Chart of the Week

August 24, 2018

Will Rising Rates Damage Real Estate Returns?

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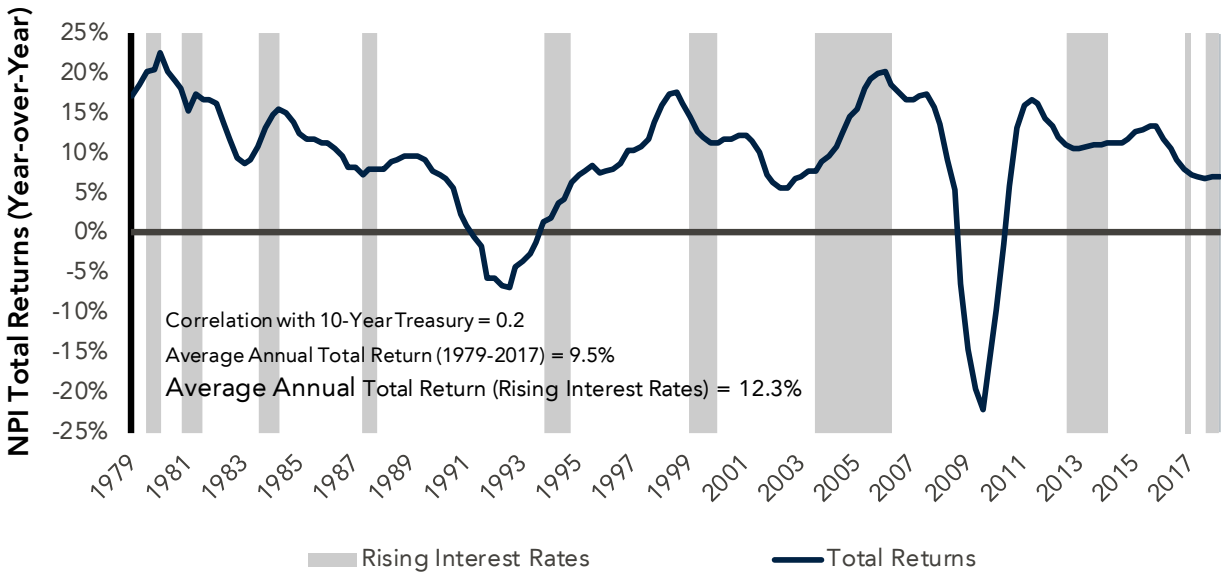
Commercial real estate has historically showed little correlation with interest rates



Sources: NCREIF, Federal Reserve via DWS

Our chart this week examines the historical[1] total returns of the NCREIF Property Index ("NPI") during times of rising interest rates. As illustrated in the chart, real estate has historically showed little correlation with interest rates indicating changes in interest rates do not immediately translate to asset prices. In fact, the average annual total return during periods of rising rates is 12.3%; typically rising rates are accompanied by stronger economic growth and/or inflation, both which inevitably draw investors to real assets. It is important to keep in mind, however, that private real estate is valued less frequently than its publicly traded (daily valued) counterparts. This is important because changes in private real estate prices will typically lag changes in interest rates as a result of less frequent valuations.

With interest rates expected to rise further, the spread between the 10-Year Treasury and real estate cap rates will continue to shrink, but strong fundamentals – such as rent growth and economic growth – are much more important than movements in the 10-year Treasury. There is no magic number for the 10-year that would trigger a re-pricing of real estate, but some property types are more susceptible to higher rates such as those with longer-term bond-like leases. Going forward, we believe that a mix of strong fundamentals mixed with stable rising rates will translate into moderate, income-driven returns to core real estate in the mid to high single-digit range.

[1] Since inception

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