

OFFICE INDEX

OFFICE SECTOR: LOWER RETURNS CONTINUE FOR 3RD STRAIGHT YEAR

The final quarter of 2018 marks 12th straight quarter of below historic average total returns in the office sector of the NCREIF Property Index (NPI). The sector's 2018 appreciation returns reached 2.3%, an increase of 94 basis point (BP) over 2017, but historically low income returns kept the annual total returns below 7% for the 3rd straight year. The annual income returns in 2018 were 4.49%, the lowest for the sector in index history. Yields in the other sectors are also near all-time lows. Nonetheless, the annual total returns for 2018 reached 6.85%, slightly outpacing the full NPI total returns of 6.72%. This is the first year the office sector has out-performed the broader index since 2007.

In the fourth quarter, the office sector achieved quarterly total returns of 1.65%, slightly lower than in 2018Q3. The quarterly total returns out-performed the broader index by 27 basis points. Only the industrial sector had higher quarterly total returns than the office sector. The quarterly total returns were comprised of appreciation returns of 0.58% and income returns of 1.07%. The apartment sector was the only sector with lower quarterly yields, at 1.05% in the 4th quarter.

Across regions, the office sector had a wide dispersion of returns. The West region significantly out-performed other regions, with quarterly total returns reaching 2.38%. The West region has been the top office region in 6 of the last 8 quarters. With total returns of 1.26%, the East region was the second highest performing Office region, driven by positive appreciation returns of 0.25%. The two worst performing Office regions, the South and Midwest, both had negative appreciation returns, -0.09% and -0.10% respectively. For the South region, this is a significant decline from 2018Q3, when appreciation returns were 0.65%.

Office occupancy is near all-time highs, at 90% leased, according to Costar Market Analytics. After 6 years of annual asking rent growth over 2%, rent growth has slowed to 1.99% in 2018. This marks the third year of decelerating rent growth from the post-recession peak of 6.1% growth in 2015. The NPI same-store annual NOI growth was 1.82%, down from 8.96% in 2017. New starts in 2018 reached a 5-year low at only 49 million square feet. Office-Using employment growth rose to 2.1% in 2018, after 4 prior years of declining growth.

The Office sector had a 15% increase in quarterly sales volume in 2018Q4 over 2017Q4, according to Real Capital Analytics. Although volume has risen the last 6 months, the total volume for 2018 is only 2% higher than in 2017. The increase in quarterly transaction volume is attributable to a large gain in the East Region, whose transaction volume in 2018Q4 increased by 46% over 2017Q4. This increase in the East Region was seen across markets, with Boston, NYC, Philly and DC all having significant increases in volume. The South saw a decline of 19.2%; Both Atlanta and Miami saw declines, while volume in Charlotte doubled. The West and Midwest regions saw modest increases, 2.3% and 4% respectively.

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OFFICE TOTAL RETURNS

	Total NPI	Total Office	East	Midwest	South	West
4th Q 2018	1.37	1.65	1.26	0.95	1.17	2.38
3rd Q 2018	1.67	1.69	1.36	1.23	1.97	2.06
One Year	6.72	6.85	4.96	5.28	8.03	8.93
Three Years	7.21	6.36	4.93	5.34	6.14	8.33
Five Years	9.33	8.58	6.91	7.48	8.86	10.73
Ten Years	7.49	6.44	6.02	4.76	6.16	7.45
Twenty Years	8.98	8.28	8.75	5.92	7.26	9.05

OFFICE INCOME RETURNS

	Total NPI	Total Office	East	Midwest	South	West
4th Q 2018	1.11	1.07	1.00	1.05	1.26	1.09
3rd Q 2018	1.11	1.10	1.04	1.10	1.32	1.11
One Year	4.56	4.49	4.15	4.88	5.35	4.53
Three Years	4.67	4.55	4.15	5.43	5.58	4.55
Five Years	4.88	4.73	4.38	5.63	5.68	4.68
Ten Years	5.48	5.40	5.14	6.19	6.03	5.36
Twenty Years	6.39	6.38	6.26	6.98	6.87	6.23

OFFICE APPRECIATION RETURNS

	Total NPI	Total Office	East	Midwest	South	West
4th Q 2018	0.26	0.58	0.25	-0.10	-0.09	1.29
3rd Q 2018	0.56	0.58	0.32	0.13	0.65	0.95
One Year	2.08	2.28	0.78	0.39	2.58	4.26
Three Years	2.46	1.75	0.76	-0.09	0.54	3.65
Five Years	4.30	3.72	2.44	1.78	3.06	5.85
Ten Years	1.92	1.00	0.84	-1.37	0.12	1.99
Twenty Years	2.47	1.81	2.38	-1.01	0.36	2.69

OFFICE INDEX—QUARTILE RANGE OF RETURNS

