

OFFICE INDEX

THIRD QUARTER 2018 OFFICE MARKET PERFORMANCE

For the third quarter of 2018 the office sector of the NCREIF Property Index (NPI) posted a total return of 1.69%, slightly ahead of the NPI's quarterly performance of 1.67%. The 1.69% total return consisted of 1.10% income and 0.58% appreciation. The office sector's total return this quarter outperformed seven of the last eight quarters. The office sector accounts for 36.0% of the NPI's total market value. The office sector outpaced apartments (1.55%) and retail (0.56%) during the quarter and trailed industrial (3.36%) and hotels (3.22%).

For the year ending 3Q 2018, the office sector posted a 6.85% total return consisting of 4.62% income and 2.15% appreciation. This was 113 bps higher than the 3Q 2017 one-year total return of 5.72%. While office income returns have remained stable, the higher performance is the result of a slight uptick in appreciation.

By region, during the third quarter 2018, the West returned the highest total return in the office sector at 2.06%, followed by the South at 1.97%, Midwest at 1.23% and the East at 1.36%. Baltimore, MD (3.61%), Nashville, TN (3.12%) and Cambridge, MA (3.03%) were the strongest performing office MSAs during the quarter. The South posted the highest income return of 1.32% while the West posted the highest appreciation return of 0.95%.

Office vacancy rates have leveled off and are at its lowest levels since the Great Recession. Although rent growth has moderated from earlier in the recovery cycle (4-5%) office rents are continuing to achieve 2-3% annual growth. The office sector posted rent growth of 0.70% for third quarter 2018. Recently, net absorption has moderated as supply has begun to outpace demand in the sector. Although, during the third quarter 2018, absorption of 14.4Msf outpaced construction of 10.8M.

According to Real Capital Analytics, quarterly office sales volume increased for the first time in five quarters, up 15% from third quarter 2017. The increase was not due to one-time portfolio sales or entity level transactions. During the quarter single asset sales grew 21% year over year. Office cap rates stood at 6.6% for the third quarter 2018, the same level as a year ago. CBD office cap rates for the quarter were 5.4%, 60bp lower than a year ago while Suburban office cap rates stood at 6.9% which were unchanged from a year ago.

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OFFICE TOTAL RETURNS

	Total NPI	Total Office	East	Midwest	South	West
3rd Q 2018	1.67	1.69	1.36	1.23	1.97	2.06
2nd Q 2018	1.81	1.54	0.87	1.77	2.32	2.01
One Year	7.16	6.85	4.91	5.50	8.90	8.67
Three Years	7.75	6.69	5.17	5.83	6.54	8.71
Five Years	9.57	8.73	7.16	7.63	9.01	10.75
Ten Years	6.42	5.24	4.54	4.06	5.46	6.28
Twenty Years	9.09	8.42	8.91	6.10	7.38	9.15

OFFICE INCOME RETURNS

	Total NPI	Total Office	East	Midwest	South	West
3rd Q 2018	1.11	1.10	1.04	1.10	1.32	1.11
2nd Q 2018	1.14	1.15	1.07	1.44	1.35	1.12
One Year	4.62	4.62	4.21	5.57	5.60	4.63
Three Years	4.70	4.56	4.17	5.53	5.60	4.55
Five Years	4.92	4.77	4.43	5.75	5.71	4.71
Ten Years	5.50	5.41	5.16	6.22	6.04	5.37
Twenty Years	6.44	6.43	6.31	7.03	6.91	6.27

OFFICE APPRECIATION RETURNS

	Total NPI	Total Office	East	Midwest	South	West
3rd Q 2018	0.56	0.58	0.32	0.13	0.65	0.95
2nd Q 2018	0.67	0.40	-0.20	0.33	0.97	0.89
One Year	2.46	2.15	0.68	-0.07	3.16	3.91
Three Years	2.95	2.05	0.97	0.29	0.91	4.03
Five Years	4.49	3.82	2.64	1.81	3.17	5.84
Ten Years	0.88	-0.17	-0.60	-2.07	-0.55	0.87
Twenty Years	2.53	1.89	2.47	-0.88	0.44	2.74

OFFICE INDEX—QUARTILE RANGE OF RETURNS

