MARKETBEAT

U.S. Capital Markets

Q2 2017

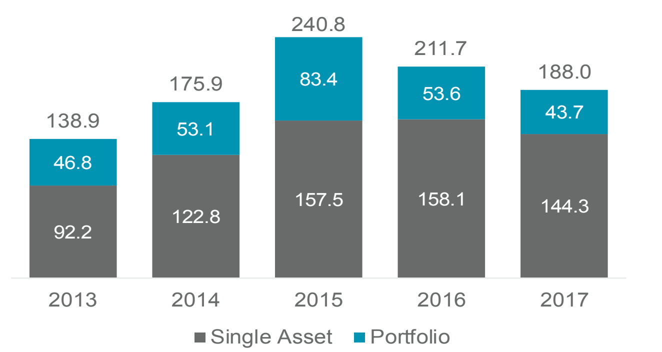
CUSHMAN & WAKEFIELD

CELEBRATING 100 YEARS

U.S. CAPITAL MARKETS

Investment Sales Volume

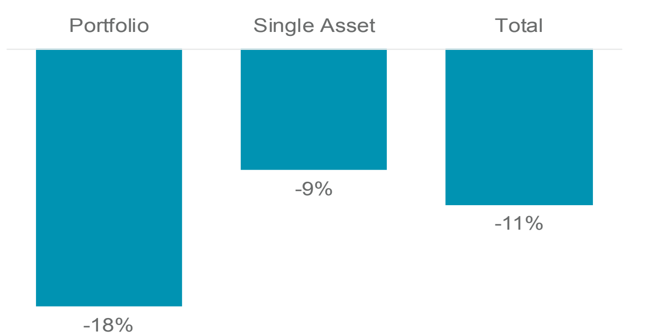
H1 2017, $ Billions



Source: Real Capital Analytics
Deals over $5 million

Investment Sales Volume

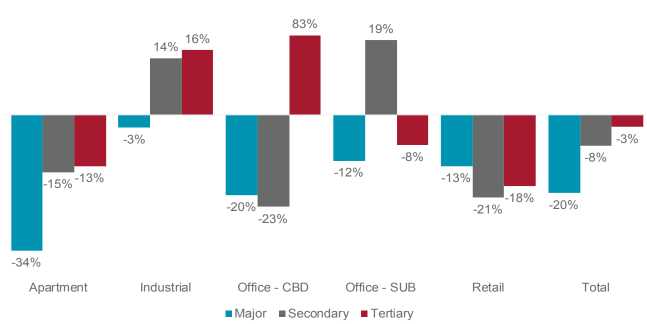
H1 2017 vs. H1 2016, % Change



Source: Real Capital Analytics
Deals over $5 million

Investment Sales Volume by Property Type

H1 2017 vs. H1 2016, % Change



Source: Real Capital Analytics
Deals over $5 million

A Restrained First Half of 2017

There have been two developments since our Q1 2017 U.S. MarketBeat Report, both of them favorable. First, Q1 2017 volume data have been revised upwards, from -26% to -15% year-over-year. Second, transaction activity picked up in the Q2 2017 both in absolute terms—volumes were up 7% quarter-over-quarter—and relative to 2016 as the rate of decline narrowed to 7%.

These developments underscore our earlier assessments that activity would accelerate but that overall the capital markets remain restrained by the uncertainty about how to deploy and redeploy capital in the later stages of the economic cycle.

In the first six months of 2017, investment sales volumes totaled $188.0 billion (B), down 11% from the same period in 2016 when $211.7B traded. Portfolio sales declined the most on a percentage basis (down 18%). Single asset sales accounted for the majority of the overall decline ($13.8B out of a total $23.7B); on a percentage basis, single asset sales were down 9% compared to H1 2016. The trend was slightly better when looking at single asset sales under $100 million (M)—the core of the market—which declined only 4%. Large asset sales and portfolio deals tend to be more pro-cyclical—i.e., they move more in sync with the fluctuations of the economic cycle. It is therefore not surprising that large single asset transactions and portfolio sales have declined comparatively more than smaller single asset transactions as we are now eight years into the expansion. That is not to say that smaller single asset volumes are not impacted by uncertainty—or still less, cyclicality—but rather that their trends better reflect the underlying impetus of the market.

Accordingly, one could argue that this reflects a picture of a market that reached its cyclical volume peak in 2015, essentially plateaued in 2016, and is now registering a fairly gentle decline in 2017. In our view, investment sales are settling into a slower, more sustainable pace. The wave of capital raised for commercial real estate is large and growing. As a general indicator, dry powder at closed-end funds has risen 15% so far this year and is now 67% above its previous cyclical peak. Absent serious exogenous shocks, this will keep the market very active.

Not Every Asset Class Has a Thorn

The decline in volumes was largely due to multifamily, which declined 21% in the first half and accounted for 62% of the overall decline in volumes compared to H1 2016. It should be noted however that multifamily volumes were down only 6% in the second quarter. Retail volumes also saw significant declines of 18% in the first half and 31% in the second quarter. Finally, CBD office volumes were off 20% in the first half of the year with the pace accelerating from -15% in Q1 to -24% in Q2.

By contrast, industrial volumes increased 8% in the first six months of 2017 —warehouse volumes were particularly strong, up 12%. Meanwhile, demand for suburban office has picked up significantly driving volumes 10% higher year-over-year. Hotel volumes were flat overall, but limited service hotel volumes were up 11% in the first half.

A Tale of Tiers

In the first six months of 2017, liquidity continued to shift to the non-major metro markets on the margin. Major market volumes declined 20% year-over-year, compared to secondary market volumes which declined 8% and tertiary market volumes only 3%. The outsized decline in major market volumes was driven primarily by the multifamily sector where major markets declined 34% compared to 15% and 13% for secondary and tertiary markets, respectively. A similar pattern, albeit less important on a volume basis, is apparent in the suburban office market where major market volume declined by 12%, while volumes in secondary markets actually increased by 19%. Moreover, major market industrial volumes declined 3% year-over-year, whereas secondary and tertiary industrial volumes surged 14% and 17%, respectively. It should be noted that these industrial volume trends bring the secondary and tertiary markets to levels 5-10% above those seen in 2014, while the major market volumes are still 41% above 2014 levels. Major markets performed in-line with secondary markets in CBD office, declining 20% vs. 23% (tertiary market volumes were up 81% but on negligible volume by comparison). As a result, major markets maintained their share of CBD office volumes, which have grown in recent years (they were 75% in the H1 2014 and 81% in the current period). Retail reversed the overall trend entirely. Major market volumes proved the most resistant to the stresses on the sector—down 13% versus 21% and 18% for the secondary and tertiary markets, respectively.

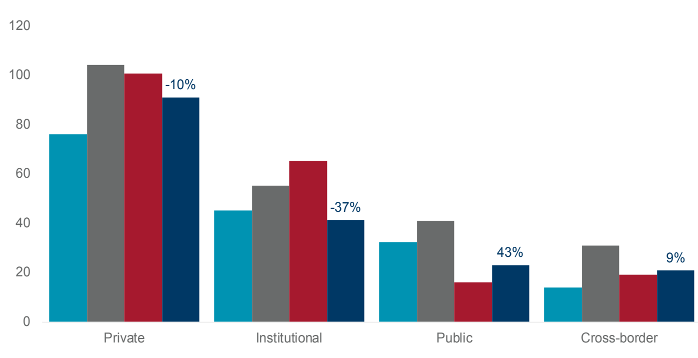
Cross-border Investor Demand Undiminished

Overseas investors continue to increase their acquisitions of U.S. assets attracted by the depth and diversity of the markets, a firm economic and fundamental outlook and relatively attractive yields in certain areas. Cross-border investors joined public investors as the only major group to increase acquisitions as volumes increased 9% year-over year. In doing so, they accounted for 11% of volumes in H1 2017, in-line with the trailing three-year quarterly average. Overall, overseas investors remained focused on the major metro markets (63% of volumes) and on CBD office (41% of volumes). However, industrial volumes nearly tripled and increased significantly across all market tiers. Cross-border investors also significantly increased acquisitions of tertiary apartment product (+97%) and suburban office (+62%), the latter particularly in secondary markets.

Despite the publicized imposition of capital restrictions, capital from China and Hong Kong were responsible for 5.7B in volumes, an increase of 41% compared to H1 2016. Singapore which lay relatively dormant last year following its spree of acquisitions in 2015 deployed just under $3B in the first half, a 436% increase. Japan and Germany were each responsible for $1.4B in volume, increasing 7% and 5%, respectively.

Aquistion Volume by Investor Type

2014-2017, $ Billions



Source: Real Capital Analytics
Deals over $5 million

Outlook

- Transaction activity will accelerate in the second half of the year as institutions engage the market more aggressively, increasingly deploying capital into a broader set of markets and product classes than they have previously, as well as into niche asset types.
- Price appreciation will remain positive across product types with the possible exception of certain retail segments. CBD office returns, which have accelerated in recent months, will decelerate while non-major market returns will increase relative to the major markets.
- Yields on the highest quality assets will remain fairly stable across asset classes; however, average transaction cap rates will tend to increase as investors search for yield. Closer examination by subset and class will likely show greater yield convergence as the cycle continues; recent examples include suburban and CBD office and apartment product.

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