Nareit Commercial Property Update

2017: Q4

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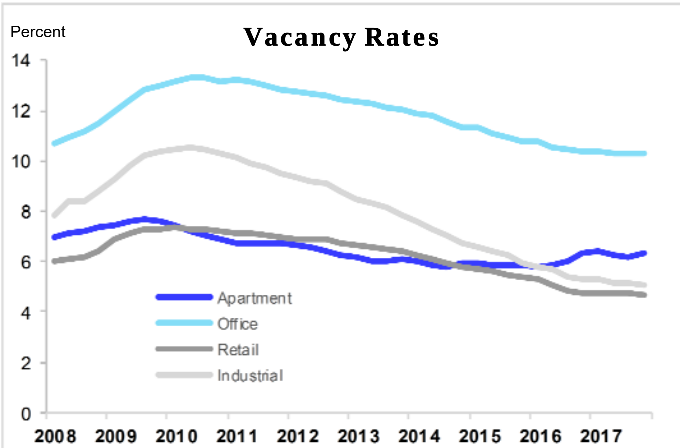
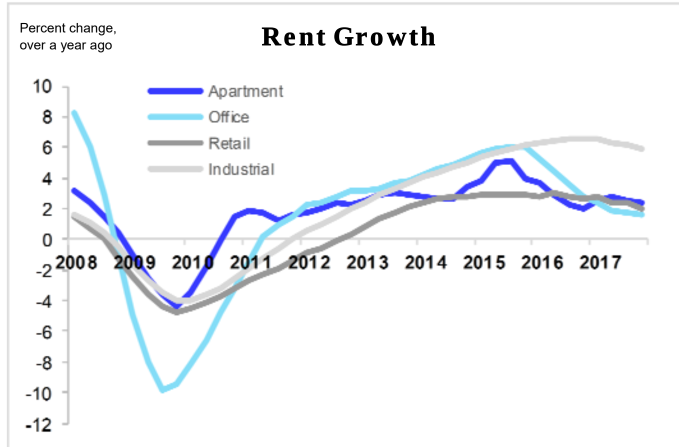




Apartment

The apartment sector softened in the fourth quarter. Both completions and net absorption decelerated compared to Q3, with absorption falling short of construction by a bit. This slower growth of demand caused vacancies to tick up slightly, to 6.3 percent, and rent growth decelerated to 2.4 percent growth over year ago. 2017 was a strong year for the sector, though, with net absorption up 40 percent from 2016. Affordability remains an issue—rents are sky-high in many cities—and weighs on rent growth.

Office

Demand and supply both rebounded in the fourth quarter of 2017, and net absorption outpaced completions by a whisker. Vacancy rates have been flat for several quarters, at the bottom of the range for the past decade. Rent growth continued to decelerate, however, but still outpaced inflation. The slowdown in rents is surprising given the pace of growth of office jobs. We expect rent growth to be steady-to-up in 2018, as dampened employment in Gateway cities reverts to trend.

Retail

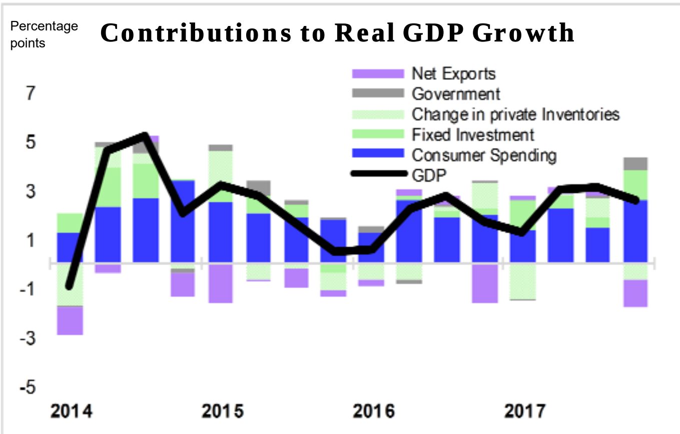
Net absorption for retail space gained speed in the fourth quarter, rising 21 percent over year ago, after five straight quarters of slowing growth of demand. The vacancy rate decreased by 20 basis points, to 4.6 percent. Rent growth eased to 2.0 percent, the slowest in over four years. Some retailors are optimistic for the coming year, despite recent store closures and bankruptcies in 2017, as the added income from tax reform bolsters consumer budgets.

Industrial

Demand for industrial space was robust, with net absorption rising to the highest level since 2016:Q3. Demand exceeded new supply, lowering vacancy rates by 20 basis points, to 5.0 percent. Rent growth decelerated a bit, but remains near its highs for the cycle, as E-Commerce continues to fuel the need for logistics facilities.

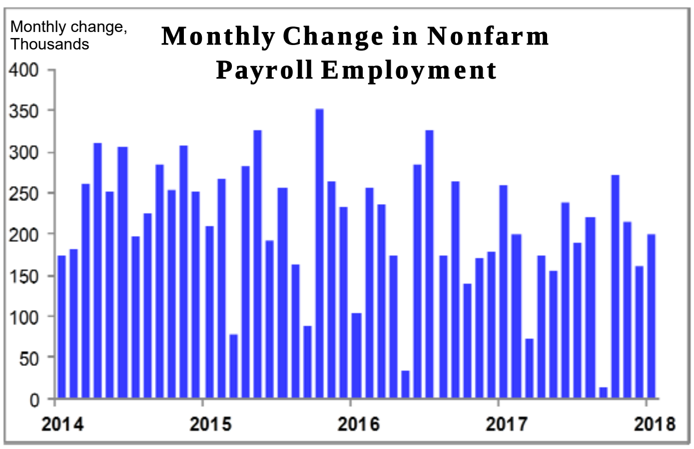
Source: Data from CoStar and Nareit 2018.

Economic Fundamentals for Commercial Real Estate



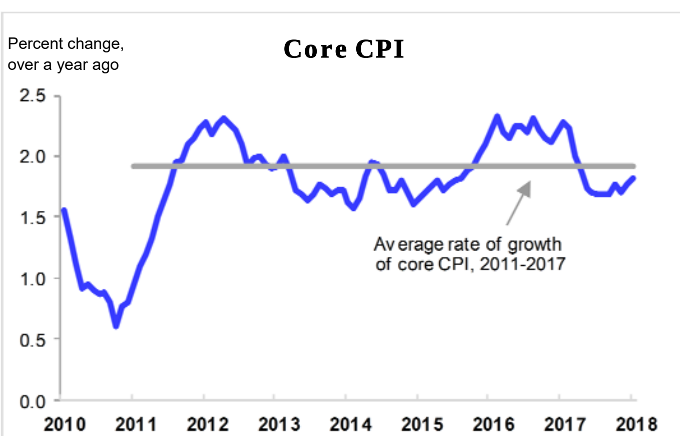
Economic activity slowed slightly in Q4

GDP rose at a 2.6 percent annual rate in the fourth quarter of 2017. Consumer spending (blue bars; total GDP growth in solid line) was on the high side of recent trends, boosted by spending on durable goods like autos, furniture and appliances. Fixed investment (green bars) rose, adding 1.3 percentage points to total GDP growth. A decline in private inventories (green checkered bars) and net exports (purple bars) subtracted from total growth for the quarter. These variables, however, tend to be volatile and are less indicative of long term trends.



Strong payrolls report kicks off 2018

Payroll employment rose 200,000 in the first month of 2018, up from an average 181,000 monthly increase in 2017, while the unemployment rate was steady at 4.1 percent. Average hourly earnings accelerated to 2.9 percent over 12 months, highest since 2009. Rising wages focused attention on inflation trends (see below), and interest rates rose following the report.



Rising inflation rates

Consumer price inflation picked up in January, with the CPI up 2.1 percent over 12 months. Higher prices of gasoline, medical care and apparel boosted the January figure. Core CPI, which excludes food & energy, rose 1.8 percent over 12 months, a slight pickup from the 2nd half of 2017, but still below the average since 2011—and also below the Fed's target. Analysis by Nareit economists indicates that wage-push inflation, which characterized the 1970s, has disappeared since 1990, as a decline in union labor, deregulation and globalization have moderated price dynamics.

Source: Data from BEA, BLS, Haver and Nareit 2018.