

U.S. COMMERCIAL REAL ESTATE MARKETS OFFER SOLID RETURNS IN GLOBAL LOW-YIELD ENVIRONMENT

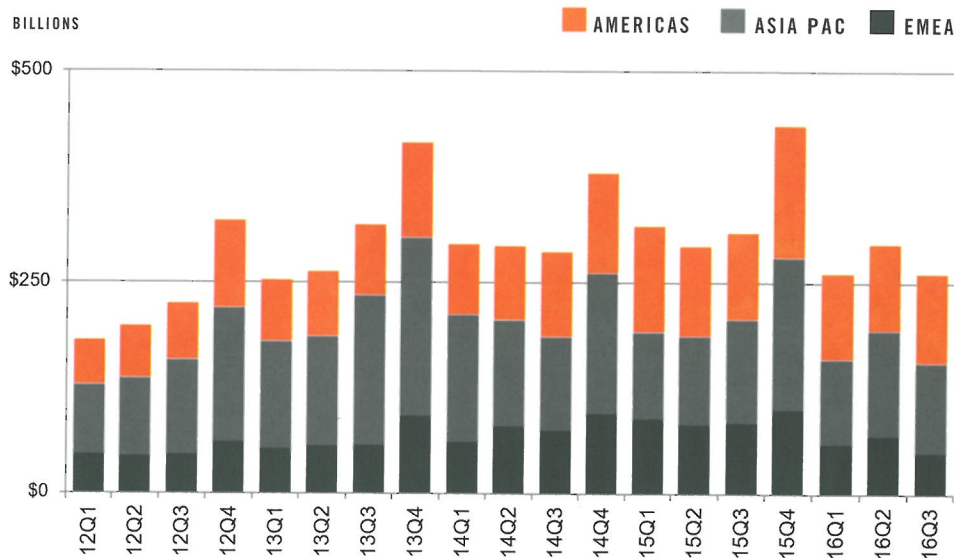
By George Ratiu, Director of Quantitative & Commercial Research, NAR

The first nine months of 2016 witnessed broad softening in global economic conditions. The annual rate of gross domestic product (GDP) for most developed economies was well below 2.0 percent. In response, central banks continued policies of monetary easing, some pushing short-term interest rates into negative territory. Even the United States (U.S.) Federal Reserve Bank moderated its outlook and held steady on its funds target rate.

Amid the global low-yield environment, commercial real estate moderated. Global investment sales for the first three quarters of 2016 totaled \$549.4 billion, according to Real Capital Analytics (RCA). The figure marked a 17.7 percent decline on a yearly basis. Mirroring weak economic trends, commercial real estate investments dropped 30.5 percent in the Europe, Middle-East and Africa region (EMEA), as the United Kingdom and Germany, Europe's two largest markets experienced declines. The Asia Pacific region posted an investment decline of 20.2 percent in the first nine months of 2016. The Americas notched a 7.0 percent yearly decline in investment sales.

FIGURE 1

GLOBAL COMMERCIAL REAL ESTATE INVESTMENT VOLUME



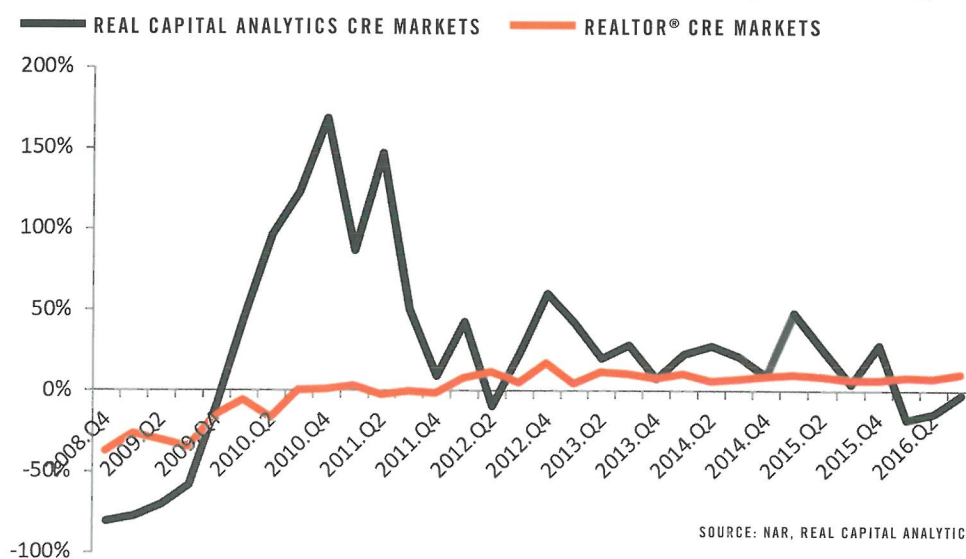
SOURCE: REAL CAPITAL ANALYTICS

While the broad figures denote a downward trend in investment volume, the U.S. commercial real estate landscape proved noticeably more nuanced, with diverging large cap and small cap markets. U.S. investment volume in large cap markets totaled \$343.1 billion in the first three quarters of 2016, a 9.1 percent year-over-year decline, based on data from RCA. Meanwhile, sales in U.S. small cap markets moved in the opposite direction, experiencing acceleration in the pace of investments. Based on data from Boxwood

Means, small cap sales volume totaled \$46.1 billion in the first six months, a 1.6 percent increase compared with the first six months of 2015. Additionally, based on market information from the National Association of REALTORS® (NAR), sales volume rose 8.5 percent in the first quarter and 8.4 percent in the second quarter of 2016, respectively. Third quarter NAR data indicated accelerating sales pace, with an 11.0 percent gain in volume.

FIGURE 2

U.S. COMMERCIAL REAL ESTATE SALES VOLUME (YoY % CHG)



Cross-border investment proved to be a significant driver of U.S. transaction activity. The U.S. continued to be the top destination country for international investors. Chinese investors acquired \$4.3 billion worth of commercial real estate properties in the first half of 2016, a 17.0 percent year-over-year increase, according to RCA. Canada, Germany and Singapore continued to be top investors in U.S. markets, even as yearly volumes declined. However, Qatar and Saudi Arabia provided renewed interest in U.S. assets, with transactions totaling \$1.8 billion each, a 204 percent and 5,314 percent increase, respectively. Amid a global low-yield environment marred by geopolitical risks, U.S. markets—especially in secondary and small cap markets—offered investors solid returns and safety of capital. Capitalization rates in large cap commercial real estate markets averaged 6.8 percent by the end of September 2016, based on RCA data, while yields in small cap markets averaged 7.0 percent, according to NAR. Of the top 30 most active global markets, 17 were U.S. metropolitan areas. While New York, Los Angeles and San Francisco continued in the top-five bracket, U.S. secondary markets proved to be

shining stars, as global investors broadened their search for performing assets offering higher yields. Some of the best performers—based on investment gains—were Las Vegas (up 101%), Denver (up 51%), Philadelphia (up 28%), and Miami/South Florida (up 10%). Several other markets also posted gains in sales volume, rising up the ranks of top markets—Phoenix, Austin, Ft. Lauderdale and Tampa.

With spreads between cap rates and 10-year Treasury notes running in a 450-500 basis point range, commercial real estate assets are expected to continue as an attractive investment vehicle for investors. An additional benefit for U.S. markets is the recent creation of an 11th Real Estate Sector in the Global Industry and Classification Standard (GICS), which includes equity real estate investment trusts (REITs) and other publicly-traded real estate companies. Given the exposure which REITs offer foreign investors to U.S. markets, the change is expected to draw additional global investments, especially from pension funds, sovereign wealth funds, and other institutional and equity investors.