The Case for Real Estate

Prepared for:

National Association of Real Estate Investment Managers

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Real Estate Investment Managers

Executive Summary

This paper helps to answer the questions, "Why invest in commercial real estate?" and, "Why invest in commercial real estate now?" For a time during the Financial Crisis and the immediate aftermath, comparatively few investors were inclined to consider these questions in a positive sense with much investment flowing to "safe" assets like cash and government bond instruments. Guilt by association hurt commercial real estate with the downturn in the broader single family market casting aspersions on the commercial sector.

Over time as the initial panic faded, the fact that the residential market performs differently than the commercial market became clear. In this paper we make the point that commercial real estate is an investment class that makes sense for institutional investors on both an absolute and a relative basis. There are six broad sections to this paper, with the following topics addressed in each:

- Better Current Performance Relative to Other Asset Classes
- Better Performance Relative to Other Asset Classes over a Typical Holding Period
- Diversification Benefits in a Mixed-Asset Portfolio
- Timing Benefits of Commercial Real Estate Returns Relative to the Business Cycle
- Constraints on New Construction Benefit Performance of Current Investments
- Inflation Hedging Characteristics of Commercial Real Estate

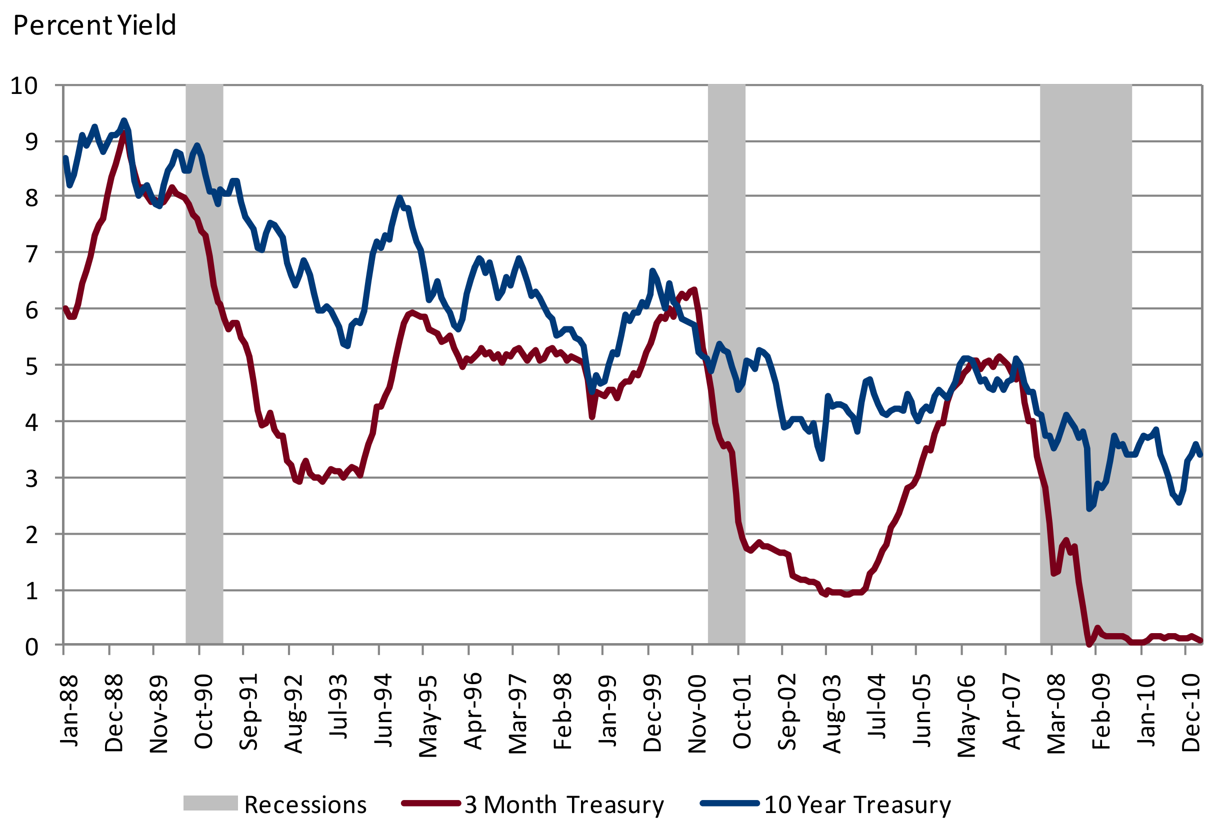
In this paper, we will demonstrate how both the absolute and relative benefits of commercial real estate converge to make a case for the asset class generally and for the specific post-downturn environment of the US economy. The paper looks at use historical comparisons, alternative asset performance, construction data, as well as data points on highly inflationary periods in U.S. history, to make the case for why to invest in commercial real estate now.

Better Current Performance Relative to Other Asset Classes

Part of the renewed interest in commercial real estate investment as the economy moved out of recession in 2010 stems from the fact that other assets classes were simply not delivering in terms of rates of return. Consider the yield trends on the safe asset class of US Treasuries. As shown in Figure 1 that follows, the yield on the three-month Treasury fell dramatically during the recession, hitting a low of 0.12% in June of 2010. To put this figure in context, an investor putting $10,000 into a three-month Treasury instrument in June of 2010 would get $12 back on their investment in September. By contrast, an investor back in 1993 would receive $313 for the same investment over the same time frame.

Rates of return in the government bond market have become too low to compete with other asset classes. Even on longer maturities on the yield curve, the opportunities simply are not that attractive. The 10-year Treasury dipped below the 3% level in 2010, meaning that, for a long-term commitment of capital, an investor would get less today than one could have had from a three-month commitment back in 1993. In this environment, investors are challenged to obtain any sort of return; and commercial real estate, along with those investments which are stable and cash-yielding, have been particularly attractive in recent quarters.

Figure 1. Poor Rates of Return in Other Asset Classes



Sources: FRB, NBER

Though the 10-year Treasury and long-term yields have increased slightly in response to the uptick in inflationary expectations that have accompanied the second round of quantitative easing initiated by the Federal Reserve Bank, it is expected that these changes will have a beneficial impact on certain real estate investments. In this environment of low bond yields, consequently, the appetite for commercial real estate investment will remain healthy as investors chase yield.

The pursuit of yield has been a good story for commercial real estate investment in recent quarters, but other characteristics have been attractive as well when considered in relation to alternative asset classes. Commercial real estate performance characteristics are simply less volatile than other high-yielding asset classes and the instability of other asset classes during the economic recovery has emerged as a compelling argument for increased allocations to commercial real estate.

Better Performance Relative to Other Asset Classes over a Typical Holding Period

To move from the safe yields of government bonds to higher yields in other asset classes, investors must assume more risk. Nothing in life is free and there is tradeoff in the risk and return characteristics of investment opportunities. One risk that investors can undertake is to commit capital over longer periods and over a 10 to 15 year horizon, a typical holding period for most Core commercial real estate investments, real estate outperforms other asset classes.

As shown in Table 1 that follows, over 10- and 15-year horizons, commercial real estate outperformed both stocks and bonds, from a total return perspective. Given better statistics on volatility of returns, commercial real estate also delivers a superior Sharpe ratio over the 10 and 15 year horizons. In other words, the return per unit of volatility was better in commercial real estate over 10 and 15 year horizons than it was in stocks or bonds.

When thinking about constructing a portfolio over a longer term, however, investors will focus on high allocations to stocks, as over a 20-year period. That said, over the short run, the performance of the equity markets has been disappointing from a volatility perspective.

Table 1. Long Term Perspective, Commercial Real Estate versus other Asset Classes

		Period Ending in 2010Q4			
		5	10	15	20
(NPI)	Average Return, %	4.33	7.92	9.55	7.44
	Sharpe Ratio	0.05	0.35	0.54	0.24
S&P 500	Average Return, %	4.71	3.40	8.72	10.90
	Sharpe Ratio	0.04	-0.03	0.20	0.30
Government Bond	Average Return, %	5.57	5.51	5.89	6.82
	Sharpe Ratio	0.34	0.33	0.26	0.28

$$\text{Sharpe Ratio} = \frac{\text{Period Average (Return - 10 Year Treasury)}}{\text{Period Standard Deviation (Return - 10 Year Treasury)}}$$

Grey color highlights the highest return; green color highlights the highest ratio of average annualized return to standard deviation.

Sources: S&P, Barclay's, NCREIF, FRB

Volatility matters to investors as it creates hazards for the predictability of the income one obtains from investments. The preceding table suggests stocks have the best overall return performance over a 20-year horizon and the best risk-adjusted return over such a horizon. These facts over a 20-year period will smooth out the noise and unexpected shocks one might experience over the short run, but the impacts over the short-run have had an impact on investor behavior.

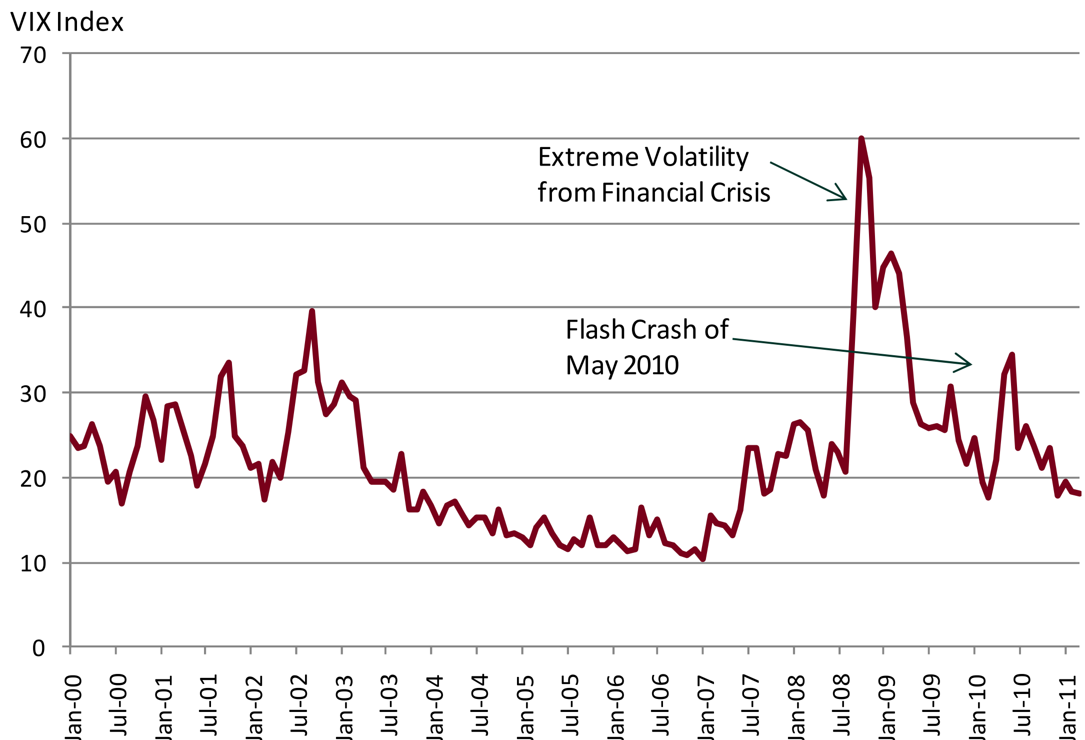
As Table 1 illustrates, over the last five years, bonds were the strongest performers, both from an absolute return perspective and in terms of the return per unit of risk. As the economy entered a tail spin in 2008, the returns for stocks and bonds fell at an extreme pace such that the volatility of returns for both commercial real estate and stocks have been harsh. This volatility is measured by examining performance characteristics over the past five years, which, there is reason to believe as the economy jumps back into gear, will revert to something more like what was seen over the intermediate-to-long term. Specific factors which had affected market volatility over the last three years may push additional interest in commercial real estate, relative to the past.

A key argument in favor of stocks in a mixed-asset portfolio is they provide more liquidity than hard assets like commercial real estate. This argument can hold up during periods when the economy is robust and growing, with large blocks of shares easily transacted, given the clarity of price discovery available in the public markets. This notion that the stock markets are more liquid than commercial real estate has taken a blow in this downturn, however, especially in light of the "Flash Crash" seen in the stock markets in May of 2010.

The time required to market a commercial property can vary with the point in the cycle. When demand for assets is strong, deals have been completed in 16 weeks, while deals can take as long as 24 weeks to close in a period of slack demand. In the stock markets by contrast, sales can be completed more quickly, but not necessarily at the desired prices; selling in "the wrong week" can be disastrous compared to waiting a few days.

Whether for portfolio-balancing requirements or generating cash in the short run, some investors facing a need to dispose of portions of their stock portfolios have taken severe hits in this downturn. The S&P 500 took a hit of 45% between the third quarter of 2007 and the first quarter of 2009. This hit was not a slow steady decline, however; there were periods of major, fast price moves along the way.

Figure 2. Volatility of Stock Markets Highlight Overstated Liquidity Advantages



Source: CBOE

Investors were particularly spooked by the "Flash Crash" in early 2010, when $1 trillion in market value was erased in 15 minutes. Subsequent investigations of this event have uncovered structural problems, which have been addressed with tests of new circuit breakers that temporarily limit the process of price discovery in the equity markets. These periods of poor performance and sudden unexpected shocks, however, have prevented investors from moving expectations for stock market volatility back to the low levels seen in the past. By contrast the performance of the commercial real estate markets in 2010 gave investors no new signals requiring additional regulations. With the risks of investment in this sector well understood, the appetite for these investments will grow along with expectations for the economy.

One measure of this volatility is the VIX index published by the Chicago Board of Options Exchange (CBOE). This index represents the market's expectation of stock market volatility over the next 30 day period, as developed from pricing on options on the S&P 500 Index. Some investors call the VIX the "fear index" and, into the first quarter of 2011, as shown in Figure 2 above, the VIX was still at the same approximate level as it was in late 2007 through early 2008. Expectations for volatility have not returned to the low levels seen between 2004 and early 2007, and, as such, investors are likely to continue to approach stock market investments with more caution than in the boom years, given that they expect more uncertainty.

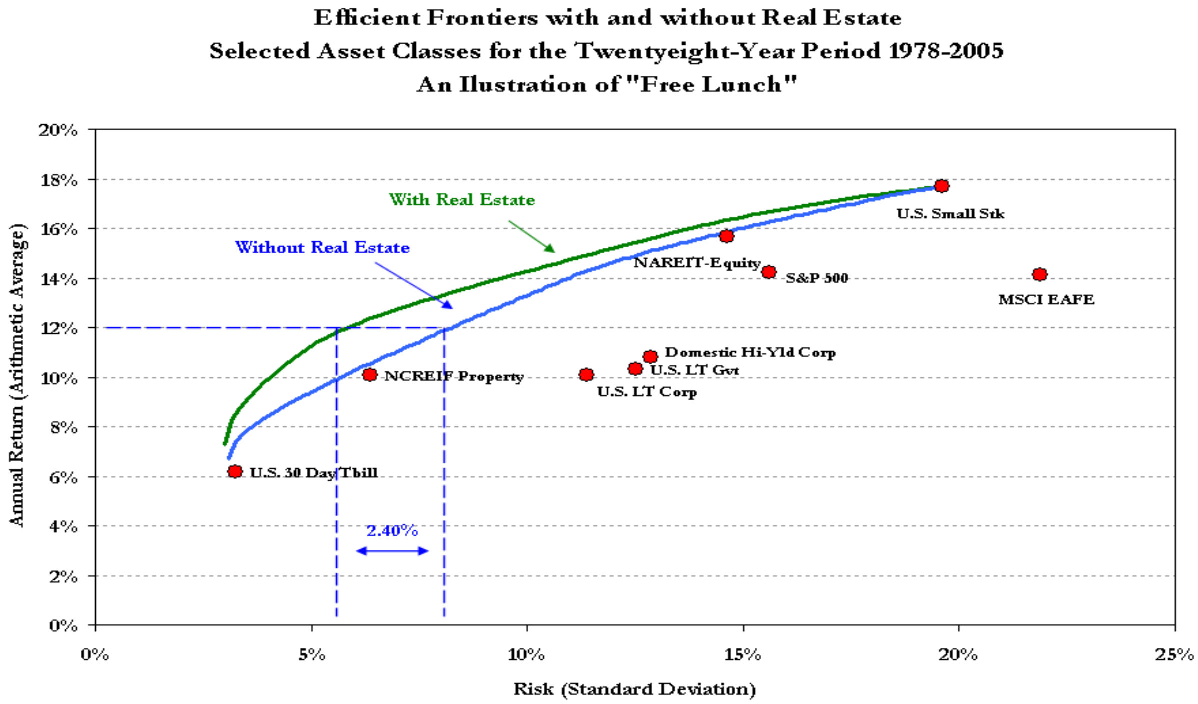
Whether in an upswing in the business cycle or on the way down, as an investor tries to sell a commercial real estate investment, its time on market will be longer than the time it takes to sell a stock portfolio with a similar market capitalization. This said, in this longer time on market, an investor can feel more secure that pricing achieved in a transaction is not due to a short-term movement in market activity. While price discovery is longer in the commercial property markets, the pricing that results is less volatile and, in the current environment, where investors expect ongoing, slightly-elevated volatility in stocks, the more stable pricing of commercial real estate assets will continue to look more attractive.

Diversification Benefits in a Mixed-Asset Portfolio

Another positive benefit of commercial real estate is the diversity it brings to a given portfolio. As we have seen from the prior Sharpe ratio analysis, private real estate approaches the returns of the stock market while minimizing the risk and volatility. It provides the cash flow of bonds, without the heavy exposure to interest rate risk which can make bond values dramatically different at the end of their investment horizons. Most importantly, commercial real estate has low, and in some cases, negative, correlations with other traditional investment classes.

According to the tenets of Modern Portfolio Theory (MPT), the most effective way to maximize return while concurrently minimizing risk in a portfolio is to add uncorrelated assets. The addition of private real estate has a strong track record in this regard, with low and negative pair wise correlations to both the S&P 500 (.12)and the Barclays Government Bond Index (-.05) respectively from 1985 through the second quarter of 2010. As Figure 3 illustrates, adding real estate to a portfolio of diversified assets, as illustrated by the blue line, moves the performance of the portfolio to the green line, which simultaneously increases return, while holding risk constant. This result demonstrates why commercial real estate should be a component of any portfolio that confers the risk and return benefits of diversification.

Figure 3. Efficient Frontiers Maximize Returns & Minimize Risk with the Addition of Commercial Real Estate



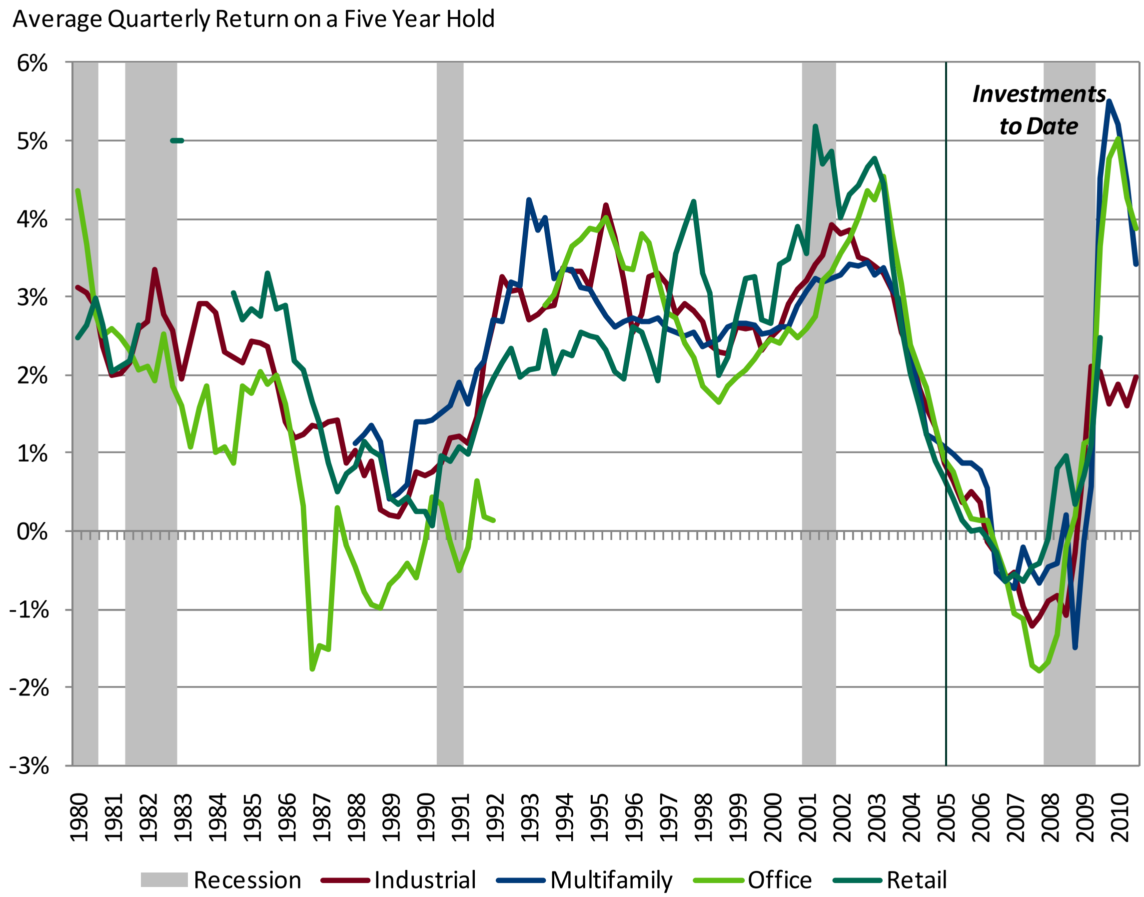
Source: Joseph Pagliari, Northwestern University 2006

Timing Benefits of Commercial Real Estate Returns Relative to the Business Cycle

The performance characteristics of commercial real estate are far less volatile than those of the stock markets and this feature makes the sector attractive relative to other asset classes in the this uneven recovery. This lower volatility is due to issues in the construction of the performance indices as well as the underlying characteristics of the assets themselves. The office sector for instance, has long leases generating stable income streams while the multifamily sector has steady access to debt from government sponsored entities, generating stability around valuations. Across all commercial property types, such features combine to deliver returns that over time have delivered predictable returns relative to the business cycle.

The NCREIF data provides an interesting way to gauge the performance of commercial real estate investments relative to the point in the cycle. Rather than simply looking at overall returns for the sector, one can gauge the performance of assets relative to that of the year and quarter in which these assets were purchased. Granted, the NCREIF index is typically composed of assets with Core characteristics given the 60% occupancy criteria on the index but even the trend in Core assets relative to the business cycle is instructive. In Figure 4 that follows, such indices were created for each of the four major property types, with returns calculated on a quarterly basis on the average over the subsequent five years in which the investments were held. The year indicators on the x-axis indicate the point at which the investments were made, and with respect to the timing of the investments, it is evident that not all years are equal in subsequent performance.

Figure 4. Real Estate Investments Outperform When Made Just After a Downturn



Sources: NCREIF, NBER

Returns lag for those investments made just ahead of economic downturns, as the highest pricing levels are usually achieved just ahead of the downturns. This is especially true of the 1990 and 2008 downturns; the availability of real estate financing became more challenged for these investments throughout the expected lifecycle of the investments. These same characteristics, however, benefit investors making new investments just as the economic downswing reaches its end.

Historically, all sectors have seen the best absolute returns for investments made in the periods just into or after economic downturns. While the economic downturns were over, cap rates continued to adjust upward for some time. The office investments with the best return profile following 1991 were those made in 1994, with average quarterly returns of 4% over the subsequent five years. Figure 5 that follows highlights why this outperformance occurred, with transaction cap rates hitting a peak level just under 9.5% in late 1993 and early 1994. These investments were destined to see returns boosted by cap rate compression on the order 50 to 60 bps over the subsequent five years.

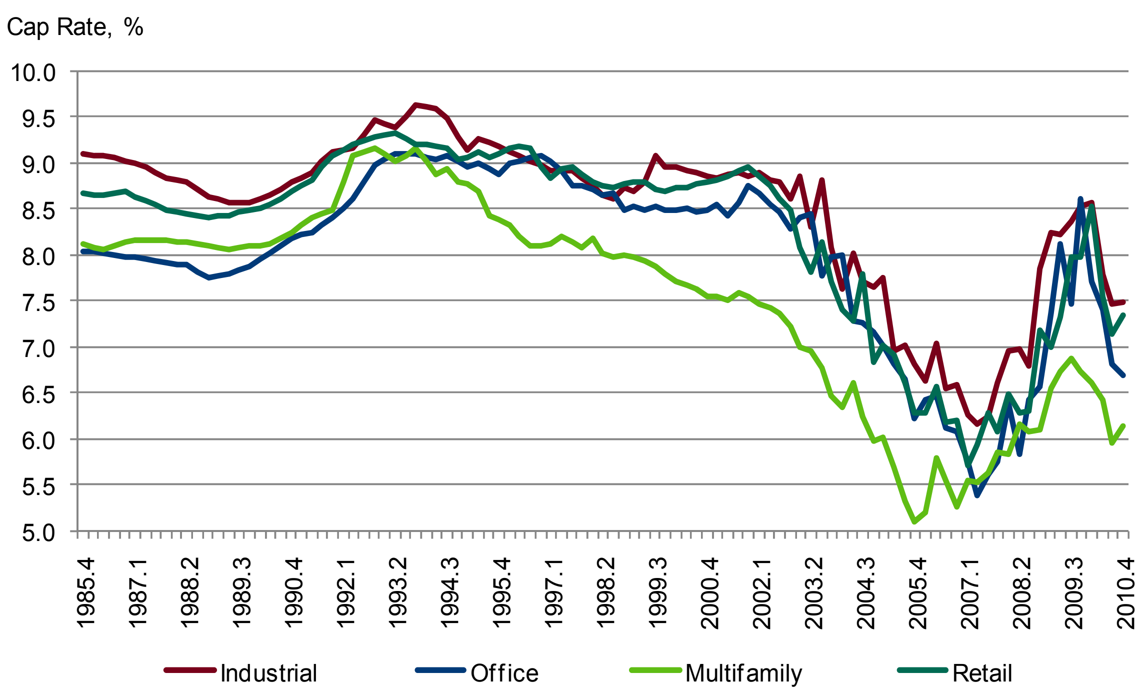
An astute reader looking closely at Figure 4 may notice gaps in the historical trends. These gaps are not a bug, rather they are a feature. The office sector for instance shows no data in 1993 and 1994 and obviously investors bought some assets in those years. The issue though is that the type of assets being bought and the investors who were active did not generate enough observations to meet the masking criteria imposed by NCREIF. The early 1990s saw the sale of many largely empty office assets build by cowboy developers in the late 1980s and early 1990s. These assets simply did not meet the 60% occupancy standard, nor were many of the investors acting for institutional sources of capital.

The timing of investment performance is a feature that many investors understand but not all can act on such cyclic trends. Institutional sources of capital often tread more lightly in the early stages of a recovery while private wealth investors have a greater tolerance for the risks posed in investments made in these periods. Those investors who have made the decision to re-enter the market in the early stages of the recovery may, as they have before, reap return gains greater than those of their peers who decide to wait.

Again, it is not quite fair to compare the performance of investments made in and around the 2008 downturn to those made in the two other recent economic downturns, due to the fact that five years' worth of investment performance data is not yet available. Doing so anyway, with a bit of caution on the results, it is interesting to see how investments made in 2009 and 2010 are already delivering positive returns. The retail sector stands out with no evidence of a recovery in returns due to a lack of observations. Again, the NCREIF data has Core characteristics and retail properties exhibit more distress in the current environment.

On the returns to date though a reset in values followed by a sharp recovery helps to explain much of the good performance. Cap rate compression was seen in 2010 with some of the fear of real estate that drove cap rates to near term highs in 2009 beginning to abate. This cap rate compression is shown below in Figure 5, with cap rates peaking in 2009 and falling so sharply already, helps to explain returns here as with previous downturns.

Figure 5. Transaction Cap Rates Turned the Corner in 2010



Sources: CBRE Capital Markets, Real Capital Analytics

Constraints on New Construction Benefit Performance of Current Investments

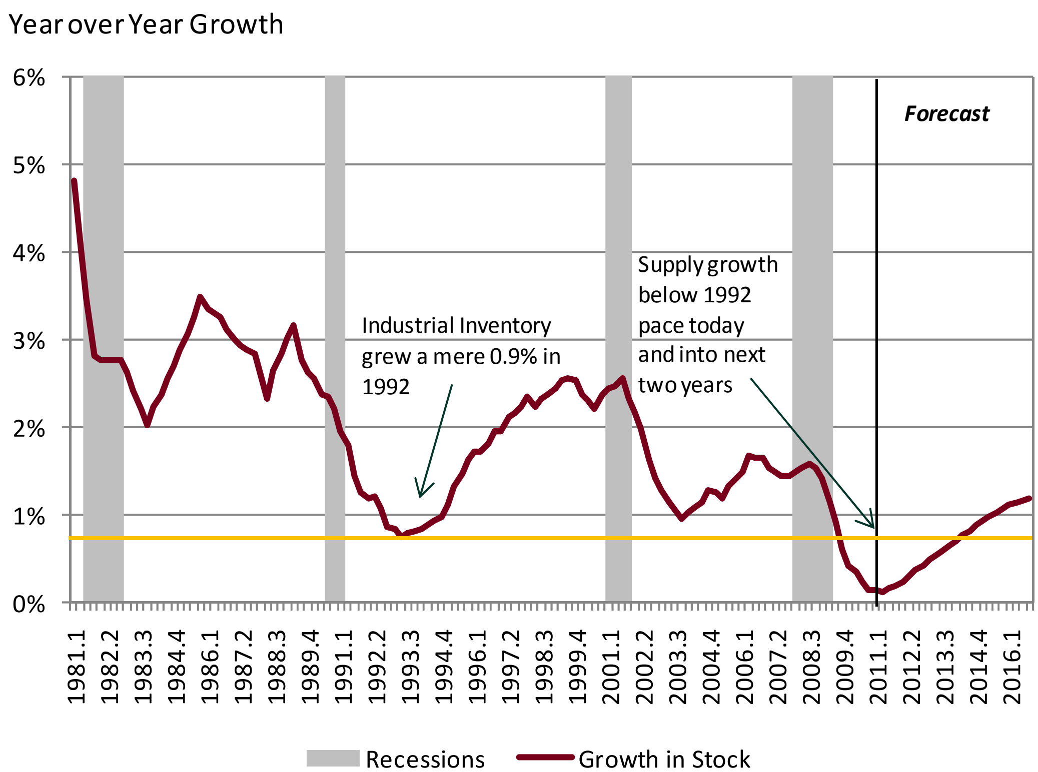
Real estate investments are sensitive to the competitive situation that prevails in the leasing markets over the life of the investment. In the early 1990s even as the job market was growing, it took time to lease up empty assets and build up healthier income streams given the large number of newly-built empty assets on the market that kept rents at low levels. Commercial real estate investments made in the current environment face far less competition from new empty assets.

Looking across all types of commercial real estate, the patterns of construction exhibited in the industrial sector in the run-up to the recession were a bit of a worst case scenario. Older assets were carrying high availability yet construction accelerated into 2007 with the stock of new space growing at a pace of 1.5% per year. The market at the time was experiencing a severe case of "robbing Peter to pay Paul" with tenants leaving these older facilities in favor of new, high-cube logistics facilities. Due to this excess construction and the slack demand seen during the downturn, industrial availability hit an all-time high of 14.6% in the middle of 2010. Other commercial real estate sectors fared much better with less construction into the recession.

Even in this worst case scenario of an overhang of new supply detracting from the income performance of existing assets, the outlook in the current market is far more favorable than in the early 1990s. As shown in Figure 6 which follows, the trend in new construction of industrial space is shutting off far faster into 2011 than it had into the early 1990s. A relative comparison is made here looking at the percentage growth in stock to control for the fact that the industrial market is far larger today in 2011 than it was in the early 1990s and it now takes more square footage to undermine leasing market performance.

In 2009 the pace of construction fell below the minimum pace of development set in 1992 (as indicated by the gold line in Figure 6) and given the Pipeline of new projects underway, CBRE-EA anticipates that new supply will grow more slowly than the minimum pace set in 1992 through at least 2013. Despite a high current industrial availability rate, such a shutdown of new construction will permit a healthy recovery in industrial leasing market conditions with new demand for industrial space flowing to existing assets.

Figure 6. Industrial Inventory Growth Rate Hit Record Low during the Recession

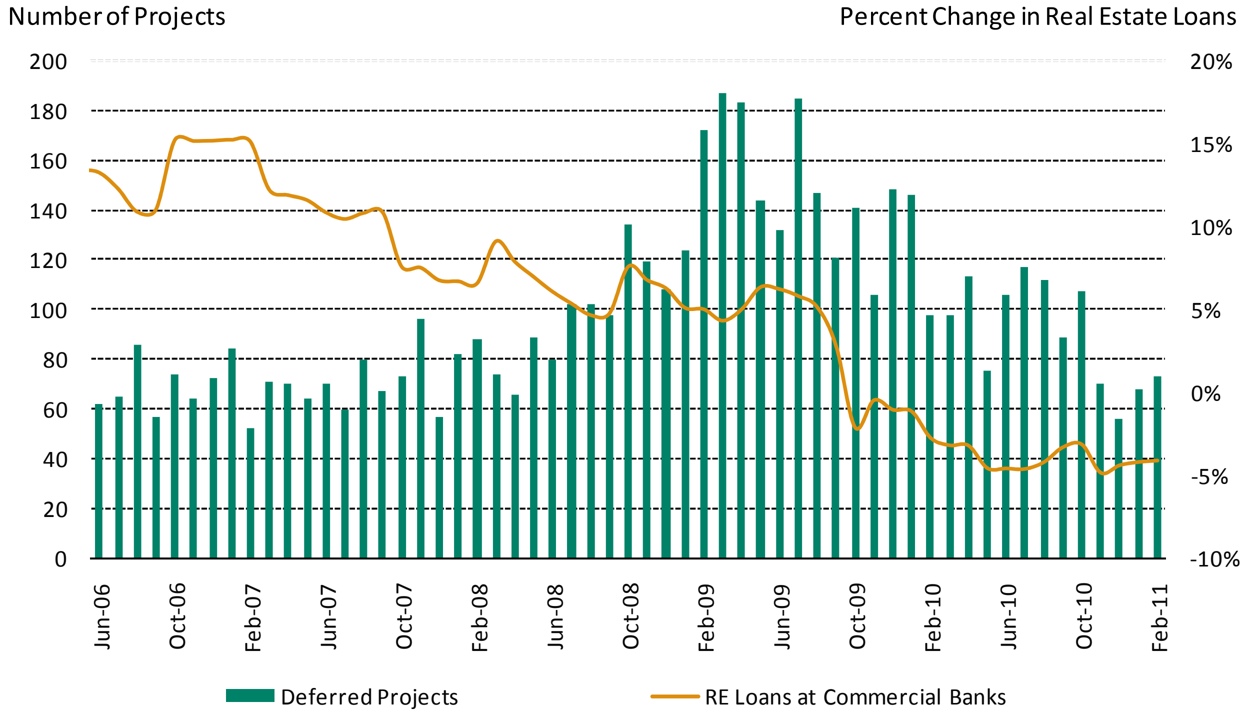


Source: CBRE-EA Industrial Outlook, Spring 2011

The patterns exhibited for the industrial sector are different than other commercial properties during the boom into 2007 with a fast pace of new construction as older space was obsolesced. The response into 2009 through 2013 is typical however due to factors of both weak leasing market performance and changes in the availability of construction financing.

As shown in Figure 7, a number of new development projects continue to be deferred. The way to interpret this chart is as a count of projects which developers had started planning deferred until later due to various considerations. This pace of deferrals is for all commercial property types across the US and even in good times we saw something like 60 projects deferred each month. Into 2009, the pace of deferrals accelerated with developers pulling back on anywhere from 140 to 160 projects per month. The pace of deferrals pulled back into the second half of 2010 with only 90 projects deferred each month. In part though, the pace of deferrals slowed as fewer projects hit the planning stages due to financing issues.

Figure 7. Deferred Projects Slowly Ticking Down to Pre-Recession Levels, Overall Lending Volume Still Slow



Source: CBRE-EA/FW Dodge Pipeline, Federal Reserve Bank of St. Louis

A feature of this latest valley in the business cycle that has been a boon to commercial real estate is the supply side constraint imposed by traditional sources of construction financing running dry. Figure 7 also shows that the inventory of real estate loans at commercial banks shrank into 2009. This downturn in the inventory of loans is significant as commercial banks did the majority of construction financing in the commercial real estate sector. While the CMBS market grew at a lightning pace into the 1990s and 2000s, by some saving grace construction debt was never securitized. The sources of financing that have recently been making a comeback, such as CMBS, and life companies, are being used to fund existing assets as well.

This said, the multifamily sector is seeing new construction vis-à-vis GSE support for rentals and condos, albeit at a much slower pace than prior to the 2008 recession. CBRE-EA anticipates that the quarterly double digit growth rate of multifamily completions will wind down in 2013 and settle in at the low single digit range in the 2014-2016 time period.

Even as leasing market fundamentals recover, new construciton will lag unless and until new sources of construction financing come forward. Bankers by nature are cautious individuals; there is no upside risk for loans, only downside. Commercial banks will not undertake a big new program of commercial real estate construction financing until they feel the demand for commercial real estate has been steady for some time. Such steadiness will not happen until the employment figures, a lagging indicator of economic performance, show a strong and robust economy has been with us for a while.

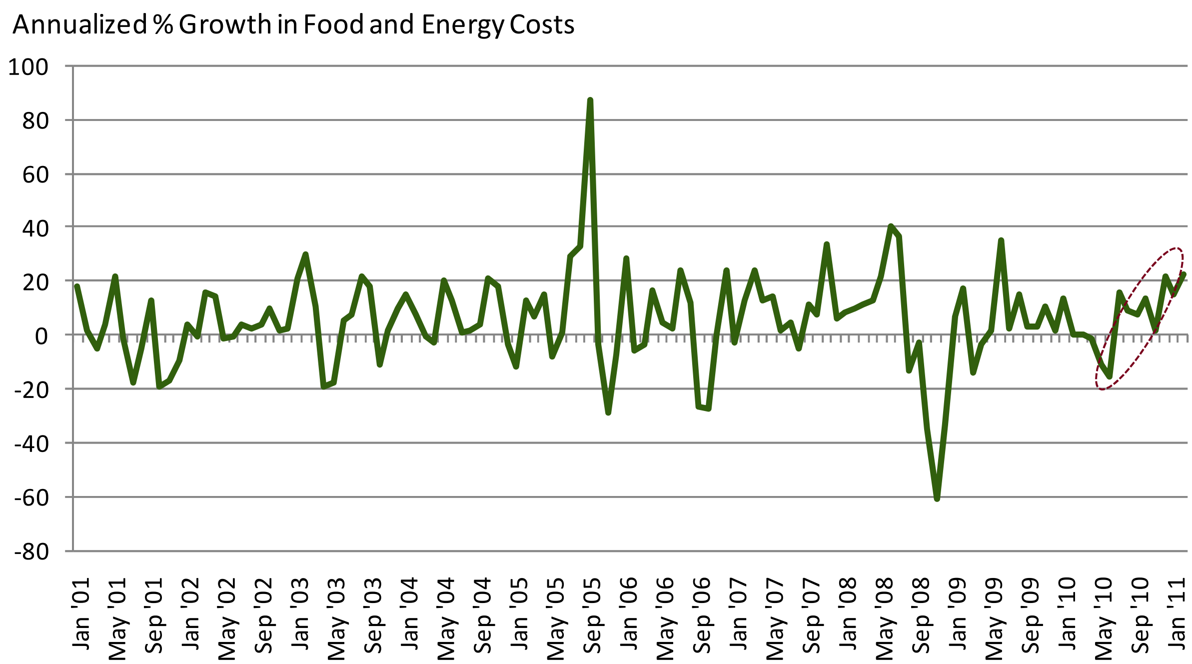
Movements in supply motivate the outcome of leasing market conditions which in turn impact the income characteristics of a commercial real estate investment. With inventory levels stagnating and in some cases dwindling in relation to their long term averages for the majority of property types, the forces are in place to permit a steady recovery in property incomes and ultimately values over the coming years.

Inflation Hedging Characteristics of Commercial Real Estate

Commercial real estate investments are not magic. All the inputs to the development, leasing and management of a commercial real estate asset are drawn from the economy itself and it defies logic to think that price increases in the broader economy would have no impact on the performance of a commercial real estate asset. This said, commercial real estate, in the right hands, can offer some hedging characteristics relative to broader inflationary trends.

Inflation rates have been moderate in the U.S. over the past decade owing to improvements in global trade and a freer flow of goods and services. Cost push inflation, which is to say, price increases coming from limits on resources such as the amount of available labor, could not really gain steam in a world that was globalizing thus cost increases have been low. However, recent shocks to world commodity and food supplies have put pressure on prices with the U.S. consumer anticipated to see increases passed on in the cost of cotton, oil and food later in the year.

Figure 8. Food & Energy Components of the CPI on the Rise



Source: Bureau of Labor Statistics

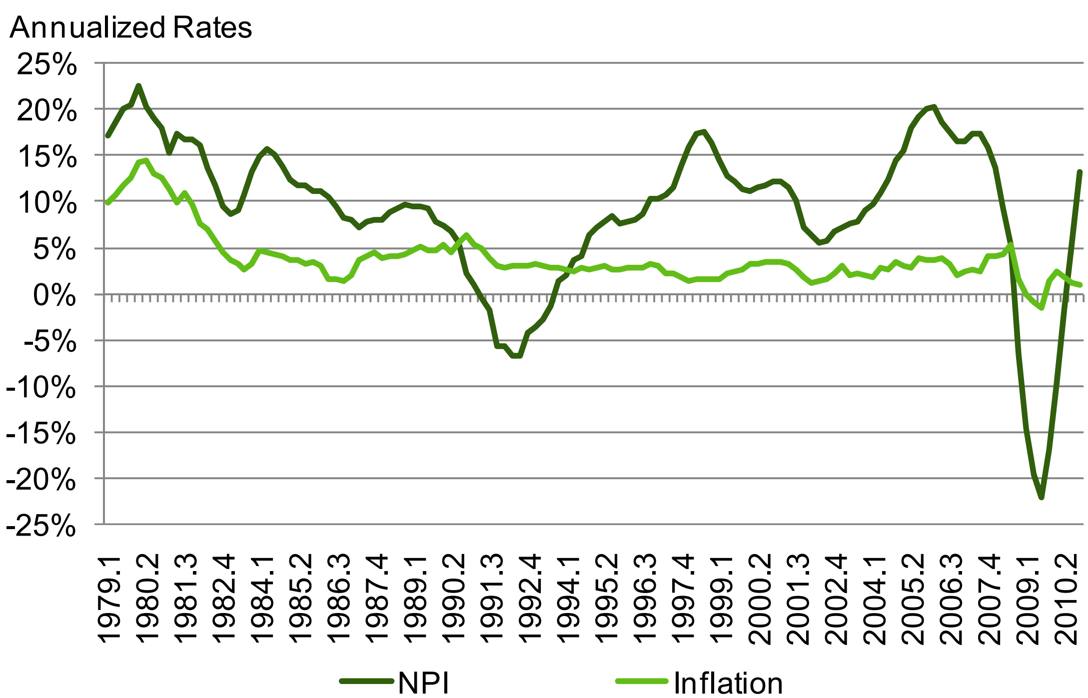
This acceleration has already been reflected in the upward direction of the food and energy components of the CPI since late 2010, as indicated in Figure 8. Food and energy prices represent 23% of the CPI index and have been growing above 20% on an annual basis since December of 2010 and this trend has some investors worried that inflation will sting more sharply across all types of goods and services in the near term and undermine the value of investments such as government bonds. With these fears, some are looking to commercial real estate as a hedge against price increases.

The value real estate offers as an investment class during inflationary time periods can be seen by looking at history. We have had one really hard period of inflationary activity in recent memory with annual price changes above 10% per year in the late 1970s and early 1980s. The NCREIF index was started in 1978 to provide an objective benchmark of the performance of commercial real estate investments and clearly commercial real estate outperformed inflation at the time. There was a nearly 700 bps spread between inflation and total return at the time.

Granted some of this return performance came from an investor preference for hard assets in this period of spiking inflation. Asset values grew at an average pace of just under 10% per year in 1979 and 1980 and roughly one third of this price increase came from falling cap rates. Cap rates fell as investors were fearful of having the initial value of their capital eroded in other asset classes and more capital flowed to the commercial estate sector. That said two thirds of the gain in asset values came from the simple fact that property income was growing at the time.

Of course, Figure 9 also shows a minor spike in inflation above the 5% range in early 1990 with returns in commercial real estate lagging broader inflationary activity. Returns were faltering into 1990 with asset values falling due to a combination of rising cap rates and faltering income given the vast excessive construction seen in the late 1980s and early 1990s. Broader market trends clearly have an impact on property income.

Figure 9. NPI Return vs. Inflation



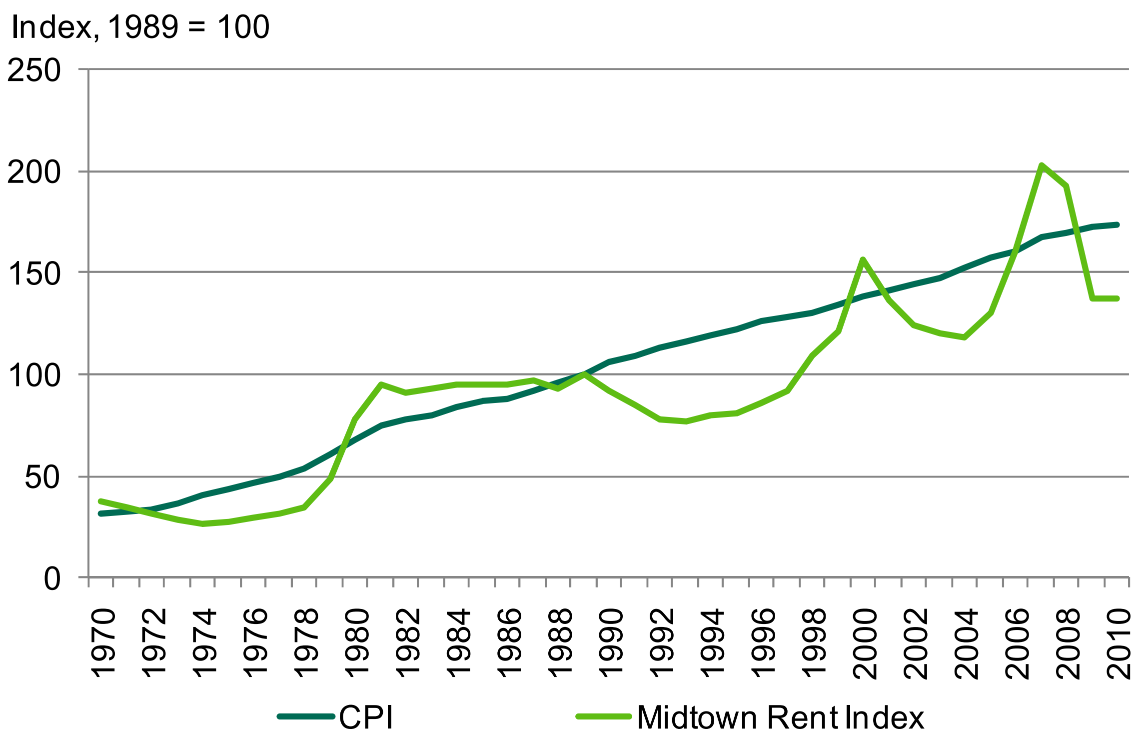
Source: NCREIF, Bureau of the Census

To understand how property income can vary over the business cycle and against broader inflationary trends, it helps to look at the bedrock of income, the rents achieved. Looking at office rents in Midtown Manhattan back to 1970, Figure 10 below shows office rent level alongside a comparable time series in the CPI, both of which are indexed to 100 in 1989. When returns outpaced inflation into 1979 and 1980, rents were growing faster than inflation in Midtown given a dearth of new supply and growing demand for space. The opposite was true into 1990. The chart shows that inflation plays a strong role in driving rents across cycles, but that within a given cycle, supply and demand can cause rents to diverge greatly from the inflation path that would otherwise hold.

In any short-term view of commercial real estate investment, real estate will not be a perfect hedge. Inflation plays a part in the long run performance of commercial real estate. In observing performance metrics over extremely long periods—as with the New York City historical data—we can identify across cycles a return to levels in line with inflation growth not just for rents, but also for values. Theory suggests that this convergence is because there are two other important real estate measures that travel largely with inflation, not just across cycles but shorter-term as well.

First, construction costs have many of the same influences as the broader CPI. Exempting land, the commodities and labor involved in construction tend to accelerate their price increases when inflation surges and slow their increases when CPI growth weakens. To the extent that values need to keep up with these replacement costs, "replacement rents" that justify new construction need to match the levels of the previous building boom plus this inflation element. This also helps explain why rents can diverge from inflation in the short term. If supply and demand dictate no need for new buildings, rents do not need to keep up with inflation in the period where supply needs to slow.

Figure 10. Midtown Manhattan Rents vs. Inflation



Sources: CBRE Research Midtown Manhattan, Bureau of the Census

The second, shorter-term mover with the inflation rate is the ongoing occupancy cost incurred by landlords in a building with gross leases. That management, utilities, taxes, etc. are largely growing with inflation when looked at on a year-to-year basis provides an incentive for all landlords to raise their rents in line with inflation, in order to preserve their net operating income margins. Again, supply and demand may preclude landlords' ability to do this within the cycle, but the incentive wins out over the long term as supply and demand correct themselves.

All this said, while supply and demand may preclude a landlord's ability to push rising costs onto tenants during a period of inflationary spikes, astute property managers will have anticipated such changes. Academic research by Hudson, Gordon, Fabozzi et al does show that the inflation hedging characteristics of commercial real estate varies by property type. Net operating income is impacted to a greater extent by inflation for office assets due to the generally gross nature of their lease structures. However, in recent years the highest quality office assets in many markets today quote asking rents on a net basis with detailed leasing provisions set up to pass through price increases to tenants. In the last twenty years in which many tenants have not been concerned with inflation (and why would they in a market with little inflation) it has been easier to push these leasing provisions onto tenants.

The idea of commercial real estate as an inflation hedge can be a compelling argument for those investors worried about potential inflationary spikes. Understand however that such hedging does not provide inflation protection from year to year, but does provide some benefit for investors who are willing to hold out for long horizons. Furthermore, proactive management that takes advantage of the upswings in the rental market to lock in higher than cycle rents and also to push expenses on to tenants can shelter some aspects of asset income from broader inflationary trends.

Conclusion

During the height of the Financial Crisis, commercial real estate was shunned as an investment class due in part to guilt by association given the problems faced by residential real estate. Over time as the initial panic faded, the fact that the residential market performs differently than the commercial market became clear. In this paper we made the point that commercial real estate is an investment class that makes sense for institutional investors on both an absolute and a relative basis.

On an absolute basis, commercial real estate provides diversification benefits when added to a portfolio, through low and negative correlations with most other asset classes that can significantly enhance the risk and return profile of an investor's portfolio. In addition, commercial real estate has consistently performed well following economic downturns. Analysis of NCREIF returns data following the recessions of 1990 and 2008 has shown that investing in the commercial real estate asset class, across property types, to be one of the smartest strategies for maximizing returns. Finally, the shutdown in construction financing for the majority of property types has pushed inventory to levels that will not be replaced until employment rebounds. Limited supply will translate to positive market fundamentals going forward for investors, as the supply and demand imbalance continues to grow across the majority of property types.

On a relative basis, commercial real estate, with bond-like cash flows, is less volatile than other competing asset classes, yet delivers higher returns, consequently outperforming other asset classes with higher Sharpe ratios. Additionally, this asset class adjusts in the long run to provide protection in highly inflationary environments. This characteristic lies in contrast to many competing asset classes which see their valuations dramatically eroded by inflation.

Commercial real estate is an asset class that has performed well on an absolute basis and in relation to other asset classes. Emerging from a downturn, with supply constraints in place, the asset class is a particularly advantageous place to be. In constructing a portfolio, it makes sense to include commercial real estate in order to maximize an investors risk and return profile and position positively for future upside in space fundamentals.