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Economic Update

OCTOBER 30, 2020

CHANDAN ECONOMICS

1. MULTIFAMILY

- According to Real Capital Analytics' hedonic cap rate series, apartment cap rates ticked down a minuscule two basis points between Q2 and Q3 2020, settling at 5.23%.
- Conversely, RCA's transaction cap rate series ticked up by 20 bps, signaling that there are widening differences between the assets trading and the rest of the market.
- Following a 67.3% YoY drop off in apartment transaction volumes in the second quarter, volumes remained down 51.2% year-over-year through Q3. Still, Q3 numbers mark an improvement from Q2, rising 55.9% above shutdown-lows.

2. RETAIL

- Measured across the entire sector, according to RCA's hedonic cap rate series, Retail cap rates ticked down four basis points in the third quarter, averaging 6.59%. Assets with Grocery tenants saw the most cap rate compression, falling by 11 bps to 6.44%.
- At the other end of the spectrum, Big Box retail assets experienced the most cap rate widening, ticking up by 6 bps to 6.63%.
- Transaction volumes in Q3 2020 for all retail assets remained down by 58.3% compared to the same period last year, though they did recover 29.8% from Q2 2020.

3. INDUSTRIAL

- According to Real Capital Analytics, Industrial cap rates barely budged in the third quarter, narrowing by two basis points to 6.14%.
- Despite prevailing optimism for the sector as a whole, Industrial has followed the rest of commercial real estate in seeing depressed transaction volumes, falling 63.2% year-over-year in Q3.
- Cross-border investments into the Industrial sector have, thus far, more than kept pace with 2019 totals. Through the first three fourths of the year as compared to the same period in 2019, international investors have stepped up their acquisitions by 15.2%.
- Institutional funds and private investors, the two largest buyer groups in the Industrial sector, have both pulled back considerably in 2020, reducing acquisitions by 49.9% and 41.7% YTD, respectively. Still, despite the relative decline in activity, these two buyer groups accounted for 75.0% of all acquisitions in the third quarter.

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svn.com
33 Arch Street, 17th Floor
Boston, MA 02110
T: 888-311-0605

4. HOTEL

- Hotel occupancy rates, according to STR, averaged 50.1% in the week ending October 17th, down 30.7% from the same time one year ago. In the heat of the shutdown, occupancy rates fell as low as 22% before recovering through the Spring and into the Summer.
- However, since early-August occupancy rates have plateaued, suggesting the hospitality sector may not see much further improvement until the pandemic ends and traditional travel patterns return.
- Across the core-CRE property types, the Hotel sector was the only one to have cap rates rise in the third quarter, according to RCA's hedonic series. Cap rates ticked up by 8 bps between Q1 and Q2, then rose again by 3 bps in Q3, settling at 8.70%.

5. OFFICE

- According to Real Capital Analytics, cap rates in U.S. Office properties went virtually unchanged between the second and third quarters, falling 2 bps to 6.63%. While cap rates are holding steady, there are some signs of COVID-induced softness when pricing on a per square foot basis.
- According to RCA's hedonic model, which measures valuations using a 'sum of parts' approach, the price per square foot of office space is up 0.05% from one year ago, the slowest annual growth rate since 2010 when valuations were still falling post-GFC. Transaction volumes in the third quarter were down by 60.4% and only recovered by 14.8% from Q2.
- JLL reports that space givebacks led to a 28.9 million square feet reduction in national occupancy, the single largest quarterly decline ever. Further, JLL finds that today's subleasing market is larger than previous highs set during the dot com-bubble and may rise to 150 million square feet by the end of the year.

6. MULTIFAMILY PERMITS

- Newly issued private Multifamily construction permits rose to an annualized 390,000 units in September, improving marginally from 386,000 in August. While permit issuance has slowed in 2020, the pandemic does not appear to be the causal driver.
- Between November 2019 and February 2020, annualized permit issuance fell from 534,000 to 399,000. From the beginning of the national outbreak in March onwards, little new directionality has formed. Whether permitting activity hits a significant cyclical inflection depends on the timing and severity of the ongoing COVID-recession, as well as the permanence of accelerated urban outmigration.
- The two most recent U.S. recession offer contrasting comps. New Multifamily permitting did not hit a low point during the GFC until July 2009, falling by 77% from pre-recession levels. Meanwhile, during the dot com-recession of 2001, new issuance went mostly unaffected.

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7. THE BEIGE BOOK

- According to the Federal Reserve's Beige Book, an anecdotal summary of economic conditions last released on October 21st, the U.S. economy continues to recover, though at a modest rate. The uptick in activity varied by sector.
- Both the manufacturing and banking sectors saw a moderate pickup across all twelve Fed districts, with increased residential mortgage demand cited as a primary driver for the latter.
- Across the entire Commercial Real Estate market, only warehouse and industrial spaces are charting steady construction and leasing activity.
- There are concerns in the banking sector of an impending rise in delinquency rates in the coming months.
- Consumer spending has stabilized, driven in part by a slight rise in tourism.
- Automobile demand remains steady, though low inventories continue to constrain sales.
- Agriculture conditions vary widely– a symptom of adverse climate conditions in several districts.
- Restaurant owners continue to express concern about customer demand once colder weather hits, especially in districts that have relied on outdoor dining.

8. RETAIL SPENDING

- According to Census reported figures, year-over-year retail sales (excluding food services) rose by 8.2% in September, up from a 5.4% annual growth rate in August. The online share of retail transactions continues to climb.
- Nonstore retailers accounted for 17.0% of all retail spending in September 2020, up 14.8% during the same month last year. Spending at restaurants and bars remains hard-hit.
- In total, Americans have spent an estimated $458 billion on food and beverage services in 2020 through September, down 20.1% from last year's three-quarters mark.

9. REITs

- Equity REITs remain down by 10.8% from the beginning of the year, according to the FTSE Nareit All Equity REITs Index, reported through October 23rd.
- Market capitalizations did, however, stabilize in the third quarter, recovering 1.68% from Q2.
- Measured year-to-date, Regional Malls are the hardest-hit subsector, with REITs in this category losing an average of 51.2% of their value from the start of 2020.
- Industrial, Self-Storage, and Data Center REITs continue to stand as market-beating outperformers, up 13.0%, 13.6%, and 29.9% YTD, respectively.

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10. INDUSTRIAL SPACE DEMAND

- According to NAIOP's Q3 industrial space demand forecast, net absorption will likely remain negative throughout the end of 2020 and into the new year before turning positive again in Q2 2021.
- In 2019, net absorption in the Industrial sector totaled 183.3 million square feet.
- In 2020, NAIOP forecasts net absorption will fall to -103.4 million square feet.
- The report suggests that while the pandemic has boosted demand for e-commerce, the industrial sector is not immune from downside effects. Disruptions to global supply chains and trade, store closures, and a reduction in manufacturing and construction activity are some of the headwinds weighing down the near-term projections.
- Looking ahead to 2021, while projections are muted and far below pre-COVID norms, net absorption is forecasted to rise to a positive 35.3 million square feet.

SUMMARY OF SOURCES

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