UNITED STATES

Perspective

MID-YEAR 2018

ECONOMY

Geopolitics and trade disputes create uncertainty, but the U.S. expansion is persisting. Steady hiring has led unemployment below 4%.

CAPITAL MARKETS

Investor demand for commercial real estate remains high, even as return expectations moderate. Industrial is the clear outperformer.

PROPERTY MARKETS

Rent growth is slowing as supply is meeting demand in most markets. Vacancy rates generally remain low versus historical levels.

Bentall Kennedy

Contents

Property Type Metrics

VACANCY / AVAILABILITY

ABSORPTION

NEW SUPPLY

RENT

BENTALL KENNEDY RESEARCH SENTIMENT

Positive ⟷ Negative

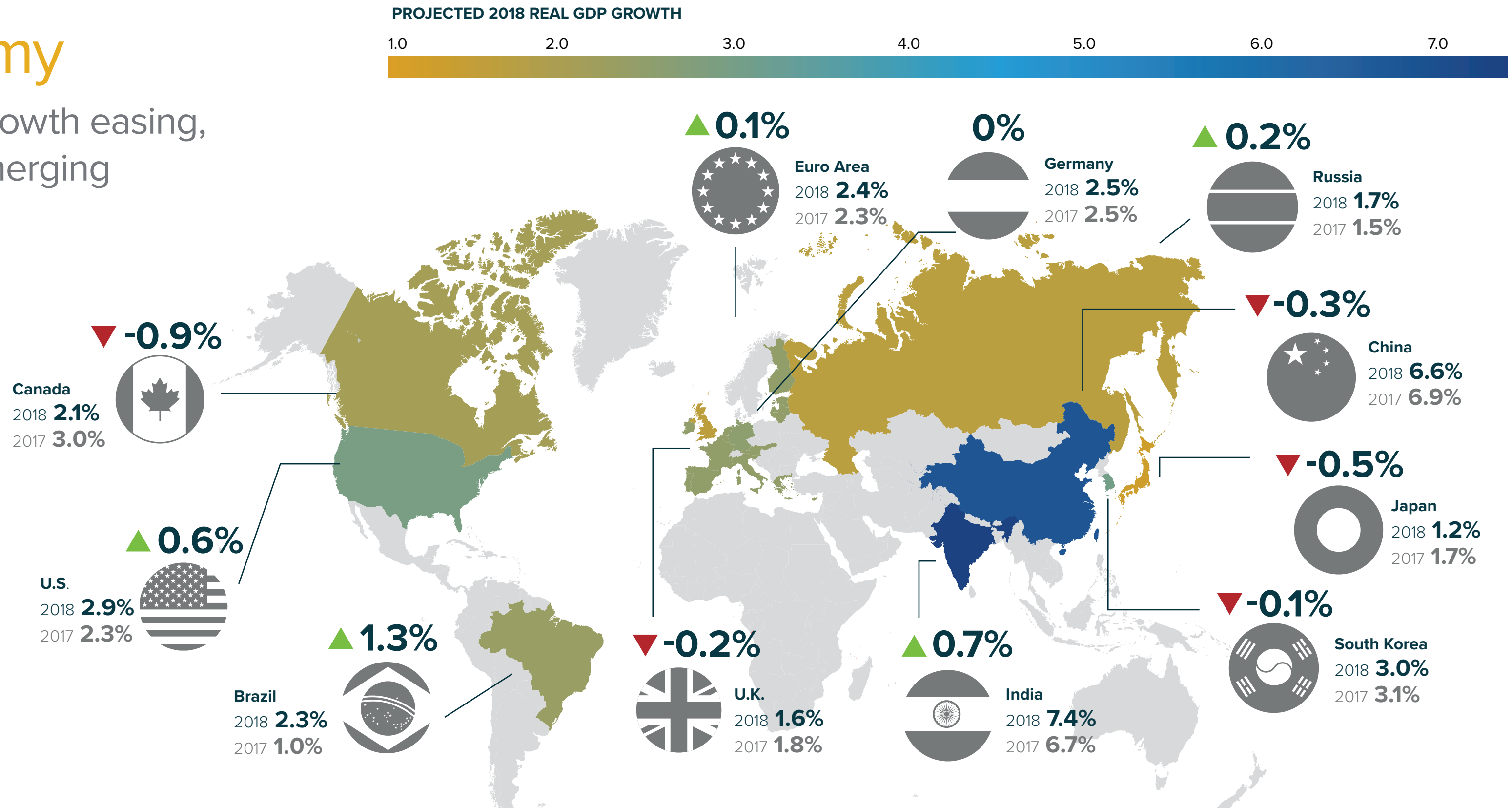
Global Economy

Synchronized global growth easing, signs of divergence emerging

GLOBAL REAL GDP GROWTH

PP Change	▲ 0.1%
2018*	3.9%
2017	3.8%

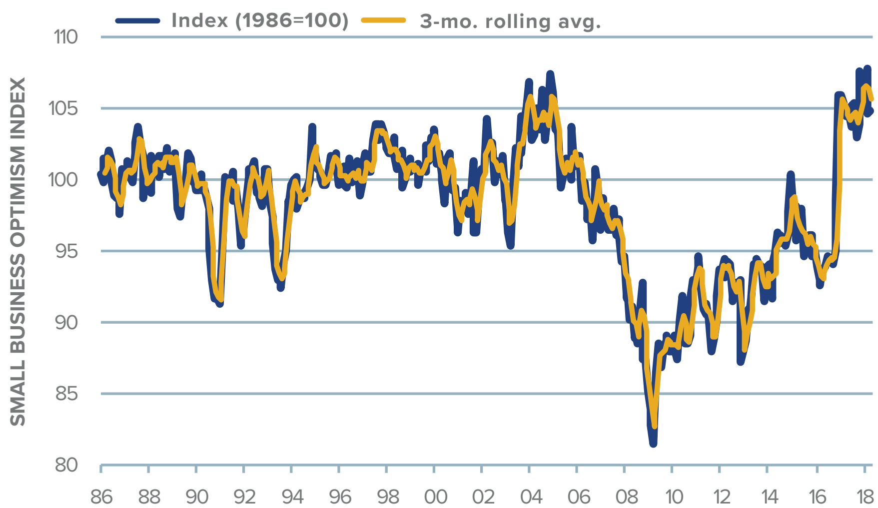
*Projected
Source: IMF



ECONOMIC **Global growth moderating**	**GEOPOLITICAL** **Political tensions threaten outlook**	**FINANCIAL** **Volatility returns**
U.S. economic growth accelerated, while growth moderated elsewhere, particularly in the euro area and Japan.	Uncertainty surrounding the looming "Brexit" and Italy's political and financial struggles has clouded the outlook for the euro area.	Despite healthy corporate profits, global equity markets have been weaker and more volatile in 2018.
China's GDP growth has stabilized, albeit at a pace that is significantly slower than the previous decade.	Military posturing between North Korea and the U.S. has subsided for now, but the dissolution of the Iran nuclear deal puts the Middle East back in the spotlight.	Risk of contagion from political unrest in the eurozone and the prospects of trade wars could prolong capital market volatility.
Protectionist policies pose a risk to global trade flows. Tensions are escalating as the U.S. implements tariffs on imported goods from China, Canada, and other nations.	Ongoing border and immigration disputes further strain U.S. and Mexico relations. Meanwhile Venezuela's new government could amplify social unrest across South America.	While healthier economic fundamentals justify less accomodative monetary policies, a brisk transition towards higher rates could have undesired consequences.

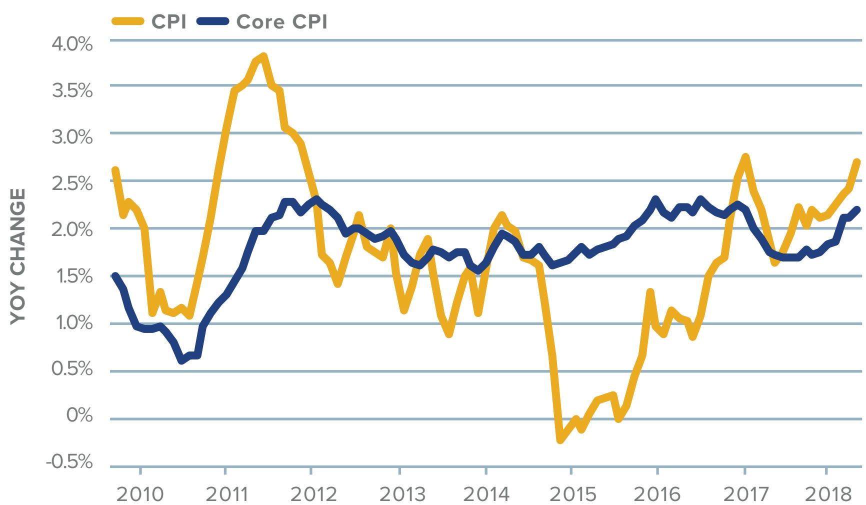
U.S. Economy

U.S. Businesses Feel Optimistic About The Economy



Source: National Federation of Independent Business (NFIB)

Signs Of Inflation Finally Cropping Up



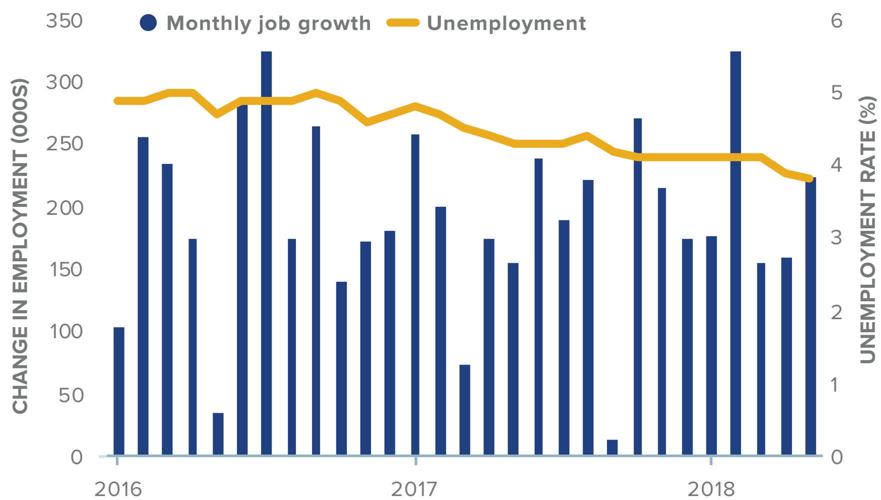
Source: U.S. Bureau of Labor Statistics

A persistent U.S. expansion

- Most indicators point to real GDP growth of near 3% in the U.S. for 2018 as government spending and tax policy invigorate businesses. Small business optimism is near record highs.
- Trade disputes and the possibility of a full-fledged trade war represent the most pressing economic risk. That said, the impact of already announced tariffs should be minor.
- Major inflation indices are rising, prompting the Fed to continue to raise rates. A total of four hikes in the Fed Funds rate seems likely in 2018.
- Oil prices are up dramatically from a year ago, contributing to higher inflation. Gas prices could have a modest cooling effect on consumption this summer.
- The flattening yield curve is a material concern for the economic outlook. When short-term rates rise above long-term rates it generally foreshadows a recession as banks reduce lending.
- This dynamic creates a dilemma for the Fed as it tries to temper inflation with higher short term interest rates.
- Global demand for stability and yield will continue to keep longer-term Treasury yields low. In a global context, 10-year U.S. Treasury yields are relatively high.

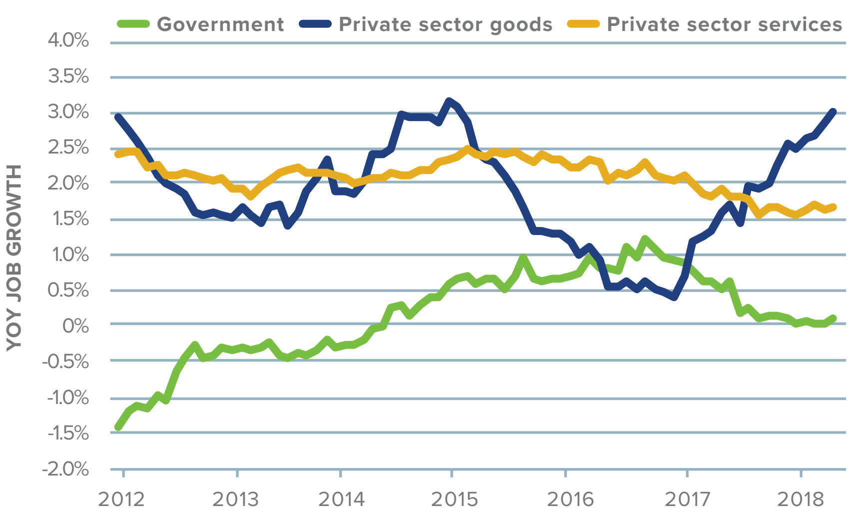
U.S. Economy

Steady Job Gains Bring Unemployment To 50-yr Low



Source: U.S. Bureau of Labor Statistics

Goods-Producing Sectors Gaining Momentum



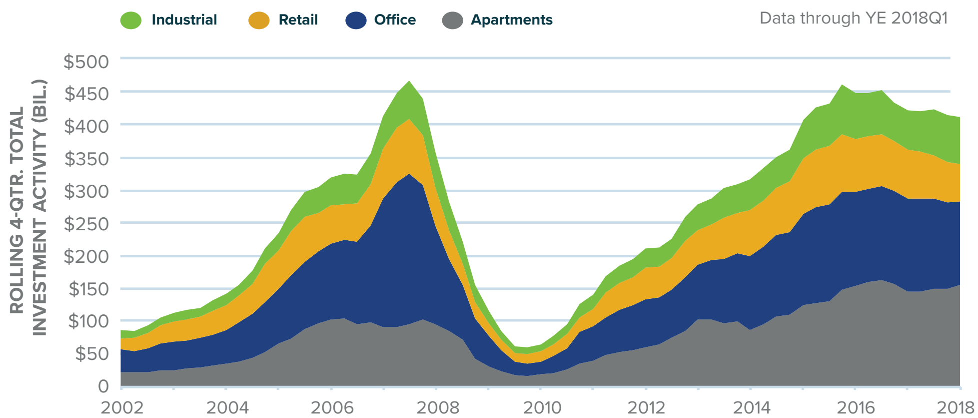
Source: U.S. Bureau of Labor Statistics

- The U.S. labor market continues to impress with growth not materially changed from a year ago. Year-over-year as of May employment was up 1.6% or 2.4 million jobs.
- Unemployment is at its lowest level since 1969 and looks to head lower. For the first time on record, the number of job openings exceeds the number of unemployed individuals.
- This tight labor market is supporting wage growth, but it also represents a headwind as expanding employers encounter a shortfall in available skilled labor.
- Goods producing sectors are now among the fastest growing sectors in the U.S. Mining (8.6%), construction (4.1%), and manufacturing (2.1%) all posted strong year-over-year gains.
- Professional & business services employment continues to rise, but there are significant differences across subsectors.
- Occupations such as legal, advertising, and accounting are performing poorly, while technology, scientific research, and architecture & engineering fields continue to do well.
- Slower growth in healthcare, leisure & hospitality, and financial activities employment is further weighing on the pace of expansion in private sector services.
- Overall, healthy job gains should persist in 2018, leading unemployment even lower and pushing wages higher.

Note: Data from U.S. Bureau of Labor Statistics

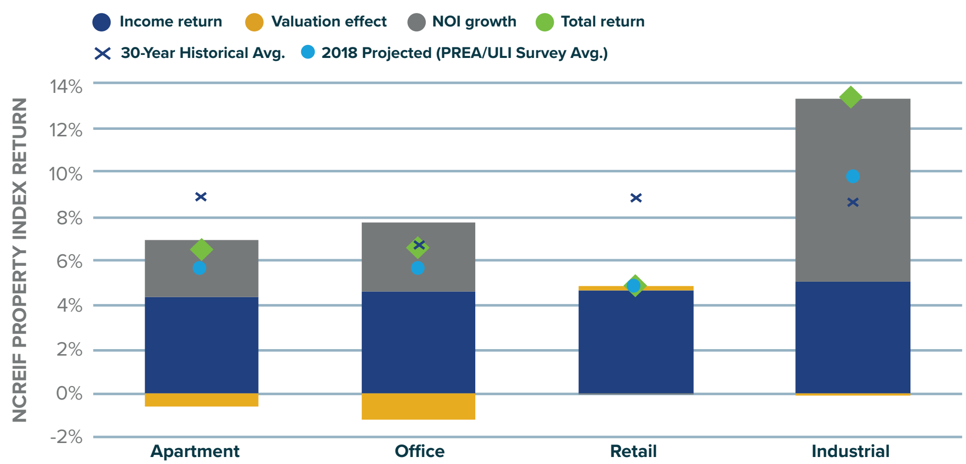
U.S. Capital Markets

Transaction Volume Continues To Ease



Source: Real Capital Analytics, Inc.

Performance Has Dipped And Expectations Are Down



Source: NCREIF, PREA, ULI, Bentall Kennedy

Lower returns across asset classes

- Performance across asset classes has been rocky in 2018. REIT prices were lower year-to-date as of May. Equity markets are undulating, with weaker growth versus a year ago and major bond indices are down.
- The 10-Year Treasury rate is averaging 50 bps higher YTD than its average for all of 2017 and short-term rates have been rising even faster.
- In this environment investors have continued to place high demand on commercial real estate properties, even if investment activity has backed off somewhat.
- Sales volume was down year-over-year in the office and retail markets and rose in the apartment and industrial markets. However, in a longer term context, activity remains robust.
- Investment returns for private commercial real estate have held up relative to a year ago, but are down from cyclical highs and long-term historical averages in most cases.
- Four-quarter trailing appreciation in the overall NPI index was near its lowest levels since mid-2010 as occupancy gains level out and rent growth moderates.
- Investor expectations for calendar year 2018 are even lower than the past four quarters, but this reflects, at least in part, lower return expectations across asset classes.

U.S. Apartment

New supply is weighing on rent growth, but robust demand is sustaining fundamentals

Vacancy

5.5%

Vacancy

As of 18Q1

Quarterly Vacancy Trend

10-Year Average Vacancy: 5.9%

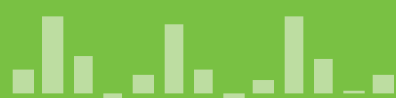
- Apartment vacancy ticked higher in the first quarter of 2018, but was on a par with year-ago levels.
- Vacancy remains below its long-term average, despite heavy net completions.
- Sunbelt markets have experienced recent volatility in vacancy, while gateway markets remained stable.

Absorption

348K

Units

Four quarters ending 18Q1



Quarterly Demand Trend

10-Year Avg. Ann. Demand Growth: 266,000 Units

- Net absorption strengthened over the past year, as the labor market has gained some momentum recently.
- Homeownership rates ticked higher year-over-year but will likely remain below historical levels.
- Solid demand growth prospects will likely be supported by improving household formation and rising homeownership costs.

New Supply

374K

Units

Four quarters ending 18Q1

Quarterly Supply Trend

10-Year Avg. Ann. Supply Growth: 256,600 Units

- Annual supply growth has steadily accelerated, reaching its highest post-recessionary level.
- Supply growth was strongest in southeastern metros, but moderated in gateway markets.
- Overall construction activity is slowing and has likely peaked this cycle but it may persist near current levels or even pick up in certain markets.

Rent

2.5%

YOY Growth

As of 18Q1

Quarterly YoY Rent Trend

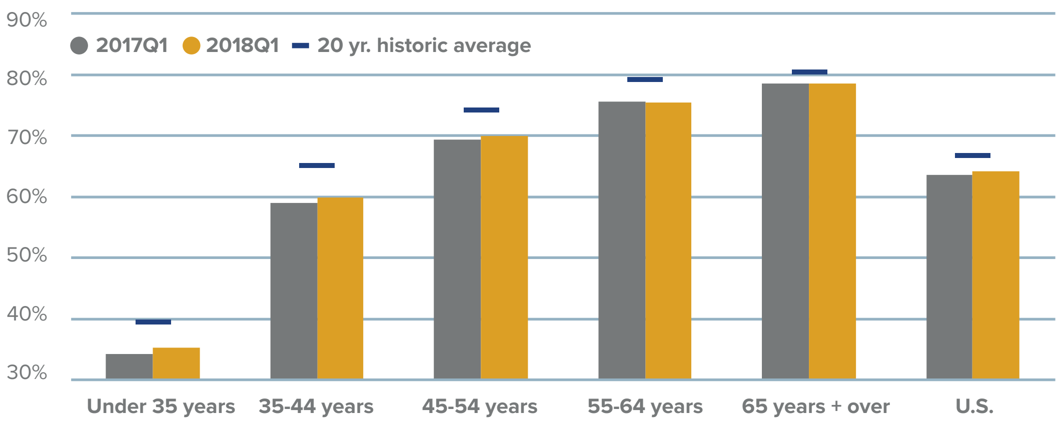
10-Year Avg. Ann. Rent Growth: 2.3%

- Rent growth continued at a fairly modest pace and was at half the peak rate achieved in mid-2015—though it remains slightly above its 10-year average.
- Wage growth has improved recently but increased supply and affordability constraints have weighed on rent growth.
- Secondary and tertiary markets in the West and Southeast posted the strongest annual rent gains.

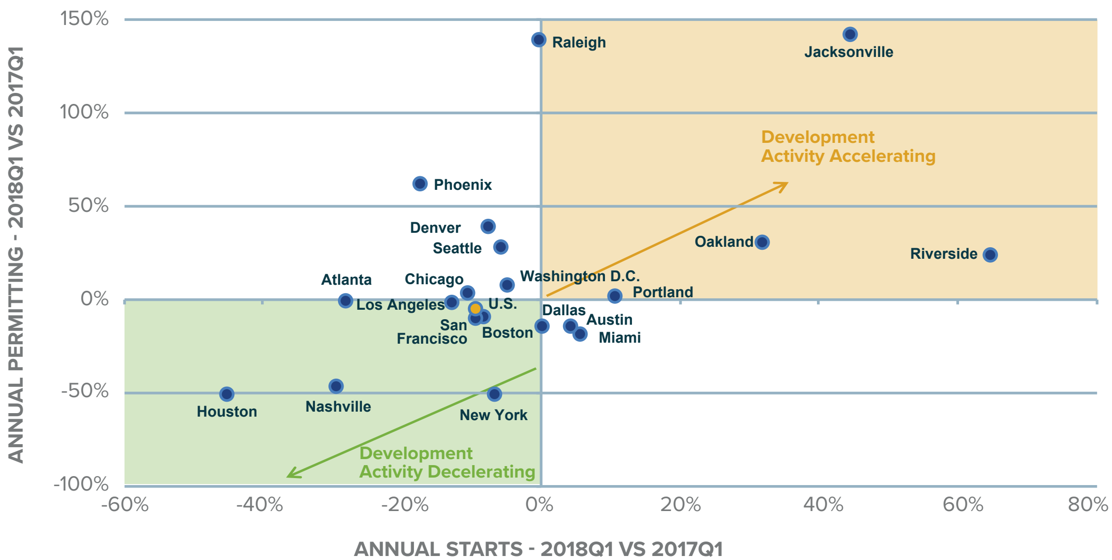
Source: Axiometrics
Note: Charts show the past 13 quarters

U.S. Apartment

Homeownership rates remain relatively low



Development activity moderating in most markets



Sources: U.S. Census Bureau, Moody's Analytics

- Apartment demand growth accelerated over the past year, despite a rising homeownership rate. Job growth has continued at a healthy rate and wage growth is showing signs of acceleration.
- Homeownership rose most significantly among those less than 35 years old but the rate remains four percentage points below its 20-year historical average.
- Rising mortgage rates and the new state and local tax deduction cap could limit homeownership in high-cost states moving forward.
- National mortgage rates have risen to their highest levels since 2014, according to Freddie Mac. This contributed to a 3.5% year-over-year decline in the National Association of Realtors' composite housing affordability index.
- Multifamily starts and permits remained below cyclical peak levels and fell nationally over the past year—likely restrained by construction costs and lending restrictions—which should allow fundamentals to stabilize. However, the loosening of financial restrictions by the Trump administration could support increased lending for development projects.
- Conversely, a handful of markets, such as Jacksonville and Riverside, experienced a significant rise in annual starts and/or permits, suggesting that supply growth will accelerate in these metros.
- Secondary and tertiary markets in the Southeast and West have outperformed, such as Orlando, Las Vegas and Phoenix. These markets were slower to recover from the Great Recession and are benefiting from outsized demand growth and vacancy declines, despite strong supply growth.

U.S. Office

Office fundamentals have weakened due to moderating demand and rising supply

Vacancy

13.3%

Vacancy

As of 18Q1

Quarterly Vacancy Trend

10-Year Average Vacancy: 14.7%

- Office vacancy is up modestly, but remains below its long-term average. Vacancy is lowest in tech markets.
- Construction is leading to significant vacancy increases in some markets, including Nashville and San Jose.
- Vacancy is expected to rise further as net completions pick up over the next year.

Source: CBRE-EA

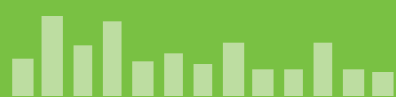
Note: Charts show the past 13 quarters

Absorption

33

Million SF

Four quarters ending 18Q1



Quarterly Demand Trend

10-Year Avg. Ann. Demand Growth: 27.7 million SF

- Net absorption moderated year-over-year. Office-using job growth picked up recently, but remains below cyclical peak rates.
- Tech is still a key source of growth, though accelerating gains in back-office sectors are generating demand in certain markets.
- Office demand growth should remain steady, but labor shortages will temper gains.

New Supply

48

Million SF

Four quarters ending 18Q1

Quarterly Supply Trend

10-Year Avg. Ann. Supply Growth: 34.2 Million SF

- Annual net completions have reached their highest levels since early 2010.
- Supply growth was strongest in tech markets, which have benefited from hefty rent gains in recent years.
- Construction is expected to continue to pick up this year, but will remain below the highs of previous economic expansions.

Rent

1.6%

YOY growth

As of 18Q1

Quarterly YoY Rent Growth

10-Year Avg. Ann. Rent Growth: 0.9%

- Annual rent growth slowed to below the rate of inflation.
- The strongest office rent gains have been in Sunbelt and certain tech markets. Charlotte and Seattle are among the markets with the strongest growth.
- Rent growth is likely to continue at a relatively modest pace as vacancy trends higher.

U.S. Office

Tech sectors remain a key source of office net absorption, but accelerating job creation in administrative and support services will likely drive leasing among back-office tenants, particularly in certain late-cycle Sunbelt markets.

Financial firms have pulled back on hiring recently due to tepid profit growth. Deregulation and tax cuts are tailwinds for the sector, but a flattening yield curve and decreased mortgage demand are headwinds.

Leasing among coworking tenants continues at a rapid pace. According to JLL, flexible work space amounted to about one-third of net absorption in 2017.

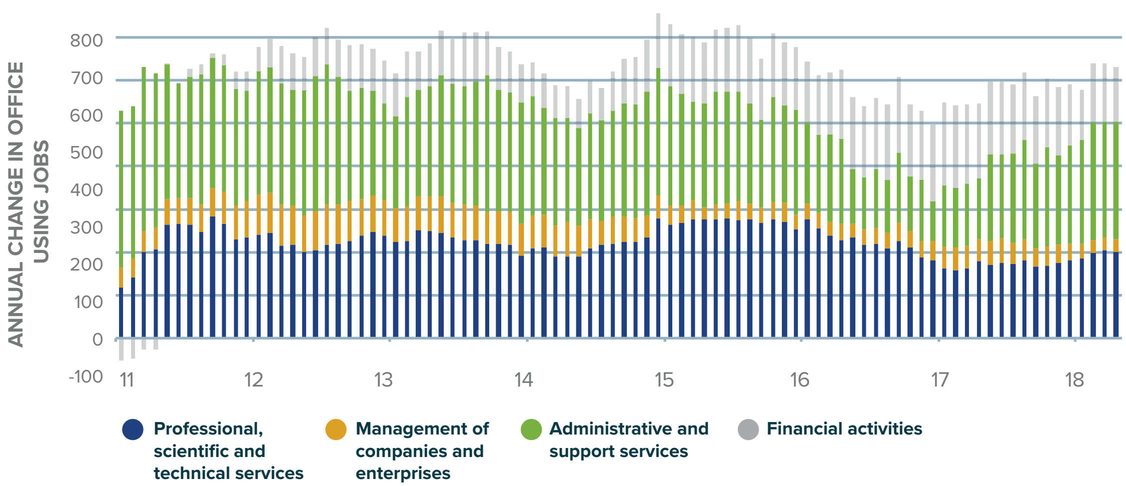
The coworking/flexible work space segment is expected to continue to rise in prevalence as tenants demand shorter lease terms and more flexible use of space, particularly those with a significant contingent workforce.

With leasing trends subdued compared to previous growth cycles, property owners are offering more amenities and concessions to draw desirable tenants.

Knowledge-based tech firms are among the most sought-after tenants, and they demand highly amenitized buildings in order to attract and retain talent.

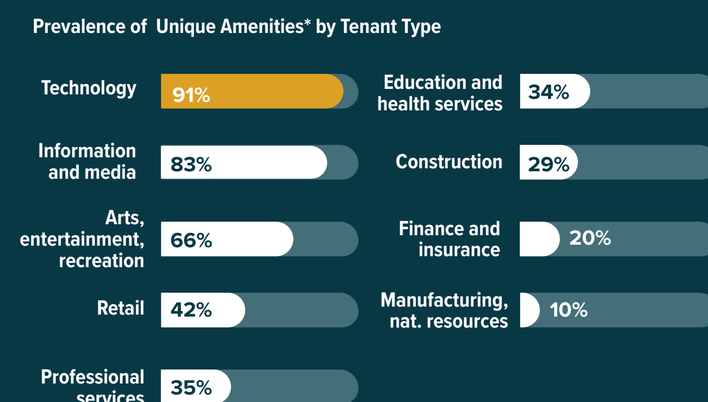
The most popular amenities include full-service cafeterias, fitness centers, and bike storage. Other amenities being offered include collaborative workspace, game rooms, child care, and wellness services.

Back office job creation is accelerating



Source: Moody's Analytics, BLS

Tenants placing a premium on space with amenities



*Amenities that promote vibrant environments, such as access to games, outdoor space, etc.
Source: NAIOP Research Foundation Reprinted with permission from 'Activating Office Building Common Spaces for Competitive Advantage,' Richard B. Peiser, Ph.D., and Raymond G. Torto, Ph.D., NAIOP, 2017.

U.S. Retail

Cracks in the retail landscape remain significant, but some retailers are beginning to find footing

Availability

9.4%

Availability
As of 18Q1

Quarterly Availability Trend

10-Year Average Availability: 11.2%

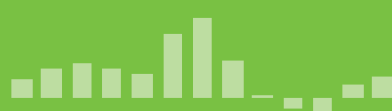
- Availability compressed in 18Q1 after rising in each of the prior four quarters.
- Strong consumer confidence and healthy retail sales growth have not translated into a steadily improving retail space market.
- Retail availability may continue to fluctuate going forward as ecommerce further disrupts the sector.

Source: CBRE-EA
Note: Charts show the past 13 quarters

Absorption

2.0

Million SF
Four quarters ending 18Q1



Quarterly Demand Trend

10-Year Avg. Ann. Demand Growth: 18.1 million SF

- Retail demand shrank in mid-2017 for the first time since 2011, but rebounded in subsequent quarters.
- Many brick-and-mortar retailers continue to struggle with tepid sales growth and substantial debt loads. More bankruptcies and closures are expected.
- Small-format, experiential and service retailers have performed well and should continue to do so in the new retail paradigm.

New Supply

14.6

Million SF
Four quarters ending 18Q1

Quarterly Supply Trend

10-Year Avg. Ann. Supply Growth: 22.5 million SF

- Supply totals remain well below prior-cycle peaks as development is selective.
- The U.S. remains significantly over-retailed as ecommerce grabs a growing share of consumer dollars.
- Metro areas with strong long-term demographic prospects including Houston, Dallas, Atlanta, and Phoenix have faced the strongest supply growth.

Rent

3.2%

YOY Growth
As of 18Q1

Quarterly YoY Rent Trend

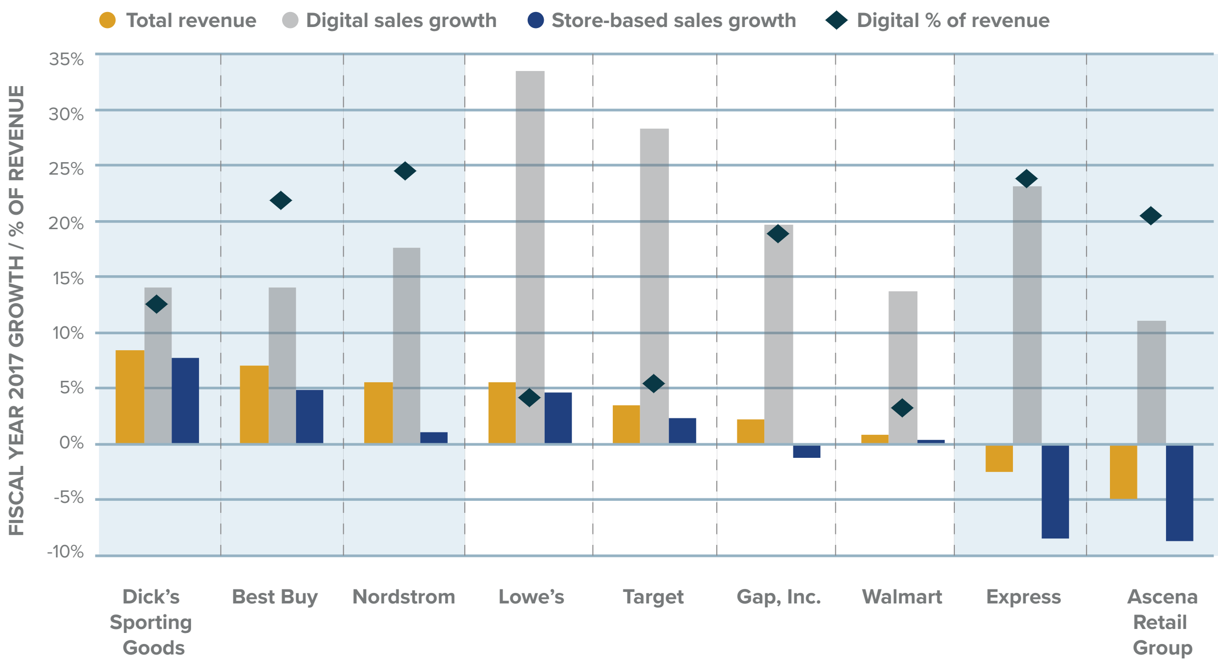
10-Year Avg. Ann. Rent Growth: -0.6%

- Retail rent growth continues to edge up despite headwinds. Growth in the sector is outperforming office and apartment.
- Physical stores are key to omni-channel retailing and that has driven rent growth at the most strategic retail centers.
- Many distressed retail centers likely won't survive without significant capital reinvestment and repositioning.

U.S. Retail

Online sales growth won't save all brands

Ecommerce has fundamentally changed the way that retailers operate. The strongest omni-channel retailers are now seeing as much as one quarter of their total sales from online platforms.



Nordstrom, Best Buy and Dick's have managed to show strong ecommerce growth while increasing in-store revenues as well.

However, strong online sales haven't been enough to offset shrinking store-based sales for many retailers.

Retailers such as Ascena Brands and Express continue to see overall revenue decline. The sector will see more attrition in the years ahead.

Sources: Company reports, eMarketer.com
Note: For retailers that do not report digital sales independent of store-based sales, eMarketer estimation was used.

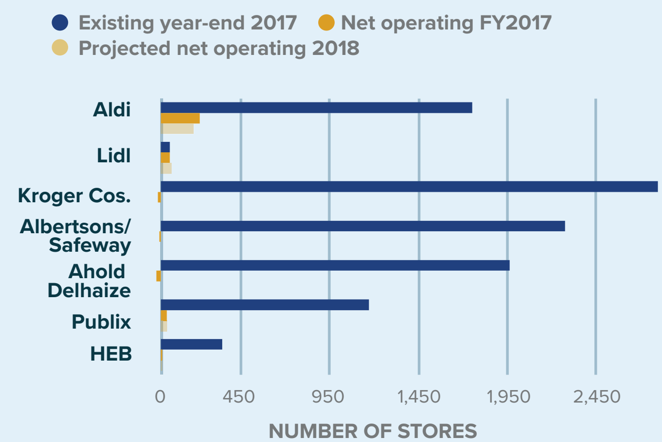
Grocery is considered among the last principally brick-and-mortar retail segments.

2.0%-4.3% -of- **$641B USD**

Estimated Online Grocery Sales (FMI-Nielsen)

Overall Grocery Sales

Major grocery chains are cautious amid new competition



Note: Projected openings included for companies with predictions provided. Publix 2018 data reflect 2018 H1 openings. Ahold Delhaize includes U.S. brands Stop & Shop, Giant, Food Lion and Hannaford

New, often smaller format Aldi and Lidl stores continue to push into U.S. markets. Aldi expects to increase its U.S. footprint to 2,500 stores by 2022.

Over the past several years Target and Walmart have also pursued grocery as a strategy for bringing in shoppers.

Traditional grocers aren't significantly shrinking their store counts yet, but most are not actively expanding either. Many grocers are on the defensive with heavy investments in existing stores.

U.S. Industrial

Industrial is outperforming other property sectors as demand remains robust

Availability

7.3%

Availability

As of 18Q1

Quarterly Availability Trend

10-Year Average Availability: 11.0%

- The national industrial market continues to outperform other property sectors. Availability is currently at its lowest rate since 2000.
- New supply has led to a modest uptick in availability in a number of markets.
- We expect availability to rise slowly over the next year, but remain relatively low.

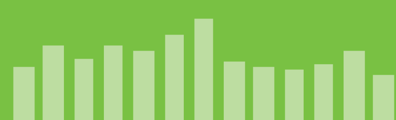
Source: CBRE-EA
Note: Charts show the past 13 quarters

Absorption

227

Million SF

Four quarters ending 18Q1



Quarterly Demand Trend

10-Year Avg. Ann. Demand Growth: 145.0 Million SF

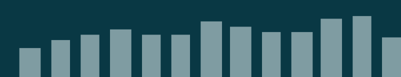
- Major indicators point to growing industrial space demand, but trade disputes pose a downside risk.
- Rapid ecommerce sales growth remains a key demand generator.
- Low availability is tempering net absorption in some markets. New projects are seeing healthy leasing.

New Supply

212

Million SF

Four quarters ending 18Q1



Quarterly Supply Trend

10-Year Avg. Ann. Supply Growth: 120.1 Million SF

- Supply growth has failed to outpace demand despite accelerating in each of the past eight years.
- Construction totals over the next four quarters will roughly match that of the prior year.
- Modern space is scarce in many markets and high valuations on existing assets should encourage more development.

Rent

4.6%

YOY Growth

As of 18Q1

Quarterly YoY Rent Growth

10-Year Avg. Ann. Rent Growth: 0.6%

- Rent growth is slowing, but industrial retains a clear edge versus other sectors.
- The disparity in rent growth across markets has narrowed. Many are still seeing strong growth but there are fewer outliers.
- Rent growth may slow further, but rents should continue to expand as availability remains tight.

U.S. Industrial

Supply and demand are evenly matched for now

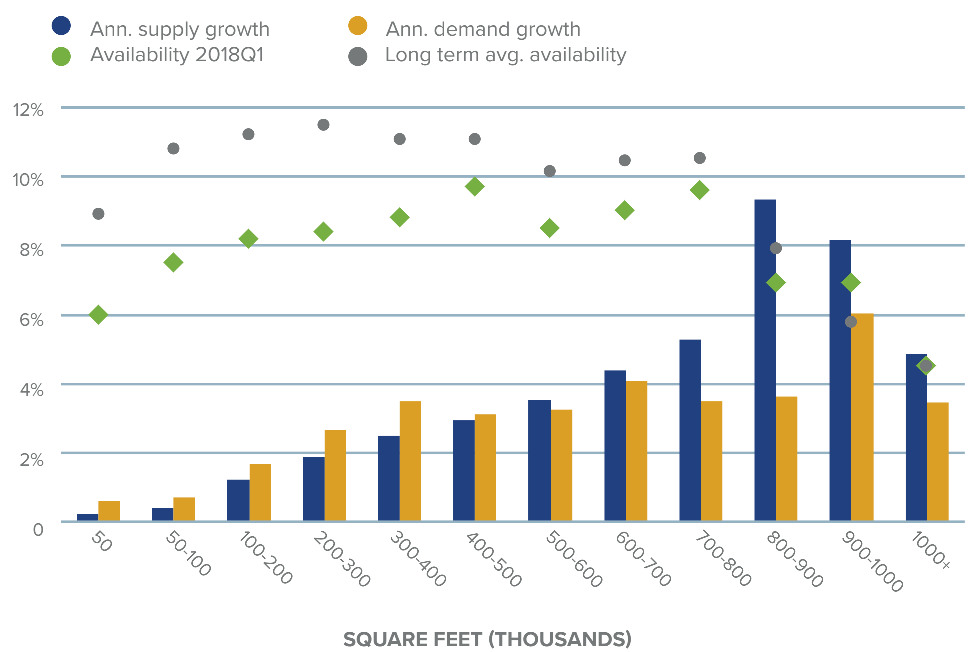
Construction is a material risk to industrial market fundamentals should demand falter. Supply growth is expected to remain strong over the next two years.

Developers are relatively more active at the larger end of the building size spectrum where availability is low and tenant and investor demand are high. Availability has been low in these properties historically as well.

Less construction is happening at the smaller end of the spectrum despite low availability and steady demand as the mature economic expansion benefits smaller, local users.

The data show differences in fundamentals across building sizes. These differences and the resultant potential investment risks should be carefully considered at the market level before investing.

Fastest industrial supply growth in large spaces



Source: CBRE-EA

Retailers are experimenting with new supply chain strategies for efficient omni-channel sales

Target recently introduced a flow center concept:

Distribution centers strategically restock stores with smaller, more frequent shipments

This reduces excess inventory in the store to free up space for online order fulfillment

The store plays a greater role in "last-mile" delivery

This approach may increase the need for strategically located industrial properties that can efficiently facilitate more frequent shipments to stores without dramatically swelling transportation costs. Target's first "flow center" is in Perth Amboy, NJ.

Other recent innovations and evolutions in the sector include, Walmart turning existing Sam's Club stores into distribution centers and Kroger and Albertson's automating some distribution functions.

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