Real Estate Strategy Semi-Annual Report (Open Session)

Prepared for California State Teachers' Retirement System

As of Q1 2023

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CalSTRS Q1 2023 Open Session Report

Goals and Objectives

The objective of this semi-annual report is to provide the Committee with an evaluation of the real estate portfolio's alignment with CalSTRS' established goals and policies and the investment opportunities presented by property and capital markets.

To accomplish the above objective, we reviewed the CalSTRS portfolio, policies and limitations, previous recommendations and activities, as well as current and forecasted economic, capital market, and property market conditions.

Current and long-term portfolio goals and objectives that the semi-annual report evaluates include:

- A real estate allocation target of 15% +/-3%;
- Target a net return that exceeds the NCREIF NFI-ODCE Index;
- Provide stable income, a hedge against inflation, and improved diversification to the overall CalSTRS Investment Portfolio;
- Allocation based on property stage – stable and value creation (lease-up/reposition and construction) – to maintain an appropriate risk profile; and
- An appropriate level of leverage, with a loan-to-value (LTV) limit of 50% for the controlled portfolio and 65% for the non-controlled portfolio.

Source: CalSTRS

Performance

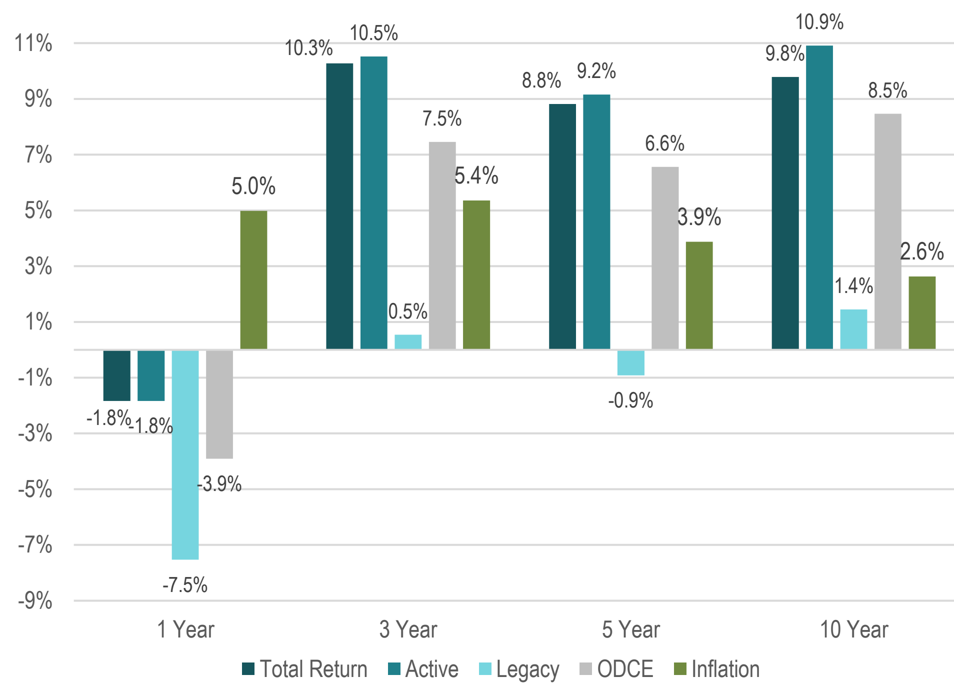
As of Q1 2023

- The real estate portfolio has outperformed both its target return benchmark and inflation over the last decade. The portfolio has generated a 10-year net TWR of 9.8%, outperforming the ODCE benchmark return of 8.5% by ~130 basis points, and a 5-year net TWR of 8.8%, outperforming the ODCE benchmark return of 6.6% by ~220 basis points.
- The portfolio has generated net TWRs of -1.8% and 10.3% over the 1- and 3-year time horizons, outperforming the ODCE benchmark return of -3.9% and 7.5%, during the same periods, by ~210 basis points and ~280 basis points, respectively. Excluding legacy investments, the portfolio has outperformed the benchmark every year over the ten-year period.

Portfolio Performance[1]
Net Time Weighted Returns

	Including Legacy				*Excluding Legacy*			
	1 Yr	**3 Yr**	**5 Yr**	**10 Yr**	**1 Yr**	**3 Yr**	**5 Yr**	**10 Yr**
Core	-2.7%	9.3%	8.4%	9.8%	-3.2%	9.3%	8.4%	9.8%
Value Add	-5.0%	9.6%	8.6%	12.5%	-5.4%	9.5%	8.5%	12.8%
Opportunistic	3.7%	13.8%	10.4%	9.0%	6.3%	16.0%	13.0%	13.2%
Total	**-1.8%**	**10.3%**	**8.8%**	**9.8%**	**-1.8%**	**10.5%**	**9.2%**	**10.9%**
Target Return (ODCE)	-3.9%	7.5%	6.6%	8.5%	-3.9%	7.5%	6.6%	8.5%

Historical Net Time-Weighted Returns[2]



[1]Green cells denote outperformance of the target return metric. The Core portfolio has a net target return benchmarked to the ODCE, while the Value Add and Opportunistic portfolios have net target returns of 50 basis points and 300 basis points over the ODCE, respectively.
[2] Performance and inflation data through Q1 2023.
Source: State Street - PrivateEdge, NCREIF, FRED

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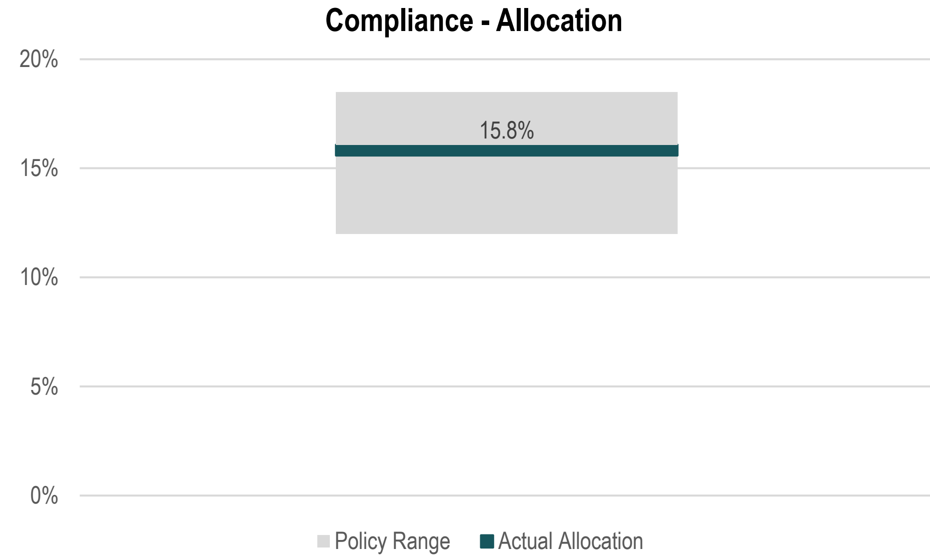
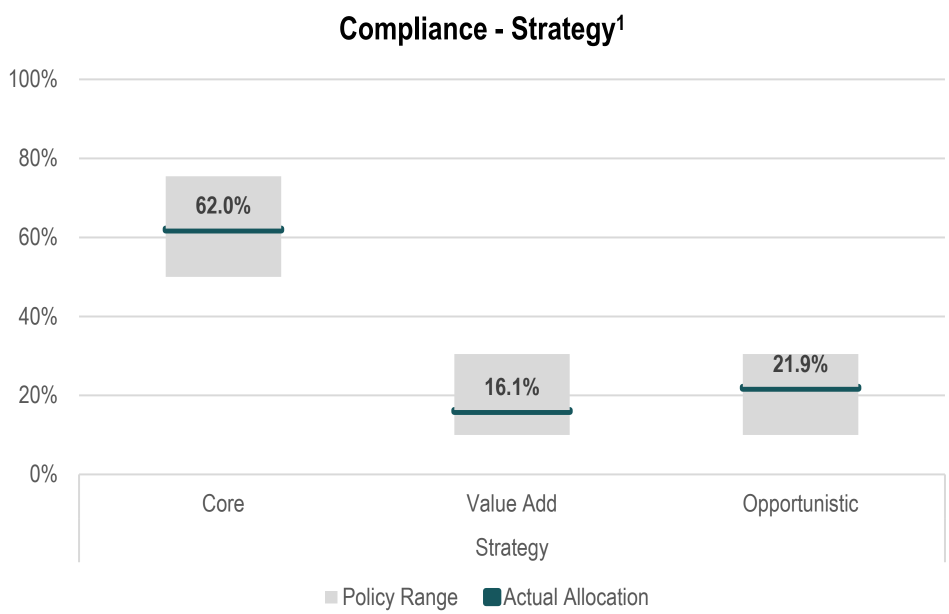
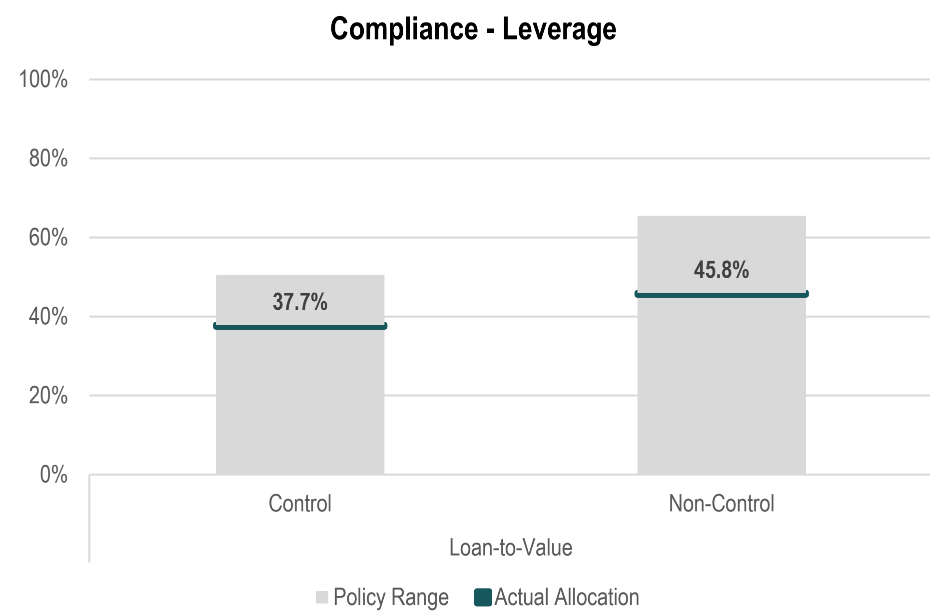
Funding Status and Compliance

As of Q1 2023

- The portfolio had a NAV of ~$50B as of Q1 2023, comprising 15.8% of the total CalSTRS Fund (~$316.5B), slightly above the target allocation of 15%, but well within the permitted range of 12% to 18%.
- The portfolio is compliant with the targeted allocation by investment strategy and is within the permitted leverage limits for the control and non-control[2] portfolios of 50% and 65%, respectively.







[1]Percentages do not account for the portion of Legacy assets. Public REITs included with Core.
[2]Control portfolios are those which CalSTRS maintains control over acquisitions, dispositions, and/or financing or has high liquidity in normal market conditions.
Source: State Street

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Current Portfolio Summary

- The CalSTRS real estate portfolio had a NAV of ~$50B as of Q1 2023, comprising 15.8% of the total CalSTRS fund (~$316.5B), slightly above the target allocation of 15%, but well within the permitted range of 12% to 18%.
- Approximately 84% of the portfolio is invested in the United States.
- The allocation to office decreased 137 basis points over the past six months, though remains 8% overweight relative to the benchmark. When excluding life science office properties, the overweight to office is in line with the benchmark.
- The portfolio continues to be underweight industrial and multifamily by 10% and 9%, respectively, which could create a performance drag going forward as these property types have exhibited the strongest net operating income growth.
- CalSTRS' real estate debt totals $33.0B as of Q1 2023, an increase of $1.6B since Q3 2022. The LTV of the portfolio increased by 133 basis points from ~39% in Q3 2022 to ~40% in Q1 2023.
- The LTV of the control portfolio increased ~2% from 36% to ~38% in Q1 2023, while the non-control LTV remained steady over the last six months at 46%. Per the investment policy statement, the leverage is within the compliance limit of 50% and 65%.
- The allocation by risk profile is 61% core, 16% value-add, and 22% opportunistic, excluding Legacy investments (which represents just ~1% of NAV).

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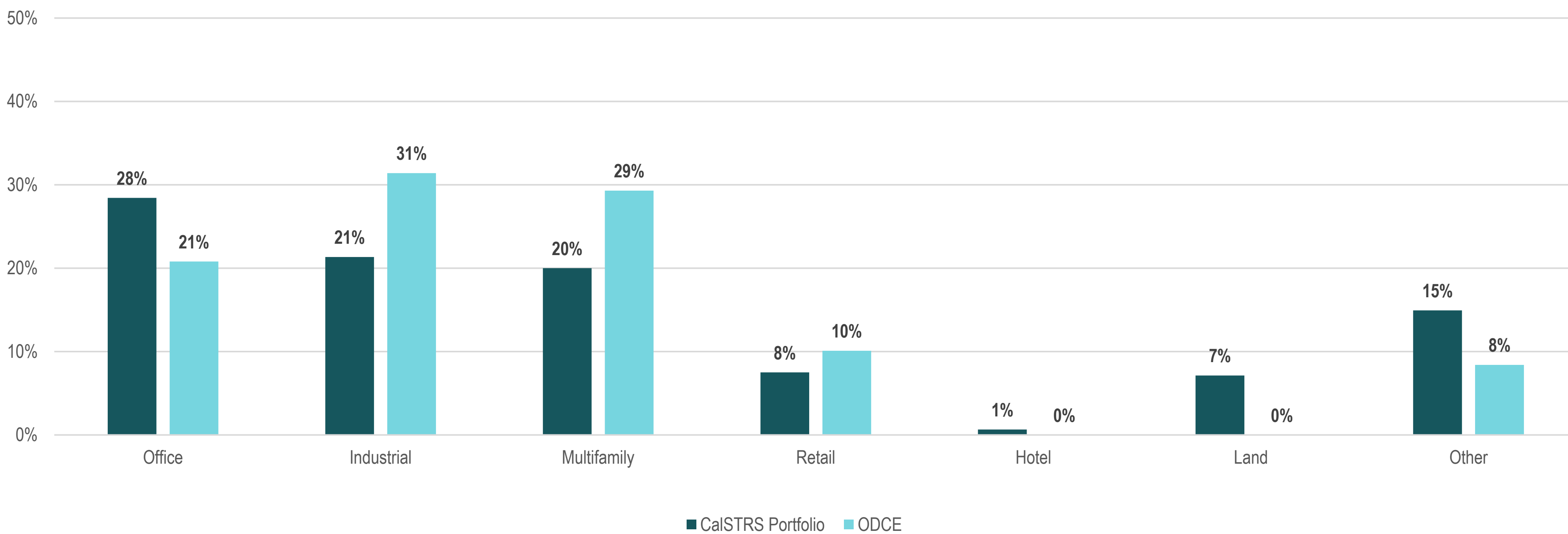
[1] *Controlled investments are those which CalSTRS maintains discretion over acquisitions, dispositions, and financing, or has high liquidity in normal market conditions.*
Source: State Street, CalSTRS

Portfolio Diversification

Property Type vs. ODCE

- The real estate portfolio remains overweight to office investments compared to the ODCE; however, the allocation to office decreased by 137 basis points over the last six months, though remains 8% overweight relative to the benchmark. Excluding life science office, the office allocation is in line with the benchmark.
- The portfolio continues to be underweight industrial and multifamily by 10% and 9%, respectively, which could create a performance drag going forward as these property types have exhibited the strongest net operating income growth.
- The portfolio has an 6% allocation to real estate debt investments, resulting in an overweight to the "Other" category.

Total Portfolio - Property Type Diversification[1]

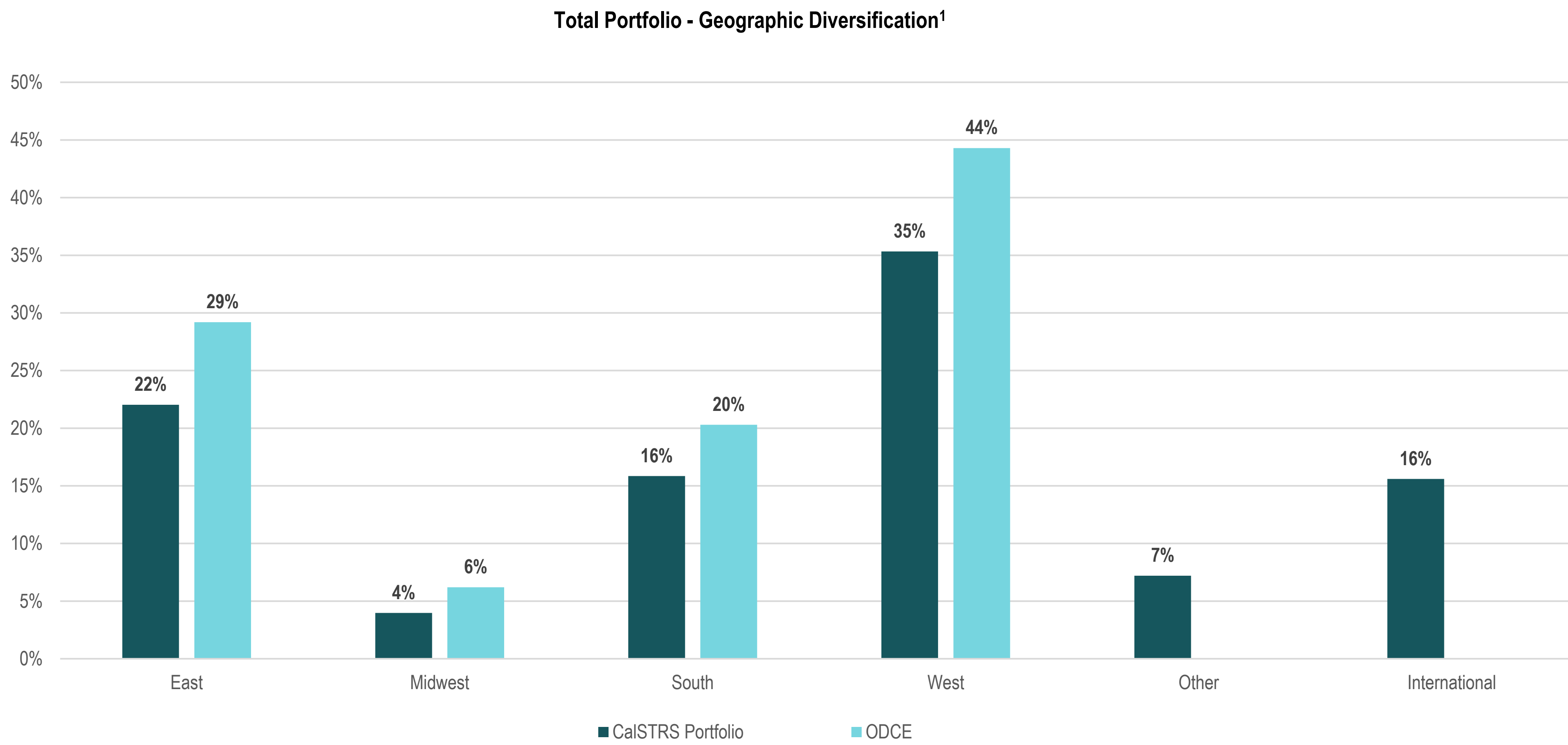


Note: ODCE and CalSTRS' weights based on gross real estate value.
[1]"Other" property type category is made up of the following property types in descending order by percentage: Other, Mixed Use, Debt, Diversified, Manufactured, Senior Living, Healthcare, Hospitality, Various, Self-Storage, Infrastructure, Entertainment, Securities, REITs, and parking.
Source: State Street, CalSTRS

Portfolio Diversification

Geographic Allocation vs. ODCE

- Approximately 84% of the portfolio is invested in the United States. The benchmark has no international allocation.
- All geographic allocations, except International, are within +/-10% of the benchmark regional weights.

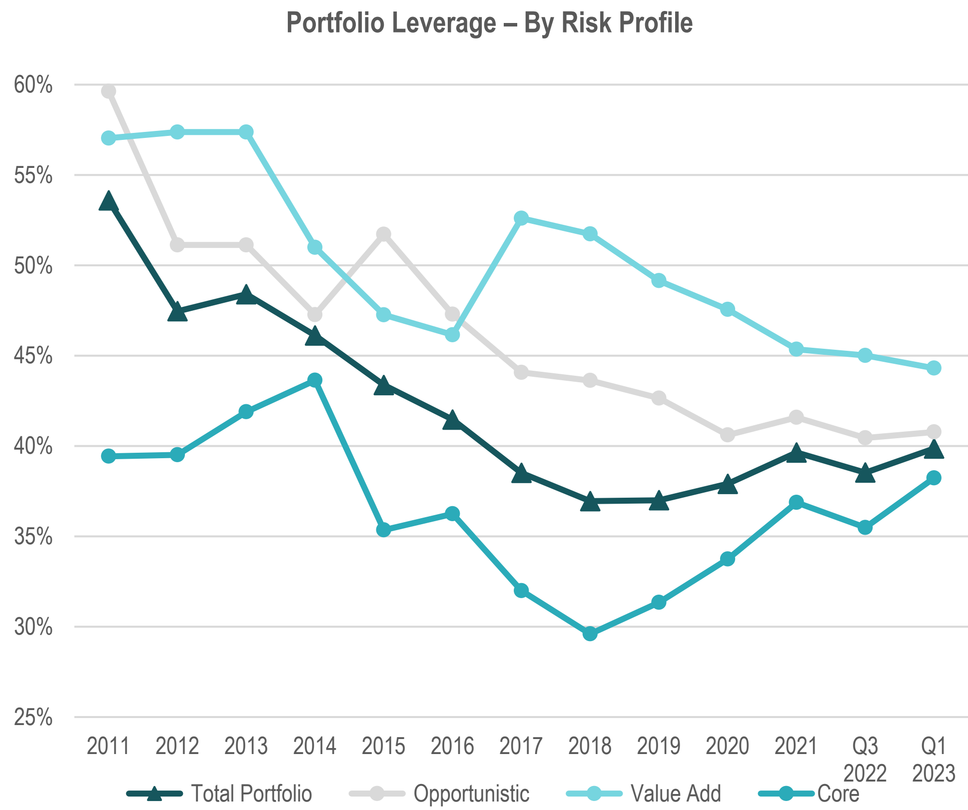


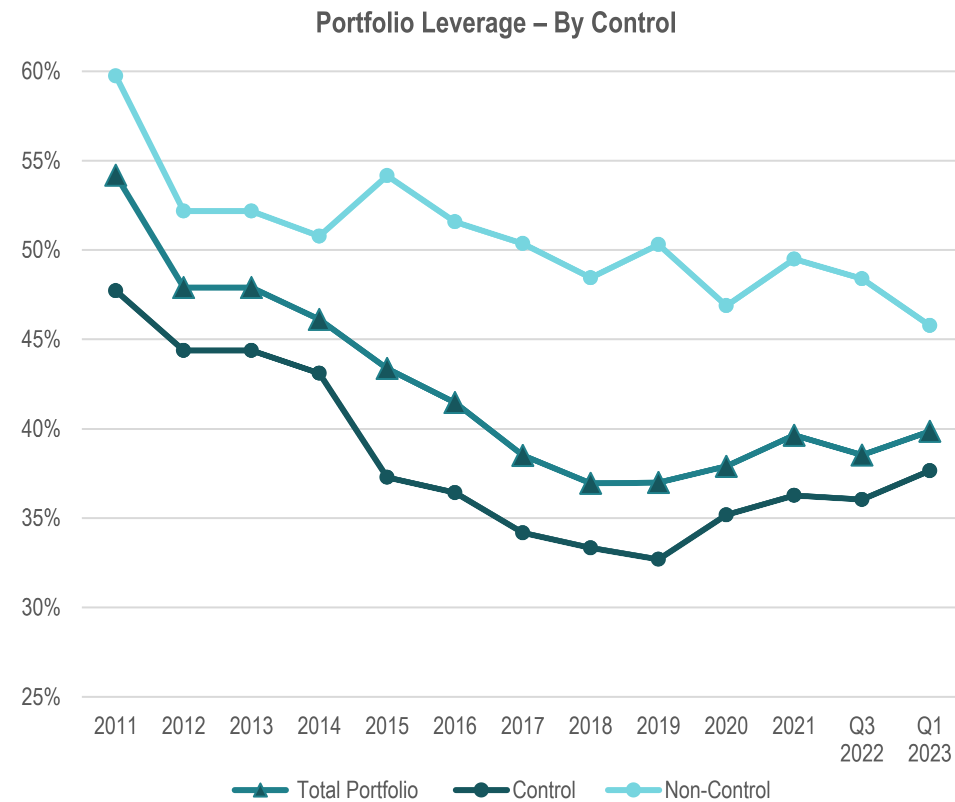
Note: ODCE and CalSTRS' weights based on gross real estate value.
[1] "Other" geographic category represents mostly U.S. diversified portfolio investments.
Source: State Street, CalSTRS

Total Portfolio Leverage

By Risk Profile and Control

- CalSTRS' real estate debt totals $33.0B as of Q1 2023, an increase of $1.6B since Q3 2022. The LTV of the portfolio increased by 133 basis points from ~39% in Q3 2022 to ~40% in Q1 2023.
- The LTV of the control[1] portfolio increased ~2% from 36% to ~38% in Q1 2023, while the non-control LTV remained steady over the last six months at 46%.





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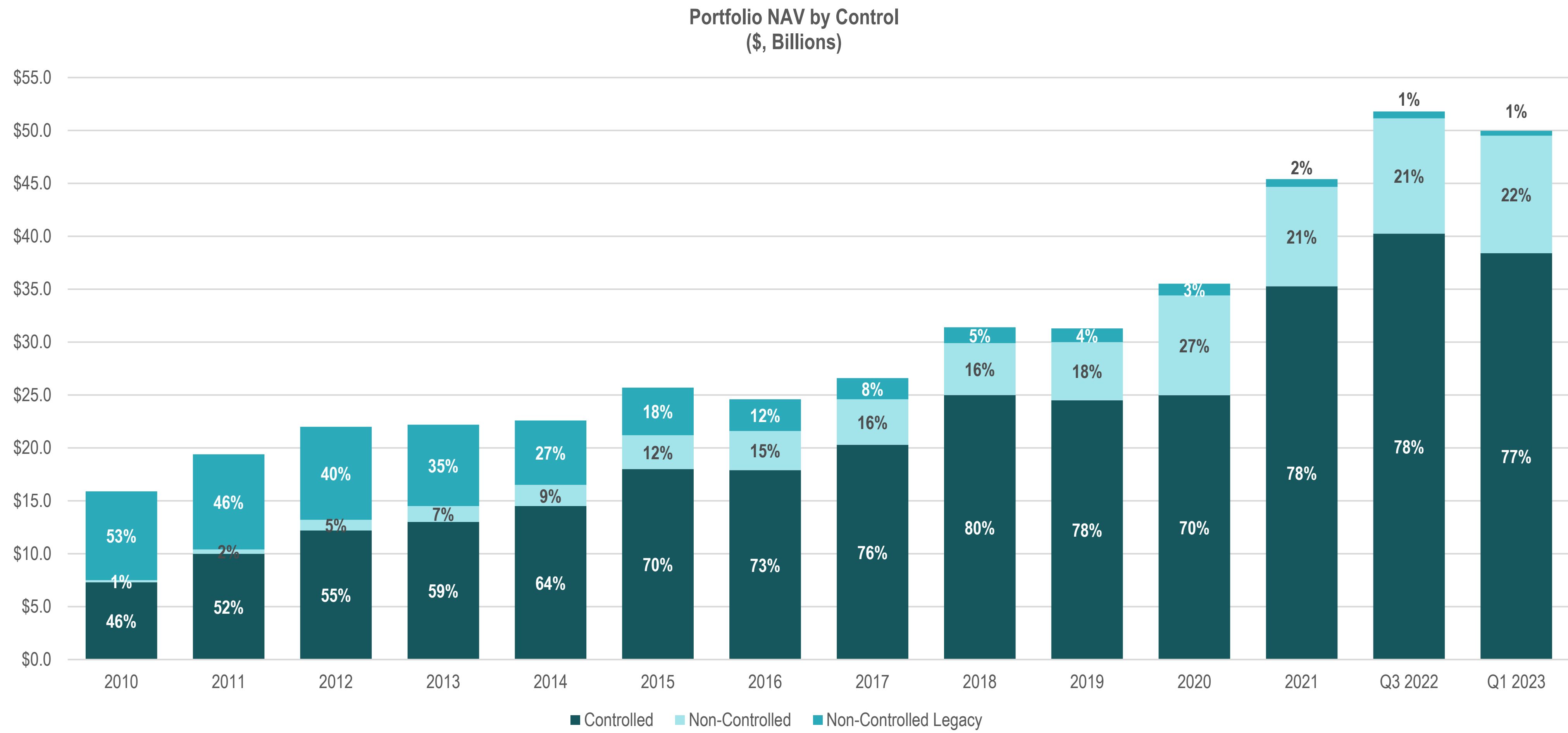
[1] Control investments are those which CalSTRS maintains discretion over acquisitions, dispositions, and financing, or has high liquidity in normal market conditions.
Source: State Street

Real Estate Portfolio Growth

Portfolio NAV by Control

- CalSTRS' real estate portfolio NAV has decreased by $1.8B in the past six months to $50.0B (as of Q1 2023). The control portfolio is 77% of NAV as of Q1 2023.
- Legacy investments represent less than $0.5B of NAV, or just under 1% of the portfolio.



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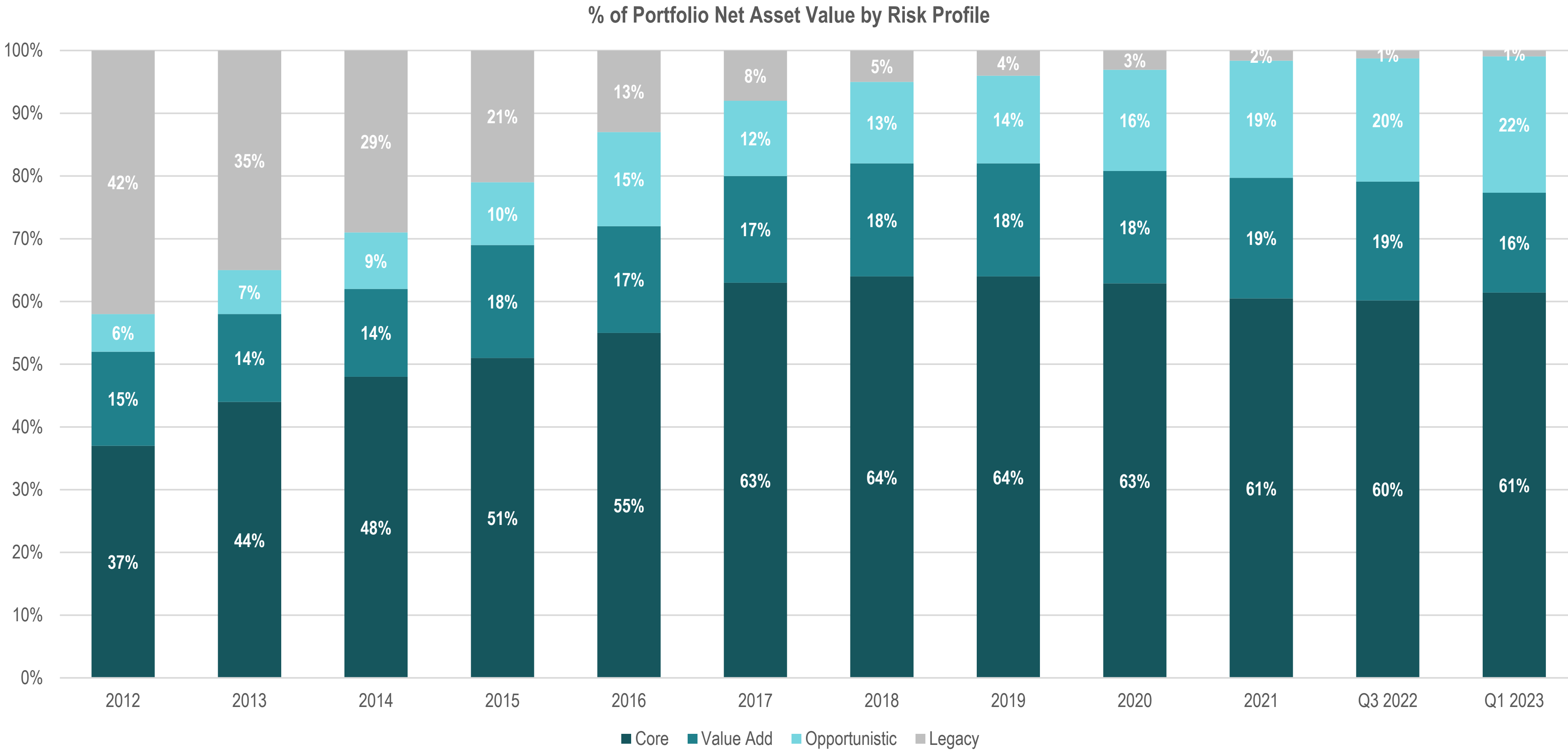
Weights based on percentage of CalSTRS' net asset value
Source: State Street

Portfolio Allocation

By Risk Profile

- Allocations to value-add investments have decreased 3% over the last six months while opportunistic and core allocations have each increased 2% and 1%, respectively.
- Legacy investment allocations have held steady around 1%.



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Weights based on percentage of CalSTRS' net asset value. REITs included in Core
Source: CalSTRS, State Street

APPENDIX: KEY MARKET TRENDS

RFA House View – Recession Likely but Soft Landing Possible

Base Case As of Q2 2023, ~65% Probability

- The **US economy remained on solid footing** through H1 2023 as fears of a downturn haven't materialized.
  - Economic **performance has exceeded expectations in 2023** as the impact of higher interest rates has been offset by strong labor markets and consumer spending. Services continue to outperform.
  - Our base case (65% odds) is that the US economy will enter into a **shallow recession (GDP decline < 1%) in late 2023** (or early 2024) and remain cool through 2024 as the impact of higher rates and tighter lending takes hold.
  - A **soft landing (no recession) has become more likely (20% probability)** assuming that companies avoid sizable layoffs (employee hoarding).
  - A **steeper downturn is still possible (15% probability)**, with a government shutdown, further credit problems and higher oil prices possible triggers.
- **Inflation will continue to subside as housing services and used vehicles data come in,** but CPI will remain elevated in 2023 (~4%) and likely won't approach the Federal Reserve's 2% target until 2025. Headline annual CPI was 3.2% in July, but core CPI was 4.7%, still a concern for the Fed.
- The **Federal Reserve raised the funds rate in July** by 25 bps, possibly the last increase of this cycle, although the Fed continues to stress "data dependence".
- The 10-Year US Treasury yield broke 4% in early August. Economists and futures markets expect that the **10-Year UST will hover in the 3.75-4.25% range for the next several years.**

U.S. Real Estate Summary

As of Q2 2023

- **Real estate fundamentals generally declined** in Q2 2023, and signs of near-term risk emerged in most property types (except industrial which remains strong).
  - **Multifamily** – Operating fundamentals deteriorated as economic headwinds cooled demand. New supply (500K units) outpaced net absorption (250K units) over the last year, sending vacancies to an 11-quarter high of 8.0% in Q2. Rent growth also slowed meaningfully, registering just 0.6%.
  - **Office** – Weak demand kept office absorption negative, totaling -35M SF over the last year. With 64M SF of new supply delivered over the same period, the average vacancy rate rose another 40 bps QoQ to 14.9%. Rent growth remained positive but modest at 0.7%.
  - **Retail** – Neighborhood center retail fundamentals held up in Q2. Trailing 4Q absorption was steady at 22M SF, just above historical average and far ahead of the 6M SF of new supply delivered. Vacancies fell to a new low of 6.0%, and rent growth was strong at 4.6% YoY.
  - **Industrial** – Fundamentals remained favorable despite continued moderation. Absorption declined but stayed strong at 290M SF, trailing the 490M SF of new supply over the last four quarters. The average vacancy rate increased to 4.7% in response, and rent growth cooled but remained robust at 9.0%.
  - **Hotel** – Spring and summer travel kept hotel fundamentals strong in Q2, consistent with seasonal expectations. Occupancy averaged nearly 67%, up notably QoQ and above its historical Q2 average of 64%. RevPAR and ADR also increased, and both set Q2 records at $104 and $157, respectively.
- **Private real estate returns remained negative in Q2** as NFI-ODCE and NPI posted quarterly returns of -2.7% and -2.0%, respectively. Appreciation returns were negative for the fourth consecutive quarter in both indices, driving trailing 4Q returns deeper into negative territory. Further negative appreciation (5-15%) is likely as appraisal values move closer to transaction values.
- **Real estate transaction volumes declined another 8% QoQ to $81B** in Q2, driven by sharp quarterly drop offs in retail and hotel deal volumes. Other property types recorded slight QoQ volume increases. Trailing 4Q totals decreased 49% to $500B and were down by at least 30% for all property types.
- **Real estate debt will likely remain scarce and expensive**, as lending officers continue tightening in the wake of regional bank troubles. Institutional dry powder rose slightly in Q2, but investors generally remain cautious. CRE distress and loan delinquencies are rising, adding downside risk to the market outlook.

RFA House View – Investment Implications

As of August 2023, 65% Probability

- **US real estate fundamentals have started to soften,** with moderately higher vacancy rates and slower rent growth. Further declines are likely through 2024, although the downturn will be modest by historical standards.
  - Industrial rent growth should stay strong at 5-6% annually through 2026.
  - Apartment rent growth will trend toward 2-3% but may suffer in a downside scenario.
  - Neighborhood retail rent growth will cool, but limited new supply will keep a floor under rents.
  - Net effective office rents will contract, and vacancy rates will hit new highs, approaching 20% by 2026.
  - Single-family for-sale prices are expected to fall; build-to-rent will gain additional share of new construction.
- **Real estate capital markets to remain constrained in 2023**. Borrowing costs have risen materially as base rates and spreads are up. The Fed is unlikely to lower base rates until mid-2024 although spreads could tighten. Institutions are constrained by valuation uncertainty and potential recession impacts, although wholesale selling is not likely. Transactions may pick up in 2024 once buyers adjust to reset prices (15-25% below peak) and the 'denominator effect' eases.
- RFA continues to recommend a **cautious investment approach in 2023**, as a wide bid/ask spread will persist.
  - Values for **many sectors will likely fall below replacement cost**, creating buying opportunities, although many office and retail properties may have limited future usefulness.
  - **Assuming that land prices adjust, solid fundamentals and long-term growth will support selective development** of rental residential, industrial, and some niche property types (life science, medical office).
  - **Widespread foreclosures/distress selling is unlikely**, except for office and regional malls.
  - Investors should focus on opportunities and markets with **strong long term demand drivers and fundamentals**.

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Property Markets Outlook

As Q2 2023

Multifamily

Multifamily fundamentals continued to decline as economic conditions dragged on consumer demand. Net absorption fell considerably behind new supply, leading to vacancy increases and sluggish rent growth.

The short- to mid-term outlook is likely to remain challenged as job losses threaten renters and elevated supply pipelines begin to deliver more inventory. The long-term outlook for the multifamily market remains favorable as demographic trends and the high cost of home-ownership are expected to continue to drive demand.

Office

Office's weak performance persisted through H1 2023 as net absorption remained sharply negative, adding to new supply delivered. Rent growth weakened but stayed positive while vacancies continued at record highs, underscoring the weakness of office fundamentals.

Newer office buildings performed more favorably as tenants' "flight to quality" continued. Absorption was positive, and rent growth was stronger in these properties. The trend towards greater employee flexibility is likely to remain a headwind for the sector.

Retail

Neighborhood center retail performance was favorable in Q2. Absorption remained strong relative to both historical averages and new supply. Vacancies fell to new lows, and rent growth was robust despite moderation.

NCREIF reports that overall retail NOI contracted in Q2, but growth varied broadly across retail subsectors. Regional mall NOI increased the most over the last four quarters (2.9%) but is still 5% below pre-pandemic levels. In contrast, neighborhood center NOI has grown the fastest since the pandemic's onset, up 5.4% cumulatively.

Industrial

Industrial remains the strongest major property type despite some moderation in operating fundamentals. Vacancies remain low and rent growth is still very high, but both have cooled from their 2022 records. Above average absorption has persisted, but deliveries have ramped up and are projected to continue rising.

Industrial fundamentals are expected to continue moderating but are likely to continue outperforming other property types in 2023-24.

Hotel

Hotel fundamentals have firmly reverted to pre-pandemic seasonality trends and were strong in Q2. Occupancies increased and outpaced historical averages while RevPAR and ADR both grew to record highs.

Hotel performance outlook depends in part on the degree to which business travel holds up in the coming years and how businesses and cities develop and adapt to post-pandemic work norms.

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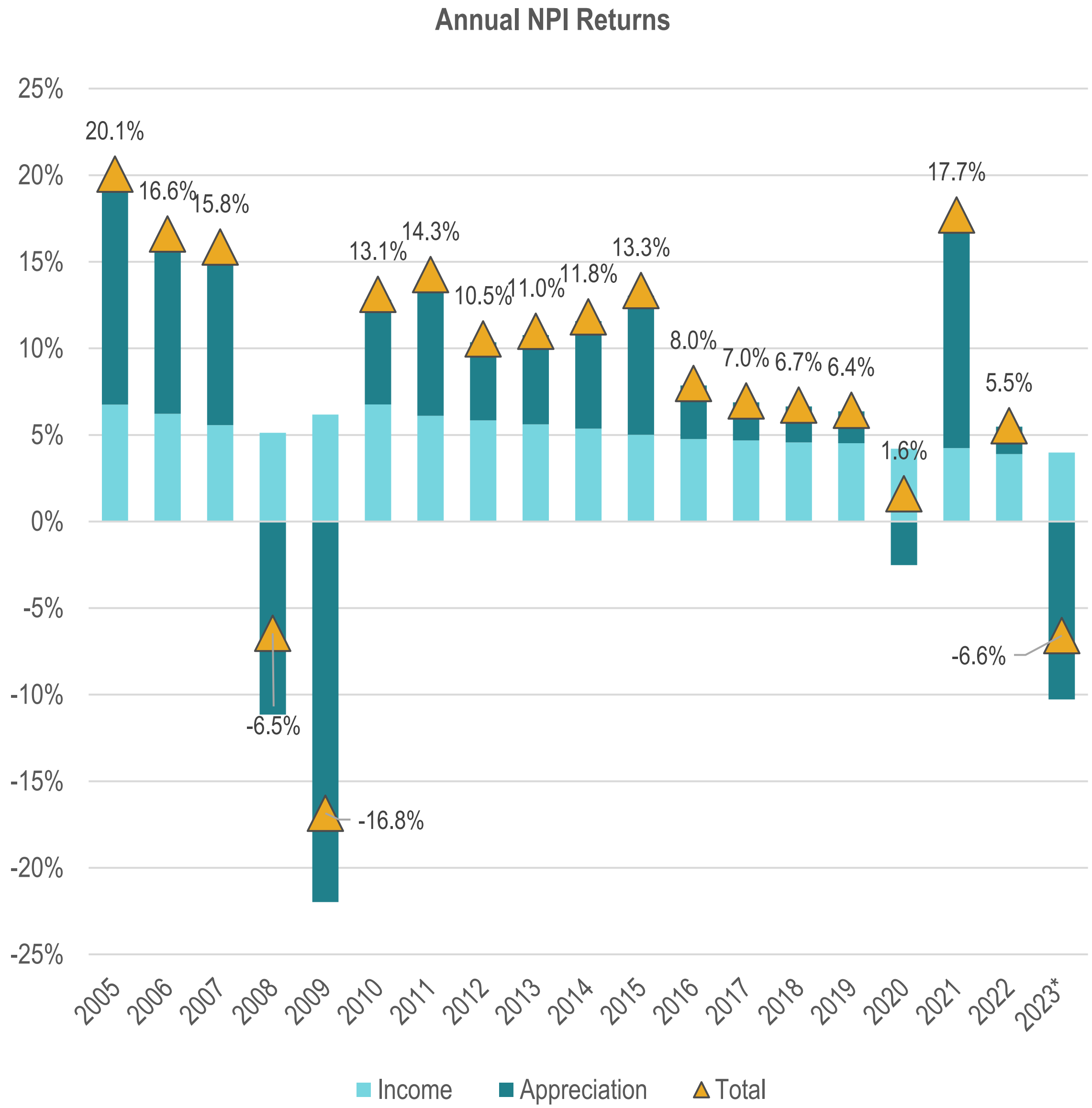
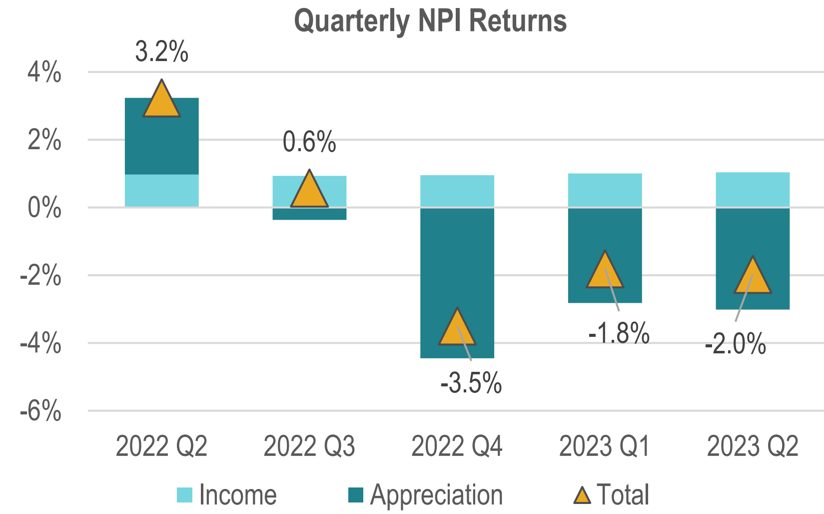
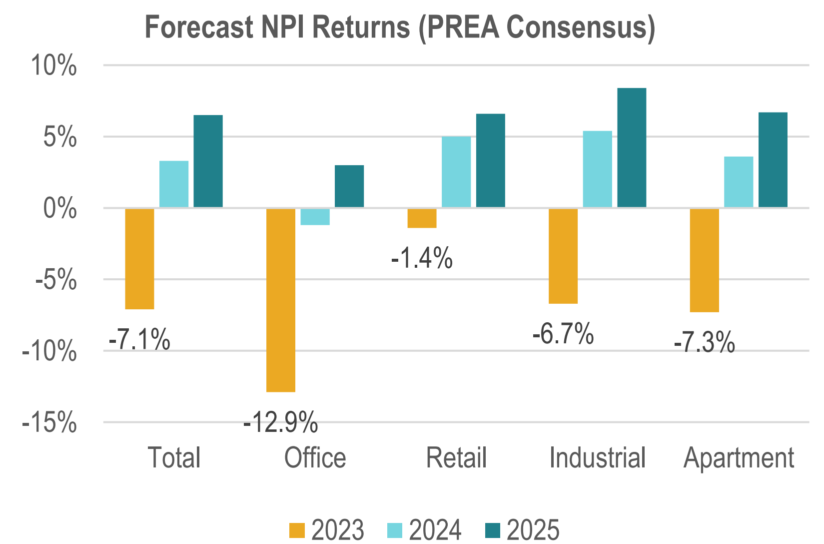
NPI Depreciation Continued to Drag Returns Negative in Q2

Office Returns Are Forecasted to Remain Negative Through 2024







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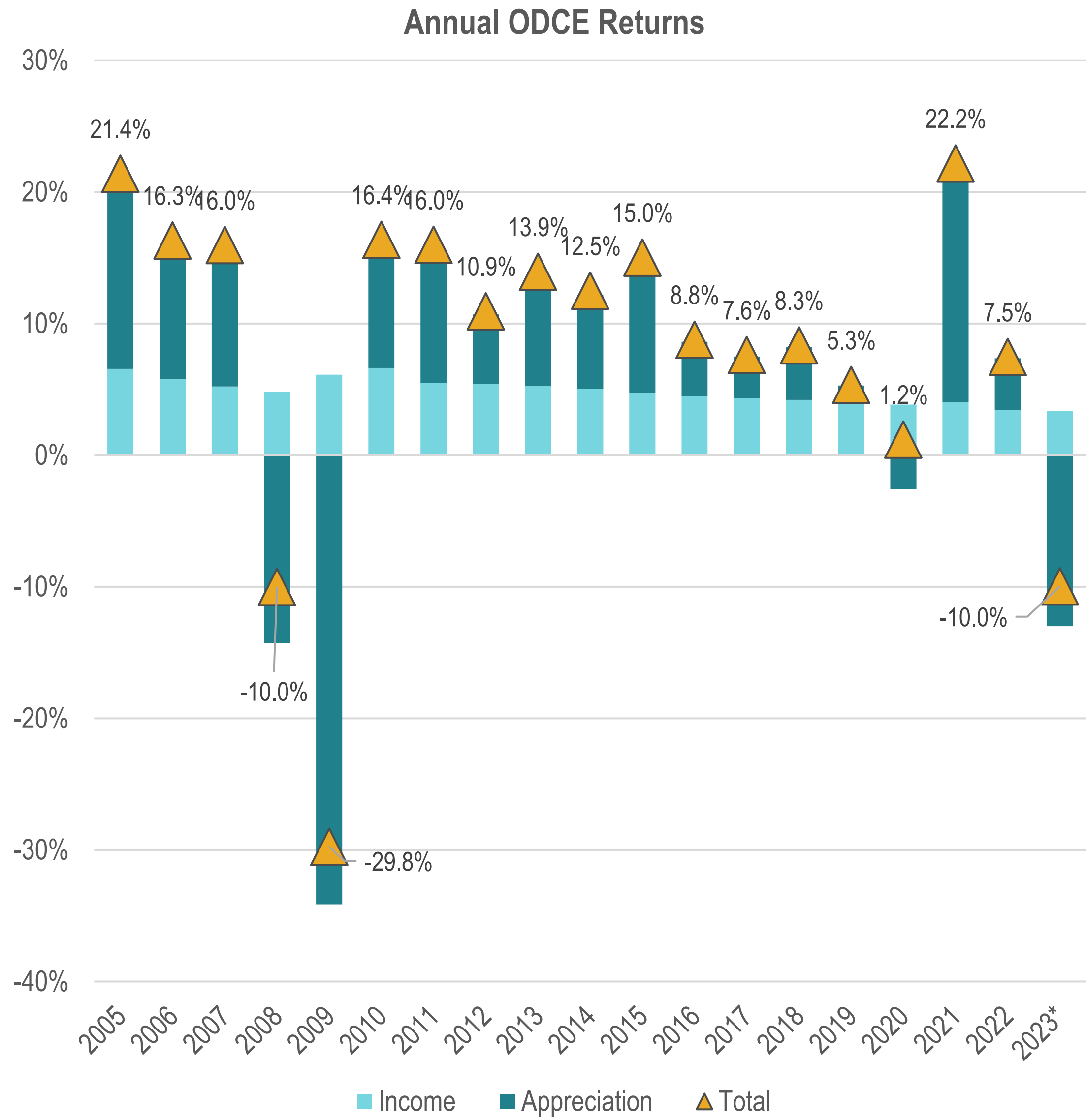
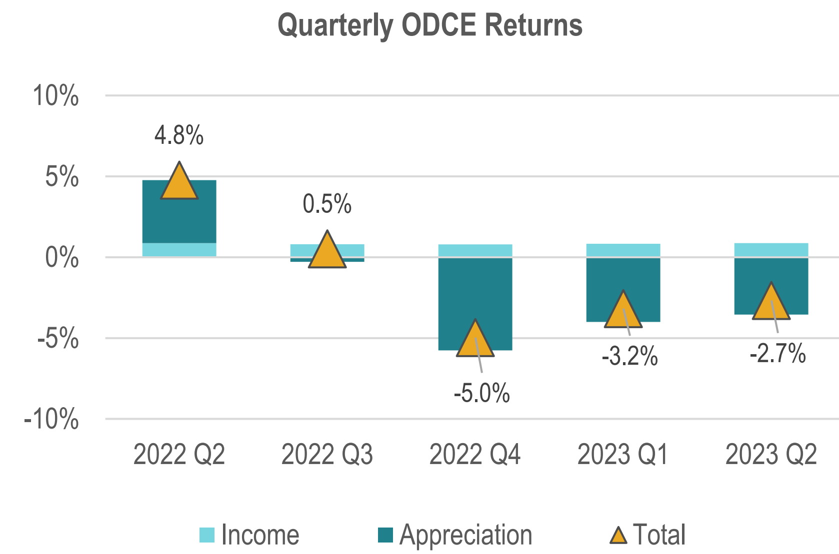
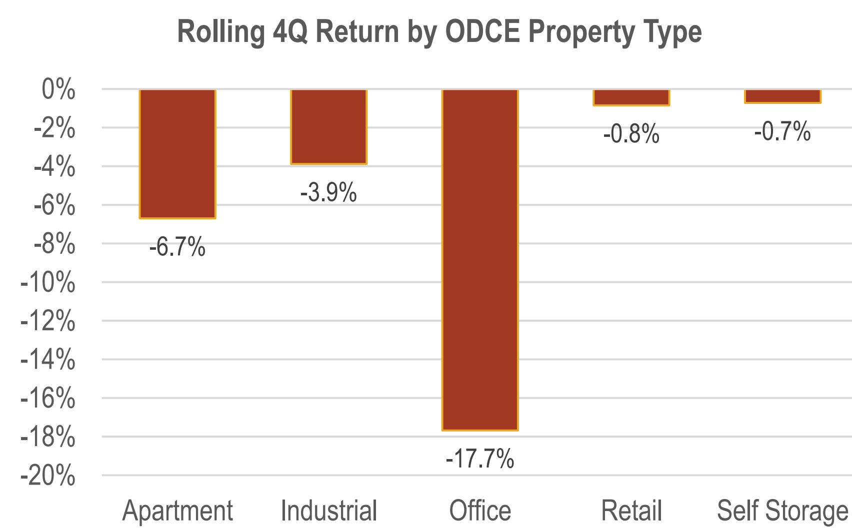
** Rolling four-quarter return as of 2022 Q4.*
Note: Returns are gross unlevered.
Source: NCREIF

ODCE Values Declined for a Fourth Consecutive Quarter

Trailing 4Q Returns Were Negative Across All Property Types in Q2







** Rolling four-quarter total as of 2022 Q4.*

Note: Total annual and quarterly returns are levered, gross of fees at ownership share; returns by property type are unlevered, gross of fees at ownership share.

Source: NCREIF

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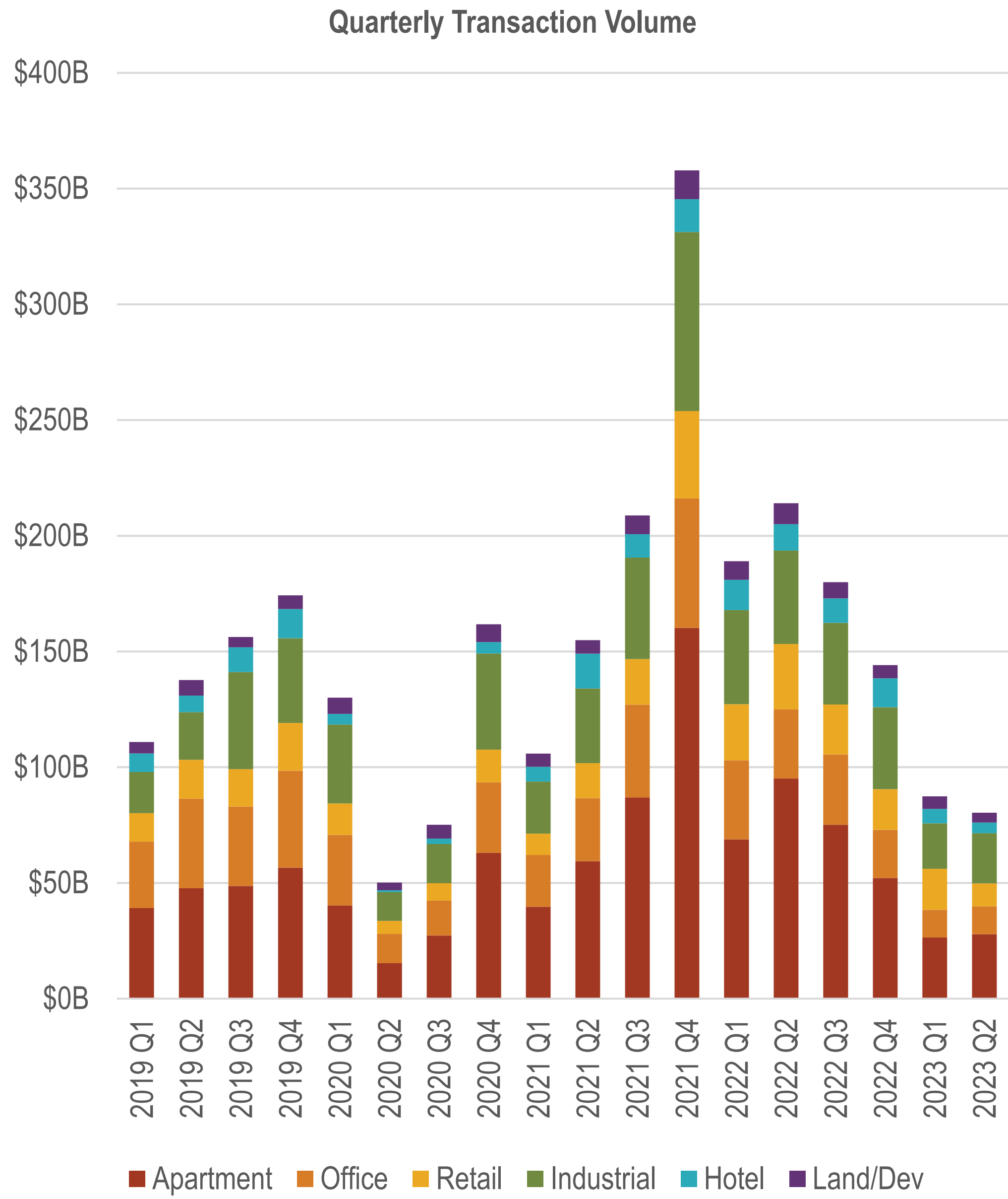
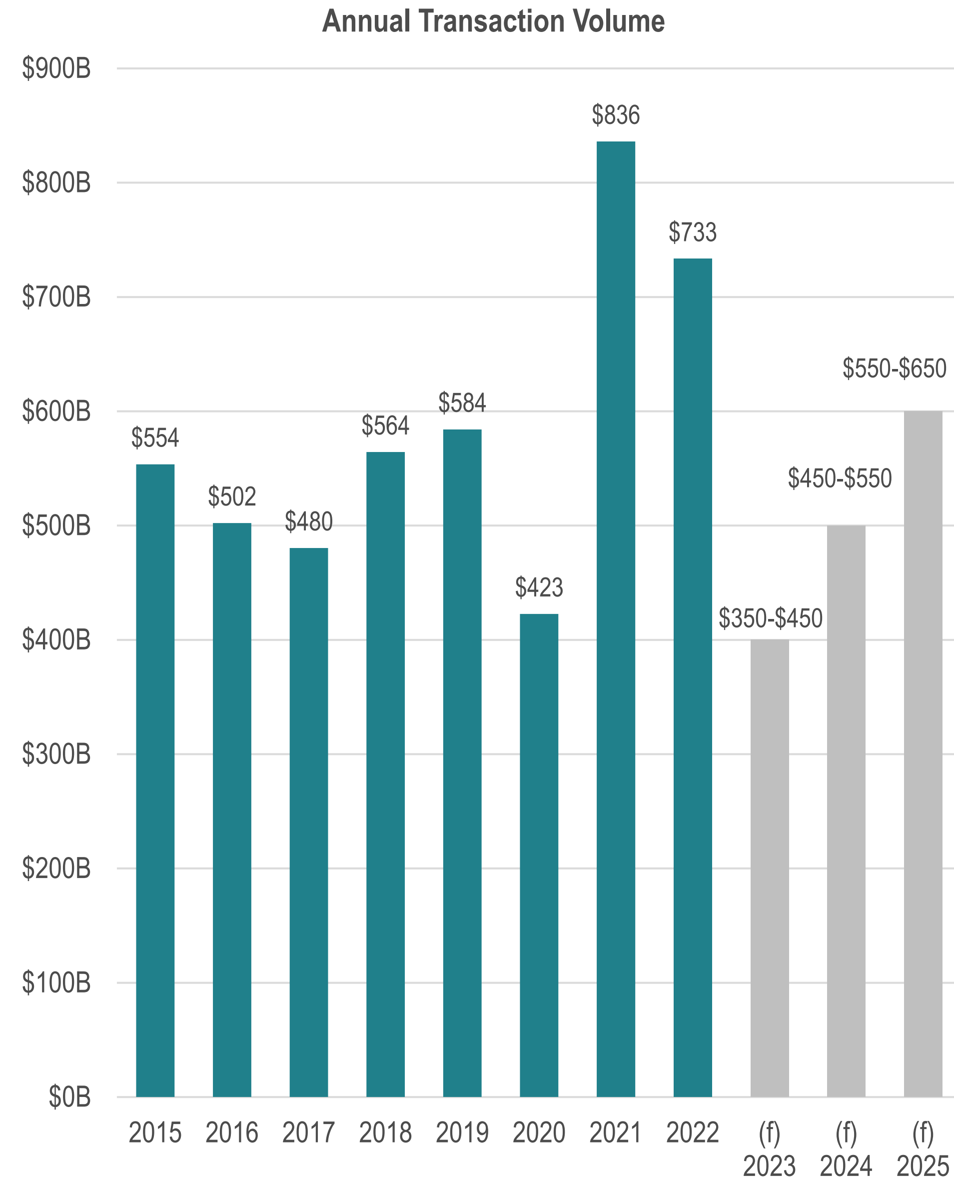
Transaction Volumes Have Fallen to Lowest Levels Since the Pandemic

Investment Activity Is Expected to Remain Depressed in 2023-24 With Wide Bid/Ask Spreads





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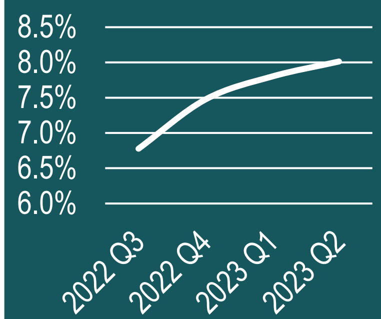
Source: RCA

Multifamily Property Market Overview

Near-term Outlook Deteriorates with Lagging Demand and Elevated Supply; Long-term Demand Still Strong

Vacancy

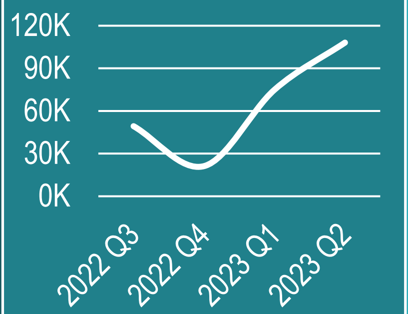
8.0% Vacant



Multifamily vacancy rates continued to increase for a seventh consecutive quarter, up 20 bps in Q2 to 8.0%, notably above their mid-2021 low of 5.4%. Vacancies were above their long-term average since 2000 of 7.2% and are projected to increase further as new supply outstrips demand.

Absorption

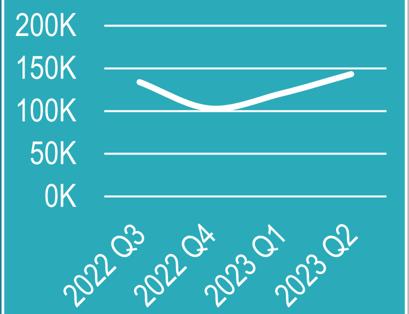
2.3% of Inventory



Net absorption has improved somewhat from its recent lows in H2 2022, increasing to 110K units in Q2 and 250K units on a trailing 4Q basis. Absorption is projected to be modest in H2 2023 as renters face economic headwinds, but demand is expected to increase somewhat again in 2024.

New Supply

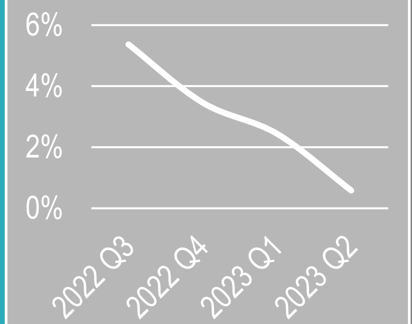
4.6% of Inventory



New supply has been largely consistent, between 100K and 150K delivered units per quarter, totaling 500K over the last four quarters. Supply is expected to continue outpacing absorption by 1.5-2X through 2023. The gap is projected to narrow in 2024 and reach equilibrium in late 2024 or early 2025.

Rent Growth

0.6% YoY



YoY rent growth fell to just 0.6%, its lowest rate since Q4 2020. Rent growth is projected to remain positive but <1% through early 2024, with long-term average growth (~2.3%) resuming by the end of 2024.

Transaction Volume

$28B

Transaction volume remained muted in Q2 at $28B, well below its long-term average quarterly volume of $45B. Investor activity is expected to remain depressed in the face of elevated borrowing costs and wide bid-ask spreads.

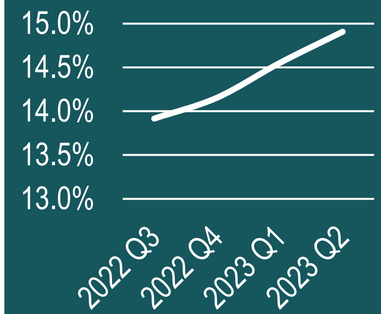
Note: Throughout this section, multifamily data are filtered for Class A&B; rent growth and vacancy are rolling four-quarter averages; absorption and completions are four-quarter totals; rent is based on asking market rent data.
Source: CoStar; RCA

Office Property Market Overview

Operating Fundamentals Decline Further; Some Variation by Asset as a “Flight to Quality” Drives the Sector

Vacancy

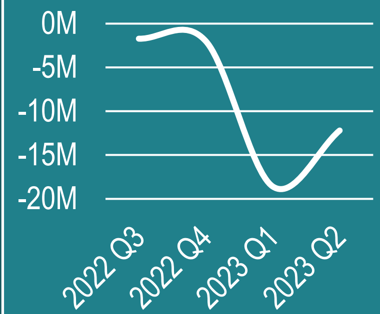
14.9% Vacant



Office vacancies continue to swell to record highs, climbing 40 bps QoQ to 14.9%, far above their long-term average of 11.9%. Overall vacancy is projected to continue rising for the next several years.

Absorption

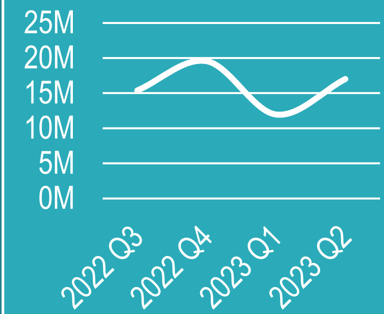
-0.5% of Inventory



Net absorption fell more sharply negative in H1 2023 at -12M SF in Q2 and -34M SF over the last four quarters. Overall absorption is projected to remain negative through the next several years; however, newer office vintages have recorded positive absorption.

New Supply

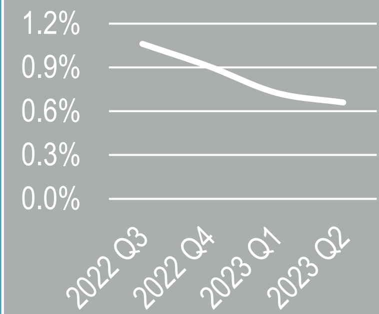
0.9% of Inventory



New supply increased modestly to 17M SF in Q2 for a trailing 4Q total of 64M SF in deliveries. Including absorption losses, office inventory increased by almost 100M SF over the last year. Deliveries are expected to increase in H2 2023 before moderating in 2024 and 2025.

Rent Growth

0.7% YoY



Rent growth held steady in Q2 at 0.7%. Rents are projected to begin contracting in late 2023 or early 2024 with persistently negative growth for several years as anemic demand affects the office sector. Rent growth is expected to vary across properties as a “flight to quality” dynamic shapes the sector.

Transaction Volume

$12B

Quarterly transaction volume held steady at $12B, roughly a third of its long-term average of $32B. Uncertainty in the office sector around pricing and demand dragged on investor activity in the space.

Note: Throughout this section, office data are filtered for Class A&B; rent growth and vacancy are rolling four-quarter averages; absorption and completions are four-quarter totals; rent is based on asking market rent data.

Source: CoStar; MSCI

Retail Property (Neighborhood Center) Market Overview

Neighborhood Retail Centers Display Resilience Aided by Low New Supply

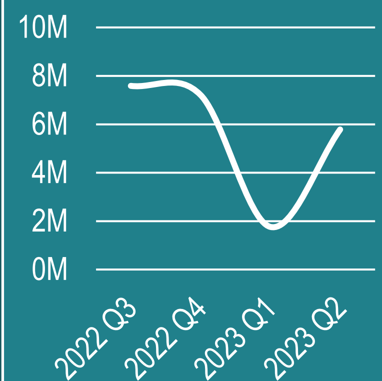
Vacancy

6.0% Vacant

Neighborhood center vacancy contracted 20 bps to 6.0% in Q2, significantly below its long-term average since 2010 of 8.4%. Vacancy is projected to increase slightly but remain near its current low for the next several years.

Absorption

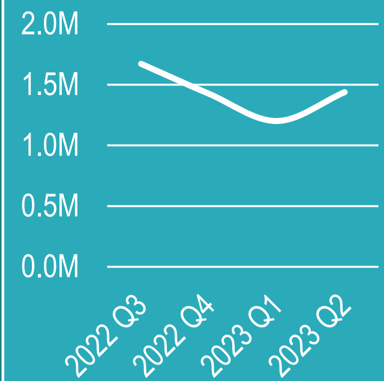
0.7% of Inventory



Net absorption increased in Q2, totaling 5.8M SF over the quarter and 22M SF on a trailing 4Q basis, marginally above its post-GFC average of 20M SF. Neighborhood center absorption is expected to cool in H2 2023 with negative absorption possible in late 2023 or early 2024.

New Supply

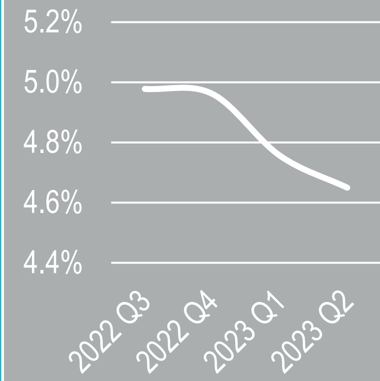
0.2% of Inventory



New supply increased marginally to 1.4M SF in Q2, totaling just under 6M SF of deliveries over the last four quarters, roughly 25% of net absorption. Retail deliveries are expected to increase slowly over the next year and surpass absorption possibly as soon as YE 2023.

Rent Growth

4.6% YoY



Rent growth continued to cool from its recent records but remained strong at 4.6% in Q2. Growth rates are expected to continue falling with modest rent contractions predicted in mid-2024 as demand falls off and supply increases.

Transaction Volume

$10B

Retail transaction volume declined over 44% QoQ to $10B, just over half of its average quarterly volume of $19B. Investor activity is expected to remain below average and concentrate in more e-commerce resistant subsectors.

Note: Throughout this section, retail data only include neighborhood centers and small community centers; rent growth and vacancy are rolling four-quarter averages; absorption and completions are four-quarter totals; rent is based on asking market rent data.
Source: CoStar; MSCI

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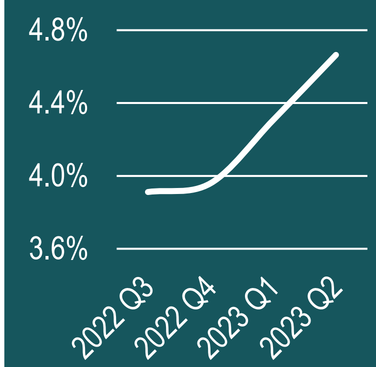
Industrial Property Market Overview

Sector Remains Strong and Favorably Positioned for Continued Growth Despite Moderating Fundamentals

Vacancy

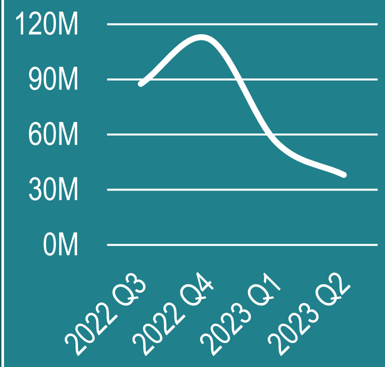
4.7% Vacant



Vacancy increased another 40 bps to 4.7%, still well below its long-term average since 2000 of 7.2%. Industrial vacancies are forecasted to increase from their recent record lows and stabilize around 5.5-6% in 2024 and 2025.

Absorption

1.6% of Inventory



Net absorption declined sharply, falling to under 40M SF in Q2 for a trailing 4Q total of 290M SF, still well above its long-term average of 180M SF. Absorption is projected to remain below its recent highs but stay strong through 2025 in response to robust demand for logistics space.

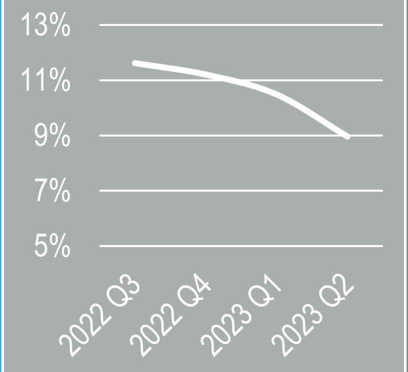
New Supply

2.6% of Inventory

New supply moderated further to 110M SF in Q2, totaling 490M SF over the last year, outpacing absorption by almost 70%. Deliveries are projected to increase again in H2 2023 and remain above absorption through most of 2024 before returning to equilibrium.

Rent Growth

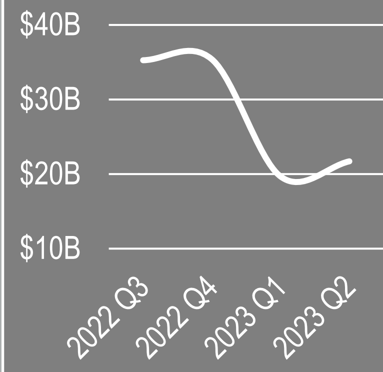
9.0% YoY



Rent growth has continued to moderate from its record-setting run in 2022 but remained exceptionally strong at 9.0%. Rent growth is projected to continue cooling in 2023 and 2024 but anticipated to remain elevated until industrial supply meaningfully catches up to demand.

Transaction Volume

$22B



Quarterly transaction volume ticked up modestly to $22B, 10% below its average quarterly volume of $24B. Investor activity is expected to remain muted in coming quarters.

Note: Throughout this section, rent growth and vacancy are rolling four-quarter averages; absorption and completions are four-quarter totals; rent is based on asking market rent data.
Source: CoStar; MSCI

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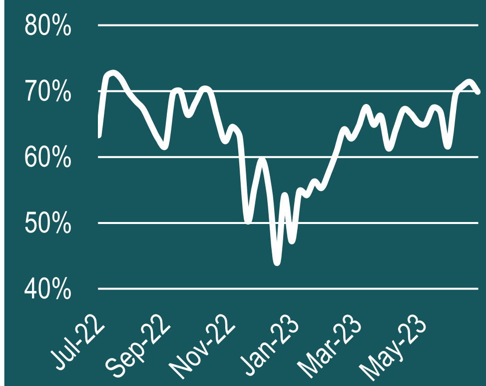
Hotel Property Market Overview

Fundamentals Held Steady at Strong Levels Throughout Q2, Consistent with Seasonal Expectations

Occupancy

66.7%



Hotel occupancy entered the quarter at 66% and held steady through Q2, averaging just shy of 67% and ending the quarter up to almost 70%. Quarterly average occupancy increased nearly 7 ppts QoQ but was down by a modest 30 bps YoY.

Revenue per Available Room

3.0% Up YoY

RevPAR followed a similar trend, starting Q2 at $105 and averaging $104 over the quarter, up 15% QoQ and 3% YoY. It ended Q2 at $109, slightly higher than its quarterly average rate.

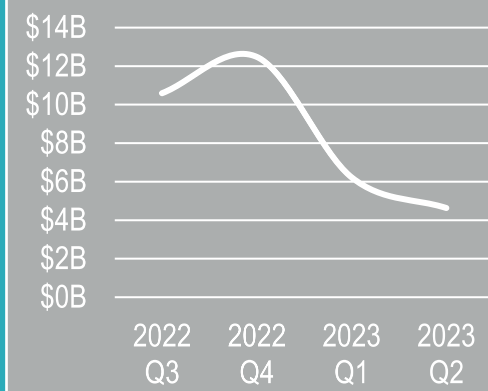
Average Daily Rate

3.6% Up YoY

ADR stood at $158 at the beginning of the quarter and averaged $156 in Q2, ending the quarter at the same rate. ADR's QoQ increase was more modest at 3.0%, but its YoY increase was slightly larger at 3.6%.

Transaction Volume

$5B



Hotel transaction volume declined another 25% QoQ to a 10-quarter low of $5B, just over half of its long-term quarterly average of $9B. Capital market conditions are likely to continue to chill investor activity in commercial real estate markets, including hotels.

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Note: Throughout this section, rent growth and vacancy are rolling four-quarter averages; absorption and completions are four-quarter totals; rent is based on asking market rent data.
Source: CoStar; MSCI

Disclaimers

Critical Assumptions

Our analysis depends on the correctness and completeness of data available as of the date of this memo. The future performance of the global, national, and local economy and real estate market, and other factors similarly outside our controlled may vary. Given the fluid and dynamic nature of the economy and real estate markets, as well as the uncertainty surrounding particularly the near-term future, it is critical to monitor the economy and markets continuously. Stable and moderate growth patterns are historically not sustainable over extended periods of time; the economy is cyclical; and real estate markets are typically highly sensitive to business cycles. Further, it is very difficult to predict when an economic and real estate upturn will end.

Our analysis cannot predict unusual economic shocks on the national and/or local economy, potential benefits from major "booms" that may occur, or the residual impact on the real estate market and the competitive environment of such a shock or boom. Also, it is important to note that it is difficult to predict changing consumer and market psychology.

As such, we recommend the close monitoring of the economy and the marketplace, and updating this analysis as appropriate.

General Limiting Conditions

Reasonable efforts have been made to ensure that the data contained in this study reflect accurate and timely information and are believed to be reliable and comprehensive. This study is based on estimates, assumptions, and other information developed by RCLCO Fund Advisors from its independent research effort and general knowledge of the industry. No responsibility is assumed for inaccuracies in reporting by any data source used in preparing or presenting this study. This memo is based on information that to our knowledge was current as of the date of this memo, and RCLCO Fund Advisors has not undertaken any update of its research effort since such date.

***Cover Image:** Fairfield Aspect at Totem Lake, Kirkland, WA*

***Table of Contents Images**: 12521 Los Nietos Road, Santa Fe Springs, CA*

***Back Cover Image**: Fairfield North at Totem Lake, Kirkland, WA*

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