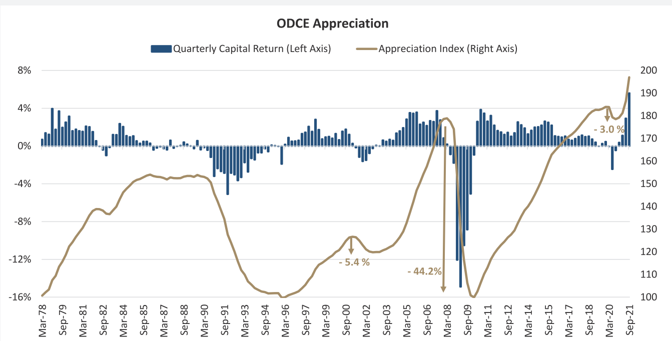
ODCE

RECORDBREAKING QUARTER FOR ODCE RETURNS

In Q3 2021, the NFI-ODCE posted the single highest quarterly performance since the inception of the Index in 1977. Of the 6.63% quarterly gross total return, appreciation contributed 561 basis points, which is also the greatest single-quarter capital return. The income returns, which since Q2 2020 have been the lowest in the history of the Index, trended above the 1% mark and contributed 101 basis points to the total return.

The pace of the ODCE rebound in the current expansion cycle resembles the sharp recoveries from past value declines. ODCE depreciation in 2020 was limited to -3.0%, much less than the value loss during previous U.S. economic downturns. Yet the cumulative appreciation from the Q3 2020 trough is already +10.4%, compared to the one-year rebound of +13.2% following the Great Recession trough and +1.2% from the post-Dot Com recession recovery.



The precipitous value increase of the Index continued to be characterized by property type differences, with industrial and apartment driving performance. The under-performing sectors showed improvement as well, with Q3 2021 marking the first positive capital return quarter for the retail sector since 2018.

ODCE industrial appreciation of 10.7% in Q3 alone brought the sector's post-pandemic cumulative capital return to a remarkable 31.2%. Fundamentals tightened in the third quarter, with the national ODCE industrial vacancy rate falling to 2.5%, with 88% of properties fully leased and 92% having occupancy at or above 95%. Demand momentum continued to translate into strong rent growth, aggressive pricing, and further yield compression. Among the top 20 ODCE markets by total allocation, Riverside led industrial returns with a gross unlevered quarterly total return of 22.2%, followed by Los Angeles, Austin, Phoenix, and Anaheim, all with double-digit appreciation.

Depreciation slowed to a flat -0.1% for regional and super regional mall retail investments. Non-mall retail appreciation rose to 0.7%, following ten quarters of depreciation and a flat 0.1% increase in Q2 2021. This turning point reflects improving sector fundamentals as well as investor sentiment. The ODCE retail Index registered 90.0% average occupancy, up 127 bps from two quarters ago, with leasing gaining pace during the summer months. Recent valuations reflect appraisers recognizing a more stable investor outlook that stems from positive economic tailwinds driving retail sales.

The divergence in property type returns performance has transformed the ODCE sector weights. The table below shows the allocation change, along with the gross value change and appreciation, and the comparison of those indicates fund investment activity. Between Q4 2019 and Q3 2021, the office share of ODCE gross unlevered property value fell from 34% to 28% due to both depreciation and net disposition of assets. Similarly, the ODCE retail allocation decreased from 17% to 13% as mall valuations declined the most among the major sectors. Apartments are now a close second to office with a 28% ODCE weight. Industrial weight is up 688 bps since Q4 2019. The growth is attributable to unprecedented appreciation and ODCE managers' increasing investment activity in the sector. 'Other' (comprised of niche property sectors) has also seen a positive allocation trend, with the gross investment value rising by 48%.

ODCE Gross Unlevered Property Value by Property Type	Share of ODCE		Gross Value (GRE)	Appreciation
	Q3 2021	Δ from Q4 2019	Δ from Q4 2019	from Q4 2019
Office	28%	-582 bps	-7%	-2.5%
Industrial	25%	+688 bps	+54%	31.2%
Retail	13%	-350 bps	-12%	-12.6%
Apartment	28%	+106 bps	+17%	7.3%
Other	6%	+138 bps	+48%	14.5%
Total	100%	-	+12%	7.1%

Source: Q3 2021 NFI-ODCE Property Type & Region Diversification, NFI-ODCE Preliminary Performance Attribution.

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