MARKETBEAT

U.S. Capital Markets

Q2 2018

Modest Increase in Activity During First Half of 2018, but No Second Quarter Acceleration

Transaction activity was flat in the second quarter of 2018, totaling $105.5 billion (B) and up 1% year-over-year (YoY). However, transaction volumes were driven primarily by the completion of the Unibail-Rodamco-Westfield merger—an entity-level transaction. Single-asset sales, a better indicator of underlying transaction activity fundamentals, decelerated in the second quarter—down 7% quarter-over-quarter (QoQ) and 6% YoY.

The picture that emerges of the first half of 2018 is one of modestly rising volumes (up 5% YoY). The volume of single-asset sales under $250 million was the highest on record, just besting H1 2016. Multifamily and industrial single-asset sales posted strong increases, hotel and suburban office sales less so and CBD office and retail volumes were down.

Megadeal volume was flat compared to the first half of 2017 and slightly down from the levels seen in 2015 and 2016. Portfolio sales increased modestly (+4% YoY) as strong industrial (+23% YoY) and hotel (+204% YoY) portfolio sales offset a sharp decline in suburban office. Entity/M&A transaction volume increased significantly due to the Unibail-Rodamco-Westfield merger in the second quarter and the management buyout of GLP in the first quarter.

Major Markets Bouncing Back

Transaction volume increased from the first quarter of the year across market tiers—up 1% QoQ in the major markets and 5% in the secondary and tertiary markets. Year-over-year, the major markets experienced the largest growth in activity—up 11%. In contrast, secondary market volume was down 10% YoY. Among the major metro markets, Boston was the only one that saw activity decline (down 25% YoY) due to weaker CBD office and multifamily sales. Volume increased strongly in Chicago (+55% YoY) as CBD and suburban office volume surged, and also in San Francisco metro (+29% YoY) on the back of strong retail and suburban office activity. Among secondary markets, volumes rose sharply in Las Vegas (+73% YoY) and Phoenix (+47% YoY) due to hotel and multifamily sales, while activity declined in several top Sunbelt markets including Dallas (-21% YoY), Atlanta (-32%), Houston (-31%) and Austin (-62%).

Compared to the first half of 2017, major metro volume increased 7% YoY to $91.4B but remained well shy of the volumes recorded in 2015 and 2016. Major metro volume increased across product types with the exception of office. Multifamily and retail sales contributed most to the increase in volume—up 31% and 20% YoY, respectively. Secondary market volume was down slightly from a year ago but remained within 7% of the 2015 cycle peak. Secondary markets experienced weakness in all product types with the notable exception of industrial. Tertiary market volume increased to an even greater extent than that in the major metros as multifamily and industrial activity rose.

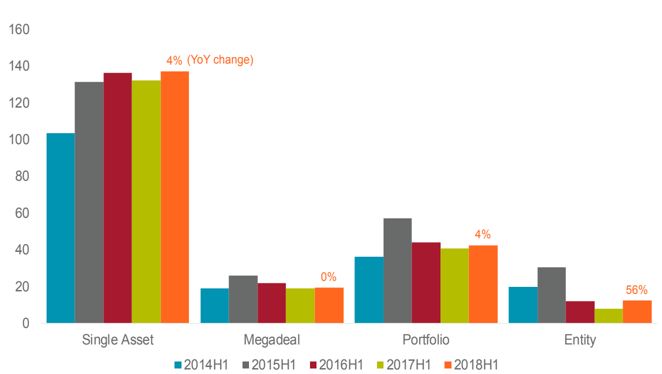
In the first half of the year, the New York metro area recorded the largest transaction volume of $29.2B, followed by the Los Angeles ($19.1B) and the San Francisco ($13.6B) metros. Among the larger major and secondary markets, Phoenix (+52% YoY), Chicago (+36%) and New York (+21%) posted the greatest increases in volume while volumes declined in Atlanta (-12%), Dallas (-15%) and Miami (-18%).

Most Product Types Experienced Slowing Activity in Q2

Transaction volumes for the majority of product types and subtypes declined in the second quarter of 2018 from the first quarter. Only suburban high-rise multifamily (+16%), strip centers (+4%), development sites (+10%) and malls (+966%) recorded a QoQ increase in volume. The meteoric rise in mall volumes was due to the Unibail-Rodamco-Westfield merger and sufficiently large to counteract quarterly declines in industrial (-17%), hotel (-14%), CBD office (-4%) and garden apartment (-9%) volumes. Momentum in second-quarter volume also slowed on a year-over-year basis as garden apartment (-17% YoY),

CORE SINGLE ASSET SALES DRIVING ACTIVITY

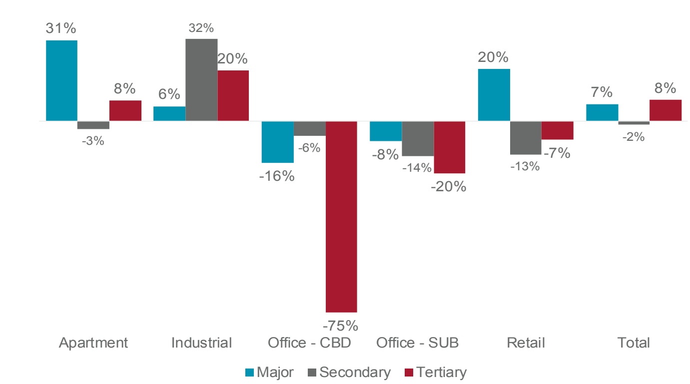
Investment Sales Volume ($ Billions)



Source: Real Capital Analytics, Cushman & Wakefield Research
Deals over $5 million

MAJOR METROS MAKING A COMEBACK

Investment Sales Volume: 1H 2018 VS. 1H 2017 (% Chg.)



Source: Real Capital Analytics, Cushman & Wakefield Research
Deals over $5 million

NUANCE IN INDIVIDUAL MARKETS
Top 15 Markets by 1H 2018 Volume

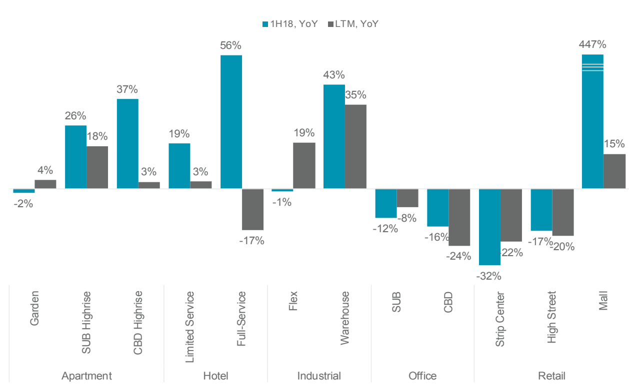
		Year-Over-Year Percent Change						
Metro Area	**1H18 Volume ($M)**	**Apartment**	**Hotel**	**Industrial**	**CBD Office**	**SUB Office**	**Retail**	**Total**
NYC Metro	29,205	28%	260%	-24%	21%	-34%	35%	21%
LA Metro	19,114	33%	-63%	11%	-64%	-27%	92%	4%
SF Metro	13,571	11%	35%	33%	-48%	1%	-24%	-1%
DC Metro	10,997	94%	41%	30%	-30%	-2%	34%	20%
Chicago	8,599	22%	28%	48%	105%	109%	-39%	36%
Dallas	8,225	-18%	19%	-3%		-29%	-11%	-15%
Phoenix	6,719	40%	316%	87%	392%	4%	24%	52%
Atlanta	6,308	-7%	-44%	-13%	-75%	44%	-33%	-12%
Miami/So Fla	6,153	3%	139%	-3%	-46%	32%	-62%	-18%
Seattle	5,998	6%	28%	32%	-27%	35%	86%	18%
Houston	5,410	41%	19%	-28%	-64%	-41%	-20%	-6%
Boston Metro	5,152	-14%	94%	12%	-71%	68%	-70%	-43%
Denver	4,671	-29%	136%	49%	3643%	10%	118%	11%
Las Vegas	3,476	4%	372%	186%	266%	41%	-50%	52%
Philly Metro	3,258	100%	22%	49%	101%	-32%	-91%	7%

Source: Real Capital Analytics, Cushman & Wakefield Research
Deals over $5 million

suburban and CBD office (-17%, -20%), strip center (-18%) and urban retail (-23%) volumes fell short of that a year ago. Suburban high-rise apartment (+12% YoY) and industrial were exceptions to this trend (+21%).

Despite the second-quarter slowdown, investment sales in the first half of 2018 remained above their level a year ago. Multifamily (+8% YoY), hotel (+43%) and industrial (+29%) each increased significantly. Office sales velocity declined, however, in both CBD (-16% YoY) and suburban (-12%) office. Retail volume was flat but excluding entity-level transactions, volume was down 12% YoY in the first half of 2018.

DEAL MOMENTUM MORE POSITIVE IN FIRST HALF
YTD and LTM % Change in Volume by Product Type



Source: Real Capital Analytics, Cushman & Wakefield Research
Deals over $5 million

Foreign Flows Falling

Most classes of investor increased acquisitions in the second quarter of 2018 compared to the same period in 2017. Private capital continued to constitute the largest buyer pool, accounting for 50% of acquisitions, followed by institutions at 23%. Purchases by these two groups were up marginally. Private capital bought more CBD office and hotel properties than in the second quarter of 2017, while institutions acquired hotels, industrial and office (both CBD and suburban) properties in greater volumes.

At first look, cross-border investors appear to have been unusually active in the second quarter, accounting for 16.7% of total transaction volume. However, this was entirely due to entity/M&A transactions. Excluding this, cross-border acquisitions declined 26% YoY in the second quarter of 2018 to $9.6B and accounted for just 9.8% of investment sales compared to a post-2010 average of 11.3%.

Canada and China have driven cross-border acquisitions in recent years, together accounting for 39% of cross-border investment in CRE since 2015. Canada is the largest foreign purchaser of U.S. commercial real estate properties, recovering to the 2015 level from a slowdown in 2016. In contrast, Chinese acquisitions have continued to decline and remained at low levels in the second quarter. However, declining cross-border purchases is not just a China story. Looking at the top 10 sources of cross-border capital to the U.S. in the current cycle, the median decrease in four quarter flows compared to the preceding (non-overlapping) period is -27%. Factors behind this decline include improving economic conditions in other countries, rising U.S. interest rates and a stronger dollar combined with elevated pricing

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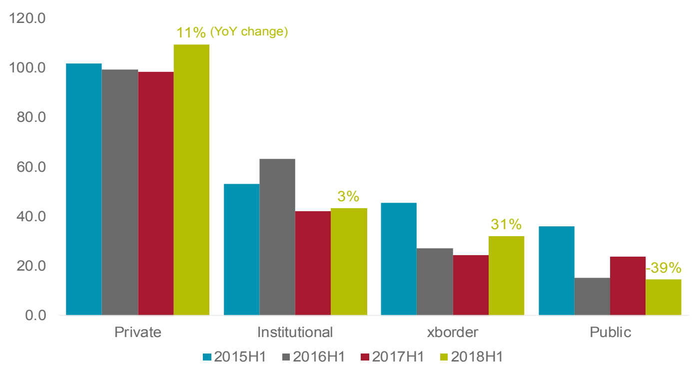
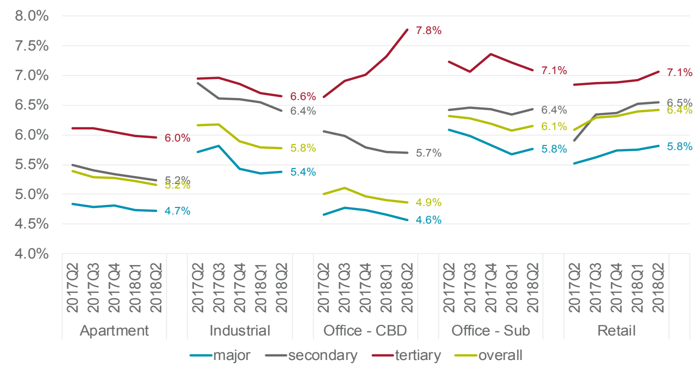
PRIVATE CAPITAL LEADING THE WAY
Acquisition Volume by Investor Type (2015-2018), $ Billions



Source: Real Capital Analytics, Cushman & Wakefield Research
Deals over $5 million

CAP RATE TRENDS REMAIN INTACT AMID VOLATILITY
Rolling 4 Qtr Volume-Weighted Cap Rates



Source: Real Capital Analytics, Cushman & Wakefield Research
Deals over $5 million

in the U.S., particularly in the markets and product segments that have traditionally attracted the greatest foreign investment.

Pricing & Return Trends Intact Amid Market Volatility

Transaction cap rate trends have remained fairly consistent across product types and tiers in recent quarters.

Multifamily yields continued to compress across market tiers, with yields reaching 4.7% in the first half of 2018 in the major markets and 5.2% and 6.0% in secondary and tertiary markets, respectively.

On a rolling four quarter basis, industrial cap rates are stabilizing at historically low levels in major industrial markets while continuing to compress in secondary and tertiary markets. Looking at quarterly transaction cap rates, there has been a sharp increase in major market yields; however, given the imbalance of supply and demand for this product among investors, it seems more likely that this reflects a shift towards class B assets trading in these markets than any actual rise in cap rates.

CBD office transaction cap rates have continued to trend downward in both major and secondary markets, averaging 4.6% and 5.7%, respectively, over the last four quarters. In the major markets at least, the observed decline is more likely due to a shift in the asset mix towards higher quality product rather than to further yield compression as this would be more consistent with the results of C&W's latest capital sentiment survey. Yield compression in secondary markets, however, reflects a mix of factors as valuations are generally less extended in these markets.

Suburban office transaction cap rates seem to have inflected upwards over the first two quarters of 2018, particularly in the major metro markets. However, yields are at or below (as in the case with major markets) levels a year ago and differentials with comparable CBD office product remain elevated while fundamentals in the suburbs are outperforming. Price per square foot has remained stable in the major and secondary markets as well.

Finally, retail transaction cap rates have risen overall across market tiers. While the greatest increase has been in the mall subtype, strip centers, urban/high street and shops have also seen 20-30 basis point (bps) moves in cap rates since the second quarter of 2017 on a four-quarter volume weighted-basis.

NCREIF's National Property Index (NPI) indicated a total return of 1.8% (7.4% annual) in the second quarter of 2018—up marginally from the 1.7% (7.0% annual) return in the first quarter. Industrial continued to outperform every other product type by a wide margin as total return increased to 15.1% annualized in the second quarter compared to office and apartment, each increasing 6.3% annualized.

There continues to be considerable differentiation among product subtypes. Garden apartments returned 9.6% annualized in the second quarter of 2018 compared to 4.8% and 5.7% for high and low-rise properties, respectively. Industrial returns were elevated across subtypes, but flex (15.2% annual) and warehouse (15.3%) stand out. Suburban office (7.8%) continued to outperform CBD office (5.3%) by a considerable margin. Within the retail segment, the best-performing subtypes were at two ends of the spectrum: neighborhood centers (5.4% annual) and super-regional centers (5.8% annual).

According to RCA's Commercial Property Price Index (CPPI), overall prices were 6.5% higher in June compared to a year ago—down from the trailing three-year average price return of 7.7%. Non-major markets (6.9% YoY) saw prices rise faster than did the major markets (5.6%) in a reversal of the trend in place for much of the current cycle, although both market segments have seen price returns decelerate. Among property types, apartments (11.6% YoY) have seen the greatest rise in prices. Industrial prices returns (6.5% YoY) slowed following several years of outperformance. Given the contrast with the cap rate and NCREIF data, we expect this series to either recover or be restated. As with the NCREIF

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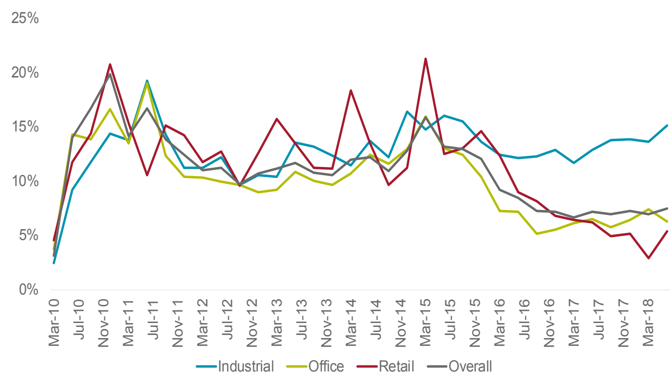
INDUSTRIAL OUTPERFORMING OTHER PRODUCT TYPES

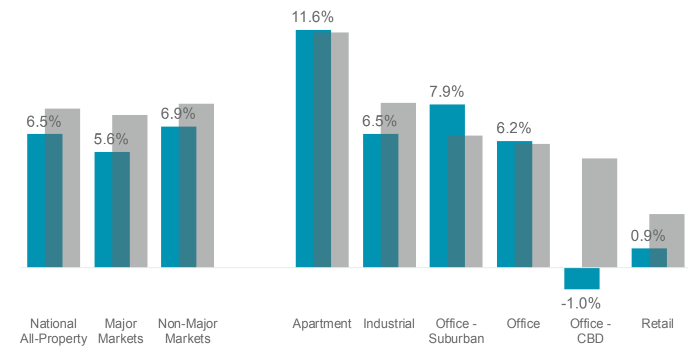
NCREIF National Property Index Annualized Return



Source: NCREIF, Cushman & Wakefield Research

PRICES RISING ON MULTIFAMILY

RCA Commercial Property Price Index



Source: Real Capital Analytics, Cushman & Wakefield Research

returns, suburban office (7.9% YoY) strongly outpaced the CBD where prices actually declined from a year ago (-1.0%).

Outlook

- Our most recent forecast calls for volume to decline 2.8% in 2018, for the RCA CPPI to rise 6.0% and for the NPI to return 6.7%. Figures for the first half of the year suggest the investment real estate market is poised to outperform each of these expectations.
- In the second half of 2018, we expect multifamily and industrial to recover momentum while office, particularly suburban office, should stabilize. The underlying negative trend in retail volumes is likely to persist for the time being, while at the same time retail as an amenity is increasingly in focus for multifamily and office properties. Overall, we do not expect a significant increase in transaction volume in the second half of the year compared to the first half. However, with dry powder now up to $179B at North American closed-end funds (according to Preqin), the pressure to deploy capital is unabated.
- Real estate debt markets remain highly accommodative as spread compression has largely absorbed interest-rate increases at the beginning of the year and the long-end of the curve is likely to remain range-bound in the near term. As in last quarter's report, equity spreads are for the most part not far from long-term averages and significantly wider than those spreads in the later stages of previous cycles. However, any significant move in long-term interest rates will begin to put pressure on valuations, particularly those that could be pushed into negative leverage.
- The economy recorded real GDP growth of 4.1% in the second quarter of 2018, unemployment is near all-time lows, inflation remains contained and there are few signs of systemic imbalances that would threaten recession. Meanwhile, caution prevails at the Fed, especially amid the greater uncertainty following from ongoing trade negotiations.
- Concern over tariffs has engendered a mood of caution in the broader capital markets and contributed to increased public market volatility without having any identifiable negative impact on commercial real estate fundamentals, which should, for the most part, be less exposed than the corporate sector. All of these factors should make commercial real estate more attractive on a relative basis, potentially adding to the substantial queues of capital seeking to deploy into the market. All of this provides continued support for the market.

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