U.S. REAL ESTATE SNAPSHOT

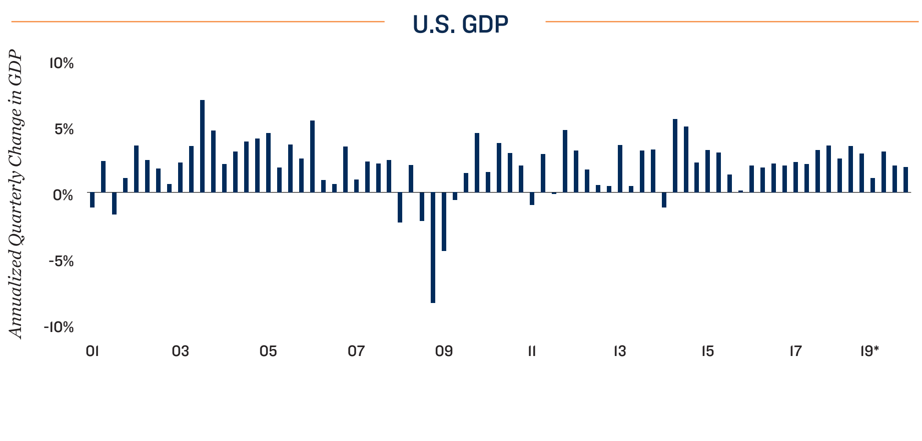
Marcus & Millichap

4Q 2019

Resurgent Economy Bolsters Commerical Real Estate Outlook; Favorable Interest Rate Climate Key

Fed action extends economic growth cycle. The U.S. economy remains in expansion, growing by 1.9 percent in the third quarter as the nation's positive economic momentum battles headwinds. Ongoing trade negotiations with China and slowing global markets have remained a restraint on the domestic economy in recent months, weighing on exports and manufacturing. The Fed has taken note of this, issuing three successive rate cuts, while balancing these reductions with existing economic momentum. The national unemployment rate, still near a 50-year low at 3.6 percent in October, reflects the strong hiring climate. Robust consumption delivered 4.5 percent core retail sales growth in the third quarter following the dip into the mid-2 percent range earlier this year. An extended cycle of wages gains has supported this trend, pushing disposable income to a record high. The nation's sturdy economic foundation continues to overshadow ongoing international challenges and recession risk, pointing to continued domestic growth.

Sustained hiring remains primary driver of economy. The tight labor market continues to fuel rapid growth and will power the U.S. economy in the foreseeable future. Job openings in September again outstripped the number of unemployed Americans actively searching for work by roughly 1.2 million. Openings have exceeded unemployment since the beginning of 2018, a trend that had never previously occurred since records began in 2000. Through the first 10 months of the year, almost 1.7 million jobs have been created, keeping the nation on pace to reach 1.3 percent employment growth by year end. This is down slightly from the 1.8 percent gain registered in 2018 as the tightest labor market in 50 years is creating challenges for employers in search of talent. Much of the recent job growth has been attributed to areas that serve U.S. consumers, including education and healthcare, which have added 633,000 jobs in 2019, while 435,000 and 412,000 positions have been created in hospitality and restaurants as well as professional and business services, respectively. The strength of the labor market will remain key moving forward, fueling healthy consumer spending and benefiting the broader economy.



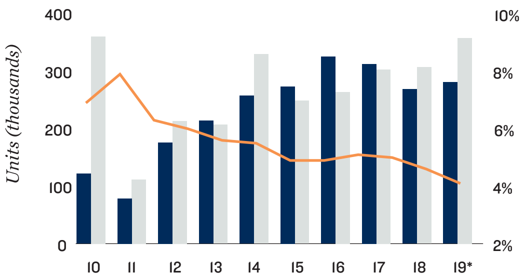
* Through 3Q

Executive Summary

- The tight labor market remains a primary driver of domestic growth, expanding the economy by 1.9 percent in the third quarter. The Fed will continue to balance the nation's steady economic momentum and ongoing geopolitical risks to help determine future rate policy.
- An average of 150,000 apartments have been absorbed during each of the past two quarters, pushing the national apartment vacancy rate below 4 percent.
- Steady economic growth and limited supply growth continue to support the national office market, keeping fundamentals balanaced as corporations build out their infrastructure.
- Ongoing trade negotiations and concerns of economic cycle maturity have moderated absorption in the retail and industrial sectors, causing vacancy rates to nudge higher in recent months.
- With the 10-year Treasury bouncing back to the upper-1 percent range in the past month, investors may begin to lock in lending. The average combined commercial real estate cap rate remains in the low-6 percent band, providing a 400- to 450-basis-point premium above the 10-year note.

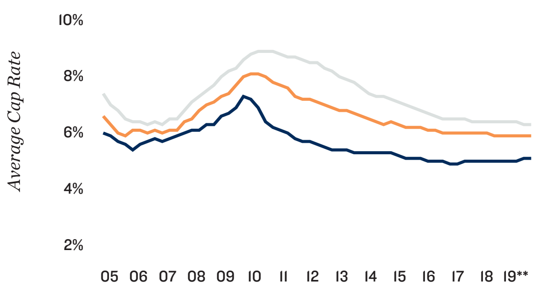
Apartment Supply and Demand

Completions *Absorption* *Vacancy*



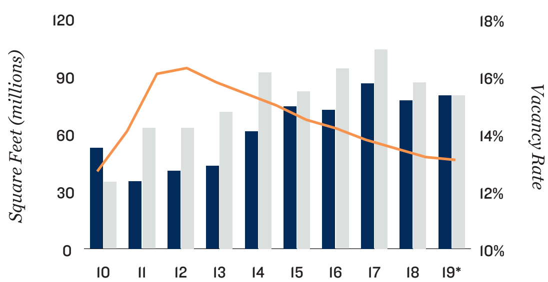
Cap Rate Trends by Market

Primary *Secondary* *Tertiary*



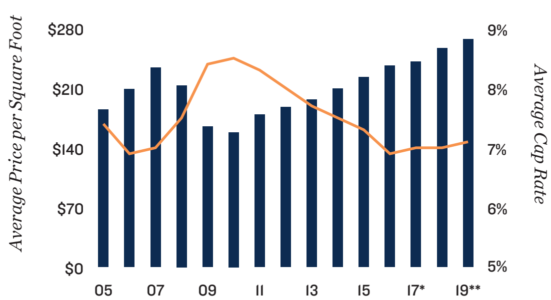
Office Supply and Demand

Completions *Absorption* *Vacancy*



Price and Cap Rate Trends

Average Price *Average Cap Rate*



** Forecast*

*** Through 3Q*

Multifamily

Apartment availability still tightening. Exceptional leasing activity highlights the national apartment market as an average of 150,000 units have been absorbed during each of the past two quarters. This has brought vacancy down to 3.7 percent — the lowest level in almost 20 years. Developers will again fall short of demand in 2019 despite the expected 280,000 units to be delivered. Dallas/Fort Worth and New York City will lead construction efforts by a wide margin this year, adding 24,800 and 18,900 apartments, respectively. While primary metros headline development, a number of secondary markets are witnessing strong construction activity, including Denver and Phoenix. Many smaller metros remain beneficiaries of the extended business cycle, drawing additional economic growth from large gateway cities. While this has boosted development in many markets, rent growth remains strong on a national level as it's on track to log a 4.6 percent gain this year.

Buyers pivot focus to smaller metros. Apartment investors remained active in the U.S. over the past year, although price expectation gaps postponed some deals. Like developers, buyers are increasingly zeroing in on smaller markets as secondary and tertiary tiers posted solid increases in transaction velocity, while primary metros witnessed a modest contraction. Though some of this diverted interest can be attributed to the number of available assets, yields have also been a key driver of investment. Some Midwest markets offer cap rates up to 200 basis points higher than those in large coastal cities for similar properties. Metros including Columbus, Minneapolis-St. Paul and St. Louis have witnessed aggressive growth in deal flow during the past five years.

Office

Suburban space demand boosting sector performance. Steady economic growth continues to fuel the office market, generating sustained job creation and keeping corporate growth strategies active. Office development will remain moderate yet stable in 2019, totaling 80 million square feet, just above the previous five-year average. The nation's steady construction pace has allowed demand to stay ahead of supply, pushing the national vacancy rate down 190 basis points to 13.1 percent since the start of 2014. Driving this trend is the strengthening demand for suburban office space, which boasts a 200-basis-point decrease to 13.3 percent during the same time frame. With millennials beginning to form families and transition from the urban core to the suburbs, many companies are establishing suburban campuses to account for this lifestyle shift.

Buyer pools refined amid climbing valuations. Bidding environments remain competitive nationwide, pushing pricing up 5.2 percent during the past year to $267 per square foot, largely driven by near double-digit increases in primary and secondary markets. Strong growth in these markets has paved the way for more sophisticated capital, refining buyer pools as some investors get priced out. As a result, buyers who historically targeted larger metros are shifting their interest to smaller, more affordable cities. Increased urban renewal efforts in these markets stemming from the extended growth cycle are also driving investment, putting returns in the mid-7 percent range, attracting many yield-driven investors. At the end of the third quarter, the nationwide average sat at 7.0 percent, a 10-basis-point increase from the previous year.

Retail

Retailers keep expansion plans in check. The national vacancy rate increased for the first time since 2010 in the third quarter, rising 20 basis points to 5 percent as absorption softened on a national level. Space demand has been slowed by two factors: Retailers have become more cautious in their expansion plans as they weigh the risks of tariffs and secondly, the availability of premium retail locations has been limited. The modest pace of construction has helped maintain stability in the national retail market despite moderating absorption. Developers will complete 48 million square feet in 2019 — about a third of the annual average witnessed during the last cycle. Tempered supply additions have supported rent gains, giving them a chance to recover back above $20 per square foot. While rent growth has moderated in recent quarters, it continues to outpace inflation, providing investors steady NOI growth.

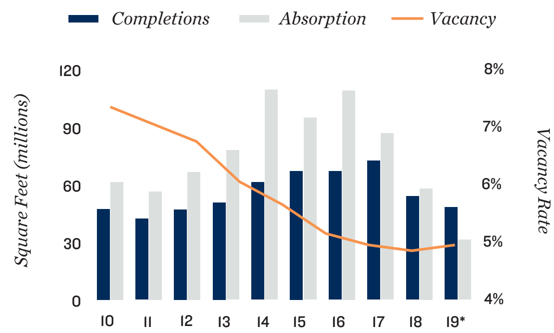
Tenant mixes drawing more interest from buyers. Multi-tenant retail continues to serve as a viable value-add option for many investors, providing an avenue for portfolio diversification in the maturing cycle. Sunbelt metros have become highly targeted by investors as their quickly growing populations and exceptional job creation drive retail demand. Several Midwestern markets have also recorded increased trading activity due to their generally strong first-year returns, attracting many buyers with yield-driven strategies. While location preferences vary by investors, a sustainable tenant mix has become an increasingly important part of all retail investments. Assembling retailers with modern business models and strong omnichannel capabilities will be key for investors moving forward, especially with the retail landscape continuing to evolve.

Industrial

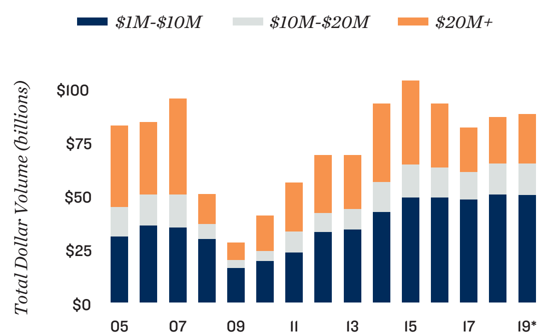
Fulfillment and logistics driving force behind construction. The proliferation of online shopping and the expansion of last-mile delivery strategies is keeping construction elevated this year as 285 million square feet will be completed by year end. This follows the finalization of 1 billion square feet during the previous four years. Large facilities in hub markets including Atlanta and Dallas/Fort Worth remain atop development headlines, while many coastal cities continue to see limited construction as sparse land availability restrains traditional development strategies. Supply growth along with softened absorption stemming from increased economic uncertainty has put pressure on the national vacancy rate, driving it up 40 basis points during the past year to 5.0 percent. Through the first three quarters this year, 120 million square feet has been absorbed, about 44 percent below the previous five-year average for the same time frame.

Industrial demand moving closer to city centers. The perceived value of logistics real estate resonates with investors, translating into an aggressive acquisition period over the past year as owners seek operational advantages. Structural shifts in supply chains have boosted demand for new industrial assets near population centers as e-commerce has substantial room for growth ahead. These dynamics, coupled with the high cost of new construction, will likely continue to put upward pressure on industrial rents. Pricing reflects the robust investor demand in the sector, climbing 11.8 percent in the third quarter from a year ago.

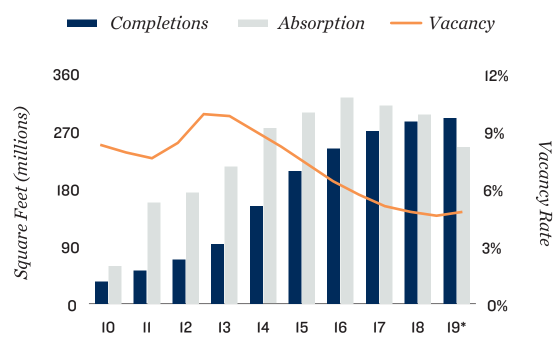
Retail Supply and Demand



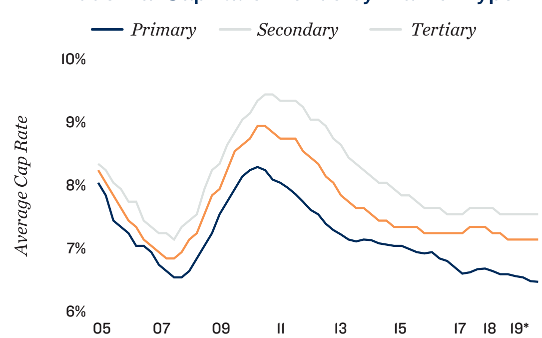
Retail Sales Volume by Price



Industrial Supply and Demand



Industrial Cap Rate Trends by Market Type



* Forecast
** Through 3Q

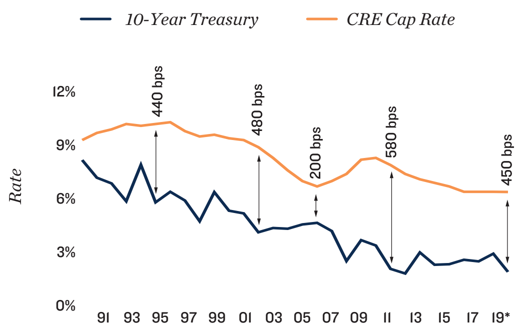
Fed Delivers Third Rate Cut, Sustains Prospect of Continued Growth

Fed remains accommodative. In an effort to lengthen the economic runway, the Federal Reserve on Oct. 30 cut the overnight rate by 25 basis points, the third reduction in 100 days. Domestic growth has been moderating this year, falling to 1.9 percent in the third quarter as the trade war with China curtailed exports and ebbed inventory investment. With tariffs on Chinese goods increasingly coming into play, the economy could face additional pressure, but the Fed has signaled that another rate cut in December will be dependent on incoming data. Several Fed members have argued against additional cuts, as both inflation and unemployment remain very low. A decision on rate policy will largely be determined by the holiday retail season and ongoing trade talks. Should a resolution to the trade war be achieved, the economy and interest rates will likely witness an upward bounce. The Fed's commitment to short-term Treasury purchases remains another key factor, increasing liquidity in the overnight markets and reducing short-term interest rates. This has helped "uninvert" the yield curve as the three-month Treasury rate fell below the 10-year reading. Though this has reduced recession risk, many speculate that a recession could still be on the horizon.

Investor activity sluggish despite widened yield spreads. With the 10-year Treasury hovering between 1.5 to 2.0 percent in recent months, investors have been favored by strong levered yields. The average combined commercial real estate cap rate remains in the low-6 percent range, delivering a 400- to 450-basis-point premium above the 10-year Treasury, among the widest spreads witnessed in the past decade. While this has bolstered levered return prospects, many buyers remain wary of a potential economic slowdown and their underwriting models continue to deliver more cautious valuations. Sellers, meanwhile, are citing strong performance metrics that support aggressive asking prices. The resulting bid/ask spread has moderately slowed transaction activity for all commercial real estate property types excluding industrial assets. Though third quarter commercial real estate sales slowed relative to the same period last year, they are still quite strong compared with the long-term average.

10-Year Treasury vs. 2-Year Treasury Yield Spread Tightens

10-Year Treasury vs. All CRE Cap



** Through Nov. 6*
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