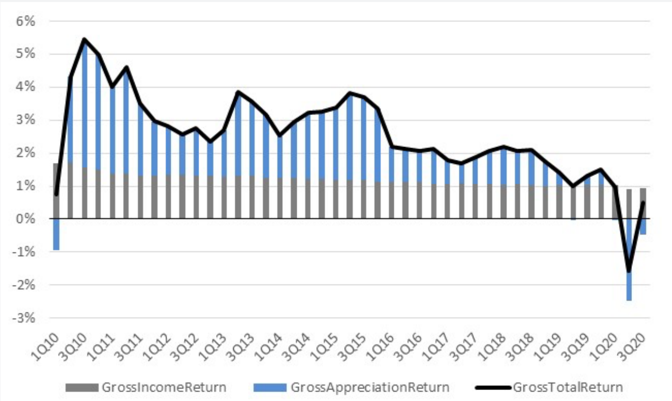
ODCE

CORE REAL ESTATE PERFORMANCE RECOVERS AFTER LARGE SHOCK IN THE SECOND QUARTER

We saw a large, initial shock to the real estate sector in the second quarter of 2020, as pandemic-related quarantine measures weakened real estate fundamentals and led to a sharp decline in transaction volume. These trends negatively impacted net operating incomes, values, and returns. The latest quarter's NFI-ODCE Fund Index figures show that the large initial impact on private core real estate performance we saw in the second quarter of 2020 has recovered into the third. In the third quarter of 2020, the NFI-ODCE Fund index posted gross quarterly returns of 0.48%, which marks a significant inflection from -1.56% in the second quarter. This improvement was primarily driven by appreciation returns, which improved to -0.46% in the third quarter from -2.46% in the prior. Income returns improved slightly to 0.95% from 0.91%. Total annual returns remained positive but continued to moderate considerably from recent trends. Total gross returns over the previous year amounted to 1.39% — about one-quarter of the 5.59% level recorded in the third quarter of last year. Performance was constrained by worsening appreciation returns of -2.50%.

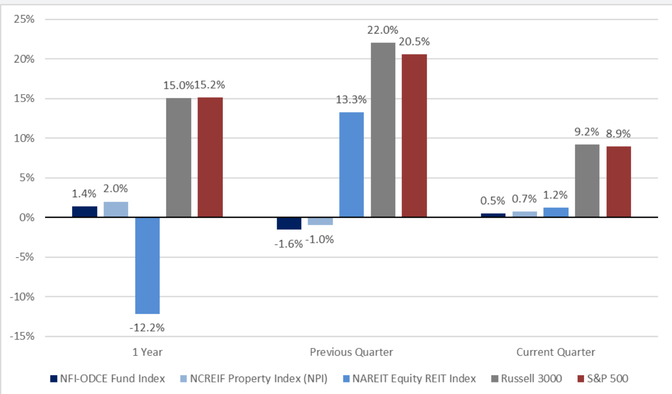
Figure 1: NFI – ODCE Index Returns (Quarterly)



Source: NCREIF, 3Q20

Negative appreciation returns may 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 was up 1.2% in the third quarter after making a strong recovery in the second quarter (Figure 2). However, the index has still not fully recovered from sharp losses during the first quarter and is still down 12.2% for the year. In comparison, other public equity indices (such as the Russell 3000 and S&P 500) are up ~15% over the past year.

Figure 2: Returns Comparison Across Asset Classes



Annual unlevered returns were mixed across property types (Figure 3). Hotel and Retail returns both remained negative in the third quarter. The hotel sector has been the hardest hit segment thus far with double-digit losses (-19%) primarily due to a large decline in capital values over the past year (-17.9%). Retail performance also deteriorated in the third quarter, with total annual returns of -7.6% and appreciation returns of -11.3%.

Contrary to Hotel and Retail, the three other major sectors posted positive unlevered returns on both an annual and quarterly basis (Figure 4). Industrial returns have moderated somewhat relative to history but continued to strongly outperform all other sectors. Appreciation was robust in the third quarter (+1.9%) after flat performance in the prior (+10bps). The Office and Apartment sectors also posted positive returns in the third quarter, following negative performance in the second. Appreciation returns for each were negative, but still-positive income returns more than offset this.

Figure 3: NFI-ODCE Index Annual Unlevered Returns by Property Type

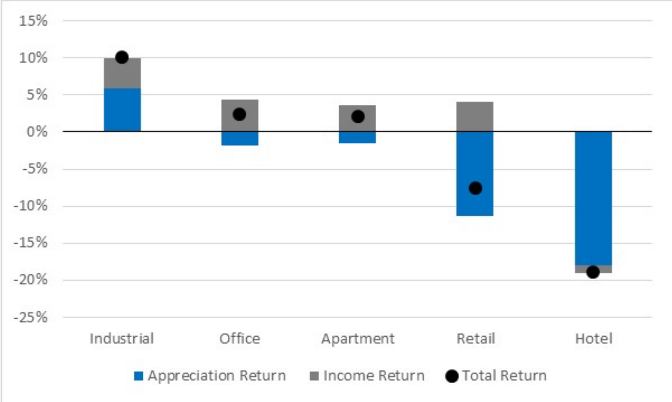


Figure 4: NFI-ODCE Index Quarterly Unlevered Returns by Property Type