PRIVATE REAL ESTATE

Market Commentary

Q4 2023

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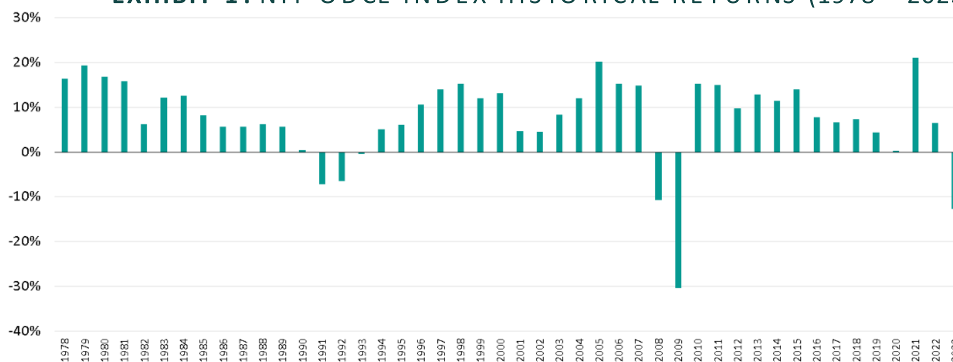
Dear Valued Clients,

It's that time of year again where market prognosticators gaze into their crystal balls attempting to forecast returns for the coming year. The problem is…they rarely get it right! In fact, a comprehensive study by CXV Advisory Group, found that the accuracy of stock market forecasts from so called "investment gurus" was worse than a flip of a coin – on average, they were correct less than 46% of the time.[1] So if public market analysts fall short in an asset class where the data are most plentiful, accessible, and transparent, one could argue that the bar for predicting private real estate performance should be decidedly lower. This is not to fully disparage forecasting because, despite the lack of accuracy, we've found that going through this intellectual exercise has merit. Not because we're competing against our peers to see how closely we can calculate an outcome that's 12 months away, but rather it helps us frame actionable solutions that can protect and enhance a diversified portfolio. So, near the end of this article, we'll certainly share our view on the benefits of core real estate in a diversified portfolio, but we'll spend most of our time discussing a topic we have the most conviction about – why we believe *Now* is the time for investors to begin playing offense with respect to core real estate.

A potential buying opportunity: From a value perspective, in our view the current market offers arguably the best opportunity to buy core real estate in well over a decade. Core real estate values have fallen for five consecutive quarters, resulting in a peak-to-trough value decline of -17.2% as of Q4 2023. For context, real estate hasn't revalued at such a pace since the Global Financial Crisis (GFC) which saw six quarters of negative returns. In fact, prior to 2023, the NFI-ODCE Index had experienced only five years of negative performance over the past 45 years, and even those occurrences were clustered between two generation-defining downturns – the early 1990's S&L Crisis and more recently during the GFC (See Exhibit 1). So, today's market conditions offer an exceedingly rare occasion (one that only occurs every 15 years on average) as some of the best quality real estate in the world is trading at a considerable discount from previous highs. Of course, no one wants to catch the proverbial falling knife, and we can never say with 100% certainty as to when the bottom will occur. However, we do know that NFI-ODCE drawdowns historically have been fairly limited, typically lasting 12-24 months. At a minimum, history is on our side, and at best, the coming year could represent a generational buying opportunity for prudent investors that add core real estate to their asset allocation.

EXHIBIT 1: NFI-ODCE INDEX HISTORICAL RETURNS (1978 - 2023)[2]



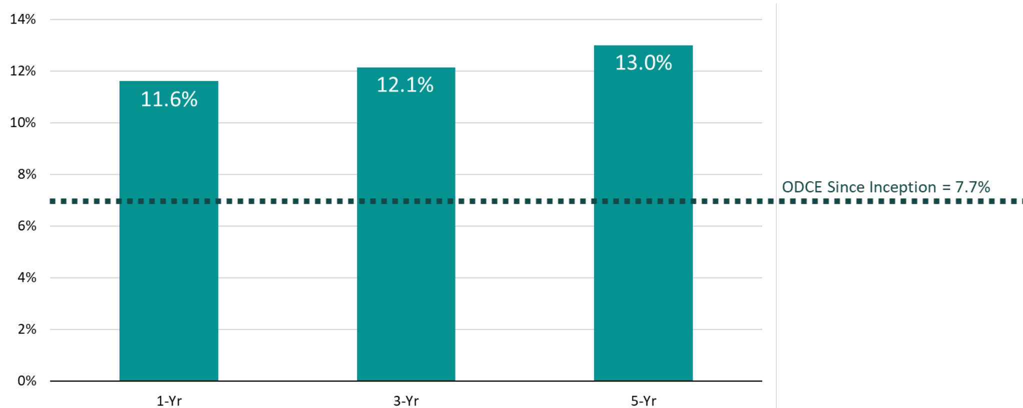
[1] CXO Advisory Group.
[2] IDR Investment Management, NCREIF.
Past performance is not a guarantee of future results.

Assessing a leading indicator: In addition to our proprietary data and analytics model, we often look to other indicators (such as the public markets) to either confirm or even challenge our investment thesis. In this case, public market REITs have reinforced our outlook. For context, REIT prices have historically reacted ahead of private real estate on both the downside and the upswing due to the inherent volatility of the public markets. For example, REITs were down more than 25% in 2022, while NFI-ODCE returns were up over 20% during the same period. Fast forward to the end of 2023 and public REITs delivered nearly a 12% total return with strong momentum heading into the new year, while private real estate values were down almost 13% over the same 12-month window.[3] As noted, this 6-18 month lag between public and private real estate has been well-documented, and with REITs now recovering, we believe private real estate may follow suit.[4] Interestingly, however, REITs have also seen a meaningful shift in capital raising with more than $5B raised across 80 offerings in 2023. While the total amount of activity is about one-third of what we saw prior to the pandemic, the opportunities that came to market recently have been well received by investors. In fact, last year represented the most capital raised per offering since NAREIT began tracking this data in 1992, suggesting that there is budding optimism across the REIT market.[5] Thus, given the longstanding connection between the public and private real estate markets, it seems only a matter of time before comparable levels of opportunistic capital begin to flow into the private real estate sector.

Structure and discipline matters: Private real estate investors use varying degrees of leverage to enhance returns, and so, during periods of stress, it matters how deals are structured, particularly concerning leverage. We saw this dynamic play out over the last few years as the Federal Reserve increased short-term interest rates at the fastest pace in history, and even now floating rates have risen almost 4x from the lows in early 2022. This unprecedented period disproportionately impacted overleveraged real estate owners, causing many of them to default and ultimately lose all their investors' equity. Certainly, these occurrences are unfortunate, but they also make for sensational news headlines that tend to cast the entire industry in a bearish light. Therefore, it's imperative that we delineate this higher risk segment of the market from core real estate.

For starters, one of the hallmarks of core real estate, as defined by the NFI-ODCE Index, is that it has structural limits intended to guard against overleveraging. Not only are managers required to maintain responsible debt levels of less than 35% loan-to-value (LTV, actual is 25% as of Q4 2023), but they are also precluded from relying on financial engineering to drive performance. As a result, core real estate has experienced minimal erosion of income from interest expense during this period of rising interest rates, let alone suffered from a rash of foreclosures as some in the media would lead you to believe. This conservative approach allows responsible owners (those of who were well-capitalized and used reasonable, long-term fixed rate debt) to have staying power and hold assets over what has been a less-than-favorable selling period. And now, as we enter 2024, rates seem poised to moderate, which may reward those investors who maintained their ownership. To be clear, this is not an indictment of higher risk/reward strategies, for that approach can certainly be executed responsibly, but rather, this is an endorsement of core real estate's inherently conservative structure that has it well positioned to benefit as interest rates and market conditions begin to normalize. In fact, one could argue that now is the time to consider higher return strategies as well given the unique buying opportunities that have resulted from a lack of liquidity in the sector. One must however recognize that core real estate and non-core strategies perform differently over time when assessing how to allocate within their portfolios.

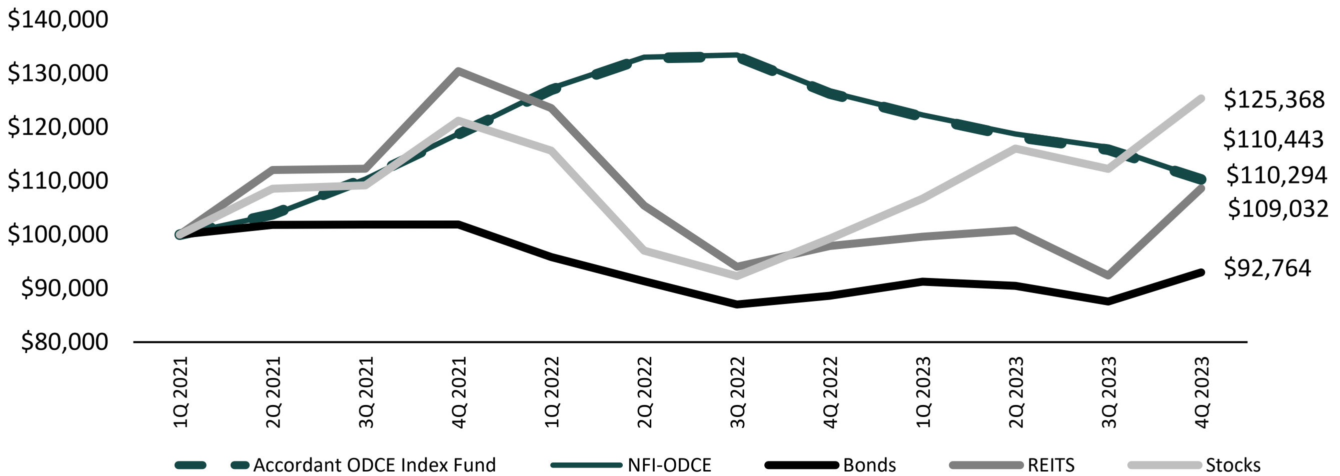
EXHIBIT 2: MARKET TIMING IS DIFFICULT - AVERAGE NET RETURN AFTER REVALUATION PERIODS[6]



[3] Nareit.
[4] Pierzak, "Public and Private Real Estate Divergence Presents Opportunity for Investors," Nareit, 02/07/2023, REIT.com.
[5] Barwick, "REITs Raised $5.2 Billion Through Secondary Offerings in 2023: Q4," Nareit, 01/08/2024, REIT.com.
[6] IDR, NFI-ODCE Index. Average net total return post-drawdown from 1Q 1978 to 4Q 2022. Post-drawn is defined based on quarters following periods of significant depreciation for the NFI-ODCE index. Past performance is not indicative of future results.

As expected: Many of you will at this point rightly have concluded that, while headwinds remain for some parts of real estate, we're excited about the prospect of 2024 as it is shaping up to be a period of value discovery after revaluations in 2023. In terms of performance, as shown in the chart above, we expect the NFI-ODCE Index to deliver an 8% return over a full market cycle with 2/3 from income and 1/3 from appreciation. One must remember that income typically grows from rising rents; therefore, unlike a bond, the going-in yield isn't the cash flow to expect over a long-term hold period. It's also important to remember that, despite real estate values declining in recent quarters, the sector has delivered on its promise to produce non-correlated portfolio outcomes. In fact, since the launch of the Accordant ODCE Index Fund (the “Fund”), the NFI-ODCE Index and the Fund have outperformed the traditional bond and REIT indices, as well as stocks at least until the most recent quarter, but above all else, it continues to provide a non-correlated portfolio allocation to investors that value the primary core real estate attributes (reliable income, portfolio diversification, attractive risk-adjust returns, and an inflation hedge).

EXHIBIT 3: GROWTH OF $100,000 (SINCE INCEPTION TOTAL RETURN 4/1/2021 - 12/31/2023: 10.29%)



Performance data quoted represents past performance; the past performance does not guarantee future results. Current performance may be lower or higher than the performance data quoted. Performance shown for the Fund before September 11, 2023, reflects a management fee of 40 bps and the performance shown after September 11, 2023, reflects a management fee of 60 bps.
Inception date of the Class IShares is September 11, 2023. Fund data shown as I-share class.

Summary: Those of you who are already fully allocated to real estate can rest well knowing the sector is performing as expected. For others who may have seen a recovery in public equites and are now under-allocated to private real estate, we would encourage you to seize the moment because market conditions can change quickly. For instance, during the GFC, the NFI-ODCE went from having an exit queue equivalent to 15% of the index’s value to having an entry queue that was 12% of the index’s value in only a matter of two quarters – leaving many would-be investors without real estate exposure during the initial stages of the recovery. So, what should you do? Each person's financial situation is obviously unique, but if we were currently under-allocated to real estate, we would look to right-size our portfolio by dollar cost averaging into our target allocation. That way, one could secure an attractive entry point and be well positioned as market dynamics shift in favor of core real estate.

On behalf of the team at Accordant, we look forward to engaging with you in 2024 as the real estate market continues to evolve.

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Data Sources

IDR, NCREIF, NFI-ODCE operations benchmarks report, CBRE-EA, CoStar, Federal Reserve, Bureau of Labor Statistics, and Component Funds. Property type sector appreciation and total returns referenced are unlevered and gross of fees.

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Past Performance is No Guarantee of Future Results.

Investing in the Fund involves risks, including the risk that you may receive little or no return on your investment or that you may lose part or all your investment. The Fund's investment objective is to employ an indexing investment approach that seeks to track the NCREIF Fund Index – Open End Diversified Core Equity (the "NFI- ODCE Index") on a net-of-fee basis while minimizing tracking error. There can be no assurance that the actual allocations will be effective in achieving the Fund's investment objective or delivering positive returns. It is not possible to invest in an index. You cannot invest directly in an index and unmanaged indices do not reflect fees, expenses, or sales charges.

The ability of the Fund to achieve its investment objective depends, in part, on the ability of the Advisor to allocate effectively the Fund's assets across the various asset classes in which it invests and to select investments in each such asset class. There can be no assurance that the actual allocations will be effective in achieving the Fund's investment objective or delivering positive returns. Limited liquidity is provided to shareholders only through the Fund's quarterly repurchase offers for no less than 5% of the Fund's shares outstanding at net asset value. There is no guarantee that shareholders will be able to sell all the shares they desire in a quarterly repurchase offer. The first repurchase offer following the Conversion is expected to occur in February 2024.

An investment in the Fund represents an indirect investment in the securities owned by the Fund. The value of these securities, like other market investments, may move up or down, sometimes rapidly and unpredictably. The Fund is classified as a "non-diversified" under the Investment Company Act of 1940 and therefore may invest more than 5% of its total assets in the securities of one or more issuers. As such, changes in the financial condition or market value of a single issuer may cause a greater fluctuation in the Fund's net asset value than in a "diversified" fund. The Fund is not intended to be a complete investment program.

The Fund is subject to the risk that geopolitical and other similar events will disrupt the economy on a national or global level. For instance, war, terrorism, market manipulation, government defaults, government shutdowns, political changes or diplomatic developments, public health emergencies (such as the spread of infectious diseases, pandemics, and epidemics) and natural/environmental disasters can all negatively impact the securities markets.

Pandemics and other similar worldwide events may have potential impacts on the real estate market may include lower occupancy rates, decreased lease payments, defaults and foreclosures, among other consequences. It is not known how long such impacts, or any future impacts of other significant events described above, will or would last, but there could be a prolonged period of global economic slowdown.

The Fund will concentrate its investments in real estate industry securities. The value of the Fund's shares will be affected by factors

affecting the value of real estate and the earnings of companies engaged in the real estate industry. These factors include, among others: (i) changes in general economic and market conditions; (ii)changes in the value of real estate properties; (iii) risks related to local economic conditions, overbuilding and increased competition; (iv) increases in property taxes and operating expenses; (v) changes in zoning laws; (vi) casualty and condemnation losses; (vii) variations in rental income, neighborhood values or the appeal of property to tenants; (viii) the availability of financing; (ix) climate change; and (x) changes in interest rates. Many real estate companies utilize leverage, which increases investment risk and could adversely affect a company's operations and market value in periods of rising interest rates. The value of securities of companies in the real estate industry may go through cycles of relative under-performance and over-performance in comparison to equity securities markets in general.

Additional risks related to an investment in the Fund are set forth in the "Risks" section of the prospectus, which include, but are not limited to the following: correlation risk; credit risk; fixed income risk; leverage risk; and risk of competition between underlying funds.

Investors should carefully consider the investment objectives, risks, charges, and expenses of the Accordant ODCE Index Fund. This and other important information about the Fund are contained in the prospectus, which can be obtained online at accordantinvestments.com. The prospectus should be read carefully before investing. Investors should consult with their selling agents about the sales load and any additional fees or charges their selling agents might impose on each class of shares.

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