The Real Estate Roundtable Sentiment Index

Fourth Quarter 2017
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The Real Estate Roundtable is pleased to announce the results from the Q4-2017 Real Estate Roundtable Sentiment Survey. The quarterly survey is the commercial real estate industry’s most comprehensive measure of senior executives’ confidence in the real estate environment. Conducted by FPL Advisory Group on behalf of The Roundtable, it measures the views of CEOs, presidents, and other top commercial real estate industry executives regarding current conditions and the future outlook on three topics: (1) overall real estate conditions, (2) access to capital markets, and (3) real estate asset pricing.

Topline Findings

- The Q4 index came in at 53, a three point increase from Q3. Despite the fact that fundamentals continue to hold strong, the commercial real estate industry appears to have entered a period of caution driven by concerns regarding cycle timing.

- Most do not expect current real estate market conditions to change materially in the near-term. That said, the industry is closely watching proposed tax reforms and reserving predictions for the coming year until greater clarity is achieved.

- High quality assets in core, urban locations continue to be aggressively priced. That said, many still suggest that there are good deals to be found. More broadly, real estate pricing is still seen as attractive relative to other asset classes.

- Many respondents cite difficulty sourcing new equity commitments from limited partners. While this has always been perceived as a challenging undertaking, the market’s wariness of cycle timing is exacerbating the difficulty.

¹ The Real Estate Roundtable Sentiment Index is measured on a scale of 1–100. It is the average of The Real Estate Roundtable Future Index and The Real Estate Roundtable Current Index. To register an Index of 100, all respondents would have to answer that they believe conditions are “much better” today than one year ago and will be “much better” one year from now.
General Conditions

The Q4 index came in at 53, a three point increase from Q3. Despite the fact that fundamentals continue to hold strong, the commercial real estate industry appears to have entered a period of caution driven by concerns regarding cycle timing.

“I think everyone feels like conditions are generally good in the market but there’s a lot of angst about when it will end. Everyone’s been through it, we all know it ends, and we’re seeing a cautious approach this time around.”

“It’s a healthy, vibrant market. That said, we’re proceeding with more caution to quickly respond to any changes in the market.”

“The fears out there are slightly overblown. People are pulling back assuming we’re at the end of the cycle. The Global Financial Crisis means we have better risk mitigants in place and better sensitivity to poor fundamentals; the industry has been more disciplined this cycle.”

“It may not be real estate that ends it this time. Credit and new construction aren’t out of whack. Nothing major seems to be awry.”

“Everyone seems to be nervous without any understanding of why they should be.”

“I’m not predicting the market is going to fall off a cliff, but you have to recognize we’re late in a cycle. The big difference this brings is the increased requirement for operating professional resources. You can’t just buy in a good market and watch value rise; you need to work the asset to achieve the yield you want. This means more human resources are required.”

“It has surprised us how long this cycle has lasted.”

“I’m seeing a really neat trend of secondary and tertiary asset classes (self-storage, medical office, etc.) getting more attention from investors chasing yield. These areas of the market are getting institutionalized as a result, which is great.”

Exhibit 1

The Real Estate Roundtable Sentiment Index

Index Reading | Future Conditions | Overall | Current Conditions
---|---|---|---
Q1 2008 | 10 | 20 | 30
Q1 2009 | 15 | 25 | 35
Q1 2010 | 20 | 30 | 40
Q1 2011 | 25 | 35 | 45
Q1 2012 | 30 | 40 | 50
Q1 2013 | 35 | 45 | 55
Q1 2014 | 40 | 50 | 60
Q1 2015 | 45 | 55 | 65
Q1 2016 | 50 | 60 | 70
Q1 2017 | 55 | 65 | 75
Q3 2017 | 53 | 63 | 73
Q3 2016 | 52 | 62 | 72
Q3 2015 | 51 | 61 | 71
Q3 2014 | 50 | 60 | 70
Q3 2013 | 49 | 59 | 69
Q3 2012 | 48 | 58 | 68
Q3 2011 | 47 | 57 | 67
Q3 2010 | 46 | 56 | 66
Q3 2009 | 45 | 55 | 65
Q3 2008 | 44 | 54 | 64
General Conditions
(continued)

Most do not expect current real estate market conditions to change materially in the near-term. That said, the industry is closely watching proposed tax reforms and reserving predictions for the coming year until greater clarity is achieved.

“I think we’re looking at an environment that will likely stay close to the same in the near future. Let’s see what happens with changes to the tax code - changes there, or any lack of changes, will affect everything.”

“Uncertainty with respect to achieving policy initiatives underway in DC (tax reform) is a wild card.”

“Comprehensive tax reform has the potential to materially change the near-term investment performance of the multifamily sector.”

“I think we keep seeing more of the same in this market, assuming the world holds together, which is a huge assumption.”

“In our industry, the tenants have realized they have greater leverage as a result of where they perceive us to be in the cycle. They are more cautious, looking at shorter term obligations and trying to extract the greatest quantity of concessions.”

“Look, if you’re in the real estate business and you aren’t having fun right now, you shouldn’t be in the business.”

“We’re not panicking or predicting any immediate change in the market; we just realize the next five years can’t mirror our last five years in terms of growth and positive momentum.”

“Rent has recovered on an absolute basis, so you’ve seen extraordinary growth relatively speaking (since the recession), but we’re still behind historical rates.”

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Exhibit 2
Perspectives on Real Estate Market Conditions
% of respondents

<table>
<thead>
<tr>
<th></th>
<th>Today vs. One Year Ago</th>
<th>One Year From Now vs. Today</th>
</tr>
</thead>
<tbody>
<tr>
<td>Much worse</td>
<td>25%</td>
<td>24%</td>
</tr>
<tr>
<td>Somewhat worse</td>
<td>2%</td>
<td>3%</td>
</tr>
<tr>
<td>About the same</td>
<td>57%</td>
<td>49%</td>
</tr>
<tr>
<td>Somewhat better</td>
<td>16%</td>
<td>24%</td>
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<td>Much better</td>
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Asset Values

High quality assets in core, urban locations continue to be aggressively priced. That said, many still suggest that there are good deals to be found. More broadly, real estate pricing is still seen as attractive relative to other asset classes.

“We’ve made investments in this market, but we’ve really focused on clearing out our portfolio. We think it’s better to be a seller in our space.”

“Our theory: pricing may be higher than we’d like, but we chose to invest in markets where people want to move and live. Those markets, even during the downturn, fared well and have outperformed the last peak already.”

“Stable, quality assets in core, urban markets are seeing very little pricing change. Debt is plentiful, which is driving the availability of equity.”

“I hear a lot of noise about how high pricing is, but when you look at it relative to ten year treasuries, it isn’t that bad. I suppose you could say it feels expensive, but it’s relative.”

“All assets, not just real estate, are at the more enthusiastic side of the spectrum.”

“Values keep going up. Our portfolio is experiencing incredible growth on a nearly quarterly basis as a result of how pricing is moving.”

“Asset pricing of the best assets is holding strong. Maybe softening for assets not down the fairway for investors. If you own a great, class-A asset in a top market, you’ll be priced close to perfection. Pricing will be more challenging for class-B assets, irrespective of what market you’re in.”

“I think one of the major challenges in the real estate market today is the tremendous amount of capital in the system.”

Exhibit 3

Real Estate Asset Values

<table>
<thead>
<tr>
<th></th>
<th>% of respondents</th>
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<tbody>
<tr>
<td>Much lower</td>
<td>2%</td>
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<tr>
<td>Somewhat lower</td>
<td>16%</td>
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<tr>
<td>About the same</td>
<td>43%</td>
</tr>
<tr>
<td>Somewhat higher</td>
<td>39%</td>
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<tr>
<td>Much higher</td>
<td>1%</td>
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Today vs. One Year Ago

<table>
<thead>
<tr>
<th></th>
<th>% of respondents</th>
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<tbody>
<tr>
<td>Much lower</td>
<td>2%</td>
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<tr>
<td>Somewhat lower</td>
<td>16%</td>
</tr>
<tr>
<td>About the same</td>
<td>43%</td>
</tr>
<tr>
<td>Somewhat higher</td>
<td>39%</td>
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<tr>
<td>Much higher</td>
<td>1%</td>
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One Year From Now vs. Today

<table>
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<tr>
<th></th>
<th>% of respondents</th>
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<tbody>
<tr>
<td>Much lower</td>
<td>27%</td>
</tr>
<tr>
<td>Somewhat lower</td>
<td>27%</td>
</tr>
<tr>
<td>About the same</td>
<td>54%</td>
</tr>
<tr>
<td>Somewhat higher</td>
<td>18%</td>
</tr>
<tr>
<td>Much higher</td>
<td>1%</td>
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Capital Markets

Many respondents cite difficulty sourcing new equity commitments from limited partners. While this has always been perceived as a challenging undertaking, the market’s wariness of cycle timing is exacerbating the difficulty.

“There is broad availability of debt and equity in the market today. What is harder is raising equity for commingled fund strategies.”

“LPs are very concerned about where we are in the cycle. They are very sector specific and cautious with new commitments.”

“Equity sources have a more influential seat at the table.”

“There are more shadow lenders now. You start to feel bad for the banks with all the regulatory pressures they have to endure. But even with all the new sources of financing, we still aren’t getting excessive, and it’s a reason why real estate won’t likely be the reason for the next correction.”

“Debt continues to be plentiful. Real estate debt funds and investment management houses are lending more to the real estate industry than they used to.”

“The argument that there is no construction lending is not true. One year ago, you were in the teeth of it. Now some of the scarcity has relaxed. Funds moving into the construction lending space means there are plenty of avenues for construction financing.”

“What is less available, in terms of debt and equity, is out on the risk spectrum. One reason you see less supply of new product, despite the demand, is the lack of available, affordable construction financing.”

“We think banks are still playing games. If you get the word ‘construction’ involved in a conversation, no matter what the context, your financing gets more expensive.”

Exhibit 4

Availability of Capital

<table>
<thead>
<tr>
<th>% of respondents</th>
<th>Today vs. One Year Ago</th>
<th>One Year From Now vs. Today</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Equity</td>
<td>Debt</td>
</tr>
<tr>
<td>Much worse</td>
<td>14%</td>
<td>24%</td>
</tr>
<tr>
<td>Somewhat worse</td>
<td>55%</td>
<td>37%</td>
</tr>
<tr>
<td>About the same</td>
<td>23%</td>
<td>32%</td>
</tr>
<tr>
<td>Somewhat better</td>
<td>7%</td>
<td>7%</td>
</tr>
<tr>
<td>Much better</td>
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