Quarterly Market Review

4Q 2022

Union Square Capital

The 4th quarter of 2022 provided some much-welcomed relief for many asset classes. The S&P 500 posted a return of +7.56% for the quarter. Fixed income returns were also positive posting a return of +1.87% (Bloomberg U.S. Agg. Bond Index TR). Publicly traded REITs (as measured by the MSCI US Real Estate Index GR) moved in line with the broad markets, as they typically do in periods of volatility, posting a +5.22% return. Core private real estate (as measured by the NFI-ODCE NR) declined for the quarter posting a preliminary return of -5.13%, but still achieved a positive return for the calendar year of +6.59%. The strong positive return for the year is quite remarkable given that many investors had nowhere to hide with the significant drawdown in both public equities and fixed income. The resilience of core private real estate returns cannot be overlooked in times such as these. Diversifying into other asset classes, especially private markets, should continue to be a strategy considered by all investors.

The Federal Reserve's messaging that they want to bring down inflation at all costs continues to wreak havoc across public equity and fixed income markets. Although the Fed has acknowledged that their policy change seems to be working as headline inflation eases, they are now laser focused on the tight labor market and want to see signs of it loosening before they declare victory. The good news for rates is that we may in fact be seeing signs that the labor market is beginning to soften, though not to a point that would resemble many hardships as we have seen in previous downturns. A number of large companies have announced layoffs and we have seen wage growth ease as of the last jobs reports. We remain cautiously optimistic that the Fed will end its rate hiking campaign by the middle of 2023, and we will not face a deep recession. In regard to longer dated interest rates, the 10-yr Treasury is now at about 3.5%, well off its high of about 4.2% from a few months ago. We expect this trend down in interest rates to continue as long as we continue to see inflation easing.

As it relates to private commercial real estate, we continue to believe the asset class remains well-positioned in the current environment. Returns were negative this quarter primarily as a result of cap rates expanding to account for higher interest rates. It should be noted that cap rates and discount rates had been rising throughout the year, however increasing rent growth from strong tenant demand largely offset the majority of the cap rate expansion until this quarter. While rent growth is still strong, it has moderated from the very high levels that we saw a year ago, as expected. Additionally, it is important to mention that cap rates have expanded mainly due to the move in interest rates – which have pushed financing rates up and significantly slowed transaction volume. However, we are not seeing distressed selling in the commercial real estate market. Many owners of real estate are simply holding the assets as rents rise and limited market activity makes it difficult to assess comparable sales. That said, as most properties in the NFI-ODCE index are appraised each quarter, appraisers are taking a prudent approach by increasing cap rates which has resulted in modest decreases in values. Importantly, though appreciation has turned slightly negative recently, the operating fundamentals in commercial real estate remain incredibly strong, including occupancy, net operating income (NOI) growth, and supply/demand dynamics.

While we certainly can't predict the future, we want to provide some color on our expectations of returns as we move into the new year. If the Fed continues down the path of combating inflation by raising interest rates, we expect the first quarter may again result in a relatively smaller negative return as cap rates continue to push higher and outweigh continued rent growth. In other words, we believe the majority of the declines are now behind us barring any exogenous events. By the second half of this year, we expect total returns of core private real estate to normalize to their long-term historical trend of 6-8% annually. Furthermore, if we see a reversal in interest rates, it may be a period in which real estate again posts above average returns as cap rates could compress once there is some level of clarity in the markets. As a reminder, through most economic environments, private core real estate has generally delivered consistent positive returns. The only times we have seen significant drawdowns are when markets are oversupplied and over leveraged, neither of which are true today. As such, high quality commercial real estate in well-located markets remains in high demand.

Finally, with the national media talking so much about shareholder redemptions in the largest non-traded REITs, we would be remiss if we did not address investor flows in this commentary. We have not experienced substantially higher redemptions in recent quarters. That said, if elevated requests are received, interval funds are designed to protect all shareholders by limiting redemptions on a quarterly basis to 5% of fund assets. One notable difference between our approach and that of many other

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private real estate offerings is that we focus our asset raising efforts within select channels that have historically been long term investors. We believe this focused approach allows us to educate investors before entering the space with the understanding that the benefits of private real estate investing are primarily achieved by investing throughout the entire cycle, rather than trying to time the asset class.

Below is a brief summary of performance by property type:

INDUSTRIAL properties' return were negative for the quarter. We saw cap rate expansion especially for assets that have longer dated leases. The demand for industrial properties continues to outpace supply and we believe industrial assets will continue to deliver above average returns in future years.

MULTI-FAMILY returns were mixed as cap rates increased. Rent growth persists but it has moderated from the historically high levels experienced last year. The supply-demand dynamics for housing in the U.S. continues to make this sector attractive from a longer-term perspective. These supply-demand fundamentals are likely to persist as many potential homebuyers are not able to purchase homes with residential 30-year fixed rate loans at multi-year highs and housing prices still at elevated levels.

OFFICE properties were negative for the quarter as cap rates continued to expand, keeping with the trend for the sector going back to 2020. In select markets, however, leasing activity has begun to pick up. Furthermore, many companies continue to implement return-to-office plans as employers seek a balance in productivity and flexibility with many high-profile technology companies strongly encouraging a return to the office.

RETAIL properties continue to experience meaningful increases in NOI. Returns were slightly down but overall the sector performed well on a relative basis for the quarter.

SPECIALTY: We continue to see strong demand from institutional investors for more specialty type property sectors such as self-storage, life science, and single-family residential. As with the other sectors, we saw increased pressure on cap rates but again believe that over the long term these assets will be accretive to returns.

WHY ARE SOME PRIVATE REAL ESTATE VEHICLES GATING?

As it has been plastered across major news stations, and in most cases characterized inaccurately, that the largest non-traded REITs have limited shareholder redemptions in this period of volatility, we wanted to provide our thoughts. First and foremost, while the media reporting may lead some to believe there is a systemic problem in commercial real estate, we believe that is simply not the case. In fact, we are very constructive on the space and believe the fundamentals underlying commercial real estate remain strong and will likely remain strong for the foreseeable future. Second, before investing in private real estate, it is important to remember that the ability to gate is for the protection of all shareholders and should not be viewed negatively simply because a gate was enacted. Often times, investors are better off staying the course which has been illustrated time and again throughout academic literature. Finally, as part of due diligence, before entering a private real estate vehicle (interval fund, private fund, non-traded REIT), investors should understand the terms of the product but also understand who else is investing in the vehicle, which is frequently overlooked. Understanding other investors' historical reactions throughout market cycles can help investors make prudent decisions for which strategies they would like to utilize and what to expect with regard to liquidity in times of market stress.

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Definitions:

Cap rate represents the rate of return based on the income that the property is expected to generate.

Bloomberg U.S. Aggregate Bond Index is an unmanaged market value-weighted index for U.S. dollar denominated investment-grade fixed-rate debt issues, including government, corporate, asset-backed, and mortgage-backed securities with maturities of at least one year.

MSCI U.S. REIT Index is a free float-adjusted market capitalization index that is comprised of equity REITs. With 129 constituents, it represents about 99% of the US REIT universe and securities are classified in the Equity REITs Industry (under the Real Estate sector) according to the Global Industry Classification Standard (GICS®). It however excludes Mortgage REIT and selected Specialized REITs.

NCREIF Fund Index — Open-end Diversified Core Equity (NFI-ODCE) consists of private real estate equity funds that meet certain criteria with respect to such things as leverage (less than 35%), operations (at least 75% invested in properties that are 75% or more leased), sector and geographic diversification, and investment in core real estate (at least 75% in office, industrial, apartment and retail properties).

S&P 500 Index is a market capitalization-weighted index of 500 common stocks chosen for market size, liquidity, and industry group representation to represent U.S. equity performance.

Past Performance is no guarantee of future results. One cannot invest directly in an index.

Risk Disclosures

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