Top 10 Real INSIGHTS

2018 Global Property Markets

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1. POLITICS & POLICY SEND PROPERTY ON A WILD RIDE

Key elections and policy changes could have a profound effect on the property markets

EU

Despite political uncertainty across the European continent in 2017, where there were no less than 6 national elections, its economy posted healthy gains, posting an increase to 2.4% from 1.8% in 2016.

EU data shows that home prices increased by an average of 4.7% across the bloc in the first quarter, the highest price growth since late 2007. Demand has been fueled by low interest rates, an improving job market, rising consumer confidence and growing interest from foreign buyers, according to Knight Frank.

Changes in monetary policy could constrain future demand. The European Central Bank has announced plans to end its €2.5 TT stimulus program and it could hike interest rates as early as 2019.

Brexit

Shortly after the referendum outcome became known, the pound sterling to US dollar exchange rate dropped 10% to below 1.30 US dollar per pound, the lowest level in over 30 years.

Brexit is likely to have a positive impact on the US CRE sector Deloitte states. A potential flight to safety may result in an increase in inflow of global funds to US markets as they are considered relatively more stable and secure. CRE firms with limited to no exposure to the United Kingdom are likely to benefit from increased investments and higher transaction activity resulting in a rise in property prices.

According to the Financial Times, at the time of the Brexit vote, London house prices were growing at an annual rate of 12%. More recent stats show that they fell by 0.4% in the 12 month period ending in May 2018.

With the ratifying of Brexit on March 29, 2019, Germany will likely replace London as the financial capital of the EU. The London financial services industry is valued at about £119 BB.

Of 222 large banks, insurers, asset managers and other financial services companies tracked by Ernst and Young, more than a third have said they are considering or have confirmed they are moving operations and/or staff from the UK to the EU. 53 firms have confirmed at least one relocation destination, with the main beneficiaries being Frankfurt and Dublin.

US Midterms & Tax Reform

The Tax Cut and Jobs Act which was passed by the senate last December is the most sweeping tax reform in the US since the Tax Reform Act of 1986, will represent an overall tax cut of US $1.2 TT over 10 years. The TCJA provides enhanced depreciation deductions and signification deductions for real estate held in a “pass through entity”.

US Democrats are hoping to rally the almost 200,000 Americans who live in Vancouver full- or part-time to vote in the US midterm elections. They say Americans living abroad could tip the balance in tightly contested fights for seats for the US congress, the senate and state governors.

At stake in the national midterms is President Donald Trump’s economic agenda if the Democrats make inroads against Republican control of the House and the Senate.

Michael Bloomberg is spending US $80 MM to support the democrat’s bid to take back the House. According to Forbes, Bloomberg has the potential to upend the financial dynamics of the midterm campaign, which have appeared to favor Republicans up to this point. Republicans, who are facing intense opposition to Trump and conservative policies, have been counting on a strong economy and heavily funded outside groups to give them a political advantage in key races.

2. LIQUIDITY IN THE PROPERTIES MARKETS REMAIN, DESPITE POLICY & POLITICAL UNCERTAINTY

Although global deal volumes are down H1 2018 from the previous year, there is no shortage of major deals being done

Earlier this year Brookfield Property bought the 66% of General Growth Properties (GGP) that it didn’t already own for US$9.25 BB. GGP is the second largest mall owner in the US. Brookfield’s plans include redeveloping the land GGP’s mall are situated on, according to the Globe & Mail.

LaSalle Hotel Properties sold to Pebblebrook Hotel Trust for approximately US $5.2 BB, beating out a bid from Backstone Group. Pebblebrook is already under contract to sell three LaSalle properties for US $715 MM when the merger closes. They are the Park Central San Francisco, the Park Central New York and the WestHouse hotel.

Meanwhile, Brookfield Asset Management Inc. agreed to acquire Forest City Realty Trust Inc. in early August in a deal valued at $11.4 BB after Forest City ceded board control to activist shareholders. Forest City’s portfolio includes office space, life science assets, retail space and multifamily units.

Columbia Property Trust Inc. has hired Morgan Stanley after being approached by interested buyers. Columbia owns and operates Class A office buildings in New York, San Francisco and Washington, with a portfolio of 19 properties encompassing 9 MM SF

New York’s sales volume in the multifamily sector hit $5.34 billion during the first half of 2018, up 64 percent from US $3.25 BB a year earlier, according to Ariel Property Advisors. There were six transactions over US $100 MM during that time period, compared to just one in 2017. One of the largest deals include the US $905 MM sale of Starrett City to Brooksville Company and Rockpoint Group in May.

Blackstone will acquire Parker Towers, a 1,300 unit complex in Queens from the Jack Parker Corporation for about US $500 MM. Slate and GreenOak Real Estate are in talks to acquire their 464 unit Biltmore rental tower for US$250 MM.

In May, H&R REIT has entered into an agreement to sell 63 US retail properties for approximately US $633 MM. The sale includes all of H&R REIT’s retail properties in the United States, other than 16 gas stations and convenience stores.

US-based private equity fund, Apollo Global Management, LLC. Purchased Germany-based Fair Value REIT-AG for US $264 MM.

Host Hotels & Resorts Inc., a REIT based out of Bethesda, Maryland, started interview advisers regarding the sale of a large portfolio of non-core hotels whose volume could exceed US $2 BB according to a report by Bloomberg.

3. CROSS BORDER CAPITAL ACTIVITY ON THE RISE

Excess liquidity in the Asian markets resulting in increased volume of capital finding its way into the EU

Global real estate investment will remain at around US $1 TT in 2018, not varying too much from the averages that have been seen over the past few years. This is from a mid year review by Knight Frank. Cross-border activity has been rising, in 2017, 32% of all transactions by volume involved cross-border purchases, up from 25% during 2009-2011.

Frank Knight states that this is a trend that is expected to continue for the following reasons:

- As the real estate cycle extends, some investors are increasing risk in search of return and for some, this entails looking beyond the confines of their domestic markets.
- Many of the sovereign wealth funds and much of the emerging private wealth are being created in locations without a deep or transparent local real estate market, making overseas investment the only practical option.
- While much of the world's real estate remains uninvestible even in mature economies, liquidity is being enhanced by private equity funds and REITs, which assemble, manage and ultimately resell assets or portfolios.

Cross border capital has been focused this year on the continental European markets due to good rental growth and economic stability despite rising pricing.

2017's total real estate transactions show that Asia-Pacific was the largest exporter of capital in 2017. Asia-Pacific exported US$90 BB, of which US$19.8 BB was invested in the US and the UK, respectively. The slowdown in capital coming from China due to government capital controls was offset by an increase of capital emanating from Singapore, Japan and South Korea to a less extent according to Knight Frank's 2018 Active Capital Report.

Bloomberg conducted an audit of Chinese investment in Europe between 2008 and 2018. Of the US$318 BB that was invested during this time period, 63% of the investments were either backed by the Chinese government or state investment funds. The audit also found that China has invested US $23.9 BB in property across the EU since 2008.

In September of this year, Blackstone was expected to raise US $18 BB for its biggest real estate fund ever. The strategy of this fund is to invest in distressed properties globally, according to Forbes.

4. EVOLUTION OF RETAIL

Signs of a retail renaissance despite store closures

Last year, total retail sales, including food services and motor vehicles and parts, grew 4.2%, adding US$231.5 BB to the American economy, which is more than the GDP of some countries.

However, as of August, 13 US retailers have filed for bankruptcy or announced liquidations so far in 2018.

Retail defaults hit an all-time high in the first quarter of the year, soaring past last year's records, according to Moody's Investor's Service. More defaults and bankruptcies expected for the remainder of 2018.

"We believe defaults in 2018 could match or exceed last year's record level," S&P Global Ratings analyst Robert Shulz wrote in a report that identified 20 retailers at risk of defaulting. They include Eddie Bauer, J.Crew, PetSmart, David's Bridal, Neiman Marcus and Payless.

Business Insider reports that 3,800 stores will close in 2018. Among them include Walgreens (600), Gap (200), Children's Place (144), Foot Locker (110) and Gymboree (102).

Excess supply of retail space per capita, which is 23.6 SF in the U.S., as compared to 16.5 SF in Canada and 4.6 SF in the United Kingdom, is seen to be a major cause of store closures. To grow that brick-and-mortar capacity, retailers across the board went heavily into debt.

Now that debt is coming due, but many retailers can't pay it back in the face of rapidly changing consumer shopping behavior drawn to ecommerce for many needs. It's further complicated by consumers' shift away from accumulating more stuff to acquiring more meaningful experiences, says Pamela Danzinger of Unity Marketing.

"Retailers need to give a different experience that is valuable to the customers so they will come into the store," says Ray Wimer, who is an assistant professor of retail practice at Syracuse University. "Otherwise if it is just the product being sold, customers are going for price and convenience and that means going online."

Despite all the bad news, Target, Walmart, Nordstrom and Home Depot all reported growth in both brick-and-mortar and e-commerce sales, and Deloitte is estimating that the retail industry will grow at 11.7% between 2017 and 2022. IHL Group recorded a net increase of 4,000 new store openings in 2017. 59.5% of consumers are confident or very confident as of January 2018, according to the Consumer Mood Index. High consumer confidence is always good news for retailers.

5. E-COMMERCE CONSUMING BULK OF INDUSTRIAL SPACE

Online shopping is the biggest driver of demand for industrial real estate

Cushman and Wakefield estimates that 25% to 30% of industrial leasing can be traced to e-commerce needs. On a global basis, e-commerce concerns take up 20% of new leases, up from less than 5% five years ago according to Prologis.

Online retailers on average need approximately 1.2 M SF of space per US $1 BB worth of online sales, three times the distribution centre space required for traditional brick-and-mortar retailers.

The GTA has the third largest industrial real estate inventory in North America with 760 M SF. It trails only Los Angeles at 1.1 B SF and Chicago at 1.2 B SF. However, new industrial space is being absorbed as fast as it is being built and the vacancy rate is sitting at an all time low of 2.5% at the end of Q1 2018, according to Avison Young.

About three of every 10 goods purchased on online are now returned, about three times the rate of in-store returns, said Ben Conwell who is the Seattle-based senior managing director at Cushman and Wakefield and leader of its e-commerce fulfillment division. This produces an increase in demand for warehousing as the returns don't always go back to the distribution centre.

CEO of Granite REIT Kevan Gorrie, stated that "the reverse logistics side is really interesting in that more and more companies are specializing in that and they are taking up more and more space in and around the cities in North America," he said. "It is becoming a standalone business on its own."

In the US, e-commerce represents about 10% of all retail and Amazon is by far the largest player, with an estimated share of 43%.

With Amazon now offering one and two hour delivery in some cities, there is a greater demand than ever for distribution warehouses located close urban centres.

Prologis, the largest owner of industrial real estate owns 687 MM SF of warehouse space in 19 countries. Amazon occupies 16 MM SF of it making Amazon ,Prologis' biggest tenant.

In the US, between 2013 and 2017, developers added about 848 MM SF of warehouse space, or more than double the roughly 300 MM SF built over the five previous years, according to Cushman & Wakefield.

The vacancy rate for industrial space in the US fell to 5.2% in the Q3 2017, the lowest on record, Colliers states in a recent report. The scarcity of 50 to 100 acre tracts close to major highways caused industrial land prices to more than double in a few years. The price of an acre on the outskirts of metro areas was about $50,000 in 2015 and has since climbed to more than $100,000, according to CBRE.

A similar squeeze is being felt in Canada. In Vancouver, the industrial vacancy rate is less than 2%. Rents have increased by 15% since 2016. In the GTA, vacancy is less than 3% with rents increasing by 7.3% in the last year, according to Cushman & Wakefield.

Adam Mullen, CBRE's Industrial and Logistics Leader for the Americas, stated in an interview that where you see a surge in population growth (signaled by new single-family home sales), a surge in industrial real estate is likely to follow.

Industrial real estate booms are starting to follow housing booms because so many consumers are buying goods online, and so e-commerce companies need to expand their distribution and fulfillment networks to meet growing consumer demand.

6. ALTERNATIVE ASSET CLASSES GENERATING INCREASED INTEREST

In the quest for yield, investors are turning to alternative asset classes

Traditional asset classes are producing record low yields around the globe. Investors are looking to alternative asset classes for superior returns.

JLL's Global Alternatives Sector report shows volumes reached US $52.1 BB in 2016, with alternatives making up 6.2% of the total commercial real estate market – the highest yet. Investment in the sector has more than tripled since 2010.

In 2016, student housing, seniors housing, laboratories and data centres make up more than 99% of the market for alternative assets, with cold storage making up the remainder.

Education

In Asia, the demand for Western-style of education is growing. ISC Research calculates that 60% of children enrolled in China's international schools are Chinese citizens. This sector is attractive for its long leases making it less vulnerable to volatility according to JLL.

Last year CPPIB acquired Nord Anglia Education, Inc. with Baring Private Equity Asia for US $4.3 BB, including the repayment of debt. Nord Anglia operates more than 45 leading international schools globally in 15 countries in Asia, Europe, the Middle East and North America.

Data Centres

Asia Pacific's data centre market is worth US $12 BB, according to a recent PWC report, and it's continuing to grow with the region's financial centres of Hong Kong and Singapore leading the way.

JLL estimates that region's data centre market to grow by 27% annually – exceeding its European counterpart in size by 2021.

Key drivers include urbanization, expanding consumer markets and household wealth, and technological developments – the adoption of smart phones, the rise and ubiquity of cloud computing, and IoT.

Marijuana

The Inception Cos. recently launched Inception REIT, which provides sale-leaseback, senior debt and capital improvement financing to businesses in the medical and recreational segments of the marijuana industry. Some estimates have the US marijuana industry reaching US $75 BB by 2030 however many institutions stay clear of this sector because of federal restrictions on pot. This is the first REIT to enter into this niche market.

According to Richard Costa, the CEO of Inception REIT, "the opportunity in California alone is clearly in the hundreds of millions of dollars if you just think about cannabis real estate assets".

7. BLOCKCHAIN INVADES THE REALM OF REAL ESTATE

Blockchain & Cryptocurrencies are starting to change the way business is getting done.

"Of all the new property-related technologies under development, blockchain is perhaps the most revolutionary. It has the potential to radically change the securitization of commercial real estate, improving liquidity as well as access to investment markets for both institutional and retail investors." - Christopher Clausen, Associate Director, Asia Pacific Research, JLL

Flex office company Knotel has just acquired 42Floors, a commercial real estate search engine company, as part of its plan to launch a blockchain-based listing platform. The acquisition would enable the company to bring new properties onto its platform and let non-blockchain-based contracts move to blockchain. "The deal is to get access to data and technology on over 10 BB SF of office space, driving further liquidity to Knotel's marketplace, while also accelerating its plans for a blockchain platform," Knotel co-founder Amol Sarva told Tech Crunch.

The UK government plans to move the country's land registry to blockchain by 2022.

Several municipalities in the US have already launched pilot projects to examine the benefits of blockchain for land registry and the transfer of documents. The city of South Burlington in Vermont has partnered with startup Propy, Inc. to convert their current system for real estate transfer document recording to a blockchain-based system.

In Canada, the government is launching a trial program to explore the use of blockchain to make government funding more transparent.

Canada currently sits third in the world in the number of blockchain startups located here. In Vancouver, the start-up IMBY, is looking to tokenize real estate property and then make it available for consumers to buy and sell within an exchange platform.

Another start up is BitRent. It is the first blockchain real estate platform that connects property developers with investors all over the world and attracts investments at early stages of construction. It is possible to invest small amounts and protect them by recording them in the decentralized registry. BitRent also allows real estate transactions via smart contracts and has their own coin, an RNTB token.

Calgary was one of the first cities in Canada, to allow renters to use cryptocurrencies to pay for a commercial lease. Tenants in the Real Equity Centre will have the option of paying their rent in bitcoin (BTC), ether (ETH) or litecoin (LTC), instead of the Canadian dollar. Systems are in place to protect both the tenant and the landlord from wild fluctuations in the value of these cryptocurrencies.

Anthony Di Iorio, the Canadian co-founder of the cryptocurrency Ethereum just bought a three-storey penthouse at the St. Regis Residences in Toronto for $28 MM paying for the it in part with cryptocurrency.

There has been an increase in Chinese investors buying real estate with cryptocurrencies, Natalia Karayaneva, CEO of Propy, a crypto-powered real estate marketplace, told CoinDesk in a recent article. She added: "We're seeing that more and more people are willing to buy properties with cryptocurrencies because it's getting easier to get their money out of the country using bitcoin, rather than establishing a bank account based in Hong Kong and getting their money out of the country using business channels."

8. WELLNESS ARCHITECTURE GAINING TRACTION

Data and studies show how the built form can contribute to employee wellness and increased production

Showing up for work sick or, ‘presenteeism’ as it is called, costs an estimated US $150 BB per year in the US. Most studies confirm that presenteeism is far more costly than illness-related absenteeism or disability.

Building owners are realizing that wellbeing extends to the built environment as a means to cultivate productivity and tenants are starting to demand space that promotes wellness.

Buildings with improved air quality and ventilation not only mitigate the health risks of exposure to CO_2, VOCs and other indoor air pollutants, but studies suggest they can also improve employee productivity by up to 11%, according to the World Green Building Council. Meanwhile, buildings that promote the physical fitness of their occupants can help reduce absenteeism, with the Public Health Agency of Canada finding that physically active employees take 27% fewer sick days.

A case study by the American Society of Interior designers (ASID), which moved into their new HQ in Washington DC in 2016 reveals that by creating a space that supports health, wellness and the well-being of employees, resulted in significant improvements in these areas:

- Collaborative work increased 9%
- Physical health and mental health scores improved
- Productivity increased 16%, yielding an estimated increase of $694,000 financial impact to the Society’s bottom line during the first year of occupancy
- Energy savings amount to $7,636 or 38.2 tons of coal not burned, and 72.9 tons of CO_2 not emitted, during first 15 months of occupancy

The elements that ASID incorporated into their building to achieve these stats were: workspace choice, active design, the use of healthy materials, biophilic design and circadian lighting.

Biophilia has been defined as the inherent human inclination to affiliate with nature. Biophilic design, therefore, incorporates natural materials, natural light, vegetation, nature views and other experiences of the natural world into the modern built environment.

The 2015 the Human Spaces’ report, The Global Impact of Biophilic Design in the Workplace, found employees in environments with natural elements are reporting a 15% higher level of well-being, are 6% more productive, and are 15% more creative overall.

Created in 2014, the WELL Building Standard serves as a system for measuring, certifying and monitoring features of the built environment that impact the health and well-being its tenants. WELL focuses on seven categories of building performance: air, water, nourishment, light, fitness, comfort, and mind.

TD’s 25,000 SF office renovation in the Toronto-Dominion Centre earned a WELL Certification at the Gold level and was the world’s first WELL Certified™ project under WELL v1.

Now there are 1,002 projects encompassing over 188 MM SF are applying WELL across 36 countries.

9. GLOBAL TALENT SHORTAGE

The converging forces of business disruption and talent disruption are creating a perfect storm for RE&C (Real Estate & Construction) companies. – Deloitte

Major global economies, companies are facing problems recruiting staff. In Q2 2018, the unemployment rate is 4.1% in the US, 3.9% in China, 3.5% in Germany and 2.5% in Japan.

The risk for the global economy is that firms will struggle to recruit, which could act as a brake on growth, a report by Frank Knight states.

One of the possible fallouts of Brexit will be the restriction of free movement of labour and this will impact cross-border recruitment and the ability to attract foreign labour according the PWC.

The growing population in India, overall economic growth, rising income levels and an increase in foreign investment, has led to a heightened need for improved infrastructure across urban, semi-urban and rural India. Such demand for real estate, together with increased regulatory vigilance is leading to an unprecedented requirement of manpower in this space. By 2020, the Indian real estate industry is anticipated to be a US $180 BB opportunity, according to Human Capital – India’s leading HR magazine.

As compared to the soaring demand, the supply of core and noncore professionals remains low at present. This shortfall of core professionals is estimated to be 4 MM at present. Human Capital reports that by 2022, the total expected shortfall of skilled professionals in the Built Environment (real estate, infrastructure and allied services) is presumed to touch 150 MM.

In the US, the Real estate sector is facing a talent shortage with a larger proportion of Baby Boomers in approaching retirement and fewer Generation Xers and Millennials to replace them. According to the US Bureau of Labor Statistics, 35.7% of employees in this sector were 55 years or older in 2016 compared to 32.1% in 2011. Research by the ULI suggests that many real estate companies aren’t effectively developing the next generation of leaders despite a tenured leadership.

In the Forrester study commissioned by JLL, the inability of firms to find suitable talent to improve CRE data and analytics collection and application is highlighted as one of the three biggest weaknesses inhibiting CRE’s contribution to overall business strategy. Numerous reports acknowledged a severe shortage in the global supply of talent in this field.

The MIT Sloan Management Review and Deloitte Digital’s 2017 global study of digital business revealed that only 10% of the global RE&C respondents agreed or strongly agreed that their organization has sufficient talent today to support their digital business strategy.

RE&C companies should likely realize and accept the fact that the borderless talent economy is here to stay. Workers now take many forms—traditional “balance-sheet” employees, contingent workers who are part of the “gig” economy, contract outsourcers or “as a service” workers, and autonomous machines/robots. Deloitte advises that the best way forward for RE&C companies may be to integrate the concept of the open talent economy into their talent strategy.

10. WORKER MOBILITY FUEL COWORKING

Scarcity of talent and an increase in the number of freelancers means that companies have to become more flexible about remote working

According to a survey done by Upwork, a Silicon Valley freelance platform, 52% of hiring managers at companies with work-from-home policies say hiring has become easier in the past year.

Right now, more than one third of US workers are freelancers. This number is expected to rise to 50% by 2020.

58% of midmarket companies report that a significant driver behind their use of gig workers is to access skills and experience that is not available in their current workforce. Talent tends to be concentrated in certain areas, and is less agreeable to permanent relocation. Remote work or contract-based work arrangements can help companies attract the right talent and fulfill current needs to remain competitive.

A JLL study states that 34% of employees work at least once a month from third places such as internet cafes, public libraries or coworking spaces. 84% of people who use coworking spaces are more engaged and motivated and 89% of people who cowork reported being happier.

The open concept work environments, with living-room style common areas and perks such as micro-roasted coffee, craft beer on draft and social events, also appeals to the sought-after millennial workforce, which has surpassed the Baby Boomer generation in size, said Roberto D'Abate, a vice-president in PwC's real estate division. "Everyone is chasing that younger millennial workforce. And the way to do it is to have these open concept spaces, services, coffee shops... All those sort of creative incentives for people to come work for them."

The growth in coworking inventory has accelerated over the past three years. Cushman & Wakefield reports that half of all current US coworking space has opened since early 2015, with over 5 MM SF of new space coming online each of the past three years. Another 3 MM SF of new space has opened in the first half of 2018. WeWork has consistently been the largest lessee of new space, accounting for over 8 MM SF between 2015 and 2017.

Flexible workspace operators currently occupy around 10.7 MM SF of space across central London and operate at 84% capacity in Central London. CBRE estimates that flexible office operators accounted for about 14% of office take-up in London in 2017.

The amount of coworking space in Australia increased by almost 300% between 2013 and 2017.

In 2017, co-working took 5% of the leased space in India, JLL reports. "So far, we have leased 1.1m sq ft across cities and are further looking to add 1m sq ft by March 2019," said Sidharth Menda, CEO, CoWrks.

JLL research found that flexible workspace in Asia-Pacific increased by 150% from 2014 to 2017. The number of major flexible workplace operators more than doubled in the Asia Pacific region during the period. Singapore's sovereign wealth fund GIC has partnered with property firm Frasers to inject US $177 MM into expanding JustCo across Japan, China, Australia and India.

According to the Global Coworking Survey 2017, 45% of people currently occupying coworking space were previously working from home before becoming a member and 26% were in traditional office space before moving, down from 37% in 2016. This shows that increases in coworking do not have a direct, proportionate effect on absorption.

What may affect absorption rates is the marketing of flexible space to corporate occupiers on a larger scale. IBM has already reportedly signed a deal for all of the desks in a 100,000 sq ft WeWork centre in New York City.

However, there has been a fall in demand across Central London for sub-5,000 SF units on traditional leases over the last three years, which can be in part attributed to the rapid growth in the number of flexible working centres.

Co-working facilities typically require less space - about 75 SF per worker compared with roughly 175 SF in traditional offices. Green Street's base case estimates a cumulative 2-3% demand reduction by 2030.