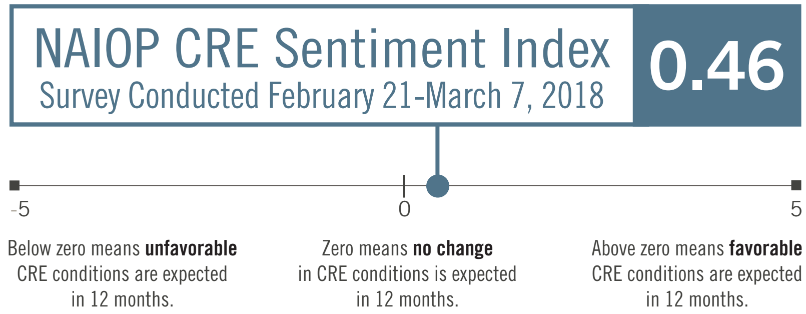
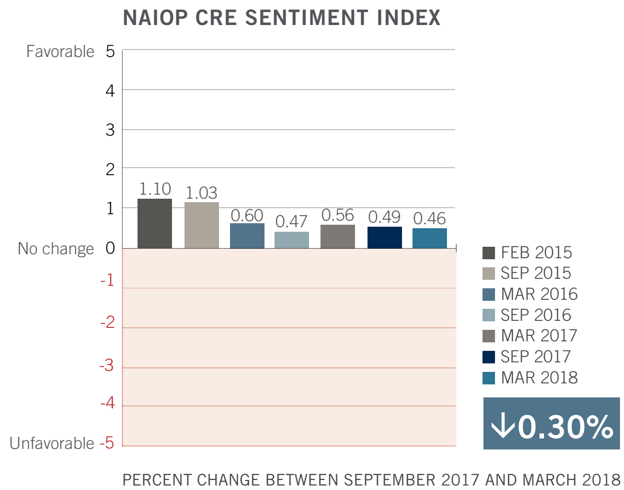
The NAIOP CRE Sentiment Index

Industry Leaders' Outlook for Commercial Real Estate Spring 2018





Key Findings

The NAIOP CRE Sentiment Index for March 2018, a composite of nine survey questions, showed little change, decreasing slightly over six months to 0.46 from 0.49. The results are fairly consistent with responses posted over the four prior surveys (going back to March 2016) indicating an expectation of continued but slow growth over the next 12 months. Since the composite Index is greater than zero, this indicates that respondents believe, as a group, that general market conditions over the next 12 months will continue to be favorable for the commercial real estate (CRE) industry. Furthermore, overall commercial real estate development conditions will be even better in 12 months (March 2019) than they are today. This consistent, positive Index level over the past 24 months is a sign that real estate development is not overheating and should support an extended real estate market expansion for at least 12 more months.

Notable Changes From the September 2017 Survey

The two most positive changes in the survey that helped keep the Index above zero were expectations regarding the availability of both debt and equity over the next 12 months. Year-over-year, the readings for the availability of equity and debt increased by 5.00 percent and 6.70 percent respectively. This is a continuation of the reversal for these two categories after both slid consistently between March 2016 and March 2017. At the same time, however, respondents are still greatly concerned about the costs of construction materials as indicated by the 5.00 percent slide in the reading. Of note is that the score of the labor cost question did not change over six months (-2.43) and remains the lowest number in the survey.

Agreement/Disagreement Among Respondents

The most consistent responses (meaning there was the most agreement among survey participants) were in the categories of occupancy, rents and capital sources. Scores for these categories were highly positive contributors to the overall Sentiment Index. Readings regarding occupancy rates, face rents and effective rents have fallen slightly over the past year, but the outlook for the availability of debt and equity capital sources has rebounded nicely to levels not seen since the September 2015 survey. The questions with the least consistent responses (most dispersion) among survey participants regarded employment and construction labor costs. These employment-related readings are consistent with the uneven real estate-related job growth that has occurred in various regions across the country over the past few years.

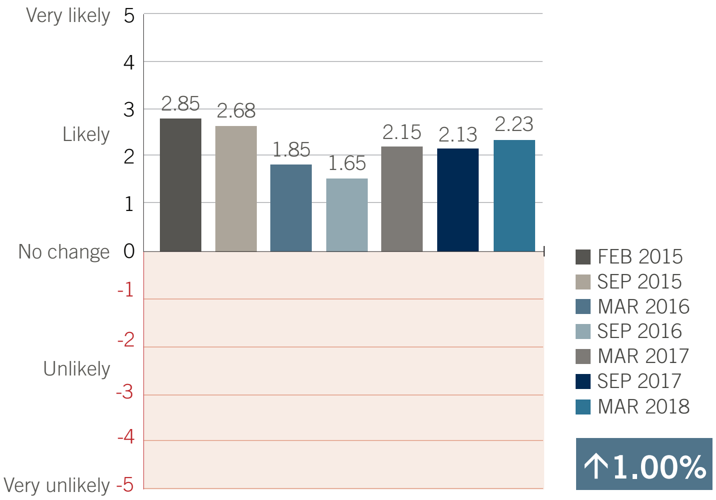
About the NAIOP CRE Sentiment Index

The NAIOP Sentiment Index is designed to predict general conditions in the commercial real estate industry over the next 12 months. The forecast is not based on an analysis of historical data, but rather it represents a look into the future by real estate developers, investors and operators. These NAIOP members are asked to respond to questions based on their ongoing work, including projects in their pipelines. (For more information, see "Understanding the Index" on page 5.)

NAIOP
COMMERCIAL REAL ESTATE DEVELOPMENT ASSOCIATION

EMPLOYMENT

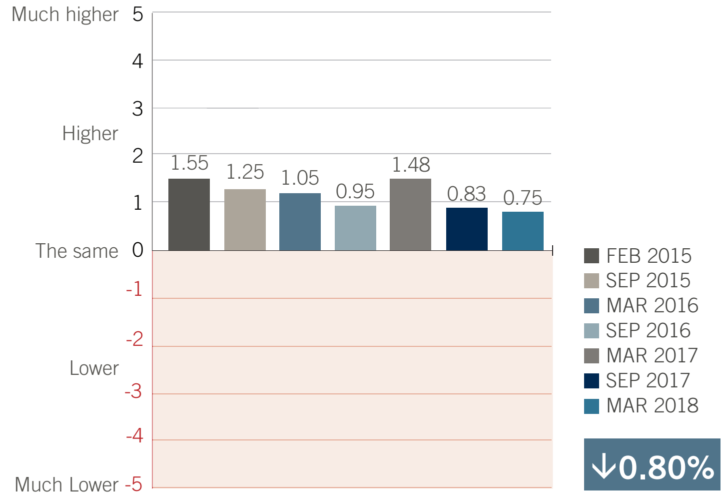
1. How likely is it that your company will add employees within the next 12 months?



Expectations regarding employment growth at CRE companies are the highest they have been since the September 2015 survey and represent a 5.80 percent increase in the employment score since the low point registered in September 2016. Scores for this question have consistently ranked among the highest in the survey since 2015; however, as noted earlier, in the current survey responses were widely dispersed indicating disagreement among respondents. As such, in the March 2018 survey, the employment question is contributing less weight to the overall Sentiment Index. Even so, the overall employment outlook is still quite positive, indicating that survey respondents expect they are likely to add more jobs in 2018 than they thought they would in 2017.

OCCUPANCY RATES

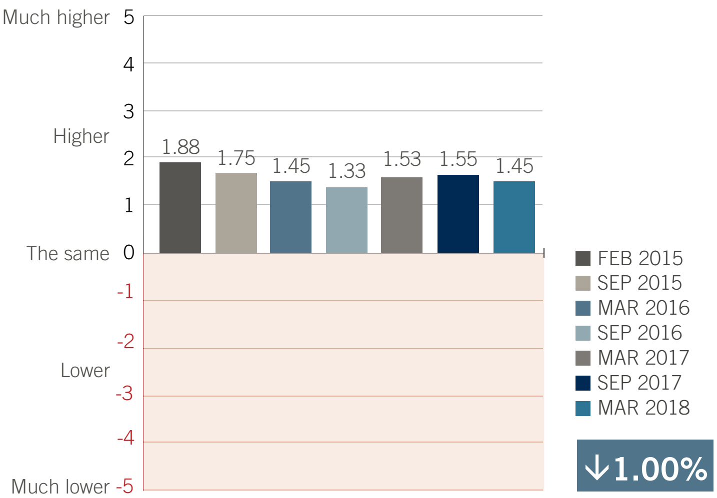
2. Based on your own projects, where do you believe occupancy rates will be in 12 months?



The occupancy rate score (0.75) is the lowest positive response in this survey, and it reflects the second highest level of agreement among survey respondents. This means there is certainty among the respondents that occupancy rates are likely to grow. However, the slight decline (by 0.80 percent) indicates occupancy rates may grow more slowly than expected six months ago, potentially reflecting the maturing market. The March 2017 score appears to be a bit of an anomaly given the otherwise steady softening in respondents' scores since the survey's inception. Two consecutive downward readings might be a sign that commercial real estate occupancy rates may be expected to flatten in the next 12 months.

FACE RENTS

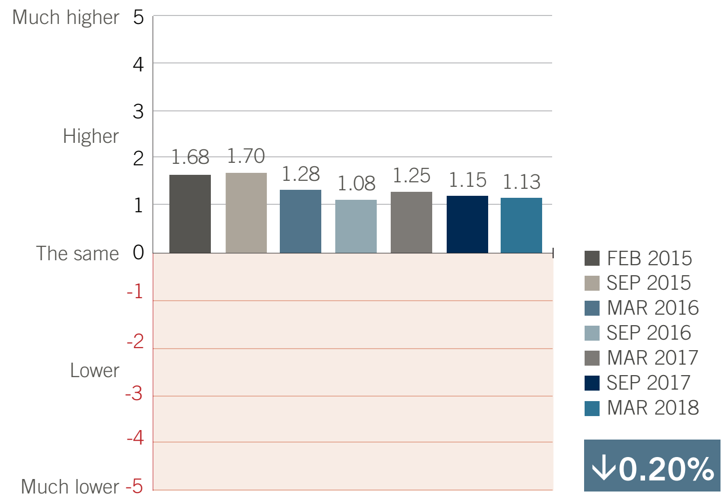
3. Based on your own projects, where do you believe face rents will be in 12 months?



Responses relating to face rents have maintained a relatively stable, highly positive level. In the March 2018 survey, this question featured the least dispersion among the responses, indicating significant agreement among survey participants. This survey question has helped keep the overall Index positive over the past two years. The score for face rents (1.45) is just 1.00 percent less than it was six months ago. Overall, face rents are expected to remain positive and improve between now and early 2019.

EFFECTIVE RENTS

4. Based on your own projects, where do you believe effective rents will be in 12 months?

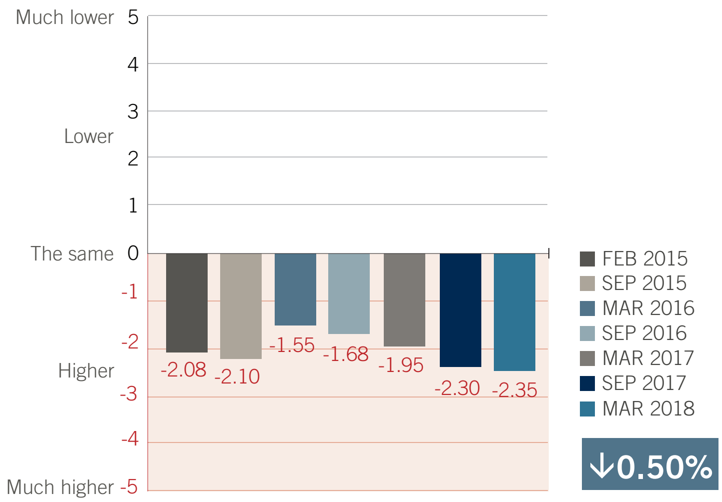


Expectations regarding effective rents decreased slightly by 0.20 percent compared to the September 2017 survey but the positive score of 1.13 indicates that effective rents are expected to continue to rise over the next year. With readings for both face rents and effective rents remaining in solidly positive territory but both falling slightly, it may be that respondents anticipate that rents may begin to stabilize.

THE PERCENT CHANGE NOTED IN EACH GRAPH COMPARES THE SURVEYS CONDUCTED IN SEPTEMBER 2017 AND MARCH 2018.

CONSTRUCTION MATERIALS COSTS

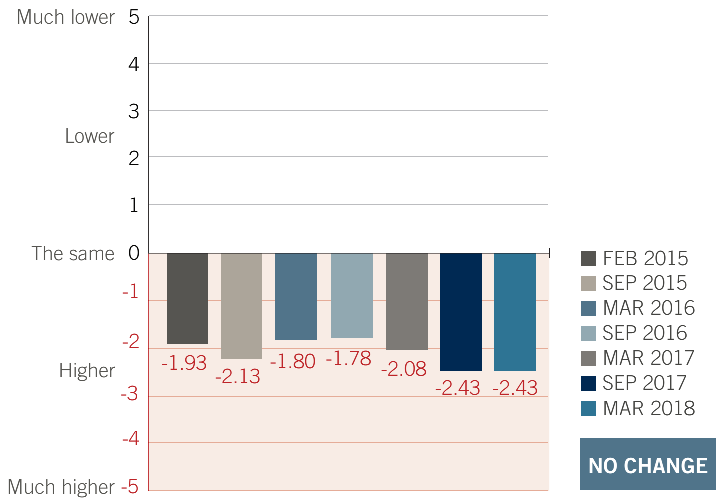
5. For projects on which you are seeking bids, where do you believe the cost of construction materials will be in 12 months?



As with the three prior surveys, the construction materials costs score (-2.35) provided the most downward pressure to the overall Sentiment Index. Compared to September 2017, the score for construction materials fell by 0.50 percent, and hit an all-time low. This indicates that survey respondents expect the cost of construction materials to rise in the next year. The consistency of responses to this question indicate that expectations of rising costs are fairly uniform across the U.S. and across product types. Of note is that while this survey was open, President Trump had not yet imposed stiff tariffs on imported steel and aluminum so the anticipated effects of that action are not reflected in these figures.

CONSTRUCTION LABOR COSTS

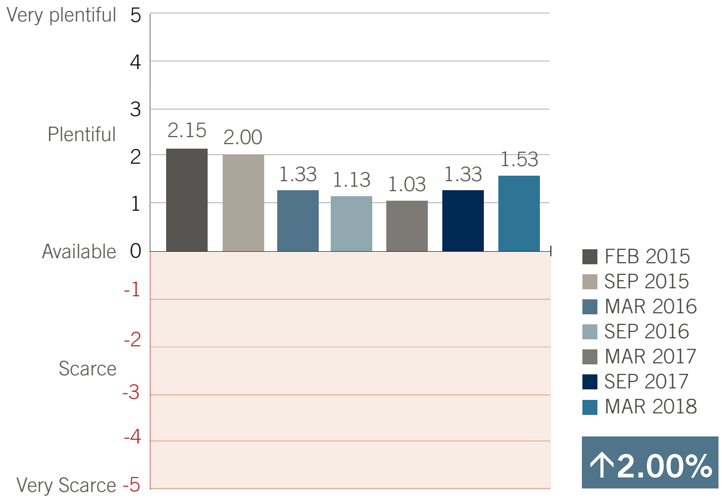
6. For projects on which you are seeking bids, where do you believe the cost of construction labor will be in 12 months?



The score for construction labor costs (-2.43) remained the same over six months and continues to be the most negative component of the overall Sentiment Index. Survey responses were less consistent (more dispersed) than those relating to construction materials costs; however, given the large negative score for this question, survey respondents expect construction labor costs to continue to rise over the next year at a greater rate in 2018 than they did in both 2016 and 2017.

AVAILABLE EQUITY

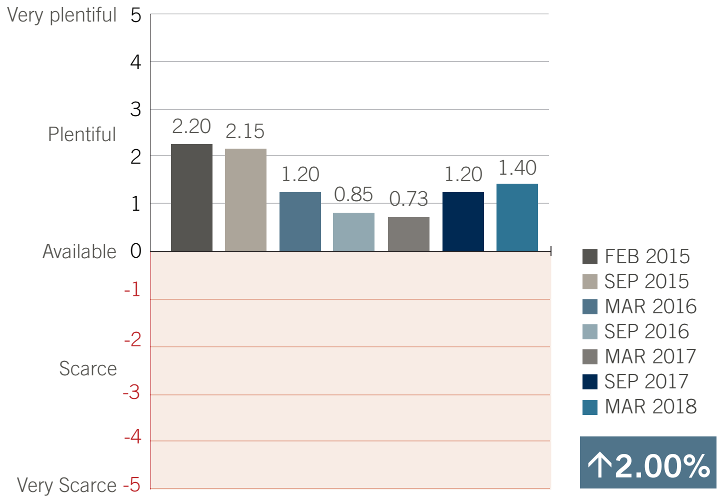
7. For projects you will be financing/refinancing, how plentiful do you believe equity will be in 12 months?



The score for available equity continued its steady rebound in this survey, increasing 2.00 percent over six months. Since hitting a low point in March 2017, the available equity score has increased 5.00 percent and is at its highest level since the September 2015 survey. The available equity measure is also the second highest positive contributor to the overall Sentiment Index, and since it had a more tightly packed response rate, it contributed greatly to the overall Sentiment Index's positive level.

AVAILABLE DEBT

8. For projects you will be financing/refinancing, how plentiful do you believe debt will be in 12 months?

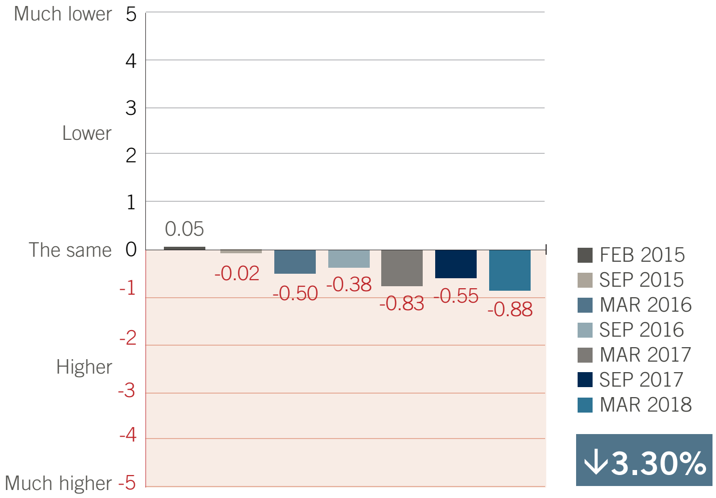


The question regarding available debt registered a moderate rebound for the second consecutive time (2.00 percent), continuing the reversal of a consistent decline that existed between February 2015 and March 2017. Like equity, debt capital is expected to be available at still favorable rates over the next twelve months for projects in the pipeline.

THE PERCENT CHANGE NOTED IN EACH GRAPH COMPARES THE SURVEYS CONDUCTED IN SEPTEMBER 2017 AND MARCH 2018.

FIRST-YEAR CAPITALIZATION RATES

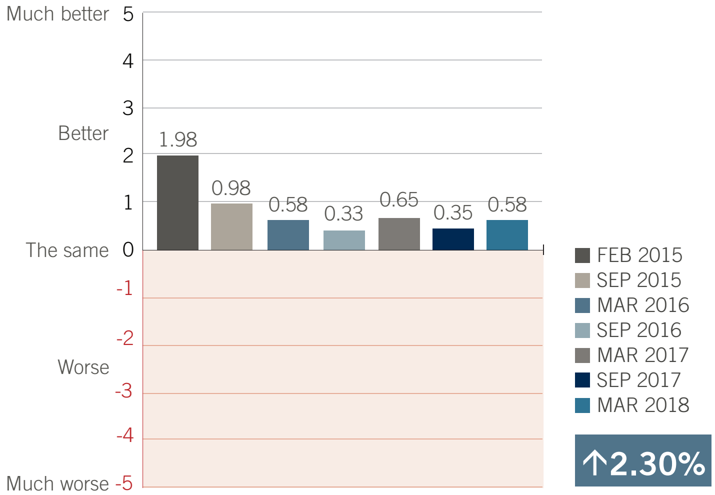
9. Where do you expect first-year cap rates to be for deals you will close 12 months from now?



Survey responses indicate that there is a solid chance that first-year cap rates will increase in the coming year, with this survey's level the most pessimistic ever recorded (-0.88). This score has oscillated consistently between March 2017 and March 2018. The silver lining with this question is that survey responses were dispersed, indicating that some believe cap rates will definitely rise, while others are not so certain. Though the score was negative, this inconsistency among the respondents meant that the question carried a low weight in the overall composite Index. Of note is that while this survey was open, the Board of Governors of the Federal Reserve had not yet announced plans to raise the federal funds rate three times in 2018.

GENERAL SENTIMENT

10. What is your general sentiment regarding conditions in the commercial real estate industry; as a commercial real estate professional, how do you see the industry in 12 months?



The general sentiment score rose in this survey compared to the reading taken in September 2017. It was boosted primarily by big gains in the capital markets questions, even though the scores declined slightly for occupancy rates, face rents, effective rents, construction materials costs and cap rates. The 0.58 score for this question is 2.30 percent higher than the reading noted six months ago, and it is at about the same level as it was one year earlier in March 2017. This overall score is still a positive sign for the CRE industry in that survey respondents expect the commercial real estate climate will improve slightly over the next 12 months, a score that is fairly consistent with responses given in the spring surveys administered in each of the prior two years.

THE PERCENT CHANGE NOTED IN EACH GRAPH COMPARES THE SURVEYS CONDUCTED IN SEPTEMBER 2017 AND MARCH 2018.

Direct From the Survey Participants

"We think demand for office space, industrial facilities and housing will continue to be strong as people migrate to job centers."

"For items [in this survey] marked "the same" or "in the middle" — that's not a bad thing, considering how good things are right now from a landlord/developer perspective. [The] biggest concern is [the] rising costs of construction, with rising interest rates being an issue, but very secondary in my mind."

"[I] think [the] recovery was getting long in [the] tooth, but tax cuts will keep things selectively improving (albeit at [a] slower pace) for two to three years. In any event, until the rest of the globe presents a viable alternative to [the] U.S. (terror in Europe, investors removing wealth from China, etc.) we will not see a dramatic correction."

"Pricing remains strong but compression will slow as rates rise. Fundamentals and tenant demand remain strong and I see rents continuing to grow, although the growth will be a bit slower but still healthy. There is a ton of equity available, and debt still remains consistent and available."

"I think the biggest risk to the industry right now is the [Federal Reserve]. By pushing interest rates up too aggressively, they are likely to throw us into recession — not necessarily within 12 months, but soon."

"Some frothiness and crowds, but still good fundamentals."

"Construction prices and interest rates are both on the rise, and rent expectations remain the same. This will delay some projects that were being done solely due to the low interest rate environment. However, I am hopeful that a strong economy will continue to support new development."

"The averages are a bit deceiving. I expect an improving industrial development market. I believe that suburban office [products] will be much better for leasing next year. I believe that downtown opportunities for acquisitions are poor and getting worse."

Understanding the Index

The survey's final question about overall sentiment regarding future conditions is designed to serve as a verification of the Sentiment Index and is not included in the calculation of the Index. **The score for the final question is 0.58, whereas the Index is slightly lower at 0.46. Said differently, when responses to the first nine questions — which relate to real estate fundamentals — are combined into the composite Index, the result is only slightly less positive than when respondents were asked a single, subjective question regarding overall sentiment toward the CRE marketplace.** When these two indicators are very close to each other (within 2.0 percent for the March 2018 survey), the single general sentiment question is validated, which is the case, again, with this survey.

The NAIOP CRE Sentiment Survey is conducted biannually, in March and September. **The survey is sent to roughly 5,000 NAIOP principal members in the U.S. who are developers, investors and operators in the office, industrial, retail and multifamily sectors**. It asks 10 questions about jobs, the space markets, construction costs and the capital markets. Respondents indicate whether their 12-month outlook for each category is positive, negative or neutral. **The responses are not equally weighted. Instead, weighting varies based on whether the responses to a question are tightly packed or dispersed**. Questions with tightly packed responses (meaning there is more consistency among the answers to that question) are more heavily weighted than those with more dispersed responses (which indicate less consistency).

If every participant in the survey selected the most optimistic answer to each and every question, the Index would be positive 5. Conversely, if all of the participants chose the most pessimistic response to each and every question, the Index would be negative 5. **The Index is on a 10-point scale, meaning that changes to the composite scores — and the Index itself — will range between zero and 10. A one-point change in the Index equates to a 10 percent change (on an absolute basis)**.

Changes in the scores of the individual survey questions between the September 2017 and March 2018 surveys ranged between 0.0 and 3.2 percent. This is typical of what was seen in all surveys since March 2016, with the exception of the September 2017 survey. The overall composite index for March 2018 (0.46) decreased by 0.30 percent since September 2017 (0.49) and it has been at about this level since March 2016. **The current survey indicates that there continues to be positive, but guarded optimism in the CRE industry due to capital markets (positive influences) and to construction labor and materials costs (negative influences).**

Distinct companies that participated in this survey total 357, representing 17.9 percent of the 1,989 distinct companies invited. Product types owned/under development by respondents broke out to roughly 31 percent office, 34 percent industrial, 18 percent retail and 17 percent multifamily; Western regions were slightly more represented than Eastern regions followed by the South and the Midwest. The response rate for this survey was 8.6 percent and the margin of error for the Index was 4.55 percent — both of which were improvements over the September 2017 and March 2017 surveys.

Survey participants are sent a three-page summary of results showing the percentage breakdown of responses to each question just three days after the survey closes. This final report is released to all NAIOP members and the public three weeks later. **Survey responses for this Index were gathered between February 21 and March 7, 2018. The first two readings in this survey were beta tests sent to approximately 600 NAIOP members in February and September 2015, generating response rates of around 17 percent.** Comparing this survey to the previous beta tests, respondents' consistency across questions was nearly the same, with face rents being the most consistently answered question and construction materials costs, construction labor costs and employment being the least consistently answered questions. As such, the 2016, 2017 and 2018 results do not vary significantly from those in the beta tests.

The statistical methodology for this survey was developed and the data analyzed by Tom Hamilton, Ph.D., MAI, CCIM, CRE, the Gerald Fogelson Distinguished Chair of Real Estate in the Chicago School of Real Estate at Roosevelt University. The survey data are collected by NAIOP and the survey questions were created, refined and finalized between 2014 and 2016 by the NAIOP Distinguished Fellows listed below.

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