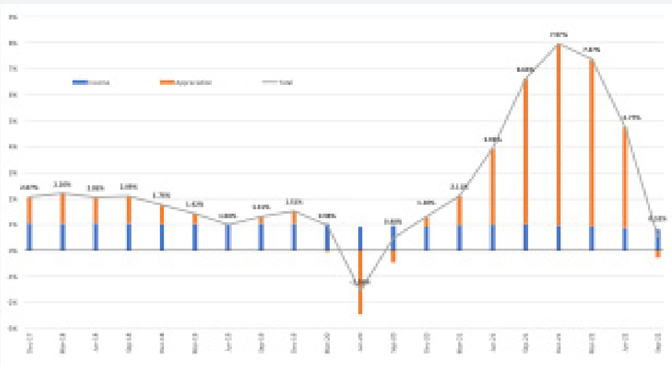
ODCE

A MIXED BAG WITH A HINT OF SLOWDOWN

In the third quarter of 2022, the NFI-ODCE (the "Index") generated a gross total return of 0.52% (0.31% net), which was comprised of a 0.81% income return and -0.28% capital return. Over the trailing 12-months, the index generated a gross total return of 22.09%. Based on the quarterly results, commercial real estate could be entering the beginning of a price correction given the significant decline in transaction activity amid aggressive interest rate hikes by the U.S. Federal Reserve and the impact of higher borrowing costs on cap rates. Further, NOI growth turned lower from recent peak levels due to fading pent-up demand from the pandemic coupled with an already lengthy expansionary cycle from historical standards.

EXHIBIT 1: NFI-ODCE Quarterly Returns (Trailing 5 Years)



Source: NCREIF

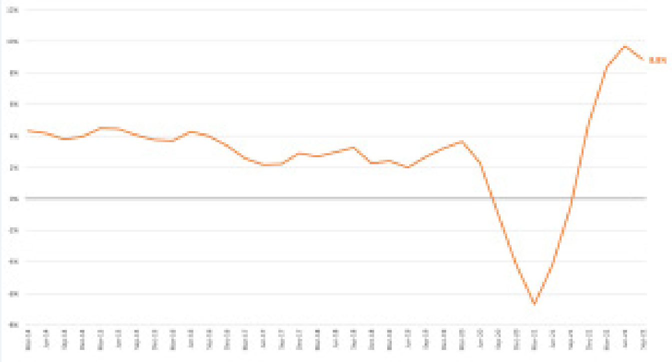
Although just 7.2% of the index, the Other property type – generally the self-storage, healthcare, and parking subtypes – rose 2.42% and outperformed the broad index's restrained total return of less than 1%. Self-storage rose 3.02% and was the strongest subtype during the third quarter. Turning to the major property types, Retail outperformed during the quarter and rose 0.58% based on renewed strength in Neighborhood and Power Center subtypes. Elsewhere, Office fell 0.76% on continued weakness in the CBD subtype. Also underperforming were the Apartment and Industrial sectors, rising 0.40% and 0.12% during the third quarter, respectively. Over the trailing 1-year, Warehouse Industrial remained the best performing subtype, generating a 37.13% total return. While experiencing a significant structural shift to the sectors over the past decade, the index's weightings moved at the edges based on the tepid quarterly performance – still comprised of roughly 31% industrial, 29% apartments, 23% office, 10% retail, 7% other assets.

EXHIBIT 2: NFI-ODCE Cap Rate Spreads (Trailing 10 Years)

Source: NCREIF, Bloomberg, USAA Real Estate Research

Transaction volume has slowed in reaction to a tighter capital markets environment and property sales for the index declined 66% year-over-year. While going-in cap rates remain firm, the decline in Net Asset Values for the quarter was a consequence of exit cap rates steadily rising on a broad basis for most property types. With the 10-year Treasury Yield and more equivalent Baa Corporate Yield increasing to levels not seen since 2008, cap rate spreads have collapsed into negative territory and are 220 to 240 basis points below their respective 10-year averages. Despite a softening of capital values, fundamentals were healthy during the quarter, as occupancy rose slightly to 93.4% – just shy of the record tightness achieved in the first quarter of the year. Same-store NOI growth across the index was also strong at 8.8% versus the year prior.

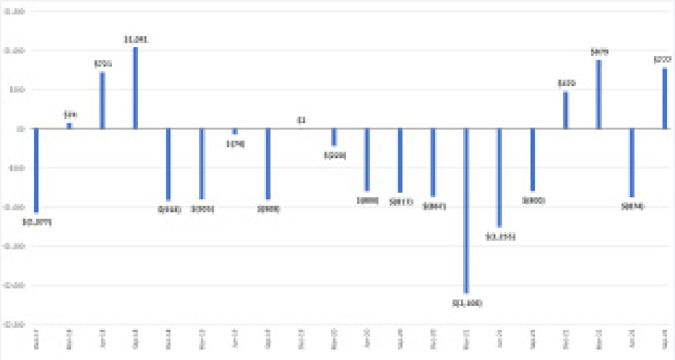
EXHIBIT 3: NFI-ODCE 12-Month NOI Growth



Source: NCREIF, USAA Real Estate Research

Net investor inflows totaled $777 million during the third quarter. On a 4-quarter rolling basis, net investor inflows have totaled $1.251 billion – the highest contribution rate since late 2016. The overall size of gross assets rose to $356.3 billion in 2022 from $220 billion in 2017 – an increase of over 60% in five years – given the relative attractiveness of core U.S. real estate in a low-interest rate environment in addition to portfolio diversification benefits.

EXHIBIT 4: Net Investor Cash Flow (In Millions)



Source: NCREIF

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