PCS ADVISORS

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State of Commercial Real Estate

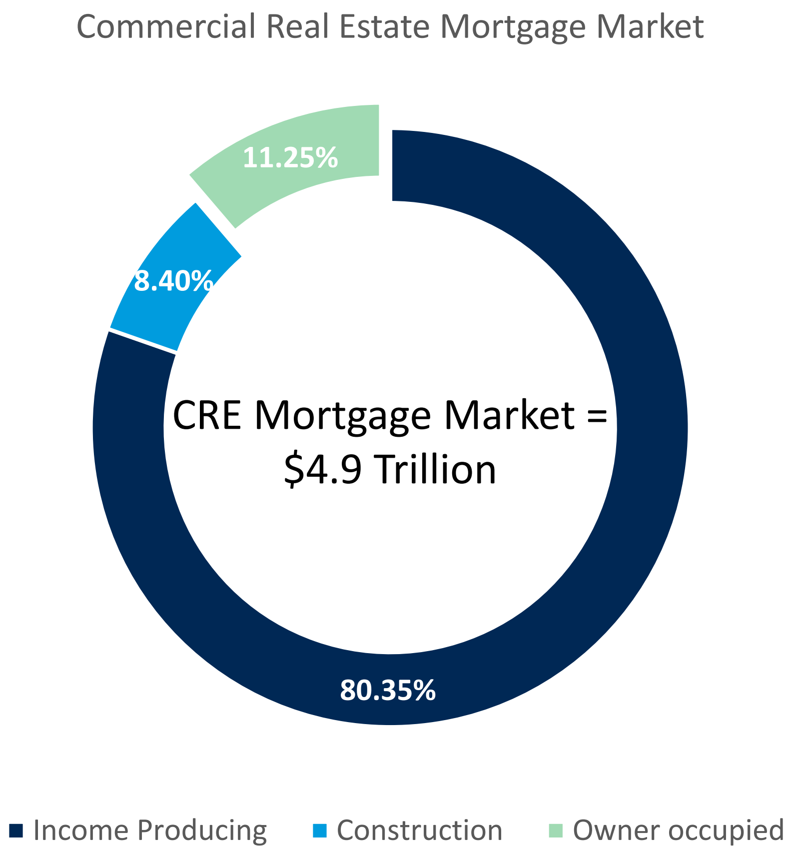
2Q 2023

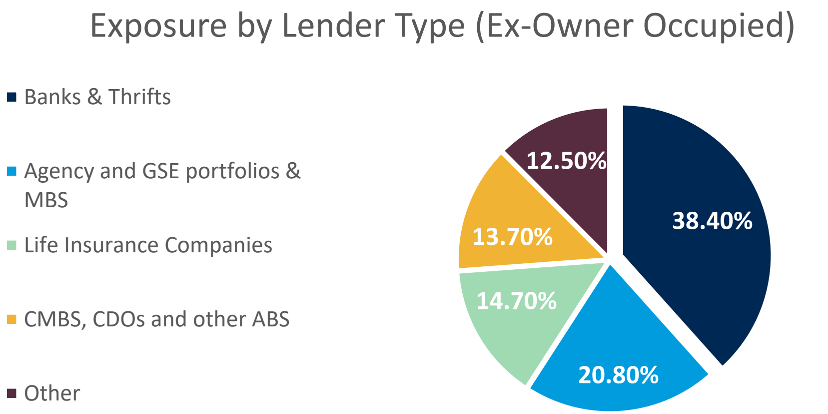
Commercial Real Estate: The Next Shoe to Drop?

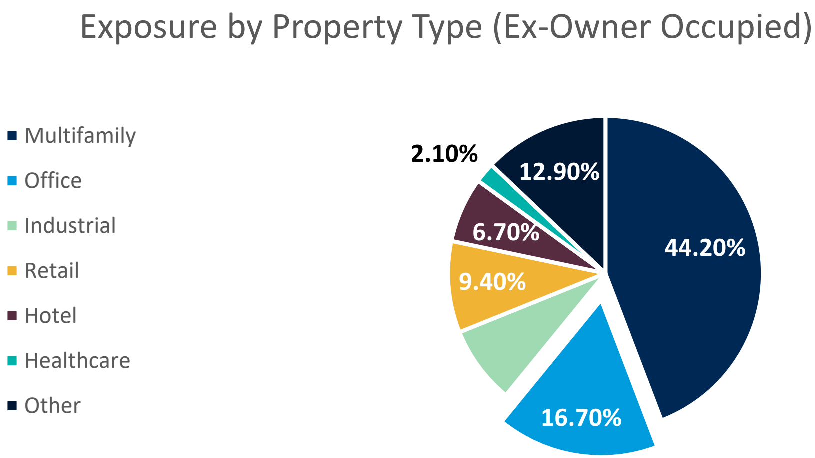
- There appear to be several misperceptions around the level of stress in the commercial real estate market today.
- The extreme pessimism around the outlook for real estate is the result of multiple factors:
  - Fallout of Silicon Valley Bank and subsequent scrutiny of regional banks broadly. This has resulted in tighter lending standards and put into question commercial real estate's access to capital, particularly in the face of more immediate refinancing needs.
  - Burden from the Federal Reserve's interest rate hikes, as higher discount rates and borrowing costs have pressured cap rates.
  - Fears of an economic slowdown, as segments of the real estate market tend to have a level of cyclicality associated with them.
- Much of this has already been priced into the public market, with REITs (as measured by the FTSE NAREIT All Equity REITS Index) down approximately 25% in 2022.
- Core private real estate traditionally lags the public market and is experiencing current asset write-downs.
- While the private market may be more susceptible to the stress, given its property makeup, widespread defaults and a systemic fallout are unlikely outcomes in our view.

Source: Morningstar, Data as of March 31, 2023. Past performance does not indicate future performance and there is a possibility of a loss.

Commercial Real Estate Mortgage Market







- The Commercial Real Estate Mortgage Market represents $4.9 trillion, $4.5 trillion in income producing properties and construction loans (owner occupied not representative of investable market).
- Of the $4.5 trillion, only 38.4% of the exposure comes from banks & thrifts, and only 16.7% of this is in office loans – which is the most stressed property type.
- Therefore, only ~6.4% of all income producing and construction loans outstanding are office loans issued by banks.

Sources: Mortgage Bankers Association, FDIC, Cohen & Steers. Data as of March 10, 2023. Past performance does not indicate future performance and there is a possibility of a loss.

Commercial Real Estate Lending: Regional Bank Exposure

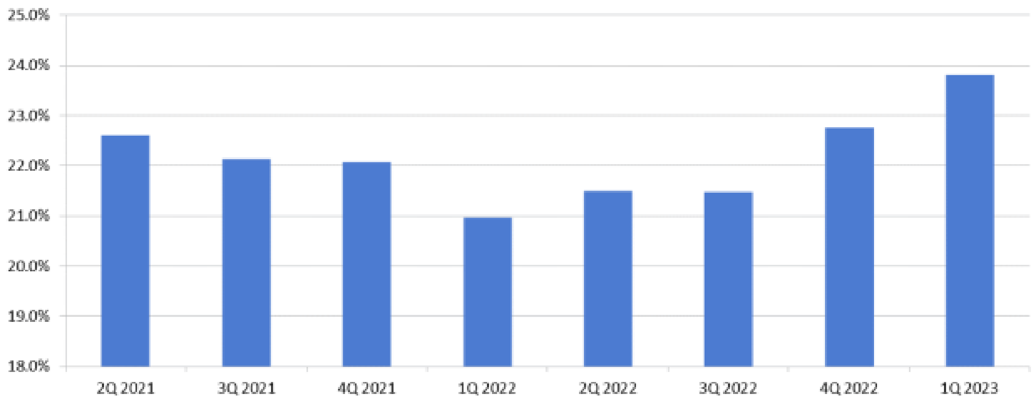
Bank Size	# of Banks	% of Total Assets	CRE % of Total	Office % of Total	% of Total Bank CRE	% of Total CRE Mortgages
Top 25	25	64.9	4.3	0.5	29.9	13.4
$10 bn -$160 bn	135	20.6	16.2	2.0	35.7	16.0
$1 bn - $10 bn	829	9.7	24.3	3.2	25.3	11.4
$100 mn - $1 bn	2,965	4.6	18.3	2.6	9.0	4.1
<$100 mn	761	0.2	7.2	1.1	0.1	0.1
Total	4,715	100.0	9.3	1.2	100.0	44.9
Regional & Community	**4690**	**35.1**	**18.6**	**3.0**	**70**	**32**

- Banks represent ~45% of all Commercial Real Estate Loans. Regional Banks account for only ~32%.
- Of the ***bank*** exposure (not total CRE loan exposure), regional and community banks make up ~70%, whereas the Top 25 banks account for ~30%.
- Office, the most stressed real estate sector, represents only ~3% of total assets amongst regional & community banks.
- Regional bank lending is well diversified – spread out across nearly 4700 regional and community banks, meaning the fallout of even a few would likely have minimal impact.

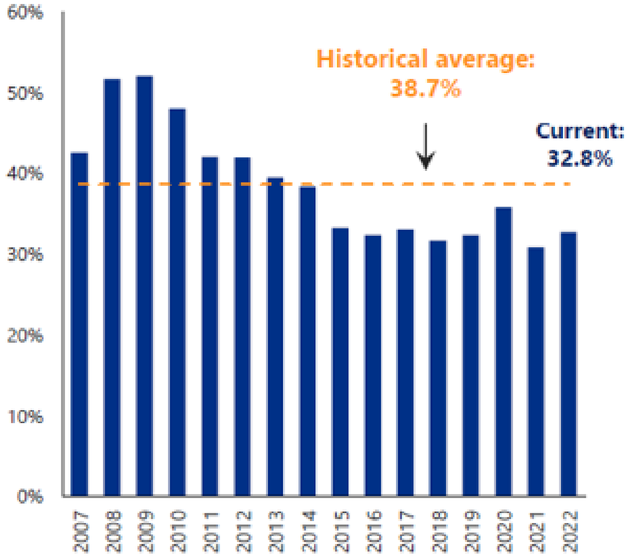
Sources: Mortgage Bankers Association, FDIC, Cohen & Steers. Data as of March 10, 2023. Past performance does not indicate future performance and there is a possibility of a loss.

Leverage in Today's Real Estate Market

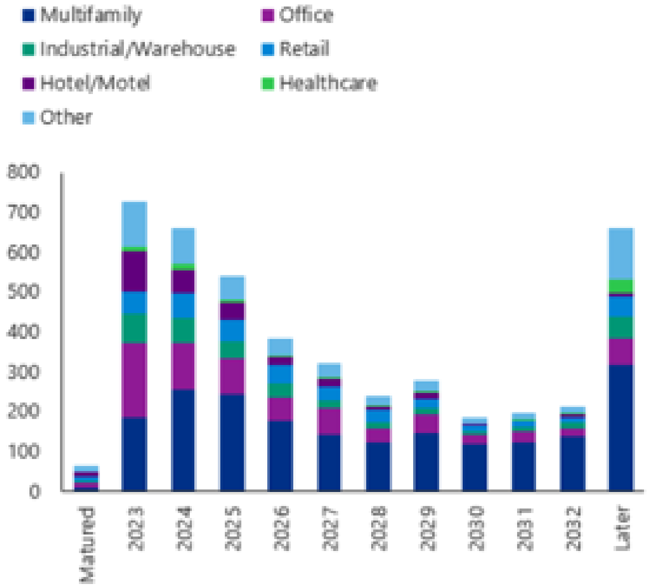
NFI-ODCE Leverage Trends (% of total assets)



U.S. REITs average leverage has declined



Debt by property type ($)

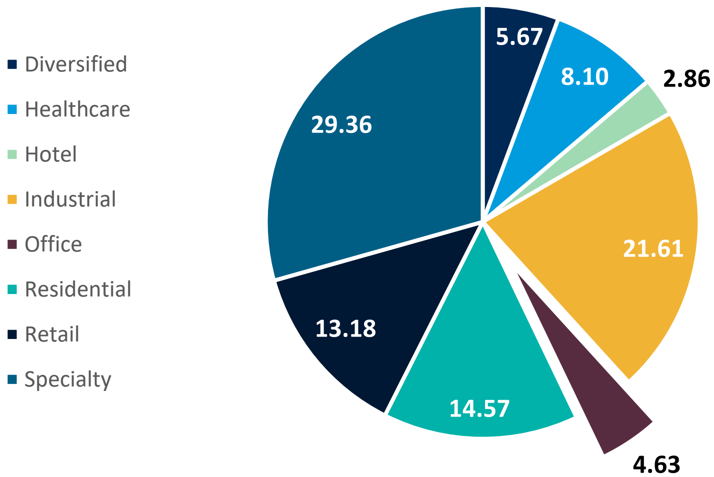


- **Above:** CRE borrowers have been conservative in their use of leverage since the GFC, in both the ODCE and REIT markets, with the ODCE below 24% and REITs just under 33%. While ODCE loan-to-value (LTV) ratios appear to have increased, this is a denominator effect, due to recent value write-downs.
- **Left:** 16% of CRE debt is maturing in 2023, 26% of which is office loans. Said differently, only about 4.2% of CRE debt outstanding is office loans coming due in 2023.

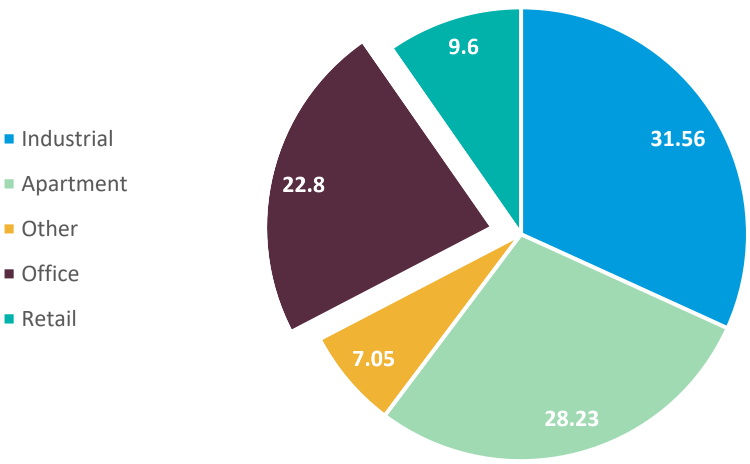
Sources: Mortgage Bankers Association, Cohen & Steers, NCREIF. "NFI-ODCE Leverage Trends" data as of March 31, 2023; "U.S. REITs average leverage has declined" data as of December 31, 2022; "Debt by property type" data as of March 10, 2023. Past performance does not indicate future performance and there is a possibility of a loss.

Office: Public vs. Private Real Estate

FTSE Nareit All Equity REITs Sector Weights



NFI ODCE Index



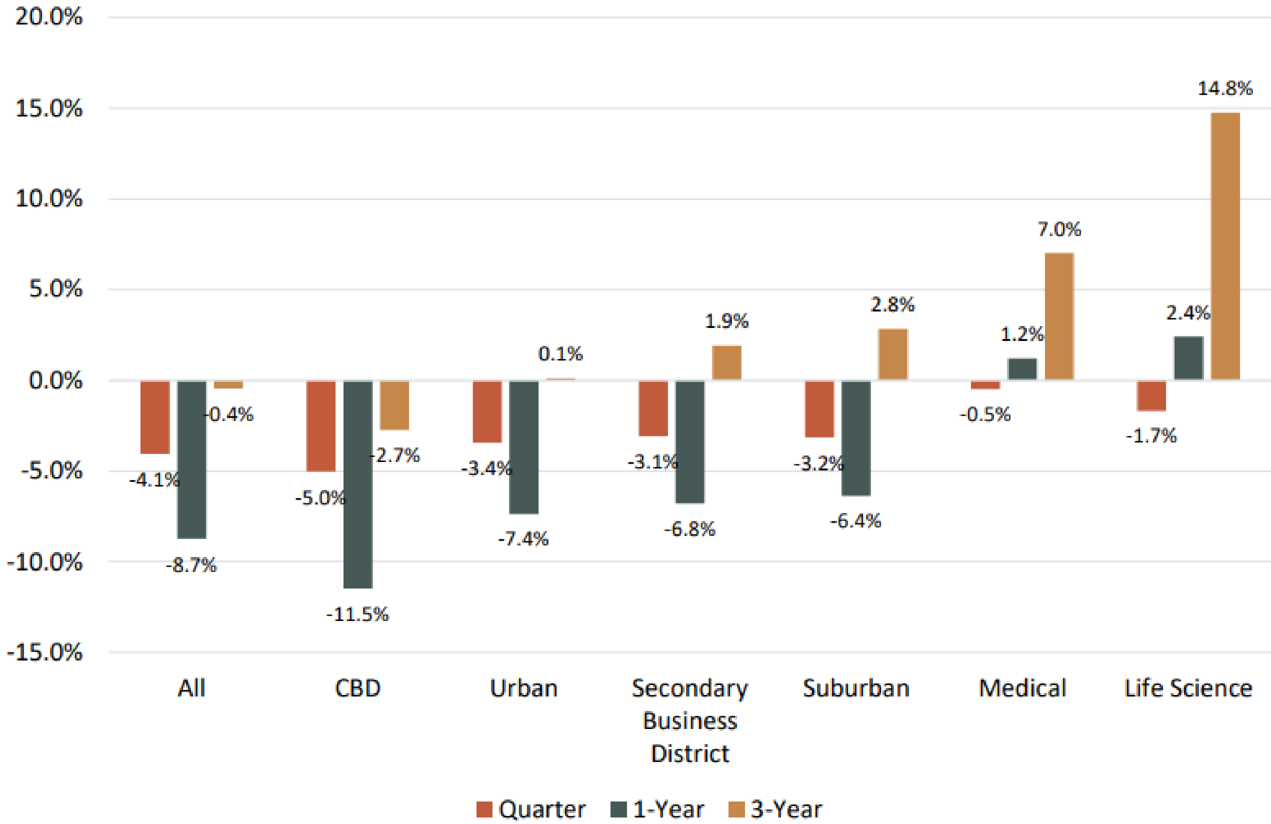
	2022	2020-2022	4Q 2022	1Q 2023
FTSE Nareit All Equity REITs	-24.95	0.20	4.14	1.74
FTSE Nareit Eqty Office	-37.62	-14.70	-1.47	-15.86

	2022	2020-2022	4Q 2022	1Q2023
NCREIF Fund ODCE	7.46	9.93	-4.97	-3.17
NCREIF Office	-3.36	1.37	-4.80	-4.06

- Office represents only a small proportion of the publicly traded REIT market, at 4.63%. While a more substantial weight in private markets, not all office buildings are under the same amount of stress (see next slide).
- Work-from-home and hybrid work environments post-pandemic has put into question future demand for office space and weighed on returns, with the sector underperforming broader real estate in both public and private markets.
- Public REITs were down close to 25% in 2022, while private real estate was positive in aggregate. Public REITs tend to be a leading indicator of the private market. We have started to witness this turn in private markets, with greater write-downs reflected in performance.

Sources: Morningstar, NCREIF. Data as of March 31, 2023. Past performance does not indicate future performance and there is a possibility of a loss.

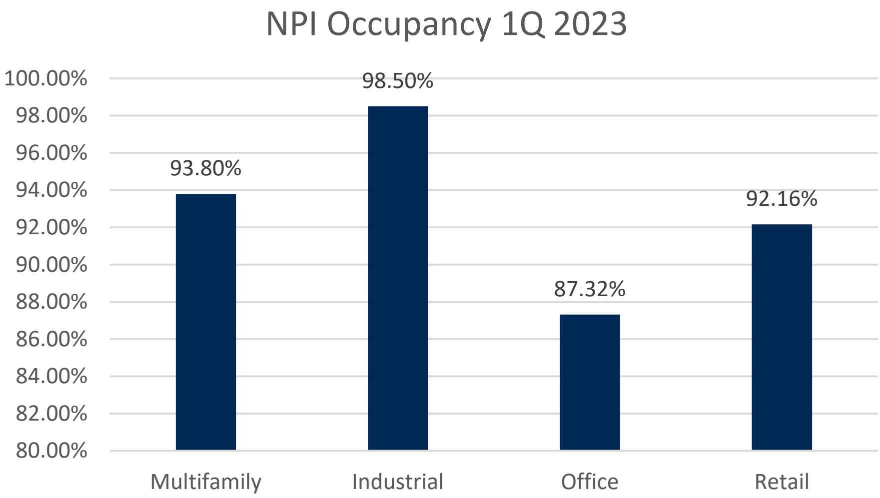
Not All Office is Created Equal

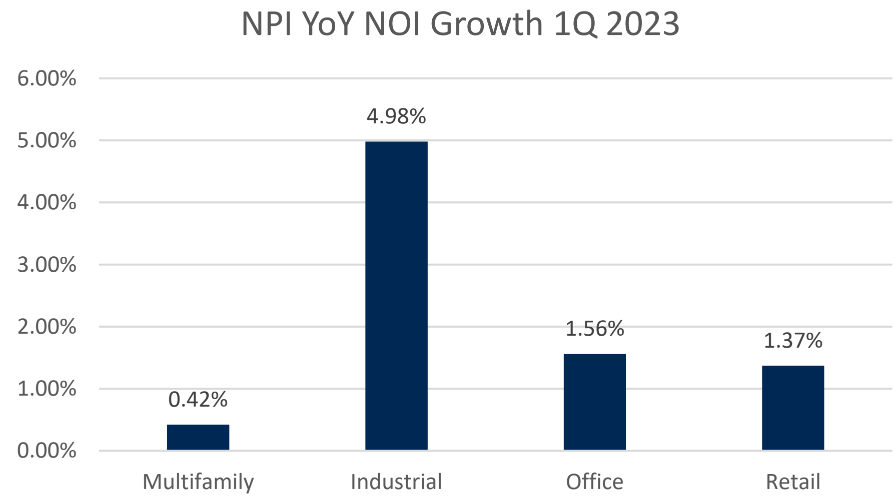


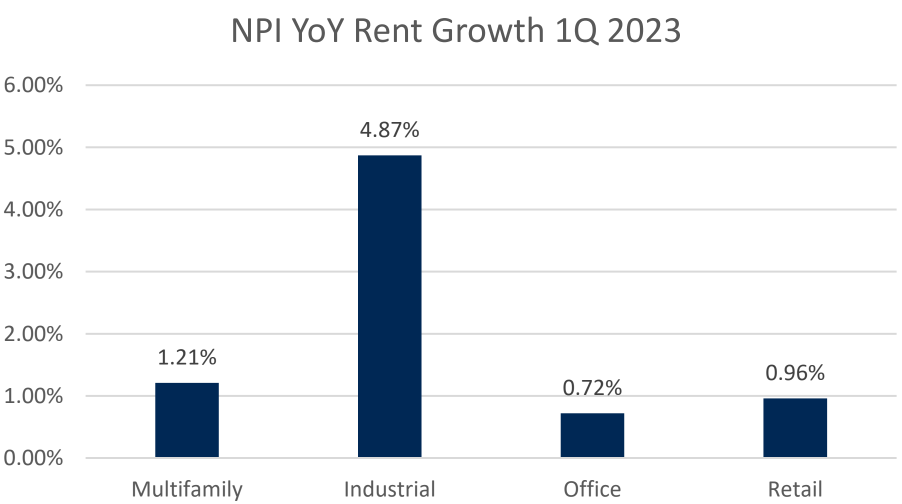
- Needs based office assets, such as medical and life science, have shown resilience.
- Additionally, suburban and secondary business district assets have held up better than central business district and urban counterparts.
- Newer office assets in sunbelt regions with stronger job and population growth, have outperformed.

Sources: NCREIF, Affinius Capital Research. Data as of March 31, 2023. Past performance does not indicate future performance and there is a possibility of a loss.

Real Estate Fundamentals Remain Resilient







- In aggregate, property fundamentals appear to be holding up for commercial real estate.
- While occupancy is becoming stressed in office, industrial occupancy is near all-time highs, while apartment and retail are healthy, exceeding 90%.
- Year-over-year NOI and rent growth remains positive across the NCREIF Property Index (NPI).

Sources: NCREIF, Barings. Data as of March 31, 2023. Past performance does not indicate future performance and there is a possibility of a loss.

Key Takeaways

- Banks' commercial real estate (CRE) loan exposure is overstated and much more modest than what has been reflected in recent headlines.
- While the office sector is challenged, it represents only a small piece of loan exposure and represents a fraction of the total commercial real estate market.
- REIT balance sheets and broader CRE LTVs are in good shape.
- Staggered loan maturities help mitigate the risk from any surge in refinancing. Only about 4.2% of CRE loans are office loans due in 2023.
- Broader fundamentals remain healthy across many property types.

Index Definitions & Disclosures

- Comparisons to any indices referenced herein are for illustrative purposes only and are not meant to imply that actual returns or volatility will be similar to the indices. Indices cannot be invested in directly. Unmanaged index returns assume reinvestment of any and all distributions and do not reflect our fees or expenses.
- **FTSE NAREIT All Equity REITs Index** is a free-float adjusted, market-capitalization weighted index that contains all U.S. Equity REITs.
- **NCREIF Property Index (NPI)** is a quarterly, market value weighted index of private, core, operating properties located in the U.S. The index reflects unleveraged returns of apartment, hotel, industrial, retail and multifamily properties that were acquired on behalf of tax-exempt institutions for investment purposes only.
- **NFI ODCE Index** is a quarterly, market value weighted index of qualified open-end, diversified, core equity private real estate funds.

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