A VIEW FROM THE TOP 2016

IS THERE LIFE IN THE PROPERTY BULL MARKET?

Colliers
INTERNATIONAL

THE TITLE OF THIS PAPER 'A VIEW FROM THE TOP' WAS CONCEIVED AS A MEANS OF SUGGESTING THAT THERE IS NOT YET A DEFINITIVE PEAK IN PROPERTY PRICING. INSTEAD, UK AND EUROPEAN PROPERTY MARKETS, ESPECIALLY THE CORE SEGMENTS, APPEAR TO BE ON A RIDGE LINE, AT A HEIGHT IN TERMS OF PRICING, BUT NEITHER APPEARING TO BE RISING NOR FALLING IN ANY CONVINCING TREND. TRANSACTIONAL VOLUMES ARE ALSO AMBIGUOUS. WHILE THERE IS EVIDENCE TO SUGGEST A TRANSACTIONAL PEAK IN 2015, EUROPEAN VOLUMES ARE STILL RISING. FURTHERMORE, THE UNDERLYING FORCES AT WORK IN 2016 ACROSS MARKETS ARE RELATIVELY UNCHANGED. HENCE, IT IS TOO SOON TO CALL AN END TO THE BULL MARKET, ALTHOUGH INCREASED GLOBAL POLITICAL, ECONOMIC AND FINANCIAL VOLATILITY IS GIVING INVESTORS CAUSE TO PAUSE.

LISTED PROPERTY INDICES ALSO FELL IN JANUARY. EPRA UK -13.5% AND EPRA EUROPE -11.3%

A photograph in a recent edition of the FT (Feb 20th) showing a bull being impaled by a matador -- a metaphor for the end of an equity bull market -- was greeted with hostility by numerous readers. Several FT readers commented that the photo should be removed. This was less because they disagreed with the suggestion that the US equity bull market was under threat, like most other global indices, the FTSE100 and S&P 500 were down around 10% in the first weeks of January, but more because they felt that the article comprised the thoughtless promotion of animal cruelty.

©Reuters

According to one definition, to qualify as a technical bear market, shares need to fall by at least 20% over a period of at least two months. Hence, fears for the equity bull market may be, for the moment, misplaced - at least in developed economies where equity markets have recovered by half since mid-January. The Shanghai composite is perhaps another story, although, if you invested in 2014, odds are that you are still up by 30%.

Likewise, bond markets have been volatile. The US Fed raised rates in December by 25 bps. Ten year bond yields rose by around 20 bps in the US and UK and then fell in January by around 35bps in response to falling oil prices, signs of global economic weakness and equity market falls. They have since fallen much further.

The question for commercial property in the midst of all this volatility is simple. Has the property bull market already run its course? After all, like the other equity indices, EPRA's property indices also fell in early January and have remained volatile. As of late February, EPRA NAREIT/UK is down by almost 20%. In contrast, EPRA Eurozone has recovered in line with other equity markets and is down by a more modest 6%.

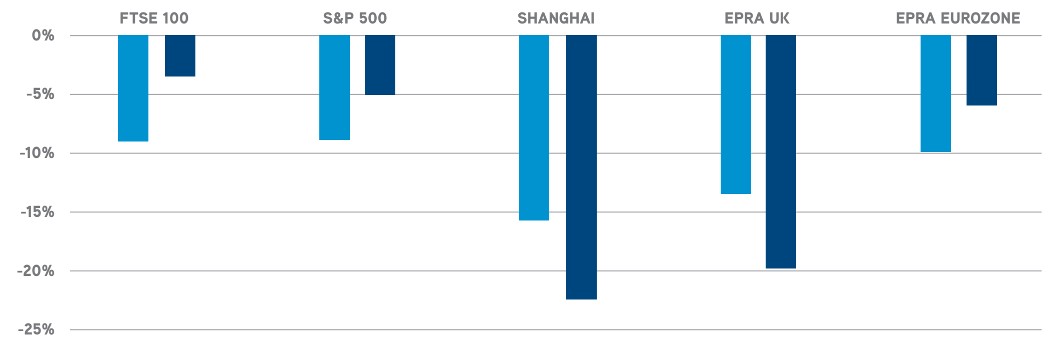
Given that the 'bull market' was the subject of last year's Colliers white paper 'How long will this bull market last?' (March 2015) and that the main conclusion was, 'for some considerable time, including 2016', then the answer must be an unequivocal ''not yet!' But in light of these recent equity and bond market movements, what evidence can be produced to suggest that the bull market rumbles on in property, in the UK, in Europe, or indeed anywhere? The question might be reduced to: 'What has changed in 2016?' The answer in terms of property fundamentals might be 'not much', but look beyond the quantitative fundamentals into the political and international security realms and there are staggering changes in play. The UK Referendum is perhaps the most immediate and palpable political threat and may explain, in part, why the EPRA UK equity indices have not recovered in line with the FTSE100.

2016 SHARE INDEX MOVEMENTS

YTD UNDER MOVEMENTS

SOURCES: LSE, FT, EPRA

- YEAR TO MID-JAN
- YEAR TO END-FEB



PROPERTY FUNDAMENTALS IN 2016. WHAT REMAINS THE SAME?

Perhaps the best point of departure in trying to understand what has changed in 2016, and whether these changes are significant, is to dismiss what has not changed. Here, the thinking is linked to several property market drivers including: interest rate expectations, the weight of capital targeting property, demographic pressure and the international search for yield. These drivers look generally unchanged. In contrast, drivers that have changed include the level of core property prices, the availability of investment grade assets, debt conditions and development. Perhaps of greater importance is the general increase in economic and financial volatility, especially as expressed in equity and bond market movements, but also in exchange rate movements and in the altogether far less quantifiable political and geopolitical realms.

A VIEW FROM THE TOP 2016

> DESPITE 'LIFT-OFF' IN THE US, BASE RATES IN FIVE YEARS' TIME ARE EXPECTED TO BE AT AROUND HALF THE LEVEL SEEN IN 2007, THE PREVIOUS PROPERTY MARKET PEAK

INTEREST RATE EXPECTATIONS – NO CHANGE

Forecasting interest rates across markets has become less of a dark art and more of a game for the bookies. Forward guidance has proven to be of little value, although the US Fed's December rate hike was so widely expected that the developed markets moved little. In fact, lifting the federal funds, target rate from the 0% to 0.25% range to the 0.25% to 0.50% range achieved little in changing long-term sentiment. Interest rate expectations have fallen substantially since early December.

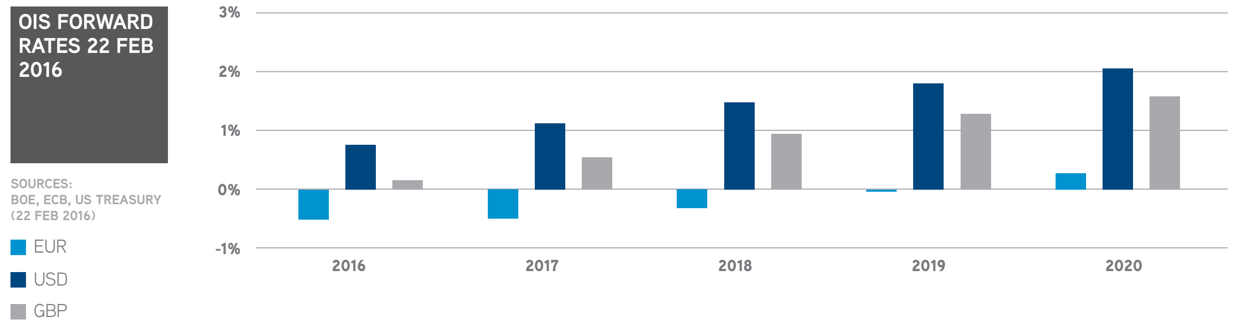
Despite so called 'lift-off' of rates in the United States, expectations have fallen and base rates in five year's time are anticipated to be less than half the level they were in 2007 at the property market's previous pricing peak. For the property market this has a few key impacts. Foremost among these is a positive impact on the weight of capital targeting property and, increasingly, the ability of investors to use 'cheap debt'.

WEIGHT OF GLOBAL CAPITAL - INCREASING

The global weight of capital is phenomenal. Last year it was estimated (conservatively) that global institutions, private equity and sovereign wealth funds together held around $33 trillion of assets under management. As of end 2015, this has been revised up to $36 trillion. As the totals have risen, so, too, has the target allocation of these funds to property. Figures for institutional investors show this allocation rising from 8.9% in 2013 to 9.6% in 2015. The allocation is expected to approach 10% by end-2016, with reports that a few US institutions are already targeting much higher and unprecedented allocations of close to 20%. A one per cent increased allocation across the funds is equivalent to a $360bn increase in funds targeting property. This is equivalent to over one-third of total annual global investment turnover in 2015. In the last few months, equity values have fallen, which would imply a de facto increase in weightings to property. Nevertheless, given the recent equity market recoveries, there is little to suggest that this has had a sustained effect on the appetite for property. Furthermore, the wealth of High Net Worth Individuals (HNWIs) and family trusts have not been included, but are estimated to hold an additional $53 trillion in funds (CapGemini, 2015). Simply put, the weight of capital in 2015 has been replaced by an even greater weight of capital in 2016.

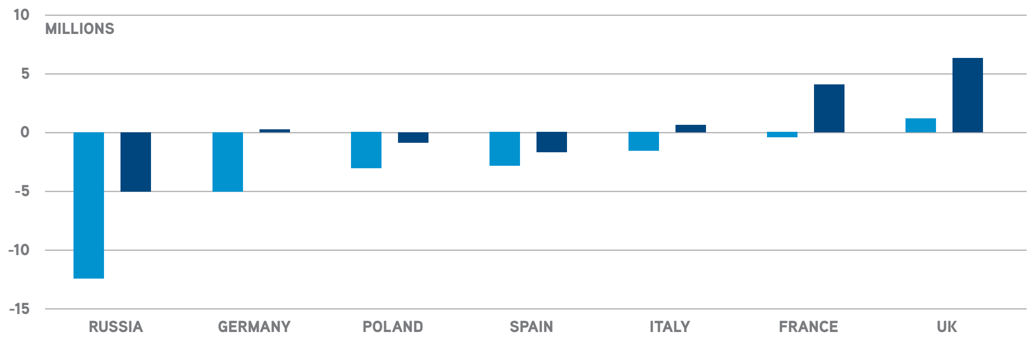
OIS FORWARD RATES 22 FEB 2016

SOURCES: BOE, ECB, US TREASURY (22 FEB 2016)



THE EUROPEAN WORKING AGED POPULATION IS FALLING ACROSS MOST OF EUROPE

POPULATION CHANGE 2015 TO 2030



SOURCES: OXFORD ECONOMICS

WORKING AGE
TOTAL

DEMOGRAPHIC PRESSURE - INCREASING

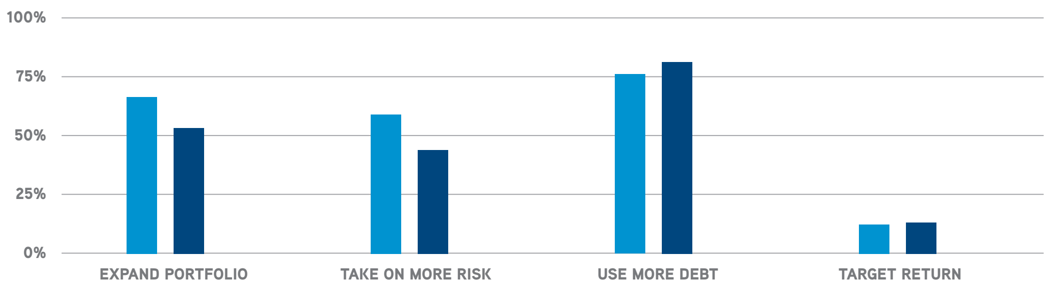
Possibly one of the least appreciated forces at work in commercial property is on-going demographic pressure. This is especially apparent in the increasing pressure on pension funds to find sufficient returns to match the growing annuity liabilities of a rapidly growing, yet ageing, population. The 'baby boomer' retirement phenomenon is generally well-known. Across the developed world, the retirement population is growing faster than the working-age population. This is especially true in Continental Europe and the UK and there are similar trends evident in Asia.

Given these trends, governments are already struggling to fund support for ageing populations. In 2015, this pressure resulted in completely new allocations to property. In Japan, ten year government bonds were yielding less than one per cent in 2015, hence state pension funds were recently authorised to allocate funds to international property, which is estimated at some $60bn. In March, ten year bonds are yielding -0.01% (03-Mar). Clearly, the pressure on pension funds is increasing. Likewise, the Taiwan Public Service Pension fund ($19bn) made its first allocation to property with a $150m mandate. This follows on from Taiwan's Labour Pension Fund, who set up exposure to it first global listed real estate portfolio in 2014. The list is growing across Asia and will continue to grow. European and US pension funds are also feeling the heat.

SEARCH FOR YIELD - INTENSIFYING

Despite investors having taken on increased levels of risk over the course of 2015, there is evidence that there is still a fair share of global investors willing to take on additional risk in 2016 and expand their property portfolios in order to achieve adequate returns. At the end of 2015, Colliers Global Investor Outlook shows that despite some cooling of risk appetite, just under half (44%) of the global sample of 600+ investors intended to take on additional risk.

GLOBAL INVESTOR OUTLOOK 2016



SOURCES: COLLIERS INTERNATIONAL 2015

2014
2015

Likewise, with debt becoming more available and affordable across markets, the use of leverage looks like it is also on the increase, alongside average return expectations (IRRs are also increasing slightly from 12.8% to 13.5%). Far from the search for yield moderating in the face of increased risk, there is evidence to suggest that, as early-year economic and financial volatility passes, that commercial property may be faced with a new episode of 'risk on' investing.

While the 'international search for yield' was flagged by the UK Financial Stability Committee as a systemic risk to global economies as early as 2012, more recently in mid-2015, the OECD warned pension fund managers and life insurance companies specifically that they increase their risk of insolvency if they become involved in an 'excessive search for yield' and shifted aggressively into 'alternative assets' (OECD, 24 June 2015). But what choice do they realistically have, as existing low bond and equity income returns cumulatively fall behind their liability requirements?

SUMMARY – WHAT REMAINS THE SAME

In summary, many of the key drivers of commercial property in 2015 are unchanged in 2016, that is, they remain key drivers of commercial real estate performance. In fact, in most cases, the drivers have become more substantial. This, of course, raises the corollary question of what has changed or what is significantly different in 2016. As many thoughtful investors will suggest, 'quite a lot'. If there has been a change, a likley candidate is increased volatility -- volatility across all asset classes, financial markets, economies and political blocs.

OVER HALF OF GLOBAL INVESTORS INTEND TO EXPAND PROPERTY PORTFOLIOS IN 2016 AND JUST UNDER HALF INTEND TO TAKE ON MORE RISK

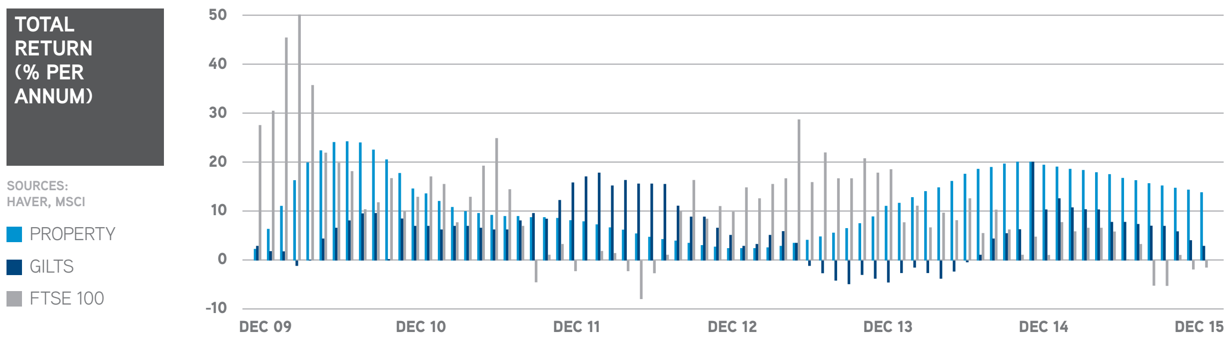
PROPERTY FUNDAMENTALS (2016). WHAT HAS CHANGED?

VOLATILITY AND CORE PRICING

Since the beginning of 2016, financial and equity markets have proven very volatile. The FTSE100 volatility index (VFTSE:AEX) and S&P volatility (VIX) both registered levels similar to those seen in August and September with the onset of the equity correction in China. The levels are also in line with volatility not seen since mid-2012, immediately prior to Draghi's 'whatever it takes to save the Euro' speech. Investors are spooked by a combination of on-going worries about a 'hard landing' in China, concerns that further oil price falls may reflect hidden underlying weaknesses in the global economy, growing suspicions that a US recession is in the making due, in part, to a Fed mistake in raising rates too early, as well as general fears about commodity reliant emerging markets and global political mayhem, including Middle East turmoil, Russian revanchist, the European migrant crisis and the EU Referendum. In short, there would appear to be a ready-made pick list of pre-packaged worries on offer.

Likewise, bond yields have been bouncing around, with ten-year bonds in the US rising from 2.15% in December to 2.30% after the rate hike and back to 1.87% at the beginning of February. UK ten-year gilts rose over the same period from 1.76% to 1.95% and fell back to 1.57%. By mid-February, bond yields globally were plumbing new depths, with ten-year Japanese bonds in negative territory, the US and UK rates below 1.70% and 1.40% respectively. For property investors, the impact is two-fold:

PROPERTY CONTINUES TO MAKE SENSE IN COMPARISON TO OTHER ASSET CLASSES



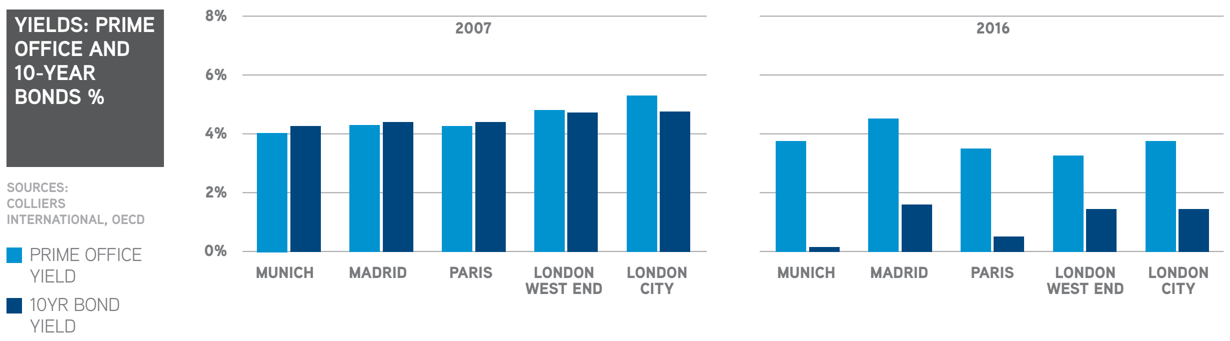
(1) Volatility

Volatility in other asset classes is a classic driver of investment into direct property. Historically, real assets are less volatile. Furthermore, if asset return profiles are examined, real estate continues to make sense by a wide margin. In December 2015, UK total returns exceeded equities by over 10%.

(2) Pricing

Property investors are not immune from general financial market sentiment. Property may be less volatile, but core property looks expensive by historical standards. Prime office yields in key European markets are on average 75 bps lower, in a range from 3.25% to 4.50%, than they were at the market peak in 2007 (4.00% to 5.25%). Investors may be forgiven for wondering whether a substantial pricing correction is on offer.

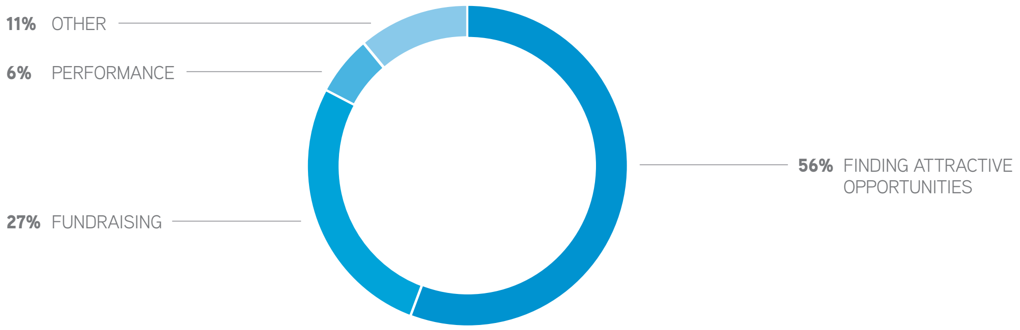
What is obviously different is underlying yield pressure. In 2007, ten-year bonds were roughly equal to prime office yields. In early 2016, ten-year bonds are, on average, 2.75% lower. Clearly, there is scope for core assets to continue trading at lower yields. Hence, many investors see little likelihood of a substantial outward shift in property yields for some considerable time. In fact, some observers suggest that core commercial property may begin trading and cycling within a narrower and lower yield band for a period that, increasingly, is looking like perpetuity, especially since GDP growth across the developed world is set to remain moderate for the foreseeable future and monetary policy will, of necessity, remain accommodative. In the UK, the results of recent 'fair value' analysis suggests that given strong rental growth expectations and low ten year bond rates, that core property in many cases is not far off 'fair value'.



FINDING ATTRACTIVE OPPORTUNITIES IS THE BIGGEST PROBLEM IDENTIFIED BY PRIVATE EQUITY INVESTORS

PE FUND MANAGER CHALLENGES

SOURCES: 2016, PREQIN GLOBAL REAL ESTATE REPORT



IMPACT ON STOCK AVAILABILITY

One of the key impacts of 'full pricing' of core assets is that future performance will not be linked to further yield compression. Instead, investors buying core assets will rely primarily on income and rental growth to generate returns. Hence, those investors who already own core assets look unlikely to sell as there is little chance to replace these assets with other core assets. One obvious result is that finding attractive opportunities is difficult as a recent Preqin survey suggests.

The situation and impact does, however, differ according to investor types and styles.

- Private equity investors typically look for value-add opportunities which they can work, and then sell back into the market over a 3-7 year time frame.
- Many long-term investors look to hold assets and manage them long-term, with returns viewed over 20-30 year period.

Essentially, as more long-term investors have entered the market, the volume of available stock on rotation has diminished. The main impact has been to drive investors to look at 'alternative' property assets where competition for product is not as keen. This alternative search is also being driven by mega-trends such as ageing demographics, increasingly urban and digital populations and the increasingly important role of technology.

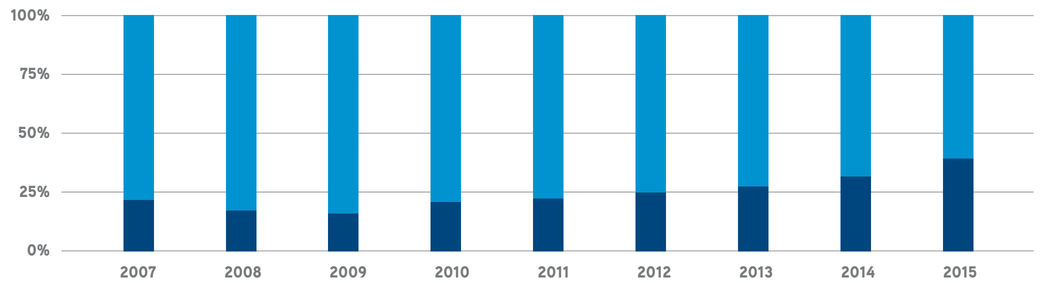
THE TREND TOWARD ALTERNATIVE PROPERTY

In the first context, alternative property is considered such by asset quality, asset type and asset location. After several subsequent years of increase, direct investment into alternative property assets reached £28bn in the UK in 2015, or 40% of total direct property investment. This looks increasingly like a substantial structural change in the UK investment market.

UK DIRECT INVESTMENT VOLUMES BY VALUE

SOURCES: PROPERTY DATA LTD

CORE SECTORS
ALTERNATIVES



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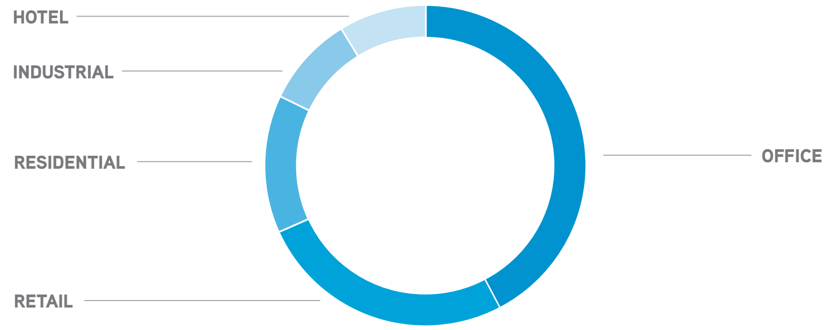
DIRECT INVESTMENT INTO ALTERNATIVE PROPERTY ASSETS REACHED A NEW HIGH IN 2015 AMOUNTING TO 40% OF TOTAL DIRECT INVESTMENT

EUROPEAN INVESTMENT VOLUMES BY SECTOR: 2015

SOURCES: REAL CAPITAL ANALYTICS, COLLIERS INTERNATIONAL



Across Europe the story is different, but perhaps surprisingly, not far off the shift to alternatives in the UK. Since 2009, alternative investment in Europe has increased market share, with residential the clear leader. By end-2015, residential investment surpassed industrial/logistics as the third most prominent form of investment (13.7%) after office (42.2%) and retail (26.4%). In fact, hotels (8.7%) were on a par with industrial/logistics investment (9%) taking the total alternatives total to 22.4%.

A closer look at the figures since 2007 shows a gradual, albeit small, decline in market share for offices, retail and industrial/logistics. The other obvious change witnessed in 2015 was a surge in land/development acquisitions across Europe, which rose by close to 40% over 2014. Not only are alternatives being sought for very legitimate logical reasons, but a lack of product appears to be driving a much-needed increase in development. This is supported by improved debt conditions in many European markets. While it might be argued that peak pricing has been reached for core assets in a few prime Western European markets, in general, the continental market is not as advanced in the pricing cycle as similar markets in the UK. As core pricing becomes full across a wider range of markets and assets, a continued shift into alternatives will become increasingly apparent across a wider range of markets. Considering the focus on core assets by 'traditional' investors, these investors can perhaps be forgiven for asking the simple question:

'Are these alternatives a real alternative?'

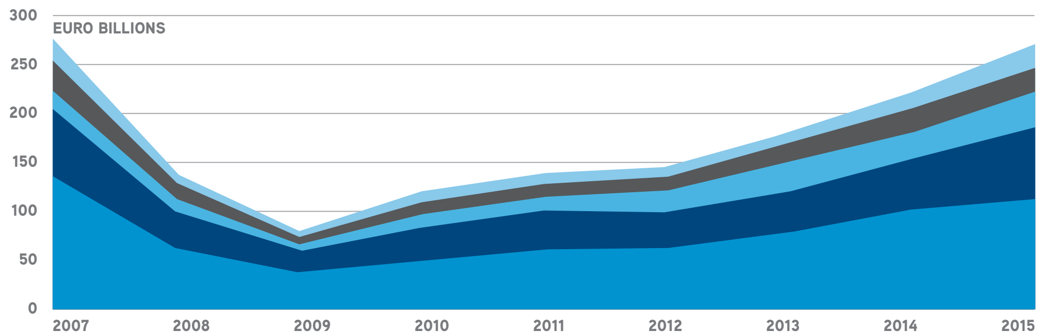
Can the alternatives and new formats that we see rising across sectors such as hotels, healthcare, leisure, student accommodation, new residential formats, urban logistics and others, be considered genuine long-term investment alternatives? Do we really need more property and more property types?

Clearly, many similar forces are at work across the UK and Europe as well as globally. These forces, driven primarily by a combination of technological innovation, demographic pressure, as well as associated changes in consumer and workplace behaviour, are giving rise to a new generation of assets derived from what might be collectively referred to as the 'Great Market Disrupters'.

EUROPEAN INVESTMENT VOLUMES BY SECTOR

SOURCES: REAL CAPITAL ANALYTICS, COLLIERS INTERNATIONAL

OFFICE
RETAIL
RESIDENTIAL
INDUSTRIAL
HOTEL



GENUINE ALTERNATIVES AND THE 'GREAT MARKET DISRUPTERS'

In a broader and economic sense, structural disruption is nothing new in real estate markets. As we look back at major changes witnessed over the last 25 years, but especially over the last 10, it is evident that technology is typically a trigger for disruptive change. Technology is embraced by the corporate world, in some instances in surprising and unexpected ways, to drive change and advance business. Governments and market regulators then respond to accommodate, support and standardise this change as a new market is recognised and a future growth path becomes understood, accepted and entrenched. This is accompanied by growth of a culture, a new set of economic relations and fundamentals that underlie the market.

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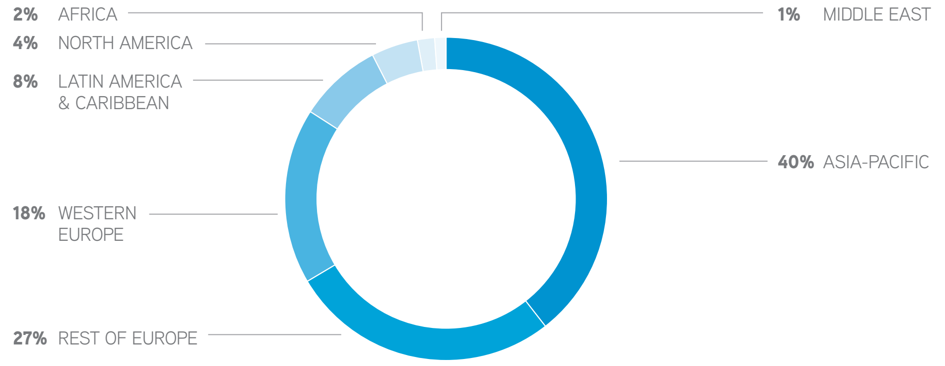
SHARE SERVICE CENTRES (SSCs) - DESTINATION REGIONS

SOURCES: DELOITTE/COLLIERS INTERNATIONAL



OFFICE MARKETS

Over the last 25 years, globally, let alone European, office markets have gone through significant changes – triggered by both technological and political events.

Offshoring & Outsourcing (O&O).

Creating back offices is nothing new and goes back to the 1960 and 70. However, the market took a quantum leap in the 1980s when the growth and expansion of the internet, coupled with the global expansion of multi-national corporations (MNC's) into emerging global economies, led to a Eureka moment. Quite suddenly, MNCs found they could run back-office operations in Bombay and Bangalore at an 'nth' of the cost. Since then a reported five million jobs have been created in O&O, and around four million of those have been created in the last ten years.

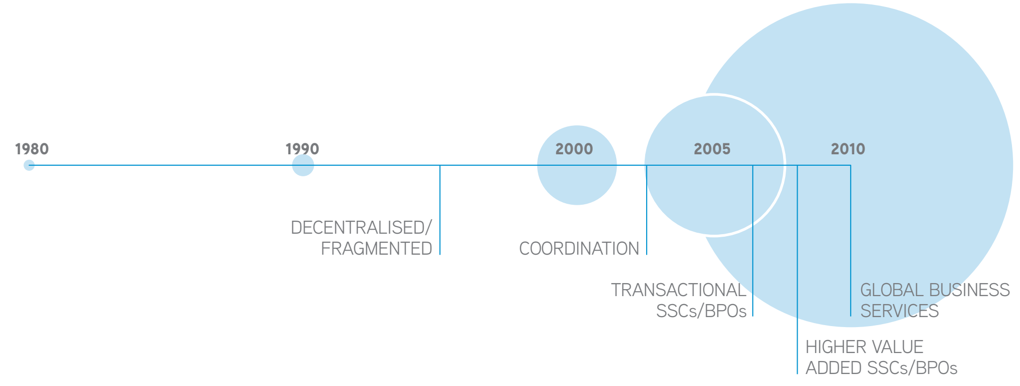
Over half of these jobs have been in Europe, with Central and Eastern Europe the major beneficiary. This would not have been possible without the technology (information and communications infrastructure) to support it. The fall of the wall, the re-unification of Germany and EU expansion into a trading bloc of 28 member countries was also instrumental. It is estimated that around 500,000 jobs have been created in CEE over the last ten years. Over this same period, around 1.5 million jobs have been made obsolete by new technology. That's a big number and underscores the threat that automated software and artificial intelligence has had and will continue to have on office space and overall job markets in years to come.

Re-invention.

The good news is that we're a resilient lot with a capacity for re-invention. Although technology has advanced rapidly in the last ten years and a number of jobs have been re-located, the European jobs market has actually grown significantly over the same period. Despite a significant dip in 2009, as well as the economic contraction and austerity programmes that followed, the job market has, in fact, grown by 5 million jobs since 2005. The Tech Media and Telecoms (TMT) sector has been at the forefront of this expansion, suggesting that the overall impact of new technology is positive, certainly in terms of 'bums on seats' – which ostensibly is good news for office developers and investors.

BIG PICTURE: O&O GROWTH

SOURCES: DELOITTE/COLLIERS INTERNATIONAL



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“ THE EUROPEAN OFFICE JOBS MARKET HAS GROWN SIGNIFICANTLY SINCE 2005, DESPITE TECHNOLOGICAL CHANGE AND RECESSION. 2016 COULD BE THE YEAR THAT OFFICE-BASED JOBS SURPASS THEIR PREVIOUS PEAK

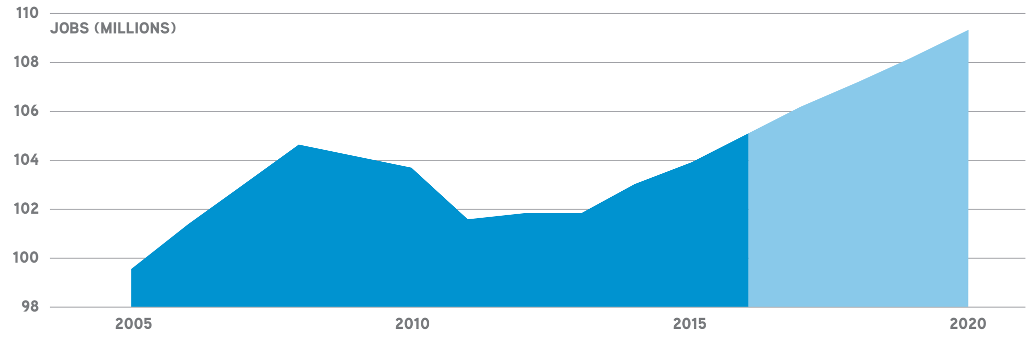
However, this growth in jobs has come at a cost, or at least a caveat. Post-crisis employment is driven by part-time and contractual employment, rather than full-time employment with benefits. Self-employment growth is a mixed-bag, with the more liberal UK/Ireland, Nordic and Benelux markets seeing growth, alongside Germany, with little to negative growth in the rest of CEE and Southern Europe. The full impact over the last ten years can be seen below, with the less liberalised economies suffering most. At least Spain has gone some way to reverse this change, adding much needed flexibility to their labour laws and adding 0.5 million new jobs to the economy in 2015 – it needs to with youth unemployment above 40%. Italy will hopefully follow suit. It's at least trying to, which is more than can be said about France.

Overall, this means we have a geographically distributed occupier footprint, which draws upon a workforce that increasingly is flexibly employed. Add the culturally collaborative Millennial workforce to the mix, plus an increasing likelihood that self-employment will be driven by an ageing population, and the days of fixed desks in dedicated workspaces looks increasingly numbered. So while office based jobs are growing, a corresponding growth in floor space may not occur.

Flexible working and technology are also changing the role of office landlords from 'coupon clippers' to hands-on 'service providers'. WeWork LLC is one example of the many emerging flexible-office and start-up space providers that are mushrooming across European towns and cities. Looking forward, one of the key questions to ask from a landlord/investor perspective would be: 'Is my office portfolio of the right size, does it have the right footprint and locations to capture this emerging workforce and meet occupier needs?' 'Not all of it!' might prove be the answer; a large number of older offices require redevelopment or redeployment with a change of use.

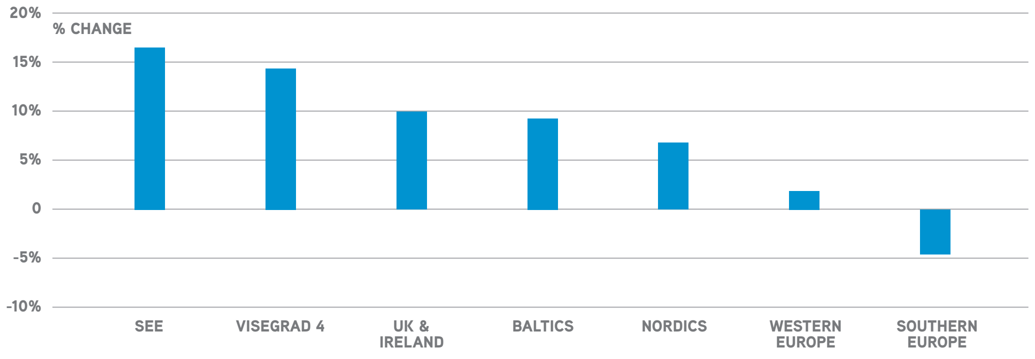
EU OFFICE-BASED EMPLOYMENT GROWTH: 2005-2020

SOURCES: IMF/ EUROSTAT/ COLLIERS INTERNATIONAL



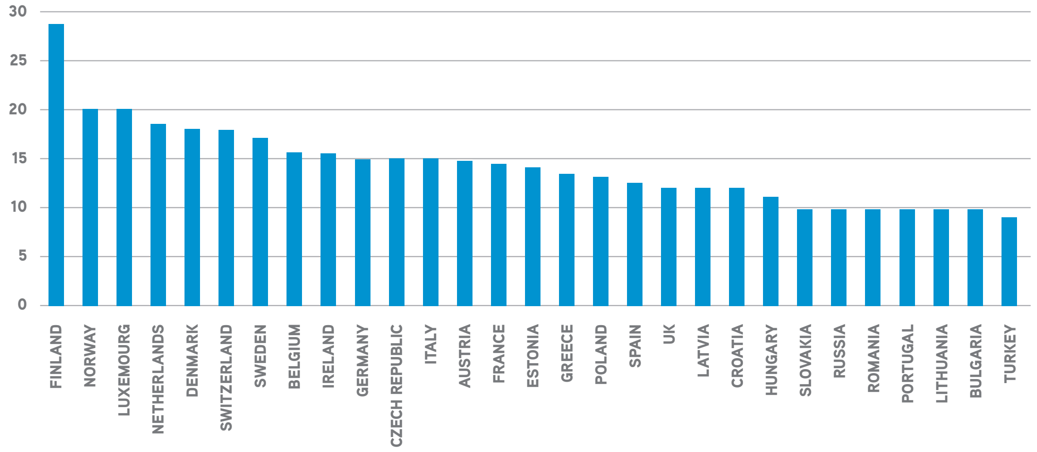
EU OFFICE-BASED EMPLOYMENT GROWTH, BY SUB-REGION: 2005-2020

SOURCES: IMF/ EUROSTAT/ COLLIERS INTERNATIONAL



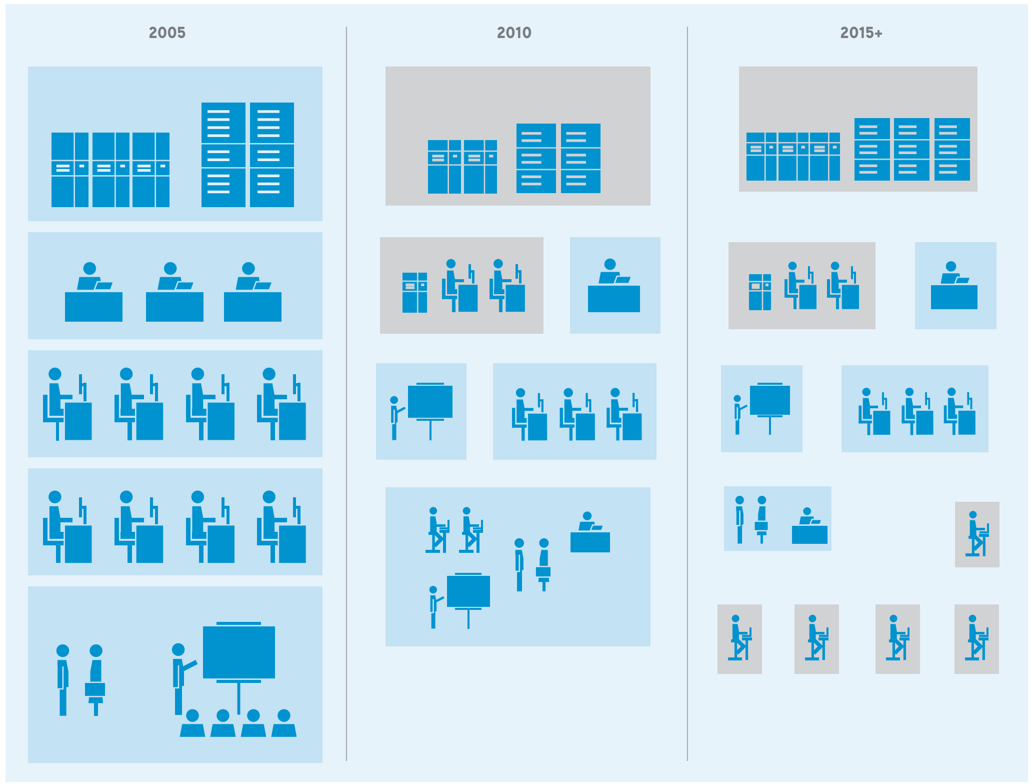
GLA M² PER WORKPLACE

SOURCES: COLLIERS INTERNATIONAL



SUMMARY: ONE SIZE DOESN'T FIT ALL

SOURCES: COLLIERS INTERNATIONAL



CHANGE OF USE, ANYONE?

A change of use may not be such a bad solution for redundant office space, with demand for residential (private rentals, student housing and senior housing) on the rise. This demand is supported by very strong demographic fundamentals. Also, an increasing investor understanding of the operational mechanics and performance of these assets is driving an increase in investor appetite. Hotels are another growth sector, driven by a relentless growth in global tourism levels since 2009. However, technology is also driving change in this sector alongside changing demographics and increasing urbanisation.

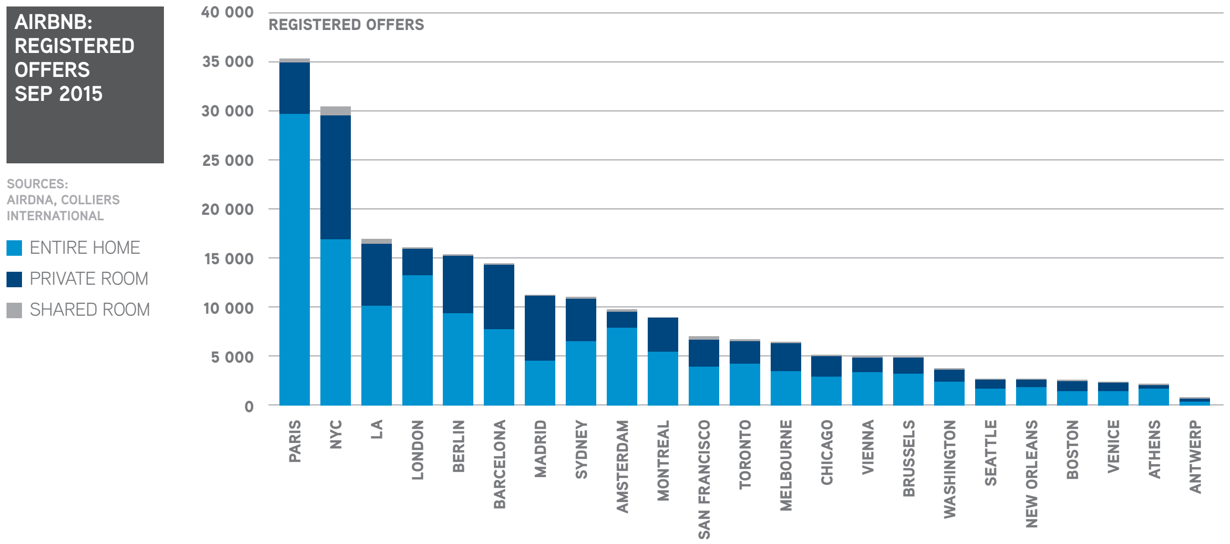
One just has to look at the impact that Airbnb is having on both the private rented sector and the hotels industry, especially the lower grade <2*hotels industry.

A recent report in the Economist reveals that researchers at Boston University had found that Airbnb has forced down hotel revenues in some American cities by as much as 10%. Over in Europe, however, the impact is not as transparent and there is still no sign of overcapacity in the combined hotels/Airbnb market.

In London, 2015 hotel occupancy rates reached their highest levels in a decade and average prices were higher than ever. An additional 20,000 hotel rooms have been added to the market in little over two years, and plans to add to the stock of 149,000 hotel rooms continues to grow. In part, this is because of the limited impact of Airbnb rentals - only 0.5% of Londoners advertise their properties on Airbnb, compared with 2.4% of Parisians. One reason is that there is a shortage of reasonably priced residential stock near London's main tourist attractions.

AIRBNB: REGISTERED OFFERS SEP 2015

SOURCES: AIRDNA, COLLIERS INTERNATIONAL



And according to a recent report by Citi, the growth of Airbnb listings in London and other big European cities is already slowing, meaning that spare rooms are unlikely to be able to soak up much more demand.

This is partly because of a growth in demand from business travel, not budget-conscious holidaymakers. While tourist spending stagnated in 2015, business folk splashed out 7% more in Britain than the previous year, according to the Global Business Travel Association (an industry body), which forecasts further growth of 6% this year. Most businesspeople are travelling on expense accounts. Meanwhile their employers, citing a duty to ensure safety, remain wary of booking spare rooms, which they fear conceal a myriad of litigational hazards.

Another drawback of Airbnb is security of tenure, with reports of 'visitors' outstaying their original welcome and turning their short stay into a much longer one. There isn't much landlords can do about the law and it is making aspiring owners think twice about what, and how, they offer in terms of their accommodation. Many city governments have laid out plans to restrict the growth of Airbnb lettings, due to the many safety and security risks. This suits hoteliers nicely. The combined impact of these factors appears to be an increase in the development of lower cost, 'pod-style' hotels allowing comfort to meet cost in a secure environment.

LOGISTICS MEETS RETAIL

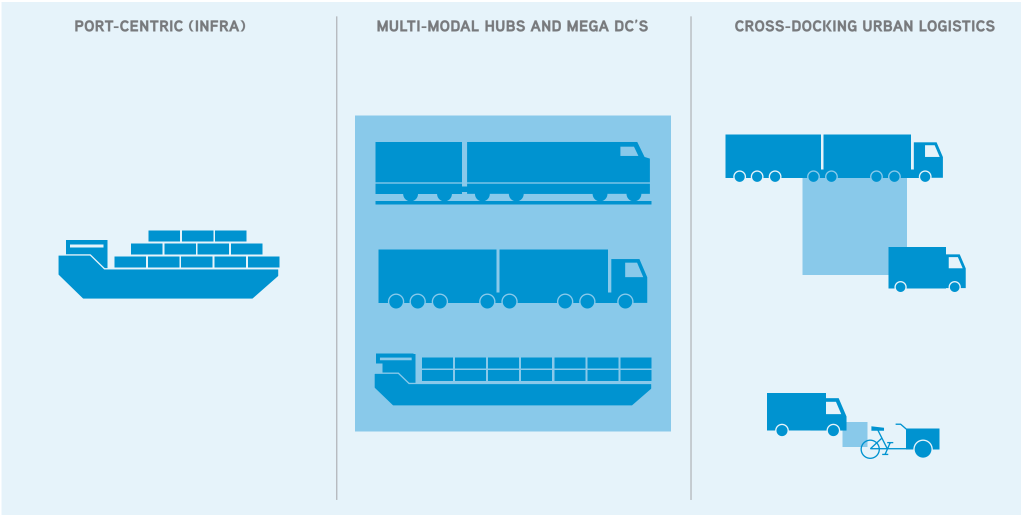
Colliers International has published numerous pieces about changes to both the industrial/ logistics and retail industries as the two sectors become less discrete and increasingly intertwined by technology, urbanisation and changing consumer behaviour. Technological disrupters such as Amazon, Alibaba, Ocado and Zalando have taken a lead role in benefitting from these changes. Most recently, the impact on Argos' re-invention in the UK is evident, as it is now a hotly pursued acquisition for major retail groups. With an increasing push towards same day delivery, driven by consumer expectations and the growth of a new technologically-savvy class of urban consumers, logistics and retail both need to accelerate their response all along the supply chain – from first mile to last mile.

Our forecast requirement for new, modern facilities across Europe highlights the significant volume of new space required all along this supply chain: from modern, mega distribution centres to cross-docking and urban facilities. If e-retailing rates increase to 20% or more, we'll get an even higher requirement. And these strong requirement figures are based on new forecast demand only – there are an awful lot of retailers yet to redefine and build their modern logistics infrastructure. John Lewis have tripled their logistics base in little over three years.

“ AT THE URBAN LEVEL, HUGE INVESTMENT OPPORTUNITIES ARE LINKED TO SUSTAINABLE MICRO-LEVEL SORTING AND DISTRIBUTION

LOGISTICS: SHIFTING SPACE REQUIREMENTS

SOURCES:
COLLIERS INTERNATIONAL



As a first step, global and European supply chains must improve to accommodate ever-larger container vessels through deeper and more efficient water ports to compete for global trade flows at the first mile level. Likewise, distribution centres need to be more efficient and sustainable, driving the need for better connected facilities which utilise a combination of road, rail and inland waterway. The North American distribution market is well ahead in this inter-modal respect and is driving an increasing response from the UK, mainland Europe, China and India.

At the urban level, efficient cross-docking facilities are in great demand. Within towns and cities, a vast need for far more efficient urban logistics facilities offers huge investment opportunities. Sorting and mini-distribution centres located and linked to allow incorporation of sustainable transport such as electric vehicles and vans and cycle-cargo bikes are required at the micro level.

Urban logistics is also starting to merge with other mixed-use projects to help re-develop towns and cities, creating jobs in the process. On the other hand, retail property assets are moving toward ‘showrooms’ which emphasise branding and merchandising as paramount functions, rather than conventional retail which includes storage. Retailer footprints are becoming far more focused, with a reduction in need for outlets in smaller towns and cities or in less visible pitches in larger, urban markets.

All in all, these trends offer an effective re-use of existing, defunct facilities. They provide opportunities for private-equity style investors with a value-add strategy to test their skills in creating long-term assets suitable for institutional, long-term investor groups. In summary, it’s fair to say that technology has proven to be a positive driver of change, rather than being a (negative) disruptive threat. This is the good news. Staying ahead of the associated trends, or at least remaining up to speed with these changes, is the key challenge.

POLITICAL RISK AND THE ALTERNATIVE GROWTH SECTORS

The less good news is that political change could well scupper these future opportunities. The expansion of the EU has been an overall positive event, economically and politically. Current uncertainty over its future, driven largely by issues over national sovereignty, migration and social benefits, could act collectively to undermine these alternative growth sectors. Pan-European distribution and the free movement of goods would clearly suffer from the raising of national borders should Schengen fail.

A European market, fragmented by the reappearance of national borders and the increased need for transit tariffs, in part to pay for secure border facilities, has the potential to drive much higher import costs. Given the dominance of road freight, this would add considerable costs and delays to a market in need of further streamlining and acceleration. Time is money for modern logistics and the consequence of EU fragmentation could be accompanied by an unfortunate shift back to national distribution models.

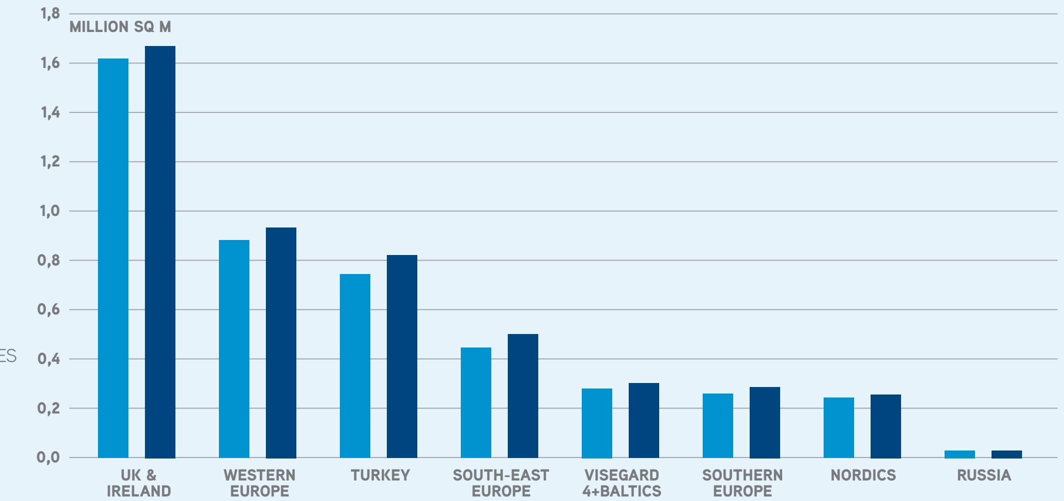
Overall, this would undermine a fundamental economic tenet of the EU common market – the free movement of goods, labour and capital. This would work against the multitude of occupiers and property investors who have worked hard over the last two decades to build pan-European footprints and portfolios. Hopefully, a joined-up, secure Europe will survive and strengthen alongside a political platform that encourages further investment into modern infrastructure and associated real-estate. The UK Referendum is a critical litmus test as to whether or not this model will succeed (see Collliers International’s ‘Logic Dictates: the EU Referendum and its impact on UK commercial property’, March 2016).

EUROPEAN ANNUAL WAREHOUSE REQUIREMENTS (MILLION SQM) TO 2020: CURRENT RETAIL VS 20% E-RETAIL

SOURCES:
COLLIERS INTERNATIONAL,
WORLD BANK, IMF,
OXFORDECONOMICS

■ LOGISTICS SPACE M² BASED ON CURRENT E-RETAILING % OF SALES

■ LOGISTICS SPACE M² BASED ON 20% E-RETAILING



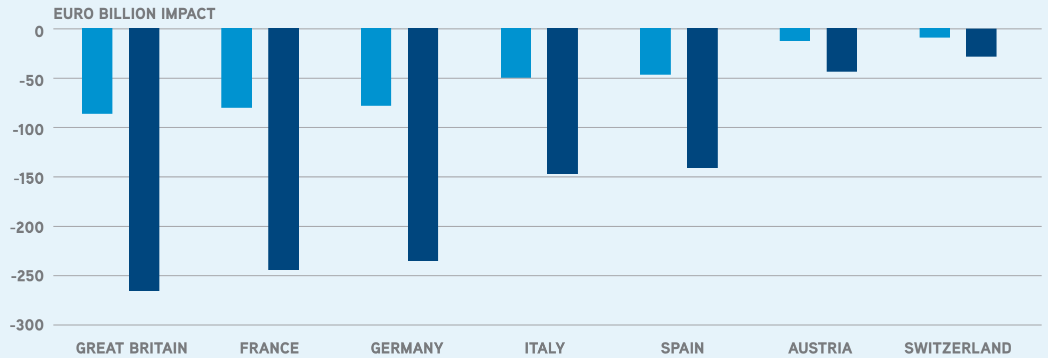
IF SCHENGEN FAILS - POSSIBLE ECONOMIC FALLOUT FROM REINSTATING PERMANENT BORDER CONTROLS IN EU* (€BN)

SOURCES:
BERTELSMANNSTIFTUNG,
STATISTA

*ACCUMULATED GDP-DEVIATION FROM REFERENCE SCENARIO UNTIL 2025

■ COST OF IMPORTS INCREASES 1 PER CENT

■ COST OF IMPORTS INCREASES 3 PER CENT



INTERNATIONAL ECONOMIC AND GEOPOLITICAL RISKS

In last year's Mipim paper -- 'How long will this bull market last? -- it was concluded that enormous global demographic pressure has the potential to create a generational super cycle of investment in infrastructure and new fit for purpose real estate. At that time, it was also concluded that the greatest risk to the bull market was political risk. This view has not changed. In fact, the risks are all the more apparent. The current pick list of threats includes:

1. UK's EU referendum
2. International monetary policies and finance
3. Oil prices and instability of oil sovereigns
4. Chinese economic transformation and exchange rate normalisation
5. Emerging market dollar denominated debt and commodity sales dependence
6. US neo-conservative politics and foreign policy
7. ISIS and the European migrant crisis
8. Russian revanchist adventurism

Arguably, none of these risks is likely to undermine the noted shift of property investment from traditional core assets into new alternative property assets. The rise of the alternatives reflects an even stronger underlying secular shift in demographics, technology and business models. However, the source of funding for this transition looks increasingly at risk. From a UK and European property perspective, the most immediate threat is the potential for disruption of funding sources and, especially, international capital flows that have become increasingly important in supporting the markets over the last 5 years.

"CHINESE/ASIAN INVESTMENT IS ON THE INCREASE – WITH A VERY STRONG Q4 15 APPARENT

INTERNATIONAL CAPITAL FLOWS INTO UK AND EUROPE

So far, political, economic and financial turmoil has not slowed the general flow of investment into the UK and European markets, even though the geographical sources of capital are shifting, in some cases. The most stable capital comes from long-term investors with long-term commitments to establishing multi-market portfolios. While this has been a general theme of global sovereign wealth funds (SWFs), resulting in considerable investment stability, oil sovereigns have been feeling the effects of low oil prices and this has begun to affect their investment strategies and flows.

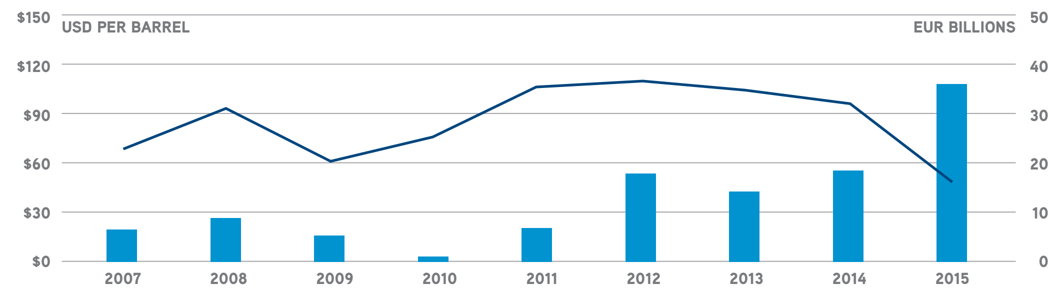
CHINA'S CHANGING GLOBAL ROLE

Despite considerable financial and economic volatility in China and the Far East, investment flows are stable and look set to increase. To date, Chinese investment has not been negatively impacted. In fact, Chinese/Asian investment is on the increase – with a very strong Q4 '15 apparent. The theme is predominantly re-positioning, especially from the UK (where they invested very early in the cycle) into Europe (where the cycle is not as greatly advanced). The investment drivers remain the same – the search for yield and cashing in on big profits to free up capital for re-investment. Modest capital flight from Asian economic instability has also meant that prime residential markets are relatively stable.

NET CAPITAL FLOWS: SWF/ ASIAN CAPITAL INTO EUROPE

SOURCES: EIA, RCA

INVESTMENT
OIL PRICE



OIL DEPENDENT GEOPOLITICAL SHIFTS

When combined with oil-based SWFs the net impact of their cumulative activity remains positive, but there are clear signs that a continued low oil price will impact oil sovereign strategies, especially when combined with other market events.

For example, according to FT reports, at the end of 2015, various SWF investors were heavily invested in both VW & China, negatively impacting their year-end returns, significantly. Likewise, back in June 2015, an Invesco report asserted that '...more than a third of Middle Eastern sovereign wealth funds expect new funding to decrease as the region adjusts to a period of lower oil prices.' Interestingly, Invesco's 2015 global sovereign asset management survey revealed that 38 per cent of Middle Eastern sovereign funds expected funding to decrease; 31 per cent expect it to stay the same; and 31 per cent see it increasing.

If the oil price environment persists, there is a growing recognition that governments may need to tap into fund assets to finance sizeable spending programmes to deliver economic growth for growing populations. The survey found that 62 per cent of regional funds believed that they would have to liquidate assets to fund fiscal shortfalls if oil prices were to fall to $40 a barrel for two years. In mid-2015, this seemed a distant prospect, but with oil dipping below US$30 in January 2016 and no end to low oil prices in sight – it costs more to switch the taps off than it does to keep oil flowing - the odds of oil-based SWFs disposing of commercial property has shortened. Oman and Kuwait Investment Authorities are already acting. ADIA, Norges and QIA are potentially the market movers, but each takes a very long-term view of markets and returns (20 to 30 years). QIA took a US$12 billion hit, on paper, in Q3 2015 – primarily the result of VW losses. For a $250 billion fund that loss can be absorbed, but opacity surrounding QIA financial reporting makes evaluation of the impact very difficult. In contrast, KWAP - the Malaysian pension fund has made it clear that they are definitely selling (notably in London) to repatriate capital as the combined impact of a low oil price, a weak currency and government corruption have forced the government's hand.

UK EU REFERENDUM

While it may have been conceived as a means of establishing long-term domestic political stability in the UK, the referendum is already impacting occupier and investor sentiment in both the UK and in the EU. As one Japanese investor suggested, there may be no relative investment play between the UK and the EU, if the one goes, the other goes with it. Little clarity will be achieved until the referendum has taken place, but clearly any political event that has the potential to reshape the global economy and geopolitical balance of power must, by definition, have a significant impact on global investors. If not through the force of ideology, then most certainly through its impact on financial and exchange markets, where arguably, the impact on commercial property is already clear. Opinion polls and bookmaker odds suggest that the most likely result will be a vote to remain in the EU. Hence from a commercial property perspective, the most likely result with be a 'relief rally' in Q3 16. The other scenario is daunting and the impact of Brexit is likely to be so great that the impact on commercial property may be the least of our worries.

CONCLUSION

Given the elevated state of global political, economic and financial uncertainty, a certain chutzpah is probably necessary to argue that the property bull market of the last few years will continue through 2016. The prima facie evidence that supports such a view is substantial. Global demographic pressure, the extraordinary weight of international capital and very low interest rates have created an extraordinary international search for yield that looks set to support property markets globally, irrespective of where these markets might be in their respective cycles.

In fact, there is some evidence to suggest that core property assets may have become less cyclical, or at least, are cycling in a narrower and lower yield band. Commercial property returns are moderating in some markets, but are still offering a substantial boost over returns available in other asset classes. However, lower yields across core asset classes are driving considerable interest in other property asset classes which are described as alternative. These alternative classes include many tried and tested assets such as leisure, hotels, healthcare and others.

The real proposition is to seize opportunities and assets that are qualitatively new. These opportunities are found at the proliferating points of intersection between the core assets classes. The structural change and integration of retail and industrial is one area that is changing rapidly with many new asset types arising. Likewise, the new approach to retail with increasing integration of leisure and shops into 'destination' offers has refreshed an older tried and test format. The new approach to employment and office use is also spinning off many new opportunities. Whether or not you subscribe to the views of futurists whose ideas seem to sit securely in the world of fantasy, these ideas are increasingly finding material expression in the commercial property world.

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REVENUE	**€2.3B**
COUNTRIES	**66**
OFFICES	**554**
PROFESSIONALS	**16,000**
BROKERAGE PRODUCERS	**5,800**
SQM MANAGED	**185M SQ M**
LEASE / SALE TRANSACTIONS	**> 80,000**
TRANSACTION VALUE	**€103B**