Our Thesis for Real Estate Investing

SPEEDING TOWARDS NORMALIZED GROWTH

To say a lot has changed since the beginning of 2022 would be an understatement. Just as we were picking up the pieces from the COVID-19 pandemic, Russia invaded Ukraine, inflation in the U.S spiked, and the Fed began its interest rate hiking spree. The convergence of these events has tanked consumer confidence levels and plunged the stock market into bear territory. In addition to volatile construction prices and a shortage of construction labor, current interest rates are now close to 2019 levels, which means they are markedly higher than last year. Forward-looking interest rates are expected to hike more than 1.5x in the next year based on the SOFR curve.

The expectation of a continuous increase in interest rates is affecting deal pricing as groups are basing their underwriting assumptions on a higher cost to acquire debt, to build new projects, and to maintain existing ones. The price adjustments we're seeing are, almost without exception, downward and can range from 3% to as high as 20%* (in a few rare situations) depending on the property type and location. Commercial real estate (CRE) property values are shifting and we are observing widening bid/ask spreads on deals coming to the Marketplace depending on the property type, location, risk profile of the investment, and the motivation of the seller.

Even with the prospects of lower growth on the horizon, when you combine a price reduction with continued growth in underlying fundamentals, you get an asset class that begins to look more rational from an underwriting perspective. Overall, we welcome a return to "cooler heads prevailing" as we analyze deals moving forward.

The private CRE market, although historically less correlated to the highs and lows of the public stock market, does not operate in a vacuum. Keeping in mind that many trends in this economic environment are still taking shape, our latest thesis updates combine industry knowledge, in-depth research, and the expertise of our Investments Team to build our outlook and assess opportunity across multiple real estate property types.

**Based on internal CrowdStreet data as of August 8th, 2022*

How we're evaluating each asset class

As we enter the next phase of the real estate cycle, we believe that nearly every asset class has the potential for growth, although the growth outlook is tempered as compared to 2021 levels. Certain assets are far from "on-sale" but continue to be driven by robust underlying fundamentals, while others show signs of pivoting off of their lows and potentially offering acquisition opportunities at relative values. Overall, with less polarization so far in 2022, we view the market as more balanced and better positioned for broader, albeit moderated, growth across the board.

Hospitality

OUTLOOK

Despite all the tumult of 2022 thus far, recovery in the hospitality sector has continued thanks to a notable uptick in business travel and continued growth in leisure travel. Although a complete business travel recovery is still likely a year away according to STR, businesses now have "the least negative sentiment" for business travel (globally) since the pandemic began.

Overall, hotels are now operating above pre-pandemic performance, with total U.S. hotel occupancy above 70% as of July 2022. Revenue Per Available Room (RevPAR) is expected to surpass 2019 levels on an annual basis by 2024 on a real level after accounting for inflation, with central business district recovery expected to lag suburban recovery. However, hotels are somewhat more susceptible to inflation given their larger operating budgets. While the pent-up demand for hotels is pushing up occupancy and revenue rates nationwide, we still see labor shortages, high inflation, and a rise in interest rates collectively hampering the pace of recovery.

OPPORTUNITY

Given the outlook for this property type, 2022 may be the final window to bargain shop for hospitality deals. In the immediate aftermath of the pandemic, our team saw asset pricing discounted by as much as 20%* relative to 2019 trades. For the most part, hotels are no longer priced at a discount and are entering an expansionary phase. While discounted pricing for hospitality assets in comparison to 2019 values is

still possible, it's much more likely to occur as one-off or unique situations. By sifting through and discarding marginally priced deal flow, we aim to focus on those situations where pricing disparities continue to exist.

We are also seeing specific property types bounce back, particularly leisure, high-tier/luxury, and extended-stay hotels, especially in drivable, leisure-oriented destinations or vacation markets with pent-up travel demand. On the flip side, urban-located hotels may present the most compelling mispriced opportunities. As a result, we are tuning into some urban-located hotels, provided the going-in basis is attractive and the deal is adequately capitalized to see it through to 2023 and beyond. Urban districts and STR's "Top 25 Markets" are not expected to reach full RevPAR recovery until after 2024. Yet, in the "age of the new traveler," remote work has given many people the flexibility to extend vacations and work from their destination. As business travel is recovering, the blending of remote work into leisure travel or, as STR calls it, "work-cation," may provide opportunities in upcoming years for urban, leisure, and extended-stay hotels.

**Based on CrowdStreet data as of March 3, 2022*

Industrial

OUTLOOK

Demand for industrial space is still some of the highest among all property types. Relative to projected demand by 2025, the sector still appears far undersupplied, however, the frenzy of 2021 for industrial space is starting to fade on the heels of a slow-down in e-commerce sales, as reported by Amazon and Mastercard Spending Pulse. After doubling its warehouse space in the aftermath of the pandemic, Amazon is now scaling back on its expansion plans by giving back space, with plans to give up more space, which is a testament to the simmering down of e-commerce overall. The e-commerce cool down is by no means an indication that the sector's strong growth will come to a halt. According to a forecast by Morgan Stanley, e-commerce sales in the U.S. could reach 31% of total sales by 2026, which is up 23%

from 2022, showing a "permanent" or a real shift in behavior and a preference toward online shopping.

The current market shift is, however, affecting cap rates, which had compressed to record levels for the industrial sector in early 2022, reaching as low as 3.5%*. As soon as interest rates began to rise to the level that industrial cap rates would intersect with the yield on the 10-year treasury (also known as the "risk-free" rate), it became clear that the industrial sector must soon experience cap rate expansion. Since then, industrial cap rates have expanded to 4.1% nationally**. Accordingly, we are now seeing asset values decrease 5-10%.

Although relative demand for industrial space is tapering from its peak, the outlook for the sector remains relatively unchanged and will remain elevated, especially in low vacancy and high-barrier markets.

**Green Street Advisors* - Industrial Sector Update: Still "Prime" Real Estate, 2022.

***Green Street Advisors - Cap Rate Observer, July 2022*

OPPORTUNITY

Considering that long-term trends such as undersupply, low vacancies, and high demand for industrial projects are still in place, we are keeping an eye on industrial developments. As with other property types, lenders are requiring an increase in interest reserves on these deals which is adding to the total project costs. Industrial projects do, however, require fewer interest reserves, as well as shorter construction and stabilization timelines compared to multifamily and hospitality, thanks to less complicated build-outs, which alleviates some of the burden on the supply side.

Primary markets with strong industrial demand are highly competitive and, as such, we are seeing increased demand in tertiary markets with burgeoning institutional presence. We also like niche strategies such as industrial storage facilities, which are essentially infill fenced yards (that may or may not have structures on them) leased out to companies who can park their vehicles, trailers, and containers to accommodate their supply chain and logistical demands.

Industrial properties have less operational risk right now due to the Triple Net (NNN) nature of leases, where tenants pay all the expenses. This insulates these deals as operational costs go up. However, the current locked-in cash flows are not as attractive as they were a few months ago due to inflation, which is also part of the reason behind the cap rate expansion we are currently seeing in the market. Although the value proposition has diminished slightly for industrial, it is affecting stabilized deals first and foremost. As long as we budget exit values that reflect the current expanding cap rate environment, we continue to believe in adding new supply, especially in tight markets.

Medical Office

OUTLOOK

The healthcare industry is poised to benefit from strong demand, which will in turn drive growth for the medical office sector over the next decade. According to the 2020 Profile of Older Americans, the average U.S. population is aging. U.S. Census data estimates that one in five Americans will be 65 or older by 2030, which increases to one in four by 2060. Furthermore, population projections from the census show that by 2034, older adults will outnumber children for the first time in U.S. history. Americans in the 65+ cohort visit their physicians more frequently than younger people, which means increased demand for medical office facilities.

The COVID-19 pandemic was turbulent for the economics of the healthcare system. Hospitals canceled elective procedures and postponed non-urgent treatments , while urgent care facilities operated at maximum capacity. There is pent-up demand for postponed procedures from the last two years, which will likely manifest in increased in-patient visits.

OPPORTUNITY

A consistent and ever-growing need for healthcare bodes well for the medical office sector. We see strong opportunity, especially in areas where population projection for older Americans is expected to rise. According to the Population Reference Bureau,

most of the older population is concentrated in markets like California, Florida, and Texas.

We also expect increased demand for medical offices located further out and away from Central Business Districts as hybrid workers are relatively less tied to medical offices that are solely near their office. We continue to like small-to-mid-sized medical offices which are located near hospital campuses rather than inside large hospitals. Such facilities offer patients greater accessibility and they lower operating costs for practices. As a result, health professionals have been migrating from hospital campus locations to purpose-built outpatient facilities, a trend we previously pursued for the Marketplace and see continuing in the years ahead.

Medical offices near well-performing retail locations like power centers and strip centers also tend to do well as people often schedule their appointments around running other errands due to convenience. Overall, we expect continued recovery for the medical office sector in 2022 as healthcare employment recovers and patients return for in-patient visits.

Multifamily

OUTLOOK

To put it bluntly, record-breaking price appreciation for multifamily in certain markets reached stratospheric levels and now must return back to Earth. Growth is still “robust” according to Green Street Advisors, yet is expected to be “trimmed” in 2022 from the “aggressive levels” of growth in 2021.*

Despite some cap rate expansion and price adjustment, the sector is performing well in terms of market fundamentals. CBRE reports that in the first quarter of 2022, vacancy further dropped, rents increased, and investment sales activity set a record. Net absorption in multifamily units also beat a record in the first quarter of 2022, achieving the highest absorption rate since the year 2000. The rental rates in Sunbelt markets still lead the way for year-over-year tradeouts but are tapering from their

record growth rates for some of the top markets. Still, solid rent growth is expected for the remainder of the year.

The multifamily sector has outperformed Zelman & Associates' 2022 forecast, leading the group to update its revenue growth from 5.8% to 7.8%, with 13% higher new starts forecasted in 2022 as compared to 2021 and elevated new completions, setting the stage for "more multifamily completions over the next three years than any comparable period dating back to 1988". Given the overall undersupply of multifamily relative to demand (850,000 units of total undersupply according to the Linneman Associates Summer 2022 Letter*), we're not concerned about the increasing supply at the macro level, but we do believe that certain submarkets may overshoot.

**Green Street Advisors - U.S. Commercial Property Outlook, June 2, 2022*
***Linneman Associates - The Linneman Letter, Summer, 2022.*

OPPORTUNITY

We are seeing multifamily prices shift to reflect an outlook of more normalized growth. In addition to a realignment of expectations, we also view the current market dynamic as pricing in much of the borrowing cost disruption that is coming from interest rate increases. On the whole, depending on the risk profile of the investment, we are seeing anywhere from 25 to 100 basis points (bps) of expansion in cap rates–a reasonable general reset for the sector. Situations where we see a spike of greater than 50 bps in the going-in yield suggests to us that the short-term price adjustment may be knee-jerk in nature, and presenting an attractive acquisition opportunity.

We are paying close attention to value-add multifamily acquisitions, particularly well-located properties with "good bones." With the rise in interest rates, we are seeing more off-market opportunities from owners that have un-capped debt on their deals and are seeking relief from their rapidly rising debt service. However, because we expect rent growth in the multifamily sector to moderate over the next few years, it is possible that value-add plays may diminish in volume over the next

few years as more properties are renovated, and rents are adjusted to capture current market rents.

We also favor ground-up multifamily developments. 2021's rent growth led to massive appreciation for this sector which outpaced the increase in construction costs. Provided we believe we can still obtain a 6% or greater stabilized yield on cost, with all adjustments of 2022 factored in, we see the ability for those projects to maintain 150 to 200 bps of premium over their exit cap rate and deliver a successful exit

Office

OUTLOOK

Our previous speculation was that we may have witnessed the bottom of the office market in 2021, but the looming possibility of a recession could further delay the recovery of the office sector. Even with the assumption of a delayed recovery baked in, however, we continue to believe that the office market, on the whole, will look better by 2025 than it looks today. With higher-quality office projects in demand, obsolescence is a serious issue for this market segment, and data suggests that offices will lose at least if not more than 28% of their market value within the next decade as compared to 2019 levels. Most major asset classes experienced cap rate compression during the last two years (particularly for multifamily and industrial property types), while office is the only property type that has been experiencing cap rate expansion continuously since after the pandemic.

Although the future of office is still uncertain, it is undeniable that the hybrid-work model has gained more traction since the beginning of the pandemic. Before the pandemic, roughly 1 out of 67 jobs were remote according to data provided by LinkedIn. That number climbed to 1 out of every 6 jobs in 2022. The major question that remains to be answered for the hybrid work model is whether it will continue to gain traction or if we see the pendulum swing back towards greater physical presence in offices. As business market volatility increases, as one would expect in a tumultuous business environment, we may see more companies call employees

back to the office in order to better navigate the choppy waters ahead. While uncertainty remains, an environment where office currently trades in a similar range to retail cap rates suggests that a considerable amount of risk has already been priced in for this sector.

OPPORTUNITY

With increased caution for this sector, we are tuning into the flight-to-quality trend in the office market and chasing high-quality, newer construction projects and/or properties located in strategic locations. Tenants are increasingly disqualifying older projects and relocating or moving into new construction projects that offer modern amenities to uplift the office experience.

The credit quality of the tenant is always a requirement for a good investment, but now more than ever, we are paying close attention to the entire tenant mix when considering office deals. While we still like stabilized, cash-flowing office deals (as these types of properties currently offer relatively high annual operating yields when compared to multifamily and industrial property types), we are taking a cautious approach and tuning into particular value-add and opportunistic deals with an attractive going-in basis, high asset quality, an experienced sponsor behind the deal, and a location in a resilient submarket with high employee occupancy.

While people are increasingly coming back to the office, the volume of reentry varies across markets. According to Kastle Systems, Houston, Austin, and Dallas are among the top metros in terms of bringing people back to the office. These Texas markets are currently hovering at an average occupancy level of ~55%. On average, looking across the top 10 metros tracked by Kastle Systems, office re-utilization rates are currently around 44% (as of 8/12/2022); this discrepancy in occupancy rates among submarkets is part of what makes us more bullish on Sunbelt office locations in 2022, as office occupancy is strongest in these markets

Retail

OUTLOOK

Brick and mortar sales growth in the retail sector surpassed online sales growth in 2021. E-commerce sales were up just 14.2% in 2021, less than half of the exponential growth of 31.8% e-commerce sales saw in 2020. The tapering down of online shopping is bringing activity back to cities and reviving experiential retail, as well as the overall outlook for this sector. Despite high inflation, consumers spent 18% more in March of 2022 than they did two years prior, which steeply increased consumer spending after the brunt of the pandemic. And visitation data confirms this trend. As of August 2022, according to Google's mobility data, visitation to restaurants and recreation places has returned to within 6% of pre-crisis levels and has fully recovered for visitations to grocery stores and pharmacies.

JLL's Retail Recovery report* points to healthier retail market recovery and higher rent growth for the Sunbelt markets than in the Northeast and California markets, observing that "retailers are going where the people are," following the migratory pattern of consumers. After the grueling months of retailers struggling to keep their doors open, Coresight reported that during the first half of 2022 there were significantly more new store openings announced as compared to store closures, with 1.9% more openings and 58% fewer store closures as compared to the first half of 2021. According to Axios, this marks a reversal of the trend for the first time since 2017, supporting our long-held belief that the retail sector is evolving, but not dying.

**JLL - Retail Recovery, 2021*

OPPORTUNITY

The pandemic served a pruning function of sorts for retail centers, causing weaker retailers to exit centers around the U.S., resulting in some consolidation in rent rolls. In 2022, we feel confident that a center considered viable today is likely to remain viable in the years to come. We will observe market conditions and look to bring retail deals to our Marketplace that have fared well relative to others, such as grocery-anchored centers and neighborhood shopping centers, as opposed to the

segments impacted the most like traditional shopping malls and second-tier big-box stores. In a current market dynamic where going-in yield is valuable, on average, retail continues to offer the best going-in yields of any asset class. We continue to view this sector as an overlooked opportunity, particularly in the grocery-anchored segment.

While retailers are benefitting from a recovering market, they are increasingly "rightsizing" their space at the end of their leases, which means they are letting go of any space that represents a drag on their profits. On top of rightsizing their existing space, retailers are also rightsizing their entire portfolios by closing down stores that are hindering revenue growth. With muted new construction, we expect to see more redevelopment of existing space.

Self-Storage

OUTLOOK

The self-storage sector boomed in the last two decades, but saw decelerating market fundamentals in the three years prior to the COVID-19 pandemic. Fast-forward to 2020, demand for self-storage space spiked again, bolstered by pandemic-related migration as people moved across states, as well as intrastate, from urban to more suburban locations.

The sector is institutionalizing with major storage REITs, including Extra Space, Cube Smart, Public Storage, and Life Storage acquiring properties and consolidating this fragmented asset class.

The self-storage pricing shot skyward, up 66% in 2021, according to Green Street Advisors*. This rampant appreciation is driven by a few factors. Double-digit rent growth and occupancy rates of 95% (a record high nationwide) translated into a 16.5% increase in NOI in 2021, contributing to strong pricing. At the same time, cap rates have compressed close to 100 basis points since the beginning of the pandemic, down to 4.6%** nationally. All told, self-storage ranks right at the top, alongside

industrial, as one of the better performing of all property types over the past two years with a strong outlook for growth.

**Green Street Advisors - U.S. Self-Storage Outlook, 2022*
***Green Street Advisors - Cap Rate Observer, July 2022*

OPPORTUNITY

There is an increasing need for self-storage due to work-from-home and relocation trends, which will likely create more opportunities in non-coastal markets due to pandemic-induced migratory patterns. We also expect major university towns to see strong demand for storage space. Older self-storage facilities often lack amenities such as climate-control, security systems, etc., which continues to create opportunities for further development of this asset class. We seek growing metros with a relative dearth of supply, namely five square feet or less of self-storage space per capita within the primary market area.

We are also bullish on adaptive reuse projects as oftentimes they are situated in great in-fill locations which are development sites in an urban area that is mostly built out, such as a retail center on a busy thoroughfare. In our experience, both development and adaptive reuse projects benefit from an unusually large spread between a typical stabilized yield on cost at stabilization (typically ranging from 7.5–8%) versus the typical exit cap of a fully stabilized self-storage property (roughly 3.5–4.5%). This outsized spread means a sponsor can often sell a stabilized self-storage property for 40–45% more than the cost to build it.

According to Green Street Advisors*, there will be a downtick in new self-storage deliveries in 2022, predicted to last until 2024, due to labor shortages and supply chain issues. However, construction deliveries are expected to climb in 2025 and beyond due to the ever-increasing demand for self-storage. This suggests to us that the next two years may provide an extended window of opportunity to invest in the self-storage sector and re-evaluate our strategy to get in front of opportunities as we approach 2024.

**Green Street Advisors - U.S. Self-Storage Outlook, 2022*

Senior Housing

OUTLOOK

The senior housing sector was hit particularly hard by the pandemic in terms of both occupancy levels and labor shortages, as well as concerns about the health and safety of medically fragile senior adults in close quarters. In 2022, we remain cautiously optimistic about the senior housing sector in spite of lingering uncertainty.

In Q2 2022, the occupancy rate for senior housing properties recovered from the pandemic-related low of 78% seen in the first half of 2020 to 81%. These occupancy levels remain historically low as the senior living sector faces challenges from labor shortages, higher death rates from the COVID-19 pandemic, and an increase in alternative living arrangements. High operational costs are an additional concern for the overall sector.

With the first set of Baby Boomers turning 80 in 2025, we expect an influx of demand for senior housing amid an aging population. According to the U.S. Centers for Medicare and Medicaid Services, the number of individuals needing long-term care will double by 2050. Thanks to medical advancements, the U.S. population is living longer, increasing the average age of residents in these facilities to 84 years old.

OPPORTUNITY

We are taking a “wait and see” approach for senior housing in 2022. While the need for senior care is growing, we may not see a meaningful spike in demand until closer to 2025. Advancements in medical technology have increased opportunities for alternative living arrangements, affording many seniors the opportunity to live in their own homes longer, which can potentially reduce demand for traditional senior living arrangements.

In the meantime, there may be opportunities to seek discounted properties as compared to pre-pandemic levels. According to CBRE's Q2 2021 Senior Housing Market Insight report, transaction volume and development are down significantly. However, demand for senior housing is forecasted to grow by 177% from 2021 to 2050, which will eventually push construction activity to keep up with the demand for senior care. The PWC Emerging Trends in Commercial Real Estate report ranked senior housing as one of the top asset classes for investment prospects in 2022. While we may not be quite as bullish as ULI on this sector for 2022, we will continue to keep our eyes open for compelling deals going forward, especially as the dust starts to settle from the impacts of new COVID-19 variants.

Student Housing

OUTLOOK

In an effort to stop the spread of the virus, COVID-19 vaccinations were mandated for close to 1,000 colleges and universities in late 2021, according to The Chronicle of Higher Education. As a result of these precautionary measures, students were allowed to return to campuses for the 2021 fall semester, and pre-leasing was up 5.2% from the year prior.

Fannie Mae reported uninterrupted new supply by bed deliveries for 2020 and 2021, which translated into level supply year-over-year. However, due to supply chain issues that are impacting most asset classes, new student housing project completions are expected to be sluggish, with a relatively low new supply of bed deliveries forecasted for 2022 according to RealPage Inc.

Although the student housing sector is normalizing faster than was previously anticipated, we do not view the current state of the sector as a rising tide that will lift all boats, because overall reduced enrollment in colleges and universities and declining birth rates may pose future challenges to a number of schools. According to the National Student Clearinghouse Research Center, enrollment in colleges and universities has not yet caught up to pre-pandemic levels and is actually declining,

with undergraduate enrollment accounting for most of the decline, down 4.7% from Spring of 2021 to Spring of 2022.

OPPORTUNITY

The opportunity in the student housing sector is dichotomous, and location plays a key role in choosing the right investment. The most desirable and best-capitalized flagship universities will exploit their competitive advantage to attract students in record numbers, which will propel the student housing markets in areas with large universities at the expense of markets with smaller institutions and community colleges. This leads us to be generally bullish on Tier I universities (schools that are expected to bring in at least $100 million per year in research grants, plus have selective admissions and high-quality faculty), particularly those with large student populations and affiliated with major conferences.

According to the Yardi Matrix Student Housing report, the outlook for student housing is positive, especially for off-campus properties and in highly selective universities. The report also mentions that rents are at above pre-pandemic levels. Low vacancies in the student housing sector are pushing rents up in areas where student enrollment is anticipated to be high, and where supply is strict.

We fully expect more educational institutions to adopt a blended learning approach with both in-person and online courses. However, there is little evidence as of now to support that blending virtual classrooms into the traditional university settings will negatively affect the student populations that are local to campuses, considering that the in-person college experience is still important to students.

Overall, we see an opportunity for the sector and will focus on areas surrounding top-tier universities with a prudent supply of new housing relative to forecasted demand.

Life Sciences

OUTLOOK

Life sciences is one of the fastest-growing industry sectors, with a record $70 billion of private and public capital poured into life sciences-related companies in the U.S. in 2020; this was a whopping 93% increase from the previous record of $36 billion received in 2018.

According to PWC, the life sciences sector is projected to continue investing in oncology, gene therapy, neurology, and cardiology for the foreseeable future. A report by Green Street Advisors* showed NOI growth for the past decade for this sector at well above the average for other property sectors, which “looks repeatable the next five years given the tailwinds in the sector.”

Keeping the numerous data points in mind regarding the ever-growing potential of this sector, we are bullish on life sciences in 2022 and beyond.

**Green Street Advisors - Life Science Insights, 2021*

OPPORTUNITY

A unique aspect of life sciences occupiers is that they tend to cluster around specific areas. We see opportunities near bustling urban environments, especially in areas with top talent, high intellectual capital, and the presence of top research universities. In a report by CBRE, the top markets for life sciences real estate include Boston, the San Francisco Bay Area, and San Diego, where demand grew by more than 34% since mid-2020, with significant rent growth, tightening vacancies, and pre-leasing in new projects. See which life sciences markets we’re the most excited about in our 2022 Best Places to Invest report.

Life sciences tenants require highly specialized real estate, which is tough to come by–appropriate ceiling heights, robust power, high floor load capacity, venting, excess plumbing, and freight elevators. In addition, life sciences tenants need to consider the overall feasibility of the building for their specialized operations. Currently, there

is a limited supply of lab space and R&D facilities nationwide, which has translated into tremendous excess demand in this sector, leading to rising rents and record development. The Boston-Cambridge life sciences market, for instance, has the tightest vacancy in the nation at one percent. In clusters where we see demand outstripping current supply, we will seek to fund ground-up developments.

In addition to ground-up development, we see creative opportunities to reposition existing properties when they are suitable for conversion. Converting existing office properties to life sciences uses is complex, so we're placing heightened sensitivity on the experience of the sponsor.

Outlook by geography

We are honing our focus on the metros we view as best positioned to benefit from a real estate market that is adjusting to a normalized outlook. In 2022, we are seeing emerging opportunities for urban recovery, which is why certain markets, such as Seattle-Tacoma, moved up significantly in our rankings this year relative to their 2021 rankings. We have visited markets like Philadelphia, New York, and San Diego, and we have witnessed the momentum and energy returning to these larger markets and city centers. We see continued momentum for the resurgence of certain larger cities in the year ahead, which may lead us to move these markets higher when determining our 2023 Best Places to Invest report.

This focus also translates to continued belief in many growing secondary markets. Wherever we see a market as maintaining above-average rent growth, strong absorption rates, continued job growth, and strong median household income growth, such markets still stand out to us this year. That means that a theme that continues to carry over from 2021 into 2022 is the conviction in our 18-hour city thesis. Many of our perennial favorite secondary markets experienced outsized rent growth and asset appreciation in 2021. We still see the underlying fundamentals that are currently driving this growth as continuing in 2022. However, we are also cognizant of the increase in supply that is arriving in many of these markets, so we are tracking the possibility of some of them overshooting in the short term. Also, while most of

our top markets demonstrated enough consistency to merit inclusion again in 2022, we welcomed four new markets–San Antonio, Charleston, San Diego, and Fort Lauderdale–to our top metros nationwide, and we are pleased to continue to see the momentum continue to build for our newest entrants. See The Full List.

Environmental, Social and Governance (ESG)

The three pillars of ESG consider the impact of a business on environmental sustainability, social issues, and fair corporate governance practices to more holistically evaluate long-term risk and opportunities. This means we must rethink how commercial real estate exists within the built environment, how and by whom it is operated, and the long-term impact of our business operations.

CrowdStreet recognizes that the time has come for the commercial real estate industry to cease being a part of the problem regarding ESG issues and strive to become a part of the solution. In 2021, we set a goal of having 15% of all approved Marketplace deals satisfying one or more CrowdStreet ESG components, which are usually listed out in the business plan of the offering. These include (but are not limited to) the following checkmarks:

- Sponsorship diversity, equity and, inclusion - the founder or principal is a member of a minority group
- Certified sustainable building or green asset - e.g., LEED or WELL Certification
- Positive social impact–low income housing, historical tax credit, or community engagement
- Governance–sponsor is, or partnering with a B-corporation (typically 30% or more of rent roll)

Although this is just the beginning of our ESG revolution, we are happy to say we exceeded our goal, with 16.7%* of our total approved deals meeting these criteria. We're reaffirming our commitment and responsibility and have raised the bar in 2022 to a goal of 20%.

**Based on internal CrowdStreet data as of February 25th, 2022*

Conclusion

The massive momentum we saw in 2021 has rapidly transitioned into a volatile 2022. However, despite the roller coaster ride of the first half of 2022, an outlook of moderate growth remains in place for H2. In May, Goldman Sachs revised their outlook and forecasted the US economy to grow by 2.4% this year and by 1.6% in 2023. However, both growth metrics are lower than they were forecasted previously. In June, Citi published its Mid-Year Outlook 2022, which forecasted GDP growth of 1.9% for the entirety of 2022. So, while major banks may differ in their outlook, there appears to be consensus on an expectation of growth in the second half of this year. As we noted at the outset of 2022, we viewed the market dynamic of 2021 as unsustainable, and we welcomed a return to normalized expectations. While we would have preferred a calmer descent to normalized growth, we ultimately believe the market is on the right trajectory for sustainable growth in the years ahead.

Any outlook right now must consider higher interest rates as well as the possibility of an extended period of above-average inflation. On the inflation front, while we acknowledge that it may continue at relatively high rates for another year or more, we believe our current inflationary environment will be relatively transitory in nature and should abate in 2023 as supply chains begin to catch up to demand.

As for rising interest rates, we see a moderately rising interest rate environment on the horizon, and we consider that generally good for the CRE industry. In our opinion, a ten-year treasury note that hovered around 1.5% last year, combined with massive injections of liquidity from the Fed, drove price appreciation to a degree that, were it to continue unabated for another two years, could result in an overheated market that would run a risk of crashing by 2024. We are pricing in the assumption of a roughly 2.75% 10-year Treasury by early 2023 (essentially relatively in line with where it is trading in July of 2022), and we have already adjusted our investment criteria accordingly. While volatility remains in the market, a possible continuation of the heightened current bid-ask for the remainder of this year not only gives us greater confidence in a longer, more sustainable cycle in the years ahead but also presents a

greater probability of identifying and seizing upon mispriced investment opportunities.

While we are forecasting some cap rate expansion over the course of this cycle, it's worth noting that, ultimately, cap rates tend to be more supply/demand driven than interest rate driven. For example, from 2016 to 2019, the yield on the 10-year Treasury note increased from roughly 1.5% to over 3%, yet cap rates compressed over that same period. Therefore, we view scenarios where cap rates have spiked upwards of 100 bps as potentially short-term mispriced buying opportunities as we do not see 100 bps of cap rate expansion in most markets as the new bar but more of a spike over the mean. As such, we will aggressively pursue opportunities where we see sponsors exploiting this phenomenon to obtain substantial price discounts and compelling going-in bases.

While we see continued momentum behind the multifamily and industrial sectors that grew abundantly in 2021, we see a broadening of the market with increased opportunity coming to other sectors as well. From the demographic drivers of an aging population leading to increased demand for healthcare-related real estate to our urban reshuffle that has driven demand for self-storage, to the ushering in of a new office culture centered around flexibility, 2022 is looking to us to be a year in which nearly all asset classes present the prospect of opportunity, just in varying shapes and forms and highly dependent on acquisition price or development cost.

As is always the case, the possibility of unknown shocks around the corner, good and bad, are always present. As such, we will continue to monitor markets and update our thesis accordingly. To the extent we shift our outlook, we'll keep you apprised of our latest perspective.

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