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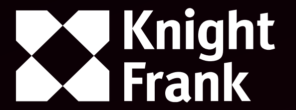

COMING OUT OF LOCKDOWN

GLOBAL INVESTMENT HOT SPOTS

CONTENTS

P03 LETTER FROM THE EDITOR

P05 THE VIEW FROM ASIA
Neil Brookes, Head of Capital Markets, Asia Pacific, Knight Frank LLP
Emily Relf, Head of Outbound Capital, Asia Pacific, Knight Frank LLP

P09 THE VIEW FROM EUROPE
Victoria Ormond, CFA, Partner, Capital Markets Research, Knight Frank LLP
Mike Bowden, Co Head of European Capital Markets, Knight Frank LLP

P13 THE VIEW FROM THE US
Alex Foshay, Vice Chairman, Divisional Head of International Capital Markets, Newmark
Brett Siegel, Vice Chairman, Co-Head of New York Capital Markets, Newmark

P16 KEY TAKEAWAYS

LETTER FROM THE EDITOR

By Andrew Sim, Head of Global Capital Markets & Managing Director, Europe, Knight Frank LLP

Wherever you are in the world, welcome to our global capital markets whitepaper, a series of insights collated from our last webinar, 'Coming out of Lockdown: Global Investment Hot Spots'.

The title of this whitepaper positively refers to us all 'Coming out of lockdown', and we'll bring you 'on-the-ground' regional updates from Asia Pacific, Europe and the USA.

Each update highlights current market conditions, the pushes and pulls driving international investor activity and our thoughts for the coming months as lockdown restrictions ease further.

Before we dive in, I would like to share some of the headline themes impacting global real estate.

We've been through an extraordinary year, with Covid-19 changing the way we've been able to live and work to varying degrees right around the world. We have seen an unrivalled series of economic restrictions across the globe, supported with unparalleled fiscal an monetary support. This has pushed bond yields to record lows with $18tn of negative yielding bonds globally, just as equity markets have seen massive amounts of volatility.

Commercial real estate has not remained immune to the pressures of the pandemic, which has served to accelerate structural changes that we were already seeing, underpinned by demographics and technology. However, in an uncertain environment of volatile equity markets and $18tn worth of negative yielding bonds, the case for the right sort of real estate remains persuasive.

> **"Despite facing Brexit alongside the pandemic, UK cross-border activity was only 8% lower than 2019 and remains the second largest destination of capital globally"**

In the face of massive headwinds, it is significant to see that $214bn orth of cross-border commercial real estate transactions were still completed last year. While this is just over one quarter down on 2019, it remains above the long-term average. Real estate has once again shown its strength.

However, at the regional, country and sector levels, there have been marked differences in the resilience of cross-border capital flows, which you will find out more about in this whitepaper.

Suffice to say, at regional level, Europe was a major beneficiary of cross-border transactions with over 60% of all cross-border activity occurring on the continent in 2020.

At a country level, Japan was one of the best performers for cross-border capital inflows, ranking the fifth highest country globally with volumes increasing by 17% over the year. In Europe, despite facing Brexit alongside the pandemic, UK cross-border activity was only 8% lower than 2019 and remains the second largest destination of capital globally, after the United States, speaking to its continued safe-haven status. Despite the US's number one position for cross-border capital flows, the country saw transaction volumes decline by 31% to $34bn over the year.

In terms of sector performance, we have heard a lot of over-dramatic rhetoric about the death of the office. Not only do e not buy into this narrative, but the numbers don't reflect it Cross-border office volumes did see a notable decline last year, falling 38% year on year, but despite this, the sector was still the largest

LETTER FROM THE EDITOR

traded, making up 40% of total cross-border flows, significantly ahead of the 23% share for industrial.

Nevertheless, we do forecast structural changes to drive continued growth of the industrial and non- traditional sectors over the coming years. We are undoubtedly at the epicentre of a real estate sector redistribution revolution.

To illustrate this, we've predicted how private equity investors (who tend to be a great indicator of future investment trends as they champion new sectors and create institutional products) will organise their global real estate allocations in the future.

Using a portfolio optimisation model, we found that the industrial sector could almost triple to 20% of private equity investors' global real estate holdings over the next few years, while the non-traditional sectors, ranging from healthcare; senior living; data centres; life sciences and beyond, could total half of private equity portfolios.

> **We are undoubtedly at the epicentre of a real estate sector redistribution revolution.**

The model predicts that the office secto has a significant ole to play, with about 21% of global allocations, but this is a reduction from its current 39%. Retail could become the smallest slice of holdings at just 8%. In looking at this, we should keep in mind that these are smaller slices, but of a bigger pie, as we expect the private equity sector to keep on growing.

Looking at regional forecasts, we expect capital flows to follow two main themes over the coming year. Intra-regional, near-neighbour investing, for example, within Europe, takes advantage of local expertise and mitigates the issues of travel disruption. Safe-havens – those large, relatively liquid, transparent locations – will also be destinations for capital, regardless of travel disruptions. We have already seen

> **The industrial sector could almost triple to 20% of private equity investors' global real estate holdings over the next few years**

evidence of motivated investors from Asia buying best in class buildings in London with virtual inspections. Both of these drivers will benefit locations such as the US, the UK, Canada, Germany and Singapore; our top five predicted destinations for capital over the next 12 months.

So, to add some detail behind the headlines, our network of partners from around the globe will give you the view from the ground.

THE VIEW FROM ASIA PACIFIC

FOUR KEY INVESTMENT THEMES AND BUYING OPPORTUNITIES FOR ASIA PACIFIC IN 2021

By Neil Brookes, Head of Capital Markets, Asia Pacific, Knight Frank LLP

It's been a year since Covid-19 emerged in the region and Asia Pacific is now showing signs of recovery. To identify these, I'm going to examine the key investment themes that will play out in 2021 and outline where these buying opportunities will come from.

> "The success of many mature markets in this region in controlling the virus means they are less likely to experience significant recurring spikes and a return to economic growth will occur before the western markets"

1. Increase in capital allocation to real estate

Frothy equity markets have brought stocks in both the US and Chinese Mainland to recent record highs. Those valuations appear to have already priced in a global economic recovery, leaving investors concerned about prospects for added capital gains.

Real estate provides the benefit of diversification away from turbocharged stock prices and acts as a good inflation hedge if and when economic recovery does prove sustained. For this reason, we expect global investors' allocation to real estate will increase substantially throughout 2021.

2. Covid-19 resilience

The share of global deals occurring in Asia rose to 19% in 2020, a statistically significant boost of two percentage points over the 17% rate sustained over the last three years.

The success of many mature markets in this region in controlling the virus means they are less likely to experience significant recurring spikes and a return to economic growth will occur before the western markets. This will drive global investors to increase their allocation to Asia-Pacific as a whole.

3. Portfolio diversification into alternative assets

Investors are increasingly moving into sectors spurred by Covid-19 effects, including cold storage and logistics space. E-commerce demand is necessitating significant usage increases in both types of property, to ship fresh food and medicines as well as to process more typical online purchases.

The living sectors, which includes Build to Rent, student housing and senior living, will also see a substantial increase in demand as they are generally performing well during the pandemic and show a negative correlation to the office sector; providing diversification benefits to investors.

Apartment-block purchases across Asia reached a record high in 2020, with $12bn in deals transacted – a figure which is up 57% on the previous year.

FOUR KEY INVESTMENT THEMES AND BUYING OPPORTUNITIES FOR ASIA PACIFIC IN 2021

4. Rise in the importance of Environmental, Social and Governance (ESG) considerations

This is being driven by the large proportion of active US and European investors who have already adopted many of these principles in their home markets.

Assets with good sustainability credentials will be more in demand from investors, occupiers and lenders alike. ESG credentials will have an increasing impact on cap rates and assets with good sustainability credentials will hold their value better and see greater potential capital gains in 2021.

BUYING OPPORTUNITIES

1. Large increase in closed-end fund expiries

Close to $30bn worth of fund assets are due to reach the end of their life in the next 24 months. Most of these expiries are coming up in Australia, India and Chinese Mainland and comprise mainly retail, hotel and office assets. With these funds under pressure to offload assets upon expiry, there may be opportunities for investors to negotiate attractive deals.

> **"Apartment-block purchases across Asia reached a record high in 2020, with $12bn in deals transacted – a figure which is up 57% on the previous year."**

2. Opportunities to acquire assets on a sale and leaseback basis

Many corporate balance sheets remain under pressure as lockdown restrictions continue and the withdrawal of government stimulus is likely to spur companies to unlock liquidity though the sale of their real estate assets in the latter half of the year.

> **"The need to comply with more stringent ESG requirements is likely to drive some regional funds to sell non-ESG compliant assets"**

3. Pricing dislocation in the public markets

Several Asia Pacific REITs continue to trade below their Net Asset Value, which may drive some managers to review their portfolios and dispose of assets to reinvest into other opportunities.

4. More stringent ESG requirements

The need to comply with more stringent ESG requirements may drive some regional funds to sell non-compliant assets. This will provide an opportunity for value add investors to acquire these assets at a discount and repurpose them back to core product.

TOP THREE INVESTMENT HOT SPOTS IN ASIA PACIFIC AND PREDICTED CAPITAL FLOWS

By Emily Relf, Head of Outbound Capital, Asia Pacific, Knight Frank LLP

Considering the investment themes and buying opportunities discussed, where are the top three investment hot spots in the region?

1. Japanese multifamily

With an urbanising population, a growing generation of renters and investment opportunities of scale, you can see why the Japanese multifamily market attracted $8.6bn of investment last year. Given the potential for yield compression in Japan, the resilient income profile and attractive risk-adjusted returns, we believe Japanese multifamily should continue to attract global capital in 2021.

> **You can see why the Japanese multifamily market attracted $8.6bn of investment last year.**

2. Sydney suburban offices

Rapid urbanisation and infrastructure improvements have helped many cities in Asia Pacific establish new decentralised business hubs, attracting occupiers seeking lower costs and higher efficiency. North Sydney and Macquarie Park are great examples of this, hence why we think they are worthy of a hotspot title.

In these suburban markets, there is up to a 30% discount on rents compared to the commercial business district, so offers not only a yield discount but also an opportunity to increase rental levels in line with the potential structural change in office use going forward.

3. Cold storage in Chinese Mainland

Surging requirements for fresh food, medical products and upcoming vaccines will support robust demand for cold storage facilities throughout Asia Pacific. As it stands, total cold storage logistics warehouse stock in China accounts for only circa 3% of the total logistics warehouse market. Given the huge increase in demand, we see immense opportunity in this sector for investors willing to navigate the various barriers to entry.

Inbound Capital Flows

In 2020, approximately 30% of transaction volumes were attributed to US capital, the majority of which were private equity funds, and we see the dominance of these private equity funds continuing into 2021. Investment firms raised $9bn in 47 Asia-focused real estate funds last year, following a record $26 billion raised in 2019, meaning they have a huge amount of dry powder to put to work this year.

Singaporean capital was hot on the US's tail last year, accounting for 24% of transaction activity in the region. We again expect the Singaporean REITs to continue to be acquisitive this year in near-neighbour markets, driven by proximity and on-the-ground experience. We see their focus being on suburban offices, logistics and alternative sectors, mainly in Chinese Mainland and Australia.

> **Rapid urbanisation and infrastructure improvements have helped many cities in Asia Pacific establish new decentralised business hubs, attracting occupiers seeking lower costs and higher efficiency.**

TOP THREE INVESTMENT HOT SPOTS IN ASIA PACIFIC AND PREDICTED CAPITAL FLOWS

We also anticipate the continued resurgence of European capital in the region in the next 12-18 months, as German, French and UK pension funds take advantage of more favourable costs of capital. Look out for these capital sources making big plays in the living sectors, in particular.

With travel restrictions set to remain in place for 2021 in some shape and form, what capital do we think will navigate these and be the most active outside of the Asia Pacific region?

Outbound Capital Flows

As well as being active investors within Asia Pacific, we also expect to see big outflows from the **Singaporean GLC's** into Europe and the US. Driven by their robust performance of their REITs on the SGX and their access to various pots of capital, we will see them active across geography and sector, from life sciences and multifamily in the US to logistics in eastern Europe.

As well as the Singaporean REITs, the **Hong Kong REITs** will continue to make their presence felt on the international stage. Driven by a need to diversify out of Chinese Mainland into safe-haven markets, we are likely to witness them acquiring long income office assets global gateway cities, primarily in London, Europe and Australia.

Finally, after an inward focused year in 2020, 2021 will see the return of the Korean powerhouses in international markets. With a large allocation for overseas real estate that needs to be placed, and hedging premiums now in their favour, we will see the Korean securities firms, asset managers and institutions ali e very active in the US and Europe. We expect a focus on logistics, long leased offices and increasingly a shift towards the resilient living sectors.

> **“Surging requirements for fresh food, medical products and upcoming vaccines will support robust demand for cold storage facilities throughout Asia Pacific.”**

THE VIEW FROM EUROPE

THE THEMES SET TO DRIVE EUROPEAN CAPITAL FLOWS IN 2021

By Victoria Ormond, CFA, Partner, Capital Markets Research, Knight Frank LLP

Europe held steadfast as the largest recipient of cross-border capital in 2020. With $132bn worth of inbound investment, the region increased its market share last year to 62% of global cross-border capital. While we did see a 19% decline in European cross-border activity, this is much less than the average global decline of 28%.

Cross-border activity was actually somewhat more resilient than domestic through 2020, leading to an overall investment volume decline for Europe of 23% over the year to $278bn. This remains a softer fall in volumes than the global average of a 28% drop in transactions, however.

Europe was also home to eight out of the top 10 global cities for real estate investment last year. These ranged from the safe-haven locations of London, Paris and Berlin, to cities such has Madrid in the south, which has benefitted over the last few years from a continued later recovery from the Eurozone crisis earlier last decade.

Looking forward, we expect two themes to drive European capital flows over the coming year. The first is the continued d aw of capital to liquid, transparent, globally understood, safe-havens, while the second is a continuation of more local, intra-European investing between near-neighbour countries.

This prediction is borne out of our flagship Active Capital research, where we have used a capital gravity model to predict where we think capital will flow over the coming year. Using a variety of economic, geographic and real estate inputs, as well as a shock factor to try and capture the lagged effects of the pandemic, we predict top destinations for capital in Europe will include the UK, Germany, France and the Netherlands.

For the UK, we forecast an increase, even compared to pre-pandemic levels, in inbound capital from near-neighbours such as Germany and the Netherlands, while we think the UK's safe-haven status could support interest from locations such as Singapore, which could deploy capital into the UK at levels up to 20 to 25% higher than we saw pre-pandemic.

Our model also predicts that Germany should benefit from robust, within-Europe, near-neighbour investment, particularly from France, the Netherlands and the Nordics, as well an increase in interest from further afield such as the United Arab Emirates. We also think that France could particularly see an increase in investment from the United States.

> **Europe held steadfast as the largest recipient of cross-border capital in 2020.**

Currency hedging benefits or dollar-denominated investors investing into Europe on a five-year basis have been seeing some improvement recently, as they also have for Korean capital. This could energise investment from these locations into Europe over the coming year. In fact, we have already seen motivated south Korean investors.

In terms of investor type, we see a broad spectrum targeting European real estate, from private equity investors looking for opportunities, particularly in those more non-traditional asset classes, through to institutional investors looking for quality income. And of course, overlaying all of this, is an increase in demand for sustainable-led assets.

KEY EUROPEAN SECTORS AND HOT SPOTS FOR 2021

By Mike Bowden, Co Head of European Capital Markets, Knight Frank LLP

By any measure, 2020 was an exceptional year for the European logistics sector. Upwards of €40bn was traded over the year, showing a 4% increase from 2019 (which was the previous record) and a 47% increase on the 10 year average.

Two of the top performing markets were the UK, which was up by 32% and Germany, which was up by 10%. France was the anomaly last year with a 43% drop off, although there is substantial Q1 momentum suggesting a strong come back this year.

Overall, we expect another really strong year in 2021 and we're forecasting a particularly dramatic pick-up in Southern Europe. For the other markets, stock rather than demand will be the only handbrake on overall volumes.

> **"Overall, we expect another really strong year in 2021 and we're forecasting a particularly dramatic pick-up in Southern Europe. For the other markets, stock rather than demand will be the only handbrake on overall volumes."**

In response to the pandemic, the sector has clearly benefited from the super charging of e-commerce. Beyond that we have also seen an increased emphasis on logistics supply chain resilience, as well as a focus on the importance of holding inventory closer to consumers. The net result is huge tenant demand and a race for space.

The prime end of the market has been largely driven by insurance and core fund capital, predominantly out of Germany and France, and whilst this capital will continue to be very aggressive, we do expect a further pick-up in inbound Asian capital. We saw several Chinese groups coming back in the market in Q4, and beyond that Korean investment demand is picking back up – especially for mainland Europe, where the all-important hedging costs are back in favourable territory.

This is evidenced by one of our recent sales in Poland, where we acted on behalf of Eurobox. We sold the asset to SIM and Vestas for €65.5m into a raised fund with discretionary capital with no syndication requirement. We expect to see more of this model going forward.

Other trends I believe will pan out in the year ahead:

1. S&L activity will be strong

Sale and leaseback activity was up 15% in Europe last year. However, I would note that the general sell rational isn't one of being 'cash strapped' – rather, a case of tenants seeking to upgrade their inventory and invest in evermore costly automation projects. I predict this will pick up further in 2021.

2. Massive growth and interest in on-line grocery

E-commerce growth will continue to power on, but on-line grocery will see the strongest acceleration.

3. No let up from Amazon

The Delivery Station (DS) roll-out will be an area of particular focus. Our teams advised investors in funding DS schemes across Europe and we expect to see more this year.

4. The retail and logistics worlds will continue to collide

We foresee an increase in retail to logistics trades as the pressure to access the urban last mile continues to build. P3 (GIC) made a big play in Germany acquiring 33 metro wholesale assets in an €800m+ trade. Here in London, we've traded two OTT retail parks for logistics conversions, both being acquired by Prologis.

KEY EUROPEAN SECTORS AND HOT SPOTS FOR 2021

5. Rental growth set to push on
Whilst the UK has seen plenty of rental growth, it has been long anticipated in mainland Europe and has lagged. With the continued race for space, we anticipate growth in the tighter markets.

As well as huge demand for logistics, residential real estate has become increasingly important for all investors across the entire risk spectrum. Residential volumes topped €60bn in Europe last year, which makes it one of the top performing asset classes and is now the second largest asset class behind office

“Residential volumes topped €60bn in Europe last year, which makes it one of the top performing asset classes and is now the second largest asset class behind offices.”

Given the embryonic nature of the asset class in Europe, over 30% of all residential transactions were completed via a forward structure, with fundings becoming more attractive as development finance become materially more expensive for developers. Forward transactions in the sector increased by 13% in 2020 compared to 2019 and we anticipate this trend to continue to increase as supply attempts to keep up with demand.

In terms of offices, the most aggressive capital and demand remains in the core space, focussed on modern, well-let properties both in terms of income sustainability and term certainty, with appropriate environmental accreditation becoming extremely important. ESG is fast becoming a key value driver in this sector. In fact, assets that don't or can't conform to ESG credentials post-refurbishment will see exponential value deterioration.

A good example of how the core capital is putting this strategy into effect is an asset we recently acquired for Amundi. Fitzwilliam St in Dublin is a brand new office building d to PC imminently, with a long WAULT and all appropriate environmental accreditations. The asset held pre-Covid pricing and at approximately €180m and an NIY of 4.0%, highlighting how pricing is remaining robust for core product.

In last year's European Breakfast presentation, we majored on how we felt innovation would drive investors' focus. Looking to invest in real estate that is strategically located near universities or hospitals, for example, by acquiring or developing sophisticated, high-quality real estate such as lab space suitable for research and development, plays perfectly into the life sciences space. At Knight Frank we are at the forefront of this exciting area of the market.

Our UK team recently sold Cambridge Science Park on behalf of L&G. The opportunity had nearly £2bn of capital chasing it, and over 20 bids received. The asset sold to Brockton Everlast for just under £100m, reflecting a price tag which wa over 50% ahead of guide.

The other area of the market I anticipate returning with stronger volumes this year is the core-plus and value-add arena. Since the pandemic, this area has been held back by a less favourable debt market. In our opinion, the equity has remained extremely keen to buy, but with debt terms softening, pricing has moved out, which has prevented transactions. As investment conditions improve, the raised debt capital that has also suffered from a lowering of volumes and opportunities will be keen to get invested.

This will help to kickstart this area of the market and sales that were perhaps put on ice mid-2020 will return with the pricing discrepancies between buyer and seller becoming less stark as debt becomes increasingly accretive.

For true core in all the mainstream sectors, we are confident prime yields will harden further with a flight to prime, which will in turn make core-plus and value-add look increasingly attractive.

An exciting year lies ahead for many reasons.

THE VIEW FROM THE US

WHAT'S THE INTERNATIONAL APPETITE FOR US COMMERCIAL REAL ESTATE?

By Alex Foshay, Vice Chairman, Divisional Head of International Capital Markets, Newmark

The US has been the beneficiary of an influx European, Middle Eastern and Asian capital since the second half of 2020 and into early 2021, with the majority of transactions occurring in the longer term, credit rated tenancy, NNN (triple net rent space.

Logistics continues to be the most sought-after asset class by the majority of non-domestic groups, with long leased office and stabilize multifamily seeing a resurgence in demand in the latter end of 2020 and at the start of 2021.

Alternative asset classes such as life sciences, data centres, healthcare and student housing are also seeing significant rising l vels of overseas investor demand – well above where it stood pre-pandemic.

Capital for development remains thinner, with a handful of offsho e sovereign wealth funds and national pension fund players focused on large scale opportunities in markets which have strong demographics; particularly those showing growth in the major tech tenancies of Facebook, Amazon, Apple, Netfli and Google.

We expect international appetite for US commercial real estate to continue to grow in 2021 due to a combination of relative pricing attraction compared to other cross-border capital destinations, lower hedging costs, a weaker dollar and continued demand for stabilized returns in mature economies.

A key driver of the increased international demand for US commercial real estate has been the significantly declining hedging costs overseas that investors have witnessed over the course of 2020.

That fall has been driven by the Fed cutting rates to a historically low range of 0%-0.25% in early 2020.

> **“A key driver of the increased international demand for US commercial real estate has been the significantly declining hedging costs overseas that investors have witnessed over the course of 2020.”**

Korean institutions and German open-ended funds, in particular, are required to hedge the equity portion of their overseas investments – resulting in this hedging movement having the greatest impact on their appetite for investment into the US.

We've seen hedging costs for Korean investors fall by over 200 bps in 24 months, and we've seen hedging costs for German investors fall by 100 bps in only 12 months. Both of these are unprecedented levels of decline in the cost of hedging and that has resulted in significan investor demand and deal activity.

Some recent examples include:

- Hana Financial's recent acquisition of the 2+U Tower in Seattle for $669m.
- Mirae Asset Management's recent purchase of four Amazon and FedEx leased logistics assets located in Charlotte, Cleveland and Indianapolis for $365m.
- Our sale of Uptown Station in Oakland, CA, Square's headquarters, to Mapletree from Singapore for $419m – the REIT's first office purchase on the West Coast of the US.

WHAT'S THE INTERNATIONAL APPETITE FOR US COMMERCIAL REAL ESTATE?

So, while overall international investment into the US is off by 30% year on year, it is clear that certain investors are bucking the trend:

- Korean investment into the US has increased by a whopping 93% year on year.
- Singaporean investment into the US has increased by 17% year on year.

Further significant pockets of active international capital into the US include:

> "Korean investment into the US has increased by a whopping 93% year on year."

Sovereign wealth funds and national pension funds seeking joint venture co-investment opportunities on large scale single assets, portfolios or platform level investments. This has been seen with NPS's recent 49% joint venture with SL Green at One Madison in New York.

German open-ended funds have recently been actively re-engaging on core logistics and offic products in the gateway markets. We expect to see further investment activity from this group over the next 12 months, as more data points become more evident. One early example of this appetite is our sale of 915 Wilshire in LA to Deka for $195m.

Best in class Middle Eastern syndicators are acquisitive in the US, particularly for single tenant, long leased assets in office, logistics o life sciences. A recent example of this is Sidra Capital's acquisition of the Arborcrest Corporate Campus, a $225m life science asset in suburban Philadelphia.

Ultra High Net Worth investors, predominately from Europe and Asia Pacific are currently active for best in class, core opportunities in gateway cities – one such example is the Reuben Brothers purchasing both 609 Fifth Avenue and the Surrey Hotel in New York. We are seeing continued demand from these individuals for prime assets with attractive cash flow.

The breadth of investor demand from overseas capital seeking to enter the US commercial real estate market has arguably never been wider. We expect that to remain the case through 2021 and for that capital to expand the product types and investment strategies it will pursue.

CAPITAL MARKETS IN THE US – AND THE STORY FROM NEW YORK

By Brett Siegel,
Vice Chairman,
Co-Head of New York
Capital Markets, Newmark

Four key investment themes and buying opportunities for Asia Pacific in 2021

Overall, institutional demand for US commercial real estate remains very strong, however, investor appetite has shifted as result of the short-term disruption created by the Covid-19 pandemic.

With a sharp global focus on supply chain efficiency and last mile distribution capabilities, the US industrial market has continued accelerating, resulting in significant growth in fundamentals and in turn, attracting investors with the lowest cost of capital.

Core investors are also focused on the burgeoning life sciences sector – with a particular focus in Boston, San Diego, San Francisco and Raleigh Durham – as well as multifamily opportunities and new vintage office products with long-dated WAULT. More opportunistic capital has been focused on older vintage transitional offi products, where non-credit tenants may be more vulnerable to pandemic-related issues, as well as opportunities in the retail and hotel sectors, which have suffered disproportionately over the past year.

The pandemic accelerated allocations toward industrial and multifamily products in 2020, attracting a combined 63% of investment volume among the five major property types. While this trend has progressed over the past 15 years, both property types have remained resilient to pandemic-related disruption and are supported by secular tailwinds.

US-based real estate fund investors remain extremely well capitalized, with over $180bn in capital raised in 2019, immediately preceding the onset of the Covid-19 pandemic – an all-time record since the data started being reported in 2002. In fact, there is approximately $40bn of additional dry powder currently chasing real estate opportunities compared to the last peak, in 2007.

> “There is approximately $40bn of additional dry powder currently chasing real estate opportunities compared to the last peak, in 2007.”

Ample dry powder and continued fundraising activity has supported transaction volumes across all property types and low lending rates have allowed for sellers to exit at prices that align with their original underwritten values despite lower growth expectations. Pent-up demand from fund investors seeking to deploy this capital will likely reduce the trough-to-peek recovery timing as we stabilize in 2021 and beyond.

Investment volume in 2020 declined 32% year-over-year, as Covid-19 severely impacted demand for hospitality, retail and urban offic However, overall capital markets activity and investor sentiment has recovered since the second quarter, bolstered by economic stimulus, the completion of multiple Covid-19 vaccines and pent-up investor demand. Fourth quarter volumes increased by 93.9% quarter-on-quarter and December volumes reached a 2020 peak of $70.9bn.

By the end of 2020, public REIT stocks recovered approximately 48% since the trough in March but remained 14.9% below their peak level before the pandemic. REIT stocks underperformed the major stock indices, including the Dow Jones Industrial Average as well as the S&P 500, which have surpassed their pre-pandemic historic levels.

CAPITAL MARKETS IN THE US – AND THE STORY FROM NEW YORK

As commercial real estate is generally considered a trailing indicator, many believe that REIT stocks are posed to narrow the recovery gap as investor demand shifts away from technology-oriented growth opportunities and back towards cash flow driven yield opportunities created by long-term lease stability.

The federal government is expected to continue expansionary monetary and fiscal policies throughout the Covid-19 pandemic, and these measures will support liquidity and low interest rates, which will reinforce both institutional investor confidence and tenant demand for real estate.

“By the end of 2020, public REIT stocks recovered approximately 48% since the trough in March but remained 14.9% below their peak level before the pandemic.”

Vaccine development provides hope for a return to normalcy during the first half of 2021 That timeline depends upon the efficiency of vaccine distribution to the public. In addition to breakthroughs in therapeutics, schools reopening for in-person learning and renewed comfort with public transit will also influence the national office markets recovery.

Ultimately, it is likely that an increase in flexible scheduling will result in a net neutral or possible modest decline in long-term net demand for office space, but the many compelling reasons to return to the office me it will remain an essential part of the work environment for most professional firms. The forced work experiment of 2020-2021 has highlighted both the value of technology and the importance of in-person interactions.

With densely populated major urban centers

“The forced work experiment of 2020-2021 has highlighted both the value of technology and the importance of in-person interactions.”

around the globe experiencing pandemic-related disruption, many investors have shined a spotlight on large central business district markets, such as New York City, which is widely viewed as the business capital of the world. While New York, like all other large urban global markets, experienced significant headwinds in 2020, many green shoots throughout the depths of lockdown signal long-term stability in fundamentals as the broader economy reopens and office employees return to the workplace.

Namely, six of the 10 largest companies in the world by market cap have increased their presence in NYC over the last 12 months and all of the FAANG (big tech companies have expanded dramatically in New York since 2018, with Amazon, Facebook and Apple increasing their collective footprint in Manhattan by approximately two million square feet throughout the pandemic.

KEY TAKEAWAYS

By Andrew Sim,
Head of Global Capital Markets & Managing Director, Europe,
Knight Frank LLP

In Asia Pacific, the continued dominance of Singaporean capital in near-neighbour markets, together with continued strong US volumes and a resurgence of European capital will help fuel the region; outbound, Hong Kong REITs and Korean funds will dominate.

In the USA, international investor appetite will continue to grow given attractive pricing, lower hedging costs and a weaker dollar, with New York continuing to lead the path to recovery; outbound, perhaps not surprisingly, private equity will become increasingly prolific.

In Europe, in the true core, we are confident prim yields will harden, yet further German and French insurance capital will continue to be dynamic. This will be accompanied by far stronger volumes in the core-plus to value-add arena; outbound, German capital will lead the way.

Throughout the world, investor focus is on logistics and multifamily products, with a surge in interest for data centres and life sciences. Safe-haven and near-neighbour investing are common themes for all of us. Likewise, the fast moving ESG agenda is now global with intercontinental investors rightly evangelising their sustainability expectations, whatever the jurisdiction.

This has been a year like no other. I would like to take this opportunity to thank you on behalf of the Knight Frank team. Our clients are at the heart of everything we do and never before have we been more grateful for your support and engagement than during lockdown.

The very best of health to you and your families.

Watch the event replay on-demand
knightfrank.asia/InvestmentHotSpots

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