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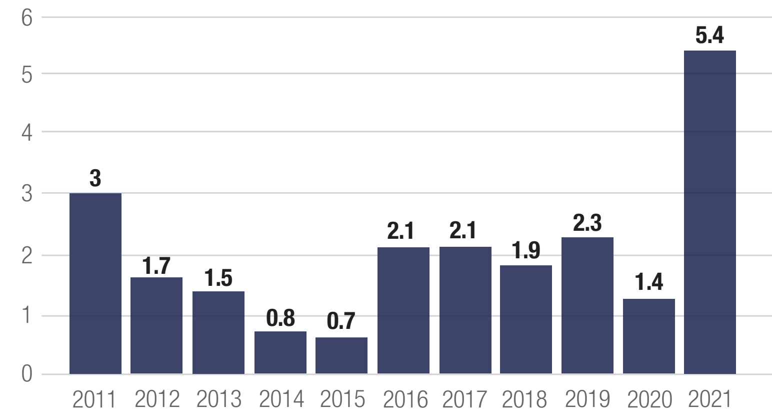
Got Inflation? Real Estate May Act as a Hedge

Income-producing properties may provide an effective inflation mitigation strategy

As the economy makes significant progress in its return to "normal," some have noted inflation increasing at an accelerated pace over 2020. In June 2021, the year-over-year inflation rate, as measured by the Consumer Price Index (CPI), surged 5.4 percent from a year prior, the largest annual increase since 2008. Core CPI, which excludes food and energy, rose 4.5 percent from June 2020, the fastest rate since November 1991.[1] With economists predicting an inflationary environment possible over the next few years, it may be a good time to revisit how commercial real estate may prove to be an effective inflation mitigation strategy.

Annual Inflation Rates (2011-2021)[4]
Percentage Change

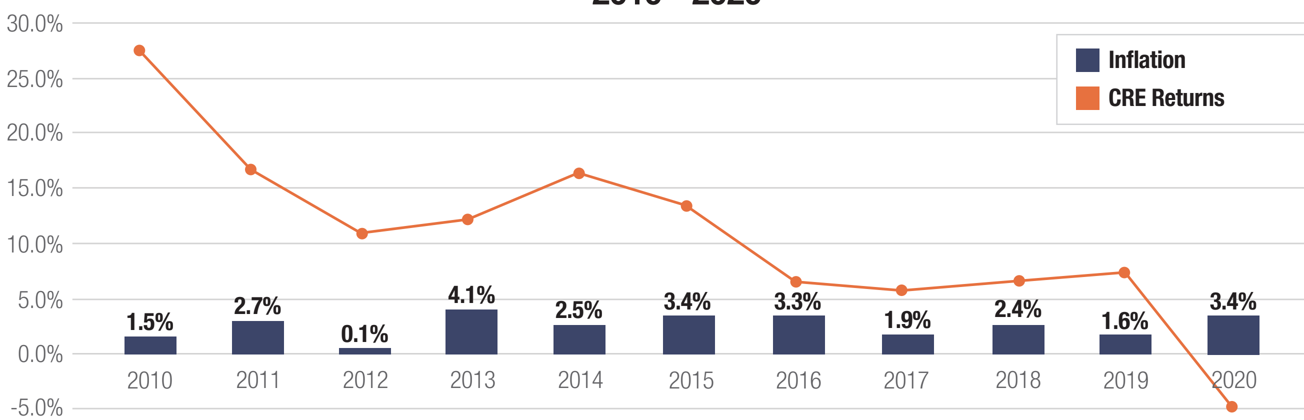


Inflation is defined by the decline of purchasing power of a given currency over a certain period of time. While several factors can lead to an inflationary market, generally, inflation occurs when the demand and prices for certain goods and services begin to rise, while the value of money is declining.[2] One of the most widely used inflation indexes is the CPI, which reports on the average change in prices paid for consumer goods and services.[3]

Real Estate May Protect Against Inflation

While inflation may have a sizable impact on a myriad of asset classes, investors in tangible assets such as commercial real estate can benefit from the effects of rising inflation rates. It's important to keep in mind that past performance is not a guarantee of future results.

Historical Real Estate Performance vs Inflation[8,9]
2010 - 2020



Source: US Inflation Calculator, Historical Inflation Rates 1914-2021; Green Street Advisors, Commercial Property Price Index (CPPI). Green Street Advisor's CPPI is a time series of unleveraged U.S. commercial property values that captures the prices at which commercial real estate transactions are currently being negotiated and contracted. The index measures price changes across fifteen property types.

Real Estate Can Navigate Various Economic Conditions

Commercial real estate generally offers strong fundamentals amid challenging economic environments, such as rising inflation. People will always need places to live, work, eat, and shop, usually resulting in a consistent demand for commercial real estate properties. While not all income-producing properties are created equal, the variety of property types, markets, geographic locations, and tenants lends itself well to the potential stability of commercial real estate.

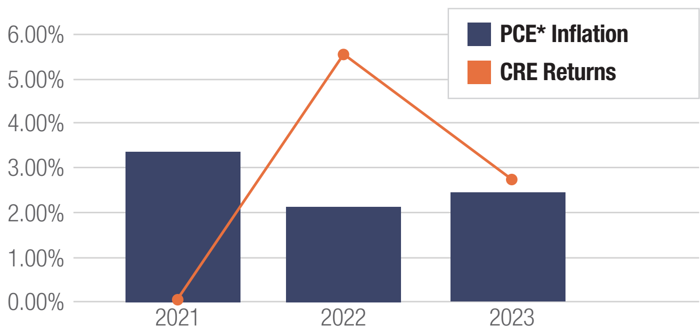
Real Estate Values Tend to Rise with Inflation

Commercial real estate holds intrinsic value because the demand for real estate properties does not typically decrease, even when inflation rates rise. In fact, rising inflation generally indicates a potential increase in property values and the cost of real estate development. Since the price of building materials and labor will be higher in an inflationary environment, developers will need to spend more to build new structures, resulting in an increase in the price of new real estate properties. Moreover, current property values may also rise due to a limited supply of new properties given the rising cost of construction.

Rents Can Rise with Inflation

With inflationary economic climates comes rising rental rates for many commercial real estate property types. Multifamily owners benefit from the fact that many Americans will opt to rent verses buy a new home due to the high cost that comes with mortgages. This greater demand for multifamily rental coupled with an influx of potential tenants will give real estate owners the ability to increase rental rates. Retail and office property owners can benefit from longer lease agreements that often include annual rental increases in of 2 to 3 percent[5], which typically meet or exceed inflation.

Inflation Projections vs Commercial Real Estate Returns[7]
2021 – 2023



Source: FOMC Summary of Economic Projections
* Personal Consumption Expenditure

While economists' predictions may differ, the Federal Reserve considers this recent spike in inflation transitory and forecast rates to settle at 3.4 percent by year-end 2021 with long-term rates declining to around 2.2 percent by the end of 2023.[6]

While it's impossible to predict just how much inflation rates will rise, commercial real estate demonstrates the fundamentals needed to be considered an inflation hedge.

Sources:
[1]https://www.bls.gov/news.release/pdf/cpi.pdf
[2]https://www.investopedia.com/terms/i/inflation.asp
[3]https://www.bls.gov/cpi/questions-and-answers.htm
[4]https://www.usinflationcalculator.com/inflation/current-inflation-rates/
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[8]https://www.usinflationcalculator.com/inflation/historical-inflation-rates/
[9]https://www.greenstreet.com/reit/macroanalysis/cppi/cppi

Important Risk Factors to Consider

Investments in real estate assets are subject to varying degrees of risk and are relatively illiquid. Several factors may adversely affect the financial condition, operating results and value of real estate assets. These factors include, but are not limited to:

- changes in national, regional and local economic conditions, such as inflation and interest rate fluctuations;
- local property supply and demand conditions;
- ability to collect rent from tenants;
- vacancies or ability to lease on favorable terms;
- increases in operating costs, including insurance premiums, utilities and real estate taxes;
- federal, state or local laws and regulations;
- changing market demographics;
- changes in availability and costs of financing;
- acts of nature, such as hurricanes, earthquakes, tornadoes or floods
- economic risks associated with a fluctuating U.S. and world economy, including those resulting from the novel coronavirus and resulting pandemic.

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