savills investment management

Outlook 2019

Navigating the uncertainty

OUTLOOK 2019

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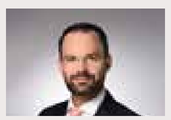

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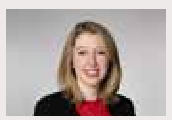

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NAVIGATING THE UNCERTAINTY

"Everything in life has some risk, and what you have to actually learn to do is how to navigate it."

Reid Garrett Hoffman
Co-Founder
LinkedIn

Global financial market volatility picked up in 2018, pointing to an anticipation among investors that a more serious deterioration in global macro conditions is in the air. Fuelling these fears are issues such as rising interest rates, trade protectionism, fiscal imbalances and Brexit.

Against this uncertainty, reliable indicators continue to signal that developed economies have the stamina to keep growing through 2019. This suggests that the Outlook 2019 analysis should be more about assessing opportunities that would benefit from an extension of the global business cycle but are insulated against the possibility of a more pronounced downturn in the next few years.

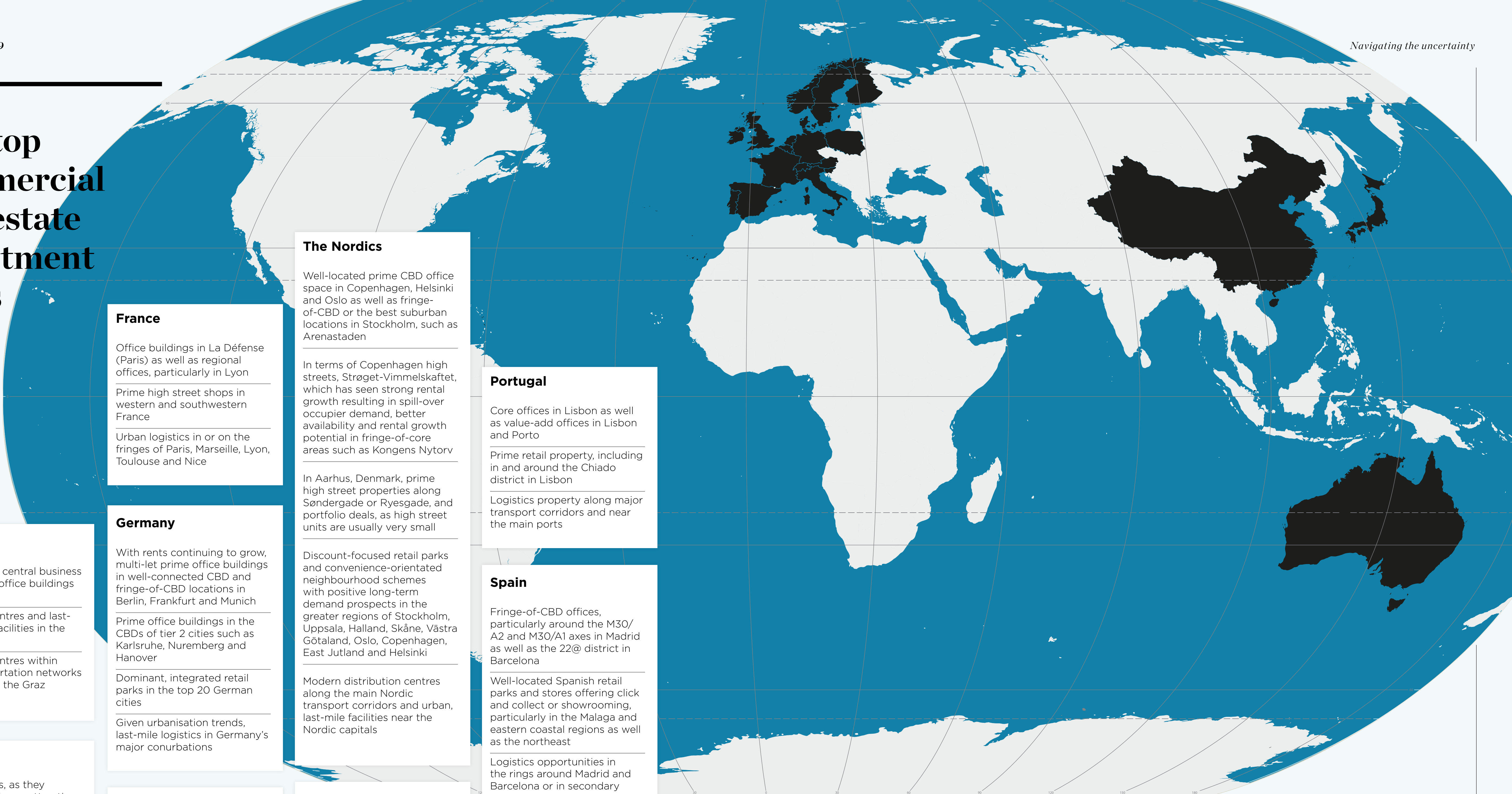
Investors would be well-advised to work with a commercial real estate investment manager with the local knowledge and expertise to help investors navigate these uncertain times. The Savills Investment Management Outlook 2019 report features a collection of commentary from internal fund managers and research analysts, highlighting the strategies they employ to capitalise on current investment market opportunities.

IRFAN YOUNUS

Head of Research, Europe
Savills Investment Management

Contents

Our top commercial real estate investment picks



EUROPE

Austria

- Multi-let prime central business district (CBD) office buildings in Vienna
- Distribution centres and last-mile logistics facilities in the Vienna region
- Distribution centres within strong transportation networks in the Linz and the Graz regions

Benelux

- Brussels offices, as they continue to offer an attractive yield play
- In Amsterdam, modern office buildings west of the South Axis; in Rotterdam, office buildings trading close to their replacement cost
- Luxembourg offices, which could benefit from Brexit-related relocations and demand-supply dynamics
- Logistics assets along the Brussels-Antwerp corridor and in the Noord-Brabant, Limburg and Zuid-Holland logistics hubs

France

- Office buildings in La Défense (Paris) as well as regional offices, particularly in Lyon
- Prime high street shops in western and southwestern France
- Urban logistics in or on the fringes of Paris, Marseille, Lyon, Toulouse and Nice

Germany

- With rents continuing to grow, multi-let prime office buildings in well-connected CBD and fringe-of-CBD locations in Berlin, Frankfurt and Munich
- Prime office buildings in the CBDs of tier 2 cities such as Karlsruhe, Nuremberg and Hanover
- Dominant, integrated retail parks in the top 20 German cities
- Given urbanisation trends, last-mile logistics in Germany's major conurbations

Ireland

- Dublin retail parks
- Smart logistics solutions near Dublin's main infrastructure hubs

Italy

- Large-scale logistics properties and last-mile solutions around urban centres, particularly in the northern regions

The Nordics

- Well-located prime CBD office space in Copenhagen, Helsinki and Oslo as well as fringe-of-CBD or the best suburban locations in Stockholm, such as Arenastaden
- In terms of Copenhagen high streets, Strøget-Vimmelskaftet, which has seen strong rental growth resulting in spill-over occupier demand, better availability and rental growth potential in fringe-of-core areas such as Kongens Nytorv
- In Aarhus, Denmark, prime high street properties along Søndergade or Ryesgade, and portfolio deals, as high street units are usually very small
- Discount-focused retail parks and convenience-orientated neighbourhood schemes with positive long-term demand prospects in the greater regions of Stockholm, Uppsala, Halland, Skåne, Västra Götaland, Oslo, Copenhagen, East Jutland and Helsinki
- Modern distribution centres along the main Nordic transport corridors and urban, last-mile facilities near the Nordic capitals

Poland

- Grade A offices on long leases in prime CBD and city centre Warsaw locations with strong transport links, such as Wola
- Centrally located prime offices in Kraków, Wrocław and TriCity, as these markets are becoming more liquid
- Modern distribution centres within strong transport networks such as Wroclaw, Poznań and Szczecin, which are used to fulfil orders from Western Europe

Portugal

- Core offices in Lisbon as well as value-add offices in Lisbon and Porto
- Prime retail property, including in and around the Chiado district in Lisbon
- Logistics property along major transport corridors and near the main ports

Spain

- Fringe-of-CBD offices, particularly around the M30/A2 and M30/A1 axes in Madrid as well as the 22@ district in Barcelona
- Well-located Spanish retail parks and stores offering click and collect or showrooming, particularly in the Malaga and eastern coastal regions as well as the northeast
- Logistics opportunities in the rings around Madrid and Barcelona or in secondary cities with strong demand drivers

United Kingdom

- The London office market, particularly multi-let City of London office buildings
- Logistics units in the southeast, the Big 6 (Birmingham, Bristol, Edinburgh, Glasgow, Leeds and Manchester) as well as Oxford and Cambridge

ASIA-PACIFIC

Australia

- Melbourne's office market over Sydney's, especially Grade B value-add opportunities, and Brisbane offices, which are enjoying cyclical rental uplift
- Well-located neighbourhood retail centres in Sydney, Melbourne and Brisbane that have sizable catchment areas and a defensive mix of retail offerings
- Logistics properties – particularly intermodal terminals – in Melbourne and Sydney

China

- Shanghai offices in growth regions, new CBDs supported by infrastructure (e.g., Pudong) and decentralised business districts
- Distribution centres tied to e-commerce, particularly in satellite cities such as Langfang and Baoding, which serve both tier 1 and inland tier 2 Chinese cities

Japan

- Risk-adjusted Grade B offices as well as multifamily accommodation in Greater Tokyo's sub-core districts
- Mispriced office and multifamily assets in established regional submarkets such as Osaka, Nagoya and Fukuoka

Singapore

- CBD offices enjoying robust rental uplift amid easing new completions
- Last-mile logistics facilities such as accessible distribution centres or ramp-up facilities

Risks in 2019

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Head of Research, Europe
Savills Investment Management

Nicole Bångstad
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Savills Investment Management

Monetary policy

Central banks are continuing to withdraw their stimulus, but at different speeds. The US Federal Reserve is on a tightening cycle, which has created a divergence between its interest rate curve and Europe's. The European Central Bank (ECB) ended its EUR 2.5 trillion quantitative easing (QE) programme in 2018 but is not expected to adjust interest rates until after Summer 2019.

Yet recent Eurozone growth numbers were the weakest since 2014, raising the pressure on the ECB to reassess whether the economy can handle an end to its crisis-era stimulus. Additionally, there are rising concerns that the ECB's long-term liquidity programmes (TLTROs) are nearing maturity at a time when macroeconomic risks are growing, spurring discussions that these may be extended, with another round this year.

The loose monetary conditions have contributed to a favourable commercial real estate (CRE) investment climate in Europe. By historical standards, monetary policy is likely to stay loose past the end of QE, but as negative interest rates have played a role in pushing up asset prices, there are rising concerns over what will happen when the stimulus is withdrawn.

At the same time, the Fed's policy outlook is becoming less clear. The central bank is approaching the bottom end of the estimated range for neutral policy and has highlighted an array of downside risks to the US economy in 2019 that may have been masked by boosts from higher public spending. Moreover, the US interest rate curve (the gap between shorter- and longer-term US Treasury yields) dropped below zero in the beginning of December for the first time since 2007. An inverted yield curve is viewed as a possible indicator of an economic recession in the US.

US-China trade conflict

Trade policy became the biggest risk to the global economy in 2018 as US President Donald Trump shifted his country's previous qualified support for free trade in a protectionist direction. On 15 June the US confirmed that USD 34 billion worth of Chinese goods would be subject to additional tariffs of 25%, with the possibility that another USD 16 billion worth of goods could be targeted. China responded in kind.

The threat to the global economy increased in September when Trump announced a 10% levy on a further USD 200 billion worth of Chinese imports to the US. Signs from China, such as factory output and PMI, demonstrate that the country's economy is under pressure even though the impact of US tariffs has yet to appear in trade data. China has already implemented several economic stimulus measures, and the slowdown could force policymakers to use stronger measures. The weakening economy has also put pressure on the Chinese currency, with the renminbi at a 10-year low against the US dollar.

In early December, President Trump and Chinese President Xi Jinping came to a temporary truce, deciding to postpone planned tariff increases on Chinese goods and pledging to work to lower trade tensions. The news initially led to a broad-based equity market rally and renewed investor optimism, but there remains uncertainty regarding whether tensions will escalate further in 2019 or a new trading framework may be adopted.

The global trade dispute has snowballed alongside other concerning trends in China. Financial markets are becoming more volatile, and the effect of tighter monetary policy, corporate deleveraging efforts and a crackdown on shadow financing have become more apparent in the Chinese economy in 2018.

This is resulting in lower private consumption and investment. Further escalation of US tariffs could push China's current account into deficit. The renminbi could depreciate depending on the size and timing of President Trump's tariff escalation in 2019. Observers expect the People's Bank of China to intervene to dampen volatility.

Europe and the US

A number of European economies slowed in H2 2018. Financial market volatility, protectionism, rising trade tensions, a slowdown in emerging markets and Italian government policy all pose risks. The era of large parties in the centre of the political landscape is coming to an end. Small parties at both ends of the political spectrum are gaining support, particularly those to the far right, which was evident after elections in Germany and Sweden, among others.

The US midterm elections delivered a divided Congress. The Democrats took control of the House of Representatives while the Republicans gained a tighter grip on the Senate. A divided House and Senate implies legislative gridlock resulting in no additional tax cuts, possible slowing deregulation, higher probability of disruptive outcomes in trade policy and temporary government shutdowns.

Furthermore, trade tensions are rising, and Trump could impose car tariffs on Europe. In Italy, high public debt is one of the most pressing problems. If the proposed expansionary policy agenda is fully implemented and opposition to European budget rules intensifies, the populist coalition could damage Italy's debt sustainability and longer-term growth prospects.

The likelihood of anti-austerity measures and tax cuts have caused concerns over Italy's fiscal stability and have resulted in higher government bond yields. This could impact on Italian property yields over the coming period, although some of the anti-austerity measures could result in higher rental growth. However, further political instability and increased cost of lending may call for more careful selection of Italian CRE assets and locations.

Emerging markets

The US is on a fiscally induced rapid growth path combined with quantitative tightening. This is creating a liquidity drain in emerging markets (EMs), with some expected to see economic contraction. Rising concerns about global trade are also contributing to a negative outlook. As global interest rates gradually rise from ultra-low levels, investors are becoming less forgiving of countries with financial, macroeconomic or political vulnerabilities.

EM currencies are at multi-decade lows with, for example, the Argentine peso losing half its value against the US dollar this year and the Turkish lira about one-third. This is, however, also due to the dollar's current strength. We believe that most EM currencies will be able to weather a moderately faster pace of quantitative tightening in the US provided that overall economic conditions remain favourable.

Middle East

There are rising economic risks posed by the complex and deepening tensions in the Middle East. Various proxy wars between Iran and Saudi Arabia have the potential to further destabilise the region. Trump's decision to withdraw from the Iran nuclear deal is likewise a signal that the US is inclined to offer stronger support to its traditional allies in the region, Israel and Saudi Arabia, in coming years.

Heightened geopolitical risk in the Middle East increases the likelihood of volatility in global energy markets. Year-on-year growth in US crude oil production rose in 2018. Expectations that markets will be well supplied despite US sanctions on Iran have led to lower oil prices, with the price of crude oil tumbling almost 30% in Autumn 2018.

Portfolio allocation

Global institutional portfolios of alternative assets are growing more diverse. Asset pricing and high valuations are of concern, and many investors believe equity markets have peaked. According to a Q3 2018 Preqin report, investors' average allocation to real estate is 8.8%, which represents a slight increase from 8.6% in 2015. The risk of sector allocation relates to multi-asset managers' intentions to change allocations for reasons that are not due to changes in real estate fundamentals, which makes the risk difficult to foresee.

As we are approaching the end of the cycle and can expect higher interest rates and weaker equity markets going forward, the allocation to real estate could change. Preqin reports that 27% of investors currently place the real estate market in the recovery/expansion phase, while 56% assess that we have reached the peak. Over the 12 months from the end of Summer 2018, 30% of the institutional investors surveyed responded that they have plans to invest more capital into real estate, while 17% respond that they will invest less than in 2018.

North America and Europe continue to dominate real estate investors' portfolio planning, but Asian-Pacific and other EMs feature highly on the agenda across alternative asset classes. Opportunistic vehicles have captured large amounts of capital over the last year, but there is evidence of investors de-risking real estate portfolios as surveys show the two strategies currently offering the next-best opportunities are core and core-plus.

The intensification of warehouse space in land-constrained London

Lucy Winterburn
Director of Investment and Portfolio Manager
Savills Investment Management

London's population and economy continue to grow.

The mayor's draft New London Plan (2018) proposes a 'good growth' agenda with policies and strategies to maintain the city's global status. It suggests that at least 66,000 new homes must be built – along with space for tens of thousands of new jobs – every year through 2041 to accommodate a projected population rise to 10.5 million. As more people seek to live and work in this vibrant city, land pressures will continue to increase.

Did we mention scarcity of land?

Commercial and residential have long competed over land, with high-value residential uses historically winning the day. Swathes of former industrial land east and west of the city along the banks of the River Thames have been lost to high-value, high-rise development. Where do those displaced businesses go?

There are plenty of industrial land options available in rural areas beyond the M25, but the well-documented structural shift in how we shop – with a growing reliance on e-commerce – has forced many businesses to bring warehouse operations closer to customers. This is driving industrial demand founded on the need for increasingly speedy deliveries, where efficiency of land use is key.

We have seen record lows of available warehouse space in many London industrial submarkets, driving up industrial land values and raising rents to new highs. Our managed estates in Tottenham and Lewisham have seen rents more than double over the last five years, with no signs of abatement.

This relatively recent rental growth phenomenon is not altogether surprising when we consider industrial land loss to alternative uses. The *London Industrial Land Supply & Economy Study 2015* reports that 1,300 hectares of London industrial land was transferred to other uses between 2001 and 2015, representing a 16% contraction over that period.[1] It further warned that if this rate of loss were to continue, levels of industrial land would reach critical levels that could lead to difficulties in market operation.

[1] AECOM, *London Industrial Land Supply & Economy Study 2015*, www.london.gov.uk/sites/default/files/industria_land_supply_and_economy2015.pdf.

1

Urban logistics below or alongside other commercial and residential uses will inevitably become the norm given the increasing need for intensification of warehouse space.

2

3

1 **Aukett Swanke** industrial + residential hybrid design with full-size industrial sheds and market-flexible residential units, creating a friendly new and vibrant model for urban intensification

2 **London** aerial view

3 **Aukett Swanke** internal remodelling of an existing multilevel industrial building that retains industrial uses alongside new research and development as well as workplace opportunities, with public spaces and the potential for residential above

Again, where do those displaced businesses go?

Urban logistics below or alongside other commercial and residential uses will inevitably become the norm given the increasing need for intensification of warehouse space. In recent years we have seen industrial developers beginning to outbid their residential rivals for strategic sites in and around London.

In April 2018, Gazeley acquired a six-acre plot in the London Docklands to speculatively develop the UK's first three-storey logistics facility totalling 426,000 square feet. Gazeley acquired the site from a residential developer – a sign of the times.

In another example, the City of London Corporation has battled it out with Amazon to secure the 42-acre Barking Power Station site in East London at prices that will set a new benchmark for industrial land values in the locality. The London Corporation is looking to consolidate its three food markets in one location, unlocking three valuable core London sites (Canary Wharf, Farringdon and Leyton) for redevelopment.

London land is in scarce supply and is undoubtedly a valuable commodity, and the intensification of use is a given. The value creation that intensification brings is recalibrating land prices that developers and occupiers can afford to pay, while scarcity of supply continues to support rental value growth to unprecedented levels. The opportunity is obvious.

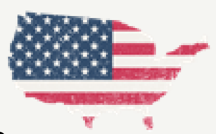
The case for European retail investment

Ian Jones
Portfolio Manager
Savills Investment Management

Given the press coverage of apparent retailer woes in the UK and US, it is difficult not to sympathise with the general investor trend to avoid the sector. However, this would, from our perspective, be to miss a significant investment opportunity across Europe.

"Europe's historic fabric has led to a highly urbanised population structure, with retail facilities often benefitting from high catchment areas and relatively low travel times."

2,000 *square metres of retail space*



per 1,000 people in the US

vs.

180 *square metres of retail space*

per 1,000 people in Germany

227 *square metres of retail space*

per 1,000 people in Italy

245 *square metres of retail space*

per 1,000 people in Spain

Source: Statista

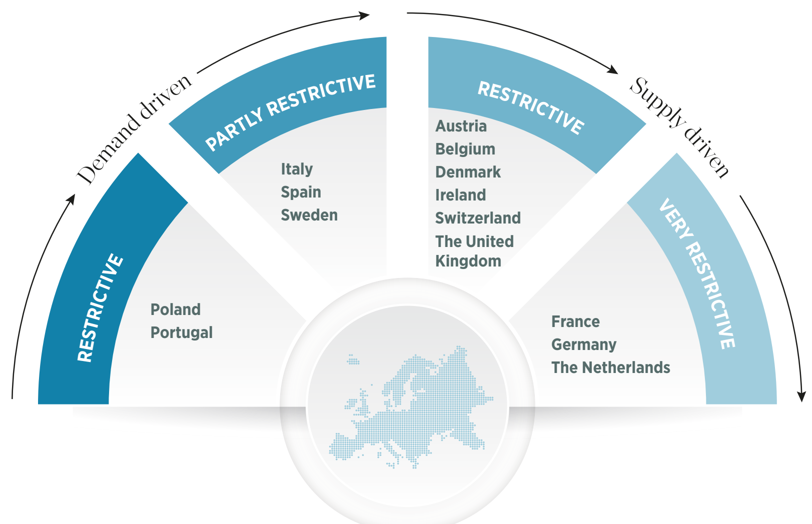
First, the retail landscape in the US is very different from Europe, with a dramatic discrepancy in retail provision: 2,000 sqm of retail space per 1,000 people in the US compared to around 180 sqm per 1,000 in Germany, 227 in Italy and 245 in Spain, according to Statista.

US retail space has grown mainly because of more laissez-faire planning policy, resulting in US retail becoming commoditised: one shopping mall is much like another. The retail landscape is dominated by shopping centres, which tend to be anchored by department stores, which, in Europe, typically only have a sales density of around 50%.

The European retail landscape is more diverse. The high street remains an integral part of shopping patterns, and shopping centres are anchored by grocery stores, which remain an important driver of footfall. Europe's historic fabric has led to a highly urbanised population structure, with retail facilities often benefitting from high catchment areas and relatively low travel times. Distinctive local cultures, legal and planning systems create a heterogeneous environment.

E-commerce in the US is centred on the younger population. But travel times also tend to be longer, and the commoditised nature of shopping centres offers little incentive.

European planning systems



Sources: Cushman & Wakefield Research, Savills Investment Management

What of online?

There is no doubt that European retailers are fully aware of the threats and opportunities offered by online and are reacting to capitalise on them. Yet physical stores remain an essential part of an omnichannel policy. Retailers remain hungry for the right locations and unit configurations.

For our active retail funds, we tend to focus on those properties offering either convenience or experience. For the former, we seek properties in easy reach of a substantial population, often anchored by grocery, pharmacy or daily needs. These could be established smaller shopping centres or retail parks in urban locations.

In the case of experiential retail, the shopper makes a conscious decision to travel to a location because of the quality of the experience and offering – this could apply to attractive high street locations with a blend and breadth of high quality retail as well as food and beverage experiences, or to the dynamic outlet centre market with its focus on strong operational management.

From our perspective, retail investment offers a compelling investment rationale. Markets' recent focus on the office and logistics sectors has, from our perspective, created a buying opportunity, with general pricing for retail assets now at an attractive discount to those sectors.

How best to capitalise on this opportunity?

A local platform is essential. Given the heterogeneity mentioned earlier, a team that is culturally embedded in a country and able to navigate the particular legal and planning environment is crucial, both at the transaction level and to implement efficient and proactive asset management strategies. Having a market presence is also crucial so that the best opportunities can be sourced, often off market. Specialised tax and debt teams are also vital to optimise distribution and internal rate of return (IRR).

Our core European Retail Fund has continued to outperform the market since inception in 2012, producing a 9% net IRR to date,[1] with a weighted average unexpired lease term of nine years, negligible vacancy and extremely high tenant quality. Our new high-income retail fund Euro V has spent its first-close equity during its first year of investment and is already making distributions with significant valuation increase.

[1] Net of all fees and charges

Commercial real estate debt:

the rise of alternative lending in Europe

Dale Lattanzio
Managing Partner
DRC Capital

Before 2008, bank lenders dominated CRE due to the Basel I framework's favourable regulatory capital environment. According to Cass Business School, banks provided roughly 95% of all outstanding debt in the form of traditionally funded bilateral loans held on their proprietary balance sheets.

In 2008, following the global financial crisis (GFC), Europe's CRE lending landscape changed dramatically as high-leverage CRE lending became very expensive for banks under the new Basel II regulatory capital rules. This trend has continued as regulators have introduced further reforms under Basel III and IV.

Such regulatory activity forced the banks to retrench, resulting in a massive reduction in both the amount of debt and the level of leverage available for European CRE, creating a funding gap that alternative lenders filled upon entering the market.

The vast majority of CRE debt in Europe has traditionally been held by banks rather than insurance companies or alternative lenders. The European debt market is likely to continue to evolve into a more balanced and efficient lending market similar to the US, where the banks hold approximately 40% of all outstanding CRE debt versus a far greater proportion provided by alternative lenders. The role of alternative lenders in Europe should continue to expand for the foreseeable future, providing much needed diversification from the historically bank-dominated landscape.

> **Alternative lenders are entering the CRE lending market with increasing speed.**

Since the GFC, a stronger and more balanced recovery has allowed the CRE market to recover substantially. While equity returns currently remain positive, they are more likely to be driven by income rather than capital growth for the next few years.

The lack of available debt means that the current recovery will not match the highs of the previous economic cycle, when debt was more freely provided by banks. This supply-demand differential allows alternative lenders to achieve higher income returns for investors while taking less property risk, which is increasingly important as we enter the later stages of the current cycle. This supports the case for investment in CRE debt, where attractive returns are available and, in certain cases, may be greater – on a risk-adjusted basis – than those generated by direct CRE investment strategies.

CRE debt investment can target specific areas of the risk-return spectrum. Managers offer various strategies depending on investor risk appetite. These can range from senior debt to whole loans to high-yield debt. Today, investors can target gross returns ranging from 4% to more than 12% depending on loan structure and level of property risk.

Risk management is an important part of any debt-based strategy. It begins with portfolio construction that allows diversification by asset class and geography, enhancing risk-adjusted returns for investors. Additionally, active asset management, facilitated by strong loan-level covenant packages, plays an important role in risk mitigation throughout the life of individual loans.

Alternative lenders are entering the CRE lending market with increasing speed. During the first half of 2018, new loan originations in the UK lending market finished 27% higher than lending volumes 12 months prior. Alternative lenders with balance sheets of GBP 1-5 billion accounted for 53% of the GBP 22.5 billion of new loans originated during that time.

The total 2018 lending volumes are set to exceed the GBP 45-55 billion seen in each of the previous four years, and alternative lenders are taking a growing share of the new origination market. We expect this to continue as new capital enters the space vacated by banks, propelled by investors seeking yield-based income and stable returns in the later part of the market cycle.

Note: figures in this article are sourced from *Cass UK Commercial Real Estate Lending Report.*

How Savills IM is furthering the Sustainable Development Goals

Lucy Auden
Global Head of ESG
Savills Investment Management

In 2015 the United Nations (UN) General Assembly agreed on 17 global, value-driven targets to guide worldwide sustainable development. Built on the formerly agreed Millennium Development Goals, the Sustainable Development Goals (SDGs) sit at the heart of the 2030 Agenda for Sustainable Development, which was adopted by all UN member states in 2015, making the goals' adoption and impact global.

The SDGs include targets to sustainably protect the environment; end worldwide inequalities including gender, poverty and hunger; and promote peace and prosperity for current and future populations, with the intention to 'leave no one behind.'

Coming into effect in January 2016, the SDGs solidify the connection between business activities and environmental and social factors such as economic growth, innovation, sustainable consumption and climate change.

There are clear opportunities to support the mission of SDGs within the real estate investment industry. Working to further the SDGs in all Savills Investment Management (Savills IM) operations has become part of our obligation to manage portfolios in an environmentally and socially responsible way, on our clients' behalf. Here we provide examples of Savills IM projects and initiatives that are serving the aim of various SDGs.

The focus on quality of space, health and wellbeing in industrial assets is a new and exciting concept, but one we feel makes perfect commercial sense in light of an occupier market where social aspects are increasingly material.

JO BUCKLEY
Assistant Portfolio Manager
Savills Investment Management

2 ZERO HUNGER

End hunger, achieve food security and improved nutrition and promote sustainable agriculture

We are furthering goal #2, Zero Hunger, by promoting the installation of food banks at Savills IM retail assets that have food and beverage company tenants. With circa 88 million tonnes of food wasted annually and a rising number of families living below the poverty line, this is increasingly important.

At a retail asset in Växjö, Sweden, Savills IM has engaged with the food industry tenant to stress the importance of combatting hunger and malnutrition. The tenant collaborates with local churches, homeless charities and sports clubs to distribute food that would otherwise be thrown away daily.

3 GOOD HEALTH AND WELLBEING

Ensure healthy lives and promote well-being for all at all ages

Savills IM's proposal to develop two industrial buildings in the English town of Didcot, Oxfordshire, promotes the health and wellbeing of tenants. The development is designed to allow for WELL Standard accreditation and adheres to high standards of indoor air quality, nourishment, light, movement, sound and mental health.

7 AFFORDABLE AND CLEAN ENERGY

Ensure access to affordable, reliable, sustainable and modern energy for all

We are also capitalising on renewable energy to further goal #7, Affordable and Clean Energy. Savills IM has powered 100% of the heating and cooling system of a mixed-use residential/retail asset in Spain using geothermal energy. The eco-friendly system provides highly efficient, radiant underfloor heating and cooling as required, more than halving annual energy consumption and expenditure.

9 INDUSTRY, INNOVATION AND INFRASTRUCTURE

Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation

The aforementioned Didcot development also furthers goal #9 – Industry, Innovation and Infrastructure – by using health and wellbeing enhancements to challenge the stereotype that industrial real estate assets are merely a low cost, basic specification and functional area of the market that has little regard for future proofing, sustainable innovation or social benefit.

15 LIFE ON LAND

Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss

Recognising the connection between natural surroundings and mental health, the Didcot design also features attractive landscaped gardens, woodland walking routes, outdoor seating and even a grass-covered amphitheatre providing communal areas for employee socialisation during breaks from shift work. These elements incorporate goal #15, Life on Land, which is furthered by an office building owned by the Charities Property Fund. In order to promote biodiversity in the asset's Central London location, the property has been fitted with bird boxes and insect hotels.

Guidelines for the use of the SDG branding

SUSTAINABLE DEVELOPMENT GOALS

The SDGs provide a plethora of opportunities for real estate investment managers to further sustainable development and the 2030 UN Agenda.

At Savills IM, we are aligned with and working to further the goals in innovative ways that impact the environment and communities in a sustainable way.

The Asia-Pacific century

Lee Tredwell
Head of Investment, Australia
Savills Investment Management

Asia-Pacific continues to evolve as the world's fastest-growing and arguably most dynamic region. Since the turn of the century it has outperformed the US and Europe in terms of GDP growth, reports Oxford Economics, and its share of the global economy continues to rise, forecast by the International Monetary Fund to reach 40% by 2023.

Drivers of this growth directly impacting real estate include:

Favourable demographic and population trends

The younger and faster-growing population feeding into the workforce increases occupier demand and creates larger pension fund pools from earnings needing to invest.

Rising urbanisation

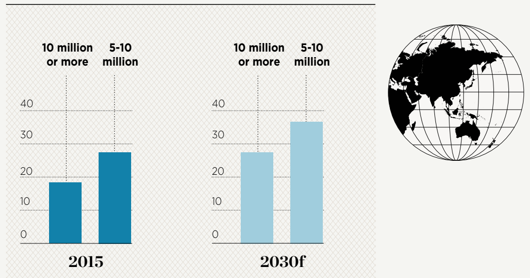
Asia-Pacific already has 17 megacities, of which 12 are among the worlds' top 20 megacities (population over 10 million). The United Nations expects that by 2030, the region will have 7 new megacities and over 30 cities with populations above 5 million.

Structural transformation alongside a growing middle class

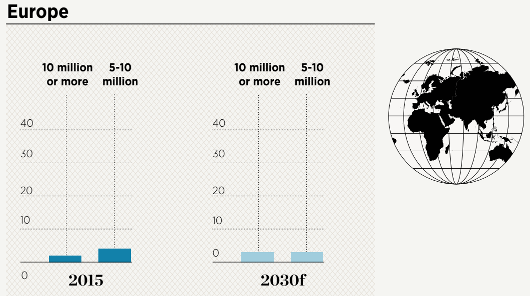
Asia-Pacific has evolved from a historically manufacturing and exports-driven region into a services and consumption focused one. By 2030 the United Nations projects that the region will account for 60% of the world's middle-class wealth. This will drive retail and tourism spend and, in turn, demand for retail space and logistics (via growing e-commerce) as well as various forms of accommodation.

Number of megacities by region

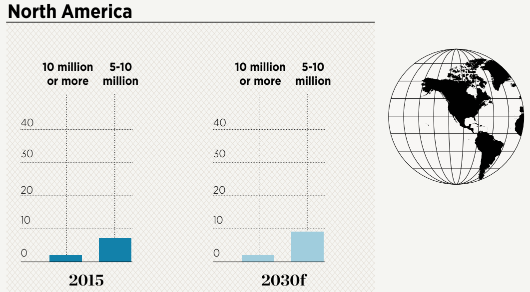
Asia-Pacific



Europe



North America

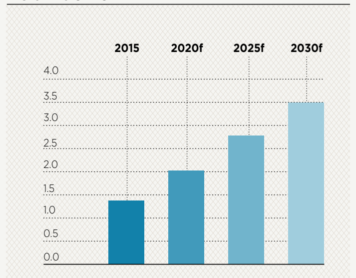


Source: United Nations, Department of Economic and Social Affairs, Population Division, *World Urbanization Prospects: The 2018 Revision*, https://population.un.org/wup/Download

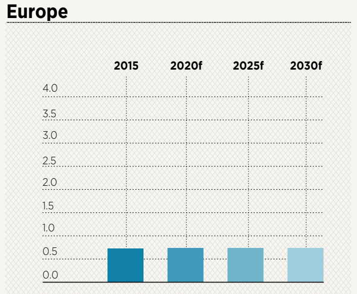
Note: 'f' denotes forecast.

Forecast middle-class population by region (billion, 2015-30)

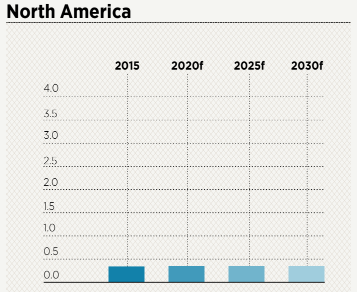
Asia-Pacific



Europe

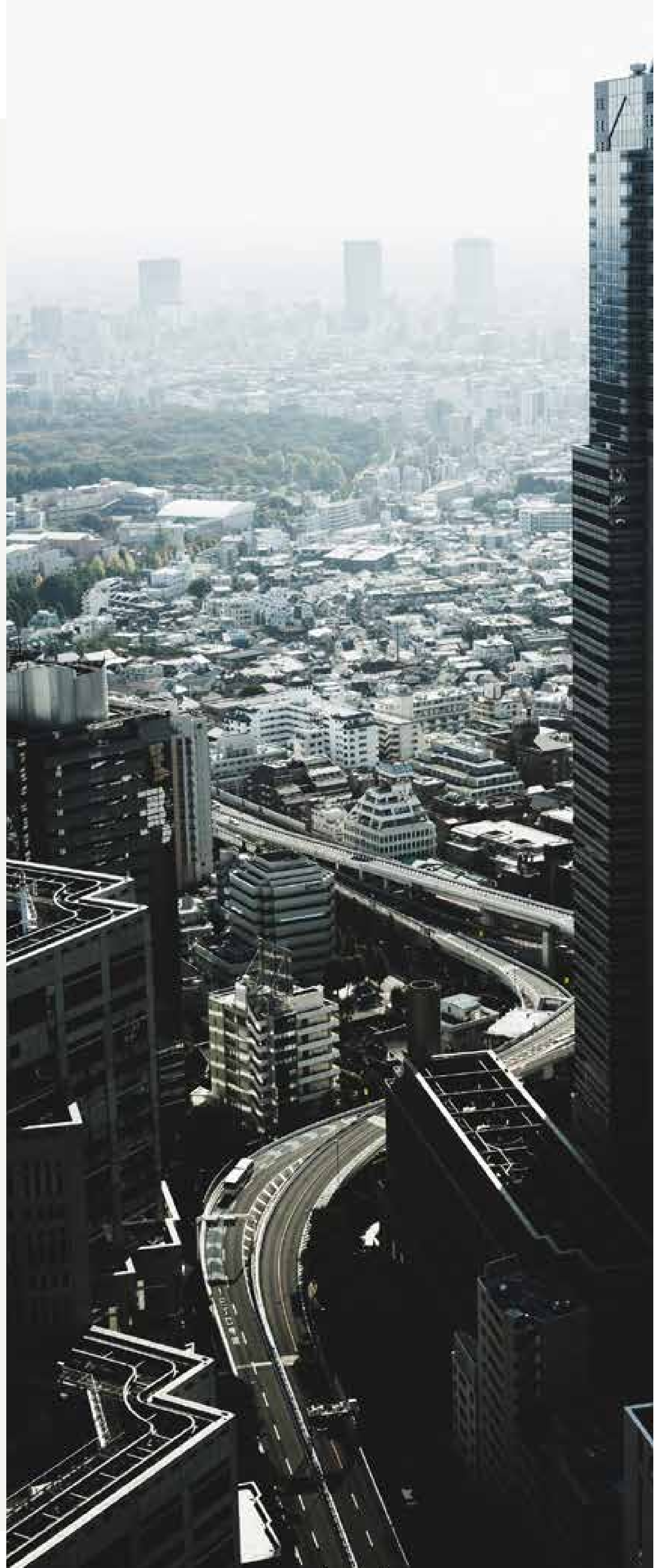


North America



Source: Statista

Note: 'f' denotes forecast.



From a real estate investment perspective, the region has traditionally been seen as more of a value-add or opportunistic play. However, that view has changed since the GFC, when many of Asia-Pacific's major markets weathered the global downturn far better than the US and Europe, showing the benefit of global diversification.

Intraregional differences offer investors the opportunity to further diversify, with a mix of highly developed economies such as Japan, Australia, Singapore and South Korea; emerging economies such as Vietnam, Malaysia, Indonesia and Thailand; as well as the world's second largest economy, China, and its established global gateway cities of Hong Kong and Shanghai.

The rapidly changing global political and economic climate creates multiple risks and opportunities for investors to navigate in the region. The US-China trade war (and increased political tensions across the Pacific since the beginning of the Trump administration) likely has the largest potential to impact growth, markets and currencies regionally.

Given these risks and the current position of the real estate cycle, we strongly favour investment in the more developed, highly liquid markets and asset classes with resilient income. We believe growth will be driven by income as opposed to further wholesale capitalisation rate compression.

In the event of a full-blown trade war with reduced trade as well as tariffs, we believe office demand would be hardest hit. This may lower demand in some of the more cyclical markets exposed to regional or global events, such as Hong Kong and Singapore.

We believe investments in logistics around the region (particularly Australia and Singapore), lower-volatility office markets (such as Melbourne and major cities in Japan), the Japanese multifamily segment (which is benefitting from long-term stable occupancy and consistent demand) together with selective retail investments (prime CBD, convenience and transport-orientated centres) will provide investors with resilient income and mitigate some of the risks.

We also favour moving further up the capital stack and investing real estate debt in markets such as Australia, where it is possible to take advantage of the equity cushion and structural shift in the banking industry.

Challenges and opportunities in the expanding global REIT market

Thomas Körfgen
Managing Director
Savills IM KVG GmbH

The outlook for the listed real estate investment trust (REIT) market is positive at the time of writing this piece. REITs are attractively valued and have healthy fundamentals, with strong operating performance, high occupancy rates and strong rental growth. The REIT model is also expanding globally. Countries such as China, Poland and Sweden are working to establish REIT status.

Based on our proprietary model, global REITs may provide a 10% total return in 2019. The underperformance of REITs compared to other equity sectors on the stock market in recent quarters reflects rising interest rates in 2018. Nonetheless, REITs have historically performed well amid rising interest rates and solid economic backdrop.

> **"In the current competitive environment it is of utmost importance to choose only those companies with a strategy in line with future requirements."**

REITs' overall valuation is low. In Europe, they trade at an average discount to net asset value (NAV) of more than 10% (figure 1). As of Q3 2018, more than 60% of the market capitalisation was trading at a discount.

Figure 1: Average discounts in Europe

	End-Sept 2018	Year to Sept 2018	1 year	2 years	3 years	5 years	10 years	15 years	20 years
Europe	-10.2%	-9.4%	-9.3%	-9.2%	-6.4%	-3.5%	-10.4%	-8.7%	-11.6%
Non-UK Europe	-6.6%	-6.4%	-6.1%	-5.5%	-1.9%	0.2%	-9.1%	-5.0%	-6.5%
Austria	1.2%	2.3%	0.3%	-5.7%	-9.5%	-16.4%	-34.0%		
Belgium	28.2%	25.5%	25.0%	24.7%	24.9%	20.2%	8.4%	10.2%	6.6%
Finland	-20.7%	-24.3%	-23.1%	-21.8%	-21.8%	-20.8%	-26.2%	-20.4%	-24.0%
France	-14.5%	-11.2%	-10.6%	-10.3%	-6.4%	-3.0%	-7.8%	-6.6%	-8.3%
Germany	-0.4%	-3.7%	-4.0%	-4.1%	-0.8%	1.2%	-15.7%	-10.9%	
Italy	-22.6%	-20.7%	-19.6%	-26.9%	-28.0%	-31.0%	-42.5%	-38.4%	
Netherlands	-21.5%	-14.9%	-11.9%	-5.7%	2.8%	9.5%	-4.6%	-1.0%	-3.4%
Norway	-14.0%	-15.4%	-13.5%	-14.6%	-15.5%	-15.2%	-21.6%		
Spain	-11.4%	-5.6%	-6.5%	-7.5%	-4.9%				
Sweden	-1.1%	-8.0%	-8.3%	-8.2%	-2.8%	1.6%	-4.8%	-2.2%	-4.8%
Switzerland	6.0%	8.1%	-7.3%	7.1%	4.9%	0.4%	-2.9%	-3.5%	-2.2%
UK	-19.9%	-17.3%	-17.4%	-18.0%	-16.3%	-10.8%	-12.6%	-13.5%	-17.2%
Ireland	-6.8%	-6.4%	-5.5%	-7.2%	-4.8%				

Source: European Public Real Estate Association (EPRA)

REIT valuation varies across countries and sectors, however. While REITs in Italy, the Netherlands, Finland and the UK trade approximately 20% below NAV, Belgian REITs trade at a premium of nearly 30% (figure 1). Due to structural challenges in the retail sector, REITs focusing on retail trade at a discount of circa 27% while REITs with an emphasis on industrial trade at a premium of up to 20% (figure 2). More than ever, the key to the right REIT exposure is stock selection rather than index tracking.

The spread between the loan-to-value (LTV) ratio of REITs versus non-REITs remains historically wide. We continue to believe that this level will remain stable, keeping financial risk for listed REITs low, even in a rising interest rate environment (figure 3). The average dividend yield has risen this year, but we expect dividend yields to be stable in 2019.

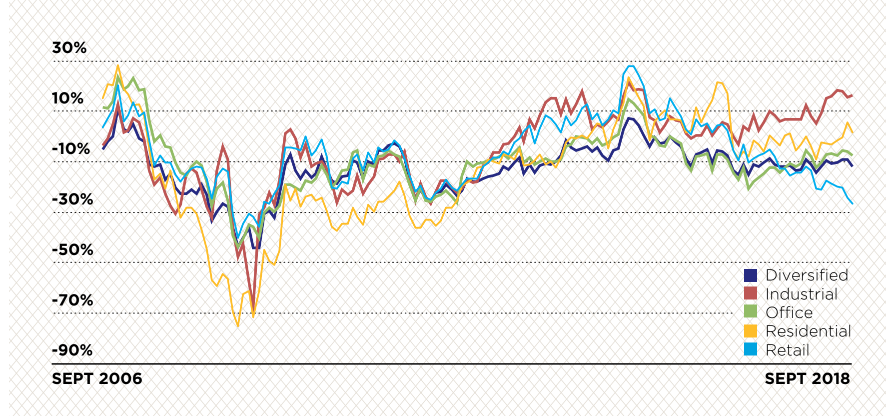
While real estate companies in developed markets yield on average below 3.0%, developed-market REITs yield 4.4%. By taking an active approach while investing in conservative companies, a yield above 5.0% is achievable (figure 4).

Due to their structure, most REITs are flexible. Flexibility will be both one of the major challenges and opportunities for real estate companies in the future.

Real estate is no longer just about location and price, but also connectivity and digital infrastructure. Boundaries between sectors are blurring, with mixed-use properties becoming more pervasive.

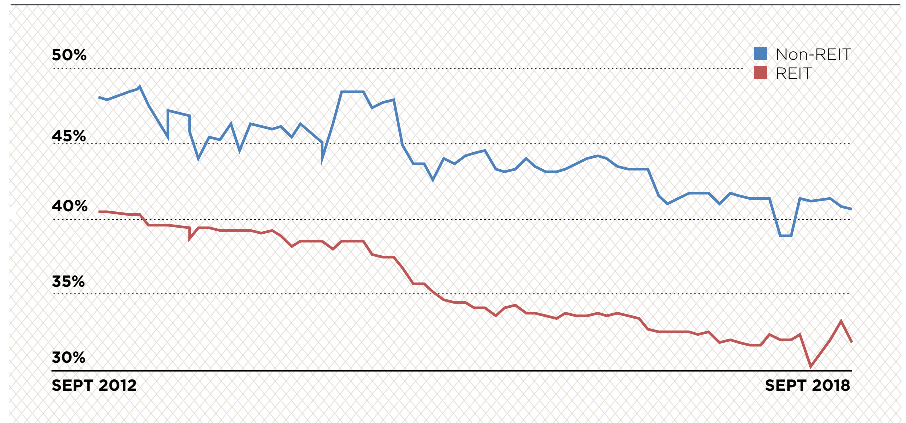
In this competitive environment it is of the utmost importance to choose only those companies with a strategy in line with future requirements. Those able to adapt their strategies and policies at an early stage may be more successful in the long run.

Figure 2: FTSE EPRA Nareit Europe sector indices discount to published NAV



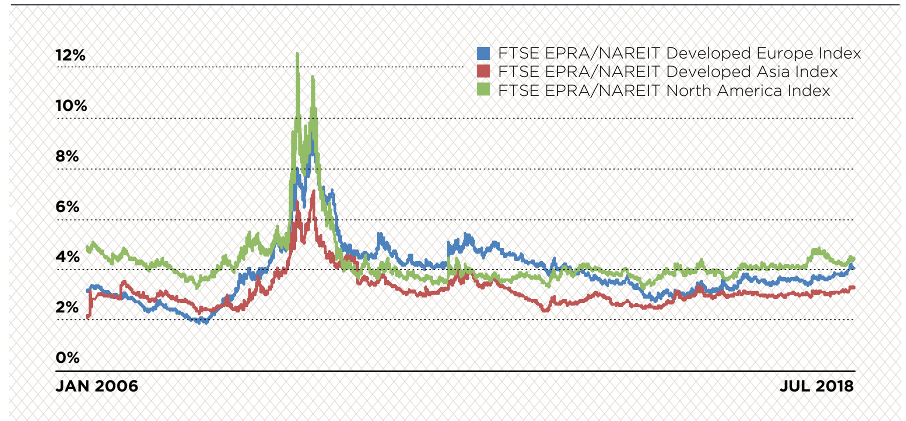
Source: EPRA

Figure 3: Historical LTV ratio: REIT vs. non-REIT



Source: EPRA

Figure 4: Dividend yields



Source: EPRA

Extracting value from REIT rotation:

the case for Spain

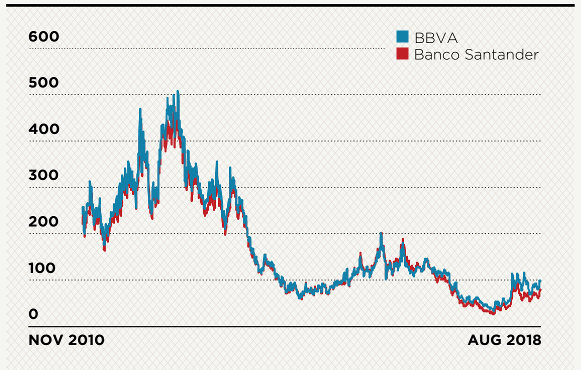
Fernando Ramírez de Haro
Head of Spain and Portugal
Savills Investment Management

The phoenix rises

Spain was hit hard by the global financial and Eurozone crises. Indeed, the six-year period between 2008 and 2014 is known as the Great Recession in Spain. The housing market collapsed, development all but ceased, bank exposures to non-performing loans soared and the unemployment rate rocketed to 27%, according to Eurostat, leading to an exodus of talent. This culminated in a EUR 100 billion bail-out by the European Stability Mechanism.

Fast forward to the end of 2018 and Spain is enjoying above-average growth. The unemployment rate is now below 15% and continues to decline, according to Eurostat. Banks have gone through a significant deleveraging program and de-risking process while shoring up their balance sheets (figure 1).

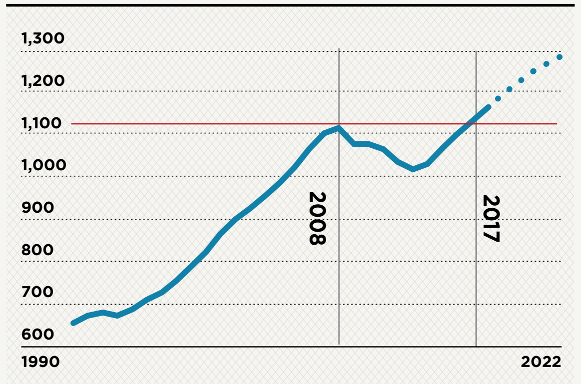
Figure 1: Credit default swap prices (2010-18)



Source: Bloomberg

Although the pace of economic growth is moderating, reflecting a global increase in downside risk, Spain's GDP has only just exceeded the level seen at the peak of the last cycle (figure 2). Our view is that Spain is not as far along in the cycle as other countries and has more growth to come.

Figure 2: GDP (EUR billion)



Source: Oxford Economics
Notes: dashed line indicates forecast; red line indicates maximum level of GDP at the previous cycle peak.

The country's economic recovery has been positive for Spanish real estate markets. Rents are rising due to supply-demand imbalance, with increasing consumption and employment driving take-up across the major sectors. Lack of development throughout the GFC and moderate new supply since then have kept stock levels low across sectors.

The investment market is characterised by a scarcity of Grade A product. Spain is also seeing capitalisation rate compression alongside other European countries, as well as increased demand from international investors, including end-investors in Spanish REITs, or SOCIMIs.

> **“Spain is seeing capitalisation rate compression alongside other European countries, as well as increased demand from international investors, including end-investors in Spanish REITs.”**

The maturing SOCIMI market

SOCIMIs were first introduced in 2014. The combination of renewed international demand to gain exposure to Spain together with updated Spanish REIT regulations created the perfect environment for international investment in the Spanish real estate market.

Between April and July 2014, four REITs were established – Hispania, Grupo Lar, Merlin and Axiare – with a total equity of EUR 2.5 billion raised. Since then, SOCIMIs have been one of the most active players in the Spanish market.

In 2014-15, the SOCIMIs gained exposure through asset and corporate acquisitions, originating their current portfolios. Four to five years in, the SOCIMI market is starting to mature, and over the last six months, we have begun to see the following trends emerge:

CORPORATE CONSOLIDATION
Blackstone taking over Hispania and Colonial acquiring Axiare have consolidated Inmobiliaria Colonial and Merlin as the main players in terms of assets under management.

SPECIALISATION
Following the American trend, each SOCIMI has specialised in what its management does best. We see specialisation in offices, retail and hotels.

CAPEX PROGRAMMES
After the first years of aggressive deployment, SOCIMIs have focused their new investment on capital expenditure (capex) to improve the quality of their stock in order to enhance rental value and returns.

PORTFOLIO ROTATION
Now that the lock-up statutory period of three years has elapsed, the SOCIMIs have decided to rotate part of their non-core assets (total disposals in 2018 amounted to EUR 802 million).

As key REIT players rotate their portfolios to crystallise gains, dispose of assets and rebalance portfolios in a market with significant available dry powder, we anticipate high transaction volumes through 2019, both in core-plus and value-add transactions.

The key factors driving success in Europe's dynamic cities

Victoria Ormond
Senior Research Analyst
Savills Investment Management

Judith Fischer
Research Analyst
Savills Investment Management

Urbanisation, new technology and changing demographics are just a few of the factors driving changes in Europe's CRE markets. Despite this fluid environment, 8 cities retained a top 10 position in the 2018 Savills IM Dynamic Cities index compared to the previous year.

RANK 2018	RANK 2017	OVERALL	Infrastructure	Interconnection	Inclusion	Inspiration	Innovation	Investment
1	1	London	London	London	Cambridge	London	London	London
2	3	Cambridge	Paris	Paris	Dublin	Cambridge	Cambridge	Paris
3	2	Paris	Cambridge	Berlin	London	Prague	Paris	Stockholm
4	4	Amsterdam	Oslo	Munich	Oxford	Amsterdam	Munich	The Hague
5	5	Berlin	Prague	Copenhagen	Edinburgh	Reykjavik	Oxford	Milan
6	7	Dublin	Brescia	Frankfurt am Main	Basel	Oxford	Amsterdam	Zurich
7	6	Munich	Copenhagen	Barcelona	Luxembourg City	Edinburgh	Eindhoven	Munich
8	14	Oxford	Stockholm	Amsterdam	Bristol	Berlin	Basel	Amsterdam
9	15	Basel	Dublin	Innsbruck	Zurich	Florence	Stockholm	Lausanne
10	8	Stockholm	Vienna	Gothenburg	Lausanne	Basel	Berlin	Rotterdam
11	10	Zurich	Bern	Vienna	Amsterdam	Dublin	Lausanne	Nottingham
12	9	Edinburgh	Zurich	Bonn	Brussels	Vienna	Dublin	Bristol
13	16	Lausanne	Berlin	Stockholm	Barcelona	Madrid	Zurich	Madrid
14	19	Copenhagen	Lausanne	Leipzig	Manchester	Rome	Luxembourg City	Geneva
15	24	Luxembourg City	Istanbul	Brussels	Newcastle upon Tyne	Paris	Barcelona	Manchester
16	25	Bristol	Basel	Madrid	Berlin	Copenhagen	Copenhagen	Dublin
17	21	Frankfurt am Main	Bergen	Milan	Munich	Lausanne	Ljubljana	Oslo
18	12	Vienna	Amsterdam	Geneva	Geneva	Munich	Brussels	Frankfurt am Main
19	13	Oslo	Helsinki	Brescia	Frankfurt am Main	Ljubljana	Frankfurt am Main	Reading
20	11	Madrid	Brussels	Oslo	Madrid	Seville	Bristol	Berlin

City success is about more than size

Larger cities with a higher population are, of course, likely to offer a greater volume and scale of investment opportunities, but this is not what the Savills IM Dynamic Cities index sets out to measure. Rather, it serves to highlight those cities that have a strong long-term investment foundation via their ability to capture talent, embrace disruptive technology and thrive in the knowledge economy.

While supercity London kept its number one position, Cambridge's rise to second place as well as the higher scores achieved by smaller cities such as Dublin, Oxford and Basel demonstrate that they are well positioned to grow in influence over the coming years.

In our fast-evolving, increasingly urbanised world, real estate investors must now consider a broader range of factors influencing cities, especially in Europe, which stands among the most urbanised regions worldwide. Such dynamics are essential considerations to future proofing investments and securing higher returns.

London ranked first for a second consecutive year in 2018, followed by Cambridge, Paris, Amsterdam, Berlin, Dublin and Munich; newcomers Oxford and Basel; and Stockholm. The majority of 2017's top 40 cities consolidated their places in this year's index by increasing their scores, underlining their continued progress.

Our analysis also shows that over the last 20 years the top 10 dynamic cities have collectively outperformed the EU-28 overall in terms of GDP and employment growth, providing a backdrop for stronger CRE investment performance.

The index analyses and ranks 130 European cities across six categories – Infrastructure, Interconnection, Inclusion, Inspiration, Innovation and Investment – and works on the basis that top cities will perform well across all categories. It highlights those cities able to attract and retain talent, spur innovation and increase productivity, which encourages the wealth and population growth that foster successful CRE markets.

Infrastructure projects driving outperformance among UK cities

Several of the highest-ranking UK cities are the target of infrastructure projects. These include the opening of a new railway station in Cambridge, Crossrail in London and HS2 in Birmingham and Manchester.

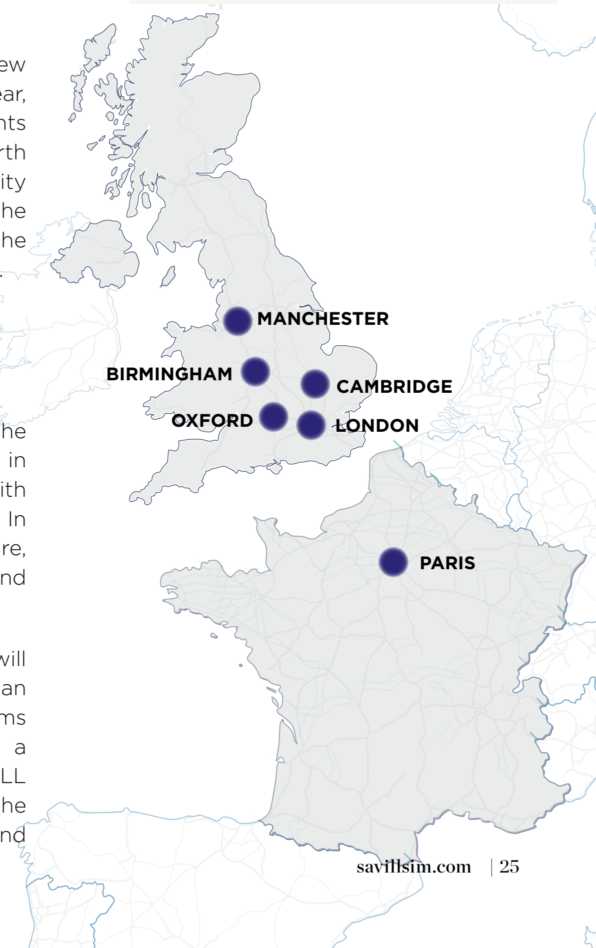
London's position atop the index for a second consecutive year also comes down to its range of knowledge-based industries, population growth forecasts and diversified workforce. The city's strong human capital is expected to expand further, supported by initiatives such as the London 2050 plan and transformation of the Greenwich Peninsula, a formerly underdeveloped area that is fast becoming a vibrant community for living, working and recreation. Both projects underline the scale of London's ability for self-improvement.

Cambridge, which ranked second in 2018, has faced housing pressures of late, but an average of 2,000 new homes are completing each year, including residential developments in Trumpington Meadows and North West Cambridge. Fellow UK university city Oxford, which climbed into the top 10 in 2018, was earmarked by the government for 100,000 new homes.

Paris to be shaped by a major urban development project

The French capital is one of the most liquid investment markets in Europe, second only to London, with a diverse international investor base. In 2018 it ranked second on Infrastructure, Interconnection and Investment, and third on Innovation.

Parisian real estate markets will be shaped by the Grand Paris urban development project, which aims to transform Greater Paris into a sustainable metropolitan area. JLL reports that this is set to double the size of the metro network by 2030 and create thousands of jobs.



European real estate market view

PMI figures painted a rather weak picture of Eurozone growth in Q4 2018. On top of yet another decline in manufacturing output, services sector activity also slowed. Given the difficult external environment, a deterioration in the Eurozone economy would be a blow to growth prospects in 2019. Regardless, current projections are for a continued modest recovery in economic growth over the next few years, aided by loose monetary policy.

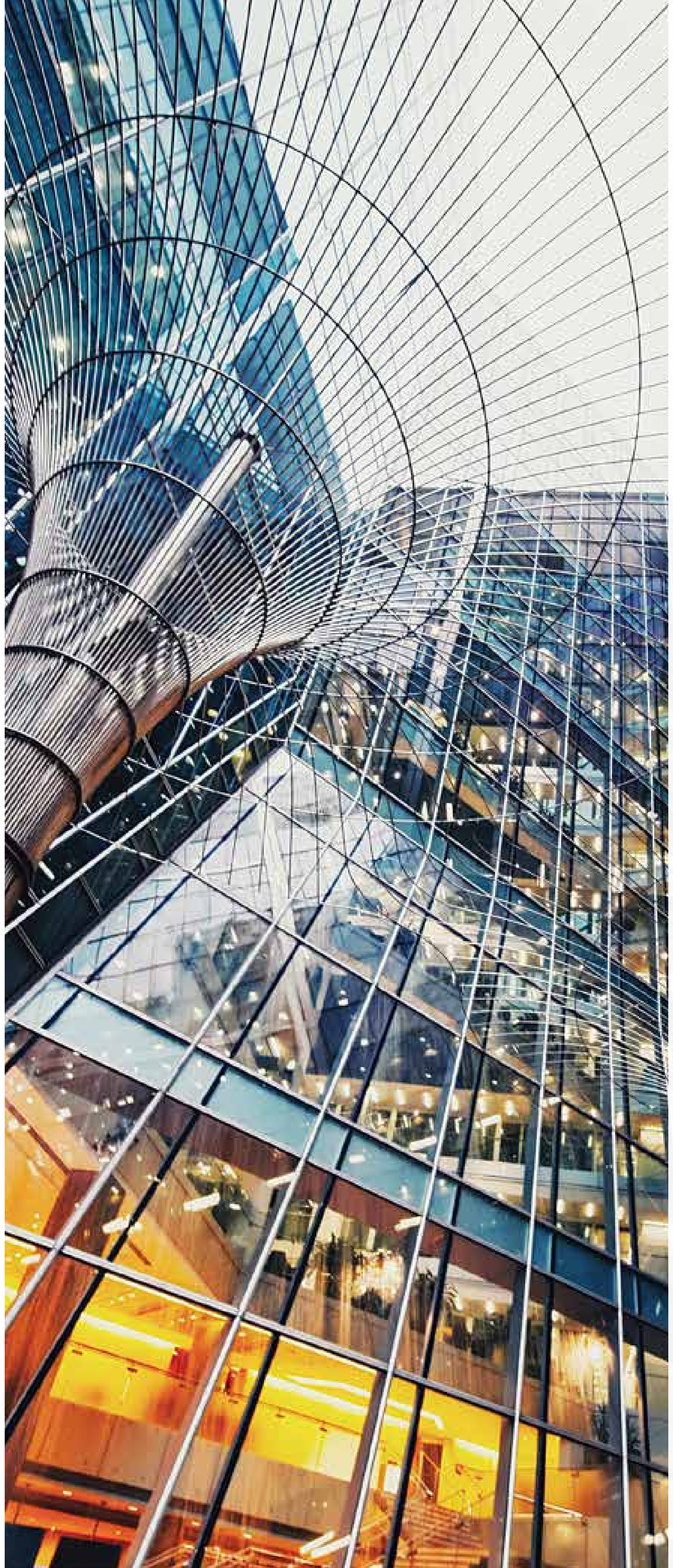
The ECB remains calm amid fiscal troubles in Italy and France. Lack of contagion in peripheral bond markets means that the central bank can continue to focus on its inflation mandate and taper its quantitative easing programme. Yet material deteriorations in the growth and inflation outlooks could force the ECB to consider additional measures to support the bloc's economy in 2019.

Consumer spending remains a key driver of economic growth, with demand supported by improving labour market conditions and low interest rates. An increase in energy prices could temper household spending recovery. Countries forecast to enjoy the strongest consumer spending growth include Ireland and Poland, whereas France, Belgium and Italy are projected to underperform.

EU-US trade tensions moderated after they agreed to work together to eliminate transatlantic trade barriers for many industrial goods and to reform the World Trade Organization. For now, the two sides agreed to put on hold any new tariffs. Italy's budget plan is putting the country's populist coalition government under pressure via rising sovereign debt yields and the fact that the plan's spending priorities flout EU budget rules.

Brexit negotiations are underway following the triggering of Article 50 of the Lisbon Treaty on 29 March 2017. The pound may suffer headline volatility, but its path in the year ahead will likely be dictated by the economy, not Brexit.

Globally, a trade war between the US and China and tighter US monetary policy have the scope to trigger a financial market response, weakening growth prospects.



OFFICE

According to JLL, robust occupier demand pushed European office take-up to 3.3 million square metres (sqm) in Q3 2018, representing the strongest Q3 in 10 years. While the European aggregate was up 4% year on year (y/y) in Q3, activity in both Western Europe (+3% y/y) and Central and Eastern Europe (+5% y/y) increased. This performance underlines the continued strength of the office occupier market.

As of Q3, Brexit headwinds had so far not had a significant impact on occupier activity. In Germany, office take-up continued apace, but total take-up for the first three quarters of 2018 was down on the same period the previous year.

Occupiers are finding it increasingly difficult to secure Grade A space in the key European office markets. While the development pipeline will provide some breathing room in Amsterdam, one of Europe's tightest markets, it is likely that take-up will level out in the short term.

European office vacancy continued to decrease in Q3, dropping 20 bps to 6.5%, reports JLL. The office development cycle continues to pick up, with office completions coming in at 0.9 million sqm. Looking ahead, JLL expects vacancy to stabilise between 7.0% and 8.0% as the development pipeline increases in 2019.

The JLL European Office Rental Index rose 2.4% quarter on quarter in Q3, with 15 of the 24 key markets seeing rental growth. In Europe, prime office rental growth reached 6% y/y, reflecting that supply-demand imbalances persist in many markets across the region. Prime office rents increased in Amsterdam, Barcelona, Berlin, Budapest, Frankfurt, Glasgow, Hamburg, London, Madrid, Munich, Oslo, Paris, Rotterdam, The Hague and Warsaw, but remained stable elsewhere.

RETAIL

On the back of economic growth and decreasing unemployment, European countries are experiencing an increase in retail sales. In many cases, retail sales volumes were boosted by price discounting. Retailer profit margins continue to be squeezed by increasing competition, especially from e-commerce. Retailers will likely remain cautious about expanding store networks, closing or disposing of nonperforming stores and brands.

The available supply of quality retail space on Europe's best high streets and in its best shopping centres is limited, but the availability of secondary space remains high. Moreover, shopping centre owners are seeing the need to increase their capex to maintain footfall.

Overall, shopping centre development has been well below average for the past three years. PMA expects completions to increase y/y in 2019. Retail park development has also been rising and is likely to have increased in Q3, notably in France. Small or outdated schemes are also being future proofed via redevelopment and refurbishment.

Except for in Brussels, where prime retail rents declined, prime high street retail rents either increased or remained stable in Q3. PMA expects stable demand for limited available space to result in prime rental growth in key European retail markets in 2018.

INDUSTRIAL

Occupier demand for logistics remained strong in Q3, boosted by growing e-commerce. With availability low, demand is moving beyond core logistics locations, and build-to-suit activity is increasing. As space requirements remain strong, urban logistics could see innovative approaches to address demand, resulting in a multi-stage model for logistics real estate.

Speculative completions of logistics units have increased, but there is a shortage of vacant, prime and modern space in Europe's core logistics hubs. Urban logistics is set to be one of the most significant growth markets over the next few years as e-commerce continues to grow across Europe.

JLL data suggest that prime logistics rents increased in Budapest and Lyon in Q3 2018 but remained stable elsewhere in Europe. According to Cushman & Wakefield Research (C&W), although rents have been flat for larger logistics facilities, there is growing demand and competition for smaller urban logistics units on the edge of cities. Operators streamlining their supply chains is driving higher rents for these smaller facilities, a trend that is set to continue over the long term.

Weight of money and yields

Preliminary data from Real Capital Analytics (RCA) suggest that all property investment volumes for transactions valued USD 2.5 million or more in core European markets declined in Q3: the total European investment volume of EUR 49.5 billion in Q3 2018 was 30% lower than Q3 2017.

Germany was the dominant market, followed by the UK, Spain, the Netherlands and Sweden. Approximately 50% of transactions were cross border.

According to RCA, no one sector or geography led the Q3 y/y slowdown. This suggests there may be nothing more behind it than a general reassessment of where markets are in the cycle. Indeed, much of the industry talk is of late-cycle tactics and how investors can find value in a crowded market.

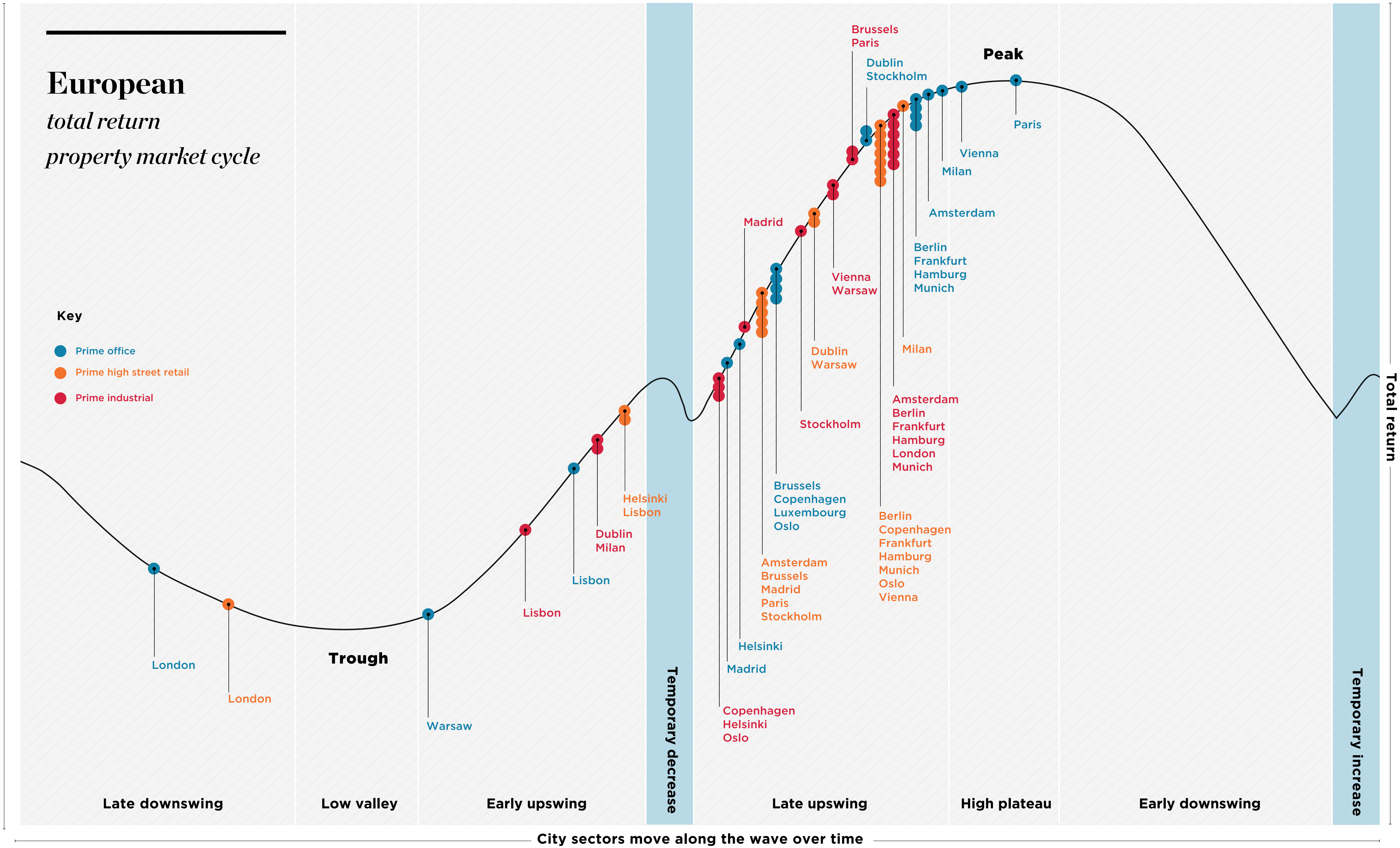
Perceptions of elevated geopolitical, trade protectionism, capital protection measure and economic risk could possibly constrain real estate investment across Europe. However, recent volatility in the equity and bond markets, as well as stretched market valuations, reinforce the case for real estate investment, as property can provide long, stable income flows and potential opportunities to add value through active asset management.

Intense competition for limited property supply in core markets continues to exert downwards pressure on yields, with prime yields declining in a number of markets in Q3 2018. Despite Brexit-related uncertainty, prime London office yields remained stable. However, yields in some UK markets could come under upwards pressure if Brexit negotiations start to falter.

There is sufficient momentum in the real estate market going into Q4 2018 to result in prime yields on average moving lower. With interest rates rising in the US and the UK and the tapering of the Eurozone's quantitative easing programme, we expect yield compression to be limited going forwards.

As the risks to income are likely to be higher for secondary property than for prime, yields for secondary assets may also come under upwards pressure as a result of lower growth forecasts, investors' flight to safety and expectations that lenders will have less appetite to lend on such assets.

European
total return
property market cycle



Sources: PMA, Savills Investment Management
Note: relative property market cycle points based on total return index.

Austria

OFFICES

While slowing external demand is increasingly weighing on Austria's manufacturing outlook, Oxford Economics expects domestic demand to remain robust and supportive of GDP growth in the months ahead. After a couple years of subdued development activity, completions increased strongly in 2018, according to EHL. Demand rose as well, with average rents showing upwards movement while prime rents remained stable. Due to challenging purchase prices in Europe's key office markets, smaller markets such as Vienna are back on investors' radar.

RETAIL

Vienna remains one of the top five European locations for international retailers, according to EHL, particularly as the city steadily gains popularity with tourists. Furthermore, positive labour market prospects are supportive of employment and wage growth as well as household incomes and consumption, according to Oxford Economics. However, retailers are increasingly focusing only on prime pitches, which is why overall high street completions and prime rental growth have come to a standstill, according to EHL. Nonetheless, high street properties remain a sought-after investment product.

INDUSTRIAL

Austria's logistics market benefits from its location in the heart of Europe. With close proximity to large economies and as a historic gateway to Central and Eastern European countries, central and eastern Austria contain the country's logistics hot spots. Increasing e-commerce is shaping both the mega-shed and last-mile logistics segments, according to CBRE, driving supply and demand as well as rents and yields.

Vienna	PRIME RENTS (EUR/sqm/year) 2018	2019f	PRIME YIELDS (%) 2018	2019f
OFFICES	306	→	3.50%	→
HIGH STREET	4,800	→	3.50%	→
INDUSTRIAL	78	→	6.40%	→

Source: Savills Research
Notes: 'f' denotes forecast; data as of Q3 2018.

OUR PICKS

We favour multi-let Grade A Vienna CBD offices on short leases where we can add value by increasing rents through active asset management.

Liquidity is key, which is why investments should fit the city's market size and liquidity.

We are cautious of retail facilities countrywide due to oversupply risk.

We would consider distribution and last-mile logistics facilities in the Vienna region as well as fulfilment centres in the regions of Linz and Graz.

Belgium

OFFICES

Continued employment gains, resilient household spending and solid investment point to a stable economic outlook for Belgium in 2019. While the corporate sector dominated office take-up in 2018, increased public sector demand is likely over 2019-20. JLL expects more speculative completions to push the Brussels vacancy rate back up from the 8.0% recorded in Q3. Despite projected office rental stability, the Brussels CBD yield spread remains significant compared to the Munich or Paris office markets.

RETAIL

Oxford Economics expects Belgian retail sales to grow at a faster pace in 2019, largely driven by e-commerce. Although online sales still account for a relatively small share of overall retail spending in Belgium compared to other European countries, they are growing quickly. Vacancy is likely to continue to trend upwards, particularly in secondary and tertiary locations, putting downwards pressure on rents. After years of continuous compression, prime yields seem to have bottomed out, but C&W expects them to pick up this year and next.

INDUSTRIAL

Demand for semi-industrial space is likely to remain stable, while logistics deals are decreasing in number and size due to evolving trends in urban logistics and automation, C&W reports. The strong demand for logistics warehouses in densely populated urban areas alongside rising e-commerce has led to an increase in land values. Meanwhile, almost all logistics developments are turnkey projects, C&W reports. The outlook for headline rents and yields in prime locations remains stable.

Brussels	PRIME RENTS (EUR/sqm/year) 2018	2019f	PRIME YIELDS (%) 2018	2019f
OFFICES (LEOPOLD)	305	→	4.30%	→
HIGH STREET	1,850	→	3.15%	→
INDUSTRIAL	58	→	5.50%	→

Sources: Cushman & Wakefield Research, Savills Research, CBRE
Notes: 'f' denotes forecast; data as of Q3 2018.

OUR PICKS

Despite projected office rental stability, we continue to recommend Brussels offices, as they offer an attractive yield play.

We also like Belgium logistics assets with multimodality and those located along the Brussels-Antwerp corridor where land values are on the rise.

Denmark

OFFICES

Copenhagen's occupier market is benefitting from high demand, particularly the CBD, which is forcing tenants to less central parts of the Danish capital. There is rising interest in shared workspace and serviced offices, resulting in an expansion of existing operators and entrance of new players. The office pipeline has increased, with some speculative construction in response to the healthy occupational market. A combination of improving economic outlook and population growth has also led to more positive prospects for the fringe-of-core office market.

RETAIL

E-commerce growth continues to influence and reshape demand for retail, but strong tourism has led to an influx of international retailers in the prime high street area of Copenhagen's city centre. As it has become increasingly difficult to find investment opportunities in this segment, however, we expect a continued shift towards strong fringe-of-core high street locations in Copenhagen. Favourable demographics and positive economic outlook in regional cities such as Aarhus have also placed them on the Danish retail map.

INDUSTRIAL

Expanding e-commerce and strong economic backdrop in Denmark have led to a boom in occupational and investor demand for modern, efficient logistics facilities, for which vacancy rates are currently low. Limited availability of land, among other factors, has constrained supply of such premises, which has led to strong demand for older stock as well. There has been a shift away from the traditionally owner-occupied market due to rising interest from foreign investors. Denmark's logistics supply chain may eventually benefit from the planned Fehrman Belt Fixed Link tunnel connecting the country to Germany.

Copenhagen	PRIME RENTS (EUR/sqm/year) 2018	2019f	PRIME YIELDS (%) 2018	2019f
OFFICES	255	↗	3.75%	→
HIGH STREET	3,217	→	3%	→
INDUSTRIAL	80	→	5.75%	→

Source: Cushman & Wakefield Research
Notes: 'f' denotes forecast; data as of Q3 2018.

OUR PICKS

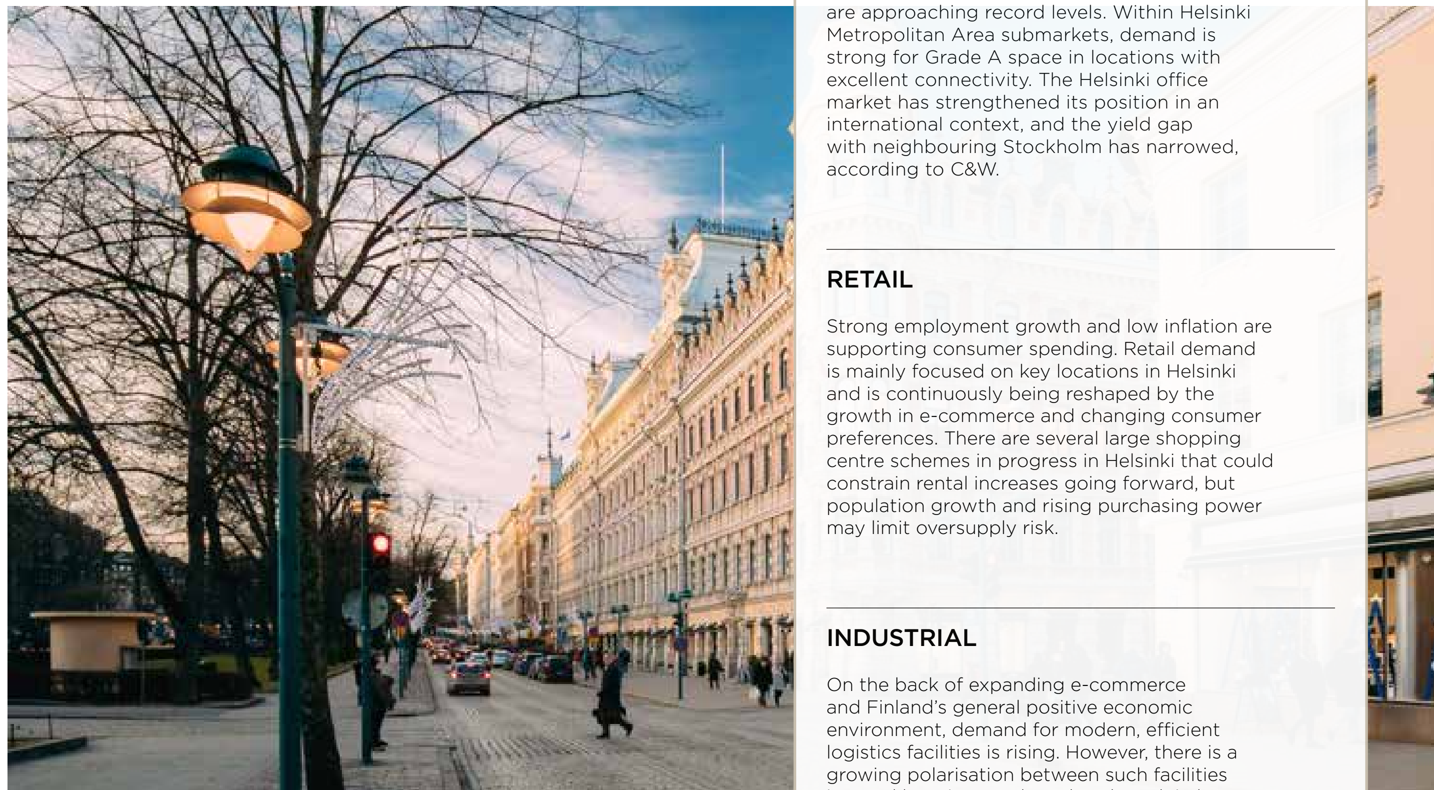
In terms of the office market, we recommend well-located prime CBD office space in Copenhagen.

In the Danish capital, strong high street rental growth around Strøget-Vimmelskaftet has resulted in spill-over occupier demand in fringe-of-core areas such as Kongens Nytorv, where better availability and rental potential may be found.

We also recommend targeting prime high street properties along Søndergade in Aarhus, or Ryesgade for its high footfall from the central station. As high street units are usually very small, portfolio deals are appealing.

We also prefer modern distribution centres along the main Danish transport corridors and urban, last-mile facilities around Copenhagen.

Finland



OFFICES

The strength of the Finnish economy combined with lower all-in borrowing costs makes Helsinki CBD offices a favourable investment. Office vacancy rates have decreased, and prime rents are approaching record levels. Within Helsinki Metropolitan Area submarkets, demand is strong for Grade A space in locations with excellent connectivity. The Helsinki office market has strengthened its position in an international context, and the yield gap with neighbouring Stockholm has narrowed, according to C&W.

RETAIL

Strong employment growth and low inflation are supporting consumer spending. Retail demand is mainly focused on key locations in Helsinki and is continuously being reshaped by the growth in e-commerce and changing consumer preferences. There are several large shopping centre schemes in progress in Helsinki that could constrain rental increases going forward, but population growth and rising purchasing power may limit oversupply risk.

INDUSTRIAL

On the back of expanding e-commerce and Finland's general positive economic environment, demand for modern, efficient logistics facilities is rising. However, there is a growing polarisation between such facilities in good locations and outdated stock in less-desirable ones. New supply is mainly build-to-suit.

Helsinki	PRIME RENTS (EUR/sqm/year) 2018	2019f	PRIME YIELDS (%) 2018	2019f
OFFICES	441	↗	3.50%	→
HIGH STREET	1,644	→	4.10%	→
INDUSTRIAL	111	→	5.50%	↘

Source: Cushman & Wakefield Research
Notes: 'f' denotes forecast; data as of Q3 2018.

OUR PICKS

Underpinned by improving economic fundamentals, well-located prime CBD office space could see further rental growth.

Occupier demand is likely to improve further for prime logistics products, and we like modern distribution centres along the main Finnish transport corridors and urban, last-mile facilities near Helsinki.

France

OFFICES

Despite moderate economic slowdown, the office occupier market has remained stable. Vacancy rates remain low in the Paris CBD, inner suburbs and La Défense, but elevated in the Western Crescent. Greater Paris Region prime yields are stable, while regional office yields in Nantes, Bordeaux, Lyon and Lille are tighter. Global investors continue to target French offices, driven by the market depth; attractive risk-adjusted, long-term returns; and stable leasing environment.

RETAIL

Soft economic growth and weak consumer confidence in recent quarters failed to put a dent in household spending, which continues to grow at a moderate pace. Sales volumes have shown some resilience, particularly in the food and beverage, home equipment and leisure goods segments. Small units on prime Parisian and luxury streets as well as in new-generation retail parks offer rental growth potential. Rents for other retail formats, however, are likely to decline. Occupier and investor demand for core retail stock are forecast to remain steady, while softer, more selective demand for second-tier and secondary markets may lead to yield adjustments for the most vulnerable assets.

INDUSTRIAL

E-commerce growth continues to fuel occupier activity in the French logistics market. The logistics corridor regained momentum in 2018, driven by the Greater Paris Region, Lille and Marseille markets, while activity in Lyon remains limited. The XXL size segment continues to play a central role, and strong take-up levels have kept supply relatively low, putting upwards pressure on rents. Although we believe market average investment yields have plateaued, some of the core markets may see further yield compression.

Paris	PRIME RENTS (EUR/sqm/year) 2018	2019f	PRIME YIELDS (%) 2018	2019f
OFFICES (CBD)	850	↗	3.00%	→
HIGH STREET	19,000	→	3.50%	→
INDUSTRIAL	55	↗	4.75%	↘

Sources: Cushman & Wakefield Research, PMA

Notes: 'f' denotes forecast; data as of Q3 2018; reference market for high street is Avenue des Champs-Élysées.

OUR PICKS

In our view, there is better value in regional offices, particularly in Lyon.

In terms of retail, Paris prime high street shops are fairly valued, but we see opportunity in western and southwestern France due to positive sociodemographic and economic growth.

We prefer modern distribution centres in the logistics corridor and recommend urban logistics in or on the fringes of Paris, Marseille, Lyon, Toulouse and Nice.

Germany

OFFICES

Despite soft sentiment data readings of late, Germany's economy remains in good shape. The backdrop for office space demand is positive, as office-based employment growth is likely to persist through 2023, according to PMA. Scarce supply remains the bottleneck in the short term, driving rental and capital value growth prospects.

RETAIL

Real wage growth, low unemployment and overall positive economic conditions should underpin consumer spending growth. While store-based retail sales are growing moderately, e-commerce sales are increasing more rapidly. The competition between retail formats is evident in the decreasing high street market share of fashion retailers, which remain the most active tenants on German high streets, according to BNP Paribas Real Estate (BNPPRE). Although prime shop rents may have peaked, prime yields could compress further in the short term, suggests PMA.

INDUSTRIAL

Germany's logistics market remains at full steam. Third-party logistics providers and online retailers are contributing strongly to excess demand, according to BNPPRE. While scarce supply of modern logistics space is still limiting take-up, it is also driving prime rental growth. With prime yields still above 4%, it is hardly surprising that investors remain focused on logistics properties.

		PRIME RENTS (EUR/sqm/year) 2018	2019f	PRIME YIELDS (%) 2018	2019f
OFFICES	Berlin	418	↗	2.90%	→
	Cologne	270	→	3.50%	→
	Düsseldorf	330	→	3.30%	→
	Frankfurt	480	↗	3.00%	→
	Hamburg	306	→	3.00%	→
	Munich	438	↗	2.90%	→
HIGH STREET	Berlin	3,780	→	3.10%	→
	Cologne	3,540	→	3.60%	→
	Düsseldorf	3,480	→	3.10%	→
	Frankfurt	3,720	→	2.80%	→
	Hamburg	3,720	→	3.10%	→
	Munich	4,440	→	2.50%	→
INDUSTRIAL	Berlin	56	↗	4.40%	↘
	Cologne	60	→	4.60%	↘
	Düsseldorf	65	→	4.60%	↘
	Frankfurt	72	↗	4.40%	↘
	Hamburg	67	→	4.40%	↘
	Munich	82	↗	4.40%	↘

Sources: Cushman & Wakefield Research, Savills Research

Notes: 'f' denotes forecast; data as of Q3 2018.

OUR PICKS

We continue to recommend multi-let prime office buildings in well-connected CBD and fringe-of-CBD locations in Berlin, Frankfurt and Munich, where core-plus properties may allow investors to achieve increased rents and capital values via active asset management.

We also like prime office buildings in CBD locations in tier 2 cities such as Karlsruhe, Nuremberg and Hanover.

While we are selective regarding German high street properties, we still recommend dominant, integrated retail parks in Germany's top 20 cities.

In the context of increasing urbanisation, we also like last-mile logistics in Germany's major conurbations.

Ireland

OFFICES

Ireland's low unemployment and strong office-based employment growth provide a positive office market backdrop. Take-up is largely characterised by expansions or relocations. The technology, media and telecommunications sector continues to drive demand, and there are growing requirements for flexible office leases. Despite new supply coming through this year, much has been pre-let, and PMA suggests that rental growth prospects are likely to remain bright in the medium term.

RETAIL

Encouraging employment dynamics and middle-income tax cuts in Budget 2019 should underpin consumer spending growth. Despite moderate increases in online shopping, Ireland's e-commerce penetration lags countries such as the Netherlands and the UK, reports CBRE. While retail yields remain stable, Savills Research expects job creation to be a primary driver of rental growth over the medium term. Discounting has, however, become more widespread over the past two years, emphasising the importance of rightsizing retail space.

INDUSTRIAL

Limited available high quality, modern industrial and logistics stock contributed to lower take-up in H1 2018. Nonetheless, Dublin's Q3 2018 volume was the highest since Q4 2015, according to CBRE. Healthy investor appetite and low vacancy mean we should continue to see upwards pressure on prime rents. Domestic supply chains are likely to become more efficient to accommodate trends in e-commerce and potential Brexit effects, driving logistics demand.

Dublin	PRIME RENTS (EUR/sqm/year) 2018	2019f	PRIME YIELDS (%) 2018	2019f
OFFICES (2/4 DISTRICTS)	646	→	4.00%	→
HIGH STREET (ZONE A)	6,750	↗	3.50%	↘
INDUSTRIAL	100	↗	5.10%	↘

Sources: Cushman & Wakefield Research, Savills Research

Notes: 'f' denotes forecast; data as of Q3 2018.

OUR PICKS

We still recommend Dublin retail parks given the persistent jobs growth and strength of the Irish economy.

Logistics availability is limited and competition fierce, therefore we suggest targeting smart logistics solutions near Dublin's main infrastructure hubs.

Italy

OFFICES

Italy's moderating growth outlook, political uncertainty and high debt exposures lifted the risk-free rate over the latter part of 2018. Despite this challenging environment, prime office rents increased, supported by strong employment growth. Competition for limited stock also pushed prime office yields to a record low. Should Italian bond rates remain elevated and investors able to continue to hold rather than crystallise their assets, we might see a reduction in office market activity.

RETAIL

Italy is seeing double-digit e-commerce growth, but overall sales penetration remains among the lowest in Europe. While countrywide GDP growth is muted, cities such as Milan, Rome and Venice continue to see strong tourist flows, supporting their luxury retail segment offering. Milan in particular has benefitted from shopping tourism, with its GDP now comfortably above the previous cycle peak. On a rent-relative-to-footfall basis, Milan and Rome look attractive. Several international and domestic chains, especially in the value space, are also planning expansions across the country.

INDUSTRIAL

Limited supply, particularly of core product, and sustained demand from e-commerce supported industrial rents and yields over 2018. Italy is seeing occupier demand for both large-scale centres and last-mile solutions around urban centres. Lack of supply led some investors to move somewhat up the risk curve last year, but demand for core product persists. Despite cooling economics and political uncertainty, logistics yields remain on the right side of bond yields and are relatively attractive compared to the European average.

		PRIME RENTS (EUR/sqm/year) 2018	2019f	PRIME YIELDS (%) 2018	2019f
OFFICES (CBD)	Milan	570	↗	3.50%	→
	Rome	420	→	4.00%	→
HIGH STREET	Milan	13,500	→	2.75%	→
	Rome	11,500	→	2.75%	→
INDUSTRIAL	Milan	52	→	5.50%	↘
	Rome	55	→	6.25%	↘

Sources: Cushman & Wakefield Research, Savills Research

Notes: 'f' denotes forecast; data as of Q3 2018.

OUR PICKS

Central Milan's economic outperformance relative to the rest of Italy creates opportunity for offices there.

Tourism-led footfall and consumer spending are, similarly, beneficial for retail pitches such as Via Montenapoleone, Via Dente and Corso Vittorio Emanuele II in Milan.

Despite possible contagion risk from country-level political and financial uncertainty, yield compression in 2018 and the prospect of further demand growth alongside increasing e-commerce make the logistics sector appealing.

Luxembourg

OFFICES

Luxembourg's economy is likely to expand at a solid, albeit slower, pace in 2019, with the financial and insurance sector set to be a key driver of growth. According to Savills Research, Luxembourg City could also benefit from Brexit relocations, with as many as 2,000 employees likely to move to the city over the course of two years. The CBD and Kirchberg office markets are, however, under supply pressure: strong take-up levels and limited new completions led to vacancy rates of less than 3% and 1%, respectively, in Q3 2018, CBRE reports. The development pipeline for 2019 and 2020 should, however, somewhat ease supply pressures.

RETAIL

Healthy macroeconomic fundamentals should benefit the Luxembourg retail sector this year. Oxford Economics expects household disposable incomes to grow by 3.8% in 2019, while retail sales growth should pick up to 2.2%. Prime retail rents are likely to remain stable, according to C&W, as several new schemes have boosted activity, and competition for the best stock remains strong.

Luxembourg City	PRIME RENTS (EUR/sqm/year) 2018	PRIME RENTS (EUR/sqm/year) 2019f	PRIME YIELDS (%) 2018	PRIME YIELDS (%) 2019f
OFFICES (CBD)	600		4.20%	
HIGH STREET	2,160		3.25%	

Sources: Savills Research, Cushman & Wakefield Research
Notes: 'f' denotes forecast; data as of Q3 2018.

OUR PICKS

We recommend the Luxembourg City office market, which could benefit from Brexit-related relocations and, therefore, increased need for office space.

Demand-supply dynamics should support office rental values.

The Netherlands

OFFICES

The outlook for the Dutch economy remains positive and supportive of office demand, especially in cities such as The Hague and Rotterdam as it becomes increasingly difficult to secure space in Amsterdam's key districts. Tight vacancy in the Dutch capital is likely to put upwards pressure on rents, and incentives are on the decline. Investor sentiment should remain positive. Yields in prime locations could compress further, C&W reports.

RETAIL

Consumption growth is likely to continue into 2019 thanks to very low unemployment levels and strong employment growth, which should benefit the retail sector. The retail market recovery started with a decline in retailer bankruptcies, heightened conversion activity and improving take-up, which we anticipate will reduce vacancy. On the investment side, market polarisation is likely to continue, with investors preferring high quality retail space in the top cities – including Amsterdam, Rotterdam, The Hague, Utrecht and Eindhoven – where prime high street yields could decline further, according to C&W.

INDUSTRIAL

In line with the wider European trend, e-commerce growth is fuelling demand for Dutch logistics space. The share of online spending in the Netherlands is lower than in the UK and Germany, indicating there is still potential for expansion over the next few years. According to Savills Research, rents are likely to increase due to lower incentives. Dutch logistics yields have compressed since 2013 and are now moving towards 4.5% in prime locations, Savills Research reports.

Amsterdam	PRIME RENTS (EUR/sqm/year) 2018	PRIME RENTS (EUR/sqm/year) 2019f	PRIME YIELDS (%) 2018	PRIME YIELDS (%) 2019f
OFFICES (CBD)	410		4.00%	
HIGH STREET	3,000		3.00%	
INDUSTRIAL	95		5.25%	

Sources: Cushman & Wakefield Research, Savills Research
Notes: 'f' denotes forecast; data as of Q3 2018.

OUR PICKS

We recommend modern office buildings west of the South Axis in Amsterdam as well as Rotterdam office buildings, which are trading close to their replacement cost.

We also recommend logistics opportunities in the major logistics hubs of Noord-Brabant, Limburg and Zuid-Holland.

With further e-commerce growth potential, Dutch logistics could benefit from rising rents and further yield compression.

Norway

OFFICES

Economic growth is strong in Norway, fuelled by an increase in oil investments. Demand for office space is robust, especially in central locations, but companies are using less space per employee. Union expects supply to stay low until 2020, after which rising vacancy may limit rental growth. Transaction volumes remain high, but foreign investors became net sellers for the first time this year since 2012.

RETAIL

With the increase in e-commerce, online and offline sales formats are blurring, and segments such as click-and-collect are expanding. The discrepancy between more and less attractive retail assets is also becoming more pronounced, making investors more cautious. The outlet segment, however, looks resilient and is seeing expansions of existing players and strong growth in sales turnover, particularly compared to shopping centres.

INDUSTRIAL

Investors are drawn to the Norwegian logistics sector's potential for long, stable income streams and positive outlook due to rising private consumption and e-commerce trends. Rental growth is likely for smaller warehouses and mixed-use schemes, which typically attract small- or medium-sized tenants, with particularly strong demand in the Groruddalen area.

Oslo	PRIME RENTS (EUR/sqm/year) 2018	PRIME RENTS (EUR/sqm/year) 2019f	PRIME YIELDS (%) 2018	PRIME YIELDS (%) 2019f
OFFICES	474	↗	3.60%	→
HIGH STREET	2,575	→	3.75%	→
INDUSTRIAL	118	→	5.25%	↘

Source: Cushman & Wakefield Research
Notes: 'f' denotes forecast; data as of Q3 2018.

OUR PICKS

We recommend well-located prime CBD office space in Oslo.

We also like modern distribution centres along the main transport corridors as well as urban, last-mile facilities around Oslo, such as in the Groruddalen area.

Poland

OFFICES

Poland is one of the fastest-growing European economies, according to Oxford Economics. Its office market is benefitting from this as well as Brexit-related relocations of firms such as Goldman Sachs and J.P. Morgan from London to Warsaw. These factors are driving high levels of occupier activity. While rents are currently trending higher, future supply remains a constraint, which dampens both rental growth prospects of future lettings and potential capital growth through 2023, according to PMA.

RETAIL

Rising wages, low unemployment, still low inflation and strong private consumption are supporting the Polish retail sector, according to C&W. Demand is currently shifting more towards food and beverage as well as leisure formats, and online retail is growing, with Statista predicting strong e-commerce revenue growth over the next couple years. Prime rents for high street retail and shopping centres remain largely stable.

INDUSTRIAL

Poland's logistics market is benefitting from strong economic growth as well as growing demand from domestic and cross-border online retailers. Amazon and Zalando have already opened a number of distribution hubs close to the German border and in other well-connected logistics locations in Central Poland and Silesia. Despite record-high construction pipelines, vacancy remains close to historic lows, and the gap between headline and effective rents is shrinking, particularly in regions with limited availability of space, according to BNPPRE.

Warsaw	PRIME RENTS (EUR/sqm/year) 2018	PRIME RENTS (EUR/sqm/year) 2019f	PRIME YIELDS (%) 2018	PRIME YIELDS (%) 2019f
OFFICES	282	→	4.75%	↘
HIGH STREET	960	→	4.00%	→
INDUSTRIAL	43	→	6.40%	→

Sources: Cushman & Wakefield Research, Savills Research
Notes: 'f' denotes forecast; data as of Q3 2018.

OUR PICKS

We maintain our view to focus on Grade A offices with long-term rental agreements in prime locations in the Warsaw CBD and city centre submarkets, such as Wola, which are close to or integrated with metro line stations.

We remain cautious regarding peripheral locations such as Mokotów but encourage well-selected investment opportunities in centrally located submarkets in Kraków, Wrocław and TriCity, as these markets are becoming more liquid.

We also favour modern distribution centres within strong transport networks such as Wroclaw, Poznań and Szczecin, which are used to fulfil orders from Western Europe.

Portugal

OFFICES

Healthy GDP and employment growth has boosted demand for office space, with an uplift in rents and decreasing vacancy seen across Lisbon last year. The technology, media and telecommunications sector has been leading this demand. There are increasing supply constraints due to a lack of prime stock, however, with rising pre-letting activity in the Portuguese capital. 2019 could bring a further tightening of supply, supporting rental growth and yields.

RETAIL

Portugal has been enjoying an uptick in tourism, supporting levels of consumer spending above the Eurozone average, which is positive for retail. So far, e-commerce penetration has been fairly limited, which is positive for high street rents and yields, and there is room for further rental growth over the coming year. High street retail property remains in limited supply, which has led to a continued reduction in vacancy, although there are several refurbishment projects underway.

INDUSTRIAL

Portugal's fringe-of-Europe location, combined with only nascent e-commerce, means that logistics sector growth is not likely to be as significant as some other European locations. This is reflected in muted historic investment volumes relative to other European locations as well as muted country-level investment volumes last year. Nevertheless, while being mindful of liquidity, there is scope for further logistics yield compression, particularly along major transport corridors and around the main ports.

Lisbon	PRIME RENTS (EUR/sqm/year) 2018	2019f	PRIME YIELDS (%) 2018	2019f
OFFICES (ZONE 1)	252	↗	4.25%	→
HIGH STREET (CHIADO)	1,560	↗	4.25%	→
INDUSTRIAL	45	↗	6.25%	↘

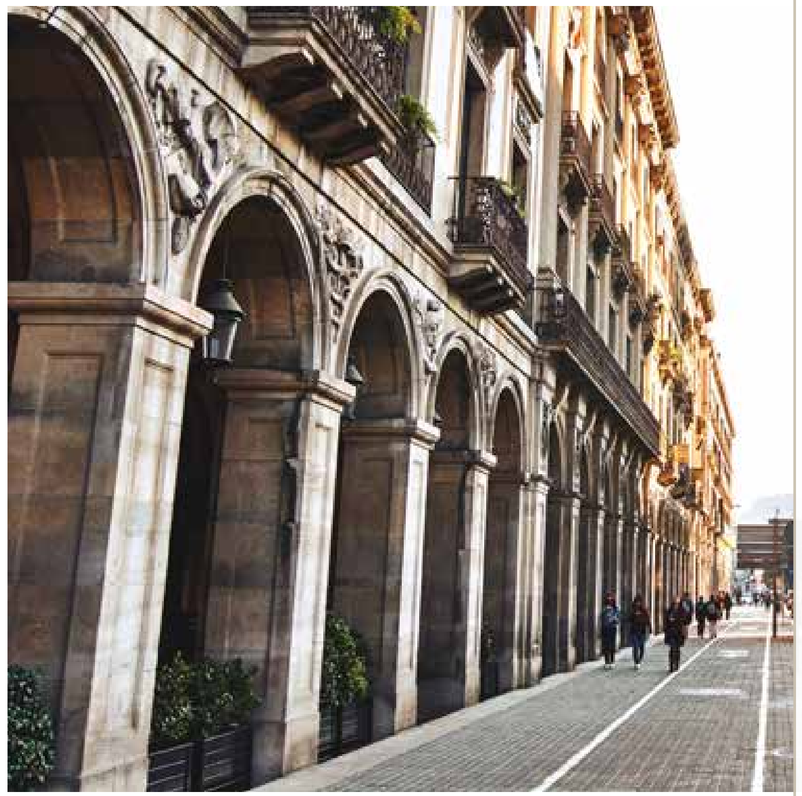
Sources: Cushman & Wakefield Research, Savills Research
Notes: 'f' denotes forecast; data as of Q3 2018.

OUR PICKS

We recommend core offices in Lisbon as well as value-add offices in Lisbon and Porto.

Prime retail yields in Lisbon are attractive on a relative basis for a capital city, and there is scope for yield compression for well-located logistics property.

Spain



OFFICES

Spain's improving employment and above-Eurozone-average GDP growth have generated strong demand for office space. Limited stock in respective CBDs has encouraged both larger occupiers and investors to also consider the M-30 fringe in Madrid and 22@ district in Barcelona. Despite an outlook of softening economic conditions for Spain in the coming year, continued favourable demand conditions and a limited supply pipeline are supportive of rental growth and possible further yield contraction supported by increased cross-border activity.

RETAIL

Spain has enjoyed an ongoing recovery from the Eurozone crisis. Combined with record levels of tourism, this has boosted consumer spending. However, underlying this spending is an increasing reduction in household savings as the rate of economic growth slows. The latter part of 2018 saw some moderation of retail sales, but this is not even across Spain. Retail demand drivers are strongest in the northern and eastern coastal regions as well as Madrid, which should support further rental growth in these areas.

INDUSTRIAL

Double-digit e-commerce growth, albeit from one of the lowest bases of any country in Europe, is supporting strong logistics take-up, not only around Madrid and Barcelona but also for the last mile in more secondary locations. PMA expects availability to remain low despite healthy construction activity, supporting rental growth. Yields have compressed but continue to remain attractive compared to other core European markets, drawing significant cross-border capital over 2018.

		PRIME RENTS (EUR/sqm/year) 2018	2019f	PRIME YIELDS (%) 2018	2019f
OFFICES (CBD)	Barcelona	306	↗	3.50%	→
	Madrid	405	↗	3.50%	→
HIGH STREET	Barcelona	3,360	↗	3.30%	→
	Madrid	3,240	↗	3.30%	→
INDUSTRIAL	Barcelona	81	↗	5.50%	→
	Madrid	60	↗	5.75%	↘

Sources: Cushman & Wakefield Research, Savills Research
Notes: 'f' denotes forecast; data as of Q3 2018.

OUR PICKS

We recommend fringe-of-CBD offices in Madrid and Barcelona, particularly in Madrid around the M30/A2 and M30/A1 axes as well as the 22@ district in Barcelona.

We also like retail schemes offering synergies with e-commerce, including well-located retail parks and stores offering click and collect or showrooming, particularly in the Malaga and eastern coastal regions as well as the northeast.

We also see logistics opportunity in the rings around Madrid and Barcelona in addition to select secondary cities with strong demand drivers.

Sweden

OFFICES

The Swedish economy remains strong, and loose monetary policy is supporting the investment climate. The labour market dynamics are also positive for the office sector, with employment rising and unemployment at its lowest level since 2008. Prime CBD office rents in Stockholm have grown significantly over recent years, and PMA expects rental growth to flatten going forward. However, office demand is likely to remain high and supply limited, with fierce competition for space in the Stockholm CBD.

RETAIL

Strong population growth, urbanisation and a rising number of tourist arrivals should continue to fuel retail spending growth. The share of online sales in Sweden is rising, but there is a large discrepancy between online sales of consumable and durable goods. Both the discount segment, which is expanding its physical store network, and well-located retail parks, which offer high yields compared to other asset classes, are likely to remain resilient as we approach the last phase of this economic cycle.

INDUSTRIAL

With over 600,000 sqm of new supply expected in 2018, industrial and logistics stock is rising in Sweden, according to Savills Research. Demand is strong and likely to remain so due to the continuous growth in e-commerce. The rental market is stable, with a low vacancy rate. Online retailers are striving to meet consumers' demand for shorter delivery times, meaning we are likely to see more innovative solutions such as urban logistics and mixed-use schemes.

Stockholm	PRIME RENTS (EUR/sqm/year) 2018	2019f	PRIME YIELDS (%) 2018	2019f
OFFICES	709	↗	3.50%	→
HIGH STREET	2,041	→	3.25%	→
INDUSTRIAL	112	→	4.75%	↘

Source: Cushman & Wakefield Research

Notes: 'f' denotes forecast; data as of Q3 2018.

OUR PICKS

In the office sector, we see potential opportunities in Stockholm's fringe-of-CBD or best suburban locations, such as Arenastaden.

Considering the rapid growth in e-commerce and growing demand for modern logistics solutions, we recommend urban, last-mile facilities around Stockholm, Gothenburg and Malmö as well as modern distribution centres along the main transport corridors.

United Kingdom

OFFICES

Despite Brexit-related uncertainty, London office market take-up remained healthy in 2018. Low levels of supply and occupiers' preference for new stock will likely keep rental values stable into 2019. The development pipeline is characterised by high levels of pre-letting activity, with 49% of all space under construction having already been absorbed, according to CBRE. Flexible office providers and the technology, media and telecommunications sector have taken over from banking and finance as the major pre-letters, Savills Research reports. On the investment side, PMA expects Central London prime office yields to soften over the next two years.

RETAIL

Record levels of employment and a pickup in real wage growth should stimulate consumer confidence and future retail spending. However, the UK retail environment remains challenging. Structural changes and higher costs have impacted retailers' profitability and are leading to corporate failures and store closures. Hence, vacancy rates are likely to rise over the coming months as store rationalisation and rightsizing continue. Occupier demand is focused on convenience-led retail locations and those with strong catchment areas.

INDUSTRIAL

E-commerce growth continues to fuel occupier activity in the UK logistics market. Strong take-up levels have kept supply relatively low, putting upwards pressure on rents. Going forwards, major infrastructure investments could unlock opportunities for industrial development, including the Hutchinson Ports Port of Felixstowe expansion and planned development of the Tilbury 2 port.

		PRIME RENTS (EUR/sqm/year) 2018	2019f	PRIME YIELDS (%) 2018	2019f
OFFICES	Birmingham	421	↗	4.75%	→
	Edinburgh	433	↗	4.75%	→
	London	1,279	→	3.25%	↗
	Manchester	421	↘	4.75%	→
HIGH STREET	Birmingham	1,296	↘	4.50%	→
	Edinburgh	1,997	→	4.75%	→
	London	16,339	↘	2.50%	→
	Manchester	1,729	→	4.50%	→
INDUSTRIAL	Birmingham	82	→	4.75%	→
	Edinburgh	103	↗	6.00%	↗
	London	182	↗	4.00%	→
	Manchester	85	↗	4.75%	→

Sources: Cushman & Wakefield Research, Savills Research, CBRE, PMA

Notes: 'f' denotes forecast; data as of Q3 2018; Birmingham, London and Manchester office rents calculated based on a 1.15 GBP/EUR conversion rate at time of writing, and assuming approximately 10.76 sq ft = 1.00 sqm.

OUR PICKS

The London office market offers attractive opportunities, particularly multi-let London City office buildings.

Logistics units in the southeast remain attractive, and we also recommend the Big 6 cities (Birmingham, Bristol, Edinburgh, Glasgow, Leeds and Manchester) as well as Oxford and Cambridge.

Asia-Pacific real estate market view

Healthy economic fundamentals tainted by trade war fears

The Asia-Pacific region continued to post reasonable economic growth in late 2018, with slightly dimmer prospects in 2019. The global economic expansion has become less balanced across regions. Downside risks to Asia-Pacific intensified in 2018 following further escalation of the US-China trade conflict, which has the potential to disrupt cross-border production links.

In addition, the strong US dollar, tightening monetary policies in some Asia-Pacific markets and a set-back in commodity prices of late pose some short-term downside risks to many of the export-orientated Asia-Pacific economies. The looming challenges for export markets may mean slower economic growth momentum across most of the region this year, according to Oxford Economics.

Nevertheless, the region is still poised to weather headwinds. Domestic demand remains strong, reflecting tight labour markets as governments across the region seek to achieve sustainable growth. Bolder monetary and fiscal support should also help the region circumvent a sharp slowdown, according to Focus Economics, with some markets such as Japan likely to maintain an accommodative monetary policy stance.

The resilience of Asian economies may again be tested. Asian governments will continue to focus on structural reforms such as leveraging technology to ensure sustainable economic growth, meanwhile striving to confront demographic challenges, boost productivity and reap the full benefits of increasing digitalisation in the global economy.

> "Asia's strong economic fundamentals and lessons learned from both the Asian financial crisis and GFC should help the region navigate through headwinds of uncertainty."

Sound property demand fundamentals ...

OFFICE

Office property performance across much of the region remains healthy on the back of strong capital markets and stable occupier fundamentals. Aggregate vacancy rates across Japan, Australia and Singapore continue to decline amid robust leasing demand led by expansions, particularly technology firms and co-working operators.

Pre-commitment levels of 2019 developments across the region have been relatively robust except for Chinese tier 1 cities, where there is a supply overhang. PMA expects vacancy rates to rise in these cities. Overall leasing demand should remain in good shape across most of the region, albeit rental momentum is likely to ease in line with modest economic growth and business sentiment this year.

RETAIL

Despite the restrained economic growth in most Asian economies, retail sales growth and domestic spending remain resilient. Key markets in China, Australia, Hong Kong, South Korea, Japan and Singapore continue to see positive retail sales growth thanks to buoyant tourism and domestic consumption.

Nonetheless, the retail environment in most regional markets remains in favour of tenants, as landlords are increasingly forced to offer better incentives, especially in the discretionary retail space due to competition from e-commerce. Some online retailers are also looking to open physical stores to facilitate a seamless omnichannel retail experience.

INDUSTRIAL

The rapid growth of e-commerce and third-party logistics providers in the Asia-Pacific region continues to prop up demand for logistics facilities, underpinning positive rental growth trends. Thanks to urbanisation, the growth of the middle-class and higher incomes, consumer behaviour is shifting. Significant investments by major Chinese e-commerce giants Alibaba and Tencent in Southeast Asia over recent months have brought the region into sharper focus.

With the introduction of cross-border payment solutions, there is significant scope for further logistics market growth. Increasing demand for modern logistics warehousing around major urban centres and transport nodes will be a prominent trend going forward. As interest rates normalise, PMA expects the industrial sector to provide consistently higher returns than office and retail owing to higher income yield, increased transparency and strong underlying occupier demand.

...as supply risks subside in most developed markets

According to PMA data, overall regional office supply will increase further into 2019, with over 4 million sqm of space set to enter the region. While supply risks appear to be mounting, the majority of new supply set to complete this year (65%) is concentrated in the tier 1 Chinese cities. Developing markets aside, 2019 office supply is actually below the 10-year average (1.3 million sqm versus 1.7 million sqm, according to PMA), suggesting that supply risks are abating, even if this varies across developed markets.

According to PMA, shopping centre supply varies across the region, with higher oversupply risk in developing Chinese and Malaysian cities. New supply should moderate in most other markets this year, although China's supply is likely to reach a peak in 2019 before beginning to moderate.

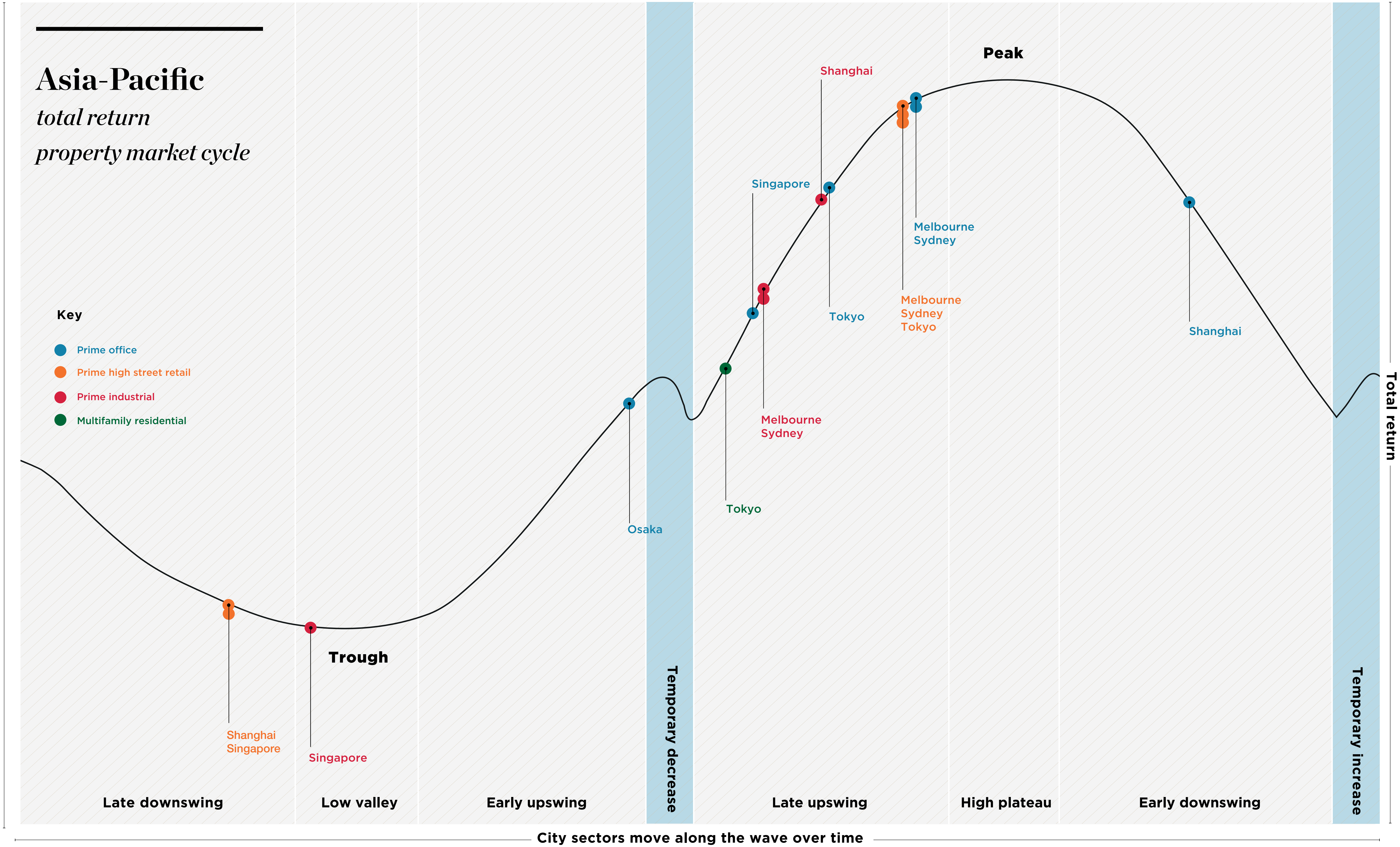
Robust underlying fundamentals for logistics facilities continue to fuel development, with PMA data showing new supply building up in inland Tokyo, Melbourne and secondary tier 2 Chinese cities. As the trade conflict continues to unfold, however, many logistics companies are focusing on their domestic markets, according to IPE Real Assets.

Are yields at a tipping point?

An abundance of liquidity, low interest rates and a lack of investible stock continue to keep yields low. The accommodative monetary stances in markets such as Japan mean that yields are likely to remain low in these markets. As competition for core products continues to intensify, investors are likely to seek value-add opportunities in locations such as Seoul, which has seen a resurgence of investor interest in 2018.

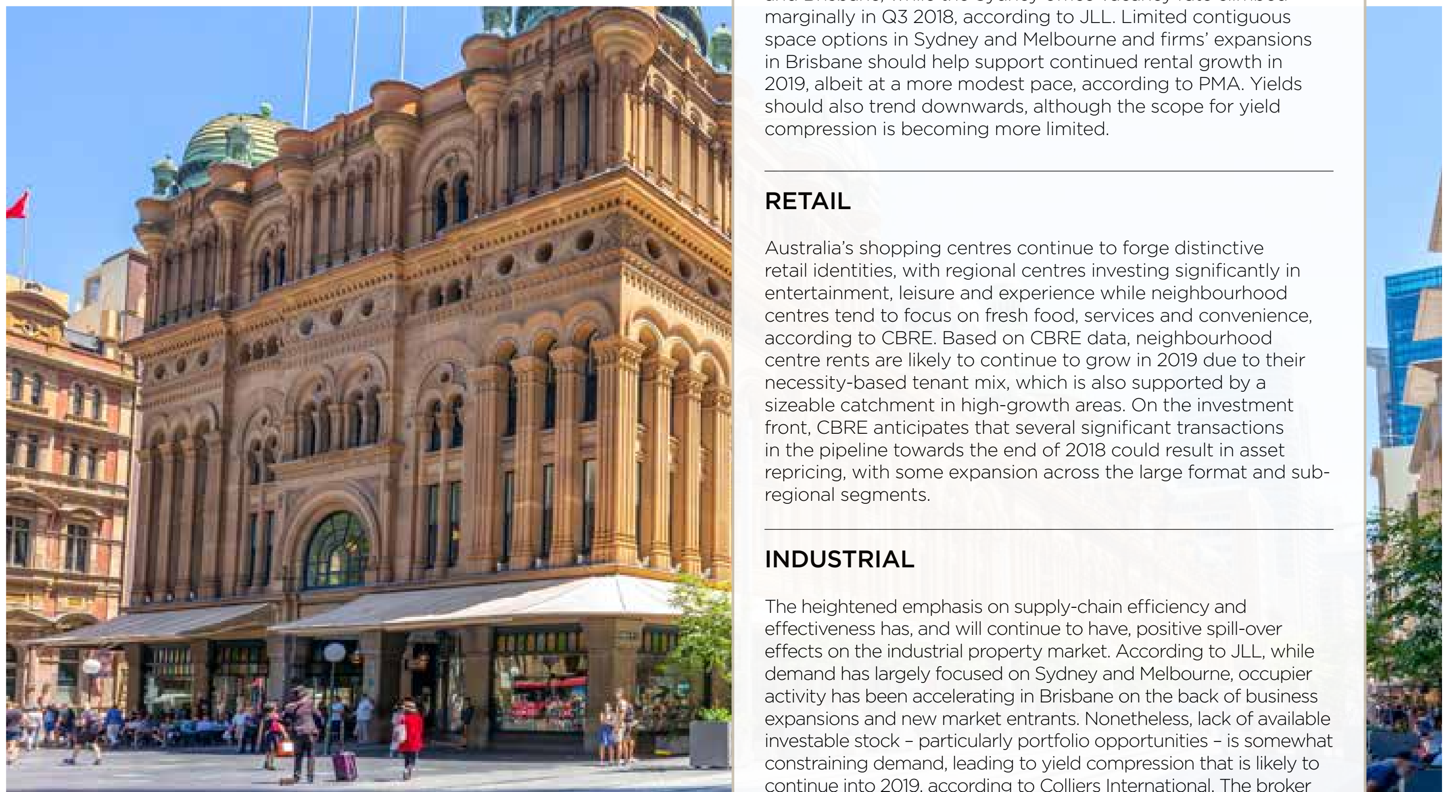
The next few years may bring higher interest and capitalisation rates, lower returns driven by income growth, pockets of illiquidity and distress as well as slowing capital flows driven by fewer, more selective investment opportunities. Nevertheless, Asia's strong economic fundamentals and lessons learned from both the Asian financial crisis and GFC should help the region navigate through headwinds of uncertainty.

Understanding local market dynamics and having asset-level knowledge will become more important than ever to identifying investment opportunities. In view of this, we recommend that in the year ahead investors leverage operational efficiency and expertise to drive returns instead of pursuing financial leverage while rebalancing their portfolio.



Sources: PMA, Savills Investment Management
Note: relative property market cycle points based on total return index.

Australia



OFFICES

Office leasing activity is still holding up thanks to broad-based economic growth supporting positive occupier demand for space. CBD vacancy rates continue to decline in Melbourne and Brisbane, while the Sydney office vacancy rate climbed marginally in Q3 2018, according to JLL. Limited contiguous space options in Sydney and Melbourne and firms' expansions in Brisbane should help support continued rental growth in 2019, albeit at a more modest pace, according to PMA. Yields should also trend downwards, although the scope for yield compression is becoming more limited.

RETAIL

Australia's shopping centres continue to forge distinctive retail identities, with regional centres investing significantly in entertainment, leisure and experience while neighbourhood centres tend to focus on fresh food, services and convenience, according to CBRE. Based on CBRE data, neighbourhood centre rents are likely to continue to grow in 2019 due to their necessity-based tenant mix, which is also supported by a sizeable catchment in high-growth areas. On the investment front, CBRE anticipates that several significant transactions in the pipeline towards the end of 2018 could result in asset repricing, with some expansion across the large format and sub-regional segments.

INDUSTRIAL

The heightened emphasis on supply-chain efficiency and effectiveness has, and will continue to have, positive spill-over effects on the industrial property market. According to JLL, while demand has largely focused on Sydney and Melbourne, occupier activity has been accelerating in Brisbane on the back of business expansions and new market entrants. Nonetheless, lack of available investable stock – particularly portfolio opportunities – is somewhat constraining demand, leading to yield compression that is likely to continue into 2019, according to Colliers International. The broker expects the east coast markets of Sydney, Melbourne and Brisbane to see stronger capital appreciation compared to the west coast markets of Perth and Adelaide.

		PRIME RENTS (AUD/sqm/year)		PRIME YIELDS (%)	
		2018	2019f	2018	2019f
OFFICES					
	Melbourne	580	↗	4.65%	↘
	Sydney	1,065	↗	4.45%	↘
PRIME RETAIL					
	Melbourne	7,375	↗	4.20%	↘
	Sydney	12,553	↗	4.40%	→
INDUSTRIAL					
	Melbourne	78	↗	5.40%	→
	Sydney	123	↗	5.10%	→

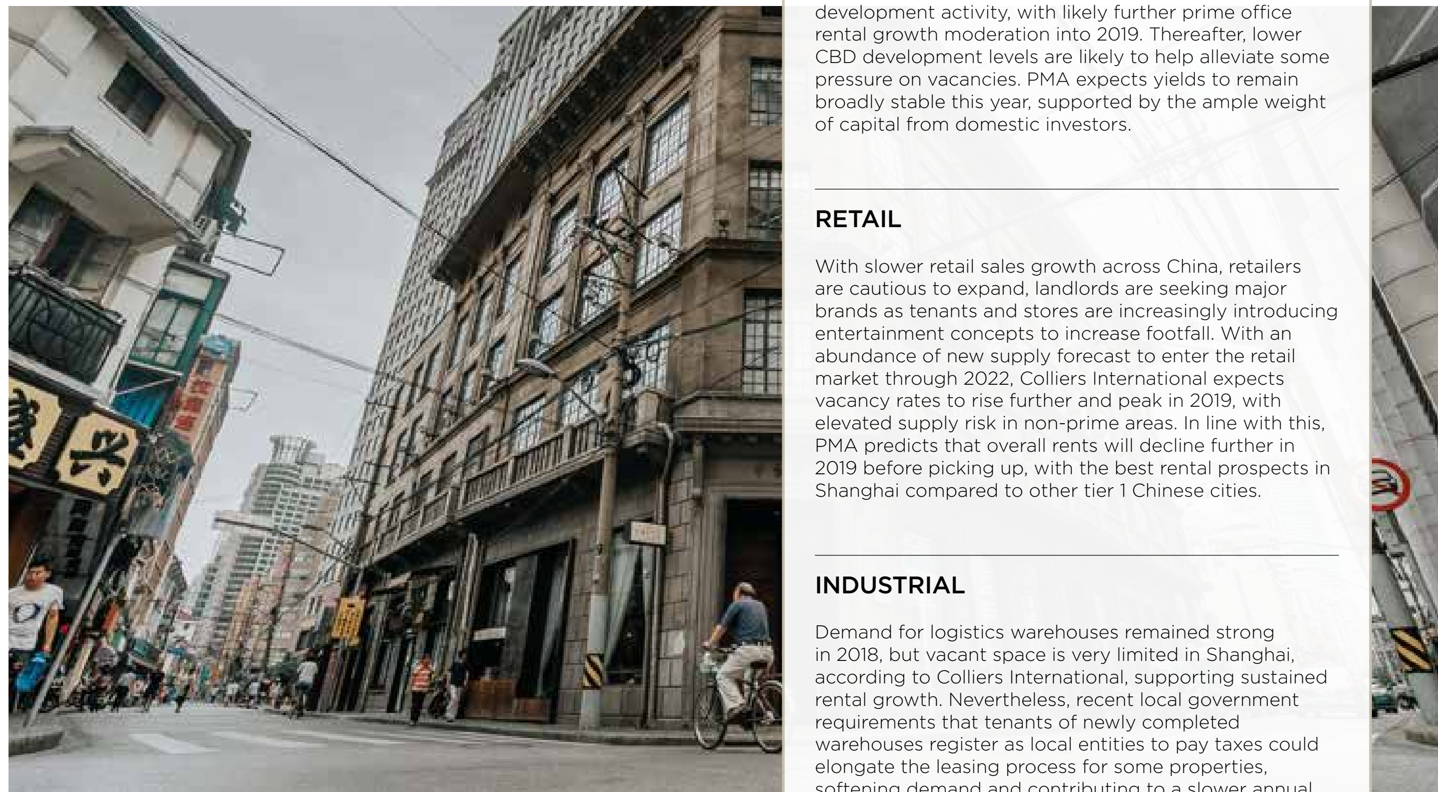
Sources: Savills Research, Colliers International, PMA
Notes: 'f' denotes forecast; data as of Q3 2018.

OUR PICKS

Regarding office markets, we suggest Melbourne over Sydney, due to pricing and supply concerns in the latter market, and Brisbane, which is enjoying cyclical rental uplift

We also recommend considering well-located neighbourhood retail centres in Sydney, Melbourne and Brisbane.

China



OFFICES

Ongoing US-China trade tensions have somewhat dampened occupier demand for Shanghai office space amid growing supply risks. PMA reports that vacancy rates continue to climb alongside sustained development activity, with likely further prime office rental growth moderation into 2019. Thereafter, lower CBD development levels are likely to help alleviate some pressure on vacancies. PMA expects yields to remain broadly stable this year, supported by the ample weight of capital from domestic investors.

RETAIL

With slower retail sales growth across China, retailers are cautious to expand, landlords are seeking major brands as tenants and stores are increasingly introducing entertainment concepts to increase footfall. With an abundance of new supply forecast to enter the retail market through 2022, Colliers International expects vacancy rates to rise further and peak in 2019, with elevated supply risk in non-prime areas. In line with this, PMA predicts that overall rents will decline further in 2019 before picking up, with the best rental prospects in Shanghai compared to other tier 1 Chinese cities.

INDUSTRIAL

Demand for logistics warehouses remained strong in 2018, but vacant space is very limited in Shanghai, according to Colliers International, supporting sustained rental growth. Nevertheless, recent local government requirements that tenants of newly completed warehouses register as local entities to pay taxes could elongate the leasing process for some properties, softening demand and contributing to a slower annual rental growth pace of 5% for 2019-20, reports Colliers.

Shanghai	PRIME RENTS (RMB/sqm/year)		PRIME YIELDS (%)	
	2018	2019f	2018	2019f
OFFICES	10.4	↘	3.90%	→
PRIME RETAIL	51.1	↗	4.25%	→
INDUSTRIAL	1.38	↗	4.90%	→

Sources: JLL, PMA
Notes: 'f' denotes forecast; data as of Q3 2018.

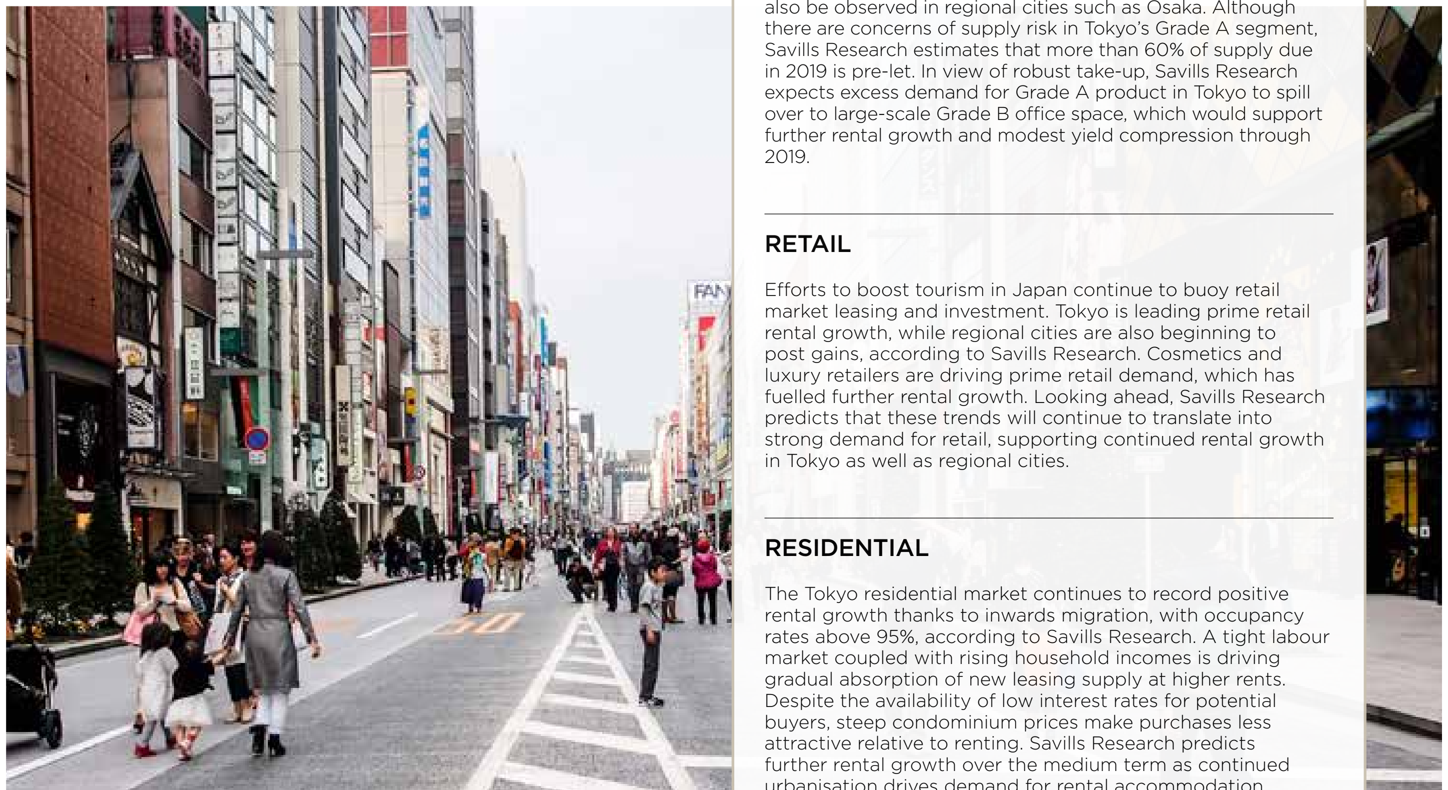
OUR PICKS

Thematic investing provides a means of circumventing political and monetary policy headwinds and tapping into the growth stories of the future. We advocate investing in logistics assets tied to e-commerce.

In Shanghai, we would recommend offices in growth regions, new CBDs supported by infrastructure (particularly in Pudong) and decentralised business districts.

We also note that special situations and funding gap opportunities are becoming more prevalent due to the rapid growth in credit.

Japan



OFFICES

Japan's office market fundamentals remain strong thanks to a tight labour market, growing corporate profits and economic optimism. Despite the arrival of new office supply in Tokyo, all-grade vacancy rates continue to decline – a trend that may also be observed in regional cities such as Osaka. Although there are concerns of supply risk in Tokyo's Grade A segment, Savills Research estimates that more than 60% of supply due in 2019 is pre-let. In view of robust take-up, Savills Research expects excess demand for Grade A product in Tokyo to spill over to large-scale Grade B office space, which would support further rental growth and modest yield compression through 2019.

RETAIL

Efforts to boost tourism in Japan continue to buoy retail market leasing and investment. Tokyo is leading prime retail rental growth, while regional cities are also beginning to post gains, according to Savills Research. Cosmetics and luxury retailers are driving prime retail demand, which has fuelled further rental growth. Looking ahead, Savills Research predicts that these trends will continue to translate into strong demand for retail, supporting continued rental growth in Tokyo as well as regional cities.

RESIDENTIAL

The Tokyo residential market continues to record positive rental growth thanks to inwards migration, with occupancy rates above 95%, according to Savills Research. A tight labour market coupled with rising household incomes is driving gradual absorption of new leasing supply at higher rents. Despite the availability of low interest rates for potential buyers, steep condominium prices make purchases less attractive relative to renting. Savills Research predicts further rental growth over the medium term as continued urbanisation drives demand for rental accommodation, especially for conveniently located residences within commuting distance of Tokyo's CBD.

		PRIME RENTS (JPY/tsubo/month)		PRIME YIELDS (%)	
		2018	2019f	2018	2019f
OFFICES					
	Tokyo	34,100	↗	2.50%	→
	Osaka	20,700	↗	3.30%	→
PRIME RETAIL					
	Tokyo	274,100	↗	2.65%	→
	Osaka	215,100	↗	3.40%	→
RESIDENTIAL*					
	Tokyo	12,500	↗	3.60%	↘

Sources: PMA, MSCI, Savills Research

Notes: 'f' denotes forecast; data as of Q3 2018;
* average for midmarket multifamily in 23 Tokyo wards.

OUR PICKS

With Japanese monetary policy set to remain loose for the foreseeable future, historically wide yield spreads suggest a strong possibility for further modest yield compression in Greater Tokyo and the major regional Japanese markets, where investors are increasingly active.

In light of the Grade B office market's favourable yield and rental outlook relative to the prime segment, we recommend that investors consider risk-adjusted Grade B offices and multifamily rental accommodation in sub-core districts of Greater Tokyo and selected established submarkets of regional cities such as Osaka, Nagoya and Fukuoka.

Singapore

OFFICES

Singapore's low unemployment and solid job market prospects continue to support its robust office leasing market. While technology and co-working operators have largely led take-up, there has been increased leasing activity by the professional and financial service sectors as well as shipping firms of late, according to CBRE. As vacancies tighten and rents increase in the Grade A office segment, occupiers are considering Grade B options. Tighter future supply through 2020 suggests that rental growth prospects are likely to remain strong in the medium term, according to PMA.

RETAIL

Despite encouraging tourism levels and positive retail sales growth, the retail rental market remains subdued. To drive footfall in shopping centres, landlords are introducing large-format, activity-based anchor tenants, who pay lower rents, reports JLL. The agent expects the substantial supply of island-wide retail space set to enter the market over the next 15 months to continue to weigh on rents. However, CBRE expects demand for prime retail space to remain healthy based on current pre-committed levels for some projects.

INDUSTRIAL

The occupancy rate for Singapore industrial properties has improved, based on JTC Corporation data. The recovery in the manufacturing sector is fuelling expectations of demand potentially bottoming out in 2019, barring any external shocks. As new supply starts to taper in the coming years, JLL expects rents and capital values to continue to stabilise in tandem with occupancy rates. In this context, yields are unlikely to record significant movement.

	PRIME RENTS (SGD/sq ft/month)		PRIME YIELDS (%)	
Singapore	2018	2019f	2018	2019f
OFFICES	10.00	↗	3.25%	↗
PRIME RETAIL	31.70	→	4.30%	→
INDUSTRIAL	1.23	↗	4.75%	→

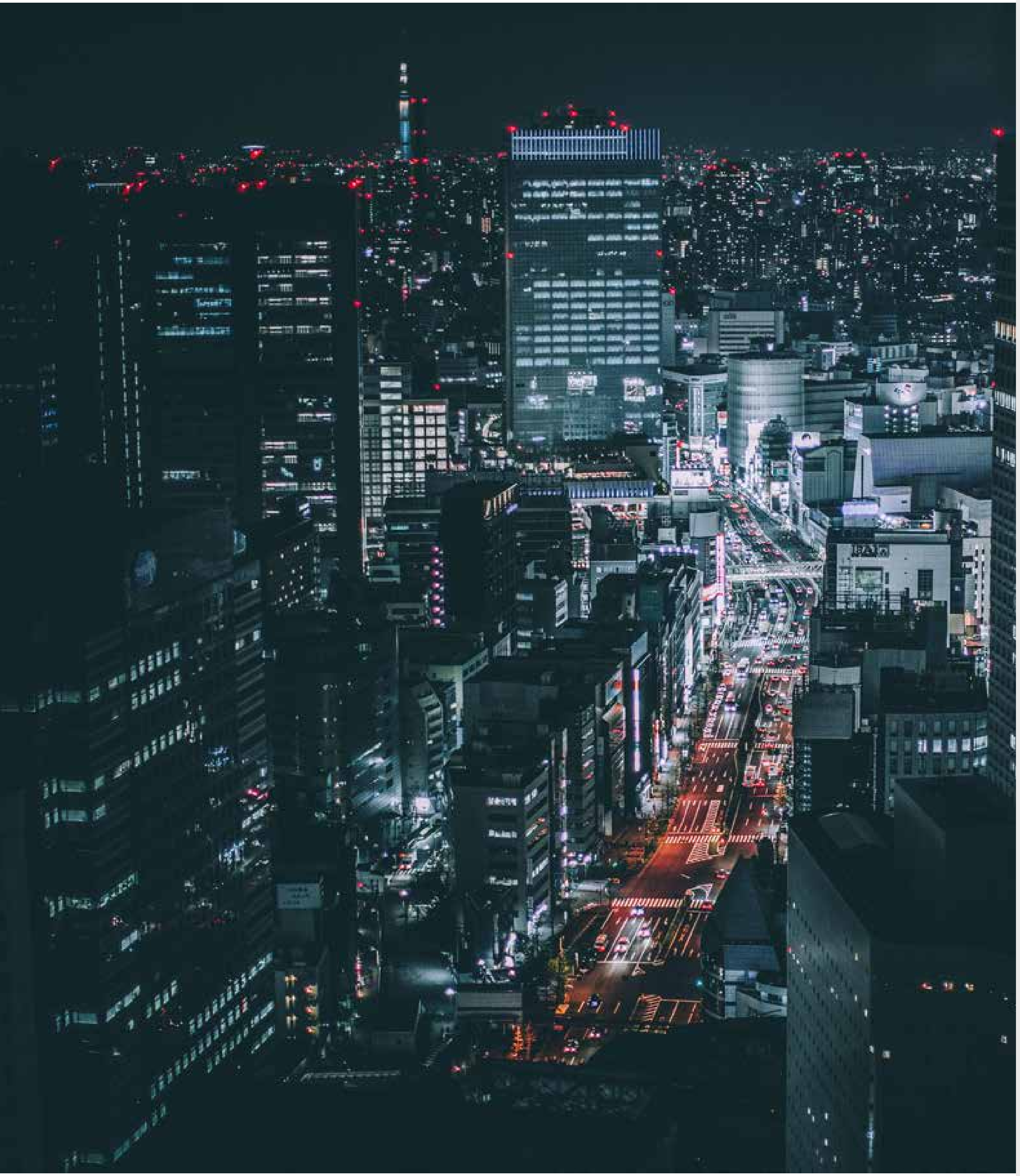
Sources: Cushman & Wakefield Research, CBRE, PMA

Notes: 'f' denotes forecast; data as of Q3 2018.

OUR PICKS

We expect the country's open economy to moderate in the year ahead. Should the US-China trade conflict escalate, business sentiment may weaken and underpin reduced demand for office and industrial properties. We likewise remain cautious about the retail market.

Nevertheless, the office market may record some of the strongest rental growth across Asia-Pacific region, even though yields are at historic lows.



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