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Real Estate sector report

January 2021

Sector conditions and outlook

Current condition | Outlook

Apartment

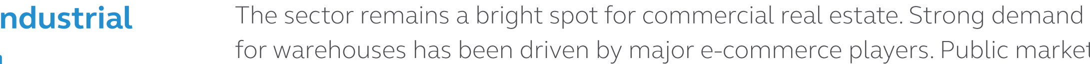
The sector has held up relatively well to date, but space market fundamentals are showing signs of stress. There is a continued divergence in performance between gateway and secondary markets, as well as Central Business District (CBD) v. Suburban across both private and public quadrants. Debt spreads remain favorable and rates are the lowest across property types. Government Sponsored Enterprise's (GSE's) continue to play a large role in the sector, which is also benefitting from a shift away from retail and hotel.

Hotel

Demand for hotels remains soft, particularly for the full-service segment as the pandemic has effectively curtailed business and leisure travel. Private equity capital remains sidelined awaiting a resolution to price discovery with very few transactions occurring. Debt markets are operating but only opportunistic lenders are currently active. REITs have materially underperformed with upwards of 15% of luxury hotels still closed.

Industrial

The sector remains a bright spot for commercial real estate. Strong demand for warehouses has been driven by major e-commerce players. Public markets are pricing warehouses at 10%-15% premium to NAV and data center REITs are benefiting from a continued shift toward the digital world. Credit market conditions remain favorable, but an increased concentration of e-commerce credit in the sector should be monitored.



Office

Demand for office space is minimal as leasing remains soft and net demand is negative. Capital demand remains bifurcated and remains focused on quality as physical occupancy is minimal. Sublease space remains problematic in the largest markets and REITs are trading at a 10%-20% discount as further occupancy and rent erosion is anticipated. Though private debt has remained conservative, delinquency rates remain low. The CMBS market remains tilted toward office exposure although investors have cooled; conservative underwriting, solid NOI and portfolio diversity has helped balance the sector.

Retail

Retail remains the weakest of the major sectors. Rent collections have improved, but we anticipate another round of relief requests. Continued uncertainly vexes the public market with regional malls exhibiting the weakest performance. Private and public debt markets are unfavorable and debt for regional malls is generally unavailable.

Key:

● Improving ● Neutral ● Deteriorating

↑ Positive ↗ Moderately positive → Neutral ↘ Moderately negative ↓ Negative

Apartment

Sector rating	New supply	Demand	Rent growth	Capital values	REIT pricing relative to NAV*	Debt availability
→	↓	↗	→	→	↘	↑

Key: ↑ Positive ↗ Moderately positive → Neutral ↘ Moderately negative ↓ Negative

*REIT pricing relative to NAV: Red/downward yellow signifies prices are trading at a discount, upward if trading at a premium.

Sector overview

The apartment sector has held up remarkably well under the weight of the pandemic-driven economic recession, but some signs of stress are beginning to emerge. Overall, the state of the market remains largely healthy as demand and occupancy levels remain generally positive and rent collections through 2020 have continued to surprise to the upside. Vacancy rates have continued to climb, but largely in line with prior expectations due to an extremely active supply pipeline that had raised caution flags through the second half of the last expansion. Income growth has slowed, but has remained positive, as demand has eased through the second half of the year. Space markets will remain bifurcated as millennials are showing preference for more space and leaving urban locations for the suburbs. We have seen asking rents in key markets such as San Francisco and New York correct by between 10% to 15% and concessions are running near 3% to 5% , further tamping down income expectations.

The apartment sector remains reasonably well positioned to start 2021. Some policy uncertainty surrounding evictions will loom large for lower income and workforce housing as the recession has disproportionately affected its tenant bases' earning potential. As with other property types, the outlook hinges on the successful deployment and effectiveness of the coronavirus vaccines, but for now we continue to view the apartment sector as defensive.

Private equity

We continue to see the sector perform well with meaningful bifurcation of performance between infill, luxury product and suburban, particularly garden-style apartments. Capital market demand has been consistent, buoyed by the widespread availability of low-cost debt capital. Performance across the sector is disparate, with notable differentiation by market, subtype and even individual property. We continue to see an erosion in fundamentals within densely populated gateway markets, which underperformed through much of 2020.

Regionally we are seeing downward pressure on rents, increased concessions, and rising vacancy in cities like the San Francisco, New York, and Los Angeles. Secondary and high-growth markets and suburban product are currently outperforming. Renters are seeking more space and affordability, which is supporting non-luxury product. Performance in the student housing sector has been somewhat sporadic with some pockets of outperformance, but with several universities well behind previous occupancy benchmarks. We continue to take a wait-and-see approach to the subsector but see a flight to quality as the most desirable buildings are filling up quickly. In general, the sector has remained liquid through the pandemic given significant lender demand and a very low cost of debt capital, reinforcing its defensive characteristics.

Private debt

Despite the moderating supply and demand profile, lenders continue to view multifamily (along with industrial) as a preferred property type. Lenders' favoritism for multifamily, paired with extremely competitive pricing from the government-sponsored enterprises, make multifamily lending rates the lowest of all property types. Lenders are frequently offering interest rates in the very low 2% range today for loans with over 60% loan to value, intermediate term debt secured by high-quality multifamily properties in suburban and less dense urban locations. Loans up to 70% loan to value or secured by high-rise urban properties are also available with rates in the mid- to upper 2% range.

REITs

Apartment REITs performance has been bifurcated since the outbreak of COVID-19, with Sunbelt and suburban-focused portfolios outperforming coastal, urban portfolios, especially those with significant exposure to New York City, San Francisco, Boston, and Los Angeles. This is mostly driven by the trends of working from home, decentralization, and suburban (or even cross state) migration. However, recent messaging from the companies regarding potential early signs of stabilization, a defeat of California Costa Hawkins II, and positive news regarding the success of vaccines have caused the group to rebound into year-end 2020.

Looking into the year ahead, fundamentals are expected to remain under pressure through most of the first half, but improve in the second half given likely increasing demand as well as the benefit of easier comps, although it remains too early to predict the degree of the strength. As of the end of November 2020, NAV estimates (the estimated private market value of a REIT's assets minus the value of its liabilities) for apartments REITs have declined 12% since the beginning of the COVID-19 pandemic, compared to a U.S. REIT average decline of 9%. Apartment REIT stock prices trade at about a 10% discount to NAV on average with coastal peers at wider discount. This is a relatively large discount compared to the broader REIT market, which traded at a 5% premium on November 30, 2020.

CMBS

The GSE's continue to be a dominant lender holding a 38% market share of all outstanding multifamily loans.[1] Agency lending caps have been reduced for 2021 and new guidelines require a higher proportion of loans directed to affordable housing. Meanwhile, the composition of conduit CMBS issuances favors a reduction of retail and hotel exposure resulting in high demand for more "in favor" property sectors, such as multifamily. While this is positive for the diversification profile of conduit CMBS, credit assumptions must be applied at the property level, considering metro-specific trends and outlooks.

[1] Source: Fannie Mae, Freddie Mac, Citi Research, Q2 2020

Hotel

Sector rating	New supply	Demand	Rent growth	Capital values	REIT pricing relative to NAV*	Debt availability
↓	↘	↓	↓	↓	↑	↓

Key: ↑ Positive ↗ Moderately positive → Neutral ↘ Moderately negative ↓ Negative

*REIT pricing relative to NAV: Red/downward yellow signifies prices are trading at a discount, upward if trading at a premium.

Sector overview

Hotel demand driven by tourism, business, and conferences has seen an unprecedented decline. Hotels have been dealt a double dose of challenges amid the pandemic and subsequent government-ordered shutdowns, effectively halting travel. Leisure and corporate travel declines have led to dramatic declines in hotel occupancy rates and swiftly pushed many owners towards financial distress. Room rates have fallen sharply, and previously sold-out destinations are struggling with unthinkably low occupancy levels. Global gateway cities such as New York, Los Angeles, and San Francisco have been hit particularly hard.

Private equity

Hotel supply has started to decline significantly especially early stage projects, but existing projects in the pipeline continue to come to the market, placing further strain on occupancy and profitability. Current conditions reflect pandemic related restrictions—both personal and mandated. The sector outlook remains tenuous but should improve over the course of the next 12-24 months as inoculations become more widespread and leisure travel picks up, followed by the business segment.

While the hotel sector is reeling from pandemic induced weakness, it is critical is to understand and evaluate the difference between the cyclical downturn as a result of COVID-19. Interestingly, there is potential for longer lasting structural demand changes in business travel as video conferences replace traditionally in-person meetings. This structural change may have a significant, albeit difficult to forecast, negative impact on individual business travelers and the meetings and conventions segments of the market.

Many private equity players have started to look at the sector, but pricing has not moved enough to reflect the risk. Although hotel values were under some pressure prior to the pandemic, they have fallen 24.1% since the end of last year.[2] Transaction volumes remain as thin as they have been since 2010, suggesting little in the way of price discovery for private investors.

Private debt

Hotel market duress has driven all but the most opportunistic lenders away from making new hotel loans. New non-recourse permanent debt for hotels is generally unavailable from traditional senior lenders today. Debt may be available on a shorter-term, "rescue" basis from higher rate/more equity-oriented lenders under limited circumstances.

REITs

Lodging REITs have materially underperformed other property types since the onset of COVID-19, with limited-service, suburban properties showing greater resilience compared to large, urban hotels. This is primarily driven by leisure travel to drive-to locations, local business demand, and lack of higher-rated corporate travel. Both occupancy and rates have come under extreme pressure, with upwards of 15%

[2] Private equity pricing derived from NCREIF National Property Index (NPI) Q4 2020.

of luxury hotels still closed today as current levels of demand are not robust enough to reduce cash burn and support re-opening.

Since the beginning of the COVID-19 pandemic, lodging REIT NAV estimates declined ~35% compared to the broader U.S. REIT universe which remained relatively flat. As of year-end, lodging REITs traded at a 10% premium to consensus NAV following outperformance from the group on headlines of better than expected vaccine efficacy in early November. This NAV premium reflects an optimistic forecast from investors for a material ramp up in demand in the second half of 2021 and into 2022.

CMBS

Hotels have been the hardest hit property sector within CMBS, resulting in a spike in hotel delinquency rates. The 30 day+ delinquency rate for conduit and SASB hotel loans currently stands at 23% and 14%, respectively[3] and appear to have stabilized at these levels for now. Servicers are working with borrowers to bridge the gap in property cash flows by offering a variety of short-term forbearance arrangements. These have been helpful in the near-term, but longer-term solutions will be required to carry these loans as property performance recovers in tandem with the return of travel.

Vaccines are helping borrowers look-through the current state of distress which should improve the willingness to carry better quality properties through. Institutional sponsorship with stronger balance sheets and flexible capital sources are better equipped to weather the storm. Market credit assumptions are taking borrower strength and long-term property viability into account.

Post-COVID CMBS issuances have included very little hotel exposure as the sector is squarely out of favor. That said, we have seen hotel loans slowly return to new issue pools. To date, the market has priced for this risk while showing a willingness to provide a more conservative level of financing to the sector. Many of these loans require enhanced loan structure including debt service reserves to mitigate near term credit stress.

[3] J.P. Morgan Research, as of December 31, 2020

Industrial

Sector rating	New supply	Demand	Rent growth	Capital values	REIT pricing relative to NAV*	Debt availability
↑	↘	↑	↑	↑	↗	↑

Key: ↑ Positive ↗ Moderately positive → Neutral ↘ Moderately negative ↓ Negative

*REIT pricing relative to NAV: Red/downward yellow signifies prices are trading at a discount, upward if trading at a premium.

Sector overview

Industrial rental growth, occupancy and transaction volume are all at or above equilibrium levels as of the close of the year. Concerns over trade disputes and disruptions in trade flows from the Asia-Pacific region appear to have been overdone as port activity has received a significant boost in the second half of the year. Moreover, the rapid shift toward increased e-commerce activity ranging from durable goods, commodities and groceries helped boost market penetration. Good news for industrial properties, bad news for struggling regional malls.

Vacancy rates have increased modestly over the past 12 months but are more a reflection of new development than a lack of demand. The key strategic port markets of New York and Los Angeles have experienced declines in vacancy as have other major markets such as DC/Baltimore, Atlanta, Dallas and Austin. Leasing activity is currently being driven by major e-commerce players, which are accounting for roughly 80% of leasing activity year to date, and Third-Party Logistics Providers (3PLs). Demand for secondary and niche space is being bolstered by the pandemic as increased demand for data and online shopping has proved to be a boon for both data centers and cold storage in recent months. Demand and pricing have remained firm for the most part and the outlook remains healthy as we start the year.

Private equity

Industrial remains one of the most favored property types. We continue to see favorable space market fundamentals and fervent capital market demand, driving up pricing for core, well-located product. The growth in demand extends to niche sectors including data centers and cold storage given the acceleration of secular trends in 2020.

Development remains attractive in many markets nationwide relative to existing product, but we are monitoring pockets of elevated supply around fast-growing population centers such as Las Vegas, Phoenix and Seattle. Nashville also stands out as a market where vacancy has risen in the several quarters as a result of an active delivery pipeline.

Demand fundamentals are very strong, and the continued expansion of supply chain and distribution networks means we're seeing lease activity not only from traditional large e-commerce tenants but also 3PL operators, discount retailers, and home improvement stores. Although, net absorption is currently concentrated among top e-commerce users. Near-term, demand should continue to outpace the elevated levels of supply to meet space requirements for distribution, low-latency data processing and household formation.

Private debt

As previously stated, lenders today view industrial (along with multifamily) as a preferred property type. Many lenders' relative under-exposure to the property type and a lack of confidence in certain other traditional property types (e.g., retail, office, and hotels) have fueled lenders' voracious appetite for debt secured by core industrial properties. Consequently, lenders today frequently offer industrial loan interest rates very near the levels offered for prime multifamily properties, with Loan-to-Values (LTVs) commonly up to 65%.

REITs

Industrial was a bright spot in 2020 with both warehouse and logistics owners posting the strongest returns amongst all property types. Warehouse demand was fueled by an acceleration in e-commerce sales that drove a robust fundamental backdrop and strong operating results. The outlook looks favorable heading into 2021 as well, given high build-to-suit demand, increased speculative development opportunities, and a lull in new deliveries that is expected to cause an acceleration in rent growth.

Key trends investors are watching include: whether there was a pull-forward in e-commerce and digital demand; development yields given increased competition; can re-stocking and higher inventory levels drive demand even higher; and can cap rates compress even further given the capital chasing the sector. Warehouse and logistics REITs are trading at approximately 10% - 15% premiums to NAV on optimism for potential further cap rate compression and favorable growth prospects. Both segments were also a minority which saw NAV estimates move higher since COVID-19 hit, with each seeing a nearly 10% increase.

CMBS

Industrial loans currently carry the lowest delinquency rate within the CMBS universe and hold the same "in favor" label as multifamily. The CMBS single asset/single borrower market has proven to be an efficient source of financing for very large portfolio financings; offering investors pure-play public debt exposure to the sector. Industrial allocation has increased in "post-COVID" conduit issuances, again benefiting the general diversification profile. Exposure to tertiary locations, less functional layouts, non-investment grade tenancy, and a concentration of e-commerce-related credit must be properly considered and monitored.

Office

Sector rating	New supply	Demand	Rent growth	Capital values	REIT pricing relative to NAV*	Debt availability
↓	↘	↓	↓	↘	↘	→

Key: ↑ Positive ↗ Moderately positive → Neutral ↘ Moderately negative ↓ Negative

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Sector overview

Office fundamentals are in the process of correction as leasing activity has fallen below its post Global Financial Crisis pace, causing vacancy rates to rise quickly across markets. Several key markets, such as San Francisco, New York, and Boston have seen significant increases in sublease vacancy, which tends to foreshadow periods of significant rental decline. To date, weakness in fundamentals has been pervasive, but the brunt of the fallout is being felt in densely populated high-profile global gateway markets that are dependent on public transportation and feature a high concentration of high-rise CBD offices. Net demand has declined by more than 70 msf over the last 12 months and is likely to fall more in coming quarters. Net operating income has remained stable due to the property type's long-term lease structure, but there is a long way to go before the market normalizes.

Headwinds include 1.5 million fewer office-using jobs in the U.S. than there were when we started 2020. Though the labor market is once again creating new jobs, the pace has slowed dramatically. Occupiers are also no longer looking to expand as backfilling shadow space will be top priority early on in the recovery. Perhaps more significant, however, is the prospect of increasing flexibility of work schedules facilitated by months of working from home without material productivity declines, which means once workers are called back to the office they may only work a fraction of the time in the office. As a result, we anticipate a moderate marginal reduction of demand for space over the next cycle.

Private equity

Capital market demand for office is bifurcated with strength for well-leased buildings with long lease terms in high-growth markets. We are seeing thin trade volume and limited price discovery for buildings with a transitional rent roll, particularly in dense, CBD locations.

Space market fundamentals are challenged with limited new demand for space, particularly in dense markets accessed primarily via mass transit. Limited near-term supply additions and longer lease terms typical of the property sector will help to offset increased vacancy in the near-term. Many occupiers with near-term expirations are executing shorter-term renewals in place until there is more clarity around the timeline for mass inoculation and the long term need for space in a hybrid office/work-from-home model. Nonetheless, there are still some pockets of traditional office activity in markets across the country such as life science users in the pharmaceutical, biotech, and medical research fields looking to expand in markets like San Diego, Raleigh-Durham, Cambridge/Boston, and the Bay Area.

Most markets are still reporting under 20% physical occupancy with gateway markets are more negatively impacted than less dense, non-gateway markets.

Long-term, a vaccine offers hope for a return to normalcy, but we feel that the pandemic will increase the number of remote workers therefore reducing the demand for space ultimately adding to the headwinds for a sector that was already seeing increased tenant buildout costs and amenity requirements from tenants.

Private debt

Some lenders remain willing to finance office properties on a conservative basis today. Others—particularly those with large office concentrations in their existing portfolios—are avoiding almost all new office lending. The quality of an office building's tenancy, its remaining weighted average lease term (or "WALT"), its recent rent collection experience and its conformance with emerging design preferences are all greatly impacting lenders' willingness to lend in the current environment.

Interest rates for senior office loans today, when such loans are available, are frequently 25+ basis points higher than interest rates for multifamily and industrial properties with comparable leverage. In addition to lower LTVs, lenders may require larger escrows for potential downtime and rollover expenses and more rapid amortization schedules for office than they require for more favored property types.

REITs

Office REITs performed poorly in 2020 as investors assess the long-term impact of increased work from home on future demand. REIT NAVs have been lowered 10-20% as rents are declining and weak occupancy is anticipated. Most large tenants have delayed leasing decisions, driving leasing activity down 30-40% with most activity being renewals. Office demand is not anticipated to normalize until employees return to the office which is looking increasingly like a late summer or fall 2021 event.

Large increases in sublease space in New York City and San Francisco led to underperformance for REITs most exposed to these markets. Office REITs serving niche areas like life sciences or government/defense have performed best as the tenant base is more insulated from remote work. Another key trend that investors have been watching is outmigration from the higher cost coastal cities to more business friendly, lower cost locales in the Sunbelt. Several California based companies have announced relocations or large expansions to Texas while Florida has also benefited from migration out of NYC. This has driven outperformance for the sunbelt-focused office REITs. Office REITs continue to trade at sizable (~20%) discounts to NAV but is not likely to narrow until investors see signs that office rents and property values have bottomed. This is likely a multi-year process given the level of available sublease space and slow normalization of leasing activity.

CMBS

Office has represented the largest property type exposure in CMBS over the past several years; a trend that has accelerated recently alongside the pullback in retail exposure. Uncertainty around longer-term macro themes has caused investors to cool on the sector, but not to the same degree as other quadrants. Contributing factors include conservative underwriting metrics providing a significant buffer to a drop in NOI; larger exposures to high-quality and well-positioned properties; a mix of urban and suburban exposures; and credit performance to date. Office currently carries the second lowest CMBS property sector delinquency rate, supported by longer term leases and a manageable rollover schedule. The CMBS market considers this a developing story.

Retail

Sector rating	New supply	Demand	Rent growth	Capital values	REIT pricing relative to NAV*	Debt availability
↓	→	↓	↓	↓	↓	↓

Key: ↑ Positive ↗ Moderately positive → Neutral ↘ Moderately negative ↓ Negative

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Sector overview

The retail sector is challenged with significant cyclical and structural headwinds. Though the sector remains bifurcated in terms of format, vacancy rates across all segments from neighborhood and community centers to super regional malls have experienced significant increases. During the first half of last year when state and local shutdowns impacted non-essential businesses, regional malls were among the most deeply impacted of the major sub-sectors. This is hardly surprising given the significant income generated by movie theaters and dining that was reduced if not wiped away completely.

For its part, retail sales (a primary economic driver of the retail sector) has already made a full recovery, aided by a historic fiscal stimulus effort and an asymmetric recession that spared higher-earning occupations on a relative basis. Despite an increase in spending power during the downturn, there are few signs that brick and mortar retailers should expect a quick snapback. Before the pandemic retail had continued to struggle as income and capital values had already begun to decline, moreover, e-commerce penetration accelerated from 11% to 16% during the early phase of the pandemic as online sales increased across a broad spectrum of subsectors including food and groceries.

Private equity

Retail has been the weakest of the sectors by nearly all measures and the outlook remains challenging as pandemic pressures drag on. Rent collections strengthened over the second half of 2020 and tenants with lease modifications are beginning to repay deferred rent.

Even with some stabilization towards the end of 2020, we anticipate a second round of tenant rent relief requests likely from local and highly levered retailers and those in the restaurant, fitness, and theater space.

Private debt

Lenders today view all but the most attractive retail properties unfavorably. Neighborhood and community centers anchored by major grocers will likely find core, senior debt levels at low LTVs with interest rates perhaps 15bps greater than similarly leveraged multifamily or industrial properties. Creditworthy discounters and home improvement stores, with significant lease terms, are also seeing similar pricing. Debt for high street properties, power centers, and lifestyle centers may or may not be available with less favorable terms. Debt for regional malls is generally unavailable today.

REITs

Retail REITs exhibited poor performance in 2020 and materially trailed other property types due to elevated store closures/bankruptcy activity, low rent collections, and a general view that the sector's secular headwinds have only been accelerated by COVID-19. Within the group, shopping centers outperformed malls given comparatively better trends and investor sentiment. Occupancy levels have perhaps held up better than anticipated, but non-

paying tenants (that have yet to vacate) and landlord preferences to preserve occupancy at the expense of rents were important drivers.

A high degree of uncertainty remains on how much property income levels will ultimately reset versus 2019 levels, but additional occupancy loss and rental pressure in the year ahead is anticipated, with a longer and more perilous road to recovery for the regional mall group given a more challenged tenant base. As of the end of November 2020, shopping centers traded at approximately 15% discounts to NAV while malls traded at approximately 20% discounts. These discounts already account for NAV estimates falling around 25% for shopping centers and about 40% for mall REITs. Discounts are likely to remain in place until there is greater clarity on private market values and fundamental trends.

CMBS

Retail presents a significant challenge for the conduit CMBS market, carrying a delinquency rate second only to hotels and an unfavorable fundamental outlook. This has led to a stark decline in the amount of retail loans being securitized post-COVID, a trend that had been slowly developing for years. Investors are becoming more discerning in how hard they hit retail properties as it is evident that there will be winners and losers. Additionally, CMBS servicers are attempting to work with borrowers to make the best of a bad situation by granting loan forbearance and/or modifications. The rating agencies negative view towards retail has also resulted in a large number of lower-rated bonds being placed on some form of ratings watch or actually incurring downgrades.

Data centers:

Data center REITs posted the strongest returns of any property type in 2020.

The data center subsector remains one of the strongest across all quadrants. Data center owners have seen minimal negative operational disruption from the COVID-19 pandemic while the demand backdrop has strengthened as stay-at-home orders have accelerated the transformation towards a more interconnected digital world. Notably, data and connectivity requirements from consumers and businesses have increased with the sudden move to work-from-home and social distancing measures. Demand momentum remains strong into 2021 with companies reporting strong sales funnels while digital transformation plans are being prioritized by enterprises.

Private equity markets have seen increased capital to the sector, which has traditionally been dominated by REITs. There is growing interest from other institutional investors, particularly for properties with long-term leases. Though a small part of the NCREIF ODCE benchmark today, data centers are poised to see increased interest over the next several years.

On the demand side, hyperscale users are still active in the market with requirements and search activity. Activity in the co-location space is slower, with some likelihood for continued consolidation of co-location providers to those with the strongest balance sheets. Significant new supply is in the pipeline, though the majority is concentrated in the largest data center markets of Northern VA, Dallas, Chicago, the Bay Area, and Phoenix. We see value in the overarching investment thesis of demand for low latency data processing capability, particularly amid continued technologies advances that require high-speed data transmission.

From a private debt perspective, insurance company and bank lenders actively seek to invest in data centers today, offering interest rates similar to those offered for high-quality retail and office properties. However, loan terms and/or amortization schedules may be shorter for data centers than those offered for other core property types as lenders seek to limit their balloon exposure to data centers subsequent to anchor tenant lease expirations and potentially at a time when technological needs might have changed.

Data center REITs posted the strongest returns of any property type in 2020. Demand has benefitted from a clear tailwind as a result of the pandemic, which have seen record leasing activity with notable strength seen from cloud and other technology companies looking to quickly add compute and storage capacity, and connectivity. As a result of the strength, NAV estimates increased 2% since the onset of the pandemic.

A key question/risk is whether the pandemic has led to some pull forward of demand. Nonetheless, the long-term trajectory of demand is upward sloping, driven by rapid expansion of IP traffic and interconnection bandwidth, and continued migration of enterprise workloads off-premise into public cloud and hybrid cloud architectures. This positive outlook has not gone unnoticed by investors with data center REITs trading at roughly 20% premiums to consensus NAV on average, the largest premiums of any property type.

Life sciences:

> The COVID-19 pandemic has shone a light on the importance of the industry and need for continual innovation and development of new drugs and treatment therapies.

Fundamentals for life science/lab office space continue to be among the strongest across all sectors. The COVID-19 pandemic has shone a light on the importance of the industry and need for continual innovation and development of new drugs and treatment therapies. This has driven record venture capital, government, and public market fundraising for the industry, which in turn has generated robust demand for R&D/life science space across the country.

Institutional investors continue to provide capital for investment, driving pricing despite weakness in more traditional office assets. Though the sector remains far more concentrated (and active) in the REIT market, it continues to garner interest among private investors, which is evidenced in recent transactions with deep bid lists. Slower tenant demand for traditional office and accelerated demand for life sciences has led many owners to evaluate potential building conversions – adding to the supply pipeline in some markets. Small inventory base, (grew 12% to 95 million square feet in 2020) that could be sensitive to supply/conversions if it becomes only office component, is seeing new investment.

Market selection however remains critical in the sector with significant activity concentrated in Boston/Cambridge, San Francisco Bay Area, and San Diego. Growing pockets of life science in other markets may provide additional investment opportunities, particularly in growth markets with research universities and highly-educated workforces, such as the Research Triangle in the Raleigh-Durham metro area.

Despite favorable fundamentals and capital flows, private debt markets are not yet fully engaged in the sector, which may be a reflection of the systematic risks and size of the investor universe. Traditional core, senior lenders seek to finance life science properties today with interest rates comparable to those offered for office properties of similar quality. Life science properties located in prime research submarkets may receive more favorable financing terms.

Private real estate investors also took notice, with many institutional funds raised targeting the property type. Competition is fierce for new acquisitions, which has led to investors seeking development and conversions of traditional office to meet robust tenant demand. The barriers to entry for the property type are high, particularly in the top research submarkets, though the meteoric rise of new entrants poses a longer-term risk to the fundamentals for the sector. The sector also faces legislative risk around changes to drug pricing that could alter future demand and rents tenants are willing to pay.

Single-family rentals:

> Record occupancy and improving pricing power should drive some of the strongest same store growth.

The single-family rental sector continues to see robust demand as home price appreciation throughout the last cycle effectively limited individuals—particularly millennials—ability to purchase starter homes. Compounding that effect is the pandemic, which is pushing younger professionals out of smaller and expensive urban rentals to the suburbs in search of more space. The balance of supply and demand for single family rentals remains tight as occupancy rates for single-family rentals is tracking at better than 95% according to data from the U.S. Census Bureau.

As has been the case with many smaller niche sectors, REITs have been more active within the single-family sector, which comprises a small share of private institutional benchmarks so far. Given the dynamics of the housing market as a whole, including further erosion of home price affordability and a housing shortfall for both the single-family and multifamily units, the flow of capital to this sector will increase.

Private debt markets remain largely on the sidelines as well. Most portfolio lenders are not active in the market for multi-million-dollar single-family rental property portfolios. Such portfolios are primarily financed via securitization.

Single-family rental REITs posted a strong year and benefitted from the COVID-19 disruption. On top of strong demographic tailwinds, the trends of work from home and suburban migration that emerged during the pandemic drove increased tenant demand and caused occupancy levels to increase to record highs. Select companies elected not to push rate increases early in the pandemic, but pricing power improved considerably over the remainder of the year benefiting from the robust demand backdrop. The strength and resiliency of fundamentals also caused increased institutional interest and helped push consensus NAV estimates higher by approximately 5% since the beginning of the pandemic.

Looking into 2021, the favorable momentum is not expected to reverse, as there continues to be real pent-up demand and constrained supply. Record occupancy and improving pricing power should drive some of the strongest same store growth. As of year-end, single-family rental traded at slightly discount to NAV. This is an attractive valuation level given the group's resilient fundamentals and faster growth potential.

Risk considerations

Investing involves risk including possible loss of principal. Past performance is no guarantee of future results. Potential investors should be aware of the many risks inherent to owning and investing in real estate, including: adverse general and local economic conditions that can depress the value of the real estate, capital market pricing volatility, declining rental and occupancy rates, value fluctuations, lack of liquidity or illiquidity, leverage, development and lease-up risk, tenant credit issues, circumstances that can interfere with cash flows from particular commercial properties such as extended vacancies, increases in property taxes and operating expenses and casualty or condemnation losses to the real estate, and changes in zoning laws and other governmental rules, physical and environmental conditions, local, state or national regulatory requirements, and increasing property expenses, all of which can lead to a decline in the value of the real estate, a decline in the income produced by the real estate, and declines in the value or total loss in value of securities derived from investments in real estate. Direct investments in real estate are highly illiquid and subject to industry or economic cycles resulting in downturns in demand. Accordingly, there can be no assurance that investments in real estate will be able to be sold in a timely manner and/or on favorable terms.

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