MARKETBEAT

U.S. Capital Markets

Q3 2017

Transaction Volumes Recover, Led by Industrial and Multifamily

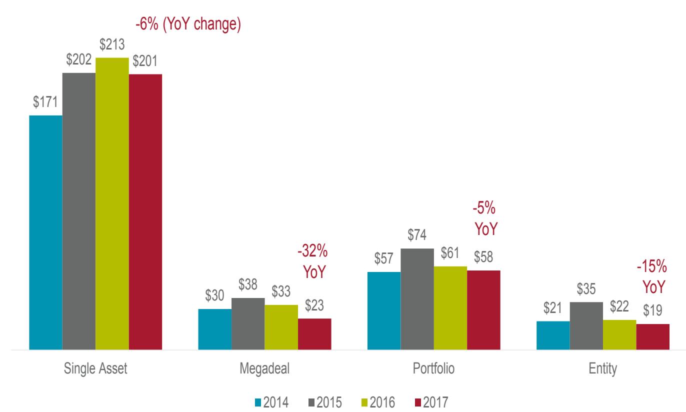
Investment sales volume increased 5.3% to $105 billion (B) from Q2 to Q3 2017. However, this acceleration was significantly less than the increase seen in Q3 2016, resulting in third quarter volume decreasing by 11% year-over-year. This brings year-to-date transaction activity to $300B, down 9% from the $329B traded during the same period in 2016.

The first two quarters of 2017 saw declining portfolio sales, sharply declining large single asset transactions (or "megadeals")[1], and more mild declines in the "core" single asset transaction market[2]. While some positive momentum occurred in Q3 with portfolio sales up 5% quarter-over-quarter and 2% year-over-year, megadeal volumes continued their downward trajectory – off 43% quarter-over-quarter and 66% year-over-year.

Year to date, core single asset and portfolio sales volumes are down 6% and 5%, respectively. Entity-level (-15%) and megadeal (-32%) volumes have experienced a sharper decline despite the recent pickup in M&A activity. This decline in megadeals accounts for 32% of the overall deceleration in transaction volumes compared to 2016.

Investment Sales Volumes Through Q3

$ Billions



Source: Real Capital Analytics
Deals over $5 million

CBD Office Sales Declining

Year to date, CBD office volumes are down 27%, compared to the same period in 2016, with New York and Chicago playing a large role in the decline, down 52% and 56%, respectively. By contrast, CBD office volumes are nearly triple 2016 levels in the DC metro area and have also increased in Boston (+20%), Philadelphia (+55%), and Portland (+43%).

Suburban Office Volumes Grow

Year to date, suburban office volumes have increased by 8% compared to the first three quarters of 2016. Major metro market volumes experienced a 49% increase quarter-over-quarter, led by strong deal activity in Los Angeles (+46%), San Francisco (+115%), and Chicago (+232%). Secondary market volumes, however, were down 21% quarter-over-quarter, as transaction activity slowed in 23 of 34 markets. This is perhaps not unexpected as the secondary markets had seen a disproportionate amount of deal activity in the first half of the year. Year to date, suburban office volumes are higher across all market tiers.

Multifamily Volumes Recovered Primarily in Suburban Plays

Multifamily volumes continued their recovery from the sharp falloff in the first quarter, increasing 12% quarter-over-quarter and 4% year-over-year, bringing year-to-date volumes roughly in-line with the overall market for 2017, down 10% to the market's 9%. These figures are skewed by large entity-level transactions in the second and third quarters – most recently the $4.4B acquisition of Monogram Residential Trust by Greystar Growth and Income Fund. Excluding such transactions, multifamily volumes nonetheless increased 13% quarter-over-quarter, led by particularly strong growth in the single asset transactions (+18%). Year-to-date volumes (ex. entity-level) are down 13% compared to 8% for the overall market.

CBD mid/highrise product has seen a proportionally greater decline – down 33% year to date. This is the result of volumes falling more quickly in the major metro markets (-20%) than in the secondary (-7%) or tertiary (-2%) markets. As with CBD office, the New York market has seen the greatest declines (-44%) followed by San Francisco (-26%). Roughly twice as much suburban (as opposed to CBD) mid/high-rise product has traded in 2017, representing a 10% increase year-over-year.

Q3 Sees Largest Industrial Volumes Since Q4 2015

Industrial volumes grew 41% quarter-over-quarter, to $17.7B. The quarterly increase was largely attributable to portfolio sales, which leapt from $3.4B in the second quarter to $8.9B in the third. Two notable portfolio transactions were Ivanhoe's $963M purchase of 87 last-mile logistics properties from Evergreen Industrial and Blackstone's $563M purchase of 65 properties, primarily in the Sacramento area, from a DRA/Westcore JV.

Year to date, industrial volumes are up 22% year-over-year, with stronger growth in warehouse (+27%) compared to flex (+13%), though flex volumes remain elevated as a proportion of total industrial deals, relative to earlier in the cycle.

While tertiary industrial market volumes remain up 50% year to date, compared to 2016, they declined 20% quarter-over-quarter. Major and secondary industrial market volumes, however, increased 50% and 53% quarter-over-quarter, respectively. As a result, major industrial market volumes, which were relatively flat with 2016 levels through the first two quarters, are up 17% year to date. These increases were driven by accelerated activity in the LA metro (+56% quarter-over-quarter), DC metro (+432%), and Chicago (+155%). Among the secondary markets, Sacramento (+859%) stands out as a result of the aforementioned DRA/Westcore portfolio sale. Baltimore and Charlotte also saw accelerating sales activity in the third quarter, with year-to-date volume increases of 81% and 91%, respectively.

Retail Activity Continues to Decline

Retail transaction activity decreased 14% quarter-over-quarter to $10.6B, bringing the year-to-date decline to 21% as compared with 2016. Grocery remains the most actively-traded product, with volumes up 22% so far in 2017. This represents nearly a third of total deal volume, as compared to less than a fifth in previous years. Grocery volumes, however, have been slowing since $5.2B traded in the first quarter. Malls, power centers, and urban shops continue to struggle, as further decelerations in

[1]*Defined here as single asset transactions over $250M*
[2]*Defined here as single asset transactions under $250M*

volumes have brought year-to-date declines to 82%, 33% and 30%, respectively. Both in the third quarter and in 2017, the major metro markets have tended to outperform, down 6% from Q2 to Q3 2017, and 18% YTD, as compared to 20% and 21%, respectively, in the secondary markets.

Private Investors in Purchasing Mode

Private investors increased purchases by 8% quarter-over-quarter, to $52.6B. Private acquisition volumes year to date remained essentially flat with 2015 and 2016 volumes.

Institutional investors, however, decreased purchases by 9% quarter-over-quarter. This occurred even as dry powder at close-end funds rose 13% through the third quarter to $152B, 83% above the previous cycle peak. This suggests that institutional investors are remaining disciplined as the cycle continues but are also suffering an immediate drag on returns from large amounts of uninvested capital. Public investors have continued to re-engage the market after anemic acquisition activity in 2016. Purchases increased 17% quarter-over-quarter, bringing year-to-date volumes to $37.2B, or 54% above 2016 levels. This increase is well shy of volumes seen in 2014 or 2015.

Cross-border Capital Accounts for 11.8% of Activity YTD 2017

Acquisitions by foreign investors increased 13% quarter-over-quarter to $11.6B, but were down 27% year to date, compared to 2016, largely due to the reduced presence of Chinese capital. In the second half of 2016, investors from China and Hong Kong purchased $12.6B in U.S. commercial real estate property, most in the third quarter. Chinese deal volume in the first half of 2017 was thought to have been largely funded with cash that had already been moved offshore; however, with the imposition of more stringent controls in recent months and depletion of offshore resources, acquisitions by Chinese and Hong Kong investors plummeted to only $331M in the third quarter.

Fortunately for U.S. markets, the country remains the top destination for investment among foreign investors. Continued strong interest from Canadian, Dutch, Singaporean, and Japanese capital have partially offset declining China/Hong Kong volumes. So far this year, the top sources of foreign capital have been Canada ($11.6B), China/Hong Kong ($6.3B), Singapore ($3.1B), the Netherlands ($3.1B), and Germany ($1.8B), with Japan and South Korea slightly behind.

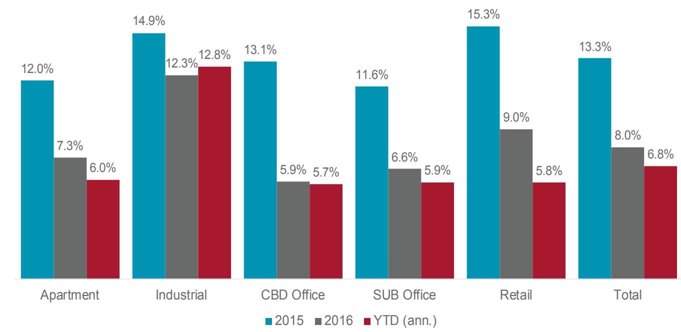
Transaction Volumes to End Year Modestly Down from 2016

Transaction activity is expected to accelerate through the balance of the year. Demand should remain robust for suburban office and industrial product.

Price appreciation has slowed broadly in recent quarters, according to both NCREIF returns and the RCA CPPI. Going forward, a combination of positive but slowing rent growth and limited upward cap rate pressure should contribute to moderately rising prices across product types, with the possible exception of certain retail segments. Secondary Sunbelt office markets, high-quality suburban office, and industrial as well as suburban- and workforce-multifamily are likely to outperform.

We reiterate our view that yields on the highest quality assets will remain fairly stable across product types. However, average transaction cap rates data will remain murky due to adverse selection. Closer examination by subset and class will likely show greater yield convergence as the cycle continues; with a recent example being smaller deltas between suburban and CBD office and apartment product.

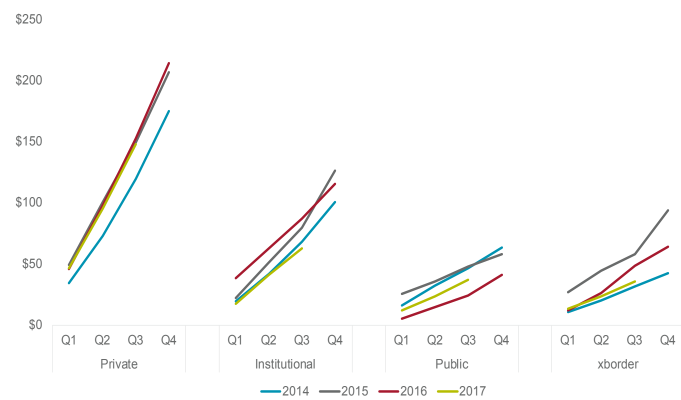
NCREIF NPI Total Returns



Source: NCREIF, Cushman & Wakefield Research

Cumulative Investment Sales Volumes by Investor

$ Billions



Source: Real Capital Analytics
Deals over $5 million

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