Winter Newsletter

2018 Property Sector Outlook and Core Investment Strategies:

One Size Does Not Fit All

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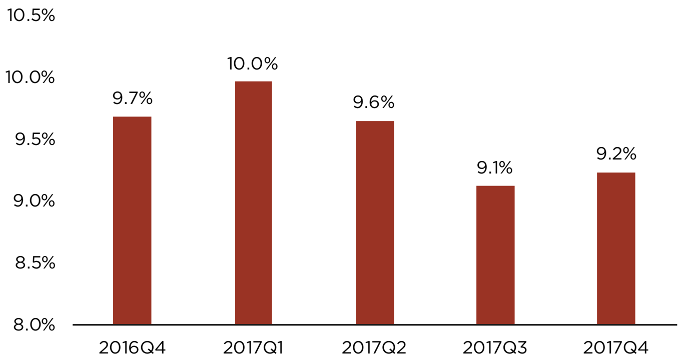
As we enter 2018, significant tailwinds and moderate headwinds confront the four major property sectors in commercial real estate. We expect these cross-currents to lead to a divergence of performance amongst property sectors as well as disparities within each individual sector.

Rather than favoring one property category over another on a broad spectrum, current economic conditions require more detail and diligence in identifying those segments of each major asset type where opportunity for success exists. We have outlined key aspects of each type below and are focusing our core portfolio to take advantage of these specific trends to capture out-sized risk-adjusted returns.

Multifamily: Submarkets Matter More Than Ever

Higher quality assets in major markets collectively saw a 50 bps decline in vacancy rates for the year ended 2017. Reduced construction lending, increasing construction costs and tapering rent growth foretells an eventual decrease in supply and this supports increasingly favorable fundamentals going forward.

> Vacancy Rate



Source: CoStar

Multifamily housing, particularly in the coastal blue states, should benefit the most from the recently passed tax bill as the reduced mortgage interest deduction caps, and caps on state and local tax deductions will tilt the "rent vs. own" economics toward renting most in these high cost housing and tax markets. This benefits higher-end multifamily housing demand in markets with low affordability, as the already prohibitive cost of owning only increases. Alternatively, the advantage already enjoyed by lower cost states will increase as the cap on state and local tax deductions impacts higher cost states.

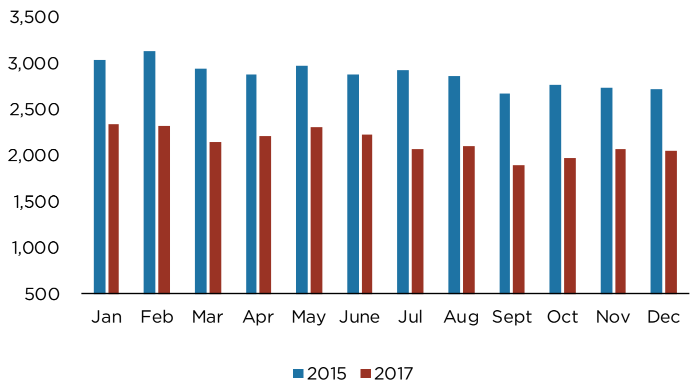
While a significant slowdown in supply has yet to materialize nationally, activity in select submarkets is creating targeted opportunities this year. With strong supply in many submarkets and less new competition in others, discipline in submarket selection will be the key to multifamily investment success in 2018.

Key Core Investment Strategy Success Factor:
Discipline in submarket selection will be the key to investment strategy success in 2018.

Office: Most in Need of Boost from Tax Reform

Moderating employment growth and increased tenant willingness to pay outsized premiums for top quality assets characterized the office sector in 2017 with the negative effects of moderating employment growth impacting the sector more than any other.

> Employment



Source: Bureau of Labor Statistics

Add to this increasing supply, 2017 saw a softening in office property rent growth. As future employment growth continues to be constrained by an increasingly small supply of qualified workers, the office sector is the most likely to benefit from the recently passed tax bill delivering the promised acceleration in wage growth. If the rate of wage growth were to materially increase, that could encourage workers currently on the sidelines to reenter the labor force, creating greater employment growth. While today's stagnant rate of wage growth - despite the low unemployment rate - is a cautionary tale in forecasting outsized future wage growth, a moderate increase in the rate of wage growth is plausible based on an ever-tightening labor supply. Even a moderate uptick in wages would be beneficial to the office sector's prospects in 2018. As companies face increasing challenges in recruiting and retaining top talent, the highest quality assets will continue to reap outsized rent premiums relative to next tier assets as companies use high quality work environments as a competitive tool in attracting and retaining talent.

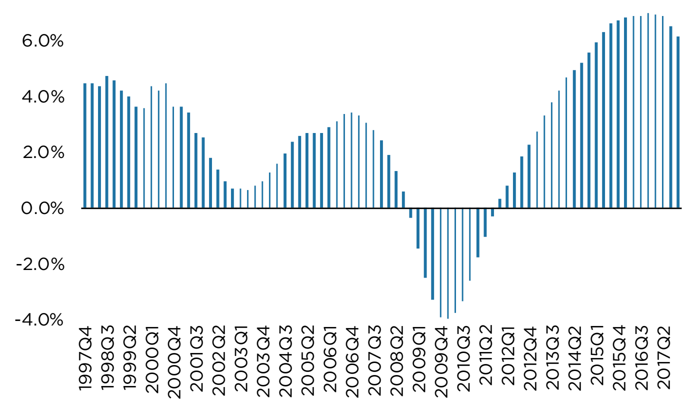
Anticipating that office fundamentals would be peaking, understanding that tenants were willing to pay outsized premiums for quality assets, and noting the important role that office assets can play in providing greater income stability and credit quality within a core portfolio, we previously began shifting our office investment strategy to favor top-tier assets occupied by larger higher credit quality tenants with longer-term leases and built-in rent escalations. If wage growth does not accelerate in 2018, our portfolio will continue to benefit from steady and contractually growing income streams and this shift will protect our office assets from the potential threat of companies with global operations shifting operations overseas to take advantage of greatly reduced tax rates on profits earned overseas.

Key Core Investment Strategy Success Factor:
Focus on best-in-class assets occupied by larger higher credit quality tenants with longer-term leases and contractual rent escalations.

Industrial: Changing Consumer Preferences Continue to Propel Industrial

With online holiday-period retail sales increasing nearly 19% over the prior year, the significant tailwind provided by e-commerce continues to drive industrial demand and rents higher to levels not previously seen.

> Year-Over-Year Rent Growth by Quarter



Source: CoStar

We expect that demand will remain robust for the foreseeable future although the industrial sector is not without risks. Supply is increasing at meaningful levels in select submarkets. While this supply is currently being absorbed, a disruption in industrial demand would leave these submarkets most vulnerable, specifically as a result of meaningful disruption in imported goods. While this is not our base case scenario, the current rhetoric surrounding global trade agreements makes this a concern worth noting.

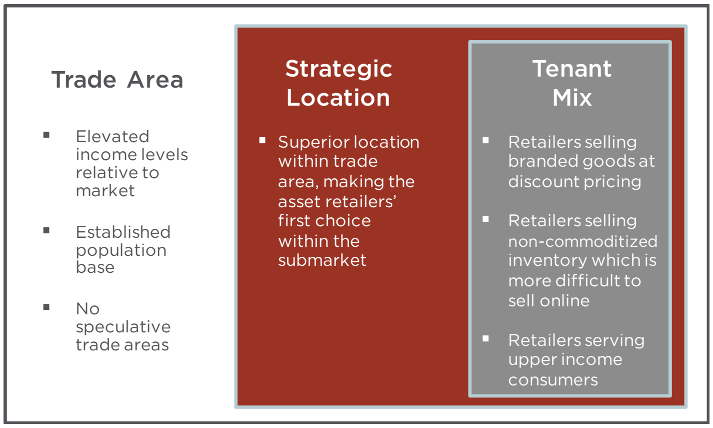
Key Core Investment Strategy Success Factor:
Overweight the highest quality logistics assets able to meet both the locational and asset specific demands of the widest array of companies and logistics supply chains.

Retail: Winner-Take-All

With continuing headwinds from e-commerce and ever-changing consumer preferences, retail is increasingly a winner-take-all property sector with national headlines and statistics masking wide variations in asset level performance.

The highest quality assets in strongest trade areas continue to experience significantly lower vacancy rates and greater tenant demand than lower quality assets in weaker trade areas.

These assets are best positioned to capitalize on macroeconomic forces that will promote spending. Continuing employment gains, the wealth effect from rising equity markets, home values that increase consumer confidence, and the resultant willingness to both save less and take on more debt are all positives for retail activity. Given the run up in consumer debt and the decline in the consumer savings rate, future retail sales growth will be increasingly dependent on both employment growth and wage growth acceleration. Since we do not foresee a substantial increase in employment growth, extending the favorable current macroeconomic environment for retail spending will become increasingly dependent on wage growth acceleration.



Source: American Realty Advisors

The strongest retail assets are characterized by the following three key indicators: a center's strategic position within a trade area, a center's tenant composition, including financially strong, market-leading grocery anchors and/or non-grocery anchors selling branded goods possibly at discounted prices, and centers located in higher income, established trade areas with the necessary population base already in place.

Key Core Investment Strategy Success Factor:
The ability to identify the dominant assets in the strongest trade areas and to focus solely on those assets.

The four major property sectors have opportunities and challenges unique to each of them. This requires an understanding of those opportunities and challenges to identify the most important core investment strategies for each. Understanding the importance of each sector's underlying drivers will increase the chances for investment outperformance in 2018.

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