BARINGS

U.S. Real Estate

QUARTERLY RESEARCH

2Q 2020

20-1288709

Executive Summary

ECONOMY

- The U.S. economy is recovering from the sharp fall in output and increase in job losses caused by the pandemic and containment measures designed to "flatten the curve."
- The initial shape of the rebound will be V-like, but the near-term path of the economy and job market remains highly uncertain.
- Massive fiscal and monetary stimulus is supporting the U.S. and global economies and financial markets for now, but both will likely need continued support.
- Significant job losses since February will be a headwind to near-term growth, but consumers appear to be tentatively regaining confidence, and getting back to spending more and saving less.
- Our base case continues to look for a modest bounce back in the second half of the year, followed by more tempered growth in 2021, and a slow and uneven recovery to pre-COVID levels of output and employment.

PROPERTY MARKETS

- The impact of the pandemic is beginning to show up in second quarter property market fundamentals—demand across most property types remains weak, as tenants await further clarity on the near-term and post-pandemic outlook.
- Apartment asking rents have fallen and concessions have increased as new supply continues to come online, but occupancies and rent collections have held up better than expected.
- Warehouse demand remains firm, as e-commerce and omni-channel retailers scoop up modern facilities to support growing online purchases.
- Office fundamentals have weakened noticeably as leasing came to a halt in the second quarter, while supply continued apace and sublease availability increased.
- Foot traffic at retail centers is showing tentative signs of recovery, but the steady drumbeat of retailer bankruptcies and store closures underscores the difficult road ahead.
- Hotel demand has also picked up, as travel restrictions have been lifted and leisure travelers have begun to venture out, but business travel will remain tepid as long as the virus remains a threat.

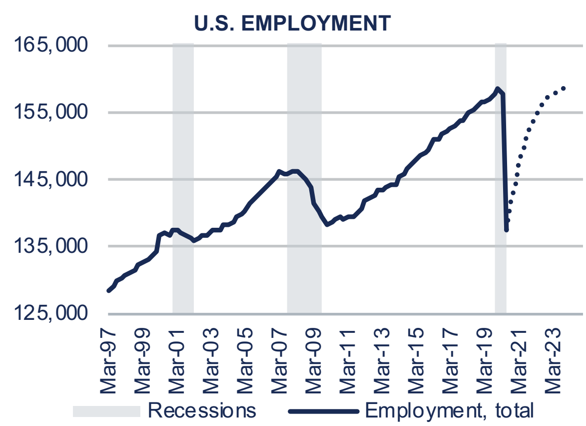
Economic Outlook

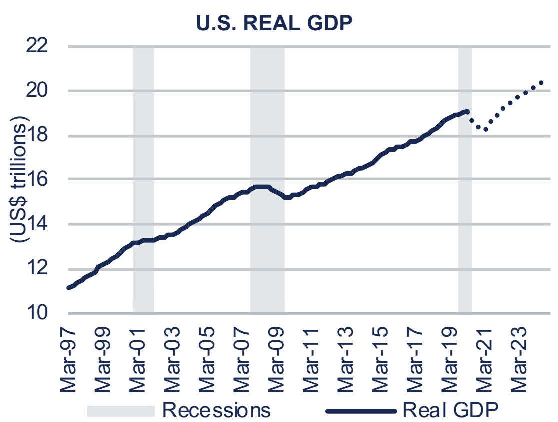
The U.S. economy is awakening from the induced coma designed to “flatten the curve” of COVID-19. As activity resumes and businesses reopen, data for everything from jobs to consumption is showing a rebound from the stunningly depressed levels in the second quarter. For many data series, the initial shape of the rebound will undoubtedly be V-like, giving hope that the recovery will be as swift as the collapse. Unfortunately, the V-shape may say more about the speed and severity of the downturn than the path ahead, particularly as the curve of infections in the U.S. steepens with surging new case counts across much of the South and West.

While the worst of the economic damage is likely behind us, even with the wave of new cases, the near-term trajectory of the economy and job market remains highly uncertain and dependent on medical progress in finding an effective treatment, cure or vaccine. Unlike the global financial crisis (GFC), however, the coronavirus recession was not caused by excesses in the financial markets or the economy. Rather, at the onset of the crisis, the global banking system was in relatively good shape, and virtually everything was looking up for many—though certainly not all—U.S. consumers. Unemployment was at a generational low; wages were rising; major stock indexes were at or near their all-time highs; household balance sheets were healthy; and even the housing market seemed to be gaining some momentum.

The significant job losses since February clearly have changed that narrative, even after the healthy job gains in May and June. But the “system” is largely intact, and at least for now, massive fiscal and monetary stimulus is supporting the economy and financial markets while science pursues a more lasting solution. Consumers appear to be tentatively regaining confidence and getting back to spending more and saving less. But it remains to be seen how well spending and sentiment will hold up in the face of surging COVID-19 cases, and what will likely be a contentious election, especially if benefits from fiscal stimulus programs are allowed to expire or are scaled back significantly. Our base case continues to look for a modest bounce back in the second half of the year, which may include a sharp rebound in the third quarter, followed by more tempered growth next year. However, we expect that the recovery back to pre-COVID output and employment levels will be slow and uneven, and likely will be measured in years, not quarters.

U.S. ECONOMY HAS BOTTOMED, UNEVEN RECOVERY AHEAD





Sources: Oxford Economics, National Bureau of Economic Research, Barings Real Estate Research. As of July 2020.

Capital Markets

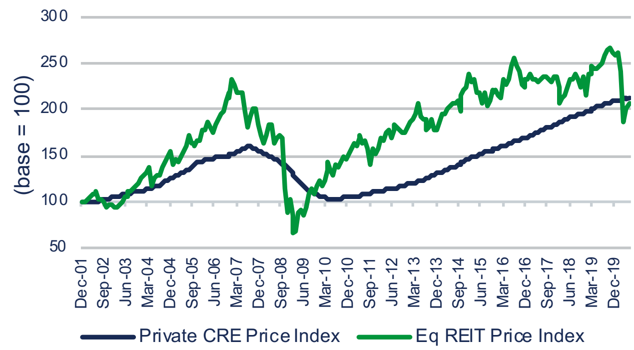
Swift and decisive actions by the U.S. Federal Reserve (Fed) and other central banks around the world have provided critical liquidity and support to the financial markets since the coronavirus outbreak. Nowhere is this support more appreciated—and perhaps more than fully priced in—than in the U.S. stock market, which has fully recovered from the more than 30% plunge in March.

Not all companies or sectors have participated in the rally, of course, and the list of losers includes most U.S. REITs. Through the second quarter, the FTSE NAREIT U.S. equity REIT index was down more than 20% year-to-date (YTD). However, performance varied widely across sectors, ranging from declines of more than 50% for hotel and mall REITs, to modest gains for industrial REITs, and nearly 20% gains for data centers, which are currently hosting much of the activity that took place in physical properties before COVID-19.

The impact of the pandemic on private market valuations will take longer to discern. Transaction activity collapsed in the second quarter, making price discovery almost impossible. According to Real Capital Analytics (RCA), U.S. transaction volume for the three months from April through June sunk below $50 billion for the first time since the first quarter of 2011, but average prices across all major property types have held firm so far. Through June, RCA's Commercial Property Price Index (All Property) was up 0.9% YTD, led by a 3.6% YTD average gain for industrial and a 1.7% increase for apartments.

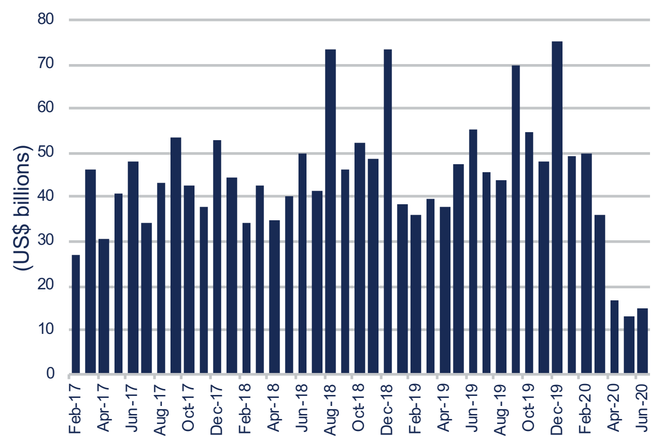
Performance likely will be weaker for the balance of 2020. The preliminary second quarter estimate for NCREIF's ODCE fund index showed a -1.6% total return for the quarter, which included a -2.5% appreciation return. How far prices might fall and for how long depends partly on the unknowable duration of the pandemic, and how long the economy will be forced to operate at constrained capacity. For now, capital remains readily available for apartment and industrial properties, selectively available for office, and is generally unavailable for retail and hotels.

PUBLIC VS. PRIVATE REAL ESTATE PRICING



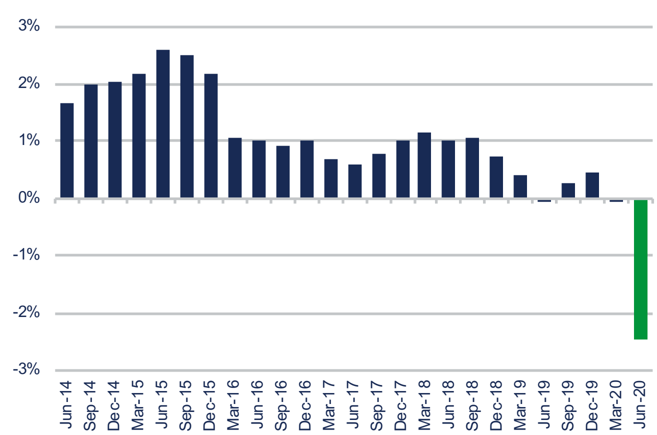
Sources: Real Capital Analytics, NAREIT. As of June 2020.

MONTHLY TRANSACTION VOLUME



Source: Real Capital Analytics. As of June 2020.

NFI-ODCE QUARTERLY APPRECIATION RETURNS



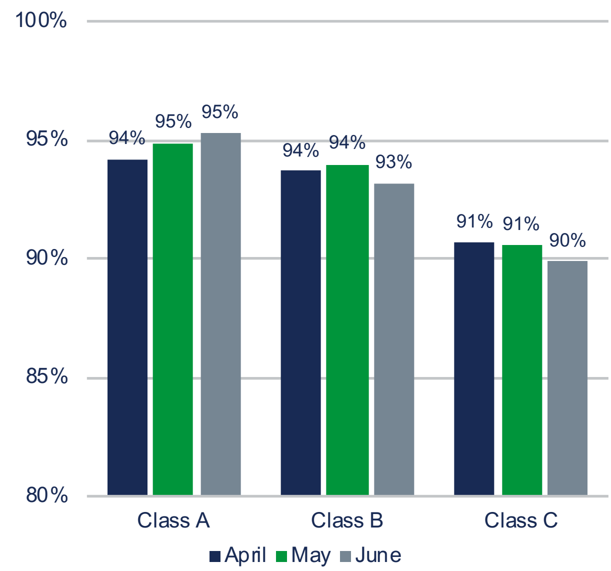
Source: NCREIF. As of June 2020.

Property Markets

APARTMENT

The effects of COVID-related pressures on the apartment sector are finally beginning to appear in data releases. According to CBRE-EA, vacancy at the national level has increased 70 basis points (bps) year-over-year, and asking rents in most major markets have declined since the onset of the pandemic. Unsurprisingly, concessions have spiked in markets experiencing elevated new supply deliveries, as projects struggle to lease in an environment of weak demand and limited mobility. Rent collections, however, have held up better than many expected when the pandemic began. Going forward, we expect continued near-term challenges, as leasing demand stays subdued relative to pre-COVID levels and the virus remains a threat. Long term, we still believe the sector offers attractive opportunities as structural demand tailwinds remain in place, mortgage credit availability remains constrained, and single-family home prices remain out of reach for many households.

APARTMENT RENT COLLECTIONS HAVE HELD UP

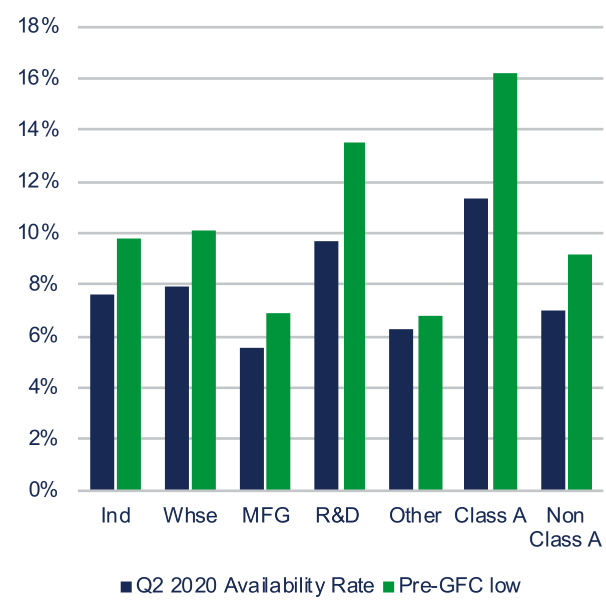


Source: JLL. As of June 2020.

INDUSTRIAL

Continued demand for industrial property helped keep fundamentals stable in the first half of 2020, even though supply outpaced net absorption for a sixth consecutive quarter. Per CBRE-EA, the national availability rate increased 30 bps to 7.6% during the second quarter, the smallest increase among the four main property types. The increase was driven by weak demand for manufacturing and R&D, while the resilient warehouse sub-sector reported positive net absorption that was only slightly below the levels seen one year ago. The recent increase in non-store retail sales is further proof of the rising ubiquity of e-commerce, as closures of brick-and-mortar retail stores shifted consumption online. We expect that a portion of this shift will turn permanent post-pandemic, as consumers settle into the convenience and routine of both home and “click-and-collect” delivery modes. Other structural shifts (e.g. increase in the inventory-to-sales ratio and the reconfiguration of retail supply chains) will further boost industrial demand over the long run, strengthening the investment case for the sector.

INDUSTRIAL AVAILABILITY BELOW PRE-GFC LOWS



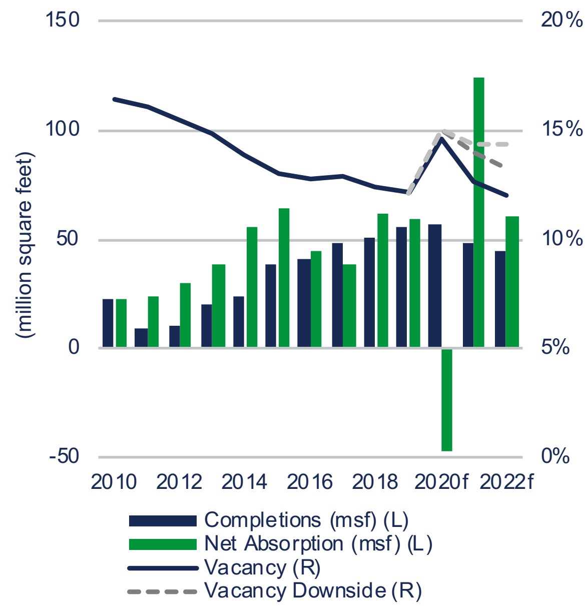
Source: CBRE-EA. As of June 2020.

Property Markets

OFFICE

COVID-19 has taken a toll on the office sector, with widespread negative net absorption reported for the second quarter. Per CBRE-EA, U.S. office vacancy increased 70 bps to 13% during the second quarter, driven by more than 20 million square feet (MSF) of negative net absorption, a level matching the worst quarter during the GFC. Completions totaled 7.8 MSF, slightly less than half of 16 MSF projected pre-COVID, reflecting construction delays and suggesting a spike in new supply likely in late 2020 and early 2021. Office demand will remain under pressure during the second half of the year. Densely populated, public transit-dependent urban centers and markets with elevated new supply are most at risk until the pandemic is contained, but the long-term impact is harder to predict. While it's still too early to tell how office demand and use might change, some large firms reportedly are putting leasing decisions on hold to reassess their space needs in a post-COVID world.

OFFICE DEMAND IS ON HOLD

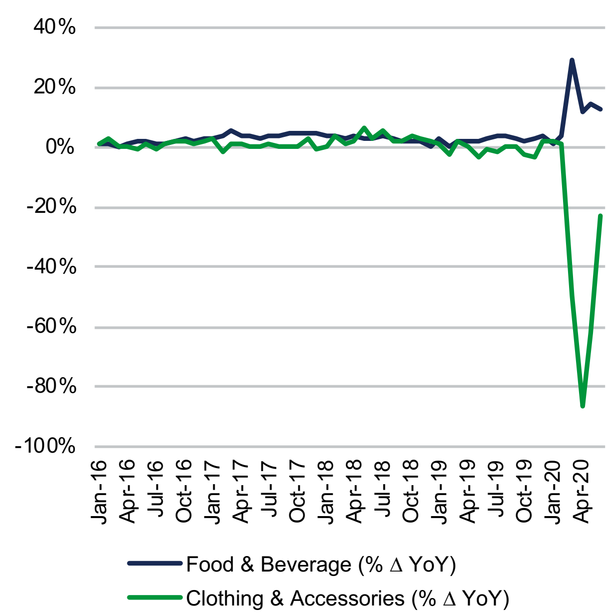


Source: CBRE-EA. As of June 2020.

RETAIL

Improving consumer sentiment has translated into a tentative rebound in spending. Although discretionary spending remains far below levels seen one year ago, many non-essential categories rebounded in June. Spending on essential goods has moderated a bit after surging in the early months of the coronavirus outbreak, but sales through June remain well above levels seen one year ago. In the near term, we expect consumers will continue to rely on their local grocery-anchored centers for daily necessities, even as new COVID-19 cases surge and authorities re-impose containment measures. Many consumers have become accustomed to alternative approaches to shopping—such as buying online and picking up in store (or curbside)—and more retailers have adapted store operations to serve online fulfillment. While we expect online shopping will continue to take market share from traditional brick-and-mortar sales, we believe omni-channel retailing with local fulfillment through retail centers will likely remain an important part of retailers' strategies, and will continue to bring foot traffic to neighborhood and community centers.

NARROWING GAP BETWEEN DISCRETIONARY AND NON-DISCRETIONARY SALES



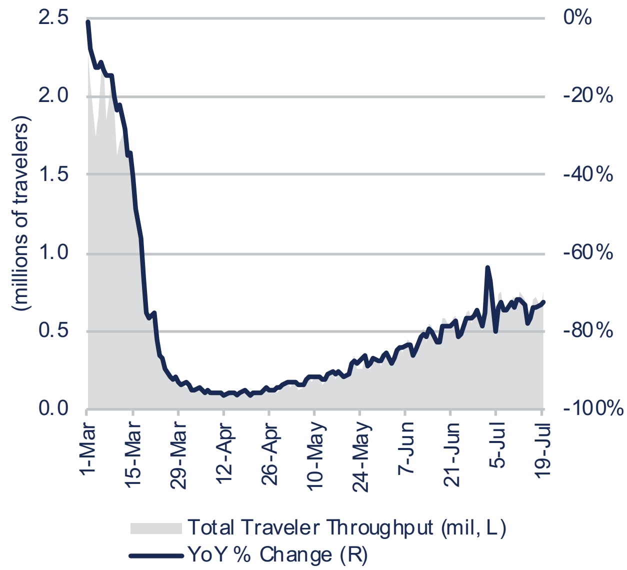
Source: U.S Census Bureau. As of June 2020.

Property Markets

HOTELS

The lodging sector has taken the most severe hit from COVID-19, and remains under pressure as business and leisure travel have come to a near halt, and as surging cases threaten to push back the demand recovery. Despite near-term headwinds, green shoots of a recovery are beginning to emerge. As of mid-June, revenue per available room (RevPAR) at the national level has rebounded 159% since bottoming out during the second week of April. However, it remains 51% off February highs, and more than 60% lower than the same week in 2019. High frequency is more encouraging, and suggests consumers are slowly returning to air travel, but the lodging outlook is murky over both the near and long term. In the near term, surging new infections—especially in states that reopened early and reported a rebound in lodging demand (e.g. Florida and Arizona)—threaten to put the demand recovery on hold. Longer term, broader adoption of virtual meeting technologies (e.g. Zoom and WebEx) is a headwind for business travel, as corporations reassess travel needs.

HOTEL ROOM DEMAND HAS DISAPPEARED



Source: TSA. As of July 2020.

SUMMARY

Nearly six months into the COVID-19 pandemic, businesses and individuals are still learning to adapt to living with a potentially deadly virus with no proven cure, treatment or vaccine. While many of the adaptations will prove temporary once the threat of the virus recedes, others—such as broader adoption of technology—will alter future demand and use for different types of property. In the near term, leasing and sales activity will likely remain subdued, as tenants and investors await further clarity on the outlook for the economy and demand in a post-COVID world. Longer term, the outlook for much of the commercial real estate universe remains positive against a backdrop of a slow-growth, low-return world. But the pandemic has changed the risk-return profile across and within different sectors, and investors will need to respond accordingly.

About the Team

BAI Research & Analytics is led by Colin Gordon and consists of 12 members that sit alongside the investment team globally. BRE's research team efforts are led by Philip Conner in the U.S. and Paul Stewart in Europe. The research team is structured by sector and geographic expertise. The team's diverse background includes appraisal, legal, technological and academic applications, across multiple asset-classes, across buy and sell-side shops in markets around the globe. The real estate research team is complemented by an analytics function enhancing the team's ability to collect, augment and analyze data to inform better decision making.

Philip Conner
Head of Real Estate Research & Strategy—U.S.

Ryan LaRue
Director

Ryan Ma
Managing Director

TJ Parker
Managing Director

Abby Rosenbaum
Director

Important Information

Any forecasts in this document are based upon Barings opinion of the market at the date of preparation and are subject to change without notice, dependent upon many factors. Any prediction, projection or forecast is not necessarily indicative of the future or likely performance. Investment involves risk. The value of any investments and any income generated may go down as well as up and is not guaranteed. Past performance is no indication of current or future performance. PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS. Any investment results, portfolio compositions and or examples set forth in this document are provided for illustrative purposes only and are not indicative of any future investment results, future portfolio composition or investments. The composition, size of, and risks associated with an investment may differ substantially from any examples set forth in this document. No representation is made that an investment will be profitable or will not incur losses. Where appropriate, changes in the currency exchange rates may affect the value of investments. Prospective investors should read the offering documents, if applicable, for the details and specific risk factors of any Fund/Strategy discussed in this document. For Professional Investors / Institutional Investors only. This document should not be distributed to or relied on by Retail / Individual Investors. Barings LLC, Barings Securities LLC, Barings (U.K.) Limited, Barings Global Advisers Limited, Barings Australia Pty Ltd, Barings Japan Limited, Barings Real Estate Advisers Europe Finance LLP, BREAE AIFM LLP, Baring Asset Management Limited, Baring International Investment Limited, Baring Fund Managers Limited, Baring International Fund Managers (Ireland) Limited, Baring Asset Management (Asia) Limited, Baring SICE (Taiwan) Limited, Baring Asset Management Switzerland Sarl, and Baring Asset Management Korea Limited each are affiliated financial service companies owned by Barings LLC (each, individually, an "Affiliate"), together known as "Barings." Some Affiliates may act as an introducer or distributor of the products and services of some others and may be paid a fee for doing so.

NO OFFER: solicitation for the purchase or sale of any financial instrument or service in any jurisdiction. The material herein was prepared without any consideration of the investment objectives, financial situation or particular needs of anyone who may receive it. This document is not, and must not be treated as, investment advice, an investment recommendation, investment research, or a recommendation about the suitability or appropriateness of any security, commodity, investment, or particular investment strategy, and must not be construed as a projection or prediction.

In making an investment decision, prospective investors must rely on their own examination of the merits and risks involved and before making any investment decision, it is recommended that prospective investors seek independent investment, legal, tax, accounting or other professional advice as appropriate.

Unless otherwise mentioned, the views contained in this document are those of Barings. These views are made in good faith in relation to the facts known at the time of preparation and are subject to change without notice. Individual portfolio management teams may hold different views than the views expressed herein and may make different investment decisions for different clients. Parts of this document may be based on information received from sources we believe to be reliable. Although every effort is taken to ensure that the information contained in this document is accurate, Barings makes no representation or warranty, express or implied, regarding the accuracy, completeness or adequacy of the information.

These materials are being provided on the express basis that they and any related communications (whether written or oral) will not cause Barings to become an investment advice fiduciary under ERISA or the Internal Revenue Code with respect to any retirement plan, IRA investor, individual retirement account or individual retirement annuity as the recipients are fully aware that Barings (i) is not undertaking to provide impartial investment advice, make a recommendation regarding the acquisition, holding or disposal of an investment, act as an impartial adviser, or give advice in a fiduciary capacity, and (ii) has a financial interest in the offering and sale of one or more products and services, which may depend on a number of factors relating to Barings' business objectives, and which has been disclosed to the recipient.

OTHER RESTRICTIONS: The distribution of this document is restricted by law. No action has been or will be taken by Barings to permit the possession or distribution of the document in any jurisdiction, where action for that purpose may be required.

Accordingly, the document may not be used in any jurisdiction except under circumstances that will result in compliance with all applicable laws and regulations.

Any service, security, investment or product outlined in this document may not be suitable for a prospective investor or available in their jurisdiction. Any information with respect to UCITS Funds is not intended for U.S. Persons, as defined in Regulation S under the U.S. Securities Act of 1933, or persons in any other jurisdictions where such use or distribution would be contrary to law or local regulation.

INFORMATION: Barings is the brand name for the worldwide asset management or associated businesses of Barings. This document is issued by one or more of the following entities:

Barings LLC, which is a registered investment adviser with the Securities and Exchange Commission (SEC) under the Investment Advisers Act of 1940, as amended (Barings LLC also relies on section 8.26 of NI 31-103 (international adviser exemption) and has filed the Form 31-103F2 in Ontario, Quebec, British Columbia, Alberta, Nova Scotia, Manitoba, New Brunswick, Newfoundland and Labrador, Prince Edward Island and Saskatchewan); Barings Securities LLC, which is a registered limited purpose broker-dealer with the Financial Industry Regulatory Authority (Baring Securities LLC also relies on section 8.18 of NI 31-103 (international dealer exemption) and has filed the Form 31-103F2 in Ontario, Quebec, British Columbia, Alberta, Nova Scotia, Manitoba, New Brunswick, Newfoundland and Labrador, Prince Edward Island and Saskatchewan);

Barings (U.K.) Limited, which is authorized and regulated by the Financial Conduct Authority in the United Kingdom (Ref No. 194662) and is a Company registered in England and Wales (No. 03005774) whose registered address is 20 Old Bailey, London, EC4M 7BF.

The document is for informational purposes only and is not an offer or Barings Global Advisers Limited, which is authorized and regulated by the Financial Conduct Authority in the United Kingdom (Ref No. 552931) and is a Company registered in England and Wales (No. 07622519) whose registered address is 20 Old Bailey, London, EC4M 7BF and is a registered investment adviser with the SEC; Baring Asset Management Limited, which is authorized and regulated by the Financial Conduct Authority in the United Kingdom (Ref No. 170601) and is a Company registered in England and Wales (No. 02915887) whose registered address is 20 Old Bailey, London, EC4M 7BF; Baring International Investment Limited, which is authorized and regulated by the Financial Conduct Authority in the United Kingdom (Ref No. 122628), and is a Company registered in England and Wales (No. 01426546) whose registered address is 20 Old Bailey, London, EC4M 7BF, is a registered investment adviser with the SEC (Baring International Investment Limited also relies on section 8.26 of NI 31-103 (international adviser exemption) and has filed the Form 31-103F2 in Quebec and Manitoba;

Barings Real Estate Advisers Europe Finance LLP, which is authorized and regulated by the Financial Conduct Authority in the United Kingdom (Ref No. 401543); or

BREAE AIFM LLP, which is authorized and regulated by the Financial Conduct Authority in the United Kingdom (Ref No. 709904);

Baring Fund Managers Limited, which is authorized as a manager of collective investment schemes with the Financial Conduct Authority in the United Kingdom and is authorized as an Alternative Investment Fund Manager in several European Union jurisdictions under the Alternative Investment Fund Managers Directive (AIFMD) passport regime;

Baring International Fund Managers (Ireland) Limited), which is authorized as an Alternative Investment Fund Manager in several European Union jurisdictions under the Alternative Investment Fund Managers Directive (AIFMD) passport regime and, since April 28, 2006, as a UCITS management company with the Central Bank of Ireland;

Baring Asset Management Switzerland Sàrl, which is authorized by the Switzerland Financial Market Supervisory Authority to offer and/or distribute collective capital investments;

Barings Australia Pty Ltd (ACN 140 045 656), which is authorized to offer financial services in Australia under its Australian Financial Services License (No: 342787) issued by the Australian Securities and Investments Commission;
Baring Asset Management (Asia) Limited, which is licensed by the Securities and Futures Commission of Hong Kong to carry on regulated activities Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 4 (advising on securities), Type 5 (advising on futures contracts) and Type 9 (asset management) in Hong Kong in accordance with the requirements set out in the Securities and Futures Ordinance (Cap 571);

Barings Japan Limited, which is registered as a Financial Business Operator (Registration No. 396-KLFB) for Type II Financial Instruments Business, Investment Advisory and Agency Business, and Investment Management Business with the Financial Services Agency in Japan under the Financial Instruments and Exchange Act (Act No. 25 of 1948);Baring SICE (Taiwan) Limited, an independently operated business (Business license number: 2008 FSC- SICE- Xin- 030; Address: 21 F, No.333, Sec. 1 Keelung Road, Taipei 11012; Taiwan Contact telephone number: 0800 062 068); or

Baring Asset Management Korea Limited, which is authorized by the Korean Financial Services Commission to engage in collective investment business and is registered with the Korean Financial Services Commission to engage in privately placed collective investment business for professional investors, discretionary investment business and advisory business.