

OFFICE INDEX

STEADY RETURNS WITH CONTINUED REGIONAL VARIATIONS

Office sector performance over the past year can be characterized as slow but steady returns with widening regional variations. Office returns have managed to outpace the overall NPI in three out of the past four quarters including the most recent quarter. The NPI office sub-index's total return of 1.66% in the second quarter of 2019 made office the second best performing sector during the quarter, after only industrial. On the year-over-year basis, the office sector produced a 6.79% total return, compared to the NPI's 6.51%. This steady performance is consistent with the trends seen in the property market, where demand for office space has picked up since 2018, driving vacancy lower despite rising new supply per CBRE Econometrics Advisors.

Regional return patterns have been consistent over the past several years reflecting local property market dynamics. The Pacific division continues to lead by a wide margin with a total return of 9.35% YoY, driven by a healthy appreciation return of 4.68%. Mountain, Southwest and Southeast are also outperforming the office sub-index, but trail Pacific by more than 200bps. The bottom performers are West North Central and Mideast, where appreciation returns were negative in the second quarter.

Suburban versus CBD performance has been of great interest to investors in this cycle with the structural shift in tenant preferences towards walkable amenities making investors wary about the future of suburban office space. Steady demand for suburban office space by tenants as well as investors according to net absorption and transaction volume statistics indicates America's suburbs are still alive and well. The suburban office subtype has managed to outperform CBD in terms of returns since 2016. In the quarter, suburban office recorded a 1.88% total return, outpacing CBD by 37bps.

Office transactions rebounded in the quarter after a pullback seen at the start of the year with volume up 30% YoY, leading all other major sectors, per Real Capital Analytics. While overall CBD and suburban volumes were both up close to 30%, it is worth noting that single asset sales in the CBD markets were up a strong 42% YoY, versus just a 5% in the suburbs. The strongest growth in office asset sales YTD, not surprisingly, was seen mostly in tech markets including San Francisco, San Jose, Austin, Portland, Boston and Seattle, while sales volume declined in Chicago, Washington D.C. and New York.

The prospect of slowing rent growth as moderating employment growth weighs on office demand will constrain appreciation returns. However, property market fundamentals remain supportive and declining interest rates are a welcome relief for real estate including office. As such, office appreciation returns should remain positive albeit at a slowing pace in the coming quarters. Volatility in transaction volume, however, may continue as global and U.S. economies are still laden with uncertainties.

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OFFICE TOTAL RETURNS

| | Total NPI | Total Office | East | Midwest | South | West |
|--------------|-----------|--------------|------|---------|-------|-------|
| 2nd Q 2019 | 1.51 | 1.66 | 1.15 | 1.06 | 1.79 | 2.33 |
| 1st Q 2019 | 1.80 | 1.63 | 1.17 | 1.24 | 2.09 | 2.07 |
| One Year | 6.51 | 6.79 | 5.03 | 4.55 | 7.21 | 9.14 |
| Three Years | 6.89 | 6.30 | 4.67 | 4.97 | 6.91 | 8.30 |
| Five Years | 8.83 | 8.18 | 6.65 | 7.12 | 8.23 | 10.22 |
| Ten Years | 9.25 | 8.41 | 7.95 | 6.02 | 7.96 | 9.67 |
| Twenty Years | 8.88 | 8.16 | 8.58 | 5.81 | 7.19 | 8.94 |

OFFICE INCOME RETURNS

| | Total NPI | Total Office | East | Midwest | South | West |
|--------------|-----------|--------------|------|---------|-------|------|
| 2nd Q 2019 | 1.12 | 1.12 | 1.04 | 1.19 | 1.30 | 1.14 |
| 1st Q 2019 | 1.11 | 1.09 | 1.00 | 1.01 | 1.30 | 1.15 |
| One Year | 4.53 | 4.46 | 4.15 | 4.42 | 5.28 | 4.56 |
| Three Years | 4.62 | 4.53 | 4.14 | 5.22 | 5.49 | 4.56 |
| Five Years | 4.79 | 4.65 | 4.31 | 5.45 | 5.58 | 4.62 |
| Ten Years | 5.42 | 5.32 | 5.05 | 6.10 | 5.99 | 5.30 |
| Twenty Years | 6.29 | 6.29 | 6.15 | 6.88 | 6.79 | 6.15 |

OFFICE APPRECIATION RETURNS

| | Total NPI | Total Office | East | Midwest | South | West |
|--------------|-----------|--------------|------|---------|-------|------|
| 2nd Q 2019 | 0.38 | 0.54 | 0.11 | -0.13 | 0.50 | 1.20 |
| 1st Q 2019 | 0.69 | 0.53 | 0.17 | 0.23 | 0.79 | 0.92 |
| One Year | 1.91 | 2.25 | 0.86 | 0.13 | 1.86 | 4.43 |
| Three Years | 2.19 | 1.71 | 0.51 | -0.25 | 1.36 | 3.61 |
| Five Years | 3.90 | 3.41 | 2.27 | 1.61 | 2.54 | 5.42 |
| Ten Years | 3.68 | 2.97 | 2.79 | -0.08 | 1.89 | 4.20 |
| Twenty Years | 2.46 | 1.78 | 2.32 | -1.02 | 0.38 | 2.66 |

OFFICE INDEX—QUARTILE RANGE OF RETURNS

