

Real Estate Perspectives

January 2025

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HEITMAN

A REAL ESTATE INVESTMENT MANAGEMENT FIRM

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Macro/Structural Introduction

The Macro Backdrop is Becoming More Favorable for Real Estate as Tightening Gives Way to Easing

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HEITMAN BELIEVES THAT:

The global economy has weathered high interest rates relatively well. Many Central Banks are declaring victory against inflation and cutting rates

Higher interest rates sparked a real estate value correction. That correction is complete or close to it

As property values stabilize, momentum is building in real estate capital markets

As painful as the value correction period has been, it has created investment opportunities across the risk spectrum

Alternative sector performance remains a bright spot

Diversification is key in an era of **deglobalization and climate change**

But Investors Are Contending With Big Questions as They Contemplate New Investments

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The future of cities. COVID caused households in the US and Europe, in particular, to flee to lower-density locations where social distancing was possible. The loss of customers prompted a spike in urban retail vacancy rates as businesses closed

The future of the office. While Work From Home (WFH) was occurring prior to COVID, the pandemic accelerated this trend. Technological advances made WFH more productive and acceptable, particularly in the US.

Office investments dominate institutional portfolios in Europe and Asia. Given the recent underperformance of office, what should replace it in portfolio construction?

Climate change, as measured by the frequency of natural disasters, has accelerated over the past decade. How should investors structure their portfolios to manage risks related to climate change?

Policy Impact on CRE

New Economic Policies May Be Positive for Residential and Office; Negative for MOB, Industrial, and Retail

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FUNDAMENTALS: NEAR- TO MEDIUM-TERM

	Residential	Student	MOB	Office	Industrial	Retail	Self-Storage	Senior Housing
Deregulation**	↑	↗	↘	↗	↗	↗	↔	↗
Tariffs*	↗	↘	↔	↔	↓	↓	↘	↘
Immigration*	↓	↘	↓	↘	↓	↓	↘	↘
Tax Policy Change*	↑	↗	↔	↑	↑	↑	↗	↑
Net Effect	↗	↔	↘	↗	↘	↘	↔	↔

***Deregulation*: Reduction in federal government capacity and workforce that leads to more efficient operations and minor deficit reduction. Though specifics are scarce, likely candidates for deregulation are environmental (EPA) and financial (SEC, CFPB, FTC).

Tariffs: Assumes targeted tariffs, leading to a 5% effective tariff rate (+2% from current level), beginning at the start of 2026 and phased in over the course of the year. (25% tariffs on steel, aluminum, and motor vehicle imports from the EU, 25% tariffs on machinery/electronics and chemical imports from China, 10% tariffs on steel, aluminum, and any Chinese-made electric vehicles from China, and 10% tariffs on Canadian steel, aluminum, base metals, and dairy products).

Immigration: Assumes more restrictive policy beginning in mid-2025, slowing the flow of humanitarian migration via lower refugee admissions and reinstatement of the Migrant Protection Protocols. Implementation results in net migration falling to 800k/year (versus previous baseline assumption of 1.1M/year).

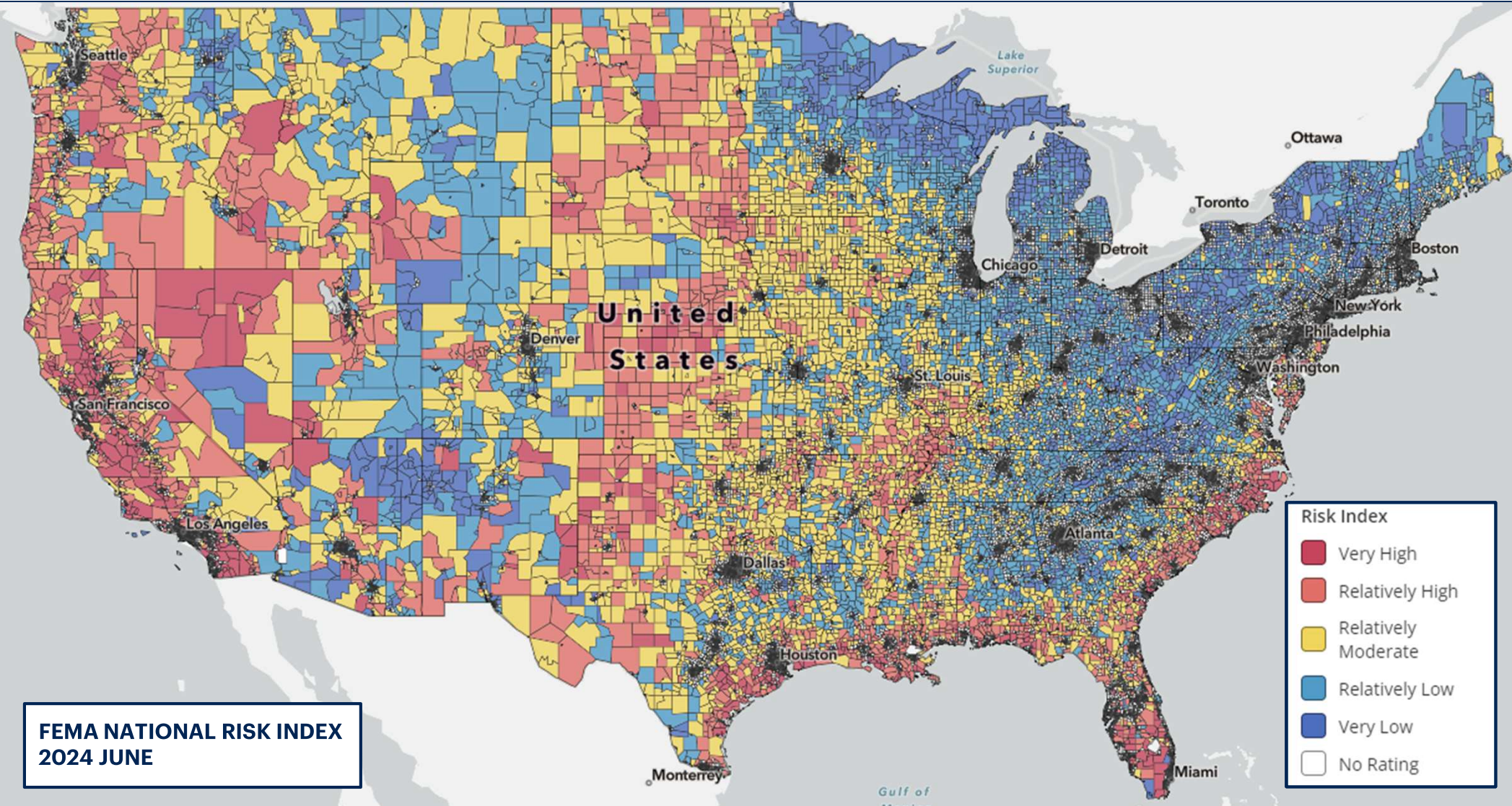
Tax Policy Change: Assumes a preservation of the expiring provisions of the 2017 Tax Cuts and Jobs Act (TCJA). This would include full extension of the personal side of the tax code (including the lower marginal tax rates on individual income, higher Alternative Minimum Tax exemption, larger standard deduction, and an expanded Child Tax Credit) and some of the business tax provisions (including 100% bonus depreciation and the immediate deduction of research and development expenses). Outside of the TCJA, assumes partial reversal of the Inflation Reduction Act, particularly the electric vehicle tax credits.

*These fields (above in white) are based on Oxford Economics' new Baseline, formerly "Limited Trump", scenario assumptions. Grey portion above is based on analysis from Heitman Research:

Climate Risk

Climate Risk: Less of a Problem for the Great Lakes Region

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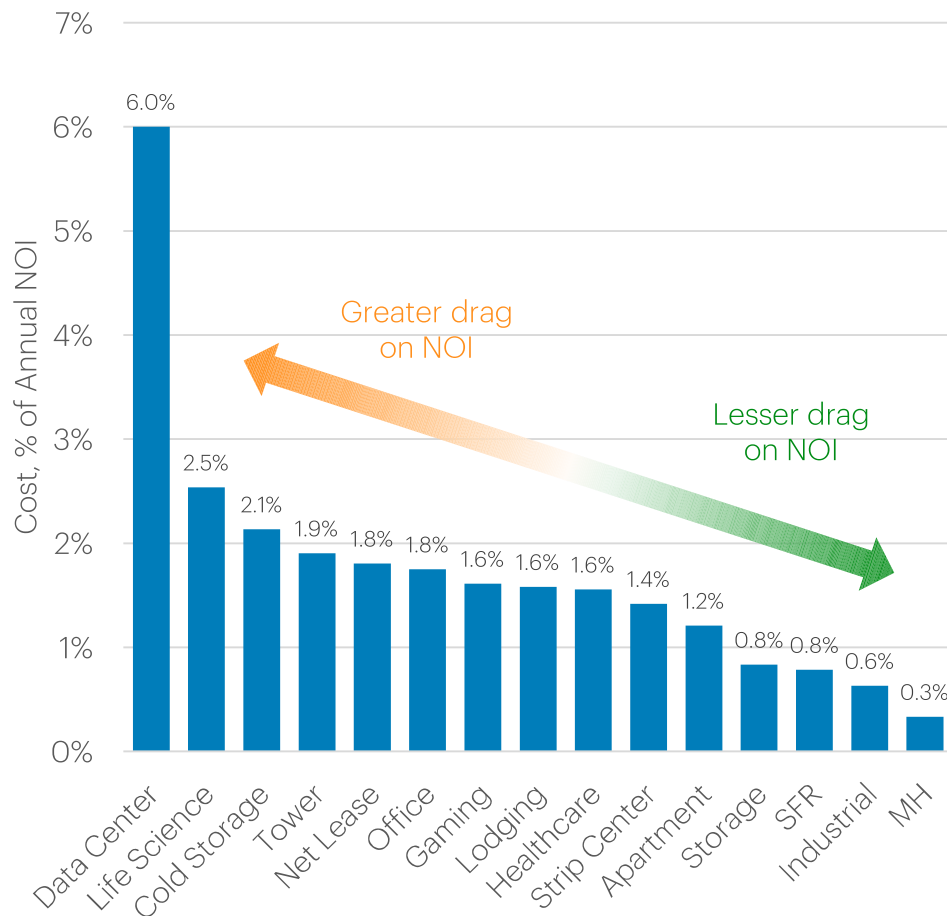


**FEMA NATIONAL RISK INDEX
2024 JUNE**

Data Sources: FEMA National Risk Index (NRI), accessed 2024 June. The NRI is a composite index measuring exposure to 18 natural hazards, incorporating measures of local social vulnerability and community resilience.

Some Sectors are More Climate-Resilient Than Others

COST OF COMPLIANCE WITH NEW EMISSIONS REQUIREMENTS US AS OF 2024 Q2



Data Sources: Green Street, "All Quiet on the Eastern Front," 7 May 2024
"MH" is Manufactured Housing.

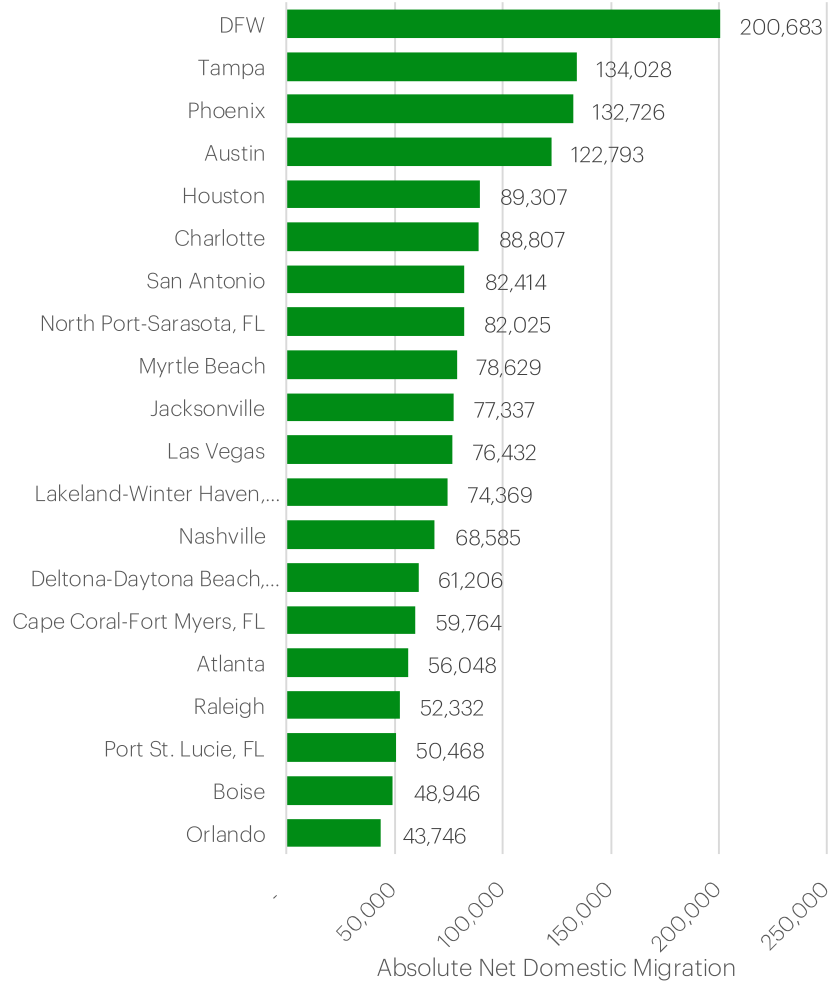
- “Cost of compliance” is one way to measure exposure to climate risk
 - To the left is Green Street’s estimate of each sector’s annual, recurring cost of complying with new & existing regulation—primarily emissions regulation—as a % of NOI.
 - Major inputs include:
 - Emissions intensity of the sector,
 - Likelihood of additional regulatory action, and
 - Likely costs of non-compliance (e.g., fines).
- Does *not* account losses from climate events
 - The analysis does not model exposure to losses from climate disasters.
 - In the US, emissions regulation is generally light; it is therefore likely that this analysis does not capture a comprehensive sum of costs associated with climate change.

Migration Patterns

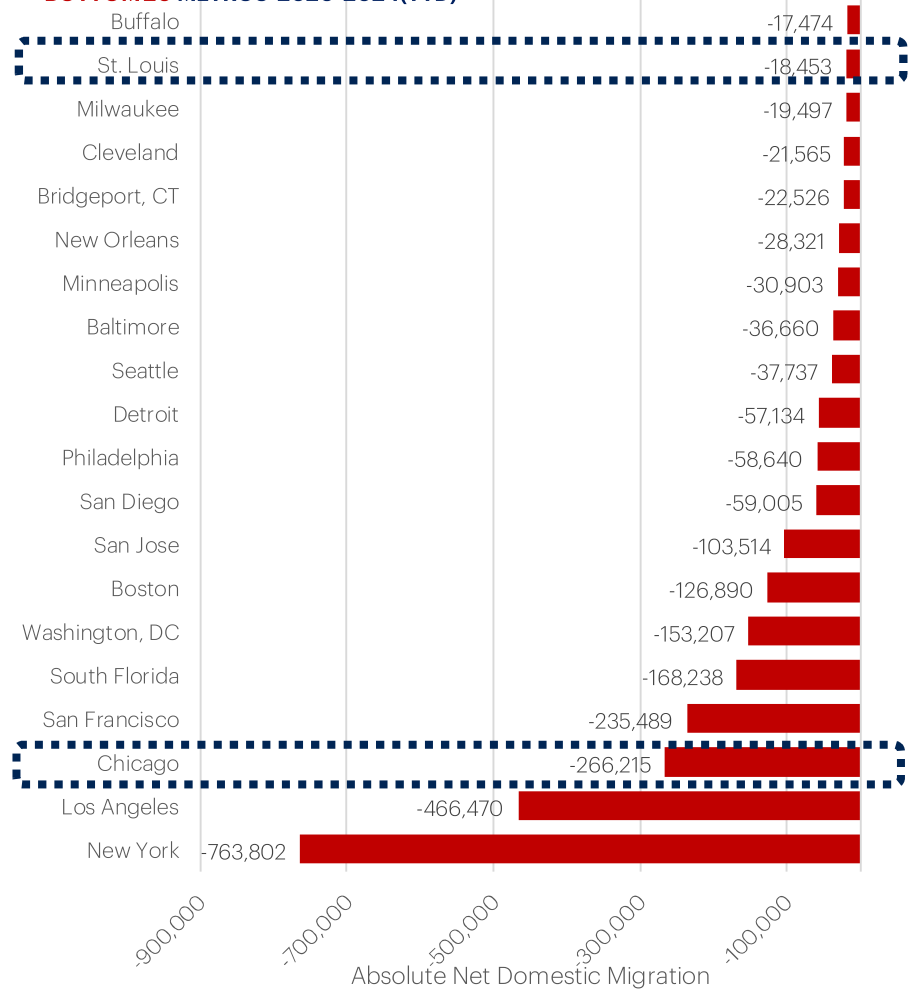
Major Sunbelt Cities Have Seen Major Migration Since 2020...

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TOTAL NET DOMESTIC MIGRATION
TOP 20 METROS 2020-2024(YTD)



TOTAL NET DOMESTIC MIGRATION
BOTTOM 20 METROS 2020-2024(YTD)

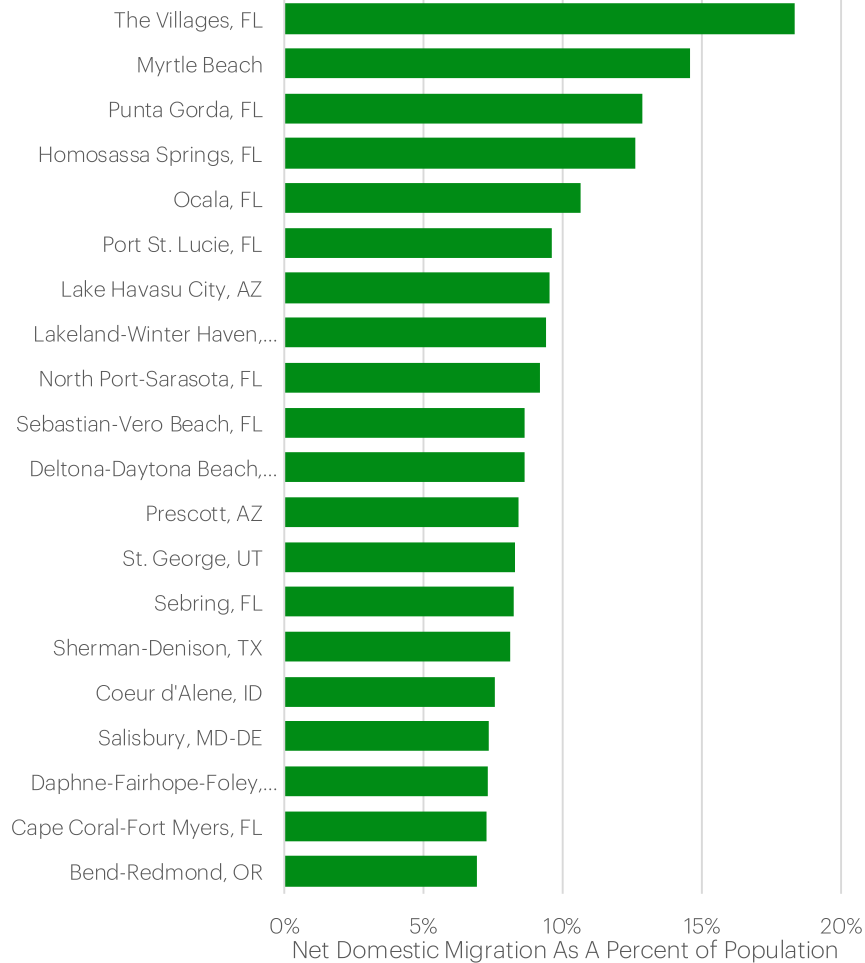


Data Sources: Moody's Analytics, accessed Q4 2024

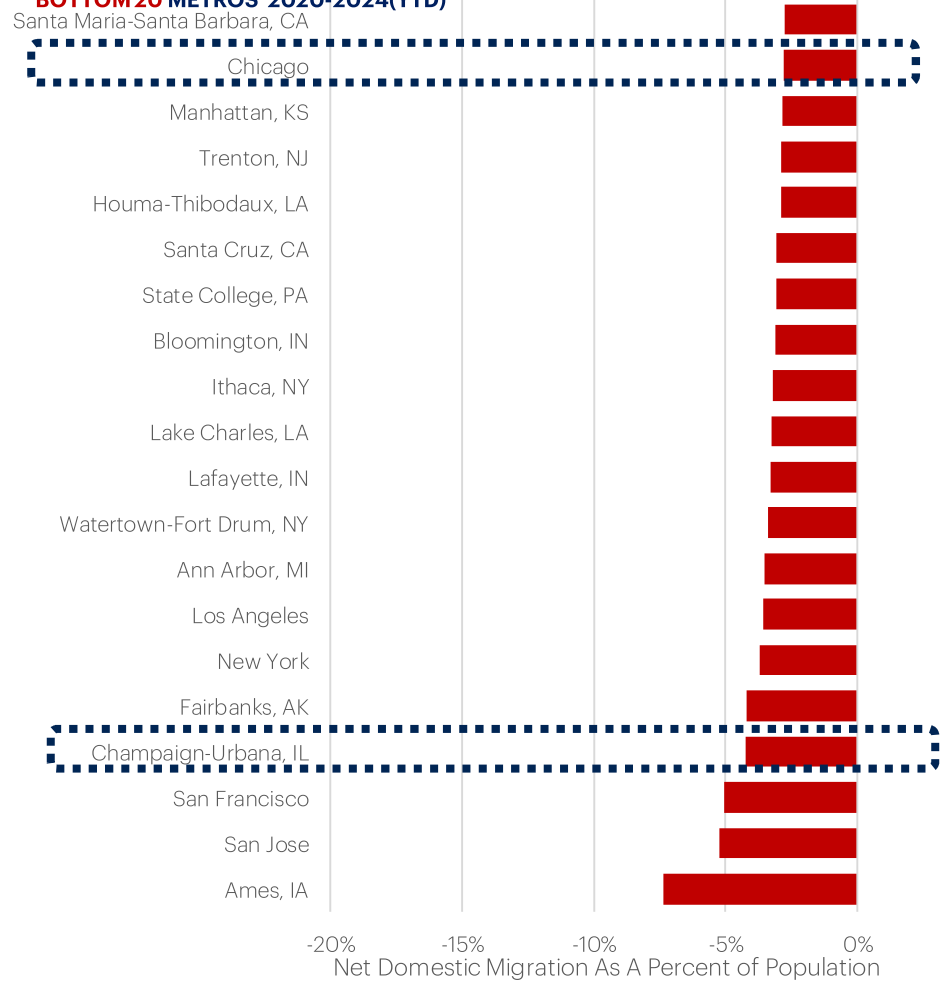
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...But Smaller Markets Also Seeing A Surge

TOTAL NET DOMESTIC MIGRATION AS A PERCENT OF POPULATION
TOP 20 METROS 2020-2024(YTD)



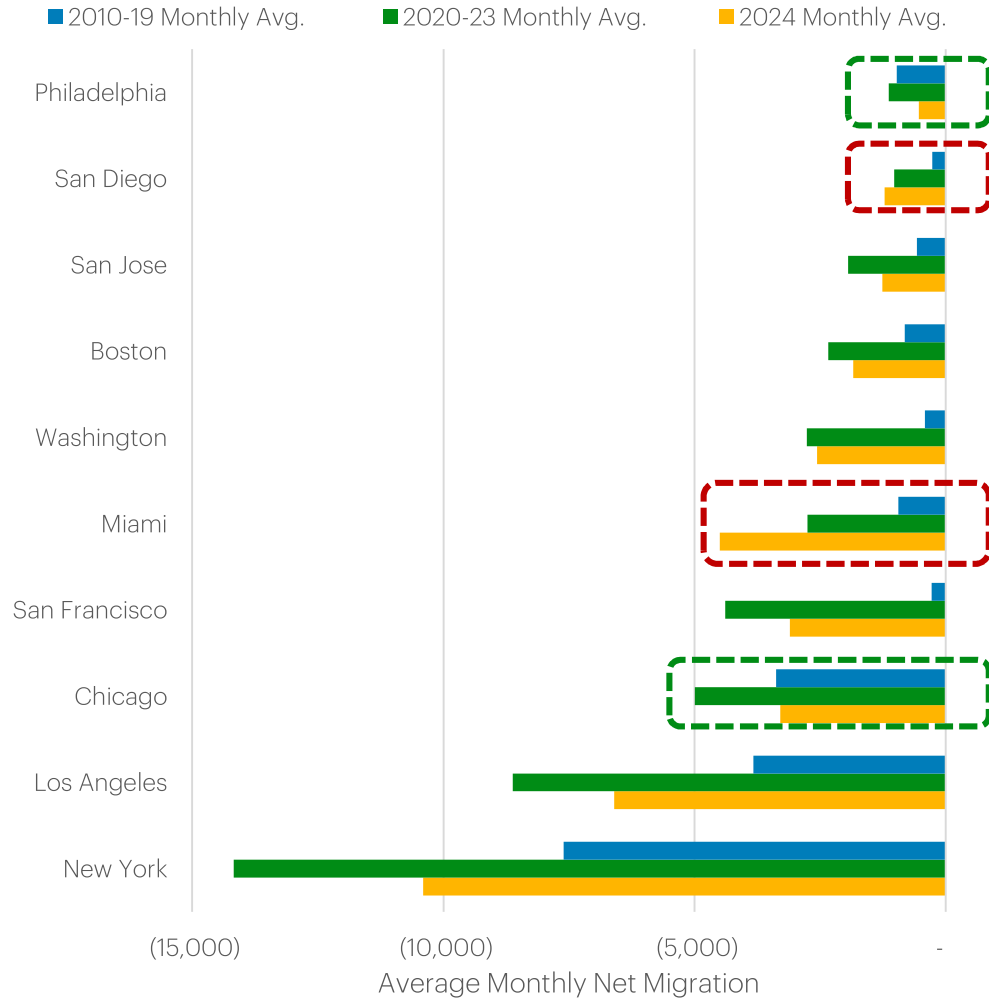
TOTAL NET DOMESTIC MIGRATION AS A PERCENT OF POPULATION
BOTTOM 20 METROS 2020-2024(YTD)



Data Sources: Moody's Analytics, accessed Q4 2024

Migration Trends Are Normalizing This Year

SHIFTS IN AVERAGE MONTHLY NET MIGRATION SELECT MAJOR METROS 2010-2024(YTD)



Philadelphia and Chicago match or beat pre-pandemic trend

Miami, San Diego net out-migration steadily increasing

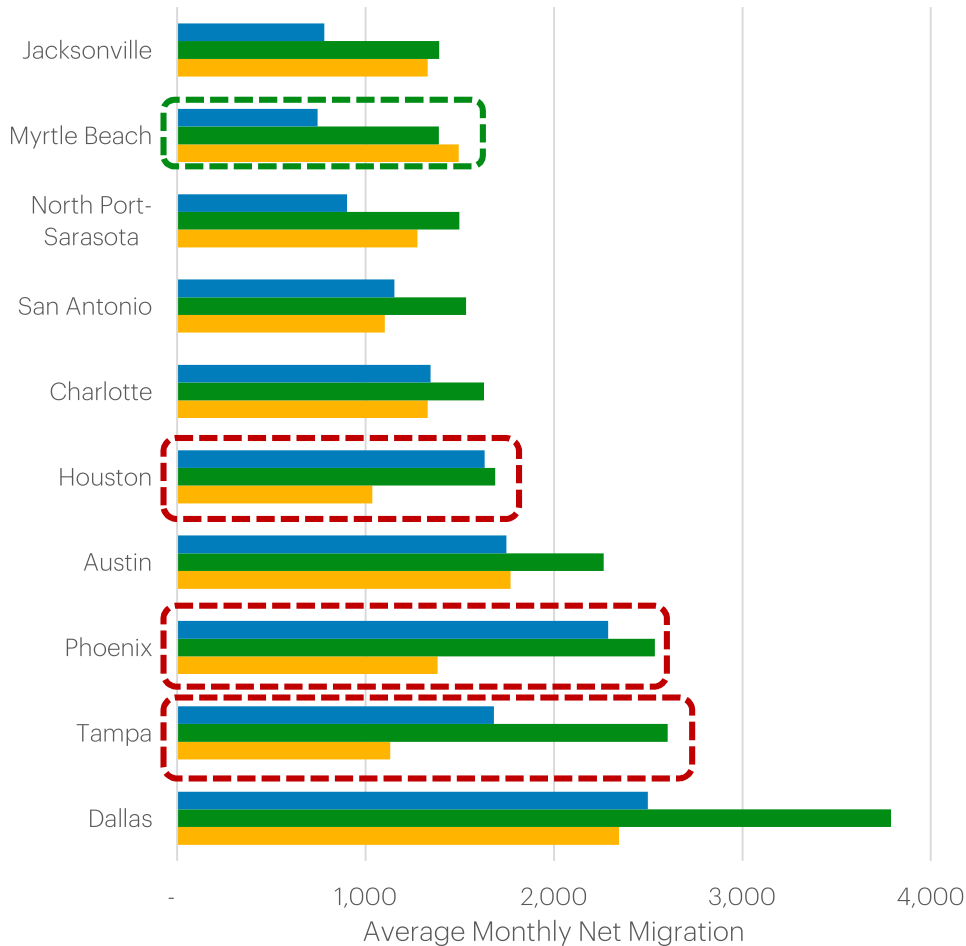
Data Sources: Moody's Analytics, accessed Q4 2024

Migration Trends Are Normalizing This Year

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SHIFTS IN AVERAGE MONTHLY NET MIGRATION SELECT MAJOR METROS 2010-2024(YTD)

■ 2010-19 Monthly Avg. ■ 2020-23 Monthly Avg. ■ 2024 Monthly Avg.



Myrtle Beach is accelerating

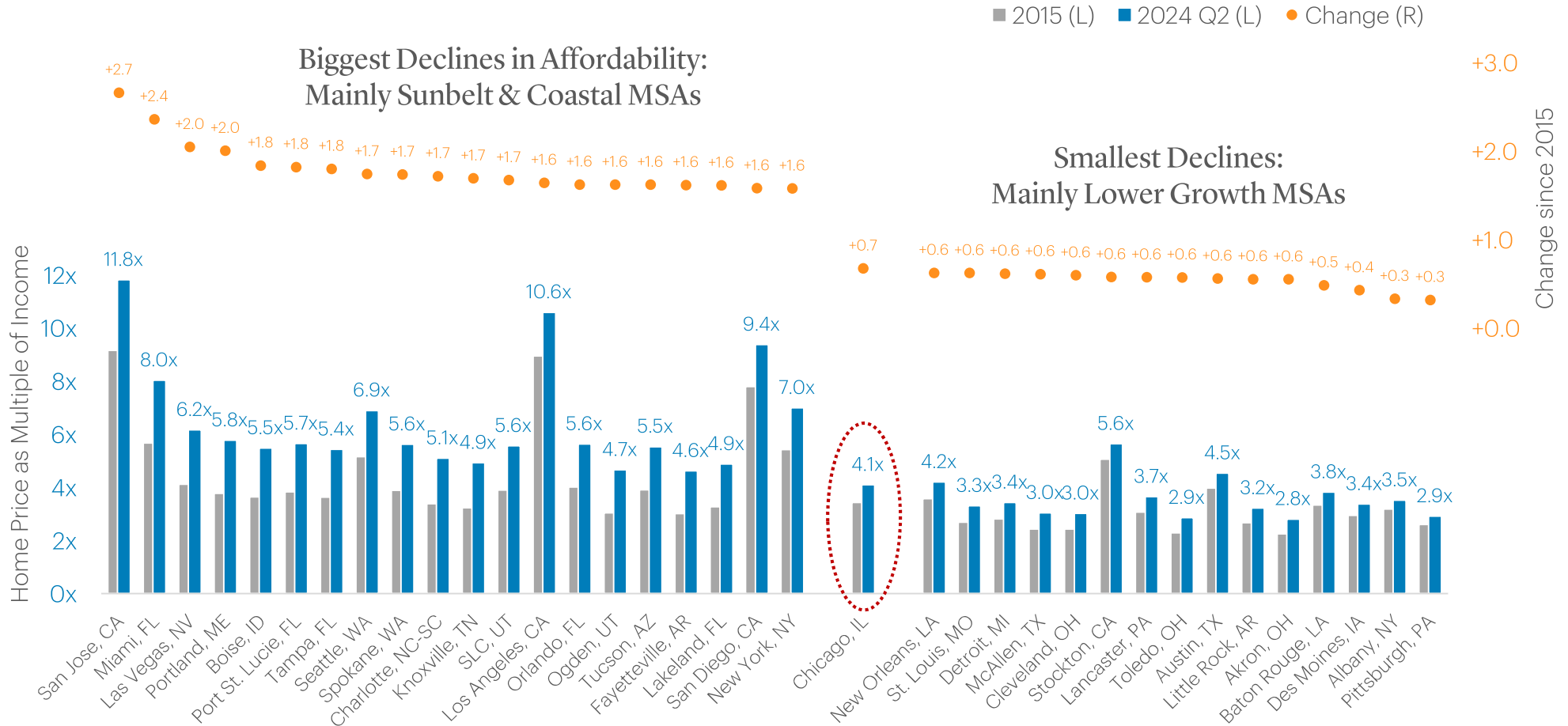
Houston, Phoenix, Tampa lag pre-pandemic trend

Data Sources: Moody's Analytics, accessed Q4 2024

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Affordability Concerns are Likely Eroding Sunbelt's Advantage

**MEDIAN HOME PRICE VS MEDIAN HOUSEHOLD INCOME BY MSA
US 2015 VS 2024 Q2, TOP 20 & BOTTOM 15 BY CHANGE**



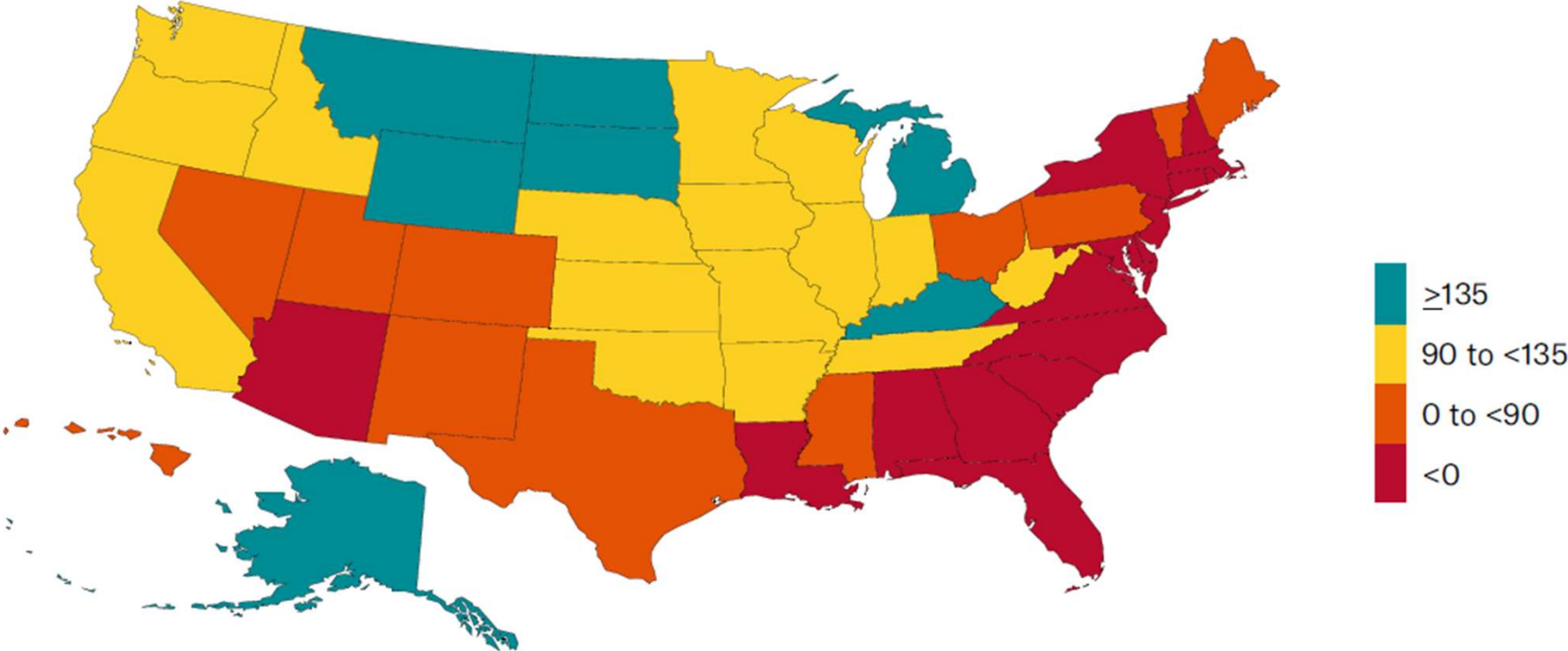
"Home Price" is for existing homes and excludes new construction. Analysis excludes MSAs with populations under 500,000 people.
Data Sources: Moody's Analytics database, accessed 2024 Q4

Illinois And Midwest Could Stand To Gain From Climate Migration Long-Term

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MOODY'S ANALYTICS NET MIGRATION ESTIMATES DUE TO CLIMATE CHANGE
US 2051-2100

Avg annual net domestic migration per 1 million residents, current policies minus reference scenarios, 2051-2100

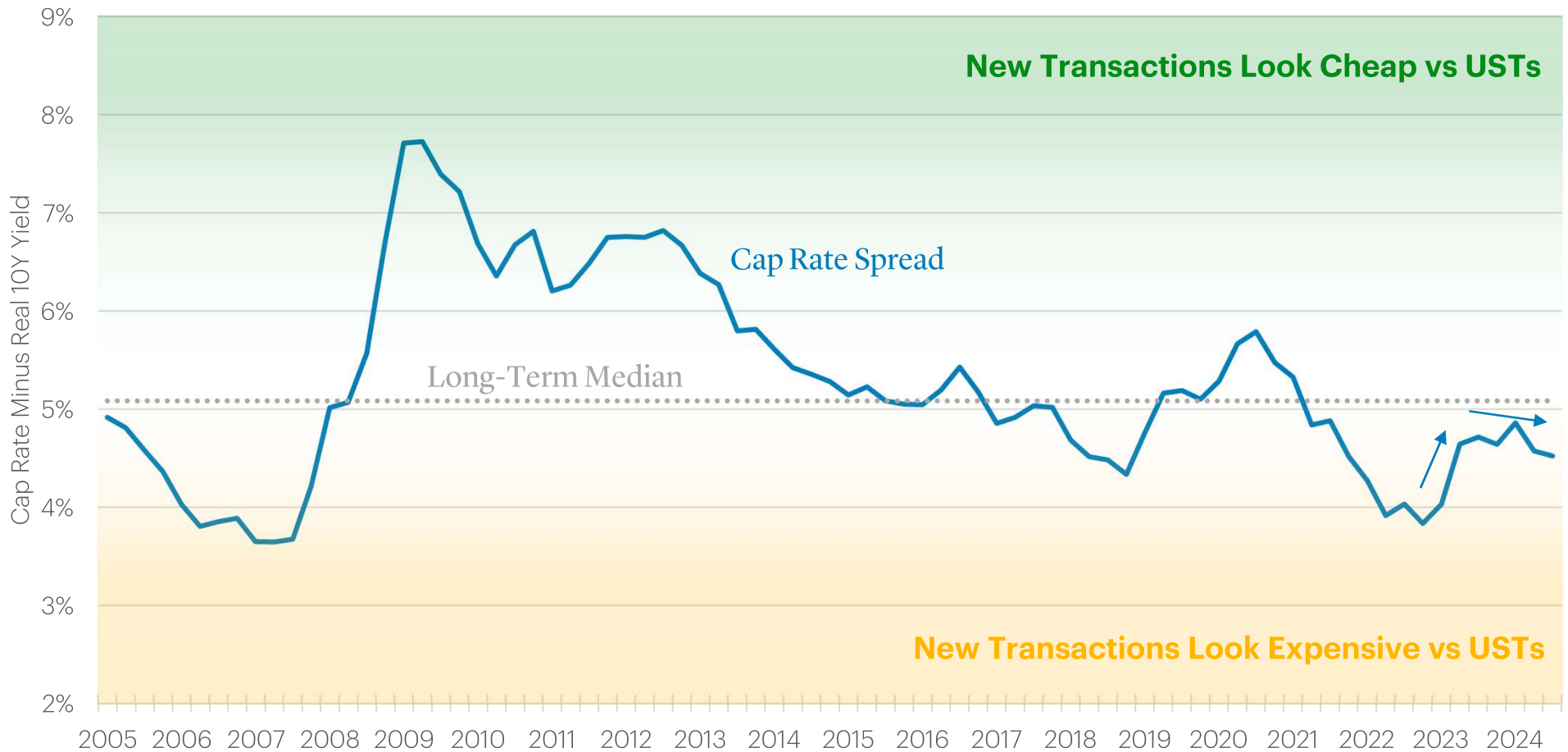


Sources: Census Bureau, NGFS, Moody's Analytics

Real Estate Valuations

Deals in the Market Today Appear More Fairly Priced vs Treasuries Than in 2022

TRANSACTION CAP RATES VS REAL 10Y US TREASURY YIELDS
US, 2005 – 2024 Q2, USD BILLIONS

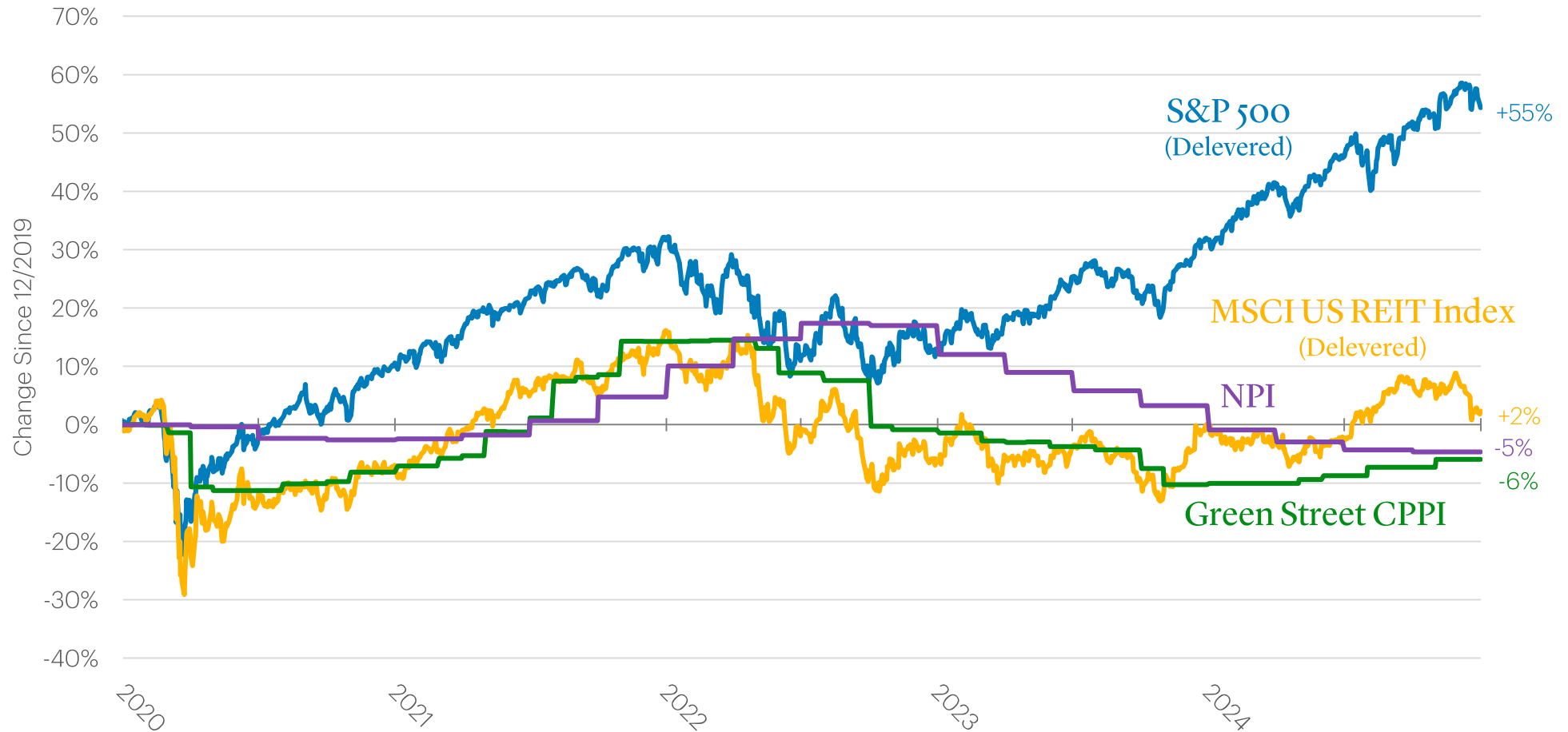


Data Sources: Green Street database and the Federal Reserve Bank of Cleveland, both accessed 2024 Q3
"Cap rates" are a simple average of Apartment, Industrial, Office, Strip Centers, Self-Storage, SFR, and Senior Housing.

Private Real Estate Now Looks Undervalued vs. Public Markets

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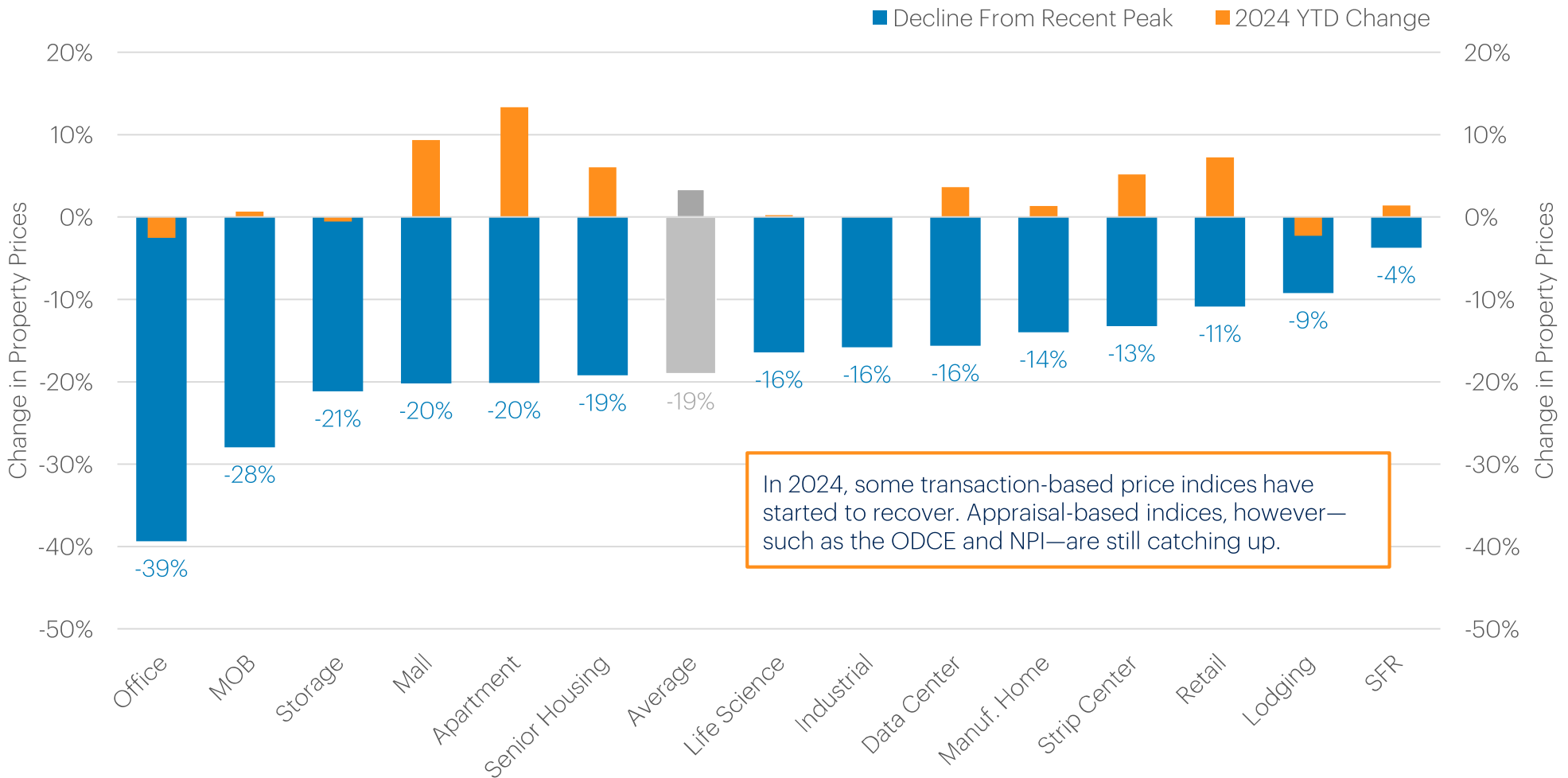
CAPITAL VALUE INDEX CHANGE SINCE END-2019 US 2020 – 2024, DAILY



Data Sources: Green Street, NCREIF, & Bloomberg databases, accessed 2025 Q1. Daily data is through December 31st.
MSCI REIT Index (RMZ) and ODCE indices are delevered. Indices represent capital returns only, and do not include income returns.

Interest Rate Stabilization Has Led to Some Modest Valuation Recovery in 2024

CHANGE TO PROPERTY PRICES YTD & TOTAL DECLINE FROM RECENT PEAK AS OF 2024 NOVEMBER

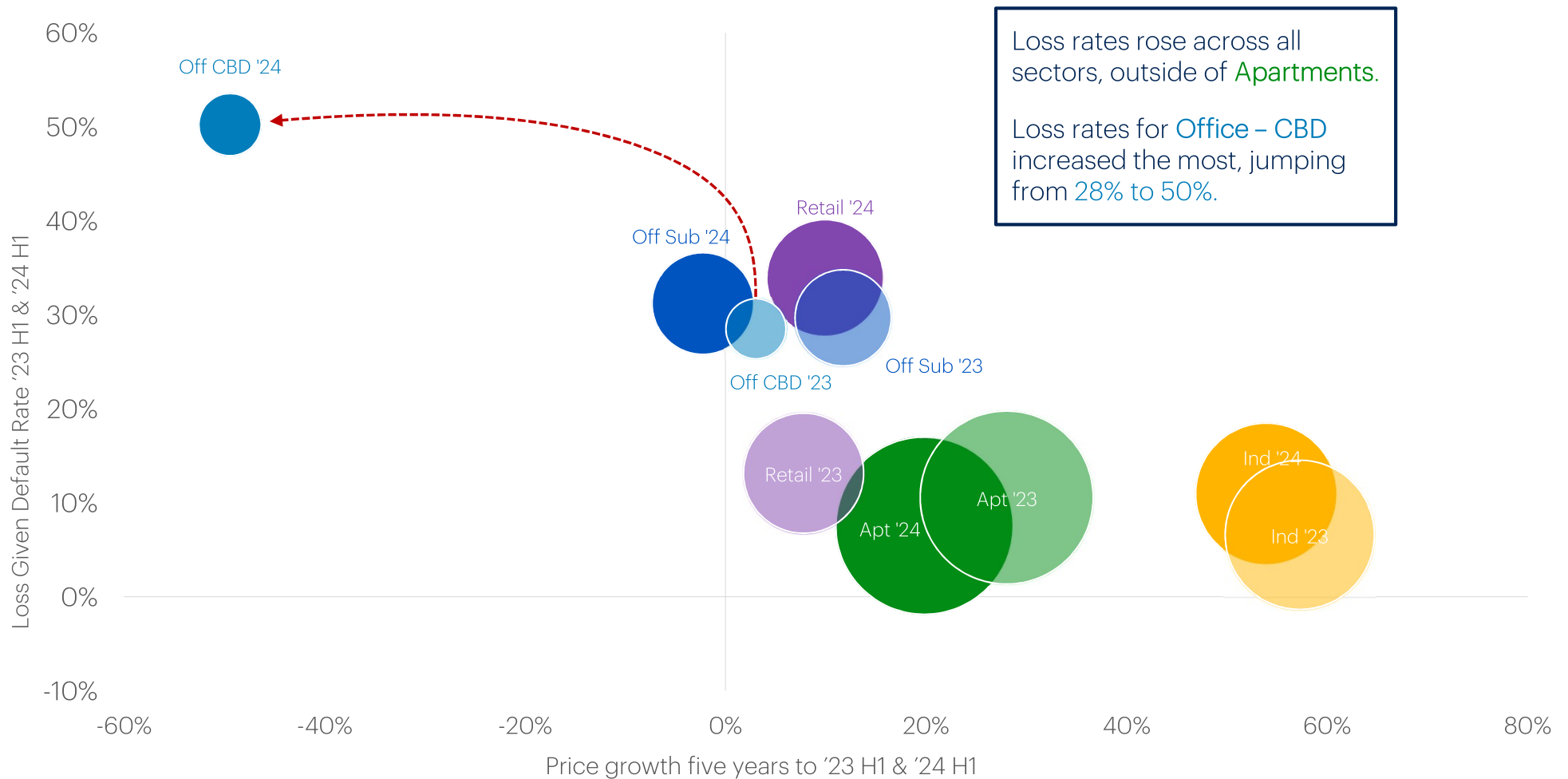


In 2024, some transaction-based price indices have started to recover. Appraisal-based indices, however—such as the ODCE and NPI—are still catching up.

Underlying Data Sources: Green Street Commercial Property Price Index (CPPI), accessed 2024 Q4

Distress Still Primarily Limited to Office Sector

**LOSS GIVEN DEFAULT RATE BY SECTOR
US 2019 – 2024 H1, USD BILLIONS**



*Bubble size = H1 Transaction Volume
Data Source: MSCI Real Capital Analytics, "Capital Trends US Big Picture August 2024" & "Capital Trends US Big Picture August 2023"

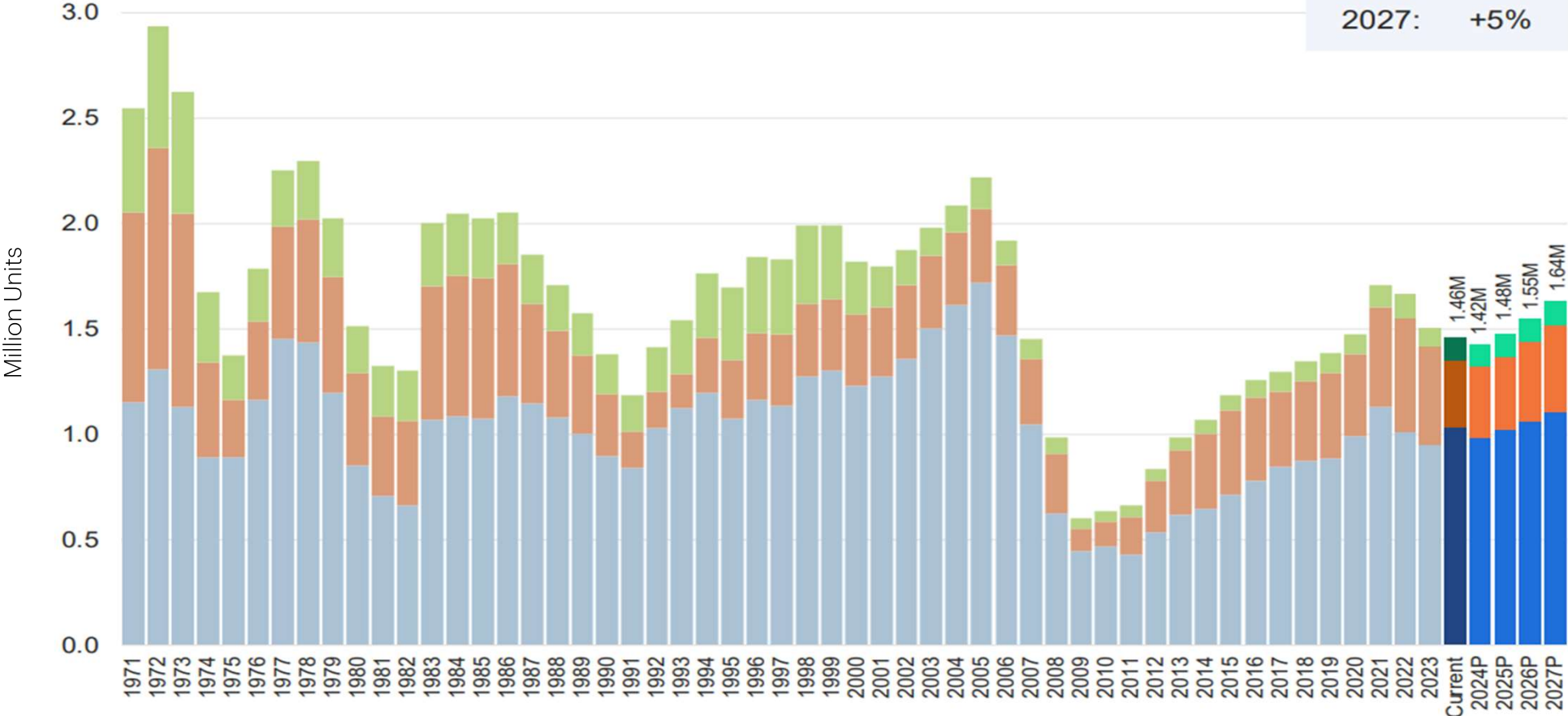
US Housing Markets

Housing Supply is Still Pretty Low Relative to the Long-Term

National Housing Starts

Millions ■ Single-family starts ■ Multifamily starts ■ Manufactured housing starts

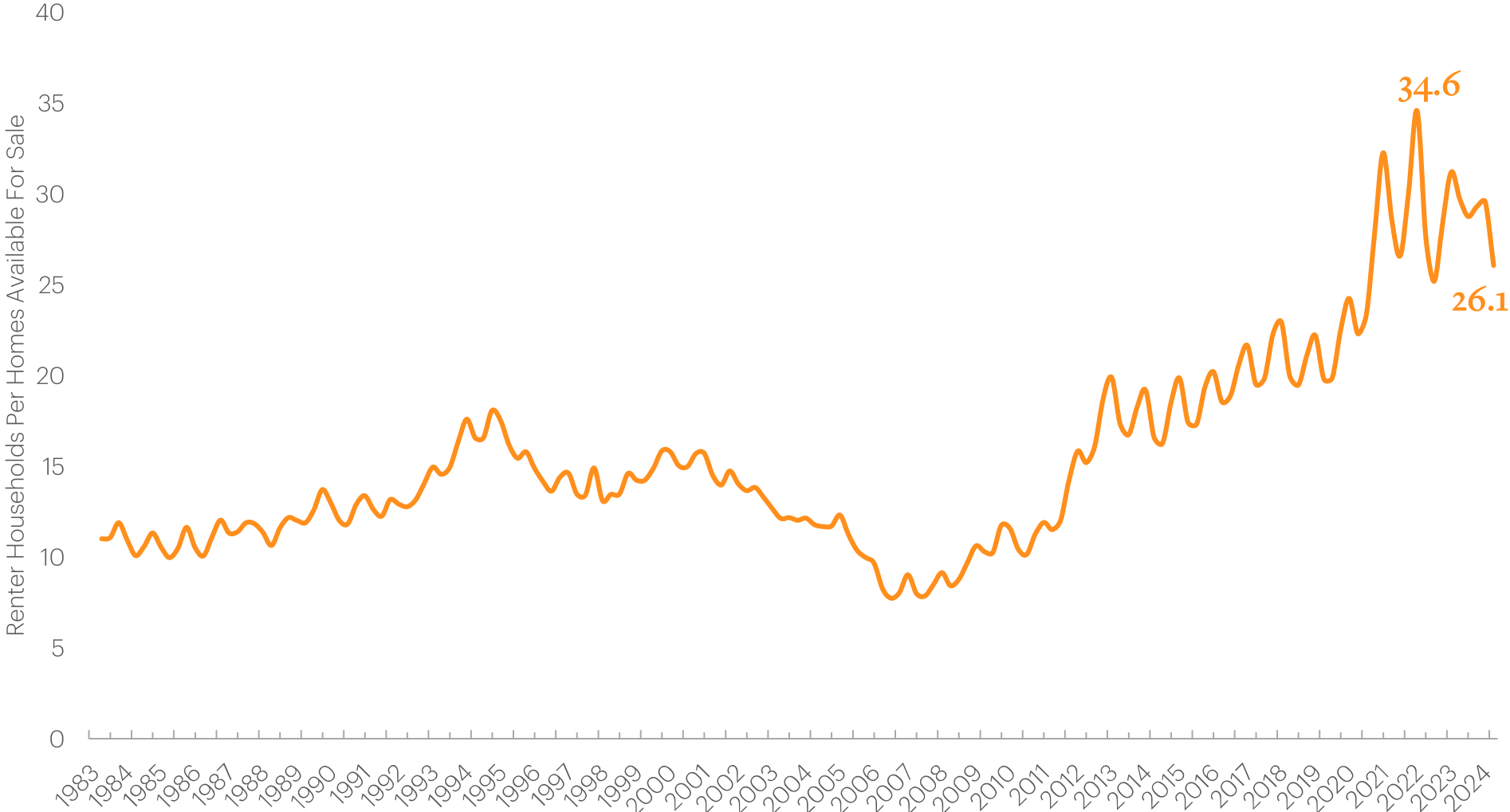
2024:	-6%
2025:	+4%
2026:	+5%
2027:	+5%



Data Sources: US Census Bureau and JBREC, "Rental Communities Analysis and Forecast" 2024 Q4

Lack of Inventory Keeps Households Renting

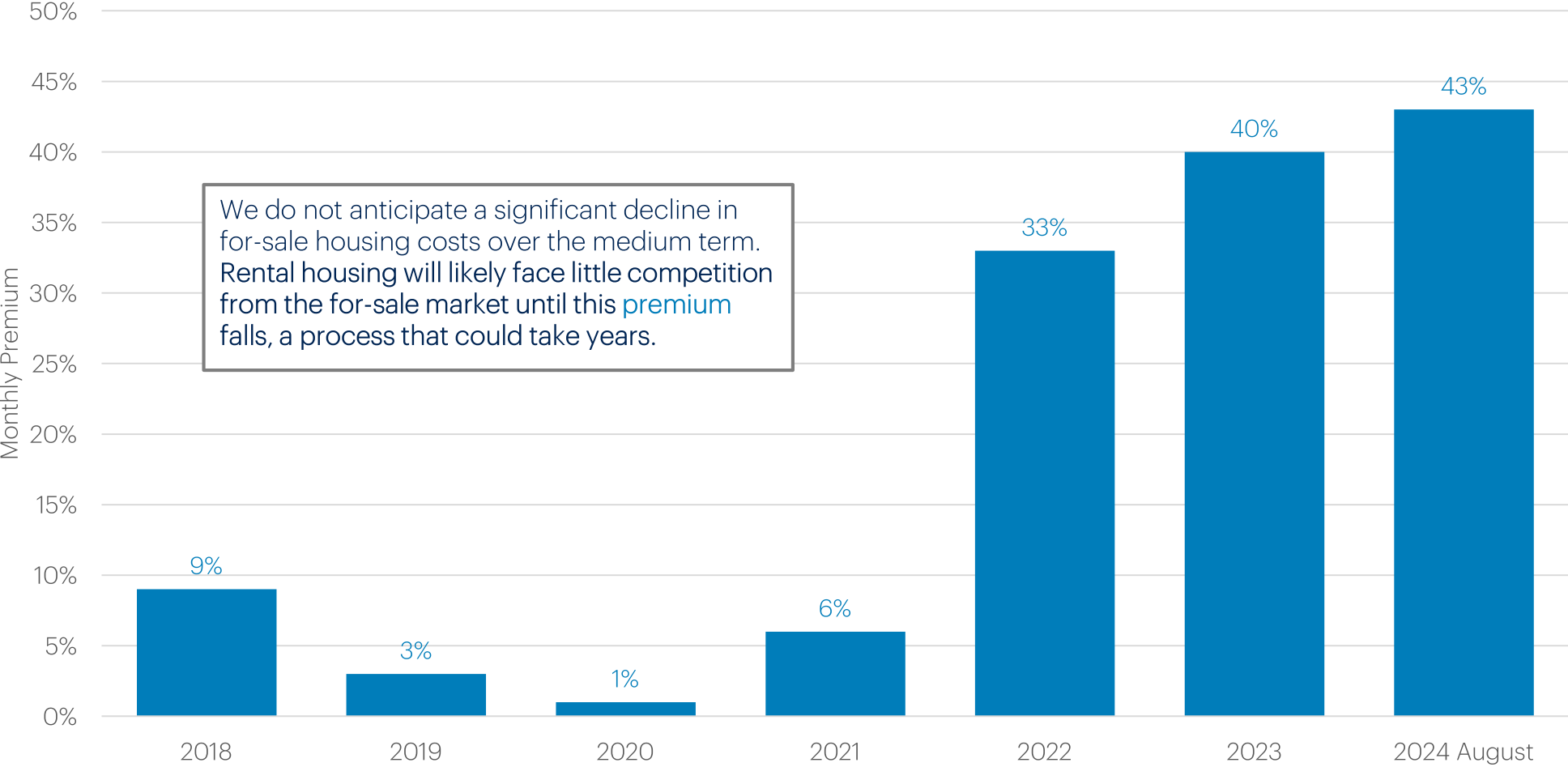
**NUMBER OF RENTER HOUSEHOLDS PER HOMES AVAILABLE FOR SALE
US 1983 - 2024 (Q2)**



Data Sources: John Burns database accessed 2024 Q4; US Census Bureau database, retrieved from Federal Reserve Bank of St. Louis 2024 Q4

High All-In Costs Preclude Home Purchases

MONTHLY COST PREMIUM OF OWNING VS RENTING AN ENTRY-LEVEL HOME US 2018 - 2024 AUGUST



Data Sources: US Census Bureau and JBREC, "Rental Communities Analysis and Forecast" 2024 Q4

Difficult For-Sale Environment Keeping Households In The Renter Pool

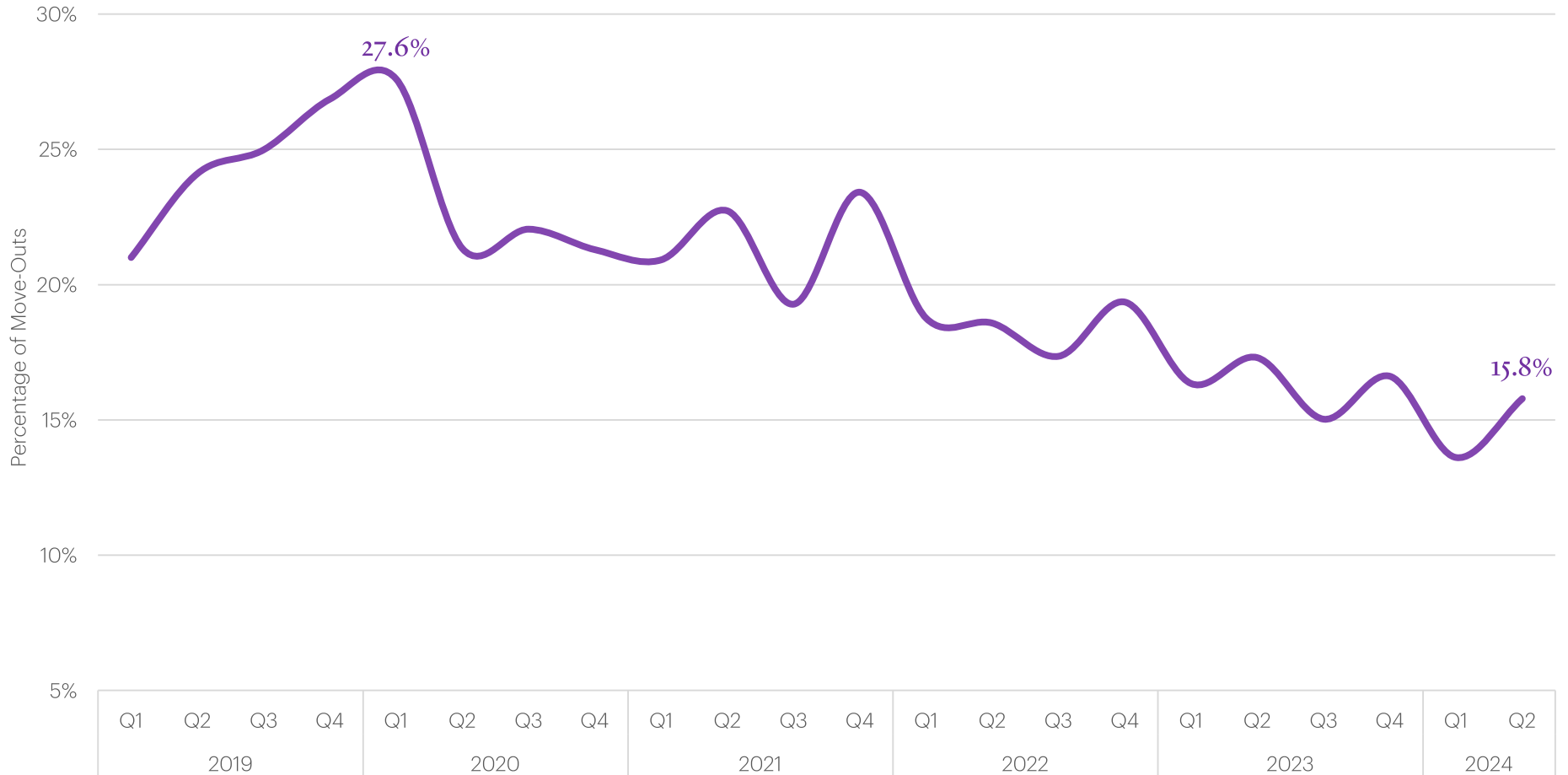
**SURVEY: HOW IS THE CURRENT PERCENTAGE OF TENANTS MOVING OUT TO BUY A HOME?
US JUNE 2017-MAY 2024**



Data Sources: EvercoreISI; accessed Q3 2024

Difficult For-Sale Environment Keeping Households In The Renter Pool, for Heitman Too

**RESIDENT MOVE-OUTS FOR HOME PURCHASES AS PERCENTAGE OF ALL REASONS GIVEN
HEITMAN SAME-STORE EQUITY APARTMENT PORTFOLIO 2019-2024**



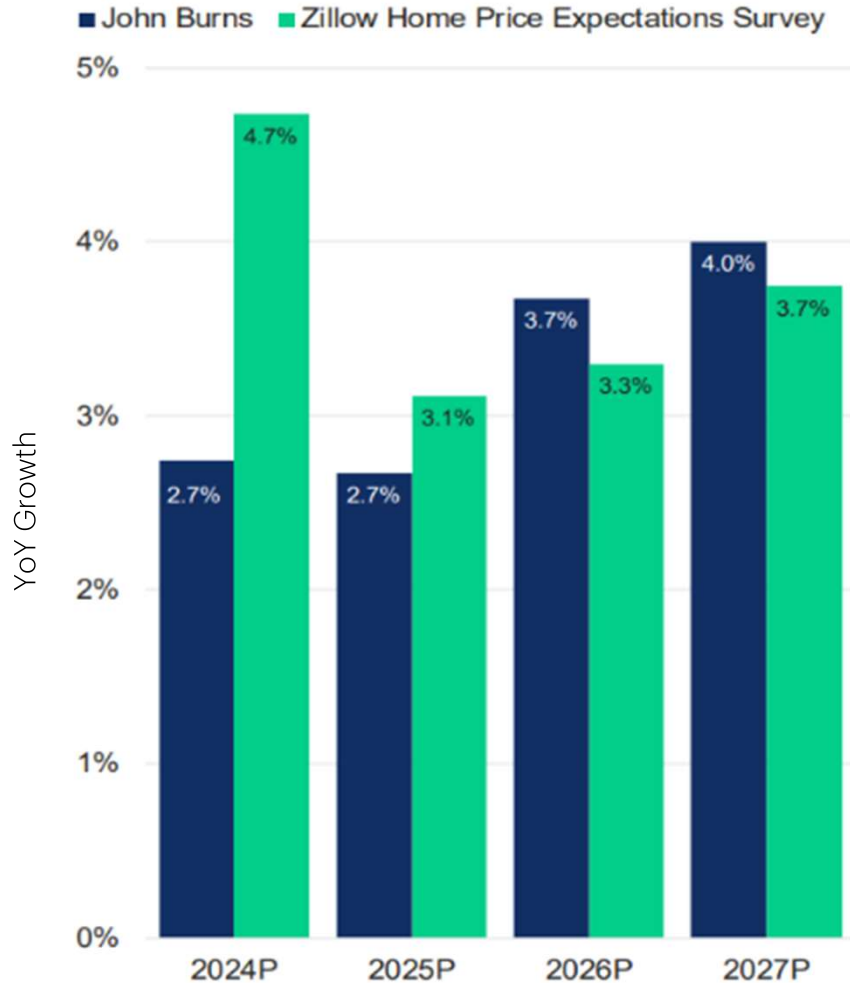
Data Sources: Heitman, LLC

Note: Same-store portfolio as of May 2024 consists of roughly 7,900 units across 23 properties.

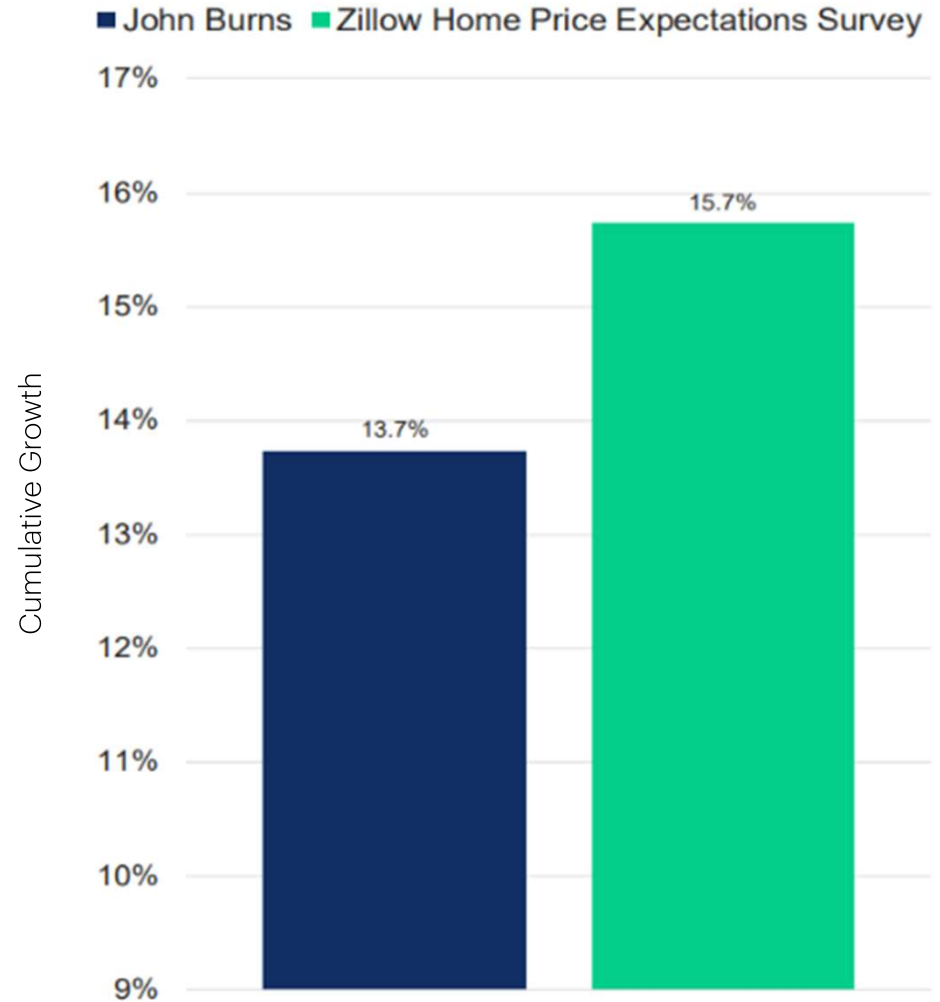
No Relief From High Home Prices Coming Soon

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**PROJECTED HOME PRICE APPRECIATION (ANNUAL)
US 2024 - 2027**



**PROJECTED HOME PRICE APPRECIATION (CUMULATIVE)
US 2024 - 2027**



Data Sources: JBREC, "Rental Communities Analysis and Forecast" 2024 August

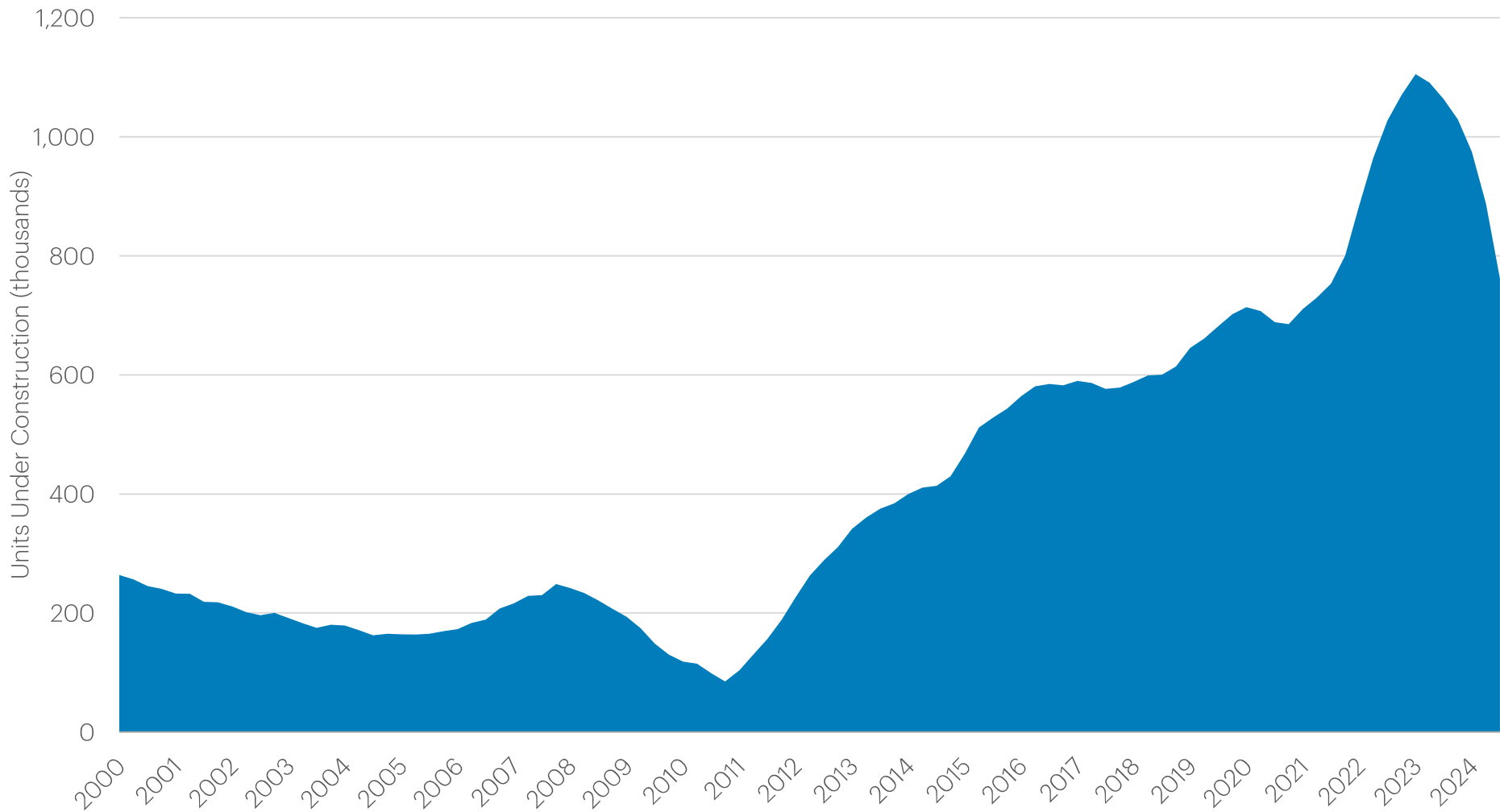
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Apartments

<800k Apartment Units Under Construction For First Time Since 2021

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**APARTMENT UNITS UNDER CONSTRUCTION
US 2000 - 2024 (Q3)**

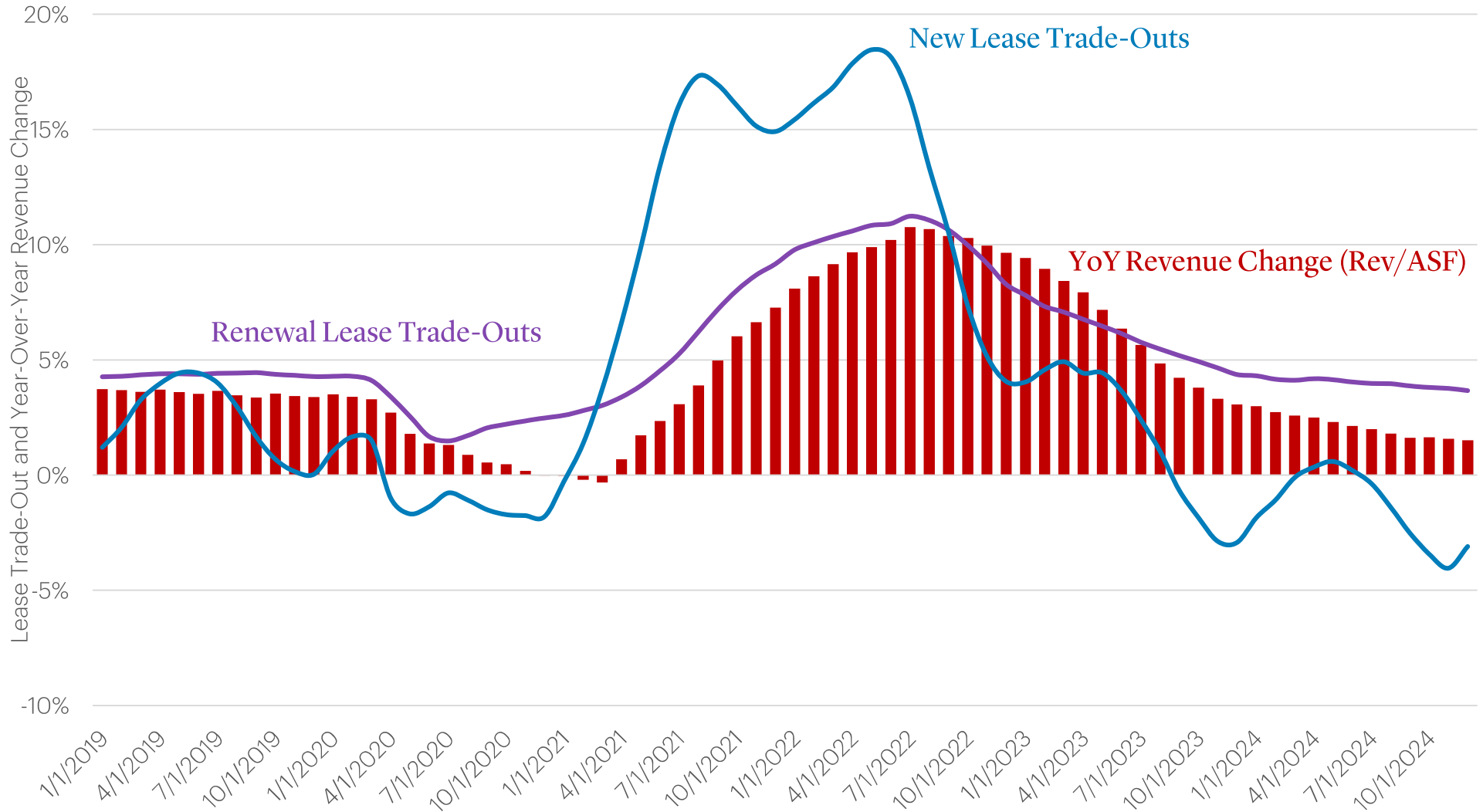


Data Sources: RealPage database, accessed 2024 Q4

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Steady Renewal Trade-Outs Drive Revenue Growth

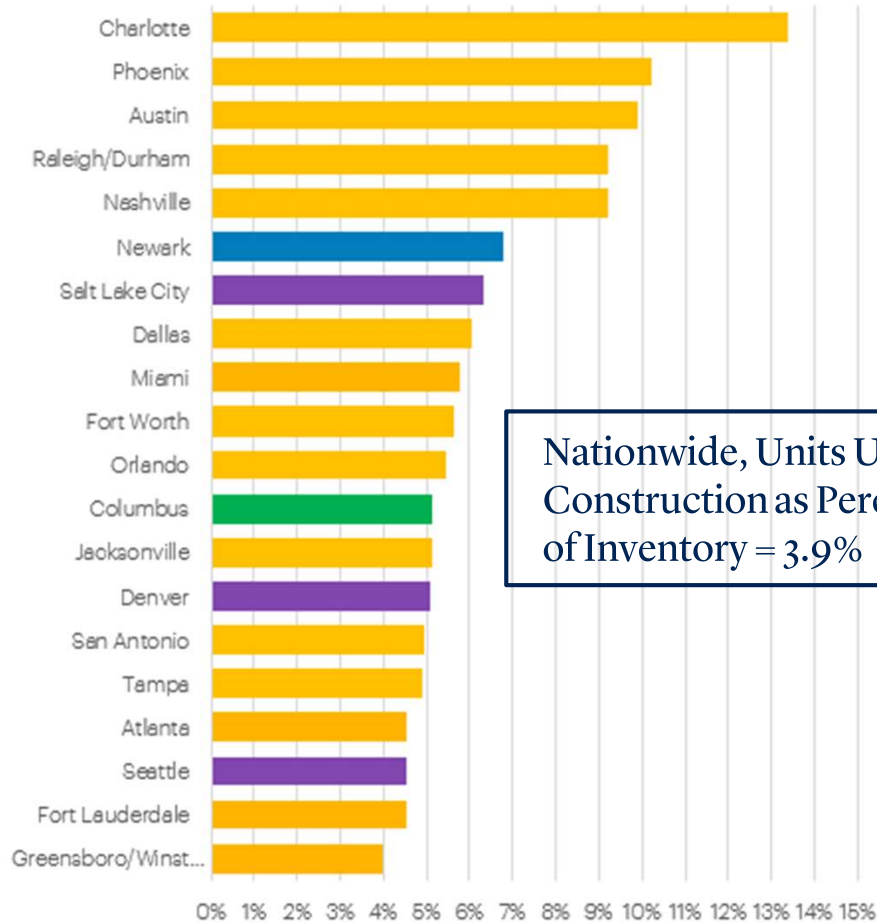
**APARTMENT LEASE TRADE-OUTS AND REVENUE CHANGE
US 2010-2024**



Data Sources: RealPage Data Direct, accessed 2025 Q1

Elevated Supply Will Test Mettle Of Hot Markets

APARTMENT UNITS UNDER CONSTRUCTION AS PERCENT OF INVENTORY, TOP 20 MARKETS - 3Q24



APARTMENT UNITS UNDER CONSTRUCTION AS PERCENT OF INVENTORY, BOTTOM 20 MARKETS - 3Q24

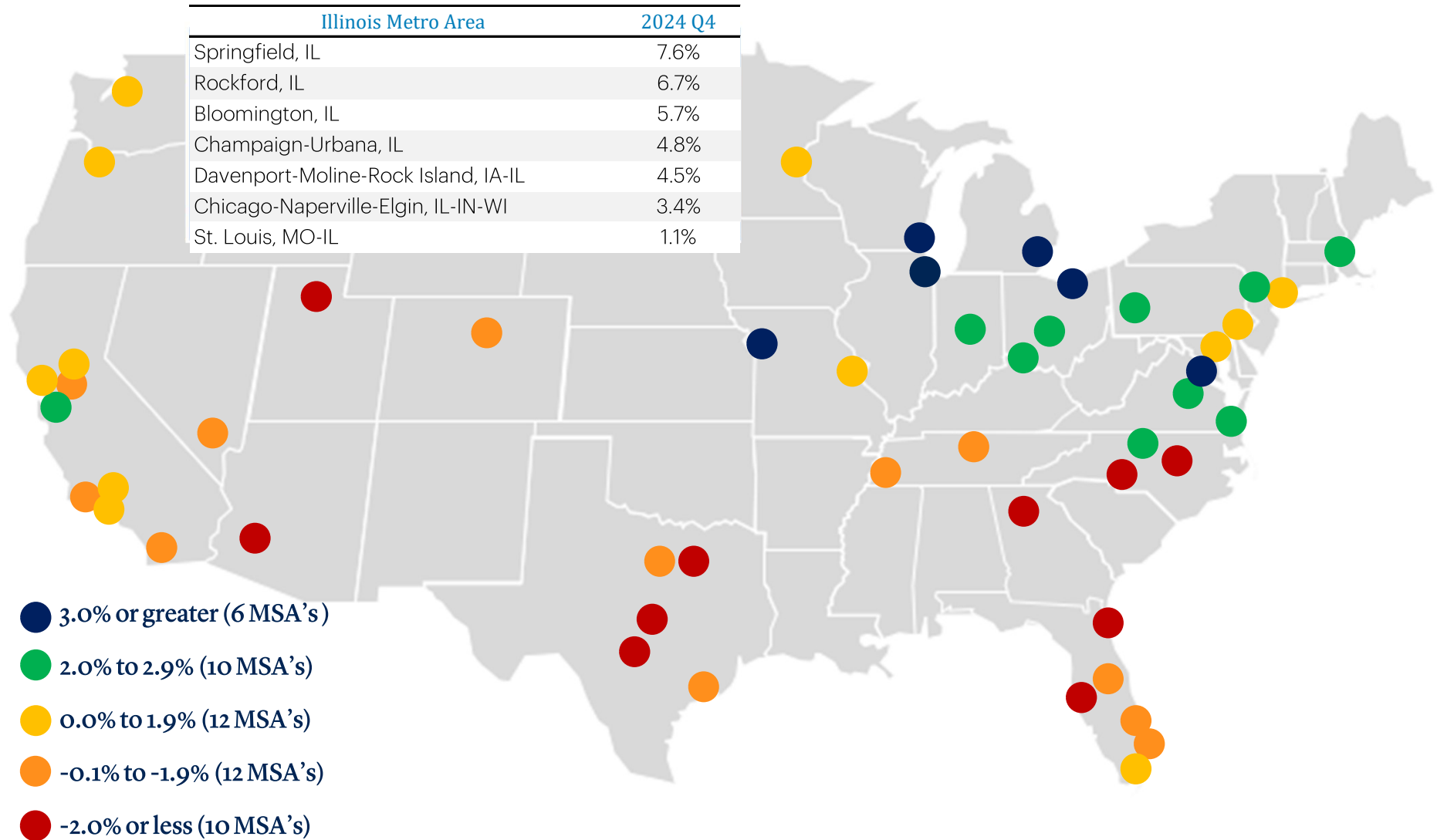


Nationwide, Units Under Construction as Percent of Inventory = 3.9%

Data Sources: RealPage database, accessed 2024 Q4

Sunbelt Sees Rent Cuts While Midwest and Northeast Post Modest Growth

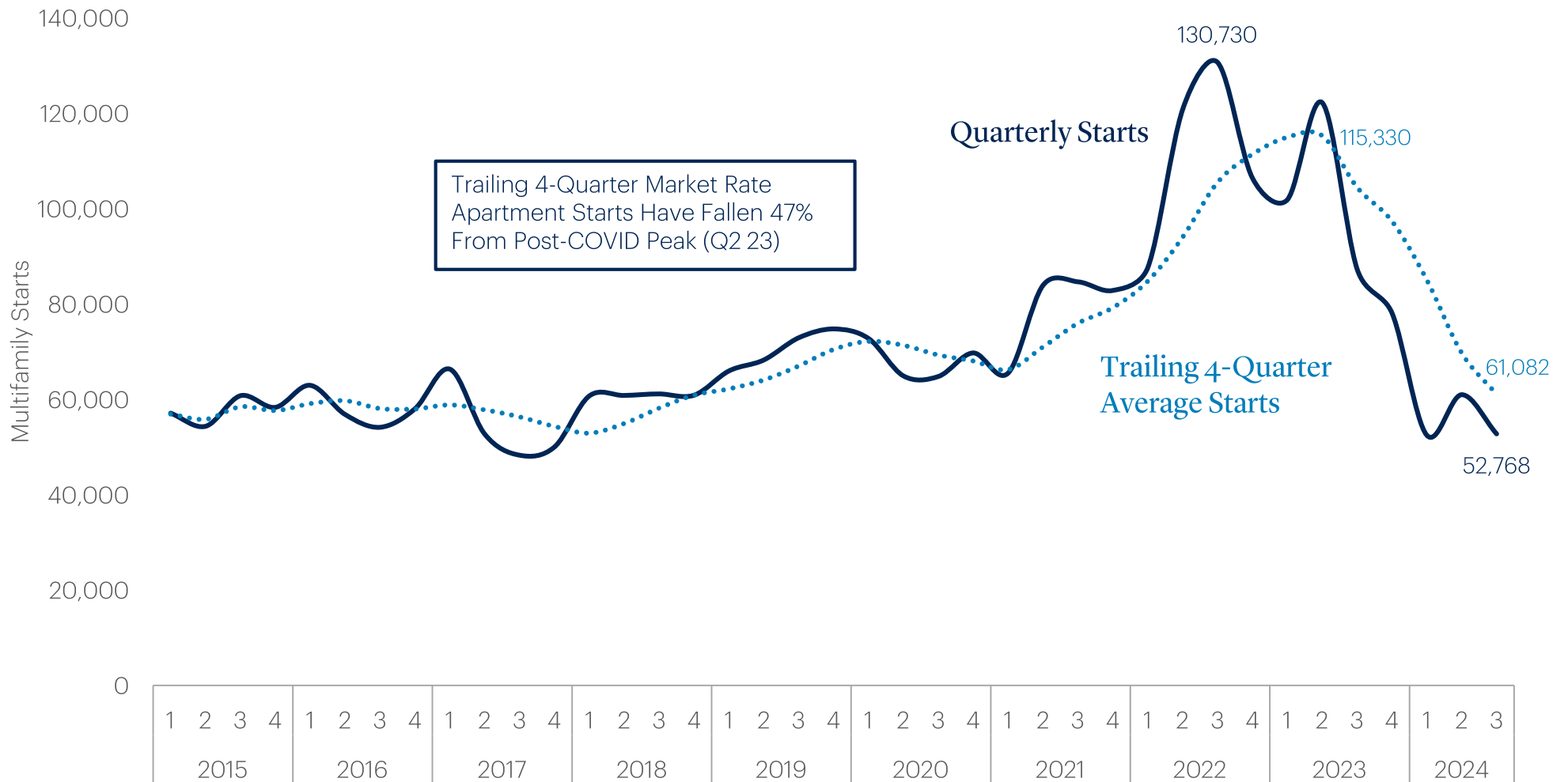
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Data Sources: RealPage Database, accessed 2024 Q4

Starts Off Record Highs, Nearing Pre-COVID Trend

CONVENTIONAL APARTMENT STARTS US 2015 – 2024 (Q3)



Data Sources: Yardi Matrix, accessed Q4 2024

New Living Sectors

New Living Sectors Serve New Housing Demand, and Can Even Help Ease the Affordability Crisis

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SELF-STORAGE



COLD STORAGE



STUDENT HOUSING



MANUFACTURED HOUSING



LIFE SCIENCES



MEDICAL OFFICE



SINGLE FAMILY RENTALS



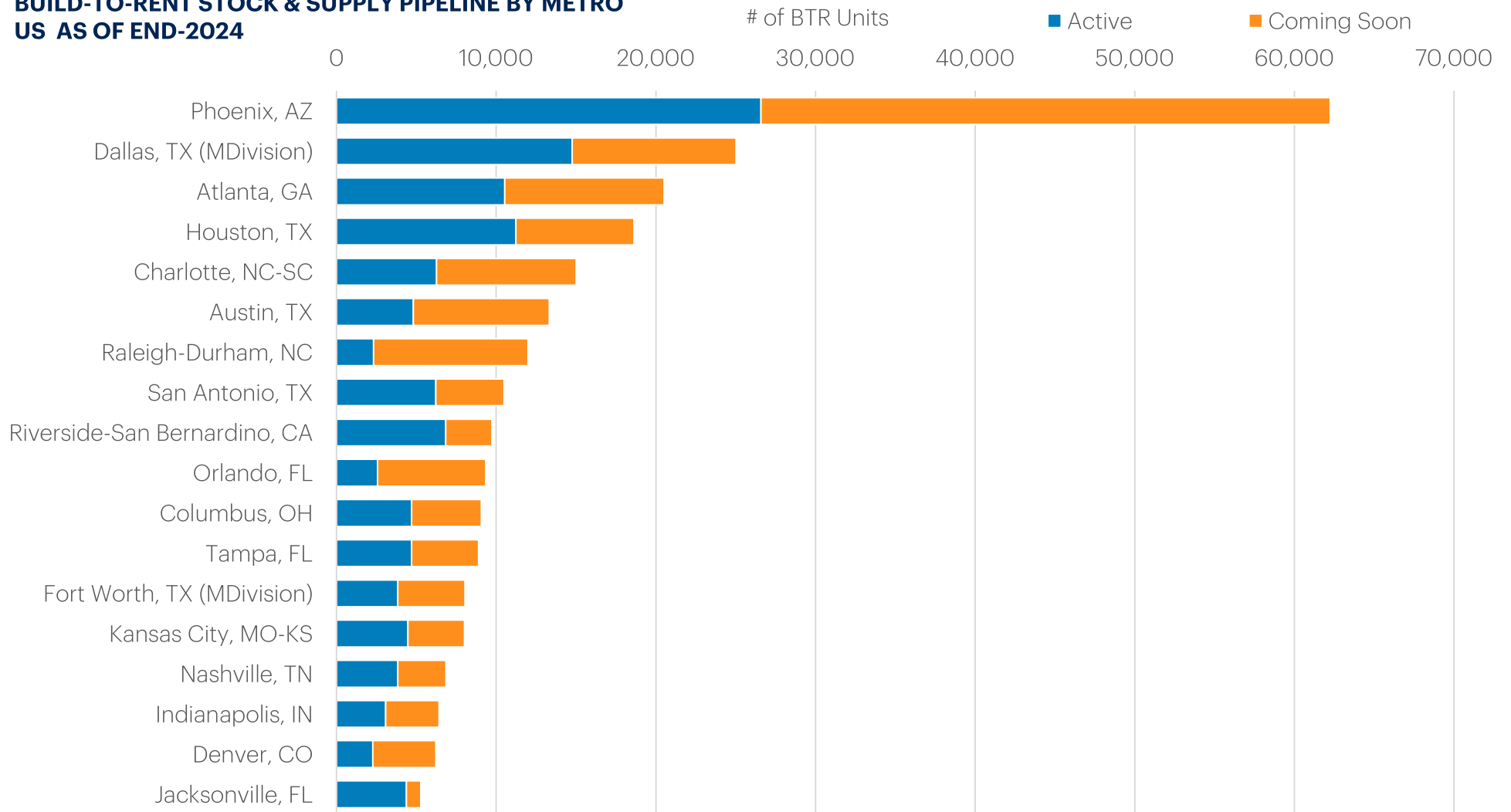
SENIOR HOUSING

Images for illustrative purposes only.

BTR Stock is Expanding Rapidly in the Sunbelt

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BUILD-TO-RENT STOCK & SUPPLY PIPELINE BY METRO US AS OF END-2024



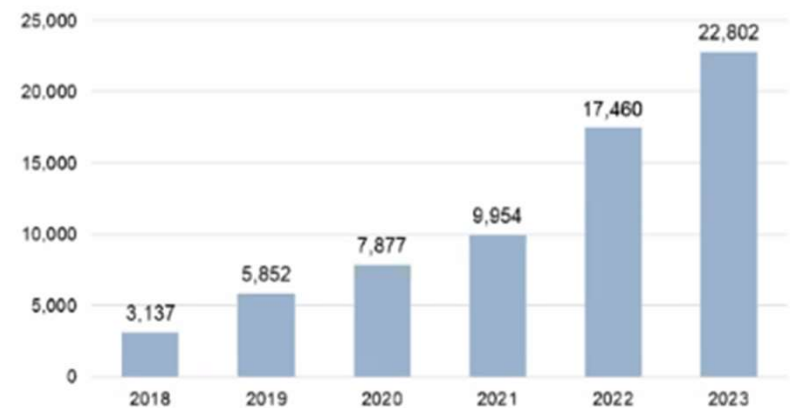
Data Sources: US Census Bureau and JBREC, "Rental Communities Analysis and Forecast" 2024 Q4

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ADUs: Can Help (Albeit Marginally) With Housing Supply & Affordability

- Can allow homes to grow with and adapt to the changing needs of families (**extra space for adult children or aging parents/grandparents**)
- Can allow homeowners to stay in their current homes while keeping their irreplaceably low fixed mortgage rates (**extra space for a home office or extra income**)
- **Rental income from ADUs can help cover an owner's monthly mortgage payment.**

ADUs Built in California, 2018–2023



Source: California Department of Housing and Community Development



What defines an Accessory Dwelling Unit (ADU)?



An accessory to the primary home
But can now be sold independently in California.

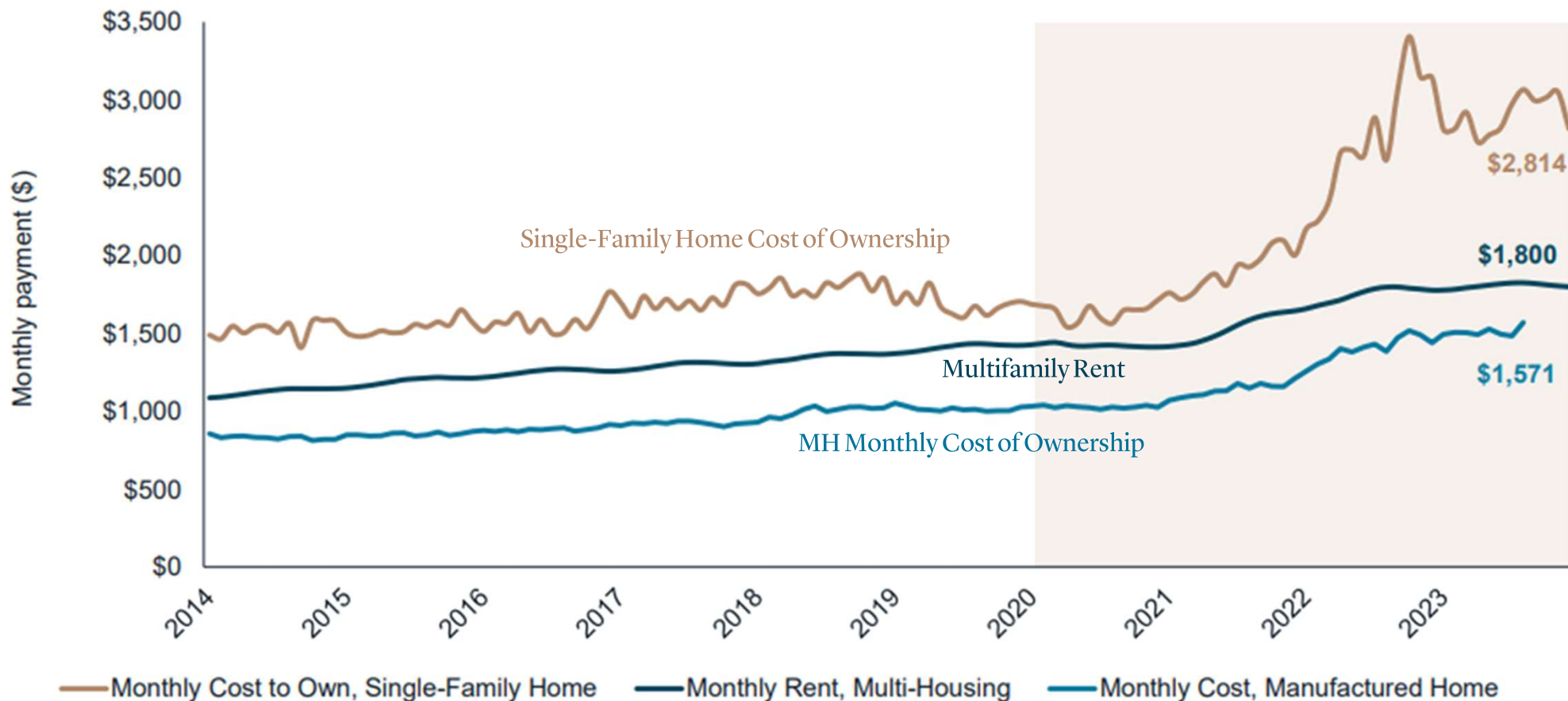
Separate living spaces
Must have private entrances, amenities, and HVAC

Small, independent structures
Less than 1,000 square feet with 1-2 bedrooms



Manufactured Housing: It's Cheaper to Own a MH Than it is to Rent an Apartment

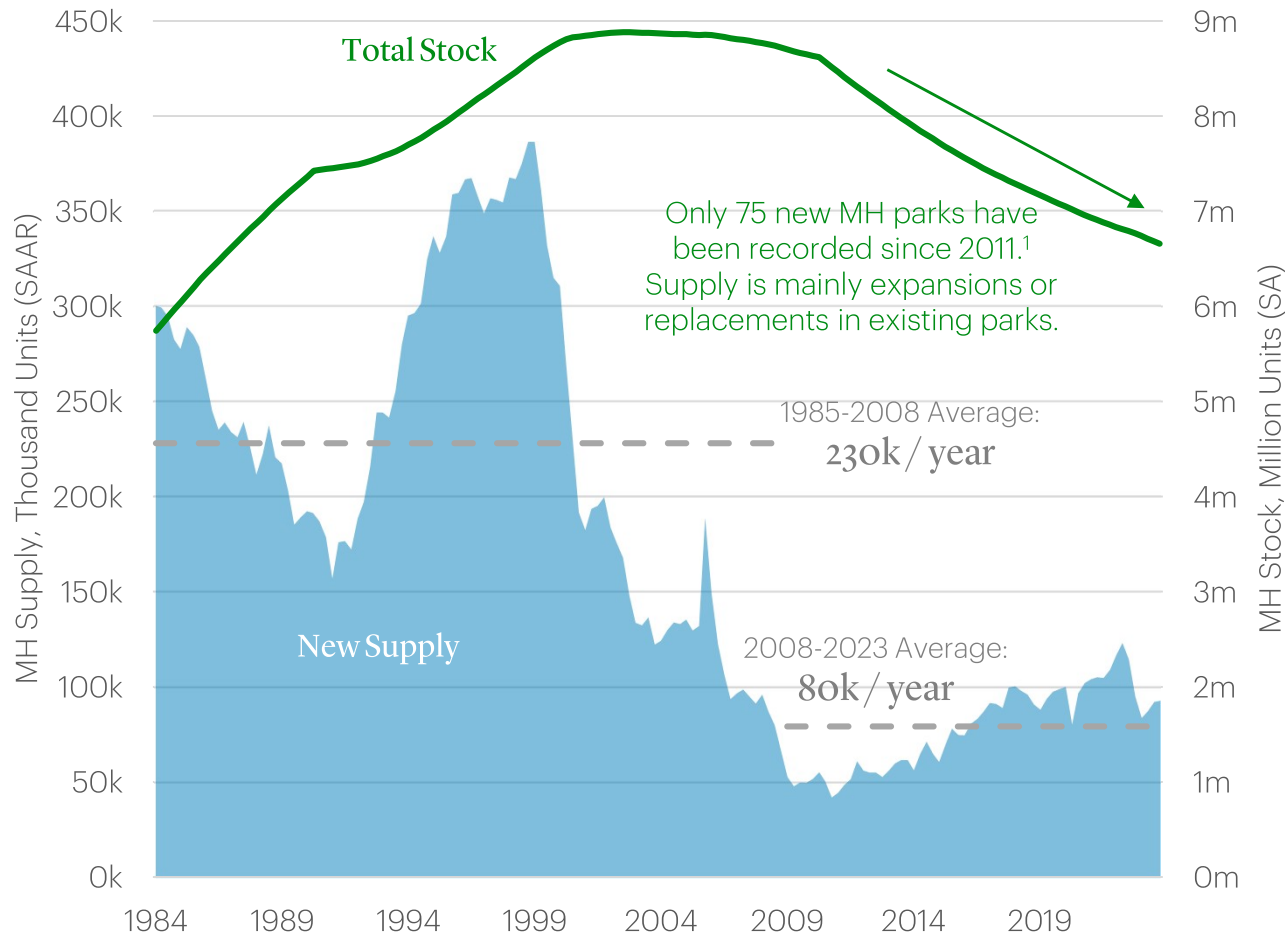
MONTHLY PAYMENT, IN USD, FOR SELECT HOUSING OPTIONS US THROUGH END-2023



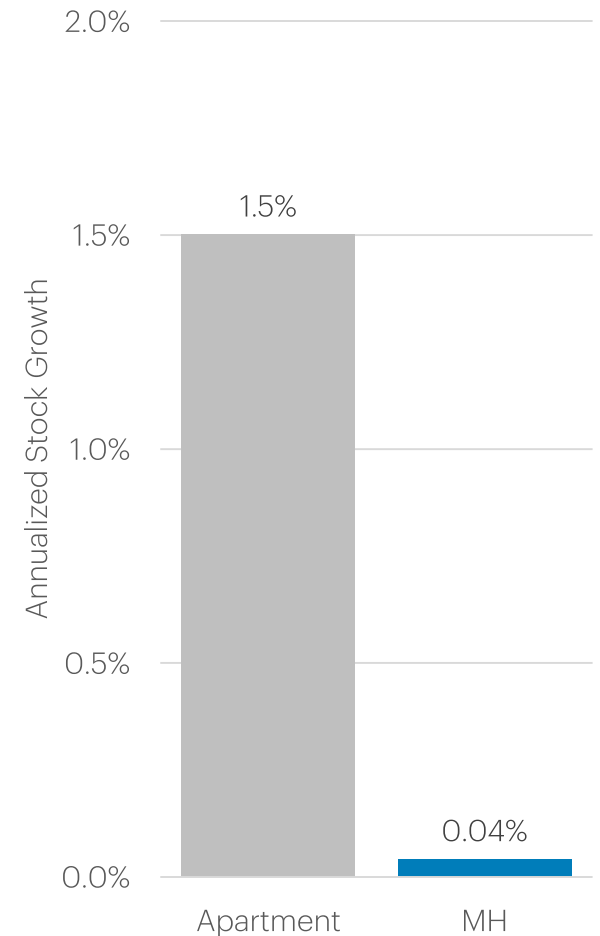
Source: JLL Research, U.S. Census Bureau, Freddie Mac, Axiometrics, NerdWallet, Green Street, EDGAR public filings
 Note: Cost to own includes principal, interest, property taxes, and insurance on a 30-year fixed rate mortgage assuming standard mortgage underwriting criteria on a median-priced new home, based on national data.
 Cost of manufactured housing includes average pad site rent (calculated as an average of SUI and ELS pad site rents nationally) in addition to principal, interest, and insurance on a 30-year fixed rate mortgage assuming standard mortgage underwriting criteria on an average-price new manufactured home, based on national data.

New MH Deliveries Have Plummeted Since 2000

MH TOTAL STOCK AND NEW SUPPLY
OF UNITS, SEASONALLY ADJUSTED, 1984-2023



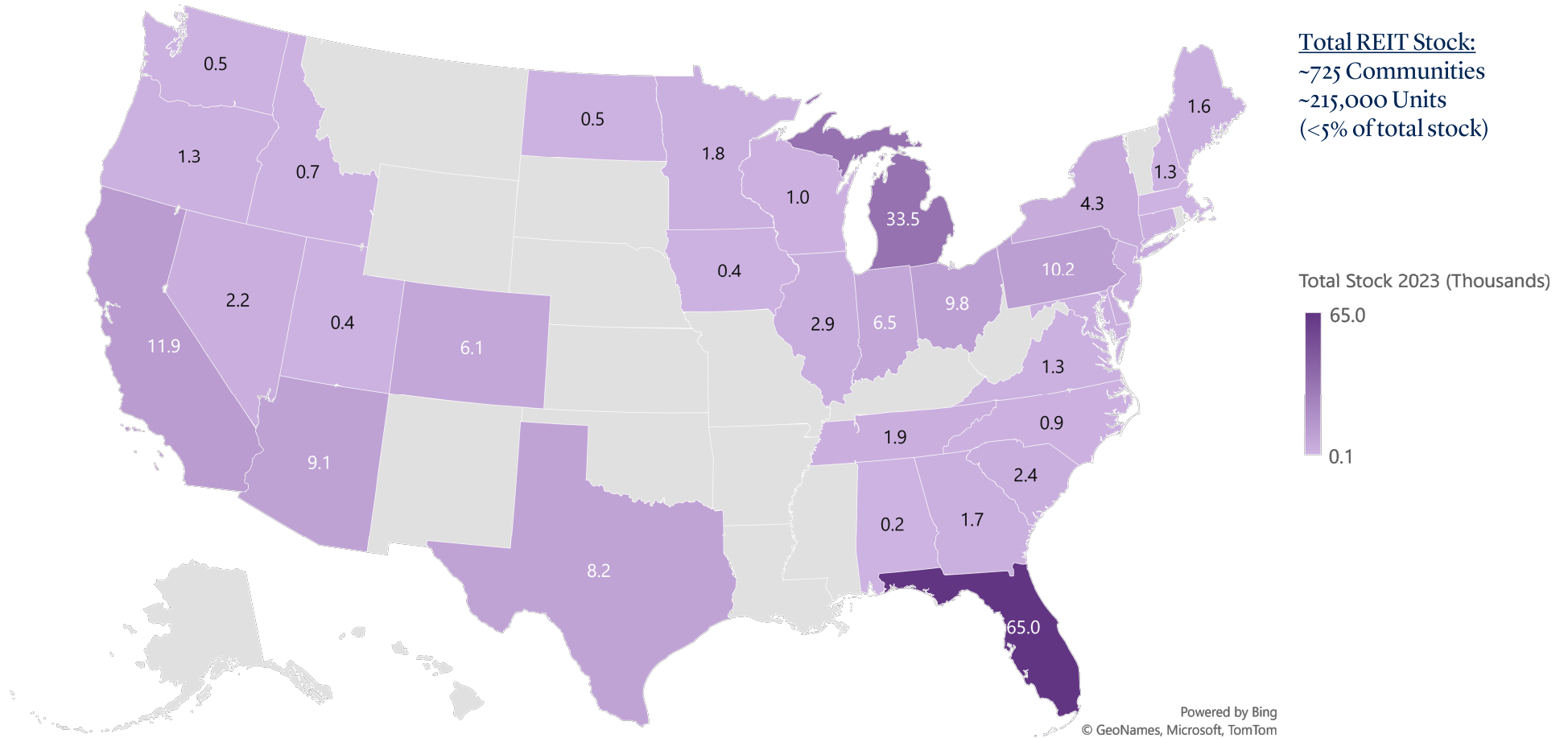
2024-2028F ANN. STOCK GROWTH
% OF TOTAL, GREEN STREET FORECAST



Data Sources: Moody's Analytics database, accessed 2024 Q2
 1: Broadvail Capital Partners, "Manufactured Housing White Paper" 2021

IL Has Low Institutional MH Presence; MI Has a Very Large Institutional Presence

**REIT MANUFACTURED HOUSING STOCK BY STATE
US, THOUSAND UNITS, 2023**



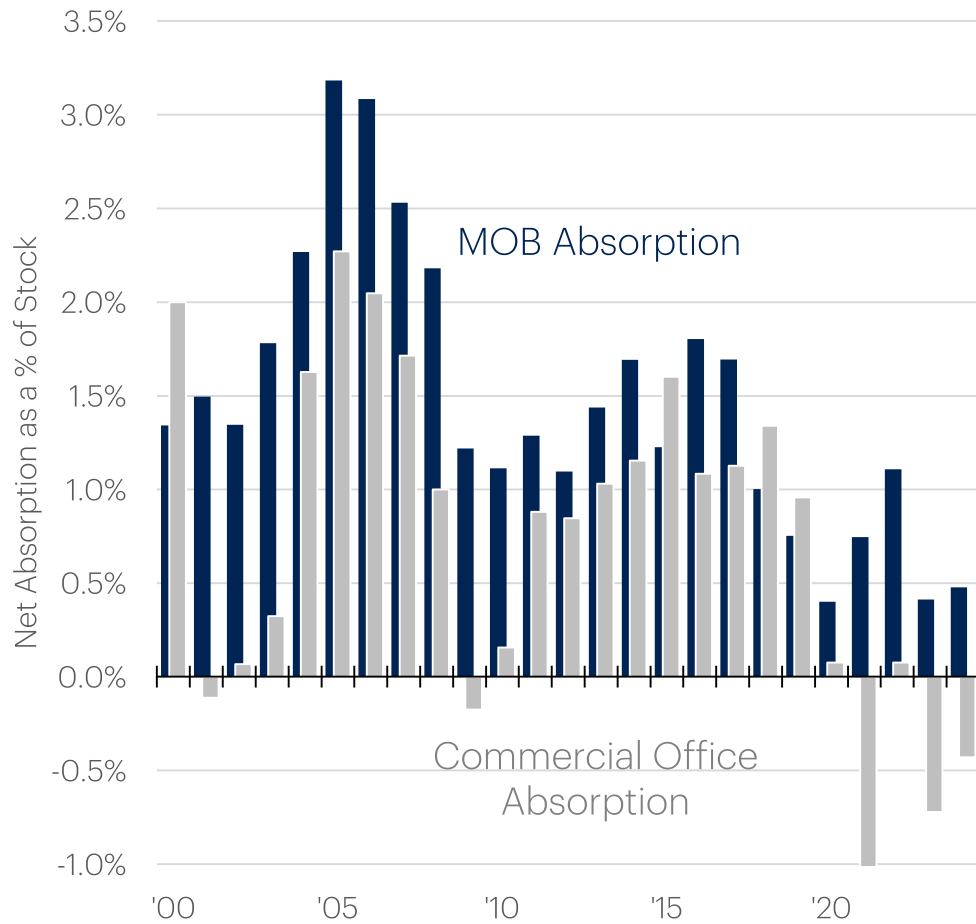
Underlying Data Sources: Annual REIT 10-Ks:
UMH (UMH Properties), ELS (Equity Lifestyle Properties), SUI (Sun Communities)

Medical Office (MOB)

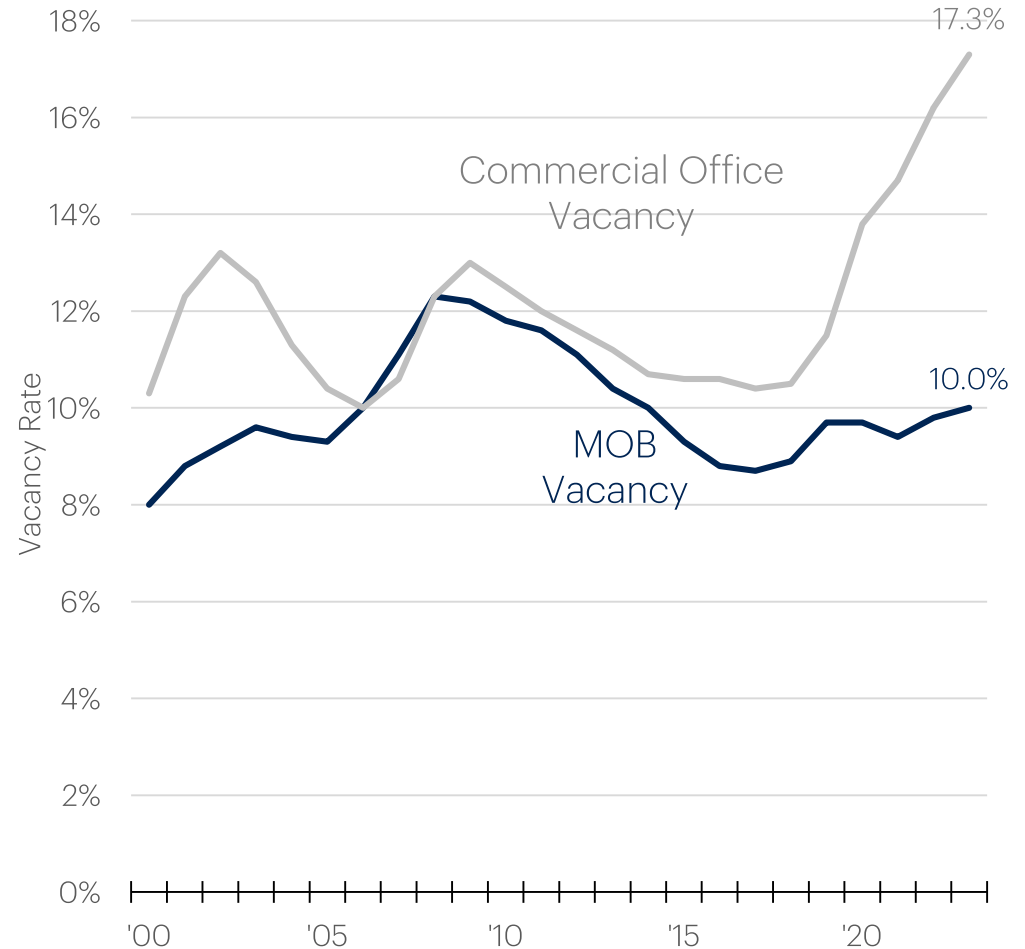
Consistent MOB Absorption Has Kept Vacancy Low

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**NET ABSORPTION AS A % OF STOCK
US, 2000 – 2024, YEARS ENDING Q3**



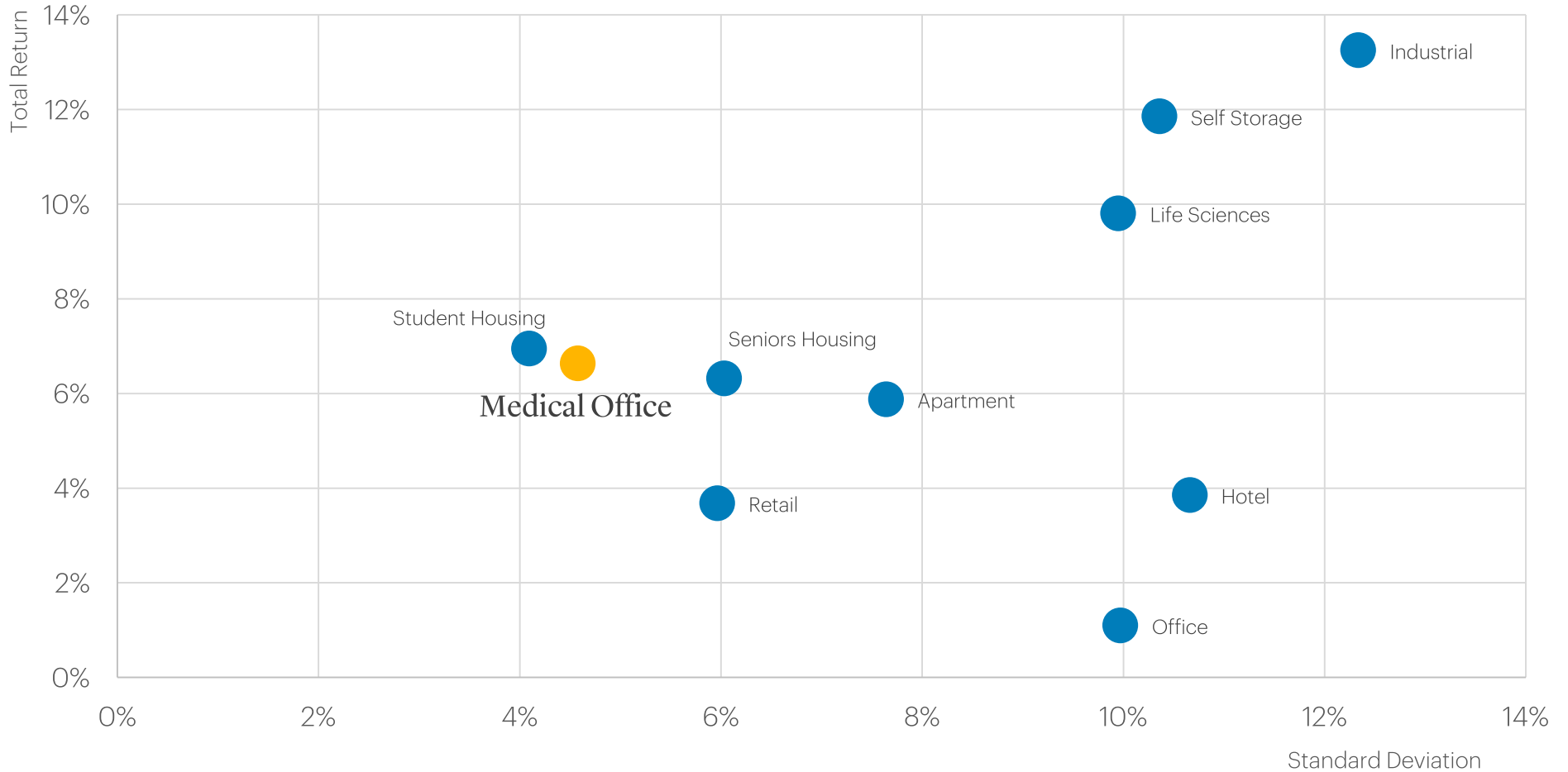
**VACANCY RATES
US, 2000 – 2024, YEARS ENDING Q3**



Data Sources: CoStar Database, accessed Q3 2024

MOB Exhibits Attractive Risk-Return Profile

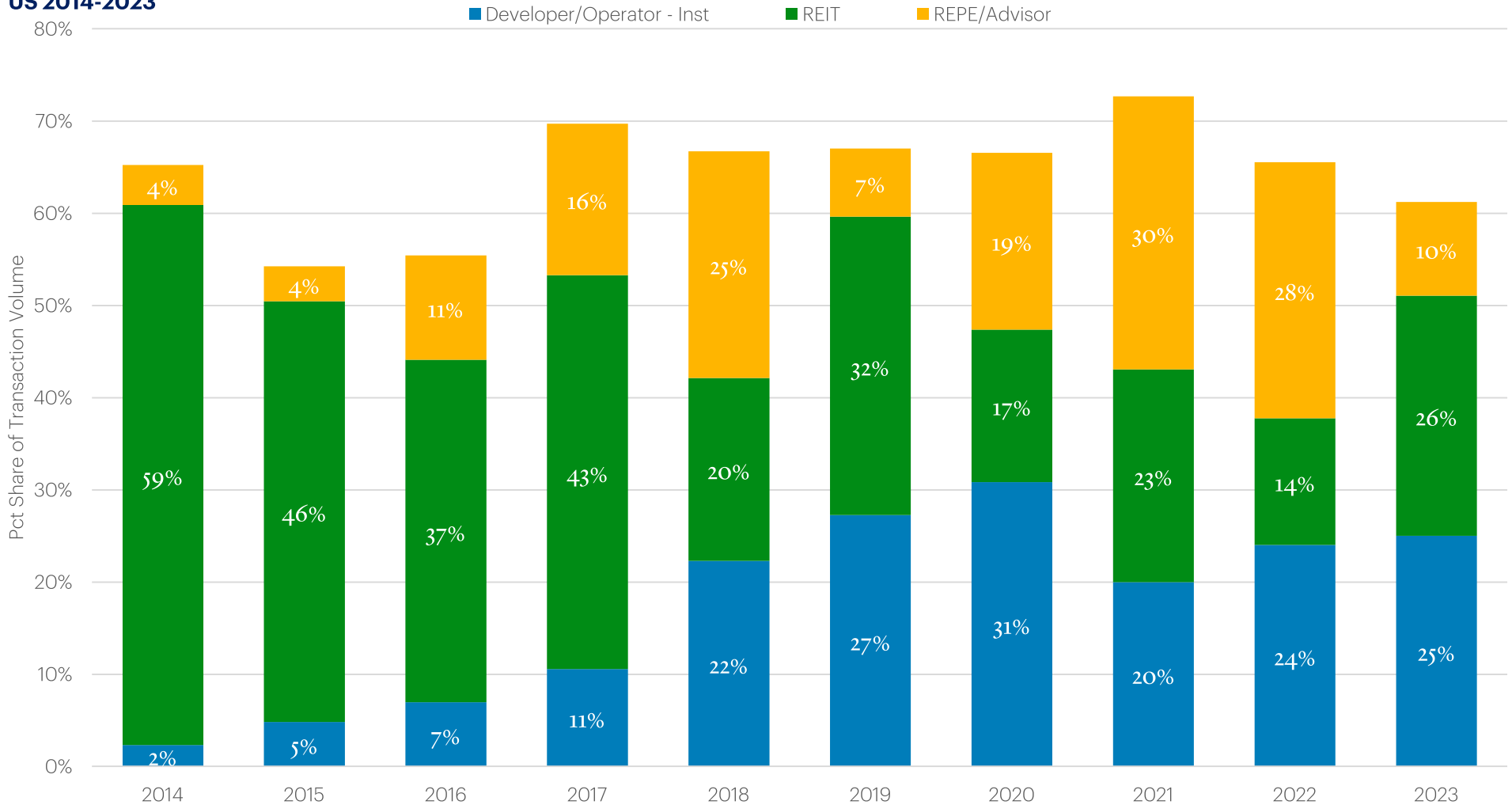
EXPANDED NPI TOTAL RETURNS VS RISK BY SECTOR US 2015 - 2024 Q3



Data Sources: 2024 Q3 NCREIF Expanded NPI, accessed 2024 Q4

MOB Investor Base Continues To Diversify

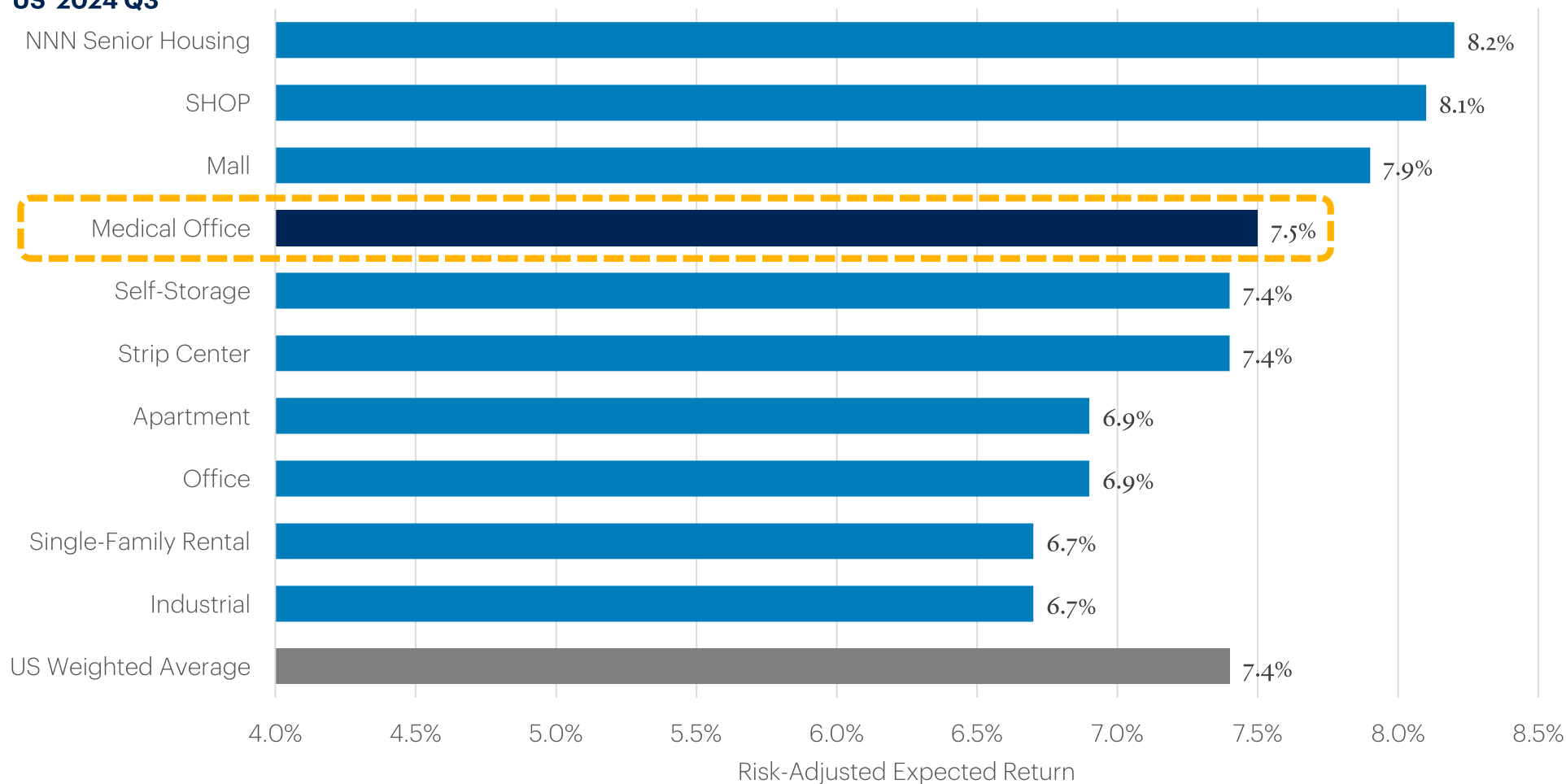
**INSTITUTIONAL INVESTOR SHARE OF TOTAL MEDICAL OFFICE TRANSACTION VOLUME, BY TYPE (EXCLUDING ENTITY LEVEL)
US 2014-2023**



Data Sources: Revista database, accessed Q3 2024

Go-Forward Return Expectations for MOBs Stack Up Well Against Most Sectors

PRIVATE MARKET SECTOR EXPECTED RETURNS US 2024 Q3



Data Sources: Green Street Healthcare Sector Update (August 22, 2024)

Advocate Expanding Illinois Facilities Aggressively, Including On Chicago's South Side

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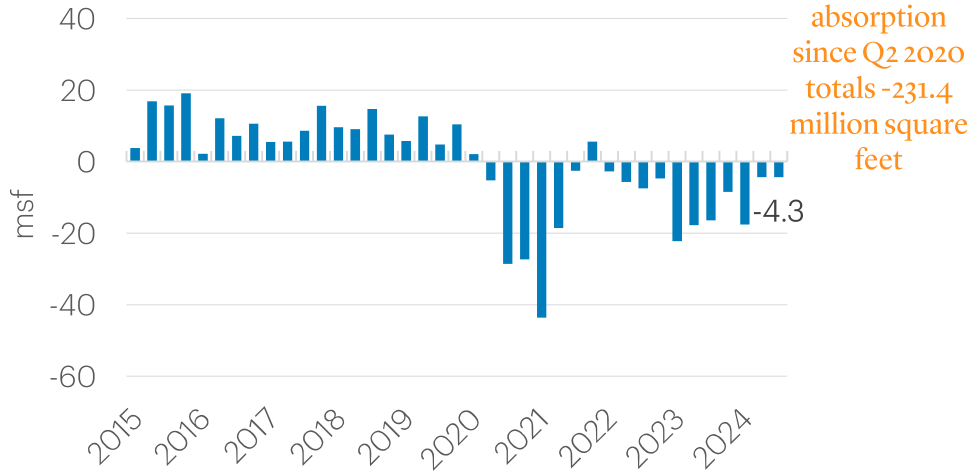


Rendering of Advocate Hospital at US Steel South Works site

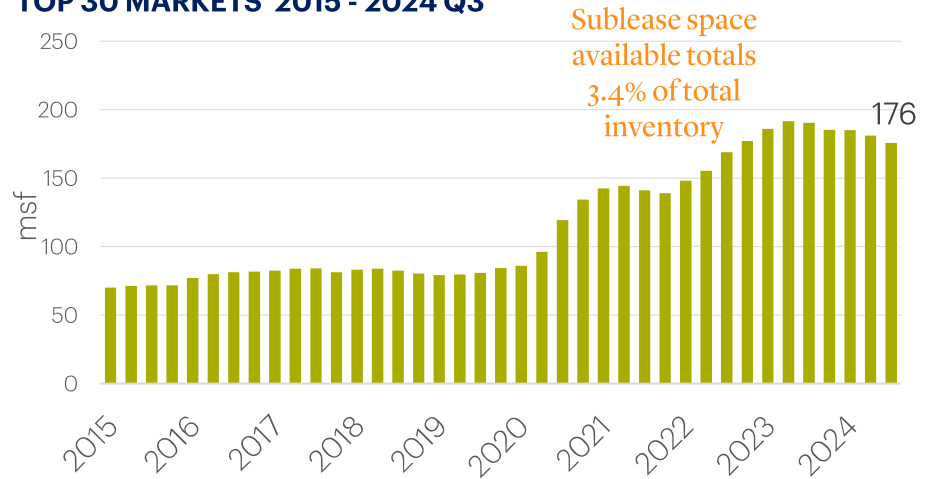
Office

A Long Road to Recovery for Offices

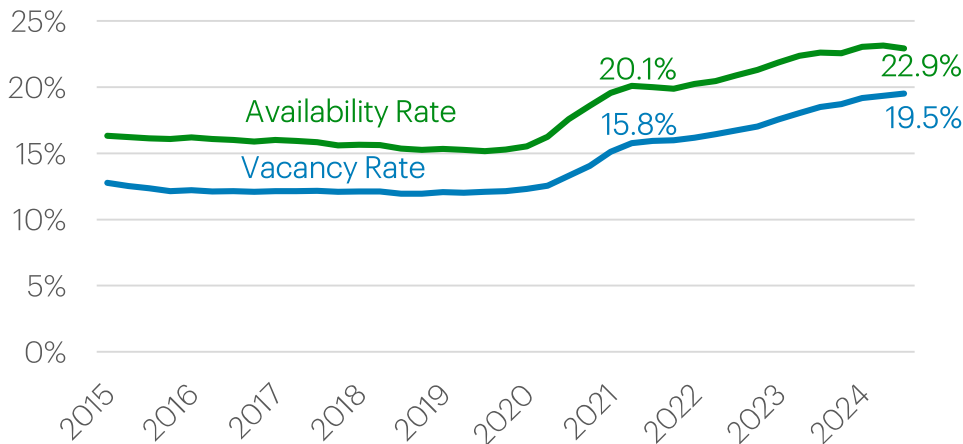
**QUARTERLY OFFICE NET ABSORPTION
US 2015 - 2024 Q3**



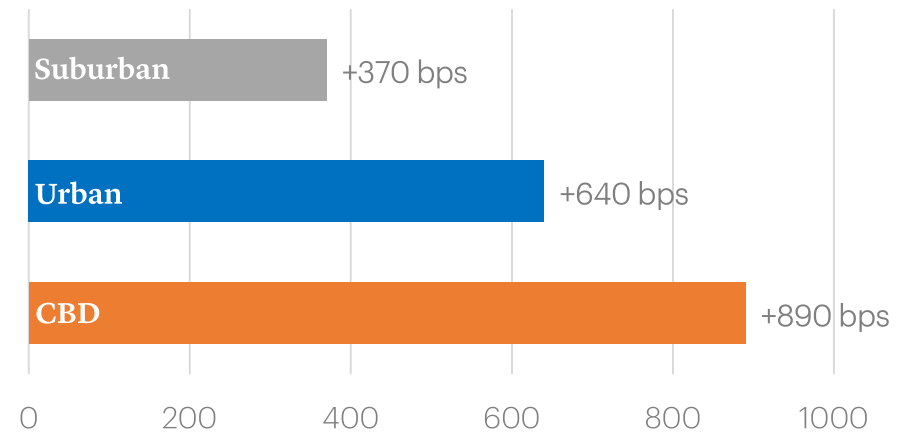
**SUBLEASE SPACE AVAILABLE
TOP 30 MARKETS 2015 - 2024 Q3**



**OFFICE VACANCY RATE VS AVAILABILITY RATE
US 2015 - 2024 Q3**



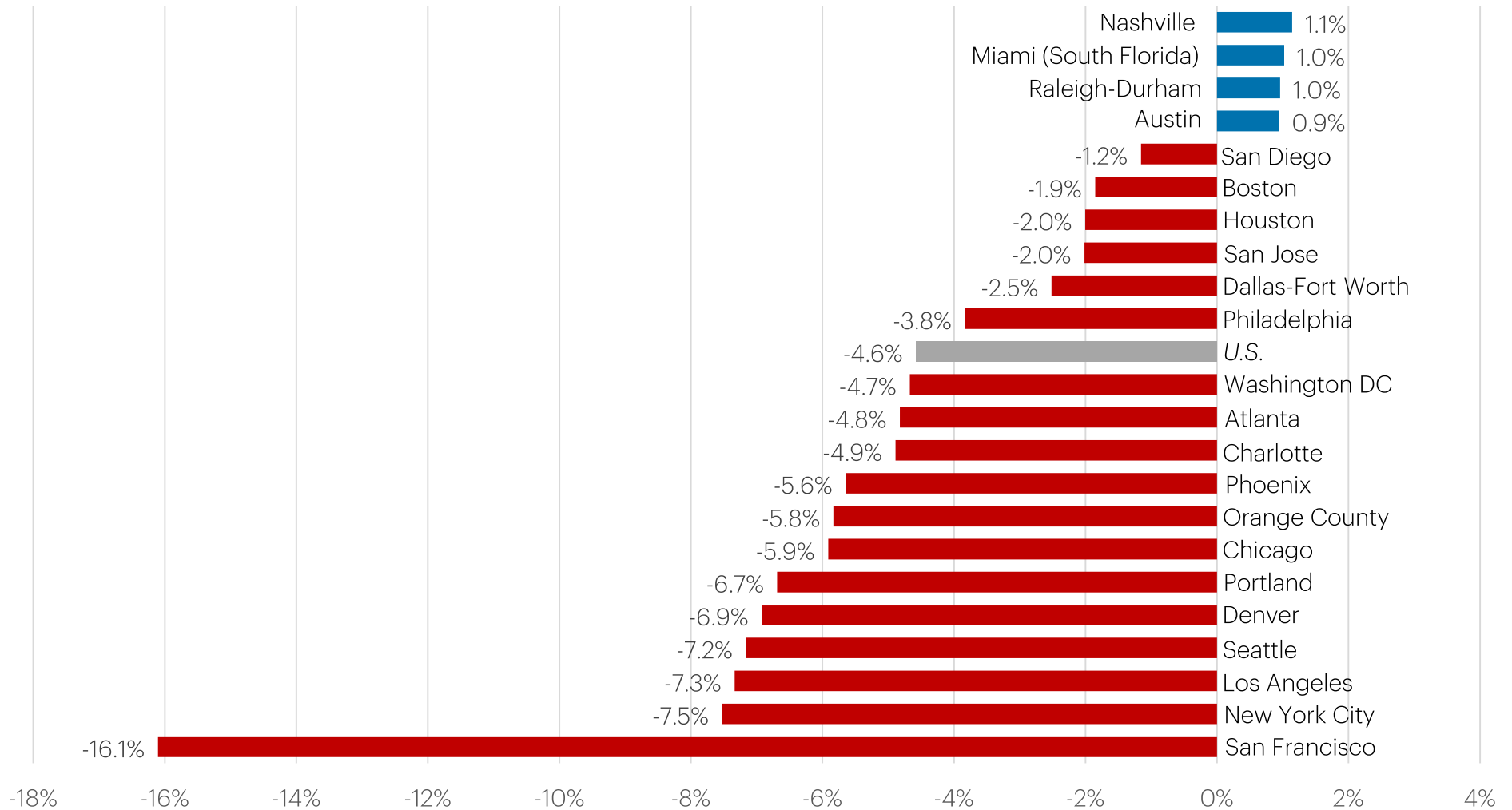
**VACANCY CHANGE BY MARKET TYPE
US 2024 Q3 (CHANGE SINCE Q1 2020)**



Underlying data source(s): CoStar (accessed Q4 2024)

Chicago is in the Middle of the Pack

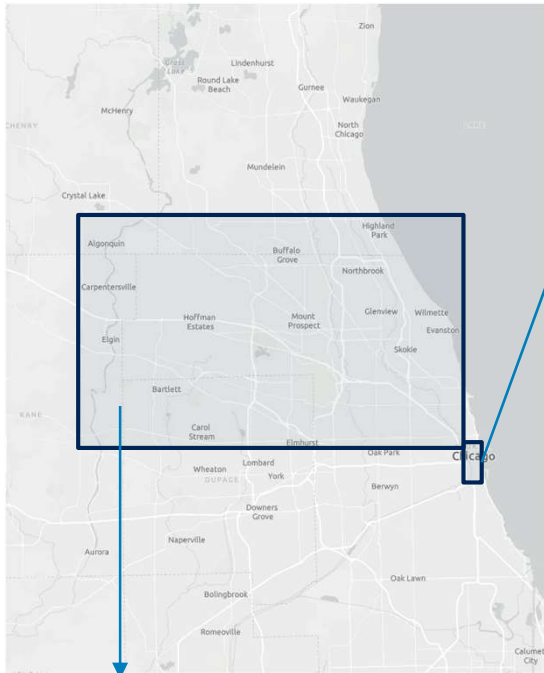
NET ABSORPTION - SHARE OF EXISTING INVENTORY SELECT TOP MARKETS 2020 Q2 - 2024 Q3



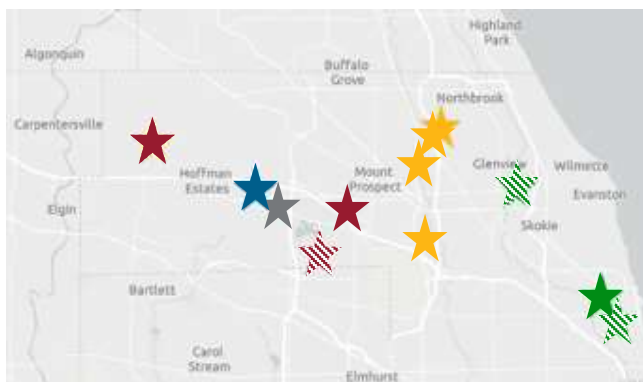
Underlying data source(s): CoStar (accessed Q4 2024)

Office Redevelopment Varies From Suburbs To CBD

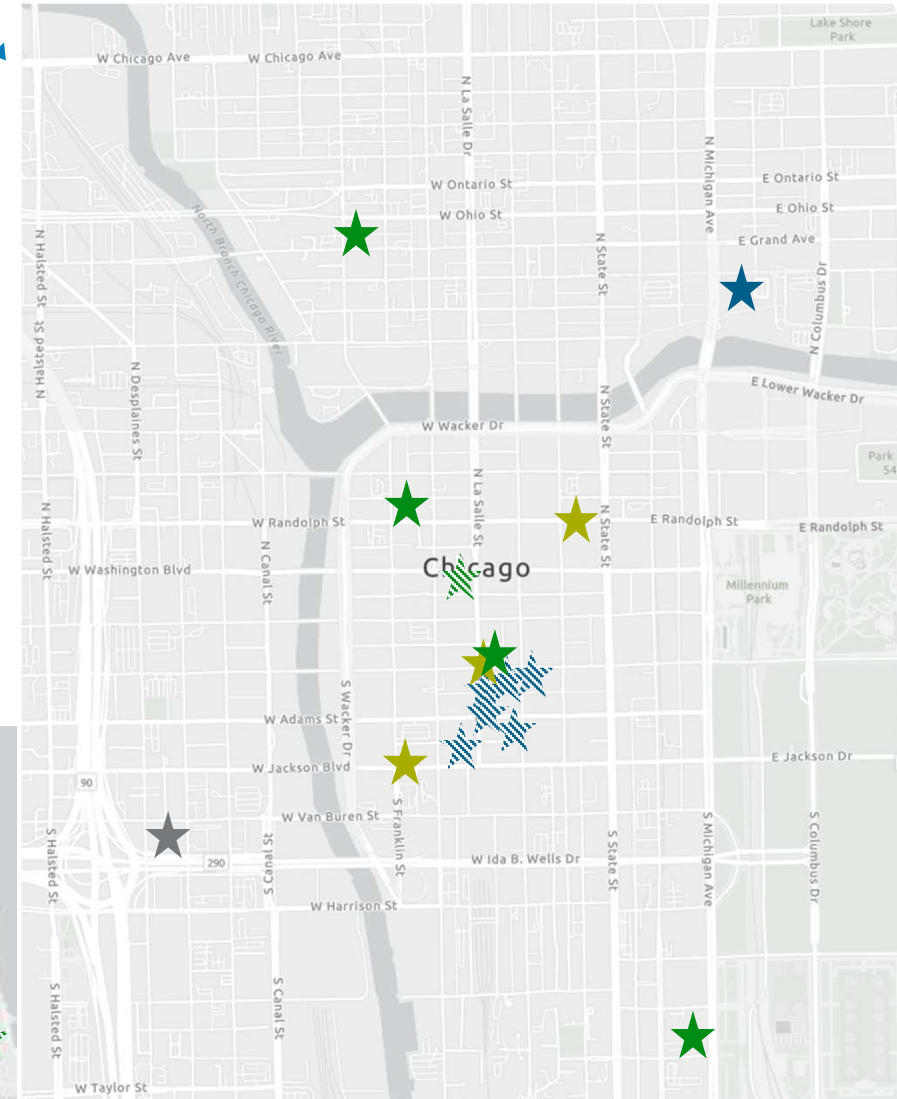
Chicago and Surroundings



Chicago North/Northwest Suburbs



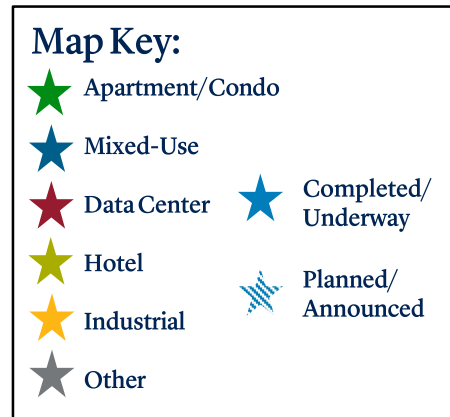
Chicago Loop Detail



In suburbs, more industrial and data center via whole site redevelopment; some residential closer in.

In the CBD, more conversions into residential and multifamily (fewer demolitions).

Unique "other" uses including schools and community centers.

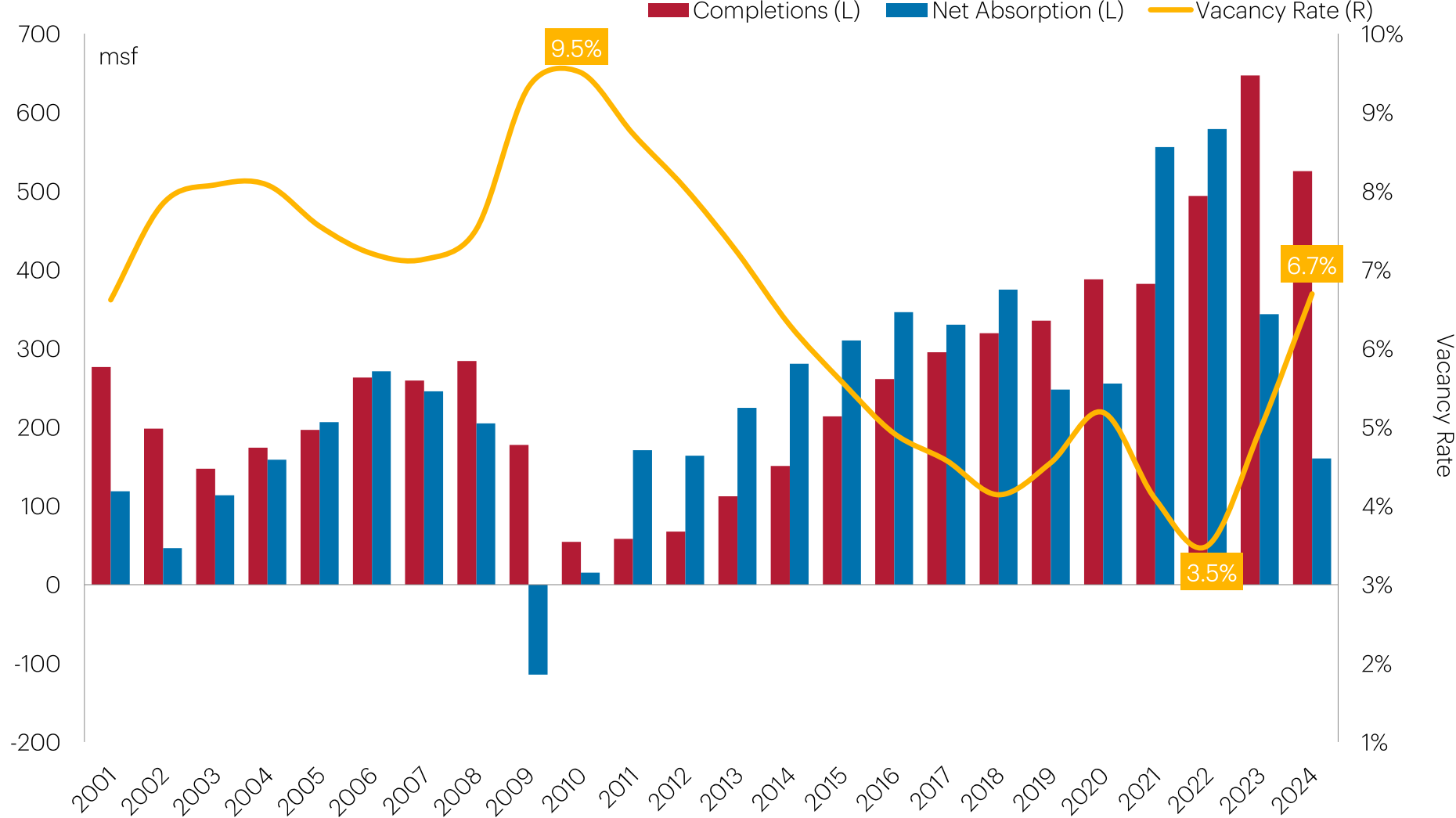


Underlying data source(s): CBRE; third-party news sources (accessed Q1 2024)

Industrial

Industrial: Supply > Demand Over Last Two Years

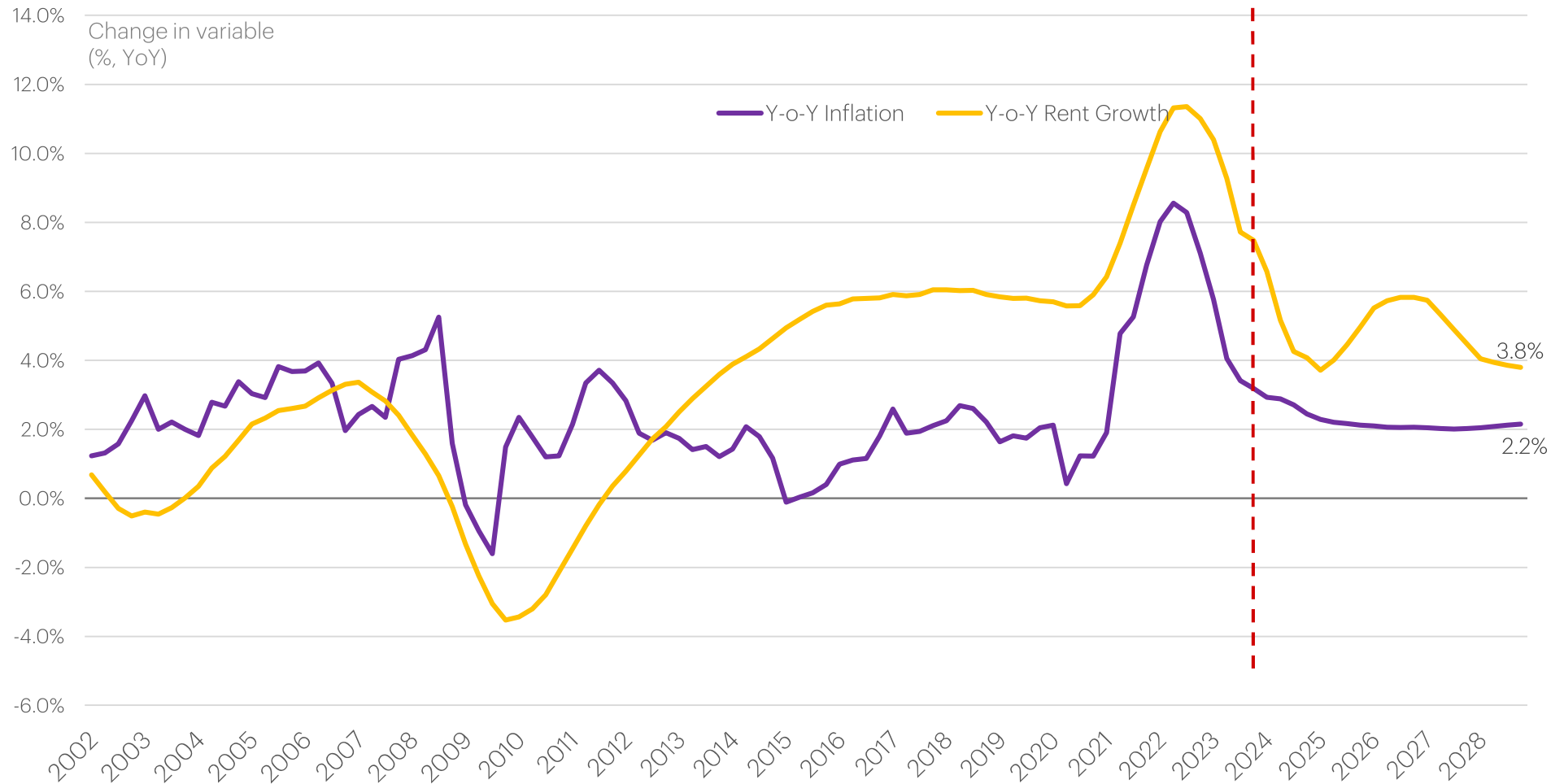
INDUSTRIAL COMPLETIONS, NET ABSORPTION, AND VACANCY
US 2001 - 2024 YEARS ENDING Q3



Underlying data source(s): CoStar (accessed Q4 2024)

Industrial Rent Growth Expected to Outpace Inflation Through the End of 2026

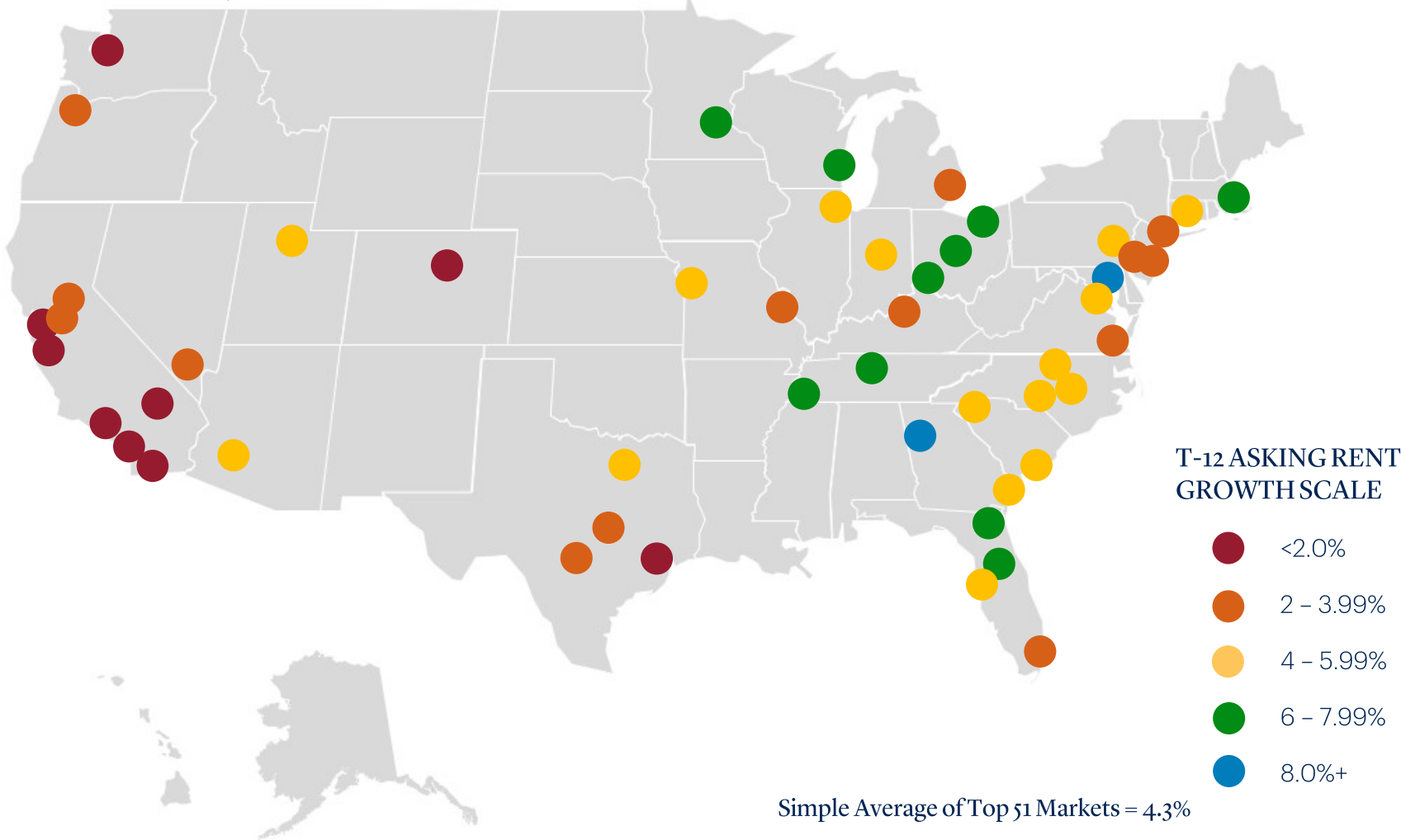
LOGISTICS RENT GROWTH VERSUS US INFLATION (CPI) US 2002 - 2027(F)



Source: Bureau of Labor Statistics, Moody's Analytics, CoStar

East Coast/Midwest Metros Outperforming

INDUSTRIAL ASKING RENT GROWTH TOP 51 US MARKETS 2024 Q3



Underlying data source(s): CoStar (accessed Q4 2024)

Concluding Remarks

Investment Implications for an Uncertain Environment HEITMAN

HOUSING AFFORDABILITY

The cost of housing in the US relative to income has reached historic highs. Data provider JBREC estimates that **the cost of housing has reached 43% gross annual income, and is unlikely to fall much**. The Chicago-Naperville-Elgin MSA enjoys a modest relative advantage at 35%. **Typologies that may boost housing supply include ADUs, manufactured homes, and rental home communities**.

CLIMATE RISK

The timing and magnitude of the fiscal effects of climate change are hard to foresee; however, **Illinois appears set to weather the storm better than its coastal and sunbelt peers**. Net migration may increase as the sunbelt—the biggest beneficiary over the last cycle—faces new challenges.

MIGRATION

Though Chicago is still suffering net outmigration, **conditions have improved since the pandemic period**. Record international migration—if allowed to continue—will likely benefit the region over the long term. **Chicago's relative affordability and insulation from climate risk are structural advantages** not shared by most other gateways.

OFFICE CONVERSIONS

Converting office buildings to other types of real estate is complex and costly. **Most private sector investors will not be able to shoulder the risk & up-front outlay without public assistance**, whether it takes the form of cutting red tape (e.g., waiving parking requirements) or direct subsidy (e.g., tax abatements). The long-term benefits of a revitalized neighborhood should **kindle network effects that benefit surrounding areas—a great public good**.
