UBS

Asset management
Real estate research & strategy

February 2015

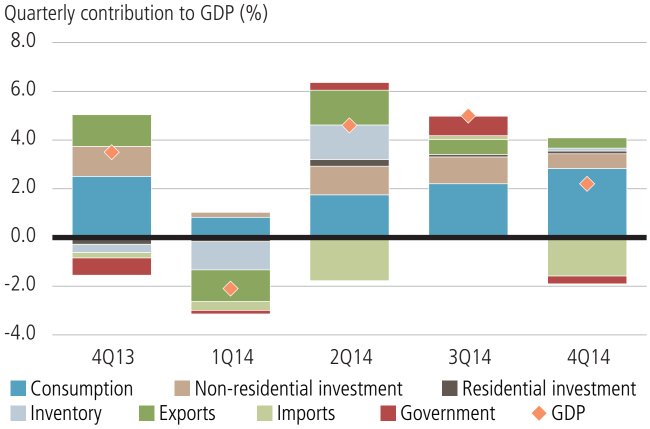
Outlook quarterly

US real estate market

- As 2014 drew to a close, strong job growth, falling oil prices and lower homeownership rates commanding headline attention, weaving a supportive story for on-going commercial real estate demand.
- Consumer spending, which is represented by the blue column in *exhibit 1*, is a key determinant of economic prosperity in the US.
- US consumers and businesses are benefiting from lower interest rates and cheaper fuel costs, despite the short-term drag on the domestic energy industry.
- Commercial real estate fundamentals should support continued positive income growth.
- Rent growth is exceeding inflation for all major commercial property sectors, *exhibit 2*.
- For the fifth consecutive year, 2014 property level returns were above average.

Exhibit 1 - Components of GDP

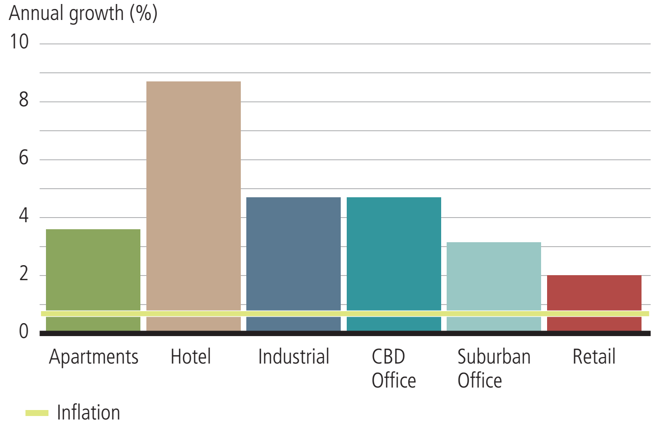
Quarterly contribution to GDP (%)



Source: Moody's Analytics as of March 2, 2015

Exhibit 2 - Rents and inflation

Annual growth (%)

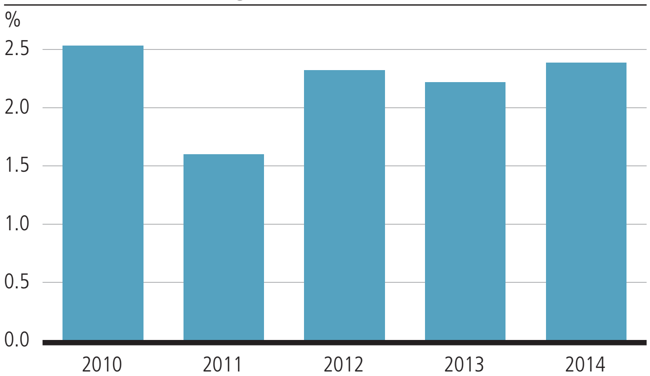


Source: Moody's Analytics, CBRE-Econometric Advisors and Reis as of December 2014

Economic viewpoint

- We cannot say that economic growth was smooth or steady during 2014, but the US economy did manage to grow at the fastest pace since a recovery pop in 2010. *Exhibit 3* shows annual GDP growth.

Exhibit 3 - Real GDP growth

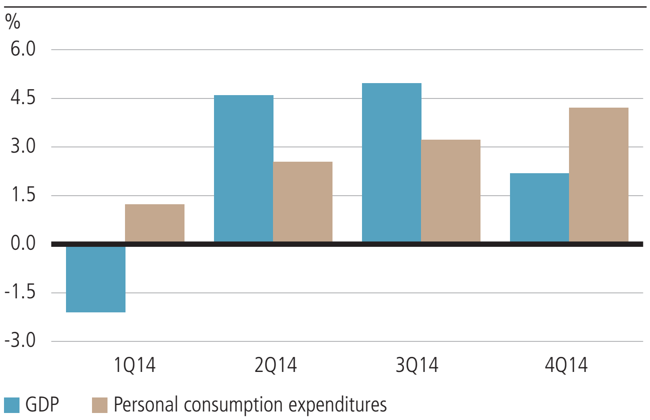


Source: Moody's Analytics as of March 2, 2015

- What is even more hopeful for commercial real estate investors is that positive growth is expected for the foreseeable future.

- During the fourth quarter of 2014, consumer spending grew at an annualized pace of 4.2%, helping to drive 2.2% annualized growth in GDP, *exhibit 4*. Over the full year 2014, consumer spending increased by 2.8%.

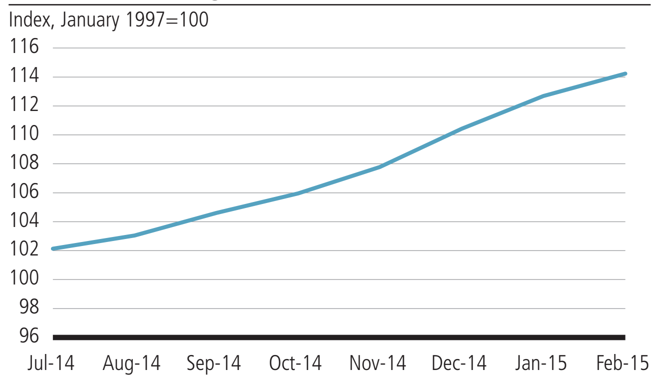
Exhibit 4 - Growth in GDP and consumption



Source: Moody's Analytics as of March 2, 2015

- Positive forecasts for job growth and wage inflation lead us to be optimistic about future growth in consumer spending, helping to support our 3.1% GDP growth expectation for 2015. (See our January release of the *US Real Estate Market Outlook 2015* for a full description of our base case forecasts for the year.)

Exhibit 5 - Exchange value of the US dollar

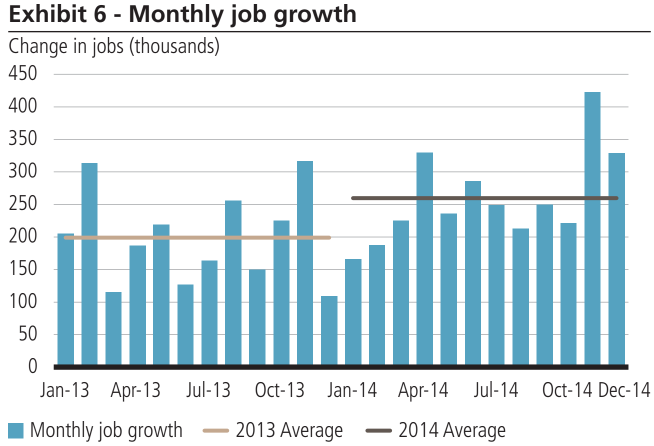


Source: Moody's Analytics as of March 2, 2015

- The exchange value of the US dollar increased by 12% compared to other major currencies, exhibit 5, since mid-2014. A more expensive dollar could put downward pressure on foreign real estate acquisitions in the US; however, that impact has yet to materialize.

- After averaging 199,000 net new jobs per month during 2013, the US economy added an average of 260,000 jobs each month during 2014 (*exhibit 6)* which is in line with expectations for a self-sustaining expansion.

Exhibit 6 - Monthly job growth

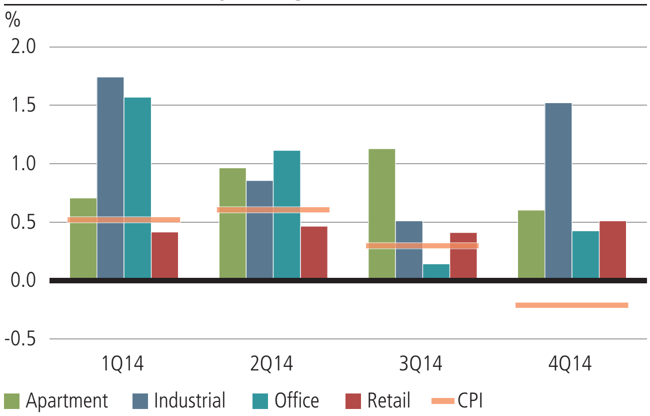


Source: Moody's Analytics as of March 6, 2015

Job growth supports self-sustaining expansion

- As shown in *exhibit 2*, rents in all major US property sectors are growing faster than inflation. *Exhibit 7* compares quarterly rent growth detail with the change in the Consumer Price Index (CPI).

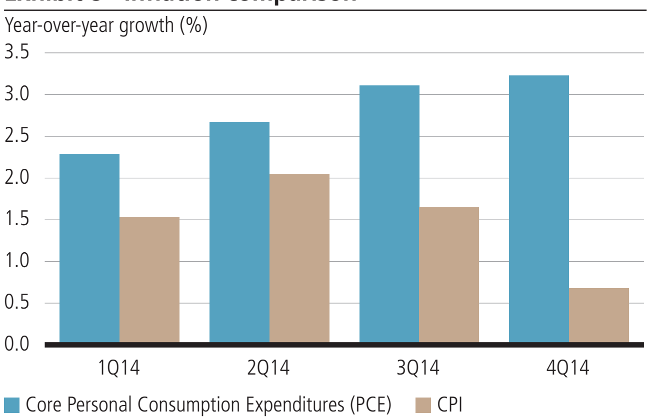
Exhibit 7 - Quarterly rent growth and inflation



Source: Moody's Analytics, CBRE-Econometric Advisors and Reis as of December 2014

- The Federal Reserve focuses more on core inflation, which excludes the volatile food and energy components, but we can hardly ignore the quick drop in oil prices during the fourth quarter of 2014 which impacted CPI, *exhibit 8*.

Exhibit 8 - Inflation comparison



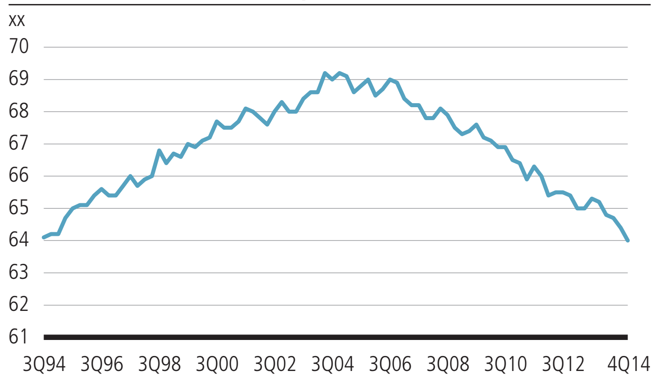
Source: Moody's Analytics as of March 2, 2015

- Energy analysts have disagreed for months as to whether oil prices are near a floor or could fall further. Most economists, including the UBS Investment Bank's Maury Harris, are forecasting higher oil prices by the end of 2015. It is unlikely firms and consumers would change their long-term behavior under this level of uncertainty.

- Monthly fluctuations in commodity prices (e.g. oil, food, minerals) are not likely to impact property values unless the market is convinced that the change will persist. Private real estate values continuously adjust but do so over long time periods. Only a sustained period of lower energy prices should change real estate usage.

- Homeownership has been on the decline in the US for nearly a decade, supporting strong demand for apartment rentals. During the fourth quarter, the rate fell to 64%, the lowest rate since 1994, *exhibit 9*.

Exhibit 9 - Homeownership



Source: Moody's Analytics as of December 2014

- Despite persistently low interest rates that could have incentivized buyers, the residential home market continues to disappoint economists who were anticipating that a turnaround in this sector would lead to stronger economic growth. However, after twelve months of decline, home sales began increasing slowly at the end of 2014.

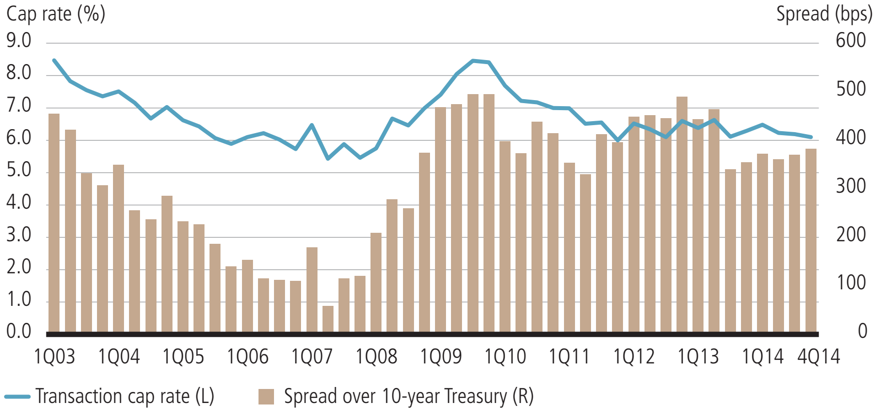
Commercial real estate

- Investors have been pricing income growth since recovery began in 2010, they are now reaping the benefits.

- Vacancy rates across all five major property types are either low relative to historical standards or moving toward long term average rates, show in *exhibit 10*, and all sectors are experiencing real rent growth (*exhibit 7*).

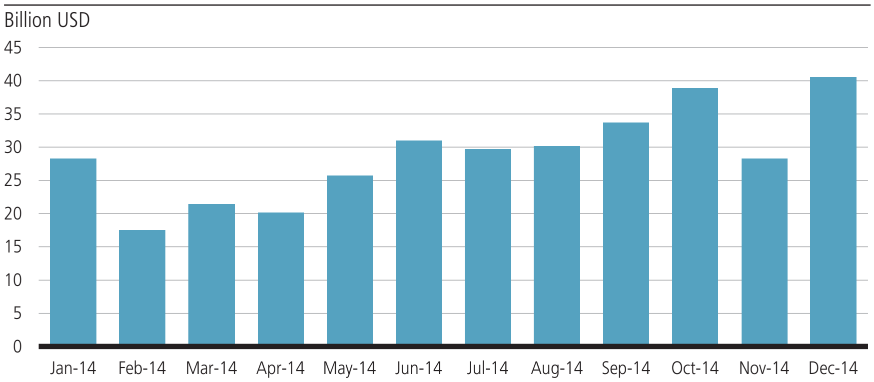
- A combination of decreasing risk premiums and increasing income growth expectations have driven cap rates down over the past five years, *exhibit 11*.

Exhibit 11 - Cap rates and Treasury spread



Source: Moody's Analytics as of March 2, 2015

Exhibit 12 - 2014 Transactions

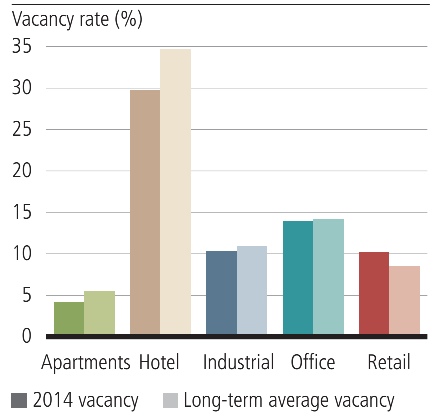


Source: Real Capital Analytics as of December 2014

- During 2014, total commercial and multifamily real estate transactions (excluding privatizations) were USD 345 billion, an increase of 16% over 2013. *Exhibit 12* provides detail on the progression of monthly transaction volume during the year.

- During 2014, unlevered property-level returns were 11.8%, as shown in *exhibit 16*, marking the fifth consecutive year of above-average performance.

Exhibit 10 - Property sector vacancy



Source: CBRE-Econometric Advisors and Reis as of December 2014

Key fourth quarter happenings: a million new jobs, oil price slide, homeownership hits 20-year low

Property sector focus

Apartments

- Apartment vacancy rates are bouncing along the bottom and will face upward pressure from new supply in 2015, *exhibit 13*.

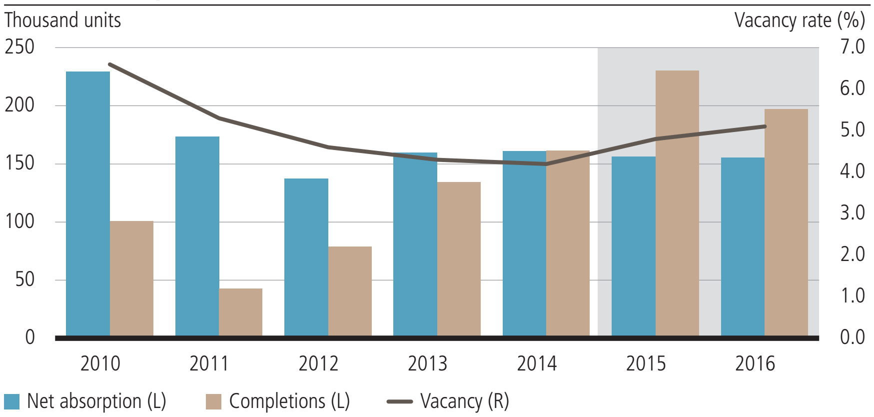
- Supply increased by more than 160,000 new units in 2014, which is 25% above the long-term annual average.

- Demand for apartments was strong as job growth accelerated and the homeownership rate declined throughout the year.

- Vacancy held steady at 4.2% during the fourth quarter.

- Rent growth should slow somewhat from the 3.6% rate achieved during 2014 but is expected to remain above inflation for the foreseeable future.

Exhibit 13 - Apartment fundamentals



Source: Reis as of December 2014
Shaded area indicates forecast data

Hotels

- With an outlook for the economy to support business and leisure travel, we expect hotels to maintain high occupancy and room rates; however, the pace of growth of RevPAR is unsustainably high.

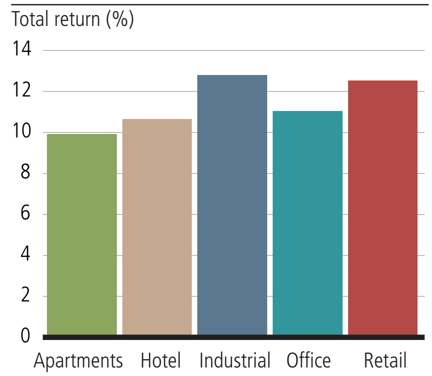
- After achieving nearly a 10% increase during 2014, growth in Revenue per Available Room (RevPAR) will likely begin to wane in 2015.

- The supply of upper-tier hotels is already increasing in response to strong demand. Construction of lower-tier hotels will pick-up noticeably by 2016.

Industrial

- For the first time since the NPI began in 1978, the industrial sector produced the highest total return of the five major property types during the full year 2014, *exhibit 14*.
- Industrial availability has declined to its long-term average rate of 10.3%. There is likely continued recovery ahead for rents, which are still 6% below their pre-recession peak level.
- Warehouses comprise 65% of the US industrial market with light manufacturing and research & development (R&D) space making up the rest.
- Average availability for US warehouses was 10.4% in the fourth quarter of 2014. The 20-year average availability rate is 10.6%.
- Net rent grew by 3.9% over the year in the warehouse subsector.
- Supply is responding to below-average availability and above-average rent growth. During 2014, 101 million square feet of new warehouse space was constructed, an increase over the 65 million square feet delivered during 2013. For comparison, in 2008 warehouse supply increased by 175 million square feet.

Exhibit 14 - 2014 NPI total returns

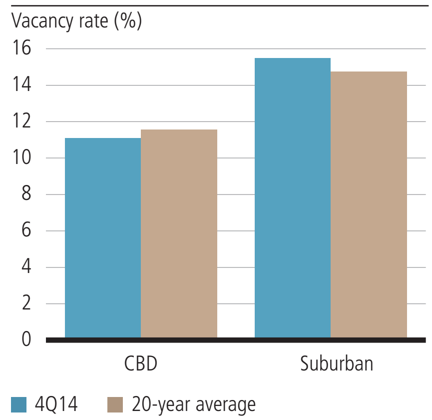


Source: NCREIF as of December 2014
Past performance is not indicative of future results

Office

- Office is still a tale of two subsectors, with Central Business District (CBD) office properties currently experiencing below-average vacancy (*exhibit 15*) and above-average rent growth, while the recovery in Suburban office properties is intact but lagging.
- Rent growth was 4.7% for CBD offices in 2014 and slowly decelerating. Suburban office rent growth was 3.2% in 2014 and sluggishly accelerating.
- The outlook for hiring among primary office-using employers remains strong after this subsector accounted for 890,000 of the 975,000 net new jobs added in the US during 2014.
- With supply growth still low and hiring poised to fuel steady demand, office properties should experience sustained, positive revenue growth for the foreseeable future.

Exhibit 15 - CBD and Suburban office vacancy



Source: CBRE-EA as of December 2014

Retail

- During 2014, vacancy rates in community and neighborhood shopping centers declined by 20 basis points (bps) ending the year at 10.2%.
- As shown in *exhibit 7*, rent growth has lagged the other sectors but is now exceeding inflation.
- Store closures caused a 10 bps increase in mall vacancy to 8.0% during 2014, according to Reis.
- High end malls are near full occupancy. Mid-level malls are beginning to experience rent growth; however, low end malls continue to struggle.
- As noted in the *Economic viewpoint*, we have a positive outlook for consumer spending as hiring persists and wages begin to face upward pressure.

Real estate and capital markets activity

Exhibit 16 - Historical performance data (%)

Total returns	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	3Q14	4Q14	3 YR	5 YR	10 YR
Bar Cap	9.76	9.48	(2.16)	11.85	8.50	11.04	4.67	4.19	2.37	3.78	7.24	5.70	4.51	6.59	8.74	4.80	(2.34)	6.01	0.17	1.82	2.76	4.69	4.70
S&P 500	33.36	28.58	21.05	(9.11)	(11.90)	(22.11)	28.69	10.87	4.91	15.80	5.50	(36.99)	26.47	15.06	2.11	16.00	32.38	13.69	1.13	4.93	20.41	15.45	7.68
Russell 2000	22.36	(2.55)	21.26	(3.02)	2.49	(20.48)	47.25	18.32	4.55	18.37	(1.56)	(33.79)	27.18	26.85	(4.19)	16.35	38.81	4.90	(7.36)	9.73	19.21	15.54	7.76
EAFE	2.05	20.34	27.29	(13.96)	(21.21)	(15.67)	39.17	20.69	14.01	26.86	11.63	(43.06)	32.46	8.20	(11.73)	17.89	23.29	(4.48)	(5.83)	(3.53)	11.56	5.81	4.91
NAREIT	20.27	(17.51)	(4.62)	26.36	13.93	3.81	37.14	31.59	12.16	35.07	(15.69)	(37.73)	27.99	27.94	8.28	19.70	2.86	28.04	(2.48)	12.94	16.39	16.91	8.32
CPI	1.70	1.61	2.68	3.44	1.60	2.48	2.04	3.34	3.34	2.52	4.11	(0.02)	2.81	1.42	3.02	1.76	1.51	0.66	(0.03)	(0.62)	1.31	1.67	2.11
NCREIF Property Index returns																							
Total	13.91	16.25	11.36	12.25	7.28	6.75	9.00	14.49	20.06	16.60	15.85	(6.46)	(16.85)	13.11	14.26	10.54	10.98	11.82	2.63	3.04	11.11	12.14	8.38
Income	9.08	8.78	8.38	8.58	8.67	8.42	7.97	7.46	6.75	6.22	5.56	5.13	6.17	6.76	6.11	5.84	5.61	5.36	1.31	1.29	5.60	5.93	5.95
Appreciation	4.52	7.02	2.81	3.46	(1.31)	(1.58)	0.97	6.66	12.68	9.92	9.88	(11.15)	(21.98)	6.05	7.80	4.51	5.16	6.21	1.32	1.75	5.29	5.94	2.33
NCREIF total returns by property type																							
Apartment	12.90	14.12	11.73	12.99	9.37	8.76	8.90	13.04	21.15	14.63	11.36	(7.29)	(17.51)	18.21	15.45	11.23	10.42	10.29	2.53	2.77	10.65	13.08	8.14
Industrial	15.94	15.86	11.65	14.02	9.30	6.70	8.23	12.07	20.31	16.96	14.95	(5.76)	(17.85)	9.37	14.59	10.71	12.32	13.42	2.92	3.87	12.14	12.07	8.27
Office	17.87	19.62	12.22	14.11	6.20	2.78	5.67	12.02	19.46	19.16	20.51	(7.29)	(19.10)	11.74	13.76	9.49	9.86	11.50	2.78	3.09	10.28	11.26	8.17
Retail	8.53	12.91	9.55	7.76	6.74	13.74	17.15	22.95	19.98	13.35	13.51	(4.11)	(10.95)	12.62	13.77	11.61	12.87	13.12	2.33	2.69	12.53	12.80	9.18
Core Farmland Index returns (market weighted) *																							
Total	9.45	7.73	7.01	8.51	3.29	6.47	8.78	19.54	21.94	17.08	16.97	13.40	7.30	7.68	14.93	17.33	15.82	7.92	1.36	1.58	13.61	12.66	13.94
Income	6.27	5.71	5.71	5.63	5.06	5.44	5.16	5.64	5.52	5.53	5.74	4.33	4.81	4.96	5.14	5.61	4.67	4.52	0.90	1.24	4.93	4.98	5.08
Appreciation	3.05	1.93	1.25	2.76	(1.70)	0.99	3.48	13.38	15.79	11.09	10.77	8.79	2.40	2.63	9.44	11.27	10.78	3.29	0.46	0.33	8.38	7.42	8.54

Source: NCREIF, NAREIT, Bureau of Labor Statistics, Morningstar and Moody's Analytics as of December 2014

*The Core Farmland Index (CFI) is composed of all annual and permanent cropland investments in the NCREIF Farmland Index that are leased. For a more market-neutral benchmark, CFI excludes investments that are owner/operated and re-weighted NCREIF Farmland Index returns to 80% annual cropland and 20% permanent cropland.

Real Estate Research & Strategy - US

William Hughes
Dan Bu, Kurt Edwards,
Tiffany Gherlone, Amy Holmes,
Kim House, Brian O'Connell,
Joshua Rome, Shane Russo &
Laurie Tillinghast

For more information please contact:

UBS Realty Investors LLC
10 State House Square
Hartford, CT 06103
Tel. +1-860-616 9000

@UBSamericas

www.ubs.com/realestate

UBS