Outlook 2021

Building resilience in global real estate portfolios

investment management

Outlook 2021

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A message from the Global CIO and Deputy Global CEO

When we entered 2020, we could have not anticipated how different this year would turn out to be. The global COVID-19 pandemic has radically changed the way we live, work and play. Some of the major central banks have implemented a ‘whatever it takes’ policy to save economies, lowering interest rates to around zero and conducting large-scale asset purchases through quantitative easing programmes. Meanwhile, global sovereign debt levels continue to grow.

While containing the spread of the pandemic will remain the focal point, other challenges also lie ahead in 2021. The impact of the UK leaving the EU will come into full effect. There are climate-related risks, rising inequalities and continuous geopolitical tensions all of which could threaten global stability. Embracing disruption to protect existing portfolios and identify new investment opportunities is, therefore, ever more important. Part of this involves capitalising on structural trends that have accelerated as a result of COVID-19.

This year for the first time we have conducted a survey for our Outlook publication. Some 45% of investors expect that real estate investment will increase over the next 12 months and 25% expect investment to stay the same. The even lower-for-longer interest rate environment leaves investors with less choices to meet their return targets. Given the challenges facing financial markets, we believe investors need to look at alternative asset classes with more attractive risk-adjusted returns. Real estate has the characteristics and fundamentals to take advantage of this secular shift in capital markets.

The Savills Investment Management Outlook 2021 report features our views on the commercial property markets, serving to help investors build resilience in global real estate portfolios in these unprecedented times.

Kiran Patel
Global CIO and Deputy Global CEO

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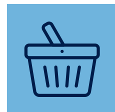
Our top commercial real estate investment picks

EUROPE

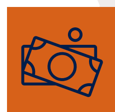
Office

- Multi-let core/core plus office buildings near transport hubs in CBD locations and well-established city fringe locations across Europe
- Long-income core office opportunities in regional cities mainly in Germany, the Netherlands, Poland and France



Retail

- Larger food anchored retail parks and neighbourhood centres in metropolitan areas of Tier 1 and Tier 2 cities across Europe
- Daily goods and grocery retail formats such as supermarkets and food discounters in urban areas across Europe
- Destination and convenience segments of the outlet centre market in Western Europe



Real estate debt

- Debt investing can provide an attractive, robust income-based return underpinned by European property, which will exhibit lower volatility than in the previous cycle correction

Logistics

- Core/core-plus assets with a strong long-term covenant in the main logistics clusters across Europe
- Modern distribution centres along the main motorways and transport networks such as the North Sea-Baltic, the North Sea-Mediterranean and the Atlantic corridors
- Logistics facilities in regional markets in well-connected locations in France, Germany, the UK
- Urban logistics units and multi-let assets close to large and densely populated areas across Europe

Alternatives

- Residential, particularly build-to-rent multi-family buildings and student accommodation in the UK, and healthcare and senior care facilities in Italy, providing long-term, stable income returns

ASIA-PACIFIC

Office

- Fringe-of-CBD or Grade B properties in prime locations to carry out value-add/ core-plus opportunities in Singapore and Seoul
- Offices in regional Japanese cities as occupiers become more cost conscious

Retail

- Opportunities to acquire underperforming smaller sub-regional shopping centres to reposition as neighbourhood centres particularly in Australia

Real estate debt

- Funding gap opportunities in the debt and mezzanine loan space in Australia

Logistics

- Logistics properties across Asia-Pacific, particularly last-mile distribution and fulfilment centres owing to strong secular trends
- In markets with a shortage of modern logistics facilities amid rising land prices suggests opportunities to create mixed-use logistics facilities such as cold storage and general logistics facilities

Residential

- High quality assets that offer stable income streams, such as the Japanese multifamily residential sector

Risks and opportunities in 2021

The EU Recovery Fund offers the chance for further political integration

Europe's political fragmentation is a reality at both the national and EU levels. The COVID-19 crisis has revealed the limits of the EU, which operates as a technocratic administration parallel to rather than sovereign over respective nations. Competing social models have been more or less able to respond to the health crisis, resulting in tensions between countries for several months.

These have partially relaxed with the agreement on the EU Recovery Fund in July 2020. New balances, coalitions and counterweights have emerged. Nonetheless, political turbulence is set to continue throughout 2021, as economic, geopolitical and social challenges as well as climate-related risks still need to be addressed. The compromise on the Recovery Fund points to a further integration process of the EU; however, due to a second wave of infections across Europe and discussions on fund governance, the package might be delayed, or countries might reconsider the loans component.

Brexit – changes ahead, deal or no deal

With only around 40 days (at time of writing) until the UK's Brexit transition period is due to expire on 31 December 2020, negotiations continue. While an agreement is in both sides' interest, with time running out and differences remaining on a few key issues there remains a risk that negotiations will reach an impasse and negotiators will fail to strike a deal. Such an outcome would be an economic blow for both the UK and EU as the imposition of tariffs increases the cost of imports.

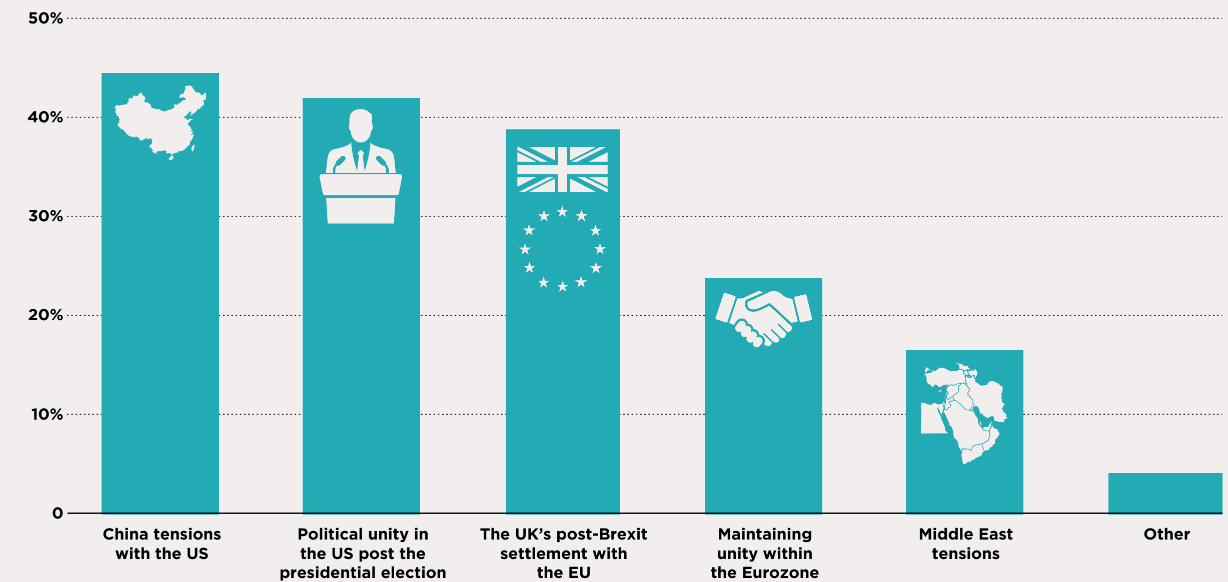
That said, the hit to GDP for both parties would be small in comparison to the impact of the pandemic. Even if a deal is reached, businesses will face a different trading environment as customs checks are introduced, potentially disrupting supply-chain times, and UK financial institutions are faced with a less secure equivalence regime. For property markets, long-term changes are likely to be more important for occupier demand, including the impact of new technology and increased agile working.

US presidential election leaves the country divided

Of course, 2020 represented a political turning point for the US as well as the UK. As feared, the US presidential election remained undecided after the first highly anticipated election night, but unforeseen was the four-day election mini-series that would ensue. Although Joe Biden won the election, the race to win the US Senate will not be decided until January, with two run-off elections in Georgia. If the Republicans manage to maintain control of the Senate, a divided Congress could hamper Biden's presidency. Hopes for major infrastructure spending such as a 'green new deal' will be tempered, with further fiscal stimulus packages likely to be scaled back.

However, President Elect Biden's proposed corporate tax increases may now be less likely, too, which could help support the economic recovery. In our view, the election result will not have an impact on the global real estate markets at least in the short term, with the impact from the COVID-19 pandemic more likely to a be a significant driver of occupier markets. We think investors are well-advised to focus on market fundamentals, economic and interest rate cycles as well as longer-term trends such as urbanisation, climate change, digitisation and technology.

FIGURE 1: WHAT WILL BE THE MOST SIGNIFICANT POLITICAL CHALLENGE FACING THE WORLD IN 2021? (% OF RESPONDENTS)



Source: Research conducted on behalf of Savills Investment Management by PollRight among 122 institutional investors in September 2020. Investors came from a global database, centred around North America, the UK and Continental Europe, and held an average AUM of GBP 18.9 billion (USD 25 billion) in real estate investments.
Note: Multiple answers were possible.

Geopolitical tensions continue to put global economy at risk

Broadening our focus to global geopolitics, bilateral tensions that have intensified since the start of the COVID-19 pandemic will likely continue into 2021. Aside from the US-China trade war, which is considered the most significant political challenge in 2021, according to our investor survey, geopolitical tensions have escalated globally (figure 1). The refugee crisis is currently flying under the radar but could flare up again quickly, particularly if tensions between Greece and Turkey regarding gas fields in the east Mediterranean Sea tighten further. Risks are tilted to the downside overall in 2021, which may affect corporate expansion plans. For instance, firms such as Nike, Apple and Samsung Electronics are reducing reliance on China to mitigate geopolitical risks.

Reshoring – a boost for the industrial and logistics sector?

While the pandemic presents a number of downside risks for the global economy and commercial property markets, it could also provide an opportunity for increased industrial and logistics demand. And not one related to increased online penetration.

COVID-19 has exposed the fragile nature of today's supply chains, reigniting a debate around (de)globalisation and the possibility of firms reshoring[1] production capacity. The trend of manufacturers relocating at least some production back or close to domestic markets can have commercial benefits – diversifying suppliers to reduce possible supply chain disruptions, shortening transport times and aiding to reducing carbon emissions. A reversal of the trend to offshoring would be positive for industrial and logistics occupier markets. But reshoring usually entails higher production costs due to higher wages. Therefore, the key question is, how much are consumers prepared to pay for more localised production?

Given the already complex nature of global supply chains, we think that the near-term opportunities from reshoring are limited, particularly in high-wage developed markets. We think that it is more likely that companies will seek to increase the resilience of their supply chains by diversifying across low-cost countries, which could benefit industrial and logistics demand in other parts of Asia (away from China).

Where there could be some increased demand opportunities in the short term would be if firms look to hold more inventory in order to minimise supply-chain disruptions. But this would likely be a one-off boost, with regional markets such as Central and Eastern European countries most likely to benefit. The CEO of Prologis, the world's largest logistics investor, has suggested that just-in-time supply chains could become just-in-case supply chains, with companies carrying 5-10% more inventory in the future.[2] But like reshoring, the extent to which this boosts occupier demand will depend on firms' trade-off between the costs of holding higher inventories and supply chain disruptions.

A slower-than-expected economic recovery

As economies reopened after COVID-19–related lockdowns, global activity started to recover quickly. The US for example, had regained around 66% of lost output by the end of Q3, while the Euro-zone had made up around 70% of its fall in GDP. But with many countries experiencing second waves of infection and localised lockdowns, various indicators suggest that recovery momentum is losing steam sooner-than-expected. Indeed, a number of forecasters, including the International Monetary Fund have cut their outlook for 2021.

With unemployment rising and the strength of the recovery still very dependent on the path of the virus and the speed at which a vaccine might be available, we could yet see further downgrades for growth in 2021. Prolonged periods of social distancing and/or local lockdowns risk undermining consumer and business confidence, holding back spending and investment decisions. This would be negative for commercial property occupier markets and near-term rental growth prospects. In particular, the retail and leisure sectors look particularly exposed to lower footfall and soft consumer demand, as well as the office sector if firms put off expansion and re-location decisions.

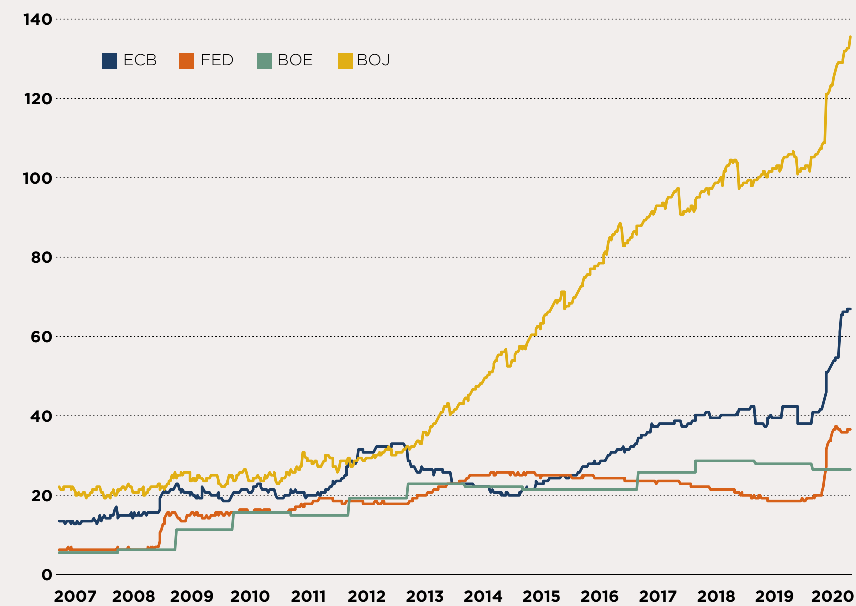
That said, should the recovery start to stall, this will almost certainly be met with more support from central banks, either in the form of interest rate cuts or additional quantitative easing. The possibility of even lower government bond yields would be supportive for capital flows into real estate as investors seek relatively higher returns.

[1] Offshoring/reshoring is defined as shifting production or service facilities away from or closer to the domestic market.
[2] Nareit, "Prologis CEO expects shift away from lean supply chain strategy post-COVID", 30 July 2020.

Will financial market volatility be a boon for real estate?

To mitigate the impact of COVID-19 on economies, countries have introduced fiscal stimulus measures to support companies via credit guarantees, and workers through subsistence payments. At the same time, some of the major central banks have implemented a 'whatever it takes' policy to save economies, lowering interest rates to around zero or ventured into negative territory and are conducting large-scale asset purchases through quantitative easing programs boosting up their balance sheets (figure 2).

FIGURE 2: CENTRAL BANKS BALANCE SHEETS TO GDP (%)



Source: Macrobond, October 2020

Systemic risks are on the rise

Global sovereign and corporate debt levels, which were historically high even before the current crisis, have been ballooning. While economic leveraging has helped avoid further damage in the short-term, questions are being raised about the sustainability of the global debt pile and rising systemic risks in the financial and nonfinancial corporate sectors over the longer run.

Wider unintended consequences, such as the risk of major misallocations of capital towards unproductive segments, and the 'zombification' of banks and companies have increased. Furthermore, the impact of the rising debt burden on future investment capabilities have the potential to hamper economic growth as well as fiscal resources to tackle future downturns in the long-run.

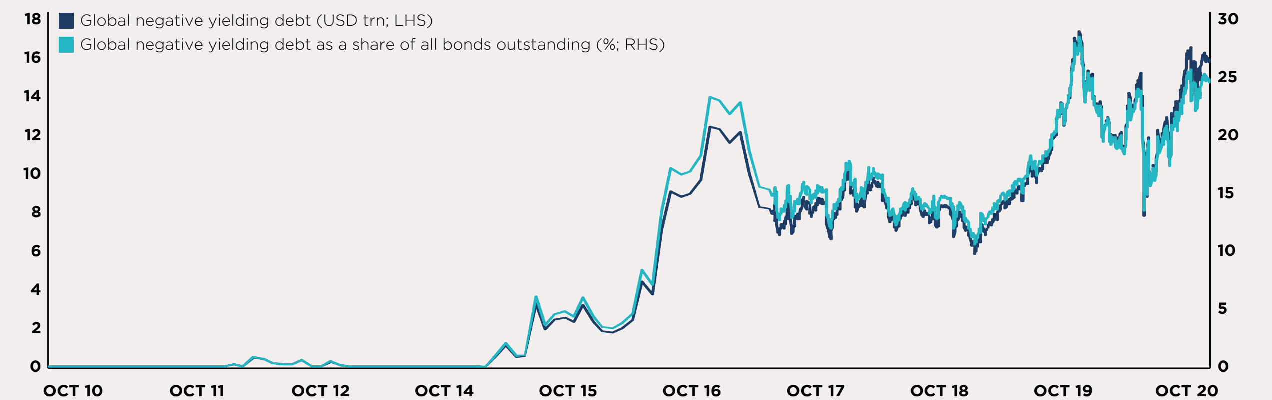
Due to the significant amount of spare capacity in the economies, inflation is set to remain low, posing various threats to growth. Until this returns to a sustainable level, central banks are unlikely to lift interest rates, meaning bond yields and returns will also remain low. Moreover, the adjustment should be gradual to give the economy time to adapt.

Although uncertainty is likely to continue in 2021, governments may start to gradually cut support for COVID-19 and move towards a model that promotes productivity growth. To be successful they need to support private and public consumption, invest in high-tech sectors, foster infrastructure investments, implement structural reforms and offer incentives for private and corporate investments.

Secular shifts in capital markets benefit real estate

In the absence of favourable outlooks for demographics and productivity growth in most advanced economies, the most likely scenario is a prolonged phase of economic stagnation with low growth and low inflation, leaving investors with less choices to meet their return targets. In this new reality, asset allocators should rather lower their return expectations than stretching too far and making sacrifices on asset quality. Further, with historically low and negative yields in the bond markets (figure 3) and high valuations in the financial markets, investors need to consider to looking at alternative asset classes offering attractive risk-adjusted returns in order to enhance their portfolios. We believe real estate has the characteristics and fundamentals to take advantage from this secular shift in capital markets.

FIGURE 3: GLOBAL NEGATIVE-YIELDING BONDS (USD TRILLION) AND AS A SHARE OF ALL BONDS OUTSTANDING (%)



Source: Bloomberg (October 2020)
* Bloomberg Barclays Global Aggregate Negative Yielding Debt Index
** Bloomberg Barclays Global Aggregate Bond Index

Investors will increasingly look to move up the risk curve

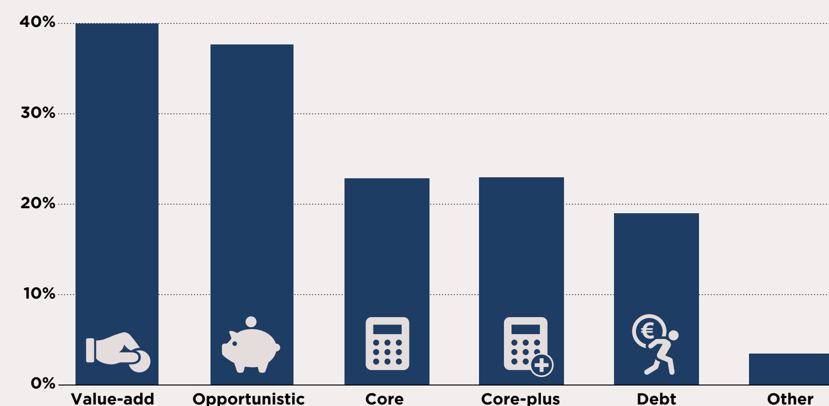
ANDREAS TRUMPP

BENEDICT LAI

There is a big question mark about what real estate will look like in a post-COVID-19 world, and what it means for investors and their strategies. The pandemic has both served as an accelerant for real estate trends that were already underway while also challenging traditional notions of various real estate sectors.

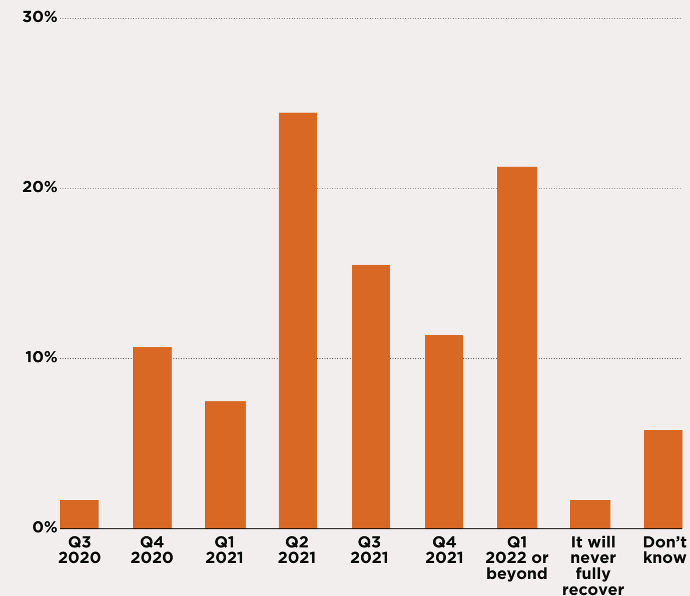
In an uncertain economic environment with low interest rates, real estate investors are directing more commitments towards riskier opportunities. In our investor survey we found that the majority of respondents believe that value-add, opportunistic and core-plus investment strategies will be most popular in the wake of COVID-19 (figure 4).

FIGURE 4: WHICH OF THE FOLLOWING INVESTMENT STYLES DO YOU BELIEVE WILL BE MOST POPULAR AMONG REAL ESTATE INVESTORS IN THE WAKE OF COVID-19?



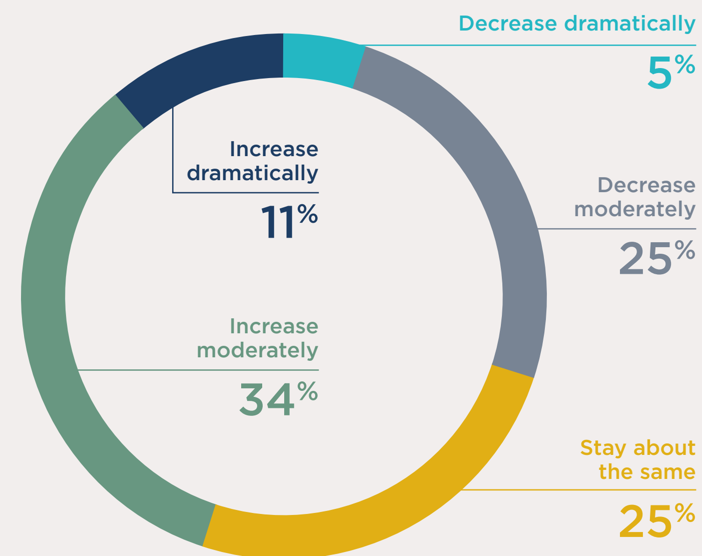
Source: Savills Investment Management Investor Survey (September 2020) Note: Multiple answers were possible.

FIGURE 5: WHEN DO YOU THINK THE EUROPEAN REAL ESTATE MARKET WILL BEGIN TO RECOVER?



Source: Savills Investment Management Investor Survey (September 2020)

FIGURE 6: OVER THE NEXT 12 MONTHS, HOW DO YOU EXPECT INVESTMENT IN PROPERTY TO CHANGE COMPARED TO THE PREVIOUS 12 MONTHS?



Source: Savills Investment Management Investor, Survey (September 2020)

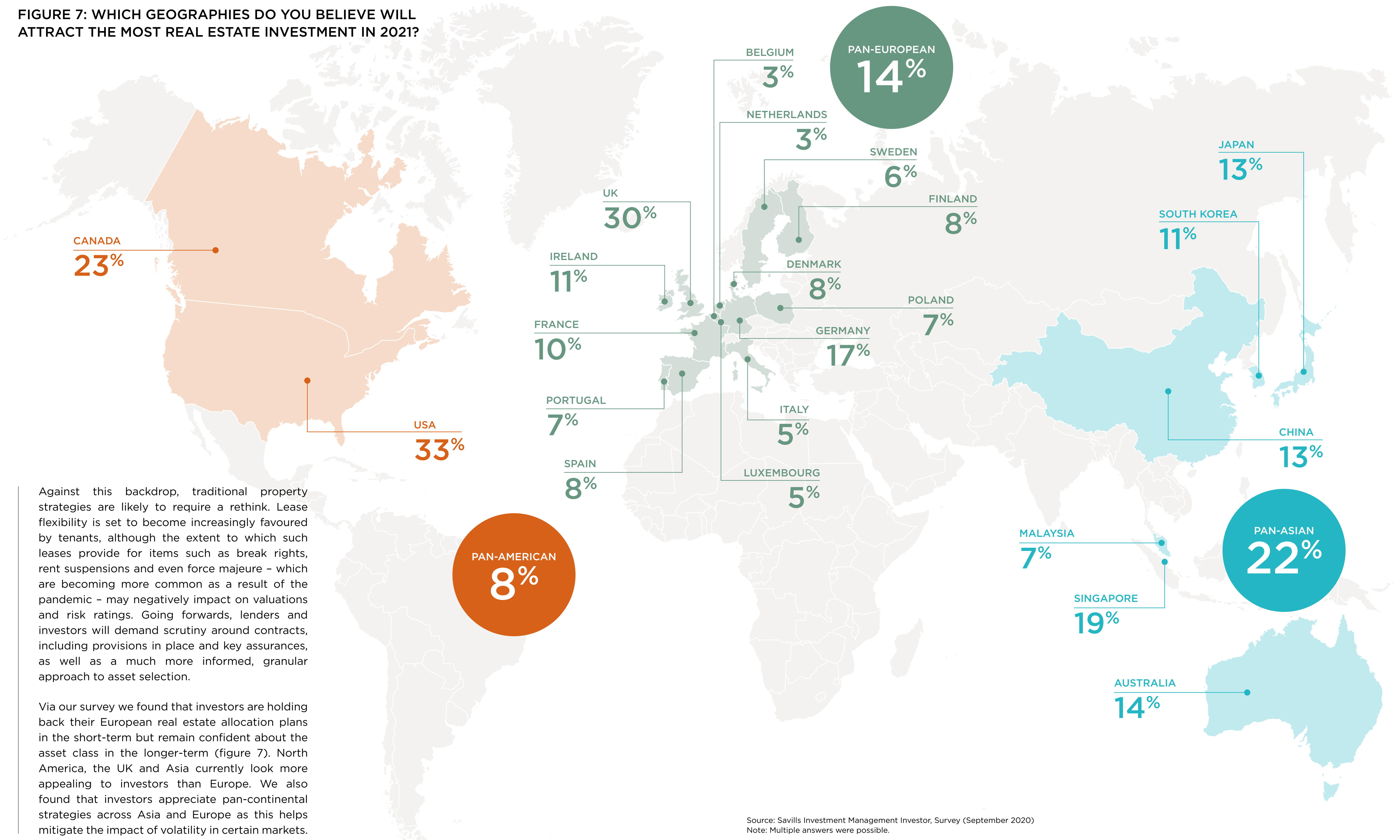
Riskier investments usually experience greater yield shift at times of market stress, meaning they can potentially deliver stronger returns through a recovery phase. While core is still relevant in many real estate strategies, pricing expectations were elevated even before COVID-19, already forcing investors to move up the risk curve.

We believe that a number of investors are currently re-evaluating their investment strategies to prepare for the real estate market recovery phase. Slightly more than 50% of the surveyed investors expect the real estate markets in Europe to recover between Q2 and Q4 2021, as the region began facing a second wave of infections in Autumn 2020. About one-fifth expect a recovery from Q1 2022 (figure 5).

We believe that real estate will remain appealing to investors within the lower-for-longer interest rate environment. Indeed, research from Preqin indicates healthy momentum in fundraising activities, and dry powder ready to be allocated into the asset class in 2021. 45% of investors we surveyed expect higher real estate investment volumes over the next 12 months compared to the previous 12, 30% think that investment volumes will decrease whereas 25% expect no changes at all (figure 6).

Funds targeting European real estate have continued to attract investment, with 40 securing a total of EUR 18 billion in H1 2020 despite market uncertainties, according to Preqin. The market environment in 2021 is likely to continue to be shaped by high liquidity, uncertainty and volatility fuelling market polarisation. The stable income, low volatility and relatively attractive risk-return profile of real estate strategies will help ensure that they see rising demand from both income-seeking investors and those aiming to capitalise on future capital value growth after the current phase of repricing.

FIGURE 7: WHICH GEOGRAPHIES DO YOU BELIEVE WILL ATTRACT THE MOST REAL ESTATE INVESTMENT IN 2021?



Source: Savills Investment Management Investor, Survey (September 2020)
Note: Multiple answers were possible.

Against this backdrop, traditional property strategies are likely to require a rethink. Lease flexibility is set to become increasingly favoured by tenants, although the extent to which such leases provide for items such as break rights, rent suspensions and even force majeure – which are becoming more common as a result of the pandemic – may negatively impact on valuations and risk ratings. Going forwards, lenders and investors will demand scrutiny around contracts, including provisions in place and key assurances, as well as a much more informed, granular approach to asset selection.

Via our survey we found that investors are holding back their European real estate allocation plans in the short-term but remain confident about the asset class in the longer-term (figure 7). North America, the UK and Asia currently look more appealing to investors than Europe. We also found that investors appreciate pan-continental strategies across Asia and Europe as this helps mitigate the impact of volatility in certain markets.

A new 'mixed-working' approach means physical offices are here to stay

JUDITH FISCHER

While many commentators and mainstream media outlets were quick to predict the death of the office when the COVID-19 pandemic first began, the reality is looking increasingly different. Three of the five 'FAANG' tech companies (Facebook, Amazon, Apple, Netflix, Google), all of which previously announced that they would allow their employees to work from home permanently, have signed office leases in major global cities. Most prominent is Facebook's lease of 730,000 sq ft (ca. 68,000 sq m) of office space in New York City.

2021 will undoubtedly be a challenging year for the office sector as result of increasing job losses – a consequential side effect of COVID-19. Weak employment conditions will weigh on office space demand and rental growth prospects (figure 8). However, we remain optimistic about the sector in the long-term, as office-based collaboration is an integral part of productivity, creativity and company culture.

The COVID-19 pandemic has accelerated the trend towards agile working, but physical offices are here to stay. Most employees want to work in the office, be it only for a few days per week, as it serves as a hub for social interaction, facilitates face-to-face collaboration and improves ingenuity.

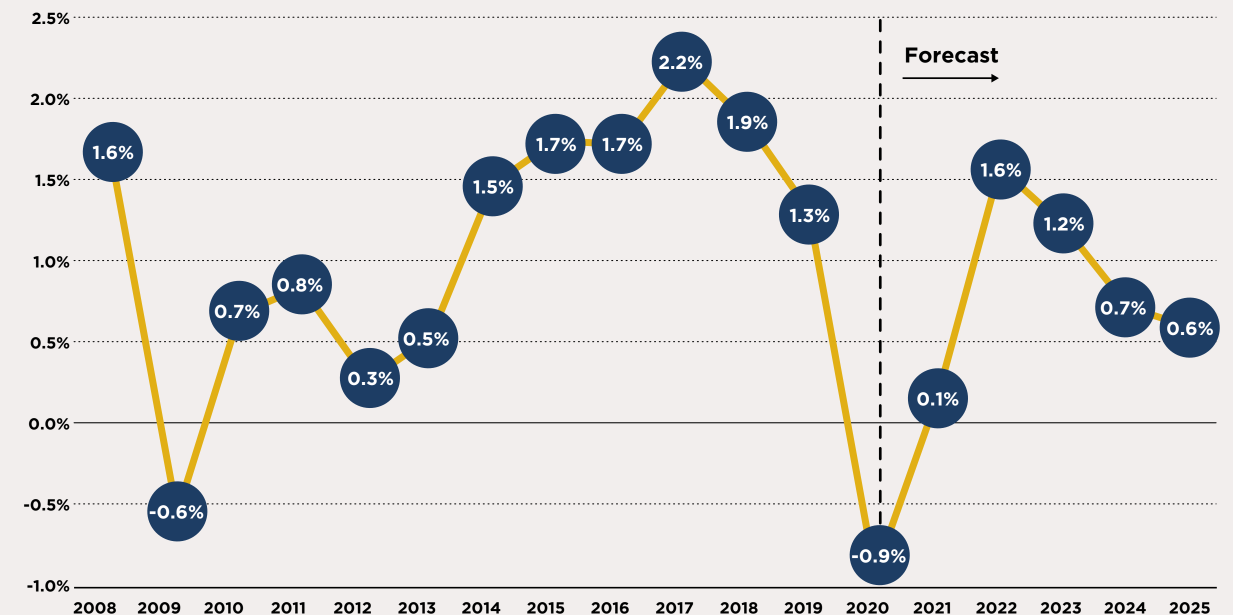
In fact, new research finds, some 46% of UK office workers intend to split their working time between home and the office, while 30% plan to return five days a week.[4] Similarly, 62% of Google employees expressed an interest in returning to the office part-time,[5] all of which suggests a new 'mixed-working' approach. Working in the office versus working remotely are increasingly being viewed as complementary options, rather than an either-or choice.

That said, from an occupier perspective, the need for more flexibility is likely to gain momentum. We do see this as an ongoing characteristic feature of the real estate market. For example, shorter lease lengths or earlier break options are likely to become more prevalent. The pressure on costs due to greater asset management will be upwards, but the trade-off for increased occupier flexibility might limit the fallout we expect to see in property rentals and therefore pricing.

In the post-COVID-19 period employers are also likely to start placing greater emphasis on the quality of the office environment, including more desk space per employee and more breakout facilities. This is likely to lead corporate responsibility to move up the agenda even faster than before. While environmental factors have tended to be the focus of ESG, our survey finds that 'S'-related issues, such as social impact, are increasingly important for investors.[6]

Occupiers tend to take office space in locations that offer good transport links, entrepreneurial spirit and universities producing a well-educated workforce, which reinforces the advantages of central locations, as highlighted in our Dynamic Cities Index.[7] Moreover, if people work fewer days a week in the office, they might prefer city centre locations that offer a wider range of services and amenities. Central business district (CBD) offices are, therefore, one subsector that we believe should be a mainstay of any future diversified real estate portfolio.

FIGURE 8: EU OFFICE-BASED EMPLOYMENT GROWTH



Source: Oxford Economics (September 2020)

[4] British Council of Offices, October 2020
[5] Google staff survey, The Guardian, September 2020
[6] Savills IM Investor Survey, September 2020
[7] https://www.dynamiccities.savillsim.com/

European logistics to remain ‘investors darling’ in 2021

MATTHIAS DÜSING

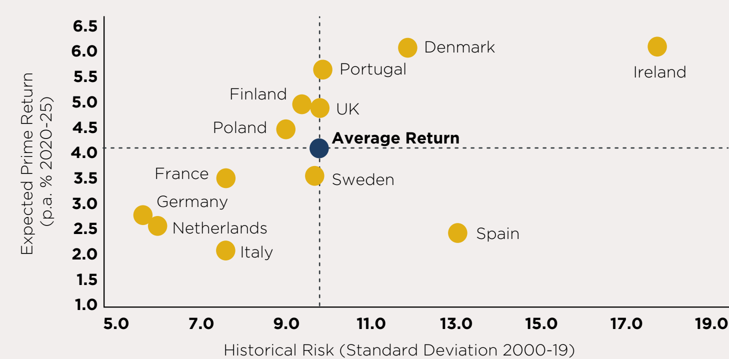
Logistics is positioned well to remain a bright spot within the real estate landscape. Backed by solid fundamentals and structural tailwinds, investor sentiment is particularly positive for logistics. Among those investors polled in our survey, more than 55% are planning to increase their exposure to the sector in 2021.

A 'wall of money' will keep pricing in the core and core-plus segments challenging. Further yield compression in primary markets such as Germany, France and the Netherlands also seems likely. We expect the spread between core and non-core to increase as an outcome of investors' excessive ‘flight-to-safety’. Market diversification will be key in 2021 as well to achieve risk-adjusted returns (figure 9).

Investors would be wise to consider moving up the risk curve to capture capital and income growth. New opportunities will arise from the reassessment of manufacturing supply chains, and accelerating trends around e-commerce, urban logistics and online grocery. On the downside, however, economic headwinds are weighing on occupier demand, leading to overall muted or even negative rental growth in some markets. An anticipated economic rebound could trigger new requirements in the mid-term, though.

Oversupply is a potential threat in some geographies. Completions have been above their long-term averages across Europe, while vacancy rates have reached historical lows. In aggregate, we do not think this is indicative of an immediate supply-side risk. The shortage of developable land will remain a key challenge in the mature Western European markets, where future supply is kept tight by restrictive zoning. In Central, Eastern and Southern Europe, on the other hand, availability was already trending upwards pre—COVID-19, and the overhang of speculative projects will need to be absorbed first.

FIGURE 9: RISK-RETURN PROFILES OF EUROPEAN LOGISTICS MARKETS



Source: PMA (October 2020), Savills Investment Management (October 2020)

[8] Property Market Analytics (October 2020)
[9] Local brokerage companies

Secular demand drivers have the potential to carry forwards the demand surplus, at least in some market segments. E-commerce has accelerated since the start of the COVID-19 pandemic, fuelling additional demand. Income-orientated investors' focus is on the consumption end of supply-chains and last-mile distribution warehouses in the key logistics hubs of Western Europe. In particular, we see opportunities in:

- markets with fast-growing online penetration rates — such as Central and Eastern Europe as well as Southern Europe – which offer attractive, albeit selective, risk-adjusted returns
- last-mile and urban logistics, which continue to attract interest based on the online shopping boom and the defensive nature of urban land values
- pronounced value-add and opportunistic strategies within buy-to-let or build-to-core approaches, where investors are teaming up with developers to unlock scope for higher returns

One e-commerce subsector to watch in 2021 is online grocery. Still in its infancy, it is showing exceptional growth, but requires specific fit-outs dedicated to food distribution. The UK, Nordics, Netherlands and Germany will be first-movers in this growing niche. The main question facing this trend is how fast demand will continue to grow, how supply can deliver suitable solutions and, ultimately, whether current valuations and forward pricing anticipations based on these are justified.

Insights from Alistair Ennever, Portfolio Manager, Savills IM

1. In your opinion, where is the logistics market heading to in 2021?

It is seen as being amongst the most defensive products, currently offering long-term sustainable income supported by underlying occupier demand. In my opinion, pricing will continue to harden in 2021 in this low interest rate environment as long as the debt market remains open for business. The challenges are around availability of product and increasing logistics-focussed planning restrictions across Europe. Tenant solvency could become an issue if the wider European economy is harder hit than expected.

2. Given logistics is the ‘hottest game in town’ now, in which segments do you see the most new opportunities?

I believe that several investors will have to complement their existing core investments with build-to-core strategies where they either develop speculatively themselves or back developers. Investors will also start to consider geographies previously thought of as more peripheral, like Portugal, Ireland, Denmark and Finland, to generate greater returns. Occupier demand in these markets is also set to improve as nearshoring becomes a focus for many supply chains.

3. In the mid- to long-term, what are the biggest trends you are seeing?

We see continued occupier investment in the automation of their facilities. This has wider implications for building design, reliance on labour and locations. Multi-storey centres are becoming more prevalent in dense metropolitan locations for several occupiers as they look to maximise the use of logistics assets. Re-purposing of retail assets to logistics is a very exciting trend to watch. We hope to see a continued focus of developers and investors on enhancing the sustainability credentials of new and existing facilities. Encouragingly, developers in Europe are integrating ESG into their design and build processes to deliver suitable product to the market.

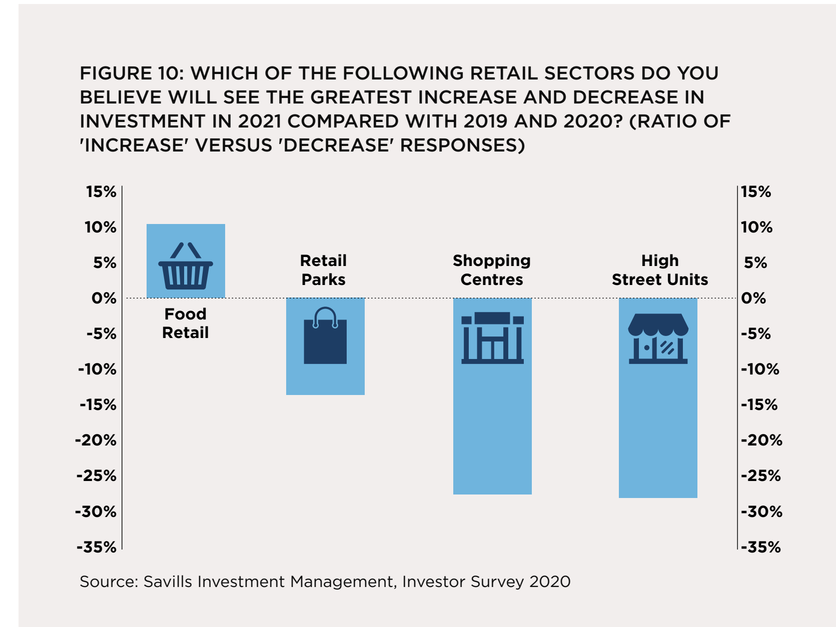
Defensive food and discount retail subsectors show resilience to disruption

ANDREAS TRUMPP

Brick-and-mortar retail has been in a very difficult position since long before the beginning of the COVID-19 crisis. Almost all non-food retail units were closed across large parts of Europe during March and April. This has prompted some important changes in retailer business strategies. For example, a number of retailers are planning to notably shrink their store networks to reduce the rental burden of physical shops. They are now placing greater emphasis on their e-commerce strategies, with far-reaching implications for the retail property market.

This has magnified concerns that many real estate investors already had about investing in retail. However, more nuanced consideration seems advisable. Some formats, such as food retailing and outlet malls, continue to be resilient to e-commerce trends. Shopping centres and certain high street properties, on the other hand, do not provide the required stability that security-orientated investors are currently seeking.

FIGURE 10: WHICH OF THE FOLLOWING RETAIL SECTORS DO YOU BELIEVE WILL SEE THE GREATEST INCREASE AND DECREASE IN INVESTMENT IN 2021 COMPARED WITH 2019 AND 2020? (RATIO OF 'INCREASE' VERSUS 'DECREASE' RESPONSES)



Source: Savills Investment Management, Investor Survey 2020

Grocery retailers benefit from relatively resilient income streams as groceries are nondiscretionary purchases. We think investors should focus on grocers with the best in-store and online offerings, since e-commerce is also rising in the grocery segment. Most leading supermarket and discounter chains are already implementing protective measures such as enhancing the customer experience, optimising in-store technology and developing omnichannel strategies to future proof their store networks.

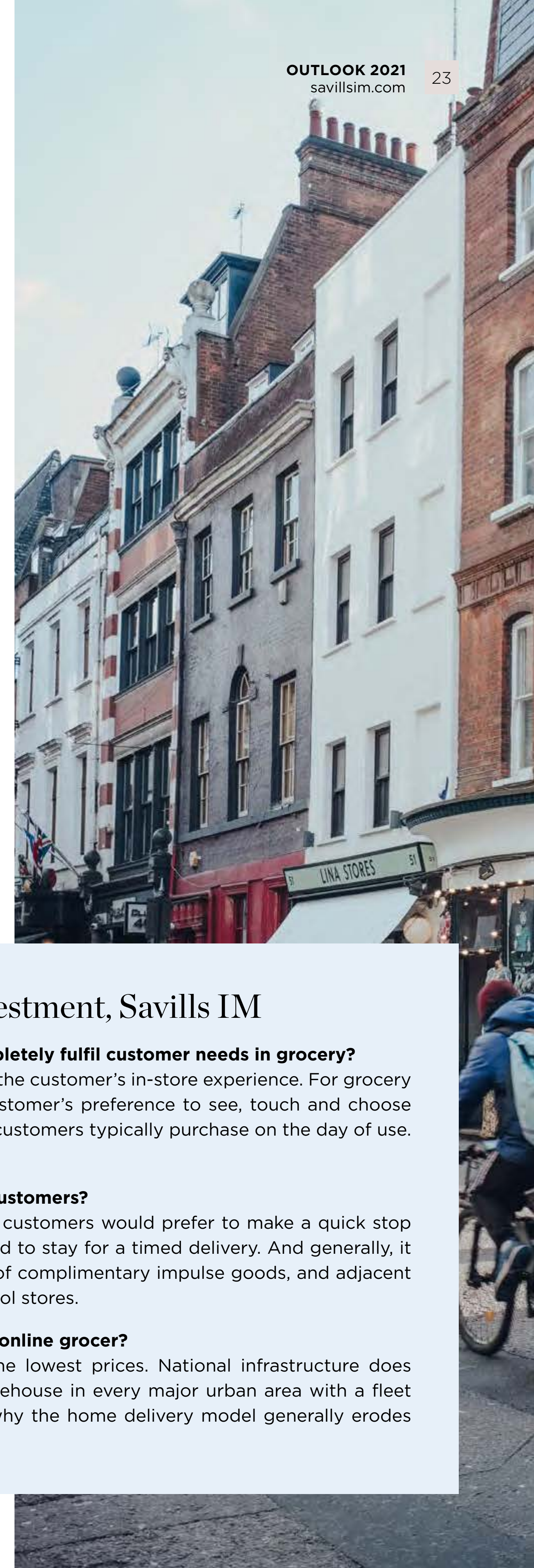
Supermarkets and food-anchored retail park valuations do not look overly stretched in the context of other retail segments and appear particularly attractive compared with risk-free rates. While average prime property yields are still close to record lows, the average pan-European prime supermarket yield stood at about 5.3% in September and is likely to compress further in 2021. This is more than 500 basis points above the average European 10-year government bond yield.

In fact, investors with a defensive investment approach have been able to benefit from stable and inflation-linked income returns in the grocery retail sector. This is reflected in our investor survey. Food retail is the only segment of the retail sector where investors want to increase rather than decrease their exposure (figure 10).

We think integrated food retail facilities in growing urban locations close to customers seem to be best placed to outperform in this context. Investors should be able to achieve attractive yields, particularly since there is the opportunity to increase capital values by adding student housing, residential or other uses on top of such assets in densely populated cities.

The outlet segment seems to have recovered well after the COVID-19 lockdown period, particularly those schemes with strong management. However, centres that rely on tourism continue to be challenged by lower turnover levels.

Outlet malls in areas without broader travel restrictions and where international tourism is not a major factor have in some cases produced stronger sales than the same period in 2019. This is partly due to some latent spending power, but also to consumers feeling safer in the outlet environment, which normally offers outdoor shopping and parking as well as a secure, well-managed experience. We maintain our view that attractive risk-adjusted returns are still available for investors if they focus on destination and convenience segments of the market.



Insights from Ian Jones, Director, Investment, Savills IM

1. In your opinion, will online ever have the chance to completely fulfil customer needs in grocery?
There are clear reasons why online is struggling to replicate the customer's in-store experience. For grocery shopping, freshness matters and hand picking – i.e. the customer's preference to see, touch and choose the product – is still key. Research suggests that in Europe, customers typically purchase on the day of use. Online cannot accommodate impulse purchases either.

2. But isn't online grocery shopping more convenient for customers?
In a lot of cases, timed deliveries are not convenient. Most customers would prefer to make a quick stop at their grocer when returning from work than being obliged to stay for a timed delivery. And generally, it is about more than food. Most supermarkets offer a range of complimentary impulse goods, and adjacent services include banks, coffee shops, dry cleaners and alcohol stores.

3. Is there a cost advantage for either the customer or the online grocer?
Customers prefer comparison shopping in store to get the lowest prices. National infrastructure does not work for grocery, so an online grocer must have a warehouse in every major urban area with a fleet of vehicles. This is putting pressure on margins, which is why the home delivery model generally erodes profitability — even with a fee.

‘Living’-focused alternative asset classes on the rise

HAMISH SMITH

MATTEO VAGLIO GRALIN

With interest rates at rock bottom and returns on traditional property assets – office, industrial and retail – low, investors are looking to alternatives.

Between 2010 and 2014, investment in alternative assets averaged EUR 30 billion per annum (p.a.) across Europe. This rose to EUR 82 billion over the next four years, with its share of total commercial property hitting 32% in 2019, up from 19% in 2010.[10] Apartments and hotels have been the dominant alternative sectors, accounting for close to 80% of such investment in 2019.

The attraction of different commercial property assets – such as hotels, student housing, senior living, build-to-rent or life sciences – is not just in their potential for higher returns, but also in their long leases that offer stable income returns. They can also present an opportunity for inflation-linked rental growth, which is particularly appealing for the likes of pension funds.

Alternatives are not just about higher returns. They can also offer counter-cyclical characteristics. Take, for example, that during normal downturns, demand for higher education often increases, boosting the appeal of student housing. Alternatives also allow investors to diversify risk.

That said, alternatives are not as straightforward or transparent for investors as offices or industrial assets, presenting unique challenges. Indeed, a shift to more operational real estate may take some investors out of their comfort zone. The European market also varies enormously by asset type, depth and maturity. For example, investment in apartments totalled EUR 53.6 billion in 2019, student accommodation transactions were worth EUR 9.4 billion and self-storage just EUR 183 million.[11]

We think that the following three ‘living’ sectors, benefit from strong underlying structural trends that provide long-term investors with appealing opportunities.

[10] Real Capital Analytics, September 2020
[11] Real Capital Analytics, September 2020

STUDENT HOUSING/PURPOSE-BUILT STUDENT ACCOMMODATION (PBSA)

Rising demand for higher education is underpinning the growth of the student accommodation sector. In the EU, for example, the number of full-time university students rose by over 1 million between 2013 and 2018.[12]

Governments' desire to increase higher education attainment has supported this trend. The European Union's Europe 2020 strategy, for example, aimed to have at least 40% of 30-34-year-olds complete a higher education course.

In addition, the global shift towards a service-based economy, along with digitalisation and automation, have highlighted the importance of higher education for young people to compete. Increased mobility and the rise of the middle classes in developing countries, who have a strong appetite for top-ranking universities, have underpinned demand from foreign students – 40% of the world's top universities are in Europe.[13]

The growth of the student market has boosted investor interest in stable, long income streams. Between 2010 and 2015, investment averaged EUR 3.2 billion per annum. This more than doubled to EUR 7 billion p.a. between 2016 and 2019.[14]

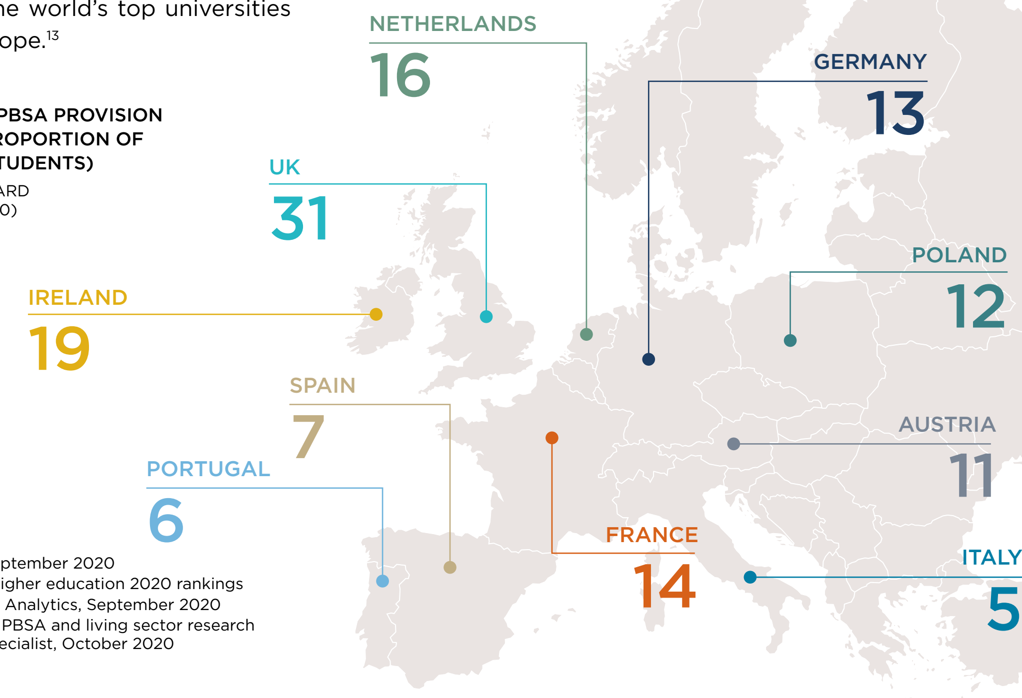
While COVID-19 has raised questions about near-term demand given the prospect of lower onsite student numbers this year, students have generally been keen to get back to university campuses. While teaching models are likely to adapt to technology, the prospect of in-person knowledge transfers leading to creativity and innovation – not to mention perhaps the most appealing aspect of university for many, social interaction – means students are likely to demand more than just online lessons in the future.

Despite a steady increase in availably, the provision of PBSA beds hasn't matched demand. Across Europe, the number of PBSA beds per 100 students is low, even in markets like the UK which is considered to be more mature than other European markets. Data from Bonard show that less than one in three students in the UK has access to a PBSA bed. This falls to one in ten in Germany and less than one in twenty in Italy and Portugal (figure 11).[15]

While it is important to take into consideration local conditions in university markets, the student housing market can provide appealing opportunities for long-term investors.

FIGURE 11: PBSA PROVISION RATE % (PROPORTION OF BEDS TO STUDENTS)

Source: BONARD (October 2020)



[12] Eurostat, September 2020
[13] The Times higher education 2020 rankings
[14] Real Capital Analytics, September 2020
[15] BONARD, a PBSA and living sector research and data specialist, October 2020

BUILD-TO-RENT (BTR) RESIDENTIAL ACCOMMODATION

Like other 'living' sectors, BTR is supported by long-term demand drivers. In particular, rising urbanisation, smaller households and affordability constraints to home ownership are forcing younger people to rent for longer before purchasing their first home.

These trends explain why institutional residential investment in Europe has more than doubled since 2014 to EUR 54 billion in 2019. Admittedly, Germany – one of the few European countries with a well-established institutional BTR sector due to the low proportion of home owners – accounted for 34% of this. Even so, average investment there rose from EUR 5.7 billion between 2010 and 2014 to EUR 15.5 billion between 2014 and 2019.[16]

Stable, long-term income returns in the sector are also appealing for investors. During times of economic turbulence, residential property is often viewed as a safe haven asset, as rental income tends to be more secure than in other sectors. In the near term, the economic downturn is likely to limit rental growth prospects. Consideration also needs to be given to potential changes in tenant expectations as a result of experiences from COVID-19 lockdowns. This could include greater demand for balconies, larger communal areas or the provision of space to work from home.

While tenant preferences might change, we do not anticipate any major shifts in the underlying demand drivers. These will continue to underpin the need for good quality, institutional BTR residential properties. As such, we believe that the BTR sector will continue to offer investors good long-term investment potential. More so now, given net yields in this sub sector are on a par with prime office and logistic yields. An aspect that was not the case 5-10 years ago.

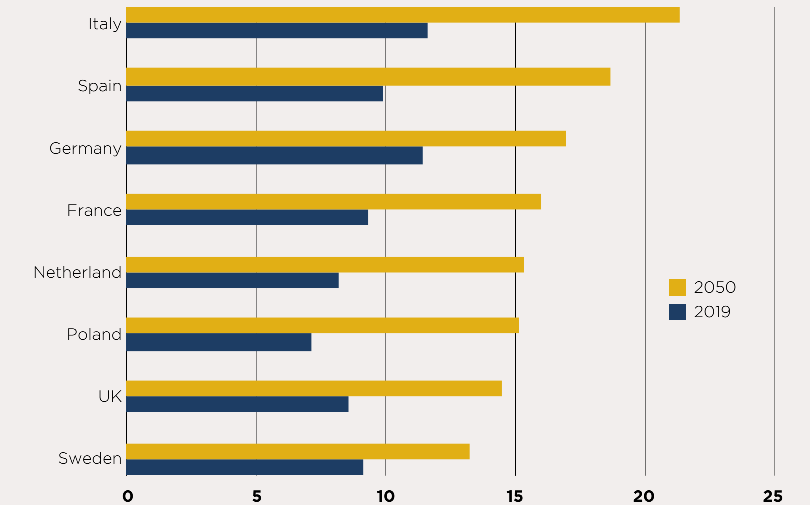


FIGURE 12: PROPORTION OF 75+ POPULATION, AS A % OF TOTAL POPULATION

Sources: Savills Investment Management, Oxford Economics (August 2020)

SENIOR LIVING

The senior living sector has been impacted by the COVID-19 crisis throughout 2020. We expect that the sector will continue to suffer by weaker demand from residents, higher costs and a less dynamic investment market into 2021.

To put prospective residents more at ease, safety standards must be reviewed and enhanced. In the meantime, weaker demand for beds will detract from income. The risk of increased regulation is also likely to add further cost pressures on the sector, both in terms of labour and operating expenses.

In the near term, therefore, it is all about finding an asset that is resilient to regulatory changes and that has the capacity to manage crisis situations such as COVID-19. Fund managers must negotiate an attractive entry price. Demand may remain moderate, if increased operating costs leads to higher costs for residents, especially if they rise above the average pension income.

Nonetheless, we remain positive in the long term about this sector. There is a substantial imbalance between demand and supply. The population is aging (figure 12); life expectancy has been steadily increasing for many years; baby boomers are entering retirement age and given their high-income potential they expect a good quality of life. On the supply side, the provision of new developments is low on average. The recovery will start once there is some degree of certainty about the COVID-19 outlook. Moreover, a transformation may be on the horizon in the form of increased privatisation. Investing in this sector is a strong buy for players who want to move up the risk curve and add value-add elements to their portfolios.

[16] Real Capital Analytics, September 2020

Spotlight on the 'S' in ESG

HAMISH SMITH

Environmental, social and governance issues (ESG) have become a hot topic in the property world as investors increasingly consider the impact of real estate on the environment and people who live, work and play in built space. It is not just financial returns that drive investment decisions today. Investors also want greater transparency around environmental and social responsibility from their managers and advisers, and the businesses in which they entrust their money.

This reflects a growing recognition of changing societal concerns and the recognition that ESG factors can play a positive role in a corporate context, such as via improving and protecting brands, attracting and retaining talent, and reducing long-term risks.

In the real estate industry, ESG has tended to focus on environmental sustainability considerations – E factors. Increased awareness of climate change, legislation aimed at reducing carbon emissions and initiatives such as net-zero carbon have underpinned this. At Savills IM, for example, the need to consider the lifecycle of a building, in both development and use, in order to truly embrace net zero carbon means that design teams are challenged to make specifications that will future proof new assets.

Measurability also explains why E factors have hogged the limelight thus far. It is far easier to calculate the amount of CO2 saved by using renewable energy sources than to quantify whether an employee is being treated fairly or not.

But the ESG focus is starting to change. Investors increasingly demand concrete evidence of what firms are doing in relation to S and G issues. This is not surprising given concerns around 'greenwashing' – the claim that a product or strategy is 'greener' than its reality. Additionally, poor governance can increase risks for investors, especially if an investment is linked to unethical or misleading business practices. There has also been a marked shift in investor mindset, with an expectation that businesses and investors will make a positive contribution to society, not just to shareholders.

We asked Lucy Winterburn, Director, Investment, Savills IM, about how S issues are evolving and becoming increasingly important for real estate investors.

The focus of ESG in the real estate industry has tended to be on the E, but this appears to be changing. How are you seeing investors views towards S and G issues evolving?

Social and governance issues are racing up the agenda, with more and more investors wanting to know what we are doing on the social side to make a real positive contribution. And not just for Savills IM as a business. Investors also want to know how we ensure that their assets and their tenants can make a positive impact too.

Can you give an example of how Savills IM is supporting clients and tenants with their social goals?

At one of our recently completed industrial logistics scheme in Didcot, UK, we included generous green space, encompassing a walking and running track, landscaped garden and water features and an amphitheatre for workers to enjoy. Amenity space for workers only tends to be considered in the office sector, but there is no reason why it shouldn't be a key consideration in other sectors as well.

Does a lack of measurability or industry standardisation hold back S issues from being on more equal footing with E?

It definitely makes it harder to quantify betterment and to compare apples with apples, but ultimately, that isn't an excuse. We must demonstrate 'S' impact considerations in our strategies. It would be foolish to ignore the tidal wave of interest in this area – investors have choice.

Small businesses often say that they don't have the resources to focus on ESG issues. How does Savills IM help them to make an impact?

We have many smaller tenants who we engage with to try and understand what we can do to support their ESG agenda and local community needs. ESG initiatives don't have to be grandiose and expensive – simply improving recycling, installing more efficient lighting or supporting a local food bank can all have important positive impacts. Collaboration is of paramount importance to this success. One of the few positive outcomes of COVID-19 has been increased tenant engagement across our portfolios, with a recognition that working together can reap rewards for both owner and occupier.

Technology as disruptor and facilitator

ERI MITSOSTERGIOU
Savills European Research Director

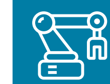
The real estate industry has been experiencing the disruptive impact of technology, with implications for occupier requirements, construction, property management and financing tools as well as transaction processes, to name a few. The COVID-19 crisis is accelerating change, putting pressure on the industry to react. Technology will enable buildings and cities to respond to the shock and recover.

SMART CITIES, BUILDINGS AND INVESTORS

Technology and automation are helping developed cities overall to become more efficient, sustainable and safe. The use of sensors allows for better management of traffic, energy and waste at all levels. And data collected from communities' electronic infrastructure is used to enhance efficiency and adaptability in the way people use space. Citizens have become the sources of big data via their mobile devices, and city managers are applying big data analysis to monitor and anticipate urban phenomena.

At the building level, the adoption of smart technologies is likely to pick up strongly as a means to ensure that buildings help prevent contagion in the future. But post-pandemic, automated building controls that factor in temperature, air quality, weather conditions and occupancy will also be used widely. These technologies help manage building systems, optimise energy and space usage and improve user experience and wellbeing.

Big data will not only be a tool for the efficient design and operation of smart cities and buildings, it can also become a facilitator of more informed decisions by investors and developers. By measuring and analysing the impact of market conditions on building performance, they can create algorithms to anticipate future trends and opportunities.



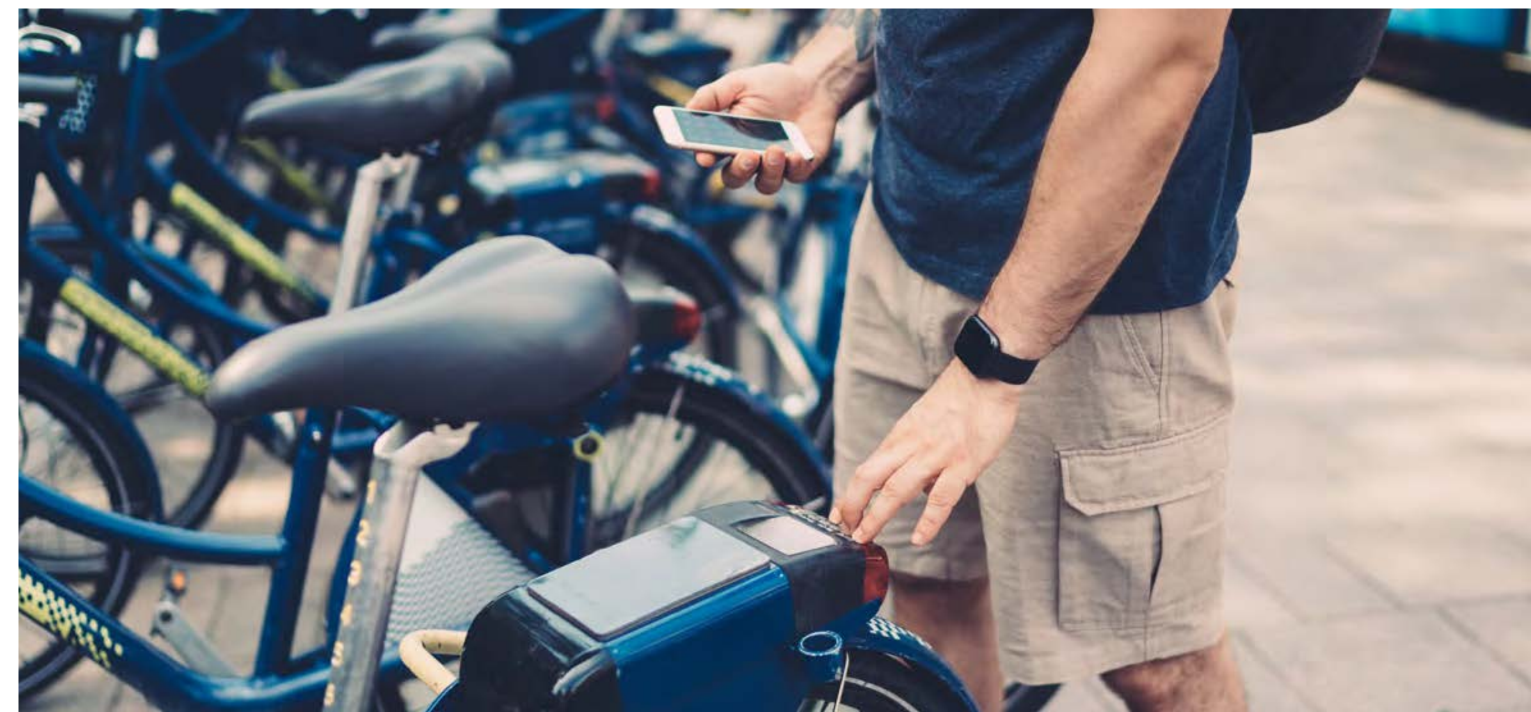
SMART MOBILITY AND CONSTRUCTION

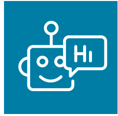
Driverless car technology in combination with the Internet of Things has the power to transform the way cities function. In city centres, it could release parking spaces for redevelopment into affordable housing or green public areas. In retail destinations, it could free up lots for outdoor leisure, food and beverage or alternative uses such as apartments, flexible office space, self-storage or last-mile logistics.

With on-demand automated mobility, residential choice will not fully rely on transit hubs and connections, but also on inter-modality between public transport and car-sharing services. In combination with the rise of agile working, this could take some demand pressure from the most expensive cities, which have become congested and unaffordable for large groups of the society.

Some demographic groups may choose to relocate to well-connected satellite suburbs and towns that still offer good amenities and variety of uses, functioning as a polycentric system of employment and population distribution. This trend is likely to create more demand for decentralised, well-connected mixed-use developments offering good quality, affordable housing and services. This includes convenience retail, flexible workspace, health and wellness centres and communal areas.

Construction technologies that help reduce costs and facilitate flexible space production – such as 3D printing, modular construction and the use of robotics – are more efficient, less labour intensive and could relieve high costs and labour shortages in the construction industry. This could transform the residential sector in particular, and offer a solution to housing shortages in major cities.

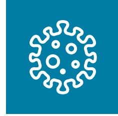




THE AUTOMATION EFFECT

The big question about technology is the impact that it will have on employment and the demand for workspace. Artificial intelligence is replacing repetitive and predictive white-collar jobs, while automation and robotics have implications more so for blue-collar jobs. Higher business efficiency could lead to reduced demand for office, retail and warehousing/factory space. However, demand for higher-skilled workers is likely to remain strong, as robots will lack creativity and social intelligence. Therefore, automation is likely to pose a bigger threat to income equality than to work itself, as the balance of power shifts in favour of educated workers.[18]

About 14% of the global workforce, or circa 375 million workers, will probably need to build new skills and redefine their career paths by 2030 as a result of these trends.[19] At the same time, aggregate machines will add jobs to the economy. There are already new industries emerging from the technology sector that are creating new specialisations, such as life sciences, e-commerce and gaming. Besides, the expected rise in productivity can lead to economic growth, further investment and rises in employment.



THE IMPACT OF THE PANDEMIC

It is widely accepted that the COVID-19 crisis has and will further intensify the use of technology, bringing forwards some of the trends and the changes that were already underway. This raises more intense questions about the future of buildings and cities. Working from home, shopping from home, eating from home and learning from home became increasingly routine during the lockdown, generating concerns that people will not go back to densely occupied buildings and cities.

The difficulty is that cities have always been enablers of creativity, innovation and economic activity, with buildings driving human interaction. During the pandemic, technology allowed us to perform our activities solely, remotely and independent of location. 'Location, location, location' has always been the key factor determining the attractiveness and value of a building. Will it remain relevant in the new post-pandemic normal? The short answer is, 'yes'.

Until a vaccine is found, social distancing and intensive hygienic protocols will reduce personal contact to a certain extent. In the short term, technology will help compensate for the loss of direct human interaction through virtual communication. In the medium to long -term, however, collaboration, growth, the generation of ideas and the development of talent will continue to require personal interaction in physical space. Buildings will remain relevant and will adapt to change (figure 13).

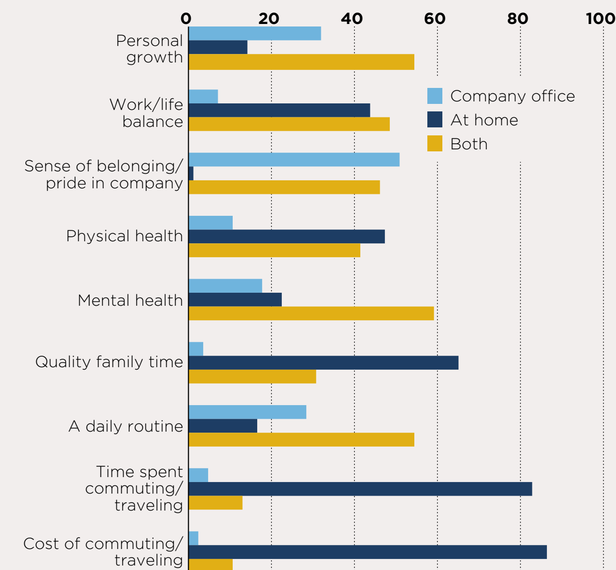
[18] Oxford Economics
[19] McKinsey Global Institute

Location will remain important as people become more selective with regards to the neighbourhoods and the cities they choose to live in. People will prefer to live in mixed-use, walkable and cyclable communities in proximity to amenities, cultural attractions and green spaces, with access to quality and affordable housing as well as jobs. Cities – which offer a high quality of life, ensure their citizens' safety, wellbeing and are more resilient to external shocks – will attract both highly skilled people and businesses. They will remain the main hubs of innovation and growth. The Savills IM Dynamic Cities Index helps to identify the factors that make a city attractive to talent, resilient to disruptive technology and a leader in the knowledge economy.[20]

Working-age populations across European cities are set to increase by an average of 1.5% over the next 10 years, Oxford Economics statistics suggest, with the strongest growth in Stockholm (14.7%), Copenhagen (9.9%), Oslo (9.3%) and London (9.2%) during this period (figure 14).

In this new era of competition between cities, national and local governments need to invest in smart technologies to become more adaptable and resilient. Technology will shape the 'new normal', facilitating the creation of smarter, more sustainable and more liveable buildings and cities.

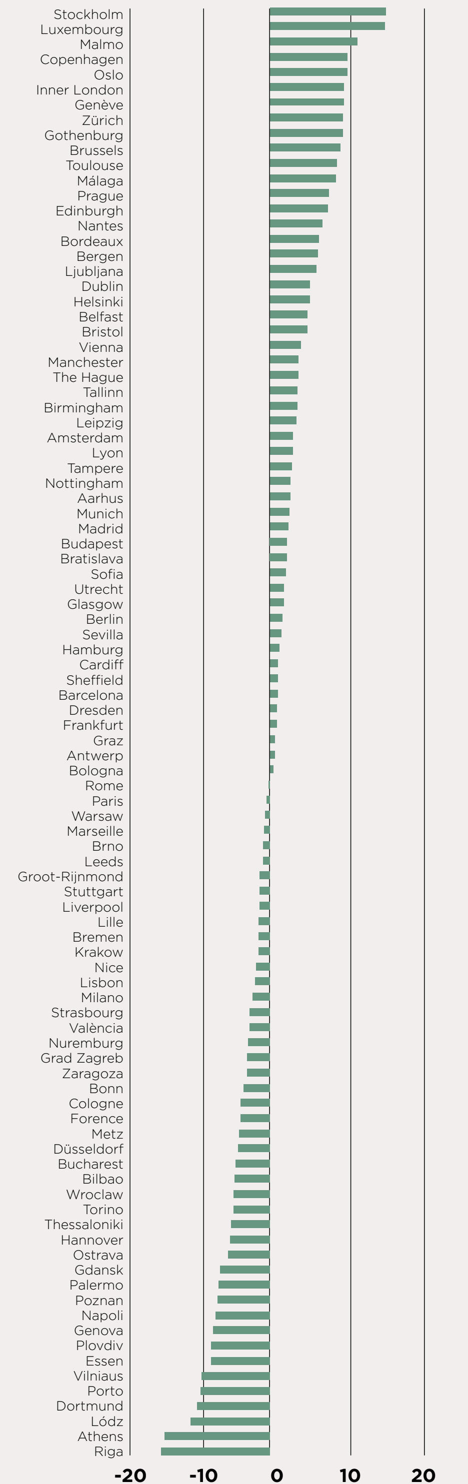
FIGURE 13: PLEASE SELECT WHICH LOCATION YOU THINK CAN BEST FACILITATE THE FOLLOWING FACTORS (%)



Source: KKS Savills Office FiT survey

[20] https://www.dynamiccities.savillsim.com

FIGURE 14: WORKING AGE (15-64) POPULATION GROWTH (%) 2020-30



Source: Oxford Economics

Market turbulence creates interesting opportunities in real estate debt investment

DALE LATTANZIO
Managing Partner, DRC Capital

In 2008 the European property markets were entering a historic correction in the face of the unfolding global financial crisis (GFC). The commercial real estate (CRE) debt market preceding this turning point was extremely liquid and deep (figure 15). Dominated by banks, cheap leverage helped propel capital values to new highs. The corresponding pull-back in liquidity, prompted by changing capital rules in the form of Basel II, was compounded by the financial crisis and corresponding recession.

The recovery was slow but ultimately steady, and new alternative lenders – including Insurance companies and debt funds – started entering the market, filling the funding gap left by the departing banks who concentrated on rebuilding their equity cushions. These new providers of debt capital now account for roughly 25% of lending in the UK.

The CRE market is once more faced with challenges and uncertainty driven by a new phenomenon that has impacted markets globally: COVID-19. While the underlying root cause is vastly different, some of the uncertainties the market faces today are like those witnessed in 2008:

- The shape of the economic recovery was unclear.
- Rents were expected to decline in most asset classes.
- Additional risk premium was required, and yields moved outwards but not uniformly (secondary yields expanded further than prime yields).
- The market was illiquid, characterised by pricing differentials between buyers and sellers.
- There was very little availability of debt.

But there are some distinct differences that will positively impact availability of debt during this cycle:

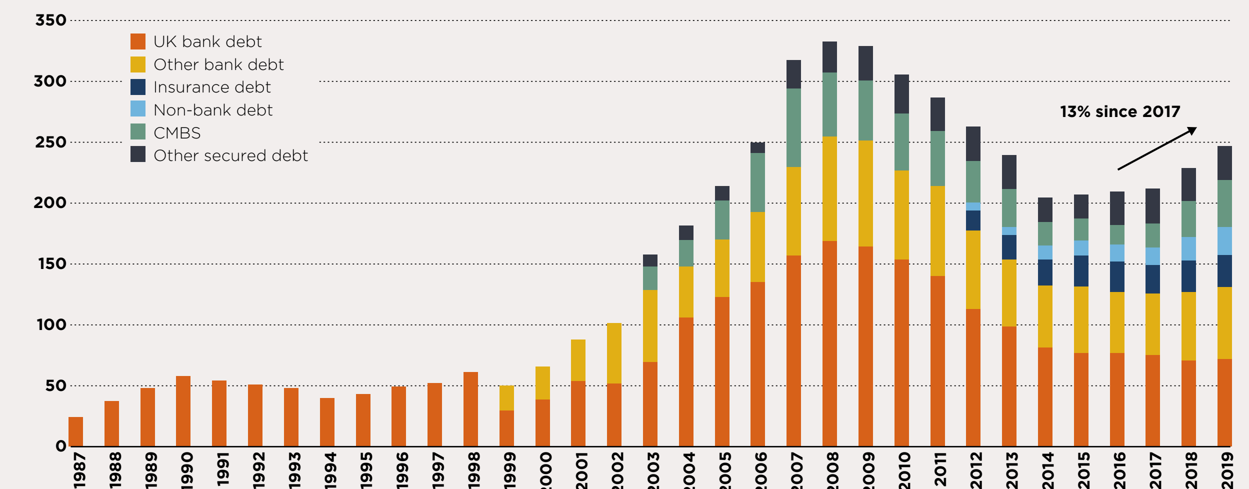
- The banks are much better capitalised.
- Loan-to-value ratios are substantially lower.
- There is a more diverse CRE lending market, and alternative lenders are well established and already active players in this current market.
- Governments have acted with extraordinary speed to provide liquidity to the market.

Therefore, we are less likely to see a similar broad-based debt liquidity element to capital value declines than we witnessed in the last correction. The property market certainly faces some significant structural challenges – there are economic and behavioural forces affecting asset classes disproportionally. Emerging occupier trends are being propelled forwards faster, as we have seen in retail, hotel, leisure and flexible office working.

However, due to structural differences, there will be more debt available compared with the early stages of recovery during the GFC. Debt provision will initially be tempered. Risk aversion will be a dominant theme for lenders, with a focus on the most resilient asset classes (logistics and industrial as well as residential). Banks will retreat and move back towards the risk centre, preferring core assets and locations. They will be less likely to expand their client bases but will mostly provide liquidity to their best customers. Alternative lenders will therefore see more opportunities and will be able to generate required returns for their stakeholders by taking less risk.

While there will no doubt be interesting equity opportunities for investors, debt investing will provide an attractive, robust income-based return underpinned by property, which will exhibit lower volatility than in the previous cycle correction.

FIGURE 15: LONG-TERM DEBT CYCLE - GBP BILLION



Source: Cass Business School

European occupier and investment markets to remain subdued into 2021

ANDREAS TRUMPP

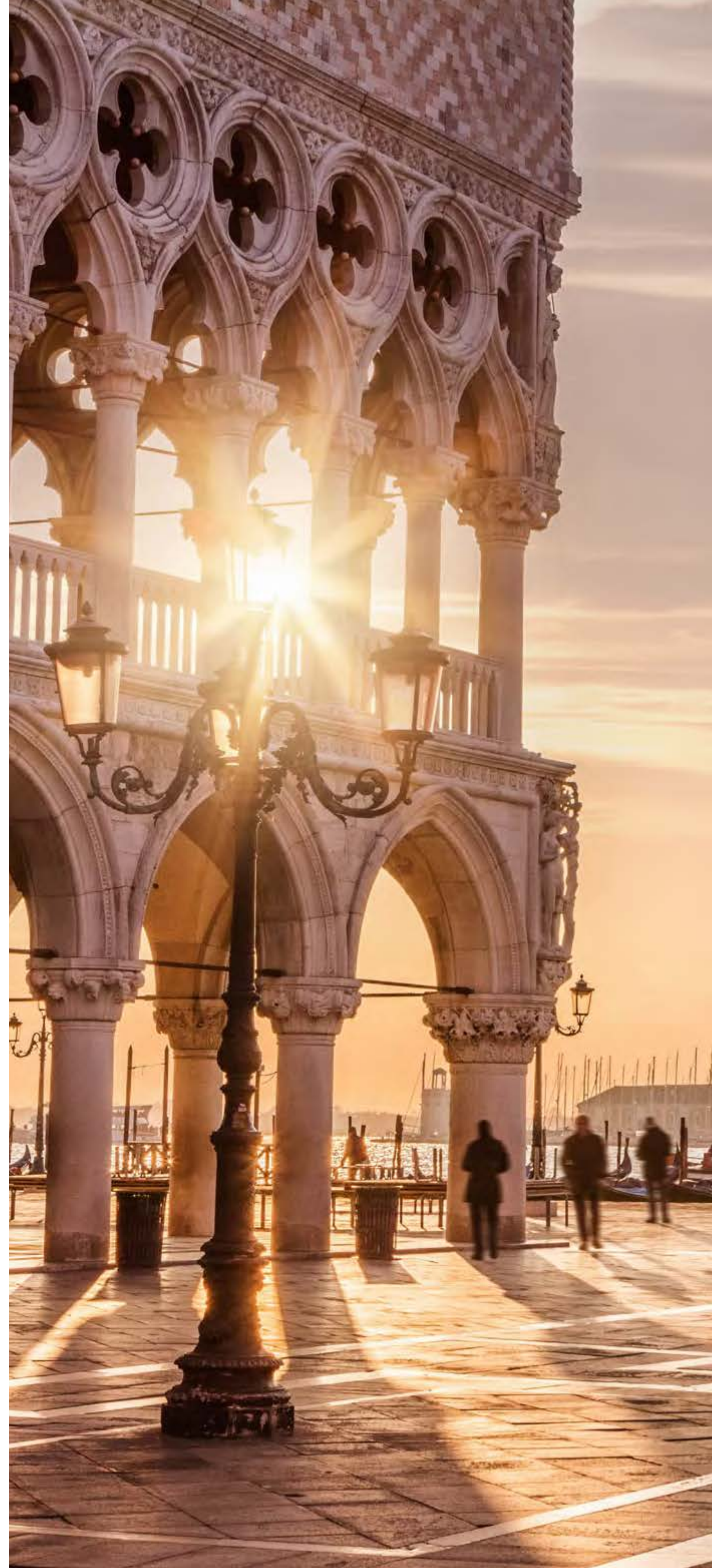
The first weeks of Autumn 2020 dashed hopes for a lasting COVID-19 pandemic slowdown, and the already highly improbable V-shaped economic recovery has turned into a W. Although at time of writing, a notable 5.3% growth in Eurozone GDP in 2021 is expected, one cannot ignore the deepest recession since World War II.[21]

The longer-term recovery will largely depend on the damage the pandemic causes to the labour market. With governments set to provide less support in the future, unemployment will rise further in coming months. Capital Economics expects the unemployment rate to peak at around 10% in 2021, up from around 8% at the end of 2020 and 7.6% at the end of 2019.

Due to potentially rising COVID-19 infections over the winter months as well as the pending risk of further lockdowns across Europe, it is likely that overall take-up numbers will remain subdued for the foreseeable future. Cost control has risen to the top of the corporate agenda, and companies are remaining conservative in their approach towards capital expenditure. Many questions are still yet to be answered regarding the long-term behavioural changes emerging from COVID-19, and the resulting effect on demand for office space.

A rise in remote working following the pandemic is potentially reducing new space requirements for the future. Shorter lease lengths and earlier break options are likely to become more prevalent. This will have consequences for both the rental outlook and development prospects from 2021. On a more positive note, European office markets entered the current crisis in quite good health and on a vacancy level roughly 200 bps lower than before the global financial crisis.

[21] Consensus Economics (October 2020)



The post-COVID-19 retail landscape is looking very different from what we knew before. A structural change in consumer behaviour, combined with the accelerated shift to e-commerce in the wake of the pandemic, has accelerated the issues brick-and-mortar retailers were already facing before the crisis. The consolidation of store networks is likely to continue over the coming years since a number of department stores and fashion retailers have already gone into administration.

Although online grocery shopping habits have increased since the beginning of the pandemic, food retailers benefit from a relatively resilient income stream, as groceries are nondiscretionary purchases. Gains were also noted in the DIY, furniture, homeware, sports and electronics segments as consumers had more time for home improvements and hobbies during lockdown. These trends will potentially continue into 2021 since international travel and tourism will remain constrained until a vaccine comes to market.

The World Trade Organization (WTO) expects the global trade volume to grow by about 7% y/y in 2021, following a massive fall of -9% y/y in 2020. Although the COVID-19 pandemic has disrupted international trade massively, global as well as European trade had already started to stagnate before the outbreak. For instance, intra-EU trade growth was flat in 2019, according to Eurostat data.

Furthermore, the pandemic-induced lockdown period has strengthened the strategic role of the European logistics sector as 'essential infrastructure'. E-commerce sales as a percentage of total retail sales accelerated further in 2020, and that trend is expected to continue. Strong occupier demand – particularly from online retailers and third-party logistic (3PL)s operators – has driven logistics take-up across Europe and has also partly offset an increasing weakness in the manufacturing sector. Nevertheless, there are still downside risks given the uncertain economic outlook and the responsive and disperse nature of supply.

Due to the resurgence of the pandemic in Q4 2020, including potential travel restrictions and local lockdown measures until Spring 2021, we expect that investor activity is likely to remain subdued for the time being. It is therefore not a surprise that overall investment volumes are down across the board, with the exception of logistics.

That said, the lower-for-longer, or lower-forever, narrative around interest rates will support commercial property amid very low government bond yields. This is especially true against the backdrop of EUR 16.6 trillion in government bonds yielding negatively across the globe at the time of writing. However, the weaker outlook for rental growth combined with a forecast short-term dip in yields is likely to result in softer capital values across most sectors and countries in 2021.

BELGIUM

Country analyst: Judith Fischer

TOP PICKS

- offices in the European district and CBD and those near transport hubs in Brussels North

ECONOMY

The outlook for the Belgian economy is challenging, as for the rest of the Eurozone. Rising unemployment, lower consumer spending and weak external demand will hamper economic growth. GDP is expected to remain below pre-COVID-19 levels until 2022.

Nearly 500 days after the country's general election a new federal government was formed in Autumn 2020. This should give Belgium the much-needed political stability to tackle the impact of the COVID-19 pandemic.

OFFICE

The strong presence of European institutions and governmental organisations makes Brussels attractive to institutional investors searching for long leases and stable income. The European district and CBD (Pentagon) are the most dynamic office markets in Brussels, with the latter seeing large developments and restructurings. Brussels North also offers selective opportunities near public transport hubs.

While flexible office providers expanded strongly in Brussels over the last few years, the effects of the COVID-19 pandemic could lead to an increase in vacant space. Prime office properties on long leases trade at 3.5% net initial yields. However, there are also value-add opportunities for investors willing to take refurbishment risks in submarkets such as Brussels North.

LOGISTICS

The Belgian logistics market is not a very large market. Logistics lot sizes are relatively small and there is very little speculative development. Investment opportunities are scarce, with the annual investment volume over the last five years averaging less than EUR 300 million.[22] There are few opportunities around Antwerp, or for last-mile logistics in the Brussels region. Given the proximity of the Dutch border, it is advantageous to take up logistics opportunities in the neighbouring Netherlands to serve the Belgian market.

RETAIL

The Belgian retail market offers scarce opportunities for retail parks and high street shops due to its small market size and small lot sizes. Brussels high street prime locations are mainly limited to Rue Neuve for mass market retailers and Avenue Louise and Toison d'Or for luxury retail. There is a constrained number of investment opportunities on those high streets, including within mixed-use properties featuring upper-floor offices. Market trends and prices are therefore difficult to assess.

[22] Real Capital Analytics (September 2020)

DENMARK

Country analyst: Judith Fischer

TOP PICKS

- central multi-let office buildings and single-let out of town offices in Copenhagen
- larger food anchored retail parks in Tier 1 and Tier 2 cities
- distribution centres along the main motorways

ECONOMY

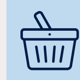
Supportive fiscal policy, an improving labour market and a pick-up in international trade should support Denmark's economic recovery in 2021, following the sharp fall in activity in 2020. Danish GDP is forecast to grow by 3.9% in 2021.[23]

OFFICE

Office employment in Copenhagen is expected to pick up again in 2021 as labour market conditions improve. Office buildings in central Copenhagen as well as in out-of-town office parks remain attractive for both occupiers and investors. Prime office rents, however, are likely to see a rental correction, albeit more muted than in the other Nordic office markets.[24] We prefer evaluating office market opportunities on a case-by-case basis because of the fragmented nature of the Copenhagen market.

LOGISTICS

The Danish logistics market is among the smallest in Europe. Letting activity is likely to decline, but prime logistics rents should remain stable and pick up following economic recovery.[25] Wider European trends such as accelerated e-commerce growth and urban logistics also offer opportunities in the Danish logistics sector.



RETAIL

Retail market conditions in Copenhagen weakened well before the COVID-19 pandemic, particularly nonessential retail. After a dip in 2020 due to COVID-19–related store closures and grim consumer confidence, Danish retail sales are expected to recover from 2021 onwards.[26] The online share in retail spending jumped to more than 17% in 2020 from less than 11% a year earlier.[27] This is offering opportunities for retailers that had already started investing in their online channels. From a brick-and-mortar perspective, the grocery segment remains resilient as well as segments related to home, garden and outdoor activities.

[23] Oxford Economics (September 2020)
[24] Property Market Analysis, Recession Scenario (Autumn 2020)
[25] Property Market Analysis, Recession Scenario (Autumn 2020)
[26] Oxford Economics (September 2020)
[27] Property Market Analysis (Summer 2020)

FINLAND

Country analyst: Judith Fischer

TOP PICKS

- central office buildings with refurbishment opportunity
- food-anchored neighborhood centers in Helsinki metropolitan area
- newly built logistic facilities

ECONOMY

The economic recovery in Finland is likely to be more muted compared to other European countries, although the Finnish economy experienced a milder contraction in 2020. Higher unemployment will weigh on wage growth, and combined with consumers' precautionary savings, the recovery in private consumption will remain suppressed. Weaker demand from the country's main trading partners will hamper a fast revival of exports. GDP growth is forecast at 1.8% in 2021, mainly supported by government spending.[28]

OFFICE

The central Helsinki office market remains of interest thanks to improving stock quality and office space modernisations. Vacancy levels in Helsinki's out-of-town areas, however, remain high, and the current weak employment conditions will weigh on demand for office space. Prime office rents in Helsinki will see a downwards correction in 2021, with an expected fall of -2.0%.[29]

LOGISTICS

The most preferred Finnish logistics locations are between Tuusula and Hämeenlinna motorways and along Ring Road III. There is strong demand for modern, medium-sized (1,000 –3,000 sq m) logistics premises. Due to a balanced demand-supply ratio, prime logistics rents have remained fairly stable over the past few years, and we do not expect major changes in 2021.

RETAIL

Retail sales in Finland are set to recover from 2021 onwards. While a larger portion of retail spending has moved online, the total e-commerce share remains slightly lower than in the other Nordic countries.[30] Food retail is one of the segments that remains resilient

[28] Oxford Economics (September 2020)
[29] PMA Recession Scenario (Autumn 2020)
[30] PMA Recession Scenario (Autumn 2020)

FRANCE

Country analyst: Matteo Vaglio Gralin

TOP PICKS

- logistics along the 'North Sea - Mediterranean' corridor and in regional markets in well-connected locations
- offices in well connected locations in Paris (including inner suburbs) and in regional markets such as Lyon

ECONOMY

In France during the lockdown period, consumption, investment and activity in the public sector fell sharply. Economic activity should partially recover in 2021, growing by 6.9% compared to -9% in 2020, although it will be necessary to wait at least until mid-2022[31] for the recovery to be complete. The unemployment rate could exceed the record levels of 2010, reaching 11.5% in Q1 2021, and then gradually receding.

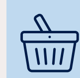
OFFICE

In Paris, occupier demand is weak while there is still a large pipeline expected to hit the market, particularly in La Défense. The investment market remains dynamic, with competition for core products. Good access to public transportation and bike lanes are playing a key role in increasing the attractiveness of some central areas; for example, Paris downtown is attracting younger workers who prefer to commute by bike.

Among regional markets, Lyon stands out because of its comparable market features to Paris, but higher yields. Availability is under control due to high pre-letting activity and limited planning construction, which helps balance out the weaker demand.

LOGISTICS

In the past, the logistics demand was concentrated along the main logistics corridor, however several national players are taking space in the regional markets, driven by the good performance of mass distribution and wholesale. Moreover, along the main corridor, availability is low (as in Lyon and Marseille for example) and it is becoming more difficult to make the land suitable for construction in efficient times. We believe investors' interest will remain high.



RETAIL

Although grocery is performing well, it is not a large investment segment in France, as most of the supermarket chains own their stores. Interest from investors is also limited both for high street and out-of-town retail. The former relies on tourism,[32] particularly luxury brands, which has yet to recover. The latter includes shopping centres that are suffering, even if some formats such as discount stores are still doing well.

[31] Oxford Economics (October 2020)
[32] 89.3 million visitors to France in 2018, the UN World Trade Organization reports

GERMANY

Country analyst: Matthias Düsing

TOP PICKS

- multi-let core/core-plus office assets in well-connected locations in theTop-7[33] markets and long-income opportunities in regional cities
- core/core-plus assets with a strong long-term covenant in the main logistics clusters and liquid second-tier markets
- food-anchored retail parks and supermarkets

ECONOMY

Germany is well positioned to weather the crisis and return decisively to its pre-recession growth path, which is expected by Q2 2022.[34] Despite the encouraging return of trading activity and industry output, weaknesses in global demand alongside structural changes continue to weigh on key industries in the export-orientated manufacturing sector.

Hence, the timing of Germany's recovery will be determined by domestic demand and labour market stability. In its current 'flight to safety' mode – and as reflected in our investor survey – Germany remains highly attractive for risk-adjusted returns and in the context of real estate investments globally.

OFFICE

Rental growth is muted, as occupier demand is forecast to be weaker at least until mid-2021. The supply situation in the Top-7 markets and regional cities is likely to improve slightly, but will remain tight as vacancy rates have reached historical lows. In the prime segment, excess liquidity spells further yield compression despite the COVID-19 crisis. We expect increasing spreads between Top-7 versus regional cities and core versus non-core segments as defensive strategies are preferred during the continued phase of uncertainty.

LOGISTICS

Unwavering strong investor appetite for German logistics has led to yield compression even during the pandemic. In light of excess liquidity, pricing is trending stronger for 2021. Logistics has become an institutional and liquid asset class, and yield differences with are offices declining.

Nonetheless, the recession will leave its mark on occupier demand and the already low rental growth prospects. Increasing speculative developments relieving some constraints on the supply-side, and we anticipate opportunities emerging around forward-fundings, build-to-core and themes such as e-commerce and urban logistics.

RETAIL

Pricing in the distressed retail sector remains under downwards pressure. Occupier markets are facing accelerated consolidation and rationalisation, and weak demand is turning rental growth forecasts negative. We continue to monitor the high street and shopping centres segments closely. We anticipate renewed opportunities for risk-adjusted returns again in assets where, albeit lower, rental levels have been achieved.

[33] Berlin, Düsseldorf, Cologne, Frankfurt, Hamburg, Munich, Stuttgart
[34] Consensus Economics (September 2020)

IRELAND

Country analyst: Hamish Smith

TOP PICKS

- industrial and logistics sector around Dublin where a demand-supply imbalance persists – especially for modern space.

ECONOMY

Ireland is expected to have weathered the COVID-19 storm better than most Eurozone economies. Its economy is forecast to contract by only -3.2% in 2020, with 2.3% growth returning in 2021.[35] Unemployment is rising, however, with a potential peak of 6.4% by the middle of 2021 – well-below the 16% peak witnessed following the financial crisis. A no-deal Brexit remains a downside risk.

OFFICE

The sharp downturn in leasing activity has coincided with a rise in completions in the Dublin office market, pushing vacancy sharply higher. Vacancy is likely to continue rising, as corporate expansion plans and relocations remain on hold for some time yet. Meanwhile, a further 260,000 sq m, equivalent to 6.5% of stock, is expected to complete in 2021.[36] Significant pre-lets mean that less than half of new completions are available, but second-hand space is also coming back onto the market.

Prime headline rents have started to come under pressure, falling by -4% quarter on quarter in Q3 2020.[37] We expect them to come under more pressure as vacancy rises.

LOGISTICS

Dublin's industrial and logistics sectors continues to benefit from a supply-demand imbalance. While take-up dipped in the first half of 2020 as some firms put requirements on hold due to COVID-19, delays in construction have pushed vacancy to very low levels.

Ireland's economic recovery will support industrial demand moving forwards, along with increasing online retail penetration. A lack of modern stock should continue to support rental growth. With prime yields still around 5%, we think the logistics sector continues to look attractive.

RETAIL

Retail sales rebounded sharply as COVID-19 restrictions were eased. But with consumer confidence still low and unemployment expected to continue rising, there is a question over the sustainability of this recovery. High streets in particular are struggling with low footfall.[38] And with certain retailers closing some or all of their stores, this will have inevitable consequences for vacancy and rents. The challenges facing the sector are highlighted by the rise in prime yields in 2020.

[35] Oxford Economics (September 2020)
[36] JLL Research (Q2 2020)
[37] CBRE Research (Q3 2020)
[38] CBRE Research (September 2020)

ITALY

Country analyst: Matteo Vaglio Gralin

TOP PICKS

- logistics in Northern Italy along the Mediterranean corridor and in Rome Area
- healthcare
- grocery retail
- senior care

ECONOMY

Italy was the first European country to be affected by COVID-19 and responded quickly to the outbreak. In 2021, the economy is projected to grow by 5.9%, up from a drop of 9.5% in 2020, and to return to pre-pandemic levels by the end of 2022[39]. High public debt, rising unemployment and low potential growth pose downside risks to the outlook.

OFFICE

Milan and Rome remain the main markets. Prime rents had increased significantly before the pandemic, especially in Milan, but have stabilised. Occupier demand is weak, as companies are postponing their leasing initiatives. However, the impact on yields and investment transactions has not yet been felt, and we believe investor appetite will remain muted.

LOGISTICS

Investor interest in Italian logistics is growing strongly. The sector is characterised by a lack of quality space, and solid demand supported by e-commerce. The primary hotspots remain in Northern Italy, especially in Milan, Verona, Bologna as well as Rome. Demand for last-mile logistics is booming, even if it is not easy to find opportunities to build a notable portfolio. There is also an increased interest in cold storage logistics.

RETAIL

Grocery proved remarkably resilient during the lockdown and the interest from consumers and investors should persist, especially for neighbourhood stores. The recovery of prime high street depends on the resumption of international tourism,[40] and we expect there to be fewer but larger stores, with an emphasis on the show-room format. There is little interest from investors for out-of-town retail. In this environment, schemes must adapt to new trends and find the most suitable solutions to meet the new needs of consumers.

ALTERNATIVES

Senior care represents an excellent long-term opportunity due to the structural changes taking place and solid fundamentals underpinning investment. Increased interest from institutional investors in the residential sector could prove to be another great opportunity.

[39] Oxford Economics (October 2020)
[40] 61.6 million visitors to Italy in 2018, the UN World Trade Organization reports

LUXEMBOURG

Country analyst: Judith Fischer

TOP PICKS

- offices in the CBD and Kirchberg

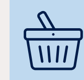
ECONOMY

Luxembourg's economy is expected to rebound by 5.4% in 2021 after an estimated plunge in GDP of -6.2% in 2020.[41] Luxembourg's traditionally strong fiscal position will be temporarily threatened, but generous budgetary spending will support economic recovery. Improving labour market conditions will likewise boost consumer spending, which is expected to bounce back by 9.3%.[42]

OFFICE

The Luxembourg office market is likely to hold up well in the wake of the COVID-19 pandemic. Office space demand remains strong in the central office locations where vacancy rates are at very low levels and rents are on an upwards trend, making it an attractive market for core investors. This is supported by a new tramline, part of which has already been constructed.

However, there is low demand for office space on the outskirts of Luxembourg City. On the investment side, prime office yields in Luxembourg's central locations are trading at 3.5% for long leases in the best locations such as the CBD and Kirchberg. New construction is very restricted except in Cloche D'Or, where most new developments are successfully pre-let and sold at yields very close to the CBD and Kirchberg.



RETAIL

The retail sector in Luxembourg is very small, consisting of high street shops in the city centre, a few big shopping malls and retail parks on the outskirts of Luxembourg City. Although leasing activity on the high street is still holding up quite well, smaller lot sizes and complex ownership structures translate into limited investor interest in these locations.

[41] Oxford Economics (September 2020)
[42] Oxford Economics (September 2020)

NETHERLANDS

Country analyst: Judith Fischer

TOP PICKS

- urban logistics and e-commerce logistics
- offices in regional capitals such as Groningen and Arnhem

ECONOMY

The Dutch economy has held up better than most European economies, and is set to gradually recover in 2021. Trade will, however, hamper economic recovery because of weaker demand in the country's major trading partner countries, plus uncertainty around an EU trade deal with the UK. With the end of government support measures, more bankruptcies and reorganisations in the coming quarters are likely, which could push the unemployment rate further up to 6.6% in 2021.[41]

The overall stable political and economic environment in the Netherlands contributes to a positive climate for investors. In particular, European investor interest in Dutch real estate has been increasing for some time.

OFFICE

The Randstad region remains an attractive office location, where Amsterdam, Rotterdam and Utrecht as well as other regional capital cities such as Groningen and Arnhem continue to attract demand from larger tenants. Net initial yields have stabilised and range between 3.5%–3.75% in Amsterdam.

LOGISTICS

Well-developed infrastructure and accessibility make the Netherlands an attractive location for logistics investments, with strong demand from foreign investors. Core logistics space is facing downwards yield pressure, with gross initial yields ranging below 4%. The structural shift towards e-commerce, which has been accelerated by the COVID-19 pandemic, is one of the major drivers of the logistics sector. While there is not a threat of oversupply, newly developed logistics space is getting larger in size, and older space is being redeveloped.

RETAIL

The retail sector was facing difficulties even before the pandemic. Food retail, however – such as supermarkets and convenience stores offering rent indexation – have continued to perform well. Consumer electronics and the DIY and furniture sectors have also seen an uptick in demand throughout the pandemic. This trend is likely to maintain momentum in the next year. While online grocery retail has seen increased demand, the profitability of this segment remains an issue.

[41] Rabobank (October 2020)

POLAND

Country analyst: Matthias Düsing

TOP PICKS

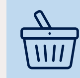
- core assets in Warsaw that are preferably part of mixed-use projects, and core facilities in regional cities such as Kraków, Wrocław or Tri-City
- modern distribution centres along the main corridors and multi-let assets near urban areas

ECONOMY

Poland's mid- to long-term prospects remain positive as the fundamental drivers of the country's economic success story remain intact. Above-average infrastructure spending, foreign direct investments, domestic demand growth and economic competitiveness continue to underlie the attractiveness of the commercial real estate market.

OFFICE

Weaker occupier demand, increasing lease renewals, subletting and incentive packages are weighing on rental growth and anticipated returns. Nonetheless, occupational costs remain more appealing than in the expensive Western European markets. Pricing for core assets is expected to move out slightly by 25-50 basis points, whereas the yield spread between Warsaw and regional cities is decreasing. Further polarisation between new core assets and older stock is generating opportunities in the core-plus and value-add segments.

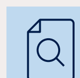


RETAIL

We expect accelerated repricing following weaker occupier demand and downwards pressure on rents. Outlet centres and food-anchored retail parks are attractive subsectors, however with limited scalability of platforms.

LOGISTICS

Poland's remains one of the most sought-after logistics markets in Europe. Despite the pandemic, a high degree of liquidity is fuelling transaction volumes and is keeping pricing keen, and speculative development is likely to slow again in 2021. Given stable occupier demand, the supply-side risk is moderate. Investors are increasingly joining up with developers in forward fundings to secure assets. New secondary markets are also emerging around infrastructure developments, such as in the northern and eastern parts of the country.



ALTERNATIVES

Virtually non-existent until late 2019, the Polish institutional living sector, mostly the build-to-rent sector, is becoming a very dynamic asset class. Higher returns compared to Western Europe combined with the infancy of the market presents opportunities to investors willing to move up the risk curve. The build-to-rent market is expected to grow ten-fold in the next five to six years,[42] with a growing, albeit still small, number of developers and operators. Excess demand, long-term structural shortages in the housing market and increasing propensity to lease will trigger yield compression in the mid-term.

[42] ThinkCo (2020): Build-to-Rent in Poland

PORTUGAL

Country analyst: Matteo Vaglio Gralin

TOP PICKS
- logistics along the Atlantic corridor

ECONOMY
Portuguese GDP is likely to increase by 6.5% in 2021 from -9.0% in 2020, and to return to pre-pandemic levels by early 2022[43]. The unemployment rate could potentially peak at 8.4% in Q1 2021 (compared with 6.6% in Q4 2019) before a gradual decrease. Therefore, private consumption will only return to pre-pandemic levels at the end of 2021 at the earliest.

OFFICE
Foreign companies are attracted to the Lisbon and Porto office markets by low labour costs in a European context, the well-educated workforce and a lively business environment. Occupier demand is weak, but new supply is limited, therefore vacancy should not increase to a great extent. Investment activity is limited, as many investors are adopting a wait-and-see approach until there is more clarity regarding the effects of COVID-19.

LOGISTICS
Market fundamentals in Portugal are weaker than in other European markets due to the country's fringe location. Yet with the increase of e-commerce, operators are adjusting their operations, leading to a higher demand for proximity warehouses and last-mile logistics. Nonetheless, the lack of quality assets is still an issue. We prefer modern assets along major transport corridors and near the key ports. Core-plus investors that are looking to diversify their portfolio are attracted by very competitive yields compared to other European logistics markets.

RETAIL
The grocery retail segment has suffered less from the impact of online sales, as consumers generally still prefer to buy food in store. Consequently, investor interest in this area is likely to continue. In terms of prime high street retail, central Lisbon is our top pick – the recovery of the sector depends, however, largely on whether international tourism returns to pre-pandemic levels.[44] There is little interest from investors for the out-of-town segment, and retail parks are slightly more resilient than shopping centres.

[43] Oxford Economics (October 2020)
[44] 16.2 million visitors to Portugal in 2018, the UN World Trade Organization reports

SPAIN

Country analyst: Matteo Vaglio Gralin

TOP PICKS
- logistics along the Mediterranean and Atlantic corridors
- grocery retail

ECONOMY
The drop in tourist arrivals is having a huge impact on Spain as tourism is one of the key economic sectors. Although the output is expected rebound by 6.4% in 2021, up from -11.9% in 2020, it will take at least until mid-2023[45] for Spain to return to pre-emergence levels. High unemployment and high public debt are among the main downside risks to the outlook.

OFFICE
Madrid and Barcelona remain the main office markets in Spain. Demand is weak as companies' leasing initiatives are on hold while building starts are up, particularly in Barcelona. This might lead to an increase of availability and a correction in prime rents. Although sentiment remains positive, investors are adopting a wait-and-see approach until there is more clarity regarding the effect of COVID-19.

LOGISTICS
The logistics sector is attracting more and more investors since occupier demand continues to be supported by growth in e-commerce. The hotspots remain along the main transport corridors and near the main ports. Strong investor appetite and a lack of quality stock has pushed prime yields to low levels comparable to other primary European markets. While investor interest remains high, many are waiting for the current backdrop to improve.

RETAIL
In Spain, investors' interest in the grocery segment is constantly growing thanks to its resilient characteristics and large population base. The resumption of prime high street retail, however, depends on the recovery of international tourism.[46] There is little interest from investors for out-of-town retail, and retail parks are doing slightly better than shopping centres.

ALTERNATIVES
The private rented sector (PRS) is quickly gaining traction in the Spanish market. The sector benefits from social changes, increasing interest from international investors and robust fundamentals supporting investment. It could be a good opportunity in the long-term.

[45] Oxford Economics (October 2020)
[46] 82.8 million visitors to Spain in 2018, the UN World Trade Organization reports

SWEDEN

Country analyst: Judith Fischer

TOP PICKS

- offices in central or fringe locations with a 5-year WAULT
- necessity driven retail parks in Tier 1 and Tier 2 cities, preferably in an urban location
- modern logistics with shorter lease terms

ECONOMY

The Swedish economy is expected to gradually recover from 2021 onwards, supported by a fiscal stimulus of SEK 100 billion, involving tax cuts, welfare spending and investments. However, the unemployment rate increased sharply as a result of the COVID-19 pandemic. Hence, weak labour market conditions will weigh on wage growth and consumer spending over the next few years.

OFFICE

Tenants are in wait-and-see mode, with no major letting announcements in the first three quarters of 2020. On the supply side, there is no threat of oversupply as only limited new supply is being built in Stockholm. With increased working from home, companies might consider moving to more affordable office locations. We like modern and highly accessible offices outside the central parts of Stockholm, which offer lower rents. We recommend avoiding multi-let or single-let buildings with short leases. Lease contracts with more than five years, however, will bridge the current uncertain environment.

LOGISTICS

The logistics sector in Sweden remains an attractive sector in which to invest, offering long leases and stable income. There is strong competition, all from foreign investors. We prefer the triangular region between Stockholm, Gothenburg and Malmo. We also see opportunities to take on more risk in terms of leases and stock, which offers lower entry costs and value creation. Urban logistics benefits from stable long-term drivers, with strong urbanisation and the structural change towards e-commerce accelerating.

RETAIL

With demand for online shopping having skyrocketed due to the pandemic, retailers with an online platform have clearly outperformed. Retail parks also remain resilient, with grocery-anchored retail and discount concepts performing particularly well. Consumer electronics, DIY and sports equipment segments have also shown good performance throughout the pandemic. This trend is likely to continue as long as social distancing and travel restrictions stay in place and consumers' focus remains on home and local activities.

UNITED KINGDOM

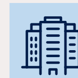
Country analyst: Hamish Smith

TOP PICKS

- good quality, well located industrial and logistics assets as well as last-mile urban logistics units close to large and densely populated areas
- for long-term, stable income returns, the residential sector, particularly build-to-rent multi-family buildings and student accommodation

ECONOMY

The UK's recovery has started to falter. Rising unemployment, subdued consumer confidence and the prospect of more local lockdowns will be headwinds for the economy and occupier markets alike in H1 2021.



OFFICE

With vacancy rising and leasing activity likely to remain subdued until there is a clear path out of the pandemic, office rents are likely to come under further pressure in 2021. As such, we would avoid taking leasing risk until demand starts to recover.

That said, we retain a positive long-term view on well-located, high quality Grade A office space, although are cautious about large floor plates that cannot easily be reconfigured for multiple tenants. With prime central London office yields already offering a 100–125 basis point premium over major European markets, any re-pricing could offer opportunities for investors looking for attractive income returns with long-term hold strategies. Regional office markets with strong economic fundamentals and a shortage of Grade A space are well placed to benefit as occupier demand picks up.

RETAIL

COVID-19 has only added to retail's challenges, accelerating the trend towards online purchases. The UK government's decision to scrap tax-free shopping for visitors will not help either. Proposed regulatory changes should make it easier to repurpose obsolete retail space, but this will not be a quick fix to an oversupplied market.

Grocery retail is a bright spot given its countercyclical characteristics. Retail parks have also performed well, especially those anchored by grocery, DIY and home furnishing tenants. With the ability to benefit from easier social distancing, click and collect and less exposure to online competition, retail parks with good accessibility and limited competition can provide appealing prospects. But strong locations and covenants are key.

LOGISTICS

The industrial and logistics sector has continued to march ahead, with take-up in 2020 at a record high. While a surge in online shopping has boosted the sector, it is unlikely to be completely immune to distress. A weak outlook for manufacturing, and the likelihood of more retail failures, both pose risks to occupier demand.

With occupiers focusing on Grade A space, we would avoid older, secondary stock with poor accessibility. Good links to transport is a must have. Smaller last mile urban logistics units located close to large and densely populated areas also provide attractive opportunities.

ALTERNATIVES

The UK residential sector, including purpose-built multi-family accommodation and student housing, is benefiting from strong underlying demand drivers. COVID-19 has raised some questions about short-term demand. However, the long-term drivers remain unchanged. With the potential for stable income returns, we think that residential sector provides an appealing opportunity for long-term investors.

Asia-Pacific on a path to a new normal fraught with volatility

BENEDICT LAI

The COVID-19 pandemic, which first emerged in the Asia-Pacific region, has taken a severe human and economic toll that has become widespread. The world economy will shrink in 2020 at the sharpest rate in decades, as measures taken to contain COVID-19 severely restrain private consumption, investment, trade and travel. That said, extensions of job support schemes, easing of travel restrictions in addition to the multiple rounds of significant fiscal stimulus introduced throughout 2020 amid a resumption of economic activity should help bolster growth in 2021.

The region is expected to bounce back strongly in 2021 from a low base, with GDP projected to grow from an estimated -1.6% in 2020 to 6.2%.[47] Nevertheless, risks to the 2021 outlook are elevated, given uncertainty over the evolution of the pandemic, including the possibility of another wave of infections into 2021, sustained social distancing restrictions and the absence of an effective medical solution. All of these factors could derail the region's return to growth. Continued policy support is still needed to underpin the regional economic recovery, which is aided by the low inflation environment.

Recent weakness in oil prices and real estate markets, as well as increasing unemployment, have also had a deleterious impact on growth. The extraordinary measures needed to shore up economies are bound to lead to higher debt, weaker balance sheets and less appetite for spending in the future.[48] Investment is likely to remain sluggish, especially in the private sector. Even if state-owned enterprises were to spend more, a reduction in capital productivity, lower potential output and a permanent 2–3% loss of output in most economies is a more probable outcome compared to the pre-pandemic trend.[49]

Heightened geopolitical tensions and a rethink of global supply chain diversification are fuelling further uncertainties. China's assertiveness regionally and the deterioration in intraregional relationships such as that between China and India or China and Australia may have some impact on local economies, given China's role as an important trade partner. Plans to diversify supply chains away from China would also hasten the exodus of foreign manufacturing firms to other neighbouring alternative markets (i.e., onshoring).

On the bright side, the pandemic has accelerated trends that were underway pre-COVID-19. These include the accelerating shift from in-store to online shopping; investment in research and development and innovation; and supply chain diversification, all of which are likely to continue into 2021.

Office markets witnessed extensive disruption in 2020, with global leasing volumes down more than 50% y/y during the peak of the crisis. This is clearly a result of the lockdowns that led to widespread work-from-home arrangements.[50] Looking ahead, all eyes will be on the ability of markets to withstand or contain another wave of COVID-19, as well as on tenants' response to re-open offices, which began gradually in Q2.

Most occupiers are focused on reopening their offices and getting used to the 'new normal', including some level of density reduction to meet social distancing requirements. While some IT companies have announced long-term agile working arrangements (e.g., Fujitsu and Tata Capital), there are other instances of increased leasing activity within the IT sector, which could continue in the medium term.

Additionally, there is now an abundance of survey evidence showing employees are keen to return to the office for at least part of their working week.[51] In turn, offices will need to accommodate a more hybrid workforce that operates both from offices and remote locations.

[47] Capital Economics (October 2020)
[48] S&P Global
[49] S&P Global
[50] JLL
[51] Colliers International (August 2020)

Nevertheless, the economic slowdown, combined with job losses in the advanced economies, will challenge the region's office leasing fundamentals over the near term. Rents are expected to remain soft on the back of recovering office demand across the region.[52] That said, the impact of the current global recession is more benign and shorter lived in Asia-Pacific than in other regions globally, which is likely to aid the recovery in net absorption.

Before the COVID-19 outbreak, a significant amount of new office supply across the region was expected in 2020 and 2021. Combined with weak office demand in the shorter term, vacancies are likely to remain elevated into 2021 before a stronger economic recovery fuels office take-up.[53]

The lack of tourism as a result of international border closures and weak consumer sentiment has crippled the retail sector. Against a collapse in demand for new stores – particularly among non-food retailers – and an increase in corporate failures, less new retail floorspace will be delivered in the near term.

With the lifting of lockdowns in most parts of Asia, however, footfall and retail sales have seen a recovery, albeit to levels below 2019. But operating conditions will remain challenging, compounded by the acceleration in online retailing. The short-term outlook remains highly uncertain, with ongoing social distancing measures and new outbreaks limiting many operators' recoveries. Most retailers continue to be cautious and focused on returning to profitability, reassessing strategies to best meet changing consumer habits amid rising job losses into 2021. Yet a delay in construction over the next 12 months may be a silver lining allowing some time for consumer sentiment to recover.

The resumption of industrial production following the gradual lifting of lockdown restrictions helped to ease the supply chain disruption seen in 2020. Sectors such as medical supplies, grocery and online sales proved resilient and have boosted demand for logistics. Leasing activity is expected to be robust as retailers add more inventory to handle demand fluctuations. Manufacturers looking to diversify their supply chains to reduce dependence on China will also support additional leasing demand. Furthermore, buoyant leasing demand from e-commerce platforms and 3PL firms continue to attract investors to the sector.

Most logistics markets in Asia-Pacific recorded low vacancies, with Singapore being the only exception. As such, the risk of a demand shock is limited. However, the wave of new supply as a result of high domestic and global investor interest should see a slight upwards adjustment in the regional vacancy rate in 2021 amid a challenging economic environment.

Consequently, logistics rental growth is likely to be limited, although most of the modest growth is weighed down by older logistics stock. The lack of modern logistics facilities is giving rise not only to obsolescence risk but also, positively, to potential for refurbishment or build-to-suit opportunities as e-commerce continues to grow.

As widespread lockdowns and travel restrictions stalled investors' short-term capital deployment plans throughout 2020, commercial real estate investment fell sharply. Despite the impact of the pandemic on economies around the globe, investment activity has been less affected in markets such as Japan and South Korea, both of which showed resilience as they leant on deep domestic pools of capital.

Having dealt with the pandemic the earliest, Asia-Pacific is widely expected to lead the global recovery, although at a differing pace across countries. As economies rebuild amid improving business sentiment, easing travel restrictions and accommodative monetary policies, domestic capital will continue to play an important role in the real estate market recovery. Large and deep liquid gateway markets such as Seoul, Tokyo, Sydney and Melbourne continue to be examples of key markets to look out for in 2021. Investors are likely to deploy defensive strategies, diversifying portfolios and focusing on operationally critical sectors such as industrial, multifamily and alternative assets such as data centres.

Given the low-returns growth outlook, investors who are able to venture slightly up the risk curve may consider a core-plus or a light value-add strategy that offers a better risk-reward proposition. In particular, the likelihood to secure softer entry prices for assets with more leasing risks but in markets with low beta offers better risk-adjusted performance.

[52] Cushman & Wakefield (September 2020)
[53] PMA

AUSTRALIA

Country analyst: Benedict Lai

TOP PICKS

- the logistics sector, particularly last-mile distribution and fulfilment centres owing to strong secular trends
- opportunities to acquire underperforming smaller sub-regional shopping centres to reposition as neighbourhood centres
- Melbourne offices over Sydney due to overly aggressive pricing in the latter market as well as relative affordability concerns
- funding gap opportunities in the debt and mezzanine loan space

ECONOMY

Australia is going through the sharpest recession on record. Both domestic and external demand are battered by the pandemic and associated restrictions. Unemployment is likely to remain elevated, which is expected to feed through to low wage growth in 2020–21 at 1.25%.[54] That said, expansionary fiscal and monetary measures such as the extension of the JobKeeper scheme should cushion the fallout and support a healthy but modest recovery in latter half of 2021.

OFFICE

As working patterns normalise in 2021 and beyond, many occupiers will likely introduce changes in the way they occupy office space. More flexible working arrangements and a preference towards working away from CBD offices may mean higher vacancies in the near term. Higher rental incentives to maintain tenancy will also be a likely feature amid elevated vacancies in 2021.

LOGISTICS

The pandemic has accelerated e-commerce trends, which has fuelled robust logistics demand from supermarkets and third-party logistics firms upgrading to meet the short-term surge and long-term expansion of online demand. We anticipate that the economic recovery in 2021 and sustained growth thereafter should support rental growth in Sydney and Melbourne. Consumer demand for fast delivery will increase the desirability of centrally located sites with good transport links.

RETAIL

An accelerating shift towards online retailing, social distancing measures and in-place international border closures make for a challenging retail operating environment ahead, particularly for prime retail formats in the CBD areas. Yields are expected to surge 40–50 basis points, especially in Melbourne, by end-2020 due to the lockdown, while the lack of tourists would also see a continued yield expansion in Sydney into 2021. However, prime retail formats that are anchored by non-discretionary tenants, such as food retail, will remain resilient.

[54] Reserve Bank of Australia

JAPAN

Country analyst: Benedict Lai

TOP PICKS

- opportunities in the Tokyo Grade B office space or offices in other regional Japanese cities as occupiers become more cost conscious
- high quality assets that offer stable income streams, such as the multifamily residential sector

ECONOMY

Japan's near-term economic outlook appears challenging, as high-frequency indicators suggest the recovery is struggling to gain pace.[55] Consequently, risks remain skewed to the downside. Pandemic-related disruptions and the consumption tax hike in Q4 2019 have also left the economy vulnerable to a renewed setback in domestic or overseas demand, resulting from a significant pick-up in COVID-19 infections. Nonetheless, GDP is expected to rebound to 2.6% y/y in 2021 from -5.6% in 2020.[56]

OFFICE

While office vacancy rates were on an increasing trajectory in 2020, a more robust employment market and an anticipated economic recovery in 2021 should see occupancy rates remain firm. Japan's rising but low unemployment rates also mean that vacancy rates are unlikely to surge and remain below their 10-year average of 5.4%.

There will likely be muted declines in rent before a rebound in 2021, aided by an easing supply pipeline in Tokyo. In the context of a less pronounced decline in values, yields are likely to remain stable, in part due to the accommodative monetary policies and fiscal stimulus in place.[57]

RETAIL

The lack of inbound tourists has resulted in falling prime rents in Ginza, Tokyo. While the gradual re-opening of international borders and the postponement of the Tokyo Olympics to 2021 should help to boost retail demand, domestic consumers will probably be less willing to return to shops until an effective medical solution is found. As such, retail rents are likely to remain under pressure into 2021.

RESIDENTIAL

With Japan's economy facing a recession in 2020, the potential for short-term rental growth will likely be outweighed by the financial constraints of residents. Nonetheless, occupancy rates are likely to hold firm above 90%, supported by favourable urban demographics while many workers embrace widespread work-from-home arrangements.

Prospective residents from regional Japan are likely to hold off on making a move to Tokyo until the COVID-19 situation improves. However, investors remain confident in the long-term fundamentals and resiliency of Tokyo's residential sector – as significant capital continues to chase the few available assets, yields are likely to remain flat in the foreseeable future.

[55] Oxford Economics
[56] Capital Economics
[57] PMA

SINGAPORE

Country analyst: Benedict Lai

TOP PICKS

- CBD offices due to long-term plans and incentives to rejuvenate the area, which should help attract investor interest
- fringe-of-CBD, Grade B value-add opportunities
- logistics sector, although much hinges on the strength of the economic recovery in view of the Singapore economy's dependence on exports

ECONOMY

Singapore's economy is predicted to contract at its sharpest-ever rate in 2020. That said, fiscal stimulus should cushion the slowdown and help drive a recovery in 2021, expanding to 5.8% from -6.2% in 2020.[58] Nonetheless, the sluggish resumption of trading with regional partners clouds the outlook, alongside persistent trade tensions between the US and China. The labour market is likely to remain weak as unemployment rates continue to rise steadily. However, the extension of the Job Subsidy Scheme until Q1 2021 should cushion the impact of a surge in retrenchments.

OFFICE

The weak labour market is expected to underpin modest office take-up in 2021. With vacancy rates expected to rise, landlords are likely to readjust rental levels downwards. Nevertheless, given that office completions are expected to remain low over the near term (2021–22) and in part due to construction delays, the vacancy rate is likely to tighten. The long-term government plan to rejuvenate the CBD should also serve to attract continued investor interest, supporting yield compression of 20 basis points from 2020 levels amid limited investable office stock.

LOGISTICS

Leasing demand remains healthy, led by e-commerce, food logistics and third-party logistics players, with warehouses reportedly close to full occupancy, with some room to improve.[59] Looking ahead, occupancy levels are set to increase further in line with an anticipated economic recovery. Construction delays as well as intentional reductions of new public industrial projects should also support positive take-up, albeit not strong enough to warrant positive rental growth in 2021.

RETAIL

The lack of tourism and weaker local spending in Singapore continue to underpin dismal prime retail performance. As a result, more retailers are likely to continue with business consolidation while retaining their key performing stores.[60] Landlords are likely to be more flexible with rental and leasing terms, leading to a sustained rental growth trajectory in line with inflationary trends, yet amid a cautious investment market.

[58] Capital Economics (September 2020)
[59] CBRE, Savills Research
[60] Savills Research

SOUTH KOREA

Country analyst: Benedict Lai

TOP PICKS

- Seoul office submarkets with limited pipelines, such as Gangnam, are expected to remain resilient relative to other submarkets (e.g., CBD, Yeouido) and present an opportunity to carry out value add-strategies
- shortage of modern logistics facilities in South Korea amid rising land prices suggests opportunities to create mixed-use logistics facilities such as cold storage and general logistics facilities

ECONOMY

South Korea's pandemic-related economic fallout is set to be less extreme than in most other large economies, reflecting swift management of the virus outbreak combined with speedy implementation of expansionary fiscal and monetary policies.

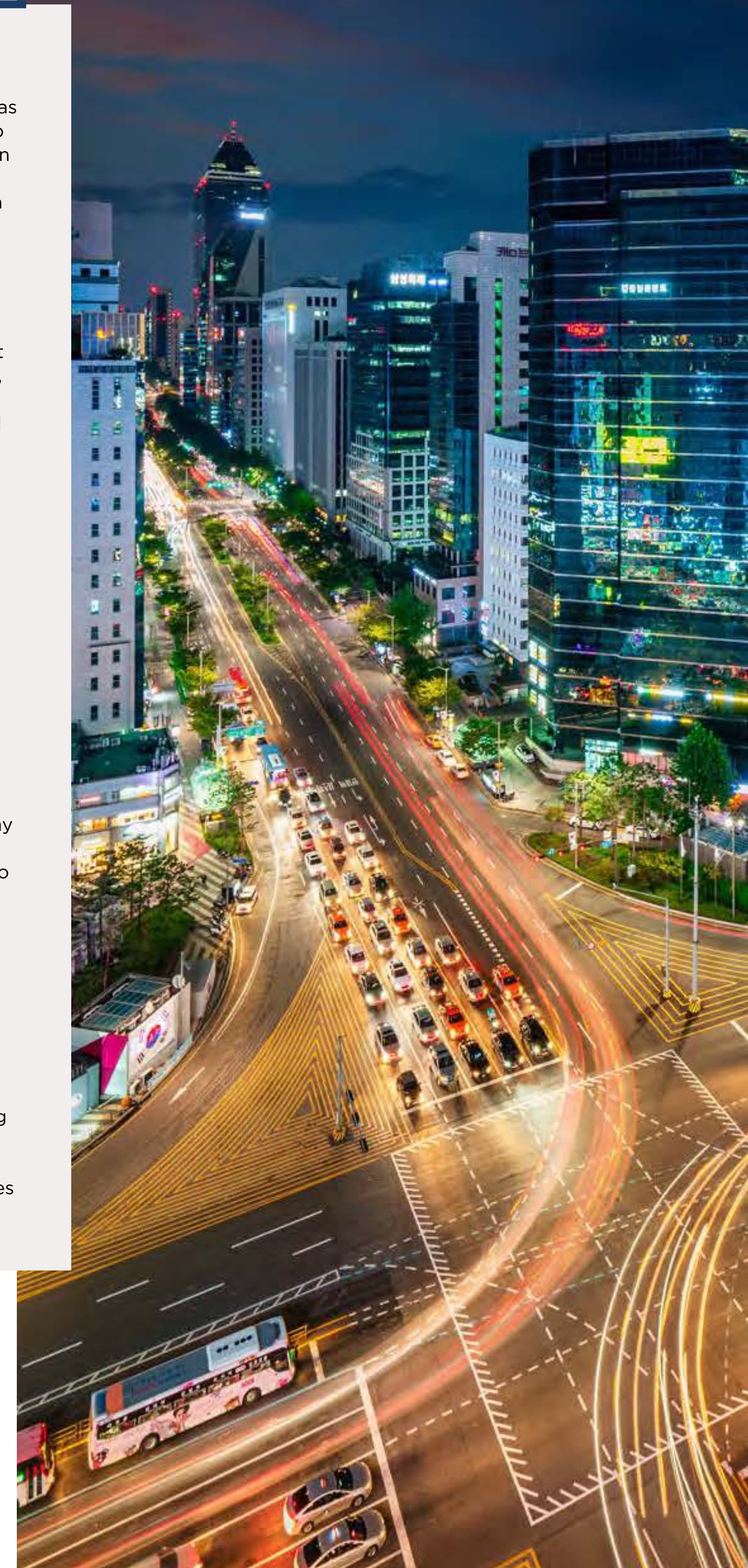
Domestic demand will be a crucial factor for lifting the economy out of recession, however. Household spending will likely strengthen over the coming months as consumer confidence continues to recuperate gradually along with a stabilising labour market. Nevertheless, new virus outbreaks have the potential to quickly reverse improvements in sentiment.

OFFICE

The Seoul office market displayed resilience in the first half of 2020, even as the pandemic affected global markets, in part thanks to an avoidance of a stringent lockdown. However, supply pressure from upcoming projects may see an increase in the vacancy rate in Yeouido by end-2020. Thereafter, supply is set to remain low until at least 2023, helping to stabilise and improve the market balance as the global economy recovers from the pandemic. With business sentiment set to recover in 2021, both demand and rentals are likely to improve into 2021, although landlords would be cautious in raising rents.

LOGISTICS

Demand for logistics space is likely to remain firm, driven by e-commerce, third-party logistics and manufacturing firms. With land prices on the rise – driven by significant capital inflows to development modern logistics facilities – developers and asset management companies (AMCs) are likely to increase rental income to achieve a certain yield level. This would encourage a wider variety of uses, including cold storage, which typically incurs higher rents.[61] Nevertheless, the recent influx of new supply and uncertain macroeconomic environment may see landlords offer more flexible rental incentives to maintain tenancy, particularly for the older logistics facilities.



[61] CBRE

Industrial a bright spot amid pain of 'pandemic pause' to US commercial property market activity

SARAH DREYER
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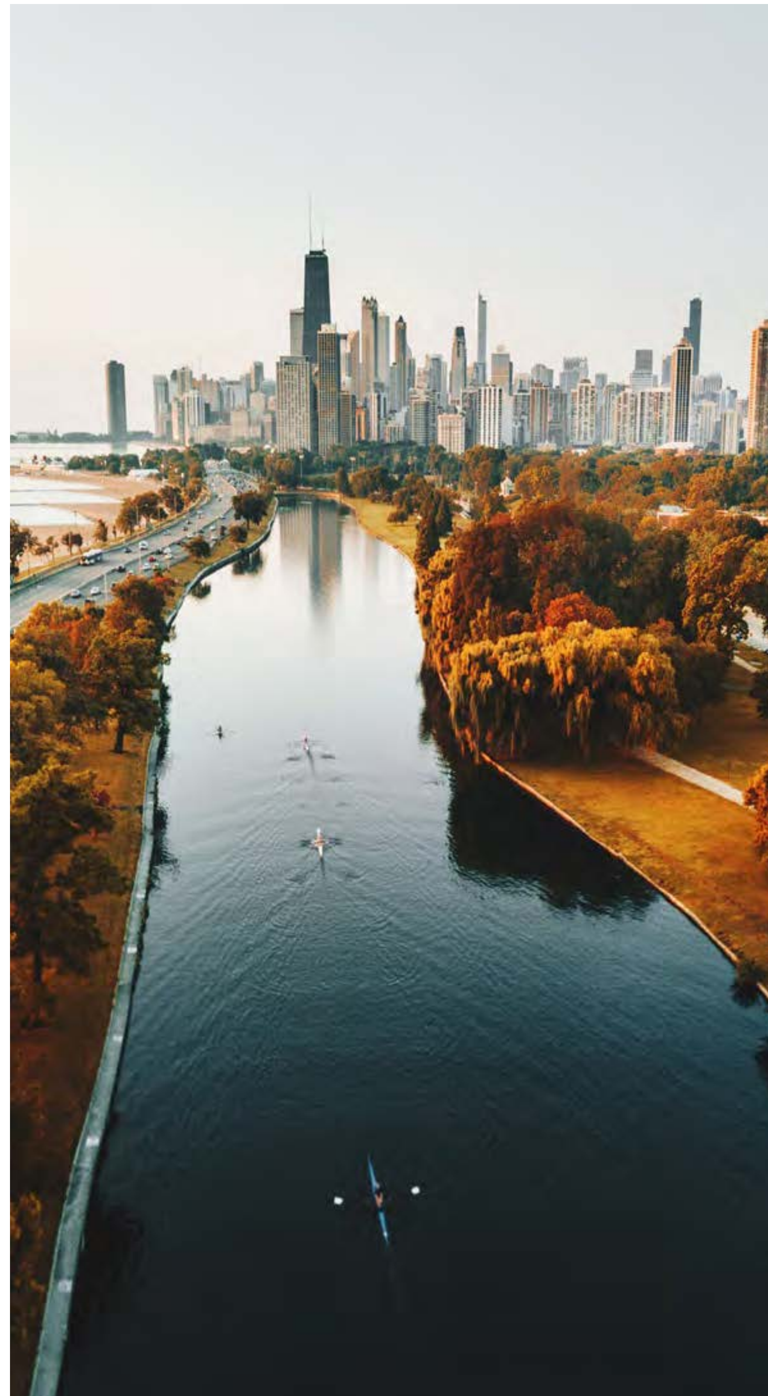
Since its US onset in March, the COVID-19 pandemic has caused considerable dislocation in the economy and commercial real estate markets. Worsening over the second and third quarters, disruption is expected to continue until there is more clarity around vaccine availability and timing – particularly with fears of a second wave as winter approaches.

Just before COVID-19's global spread, the US economy was fundamentally at its strongest in years. Unemployment was at a historical low (3.5%), and the nation was experiencing one of the most prolonged economic recoveries in US history – an expansion that started in mid-2009.

Within a few short weeks, however, unemployment had reached a peak of 14.7%, well above levels seen during the global financial crisis. However, as business restrictions began to lift, a slow recovery began. By September, unemployment declined to 7.9% and the economy had regained 52% of the jobs lost between February and April. Moody's and CNN Business have reported that the economy is now operating at 81% on a 'return to normal' (pre-pandemic) index.



Office market faces softening and rise in sublease inventory

By Q3, office indicators had revealed across-the-board softening, as many cities were seeing a surge in sublease inventory that served to push overall availability up across all markets. Volume has declined significantly – in both leasing and sales activity – and is expected to remain subdued into 2021. With ongoing economic and business uncertainty, many occupiers are putting real estate decisions on 'pandemic pause', postponing the leasing process or opting for shorter-term solutions for now. Cost reduction is top of mind, and many companies are reevaluating how they will use office space going forwards – particularly as the work-from-home timeline becomes more indefinite.

As a result, overall availability increased 260 basis points year on year to 19.5% in the autumn. With dense urban environments more impacted by the pandemic than suburban locations, availability in central business districts increased at a sharper pace, rising 330 basis points to 17.1%. Markets experiencing the most pronounced post-pandemic increase in availability include San Francisco, Austin, Denver, Dallas, Phoenix and Chicago. Availability is likely to continue to increase into 2021 given ongoing sublease additions and tepid occupier demand.

Looking at total leasing volume, Q3 2020 activity declined by 49% compared to Q3 2019. San Francisco and Silicon Valley, Austin and Chicago experienced some of the most significant drops. These cities have also seen a surge in sublease availability and overall softening in market conditions. The San Francisco Bay Area is doubly impacted, given the havoc wreaked by the wildfires.

Markets that have been more resilient include those safeguarded by a strong government-sector presence, like Washington, DC, and those that are less reliant on public transportation, including Atlanta, Tampa and Raleigh. In terms of more robust industries, the tech sector has bucked the leasing volume trend. In the year through October, the tech sector accounted for 30% of all leasing demand, increasing to 40% when incorporating new leases and expansions alone. Tech giants Amazon, Facebook, Microsoft, Google and Apple continue to lease large blocks in core tech hubs.

Generally, asking rents have seen little change since the pandemic onset. Cities that have seen more sublease inventory come to market have also had greater declines in average asking rent – including New York and San Francisco – but mostly due to the addition of lower-priced sublease options. Owners are hesitant to significantly reduce rates but have offered generous concessions and flexible terms to secure tenants, which will lead to a compression in effective rents. Downwards repricing of direct space is likely in coming quarters as owners adjust to the ongoing pandemic effect on demand.

As of Q3, commercial office sales volumes in major US metros declined by 40%, with the average price per square foot falling 7% over the same period. Pricey tier one markets – such as New York, DC and Los Angeles – have seen the steepest pullback.

Industrial shines through as shopping moves online, brick-and-mortar retail far from recovery

The rise of online shopping was already in motion pre-pandemic, yet the unprecedented shift to e-commerce and corresponding rise in delivery requirements resulting from current circumstances have kept the industrial sector in high demand.

After seeing a slowdown immediately following pandemic business closures and stay-at-home measures, industrial leasing activity rebounded through Q3, led by the largest players in the e-grocery sector – Amazon, Walmart and Target. Healthcare and medical suppliers have also continued to grow footprint. The demand for multi-temperature cold-storage facilities to support grocery and medical stock delivery is far outpacing supply, meaning this logistics segment could emerge as an attractive asset class for investors.

Industrial sales volume in major markets was down 22% year on year in Q3 – more muted than the decline seen for offices, but nevertheless causing investor pause due to the ongoing uncertainty. Despite the dip in volume, the average industrial price per square foot increased 2% over the same period.

The retail sector certainly remains the most vulnerable of all given the impact of the current economic downturn on consumers. Leasing in Q3 declined to a fraction of what was seen during the period in 2019, and businesses and restaurants continue to close doors due to financial hardship. Investors are generally cautious of tenant distress and rising vacancies due to closures. As a result, assets with long-term leases and stable, 'essentials'-orientated tenants (grocery, health) will remain more attractive.

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