European Outlook 2017
Changing Landscape

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Preface

2016 saw a series of unprecedented changes in the geopolitical landscape following the United Kingdom's vote on its European Union membership. With further elections in 2017, including in the Netherlands, France and Germany, a new type of uncertainty emerges due to surging populism. This trend is driven by a long period of fiscal austerity, loose monetary policy and globalism, which have collectively served to leave behind and embitter large swathes of society. The uncharted territory following political shocks make it almost impossible to assess their effects, which will partly depend on future relationships between the UK and EU, the extent of protectionism instituted by Donald Trump during his US presidency and how Italy manages the fallout from the resignation of Prime Minister Matteo Renzi following the Italian referendum.

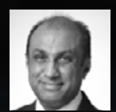
In terms of capital markets, the US Federal Reserve is the only major central bank on a tightening cycle. Policy divergence is expected to lead to volatility in the capital markets, notably in the bond market, which could have a material impact on weight of money and discount rates used to value investment cash flows.

In 2017, European real estate markets on average have sufficient momentum to continue to perform well. Locations devoid of new supply are expected to see rental growth, and weight of money is sufficient enough to push prime yields down. However, we are wary that lower yields and low cost of borrowing could tempt some investors to move further up the risk curve, valuing assets higher than their intrinsic value. Historically, this has resulted in underperformance, as downsides are most acute in those markets and assets that do not have the support of fundamental demand drivers. While we do advise making selective calls on emerging micro-locations and occupier trends, this is — in contrast — not entirely about the attractive entry yield, but rather about the underlying growth story, which weaker locations and segments often lack.

The challenge is for value-add and opportunistic asset-priced stock to deliver performance commensurate with their risk profile, particularly if that return profile is dependent on above-average economic growth.

In a low growth, low interest rate environment, delivery of what would be high real rates of return — considerably higher than in the past — can be considered as too unrealistic. Something has to give. Either those target returns are reduced or the property market has to see a severe correction in capital values to improve entry prices.

Our European Outlook 2017 paper provides city profiles and country overviews and highlights key themes that will affect investment markets this year.



Kiran Patel
Chief Investment Officer

DO

Do buy offices in Brussels central business district (CBD), sought-after locations in Amsterdam's South Axis and city centre, Warsaw offices on long leases and core offices in Germany's Big 7 as well as growing secondary cities in Germany.

Do buy edge-of-CBD offices in Stockholm.

Do buy prime high street shops in Copenhagen and Helsinki, key cities in Germany and well-located retails parks in Austria, Italy, Spain and Germany.

Do buy mixed-use high street properties in Warsaw.

Do buy last-mile logistics in major conurbations of Austria, France, Germany, the Netherlands, Sweden, Warsaw, Spain and the UK.

Do buy distribution centres in prosperous locations in Germany and Austria.

Do buy mainstream residential in London.

Do buy alternatives sectors in the UK, Germany, France and Sweden.

Do take advantage of low all-in-cost borrowing rates in Denmark, Germany and France.

DON'T

Don't buy central London offices until certainty emerges over the Brexit negotiations.

Don't chase yields down on properties with fuller rents in Munich, Paris CBD and Stockholm.

Don't buy fringe or out-of-town locations in Warsaw.

Don't be attracted to higher-yielding secondary assets that have limited rental growth potential in France, Germany, Italy and the UK.

BEWARE

Beware of upcoming elections in the Netherlands, France and Germany.

Beware of political unrest and the threat of terrorism, which may lead to lower growth, higher risk premiums and lower investor risk appetite.

Beware of the brewing banking crisis in Italy. The Italian banking sector is working out EUR 350 billion worth of non-performing loans. In our view, risk of financial contagion is high.

Secular stagnation's new normal of low economic growth

More than eight years after the onset of the global financial crisis, the US, European and Asian economies are generally seeing long-term low growth, low inflation and low interest rates, often described as 'secular stagnation.'

US economist Alvin Hansen coined the term in the aftermath of the Great Depression, and US finance minister Larry Summers reintroduced it in 2013 in reference to the economic hangover industrialised economies are suffering after the 2008-09 global crisis. The secular stagnation debate remains controversial, but consensus exists that current growth trends imply that negative real interest rates are required to restore full employment, which has serious policy implications.

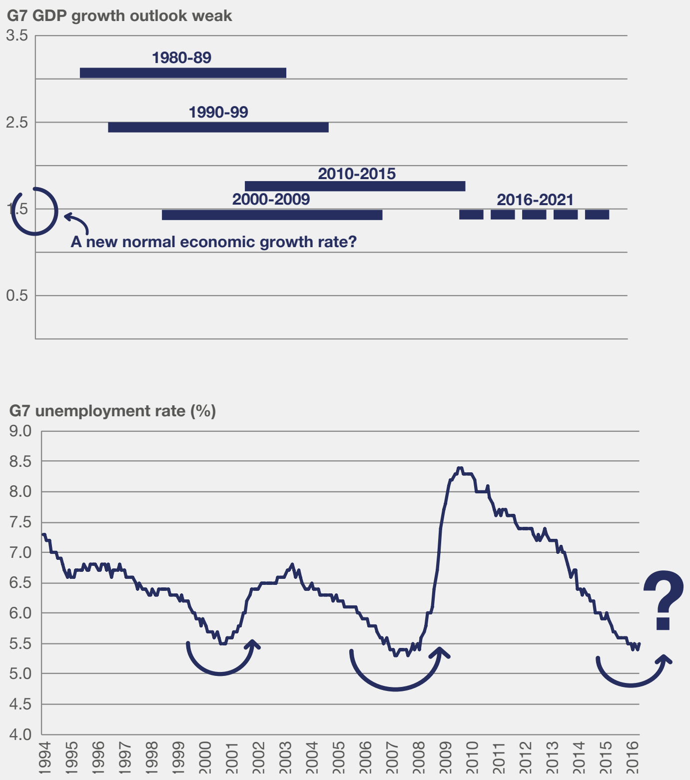
From an investment standpoint, the seeming new norm of lower growth in G7 countries (Canada, France, Germany, Italy, Japan, the UK and the US) means that expected nominal returns will probably remain below the historical norm for a protracted period (figure 1). Economic growth in the G7 countries has remained subdued since the financial crisis, but it had also been on a decreasing trend since the 1980s. Globally, this trend was mitigated by the strong growth of the emerging market economies from the late 1990s until the financial crisis, powered particularly by China.

Beginning in the late 1990s globalisation put a brake on cost and intensified international price competition. More recently, the post-crisis large capacity overhang and steep fall in oil prices aggravated falling inflation, raising the danger of outright deflation.

On the back of these trends, interest rates have declined to levels not seen in decades. Monetary policy rates and bond yields are now negative in many countries. Over the long term, decreasing inflation contributed to the fall of nominal rates, but real interest rates have also decreased over the longer term.

Low growth, low inflation and low interest rates

Figure 1: New norm economic growth rate in G7 countries



Sources: Macrobond, Savills Investment Management

Policy implications

Important factors cited on either side of the secular stagnation debate are the slowing population and workforce growth, particularly among aging economies; rising inequality; disruptive technological advancements suppressing productivity growth since the late 1980s and new technologies requiring less investment volumes. However, consensus exists that secular stagnation implies that negative real interest rates are required to restore full employment, which has serious policy implications.

Monetary and fiscal policy are typically used to manage the business cycle in order to overcome low growth. But both are subject to limitations.

Monetary policy, the most potent short-term tool, is limited mainly through the lower bound for nominal rates, zero, and through low inflation. To achieve negative real interest rates, required during secular stagnation, central banks have to lower nominal interest rates below inflation, which is difficult to achieve amidst low inflation or even deflation. Central banks have instead reverted to unconventional policy tools such as buying assets, or so-called 'quantitative easing.'

Another possible solution is fiscal policy, which is constrained in many countries by high public debt or institutional limitations, such as the Eurozone's Maastricht criteria. Countries that can afford higher (deficit) spending are typically the ones who do not need it (e.g., Germany), whereas countries suffering from weak growth (e.g., Italy) are often highly indebted. The best option in the latter case is the (re-)direction of public spending to growth-enhancing, productive areas such as physical infrastructure or education and non-consumptive uses.

Growth-enhancing structural measures represent another tool, such as reforms of labour markets, public pension and health care systems, free trade policies, the globalisation of financial markets and banking sector restructuring. These measures are probably most beneficial over the medium to long term but are also very unpopular and would face political resistance in the current context of rising populism.

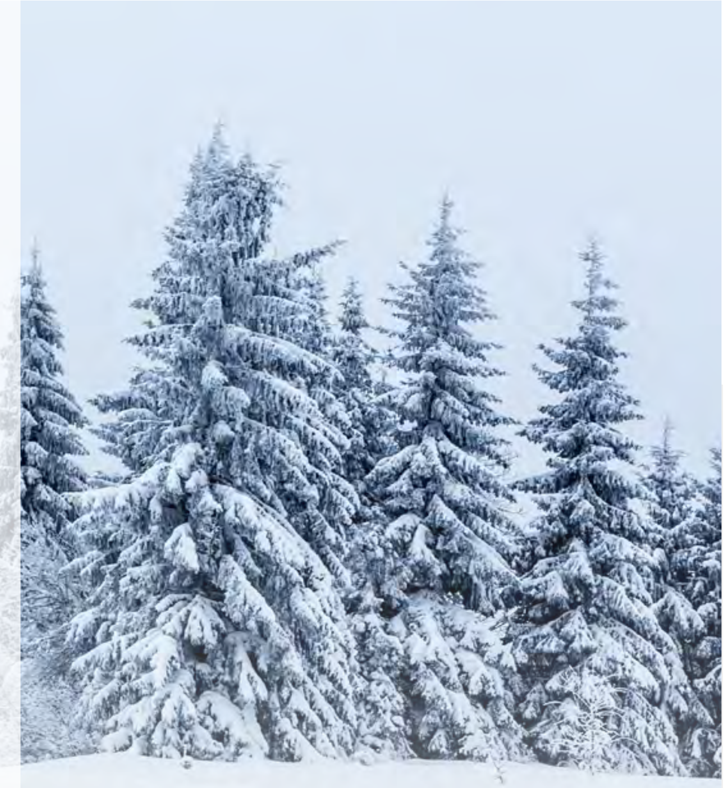
Looking forward

The long-term trend of slower productivity growth is most concerning as it limits GDP growth potential, and it is unclear whether the current innovation cycle can adequately boost productivity growth. Furthermore, private sector debt is at a record high, and the current deleveraging process is far from complete. European banking sector restructuring is slow and the low yield environment continues to constrain banks and credit growth.

With current structural headwinds, high public and private debt and limited policy options, G7 real GDP is forecast to remain low going forward: according to Consensus Economics, 1.5% is expected over the next five years, and a similar trend is evident in Asia.

Inflation is expected to increase over the next few years. In the short term, higher energy prices and domestic price pressures may increase with improving economies. However, in historical terms inflation is expected to remain rather low, ranging between roughly 1.0% and 2.5% in the major advanced countries, according to Consensus Economics. This could mean that central banks will gain a little more room to lift policy rates.

What are the possible implications for investors? As long-term nominal returns are determined by real GDP growth and inflation, expected nominal returns will probably remain below the historical norm for a protracted period. Investors should also remain attentive to the economic cycle as we have experienced an unusually long upswing contingent on massive policy support.

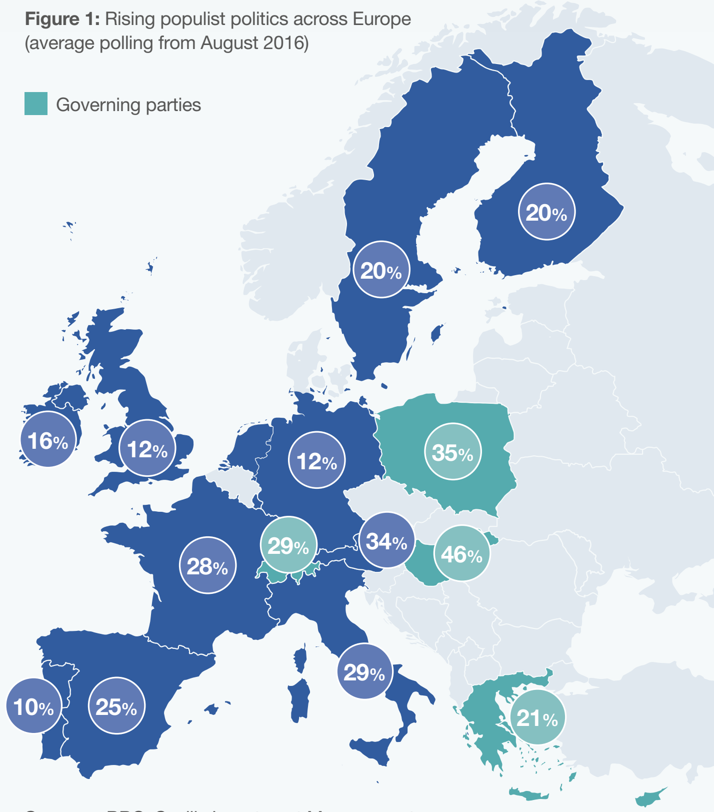


Secular stagnation implies that negative real interest rates are required to restore full employment, which has serious policy implications.

The rising tide of populism

Populism continues to gain momentum, and not only throughout Europe (figure 1) but also across the pond. Donald Trump's unexpected victory over Hillary Clinton in the November 2016 US presidential election was based on a campaign that ran in sharp contrast to the trade, tax, immigration and federal regulation policies of both the Republican and Democratic Parties. And more recently on the continent, Italy voted against Prime Minister Matteo Renzi's constitutional referendum, making way for opposition parties such as the populist Five-Star Movement. In the weeks leading up to Italy's vote, many news outlets aligned the possible referendum rejection with the UK's Brexit vote in June.

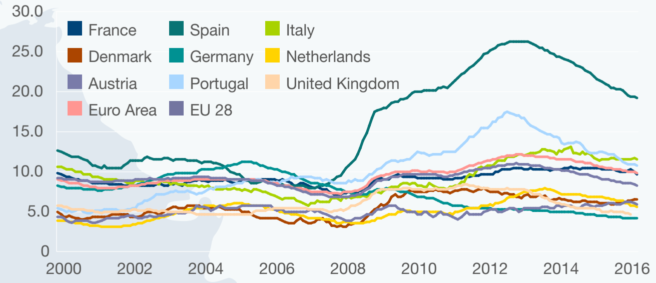
Figure 1: Rising populist politics across Europe (average polling from August 2016)



Sources: BBC, Savills Investment Management

Many observers interpret this trend of rising populism as a growing dissatisfaction with globalisation and the establishment, and one of the main drivers in Europe is a long period of subdued economic growth in large parts of the continent since the global financial crisis. Persistently high unemployment has been a scourge in countries such as Spain, Italy and France, fuelling anger towards political and business elites (figure 2).

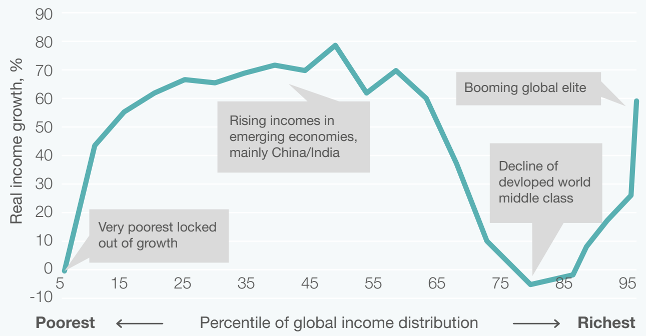
Figure 2: Unemployment rates across Europe (%)



Sources: Eurostat, Macrobond

Furthermore, escalating income inequality, including stagnating or even shrinking middle-class incomes, is increasing tensions. The main beneficiaries of globalisation have been emerging countries and those individuals in the top 1% of the income distribution, whereas salaries for the average US or European worker have stagnated at best (figure 3).

Figure 3: Change in income from 1988 to 2008 (real % change in 2005 Purchasing Power Parity terms)



Source: Tagesanzeiger

While stagnant economic growth and income inequality have lead to increases in populism on both sides of the political spectrum, rising immigration rates and attendant cultural and religious diversification have supported right-wing populists in particular. Populists tend to use immigrants as scapegoats for increasing labour market competition, for additional burdens on public finances and for loss of cultural and religious values and identity.

Populist policies based on trade restrictions and excessive public spending involve the danger of stagflation, or low economic growth combined with high inflation. Uncertainty around future economic and fiscal policy could impact business, investor and consumer confidence across Europe as it leads to lower growth due to delayed investment and reduced consumer spending. Associated weaker employment could impact the office and retail sector.

In order to accelerate economic growth and reduce income inequality, Europe may need to shift away from current austerity and supply-side economics and towards more demand-side policies, increased public spending and higher taxation of capital and other financial assets. It is highly likely that in 2017, markets will be mainly reliant on political events such as the French presidential and general elections and the Netherlands, German and possibly Italian general elections.

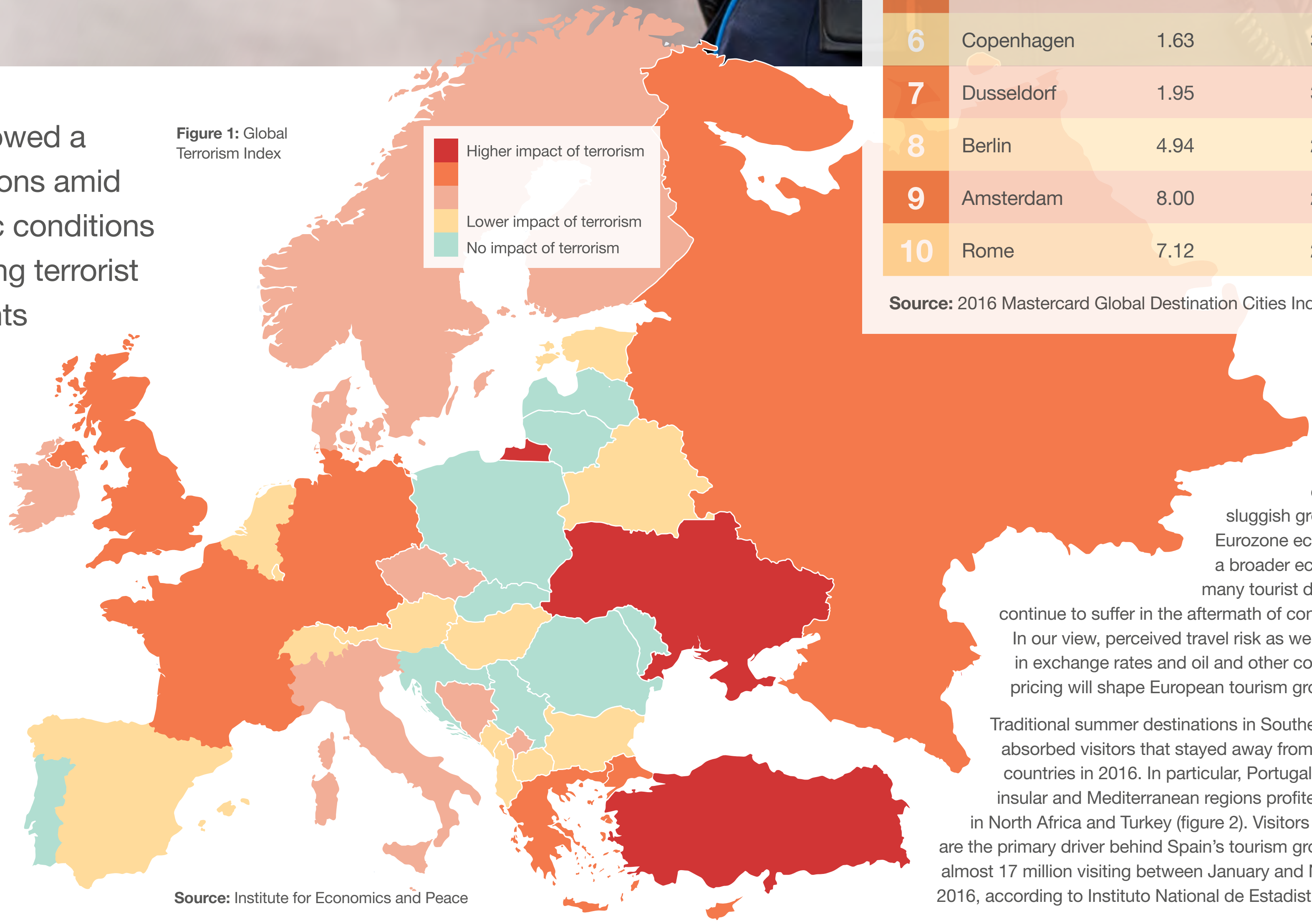
Economic and political uncertainty might result in lower investment volumes — in particular, cross-border transactions where there are political event risks — and increase the associated country risk premiums. There might be upwards pressure on real estate yields, too. But the European Central Bank remains on standby and would likely further increase its quantitative easing program. Thus, looser monetary policy and lower interest rates would restrict the outward shift of property yields.

We therefore recommend a defensive, income-focused approach towards real estate. In our view, long-term opportunities lie within 'winning' European cities, urban logistics, alternative real estate segments and tactical asset management opportunities.

Changing European tourism in a heightened security environment

In 2016 European tourism showed a mixed picture across sub regions amid volatile political and economic conditions and security concerns following terrorist incidents (figure 1). Such events in Brussels and Paris have contributed to a fall in international arrivals to Belgium and France since late 2015, with cities such as Vienna seeing a 7.38% increase in visitors in 2016 (table 1). According to the World Tourism Organization, 2016 tourism growth in Spain and Portugal was offset by declines in Belgium, France and Turkey.

Figure 1: Global Terrorism Index



Source: Institute for Economics and Peace

Table 1: Overnight international visitors to the fastest-growing cities in Europe

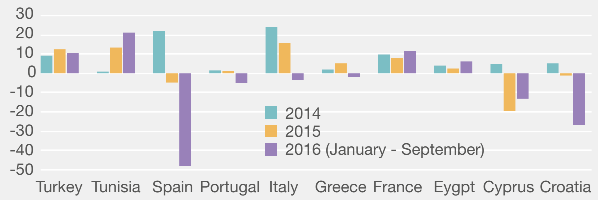
Rank	City	Overnight International Visitors (mn) 2016	Change 2016/15
1	Vienna	6.69	7.38%
2	London	19.88	7.00%
3	Barcelona	8.20	6.49%
4	Madrid	5.26	5.84%
5	Sofia	1.01	4.12%
6	Copenhagen	1.63	3.85%
7	Dusseldorf	1.95	3.72%
8	Berlin	4.94	2.92%
9	Amsterdam	8.00	2.83%
10	Rome	7.12	2.45%

Source: 2016 Mastercard Global Destination Cities Index

Declines in airline and accommodation bookings combined with sluggish growth across Eurozone economies could have a broader economic impact as many tourist destinations continue to suffer in the aftermath of concerning incidents. In our view, perceived travel risk as well as fluctuations in exchange rates and oil and other commodities pricing will shape European tourism growth in 2017.

Traditional summer destinations in Southern Europe absorbed visitors that stayed away from terror-hit countries in 2016. In particular, Portugal's and Spain's insular and Mediterranean regions profited from instability in North Africa and Turkey (figure 2). Visitors from the UK are the primary driver behind Spain's tourism growth, with almost 17 million visiting between January and November 2016, according to Instituto National de Estadistica.

Figure 2: International arrivals (% average)



Sources: PMA, Macrobond

Notes: France data include France Métropolitaine and Départments d'Outre-Mer, Italy and France 2016 data are from January to July and Greece 2016 data are from January to June.

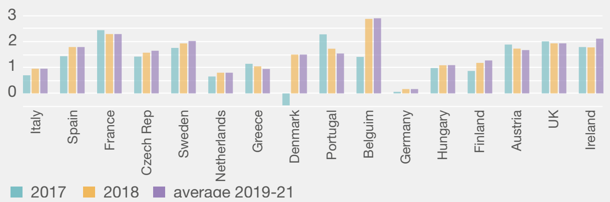
Southeastern European regions have not been affected by any major incidents and have benefited from travellers changing their destination preferences. In particular, seaside resorts in Bulgaria and Croatia are attracting a growing number of tourists due to low-fare air travel and relatively lower accommodation and food services costs. One of the key engines of economic growth in Greece, tourism there remained well below expectations in the first half of 2016.

Going forward, some major factors affecting tourism growth will be fluctuations in exchange rates and oil and other commodities pricing as well as global concerns around terrorism. The US dollar's relative strength will continue to shape tourism trends in 2017, as the US outbound travel market will see increased demand. The enhanced international purchasing power of travellers from developing countries and increasing popularity of shopping tourism will have a positive impact on tourist expenditure in destination markets, fuelling retailer activity.

In our view, traditional European holiday destinations Portugal and Spain will continue to see robust growth in international tourism, boosting job creation and retail sales (figure 3). Economic recovery and increased domestic consumer spending should then stimulate occupier demand for retail space and deliver positive rental growth prospects.

In Southeastern Europe, rising infrastructure standards are likely to sustain regional tourism growth. While retail sales growth has been negative in Greece since 2009, it is projected to enter positive territory from 2018 onwards.

Figure 3: Retail spending growth (%)



Sources: PMA, Macrobond

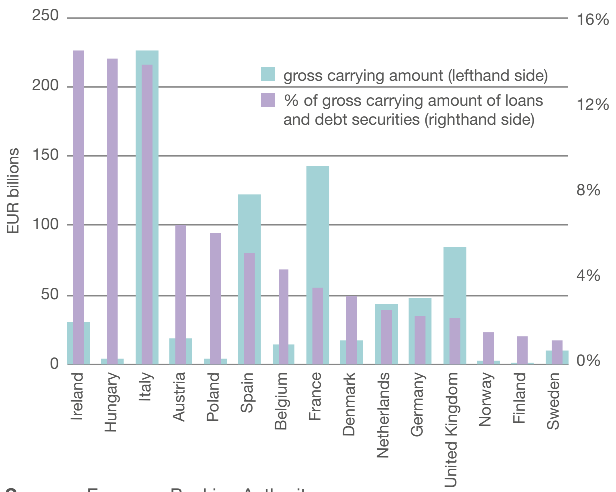
And despite Italy's projected weak retail spending growth, prime locations in Milan, Rome, Florence and Venice remain attractive due to consistently strong tourist flows and luxury spending. As retail activity is mostly concentrated in the historical city centres, supply is very restricted and high demand from domestic and foreign retailers will translate into stable or increasing rental values, low vacancy rates and yield compression.

We expect to see Brexit's biggest effect on UK tourism in 2017, since many trips for 2016 were booked in advance. However, the pound's exchange rate weakness has enhanced the competitiveness of the UK as a tourism destination, driving up international tourist arrivals while the number of UK residents opting for domestic holidaying is expected to rise. International travellers' lower price sensitivity will make London a more attractive shopping tourism destination, boosting tourism spending that will in turn fuel occupier demand for quality retail space and generate a positive growth outlook for prime shop rents.

Italy's failing banks renew fears of European banking crisis

Lower net interest margins, higher regulatory costs and non-performing loans (NPLs) have put significant strain on Europe's banking sector (figure 1). In June, the International Monetary Fund said that Deutsche Bank appeared to be 'the most important net contributor to systemic risks,' which is particularly true now that it faces a hefty fine from the US Department of Justice.

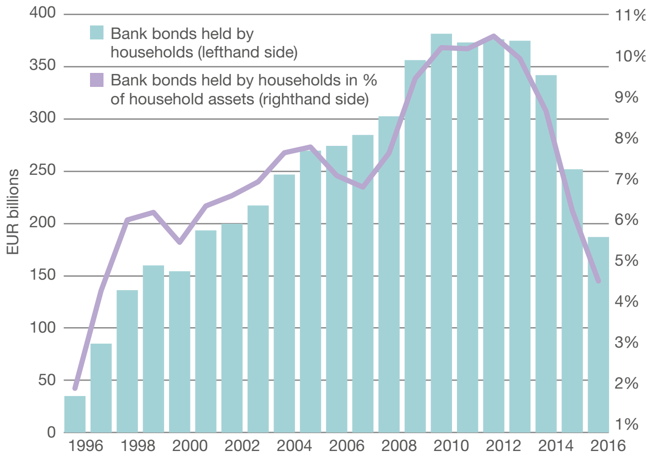
Figure 1: Europe's NPLs



Sources: European Banking Authority, Savills Investment Management

Italy's rejection of Prime Minister Matteo Renzi's proposed constitutional reform on 4 December further complicated EUR 5 billion recapitalisation efforts by struggling Italian bank Monte dei Paschi di Siena. Even before the referendum vote, the Italian government effectively attempted to bail out Veneto Banca and Banca Popolare di Vicenza, and Italian families were hit harder than businesses in terms of losses on shares (figure 2). Concerns around potential financial contagion remain elevated.

Figure 2: Bank bond holdings by Italian households



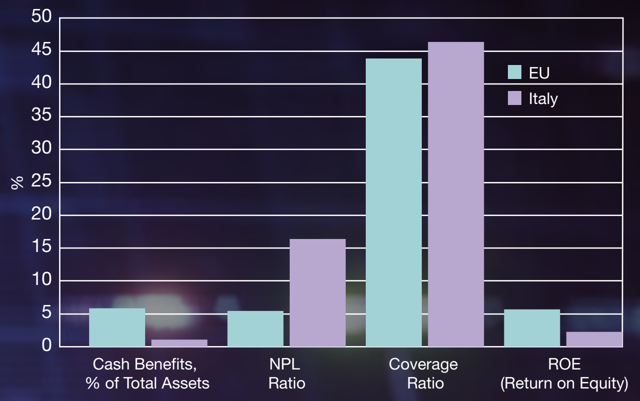
Sources: Macrobond, Savills Investment Management

Overall, the European banking sector is in better shape than after the financial crisis in 2008-09, but compared to the US, its healing process has lagged. The European Banking Authority's recent stress test revealed large disparities within Europe, with notable weak spots in the crisis-shaken countries of the southeast.

European banks suffer from weak profitability due to economic weakness and increasing numbers of NPLs. Negative yields and flat long-dated yield curves are having a negative impact on bank profits, delaying the necessary balance sheet repair, which is further affected by tougher regulations and increased competitive pressures. Structural overbanking suggests that consolidation and reduction of 'overcapacity' are inevitable.

Italy's economic underperformance since the financial crisis has resulted in increased levels of NPLs (figure 3), which stood at approximately EUR 350 billion at the end of 2015. Of this total amount, EUR 210 billion were bad debt, according to the Bank of Italy.

Figure 3: Italian banks versus EU average



Sources: Macrobond, EBA, Savills Investment Management

The Italian government's steps to repair bank balance sheets were inadequate in alleviating the wider economic impact. According to various estimates, Italian banks need a further capital injection of EUR 50 billion, which looks difficult following the Italian referendum. There are concerns that up to eight banks could fail. Moreover, the worst-rated banks lack access to capital market funding, further exacerbating the issue.

In our view, a comprehensive banking sector solution — such as the one implemented in Spain in 2012 — is desirable. But Italy's current political situation could delay the process. Italian banks such as UniCredit will continue with their private restructuring plans, but if those fail, public intervention is unavoidable (table 1). Monte dei Paschi di Siena is currently most at risk, as private investors are reluctant to step in, and the European Central Bank rejected a request to lengthen the recapitalisation deadline.

Table 1: Italian bank figures

	Assets	Market Cap	Tier1 capital ratio	NPL	NPL/ Loans ratio	Coverage ratio	Texas ratio	Net interest margin	Cost/ Income ratio	ROE	Long-term Ratings		
	bn EUR	bn EUR	in %	bn EUR	in %	in %	in %	in %	in %	in %	S&P	Moody's	Fitch
UniCredit	860.4	12.8	11.6	79.8	16.3	54.2	87.2	1.5	74.4	3.8	BBB-	Baa1	BBB+
Intesa Sanpaolo	676.5	33.1	13.8	63.1	17.5	51.2	78.8	1.3	62.0	4.9	BBB-	A3	BBB+
Banca Monte dei Paschi	169.0	0.5	12.9	46.9	36.0	49.9	142.2	1.3	60.3	-11.2	-	B2	B-
Banca IMI SpA	154.0	n.a	10.7	1.3	5.4	34.1	34.3	0.4	42.3	15.4	BBB-	A3	BBB+
Banco Popolare	120.5	1.7	13.2	18.3	23.3	37.7	119.0	1.2	71.2	-7.4	-	Ba1	BB
UBI Banca	117.2	1.8	12.1	13.4	15.1	31.0	95.0	1.4	70.6	-8.4	BBB-	Baa1	BBB
Banca Nazionale del Lavoro	85.0	n.a	10.0	9.6	13.9	53.8	89.5	n.a	65.2	-0.8	BBB-	A3	A-
Mediobanca	69.8	5.0	12.1	1.0	2.6	142.1	9.8	2.4	54.9	7.2	-	Baa3	BB
Banca popolare dell'Emilia	61.3	1.6	11.3	11.4	23.3	46.1	110.9	1.9	62.7	4.7	-	BBB+	
Banca Populare di Milana	50.2	1.6	12.1	4.4	12.1	57.8	61.6	1.7	63.9	3.9	-	Ba1	BB+
Banca Populare di Vicenca	39.8	n.a	6.7	6.1	20.9	62.5	95.8	1.2	121.5	-44.9	-	-	B-
Veneto Banca Spa	33.3	n.a	7.2	5.2	20.6	49.3	113.8	1.6	82.0	-36.9	-	B3	B-
Banca Carige	30.3	0.2	12.8	6.8	27.8	44.6	124.1	1.3	90.1	-14.4	B	-	-

Coverage ratio = reserves for loan losses/NPL; texas ratio = NPL/(Equity + provisions for loan losses)

Sources: Bloomberg, Landesbank Baden-Württemberg, Savills Investment Management

State intervention would have political repercussions as EU rules require a bail-in of current capital holders (equity and junior debt) before a bail-out can take place. As domestic retail investors are still heavily invested in bank bonds, the burden could amount to around EUR 15 billion, or 1.3% of the disposable income. This could damage public morale and bolster support for populist parties such as the Five-Star Movement in coming elections.

European Stability Mechanism participation would also be politically problematic because Italy would become a 'program country' subject to external conditions, such as in the cases of Greece, Portugal or Spain. This, too, would certainly further boost populist party backing. Therefore, this will only be a last resort, if the government is not able to raise the necessary funds on the capital market. We therefore remain cautious on the investment outlook.

Post-Brexit landscape

A series of unprecedented events have changed the geopolitical landscape following the Brexit vote in June 2016, including UK Prime Minister Theresa May announcing a proposed date to start negotiations for Britain to leave the EU, Donald Trump winning the US presidential election and Italian Prime Minister Matteo Renzi stepping down after voters rejected his constitutional reform.

In the short period following the UK referendum, real estate markets were negatively affected by increased uncertainty and a slowdown in activity, which hurt rental growth expectations and put upward pressure on property yields. In the UK we saw 'animal spirits' drive unprecedented levels of redemptions from daily dealt open-ended property funds, although a more informed reflection is now settling into the market.

From a long-term investor's point of view, the UK market continues to look attractive, aided by the devaluation of sterling and sound underlying fundamentals. However, the full impact of Brexit will be dependent on the final agreed upon deal.

For some overseas investors, UK entry prices are nearly **20% cheaper** than before the EU referendum.

In terms of mainland Europe, over the longer term the European office sector could profit from any functions transferred away from London in the event of the UK losing passporting rights for financial services activity with the EU. The larger markets of Frankfurt, Paris and Berlin would be set to benefit the most, and Dublin, Luxembourg, Amsterdam and Brussels to a more moderate extent. The City of London would be expected to take the biggest hit. Retail markets could also be negatively affected in the short term by lower consumer confidence and spending as well as less-aggressive store expansion strategies across the EU.

Europe's industrial sector could be negatively affected by slower trade flows and retail sales in addition to uncertainty surrounding the renegotiation of trade agreements. Brexit may increase the cost of trading with the UK and, over the longer term, could prompt a rethink of cross-border supply chains. This has implications for optimal industrials locations, occupational demand, rental growth prospects and logistics asset yields.

In terms of specific country exposures, Germany's automotive, electronics and metal production sectors are most at risk post Brexit, whereas its chemicals and financial industries may benefit. France and Spain have substantial direct investments in the UK, and Paris's relatively strong financial services workforce and infrastructure could benefit from financial services jobs relocating from the City.

The relatively Eurosceptic, export-oriented Scandinavian countries all have strong trade links with the UK, and their central banks have indicated that they are prepared to intervene should exchange rates come under pressure or banks require further liquidity. The Czech Republic and Hungary would be most affected via their role in the automotive sector value chain and through potential reductions in EU distributions. Poland would be mostly affected by remittances, due to the large number of Polish residents in the UK, and by it being the largest net receiver of contributions from the EU.

Trump in the White House

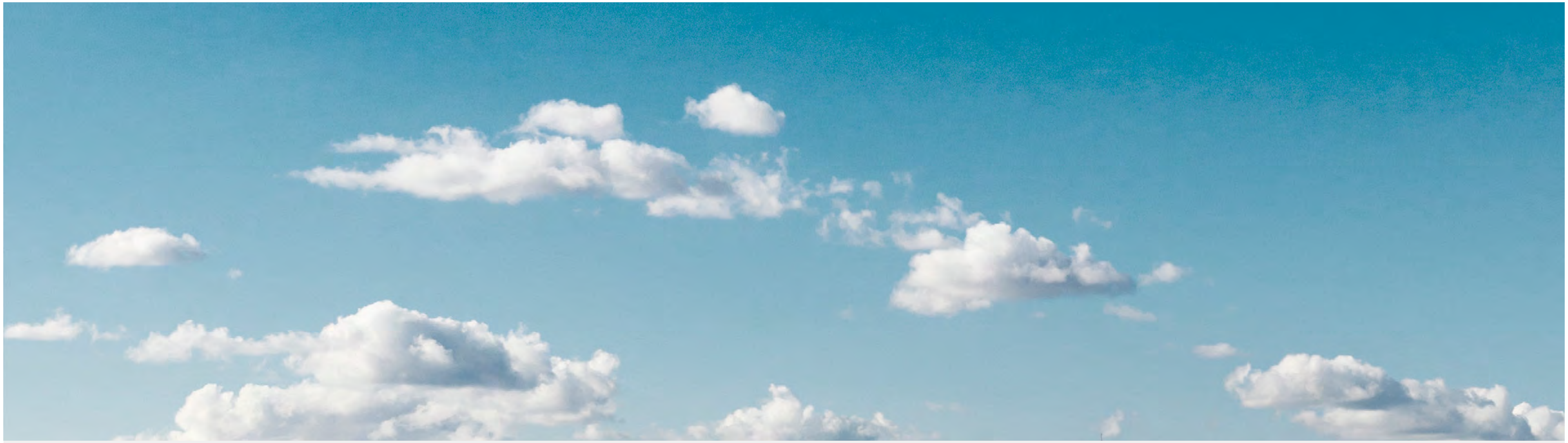
The election of Donald Trump coming hard on the heels of the Brexit vote could mean that markets begin paying closer attention to looming political risks. Facing a raft of important country elections, European markets could now assign a higher probability to more nationalistic, anti-establishment politicians in Europe being elected, leading to upwards pressure on real estate yields and a preference for local assets. If we take Trump's election as a leading indicator for 2017 European elections, we may see an increase in alternative 'socio-infrastructure' investment in mainland Europe and the UK.

If Trump's campaign proposals on trade, taxes, immigration and federal regulations are enacted, we expect US protectionism that could encourage the strengthening of non-EU trade relationships with the UK. Alongside conservative social policy, a protectionist-driven Trump presidency may also lead to a shift in financial and human capital from the Middle East and the US towards Europe and the UK, boosting the property sector as well as potentially helping the UK pursue its goal of forging new trade links post-Brexit.

Increased uncertainty regarding US economic and foreign policy will likely have an impact on business, investor and consumer confidence globally. More specifically, we expect uncertainty to affect real estate investment volumes in countries such as the Netherlands, France and Germany where elections are forthcoming.

Should the US initiate a trade war against countries it has significant trade deficits with, Europe's retail sector would suffer lower demand as a result of increased import costs leading to either squeezed margins or higher prices for customers. On the other hand, European retail may be able to tap into a redirection of cheaper raw materials and goods from China and other countries affected by US protectionism, leading to increased margins and boosted revenues and tenant covenants.

Overall, 2017 is likely to be characterised by increased uncertainty, over whether the UK can retain access to the single market after the triggering of Article 50, the effect of US economic and foreign policy and the trend of surging populism across Europe. We consequently recommend a defensive, income-focused approach towards real estate. In our view, long-term opportunities lie in 'winning' European cities, urban logistics, alternative real estate and tactical asset management opportunities.



Alternative real estate: segment on the rise

Historically, the European real estate investment market has been focused around the main commercial property types of retail, office and industrial. However, diversification and attractive return profiles of the alternative real estate segments have moved these assets off the sidelines (figure 1).

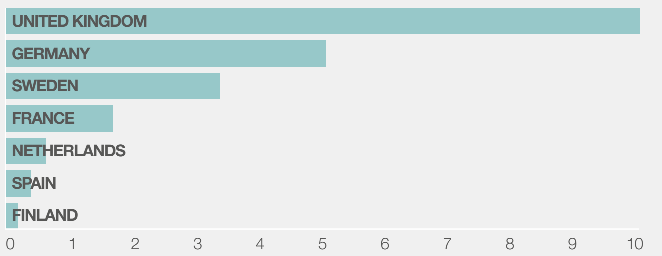
The attraction of alternative commercial real estate sectors is driven by a number of factors, including long leases, indexed rental uplifts and better covenants. Some estimates suggest that only half of Europe's investable real estate is currently in the hands of investors, with much of the untapped market being in these alternative sectors. Diversification is also an important driver. However, despite this growth, alternatives pose some unique challenges for investors.

Alternative real estate market size, depth and characteristics vary across Europe. The larger, more liquid markets are best positioned for development of investment-grade alternative sectors where product of sufficient scale and quality will attract investors (figure 2).

Figure 1: Alternative real estate segments

- Aged and primary health, hospitals, medical offices and premises
- Leisure centres, cinemas, resorts
- Car dealerships, fuel retailing, motorway service areas
- Student accommodation, educational facilities
- Self storage, government/public sector, private rented sector and houses in multiple occupation

Figure 2: Alternative real estate market investment volumes (EUR billions, 2015)



Source: Savills

The alternative sectors are characterised by a prevalence of longer leases. This feature, combined with the relative lack of comparative rental data, means that many leases are index linked or subject to fixed uplifts. The lease term and strength of the covenant is highly important in determining the price.

At the same time, many good quality assets may be mispriced in a market where overall supply is limited. Prime yields in these sectors are now at or below 6%, with scope for further compression as these markets develop and mature.

But many investors are still relatively unfamiliar with the alternative sectors and so perceive a greater degree of risk than traditional commercial property. However, longer leases and fixed uplifts mean that the reverse is frequently true.

By their nature, the alternative sectors have a lower market transparency than the mainstream market, although there is considerable variation. For example, investors in healthcare have access to a relatively large amount of market information, while a limited amount of data is readily available in the energy and waste management sector.

There is no comprehensive index showing the overall performance of alternative assets. This reflects their diverse nature and differing levels of maturity as well as the lower market transparency that characterises some alternative asset classes.

Outlook

In our view, long-term trends in urbanisation and demographics are there to stay and support the appeal of alternative segments such as residential, student accommodation, care homes and medical centres and clinics. These sectors may attract the type of investors with long term strategies, who can benefit from stable, long term income. At the same time, the demand and supply conditions in some markets and the index-linked income of some of these asset types may deliver positive rental growth prospects in the future.

The rising competition in the traditional market for the best assets is out pricing some investors who are interested in higher returns and are also prepared to take higher risk. These investors are looking into niche market segments and are partnering with strong local players to benefit from higher returns.

We believe that the alternative real estate sector will further increase its share in the real estate investment universe over the coming years in Europe.

We think the key sectors that will see strong activity this year are the multi-family, automotive, healthcare and socio-infrastructure markets in the UK, Germany, France, the Netherlands, the Nordics and, increasingly, Spain (figure 3).

Figure 3: Key considerations

- Level of investment market maturity
- Stock selection
- Business model/ease of entry
- Occupiers ability to service rent
- Covenant strength
- Exit strategy

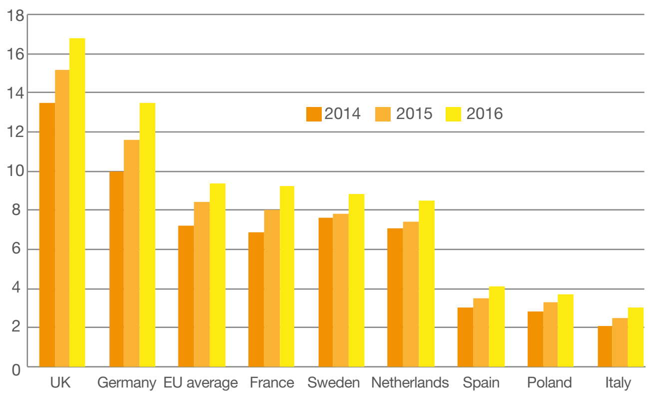
Urban logistics distribution moving closer to the customers

The expansion of online retail across Europe (figure 1) is causing a rethinking of many logistics networks as E-tailers seek to distinguish themselves through increasingly rapid delivery. In particular, urban distribution centres within city limits will become crucial to enabling rapid delivery to customers.

The growing urban population, which is more tech savvy and comfortable shopping online, is changing the logistics landscape. We expect this trend to continue, driving the need for innovative last-mile delivery capability and smart urban warehousing.

The rise in online sales and expansion of rapid delivery is fuelling parcel growth. Ecommerce Europe estimates that there were more than 4.2 billion business-to-consumer parcels across Europe in 2015, and this number is expected to increase.

Figure 1: Online market share by country (% total retail)



Source: Centre for Retail Research

As a result of the growth in online retail, Prologis has predicted that through 2020 an additional 15 million square metres of logistics space will be required. In addition to the traditional distribution centres and cross-docking facilities, this will also include parcel lockers (figure 2), smart lockers and smart urban warehouses.

Figure 2: InPost parcel lockers

Source: InPost

In particular, cross-docking facilities (figure 3) and parcel delivery centres of around 3,000-9,000 square metres in the vicinity of major cities and conurbations will become increasingly important to enable next-day, same-day or even same-hour delivery on selected items. Thus, there is an increasing need for urban distribution centres within the city limits to fulfil these promises.

Figure 3: Cross-dock facility

Sources: DHL, CBRE

Due to expensive costs for a limited amount of land, even in European cities developers have started to build multi-storey distribution centres such as those Segro constructed for Amazon in London and Munich.

The last mile of the logistics chain, which accounts for a large proportion of shipment costs and complexity of operations, is often the most inefficient (low load factors, long dwell times at loading and unloading points, high numbers of individual deliveries). This is leading to more expensive and complicated logistics processes and spurring growth of cross-docked distribution centres on the edges of towns and cities as a go-between for national and pan-regional distribution centres.

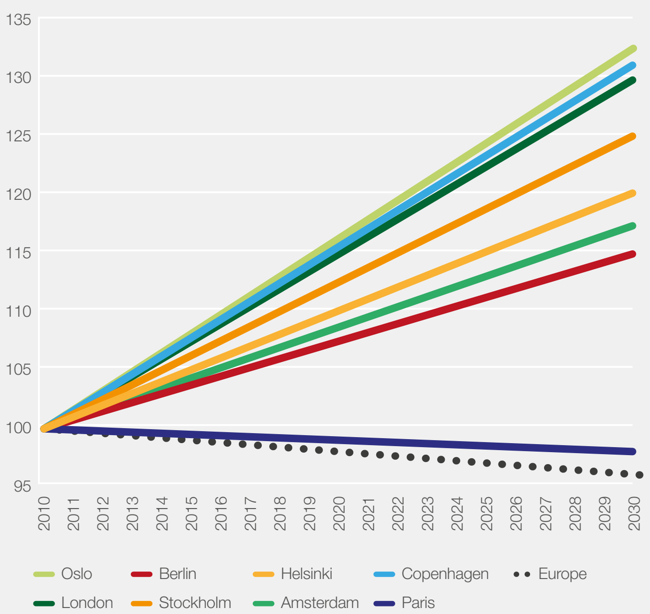
A variety of urban logistics and retail fulfilment options are also developing across cities globally, served by smaller transit vans as opposed to larger trucks. E-tailers have started to include smaller urban warehouses (facilities up to 2,500 square metres) in their network in order to shorten delivery routes and provide quick delivery services to online customers.

We think that urban logistics is a preferred sector to invest in across Europe, particularly in markets where Internet sales as a proportion of total retail sales are at or about to exceed the 5% threshold. This is certainly the case in the UK, Germany, France, Sweden and the Netherlands, but countries such as Spain, Italy and Poland are catching up.

What makes a winning city?

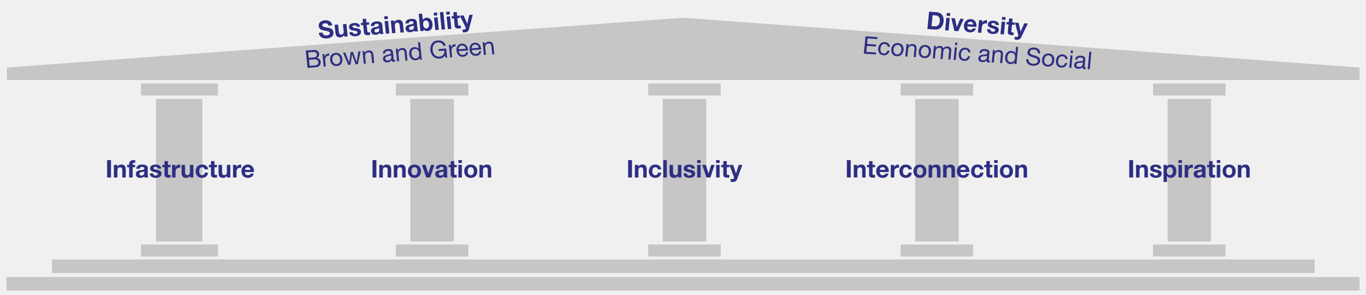
As commercial real estate (CRE) markets mature and returns fall to a new normal, real estate investors must look beyond the traditional markers of winning markets. Rising urbanisation across Europe (figure 1) means that it is more important than ever to identify what makes a European city attractive to live, work and invest in. We see particular value in the smaller, '18-hour' cities that provide the five-factor platform of infrastructure, innovation, inclusivity, interconnectedness and inspiration to drive brown and green sustainability as well as social and economic diversity. The investible city of the future requires a balanced foundation that takes advantage of growth peaks and is resilient to market troughs (figure 2).

Figure 1: European population forecast (rebased 2010 = 100)



Sources: Oxford Economics, United Nations, Savills Investment Management

Figure 2: Five-factor platform



Source: Savills Investment Management

This urbanisation is specific to certain cities, however. Many East German and Eastern European cities have forecast overall population and working population declines (table 1). Even some of the currently winning, larger global cities are also forecast to see declines in working age populations, including Barcelona and Madrid. On the other hand, according to Oxford Economics forecasts, both London and some cities in Turkey and the Nordics will enjoy population boosts as a result of urbanisation (table 2).

Table 1: Five largest forecast declines in working age population (Europe, 2016-30)

Area*,**	Country	% Cumulative Decline
Kaunas	Lithuania	-35.10%
Klaipeda	Lithuania	-33.35%
Daugavpils	Latvia	-30.57%
Chemnitz	Germany	-25.27%
Vilnius	Lithuania	-24.99%

Sources: Oxford Economics, Savills Investment Management

Notes: *NUTS 3; **five areas are taken from a subsample of 195 locations across Europe

Table 2: Five largest forecast increases in working age population (Europe, 2016-30)

Area*,**	Country	% Cumulative Increase
Istanbul	Turkey	15.85%
Copenhagen	Denmark	15.52%
London	United Kingdom	15.48%
Ankara	Turkey	14.87%
Oslo	Norway	14.81%

Sources: Oxford Economics, Savills Investment Management

Notes: *NUTS 3; **five areas are taken from a subsample of 195 locations across Europe

Infrastructure

Cities are reliant on underlying infrastructure for sustainable growth, and cities of the future require seamless transportation of people and information. Infrastructure is especially vital to energy, sanitation, transportation (table 3) and information transfer, especially in the age of digitalisation in which communication and Internet speed and access are paramount.

Interconnection

Cities that are well-connected physically, globally and locally foster and promote enterprise and encourage growth. Successful cities of the future need seamless transportation of people and information. While cars are likely to continue to dominate in the near to medium term, a successful city is walkable, cyclable and has a good spread of efficient and reliable public transport, be it trams, buses, light rail, metro systems or inter-city rail networks.

Innovation

Forward-thinking research and development serves to future proof cities. Cities with established universities that help bring research to the commercial realm as well as those that have a higher proportion of postgraduates or draw graduates home after they finish university benefit from the human capital and other resources necessary to encourage innovation.

Inspiration

City-scapes that nourish the body and mind attract and retain talent and encourage innovation. Green spaces are the lungs of the city and places to reflect and inspire. As Richard Florida expounds, with the right combination of talent, technology and tolerance, bohemians are the seeds that attract and inspire the innovation necessary to grow a successful city.

Inclusivity

Inclusivity, whether defined by culture, ethnicity, religion, age, ability, gender, sexuality or any other demographic, encourages successful cities by promoting diversity. A city dynamic that supports interconnectivity and collaboration and provides opportunity for inspiration creates a positive environment for innovation. People of different backgrounds benefit economic growth through a wide array of experiences, skills and perspectives.

Table 3: Five of the largest transport-related rail infrastructure projects

Project	City	Country	Cost (USD)	Construction Start	Expected Completion
London Infrastructure Plan 2050 Program	London	United Kingdom	1.85 trillion	2015 Q1	2050 Q4
Lyon-Turin High Speed Rail	Lyon - Turin	France	38 billion	2002 Q4	2029 Q4
Istanbul New Airport	Istanbul	Turkey	36 billion	2015 Q2	2028 Q4
Grand Paris, Express Metro Rail	Paris	France	33.7 billion	2015 Q3	2030 Q4
Bresica to Padova High Speed Railway Line	Bresica - Padova	Italy	11.8 billion	2015 Q4	2020 Q4

Sources: Timetric Construction Database, Savills Investment Management

Outlook

As the returns in traditional winning, larger global cities such as London, Paris and Berlin continue to mature, we see opportunity in 18-hour cities that offer the walkability, interactive streets, short commutes and affordability to live and work. Essentially, these new winning cities have good connectivity to the major cities and are likely to see future demand across the CRE sectors (table 4).

Table 4: Six of the top fifty winning cities

City	Overall Ranking (of 130)
Copenhagen	12
Oslo	10
Helsinki	8
Istanbul	11
Prague	7
Munich	3

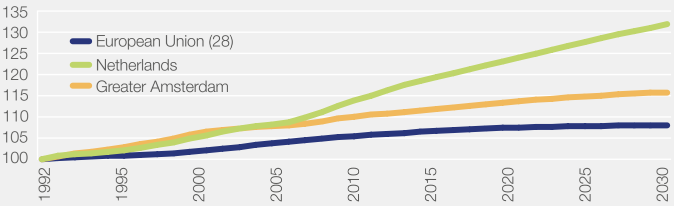
Sources: Oxford Economics, Meetup, TripAdvisor, 2thinknow, Grid.ac, Timetric Construction Database, Times, Crowdsurfer, Numbeo, World Health Organisation, Economic Community Development Institute, Savills Investment Management

Notes: The scoring model is based on a number of indicators, with these six cities performing particularly well on population growth forecasts and technology and infrastructure indicators.

Amsterdam

Amsterdam has 1.3 million inhabitants and is formally the capital of the Netherlands, even though the government seat is in The Hague. It is a wet city, lying below sea level, with a large inland waterfront connected to the North Sea. The medieval city centre is famous for its multitude of canals (grachten) and bridges. Often compared to Venice, the old town is a very attractive destination for domestic and international tourists.

Figure 1: Population growth index (1992=100)



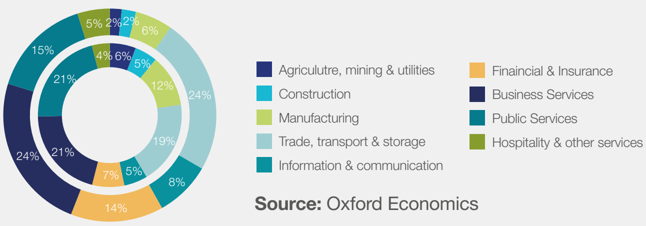
Source: Oxford Economics

Geographically, Amsterdam is part of the Randstad, a closely interlinked agglomeration of the four largest Dutch cities. With 7.5 million inhabitants, the Randstad is one the largest metro regions in Europe and one of the most densely populated areas. The Randstad forms the Dutch economic heartland, hosting 40% of the Dutch population and contributing around 50% of the national GDP.

Amsterdam is the commercial and financial centre of the Netherlands and the most prosperous area of the country. A large number of domestic and international corporations are either headquartered or have large branches there (e.g., BCG, KPMG, Philips, ING, ABN AMRO, Heineken, AkzoNobel). Due to the city's size, seaport and international Schiphol airport, Amsterdam is also a major national and international distribution hub.

Amsterdam is expected to outpace all other Dutch cities or regions in terms of GDP and population growth: Oxford Economics forecasts an average growth of 0.8% and 2.4%, respectively, over the next decade, both above the European average.

Figure 2: Greater Amsterdam versus Netherlands gross value added by sector (%)



Source: Oxford Economics

Amsterdam is the most liquid and transparent real estate market in the Netherlands and offers tactical, strategic and income-oriented opportunities. Expectations over the medium term are positive, although messy Brexit and elections in 2017 could have an impact on the investment market.

Office

Amsterdam is leading the Dutch office market's recovery in 2016. Occupiers are focused on quality space in better locations. The city centre and central business district (South Axis) are clear beneficiaries. There is a shortage of modern stock in these areas, which is supporting rental growth. Brexit-related service relocations could intensify this trend. Positive investor sentiment and robust investment activity are expected to push prime yields down. Overall, PMA expects an average annual total return of 5-6% over the next five years.

Retail

Amsterdam is by far the largest retail market in the Netherlands, and the city centre's main shopping streets command the highest rents. Amsterdam was not immune to higher insolvencies in the recent past, but the market situation varies considerably by location. Retailer demand in the main shopping streets is expected to remain strong, especially from international fashion chains and discounters. Oxford Economics expects Amsterdam to have the strongest growth of retail sales nationwide. We expect that occupiers' and investors' high competition for the best units in prime locations will continue supporting rental grows and suppressing yields. PMA expects average total returns of around 6% over the next five years.

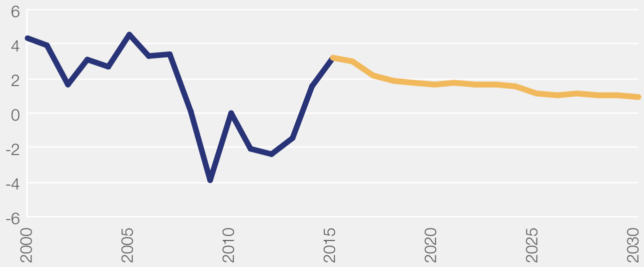
Industrial

Amsterdam's logistics market is an integral part of the European logistics network that stretches from the UK to Italy (known as the Blue Banana). Because of limited land, the city's logistics stock is constrained and mainly clustered around the port and airport areas, with the latter area commanding the highest rents nationwide. Demand is strong, driven by the improving economy, E-commerce and the related restructuring of logistics networks. Modern space is scarce and developments are mostly build-to-suit. Therefore, we expect moderate rental growth and continued yield compression. PMA expects total returns averaging between 5% and 6% over the next five years.

Barcelona

Barcelona, the cosmopolitan capital of Spain's Catalonia region, is known for its art and architecture. The fantastical Sagrada Família church and other modernist landmarks designed by Antoni Gaudí dot the city. Museu Picasso and Fundació Joan Miró feature modern art by their namesakes, and city history museum MUHBA includes several Roman archaeological sites.

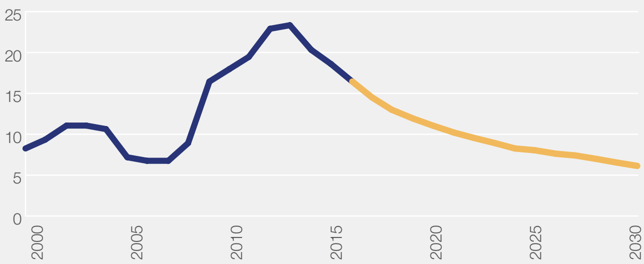
Figure 1: GDP (%, 2000-30)



Source: Oxford Economics

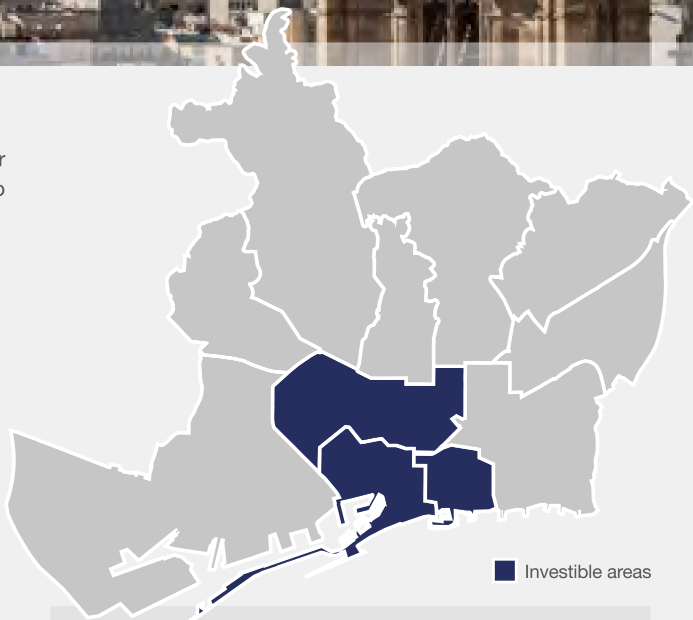
Barcelona's top three industries are currently manufacturing, retail and real estate, and retail is forecast to exhibit strong rental growth. Oxford Economics anticipated workplace-based employment to grow by 1.5% over 2017. The city's employment growth reflects a continued shift towards the services and high-tech sectors. According to the Economic Community Development Institute (ECDI) and Crowdsurfer, Barcelona start-ups received EUR 7.3 million in crowdfunding in 2015 compared to just EUR 372,000 in Madrid. ECDI also reported that Barcelona scored second highest to London in terms of access to technology accelerators.

Figure 2: Unemployment rate (%, 2000-30)



Source: Oxford Economics

Going forward, Barcelona provides opportunity for retail rental growth, with prime high streets in particular seeing a steady increase in rents as tourism is diverted away from terrorist-hit countries such as France and towards countries such as Spain.



Office

Barcelona office space is largely concentrated in the Passeig de Grácia/Diagonal and city centre. Growth in office-based employment is forecast to remain positive through 2021, but to dip below 2% per year, according to PMA. After almost no change forecast for 2017, we do expect to see net additions to office stock from 2018. In terms of capital value growth, after healthy growth over 2016, we forecast a drop off in capital values, potentially falling into negative territory from 2018 onwards. Therefore, while income returns for prime office locations should remain relatively stable, prime total returns for 2017 are forecast by PMA at 14.5%.

Retail

The best shopping areas in Barcelona are Passeig de Grácia and streets to its southwest, including Barri Gotic's Carrer de la Portaferrissa, Carrer de la Boqueria and Carrer de Ferran as well as the Plaça de Sant Josep Oriol area. On the back of steady consumer spending and a redirection of tourism from other holiday destinations following terrorist incidents, we expect to see a steady increase in prime high street rents for 2017. We also expect further uplift in prime capital values over 2017.

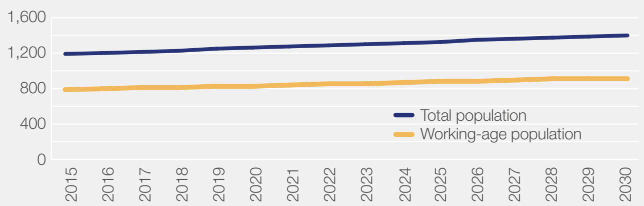
Industrial

We expect consumer spending to moderate in 2016, albeit continuing to support prime rents at around EUR 6 per square foot. Prime capital value growth for 2017 is expected to pick up on 2016's before declining from 2018 to reach negative growth by 2020. We expect continued yield compression over 2017 on prime logistics yields. Overall, we expect prime total returns for logistics to pick up on 2016 levels.

Brussels

Brussels, officially the Brussels-Capital Region, comprises 19 municipalities in Belgium, including the City of Brussels, which is the capital of Belgium. With GDP growth for 2017 expected at 1.3% and employment projected to expand by 1.0%, the outlook for Brussels is muted. The unemployment rate will remain high at almost 17%, which is well above the projected national level of around 8%. It remains to be seen whether the 'tax shift' reform to cut labour-unit cost will have a substantial enough impact to reduce unemployment.

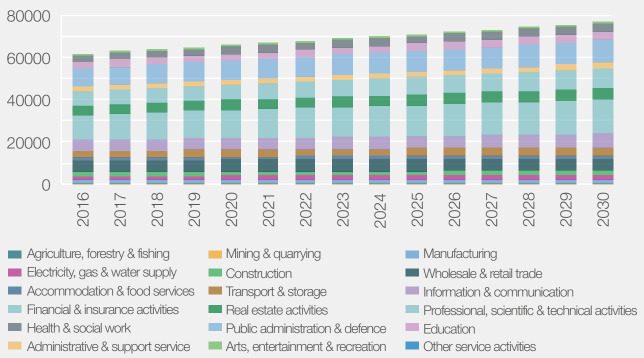
Figure 1: Brussels-Capital Region population (thousands, 2015-30)



Source: Oxford Economics

Brussels is among the cities in Europe with relatively strong population growth: Oxford Economics reported that over the next five years the region is projected to add 54,000 people, with the total population set to reach 1.28 million. At the same time, Brussels has a catchment area of almost 12 million people within three hours commute by train, which makes the region attractive to commuters. The rapid transit system that is due to be completed in 2025 will double the capacity of the major railway axes around Brussels.

Figure 2: Gross value added by sector (EUR million, constant 2010 prices)



Source: Oxford Economics

Overall, the outlook for Brussels is muted, although the city is forecast to experience relatively strong population growth over the next five years. Office rental growth prospects in particular are modest and office vacancy rates are under pressure to decline further.

Office

Main office areas in Brussels are in the city centre and Louise and Leopold districts. Growth in office employment is forecast to remain positive up to 2021. However, given post-Brexit uncertainty and the rise of anti-EU parties, according to PMA rental growth prospects are a fairly modest 1.3% on average per year for the next five years, despite the shortage of high-quality office space in prime locations. Office vacancy rates are under pressure to decline further in the core districts, while they remain high in the decentralised district and, according to Savills, at 21% in the periphery due to weaker demand. In terms of capital growth, we expect growth rate to moderate over the coming years.

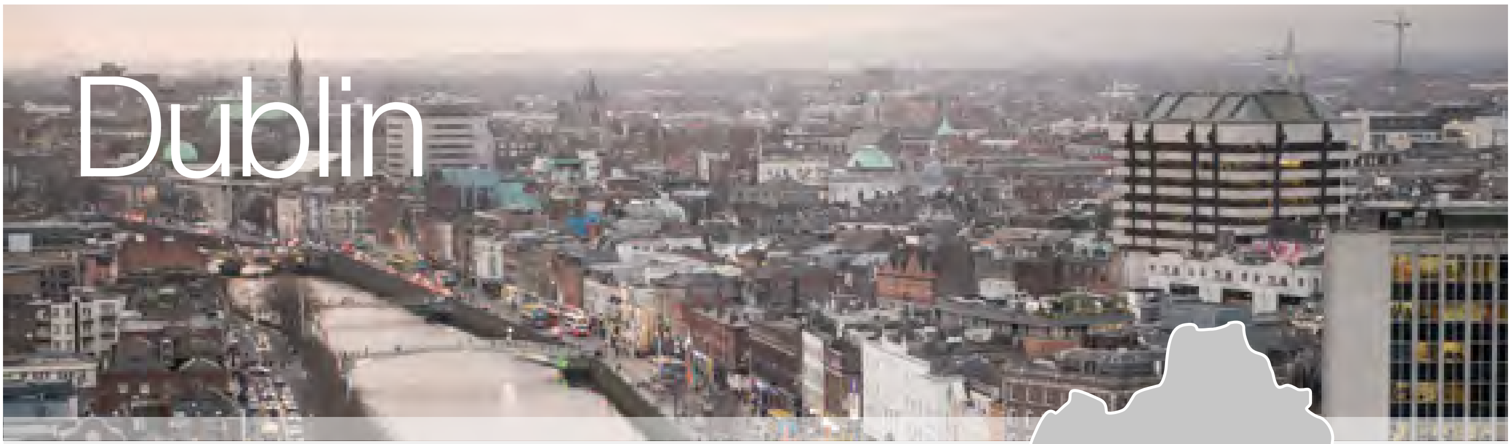
Retail

Luxury brands and boutique shops can be found on two renowned shopping streets in Brussels: Boulevard de Waterloo and Rue Antoine Dansaert. The 'regular' shopping street is pedestrian-only Rue Neuve, which offers a great variety of shops and large shopping mall called City2. On the back of slower household income growth, retail sales growth is forecast to average 1.1% per year over the next five years, according to Oxford Economics. According to PMA, prime retail rental growth will average 3.1% per year from 2017 to 2021 and prime net yields are forecast to remain stable at 3.2% over the next five years, while we expect capital growth to moderate in 2017.

Industrial

Logistics sector performance will remain stable. In nominal terms, rental values are projected to grow at a modest rate of 0.7% in 2017, but are then forecast by PMA to pick up to 1.4% in 2018 and 1.7% per year through 2021. We expect to see prime net yields decline over the coming years. According to PMA, capital growth will moderate between 2017 and 2020. Prime total returns on logistics are expected to surpass the 2016 level to rreach 11.6%, according to PMA, but will gradually decelerate to 3.3% by 2021.

Dublin



Dublin, the capital of the Republic of Ireland, is on Ireland's east coast at the mouth of the River Liffey. Its historic buildings include Dublin Castle, dating to the 13th century, and the imposing St Patrick's Cathedral, founded in 1191. City parks include landscaped St Stephen's Green and huge Phoenix Park, which contains the Dublin Zoo. The National Museum of Ireland explores Irish heritage and culture.

The City of Dublin is the area administered by Dublin City Council, but 'Dublin' normally refers to the contiguous urban area including parts of the adjacent local authority areas of Dún Laoghaire–Rathdown, Fingal and South Dublin. Together, the four areas form the traditional County Dublin.

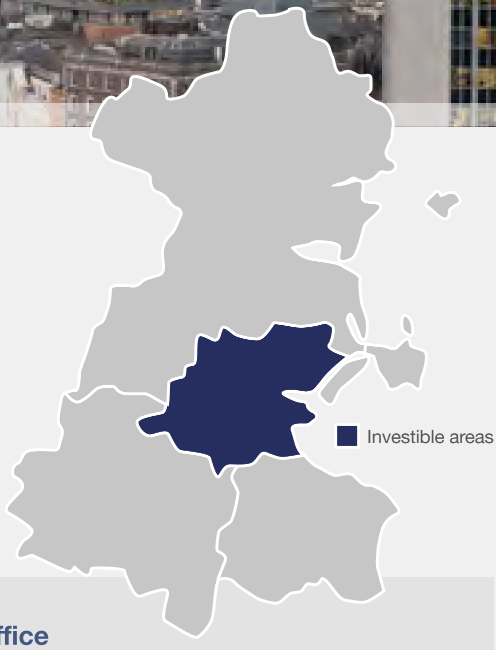
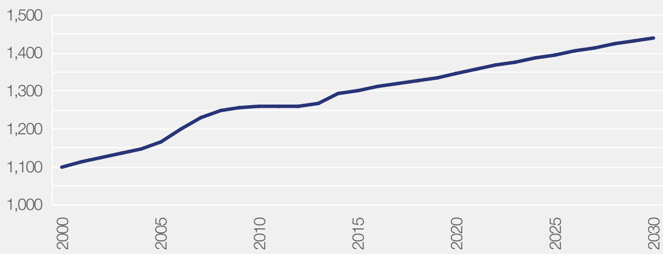


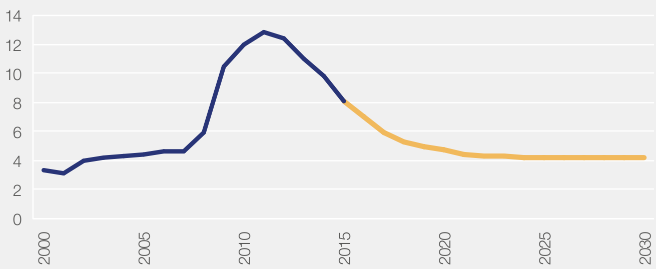
Figure 1: Total population (thousands)



Source: Oxford Economics

The population of the City of Dublin was 553,165 in the 2016 census, while the population of the urban area was 1.35 million. County Dublin's population was 1.27 million, and that of the Greater Dublin Area was 1.90 million. The area's population is expanding rapidly and is estimated to reach 2.10 million by 2020, according to the Central Statistics Office.

Figure 2: International Labour Organisation unemployment rate (%)



Source: International Labour Organisation

The strong performance of the Irish economy and positive short- and medium-term growth outlook provides a solid backdrop for real estate investments. We expect Dublin to benefit from any Brexit fallout given its English speaking, educated and relatively young population.

Office

The Dublin office market is centred around districts 2 and 4 of the city centre. Take-up volume has continued to improve, notably from the information technology and telecommunication sectors. A key shortage of space — in particular, Grade A space — remains an issue, which has resulted in a sharp increase in rental growth. Dublin prime office rents stood at EUR 592 per square metre in Q3, with net initial yields of 4.25%.

Retail

Dublin's main shopping area is concentrated around the city centre, notably Grafton and Henry Streets. A number of in-town shopping centres, such as Liffey Valley Park and Blanchardstown and Dundrum Town Centres, are also popular destinations. Dublin continues to be the main focus for new entrants to Irish markets. These new entrants include Sostrene Grene, Prezzo, & Other Stories, Cath Kidston, The Range and Victoria's Secret, among others. Prime Dublin high street shop rents stood at EUR 5,900 per square metre as of the end of Q3, with net initial yields of 4.0%

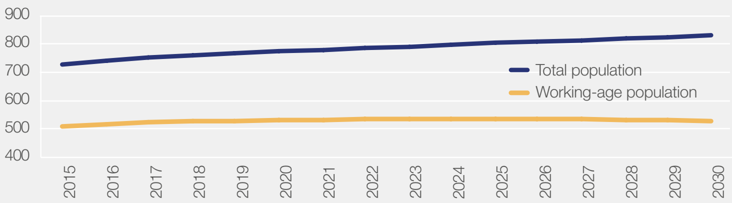
Industrial

The main Dublin logistics hub is located in the southwest (N7) corridor. The lack of available Grade A space remains a key feature of the market, and in our view, the build-to-suit route remains one of the few viable options for occupiers to secure accommodation. However, there remains a lack of confidence from occupiers to proceed with designing and building facilities due to the long lease term required to make the facilities viable. Prime Dublin logistics rents stood at EUR 81 per square metre at the end of Q3 2016, with prime net initial yields of 5.75%.

Frankfurt

Frankfurt, located in the heart of Germany, has a population of more than 740,000 within the city limits and more than 5.8 million people in the Frankfurt Rhine-Main Metropolitan Region. According to Oxford Economics, Frankfurt's population will grow by 12% until 2030. Average GDP growth is forecast at 1% per annum until 2030.

Figure 1: Frankfurt population (thousands, 2015-30)

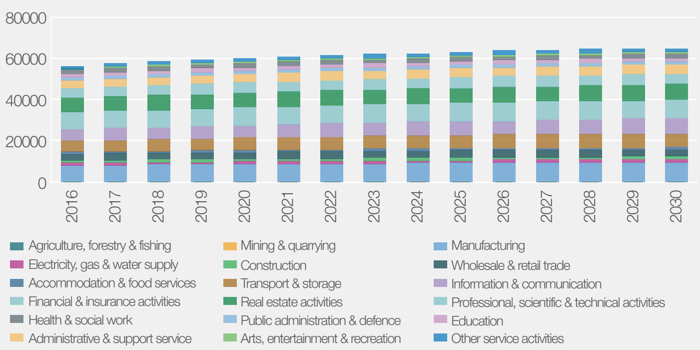


Source: Oxford Economics

Frankfurt is the financial centre of both Germany and Continental Europe, hosting the headquarters of the European Central Bank, German Federal Bank, Frankfurt Stock Exchange, Deutsche Bank, Commerzbank, KfW and others. Frankfurt is also an important centre for accountancy and professional services, investment trust companies, management consultancies, real estate services companies, law firms and information and communications technology companies.

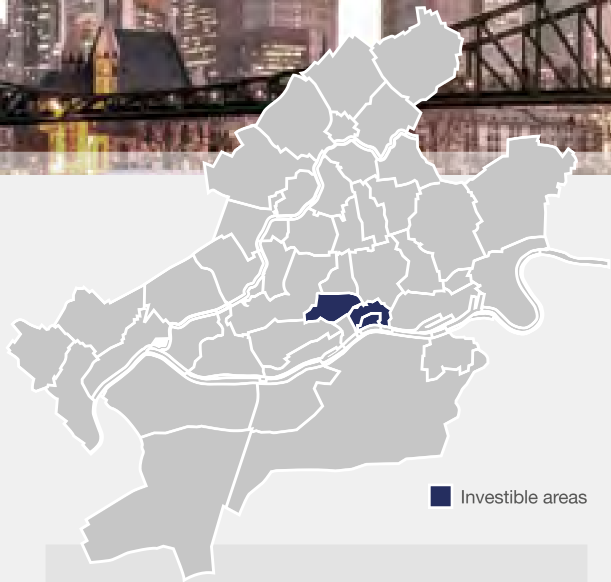
Although Deutsche Bank and Commerzbank in particular are currently cutting bank office jobs, the Frankfurt office market could become one of the winners of bank and financial service job relocation following Brexit. For example, 5,000 relocated bank jobs could add up to approximately 125,000 square metres of additional office space demand.

Figure 2: Gross value added by sector (EUR million, constant 2010 prices)



Source: Oxford Economics

Frankfurt is the financial centre of both Germany and Continental Europe, and the Frankfurt office market could become one of the winners of bank and financial service job relocation following Brexit. Furthermore, in the logistics sector prime capital values are forecast to grow by 13% until 2021, and retail should benefit from the increasing population and good economic conditions.



Office

After two years of subdued leasing market activity, take-up gained momentum due to a broad upswing in all market segments. Total take-up stood at its highest level since 2012. Vacancies dropped further, mainly due to the high net absorption and conversions from offices to other usages. Prime office rent remained stable but is expected to grow by 8% until 2021, according to PMA. After a quiet first half of the year, investment volume picked up from Q3 2016. Due to high investor demand, prime yields are expected to fall below 4%, while prime capital values are forecast to grow by 14% until 2021.

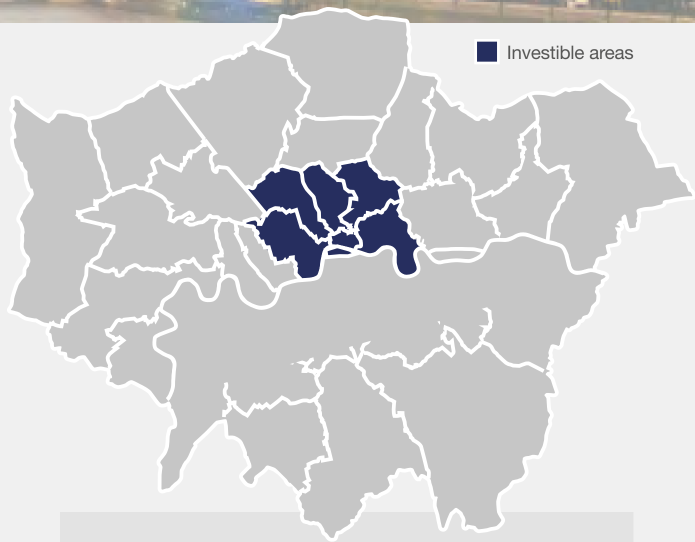
Retail

The high street retail leasing market saw an above-average take-up result in 2016. However, prime rent is under pressure in the short term as supply increased due to a number of completions in the last 12 to 18 months, and demand did not quite keep pace. Due to high investor demand for core high street properties, prime capital values are forecast to grow by almost 16% until 2021, according to PMA. All in all, retail will benefit from the increasing population and good economic conditions.

Industrial

The metropolitan area of Frankfurt is one of the major logistics hubs in Germany due to its location within Europe and its excellent transportation links. According to PMA, prime logistics rents stood at EUR 6 per square metre in 2016 and are forecast to grow only marginally despite the scarcity of newly built, modern logistics properties and increasing demand for quality space. As prime yields are expected to fall further due to growing investor demand for high-yielding real estate product, PMA forecasts prime capital values to grow by 13% until 2021.

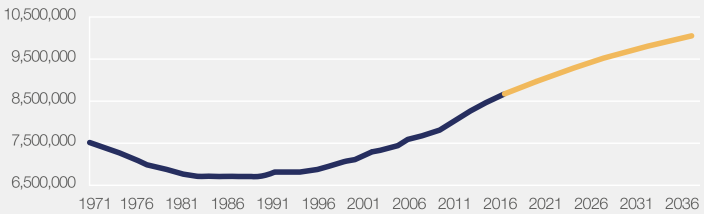
London



London, the capital of England and the United Kingdom, has a history stretching back to Roman times. At its centre stand the imposing Houses of Parliament, the iconic Big Ben clock tower and Westminster Abbey, the site of British monarch coronations. Across the Thames River, the London Eye observation wheel provides panoramic views of the South Bank cultural complex and entire city.

London has a diverse range of people and cultures, and more than 300 languages are spoken in the region. Its estimated mid-2015 municipal population (corresponding to Greater London) was approximately 8.7 million, which accounts for 12.5% of the UK's population and makes London the largest population of any city in the EU.

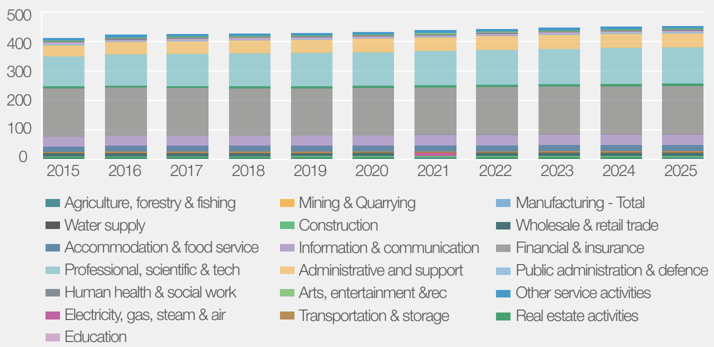
Figure 1: London population, 1971-2036



Source: Oxford Economics

Its urban area is the second-most populous in the EU after Paris, with about 9.8 million inhabitants at the 2011 census. The metropolitan area is one of the most heavily populated in Europe, with approximately 13.9 million inhabitants, while the Greater London Authority states that the population of the city region (covering a large part of the southeast) is 22.7 million.

Figure 2: London employment assuming hard Brexit



Sources: Oxford Economics, Savills Investment Management

From a long-term investor's point of view, the London real estate market provides an attractive entry point, accentuated by price discounts from the devaluation of the pound. However, it is important that investors understand the implications of Brexit for different sectors and industries in order to capitalise on opportunities.

Office

London has the largest and the most liquid office market in Europe. The market is comprised of the City of London, the West End, Canary Wharf and the fringe markets. In the short term, we expect the City market to remain under pressure given the risks surrounding financial services passporting rules after Brexit. Canary Wharf and the West End are in part insulated by limited supply and more diversified occupiers. Prime office rents stood at GBP 70 and GBP 120 per square foot in the City and West End, respectively, with net initial yields of 4.25% and 3.25%, respectively, at the end of Q3.

Retail

London hosts a number of top UK shopping locations. The most popular destinations are Oxford and Bond Streets, Covent Garden, Knightsbridge and in-town shopping centres. London retailers have experienced a boon period following the Brexit referendum: weak sterling and an increased number of tourists have resulted in a significant increase in trading volumes. London prime Zone A high street shop rents stood at GBP 2,200 per square foot, with prime retail yields at 2.5% at the end of Q3.

Industrial

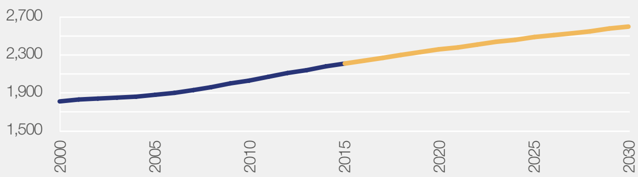
Demand for logistics space around London is at unprecedented levels due to the growth in E-commerce and last-mile fulfilment. Retailers, supermarkets and third-party logistics providers are all very active, with much of the demand still focused on modern, big-box space. Prime logistics rent stood at GBP 14 and GBP 11 per square foot in London Heathrow and London Croydon, respectively, with net initial yields of 4.25% and 4.75%, respectively, at the end of Q3 2016.

Stockholm

Stockholm, the capital of Sweden, encompasses 14 islands and more than 50 bridges in an extensive Baltic Sea archipelago. The cobblestone streets and ochre-coloured buildings of Gamla stan (the old town) are home to the 13th-century Storkyrkan Cathedral, Kungliga Slottet Royal Palace and Nobel Museum, which focuses on the Nobel Prize, and some of Europe's leading universities, such as the Stockholm School of Economics.

The vast majority of residents work in the service industry, which accounts for roughly 85% of jobs. The last decade has seen a significant number of jobs created in high-tech companies, and large employers include IBM, Ericsson and Electrolux. A major information technology centre is located in Kista, in northern Stockholm.

Figure 1: Total population (thousands, 2000-30)



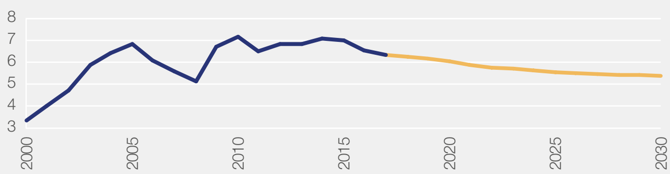
Source: Oxford Economics

Stockholm is Sweden's financial centre. Major Swedish banks — such as Nordea, Swedbank, Handelsbanken and Skandinaviska Enskilda Banken — are headquartered there, as are major insurance companies Skandia, Folksam and Trygg-Hansa. Stockholm is also home to Sweden's foremost stock exchange, the Stockholm Stock Exchange (Stockholmsbörsen).

Additionally, about 45% of Swedish companies with more than 200 employees are headquartered in the capital. Stockholm County is ranked as the 10th largest visitor destination in Europe, with more than 10 million commercial overnight stays per year, according to the Stockholm Business Region.

According to Oxford Economics, Stockholm's population is expected to grow from 2.2 million in 2015 to 2.6 million in 2030, a 17% increase in absolute terms. The economy is expected to outperform its national growth rate, with an average growth of 2.5% per annum over the next 10 years.

Figure 2: Unemployment rate (%, 2000-30)



Source: Oxford Economics

Stockholm's population is expected to increase by 17% in absolute terms through 2030, and its economy is expected to outperform its national growth rate. Population growth and rising disposable income continue to fuel the city's positive annual retail growth, and Stockholm County is ranked as the 10th largest visitor destination in Europe.

Office

The Stockholm office market remained one of Sweden's best-performing occupational markets in 2016. Despite strong take-up, the development pipeline remains modest, with few speculative projects expected to start in the near future. However, according to PMA, office stock is expected to increase by 10% over the next five years. We expect demand-supply imbalance to result in further rental growth in 2017, underpinning capital values. PMA also projects that over the next five years, total return is expected to average 3.0% per year, and most of the return is expected to be front loaded.

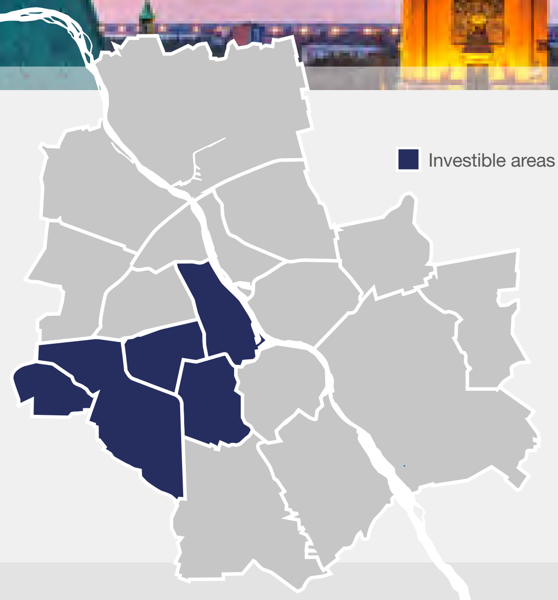
Retail

The upmarket end of the Stockholm shopping scene is located where Norrmalm meets Östermalm, in the mainland part of town. The adjacent streets of Mäster Samuelsgatan and Biblioteksgatan are a hub for mid-range and designer Swedish brands. Stockholm's retail market has enjoyed positive annual growth for 18 consecutive years, fuelled by both steadily increasing population growth and rising disposable income. Demand drivers continue to evolve, with national retail chains looking for opportunities to consolidate their store portfolios, while café, restaurant and convenience store operators are still looking for new space. According to PMA, prime high street shop rents now exceed SEK 15,000 per square metre per annum, with rents on average expected to rise further by 3.1% per year over the next five years. Prime yields continue to drift lower, and at the end of Q3, Stockholm prime shop yields stood at 3.5%.

Industrial

The rapid growth of the E-commerce sector and improving supply-chain efficiency continues to drive occupier demand for large, modern logistics platforms in northern and western submarkets. Speculative development remains limited, while build-to-suit is still the main source of new supply. Prime logistics rent stood at SEK 1,050 square metres per annum at the end of Q3. Prime Stockholm logistics rents are expected to increase by 1.0% per year over the next five years, according to PMA. Moreover, strong investor demand is expected to add downward pressure on prime yields over the coming period. Prime Stockholm yields stood at 6.0% at the end of Q3.

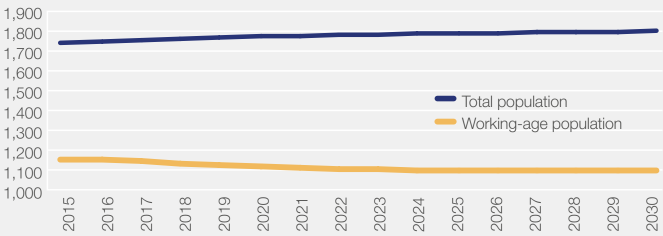
Warsaw



Warsaw, the capital and largest city of Poland with more than 1.7 million inhabitants, is a major cultural, political and economic hub in Central and Eastern Europe. In 2012 the Economist Intelligence Unit ranked the Polish capital as one of the most liveable cities in Central Europe. The population of both the core city and greater metropolitan area — which has more than 3.1 million inhabitants — are expected to grow by 3% until 2030, according to Oxford Economics.

Warsaw's overall broadly diversified economic structure is based on fast-moving consumer goods manufacturing, metal processing, steel and electronic manufacturing and food processing. The city is likewise an important centre for research and development, business processes and information technology outsourcing as well as the Polish media industry.

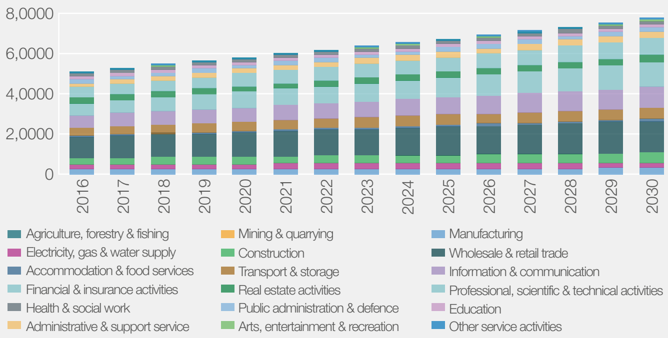
Figure 1: Warsaw population (thousands, 2015-30)



Source: Oxford Economics

Warsaw's widely varied architecture reflects the changes in its lively, often turbulent history: 84% of the city had to be reconstructed after World War II. In recent years, it became one of the cities with the highest number of skyscrapers, together with London, Paris, Barcelona and Frankfurt.

Figure 2: Gross value added by sector (EUR billion, constant 2010 prices)



Source: Oxford Economics

Prime logistics rents in Warsaw remained widely stable in 2016, and the city's shopping centre market is becoming increasingly matured and saturated. Warsaw's high street retail market is hampered by lack of high-quality, multi-storey properties. Demand for prime office space remains high as the supply of high-yielding alternatives continues to be limited.

Office

Warsaw's main office areas are its city centre, central business district and Upper South and South West zones. 2016 was a year of transition for the Warsaw office market: demand-side fundamentals remained strong and prime rents were stable. However, oversupply in certain parts of the market is expected to have a negative impact on headline rents. We expect the demand-supply imbalance to stabilise over the coming years as the development pipeline slows and office demand is forecast to remain stable. Investor demand for prime product remains high due to limited supply of high-yielding investment.

Retail

Warsaw's purchasing power is 68% above the national average. The city's shopping centre market is becoming increasingly matured and saturated. Compared to shopping centres or other major European cities, high street shops have only marginal relevance. This is mainly due to the limited supply of high-quality, multi-storey high street properties. But the city has large potential to develop its high streets, including Nowy Swiat and Chmielna Streets as well as those of Three Crosses Square.

Industrial

Warsaw remained the most active industrial and logistics market in Poland, with the highest stock and take-up in 2016. However, the city has a below-average logistics catchment population within a three-hour drive compared to other major European hubs. Due to high demand for modern logistics space, vacancy — particularly in suburban markets (e.g., the South West zone) —significantly dropped below 10% while it remained above this mark in the inner-city submarket, according to JLL. As supply and demand was balanced, prime rents remained widely stable.

Austria

Colliers International estimated that there is a need for new logistics space of around 1 million square metres in the Vienna region due to outdated stock.

On 4 December 2016, Austria elected liberal-minded, pro-European Alexander Van der Bellen for president and therewith rejected voting in the EU's first far-right head of state. Annual retail sales are expected to grow by 1.4% year on year for the next 10 years, according to Oxford Economics, whereas consumer spending is expected to grow by 1.6% during the same period.

Compared to 2015, Austria's investment market lost momentum, largely because of fewer portfolio transactions and restraint from cross-border investors. However, the positive outcome of the presidential election is expected to boost investment volume over the coming quarters.

Against a backdrop of slightly improved international indicators, economic development accelerated in the second half of 2016, but to a rate below the EU average.

According to CBRE, prime yields have been falling since a cyclical peak in 2009 and stood at 4.05% for prime offices and 3.50% for high street retail properties in Vienna at the end of Q3, down 10 basis points compared to Q2. Shopping centre and retail park yields were 4.15% and 5.75%, respectively, whereas industrial and logistics yields stood at 5.85%.

Office

Vienna's office market is attractive to international investors. Leasing activity was high due to a number of leases on office space greater than 5,000 square metres.

The low number of completions combined with high demand resulted in a further decrease in office vacancy. According to CBRE, the vacancy rate is forecast to fall below 5.4% from 2017 due to the high demand and pre-let figure of around 50% for buildings under construction that will be delivered to the market in 2017.

Prime office rents have been increasing since they bottomed out in 2009. Prime monthly rents averaged EUR 26 per square metre in core central business district locations, according to CBRE. Due to increasing scarcity of office space, rental growth in secondary and tertiary locations gained momentum, too.

Retail

The retail sector was supported by low inflation rates and improving economic conditions during 2016. Annual retail sales are expected to grow by 1.4% year on year for the next 10 years, according to Oxford Economics, whereas consumer spending is expected to grow by 1.6% during the same period.

Prime high streets as well as shopping centres experienced good demand from potential tenants as consumer demand and the number of international occupiers looking for new stores remained high. Development activity has been muted thus far, meaning there are currently no signs of oversupply.

However, despite high demand, rental rates remained stable. According to Cushman & Wakefield and CBRE, prime high street monthly rents in Vienna's prime location were EUR 300-310 per square metre compared to EUR 110-130 in Graz, Innsbruck, Linz and Salzburg. Prime shopping centre monthly rents across the country were EUR 115 per square metre versus EUR 14 for prime retail park monthly rents.

Industrial

The most in-demand industrial and logistics hubs besides Vienna are the southern environs of Salzburg, Graz's metropolitan area and Cargo Center Graz and the industrial zone around Wels, Linz and Steyr.

In 2016, the occupier market profited from increasing demand from online retailers and was generally dominated by owner-occupiers.

Little speculative development over the course of 2016 made modern supply a bottleneck. Colliers International estimated that there is a need for new logistics space of around 1 million square metres in the Vienna region due to outdated stock.

According to Cushman & Wakefield, prime monthly rents remained stable at EUR 4.75 per square metre in Vienna, EUR 4.25 in Innsbruck and EUR 4.00 in Graz, Linz and Salzburg. Demand and supply are forecast to remain stable in 2017.

Recommendation: focus on prime properties in new developed business areas in Vienna, selected retail parks, shopping centres, prime high streets and prosperous industrial and logistics hubs.

Belgium

Demand for logistics and warehouse space remains robust due to the growth in E-commerce, improvements in supply chain productivity and the country's central location.

According to the European Commission, Belgium's economy is projected to grow by 1.3% in 2017 and 1.5% in 2018. The unemployment rate dropped below 8% in October and is expected to fall further due to the government's so-called 'tax shift' reform, which reduces unit labour cost. However, the youth unemployment rate remains persistently above 20%, which is linked to differences in educational background.

Inflation picked up in 2016 following wage growth and the rise of consumer taxes, exceeding the Eurozone average. In 2017, inflation is expected to move clearly towards the EU target. Consumer confidence is on a slight upward trend, mostly as a result of a more positive wage outlook and lower unemployment rate.

The budget deficit is expected to expand to 3% in 2016, but the 2017 government budget will be cut to meet the EU deficit target. In light of the 2019 federal elections, the government might be cautious to initiate any unpopular measures that the budget cuts might require. The public debt to GDP ratio stands at 106%, well above the EU reference rate of 60%.

We envision possible income opportunities in the logistics sector as E-commerce grows and prime and flagship stores play an increasing showroom and marketing role. The office market looks positive due to strong public sector activity, but corporate demand has weakened.

Office

Total take-up volumes in 2016 outperformed the five-year average as the public sector did well. But recent downsizing announcements by financial and insurance firms such as AXA and ING have undermined corporate office demand.

Office-based employment is projected to grow at a steady pace over the next few years, but uncertainty around Brexit could also have an impact on the Belgian economy through spillover effects on trade and investment and reduced business travel.

Limited supply and stable demand for prime stock in the core districts will put upward pressure on rental values, while non-core locations will experience weaker demand. Further yield compression in the Brussels office market is expected through 2021.

Retail

According to Eurostat, Belgium retail sales declined by 1.9% year on year in October 2016. The drop in retail spending was mainly brought about by lower consumer confidence following corporate restructuring plans and the government-enforced wage indexation freeze.

The robust pipeline for large shopping centres in the Brussels region combined with relatively weak retail spending growth means that rental values are expected to grow only modestly in the next few years. Increasingly strict urban planning controls in Flanders compared to Brussels and the south mean that new retail capacity in Antwerp is low. As a result, retail rental growth in Antwerp is expected to exceed that of Brussels.

In terms of investment, yield compression is expected to continue in all retail segments due to low interest rates and the amount of capital directed at prime property.

Industrial

The performance of the industrial sector remains positive despite the challenges facing the Belgian economy. Business confidence is expected to continue to regain strength after a number of industrial firms including Caterpillar, SAS Automotive and Douwe Egberts announced job cuts in earlier 2016.

Demand for logistics and warehouse space remains robust due to the growth in E-commerce, improvements in supply chain productivity and the country's central location. Modern prime space is limited, and speculative development is constrained in what is almost entirely a build-to-suit market. This places upward rental pressure on primary locations in the major logistics concentrations along the Brussels-Antwerp and Antwerp-Ghent axes.

Recommendation: focus on logistics along the Brussels-Antwerp and Antwerp-Ghent axes and offices in Brussels central business district.

Denmark

The Liberal Party–led coalition government with two other centre-right ‘blue bloc’ parties looks weak. Although we don’t expect an imminent failure of the government, the coalition, which does not hold a parliamentary majority, is less likely to last a full term.

According to Consensus Economics, after estimated 0.9% GDP growth in 2016 Danish economic growth is expected to accelerate to 1.6% in 2017-21. In our view, downside risks stem from the indirect fallout of the UK’s vote to leave the EU.

Office

Office occupational demand is expected to improve in line with accelerating economic growth. However, most of the demand is focused on the Copenhagen central business district. We expect prime office rents to increase gradually.

Some occupiers are investigating options in the newer parts of Copenhagen where larger office blocks are being developed. A good example of this is Vestas, which is leasing 5,000 square metres from Solstra in Ørestaden.

Retail

Prime retail pitches in Copenhagen, such as Strøget and Købmagergade, continue to see strong demand from retail occupiers. Due to limited availability, prime rents have seen a steady increase. Moreover, some retailers are considering alternative sites, resulting in fringe-of-prime high streets performing strongly.

Secondary locations and dominant regional shopping centres are also recording healthy and steady levels of demand, especially from newcomers entering the Danish market.

Core high street locations will continue to be in high demand for both occupiers and investors. This is expected to add downward pressure on prime yields.

Industrial

Take-up of industrial space remained stable in 2016. End-users continue to play a dominant role in acquiring industrial space for occupation. Supply of Grade A space remains limited, resulting in increasing prime logistics rents in certain parts of the market.

We expect the upward rent momentum to continue over the coming year as relatively healthy demand continues to face a limited pipeline. Appetite for prime grade investment assets remains strong and continues to support investment market momentum.

Recommendation: focus on fringe-of-prime high streets in Copenhagen and last-mile urban logistics assets.

Some retailers are considering alternative sites, resulting in fringe-of-prime high streets performing strongly.

Finland

Vacancy in the Helsinki Metropolitan Area, the most popular destination for logistics occupiers, remained relatively stable at around 7.0%.

Fault lines within Finland's centre-right coalition government make it less likely to see out its full term to 2019. However, the government remains focused on economic growth, market competitiveness and public debt reduction.

Domestic demand in Finland has strengthened, but the external trade environment may become less favourable, namely if the UK has to deal with a untidy Brexit negotiation and the Chinese economy weakens further.

Office

Office occupier demand continued to improve in 2016. Although we expect the momentum to continue in 2017, overall vacancy remains relatively high.

Occupiers remain focused on modern buildings in Helsinki central business district (CBD), but supply at this end of the market is declining. Moreover, there are clear signs that the demand for good-quality secondary office properties is also rising. In our view, the current market conditions are supportive of rental growth.

Investor demand remains strong for prime, well-let assets, although demand for non-core assets is also improving.

Retail

Prime high street retail and shopping centre locations continue to see steady occupier demand, with a clear focus on units along the key high streets in Helsinki. Prime rents remain unchanged across all retail segments, both in prime and secondary retail locations, but there may be some uplift as the year progresses, demand strengthens further for key thoroughfares and the availability of suitable available units declines further.

In our view, the retail property market is expected to remain relatively stable, but with a positive outlook. Occupational and investor demand is expected to improve in 2017.

Industrial

Third-party logistics companies remain the most active occupiers to take new logistics space. Most of the activity in 2016 was focused on consolidation strategies.

Positive absorption of space remains limited considering the current market environment, with a notable decline in expansion-driven demand. As a result, vacancy in the Helsinki Metropolitan Area, the most popular destination for logistics occupiers, remained relatively stable at around 7.0%.

Challenges in the industrial market are expected to persist until exports regain some momentum. The fundamentals underpinning the industrial real estate sector will remain stable, with further occupier consolidation dominating activity going forward.

Recommendation: focus on Helsinki CBD offices, prime high street shops and dominant shopping centres.

France

French GDP growth decelerated in 2016 and is expected to remain below the European average in 2017. The medium-term outlook for France depends on the 2017 elections and on whether the incoming government strives for further structural reforms or trims them back.

Current polls indicate that Marine Le Pen, who heads the populist Front National party, will reach the second round of the presidential election, but she is less likely to win. Related uncertainty could potentially affect some investment decisions.

We expect a conservative government to implement accelerated reforms, which may curb GDP growth in the short term but would have a positive economic impact over the longer term.

However, some unfavourable regulatory and tax changes are resulting in headwinds for domestic real estate markets, limiting investors' ability to achieve uplifts in rental values or increase tax bills for a number of those investing through Luxembourg structures.

The Grand Paris infrastructure project is expected to improve accessibility to the southern fringe areas of the city.

Office

Demand for office space hit a record level in 2016, led by Lyon and Paris La Défense. Vacancy rates decreased, whereas prime headline rents started to increase in Paris central business district but remained unchanged in the main regional markets. Tenant incentives still remain significant but seem to have stabilised in Paris.

On the back of steady economic growth, demand prospects are expected to improve for the French office sector, although emerging supply may curb rental growth.

We expect investment demand to remain strong and prime office yields to fall further in 2017.

Retail

Retail sales in Paris moderated following terrorist attacks there, and retail sales growth is forecast to remain subdued in the years ahead. The gradually improving labour market is supportive, but higher inflation in 2017 will curb the increase of real wages.

The occupational market for prime high street locations remains competitive, with new entrants and international retailers targeting the best units with regard to footfall and visibility. Hence, prime retail rents have remained stable in Paris and some major markets but have declined in others.

Overall, however, we continue to believe in the long-term attractiveness of Paris as a top global destination.

Industrial

Domestic logistics market demand is boosted by the growth of E-commerce and improving supply-chain efficiency in the retail distribution sector. Occupier and investor demand is expected to remain healthy in 2017.

Despite developers responding to this strong demand, speculative developments are quickly absorbed and supply of modern logistics space will remain well below what is needed.

Rents are expected to slowly improve in most in-demand locations, and the lack of investment opportunities will continue to place downward pressure on yields in 2017.

Recommendation: focus on the logistics sector, especially in the main North-South corridor, as well as urban logistics around Paris and prime offices in well-connected areas in the Western Crescent.

Demand for office space hit a record level in 2016, led by Lyon and Paris La Défense.

Germany

Germany's role in the EU has been gaining importance, particularly in the period following the Brexit vote. Employment levels are at a record high, business confidence is good and political backdrop is stable. Retail sales and consumer spending have been supported by real wage growth.

After a record year in 2015, the investment market remained lively in 2016. According to JLL, around EUR 53 billion were invested in commercial properties across Germany — a 4% decrease compared to last year's level.

In our view, investment volume is held back due to lack of availability of assets to sell and a lower number of large-scale portfolio deals. In particular, there is a scarcity of new or fully renovated properties, which will limit investment volume growth further.

Also according to JLL, prime yields continue to harden and stood at record lows at the end of 2016. Prime office net yields stood at 3.6%, whereas prime shop and prime logistics net yields were 3.5% and 5.0%, respectively.

Office

The office leasing market is benefiting from economic conditions and higher office employment. According to JLL, take-up volumes reached almost 4 million square metres, reflecting an increase of more than 9% compared to the previous year. 2016 was a record year, with total office take-up the highest ever for the Big 7 German cities.

Office vacancies have been declining since their peak in 2012, and the vacancy rate fell below the 6% threshold. Despite the highest construction levels since 2009, supply is falling further. Only 16% of the office spaces due for completion are still available for rent.

Strong demand and shrinking supply led to both prime and average rents rising further in most of the Big 7 markets. We expect prime rents to rise more in Munich, Berlin and Cologne in 2017 and 2018.

2016 was a record year, with total office take-up the highest ever for the Big 7 German cities.

Retail

German consumer confidence and retail sales have been supported by positive economic conditions, record high employment, real wage growth and low inflation. According to Oxford Economics, German retail sales are expected to increase on average by 0.9% year over year throughout the next 10 years.

German high streets are currently in a state of transition as a number of well-known retail chains such as Pohland, Zero, Wöhrl, SinnLeffers and Strauss Innovation have gone into administration and closed most of their stores.

A number of retailers are optimising their store networks, closing down unprofitable physical stores and focusing on mono-label or flagship stores in the best locations on high streets. Furthermore, they are reducing their space requirements.

Physical stores will remain a key point of contact between retailers and customers. In particular, medium-sized regional centres and major cities with good economic foundations and socio-demographic parameters are better able to withstand E-commerce pressures.

Modern, newly developed or refurbished retail parks with food anchors are in high demand for both price-orientated retailers and investors. These retail parks benefit from the increasing price sensitivity of tenants and consumers, and they can be used as click & collect points for online orders.

Industrial

2016 is expected to be a record year for logistics take-up. A number of occupiers are pre-leasing projects given limited availability of ready-to-rent space.

Occupier demand is split across the wholesale and retail, manufacturing and third-party logistics sectors. E-commerce is expected to remain one of the drivers of demand for logistics space in the future.

The tight margins in the logistics sector are limiting rental growth for traditional distribution centres and mega-sheds, whereas tenants are willing to pay higher rents for urban logistics such as cross-docking facilities. Time will tell if multi-storey urban warehouses will become more than a niche product in the German market.

Recommendation: focus on repositioning assets in the Big 7; also focus on core offices and retail in larger, growing secondary cities and core logistics and cross-docking facilities. In B to D cities, focus on newly built or refurbished assets, core offices, well-established retail parks in integrated locations and core high street assets. Be prepared to pay higher prices to secure core properties. Consider moving up the risk curve by accepting shorter leases on core properties in core locations, and consider value-add properties in core locations.

Italy

On 4 December, Italy voted against Prime Minister Matteo Renzi's proposed constitutional change to the Senate. Facing a strong margin for 'no change' at around 60%, Renzi announced his resignation. While we don't expect a snap election, a new caretaker government would have to deal with a highly fragmented parliament.

Although investors largely priced in a 'no' outcome, the Italian financial system remains fragile, and the banking sector could take the biggest hit: the referendum outcome is expected to jeopardise plans by Monte dei Paschi di Siena, Italy's struggling third-largest bank, to raise up to EUR 5 billion.

Office

According to PMA, a 'no' vote is expected to impact business confidence, which in turn could result in firms stalling their investment and hiring plans, placing further pressure on Italy's already fragile economic recovery.

Although recent labour market data suggest that the Jobs Act, a comprehensive labour market reform effort introduced in 2014, has enjoyed some success, its effectiveness appears to have diminished in 2016: following a significant reduction in tax breaks granted to employers hiring workers on a permanent basis, the hiring rate has slowed. Local commentators argue that these incentives were the key driver of employment growth last year.

Milan has historically out-performed the national economy, and office take-up on a rolling annual basis to Q3 is significantly above the city's long-term average. While the occupier market has certainly enjoyed an uptick in activity, closer inspection of recent demand indicates that take-up is being driven primarily by relocation (to better and more efficient buildings) and consolidation rather than net absorption.

Milan has historically out-performed the national economy, and office take-up on a rolling annual basis to Q3 is significantly above the city's long-term average.

Retail

Although the retail market backdrop is expected to remain generally stable across Italy, rental growth is not expected in the short term. Occupier demand remains polarised, with a steady demand for the top cities, such as Milan, Rome, Florence, Venice and Turin. Although plans for space expansion are limited, some operators are willing to pay higher prices in order to secure prime locations. On the other hand, mass-market operators remain cautious.

In the shopping centre segment, rents continue to hold in prime schemes, while secondary locations are suffering.

Investor interest is expected to remain high and yields are mostly anticipated to remain stable for prime assets.

Industrial

The Italian logistics market continues to report stable occupier demand, which is focused on Grade A units in Lombardy. The Emilia-Romagna region follows, with take-up mainly concentrated in the provinces of Bologna and Piacenza.

The Grade A vacancy rate is currently very low, and build-to-suit projects are experiencing a positive trend.

The majority of demand arises from the retail sector, especially from food companies requiring temperature-controlled warehouses and third-party logistics providers benefiting from E-commerce growth.

Recommendation: proceed with caution, as we suggest core-only strategy and a 75 basis points per annum country risk premium over the five-year investment hold period. In terms of sectors, focus on Grade A logistics units and prime retail parks.

Netherlands

After a double dip, 2016 marked a turning point for the Netherlands economy. GDP is growing moderately but steadily, and consumers are benefiting from rising employment, higher wages, lower inflation and tax reductions. Additionally, the improving housing market, supported by low mortgage rates, is helping some households out of negative equity.

Consensus Economics, among other sources, expects 2017 GDP growth to slow to around 1.5%, mainly due to slower investment and export growth. As a small open economy that is highly integrated with the global economy, downside risks emanate mainly from Brexit.

The March 2017 general elections pose a political risk due to rising populism. Opinion surveys show Geert Wilders's populist Party for Freedom (PVV) in the lead but likely to miss out on an absolute majority. Whether the PVV will be part of the future government is still uncertain.

Office

The office markets still show high vacancy rates, but the situation is forecast to improve. Conversion activity remains brisk, and new developments are being quickly absorbed.

Occupiers are still trying to lift space efficiency, focusing on modern, multifunctional space in attractive central locations. Availability in these areas is expected to further tighten, with Amsterdam continuing to lead the cycle. But positive signs are also emerging in central locations in Utrecht and The Hague, whereas other major cities and secondary locations are still lagging. Further hardening of yields is expected given the weight of capital targeting the office sector.

Retail

Several structural changes are shaping the retail market. The increased presence of international retail chains and discounters and the rising share of online sales led to an erosion of the mid-market segment and a general increase in bankruptcies and voluntary closures in 2016.

There is high competition between occupiers and investors for the best properties in the best high street locations, with Amsterdam remaining a top target. Besides the high street and luxury segments, smaller centres with a strong food anchor are expected to perform well. Investment demand is expected to remain steady, keeping yields at record lows.

Industrial

Logistics markets have been booming since 2015, and take-up has remained lively. Demand drivers include the improving economy, E-commerce and the related restructuring of logistics networks.

Modern large space remains scarce, and occupiers are turning to build-to-suit solutions, although speculative developments are slowly rising. Despite this trend, rents are expected to grow only moderately, trapped between low availability and the low-yield environment. Yields are expected to further harden in 2017 due to strong investor demand.

Recommendation: focus on urban logistics and modern logistics units in established locations with good transport links, on prime retail pitches in cities or locations with positive demographics and economic prospects or on smaller shopping or neighbourhood centres with a strong food anchor. Watch the positive trends in the office markets, especially central locations with good access to public transport. Avoid prime high street shops in Amsterdam.

Besides the high street and luxury segments, smaller centres with a strong food anchor are expected to perform well.

Norway

Although the centre-left Labour Party remains the largest in the parliament, Norway is governed by a centre-right coalition consisting of the Conservative and the Progress Parties. We expect the government to remain in its existing form until the next parliamentary election, set for 11 September 2017.

Supported by household spending, fiscal stimulus and higher oil prices, economic growth is expected to pick up to an average of 1.8% per year in 2017-21, from a low of just 0.8% in 2016.

Office

While occupiers remain active — both the level of active requirements and registered take-up improved over recent quarters — the impact of lower oil prices continues to weigh on those districts most exposed to the oil sector.

Lysaker, Fornebu, Asker and partly Skøyen in the western fringe have begun to see a rise in availability following consolidation measures taken by some occupiers. However, other areas — the Oslo central business district in particular — continue to enjoy solid fundamentals and attract strong interest.

The pipeline in Oslo continues to be slim and is decreasing. Similarly, the proportion of pre-committed space in the pipeline has been gradually declining as occupiers get increasingly wary of any forward commitment in the current environment.

Retail

Demand for shops on key high streets across Norway remain strong, particularly from international brands that are keen to start trading in the Norwegian market.

With robust demand for prime pitches, retailers are looking for opportunities on streets adjacent to the main ones.

The shopping centre market is relatively stable, but international demand is more selective in relation to the layout and tenant mix in potential sites. Prime high street and shopping centre rents remained stable in 2016, but are expected to rise in 2017.

Industrial

Modern logistics schemes with good transportation links continue to be the most sought after by occupiers, while the third-party logistics segment continues to be the most active, supporting take-up and new requirements.

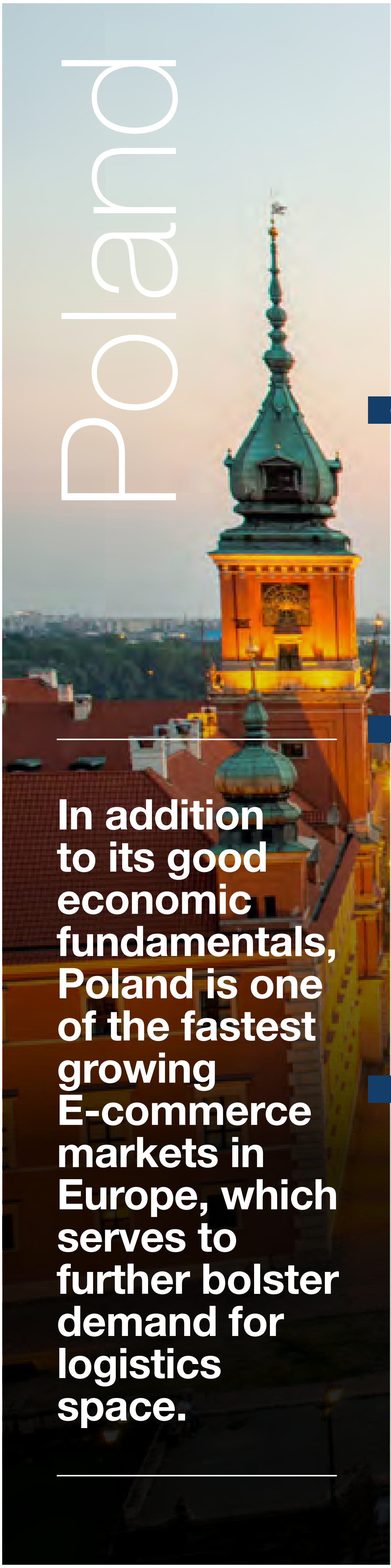
There is also good demand linked to occupiers servicing E-commerce in the core locations such as E6 and Alnabru. However, persistently tight supply continues to hamper overall letting volumes in these areas and to put upward pressure on rents.

We expect the core logistics assets to continue to remain in demand by investors.

Recommendation: focus on fringe-of-prime high street shops and last-mile urban logistics units.

With robust demand for prime pitches, retailers are looking for opportunities on streets adjacent to the main ones.

Poland



In addition to its good economic fundamentals, Poland is one of the fastest growing E-commerce markets in Europe, which serves to further bolster demand for logistics space.

The Law and Justice (PiS) party's interventionist economic model and nationalist stance have hampered relations with the EU. More government spending may result in short- to mid-term growth, but could raise questions about long-term fiscal sustainability.

After a record year in 2015, the Polish investment market remains on a growth path. In the first nine months of 2016, more than EUR 3 billion were invested in commercial properties across Poland, according to Real Capital Analytics. Thus, prime yields in all property sectors strengthened further across the country.

While the capital city has seen strong investor demand over the past few years, investors have slightly diverted their activities due to high levels of new supply and decreasing office sector rents.

From a long-term investor's point of view, the Polish market generally looks attractive despite political tension. Poland's economic growth is expected to outperform the EU and its biggest member states over the next five years. This should have a positive impact on business and consumer confidence and stimulate demand in all sectors.

Office

Due to good economic fundamentals, both the Warsaw and regional office markets showed sound performance and high levels of leasing activity through the end of Q3.

According to Savills, almost 440,000 square metres of new office space were delivered to the regional office markets in 2016. Since demand has kept pace, rental growth has been visible in some of the regional markets, such as Tricity and Lodz.

In Warsaw more than 450,000 square metres of office space were delivered to the market in 2016, exceeding the long-term average by 101%, according to Savills. Thus, prime rents in the capital city remain under pressure.

Despite healthy demand, rising development and vacancy rates are nonetheless major threats for the Warsaw office market. Rents will remain under pressure and incentive levels are expected to rise in 2017. From 2018, rents should bottom out and then slightly increase in the following years.

Retail

Supported by good economic conditions, an improving labour market, growing employment and low inflation, consumer confidence in Poland has been rising since mid-2012. Retail sales are expected to grow by 3.1% year over year for the next 10 years, according to Oxford Economics.

The Polish shopping centre market is on the move as traditional schemes are no longer sufficient for the modern consumer. New developments contain more space for leisure, food and social interaction, offering a more enhanced consumer experience.

Compared to shopping centres and other European countries, the relevance of high street shops is marginal and limited to the major city centres of Warsaw, Kraków, Wroclaw and Poznan. In our view, further maturity of the Polish retail market could lead to high streets becoming more important in other agglomerations, too.

Besides domestic investors, German, US and UK investors in particular are buying Polish retail properties. As there is a scarce availability of prime product, investors are looking to secondary locations.

Industrial

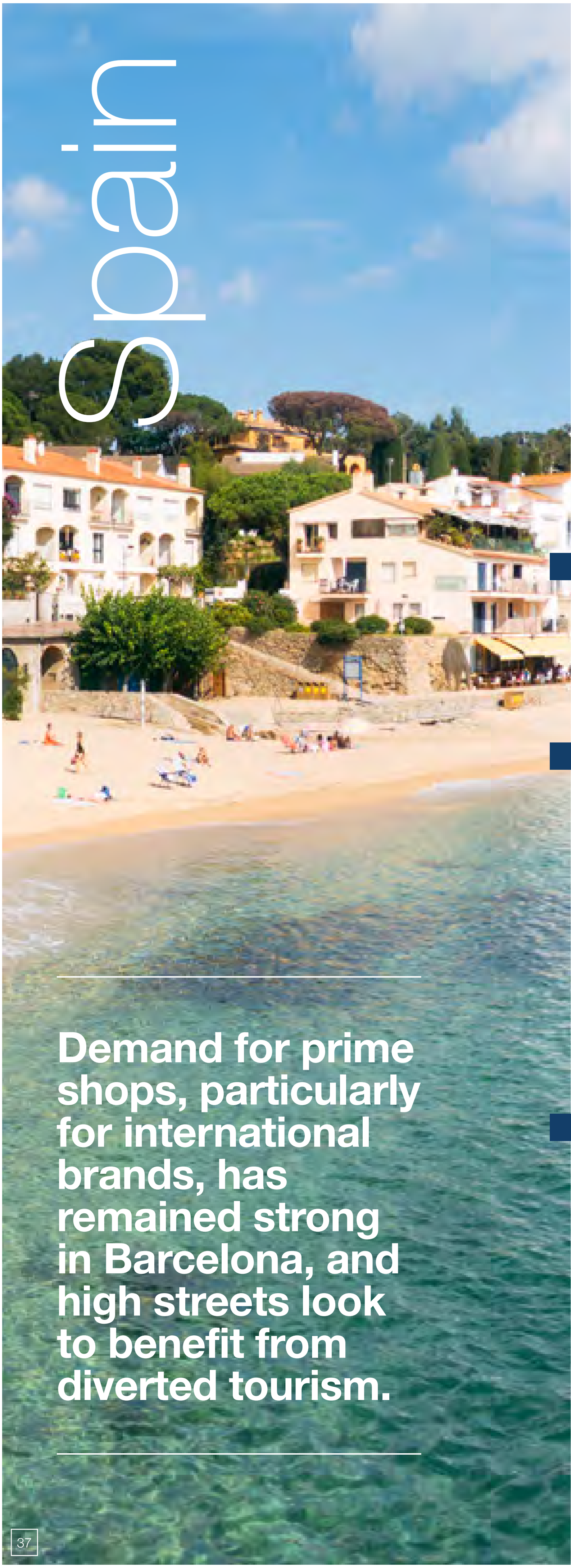
Leasing activity in the Polish industrial and logistics market remains very lively and is expected to have reached a historical peak in 2016. According to JLL, the vacancy rate reached an all-time low of 6% at the end of Q3 2016.

Developers continue to increase their activities: more than 1 million square metres are currently under construction. However, the agricultural land act introduced on 1 May 2016 will limit the availability of land for future development and may result in increasing rental levels.

In addition to its good economic fundamentals, Poland is one of the fastest-growing E-commerce markets in Europe, which serves to further bolster demand for logistics space. However, according to BNPP RE only five investors own more than 50% of the existing industrial supply.

Recommendation: focus on mixed-use high street properties and Grade A offices in prime Warsaw locations with long-term rental agreements and on distribution centres in the top five locations: Warsaw, Katowice, Poznan, Wroclaw and Central Poland (Lodz). Avoid fringe or out-of-town locations in Warsaw.

Spain



Demand for prime shops, particularly for international brands, has remained strong in Barcelona, and high streets look to benefit from diverted tourism.

2016 saw 300 days of political deadlock before the formation of a minority government. Overall, unemployment dropped to just under 20% from more than 26% in 2013, however youth unemployment remained very high in 2016, according to Eurostat, and we expect this to continue into 2017. Spain's struggle with high levels of debt is also forecast to continue into 2017.

While Spain has tended to stick to traditional methods of retailing more so than, say, the UK and Germany, E-tailing is forecast to break the 5% online retail penetration barrier. While this means traditional retailers may struggle, it provides particular opportunity for well-located retail warehouses offering click & collect and showrooming options.

Tourism and demand for international brands may be diverted away from terror-hit countries such as France, Brussels and Turkey, especially benefiting high street retail. In terms of logistics, mega distribution centres and last-mile fulfilment offer particular opportunity. Offices, on the other hand, are looking full in 2017, with an expected increase in completions that will not be matched by GDP and employment growth.

Office

Prime market total returns for Barcelona and Madrid peaked in 2015-16, forecast to tail off to the mid to high teens in 2017.

In our view, 2017 may be a good time to sell and capitalise on returns. Particularly for Madrid there are some concerns about 'grey space' and hidden vacancy.

Retail

Prime retail spaces in Barcelona and Madrid are forecast to exhibit strong rental growth providing income-seeking opportunity, sitting behind only London and Dublin through 2021. Demand for prime shops, particularly for international brands, has remained strong in Barcelona, and high streets look to benefit from diverted tourism.

Prime retail warehouse rental growth is forecast to continue in 2017. We also expect gentle compression of prime yields. According to PMA, rental growth for average shopping centres is forecast at just under 4.9% for 2017, and we expect net initial yields to experience marginal compression. Total returns are forecast to increase in 2017.

Shopping centre completions for 2017 are forecast to be lower than that of 2016, with space doubling in 2018.

Industrial

There is value to be found in logistics with steady rental growth forecast through 2021, including last-mile and mega distribution centres, particularly those that can meet increasing power supply needs. After the flat prime rental growth of 2016, we expect a pick-up of prime rents into positive territory from 2017 onwards.

Increasing retail spending, E-commerce and urbanisation will likely drive some pick-up in the growth of prime capital values, with growth tapering off in subsequent yields.

Recommendation: focus on well-located retail warehouses offering multichannel options, selected high street retail and last-mile and mega distribution centres.

Sweden

Developers are responding to this supply-demand imbalance with 580,000 square metres of new and refurbished office space, to become available between 2016 and 2018.

Despite some downward revisions following the Brexit referendum, according to Consensus Economics Sweden's economy is still expected to grow by more than 2% in 2017.

In the political realm, we expect cooperation between the Swedish Social Democratic Party (SAP) and Green Party to continue despite growing coalition fault lines, serving to undermine the rising far-right Sweden Democrats (SD).

The Swedish krona has weakened, which is expected to lead to higher inflation, but the central bank will likely maintain its easing bias.

Office

Stockholm central business district (CBD) and other popular office zones in the capital continue to experience good occupational demand. Demand for modern offices with good access to public transport is particularly strong.

Steady demand and lack of supply have resulted in prime office rents rising to SEK 7,000 per square metre per annum in the CBD. We expect prime rents to rise further over the short term. Developers are responding to this supply-demand imbalance with 580,000 square metres of new and refurbished office space, to become available between 2016 and 2018.

Office market rental growth is expected to drive capital values going forward, with investor demand remaining strong. Increasing numbers of core buyers looking at the best suburban locations add to pressure on yields. In Gothenburg and Malmö interest is more local and regional, with the market revolving around the big public and private companies active in the region, but investment sentiment remains solid.

Retail

Retail sector demand drivers continue to evolve, with national retail chains seeking opportunities to consolidate their store portfolios. Meanwhile, café, restaurant and convenience store operators are still looking for new space.

The shopping centre segment has been growing slower than other retail areas, although modern shopping centres — such as the Mall of Scandinavia — are still in high demand. Occupiers are also showing good demand for prime high streets, while demand for prime out-of-town space is steady.

Occupier and investor demand for core retail stock is forecast to remain steady in the short term. Good second-tier locations still offer the best prospects for capital growth, and more buyers are expected to target these areas in search of yield and other opportunities.

Industrial

The rapid growth of the E-commerce sector and improving supply-chain efficiency continue to drive occupier demand for large, modern logistics platforms across the country. Retailers and third-party logistics operators are the main sources of demand, with a strong focus on regional locations with good transportation links, such as Borås, Örebro and northern and western submarkets in Stockholm. Gothenburg's harbour area is attracting strong demand.

Occupier and investor demand is expected to remain at current healthy levels, but the lack of large, modern logistics space may limit future activity. The speculative development pipeline is not expected to improve markedly over the coming months, and turnkey schemes will remain the quickest route to new space for many occupiers.

Recommendation: focus on edge-of-Stockholm CBD offices, good second-tier retail locations and last-mile urban logistics.

United Kingdom

In the short period following the referendum, we saw 'animal spirits' drive unprecedented levels of redemptions from daily dealt open-ended property funds. However, much of the earlier commentary now appears somewhat irrational, and a more informed reflection is settling into the market.

In terms of market activity, over the last six months clear signs have emerged from buyers that while secondary or short-term income assets have seen declines, long-term income and annuity-type investments with fixed uplifts are maintaining their value.

From a long-term investor's point of view, the UK market continues to look attractive, accentuated by the devaluation of sterling and some price discounts, meaning entry prices are nearly 20% cheaper than before the referendum for some overseas investors.

Office

Initial concerns that the EU referendum result would lead to a sharp downturn in office activity have proven largely unfounded. According to the Markit/CIPS UK Services PMI, after a sharp drop in July, business activity in the important services sector has rebounded strongly while the manufacturing PMI hit a nine-month high in September. Prime offices in London and regional hubs remain in demand, although at a lower run rate.

Uncertainty is expected to increase in 2017 as Brexit negotiations get under way. Demand is forecast to remain steady in core locations, but activity in second-tier and secondary markets may become more subdued as occupiers and investors re-assess risk.

Retail

According to the BRC Retail Sales Monitor, UK retail sales rose by 1.3% year on year in September 2016. The BRC said retail spending had been boosted by a recovery in consumer confidence to pre–EU referendum levels.

Occupational metrics held firm in Q3 following the EU referendum result. Vacancy rates have continued to decline across all retail sub-sectors. Demand continues to be strongest in large dominant retail centres.

Industrial

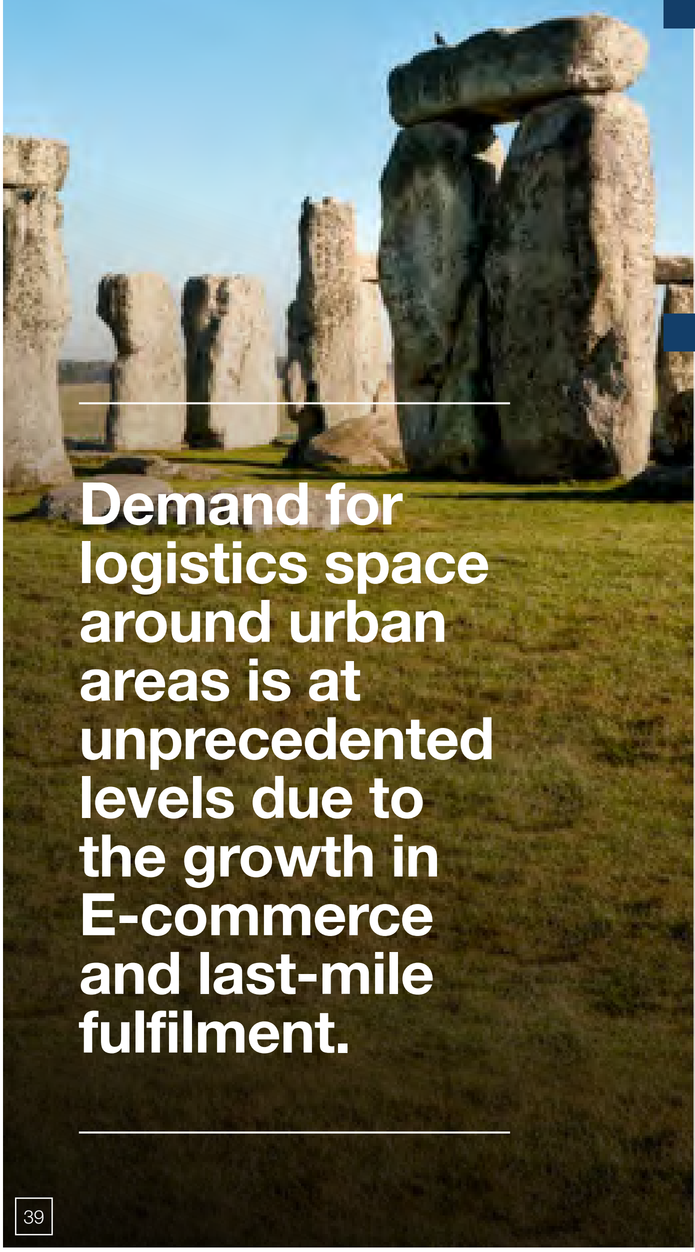
Investor confidence is improving with renewed overseas interest. Increased supply chain costs should filter through to the retail market next year, which may impact retail sales growth in 2017. We encourage targeting locations that are benefitting from a rising number of tourists given the weakness of the pound, and assets that are let on long leases to quality tenants.

There has been little evidence of industrial take-up deals collapsing due to Brexit and, despite some renegotiations, there are still robust levels of occupier and investor demand across most regional locations.

Demand for logistics space around urban areas is at unprecedented levels due to the growth in E-commerce and last-mile fulfilment. Retailers, supermarkets and third-party logistics providers are all very active, with much of the demand still focused on modern, big-box space. There is also good demand for mid-box and cross-dock facilities in prime and second-tier locations, as occupiers look for opportunities to optimise their distribution networks across the UK.

The underlying fundamentals in the industrial sector remain positive, despite the wider economic and political uncertainty generated by Brexit. Supply is expected to gradually improve due to increased speculative development, although strong absorption will ensure that some supply constraints will remain in the best locations.

Recommendation: focus on urban logistics, retail warehouses, mainstream residential and alternatives. Avoid central London offices.



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