Commercial Real Estate and REITs at the One Year Mark in the Pandemic

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Economic Fundamentals for Commercial Real Estate

The pandemic was an external shock to the economy and to CRE markets. CRE entered the crisis with solid fundamentals, which will aid the recovery

- Traditionally, the three greatest risks to CRE markets are:
  - Overbuilding
  - Overheating
  - Over-leveraging

- CRE markets (and the overall economy) turned down in 2020 due to an external shock, not internal weakness:
  - Supply and demand were well-balanced in most property markets
  - Pricing was reasonable with few signs of speculative excess
  - Both lenders and borrowers had been cautious after 2008-2009; debt growth moderate

- The pandemic has had disparate impacts across property types:
  - Travel/hotels/entertainment, retail; Digital economy real estate; The rest
  - Short-term vs long-term impacts

REITs and the Pandemic at the One Year Milestone

Share prices fell across the board in spring of 2020. Valuations are recovering, but unevenly across property types

		Total Return (%) Period			
Index / Property Sector	**Market Cap ($B)**	**Feb 21, 2020 - Mar 23 2020**	**Mar 23, 2020 - Nov 8, 2020**	**Nov 8, 2020 - Feb 19, 2021**	**Feb 21, 2020 - Feb 19, 2021**
All Equity REITs	1,187	(41.9)	41.6	11.5	(8.3)
Equity REITs	952	(44.4)	40.9	15.0	(9.8)
Retail	137	(54.6)	25.9	45.7	(16.7)
Shopping Centers	48	(52.0)	11.0	67.3	(10.8)
Regional Malls	38	(62.3)	21.8	77.1	(18.6)
Free Standing	51	(50.3)	41.9	15.4	(18.7)
Lodging/Resorts	38	(56.5)	25.2	72.3	(6.1)
Data Centers	115	(24.8)	53.5	(10.3)	3.6
Infrastructure	200	(28.5)	39.7	(4.4)	(4.5)
Industrial	135	(34.5)	58.6	1.8	5.7
Office	81	(43.8)	12.7	21.4	(23.1)
Residential	174	(44.1)	35.4	15.6	(12.6)
Apartments	121	(44.7)	27.5	20.8	(14.9)
Manufactured Homes	27	(40.9)	40.0	5.7	(12.6)
Single Family Homes	25	(44.4)	75.6	4.6	2.1
Diversified	44	(53.1)	33.0	21.6	(24.1)
Health Care	112	(50.6)	43.8	20.1	(14.7)
Self Storage	66	(30.9)	52.0	5.1	10.4
Timber	35	(51.1)	91.4	25.7	17.6
Specialty	51	(56.1)	71.6	20.8	(9.0)
Home Financing	40	(61.0)	53.4	24.0	(25.8)
Commercial Financing	25	(66.2)	90.8	40.5	(9.5)
Russell 1000		(33.7)	62.0	13.7	22.1

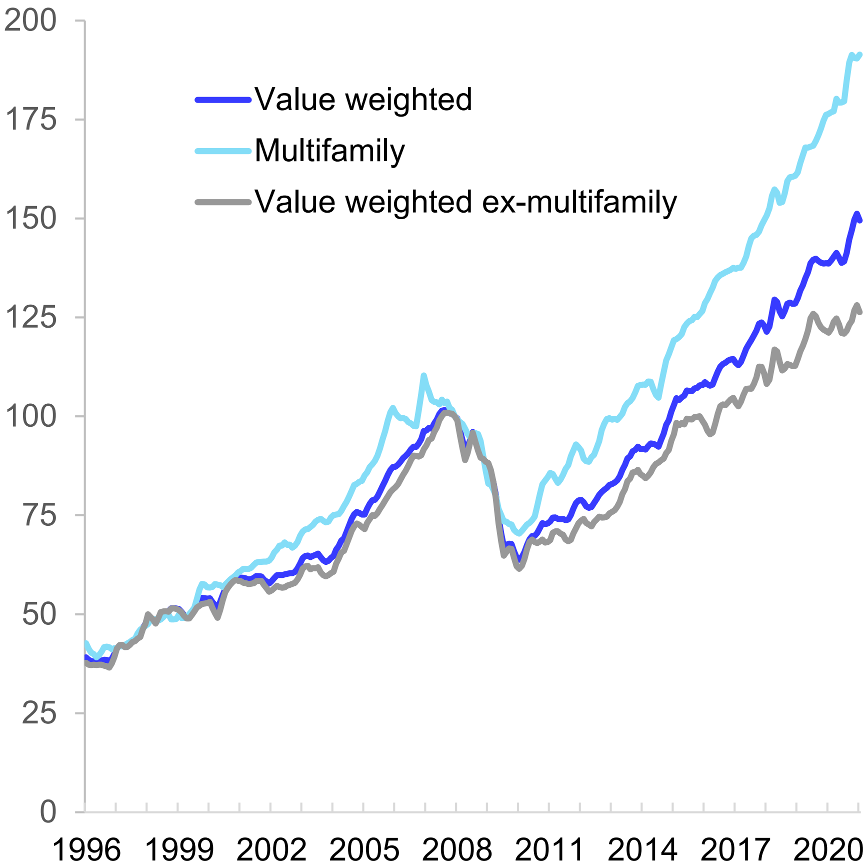
Source: FTSE, Nareit, FactSet.

CRE pricing, Sales Volumes and Capitalization Rates

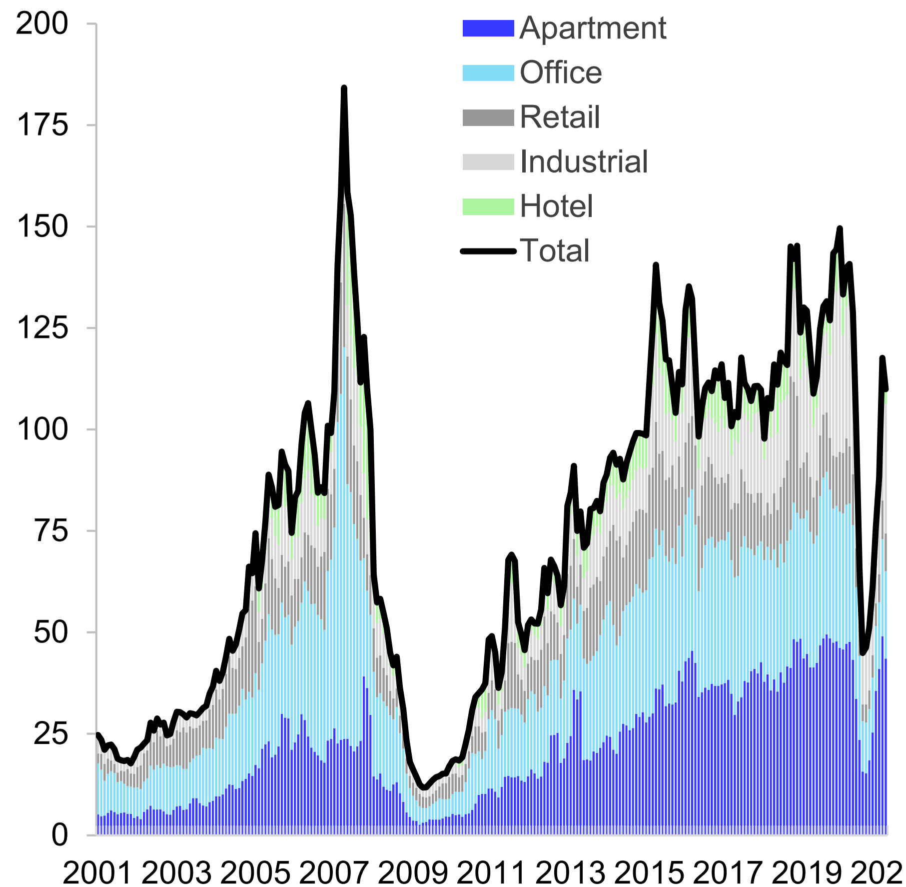
Prices and Sales Volumes

Property prices have been stable, rising in multifamily, despite the drop in sales volumes during the shutdowns

CoStar Commercial Repeat Sales Index



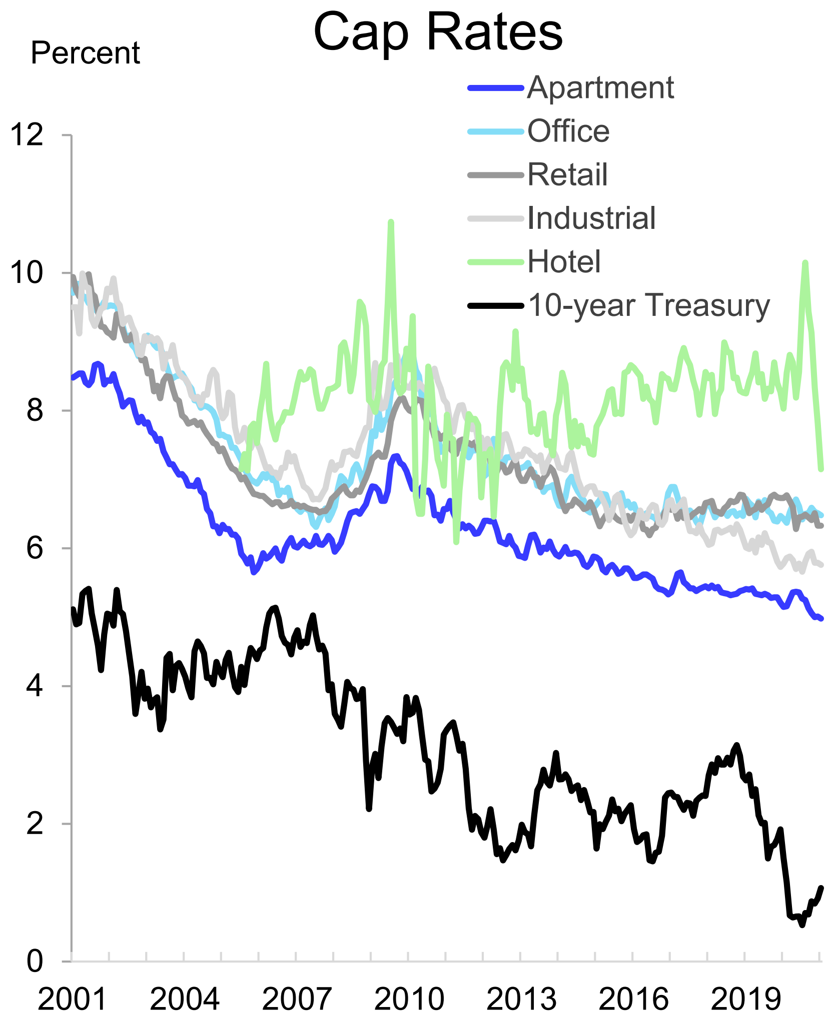
Sales Volumes

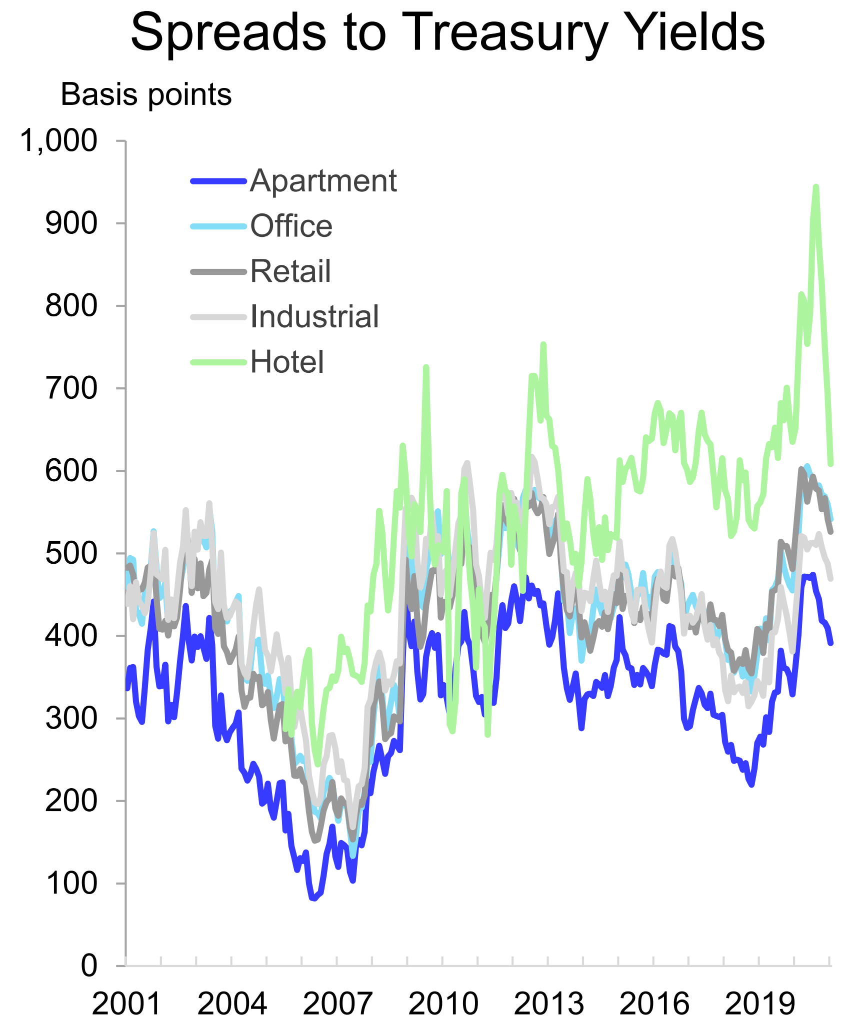


Source: CoStar, RCA, Bloomberg, Nareit

Capitalization Rates and Spreads to Treasury Yields

Cap rates are low, but in a low-inflation, low-yield environment, spreads are moderate to wide

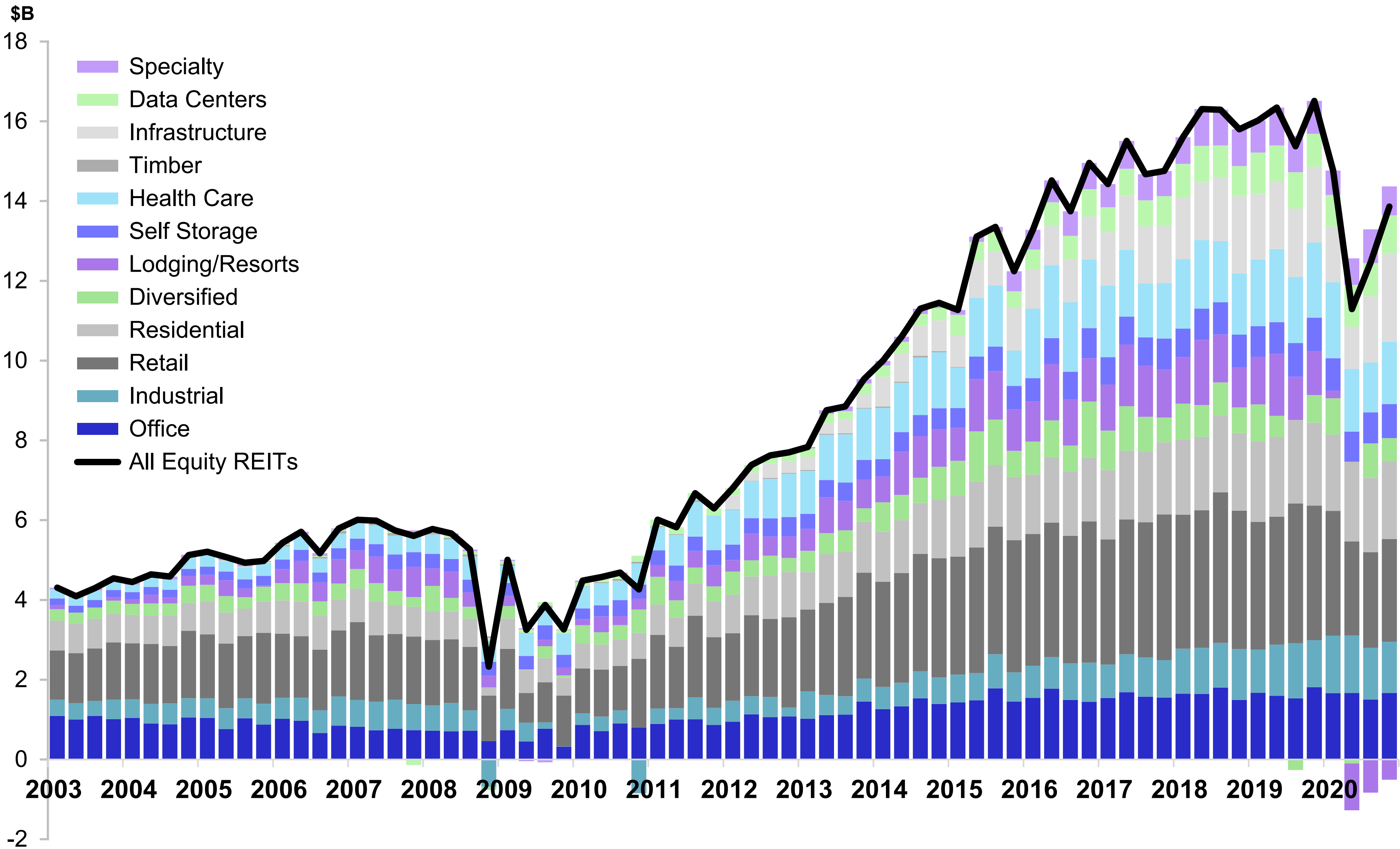




 Source: RCA, Bloomberg, Nareit

Funds from Operations

All listed U.S. equity REITs



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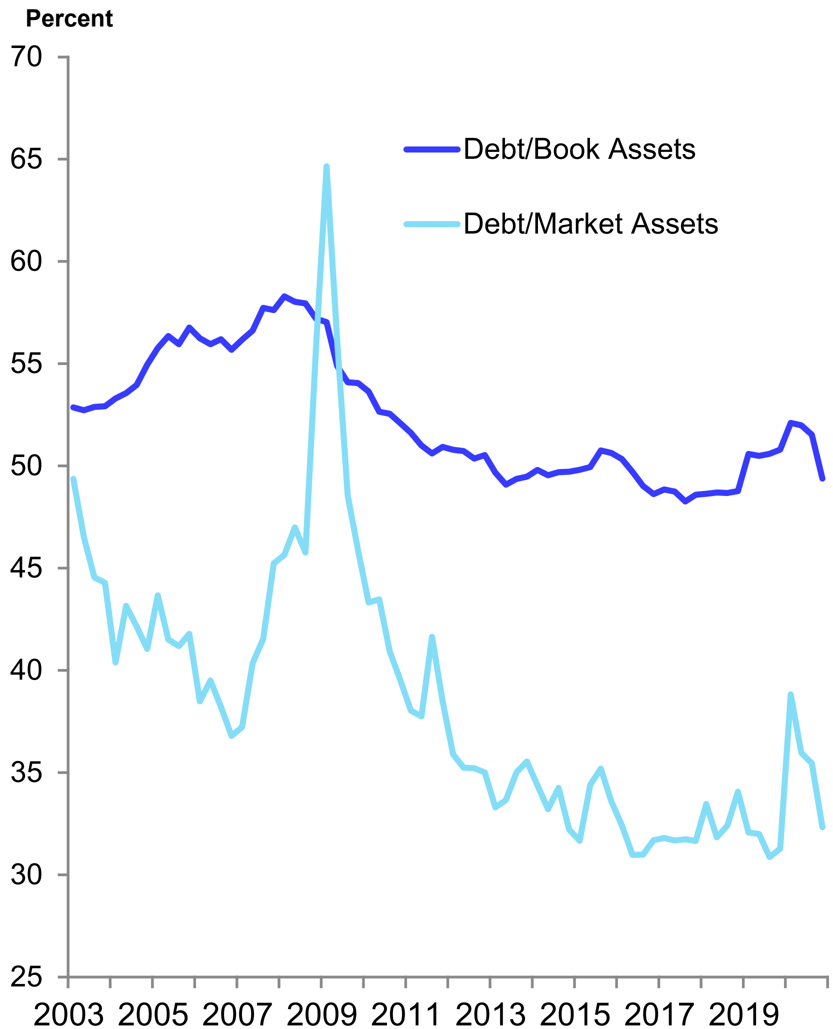
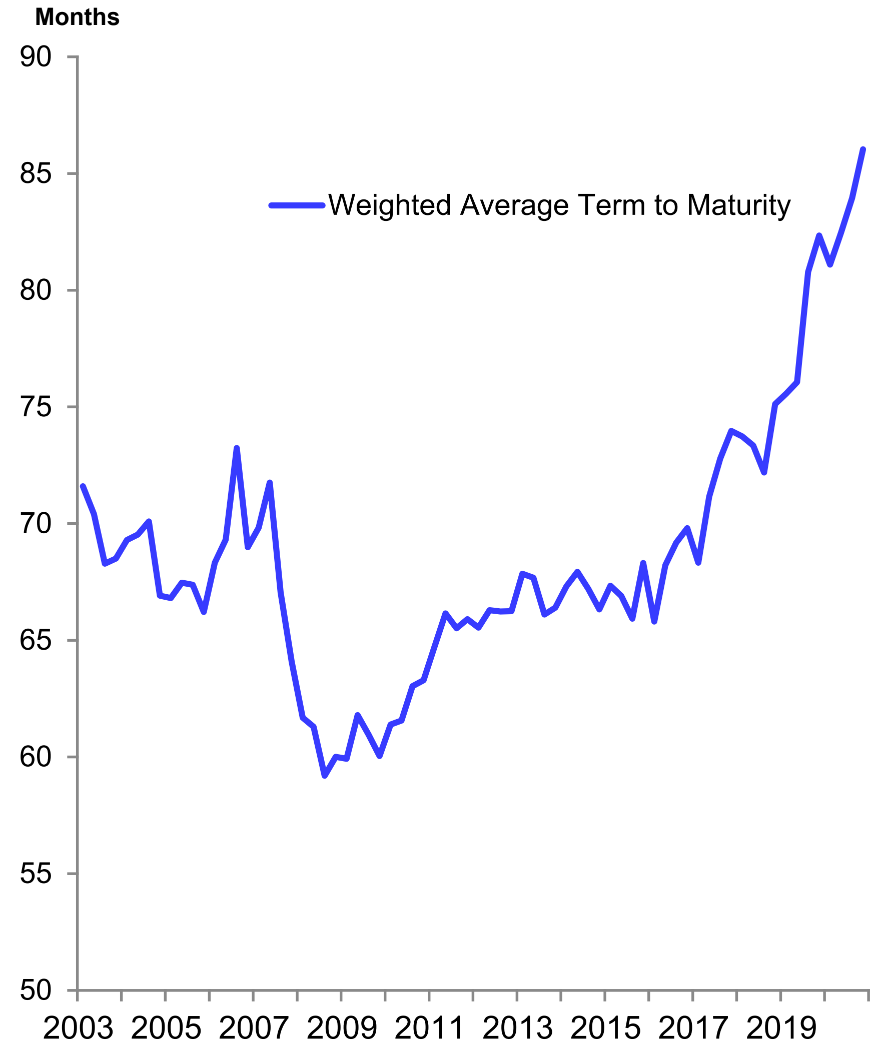
Source: S&P Global Market Intelligence, Nareit T-Tracker®

REITs: Leverage and Debt Maturities

All listed U.S. equity REITs

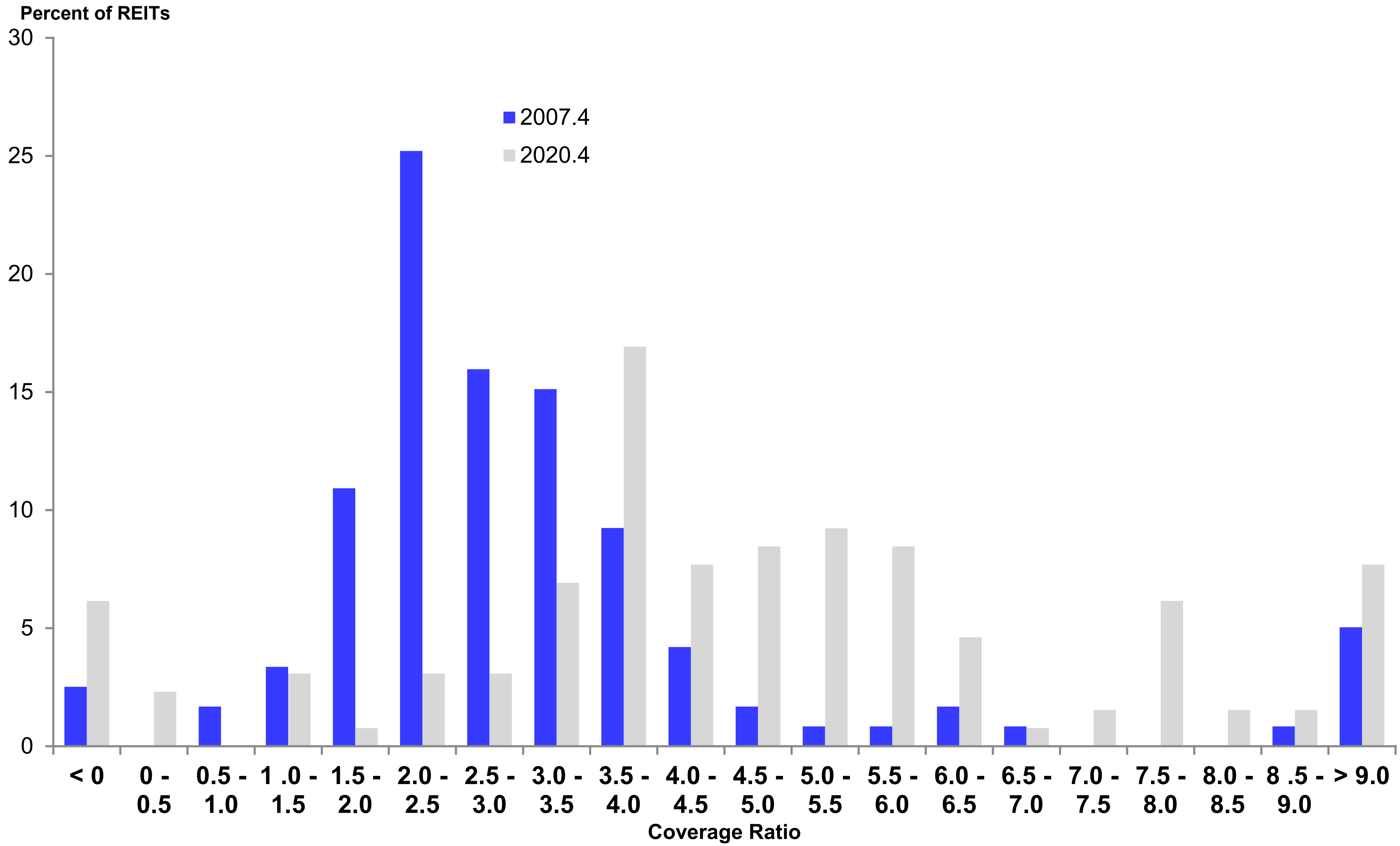




Source: S&P Global Market Intelligence, Nareit T-Tracker®

Distribution of Interest Coverage Ratios Across REITs

All listed U.S. equity REITs; Great Financial Crisis vs latest



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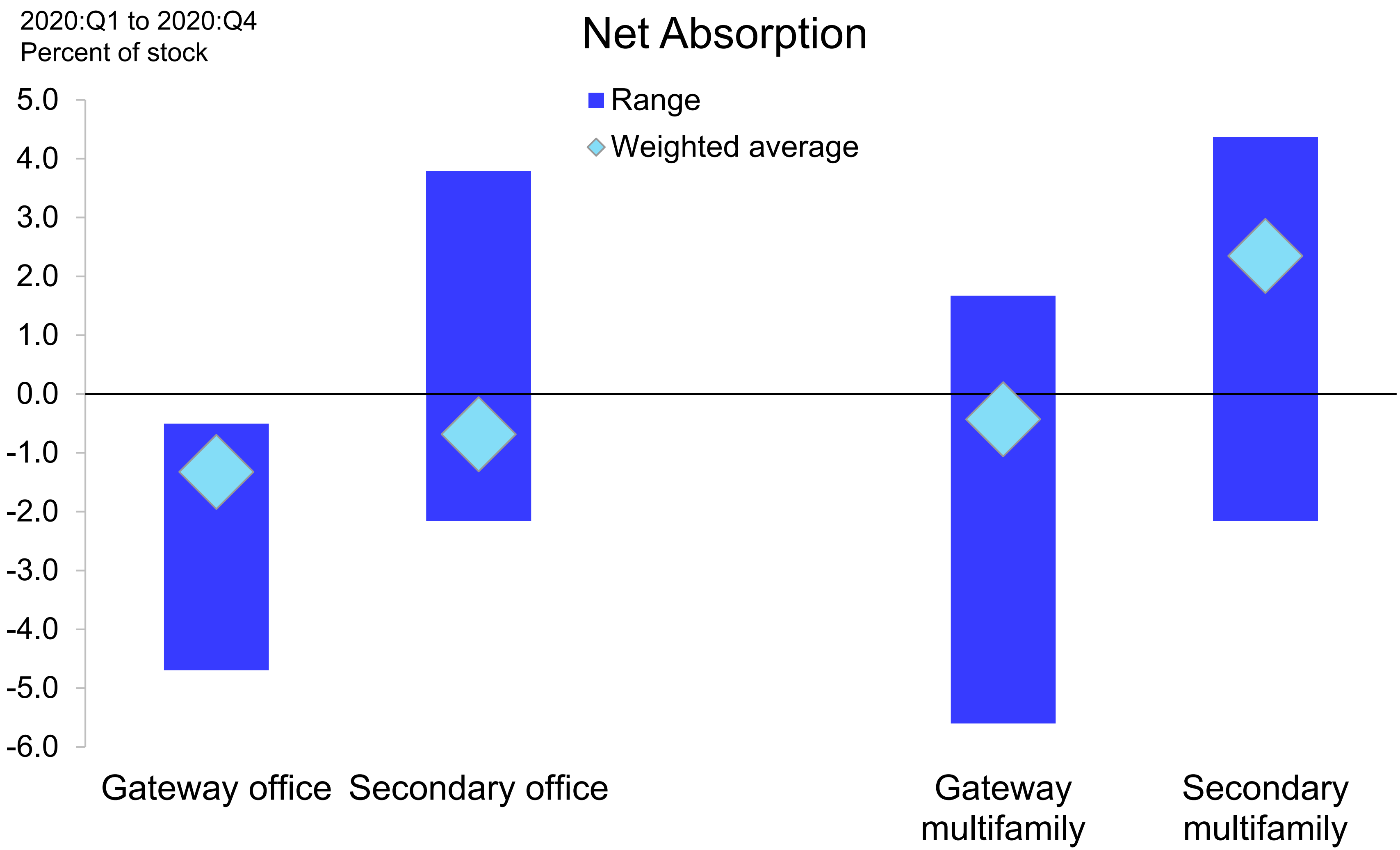
Source: S&P Global Market Intelligence, Nareit T-Tracker®

Work-from-home and CRE Markets

WFH has different impacts on office and multifamily markets across geographies. Are the effects transitory or permanent?

Work-from-home (WFH) and Net Absorption

WFH and the pandemic caused a decline in leased office space, esp in Gateway cities. Demand for apartments was weak in Gateway cities but strong elsewhere



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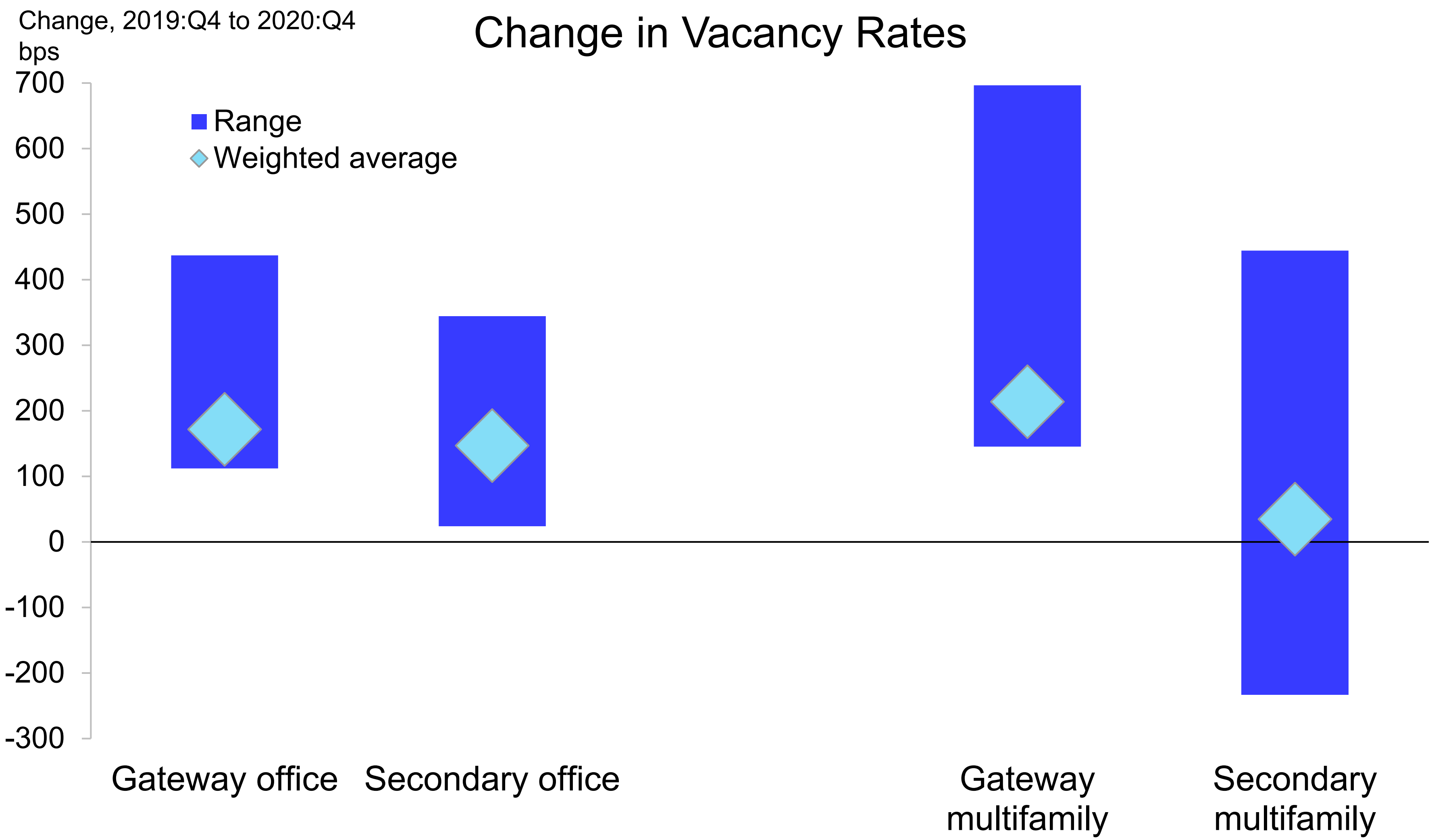
Source: CoStar, Nareit

WFH and Vacancy Rates

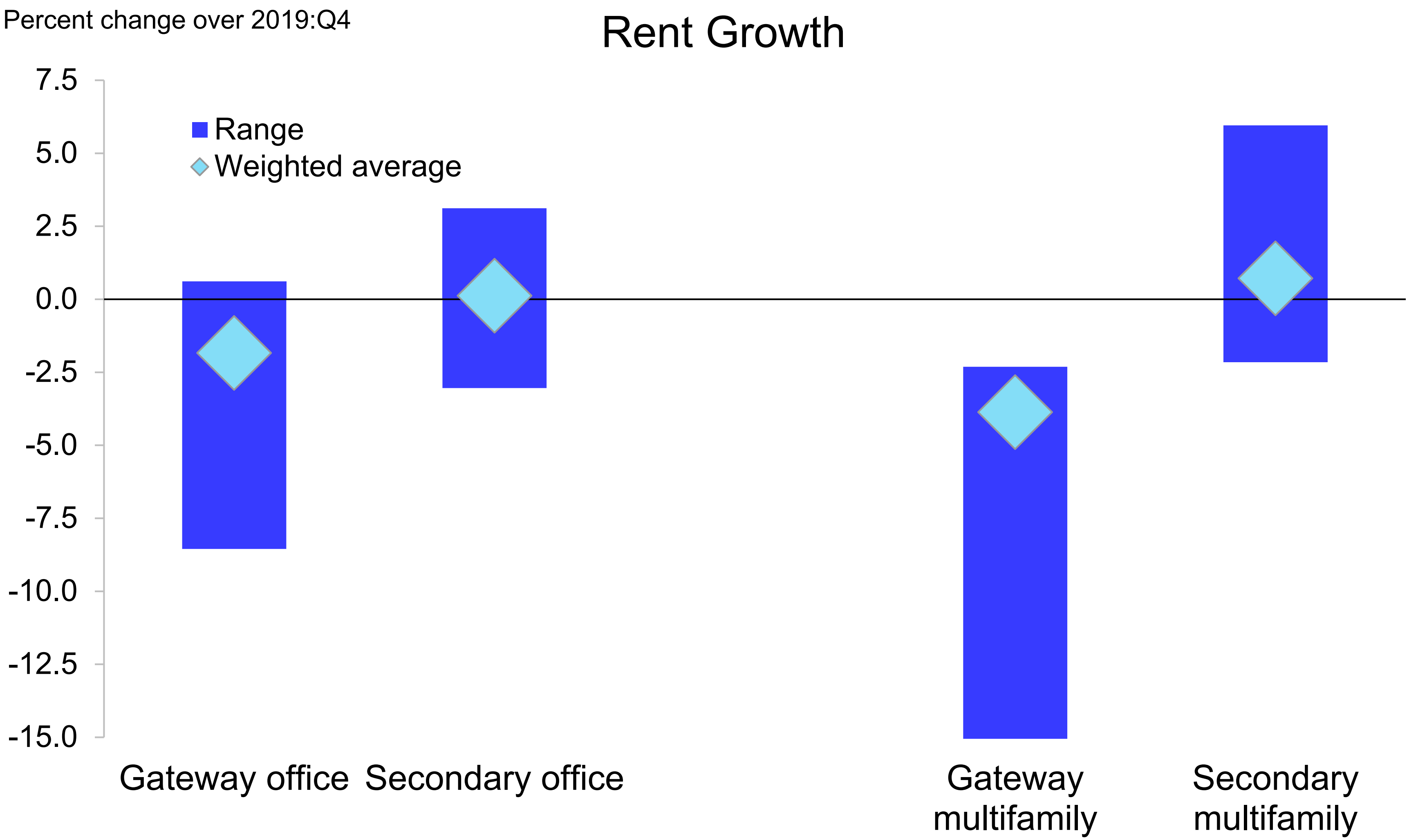
Vacancy rates rose in office markets and in Gateway apartment markets, but were less affected in secondary cities—and vacancies declined in many cities



Source: CoStar, Nareit

WFH and Rent Growth

Office rents declined in Gateway cities, but flat in others.
Apartment rents fell in Gateway cities, but continued to rise elsewhere.



Source: CoStar, Nareit

CRE Markets to Watch

Most traditional property sectors will be on path to recovery later this year

- ***Multifamily:*** Longer-term issues of lack of supply, demographics will re-emerge as transitory impacts of pandemic fade. Affordability remains a key issue.
- ***Office:*** WFH to boost flexibility, with some differential impact across major cities, suburbs and other cities. Impact on demand expected to be moderate.
- ***Retail:*** E-commerce impact on bricks & mortar retail accelerated during the pandemic. In-store experiences cannot be replicated online, though, and hybrid models—order online with curbside pickup—sustain need for store locations.
- ***Industrial:*** Logistics facilities are a clear winner from the surge in digital commerce.
- ***Senior housing:*** Vaccinations will revive move-ins. Cost pressures and labor scarcity remain, but Baby Boomer demographics are looming.

CRE Markets to Watch II

Newer sectors, including real estate for the digital economy, are thriving

- ***Data centers:*** The need for servers for cloud computing surged in 2020 and will continue to grow.
- ***Cell towers (infrastructure):*** No slowing in sight for voice and data communications.
- ***Self storage:*** The surge in construction 2016-2019 did not approach market saturation; small size of geographic markets leaves many pockets untapped.
- ***Lodging/resorts:*** Leisure travel to recover as vaccines allow "catch-up" family visits and resort get-aways. Business travel may be damped by Zoom.
- ***Specialty:*** The REIT structure has proven effective and flexible with many property types outside the traditional core CRE. What new types might emerge?

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