Commercial real estate loan exposure at large banks is generally less than at smaller, and/or regional banks. While some smaller banks may be experiencing stress, primarily due to high interest rates, commercial office building high vacancy coupled with declining values of these buildings, the situation is currently not anticipated to be a risk to the entire US banking system. However, there is more concern with non-bank mortgage lenders as they can have less liquidity options and cannot access the Federal Reserve's discount window through which the Federal Reserve is able to lend money directly to eligible banks.

As of December 31, 2023, the NCREIF ODCE index has recorded six consecutive quarters of negative appreciation. Trailing one-year net appreciation returns of negative 15.2% and trailing one-year net total returns of negative 12.7% are vastly different than the record-setting returns notched during calendar 2021 and the first half of 2022. During the second half of 2022 and throughout 2023, rent growth slowed dramatically across property types and locations. While overall fundamentals, such as occupancy, remain healthy, softening demand is causing some property level fundamentals to be under pressure.

While investors continue to evaluate the overall attractiveness and investment return potential of various property types and markets as they form their target allocations, asset selection has increasingly become paramount. Investors have become hyper-focused on using various criteria to narrow down the specific asset(s) they want to target. The increasing amount of data available and technological tools able to compile and analyze various data points and performance metrics is only anticipated to grow.

Core investors have been actively rebalancing their portfolios in light of portfolio growth, liquidity needs, increasing interest rates, and declining commercial real estate values. The redemption queues at many large open-end funds increased throughout 2023. While some funds satisfy redemption requests on a first-come first-serve basis, some will distribute redemption proceeds on a pro-rata basis. Given the dearth of transaction volumes and new commitments to core funds, it is unclear how long it will take to satisfy these redemption requests.

There remains significant dry powder equity capital (nearly $405 billion) raised and sitting on the sidelines ready to invest. However, capital raising slowed significantly in 2023, down 40% as compared to a year earlier. Low transaction volumes have kept capital tied up in existing investments, so there have been fewer distributions of invested capital back to investors. Additionally continued price opacity and costly debt financing have severely constrained new capital deployment. Investors have been navigating both numerator and denominator effects on real estate allocations over the last few years and are likely to remain discerning around new capital commitments in today's uncertain markets.

Increasing interest rates, lack of construction financing, rising input costs (labor and materials) and a slowing economy are causing a reduction in construction starts and, therefore, new supply. This represents an opportunity for investors like CalPERS with high quality, well-located assets to maintain long-term resilient income streams, and also- for those with quality development projects far enough along in the development pipeline with certainty around execution pricing and timing.

## Conclusion

CalPERS' continued discipline, long-term investment horizon in this illiquid asset class, and its focus on the intended role the asset class, should continue to serve the needs of the System. Adhering to the Strategic Plan, particularly in times of market uncertainty and disruption, will ensure the real estate program continues to scale in an appropriate manner and contribute to achieving CalPERS' investment objectives.

Please do not hesitate to contact us if you have questions or require additional information.

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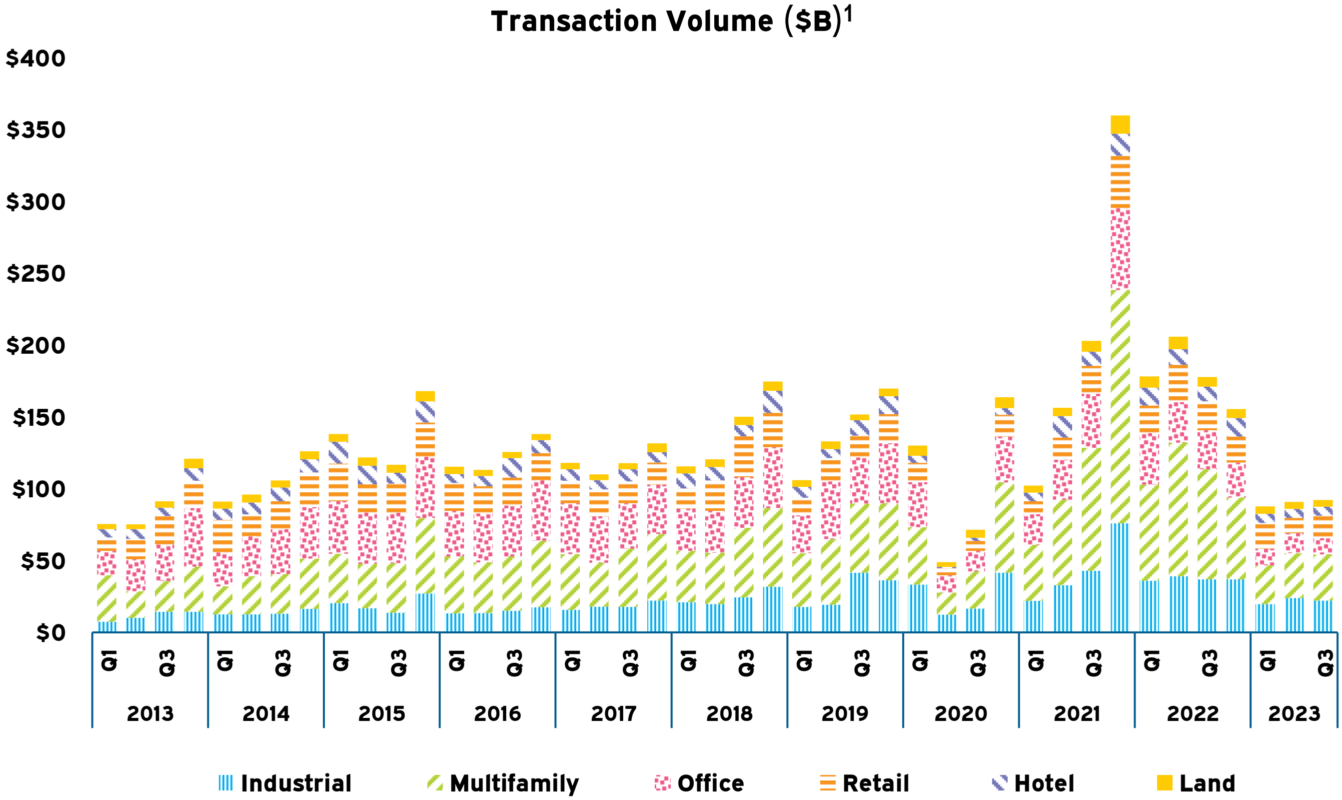
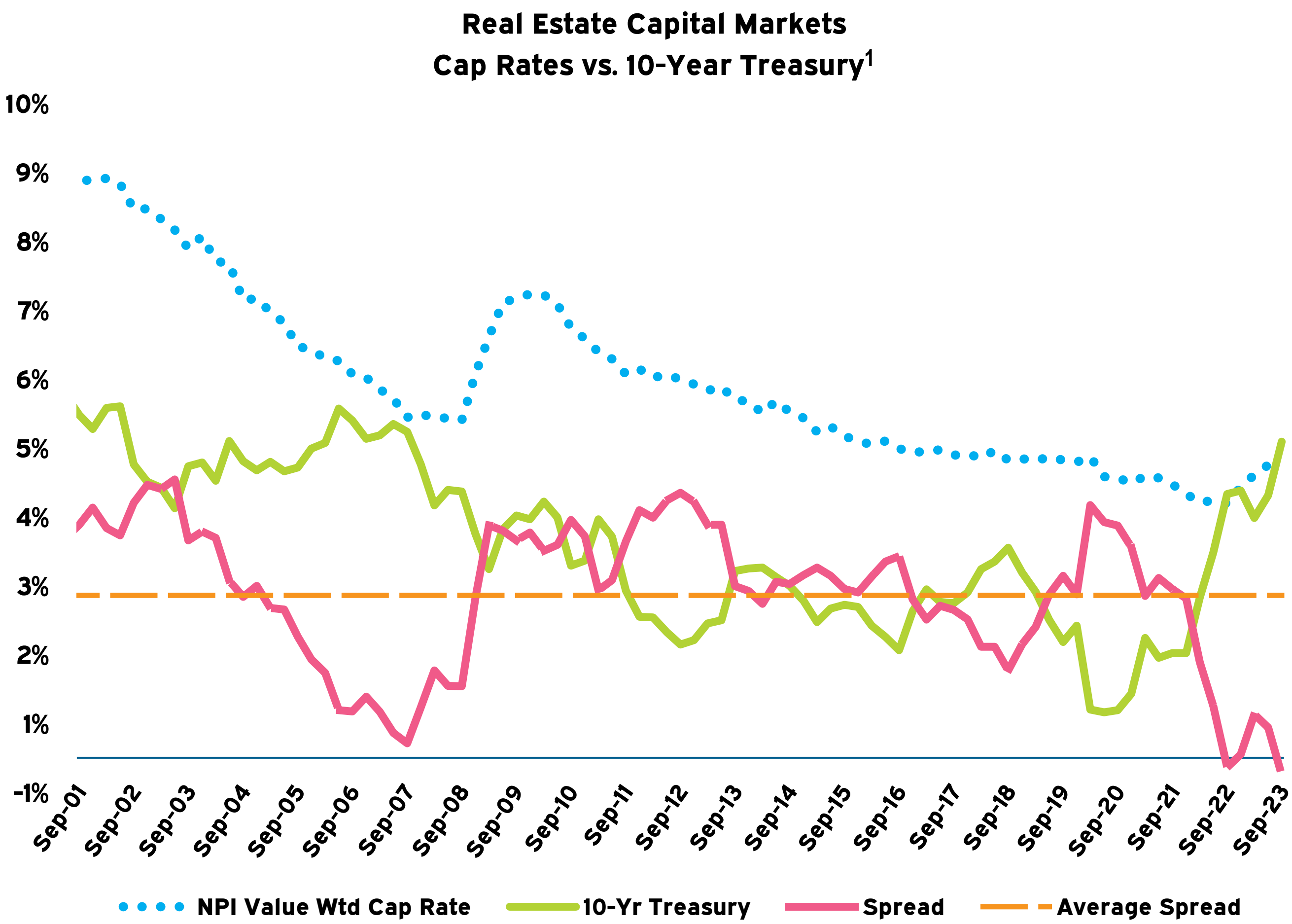



Private real estate transaction volume for properties valued over $2.5 million was $92.1 billion in Q3 2023, slightly up from the $90.9 billion total last quarter, but remaining generally low overall relative to prior quarters as a result of the rising rate environment and continued market volatility. The retail sector experienced the largest increase in transaction volume from the prior quarter of $5.0 billion. The only other sector to report a positive change in transaction volume was industrial, increasing by $1.0 billion over the quarter. Transaction volume in both office and multifamily slowed over the quarter, decreasing by $2.6 billion and $1.8 billion, respectively. Hotel and land volumes also declined by minimal amounts of less than $500 million from the prior quarter.

[1] Source: PREA.




The NPI Value Weighted Cap Rate increased slightly to 4.34% (+9 basis points) in Q3 2023. The 10-year Treasury yield increased by 78 basis points in Q3 2023 to approximately 4.6%, resulting in a negative spread of 25 basis points between cap rates and treasury yields. This represents only the second time that the treasury yield has exceeded the NPI cap rate over the last 20 years, with the first instance occurring in Q3 2022 when the Fed began consistently raising interest rates by 75 basis points.

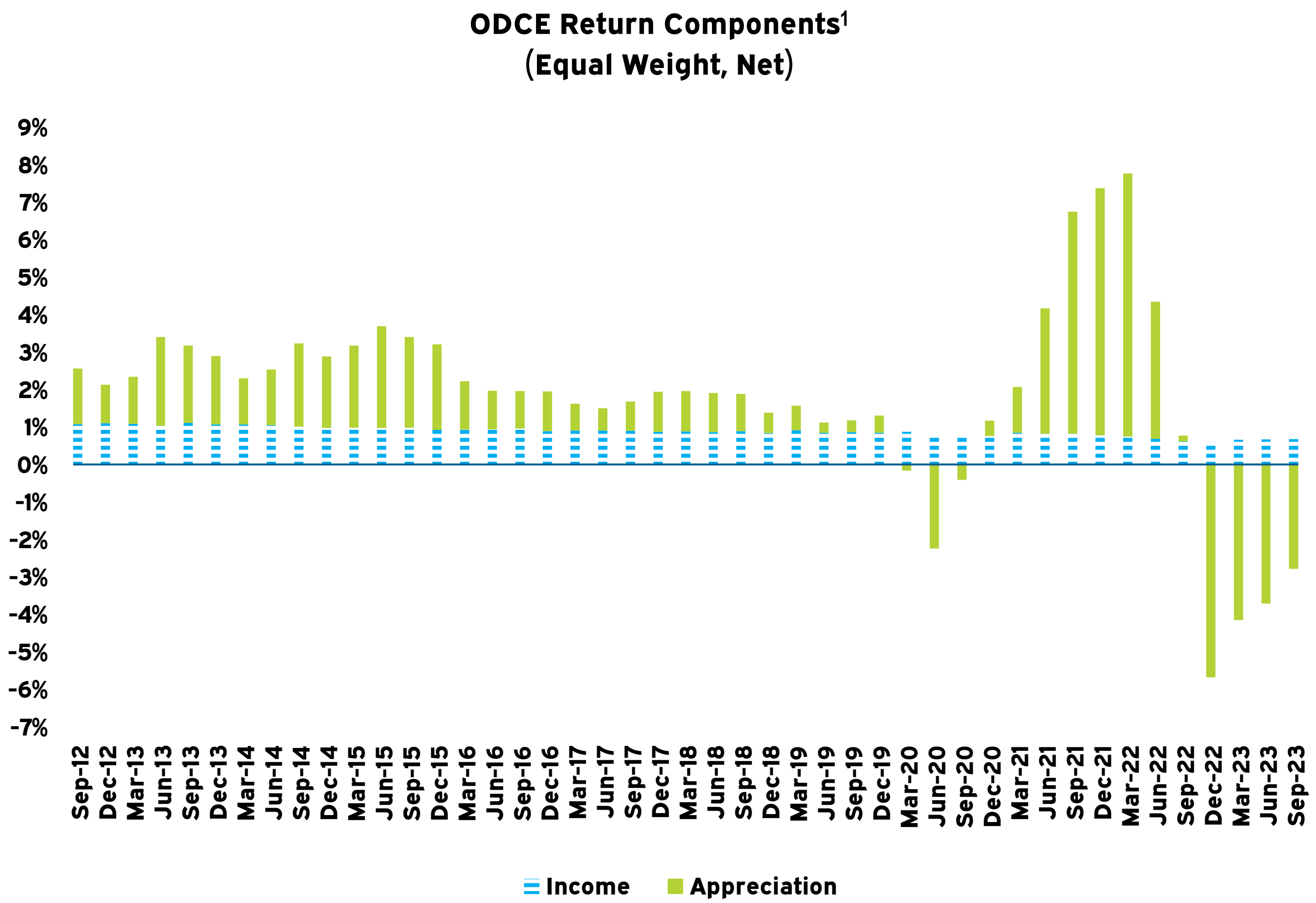
[1] Source: NCREIF and US Department of the Treasury.

**Trailing Period Returns**[1]

| *As of September 30, 2023* | Quarter | 1 Year | 3 Years | 5 Years | 10 Years |
|---|---|---|---|---|---|
| NFI-ODCE (Equal Weight, net) | -2.1 | -13.1 | 6.7 | 5.2 | 7.6 |
| NFI-ODCE (Value Weight, net) | -2.1 | -12.9 | 6.2 | 4.7 | 7.2 |
| NCREIF Property Index | -1.4 | -8.4 | 6.0 | 5.3 | 7.4 |
| NAREIT Equity REIT Index | -8.3 | -1.7 | 2.7 | 2.8 | 6.1 |

Private real estate indices generated negative returns in Q3 2023, as well as over the one-year time horizons. The 3-year, 5-year, and 10-year horizons remained positive. The NFI ODCE Equal Weight Index posted a negative return in Q3 2023 of -2.1%, representing a slight increase of 93 basis points from Q2 2023, however all other time horizons experienced a decline in returns over the last quarter. The Equal Weight Index's one-year return saw the largest change from the prior quarter of -257 basis points, representing the first one-year time horizon in which the NFI-ODCE Equal Weight Index generated a negative overall return in each of the four prior quarters. Over the long-term, private core real estate has generally outperformed the NAREIT Equity REIT Index for all periods presented, apart from the one-year time horizon in which the public index represents the highest performing metric as of Q3 2023.

[1] Source: NCREIF.




In Q3 2023, the NFI-ODCE Equal Weight Index reflected a net return of -2.1%, representing its fourth consecutive negative return, although increasing by 93 basis points from Q2 2023. This result was driven by a -2.8% appreciation return for the quarter, which was slightly offset by a 0.9% income return. Upward adjustments to the discount rate, used in valuations to reflect increasing interest rates and the cost of debt financing, continue to negatively impact the appreciation component of returns. Over the last four quarters, the NFI-ODCE Equal Weight Index has reported a cumulative negative appreciation return of -15.4%.

[1] Source: NCREIF.