Aegon Asset Management

Real Assets Research
March 2024

AEGON **INSIGHTS**

US CRE Market Insights

Executive summary

- *The US Federal Market Operating Committee (FOMC) agreed to hold interest rates steady for the fourth consecutive time at its meeting in January, leaving its benchmark interest rate at a target range of 5.25% to 5.50%.*[1]
- *The 10-year US Treasury notched a 16-year high in October and has since eased to just over 4% as of late February. The decline in long-term rates stems from the expectation that the US Federal Reserve (Fed) will not be raising interest rates as many times in 2024 as investors initially thought. The Fed still expects rate cuts to occur in the second half of 2024, but they seem to be delaying any premature cuts until they see signs that inflation has permanently cooled.*[1]
- *Inflation, as measured by the core personal consumption expenditure (PCE) index, declined meaningfully to 2.9% in December but remained higher than the Fed's 2% goal. As a result, most economists surveyed by the Blue-Chip Economic Indicators are now expecting rate-cuts to occur later into 2024, as well as fewer cuts to happen within the year overall.*[2,3]
- *Within commercial real estate (CRE) debt, commercial mortgage loan (CML) spreads are adjusting, albeit at a slower pace, and at the time of this writing were in the 150 to 215 bps range. Life companies have remained disciplined in their lending standards with most having similar allocations in 2024 compared to 2023.*
- *Property transaction volume was down 41% during 4Q 2023 compared to a year earlier. Transaction volume was down 51% in 2023 compared to 2022.*[4]
- *Property values were essentially flat for the past three quarters. However, property prices still declined by 5.9% in December compared to the previous year.*[4]
- *NCREIF National Property Index (NPI) returned -7.9% in 4Q 2023 compared to a year earlier. Capital appreciation was reported as -11.8%, with income return at 4.3%.*[5]

Content

Property sector outlook

	4Q 2023 total return	Under construction as % of inventory	4Q 2023 vacancy rate	4Q 2022 vacancy rate	4Q 2023 YoY rent growth	4Q 2022 YoY rent growth	Aegon AM Real Assets sector outlook
Apartment	-7.3%	5.0%	7.6%	6.5%	0.9%	3.9%	Neutral
Industrial	-4.1%	2.4%	5.7%	3.9%	6.7%	10.5%	Neutral
Office	-17.6%	1.2%	13.5%	12.4%	0.8%	1.1%	Most Cautious
Retail	-0.9%	0.5%	4.0%	4.2%	3.4%	4.4%	Neutral

Sources: National Council of Real Estate Investment Fiduciaries, CoStar Realty Information Inc., and Aegon AM Real Assets US. As of December 31, 2023.

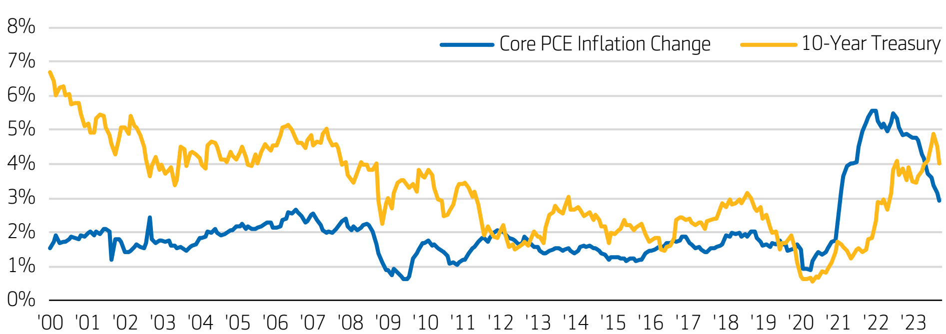
Economic outlook

The FOMC decided to hold interest rates steady at both its December and January meetings. Policy makers also signaled that the most aggressive tightening cycle of rate increases in four decades has come to an end. Although the market has responded favorably to Fed Chairman Powell's comments with the 10-year Treasury dropping to the 4% range, a disconnect on how fast rates will come down now lies ahead between the market and the Fed for 2024.

The latest FOMC Summary of Economic Projections shows that the Fed expects three interest-rate cuts by the end of 2024.[1] Furthermore, Chairman Powell reiterated during the central banks' January meeting that the Fed will likely not reach the level of confidence required to justify a rate cut in time for its March meeting.

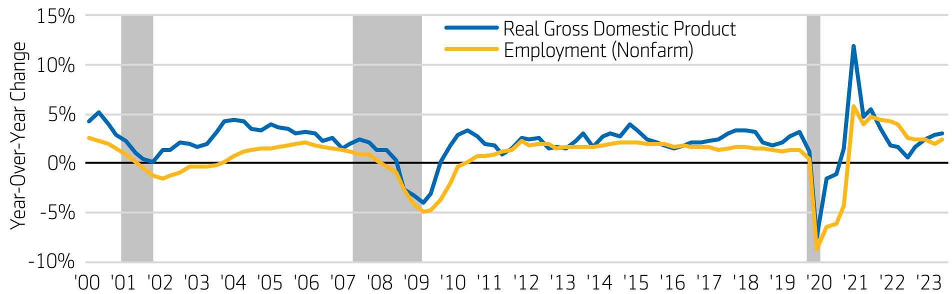
While the future path of interest rates is notoriously difficult to predict, we know that the Fed will continue to work toward its dual mandate of stable pricing and maximum employment. Inflation as measured by the core personal consumption expenditures rose 2.9% in December compared to a year earlier—the smallest gain since March 2021, but still higher than the Fed's 2% target.[3] The latest GDP and labor market report has also thrown cold water on the market's expectation that the Fed will cut interest rates soon. Despite tightening monetary policy, the US economy expanded a solid 3.2% in 4Q 2023 on a seasonally adjusted annualized rate.[6] Employers added 353,000 jobs during January, shattering market expectations. The number of new jobs per December's jobs report, which was already higher than market projections, was revised upward significantly from 216,000 to 330,000. The unemployment rate held steady at 3.7% in January.[7]

Core personal consumption expenditures (PCE) ease but remain above Fed's 2% target



Sources: US Bureau of Economic Analysis, as of January 26, 2024, and US Department of Treasury as of December 31, 2023.

The US economy grew at a faster-than-expected pace despite tighter financial conditions



Sources: US Bureau of Labor Statistics as of February 2, 2023. Bureau of Economic Analysis as of December 31, 2023. Employment figures reflect private and government non-farm jobs. Shaded areas indicate US recessions.

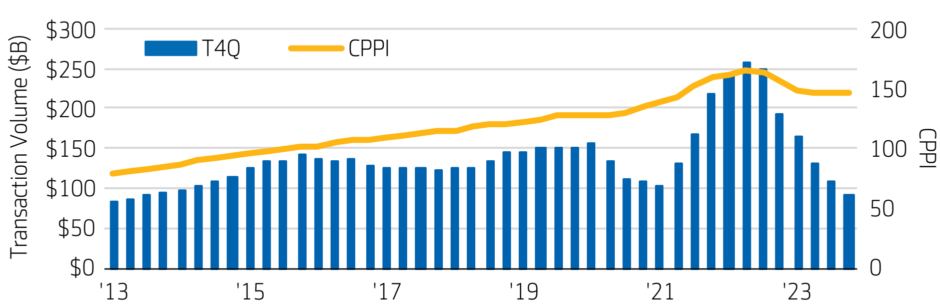
We expect transaction volume to gradually pick up through 2024 due to several factors.

Relatively tight monetary policy and the slowdown in the economy continues to impact property transaction volume and property values. The disconnect between buyers and sellers remains wide. Fourth quarter transaction volume, which is typically the strongest quarter of the year, for 2023 was at its weakest level at $89.5 billion. Although the pace of declines in deal volume is moderating, fourth quarter volume was still down 41% compared to a year earlier. Annual transaction volume was down 51% compared to the prior year, and down 32% compared to its pre-Covid level. Similarly, while property prices declined 5.9% compared to last year, the RCA Commercial Property Price Index (CPPI) was essentially flat for the past three quarters. Industrial property was the only property type to post an annual pricing gain of 0.5%, and pricing for the office sector declined the most by -16.1%.[8]

We expect transaction volume to gradually pick up through 2024 due to several factors: 1) a declining 10-year Treasury yield and a clearer view on the fed-funds rate; 2) some property owners will be forced sellers in 2024, facing a potential refinance scenario requiring significant capital infusion and/or current lender denying additional extensions; and 3) an influx of opportunistic capital that should increase transaction activity (both direct property acquisitions and distressed loan sales) and provide some much-needed liquidity into the market.

Economic uncertainty continues to take its toll on transaction volume

Sources: Aegon Real Assets US and. Real Capital Analytics. As of December 31, 2023



AEGON Asset Management

Transaction volume by property type

	4Q 23	4Q 22	YoY changes
All Apartment	**$26.9 B**	**$53.7 B**	**-50.0%**
Garden	$16.4 B	$34.8 B	-52.9%
Mid/Highrise	$10.5 B	$18.9 B	-44.5%
All Industrial	**$20.8 B**	**$36.4 B**	**-42.9%**
Flex	$2.8 B	$5 B	-43.6%
Warehouse	$17.9 B	$31.4 B	-42.8%
All Office	**$14.5 B**	**$21.4 B**	**-32.4%**
CBD	$4.1 B	$4.7 B	-14.2%
Suburban	$10.4 B	$16.6 B	-37.6%
All Retail	**$12.4 B**	**$17.9 B**	**-30.8%**
Strip Center	$7.6 B	$11.4 B	-32.9%
Mall & Other	$4.8 B	$6.6 B	-27.1%

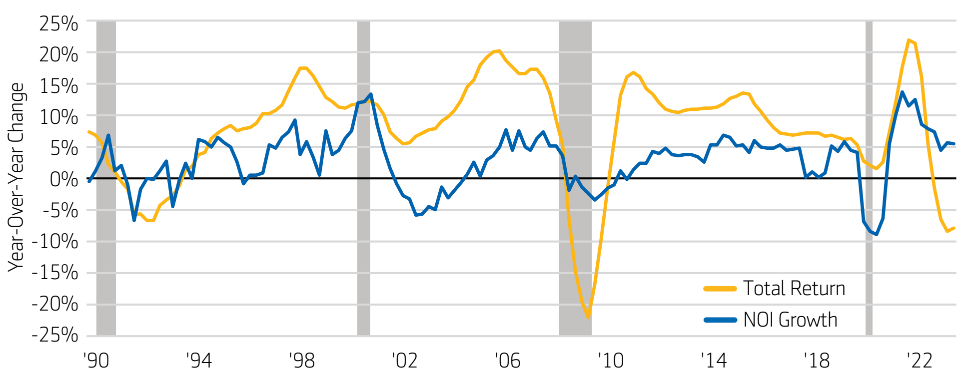
Source: MSCI Real Capital Analytics. As of December 31, 2023.

Within property sectors, subtypes continue to show a broad dispersion in performance with the range particularly wide in the office sector.

Real estate equity

The trailing one-year return for the NCREIF National Property Index (NPI), a measure of unleveraged returns, was -7.9% in the fourth quarter of 2023 compared to 5.5% a year ago. Capital appreciation was reported as -11.8%, with income return at 4.3%.[5]

Unlevered core real estate total return continues to decline



Source: NCREIF Property Index Detail Report as of December 31, 2023. **Shaded areas indicate US recessions.**

During 4Q 2023, retail property performance outpaced the other three main sectors with a -0.9% total return. At the other end of the spectrum, office property returns remained the lowest, totaling -17.6%.[5]

Within property sectors, subtypes continue to show broad dispersion in performance. The range is particularly wide in the office sector where there is an 8.4% difference in the fourth quarter returns between central business district (CBD) and suburban office properties.[5]

Property sector subtypes continued to show broad dispersion in performance

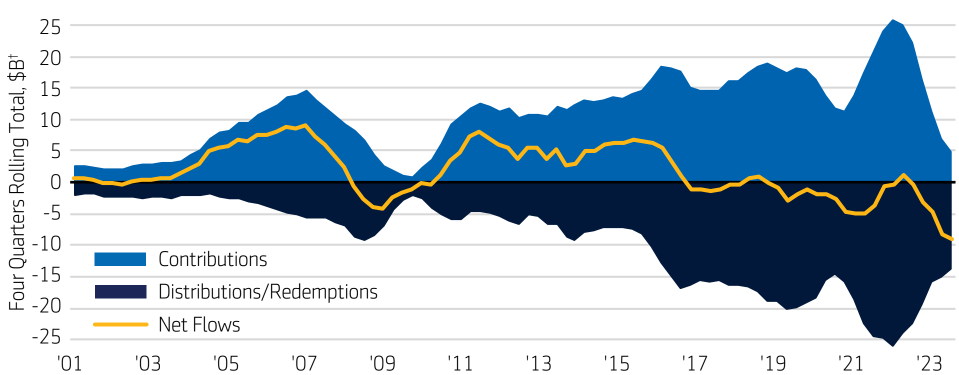
Trailing four quarter return by sub property type (%)	4Q 23	4Q 22	Trend
NPI	**-7.9%**	**5.5%**	**-13.5%**
All Apartment	**-7.3%**	**7.1%**	**-14.4%**
Garden	-6.9%	11.0%	-17.9%
Highrise	-7.9%	5.0%	-12.9%
Lowrise	-5.6%	6.7%	-12.3%
All Industrial	**-4.1%**	**14.5%**	**-18.6%**
R&D	-0.2%	5.8%	-6.0%
Flex	-4.2%	15.2%	-19.4%
Warehouse	-3.6%	14.5%	-18.1%
Other	-0.5%	20.2%	-20.7%
All Office	**-17.6%**	**-3.4%**	**-14.3%**
CBD	-21.5%	-5.7%	-15.7%
Suburban	-13.1%	-0.4%	-12.7%
All Retail	**-0.9%**	**2.7%**	**-3.6%**
Community	0.2%	7.7%	-7.5%
Neighborhood	-0.6%	5.1%	-5.8%
Power Center	1.1%	6.5%	-5.4%
Regional	-2.2%	-2.1%	-0.1%
Super Regional	-1.0%	0.5%	-1.6%

Source: NCREIF Property Index Detail Report. As of December 31, 2023. Trend is the year-over-year change of sub property type trailing four quarter return. **Past performance is not indicative of future results.**

During 4Q 2023, NFI-ODCE investor's distributions and redemptions exceeded contributions by $1.9 billion compared to the previous quarter's $2.7 billion. Contributions declined by 60% in 4Q 2023 compared to the previous year, easing from the previous quarter's 83% which was the largest decline since 2009. For the year ending December 31, 2023, contributions were $4.9 billion, and distributions and redemptions were $13.8 billion which resulted in an annual net cash flow of -$8.9 billion.[5]

The NCREIF Fund Index for Open-ended Diversified Core Equity (NFI-ODCE) returned -12.0% gross of fees (-12.7% net) and inclusive of leverage over the past four quarters spanning from 4Q 2022 to 4Q 2023 with a -4.8% gross (-5.0% net) return in the fourth quarter separately. Over the last 10 years, the NFI-ODCE averaged a 6.1% gross (5.2% net) annual return.[5]

NFI-ODCE investor cash flow trends



†The Open End Diversified Core Equity (NFI-ODCE) fund index 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. Source: NCREIF. As of December 31, 2023.

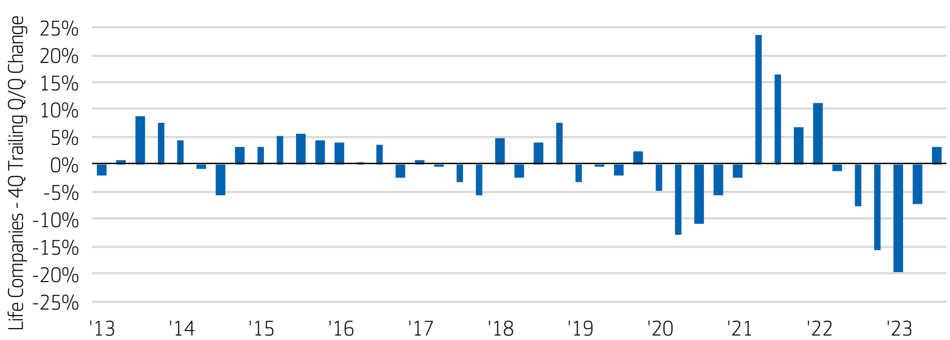
Real estate debt

The 10-year US Treasury yield surged past 5.0% during early October last year, the highest since 2007. The Fed at that time was still highly concerned about inflation, and raised expectations that another rate hike may not be completely off the table by year end 2023. However, this level has dropped to the low 4% range as of this writing. The decline in long-term rates is largely driven by market expectation that the Fed is done raising rates and will lower rates significantly over the next 12 months. At the same time, CML coupon rates have increased by approximately 25 bps from the 5.50% to 6.25% range to 5.75% to 6.50% for good quality 5-to-10-year CMLs. CML spreads are adjusting, albeit at a slower pace, and at the time of this writing are in the 150 to 215 bps range. However, corporate bond spreads continue to tighten, maintaining the CMLs-to-corporates spread gap. Life companies have remained disciplined in their lending standards with most having similar allocations in 2024 compared to 2023.

Borrowers continue to seek shorter loan terms, interest-only options, and flexible prepayment during the last 12 to 24 months of the loan term. However, with the decline in the 10-year Treasury, there is an expectation that some borrowers will consider longer-term financing options.

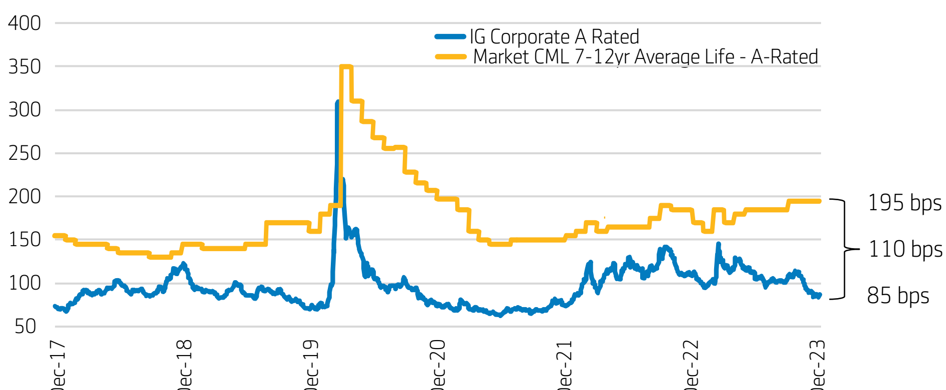
Life companies have remained disciplined in their lending standards with most having similar allocations in 2024 compared to 2023.

Commercial mortgage commitments (life companies)



Source: American Council of Life Insurers (ACLI) as of September 30, 2023.

CMLs continue to offer a spread advantage over investment grade corporate bonds January 2018 - December 2023



Sources: Corporate Bonds – Bloomberg Barclays. Aegon Real Assets US Commercial Mortgage Mark-to-Market Matrix - A Internal rating using Proprietary CML pricing matrix, developed, and maintained by Aegon Real Assets US as of December 31, 2023. **Past performance is not indicative of future results.**

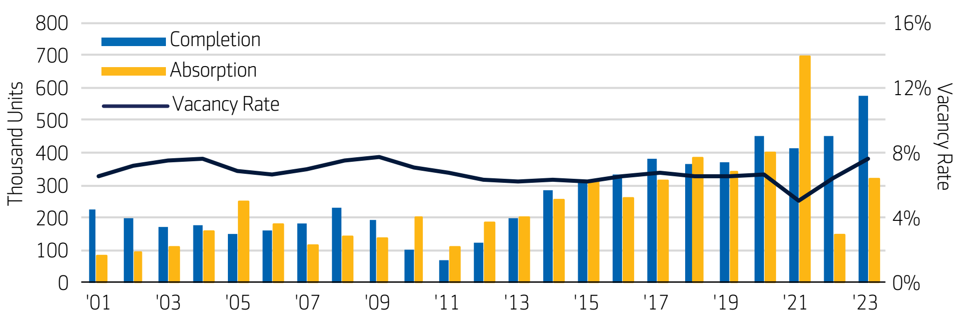
Asset Management

Sector overview

Apartment

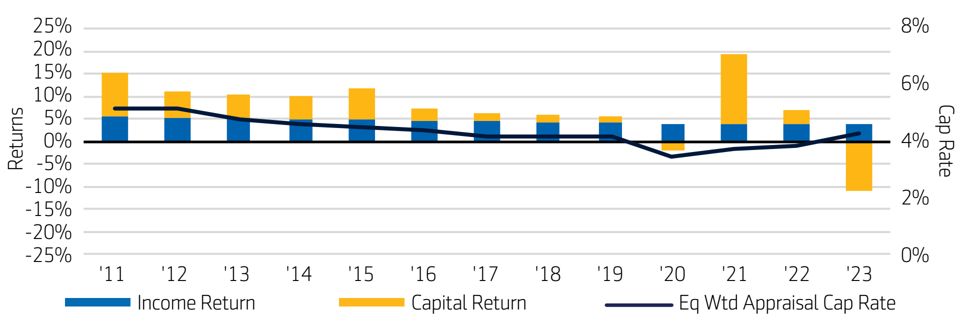
- The apartment sector continues to face cyclical supply headwinds, while demand fundamentals remain healthy. Absorption for 2023 ended at approximately 320,000 units, more than doubling the amount in 2022, and in line with the pre-Covid average. However, despite the strong reversal in demand, it still fell short of the approximately 574,000 units delivered for the year, continuing an eight-quarter trend of supply outpacing demand. As a result, the vacancy rate increased 32 bps to 7.6%, and rent growth increased 8 bps but remained low at 0.9%.[9]
- While supply headwinds are affecting the majority of the top 50 markets, the magnitude of new supply and performance across these markets differs significantly. 16 of the top 50 markets saw negative year-over-year rent growth during 4Q 2023. Of those 16, 14 are Sun Belt markets with average construction as a percentage of inventory of 7.4%. On the other hand, the top 10 performing markets in terms of rent growth are all in the Midwest and Northeast markets with an average supply as a percentage of inventory of 3.8%.[9]
- A high interest rate environment, combined with a pullback in lending from banks has seen construction starts decline significantly since early 2023.[10] The current pipeline suggests that by early 2025, we should see a meaningful pause in new deliveries and supply to dip below its historical average. Given strong demand supported by low homeownership affordability and the necessity of housing, we believe apartment sector performance will likely stabilize towards the end of 2024.

Apartment sector vacancy rate continues to rise with near-term supply headwinds outpacing demand



Source: CoStar Realty Information Inc., annual data as of December 31, 2023. Current year returns reflect trailing 4-quarter average.

Apartment performance (4Q 2023)



Source: NCREIF Property Index (unlevered) - Equal weighted appraisal cap rate as of year-end or most recent in current year, current year returns reflect trailing 4-quarter average, as of December 31, 2023. **Past performance is not indicative of future results.**

Vacancy Rate[6]

▲ 7.6%

Rent Growth[6]

▲ 0.9%

Total Return[5]

▲ -7.3%

Outlook

Neutral

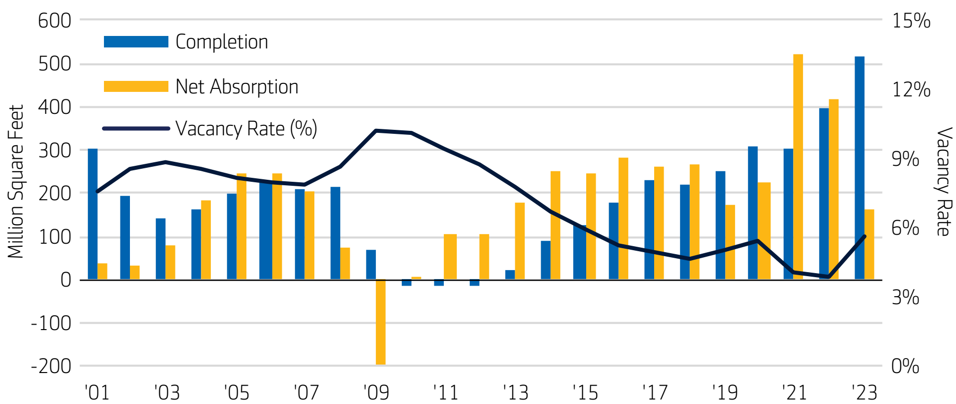
Arrows indicate change from previous quarter.

Industrial

- The industrial sector remained relatively tight in 4Q 023 but performance softened heading into 2024 as a near-record amount of new supply hit the market and demand continued to moderate. The vacancy rate rose 52 bps to 5.7%, and rent growth moderated declining 6.7% during the fourth quarter of 2023.[9]

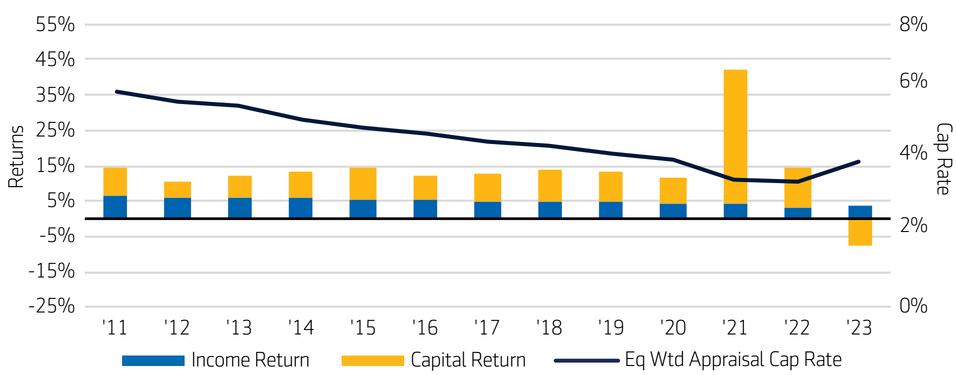
- Heightened supply levels are projected to be above trend over the next several quarters, with increases in vacancy rates likely to persist. However, recent pullback in starts signaled supply side pressure is expected to recede by early 2025.[9] Longer-term growth prospects continue to be supported by supply chain reshoring, near-shoring, and e-commerce driven consumption. We expect the occupancy rate to decline and rent growth to moderate further as new supply gets digested.

Record-high completion rates lead to higher vacancy rates



Source: CoStar Realty Information Inc., annual data as of December 31, 2023. Current year returns reflect trailing 4-quarter average.

Industrial performance (4Q 2023)



Source: NCREIF Property Index (unlevered) - Equal weighted appraisal cap rate as of year-end or most recent in current year, current year returns reflect trailing 4-quarter, as of December 31, 2023. **Past performance is not indicative of future results.**

Vacancy Rate[6]

▲ 5.7%

Rent Growth[6]

▼ 6.7%

Total Return[5]

▲ -4.1%

Outlook

Neutral

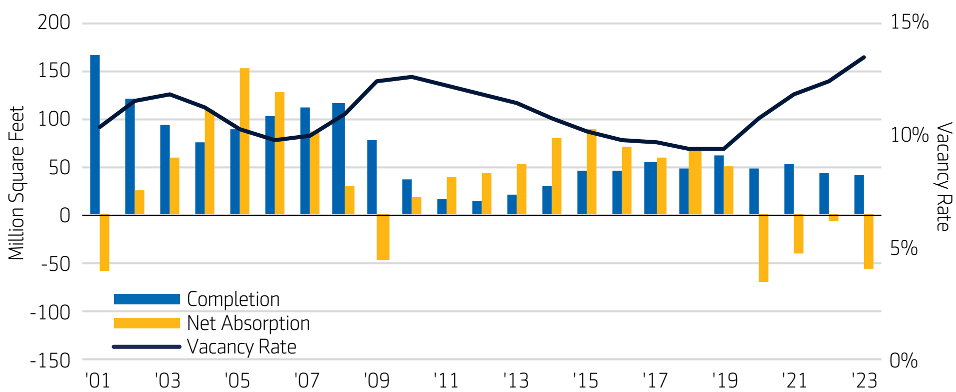
Arrows indicate change from previous quarter.

AEGON Asset Management

Office

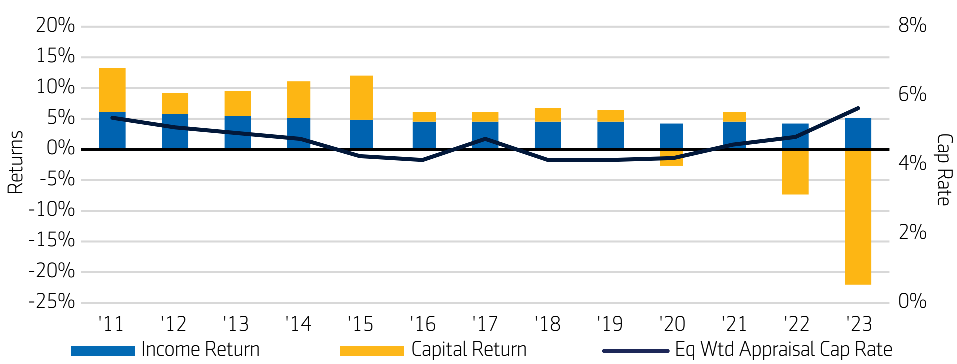
- The office sector continues to face structural challenges with the hybrid work model not showing any signs of ending in most metros. Although office key swipes tracked by Kastle Systems hit a weekly average high at 53% in late-January 2024, numbers are still not where most offices want to be compared to pre-pandemic levels.[11] As a result, the sector's vacancy rate continues to climb and reached 13.5% at the end of 4Q 2023.[9]
- Firms are still exhibiting a flight to quality, seeking high-quality and well-equipped office buildings to attract employees back to the office setting. Class A+ and new-vintage buildings continue to perform well boasting positive net absorption and rent growth.[12]
- Higher interest rates and limited capital availability are causing financial distress particularly when loans come due. The delinquency rate for office CMBS loans has risen from 1.9% a year ago to 6.3% as of the end of January 2024.[13]
- Roughly a quarter of existing office leases are expected to expire in 2024 and 2025, with more than 80% of these leases being executed before the pandemic.[14] We believe office tenants are likely to negotiate for lower rates or downsize to smaller square footage if the overall sentiment on office use does not improve.

Office sector vacancy rate continues to rise with no signs of easing



Source: CoStar Realty Information Inc., annual data as of December 31, 2023. Current year returns reflect trailing 4-quarter average.

Office performance (4Q 2023)



Source: NCREIF Property Index (unlevered) – Equal weighted appraisal cap rate as of year-end or most recent in current year, current year returns reflect trailing 4-quarter average, as of December 31, 2023. **Past performance is not indicative of future results.**

Vacancy Rate[6]

▲ 13.5%

Rent Growth[6]

▲ 0.8%

Total Return[5]

▼ -17.6%

Outlook

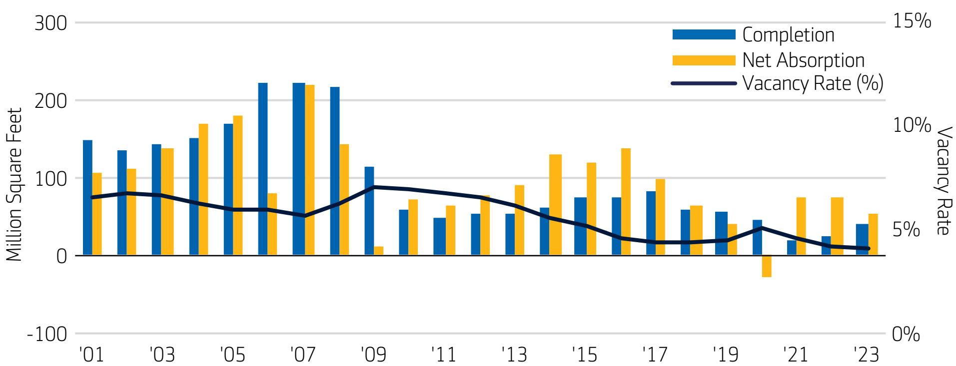
Most Cautious

Arrows indicate change from previous quarter.

Retail

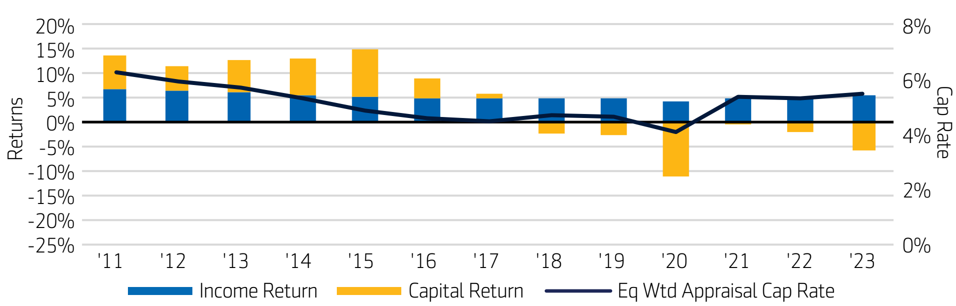
- The retail sector continues to demonstrate resilience as its vacancy rate declined to the tightest level ever recorded at 4.0% while rent growth remained solid at 3.4%. Real estate fundamentals in the retail sector are expected to remain strong in 2024 due to very little new construction deliveries over the past decade, and availability rates are expected to continue to be tight through 2024.[9]
- Demand for retail space remains high supported by a strong and resilient labor market that continues to drive up consumer spending as wage growth outpaces inflation. However, changes in monetary policy affect the economy with a long and variable lag. With the resumption of student loan payments, rising credit card and auto loan delinquency rates, and a falling personal savings rate, we expect the labor market and consumer spending to soften as we head into the spring.
- Despite high demand, we expect supply-side pressure to remain minimal as very few markets can command asking rents that are high enough to justify stringent lending conditions and the expensive cost of new construction.

Retail fundamentals remain solid with minimal supply pressure



Source: CoStar Reality Information Inc., annual data as of December 31, 2023. Current year returns reflect trailing 4-quarter average.

Retail performance (4Q 2023)



Source: NCREIF Property Index (unlevered) - Equal weighted appraisal cap rate as of year-end or most recent in current year, current year returns reflect trailing 4-quarter average, as of December 31, 2023. **Past performance is not indicative of future results.**

Vacancy Rate[6]

▼ 4.0%

Rent Growth[6]

▼ 3.4%

Total Return[5]

▲ -0.9%

Outlook

Neutral

Arrows indicate change from previous quarter.

[1]Board of Governors of the Federal Reserve System. January 31, 2024
[2]Wolters Kluwer. Blue Chip Economic Indicators. February 9, 2024
[3]US Bureau of Economic Analysis. Personal Income and Outlays. January 26, 2024
[4]MSCI Real Capital Analytics. January 23, 2024
[5]National Council of Real Estate Investment Fiduciaries. December 31, 2023
[6]US Bureau of Economic Analysis. Gross Domestic Product. January 25,2024
[7]US Bureau of Labor Statistics. Employment Situation. February 2, 2023
[8]MSCI Real Capital Analytics, Capital Trends, US Big Picture. February 22, 2024
[9]CoStar Realty Information, Inc. January 31, 2024
[10]US Census Bureau. February 16, 2024
[11]Kastle. Kastle Back to Work Barometer. February 12, 2024
[12]CoStar Realty Information, Inc. September 30, 2023
[13]Trepp CMBS Research. February 2023
[14]Compstak, October 4, 2023

Disclosures

Unless otherwise noted, the information in this document has been derived from sources believed to be accurate at the time of publication.

This material is provided by Aegon Asset Management (Aegon AM) as general information and is intended exclusively for institutional, qualified, and wholesale investors, as well as professional clients (as defined by local laws and regulation) and other Aegon AM stakeholders.

This document is for informational purposes only in connection with the marketing and advertising of products and services, and is not investment research, advice or a recommendation. It shall not constitute an offer to sell or the solicitation to buy any investment nor shall any offer of products or services be made to any person in any jurisdiction where unlawful or unauthorized. Any opinions, estimates, or forecasts expressed are the current views of the author(s) at the time of publication and are subject to change without notice. The research taken into account in this document may or may not have been used for or be consistent with all Aegon AM investment strategies. References to securities, asset classes and financial markets are included for illustrative purposes only and should not be relied upon to assist or inform the making of any investment decisions. It has not been prepared in accordance with any legal requirements designed to promote the independence of investment research, and may have been acted upon by Aegon AM and Aegon AM staff for their own purposes.

The information contained in this material does not take into account any investor's investment objectives, particular needs, or financial situation. It should not be considered a comprehensive statement on any matter and should not be relied upon as such. Nothing in this material constitutes investment, legal, accounting or tax advice, or a representation that any investment or strategy is suitable or appropriate to any particular investor. Reliance upon information in this material is at the sole discretion of the recipient. Investors should consult their investment professional prior to making an investment decision. Aegon AM is under no obligation, expressed or implied, to update the information contained herein. Neither Aegon AM nor any of its affiliated entities are undertaking to provide impartial investment advice or give advice in a fiduciary capacity for purposes of any applicable US federal or state law or regulation. By receiving this communication, you agree with the intended purpose described above.

Past performance is not a guide to future performance. All investments contain risk and may lose value. This document contains "forward-looking statements" which are based on Aegon AM's beliefs, as well as on a number of assumptions concerning future events, based on information currently available. These statements involve certain risks, uncertainties and assumptions which are difficult to predict. Consequently, such statements cannot be guarantees of future performance, and actual outcomes and returns may differ materially from statements set forth herein.

The following Aegon affiliates are collectively referred to herein as Aegon Asset Management: Aegon USA Investment Management, LLC (Aegon AM US), Aegon USA Realty Advisors, LLC (Aegon RA), Aegon Asset Management UK plc (Aegon AM UK), and Aegon Investment Management B.V. (Aegon AM NL). Each of these Aegon Asset Management entities is a wholly owned subsidiary of Aegon Ltd. In addition, Aegon Private Fund Management (Shanghai) Co, Ltd., a partially owned affiliate, may also conduct certain business activities under the Aegon Asset Management brand.

Aegon AM UK is authorised and regulated by the Financial Conduct Authority (FRN: 144267) and is additionally a registered investment adviser with the United States (US) Securities and Exchange Commission (SEC). Aegon AM US and Aegon RA are both US SEC registered investment advisers.

Aegon AM NL is registered with the Netherlands Authority for the Financial Markets as a licensed fund management company and on the basis of its fund management license is also authorized to provide individual portfolio management and advisory services in certain jurisdictions. Aegon AM NL has also entered into a participating affiliate arrangement with Aegon AM US. Aegon Private Fund Management (Shanghai) Co., Ltd is regulated by the China Securities Regulatory Commission (CSRC) and the Asset Management Association of China (AMAC) for Qualified Investors only.

AdTrax: 6418859.1GBL