NPI TURNS NEGATIVE WITH HISTORICAL DROP IN RENT

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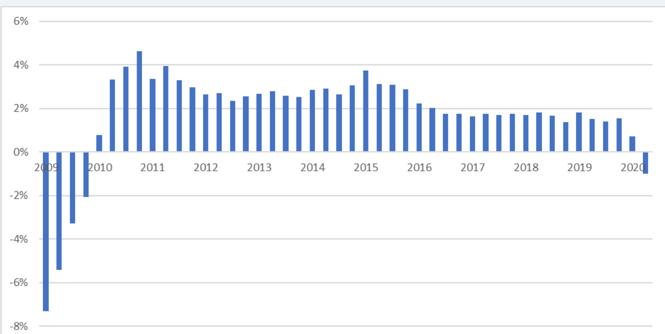
The NPI total quarterly return was -0.99% in the second quarter which was a decrease from the 0.71% return for the prior quarter. This is the lowest return since the fourth quarter of 2009 which was the midst of the financial crisis that lead to the Great Recession. This is an unleveraged return. The leveraged return for those properties in the index that have leverage was -2.76% for the quarter because the properties were earning less than the cost of debt.

NPI Unleveraged Total Quarterly Returns Since Great Recession

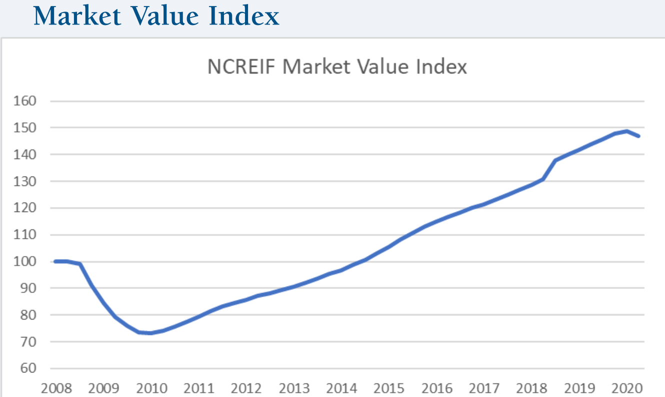


The total return turned negative for the quarter because the capital return (change in value net of any capital expenditures) of -2.00% offset the net operating income (NOI) return of 1.01%.

Market Value Index Drops after Peaking Last Quarter

The NCREIF market value index (MVI) measures the change in property values each quarter. The MVI declined by 1.1% for the quarter. This is a pure change in value before deducting capital expenditures for the quarter which is why it declined less than the NPI capital return. It is the first decline since the financial crisis.

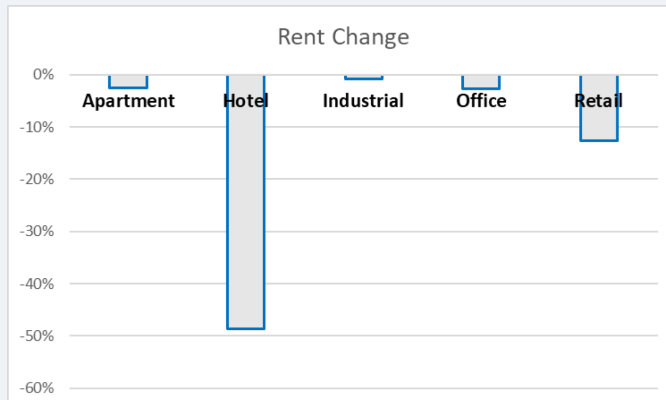
Market Value Index



Rent and NOI at Historic Lows

Both rent and NOI growth rates were the largest decline since NCREIF started collecting data which goes back to 1978 for NOI and 2001 for Rents. Not surprising, hotels had the greatest rent decline of 48.73% due to the impact of COVID-19 followed by retail with a 12.68% decline.

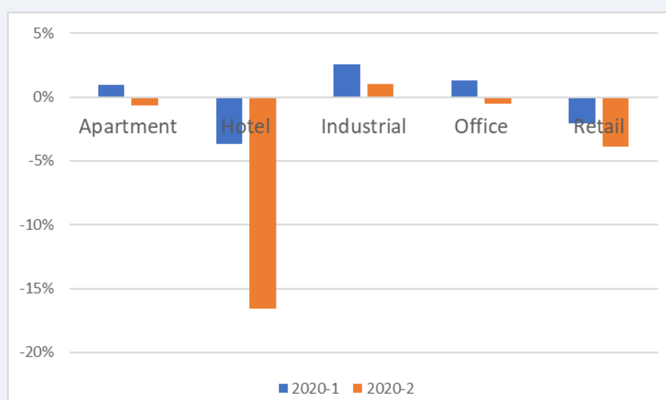
2nd Quarter 2020 Change in Rents by Property Sector



Returns Drop for all Sectors

Total returns were lower for all property sectors this quarter and they were negative for all property types except industrial which had a negative capital return but the income return offset that to deliver a positive 1.02% return.

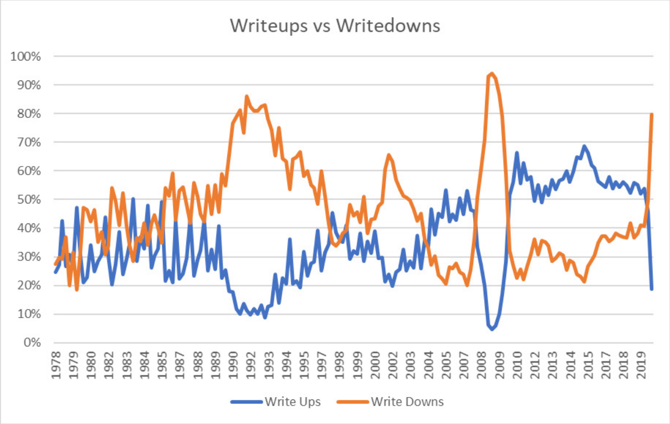
NPI Total Quarterly Unleveraged Returns by Property Sector



Write-ups vs Write-downs

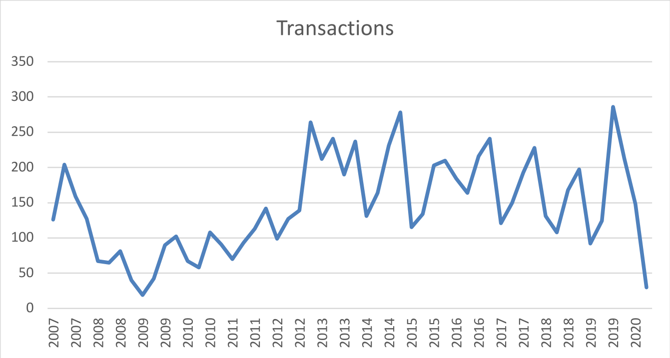
Whether the market is weak or strong, there are generally some properties that are increasing in value whereas others are declining in value. The number of properties written up vs. those written down, however, does vary significantly with market conditions. The number of properties that were written down this quarter jumped to about 80% of the properties in the NPI vs. 20% that were written up. This is the greatest disparity since the financial crisis.

Write-ups vs. Write-downs in the NPI



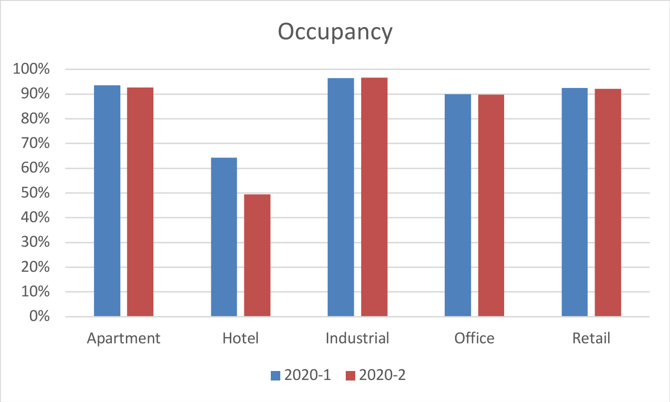
Transactions Plummet

While NCREIF participants are typically long-term investors, there are generally between 100 and 200 sales of properties each quarter. This quarter the number of sales dropped to 30 properties. The lack of transactions in the overall commercial real estate market has made price discovery challenging for appraisers and resulted in less liquidity for investors.



Occupancy

Somewhat surprising, occupancy remained about the same this quarter except hotel which dropped from about 65% to 50%. Occupancy probably remained about the same for the other property types because the space was still considered leased even though many of the tenants didn't pay rent during the quarter.



Conclusion

We experienced declines in rents and returns this quarter that haven't occurred since the financial crisis. Whether this will turn out to be a short or long-term decline is difficult to say because the cause of this decline is very different from that of past downturns. We have already seen a rebound in stock prices and to a lesser extent REIT returns. What may differ this time is the disparity of the impact on different property types and geographic locations.