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

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# 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.

<table>
<thead>
<tr>
<th>Index / Property Sector</th>
<th>Market Cap ($B)</th>
<th>Total Return (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Equity REITs</td>
<td>1,187</td>
<td>(41.9)</td>
</tr>
<tr>
<td>Equity REITs</td>
<td>952</td>
<td>(44.4)</td>
</tr>
<tr>
<td>Retail</td>
<td>137</td>
<td>(54.6)</td>
</tr>
<tr>
<td>Shopping Centers</td>
<td>48</td>
<td>(52.0)</td>
</tr>
<tr>
<td>Regional Malls</td>
<td>38</td>
<td>(62.3)</td>
</tr>
<tr>
<td>Free Standing</td>
<td>51</td>
<td>(50.3)</td>
</tr>
<tr>
<td>Lodging/Resorts</td>
<td>38</td>
<td>(56.5)</td>
</tr>
<tr>
<td>Data Centers</td>
<td>115</td>
<td>(24.8)</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>200</td>
<td>(28.5)</td>
</tr>
<tr>
<td>Industrial</td>
<td>135</td>
<td>(34.5)</td>
</tr>
<tr>
<td>Office</td>
<td>81</td>
<td>(43.8)</td>
</tr>
<tr>
<td>Residential</td>
<td>174</td>
<td>(44.1)</td>
</tr>
<tr>
<td>Apartments</td>
<td>121</td>
<td>(44.7)</td>
</tr>
<tr>
<td>Manufactured Homes</td>
<td>27</td>
<td>(40.9)</td>
</tr>
<tr>
<td>Single Family Homes</td>
<td>25</td>
<td>(44.4)</td>
</tr>
<tr>
<td>Diversified</td>
<td>44</td>
<td>(53.1)</td>
</tr>
<tr>
<td>Health Care</td>
<td>112</td>
<td>(50.6)</td>
</tr>
<tr>
<td>Self Storage</td>
<td>66</td>
<td>(30.9)</td>
</tr>
<tr>
<td>Timber</td>
<td>35</td>
<td>(51.1)</td>
</tr>
<tr>
<td>Specialty</td>
<td>51</td>
<td>(56.1)</td>
</tr>
<tr>
<td>Home Financing</td>
<td>40</td>
<td>(61.0)</td>
</tr>
<tr>
<td>Commercial Financing</td>
<td>25</td>
<td>(66.2)</td>
</tr>
<tr>
<td>Russell 1000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*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

Index, Dec 2007 = 100

Sales Volumes

Billions of dollars, Seasonally adjusted

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

Source: S&P Global Market Intelligence, Nareit T-Tracker®
**REITs: Leverage and Debt Maturities**

All listed U.S. equity REITs

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![Graph showing Debt/Book Assets and Debt/Market Assets over time.](image)

![Graph showing Weighted Average Term to Maturity over time.](image)

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

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.

Net Absorption

2020:Q1 to 2020:Q4
Percent of stock

Gateway office  Secondary office  Gateway multifamily  Secondary multifamily

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.

Change in Vacancy Rates

<table>
<thead>
<tr>
<th>Change, 2019:Q4 to 2020:Q4</th>
<th>Range</th>
<th>Weighted average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gateway office</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Secondary office</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gateway multifamily</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Secondary multifamily</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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.

Rent Growth

Percent change over 2019:Q4

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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