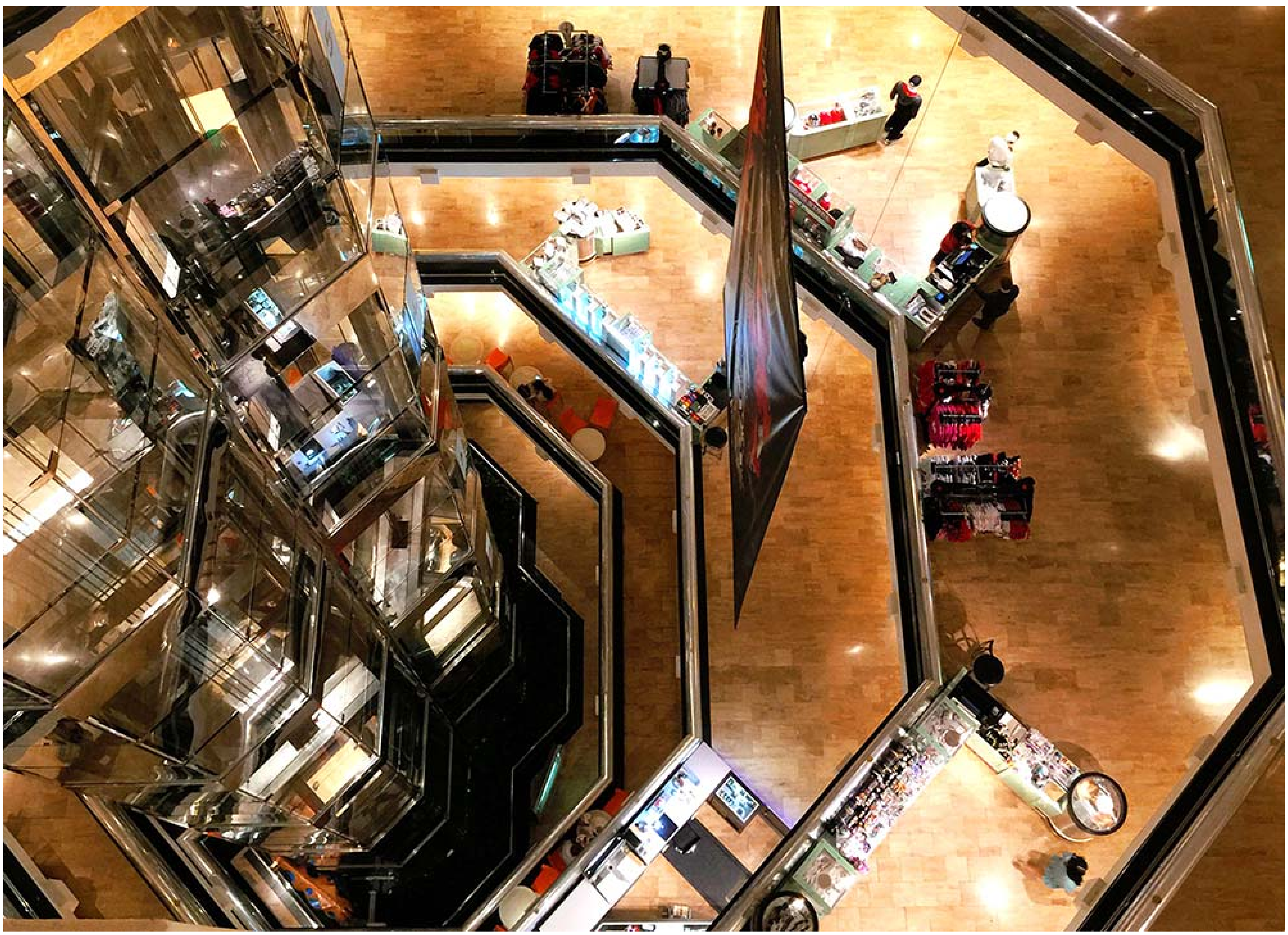
US Real Estate Summary.

Edition 2, 2016

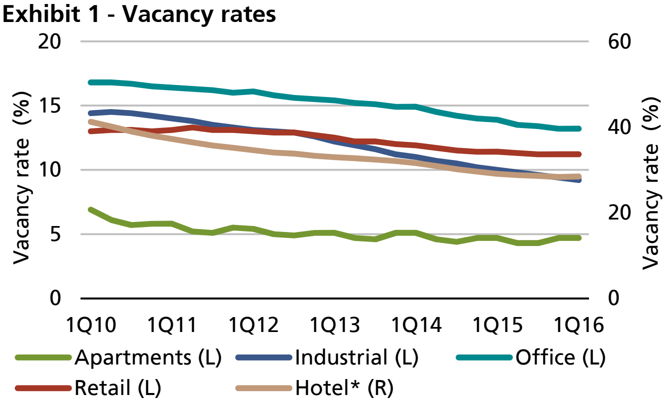
US commercial real estate rents are rising faster than inflation.
Transactions volume appears to be leveling off near record highs.
Appreciation remains higher than history but slowed during 1Q16, as expected.
Positive outlook for 2016 even with reduced expectations for total return.



Commercial Real Estate

Demand for commercial and multifamily real estate space remained in force at the property level even as the US experienced expected deceleration in the momentum of sales volume and appreciation during the first quarter of 2016. Vacancy, shown by property type in *exhibit 1*, appears to have stabilized at low levels in the apartment and hotel sectors and continues to decline in the office, industrial and retail sectors.

Exhibit 1 - Vacancy rates



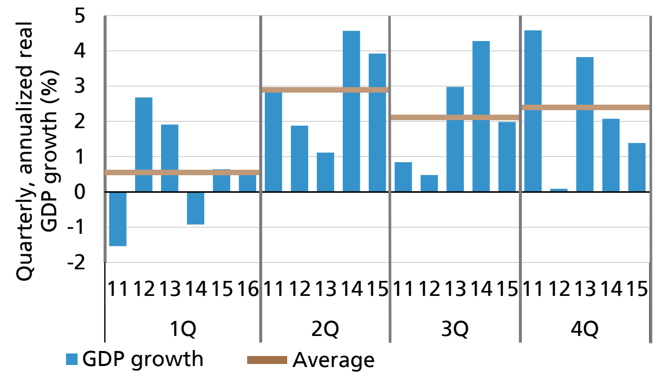
Source: CBRE-Econometric Advisors as of March 2016
*Hotel data represent the four-quarter rolling average.

General economic and labor market conditions are supportive to continued slow improvement in commercial and multifamily real estate. Yet, the specter of slower job growth is a concern. Even though the level of layoffs in the US is relatively low, hiring is not robust. Job growth has decelerated since February 2016, marking the slowest start to the year since 2010.

Commercial real estate demand is affected more directly by the inherent stability in the job market than by quarterly fluctuations in GDP. During first quarter 2016, Gross Domestic Product (GDP) growth showed seasonal weakness, similar to the beginning of six of the past seven years, see *exhibit 2*. Despite weak GDP performance early in 2016, the US labor market added an average of nearly 150,000 jobs per month during the first five months of the year – a level of hiring that is disappointing but not debilitating.

The current investment environment appears to be shifting toward a more sustainable, longer-term view where income, rather than appreciation, dominates commercial real estate return. First quarter NCREIF returns are consistent with this expectation, though one quarter does not make a trend. During the first quarter 2016, income return exceeded appreciation, the first time this has occurred since the fourth quarter of 2013.

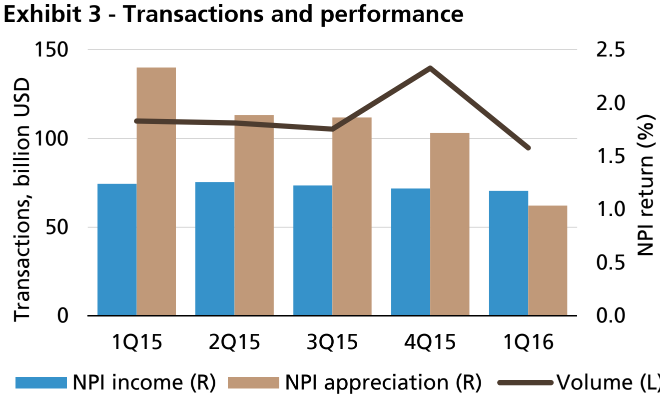
Exhibit 2 – US GDP growth by quarter



Source: Moody's Analytics as of April 2016

The US yield curve flattened during the first quarter primarily due to decreasing rates on long-term bonds. Rates on 10-year Treasuries started 2016 at 2.24% and as of June 15th, had fallen 64 basis points to 1.60%. Inflation has remained below actionable targets for the Federal Reserve, which helps to maintain the prevailing low interest rate environment. Year-on-year growth in headline consumer price inflation is around 1%. Excluding food and energy, year-on-year inflation exceeded 2% for the seventh consecutive month during May 2016.

Exhibit 3 - Transactions and performance



Source: Real Capital Analytics and NCREIF as of March 2016

Total transactions were down nearly 20% during the first quarter 2016 compared to a year earlier, according to Real Capital Analytics. The 12-month rolling sum was up 9% versus March 2015, but that represents a slowdown from the 20% to 25% steady growth experienced during 2015.

The details behind the slowdown in transaction volume show that fewer entity-level transactions played a role, but those trades are highly volatile. Excluding entity-level sales, transactions still fell by 12% during the quarter.

Sales of large buildings dropped by nearly one-third during the first three months of 2016. Publicly-traded Real Estate Investment Trusts (REITs) have faced some pressure to issue debt and buy back shares rather than purchase real estate.

Property Types

Apartments
Widespread job growth, low homeownership rates and increasing household formation support demand for apartment rentals. Homeownership could flatten out in 2016 but is unlikely to rise. Apartment construction is expected to peak near record-high levels in 2016. Although the effects will vary by region, rent growth is likely to slow somewhat after increasing 4.0% during the year ended March 2016. If occupancy continues to be near 95%, landlords should still be able to push rents higher over the coming year.

Hotels
Supply growth is currently meeting demand for hotel rooms; however, the hotel sector is likely near peak performance as supply growth rises to meet the current high levels of demand. Full service hotel construction is already above long-term average levels with limited service hotel supply expected to double by 2017. We anticipate occupancy rates will stall. Growth in Revenue per Available Room should soften as it will be entirely dependent upon increases in room rates.

Industrial
Industrial development continues to increase, especially construction of massive warehouse properties. Overall, supply growth is near long-term average rates. Demand for industrial space, which is in-part driven by e-commerce, is winning the day and pushing availability rates down below 10%.

Office
Office construction remains low relative to historic levels. Gross rent growth is accelerating even as Downtown office buildings began to face slight upward pressure on vacancy. With 10.4% vacancy, Downtown office markets are tighter than their Suburban counterparts at 14.7% vacancy; however, the Downtown rate is up 10 bps from the prior quarter. Nationally, office rents continue to grow in the range of 2.5% to 4%.

Retail
US retail sales (excluding auto and gas) grew 3.9% during the year ended March 2016, supporting continued modest improvement in the sector. Construction of new retail projects is at the lowest rates on record (data begin in 1980) influenced by the slow housing market. First quarter 2016 availability was 11.2%, down 20 bps for the year. Rent growth is positive between 2% and 3% but has lagged other property types.

Viewpoint

Conditions remain supportive for US commercial real estate performance. Interest rates are low; rent growth is well above inflation and supply growth remains low-to-balanced across the five major property types.

As presented in our *US Real Estate Market Outlook 2016*, over the coming year, commercial real estate returns are likely to be lower for US properties relative to the previous six years with appreciation slowing to a more sustainable level and income once again accounting for the majority of total return.

Since our *Base Case* was published, equity markets experienced a highly volatile start to 2016. In the US bond markets, risk spreads first widened but have begun to shrink somewhat. None of these short-term fluctuations changes our broad expectations or guidance concerning commercial real estate over the balance of the year.

Exhibit 4 – Historical performance (%)

Total returns	2013	2014	2015	4Q15	1Q16	10-yr	20-yr
Bar cap	(2.4)	6.0	0.1	(0.7)	3.5	4.9	5.6
S&P 500	32.4	13.7	1.4	7.0	1.3	7.0	8.0
NAREIT	2.9	28.0	2.8	7.7	5.8	6.5	11.1
CPI	1.5	0.6	0.7	0.1	0.0	1.8	2.1
NCREIF Property Index							
Total	11.0	11.8	13.3	2.9	2.2	7.6	9.9
Income	5.6	5.4	5.0	1.2	1.2	5.7	7.0
Appreciation	5.2	6.2	8.0	1.7	1.0	1.8	2.8
NCREIF total returns by property type							
Apartment	10.4	10.3	12.0	2.7	1.9	7.1	9.8
Hotel	7.7	11.1	13.2	3.0	1.2	6.2	9.6
Industrial	12.3	13.4	14.9	3.2	3.0	7.7	10.2
Office	9.9	11.5	12.5	2.6	1.7	7.3	9.8
Retail	12.9	13.1	15.3	3.5	3.0	8.7	10.6

Sources: NCREIF, NAREIT, Bureau of Labor Statistics, Morningstar and Moody's Analytics as of March 2016

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