4Q 2022 Report

Since 1931, the most trusted investment analysis in the commercial real estate industry.

Holding Pattern

SitusAMC

With high interest rates continuing to rattle the capital markets, investors are in a holding pattern as they wait to see how higher interest rates and potentially slowing economic growth change pricing, transaction activity and space market conditions of the commercial real estate (CRE) market.

The market euphoria of 2021 and 2022 has come to an end. Returns fell into negative territory in fourth quarter and CRE yields over the 10-year Treasury are the narrowest since the GFC. Our on-the-ground intel suggests further retreat in valuations in the first quarter. Transactions have stalled and CRE remains in a period of price discovery. The few transactions that are taking place are skewed in a dumbbell pattern, distress and special-story high valuation properties, providing little guidance as to where prices stand.

Economic and geopolitical uncertainty abounds. Still, space market fundamentals for most segments have not shifted much, with some segments very healthy and others still floundering from longer-standing problems. The mix of capital market turbulence, economic uncertainty and secular headwinds to some property segments have investors in a holding pattern, with our data showing the highest call for hold and the lowest level for either buy or sell on record.

Rising interest rates are at the heart of the challenged capital markets. The Fed raised rates seven times in 2022 and again in January of 2023 to the highest level since 2007. In the second half of 2022 the Fed was the most aggressive in raising rates than it has been since the early 1980s. The 10-year Treasury rate reached a peak of 4.25% in October 2022, a 14-year high. The rate stayed in about the 3.5% to 3.8% range from November to February, but rose above 4.0% on March 1.

While inflation has recently started to cool, all major inflation indices remain near 40-year highs. In addition, the labor market remains resilient with the unemployment rate the lowest in over 50 years. The combination of a tight labor market and hot inflation will likely lead the Fed to continue its rate-hiking policy. With economic uncertainties, low liquidity and the high cost of capital, lenders are being cautious, and capital remains constrained. Investor ratings of the availability of capital was the lowest since the GFC; underwriting standards were also the most restrictive since the GFC.

Fourth quarter NCREIF NPI overall CRE total returns fell by over 400 bps into negative territory for the first time since the onset of the pandemic. Total returns were the lowest since the GFC, as was capital appreciation. Returns for the apartment, industrial and office segments were the lowest since the GFC; retail was the lowest since the start of the pandemic. Hotel was the only sector to earn a positive return in fourth quarter.

Capital markets slowed again in fourth quarter with substantial YoY declines in transaction volume for all property types, as measured by MSCI Real Assets. Since the Fed embarked on its aggressive tightening last June, CRE transactions have fallen 79%. Apartment fared the worst among the property types with a 82% decline since June, coming down from the 2021 and early 2022 boom in multifamily transactions. Retail was the best among the segments, but still down 76%. Industrial and office volume slowed by about 80%.

Property prices have also declined since the Fed's aggressive tightening began, by 7.5%. Following the run-up in prices in 2021 and early 2022, apartment has been hit hardest with a nearly 10% drop in prices since June. Retail and office prices are down by over 3%; industrial prices have stayed relatively steady. However, with the dearth of deals, property signals remain weak.

While property type fundamentals for most property types are waning from their fervent pace over the last couple of years, they have not shifted as dramatically as capital market conditions. Industrial continues to see strong demand from investors and tenants, with low vacancy and healthy rent growth, though there has been some easing from the red-hot demand of recent years. Retail occupancy remains steady amid minimal completions. Rent growth remains strong for apartments amid limited supply, but the double-digit post-pandemic increases have abated. Fourth quarter hotel fundamentals were weak relative to records set earlier in the year but are historically strong. Unsurprisingly, office demand conditions to deteriorate amid the sector's secular changes and the onset of cyclical headwinds, especially form layoffs in the tech sector. Still the segment eked out positive rent growth in the fourth quarter.

Investor sentiment for the CRE asset class continues to sour as they come to terms with market challenges. After dropping for the fourth consecutive quarter, investor preference for the CRE asset class reached the lowest in history, according to RERC data. Not all is doom and gloom. Though economic uncertainty and the possibility of a recession are major risks in the near-term for CRE, investors note that the asset class is more protected from inflation and the long-term outlook for the asset class is positive.

01

CAPITAL MARKET VALTRENDS

Capital Markets Chaos Erodes CRE Sentiment

Economy & Financial Markets

GDP increased at an annual rate of 2.7% in the fourth quarter of 2022 (second estimate), slowing from third quarter's rate of 3.2%. The increase in the fourth quarter primarily reflected increases in inventory investment and consumer spending that were partly offset by a decrease in housing investment. The overall increase in consumer spending was driven by an increase in services that were partly offset by a decline in goods.

The labor market continues to be strong. Ticking up 20 bps from a more than 50-year low in January, February's unemployment rate was 3.6%, slightly higher than at the start of the pandemic, but about 200 bps above the long-term average (LTA). The labor force participation rate (LFPR) was 62.5% in February, 10 bps higher than January, but 80 bps lower than the pre-pandemic rate.

Inflation may have peaked but remains near 40-year highs. The consumer price index (CPI) slowed throughout fourth quarter from 8.2% in September to 6.4% in December. January's rate of 6.3% was the lowest since October 2021. Core CPI, which excludes food and energy, also eased in

CRE & Investment Alternatives

	2022[6]	3-Year Trailing	5-Year Trailing	10-Year Trailing	15-Year Trailing
NPI[1]	5.5%	8.1%	7.5%	8.8%	6.5%
NFI-ODCE[1]	6.5%	9.0%	7.7%	9.1%	5.3%
NAREIT Index (All Equity REITs)[2]	-24.9%	0.2%	4.4%	7.1%	6.6%
Consumer Price Index[3]	7.1%	5.0%	3.8%	2.6%	2.3%
Dow Jones Industrial Average[2]	-6.9%	7.3%	8.4%	12.3%	9.0%
Nasdaq Composite[4]	-33.1%	5.3%	8.7%	13.2%	9.6%
NYSE Composite[4]	-11.5%	3.0%	3.5%	6.0%	3.0%
S&P 500[2]	-18.1%	7.7%	9.4%	12.6%	8.8%

	4Q 2022	4Q 2021	4Q 2019	4Q 2017	4Q 2012	4Q 2007
10-Year Treasury Bond[5]	3.8%	1.5%	1.8%	2.4%	1.7%	4.3%

[1]NCREIF NPI is a property-level (unleveraged) total return index, gross of fees; NCREIF NFI-ODCE is a fund-level (leveraged equity) total return index, net of fees.
[2]Based on total return index, and includes the dividend yield.
[3]Based on the published data from the Bureau of Labor Statistics (seasonally adjusted).
[4]Based on price index, and does not include the dividend yield.
[5]Based on average quarterly T-bond rates.
[6]Averages are not compounded annually except for CPI and NAREIT.
Sources BLS, Federal Reserve Board, S&P, Dow Jones, NCREIF, NAREIT, compiled by SitusAMC Insights, 4Q 2022.

fourth quarter from 6.6% in September to 5.7% in December. Core CPI again decreased in January to 5.5%. The core personal consumption expenditures (PCE) price index, the Fed's preferred inflation measure, slowed from 5.2% in September to 4.6% in December. However, it ticked up in January to 4.7% driven by an increase in the price of services.

The combination of a tight labor market and hot inflation will likely lead the Fed to continue its rate-hiking policy. The Fed raised rates seven times in 2022 and again in January of 2023. The federal funds rate was up 450 bps in January from a year prior and the highest rate since 2007. The 10-year Treasury rate reached a 14-year high of 4.0% in October 2022 and ended the year at 3.6%. The rate dipped by 10 bps to 3.5% in January but was still among the highest rates in over a decade. The 10-year rate resumed its ascent in February and topped 4% on March 1.

Though generally increasing throughout the fourth quarter, the Dow, S&P 500, and Nasdaq indexes all posted their largest annual losses since 2008 in 2022. With stubbornly high inflation and aggressive rate hikes, the Dow, S&P 500 and Nasdaq were down about 9%, 19% and 33% in 2022, respectively. Stocks gained strength in January, with the Dow up 1.1%, the S&P 500 up 1.5% and the Nasdaq up 1.7% but fell in February. February 24 marked the worst week in 2023 for stocks, With major averages down about 3.0%.

Spreads between RERC real estate yields and the 10-year Treasury and corporate bonds compressed QoQ, with the increase in bond rates outpacing the increase in real estate yields.

The fourth quarter CRE yield over 10-year Treasury spread was the narrowest since 3Q 2007, just prior to the GFC, and almost 210 bps below the LTA.

Fourth quarter real estate yield spreads over corporate bonds were narrowest since the GFC. The CRE yield over Moody's Baa and Moody's Aaa spreads were 150 bps below their LTAs.

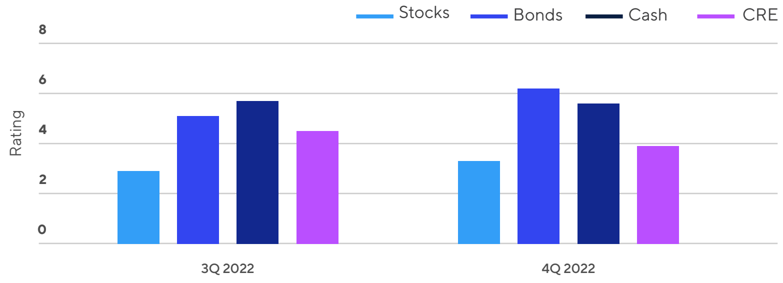
CRE & Investment Alternatives

After dropping for the fourth consecutive quarter, investor preference for the CRE asset class reached the lowest in history, according to RERC data. Though investors note that CRE is more protected from inflation and the long-term outlook for the asset class is positive, economic uncertainty and the possibility of a recession are major risks in the near-term.

Meanwhile, the preference for bonds increased substantially QoQ to the highest level in history and was the highest rated of the asset classes. According to investors, bonds are low risk in the current uncertain environment and the high base rates result in equity-like return on debt investments.

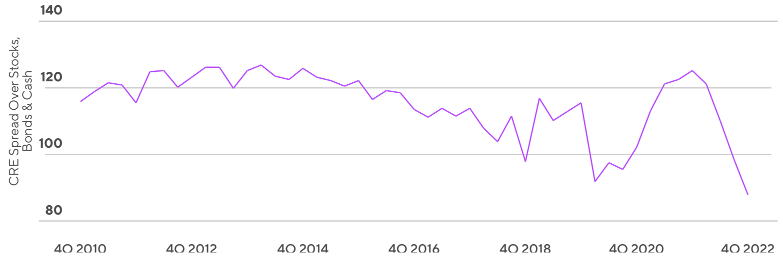
> "CRE's day is likely 12-18 months out after the reckoning of 2023. Ouch."
>
> - INSTITUTIONAL INVESTOR

Ratings of Investment Alternatives



Ratings are based on a scale of 1 to 10, with 10 being excellent.
Sources: RERC, SitusAMC Insights, 4Q 2022.

CRE Attractiveness Index[1]



[1]The RERC Attractiveness Index shows CRE investors' changing preferences for CRE over the traditional asset classes. The baseline of 100 indicates that investors feel traditional assets and cash, on average, are as attractive as CRE. Sources: RERC, SitusAMC Insights, 4Q 2022.

Market uncertainty is causing concern for investors. Institutional investor preference for stocks increased QoQ, but remains the second-lowest rating in history, following the previous quarter's record. Stocks were the least favored asset class among investors. Stock prices typically move downward when interest rates rise and with the Fed signaling that on-going rate hikes will be necessary, we may see this rating decline next quarter.

Investors state that market uncertainty will precipitate holding cash. Cash is the safest option; it can provide liquidity until the market stabilizes. The preference for cash and cash equivalents declined slightly in the fourth quarter but remained an above-average investment alternative.

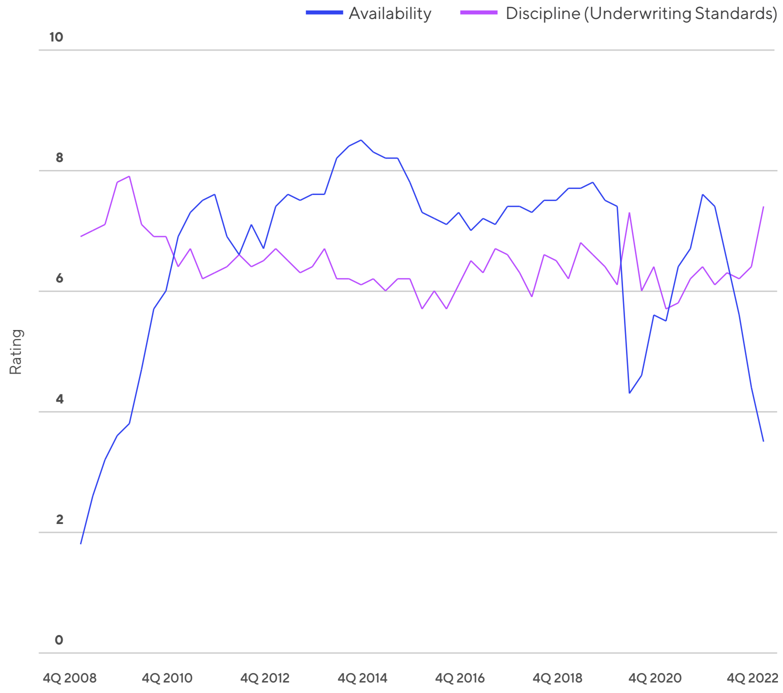
Availability & Discipline of Capital

With interest rates the highest since 2007, the availability of capital (equity and debt combined) dropped for the fifth consecutive quarter to the lowest level since the GFC. With a significant quarterly jump, underwriting standards were rated as the most restrictive since the GFC. Investors remark that lenders and investors are being more cautious due to economic uncertainties, low liquidity and the high cost of capital.

Both equity and debt capital continued to dry up in fourth quarter to the lowest levels since at least 2014 when RERC began collecting data on debt and equity capital separately. Debt availability remained more constrained than equity. Underwriting standards tightened for debt and equity capital, with both reaching record highs.

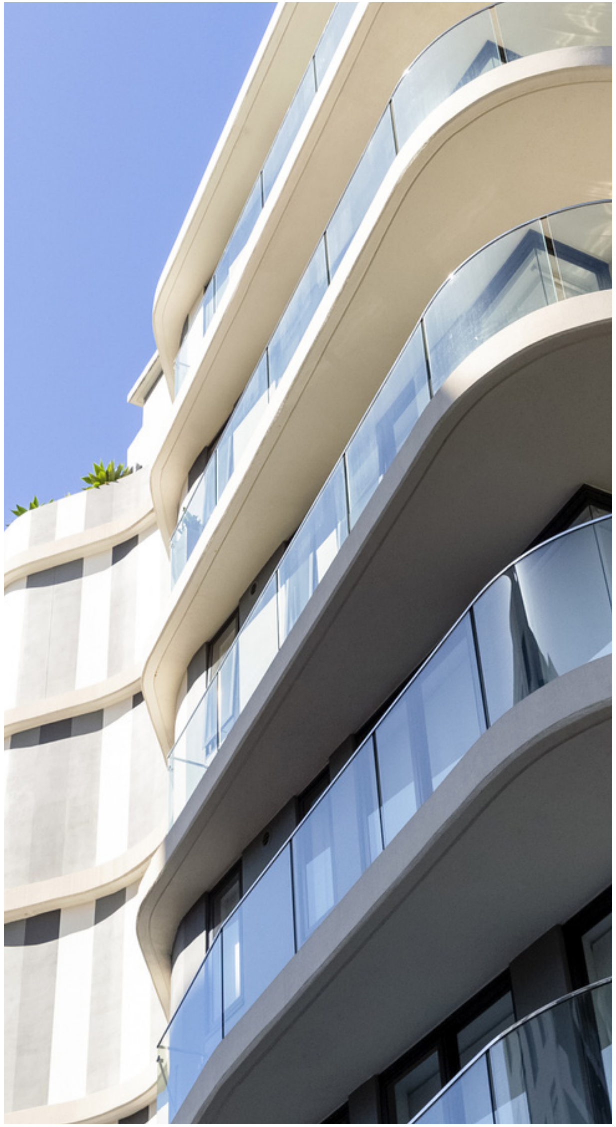
> "Lenders [were] basically pencils down for the 4th quarter."
>
> - EAST REGION INVESTOR

Historical Availability & Discipline of Capital – Equity & Debt Combined

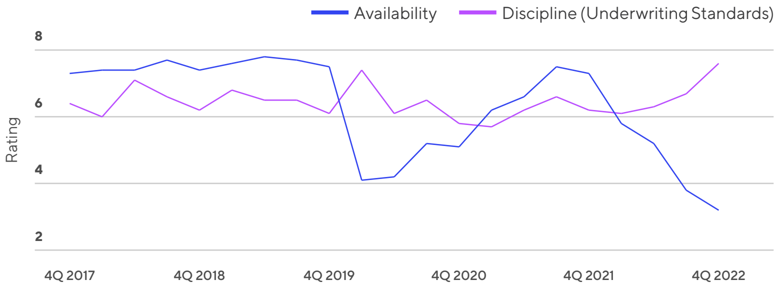


Availability ratings are based on scale of 1 to 10, with 10 being plentiful.
Discipline ratings are based on a scale of 1 to 10, with 10 being extremely restrictive.
Sources: RERC, SitusAMC Insights, 4Q 2022.

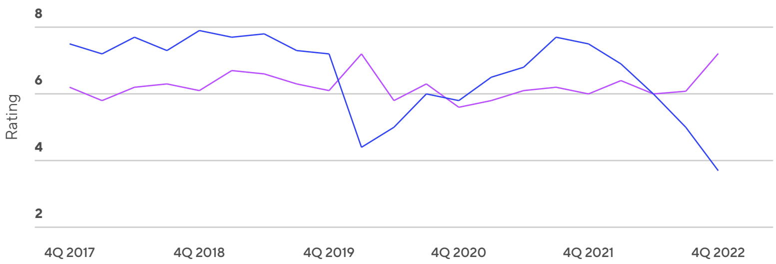
Concerns about a potential recession has many lenders pulling back; investors note that it has become very difficult to secure debt, and that debt is expensive. Also, underwriting standards are getting tougher with the rising cost of capital so investors are having to provide more equity and returns are dropping. Lenders are hyper-focused on the credit worthiness and liquidity of borrowers, debt service coverage ratios and the quality of assets.



Historical Availability & Discipline of Capital – Debt



Historical Availability & Discipline of Capital – Equity



Availability ratings are based on scale of 1 to 10, with 10 being plentiful.
Discipline ratings are based on a scale of 1 to 10, with 10 being extremely restrictive.
Sources: RERC, SitusAMC Insights, 4Q 2022.

CRE Returns, Volume & Pricing

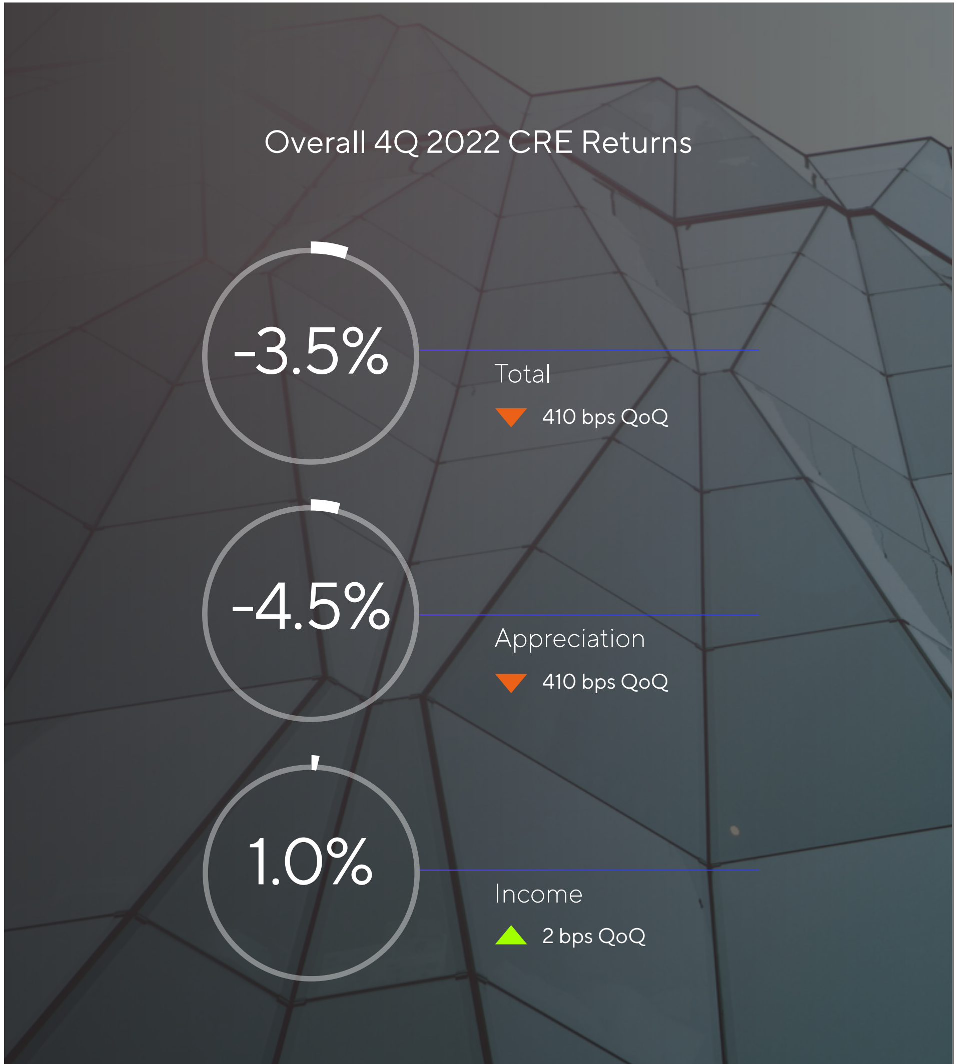
Returns

Fourth quarter NCREIF NPI overall CRE total returns fell by over 400 bps into negative territory for the first time since the onset of the pandemic. Total returns were the lowest since the GFC, as was capital appreciation. Income returns were the second lowest in history, just 2 bp above last quarter's record low. One-year trailing total returns were 5.5%, down over 10.5 percentage points QoQ and about 370 bps below the LTA.

Increasing almost 70 bps QoQ, hotel was the only property segment with positive returns in fourth quarter. Hotel's quarterly return was the highest in one year and nearly 210 bps higher than the LTA. One-year trailing returns were about 10%, about 425 bps higher than the LTA.

Apartment returns tumbled by over 440 bps in fourth quarter, turning negative for the first time since 2Q 2020, according to NCREIF. Returns were the lowest since the height of the GFC. One-year trailing returns topped 7%, about 160 bps higher than pre-pandemic levels, but 220 bps below the LTA. All apartment subtypes had negative returns in fourth quarter, with high-rise apartments performing the worst.

Industrial returns tumbled almost 470 bps to -3.6% in fourth quarter. It was the first quarter of negative returns since the GFC. All industrial subtype returns were negative, except for manufacturing; warehouse and R&D were the worst performing major subtypes. The industrial segment produced a one-year trailing return of 14.6%, far below



Sources NCREIF NPI, SitusAMC Insights, 4Q 2022.

the records seen over the past two years, but still 220 bps above the LTA. The one-year trailing return will continue to slow as we move away from the hyper-strong quarters of late 2021 and early 2022.

Retail returns declined by 200 bps QoQ to -1.6%, negative for the first time in two years and the lowest since 2Q 2020. One-year trailing returns were 2.7%, over six percentage points below the LTA. All retail subtypes were negative in the fourth quarter; fashion/specialty was the highest performing segment and regional malls performed the worst.

Office was the poorest performing segment in fourth quarter. At -4.8%, office returns were the lowest since 2Q 2009, dropping over 400 bps QoQ. One-year trailing returns were -3.4%, also the lowest since the GFC. Suburban office outperformed CBD office as it has since the beginning of the pandemic, but both subtypes had the lowest returns since the GFC.

Volume

Capital markets slowed again in fourth quarter with substantial YoY declines in transaction volume across all major property types. Fourth quarter overall CRE transaction volume, as measured by MSCI Real Assets, was $139 billion, a 62% decrease YoY and a 25% decline from the previous quarter. Transaction volume was about $730 billion for the year, a 15% drop from the record-breaking amount in 2021.

Apartments accounted for the greatest amount of total deal volume in fourth quarter at 36%. Quarterly volume declined by almost 70% YoY to about $50 billion. It was the lowest quarterly deal volume since first quarter 2021 but about 75% greater than the LTA. At $294 billion, 2022 apartment volume was the second largest in history, trailing only last year's record performance.

Industrial was the second most active segment (24% of total volume), transacting over $33 billion in fourth quarter, a 58% decrease YoY but still more than double its LTA.

Annual industrial volume surpassed $151 billion in 2022, a 15% decline YoY, but the second highest level on record.

Office volume was $19.6 billion in fourth quarter (14% of total volume), a 65% decrease YoY, the lowest since third quarter 2020 and almost 25% below the LTA. At $110.5 billion, 2022 office volume was down 25% YoY, but above the LTA by about $8 billion.

Retail deal activity slowed 57% YoY in fourth quarter to just over $16 billion and comprised 11.7% of total volume. However, fourth quarter activity was still 13% higher than its LTA. Deal activity in 2022 was $85.7 billion, a 4% increase YoY. It was the only property segment with an increase in transactions in 2022.

Hotel volume declined by 19% YoY in fourth quarter to about $11.7 billion (8.4% of total volume). Still, fourth quarter activity was 42% above the LTA. Hotel deal activity ticked down 1% YoY in 2022 to a little over $46 billion. It was the fourth most active year for hotel since 2005, According to MSCI Real Assets data.

Pricing

Higher interest rates and substantial declines in transaction volume took their toll on property prices in the fourth quarter. The National All-Property RCA CPPI, a gauge of property prices, was up 0.9% YoY in December, the weakest annual growth since the beginning of 2011. Prices declined every month between their peak in July and December, falling 3.2% during those five months. This is a similar pace of decline during the GFC, when it took four months to fall 3.1%. However, because of the sharp run-up in prices in 2021, overall CRE market pricing is up over 28% since the pandemic began.

Prices in the six major metros declined by 2.1% YoY, the largest YoY loss for the six major markets since 2010. Price growth for the non-major markets grew 2.6% YoY. Prices are down from their peak in August by 4.0% and 2.3% for major and non-major metros, respectively.

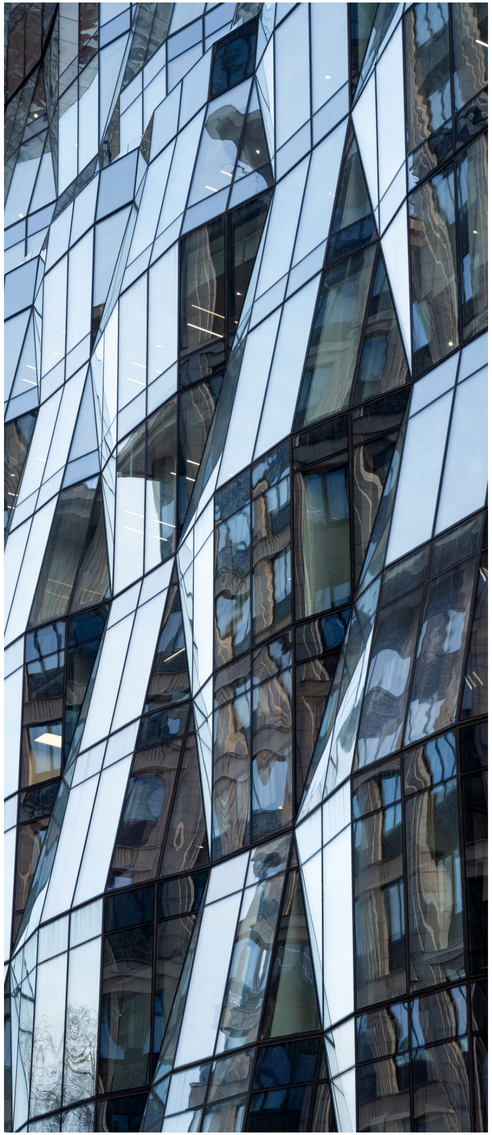
Industrial led the way in YoY price growth, with a 12.2% YoY increase. Industrial prices have grown each quarter since the onset of the pandemic; fourth quarter prices were up a whopping 55% from December of 2019. However, the monthly pace of industrial price growth has decelerated every month since its peak in October 2021, from 2.4% to 0.5% in December 2022.

Hotel price growth was over 6% YoY in December, the second highest growth among the property types. Hotel prices fell by 2.9% QoQ at the onset of the pandemic, reaching a pandemic trough by 2Q 2020. Prices have risen every quarter since; price growth was particularly strong throughout 2021. Hotel prices are up 28% from the 2Q 2020 trough.

Retail notched a 3.1% price gain YoY, the slowest rate of growth since March 2021. Retail prices peaked in July and have since fallen 1.9%. By comparison, it took about three months for prices to fall by 1.9% during the GFC. Unlike other property types, retail took value hits in 2020. Still prices are up 21% from the onset of the pandemic.

The overall office segment had a 2.9% YoY increase, the weakest growth in two years. From their peak in September, prices declined by 0.8%. The pace of this decline was similar to the rate during the GFC. The only property type with a December YoY decline in prices was CBD office. Prices fell 2.1% YoY in December, the biggest decline in prices since March 2021. December marked two months of price declines for CBD office, but current prices are about 2% higher than they were pre-pandemic. Suburban office prices grew 4.1% YoY, but were down 0.7% from their October peak. Suburban office prices have held up well during the pandemic, increasing by 22%.

Apartment posted a mere 1.8% YoY growth rate in December, the weakest among the property types. Prices were down almost 6% from their peak in July. This is remarkable, given that it took a little over a year for apartment prices to decline by the same amount during the GFC. Still, the exceptional rise in values during 2021 and early 2022 led to a pandemic growth rate in apartment prices of 34%.



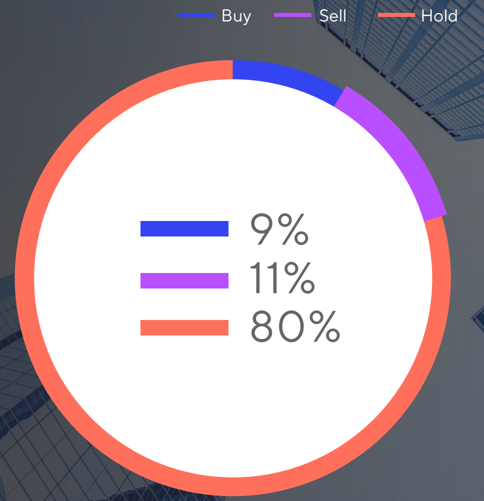
RERC Buy, Sell or Hold

Investors further shied away from buy and sell positions in favor of hold. The fourth quarter hold recommendation for overall CRE increased QoQ from 73% to 80%. Investors were least likely to recommend buying; preference for the strategy fell 3 percentage points QoQ to 9%. The recommendation to sell fell QoQ from 15% to 11%. Investors note that there are few transactions occurring outside of the highest quality properties. There is a disconnect between buyers and sellers with buyers unwilling to sell at prices indicated by buyers in many cases.

Investors recommended holding for the vast majority of property types: warehouse, R&D, flex, regional mall, power center, neighborhood and community retail and hotel. Investors were bearish on CBD and suburban office, with a recommendation to sell and more bullish on apartments, with a recommendation to buy.

> "The buyer vs. seller game of chicken will break."
>
> -WEST REGION INVESTOR

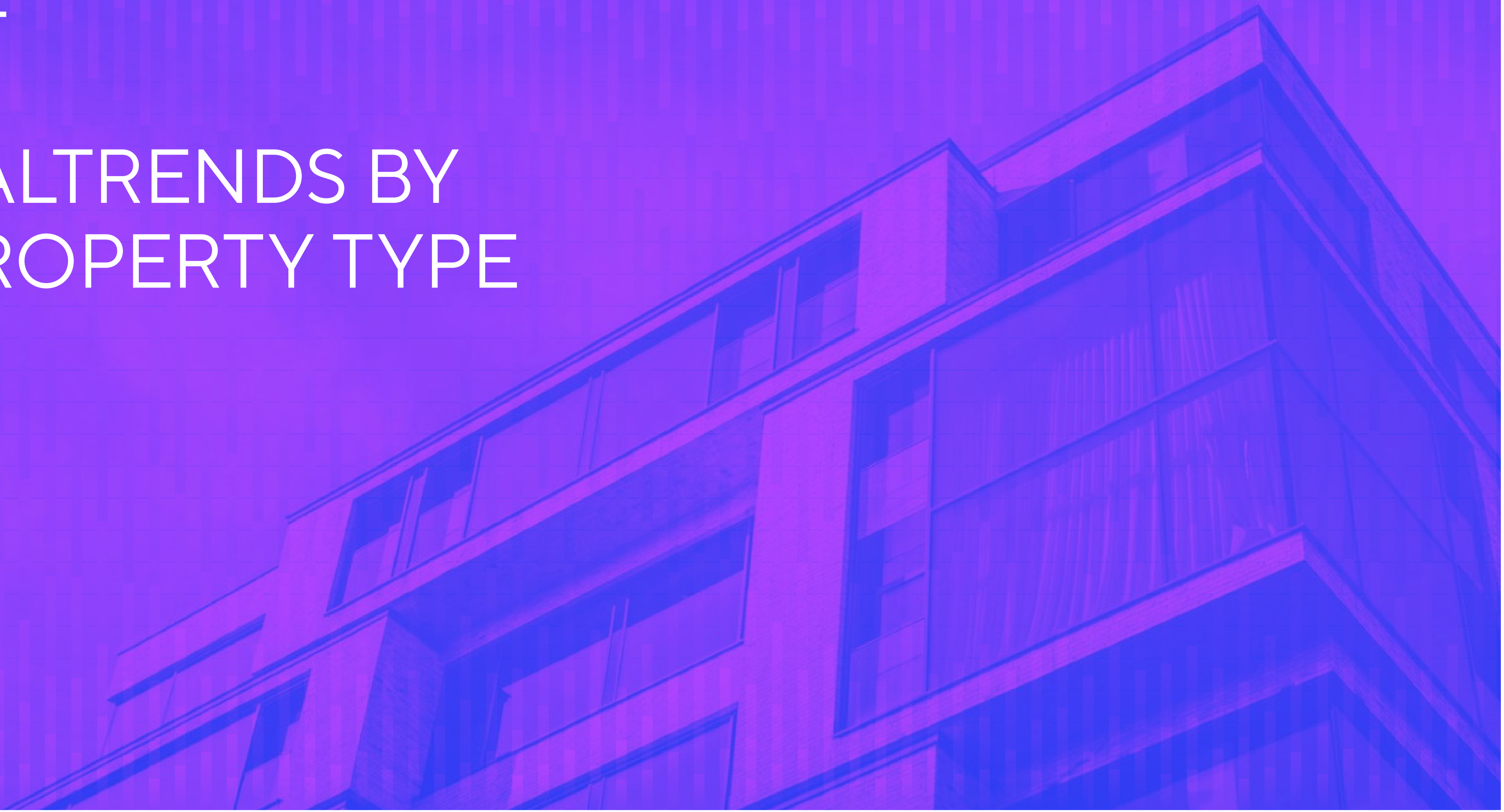
Buy, Sell & Hold Recommendations — Overall CRE



Percentage of total respondents recommending buy, sell or hold.
Sources: RERC, SitusAMC Insights, 4Q 2022.

02

VALTRENDS BY PROPERTY TYPE



Despite Headwinds, Industrial and Apartment Remain Strong.

RERC Perceived Return Relative to Risk

Investors' perceptions of returns relative to risk for the overall CRE market and each of the property segments deteriorated in the fourth quarter, indicating greater perceived risks relative to returns. The overall CRE market was perceived as increasingly risky throughout 2022. The low ratings in fourth quarter were on par with ratings in the early part of the pandemic and the height of the GFC.

With leisure travel picking up, several investors anticipate a rebound in the hotel segment. Though declining substantially QoQ, hotel garnered the highest rating among the property types in fourth quarter and was the only property type to be perceived as having higher returns relative to risk. Fourth quarter's rating was well above pre-pandemic levels and the LTA.

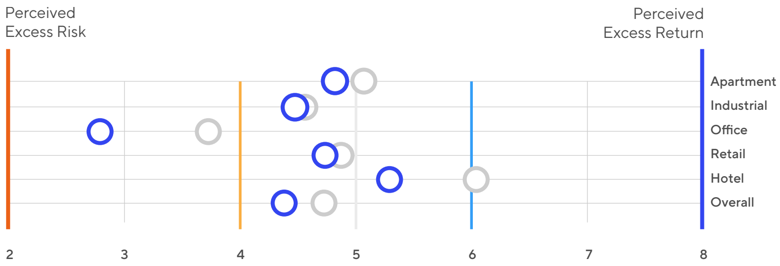
Apartment earned the second highest rating among the property segments, despite a sizeable drop QoQ. The fourth quarter rating was below average for the first time since the onset of the pandemic, indicating that risk slightly outweighed returns.

Unsurprisingly, risk from ongoing structural changes in the office sector has resulted in five consecutive quarters of declining ratings. Investors perceive the office segment as the riskiest relative to return among the property types. The fourth quarter rating was, by far, the lowest in history.

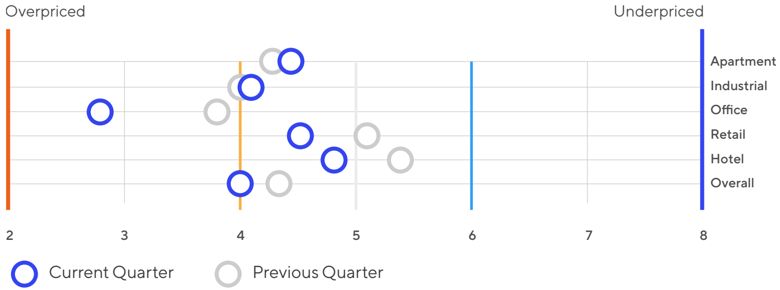
Perceptions of return relative to risk for retail decreased QoQ, but remained among the highest rating in four years. However, investors still believe the segment is relatively risky. Investors are particularly concerned about risk for malls and power centers.

Investors have become more skittish of the industrial sector over the past year. Following a slight decline QoQ, the rating was the third lowest in history, trailing only those seen at the height of the GFC and the beginning of the pandemic. The sector was considered risky relative to returns.

RERC Perceived Return Relative to Risk



RERC Relative Value Sentiment



Ratings are based on a scale of 1 to 10, with 10 indicating that return far exceeds risk or value far exceeds price. Sources: RERC, SitusAMC Insights, 4Q 2022.

RERC Relative Value Sentiment

Overall CRE relative value sentiment dipped QoQ to the lowest level on record, indicating the CRE market is considered to be the most overpriced in history. The overall CRE market has been perceived as overpriced since 2016. All property segments were rated as overpriced. Real estate values are expected to decline due to increasing expenses and flattening rent growth.

Hotel had the highest rating among the property types in fourth quarter, despite a substantial QoQ drop. The fourth quarter rating was on par with pre-pandemic levels and was equal to the LTA; however, it was the first time the segment was considered overpriced in seven quarters. Even though investors believe travel will increase, they note that performance is still below stabilized levels.

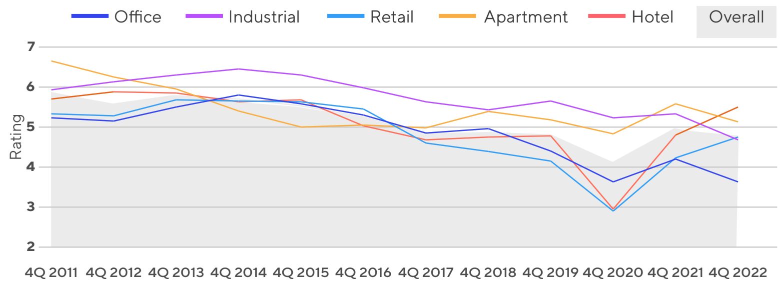
Relative value sentiment for the office fell substantially QoQ to the lowest in history and was considered the most overpriced property segment. Given the challenges on the demand side, investors believe office is overpriced and there has not seen capitulation broadly speaking by the holders of office.

Industrial's relative value sentiment ticked up slightly QoQ, but was among the lowest level in history, trailing only last quarter's record low rating. Investors note that while warehouse was the favorite earlier in 2022, prices and rental rates have likely peaked.

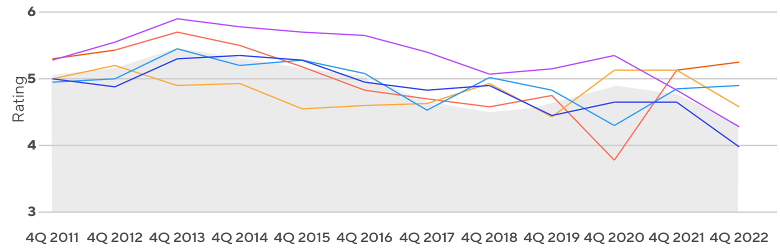
The retail segment had the second highest rating among the property types, though it was considered overpriced. The fourth quarter rating was the lowest since 2020 and was well below the LTA. Some investors comment that retail is coming back but with lower rent expectations.

Apartment relative value sentiment eked a gain in fourth quarter, but remains overpriced, according to investors. Though apartments remain in undersupply, several investors believe the apartment market is priced to perfection and persistently high inflation and a potential recession represent risks.

RERC Perceived Return Relative to Risk — Average Annual Ratings



RERC Relative Value Sentiment — Average Annual Ratings



Ratings are based on a scale of 1 to 10, with 10 indicating that return far exceeds risk or value far exceeds price. Data represent four quarter moving averages. Sources: RERC, SitusAMC Insights, 4Q 2022.

SitusAMC Office Insights

Demand conditions continue to deteriorate for the office segment. The fourth-quarter occupancy rate was the lowest in history, according to Reis. Net absorption was substantially negative in fourth quarter, on par with the negative absorption seen at the end of 2020, but well above the levels seen during the GFC.

Completions fell by over 75% QoQ and were 83% lower than the LTA. Effective rents for the overall office sector managed to eke out a small gain. Class A and Class BC office asking rents both increased QoQ, but Class BC rents outperformed Class A, increasing 0.5% versus 0.1%, respectively. The pace of Class BC rent growth is 10 bps above the long-term average.

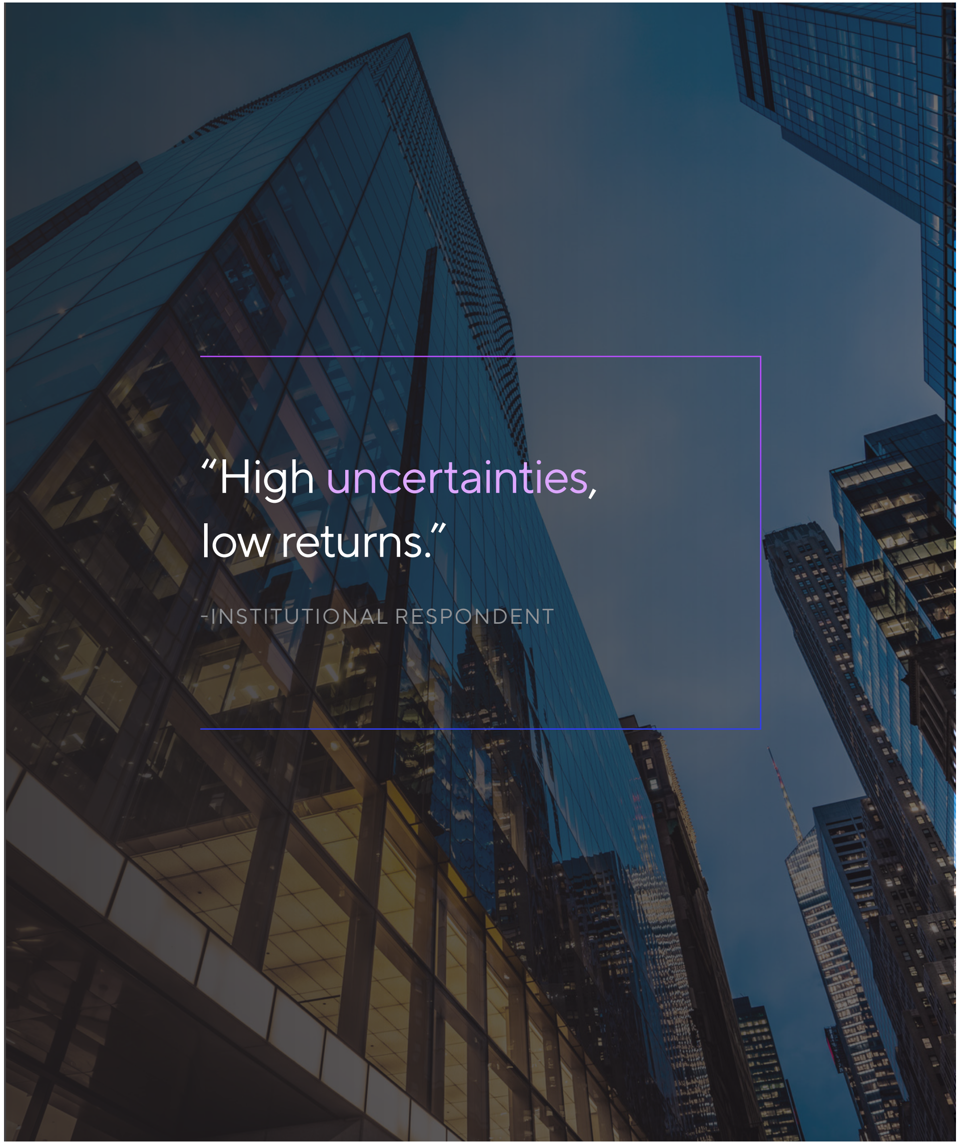
Investors participating in our quarterly survey note that CBD office has the greatest risk; employers are having trouble getting workers into the office and since this space is generally more expensive, reductions or moves to the suburbs may become more prevalent.

Occupancy rates for both Class A and Class BC office declined by 20 bps in fourth quarter. The fourth quarter Class A occupancy rate was the lowest on record; the Class BC rate was third lowest, trailing the records set in early 2021.

New York City, Washington, D.C., and San Francisco are all implementing policies to revive downtowns and address housing shortages by converting office buildings into residential. With office vacancies at record highs in these cities, politicians are hopeful that conversions can revive struggling downtown areas and boost tax revenues.

According to Bloomberg, an office landlord controlled by PIMCO defaulted on about $1.7 billion of mortgage notes on seven buildings in February 2023. The mortgages were all floating rate, causing monthly payments to swell after the steep rise in interest rates last year. This follows a default by Brookfield on two office buildings in downtown Los Angeles earlier in the month. As office demand continues to soften, some owners have considered walking away from the properties rather than continuing to pour money into them. Nearly $92 billion in debt for office properties from nonbank lenders comes due this year, and $58 billion will mature in 2024, according to the Mortgage Bankers Association.

In an effort to revive downtown areas, U.S. cities and states are considering whether to enforce tax incentive requirements that dictate how often employees must come into the office or at least live in the region. Bloomberg reports that prior to the pandemic, several New Jersey tax programs required workers to show up at least 80% of the time and one Texas program set the threshold at 50%. Some companies are forfeiting tax breaks to maintain a fully remote working policy, while others are negotiating their returns to the office.



SitusAMC Industrial Insights

Warehouse occupancy remained the same QoQ at the lowest level in history, according to Reis. Net absorption slowed QoQ, declining by almost 75%, but was about 30% higher than pre-pandemic levels.

Effective rents for warehouse grew 2.3% in fourth quarter, the slowest pace in over a year, but 140 bps above the LTA. Rents were 37% greater than pre-pandemic levels. Completions fell by 37% QoQ, the lowest in almost two years but 23% higher than the LTA.

According to investors, industrial appears to be holding its value, particularly for last-mile distribution centers. Single-tenant bulk warehouse is also performing well.

Investor demand is strong for industrial assets with shorter weighted average lease terms (WALT) as they have a better ability to mark to market. Assets with less than three years left of WALT traded at a 55% premium on price per square foot (PPSF) than assets with nearly a decade or more left in WALT.

Although the rent growth story is still strong in most markets, some tenants are gaining more bargaining power due to a tick up in supply, leading to more free rent and tenant improvement (TI) dollars. SitusAMC believes this is a temporary situation as the supply story in most markets does not have legs.

With a tight labor market and inflation causing housing and gas prices to soar, Moody's Analytics finds that warehouse/distribution center tenants are starting to look for properties close to population centers in hopes of attracting employees because of shorter commutes.

NPI Total Return **-3.6%**

Warehouse Occupancy Change **+0** bps QoQ

Warehouse Effective Rent Growth Change **+2.3%**

> "Increased demand by investors and users, low vacancy."
>
> -MIDWEST REGION RESPONDENT

Sources: NCREIF, Reis, SitusAMC Insights, 4Q 2022.

SitusAMC Retail Insights

Retail's occupancy rate remained the same in fourth quarter, but it is still 10 bps lower than the pre-pandemic rate, according to Reis. Net absorption increased 44% QoQ. Though positive, net absorption remains tepid, 78% below its LTA in the fourth quarter.

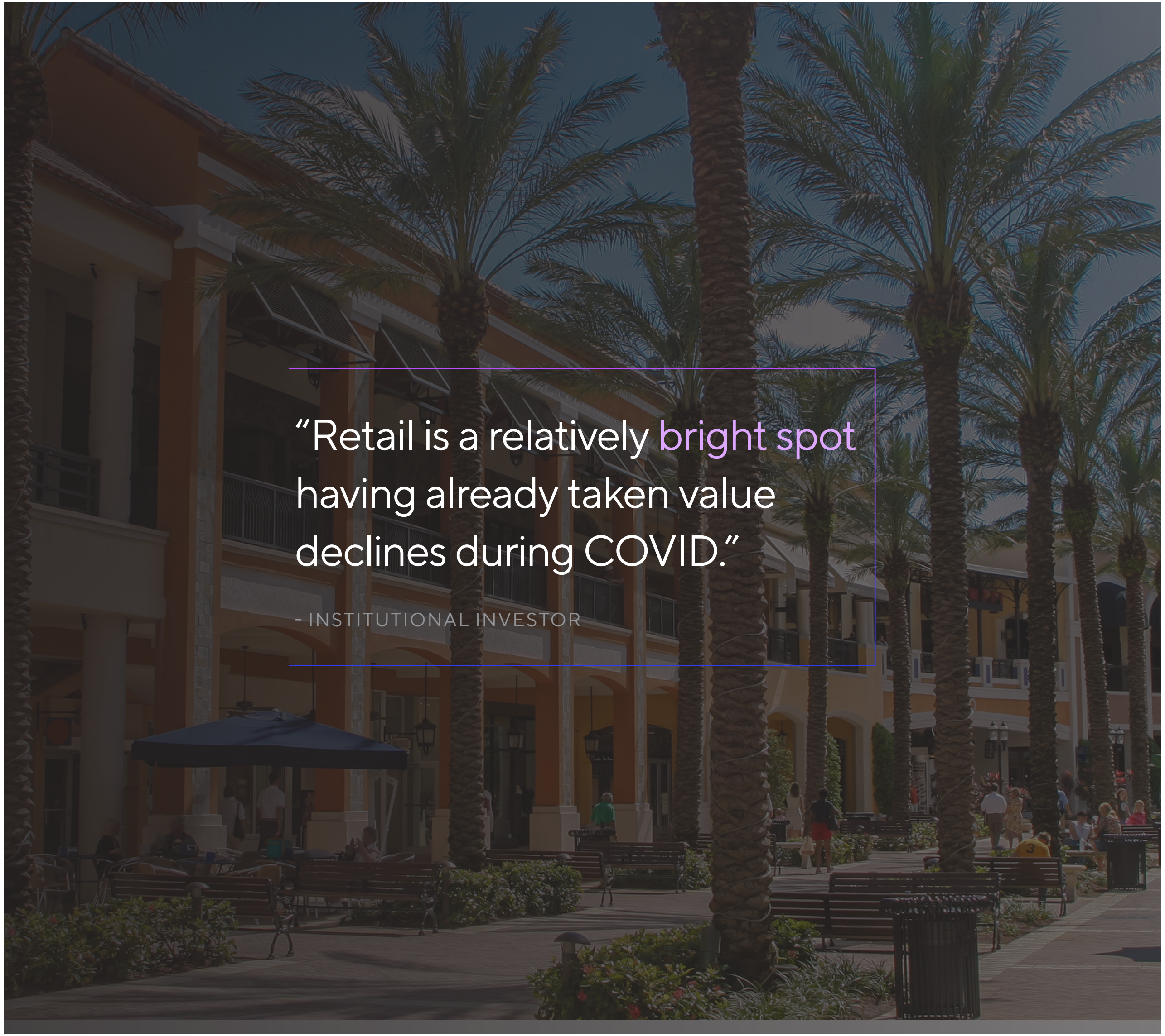
Effective rents grew in fourth quarter but are still 0.5% shy of their pre-pandemic levels. However, future supply constraints bode well for further rent increases as modest absorption whittles down vacancies. Completions fell by 22% QoQ, reaching the second lowest level in history.

The 2022 holiday shopping season was bright, according to MasterCard SpendingPulse. U.S. in-store retail sales between Nov. 1 and Dec. 24 increased 6.8% YoY. Following a broader trend toward experiential retail, spending at restaurants surged 15.1% YoY.

SitusAMC notes that the bifurcation continues in the mall segment with strong leasing in the Class A++ category, but weaker performance in Class B and below. Grocery-anchored properties continue to perform well and are in-demand from investors.

The retail sector is facing some risks, however. Consumer spending was strong in January, but many more Americans are relying on credit cards to make these purchases. Bankrate reports that 46% of cardholders are carrying debt month to month, up from 39% last year.

In addition, labor shortages are hitting retail. Retail trade and accommodation and food service have struggled to retain workers. These industries had some of the highest quit rates in 2022, according to the BLS.



SitusAMC Apartment Insights

Per Reis, fourth quarter apartment occupancy ticked down 10 bps, the first decline in nearly two years. However, the occupancy rate remained 80 bps above the LTA. Net absorption fell QoQ to the lowest since the GFC and was 58% below the LTA.

Completions fell for the third consecutive quarter by almost 45% QoQ to the lowest in over a decade. The pace of rent growth picked up QoQ; fourth quarter's rent growth was 110 bps above the LTA. Despite the quarterly bump, effective rent growth declined MoM in November and December.

Both Class A and Class BC apartment occupancy rates ticked up 10 bps QoQ. Occupancy rates for Class A are 40 bps above pre-pandemic levels and 50 bps above the LTA. Class BC occupancy was 10 bps higher than pre-pandemic, but an impressive 130 bps higher than the LTA.

Fourth quarter asking rents increased at a faster pace for Class BC than Class A at 2.3% and 1.8%, respectively. Class A completions were down nearly 40% QoQ.

Following diminished apartment affordability over the past year, the Biden Administration introduced a Renters Bill of Rights. Among the calls-to-action is ensuring accurate information on credit reports and background checks, encouraging the financing of multifamily loans that support affordable housing, and examining possible actions to limit "egregious rent increases."

SitusAMC is seeing broad rent deceleration and trade-outs from previous leases have narrowed to mostly single digits. However, the increasing expenses, particularly payroll, insurance, and utilities, are putting pressure on the bottom line and could ultimately hit value as well. Rate expansion has been more pronounced for assets that had the greatest amount of compression during COVID-19 and are experiencing negative leverage.

NPI Total Return **-3.2%**

Occupancy Change **-10** bps QoQ

Effective Rent Growth Change **+2.0%**

"Even during a recession, housing will still be needed."

-SOUTH REGION INVESTOR

Sources: NCREIF, Reis, SitusAMC Insights, 4Q 2022.

SitusAMC Hotel Insights

Though leisure travel was strong in late 2022, business travel continues to lag. Moody's Analytics notes that economic uncertainty has likely weighed on the hotel sector over the past few months but characterizes the segment as returning back to normal following record demand that emerged post-lockdown.

Also continuing the descent from record highs in second quarter, seasonally adjusted room rates and RevPAR fell by nearly 5.5% and 25%, respectively, reflecting the steep drop in occupancies. Still, room rates and RevPAR both remained about 9% higher YoY and were 27% and 10% higher than the LTA, respectively.

Continuing to retreat from the record high in second quarter 2022, the hotel occupancy rate (seasonally adjusted) dropped 20% in the fourth quarter, according to Reis. While this is a substantial quarterly decline,

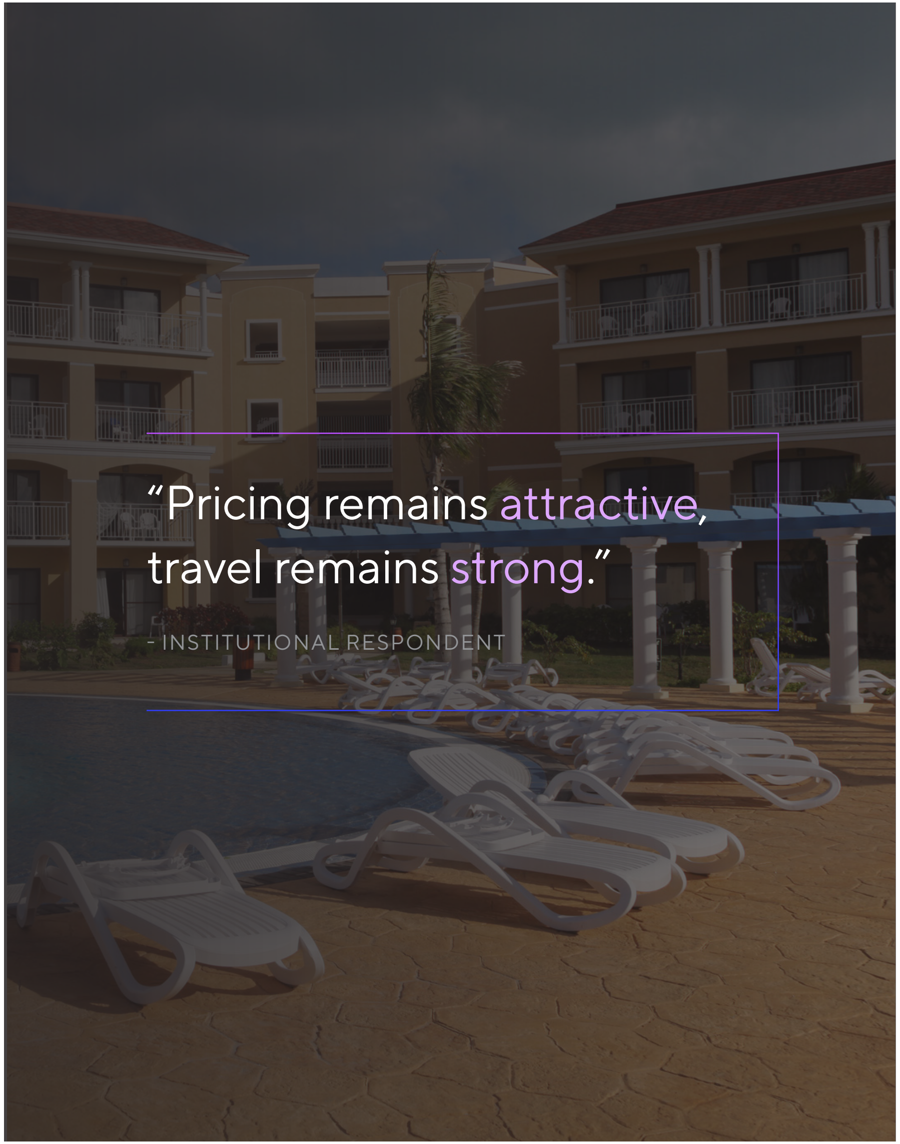
the fourth quarter occupancy rate remained the same on a YoY basis. Hotel occupancy data has been extremely volatile during the pandemic, but Reis forecasts occupancy rates to increase through 2023, returning to pre-pandemic levels by year-end.

Though strongly negative, upper-tier hotels fared better than lower-tier hotels in changes in occupancy, room rates and RevPAR. Lower-tier hotel occupancy was down over 20% in fourth quarter to the lowest level since the pandemic began and was almost 700 bps lower than the LTA. Lower-tier room rates dropped 10.3% in fourth quarter, coming off of the record highs seen in the previous two quarters. Lower-tier RevPAR plummeted 30%, also from record highs over the past two quarters. However, lower-tier RevPAR was still 16% lower in fourth quarter than it was pre-pandemic.

Upper-tier occupancy declined by almost 18% in fourth quarter, down 15% from pre-pandemic levels and 8.5% lower than the LTA. Upper-tier room rates and RevPAR both retreated from the record highs seen in second and third quarter by 3.3% and 20.5%, respectively. Both metrics are above 10% higher than they were pre-pandemic.

RERC investor survey respondents note that many hotels are poised to recover with pricing on well located properties likely indicating a discount on stabilized value. Central urban hotels are improving but still well under the needed levels to sustain the market values pre pandemic.

JLL reports that select-service and extended-stay hotels performed remarkably well in 2021 and 2022, with strong operating performance, RevPAR growth and consistently higher yields. The subtypes are able to attract a broader client base than other lodging types and their inherent longer average length of stay makes them more resilient to economic downturns.



ValTrends by SitusAMC

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