

OFFICE INDEX

OFFICE PERFORMANCE CONTINUES TO MODERATE

The office market fundamentals recovery has slowed, leading to a continued moderation in total returns. Office vacancy remained relatively stable in 2017, falling slightly among NCREIF properties by 20 basis points to 11.0% and rising modestly by 10 basis points to 13.0% per data from CBRE-EA. Net absorption moderated in line with office-using employment growth trends, while supply growth picked up. Still, vacancy remains nearly four percentage points below mid-2010 levels. Annual office rent growth slowed as vacancy has leveled off.

Despite an uptick in the fourth quarter, NCREIF office total returns in 2017 were 6.0% versus 6.2% in 2016. The fourth quarter total return of 1.65% modestly outpaced the 1.40% level in the third quarter, driven largely by a slight pickup in appreciation. Average returns during the previous two years marked a sharp deceleration from the double-digit performance achieved during 2014-15.

Total returns across CBD and suburban assets have weakened, but suburban properties have marginally outperformed in recent years. NCREIF office CBD total returns strongly outpaced those of suburban properties throughout most of this economic recovery and expansion. However, this dynamic has changed over the past two years, as suburban vacancy steadily improved and remained in line with its mid-2007 precession low as of the fourth quarter of 2017, according to CBRE-EA. At the same time, CBD vacancy has trended higher since 2015 and rent growth has slowed. These trends supported slightly above-average suburban total returns, amounting to 6.4% versus 5.8% for CBD assets in 2017.

The West region offered the strongest office returns in the nation, while markets in the East underperformed. Seattle and Oakland were among the sector's leaders for the quarter and the year, posting annual returns of 10.8% and 10.5%, respectively. Seattle continued to benefit from robust net absorption, while Oakland posted above-average rent growth during 2017, according to CBRE-EA. However, gateway markets on the East Coast, particularly New York, experienced relatively weak returns. Lofty pricing and slowing appreciation trends have weighed on performance in these markets.

Office sales and pricing remain elevated relative to history, but levels have softened or flattened in recent quarters. Annual office sales volume fell by 8% in 2017 from the prior year per data from Real Capital Analytics. NCREIF's four-quarter moving average cap rate rose slightly to 5.1% at the end of 2017, up 10 basis points from the third quarter. Even with this increase, the rolling four-quarter average cap rate remained near historic lows.

Carlos Ortea
Assistant Vice President, Research
Bentall Kennedy

OFFICE TOTAL RETURNS

	Total NPI	Total Office	East	Midwest	South	West
4th Q 2017	1.80	1.65	1.21	1.16	1.98	2.14
3rd Q 2017	1.70	1.40	1.05	1.49	1.51	1.78
One Year	6.96	6.03	4.31	5.51	6.97	7.96
Three Years	9.38	8.20	7.07	7.07	7.39	10.07
Five Years	10.19	9.19	7.71	7.80	9.45	11.14
Ten Years	6.08	4.94	4.45	3.71	5.36	5.66
Twenty Years	9.44	8.90	9.41	6.47	7.84	9.69

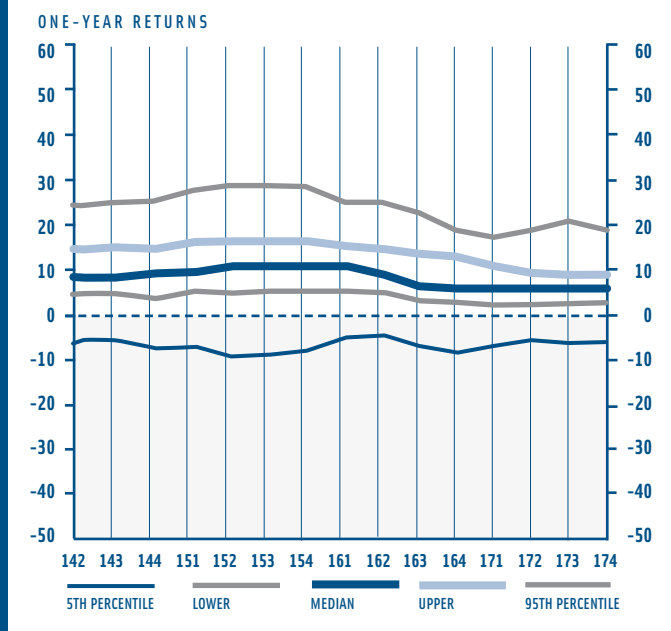
OFFICE INCOME RETURNS

	Total NPI	Total Office	East	Midwest	South	West
4th Q 2017	1.16	1.20	1.06	1.71	1.51	1.18
3rd Q 2017	1.14	1.11	1.01	1.38	1.36	1.12
One Year	4.68	4.64	4.20	5.96	5.74	4.61
Three Years	4.82	4.65	4.27	5.69	5.67	4.59
Five Years	5.08	4.91	4.57	5.97	5.85	4.83
Ten Years	5.54	5.44	5.20	6.24	6.05	5.39
Twenty Years	6.60	6.59	6.49	7.17	7.07	6.42

OFFICE APPRECIATION RETURNS

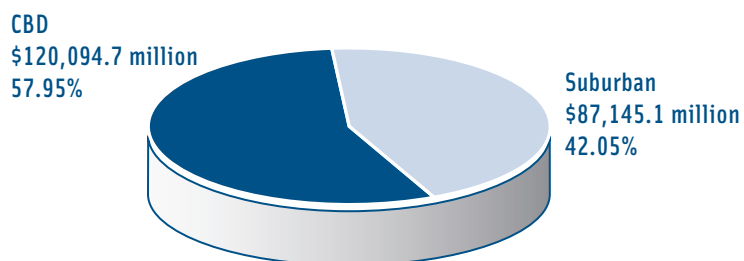
	Total NPI	Total Office	East	Midwest	South	West
4th Q 2017	0.63	0.45	0.15	-0.56	0.47	0.95
3rd Q 2017	0.56	0.29	0.04	0.11	0.15	0.66
One Year	2.20	1.35	0.11	-0.43	1.19	3.24
Three Years	4.41	3.44	2.71	1.32	1.65	5.30
Five Years	4.92	4.13	3.03	1.76	3.45	6.10
Ten Years	0.52	-0.48	-0.73	-2.42	-0.67	0.25
Twenty Years	2.71	2.19	2.79	-0.67	0.73	3.12

OFFICE INDEX—QUARTILE RANGE OF RETURNS



OFFICE SUB-TYPES INDEX

TOTAL OFFICE



Office Properties	1,461
CBD Properties	436
Suburban Properties	1,025
Total Market Value	\$207,239.7M

CBD TOTAL RETURNS

	Total NPI	Total Office	Total CBD
4th Q 2017	1.80	1.65	1.47
3rd Q 2017	1.70	1.40	1.29
One Year	6.96	6.03	5.81
Three Years	9.38	8.20	8.22
Five Years	10.19	9.19	9.10
Ten Years	6.08	4.94	5.35
Twenty Years	9.44	8.90	9.83

CBD INCOME RETURNS

	Total NPI	Total Office	Total CBD
4th Q 2017	1.16	1.20	1.12
3rd Q 2017	1.14	1.11	1.02
One Year	4.68	4.64	4.25
Three Years	4.82	4.65	4.23
Five Years	5.08	4.91	4.46
Ten Years	5.54	5.44	4.99
Twenty Years	6.60	6.59	6.23

CBD APPRECIATION RETURNS

	Total NPI	Total Office	Total CBD
4th Q 2017	0.63	0.45	0.35
3rd Q 2017	0.56	0.29	0.27
One Year	2.20	1.35	1.51
Three Years	4.41	3.44	3.87
Five Years	4.92	4.13	4.49
Ten Years	0.52	-0.48	0.35
Twenty Years	2.71	2.19	3.45

SUBURBAN TOTAL RETURNS

	Total NPI	Total Office	Total Suburban
4th Q 2017	1.80	1.65	1.91
3rd Q 2017	1.70	1.40	1.55
One Year	6.96	6.03	6.35
Three Years	9.38	8.20	8.18
Five Years	10.19	9.19	9.29
Ten Years	6.08	4.94	4.60
Twenty Years	9.44	8.90	8.27

SUBURBAN INCOME RETURNS

	Total NPI	Total Office	Total Suburban
4th Q 2017	1.16	1.20	1.32
3rd Q 2017	1.14	1.11	1.24
One Year	4.68	4.64	5.19
Three Years	4.82	4.65	5.22
Five Years	5.08	4.91	5.49
Ten Years	5.54	5.44	5.90
Twenty Years	6.60	6.59	6.92

SUBURBAN APPRECIATION RETURNS

	Total NPI	Total Office	Total Suburban
4th Q 2017	0.63	0.45	0.59
3rd Q 2017	0.56	0.29	0.31
One Year	2.20	1.35	1.12
Three Years	4.41	3.44	2.85
Five Years	4.92	4.13	3.65
Ten Years	0.52	-0.48	-1.25
Twenty Years	2.71	2.19	1.28