

OFFICE INDEX

OFFICE – A MIXED BAG

Eight years into an economic expansion, office fundamentals tell a mixed story. Vacancy rates are at cycle lows at 9.5%, and remain unchanged since year-end 2016. Absorption was positive during the third quarter at 9.7 million SF; however, still a decline from prior quarters and outpaced by new supply of 19.4 million SF. Looking forward, the office construction pipeline as a percentage of existing inventory (1.7%) is currently at its highest point since 2007 (2.3%). Nevertheless, rental rates are at their cycle highs and experienced positive growth during the third quarter.

The CBD and suburban office story remains bifurcated. Suburban office vacancy decreased from 15.1% in 2016 to 15.0% thus far in 2017, while CBD office vacancy actually increased slightly from 10.2% in 2015 to 10.3%. Rental rate growth for suburban office space remained strong over the past several years, increasing at an average annual rate of 2.9% from 2014 to 2016 and 1.0% thus far in 2017. Given limited net absorption, combined with persistent supply additions, rental rates for CBD office declined by approximately 1.5% YTD in 2017 following average annual growth of nearly 4.2% from 2014 to 2016.

Shifting to demand, office-using employment has grown at a moderate rate of approximately 2.4% annually since 2011, exceeding total non-farm employment by 70 bps. Going forward, office-using employment is projected to increase at a rate of 1.4% through 2021 compared to 1.0% for total non-farm employment. While office-using employment growth has been positive, the sector's demand drivers face long-term headwinds. Office space usage per employee has continued to decline below pre-recessionary levels (from 271 gross SF in 2010 to less than 245 gross SF in 2017), and expected to continue. Key contributing factors include the growing preference for non-dedicated office space and more collaborative work spaces. Flexible work spaces, co-working environments, and telecommuting are all tempering office demand, as nearly 60% of this space is occupied by employees in the technology or professional services industries, which are two of the primary industries driving office demand.

Third quarter results from the NCREIF Property Index (NPI) showed results consistent with prior quarters. Q3 2017 office total returns were 1.40%, of which 1.11% were driven by income returns and 0.29% driven by capital returns. While income returns remained stable and roughly consistent with the average during this recovery period (1.21% on average over the past five years), capital returns remain well below rates seen earlier in this cycle (1.04% on average over the past five years), carrying over from the past seven quarters, indicating appreciation may be nearing its cycle end.

Third quarter office total returns lagged other real estate sectors, with the exception of retail. On a regional basis, the West continued to achieve the highest total returns driven by appreciation that significantly outpaced the national average. Income returns remain highest in the Midwest and South, which have not experienced as rapid price appreciation as the coastal regions, and therefore continue to offer slightly higher yields.

Ben Maslan
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OFFICE TOTAL RETURNS

	Total NPI	Total Office	East	Midwest	South	West
3rd Q 2017	1.70	1.40	1.05	1.49	1.51	1.78
2nd Q 2017	1.75	1.58	1.29	1.59	1.57	1.97
One Year	6.89	5.72	4.27	5.34	5.54	7.70
Three Years	9.83	8.71	7.44	7.96	7.98	10.68
Five Years	10.35	9.30	7.87	7.84	9.74	11.13
Ten Years	6.23	5.16	4.68	3.82	5.41	5.96
Twenty Years	9.60	9.15	9.69	6.65	8.12	9.96

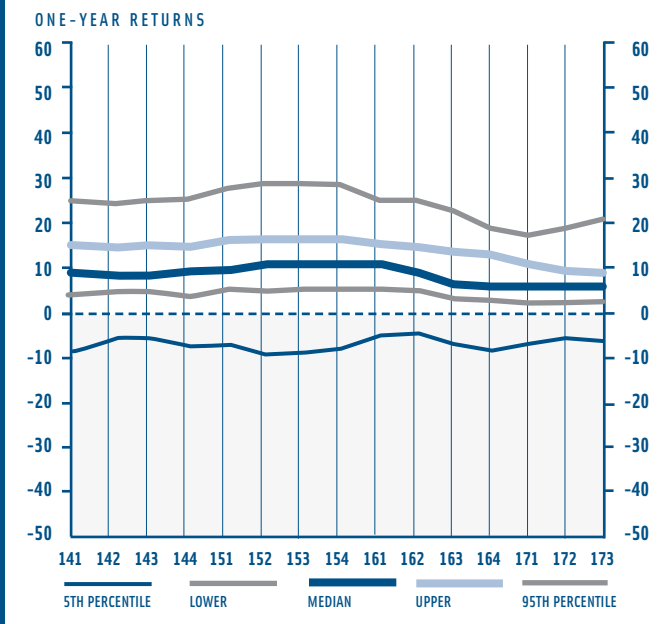
OFFICE INCOME RETURNS

	Total NPI	Total Office	East	Midwest	South	West
3rd Q 2017	1.14	1.11	1.01	1.38	1.36	1.12
2nd Q 2017	1.16	1.13	1.05	1.41	1.35	1.13
One Year	4.66	4.50	4.11	5.48	5.50	4.51
Three Years	4.86	4.66	4.33	5.61	5.63	4.59
Five Years	5.14	4.94	4.63	5.97	5.84	4.85
Ten Years	5.56	5.45	5.22	6.27	6.04	5.40
Twenty Years	6.66	6.65	6.55	7.22	7.11	6.46

OFFICE APPRECIATION RETURNS

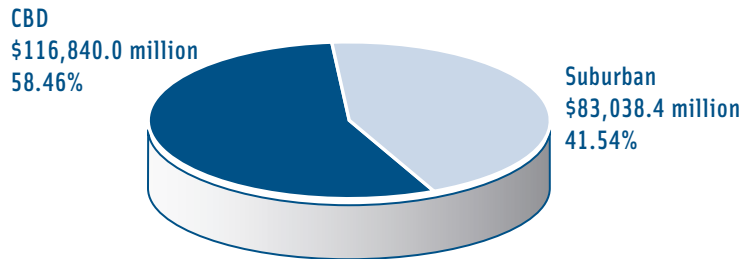
	Total NPI	Total Office	East	Midwest	South	West
3rd Q 2017	0.56	0.29	0.04	0.11	0.15	0.66
2nd Q 2017	0.59	0.45	0.24	0.18	0.22	0.84
One Year	2.15	1.18	0.16	-0.14	0.04	3.09
Three Years	4.80	3.92	3.02	2.26	2.25	5.89
Five Years	5.02	4.20	3.13	1.79	3.74	6.06
Ten Years	0.64	-0.28	-0.53	-2.34	-0.60	0.53
Twenty Years	2.80	2.39	3.00	-0.54	0.96	3.34

OFFICE INDEX—QUARTILE RANGE OF RETURNS



OFFICE SUB-TYPES INDEX

TOTAL OFFICE



Office Properties	1,367
CBD Properties	421
Suburban Properties	946
Total Market Value	\$199,878.4M

CBD TOTAL RETURNS

	Total NPI	Total Office	Total CBD
3rd Q 2017	1.70	1.40	1.29
2nd Q 2017	1.75	1.58	1.49
One Year	6.89	5.72	5.47
Three Years	9.83	8.71	8.81
Five Years	10.35	9.30	9.34
Ten Years	6.23	5.16	5.63
Twenty Years	9.60	9.15	10.06

CBD INCOME RETURNS

	Total NPI	Total Office	Total CBD
3rd Q 2017	1.14	1.11	1.02
2nd Q 2017	1.16	1.13	1.04
One Year	4.66	4.50	4.10
Three Years	4.86	4.66	4.25
Five Years	5.14	4.94	4.49
Ten Years	5.56	5.45	5.00
Twenty Years	6.66	6.65	6.29

CBD APPRECIATION RETURNS

	Total NPI	Total Office	Total CBD
3rd Q 2017	0.56	0.29	0.27
2nd Q 2017	0.59	0.45	0.45
One Year	2.15	1.18	1.33
Three Years	4.80	3.92	4.42
Five Years	5.02	4.20	4.70
Ten Years	0.64	-0.28	0.60
Twenty Years	2.80	2.39	3.60

SUBURBAN TOTAL RETURNS

	Total NPI	Total Office	Total Suburban
3rd Q 2017	1.70	1.40	1.55
2nd Q 2017	1.75	1.58	1.72
One Year	6.89	5.72	6.08
Three Years	9.83	8.71	8.58
Five Years	10.35	9.30	9.25
Ten Years	6.23	5.16	4.77
Twenty Years	9.60	9.15	8.55

SUBURBAN INCOME RETURNS

	Total NPI	Total Office	Total Suburban
3rd Q 2017	1.14	1.11	1.24
2nd Q 2017	1.16	1.13	1.28
One Year	4.66	4.50	5.06
Three Years	4.86	4.66	5.23
Five Years	5.14	4.94	5.52
Ten Years	5.56	5.45	5.91
Twenty Years	6.66	6.65	6.96

SUBURBAN APPRECIATION RETURNS

	Total NPI	Total Office	Total Suburban
3rd Q 2017	0.56	0.29	0.31
2nd Q 2017	0.59	0.45	0.44
One Year	2.15	1.18	0.98
Three Years	4.80	3.92	3.22
Five Years	5.02	4.20	3.58
Ten Years	0.64	-0.28	-1.09
Twenty Years	2.80	2.39	1.50