ValTrends
3Q 2021 Report

A Tale of Two Segments

Since 1931, the most trusted investment analysis in the commercial real estate industry.

SitusAMC™

Executive Summary
Page 3

01 Capital Market ValTrends
Page 6

02 ValTrends by Property Type
Page 17

Office 19
Industrial 21
Retail 22
Apartment 24
Hotel 25

It was the best of times for many sectors and markets. Though not the worst of times, by any means, for the other markets, the third quarter was much about ***A Tale of Two Segments*** – an acceleration of the bifurcation that has been occurring for the past couple of years.

On the one hand is industrial, the prized possession of investors today. The industrial sector shattered records for nearly every metric in the third quarter, with annualized returns of 32% and occupancy rates, net absorption and effective rents at all-time highs. On the other hand, hotel was grappling with declining occupancy and RevPAR even before the omicron variant was discovered. Hotel returns, though improving, have a long way to go before they can claw their way back from pandemic-induced losses.

Industrial and hotel's third quarter results may not be surprising; they are a continuation of the patterns that began even prior to COVID-19. What came as more of a shock was the meteoric, but segmented, rise of apartments. Fundamentals are incredibly strong. Even the "lower performing" markets are doing well, just not as extraordinarily robust as the strongest ones.

The apartment market is in the midst of unprecedented increases in value. Garden apartments are outperforming everything, with suburban outperforming urban. The growth is not universal across markets, with a clear bifurcation. High-growth, high-demand markets in Colorado, Arizona, Southern California, Texas, North Carolina, Georgia and Florida are doing the best. Momentum is brewing in some of the gateway cities for the first time since before the pandemic. Rent growth is especially prevalent in Class A- and B assets, where there is more room to grow.

In other sectors, we also see increasing segmentation. Suburban office and life science are leaving other subtypes in the dust. Boston is holding up because many offices are being converted for life science. However, most office trades are newer Class A suburban trophy properties with longer-term leases, generally in thriving markets in Florida, Texas, North Carolina, with some in Southern California. A lot of the Sun Belt markets are back to above-inflation rent growth, but rents are decreasing in troubled markets like Portland and Chicago. In New York, quite a few more leases are being signed that are longer term, but they are getting signed at rates below market assumptions.

The bleeding has stopped in retail, and it is reasonable to expect a continuation of a modest recovery in values, led by the grocery-anchored space. That's where the most transaction activity is occurring. Mall tenant sales are coming back in the strongest markets, primarily in the Sun Belt, but it is difficult to determine its cause or whether it is sustainable, especially since mall spreads are still negative. Class A+ malls are doing well, the ones that are huge and in great locations. Many of them probably have a luxury component, which has done well throughout the pandemic.

In this report, SitusAMC Insights will dive deeper into the data, which supports ***A Tale of Two Segments*** in the commercial real estate market. Considering that the pandemic has had significant ups and downs and changed the way people shop, work and spend their leisure time, it is no surprise that commercial real estate is experiencing a variegated recovery.

01

Capital Market ValTrends

Commercial real estate returns soar as economy improves.

Economy & Financial Markets

Third quarter GDP growth (2nd estimate) was 2.1%, following first and second quarter growth of 6.3% and 6.7%, respectively.

The unemployment rate continued to drop, falling to 4.2% in November. The unemployment rate is about 70 bps higher than pre-pandemic levels. Initial unemployment claims fell to their lowest level in over 50 years.

Major stock indices rose in July and August before retreating in September. The Dow, S&P 500 and Nasdaq all reached record highs in early- to mid-November. Stocks plummeted the day after Thanksgiving on fears of the omicron variant, but quickly recovered.

CRE & Investment Alternatives

	YTD[6]	1-Year Trailing	3-Year Trailing	5-Year Trailing	10-Year Trailing	15-Year Trailing
NPI[1]	10.9%	12.2%	6.7%	6.8%	9.0%	7.1%
NFI-ODCE[1]	12.4%	13.6%	6.1%	6.6%	8.9%	5.6%
NAREIT Index (All Equity REITs)[2]	21.6%	31.5%	11.7%	8.4%	12.1%	7.1%
Consumer Price Index[3]	3.5%	5.3%	2.8%	2.6%	1.9%	2.0%
Dow Jones Industrial Average[2]	12.1%	24.2%	11.0%	15.7%	14.7%	10.1%
Nasdaq Composite[4]	12.1%	29.4%	21.6%	22.2%	19.6%	13.2%
NYSE Composite[4]	11.2%	27.1%	7.3%	8.5%	9.1%	4.4%
S&P 500[2]	15.9%	30.0%	16.0%	16.9%	16.6%	10.4%

	3Q 2021	3Q 2020	3Q 2018	3Q 2016	3Q 2011	3Q 2006
10-Year Treasury Bond[5]	1.3%	0.7%	2.9%	1.6%	2.4%	4.9%

[1]NCREIF NPI is a property-level (unleveraged) total return index, gross of fees; NCREIF NFI-ODCE is a fund-level (leveraged equity) total return index, net of fees.
[2]Based on total return index, and includes the dividend yield.
[3]Based on the published data from the Bureau of Labor Statistics (seasonally adjusted).
[4]Based on price index, and does not include the dividend yield.
[5]Based on average quarterly T-bond rates.
[6]Year-to-date (YTD) averages are not compounded annually except for CPI and NAREIT.
Sources BLS, Federal Reserve Board, S&P, Dow Jones, NCREIF, NAREIT, compiled by RERC, 3Q 2021.

The consumer price index (CPI) jumped 6.8% YoY in November, a 40-year high, and personal consumption expenditures (PCE), the Fed's preferred measure, rose 5.0% in October, a 30-year high. Core CPI was up 4.9% YoY in November and Core PCE was up 4.1% YoY in October.

The 10-year Treasury declined in third quarter to 1.3%, down 30 bps QoQ. The 10-year rate averaged about 1.6% in October and most of November.

Spreads between RERC real estate yields and the 10-year Treasury and corporate bonds compressed QoQ, with real estate yields remaining steady and Treasury and bond rates both declining.

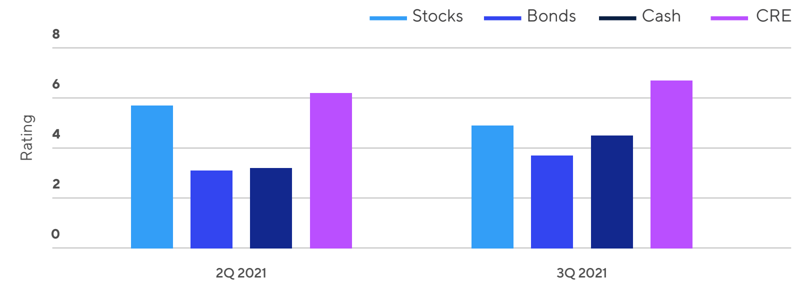
Moody's Baa spread was the widest in history, about 120 bps above the long-term average. Moody's Aaa spread was about 100 bps larger than the long-term average.

CRE & Investment Alternatives

RERC data show that investor preference for the CRE asset class increased QoQ, to the highest level in seven years. When comparing CRE to the traditional asset classes of stocks, bonds and cash, CRE has steadily increased in popularity since the onset of the pandemic, to the highest rate since 2015. With strong tenant demand for quality properties, several investors find that rents and values are rising faster than inflation. Investors remark that CRE has less downside than bonds, given increased inflation and expectations of rate hikes, or stocks, which have historically high values based on future expectations rather than current earning levels. CRE also has less risk than the stock market.

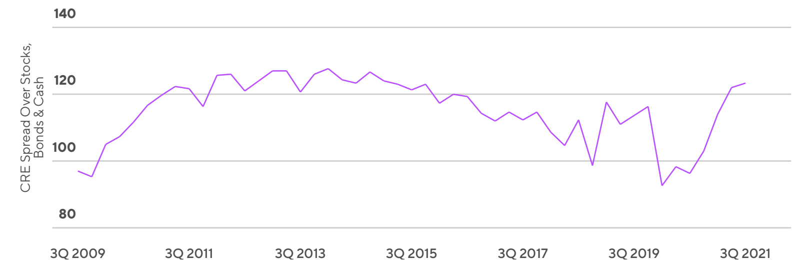
> "Commercial real estate offers several benefits the other categories don't."
>
> - SOUTH REGION RESPONDENT

Ratings of Investment Alternatives



Ratings are based on a scale of 1 to 10, with 10 being excellent.
Source RERC, 3Q 2021.

CRE Attractiveness Index[1]



[1]The RERC Attractiveness Index shows CRE investors' changing preferences for CRE over the traditional asset classes. The baseline of 100 indicates that investors feel traditional assets and cash, on average, are as attractive as CRE. Source RERC, 3Q 2021.

Preference for bonds notched up in the third quarter in anticipation of rising interest rates, though the low yields on bonds still make it the least preferred option among the alternatives. Preference for bonds was at pre-pandemic levels in the third quarter. Some investors cite peak pricing in stocks and CRE as the reason they are choosing bonds; others prefer the safety of bonds amid market uncertainties.

Institutional investors were less bullish on stocks in third quarter, with preference ratings for the asset class dropping considerably from last quarter's near-record rating. Some investors assert that stocks are too volatile in an uncertain economic environment; others note that stocks allow for more diversification to industries less exposed to headwinds.

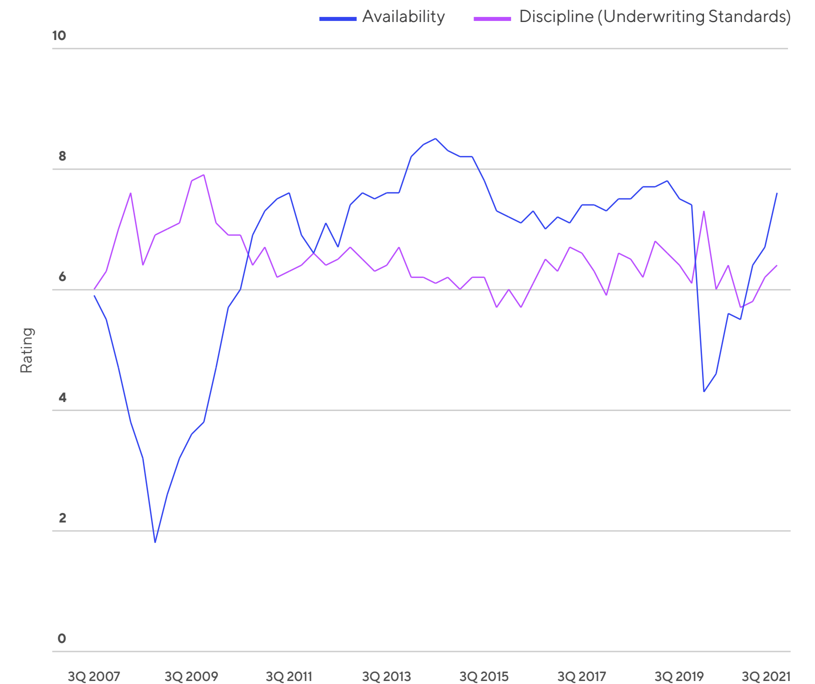
Though increasing QoQ, cash's rating has generally fallen since the all-time high reached at the beginning of the COVID-19 pandemic. As uncertainty in the investment environment has diminished, investor preference for cash has returned to pre-pandemic levels.

Availability & Discipline of Capital

Data from RERC suggests that investors are eager to deploy capital in this low interest rate environment. Since its pandemic low in 1Q 2020, capital availability has surged back to pre-COVID-19 levels. Though underwriting standards loosened in the latter half of 2020, they tightened throughout this year and are now on par with pre-pandemic levels. Since the beginning of 2021, the increase in availability outpaced the rise in discipline of capital.

> "There appears to be plenty of equity interest in deals. Availability of investment opportunities, though, at reasonable price levels, are not prevalent.
>
> - WEST REGION RESPONDENT

Historical Availability & Discipline of Capital – Equity & Debt Combined



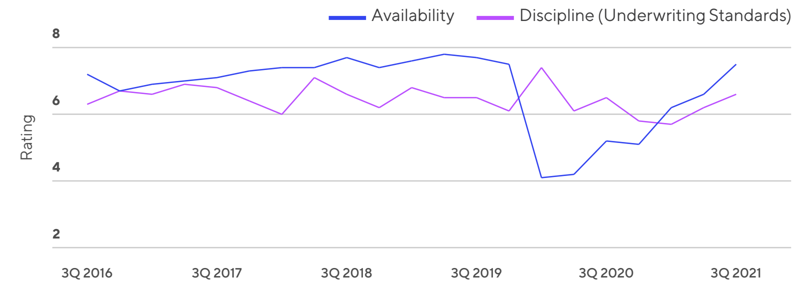
Ratings are based on scale of 1 to 10, with 10 being excellent.
Source RERC, 3Q 2021.

Since the beginning of the year, debt capital trends have been more exaggerated than equity capital trends, though they follow the same pattern as overall capital availability and discipline. Debt availability rose at a much quicker pace than equity availability, and underwriting standards became more conservative for debt than equity.

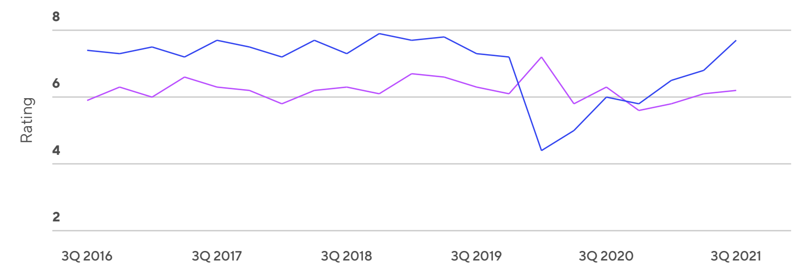
For equity capital, investors are exhibiting a high level of exuberance regarding market conditions, resulting in plenty of capital – at least for well-performing product types in solid markets. Institutional investors are sitting on a lot of cash, but non-traditional sources of funding are also prevalent. Investors are noting an uptick in public-private partnerships, 1031 exchanges and development funds. The limited supply of high-quality real estate investments, with some sectors still in recovery, has kept underwriting disciplined. Investors are noting that lending institutions are requiring greater amounts of equity.

The CRE debt market has an abundance of liquidity. With the cost of money low, banks are well-capitalized and willing to lend. Lending institutions are analyzing appraisals more aggressively, looking at borrower track records and cash flows along with the strength of the property. Lenders are concerned about soaring prices and are being careful not to repeat the mistakes they made during the GFC. Some borrowers state that it is difficult to get non-recourse loans.

Historical Availability & Discipline of Capital – Debt



Historical Availability & Discipline of Capital – Equity



Ratings are based on a scale of 1 to 10, with 10 indicating that return far exceeds risk or value far exceeds price. Source RERC, 3Q 2021.

CRE Returns, Volume & Pricing

Returns

With the highest capital return in history, NCREIF NPI total returns were 5.2% in third quarter, the largest level since 2005. Income returns remained stable throughout the pandemic near 1%. At 1.8%, office returns surpassed pre-COVID-19 levels and are near long-term averages. Capital appreciation ticked up to the highest level since 2015. At 3.1%, suburban office outperformed CBD by over 300 bps in the third quarter. Suburban returns are at a 7-year high. Suburban office was the top performing subtype in all regions.

With a 10.9% total return, industrial sector performance once again surpassed its previous record. Industrial has enjoyed positive total returns every quarter since the end of the GFC. Warehouse was the top performing major subtype in the third quarter; total returns increased by about 200 bps QoQ to 10.9%. Annual total returns for both warehouse and flex subtypes were over 30%.

The overall retail sector's return of 1.6% was the highest since 2019, but after two quarters of consecutive growth, the sector has not recovered from its pandemic losses. Capital appreciation turned positive for the first time in two years. Neighborhood retail had its highest return in five years at 2.7% and was the top performing retail subtype. Regional mall returns were back in the red at -0.6%, the worst performing subtype.

At 6.5%, quarterly apartment returns were at record highs this quarter. Capital appreciation more than doubled QoQ to 5.6%. Garden apartments were the clear subtype winner in the third quarter, with returns at a record 8.7%, outperforming the long-term average by 640 bps. The subsector's rebound from the pandemic has been remarkable – an increase of 740 bps YoY and 330 bps QoQ.

Hotel's total return was 1.8%, the highest in two years, and about 60 bps above its long-term average. The sector has had two consecutive quarters of positive returns, but it has not been able to claw its way back from pandemic losses. The sector recorded a positive income return for the first time since the onset of the pandemic.

Volume

Overall CRE transaction volume, as measured by RCA, topped $190 billion in the third quarter, the highest quarterly deal volume in history by about $11 billion. All property types had triple-digit increases in deal volume YoY.

Most notably, the hotel sector jumped nearly 290% YoY in the third quarter, with full-service taking a larger percentage of total deal volume. Though eye-popping, hotel deal volume has only increased to about pre-pandemic third quarter levels.

Apartment deal volume approached a 200% increase YoY, with almost $79 billion transacted. This was the highest apartment transaction volume in history, beating last year's record by over $15 billion. Garden apartments made up the bulk of deals. Industrial also had one of its best quarters for deal volume, driven overwhelmingly by warehouse properties.

Office and retail deal volume, up nearly 140% and 130%, respectively were near pre-pandemic levels. Retail activity was led by centers. Suburban office continued to drive office activity.

Non-major metros led in deal volume, with most of the activity occurring in the South and West. Dallas, Atlanta, Los Angeles, Phoenix and Boston were the most active markets.

Pricing

The RCA CPPI was up about 16% YoY in third quarter, the largest annual price growth in history. Overall CRE and each of the major property types had double-digit YoY price gains in third quarter.

Driven entirely by a 20% YoY increase for suburban office, the overall office sector tied with industrial for the largest price growth.

CBD office was the worst performer in third quarter; prices increased by less than 0.5% QoQ and have not returned to their pre-pandemic highs.

Larger price gains occurred in non-major metros than major metros QoQ and YoY, but both segments performed exceptionally well compared to historical standards. With double-digit gains for non-major metros and major metros, YoY price growth was the highest since 2005 and 2006, respectively.

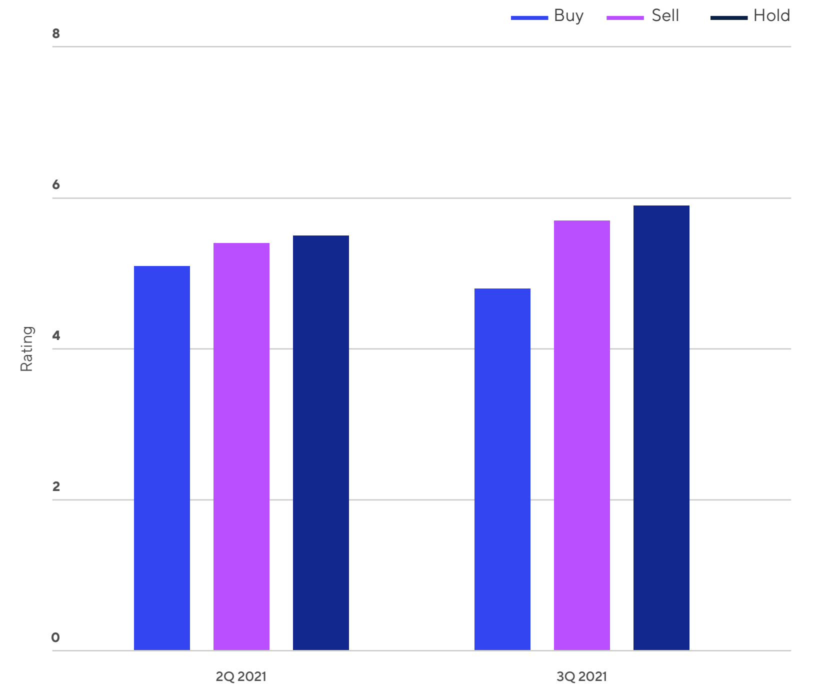
RERC Buy, Sell or Hold

Hold was the top recommendation for all property types in the third quarter except apartment and student housing, where the recommendation was to sell. Among the property types, investors were particularly keen on selling apartments. Warehouse also had a high sell rating.

CRE is becoming more of a seller's market as the buy-sell spread widened QoQ. However, the spread is well below pre-pandemic levels, reflecting investor confidence in continued appreciation and strong growth in space market fundamentals.

> "Seems as though sellers have a high expectation on price, not always reflecting the market."
>
> -EAST REGION RESPONDENT

Buy, Sell & Hold Recommendations — Overall CRE



Ratings are based on scale of 1 to 10, with 10 being excellent.
Source RERC, 3Q 2021.

02

ValTrends by Property Type

Record performance in industrial and apartment.

RERC Perceived Relative Risk

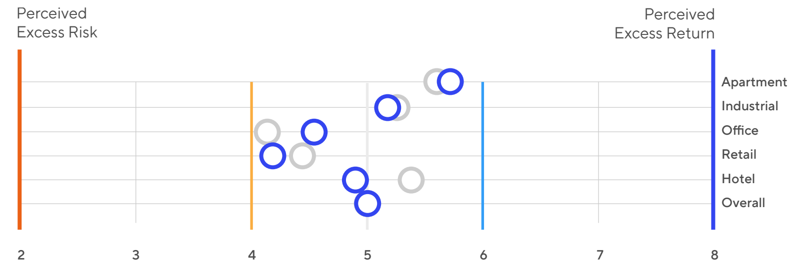
After three years of higher perceived relative risk, investors have found the sweet spot between risk and return for overall CRE. Market forces, such as demographic shifts and economic strength, have set the scene for future CRE growth. Structural changes such as e-commerce and teleworking are having mixed effects at the property-type level.

Perceptions of returns relative to risk increased QoQ to the highest level in seven years for the apartment sector. Apartment has outshined industrial since the beginning of the year in terms of the risk-reward ratio.

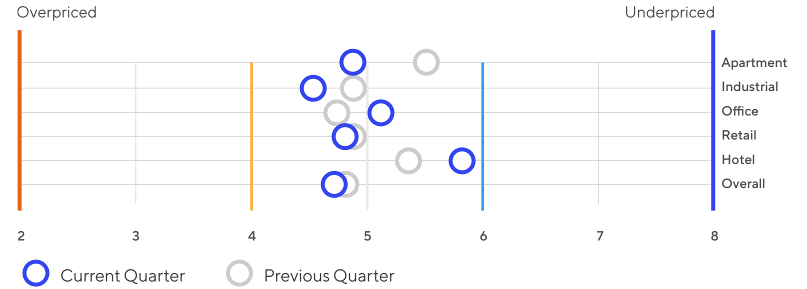
Relative risk ratings in the office sector have generally increased since the onset of the pandemic. Following the third quarter's increase, the sector is seen as having the highest risk-reward ratio over the past two years.

Retail and hotel ratings both declined QoQ, indicating greater relative risk. However, third quarter ratings returned to pre-pandemic levels following their record lows in early 2020.

RERC Perceived Relative Risk



RERC Relative Value Sentiment



Ratings are based on a scale of 1 to 10, with 10 indicating that return far exceeds risk or value far exceeds price. Source RERC, 3Q 2021.

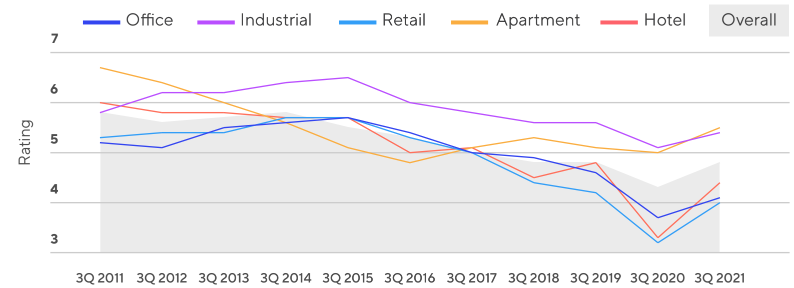
RERC Relative Value Sentiment

Prices have been high relative to values for the past five years. Since the onset of the pandemic, perceptions of relative value have been on a slow but steady decline. Investors remark that prices on most assets have gone up significantly.

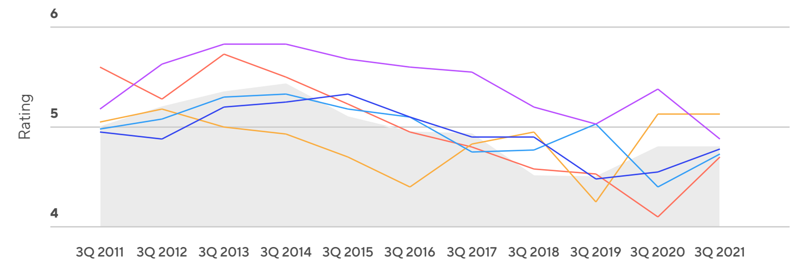
Investors are seeing bargains in the hotel sector, with perceptions of relative value jumping to their highest level in eight years in the third quarter. Perceptions of relative value in the office sector ticked up QoQ to the highest level in over three years.

Apartment, industrial and retail were all seen as pricier in the third quarter. Investors feel that prices have run away from values relative to historical levels in the industrial sector. Apartments had a substantial quarterly decline in ratings but are still seen as having greater relative value than prior to the pandemic. Relative value for the retail sector is at its long-term average.

RERC Perceived Relative Risk — Average Annual Ratings



RERC Relative Value Sentiment — Average Annual Ratings



Ratings are based on a scale of 1 to 10, with 10 indicating that return far exceeds risk or value far exceeds price. Data represent four quarter moving averages. Source RERC, 3Q 2021.

SitusAMC Office Insights

There was a surge of demand for office space in the third quarter. Net absorption was the highest since 2005, and occupancy grew at the fastest pace in 14 years. With completions at an 8-year low, office is in a favorable position for short-term rent growth. Occupancy growth was much more pronounced in Class B/C space than Class A at 60 bps and 10 bps, respectively.

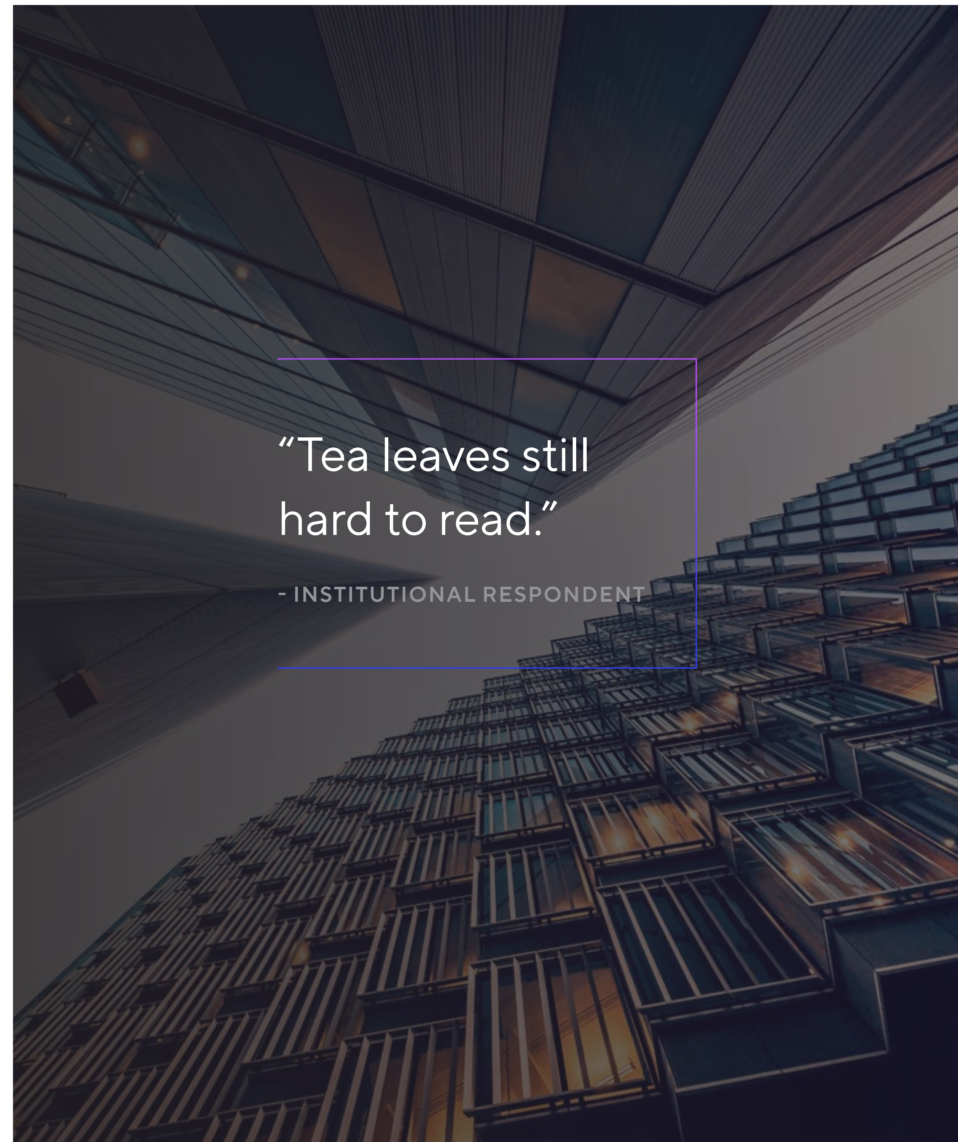
The omicron variant will likely slow the return of workers to the office. The uncertainty of COVID-19-related regulations and the willingness of people to occupy office space puts office demand in question. Many companies are likely to push their return-to-office plans back to mid-2022.

The office sector likely has not felt the full effects of tenancy shifts and downsizing due to work-from-home policies. There is a potential for mid- to long-term increases in vacancy and drags on office rents.

Some investors note a risk of obsolescence due to changes in the ways tenants use space, including an increase in virtual reality systems and other technological advances.

Any increases in vacancy rates become particularly troublesome for office. Landlords typically incur fixed and operational costs regardless of occupancy.

The news for office is not all bad. Trophy assets with top-tier tenants in long-term leases are starting to gain speed in rents and values, particularly in secondary markets.



SitusAMC Industrial Insights

Simply put, supply is not keeping up with demand. Net absorption nearly tripled QoQ to the highest level in history. With muted completions YTD, there is still room for growth despite a very strong positive performance over the past few years. Asking and effective rents are at all-time highs.

Industrial is a stable asset class that has historically performed well and is less reactive to overall macro and microeconomic changes. Industrial demand has benefited from the pandemic and the shift to online shopping – and that benefit does not yet appear to be fading.

With declines in vacancy and soaring rent increases, demand for warehouse space is insatiable, especially in coastal and urban areas. Distribution, warehouse and light manufacturing space are the clear winners. With more products being manufactured and assembled in the U.S., industrial demand will continue to grow.

Fewer buildings are under construction due to lack of supplies, shrinking land options and increased costs. There is limited potential for new deliveries in urban areas.

Industrial has a high barrier to entry. Many investors think industrial is overvalued, but deals can still be had below replacement costs.

Industrial offers top returns and relative security and stability. The sector's outlook continues to be very strong.

Industrial Return	10.9%
Warehouse Occupancy	▲ 220 bps QoQ
Warehouse Effective Rent	▲ 300 bps QoQ

Source NCREIF, Reis, SitusAMC Insights, 3Q 2021.

SitusAMC Retail Insights

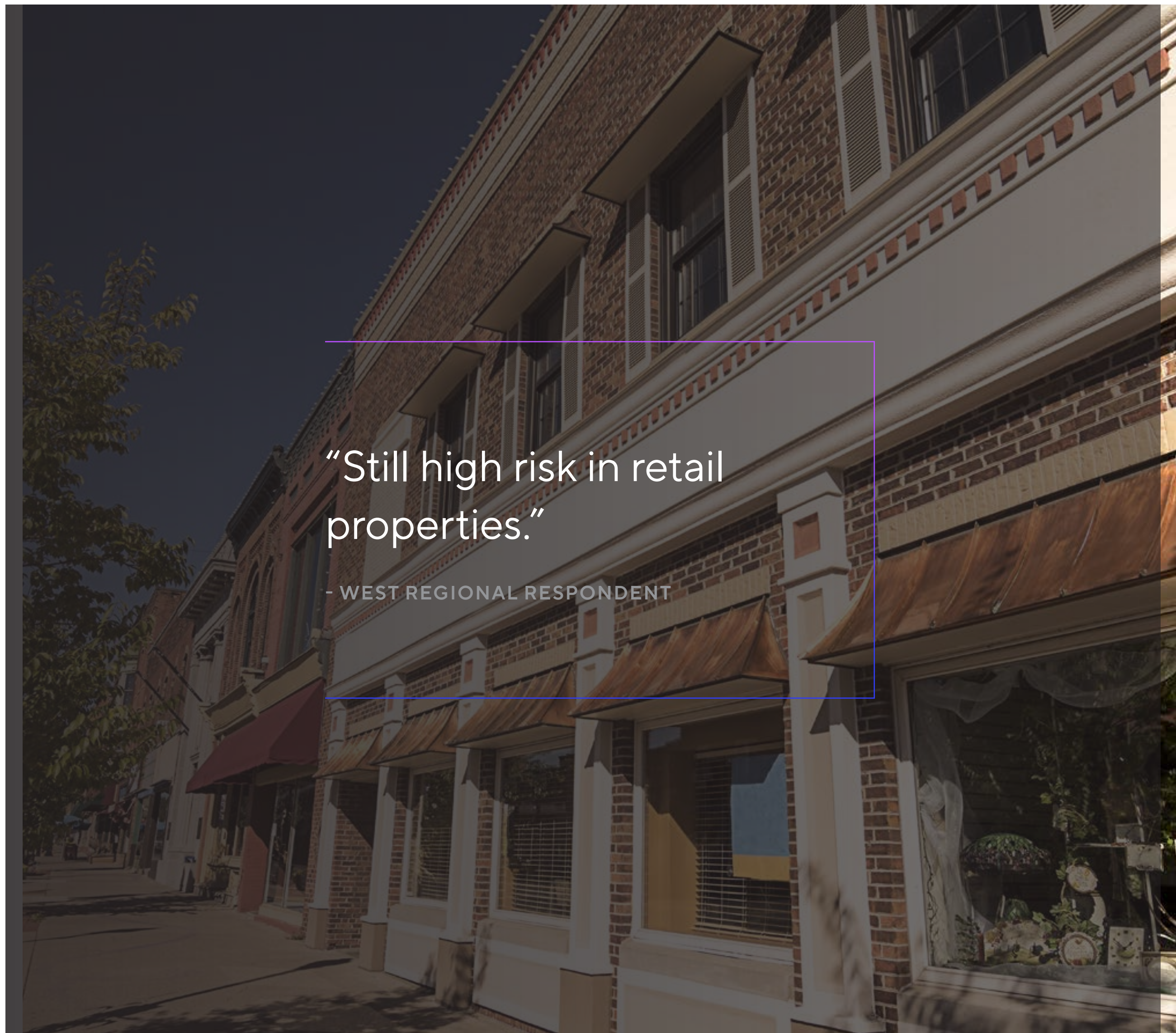
Third quarter net absorption was the highest in over two years, while completions, which were already very low, were down 70% from a year ago.

Still, many investors feel we are over-retailed and are divesting of brick-and-mortar properties. COVID-19 is still an issue and the e-tailing environment keeps gaining momentum.

Grocery-anchored retail and net lease are the top performers. The regional mall segment is experiencing difficulties. Many are being repositioned for adaptive reuse or other alternatives.

Tenants are in a precarious position as a result of labor shortages, supply chain and inventory constraints, and inflation.

On the bright side, retail asset pricing has not increased to a point where rates of return have materially compressed; retail may be undervalued at the moment.



SitusAMC Apartment Insights

The apartment sector shattered records in returns, cap rates and space market fundamentals in the third quarter. Breathtaking performances were seen in nearly every market.

Completions have fallen off since the beginning of the year and are now the lowest in eight years. Net absorption jumped 145% QoQ.

A lack of affordable options for other housing options is pushing people into multifamily rentals. Improving market fundamentals and large increases on renewals and new leases are driving valuations higher. Southern markets are especially hot with rents increasing by as much as 18% in the third quarter and cap rates compressing by as much as 50 bps.

The current costs of new construction limit the risk of overbuilding. Robust demand and a lack of inventory means room for continued above-average rent growth.

Even though cap rates are at historics lows and prices per unit are at historic highs, there is a lot of national and regional investor interest. The sector is relatively low risk and offers some protection against inflation.

Some investors believe that apartments are priced too aggressively, but interest rates are low enough to facilitate very aggressive initial yields. However, even small increases in interest rates may offset future rent growth.

Apartment Return
6.5%

Apartment Occupancy
▲ 60 bps QoQ

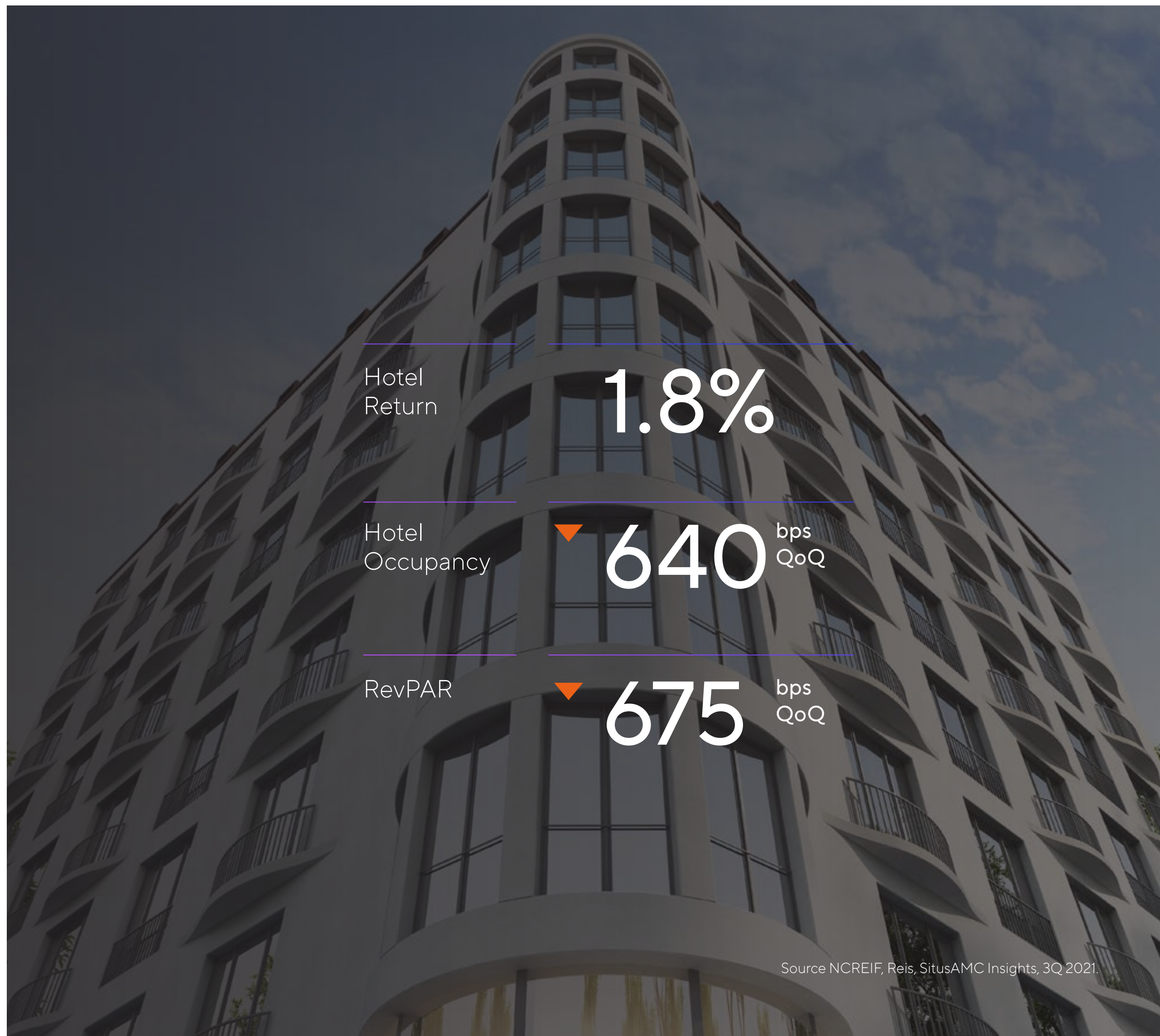
Apartment Effective Rent
▲ 790 bps QoQ

Source NCREIF, Reis, SitusAMC Insights, 3Q 2021.

SitusAMC Hotel Insights

With a 3.6% QoQ increase, room rates are approaching pre-pandemic levels. A full recovery is expected by early 2022. However, declining occupancy led to a loss in RevPAR in the third quarter. Occupancy and RevPAR are not expected to return to pre-COVID-19 levels until mid-2023.

Though personal travel is picking up, the hospitality market is still in early stages of recovery and highly susceptible to setbacks from the new omicron variant of COVID-19.

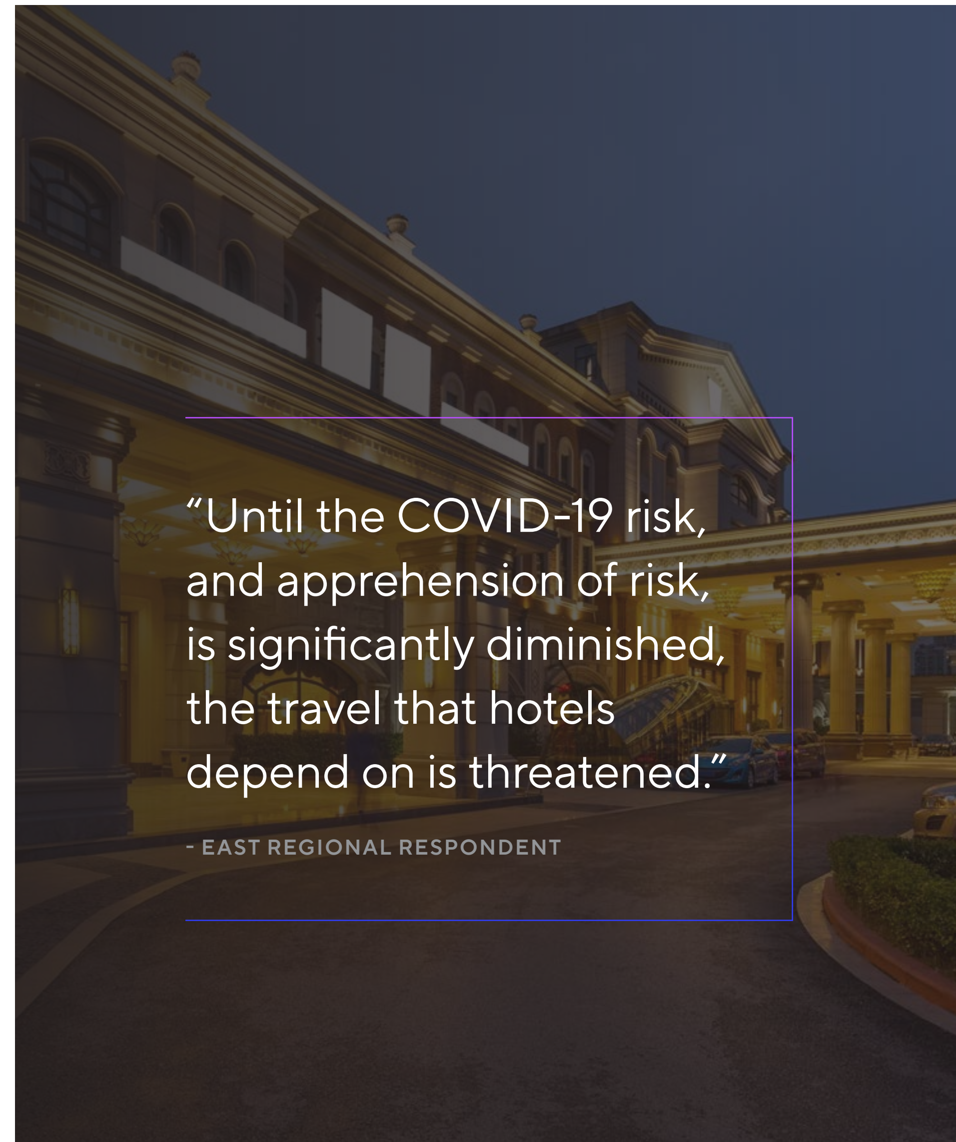


Business travel – a major driver of hotel profitability – is still limited by many companies. Virtual meetings have significantly, though not entirely, replaced the business and convention sectors. Some investors worry that business travel will never fully recover.

Large convention hotels in urban locations or other markets that are heavily reliant on convention and/or international business are likely to see the most difficulties going forward.

Labor shortages continue to plague the sector.

Budget and extended-stay hotels may be the best segments of the hospitality market.



ValTrends by SitusAMC

This disclaimer applies to this publication and the oral or written comments of any person presenting it. No part of this publication may be reproduced in any form or incorporated into any information retrieval system without the written permission of RERC, LLC, a SitusAMC affiliate company ("RERC, LLC").

This publication is sold with the understanding that the publisher is not engaged in rendering legal or accounting services. The publisher advises that no statement in this publication is to be construed as a recommendation to make any real estate investment or to buy or sell any security or as investment advice. The examples contained in this publication are intended for use as background on the real estate industry as a whole, not as support for any particular real estate investment or security.

Forward-looking statements (including estimates, opinions or expectations about any future event) contained in this publication are based on a variety of estimates and assumptions made by RERC, LLC. These estimates and assumptions are inherently uncertain and are subject to numerous business, competitive, financial, geopolitical, industry, market and regulatory risks that are outside of RERC, LLC's control. There can be no assurance that any such estimates and/or assumptions will prove accurate, and actual results may differ materially. The inclusion of any forward-looking statements herein should not be regarded as an indication that RERC, LLC considers such forward-looking statement to be a reliable prediction of future events and no forward-looking statement should be relied upon as such.

This publication does not purport to be complete on any topic addressed. The information included in this publication is provided to you as of the dates indicated, and RERC, LLC does not intend to update the information after this publication is distributed. Certain information contained in this publication includes calculations and/or figures that have been provided by third parties, and/or prepared internally and have not been audited or verified. This publication may contain the subjective views of certain RERC, LLC personnel and may not necessarily reflect the collective view of SitusAMC or certain SitusAMC business units.

Although this publication uses only sources that it deems reliable and accurate, RERC, LLC does not warrant the accuracy of the information contained herein and does not have a duty to update it. In all cases for which historical performance is presented, please note that past performance is not a reliable indicator of future results and should not be relied upon as such.

Certain logos, trade names, trademarks and copyrights included in this publication are strictly for identification and informational purposes only. Such logos, trade names, trademarks and copyrights may be owned by companies or persons not affiliated with RERC, LLC. RERC, LLC makes no claim that any such company or person has sponsored or endorsed the use of any such logo, trade name, trademark and/or copyright.

The RERC ValTrends Report is published four times a year by: RERC, LLC, a SitusAMC affiliate company, located at 1075 Jordan Creek Pkwy, Suite 240, West Des Moines, IA 50266. *Copyright © 2021 by RERC, LLC. All rights reserved.* *Send subscription requests or address changes to researchhelp@rerc.com. All of our products are available at www.store.rerc.com.*

SitusAMC is the leading independent provider of innovative, trusted solutions to the commercial and residential real estate finance industries.

We help clients identify and capture opportunities in their real estate businesses through industry-leading services and innovative technologies that drive operational efficiency, increase business effectiveness, and improve market agility across the entire lifecycle of their global real estate activity.

Learn more at SitusAMC.com

SitusAMC is not a law firm and does not render legal advice to its clients. SitusAMC does not engage in lobbying contacts on behalf of its clients. Each client should consult an attorney regarding legal obligations including possible registration under the Lobbying Disclosure Act.

About ValTrends

The ValTrends Report is produced by SitusAMC Insights, the data, analytics and research division of SitusAMC. Designed with the institutional investor in mind, the ValTrends quarterly analysis offers SitusAMC's proprietary insights into the economy, financial markets, capital markets, and property types to support better real estate decision making. This report incorporates data from internal SitusAMC valuation experts and from RERC, the survey arm of SitusAMC Insights, which has been polling institutional investors every quarter for more than 30 years.

Learn more at SitusAMC.com/Data-Research-Insights

© Copyright 2021 SitusAMC. All rights reserved.