Global Research | May 6 2020

Global Market Perspective – Highlights

Including Global Capital Flows

Summary

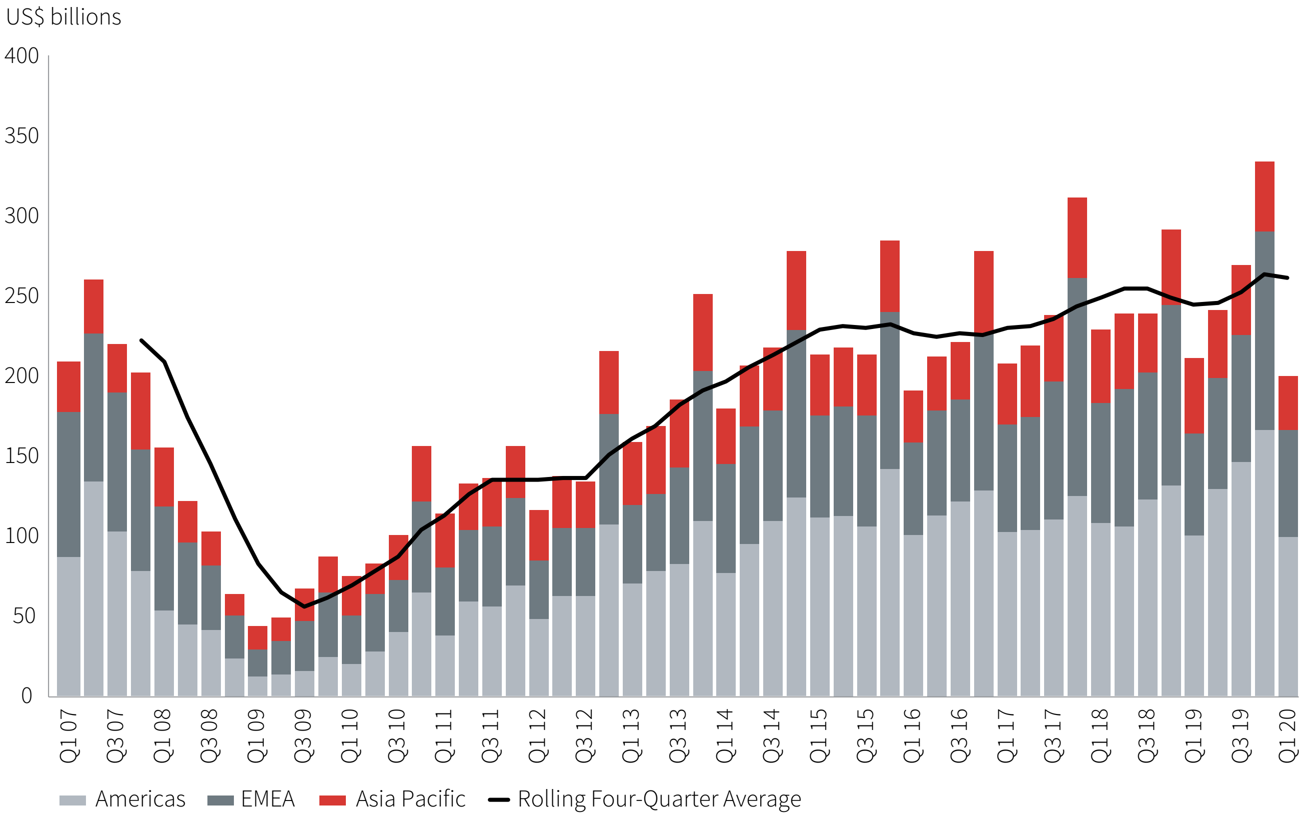
Global economy
Mounting evidence suggests that global economic growth contracted in Q1, marking the first quarter of contraction in 11 years. Although lockdowns are still in place across many parts of the world, some economies are now gradually starting to reopen. China was the first to emerge, while some European countries and U.S. states are now taking tentative steps to emerge, although timelines remain vague.

To help moderate the impact of the pandemic, several central banks have implemented a 'whatever it takes approach'; at the same time, many governments have announced large fiscal stimulus programs. Global economic growth should resume in the latter half of the year. But because so much centers on the health situation, a multispeed recovery around the world seems likely.

Global capital flows
Against the backdrop of broader market volatility and uncertainty, direct investment in global commercial real estate dropped by 5% year-on-year in the first quarter, falling to US$200 billion. Performance varied across the regions, with capital flows generally tracking the evolution of the pandemic. Areas hit first saw declines in transaction volumes, but the impact has not fully filtered into the data for markets which were later exposed in the quarter.

Defensive sectors are coming to the fore. As investors increasingly look to income stability, operation criticality and occupation density as key arbiters to asset-level risk, sectors such as industrial, multifamily and data centers are expected to benefit. Global industrial volumes rose by 7% in the first quarter, while multifamily largely maintained its performance relative to a very strong Q1 2019.

Direct commercial real estate investment, Q1 2007 - Q1 2020



Source: JLL, April 2020

Debt markets have been digesting the impact of unprecedented policies, such as rent relief and forbearance, as well as central bank intervention in structured credit markets. Despite ample liquidity in debt markets, lenders remain in a phase of 'price discovery' and are focused on asset managing their existing portfolios. This has led to a greater scrutiny over leverage, and an emphasis on experienced sponsors, resilient sectors and strong locations in quoting new deals.

Fundraising by private closed-end real estate funds fell to its lowest Q1 level since 2013 with US$22.3 billion raised through the first three months of the year. Investors continue to consolidate investments with the most experienced managers, with nearly 38% of Q1 capital raised globally by five funds. Investors are now seeking opportunities to emerge from the dislocation caused by the pandemic.

The first quarter saw an increase in global cross-border purchases, which rose by 13% year-on-year to US$55 billion, with the largest recipients being the office, multifamily and industrial sectors and markets in the U.S., U.K. and Japan. Importantly, many of these transactions were negotiated and finalized well before the COVID-19 outbreak. While the pandemic will dampen cross-border activity in the near term, it could also provide some unintended boosts to global capital flows in the medium to long term, given easing currency hedging costs.

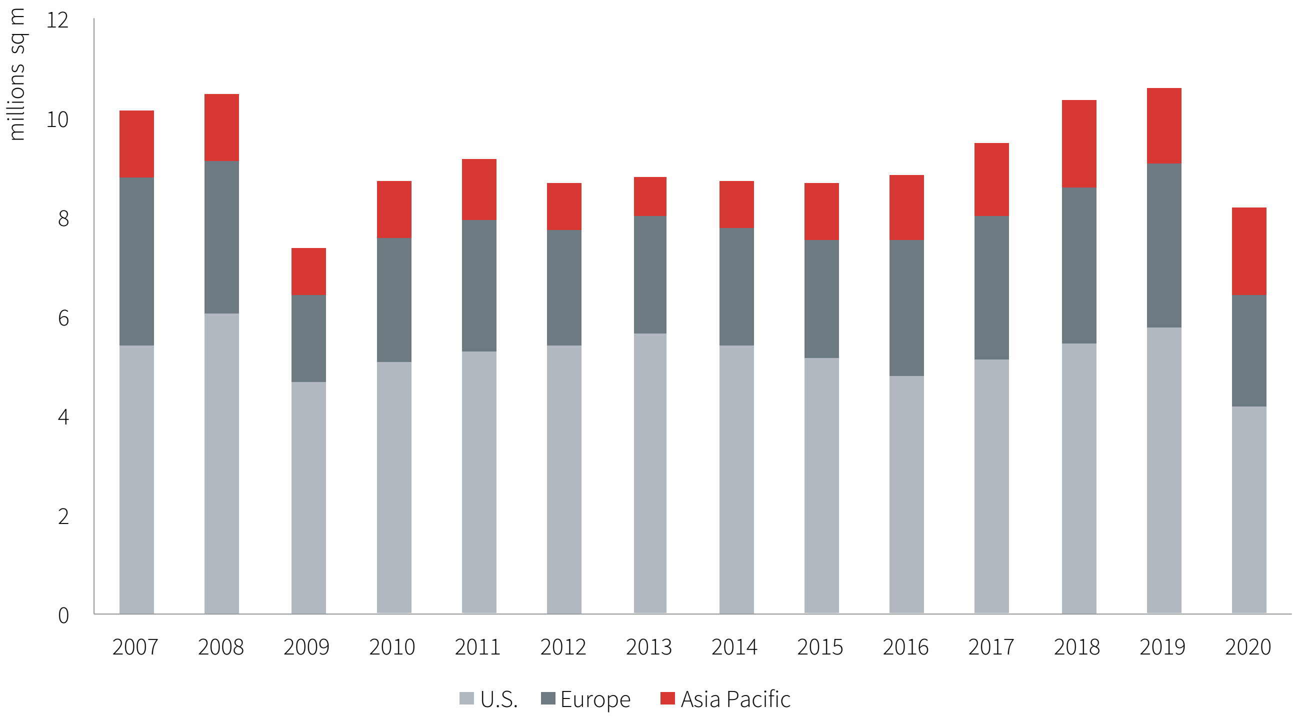
As we look ahead, it's clear that the biggest impact from the coronavirus pandemic was initially felt in Asia, but that this has not yet fully filtered into the quarterly data for EMEA and the Americas. With the near-record volume of dry powder held by investors, global commercial real estate is still poised to see healthy investment over the medium to long term. However, the repercussions of the pandemic will be realized in the short term and will result in a drop-off in capital flows in the sector.

Corporate occupiers

The short-term effects for corporate occupiers are significant as their business-as-usual activities are impacted by changes occurring on a daily basis. The immediate shock of the outbreak is over and the majority of occupiers are in response mode after a short phase of preparation and immediate actions.

Operational resilience will be crucial to recover from the outbreak. Businesses will not go back to normal as we knew it before the outbreak, but will reinvent themselves to be more resilient, adapting their operational models to the 'next normal'. The client experience journey includes 'Re-entry' and 'Reimagination', 'Implementation' and 'Flourish' in the Enterprise of the Future.

First quarter global office gross leasing volumes, Q1 2007 – Q1 2020



24 markets in Europe; 50 markets in the U.S.; 22 markets in Asia Pacific
Source: JLL, April 2020

Office sector

COVID-19 has forced office tenants globally to navigate a constantly changing environment characterized by wholesale shifts to remote working, an inability to make future growth decisions, and questions surrounding the duration and severity of both the economic shock and the potential for a quick rebound. Leasing activity across all the regions softened in the first quarter with global volumes 23% lower than in Q1 2019 as deals were canceled or delayed. However, this has yet to permeate through to vacancy rates, which remained unchanged at 10.7% globally for the third consecutive quarter.

The flexible space sector, which in recent years has accounted for a substantial share of net absorption in global gateway cities, has fallen flat as a direct result of the COVID-19 outbreak. In the short term we expect limited growth from the sector as its members cut back requirements until uncertainty subsides and economic conditions improve.

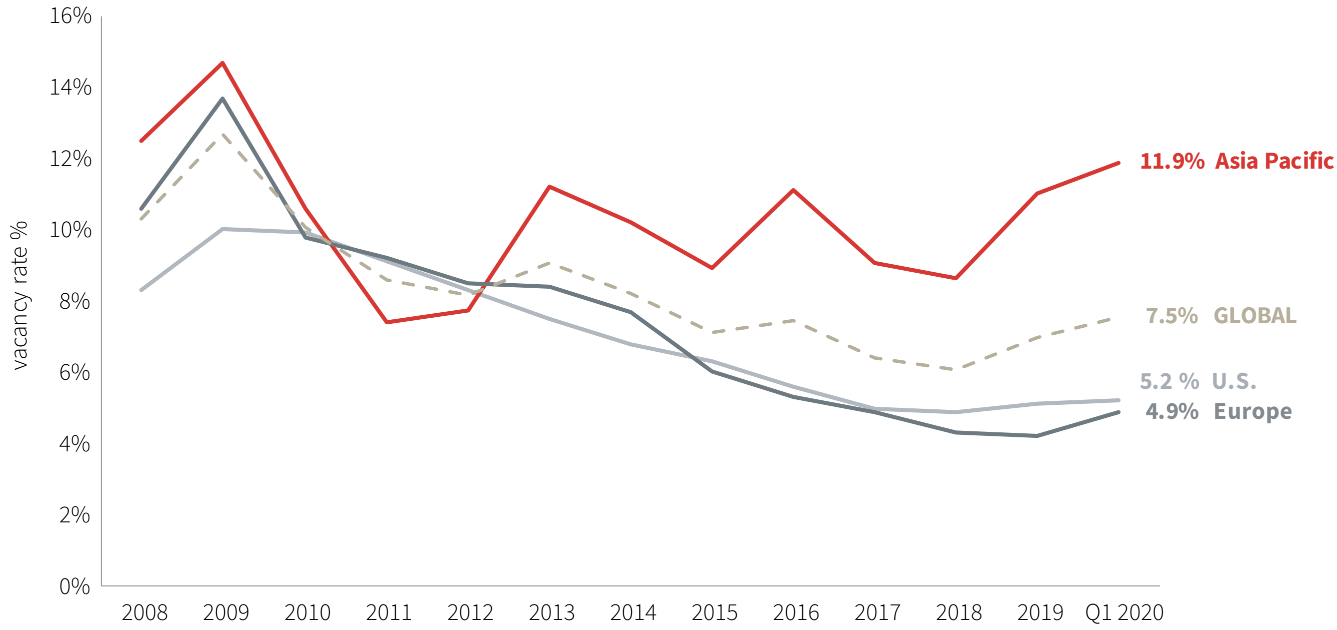
While some corporates might look to remote working in order to compress their real estate footprint, most are already exploring ways to future-proof their portfolios. It is still too early to make bold predictions in terms of a shift in the quantum of space required by companies coming out of this crisis, but the physical office will take center stage in facilitating interaction and collaboration and, ultimately, in the health, well-being and productivity of employees.

Retail sector

With more countries planning their COVID-19 exit strategies, retailers are testing pragmatic solutions to allow for a safe but gradual return of customers into their stores. Cash-flow concerns remain, particularly among retailers reliant on discretionary spending. Structural challenges vary by retailer type. Despite robust revenue growth in Q1, many grocery retailers have reported margin erosion as extra efforts have been required to keep stores supplied and online orders fulfilled during the crisis. Meanwhile, numerous fashion operators are dealing with elevated levels of unsold inventory. Continued social distancing measures and start-up challenges across retailers' supply chains will constrain their ability to swiftly return to full performance.

In the longer term, retailers will shift their attention from cash preservation toward reviewing their strategies to drive sales. They will be keen to strengthen their ability to fulfill omni-channel purchases, including micro-fulfillment, click-and-collect and product returns.

Logistics vacancy rates, 2008 - Q1 2020



U.S. based on 55 city markets; Europe based on 10 national markets; Asia Pacific based on 26 city markets.
Global weighted average according to region's (US/Europe/Asia Pacific) share of total GDP.
Source: JLL, April 2020

Industrial & logistics sector

Lockdowns and 'shelter-in-place' advisories continue to result in massive supply chain disruption across the globe. Occupier demand for industrial and logistics space across all regions has fallen, although the full impact has yet to be reflected in the numbers. Compared with the five-year quarterly average, U.S. net absorption in Q1 was down 9% and European gross take-up declined 13%; Asia Pacific net absorption was 17% lower.

There has been a spike in short-term warehouse dem and directly linked to the immediate impact of COVID-19, due to the significant expansion of grocery spending, including online, and the need to support critical health services.

Supply chain risk mitigation and resilience will become a key focus for operators. Additionally, trends already in evidence prior to the pandemic will accelerate, such as increased online penetration rates, expansion of online grocery, omni-channel retailing and the integration of technology into warehousing.

Hotels & hospitality sector

Heightened uncertainty has dulled investor appetite for hotels, with asset valuations becoming more challenging. Acquisitions are mainly on hold, with the exception of several transactions well underway at the onset of the pandemic. Global hotel investment activity slowed in Q1 2020, with transaction volumes totaling US$10 billion, marking a decrease of 29% from Q1 2019.

Travel patterns are expected to shift toward drive-to-resort destinations and less dense markets where travelers can be in open spaces and avoid large groups of people. Moreover, a greater focus on hygiene and personal well-being may move demand in the direction of professionally-run and maintained lodgings.

Living sector

Since 2010, global investment in the multifamily sector has risen at an annual growth rate of 15.6%, putting it among the fastest-growing asset classes. Investors have flocked to the sector thanks to its mainly defensive qualities as well as the demographic and secular trends which have underpinned demand.

Multifamily product is often desired due to its resilient characteristics. Markets with diversified economies, noteworthy tech and innovation sectors and/or affordable costs of living are already showing signs of that resiliency in the U.S. If such trends persist, those cities will be poised to benefit from elevated investor interest for the foreseeable future.

The full Global Market Perspective report is only available to our clients. To find out how we can support your global real estate market strategy with research insights and strategic advice, please contact one of the members of the global research team.

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