

Capital Trends

US Big Picture

17.9% YOY price change
\$39.4b Transaction volume
-16% YOY volume change

Commercial property investment in the U.S. fell relative to last year in April after 13 months of significant growth in sales volume. Some sort of pullback in growth should not come as a surprise as the market has been moving beyond the recovery from the fear-induced lows of 2020. That said, the outright decline in sales in April relative to last year was a shock.

The commercial property market is responding to the change in the interest rate environment that hit in the second half of March. Once the 10yr UST pushed past the 2% level on a consistent basis, investors began to worry about underwriting for new acquisitions. Deal volume has become the first sign of market difficulty as potential buyers and lenders reassessed their ability to put capital to work.

Across the core property sectors, only apartment and retail properties posted slightly higher levels of deal activity in April relative to a year ago. The higher pace of growth for the apartment sector was somewhat misleading as well, with one big portfolio recapitalization driving most of the increase.

The industrial sector posted the sharpest decline in sale activity across core property sectors in April. There was a surprising negative earnings release from Amazon on April 28, though the timing was far too late in the month to impact deal activity. Even with a 43% YOY decline in deal volume, activity in the industrial sector was \$1.4b above pre-pandemic norms for the month.

Despite these shocks to deal activity, pricing measures show little evidence of stress. The RCA CPPI All-Property Index climbed 17.9% YOY in April. Still, the change in this price measure from March to April suggests only a 6.3% annualized pace of growth. So clearly price growth is decelerating.

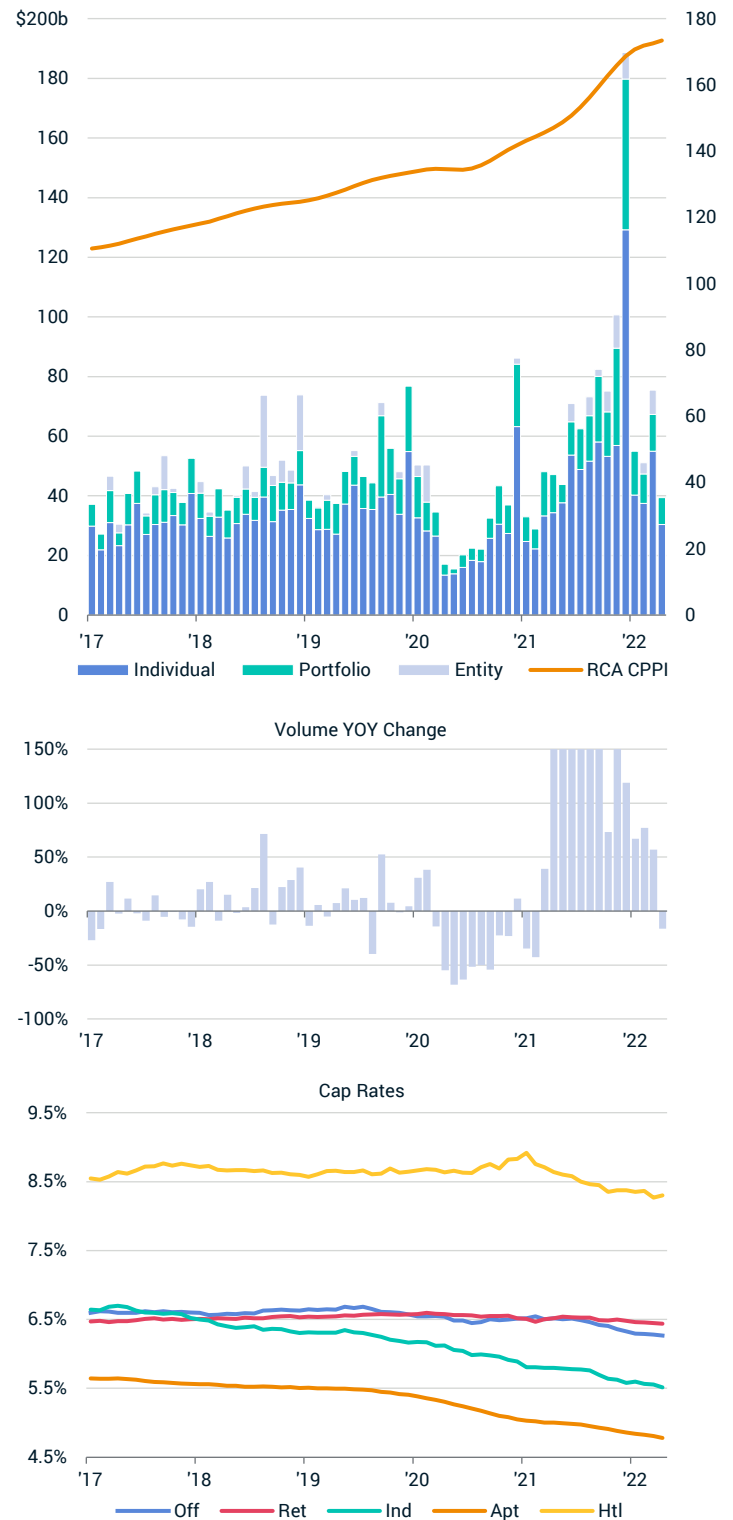
Cap rates fell 20-30 bps from a year earlier for most property sectors in April. The retail sector – despite posting stronger growth in deal volume – posted only a 10 bp decline in cap rates.

Transaction Volume Summary

	April 2022		YTD 2022		RCA CPPI	
	Vol (\$b)	YOY	Vol (\$b)	YOY	Cap Rate	YOY
Office	5.0	-40%	40.4	33%	6.3%	11.8%
Retail	5.2	10%	24.2	74%	6.4%	18.4%
Industrial	6.5	-43%	46.1	35%	5.5%	26.0%
Hotel	1.8	-23%	13.9	59%	8.3%	19.0%
Apartment	17.9	7%	83.4	46%	4.8%	23.0%
Snr Hsg & Care	0.8	-55%	3.2	-45%	5.8%	
Dev Site	2.1	18%	9.7	38%		
Total	39.4	-16%	220.9	41%		17.9%*

*All-Property Index comprises office, industrial, retail and apartment

Monthly Transaction Volume and Pricing



Trailing 12-mth cap rates; volume YOY change truncated at 150%

A Performance Perspective on Property

During the initial phases of the pandemic, U.S. commercial real estate performance dipped as markets grappled with uncertainty and the spread of Covid-19. The three-month total return for the MSCI U.S. Quarterly Property Index briefly turned negative in Q2'20, around the same time as deal volume activity shrank, as shown in the chart to the right.

However, this negative performance was temporary, with positive momentum returning in subsequent quarters. Total returns increased, and by Q3'21 had reached record highs that coincided with the strong rebound in deal activity. In the most recent quarter, total returns declined slightly, to 5.8% from 6.3%, but this was still the second strongest quarterly total return seen in the index since its inception in 1999.

The record high returns seen in recent quarters do mask some underlying variation across the various property types. A notable divergence began to emerge in the middle of the last decade as e-commerce growth buoyed industrial but weighed on retail. Steady growth in online sales and then the onset of the pandemic have contributed to further bifurcation and meant that the spread of returns across the various property types has been increasing over recent years.

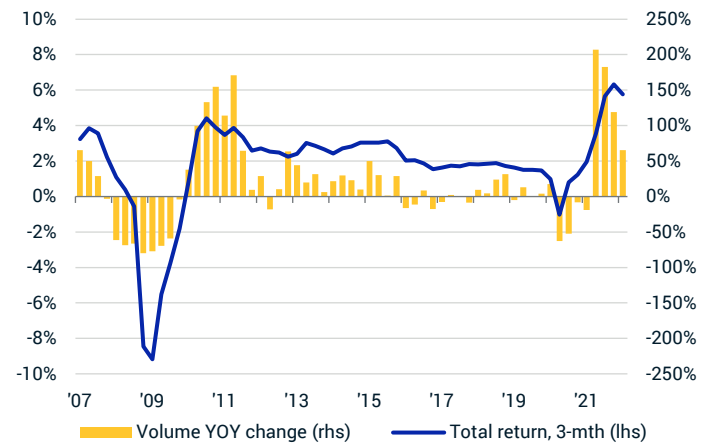
During the pandemic total returns moderated across all major property types, though some were more affected than others. For example, retail assets were typically harder hit by lockdowns and social distancing measures, which contributed to weaker performance for this property type, as shown in the chart opposite. Industrial assets, by contrast, were more resilient and only experienced a more modest dip in total returns.

Total returns have bounced back for all major sectors since mid-2020, but it is in the industrial and apartment property types that we have seen the strongest returns in recent quarters. It is therefore perhaps not entirely surprising that these two property types have accounted for a large share of the total transaction volume in the market.

Yield movements help to explain some of the variation in sector performance, as displayed in the chart to the lower right. For retail and office assets, net operating income (NOI) yields were slightly higher in Q1'22 than they were before the pandemic in Q4'19.

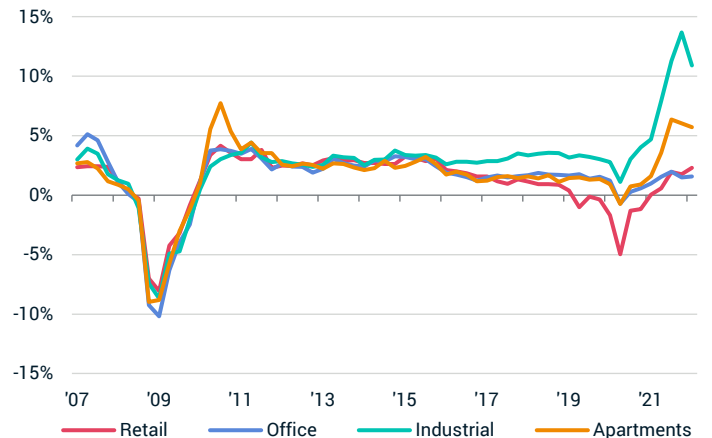
By contrast, industrial, apartment and self storage NOI yields have compressed, helping to put upwards pressure on asset values. Breaking down the asset value growth observed in the year to Q1'22, yield impact – the change in values driven by yield movements – was a significant driver, particularly for the industrial sector. The retail sector was the only major sector to see negative yield impact as NOI yields increased over the year.

US Quarterly Transaction Volume and Total Returns



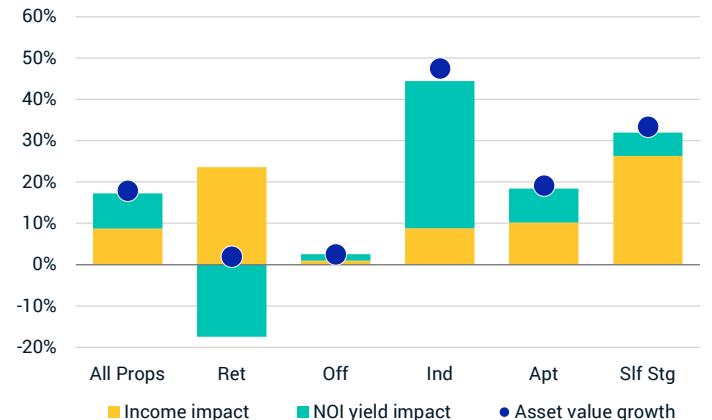
The MSCI U.S. Quarterly Property Index measures the unlevered valuation-based investment performance of 5,591 directly held properties with a total capital value of \$448.0 billion as at Q1'22. These properties include self storage and other assets not captured in aggregate deal volume figures in this report.

Total Returns by Sector



MSCI U.S. Quarterly Property Index, 3-mth total returns

Drivers of Asset Value Growth by Sector



MSCI U.S. Quarterly Property Index; 12-mth returns and impact for Q1'22; All Props includes "Other" types

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Methodology

Data based on properties and portfolios \$2.5m and greater unless otherwise stated. Data as of May 24, 2022 unless otherwise stated.

About Capital Trends

Capital Trends reports analyze and interpret trends in the global real estate market. US Capital Trends is a monthly edition comprising an overview of the U.S. market and separate reports on the five main property types. Asia Pacific, Australia, Europe and Global Capital Trends are published quarterly.

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