In the face of continued uncertainty, capital still seeks exposure to real estate

Global Capital Markets Research Q1 2017

Executive Summary

- First quarter global transactional volumes are 1% below the same period last year at US$136 billion* (Figure 1). Volumes were about 6% higher than the Q1 average from 2012 – 2016.
- Europe saw a strong increase in activity, as volumes climbed by 3%. Investment in Asia-Pacific remained consistent from last year and rose by 1%, while the Americas fell by 5%.
- London regained its spot as the most traded city in the world as New York, the leader for the last two years, tumbled down the rankings. Vancouver and San Francisco both pushed their way into the top ten while Paris and Shanghai dropped out.
- The UK became the largest exporter of capital in the first quarter as the US, last years leader, slipped down the rankings. Germany and China also fell out of the top three as outbound capital volumes declined by 32% and 36% respectively.
- Multifamily investment pulled back in the first quarter, down 38% from last year. Primary markets saw the biggest declines, while secondary markets, particularly those in the Sunbelt, continue to impress.
- The first quarter of this year saw a carryover of some of the political uncertainty from last year, particularly in Europe where the continuation of Brexit negotiations remains a top concern. Upcoming elections in France and Germany, as well as rising interest rates in the US were all on the radar of investors last quarter. In this environment real estate investments continue to be attractive from a yield perspective however pricing concerns due to continued pressure on occupier fundamentals in key global markets could be an issue, with forecast rental growth in 2017 little changed from 2016. Despite the bigger than expected pull back in the U.S. there does seem to be an improvement in the supply of investment stock especially in developed markets. It is unlikely that all of this stock will be traded in 2017 however given this improving environment we anticipate that 2017 transactional volumes will be just shy of 2016 levels at around US$625-650 billion

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Figure 1: **Direct Commercial Real Estate Volumes, Q1 2016 – Q1 2017**

US$ Billions	Q4 2016	Q1 2017	% change Q4 2016–Q1 2017	Q1 2016	% change Q1 2016–Q1 2017	2015	2016	% change 2015-2016
Americas	78	58	-25%	61	-5%	314	285	-9%
EMEA	85	52	-39%	51	3%	267	247	-8%
Asia Pacific	45	25	-44%	25	1%	123	131	6%
Total	208	136	-35%	137	-1%	704	662	-6%

*All currency figures in this report are in US dollars, unless otherwise noted. These are converted from local currencies using a quarterly average rate.

GLOBAL AND REGIONAL

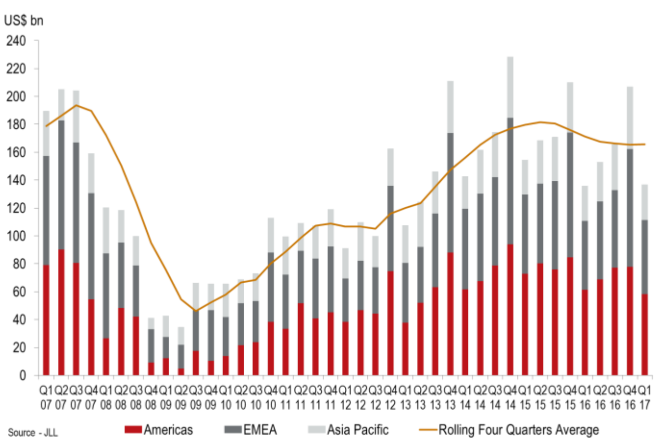
EMEA lifts opening quarter volumes

Despite political uncertainty, capital seeks real estate

Building on the political drama that we saw in the final quarter of last year, 2017 started out in a similar manner. Dutch elections and the Trump Administration made headlines, while the French presidential race became even more complicated as new candidates rose in popularity while others seemingly faded away. Despite all this, global capital markets remained active and kicked off the year with renewed optimism.

Real estate continued to perform, as the first quarter recorded volumes of US$136 billion, slightly down on the performance we saw in the first quarter of 2016 (Figure 2). This was 16% better than the Q1 average we have seen since 2007. Increased activity in EMEA and Asia-Pacific offset a decline in the Americas.

Figure 2: **Direct Commercial Real Estate Volumes By Region, Q1 2007 – Q1 2017**



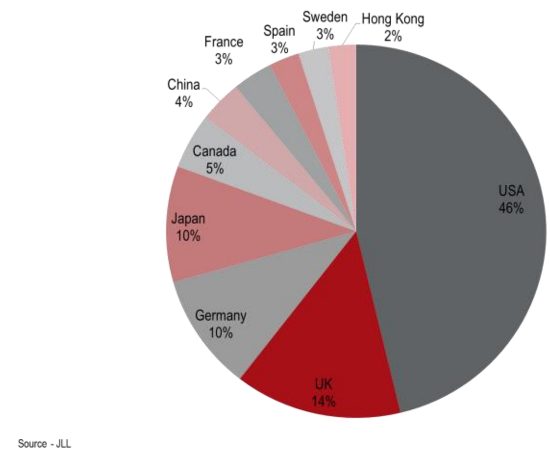
BREXIT concerns ease as the UK bounces back

While there are still many unanswered questions around BREXIT, what is clear is that investors were confident enough in the UK market to bring quarterly transactional volumes to their highest level since 2015, in local currency terms. Britain led the way as the most active market in Europe and, as we will discuss later in this report, London became the worlds most traded city, regaining the top rank it had lost two years ago. Offshore groups in particular renewed their focus on the British capital, which recorded the largest cross-border transaction of the quarter. Continued demand for portfolios in Germany brought activity to record highs. Elsewhere on the continent, strong performances from France, the Netherlands, Spain, and the Czech Republic all helped boost European volumes past last years level.

After having been beaten as the top market in Asia-Pacific last year, Japan rallied by posting its strongest quarter since 2015 to lead the region. Heightened activity in China and Singapore was contrasted with declines in Australia, Hong Kong, and South Korea, as investment volumes in the region ticked up slightly from what we recorded at this time last year (Figure 3).

In the Americas the biggest story was the decline in the US, which saw transactional volumes fall by 12%. On the other hand, Canadian volumes more than doubled thanks to a number of large deals in Vancouver. Mexico was also a bright spot in the region as volumes nearly reached $1 billion while Brazil recorded its third most active quarter in the last two years.

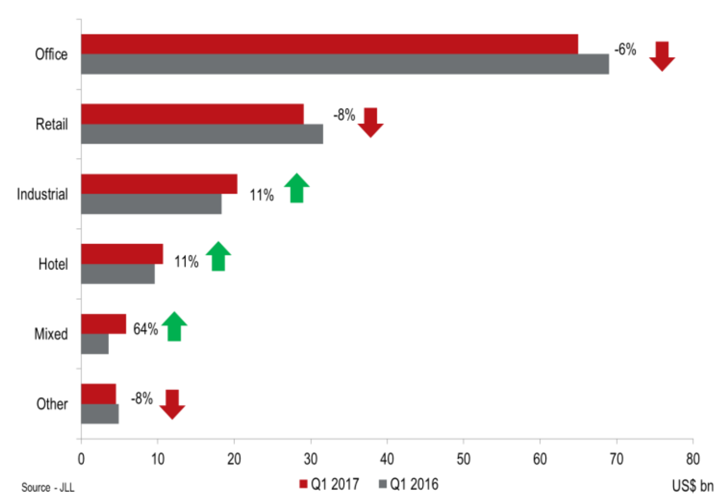
Figure 3: **Largest Markets for Transactional Volumes Q1 2017**



Hotels and Industrial start the year strong

After another year where large hotel and industrial portfolios were among the largest, and most sought after, deals in real estate, the two sectors posted investment growth of 11% (Figure 4). With another large European industrial portfolio set to close later this year, the sector is poised to continue its impressive run.

Figure 4: **Global Transactional Volumes by Sector, 2015 & 2016**



CITIES

London jumps to the top as NY falls

London regains its top spot as New York falls to fifth

For the first time in two years New York has lost its spot as the worlds most traded city. Leading the pack is London, regaining the spot it lost in 2015. Los Angeles, Washington, and Tokyo all made the top five this quarter while Shanghai fell out (Figure 5).

Vancouver made a surprise appearance in the list of the most active markets thanks to a flurry of large transactions. With half of Canada's ten largest transactions this quarter, Vancouver saw its ranking jump by 48 places.

A 62% drop in transactional volumes saw New York lose its top spot in the city rankings. Cross-Border volumes stand at their lowest level since 2013, as pricing pressures and heightened selectivity have put a damper on activity. Flat income appreciation is beginning to inhibit underwriting for transactions even given the long term strategies that have been adopted in the past few years. These long term strategies have shrunk the supply of available assets, which ultimately has slowed activity.

Figure 5: **Most Active Cities Q1 2017**

Rank Q1 2016	Rank Q1 2017	City	Q1 2017 (US$bn)	Q1 2016 (US$bn)
3	**1**	London	**8.2**	5.9
2	**2**	Los Angeles	**4.0**	6.1
7	**3**	Tokyo	**4.0**	2.6
5	**4**	Washington, D.C.	**3.8**	3.3
1	**5**	New York	**3.8**	9.9
10	**6**	Boston	**3.4**	1.9
4	**7**	Hong Kong	**2.6**	3.6
26	**8**	San Francisco	**2.4**	1.0
57	**9**	Vancouver	**2.2**	0.5
6	**10**	Seoul	**2.1**	2.7

Source - JLL

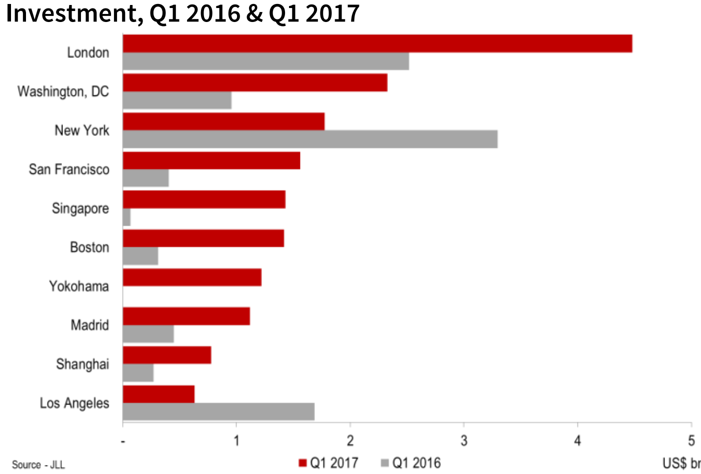
Foreign capital comes back to London

2016 saw foreign capital inflows to London come down by nearly 50% compared to the 2014 -2015 average. In the first quarter of 2017 however, London was back in the good graces of offshore investors, as it became the largest recipient of foreign investment in the world (Figure 6). For the second quarter in a row investors from Hong Kong were the most active foreign group in London. In their most active quarter in the British capital since 2014, they pursued offices in the City and West End, all while outspending global funds and all other foreign groups combined by nearly US$1.3 billion. Asian investors, particularly private buyers from Hong Kong and China, have been among the most active in London since the BREXIT vote, thanks to sterling depreciation and a slight drop in capital values.

As the only other European city on the list this quarter, Madrid was bumped up into the top ten after two large transactions in the retail and hotel sectors. UK based Intu Properties purchased the Xanadu mall for over US$560 million while a private Israeli investor bought a 50% stake in the Four Seasons Madrid for nearly US$125 million.

Foreign appetite for offices in gateway cities across the US has stayed strong. Offshore purchasers were most active in Washington, D.C., New York, San Francisco, and Boston, acquiring at least US$1 billion in office assets in the first quarter (Figure 6).

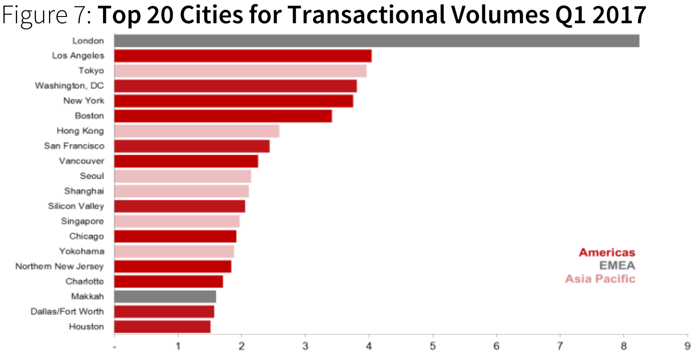
Figure 6: **10 Largest Recipient Cities of Cross Border Investment, Q1 2016 & Q1 2017**



Asian and North American cities run the table

As we have discussed in previous reports, there has been a distinct absence of European cities in the ranks of the top twenty most active transactional markets; London was the only city from the EU to make the list this quarter (Figure 7). Instead, investors have preferred the urban agglomerations of Asia and the Americas where large cities have been the major contributors to growth.

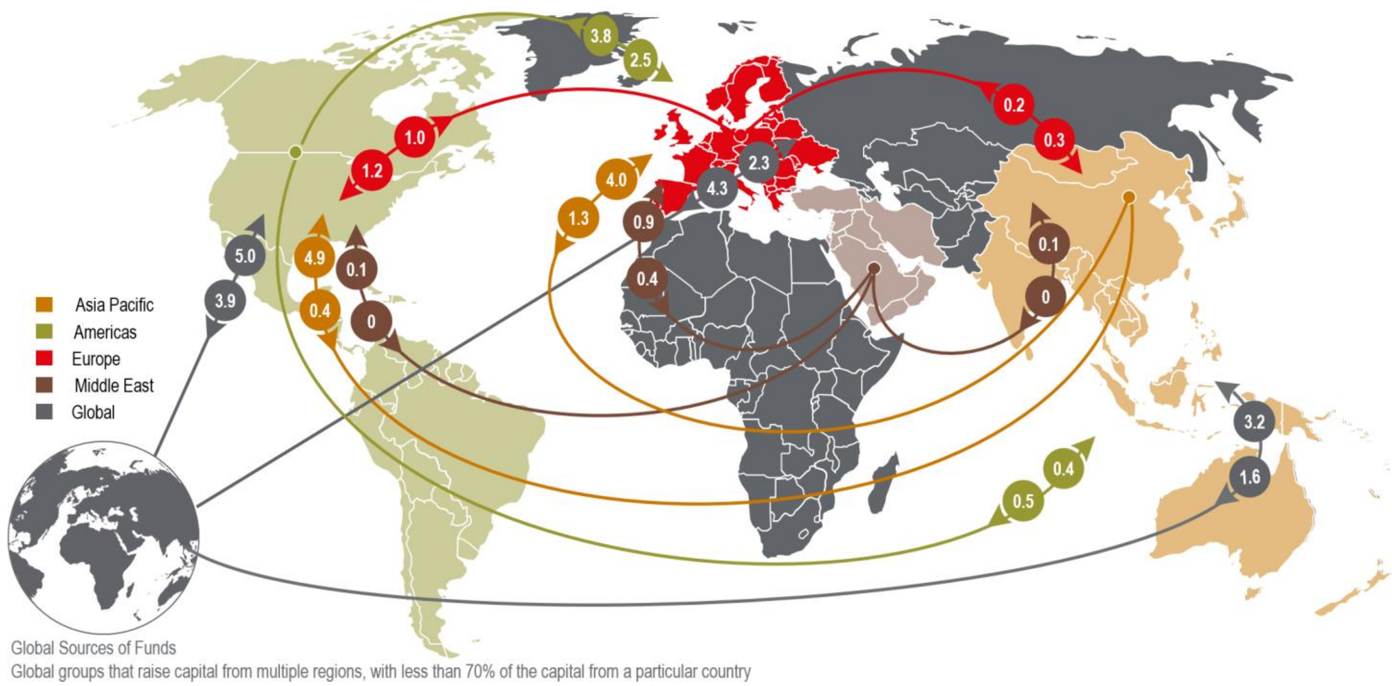
Figure 7: **Top 20 Cities for Transactional Volumes Q1 2017**



CROSS BORDER

US stays on top as capital leaves the EU

Figure 8: **Inter-Regional Flows, Q1 2017 (US$38 billion in total)**



Source: JLL
Property Data (UK); Real Capital Analytics (USA)

Capital flows from the Middle East slow down

Inter-regional capital flows from the Middle East hit their lowest quarterly volume since 2009 (Figure 8). Israelis, who were the most active group from the region, contributed almost half of the US$903 million that was exported out of the region this quarter. Despite this, capital flows between the regions is only down 1% from last year's pace. Intra-regional flows saw the biggest drop, falling by 26% on the year. The US attracted the most capital in the first quarter due to sustained interest from Asian buyers and global funds (Figure 9). In the EU, global funds and investors from the Americas pulled back, leading to capital outflows from the region. Asia-Pacific continues to be a major source of capital, while global investors and their European peers have reversed course from last year to become net buyers of real estate (Figure 10).

Figure 9: **Net Beneficiaries of Inter Regional Flows, Q1 2016 & Q1 2017**

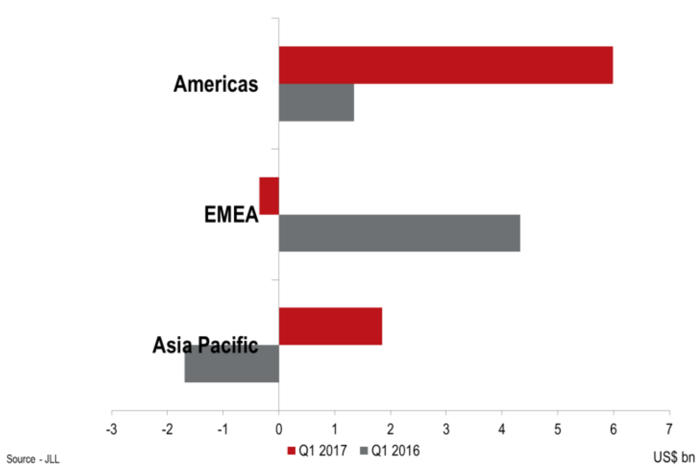
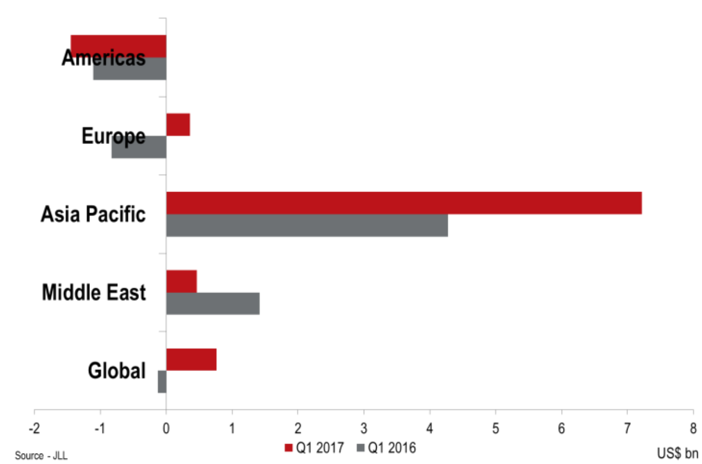


Figure 10: **Net Buying & Selling, Q1 2016 & Q1 2017**



CROSS BORDER

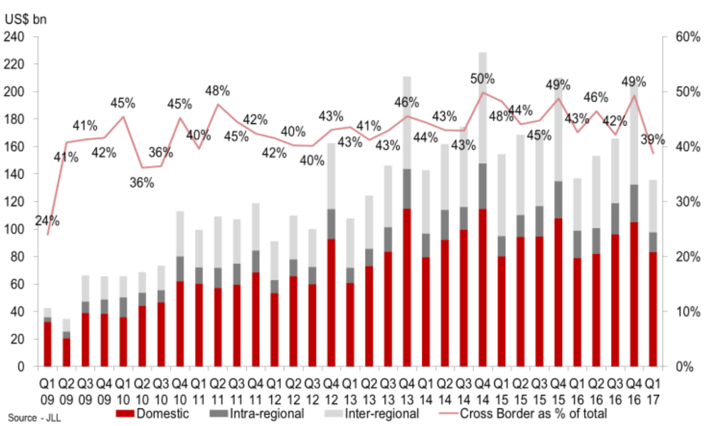
British investors set the pace

Cross-Border flows fall below 40%

As global volumes ticked down slightly, overall cross-border flows fell by 10% in the first quarter, but were 17% higher than the first quarter average from 2009 – 2016 (Figure 11).

Inbound cross-border capital was up by 17% in Asia-Pacific, largely due to heightened activity from global funds. In the EU, the British were the most prolific movers of cross-border capital, while buyers from Hong Kong spent nearly US$3 billion exclusively in the UK. As we discussed previously, Asian buyers were among the most active exporters of capital in the Americas this quarter, with investors from Singapore, Japan, and China driving most of the activity. With an investment strategy almost exclusively centred on offices in New York, Boston, and D.C., the Singaporeans and Japanese renewed their focus on core assets in global gateway cities.

Figure 11: **Global Cross Border Transactional Volumes, Q1 2009 –Q1 2017**

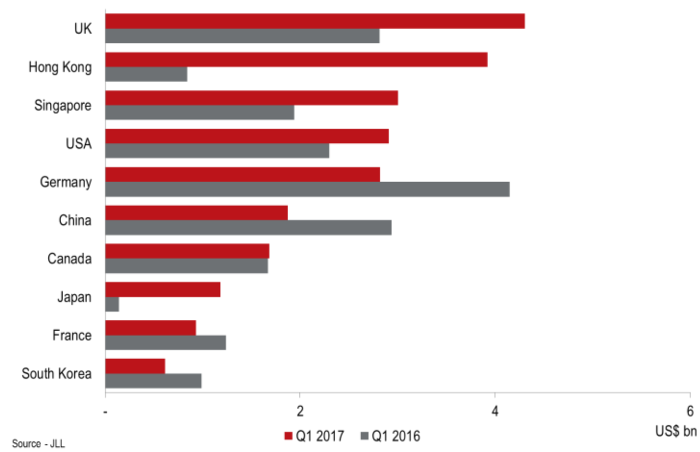


British sit atop the table

As the first quarter of 2017 came to a close UK investors were the biggest movers of capital outside of their borders as they exported US$4.3 billion, 52% more than they did this time last year (Figure 12). Large shopping centre acquisitions in Madrid, Helsinki, and Las Vegas helped them to become the most active cross-border buyers in the retail sector with almost double the volumes of the second ranked Germans. British cross-border capital flows were overwhelmingly intra-regional this quarter, with just 17% targeting markets in Asia-Pacific and the Americas. Within Europe UK investors preferred the established markets of Germany, Spain, and France for a majority of their acquisitions.

One of this quarter's biggest increases in cross-border spending came from investors in Hong Kong who spent nearly US$4 billion after tallying only $842 million at this point last year. As we have already mentioned, much of this was spent in the EU, with a particular focus on the UK. Two large office deals in Singapore, totalling over US$800 million, accounted for nearly all of their activity in Asia. Surprisingly, Hong Kong investors spent only US$37 million in the US this quarter, making up just 1% of total outbound capital.

Figure 12: **Top 10 Cross Border Purchasers by Source of Capital, Q1 2016 & Q1 2017**



'Cheesegrater' sale makes headlines

As the only cross-border deal above US$1 billion this quarter, the sale of The Leadenhall Building, also known as the 'Cheesegrater' due to its distinct shape, was one of the biggest stories of the quarter (Figure 13). With 4 out of the 5 largest cross-border deals involving inter-regional capital, investors have shown that they are willing to look to other geographies for the right deal.

As we said earlier, Asia-Pacific was the biggest source of capital in the first quarter. As Figure 13 shows, 3 of the 5 largest cross-border deals were made by investors from the region.

Figure 13: **Noteworthy Cross Border Deals in Q1 2017**

Property Name	Location	Sector	Sale Price ($ US m)	Purchaser	Purchaser Source of Capital
The Leadenhall Building	London	Office	1,425	CC Land	Hong Kong
60 Wall Street	New York	Office	988	GIC	Singapore
10 Saint James	Boston	Office	673	Mori Trust	Japan
Madrid Xanadu	Madrid	Retail	565	Intu Properties	UK
8 Cross Street	Singapore	Office	528	Manulife	Canada

Source - JLL

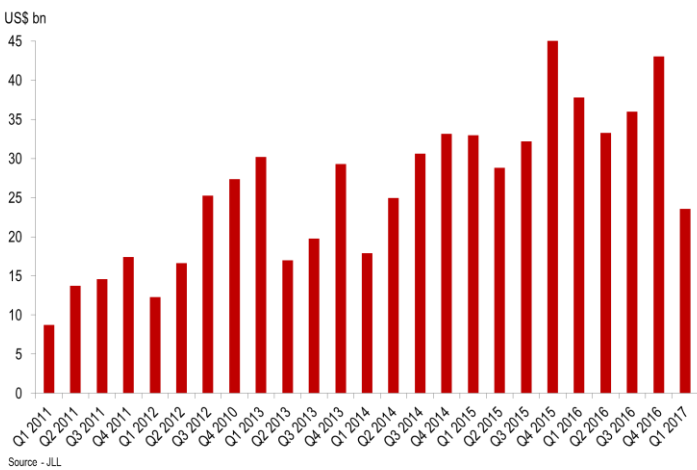
US MULTIFAMILY

Volumes fall after sustained growth

U.S. Multifamily Activity Cools in Q1

Investment in rental apartment properties in the United States took a couple of steps back as 2017 opened, with total volumes standing at US$24 billion, a 38% decline from Q1 2016 levels (Figure 14). The market could be reaching an inflection point for the cycle in some respects, as it comes off a historic run of several consecutive years of record performance, even exceeding office volumes in 2016 for the first time. While there is sustained demand from a variety of investor types, a sustained surge of new supply is being delivered to the market, resulting in substantial moderation in rent growth. Still, end demand for multifamily remains robust, and competition from the for-sale housing market is increasing only incrementally to-date.

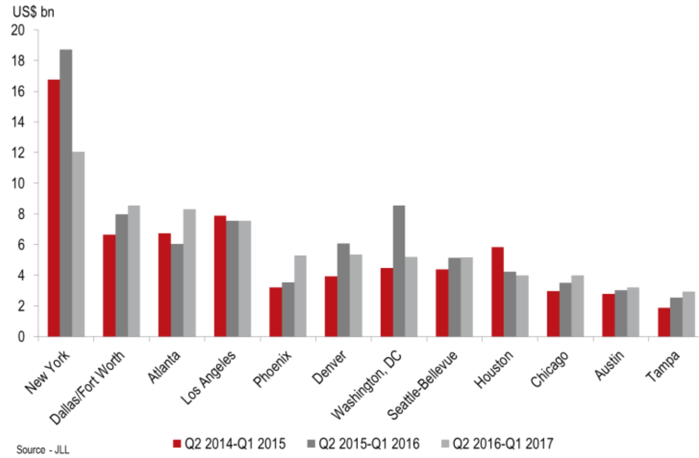
Figure 14: **US Residential Transactional Volumes, 2011 – Q1 2017**



Growth in Sunbelt Exceeding Coastal Gateways

Continuing a trend that has emerged in recent quarters, investment volumes in secondary markets are now growing at more impressive rates than in gateway cities (Figure 15). The strong run-up in rental rates and capital values in primary markets such as New York and San Francisco, as well as heavy additions to supply and selective labour market shortages have caused fundamentals and investment markets in many of these cities to pivot and face lower short-run growth prospects. By contrast, many secondary markets, particularly Sunbelt cities, continue to enjoy strong growth in both fundamentals and investment volumes. Dallas/Fort Worth, Atlanta and Phoenix are notable among them. However, despite a tightening in construction lending standards, developers are still very active in launching projects in many markets, so population and employment growth will need to remain solid across the South and Southwest in order to meet the increased supply in the pipeline over the next two years.

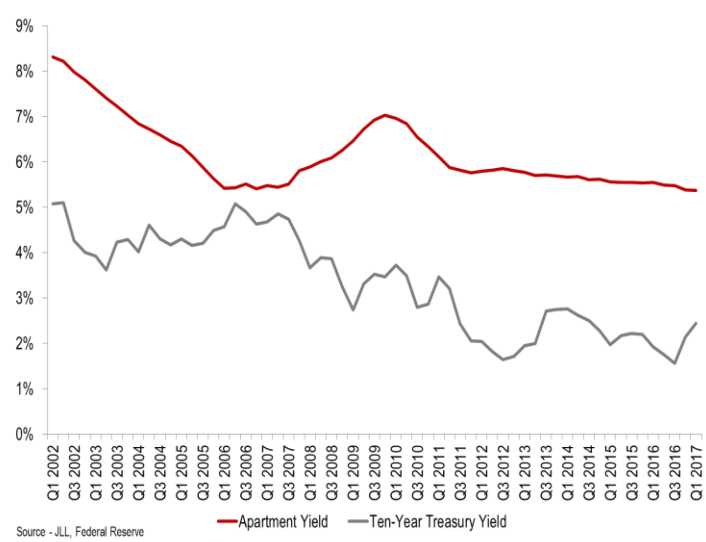
Figure 15: **Most Active US Cities for Multifamily Transactions, 2013 - Q1 2017**



Rising interest rates yet to impact pricing

The U.S. Federal Reserve increased its policy rate again in the first quarter. At the same time, longer-term risk-free rates increased during the first three months of the year – although more recently they've backed-off again. Multifamily investors were unfazed by the interest rate movements given spreads that are still at appealing levels. As Figure 16 shows, initial yields for rental apartments continued a very gradual decline, and are likely to essentially be at the bottom for this cycle. Relatively flat yields are likely in the short-run, not withstanding any dramatic interest rates shifts or changes in the economic environment.

Figure 16: **US Residential Spreads: Initial Multifamily Yields over US Treasuries, 2002 - Q1 2017**



Outlook

Demand for real estate set to stay strong

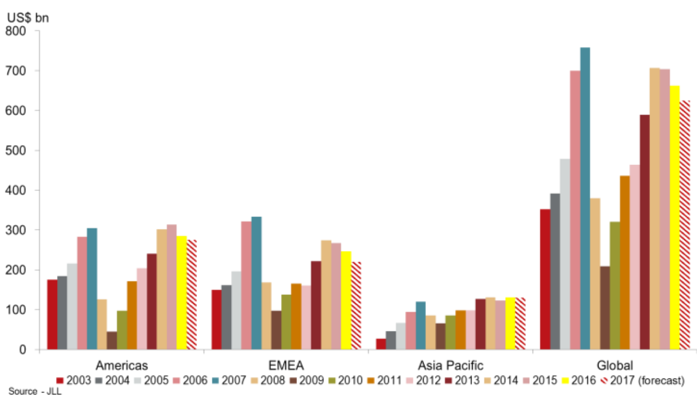
First quarter volumes set the tone for 2017

An active first quarter saw a slight drop in global transactional volumes. Political and economic ambiguity around the world remains the dominant story. Nevertheless, investors are still keen to make allocations to real estate.

French presidential elections, as well as the upcoming votes in the UK and Germany, stand to potentially impact the investment environment in Europe. In the US, President Trump's fiscal agenda remains front and centre, although his failure to pass healthcare reform has raised questions about the likelihood of increased government spending.

In this environment we expect transactional volumes to remain elevated but just slightly below what we recorded last year. As Figure 17 illustrates, we anticipate another active year in commercial property markets with full year volumes between US$625-650 billion.

Figure 17: **Historical & Forecast Global Transactional Volumes by Region, 2003 - 2017**

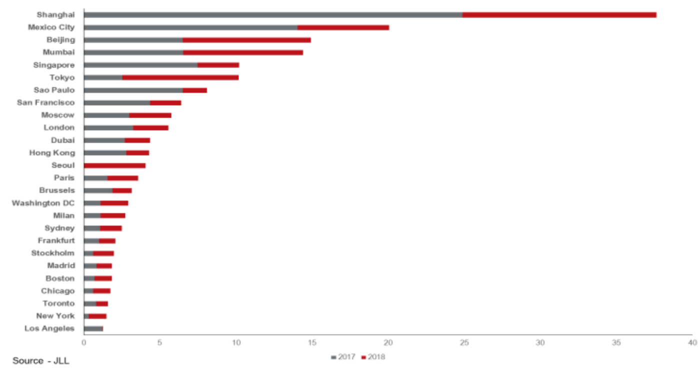


Occupational markets remain firm

Strong leasing activity in the US, Western Europe, and Australia all helped to boost global leasing volumes by 3% in the first quarter. Full year prospects are broadly in line to match the levels we saw last year, with increased take-up in the US expected to offset slight declines in Europe and Asia.

Office markets dynamics varied from region to region. The global vacancy rate stood stable at 11.9% but is expected to increase modestly by the end of the year due to new supply coming to market in the Americas and Asia-Pacific. Shanghai, Mexico City, and Singapore are expected to see the greatest additions to office stock while Seoul is the only major market that is not projected to add any new supply throughout the course of the year (Figure 18).

Figure 18: **Office Supply Pipeline – Major Markets, 2017 - 2018**

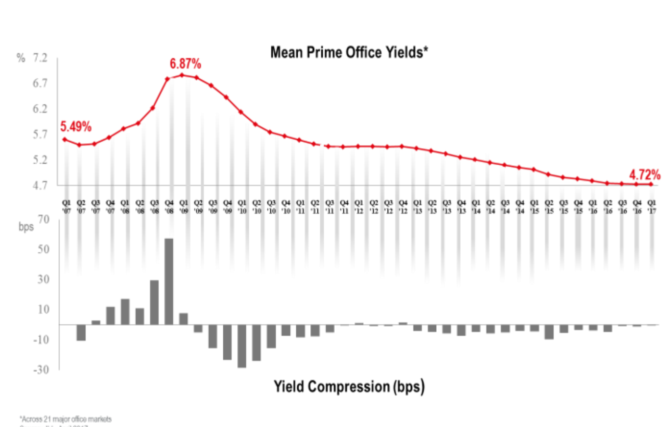


Rental growth is set to maintain a steady pace, after rising to 3.1% in the first quarter, up 50 basis points from the fourth quarter of 2016. Markets with limited supply growth saw the greatest increases, with rents in Sydney and Stockholm climbing by 28.8% and 20.8% respectively. In London, rents for prime offices have declined by 8.3% since the BREXIT vote and further falls are expected by the end of the year as vacancy is expected to increase further.

Yield compression begins to slow

The first quarter of 2017 showed that the sustained compression of prime yields may be coming to an end (Figure 19). Despite double digit drops in Frankfurt, Milan, and Sydney, prime yields remained unchanged in most major markets. In the US, yields moved out by 10-20 basis points, lending support to the perception that yield compression for this cycle has come to an end. While investors have been focused on the prospect of rising interest rates, real estate fundamentals should remain the focus, with an emphasis on income growth over capital appreciation.

Figure 19: **JLL Prime Office Yields and Compression, 2007 – Q1 2017**



Notes and Methodology

Direct Real Estate Investment	Refers to the purchase of individual commercial property assets or portfolio of assets (or shares in special purpose vehicles that own assets). Includes: • All transactions over US$5m • Sectors covered are office, retail, hotels, industrial, mixed-use and 'other' (includes nursing homes, student accommodation, etc) The data includes property company M&A, including REIT formations, where the following conditions are met: • The transaction is essentially a Real Estate transaction • Significant assets over and above the real estate assets (e.g. workforce, intellectual property, "goodwill" etc.) are not transferred • 70% + of revenues come directly from rental income • Transactions involve a significant changes of ownership • Transaction must be at 'market price' • Only includes the percentage sold to new investors at the IPO price Excludes: • Entity-level transactions; development deals; and multi-family residential investment
Entity Level Deals	Refers to corporate acquisitions, where significant assets over and above the real estate assets are transferred (e.g. workforce, intellectual property, "goodwill" etc). E.g. REIT privatisation 'Transaction churn' – e.g. where a company sells real estate assets to a majority-owned subsidiary
Development Deals	Refers to transactions categorised as 'forward funded' development and 'land' transactions
Asia Pacific	Varying coverage of the direct real estate investment markets in Australia, China, Hong Kong, India, Indonesia, Japan, Macau, Malaysia, New Zealand, Philippines, Singapore, South Korea, Taiwan, Vietnam, and Thailand
Europe	Varying coverage of the direct real estate investment markets in Belgium, Bulgaria, Croatia, Czech Republic, Finland, France, Germany, Hungary, Iceland, Italy, Luxembourg, Netherlands, Poland, Romania, Russia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey and the UK
Middle East and Africa	Varying coverage of the direct real estate markets in Bahrain, Israel, Kuwait, Lebanon, Qatar, Saudi Arabia, and UAE In Africa, we cover South Africa with varying coverage across the rest of the continent.
Americas	Detailed coverage of the direct real estate investment markets in Canada and the USA and partial coverage of Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Panama and Peru
Exchange Rates	We convert transaction values into US$ at the average daily rate for the quarter in which the transaction occurred
Grossed-up Figures	Volumes are grossed-up to reflect market coverage

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