NEW YORK LIFE REAL ESTATE INVESTORS STRATEGY AND RESEARCH GROUP
2024 MACROECONOMIC AND CRE OUTLOOK

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Key Takeaways

Macroeconomics

- The U.S. economy demonstrated resilience in 2023, however, mixed economic messages have appeared, and we have transitioned to a more somber view for 2024. We believe GDP and retail sales growth should slow and may even decline next year, while the unemployment rate will likely rise.
- Our **outlook** remains that there is a strong possibility that the U.S. economy will enter a recession in 2024; however, the likelihood of a milder outcome may have increased with the recent fairly positive economic data.
- The resilient U.S. **labor market**, renewed industrial investment (reshoring, semiconductor, and green transition), infrastructure investment, technological innovation, and higher productivity (potentially possible from artificial intelligence) are positive factors for the U.S. economy.
- **Inflation** appears to be moderating, but still remains above the Federal Reserve's 2% target. We expect inflation to remain above the target in 2024 as rising costs are supported by several long-term trends.
- U.S. **debt levels** are at all time high and will need to be refinanced at higher rates. The potential for a recession and a challenging debt environment are impacted by the possibility of both term and balloon defaults in certain sectors.
- **Geopolitical** concerns are heightened with conflict in the Middle East. Potential for spread of conflict to a wider area elevate economic concerns.
- **Globalization**, already under stress prior to the pandemic, has suffered mid-to-longer-term damage.

Commercial Real Estate (CRE)

- Higher **interest rates** are putting downward pressure on commercial real estate values, making it more difficult to refinance existing loans.
- Improved clarity around **property values** is starting to emerge but has still not fully manifested. In our view, when this happens, likely in 2024, transaction volume will increase.

- There is a wave of loan maturities coming due over the next several years that must contend with declining values and refinance rates substantially higher than at origination. This comes at a time of tightening lending standards and less availability of new loan refinancing. We believe there will likely be an increased level of **loan defaults**, particularly in the office sector.
- The large bid/ask spread between buyers and sellers will likely take time to recalibrate. Fewer commercial properties being marketed for sale are attracting a declining number of bidders. Transaction markets are suffering as a result of a broadening disparity of opinion on the extent to which distress may infect **future pricing**.
- During the era of low rates accompanied by a good economic environment, many investors benefitted from rising values across asset classes. In the new paradigm of higher rates, weakening economic indicators, and declining values, substantial prospects for investing at a low basis are manifesting, but so are the potential pitfalls. Therefore, it is vital that investors are discerning and rely on the keen investment expertise of advisors who can differentiate true opportunities from potential minefields.

CRE Sectors

- Commercial real estate **fundamentals** are softening across the U.S. Vacancy rates ticked upward in all of the major property types except retail and we expect this to become more acute in 2024. We expect overheated sectors in certain markets to retreat further.
- **Apartment** sector growth in asking rents is flattening on a year-over-year basis and vacancy rates are rising due to elevated levels of new supply the market is trying to absorb, especially in the Sunbelt. Heightened cost of homeownership may provide a ballast against further softening for the sector.
- The **industrial** sector continues to perform well, however, demand and rent growth is moderating. We expect the industrial sector to "come back to earth" as the new normal solidifies. The trend toward nearshoring some share of manufacturing and trade to Mexico could benefit demand for logistics properties in border states like Texas, Arizona, and California.
- The **office** sector is most challenged, and the back-to-office trend is progressing slowly and may, in fact, be plateauing at depressed levels. Loan default rates are expected to increase in 2024. There have been a consequential number of property sales at 25% to 50% of pre-pandemic values. Investment at that basis could result in outsized returns.
- **Retail** sector vacancy rates are at historic lows, and supply risk remains minimal with construction below the 15-year historical average. Suburban neighborhood centers are benefiting from remote work.
- We believe there are opportunities in each of following alternative asset types. Substantial demand for **data center space** is expected through 2024. **Self-storage** generally has lower operating expense ratios and lower labor costs. **Single Family Rentals (SFR)** are benefiting from the housing affordability gap and low inventory.
- All sectors have been impacted by **operating expenses increasing** rapidly over the past two years, which is a broad headwind.
- As values recalibrate and lenders' and owners' needs for liquidity mount, generationally attractive investment opportunities are beginning to manifest. We believe this dynamic should accelerate in 2024. **Investors who can play across the capital stack and up and down the risk spectrum can capitalize on the market disruption.**

New York Real Estate Investors Strategy and Research Group

The Strategy and Research Group (SRG) of New York Life Real Estate Investors (NYLREI) analyzes the macroeconomic environment, demographics, legislation, operating fundamentals and leverages proprietary research to craft and inform investment strategy across NYLREI's Equity, Debt, and CMBS platforms.

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Macroeconomics

Investors who had become accustomed to nearly a decade and a half of near-zero interest rates are now slowly adjusting to higher borrowing costs. Many are beginning to accept what was normal before the Great Recession (i.e., a median Federal Funds Rate of 4.62%, 1945-2008[1]) is likely to exist in the near term and possibly even over a longer period of time.

More than a decade of low inflation and easy financial conditions came to an end in 2022. In the 16 months between March 2022 and September 2023, the Federal Reserve raised interest rates 525 basis points to combat multigenerational high inflation. Despite the Fed's efforts, inflation is proving more stubborn than expected and we believe rates may need to remain at elevated levels through 2024.

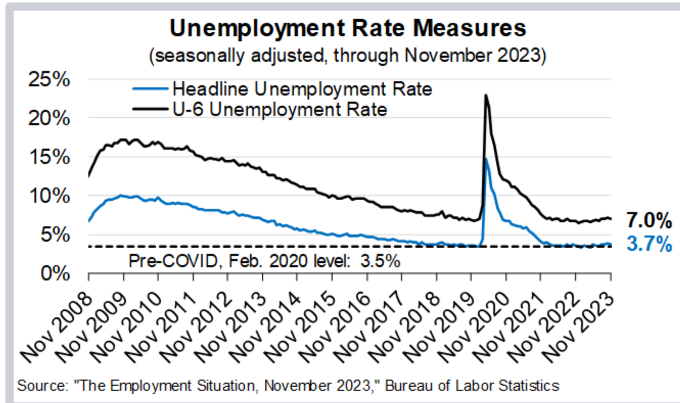
During and after the pandemic, governments, corporations and other entities accrued debt at low interest rates. With economies slowing and interest rates higher, there will be a reckoning. Several major economies could find themselves on an unsustainable debt path unless they make significant fiscal adjustments. Debt risks are back – the days of growth rates higher than borrowing costs and inexpensive debt are over for now.

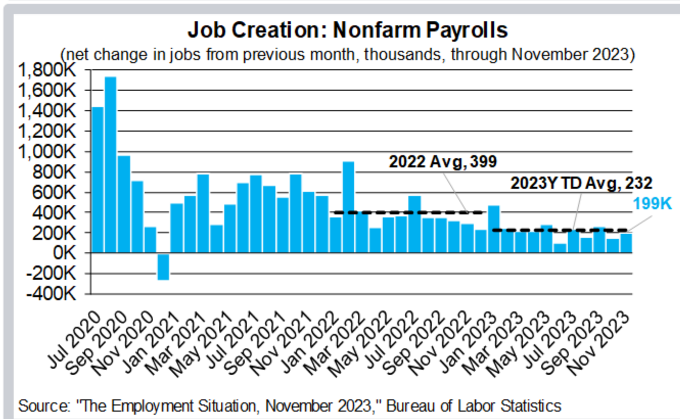
Although unlikely, the possibility of a stagflation scenario, where the country is plunged into a recession while inflation remains elevated, is something the Fed is trying to avoid. In such a scenario, the Federal reserve would have more limited options, as the ability to fight inflation with higher rates would be limited.

The Economy

Real GDP growth of 5.2% at an annual rate in the third quarter defied expectations and revealed the U.S. economy has remained remarkably resilient throughout 2023 despite mounting macroeconomic pressures.[2] Although GDP numbers released in 3Q were higher than consensus, we expect GDP growth to slow in the fourth quarter and to moderate further in the beginning of 2024, with the possibility for growth to turn outright negative in the second half of 2024.

Retail sales – a measure which is more heavily weighted towards goods than services – remained positive in 2023 on a nominal basis, supporting consumer spending. Although over the past year, through October 2023, retail sales have grown 2.5% on a nominal basis, they are down -0.8% on a CPI-adjusted basis. In the most recent observation, month-over-month growth in October 2023 turned negative for the first time following six consecutive months of growth. A continued slowdown in retail sales is expected in 2024.



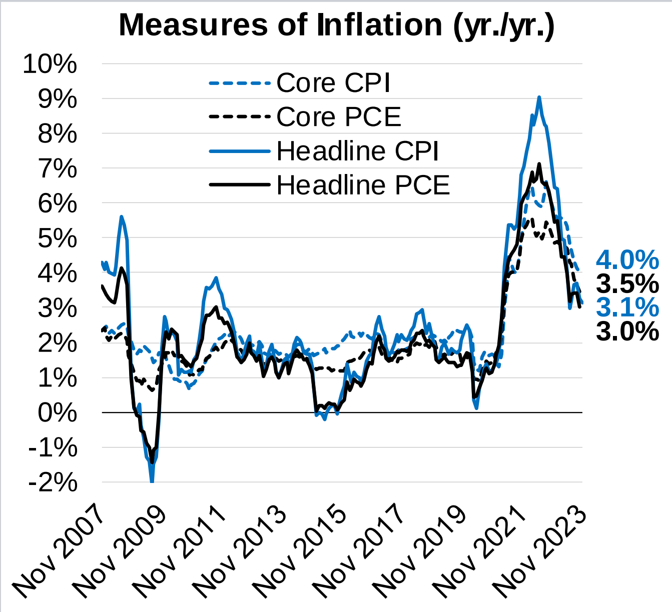


In the labor market, the headline U.S. unemployment measure – the "U3" unemployment rate – rose from 3.5% at the end of 2022 (and on par with the pre-Covid 50-year low) to 3.7% as of November 2023, still not far above that historic level (see chart above).[3] The broader "U-6" measure of the unemployment rate stood at 7.0% as of November 2023, up from 6.5% at the end of 2022, but lower than the 7.4% pre-pandemic in February 2020. The post-Covid labor market recovery has seen payrolls exceed their pre-Covid level by 4.7 million jobs. This is despite recent news of some U.S. employers laying off workers. Payroll growth has averaged 232,000 per month so far in 2023, a slower pace than the 399,000 per month

[1] Median was calculated using monthly observations. The average (mean) was 4.93% during the same time period.
[2] Source: U.S. Bureau of Economic Analysis. As of Q3 2023 (2nd estimate)

[3] "U3" unemployment rate is the headline measure of unemployment. "U6" is a broader measure intended to capture underemployment.

in 2022. Although, the labor market is exhibiting its first signs of weakness, it may prove far more resilient this cycle than in the past. Nevertheless, we expect hiring to slow in 2024 and for the unemployment to reach between 4.0% to 5.0%.



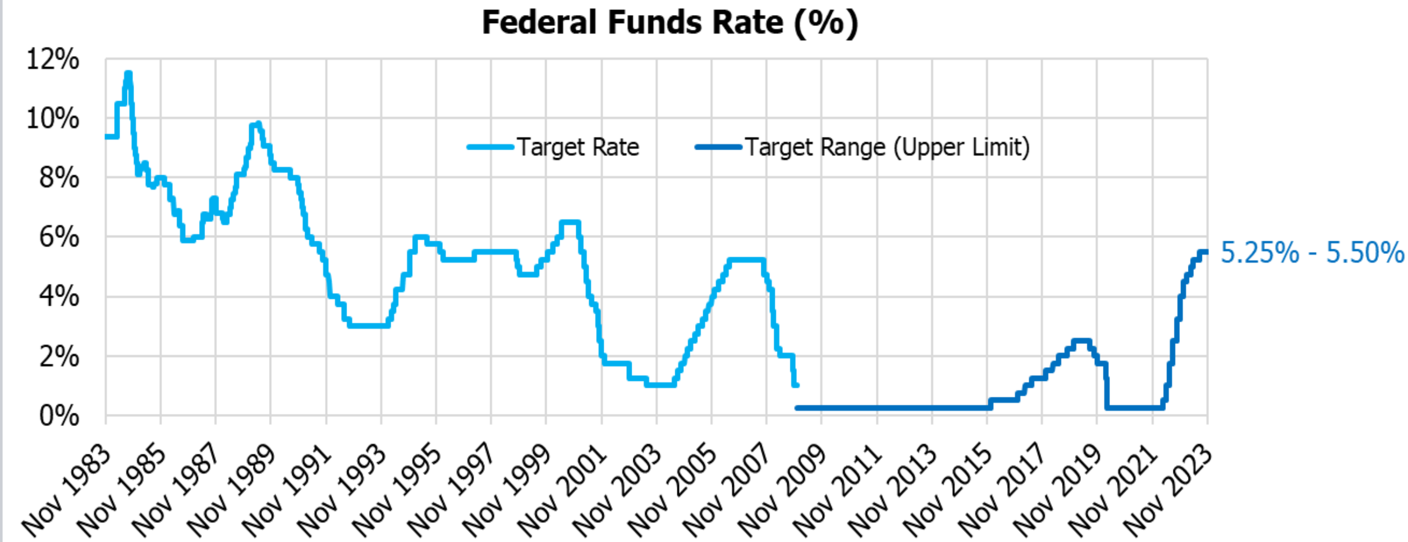
Source: U.S. Bureau of Labor Statistics; U.S. Bureau of Economic Analysis. CPI as of Nov 2023; PCE as of Oct 2023

Meanwhile, inflation, a significant threat facing the U.S. economy, has continued to retreat from multi-decade highs. Headline Consumer Price Index ("CPI") inflation, measured on a year-over-year basis, is 3.1%, which is substantially lower than the peak of 9.1% in June 2022 (see chart above). Core CPI, which excludes the more volatile food and energy components, has slowed to 4.0% as of November 2023 from 6.6% in September 2022. The Fed's preferred measure of inflation, Core Personal Consumption Expenditures ("PCE"), stands at 3.5% as of October 2023, down from a 39-year high of 5.6% in February 2022. Over the past few months, energy prices, used car prices, and airline fares have fallen. Overall, while inflation has softened, it is still significantly higher than the average of the past decade and it remains well above the Fed's 2% target. In the fight against inflation, much remains to be accomplished and we expect inflation to remain elevated above the Fed target of 2% into 2024.

Low-cost labor, goods, and capital enabled inflation to be very low, about 2%, for the past two decades prior to the recent rise in inflation. The U.S. economy no longer benefits from any of those factors to the same extent. Continued deglobalization and the pivot away from China to other markets in southeast Asia should continue. Most noteworthy, an acceleration to near shoring to Mexico and reshoring to the United States is a tailwind for higher prices of goods and is inflationary. Other factors that buttress inflation include the Russia/Ukraine war and the green transition. The U.S. M2 money supply and debt-to-GDP ratio are near their highest levels and have contributed to high inflation.[4] Demographic trends in the U.S. and worldwide make labor scarcer and more expensive and may become an additional inflationary catalyst.[5] Our expectation is that inflation moderates slowly but remains above the Fed's target of 2% next year. In fact, the most recent University of Michigan Survey of Consumer Inflation Expectations in December 2023 indicated that Americans expect prices to rise at an annual rate of 3.1% over the next year and 2.8% over the next five years.

[4] M2 is a measure of the U.S. money stock that includes M1 (currency and coins held by the non-bank public, checkable deposits, and travelers' checks) plus savings deposits (including money market deposit accounts), small time deposits under $100,000, and shares in retail money market mutual funds.

[5] Other inflationary tailwinds may include "greedflation" which is when companies raise prices substantially more than necessary as well as climate change causing droughts and other weather-related factors that impact prices for food, insurance, and other products.



Source: Federal Reserve Economic Data, New York Life Real Estate Investors Strategy & Research Group projections. Historical through Nov. 2023.
Note: Effective December 16, 2008, the FOMC began reporting the target rate as a range with an upper and lower bound.
The lower bound is 25 basis points below the upper bound.

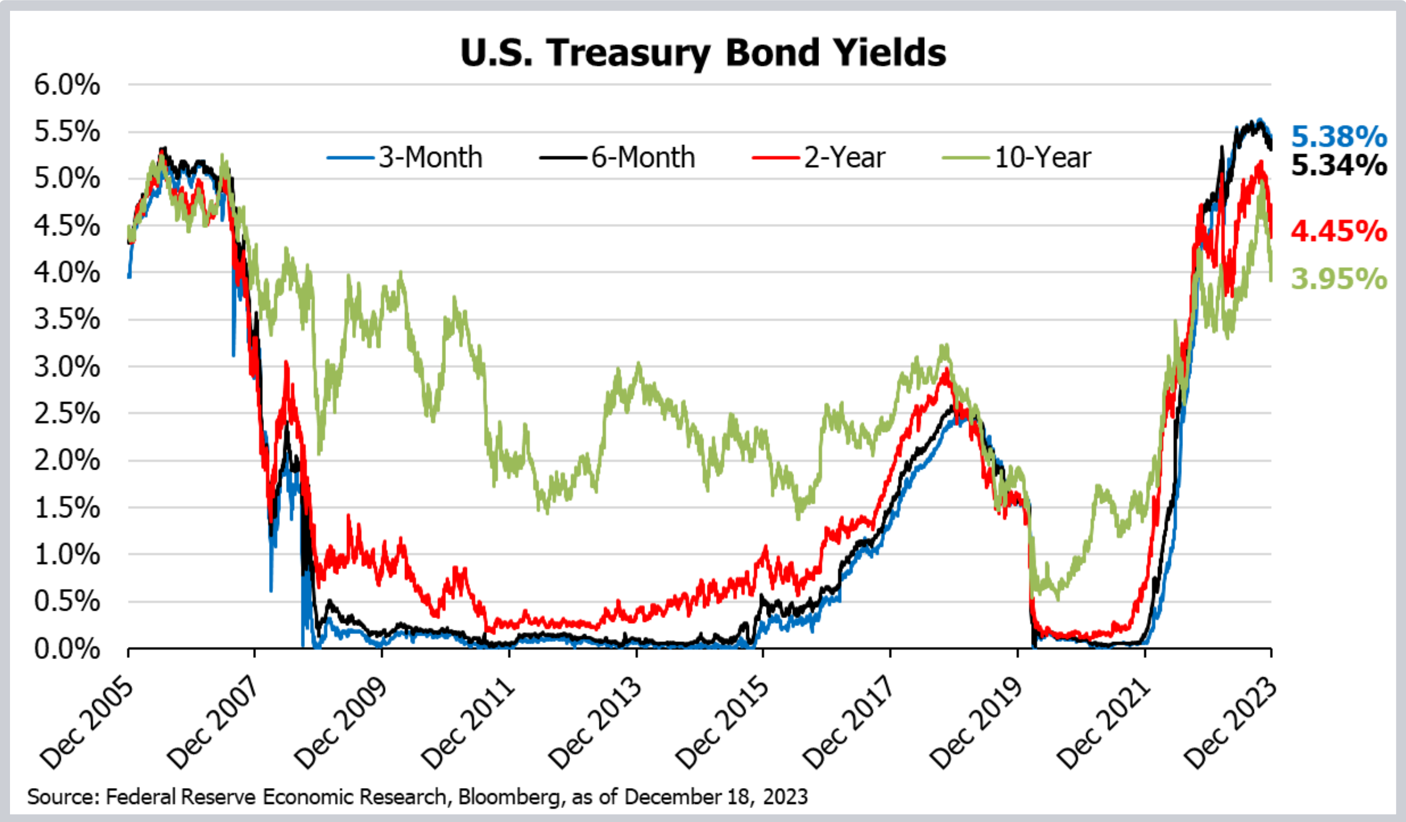
At its most recent December 13, 2023, meeting, the Federal Open Market Committee ("FOMC") kept its Federal Funds target range at 5.25%-5.50%, the highest since 2001 and up from a target range of 0%-0.25% at the beginning of 2022 (see chart above). In the 16 months between March 2022 and September 2023, the Federal Reserve raised interest rates 525 basis points. This represents the most significant and rapid stretch of interest rate increases since the early 1980s and underlines the seriousness with which the Fed views the threat of inflation. We expect rates to remain elevated into 2024 with the possibility of cuts in the second half of the year. The background or preconditions for rate cuts may include a combination (1) core inflation at a 3-month trailing average of 2.5%, (2) inflation expectations well anchored, (3) unemployment rate above 4%, and (4) wage growth commensurate with price stability[6]. A scenario in which rate cuts come sooner would include if recessionary conditions become apparent and/or if inflation has moderated substantially.

While the risk of widespread bank failure contagion appears to be contained for now, bank failures and banks' focus on bolstering their liquidity and financial strength have led to a further pullback in the debt capital markets. Additionally, regulatory scrutiny is increasing, which is leading to tighter lending standards. Since local and regional banks are a critical source of capital for small and mid-sized businesses as well as for real estate sponsors, the pullback by these lenders will place additional pressure on the economy.

Globalization, already under stress prior to the pandemic, has suffered mid-to-longer-term damage from Covid-19 and the Russian invasion of Ukraine. Meanwhile, the U.S. is seeking to reduce its reliance on China and other countries for critical supplies including semiconductor chips, active pharmaceutical ingredients, generic medicines, and personal protective equipment. This trend will likely be accelerated by geopolitics and national security considerations. In the wake of the terror attacks perpetuated against Israel on October 7, war broke out between Israel and Hamas. If regional proxies of Iran do not fully join the war and the conflict does not expand more broadly, we believe the impact on the U.S. economy will likely be minimal. Attacks by Iran or its proxies on ships on the Red Sea and the Persian Gulf may result in an escalation with worldwide adverse economic implications.

[6] Most economists believe that wage growth of no more than 3.5% annualized is commensurate with moving toward the Fed's 2% target. In November, the figure was 4.0% annualized.

Cost of Capital and its Economic Impact



The elevated cost of capital is impacting all sectors of the economy. Government debt coming due needs to be refinanced at higher rates, which damages net revenues. Likewise, increases in corporate debt service payments put pressure on companies and could force smaller, weaker, companies into default. Commercial real estate could turn out to be both a perpetrator and a victim of potential crisis. As loans struggle to be refinanced in a higher interest rate environment, their default could trigger a banking crisis. CRE is distributed throughout the U.S. and can have a broad impact. In March 2023, several banks were unsettled by substantial unrealized losses on their low yielding portfolio of bonds and CRE that resulted from the negative impact of the sudden rise in interest rates. Should rates remain high for an extended period of time, this type of crisis could become more widespread.

The rates in place from 2008 to 2022 were atypical in the extreme, and the current interest rate regime is more characteristic of most of human history.

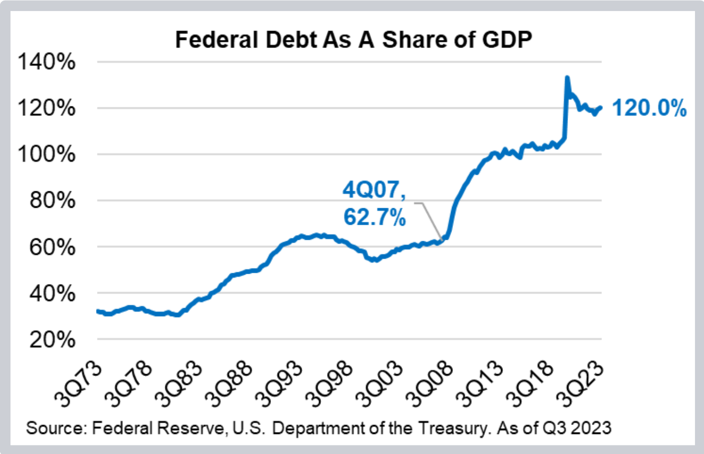
The yield on the 10-year Treasury flirted with 5.0% in October 2023 before retreating to about 4.0% as of mid-December (see chart above). Government debt issuance is likely to stay elevated because of increasing costs, including higher average interest costs on outstanding debt, infrastructure spending, and defense spending. There is also the possibility that some of the Trump administration tax cuts get extended. The situation is particularly concerning because the government's debt is likely going to be repriced at much higher interest rates than what was in place over the last 15 years.

The Federal Reserve will likely need to keep interest rates "higher for longer" (albeit at somewhat lower rates than are in place as of December 2023) for several reasons, most notably that headline inflation continues to trend 3% and core inflation above between 3.5% and 4.0%.

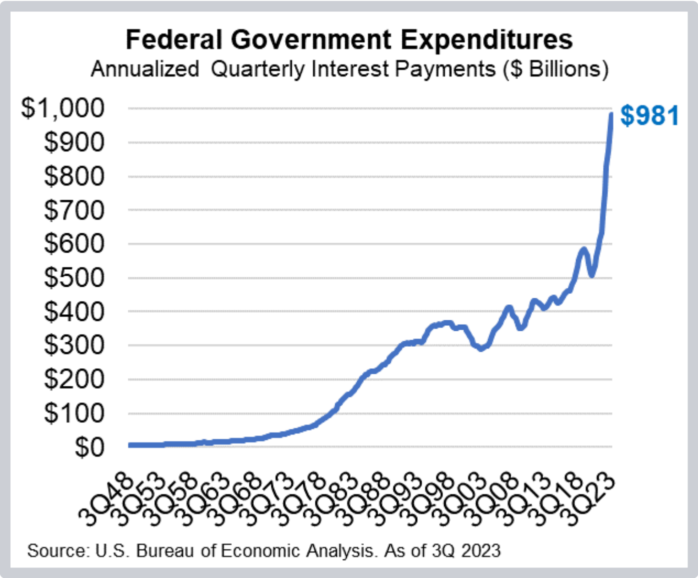
The increased cost of capital has implications for all loans and debt including government, corporate, CRE, and consumer debt.

Government Debt

Higher rates are a major challenge to the U.S. budget, since the last time yields were this high in 4Q2007, the federal government debt level was 63% of Gross Domestic Product (GDP), whereas the share is currently nearly double at 120%.



Since the U.S. government continues to borrow and spend at elevated levels and the federal deficit is growing (currently $1.7 trillion in fiscal year 2023), it is unlikely that interest rates will fall significantly in the near term. Interest costs have soared to nearly $1 trillion and Fed officials are forecasting that they will stay high for some time.

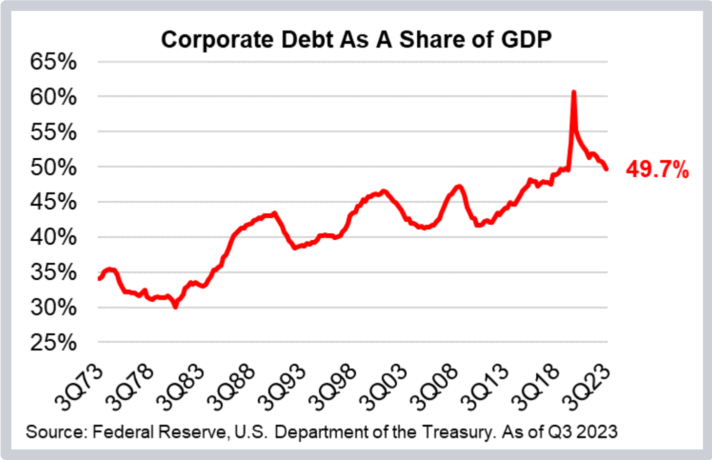


The high level of public indebtedness is not likely to subside, and debt service payments will increase as government debt is refinanced at higher rates.

Corporate Debt

Another potential crisis can stem from companies that borrowed funds at low interest rates and must now refinance at substantially higher rates. At the very least, these increased costs will damage net revenues. However, it may also lead to default and insolvency. Small and mid-sized companies are particularly struggling under the strain of higher interest rates. According to Goldman Sachs, approximately 30% of Russell 2000 companies' debt stock is floating rate in contrast to 6% for the S&P 500.[7]

Other sources of stress include companies that borrowed at very low rates during the pandemic and used funds for private-equity buyouts. Many of these companies have low credit ratings and much of this debt is adjustable rate and face elevated interest payments.



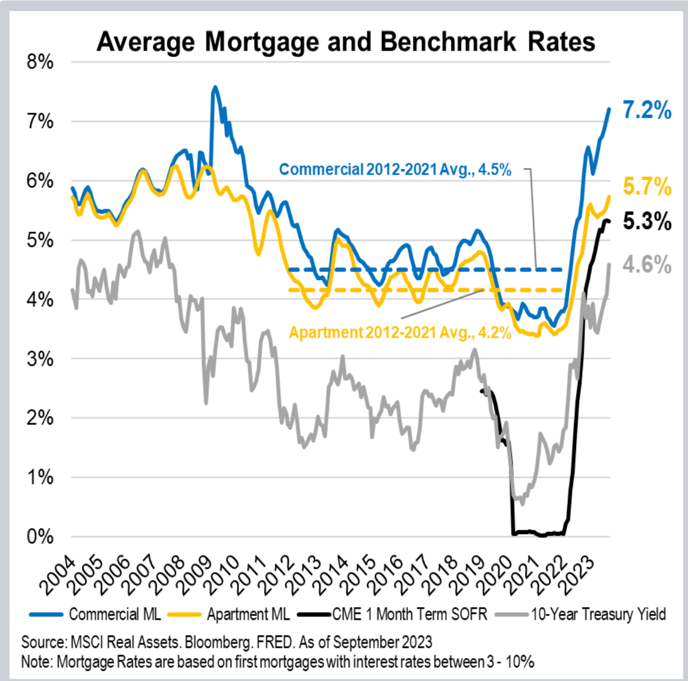
Higher corporate debt borrowing costs damages net revenues and, in some cases, may cause defaults.

Commercial Real Estate Debt

Commercial real estate debt has implications to the broader macroeconomy and is therefore covered here, as opposed to the later section on CRE. CRE loans sourced during the thirteen-year period of near zero interest rates will face refinancing challenges in

[7] Source: Ethan Wu, "US small-cap stocks wilt in the heat of higher interest rates," Financial Times, September 27, 2023. https://www.ft.com/content/9de514d5-678b-4b52-91e1-86fd53794d13

the current higher interest rate environment. The current average mortgage rate on a fixed rate commercial mortgage loan is 7.2%, up from an average of 4.5% from 2012-2021 (see chart directly below). Over the decade prior to 2022, Debt Service Coverage Ratio (DSCR) has not been a leading lending constraint due to low coupons; now it is a major constraint.



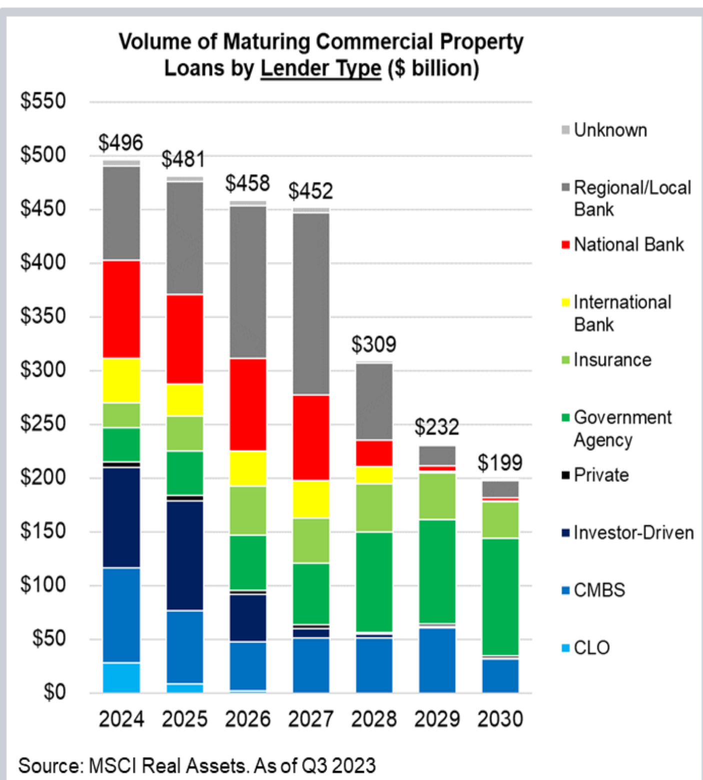
Source: MSCI Real Assets. Bloomberg. FRED. As of September 2023
Note: Mortgage Rates are based on first mortgages with interest rates between 3 - 10%

Borrowers that leaned into floating rate loans are now exposed to rapidly rising rates which could result in default. The short-term floating Secured Overnight Financing Rate ("SOFR"), currently at 5.34%, is about 100 basis points higher than it was at year-end 2022 and about 20 basis points higher than at the end of 2Q2023. This higher short-term rate raises the cost of floating rate capital, a major factor shaping buyer demand in the commercial real estate sector.

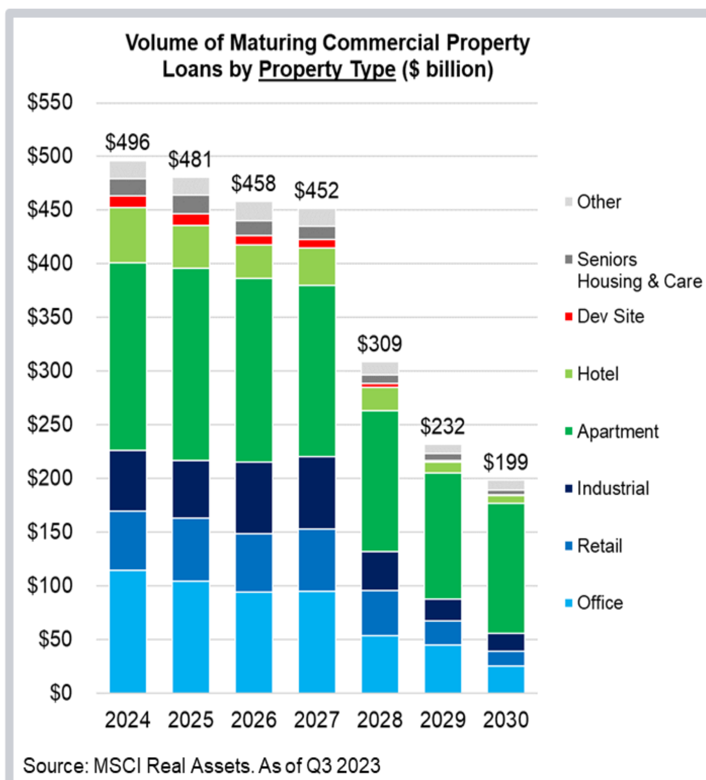
Nearly $1.5 trillion in upcoming debt maturities will come due over the next 3 years (see charts below). The perception that rates will remain at elevated levels has investors focused on a revaluation of all asset classes. Properties purchased and/or financed at very low yields with short-term debt will likely be forced to recapitalize with a significant equity infusion and/or third-party rescue capital.

A CRE debt crisis could be precipitated by elevated defaults caused by either an inability to refinance ("balloon default") or insufficient income to meet debt service ("term default"). These defaults can have a negative impact on the banking system.

Of the major sources of CRE debt financing, including insurance companies, banks, non-banks, and commercial mortgage-backed securities (CMBS), only insurance companies are lending now at substantial levels.



Source: MSCI Real Assets. As of Q3 2023



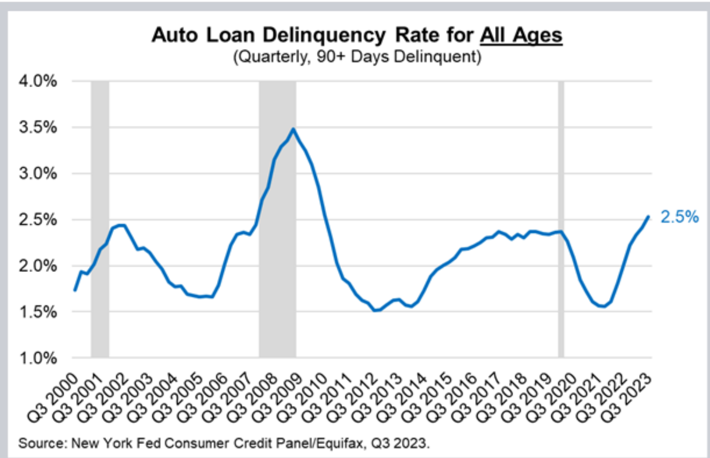
Source: MSCI Real Assets. As of Q3 2023

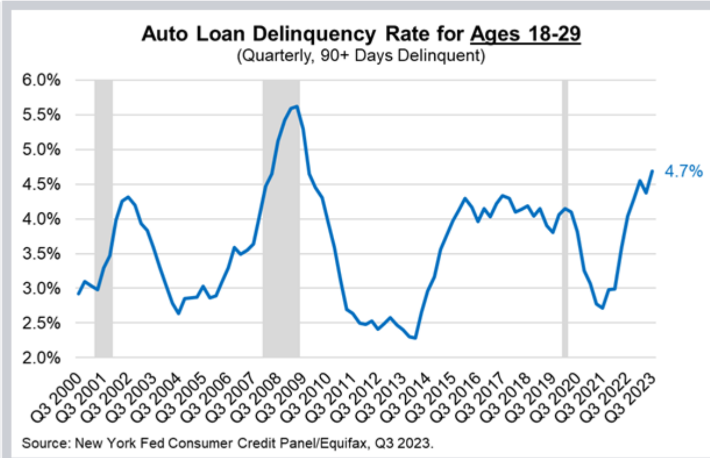
Consumer Debt: Auto Loans, Credit Cards, Residential Mortgages, and Student Loans

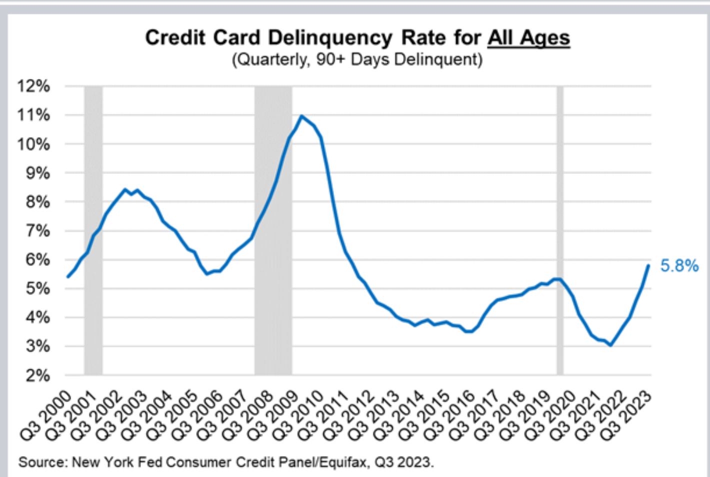
Rising delinquency rates for auto loans and credit card debt are correlated with recessions. The auto loan delinquency rate (90+ days) is at 2.5%, which is higher than its pre-Covid observation. According to Fitch Ratings, the subprime auto delinquency rate (60+ days) of 6.00% as of October 2023 is slightly above the 5.93% high before the pandemic in August 2019, and is trending higher. Subprime includes riskier borrowers and could lead a broader deterioration of consumers.

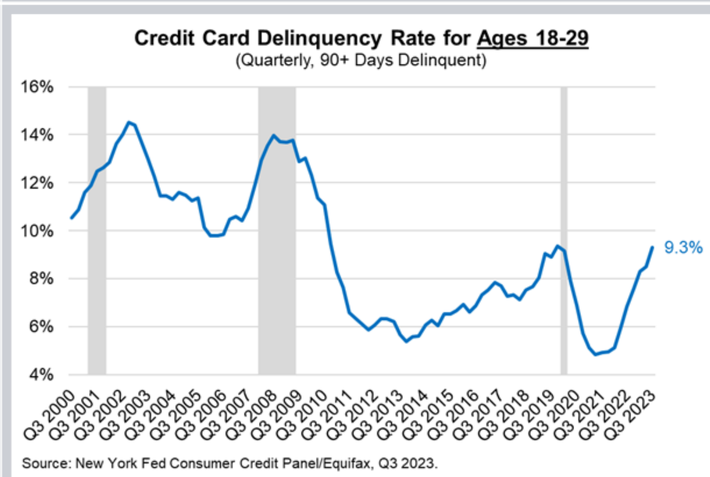
Likewise, credit card debt delinquency (90+ days) across all ages is 5.8%, also higher than its pre-pandemic observation. For those age 18-29, delinquency rates for auto loans are 4.7% and credit cards are 9.3%. We expect both these auto and credit card delinquency rates to rise in 2024.

Mortgages and student loans, two other gauges of delinquency looked at for signs of recession, are happily at very low levels. Mortgage defaults are low because most borrowers are locked in at historically low interest rates, while student loan borrowers were not obligated to pay for 43 months during and after the pandemic, with payments resuming only in October 2023.

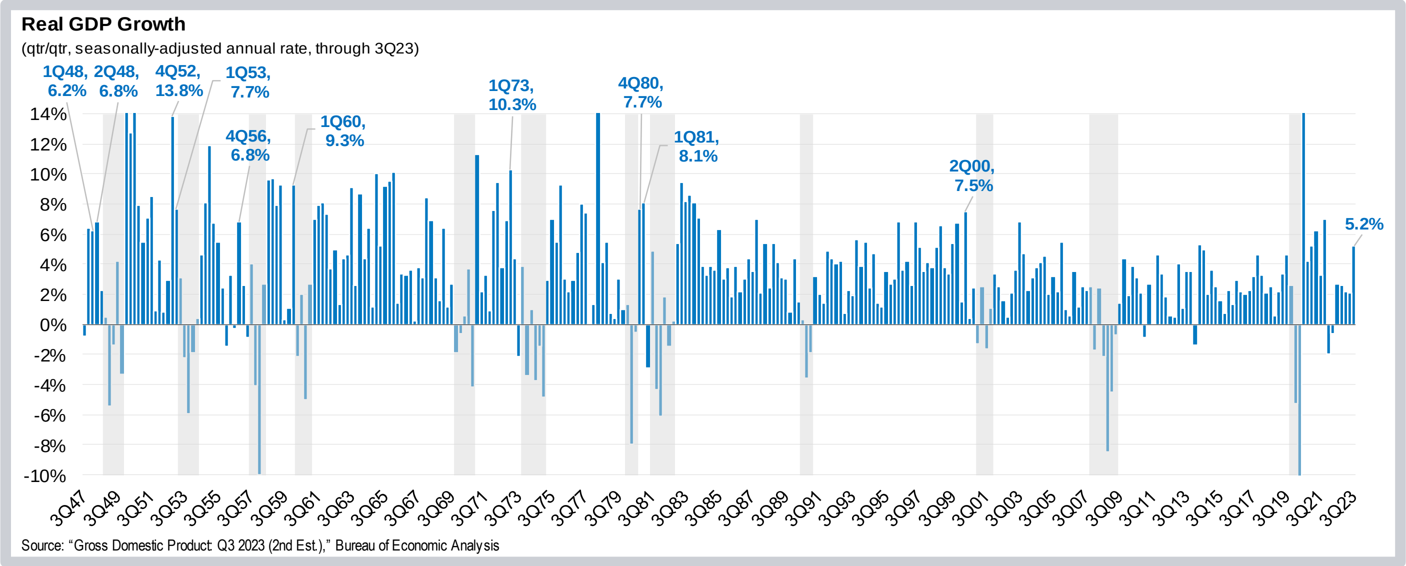








Is the U.S. Economy Going into a Recession?



Many point to the elevated level of GDP and declare that the U.S. economy is far from a recession. However, the GDP rose 5.0% or higher zero-to-three quarters before a recession ten times since 1947. The impact of the interest rate hikes has not fully taken hold and may yet have a substantial negative impact on the U.S. economy. The full force of the Federal reserve's interest rate increases (525 basis points since March 2022) will not have a more substantial impact until 2024, or to invoke Milton Friedman: "Monetary policy operates with long and variable lags."

The average timeline from Fed rate hikes to labor market impact is 18-24 months, and we are at month 20. Interest rate and liquidity sensitive sectors have been negatively impacted first followed by manufacturing[8], then services[9]. The last segments to fall are the consumer and the labor market, which we expect to happen in the first half of 2024.

Another potential negative impact could be the fallout from economic problems outside the U.S. China is currently experiencing a real estate crisis and Europe is suffering from high gas prices and from a contraction in available debt.

Conversely, the resilient U.S. labor market, renewed industrial investment (reshoring, semiconductor, and green transition), infrastructure investment, technological innovation, and higher productivity (potentially possible from artificial intelligence) are positive factors for the U.S. economy.

How can we quantify if we will have a recession in 2024? The National Bureau of Economic Research (NBER) has parameters that are used to indicate if the U.S. has entered a recession. Although there is no fixed rule about what measures contribute information to the process or how they are weighted, the following factors are considered; real personal income less transfers (PILT), nonfarm payroll employment, real personal consumption expenditures, wholesale-retail sales adjusted for price changes, employment as measured by the household survey, and industrial production. The National Bureau of Economic Research (NBER) defines a recession as: "a significant decline in economic activity that is spread across the economy and lasts more than a few months." An exploration of the aforementioned indicators the NBER uses to determine a decline in activity results in a mixed message**:**

1) Labor Market Indicators (3.7% unemployment rate, 1.3:1 Openings Ratio)

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[8] Industrial production is down -0.7% YOY as of October 2023, while ISM Manufacturing Index is 46.7 in November, below 50, in contraction territory.
[9] ISM Services Index is down from 61.7 at the end of 2022 to 52.7 as of November 2023, but still above 50, in expansionary territory.

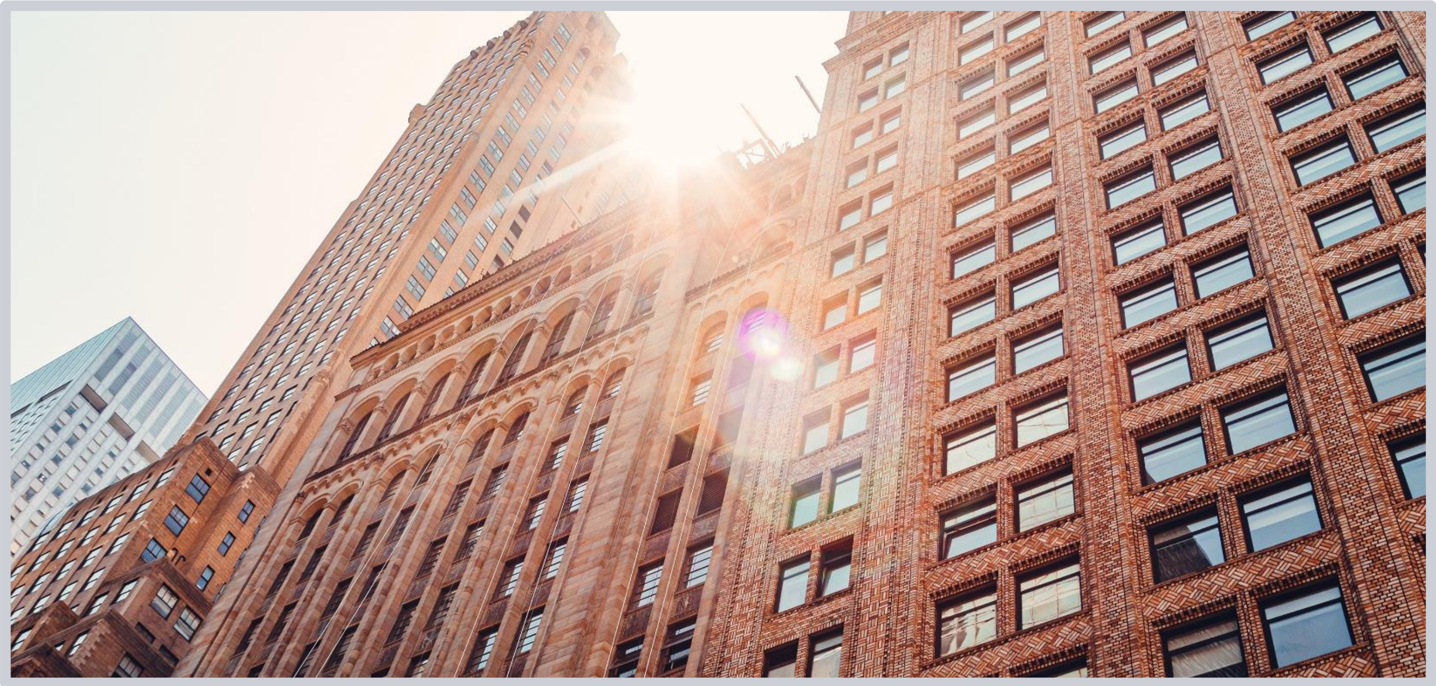
2) Inflation-Adjusted Avg. Hourly Earnings (+0.8% YOY)
3) Inflation-Adjusted Consumer Expenditures (+2.2% YOY)
4) Measures of Industrial Production (-0.7% YOY)
5) Real Wholesalers Sales (-2.8% YOY), Real Retail Sales (-0.8% YOY)

Overall, the U.S. economy faces challenges in the near term, including inflation, high interest rates, the potential for further challenges in the banking sector, and geopolitical uncertainty. Our outlook remains that there is a strong possibility that the U.S. economy will enter a recession in 2024; however, the likelihood of a milder outcome may have increased with the recent fairly positive economic data.

Macroeconomic Risks for 2024

Looking forward to 2024, we believe that primary risks to the U.S. economic outlook include:

- Inflation proves more stubborn and longer-lived than anticipated and continues deep into 2024. The possibility for oil prices to soar and, with it, inflation.
- U.S. enters recession in 2024 with an adverse impact on jobs and spending.
- Geopolitical Event (examples – but certainly not limited to)
    - China getting involved in hostilities with Taiwan, short of invasion.
    - NATO getting drawn in more directly with Russia/Ukraine.
    - An expansion of the Middle East conflict involving more proxies of Iran escalating hostilities against the United States, Israel, and Saudi Arabia. Iranian proxy attacks against ships in the Red Sea and other global trade routes leads to substantially widened conflict.
- Federal Reserve Mistake: Federal Reserve efforts to control inflation adversely impact the U.S. economy or rates reduced too early resulting in bounce back of elevated inflation.
- Debt Crisis in one or more of the segments of the economy put under pressure by higher rates.
- Deglobalization leads to diminished trade as a result of US/China Tensions.
- Gateway cities do not fully recover to their pre-Covid-19 economic health and are adversely impacted by crime.



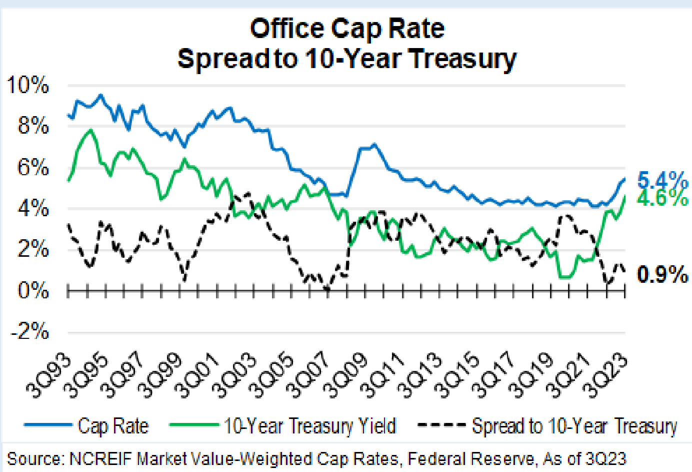
Commercial Real Estate

Capital Markets

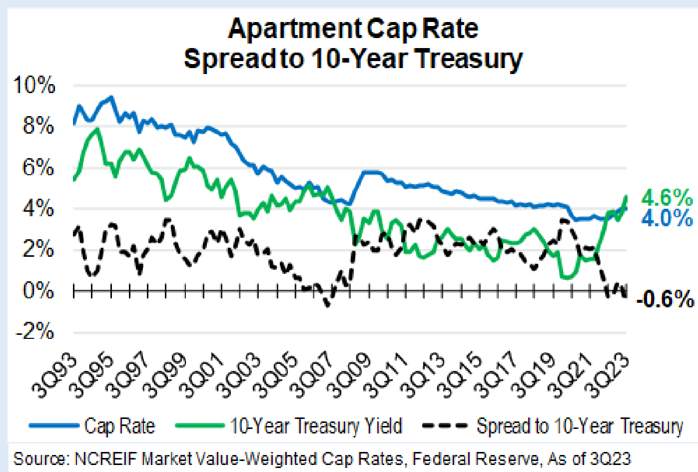
The Federal Reserve's Federal Funds Rate increases have impacted lending costs, loan refinanceability, cap rates, values and monthly payments. These higher borrowing costs have hammered rate-sensitive industries, including real estate, and there is likely more pain to come. At this point, we are projecting that rates remain steady in the first half of 2024 and then decline beginning in the second half of 2024.

In our view, the biggest issue confronting U.S. commercial real estate is the cost of capital. Higher borrowing costs impacts value in the form of higher caps rates, which are necessary to provide a premium over the elevated safe rate represented by Treasury yields. Higher cap rates result in lower values. Since industrial and apartment properties traded at lower cap rates pre-Fed rate rise, cap rate inflation will likely hit these property types in a bigger way than office, retail, and lodging. In the industrial and apartment sectors, average cap rates based on NCREIF data are currently below the 10-year Treasury yield, resulting in a negative spread, which may imply values have further to fall if Treasurys remain elevated (see chart below).[10]

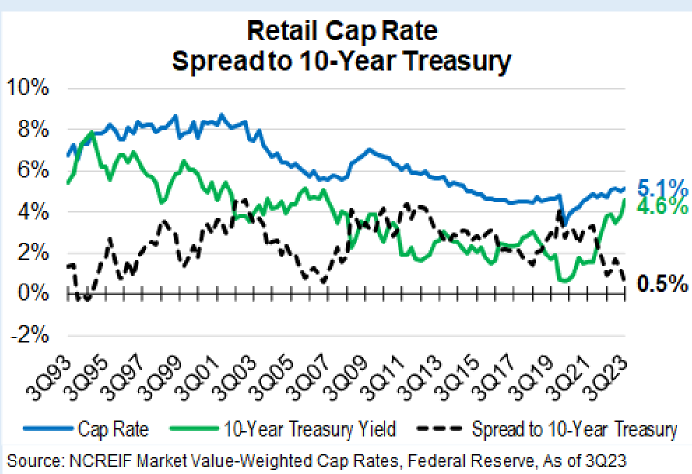
The perception that rates will remain at elevated levels has investors focused on a revaluation of all asset classes. Investors are finalizing 2024 business plans, positioning themselves for potential opportunities. Negative leverage is an issue as interest rates are high and sellers are not willing to sell for cap rates that reflect a premium over the safe rate.



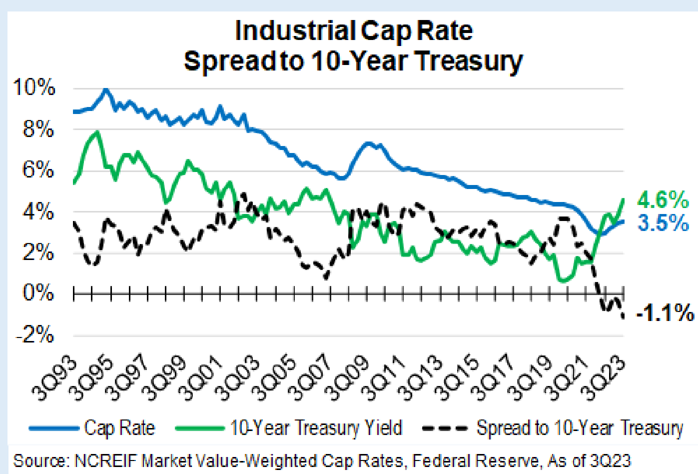
Source: NCREIF Market Value-Weighted Cap Rates, Federal Reserve, As of 3Q23



Source: NCREIF Market Value-Weighted Cap Rates, Federal Reserve, As of 3Q23



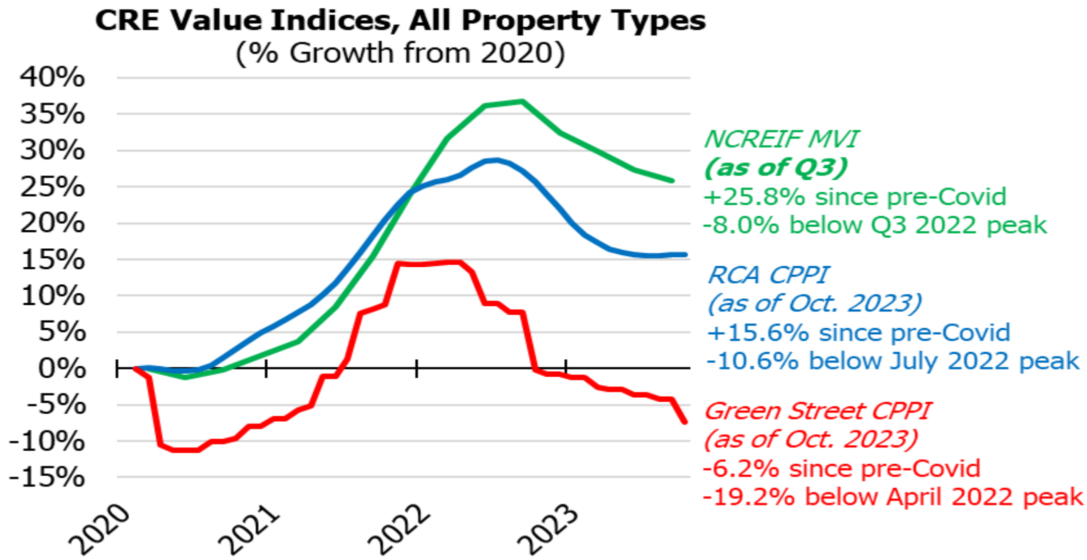
Source: NCREIF Market Value-Weighted Cap Rates, Federal Reserve, As of 3Q23



Source: NCREIF Market Value-Weighted Cap Rates, Federal Reserve, As of 3Q23

[10] Properties with embedded rent increases temper decline in some markets.

When trying to estimate how much values have changed, we track three major value indexes: NCREIF Market Value Index (MVI)[11], MSCI RCA CPPI[12], and Green Street CPPI[13]. NCREIF MVI focuses on valuations, MSCI RCA CPPI on repeat sales, and Green Street CPPI spotlights public markets. Therefore, the three indexes reveal different estimates of value change (see chart below).



Source: NCREIF Market Value Indices (MVI) quarterly data as of 3Q2023;
MSCI Real Capital Analytics Commercial Property Price Index (CPPI) monthly data as of October 2023.
Green Street Commercial Property Price Index (CPPI) monthly data as of October 2023

Although most sectors are down over the past year, office properties have suffered the greatest loss of value according to Green Street (see table below).

Change in Green Street CPPI Through October 2023

Property Type	3 Month	6 Month	1 Year (Oct '22 - Oct '23)	Previous 1 Year (Oct '21 - Oct '22)	2 Year (Cumulative)	Pre-Covid (Feb '20 - Oct '23)	10 Year (Cumulative)
All Property	-3.9%	-4.6%	**-7.2%**	-8.2%	-14.8%	-7.4%	21.1%
Apartment	-9.7%	-9.7%	**-13.7%**	-13.9%	-25.7%	-12.0%	27.9%
Industrial	-8.1%	-3.5%	**0.9%**	-9.6%	-8.7%	29.7%	127.7%
Office	0.0%	-8.5%	**-20.6%**	-11.9%	-30.0%	-33.3%	-10.0%
Mall	1.3%	2.6%	**7.8%**	-9.8%	-2.8%	-20.1%	-28.3%
Strip Center	-2.0%	-1.3%	**-2.3%**	-4.4%	-6.6%	-0.2%	10.5%
Health Care	-7.2%	-7.3%	**-8.6%**	-10.3%	-18.0%	-13.8%	12.4%
Life Science	-6.8%	-10.5%	**-12.3%**	4.3%	-8.5%	5.9%	85.8%
Lodging	-2.0%	-1.3%	**0.9%**	2.1%	3.1%	-1.2%	15.9%
Manufactured Homes	0.9%	0.9%	**-3.4%**	-6.6%	-9.8%	20.2%	161.3%
Self-Storage	-3.5%	-4.5%	**-8.8%**	13.5%	3.5%	44.2%	126.1%

Source: Green Street

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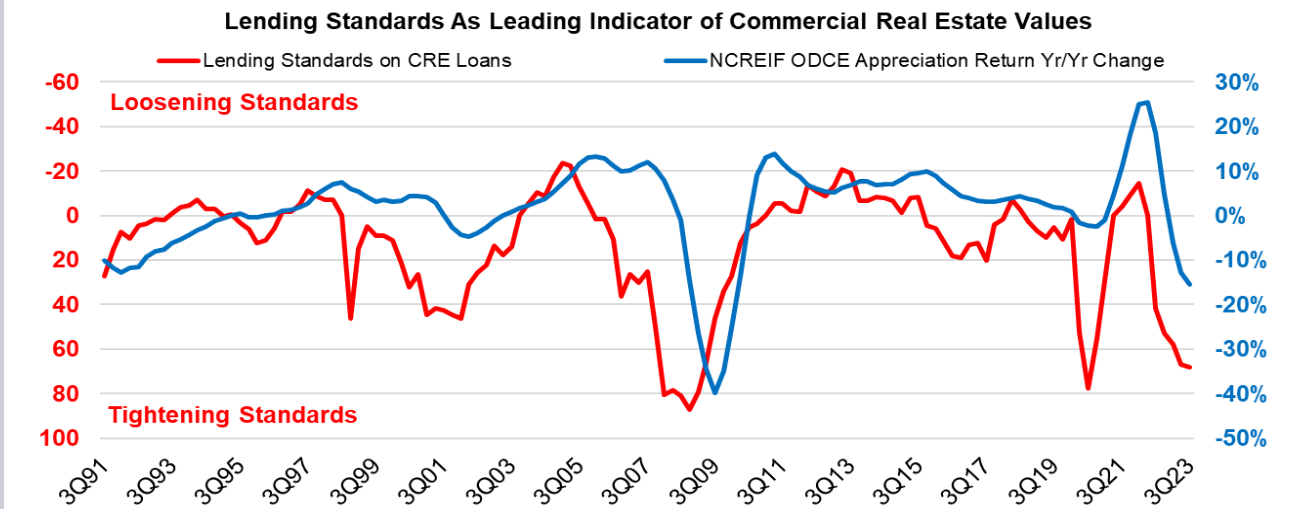
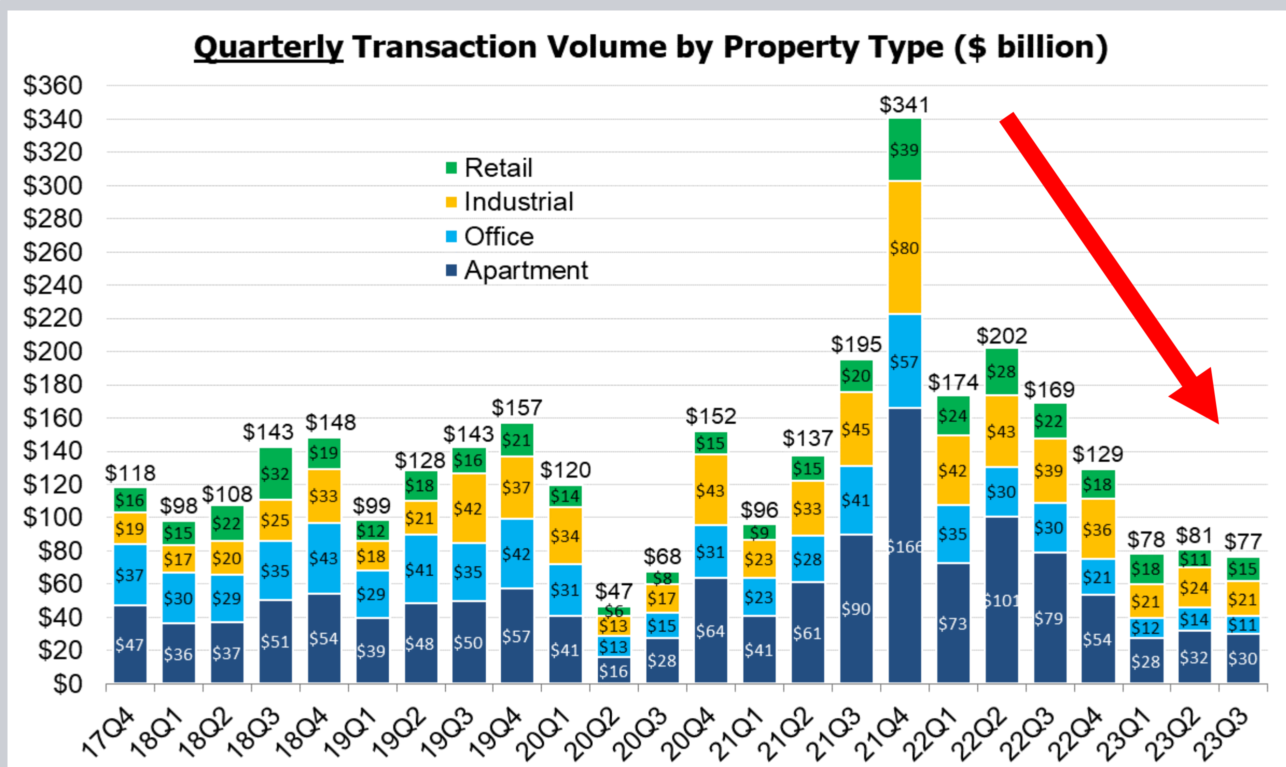
[11] NCRIEF Market Value Index/Indices are a NCREIF quarterly measure of property value change based on same-property appraisals (excluding properties with CapEx)
[12] MSCI RCA CPPI is a value index based on same-property transactions compiled by MSCI Real Assets.
[13] Green Street CPPI: Green Street's Commercial Property Price Index is a time series of unleveraged U.S. commercial property values that captures the prices at which commercial real estate transactions are currently being negotiated and contracted. Features that differentiate this index are its timeliness, its emphasis on high-quality properties, and its ability to capture changes in the aggregate value of the commercial property sector. It is not possible to invest in an index.

When the Federal Reserve's survey of senior loan officers at banks (SLOOS) indicates a tightening of loan requirements, it is often not only correlated with a recession – but also with a decline in commercial real estate values (see chart below).



Source: NCREIF ODCE Annual Appreciation Return; Federal Reserve Senior Loan Office Survey. As of Q3 2023.
NFI-ODCE is a capitalization-weighted, gross of fee, time-weighted return index with an inception date of December 31, 1977. Open-end funds are generally defined as infinite-life vehicles consisting of multiple investors who have the ability to enter or exit the fund on a periodic basis, subject to contribution and/or redemption requests, thereby providing a degree of potential investment liquidity. The term Diversified Core Equity style typically reflects lower risk investment strategies utilizing low leverage and generally represented by equity ownership positions in stable U.S. operating properties diversified across regions and property types. The NFI-ODCE, like the NCREIF Property Index (NPI) and other stock and bond indices, is a capitalization-weighted index based on each fund's net invested capital, which is defined as beginning market value net assets (BMV), adjusted for weighted cash flows (WCF) during the period. Past performance is not a guarantee of future results.

Given the continued turbulence in the capital markets, transaction volume across the major property types continued to fall in the third quarter, from $81 billion to $77 billion (a 5% decrease). This is the lowest quarterly figure since 3Q2020. Transaction volumes for apartment, industrial and office properties declined from the previous quarter by 5.7%, 12.0%, and 24.6%, respectively, while transaction volume of retail properties grew 36.6% from the previous quarter, partially recovering from a large decline in the first quarter (see chart below).



This slowdown in activity continues to contribute to reduced clarity on pricing, particularly in the office sector. Financing challenges weighed heavily on transaction volume during the quarter, which registered at levels well below the previous year high-water marks and below generally normalized levels. The comparative absence of activity has contributed to both a faded clarity on pricing and broadening opinions on the direction associated trendlines are headed.

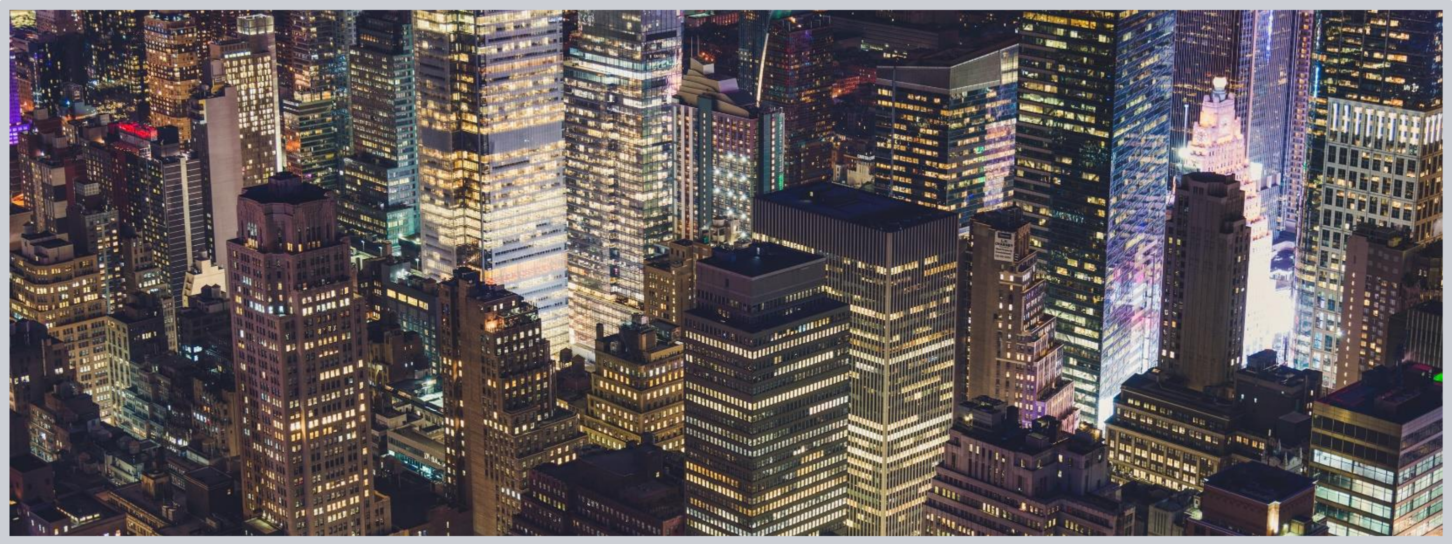
The large bid/ask spread between buyers and sellers will likely take time to recalibrate. Fewer commercial properties being marketed for sale are attracting a declining number of bidders, and the remaining bidders are disproportionately private, non-institutional investors. Transaction markets are suffering as a result of a broadening disparity of opinion on the extent to which distress may infect future pricing. Many investors have chosen to postpone new investments until more stabilized economic conditions return, supported by fully functioning credit markets.

Also influencing the transaction market is more restrictive finance environment. With elevated short- and long-term interest rates, and with banks largely on the sidelines, borrowing costs remain high. Bank lending volumes continue to remain subdued, and will likely remain so over the near term as the banking sector handles increased regulatory scrutiny and likely higher capital requirements. Life companies remain active for preferred asset classes.

Rising interest rates, a potential recession and limited credit availability remain primary obstacles obstructing deal flow. Moreover, an increasing resignation that pricing has more room to decline across all sectors has left many investors on the sidelines. This is particularly true with respect to institutional investors who have been noticeably absent in both concluded transactions and associated bids.

As values recalibrate and lenders' and owners' needs for liquidity mount, generationally attractive investment opportunities are beginning to manifest. We believe this dynamic should accelerate in 2024. Investors who can play across the capital stack and up and down the risk spectrum can capitalize on the market disruption.

Delinquency rates for mortgages backed by commercial and apartment properties increased for the fourth consecutive quarter in 3Q2023, representative of the challenges faced by CRE so far this year. CMBS loan balances which were 30 days or more delinquent rose from 3.04% at the end of 2022 to 4.63% as of October 2023, with office properties driving this increase, up from 1.58% in December 2022 to 5.75% as of October 2023, according to Trepp data. Among capital sources, delinquency rates have been the highest in CMBS, however, delinquent loans held by banks & thrifts, life insurance companies, and GSEs are beginning to increase, according to Mortgage Bankers Association. We expect to see loan stress manifest as even higher delinquency rates in 2024.



OERS Changing – What Happened in 2023 – What We Expect in 2024

Another issue challenging CRE is substantially higher operating expense ratios (OERs)[14]. This has manifested differently for various property types. The higher the operating expense ratio, the more sensitive the property's NOI is to declines in Effective Gross Income (EGI). Accordingly, hotels, and to a lesser extent offices, are the most sensitive. Property types with low OERs such as logistics and self-storage facilities are the least sensitive. In the middle are apartment and retail properties.

Expenses generally rose at a faster rate over the past several years than in previous years and except for the industrial sector, have exceeded rent increases. As a corollary, OERs are up for all major property types except industrial. For a time, rent increases on apartments exceeded operating expense increases – but that is no longer true. Above-trend increases are expected over the next year as well, and will likely outpace revenue growth.

Although a relatively small portion of overall expenses, insurance has grown faster than all other expenses. Other major expense growth contributors include utilities maintenance and administrative costs. Real Estate taxes – almost always the largest expense category has increased the most in the industrial sector.

The following table details cumulative growth of property-level income and expenses per square foot over the past one and four years. ***The industrial sector was the only to experience income growth in excess of expense growth over both time periods.***

Income & Expense Growth				
	% YOY		2Q19 - 2Q23 (Prior 4 Years)	
Property Type	Income	Expenses	Income	Expenses
Apartment	4.0%	6.0%	16%	22%
Industrial	10.0%	8.2%	28%	26%
Office	3.7%	7.8%	12%	16%
Retail	6.6%	13.3%	8%	14%

Source: NCREIF Property Index, Data access via Query Tool on September 14, 2023.

The following chart compares the change in average OERs by property type. ***Decrease in industrial sector OER is indicative of expense growth in excess of income growth over the past four years.***

Operating Expense Ratios			
Property Type	Q2 2019	Q2 2023	Change
Apartment	42.5%	44.1%	↑
Industrial	26.4%	25.3%	↓
Office	41.8%	42.4%	↑
Retail	32.2%	33.9%	↑

Source: NCREIF Property Index, Data access via Query Tool on September 14, 2023. Based on trailing 4-quarter average.

The following table compares expense growth over various time periods. ***Industrial and apartment sector expenses grew the most relative to their historical averages.***

Operating Expense Growth (Growth by SF)				
	Apartment	Industrial	Office	Retail
Cumulative **Past 4 Years** (2Q19-2Q23)	22.3%	25.8%	16.2%	14.1%
CAGR **Past 4 Years** (2Q19-2Q23)	5.2%	5.9%	3.8%	3.4%
CAGR **18 Years Before Covid** (2Q01-2Q19)	4.3%	0.9%	3.4%	2.9%

Source: NCREIF Property Index, Data access via Query Tool on September 14, 2023. 2023 with data through Q2 2023

It is important to note that, ultimately, expense reimbursement does not compensate for increased expenses, since gross rent must adjust to keep it at market levels. We expect OERs to remain elevated into 2024 and for expense growth to continue to exceed income growth for apartment, office, and retail.

Regulations

The evolving regulatory environment continues to impact real estate investors. For example, some notable U.S. markets, such as Los Angeles and San Francisco, have recently adopted higher transfer tax rates on the sale of commercial and apartment properties above a certain value threshold. Chicago and Boston have proposed substantial increases to their transfer tax rates as well. These transfer taxes

[14] See: Stewart Rubin and Dakota Firenze "Operating Expenses Rising," November 2023.

have an immediate negative impact on property investments in these markets due to lower after-tax returns to investors. Other regulatory developments include growing calls for restrictions on warehouse development in several parts of the country, including southern California, Maryland, New Jersey. Town officials in Fishkill, NY enacted a 12-month moratorium on self-storage development and in Niagara Falls, NY a zoning change aimed at curbing self-storage construction was authorized. Carbon taxes targeting commercial buildings in several large cities, including New York, Washington D.C., and Boston, are in varied stages of being phased in and will negatively impact the values of older buildings.

Also, the growing number of rent control laws will limit revenue increases for certain apartment properties in markets in certain parts of the U.S. For example, California put repeal of the Costa-Hawkins Rental Housing Act[15] on the ballot for 2024. This would enable local municipalities to impose new rent control on apartments, condos, and single-family units. There were previous attempts at repeal in 2018 and 2020 – but they were voted down. California recently enacted AB 1482[16], which is a less onerous form of statewide rent control. In Montgomery County, MD, Bill 15-23 passed and included rent caps at inflation plus 3%, up to a maximum of 6%, for rental units constructed before the year 2000[17]. These regulatory changes may have an impact on investment performance and liquidity in these markets.

In addition, as state and local governments – particularly those with substantial legacy pension obligations – require more revenues, increases in real estate, transfer, income, and sales taxes become more probable.

Demographic/Migration

The U.S. is younger demographically than other advanced economies, despite the anemic growth of its working age population. Accordingly, it is important to highlight where growth is taking place within the U.S. We expect migration from expensive coastal and Midwestern metros to Sunbelt states such as Arizona, Texas, Georgia, North Carolina, South Carolina, Florida, and Tennessee to continue, albeit at a slower pace compared to previous years. The migration of people of various ages and education levels both precipitates, and is in response to, the relocation of businesses. Tech jobs have migrated from the San Francisco Bay Area to Austin and other locations. Atlanta now has an Information LQ of 1.96, on par with some of the nation’s traditional tech centers.

A shift in finance jobs has become evident as more corporate headquarters as well jobs shift to Florida, Texas, Tennessee, and Arizona. Citadel moving their headquarters from Chicago to Miami and Charles Schwab relocating their head office from San Francisco to Dallas are two examples[18]. With migration of jobs and people comes a shift of income and tax revenue. We expect the net migration to the Sunbelt and the Intermountain West to continue, albeit at a slower rate relative to the past few years. Although suffering losses, coastal markets including the Bay Area are very relevant.

Cities

Cities, particularly urban cores, have suffered from an increase in violent crime, homelessness, inadequate facilities for migrants, less pedestrian traffic, vacant office space, and less economic activity stemming from relatively fewer workers in central business districts (CBDs). According to a new Bank of America analysis, many cities in the northern and western parts of the U.S. haven’t seen consumer spending return to pre-pandemic levels.[19]

The extent that cities do not recover to their pre-Covid stature and are adversely impacted by crime, high taxes, homelessness, diminished retail, and the lack of office workers, will have a negative impact on associated CRE.

[15] Costa-Hawkins limits local municipalities’ ability to enact rent control on residential properties. Under the ’95 law, cities are prohibited from enacting rent control on apartment units built after Feb. 1st, ’95 and all single-family homes and condos regardless of construction date. Vacancy control is also illegal. However, California cities can impose rent control on *renewal* offers for pre-’95 buildings.

[16] AB 1482 (“the California Tenant Protection Act of 2019”)

[17] New construction is exempt for 23 years. Assisted living facilities, nursing homes, and landlords with fewer than three units in the county are exempt from the controls.

[18] Other examples include Paul Singer’s Elliott Management shifting its headquarters to West Palm Beach and Blackstone Inc., Thoma Bravo, Founders Fund, Point72 and Goldman Sachs Group Inc. among others setting up offices in southeast Florida. Alliance Bernstein moved their headquarters from New York to Nashville.

[19] Source: Taylor Bowley and David Tinsley, “Central business districts: City strugglers,” Bank of America Institute, September 2023. Relative to four years prior, Seattle, Boston, San Francisco, and New York saw some significant losses of consumer spending. Seattle was down close to -30%, while San Francisco was down close to -35%, New York was shy of -20%, and Boston is just over -20%. That highlights how bad the situation can be. And yet there were metros that saw significant improvements. Tampa was up by nearly 40% and Phoenix over 40%. Columbus, Ohio, up nearly 20%, as was Nashville. And Houston, maybe 12% up.

Apartment Sector

In the apartment sector, the first half of 2023 saw asking rents rise in most markets across the nation, demonstrating a bounce back from the rent declines experienced in the latter half of 2022. In 3Q2023, however, apartment rents declined in 59 of the largest 80 markets. The phenomenal rent growth experienced in the wake of Covid-19 led to record apartment construction pipelines which put pressure on occupancy and rent growth that is likely to continue in 2024.

The most robust construction pipelines are in the Southeast and Intermountain West, where apartment units totaling at least 10% of existing inventory are under construction in the ten markets with the most building, double the national average, according to CoStar data. Markets with the highest level of new supply include Fort Myers (28% of existing inventory under construction), Miami (17%), Charlotte (15%), and Austin (15%). Each of these markets saw asking rents decline in 3Q2023, and could see further declines in coming quarters.

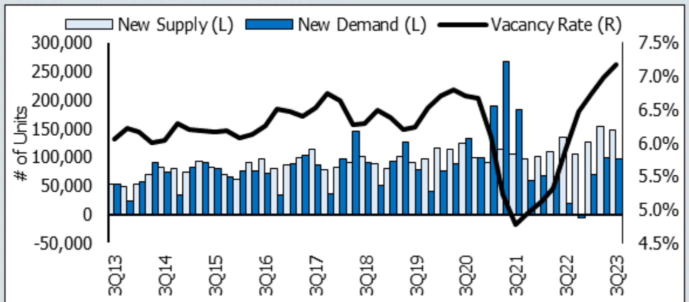
New apartment construction starts in 3Q2023 were down 26% from the previous year, the largest decline in construction since 2010, pointing to more attractive rent growth prospects over the 3-5-year period.

In the decade prior to 2021, the share of new construction considered Class A space exceeded that of Class B, sometimes by a wide margin.[20] In 2021, new construction of Class B units overtook Class A, and now stand 56% vs. 42%, respectively, as a share of total units under construction, according to CoStar. Although this increase in new supply may put additional pressure on Class B rents, non-luxury apartment units have been underbuilt nationwide for several decades. Net absorption of Class B units has continued to improve throughout 2023, recovering from nearly zero at the end of 2022, while absorption of Class A units has cooled since the second quarter of 2023. We expect these trends to continue, and Class B rent growth to outperform Class A in 2024.

Apartment Properties: Performance in the Benchmark

	Quarter	1-Year Period Ending				
	3Q23	3Q23	3Q22	3Q21	3Q20	3Q19
Income Return	0.99%	3.88%	3.77%	3.68%	4.10%	4.28%
Appreciation Return	-2.40%	-11.10%	14.02%	9.43%	-1.74%	1.08%
Total Return	-1.41%	-7.55%	18.17%	13.37%	2.31%	5.39%
Garden	-1.45%	-6.51%	24.24%	21.19%	4.66%	8.05%
High and Low-Rise	-1.39%	-8.06%	15.55%	10.31%	1.40%	4.38%
Rent Growth		0.84%	5.52%	9.73%	0.69%	2.66%
NOI Growth		3.46%	17.49%	10.76%	-10.35%	5.94%
Benchmark comparison:						
Total Return, All Properties	-1.37%	-8.39%	16.08%	12.15%	2.00%	6.24%

Source: NCREIF 3Q23; CoStar Group 3Q23



Source: CoStar 3Q23

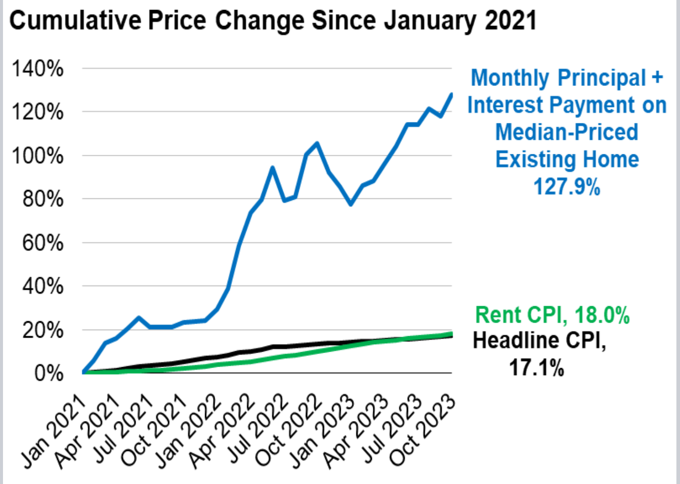
Suburban apartment rent growth is poised to outperform CBD apartment rent growth in the near term. Although suburban locations may have relatively longer commutes to CBD offices, expanded hybrid work has diminished that consideration.

Population growth of the 25–34-year-old age cohort, which is traditionally a cohort with a higher renter population, is expected to slow over the next few years, which could impact rent growth prospects.

However, the heightened cost of homeownership may provide a ballast against further softening for the sector. Residential mortgage rates reached nearly triple the pre-pandemic level, and values have not meaningfully corrected in many markets, leaving the principal and interest mortgage payment on a median-priced existing home up more than 127% relative to

[20] Class A buildings include buildings rated 4 or 5 Stars by CoStar and represent the highest end of multi-family buildings defined by finishes, amenities, the overall interior/exterior design and the highest level of specifications for its style (garden, low-rise, mid-rise, or high-rise). Class B buildings include buildings rated 3 Star by CoStar and have more modest Architectural Design which includes an exterior with materials/façade of brick, stucco, EIFS, precast concrete, or possibly higher rated materials with signs of age and wear.

the beginning of 2021 (see chart below). Homeownership has become more challenging, which is supporting apartment demand.



Source: U.S. Bureau of Labor Statistics, National Association of Realtors, Freddie Mac. As of October 2023.

In response to significant rent increases across the U.S., there has been sustained calls for regulatory changes such as rent control. At the federal level, there are early indications of a willingness to craft policies that may eventually limit rent increases. At the local level, there are jurisdictions that have enacted and expanded rent rules, including Los Angeles, which in January 2023, voted to make permanent certain tenant protection laws that arose during the pandemic. The growing number of rent control laws will cap allowable rent increases for some apartment properties in certain U.S. markets. In addition, certain jurisdictions have enacted or seek to enact certain non-eviction laws for non-payment of rent. We believe these regulatory changes may negatively affect investment performance and liquidity in these markets.

Operating expenses across property types have generally grown at a faster pace since Covid, relative to previous years, with the greatest increases experienced in the industrial and apartment sectors. Over the past two years, operating expenses at apartment properties increased an average (CAGR) 5.7% annually, relative to 4.3% annually over the 18-year period prior to Covid. It is likely that expenses will continue to rise faster than trend over the next two years, which could result in even higher OERs, and put pressure on NOI growth. According to projections from Green Street, same-unit property expenses for apartment REITs are expected to grow 6.2% in full-year 2023 and are expected to grow between 4.0% and 4.9% annually in 2024 and 2025.

Like other asset classes, the apartment sector is not immune to the effects of the greater cost of capital and cap rate inflation. According to NCREIF data, investments in the apartment sector produced an unlevered property-level total return of -1.41% in 3Q2023, consisting of +0.99% income and -2.40% net appreciation, a larger decline than the -2.02% net appreciation return in 2Q2023. Over the previous four quarters, apartment properties produced a total return of -7.55%, the largest four-quarter decline since 1Q2010.

Our outlook for the apartment sector is impacted by the sizable wave of apartment loans facing maturity over the coming three years. In addition, there are now more limited and expensive options available to borrowers. Downward pressure on pricing next year could be further impacted by pressures placed on NOI growth from heightened new supply causing rents to decline in some markets. Although this points to significant headwinds in the near-term, new apartment construction starts in 3Q2023 were down 60% from the previous year and at their lowest level since 2012.

Industrial Sector

Although industrial investments have significantly outperformed the other major property types since Covid began, no asset class is immune from the rising cost of capital. Industrial investments produced a total return of -0.26% in 3Q2023, consisting of +0.88% income and -1.14% net appreciation, the fourth consecutive quarter of negative net appreciation. Over the past four quarters, net appreciation return of -8.46% is the largest industrial sector decline since 2Q2010.

Industrial sector property fundamentals continue to perform well, but leasing demand and rent growth is moderating. The average vacancy rate rose from 4.6% in 2Q2023 to 5.1% in 3Q2023, not far from the 5.2% vacancy rate in 1Q2020 before Covid-era demand pushed vacancy rates to their all-time low. Asking rent growth on a year-over-year basis slowed from 11.2% in 3Q2022 to 7.7% in 3Q2023, further demonstrating softening in the sector. In 2024, we expect vacancy rates to continue to rise and nominal asking rent growth to moderate further.

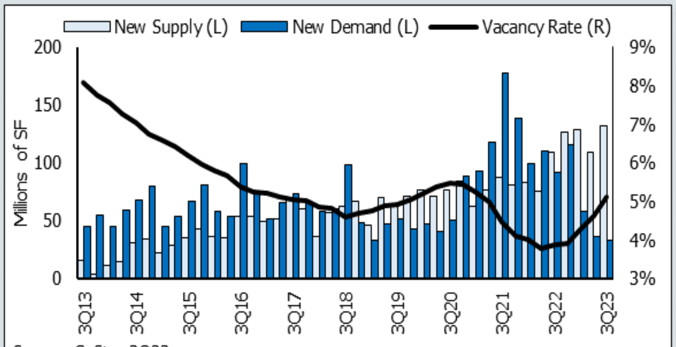
This relative slowdown is to be expected following the torrid, historic levels of demand experienced in 2021 and 2022, which saw net absorption of 299% and 233% of the 2019 level, respectively. A robust industrial construction pipeline of 535 million square feet nationally may leave certain markets at risk of oversupply, particularly if deteriorating economic conditions lead to lower consumer spending and industrial tenant demand. 3Q2023 was the fifth consecutive quarter to deliver more than 100 million square feet. However, over the past three quarters, quarterly net absorption averaged 43 million square feet, meaning nationwide demand has yet to meet new supply so far in 2023. As new space is delivered, the active construction pipeline is expected to drop significantly, as developers have been slow to seek permits for new building. Although the level of new supply hitting certain industrial markets remains a concern in the near-term, there are several demand drivers, including e-commerce and nearshoring, we believe that should support industrial occupancy over the longer term.

E-commerce sales, as a share of total retail sales, increased from 15.1% in 1Q2023 to 15.6% in 3Q2023, indicating that even after some Covid-era gains were given back, e-commerce continues to grow.

Industrial Properties: Performance in the Benchmark

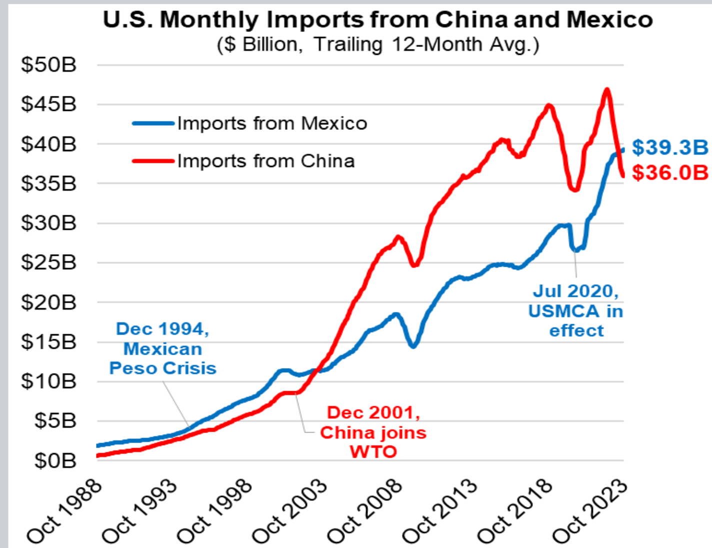
	Quarter	1-Year Period Ending				
	3Q23	3Q23	3Q22	3Q21	3Q20	3Q19
Income Return	0.88%	3.37%	3.34%	4.30%	4.54%	4.73%
Appreciation Return	-1.14%	-8.46%	30.56%	27.22%	5.42%	8.61%
Total Return	-0.26%	-5.30%	34.62%	32.38%	10.14%	13.64%
Rent Growth		7.72%	11.22%	8.42%	5.55%	5.76%
NOI Growth		9.76%	13.61%	10.20%	6.55%	7.49%
Benchmark comparison:						
Total Return, All Properties	-1.37%	-8.39%	16.08%	12.15%	2.00%	6.24%

Source: NCREIF 3Q23; CoStar Group 3Q23



Source: CoStar 3Q23

Moreover, average monthly imports from Mexico surpassed those from China (on a customs value basis) for the first time since China joined the WTO nearly 22 years ago (see chart below). This trend toward nearshoring some share of manufacturing and trade to Mexico could benefit demand for logistics properties in border states like Texas, Arizona, and California.



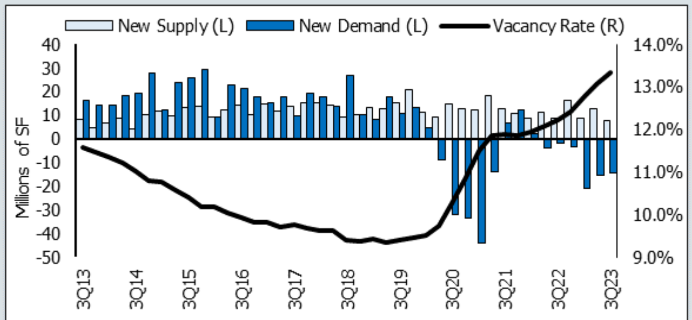
Source: "U.S. International Trade in Goods and Services," U.S. Census Bureau; U.S. Bureau of Economic Analysis. As of Oct 2023

Additionally, construction spending on advanced manufacturing facilities has increased significantly in the last two years. In September 2023, $200 billion on annualized basis was spent on new manufacturing facilities, more than double the level spent the same time in 2021. The *Infrastructure Investment and Jobs Act* signed into law in 2021 and the *CHIPS and Science Act* of 2022, as well reshoring in the wake of supply chain disruptions during the pandemic has charged this growth. The CHIPS Act will likely benefit Austin, Phoenix, and Columbus in particular. Further investment in burgeoning electric vehicle (EV)-focused manufacturing across the US. Will also support industrial demand.

Office Sector

Office Properties: Performance in the Benchmark						
	Quarter	1-Year Period Ending				
	3Q23	3Q23	3Q22	3Q21	3Q20	3Q19
Income Return	1.30%	4.79%	4.30%	4.50%	4.39%	4.44%
Appreciation Return	-4.96%	-21.12%	-1.06%	0.35%	-1.53%	2.03%
Total Return	-3.67%	-17.11%	3.21%	4.86%	2.81%	6.54%
CBD	-4.75%	-20.55%	0.81%	2.27%	1.78%	5.92%
Suburban	-2.44%	-12.98%	6.33%	8.47%	4.33%	7.46%
Rent Growth		0.65%	1.26%	0.06%	-0.50%	3.92%
NOI Growth		4.55%	-0.80%	3.30%	1.79%	6.28%
Benchmark comparison:						
Total Return, All Properties	-1.37%	-8.39%	16.08%	12.15%	2.00%	6.24%

Source: NCREIF 3Q23; CoStar Group 3Q23



Source: CoStar 3Q23

The office sector continues to face significant challenges and an uncertain outlook. Negative net absorption of 14.3 million square feet in 3Q2023 follows negative net absorption of 15.6 and 21.1 million square feet in 2Q2023 and 1Q2023, respectively, and reflects the significant challenges facing leasing activity. Although net absorption is expected to improve in 2024, it is likely to remain negative (move-outs exceeding move-ins) for the balance of the year.

Given this lack of demand, the office sector vacancy rate continued to climb in 3Q2023, reaching 13.3%, substantially higher than the pre-Covid 1Q2020 rate of 9.5%. The availability rate, which includes space offered for sublease, hit another record high of 16.6% in 3Q2023, up slightly from 16.5% last quarter, and topping the previous high of 15.9% set in 2010, according to CoStar Group. The CBDs of San Diego, Denver, and San Francisco have office availability rates greater than 30%, according to CoStar.

Tech companies, which for many years were a major driver of office leasing activity, have pulled back on hiring and also have a higher utilization of remote work, both of which has impacted office leasing demand. Another major office tenant, coworking giant WeWork filed for bankruptcy in November 2023. Although the company faced financial challenges for a time, WeWork's growth pre-pandemic contributed a major share of overall office leasing volume in certain markets including New York, San Francisco, Miami and Boston, according to analysis by CoStar. The restructuring of WeWork leases could put further pressure on office markets already significantly challenged by remote work.

At the same time, in 2023, artificial intelligence companies began to emerge as a growing office demand generator. This could be a hopeful sign for the Bay Area, which retains its long-standing reputation for access to abundant tech talent and venture capital funding.

Return-to-office physical occupancy has stagnated for most of 2023, according to Kastle Systems. In January 2023, average weekday office occupancy surpassed 50% of equivalent-day, pre-pandemic level for the first time, but has not improved much over this year, currently standing at 50.5% as of November 8, 2023.

Another proxy for "return-to-office" is average weekday ridership in major U.S. metro areas, which continue to vary widely across the nation. In New York, ridership on MTA commuter railroads (LIRR and Metro North) averaged 73% of pre-pandemic level on weekdays in October 2023, an improvement over 64% in April (see table on the next page). In Boston, MBTA weekday ridership remains lower at 61% of pre-Covid-19 levels, while the Washington, D.C. Metrorail and Chicago Metra both had weekday ridership rates at 56%. The Bay Area's BART system lags other major metros at only 40%, with not much improvement so far in 2023.

Remote and hybrid work has become entrenched for a substantial share of the work force. As a result, certain office markets have become permanently impacted by remote work. The office sector is going through a "reset," as other sectors have in the past, such as retail. Part of this process will include determining alterative highest-and-best use for some of these office properties. The pace of conversions of office properties to industrial and apartment have accelerated and will likely continue. However, viable conversions will still represent a very small share of total office inventory.

Post-Covid Transit Ridership in Major U.S. Investment Markets								
	Full Month (All Days)				Weekdays Only			
Transit Agency	Apr 2022	Oct 2022	Apr 2023	Oct 2023	Apr 2022	Oct 2022	Apr 2023	Oct 2023
MTA Subway (NYC)	59%	65%	69%	70%	57%	62%	66%	67%
MTA LIRR (NYC)	58%	68%	72%	82%	53%	61%	65%	74%
MTA Metro-North (NYC)	53%	64%	65%	74%	50%	59%	63%	71%
NJ Transit - Rail Only (NYC)	N/A			~70%	~57%	N/A		~80%
Chicago Metra	30%	37%	39%	48%	N/A	41%	48%	56%
D.C. Metrorail	37%	41%	50%	58%	34%	39%	49%	56%
San Francisco BART	34%	40%	42%	42%	32%	37%	39%	40%
Boston MBTA	N/A				57%	61%	63%	61%
Los Angeles Metro	67%	71%	N/A	79%	66%	71%	N/A	78%
Seattle Sound Transit	64%	75%	76%	75%*	56%	67%	68%	72%*

Source: LA Metro, MTA, NJ Transit, MBTA, Chicago Metra, D.C. Metrorail, BART. As of full-month October 2023 data from all agencies except Seattle. *Seattle Sound Transit's most recent available data as of August 2023. Limited data from NJ transit based on reporting from North Jersey.com

In addition to remote work trends, continuing tenant flight to higher-quality office buildings, and existing and expanding environmental emissions laws will likely challenge the performance of older office buildings, particularly Class B and C buildings. Newer, class A office buildings will likely outperform in 2024. Furthermore, office properties located in metros with shorter and more pleasant commutes as well as office tenants with greater security needs are more likely to have higher office attendance. Life science properties, which have heretofore exhibited strength, are beginning to weaken in the face of robust construction and less venture capital funding.

As a result of these evolving secular challenges, in our view the office sector could become a more "managed" asset class. Office will require more, active consistent effort for landlords to continue to attract tenants to its buildings. This could result in certain office assets moving to buyers who are better capable of managing the increased complexity of these assets (i.e., REITs, Life Companies).

As a consequence of weak fundamentals, as well as the rising cost of capital, investments in the office sector produced a total return of -3.67% in 3Q2023, with income return of +1.29% and net appreciation return of -4.96%, the sixth consecutive quarter of negative net appreciation return for the sector (see table on prior page). According to the NCREIF Market Value Index, office property values are down a cumulative -16.9% from the peak achieved in 2Q2022 before the Fed began raising interest rates, with offices in CBD locations down -26.1% year-over-year, and suburban office properties down -13.3%. The extent of value decline differs significantly by region, according to the NCREIF MVI. Office sector values in the Pacific and Northeast regions are down -22% and -19%, respectively, from 2Q2022. Conversely, the Southeast region experienced the smallest decline in values at 8% below peak.

Stress in the Office Sector

We believe the pace of office asset sales is likely to accelerate in 2024, with an increasing number of deals being brought to market in search of qualified buyers. Furthermore, the number of stressed office assets for sale is also expected to continue to rise in 2024, contributing to further pricing pressure. Amid these challenges in 2023, however, a growing number of speculative buyers have exhibited interest in bidding on and acquiring office assets in markets such as San Francisco, D.C., and Chicago for prices significantly below prices secured years prior.

For example, select San Francisco office buildings have recently sold for prices that demonstrate value declines of 50-75% relative to pre-Covid sales. In Washington, DC, some office properties have demonstrated value declines of 40-60%. And in Chicago, similar value declines from pre-Covid have been observed. The sales price for some of these office properties create such a low basis for buyers that these properties are still viable and cash flowing. Moreover, the potential for value appreciation in the future could offer generational investment opportunities.

Retail Sector

The retail sector has proved resilient given the impact of cumulative inflation on consumers. A national vacancy rate of 4.1% in 3Q2023 is 100 basis points lower than the recent high observed in 4Q2020, and a record low in data going back to 2007. Retail was the only sector to experience tighter occupancy in 2023, according to CoStar data.

In the most recent quarter, 3Q2023, investments in the retail sector returned -0.13%, consisting of +1.28% income and -1.41% net appreciation. Every property type has been affected by the rising cost of capital and cap rate expansion. In the retail sector, income return has nearly offset the loss from negative net appreciation, showing that the strength of retail fundamentals is, for now, partially offsetting the effects of rising cap rates. Nationally, retail sector's unlevered total return of -1.39% over the past four quarters has been the best performing of the four major property types (see chart to right).

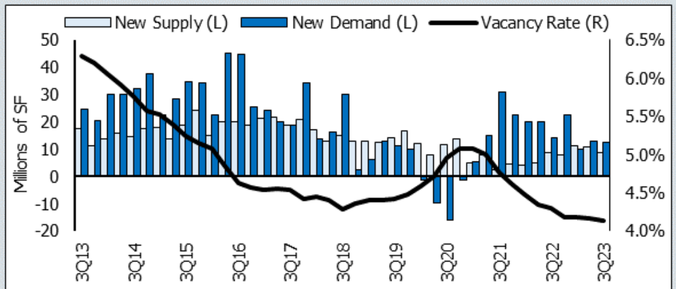
Changes in retail property values differ geographically, with certain regions benefitting more from population growth and elevated consumer spending. According to the NCREIF Market Value Index, retail sector values are down -4.8% from pre-Covid levels in 4Q2019. Declines were most significant in the eastern Midwest and Northeast regions, -12.7%, and -12.3%, respectively. Conversely, the Southeast region was the only to see retail values rise, up 4.4% since before the pandemic began. We expect continued migration to the Sunbelt to provide a broad tailwind to the retail sector.

A significant and increasing concern cited by major retailers is theft, encouraging some to retailers to close stores in 2023. Recent claims from the National Retail Federation (NRF) (which have since been retracted and modified), overstated the impact of organized retail crime. Nonetheless, retail shrink industry-wide increased again in 2022, representing $112.1 billion in losses. The NRF said loss rates as a percentage of total sales can vary significantly by retail category and averaged 1.6% for 2022 in its latest survey of store operators, up from 1.4% in 2021, and 1.3% in 2017 (see chart at bottom right). In a NRF survey of retailers, more than 67% of respondents said they were witnessing increased violence and aggression from perpetrators of theft compared with a year ago. Markets where these incidents are more common make it more difficult for retail landlords to lease space and retain tenants. The top five cities or metropolitan areas affected by organized retail crime in the past year were Los Angeles, San Francisco/Oakland, Houston, New York and Seattle, according to the NRF.[21]

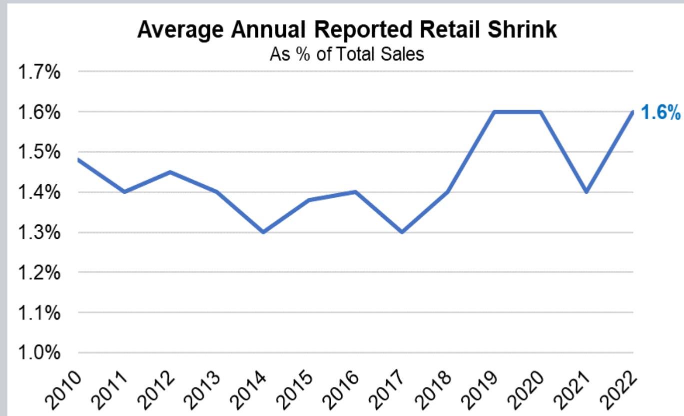
Retail Properties: Performance in the Benchmark

	Quarter	1-Year Period Ending				
	3Q23	3Q23	3Q22	3Q21	3Q20	3Q19
Income Return	1.28%	5.19%	4.98%	4.49%	4.20%	4.72%
Appreciation Return	-1.41%	-6.33%	1.60%	-3.62%	-10.15%	-3.21%
Total Return	-0.13%	-1.39%	6.65%	0.74%	-6.27%	1.41%
Malls**	-0.52%	-2.47%	4.78%	-2.62%	-8.76%	0.40%
Non-Malls**	0.21%	-0.48%	8.38%	4.20%	-3.37%	2.45%
Rent Growth		3.61%	4.40%	2.95%	1.91%	2.56%
NOI Growth		4.19%	4.04%	17.44%	-27.12%	3.77%
Benchmark comparison:						
Total Return, All Properties	-1.37%	-8.39%	16.08%	12.15%	2.00%	6.24%

Source: NCREIF 3Q23; CoStar Group 3Q23



Source: CoStar 3Q23



Source: Data aggregated from National Retail Federation's annual "National Retail Security Survey". As of 2023.

In October 2023, retail pharmacy Rite Aid filed for bankruptcy and is expected to close hundreds of stores across the nation. In its initial bankruptcy proceedings, the court provided its approval for Rite Aid to close 154 of its 2,100 stores nationwide. Rite Aid is also looking to reject 347 unexpired store

[21] Source: https://nrf.com/media-center/press-releases/shrink-accounted-over-112-billion-industry-losses-2022-according-nrf

leases. The closure of these stores will represent a headwind to retail absorption in the near term as these spaces are backfilled.

Demand for urban retail has been weakened by less daytime foot traffic in certain urban cores stemming from remote work. Conversely, suburban neighborhood centers are seeing some of the benefits from remote work, and we expect these centers to outperform in 2024.

Resilient nominal consumer spending in 2022 and thus far in 2023 were apparent in both e-commerce and physical retail sales figures. Nonetheless, real positive income growth experienced in 2023 may not continue in 2024. Higher-than-acceptable inflation that leads to falling real incomes, coupled with the risk of a recession, threaten a pullback in consumer spending, particularly on discretionary and experiential retail. Necessity-based retail will likely prove more durable in the face of mounting macroeconomic headwinds.

Despite these headwinds, supply risk remains low, according to CoStar data, with 60 million square feet of retail space under construction representing just 0.5% of inventory, below the 15-year historical average. Additionally, 80% of new retail development already has a tenant in place at delivery, according to CoStar.

Moreover, nearly 6.2 million square feet of retail space has been demolished so far in 2023, a much slower pace than the 22 million square feet demolished in the first three quarters of last year. Nonetheless, over the past six years, a cumulative 160 million square feet have been taken offline. This space is often attached to, or adjacent to, underperforming malls, where retail is often no longer the highest and best use for these properties.

Hotels

In the hotel sector, RevPAR grew 2.9% in September relative to a year earlier.[22] This puts RevPAR up 19.8% over the past 4 years, with ADR growth of 21.3% compensating for a -18.9% decline in occupancy. Luxury and upper midscale hotel chains have performed the best over the past four years. Since Covid, rising room rates have offset a decline in occupancy across hotel scales, demonstrating hotels have fewer guests but those guests are willing to pay more.

Although tourism has rebounded significantly in many major U.S. destinations, it has not yet fully recovered to pre-pandemic levels. 2022 visitation relative to 2019 was down in Los Angeles (-9%), Washington, DC (-12%), New York City (-15%), Seattle (-15%), San Francisco (-16%), and Chicago (-20%). For full-year 2023, visitation estimates project Los Angeles, New York City, and San Francisco to still be below 2019, down -3%, -5%, and -9%, respectively.

In major CBD markets, RevPAR has grown over the past four years in New York (Midtown West/Times Square) and Washington, DC CBD, up 9.3% and 4.4%, respectively, while some CBD markets have seen RevPAR decline since Covid, including Seattle CBD (-5.8%), Los Angeles CBD (-8.2%), and San Francisco Market St (-31.9%).

Overall, we believe business travel will continue to provide limited support for hotel demand and will likely plateau at a lower level than pre-Covid. "Bleasure" (individuals combining business travel with allocated leisure time) will likely become more prominent, but may not fully offset other forces. Hotel operators are likely to increase utilization of automation and AI in hotel operations in order to mitigate against rising expenses.

[22] RevPAR is revenue per available foot, a measure combining ADR (average daily rate) and occupancy.

Alternative Property Types

Data Center supply isn't keeping up with demand, nationally. The rapid adoption of AI has caused a shortage of available inventory, pushing vacancy rates down, and driving up rents. Operators in primary markets have raised rents 20% to 30% year-over-year. Record demand for data center space is expected through the second half of this year and into 2024, according to a recent report from real estate firm JLL.

Self-storage properties have seen notable value appreciation and increased investor interest over the past several years. Self-storage generally has lower operating expense ratios and lower labor costs, which provide attractive benefits, as operating expenses rise across property sectors.

Single Family Rentals (SFR) are benefiting from the housing affordability gap and low inventory. The principal and interest mortgage payment on a median-priced existing home is up more than 127% relative to the beginning of 2021. SFR demand is bolstered by renters who wish to live in certain neighborhoods and/or certain school districts where traditional apartment units are scarcer. SFRs also offer more living space for growing families and those more regularly working remotely.

CRE Opportunities and Risks for 2024

CRE is confronted by several challenges in the coming year, including interest rates remaining high and adversely impacting values, loan defaults increasing because of high refinance rates, a cyclical market downturn impacting demand, tighter regulations, and higher operating expenses. The office sector has the added challenge of secular changes impacting office space usage. However, these challenges and disruptions will likely be accompanied by opportunity.

During the era of low rates accompanied by a good economic environment, many investors benefitted from rising values across asset classes. In the new paradigm of higher rates, weakening economic indicators, and declining values, substantial prospects for investing at a low basis are manifesting, but so are the potential pitfalls. Therefore, it is vital that investors are discerning and rely on the keen investment expertise of advisors who can differentiate true opportunities from potential minefields.

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