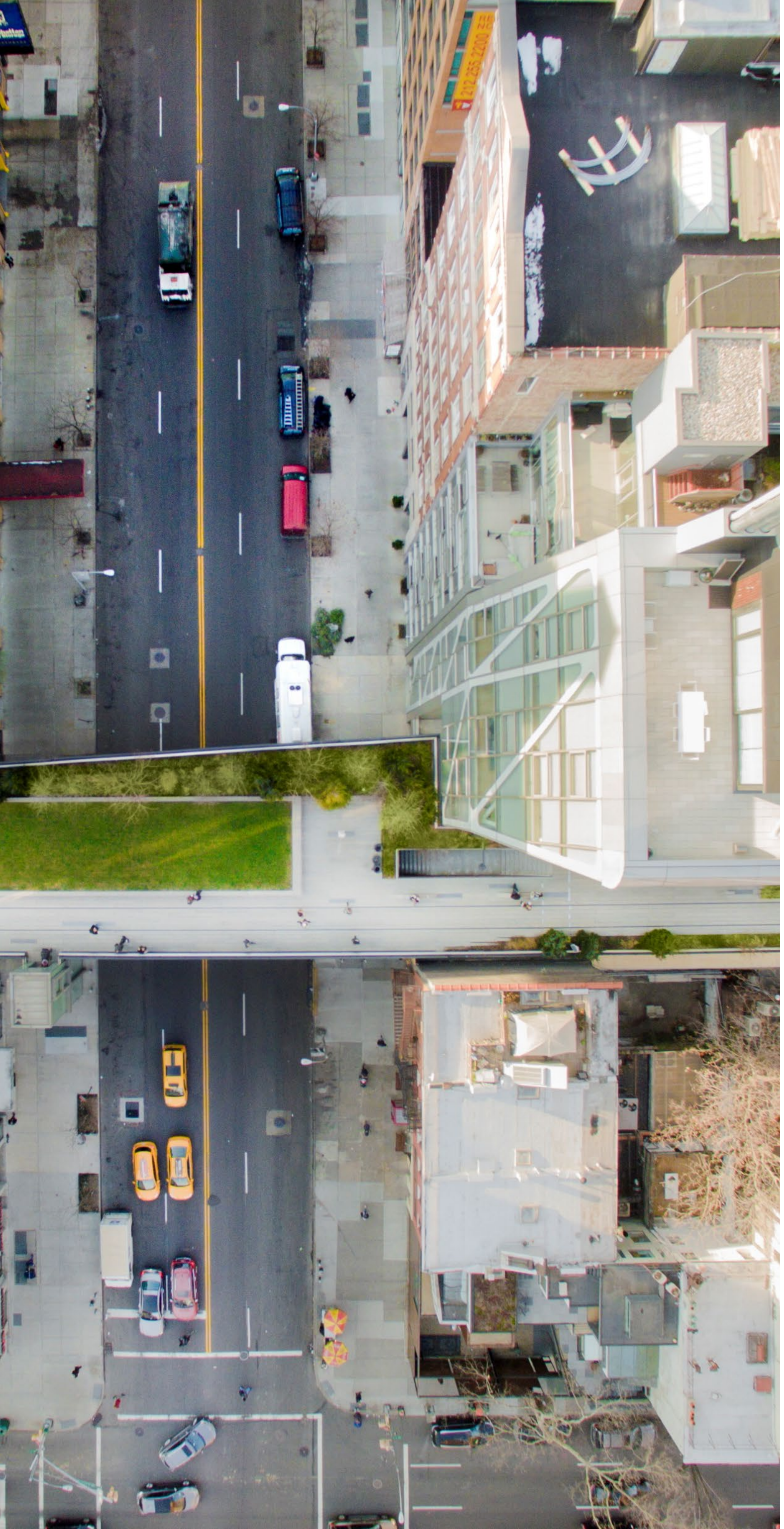
ARA HOUSE VIEW H2 2022

July 2022

AMERICAN REALTY ADVISORS
INSTITUTIONAL CAPITAL MANAGEMENT



U.S. REAL ESTATE INVESTMENT OUTLOOK

Caution Emerging As Investors Navigate Economic and Market Uncertainty.

Macroeconomic Context

- The resilient consumer-led recovery is beginning to show some cracks as inflation weighs on sentiment and spending power.
- Ongoing war in Ukraine and rolling supply chain disruptions, both domestically and internationally, continue to delay supply-demand normalization.
- Increased Fed hawkishness in response to heightened and more persistent inflation is elevating recession risk.

Real Estate Impacts

- Weaker economic outlook is anticipated to moderate demand, though the magnitude differs by sector and market.
- Rising interest rates are increasing the cost of debt, creating opportunities for lower leverage and cash buyers.
- Anticipate some cap rate expansion and price declines in response to rising cost of capital and slower growth conditions.
- Secular demand for residential rentals is bolstered by high for-sale prices; a softening in prices will do little to alleviate affordability given the higher interest rate environment.
- Despite slowing pace of e-commerce growth, industrial fundamentals look resilient given delayed supply growth.

I. MACRO OUTLOOK

Economic risks are skewed to the downside:

Despite a hot job market, Q1 GDP was negative, and consumer confidence has plummeted. Our base case assumes a deep recession is avoided with growth reverting back to pre-pandemic low levels in 2023 and beyond.

Consumers are feeling the inflation pain:

Above-average inflation in food and gas prices are forcing consumers to spend down savings and increasingly turn to credit cards to shoulder higher costs. With consumers serving as the bright spot in the GDP numbers, we expect their pain will translate into a more material slowdown this summer.

The Fed balances overheating against stagflation:

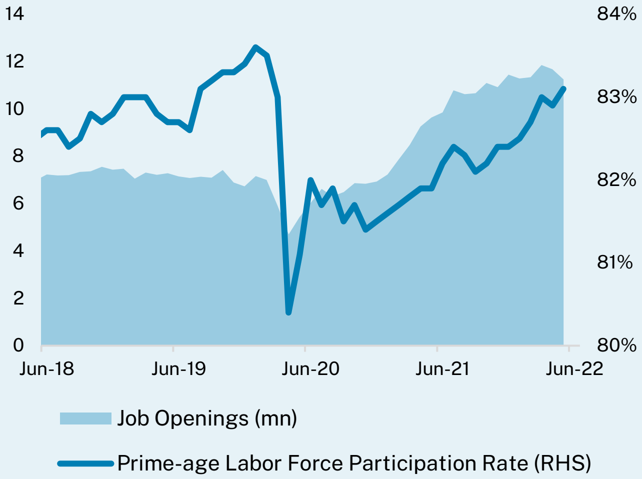
The Fed has signaled a willingness to rein in inflation even at the expense of growth. We anticipate this will increase volatility in the near term until the trade-off favors growth, stimulated by rate cuts at the end of 2023.

MIXED MACRO SIGNALS

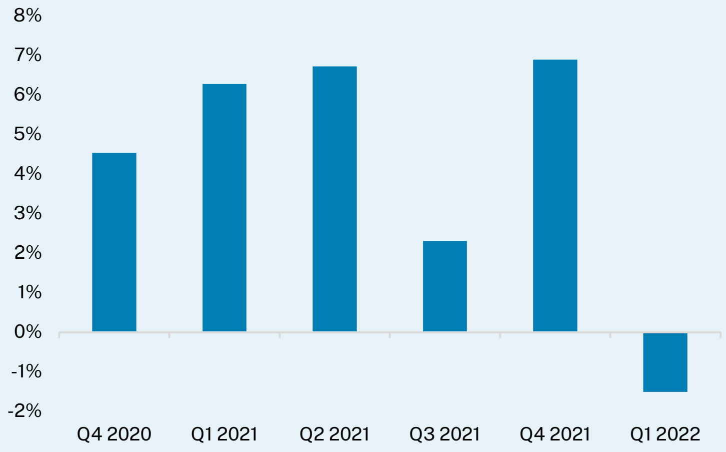
A constrained labor market and persistent above-average inflation support rate hikes, though a tightening cycle amidst a deceleration in GDP growth and waning consumer sentiment complicates the near-term outlook.

Income resiliency plays a critical role for investors during economic slowdowns.

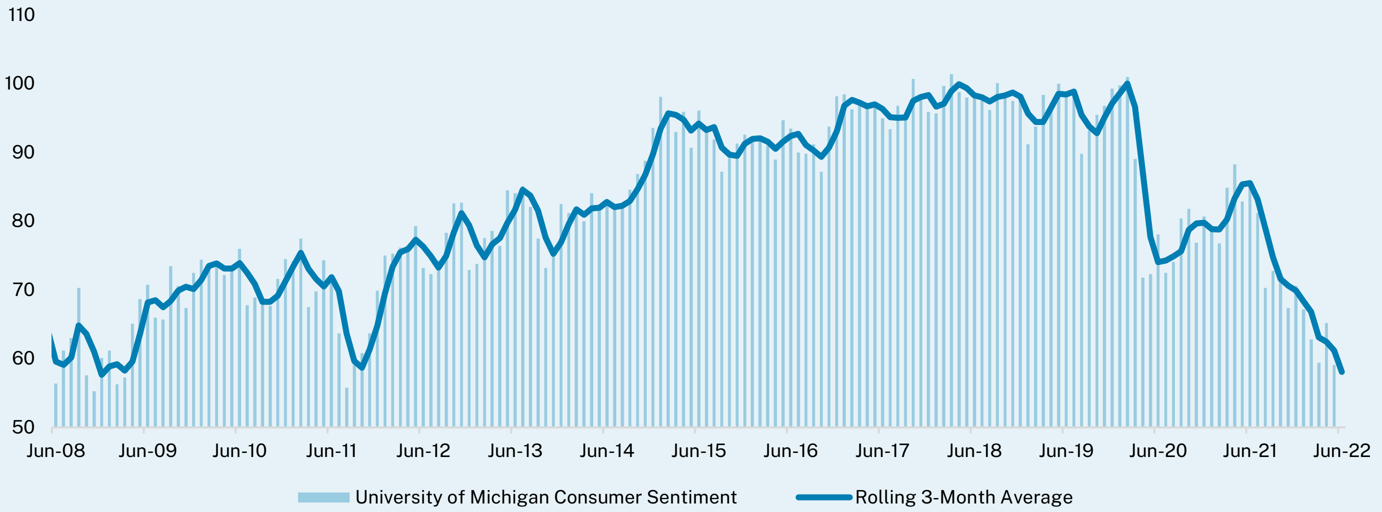
Labor Market



GDP Growth (Real, SAAR, Change over Quarter)



Consumer Sentiment



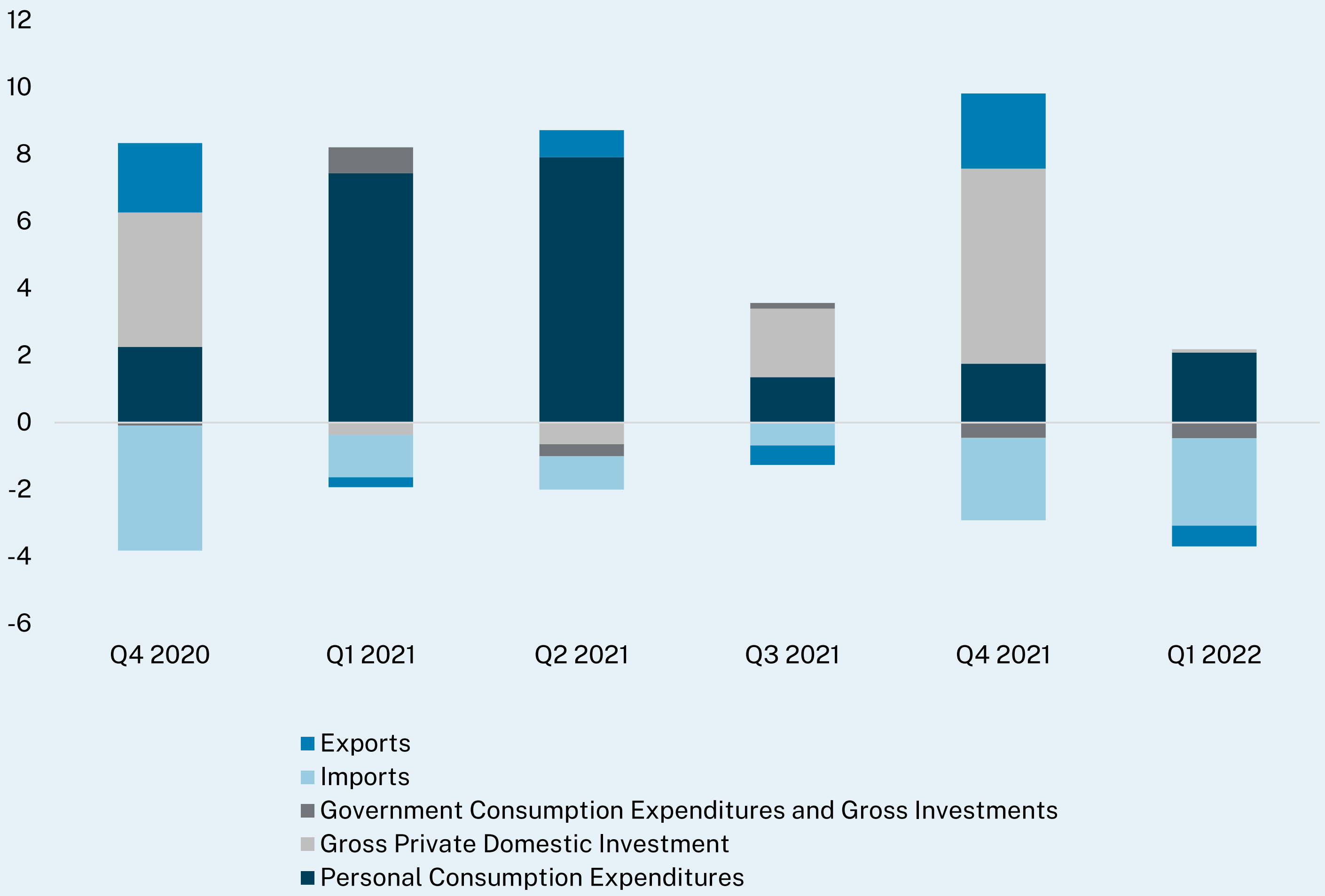
Note: Prime-age is defined as those aged 25-54 years old.
Source: American Realty Advisors based on data from Macrobond as of July 2022.

PARSING THROUGH THE GDP STATS

GDP growth in Q1 2022 was -1.6%, with the decline largely the result of a wider trade gap. Consumer spending has been the bright spot.

The health of the consumer will determine whether the Fed can achieve a soft landing.

Contributions to GDP, Percentage Points



Source: American Realty Advisors based on data from the Federal Reserve Bank of St. Louis (FRED) and Macrobond as of May 2022

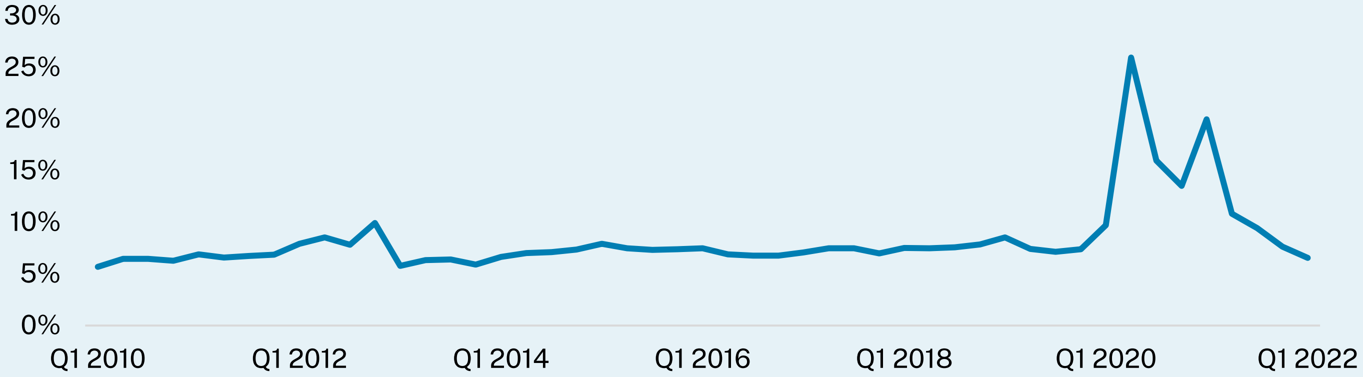
THE ALMIGHTY CONSUMER?

Despite a weakening in sentiment, spending has remained strong as households used their stimulus savings.

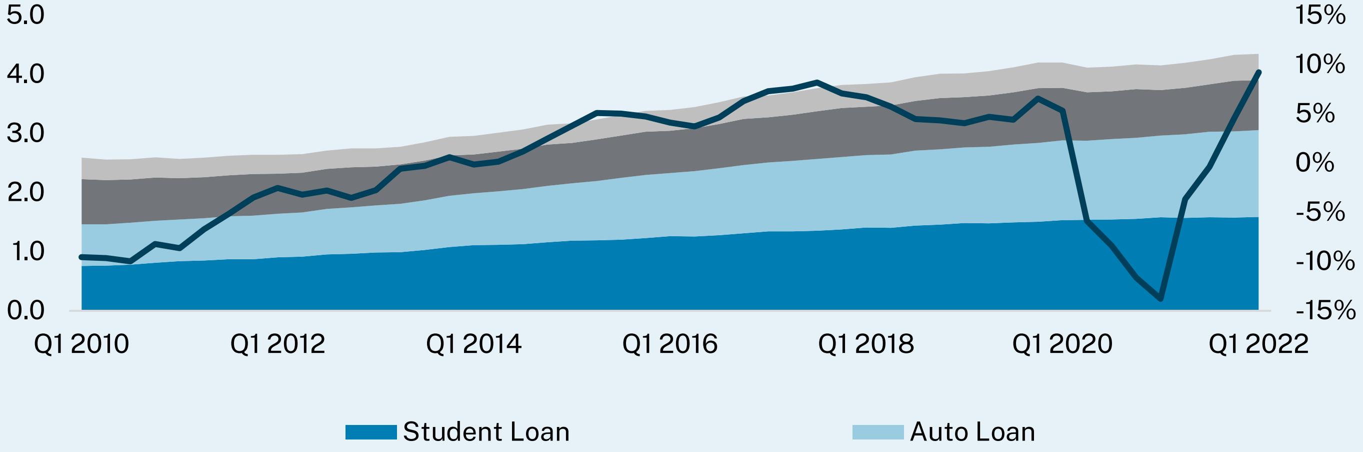
Because wages are not keeping pace with prices, consumers are increasingly using credit cards to fund the gap.

Higher credit card usage reflects a weakening consumer position – a key economic risk.

Personal Savings Rate



Non-housing Debt Balance ($, Trillions) and Year-over-Year Change In Credit Card Debt



Source: American Realty Advisors based on data from the Federal Reserve Bank of St. Louis (FRED) and the Federal Reserve Bank of New York Household Debt and Credit Report as of Q1 2022

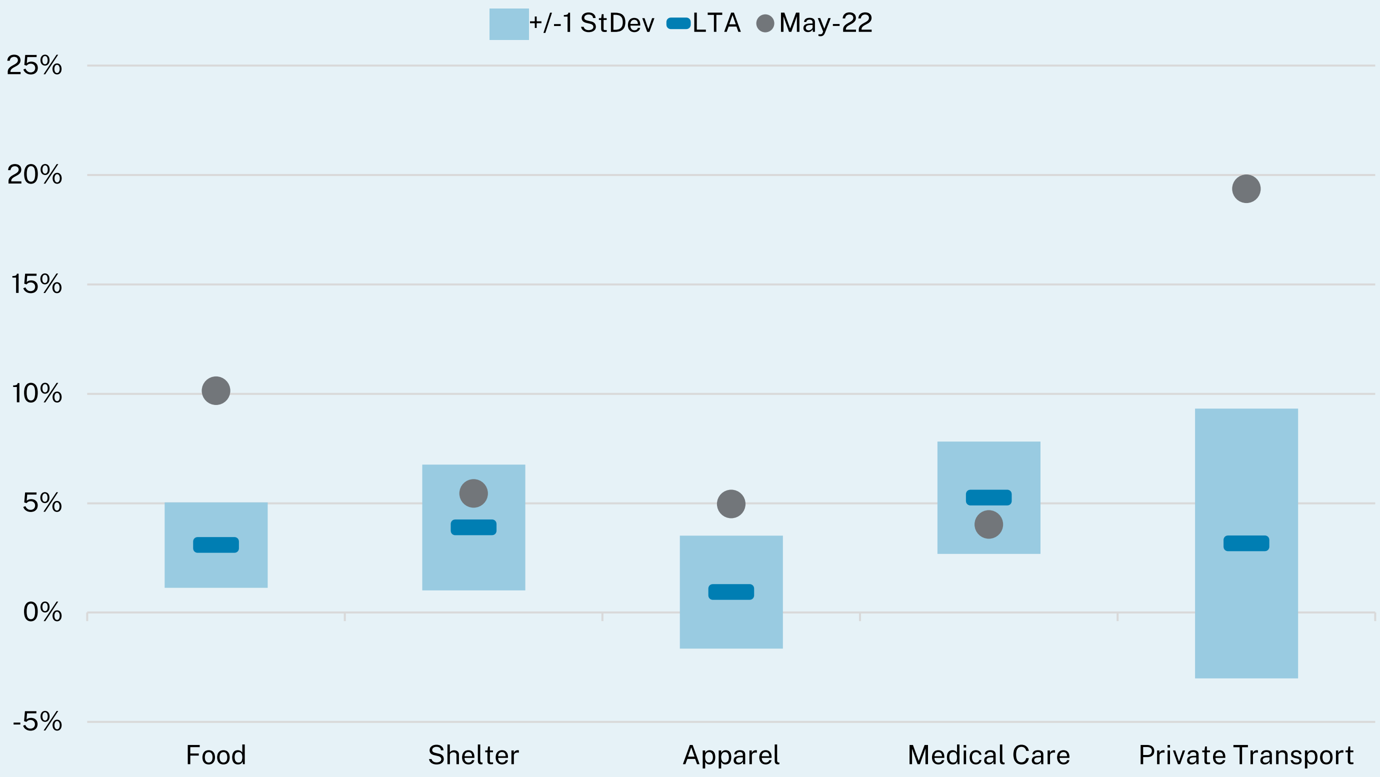
WHAT IS NORMAL FOR INFLATION SEGMENTS?

As of May, two-thirds of CPI components were increasing at a 4+% year-over-year rate, driving concern that elevated inflation may be persistent.

It is important to consider increases against what is normal – food and private transport (gas) are the two categories where inflation is the highest and most abnormal.

Abnormal price increases in necessities create disproportionate pain for consumers.

Normal Year-Over-Year Changes in CPI Components and Recent Readings

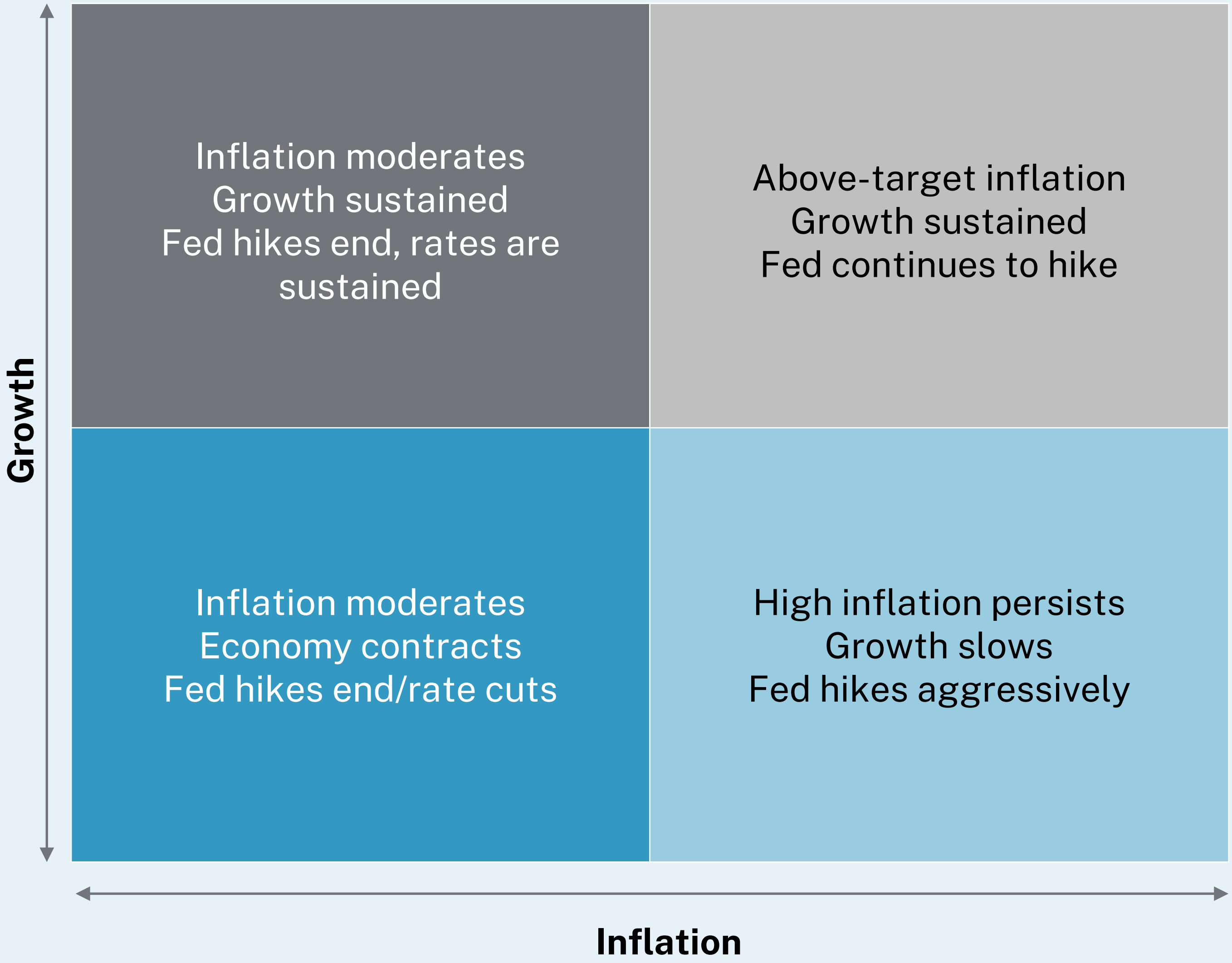


Note: LTA = Long-term average, 1980 - 2022
Source: American Realty Advisors based on data from the U.S. Bureau of Labor Statistics and Macrobond as of July 2022

NEAR-TERM MACRO OUTCOMES

How far Fed policy goes from here is contingent on the responsiveness of inflation and the resiliency of growth. We believe the near-term outlook will be categorized in two parts:

1. **Through year-end 2022: Inflation remains elevated in the near term and drags on growth; Fed hikes aggressively to reign in (bottom right).**
2. **Beginning 2023: Inflation moderates as a function of tighter policy and denominator drag; growth reverses and upward Fed trajectory ends, requiring cuts (bottom left).**



Source: American Realty Advisors based on data from Oxford Economics, CBRE-EA, Federal Reserve Bank of St. Louis (FRED) and Macrobond as of June 2022

II. CAPITAL MARKETS

Inflation expected to remain higher longer, but fall faster:

Inflation has been more persistent than originally anticipated. We believe inflation stays elevated through year end but declines rapidly amidst a broader, rate-influenced economic slowdown.

Plotting the course of further rate hikes:

The futures market and the Fed dot plot are at odds over peak rate timing and subsequent cuts. Our base case assumes a Spring 2023 peak and the first cut by the end of the same year.

Real estate repricing likely as higher rates get incorporated into underwriting:

Expect upward pressure on cap rates, though movement with rates isn't one-to-one. We anticipate repricing of 5-10% reduction in values at the trough of the hike cycle, but magnitude will depend on NOI growth prospects.

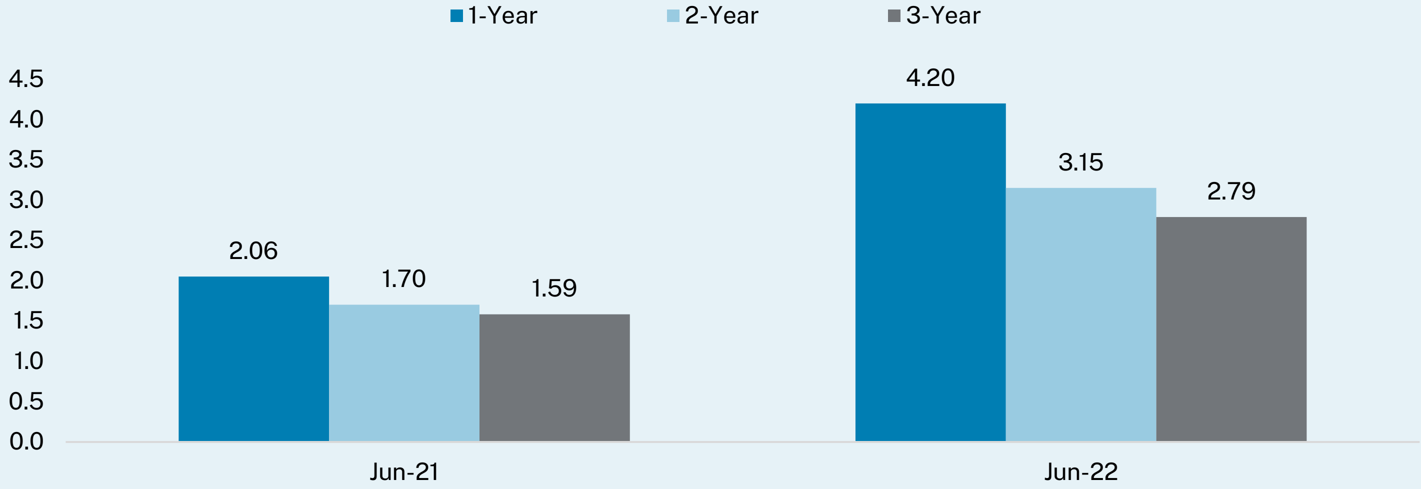
FUTURE INFLATION ESTIMATES

Recent data suggests expectations are for inflation to remain elevated over the next 12 months, and then decelerate.

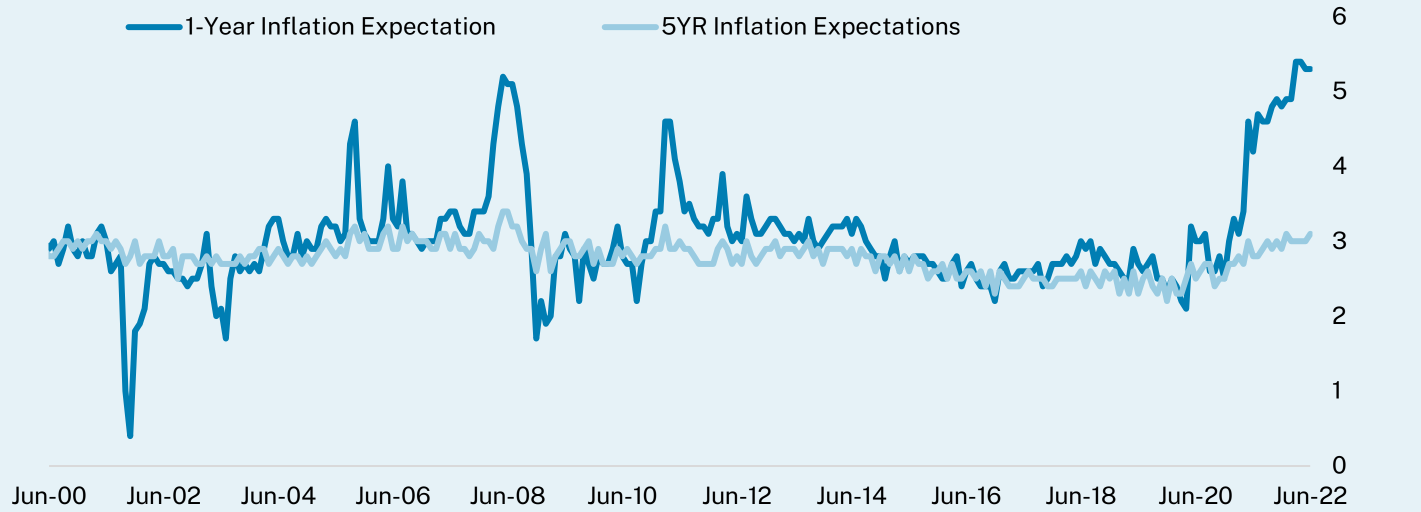
The level is less important than the trend when it comes to de-anchoring – although near term remains elevated, expectations for the next five years are essentially on par with where they were last cycle.

> **Inflation to remain elevated through year end but drop more precipitously in 2023.**

1-, 2-, and 3-Year Inflation Expectations (%)



1-Year and 5-Year Inflation Expectations (%)



Source: American Realty Advisors based on data from the Federal Reserve Bank of St. Louis (FRED), the University of Michigan Survey and Macrobond as of July 2022

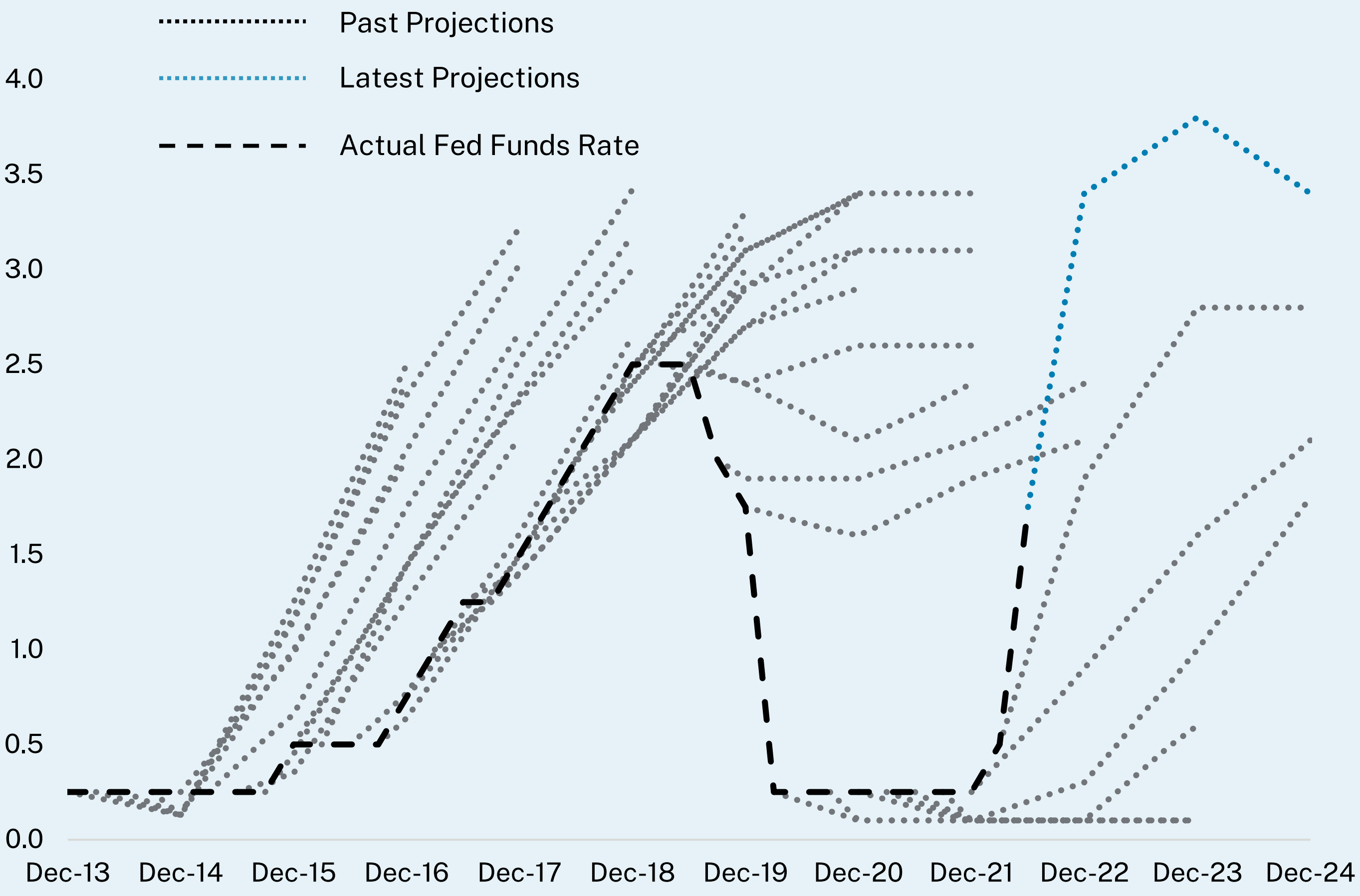
REVISITING THE ACCURACY OF THE DOT PLOT

The FOMC's projections of the Fed Funds rate are often inaccurate.

Projections from the June meeting reflect an expectation of rates reaching a high of ~3.8% by year-end 2023 before declining 40 basis points in 2024.

> **We expect peak rates and rate cuts to occur sooner than the current dot plot suggests.**

Federal Open Market Committee Fed Funds Rate Projections and the Federal Funds Target Rate (December 2012 – June 2022, %)



Note: Dotted lines correspond to median expectation of Fed Funds Rate by 12 members of the FOMC for next three years.
Source: American Realty Advisors based on data from the Board of Governors of the Federal Reserve System and Macrobond as of June 2022.

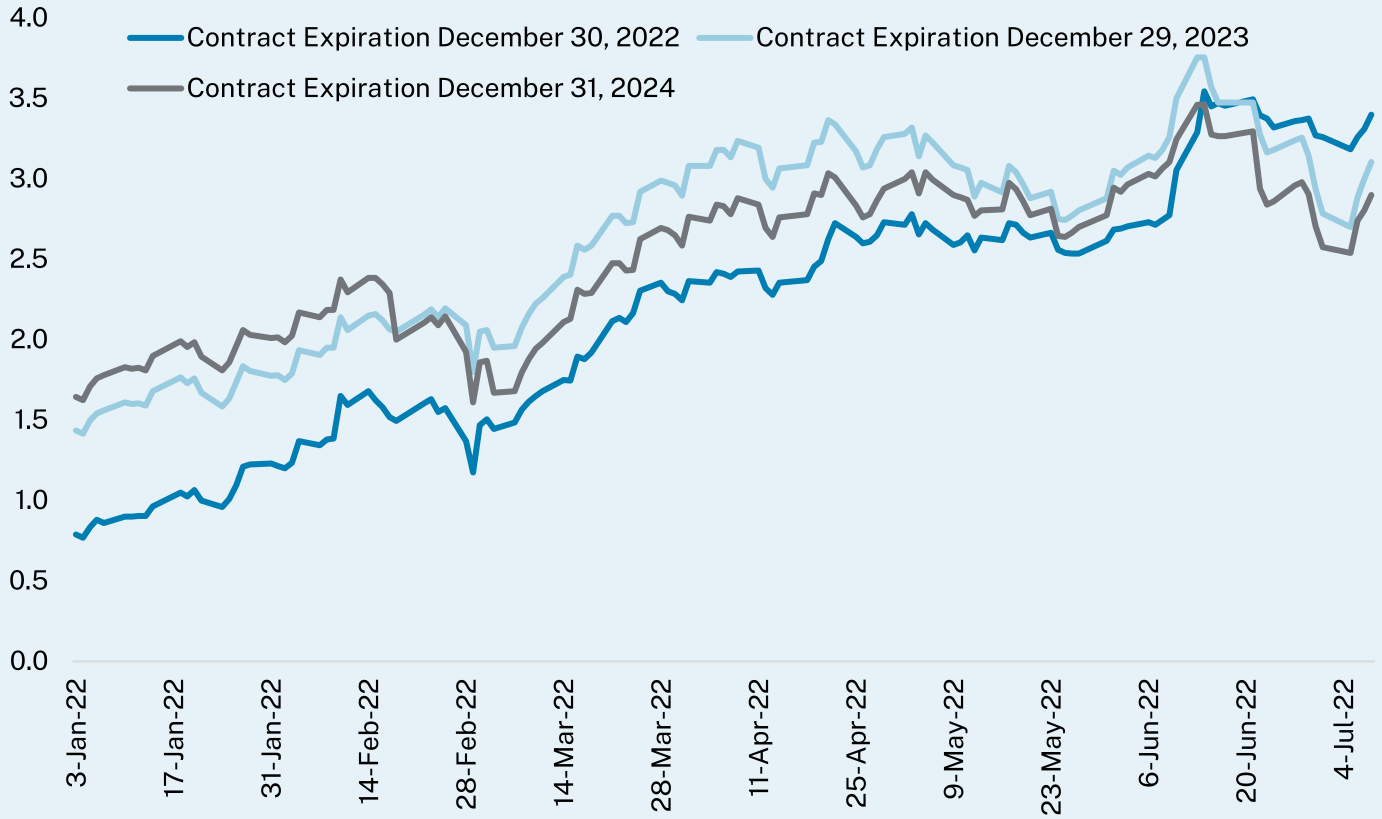
INVESTOR FORECAST OF FED FUNDS RATE

The futures market is pricing in peak rates of 3.6%, fairly aligned with the Fed, albeit with the peak occurring earlier and cuts sooner.

May's inflation reading increased market expectations of the magnitude of rate hikes and accelerated the timing of the peak, suggesting a steep-but-short rate hike cycle profile.

> **We anticipate a higher peak and shorter tail than the futures market is currently predicting.**

Futures Implied Fed Funds Target Rate at Date Noted, %



Note: Lines denote the expectation for Fed Funds rate at year-end 2022, year-end 2023 and year-end 2024 at date the futures contract was executed.
Source: American Realty Advisors based on data from the Chicago Mercantile Exchange and Macrobond as of July 11, 2022

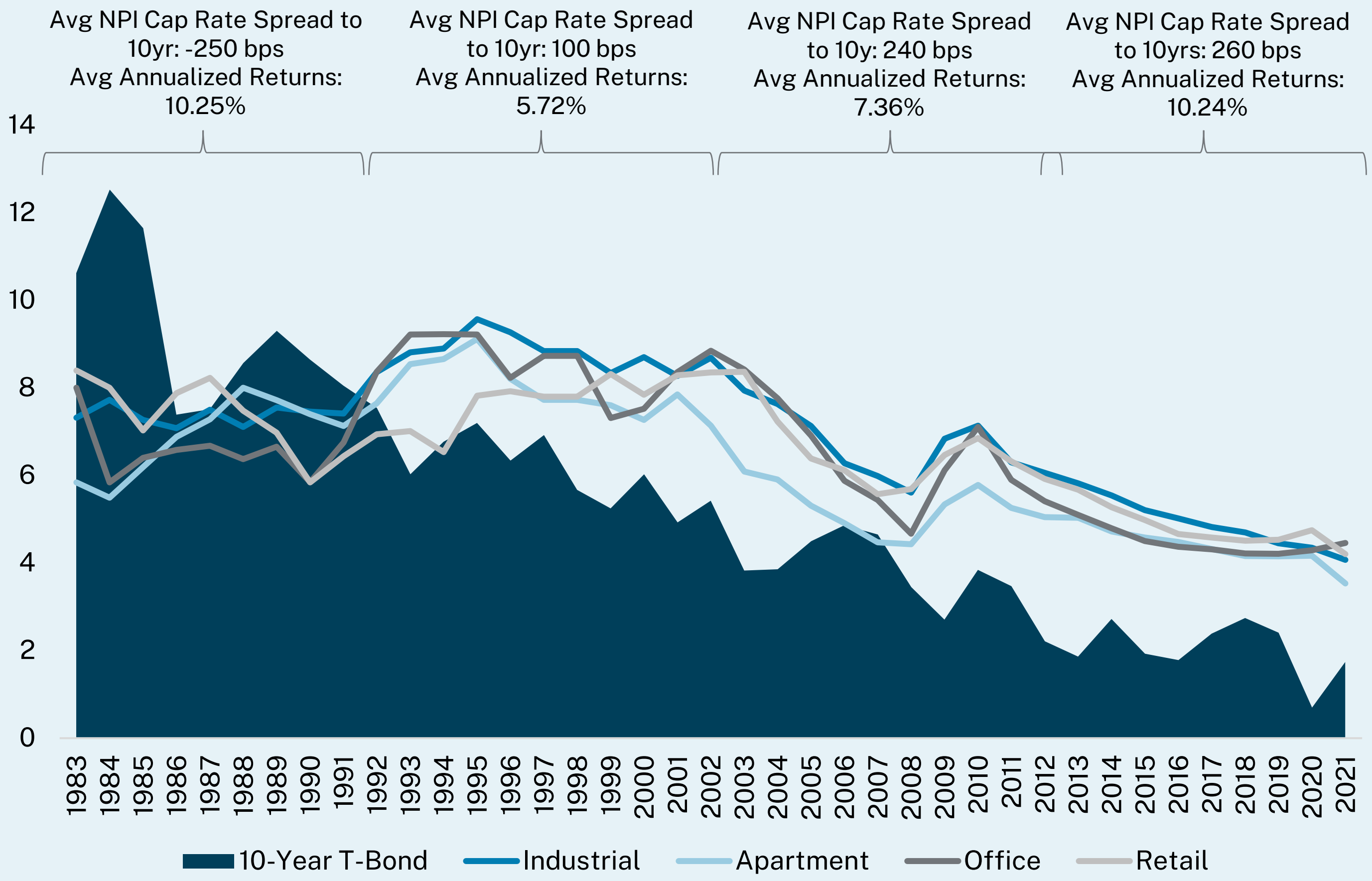
RETURNS IN DIFFERENT SPREAD CONDITIONS

The delta between cap rates and bond yields is frequently used to evaluate the relative attractiveness of real estate pricing.

History shows that narrower spreads are not necessarily a predictor of diminishing returns.

> **We expect returns to come down from recent highs but continue to outpace inflation.**

NPI Cap Rate Spread Over 10-year Treasury Bonds (1983 – 2021)



Source: American Realty Advisors based on data from the Board of Governors of the Federal Reserve System and Macrobond as of June 2022.

CAP RATES AND BONDS ARE NOT STRONGLY CORRELATED

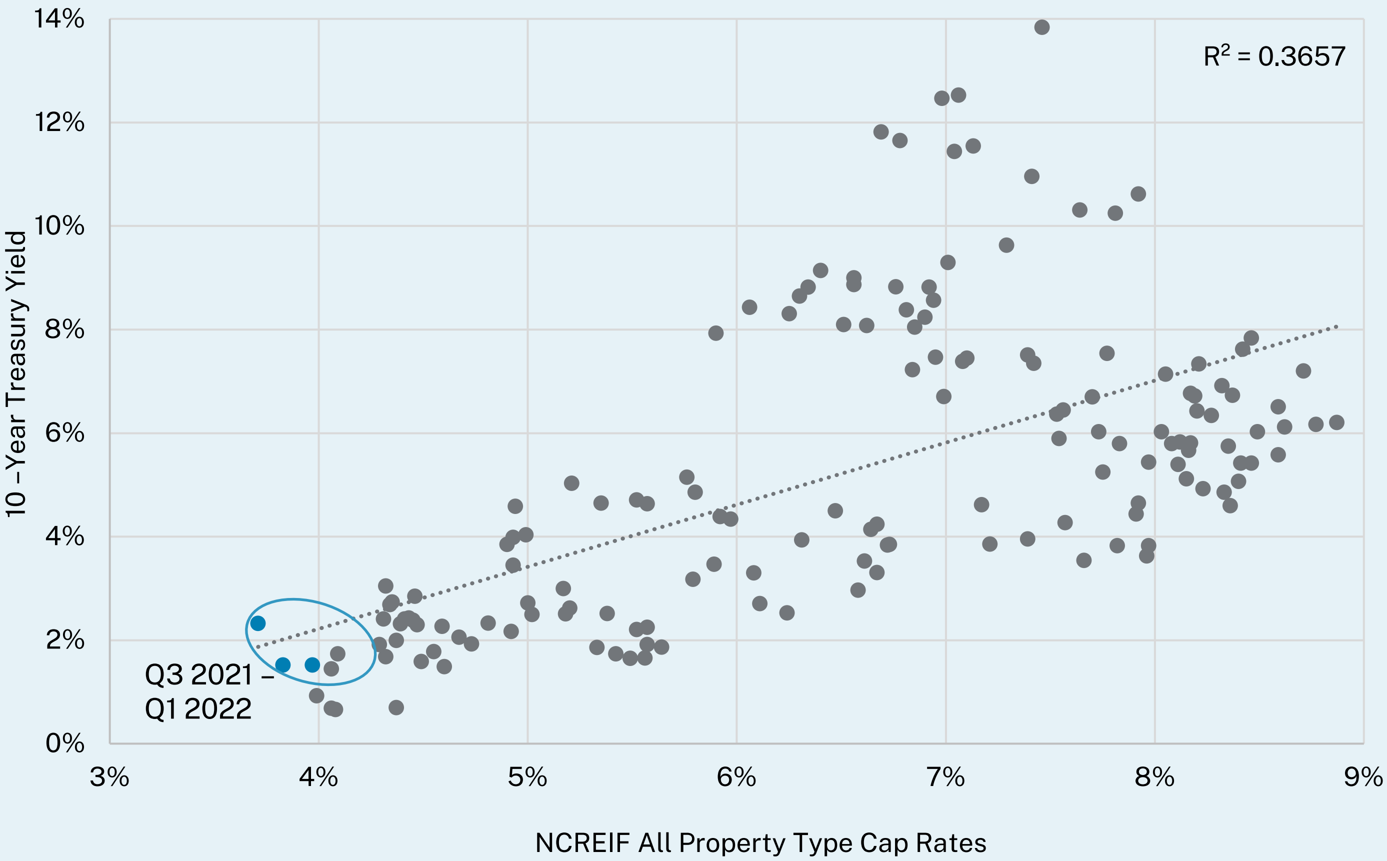
The general expectation is that cap rates should expand as treasury yields rise.

The actual correlation is statistically weak, with the two moving in the same direction only 37% of the time.

Real estate pricing is a function of more than just spreads - GDP growth, capital flows, and property-level metrics have a far greater impact on cap rates.

> **We anticipate repricing of 50-100 bps over the course of the hike cycle, differing by sector.**

10-year Treasury Yield and Overall Cap Rates (1983 – Q1 2022)



Source: American Realty Advisors based on data from NCREIF NPI Trends Report Q1 2022 and Macrobond as of May 2022.

III. PROPERTY MARKETS

Pace of e-commerce gains slow, but still enough to power industrial demand:

Even at half the pace of pre-pandemic gains, e-commerce could add 315 million square feet to demand in the next five years. We continue to favor the sector given the still-strong demand outlook and lagged supply.

Higher rates keep a moderating for-sale market unaffordable:

High absolute values and more expensive mortgages will keep more households in rentals even amidst slowing/reversing home price gains. Expect markets with less supply relative to net migration projections to outperform.

Office settles into the new hybrid norm:

Many companies expect to shed space in the coming years – a recession no doubt accelerates cost-cutting measures. We advise an underweight to office broadly given what is envisioned to be a diminished demand pool and winner-take-all future for the sector.

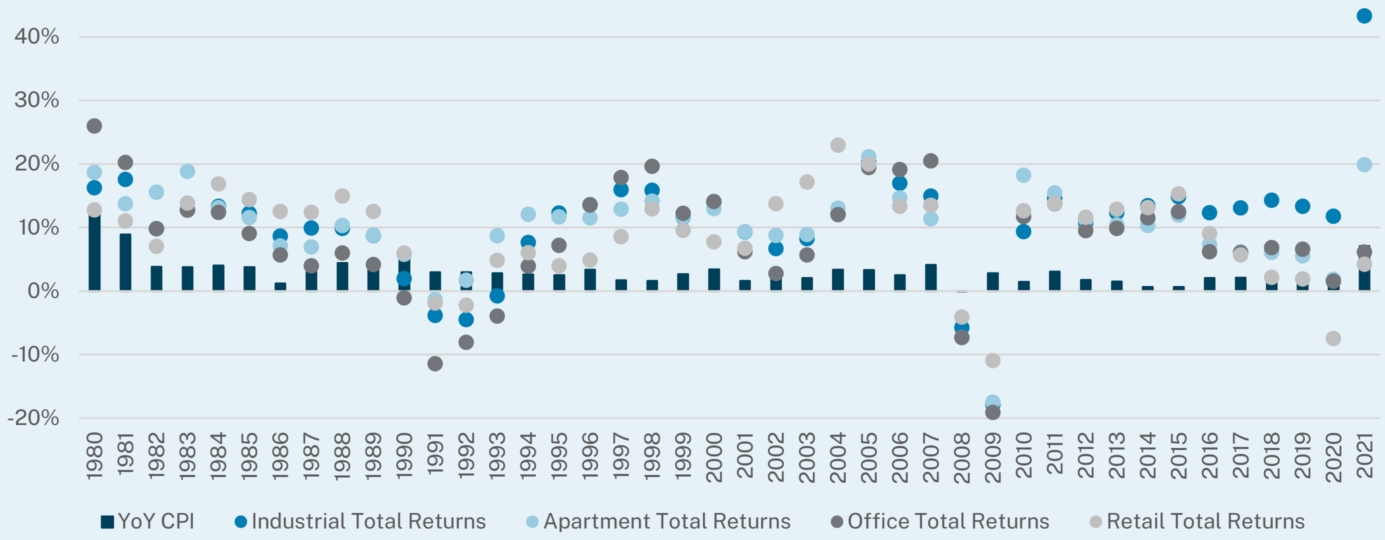
REAL ESTATE AS AN INFLATION HEDGE

Real estate is looked to in periods of rising inflation given nominal returns have historically outpaced the rate of inflation.

The persistence and magnitude of the asset class's outperformance throughout various inflation and rate backdrops is impressive – returns across property types have consistently outpaced inflation at least 75% of the time by 800+ bps.

Unlevered returns are expected to outpace inflation by ~600 bps over the next five years.

Total Returns by Property Type vs. Inflation Rate (1980 – 2021)



Property Type	% of time TR > Inflation	Magnitude of Outperformance
Industrial	85.7%	1,020 bps
Apartment	88.1%	850 bps
Office	78.6%	860 bps
Retail	81.0%	830 bps

Source: American Realty Advisors based on data from NCREIF NPI Detail Report Q1 2022 and Macrobond as of May 2022.

NORMALIZING PACE OF E-COMMERCE GROWTH

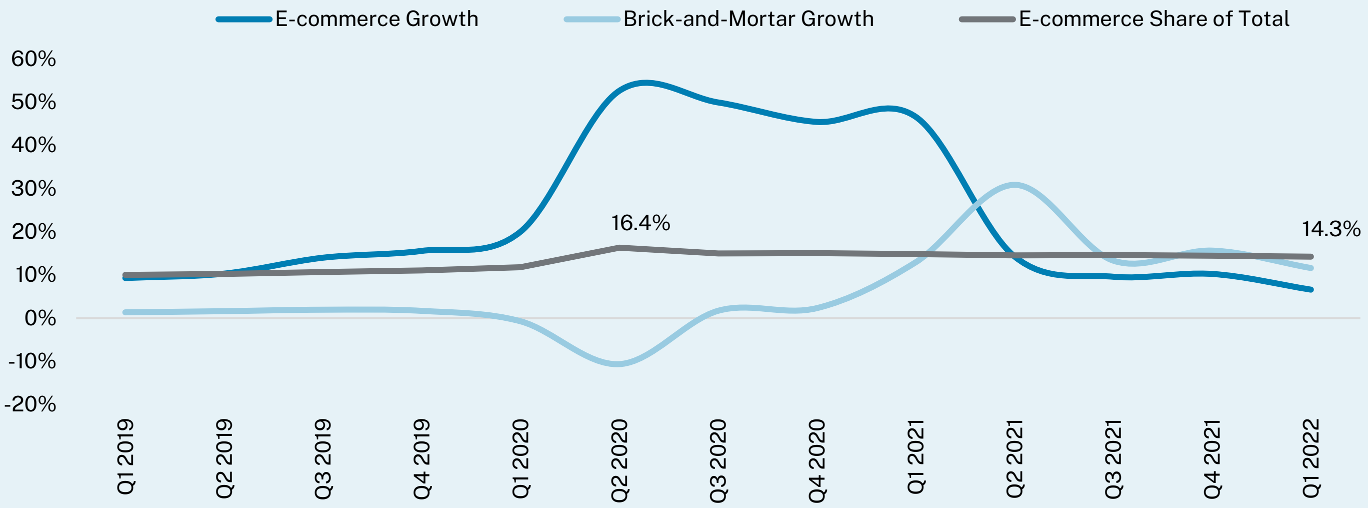
Recently the pace of e-commerce growth has slowed below that of physical retail sales.

Even at half the pace of growth that occurred in the five years prior to the pandemic, e-commerce sales could still reach $1.21 trillion by 2025, supportive of industrial demand.

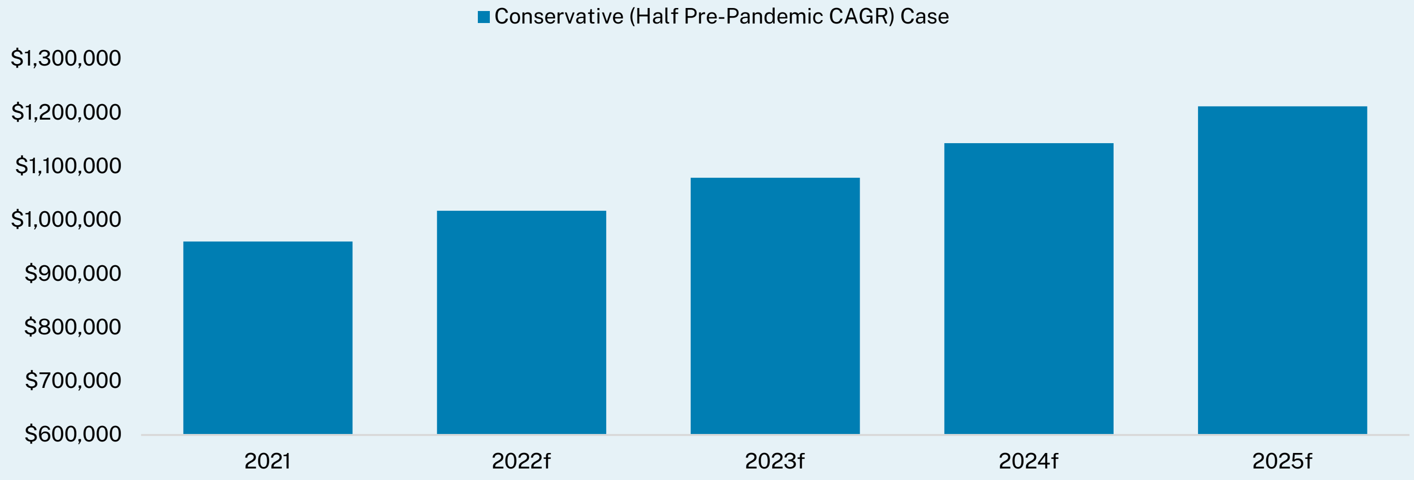
> **We believe e-commerce sales could conservatively create an additional 315 million sf of demand in the next five years.**

Source: American Realty Advisors based on data from Green Street Advisors, the U.S. Census Bureau and Macrobond as of June 2022. f=forecast.

Retail Sales Growth by Source and E-commerce Penetration Rate



E-commerce Sales Growth Projections (Millions)



DEVELOPMENT DELAYS POSITIVE FOR INDUSTRIAL

Sourcing issues and price volatility are delaying the delivery of new industrial product amidst record levels of absorption.

Weaker macro conditions and higher construction costs are expected to create a pullback in development in the near term, which could further fuel rental rate growth in the medium term.

> **Shovel-ready industrial projects may be met with pent-up demand even in the event of a macro slowdown.**

Average Entitlement and Construction Timelines, Select Markets, 2019 Versus 2022

Market	Average Entitlement Period (months)		Average Construction Period (months)		Change in Timeline (%)
	2019	2022	2019	2022	
Boston	7.5	13	11	15	51.4%
Chicago	6	9	9	18	80.0%
Central Pennsylvania	11.25	14.5	11.5	14.5	27.5%
Dallas	9	9	8.5	9.5	5.7%
Denver	6	9	9	11	33.0%
Houston	7.5	7.5	8.5	9.5	6.3%
Inland Empire	12	18	12	15	37.5%
Miami	7	9	8	8	13.3%
Northern New Jersey	12	12	10.5	13.5	13.3%
Seattle	8	12	12	13	25.0%

Note: Change in vacancy calculated as difference between Q1 2022 vacancy and Q4 2019 vacancy rate. Average entitlement and construction assumes site having zoning by right and a project size of 400,000 sf.
Source: American Realty Advisors based on data from Newmark and CoStar as of June 2022

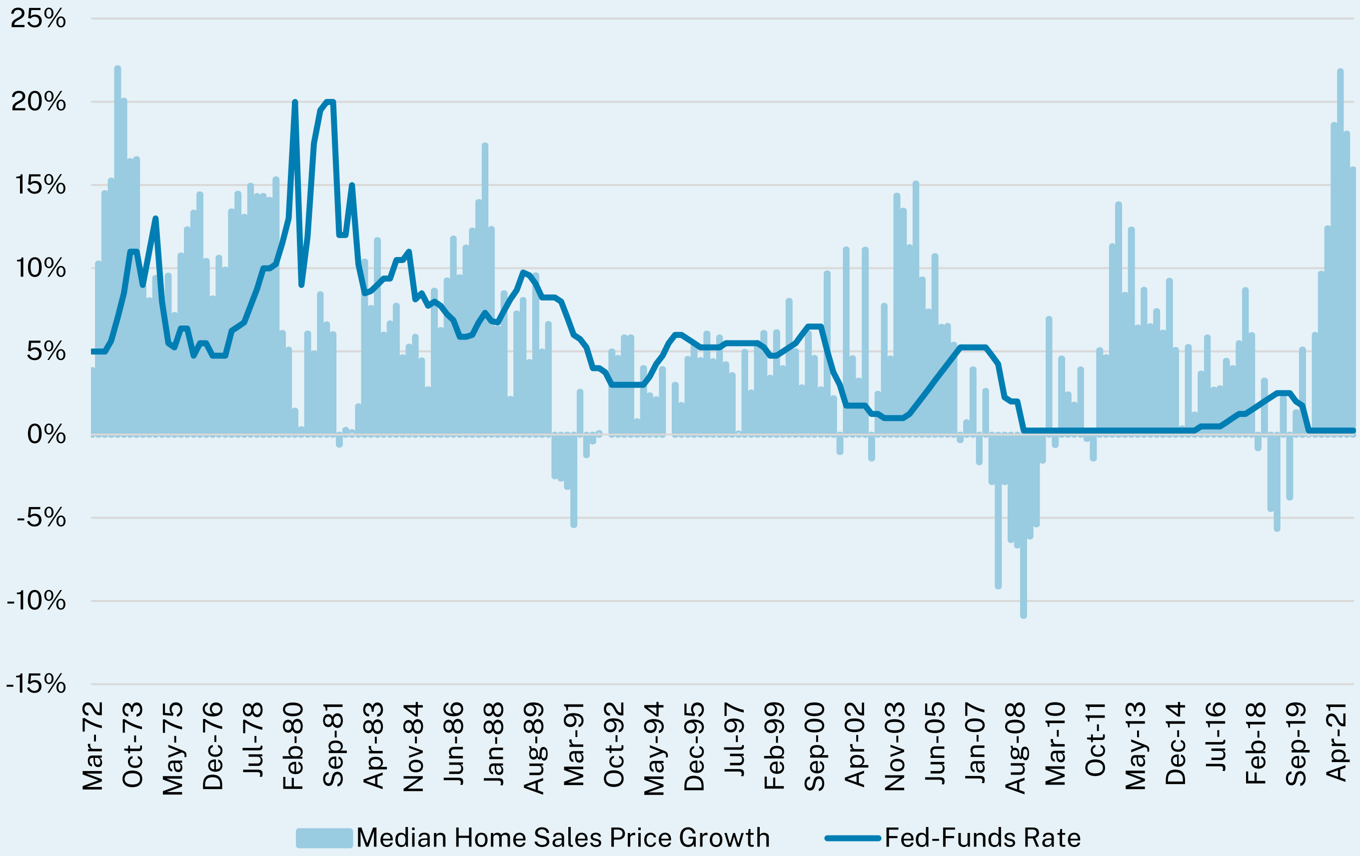
THE HOME SALES PRICE RESPONSE TO FED RATE HIKES

Higher interest rates have historically led to a slowing or contraction in the year-over-year pace of home price growth.

With multiple Fed hikes expected, we anticipate price growth to slow materially, though chronic supply imbalances will keep absolute prices high.

> **Home price growth will slow or reverse, but not enough to make buying affordable.**

Year-Over-Year Median Home Sales Price Growth vs. the Fed Funds Rate (1972 – 2021)



Source: American Realty Advisors based on data from St. Louis Federal Reserve Median Sales Price of Houses Sold for the United States and Macrobond as of June 2022.

RISING RATES MAKE HOME OWNERSHIP LESS ACCESSIBLE

Higher rates increase the monthly payment on a mortgage, meaning fewer households qualify for loans across price points.

Current owners may be less inclined to sell in the current environment given the likelihood of price reductions and the prospect of higher rates for their next home purchase, further constraining for-sale inventories.

> **Fewer and more costly homes will drive more households to rent, supporting rent growth.**

Source: American Realty Advisors based on data from John Burns Real Estate Consulting as of June 2022. Figures reflect a $400,000 home with 6% down payment, customary of first-time buyers.

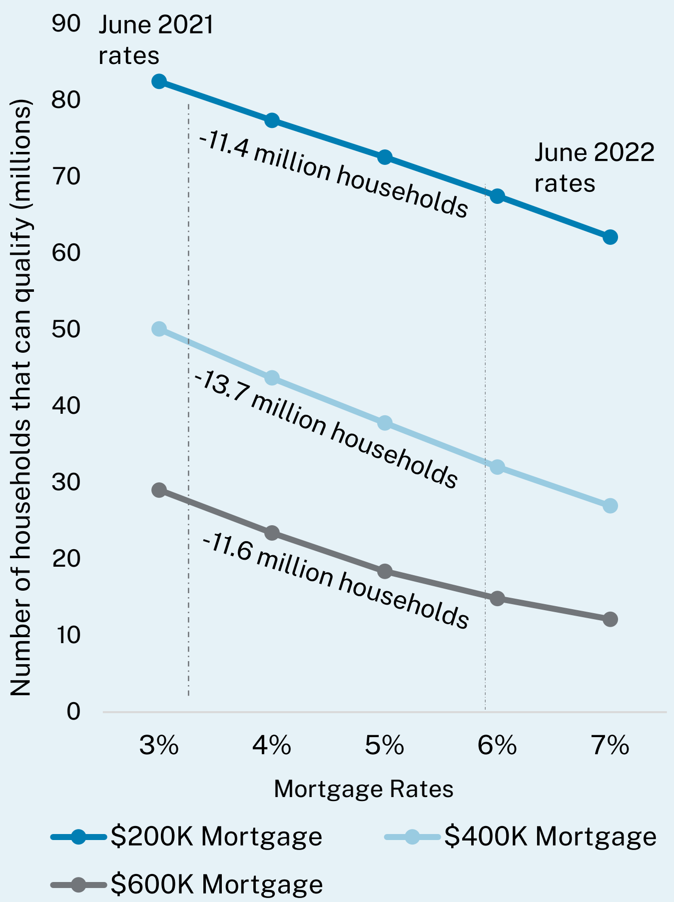
Number of Households Priced Out of a Mortgage By Price Point and Mortgage Rate

Mortgage Rate	Monthly Cost of Owning a $400K Home
2.0%	$2,247
3.0%	$2,443
4.0%	$2,653
5.0%	$2,876
6.0%	$3,112

30YR fixed rate June 2021: 2.96%

30YR fixed rate June 2022: 5.23%

+18% increase in ownership cost just from interest rate increase.



ABNORMALITY OF RECENT MULTIFAMILY RENT GROWTH

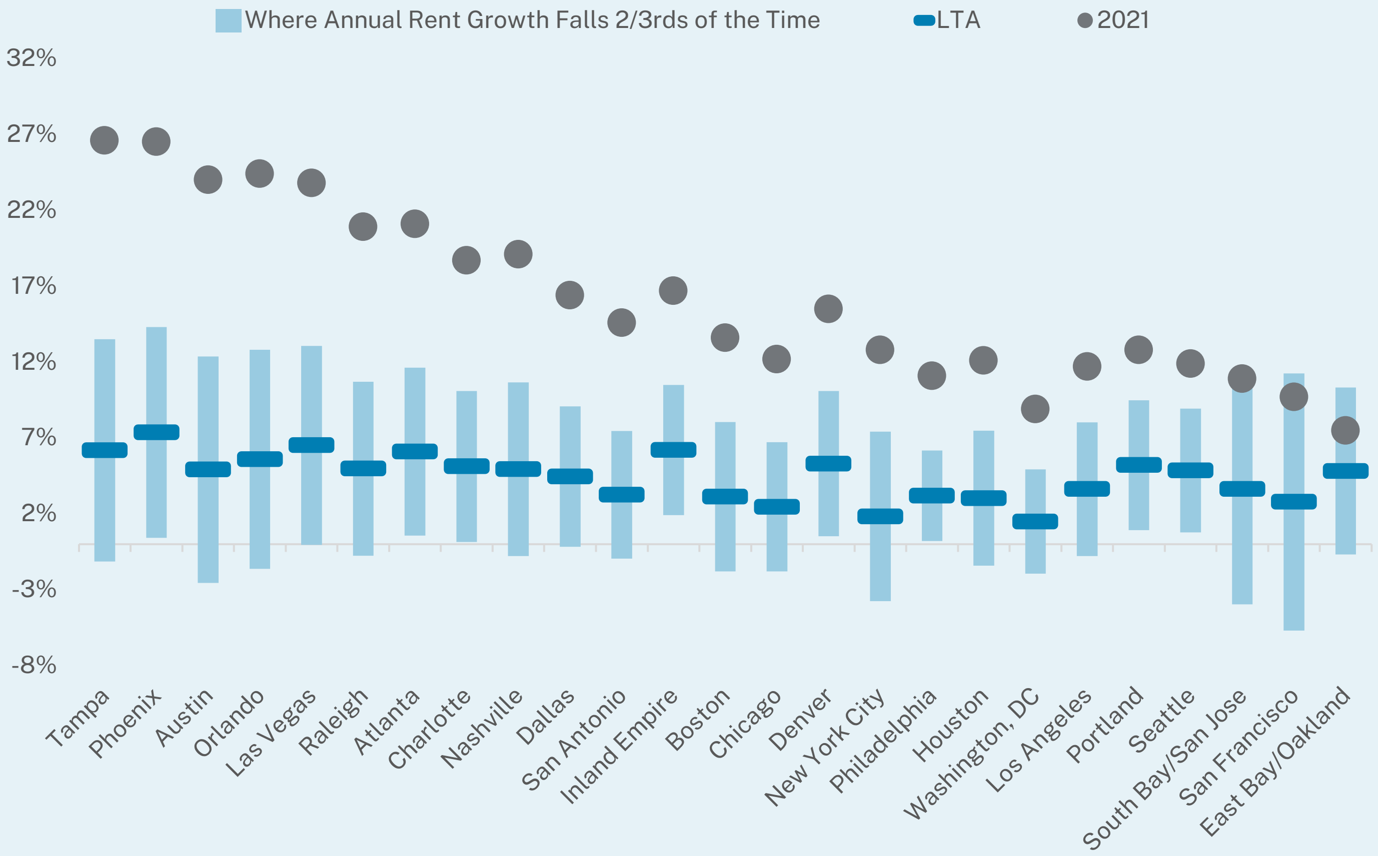
Recent rent growth has been abnormally robust, with some markets seeing growth 2.5 standard deviations above their long-term average.

These highs cannot last forever; managers should focus on markets with the greatest rent growth staying power.

In decelerating rent growth conditions, focus on markets with a longer runway to normal.

Note: LTA = Long-term average, 2012 - 2021
Source: American Realty Advisors based on data from CBRE-EA as of June 2022

Normal Rent Growth Ranges by Market (2012-2021)



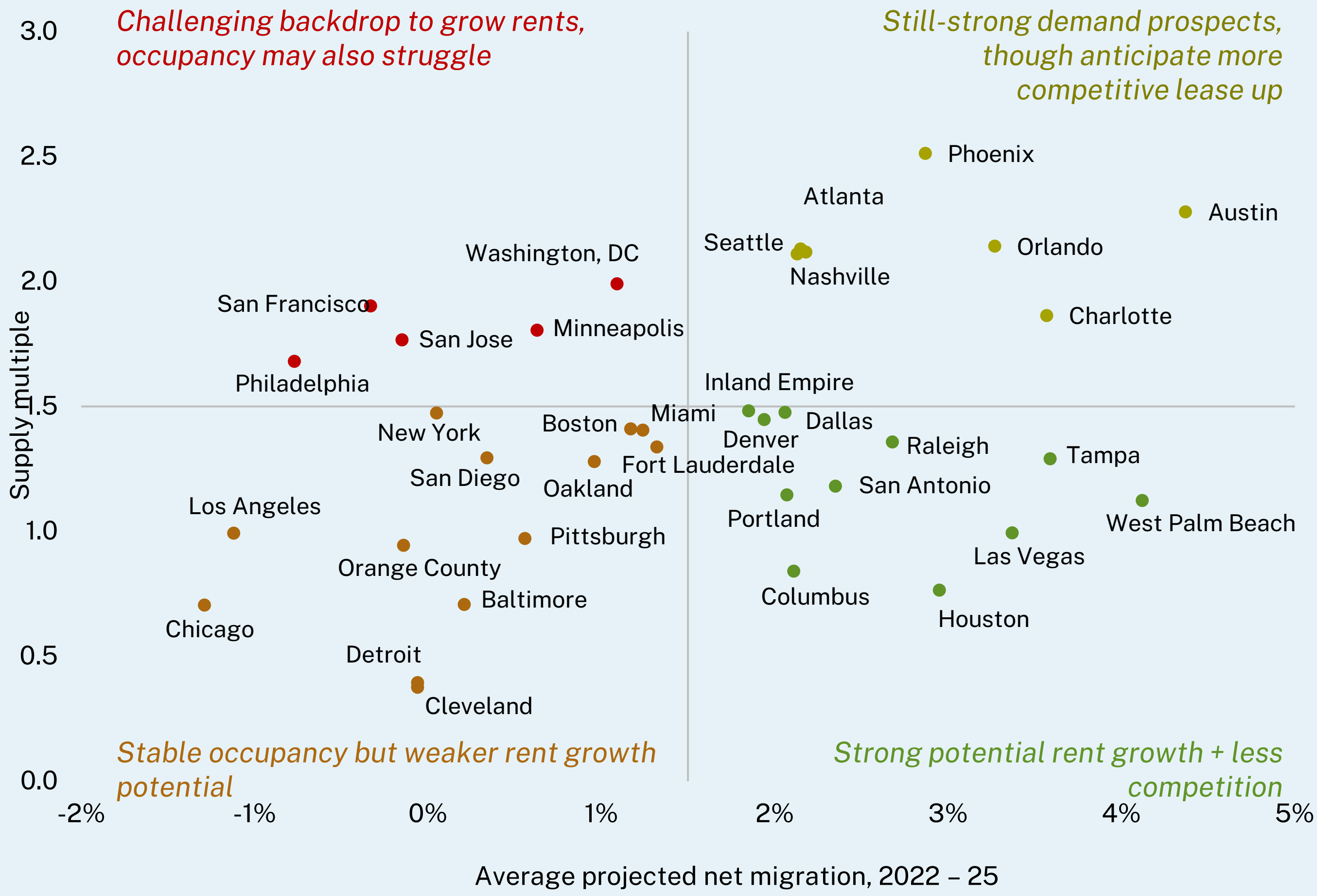
MULTIFAMILY SUPPLY COMES ROARING BACK

Multifamily construction has resumed after a pause during the pandemic.

Investors should anticipate a moderation in the pace of rent growth compared to recent highs, though by how much varies by market and depends on the amount of forthcoming supply relative to demand.

Markets in the two right quadrants have much more resilient rent growth outlooks.

Supply Under Construction as Multiple of T-24 Net Absorption and Per-Annum Projected Net Migration, 2022 – 25 (%)



Note: Horizontal and vertical lines represent the average across 69-market set. Supply multiple is calculated as the percent of units currently under construction relative to trailing 24-month net absorption.
Source: American Realty Advisors based on data from CBRE-EA, Oxford Economics and ESRI as of June 2022.

A CLEARER PICTURE OF HYBRID WORK EMERGES

80% of employees are reporting they are already in their post-COVID-19 working arrangements, working slightly more than two days per week from home.

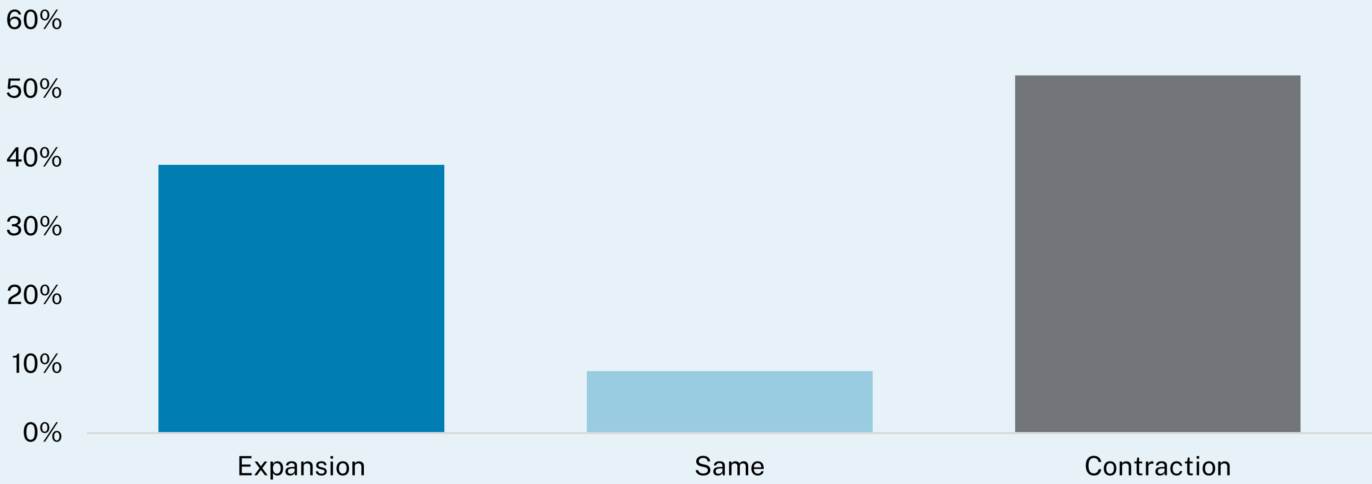
Employer plans also seem to confirm a hybrid model – three-days-in, two-days-out – will constitute the steady state for office going forward.

More than half of companies anticipate contracting their office square footage in the coming years; a recession could spur more corporate cost-cutting measures.

> **We may never see office sector occupancy return to pre-pandemic levels.**

Average Days/Week Working from Home Post-Pandemic: Employer Plans

Response: "Which of the following best describes your long-term expectations for total size of office square footage over next 3 years?"



Source: American Realty Advisors based on data from Survey of Working Arrangements and Attitudes (SWAA), WFHResearch.com and CBRE Spring 2022 U.S. Office Occupier Sentiment Survey as of June 2022

COMMUTE TIME A PREDICTOR OF RETURN-TO-OFFICE?

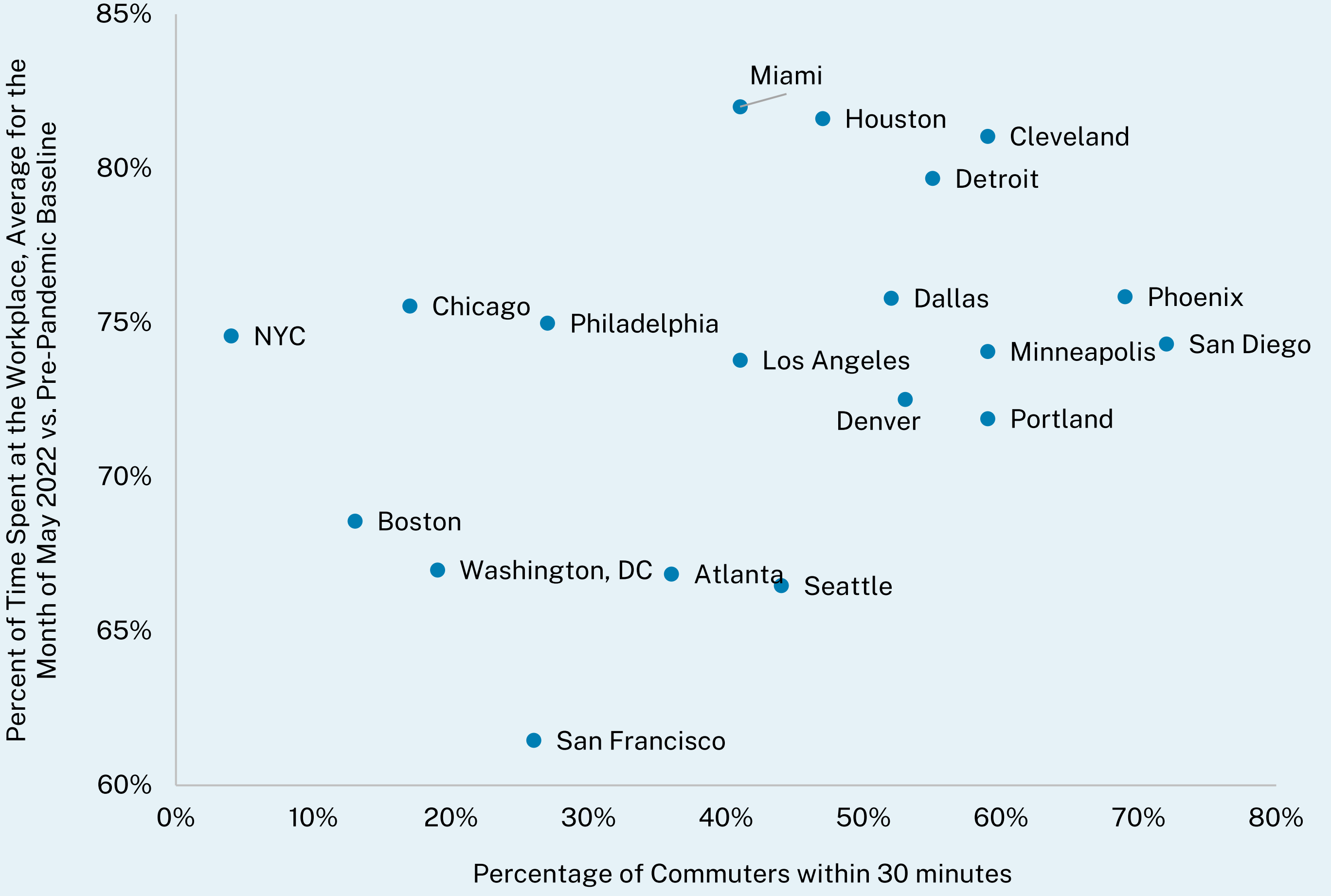
Some have hypothesized that metros with shorter average commutes may see stronger office recoveries.

Google Mobility data indicates this may not be a reliable predictor – in New York, less than 5% of workers are within a 30-minute commute of their jobs, in Dallas more than 50%; yet the percent of time spent in the workplace in both metros is virtually the same, 25% below pre-pandemic baselines.

> **We continue to recommend an underweight to all office – regardless of commute times.**

Source: American Realty Advisors based on data from GeoTab and Opportunity Insights Economic Tracker as of June 2022

Percent Of Commuters Within 30 Minutes Relative to Percent of Time Spent at the Workplace (May 2022)



OUTLOOK FOR PROPERTY SECTORS

With the economy expected to downshift in the near-term, property sectors with stronger structural drivers and less exposure to disruption offer a more insulated position today.

Although prices across sectors are likely to be impacted by broader capital market forces, fundamentals are much better positioned to withstand softening today than they were in prior cycles.

INDUSTRIAL

- Pace of e-commerce sales growth normalizing, but demand expected to persist.
- Extended development timelines expected to keep supply-demand favorably imbalanced.
- Ultra-low cap rates creating negative leverage in the sector – we expect this to translate to both lesser transaction activity and modest repricing.

RESIDENTIAL

- High absolute home prices and rising mortgage rates are pricing households out of the for-sale market, providing further tailwinds for rentals.
- Multifamily rent growth will eventually begin to normalize amidst an uptick in construction – net migration is a key driver of our market selection.

OFFICE

- The current hybrid approach, embraced by both employees and employers, seems to represent the new steady state.
- There's little correlation between time at work and commute; offices that are locationally synergistic with services and amenities have a better chance at enticing workers.

RETAIL

- Consumers are spending more on necessities, a positive for grocery-anchored centers but a negative for discretionary/experiential retail.
- An uptick in spending on credit cards is concerning from a macroeconomic standpoint.

SPECIALTY SECTORS

- Self-storage has greatly benefited from pandemic-induced migration trends, increasing investor demand in the sector.
- Low nominal monthly rates and the ability to reset rents monthly creates an opportunity to capture big percentage increases without sacrificing occupancy.

IMPLICATIONS FOR CORE AND VALUE-ADD STRATEGIES

With the economy expected to downshift in the near-term, property sectors with stronger structural drivers and less exposure to disruption offer a more insulated position today.

	Asset Management	Portfolio Construction
CORE	• Capture rental upside between renewals and new leases in most residential markets. • Drive NOI growth to outpace expense growth. • Push office occupancy with credit tenants now given expectation of future economic and sector-specific weakness.	• Lean into gap left by fewer leveraged buyers in sectors with stronger NOI growth prospects. • Continue to overweight sectors with secular drivers (industrial, single-family rental). • Selectively buy in high-demand short-lease sectors like residential and self-storage to capture inflationary upside in rates.
VALUE-ADD	• Execute leasing strategies by focusing on proactive marketing, efficient lease negotiations and competitive terms. • Actively manage operating expenses and evaluate bottom-line benefits for all major capital projects. • Mark-to-market rents at residential properties while carefully evaluating return on incremental capital renovations.	• Continue to target infill and last-mile industrial where supply-demand imbalance supports strong rent growth. • Pursue residential properties at or below replacement cost in markets/submarkets with strong population/job growth and low housing affordability. • Proactively source opportunities where market dislocation creates need for capital with favorable risk-return profile.

SUMMARY AND STRATEGY IMPLICATIONS

In this environment we continue to focus on secularly supported sectors, with an eye toward properties with the greatest inflation-hedging prospects.

- The persistence of above-target inflation is prompting a more forceful Fed response; cracks in the growth outlook increase the risk of a deeper policy-induced recession.
- Real estate has historically outperformed other asset classes during periods of elevated inflation, though pricing won't be immune to changes in the rate environment.
- Although e-commerce growth is expected to moderate and consumer conditions weakening, demand for industrial should continue to outpace supply, particularly if rising construction costs and delays hamper deliveries.
- Assets with strong demand drivers and shorter lease terms (self-storage, residential) that can capture inflation upside in rents are viewed as particularly attractive portfolio additions.
- Capital market dislocation may present opportunities for office and retail investments at attractive returns, but we continue to advise discipline and caution in these sectors given the fragility of occupier demand.

DISCLOSURES

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