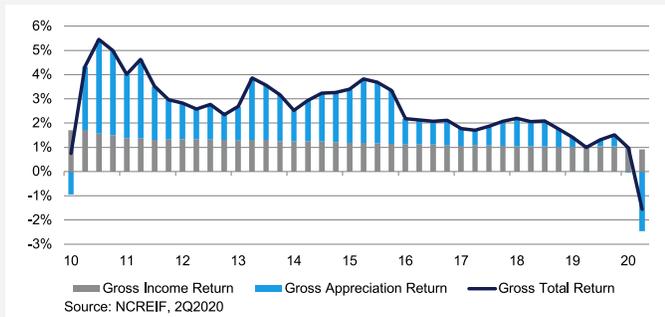


ODCE

THE PANDEMIC IS WEIGHING ON CORE REAL ESTATE PERFORMANCE

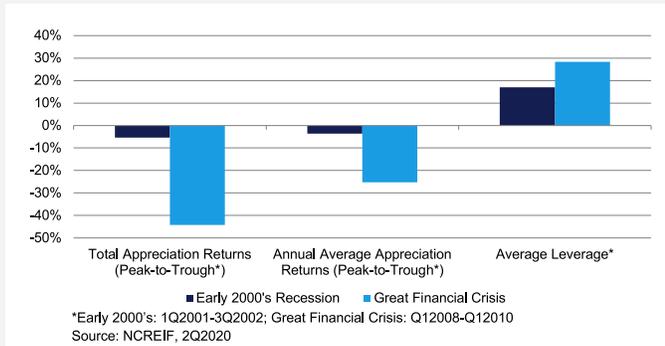
Pandemic-related quarantine measures have weakened real estate fundamentals and led to a sharp decline in investment volume. These trends have negatively affected net operating incomes, values, and returns. The latest quarter's NFI-ODCE Fund Index figures provide an indication of the initial impact on private core real estate performance. In the second quarter of 2020, the NFI-ODCE Fund Index posted gross quarterly total returns of -1.56%, which was down from 0.98% in the first quarter (Figure 1). Appreciation returns declined by -2.46%, decelerating from -0.04 in the previous period. This marked the largest appreciation losses since early 2010. Income returns slowed by 11 basis points to 0.91% in the second quarter. Total annual returns remained positive but moderated considerably from recent trends. Total returns over the previous year amounted to 2.22%—about one-third of the 6.41% level recorded in mid-2019. Performance was retrained by negative appreciation returns of -1.79% during this time period.

Figure 1: NFI-ODCE Index Returns (Quarterly)



Negative returns are likely to persist in the near future. There has been an immediate impact on real estate fundamentals in certain sectors, but the effect will likely be delayed in other property types. In addition, appraisal-based values have historically lagged public markets. The REIT market may provide an indication of expected declines in appreciation. The Nareit Equity REIT price index made a strong recovery in the second quarter after sharp losses but was still down -20% for the year. While every economic downturn varies substantially, it is also helpful to have an understanding of performance during previous recessionary periods for historical context. Note that historical data for the NFI-ODCE Index is limited to 2000. Peak-to-trough average annual appreciation returns ranged from -3.6% during the recession of the early 2000's to -25.3% during the Great Financial Crisis (GFC) (Figure 2). The economic and real estate fundamentals impact was much greater during the GFC than the early 2000's recession. In addition, average leverage was higher during this period. Leverage for the index rose in the second quarter to 22.3% but was in line with its historical average since 2000.

Figure 2: Appreciation Returns and Average Leverage by Recessionary Period

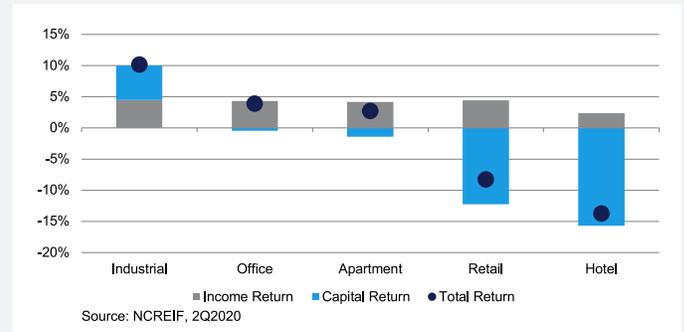


*Early 2000's: 1Q2001-3Q2002; Great Financial Crisis: Q12008-Q12010
Source: NCREIF, 2Q2020

Annual unlevered returns slowed across property types. The hotel sector has been the hardest hit segment thus far with double-digit losses, but it made up less than 0.5% of the NFI-ODCE Index market value. Retail performance deteriorated in the second quarter, with total annual returns of -8.3% and appreciation returns of -12.2% (Figure 3). In-store retail sales plummeted in the second quarter, as lockdown measures forced shopping center closures and deterred consumers from going out. Sector performance is expected to continue to struggle as bankruptcies and permanent store closures mount.

Industrial returns have moderated but continued to strongly outperform all other sectors. Appreciation was slightly negative in the quarter for the first time since 2010, as leasing activity and rent growth softened. Tenant and investor demand remains very healthy for the sector but appreciation returns are likely to continue to wane in the near term. Apartment and office each posted negative returns in the second quarter due to appreciation losses. Apartment fundamentals have weakened from subdued leasing activity and elevated supply levels. However, the economic downturn will likely limit homeownership, which could benefit apartment demand. Longer term lease structures have offered some stability to the office sector but there is significant concern regarding the impact of increased remote working on structural demand trends.

Figure 3: NFI-ODCE Index Returns by Property Type



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