2Q2021 QUARTERLY REPORT[1]

AS OF JUNE 30, 2021

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The U.S. economy grew at a 6.5% annualized rate in 2Q2021 (see Chart 1). The increase was chiefly spawned by consumer spending, propelled by pent-up demand and government stimulus. The level of GDP is now 1% higher than its pre-pandemic high. Approximately 3.3 million Americans filed continued jobless claims for the week ending July 17, 2021, a massive decline from the May 2020 peak of 23.1 million, but still nearly double the 1.7 million weekly average for the one-year period prior to the arrival of the virus. The unemployment rate stands at an improved, but still elevated, level of 5.9% as of June 2021 (see Chart 2). How long the relatively elevated level of unemployment endures will depend on how well COVID-19 can be contained. On May 14, 2021, President Biden announced that with a few exceptions, masks would not be required in public spaces for those who are vaccinated.[2] Many were hopeful that this would mark the official re-opening of the U.S. economy. However, concern over the Delta COVID-19 variant has caused the Center for Disease Control (CDC) to reinstate a mask recommendation for highly impacted areas, even for those that are vaccinated.

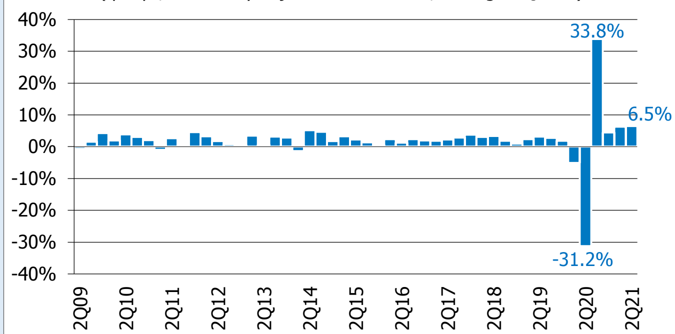
As of July 29, 2021, Senate negotiators from the two parties have reached an agreement on a roughly $1 trillion bipartisan infrastructure framework. President Biden called the deal "the most significant long-term investment in our infrastructure and competitiveness in nearly a century." The package still faces a long road to becoming law, as Democrats are pushing for an additional $3.5 trillion healthcare, childcare, and antipoverty plan (that is less likely to attract bipartisan support) and are tying the infrastructure effort to it.

The total return on core commercial real estate assets was 3.59% in 2Q2021, composed of 1.06% income and 2.54% appreciation (see Chart 3).[3] This is the highest quarterly return since 3.94% in 2Q2011 (although 3.57% in 1Q2015 was very close).

Commercial real estate capital market conditions, while remaining disjointed in some sectors due to COVID-19, showed improvement in the second quarter, as the availability of debt and equity capital increased. However, the rate of improvement has varied by asset profile. For example, well-leased apartment and warehouse properties are generally experiencing strong buyer interest and are readily financeable, while retail properties and low-occupancy office properties are experiencing less buyer interest and are less financeable. Still, while the decline in overall U.S. economic activity that occurred in the wake of COVID-19 has affected leasing demand for most types of commercial real estate, low interest rates have provided support for property values. Based on current valuation measures, commercial real estate should continue to offer good relative value compared to other asset classes.

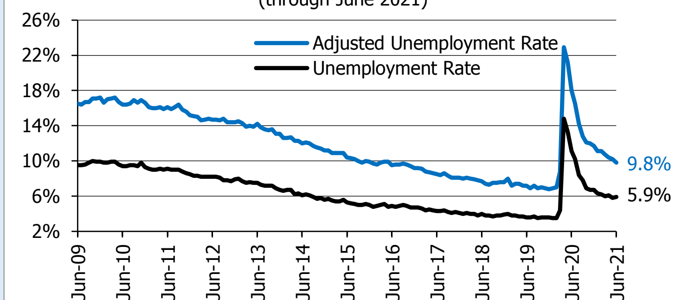
The pandemic has had, and will likely continue to have, different effects on each of the major property types. Demand for office space has been, and will likely continue to be, negatively influenced by greater adoption of work-from-home policies, but the possible post-COVID-19 shift to more office space per employee may help to offset this negative impact, at least in the short term. Office leasing velocity has declined substantially, and space available for sublease now exceeds the level reached during the Global Financial Crisis (GFC) of 2007-08. Meanwhile, the industrial sector should continue to benefit

Chart 1. Real GDP Growth
(qtr/qtr, seasonally adjusted annual rate, through 2Q2021)



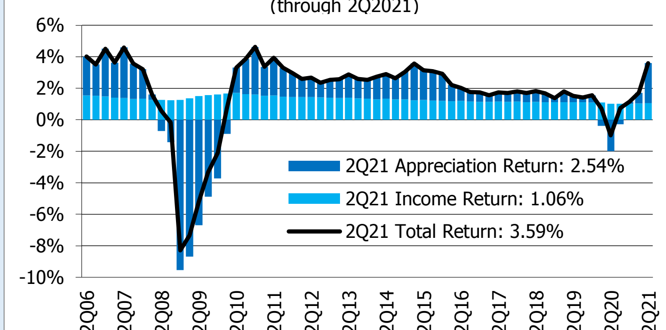
Source: Bureau of Economic Analysis, 2Q2021

Chart 2. Two Measures of Unemployment
(through June 2021)



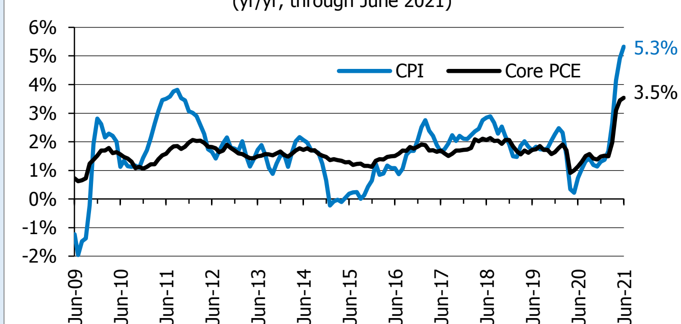
Source: Bureau of Labor Statistics, Jun 2021
Adjusted Unemployment Rate: U-6 unemployment rate (official unemployment rate broadened to include all persons marginally attached to the labor force plus total employed part time for economic reasons).

Chart 3. CRE Core Returns By Component
(through 2Q2021)



Source: NCREIF Property Index, 2Q2021

Chart 4. Two Measures of Consumer Price Inflation
(yr/yr, through June 2021)



Sources: Bureau of Economic Analysis, Jun 2021; Bureau of Labor Statistics, Jun 2021 from the accelerated consumer shift to e-commerce. The retail sector is undergoing a slow and painful recalibration due to long-term oversupply and the impact of online shopping. In recent years, construction of apartments has not kept up with household formation, spurring outperformance in apartment rent growth and occupancy despite the pandemic.

Looking forward, it seems likely that many aspects of the commercial real estate industry will evolve more rapidly than usual. Long-lasting changes going forward may include an acceleration of e-commerce, working from home, factory automation, remote learning, digital banking, data center usage, digital leisure, telehealth, and video conferencing. The Biden administration's executive and legislative priorities will also impact commercial real estate. Corporate and individual migration decisions will favor pro-business localities with lower cost housing, lower taxes, and less regulation. Those able to recognize the future direction of growth of various types of commercial real estate and understand pricing irregularities will likely achieve outsized investment gains.

THE ECONOMY

Vaccination progress has been the key to re-opening the U.S. economy. As of July 30, 2021, 69% of U.S. adults had received the first dose of the COVID-19 vaccine, and 60% of U.S. adults were fully vaccinated. Despite the progress, there has been vaccine hesitation amongst a consequential portion of the population. On May 14, 2021, President Biden announced that with a few exceptions, masks would not be required in public spaces for those who are vaccinated.[4] Many were hopeful that this would mark the official re-opening of the U.S. economy. However, concern over the Delta COVID-19 variant has caused the Center for Disease Control (CDC) to reinstate a mask recommendation for highly impacted areas, even for those that are vaccinated. The state of California reinstated a mask requirement in July. While pent-up consumer and business demand for a wide range of goods and services has led to a surge of economic activity, the spread of the Delta variant across the U.S. and reinstituted mask mandates and recommendations have renewed concerns about further progress.

With the Democratic Party having majority control over the executive and legislative branches of government, substantial changes to healthcare, taxation, and regulation are possible. As of July 29, 2021, Senate negotiators from the two parties have reached an agreement on a bipartisan infrastructure framework. A roughly $1 trillion agreement cleared the first procedural hurdle in a 67-32 vote. President Biden called the deal "the most significant long-term investment in our infrastructure and competitiveness in nearly a century." Indeed, the infrastructure spending includes money targeted for roads, bridges, clean drinking water, public transit, freight rail systems, ports, airports, broadband access, and elsewhere. However, the package still faces a long road to becoming law as Democrats are pushing for an additional $3.5 trillion healthcare, childcare, and antipoverty plan (that is less likely to attract bipartisan support) and are tying the infrastructure effort to it.

In order to partially cover the cost of some of the programs, President Biden has proposed an increase in the federal long-term capital gains tax rate to 43.4% (from its current 23.8%) for those earning more than $1,000,000 per year. The President has also proposed increasing the federal corporate income tax rate from 21% to 28%. Additional tax increase proposals are expected, including raising the top federal personal income tax rate from 37% to 39.6% and eliminating the "carried interest" provision that benefits some fund managers. He has also proposed increasing funding for the Internal Revenue Service to raise revenue by enforcing tax collection and auditing wealthy taxpayers. If enacted, the cumulative effect of these tax increases could negatively impact the U.S. economy. Although not included in the Biden tax proposal, legislators representing high tax states have championed lifting the $10,000 cap on tax deductions for state and local taxes (SALT). If passed, this could benefit states with higher taxes.

Certain states, including New York, have proposed or enacted their own tax increases. Higher state and local taxes may cause increased migration from already high tax states such as California, New York, and New Jersey, to lower- and zero-income tax states such as Texas, Nevada, Tennessee, and Florida. This is particularly true if the $10,000 SALT deduction cap remains in place.

The U.S. economy grew for the fourth straight quarter in 2Q2021, growing at a 6.5% annualized rate (see Chart 1). The level of GDP now stands 1% above its pre-pandemic high level.[5] This 6.5% annualized growth rate represents a slight acceleration in growth from the previous quarter and reflects a continuation of the largest surge in consumer spending since the 1960s. 2Q2021 GDP growth included a big increase in the important personal consumption expenditure (PCE) component, which grew at an annualized rate of 11.8%. This increase in PCE – which, at approximately 70% of GDP, is the largest and most important component of GDP – was mainly due to spending on services, which increased at a 12.0% annualized rate (led by food services and accommodations), and spending on goods, which increased at a 11.6% annualized rate (led by "other" nondurable goods, notably pharmaceutical products).

The 5% annualized decrease in federal government spending in the second quarter was primarily attributable to a decrease in nondefense spending on intermediate goods and services. Government loans to businesses and grants to state and local governments both increased, while social benefits to households, such as direct economic impact payments, declined.

In the five years preceding COVID-19's arrival, retail sales growth averaged 3.5% per year, but during the pandemic, retail sales growth has been volatile. In the early months of the pandemic, retail sales declined cumulatively by 22.0%. From that low point, sales have been improving significantly. As of June 2021, sales are 18.0% higher year-over-year and 51.6% higher than they were in April 2020. It is important to note that the $621 million in retail and food service sales in June 2021 is one of the highest on record, and 17.9% above pre-COVID-19 levels.

Employment levels continue to improve steadily. For the week ending July 17, 2021, continued unemployment claims stood at 3.3 million, which is substantially below the staggering May 2020 high of 23.1 million, yet still nearly double the 1.7 million weekly average for the one-year period prior to the arrival of the virus. The headline U.S. unemployment measure – the "U-3" unemployment rate – stands at 5.9% as of June 2021 (see Chart 2). This is a considerable improvement over the high of 14.7% recorded in April 2020 but is still substantially above the pre-pandemic level of 3.5%. The broader "U-6" measure of the unemployment rate has declined to 9.8% from the record high of 22.8% recorded in April 2020. In total, the recovery has seen 15.6 million Americans return to work between May 2020 to June 2021, a meaningful improvement. Still, payrolls are 6.8 million below the pre-pandemic peak, and recent employment growth has slowed. Paradoxically, there were 9.2 million job openings as of May 2021. The elevated federal unemployment payments ($300 per week) are one possible explanation for the dichotomy. As of July 15, 2021, approximately half of U.S. states have ended the elevated unemployment payments, while the payments from the other half will end after Labor Day (September 6, 2021). Other causes of continued elevated unemployment levels may include continuing fears of contracting COVID-19 and employee difficulties in finding childcare.

In response to the economic stress created by COVID-19, the Federal Open Market Committee (FOMC) cut interest rates to near zero at two emergency meetings in March 2020, resulting in a Federal Funds target rate range of 0% - 0.25%. The target rate has remained unchanged over the subsequent 16 months. At their two-day monetary policy meeting ending July 28th, 2021, Federal Reserve officials voted to leave the Federal Funds target rate range unchanged at 0% - 0.25% and to continue the $120 billion monthly pace of asset purchases until "substantial further progress" had been made on boosting employment and the economy.

The committee continued to maintain that inflation had risen "largely reflecting transitory factors," and that risks to the economic outlook remain. In a statement released July 28, 2021, the committee noted that "The sectors most adversely affected by the pandemic have shown improvement but have not fully recovered" and that "The economy has made progress toward these goals, and the committee will continue to assess progress in coming meetings."

Fed Chair Jerome Powell said in a post-meeting statement that "[The recovery] remains uneven and far from complete" and "[The economy] is a long way from our goals." He also added that "It will take some time before we see substantial further progress."

Inflation has accelerated over the past three months. Headline Consumer Price Index (CPI) inflation, on a year-over-year basis, jumped from 2.6% in March to 5.3% in June, the highest reading since August 2008 (see Chart 4). Likewise, the Core CPI, which excludes the more volatile food and energy components, rose from 1.6% in March to 4.5% in June. The Fed's preferred measure of inflation – the Core PCE Deflator – was up 3.5% in June, an increase from the May figure of 3.4% and substantially above the recent low of 0.9% recorded in April 2020. The overall PCE was up 4.0%, unchanged from the previous month and substantially higher than the 0.5% figure in April 2020. The S&P CoreLogic Case-Shiller index of single-family property values climbed 16.6% in May from a year earlier, the largest increase since recording began in 1988.

In May, American household incomes (from wages, investment returns and government aid programs) fell by -2.0%, as there was no additional government stimulus. The personal savings rate fell to 12.4% in May, still above the pre-COVID-19 level of approximately 8%. The data shows personal income has largely reverted to the trendline, and the savings rate is still elevated. A good portion of the savings rate decrease was due to consumers no longer having government stimulus payments to add to savings.

Substantial spending of savings has spurred GDP growth in 2021, increasing demand for goods and services to the point of causing inflation readings not seen in 13 years. The Fed insists that this burst of inflation is temporary, as pent-up demand for leisure, services, and goods has been unleashed on a market that needs time to adjust. However, the effects of the massive stimulus efforts in 2020 and 2021, unprecedented government spending, and pent-up consumer demand, could cause inflation to remain elevated for a sustained period, and potentially cause interest rates to rise.

Globalization, already under stress prior to the pandemic, may suffer long-term damage from COVID-19. The U.S. is seeking to reduce its reliance on China and other countries for critical supplies, including active pharmaceutical ingredients, generic medicines, and personal protective equipment. President Biden has signed an executive order strengthening "Buy American" rules for federal agencies, and it appears that the Biden administration may be continuing the previous administration's trade policies, albeit with a different demeanor and posture. Continued COVID-19-driven restrictions on international travel may further dampen globalization trends.

Looking forward to the balance of 2021 and into 2022, we believe that primary risks to the U.S. economic outlook include:

- The pandemic proves difficult to control and results in a reclosing of large parts of the U.S. economy;
- Inflation proves higher and longer-lived than expected;
- Labor shortages continue even after elevated unemployment payments end;
- Executive and legislative branches adopt a high tax, high regulation posture that stifles business and consumption, with federal and state tax increases stalling the U.S. recovery;
- State and local governments – particularly those with substantial legacy pension obligations – require more revenues, and raise taxes (i.e., real estate, income, transfer, and sales taxes) and cut services to meet those needs;
- Deglobalization leads to diminished trade in a post-COVID-19 world;
- Gateway cities do not fully recover to their pre-COVID-19 economic health.

COMMERCIAL REAL ESTATE

In the second quarter, core commercial real estate's total return was 3.59%, consisting of 1.06% income and 2.54% appreciation, the strongest quarterly performance since 2Q2011. As states have started to reopen, pent-up demand for a wide range of goods and services has benefited certain property types. Going forward, fundamental changes to how and where individuals live, work, and consume goods are underway, and this period may prove an opportunity to seize outsized gains on strategic and thoughtful investments in real estate.

The apartment sector had a strong quarter on many fronts, experiencing record leasing demand as the U.S. economy continued to recover from its sharp contraction in mid-2020. In 2Q2021, 229 million square feet of apartment space was absorbed nationally. This is a historic high and represents approximately two thirds of the absorption experienced in the whole of 2020. According to the National Multifamily Housing Council Rent Tracker, nationwide apartment rent collections improved, increasing from 94.2% in 1Q2021 to 95.1% in 2Q2021.[6] Rent trends were positive, as apartment asking rents grew in 78 of the top 80 largest markets on a year-over-year basis, with only San Jose and San Francisco experiencing declines. The average growth of effective rents (which are asking rents that have been adjusted to account for concessions given to renters) was 7.7%, as landlords drastically reduced concessions (compared to concessions offered during the height of the pandemic). However, in downtown areas in some expensive markets like New York and the San Francisco Bay Area, landlords are still relying on concessions to get leases signed. Gateway cities are particularly vulnerable to the economic fallout of COVID-19 and enhanced work-from-home policies. Looking forward, according to CoStar data, the current construction pipeline indicates fewer than average new deliveries are expected in coming quarters, suggesting that rents may grow further in 2022. Additionally, the persistent lack of affordable housing and continued demographic growth in certain markets have only accelerated investor interest in the apartment sector.

The industrial sector also has been positively impacted by a growing U.S. economy and the continued explosion of e-commerce, with record average monthly retail sales of $623 billion during the quarter. A dramatic increase in online sales has boosted leasing demand from tenants with e-commerce operations. In 2Q2021, industrial net absorption exceeded 100 million square feet for the first time in history, and according to projections from CoStar, is expected to grow further next quarter. According to NCREIF Market Value Index data, industrial market values are up 20.5% cumulatively over the six quarters since the beginning of the pandemic.[7] The best performing market, Inland Empire, has experienced an industrial market value increase of 29.5%, while Houston, the weakest performing market, was nonetheless also positive at 6.4%. Robust industrial performance has incentivized development across the nation, with another roughly 350 million square feet (about 2% of existing inventory) set to be delivered over the next four quarters.

In the office sector, the relative success of work-from-home arrangements and office tenants' resulting uncertainty about future space needs continued to afflict the sector. Vacancy rates rose in 56 of the top 80 markets in the U.S. The amount of space for sublease has continued to rise, although the rate of increase has slowed. Of the 15 office markets with the highest second quarter year-over-year rent growth, four were in Florida: Miami, Palm Beach, Jacksonville, and Tampa. Office employers are attracted to these locations' low costs and business-friendliness. Conversely, expensive markets with longer average commute times, like San Francisco and New York, were among markets having seen rent declines over the past year. Relative to their pre-pandemic level, office rents in San Francisco and New York are cumulatively down 12.8% and 5.1%, respectively. Although heightened new supply is being experienced in Charlotte, Nashville, Raleigh, and Austin, absorption in these Sunbelt markets has largely kept up with new supply.

While the retail sector has underperformed the other three major property types since 2015, and continued to underperform in 2Q2021, the sector has nevertheless been slowly recovering from pandemic lows. After a record 162 million square feet of retail space was vacated in 2020, announced retail store closures so far this year total just 25 million square feet. If this pace remains through the balance of the year, the retail sector will see the lowest level of closure-related occupancy losses in over 10 years. Retailers have been boosted nationally by trillions of dollars in stimulus payments, paid directly to the people for the express purpose of boosting spending. As the sector recovered from the very low levels experienced during the depths of the pandemic, retail sales hit a record of $628 billion in April 2021, 50% greater than in April 2020. As of June 2021, monthly retail sales are 17.9% greater than their pre-pandemic peak reached in January 2020. Although these figures reflect the explosion in e-commerce sales exhibited during the pandemic, brick-and-mortar sales also increased for a variety of merchants.

COMMERCIAL REAL ESTATE CAPITAL MARKETS

Commercial real estate capital markets continued to show improvement in the second quarter as optimism over economic growth buoyed investor sentiment. In 2Q2021, commercial real estate transaction volume for the four major property types totaled $122 billion, more than double the volume of 2Q2020, and approximately in line with 2Q2019. Major debt providers, including banks, life insurance companies, debt funds, and securitized lenders, have returned in force, compressing spreads for preferred property types. Life insurance company commercial real estate spreads continued the tightening trend, with quoted coupon levels for core products ranging from 2.00% to 2.75% as demand has continued to outpace supply. Improving economic conditions, coupled with vaccination adoption, have spurred investor activity for preferred property types; however, COVID-19's impacts on commercial real estate continued to weigh on certain sectors. Opportunities in the distressed lodging, retail, and office sectors are slowly emerging as sellers are beginning to test the market for price discovery.

The bridge and construction debt markets became even more competitive during 2Q2021, as more lenders began underwriting a near-term economic re-opening as their base case scenario. This has resulted in more capital being allocated to riskier loans, as lenders searched for yield. Nevertheless, risk-adjusted returns in the sector remained attractive enough to broaden the lending base, which grew to include more banks and fund operators across most asset types. Apartment value-add and lease-up projects continued to enjoy a strong bid from fund lenders. Construction loans were also available from multiple sources for both apartment and industrial projects. Within the office and retail sectors, the structured lending market is differentiating between assets that are high quality and well-located and those that are not, as the latter are viewed as more likely to be negatively impacted by a post-COVID pullback in leasing demand and sales. Lastly, during 2Q2021, more banks and insurance companies began looking at hospitality financing as another avenue to grow loan volume in a riskier sector where spread and structure have remained more favorable for lenders. The biggest risk to the continuance of these themes through year end is the potential impact of COVID-19 variants.

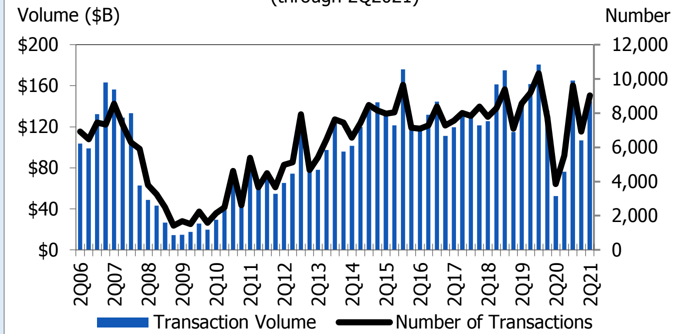
According to JP Morgan data, AAA CMBS spreads were mostly flat over the quarter, hovering in the low-to-mid +60s area. Spreads remained rangebound amid somewhat limited new fixed-rate issuance. Second quarter private label CMBS issuance totaled $43 billion, approximately 270% higher than the same period in 2020, and 47% higher than the same period in 2019. The growth in issuance was driven primarily by floating rate loan collateral, which represented more than two-thirds of the new issue volume in the first half of the year. Forecasts of 2021 private label issuance volume have been revised slightly higher, to the $110 to $120 billion range, due to robust issuance in the CRE CLO market and Single Asset/Single Borrower (SASB) market during the first half of the year.

CMBS collateral performance continued to improve in the second quarter; however, delinquency rates remain elevated relative to historical standards. The multi-borrower "conduit" delinquency rate declined by 70 basis points during the quarter to 7.2%. The progress of the vaccination program in the U.S. has improved the outlooks of many CRE investors; however, loans secured by hotel and retail properties continue to suffer, as these types of collateral continue to experience depressed cash flows and remain the largest source of delinquent loans. According to Citigroup, 19.0% of the conduit loans backed by hotels are classified as delinquent, while 11.4% of the conduit loans secured by retail are delinquent. There has been a steady decline in delinquency rates in the first half of the year. Many loans cured in 2020 were aided by forbearance agreements; however, much of the curing in the second quarter was due to collateral cash flow recovery. Additionally, loans that have rolled off forbearance agreements have delinquency rates lower than the broader market, a sign that forbearance agreements aided borrowers during the pandemic. After peaking in June 2020, loan special servicing rates have continued their slow descent, and at the end of the second quarter, stood at 9.1% for conduit loans and 5.0% for SASB loans, significant improvements over the prior quarter. Similar to the delinquency statistics, the highest special servicing rates are in hotel and retail loans, which collectively represent 75% of the Special Servicing balance at the end of the second quarter.

In the equity markets, confidence within all sectors of commercial real estate pushed higher this quarter. Year-over-year increases in pricing and transaction activity were registered in all primary sectors, materially above last year's pandemic lows.[8] Transaction activity within both the industrial and apartment sectors was particularly impressive and reached the highest level ever recorded for any second quarter period (year-over-year advancements in pricing within both sectors were commensurately impressive at 9.8% and 12.0%, respectively). It seems likely that industrial and apartment asset pricing will hold or move upward for the balance of the year as rental rates are forecast to continue their upward trend. In 44 of the country's 50 largest cities, 2Q2021 apartment rental rates were the highest ever recorded, and aggregate annual gains achieved are likely to be the highest recorded this century. Over the near term, it appears likely that property values and rental rates will continue to rise, as development of new properties is being tempered by dramatic increases in construction pricing.

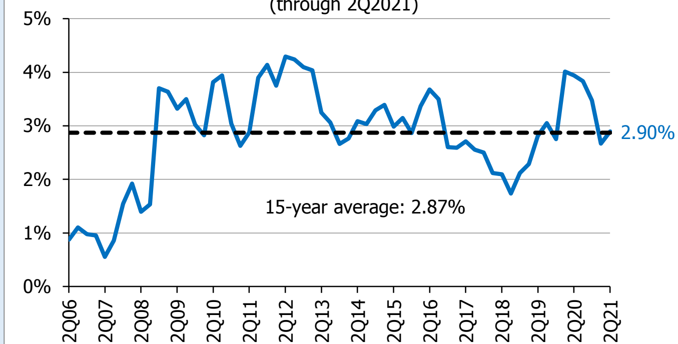
Price increases for industrial and apartment assets (and associated tempering of future return expectations) are supporting growing investor consideration of office and retail assets. After suffering four consecutive quarters of precipitous declines, investment activity in the office and retail sectors increased during 2Q2021 (while remaining well below pre-COVID five-year averages). Nonetheless, interest in both sectors remains inconsistent, segmented, and generally tepid. There is a continued dearth of distressed sale activity in both sectors, and levels of associated market confidence is growing, as measured by the Society of Industrial and Office Realtors (SIOR). Growing confidence has been a consequence of continued positive economic conditions, and more recently, of increased leasing activity. According to SIOR, 68% of office leasing brokers reported increased leasing activity in 2Q2021 as compared to 38% in 1Q2021.

Chart 5. Commercial Real Estate Transaction Volume
(through 2Q2021)



Source: Real Capital Analytics, 2Q2021

Chart 6. Spread of Cap Rates Over 10-Year Treasury
(through 2Q2021)



Source: NCREIF, 2Q2021; Board of Governors of the Federal Reserve, 2Q2021

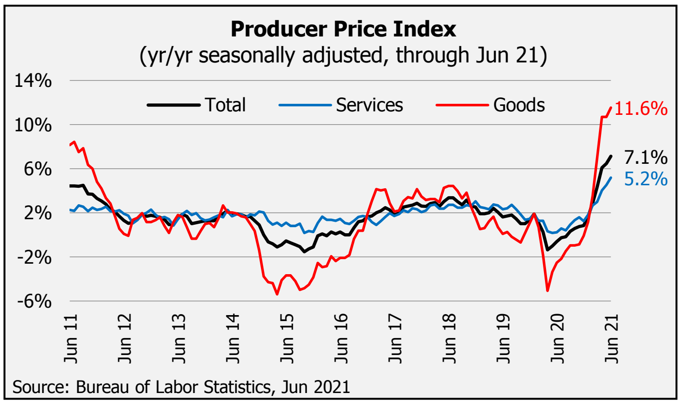
PARK-LINE PALM BEACHES | WEST PALM BEACH, FL

NORTH LOCUST | RIALTO, CA

See Endnotes for important information.

RESEARCH SPOTLIGHT

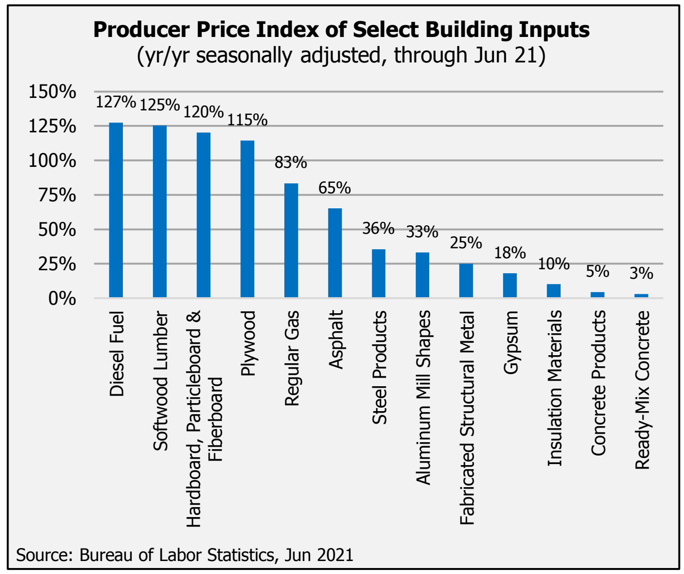
Building material prices have risen substantially since the pandemic began. In fact, supply and demand imbalances and shortages have propelled year-over-year increases to levels exceeding the Producer Price Index (PPI). The PPI measures the average change over time in the selling prices received by domestic producers for their output. The overall figure, known officially as PPI for final demand, advanced 7.1% on a seasonally adjusted basis for the 12 months ended in June.[9] The Services component rose 5.2%, while the Goods component increased 11.6%.



Subcategories of building input costs reflected even greater increases. Various types of wood rose substantially: softwood lumber is up 125.3% (despite a recent substantial decline); hardboard, particle board and fiberboard are up 120.3%; and plywood is up 114.5%. Other materials, such as asphalt (+65.1%), steel products (+35.6%), and aluminum mill shapes (+33.2%), are up significantly as well.

Building materials are used in different proportions in apartment, industrial, office, and retail construction. For example, more softwood lumber is used in constructing apartment properties, while more concrete products are incorporated in industrial facilities.

When construction weightings are applied to the above-noted construction input cost increases, it appears that apartment construction costs (excluding labor) increased 56.6%.10 Industrial experienced the lowest increase at 37.8%, mainly since industrial construction uses less lumber and more concrete. Office construction costs increased 47.4%, while retail costs rose 43.7%. The labor cost share varies according to the type of construction and specific task performed. Higher labor costs are in place for trade intensive apartment projects in contrast to warehouse distribution facilities. The share of total construction costs associated with labor is typically between 40% and 60%.



Should these elevated building material prices remain in place (or increase) over a significant period, it may have the effect of limiting new construction. Some apartment construction has slowed this year, even in the face of fierce demand.[11] If leasing demand remains high in the face of limited new supply, it may also result in higher values for commercial real estate, especially apartment and logistics properties. Naturally, this is not the only variable that influences values, and other factors may have more impact. The recalibration of office usage because of remote work and the rise of e-commerce may depress demand in the office and retail sectors, respectively. In contrast, e-commerce is having a substantial positive effect on the warehouse distribution property type. It is still too early to tell if these elevated material prices are sustainable over the medium or even the short term. The recent decline in the price of lumber indicates that the elevated levels may not be sustainable for some construction components.

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See Endnotes for important information.

The Apartment Sector*

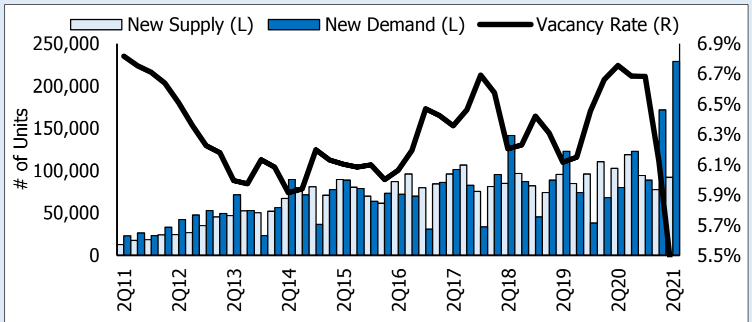
Investments in the apartment sector produced a strong total return of 3.62% in the second quarter, making apartments the second-best performing property type behind industrial. Following the deterioration of apartment fundamentals that occurred in 2020, the sector has experienced strong improvement in the subsequent quarters. In the second quarter, the vacancy rate noticeably declined from 6.1% to 5.3%, while rent growth of 7.1% year-over-year was the strongest recorded in at least the last 20 years.

- In 2020, apartment properties in suburban locations experienced rent growth of 1.5%, while CBD locations suffered a -6.5% decline in rents. Beginning in December 2020, rent growth in CBD locations has started to recover, with rents in CBD locations growing at a nearly identical pace to suburban properties, according to CoStar data.
- Notable increases in the cost of building inputs, including lumber, steel, and fuel, have caused construction starts to slow, according to CoStar data. The 584,000 units currently under construction nationally is the lowest since late 2017.
- The federal eviction moratorium first enacted under former President Trump and extended by President Biden has existed in a few iterations since the beginning of the pandemic and was extended again and will now expire on October 3.[12] Certain states have enacted their own eviction moratoriums that may extend beyond the federal action.
- There is concern among commercial real estate investors that local rent control laws, such as those passed in New York, Oregon, and California, may spread to other jurisdictions. As rents continue to rise, and housing remains scarce, this threat could continue to rise.

Apartment Properties: Performance in the Benchmark

	Quarter	1-Year Period Endings				
	2Q21	2Q21	2Q20	2Q19	2Q18	2Q17
Income Return	0.92%	3.66%	4.23%	4.27%	4.33%	4.51%
Appreciation Return	2.71%	3.22%	-1.22%	1.46%	2.07%	1.72%
Total Return	3.62%	6.96%	2.98%	5.78%	6.46%	6.28%
Garden	5.44%	13.02%	5.26%	8.25%	9.57%	8.40%
High and Low-Rise	2.89%	4.62%	2.10%	4.80%	5.14%	5.31%
Rent Growth		7.12%	0.27%	2.86%	2.88%	2.69%
NOI Growth		-5.26%	-1.51%	6.27%	2.50%	3.08%
Benchmark comparison:						
Total Return, All Properties	3.59%	7.37%	2.69%	6.51%	7.19%	6.97%

Source: NCREIF 2Q21; CoStar Group 2Q21



Source: CoStar 2Q21

The Industrial Sector*

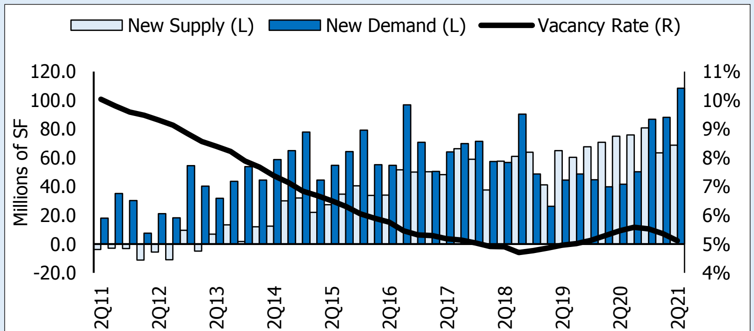
Investments in the industrial sector produced a 2Q2021 total return of 8.88%, consisting of 1.06% income and 7.82% appreciation, the strongest quarterly return in the 43 years of the NCREIF Property Index. Industrial has now outperformed the other major property types for 21 straight quarters, and for 29 out of the last 33 quarters since 2Q2013. The vacancy rate declined in the second quarter from 5.4% to 5.1%, and rents continued to grow substantially at 5.5% year-over-year. According to NCREIF data, industrial's 10.0% year-over-year NOI growth is the highest ever recorded in the sector.

- As of July 2021, e-commerce giant Amazon had leased 18.8 million square feet year to date, exceeding the leasing volume of the next nine largest tenants combined, according to CoStar data. Other industrial tenants that have increased their leased industrial footprint in 2021 include FedEx (3.3 million SF leased year to date), Walmart (2.8 million SF), XPO Logistics (2.7 million SF), Ace Hardware (1.6 million SF), and UPS (1.6 million SF).
- Following a sharp decline in container traffic in the early part of 2020, port traffic has since increased substantially. In the year ended June 2021, the Port of Los Angeles[13] experienced the greatest traffic volume in its 114-year history and became the first port in the Western Hemisphere to process 10 million container imports and exports, as measured in twenty-foot equivalent units (TEUs), in a 12-month period.[14] Los Angeles and Inland Empire, as well as other port industrial markets like Northern New Jersey and Boston, are experiencing historically low vacancy rates.[15]

Industrial Properties: Performance in the Benchmark

	Quarter	1-Year Period Ending				
	2Q21	2Q21	2Q20	2Q19	2Q18	2Q17
Income Return	1.06%	4.43%	4.57%	4.78%	4.99%	5.17%
Appreciation Return	7.82%	17.97%	5.50%	8.78%	8.79%	6.93%
Total Return	8.88%	22.98%	10.26%	13.86%	14.09%	12.37%
Rent Growth		5.48%	4.56%	5.53%	6.04%	5.97%
NOI Growth		10.02%	5.65%	7.86%	7.22%	6.96%
Benchmark comparison:						
Total Return, All Properties	3.59%	7.37%	2.69%	6.51%	7.19%	6.97%

Source: NCREIF 2Q21; CoStar Group 2Q21



Source: CoStar 2Q21

The Office Sector*

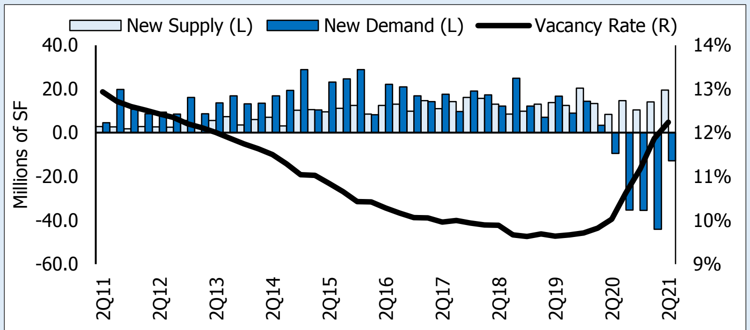
Investments in the office sector produced a quarterly total return of 1.44% in 2Q2021, up from 0.99% last quarter, made up of 1.12% income and 0.31% appreciation. Year-over-year rent growth remained negative at -1.5%, and vacancy rates rose from 11.9% to 12.2%, up from 9.7% in late 2019 and the highest level since 2012. Net absorption was negative at -13 million square feet this quarter, but still an improvement relative to the record -44 million square feet of negative absorption in the first quarter. Cumulatively, over the past four quarters, move-outs have outpaced move-ins by roughly 128 million square feet.

- According to data from Kastle Systems, 34.8% of office workers in the top ten U.S. markets have physically returned to the workplace as of July 26, 2021. Regional differences are significant, with much fewer workers returning in dense, mass transit-dependent locations. For example, over 53% of office workers in Austin have returned to work, compared to 21% in San Francisco.[16]
- Over the past several years, there has been a procession of companies reducing their presence in or moving their headquarters entirely from high tax states like California and New York in favor of lower tax and more business-friendly states like Florida and Texas.
- Amid a surge in the COVID-19 Delta variant, some major employers, including Apple, Google, and Indeed, have decided to delay their September return-to-the-office plans for another month. The increase in Delta variant cases nationwide has the attention of both employers and policymakers, and further increases in cases poses a material risk to near-term office occupancy.[17]

Office Properties: Performance in the Benchmark

	Quarter	1-Year Change As Of				
	2Q21	2Q21	2Q20	2Q19	2Q18	2Q17
Income Return	1.12%	4.47%	4.40%	4.46%	4.64%	4.49%
Appreciation Return	0.31%	-1.18%	-0.41%	2.25%	1.85%	1.05%
Total Return	1.44%	3.25%	3.97%	6.79%	6.55%	5.57%
CBD	0.67%	1.25%	3.09%	6.34%	5.98%	5.30%
Suburban	2.49%	6.12%	5.28%	7.44%	7.36%	5.96%
Rent Growth		-1.53%	1.33%	3.71%	3.17%	2.70%
NOI Growth		2.48%	2.23%	4.26%	5.60%	6.45%
Benchmark comparison:						
Total Return, All Properties	3.59%	7.37%	2.69%	6.51%	7.19%	6.97%

Source: NCREIF 2Q21; CoStar Group 2Q21



Source: CoStar 2Q21

The Retail Sector*

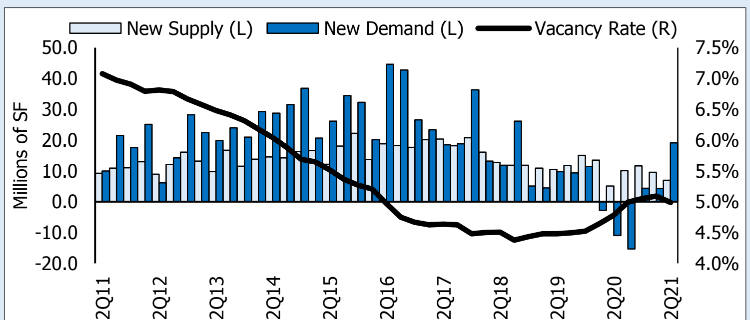
Although investments in the retail sector continued to underperform investments in the other major property types in 2Q2021, the sector returned 0.90%, the first positive quarterly total return since the pandemic began, and strongest return since early 2019. This improvement was driven by very strong net absorption of over 19 million square feet, the largest quarterly figure since 3Q2018, partially recovering some of the 29 million square feet of occupancy lost during the pandemic.

- The $1.9 trillion fiscal stimulus bill passed in March 2021 has supported economic activity, with retail sales reaching a record high of $628 billion in April, nearly 20% higher than pre-pandemic levels.
- As a result of multiple rounds of stimulus, the personal savings rate peaked sharply during the pandemic and currently sit at 12.4% as of May 2021, up from 7.3% before the pandemic. This increased savings could enable greater consumer spending through the balance of 2021, which would benefit the retail sector.
- According to CoStar, "the average-sized footprint leased continues to drift lower, most recently falling below 3,100 SF" in 2Q2021. Numerous retailers, such as Target, Macy's, and Burlington, "have growth plans that primarily focus on opening leaner, smaller formatted stores."[18]

Retail Properties: Performance in the Benchmark

	Quarter	1-Year Change As Of				
	2Q21	2Q21	2Q20	2Q19	2Q18	2Q17
Income Return	1.14%	4.25%	4.42%	4.67%	4.65%	4.78%
Appreciation Return	-0.24%	-5.40%	-9.67%	-2.82%	-0.06%	2.02%
Total Return	0.90%	-1.32%	-5.58%	1.75%	4.60%	6.87%
Malls**	0.34%	-4.12%	-8.07%	0.06%	3.99%	7.17%
Non-Malls**	1.45%	1.56%	-2.70%	3.49%	5.25%	6.62%
Rent Growth		1.12%	1.96%	2.17%	2.61%	2.48%
NOI Growth		21.13%	-32.75%	-0.36%	1.37%	2.14%
Benchmark comparison:						
Total Return, All Properties	3.59%	7.37%	2.69%	6.51%	7.19%	6.97%

Source: NCREIF 2Q21; CoStar Group 2Q21



Source: CoStar 2Q21

ENDNOTES

1. Important Disclosures: The comments, opinions, estimates, and any forward-looking statements contained herein are based on and/or derived from publicly available information from sources that NYL Investors believes to be reliable. We do not guarantee the accuracy of such sources or information. This outlook sets forth our views as of the date noted. The underlying assumptions and our views are subject to change. No part of this material may be copied or redistributed without prior written consent from NYL Investors. The information presented herein is for information purposes only and does not constitute a recommendation to buy and sell or solicitation of an offer to purchase shares in any securities in any jurisdiction. No inference should be drawn that managed accounts will be profitable in the future or that the investment team will be able to achieve its objectives. Investing involves risk; you may experience a profit or a loss and investment results may vary substantially from year to year. References to market benchmarks or other measures of relative market performance over a specified period of time are provided for comparison and information purposes only and do not imply that a client account will achieve returns, volatility or other results similar to those shown.
2. Exceptions include public transportation such as commercial airline, airports, subways, buses, etc.
3. Source: NCREIF Property Index, "Quarterly Detail Report," through 2Q2021.
4. Exceptions include public transportation such as commercial airline, airports, subways, buses, etc.
5. Source: U.S. Bureau of Economic Analysis, June 30, 2021.
6. Source: NMHC Rent Payment Tracker, June 30, 2021. https://www.nmhc.org/research-insight/nmhc-rent-payment-tracker.
7. The NCREIF MVI indices are designed to measure the change in "same store" property values over time for those properties in the NCREIF Property Index. The indices are calculated by summing net capital appreciation and routine capital expenditures (i.e., the "typical recurring expenses related to changing tenancy and ordinary repairs") while excluding major non-routine capital expenditures (i.e., those which "alter the physical, functional, or economic condition of a property").
8. The sub-property type of Office – CBD was down 2.4%, according to Real Capital Analytics.
9. IBID.
10. Although there are many variables that go into determining the amount of each material that goes into each property type, the property type numbers were based on general estimates. Precise numbers would vary based on local conditions and price fluctuations.
11. Ryan Dezember, "Lumber Prices Break New Records, Adding Heat to Home Prices," The Wall Street Journal, May 3, 2021. https://www.wsj.com/articles/record-lumber-prices-lift-sawmills-while-homeowners-do-it-yourselfers-pay-up-11620034201?mod=article_inline.
12. Source: U.S. Center for Disease Control. https://www.cdc.gov/coronavirus/2019-ncov/communication/Signed-CDC-Eviction-Order.pdf. The federal eviction moratorium has existed in a few iterations since the beginning of the pandemic, first as a legislation in the CARES Act, and then as an Agency Order from the CDC. Unlike previous versions, the federal eviction moratorium currently in place applies only to "counties experiencing substantial and high levels of community transmission," according to the U.S. Center for Disease Control.
13. Includes Port of Los Angeles only. Does not include neighboring Port of Long Beach.
14. Source: Port of Los Angeles.
15. Source: CoStar data. The industrial vacancy rates of Los Angeles, Inland Empire, Northern New Jersey, and Boston are 2.3%, 2.9%, 3.4%, and 4.5%, respectively.
16. Source: CoStar.
17. The federal government, the states of New York and California, and the cities of New York and Denver, among others, have implemented a requirement that their employees receive a COVID-19 vaccine or undergo frequent testing as a condition of employment.
18. Source: CoStar.

*Upper Exhibit: Performance data are unlevered, property-level returns from the NCREIF NPI Index; source: NCREIF. "Rent Growth" is based on effective rents (for apartments) or asking rents (for all other property types), on a year-over-year basis; source: CoStar. "NOI Growth" is same-store NOI growth from the NCREIF NPI Index, on a T12 / prior T12 basis; source: NCREIF. Lower Exhibit: "New Supply," which is net completions in units (for apartments) or square feet (for all other property types), "New Demand," which is net absorption in units (for apartments) or square feet (for all other property types), and "Vacancy Rate"; source: CoStar.

**The "malls" sub-property type is defined and calculated by New York Life Real Estate Investors and is the aggregation of NCREIF's "super-regional malls" and "regional malls" sub-property types, with retail's other property types being aggregated into the "non-malls" sub-property type.

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