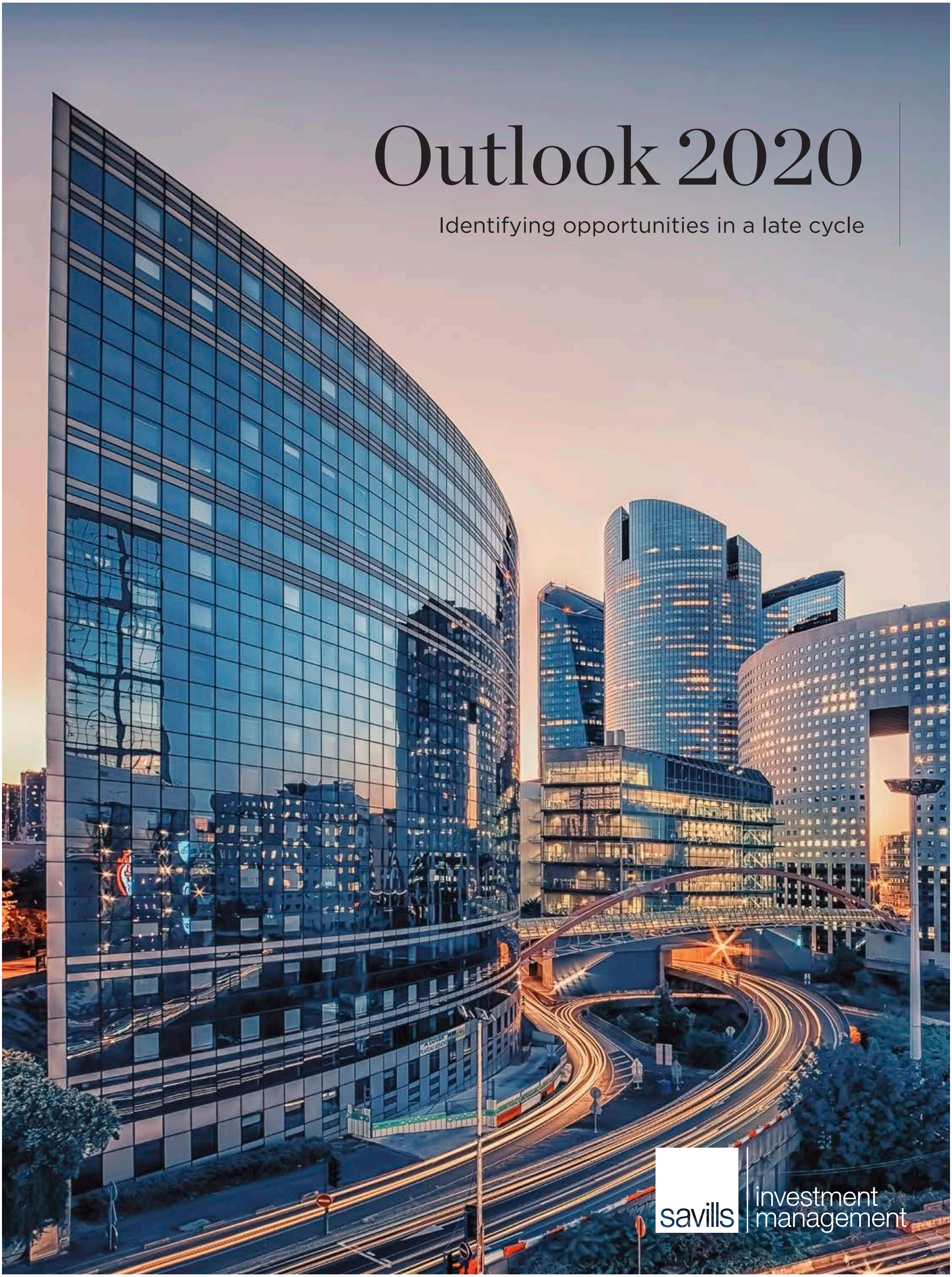
Outlook 2020

Identifying opportunities in a late cycle



savills | investment management

OUTLOOK 2020

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Preface

Some things have not changed over the last 12 months: The US-China trade conflict is still dominating global politics, geopolitical trouble spots have not calmed down and uncertainty has not decreased significantly. But in other respects, things have become even more challenging for investors.

With global growth disappointing in 2019 and forecast to slow further in 2020, occupier markets will probably be less dynamic than the last few years. The European Central Bank (ECB) and the US Federal Reserve (Fed) have changed tack, diverging from their expected tightening paths to loosening monetary policy due to slowing economic growth rates and persistently low inflation. As a result, government bond yields have fallen further, which we think will prolong the real estate investment cycle for a while longer.

In fact, we believe that the lower-for-longer interest rate environment is probably with us for the next few years. Due to the scarcity of alternative investment options, we anticipate that the share of capital that investors allocate to real estate will remain strong.

Investors can benefit from our local expertise and on-the-ground-knowledge, supported by in-house research and experienced teams in 16 offices across Europe and Asia-Pacific. The Savills Investment Management Outlook 2020 report features our views on the European and Asian commercial real estate markets, serving to help investors identify opportunities in a late-cycle environment.

Andreas Trumpp,
Head of Research, Europe

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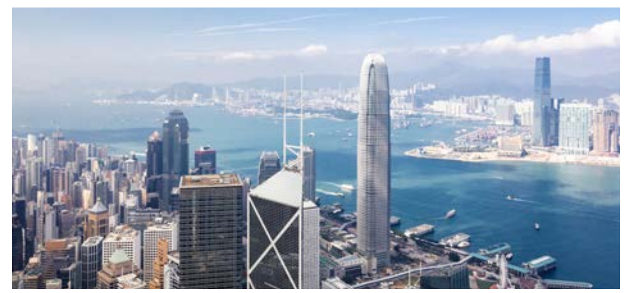

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Our top commercial real estate investment picks

Europe

OFFICE

- modern office buildings in well-connected areas in Brussels, Luxembourg, the fringe of central business district (CBD) in the German top seven, Paris, Lyon, Milan, Copenhagen, Helsinki, Oslo, Stockholm, Lisbon, Madrid, Barcelona, London, Kraków, Wrocław, and TriCity
- core/core-plus opportunities in Stockholm, German top seven and major provincials, Warsaw
- refurbishment opportunities in the Netherlands
- investment opportunities in London if there is more clarity on Brexit

LOGISTICS

- modern distribution centres along the main transport corridors around Vienna, Paris, Lyon, Marseille, Ireland (M50), Northern Italy and the Rome area, main German logistics clusters, Sjaelland in Denmark, Helsinki, the Swedish logistics triangle, hubs in Poland (such as Warsaw and Wrocław), along the main transport corridors and near main ports in Portugal, Madrid and Barcelona
- urban logistics and smaller- to medium-sized warehouses in the Netherlands (Bleiswijk), UK, major German conurbations, Copenhagen, Stockholm, Helsinki, Norway and selectively in Austria

RETAIL

- prime retail parks in areas with positive long-term demand prospects in the Netherlands, France, UK, Ireland, Germany, Italy, and Sweden – preferably food-anchored assets that include a service and experience offering
- the outlet segment due to its resilience to e-commerce
- prime high street assets with the right size and sustainable rents in France, German top seven and major provincials, London, large Italian cities, Copenhagen, Aarhus, Stockholm, Lisbon, Madrid and Barcelona
- the premium/luxury segment or areas with high local and tourist footfall

ALTERNATIVES

- student housing, retirement housing and hotels in Italy

Asia-Pacific

OFFICE

- Grade B office space in Tokyo
- offices in regional Japanese cities and Melbourne
- supply-constrained submarkets or districts benefitting from infrastructure improvements in China, such as Beijing's Zhongguancun market; business park offices or offices in emerging growth corridors in Shanghai

LOGISTICS

- logistics assets tied to e-commerce in China, Melbourne, Sydney

RETAIL

- well-located neighbourhood retail centres in Sydney, Melbourne and Brisbane

RESIDENTIAL

- multifamily accommodation for rent in subcore districts of Greater Tokyo, Osaka, Nagoya and Fukuoka

Risks in 2020

Hamish Smith

Nicole Tiblom

LOW GROWTH, LOW INFLATIONARY WORLD

Consensus Forecasts indicates that economic growth across the Eurozone will remain sluggish over the next 12-18 months, but that the single currency area is unlikely to fall into recession. However, the risks to this outlook appear to be to the downside.

While problems in the manufacturing sector have not caused a major headache for the services sector, the longer the downturn in manufacturing lasts, the more likely the service sector will start to feel the reverberations. Similarly, if consumer confidence were to deteriorate further, households are more likely to be inclined to increase their savings to the detriment of consumer spending growth.

At the same time, the external backdrop is not showing signs of improvement, with key surveys pointing to a continued slowdown in US growth. Concerns about US growth and inflation prospects are highlighted by the US Treasury curve inverting on various occasions in 2019, which has been a good leading indicator of previous US recessions. The changing economic tides also forced the Fed to cut interest rates on several occasions in 2019 in a pre-emptive effort to avoid the economy falling into a recession.

The implications of an recession for commercial property are clear. But even if growth across Europe remains positive, with monetary policy looking increasingly anaemic and interest rates likely to remain at very low levels, the region may remain trapped in a low growth, low inflationary environment in the absence of a sizeable fiscal boost, otherwise known as secular stagnation.

Against such a backdrop, we would expect weaker occupier demand and leasing activity. For landlords, this means less competition for space at a time when development pipelines in many cities are starting to rise. The combination of softer demand and higher supply would hurt rental growth prospects and could lead prospective occupiers to seek increased incentives. In addition, where rents are inflation linked, rental uplifts would be lower. Taken together, returns for investors are likely to be lower than currently assumed.

GEOPOLITICAL AND POLITICAL RISKS

The global macroeconomic landscape has been characterised by heightened US-China trade tensions and a looming slowdown over the past year. While reports suggest that the two countries are close to signing the first phase of a deal, there have been plenty of false starts before. And depending on the scope of any initial agreement, downside risks will continue to create uncertainty.

US-China bilateral trade has already fallen by about 20%, with a further decline likely absent a deal. Sharp fluctuations in financial markets in response to tariff announcements over the past 18 months and deteriorating business confidence indicate that investors and businesses have become increasingly worried about the impact of trade policy developments.

Should global trade become progressively protectionist, businesses and consumers are more likely to hold back on investment and spending decisions, which are likely to exacerbate the slowdown in economic growth. Tensions between the US and China are also starting to broaden to include economic, military and ideological dimensions, which have the potential to be long lasting by reshaping the global economic and geopolitical landscape in the coming decades.

The US-China dispute is not the only issue that is shaping geopolitical and economic uncertainty. A dispute between Japan and South Korea has the potential to disrupt the high-end tech industries on a global scale as both countries play an important role in the supply chain.

Other potential hotspots include the economic malaise in Latin America, the world's worst performing region in terms of economic growth in 2019. Meanwhile, tensions in the Middle East remain an ongoing concern.

Growing economic uncertainties in the context of the current late-cycle environment warrant caution, with asset selection becoming even more important to commercial real estate investors.

CURRENCIES

As the US-China trade conflict continues and China allows the renminbi to depreciate further against the US dollar, there is a risk that the US administration could intervene to weaken the dollar. This would turn the trade war into a currency war. The Trump administration has already labelled China a currency manipulator and has threatened to devalue the dollar if trading partners engage in what China regards as competitive currency devaluations. While it is unlikely that the Fed would intervene to devalue the dollar, if it did, potential targets to weaken the dollar would most likely be the yen, the renminbi, the euro and sterling.

But the greatest scope for global financial instability relates to the US and China. China holds more than USD 1 trillion of US Treasury securities. Therefore, a worst-case scenario could be the weaponisation of China's foreign exchange reserves against the US. Any abrupt decision to sell off China's Treasury holdings would likely lead to extreme volatility across global markets.

What's more, if the US did try to weaken the dollar, this would not only raise political tensions, but it would also likely upend financial markets as other countries rush to depreciate their own currencies, with an all-out currency war potentially sparking a global recession. Since it is impossible for all countries to weaken their currencies relative to everyone else, there would ultimately be winners and losers.

For real estate investment, capital flows would likely be skewed depending on the relative strength of the currency of respective foreign investors, while returns in local currency terms would also be affected.

BREXIT

After more than three and a half years since the UK's decision to leave the EU, during which there have been multiple extensions to the departure date, Brexit continues to cast a cloud of uncertainty over the UK. Although the chances of the UK crashing out without a deal have receded, such an outcome is not completely off the table.

While the 12 December 2019 UK general election offers an opportunity to resolve the political impasse, a hung Parliament could result in Brexit being further delayed, prolonging uncertainty for businesses and investors alike. Even if a withdrawal agreement is eventually passed and the UK leaves the EU, much would remain up in the air as both sides would then enter into a further period of negotiation to agree on the future UK-EU trading relationship.

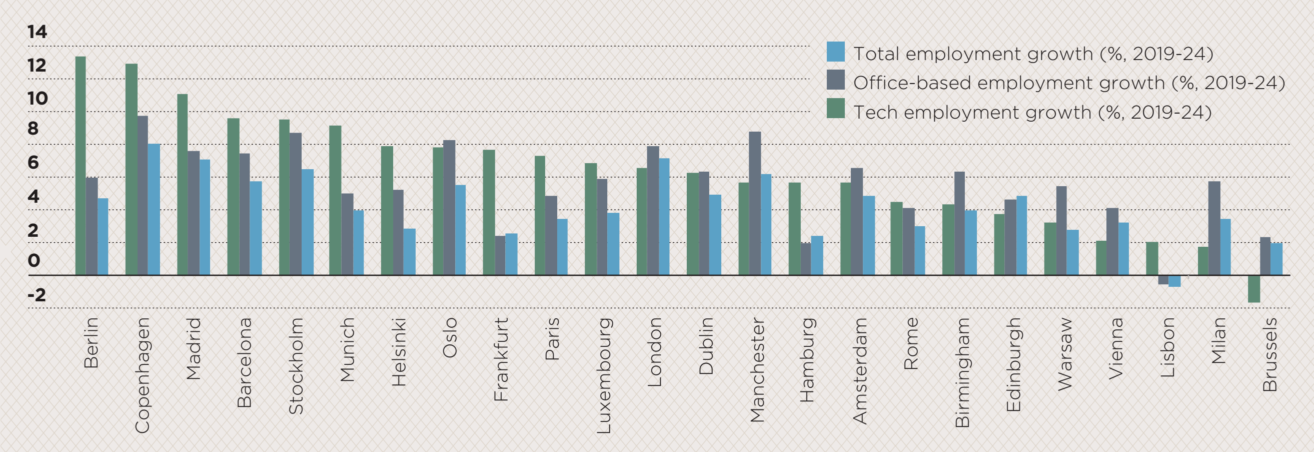
Extended European office cycle a silver lining for market players

Matthias Düsing

Nicole Tiblom

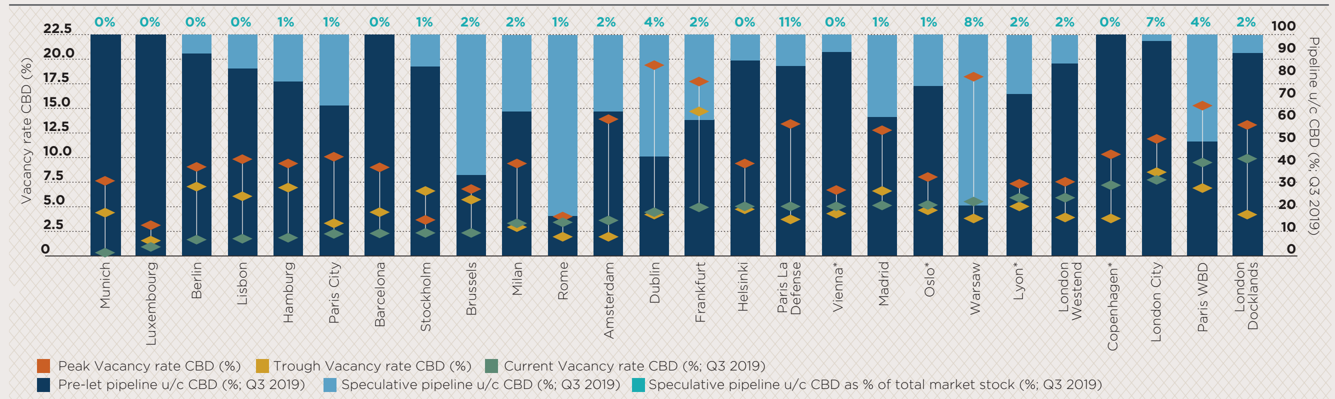
Slower economic growth in Europe is starting to feed into softer occupier demand for offices. Although the annual take-up trend is weakening, levels remain healthy, according to PMA. The tech sector has been a key driver of tenant demand in many markets, and this looks set to continue. Savills Research and Oxford Economics expect tech employment growth to outperform overall office-based employment in most markets through 2024 (figure 1).

FIGURE 1: Projected employment growth in major European markets



Source: Oxford Economics (Autumn 2019)
Notes: Total employment growth refers to the % change between 2019 and 2024 in all sectors. Office employment growth refers to the % change between 2019 and 2024 in information & communication; financial & insurance activities; professional, scientific & technical activities; administrative & support activities; public administration & defence. Tech employment growth refers to the % change between 2019 and 2024 in information & communication.

FIGURE 2: Vacancy rates and future supply in selected European markets



Source: Savills Investment Management based on PMA and various agents
Note: *overall market

Vacancy levels in several European markets are the lowest since just before the global financial crisis. At the same time, development pipelines in most office markets are fairly low as a share of existing stock, PMA reports (figure 2).

The economic slowdown alongside structural changes including agile/flexible working, technological improvements and the war for talent are driving office trends. The economic uncertainty means that firms must carefully manage their cost base, including better office space efficiency, while maintaining or improving productivity levels.

A survey by Savills Research highlights the changing nature of office markets and tenant demand. While the basics of comfort, air quality and lighting continue to be important draw factors for occupiers, so too are the length of commute to work, quality of wi-fi and availability of quiet space for focused work.

Employers across Europe report talent retention as their single biggest challenge across Europe, according to the survey: 40% of Europe's workers expect to leave their current job within the next five years. Companies will need to look for talent hotspots in strategic locations, as outlined in our Dynamic Cities report.[1] Moreover, space will be used more efficiently and effectively, increasing productivity and employee engagement as well as creating a stronger brand.

The ongoing demographic shift will also impact office space. Intergenerational working has become more widespread, and workplaces must strive to meet the demands of a more varied workforce. In addition, tenants, landlords and investors are increasingly interested in environmental, social and governance (ESG) issues. According to a survey by Savills IM,[2] worker well-being as well as health and safety remain the most important social issues. The survey also revealed that 31% of respondents believe that it will take only three to five years until green-lease clauses are universally implemented between tenants and real estate investment managers.

The scarcity of modern, Grade A space means we can still expect some rental growth in the mid-term, albeit more limited than in recent years. Central banks' dovish shift has significantly downgraded expectations for interest rate rises, meaning it may take longer than expected for property yields to bottom out, extending this cycle. This is a potential silver lining for office market players. We can expect investment volumes to hold up rather well as the attractive gap between office yields and government bond yields persists.

In this environment, investors would benefit from focusing on income protection and enhancement to ensure portfolios are structurally resilient to weather a downturn and other structural challenges. High-quality real estate assets with a stable source of income can provide a safe haven in the current environment. Regional office markets where availability is tight and pipelines small may look attractive from a pricing perspective.

1. For more information, visit dynamiccities.savillsim.com.
2. The survey polled 112 institutional investors involved in commercial real estate, based in Europe, the Middle East and Africa; North America; and Asia-Pacific. For more on this survey, stay tuned for the 2019 ESG Report, coming in Q1 2020.

Physical retail will continue to evolve – but is here to stay

Hamish Smith

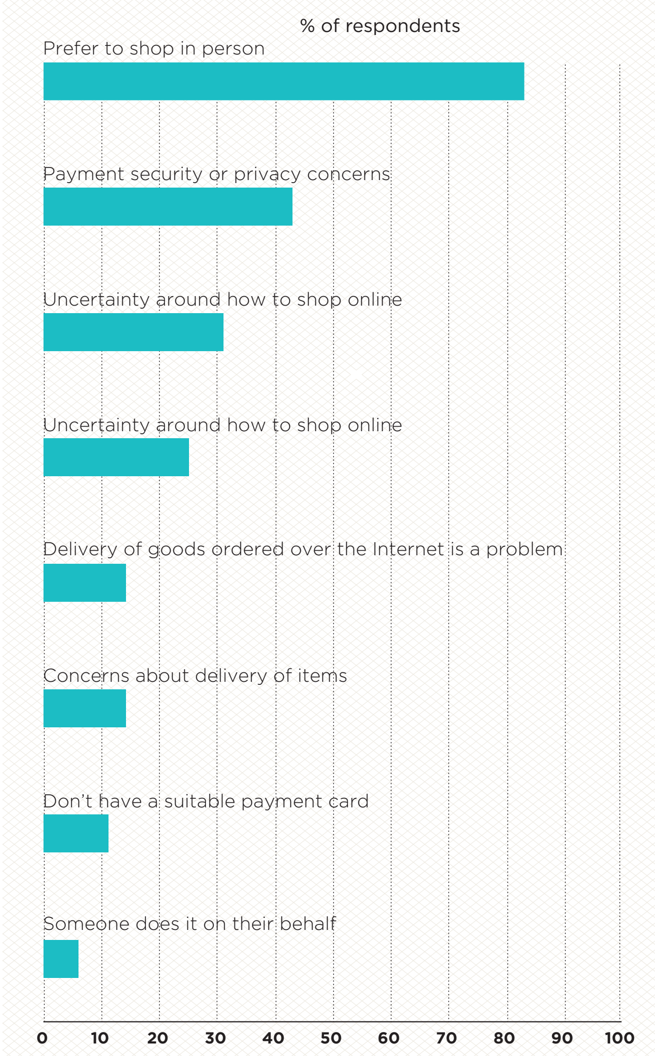
Andreas Trumpp

Technological developments, together with demographic shifts and changing consumer behaviour, are driving significant changes across the European retail sector. Smart devices have added a new dimension to consumer shopping behaviour. Although consumer purchasing patterns are transforming traditional retailer supply chains and cost models at the same time, demand for physical retail is not dead. Indeed, even in the UK, which leads Europe in terms of the share of retail sales made online, more than 80% of adults who had not shopped online within the past 12 months stated a preference to shop in store (figure 1).

Furthermore, the net number of retail stores across Europe did continue to rise in the first half of 2019, according to PMA data. Nonetheless, with constant headlines – particularly in the UK – about retailers shuttering stores or undergoing voluntary insolvency proceedings, it is not hard to see why retail is a hard sell for investment committees.

But not all retail is equal. We see pockets of opportunity in the sector, particularly in formats where shoppers make a conscious decision to travel to a location. In this respect, we prefer focusing on assets or segments that offer consumers experience or convenience options – areas of retail that we believe are more resilient to the disruption of changing shopping habits.

FIGURE 1: UK buyers still prefer to shop in store (reasons for not purchasing online)



Source: Office for National Statistics

TAKE THREE EXAMPLES

Grocery stores are relatively immune to economic downswings as people still need to meet basic food and beverage needs. And with the complication of delivering perishable goods, many people still prefer to shop in store, making the segment less vulnerable to online shopping (figure 2). In this late stage of the property cycle, for investors seeking asset-backed, secure income streams, food retail on long, inflation-linked leases looks attractive.

Outlet centres are increasingly popular and tend to be defensive against the rapid growth in online retail. For customers looking for a 'great day out' shopping experience, web browsing will not suffice. Outlet centres can drive performance through a strong leisure offering, leading to higher turnover and higher footfall.

Retail parks in reach of a large catchment and anchored by major supermarkets, pharmacy and household goods retailers can also provide some interesting possibilities from a convenience retailing perspective. By increasing food, beverage and leisure offerings, active management by landlords can provide consumers with more reason to visit while boosting dwell times and consumer spending. Retail parks also have the advantage of space, which allows click and collect options to be included. However, investors need to be mindful of nearby competition and connectivity with respect to public and private transport.

FIGURE 2: Online penetration of food sales remains very low (% of 2018 UK retail sales made in store or online)

Source: Office for National Statistics

Retail will continue to evolve as technology and consumer preferences drive changes to existing formats as well as new retail concepts. While we do not underestimate the scale of the challenges for retailers and investors, those retail formats that fail to adapt quickly run the risk of becoming outdated, meaning more active asset management is required. With a focus on destination and convenience segments of the market, we think attractive risk-adjusted returns are still available for investors who select assets that can withstand and benefit from technological change and demographics.

European logistics still to benefit from strong fundamentals in 2020

Judith Fischer

Matteo Vaglio Gralin

2019 was another strong year for European logistics demand, primarily driven by logistics operators and e-commerce. Strong investor appetite and lack of modern space led to further yield compression in the larger markets. Compared with most office and retail sectors, logistics assets still offer an attractive risk-return profile.

Not only proximity and accessibility to producers and consumers but also affordable operating costs are key for further growth in the logistics sector. There are three established and emerging industrial and logistics corridors in Europe that represent about 40% of Europe's population and a similar share of overall European GDP.[1]

The so-called Blue Banana is a corridor that stretches from the Midlands in the UK through Belgium, the Netherlands, Western Germany and Switzerland, ending in Northern Italy (figure 1). This corridor is home to around 168 million people[2] and includes the most important traditional European economic centres and logistics hubs. According to bulwiengesa, the Golden Banana refers to a Southern European conurbation lying between Valencia, Spain, and Genoa, Italy, along the Mediterranean coast (figure 1).

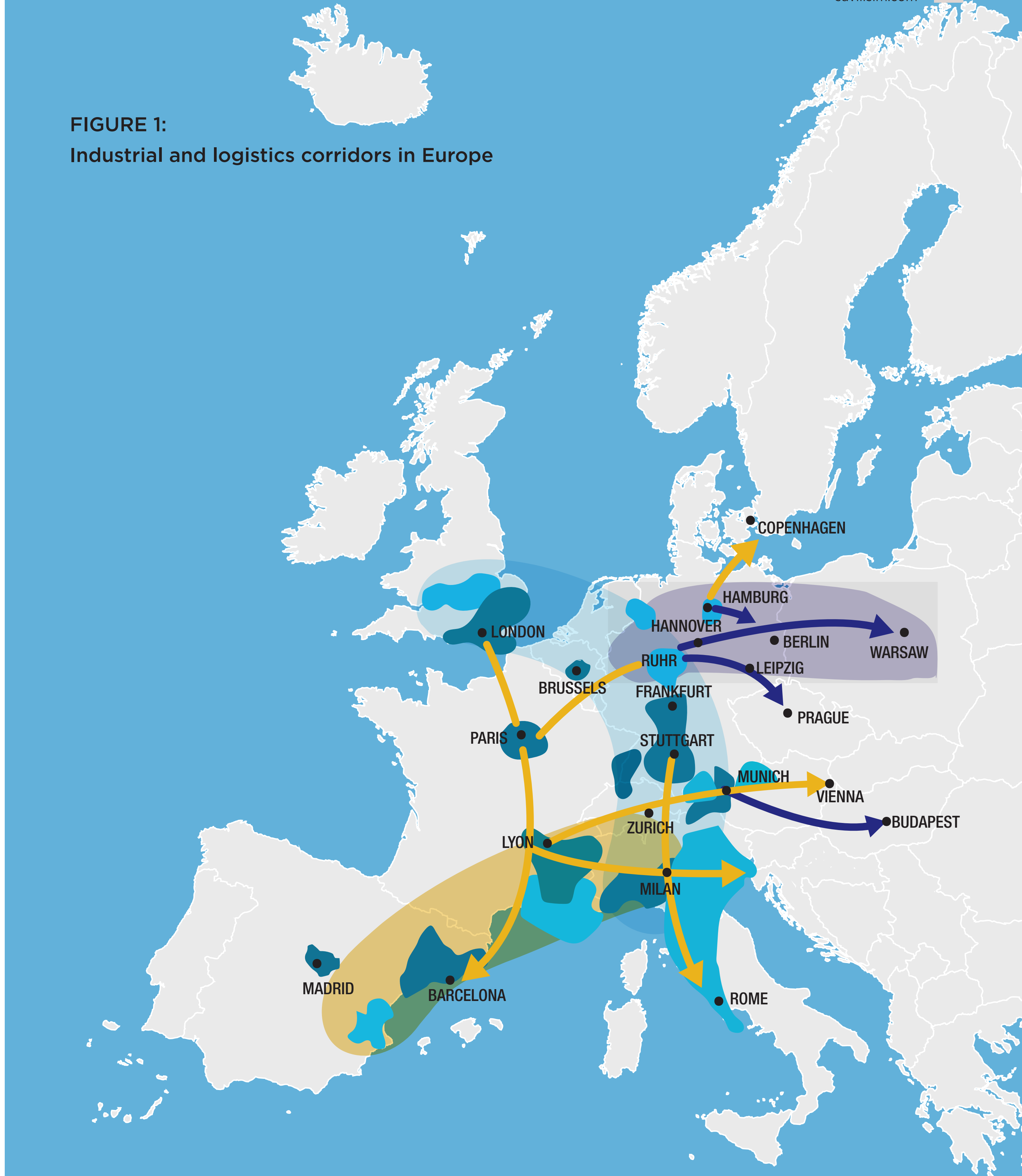
The emerging Purple Banana corridor stretches from Germany's Ruhr area to Warsaw and beyond. Poland is a key country for the logistics business in Eastern Europe due to its relatively low labour costs, availability of development sites, good connections to Western Europe (albeit longer transport times) and its strategic location along the New Silk Road stretching from China to Europe. Development initiatives such as the New Silk Road offer new business opportunities, while ongoing urbanisation leads to higher city population densities and changing consumer behaviour. Last-mile assets and multistorey warehouses will play a key role.

Looking ahead, occupier demand drivers will be affected by the weak European economic outlook and rising operating costs. However, the sector is set to benefit from structural changes such as the implementation of new technologies, automation and changes in consumer habits. Our view for 2020 is that rental growth will be moderately positive in most European markets, but weaker compared with the last few years.

A key challenge for rental growth prospects is that completions and the share of speculative developments are on the rise. In addition, occupiers are consolidating, divesting themselves of old space in order to take modern and efficient space. We expect the investment market to remain healthy in 2020 due to a large volume of available capital and attractive yields compared with other sectors. However, transaction volumes are likely to slow due to scarcity of Grade A stock. Given the strong competition for prime assets, there is still room for further yield compression next year.

1. Oxford Economics, Savills Investment Management
2. Savills Investment Management calculations based on Oxford Economics, total population at a NUTS 1 or 2 level.

FIGURE 1:
Industrial and logistics corridors in Europe



Sources: bulwiengesa, Savills Investment Management

Shift in monetary policy to low for long

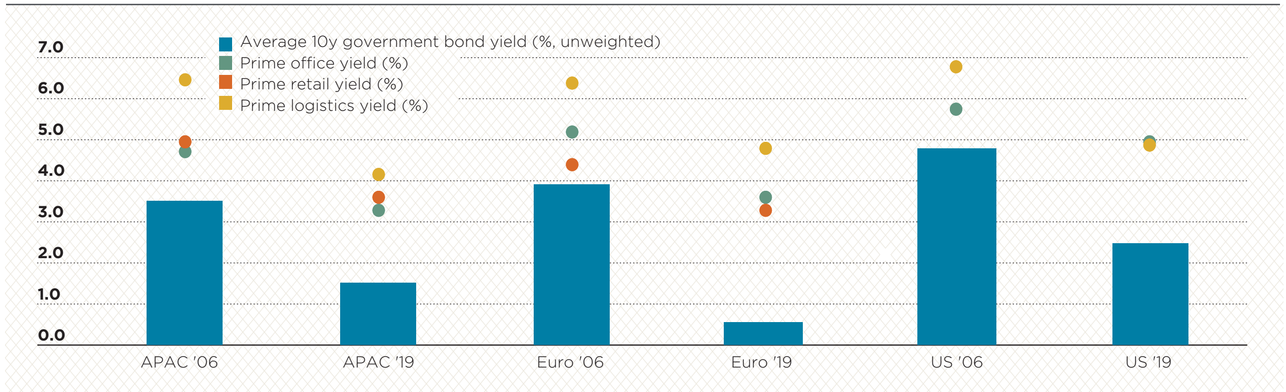
Nicole Tiblom

More than 30 central banks around the world, including the Fed and ECB, cut interest rates in 2019 amid rising concerns over global growth, lower inflation and weaker inflation expectations. Such concerns in financial markets also resulted in global government bond yields falling further – in many developed market cases, into negative territory. As a result, we can expect investors' share of capital being allocated to real estate to increase going forwards, partly reflecting the lack of alternative 'safe,' income-generating investment options.

Heightened global uncertainty could also have implications for commercial real estate demand, resulting in lower investment appetite and consumer confidence, rising financial market volatility and disruption in global supply chains. However, despite the economic slowdown, the risk premium for commercial real estate looks relatively attractive in this low-interest-rate, low-return environment (figure 1). Consequently, we can expect real estate investment volumes to hold up rather well in 2020 as investors seek safe-haven assets in their hunt for income.

Assuming the economic slowdown does not lead to a major recession, the switch to more accommodative monetary policy implies that the current property cycle will be prolonged further, which is positive for commercial real estate investment. However, property cycles are undeniably enmeshed with the economic cycle, and we assess that the European real estate market is generally in the final phase of the demand cycle.

FIGURE 1: Commercial real estate risk premium over government bonds



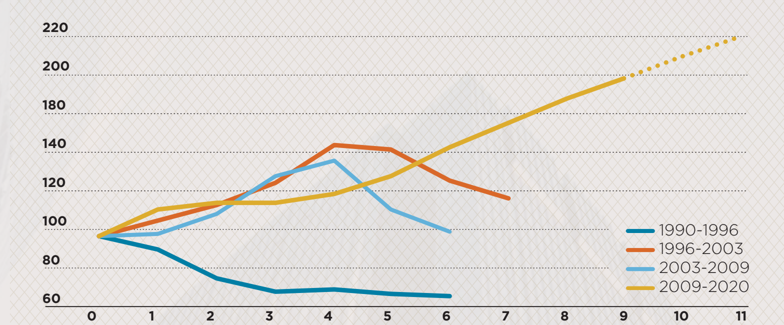
Sources: PMA, JLL, Savills Investment Management

Notes: APAC: Brisbane, Melbourne, Perth, Sydney, Beijing, Guangzhou, Shanghai, Shenzhen, Hong Kong, Nagoya, Osaka, Tokyo, Kuala Lumpur, Singapore & Seoul; Euro: Vienna, Brussels, Prague, Copenhagen, Helsinki, Lille, Lyon, Marseille, Paris: Central, Berlin, Cologne, Dusseldorf, Frankfurt, Hamburg, Munich, Stuttgart, Budapest, Dublin, Milan, Rome, Luxembourg, Amsterdam, Rotterdam, Oslo, Warsaw, Lisbon, Barcelona, Madrid, Stockholm, Birmingham, Edinburgh, Glasgow, London: Central, M25 West & Manchester; US: Atlanta, Austin, Baltimore, Boston, Charlotte, Chicago, Cincinnati, Cleveland, Columbus, Dallas, Denver, Detroit, East Bay, Fairfield, Fort Lauderdale, Fort Worth, Grand Rapids, Hampton Roads, Houston, Indianapolis, Jacksonville, Kansas City, Long Island, Los Angeles, Louisville, Miami-Dade, Marin Country, Milwaukee, Minneapolis-St. Paul, Nashville, New Jersey, New York, Northern Virginia, Oakland, Orange County, Orlando, Philadelphia, Phoenix, Pittsburgh, Portland, Raleigh-Durham, Richmond, Sacramento, Salt Lake, San Antonio, San Diego, San Francisco, San Francisco Mid-Peninsula, Seattle-Puget Sound, Silicon Valley, St. Louis, Sonoma County, Suburban Maryland, Tampa Bay, Washington D.C, West Palm Beach, Westchester; US 2019 data based on Q1; Euro and APAC data is based on Q3.

European offices: capital value growth cycles

Given the current backdrop, investors would benefit from focusing on income protection and enhancement to ensure portfolios are well placed in case of a downturn. We advocate focusing on opportunities that are defensive in this respect. Asset, lease and location selection remain key components of underwriting.

FIGURE 2: European office capital value growth cycles

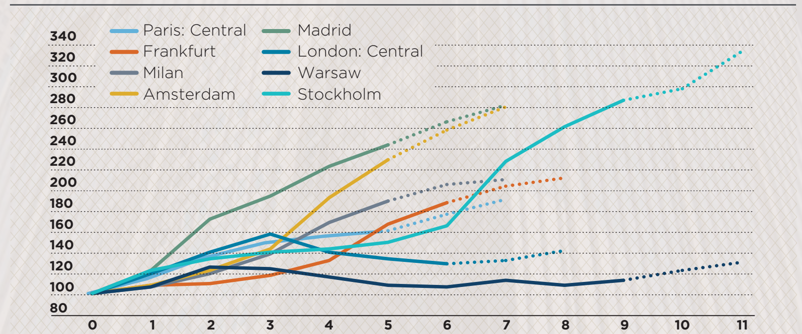


Sources: PMA (Autumn 2019), Savills Investment Management

Note: Index starts (=100) the last year of negative capital value growth, so the duration and the start of the cycle are dynamic.

The capital value growth cycle is expected to be prolonged through 2020 due to further rental growth and yields moving in further.

FIGURE 3: Office capital value growth index – last cycle trough through 2020



Sources: PMA (Autumn 2019), Savills Investment Management

Note: Index starts (=100) the last year of negative capital value growth (range 2009-13), so the duration and the start of the cycle are dynamic.

dynamic cities

Future proofing cities for long-term commercial real estate success

Judith Fischer

Europe stands among the most urbanised regions worldwide, with nearly 75% of the region's population now living in cities. The United Nations projects that this percentage will reach 84% by 2050.

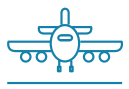
Cities are engines of economic growth. Less than 100 major European cities produce more than 30% of Europe's GDP, according to Oxford Economics. This places European cities firmly in the limelight for commercial real estate (CRE) investment.

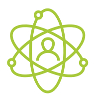
However, not all cities experience the positive effects of urbanisation equally. Given ongoing structural changes such as disruptive technology, ageing populations and environmental challenges, it is vital to identify those cities that are likely to show resilience to change.

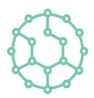
The Savills IM Dynamic Cities index examines six factors that in combination contribute to long-term wealth, economic growth and talent retention. It highlights which European cities are best equipped to handle future growth in a sustainable way, and the extent to which a city is future proofed hinges on its ability to attract investment.

Future proofing requires the right combination of soft and hard infrastructure, which is critical to support the expansion of a city's population and physical size. Successful cities of the future need seamless transport of people and information, which facilitates ease of doing business and encourages growth.

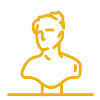
Digital connectivity in the form of strong broadband and mobile infrastructure is necessary for innovation as future technologies develop. A successful city must also be walkable, cyclable and have a good spread of public transport, which helps reduce the risk of location-, employment- and income-based disparities.


INFRASTRUCTURE


INCLUSION


INTERCONNECTION


INNOVATION

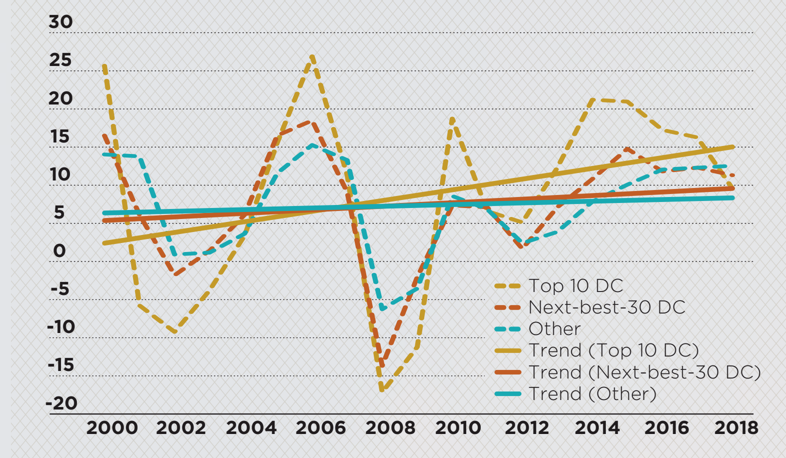

INSPIRATION


INVESTMENT

WHY DOES THIS MATTER FOR CRE?

Future CRE market performance is dependent on economic growth, wealth, technology and population trends. Rising employment, be it through the expansion of existing businesses or the engendering of new firms, helps support the office sector as demand for office space grows. The retail sector gains from growing consumer expenditure. This, in turn, is also positive for e-commerce growth, which is dependent on functioning logistics infrastructure. In a longer-term context, the three CRE markets of the top 10 dynamic cities demonstrate the strongest upwards trend in prime total returns, followed by the next-best-30 cities. Such office market trends are shown in figure 1.

FIGURE 1: Prime annual office total return trend lines



Sources: PMA, Savills Investment Management

The leading 2019 Dynamic Cities (top 20 featured in figure 2) are enjoying infrastructure investment and well-developed or developing knowledge networks. They are also supported by a backdrop of universities, strong cultural amenities and good governance structures, which foster enterprise. Together, these factors help cities attract and retain highly skilled labour, allowing them to take advantage of urbanisation and making them resilient to disruptive technology.

FIGURE 2: Top 20 Dynamic Cities 2019

RANK 2019	CITY	CHANGE 2018-19	RANK 2019	CITY	CHANGE 2018-19
1	London	→	11	Zurich	→
2	Paris	↑	12	Oxford	↓
3	Cambridge	↓	13	Edinburgh	↓
4	Berlin	↑	14	Barcelona	↑
5	Amsterdam	↓	15	Copenhagen	↓
6	Munich	↑	16	Frankfurt am Main	↑
7	Dublin	↓	17	Vienna	↑
8	Lausanne	↑	18	Bern	↑
9	Basel	→	19	Oslo	→
10	Stockholm	→	20	Madrid	→

Source: Savills Investment Management

European real estate market overview

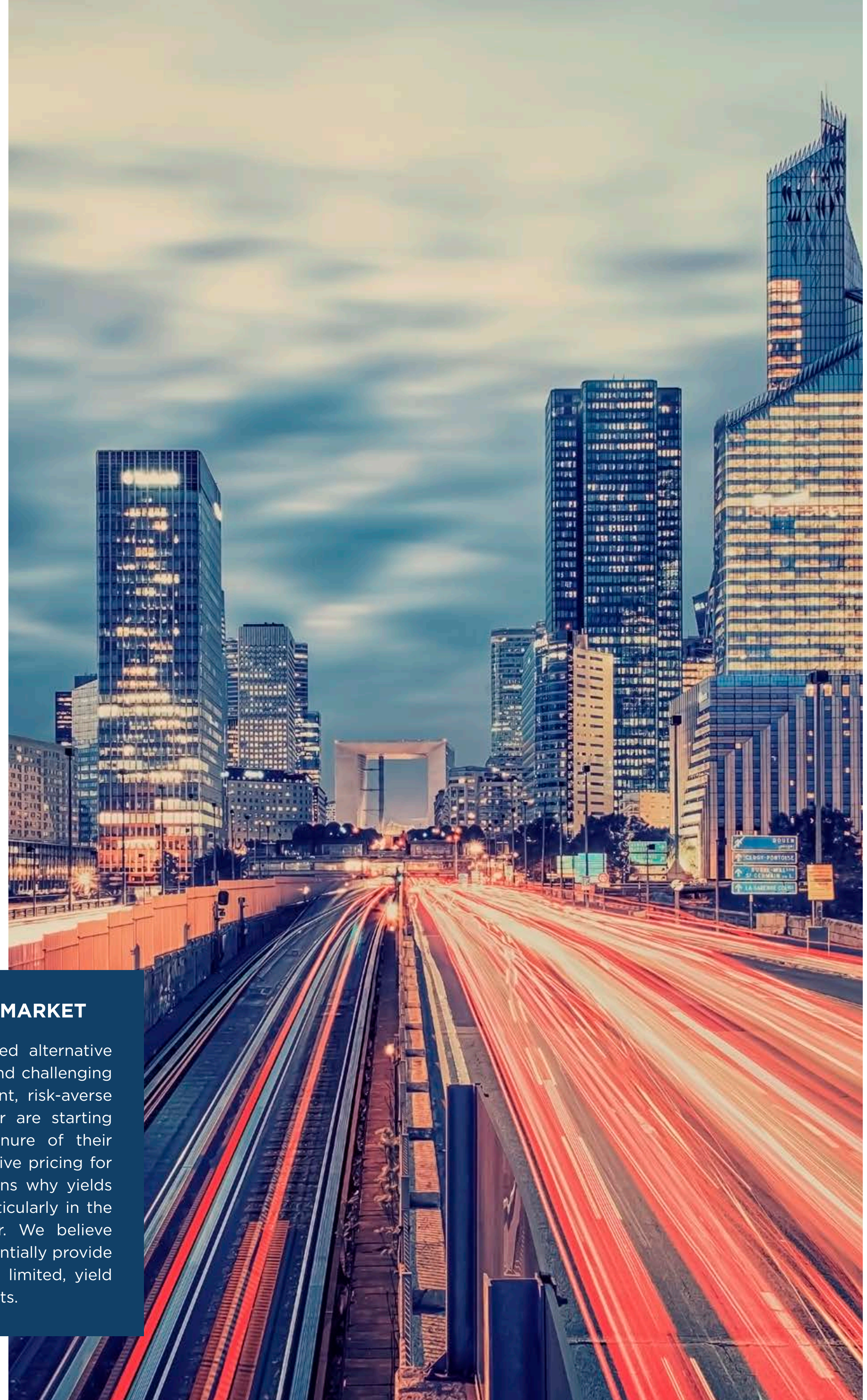
Andreas Trumpp

Overall, the outlook for pan-European occupier markets in 2020 is weaker than during the last few years. Independent forecasters expect economic growth to remain subdued over the next 12-18 months as global demand loses momentum and a number of geopolitical risks remain unresolved. While the Eurozone is expected to avoid tipping into recession, some economies such as Germany and Italy are struggling. The commercial property investment market cycle is likely to be prolonged by the ECB's decision to cut interest rates further and restart its asset purchasing programme. But a lackluster economic outlook implies headwinds for occupier demand and rental growth.

EXTERNAL FACTORS ARE SUPPORTING THE INVESTMENT MARKET

Due to a slow start to 2019, pan-European investment volumes look likely to come in lower than in 2018, data from Real Capital Analytics (RCA) suggest. However, lower investment volumes do not necessarily signal lower demand for property. Supply-side constraints are limiting investor activity on two fronts.

First, there is a persistent scarcity of new developments and refurbishments in the most sought-after core locations. Second, due to very limited alternative investment opportunities and challenging pricing in the core segment, risk-averse core investors in particular are starting to extend the holding tenure of their investments despite attractive pricing for sellers. This partially explains why yields have hardened further, particularly in the office and logistics sector. We believe that low risk-free rates potentially provide scope for additional, albeit limited, yield compression in some markets.



SOFTER OFFICE OCCUPIER DEMAND LIKELY, BUT VACANCY STILL LOW IN MOST MARKETS

Office markets are still in good shape heading into the new year, despite the slowdown in economic growth. Unlike the manufacturing sector, which has seen output shrink, the service sector has held up relatively well so far, and employment growth remains positive. However, Oxford Economics reports suggest office employment growth in the Eurozone will slow to about 0.7% per annum (p.a.) over 2020-24, from 1.8% p.a. between 2015 and 2019. We expect this will feed into softer occupier demand over the next few quarters.

Even so, vacancy rates are likely to remain low, particularly for Grade A buildings in central city locations. While development pipelines continue to pick up across Europe, they are still low as a share of existing stock in the majority of markets, PMA reports. In addition, speculative development activity has been constrained across Europe, too. Thus, even as occupier demand slows and current constraints on supply ease somewhat, markets appear unlikely to see a major oversupply of office space in the coming years.

For this reason, we think that there is scope for further, but slower, rental growth in CBD and central city locations in the short term. Given concerns about the pricing of core assets, regional markets where availability is tight and pipelines small may look attractive. However, good local knowledge is essential when considering assets in these markets.

Although the ECB's looser monetary policy settings could see some yields move in a touch more, in general we would advise against value-add and opportunistic strategies dependent on economic growth, strong employment prospects or further yield compression. Rather, we favour long income streams at this point in the cycle.

We prefer CBD, fringe-of-CBD and central city locations where buildings are located close to good transport infrastructure. Markets where modern, efficient office space is in short supply can still provide some interesting opportunities. For investors who are prepared to take on a little more risk, multi-let assets with short lease lengths in central locations provide opportunities for rental growth via active asset management.

DESPITE STRUCTURAL CHANGES, PHYSICAL RETAIL IS NOT DEAD

Oxford Economics predicts that retail sales in the European Union (EU-28) and Eurozone will grow by 1.9% and 1.6%, respectively, in 2020. While this is slightly below the average over the last five years, it is still notably above the long-term average. Consumer confidence dipped in 2019 but was still relatively high, as households benefitted from increasing employment and stronger wage growth across most of the EU-28. Indeed, unemployment is at its lowest rate in more than 10 years. In spite of economic headwinds, Oxford Economics expects unemployment to fall slightly further in 2020.

Online retail will continue to challenge and shape the future of traditional brick-and-mortar stores. However, physical retail is not dead. Retail formats that have, so far, been more resilient to competition from online can be broadly split into two categories: experience and convenience shopping. (We explore this further in our 'Physical retail will continue to evolve – but is here to stay' section.)

Even so, we believe that rental growth prospects in the retail sector are limited to certain locations and assets in major European cities due to subdued overall occupier demand and cost pressure on physical retailers.

We prefer focusing on assets that offer experience (e.g., luxury or outlet centres) or convenience shopping formats (e.g., retail parks or infrastructure retail such as that in railway stations), which have limited nearby competition and are easily accessible to large catchment areas.

E-COMMERCE IS A GROWING ELEMENT OF LOGISTICS DEMAND, BUT NOT THE ONLY ONE

With the structural changes to the way people shop continuing to evolve – and very different levels of online penetration across European – demand prospects for logistics assets continue to look solid. Savills Research expects e-commerce sales as a percentage of overall retail sales in Western Europe to grow further to 15% in 2023 from 11% in 2019.

However, it is important to note that logistics is not all about e-commerce. Traditional occupiers such as manufacturers remain an important source of occupier demand. Notwithstanding the current weakness in the manufacturing sector, these firms are facing high relocation costs. As such, locations around manufacturing hubs with strong transport connectivity can also provide good investment opportunities.

Slower economic growth will likely be a headwind for industrial and logistics demand going forwards. Against a background of rising development activity, we expect this to limit rental growth prospects in 2020. Further ahead, investors must be mindful of potential risks to the sector, particularly in the form of government intervention to support high street retail such as an online sales tax, which could hurt online sales demand.

Accessibility to main transport networks and labour are crucial ingredients in the logistics recipe. As such, investors should focus on large modern distribution warehouses that are close to main transport networks as well as smaller urban facilities within, or nearby, large and high-density cities.

BELGIUM

Country analyst: Judith Fischer

ECONOMY

Oxford Economics expects economic growth to remain subdued in 2020 at around 1.1% – slightly slower than the 1.2% expected in 2019. The national unemployment rate is at a historically low level. However, unemployment is likely to rise, according to Oxford Economics, which is of potential concern for occupier demand, particularly in fringe and noncentral city areas due to deteriorating employment intentions in the industrial and retail sectors.

OFFICE

Strong demand for office space in Brussels and historically low vacancy rates are putting upwards pressure on rents. The Brussels investment market remains competitive, which is putting downwards pressure on yields. Brussels office yields, however, remain attractive compared with other major European office markets.

For leases of more than 12 years with high-quality tenants, prime yields are below 4% depending on the age of the building. For six- to nine-year leases, yields stand at 4%, according to BNP Paribas Real Estate (BNPPRE). Going forwards, yields should remain stable or compress at a slower pace. We like modern office buildings in well-connected areas of Brussels.

LOGISTICS

Speculative development remains very low due to the strong demand for build-to-suit assets and developers' risk-averse approach. Prime rents for semi-industrial logistics assets should remain stable in 2020, Cushman & Wakefield Research (C&W) reports. The major logistics axes in Belgium, Brussels-Antwerp and Antwerp-Ghent have attracted the highest demand for logistics space over the last few years.

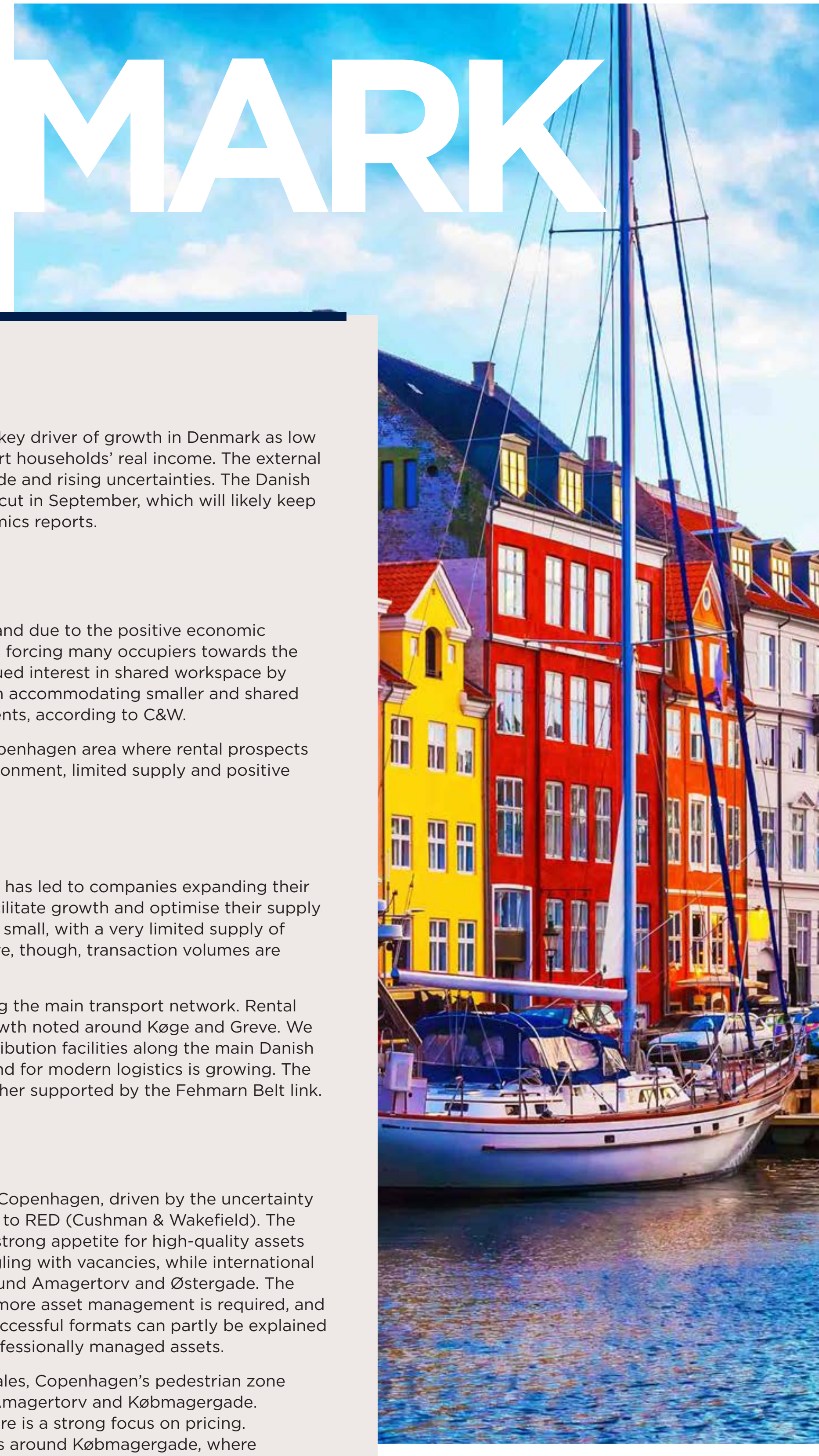
Investor appetite remains strong but there is a lack of available product that is limiting transaction volumes. The supply-demand imbalance is also putting downwards pressure on yields, which are, however, still higher than in neighbouring countries such as Germany, the Netherlands and France.

RETAIL

Structural changes in the Belgian retail sector are in line with the wider European trend. Yet appetite for retail investments is generally lower. There are some areas of greater resilience, however, such as convenience-led out-of-town retail, C&W reports, with good accessibility by car and plenty of parking spaces. Food-anchored retail is also a dynamic sector that is proving resilient amid changing consumer behaviours.

DENMARK

Country analyst: Nicole Tiblom



ECONOMY

Domestic demand should continue to be the key driver of growth in Denmark as low unemployment and moderate inflation support households' real income. The external sector is likely to slow due to weak global trade and rising uncertainties. The Danish central bank matched the ECB's deposit rate cut in September, which will likely keep investments at a healthy level, Oxford Economics reports.

OFFICE

The occupier market benefits from high demand due to the positive economic environment, and the lack of modern space is forcing many occupiers towards the outer parts of Copenhagen. There is a continued interest in shared workspace by occupiers, and investors are focusing more on accommodating smaller and shared office areas with more flexible office agreements, according to C&W.

We see opportunities in the fringe central Copenhagen area where rental prospects are positive due to the robust economic environment, limited supply and positive long-term demand prospects.

LOGISTICS

Recent years' positive economic environment has led to companies expanding their businesses and demanding more space to facilitate growth and optimise their supply chain. However, the Danish logistics market is small, with a very limited supply of modern facilities. From a historical perspective, though, transaction volumes are higher, with a broadening investor base.

Demand is focused on modern premises along the main transport network. Rental levels are rising, with the strongest rental growth noted around Køge and Greve. We prefer modern warehouses and last-mile distribution facilities along the main Danish transport corridors on Sjælland, where demand for modern logistics is growing. The Danish logistics market is expected to be further supported by the Fehmarn Belt link.

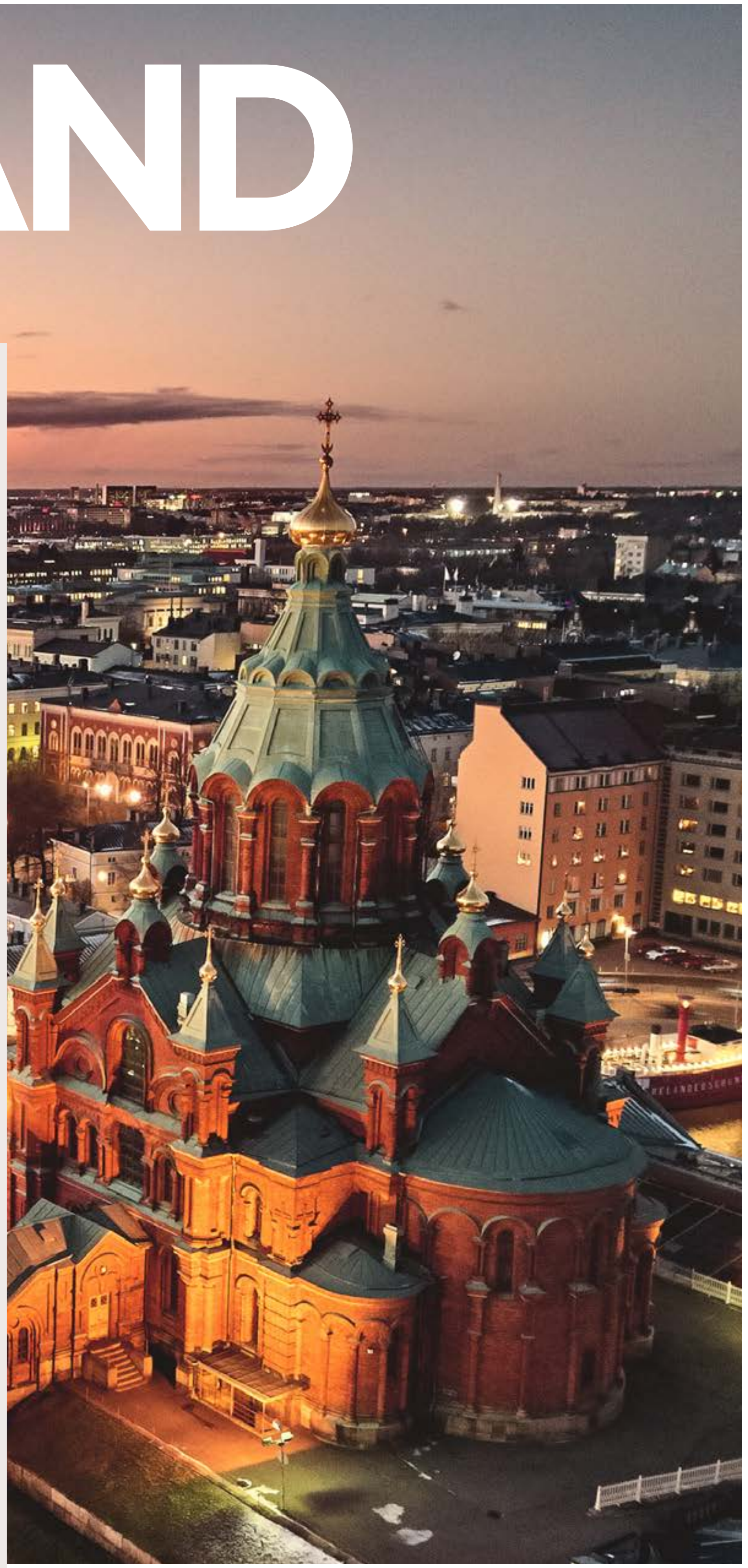
RETAIL

Prime high street yields have risen slightly in Copenhagen, driven by the uncertainty around structural changes in retail, according to RED (Cushman & Wakefield). The polarisation in the retail market is clear, with strong appetite for high-quality assets in prime locations. Parts of Strøget are struggling with vacancies, while international brands are competing for the best assets around Amagertorv and Østergade. The structural changes in the retail market mean more asset management is required, and the polarisation between successful and unsuccessful formats can partly be explained by a gap between professionally and non-professionally managed assets.

Despite increasing competition from online sales, Copenhagen's pedestrian zone is seeing strong footfall, particularly around Amagertorv and Købmagergade. Interest in secondary assets is limited and there is a strong focus on pricing. We like Copenhagen high street opportunities around Købmagergade, where occupier interest is robust, as well as in regional cities with positive long-term demand prospects such as Aarhus.

FINLAND

Country analyst: Nicole Tiblom



ECONOMY

The Finnish economy is slowing, with domestic demand likely to moderate over the next few years while remaining the bright spot in the economy as the external outlook is gloomier, Oxford Economics reports. The unemployment rate is still low, wages are rising, and moderate inflation is boosting households' real incomes. Consumers appear to be adopting a more cautious attitude to spending, with rising saving rates.

OFFICE

Investor demand for the office sector remains very strong, with prime yield compression in multiple locations. Rental growth is evident in the Helsinki CBD due to high demand and still limited supply. PMA forecasts further yield compression, which – along with stronger rental growth in the near term – means Helsinki has a rather positive outlook.

We prefer modern buildings in well-connected areas. Since limited supply in the traditional Helsinki CBD has led to a stretching of the borders of the CBD, there could be opportunities for rental growth in the fringe-of-CBD.

LOGISTICS

The fundamentals underpinning the logistics sector are positive. Occupier demand should improve going forwards, and new supply is limited. Demand is very strong for prime products, and there is a growing polarisation between such facilities in good locations and outdated stock in less-desirable ones.

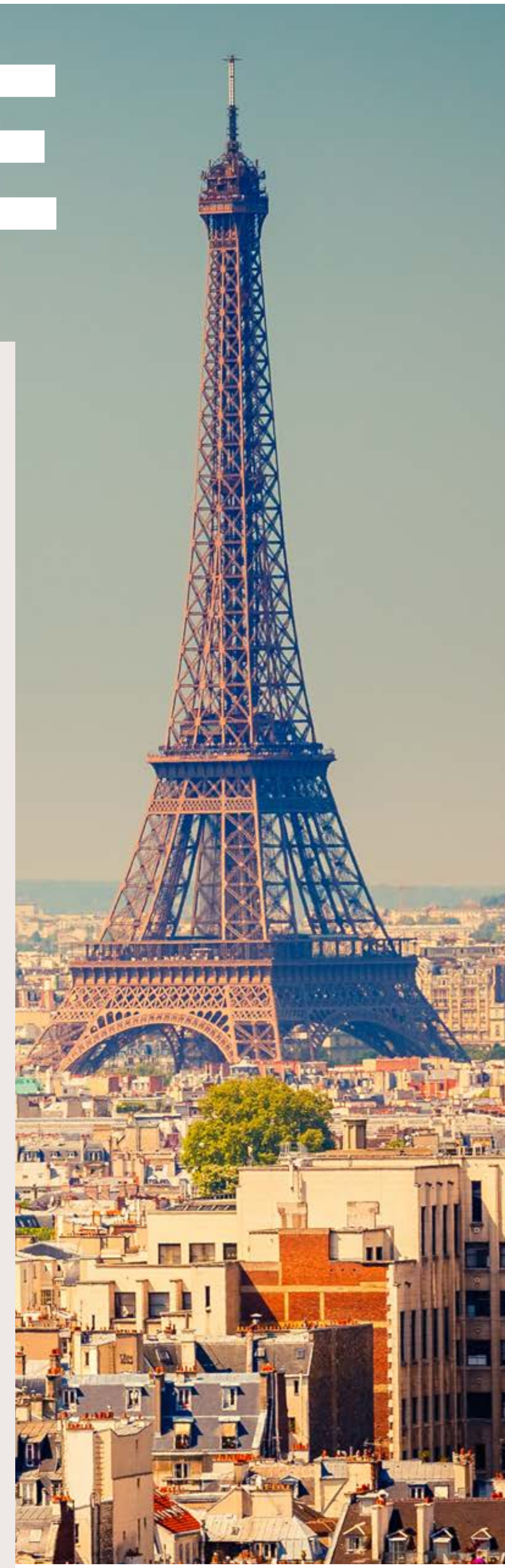
We prefer modern, high quality distribution centres along the main Finnish transport corridors and urban warehouses around Helsinki, due to robust fundamentals.

RETAIL

Occupier demand is stable, with a focus on prime locations and, particularly, retail combined with other services, such as food and beverage as well as beauty or well-being, according to C&W. International retailers not yet present in the Finnish market are looking for prime locations. There has been a strong influx of new supply, meaning even prime rents could come under pressure in upcoming years. Prime products should remain in high demand among investors, while the outlook is more uncertain for other segments.

FRANCE

Country analyst: Matteo Vaglio Gralin



ECONOMY

Oxford Economics projects that the French economy will grow 1.2% in 2020, almost in line with 1.3% expected in 2019. Performance is slightly above the Eurozone average, and unemployment is set to keep falling in 2020. Domestic demand is steady, but external weakness and uncertainty are likely to weigh on growth. Capital Economics expects fiscal policy to be tighter in 2020, with the government budget deficit set to fall to 2.7% of GDP from 3.2% in 2019.

OFFICE

In Paris we believe office occupier focus will be on areas where public transportation is planned to improve in coming years. Demand should remain sustained by strong office employment growth in 2020, Oxford Economics reports. Although PMA expects that new supply is likely to lead to an overall increase in vacancy in 2020, availability in core submarkets remains tight, except in La Défense.

We prefer areas such as the Southern and Southwestern suburbs with new underground access (Métro Line 15) and the Western Business District, where prime rents are likely to remain stable, or even potentially rise slightly, in 2020. Prime rents in the CBD could undergo a modest correction as they are comparatively high. Lyon is our second choice due to good occupier demand and a low vacancy rate (below 6%, according to PMA).

We expect the French office investment market to remain strong in 2020, which might lead to further yield compression for prime properties.

LOGISTICS

Our top picks are along the major French logistics corridors, particularly Paris, Lyon and Marseille. We think demand will remain healthy and diversified at the regional level in 2020. However, we only expect moderate prime rental growth as agents report a lack of Grade A product and limited available land. We also favour some locations outside of the main corridor, such as Toulouse, Bordeaux and Nantes, which are showing sustained rental activity and high build-to-suit completions.

We expect the logistics investment market to remain strong in 2020, therefore there is room for further yield compression.

RETAIL

E-commerce growth and changes in consumer behaviour are impacting on occupier demand. Agents report that the development pipeline is contained due to restrictive planning laws. Given the high uncertainty in the sector, we believe prime high street units and prime out-of-town assets are unlikely to see rental growth in 2020. We prefer good assets in prime areas and we think retailers should be very selective on secondary locations.

The retail investment market in 2019 is likely to have been quieter than in 2018, and we believe things will not change much in 2020; therefore, prime yields should remain at similar levels.

GERMANY

Country analysts: Matthias Düsing & Andreas Trumpp

ECONOMY

Germany's export-orientated economy is exposed to further headwinds and deteriorating business sentiment as global trade falters and technological adaptation pressure in the manufacturing sector mounts. On the upside, robust labour market fundamentals are keeping domestic demand firm, although GDP growth slumped in 2019. Consensus Economics predicts GDP growth to be close to 0.5% for the year overall and does not expect a dramatic improvement in 2020: growth of 0.8% with a possible spillover of the current industrial downbeat into the service sector.

OFFICE

Excess demand in Germany's top seven markets (Berlin, Cologne, Düsseldorf, Frankfurt, Hamburg, Munich, and Stuttgart) is poised to endure. Healthy occupier demand is stemming from positive office employment growth, the expanding tech sector and corporate consolidations. Savills Research expects average vacancy rates to stay at the low level of around 3% in the top seven, and even lower in the CBDs. Combined with restrained construction activity, rental growth is accelerating. Prime yields are well below the 3% mark, and likely to compress further.

We favour multi-let core/core-plus assets in the CBDs of the top seven markets, well-connected fringe-of-CBD locations with asset management and rent reversion potential as well as prime assets in major German provincials.

LOGISTICS

The German logistics sector remains investors' darling. Occupier demand is still robust given its underlying sector diversity. Scarcity of development plots, restrictive zoning, planning and construction sector capacity constraints are keeping the supply side on the brake, fuelling product scarcity and capital value growth. Although the share of speculative development is picking up slightly, the foreseeable pipeline is largely pre-let. Backed by market size and high liquidity, investor confidence remains high. Prime yields are at 3.80%, with further downwards potential, according to BNPPRE.

Core and core-plus assets with strong covenants in well-connected, established locations and second-tier markets with an interregional function remain our focus.

RETAIL

In spite of wage inflation, low saving rates and positive domestic demand outlooks, structural drivers and weakening consumer sentiment are putting high pressure on occupiers and landlords to adapt. New lease models necessitate increasing asset management activities. High street assets and shopping centres, which attune to these challenges by creating mixed-used destinations with food and beverage as well as consumer goods anchoring, will remain competitive.

We maintain our positive view on food-anchored retail parks and supermarkets in dominant locations to secure stable income streams. We also remain positive on high street assets in the top seven and major provincials with competitive formats and sustainable rental levels.

IRELAND

Country analyst: Hamish Smith

ECONOMY

Like the wider Eurozone region, Oxford Economics expects the Irish economy to slow but to remain one of Europe's fastest growing economies. While a no-deal Brexit is a risk for the Irish economy, the chance of this outcome appears to be receding.

OFFICE

The Dublin office market has been characterised by strong occupier demand, particularly from the tech sector. Coupled with a lack of new development, this has put downwards pressure on vacancy.

However, the market appears close to a turning point. Completions are set to rise sharply over the next couple of years, although Savills Research notes that net additions will be lower due to demolitions and withdrawals from the market.

But with occupier demand likely to slow on account of weaker economic activity, vacancy is likely to start edging higher. While this might not put immediate pressure on rental values, we think there is an increasing risk that rents could come under some pressure over the next few years. As a result, even with Dublin office yields among the highest in Europe, we remain cautious about the prospects for the sector.

LOGISTICS

Dublin's industrial and logistics sector continues to benefit from strong demand and a lack of available Grade A space, C&W reports. While occupier demand is likely to slow, the demand-supply imbalance for good quality space seems unlikely to dissipate in the near-term. This bodes well for further rental growth prospects.

With yields around 5%, industrial and logistics assets around Dublin's M50 ring road and main arterial routes remain interesting prospects.

RETAIL

Ireland's strong labour market and a steady pick-up in wage growth have supported the retail sector. However, consumer confidence fell sharply in 2019, to below the long-term average. While Brexit uncertainty might explain some of this decline, lower confidence is likely to be a headwind for the retail sector. A number of retailers continue to be active in the market, although there is also considerable noise from other retailers looking at ways to reduce store numbers and achieve a leaner cost base, according to C&W.

One area performing well is retail parks, according to Savills Research, supported by residential development. With house price growth slowing to more sustainable rates, according to Capital Economics, retail parks located close to large catchments and with limited nearby competition could offer potential investment opportunities.

ITALY

Country analyst: Matteo Vaglio Gralin

ECONOMY

Oxford Economics predicts that the Italian economy will grow by just 0.3% in 2020, having almost stagnated in 2019. A new pro-European Italian government was formed last September and needs to push for more fiscal stimulus in order to boost growth. Assuming that it does lift government spending, Oxford Economics expects the fiscal deficit to increase in 2020 but to remain within the 3% euro convergence threshold (Maastricht criteria).

OFFICE

Milan is our top pick. We expect it to keep performing well in 2020, sustained by strong fundamentals that are above the national average and comparable with other main European cities. We think demand will remain driven by quality, image and flexibility. We anticipate that vacancy rates of the core submarkets will remain almost stable and prime rental growth to remain on a solid path in 2020, although PMA reports rising completions. Rome is our second choice as PMA expects positive rental growth in 2020 (over 1%) and low new supply.

We also expect a dynamic office investment market and competition for assets to keep yields at similar levels.

LOGISTICS

We expect a slight upwards pressure on rents to continue in 2020 given the lack of quality space, while new high-quality completions should reduce the imbalance between demand and supply. We expect prime yield compression to continue in 2020, as investor interest (both national and cross-border) is solid, particularly in northern Italy and the Rome area. Moreover, logistics yields look attractive when compared to other sectors.

RETAIL

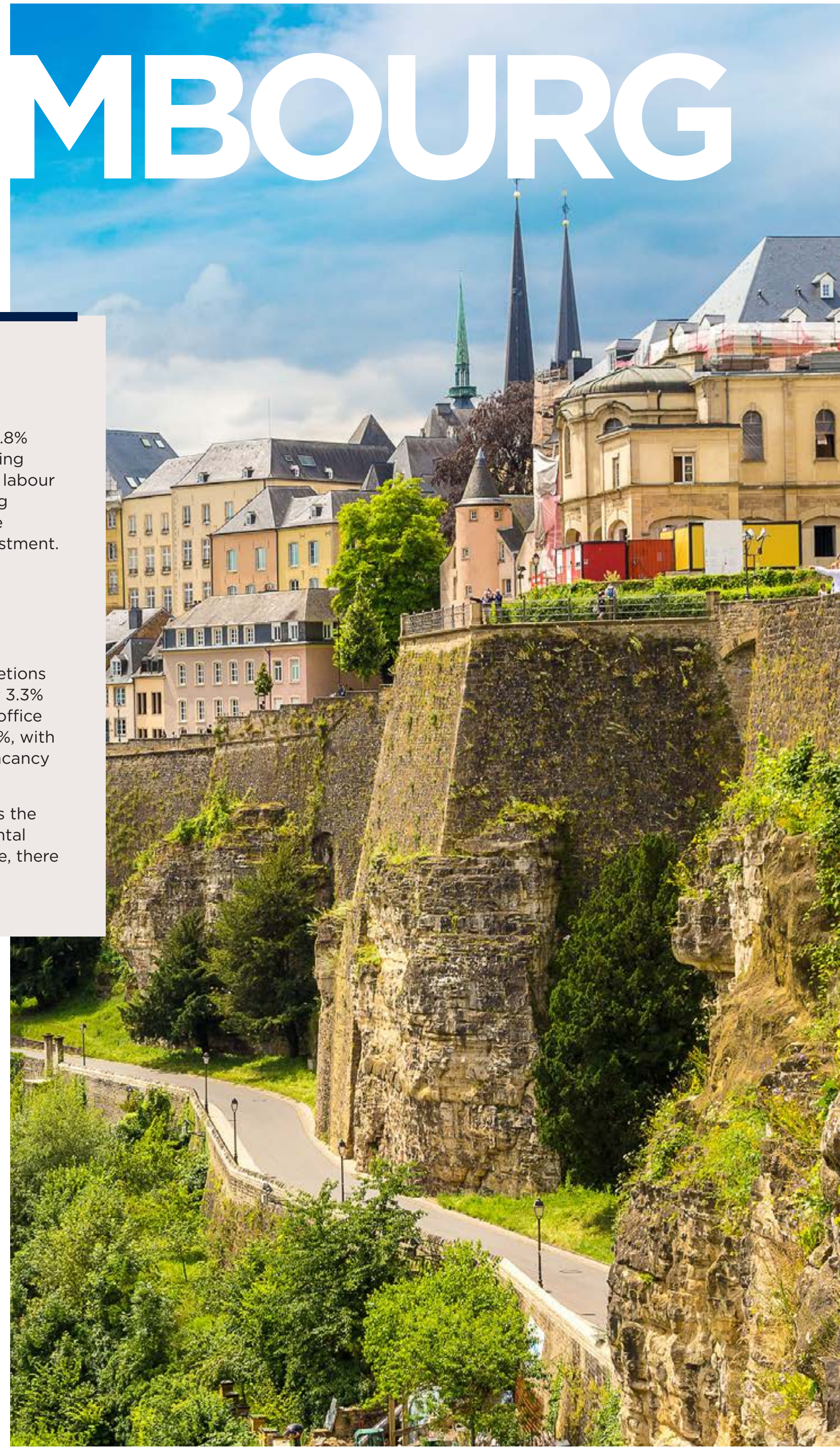
We expect high street retail (especially the luxury segment) to perform well in 2020, particularly in large cities such as Milan, Venice, Florence and Rome, supported by strong tourist flows (over 62 million visitors to the country in 2018, the UN World Tourism Organization reports). Selective opportunities remain in the out-of-town segment for the best assets in prime catchments. The supermarket sector is also attractive given the large size of the grocery market. According to Euromonitor International, Italy was the fourth largest market (by retail value) in Europe in 2018.

ALTERNATIVES

We like student housing. Demand is consistent and increasing, while the market is highly undersupplied. We also like retirement housing due to favourable demographic trends (a high percentage of the population is over 75 years old, Oxford Economics reports) and a lack of assets. Hotels are also appealing as there are opportunities to exploit a consolidation of current operators. These segments offer stable income, low return volatility and good portfolio diversification, which is attractive to investors.

LUXEMBOURG

Country analyst: Judith Fischer



ECONOMY

Luxembourg's economy will likely grow by 2.8% in 2020, Oxford Economics projects, outpacing Eurozone growth notably. Due to the robust labour market and rising wages, consumer spending is likely to remain solid, but external risks are dampening the outlook for exports and investment.

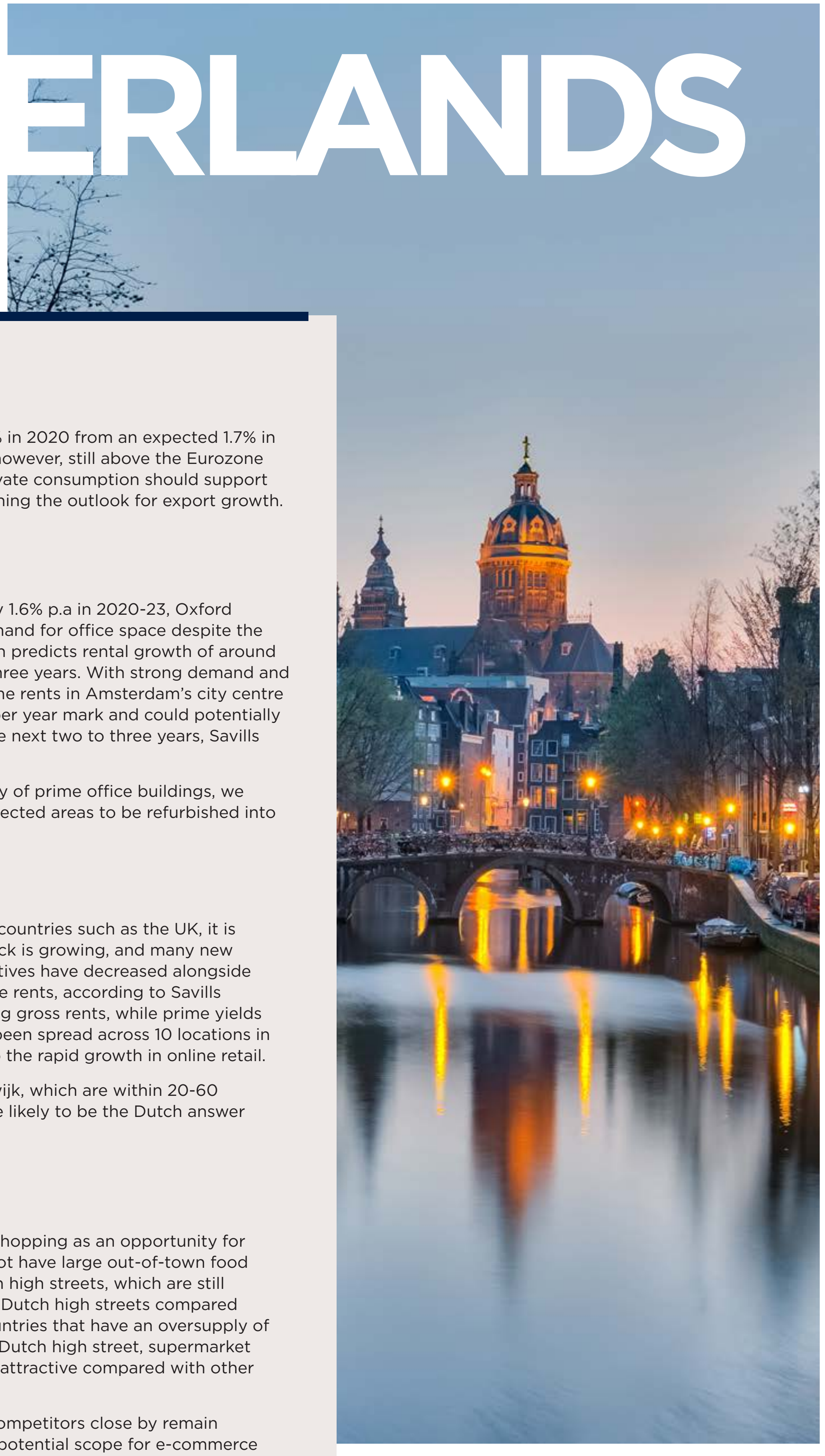
OFFICE

After a robust office development pipeline throughout 2019, PMA expects office completions in 2020 of 103,000 square metres (sq m), or 3.3% of current stock. INOWAI Research expects office vacancy in Luxembourg to stabilise below 4%, with the CBD, Kirchberg and Station recording vacancy rates below 2.5%.

We like office buildings in the key markets as the supply-demand dynamics are supporting rental values. However, due to the small market size, there may be limited opportunities.

NETHERLANDS

Country analyst: Judith Fischer



ECONOMY

Dutch economic growth is likely to slow to 1.2% in 2020 from an expected 1.7% in 2019, according to Oxford Economics. This is, however, still above the Eurozone average. While fiscal policies and domestic private consumption should support the economy, global trade tensions are dampening the outlook for export growth.

OFFICE

National office-based employment will grow by 1.6% p.a in 2020-23, Oxford Economics predicts, which should support demand for office space despite the slowdown in economic growth. Savills Research predicts rental growth of around 3-5% p.a. in Amsterdam over the next two to three years. With strong demand and dwindling options for prospective tenants, prime rents in Amsterdam's city centre have begun to exceed the EUR 400 per sq m per year mark and could potentially increase to EUR 450 per sq m per year over the next two to three years, Savills Research expects.

Given low vacancy rates and limited new supply of prime office buildings, we like value-add office opportunities in well-connected areas to be refurbished into Grade A buildings to achieve rental growth.

LOGISTICS

Although Dutch e-commerce penetration lags countries such as the UK, it is driving the Dutch logistics sector. Logistics stock is growing, and many new developments are built speculatively, yet incentives have decreased alongside high demand. This has led to rising net effective rents, according to Savills Research. There are now also signs of increasing gross rents, while prime yields are declining. Traditionally, logistics stock has been spread across 10 locations in the country, but new hubs are emerging due to the rapid growth in online retail.

We like 'agglologistics' hotspots such as Bleiswijk, which are within 20-60 minutes driving time of the major cities and are likely to be the Dutch answer to urban logistics.

RETAIL

Dutch consumers increasingly see high street shopping as an opportunity for leisure and recreation. The Netherlands does not have large out-of-town food stores; rather, food shops are mainly located on high streets, which are still achieving rental growth. This serves to protect Dutch high streets compared with high street markets in other European countries that have an oversupply of out-of-town retail and large shopping centres. Dutch high street, supermarket and food-anchored shopping centre yields are attractive compared with other European countries.

Retail parks in the right location and without competitors close by remain attractive investment opportunities. Given the potential scope for e-commerce growth in the Netherlands, the retail environment could be challenging for shopping centres that do not have strong food anchors or convenience-led offers.

POLAND

Country analysts:
Matthias Düsing & Andreas Trumpp

ECONOMY

Poland ranks among the fastest growing economies in Europe. Oxford Economics forecasts GDP growth of 3.2 % for 2020, following an expected 4.0% for 2019. Domestic growth drivers should remain stable through 2020. Based on the underlying economic and market dynamics as well as Poland's gateway function into Central and Eastern Europe, its vibrant commercial real estate market offers an attractive proposition.

OFFICE

The ongoing upswing of the Warsaw office market is fuelled by diversified demand from the tech, financial and professional sectors. In 2020, prime and net effective rents should trend upwards, as vacancy rates are likely to continue to decrease, especially in the central zones, according to Savills Research. Prime office yields are quoting at 4.50% – an attractive premium to Western European core markets.

We favour core/core-plus assets in Warsaw with strong covenants, access to the metro and tram and sustainable income returns. Well-selected core assets in regional markets Kraków, Wrocław and TriCity remain highly attractive based on capital value differentials to Warsaw.

LOGISTICS

Market growth and geographic diversification are driven by occupier demand from third-party logistics providers (3PLs) and the growing e-commerce sector. Prime rental growth has been limited by a growing pipeline. Effective rents, however, are trending upwards due to increasing construction costs and diminishing incentives. Prime net yields in the main logistics hubs compressed over the past 12 months and range between 6.25% and 6.50% at the end of 2019, whereas prime assets trade at 5.00%, according to BNPPRE.

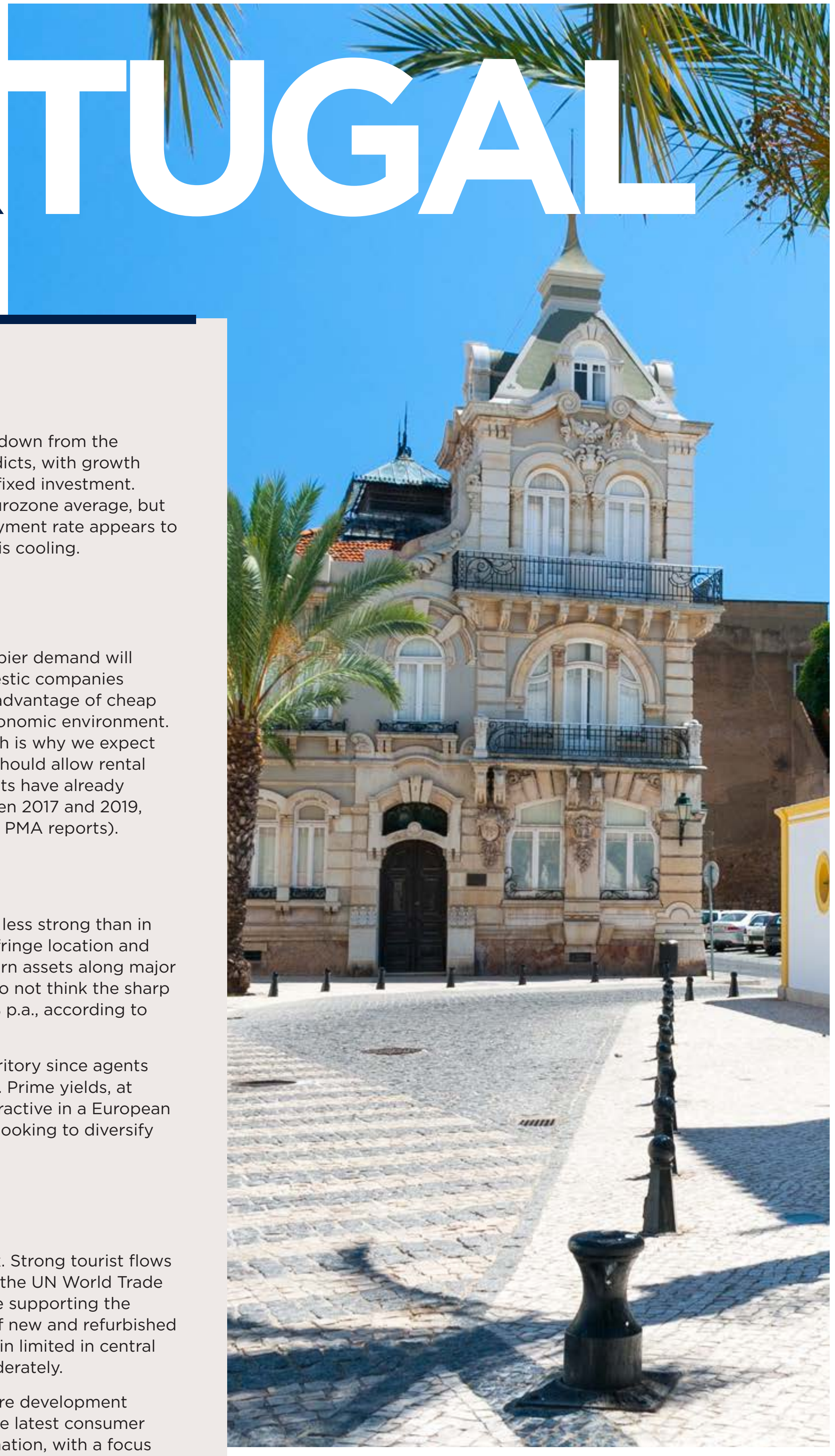
We favour modern distribution centres with capital value growth potential located along the main corridors, supporting multimodal transport, as well as multi-let assets near urban areas and in the emerging logistics hot spots.

RETAIL

Despite strong consumer spending, the retail sector is becoming more mature and polarised. State-of-the-art shopping centre schemes are enjoying healthy occupier demand and high occupancy, according to BNPPRE, but second-tier assets are increasingly exposed to growing e-commerce penetration and shifting lease models.

Asset repositioning, extensions and active asset management favouring mixed-used schemes, food and beverage offerings as well as placemaking to enhance consumer experience are key strategies. Investor demand is mainly driven by established players with expertise around the asset class and Polish market.

PORTUGAL



Country analyst: Matteo Vaglio Gralin

ECONOMY

Portugal's economy will expand 1.3% in 2020, down from the 1.9% expected in 2019, Oxford Economics predicts, with growth to remain driven by private consumption and fixed investment. Currently, Portugal is performing above the Eurozone average, but the gap is closing as the Portuguese unemployment rate appears to have bottomed out, and private consumption is cooling.

OFFICE

Lisbon is our preferred market. We think occupier demand will remain stable in 2020, supported by nondomestic companies moving their back offices to Portugal to take advantage of cheap labour, Eurostat reports, and a competitive economic environment. New supply is limited, according to PMA, which is why we expect vacancy to remain at low levels in 2020. This should allow rental growth to continue at a moderate pace, as rents have already risen very fast in recent years (4.1% p.a. between 2017 and 2019, compared with the European average of 3.6%, PMA reports).

LOGISTICS

Portuguese logistics market fundamentals are less strong than in other European markets due to the country's fringe location and low e-commerce penetration. We prefer modern assets along major transport corridors and near main ports. We do not think the sharp rise in rents seen in 2018 and 2019 (around 11% p.a., according to PMA) is likely to be repeated in 2020.

However, growth should remain in positive territory since agents report limited availability of Grade A products. Prime yields, at around 6.00-6.50%, C&W reports, are very attractive in a European context and might attract core-plus investors looking to diversify their portfolio.

RETAIL

Central Lisbon high street retail is our top pick. Strong tourist flows (almost 23 million visitors to Portugal in 2018, the UN World Trade Organization reports) and internal demand are supporting the segment. Although agents report the arrival of new and refurbished products, we predict that availability will remain limited in central locations in 2020 and that rents will grow moderately.

Agents expect the out-of-town shopping centre development pipeline to be very limited. In order to meet the latest consumer needs, the sector is going through a transformation, with a focus on modernisation through requalification and expansion. Yields, at around 4.0%, according to C&W, are attractive in European terms and should remain stable in 2020.

SPAIN

Country analyst: Matteo Vaglio Gralin

ECONOMY

Oxford Economics expects the Spanish economy to expand 1.6% in 2020, which represents a slowdown from the 2.0% growth expected in 2019. Performance is well above the Eurozone average but is moderating due to cooling domestic demand and a weak external environment. Political standstill continues: A general election held on 10 November 2019 was inconclusive. Capital Economics expects another election in 2020.

OFFICE

Madrid and Barcelona are our top picks. The most attractive submarkets in both cities are: the CBD, city centre and decentralised. Demand conditions remain favourable but are likely to ease as economic growth slows and agents report low availability, particularly in core submarkets. On the other hand, office employment growth will remain strong, Oxford Economics predicts. We expect prime rents to continue to grow in both cities in 2020, as some important development projects are planned that will add high-quality spaces.

We expect investor interest to remain strong in 2020; therefore, yields might compress further even though they are already at record low levels.

LOGISTICS

We believe that the e-commerce sector will continue to support demand for logistics space in 2020. However, prime rents in Madrid and Barcelona should increase only marginally due to the weaker economic outlook, rising operating costs, more speculative projects and occupier consolidation.

Spanish logistics yields of 5.00-5.25%, according to C&W, are still attractive compared with Western European markets, but they are converging. We think there is room for further yield compression in 2020 due to lack of Grade A products and strong competition.

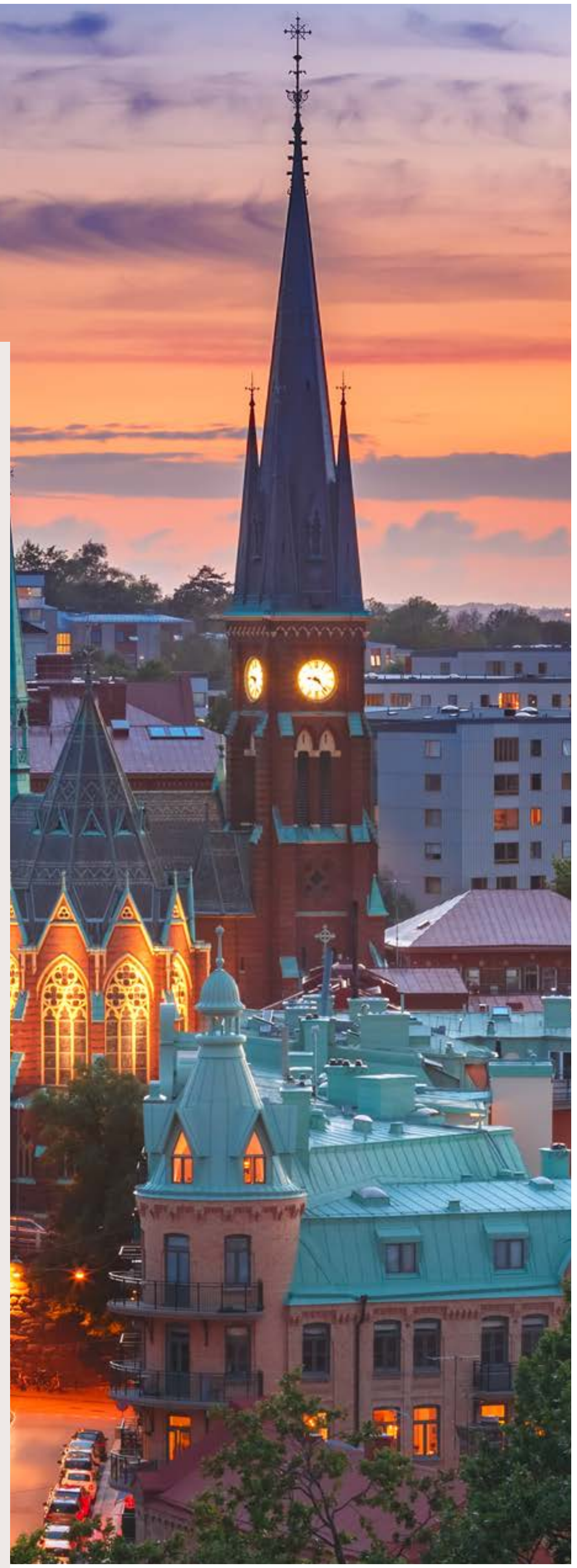
RETAIL

Oxford Economics expects retail sales growth to remain positive in 2020, supported by domestic demand and strong tourism flow (over 82 million visitors to Spain in 2018, the UN World Trade Organization reports). However, due to the structural challenges facing the sector, we only anticipate a slight increase in rental value for prime high street units in big cities such as Madrid and Barcelona. We also expect rents to slightly increase in well-located prime shopping centres.

The 2019 retail investment market is likely to have been quieter than in 2018, and we do not expect much to change in 2020. Therefore, prime high street yields should remain relatively stable. C&W reports that shopping centre and retail park yields have already moved out in 2019, and we think the correction will continue in 2020.

SWEDEN

Country analyst: Nicole Tiblom



ECONOMY

Sentiment measures such as PMI and the Economic Tendency Indicator have declined to below the long-term average in Sweden. In addition, the labour market is weakening, with a rising unemployment rate in recent months. Despite the weaker economic outlook, the Swedish real estate market is appealing to investors due to its strong business cycle, low interest rates and weak currency, which present opportunities for foreign investors.

OFFICE

Strong population growth, urbanisation trends and the ability to attract talent means occupier demand for Stockholm office market opportunities is strong. At the same time, new supply is restricted, and Grade A space in well-connected locations is very sought after. JLL expects the Stockholm office market to have among the highest rental growth in Europe over the next five years.

We like prime CBD office locations as well as modern office space in the Stockholm fringe-of-CBD. We also like the best suburban locations connected to services and rail transportation, such as Solna/Sundbyberg, due to the lack of supply in the CBD, which is pushing companies to other locations. Competition for assets offering stable income streams is intensifying.

LOGISTICS

The Swedish e-commerce market currently represents about 10% of total retail sales. According to Savills Research, there is an 11% threshold in Europe at which occupational demand for logistics space increases significantly. As the Swedish e-commerce market is approaching this threshold, we expect the logistics market to continue to be an attractive investment opportunity. At the same time, the downgraded trade outlook poses downside risks for the sector.

Therefore, we like modern logistics assets with stable cash flow in urban locations or along key transport links. We see the most positive rental growth prospects in the light industrial (last-mile logistics) segment close to Stockholm.

RETAIL

The polarisation in the Swedish retail market is becoming more evident, where some parts of the market are doing very well at the expense of others. It has led to rising rents on the absolute prime high street as well as the best-located shopping centres, while rents are on a downwards trend in secondary and tertiary locations. More asset management will be required alongside changing consumer and retailer patterns.

We prefer retail parks in regions such as Stockholm, Uppsala, Halland, Skåne and Västra Götaland counties, and preferably in the grocery, discounter or outlet segments as well as experience-orientated tenants. We also see the premium (luxury) high street segment as more resilient to the structural changes impacting the sector.

UNITED KINGDOM

Country analyst: Hamish Smith

ECONOMY

The UK economy remains weak, with ongoing Brexit-related uncertainty and the global slowdown holding back business investment. The labour market has been a bright spot, however. Nonetheless, with the number of job vacancies declining, employment growth is likely to do the same over the coming months. Even assuming an orderly Brexit, Oxford Economics forecasts economic growth of around 1.2% again in 2020 before starting to pick up in 2021.

OFFICE

All things considered, take-up has held up well since the referendum. Moreover, Oxford Economics forecasts continued office employment growth, driven by the tech and media sector alongside business services. Assuming either a Brexit deal or that the UK remains in the EU, London is well placed to benefit from reduced political and economic uncertainty, which would likely provide a boost to occupier demand.

Savills Research expects 2020 to see an increase in Central London completions. But with a third of these projected completions already pre-let and a sizeable number under offer, vacancy should not rise too much. With PMA data showing net additions falling back towards 0.5% of current stock in 2021 and 2022, a demand-supply imbalance could develop if uncertainty recedes and economic growth picks up.

With prime yields 50-100 basis points higher than other major European office markets, we think London offices look attractive from an equity perspective, especially good-quality assets near major transport hubs.

LOGISTICS

Strong demand for industrial and logistics space as well as rising rents have led to an increase in development activity. Nevertheless, the national vacancy rate is still low – at around 7% – according to Savills Research. However, its composition is changing. With increasing volumes of Grade A space available, we think greater choice of good quality space for occupiers will take the edge off rental growth prospects. E-commerce looks set to remain a key driver of take-up, with no sign that the share of online retail has plateaued.

We prefer long-income assets that have good access to main transport arterial routes, and smaller last-mile units close to large and densely populated areas.

RETAIL

The UK retail sector remains challenging as more retailers go into administration or announce store closures. At the same time, the British Retail Consortium indicates that footfall continued to decline over the first nine months of 2019. But there are some brighter spots, with retail park footfall showing some resilience in the middle of 2019.

We are cautious about the high street segment in general. Prime London, with high levels of local and tourist footfall, is an exception. Convenience formats, such as retail parks, as well as outlet centres may provide opportunities where they are located close to large and wealthy catchment areas with limited nearby competition.

Positioning for income and growth in Asia-Pacific

Benedict Lai

A slowing global economy and a prolonged period of low interest rates is on the horizon, setting the stage for multiple challenges to long-term investment. Risks have heightened from a year ago, stemming from anaemic economic growth, financial instability and geopolitical tensions. In such a scenario, it is wise for investors to approach financial markets cautiously while sticking to a pro-growth, risk-on stance.

To overcome rising uncertainties, the key is to create a portfolio that provides durable, resilient income while still being able to capture rental and capital growth from the continued economic expansion of the Asia-Pacific region, despite increasing regional and global headwinds.

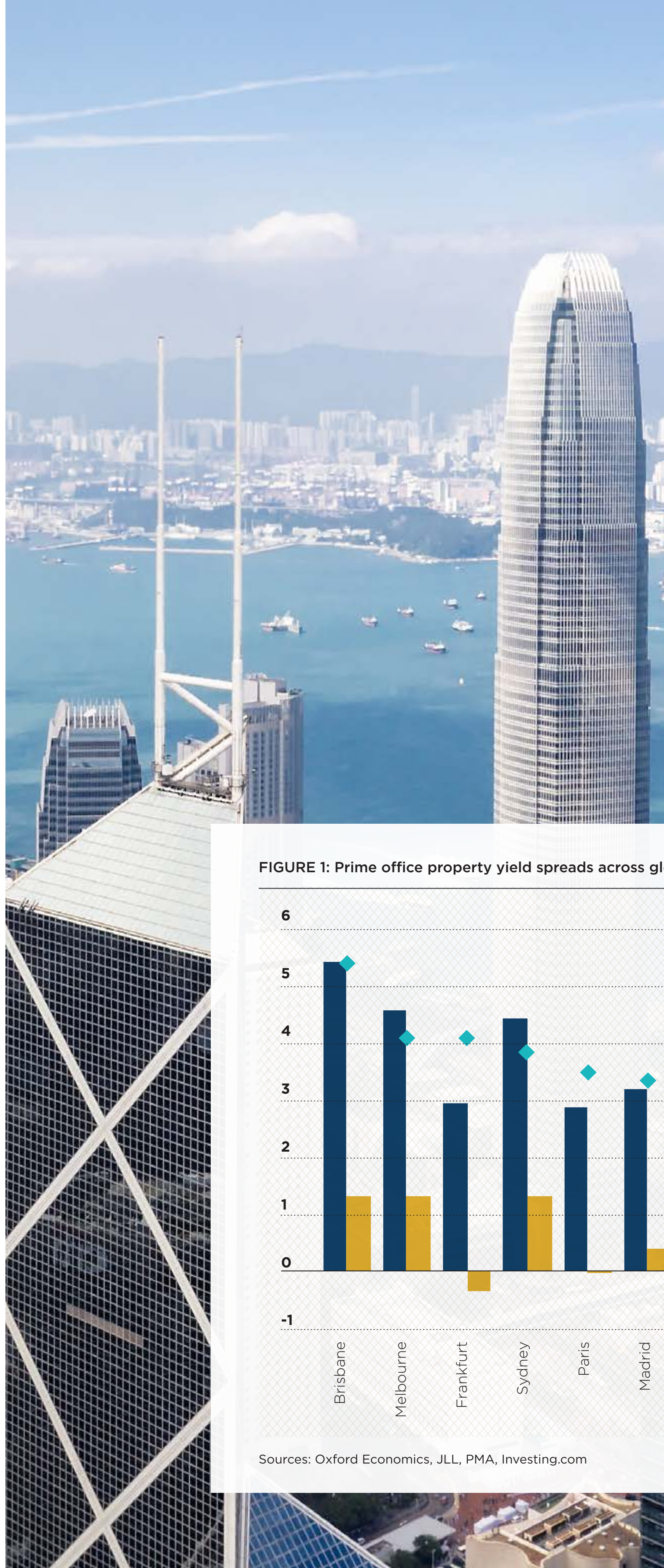
It is widely accepted that we are in the late phase of the property cycle. Despite the challenges ahead, opportunities exist if investors can identify risks and mitigate them through greater selectivity in asset profile. This includes understanding local market nuances and how regional diversification benefits portfolios.

In the face of escalating global trade tensions, rising protectionism and the current climate of uncertainty, the potential for a US recession has risen, and Asia-Pacific would undoubtedly be affected given its importance as a trade partner. This impact could range from reduced future regional growth prospects to increased volatility in currency valuation around the region.

The current low-yield environment – and the expectation that interest rates will remain lower for longer – have whetted investors' appetite to move up the risk curve. Property yields in gateway markets are now at historic lows compared with the last peak in 2007-08. While concerns regarding elevated prices and tight yields are valid, market conditions have also changed compared with the previous peak when, notably, the inflation and interest rate environment was significantly different.

This has led to generous yield spreads in some Asian cities that are comparable to those in other global gateway cities (figure 1). Hence, it is important to take a holistic look at risk-adjusted returns across all asset classes while layering in downside protection against demographic trends.

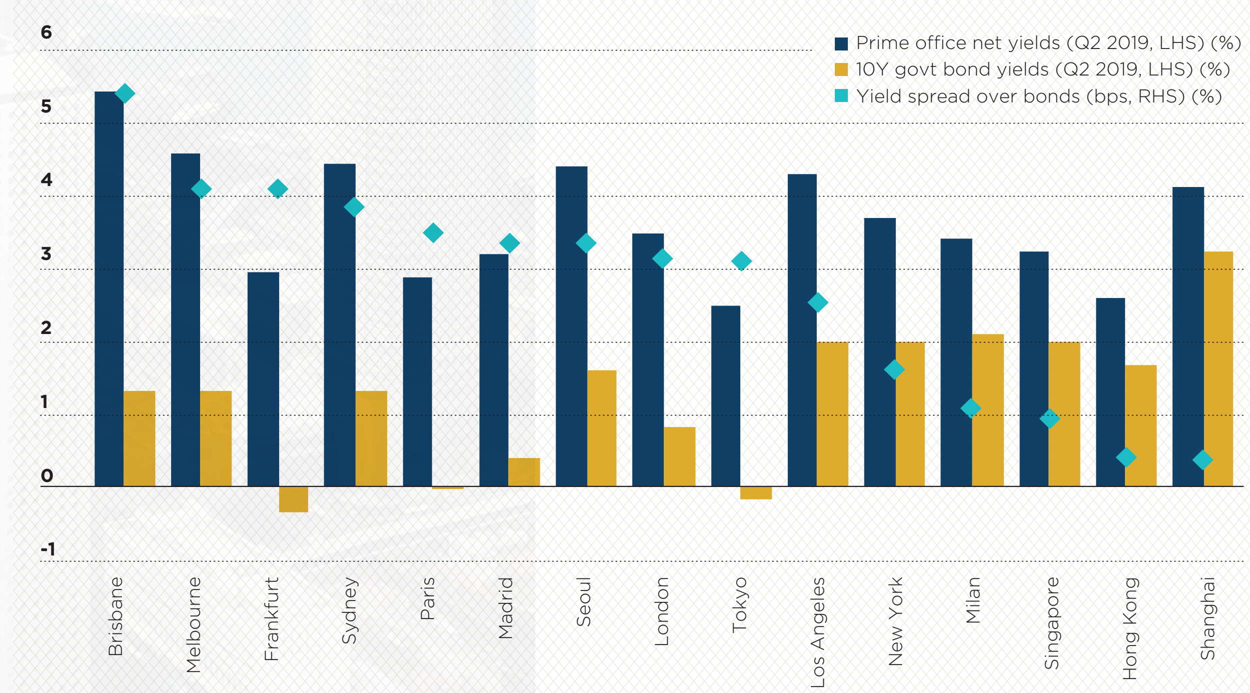
This means moving up the risk curve with caution while trying to meet investors' internal targets. In this case, a core-plus/value-add strategy with a focus on income is, in our view, the ideal strategy to mitigate risks, particularly in markets still exhibiting potential for growth.



Robust fundamentals such as urbanisation, the rising middle-class and gradual shifts towards increasing service sector output continue to reinforce the attraction of the region, particularly in a subdued global growth environment. This has spurred demand for high-quality assets as the boundaries of core locations extend and real estate market drivers change, which presents an attractive opportunity to adopt a core-plus strategy. For instance, on the back of higher returns, investors are now more receptive to the idea of investing beyond Central Tokyo in Japan or the Sydney CBD in Australia, and are willing to look at other cities or larger metropolitan areas.

The Asia-Pacific region offers significant opportunities for core-plus/value-add investors, supported by limited availability of core product and stronger growth prospects. Limited core opportunities mean investors looking to gain exposure to a particular market may only be able to do so via higher-risk strategies, including build to core or manage to core. The scarcity of core products available for investment reflects either the high percentage of owner-occupiers in a given market or the prevalence of large estates controlled by dominant single owners (such as real estate investment trusts).

FIGURE 1: Prime office property yield spreads across global gateway markets



Sources: Oxford Economics, JLL, PMA, Investing.com

Asia-Pacific real estate market overview

Benedict Lai

RESILIENCE TO BE TESTED AMID A SEA OF GROWING RISKS

Declining exports, deteriorating business confidence and weakening investment are intensifying downside risks globally, according to the World Bank. Unresolved significant geopolitical risks are exacerbating the slowdown in demand, underpinning a downgrade in the Asia-Pacific region's growth prospects for 2020.

The decoupling of the global economy is underway. Apart from the US-China trade conflict, the Japan – South Korea dispute, Brexit as well as ongoing protests – including in France, Spain, Indonesia, South Korea and Hong Kong – have complications for the investment landscape. A subdued growth and sustained low inflation environment mean interest rates are set to remain lower for longer and perhaps become the new norm. Central banks in the region are shifting gear to an easing bias in order to shore up domestic demand against a backdrop of weaker manufacturing and exports. Asian economies are also at risk of engaging in a currency war to boost exports.

As headwinds continue to grow, Asia's solid fundamentals will be put to the test. Accommodative fiscal and monetary policies should allay the impact from the trade row. Although the recent reopening in trade talks could reduce trade tensions going forwards, a slowdown in China and a potential trade reescalation are forefront risks. Having eased in 2019, regional average inflation is likely to accelerate in 2020, partially due to cheaper borrowing costs and lower oil prices. The resilience of Asian economies will likely be tested again after the GFC a decade ago.

SOLID PROPERTY FUNDAMENTALS PUT TO THE TEST

Amid the slowing economy, occupier markets in the Asia-Pacific region remain healthy, although some have posted increasing vacancies, including Seoul, Hong Kong, Perth, Kuala Lumpur, Beijing and Shenzhen. PMA expects a wave of supply to push vacancies higher in several markets in 2020: Tokyo; Seoul; Sydney; Melbourne; the tier 1 Chinese cities of Shanghai, Beijing and Guangzhou; and Kuala Lumpur.

Technology firms and co-working operators remain a key office demand driver. Pre-commitments within 2020 developments have been fairly strong except in Chinese tier 1 cities, although PMA expects vacancy rates in these cities to rise. Aggregate demand is likely to ease amid a construction peak in 2020. Additionally, the slower economic momentum as well as new office supply are likely to underpin a more modest growth in rents in 2020 as occupiers adopt a cautious stance.

RETAILERS OPTIMISING THEIR OFFERING IN THE FACE OF COMPETITION

The retail sector is reinventing itself. Landlords and developers are retooling shopping centres through redevelopment and diversification of tenant mix. Nevertheless, it is proving an uphill task given the competition from e-commerce. In Asia-Pacific markets, experienced landlords are attempting to differentiate themselves from the competition through active asset management and targeting niche consumer segments.

There has been generally modest rental growth across the region. Increased pressures from national retailers and rising incentives have held rents stable in Australia, according to PMA. Elsewhere, protests in Hong Kong have seen high street and prime shopping mall rents decline by more than 5% q/q in Q3 2019, according to C&W. In view of the current situation, we expect rents to decline further. Meanwhile, Singapore prime retail rents rose in Q3 2019, driven by low supply of prime space and higher footfall due to rising tourist arrivals.

STRONG MOMENTUM IN LOGISTICS SECTOR DESPITE RISKY TRADE ENVIRONMENT

E-commerce and the restructuring of supply chains continue to support global logistics markets, with vacancy rates at record lows. Most markets recorded improvements in rental growth in 2019, thanks to robust leasing activity, based on PMA data. While the strong leasing momentum is expected to continue into 2020, the challenging external trade environment poses a risk to rental growth, which should record a more modest pace in 2020.

Elevated interest in logistics properties has given way to a wave of new supply. With structural shifts in retail, robust demand for logistics properties has led to developers looking to boost or improve the last of mile delivery. Rising land costs and the lack of modern logistics facilities is also giving rise to potential for refurbishment or build-to-suit opportunities on the back of rapid e-commerce growth.

A CHALLENGING INVESTMENT LANDSCAPE, BUT NO ONE MARKET THE SAME

Investment volumes in China, Japan and South Korea continued to decline in 2019, according to RCA, while they remained flat flat in Australia. Investment volumes in Singapore bucked the trend, rising by more than 60% y/y as of Q3 2019, reports RCA. A CBD rejuvenation scheme announced by the Singapore planning authorities buoyed investment activity, which amounted to USD 9.5 billion of commercial transactions by Q3 2019, according to RCA.

The low interest rate environment is set to persist, which should continue to exert downwards pressure on yields across the region amid a lack of investable stock compared to the US and Europe. While respective Asia-Pacific markets are at different points in the property cycle, most markets appear to be fully priced in, with yields at historical lows and with modest rental growth outlooks. Deployment of capital would be challenging in some circumstances.

Consequently, investors would benefit from understanding local market conditions and considering taking on risks. In particular, we like core-plus/value-add strategies, secondary regional markets such as Osaka or areas within cities that offer potential upside opportunities through rejuvenation or structural uplift.

AUSTRALIA

Country analyst: Benedict Lai

ECONOMY

Leading indicators such as consumer and business confidence as well as credit growth suggest short-term headwinds in Australia's economy. Despite resilient employment growth, Oxford Economics expects weak income growth to weigh on domestic demand through slower household spending. However, net exports coupled with a weak Australian dollar, accommodative monetary policy and potential quantitative easing should help bolster economic growth. Oxford Economics expects GDP expansion to pick up to 2.3% in 2020 after a projected growth of 1.8% in 2019.

OFFICE

Demand conditions have continued to strengthen in most Australian office markets, particularly in Sydney and Melbourne. Even though an impending tranche of new supply is set to complete in 2020, with 70%-80% of new space already pre-let in Sydney and Melbourne, market conditions will remain tight, according to Savills Research. Nevertheless, landlords are likely to grant higher rental incentives to retain tenants, underpinning a slower effective rental growth pace in 2020.

Current market conditions favour Melbourne over Sydney due to overly aggressive pricing in the latter market as well as relative affordability. Increased regulatory pressures and higher capital requirements are giving rise to funding gap opportunities in the debt and mezzanine loan space.

LOGISTICS

Robust logistics demand on the back of e-commerce growth has led to an increase in speculative development in both Sydney and Melbourne, according to Knight Frank. Despite the above-trend new supply in both cities, there is a divergence in vacancy rates between the prime and secondary segments, with tenants flocking to the prime segment.

Above-trend development activity has also spurred rental growth, with tenants willing to pay a premium for the best stock, which is why Knight Frank anticipates steady rental growth to continue into 2020. We see opportunities in Melbourne and Sydney logistics properties, particularly modern intermodal terminals.

RETAIL

Falling consumer confidence in Australia and softening market conditions are driving higher incentives as landlords and tenants adjust to market expectations. In addition, supply pressure is building up in both Sydney and Melbourne, constraining rental growth, with investors cautious towards certain types of shopping centres (e.g., subregional malls and those anchored by department stores).

Nevertheless, other prime retail formats are holding up well. PMA forecasts yields will remain stable over the long term despite retail headwinds. We favour well-located neighbourhood retail centres in Sydney, Melbourne and Brisbane.

CHINA

Country analyst: Benedict Lai

ECONOMY

China's economic growth is at risk of further slowdown in 2020 as the trade war with the US continues, although there is a potential for a breakthrough in negotiations. That said, supportive fiscal and monetary policies, coupled with a healthy labour market, will shore up growth, according to Capital Economics. The latest Caixin China General Manufacturing PMI pointed to the strongest pace of expansion in the manufacturing sector since February 2017.

OFFICE

A slowing global and domestic backdrop has contributed to weakened office demand from multinationals; the technology, media and telecom sectors; and venture capital–driven co-working, according to PMA. With the exception of Shanghai, CBD office rents across tier 1 markets (Beijing, Guangzhou and Shenzhen) are at all-time highs since 2007, based on PMA data. Rising CBD supply remains a challenge that could dampen rental growth expectations. While wider decentralisation and infrastructure development present opportunities for investors, PMA predicts that it will represent a risk to future wider rental growth. Low bond yields and significant weight of capital suggest that prime yields will remain stable at around 4.2% over the five-year forecast period, according to PMA.

With office yields at record lows in the CBD, we like supply-constrained submarkets or districts benefitting from infrastructure improvements outside of the CBD, such as Beijing's Zhongguancun market, business parks or offices in emerging growth corridors in Shanghai.

LOGISTICS

Logistics occupier demand remained healthy in 2019, although a deterioration in the macro environment is a key risk, according to PMA. Interest in logistics property has led to a wave of new supply, which has in turn led to concerns regarding increasing competition. Rental performance is likely to diverge in tier 1 and tier 2 cities as landlords in some regions prioritise occupancy over rents.

As China's economy continues to rebalance towards domestic consumption to drive growth, we continue to favour logistics assets tied to e-commerce. In particular, we favour inland logistics facilities located in satellite cities, where occupier costs are lower.

RETAIL

The retail sales outlook continues to moderate, albeit still healthy, supported by economic rebalancing to consumption. Nevertheless, headwinds from online retail sales persist with sustained supply. PMA projects modest rental growth averaging around 1% per annum across the tier 1 markets over the short term, with Shanghai set to outperform the other cities given its status as China's premier retail destination. PMA also notes a slower pace of expansion by luxury and fast-fashion brands as consumers tighten their spending.

JAPAN

Country analyst: Benedict Lai

ECONOMY

With the introduction of a consumption tax hike to 10% from 8% last October, Japan's economic growth is likely to soften in 2020. However, the buoyant employment market, additional fiscal stimulus related to the 2020 Olympics and commitment by the Bank of Japan to introduce further monetary easing policies if necessary should cushion the impact of a sharp economic slowdown. Nevertheless, rising trade protectionism and a cooling global economy are key downside risks. Oxford Economics expects the economy to grow by -0.2% in 2020, following 0.9% in 2019.

OFFICE

The office vacancy rate remains low, supported by the robust employment market. Limited availability in the Grade A market continues to be a boon to the Grade B market, with average rental growth in the latter outpacing that of the former. On the supply front, around 80% of supply coming online in 2020 is pre-leased, which should ease concerns of a supply glut, according to Savills Research.

In view of accommodative monetary policy and wide yield spreads to risk-free rates, office yields should continue to compress, with investors seeking higher-risk strategies and higher yields. We think opportunities in the Tokyo Grade B segment, or offices in other regional Japanese cities, look attractive as occupiers become more cost conscious.

RESIDENTIAL

Trends supporting the residential sector remain bullish, underpinning strong annual growth in average rents (6.9% y/y in Q3 2019 – the highest level since Q4 2007, according to Savills Research). Savills Research data also showed an improvement in the occupancy rate to 97% in Q3 2019 as the strong labour market fuels demand for residential as well as rental growth. Moreover, high condominium prices from rising land costs are driving potential buyers to the leasing market. While the cloud of uncertainty remains, demand should remain buoyant.

We prefer multifamily accommodation for rent in subcore districts of Greater Tokyo and selected established regional submarkets such as Osaka, Nagoya and Fukuoka, given the multifamily segment's resilience and healthy fundamentals.

RETAIL

Buoyant tourism and retail sales growth are fuelling demand for retail space. C&W expects continued tenant demand to lead to further rental growth. That said, the impact of the consumption tax hike on retail sales has yet to fully materialise. However, the government offering concessions should soften the blow somewhat. Nevertheless, global uncertainty including a prolonged trade spat between Japan and South Korea remain a downside risk to rental growth given its potential impact on tourism.

SINGAPORE

Country analyst: Benedict Lai

ECONOMY

The global tech slump and ongoing trade tensions between the US and China underpinned a slowdown in Singapore's economy in 2019. However, Capital Economics expects economic growth to accelerate in 2020 on the back of robust domestic demand and a pick-up in investment expenditure. Despite hopes of progress in global trade negotiations, risks remain tilted to the downside due to external headwinds, chiefly from the lingering US-China trade war.

OFFICE

Office leasing activity remains robust, led by the technology and flexible working space, which is likely to continue in 2020. However, the modest economic outlook should weigh on expansion plans, with PMA forecasting a more gradual pace of rental growth in addition to 108,000 sq m of net additions entering the market in 2020. Nevertheless, PMA expects yields to remain firm on the back of the positive rental growth outlook and limited investable office stock.

Given government plans to rejuvenate the CBD, we like opportunities for value-add Grade B office space in fringe-of-CBD locations.

LOGISTICS

Leasing demand for Singapore logistics property has been muted in view of global trade tensions and disappointing export growth so far. Looking ahead, the anemic economic outlook is likely to dampen rental growth expectations in line with weak demand, according to Savills Research. Nevertheless, the easing pipeline should offset the decline in rents.

RETAIL

The retail landscape remains polarised, with prime space still resilient while secondary malls face headwinds, according to Savills Research. In view of the subdued economic outlook and rising concerns regarding the employment outlook and impact on retail sales, the broker believes prime rents could see a slower pace of growth in the year ahead in line with inflationary trends, with investors exercising caution.

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Savills Investment Management is an international real estate investment manager with offices in Australia, France, Germany, Italy, Japan, Luxembourg, Malaysia, the Netherlands, the Nordics, Poland, Singapore, Spain and the UK.

Savills Investment Management manages real estate worth circa EUR 18.9 billion worldwide (as of Q3 2019). Savills Investment Management offers comprehensive real estate asset and fund management services in the form of individual mandates and fund solutions for a broad spectrum of investors, including insurance companies, pension funds, foundations and family offices. The investment styles range from core to opportunistic.

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