ODCE

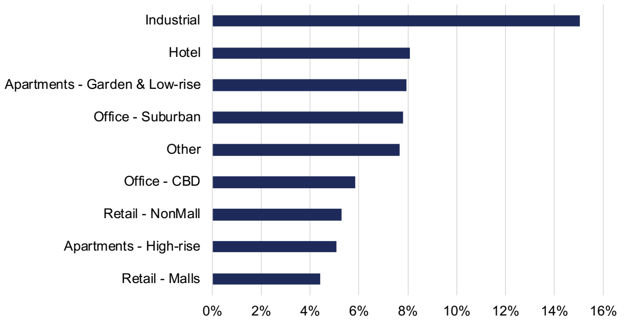
GOING BEYOND THE HEADLINE ODCE RETURNS: EVIDENCE OF GREATER SECTION DISPERSION AND DISCIPLINE

The NFI-ODCE Index produced a 2.1% gross total return in the second quarter and a trailing year return of 8.4%, both up slightly relative to a year ago. Appreciation accounted for nearly half of the total return over the last year. The trailing year gross income return was 4.3% - a record low – and trailing year appreciation was 4.0% - supported by over 4% NOI growth in the same period.

Among property types, there is an increase in the dispersion of performance over the last several quarters. The spread between the leading and lagging property types narrowed in 2017 but has increased in the first two quarters of 2018. Industrial unleveraged property level returns for ODCE-owned properties are almost twice the other major property types, with a trailing year unleveraged total return of 15%, followed by the small hotel segment and by garden apartments. Mall retail and high-rise apartment returns, on the other hand, are lagging, with trailing year unleveraged returns of 4.4% and 5.1%, respectively.

Trailing Year Performance by Property Type & Segment

UNLEVERED GROSS RETURNS FOR PROPERTIES OWNED BY NFI-ODCE FUNDS

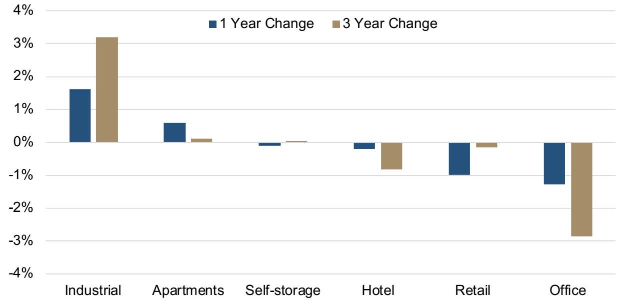


Source: NFI-ODCE. Using the Research database. As of Q2 2018.

While the industrial sector has consistently had among the strongest returns over the last three years, there have been recent swings in relative performance for other property types. The 'other' category, which includes self-storage, has had moderating returns, moving from among the best performers to middle of the pack. Malls have slowed sharply from among the best trailing year returns of any property type segment three years ago.

Change in Net Allocation by Property Type

BASED ON ODCE NET ASSET VALUE

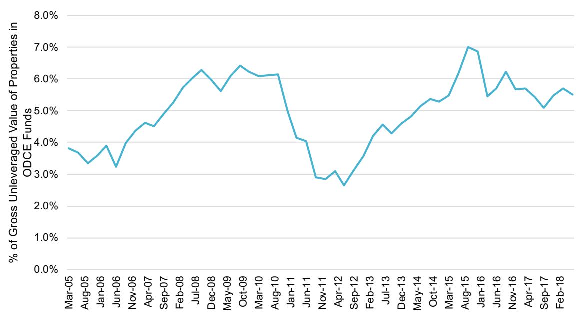


Source: NFI-ODCE. As of Q2 2018.

This wide dispersion of returns has contributed to changes in relative ODCE allocation to different property types. The ODCE Index allocation to industrial, based on net asset value, is up by 1.6% over the last year to 16.6%. Apartment allocations are also up by 0.6%. The index weights to retail and office, meanwhile, are down.

ODCE Allocation to Non-Stabilized Strategies

BASED ON GROSS UNLEVERAGED PROPERTIES HELD BY ODCE FUNDS



Source: NFI-ODCE. Research database. As of Q2 2018.

The ODCE allocation to non-stabilized strategies like development and renovation, currently 5.5%, has been consistent over the last year. In fact, this allocation appears to have peaked earlier this cycle and is currently below the levels it reached leading up to and through the global financial crisis.

Among the non-stabilized investments by ODCE funds, approximately half of this investment by value is in apartments, followed by office with just over 15%. Industrial ranks third for non-stabilized gross asset value, with just under 15%, less than its overall ODCE weight despite strong investor interest. Less than 5% of the non-stabilized assets owned by ODCE funds are retail.

The combination of discipline on allocations to non-stabilized stabilized strategies, as well as recent leverage and occupancy trends, shows that ODCE funds are, on average, staying with low risk core strategies as we move further into the current expansion – now beyond its ninth full year. ODCE Index average occupancy is up by 60 basis points over the last year to 92.9%, 210 basis points above its 15 year average. The ODCE Index leverage ratio has declined by 42 basis points over the last year to 21.1%.

Daniel Mahoney
Senior Vice President – Research & Strategy
LaSalle Investment Management