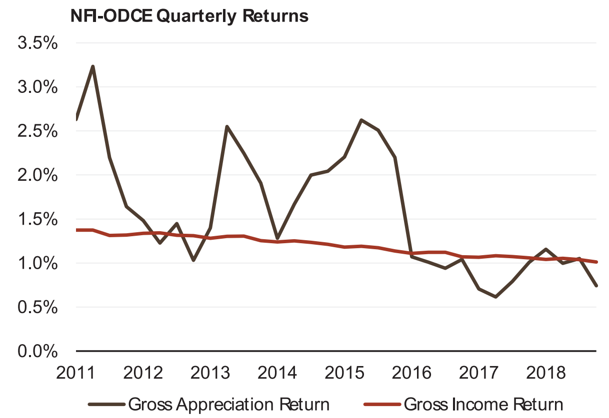
ODCE

A NEW ERA OF ODCE PERFORMANCE

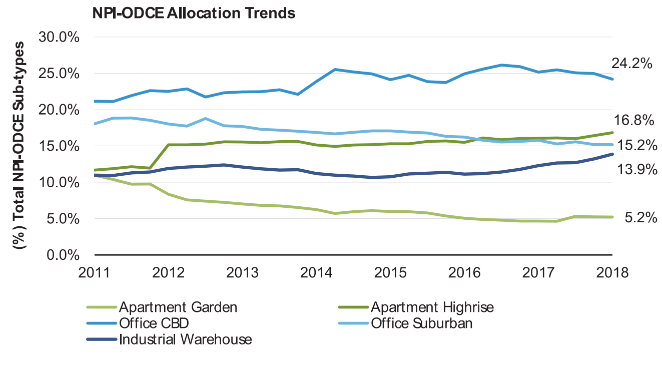
The NFI-ODCE index closed out the year with a 1.76% gross total return, of which 0.74% came from appreciation and the remaining 1.01% from income; ending 2018 with an 8.35% gross annual total return. Almost ten years since the trough of the great financial crisis, this quarter's results follow a three-year trend of income and appreciation sharing an approximately equal contribution to return, illustrated in the chart below. Over the long run NFI-ODCE income return makes up the majority of total return. Income return comprises approximately 82% of the since inception return of 8.71% as of 4Q18; with 7.16% of the return coming from income and 1.47% from appreciation.



Source: NCREIF NFI-ODCE as of 4Q18

Among the four primary property types in the ODCE, the NPI quarterly total return performance in 4Q18 remained consistent in rank from the previous quarter, as well as throughout the calendar year. Industrial cemented a fourth full year as the highest returning sector among all ODCE property types (including hotel) with a gross property-level total return of 14.1%, followed by Hotel at 9.6%, Office at 7.0%, Apartments at 5.4%, and Retail at 3.9%.

Persistent trends offer an easy (but overly simplistic) heuristic to understanding the market environment, because they hold – until they don't. Examining the ODCE allocation by sub-property type offers insight into constituent manager's reactions to changes in the market environment. Within the NPI-ODCE, three large sub-type shifts occurred over the past seven years, within the Office, Apartment, and Industrial sectors as shown on the right hand side.



Source: NCREIF NPI-ODCE as of 4Q18

Garden apartments had the largest absolute change over the past seven years since 2011 within the NPI-ODCE, decreasing from roughly 11.0% to 5.2% of the index, while high-rise apartments grew from 11.7% to 16.8%. Over this period NPI-ODCE garden apartments returned 9.9% annually, while high-rise apartments had returned 7.5%. This inverse return and allocation trend occurred simultaneously in the next largest shift in the index, within the Office sector.

The NPI-ODCE allocation to CBD office grew from 21.2% to 24.2%, while suburban office decreased from 18.1% to 15.2% as shown in the chart above. The annual total return for these sectors over the time period averaged 9.1% for CBD office and 10.1% for suburban office. At the beginning of the period before the shifts, the long-run (10-year) annual average return for CBD office at 7.6% had exceeded suburban office at 5.7%. This was also true for Apartments at the beginning of the period, where the long-run (10-Year) annual average return for high-rise apartments at 10.3% had exceeded garden apartment returns of 8.4%. Neither historic relative performance nor increasing ODCE allocations portended outperformance of these subsectors.

Industrial warehouse allocation within the NPI-ODCE increased by 2.9% since 2011 to approximately 13.9% by market value, and increased 81% by property count, compared to 51% on average for the index subtypes. The relative growth of this sector coincides with double-digit outperformance, over a period where NFI-ODCE appreciation return and cap-rate compression have become a smaller component of NFI-ODCE total return.

Joshua T. Rome
Research Analyst
UBS Realty Investors, LLC