

**Despite the strong rally in U.S. equity prices and sharp sell-off in U.S. government bonds in the days immediately following the election, we anticipate very little change in economic and property market fundamentals**

**U.S. ECONOMIC AND PROPERTY MARKET OVERVIEW**

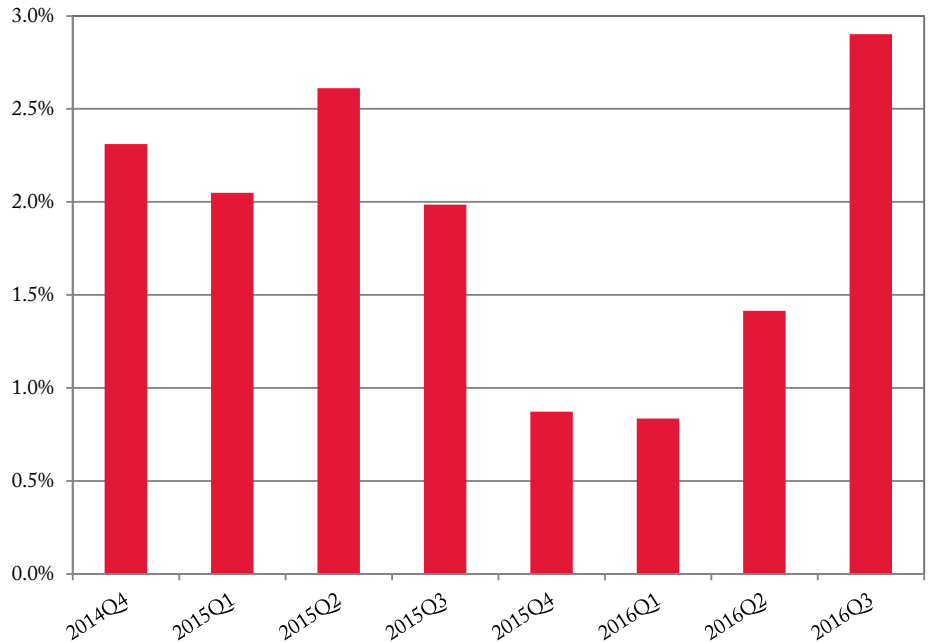
The unexpected outcome of the November 8th election was generally not priced in to most asset markets, including U.S. commercial property. Despite the strong rally in U.S. equity prices and sharp sell-off in U.S. government bonds in the days immediately following the election, we anticipate very little change in economic and property market fundamentals during the last quarter of 2016 and first quarter of 2017. Beyond that, there is very little specific information to evaluate at this time with respect to legislative priorities of the incoming administration. At this time, we anticipate that the near-term priorities will be in the areas of tax cuts, increased infrastructure spending and immigration enforcement. We will, of course, incorporate information as it becomes available and adjust our outlook for the U.S. economy and property markets accordingly.

Following a distinct two-quarter downshift in aggregate growth that heightened recession fears in late 2015 and early 2016, the U.S. economy slowly regained momentum in the second and third quarters. In fact, the economy grew at an annualized rate of 2.9% during the third quarter of 2016, the strongest growth since the third quarter of 2014. While third quarter growth was relatively broad based, preliminary reports show much of the acceleration resulted from a sharp increase in exports, particularly agricultural products. Overall, the U.S. economy seems likely to finish the year showing 2% real growth on an annual basis, roughly in-line with the average growth rate since the last recession ended in the middle of 2009.

Moreover, the U.S. economy added slightly more than 600,000 new jobs during the quarter (i.e., 200,000 per month), in line with the average quarterly job growth of recent years. Overall, the U.S. labor market appears broadly healthy. The overall unemployment rate is now below 5%, the unemployment rate for workers with a college degree is below 2.5% and new weekly claims for unemployment insurance are at the lowest levels since the early 1970s. Additionally, the number of open and unfilled positions reported by U.S. employers now stands at close to 5.5 million,

slightly below the all-time record of 5.8 million recorded during the summer, and employers are increasingly reporting that they are having difficulty finding workers for these positions.

**Figure 1**  
**Annualized Real GDP Growth**



Source: National Income and Product Accounts (NIPA)

Reflecting this, there are now clear signs of accelerating wage growth across many parts of the labor market. For example, the Federal Reserve Bank of Atlanta’s “Wage Growth Tracker” is showing average hourly wage increases of 3.6% over the past 12 months with surprisingly little variation between the various categories of workers they track. Similarly, long present deflationary pressures within the U.S. economy may also be moderating as the core consumer price index (i.e., CPI excluding food and energy) is registering more than 2% on a year-over-year basis for 11 consecutive months. More significantly, total CPI is expected to show annualized increases above 3% during the first quarter of 2017 as the impact of the prior year’s sharp drop in energy prices rolls out of the year-over-year measurement.

Despite these observations, normalization of U.S. monetary policy remains on hold as the Federal Open Market Committee (FOMC) continues to weigh the risks to U.S. and global growth. At their latest meeting, policy makers gave forward guidance for overnight lending rates that would bring the Federal Funds rate to 2% by 2018. At the same time, the market determined forward curve indicates a short-term interest rate of less than 1% by the same date.

## Key Real Estate Indicators

Property Type	Vacancy Rates	Rents	Absorption	Completions	Cap Rates	Transaction Volume
Office	13.0%	↓	↑	↓	↑	↓
Industrial	8.4%	↓	↑	↑	↓	↑
Retail	10.4%	↓	↑	↔	↓	↓
Multifamily	4.5%	↑	↑	↔	↓	↑

↑ Higher      ↓ Lower      ↔ No Significant Change

Source: CBRE-EA, NCREIF, RCA, NICMAP

Note: The arrows reflect the trend for previous 12 months for rents, absorption, completions and transaction volumes; and current quarter versus year ago for vacancy rates and cap rates. For vacancy rates, a down arrow indicates declining vacancy rates. For cap rates, a down arrow indicates falling cap rates or rising prices.

**As the marginal buyer is typically the price setter in most markets, foreign investors have helped drive property yields to record lows, particularly in the dominant U.S. gateway markets such as New York and San Francisco**

This discrepancy largely reflects the impact of a global capital market where long-term interest rates remain near or below zero in countries such as Germany, Switzerland and Japan. Indeed, a recent report by Bloomberg estimates that as much as \$10 trillion of capital is currently invested in negative-yielding sovereign debt. Most observers continue to believe that the FOMC will raise the overnight lending rate at their last meeting of the year in December. If so, this will represent the first interest rate increase since their December 2015 meeting. Moreover, unless the pace of tightening increases significantly, it is unlikely that long rates or property yields will change significantly during 2017.

Against this global low-yield environment, investor interest in U.S. commercial property remains strong, with foreign direct investment in U.S. properties doubling between 2014 and 2015 and increasing by more than 30% between the first half of 2015 and the first half of 2016. In aggregate, U.S. commercial property transaction volume dropped slightly during the first quarter of this year, while the foreign share of that volume continued to grow. As the marginal buyer is typically the price setter in most markets, foreign investors (frequently with a lower cost of capital than their U.S. counterparts) have helped drive property yields to record lows, particularly in the dominant U.S. gateway markets such as New York and San Francisco.

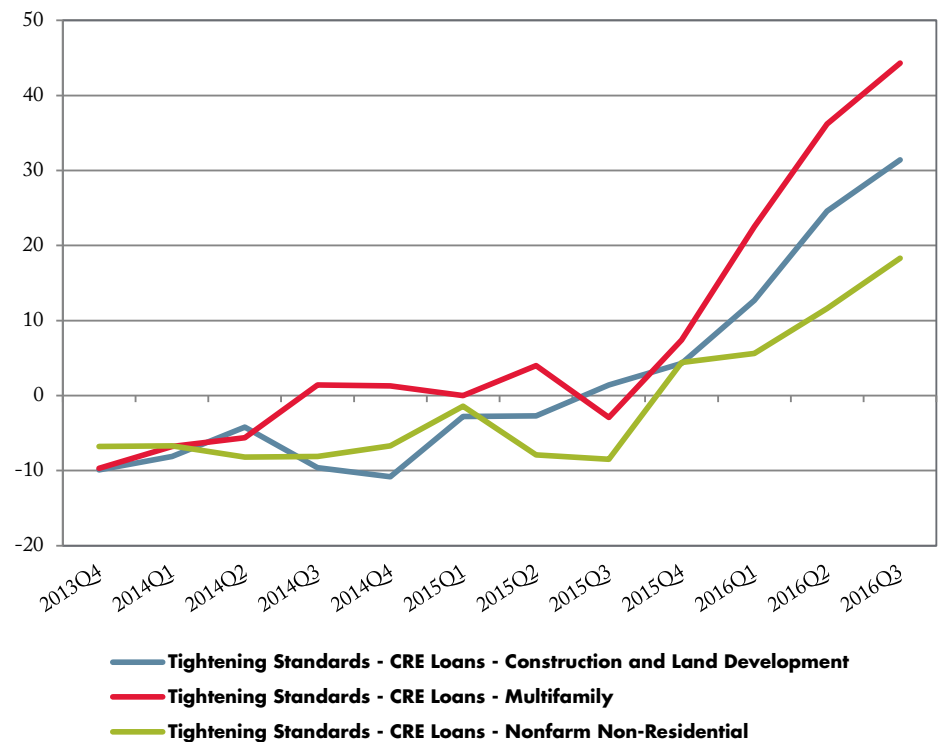
With yields at all-time lows, investor concern over current property valuations remains heightened and all measures of expected go-forward returns have moderated. Surveys of investor sentiment such as the quarterly survey conducted by the Pension Real Estate Association (PREA) suggest total returns from unleveraged core property between 6% and 7% over the next five years, with the lion's share of that return coming from income rather than appreciation.

These lower but positive return expectations reflect the combination of generally strong property market fundamentals that remain in place at this later stage of the economic cycle, offset by the realization that property yields are unlikely to move any lower in this cycle. Furthermore, with vacancy rates now at or below long-term averages in most markets and across most property types and average rents now at or above prior peaks, it is unlikely that property incomes can continue to grow at the pace they have over

the last few years. Property income will continue to grow, but the pace of growth will gradually downshift to more “normal” levels over the long term.

Historically, the most common cause of the end of a real estate cycle has been elevated levels of new construction; today, construction levels remain well below comparable periods in prior economic and property market cycles. While construction levels have been increasing more recently in response to rising rents and property income, we believe construction will remain more constrained than in the past, particularly as bank lending conditions continue to tighten as evidenced by new survey data of senior lending officers now published by the Federal Reserve.

**Figure 2**  
**Percentage of Senior Lending Officers Reporting Tightening of Credit Conditions**



Source: Federal Reserve

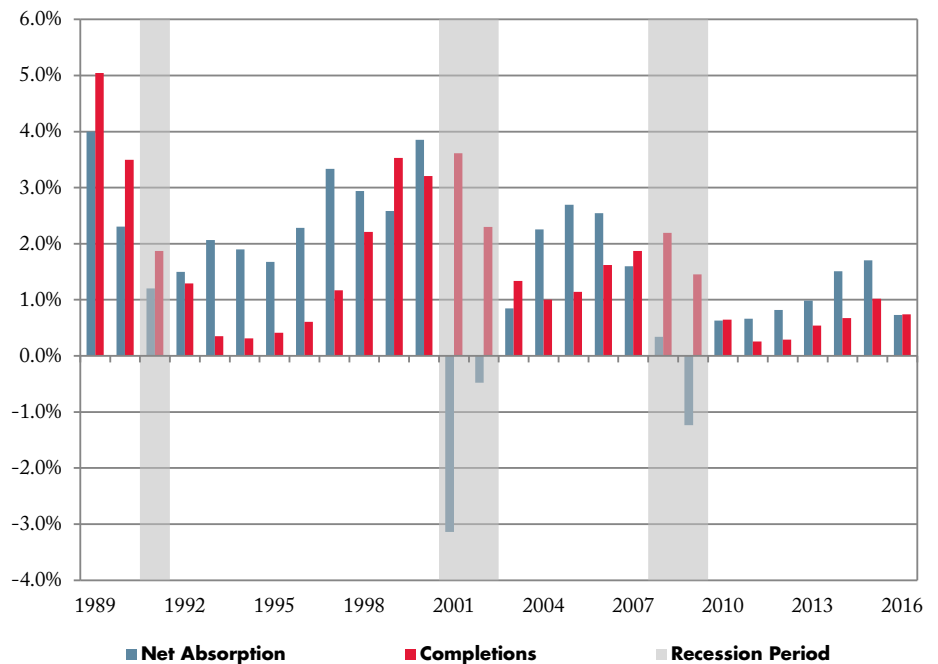
In the end, however, even in an environment of moderating returns, commercial property continues to present a compelling investment opportunity relative to other asset classes in this world of low yields. With a clear and strong earnings outlook over the next several years, real estate should continue to be competitive with other asset classes on a risk-adjusted basis.

## OFFICE

Office market conditions remained steady in the third quarter of 2016, with the national office vacancy rate of 13%, unchanged from the prior quarter. Vacancies are only 60 basis points above their pre-recession low and are down 400 basis points from their mid-2010 peak. Sustained job growth and relatively modest levels of construction continue to support today's healthy fundamentals.

While fundamentals are much improved and market conditions are the best they have been in years, the recovery/expansion has been muted relative to previous cycles. Thankfully for landlords and property owners, construction has been constrained, allowing for the moderate levels of demand to chip away at vacancies. In fact, since the recovery began in 2010, net absorption has outpaced new supply by 70%. Still, demand has been modest in comparison to the two previous real estate cycles, and during the current recovery/expansion, the absorption rate has averaged only 1.0% annually, approximately half the rate of the previous two cycles. The slower start to the recovery and the “rightsizing” of office space worked to temper demand at the onset in the early years of the recovery. Construction was slower to get started, with completions as a share of inventory averaging a mere 0.4% in the first three years of the recovery, the lowest construction rate at the onset of a recovery in history. More recently supply has picked up with completions as a share of inventory averaging 0.7% since 2013, but this is still well below the previous cycles' increases of 1.0% (late 1990s) and 1.4% (mid 2000s), and nearly half the rate of demand growth (1.2%) over the same period.

### Muted Demand & Supply Recovery Relative to Previous Cycles (Net Absorption and Completions as a Share of Inventory)



Sources: CBRE-EA, AEW Research

**Over the next couple of years, rent growth is projected to be the strongest on the West Coast, with Oakland, San Diego, Orange County and Phoenix expected to be among the top performers.**

Metropolitan areas where supply is elevated include tech markets like San Jose, Seattle, Denver and Austin, as well as growth markets like Nashville and Raleigh. Pre-leasing is generally high across all markets. San Jose and Nashville, which have the most significant construction underway as a share of stock at 18.6% and 12.5%, respectively, are reporting pre-leasing of over 70%. Further, among the thirteen markets with 3.0% or more of inventory underway, only two markets – San Francisco (31.1%) and Austin (38.0%) – reported pre-leasing of less than 40%. On average, the pre-leasing among the thirteen markets with higher construction activity is nearly 60%, a sizeable pre-development commitment and an indication that speculative development remains fairly restrained.

Going forward, supply should slowly ebb, particularly as credit markets tighten, further restricting access to construction debt. According to data from the Federal Reserve, roughly one-third of lending officers are reporting tighter credit conditions today, up from nearly zero at the start of the year. Demand should remain positive, supported by continued, but more moderate, employment gains. Office employment growth is projected to slow from the average annual growth of 2.4% over the 2014 to 2016 period to 1.5% annually over the next five years. While slowing, the continued growth in payrolls will be positive and support net new office demand, keeping vacancies relatively low and allowing for future rent growth. Rent growth will be strongest in the near term, before settling at roughly 2.5%-3.0% over the long term. Over the next couple of years, rent growth is projected to be the strongest on the West Coast, with Oakland, San Diego, Orange County and Phoenix expected to be among the top performers. Of note, several Tier II or secondary markets are expected to exhibit outsized gains in the near term as well, as tenants seek more affordable rental options and tap into markets such as Oakland, Phoenix, Charlotte and Portland that offer highly educated, skilled workers.

Office	
<b>Vacancy Rate</b>	<b>13.0%</b>
12-Month Trend	
<b>Vacancy Change</b>	↓
<b>Rent</b>	↑
<b>Absorption</b>	↓
<b>Completions</b>	↑
<b>Cap Rates</b>	↑
<b>Transaction Volume</b>	↓

**Nearly 77 msf of industrial space was absorbed on a net basis in the third quarter, a 17.6% increase from the previous quarter and the tenth time demand has topped 75 msf in a single quarter since CBRE-EA first began tracking data in early 1989**

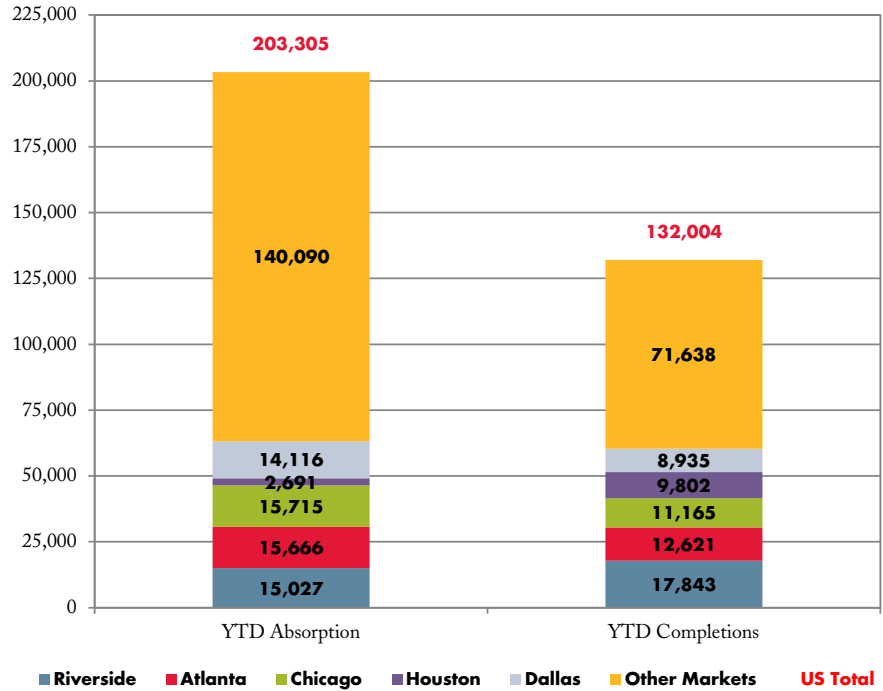
## **INDUSTRIAL**

The industrial sector continues to be the strongest performer of the four major property types. As of the third quarter, national availability dropped to 8.4%, down 20 basis points from the previous quarter and 60 basis points year-to-date. Availability has now reached its lowest levels since the first quarter of 2001 and continues to edge closer to the sub-8% levels last seen in the mid-to late 1990s. Availability is also now 5.9 percentage points below its third-quarter 2010 peak of 14.3%, highlighting the strength of the recovery seen to date. West Coast markets continue to dominate as the sector's strongest performers. Seattle joined Orange County, Los Angeles and San Francisco as metropolitan areas reporting sub-5% availability in the quarter, while Portland (5.2%) is on pace to join that group by year end. Indeed, West Coast markets represented eight of the top 10 best performing industrial markets during the past quarter in terms of availability. Additionally, 24 of the 59 markets tracked by CBRE-EA are now reporting availability of 8% or less, compared to 21 markets just one quarter ago.

The further improvement in national industrial fundamentals was fueled by one of the strongest single-quarter levels of demand seen post-recession. Nearly 77 million square feet of industrial space was absorbed on a net basis in the third quarter, a 17.6% increase from the previous quarter and just the tenth time that demand has topped 75 million square feet in a single quarter since CBRE-EA first began tracking data in early 1989. Through the first three quarters of 2016, more than 203 million square feet of industrial space has been absorbed, which is the single largest total through three quarters in this recovery. Perhaps most impressive is that absorption continues to outpace rising supply. Nearly 53 million square feet were delivered this past quarter, which is a figure nearly double the post-recession average of 24.4 million square feet per quarter and the highest completion total in the post-recession period. Despite this increase in construction, demand managed to top supply for the 25th consecutive quarter, emphasizing the positive momentum that the U.S. industrial market is currently seeing today.

Though construction has picked up over the past year, the majority of completions have been highly concentrated in the nation's largest distribution hubs. Of the 132 million square feet of space that has been completed in 2016, more than 60 million square feet (45.7%) were brought online in just five markets: Riverside, Atlanta, Chicago, Houston and Dallas. While these markets have seen an influx of new supply, new space is being absorbed at an impressive pace, as three of the five metropolitan areas (Chicago, Atlanta and Dallas) have seen absorption totals well above year-to-date completions. Demand and supply were roughly even in Riverside, with the market adding nearly 18 million square feet and absorbing more than 15 million square feet. Houston is the only anomaly in the group, where supply outpaced demand by a significant margin (9.8 million square feet of completions vs. 2.7 million square feet of absorption). Houston's demand softened in late 2015 and early 2016, as a result of the decline in the energy sector, although energy prices have recently stabilized and industrial demand has begun to pick up. Additionally, the weakness in the Houston market was generally concentrated in the market's energy nodes, which are located north and west of downtown Houston; markets to the south and southeast continued to improve despite the slowdown in the energy sector.

**Gateway Markets Lead Demand & Supply Growth  
(Ths. of Square Feet)**



Going forward, there are currently 72 million square feet of industrial space under construction with an expected completion date before the end of 2016, according to CBRE-EA. When paired with the 132 million square feet already brought to market this year, the total (204 million square feet) will amount to the highest single-year construction level since 2008. That said, demand has averaged nearly 68 million square feet per quarter thus far this year, which puts absorption on track to outpace supply by nearly 70 million square feet in 2016, registering the largest annual demand total since 2005. Going forward, AEW believes that construction should be tempered longer-term as a result of today's increasing construction costs, more stringent lending environment and continued global uncertainty. Reduced levels of construction, combined with continued healthy demand, should keep fundamentals in check and support further rent growth in the sector.

Industrial	
Vacancy Rate	8.4%
12-Month Trend	
Vacancy Change	↓
Rent	↑
Absorption	↑
Completions	↑
Cap Rates	↓
Transaction Volume	↑



**Although market performance is still strong compared to the long-term average, the national apartment market is moderating from its outstanding showing in 2014 and 2015**

**MULTIFAMILY**

According to CBRE-EA, apartment vacancies stood at 4.5% in the third quarter of 2016, up 10 basis points from the previous quarter and 20 basis points higher than the same period one year ago. The greater New York/New Jersey markets again reported some of the lowest vacancies: Newark led the area with a vacancy rate of only 2.7%, followed by Long Island (2.9%) and New York (3.1%). Compared to a year earlier, 22 of the 66 markets reported by CBRE-EA showed an improvement in vacancies, while 38 recorded increases and six reported flat vacancies. The largest declines in vacancies occurred in Norfolk, Louisville, Tucson, Minneapolis, Cleveland, San Diego, Sacramento, Las Vegas and Orange County. Of the markets that have posted year-over-year increases, the largest gains were in San Jose, Oakland, San Francisco, Chicago, Portland, Denver, Fort Lauderdale and Houston. That said, San Jose, Oakland, San Francisco, Chicago and Portland all reported vacancies below 5%.

Although market performance is still strong compared to the long-term average, the national apartment market is moderating from its outstanding showing in 2014 and 2015. According to Axiometrics, effective rents increased 3.0% year-over-year as of the third quarter of 2016, more than two percentage points below the robust 5.2% rent growth from one year ago. The slowing in rental growth is the result of several factors, including supply and lease-up concessions, renter fatigue and affordability.

New supply coming to market is playing a large part in the slowing of rent growth in some markets. Overall, roughly 360,000 units have been delivered to the market since the beginning of 2015, and an additional 360,000 units are expected over the next five quarters. While this represents a small amount of new supply on a national level, a 1.7% increase in stock annually over the 2015 to 2017 period, there are submarkets where the uptick in supply is more pronounced and these markets are seeing rents soften as a result. Markets that fall into this category include Old Town Alexandria in Washington, D.C., Central Austin and submarkets neighboring Center City in Philadelphia. Again, demand in these markets remains strong, and we expect rent growth will resume once the new supply is absorbed.

On the flip side, we are beginning to see renter fatigue in markets where rents are highest and affordability is becoming a greater issue. New York and the San Francisco Bay Area fall into this category. In New York, effective rents were down 0.2% year over year, while San Francisco and San Jose saw rent declines of 0.5% and 0.8%, respectively, according to Axiometrics. In New York, renters have increasingly left Manhattan for Hoboken, Jersey City and Brooklyn, in search of lower rent alternatives. Likewise in San Francisco, renters are seeking more affordable housing in the East Bay, San Jose and San Mateo. Overall, the slower performance of high-priced markets was partially offset by robust fundamentals in secondary markets. For example, annual effective rent growth was among the highest in Sacramento, Riverside, Salt Lake City, Las Vegas, Fort Worth, Tampa and Nashville.

Finally, Houston continues to be a laggard, having struggled for the past 18 months. As of the third quarter of 2016, current effective rents were down 2.8% from a year ago. Houston is still hurting from the job losses in the energy sector, but the good news is that employers are continuing to add more jobs outside of the energy sector. That

**Millennials are choosing to rent longer rather than purchase a home, while many empty-nester Baby Boomers are selling their homes and moving into Class A apartments**

said, this has yet to affect the market for Houston apartments as the surge of new supply, especially in the urban core Montrose/River Oaks submarket, will likely keep fundamentals tempered in the near term.

Going forward, nationally we expect supply will begin to taper, particularly as construction debt has become more difficult to obtain; demand is expected to remain healthy. The continued growth in employment, aging of the Millennial generation, downsizing of the Baby Boom generation, and overall decline in the homeownership rate all bode well for demand.

Indeed, Millennials are choosing to rent longer rather than purchase a home, while many empty-nester Baby Boomers are selling their homes and moving into Class A apartments. Although home sales are near their highest rate since October 2007, increased prices are keeping many potential home buyers out of the market. Further, single-family home construction is subdued and, while multifamily housing construction has picked up, total housing growth remains limited. Indeed, total housing construction has been running below household formation and this is not expected to change; therefore, we expect both rents and home prices will continue to advance over the long term. That said, we do anticipate the spread between household formation and housing inventory growth will narrow. Rents and home prices will advance, but at a moderate pace that is more in line with inflation over the long term.

<b>Multifamily</b>	
<b>Vacancy Rate</b>	<b>4.5%</b>
<b>12-Month Trend</b>	
<b>Vacancy Change</b>	↑
<b>Rent</b>	↑
<b>Absorption</b>	↔
<b>Completions</b>	↑
<b>Cap Rates</b>	↓
<b>Transaction Volume</b>	↑

## RETAIL

The U.S. labor market continued to generate jobs at a solid pace even in its seventh year of uninterrupted growth. This employment growth provided a strong basis for the continued recovery the retail sector experienced in the third quarter of 2016. On a year-over-year basis, total employment grew at a rate of 1.7%, while personal income grew by 4.3%. The continued improvement in the job market puts upward pressure on wages, which has translated to increased consumer spending. Retail sales (excluding autos and gasoline) increased at a solid year-over-year pace of 3.4%. Within the retail sector (excluding autos), food service and drinking places, building supply, drugstores and furniture stores reported the strongest growth; on the other hand, sales within the apparel, electronics and department store segments continued to lag.

The positive news on the consumer front continued to support the gradual improvement in retail property market fundamentals, particularly in light of limited additions to supply. As of the third quarter of 2016, neighborhood, community and strip center availability declined to 10.4%, down 10 basis points from the prior quarter and down 40 basis points year-to-date. The current availability rate has improved by 280 basis points from the mid-2011 cyclical peak of 13.2%—this continued improvement in fundamentals is translating into rent growth.

Year-to-date, the neighborhood and community segment of the market has outperformed the lifestyle, mall and power center segments of the market. Availability in the power center segment edged up 60 basis points over the first three quarters of the year, advancing to a still low 6.4%. The power center market has been hit by store closures (Sports Authority, Hancock Fabric, Eastern Mountain Sports, Sports Chalet, Office Depot and Staples). In aggregate, 2.2 million square feet of space has been returned to the market. Meanwhile, availability in the lifestyle and mall segment increased 50 basis points year-to-date to 6.9%, and like the power center segment, store closures yielded negative net absorption of 2.0 million square feet. Despite these closures, net new demand (23.5 million square feet) within the neighborhood and community shopping center segment has more than offset this softness. As such, total retail availability, at 7.3% in the third quarter, is down 30 basis points year-to-date.

Regionally, availability in the third quarter declined in 43 of the 62 markets tracked by CBRE-EA. Overall, San Francisco recorded the lowest availability at 4.1%. Miami, Orange County, Honolulu, San Jose, Los Angeles, Oakland, Austin and Raleigh were not far behind, all with availability of less than 7.5%. Denver, Nashville, Providence, Tampa and Minneapolis were among those recording the greatest year-over-year declines. Meanwhile, Trenton, Birmingham, Cleveland, Detroit and Chicago were on the other end of the spectrum with availability above 14%.

One segment of the market where construction has picked up is urban centers. Developers are ushering in a modern urban mall concept, featuring mixed uses alongside higher-end retailers. For example, in New York, the Shops at Hudson Yards will feature a Neiman Marcus, while in Miami, Brickell City Center will be anchored by Saks Fifth Avenue. So far this cycle, six of the 15 malls under construction nationwide and two of the six under renovation are urban centers. More traditional big-box retailers are also moving into urban areas with Target planning to open new,

smaller stores in cities and college towns; Target’s new urban concept will contain 50,000 square feet or less, roughly one-third the size of the traditional Target store. To maximize shelf space, Target will select smaller package sizes and fewer brands for many of the same items offered in bulk at its larger stores. Target also wants customers to use the new stores as pickup locations for online orders. The first of these stores is slated to open in New York City’s Tribeca neighborhood this fall.

Going forward, we expect fundamentals will continue to slowly improve as net new demand, driven by the strength of the broader economy, remains healthy enough to offset store closures. New supply is also expected to remain muted, allowing for availability to continue on its downward trend. We do not expect that these trends will significantly change supply and demand fundamentals, and broadly, rent growth should remain tempered with better located centers outperforming. The old real estate adage location, location, location is particularly important in the current retail environment.

<b>Retail</b>	
<b>Vacancy Rate</b>	<b>10.4%</b>
<b>12-Month Trend</b>	
<b>Vacancy Change</b>	↓
<b>Rent</b>	↑
<b>Absorption</b>	↑
<b>Completions</b>	↔
<b>Cap Rates</b>	↓
<b>Transaction Volume</b>	↓

## CAPITAL MARKETS

Transaction volume continued to decline in the third quarter, but the moderation in volume has stabilized. Nearly \$115 billion in properties changed hands during the quarter, down 2% from the same period one year ago, but less significant than the 17% and 7% year-over-year declines that were experienced in the first and second quarters, respectively. Again, by transaction type, slower portfolio and entity sales accounted for the entire moderation in transaction volume in the third quarter. The total portfolio trade volume of \$22.2 billion was down 25% year-over-year, while single asset sales increased 2% to \$92.2 billion.

Among the product types, the apartment sector recorded both the greatest volume of transactions and the highest growth. The apartment sector accounted for one-third of total volume with nearly \$37 billion in apartments changing hands in the quarter, up 7% year-over-year. Industrial and hotels were the only other property types showing an increase in sales: \$14.2 billion in industrial properties closed in the quarter, up 3% year-over-year, and \$7.6 billion in hotels closed, up 2% from a year earlier. Sale volume for development sites showed the greatest decrease with only \$3.7 billion changing hands in the third quarter, down 36% from the third quarter of 2015. Finally, roughly \$18 billion in retail properties closed, down 10% from a year earlier, while nearly \$34 billion in office assets traded hands, 4% lower than the volume one year ago.

Major markets experienced a sizeable year-to-date decline in transactions relative to 2015; \$146 billion in major market properties traded through the first three quarters of 2016, down 11% compared to 2015. Secondary market transactions totaled nearly \$52 billion in the third quarter, essentially flat on a year-over-year basis; combined with the first and second quarters, secondary market transactions totaled nearly \$150 billion year-to-date, down 4% relative to volumes in the first three quarters of 2015. Tertiary markets gained significant traction in the quarter, with nearly \$18 billion in properties changing hands, a 17% increase over the third quarter of 2015. While the third quarter volume was significant, it was not enough to offset softness in the first half of the year; overall, year-to-date volumes in tertiary markets are down 14% from the same period in 2015.

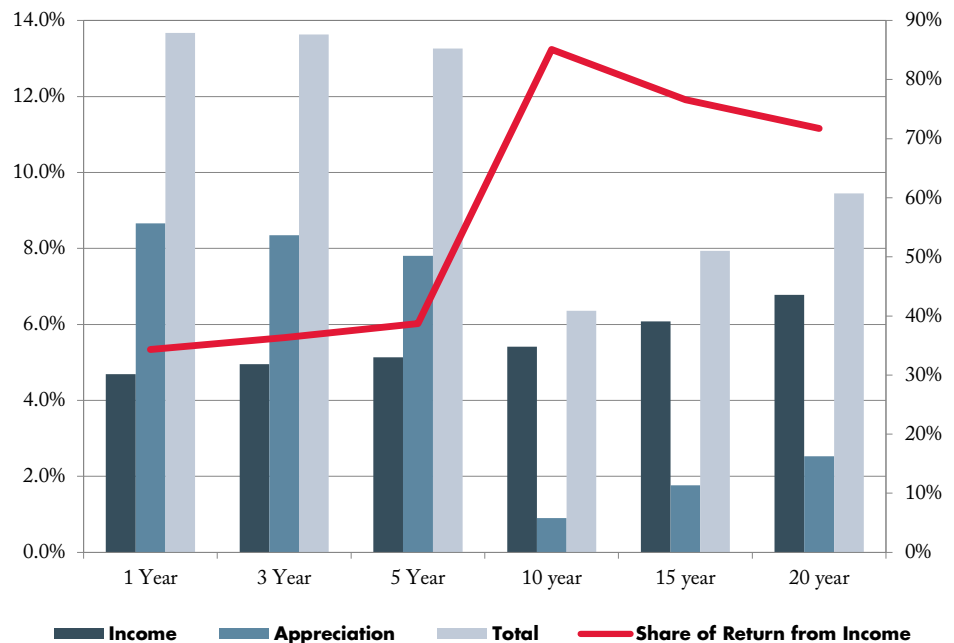
Year-to-date, transaction activity has risen substantially in Denver (40%), Oakland/East Bay (40%), Las Vegas (86%), Suburban Maryland (33%), Boston (18%) and Fort Lauderdale/Broward (23%). In 2015, Las Vegas was the 34th most active market, but year-to-date in 2016, the metropolitan area rose to the 21st most active market. Denver, Oakland, Fort Lauderdale and Suburban Maryland all climbed in the rankings as well. Not surprisingly, volume in Houston was the softest, with transaction volume declining 36% year-to-date. Despite this, Houston was the fifteenth most active market, with nearly \$6 billion in transactions.

Meanwhile, buyer composition continues to move towards foreign buyers. Cross border investors acquired roughly \$9.0 billion of properties on net (less dispositions) in the third quarter of the year. The only other investors to increase acquisitions in the quarter were private buyers, who added nearly \$8 billion in property to their portfolios on net. Institutional investors and REITs were net sellers, disposing of \$10 billion and \$7 billion of property, respectively, during the third quarter. On a year-to-date

basis, cross border, institutional and private buyers have all been net buyers. Overall, institutional investors are on track to be net buyers on an annual basis for the first time since 2012; conversely, REITs are on track to be net sellers for the second year in a row. Compared to underlying real estate prices, REITs are trading below their net asset values, making it difficult for REITs to raise equity through share issuance. Instead, REITs are funding their acquisition, development and redevelopment pipelines through property sales. Additionally, the discount to NAV also encourages REITs to buy back shares or to go private. The latest example of the latter is Brookfield Asset Management’s acquisition of Rouse Properties; Brookfield closed on the \$2.8 billion transaction in July and the stock was subsequently delisted.

While transaction volumes were lower in the quarter, prices continued to move higher. In August, the Moody’s/RCA CPPI national composite index rose 1.1% on a month-over-month basis. Further, the CPPI advanced 8.2% on a year-over-year basis, the greatest year-over-year gain since January. While prices have resumed their upward trend, the pace of growth is more restrained relative to the double-digit growth experienced since 2013. This, of course, has been expected; real estate has enjoyed several years of above-average appreciation and a return to more moderate gains is consistent with the later stages of recovery/expansion.

**Long-Term, Majority of Return Comes from Income  
U.S. Core Fund Returns**



The overall moderation in pricing is affecting returns as well, particularly the appreciation return component of the NCREIF Property Index (NPI). The third-quarter NPI appreciation return was 0.6%, the slowest growth in the post-recession period. The income return for the quarter was 1.16%, which is consistent with the previous four quarters, but down from the 1.30% average quarterly return posted over the 2014 to mid-2015 period. Overall, the total NPI return for the third quarter was 1.77%, again the slowest growth in the post-recession period, due primarily to the

slowdown on the appreciation side. Going forward, expectations are for returns to continue to moderate, again largely driven by a projected slowdown in appreciation. We expect most of the returns in the years ahead will come from income rather than from appreciation—as has been the case in the past few years. The switch to a more income-driven return is a reversion to historical norms, where income has typically made up the lion's share of returns.

## DID YOU KNOW?

Investment themes we are observing in the market today...

... According to the Job Opening and Labor Turnover Survey (JOLTS) report, job openings exceed hires in manufacturing, finance, education/healthcare and government with the largest gap in education/healthcare, where there were 1.063 million openings in September but only 592,000 hires. The overall hire rate fell to 3.5% from 3.6%, suggesting that employers are having trouble filling positions.

... Roommate renter households, or non-family renter households of more than one, have grown at an average annual rate of 2.9% since 2007, double the 1.4% average annual pace of growth in single-person renter households. The number of roommate-renter households created by the 65 and older group has started to increase, averaging more than 15,000 new such households annually since 2011—this follows essentially no growth in the cohort over the entire 2006 to 2010 period.

... According to CBRE's Tech Thirty report, since 2011, the average tech submarket reported a 13% rent premium relative to their overall metropolitan area's rent. There is, however, a wide variation in performance across markets with the tech hubs of East Cambridge, Palo Alto and Santa Monica garnering premiums of 102%, 82% and 82%, over their respective market averages, meanwhile Reston/Herndon (-18%), Northeast Charlotte (-16%), Hillsboro Oregon (-8%) and the RTP/I40 Corridor (-7%) in Raleigh/Durham are priced at a discount to their broader market.

... In August, Macy's announced it would close 100 stores, most of them in 2017; to date, the company has closed 41 underperforming stores. With an average store size of over 180,000 square feet, the closures could translate into 18.1 million square feet of idle space; this will likely lead to further bifurcation within the retail sector as Macy's underperforming stores tend to be in older, less competitive centers in smaller markets.

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