



February 2018

EXTENDING THE CYCLE?

FOCUSED ON THE FUTURE OF REAL ESTATE

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FEBRUARY 2018

EXTENDING THE CYCLE?

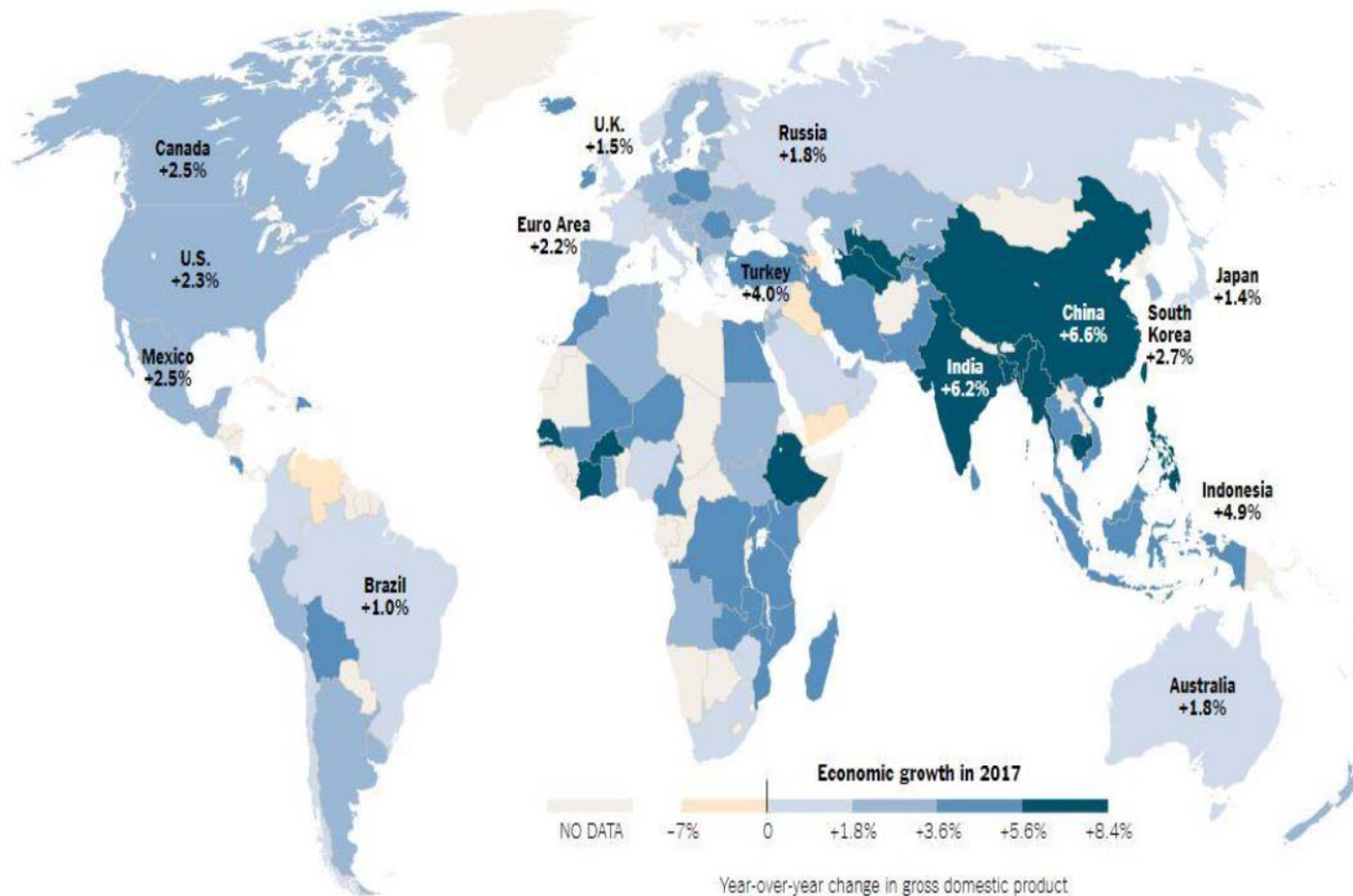
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Despite no obvious signs of an impending downturn, investors remain concerned about elevated valuations and the elongated cycle.

RETURN TO GLOBAL SYNCHRONIZED GROWTH

REAL GDP GROWTH IN 2017



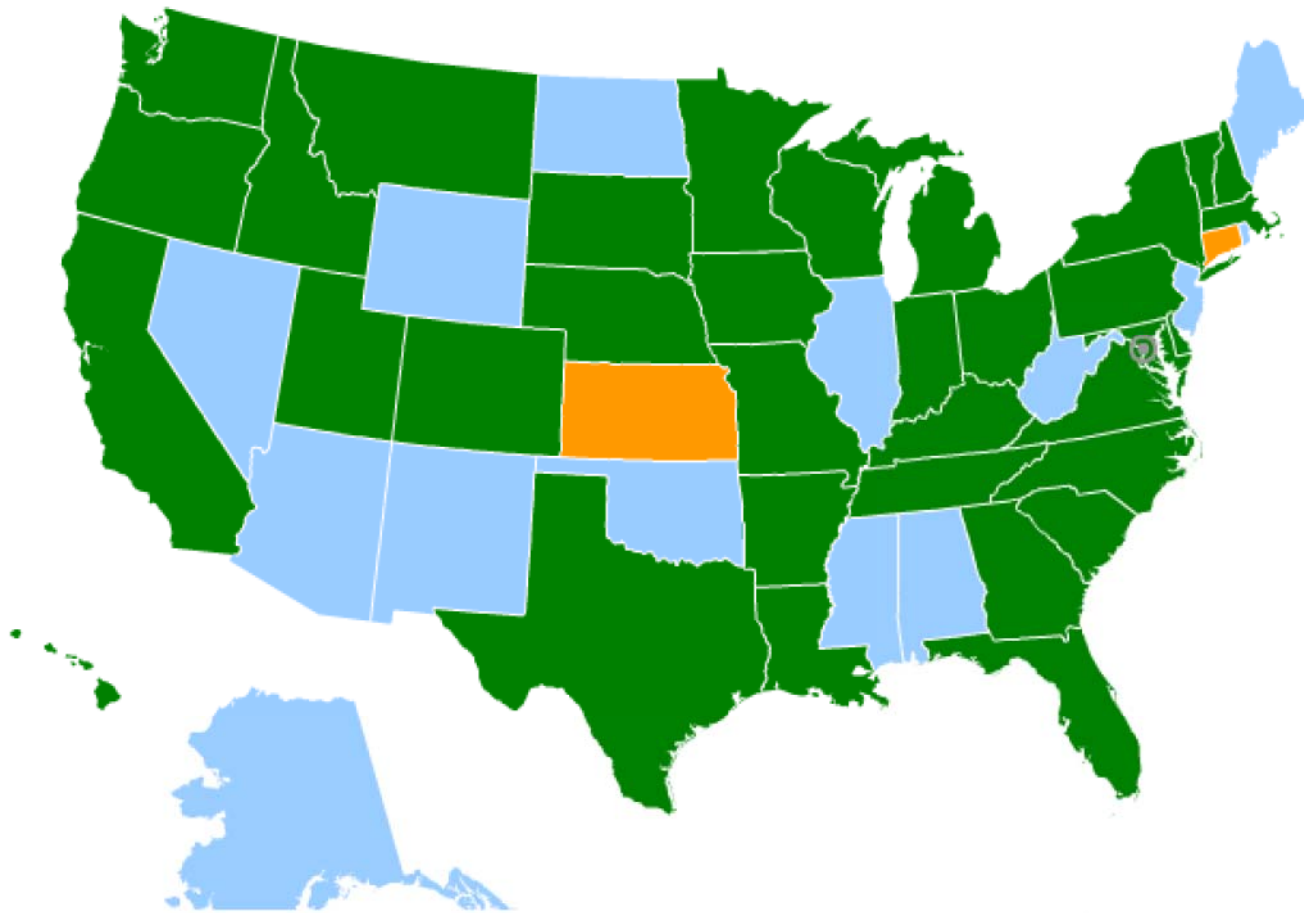
- Asia, Europe and North America broadly in expansion
- Pockets of weakness remain in resource-based and other emerging market economies
- Global growth accelerating but below pre-crisis levels

Source: New York Times January 27, 2018

SYNCHRONIZED DOMESTIC GROWTH

CURRENT STATUS OF STATE ECONOMIES

■ In Recession ■ At Risk ■ Recovering ■ Expanding



Source: Moody's Analytics

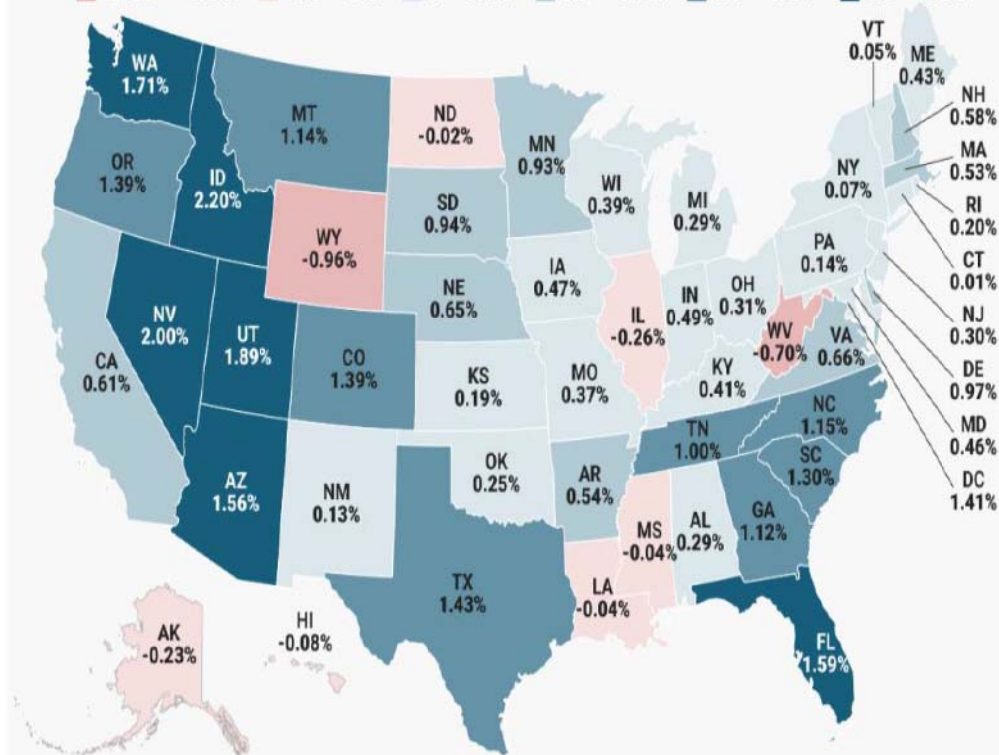
- Energy based economies generally in recovery from oil price crash
- Connecticut and Kansas are true outliers:
 - Taxes are too high in CT and too low in KS

IMMIGRATION REMAINS CRITICAL TO POPULATION GROWTH

POPULATION CHANGE

ESTIMATED PERCENT CHANGE IN POPULATION, JULY 1, 2016 – JULY 1, 2017

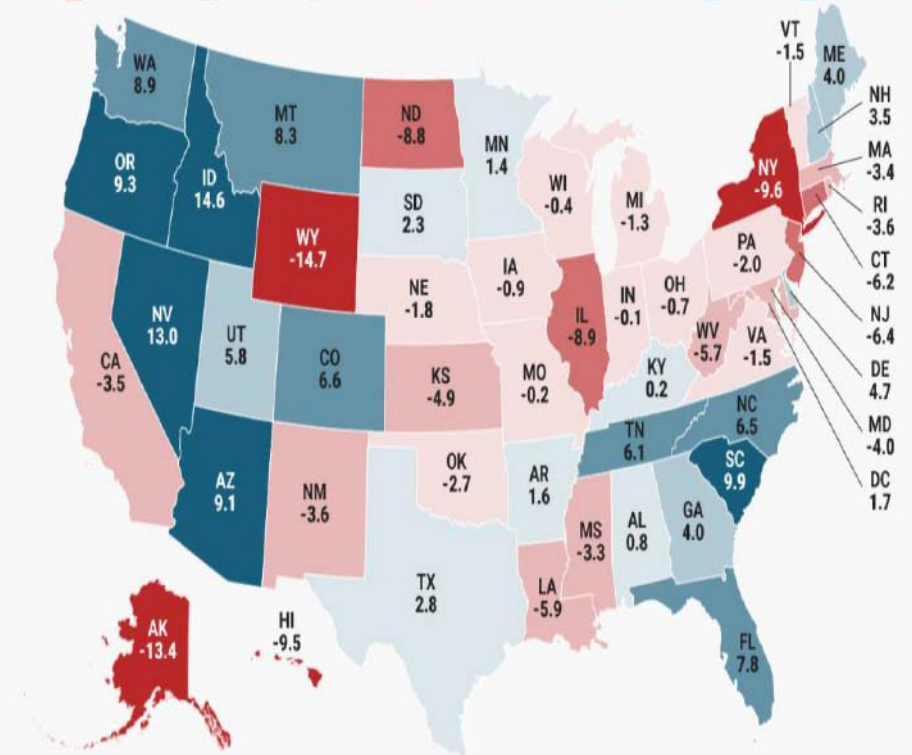
-0.96 – -0.5% -0.5 – 0% 0 – 0.5% 0.5 – 1.0% 1.0 – 1.5% 1.5 – 2.2%



NET DOMESTIC MIGRATION

NET DOMESTIC MIGRATION PER 1,000 RESIDENTS, JULY 1, 2016 – JULY 1, 2017

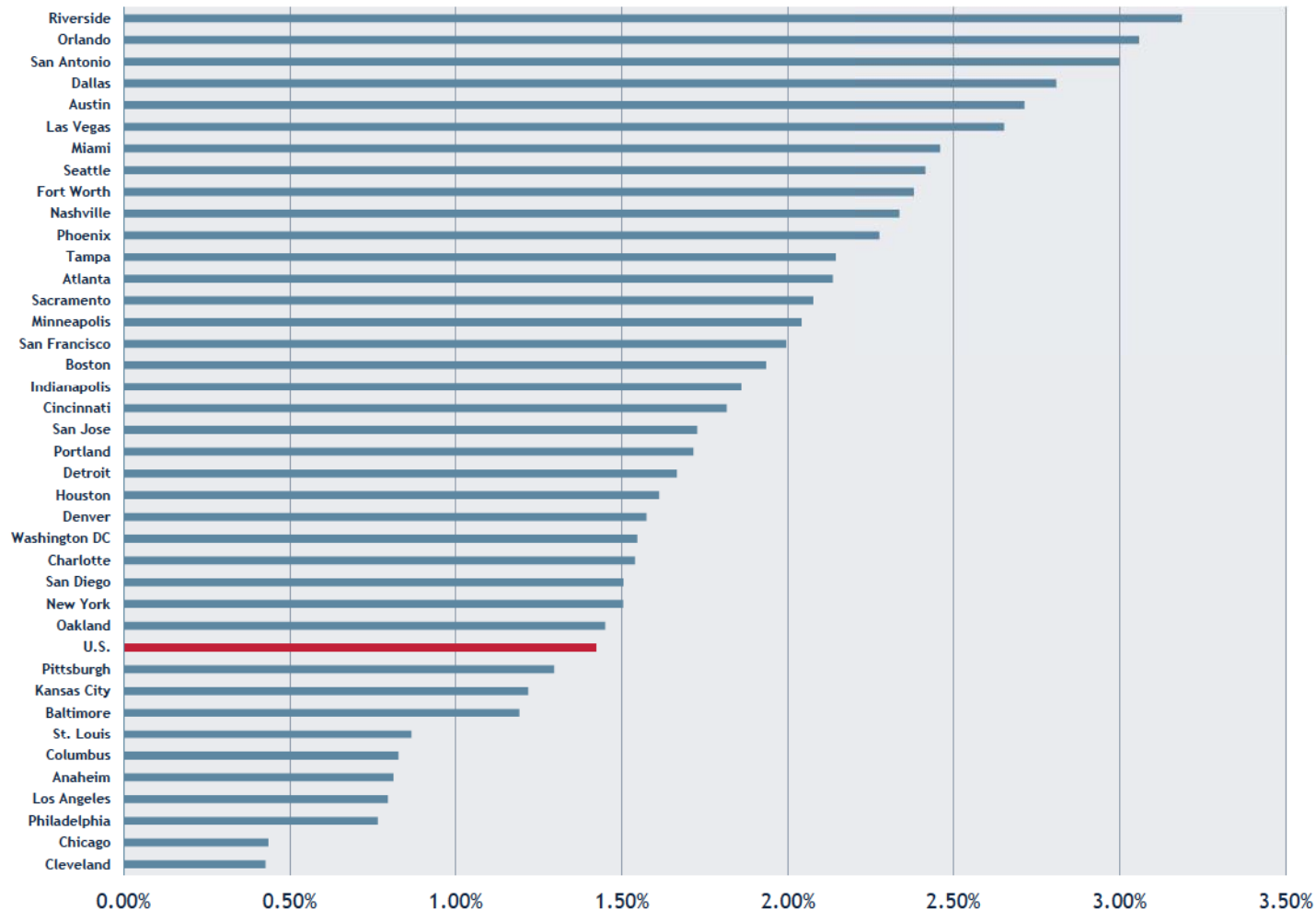
-14.7 – -9 -9 – -6 -6 – -3 -3 – 0 0 – 3 3 – 6 6 – 9 9 – 14.6



Source: Business Insider, U.S. Census Bureau

MOST MAJOR METROS STILL GROWING ABOVE U.S. AVERAGE

YEAR-OVER-YEAR JOB GROWTH - NOVEMBER 2017

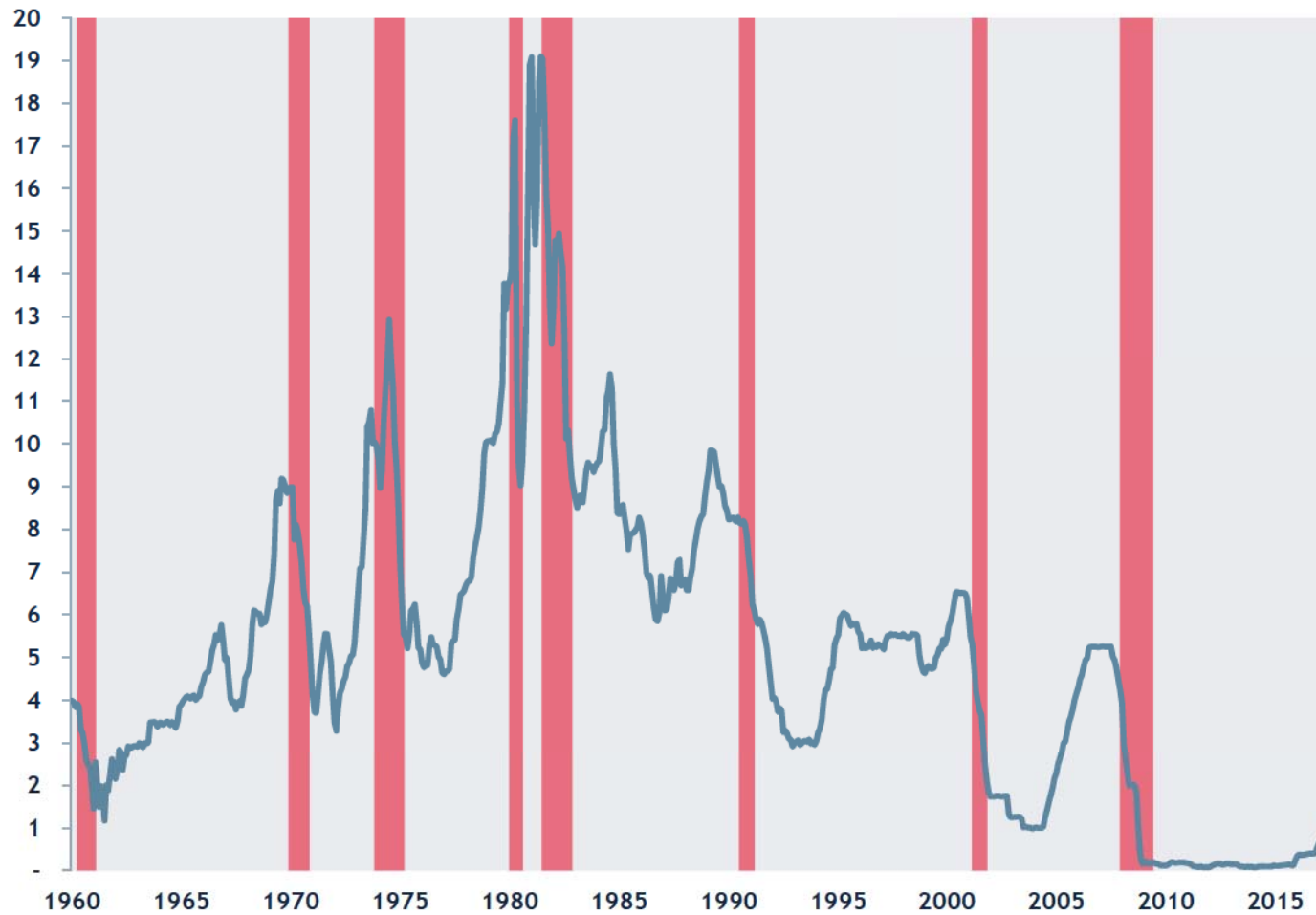


Source: Bureau of Labor Statistics

- Texas markets continue to show strength
- Houston back above U.S. average despite hurricane

FED TIGHTENING CYCLE USUALLY ENDS IN RECESSION

FED FUNDS RATE (%) AND PAST RECESSIONS

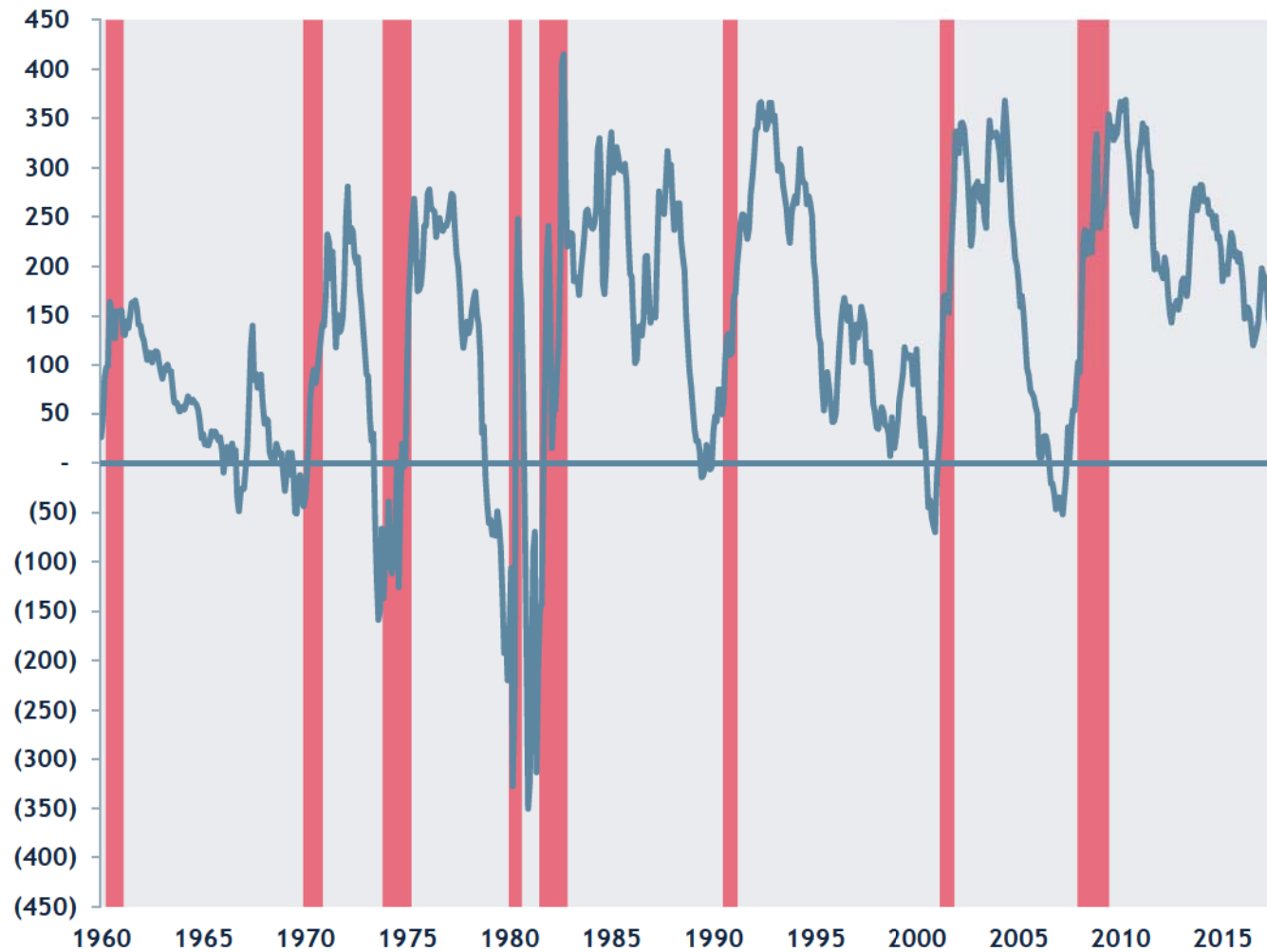


Source: Federal Reserve

- Before the financial crisis, interest rates were the primary tool of monetary policy

YIELD CURVE FLATTENING

TEN YEAR - THREE MONTH TREASURY YIELD SPREAD (BP) AND PAST RECESSION

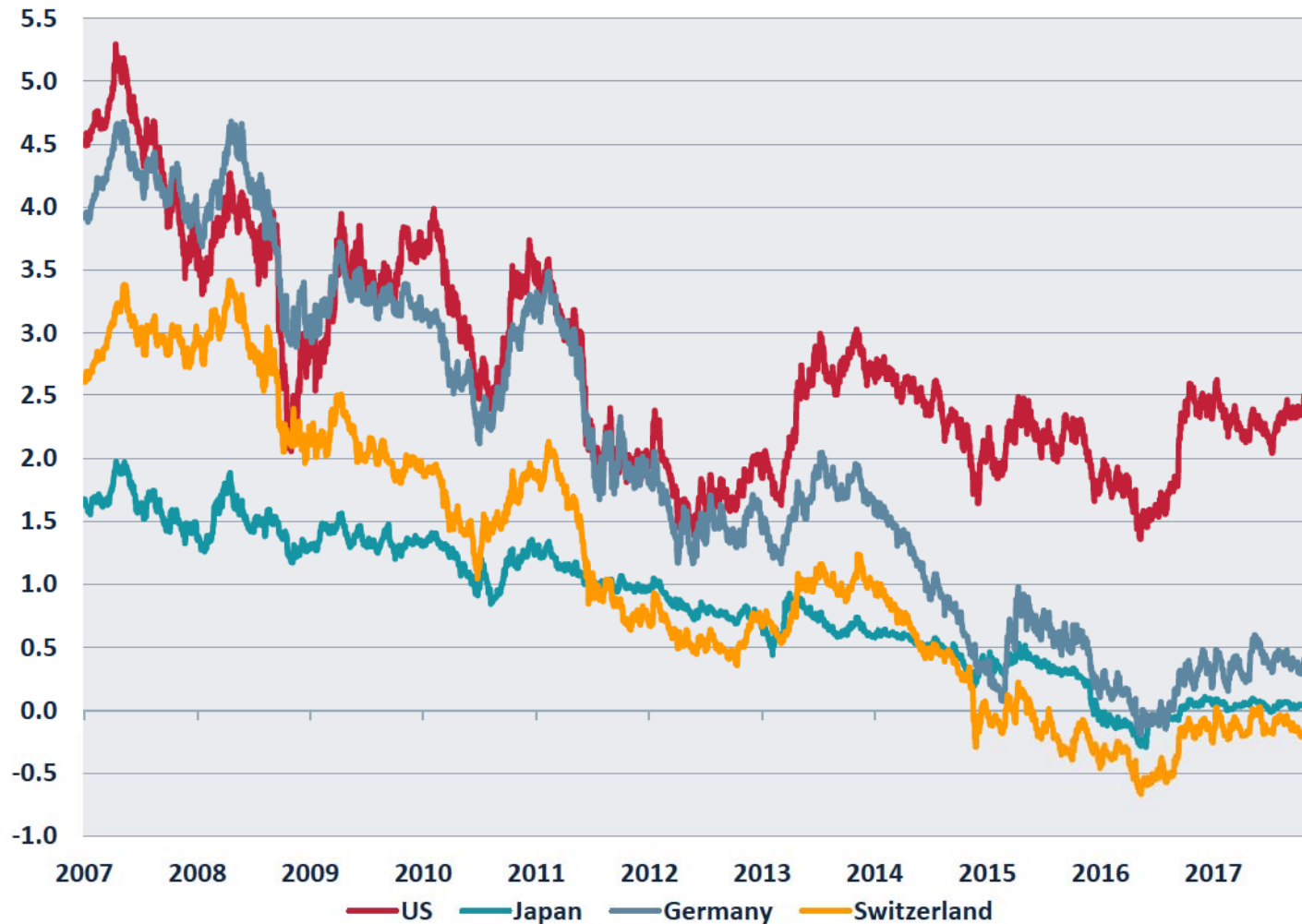


Source: Moody's Analytics

- Yield curve flattening as Fed raises short end
- Still quite far from inverted curve

HOW MUCH CAN THE TEN-YEAR YIELD RISE?

TEN YEAR SOVEREIGN BOND YIELDS (%)

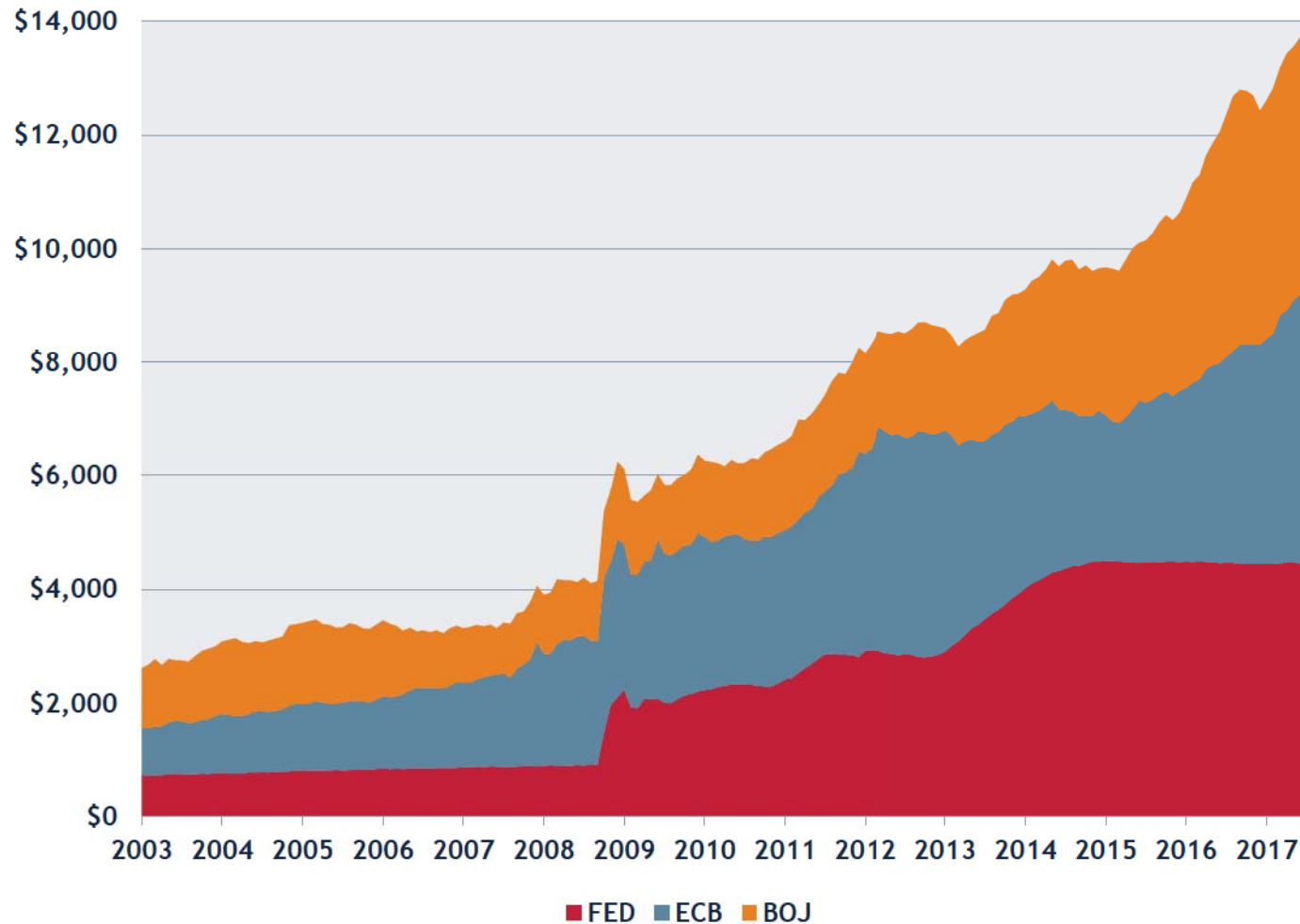


Source: Bloomberg

- 10-year yields still at zero or below in Japan and Switzerland
- U.S. - German spread still close to post financial crisis highs

QE GIVING WAY TO QT? NOT QUITE YET

SIZE OF CENTRAL BANK BALANCE SHEETS (\$ BILLIONS)

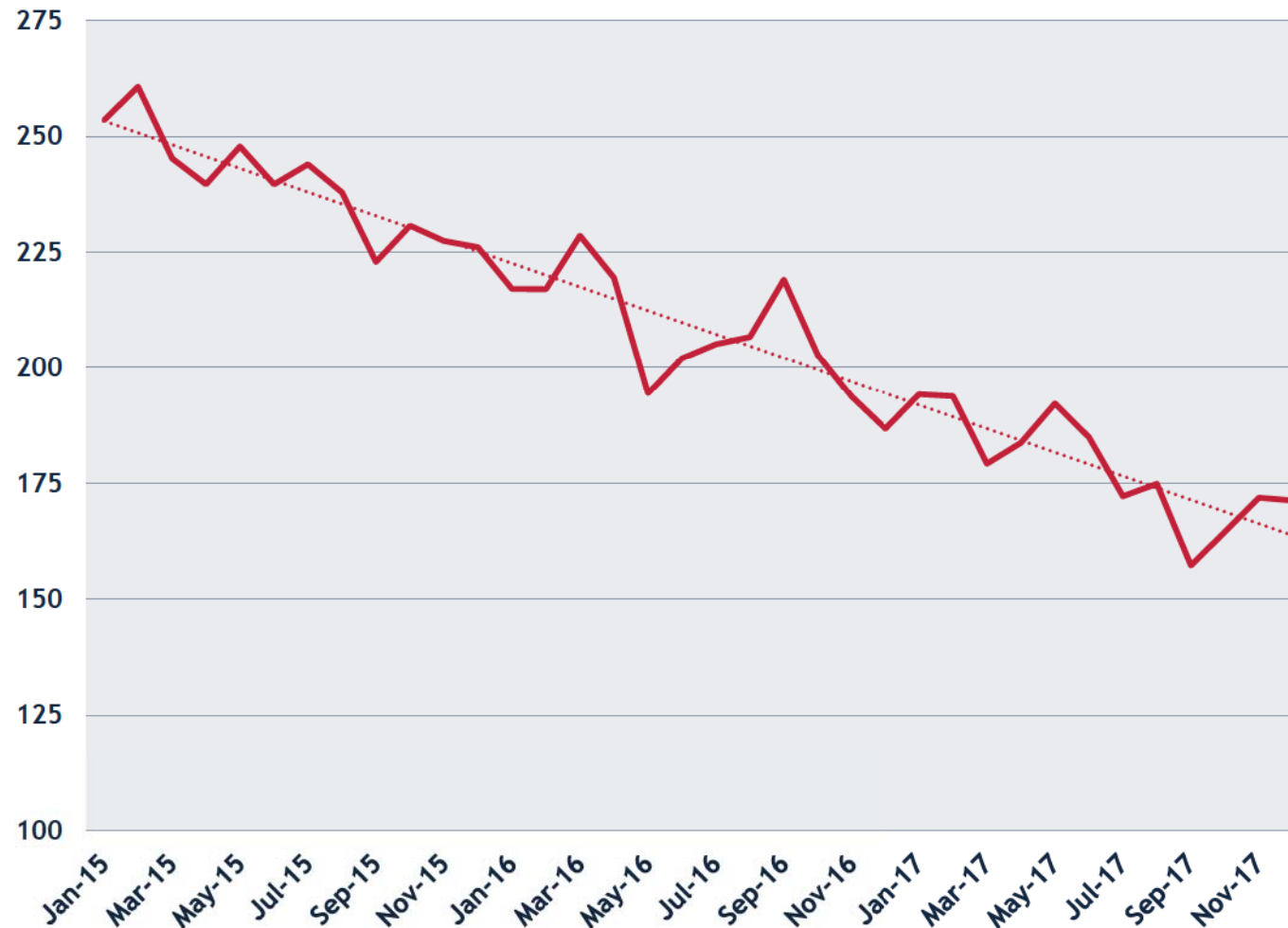


Source: Federal Reserve

- ECB and BOJ balance sheets still expanding
- Global QE to remain positive even as Fed begins QT

U.S. EMPLOYMENT GROWTH SLOWING

AVERAGE MONTHLY CHANGE IN EMPLOYMENT OVER THE PRIOR YEAR (000s)



Source: Bureau of Labor Statistics

- U.S. was adding 250,000 jobs per month at the beginning of 2015

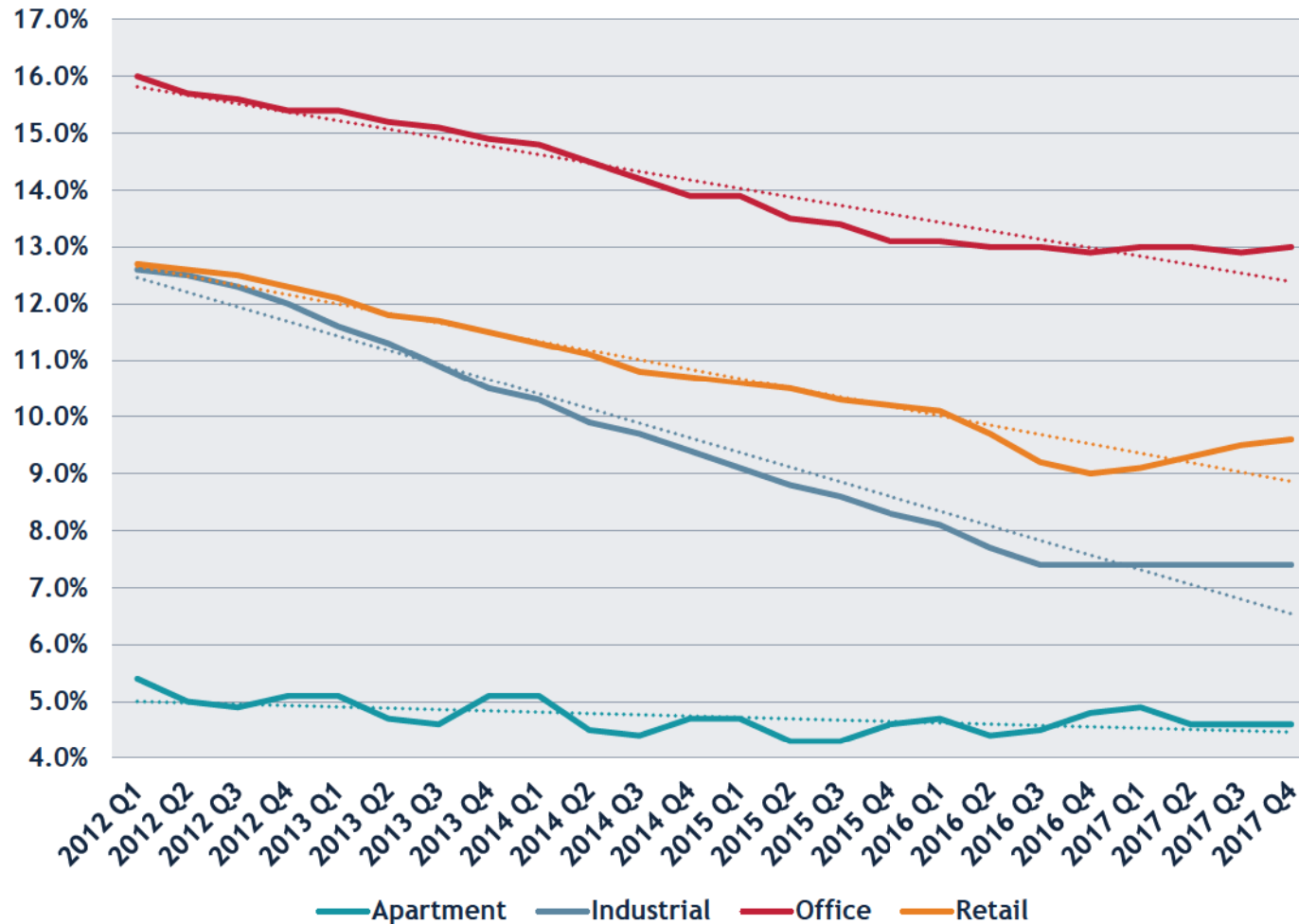
- Today, the U.S. is adding less than 180,000 jobs per month

- The slowdown is mostly due to lack of people to hire

- U.S. now has more than six million open positions

IMPROVEMENT IN PROPERTY MARKETS SLOWING

AVERAGE VACANCY RATE*



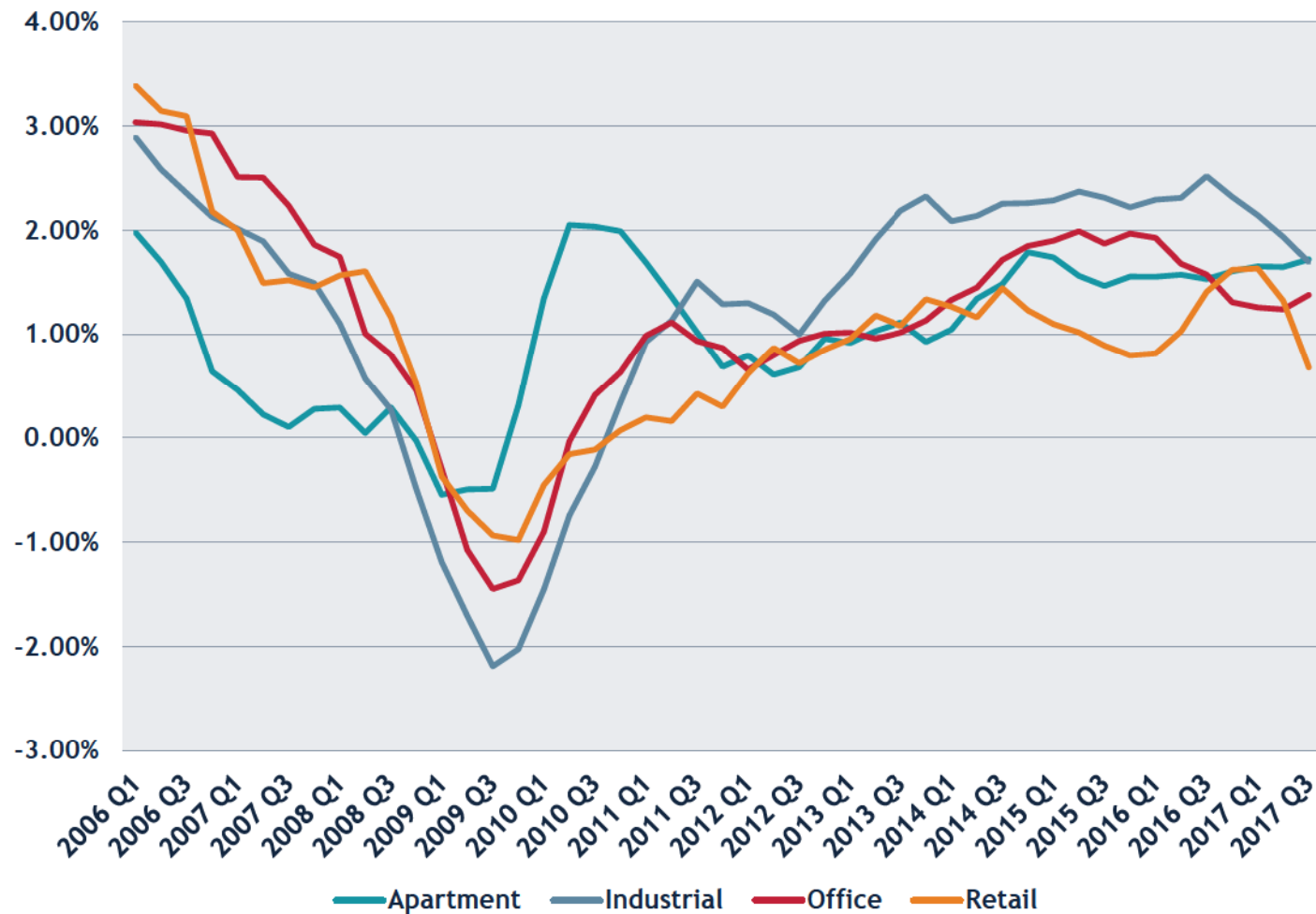
Source: CBRE-EA, 2017 Q4

* Industrial and retail reflect availability rates

- Steady demand is being matched by supply in all property types

DEMAND REMAINING CONSISTENTLY HEALTHY

ANNUAL NET ABSORPTION GROWTH (% CHG. IN OCCUPIED STOCK)

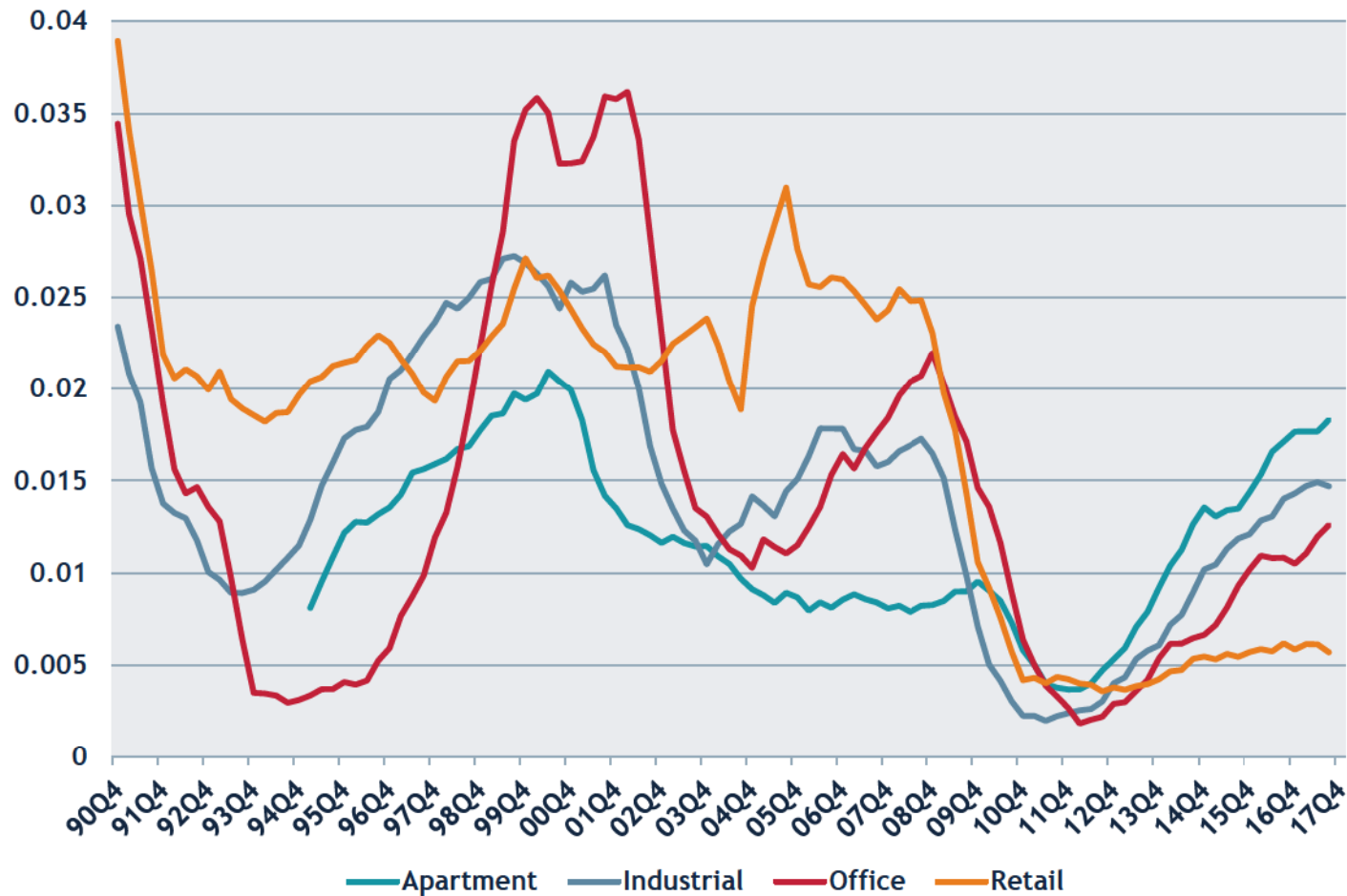


Source: CBRE-EA, 2017 Q3

- Slowing demand growth in industrial and retail

SUPPLY RISK REMAINS LOWER THAN PRIOR CYCLES

YEAR-OVER-YEAR GROWTH IN PROPERTY STOCK

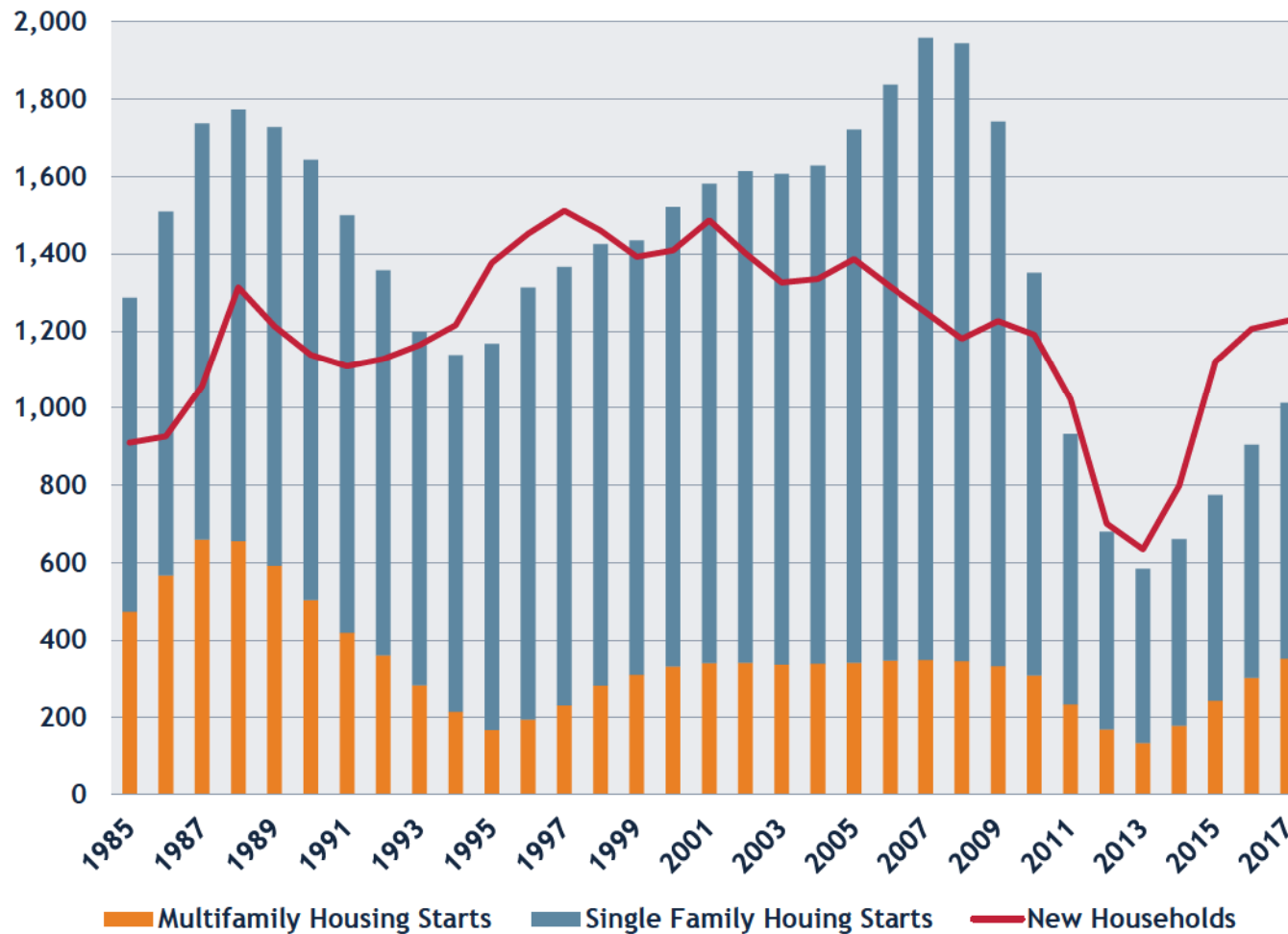


Source: CBRE-EA, 2017 Q3

- Supply risk is reduced through greater information transparency and lender regulation

U.S. NOT BUILDING ENOUGH HOUSING

HOUSING STARTS AND NEW HOUSEHOLDS (000s, THREE YEAR MOVING AVERAGE)



Source: Commerce Department

- U.S. built more houses than added households for many years prior to the financial crisis
- New households have outpaced new housing units for past seven years
- Housing affordability is becoming acute in numerous markets

VERY FEW MARKETS WITH SUPPLY RISK

TOP FIVE MARKETS WITH NEAR-TERM SUPPLY RISK BY PROPERTY TYPE

| Office | Share of Stock Currently Being Built | Current Vacancy Rate | Trailing Four Quarter Absorption |
|---------------|--------------------------------------|----------------------|----------------------------------|
| San Jose | 15.94% | 12.00% | 2.74% |
| San Francisco | 9.88% | 7.10% | 0.68% |
| Austin | 8.58% | 8.10% | 3.69% |
| Seattle | 7.24% | 7.80% | 5.08% |
| Dallas | 4.88% | 17.70% | 1.54% |
| U.S. | 2.80% | 12.90% | 1.38% |

| Industrial | Share of Stock Currently Being Built | Current Availability Rate | Trailing Four Quarter Absorption |
|----------------|--------------------------------------|---------------------------|----------------------------------|
| Trenton | 5.24% | 13.40% | -0.79% |
| Allentown | 4.98% | 6.90% | 5.64% |
| Riverside | 4.03% | 6.20% | 4.40% |
| Louisville | 3.55% | 8.40% | 2.06% |
| Salt Lake City | 3.19% | 5.40% | 2.98% |
| U.S. | 1.44% | 7.70% | 1.69% |

| Apartment | Share of Stock Currently Being Built | Current Vacancy Rate | Trailing Four Quarter Absorption |
|-------------|--------------------------------------|----------------------|----------------------------------|
| Nashville | 6.58% | 4.80% | 5.40% |
| Charlotte | 5.71% | 4.60% | 4.52% |
| Denver | 5.64% | 4.90% | 3.68% |
| Orlando | 5.25% | 4.00% | 3.13% |
| San Antonio | 5.10% | 6.90% | 3.22% |
| U.S. | 2.78% | 4.60% | 1.72% |

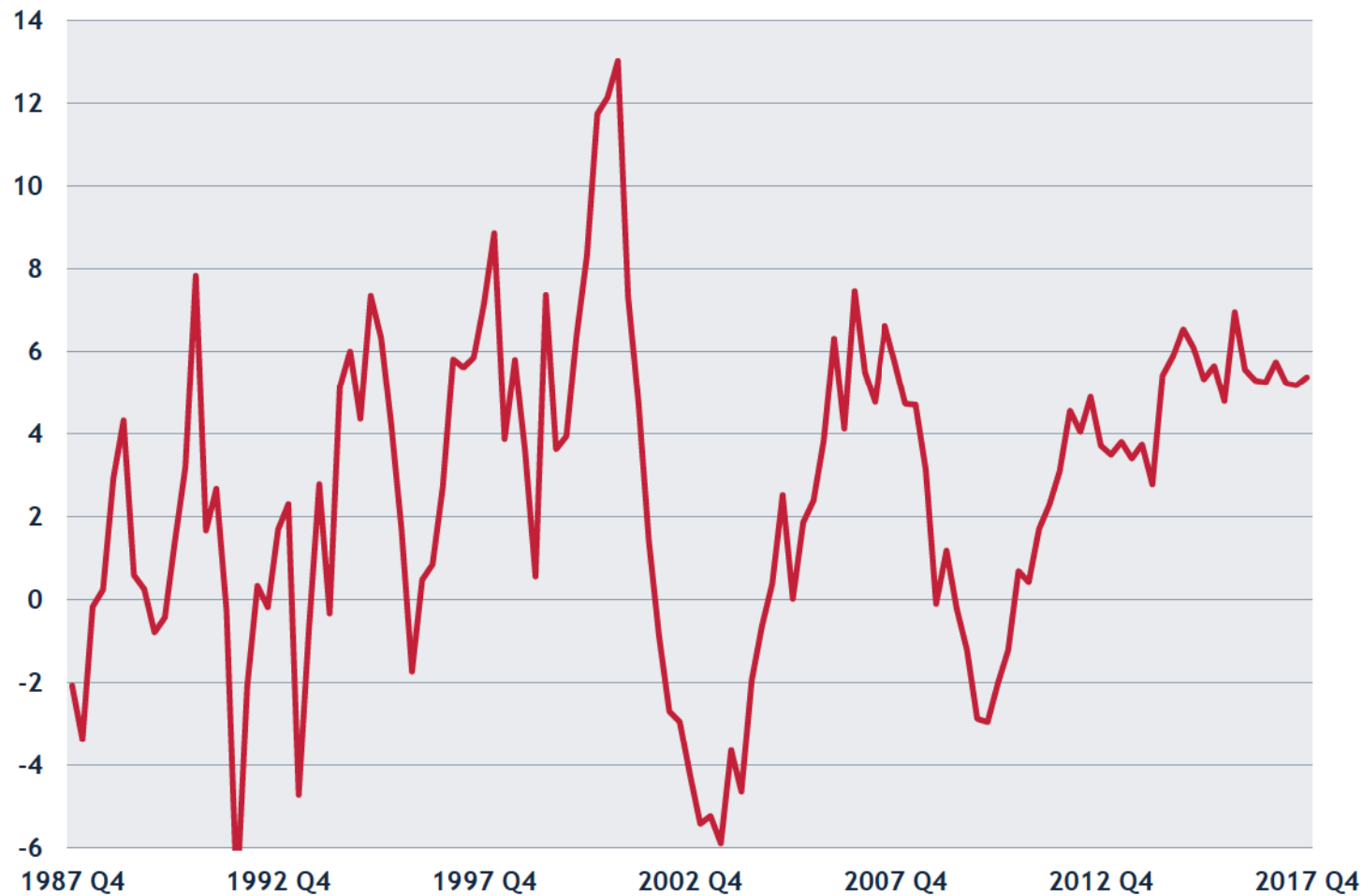
| Retail | Share of Stock Currently Being Built | Current Availability Rate | Trailing Four Quarter Absorption |
|-----------------|--------------------------------------|---------------------------|----------------------------------|
| New York | 1.64% | 10.30% | 0.14% |
| San Jose | 1.61% | 5.20% | 1.73% |
| Nashville | 1.51% | 7.60% | 0.79% |
| Miami | 1.36% | 5.60% | 0.53% |
| West Palm Beach | 1.09% | 9.40% | 1.07% |
| U.S. | 0.57% | 10.20% | 0.68% |

- Many fewer markets with glaring supply risk than in prior cycles

Source: CBRE-EA 2017 Q3

STRONGEST NOI GROWTH OF THE CYCLE IS NOW

NOI GROWTH OVER PRIOR FOUR QUARTERS (%)

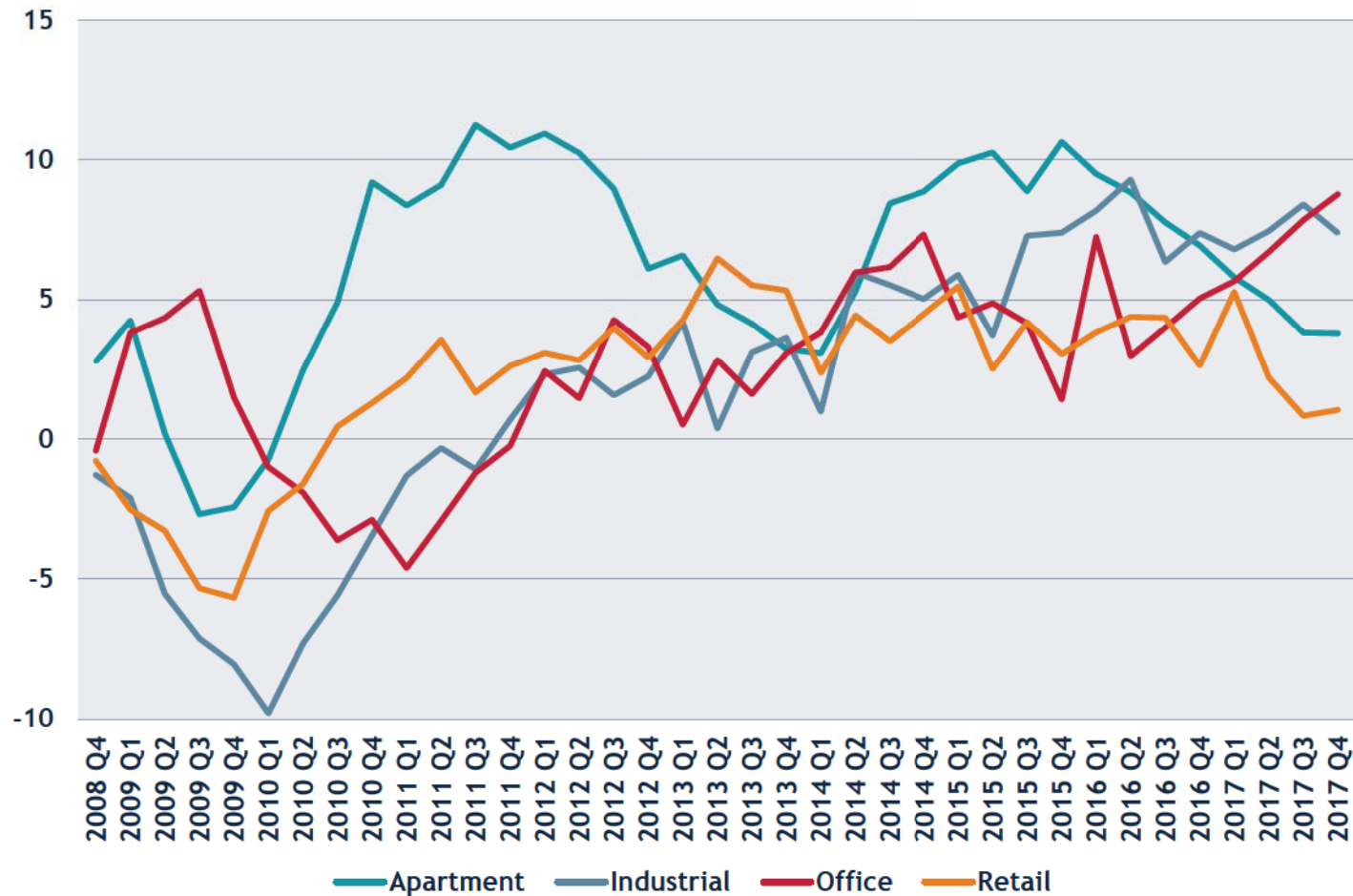


Source: NCREIF 2017 Q3

- Positive but slower NOI growth expected over the next two to three years

ALL PROPERTY TYPES DELIVERING POSITIVE NOI

AVERAGE NOI GROWTH OVER PRIOR FOUR QUARTERS (%)

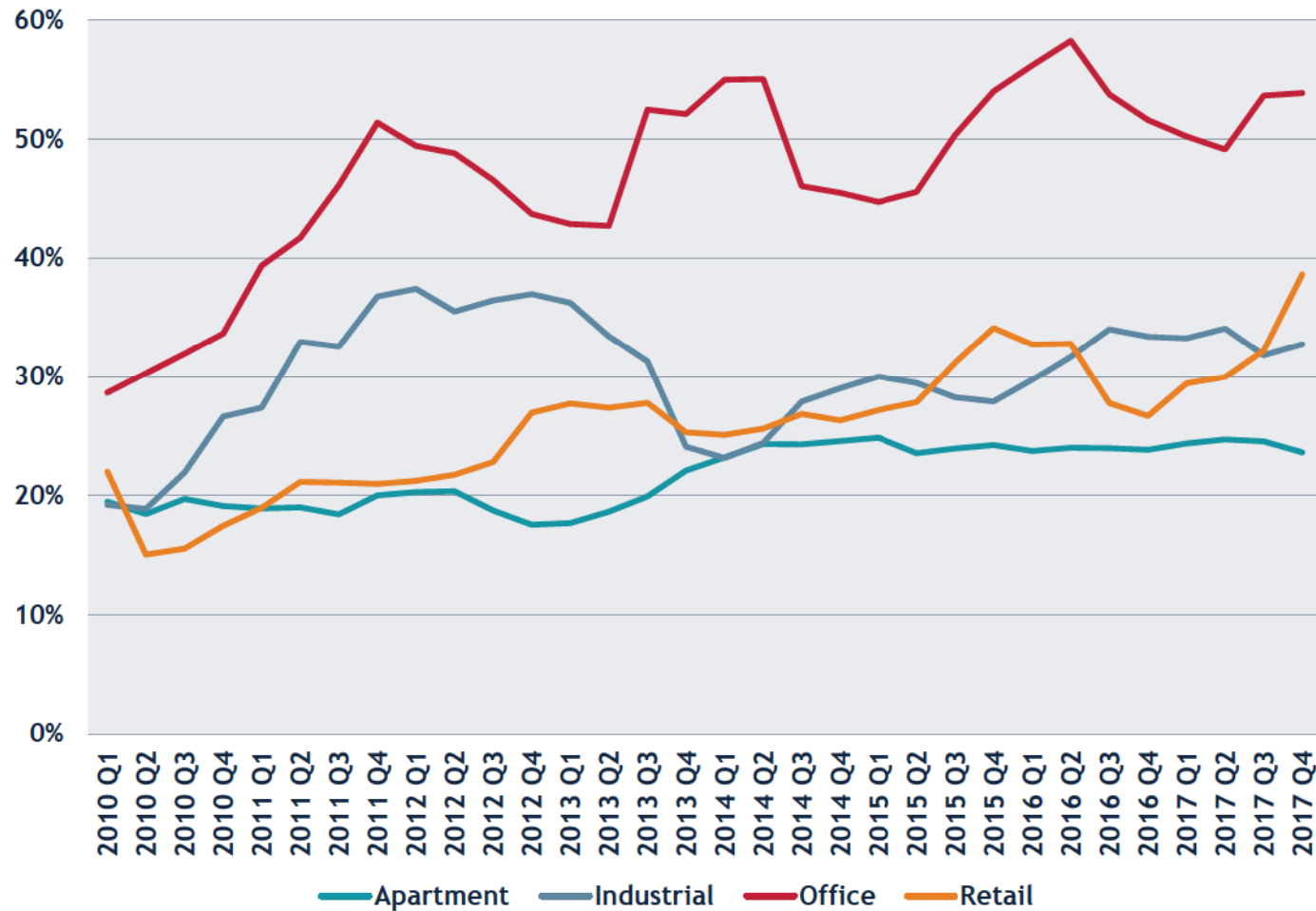


Source: NCREIG, 2017 Q4

- Industrial and office showing late cycle strength
- Apartment and retail slowing quickly
- It is difficult to see NOI growth accelerating materially from current levels

NOI GROWTH IS IMPORTANT BUT PAY ATTENTION TO LATE CYCLE CAP EX

CAP EX AS A SHARE OF NOI (%)

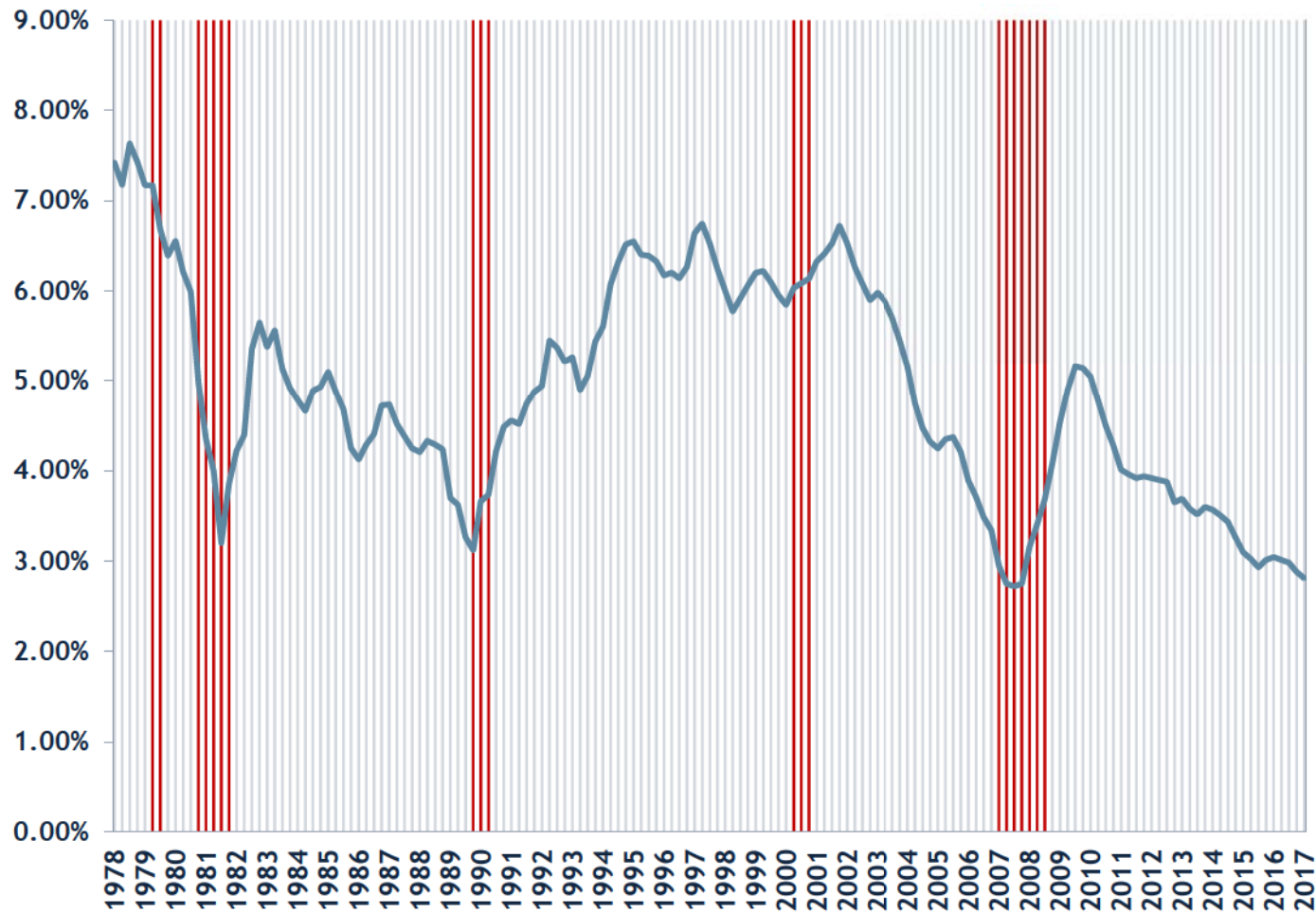


Source: NCREIF 2017 Q4

- More than half of office NOI going to cap-ex

PROPERTY CASH YIELDS AT ALL-TIME LOWS

NCREIF PROPERTY INDEX CASH YIELD

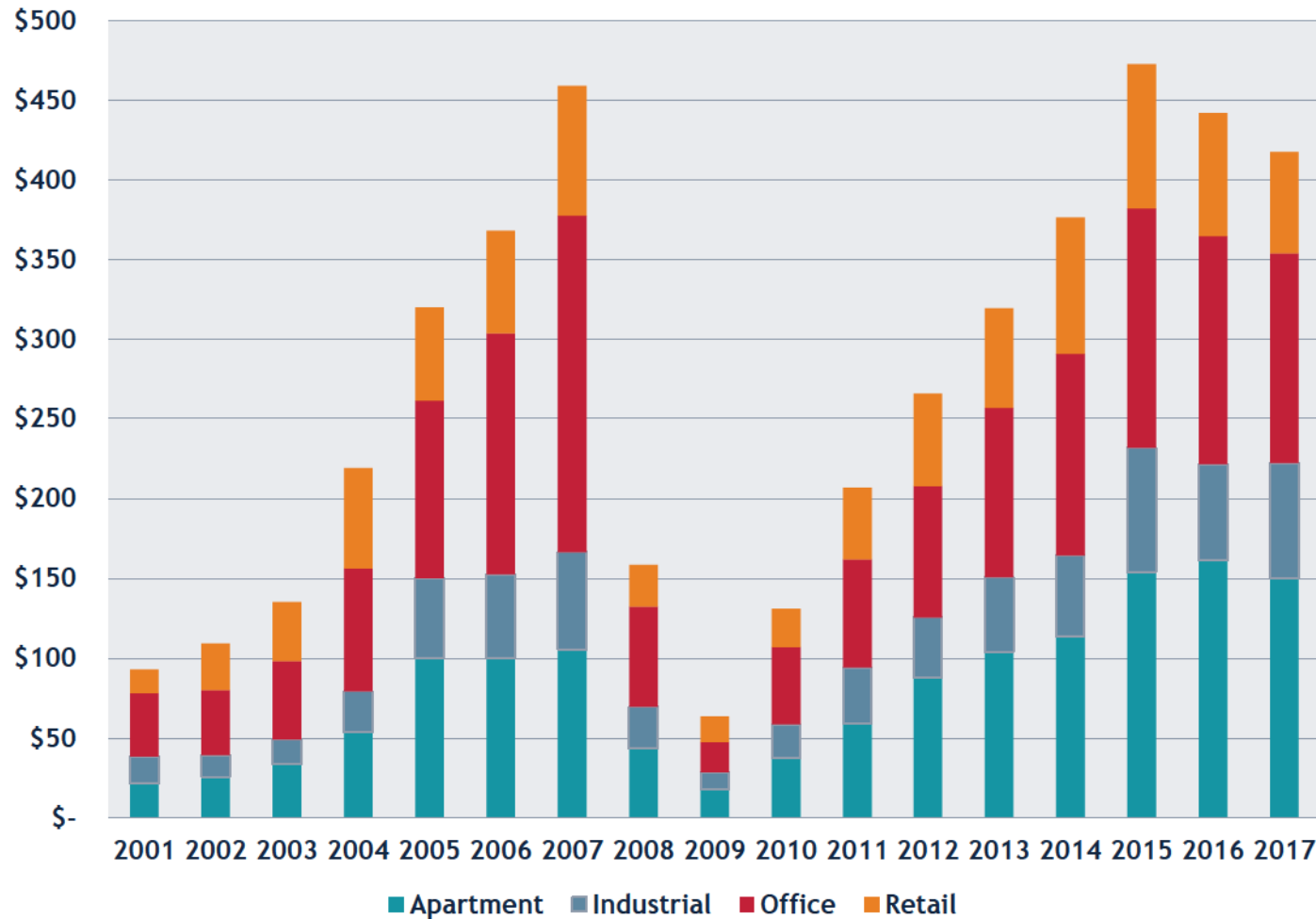


Source: NCREIF 2017 Q4

- Property cash yields near all-time lows
- Cash yields have only been this low when coming out of a recession

TRANSACTION VOLUME SLOWER BUT STILL PLENTY OF LIQUIDITY

ANNUAL TRANSACTION VOLUME (\$BILLIONS)

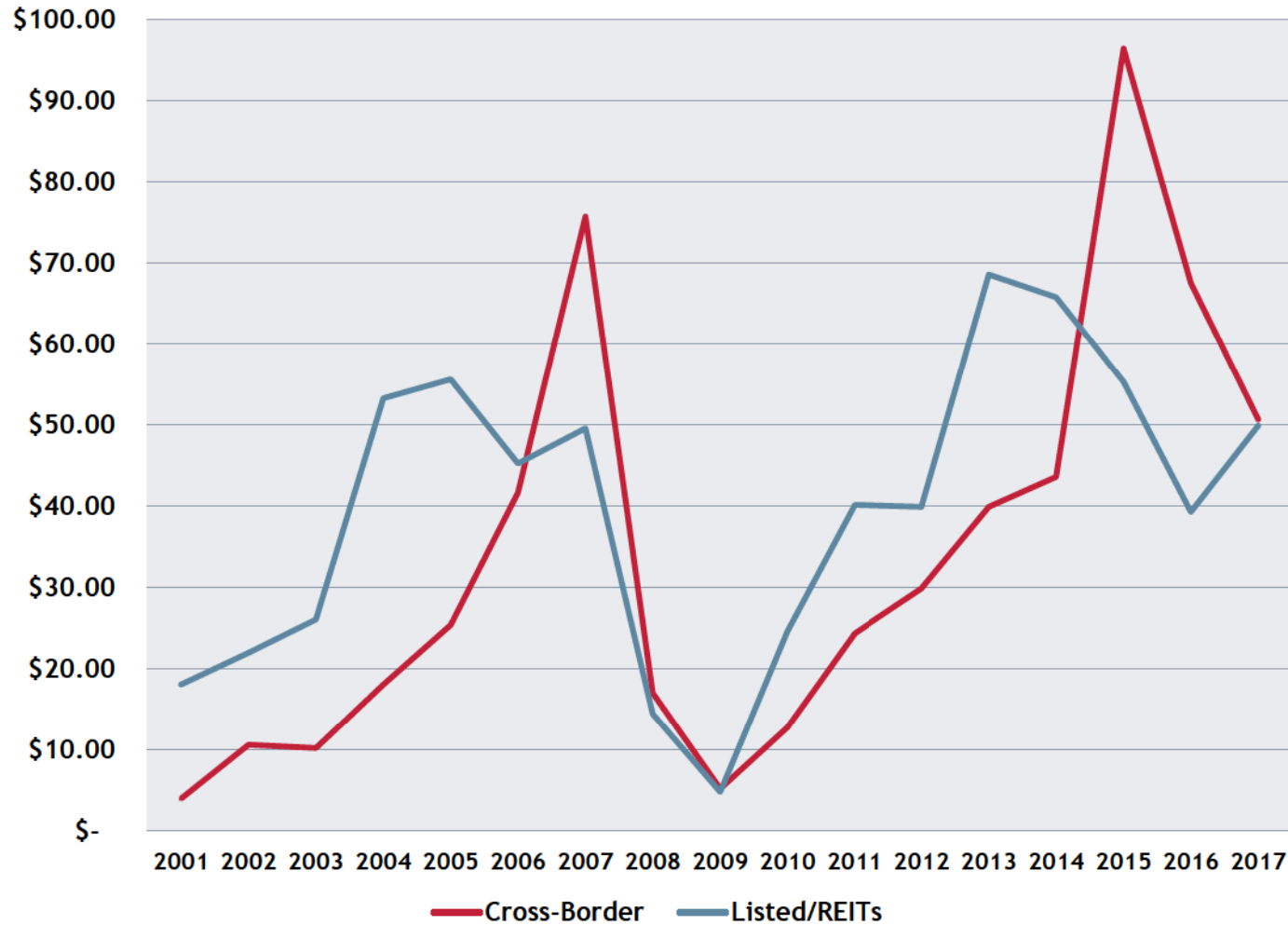


Source: RCA 2017 Q3

- Transaction volume has taken a step back from peak levels but the markets remain highly liquid

FOREIGN BUYERS SLOWING AS LISTED BUYERS PICK UP

TRANSACTION VOLUME (\$BILLIONS, FOUR QUARTER SUM)

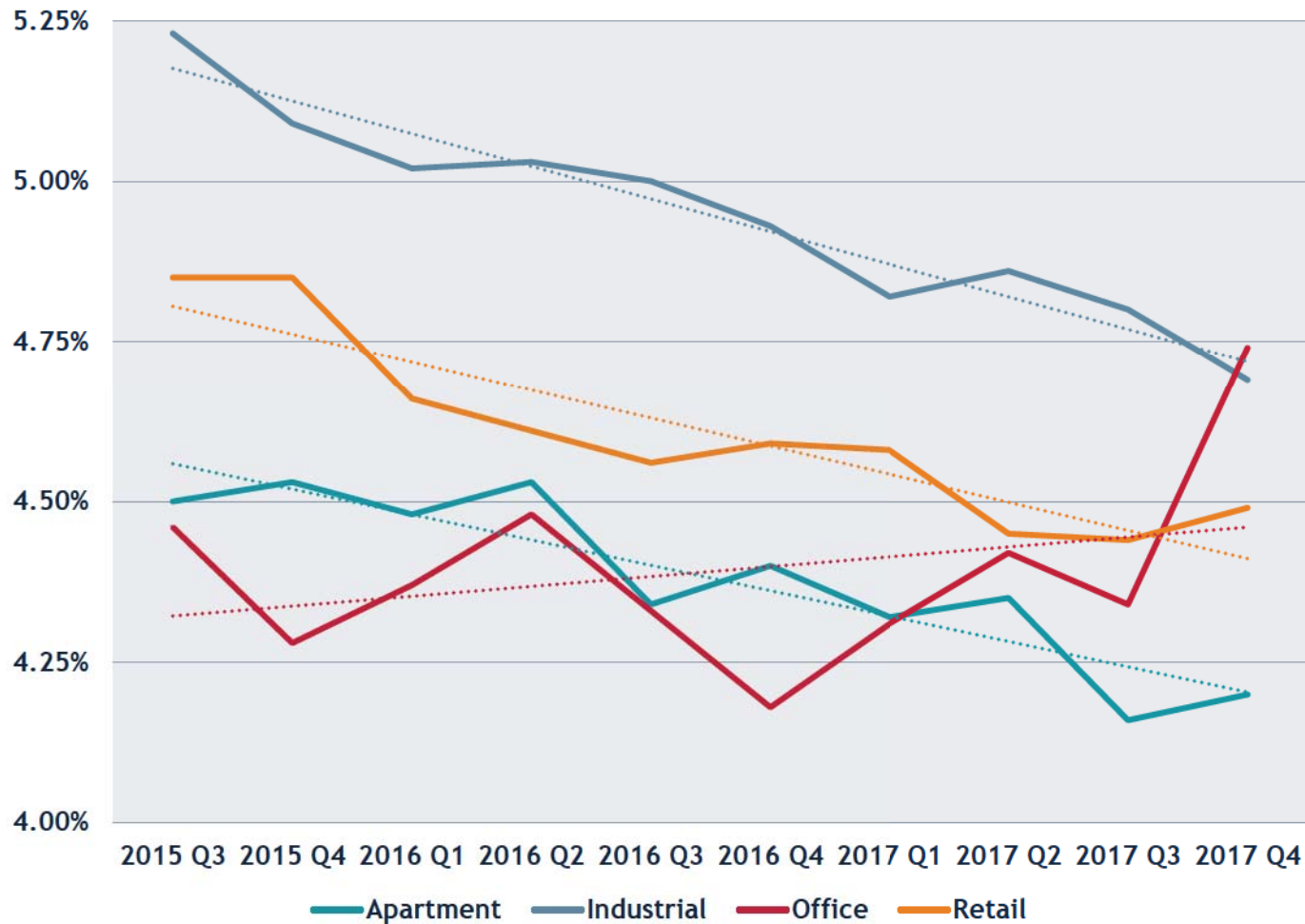


Source: RCA 2017 Q4

- Foreign buyers and REITs taking turns as marginal buyer of U.S. property
- Recent increase in REIT acquisitions has been mainly from M&A

HOW MUCH LOWER CAN WE GO?

AVERAGE CARRYING VALUE CAP RATE

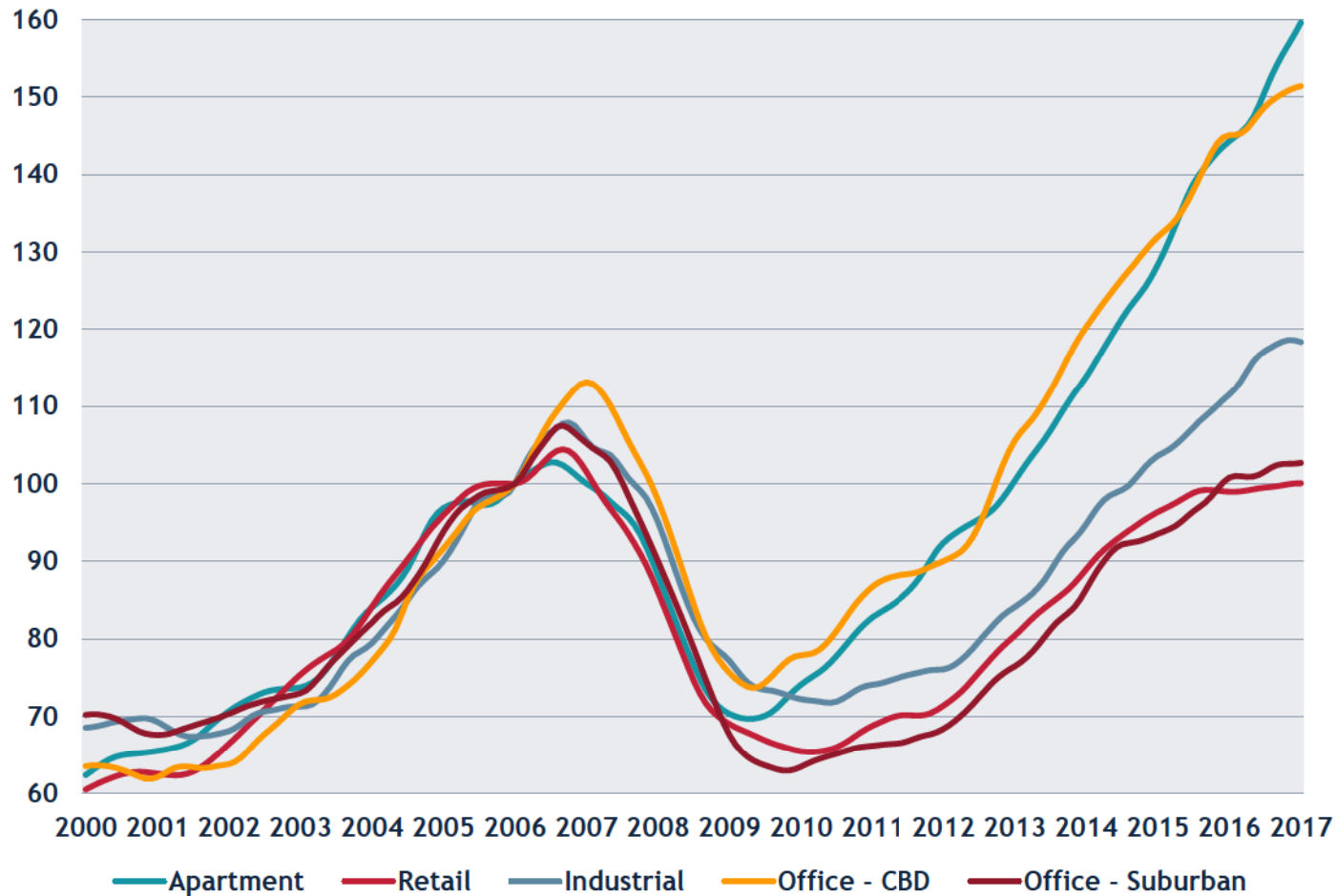


Source: NCREIF 2017 Q4

- Average office yield increased 30 basis points during Q4
- Trend is still down for other property types but slowing

SOME REAL ESTATE PRICES AT NEW PEAKS (SOME NOT)

COMMERCIAL PROPERTY PRICE INDICES (DECEMBER 2006 = 100)

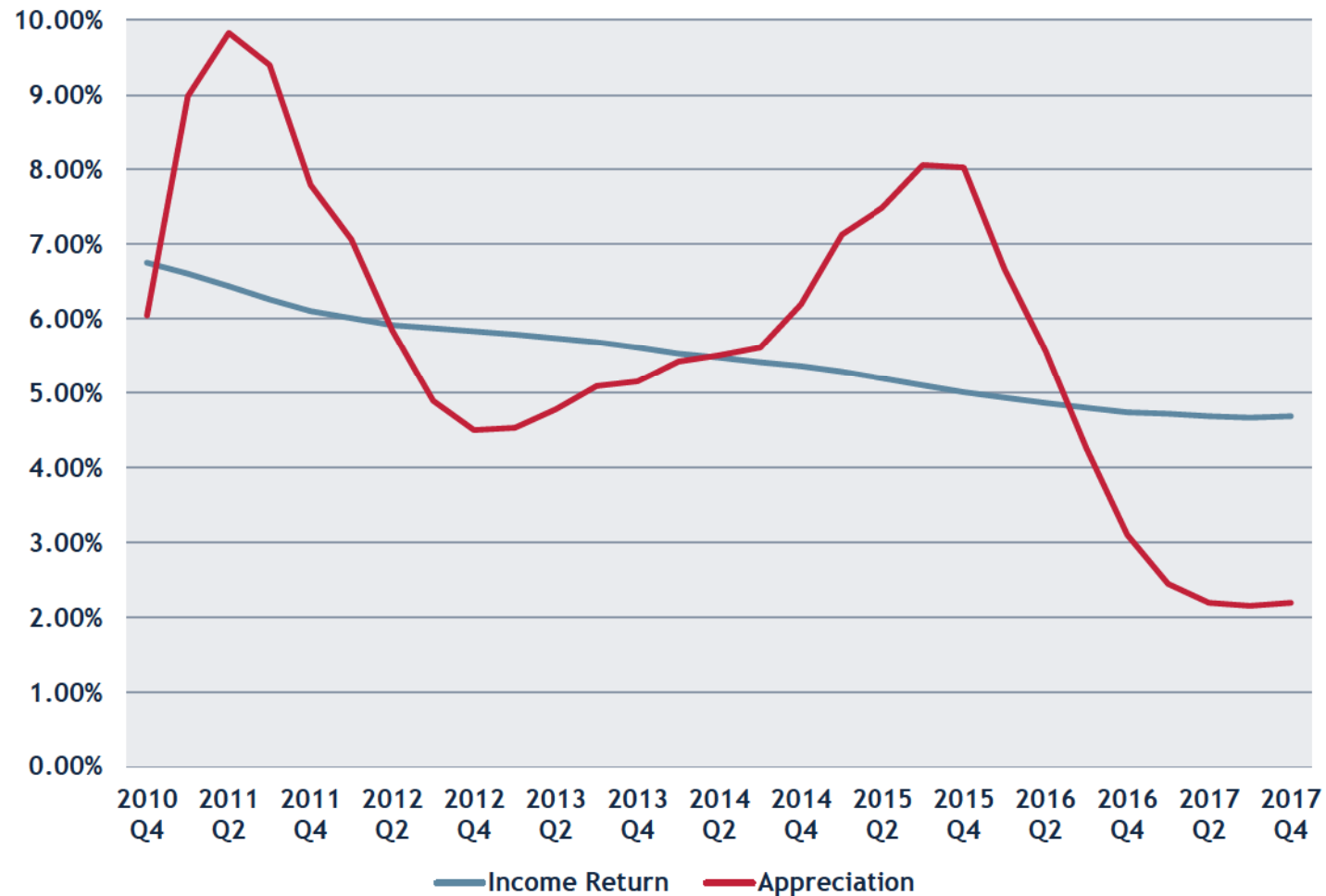


Source: RCA, Moody's CPPI Index

- Large differences in value recovery by property type
- Even large differences between Top 6 markets and smaller markets

SLOWING APPRECIATION

NCREIF PROPERTY INDEX INCOME AND APPRECIATION RETURN

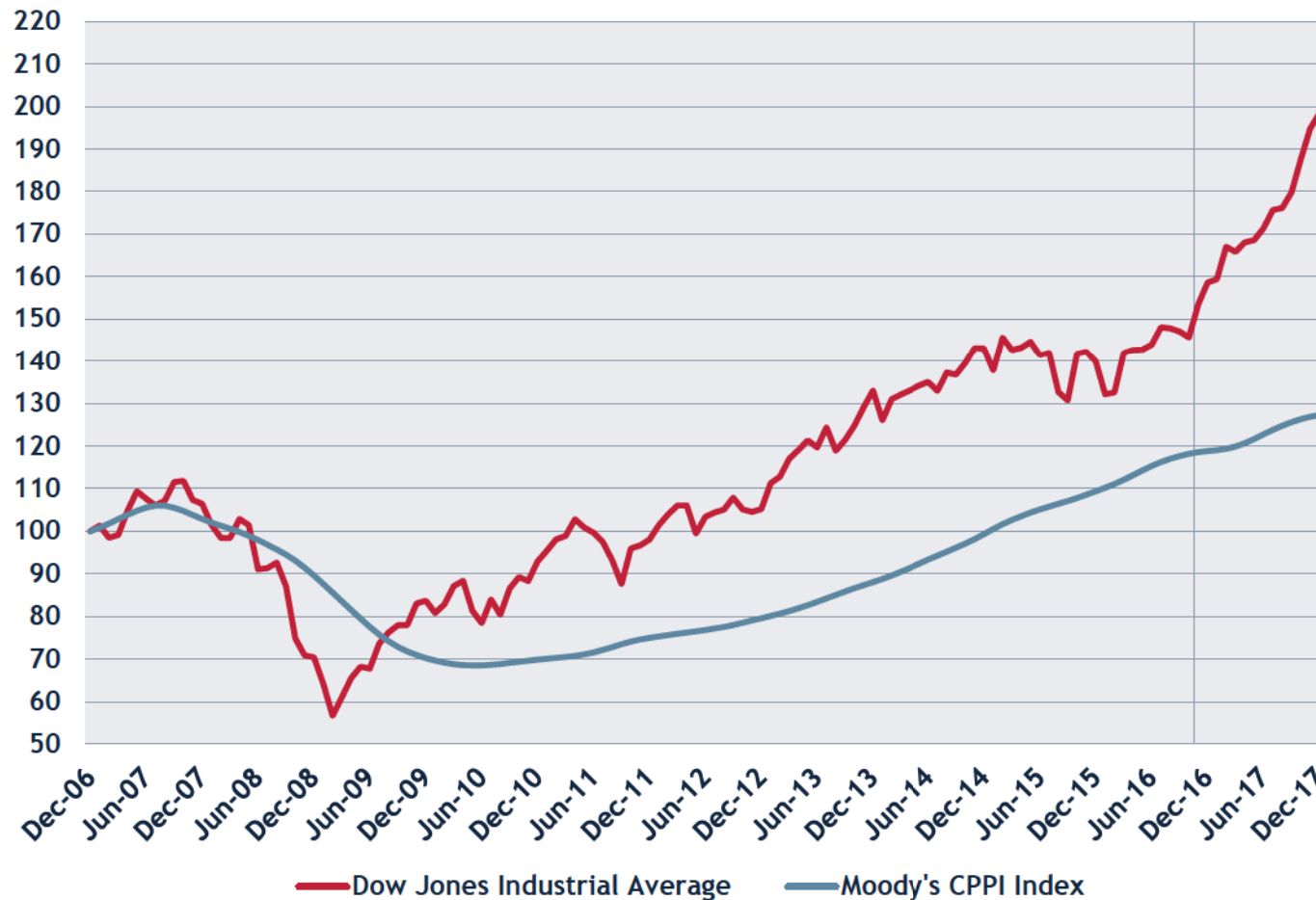


Source: Moody's Analytics

- PREA consensus survey calls for 5.5% total return over next five years
- Most of expected return will be income, not appreciation

WHICH MARKET ARE YOU MORE WORRIED ABOUT?

MOODY'S CPPI AND THE DOW JONES INDUSTRIAL AVERAGE
(DEC. 2006 = 100)

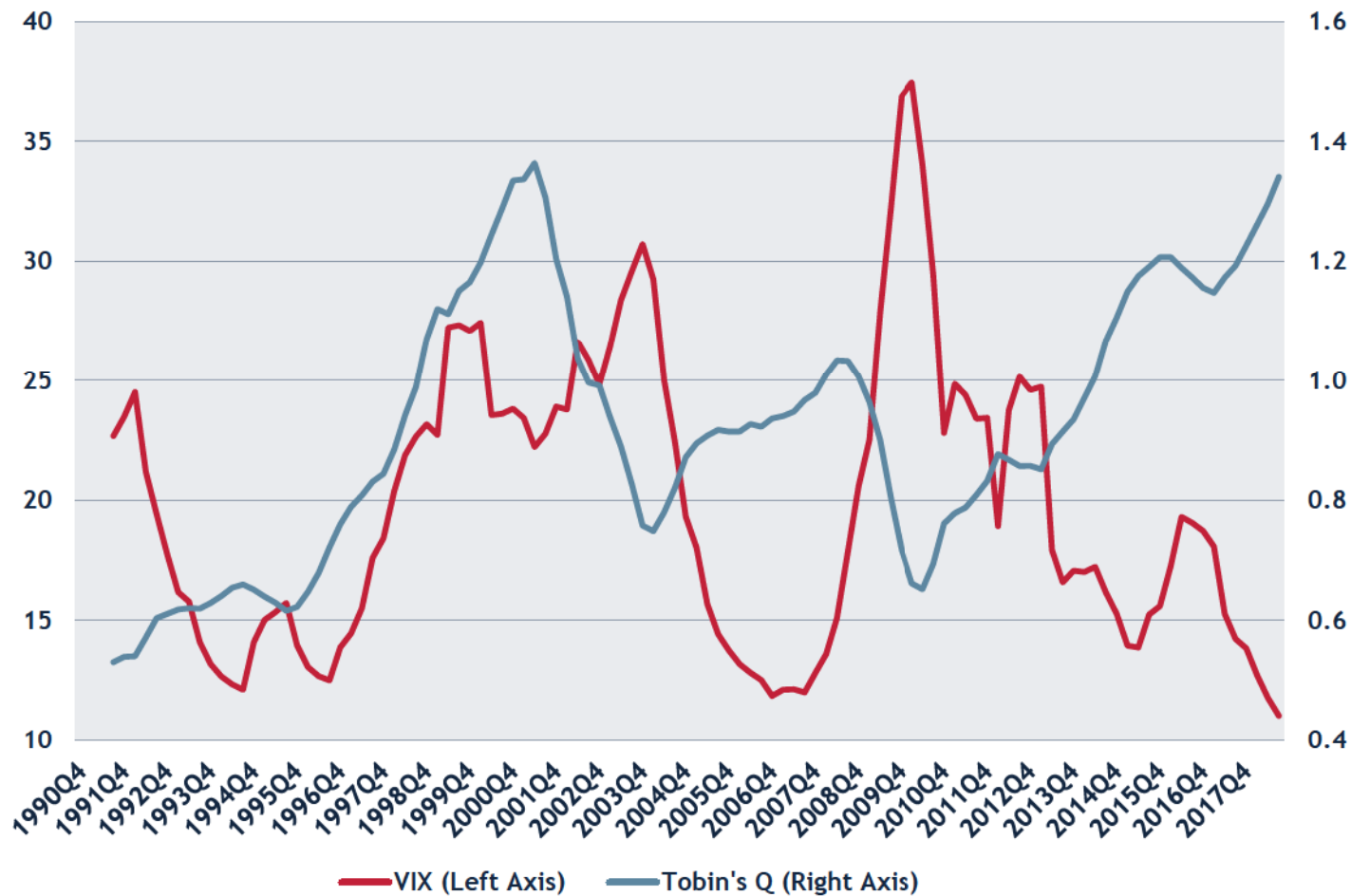


Source: Moody's Analytics

- Stock market is up nearly 50% since the election
- Average property price is up less than 8% over same period

WHICH MARKET ARE YOU MORE WORRIED ABOUT?

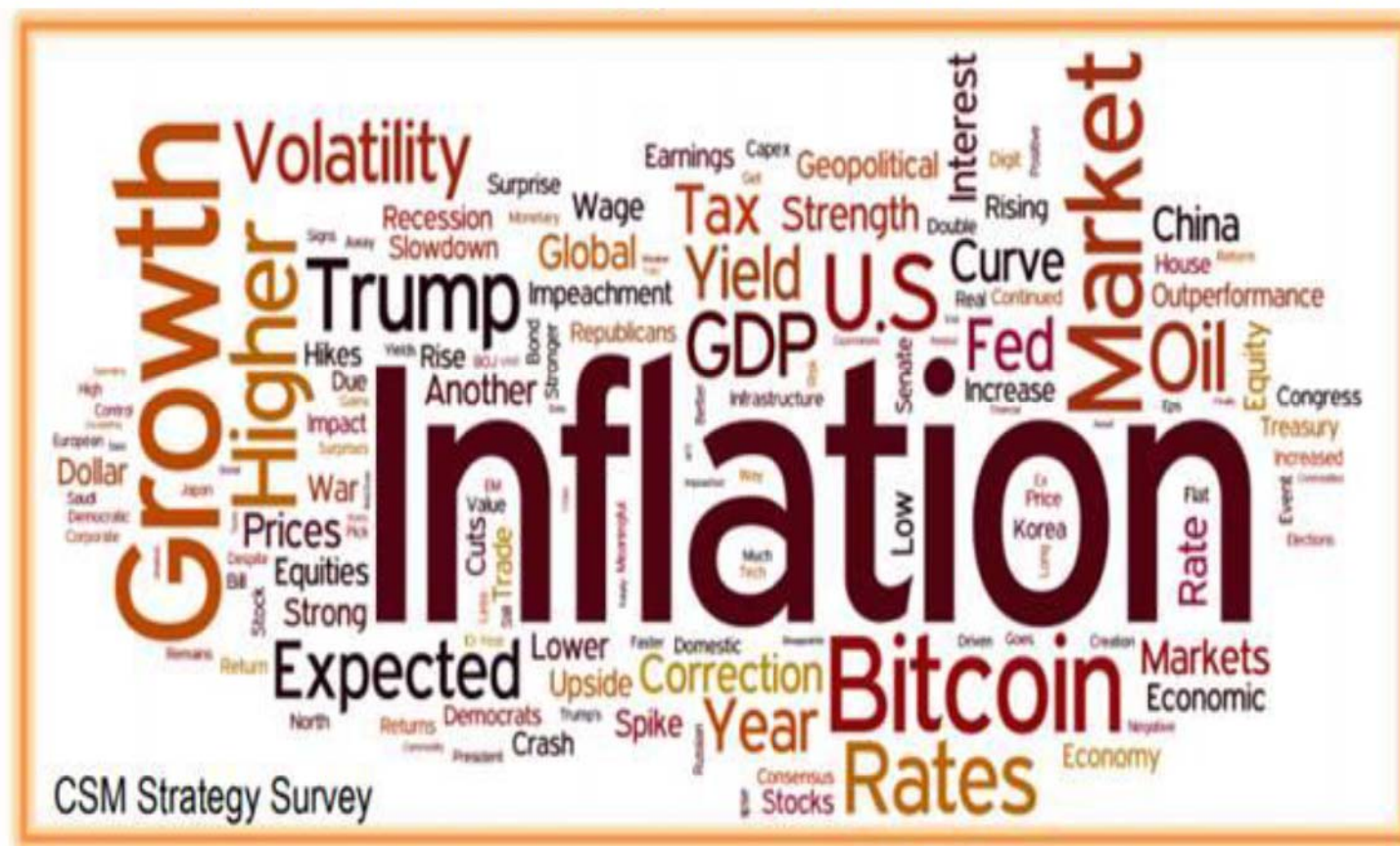
VOLATILITY (VIX) AND EQUITY MARKET CAP RELATIVE TO GDP (TOBIN'S Q)



Source: Moody's Analytics

- Volatility (and fear) at all time low
- Value of stock market relative to GDP at all time high

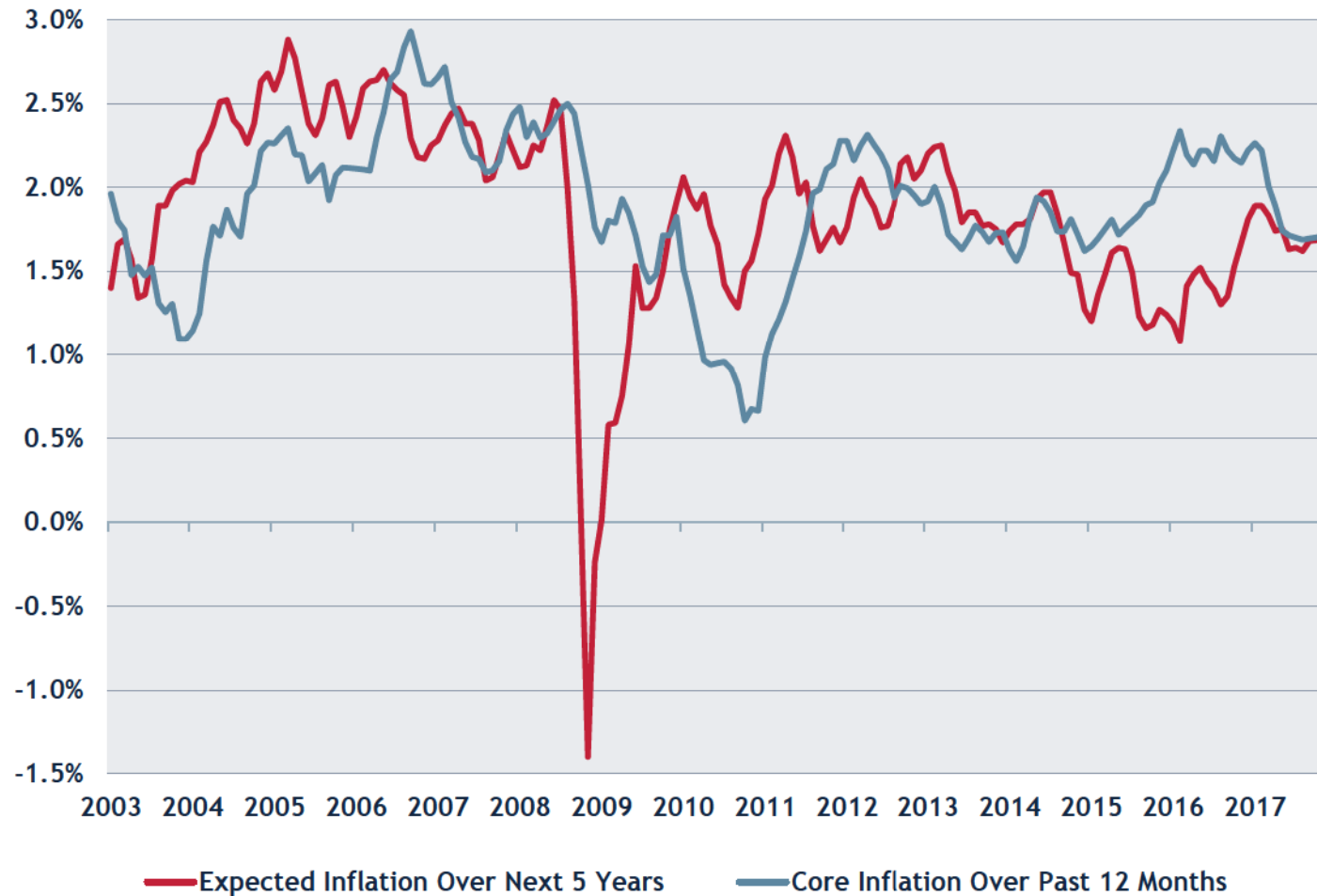
WHAT WILL BE THE BIGGEST SURPRISE TO FINANCIAL MARKETS IN 2018?



Source: Cornerstone Macro

THE MARKET DOES NOT SEE INFLATION (YET)

EXPECTED AND TRAILING INFLATION

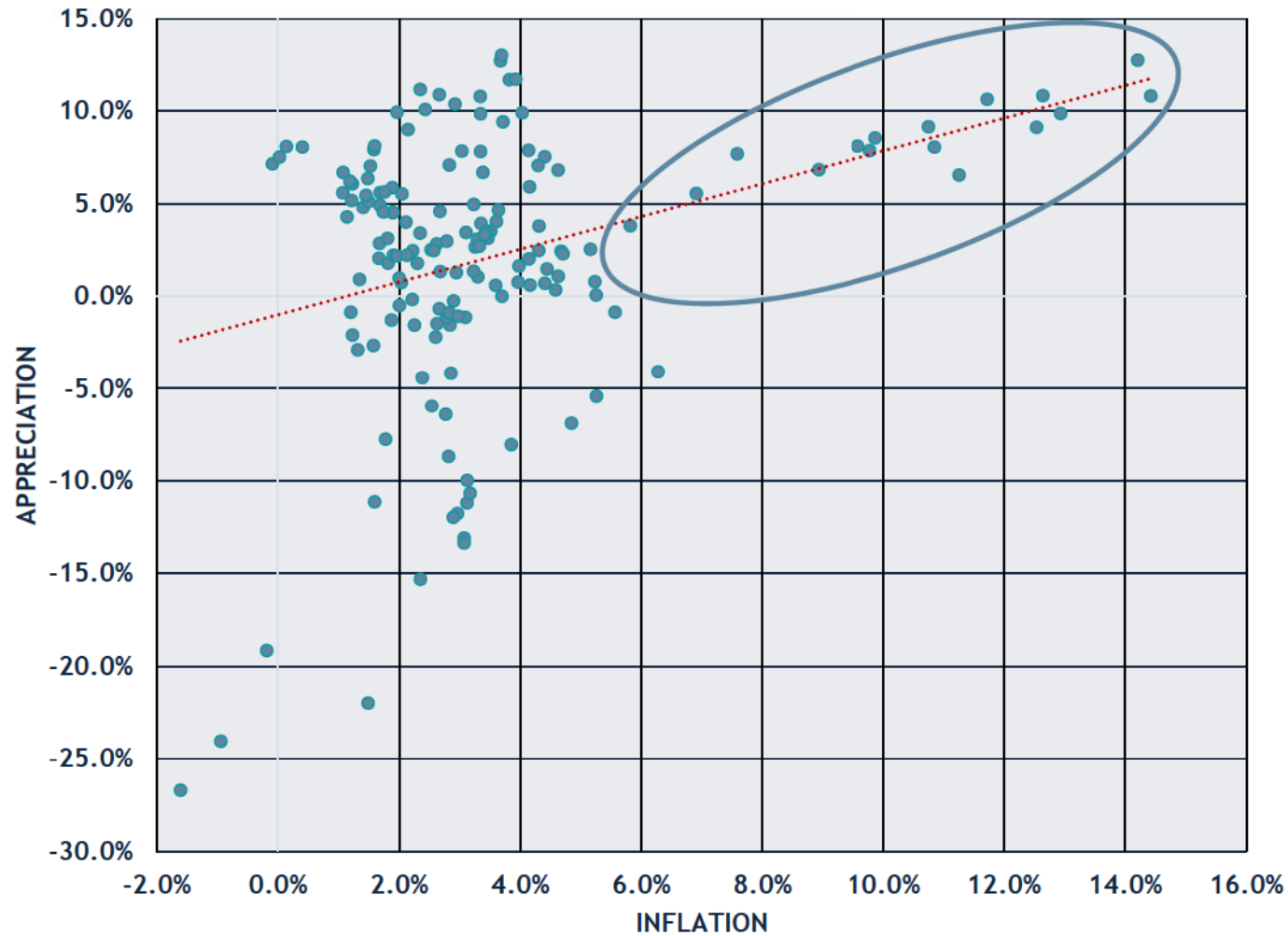


Both expected inflation and trailing core inflation are now roughly 1.7%

Source: NCREIF, Bureau of Labor Statistics

IS REAL ESTATE AN INFLATION HEDGE?

YEAR-OVER-YEAR PROPERTY APPRECIATION AND INFLATION, 1978 Q4 - 2017 Q4

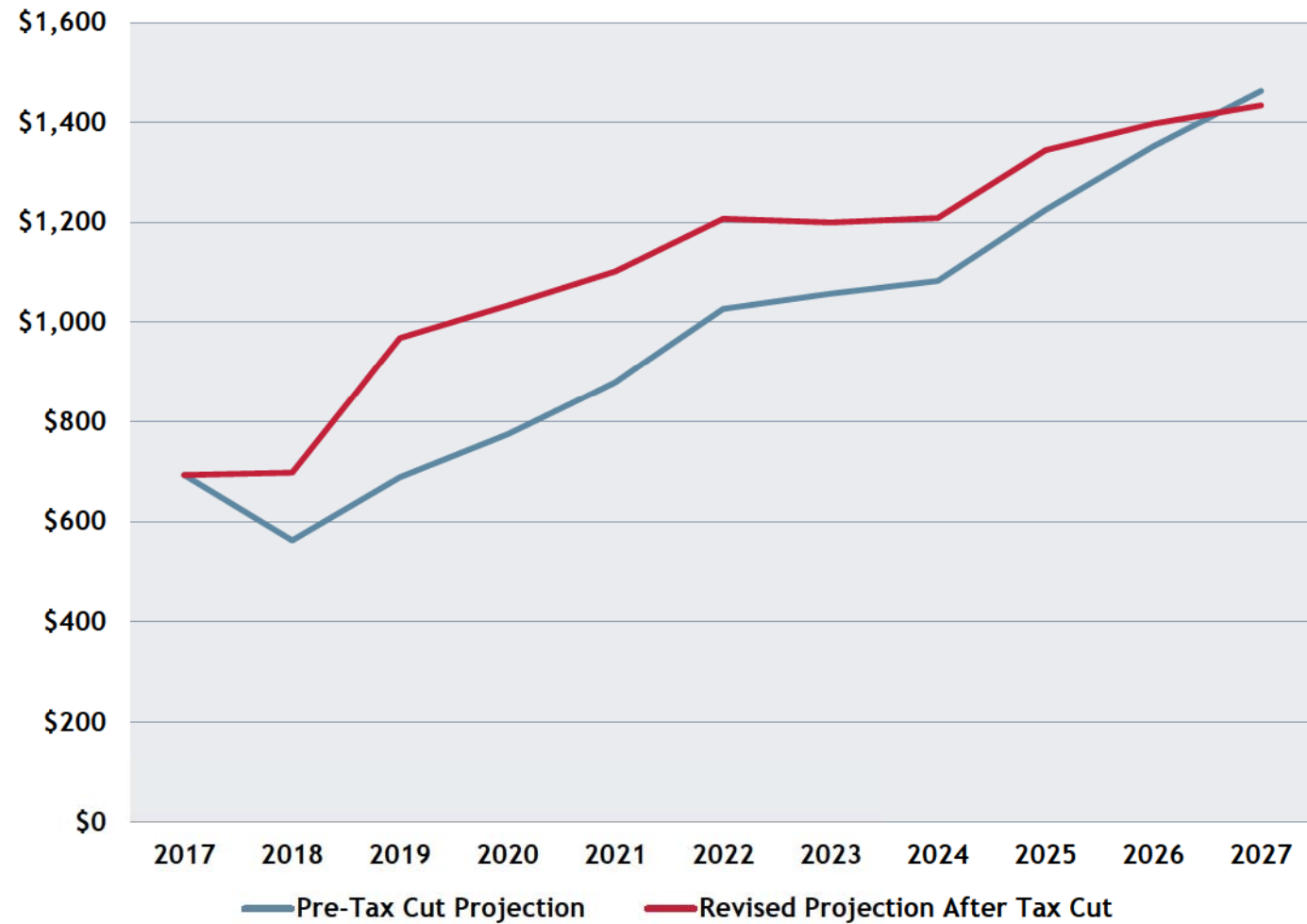


Source: NCREIF, Bureau of Labor Statistics

Real estate values move closely with inflation when inflation is extreme

ONE FINAL THOUGHT- WE MIGHT REALLY NEED SOME INFLATION

PROJECTED ANNUAL DEFICIT (BILLIONS)



Source: Congressional Budget Office

Total U.S. debt was projected to increase by \$10 trillion over the next decade before the tax cut

Tax cut will add an additional \$1.5 trillion

CONCLUSIONS

- U.S. economic growth constrained in the near-term by labor force and productivity
- Tax cut likely to boost consumption and business investment
- Commercial property fundamentals still healthy, but peaking for this cycle
- Long-term property performance should be somewhere between stocks and bonds
- If growth accelerates, property likely performs above bonds, but below stocks
- If growth stalls, property likely performs better than stocks, but trails bonds
- Unclear what happens when we stimulate an economy already at full employment

QUESTIONS?

Please feel free to contact Mike regarding any of the information contained herein

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