

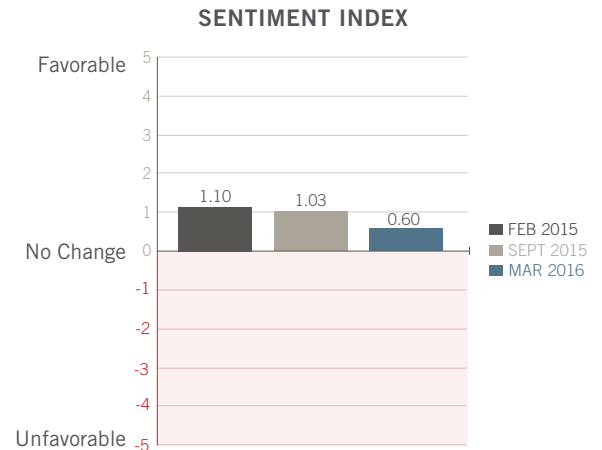
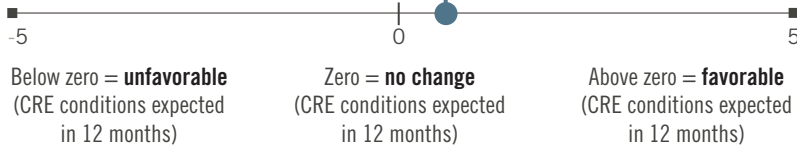
The NAIOP Sentiment Index



Industry Leaders' Outlook on Commercial Real Estate

Spring 2016

NAIOP Sentiment Index
Survey Conducted March 8-11, 2016 **0.60**



Key Findings

The current Index, 0.60, is positive, which means that respondents believe market conditions in 12 months (March 2017) will continue to favor the commercial real estate industry and could even be slightly better than they are today. The Index has declined steadily, by 0.50 points since the first beta test of the survey was conducted in February 2015, which may reflect the expectation that the commercial real estate market is approaching a period of stability. An Index reading of 0 means the market is neither expanding (positive Index) nor contracting (negative Index). Previous readings (1.03 in September 2015 and 1.10 in February 2015) were higher than the current Index, indicating that respondents expect that some moderation in the market will occur in the coming year.

Notable Changes From the September 2015 Survey

The biggest positive changes in the survey related to the cost of construction materials and labor; survey respondents expect them to rise, but not by as much as they did in the September survey. The readings for materials and labor costs demonstrated improvements of 0.55 and 0.33 points, respectively.

The three most notable declines came in relation to debt, equity and employment, with composite scores for availability of debt and equity declining by 0.95 and 0.67 points respectively. Despite this downward movement, the readings are still positive, meaning respondents expect capital to remain available. The employment reading contracted by 0.83 points, but with a composite of 1.85 it was the highest-scoring question in the survey.

Agreement/Disagreement Among Respondents

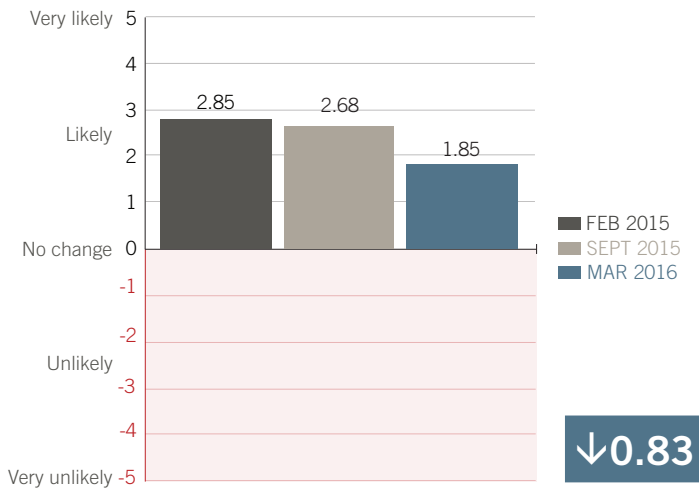
The most consistent responses (meaning there was the most agreement among respondents) were to the questions about face rents and effective rents, both of which are expected to increase over the next year. The least consistency was recorded for employment growth and the cost of construction materials and labor, with responses mixed (answers dispersed) as to whether they would rise or fall.

About the 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 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.)

EMPLOYMENT

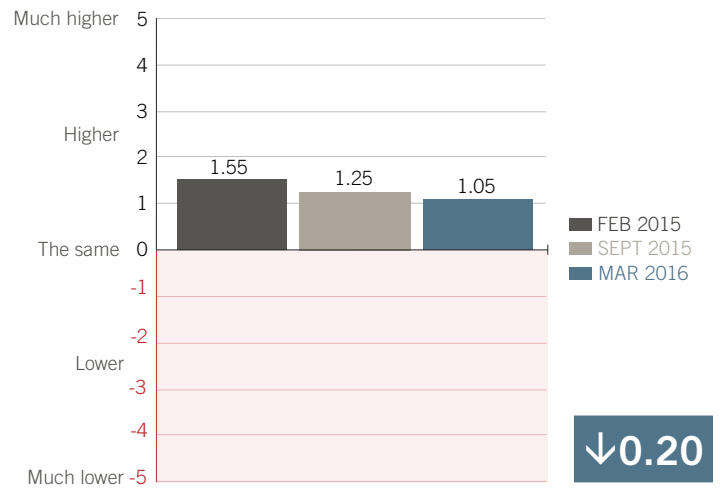
1. How likely is it that your company will add employees within the next 12 months?



Expectations regarding employment over the next 12 months declined by 0.83 points since the beta test survey in September 2015. The score for this question is still highly positive (1.85), but it had the second-greatest negative change in the survey. Overall, responders indicated that they are likely to add jobs, but at a more modest rate.

OCCUPANCY RATES

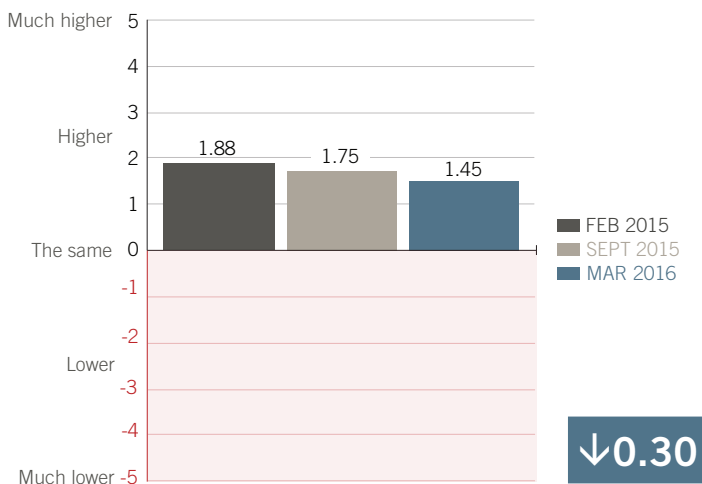
2. Based on your own projects, where do you believe occupancy rates will be in 12 months?



The score for occupancy rates, 1.05, is positive, and showed the least change from the September 2015 beta test survey, declining by just 0.20 points. Occupancy is expected to increase, but the industry appears to be approaching a point in the cycle where supply and demand are in balance.

FACE RENTS

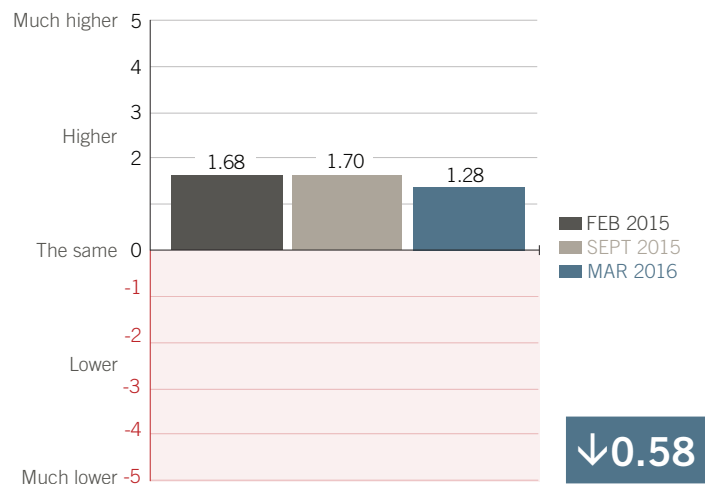
3. Based on your own projects, where do you believe face rents will be in 12 months?



With a score of 1.45, face rents, much like occupancy rates, are expected to grow, but at a slower rate over the next year. The overall growth in face rents is expected to remain solidly positive.

EFFECTIVE RENTS

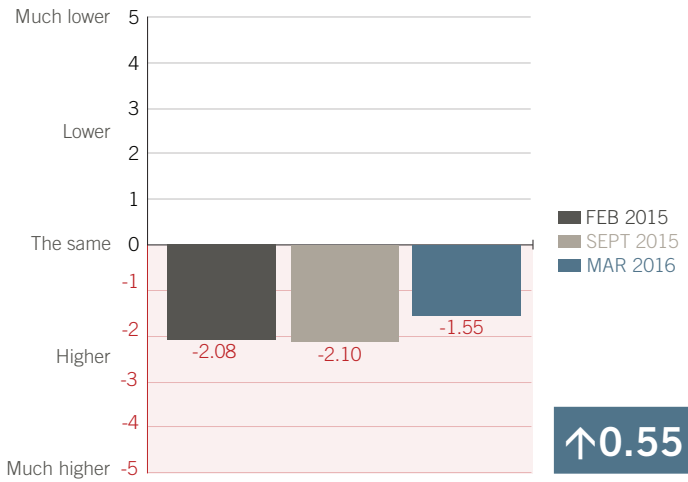
4. Based on your own projects, where do you believe effective rents will be in 12 months?



Effective rents, with a score of 1.28, and a decline of 0.58 points, are also expected to moderate in the coming year. Respondents expect effective rents to grow at a slightly lower rate than face rents. Relative to face rents, this score might indicate that operating expenses and/or concessions are expected to increase at a rate faster than face rents.

CONSTRUCTION MATERIALS COSTS

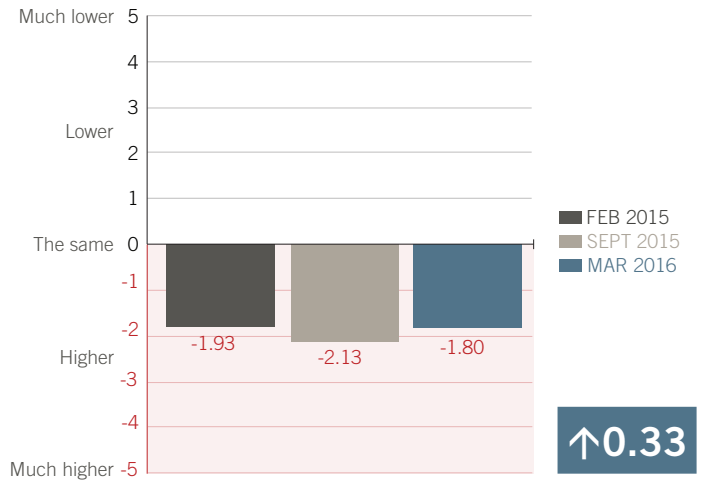
5. For projects on which you are seeking bids, where do you believe the cost of construction materials will be in 12 months?



With a score of -1.55, the cost of construction materials, was the biggest “winner,” demonstrating a 0.55-point improvement over the September 2015 test survey. The cost of construction materials is expected to be less of a hindrance to development in the next year. This score helped keep the overall Index positive.

CONSTRUCTION LABOR COSTS

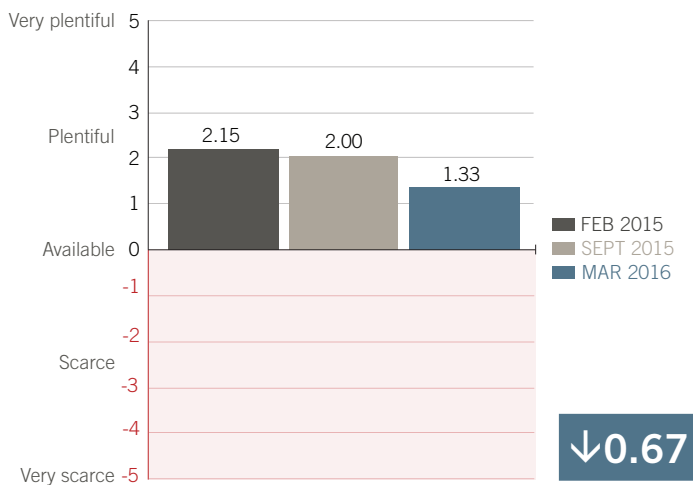
6. For projects on which you are seeking bids, where do you believe the cost of construction labor will be in 12 months?



The score for construction labor costs, -1.80, also improved by 0.33 points. This means respondents expect costs to rise, but not by as much as they did in the last test survey. This is the single largest negative component in the Index and the one that is dragging the Index down the most.

AVAILABLE EQUITY

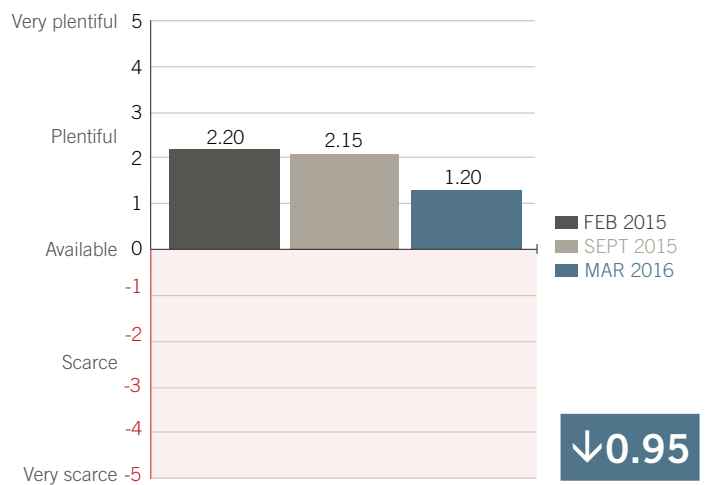
7. For projects you will be financing/refinancing, how plentiful do you believe equity will be in 12 months?



Equity availability, with a reading of 1.33, is viewed as positive. However, the response to this question fell by 0.67 points from the September 2015 beta test survey. This means that respondents believe equity will be available but not necessarily plentiful in 12 months.

AVAILABLE DEBT

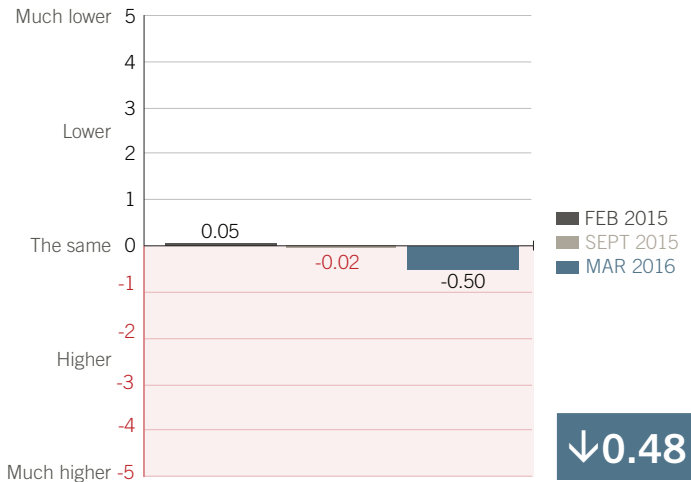
8. For projects you will be financing/refinancing, how plentiful do you believe debt will be in 12 months?



Like equity, debt capital, with a score of 1.20, is expected to be available. This reading did, however, decline the most in this survey, contracting by 0.95 points, reflecting concerns about reserve requirements and rising interest rates.

FIRST YEAR CAP RATES

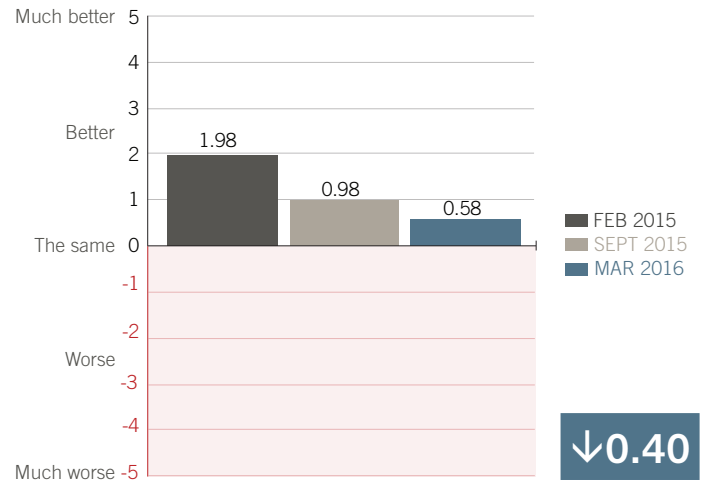
9. Where do you expect first-year cap rates to be for deals you will close 12 months from now?



Compared to the beta test surveys, this is the first time that capitalization rates, with a score of -0.50, are expected to increase, indicating that respondents may anticipate more risk, an increase in interest rates or both. Respondents to the beta test surveys expected that cap rates would essentially stay the same.

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 of 0.58 indicates that respondents expect a positive commercial real estate market over the next 12 months, albeit a less positive one than indicated by the two beta test surveys. Compared to the previous reading of 0.98 in September 2015, this reading fell by 0.40 points.

Direct from the Survey Participants

U.S. economy is doing muddling good. Real estate is doing very well. The rest of the world is doing terrible. The U.S. risks for a downturn will come from overseas.

CRE is a shining star in the investment world. Capital will continue to flow to it, and fundamentals still look pretty promising especially in the coastal markets. Construction and entitlement costs will be the biggest threat to CRE in the next few years.

This cycle has matured. Lower returns, will start facing marginally higher cap rates in the next 12 months. Debt and equity will still be plentiful for good projects, but more judicious, so some lesser quality projects will struggle to get capitalized.

We are in second half of a prolonged, but anemic recovery nationally. Don't expect an economic or commercial real estate downturn until 2019 at the earliest. But don't expect much change or improvement from historically low growth rates. The half dozen or so major global gateway cities will continue to enjoy a near normal recovery, while most markets will continue to languish.

Construction lending is getting harder to obtain and more expensive. New requirements require more equity for projects even as values are increasing. Permanent debt is easier to obtain and at good competitive rates.

Industrial is getting the benefit of the reconfiguration of retail. Warehouses are becoming the new retail, and properly configured big box is still in high demand.

We are seeing decision makers delaying decisions. We suspect this is due to the great uncertainty in the political arena.

Understanding the Index

The survey's final question about overall sentiment regarding future conditions was 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 (a weak positive expectation), while the Index is 0.60. These results indicate that when responses to the individual questions — which relate to real estate fundamentals — are combined into the Index, the overall outlook is the same as when respondents were asked a single, subjective question.

The NAIOP Sentiment Survey is conducted biannually, in March and September. The survey is sent to 5,000 NAIOP members who are developers, owners and investors 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 from the survey's 10 questions are not equally weighted. Instead, weighting varies based on how tight or dispersed each response is. 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. The changes to the scores for

the questions between the most recent beta test in September 2015 and the March 2016 survey ranged from 0.20 to 0.95. The change to the Index was 0.48. This range and shift in the Index are broader and larger than the changes recorded between February 2015 and September 2016, which ranged from 0.02 to 0.17 for the questions and just 0.07 for the Index.

The response rate for this survey was 6.7 percent and the margin of error for the index was 5.29 percent. Survey participants are sent a breakdown of responses to all questions two days after the survey closes. This report is released to all NAIOP members and the public three weeks later. Survey responses for this Index were gathered March 8- 11, 2016. The first two readings in this survey were beta tests sent to 600 NAIOP members in February and September 2015, generating response rates of 17 and 18 percent, respectively. Comparing this survey to the prior beta tests, respondents' consistency across questions was nearly the same, with face rents being the most consistently answered question and construction materials and labor costs being the least consistently answered questions. As such, March results did not vary significantly from those in the beta tests.

The data is compiled and analyzed by Tom Hamilton, Ph.D., MAI, CRE, and Gerald Fogelson Distinguished Chair in Real Estate at Roosevelt University in Chicago. The survey questions and statistical methodology were created, refined and finalized between 2014 and 2016 by the NAIOP Distinguished Fellows listed on the online NAIOP Sentiment Index.

For more information, visit www.naiop.org/index