader portfolio?

Net lease is about seeking to mitigate downside, principal protection, high-income certainty and growth backed by both high-quality real estate and strong investment-grade corporate credit. It is hard to find investments that have both an investment-grade corporate profile with a reliable income-generation component that grows over time with rent increases, and that also allows you to generate an opportunistic return with a call option for the real estate at the end. In a broader real estate allocation,

net lease has allowed us to invest and acquire assets at 7 percent cap rates or higher, which is extremely attractive, both from an income-generation standpoint, as well as in terms of the potential to generate outsized returns, particularly when compared with public REITs, with daily volatility and low single-digits dividends; open-end funds, also with limited dividends; or opportunistic funds, which do not have a large income component. In our view, net lease is a very complementary strategy that provides a differentiated risk-return – through the combination of credit and real estate – that balances the varying risks in a broader real estate portfolio.

Looking forward

What would you say is the most exciting opportunity as you look ahead to the future of private real estate?

We are focusing on the segments of the market we think provide the best opportunity with the best teams with a history of execution. The three areas on which Blue Owl is focused – net lease, real estate credit and digital infrastructure – are the areas we believe have strong relative value. As a market leader in net-lease real estate, Blue Owl has a 15-year track record of providing capital to companies utilizing real estate to meet their financial or strategic objectives. Responsible for most of the capital raising and investment in that space, we feel this team is best-in-class for what we do. Blue Owl also acquired Prima Capital Advisors last summer to anchor our real estate credit business. Prima Capital has a 30-year track record of disciplined investment with a market-leading position in commercial real estate securities and loans. And last fall's announcement of Blue Owl's acquisition of IPI Partners, the data center investment company that helps anchor our digital infrastructure strategy, adds another strong team.

We strive to continue to differentiate ourselves through scale, great management, strategic focus and access to capital. We have the largest private net-lease business already, and in real estate credit, we were able to hit the ground running with the acquisition of Prima and have \$15 billion of assets under management, immediately operating at scale. IPI is a \$10 billion digital infrastructure business, with 80 employees at the IPI level, and another 500 from their captive vertically integrated operating platform, and we believe we are poised to capitalize on the massive opportunity in that sector. We believe pairing these business verticals with the broader Blue Owl platform and its strong relationships with banks and market opportunities provides an even greater competitive advantage.

CONTRIBUTOR



Jesse Hom
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Blue Owl

Jesse Hom is a managing director at Blue Owl, the CIO of real estate and head of real estate credit. He is responsible for the real estate platform's investment and portfolio management activities, as well as other real estate and corporate initiatives. Hom also serves as a member of the investment committees for the Blue Owl Real Estate, Real Estate Credit and Insurance Solutions groups, as well as sitting on the board of directors of STORE Capital. Prior to joining Blue Owl, Hom was the global head of real estate credit and capital markets at GIC, where he focused on driving performance and growth across both GIC's real estate credit and equity businesses for more than 15 years.

COMPANY OVERVIEW

Blue Owl (NYSE: OWL) is a leading asset manager that is redefining alternatives. With more than \$235 billion in assets under management, we focus on providing businesses with private capital solutions to drive long-term growth and can offer institutional investors, individual investors and insurance companies differentiated alternative investment opportunities that aim to deliver strong performance, risk-adjusted returns and capital preservation. Together with more than 1,050 experienced professionals globally as of Sept. 30, 2024, Blue Owl brings the vision and discipline to create the exceptional.

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