CUSHMAN & WAKEFIELD

The Fed's Decision: Implications for Commercial Real Estate

December 2015 **- Perspective and Analysis**

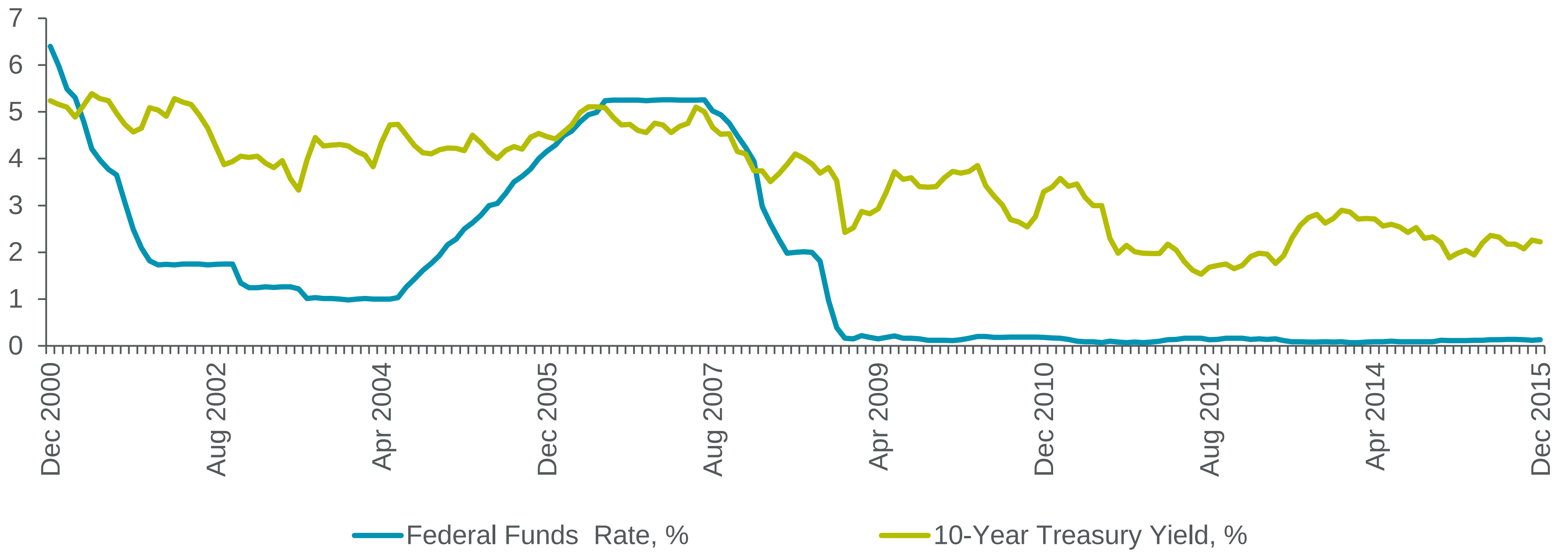
Economic Projections
Of the Federal Reserve Board members and Bank presidents, December 2015

	MEDIAN					CENTRAL TENDENCY*				
	2015	2016	2017	2018	Longer run	2015	2016	2017	2018	Longer run
Change in Real GDP	2.1	2.4	2.2	2.0	2.0	2.0	2.3-2.5	2.0-2.3	1.8-2.2	1.8-2.2
Unemployment rate	5.0	4.7	4.7	4.7	4.9	5.0	4.6-4.8	4.6-4.8	4.6-5.0	4.8-5.0
PCE inflation	0.4	1.6	1.9	2.0	2.0	0.4	1.2-1.7	1.8-2.0	1.9-2.0	2.0
Core PCE inflation	1.3	1.6	1.9	2.0		1.3	1.5-1.7	1.7-2.0	1.9-2.0	
Memo: Projected appropriate policy path										
Federal funds rate	0.4	1.4	2.4	3.3	3.5	0.4	0.9-1.4	1.9-3.0	2.9-3.5	3.3-3.5
September projection	0.4	1.4	2.6	3.4	3.5	0.1-0.6	1.1-2.1	2.1-3.4	3.0-3.6	3.3-3.8

**The central tendency excludes the three highest and three lowest projections for each variable in each year.*

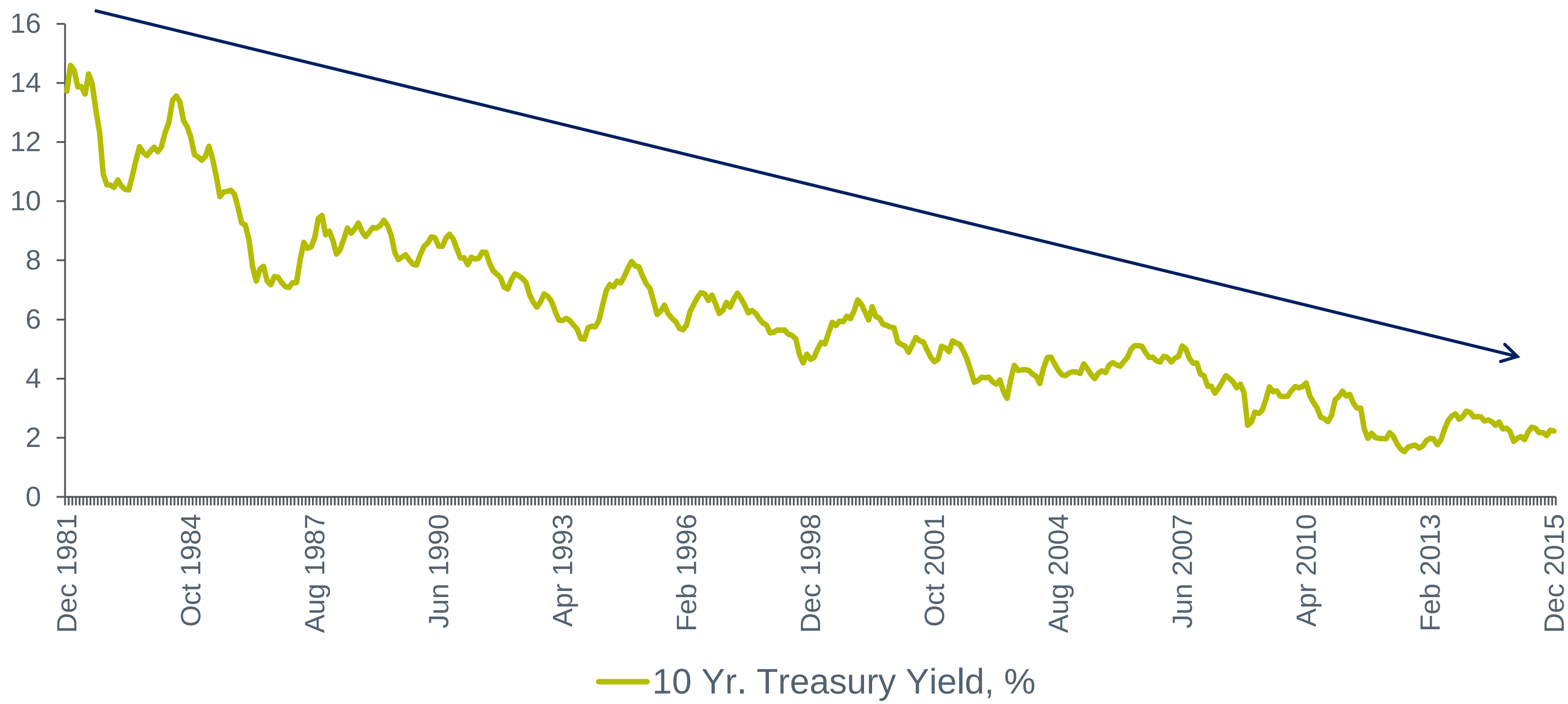
Source: Federal Reserve Bank Presidents, Federal Open Market Committee

Worth remembering that the Fed does not control long-term rates



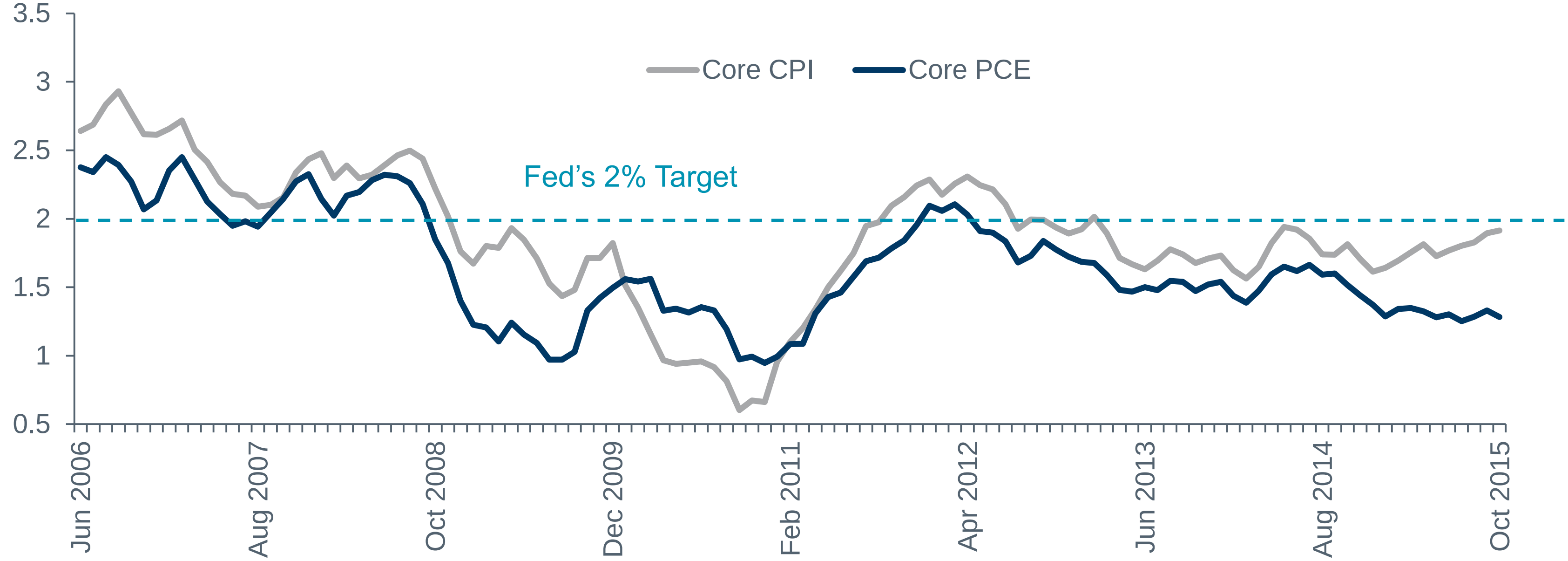
Source: Federal Reserve

And let's not forget, people who have been predicting long-term rates would rise have generally been *wrong* for the past 30+ years!



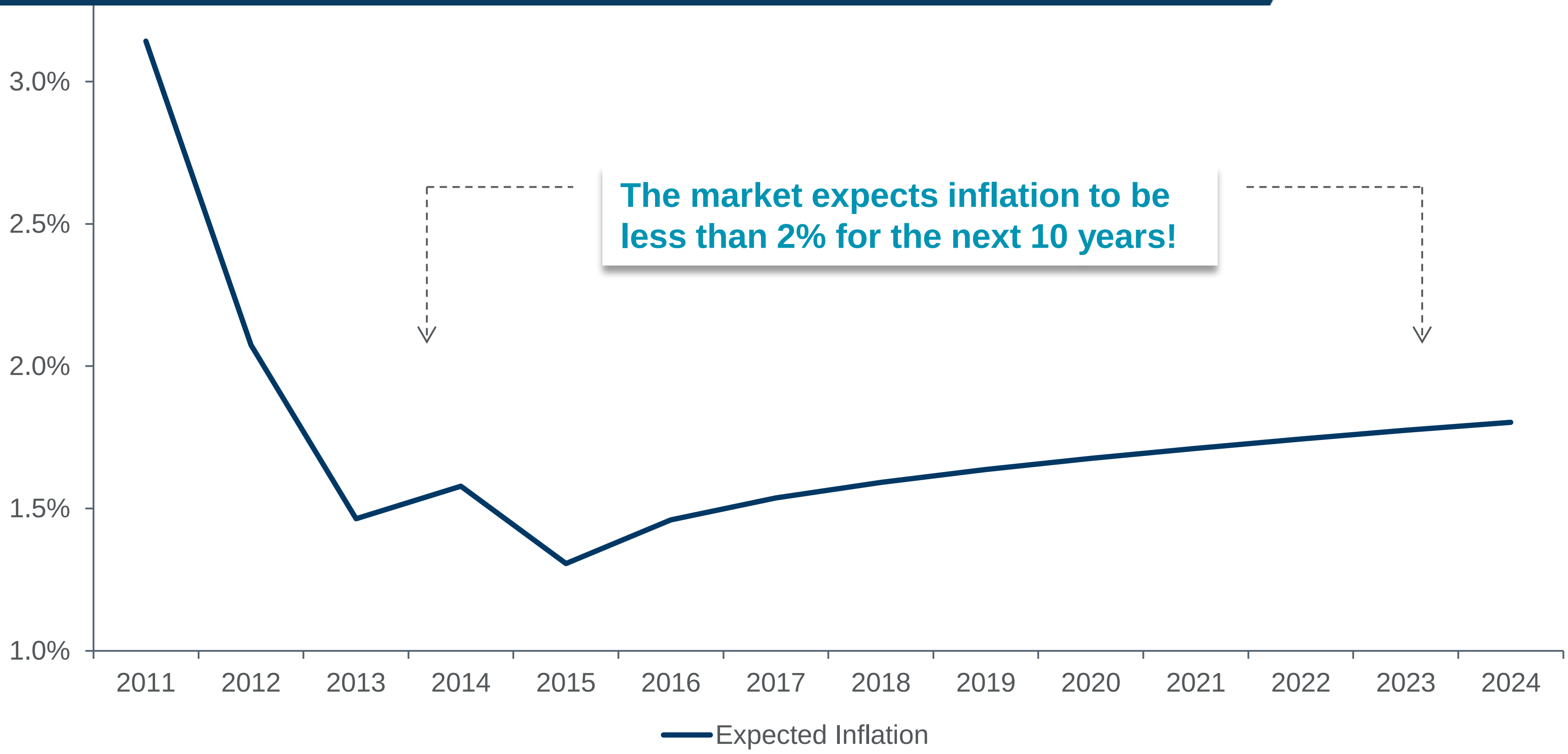
Source: Federal Reserve

There has been very little inflation year-over-year



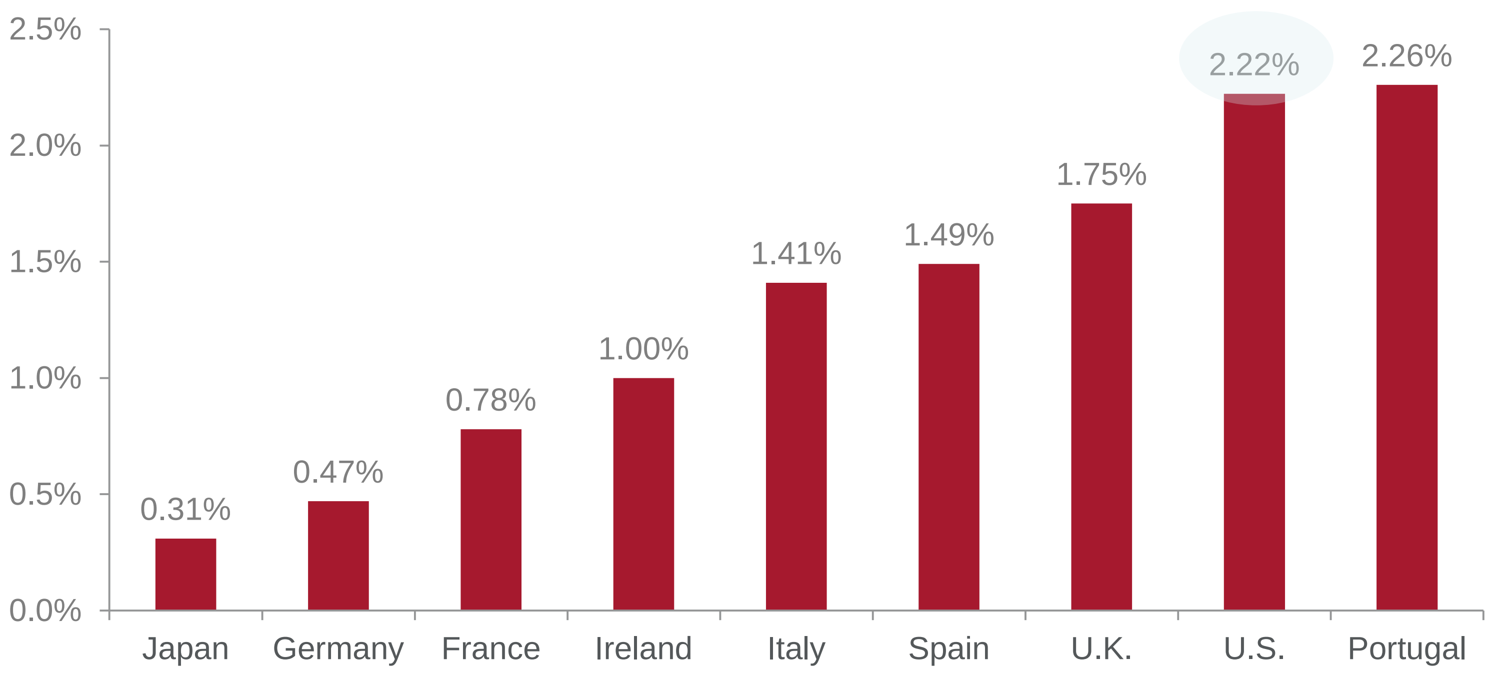
Source: U.S. Bureau of Labor Statistics, U.S. Bureau of Economic Analysis

And little change is expected the next 10 years



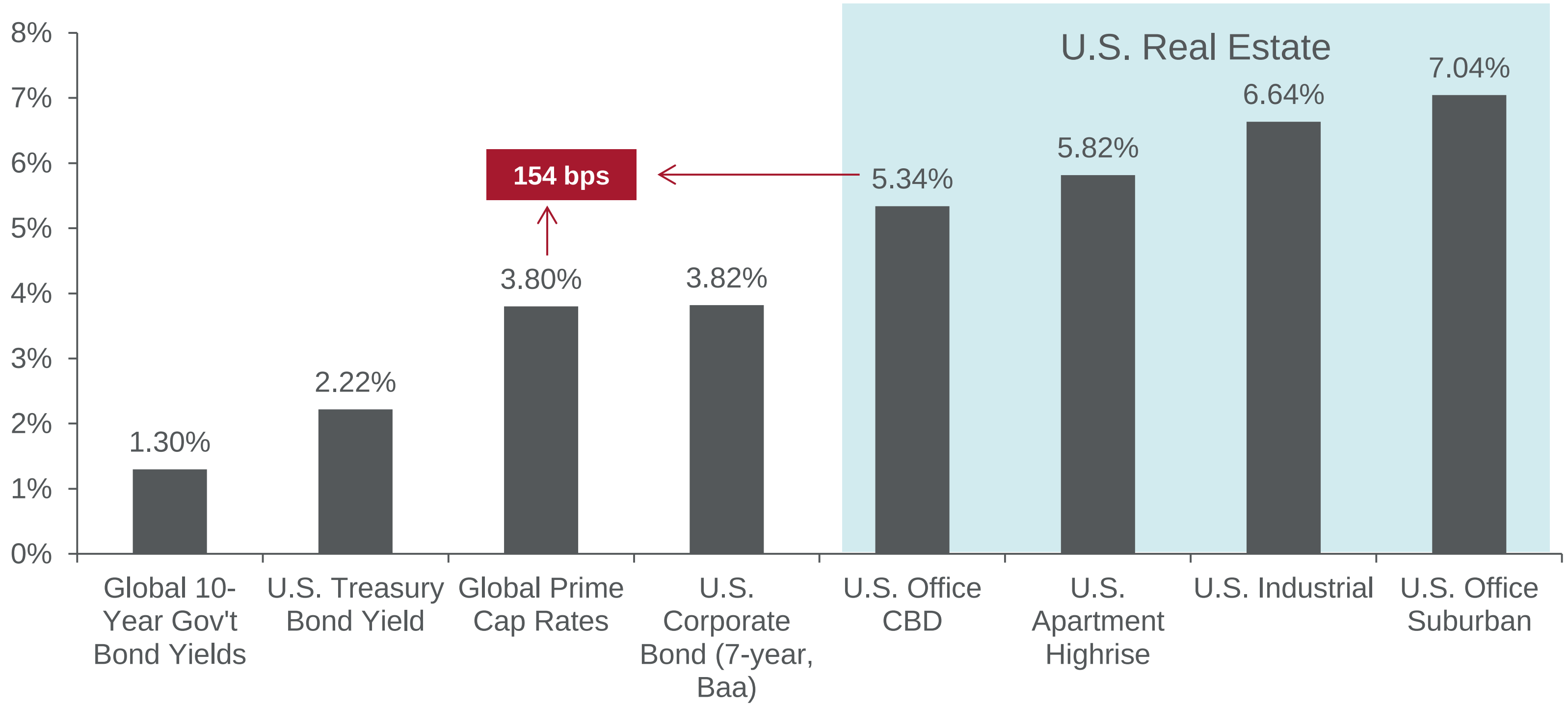
Source: Federal Reserve Bank of Cleveland

Global 10-year government bond rates remain historically low, placing little upward pressure on U.S. bond yields



Source: Bloomberg

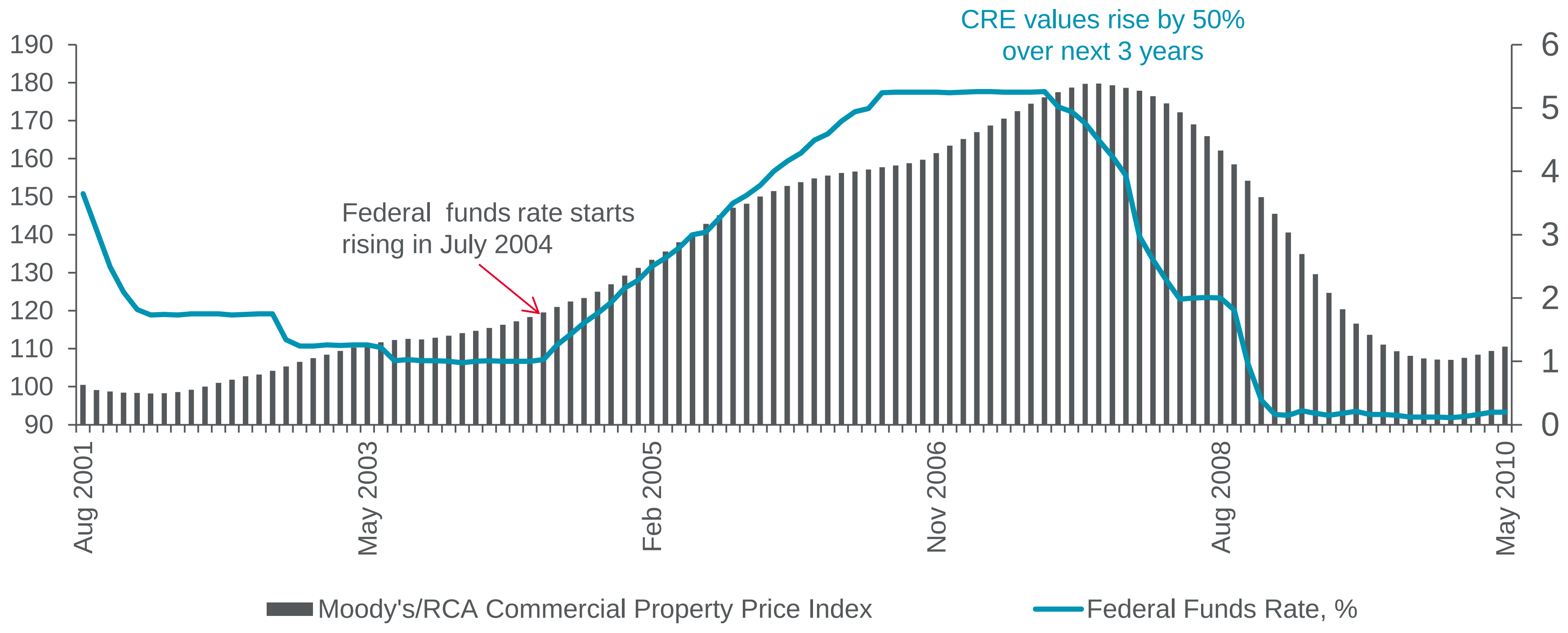
And U.S. Cap rates could go lower



Global Bond Yields: Average of Germany, Japan, France, U.K., Spain, Italy, Hong Kong
Global cap rates: Average of Beijing, Frankfurt, Paris, London, Tokyo, Hong Kong
(Global values thru September 2015; U.S. values thru November 2015)
Source: Federal Reserve Board, Real Capital Analytics, Cushman & Wakefield Research

What do rising rates mean for CRE values?

History shows that the last time the Fed raised rates, CRE values increased by 50%



Source: Federal Reserve, Moody's Analytics/Real Capital Analytics

Office values soared the last time the Fed raised rates

Growth Rate from 2004-2007

MARKET	GROWTH RATE	MARKET	GROWTH RATE
New York	142%	Baltimore	37%
Long Island	120%	Kansas City	37%
Denver	82%	Dallas	26%
Charlotte	73%	Sacramento	25%
DC – VA	69%	Cincinnati	24%
Los Angeles	61%	Atlanta	21%
Phoenix	57%	Minneapolis	20%
Orange County	54%	St. Louis	19%
San Francisco	53%	Boston	18%
East Bay	53%	Chicago	14%
San Diego	50%	Houston	10%
Raleigh/Durham	46%	Nashville	7%
San Jose	42%	DC – MD	4%
Columbus	41%	Indianapolis	1%
DC	37%		
U.S. Average = 51%			

Source: Real Capital Analytics

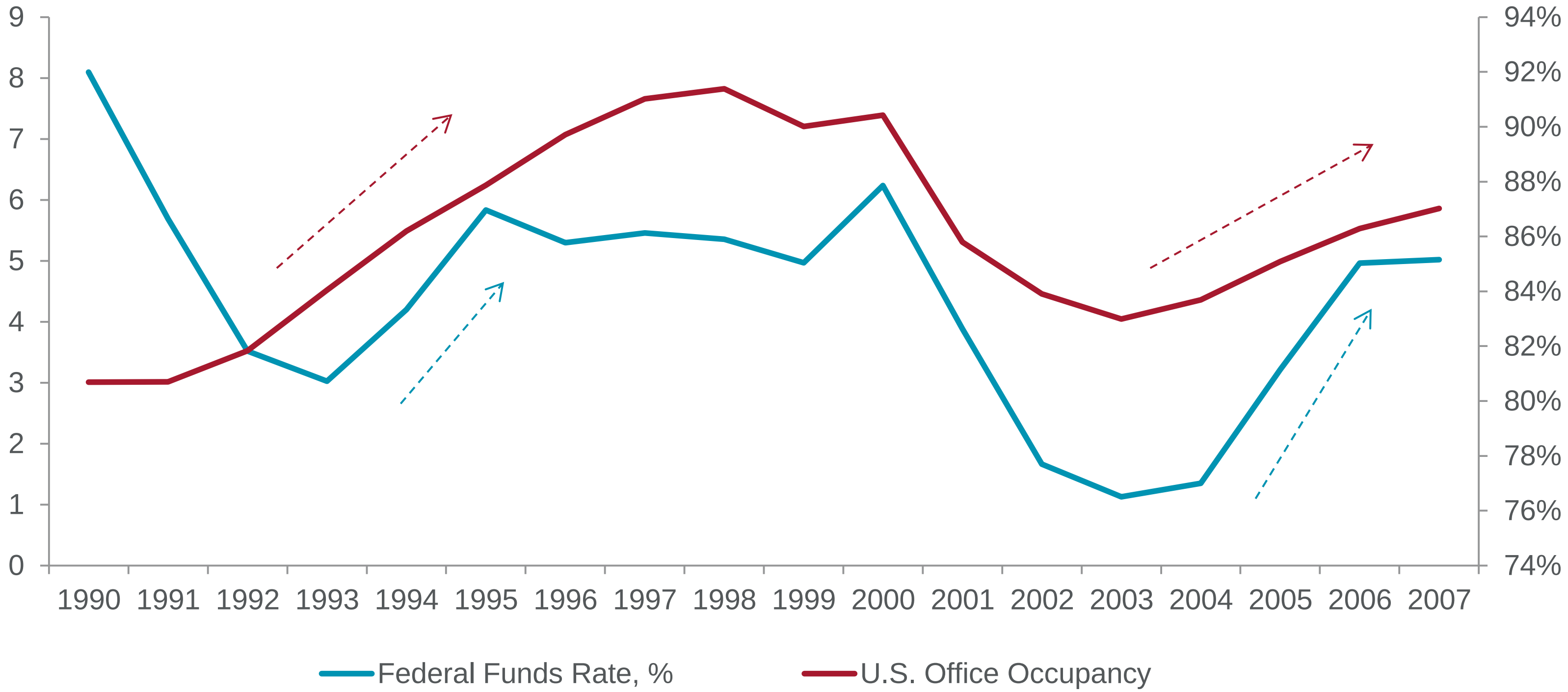
Industrial values also soared the last time the Fed raised rates

Growth Rate from 2004-2007

MARKET	GROWTH RATE	MARKET	GROWTH RATE
Kansas City	154%	San Jose	29%
Columbus	116%	St. Louis	25%
Phoenix	111%	Denver	24%
Sacramento	90%	Indianapolis	23%
Charlotte	62%	Nashville	21%
Inland Empire	32%	Northern NJ	20%
East Bay	61%	Baltimore	12%
Raleigh/Durham	59%	San Francisco	11%
Cincinnati	55%	DC	11%
Minneapolis	40%	DC – VA	2%
Chicago	32%	DC – MD	0%
U.S. Average = 38%			

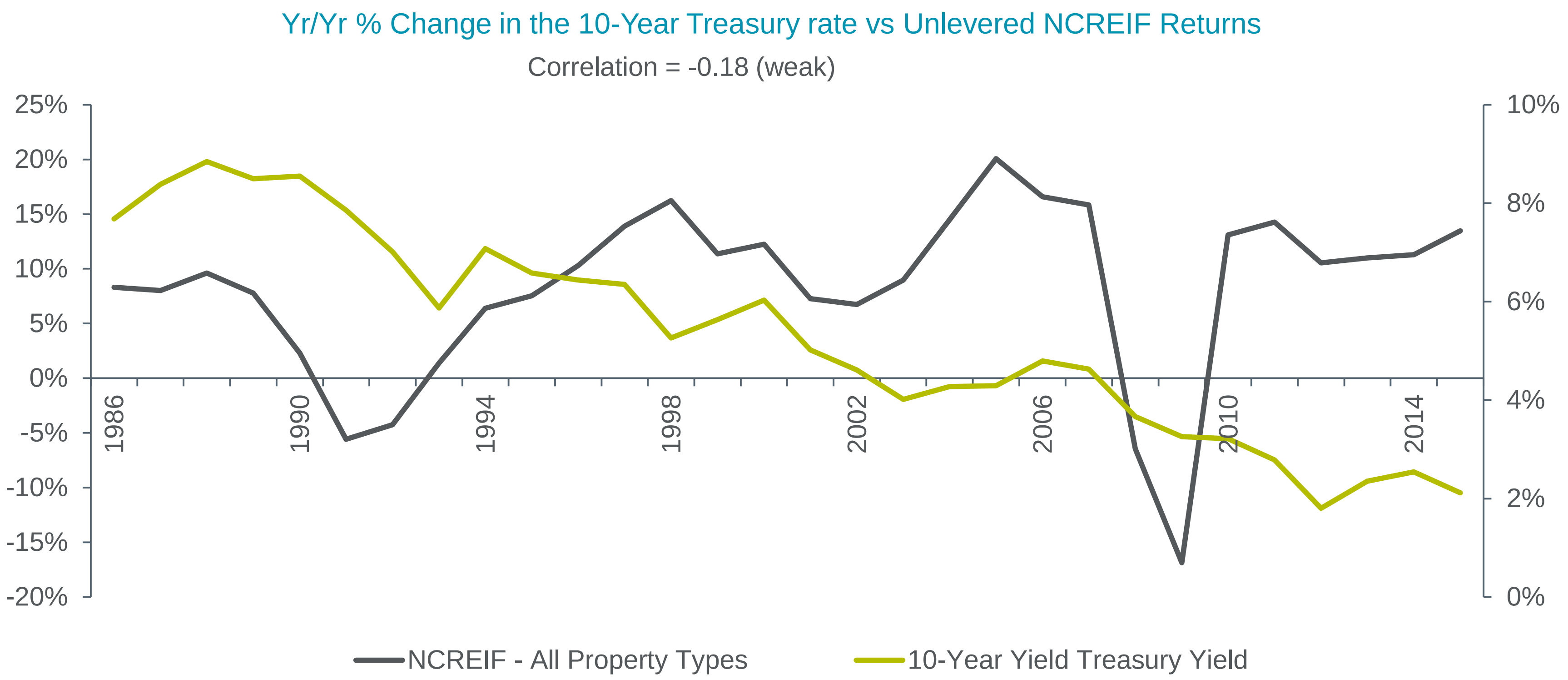
Source: Real Capital Analytics

When rates rise, so does occupancy…



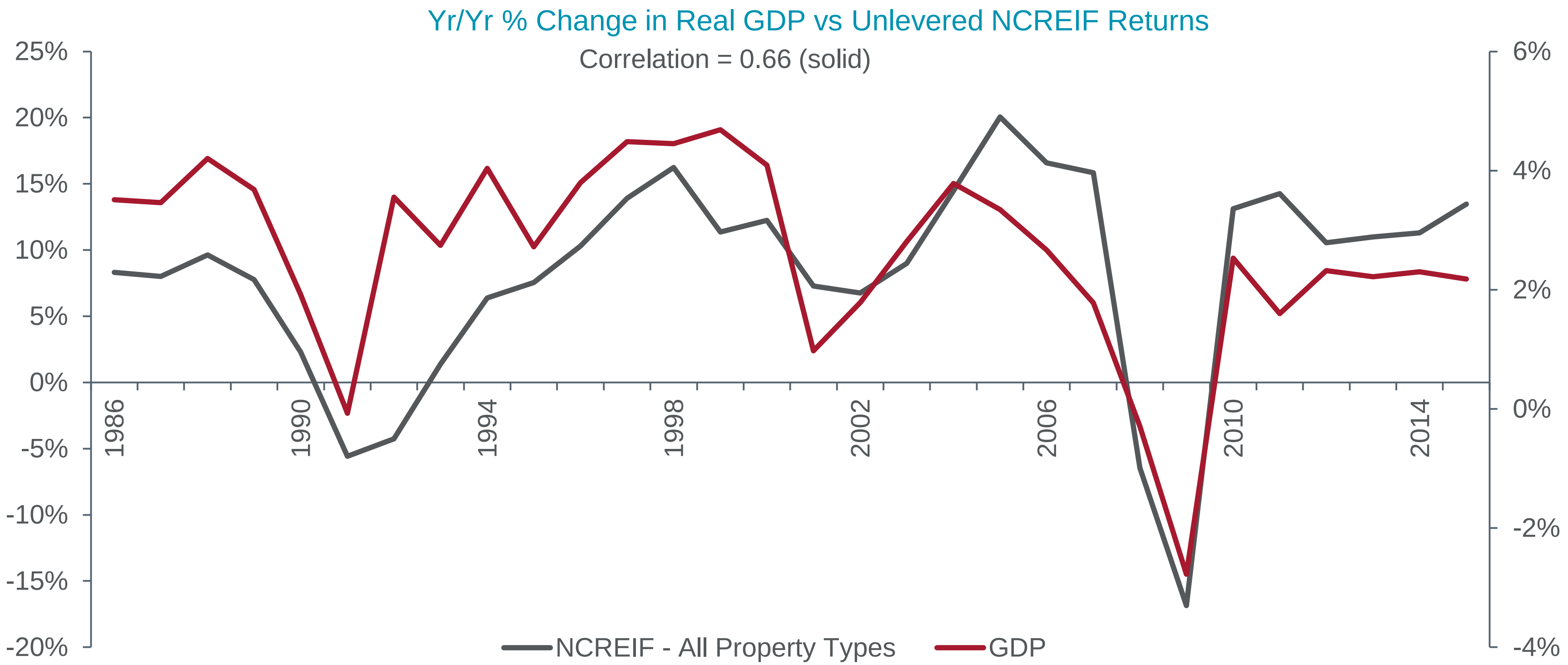
Source: Federal Reserve, Cushman & Wakefield Research

There's virtually no relationship between rising interest rates and CRE returns



Source: NCREIF, Federal Reserve

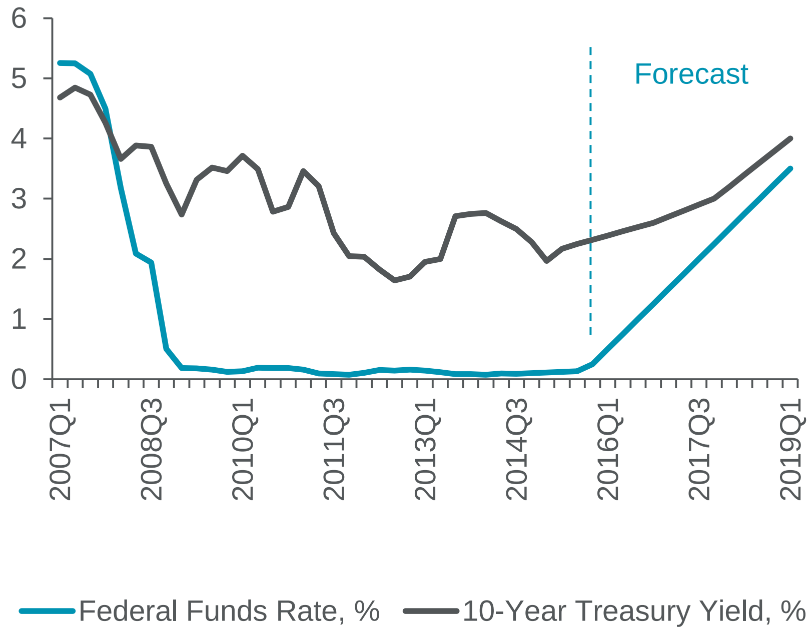
Economic growth matters more



Source: NCREIF, U.S. Bureau of Economic Analysis

U.S. Interest Rate Forecast

10-YR RATE BELOW 3% THRU 2016

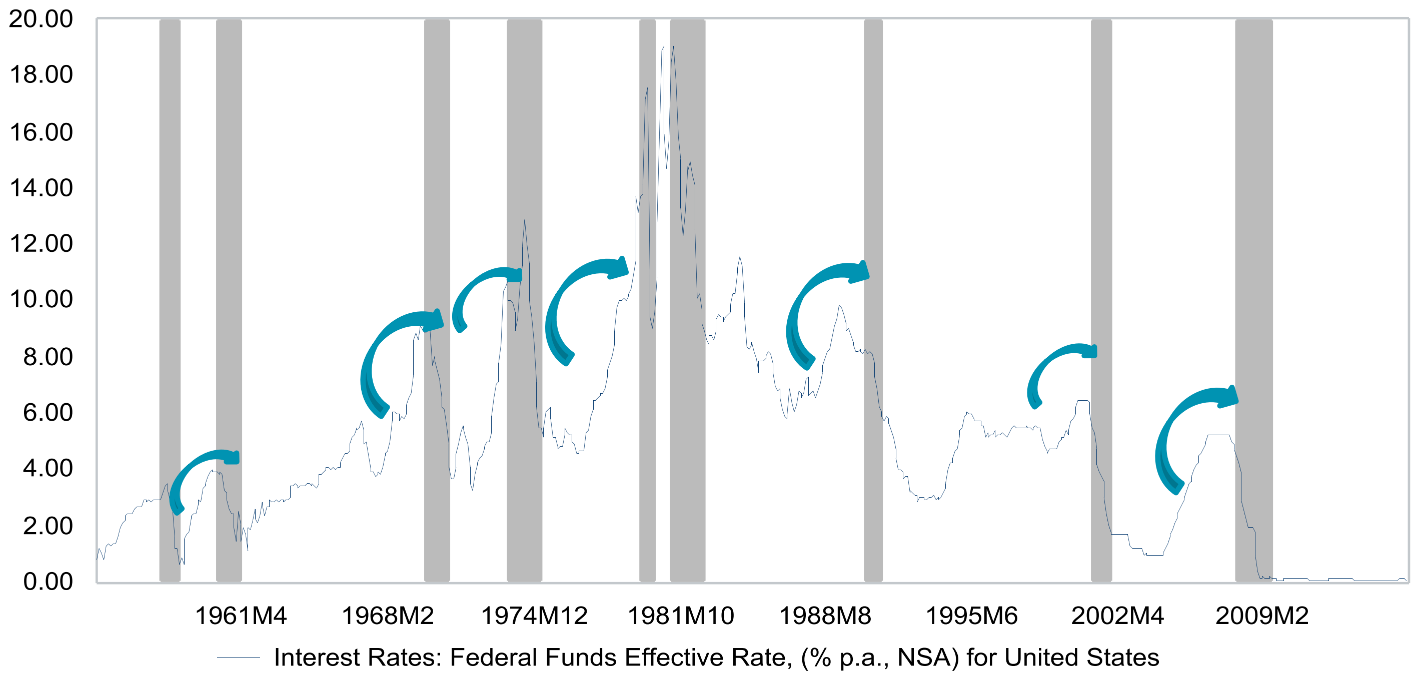


10-YR RATE FORECAST COMPARISON

	2014	2015	2016	2017	2018
Oxford	2.5	2.2	2.6	3.1	3.5
Moody’s	2.5	2.2	3.1	4.1	4.2
NABE	2.5	2.5	3.1	*	*
C&W	2.5	2.1	2.6	2.9	3.5
Avg.	2.5	2.3	2.9	3.4	3.7

Source: Federal Reserve, Oxford Economics, Moody’s Analytics, NABE, Cushman & Wakefield Research

Tighter monetary policy typically signals steps towards the next recession



Then again, global monetary policy is still simulative

EUROZONE

ECB launched QE in March 2015, bond-buying $66B per month; also dropped short-term rates to effectively 0%.

JAPAN

BOJ launched new QE in October of 2014, swelling monetary base by $650B per year.

CHINA

PBOC cut interest rates from 4.85% to 4.6% in August 2015– has continued to inject yuan into the economy via liquidity facilities and decreased the required reserve ratio (RRR) at banks. PBOC is currently considering an additional 1.2-1.5T yuan stimulus.

AUSTRALIA

Cut interest rates in May to record low of 2%.

INDIA

Central bank reduced its main rate by half a percentage point in October 2015 - citing economy is “far from robust”.

The bottom line on interest rates & CRE values

No guarantee long-term interest rates are going to rise. Inflation is the key metric to watch, not the Fed Funds Rate

If they do rise, that typically means CRE values will also rise (in general) as stronger economic growth drives NOI higher

If they do rise, value-add is the hot play as it has more upside from improving leasing fundamentals

If they do rise, core assets with long-term leases in place are the most exposed, but then again, no shortage of demand for these assets

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