MARKETBEAT

United States

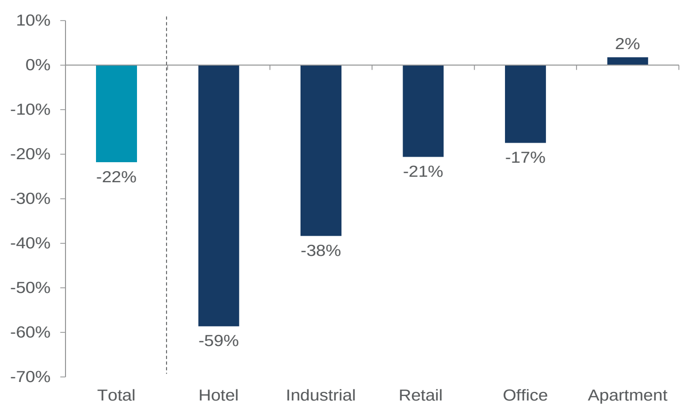
Capital Markets 2Q 2016

CUSHMAN & WAKEFIELD

U.S. CAPITAL MARKETS

Deceleration in Activity Continues

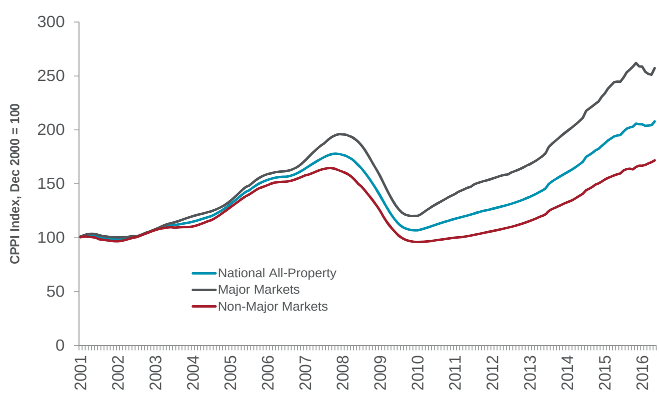
Sales Volume (Jan-May 16' VS. Jan-May 15', % Chg.)



Source: Real Capital Analytics, Cushman & Wakefield Research

Price Appreciation Picking Up

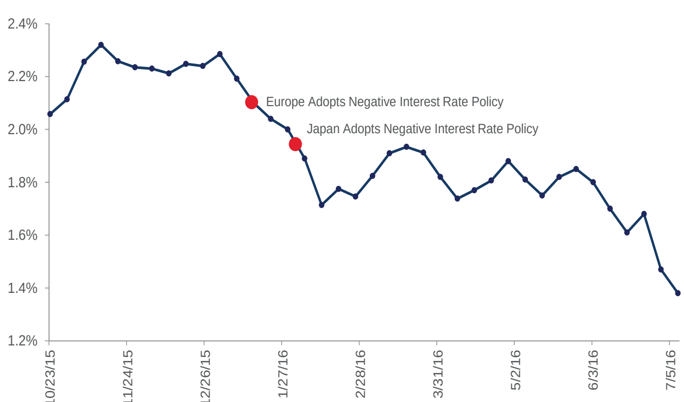
All Property Types, YTD



Source: Moody's/RCA CPPI Index, Cushman & Wakefield Research

U.S. Is A Safe Haven

10-Year Treasury Yield



Source: Federal Reserve, Cushman & Wakefield Research

Slowdown in Sales Is Not Surprising

The capital markets have clearly had a bumpy year, but given the robust pace of activity over the last few years, coupled with more recent global economic and political uncertainty in 2016, a slowdown is not all that surprising. In fact, the global uncertainty, amplified by the downturn in China's economy (and its currency devaluation) as well as the recent Brexit vote, has not only driven down U.S. Treasury yields to record lows, but has also set the stage for an additional surge of foreign capital into the U.S. as global investors search for stability and a safe haven.

Sales volume is still strong, with $169 billion of U.S. sales so far this year. While that is a 22% decline from a year ago, current volume is at its second highest year-to-date level of this most recent real estate cycle. Even though sales volume may be down from last year—in part because comparatively few portfolio transactions have transacted so far this year—prices are ticking up again as the China-related volatility observed in the first quarter now appears in the rear-view mirror. Investors are more sanguine, and the credit markets continue to function reasonably well. Year-to-date through May of 2016, prices across all property types are up 6.7% from a year ago. Secondary locations are making a comeback and are once again in investors' sights, as pricing in non-major markets increased 8.1% compared with a 5.1% increase for major markets, according to the Moody's/RCA CPPI Index.

The apartment sector has led in terms of both sales volume and appreciation. In fact, the apartment sector is the only sector in which transaction volume has increased this year, albeit at a modest uptick of 1.8% year-to-date through May of 2016. Given investors' healthy appetite for this product, prices increased by 11.7% through the first five months of this year. Pricing for retail and industrial properties also posted strong year-over-year gains in May, increasing by 9.4% and 7.5%, respectively. Office prices increased by just 1.2% from May 2015 to May 2016, but that was an acceleration from the -0.33% year-over-year rate of growth observed in April.

Brexit Could Provide a Boost to U.S. Real Estate

The recent vote in the United Kingdom to leave the European Union sent shockwaves throughout the global financial system—initially. But that shock only lasted for about three days. Most major stock indices have since rebounded (some aggressively), and currency and credit markets have mostly stabilized. Any negative economic impacts appears to be more regional in nature, not global. While the Brexit vote has caused a disruption in the U.K. and European markets in terms of leasing and sales, it may actually prove to be a boon for U.S. property markets, as more foreign investors are now more likely to re-direct capital to the U.S.

In addition, uncertainty in the Eurozone has driven more investors towards gold and U.S. bonds in their search for safety. As of mid-July 2016, U.S. Treasury yields hover around 1.4%, and that has pushed commercial mortgage rates to new lows.

Our outlook calls for rates to remain lower for a longer period of time than most analysts anticipated even two to three months ago and that has created new space for further cap rate compression. Given current low interest rates, as well as current investor demand, we expect cap rates to trend slightly lower for the remainder of the year as competition among investors increases.

Despite lower interest rates, the private lending market (including banks and insurance companies) is growing steadily while public debt markets still seem to be in limbo. The latest figures from the Federal Reserve show that commercial lending grew at an annualized rate of 10.1% year-to-date through May 2016 compared to a year-ago, driven by a 14.9% growth in multifamily loan volume. However on the public debt side, while 10-year AAA spreads over swaps have come in 50 basis points by mid-July from their peak in February of this year, the CMBS market is still grappling with the new regulatory environment. In the first half of 2016, CMBS issuance totaled $30.7 billion, down 44% from the same period one year-ago.

U.S. Now Looks More Attractive

In an environment of concerns about China's rebalancing economy, negative interest rates in Japan and parts of Europe, and the recent Brexit vote in the U.K., U.S. markets are attractive alternatives. Given the current yields of global government bonds and the lack of yield in other assets classes (e.g., stocks and corporate bonds), the U.S. real estate sector is becoming more and more attractive to investors. Indeed, the latest figures from Real Capital Analytics reveal that U.S. real estate has captured 30% of all global capital so far in 2016, nearly double the level just 18 months ago.

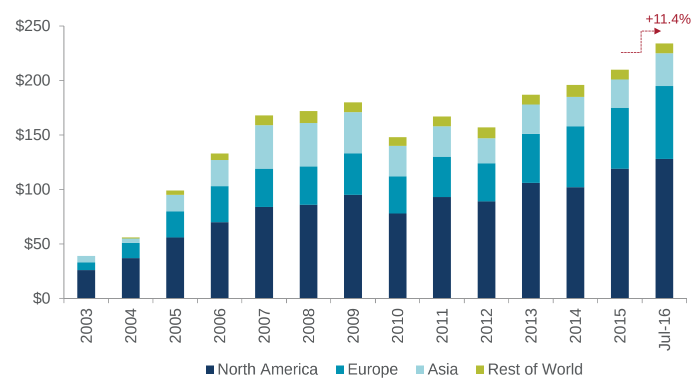
And there are some positives looking forward. The latest data from Preqin indicate that $234 billion of dry powder is waiting on the sidelines to be invested in real estate globally, up 11.4% from year-end 2015. North America accounts for $128 billion of that capital—more than 55% of that total.

Another positive for U.S. markets that could attract more capital is the upcoming creation (on September 1, 2016) of real estate as a distinct sector in the Global Industry Classification Standard (GICS), the benchmark used by the S&P and MSCI—the first time a new sector will have been created since the inception of the GICS in 1999. This will not only raise the profile of real estate as a distinct asset class, but will likely attract more capital into this sector—particularly in the public space first, as institutional investors realize that they are underweight in real estate.

In light of recent political events, there is a heightened sense of caution among real estate investors. Although risks have shifted to the downside and there are darker scenarios that could still play out, it is worth noting that leasing fundamentals in the U.S. remain solid, providing for NOI growth and cash flow. Of course, we should not discount the impact of investor sentiment on the market, as investor uncertainty is real, but underlying fundamentals still favor a healthy U.S. investment market.

Fundraising for CRE Is Spectacular

Dry Powder Targeted at Real Estate Globally ($Billion)



Source: Preqin, Cushman & Wakefield Research

Outlook:

While investors are more cautious these days because of global uncertainty, the U.S. investment market is poised to benefit:

- **Tons of capital:** We expect more foreign capital to come in to the U.S. in light of global upheaval in search of stability and yield. Not only will primary markets continue to benefit, but we expect interest in secondary markets to increase.
- **Accommodative Fed:** The "lower for longer" interest rates will serve as a tailwind for the real estate sector, exerting the possibility of downward pressure on cap rates.
- **Solid fundamentals:** Strong job growth has translated into healthy leasing fundamentals with vacancy rates declining and rental rates continuing on an upward trajectory, resulting in positive cash flows and NOIs.

About Cushman & Wakefield

Cushman & Wakefield is a leading global real estate services firm that helps clients transform the way people work, shop, and live. Our 43,000 employees in more than 60 countries help investors and occupiers optimize the value of their real estate by combining our global perspective and deep local knowledge with an impressive platform of real estate solutions. To learn more, visit www.cushmanwakefield.com or follow @CushWake on Twitter.

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