savills investment management

Outlook 2018

Navigating the Australian real estate market

Placemaking to enhance returns

Large, stable and liquid: the investment case for the Japan office market

The state of the global listed real estate market

Opportunities in Nordic retail

Generating alpha returns

OUTLOOK 2018

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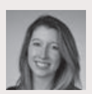

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It was the best OF TIMES...

It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair...[1]

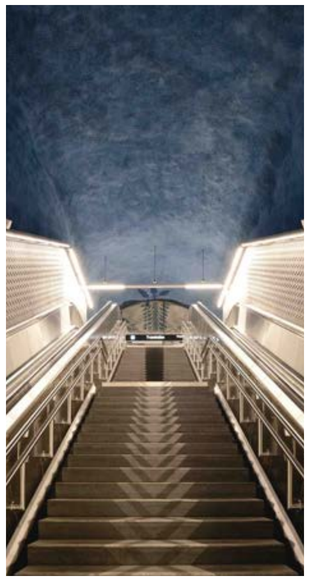
The 28-state European Union is enjoying its strongest growth in a decade, yet the European Central Bank remains concerned that tapering of its quantitative easing programme could derail the region's economic recovery. Average property yield spreads over 10-year government bond yields are close to record highs, yet investors are concerned about rising interest rates. The all-in cost to borrow money is close to record lows for core assets, yet markets are sceptical of increasing leverage. We are living in the most peaceful times since World War II, yet political risk is elevated. If the state of the world could be summarised in a few words, it is fair to say that these are uncertain times.

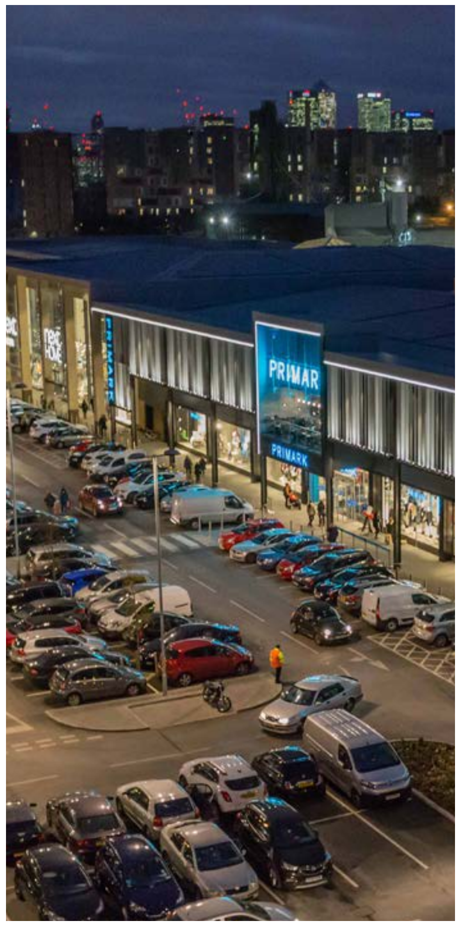
Against this backdrop, it is increasingly important to work with a real estate investment manager with the local knowledge and expertise to help investors navigate these best and worst of times. The Savills Investment Management Outlook 2018 report features a collection of commentary from internal fund managers and research analysts, highlighting the strategies they employ to capitalise on current investment market opportunities.

KIRAN PATEL
Global Chief Investment Officer,
Savills Investment Management LLP

1 Dickens, Charles. *A Tale of Two Cities*. London: Chapman, 1859.

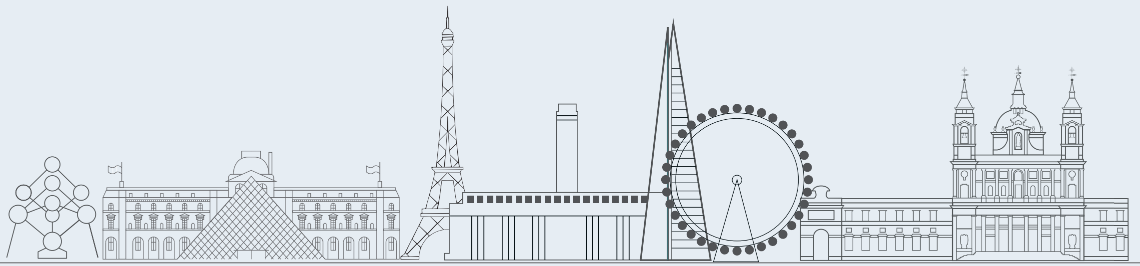
Contents





Key recommendations

EUROPE



Austria

- Focus on Grade A offices with long-term rental agreements in prime Vienna locations close to or integrated with metro line stations in the central business district (CBD) and city centre submarkets.

Benelux

- Target high quality office space in Brussels CBD and Luxembourg city central as well as central locations in the Netherlands, which are attractively priced compared to core European markets and offer further potential for rental growth.
- Look for high street opportunities in selected top 20 Dutch provincial cities such as Eindhoven and Maastricht, which are more attractively priced.

France

- Consider modern distribution centres in established logistics locations with excellent transport links along the north-south logistics corridor.
- Target urban logistics in or on the fringes of Paris as well as other major urban areas.

Germany

- Focus on core office, retail and logistics properties in and close to Germany's biggest conurbations, such as Berlin, Frankfurt, Hamburg, Munich and the Ruhr area.
- Look for investment opportunities in selected growing secondary cities such as Augsburg, Freiburg, Münster and Nuremberg.

Italy

- Grade A office buildings located in Milan CBD, which is benefitting from improving employment. We also see selected opportunities in the fringe of the Milan high street, particularly those high streets benefitting from rising tourism. Our top pick is Italian logistics space around major transport corridors, which is attractively priced compared to other segments.

The Nordics

- Seek retail opportunities in prime locations in Tier 2 cities, preferably in Aarhus, Denmark's second largest city.
- Target food-anchored, medium-sized neighbourhood schemes and regional centres in Sweden.
- Target urban, last-mile logistics facilities in Oslo and Copenhagen and modern premises in the major cities of Sweden, with a focus not only on last-mile solutions but also on mega-distribution centres suitable for large online retailers and third-party logistics providers.
- Target prime office locations in Helsinki CBD, as yields are slightly higher than those of Scandinavian counterparts, and Finland's economy is showing strong recovery.
- Look for opportunities in the Oslo office market, whose economic fundamentals are positive for rental growth.
- In Stockholm, we see potential office space investment opportunities in the fringe-of-CBD or best suburban locations that offer better availability and affordability.

Poland

- Focus on Grade A offices with long-term rental agreements in prime Warsaw locations close to or integrated with metro line stations in the CBD and city centre submarkets.
- Look for investment opportunities in centrally located submarkets in Kraków, Wrocław, TriCity (a metropolitan area consisting of Gdańsk, Gdynia and Sopot), Katowice and Łódź.
- Consider build-to-suit fulfilment and distribution centres on 10+ year leases with good quality covenants and significant tenant capital expenditure investment that can be used by third parties in the top five locations: Warsaw, Katowice, Poznań, Wrocław and Central Poland (Łódź).

Spain

- Focus on well-located retail warehouses that can take advantage of e-commerce trends, and Spanish logistics hubs along the so-called Golden Banana logistics corridor stretching from Spain to Northern Italy.

UK

- Seek well-located retail warehouses close to transport links, which are positioned to take advantage of trends in e-commerce.
- Target logistics properties near cities such as Greater London, the Big 6 (Birmingham, Bristol, Edinburgh, Glasgow, Leeds and Manchester) as well as Oxford and Cambridge.

ASIA-PACIFIC

Australia

- Invest selectively in CBD offices in Sydney and Melbourne given the generally limited risk premium between prime and secondary assets. Target assets with lower passing rents that will benefit from strong demand-supply fundamentals and improved infrastructure, including fringe/suburban locations.
- Target defensive, income-producing retail and logistics assets in Sydney and Melbourne, such as convenience-based property with fixed rental growth at above-inflation levels.

China

- Target offices in new Shanghai CBDs that are supported by infrastructure.
- Consider Tier 1 city opportunistic strategies (e.g., funding gaps, distress situations) for logistics assets or retail podiums in view of current asset pricing.

Japan

- Target risk-adjusted office and residential opportunities in sub-core districts of Greater Tokyo and selected established regional submarkets.

Singapore

- Target high quality CBD offices that have leases marked to current rental levels that are in the trough of the cycle.
- Target modern logistics facilities with strong tenants and long leases that have recently started.

BE CAUTIOUS OF…

- Mispricing risk in strongly competitive markets, where choice of asset is increasingly key, and local expertise recommended;
- All-time-high rents on the Copenhagen high street and signs of weaker letting activity, which could indicate that Copenhagen high street retail is approaching a market cycle peak;
- Paris CBD, one of the most expensive office markets in Europe, except for refurbishment opportunities. Furthermore, developing areas such as the northern fringe of Paris have yet to achieve a critical size and to establish themselves;
- The impact of Dublin's housing shortage on the city's office sector;
- German high street retail in secondary and tertiary cities due to weaker letting activities, the structural shift towards e-commerce and prime rents having already peaked in most cases;
- Increasingly challenging pricing for core properties and core locations across Germany;
- Prime retail in Singapore, as leasing demand will be tempered by stagnant consumption growth, structural challenges from e-commerce and supply risks through 2019;
- Prime offices in traditional Shanghai CBDs where prices are at historical highs and capitalisation rates are likely to remain under pressure for the foreseeable future; and
- Tokyo's prime high street retail market where rents appear to have limited upside despite the strong fundamentals supporting the sector. Rising affordability concerns and a scheduled consumption tax hike in 2019 are likely to have an impact on retail sales.

RISKS

by IRFAN YOUNUS,
Head of Research, Europe
Savills Investment Management LLP

While 2018 will present various opportunities for real estate investment, multiple widespread economic as well as country-specific trends may present market risks. For one, we believe that the retreat from monetary policy stimulus will pick up pace where there is a 'hangover' from quantitative easing (QE), presenting challenges for investors' pursuit of income. While rising interest rates pose a challenge to property pricing, central banks will likely tread cautiously to avoid negative effects on growth rates and consumption.

In the geopolitical realm, we advise keeping a close eye on both Brexit negotiations and the effects of the US administration's corporate tax reform. Additionally, China's credit cycle is starting to turn, with significant implications across Asian markets and beyond.

China's deleveraging is too big to ignore

One of the key reforms proposed by President Xi Jinping is to reduce financial leverage. Policies to tighten liquidity slowed credit growth in 2016, causing a financing contraction through 2017 that has driven a steady rise in government bond yields and credit spreads. However, looking at the bigger picture, the deleveraging and reform that is driving China's near-term slowdown are positive for its long-term growth outlook. China is committing to reforms that will impose international standards on its capital markets, open its bond market to foreign investors and create vital sources of capital for Chinese companies.

Mispricing risk

A combination of forces has fundamentally altered income demand and supply: ageing populations, technological advancements, mandatory requirements for financial institutions to hold bonds, the 'hangover' from QE and a decade of rock-bottom base rates. Against this backdrop, investors in pursuit of income in 2018 and beyond will face substantial challenges and, in some cases, a difficult choice between re-adjusting income requirements in the face of low yields or accepting a higher degree of risk.

Lower yields may tempt some investors to move further up the risk curve and outside of their defined fund style. Historically, this has resulted in underperformance, as downsides are most acute for 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, such recommendations are not entirely based on attractive entry yields but rather on the underlying growth story, which weaker locations and segments often lack.

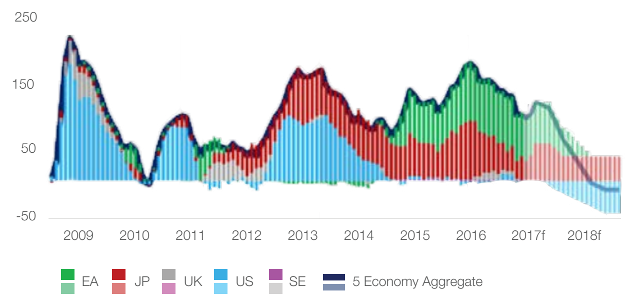
Housing market slowdowns

Following 20 years of rising house prices in Sweden, price growth is showing signs of moderation. The neighbouring Norwegian housing market is also experiencing a similar trend, as well as the London residential market. This cooling shows in sentiment surveys as well as hard data. A sustained downturn may impact on GDP growth rates, which in turn could impact on consumer spending and the construction sector. This would have negative repercussions for commercial real estate. However, sharp declines are unlikely given low interest rates, limited new housing supply and income and population growth.

Central banks stuck in 'Hotel California'?

Central bank behaviour will continue to be one of the main themes of 2018, as the drawback from extremely loose monetary policies is cause for concern. The world has taken on increased debt levels and unprecedented stimulus in order to recover from the global financial crisis and thwart deflationary pressures (figure 1) – now the question is if markets can handle the stimulus being withdrawn.

FIGURE 1:
Selected countries' net central bank asset purchases (USD billion, 2009-18f)



Source: Citi Research
Note: 'f' denotes forecast; 3 million rolling sum of change in domestic currency securities holdings expressed in USD at market exchange rates; EA = euro area and SE = Sweden.

The Federal Reserve is the first leading economy to have begun scaling back QE and raising interest rates. While the US economy has held firm amidst this slow policy shift, it clearly has not accelerated, either. As such, questions remain about possible repercussions if key central banks — not just the Fed — start to reduce stimulus faster than originally intended.

The biggest risk of this appears to be in Europe, where many countries have negative real interest rates. If negative real interest rates have played a role in pushing up asset prices to this point, what will happen when the stimulus is taken away? Do central banks remain stuck in a 'Hotel California' stimulus situation?

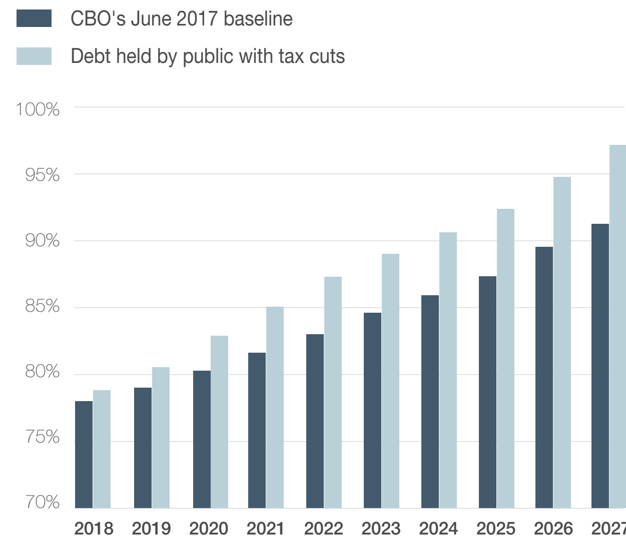
US fiscal changes

Looking at regions more specifically, the United States will soon begin to see the effects of a significant corporate tax cut. Most domestic sectors – such as retail, telecommunications and utilities, which have seen relatively high marginal tax rates – will benefit disproportionately from the tax change.

It is unsurprising, then, that we have recently seen a rotation in US equity market performance away from high tech, fast-growing companies and those with significant exports (which already enjoy relatively low tax rates) towards more domestic sectors. Beyond the near-term stimulus effect of tax cuts, one ought to also consider their longer-term impact on debt levels and the sustainability of accumulated debt.

As figure 2 illustrates, the Congressional Budget Office (CBO) projects that at some point in the next five years, the US will cross the 85% ratio of debt to gross domestic product. Empirical studies suggest that at this level, a meaningful slowdown in economic activity is likely. Consequently, we suggest investors be mindful of this possibility and its impact on European real estate markets.

FIGURE 2:
Estimated debt as a percentage of GDP



Source: CBO (as of 30 November 2017)

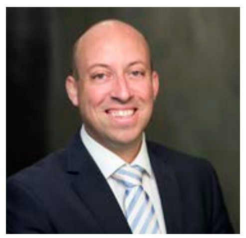
Brexit

The UK and European Commission have completed the first stage of Brexit negotiations, which focuses on three areas: the rights of EU and UK nationals in their respective territories, the financial settlement the UK will pay to the EU and arrangements for the Irish border. A transition period of 21 months will follow the UK's exit from the EU.

While it is still too early to tell what the trading relationship between the UK and the EU will look like after the transition period, there are three broad options: 1) extend the transition period, 2) exit without an extension of transition period but with an agreed trade deal or 3) exit the transition period with no deal. There is potential for option 1 to become a no-exit outcome, particularly if there is a near-term change of government.

There are currently close to even odds of a Labour or Conservative majority in the next general election. In our view, such political conditions will have potentially more significant impact on the economy in the short to medium term than Brexit. The PMA forecasts on which we base our prime real estate numbers assume a 'stable' Brexit with a transition period, continuation of trade deals and largely electronic Irish border; however, they assume no single market after transition.

NAVIGATING *the* AUSTRALIAN REAL ESTATE MARKET



by **LEE TREDWELL,**
Head of Investment, Australia
Savills Investment Management LLP

2017 saw Australia reach the longest-ever period of economic expansion globally: 26 years and counting of uninterrupted growth without a technical recession. Interest rates have remained unchanged for 16 consecutive months – at an all-time low of 1.5% – and inflation and wage growth remain low. As a result, we expect interest rates to remain unchanged during 2018, in contrast with other developed economies that are in a tightening cycle.

Australia's economy is still transitioning from the resource-led investment boom earlier this decade – which saw Australia come through the global financial crisis (GFC) relatively unscathed – towards a more diversified, service-based economy. This transition is benefitting the country's two largest cities, Sydney and Melbourne, which are both undergoing strong population growth and infrastructure investment, coupled with property markets experiencing favourable supply-demand fundamentals.

Sydney (with a population of about 5 million) and Melbourne (with a population of about 4.7 million) account for approximately 40% of Australia's population and two-thirds of its GDP. These are the global cities most favoured by local and global investors.

Sydney is undergoing a city-wide infrastructure boom, with new major roads improving access around the city, a new central business district (CBD) light rail, a new inner-city metro system and even a new airport.

Meanwhile, Melbourne's population continues to grow at a faster rate and, given greater availability of affordable land, is likely to surpass Sydney as the largest city in Australia by 2030.

Office

JLL ranks Sydney and Melbourne as the number 1 and 2 global cities, respectively, as they have over the past 12 months recorded respective net effective growth of 30.1 % and 17.3%. This growth should continue in the short term, with current vacancy rates of 5.9% and 6.5%, respectively, and new supply not forecast to be delivered until 2021 and 2020, respectively.

Sydney has benefitted from large stock withdrawals. This has forced tenants to relocate, increasing competition for space and pushing effective rents up, particularly for secondary space.

Melbourne, on the other hand, has led on the demand side, recording nearly 70% of national CBD net absorption over the past five years. Its once seemingly infinite supply of sites has now gone with completion pending for the last developments in Docklands.

Yields, as with other gateway cities, are at record lows; however, the spread over interest rates remains higher than that for other major cities within the Asia-Pacific region. With forecast rental growth in the short term, the potential total returns are still very attractive for investors.

Retail

The retail trading environment remains challenging, with increasing competition – from overseas retailers and e-commerce, including the recent launch of Amazon in Australia – reducing growth expectations in what has traditionally been somewhat of a sheltered local market. Previously strong department store or discount department store anchors, together with discretionary retailers, are likely to continue to rationalise their store footprints, closing unprofitable stores and revamping others, allowing for smaller trade area with a focus on online sales.

Australia's stringent planning system will still see this sector remain a good defensive investment; however, many shopping centre owners are having to undertake significant capital investments to maintain occupancy and competitiveness, which will reduce returns in the short term. Given the low inflation environment, we expect rental growth to be subdued and incentives to remain high. The exception is CBD retail that continues to be strongly sought after, particularly by global retailers seeking flagship stores in Sydney and Melbourne. We expect yields to remain low until there is significant upwards movement in interest rates.

Industrial

In contrast to retail, the logistics sector remains in favour, with the dynamics that are hurting the retail sector having the opposite effect on the logistics market. Reduced local manufacturing and increased reliance on imports are also leading to increased demand for quality logistics facilities. Competing land uses, largely from residential on the back of increasing population growth, is reducing supply of industrial land and pushing rents and land values upwards in Sydney.

Melbourne, which is the largest logistics market in Australia, still has a large potential pipeline of serviced land; however, available supply is reducing – and it, too, is coming under pressure from competing residential uses in some markets. Low interest rates and subsequently low capitalisation rates are still making new developments feasible for developers, and this will likely serve to keep effective rental growth limited in the short term.

For the first time, there has been significant offshore investment in the Australian logistics market, and this has pushed yields to lows not seen since before the GFC. Long leases with fixed annual percentage increases (at well above projected near-term inflation) are still providing attractive total returns.

RECOMMENDATIONS

1. Invest selectively in CBD offices given the generally limited risk premium between prime and secondary assets. Target Sydney and Melbourne assets with lower passing rents that will benefit from strong demand-supply fundamentals and improved infrastructure, including fringe/suburban locations.

2. Target defensive, income-producing assets such as convenience-based retail and long-leased logistics property with fixed rental growth at above-inflation levels.

3. Long-leased logistics will continue to provide strong returns (higher yields with strong fixed increases well above inflation). Buy assets benefitting from planned infrastructure investment.

4. Focus on non-discretionary retail with strong anchors in metro areas with population growth.

PLACEMAKING *to* ENHANCE RETURNS

by HARRY DE FERRY FOSTER,
Fund Director, Charities Property Fund,
Savills Investment Management LLP

What if you could create somewhere that becomes so attractive that workers, shoppers, residents and visitors with spending power flocked to it? This is the power of 'placemaking,' a strategy that is central to the Charities Property Fund (CPF) and has contributed to a decade of fund outperformance during which time the fund grew by more than GBP 1 billion.

Placemaking can be achieved either internally – through the acquisition of a series of buildings within an area and coordination of those buildings' repositioning – or externally, through early movement into an area or sector benefitting from both yield shift and gentrification effects as other investors follow.

CPF has enjoyed success with both strategies. We have built up significant holdings in core cities with excellent growth prospects, including in Brighton and Bath, where the fund has acquired eight separate buildings in close proximity to each other. These asset agglomerations create economies of scale and enable the fund to create prosperous new environments. For example, in Bath we have recently completed a conversion of a number of retail units and second-hand offices into retail, restaurants, a new hotel, serviced apartments, student accommodation and a gym, effectively creating a sense of place and improving the amenity as well as mix of uses and tenants.

We have also been able to take advantage of significant falls in the availability of office space due to permitted development to residential in these cities. In Brighton alone, around 800,000 square feet of office space has been lost to residential development, and developers are not replacing it, preferring instead to put more resources into residential apartments. The office vacancy rate in the city is now less than 1%. We have seen the same thing happening in Bath and Bristol and have exploited this with office acquisitions in Clifton, Bath and two buildings in Brighton.

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1 Aerial view Bath

2 Bath, 5-10 Westgate Buildings

3 Bath, 1-4 Westgate Buildings

4 Bath, Westpoint

5 Greenwich

5

We have also taken advantage of the larger placemaking of Greenwich Peninsula in London, which is rapidly transitioning from a former wasteland to a destination in its own right. At the end of 2017, CPF completed the Brocklebank Retail Park development immediately adjacent to the peninsula. Eventually, the area will have more than 15,000 residential units and a new GBP 1 billion tower sitting close to the premier O2 Arena concert venue and fast transport links to Central London.

Ikea is also investing GBP 100 million in its first new London store in 10 years, 200 yards down the road from the new park. All of these elements will serve to gentrify and place make the area. Greenwich currently boasts a retail catchment population the size of Leeds, yet currently has no dedicated shopping centre. In comparison, Leeds has five.

The retail park development contributes to the placemaking of the Greenwich Peninsula as a next-generation food and fashion retail park, tenanted by Primark, Next and Aldi – some of the standout retailers of the moment. By being involved in the construction process, we were also able to improve its placemaking potential and capture the benefits of future technological innovation with the addition of electric car charging points and almost 1,000 solar panels.

This park is a prime example of the fund's strategy of placemaking and insulating the portfolio against technological change by building up significant holdings in core cities with excellent growth prospects.

Images: Savills IM

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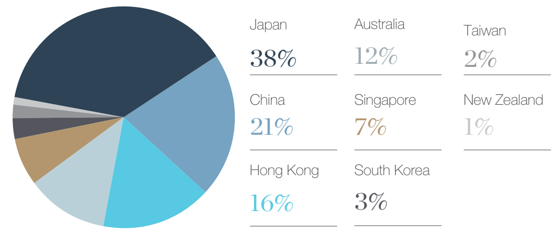
JAPAN HAS THE LARGEST CONCENTRATION OF INSTITUTIONAL-GRADE REAL ESTATE IN THE ASIA-PACIFIC AND RANKS SECOND IN THE WORLD IN TERMS OF MARKET SIZE AFTER THE UNITED STATES.

LARGE, STABLE *and* LIQUID

The investment case for the Japan office market

by **WILL JOHNSON,**
Associate Director of Investment, Japan
Savills Investment Management LLP

FIGURE 1:
Developed Asia-Pacific: institutional-grade real estate concentration by country



Source: MSCI and Savills Investment Management (June 2017)
Note: MSCI real estate coverage adopted as measure for institutional ownership ratio.

With office vacancy rates low across the board, occupier flight to quality combined with the removal of outmoded stock is expected to support average rents and the absorption of near-term supply.

Looking past the bells and whistles of Abenomics and quantitative easing, what does Japan's property market offer overseas investors? First, it has regionally unrivalled breadth and depth: Japan has the largest concentration of institutional-grade real estate in the Asia-Pacific and ranks second in the world in terms of market size after the United States.

In fact, Japan alone accounts for roughly 10% of global stock. Moreover, Japan's property market is highly liquid. There are no barriers to entry for overseas institutional investors, land is predominantly freehold and the pool of local end-buyers for assets of all shapes and sizes is deep and diverse. Such buyers include private investors, domestic corporations and developers, as well as Japan's rapidly growing public and private REIT sector.

Next, with its recovery having lagged most other global markets, Japan's once famously expensive real estate now looks relatively inexpensive – both from a historical perspective and pound for pound. Despite a steady recovery since 2012, average pricing for commercial assets in Tokyo sits 11% down from its 2007 peak, while prime office space remains around 25% cheaper than 10 years ago. Commercial land prices are also edging up from historic lows and are in line with the pre-bubble era. This not only mitigates downside risk but also suggests that capital appreciation in Japan's largest metropolitan areas can be sustained for the foreseeable future.

Furthermore, effective yields for prime Tokyo office assets are on par if not favourable compared to London, New York, Paris and Hong Kong. Meanwhile, borrowing costs are among the lowest globally, making Japanese property investments particularly attractive on a risk-adjusted, levered return basis.

We also expect the occupier market to remain landlord favourable through the medium term, particularly for quality mid-tier offices. The Tokyo market is well positioned to absorb planned medium-term supply, with cyclically low vacancy indicative of latent demand following years of post-global financial crisis cutbacks and corporate restructuring. A continued flight to quality and the gradual removal of large swathes of obsolete pre-seismic stock will also funnel Japan's plethora of small- and medium-sized enterprises s to investment-grade buildings.

With 2017 set to mark a sixth consecutive year of expansion in domestic GDP, Japanese corporates are enjoying record profitability, which has led to new property requirements for headcount increases as well as location and building upgrades. This positive economic context looks set to remain through the medium term, supported by the political stability provided by the recently re-elected Shinzō Abe cabinet, as well as the Bank of Japan's ongoing dedication to its inflationary monetary policies.

The major challenges for global investors remain Japan's relative opacity and how to access investable stock without chasing down yields. Savills IM's long and successful track record in this market is testament to the fact that having an established specialist team on the ground with experience executing through multiple cycles is key to accessing off-market deals as well as the valuable arbitrage opportunities that can provide outsized returns.

The state of the GLOBAL LISTED REAL ESTATE MARKET

by THOMAS KÖRFGEN,
Global Head of Indirect Real Estate,
Savills Investment Management LLP

The outlook for the listed real estate market is positive. We expect the listed real estate market to provide a total return of between mid to high single digits in 2018.

With a growing average dividend yield close to 4% for the entire market, we believe that with the right stock selection, investors can achieve 5%+ income return. Moreover, we expect mergers and acquisitions activity to increase over the coming period. Clampdown on tax avoidance strategies and search for liquid listed investments will result in increasing numbers of new market entrants.

Direct European real estate markets performed strongly in 2017, on average experiencing both good fundamentals and further yield compression. In our view, momentum is strong enough going into 2018 to result in higher-than-consensus net asset value (NAV) growth.

While the overall backdrop for commercial real estate remains positive, the listed sector is able to further enhance earnings per share (EPS) growth by improving the terms of its debt financing. We also anticipate that rising real estate values and disposals will reduce gearing, resulting in lower financial risk. Therefore, we do not expect that rising interest rates will likely have a significant impact on real estate investment trusts (REITs) going forward.

With interest rates expected to remain lower for longer, demand for income remains strong. REITs are attractive investments due to their high pay-out ratio, tax efficiency and liquidity.

We like REITs with a strong balance sheet as well as stable cash flow and dividend yields. Another primary consideration is the experience and track record of management teams.

Key themes *in 2018*

M&A and IPO activity to increase	EPS enhancement through refinancing	Gearing to decline	Dividends to grow

M&A and IPO activity to increase

We think the current NAV-to-share-price discounts on some REITs are attractive and could result in increasing M&A activity. In the context of intense competition for direct real estate, investors intending to grow their portfolios may choose to do so through the indirect market. UK listed property companies look particularly attractive for an M&A play, and we see rising potential for M&A activity in the shopping centre segment and for German residential companies.

Moreover, strong demand for income-yielding investment should result in new initial public offerings (IPOs). Additionally, some value-add investors who acquired assets during the global financial and Eurozone crises are now looking for an exit through the listed market route.

Smart debt refinancing

Low interest rates and strong demand for fixed income have resulted in an increase in debt issuance. For example, in the year to November 2017, debt issuance in Europe reached more than EUR 18 billion, with a weighted average yield of 1.7%, down significantly from 6% in 2008. Given its ability to borrow against its balance sheet, the listed real estate sector continues to benefit from this trend and is able to enhance EPS growth by improving debt financing terms (figure 1).

In our view, not only is the reduction in average interest rates key, but so is the tendency to increase the duration of debt in order to obtain more predictable cash flows into the future (figure 2). This provides insulation against potential future interest rate rises.

While there were some IPOs in 2017, we expect to see more primary issues as well as secondary equity and rights issues in 2018.

Further decrease in loan-to-value

With the direct real estate market remaining strong, overall loan-to-value (LTV) ratios are declining (figure 3). This has been buffeted by recent disposals by listed real estate companies. The average LTV ratio is now much lower than the historic average of 35%. With such a low ratio, REITs are much more insulated from external impacts. In our view, current LTV levels will likely remain stable, which reduces financial risk for listed companies.

Dividend yields

The average dividend yield for listed real estate is approximately 3.7% (figure 4). In our view, with interest rates remaining lower for longer and demand for income to remain strong, the right stock selection will enable investors to achieve 5% average income from a diversified listed property market portfolio.

Interest rates

Many investors worry that rising bond yields could result in a fall in real estate values and, in turn, could impact on listed property market share prices. We do not expect an increase in interest rates to have a material impact on listed property market values: higher interest rates usually follow a strong economy, and a strong economy benefits the real estate market, which more than offsets increased cost of financing. Moreover, with many listed companies having de-geared their balance sheet, we expect that even the direct impact on cost of financing should be limited.

FIGURE 1:
Capital raised in Europe (EUR million)

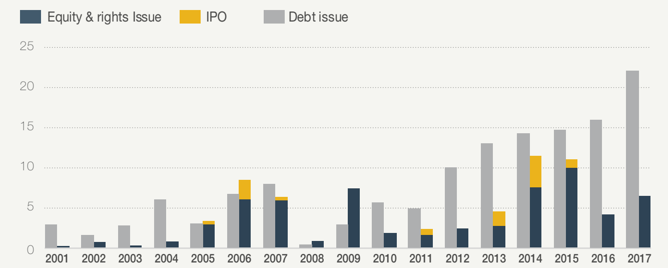


FIGURE 2:
Bond maturity schedule

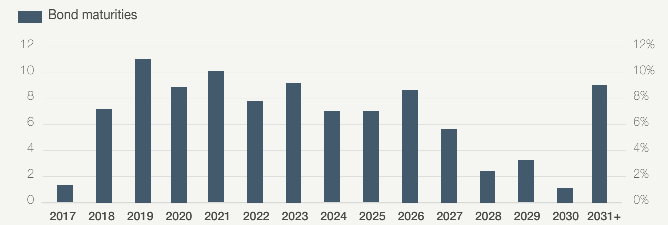


FIGURE 3:
Historical loan-to-value ratios: European market

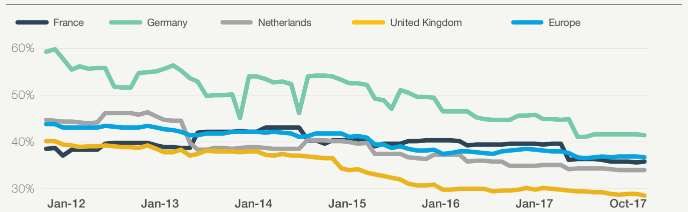
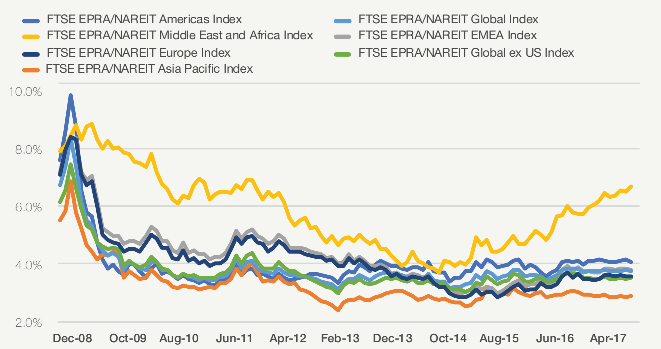


FIGURE 4:
Dividend yields



Source: European Public Real Estate Association

OPPORTUNITIES *in* NORDIC RETAIL

by PETER BROSTRÖM,
Nordic III Fund Manager,
Savills Investment Management LLP

Nordic-based retail is benefitting from the region's strong economic and employment growth, with several international brands looking to expand in these markets. Sound demographics coupled with high population growth provide strong tailwinds. The economic recovery gap between Sweden and the rest of the Nordics is expected to narrow as Denmark, Finland and Norway pick up pace. Rapid population growth and improved consumer sentiment should be supportive of retail sales going forward.

The Nordic consumer

The Nordics region is well-positioned for further growth in retail sales due to its positive economic and sociodemographic backdrop (figure 1). The success of brick-and-mortar retail will increasingly depend on the experience and services offered in stores. Retailers are increasingly recognising that successful integration of physical stores and online offerings is crucial to stay competitive, which is resulting in a larger focus on omnichannel solutions.

Despite the strong growth of e-commerce sales, the majority of Nordic retail sales still take place in physical stores. According to PostNord, the Nordic e-commerce market ranks third in Europe in terms of average online spending per year per capita (figure 2). However, consumers across the demographic spectrum prefer to shop in store for social and entertainment experiences as well as dining and trialling products. Consumers, and particularly technology-savvy millennials, embrace e-commerce, but as retailers evolve to meet consumer needs, physical shops continue to offer a multichannel experience that online platforms alone cannot.

FIGURE 1:
Nordics: consumer spending forecast (% year on year)

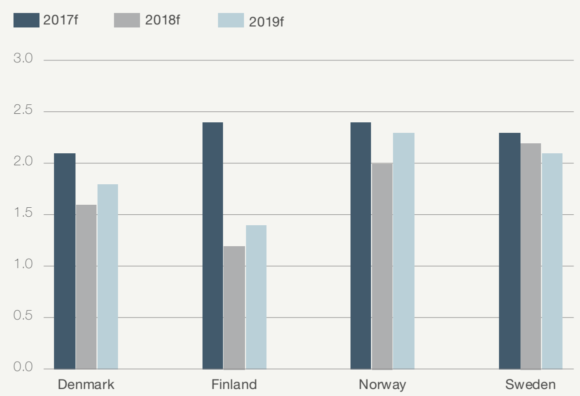
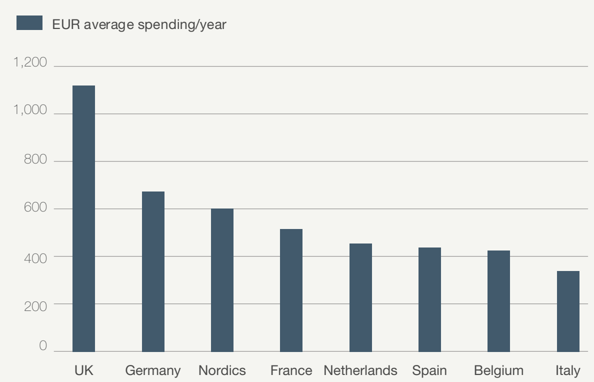


FIGURE 2:
Average online spending per year per capita (EUR, 2016)



Sources: PMA, Savills Investment Management

Note: 'f' denotes forecast.

How e-commerce is transforming retail store formats

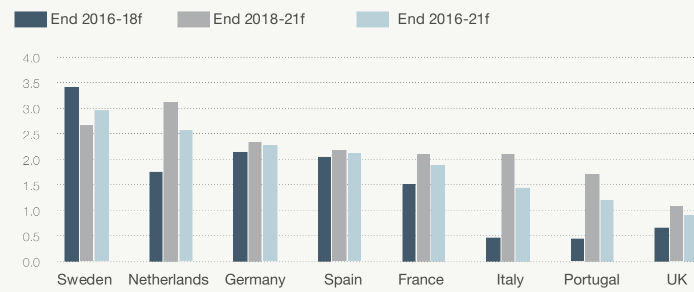
E-commerce disruption is having an impact on the way people shop and is threatening the traditional retail store concept. Nevertheless, some retail segments will be less sensitive than others to rising trends in online shopping. For example, value and convenience segments are more resilient, including retail parks offering bulky goods shopping, where shoppers generally value convenience over shopping experience.

According to PMA, Sweden is set to experience the strongest retail park rental growth among European countries over the next five years (figure 3). Furthermore, according to a global survey by PricewaterhouseCoopers (PwC), grocery, furniture and homeware; do-it-yourself/home improvement; and household appliances are the most resilient segments to e-commerce (figure 4).

Such structural changes in retail mean that factors like location, consumer experience and quality of retail premises are increasing in importance to both tenants and consumers. The trend towards eating out has led to quickly expanding food and beverage (F&B) concepts, which, in turn, has resulted in stronger demand for space. The presence of creative F&B options in retail parks and on high streets motivates customers to dwell longer.

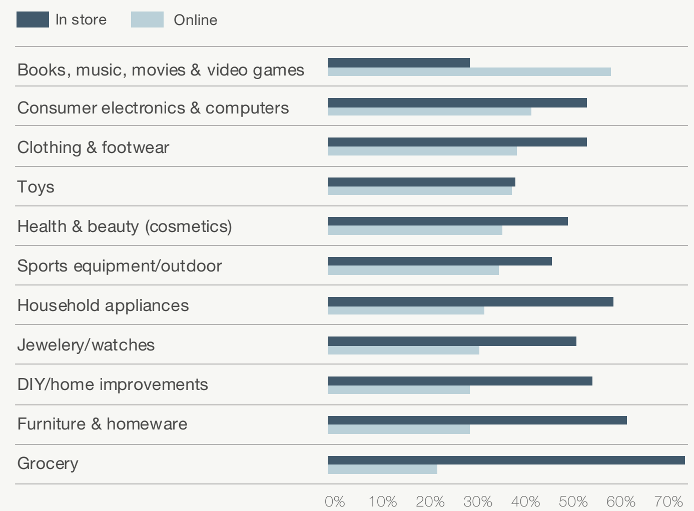
While physical stores are offering more online solutions, online retailers are also establishing physical stores across Europe. Similarly, online-only retailers are seeking to establish a store-based presence to maximise synergy effects, Savills reports.

FIGURE 3:
European retail park prime rental growth (%)



Sources: PMA, Savills Investment Management
Note: 'f' denotes forecast

FIGURE 4:
Preferred purchase method (global survey)



Source: PwC Total Retail 2017 Global Survey

Recommendations

1 We recommend targeting medium-sized regional centres and neighbourhood schemes in locations with good economic foundations and sociodemographics. Such centres and schemes offer a more enhanced shopping experience and attract footfall via F&B providers, leisure facilities and entertainment. Retail parks with easily adapted space are particularly attractive, with Sweden expected to benefit most from prime rental growth in this area.

2 The rapidly changing retail environment means that the polarisation between successful and less successful retail formats will increase. The renowned Swedish brand H&M, for example, delivered weaker-than-expected sales in 2017, believed to be partly due to a lack of successful integration between online and physical store offerings, resulting in planned store closures. This highlights the importance of stock selection for investors going forward. We recommend this approach in key high street locations in major cities.

GENERATING ALPHA RETURNS

by JAMIE PEARSON,
Fund Manager, UK Income and Growth Fund,
Savills Investment Management LLP

Alpha is the risk-adjusted excess return above the market or benchmark. In the capital markets, alpha is the risk-adjusted excess return of common stocks above a benchmark such as the FTSE 100 Index, or the risk-adjusted excess return of a portfolio of real estate investment trust (REIT) stocks above the European Public Real Estate Association REIT index.

In the commercial real estate market, alpha is the excess return generated by the investment manager above what is needed to compensate for risk. This can be achieved by both hands-on control of the real estate asset as well as optimising allocations to certain sectors and geographic regions throughout the property cycle.

The Savills IM UK Income and Growth Fund

Launched in March 2010, the Savills IM UK Income and Growth Fund's (UKIG's) core strategy is to generate income and income growth. The fund is 70% focused on income and 30% focused on growth. In the last three years, UKIG has undergone a major strategic change to position itself to capture property cycle alpha returns.

In our view, the UK real estate market is past its cycle peak, and to position the fund defensively – where yield shift is not expected to deliver performance – income is the major element of returns. Each asset within the fund has a clear role to either deliver income or capital growth.

Key terms and concepts

Alpha:

the excess return generated above what is necessary to compensate for risk. Sources of alpha include asset management such as repositioning, lease optimisation and cost control. Alpha can also arise when assets are purchased and disposed of.

Beta:

the generated portfolio return that can be attributed to overall market returns. Exposure to beta is equivalent to exposure to systematic risk.

Idiosyncratic risk:

the risk that comes from investing in a single asset or real estate segment. The level of idiosyncratic risk an individual asset possesses is highly dependent on its own unique characteristics.

Systematic risk:

the risk that comes from investing in any real estate asset within the market. The level of systematic risk that an individual asset possesses depends on how correlated it is with the overall market.

Structural shift

The fund shifted from 54.4% retail warehousing to 42.0% industrial between 2014 and 2017 (figure 1). The industrial sector has been favoured as changing shopping habits have reduced the need for high street and out-of-town retail space. At the same time, demand for industrial space to service Internet retailing has increased, leading to rental growth. The fund has targeted the industrial sector to take advantage of this dynamic.

Economic drivers

Greater London and the southeast are the UK's economic powerhouse and create 38% of GDP, according to Oxford Economics. Currently, 47% of the fund is invested in Greater London and the southeast, while three years ago, only 5% was allocated there (figure 2).

The industrial sector plays a key role in the fund's strategy within the southeast. Particularly in Greater London, industrial land has been lost to alternative uses at an average rate of 100 hectares per annum for the last 16 years, benefitting from both increased demand and reduced supply leading to exceptional rental and capital growth. The fund's London industrial assets increased in value by over 18% during the 11 months to November 2017.

Infrastructure developments

Looking at the longer-term picture, the fund seeks to acquire assets in strategic locations where potential infrastructure developments could bring fundamental change. Hounslow, which will benefit from Heathrow's third runway, and Dalston, where Crossrail 2 should drastically improve accessibility, are both locations where the fund has invested in long-term plays. These buildings will likely deliver steady income in the short to medium term, with an aim to exploit higher-value alternative uses in the long term.

FIGURE 1:
UKIG Fund sector distribution

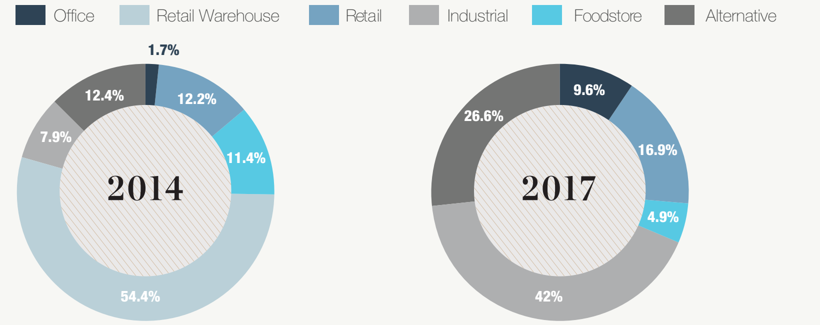
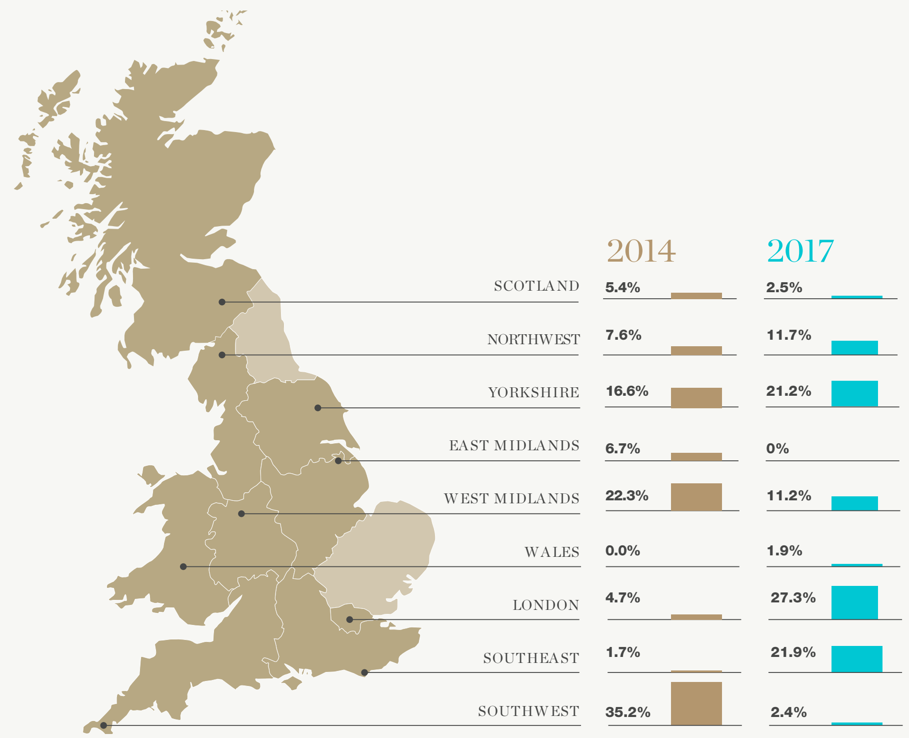


FIGURE 2:
UKIG Fund geographic allocation



Source: Savills Investment Management

OUTLOOK for 2018

Over the next few years, we expect income return to be the main driver of total returns. In what will be a more challenging environment, the fund is defensively positioned to continue to outperform. The fund's low exposure to retail should be beneficial, as weaker retailers will face headwinds in the next year, while the focus on London and the southeast will deliver income due to strong demand. However, with a bedrock of over 60% of income with guaranteed fixed or inflation-linked rental growth and 80% low-risk tenants, UKIG has relative certainty of performance in an uncertain economic environment.

EUROPEAN REAL ESTATE MARKET UPDATE: *economy to trump politics*

The global economy is now growing at its fastest pace since 2010, with the upturn becoming increasingly synchronised across countries, according to the Organisation for Economic Co-operation and Development (OECD). This long-awaited lift to global growth, supported by policy stimulus, is being accompanied by solid employment gains, a moderate upturn in investment and a pick-up in trade growth.

Furthermore, the political landscape at the close of 2017 was arguably much more positive than many would have dared hope at the outset. Resurgent support for centre-ground parties in the Netherlands, France and Germany quelled various far-right threats.

In the European economic realm, IHS Markit's index of private-sector activity suggests that both services and manufacturing continue to strengthen, reaching levels not seen in more than six years. Current projections are for a continued modest recovery in economic growth over the next few years, aided by a combination of European Central Bank (ECB) asset purchases and strengthening labour markets.

Consumer spending, supported by improving labour market conditions and low interest rates, is expected to remain a key driver of economic growth. However, increasing inflation is expected to temper household spending recovery. Countries forecast to enjoy the strongest consumer spending growth – largely because of either strong economic recovery or solid consumer fundamentals – include Poland, Hungary, the Czech Republic, Spain and Ireland, whereas Finland, Italy and the UK are projected to underperform.

Offices

DEMAND

Occupier activity in the European office sector remained robust in the year to Q3 2017. Leasing volumes remain strong across most of Europe, but there is increasing evidence of corporates struggling to fulfil their office space requirements, especially in the Grade A segment where availability is particularly low.

Office take-up rose significantly in London in 2017, with activity boosted by a few large transactions. Overall office demand was strong, with London West End recording its highest quarterly leasing volume on record in Q3 2017. The momentum in Paris continued, and in Germany, the Big 5 office markets showed no signs of weakening: Berlin and Munich saw steady increases, while activity in Düsseldorf and Hamburg tailed off. Meanwhile, Q3 2017 was one of Frankfurt's strongest quarters on record for the last 10 years. Other notable Q3 performances include Madrid, Warsaw, Prague and Budapest.

SUPPLY

European office vacancy continued to decrease in 2017. Looking ahead, JLL expects vacancy to stabilise between 7.5% and 8.0%, reflecting development pipeline increases in 2018-19.

Robust leasing activity in 2017 offset stronger development completions in most cities. In the Eurozone, 17 out of 24 key markets recorded a decrease in vacancy in Q3 2017, according to JLL. This fall was particularly strong in Warsaw (Q3 vacancy rate of 12.7%), Prague (7.6%), Budapest (7.8%) and Amsterdam (7.2%). Dublin, Milan and Stockholm all saw a minor rise in vacancy in Q3 on the back of new supply.

According to JLL, the completion dates of many planned schemes have been pushed back to 2018. At 5.3 million square metres (sqm), the 2018 European development pipeline will be more significant, with most of the increase concentrated in London, Paris, Dublin, Berlin and Munich.

Retail

DEMAND

Following economic recovery and decreasing unemployment, European countries are experiencing an increase in retail sales. However, sales volume increases varied depending on factors such as political uncertainty, terrorist incidents, CPI inflation and weather. Retail sales growth is forecast to remain positive in 2018.

In many cases in 2017, retail sales volumes were boosted by price discounting. Retailer profit margins continue to be squeezed by cost pressures as well as increasing competition, especially from e-commerce. Retailers will likely remain cautious about expanding store networks and closing or disposing of non-performing stores and brands.

SUPPLY

The availability of quality retail space on Europe's best high streets and in its best shopping centres is limited, but availability of secondary space remains high. Shopping centre development has been well below average for the past three years. According to Property Market Analysis (PMA), completions are expected to increase year on year in 2017 , especially in Finland, Portugal, Italy and Spain.

Retail park development has also been rising and is expected to increase, notably in France. Small or outdated schemes are likewise being future proofed via redevelopment and refurbishment.

Industrial

DEMAND

Occupier demand for logistics space remained strong in 2017 and is expected to remain healthy, boosted by growing e-commerce. With low availability of prime logistics space, demand is moving beyond core locations, and build-to-suit activity is increasing. Urban logistics may start to see innovative approaches to address increasing space requirements, potentially resulting in a multistage model for logistics real estate.

SUPPLY

Speculative completions have increased, but there is a shortage of vacant, prime and modern space in Europe's core logistics hubs. Urban logistics is set to be one of the most significant growth markets of the next few years as e-commerce continues to grow across Europe.

Property yields continue to drift lower

One and a half years after the UK referendum on EU membership, the UK has regained its position as the biggest property market in Europe, reports Real Capital Analytics. We expect some total investment volumes to continue moderating this year following a similar trend last year. However, in 2017 cross-border investment in Germany and the UK was at its highest recorded levels since 2008, with a growing number of active Asian investors.

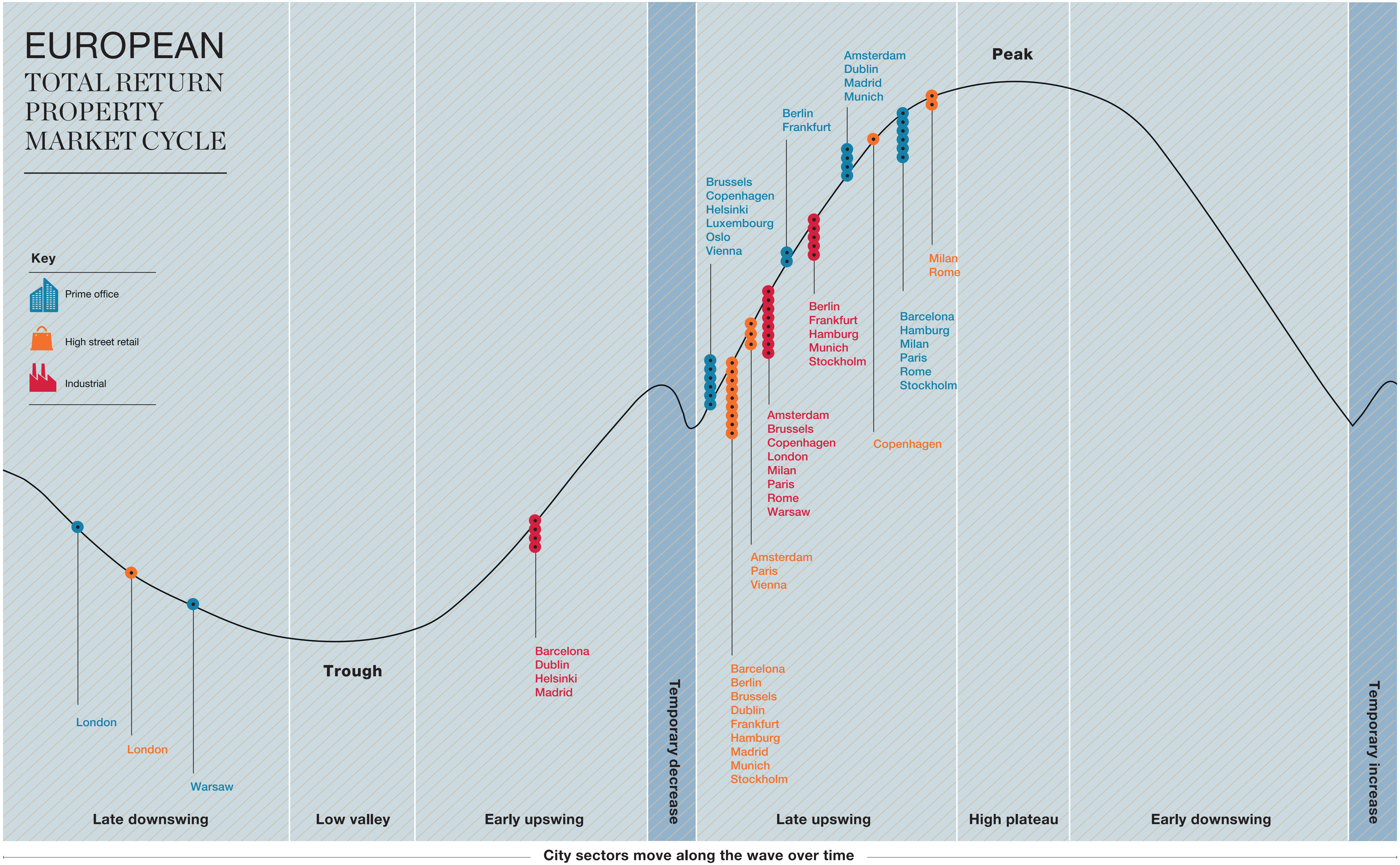
Perceptions of elevated geopolitical uncertainty, capital protection measures and economic risk could possibly constrain real estate investment across Europe. However, recent volatility in the bond market as well as stretched equity market valuations reinforce the case for real estate investment, as property can provide long and stable income flows. Furthermore, real estate potentially offers opportunities to add value through active asset management.

Intense competition for limited property supply in core markets continues to exert downwards pressure on yields, with prime yields declining in a number of markets in Q3 2017. Despite Brexit-related uncertainty, prime London office yields remained stable.

There is sufficient momentum in the real estate market going into 2018 to result in prime yields, on average, moving lower. However, we remain mindful of heightened global political risk, which could potentially upset the investment cycle.

Investor risk aversion as well as the economic environment of lower growth and lower-for-longer interest rates are forecast to result in a renewed investor focus on prime real estate in core markets. The risks to income are likely to be higher for secondary than prime property. Consequently, yields for secondary assets may also come under upwards pressure as a result of lower growth forecasts, investors' flight to safety and expectations that lenders will have less appetite to lend on such assets.

EUROPEAN TOTAL RETURN PROPERTY MARKET CYCLE



Sources: PMA, Savills Investment Management
Note: relative property market cycle points based on total return index.

Austria

Vienna

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	**2018f**	**2017**	**2018f**
Offices	285	↗	3.80%	→
High street	3,690	↗	3.25%	→
Industrial	72	n/a	5.75%	n/a

Sources: PMA (Autumn 2017), Otto Immobilien, Savills Investment Management
Note: 'f' denotes forecast.

Offices

While the Austrian economy recently gained momentum, 2017 Viennese occupier activity was more muted than in 2016, according to Cushman & Wakefield and CBRE. A possible explanation is the longer-lasting scarcity of modern office spaces larger than 5,000 sqm. Although development activity in H2 2017 picked up significantly, the effect on the leasing market was limited due to the high pre-let and owner-occupier rates. Consequently, prime rents increased only slightly in 2017 compared to 2016, but investor interest in core offices was strong. As a result, prime yields compressed further, according to CBRE. PMA projects that prime office yields will remain largely stable during the next couple of years.

Retail

Most of Austria's GDP growth momentum can be attributed to household consumption and domestic demand. As a result, the retail sector is benefitting from increased consumer spending power. While prime high street rents in Vienna remained unchanged at EUR 310 per sqm per month at the end of Q3 2017, prime shopping centre rents grew by around 4% compared to 2016. Investment activity was lively and gained momentum year on year. Prime yields for high street units, shopping centres and retail parks, therefore, compressed further in 2017, but should remain stable at their current levels, according to PMA.

Industrial

Vienna, Linz and Graz, the most important logistics hubs in Austria, are all seeing high competition for scarce development sites. While demand for modern and flexible logistics facilities – particularly, last-mile logistics – has increased in parallel with increasing online retail penetration and improving economic conditions, supply has not keep pace. 2017 investment activity was subdued because of the limited availability of core product. Prime logistics yields stood at 5.75% in Vienna and should remain stable in the short to medium term, according to Otto Immobilien.

RECOMMENDATIONS

We recommend investors focus on Grade A offices with long-term rental agreements in prime Vienna locations close to or integrated with metro line stations in the CBD and city centre submarkets.

Offices

Belgium's unemployment rate continues to decline, which should be positive for the office-based employment outlook and, subsequently, demand for office space. In Brussels, the vacancy rate should decrease further in the coming quarters, as high quality office schemes are limited. However, more speculative completions will be delivered in 2018 and 2019. Brussels office rents have reached their highest level ever of EUR 305 per sqm per year, with potential for further increases in the coming months, while rents in Antwerp are expected to remain stable at EUR 155 per sqm per year, according to Cushman and Wakefield. On the investment side, Brussels prime yields have reached a historical low, but they are expected to stabilise in 2017. In Antwerp, investor demand for prime assets should be strong going forward, leading to yield compression.

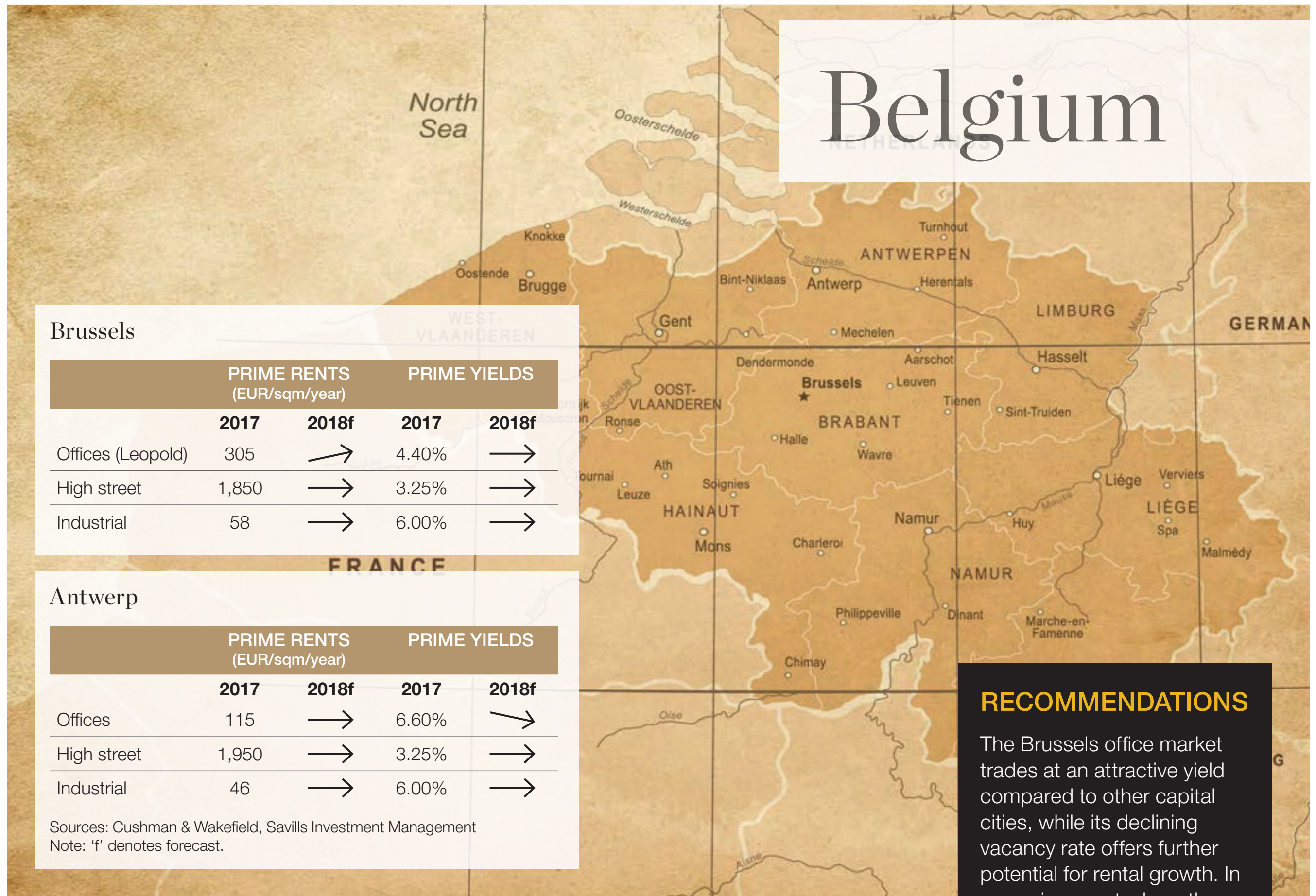
Retail

Consumer spending should be robust in 2018 as households continue to benefit from employment recovery, which has translated into earnings and income growth. Inflation has come down to around 2% from its peak of almost 3% at the beginning of 2017, improving the outlook for real disposable income growth. Positive economic developments are expected to benefit the retail sector, while security concerns around terrorist incidents have faded. Occupier demand is expected to remain stable in core locations, but could decline in secondary locations, which may put downwards pressure on rents.

Industrial

In 2017, demand for logistics remained strong in Belgium, with e-commerce, multimodality and improvements in supply chain productivity being key drivers of market activity. Prime rents are expected to remain stable. Nevertheless, in the Brussels region where demand is high and available product limited, rents could increase further in 2018. A planned project by Groep Heylen in the Port of Ghent as well as the reconversions of the Ford plant in Genk and the Petroleum Zuid brownfield site in Antwerp will likely boost logistics supply in the long term. The outlook for yields is stable, but exceptional locations within the wider Brussels region and the Brussels-Antwerp axis along the A12 and E19 highways may see yield compression.

Belgium



Brussels

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	**2018f**	**2017**	**2018f**
Offices (Leopold)	305	↗	4.40%	→
High street	1,850	→	3.25%	→
Industrial	58	→	6.00%	→

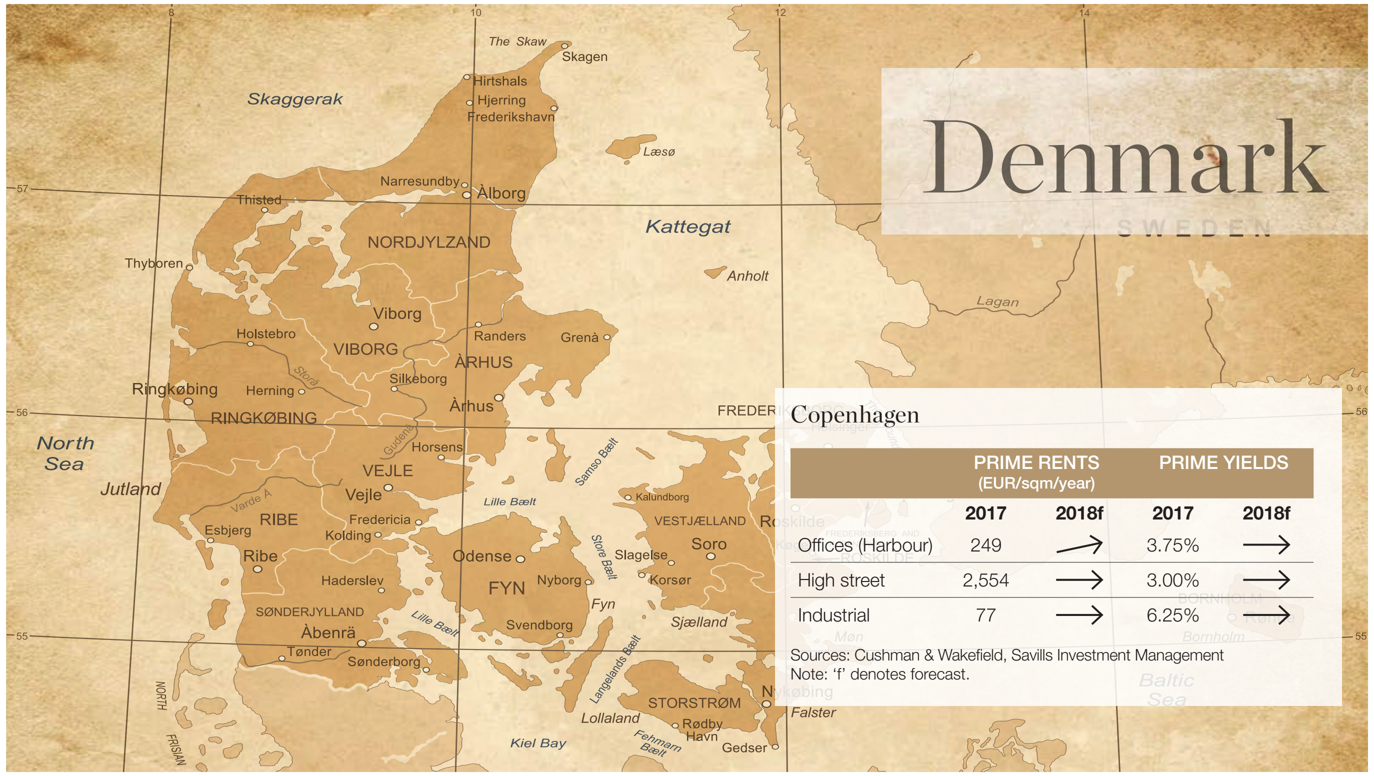
Antwerp

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	**2018f**	**2017**	**2018f**
Offices	115	→	6.60%	↘
High street	1,950	→	3.25%	→
Industrial	46	→	6.00%	→

Sources: Cushman & Wakefield, Savills Investment Management
Note: 'f' denotes forecast.

RECOMMENDATIONS

The Brussels office market trades at an attractive yield compared to other capital cities, while its declining vacancy rate offers further potential for rental growth. In an environment where there is strong competition for income returns, in our view the Brussels office market provides for an attractive yield play.



Denmark

Copenhagen

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices (Harbour)	249	↗	3.75%	→
High street	2,554	→	3.00%	→
Industrial	77	→	6.25%	→

Sources: Cushman & Wakefield, Savills Investment Management
Note: 'f' denotes forecast.

Offices

Copenhagen is seeing strong demand for office space from occupiers and investors, with solid economic backdrop, growing employment and a relatively restrained level of construction. The city's growing workforce and attendant growing need for office space has contributed to declining vacancy. Copenhagen prime office rents are considerably lower than those of neighbouring Sweden's capital, Stockholm. Local investors remain most active, but international investment is growing. The low level of new supply means the CBD fringe may benefit from competition for space. PMA expects prime rents to remain stable in the short term and rise by about 1.5% per annum over the next five years.

Retail

International tourism growth is supportive of international retailers entering the Danish market. However, the ongoing structural shift towards e-commerce is a challenge. The polarisation between successful and struggling retail formats is only set to increase, and those who adapt to changing consumer patterns are more likely to succeed. Online retail sales are growing at the expense of physical retail sales. We see certain retail segments as more resilient to e-commerce, including lifestyle/luxury, experience-oriented retail, value, convenience and infrastructure. Copenhagen high street prime rents are at an all-time high, prime net yields are compressing and there are signs of some weaker letting activity. Although the Copenhagen high street can look expensive, there are opportunities in demographically favourable regional cities with a positive economic outlook, including the five largest regional cities and, especially, Aarhus, the second-largest city.

Industrial

Modern logistics facilities on long leases are in high demand by investors, while secondary warehouse properties are of less interest. Investors are mainly focused on the Greater Copenhagen area as well as the so-called Triangle Region, including Vejle, Fredericia and Kolding. The traditionally owner-occupied market has shifted somewhat due to rising interest from foreign investors, which has driven an increase in sale and leaseback transactions over the last year. The sustained growth in e-commerce means rising investment opportunities in last-mile distribution.

RECOMMENDATIONS

We are cautious of the all-time-high rents on the Copenhagen high street and the signs of weaker letting activity, which could indicate that Copenhagen high street retail is approaching a market cycle peak. We advise investors to seek fringe-of-prime Copenhagen high street opportunities or prime locations in the top five regional cities, preferably Aarhus, Denmark's second-largest city. We also recommend urban, last-mile logistics and prime office space in Copenhagen.

Offices

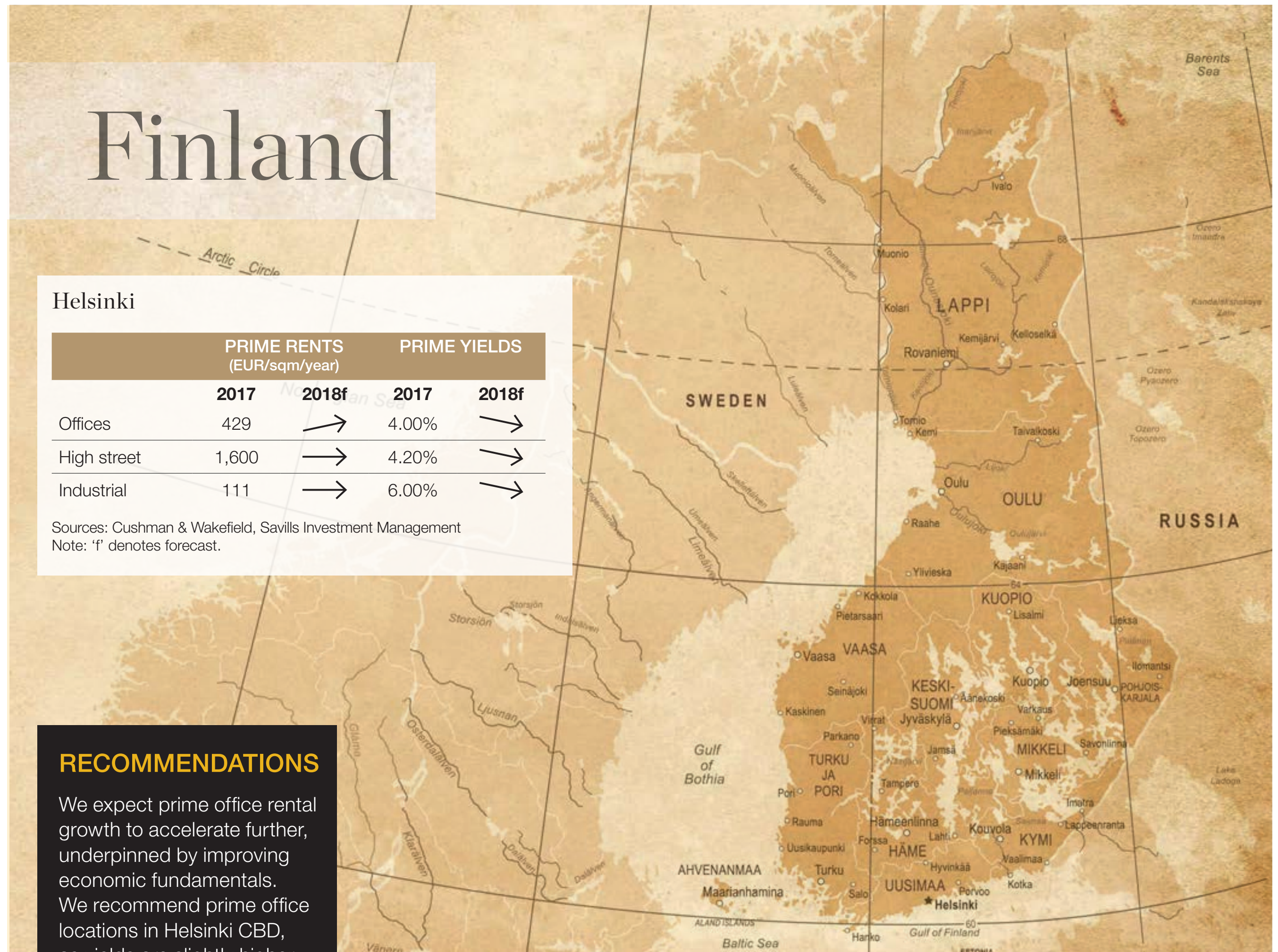
The improving economic outlook in Finland is reflected in the rental market for office space. Occupier demand is growing, and overall vacancy in the Helsinki Metropolitan Area (HMA) is declining. Supply is tight but should increase over the next few years, and current market conditions point to rental growth in the prime end of the market. Despite the positive rental outlook, office vacancy in Helsinki remains high and new construction increased over 2017. However, the conversion rate of older space to other uses remains high, which is serving to limit supply. 2017 also saw an influx of cross-border capital. Helsinki's position as the highest yielding office market in the Nordics as well as the strength of Finland's economic recovery lead us to expect rising investor interest in 2018.

Retail

Retail sector occupier demand is showing clear improvements, especially demand for prime locations. Occupier interest should further improve, with rental growth potential in key retail locations in Helsinki. Development activity – mainly shopping centre development – is likely to further increase over the next few years. However, the rather high level of new supply coming down the pipeline should be balanced by rising population growth and spending power. As occupational and investor demand is improving, some yield compression is likely in prime locations.

Industrial

In Finland, investment volumes remain rather low, mainly due to the lack of available prime product. Demand is strong from both domestic and international investors, according to Cushman & Wakefield. We expect some yield compression due to rising demand for prime units. Given current export sector growth acceleration, there is likely to be more logistics occupier market activity. Additionally, the growth of e-commerce means further need for last-mile urban logistics solutions. Prime rents remain below their pre-recession peak, and despite moderate rental growth expectations, values are unlikely to return to this level within the coming years.



Finland

Helsinki

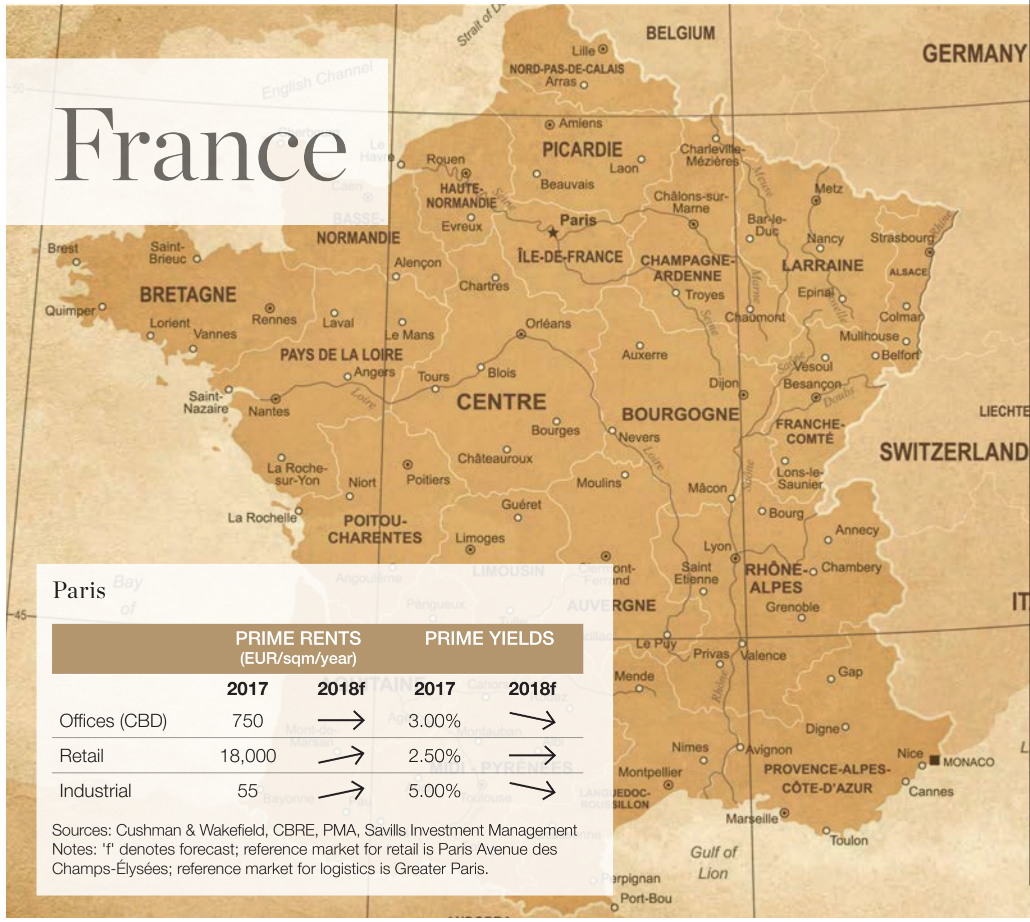
	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices	429	↗	4.00%	↘
High street	1,600	→	4.20%	↘
Industrial	111	→	6.00%	↘

Sources: Cushman & Wakefield, Savills Investment Management
Note: 'f' denotes forecast.

RECOMMENDATIONS

We expect prime office rental growth to accelerate further, underpinned by improving economic fundamentals.
We recommend prime office locations in Helsinki CBD, as yields are slightly higher than those of Scandinavian counterparts.

France



Paris

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices (CBD)	750	→	3.00%	↘
Retail	18,000	↗	2.50%	→
Industrial	55	↗	5.00%	↘

Sources: Cushman & Wakefield, CBRE, PMA, Savills Investment Management
Notes: 'f' denotes forecast; reference market for retail is Paris Avenue des Champs-Élysées; reference market for logistics is Greater Paris.

RECOMMENDATIONS

We recommend investors avoid Paris CBD, one of the most expensive office markets in Europe, except for refurbishment opportunities. Furthermore, developing areas such as the northern fringe of Paris have yet to achieve a critical size and to establish themselves. Prime offices in established and well-connected locations in La Defénse, parts of the Western Crescent and in Lyon, Lille and Bordeaux are more attractive. As Paris high street shops are expensive, we see pockets of opportunity in western and southwestern France due to positive sociodemographic and economic outlook. Footfall (tourism), shopping experience, presence of well-known chain stores (brand awareness) and accessibility are important considerations. Generally speaking, we prefer modern distribution centres in established logistics locations with excellent transport links along the north-south logistics corridor. We also like urban logistics in or on the fringes of Paris as well as other major urban areas.

Offices

The outlook for the French office market has improved as the economy has strengthened, supported by new President Emmanuel Macron's economic reforms. We expect this to support 2018 occupier demand, which was temporarily held back by election uncertainty in 2017. Supply should increase in 2017-18, particularly in Paris and Lyon, but will likely be absorbed by solid demand. In some submarkets with especially constricted supply – such as Paris CBD – new development will be particularly welcome. La Défense stands out in the short term due to low completions in 2017. The Grand Paris infrastructure project and the 2024 Olympics should strengthen the attractiveness mainly of the northern and southern fringes of Paris. French provincial office markets have historically been less volatile than Paris, and central locations in Lyon, Lille and Bordeaux have tight supply-demand balance. With this improved backdrop, we expect investors to show a larger appetite for French offices and, consequently, for prime office yields to move in further.

Retail

The French retail sector outlook should brighten on the back of improving consumer fundamentals and a marked recovery in tourism. Paris, as one of the top two destinations for international retailers in Europe, should benefit most. Among provincial markets, large cities with a strong retail presence and positive sociodemographic and economic outlook will continue to prove more resilient to the structural headwinds arising from trends such as e-commerce. Prime high street rents in these locations are forecast to rise moderately, with Paris outperforming. A large shopping centre pipeline, however, should dampen rental growth in the sector. Prime yields hardened further during 2017, although at a slower pace than 2016. We expect this trend to continue.

Industrial

France's improving economy, rising e-commerce and the modernisation and restructuring of supply chains are boosting occupier demand for French logistics. Regionally, the focus is turning back from regional areas to Greater Paris and established locations along the main north-south logistics corridor. Large modern space, which is in high demand, remains scarce. Development is picking up, but speculative schemes are rare and quickly absorbed. Owner-occupier and turnkey deals still predominate. Rents, static in past quarters, are expected to slowly improve in most in-demand locations. The French logistics investment market achieved a new record high level of take-up in 2017. Asian investors' acquisition of European logistics platforms contributed to this. French logistics yields moved in further during 2017. High investor demand and a lack of investment opportunities will also serve to drive down yields in 2018.

Offices

Germany's economy is benefitting from the strengthening global economic recovery and strong domestic demand. Employment – particularly in the services sector – has continued to grow notably, supporting occupier demand for office space. Since office demand is still exceeding supply, rents have moved up significantly across Germany's biggest office markets, according to Savills. The same is true for the investment market where strong demand for core product means investment volume remains high. Thus, prime yields remain under downwards pressure. PMA expects them to fall slightly further in the short term before bottoming out in 2019.

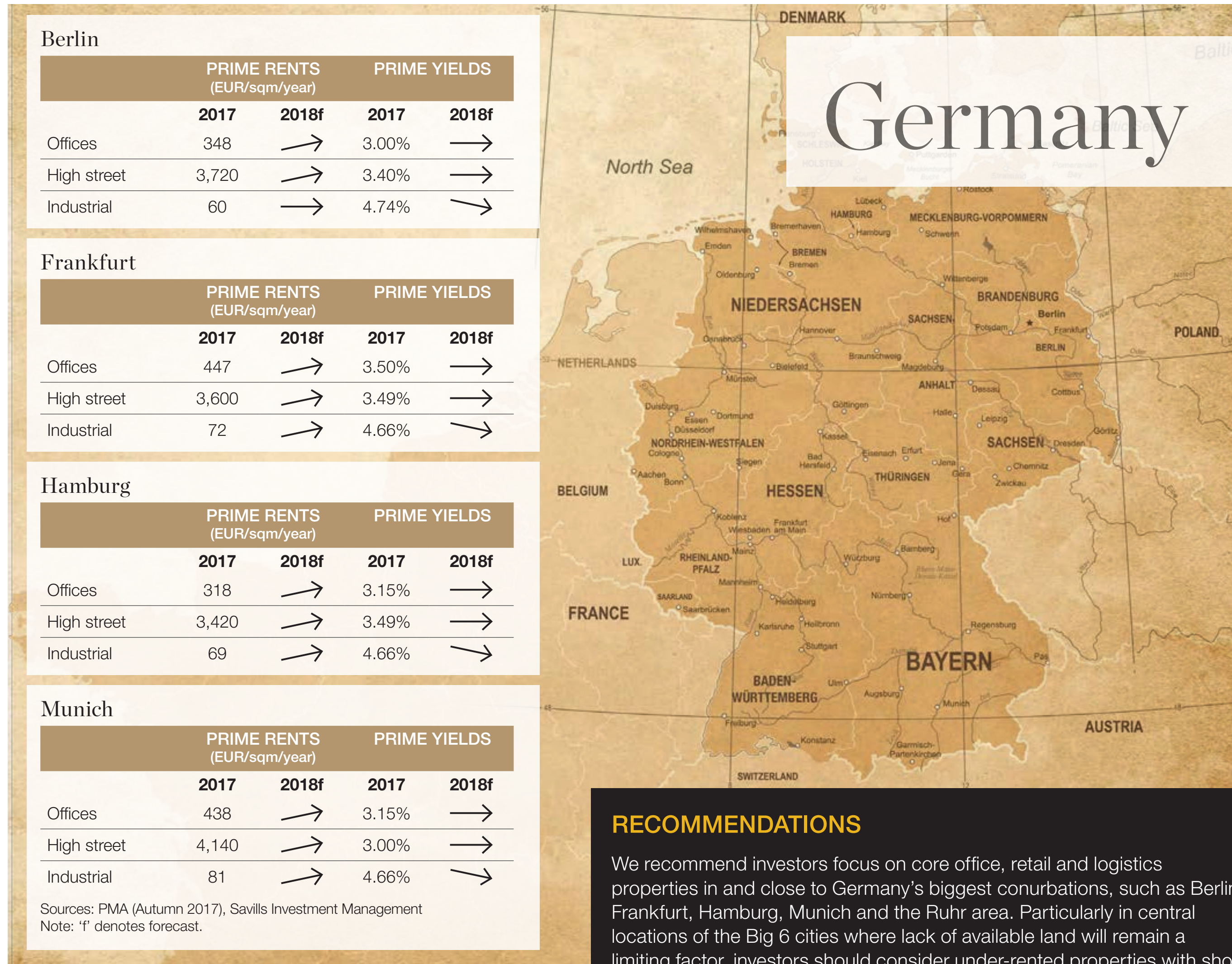
Retail

Household consumption is one of the key drivers of the recent economic recovery in Germany. However, a number of retailers have struggled with changing consumption patterns over the last couple of years, and demand for prime product on core high streets is still exceeding supply. The same is true for retail parks. As a result, prime yields have contracted further, and PMA projects that prime high street yields will bottom out in 2018. Store-based retailers are optimising their store networks and increasingly trying to negotiate shorter leases in order to compete with e-commerce operators.

Industrial

The German industrial and logistics market is currently benefitting from several megatrends – namely digitalisation, technology and urbanisation – and, thus, increasing occupier demand from different sectors. Furthermore, the global economic recovery is bolstering the German export industry. Availability of modern logistics and warehouse space of more than 5,000 sqm remains limited due to pending building permissions and the current high utilisation of German construction companies. CBRE reports that prime logistics net initial yields stood at 4.50% at the end of Q3 2017 due to the high investor demand and scarcity of modern property. According to PMA, while prime logistics yields could dip slightly further, they may have almost reached the cycle trough.

Germany



Berlin

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices	348	↗	3.00%	→
High street	3,720	↗	3.40%	→
Industrial	60	→	4.74%	↘

Frankfurt

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices	447	↗	3.50%	→
High street	3,600	↗	3.49%	→
Industrial	72	↗	4.66%	↘

Hamburg

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices	318	↗	3.15%	→
High street	3,420	↗	3.49%	→
Industrial	69	↗	4.66%	↘

Munich

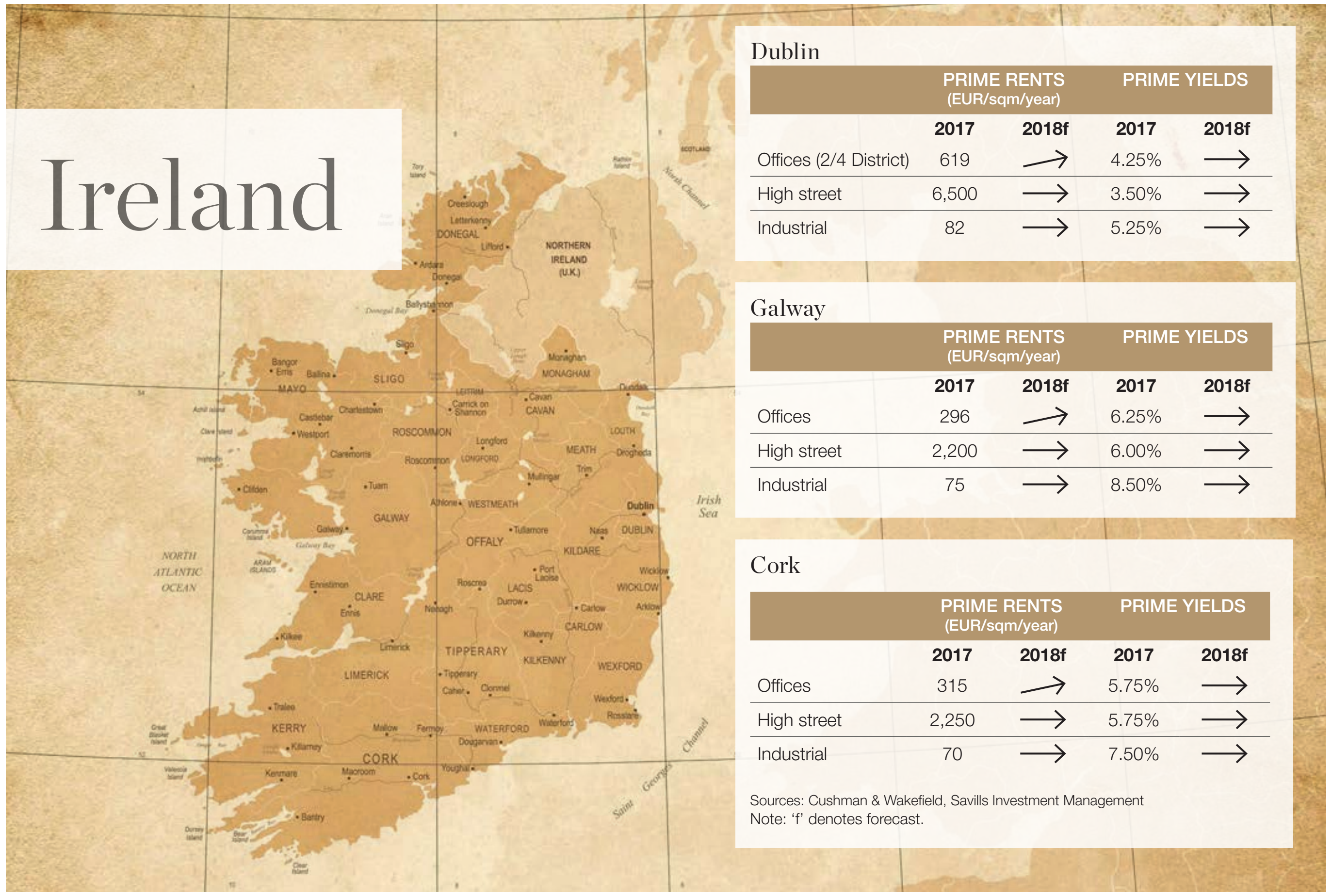
	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices	438	↗	3.15%	→
High street	4,140	↗	3.00%	→
Industrial	81	↗	4.66%	↘

Sources: PMA (Autumn 2017), Savills Investment Management
Note: 'f' denotes forecast.

RECOMMENDATIONS

We recommend investors focus on core office, retail and logistics properties in and close to Germany's biggest conurbations, such as Berlin, Frankfurt, Hamburg, Munich and the Ruhr area. Particularly in central locations of the Big 6 cities where lack of available land will remain a limiting factor, investors should consider under-rented properties with short leases. Furthermore, selected growing secondary cities such as Augsburg, Freiburg, Münster and Nuremberg offer investment opportunities.

Ireland



Dublin

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices (2/4 District)	619	↗	4.25%	→
High street	6,500	→	3.50%	→
Industrial	82	→	5.25%	→

Galway

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices	296	↗	6.25%	→
High street	2,200	→	6.00%	→
Industrial	75	→	8.50%	→

Cork

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices	315	↗	5.75%	→
High street	2,250	→	5.75%	→
Industrial	70	→	7.50%	→

Sources: Cushman & Wakefield, Savills Investment Management
Note: 'f' denotes forecast.

Offices

Ireland office market activity is in a healthy position, with continued employment growth, the lowest unemployment rate in nine years and robust demand for both new and second-hand office space. There is especially strong demand in the form of company expansions in Dublin, and there remains potential for Brexit-related relocations to the capital city. Development activity, namely speculative development, remains a key characteristic of the Dublin office market. New completions are boosting investment activity in the Dublin CBD: according to Cushman & Wakefield, the top three office deals as of Q3 2017 consisted of newly delivered stock to the CBD. This highlights the clear preference for prime Grade A space in the current cycle.

Retail

H1 2017 saw the Irish economy continue to expand, providing an encouraging retail sector backdrop. Personal consumption, fuelled by an improving labour market, is driving domestic demand and should continue to be the key driver of growth over the short term. In the context of this economic performance, retail sales have continued to trend upwards. According to Oxford Economics, retail sales grew by 1.2% in Q3 2017. While store-based retail sales are growing, they are not increasing as much as in recent years due to trends such as rising e-commerce, according to CBRE. Furthermore, the value of sales continues to lag in an environment of discounting and value-driven shopping.

Industrial

Both occupiers and investors remain active in the Irish industrial sector, as sentiment is positive. In the occupier market, a shortage of quality space is maintaining upwards pressure on prime rents. According to JLL, only two key schemes were under construction as of November 2017. The pressure on prime rents will likely remain a feature of the market over the coming year, driven by growing occupier demand and continued tight supply.

RECOMMENDATIONS

Property developers are responding to strong capital values, and PMA expects significant new development of Dublin offices in 2018, which may lead to an increase in vacancy and possible rental weakness. We are cautious of Dublin offices, especially the impact of Dublin's housing shortage, but do recommend Dublin retail parks and last-mile urban logistics units.

Offices

Occupier demand for office space in Italy remains strong, with growing interest from companies looking for flexible and co-working spaces. Properties located in central areas of Italian cities are maintaining their desirability, with Milan and Rome in the lead. Milan's quarterly occupier demand figures are slightly above the 10-year average, and the take-up volume registered to date is significantly higher than the decade average. Competition is high for spaces under development or refurbishment, especially in central areas, with the majority of completed transactions for Grade A space. Take-up has increased in Rome, where demand is generally driven by small- and medium-sized national companies or corporates looking to rationalise and improve the quality of occupied space. Both international and domestic investors are showing growing interest in the Italian office market, especially core and core-plus products as well as value-add assets strategically located in city centres.

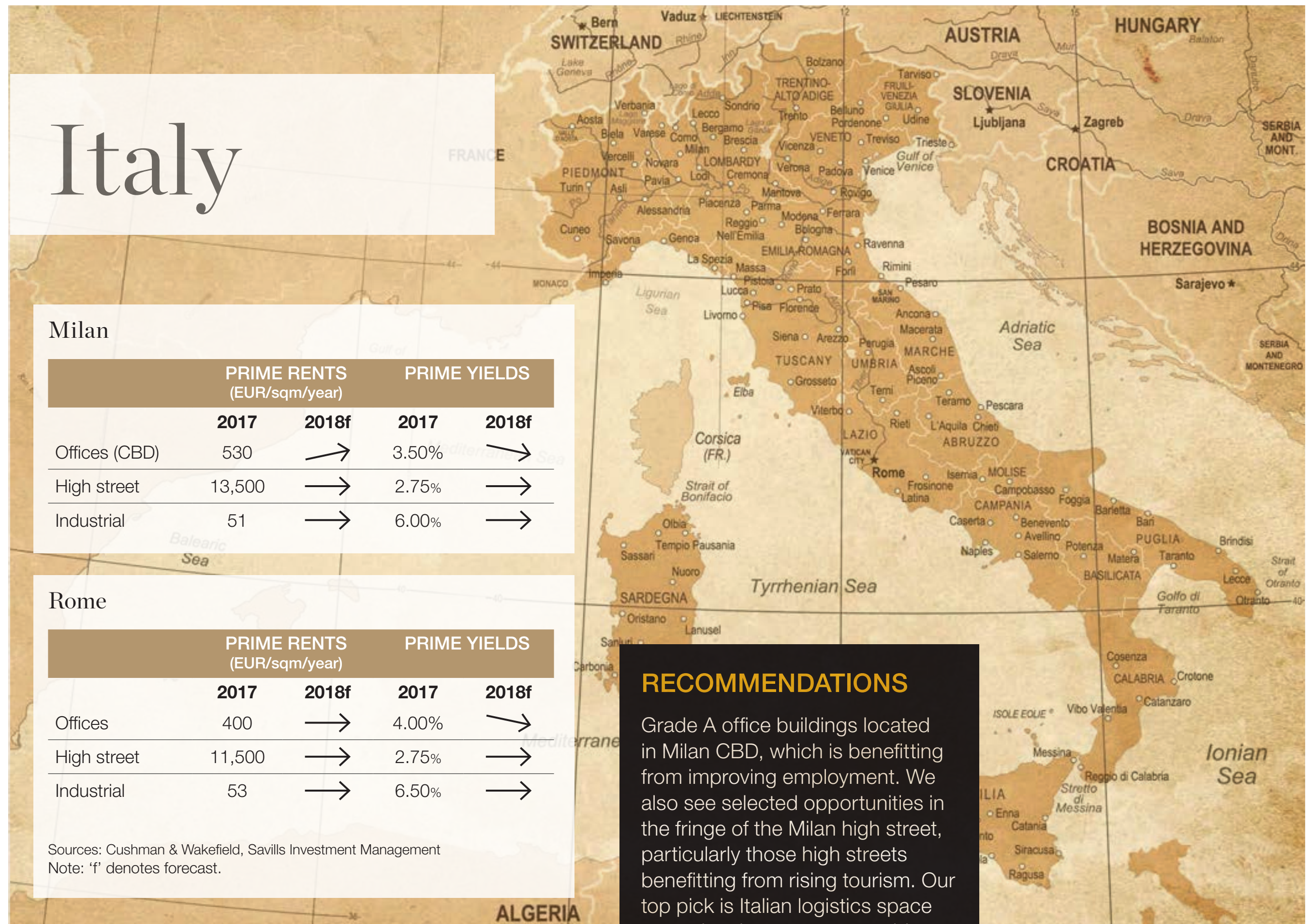
Retail

Italy's average prime high street rents have been mainly stable over the past year. Demand for locations supported by strong tourism is strong. Retailers and property owners continue to pay attention to the trend of growing online sales, with some companies putting expansion plans on hold while they contemplate new strategies. In this transitional phase, secondary locations and large stores are staying on the market longer, with retailer focus remaining on flagship stores in top locations. Prime yields remain stable across all retail segments and should hold steady for the rest of the year. The high street segment continues to attract the attention of international investors, while out-of-town opportunities must be carefully considered.

Industrial

The Italian logistics market continues to perform well. Occupier demand is strong for build-to-suit or refurbished units sought after by major retailers or third-party logistics (3PL) providers in search of larger hubs in strategic areas. Lombardy and Emilia Romagna remain the most active regions, specifically to the east of Milan and around Bologna. There is growing demand from e-commerce companies for last-mile logistics space in the vicinity of major cities. This trend should increase despite the lack of high quality space and the fact that much of the available space is in need of refurbishment. Both international and domestic investors are attracted to the high yields relative to other sectors.

Italy



Milan

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices (CBD)	530	↗	3.50%	↘
High street	13,500	→	2.75%	→
Industrial	51	→	6.00%	→

Rome

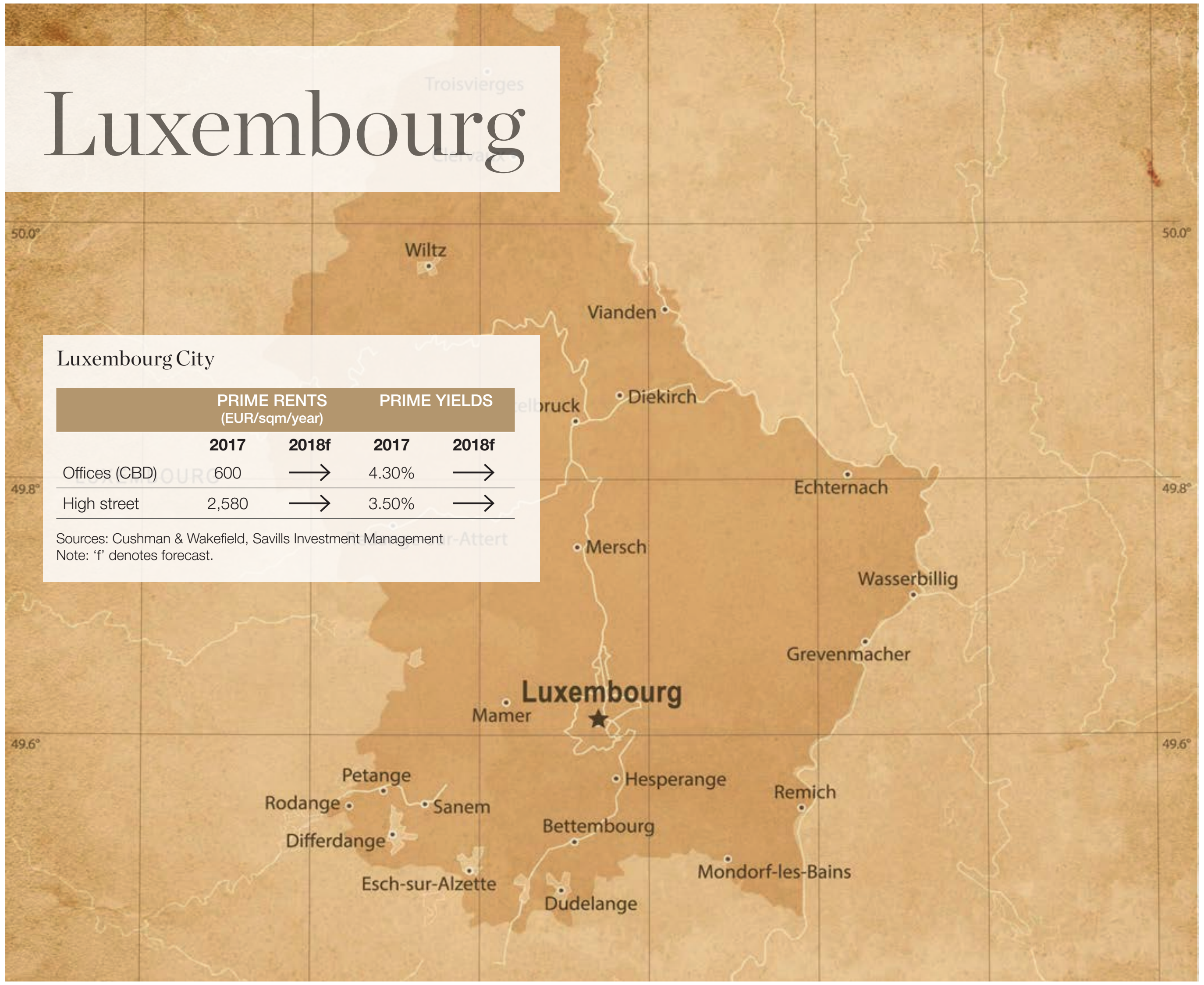
	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices	400	→	4.00%	↘
High street	11,500	→	2.75%	→
Industrial	53	→	6.50%	→

Sources: Cushman & Wakefield, Savills Investment Management
Note: 'f' denotes forecast.

RECOMMENDATIONS

Grade A office buildings located in Milan CBD, which is benefitting from improving employment. We also see selected opportunities in the fringe of the Milan high street, particularly those high streets benefitting from rising tourism. Our top pick is Italian logistics space around major transport corridors, which is attractively priced compared to other segments.

Luxembourg



Luxembourg City

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices (CBD)	600	→	4.30%	→
High street	2,580	→	3.50%	→

Sources: Cushman & Wakefield, Savills Investment Management
Note: 'f' denotes forecast.

Offices

Demand for Luxembourg office space should remain robust, as economic fundamentals look positive and Brexit-related relocations could add as many as 2,000 new jobs to the country in two years, Savills estimates. On the supply side, major developments are in the pipeline for 2018 and 2019 – most of which are pre-let – while the speculative pipeline is limited. Healthy demand combined with constrained supply has led to a decrease in the vacancy rate, pushing rental values in the CBD to their highest-ever levels. In terms of office investment, prime yields should stabilise in 2018 after reaching historically low levels in the CBD. Investment activity should remain robust amidst Luxembourg's growing importance as a destination for Brexit-related office relocations.

Retail

Economic indicators provide an encouraging environment for the Luxembourg retail sector. Consumer confidence reached an all-time high in November 2017, and the unemployment rate has continued to decline. Oxford Economics expects consumer spending to grow by 2.6% in 2018, well above the Eurozone, which should support robust GDP growth. Given the healthy economic backdrop and consumers' high purchasing power, appetite from international retailers should remain strong. On the investment side, prime high street yields are historically low, at 3.5%, according to Cushman & Wakefield. Further slight yield compression is possible due to strong competition among local investors.

RECOMMENDATIONS

We recommend Luxembourg City offices, as the sector's vacancy rate is low compared to most European markets, offering potential for rental growth. Luxembourg offices offer a higher risk premium and higher yields compared to other core European markets such as Germany and France.

Offices

The Dutch office market is improving rapidly due to solid occupier demand, contained new development and brisk conversion activity. Amsterdam is leading the cycle, and rental growth is spreading to western submarkets due to increasing shortage of space in the CBD and city centre. In central locations in the main regional cities, vacancies are also falling, with rents increasing in Utrecht. We expect these positive trends to continue on the back of strong economic growth. However, rental growth is forecast to slow, and numerous secondary locations remain characterised by oversupply. Investor interest to acquire Dutch offices is immense, particularly from abroad. The country's strong economic backdrop and improving fundamentals will continue to attract investors, and we expect yields to harden further.

Retail

The Dutch retail sector is currently in a sweet spot due to improving consumer fundamentals, growing tourism and rising retail sales. The national vacancy rate is declining and reached 7.2% in 2017, according to Locatus, but structural headwinds, mainly from rising e-commerce, remain in place. This presents a challenge to both retailers and retail destinations. Competition between occupiers and investors for the best properties in the best high street locations remains intense, with Amsterdam as the primary target. In 2017, Dutch retail assets attracted more investor interest compared to a weaker 2016. Prime high street yields thus moved in further, and we expect this trend to continue.

Industrial

Dutch industrial space remained in high demand by both occupiers and investors throughout the course of 2017. Take-up almost doubled year to date, and the transaction volume reached another record high by the end of the year. This impressive result reflects the strong cyclical upturn in Europe combined with the structural rise in e-commerce. Due to the scarcity of modern, large distribution centres, occupiers are seeking build-to suit solutions frequently sold and leased back outside of the usual logistics hotspots. Investors are also increasingly turning to portfolio deals. However, the national industrial vacancy rate remained stable in 2017 due to rising development activity. In particular, speculative developments are steadily picking up. The rental outlook is mixed, with some downwards pressure in areas characterised by strong development. Yields should harden further in 2018 due to strong investor demand.

The Netherlands

Amsterdam

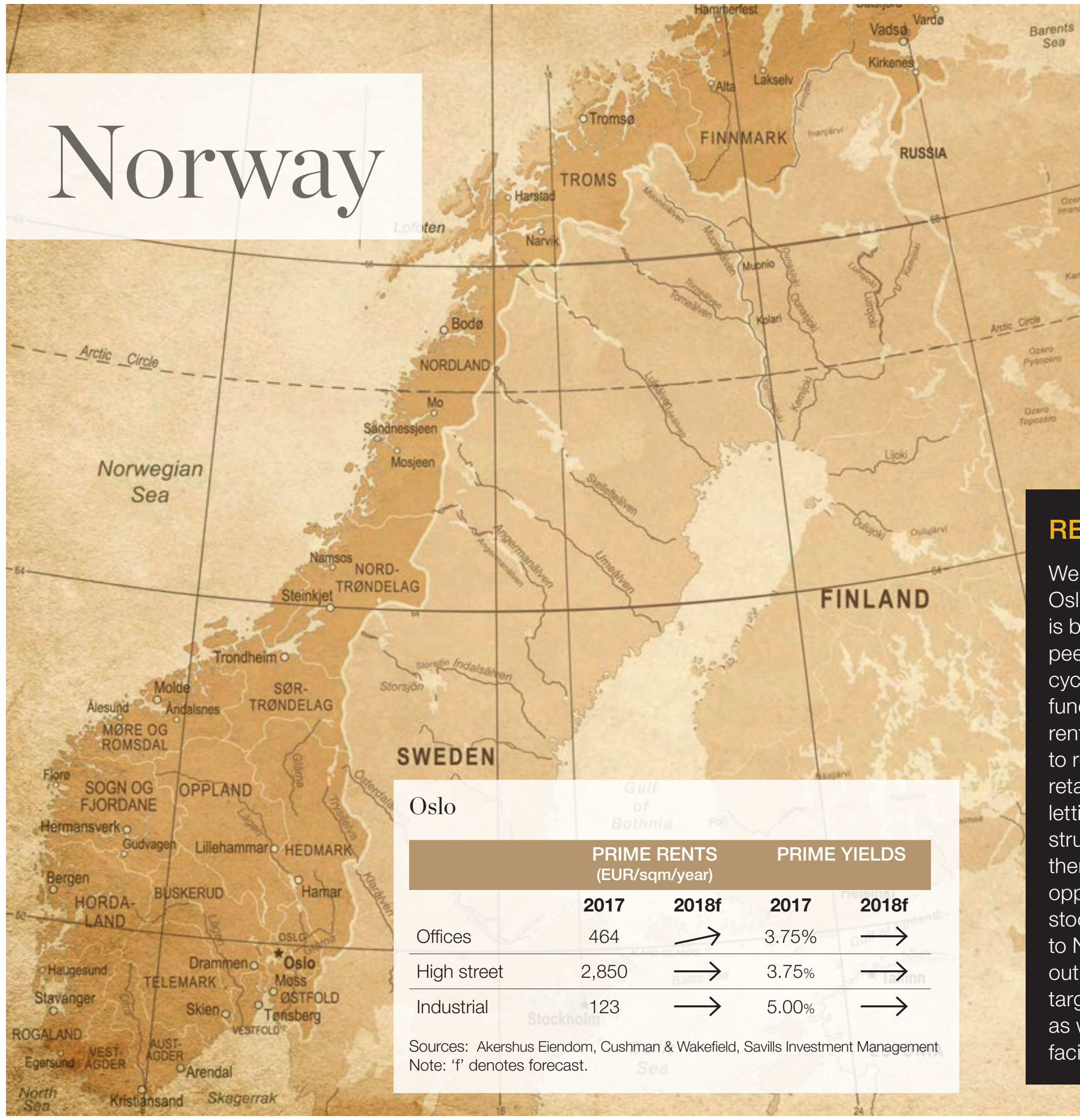
	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices	400	↗	3.80%	↘
Retail	3,000	↗	3.20%	↘
Industrial	95	→	4.90%	↘

Sources: Cushman & Wakefield, Savills Investment Management
Note: 'f' denotes forecast.

RECOMMENDATIONS

The pricing of Dutch office markets is still attractive compared to core European markets. We recommend focusing on high quality, flexible office space in central locations with rental upside and excellent access to public transport. As prime high street shops in the top four markets (Amsterdam, The Hague, Rotterdam and Utrecht) are already ambitiously priced, we see more attractively priced opportunities in selected top 20 provincial cities such as Eindhoven and Maastricht. We prefer modern, flexible, logistics assets that are benefitting from e-commerce and in established locations with good transport links. We suggest avoiding areas where high development activity is affecting rents.

Norway



Oslo

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	**2018f**	**2017**	**2018f**
Offices	464	↗	3.75%	→
High street	2,850	→	3.75%	→
Industrial	123	→	5.00%	→

Sources: Akershus Eiendom, Cushman & Wakefield, Savills Investment Management
Note: 'f' denotes forecast.

RECOMMENDATIONS

We see opportunities in the Oslo office market, which is behind its Scandinavian peers in the investment cycle but whose economic fundamentals are positive for rental growth. We are cautious to recommend high street retail due to signs of weaker letting activity and ongoing structural shifts, but we believe there are still some pockets of opportunity, although careful stock selection is crucial. Due to Norway's logistics market outlook, we recommend targeting large warehouses as well as urban, last-mile facilities.

Offices

The Oslo office market is well positioned for the future, with a recovering economy entering a cyclical upturn, moderate office vacancy and low supply-side growth. Prime rents are rising due to increased demand and record-low net construction. The lease expiry profiles of large government or municipal agencies indicate that demand for space should be greater than supply over the next years. However, companies are reporting requirements for less space per employee.

Retail

After several years of stagnation in the Oslo retail sector, climbing consumer spending represents a positive shift. According to Union Gruppen, many brick-and-mortar retail stores have seen a rise in turnover. This relates closely to a level of optimism among Norwegian consumers not seen since before 2007. The Oslo high street segment is experiencing a slight correction, with lower activity in the leasing market. However, vacancy in prime retail locations is close to zero, and retailer interest continues to exceed supply at Karl Johans gate. Locations more secondary to the prime retail pitch should experience rental growth going forward.

Industrial

Fundamental and structural trends should contribute to rising demand for logistics space in Norway, while disciplined developers are keeping speculative construction low. The strong growth in online shopping is transforming the logistics supply chain: online shopping utilises about three times the logistics space as traditional retailing. The Oslo region logistics market is on a solid performance path, supported by strong demand for warehousing players and online retailers. E-commerce logistics operators should fuel occupier demand in the context of rising private consumption and online sales. Increasing development has begun to impact on vacancy, but not enough to put pressure on rental levels.

Poland

Offices

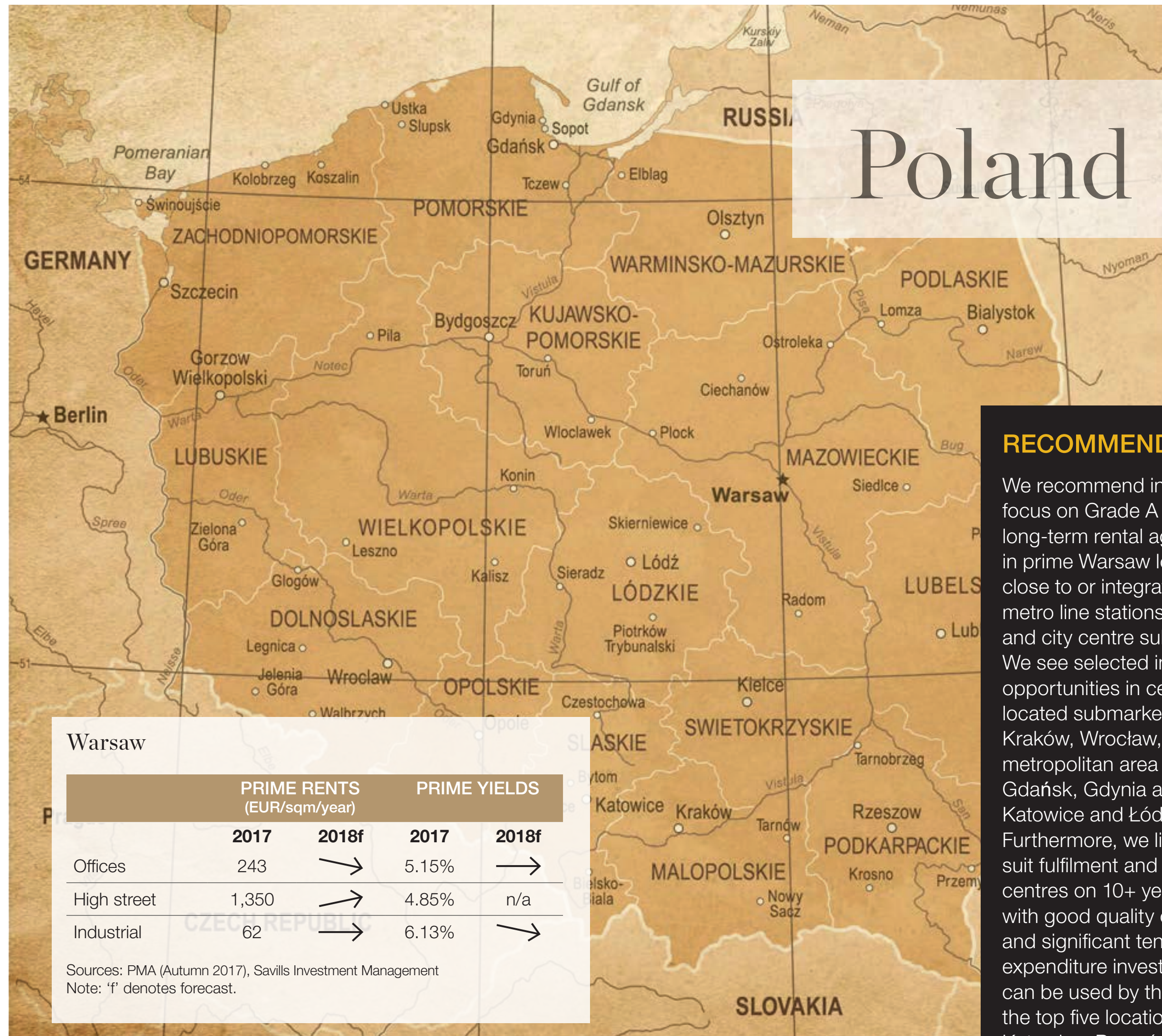
Poland's economic growth should notably outperform France, German, UK, Eurozone and European Union (EU) averages over the next five years, according to Oxford Economics. Savills reports that vacancy rates across Polish office markets have recently trended downwards, except for in Kraków and Lublin. CBRE forecasts vacancy to rise to more than 17% by 2021 due to an increasing number of completions. As a result, prime office rents are likely to remain under downwards pressure in the short to medium term. PMA expects prime yields to fall in the short term due to high investor demand for core Warsaw offices.

Retail

Loose monetary policy, tight labour market conditions and the so-called Family 500+ child benefit scheme remain supportive of consumer spending, which Oxford Economics sees growing 4.2% year on year in 2018. Consequently, Poland remains an attractive market for international retailers, according to JLL. However, a law that would gradually impose a ban on Sunday shopping from 2018 could, if put into action, cause some retail market uncertainty. The investment market remained lively, however.

Industrial

The Polish logistics and warehouse sector is benefitting from strong economic growth and proximity to its biggest trading partner, Germany. A number of online retailers such as Amazon have opened mega-distribution centres close to the Polish-German border in Western Poland to serve the Western European markets. This has boosted logistics take-up over the last couple of years. While development activity is still high, vacancy should remain low due to high demand for modern logistics space. Despite low sector transaction volumes through the end of Q3 2017, Cushman & Wakefield expects a higher number of standalone as well as portfolio deals to push the 2017 annual transaction volume above last year's level, while prime yields should remain stable at around 6% in the short to medium term, according to PMA.



Warsaw

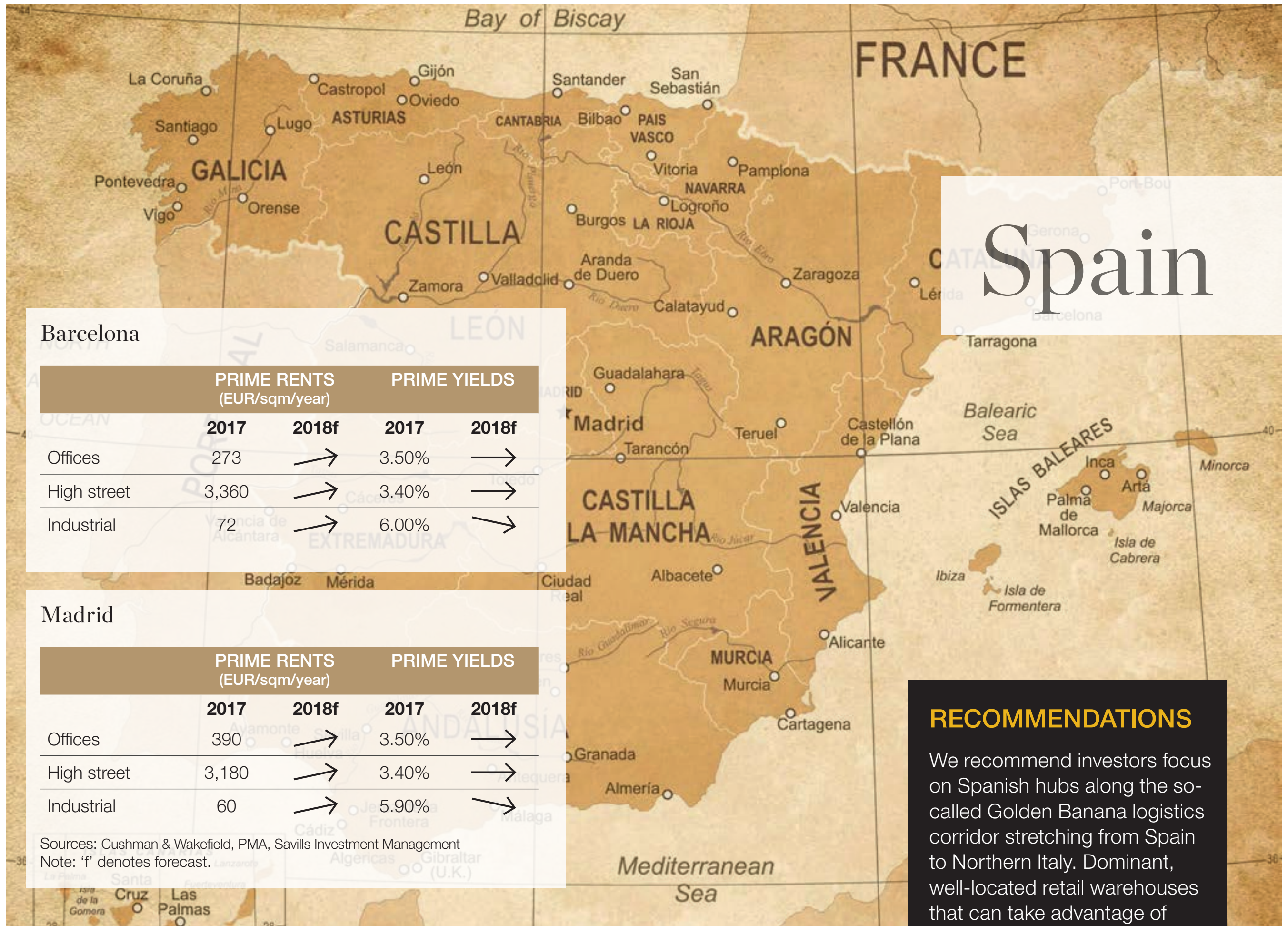
	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	**2018f**	**2017**	**2018f**
Offices	243	↘	5.15%	→
High street	1,350	↗	4.85%	n/a
Industrial	62	→	6.13%	↘

Sources: PMA (Autumn 2017), Savills Investment Management
Note: 'f' denotes forecast.

RECOMMENDATIONS

We recommend investors focus on Grade A offices with long-term rental agreements in prime Warsaw locations close to or integrated with metro line stations in the CBD and city centre submarkets. We see selected investment opportunities in centrally located submarkets in Kraków, Wrocław, TriCity (a metropolitan area consisting of Gdańsk, Gdynia and Sopot), Katowice and Łódź, too. Furthermore, we like build-to-suit fulfilment and distribution centres on 10+ year leases with good quality covenants and significant tenant capital expenditure investment that can be used by third parties in the top five locations: Warsaw, Katowice, Pozna'n, Wrocław and Central Poland (Łód'z).

Spain



Barcelona

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	**2018f**	**2017**	**2018f**
Offices	273	↗	3.50%	→
High street	3,360	↗	3.40%	→
Industrial	72	↗	6.00%	↘

Madrid

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	**2018f**	**2017**	**2018f**
Offices	390	↗	3.50%	→
High street	3,180	↗	3.40%	→
Industrial	60	↗	5.90%	↘

Sources: Cushman & Wakefield, PMA, Savills Investment Management
Note: 'f' denotes forecast.

RECOMMENDATIONS

We recommend investors focus on Spanish hubs along the so-called Golden Banana logistics corridor stretching from Spain to Northern Italy. Dominant, well-located retail warehouses that can take advantage of e-commerce trends in click and collect and showrooming are likewise attractive.

Offices

Spain's ongoing economic recovery is continuing to boost the economic backdrop in Barcelona and Madrid, despite a politically tumultuous second half of 2017. Employment has continued to grow, supporting occupier demand for office space and, consequently, rents. Investment volumes also remain strong, with rolling yearly figures for the 12 months to Q3 2017 above that of the same period in 2016, according to Real Capital Analytics. Investor demand has continued to support yields, although for now, prime yields appear to have topped out. Madrid and Barcelona should continue to see positive rental growth, as tight supply persists in this middle stage of the cycle.

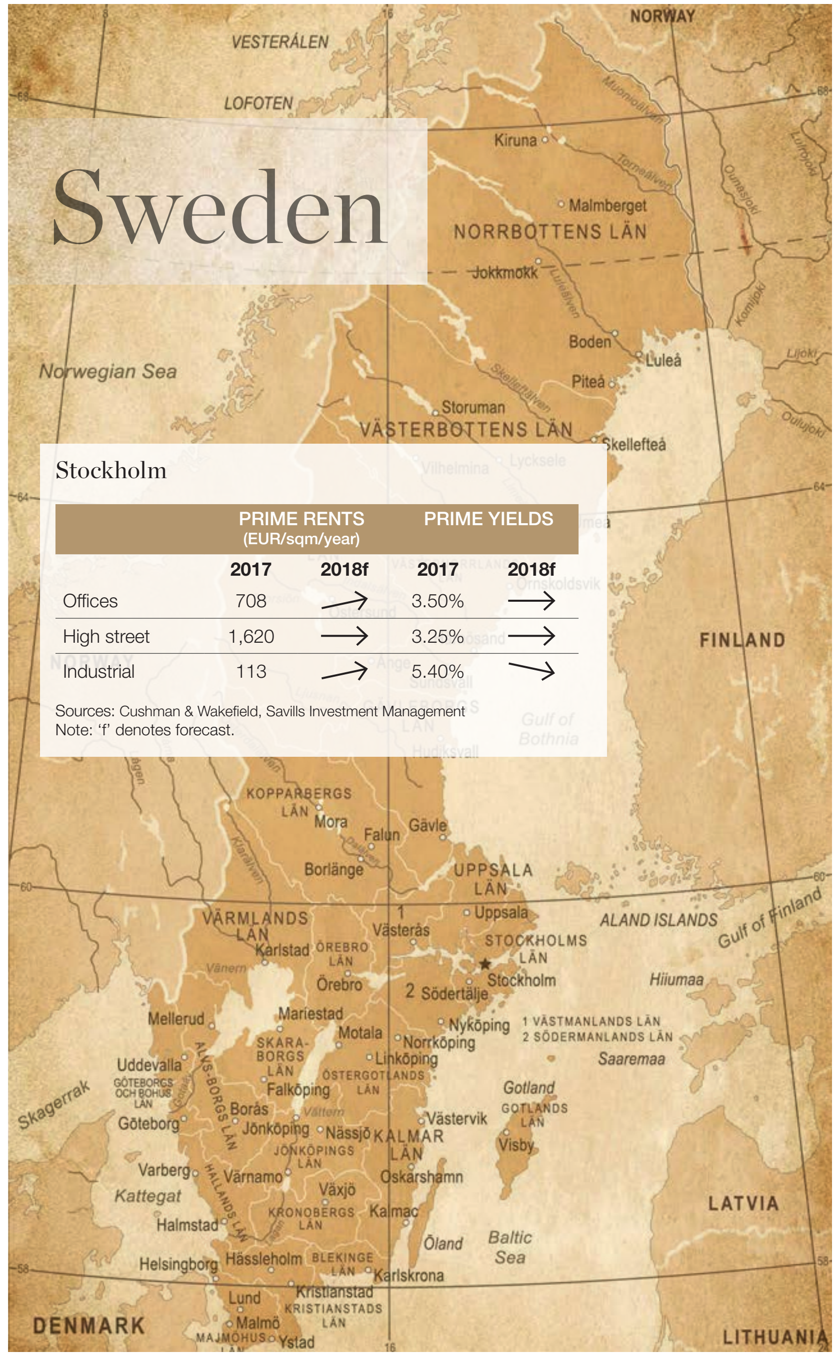
Retail

Spain has been enjoying some of the strongest economic growth in Europe, with 3.1% annual GDP growth in Q3 2017. This is underpinned by solid household consumption, driving demand for retail units. As such, prime rents continue to rise, and prime yields are either stable or contracting. Investment volumes are also up on 2016. Spanish retail could face increasing bifurcation as online retail's share of overall retail sales exceeds the critical 5-6% threshold at which stores unable to adopt an omnichannel approach start to struggle.

Industrial

Growing retail sales – an increasing share of which are e-commerce sales – and industrial production increases continued to support demand for Spanish logistics over 2017. Combined with tight supply, this has served to push up rents, particularly at the prime end. A wave of development is underway and due to complete in 2018; however, this pipeline is still below market requirements. Furthermore, with vacancy rates mostly at the lower end in Barcelona and Madrid, these cities should see further rental increases in 2018. Following a more sluggish first quarter, investment volumes for Q2 and Q3 2017 were significantly up on 2016.

Sweden



Stockholm

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	**2018f**	**2017**	**2018f**
Offices	708	↗	3.50%	→
High street	1,620	→	3.25%	→
Industrial	113	↗	5.40%	↘

Sources: Cushman & Wakefield, Savills Investment Management
Note: 'f' denotes forecast.

RECOMMENDATIONS

We see potential office space investment opportunities in the fringe-of-CBD or best suburban locations that offer better availability and affordability. Areas such as Solna/Arenastaden, which is expanding its residential and retail offering and benefitting from excellent transportation as well as modern and efficient floorplans. In the retail sector, stock selection is becoming increasingly important as the rapid growth of e-commerce creates a market polarisation where retailers who adapt to changing consumer patterns are more successful. We recommend targeting food-anchored, medium-sized neighbourhood schemes and regional centres. For logistics, we recommend targeting modern premises in the major cities of Sweden, with a focus not only on last-mile solutions but also on mega-distribution centres suitable for large online retailers and third-party logistics providers.

Offices

Sweden's solid, albeit slowing, employment growth rate will continue to drive demand for Stockholm offices. Prime office rents are at an all-time high. Capital Economics expects Stockholm to provide one of the strongest office sector returns in 2017-18. However, softer employment growth will result in a slower rate of net absorption. Completions are picking up, but are not expected to outstrip net absorption in 2018 or 2019. Vacancy should continue to decrease through 2019. However, the all-time high rents for Stockholm CBD offices may signal that this market is approaching a cycle peak: according to Cushman & Wakefield, only London and Paris have higher prime office rents than Stockholm, where rents have exceeded SEK 8,000 per sqm per year, according to JLL. Investors are continuously repricing prime assets in the best suburban locations and fringe-of-CBD due to high prices and lack of availability in the CBD.

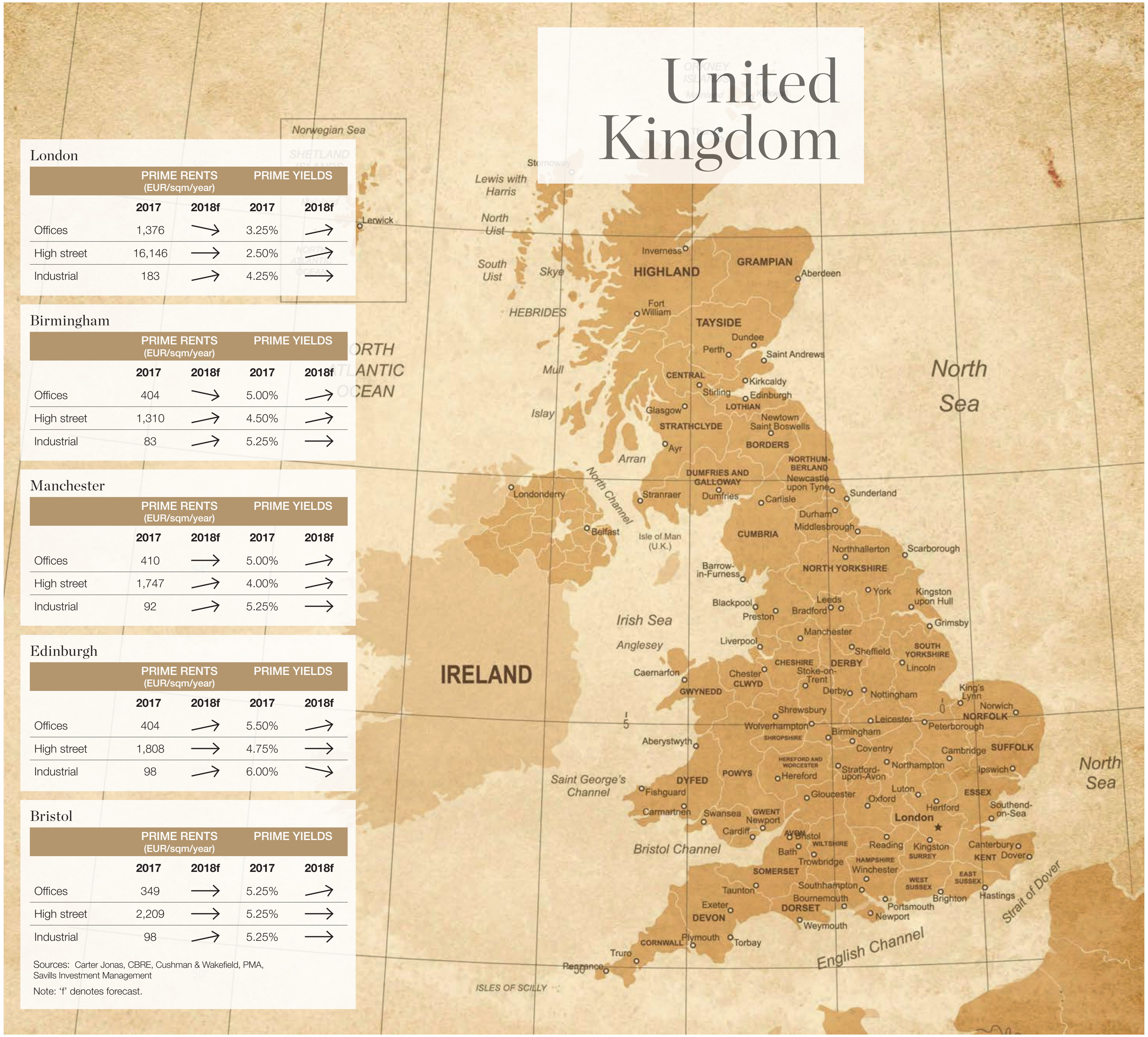
Retail

Stockholm prime high street retail rents reached a new peak in early 2016, although they have since stabilised. PMA expects rents to remain modest but to see steady growth over the coming years. Consumer spending should average 2.2% over the next five years, according to PMA. Continuing e-commerce growth remains a concern, but retailers are adapting to changing consumer patterns by focusing on omnichannel retail strategies including showrooming and pop-up stores. Additionally, demand for incorporating food and beverage offerings is quickly rising, both in central and non-central locations. Investor interest remains strong for Stockholm high street property and food-anchored retail parks. Retailer demand remains robust for prime space, with international retailers focused primarily on the best high street retail pitches.

Industrial

Retailers and third-party logistics providers are the main drivers of demand in Sweden and tend to prefer prime locations in Stockholm and Gothenburg as well as strong regional locations in the logistics triangle, such as Örebro and Jönköping. Urbanisation and rising demand for quick deliveries in the context of rapid e-commerce growth are leading to a shift in focus towards last-mile logistics solutions and mega-distribution centres. More storage space will be required closer to urban centres, as 85% of the Swedish population live in a city. Due to population growth and housing shortages, land prices are rising, increasing competition for suitable land for urban logistics. A low level of speculative development limits supply.

United Kingdom



London

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices	1,376	↘	3.25%	↗
High street	16,146	→	2.50%	↗
Industrial	183	↗	4.25%	→

Birmingham

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices	404	↘	5.00%	↗
High street	1,310	↗	4.50%	↗
Industrial	83	↗	5.25%	→

Manchester

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices	410	→	5.00%	↗
High street	1,747	↗	4.00%	↗
Industrial	92	↗	5.25%	→

Edinburgh

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices	404	↗	5.50%	↗
High street	1,808	→	4.75%	→
Industrial	98	↗	6.00%	↘

Bristol

	PRIME RENTS (EUR/sqm/year)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices	349	→	5.25%	↗
High street	2,209	→	5.25%	→
Industrial	98	↗	5.25%	→

Sources: Carter Jonas, CBRE, Cushman & Wakefield, PMA, Savills Investment Management

Note: 'f' denotes forecast.

Offices

Employment remained strong in the UK over 2017, and unemployment reached its lowest rate in 42 years. Jobs are becoming increasingly diversified by sector, particularly in areas such as the City of London where there was previously a higher financial services sector concentration. The science, technology, engineering and maths (STEM) as well as technology, media and telecommunications (TMT) sectors – which are more resilient to the impact of Brexit – are increasing in importance. This should support demand for office space.

Nonetheless, office supply is on the rise, particularly in the City. The UK office sector is currently approaching the end of the late-cycle phase, with a trough forecast for 2018-19. However, the drop-off in new development that followed the 2016 UK referendum on EU membership means that supply should contract as we exit this trough and enter the upswing. Investor confidence remains strong, demonstrated by healthy investment volumes, particularly from overseas capital at the prime end.

Retail

A combination of pricing, lack of supply and increased returns in other sectors has led to a dampening of retail investment volumes in the UK. Some retailers have also seen margins squeezed due to cost-push inflation from a weaker pound; however, we expect these impacts to have topped out for the time being.

Central London and Heritage high streets continue to benefit from tourism, particularly with the weaker pound. Better situated, dominant retail warehouses, which are well placed to take advantage of trends in showrooming and click and collect, are also performing well.

The continued rise in e-commerce and omnichannel retailing is leading to a bifurcation in brick-and-mortar retail performance: those stores and locations positioned to take advantage of this multichannel approach to retail – where convenience shopping is increasingly important – are leaving behind those stores and areas that are unable to successfully adapt to new shopping patterns.

Industrial

The UK industrial sector continues to benefit from the rise in online shopping and the artificial intelligence revolution, increasing demand for facilities and reducing unit labour costs as automation picks up. The significant internal infrastructure investment requirements for these new technologies also potentially make tenants more sticky to locations.

However, location, building specification and power sources are becoming increasingly important and hard to locate. Limited availability of suitable space in urban locations may drive a shift towards multi-storey logistics models.

Industrial investment volumes for 2017 were up on 2016, and investor appetite remains strong. The demand-supply imbalance in the modern logistics segment means rents are seeing an upwards trend. Rent-free periods are shortening or non-existent in some prime locations. Despite some uncertainty regarding the outcome of Brexit negotiations, the occupier market remains strong, especially for modern and efficient space in locations strategically placed to meet increasing demand for e-commerce.

RECOMMENDATIONS

We recommend well-located retail warehouses close to transport links, which are positioned to take advantage of trends in e-commerce. We also recommend logistics properties with the potential for intensification near cities such as Greater London, the Big 6 cities (Birmingham, Bristol, Edinburgh, Glasgow, Leeds and Manchester) as well as Oxford and Cambridge. Locations around major transport corridors and ports, particularly south of Birmingham, should also present logistics opportunities.

ASIA-PACIFIC REAL ESTATE MARKET UPDATE:

growing optimism amidst uncertainty

ECONOMIC RECOVERY TO GAIN MOMENTUM

The Asia-Pacific region continues to deliver robust economic growth in the face of concerns about growing global trade protectionism, a rapidly aging society, geopolitical tensions and slow productivity growth. Export growth has picked up, supported by strong trade flows. A combination of low interest rates across the region and loose monetary policies alongside low inflation have also buoyed private consumption. The International Monetary Fund's most recent Asia-Pacific regional GDP growth forecast is for 5.5% growth in 2018, 0.1 percentage point higher than its H1 2017 projection, driven by strong consumption and investment.

Oxford Economics, among other private economists and research think tanks, expect interest rates across the Asia-Pacific region to generally follow trends in the United States. US economic activity grew moderately in 2017, and the labour market has continued to strengthen. This has given the Federal Reserve further confidence in hiking interest rates. The Bank of Korea raised its benchmark interest rate for the first time since 2011 in November this year, marking a likely turning point for Asian central banks.

Some Asia-Pacific markets, however – namely Australia and Japan – are likely to maintain their accommodative stance in 2018, and Oxford Economics expects inflationary pressure to accelerate as commodity prices recover.

Low interest rates in developed economies as well as easily available liquidity have led to a rapid increase in debt in parts of Asia, a risk that may significantly hinder regional growth. Central banks are likely to engage in a 'go slow' tapering policy to avoid any disorderly credit flows within the region, which may potentially trigger sharp asset repricing.

Capital flows out of Asia – particularly Chinese capital flows – and into other global gateway markets have driven asset prices up significantly. The Chinese government's recent introduction of tighter capital controls has somewhat curbed Asian capital outflows; nevertheless, outflows should continue to increase, albeit at a slower pace, as yields have compressed sharply, driving domestic capital abroad in search of higher returns.

Although GDP forecasts have been revised upwards, the near-term outlook is clouded with significant uncertainty, which brings with it downside risk. Medium-term growth faces headwinds, including from population aging and sluggish productivity. Growing political tensions stem from potential military conflict between North Asia and the US. Furthermore, US trade policy and potential US economic slowdown in 2019 could act as a drag on the global economy, according to Oxford Economics projections. Nevertheless, Asian governments will continue to focus on structural reforms including rebalancing economies towards services growth and consumption, utilising technology and innovation to help ensure sustainable economic growth, addressing demographic challenges and boosting productivity.

POSITIVE PROPERTY DEMAND FUNDAMENTALS...

Offices

Office sector leasing activity has been mixed across the region's diversity of cities and markets. Overall office occupancy levels have been increasing since last year, led by the developed markets of Australia and Japan. In contrast, vacancy rates in China and Malaysia are rising and expected to face further headwinds as supply risk mounts over the next 12-18 months.

The office tenant profile is also changing across the region. Technology and co-working operators have been expanding their footprint, overshadowing the traditional finance and business services segments. We expect this to continue into 2018 as cost-conscious tenants look to upgrade before rental growth momentum accelerates further.

Retail

An improving economic outlook, low interest rates, low inflation, positive consumer sentiment and a buoyant tourism sector are supporting retail sales in parts of the region, particularly Japan. Rising retail spending in Asia is linked to growing income and wealth. This trend is likely to continue: the United Nations projects that the Asia-Pacific region's share of the global middle class should rise to 60% by 2030. Asian consumers have also benefitted from rising house prices, a key component of household wealth.

Nonetheless, the region is also facing structural challenges from e-commerce. Online retail in the Asia-Pacific is on the rise and set to overtake America's steadily increasing share as a proportion of total retail sales. Retailers are now more cautious about expanding their brick-and-mortar presence, instead looking to optimise their portfolios by closing non-performing stores and focusing on experiential retailing.

Industrial

Against a backdrop of global export uplift and rising e-commerce, manufacturers, retailers and 3PL firms are seeking logistics space. While market conditions have improved alongside leasing demand in the region, rental growth was modest owing to a wave of new supply across key markets such as Tokyo, Shanghai and Beijing. Major e-commerce retailers such as Alibaba and JD are developing their own logistics facilities, amplifying concerns of speculative supply risk. However, in our view, structural trends stemming from online retail sales growth coupled with rising incomes should lead to stronger demand for logistics space.

...BUT SUPPLY RISKS A CONCERN IN DEVELOPING MARKETS

Strong leasing performance, still-low interest rates and anticipation of a pickup in the global economy are driving developers to acquire land. Supply risks are mounting across the region: 9 out of 15 Asia-Pacific office markets monitored by PMA are expected to record a rise in new completions from 2017. According to PMA, China and Malaysia are the most vulnerable to further rental declines in response to new office completions in 2018.

Similarly, PMA reports that shopping centre supply risks are higher in suburban locations in China and Malaysia, where the rapid growth in shopping centre stock per capita may push up vacancy rates in 2018, representing development risk. Levels of new supply should moderate in most other markets, including Tokyo, in the year ahead, while supply-constrained markets such as Sydney and Melbourne should continue to see gradually improving rental performance.

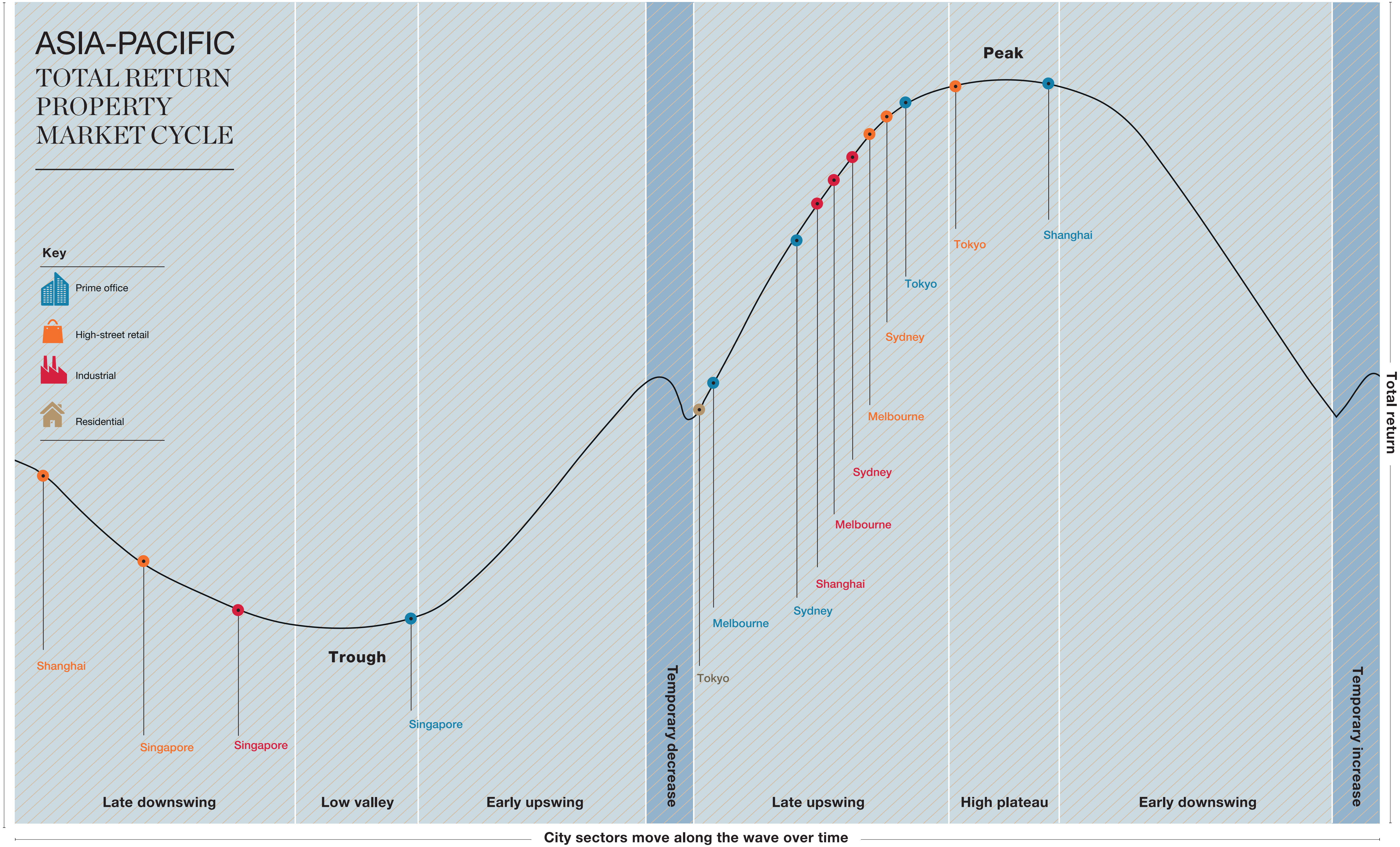
High domestic and global investor interest is funding a wave of new supply. However, the lack of modern logistics facilities is giving rise not only to obsolescence risk but also potential for refurbishment or build-to-suit opportunities as e-commerce continues to grow.

MOVING UP THE RISK CURVE

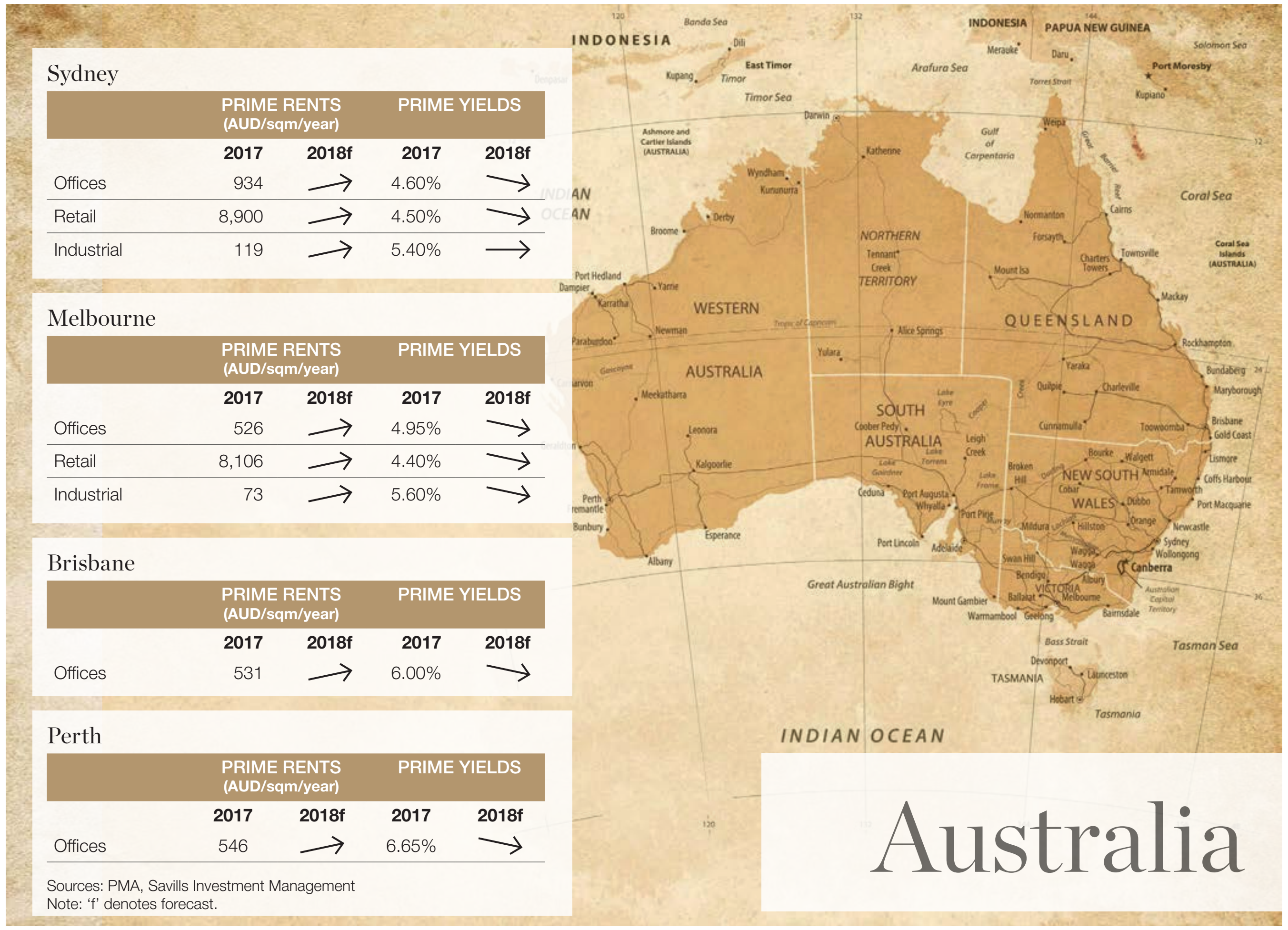
Investor sentiment surveys as well as data from CBRE and Real Capital Analytics (RCA) demonstrate that in 2017, investors remained positive about the region's long-term prospects, buoyed by domestic and intra-regional capital. According to RCA, Asia-Pacific commercial real estate transaction activity was strengthened by a surge in the multifamily apartment sector in Q3 2017, especially in Japan: JLL reports that Japan has more traded multifamily real estate than the rest of the Asia-Pacific region combined, and Tokyo is the most traded multifamily city in the world outside the US.

Artificially low interest rates, ease of access to financing and lack of available stock continue to exert downwards pressure on yields across the region. Nevertheless, lack of available stock may hamper investment volumes in Australia and Japan – the largest and most institutionalised investment markets in the region – and drive investors to take on more risk, consider core-plus/value-add strategies or secondary regional markets such as Osaka or Brisbane.

While respective Asia-Pacific markets are at different points in the property cycle, most markets appear to be fully priced in, with yields at historical lows and with modest rental outlooks. Furthermore, with interest rates set to rise in most markets, we recommend that investors capitalise on local property dynamics in order to rebalance their portfolio, and review their hurdle rate of returns in a new-normal growth environment. Nevertheless, there remain opportunities to acquire core assets, albeit with lower return expectations than before. In Osaka, for example, supply risk is considerably lower relative to Tokyo or Singapore, where a broader recovery is taking shape.



Sources: PMA, Savills Investment Management
Note: relative property market cycle points based on total return index.



Australia

Sydney

	PRIME RENTS (AUD/sqm/year)		PRIME YIELDS	
	2017	**2018f**	**2017**	**2018f**
Offices	934	↗	4.60%	↘
Retail	8,900	↗	4.50%	↘
Industrial	119	↗	5.40%	→

Melbourne

	PRIME RENTS (AUD/sqm/year)		PRIME YIELDS	
	2017	**2018f**	**2017**	**2018f**
Offices	526	↗	4.95%	↘
Retail	8,106	↗	4.40%	↘
Industrial	73	↗	5.60%	↘

Brisbane

	PRIME RENTS (AUD/sqm/year)		PRIME YIELDS	
	2017	**2018f**	**2017**	**2018f**
Offices	531	↗	6.00%	↘

Perth

	PRIME RENTS (AUD/sqm/year)		PRIME YIELDS	
	2017	**2018f**	**2017**	**2018f**
Offices	546	↗	6.65%	↘

Sources: PMA, Savills Investment Management
Note: 'f' denotes forecast.

Offices

Solid economic fundamentals should support the Australian office sector in 2018 despite headwinds in the form of weak wage growth. The country's strong labour market is supporting office occupier and investor demand in Sydney and Melbourne, but demand remains weaker in Perth and Brisbane. There is likely to be limited new office supply over the next year, pushing rents higher as landlords reduce rental incentives. According to PMA, rents in Sydney and Melbourne are more than 20% above pre-financial crisis levels. Accommodative monetary policy, wide yield spreads over 10-year government bonds and improving occupier trends signal further, if moderate, yield compression.

Retail

Australia's retail sales growth has been slowing but is holding up due to robust population growth, tourism and a weak local currency. Overall consumer sentiment has also been weak on the back of subdued wage growth. However, occupier demand from international retailers remains robust. Oxford Economics expects stronger population growth in Australia than other Asia-Pacific markets, and Australia represents a relatively unsaturated market for global retail brands compared to the US and Europe. Against this backdrop and given sustainable levels of development, PMA forecasts an improved rental outlook for Sydney and Melbourne of 2-3% growth in 2018. In view of stronger – albeit modest – growth, prime yields for Sydney and Melbourne regional shopping centres are expected to compress further, particularly for CBD retail assets, which are highly sought after.

Industrial

Investor demand for industrial property in Australia remains strong; however, supply remains a constraint, according to Colliers International. Sydney continues to outperform other Australian markets, which is consistent with the relatively stronger economic growth trend in New South Wales. Although the eastern seaboard (Sydney, Melbourne and Brisbane) is the focus of both domestic and international investors, there is heightened interest in Sydney. Existing and planned infrastructure supporting industrial uses have, and will continue to, lead to land-value uplift across several submarkets. Limited stock availability should also support further rental upside in 2018.

RECOMMENDATIONS

Despite low yields in Sydney, we recommend targeting selected offices where there is limited risk premium/rental differential between prime and secondary space, or under-rented office assets that would benefit from improved infrastructure, including fringe and suburban markets. We also suggest targeting defensive, income-producing assets such as convenience-based retail or transport-oriented logistics facilities.

Offices

Office demand in Shanghai has been slowing on the back of new supply entering the market. The current office supply cycle is set to peak in 2018, with vacancy rates still on the rise, according to Savills. Prime office rents are currently declining due to supply-demand imbalance, which is likely to persist through the next 18 months. As more tenants move to emerging submarkets, rental growth in decentralised areas should outperform that of the CBD. Despite shorter-term weakness in the rental outlook, weight of capital continues to support Shanghai offices. PMA expects prime yields to remain stable or even compress slightly before expanding from 2018.

Retail

Strong retail sales growth in China has been fuelling demand for prime retail space. In Shanghai, international sportswear and casual clothing brands continued to expand their presence in 2017, although retailers are ever more cautious of outlet centres due to a supply glut and varying performance across locations. Oversupply remains a key risk in all Tier 1 cities. This should translate into modest rental growth performance (1-2% per annum between 2018 and 2021), although post-2019, lower levels of supply as well as stronger income and consumption growth should present upside risk in Shanghai. Nevertheless, retail sector performance relies on active asset management, and not all shopping centres are alike. Yields for well-managed prime shopping centres should compress further in 2018.

Industrial

Favourable external trade conditions and the lack of available modern logistics property are underpinning logistics demand in China. The shortage of modern logistics facilities has attracted much attention from investors and, in turn, is funding a new supply wave. Developers have been active in securing land for future development, suggesting no shortage of product going forward. While robust growth in occupier and investor demand is expected to support logistics sector rental growth, the outlook differs for modern facilities versus obsolete warehouses. Given the modest rental growth forecast amid a supply glut, we expect China's logistics sector to underperform regional markets but to outperform other domestic sectors. In view of this, PMA expects total returns to decline in the long term as yields soften.

China

Shanghai

	PRIME RENTS (RMB/sqm/month)		PRIME YIELDS	
	2017	**2018f**	**2017**	**2018f**
Offices	530	↘	4.30%	↘
Retail	1,832	→	4.45%	↘
Industrial	39	↗	5.00%	↘

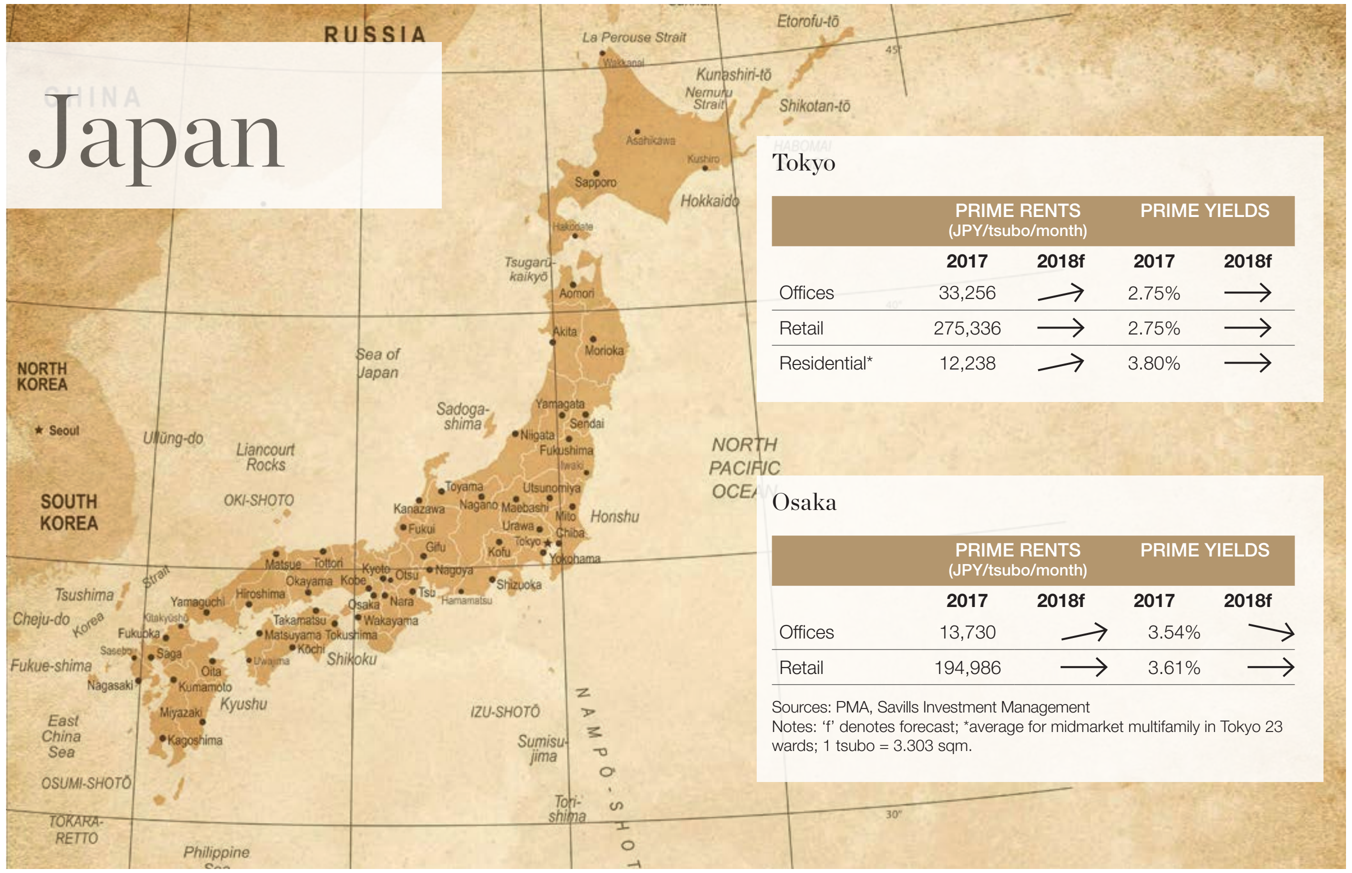
Sources: PMA, Savills Investment Management
Note: 'f' denotes forecast.

RECOMMENDATIONS

Despite oversupply risks in China, new constructions are prone to delays. Given current pricing, the supply cycle and further interest rate hikes, we do see some selective opportunities across China. In Shanghai, we would recommend offices in new CBDs supported by infrastructure, and would avoid prime offices in traditional CBDs. We see interesting opportunities for opportunistic strategies (e.g., funding gaps, distress situations) for logistics assets or retail podiums in view of current asset pricing.[1]

1 Retail podiums are small retail centres that only exist because of a non-retail commercial development such as an office building.

Japan



Tokyo

	PRIME RENTS (JPY/tsubo/month)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices	33,256	↗	2.75%	→
Retail	275,336	→	2.75%	→
Residential*	12,238	↗	3.80%	→

Osaka

	PRIME RENTS (JPY/tsubo/month)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices	13,730	↗	3.54%	↘
Retail	194,986	→	3.61%	→

Sources: PMA, Savills Investment Management
Notes: 'f' denotes forecast; *average for midmarket multifamily in Tokyo 23 wards; 1 tsubo = 3.303 sqm.

Offices

The Japanese office market remains healthy, and Tokyo continues to appeal to investors in view of its robust fundamentals and positive yield spread relative to other global gateway markets. Loose monetary policies and near-full employment point towards strengthening tenant demand. Vacancy rates in Tokyo and most regional cities have declined to cyclical lows, although new supply (around 744,000 square metres) entering the Tokyo market may exert upwards pressure on prime vacancies in 2018, according to PMA. Nevertheless, rents should remain on an upwards trend, with Osaka, a lagging market, expected to outperform Tokyo. Prime Tokyo office yields should remain low and stable, with secondary and regional markets seeing further downwards pressure on yields.

Retail

Japan's retail sector has benefitted from improving consumer confidence and record tourism flows that are supportive of retail sales. Tenant demand for retail space remains robust in Tokyo and Osaka, although prime rental growth is likely to be muted given how much rents have exceeded pre-financial crisis levels (over 30%). Moreover, wage growth remains tepid despite low unemployment and solid economic growth, which is likely to put a cap on domestic consumer spending and, in turn, achievable rents for sites outside of flagship locations. Nonetheless, strong investor appetite for quality sites with credit tenants, combined with attractive debt terms, should keep yields at cyclical lows for the foreseeable future.

Residential

Japan's housing market remains upbeat and an investor sector of choice due to its high occupancy levels and stable rents, although assets are now harder to source. Domestic lenders continue to offer very attractive terms for quality residential assets, with wide yield spreads over the 10-year government bonds available to investors. Supportive structural drivers such as growing demand for compact rental apartments in urban areas should continue to drive a modest rental upside, albeit pegged to wage growth. Residential yields are at cyclical lows, and while asset renovation or repositioning can provide upside, further yield compression for stabilised assets will likely be limited.

RECOMMENDATIONS

With central Tokyo commercial real estate sector yields at historical lows, we recommend risk-adjusted office and residential opportunities in sub-core districts of Greater Tokyo and selected established regional submarkets. Appropriate liquidity premiums ought to be underwritten to avoid chasing down yields. Despite near-term concerns of Tokyo office supply risk, new stock is concentrated in the super-prime segment where latent tenant demand is evident in significant pre-commitments. Key office market drivers are the continued flight to quality as well as the withdrawal of obsolete office buildings. In the residential market, rents have bottomed out and structural fundamentals are supportive of multifamily rental apartment demand.

Offices

Recent official indicators, including exports and GDP growth performance, point towards an improvement in Singapore's economic momentum in line with stronger global trade. The services sector is also showing signs of further strengthening that, in turn, supports office demand. Vacancy rates for CBD offices are likely to ease after a supply peak in 2017. After two-and-a-half years of decline, CBD office rents have bottomed out and should accelerate through 2021 as tenants capitalise on low rents and move to newer and better-quality buildings. Amid improving economic backdrop and business sentiment, a moderating supply cycle as well as further interest rate hikes, prime yields should remain stable in 2018 as rents recover. Investor demand for prime assets remains robust.

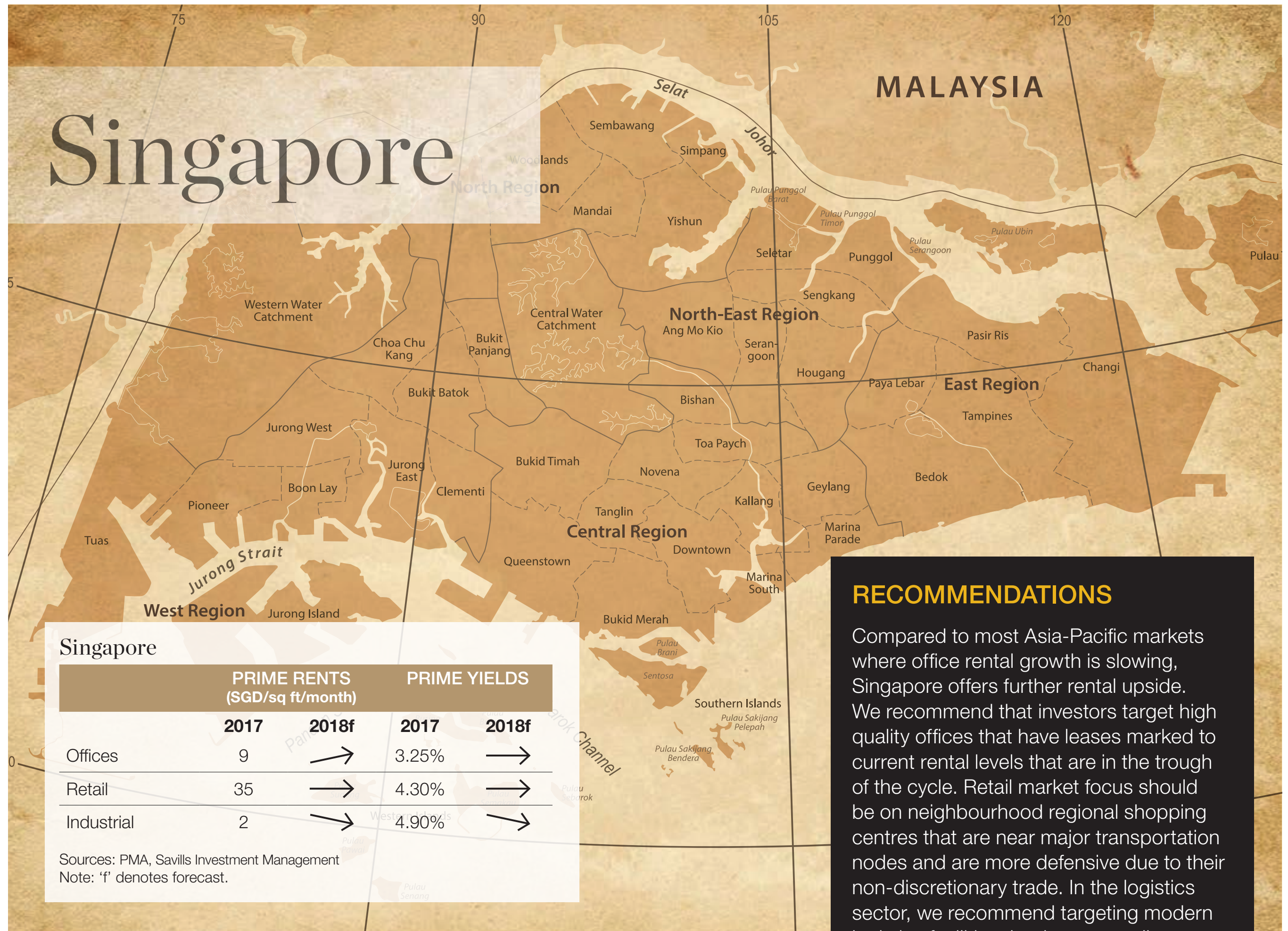
Retail

Despite a broader recovery in Singapore's economy, the country's increasing interest rate environment, elevated household debt and rising inflation mean consumers are likely to spend cautiously. On a positive note, according to the Singapore Tourism Board, tourism growth helped boost retail sales in H1 2017. Structural headwinds from e-commerce, foreign labour restrictions and high operating costs are forcing retailers to re-examine their strategies and close underperforming stores, driving up vacancy rates. Occupier demand, however, should remain, especially for well-managed regional shopping centres near or integrated with subway stations. Shopping centres in secondary locations and strata-titled shopping centres – where ownership is divided into individual units – will likely continue to suffer, underpinning further rental declines in 2018.

Industrial

Despite an uplift in the country's export growth, Singapore logistics market weakness lingers. Demand for space has lagged behind supply growth over the past few years as firms have consolidated or downsized their space requirements in order to save costs. However, this trend should reverse from 2018 as the development pipeline eases. Logistics demand also hinges on the strength of the global export uplift. In line with a broader economic and office market recovery, rents should bottom out in late 2018, while the outlook for yields remains stable.

Singapore



Singapore

	PRIME RENTS (SGD/sq ft/month)		PRIME YIELDS	
	2017	2018f	2017	2018f
Offices	9	↗	3.25%	→
Retail	35	→	4.30%	→
Industrial	2	↘	4.90%	↘

Sources: PMA, Savills Investment Management
Note: 'f' denotes forecast.

RECOMMENDATIONS

Compared to most Asia-Pacific markets where office rental growth is slowing, Singapore offers further rental upside. We recommend that investors target high quality offices that have leases marked to current rental levels that are in the trough of the cycle. Retail market focus should be on neighbourhood regional shopping centres that are near major transportation nodes and are more defensive due to their non-discretionary trade. In the logistics sector, we recommend targeting modern logistics facilities that have a credit tenant and long lease that has recently started.

ABOUT
Savills Investment Management

Savills Investment Management is an international real estate investment manager with offices in Amsterdam, Copenhagen, Frankfurt, Hamburg, Hong Kong, Jersey, London, Luxembourg, Madrid, Milan, Munich, Paris, Shanghai, Singapore, Stockholm, Sydney, Tokyo and Warsaw.

As of 31 December 2017, Savills Investment Management managed total assets of around EUR 16.4 billion.

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