ValTrends
3Q 2022 Report

Receding Tide

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

SitusAMC

Executive Summary

Page 3

01 Capital Market ValTrends

Page 5

02 ValTrends by Property Type

Page 16

Office 19
Industrial 21
Retail 22
Apartment 24
Hotel 25

Commercial real estate (CRE) performance ebbed in the third quarter as a result of a challenging capital markets environment. CRE returns and deal activity receded amid rising interest rates.

The Federal Reserve has been aggressive, raising the target range for the federal funds rate for the sixth consecutive time in November, pushing it up 3.75 percentage points since early March. While inflation appears to be beginning to ease, it remains at a level not seen since the early 1980s; expectations are for continued rate hikes into early 2023.

The 10-year Treasury rate has responded in kind. It retreated from a nearly 10-year high in the first part of third quarter before soaring between August and October. In September alone, the rate rose 62 bps, the fastest increase in nearly 20 years. The 10-year Treasury reached 4.3% in late October, the highest level since 2007. It declined from a monthly peak of 4.2% in early November to 3.8% at month's end.

The good news is that inflation continued to cool in third quarter, though it remains near 40-year highs. The consumer price index (CPI) annual rate continued to slow in the third quarter from 8.2% in September to 7.7% in October and down from a record high of 9.1% in June. The core personal consumption expenditures (PCE) price index, the Fed's preferred inflation measure, slowed from 5.2% in September to 5.0% in October.

Investor sentiment, however, pulled back in the third quarter. According to RERC data, investor preference for the CRE asset class dropped substantially QoQ to the lowest rating since 2009. Investors considered CRE as a below-average investment alternative for the first time since the early stages of the pandemic. Though investors note that CRE can perform well in a high inflationary environment, economic uncertainty and the possibility of a recession are major risks for the asset class.

Third quarter NCREIF NPI overall CRE total returns dropped by over 250 bps QoQ. At 0.6%, quarterly returns were the lowest since 2Q 2020 and 160 bps lower than the long-term average (LTA). Income returns were the lowest on record and capital appreciation was negative for the first time since the onset of the pandemic.

The receding tide of returns has been particularly acute for the high-flying industrial and apartment segments. Industrial returns tumbled 475 bps to 1.1% in third quarter, the lowest since the onset of the pandemic and nearly 180 bps lower than the LTA. Industrial income returns were the lowest on record, and appreciation, though positive, was the lowest since 2Q 2020. Apartment returns retreated by almost 270 bps in third quarter to 1.2% to the lowest since the beginning of the pandemic and nearly 100 bps below the LTA. Income and capital returns were the lowest since 4Q 2020.

Amid a surge in interest rates, the availability of capital dropped in third quarter to the lowest level since the onset of the pandemic, according to RERC. Given the rise in rates and uncertainty in value, investors note that there is very limited lending happening right now. Both equity and debt capital continued to dry up in third quarter, but debt availability remains more constrained than equity. Third quarter equity availability was the lowest since the onset of the pandemic. Debt availability was the lowest going back to at least 2014 when RERC began collecting data on equity and debt capital separately.

Transaction volume declined YoY across all major property types. Third quarter overall CRE transaction volume, as measured by MSCI Real Assets, was just above $172 billion, a 21% decrease YoY and a 19% decline from the previous quarter. Deal volume fell in every month during the quarter. With the Fed indicating further tightening, it is likely that deal volume will continue to fall, especially as sellers have yet to adjust pricing amid turbulent capital markets.

01

CAPITAL MARKET VALTRENDS

CRE HIT BY RISING INTEREST RATES

Economy & Financial Markets

After two consecutive quarters of declines, GDP rebounded in third quarter 2022, rising 2.9% (second estimate) at an annual rate.

The labor market generally remains tight, with the U.S. unemployment rate hovering near the pre-pandemic's historical lows for the past nine months. Rising interest rates and concerns of recession pushed the rate up from 3.5% in September to 3.7% in October and was unchanged in November. The labor force participation rate (LFPR) declined 10 bps between October and November to 62.1%. The LFPR is 1.3 percentage points lower than the pre-pandemic level, near a 45-year low.

Inflation may have peaked but remains near 40-year highs. The consumer price index (CPI) annual rate continued to slow in the third quarter from 8.2% in September to 7.7% in October and down from a record high of 9.1% in June. Core CPI, which excludes food and energy, also eased from 6.7% in September to 6.3% in October. The core personal consumption expenditures (PCE) price index, the Fed's preferred inflation measure, slowed from 5.2% in September to 5.0% in October.

CRE & Investment Alternatives

	YTD[6]	1-Year Trailing	3-Year Trailing	5-Year Trailing	10-Year Trailing	15-Year Trailing
NPI[1]	9.4%	16.1%	9.9%	8.6%	9.5%	7.0%
NFI-ODCE[1]	12.4%	21.0%	11.4%	9.3%	9.9%	5.8%
NAREIT Index (All Equity REITs)[2]	-27.9%	-16.3%	-1.1%	4.1%	7.0%	5.4%
Consumer Price Index[3]	4.7%	8.3%	4.9%	3.8%	2.6%	2.4%
Dow Jones Industrial Average[2]	-19.7%	-13.4%	4.4%	7.4%	10.5%	7.6%
Nasdaq Composite[4]	-32.4%	-26.8%	9.8%	10.2%	13.0%	9.5%
NYSE Composite[4]	-21.5%	-16.6%	1.2%	2.0%	5.0%	2.0%
S&P 500[2]	-23.9%	-15.5%	8.2%	9.2%	11.7%	8.0%

	3Q 2022	3Q 2021	3Q 2019	3Q 2017	3Q 2012	3Q 2007
10-Year Treasury Bond[5]	3.1%	1.3%	1.8%	2.2%	1.6%	4.7%

[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 SitusAMC Insights, 3Q 2022.

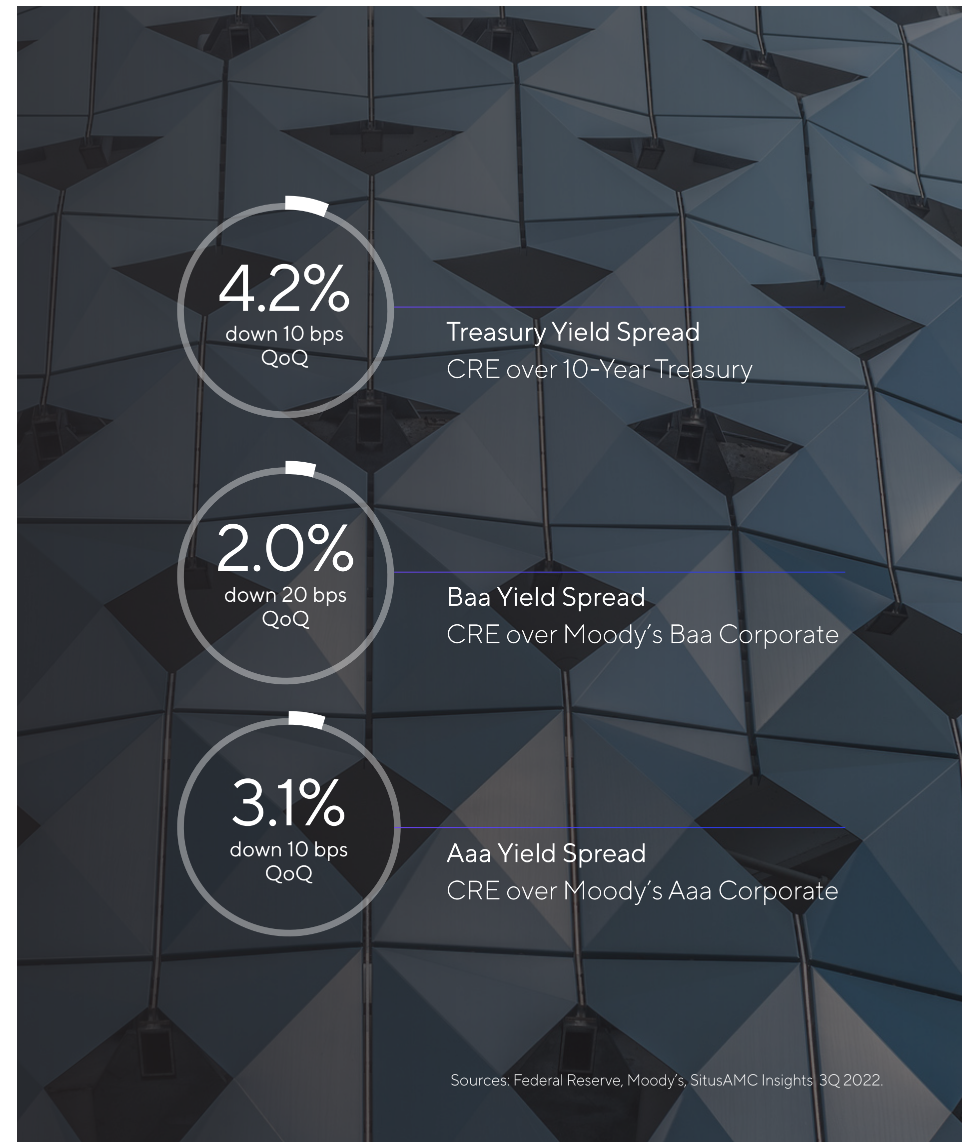
The 10-year Treasury rate retreated from a nearly 10-year high in the first part of third quarter before soaring between August and October. In September alone, the rate rose 62 bps, the fastest increase in nearly 20 years. The 10-year Treasury reached 4.3% in late October, the highest rate since 2007. It declined from a monthly peak of 4.2% in early November to 3.8% at month's end.

In the first half of the quarter, the Dow, S&P 500, and Nasdaq recovered quickly from the steep June losses by 10%, 13%, and 18% respectively. However, all three then plummeted, down 15% (Dow), 17% (S&P 500), and 19% (Nasdaq) between August's peak and the end of the quarter. Stocks fell to a two-year low in mid-October, but ascended during November, although all three indexes were negative YTD at the end of the month.

Spreads between RERC real estate yields and the 10-year Treasury and corporate bonds compressed QoQ, with the increase in bond rates outpacing the increase in real estate yields.

The third quarter CRE yield over 10-year Treasury spread was almost 160 bps below the long-term average (LTA). Third quarter spreads were the narrowest since 2007.

Third quarter real estate yield spreads over corporate bonds were among the narrowest in over 13 years. The CRE yield over Moody's Baa and Moody's Aaa spreads were 120 bps below their LTAs.



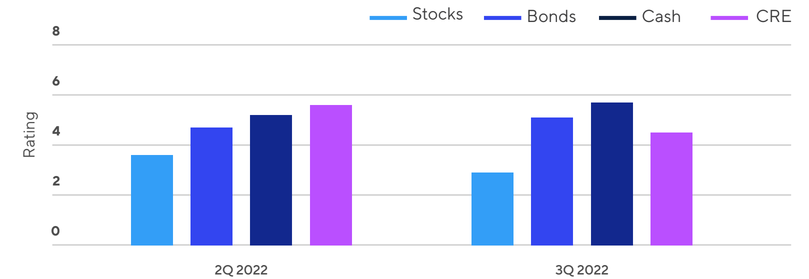
CRE & Investment Alternatives

According to RERC data, investor preference for the CRE asset class dropped substantially QoQ to the lowest rating since 2009. Investors considered CRE as a below-average investment alternative for the first time since the early stages of the pandemic. Though investors note that CRE can perform well in a high inflationary environment, economic uncertainty and the possibility of a recession are major risks for the asset class.

The volatility in the stock market is causing concern for investors. Institutional investor preference for stocks dropped for a third consecutive quarter to a new record low. Stocks were the least favored asset class among investors. Stock valuations have plummeted over the last quarter and with stubbornly high inflation and a risk of recession, many investors are turning to other asset classes.

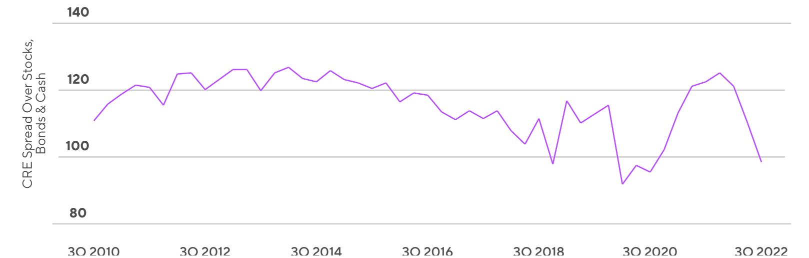
> “Too many factors in play to bet on most all investments except cash.” - INSTITUTIONAL INVESTOR

Ratings of Investment Alternatives



Ratings are based on a scale of 1 to 10, with 10 being excellent.
Sources: RERC, SitusAMC Insights, 3Q 2022.

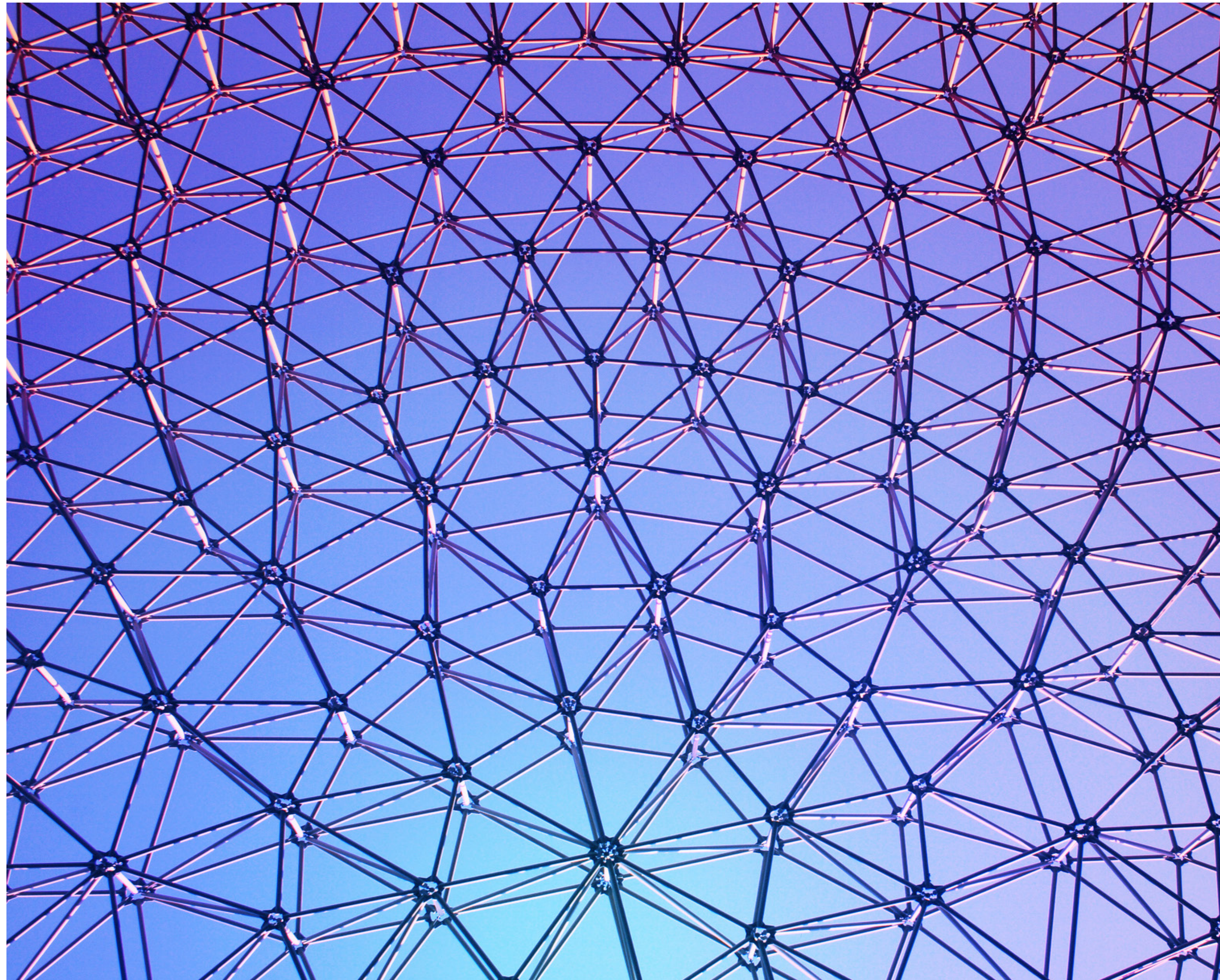
CRE Attractiveness Index[1]



[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. Sources: RERC, SitusAMC Insights, 3Q 2022.

The preference for bonds increased QoQ to the highest since 2007 and is now considered an above-average investment option. Investors expressed that bonds provide safe rates of return during an inflationary period.

Investors state that many participants will stay in a cash position until the market stabilizes. The preference for cash and cash equivalents increased substantially in the third quarter and was the most preferred investment alternative. The rating is the highest since 3Q 2020 and is well above the LTA. Cash has the added benefit of allowing for an eventual reallocation of investments into undervalued assets.



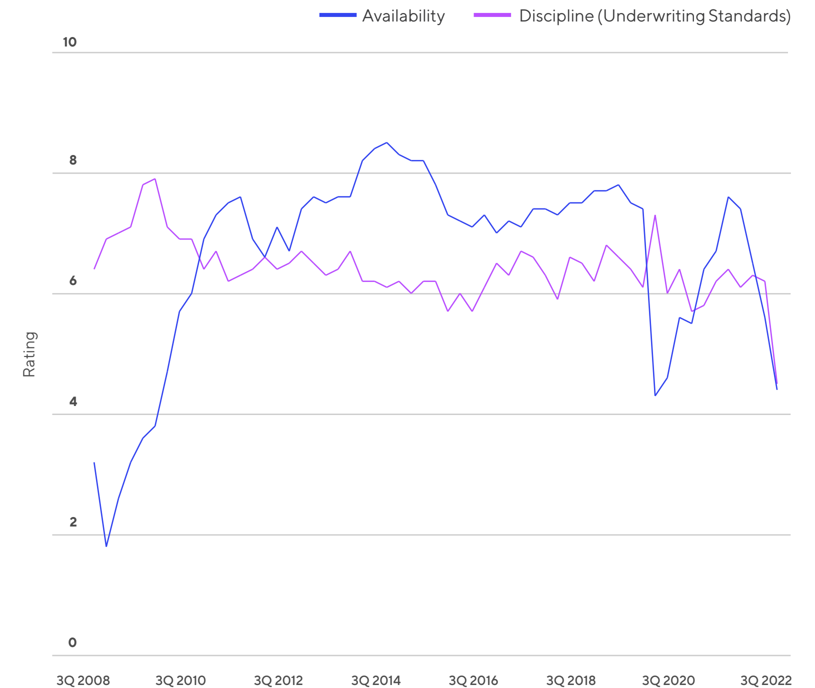
Availability & Discipline of Capital

Amid a surge in interest rates, the availability of capital (equity and debt combined) dropped in third quarter to the lowest level since the onset of the pandemic and is well below the long-term average. Interestingly, the discipline of underwriting standards fell precipitously QoQ to the lowest level since RERC began collecting these data in 1997.

Given the rise in rates and uncertainty in value, investors note that there is very limited lending happening right now. Many banks are relaxing lending terms and conditions to generate deals.

> "Higher interest rates translate into fewer deals, so banks are aggressive."
>
> - SOUTH REGION INVESTOR

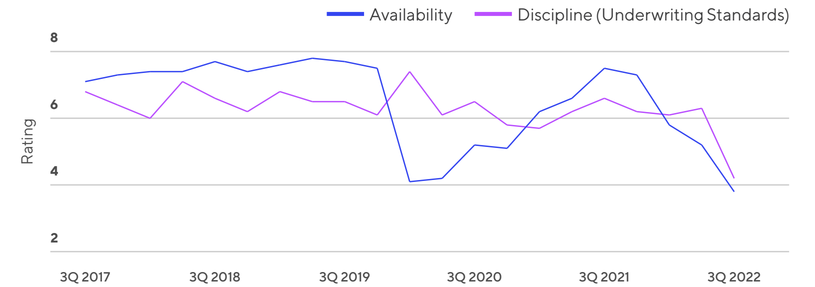
Historical Availability & Discipline of Capital – Equity & Debt Combined



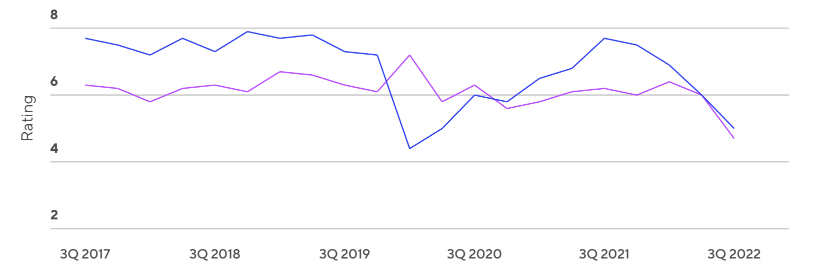
Ratings are based on scale of 1 to 10, with 10 being excellent.
Sources: RERC, SitusAMC Insights, 3Q 2022.

Both equity and debt capital continued to dry up in third quarter, but debt availability remains more constrained than equity. Third quarter equity availability was the lowest since the onset of the pandemic. Debt availability was the lowest going back to at least 2014 when RERC began collecting data on equity and debt capital separately. Underwriting standards loosened for both debt and equity, with both reaching record lows.

Historical Availability & Discipline of Capital – Debt



Historical Availability & Discipline of Capital – Equity



Ratings are based on scale of 1 to 10, with 10 being excellent.
Sources: RERC, SitusAMC Insights, 3Q 2022.

CRE Returns, Volume & Pricing

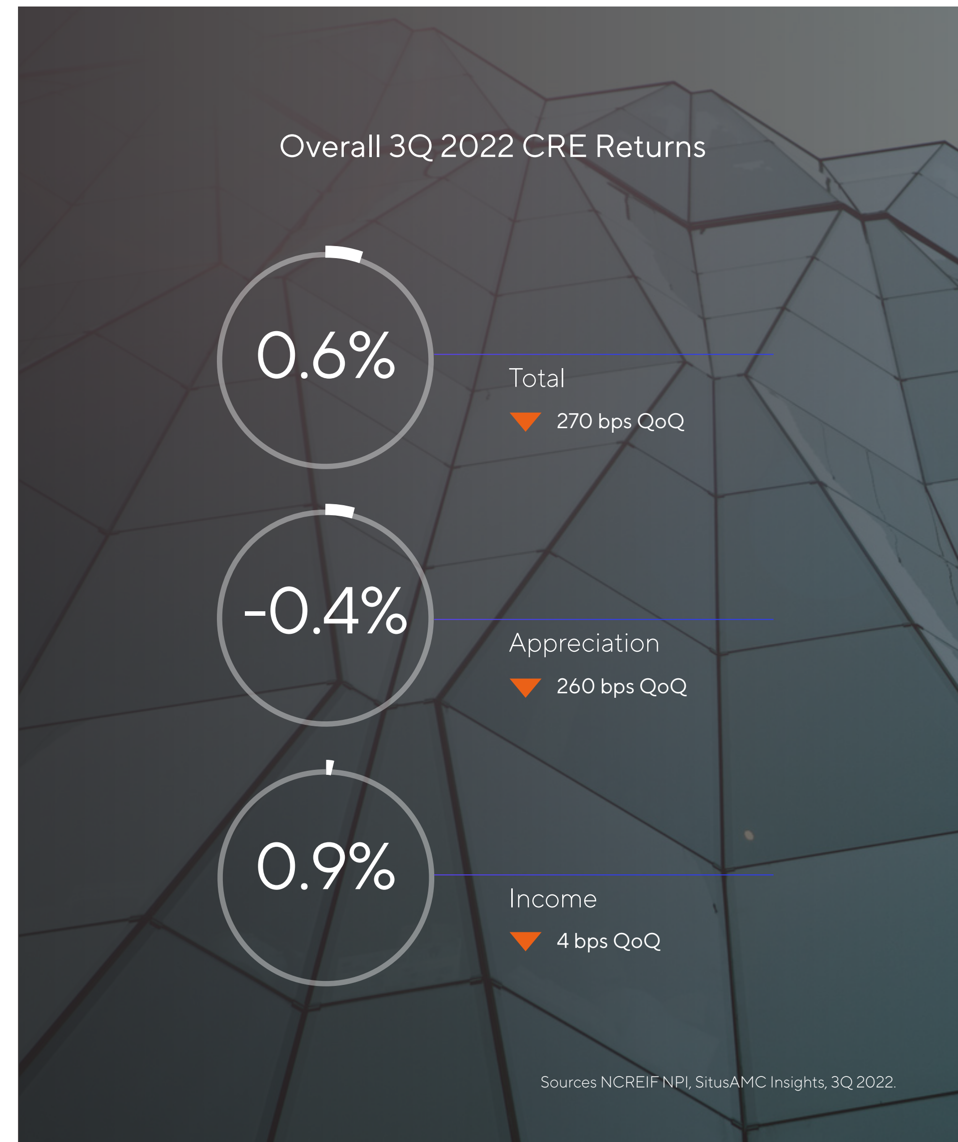
Returns

Third quarter NCREIF NPI overall CRE total returns dropped by over 250 bps QoQ. At 0.6%, quarterly returns were the lowest since 2Q 2020 and 160 bps lower than the LTA. Income returns were the lowest on record and capital appreciation was negative for the first time since the onset of the pandemic. One-year trailing returns were 16.1%, down 540 bps QoQ, but still over 650 bps above the LTA.

Among the property segments, hotel had the highest returns in third quarter. At 2.7%, hotel returns increased 90 bps QoQ to the highest in three quarters and were 140 bps above the LTA. Income and capital returns both increased QoQ; income returns were the highest since 2019. Income returns were about 55 bps above the LTA, and appreciation was about 85 bps higher than the LTA. One-year trailing returns were 11.3%, the highest since 2016.

Apartment returns retreated by almost 270 bps in third quarter to 1.2%. Returns were the lowest since the beginning of the pandemic and nearly 100 bps below the LTA. Income and capital returns were the lowest since 4Q 2020: 40 bps and 60 bps lower than the LTA, respectively. The segment produced a one-year trailing return of over 18.2%. Garden apartments outperformed high-rise and low-rise apartments, the dominant trend since 2015.

Industrial returns tumbled 475 bps to 1.1% in third quarter, the lowest since the onset of the pandemic. Third quarter marks three consecutive quarters of slowing growth coming off the record highs seen at the end of 2021. Returns were nearly 180 bps lower than



the LTA. Income returns were the lowest on record, and appreciation, though positive, was the lowest since 2Q 2020. The segment produced a one-year trailing return of nearly 35%. Industrial R&D outperformed warehouse and flex.

Retail returns declined by 130 bps QoQ to 0.4% and were about 170 bps below of the LTA. Income returns were the lowest in five quarters, and capital returns were negative. The segment posted a one-year trailing return of 6.6%, about 250 bps below the LTA. Among retail subtypes, fashion/specialty was the highest performing segment. Single-tenant retail was the lowest performing of all property subtypes in the NPI at -2.3%.

Office was the poorest performing sector in third quarter and the only property type with a negative total return. At -0.7%, office returns were the lowest since the GFC, dropping nearly 125 bps QoQ. Income returns declined QoQ to the lowest in history; capital appreciation fell to the lowest since the GFC. One-year trailing returns were 3.2%, the lowest in six quarters and over 500 bps below the LTA. Suburban office returns were 0% in 3Q 2022, but still outperformed CBD at -1.2%.

Volume

The effect of rising interest rates is hitting the capital markets, with YoY declines in transaction volume across all major property types. Third quarter overall CRE transaction volume, as measured by MSCI Real Assets, exceeded $172 billion, a 21% decrease YoY and a 19% decline from the previous quarter. Deal volume fell in every month during the quarter. Because of record-high volumes in 2021, third quarter activity was almost $76 billion (79%) higher than the LTA despite the substantial drop in activity. However, with the Fed indicating further tightening, it is likely that deal volume will continue to fall, especially as sellers have yet to adjust pricing amid turbulent capital markets.

YTD deal volume was greatest in the non-major metros, per MSCI Real Assets. The most active markets through third quarter were Dallas, Los Angeles, Atlanta, Houston and Phoenix. All except for Atlanta recorded record high transaction volume.

Apartments accounted for the greatest amount of total deal volume, as it has for over five years. Apartment comprised 43% of total deal volume, the third highest percentage on record. Third quarter's activity declined by 17% YoY to about $74 billion. Despite the drop, it was the fourth highest level of deal volume on record. Garden apartments accounted for about 60% of total apartment volume, with third quarter activity at over $45 billion, a 19% decline YoY.

Industrial was the second most active segment (21% of total volume), transacting $35.5 billion in third quarter, an 18% decrease YoY but still more than double its LTA. Warehouse comprised 78% of industrial deal activity and at $27.8 billion was 18% lower YoY.

Office volume was nearly $27 billion in third quarter (about 16% of total volume), a 33% decrease YoY, but about 5% higher than its LTA. At $21.5 billion (a 23% decline YoY), suburban office comprised 80% of office deal volume. Suburban office activity has outpaced CBD for over six years.

Retail deal activity slowed 9% YoY in third quarter to just over $18 billion and comprised 10.6% of total volume. However, third quarter activity was still 27% greater than its LTA. The centers subtype accounted for 69% of retail volume; deal activity for centers dropped 5% YoY to $12.5 billion. The shops subtype declined by 17% YoY to $5.7 billion.

Hotel volume declined by 21% in third quarter to about $8 billion (4.7% of total volume). It was the slowest quarter since early 2021, with activity 1.6% below the LTA. Full-service hotel deal activity dipped by almost 40% YoY to $3.5 billion. Limited service increased 3% YoY to $4.5 billion and comprised 67% of total hotel volume.

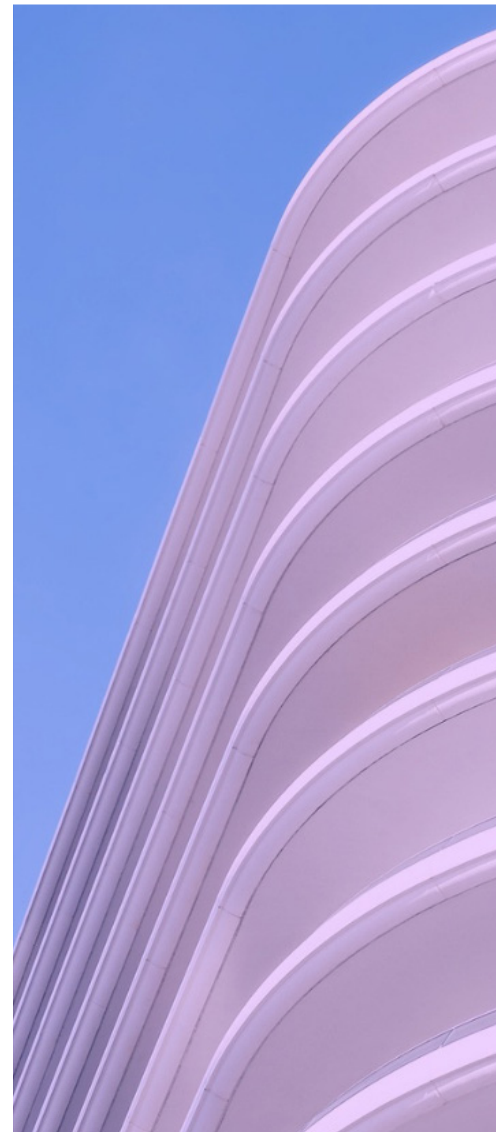
Pricing

The RCA CPPI, a gauge of property prices, was up 11% YoY in third quarter. Though each of the major property types experienced YoY price gains, the pace of growth has steadily declined since the beginning of the year. Overall CRE prices grew just 0.7% QoQ, the slowest since the onset of the pandemic. Annualized 2022 price growth was 7% in third quarter, a far cry from the 20% seen in 2021. Price gains were stronger in the non-major metros than the six major metros.

Industrial led the way in YoY price growth as it has done throughout the pandemic, with an 18% YoY increase. Price growth has decelerated throughout the year, with an annualized YTD gain of 14% compared to 26% in 2021. Apartment price growth was also strong at almost 16% YoY, though. YTD annualized prices grew 12% in third quarter, almost half of 2021's record growth.

Retail prices increased almost 12% YoY. Price growth slowed in 2022 at 8% (YTD annualized) relative to last year's growth of 20%. Hotel price growth increased by about 10% YoY in third quarter.

Office prices lagged the other segments, with a 7% YoY increase. YTD annualized growth in third quarter was only half of what it was in 2021. Looking at the two major office subtypes, suburban price growth, at 7%, outpaced CBD price growth on a YoY basis by about 300 bps.



RERC Buy, Sell or Hold

Investors overwhelmingly favored a hold position for overall CRE in third quarter, with the recommendation increasing QoQ from 60% to 73%. Investors were least likely to recommend buying; preference for the strategy fell 3 percentage points QoQ to 12%. The recommendation to sell fell QoQ from 25% to 15%.

Investors recommended holding for the vast majority of property types: CBD office, suburban office, warehouse, R&D, flex, regional mall, power center and apartment. Investors were split between buying and holding neighborhood and community retail but bullish on hotels with 63% of investors favoring the buy position.

> "[CRE is] typically a longer-term investment that is unlikely to have severe market fluctuations."
>
> -WEST REGION INVESTOR

Percentage of total respondents recommending buy, sell or hold.
Sources: RERC, SitusAMC Insights, 3Q 2022.

02

VALTRENDS BY PROPERTY TYPE

Despite Headwinds, Industrial and Apartment Remain Strong.

RERC Perceived Return Relative to Risk

Investors' perceptions of returns relative to risk for the overall CRE market improved slightly in the third quarter. However, investors deem overall CRE as having greater risk relative to return for the third consecutive quarter. Ratings differ greatly by segment, with tenant demand being the driving force.

Hotel garnered the highest rating among the property types in third quarter. Perceptions of risk-adjusted returns jumped substantially QoQ to the highest rating since 2010. Investors are seeing limited supply in the market with continuing demand, which is leading to favorable return rates.

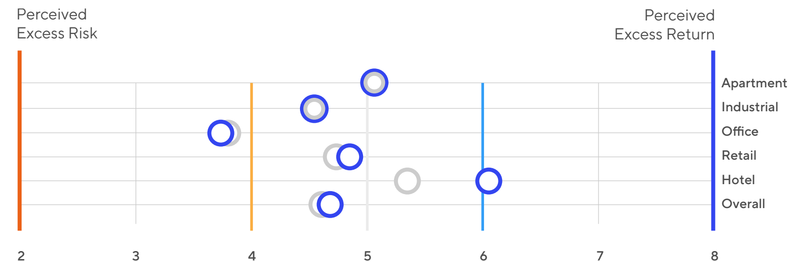
Apartment earned the second highest rating among the property segments, with risk and return roughly in equilibrium. Though the rating remained the same QoQ, third quarter's rating was the lowest in nearly two years and is well below the LTA. Breathtaking rent growth is beginning to decelerate, which is cause for concern for some investors, as rent growth has been the primary driver of the segment's stellar performance over the past year.

Perceptions of return relative to risk for retail increased QoQ to the highest rating in four years. However, investors still believe the segment is relatively risky. Investors continue to see risk bifurcation in the sector, with malls and power centers facing headwinds from changing consumer habits, but need-based retail, like neighborhood centers offering upside potential.

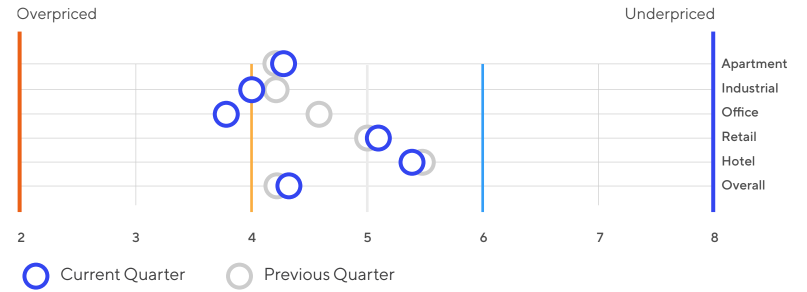
Industrial ratings were the same QoQ; the sector was considered risky relative to returns. Third quarter's rating was tied with the previous quarter for the third lowest in history, trailing only those seen at the height of the GFC and the beginning of the pandemic. There is increasing concern among investors that the run up in rents is unsustainable.

Perceived return relative to risk for office continued to sour in third quarter. The rating declined QoQ to the third lowest in history; only in the beginning of the pandemic was the sector seen as riskier relative to returns. The investment community is anticipating significant CBD office non-renewals and/or shrinking renewal size for extensions.

RERC Perceived Return Relative to 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. Sources: RERC, SitusAMC Insights, 3Q 2022.

RERC Relative Value Sentiment

Overall CRE relative value sentiment ticked up QoQ; however, third quarter's rating ties for second most overpriced on record, just slightly above the ratings seen during the GFC. The overall CRE market has been perceived as overpriced for over five years. Investors note that there is a disconnect between buyers and sellers on pricing. Sellers have not yet fully adjusted expectations based on the rising cost of capital.

Hotel was rated underpriced for the sixth consecutive quarter and has the most favorable relative value sentiment among the property segments, despite a slight decline in the rating QoQ. Investors note that the strong recovery in travel gives hotel more upside potential than other property types.

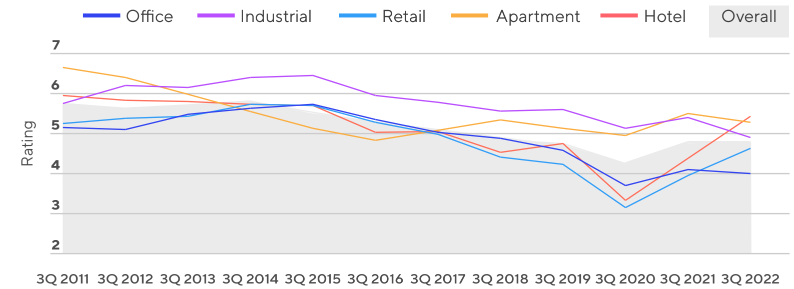
Industrial's relative value sentiment fell for the third consecutive quarter to a record low. Though cap rates increased by 30 bps in third quarter, according to RERC, pricing remains near an all-time high. In addition, investors are seeing demand begin to temper from record levels.

Apartment relative value sentiment eked a gain in third quarter, but remains considerably overpriced, according to investors. Even with rent growth beginning to cool, demand for multifamily housing remains exceptionally high and owners are charging a premium.

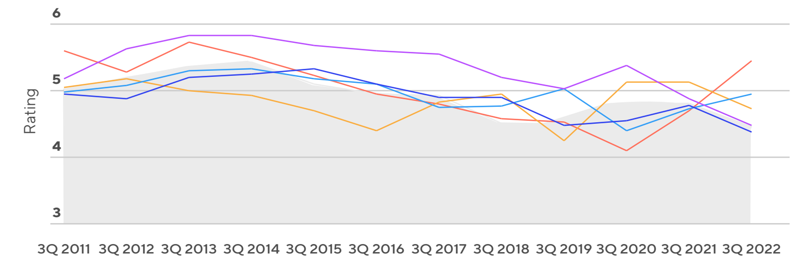
Value and price are roughly aligned in the retail segment. Following a quarterly increase, the rating was the highest in over three years. Some investors comment that values have already been corrected, whereas there is high risk of corrections in warehouse and apartment.

Relative value sentiment for the office fell substantially QoQ to the lowest since at least 2007 when RERC began collecting these data. Office was rated as the most overpriced property segment. According to investors, occupancy still has not stabilized post-COVID-19 and a possible recession could lead to a further deterioration in demand.

RERC Perceived Return Relative to 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. Sources: RERC, SitusAMC Insights, 3Q 2022.

SitusAMC Office Insights

Woes continue for office demand. Though the occupancy rate remained the same QoQ, it was the second lowest in history by 10 bps, according to Reis. Third quarter occupancy was about 160 bps below pre-pandemic levels and about 270 bps below the LTA. Net absorption, though positive, was more than 75% lower than the historical average.

Completions fell QoQ, somewhat good news for the beleaguered sector. Third quarter completions were about half the LTA. With a 0.4% increase QoQ, third quarter effective rents have recuperated their pandemic losses, up 0.3% from 4Q 2019.

Occupancy rates for Class A office declined by 30 bps in third quarter, while Class BC office occupancy increased by 10 bps. Class A occupancy is down 230 bps from the beginning of the pandemic; Class BC declined 90 bps. Asking rents have held up better in Class A, however, with rents up about 2% for Class A and 0.7% for Class BC compared to pre-pandemic levels.

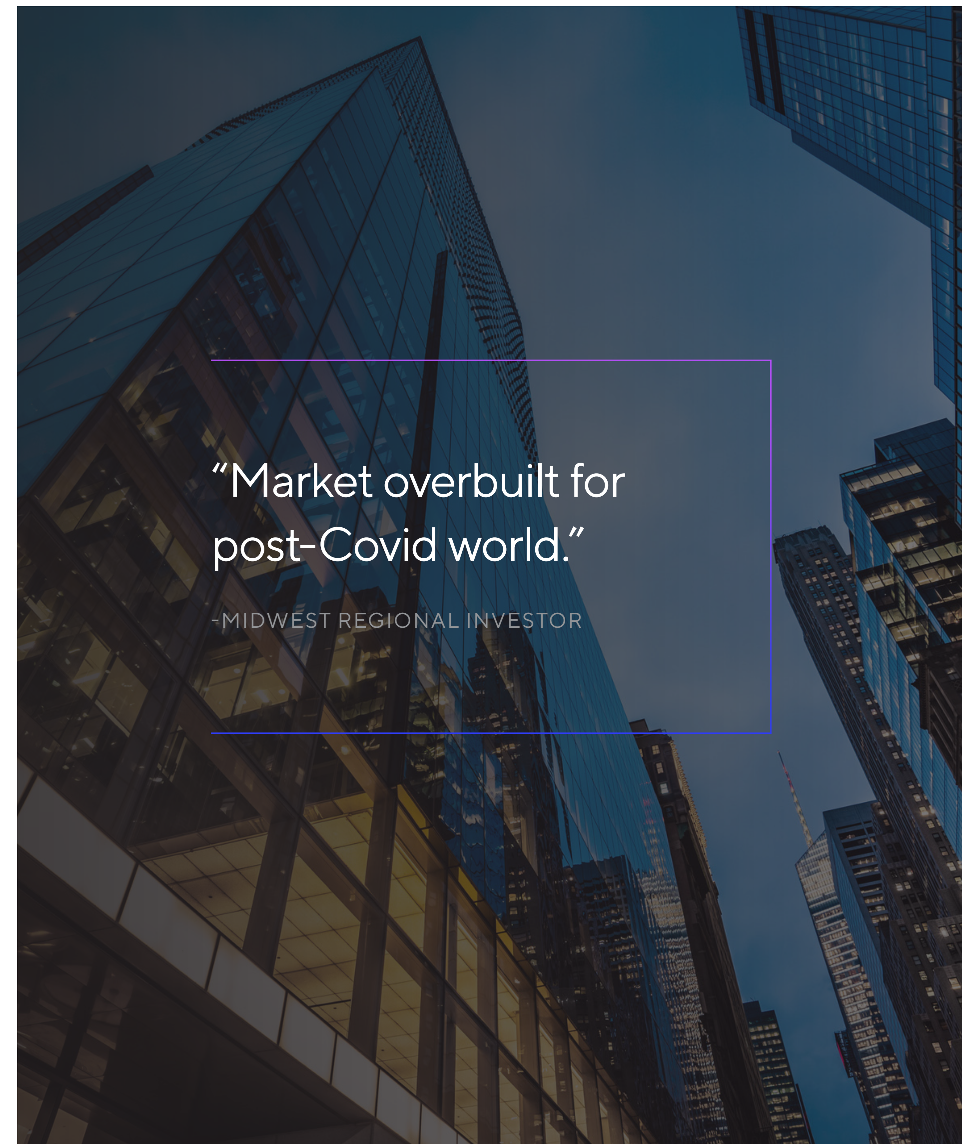
Daily office usage, as measured by Kastle Systems, reached a pandemic peak for most markets in mid-October, but have since tapered off. Maximum usage in the 10 markets tracked by Kastle was just 49% at the end of November.

Investors are still seeing the repercussions of COVID-19-related remote work According to RERC's quarterly investor survey, there is an increased risk of vacancy as leases expire and companies downsize.

A plethora of companies (Target, Optum, Prime Therapeutics), realizing that remote work will persist, have decided to sublease sizable portions of their office space (>600,000 SFT). Tech companies are leading the pack with Lyft, Salesforce, Yelp, Dropbox, Zillow, Amazon and Facebook parent Meta announcing plans to downsize, relocate or shed office space.

Office managing company Codi has created a time-share solution to deal with growing vacancies. By alternating days throughout the week, two to three companies can share the same office space, not only cutting renting costs but ensuring a clean work environment.

According to Trepp, more than $17 billion of mortgage bonds backed by office properties are coming due in 2023, more than double those in 2022 and triple those in 2021. Rising interest rates may result in the inability of property owners to pay back loans.



SitusAMC Industrial Insights

Warehouse occupancy soared to another record in third quarter, rising 120 bps, per Reis. The occupancy rate is almost 650 bps higher than it was pre-pandemic and increased almost 400 bps in the past year alone. Net absorption increased QoQ to the third highest level in history, about four times greater than pre-pandemic.

Meanwhile, supply remains extremely constrained; completions fell by 37% QoQ to the lowest in over seven years. Effective rents set another record, 33% greater than they were pre-pandemic.

During most of the pandemic, industrial real-estate boomed as consumers converted to e-commerce from brick-and-mortar stores. Many analysts predict continued, but slowing, growth in the sector as evidenced by Amazon closing, delaying, or canceling about 80 buildings.

Market rents continue to be strong in port-adjacent markets like those in Southern California. The Inland Empire, Los Angeles and Orange County remain in top demand, yet with a limited amount of developable land.

Rising interest rates, supply chain issues, labor shortages, rising construction costs and soaring rents are making it harder for both speculative and build-to-suit developments to pencil out. Higher interest rates combined with the risk of recession are leading to a more limited lending pool.

Community backlash over industrial infill is hampering the already difficult development process. NIMBYism is expanding, according to the Counselors of Real Estate, putting pressure on developments by prolonging, stalling or killing projects.

NPI Total Return: 1.1%

Warehouse Occupancy Change: +120 bps QoQ

Warehouse Effective Rent Growth Change: +5.6%

> "Strongest fundamentals. Will weather recession best."
>
> -INSTITUTIONAL INVESTOR

Sources: NCREIF, Reis, SitusAMC Insights, 3Q 2022.

SitusAMC Retail Insights

Retail's occupancy rate remained the same in third quarter, but it is still 10 bps lower than the pre-pandemic rate, according to Reis. Net absorption, though positive, was significantly weaker QoQ, declining by about 90%. Net absorption was 76% lower than its LTA.

Effective rents grew in third quarter but are still 0.7% lower than their pre-pandemic levels. However, future supply constraints bode well for further rent increases. Completions fell for the fourth consecutive quarter, reaching a record low.

NPI Total Return **0.4%**

Occupancy Change **0** bps QoQ

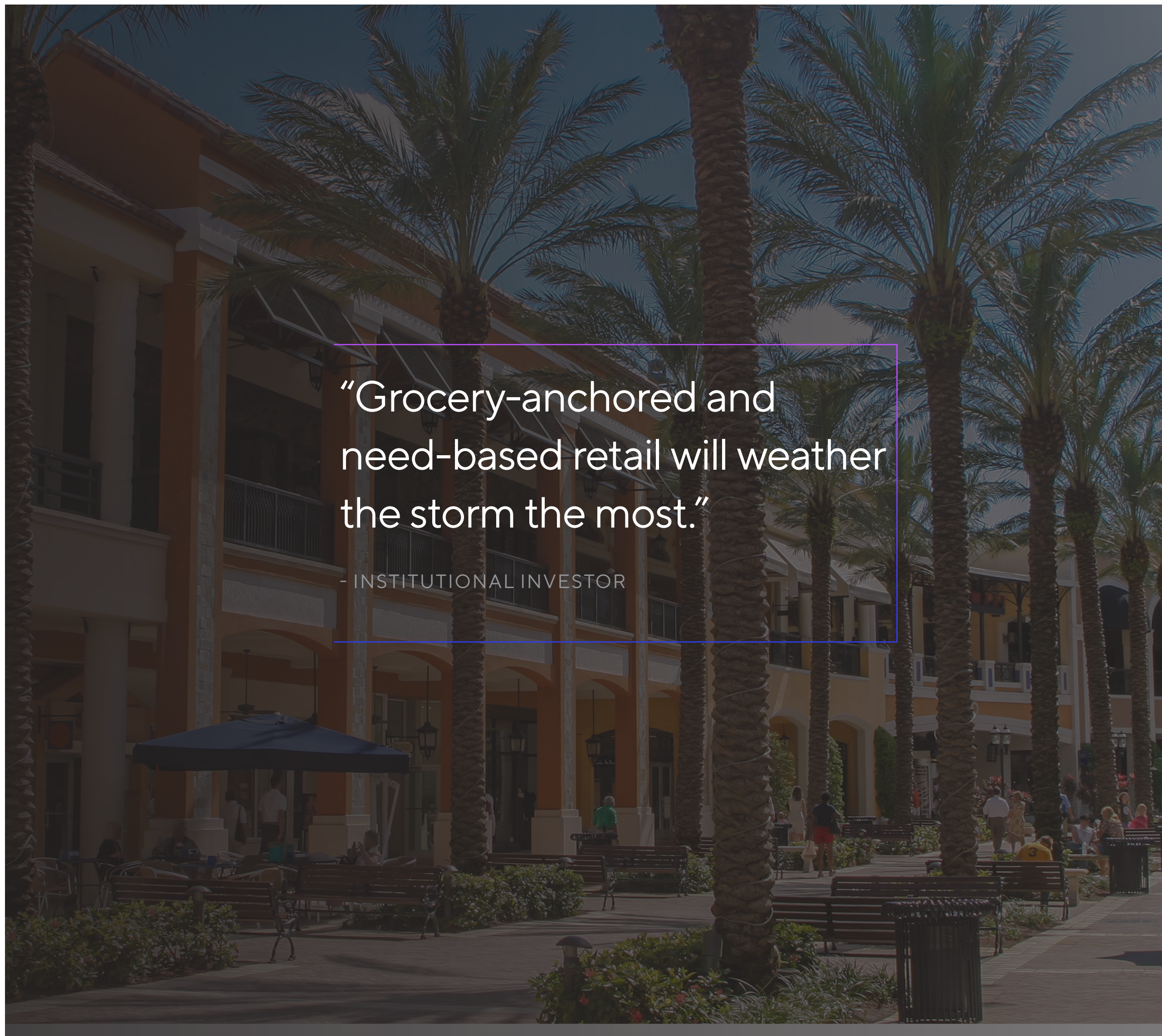
Effective Rent Growth Change **+0.1%**

Sources: NCREIF, Reis, SitusAMC Insights, 3Q 2022.

Investors are finding success with repurposing empty retail space. Transforming the space into fitness centers, restaurants, grocery stores and stores catering to niche consumer preferences are leading to increased foot traffic. Mixed-use and eco-friendly properties also attract shoppers.

Retail centers with open-air design and an experiential focus can create curb appeal. Retailers with a strong omnichannel strategy are also popular with consumers.

According to Morgan Stanley, the U.S. opened more stores than it closed last year for the first time in 27 years. Although lower quality malls continue to struggle, Class A malls have enjoyed a resurgence in occupancy. Spending at Brookfield's 132 malls, for example, is 31% above pre-pandemic levels.



SitusAMC Apartment Insights

Per Reis, third quarter apartment occupancy ticked up 10 bps to the highest level in nearly six years. The occupancy rate increased 40 bps YoY and is 90 bps above the LTA. However, net absorption fell QoQ to the lowest since 2009 and almost 30% below the LTA.

The pace of rent growth continues to cool from the torrid pace one year ago; however, third quarter's rent growth was still 100 bps above the LTA. A lack of new supply should continue to support rent growth. Completions fell by about 35% QoQ to the lowest in over a decade.

Class A apartment occupancy rates shot up 40 bps QoQ, while Class BC occupancy declined by 20 bps. Occupancy rates are above pre-pandemic levels by 40 bps and 30 bps for Class A and Class BC, respectively. Asking rent growth has also been stronger for Class A apartments at 140 bps above pre-pandemic levels compared to 90 bps for Class BC.

The National Multifamily Housing Council (NMHC) stated that the apartment segment is so underdeveloped that 328,000 new apartments are needed per year, a feat that has happened only a few times since 1989.

Apartment demand remains exceptionally strong. An August survey from Zillow found that one-third of recent renters indicated that getting their current rental was more difficult than getting a new job. Additionally, 40% reported losing sleep when searching for a rental due to cost, miscommunication with landlords and/or competition from other renters.

Renters may have reached a turning point in their ability to afford record rents. The pace of occupancy growth has slowed since the beginning of the year as soaring rent growth coupled with inflation is prompting more people to live with family or friends. A UBS survey found that 18% of adults lived rent free with other people in the last six month, up from 11% from last year.

NPI Total Return	1.2%
Occupancy Change	+10 bps QoQ
Effective Rent Growth Change	+1.8%

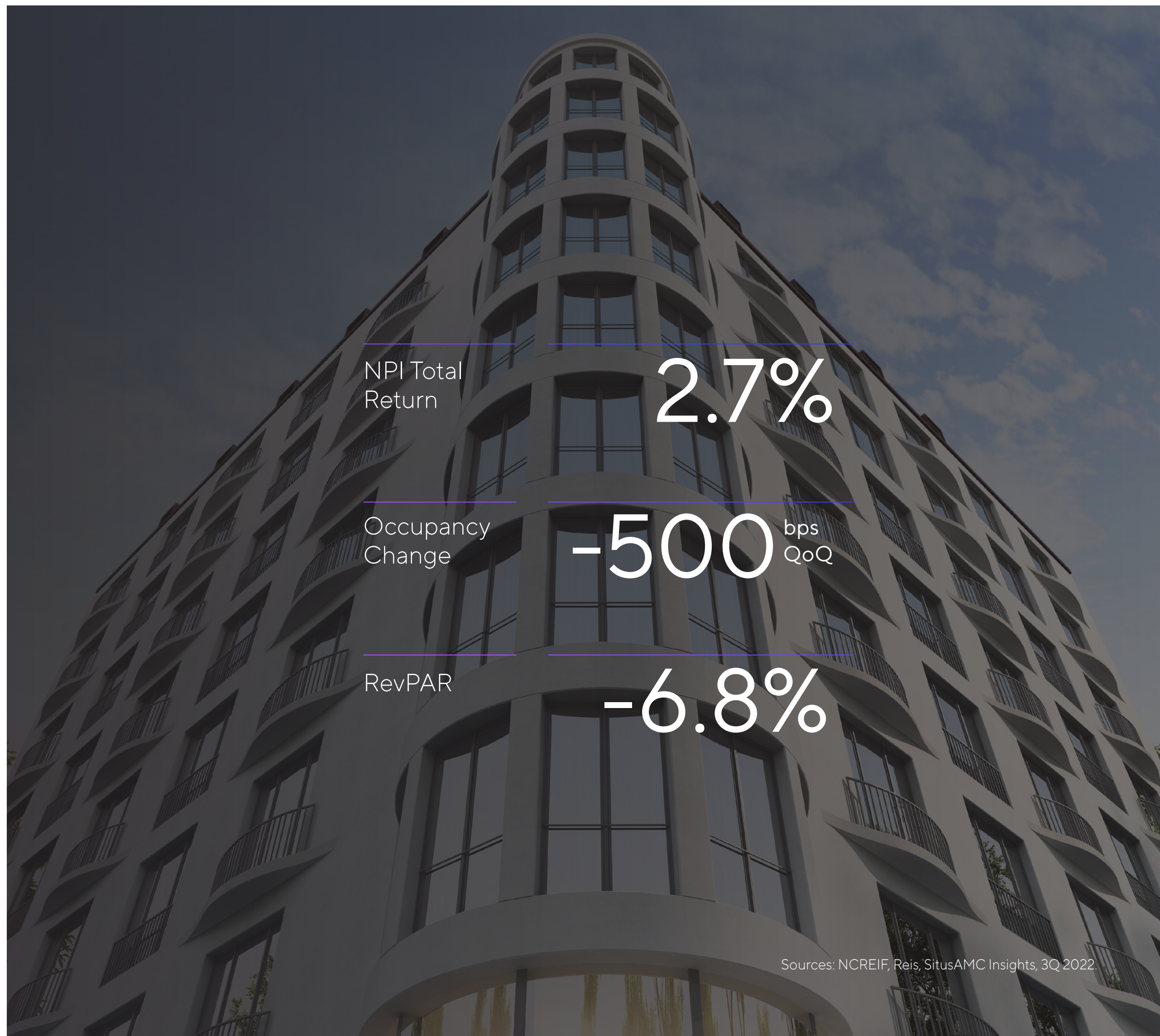
> "More people have been priced out of housing and are renting."
>
> -WEST REGION INVESTOR

Sources: NCREIF, Reis, SitusAMC Insights, 3Q 2022.

SitusAMC Hotel Insights

According to TSA checkpoint data, the number of passengers remained relatively constant QoQ. However, the hotel occupancy rate dropped by nearly 500 bps in third quarter, according to Reis. Occupancy data has been extremely volatile since the pandemic, and with no apparent major increase in rooms in the quarter, the occupancy data is puzzling and conflicts with other signs of a travel recovery as COVID-19 fear and restrictions have eased. Despite the quarter's drop, occupancies are near pre-pandemic levels.

Seasonally adjusted room rates had a slight increase in third quarter (0.3%), reaching a record high; RevPAR declined QoQ by 6.8%, reflecting the drop in occupancies. Still, it was the highest RevPAR in history, trailing only last quarter's record high. Room rates and RevPAR increased 17.9% and 26.6% YoY, respectively.

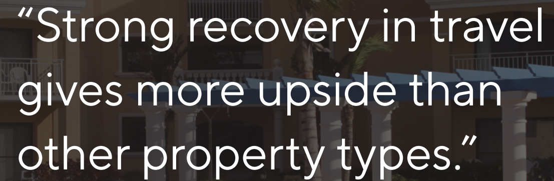


Upper-tier hotel occupancy fell nearly 400 bps in third quarter and was about 325 bps lower than pre-pandemic levels. Lower-tier hotel occupancy dropped over 550 bps QoQ, but was only 25 bps lower than pre-pandemic levels.

Upper-tier room rates decreased by 1.3% in third quarter; lower-tier room rates inched up by 0.4%. Both are substantially above pre-pandemic levels. RevPAR decreased for both upper-tier and lower-tier hotels QoQ, with more substantial drops for lower-tier. Nevertheless, RevPAR is up about 18% for lower-tier hotels and 10% for upper-tier hotels.

Labor costs and shortages remain the top concerns for hospitality asset managers, increasing the need to reassess operational efficiencies. Inflation and the possibility of a recession are also concerns for future sustained hotel demand.

Despite a predicted economic downturn, a fall survey by the Hospitality Asset Managers Association found that 80% of asset managers are considering increasing their position in hotels amid expectations of an increase in RevPAR and a resurgence in travel. RERC institutional survey respondents note tremendous upside potential for increased travel.



“Strong recovery in travel gives more upside than other property types.”

- WEST REGION INVESTOR

ValTrends by SitusAMC

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