

Robust recovery seen ahead for commercial real estate: Nareit midyear outlook

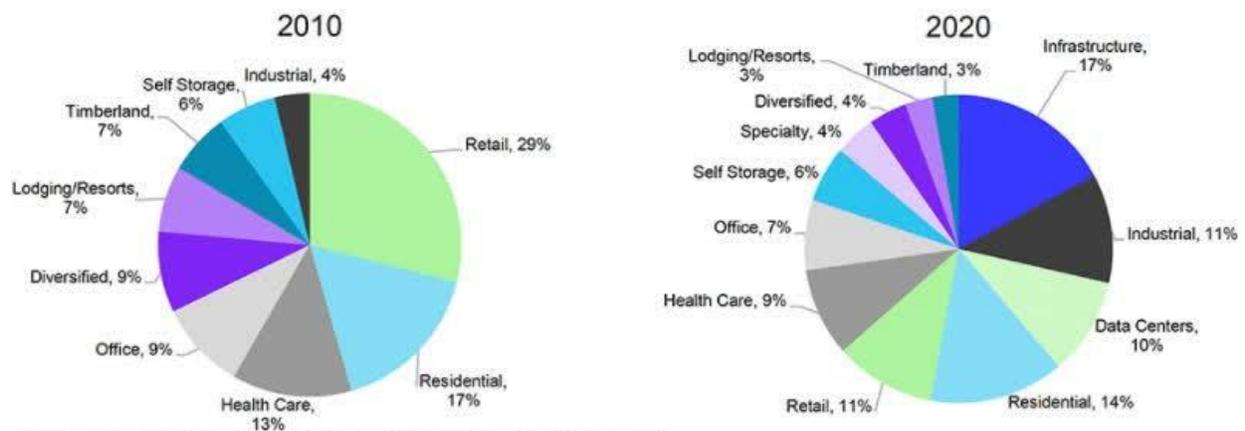
Jun. 22, 2021 4:14 PM ET

[Real Estate Select Sector SPDR ETF \(XLRE\)](#)

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- "A robust recovery is no longer a question of 'if', but rather, 'when,' " according to the National Association of Real Estate Investment Trusts (Nareit) midyear outlook for REITs and commercial real estate.
- It helped that REITs entered the pandemic with historically strong balance sheets. Still, uncertainties remain, especially the threat of inflationary pressures as the economy reopens.
- Technology advancements have transformed the economy and introduced new property sectors for investment. At the end of 2020, industrial, cell towers and data centers accounted for 39% (\$460B) of equity REIT market cap. By contrast, industrial only accounted for 4% of equity REIT market cap, and cell towers and data centers weren't yet broken out as sectors in 2010.

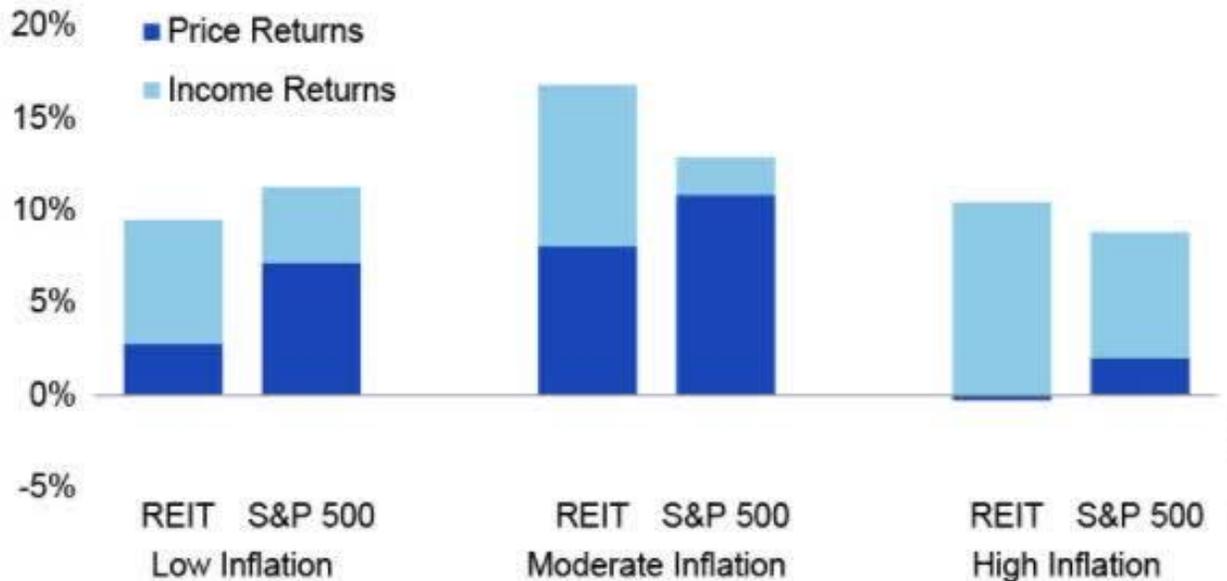
Comparison of Sector Market Capitalization Shares: 2010 - 2020



Source: FTSE Russell, Nareit. Data as of December 31, 2010 and December 31, 2020.

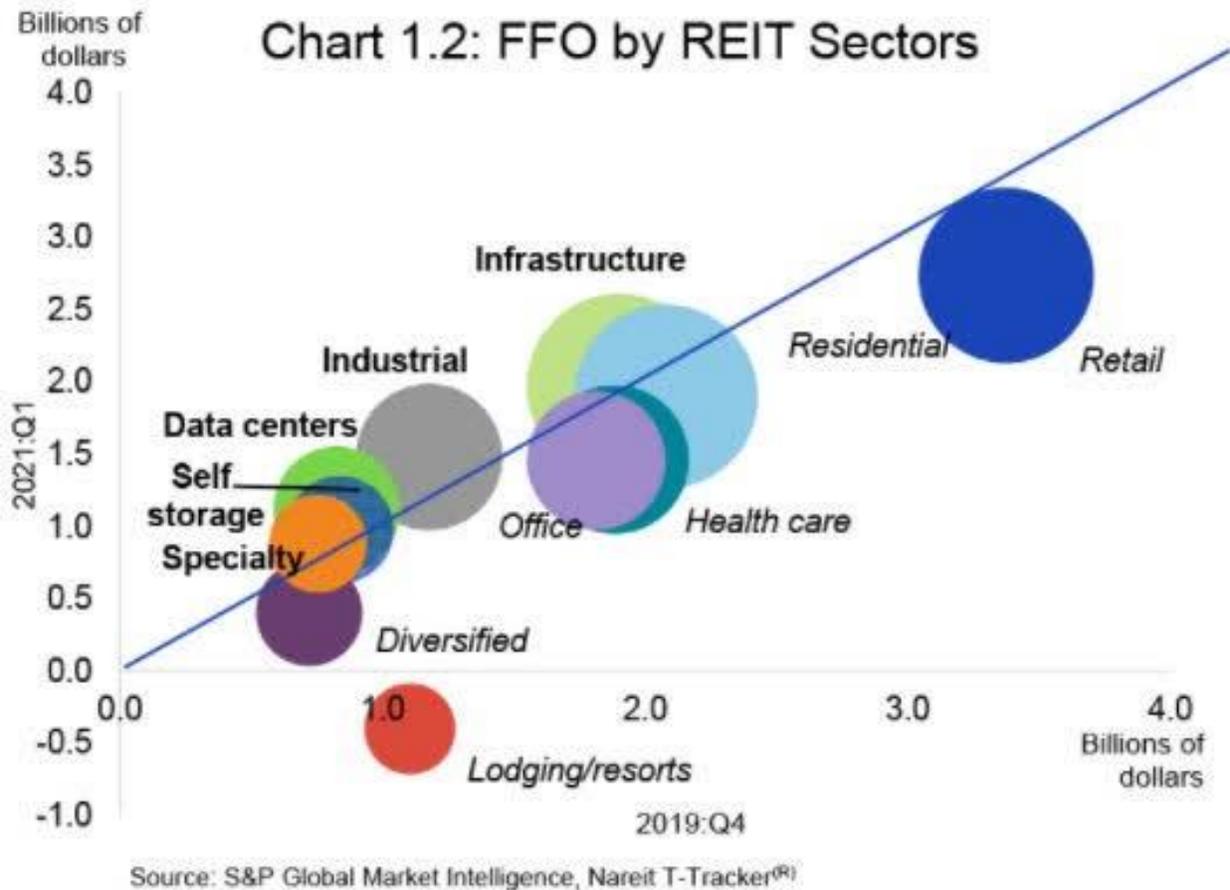
- With vaccine coverage boosting all sectors, commercial real estate is also likely to face a boost thereby pushing REIT earnings growth over H2 2021.
- YTD total return of the FTSE Nareit All Equity REITs index at the end of May was 18.1% and the index is 4.3% above its pre-pandemic high; operationally, REIT earnings reported total FFO now at 85% of its pre-pandemic level.
- Nicole Funari indicates that REITs may perform well if inflation should increase. She finds that historically, REITs outperformed in periods of moderate and high inflation, while providing competitive returns in periods of low inflation.
- REITs outperform the S&P 500 in 56% of 12-month periods with high inflation and over 80% of 12-month periods when inflation is high and rising.

REIT Returns Compare Favorably to S&P 500 Returns During Different Inflation Periods



Source: Nareit analysis of prices for the FTSE Nareit All Equity REIT Index and S&P 500 Index, 1972-2020; inflation measured for all items, all urban consumers.

- Commercial real estate recovery is seen uneven across sectors and subject to various lags and delays; FFO of digital real estate sectors was at or near record highs in Q1, and the Nareit T-Tracker shows self storage REITs and specialty REITs are reporting FFO above pre-pandemic levels.
- The chart compares REIT property sectors' FFO in Q4 2019 and Q1 2021. Bubbles that are above the line, and with bold labels, had an increase in FFO over this period, while those below the line with italicized labels had a decline in FFO; bubble size is proportional to sector equity market capitalization in Q4 2019.



- While FFO from the retail REIT sector rose 5.5% in Q1, it represented 81.2% of its level in Q4 2019.
- Among the other sectors:
 1. Lodging/resorts and retail property markets have stabilized, but are unlikely to see significant improvement (reported negative FFO through Q1) until travel volumes and shopping patterns get much closer to pre-pandemic patterns.
 2. Senior housing properties within the health care sector have experienced a drop in occupancy due to a hesitancy to move in during the pandemic, and higher costs for personnel, PPE, and cleaning supplies.
 3. Office occupancy and rents (negative 11.7% in 15 months through May 21) are likely to stabilize and begin to recover later 2021 or early 2022; it faces greater uncertainty about the longer-term impacts of WFH (led to a 12.5% drop in Q1 FFO) on the demand for office space.
 4. Demand for apartments rebounded quickly in Q1 with falling vacancy rates and an acceleration in rent growth across most metro areas; apartment REITs posted a 2.9% increase in Q1 FFO, but is 83.2% of pre-pandemic levels while total returns of apartment REITs were -4% over the pandemic as of May 21.
 5. FFO from all equity REITs rose 2% in Q1 compared with 10% in each of the prior two quarters.

