Brookes
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INVESTING IN ALTERNATIVE ASSETS

FALL 2019

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For more information, please contact:
info@brookesinvest.com
212-552-1495

Diversifying Your Portfolio

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Investing in Commercial Real Estate

Why should you invest in commercial real estate ("CRE") when there are thousands of other investment options ranging from less risky (treasury bonds) to more aggressive (technology and emerging market equities)?

Multifamily Commercial Real Estate	Equity Market
Conservative, Consistent	Volatile from Month-to-Month
Top Performer in Recessions	Retirements Hurt in Recessions
Low-Risk, High-Returns	High-Risk, High-Returns
Worry-Free Cash Dividends in Retirement	Dividends a Factor of Equity Appreciation/Depreciation
Significant Tax Benefits	Long-Term Tax Benefits
Steady Equity Growth	Shares are Intangible Assets
Tangible Real Asset	Risks Include: Political, Executive Branch Policies, Earnings/Guidance, Management/Leadership, Sentiment, and Valuations
Outperformed Stock Market (30+ years)	
Inflation Hedge	

Commercial real estate investing provides the clearest insights into future appreciation allowing proper mitigation of any potential risks.

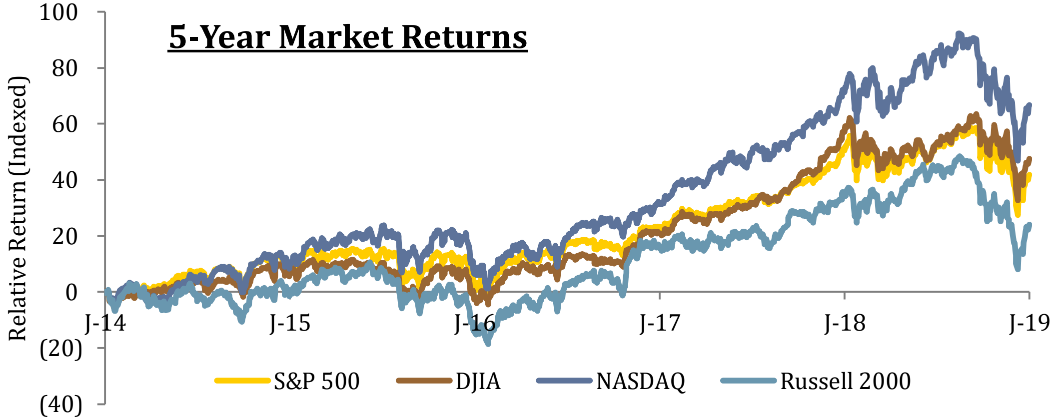
Stock market and equity exposure can often bring unwanted volatility to brokerage and retirement accounts. The day-to-day fluctuations create unnecessary worry and provide a reason for investing outside of the equities and bond markets.

- A well-rounded portfolio should not be limited to equities and bonds, but will also include **real estate**;
- Real estate is not correlated to the financial markets and is tied to more long-term macroeconomic fundamentals.

Our company mitigates the risk of multifamily investments through our **strategic approach**, investing in **our team**, **favorable loan terms**, cash **reserves**, and **exhaustive diligence**.

Capital Market Returns

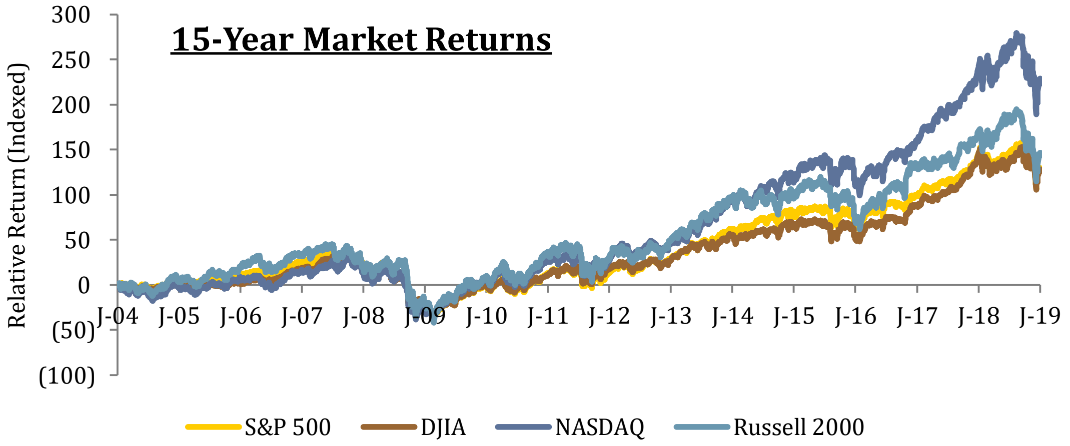
The Great Recession rebound offered institutional and individual retail investors exceptional returns if timed correctly, but the anticipation of market rallies and downtrends fool even sophisticated investors with a record number of hedge fund closures in 2018.



	S&P 500	DJIA	NASDAQ	Russell
Max:	58.77	63.42	92.23	48.38
Min:	(5.63)	(6.36)	(5.26)	(18.70)

The volatility in the equities market can be high at times and can be disastrous for individual retail investors who time the market. From October 2, 2018 to December 24, 2018, the S&P 500 (the best total market return benchmark) was down approximately 19.5%.

Prior to the Great Recession, the S&P 500 peaked on 10/1/07 at 1,549 pts. and collapsed to 735 pts. by 2/1/2009 (a drop of 52.6%).



	S&P 500	DJIA	NASDAQ	Russell
Max:	157.12	153.09	278.88	194.84
Min:	(40.65)	(38.24)	(40.73)	(41.86)

The Great Recession from 2008 to 2010 (approx.) proved costly for many Boomers planning retirement at that time. While we cannot anticipate a market downtrend of the same magnitude, we can mitigate it. Real estate returns on multifamily investments did not fair the same fate as single family home values, instead continually returned distributions to investors through that period.

Sources: Thomson Reuters; S&P Global Market Intelligence.

Commercial vs. Single-Family Real Estate Investing

Single-family residence ("SFR") investing is easier to understand, represents a great avenue for all first-time real estate investors to start, and involves less strategic planning than CRE but provides a number of challenges for single investors.

Challenges of SFR investing for new investors

- Tremendous burden of being a do-it-yourself landlord across individual properties;
- Cash on cash return when you have a mortgage is low;
- Capital expenditures (e.g. plumbing, leaks, HVAC, etc.) are costly;
- Turnover and occupancy risk are high, just one month with no tenants eliminates profits for a year;
- No economies of scale (number of doors) at the SFR level;
- Takes longer to achieve your goal of financial independence.

Benefits of CRE investing for new investors

- CRE management and property managers tend to all client/tenant requests and needs;
- Strong cash on cash return dynamics with forced appreciation;
- Reserves and deferred maintenance are factors in all business plans;
- Turnover and occupancy risks are mitigated across the entire property, performance breeds profitability;
- Benefits from economies of scale with on-site personnel and maintenance;
- Proper investment strategy can lead to extraordinary, long-term capital gains.

Capitalizing on Long-Term Trends

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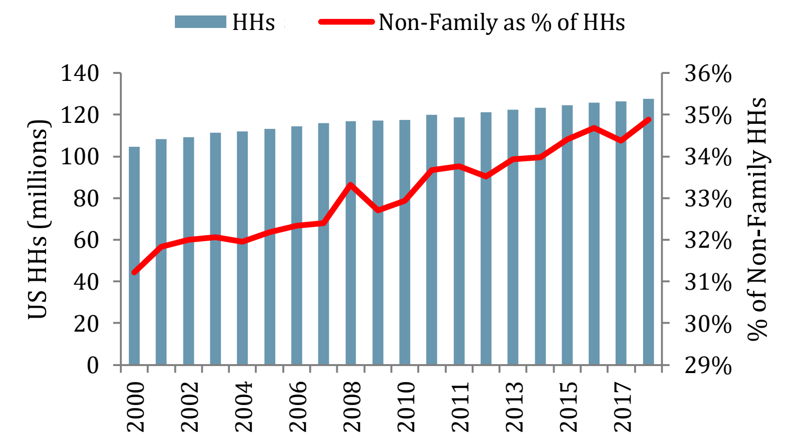
More Demand, Less Competition

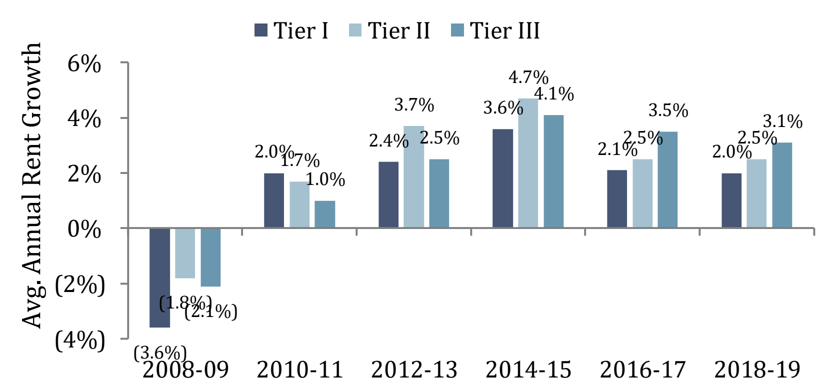
There are institutional buyers, those investors with public and pension fund capital, then there are small and middle market private equity investors with more nimble, deployable capital. Due to our firm's size, we have the ability to focus on secondary and tertiary markets, while institutional investors focus on larger, primary markets.

- **Brookes Investment Group focuses on investments in <u>second and tertiary markets</u> due to number of appealing factors:**
  - Less competition from well-capitalized buyers (institutional and big-money guys);
  - No new construction and more demand for Class A-, B+, and B type properties;
  - More likely to find properties that lack the management expertise (student housing and multifamily) and need modest capex;
- **We can make the biggest difference in these areas when it comes to providing affordable living for students and working-class families.**
- **Not to mention, secondary and tertiary markets are forecast to outperform primary markets when it comes to organic rent growth.**

Rise of Non-Family Households[1]



Average Annual Rent Growth by Tier[1]



Sources: US Census Bureau; CoStar Portfolio Strategy.

1. Non-family householders include either single male or single female households.

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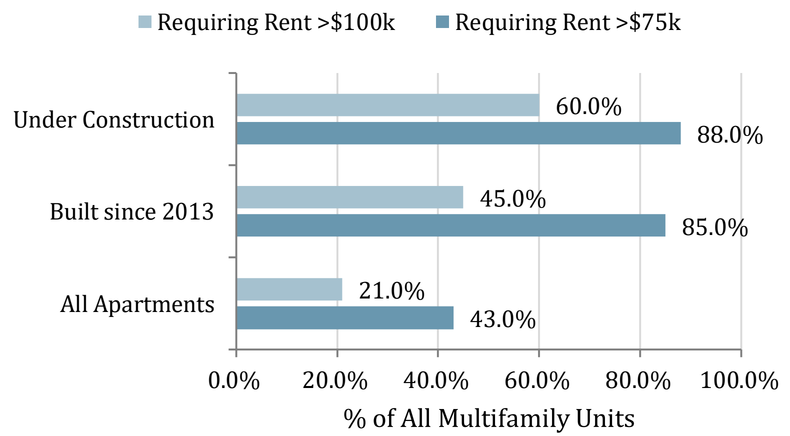
Market Strategy: Class A-, B+, and B Affordable Properties

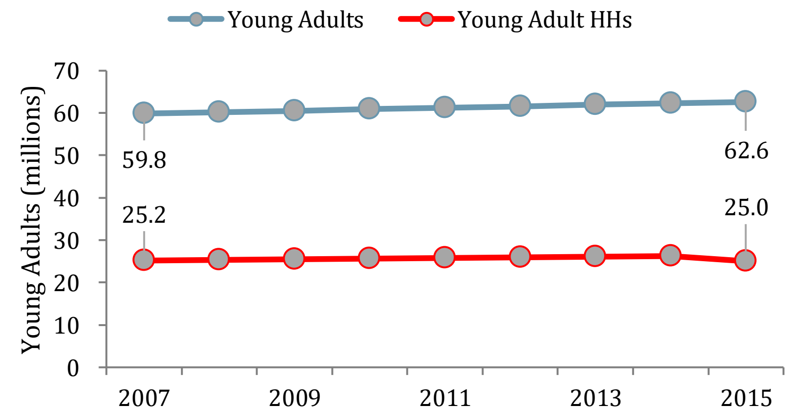
At a macroeconomic level, the supply and demand of rental properties in the United States points to a scarcity of affordable student housing and multifamily opportunities for families around the median household income range.

- **Most developers since the Great Recession have overwhelmingly chosen to build luxury type apartments, or Class A+ type properties.**
  - They have neglected to build affordable living for the general population, instead choosing to cater to household incomes in the six-figures.
  - Only about 2% of the workforce and a slim majority of students can afford these luxury rentals.
- **Since the Great Recession there are more young adults in the US, but no more young adult households.**
- **A larger portion of Millennials choose to live at home due to burdensome student debt consuming a large portion of their income.**
  - Over $1,569 billion of student loans outstanding (10% of household debt).

Less Affordable Housing Available[1]



Households Headed by Young Adults[1]

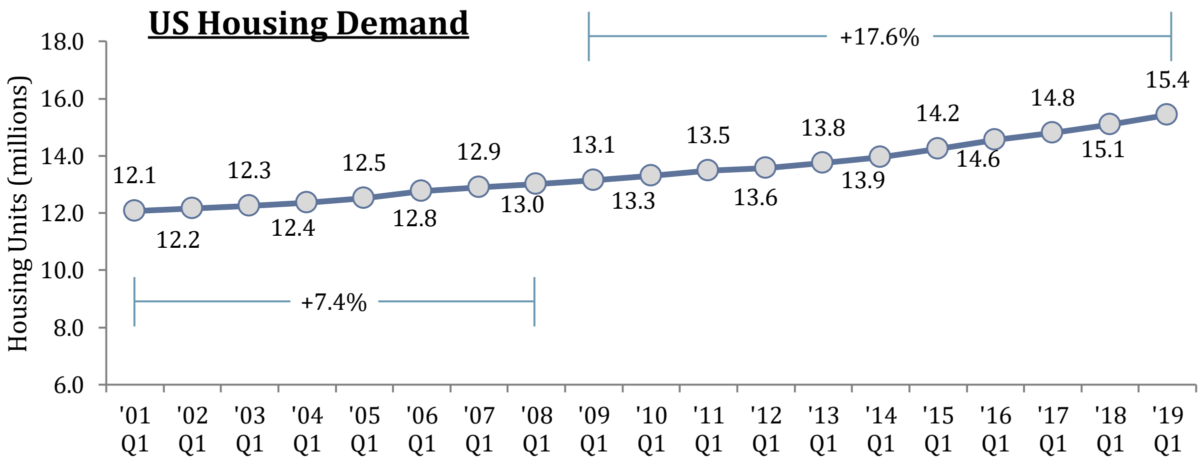


CoStar Portfolio Strategy; PEW Research Center.

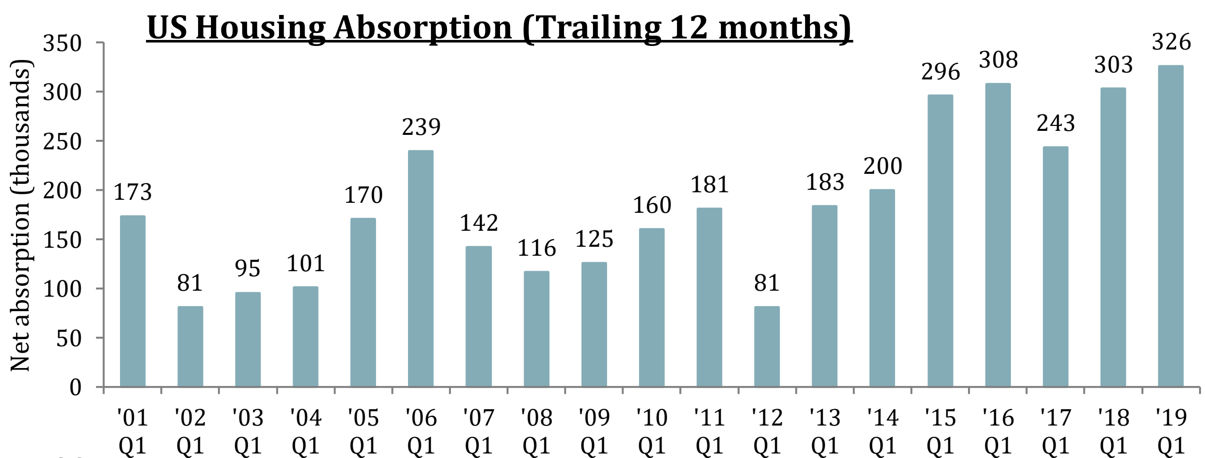
1. Based on rents not exceeding 20% of net household income.
2. Young adults are 18- to 34-years old; excludes 18- to 24-year old college students enrolled full-time.

Macroeconomic Strategy: Supply vs. Demand

The most fundamental economic principle, supply and demand, states a particular good will settle at a point where the quantity demanded (at the current price) will equal the quantity supply (at the current price), resulting in market equilibrium.



- Demand has begun to accelerate in the last ten years.
- Demand heavily favors the multifamily apartments, the supply of Class C and Class B properties underrepresented in the current market.

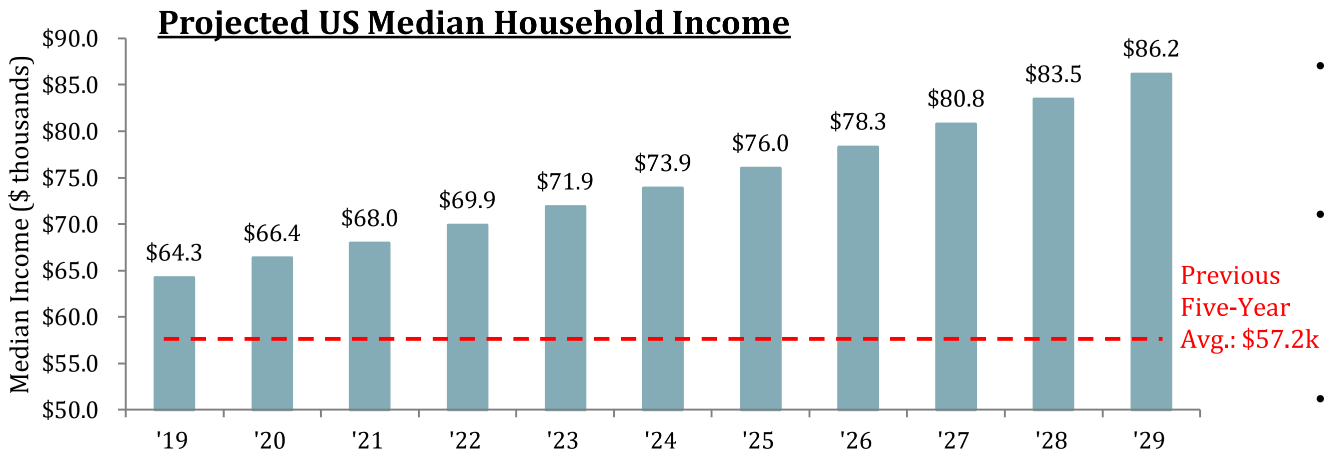


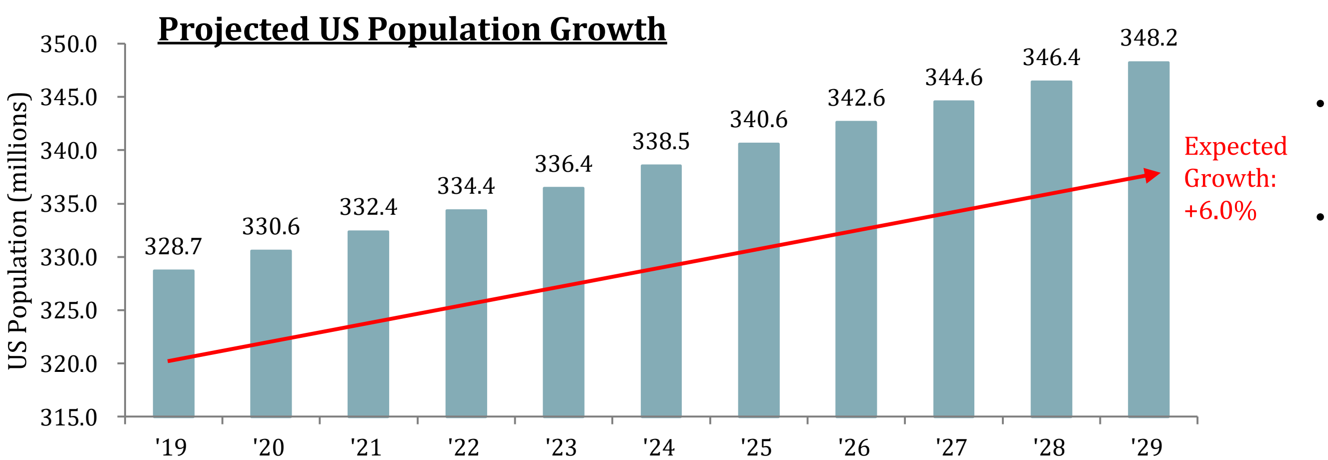
Source: CoStar.

- The graph on the left shows the net absorption of all housing units for the prior twelve months ending Q1 each year.
- Even in the face of economic hardships, demand has continued to outpace the supply.
- Absorption is unique to every market.

Robust Future US Growth

Demand for housing units, in particular multifamily units, remains high and is expected to continue as the US population continues to rise in conjunction with median household over the next ten years.





- Our strategy is to serve residents in Class A-, B+, and B affordable properties, at household incomes at the median of the market.
- As median household income is expected to continue to climb, we remain cognizant that housing expense should not exceed 30% of household income.[1]
- Analysts expect a rise of 34.2% by 2029, which would be faster than any ten year period in history dating back to 2000.

- The graph on the left shows the projected US population growth over the next ten years.
- While growth is expected to slow to 6.0% in the next ten years, down from 7.4% from the previous ten-year period (2009-2019), demand for multifamily housing will remain strong.

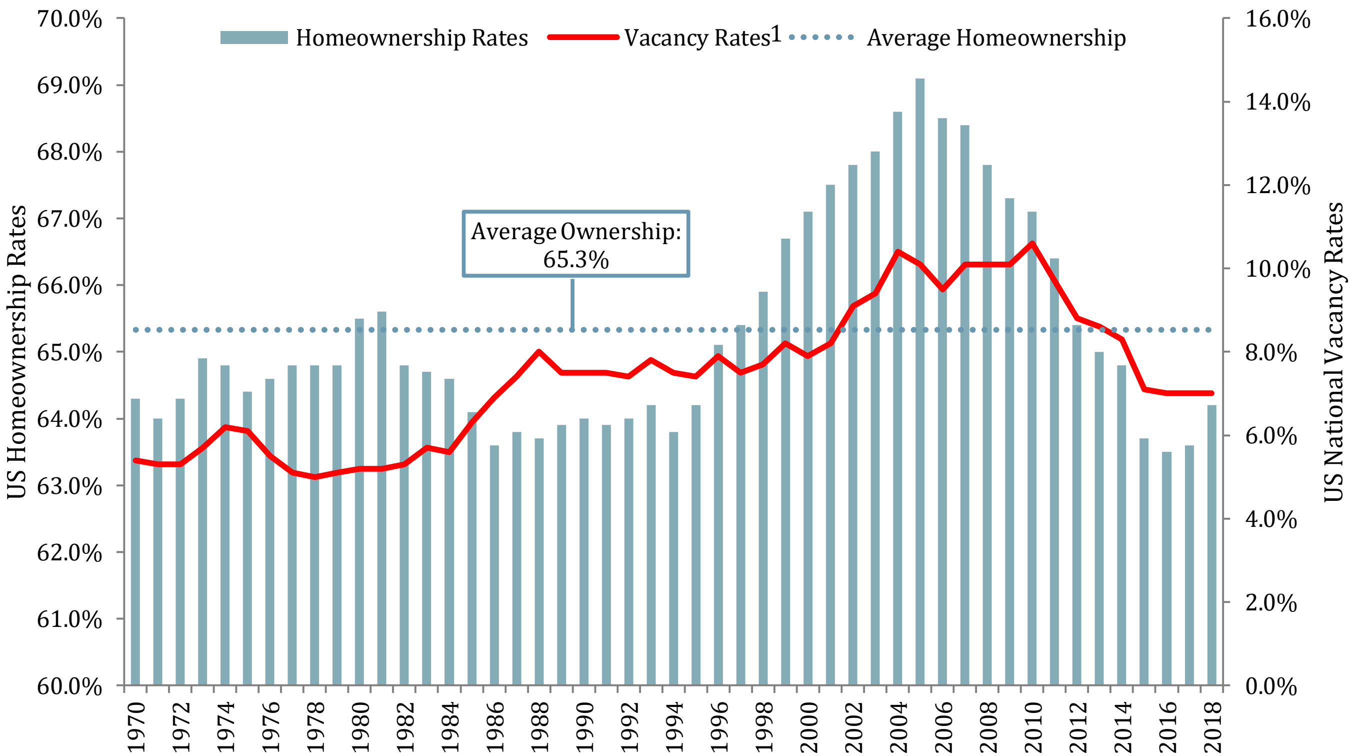
Source: CoStar

1. "Brooke Amendment" is the common name for section 213 (a) of the Housing and Urban Development Act of 1969 (Public Law 91-152) that was sponsored by Senator Edward Brooke III (R-MA), which capped rent in public housing projects at 25% of tenant's income and in 1981 the 25 percent ap was raised to 30 percent of tenant income.

US Homeownership vs. Vacancy

Does a decline in homeownership correlate to the declining vacancy rate? History would say no as the actions of over leveraged households brought on higher ownership, rates have averaged 65.3% over the last five decades with vacancy rates much lower over historical decades.

Historical US Homeownership Rates vs. US Vacancy Rates



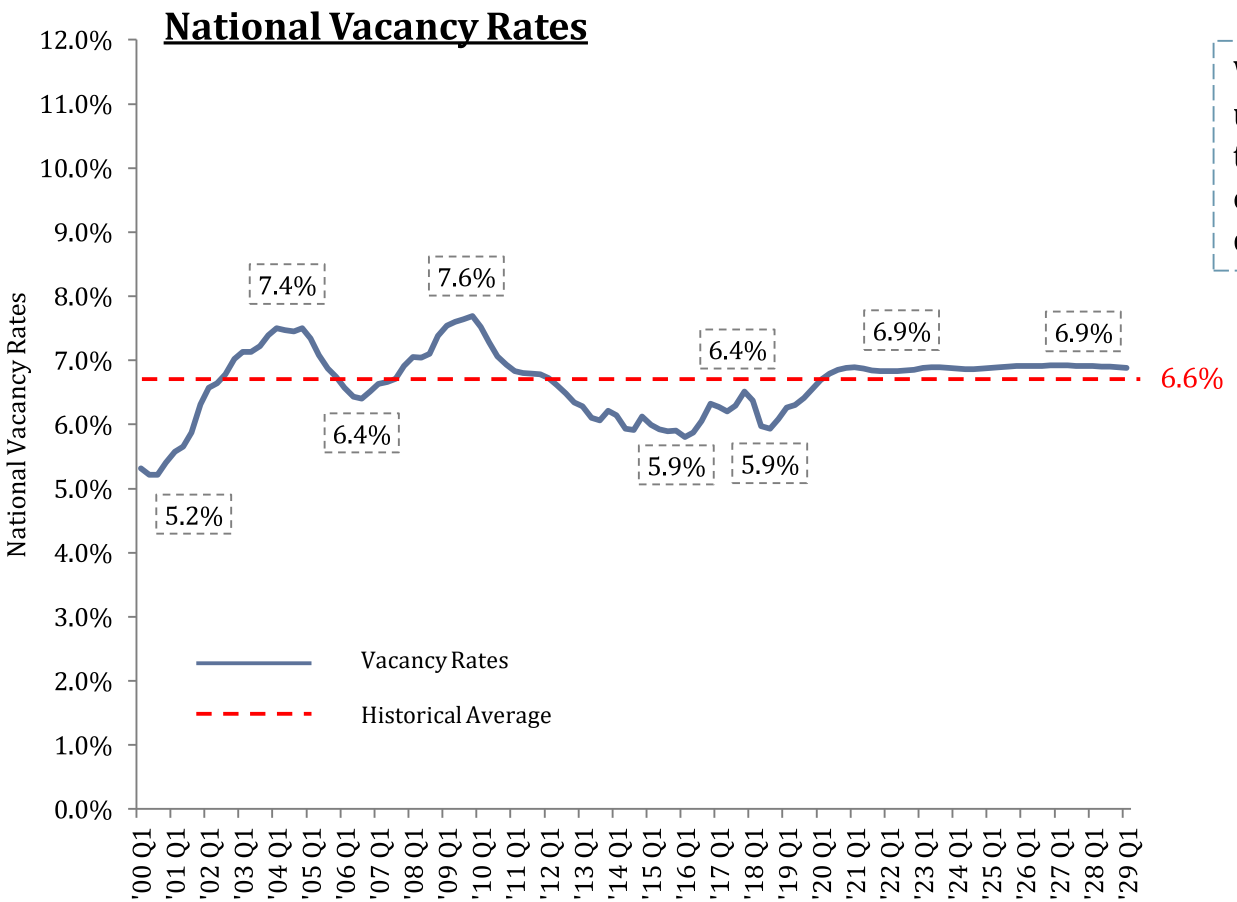
- Vacancy Rates will continue to downtrend:
  1. No one has the same pre-crisis propensity for leverage.
  2. Millennials prefer to live in markets near their work and leisure activities, not in suburban settings.
- Rental vacancy rates continue to decline at a faster pace even years after the Great Recession – this is most due to demand. The current supply and rental property construction cannot keep pace with the demand from renters.

Source: Federal Reserve Bank of St. Louis, Economic Research Division.

1. Please note FRED defines the rental vacancy rates as all properties, not solely multifamily assets.

Stability of Long-Term Vacancy Rates

From peak to trough across the nation, commercial property vacancy rates have only expanded or contracted a maximum of 240 basis points or 2.4% since 2000. We underwrite and stress-test all of our deals to higher vacancy rates should the economy take another tumble.



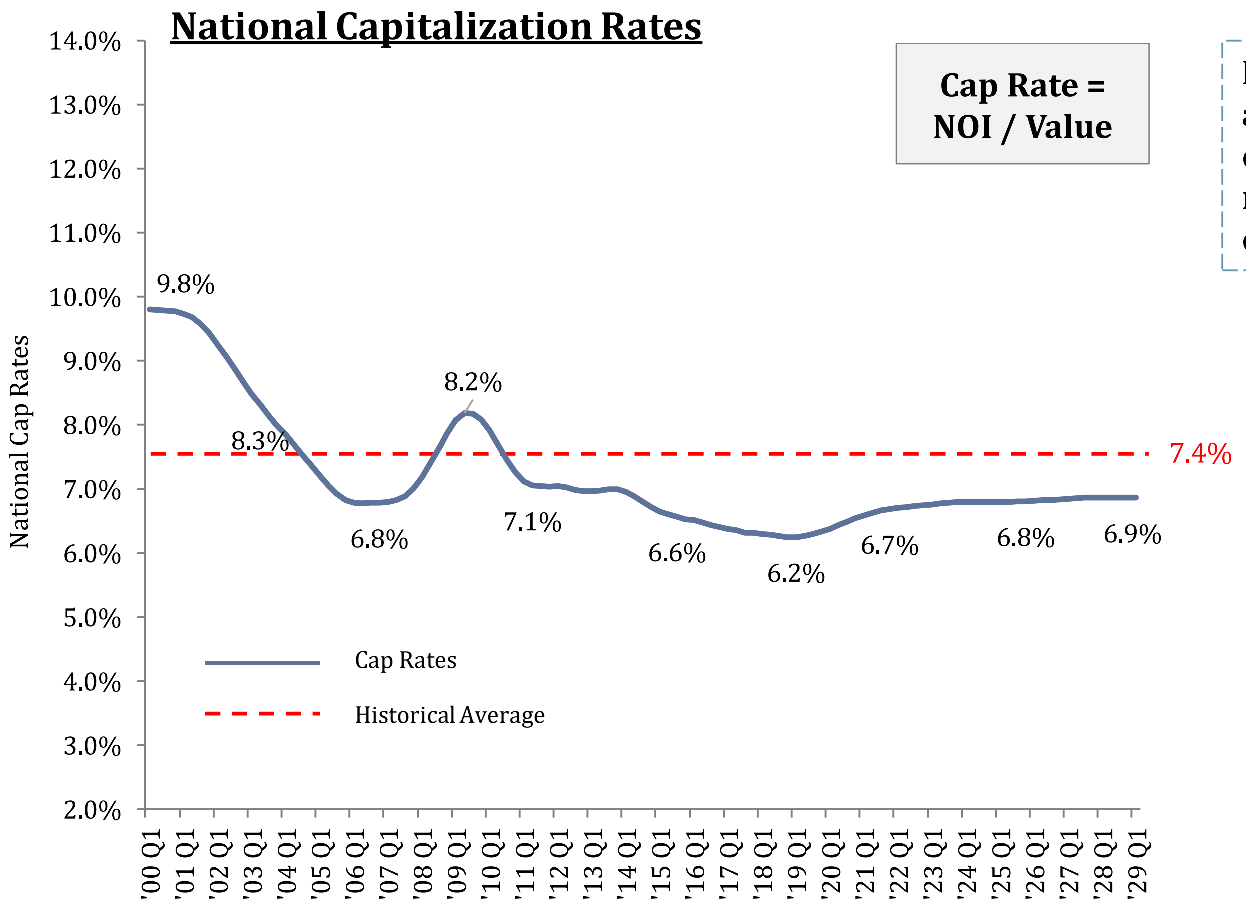
While recessionary events are unpredictable, we can mitigate the risks by conservatively estimating vacancy rates in our deals' projections.

- In the worst economic downturn in recent memory, the Great Recession, the commercial real estate sector experienced increased vacancy rates of 1.2%.
- While the single-family market saw high foreclosure rates, the CRE market was relatively unfazed as many people moved into Class B and Class C properties and out of home ownership and luxury properties.
- Affordable housing is a tenet in our business model, as we seek investments in middle-class properties.

Source: CoStar.

Long-Term Cap Rates

Since the Great Recession, values of the commercial real estate market have risen commensurately with the declining capitalization rates across the country. In our underwriting analysis, we estimate cap rates to expand 10 bps or year to account for expected expansion.



Never have we underwritten assuming the same entry and exit cap rates. We always assume cap rates will rise (inferring a lower exit value if all else is equal).

- The peak to trough from the Great Recession was approximately 140 basis points or 1.4%.
- The commercial real estate market has certainly enjoyed a honeymoon period over the last decade, and in our conservative valuation approach we do not expect it to continue.

Source: CoStar.

Downtrend Example

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CRE Values in a Downturn

The CRE asset class provides incredible stability through economic downturns. Consistent cash dividends and tax benefits continue are suitable for any environment.

	Multifamily / Student Housing			Equities / S&P 500	
	Peak	Trough		Peak	Trough
	Q1 2006	Q1 2009		Q3 2007	Q1 2009
Net Operating Income (NOI)	$2,500	$2,500			
Cap Rate	6.8%	8.2%			
Multifamily	**$36,760**	**$30,490**	**S&P 500**	**1,549**	**735**
	Decline	(17.1%)		Decline	(52.6%)

Benefits:

-Conservative
-Less Volatile
-Consistent Cash Dividends
-Safeguards Against Principal Loss
-Steady Growth
-Outperforms in Recessions

In terms of property value, assuming an investment with $2.5m in NOI, the value peaked at $37 million in Q1 2006 and dropped to $30 million by Q1 2009. This would be a decline of -17.1% – much less volatile than the equity markets during that time. Most importantly, the multifamily property would have been cash flowing through the Great Recession ensuring dividend payouts.

Skip the Smaller Investments

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