



Asset Management

June 2023

Real Assets

US CRE MARKET INSIGHTS

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*Beyond
borders™*

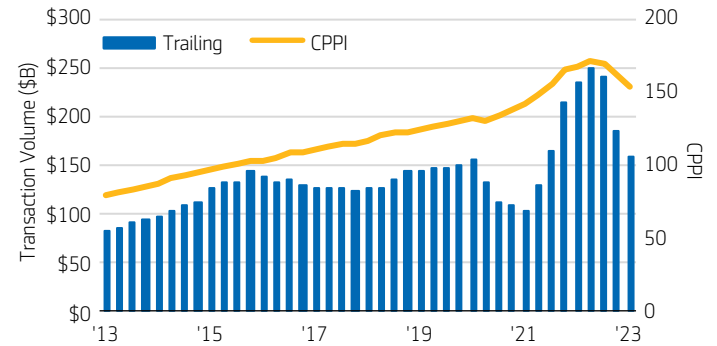
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Executive summary

- The ongoing impact of rising interest rates, tighter lending conditions and economic uncertainty continues to weigh on transaction volume. There is growing concern that the extended lag in the full effect of higher interest rates could potentially push the economy towards a recession. While we believe, along with 61% of Blue Chip Economic Indicators forecasters, a recession is likely, we expect it will be mild.¹
- Performance disparities persist across property sectors, as industrials outperformed compared to other sectors and office properties continued to face pronounced challenges with lower returns. The market's path into 2023 was disrupted by tighter monetary policy, and ongoing price discovery exercises suggest that the full impact of repricing is yet to be realized. Investors should be prepared to navigate ongoing challenges in the office sector and uncertainties associated with economic growth.
- The commercial real estate (CRE) debt market remained subdued in late May 2023 with slowing originations and widening spreads amid ongoing uncertainty. Borrowers are favoring shorter-term loans with interest-only options and flexible prepayment terms. Lenders are exercising selectivity and conservatism in their underwriting. Regional banking challenges are expected to further restrict credit availability, creating potential opportunities for non-bank lenders to play a more significant role in meeting financing demands.

US CRE transaction volume and commercial property price index



Sources: Aegon Real Assets US. Real Capital Analytics as of March 31, 2023.

The ongoing impact of rising interest rates, tighter lending conditions and economic uncertainty continues to weigh on transaction volume.

Property sector outlook

Our outlook is cautious across all sectors

| | Top 50 metros* | | | | | Aegon AM Sector Outlook |
|------------|--------------------------------------|----------------------|----------------------|-------------------------|-------------------------|-------------------------|
| | Under Construction as % of Inventory | 1Q 23 Vacancy Rate** | 1Q 22 Vacancy Rate** | 1Q 23 YoY Rent Growth** | 1Q 22 YoY Rent Growth** | |
| Apartment | 6.11% | 7.13% | 5.22% | 2.31% | 12.72% | Cautious |
| Industrial | 3.54% | 4.16% | 3.84% | 10.52% | 10.76% | Cautious |
| Office | 1.60% | 11.51% | 10.72% | 1.88% | 2.85% | Most Cautious |
| Retail | 0.61% | 4.20% | 4.51% | 4.44% | 4.45% | Cautious |

*Top 50 by Metro Areas by Population; CoStar Realty Information Inc., Aegon Real Assets US; as of March 31, 2023.

**Equal Weighted Average

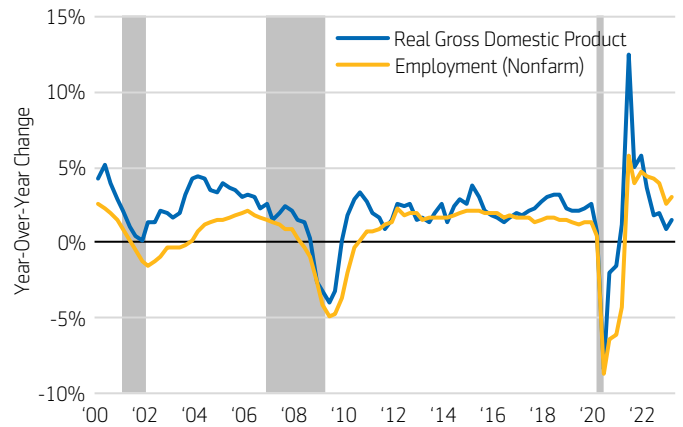
Economic outlook

- In June 2023, the US Federal Open Market Committee (FOMC) agreed to hold interest rates steady after 10 consecutive increases to a target range of 5.00 – 5.25%, but signaled more raises by year end. In the official FOMC statement, the US Federal Reserve (Fed) reiterated its goal to return inflation to 2% as recent economic data continues to show a robust job market and elevated inflation. As a result, more than half of the Fed officials expect two additional quarter point increases by year end, albeit at a more modest pace than previous rate hikes. We believe a more stable outlook of interest rates will help CRE investors get a better handle on their cost of capital and bring some relief to the tight credit market.²
- The sharp rise in interest rates over the last year, coupled with tighter lending conditions and economic uncertainty continue to take their toll on transaction volume. Relative to the first quarter of 2022, which was the most active first quarter on record, transaction volume across property types declined 56% with the sharpest decline in central business district (CBD) offices which were down 78%.³
- Despite tightening monetary policy, the labor market remained strong although signs of softening are starting to emerge. Nonfarm payrolls increased a larger than expected 253,000 jobs in April, and the unemployment rate remained near a historic low at 3.4%.⁴ However, significant downward revisions were made to the gains in February and March. Additionally, job openings are gradually normalizing although this statistic is still well above its long-term trend.
- We believe the full effect of higher interest rates will have a long and variable lag in working through the economy. The fear is that by the time inflation shows signs of abetting and the labor market begins to cool enough for the Fed to pull back, the economy may be well on its way to a recession. As a result, 61% of Blue Chip Economic Indicators forecasters and Aegon AM expect a recession, although we, and most forecasters, expect it will be mild.¹

| Economic uncertainty continues to take its toll on transaction volume | | | |
|---|----------|----------|-------------|
| | 1Q 23 | 1Q 22 | YoY changes |
| All Office | \$10.7 B | \$33.9 B | -68.4% |
| CBD | \$2.6 B | \$11.9 B | -78.4% |
| Suburban | \$8.1 B | \$22 B | -62.9% |
| All Industrial | \$18.5 B | \$40.6 B | -54.4% |
| Flex | \$3.3 B | \$12.7 B | -73.8% |
| Warehouse | \$15.2 B | \$27.9 B | -45.5% |
| All Apartment | \$25.4 B | \$71.3 B | -64.4% |
| Garden | \$16 B | \$47.3 B | -66.3% |
| Mid/Highrise | \$9.5 B | \$24 B | -60.5% |
| All Retail | \$16.9 B | \$23.4 B | -27.4% |
| Strip Center | \$5.8 B | \$16.1 B | -64.0% |
| Mall & Other | \$11.1 B | \$7.2 B | 54.0% |

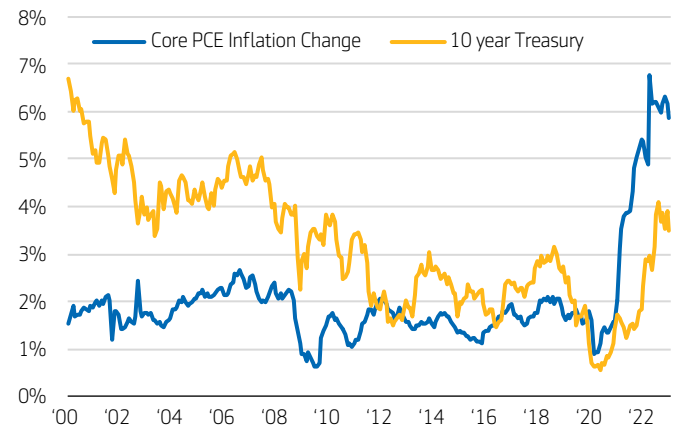
Source: Real Capital Analytics as of March 31, 2023.

US labor market remains strong although signs of softening starting to emerge



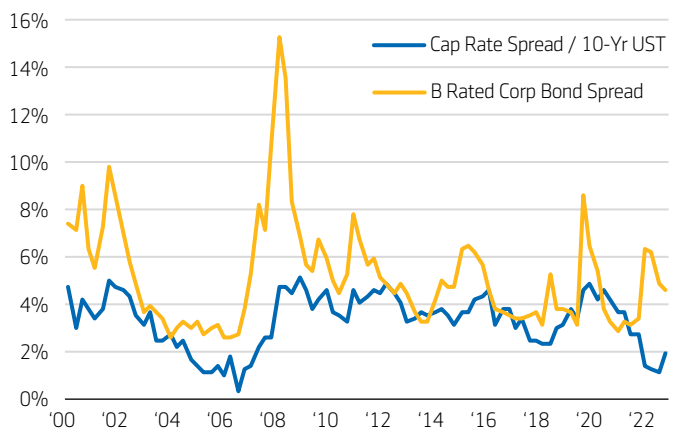
Sources: US Bureau of Labor Statistics as of March 31, 2023. Bureau of Economic Analysis as of March 31, 2023. Employment figures reflect private and government non-farm jobs. Shaded areas indicate US recessions.

Core personal consumption expenditures (PCE) inflation and 10-year Treasury



Sources: US Bureau of Economic Analysis as of March 31, 2023 and US Department of Treasury as of March 31, 2023.

Corporate bond and cap rate spread*

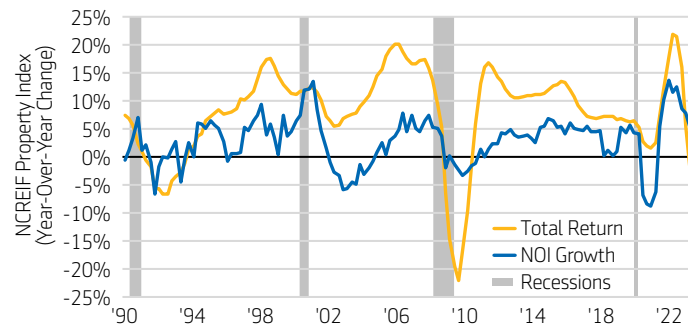


Sources: Aegon Real Assets US. Bloomberg - US Corporate B Rated Bond OAS, as of March 31, 2023. NCREIF Transaction Cap Rates as of March 31, 2023. Federal Reserve - 10-year UST as of March 31, 2023. *Average cap rate less 10-year UST. Past performance is not indicative of future results.

Real estate equity

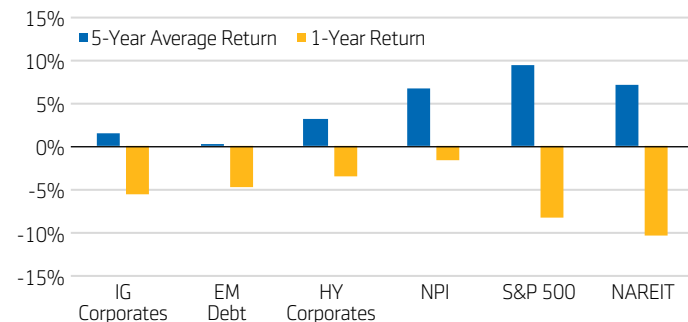
- The trailing one-year return for the NCREIF National Property Index (NPI), a measure of unleveraged returns, was -1.63% in the first quarter of 2023 compared to 21.9% a year ago. Capital appreciation was reported as -5.4%, with income return at 3.9%.⁵
- Industrial property performance continued to outpace other sectors with a 2.4% total return for the first quarter of 2023. At the other end of the spectrum, office property returns remained the lowest, totaling -8.7% for the first quarter.⁵
- Within property sectors, subtypes continue to show broad dispersion in performance. The range is particularly wide in the retail sector where there is a 5.4% difference in the first quarter's returns between power retail centers and regional malls.⁵
- The NCREIF Fund Index for Open-ended Diversified Core Equity (NFI-ODCE) returned -3.1% gross of fees (-3.9% net) and inclusive of leverage over the past four quarters from 1Q 2022 to 1Q 2023 with a -3.2% gross (-3.4% net) return in the first quarter alone. The low first quarter return was driven by a decline in property values of 4%. Over the last 10 years, the NFI-ODCE averaged an 8.7% gross (7.3% net) annual return. ODCE's diversified core properties typically reflect lower risk CRE with relatively low leverage.⁵
- During the first quarter of 2023, NFI-ODCE investor's distributions and redemptions exceeded contributions by 131.4%. Net flows for 1Q 2023 dropped even further to -\$1.96B. When calculating a four-quarter running total, year-on-year returns turned negative for the first time since 2021.⁵
- Tightening monetary policy put an abrupt end to the outsized performance momentum heading into 2023. In the time since, price discovery exercises are still on-going in most sectors of the market and we believe it is unlikely that we have seen the full impact of repricing on NCREIF's appraisal-based indices. As the end of this monetary tightening regime approaches, investors will still be left to navigate secular challenges in the office sector and uncertainty surrounding economic growth.

US CRE investment performance declines in 1Q 2023



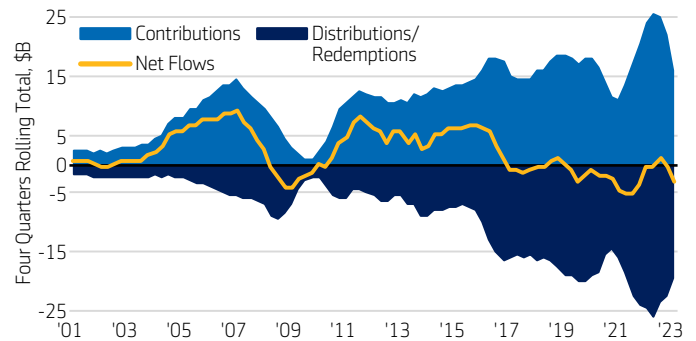
Source: NCREIF Property Index Detail Report as of March 31, 2023. Shaded areas indicate US recessions.

US CRE continuing to offer relative value opportunities versus bonds



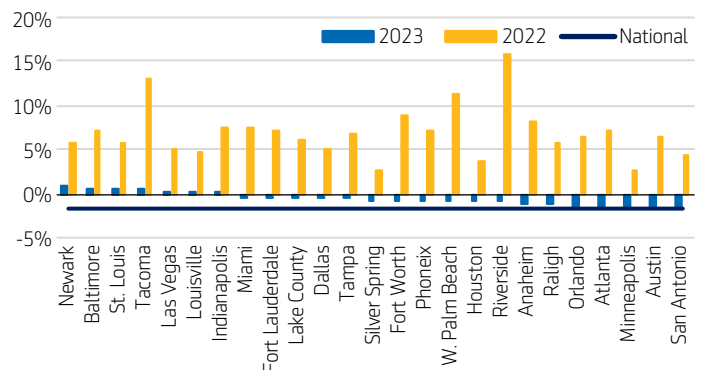
Sources: As of March 31, 2023. Corporate Bonds and EM Debt - Bloomberg, NAREIT, NCREIF, S&P Dow Jones Indices. Past performance is not indicative of future results.

Decrease in NFI-ODCE index reflects decline in property values of 4% in 1Q 2023[†]



†The Open End Diversified Core Equity (ODCE) fund is a capitalization-weighted index based on each fund's Net Invested Capital, which is defined as Beginning Market Value Net Assets (BMV), adjusted for Weighted Cash Flows (WCF) during the period. Annual rates (Appreciation + Income). Source: NCREIF. As of March 31, 2023.

Top 25 metros by total return (1Q 2023)[‡]



Source: NPI – NCREIF as of March 31, 2023. ‡Limited to NCREIF markets with greater than 40 properties. Past performance is not indicative of future results.

Property sector subtypes continued to show broad dispersion in performance

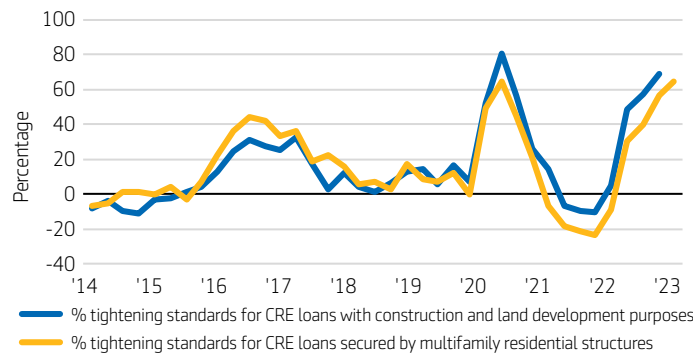
| | 1Q 23 | 1Q 22 | Trend |
|-----------------------|--------|-------|--------|
| NPI | -1.6% | 21.9% | -23.5% |
| All Apartment | -0.4% | 24.1% | -24.5% |
| Garden | 2.2% | 33.4% | -31.3% |
| Highrise | -1.9% | 19.5% | -21.4% |
| Lowrise | -0.2% | 25.3% | -25.5% |
| All Office | -8.7% | 6.8% | -15.5% |
| CBD | -11.3% | 3.7% | -15.1% |
| Suburban | -5.5% | 10.9% | -16.4% |
| All Industrial | 2.4% | 51.9% | -49.5% |
| R&D | 2.6% | 32.7% | -30.1% |
| Flex | 3.8% | 50.1% | -46.4% |
| Warehouse | 2.8% | 52.1% | -49.2% |
| Other | 7.0% | 52.3% | -45.3% |
| All Retail | 1.0% | 7.1% | -6.1% |
| Community | 3.4% | 11.2% | -7.9% |
| Neighborhood | 2.6% | 10.6% | -8.0% |
| Power Center | 3.7% | 9.5% | -5.8% |
| Regional | -1.7% | 2.6% | -4.3% |
| Super Regional | -0.5% | 5.9% | -6.5% |

Source: NCREIF Property Index Detail Report as of March 31, 2023. Trend is the year-over-year change of sub property type trailing four quarter return. Past performance is not indicative of future results.

Real estate debt

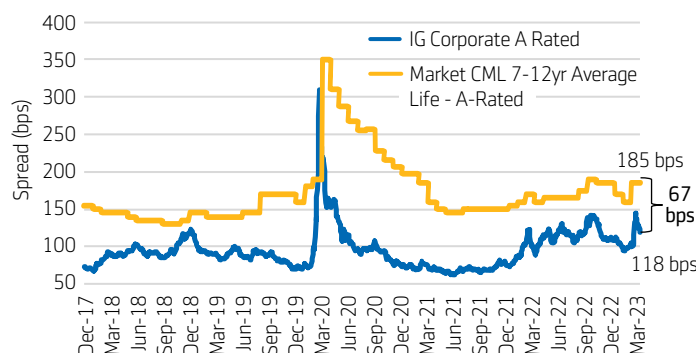
- The commercial real estate debt market remains quite subdued as of late May 2023. Commercial and multifamily mortgage origination volumes during the first quarter of 2023 declined 56% compared to last year, a decline caused primarily by a material reduction in year-over-year acquisition activity.⁶
- Non-bank lenders (i.e., life companies, CMBS, and agencies), are absorbing the effect of higher rates and seeking high-quality opportunities in the face of significantly diminished transaction activity. The general sentiment in the commercial mortgage loan (CML) lending market is to be patient and remain disciplined.
- We believe the recent crisis affecting certain regional banks will tighten credit availability due to heightened regulatory and risk management pressure. There remains a plethora of real estate-focused capital on the sidelines and any pullback in bank lending activities could create opportunities for non-bank lenders.
- Despite tightening standards and reduced lending, banks are not shying away from all credit activities. For example, banks continue to compete for construction loans with strong sponsors, especially if the sponsors are repeat bank customers. Many banks are currently focusing exclusively on existing bank relationships.
- CMBS origination has slowed considerably with 2022 market share at only 9% compared to 20% in 2021. Deal volume in 2023 has started on an even lower trajectory than last year as macro uncertainty, higher interest rates and lower transaction volume weighs on this market as well.
- Borrowers are seeking more flexible terms such as full-term interest-only, fixed rates, and shorter terms in order to compensate for the higher interest rates, while attempting to maintain return expectations

Domestic banks are tightening lending standards for US CRE loans



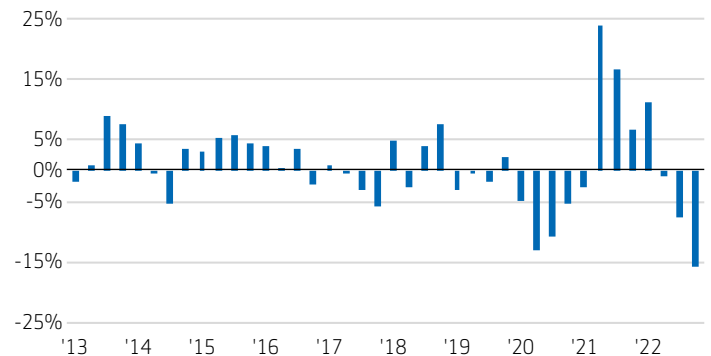
Source: Board of Governors of the Federal Reserve System (US), as of March 31, 2023.

CMLs continue to offer a spread advantage over investment grade corporate bonds



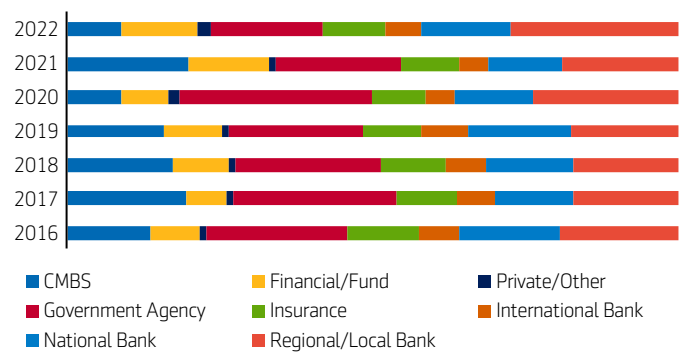
Sources: As of March 31, 2023. US Investment grade – Bloomberg US Corporate. CML - Aegon Real Assets US Commercial Mortgage Mark-to-Market Matrix. **Past performance is not indicative of future results.**

Commercial mortgage commitments
(Life companies - 4Q trailing Q/Q change)



Source: American Council of Life Insurers (ACLI) as of December 31, 2022.

US lender composition



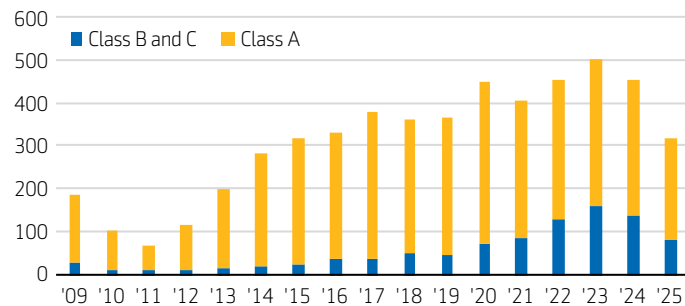
Sources: Real Capital Analytics – US Capital Trends Report as of December 31, 2022.

There remains a plethora of real estate-focused capital on the sidelines and any pullback in bank lending activities could create opportunities for non-bank lenders.

Apartments – likely to remain subdued in short term

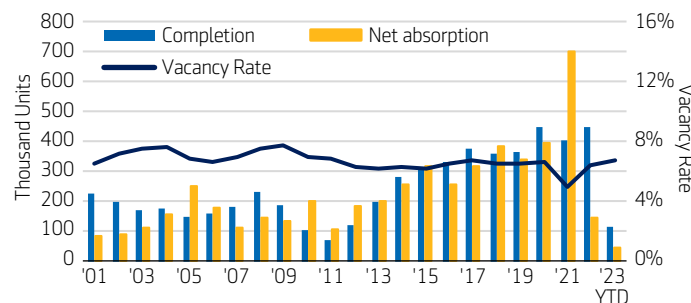
- Apartment asking rent growth for the first quarter of 2023 lowered to 2.7% year-over-year as it continues to normalize from the historic high of 11.3% seen in the first quarter of 2022. Rent growth continued to drop since the second quarter of 2022 with only 60% of the top 50 metros showing more than 2% year-over-year increases.⁷
- National apartment vacancy ticked up again in the first quarter to a 6.7% rate from 6.4% at year-end 2022. Vacancy rates in 94% of the top 50 most populous metros increased in 1Q 2023.⁷
- The NPI apartment sector produced a -0.4% unlevered total return for the past four quarters composed of 3.7% income return and -4.0% capital return. Garden-style apartments have been the best performing subtype over the last year, delivering unlevered returns of 2.2% compared to 33.4% from a year ago. Within the sector, garden-style apartments posted the only positive total return in 1Q 2023.⁵
- Apartment equal-weighted appraisal cap rates during 1Q 2023 ended at 3.9%, slightly lower than the level seen since 2019.⁵
- Apartment transaction volume of \$25.4 billion was 64.4% below the level a year ago.³
- The apartment sector will be challenged by the strong inflow of new supply in 2023 as the economy weakens. The higher cost of debt and lower demand has heightened the economic barriers to new supply. However, the lagged nature of supply responsiveness means the pullback will not materialize into subdued volume until 2025. The supply inflow will continue to exert downward pressure on occupancy rates and rents, especially for higher-quality apartments where supply is most concentrated. Conversely, medium-quality apartments demonstrate more favorable fundamentals as elevated mortgages rates and inflated home prices continue to drive demand. Underpinned by relatively modest supply and renter-by-necessity demand, we believe medium-quality apartments are well suited to address the uncertainties from a potential recession. [Read more about our views on apartment supply.](#)

Pullback in new apartment construction not expected to materialize until 2025



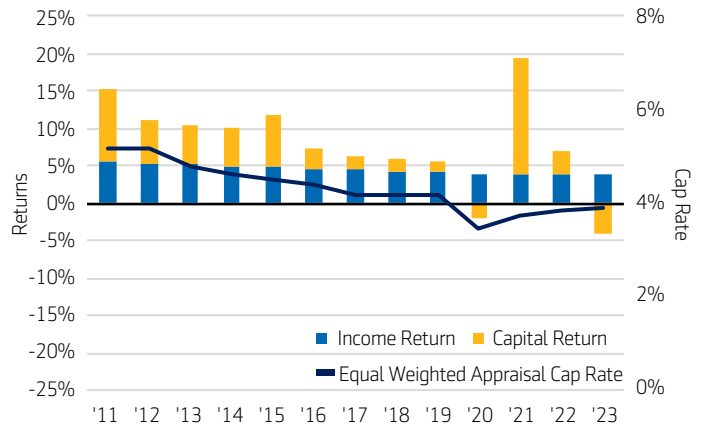
Source: CoStar Realty Information Inc as of March 31, 2023.

Supply and demand fundamentals



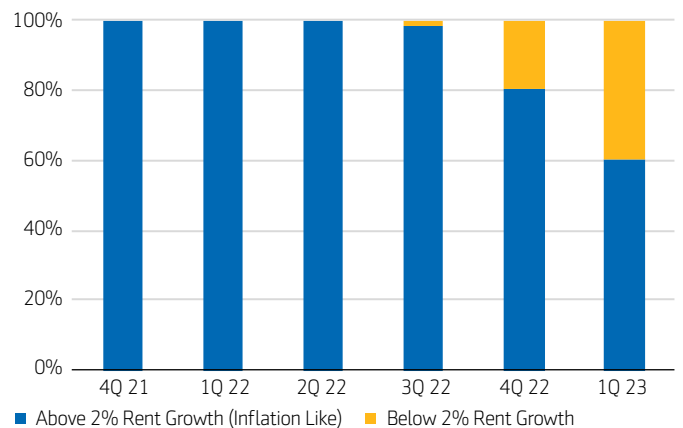
Source: CoStar Realty Information Inc., annual data as of March 31, 2023. Current year returns reflect trailing 4-quarter average.

Apartment performance



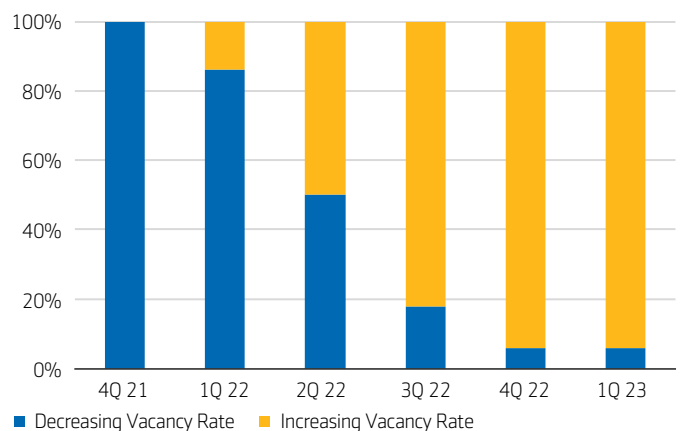
Source: NCREIF Property Index (unlevered) - equal weighted appraisal cap rate as of year-end or most recent in current year, current year returns reflect trailing 4-quarter average as of March 31, 2023. Past performance is not indicative of future results.

Apartment metropolitan statistical area (MSA) trends* (year-over-year rent growth)



Source: CoStar Realty Information Inc.; Aegon Real Assets US as of March 31, 2023. *Based on a selection of 50 most populous markets.

Apartment MSA trends* (year-over-year vacancy rate change)

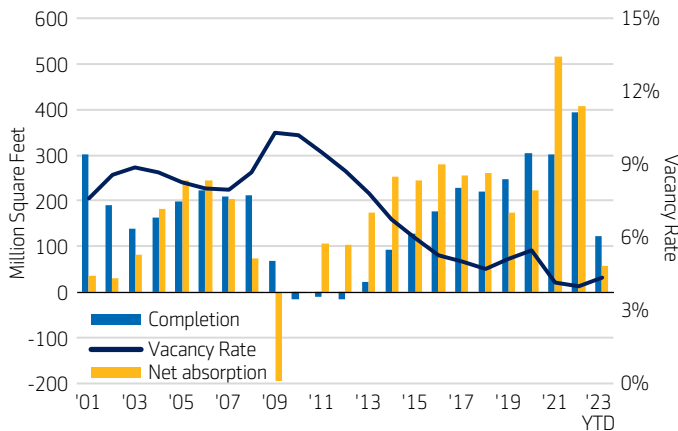


Source: CoStar Realty Information Inc.; Aegon Real Assets US as of March 31, 2023. *Based on a selection of 50 most populous markets.

Industrial – highest returns amongst property types with performance likely to slow

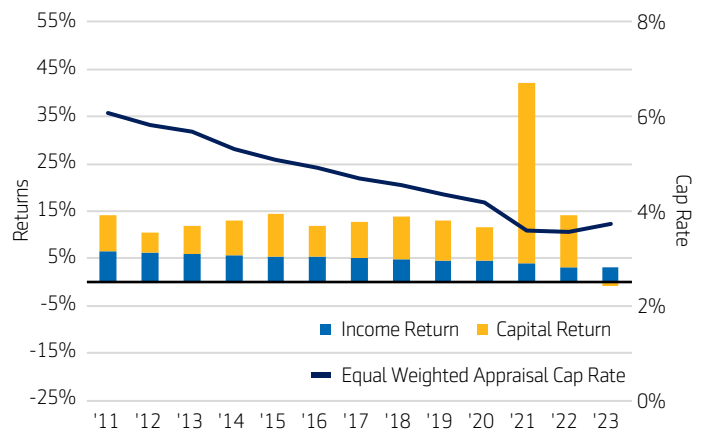
- The national industrial vacancy rate in the first quarter of 2023 rose to 4.3% compared to 4.0% in the fourth quarter of 2022. 30 out of the top 50 most populous metro areas saw industrial space vacancy rates increase.⁷
- Industrial rent for 1Q 2023 dropped to 10.5% year-over-year, slightly slower than the 11.4% year-over-year growth in 4Q 2022. Rent growth continued to increase more than 2% in all of the top 50 metro areas.⁷
- The NPI industrial sector produced a 2.4% total return for the past four quarters, exceeding all other property types. Industrial property income return amounted to 3.2% while appreciation dropped significantly to -0.8% from 11.1% in 4Q 2022.⁵
- Industrial cap rates associated with NPI appraisals averaged 3.7% on an equal-weighted basis, rising slightly from levels seen since 2021.⁵
- Transaction volume for industrial properties totaled \$18.5 billion, down 54.4% compared to a year ago.³
- Industrial property performance will likely slow in 2023 compared to the extremely strong results for last year. A record amount of new supply in 2023 could pose challenges as the economy weakens, but few metros appear challenged to digest the deliveries. Occupancy and rent growth continued to slow since the latter half of 2022 but remained above their long-term averages. We expect this trend to continue in the medium term as retailers and wholesalers pause further inventory accumulation out of caution over a potential recession.

Supply and demand fundamentals



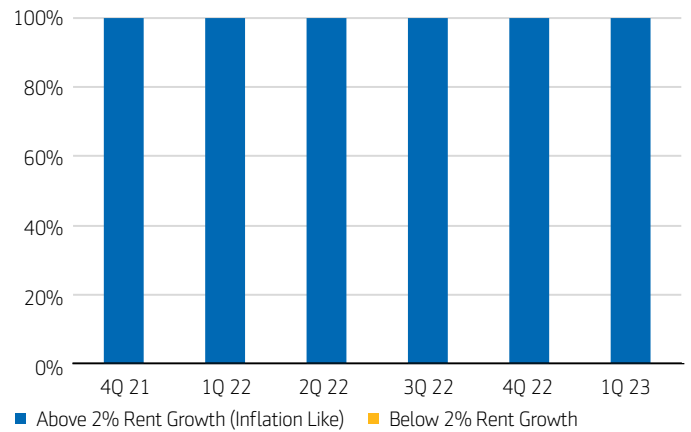
Source: CoStar Realty Information Inc., annual data as of March 31, 2023. Current year returns reflect trailing 4-quarter average.

Industrial performance



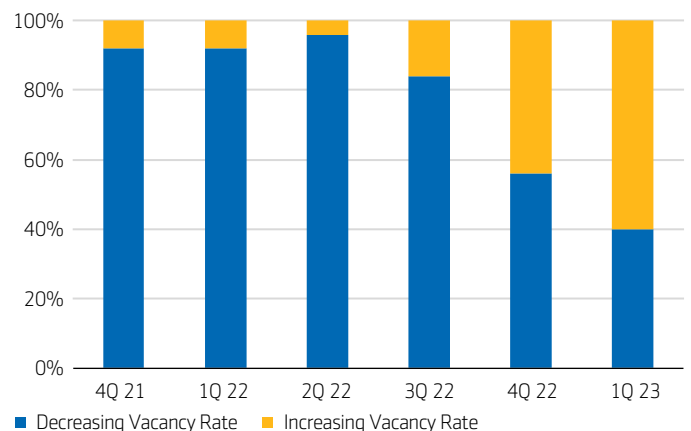
Source: NCREIF Property Index (unlevered) - equal weighted appraisal cap rate as of year-end or most recent in current year, current year returns reflect trailing 4-quarter average, as of March 31, 2023. **Past performance is not indicative of future results.**

Industrial MSA trends* (year-over-year rent growth)



Sources: CoStar Realty Information Inc.; Aegon Real Assets US as of March 31, 2023. *Based on a selection of 50 most populous markets.

Industrial MSA trends* (year-over-year vacancy rate change)

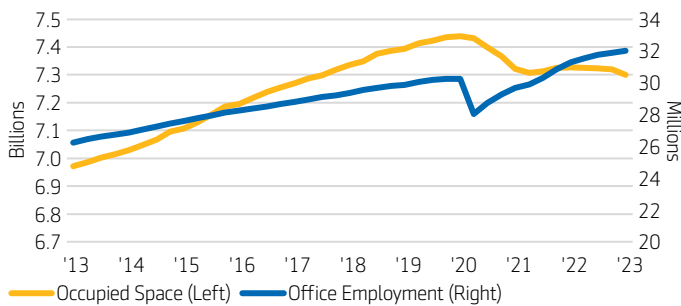


Sources: CoStar Realty Information Inc.; Aegon Real Assets US as of March 31, 2023. *Based on a selection of 50 most populous markets.

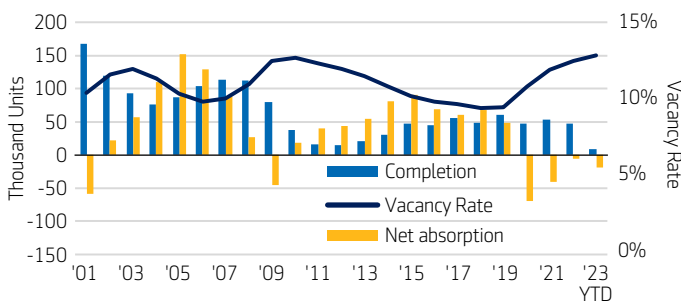
Office – still seeking its post-pandemic floor

- Office vacancy rates increased in 43 of the top 50 largest metro areas in the first quarter of 2023. The national office vacancy rate ticked up to 12.8% in the first quarter.⁷
- Only 20 of the top 50 largest metro areas produced rent growth above 2%. Office rent for 1Q 2023 advanced less than 1% year-over-year.⁷
- At the same time, the office sector posted an unlevered total return of -8.7%. This total return performance was the lowest of the four major property sectors. Income generated 4.4% return while capital depreciated 12.7%. Suburban properties returned a -5.5% compared to central business district returns of -11.3%.⁵
- Office appraisal-based cap rates reported by NCREIF increased to 5.11% on an equal-weighted basis, up 31 basis points from the level seen in 1Q 2022.⁵
- Transaction volume for office properties totaled \$10.7 billion, down 68.4% from the year prior.²
- The office sector is still seeking its post-pandemic floor as tenants continue to evaluate their need for space. Vacancy rates surged past the previous records set during the Great Financial Crisis with no signs of peaking. Office employment has recovered above the pre-Covid level, but occupied space declined further as employers continue to adopt a hybrid work model. The tight job market during the rebound from Covid also provided employees leverage to ask for a more flexible work environment, leading to many remote and hybrid positions. According to Kastle System, office key swipes remain at only 49% compared to the pre-pandemic level.⁸ As a result, companies continue to need best-in-class office space to attract talent back to the office, but this flight to quality story does not apply to all Class A properties equally. We believe Class A buildings that offer flexible workspace, ESG implementation, and other next-gen features will attract more tenants than conventional Class A buildings in need of extensive renovations.

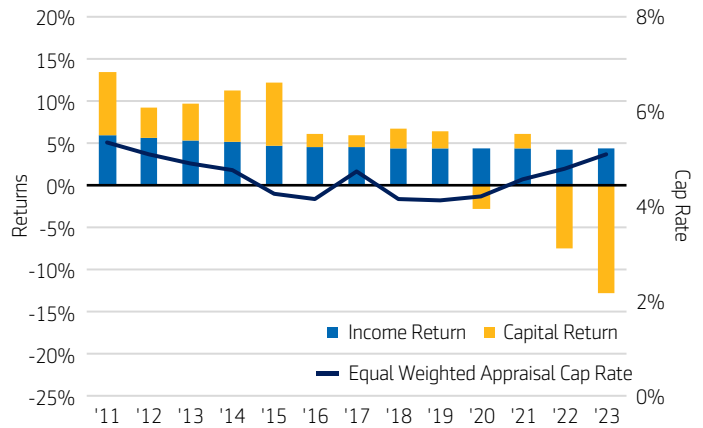
Correlation between office employment and occupied office space turned negative



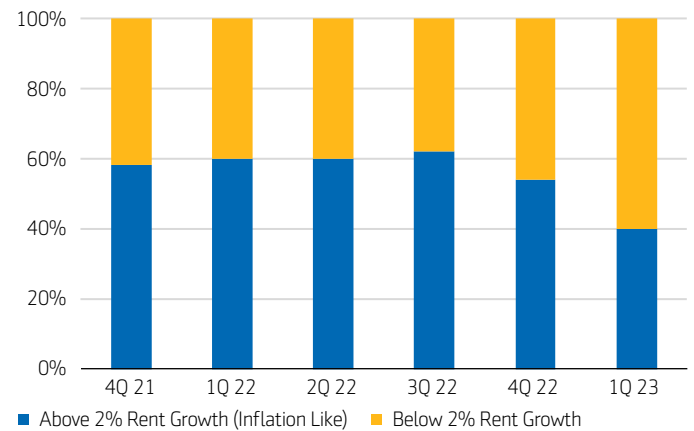
Supply and demand fundamentals



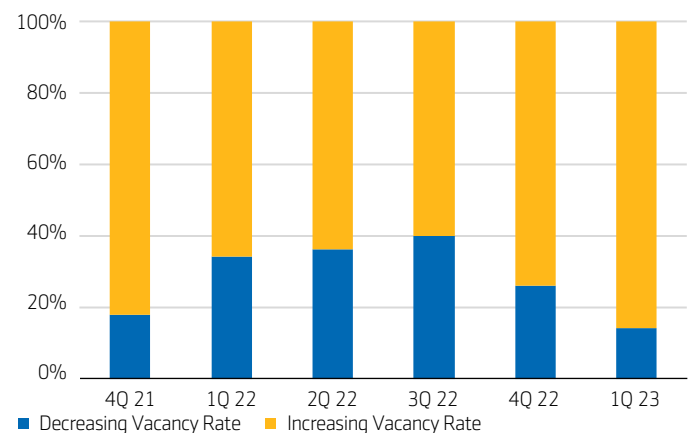
Office performance



Office MSA trends* (year-over-year rent growth)



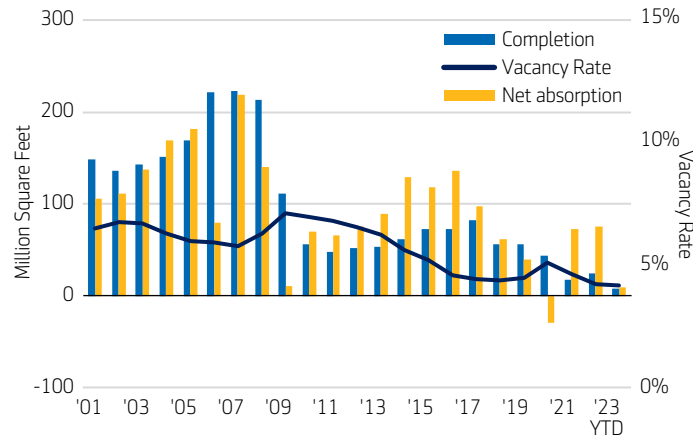
Office MSA trends* (year-over-year vacancy rate change)



Retail – fundamentals likely to remain balanced through 2023

- The national retail vacancy rate remained at 4.2% in the first quarter of 2023 with 84% of the top 50 most populous metro areas seeing a decrease in vacancy rates.⁷
- Retail rent for 1Q 2023 advanced 3.9% year-over-year with 38 of the top 50 largest metro areas seeing retail property rent growth outpacing 2%.⁷
- The retail sector delivered nearly 1.0% total return for the first quarter. Income generated 5.1% return while capital depreciated nearly 4%. Within subsectors, power center properties performed best at 3.7%, while regional mall properties performed the worst at -1.7%.⁵
- Transaction volume for retail properties totaled \$16.9 billion, down 27.4% compared to last year.²
- We believe the retail sector is in a more favorable position to weather a potential recession. The threat of new supply of retail properties is minimal across retail subtypes and geographies. The rise in construction financing costs coupled with record-high material and labor costs challenged the viability of new constructions in most markets. In addition, developers have been shying away from retail projects since the Great Financial Crisis as the sector was overbuilt together with the secular shift towards online shopping. As a result, the retail sector is at the tightest level on record with availability of retail space near historic lows. Retail tenants that stood the test of the global pandemic continue to benefit from pent-up consumer demand to shop and many retailers are looking to expand their footprint. Despite an increasingly challenging macroeconomic environment, retail fundamentals are likely to remain balanced.

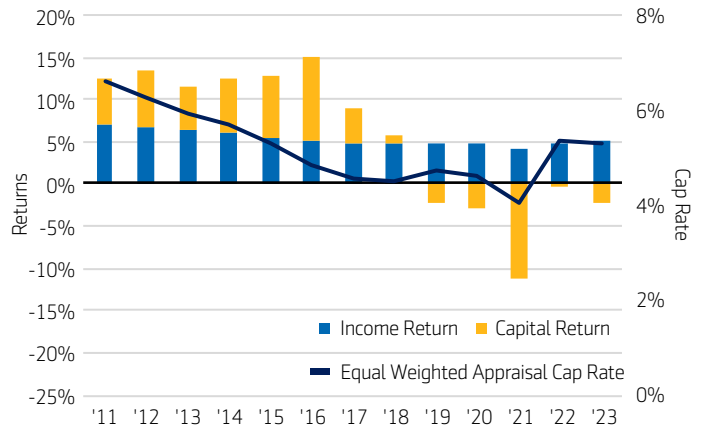
Supply and demand fundamentals



Source: CoStar Realty Information Inc., annual data as of March 31, 2023. Current year returns reflect trailing 4-quarter average.

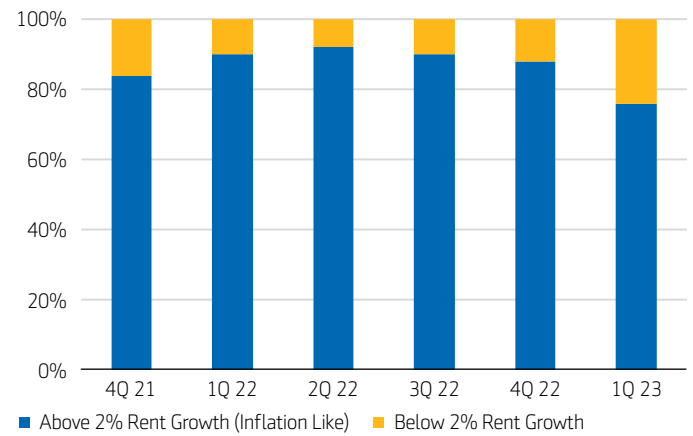
We believe the retail sector is in a more favorable position to weather a potential recession.

Retail performance



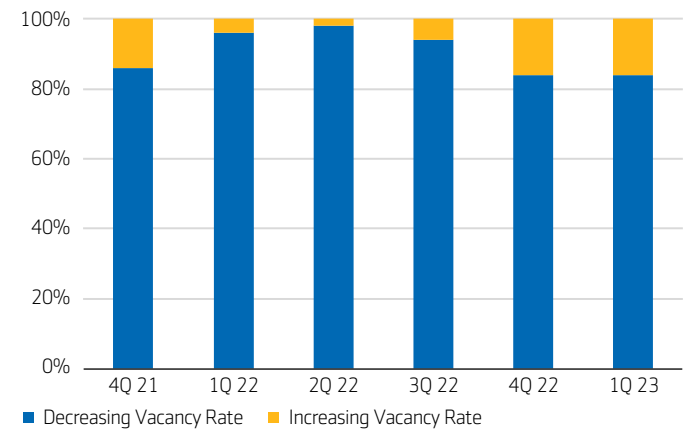
Source: NCREIF Property Index (unlevered) - equal weighted appraisal cap rate as of year-end or most recent in current year, current year returns reflect trailing 4-quarter average, as of March 31, 2023. Past performance is not indicative of future results.

Retail MSA trends* (year-over-year rent growth)



Sources: CoStar Realty Information Inc.; Aegon Real Assets US as of March 31, 2023. *Based on a selection of 50 most populous markets.

Retail MSA trends* (year-over-year vacancy rate change)



Sources: CoStar Realty Information Inc.; Aegon Real Assets US as of March 31, 2023. *Based on a selection of 50 most populous markets.

¹Wolters Kluwer. Blue Chip Economic Indicators. May 10, 2023

²Board of Governors of the Federal Reserve System. June 14, 2023

³MSCI Real Capital Analytics. March 31, 2023

⁴US Bureau of Labor Statistics. May 5, 2023

⁵National Council of Real Estate Investment Fiduciaries. March 31, 2023

⁶Mortgage Bankers Association, March 31, 2023

⁷CoStar Realty Information, Inc. March 31, 2023

⁸Kastle Systems. May 29, 2023.

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