Economic Update

OCTOBER 2, 2020

1. AFFORDABLE HOUSING

- According to REIS, the Affordable Housing Sector has gone mostly unaffected through the pandemic as of Q2 2020. While the national vacancy rate is up by 10 bps from the same time a year ago, they ticked down by 10 bps from Q1, settling at 2.4%.
- Rents are up 0.1% from the first quarter, comparing favorably to market-rate units, which saw effective rents fall by -0.4% over the same period. An estimated 5,700 new affordable units were delivered between April and June, -27.8% below the quarterly average of 7,900 units over the past year.
- The REIS report notes that construction in the sector went mostly uninterrupted during the depths of the shutdown. Still, demand growth is regularly outpacing supply growth, and the sector's robust underlying fundamentals remain intact.

2. REITs

- According to data provided by NAREIT and FTSE, year-to-date through September 25th, Equity REITs remain down by -13.7%, and Mortgage REITs are down by -36.3%.
- REITs specializing in Regional Malls, a sub-property type already that was already facing a disproportionate share of headwinds before the pandemic, are down an average of –54.7% YTD.
- A feverish demand for new suburban housing and stubborn supply shortages have contributed to both Timber REITs' mid-pandemic outperformance and volatility. Measured from the start of the third quarter, Timber REITs are up by a market-leading 17.0%. Measuring instead from the beginning of September, Timber REITs are down a market-worst -10.4%.

3. SELF-STORAGE

- According to REIS, vacancy rates in self-storage units ticked down by 70 bps in Q2 2020, settling at a national average of 14.2%.
- While seasonal factors partially explain the improvement, the prevalence of colleges sending students home is just one of the many ways COVID is continuing to displace housing patterns and boost temporary demand for storage space.
- Still, there are signs of continued softness. The sector was widely viewed as oversupplied heading into the pandemic, and, measured year-over-year, rents for 10x10 non-climate-controlled units are down by -5.4%.
- On the other hand, according to data provided by NAREIT and FTSE, Self-Storage REITs are amongst the best performers in the third quarter, up 15.1% quarter-to-date through September 25th.

4. OFFICE

- According to a recent study by the Architectural and Interior Design Firm Vocon, work from home is starting to have a material effect on productivity levels. The survey, which polled the heads of 50 leading businesses, found that 40% of firms have noticed a drop-off in work output from remote workers.
- According to REIS, Office vacancy rates rose by 10 bps in Q2 2020, settling at 17.1%. REIS forecasts that vacancy rates will continue to rise, topping 19.3% through the end of this year, and peaking near 20% in 2021. Deliveries of new Office space cratered to just 3.3M square feet in Q2 2020, well below the quarterly average of 11.8M square feet observed through 2019.
- According to data provided by NAREIT and FTSE, through September 25th, Office REITs are down a sizable -31.4% and -9.1% year-to-date and quarter-to-date, respectively.

5. DEFAULTS AND DISTRESS

- The noncurrent rate for both Multifamily and Commercial mortgages held on bank balance sheets continued to rise in the second quarter, retreating to levels last seen in 2016.
- On the Multifamily side, default rates hit a low of 0.11% to close out 2019 before rising to 0.12% in Q1 and 0.19% in Q2.
- Nonresidential Commercial loans followed a similar path, falling to a low of 0.51% in Q4 and rising through the subsequent two quarters, landing at 0.78%.
- From the previous quarter, default rates for bank held CRE loans are up 0.15%, the most substantial single period increase since Q1 2010.

6. INDUSTRIAL

- Net Absorption in the Warehouse & Distribution portion of the Industrial sector fell to 9.7M square feet in Q2, down from 27.1M square feet in the first quarter. The quarter-over-quarter drop is consistent with similar dips from Q1 to Q2 in the past two years, while activity in this property type remains strong compared to others.
- Construction fell to its lowest measure on record at 16.1M square feet in Q2, down from 30.2M square feet in the previous quarter.
- In 2019, construction in Warehouse & Distribution averaged 31.6M square feet of new inventory added per quarter.
- Industrial REITs remain one of the few real estate public equities that have maintained price appreciation through the downturn. Industrial REITs are up 6.4% from the beginning of the year and 4.0% quarter-to-date, according to NAREIT and FTSE.

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7. RETAIL

- According to a Chandan Economics Analysis of Census Bureau Retail Sales data, Brick-and-Mortar retail sales are down -9.3% through Q2 2020 compared to a year ago.
- While online retailing has accounted for a growing share of total retail sales over the past twenty or so years, the pace of cannibalization rose dramatically amid the COVID pandemic. Online retail sales grew an average of 15.1% annually between 2010 and Q1 2020.
- As the US went into shutdown, online retail sales in Q2 ballooned, rising 44.5% year-over-year. As of the first quarter, online retail accounted for 11.8% of all retail spending (excluding food services); in Q2, the share rose to 16.1%. Through September 25th, Retail REITs are down an abysmal -40.5% since the beginning of the year and -5.1% in the month.

8. APARTMENT RENTER PERFORMANCE

- 82.2% of tenants living in rental-occupied apartments met their rent this past month, according to the September 23rd release of the Census Bureau's Weekly Household Pulse Survey (HPS). The HPS, which began on April 23rd as a temperature check of sentiment, conditions, and performance during the pandemic, conveyed an average payment rate of 80.3% during its first 12 weeks through July 21st.
- The lowest measure to date came during the week of July 9th, with just 76.2% of self-reporting renters claiming to have made their payments the month prior. The latest reading suggests that the recovery in rental income has continued since its summer-low, as rebounding economic activity helps stabilize tenant cashflows.
- Broken down by household income-level, 92.1% of renters earning $75,000 and above annually made their rent payment last month, compared to just 80.4% of renters making less than $75,000.

9. APARTMENT MARKET INVESTMENT INDEX

- The Freddie Mac Multifamily Apartment Investment Market Index (AIMI), a measure of overall multifamily sector investment health that tracks asset prices, property-level incomes, and mortgage rates, ticked down to 128.5 in Q2 2020 after reaching a three-year high of 128.9 in Q1.
- The decline corresponds with an observed drop in the index's price component, which fell 0.08% from Q1. This is the first quarter-over-quarter decrease in valuations since the Great Recession.
- Despite the drop, prices are still up year-over-year, with the AIMI standing 6.1% higher today than one year ago. While property-level income growth has constrained in the pandemic, accommodative monetary policy and demand for safe-haven assets have exerted downward pressure on mortgage rates, partially offsetting negative pricing.

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- While average multifamily mortgage rates went unchanged from Q1, standing at 3.3%, they are down by 60 bps from Q2 2019.

10. SINGLE-FAMILY RENTALS

- Lease expirations for Single-Family Rental (SFR) units decreased to 7.5% in July, down 10 bps from June, according to a report by DBRS-Morningstar.
- The average retention rate on full-term leases stood at 86.0% in June – the latest month of data availability. The retention rate is up 2.8% from May and 3.8% from April, matching upward trends seen in other demand-related indicators following the economic nadir in April.
- The turnover rate on SFR leases increased by 10 bps to 2.7% in June, while the average delinquency rate increased to 3.6% in the same time period, 40 bps higher than the previous month.

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SUMMARY OF SOURCES

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