QUARTERLY RETURNS UP FOR ALL PROPERTY TYPES EXCEPT RETAIL

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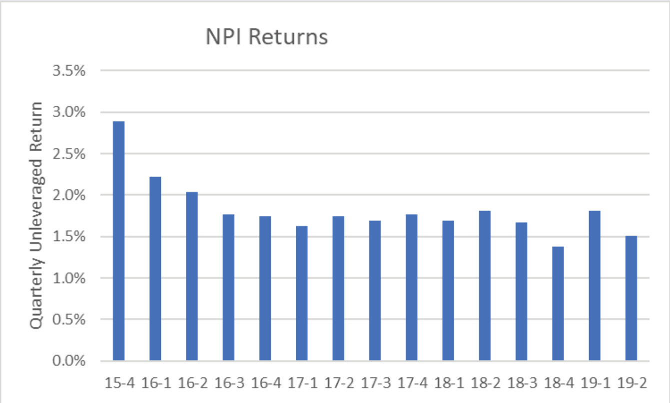
The return for institutional investors as measured by the NCREIF Property Index (NPI) was 1.51% in the second quarter, down from 1.80% last quarter. The return for this quarter was slightly below the average quarterly return over the past four quarters which was 1.59% or 6.52% annualized. This is an unleveraged return for what is primarily “core” real estate held by institutional investors throughout the US.

NPI Quarterly Unleveraged Returns

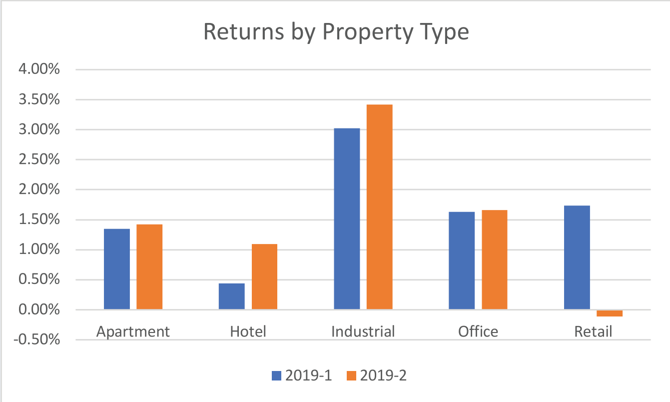


The total return of 1.51% consisted of an income return of 1.12% from NOI and a capital return of 0.38%. The positive capital return indicates that on average, properties in the NPI are still increasing in value after deducting capital expenditures that have been added. Thus, the commercial real estate market as reflected by the NPI has not yet peaked as some thought may have happened last quarter.

Retail Spoils the Party

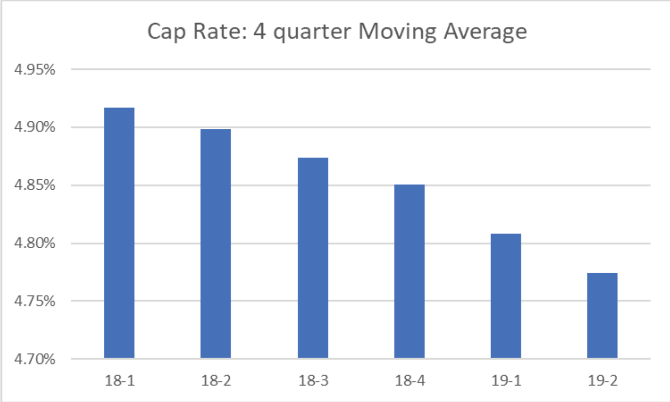
Returns for all the property types except retail were up slightly for the quarter. But returns for retail properties turned negative during the quarter by an amount that pulled down the entire NPI. The total retail return was -0.11%. Industrial properties had a return of 3.42%, up from 3.02% the prior quarter followed by office properties that had a return of 1.66% for the quarter which was up from the prior quarter return of 1.63%. Apartment returns were next at 1.42% versus 1.35% the prior quarter and finally, hotel returns increased from 0.44% last quarter to 1.09% the current quarter.

Returns by Property Type for NPI vs ODCE: 2019-2

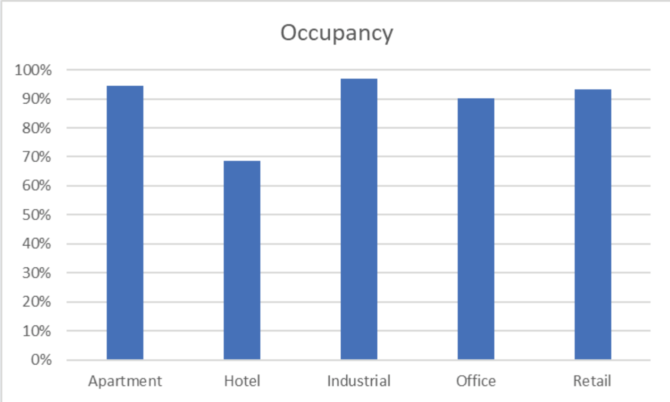


Cap Rates at Historic Lows While Occupancy Remains High

Cap rates on a four-quarter moving average basis (to remove seasonality) moved down slightly again this quarter. Equal weighted cap rates dropped to 4.77% from 4.81% the prior quarter.

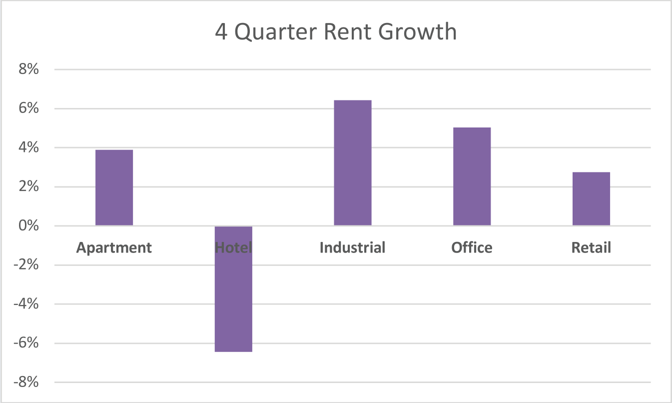


Occupancy increased to 94.3% from 93.8% the prior quarter. This is the highest occupancy since the 3rd quarter of 2000 and was the 8th highest quarter in the history of the NPI.



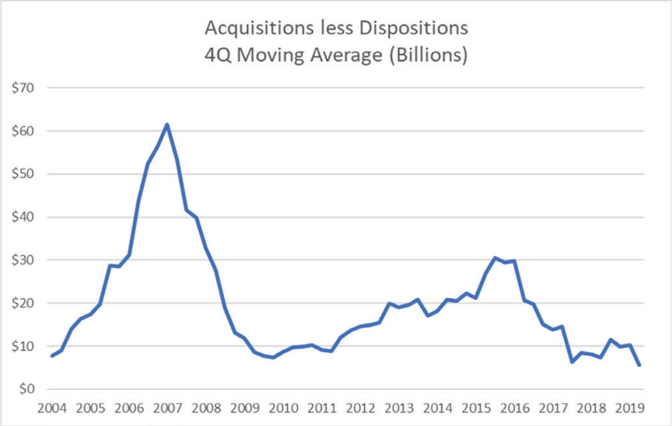
Rent Growth may be the Key

Except for hotels, rental growth was fairly strong for the past four quarters. Industrial had the highest growth at 6.63%% for the past four quarters. Office growth was 5.04% followed by apartments at 3.89%. Even retail came in with a positive four quarter growth of 2.76%. Hotel rental growth was -6.45%.

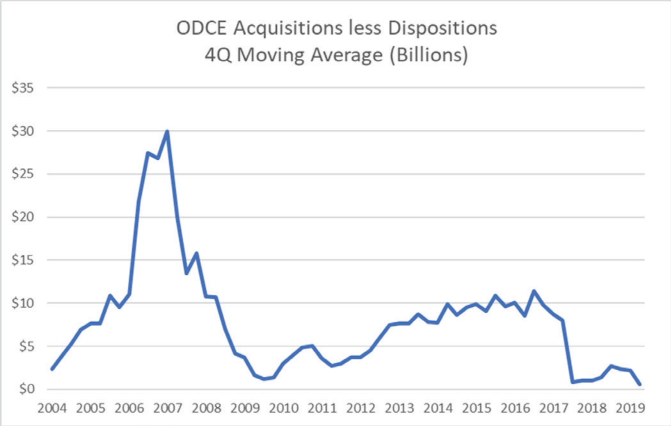


Acquisitions less Dispositions

Concern about the direction of the market is reflected in the number of acquisitions relative to dispositions (net acquisitions) of properties in the NPI. There was a significant increase in the net acquisitions before the financial crisis as seen in the following exhibit. Then not surprising, the net acquisitions dropped significantly in 2008 and 2009 although never turned negative. There was a fairly steady increase until 2016 after which the net acquisitions have been dropping almost every year to a level that is even less than during the great recession.



This pattern in net acquisitions was very similar for the ODCE funds as shown below. The pattern was also very similar for each property type (not shown). Net acquisitions have even fallen for industrial properties despite their relatively strong return performance.



Conclusion

The future course of the NPI appears to be depend a lot on whether retail returns continue to fall into negative territory. With cap rates at historic lows and occupancy near historic highs, we can't expect cap rate compression or higher occupancy to increase the returns for the other property types. Rental growth is probably going to be necessary to keep returns at current or higher levels.