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The Real Price of **MOMENTUM-DRIVEN INVESTING**



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The normalization of interest rates is exposing a fundamental truth about real estate markets: the risks investors have been accounting for may not be what they think. The zero-rate environment created a seductive illusion—the ability to value traditionally illiquid assets as if they were readily marketable securities, with perpetual demand and ever-increasing values. As this mirage fades, the relationship between capital flows and tenant demand is turning out to be far more complex than traditional underwriting suggests.

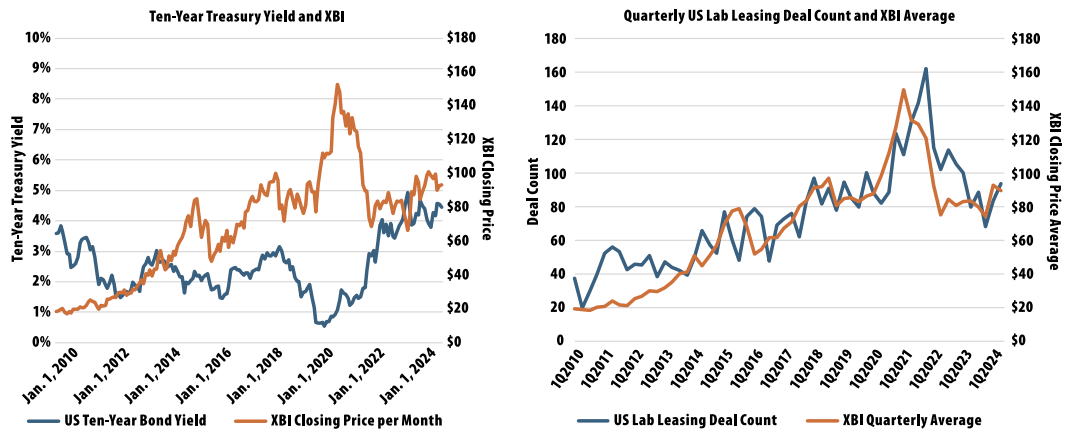
This reality marks more than a cyclic shift; it signals a structural transformation in how real estate value is created and sustained. Following broad asset class momentum, rather than rigorously assessing underlying tenant demands and market fundamentals, is proving to be a dangerously incomplete approach to real estate investment. In today’s market, understanding an asset’s physical attributes and location fundamentals, while necessary, no longer suffices to evaluate its true worth.

What matters now is grasping the increasingly complex mechanisms that drive and sustain tenant demand. These mechanisms—whether venture capital funding cycles, supply chain evolution, or technological disruption—often operate independently of traditional real estate metrics. Yet many investors continue to deploy capital based primarily on surface-level market momentum, creating an expanding disconnect between asset prices and underlying value drivers. This growing disconnect between capital flows and fundamental value drivers suggests many real estate investors may be solving the wrong equation entirely.

Capital Markets in Disguise

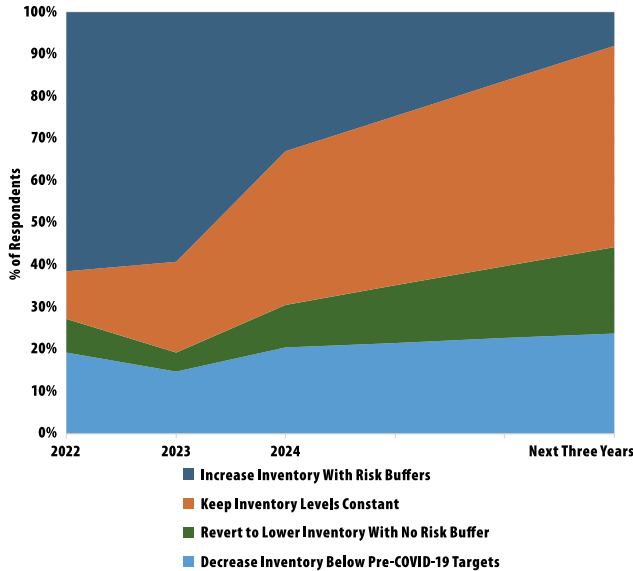
The life sciences sector offers perhaps the clearest illustration of how sophisticated these demand relationships have become. What appeared to real estate investors as straightforward demand for laboratory space was the end point of a complex chain: interest rates drive biotech valuations, which determine venture capital (VC) exit potential, which influences VC funding levels, which ultimately drives tenant demand for space (Exhibit 1).

Exhibit 1: Treasury Yield Versus XBI and Lab Leasing Deal Count and XBI Average



Sources: The Wall Street Journal; JLL Research; Bay Area, CA; Boston; Boulder, CO; greater Washington, DC, and Baltimore; New Jersey; Philadelphia; Raleigh-Durham, NC; San Diego; Seattle

Exhibit 2: Inventory Management Approach Over Previous Years and Planned for Next Three Years



Question: How have your inventory levels evolved across your global network (raw materials to finished goods) in the past year?

Source: McKinsey Global Supply Chain Leader Survey, April 26–June 10, 2024 (n = 88)

Exhibit 3: 2024—Industrial Real Estate Absorption Pre-2000 Versus Post-2022 Buildings



Source: CBRE Data

This chain created a subtle but crucial mispricing dynamic. Real estate investors, observing strong tenant demand during periods of peak VC funding, developed space on the implicit assumption that funding levels would persist. But this ignored the fundamental interest rate sensitivity of the entire biotech ecosystem. When

rates rose, they affected not just real estate cap rates but the entire funding chain that supported tenant demand.

The result was a temporal mismatch between real estate investors’ fixed, long-term capital deployment and the highly cyclic nature of tenant funding sources. The strong correlation between biotech stock valuations and leasing activity wasn’t merely coincidental—it reflected direct causation through the VC funding channel. Understanding this relationship explains both how the market became overbuilt and why recovery depends more on biotech capital markets than on traditional real estate fundamentals.

Mistaking Temporary Demand for Sustained Growth

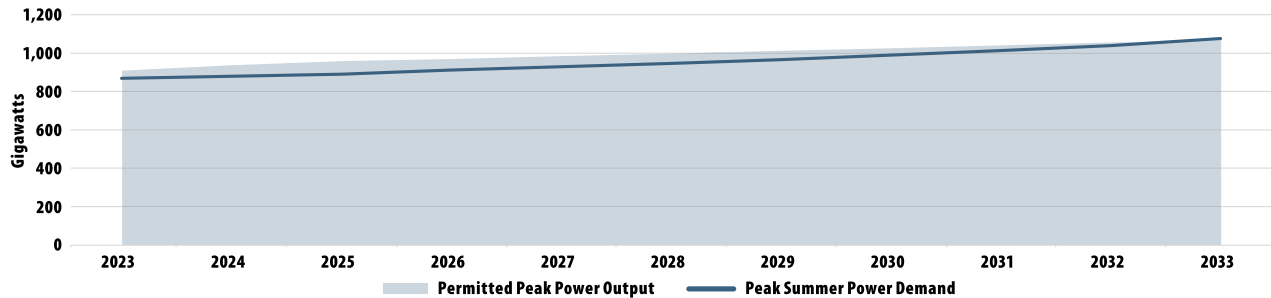
The industrial sector presents a distinct form of market mispricing: investors chasing near-term growth signals while failing to evaluate how tenants and technology would inevitably optimize away the very inefficiencies driving that growth. This wasn’t simply misreading operational evolution—it was failing to recognize that efficiency is these tenants’ core business imperative.

The latest McKinsey Global Supply Chain Leader Survey tells this story clearly: by 2024, nearly 70% of companies were moving away from inventory buffers as their primary risk mitigation strategy. This isn’t surprising—for logistics operators, inefficiency represents a cost to be eliminated, not a permanent condition to be serviced. Yet real estate investors, observing peak pandemic-era utilization, continued deploying capital as if higher inventory levels represented a “new normal” (Exhibit 2).

This misalignment is now evident in a stark market bifurcation. CBRE data show that pre-2000 buildings saw negative absorption of more than 100 million square feet in 2024, and post-2022 facilities captured more than 200 million square feet of positive absorption (Exhibit 3). This isn’t simply a flight to quality; it reflects a fundamental shift in how space supports evolving supply chain strategies. Modern facilities, particularly those positioned along diversified North American trade routes, are seeing sustained demand from third-party logistics providers focused on automation and efficiency. Meanwhile, basic storage facilities face growing obsolescence.

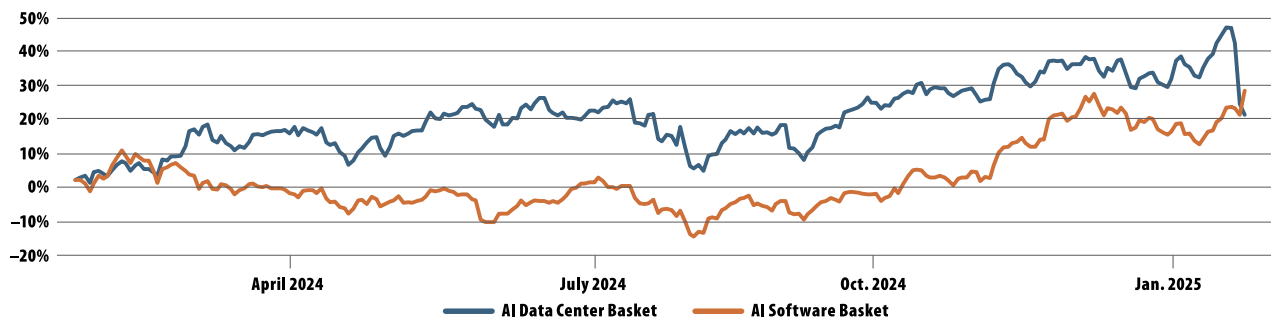
The implications for industrial assets closely mirror the office sector’s challenges: many investors will be left holding obsolete properties purchased at peak valuations

Exhibit 4: US Power Grid Supply-and-Demand Forecast



Sources: JLL Research, North American Electric Reliability Corporation (NERC), International Energy Agency

Exhibit 5: Performance of Select Goldman Sachs Thematic AI Stock Baskets



Source: Goldman Sachs

based on temporary, pandemic-driven demand. But the forces reshaping industrial real estate are structural, not cyclic. The shift toward automation, efficiency, and strategic positioning isn't a passing trend—it's a permanent evolution in supply chain strategy. As tenants continue optimizing their networks, only assets designed for this reality will retain long-term value.

When Real Estate Isn't Real Estate

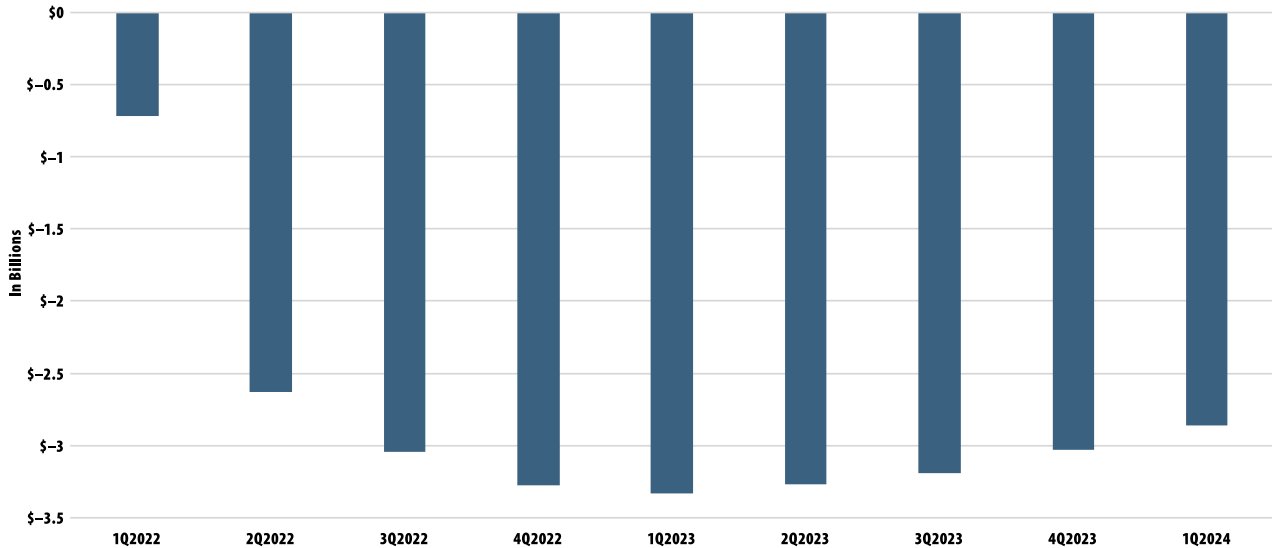
Data centers present a clear example of how investors are misreading fundamental value drivers. Although these assets trade like traditional real estate, with cap rates hovering around 6% for core transactions, this pricing reflects a problematic misconception: data centers are not real estate plays but capital-intensive infrastructure projects sitting at the intersection of technology risk, power infrastructure limitations, and rapidly evolving tenant demands.

The challenge isn't simply one of valuation metrics—it's about risk factors that traditional real estate frameworks fail to capture. Consider how artificial intelligence (AI) is

reshaping the landscape: modern AI workloads require up to 100 kilowatts per rack, nearly ten times traditional power density. According to JLL research, data center energy demand is projected to double from 31 gigawatts in 2023 to 62 gigawatts by 2028, potentially outstripping available power capacity in many markets (Exhibit 4). This creates a temporal mismatch between real estate development cycles and infrastructure reality—developers are building facilities that the power grid may be unable to support.

Technology risk adds another dimension. The recent emergence of more efficient AI models such as DeepSeek demonstrates how quickly computing architectures can evolve. Though tech executives argue that efficiency gains will drive greater demand (the Jevons Paradox), they assume stable technological paradigms. Yet developers are committing billions to hyperscale facilities based on current computing architectures, even as breakthroughs in cooling systems, chip density, or computing efficiency could render these investments obsolete faster than traditional real estate depreciation would suggest (Exhibit 5).

Exhibit 6: Blackstone BREIT Redemptions, Quarterly



Source: Robert A. Stanger & Co.

Note: January 2023 reflects a \$4 billion investment by University of California Investments.

The market appears to underweight tenant concentration risk. Although partnerships with hyperscalers offer perceived stability, they also consolidate risk in a handful of tenants whose infrastructure strategies remain fluid and who wield unprecedented leverage as customers—a dynamic fundamentally different from traditional owner-tenant relationships. Cloud and tech companies now account for 67% of data center demand, but unlike an industrial tenant with multi-decade supply chain needs, these providers' needs can shift based on cost, efficiency, and regulatory arbitrage. The combination of this tenant leverage during lease negotiations and the potential for significant asset obsolescence after lease expiration raises questions about whether investors should be satisfied with utility-like returns and limited capital appreciation.

The fundamental challenge extends beyond these individual risks to their collective implication. Data centers trade like traditional real estate at 6% cap rates, yet their profile more closely resembles utility infrastructure, where technological obsolescence and tenant concentration create inherent pressure on terminal values. The market prices these assets assuming both durable income and capital appreciation

potential while their path to commoditization suggests otherwise. For institutional investors deploying capital at scale, this may be an acceptable trade-off. For others pursuing momentum-driven strategies, the gap between expected and realized returns could prove substantial.

Maintaining a Clear View Looking Forward

What these examples reveal is a fundamental truth about today's real estate markets: the game being played is not always the one investors think they're watching. Success requires either the institutional scale to manage through market cycles or the specialized expertise to identify opportunities others miss.

For large institutions, scale itself becomes a risk management tool. With access to flexible capital and the ability to maintain long-term positions, these investors can navigate the temporal mismatches between capital deployment and evolving tenant demand. The recent experience of the Blackstone REIT—in which the firm successfully managed redemption pressures through strategic asset sales and withdrawal limitations—demonstrates how institutional scale provides insulation against market dislocations that might destabilize smaller players (Exhibit 6).



This requires understanding specific demand chains in detail—whether biotech funding dynamics, supply chain evolution, or tech infrastructure requirements.

For other investors, the opportunity lies in moving beyond surface-level sector momentum to uncover value in more focused strategies. This requires understanding specific demand chains in detail—whether biotech funding dynamics, supply chain evolution, or tech infrastructure requirements. The goal isn't to predict cycles but to recognize where fundamental value drivers diverge from traditional real estate assumptions.

As real estate markets evolve, success will belong to those who can separate signal from noise and act accordingly. The investors who thrive will be those who either wield institutional scale to withstand market dislocations or develop the deep sector knowledge to move ahead of them. The middle ground, where conventional real estate metrics offer false confidence, will be the riskiest place to operate. ■

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