2024

HOUSE VIEW

North American Property Market Outlook

March 2024

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EXECUTIVE SUMMARY

The North American real estate market is currently undergoing a significant transformation, which is characterized by a dynamic economic landscape replete with both challenges and opportunities for investors. This report provides an in-depth analysis of the complex interplay of factors that can impact the market in 2024 and offers a nuanced outlook to help investors navigate the North American property market this year:

1. **Economic Assessment:** We expect economic growth and inflation to moderate this year as household consumption, business spending, and inventory accumulation slow. There is still an elevated risk of recession in 2024 or early 2025. While headline inflation remains above the Federal Reserve's (Fed's) desired target, it will decline as the lagged impacts of housing inflation subside. Despite a weakening labor market outlook, some job categories will continue to experience modest wage growth and labor shortages. While the U.S. economy faces growth headwinds this year, we have identified two major secular themes—Artificial Intelligence (AI) and onshoring/nearshoring—that are still poised to shape the investment landscape.

2. **Interest Rate Projections:** Given our expected slowdown in economic growth, the decline in inflation, and the elevated likelihood of a recession, our analysis suggests that the Fed's interest projections may be too high. We anticipate the possibility of 100 basis points of cuts in 2024 to early 2025 if a recession hits. Yet until rate cuts occur, we expect the 10-Year Treasury to remain close to 4%. The data and market suggest that the 10-Year Treasury rate will stabilize in the 3.00-3.50% range from 2025 to 2028. This outcome will have a lot to say about real estate valuations in the coming years. The Presidential election remains a risk to our forecast—if Trump is elected, it could result in higher inflation due to a universal tariff on all imports from China. This could delay a more aggressive series of rate cuts and add 1% to CPI.

3. **Property Market Resilience:** This year ushers in a new phase of the economic cycle. Despite various challenges, the underlying health of most property types (apart from office) remains resilient for many U.S. markets. The wave of new supply in the multifamily and industrial sectors peaked in 2023, and while it remains elevated in 2024, the lack of new starts recently will be a tailwind for fundamentals in 2025 and 2026.

4. **Sector Growth Drivers:** Advancements in technology are driving demand for additional warehouse space and non-traditional property types such as data centers and life sciences. The increasing demand for sophisticated computing capabilities and the exponential data growth have established data centers as critical infrastructure across industries. Despite some economic headwinds, the biotechnology industry will be a key industry over the next decade, and green shoots have been visible in the Venture Capital (VC)/Initial Public Offering (IPO) funding markets over the past few months. The demand for housing from demographic shifts, population growth, and migration continues to be an important driver for the housing sector. In addition, the enormous undersupply of single-family housing in many markets has led to strong performance in multifamily. In the office sector, we believe the decline in demand is nearing a bottom, given the growing number of employers calling for a return to the office. However, it may take several years to absorb the surplus inventory. Many of the older office buildings will need to be repurposed or demolished. Retail's outlook has brightened as tenants navigate the impact of online sales and re-design their formats, and total space is closer to being right-sized. Consumer spending should continue to propel retail space demand particularly for those malls and necessity retail centers in strong trade areas.

U.S. ECONOMIC OUTLOOK

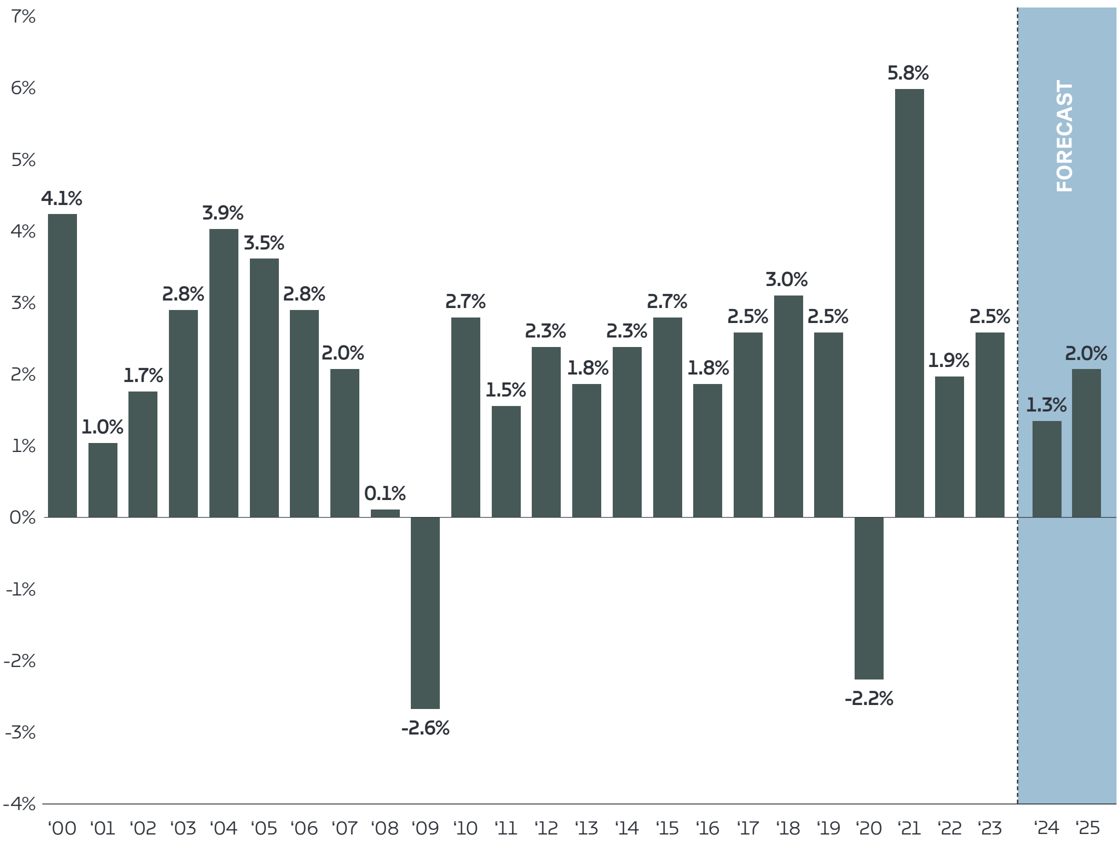
As we analyze the 2024 North American real estate market, we find ourselves navigating a complicated economic landscape filled with mixed signals for investors. We believe the prevailing economic theme this year revolves around moderating growth and declining inflation that paves the way for interest rate cuts.

Economic Growth Forecast in 2024

Our GDP forecast predicts a dip in real growth from last year to just above 1% in 2024, followed by a rebound to around 2% in 2025. (Exhibit 1).[1] The lagged impact of previous monetary tightening should begin to flow through to the economy this year, causing GDP to decline.

Household consumption growth surged to nearly 4% annualized in Q4 2023, benefitting from surplus savings accumulated during the pandemic when real incomes saw an upswing due to fiscal stimulus. **However, these savings are likely to dwindle in 2024, causing a decline in one of the major drivers of recent consumption growth.** Given this backdrop, we anticipate a modest slowdown in consumption growth this year to below the 2.2% observed in 2023, as credit balances have increased alongside a much lower savings rate. Simultaneously, business investment growth is likely to decelerate from roughly 4% to around 1%, and a marked slowdown in inventory accumulation is expected to put more downward pressure on GDP growth in the coming quarters.[2]

EXHIBIT 1: REAL GDP GROWTH (ACTUAL VS. FORECASTED)



Source: Capital Economics, Federal Reserve, Bloomberg LP

Even with a muted outlook for the U.S. economy for 2024, two key secular themes—AI and onshoring/nearshoring—are poised to significantly shape the investment landscape in the years ahead. These themes hold immense potential for driving future economic growth, and we are committed to investing in them to achieve attractive risk-adjusted results.

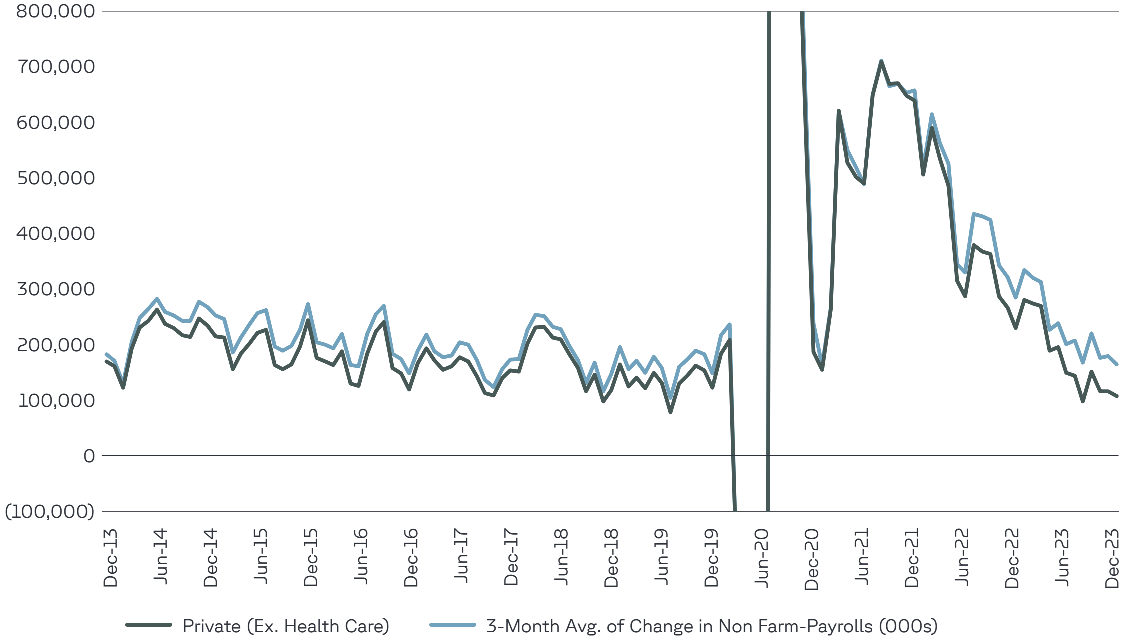
1. Capital Economics. US Economic Outlook: Despite soft landing, inflation rapidly normalizing. Published December 6, 2023.
2. Ibid.

The Labor Market: Signs of Weakening Employment

Turning attention to our labor market outlook for 2024, we see signs of weakening employment growth. We expect a gradual deterioration in labor conditions, with the slowdown in employment growth witnessed in 2023 evolving into further decline. As such, **we anticipate that unemployment could reach as high as 5% this year.**

Since late 2021, payroll employment growth has consistently trended downward, with a well-established pattern of the initial payroll estimates being revised significantly lower on the final print. **Healthcare jobs have masked a more pronounced slowdown as indicated by the divergence of the blue and green lines in Exhibit 2.**[3] Aside from the spike in payrolls from 2020 to 2021, cyclical employment growth has only aligned with the average levels prior to the pandemic, while more recently undergoing a steeper downward trend in private payrolls.

EXHIBIT 2: CHANGE IN NON-FARM PAYROLLS (3-MONTH AVERAGE)



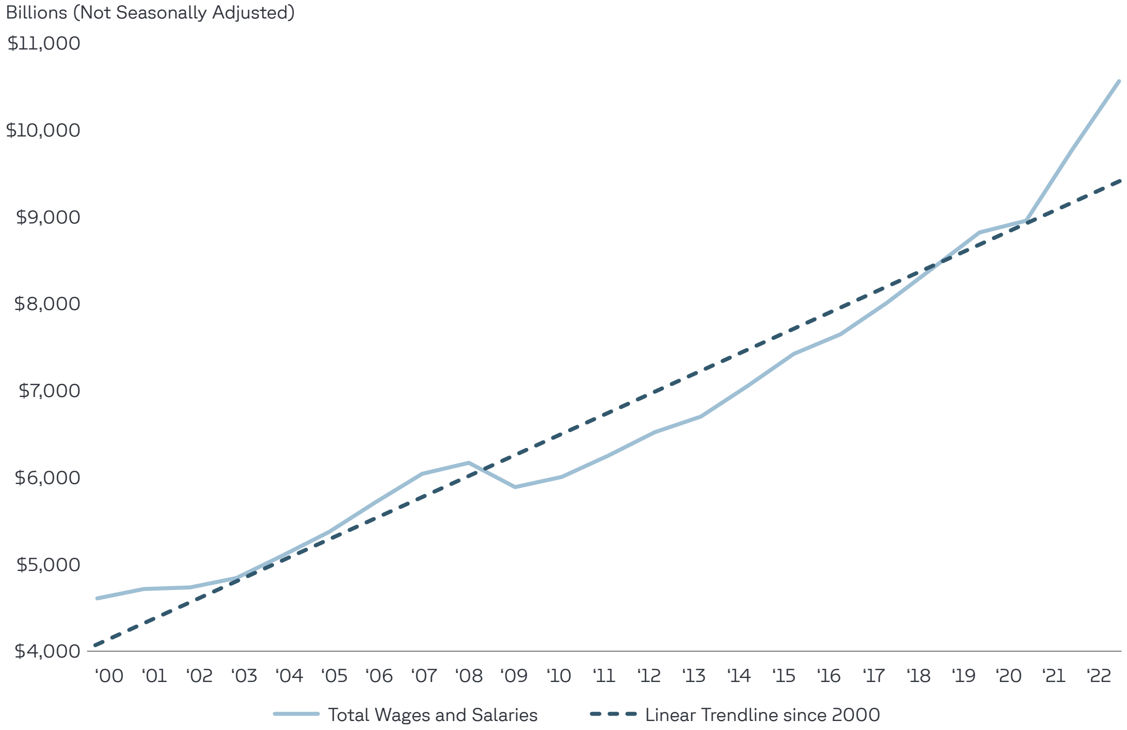
Source: FRED, Capital Economics

3. Ibid.

Certain job categories (e.g., government, healthcare) have remained surprisingly resilient and may still experience modest labor shortages. While automation will eventually boost productivity and soften the labor market long term, its impact in 2024 will be minimal. **We expect AI to eventually influence every sector of the economy. Additionally, onshoring may lead to higher production costs from labor, but it could reduce supply chain volatility, helping to stabilize prices.**

The sustained decline in the voluntary job quits rate has taken it to its lowest level since before the pandemic. The job quits rate has proven to be the most reliable leading indicator of wage growth in recent years. Its decline is consistent with expectations of a slowdown in annual wage growth (**Exhibit 3**) to below 4% over the next six months, followed by a more pronounced drop.

EXHIBIT 3: TOTAL WAGES AND SALARIES ($ BILLIONS)



Source: FRED, BLS, Affinius Capital Research

In summary, we believe the labor market outlook for 2024 is characterized by weakening employment, moderating wage growth from the recently heightened levels, and labor shortages in certain job categories, leading to a deterioration in overall conditions.

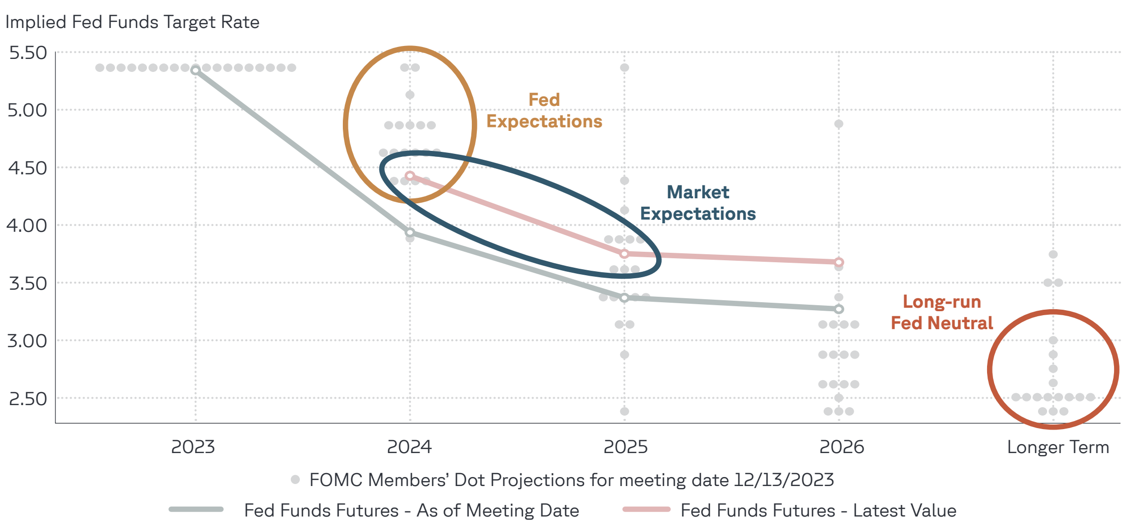
Inflation and Interest Rates: Normalizing Inflation and Yield Curve

Analyzing the current inflation data, we observe that while it remains above the Fed's desired target, it is driven by only a few areas of the economy (e.g., shelter costs) that should decline this year. Furthermore, most other areas of inflation have decreased due to the easing of supply chain disruptions and spending. The Fed's preferred measure of inflation—the Personal Consumption Expenditures (PCE) Index—is cooling faster than the headline Consumer Price Index (CPI) and is expected to reach 2% in mid-2024.

Any forecast comes with some risk, particularly in a Presidential election year. If Donald Trump is elected, it could result in high inflation due to a universal tariff on all imports from China and delaying a more aggressive series of rate cuts. Universal tariffs increase the prices of imported goods, leading to domestic products following suit shortly after. The strong pass-through effects of this type of tariff could potentially add as much as 1% to CPI, pushing inflation above the Fed's target rate. This is because the PCE Index is overweighted to goods compared to headline CPI.[4]

Based on an outlook of slowing growth and declining inflation, the Fed's interest rate projections may be slightly too high. A comparison between Fed Funds Futures (FFR) and the Federal Open Market Committee's (FOMC's) dot plot projections (see the gold oval in **Exhibit 4**) reveals a consensus view of rates decreasing at a faster pace (blue in **Exhibit 4**). **Market futures indicate four cuts totaling 100 basis points (bps) in 2024 compared to the Fed's three cuts totaling 75 bps.** We still believe that the landing will not be as "soft" as the Fed hopes, and that the market will be proven right.

EXHIBIT 4: FOMC MIDPOINT OF TARGET LEVEL FOR THE FEDERAL FUNDS RATE VS. MARKET FUTURES



Source: U.S. Federal Reserve – SOEP as of December 13, 2023, Bloomberg LP [FFR Futures as of February 18, 2024]

If the job market remains strong, we anticipate that the 10-Year Treasury rate will be close to 4% in the first half of the year, until the Federal Reserve begins to cut its benchmark rate. If the FFR drops to the low 4% range, we could see the 10-Year Treasury rate drop to the mid-3% range by year end or in the first half of 2025.

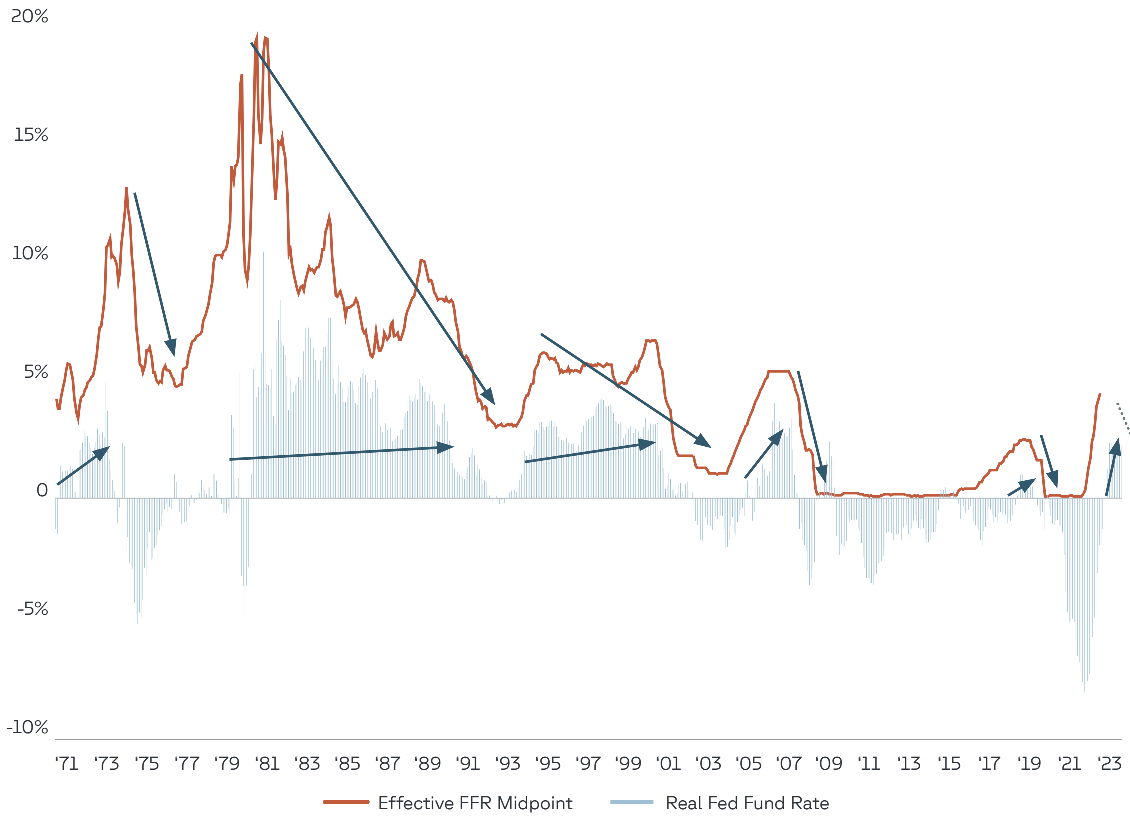
The global economic landscape introduces further complexity to the U.S. economic picture. Other risks persist as the Fed potentially underestimates countervailing indicators, particularly those linked to slowing global growth, escalating debt levels, and China's evolving financial circumstances. These issues, coupled with uncertainties regarding bond buyers in the short- to long-term, cast a wide net over potential interest rate scenarios. While the Fed's median estimate for the neutral longer-run interest rate remains at 2.5%, we feel that the rate could be closer to 3% (red circle in **Exhibit 4**), considering the influence of general-purpose technology like AI on the economy-wide productivity growth over the next decade.

4. Capital Economics. Trump's new tariffs would accelerate global fracturing. Published January 31, 2024.

The unfamiliar territory being navigated by the Fed makes it challenging to rely on the traditional playbook of raising rates until the economy "breaks." Despite these expected cuts, their efficacy could be less pronounced than in previous cycles, given that many households and corporations remain locked into the ultra-low rates available during the pandemic. This implies that interest rate changes are likely to exert a lesser influence on the broader economy.

With core inflation expected to return to around the 2% target in 2024, real rates are poised to remain higher this year than during much of the past decade. **The current real rate of long-run equilibrium has exceeded 2%, signaling a potential shift toward a neutral policy stance. Historically, the Fed has adjusted its policy rate (see the orange line in Exhibit 5 on a 12-month lag[5]) after achieving positive, persistent real rates (the blue bars in Exhibit 5).** This relationship has not received adequate market attention, in our view, despite the dovish rate cuts by the Fed when real rates are markedly positive (i.e., above 2%). This also implies that the Fed can continue reducing its asset holdings even if they start cutting interest rates, but it would be more sensible to halt Quantitative Tightening.

EXHIBIT 5: REAL FED FUNDS RATE VS. 12-MONTH LAGGED FED POLICY RATE % (1970 TO YTD 2024)



Source: Bloomberg LP

As we contemplate the tail-risk to our forecast, we believe the increasing government debt will motivate the Fed to lower rates over time versus a "higher for longer" scenario. Additionally, the Fed's rate cuts will play a crucial role in driving future economic growth as they try to navigate a slowdown and start a new cycle.

As discerning investors, it's crucial to stay informed of economic trends to help identify promising commercial real estate (CRE) opportunities. **We still believe there is an elevated risk of a recession in 2024 or early 2025, and this could lead to additional interest rate cuts.** Our analysis suggests that the Fed's interest rate projections may, therefore, be too high, and we are more closely aligned with market expectations.

5. Lag factor was strongest at 12 and 13 months for the Effective FFR as the dependent variable. 12-month lag r2 = 0.40.

TRENDS, OPPORTUNITIES, AND STRATEGIES

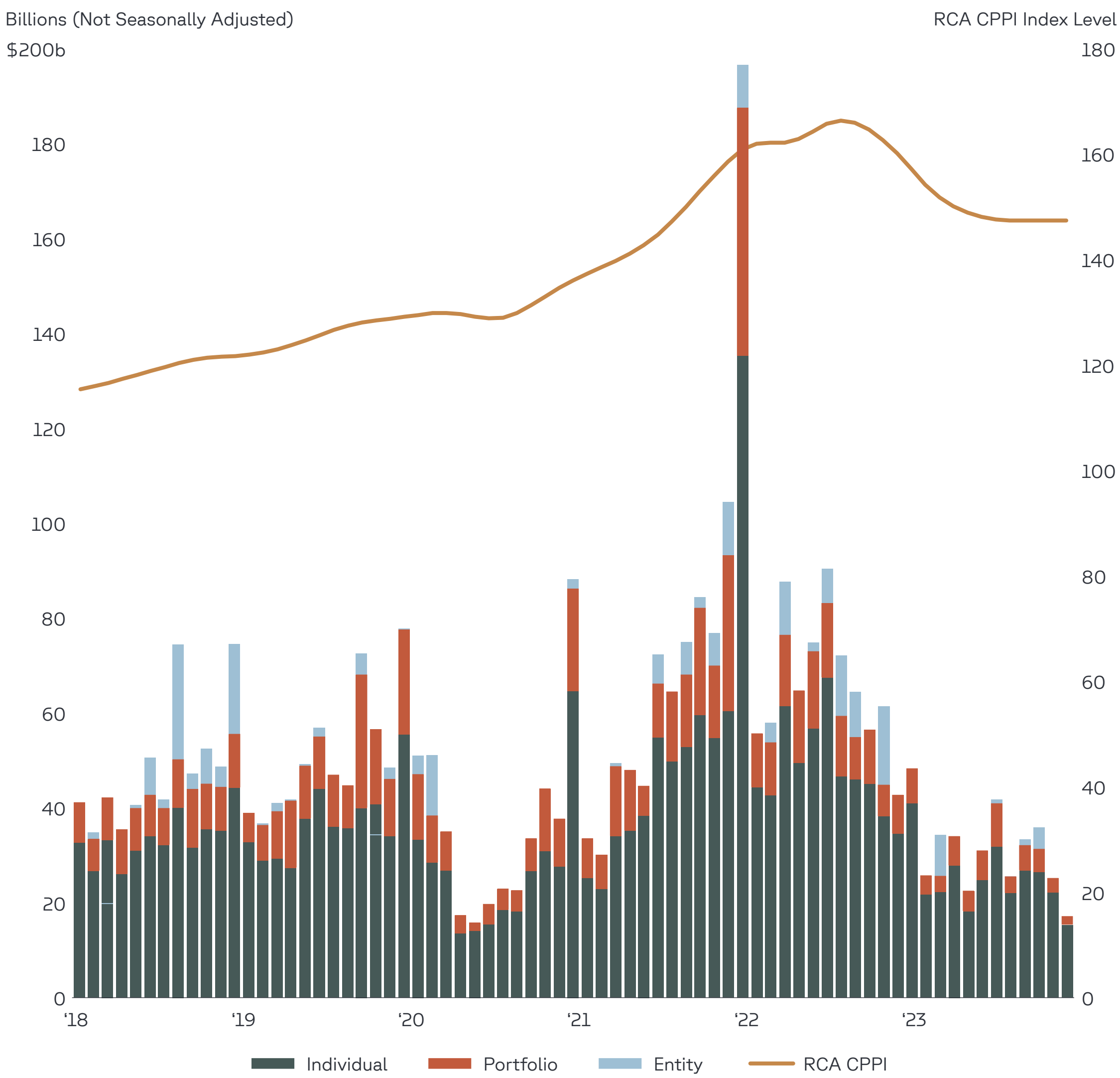
As we enter 2024, the CRE market is presenting the prospect for compelling investments beyond the conventional "beta play." To generate solid returns, a blend of industry knowledge, value creation, and strategic decision-making is required. These trends will define the current market and influence the CRE industry in the coming years.

Evaluating CRE Market Conditions

There was a substantial slowdown in the capital markets in 2023, which had a negative impact on the commercial property sector. This led to a large reduction in the volume of high-quality institutional CRE transactions. The trend worsened as the year drew to a close, with October and November witnessing a pronounced dip in deal volumes. Although December is believed to have seen a modest uptick, the overall transaction activity for the year fell by greater than 50% across all property types from the pace witnessed a year prior, with portfolio sales plunging the most, as reported by MSCI (**Exhibit 6**).

As those who are familiar with the CRE sector know, it takes a long time to complete transactions. Although there is a positive outlook for the reversal of the 10-Year U.S. Treasury yields, the property sector may not experience its full benefits until the latter half of 2024, influencing investment activity at that time. In 2023, most major property sectors experienced a downturn in transactions, as noted above. The Central Business District (CBD) office spaces were significantly impacted, with transactions down 60% compared to the previous year. While retail performed the best, it still registered a 39% decline in transaction volume over the same period. Pricing has declined along with transactions as rates have increased (**Exhibit 6**), as measured by the Real Capital Analytics Commercial Property Price Index (RCA CPPI).[6]

EXHIBIT 6: MONTHLY TRANSACTION VOLUME AND PRICING

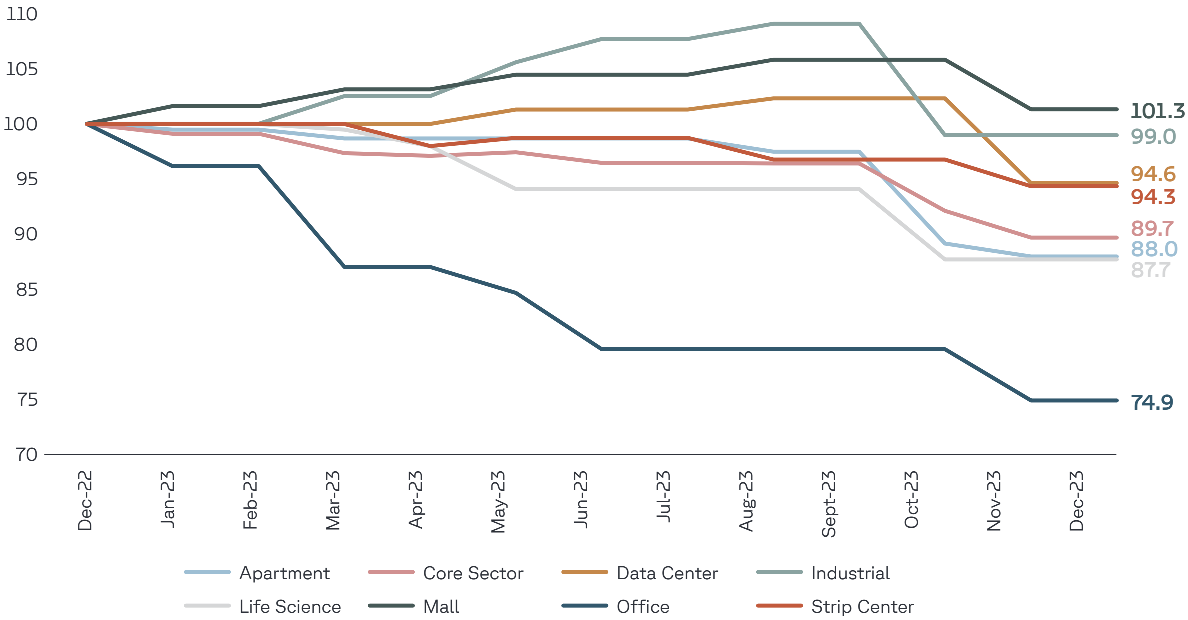


Source: MSCI RCA

6. RCA CPPI is based on actual prices for commercial properties from exclusive transaction data using a repeat-sales methodology.

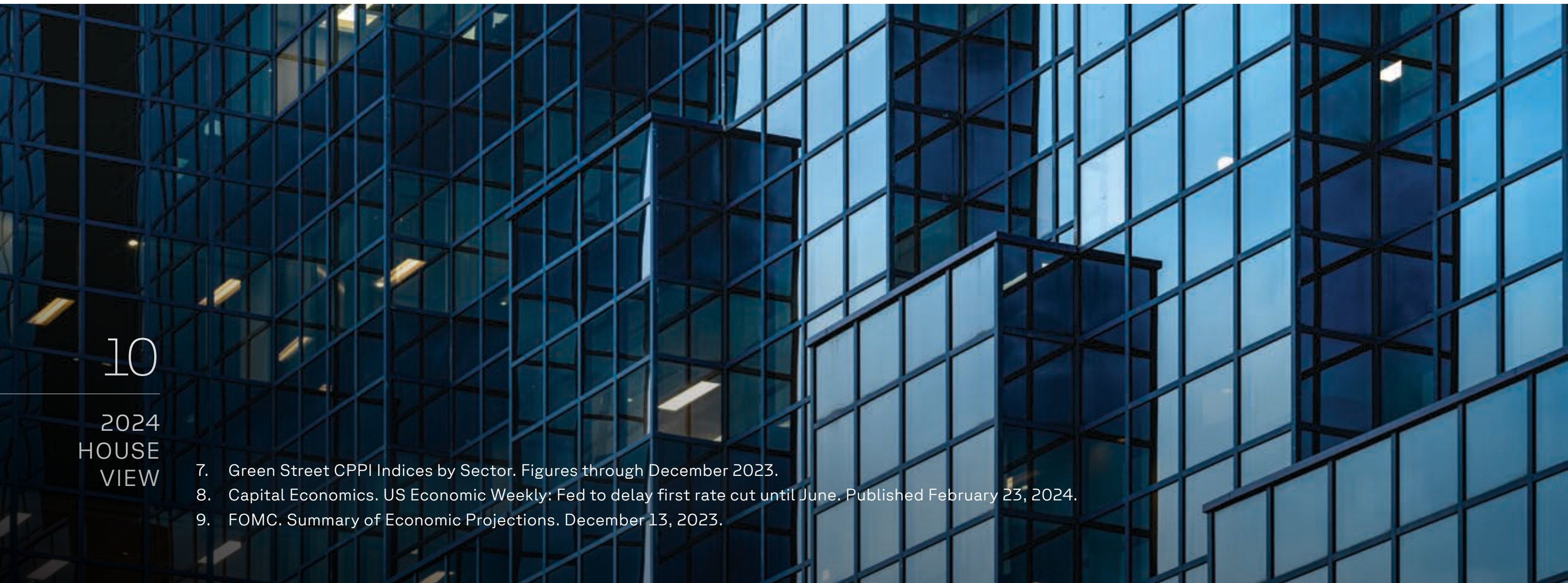
In December, the value of properties continued to decline. Based on transactions, Green Street's pricing gauge showed a 10% year-over-year drop. Among the sectors, malls performed the best with a 1% increase in prices, while the industrial sector remained flat. On the other hand, apartments and life science properties experienced a 12% decrease in value. The largest decline was observed in CBD office spaces, which decreased by about 25% in the past 12 months (**Exhibit 7**).[7]

EXHIBIT 7: GREEN STREET CPPI INDEX—TRAILING 1-YEAR PERFORMANCE BY SECTOR



Source: Green Street

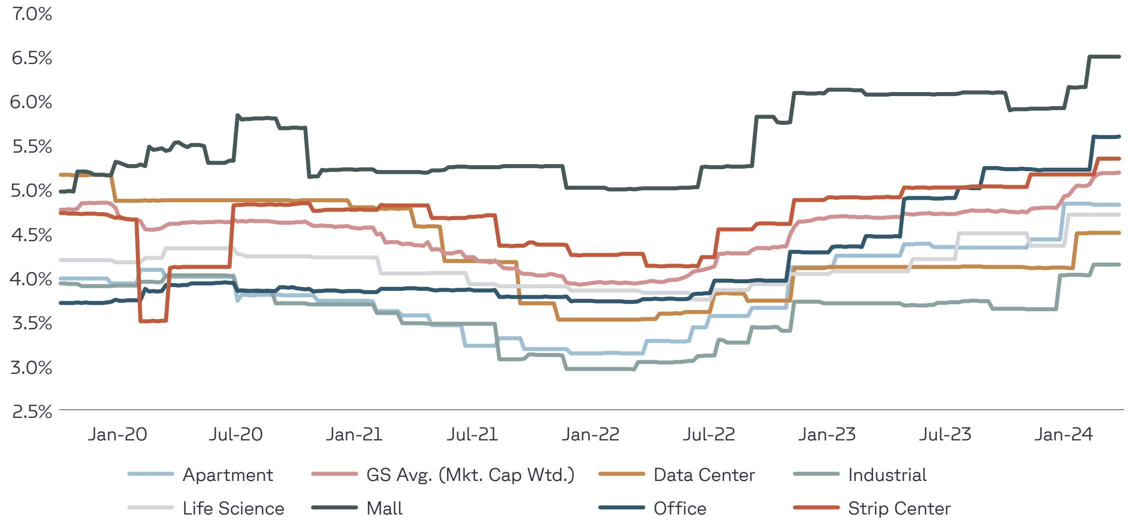
The market is currently entering a new cycle, prompting investors to adjust to cap rates that have not been seen since 2013, moving away from the ultra-low rates of the past decade. Although the Fed is anticipated to lower rates at the July meeting, with the 10-Year Treasury yield projected to remain around 4% until cuts occur, these changes are not expected to offer immediate relief to the real estate market.[8] Looking ahead, the Fed forecasts the 10-year yield to stabilize between 4.00-4.25% from 2025 to 2028, presenting investors with cap rates that diverge from those of the recent past.[9] Candidly, we have some difficulty understanding the rationale behind this forecast, given the ongoing risk of recession and what we believe will be significant pressure on governments to reduce the cost of their debt. This outcome will have a lot to say about real estate valuations in the coming years.



7. Green Street CPPI Indices by Sector. Figures through December 2023.
8. Capital Economics. US Economic Weekly: Fed to delay first rate cut until June. Published February 23, 2024.
9. FOMC. Summary of Economic Projections. December 13, 2023.

Consistent with higher interest rates, economic cap rates (which include CAPEX) across all sectors have been on an upward trend since early 2022 (Exhibit 8). Green Street's data reveals that the industrial sector saw a rise of 130 bps, and the apartment sector 170 bps, with the overall index climbing by 140 bps. Office spaces, however, experienced the most significant increase, surging 190 bps from their recent lows. Notably, office has transitioned from one of the lowest cap rate sectors in 2020, while data centers have moved from the highest to the second lowest (more on this topic later).

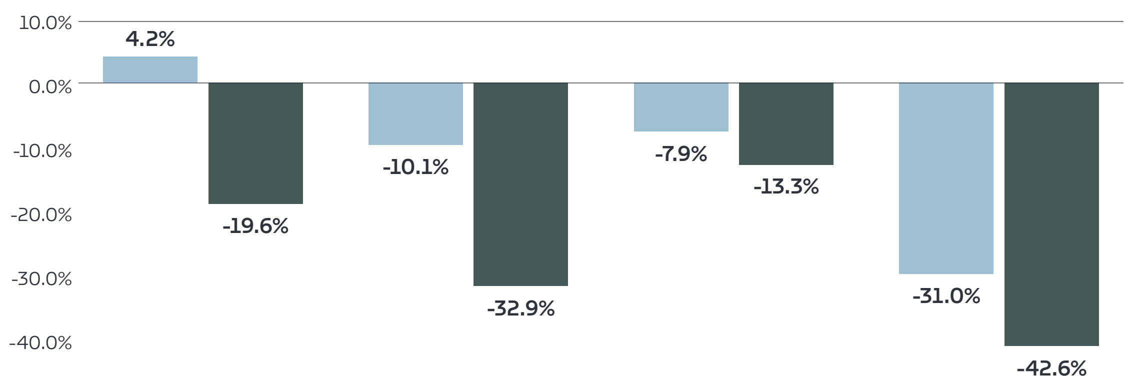
EXHIBIT 8: ECONOMIC CAP RATES (2020 TO YTD 2024)



Source: Green Street

Based on our internal research, the NCREIF index has not yet fully reflected the declines in valuation vis-à-vis the implied REIT cap rates and prices witnessed in the public markets (**Exhibit 9**). This delay in private market valuation complicates predictions about when the market will correct. However, as mentioned earlier, we can expect appraisal cap rates to increase meaningfully to align with the rising cost of capital. To effectively assess opportunities for liquidity, we should depend on informed assessments of value and fair pricing, rather than wait for appraisers to align with market conditions.

EXHIBIT 9: CHANGE IN VALUES FOR NFI-ODCE VS. REITS (YE 2021 TO Q3 2023)



	Industrial	Apartment	Retail	Office
NFI-ODCE Cap Rate	3.5%	4.1%	5.4%	5.8%
REIT Cap Rate	4.5%	6.2%	7.3%	8.7%

NFI-ODCE REIT

Source: NCREIF, NAREIT, Green Street, Affinius Capital Research

While our outlook on the direction of property values remains neutral, we firmly advocate for consistency in the valuation process, both within and across cycles. Such consistency is essential in appraisals and benchmark performance indicators like the NFI-ODCE Index. Technological advancements are likely to help resolve inconsistencies. In the interim, increased market liquidity and transaction volume are expected to mitigate this issue.

Investors should also weigh the possibility that a drop in interest rates over the next year may prevent the anticipated market correction from being as pronounced. However, if the 10-Year Treasury yield remains near 4% for a significant portion of the forecast period, then NFI-ODCE Index cap rates will need to increase by more than 100 bps from their current levels to render existing real estate assets attractive once again.[10]

Despite myriad challenges, the underlying health of most property types (with the exception of office) remains strong, regardless of a softening in demand and a slight rise in vacancies. We anticipate a slight deceleration in tenant demand for industrial and multifamily properties this year, albeit short-lived as the current wave of new supply peaks in 2024, but their long-term prospects remain strong. **The maxim "survive until '25" seems particularly apt for these sectors as we shift from short-term asset acquisition to the onset of a new development cycle.**

While our outlook on the direction of property values remains neutral, we firmly advocate for consistency in the valuation process, both within and across cycles.

In the office space market, we predict that the dip in demand is beginning to near a bottom, given the growing number of employers calling for a return to the office, although higher unemployment could complicate this. Nonetheless, it may take several years to absorb the surplus inventory, echoing the earlier situation in the retail sector. Furthermore, many office buildings still need to have their appraisals adjusted to fair market value.

Retail, while typically vulnerable in a recession, is anticipated to recover in the long term. For 2024, sectors such as Data Centers, Credit/Lending, Preferred Equity, and Opportunistic strategies are particularly promising for investors with the necessary liquidity and resources to act, all of which will be an important focus of our investment activities this year.

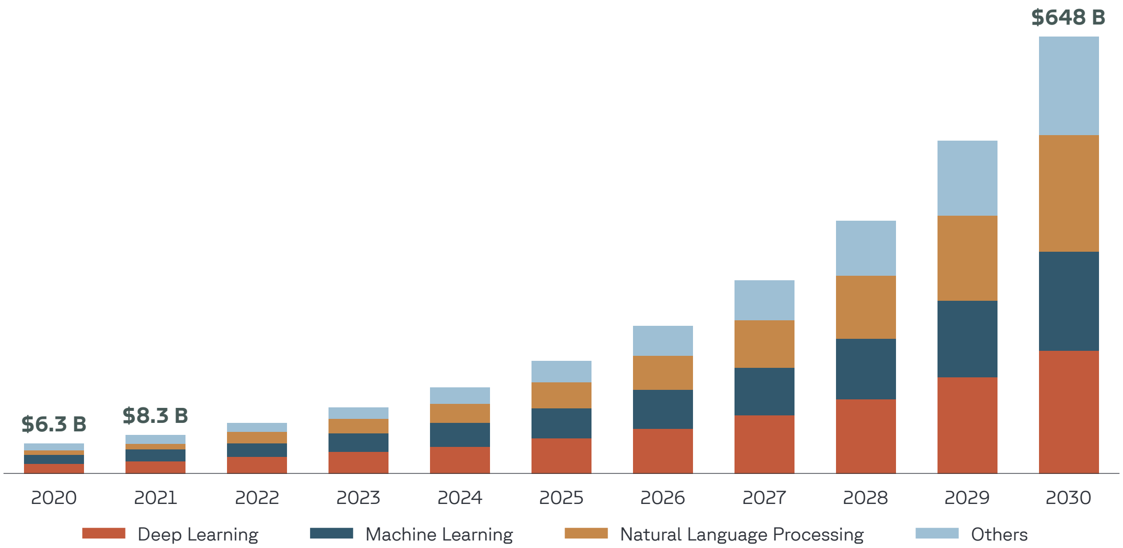
In sum, the current market conditions may pose challenges for CRE investors, underscoring the importance of meticulous environment evaluation and well-informed, high conviction investment decisions. A deep understanding of the factors driving the market, including the gradual realignment of appraisal-based values and the impact of interest rates, is essential. Such insight empowers investors to navigate the current landscape and identify attractive investment opportunities.

10. MSCI Real Assets. Capital Trends—U.S. Big Picture. November 2023.

Investment Viewpoints: The Impact of AI on Cloud Computing and Bioscience

The rise of AI is reshaping the institutional real estate landscape, especially within the data center sector. **For private equity investors, strategically investing in AI-aligned ventures may present a compelling opportunity.** Additionally, the swift pace of technological innovation, as Moore's Law suggests, may give rise to new promising areas. The increasing demand for sophisticated computing capabilities and the exponential growth of data have established data centers as critical infrastructure across industries. Forecasts suggest the global data center market could reach an aggregate $251 billion by 2025, fueled by the growing demand for cloud services and AI-powered applications. According to Grandview Research, **the global cloud AI market, valued at $45 billion in 2023, is expected to reach an astonishing $648 billion by 2030, resulting in a compound annual growth rate (CAGR) of 40% (Exhibit 10).**[11]

EXHIBIT 10: U.S. CLOUD AI MARKET SIZE (A2020 TO F2030 IN BILLIONS)



Source: Grandview Research

Constraints on power availability are impacting the development of data centers, extending the demand-supply gap. Further, this gap is anticipated to continue for the foreseeable future, causing rents to remain high and stable. **As a result, investors are actively deploying funds into acquiring and developing data centers, seeking to leverage opportunities in this rapidly expanding market.** Since 2019, nearly $220 billion has been invested into AI-centric companies within the U.S. per CB Insights. In totality, Amazon Web Services (AWS), Microsoft Azure, and Google Cloud continue to dominate the demand side of the economics within this industry.

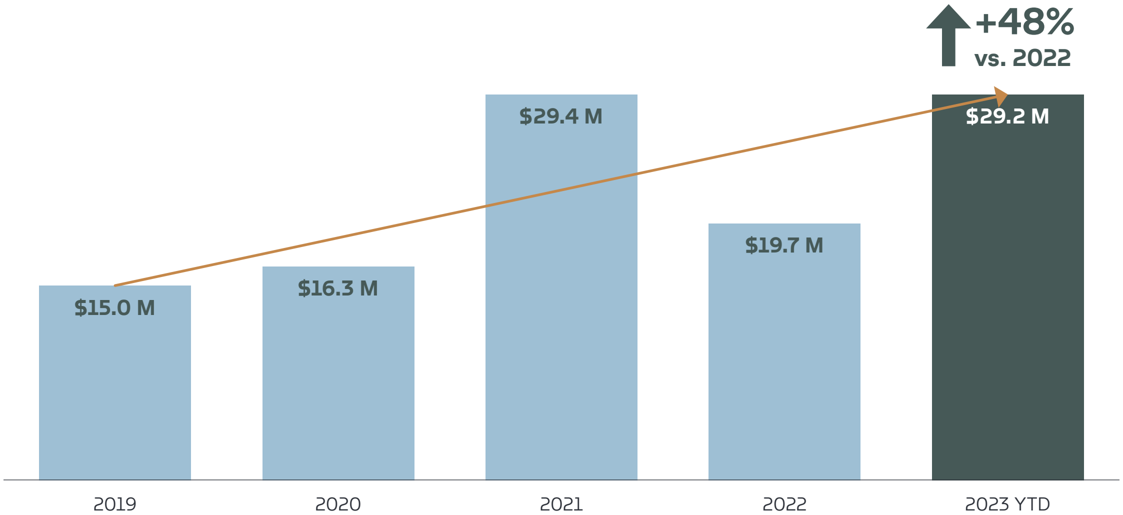
The largest AI-driven impact will be how new data centers are built to accommodate enhanced requirements. **The computational resources required to train and run AI facilities require much denser power requirements, and therefore more robust cooling, necessitating augmented infrastructure and physical space.** As discussed above, AI computing is expected to expand rapidly and will drive innovation like liquid cooling, optimized AI chips, and new data center designs—for this reason, **and given the pace of transformation, users will begin to invest in the equipment versus capitalizing the costs within the lease, to provide the flexibility to retrofit technologies as they change.** In partnership with Corscale, our affiliate developer and the vertically integrated data center platform of Affinius, we maintain an open dialogue with tenants, architects, and consultants on this digital transformation and are designing physical infrastructure that is applicable to today's use case but can also adapt to changing technologies.[12]

11. Grandview Research. Cloud AI Market Size, Share & Trends Analysis Report, 2023-2030. CAGR is compound annual growth rate.
12. Affinius Capital owns a 45% interest in the Holding Company of Corscale LLC, which provides real estate-related services to Affinius Capital's subsidiaries and underlying investments and, in certain arrangements, are members or partners in joint ventures and receive a promotion in exchange for services in addition to a fee.

Using AI-powered tools and platforms has also provided real estate investors and operators with deeper market insights and enhanced property performance analytics. By harnessing Machine Learning (ML) algorithms, they can analyze large data sets to identify value creation and risk mitigation opportunities. Additionally, tools like natural language processing and sentiment analysis have proven invaluable in providing insights into tenant perspectives and market dynamics. For instance, sensors paired with ML algorithms can actively monitor and adjust building systems, leading to a more efficient energy use and cost savings. AI platforms are also poised to offer tenants personalized recommendations, elevating their overall experience and satisfaction. These innovative AI tools enable investors to quickly identify and respond to emerging trends and opportunities, maximizing returns and minimizing risks.[13,14]

The average deal size for AI ventures has increased by 48% through Q3 2023, indicating a market shift in recognizing the front-runners and laggards in the AI race. The average investment in AI companies by VCs reached $29 million in 2023 (**Exhibit 11**), marking a significant uptick of nearly 50% from the figures reported in 2022 and near an all-time high. California-based industry leaders such as OpenAI, Inflection AI, Cohere, and Anthropic have secured investment rounds exceeding $100 million during 2023, **with the number of mega rounds tripling since 2022.**[15]

EXHIBIT 11: AVERAGE AI DEAL SIZE BY YEAR (2019 TO Q3 2023)

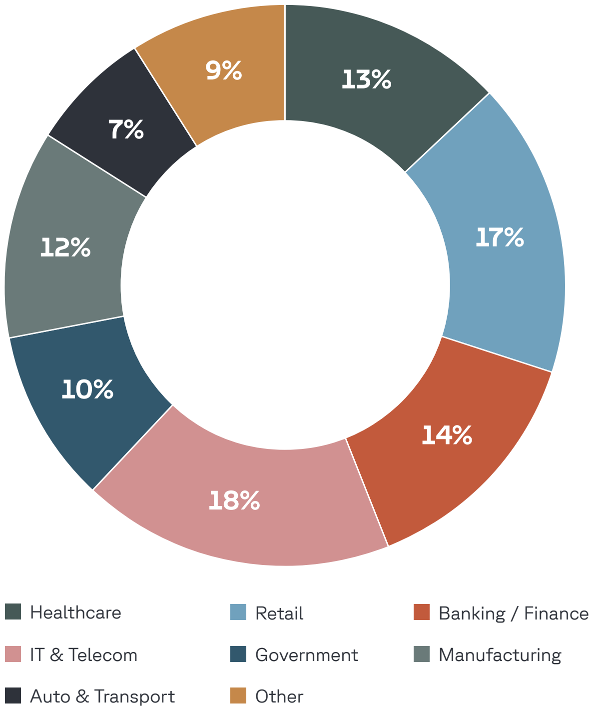


Source: CB Insights

13. McKinsey. State of AI in 2023: Generative AI's breakout year. Published August 1, 2023.
14. EY. How generative AI is transforming the future of commercial real estate. Published August 31, 2023.
15. CB Insights. State of the AI Q2'23 Report. Published August 16, 2023

Private equity investors leveraging AI-powered tools and platforms are set to establish a strong competitive edge. The AI explosion has already transformed the institutional real estate and data center sectors, positioning early adopters to capitalize on technological advancement opportunities.[16] **AI and Cloud Computing are poised to significantly impact every industry, already touching key sectors of the U.S. economy (Exhibit 12).**

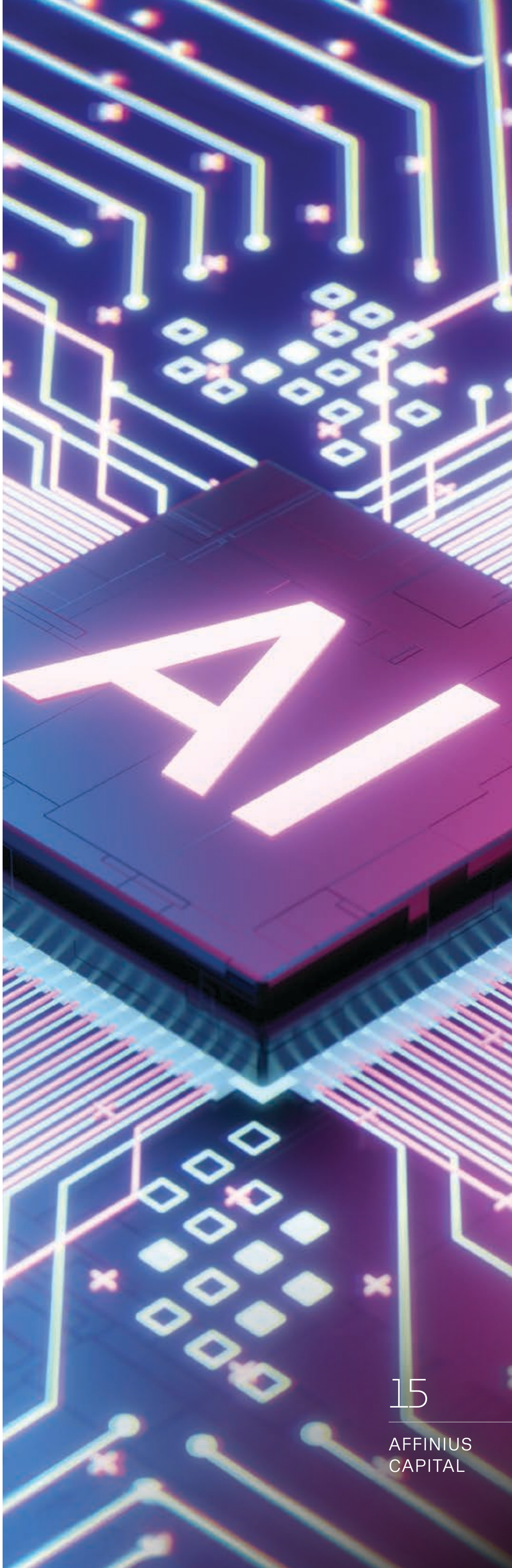
EXHIBIT 12: GLOBAL CLOUD AI MARKET SHARE (BY INDUSTRY %)



Source: Grandview Research, Affinius Capital Research

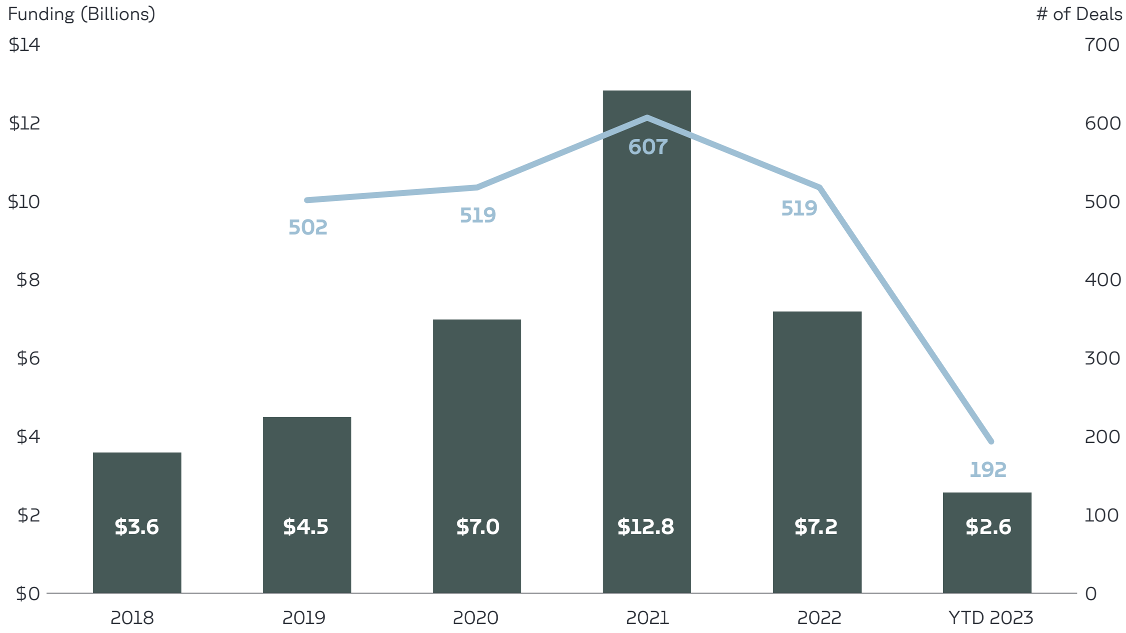
A significant segment of the Cloud AI market is dedicated to healthcare (see the dark green slice in **Exhibit 12**), where recent life science advancements have led to the development of several groundbreaking drugs. **The surge in pharmaceutical innovation, particularly in new drug discovery, aligns closely with the rise in AI/ML technology—suggesting a synergistic relationship rather than mere coincidence.**

16. Grandview Research. Cloud AI Market Size, Share & Trends Analysis Report, 2023-2030.



Many of these drugs have been developed with the aid of ML. Take, for example, LECANEMAB, the first drug approved by the FDA to slow Alzheimer's progression, which Medicare has agreed to cover. Another promising drug, DONANEMAB, could be approved soon. Drugs like OZEMPIC, which mimic the hunger-regulating hormone GLP-1, have revolutionized obesity treatment. As well, the FDA has approved the first cell-based gene therapies for sickle-cell disease, a serious hereditary blood condition. Additionally, mRNA technology, used to produce COVID-19 vaccines, is being used to develop vaccines for diseases such as malaria, tuberculosis, and HIV. AI-focused healthcare startups have received substantial funding, with a peak in 2021 reaching $12.8 billion across 607 deals (**Exhibit 13**).

EXHIBIT 13: FUNDING FOR GLOBAL HEALTHCARE AI STARTUPS (2018 TO Q3 2023)



Source: BI Intelligence, CB Insights, Affinius Capital

AI's impact on drug development is noteworthy, having played the lead role in the actual creation of new pharmaceuticals with limited human assistance. Some of the successful AI-designed drugs include INS018-055, promising in clinical trials; HALICIN, a game-changer in antibiotic development; and LAMOTRIGINE, an antiepileptic and mood-stabilizing drug, now in clinical trials. These examples highlight AI's ever-growing influence on the pharmaceutical industry.

Although VC funding and, subsequently, the demand for life sciences may have decreased from the record levels achieved in 2021, we anticipate that the development of new products and the return of capital to the sector will revive, as a lack of funding leads to the emergence of a more attractive investment thesis. Therefore, we are closely monitoring the impact of AI on the demand for physical laboratory space in this socially critical area of the economy.

In summary and as previously discussed, the advent of AI and cloud computing has transformed the real estate and data center industries and spurred innovation in bioscience. Investors using AI tools may have a clearer edge in a competitive market. Real estate professionals leverage these advancements to deepen their market understanding and enhance decision-making. As AI evolves, its significance in investment strategy and risk management continues to grow.

Investment Viewpoints: Onshoring and Nearshoring to North America

The trend toward onshoring and nearshoring to North America presents exciting prospects for private equity investors in the industrial sector. **From a macro-perspective, the continent offers the largest consumer base globally (the U.S.) in combination with the most attractive source of low-cost labor (Mexico).** At the same time, we are seeing a resurgence of the American middle class in manufacturing, supporting industrial and logistics demand. While this will be inflationary, it should positively impact the economy because it will help support a more stable workforce and fuel real wage growth.

Onshoring and nearshoring to North America offer key advantages, notably in reducing supply chain risks and improving market responsiveness. Relocating production closer to consumers enables companies to cut transportation costs and swiftly adapt to market changes. **This approach mirrors the benefits gained in "last-mile" logistics but applies to the manufacturing process itself.** The COVID-19 pandemic has further highlighted the importance of geographical proximity and diversification in mitigating global supply chain disruptions.

According to a 2023 report by Deloitte, it is now more cost-effective to bring production back to the U.S. for many of the biggest manufacturing sectors (e.g., machinery, consumer appliances, furniture).[17] Their analysis compared labor and transportation factors (**Exhibit 14**) for China-based goods against an onshoring scenario from 2016 to 2021.

EXHIBIT 14: REGIONALIZATION AND GLOBALIZATION DECISION FACTORS

	COSTS	RISKS	OTHER FACTORS
RESHORING / NEARSHORING (REGIONALIZATION)	▪ Moderate transportation costs ▪ Mitigated financial exposure ▪ Reduced direct and indirect costs across production life cycle ▪ Less overall supply chain complexity ▪ Productive challenge for industries with high level of robotization	▪ Less exposure to natural disasters and geopolitics ▪ More ability to cope with market dislocations ▪ Greater adaptability for demand fluctuation	▪ Improved sustainability (emissions, other environmental, social) ▪ Enhanced brand reputation ▪ Lessened industrial footprint complexity
FAR EAST COST BASELINE (GLOBALIZATION)	▪ Suppliers' portfolio reduction ▪ Higher transportation costs ▪ Increased financial exposure ▪ Tax inefficiency	▪ More volatile transportation costs ▪ Greater exposure to natural disasters and geopolitics ▪ Higher obsolescence risk	▪ Increased industrial footprint complexity ▪ Greater supply chain complexity ▪ Reduced market differentiation ▪ Less corporate governance ▪ Less sustainability

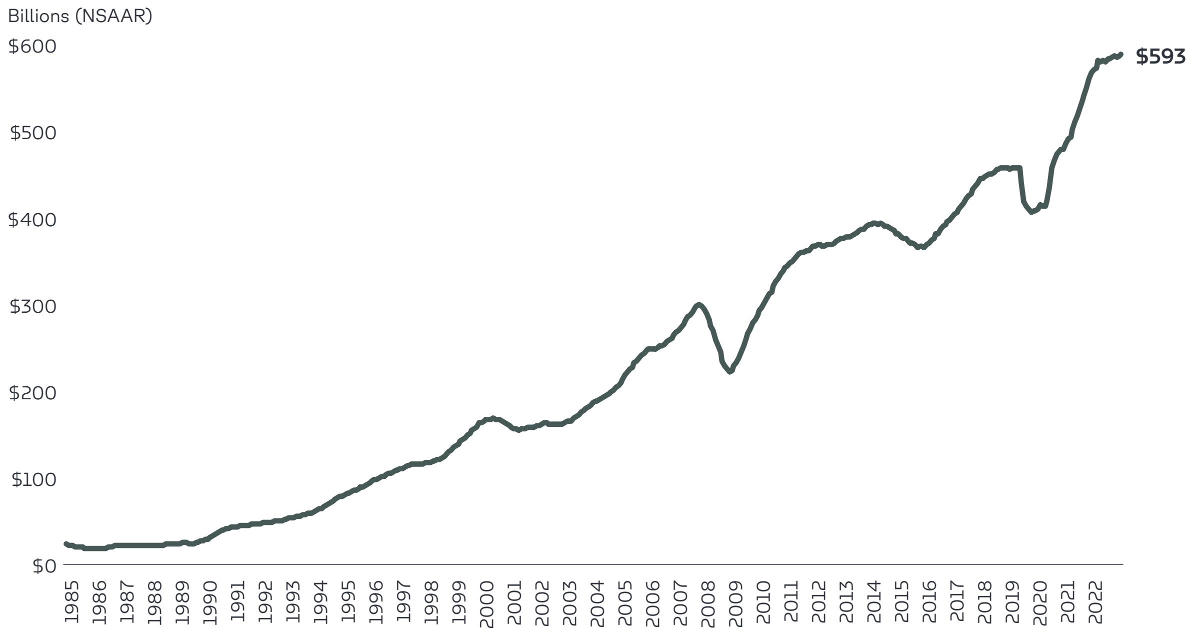
Source: Deloitte

17. Deloitte. Unlocking Supply Chain Value and Resilience Through Regionalized Restructuring. Published 2023.

Another key benefit of nearshoring to regions like Mexico is that it offers access to an abundant, prime-aged, and skilled workforce with a rich manufacturing heritage. This, coupled with its geographical proximity to the U.S. and Canada, facilitates the recruitment and retention of highly-trained workers.

Numerous companies have already relocated operations to Mexico, attracted by its established manufacturing sector, competitive labor costs, lower transportation costs, and strategic proximity to major U.S. and Canadian markets. Mexico is now the world's fourth-largest exporter of manufactured goods, boasting $400 billion in exports in 2019 (**Exhibit 15**). **Post COVID-19, exports have surged to an all-time high of $593 billion, marking a near-50% increase over pre-pandemic figures (Exhibit 15). As such, Mexico's industrial sector has significantly benefited from this shift, and the country recently passed China as the largest U.S. trading partner**. In addition, the country hosts over 3,000 maquiladoras, or manufacturing plants, which are instrumental in employing more than 2.5 million people and generating more than $100 billion to Mexico's export economy annually.

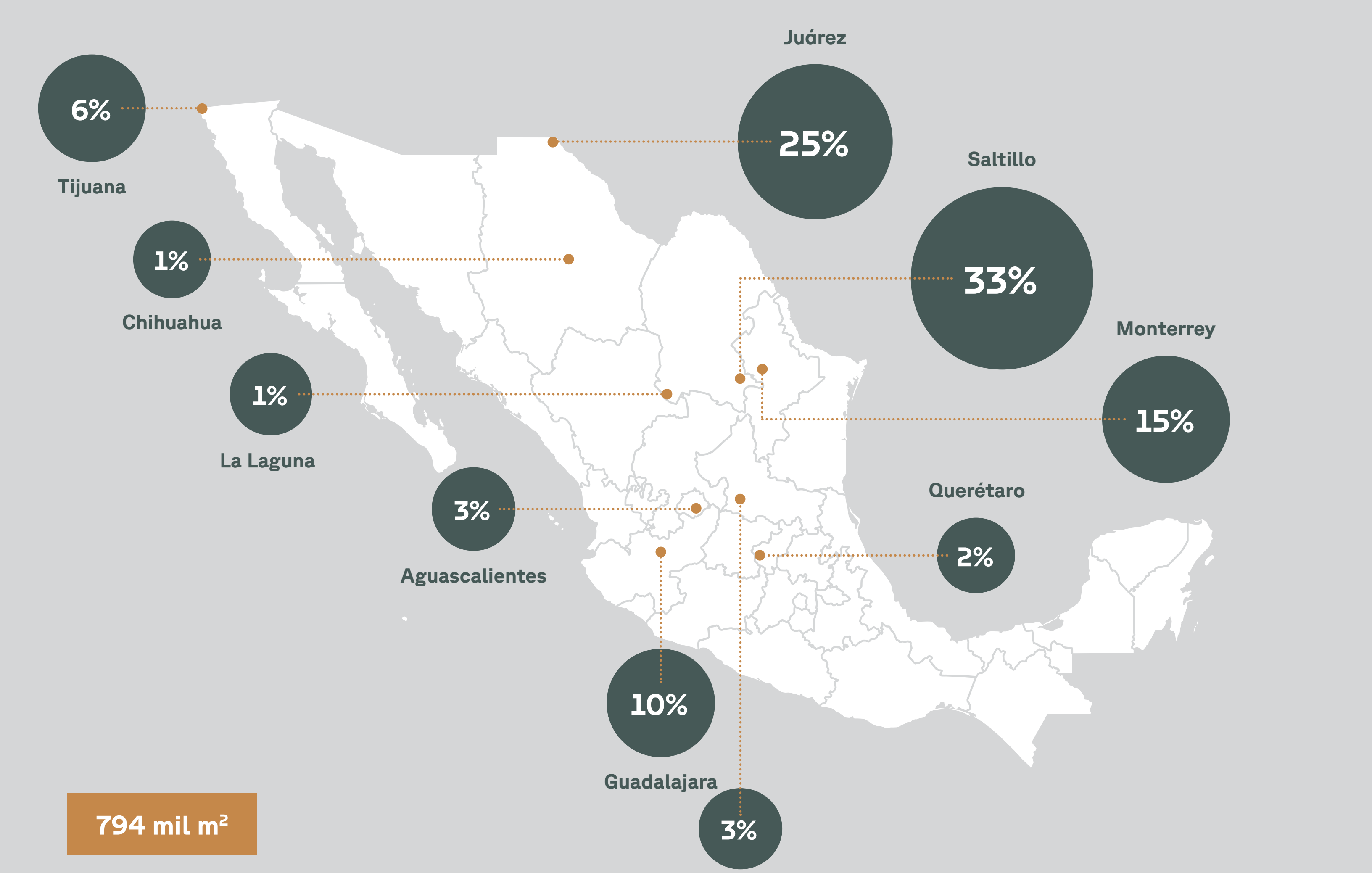
EXHIBIT 15: MEXICO EXPORTS (BILLIONS NSAAR* – 1985 TO 2023)



Source: Bloomberg LP [*Non-Seasonally Adjusted Annualized Rate]

These trends have bolstered the industrial real estate market in Mexico. According to CBRE, nearshoring demand surged by 38% in the first half of 2023 compared to the previous year. Nearly 800 million square meters of leases resulted from nearshoring last year (**Exhibit 16**), with Asian companies accounting for 60% of this activity geared toward serving U.S. consumers.[18] In Mexico's northeast, industrial property demand has soared, driving vacancy rates down to as low as 1% in key markets like Juarez and Saltillo.[19] Fitch Ratings suggests that this nearshoring trend is likely to enhance occupancy rates, stimulate rent growth, and effectuate portfolio development in the Mexican CRE sector.[20]

EXHIBIT 16: NEARSHORING DEMAND DISTRIBUTED BY KEY MARKETS (FIRST HALF OF 2023)



Source: CBRE Research

Based on a study by the Boston Consulting Group, nearshoring to Mexico can yield cost savings of up to 20% compared to offshoring to China.[21] Consequently, companies should carefully assess the regulatory landscape and other pertinent factors before deciding to relocate operations. In addition, investment in the necessary infrastructure and technology to support Mexican operations is essential. Doing so will allow companies to fully realize the benefits of onshoring and nearshoring to North America. In summary, **we anticipate that the trend toward onshoring/nearshoring will continue to significantly influence North America's industrial sector, benefitting markets in the U.S. (e.g., Texas, Arizona, California) as well as Mexico.**

18. CBRE. 1H 2023 Nearshoring Report. September 6, 2023.
19. CBRE. Industrial Real Estate Market – 1st Semester 2023. July 25, 2023.
20. Fitch Ratings. Nearshoring Boost Mexican Industrial CRE Fundamentals and Investment. August 29, 2023.
21. BCG. Harnessing the Tectonic Shifts in Global Manufacturing. Published on September 21, 2023.

Commercial Real Estate Opportunities and Strategies

Despite current uncertainties, evolving market conditions are creating new opportunities for investors. We expect the emerging cycle to follow some familiar patterns, and our strategy will continue to focus on our established sectors while remaining adaptable to capitalize on attractive tactical opportunities as they emerge.

TECHNOLOGY AND REAL ESTATE

The intersection of technology and real estate continues to drive significant investment potential in our opinion.

Data centers, crucial to the digital economy, are seeing soaring demand due to the exponential increase in data generation. With internet-connected devices projected to reach 56 billion by 2025 (seven times more than today's global population), technology firms are investing heavily in data centers, ensuring seamless service for various online applications.

Logistics and e-commerce, areas that flourished during the COVID-19 pandemic, are still well-positioned for sustained growth. The U.S. and E.U. have seen notable shifts toward online shopping, and in effect creating a structural shift in consumer habits. This is mainly due to the millions of global consumers that have fully embraced online shopping. During COVID, total retail sales in the U.S. hit an all-time high (16.1%), with e-commerce still accounting for 15.6% of overall retail spending in 3Q 2023. **This transformational shift toward online sales was already underway before the health crisis but dramatically accelerated, and consequently, there is resilient demand from businesses to fulfill the need for "last-mile" logistics solutions.**

After a brief pause, Amazon has returned to the industrial/logistics market and we are once again seeing increased demand for both speculative space as well as Build-To-Suit projects across most of the U.S. markets. In Q4 2023, Amazon initiated a new business plan aimed at leasing 30 million square feet of large bulk warehouse buildings to facilitate inventory storage requirements upstream of the fulfillment center network. In Q1 2024, Amazon has already begun engaging in new Build-To-Suit projects for 2025 and 2026. Prior to the pandemic, the company leased around 20-30 million square feet in 2018-2019, and we expect a similar level of activity from them in 2025-2026.

Real Estate Adjacent Infrastructure has gained prominence due to technology. Essential services and data storage rely on specialized physical infrastructure, such as fiber and wireless networks and data centers, to ensure secure and continuous operation. Investment in this sector keeps consumers digitally connected and promises stable, risk-adjusted returns due to its critical role in supporting burgeoning technologies.

Life sciences is a sector taking a breather, yet promising developments are on the horizon. Despite some economic headwinds, the biotechnology industry is thriving, bolstered by record levels of funding seen over the past few years. The growth is fueled by an aging population, rising healthcare costs, and the continuous need for innovative treatments. The pandemic further amplified this trend, with an urgent demand for vaccines and therapies, pushing biotech to the forefront. The industry is expected to continue its growth trajectory in part from the anticipated advantages resulting from AI, and investors should keep an eye on this opportunity as new technology influences the industry's space market requirements.

In summary, the intersection of technology and real estate presents significant investment opportunities. Throughout the COVID-19 pandemic, the industrial/logistics sector outperformed most other sectors, and the demand for data centers is expected to increase exponentially. Investments in real estate-adjacent infrastructure and the biotech sector are likely to deliver attractive risk-adjusted returns in the next cycle.

TECHNOLOGY AND CRE STRATEGIES Affinius Capital is committed to leading the integration of technology and real estate, which promises to redefine our industry's future.

We are heavily focused on emerging onshoring and nearshoring activities expected to boost demand for industrial space here and abroad. We are encouraged by the commitment from both government bodies and private sector firms to reinforce the supply chain, with substantial efforts expected to take place in the U.S. and Mexico.

- **Data center development remains a central pursuit, addressing the critical need between supply and demand fueled by the surge in cloud computing and AI applications.** In the coming years, the demand for data is expected to be substantial, presenting a strategic advantage for platforms ready to serve major cloud providers and hyperscalers with a vertically-integrated investment platform.
- The life sciences sector is experiencing a significant dip in demand amidst a capital-constrained market. Nevertheless, **we anticipate renewed investment interest reinvigorating the sector, particularly in laboratory space.** In the intermediate-term, innovations in AI are likely to expedite new drug and treatment discoveries, further stimulating the demand for high-quality labs.

We are also exploring various real estate-adjacent infrastructure and technologies, **particularly promising are those in the alternative fuels and power sectors**, to potentially boost investor returns.

REAL ESTATE LENDING

The world of commercial real estate continues to provide a range of financing options for investors seeking to maximize returns while minimizing risk.

Financing across the capital stack remains popular, with industry data revealing that the total volume of commercial real estate loans in the U.S. reached $5.8 trillion in Q3 2023, spanning across banking institutions, insurance companies, securitization, government agencies, and private capital providers. **This trend underscores the demand for financing options conducive to leveraging the CRE market's opportunities.**

Diverse strategies such as core, value-add, and construction loans each provide distinct benefits and risks. For example, core typically denotes whole loans on institutional-quality properties, presenting a lower-risk option. Value-add loans, conversely, are associated with properties that have potential for enhancement, and thus, carry both higher returns and risks. These loans are often sourced through our full spectrum of credit and lending programs (including whole loans, stretch first-mortgages, mezzanine debt, and construction lending). Construction loans, in particular, offer attractive risk-adjusted returns if properly underwritten by those with development expertise. Industry data indicates robust demand in this segment, with construction loan volume in the U.S. hitting $392.1 billion in Q3 2023.

Another financing option is preferred equity solutions, which allow investors to participate in the equity upside of a CRE transaction while providing downside protection in a more volatile investment landscape. Offering a fixed return prior to common equity distributions, these investments are increasingly favored for their potential to yield higher returns than traditional debt investments with comparatively lower risk than direct equity investments. **Rising cap rates are anticipated to drive new, creative structures within this portion of the capital structure.**

In conclusion, financing across the capital stack continues to provide compelling risk-adjusted returns and downside protection, making it an attractive option for investors in the CRE market. It is essential, however, to recognize that each financing option carries unique benefits and drawbacks, and investors should conduct careful due diligence to determine which option is most suitable for their specific investment goals and risk tolerance.

> **CREDIT STRATEGIES** Historically, amidst challenging market conditions, the most robust investment opportunities in credit tend to surface. **In a less competitive market, well-capitalized lenders can secure more favorable terms.** The current challenging market conditions are expected to persist as banks withdraw, presenting significant opportunities for non-bank lenders.
>
> Traditionally, banks have been the primary source of debt capital especially for value-add and construction loans. However, current regulatory constraints have made them more selective, leading to reduced loan-to-value ratios and the adoption of significantly more conservative underwriting practices. The implementation of risk-based capital rules and a shift towards reduced risk-taking will likely diminish the market share of traditional lenders over time. **In contrast, non-bank lenders enjoy an advantage, being exempt from regulatory risk-based capital regimes, enabling them to align strategies with investors' risk/return profiles versus formulaic regulatory schemes.**
>
> **As traditional lenders scale back senior funding, a growing funding gap emerges, compelling borrowers to seek "gap capital" to bridge the space between senior loans and equity.** Borrowers increasingly opt for stretch loans or mezzanine debt instead of more expensive common equity. Leading non-bank lenders seamlessly integrate real estate ownership expertise into their underwriting and asset management processes, leveraging deep knowledge of submarkets, sectors, construction, and sponsors. This strategic integration positions non-bank lenders to offer speed, certainty, and creativity to borrowers that create value beyond a borrower's cost of funds.
>
> Should U.S. and European banks continue to retreat, a broader range of opportunities may arise, impacting capital pricing across different sectors due to constrained financing for new and existing projects.

OPPORTUNISTIC

This strategy seeks to leverage market dislocations to realize high returns through multiple access points and investment structures.

In 2021 and early 2022, real estate transaction volume reached a new high, averaging approximately 250% of the prior 10-year average.[22] These acquisitions were largely priced at the lowest cap rates in history and with 70% of transaction volume primarily financed with floating rate debt.[23] These owners benefited from record low LIBOR and SOFR indexes at the time, resulting in satisfactory cash yields to their equity investments despite the low cap rates utilized at acquisition.

22. MSCI RCA.
23. National Council of Real Estate Fiduciaries (NCREIF) appraisal-based cap rates.

Fast forward to 2024 and the real estate industry is facing a wall of debt maturity totaling approximately $2.1 trillion over the next four years. **Due to increased borrowing costs and resultant reductions in real estate values, much of this debt will not be able to be refinanced in a traditional manner, which will result in required re-equitization or forced sales by owners or their lenders.** Even before loan maturity, many of these assets purchased with floating rate debt in 2021 and 2022 no longer benefit from monthly free cash flow distributions and in many cases require additional capital to cover monthly debt service obligations. Creative investors with structuring acumen and capital markets expertise should be well-positioned to provide investment solutions to these owners and lenders and find attractive acquisition targets below replacement cost. Importantly, because much of the distress in the real estate industry revolves around capital stack distress and not fundamental real estate concerns, investors may have the opportunity to access higher-quality real estate than in previous cycles while targeting the same or even higher opportunistic returns.

Investment structures in this strategy take the form of preferred equity, joint venture equity, platform capitalization/co-GP equity, and the acquisition of sub-performing and non-performing debt. These instruments provide a means to harness market dislocations for substantial returns while utilizing structure to reduce downside risk. **Overall, this approach presents an ideal opportunity for capital deployment in higher-returning CRE assets.**

> **OPPORTUNISTIC STRATEGIES** Affinius Capital's investment programs have an established track record of effectively leveraging market disruptions for investor gain.
>
> Looking at 2024, we anticipate opportunities that align with our expertise, including the acquisition of distressed assets, participation in debt transactions, and implementation of structured recapitalizations. Realizing the full potential of these opportunities hinges on market acknowledgement of price corrections, a recognition that may evolve over time.

OPEN-END FUNDS

Open-end funds play a pivotal role in the CRE sector by normally enhancing market efficiency.

Strategically, they can offer investors dependable income, capital preservation, diversification, and strong risk-adjusted returns. Although these funds typically focus on stabilized assets, incorporating a value-added approach can lead to enhanced returns due to a greater yield over time, and may better align with the return and risk profiles of modern investors.

Tactically, we believe the market is setting up for a compelling investment opportunity in open-ended funds, with NCREIF valuations to likely bottom in 2024, which could lead to an excellent vintage year for capital deployment. While redemption queues are currently outweighing subscriptions, this dynamic can quickly reverse, lending additional support to these strategies.

> **OPEN-END FUND STRATEGIES** Despite certain misconceptions about office spaces and appraisal inconsistencies, funds like the Government Building Fund remain robust, with mission-critical tenants recently renewing long-term leases with Federally-backed credit.
>
> A build-to-suit strategy also benefits from the need for no or limited capital outlays during the average lease term. The Eagle Fund continues to create ongoing value, particularly in its mixed-use, multifamily, and industrial segments as well as outperformance against its benchmark despite the headwinds from the ODCE Index's aggressive appraisals. We anticipate further benefits as market liquidity increases, ODCE queues decline, and appraisal data brings more clarity to comparative sector values.

HOUSING

A comprehensive analysis of the housing market reveals that the housing shortage is driving up prices and will continue to do so in the coming years as a result of various factors such as regulatory challenges, scarcity of land, and a lack of skilled labor in construction.

The U.S. is currently experiencing a shortfall of about 3.8 million homes, a key factor contributing to rising home prices nationwide. This chronic shortage has been an issue for years, as new home construction has not kept pace with demand. The affordable housing crisis is also intensifying, evidenced by more than half of the U.S. renters considered "cost-burdened," allocating over 30% of their income to housing costs. **This situation affects both homebuyers and renters.** Additionally, recent hikes in mortgage rates have increased the cost of purchasing a home by more than 50% compared to renting—the most severe disparity seen since 1996, and a 20% increase from pre-GFC levels.[24]

The housing market offers promising opportunities for private equity investors, especially in the growing urban demand for workforce and affordable housing, indicating a strong potential for multifamily housing developments. Additionally, the undersupply of skilled construction labor contributes to the need for more homes. This presents an opportunity to invest in companies that improve the construction industry's efficiency or in technology to automate construction processes.

> **HOUSING STRATEGIES** We believe a combination of demographic trends, lifestyle choices, and the challenges of home ownership, along with a significant housing shortage, will continue to fuel strong demand for rental properties across both market-rent and workforce segments in the coming decade.
>
> In the short term, opportunities may arise to buy overleveraged assets with high interest rates at values below their replacement costs that may involve restructuring the capital stack for properties experiencing financial, but not operating-level, distress.
>
> As the cost of borrowing and interest rates decrease, we expect the imbalance between supply and demand to present attractive development opportunities, as a significant slowdown in supply and falling construction costs coalesces into a more compelling environment for 2025 and beyond. With a reduction in new housing starts this year, the long-term outlook for housing development should strengthen fundamentally.

Amid current market volatility, with unpredictable economic conditions and interest rate changes expected to continue through 2024 or 2025, navigating the real estate landscape remains complex. Additionally, valuation inconsistencies across sectors and assets require attention to restore market liquidity.

With such challenges come great opportunity for those that have the insight and experience to navigate the changing landscape. The key to a successful real estate investment strategy is knowing when to "dial" exposure up and down tactically, while remaining disciplined to investment convictions based on long-term demand drivers and other fundamentals. **In today's environment, the following areas show the greatest tactical advantages and represent our highest conviction for enduring growth—data centers, structured credit, reduced basis open-end fund allocations, housing, logistics, and tactical opportunistic strategies.**

24. The Wall Street Journal. There's Never Been a Worse Time to Buy Instead of Rent. Published October 22, 2023.

CONCLUSION

The North American real estate market in 2024 holds substantial interest for investors amidst an economic climate sending mixed signals. There is cautious optimism with anticipated interest rate cuts following moderating inflation and declining growth, suggesting a potential market upswing in the coming years. However, heightened geopolitical risks add complexity to the timing of such economic growth and labor market projections, and thus require careful consideration of investment placement.

The resetting of values that is underway will provide opportunities this year for those able to infuse liquidity into capital stacks (e.g., through tactical opportunistic investments) and to buy assets at reduced values with intrinsic upside potential (e.g., open-end funds). Other areas will see significant growth this year simply based on supply/demand imbalances or strong long-term fundamentals, such as data centers, industrial, and housing. Finally, retreating capital from traditional sources provides significant opportunities for private investors to step in and capitalize on the lack of liquidity, most notably in the credit space.

Market cycles are becoming more compressed as technology drives transparency, and investors must be ready to move quickly to deploy capital when compelling opportunities arise. This tactical agility, coupled with long-term strategic conviction, is the key to managing through this dynamic cycle and achieving sustained value.

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