Global Real Estate Investments
Opportunities and Risks in the Late Stage of the Cycle

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Global Real Estate Investments

- Current Situation

- Structural Outlook / Long-Term
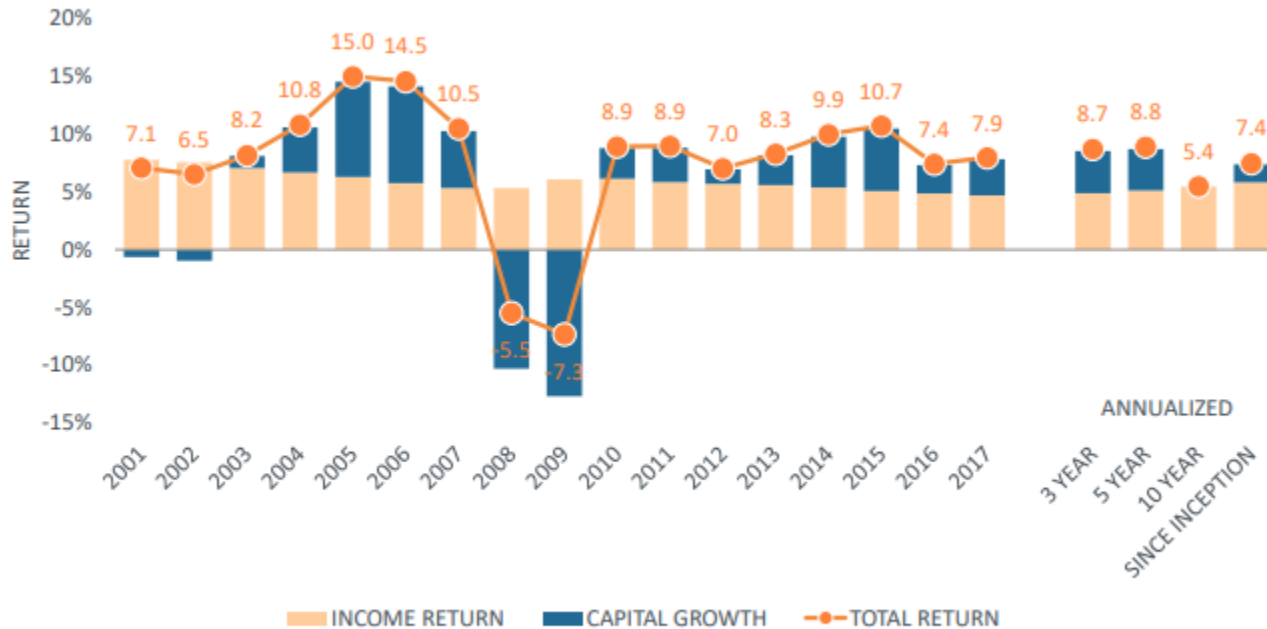
- Cyclical Outlook / Short-Term

Autumn 2018

- 1. Half 2018: Investment and corporate occupier activity at their highest level for more than a decade – after 9 years of strong (and for five years of 2-digit) total RE returns

- Other late cycle signs:
  - (1) After record-low rental yields (cap rates) in core markets and segments, expected turning point of monetary policy
  - (2) Very high market liquidity: Peak in investment volume due to limited investable products
  - (3) Turning to other sectors like industrial/logistics and moving up the risk curve from core to core-plus and value add

- Critical economic indicators are near record-low: interest rates, unemployment, yield curve spread. Therefore, many economists and market participants expect a recession (starting in the US) perhaps in 2020.

- So its necessary to evaluate the current situation in terms of risks, valuation and the current position of the economic cycle

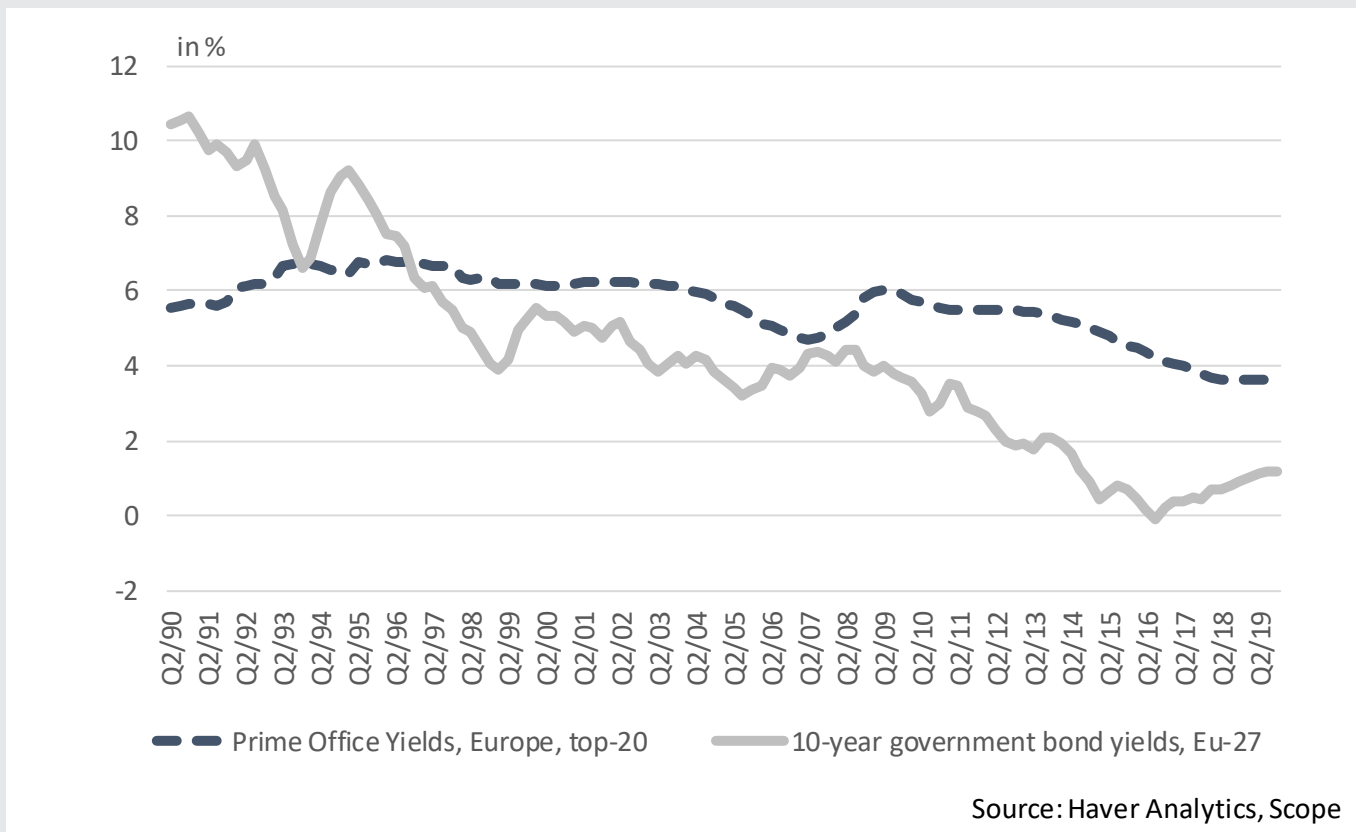## Mature property cycle after 8 years of strong total returns (average 8,6%)

Exhibit 2: MSCI IPD Global Annual Property Index Returns
All property returns in local currency

Source: MSCI, KTI

Despite slowly rising interest rates: initial yield gap still very comfortable

in %

Prime Office Yields, Europe, top-20   10-year government bond yields, Eu-27

Source: Haver Analytics, Scope

Global investment volume stable since 2014, but from 2017 on shifting from USA to Europe and Asia-Pacific

US$ billions

Legend: Americas ■ Europe (EMEA) ■ Asia-Pacific ■
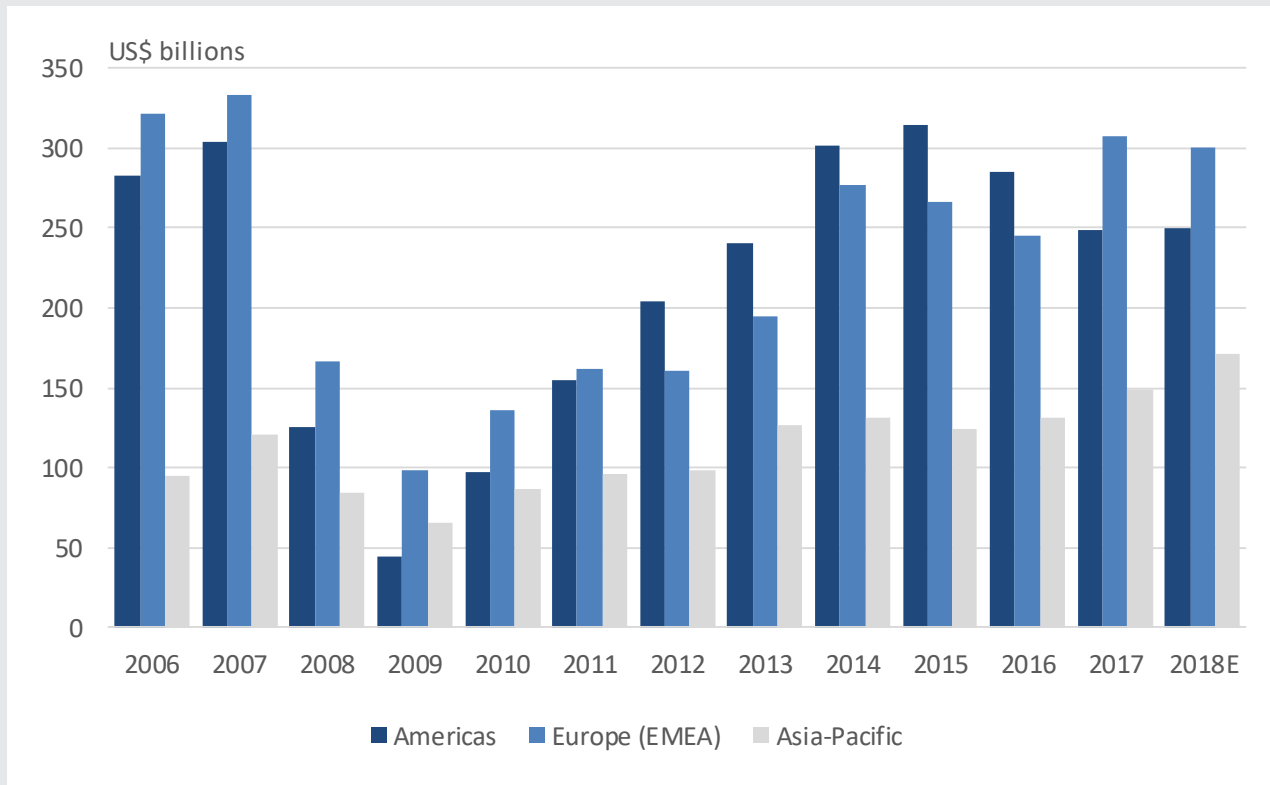
Big Challenge

How to invest the sheer volume of capital raised effectively in assets that give protection against a possible recession/market correction (not another GFC?) during the next years?

Aside going to cash/liquidity and deleveraging: adjust your diversification by taking the long-term view in a late-cycle market?

(1) There are numerous game-changing disruptions with timescale that extend beyond conventional property cycles and could cushion markets and portfolios during a downturn.

(2) Positive demographics plus demographical change offer opportunities for product innovation, i.e. mixed-use-development.

(3) Cities, which adopt striking secular trends and therefore attract young talent, high-tech-companies and work as global innovation-hubs

(4) Select defensive property types/sectors like multifamily which are resistant to cyclical downturns

→ Taking the long-term view as background in a late-cycle market to select and weight opportunities and irresponsible risks: Scope GREMM as tool

Global Real Estate Markets
GREMM – Structural Indicators: Rationale and Objectives

Rationale

- With investment capital becoming more global in its search for returns and diversification, the need for a standardised set of indicators to make sense of opportunities, risk and return expectations has become critical.

- The most common asset allocation error is "home country bias" – concentration in your home country. In: FT, John Authors, The Long View, 29 September 2018.

Objectives

- Quantitative recording of global real estate return potential and risks at the level of countries

- Optimal geographical coverage of global / regional investable property assets through structural indicators

- Decision support for global asset allocation and risk assessment

- Supporting selection for choosing different investment styles (core, core plus, value add, opportunistic) by differentiating cyclical and structural risks

Global Real Estate Markets

GREMM – Structural Indicators: Overview and Coverage

- The Global Real Estate Market Monitor depicts potential and risks of real estate markets on the country level covering 52 selected countries
    - 3 North America
    - 29 Europe
    - 6 Latin America
    - 12 Asia
    - Australia & New Zeeland

- The Scope Global Real Estate Monitor supports asset allocation decisions as well as risk management processes.

Scope's Global Real Estate Market Monitor (GREMM)	

Structural Risks		Cyclical Risks	
Country Risks	Real Estate Market Risks	Country Risks	Real Estate Market Risks

Property Market Risk	Economic Risk	Political & Institutional Risk	Financial Risk	ESG Risk
▪ Cash Flow Stability ▪ Market Transparency ▪ Liquidity and Market Size	▪ Short-Term Economic Outlook ▪ Long-Term, Strctural Conditions (Demographics, Technology, Infrastructure, Human Capital)	▪ Control of Corruption ▪ Voice & Accountability ▪ Rule of Law ▪ Freedom of Trade	▪ Public Finance ▪ Financial Stability	▪ Environmental ▪ Social ▪ Governmental

Scope´s Global Real Estate Market Monitor (GREMM)

Rank	Country	Main Risk Indicators					
		Overall Score	Property Market	Economic	Political & Institutional	Financial	ESG
1.	Australia	78	84	76	78	63	85
2.	U.S.A.	78	91	76	74	57	77
3.	Netherlands	77	71	74	81	83	86
4.	Germany	77	74	75	78	81	83
5.	Switzerland	76	63	76	81	81	97
6.	U.K.	76	84	68	77	58	85
7.	New Zealand	75	69	71	82	74	89
8.	Canada	75	79	70	80	60	82
9.	Norway	75	61	76	83	73	94
10.	Sweden	73	56	73	83	85	89
11	..	..	..	..	..	..	..

Scope´s Global Real Estate Market Monitor (GREMM)

Rank	Country	Main Risk Indicators					
		Overall Score	Property Market	Economic	Political & Institutional	Financial	ESG
..	..	..	..	..	..	..	..
42.	Mexico	43	49	37	44	45	35
43.	Turkey	42	45	31	46	59	34
44.	Brazil	42	47	27	52	43	36
45.	Bulgaria	41	21	44	53	59	47
46.	India	41	57	30	52	28	9
47.	Russia	41	40	39	35	59	46
48.	Peru	40	33	38	49	49	37
49.	Colombia	39	36	32	49	43	32
50.	Vietnam	37	38	41	40	34	24
51.	Argentina	36	20	31	52	50	38
52.	Venezuela	24	15	22	26	42	35

Scope Global Real Estate Market Monitor
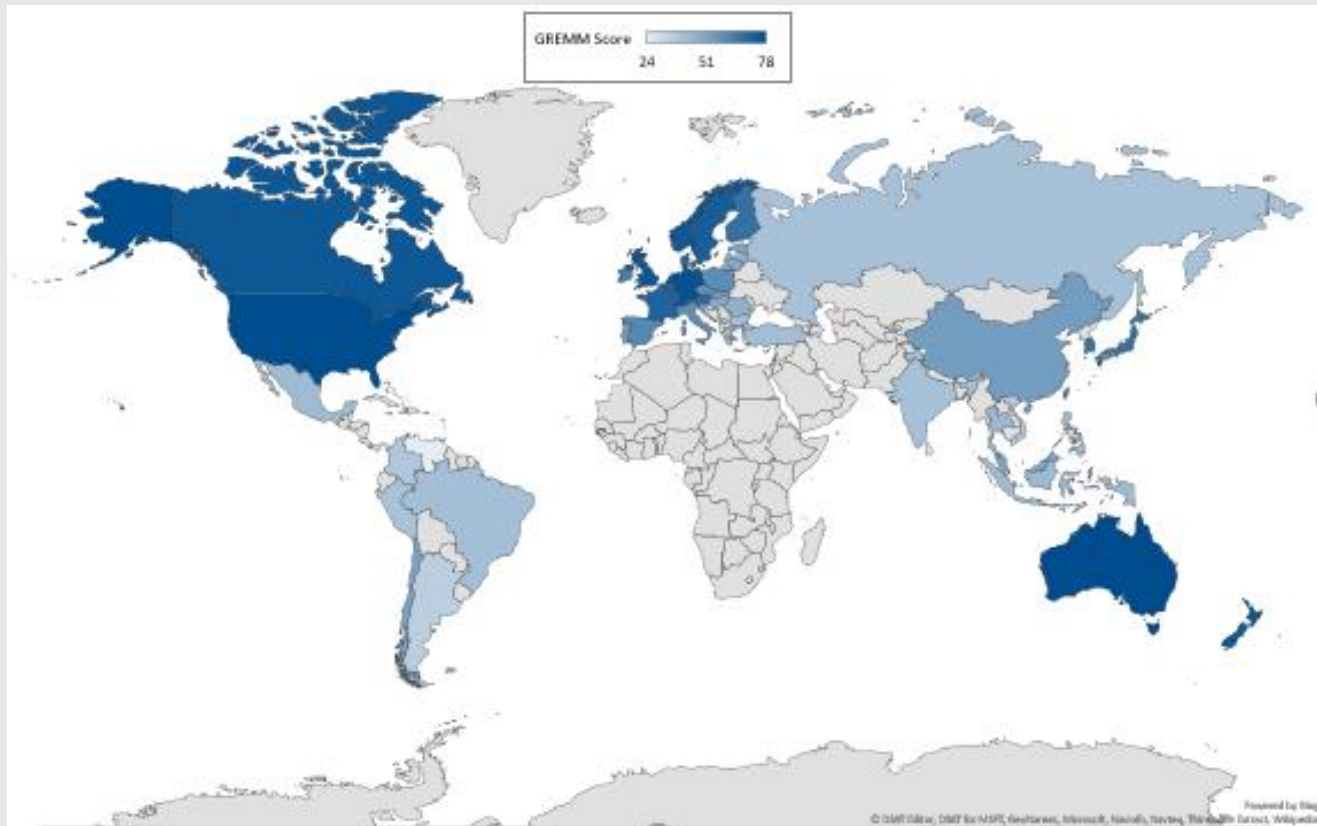
Business Cycle

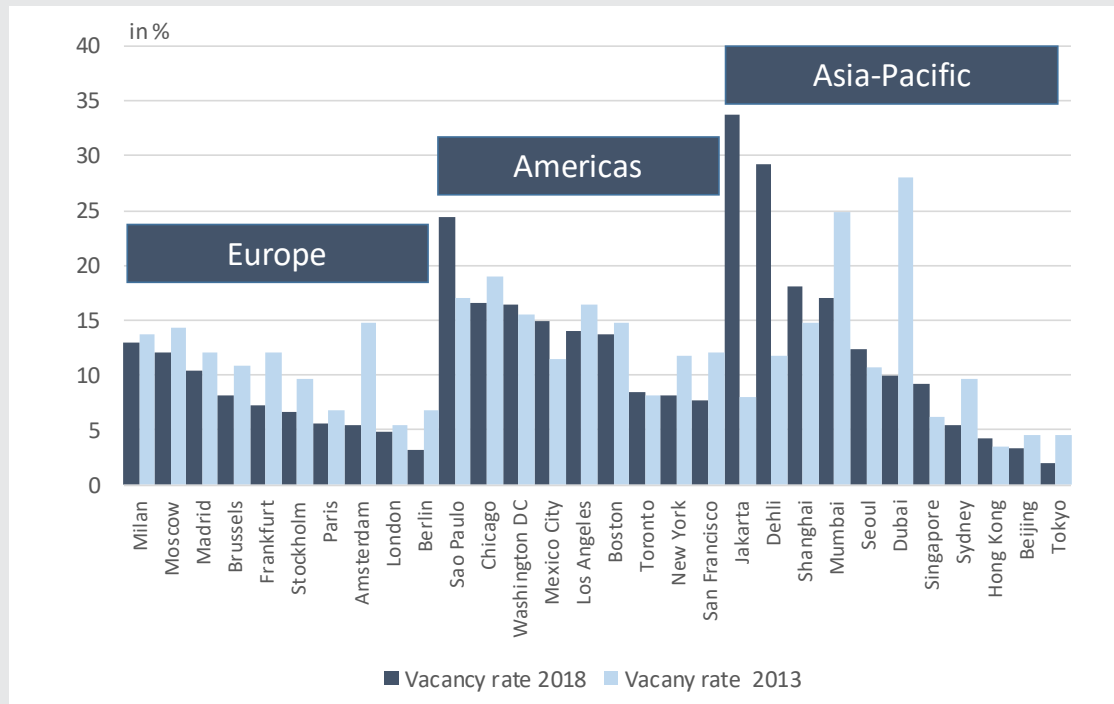- GDP-forecasts with downward revisions in 2018, after serious upward revisions during 2nd Half of 2017, remaining until 2019 above trend growth
- Purchasing Manager Indices (PMI) generally in positive growth-predicting territory
- Two historically important indicators are record-low: interest rates and unemployment, this supports the turning point in monetary policy
- Risks: US-trade policy, political uncertainty and hence volatile equity / bond markets.

Real Estate Market Cycle

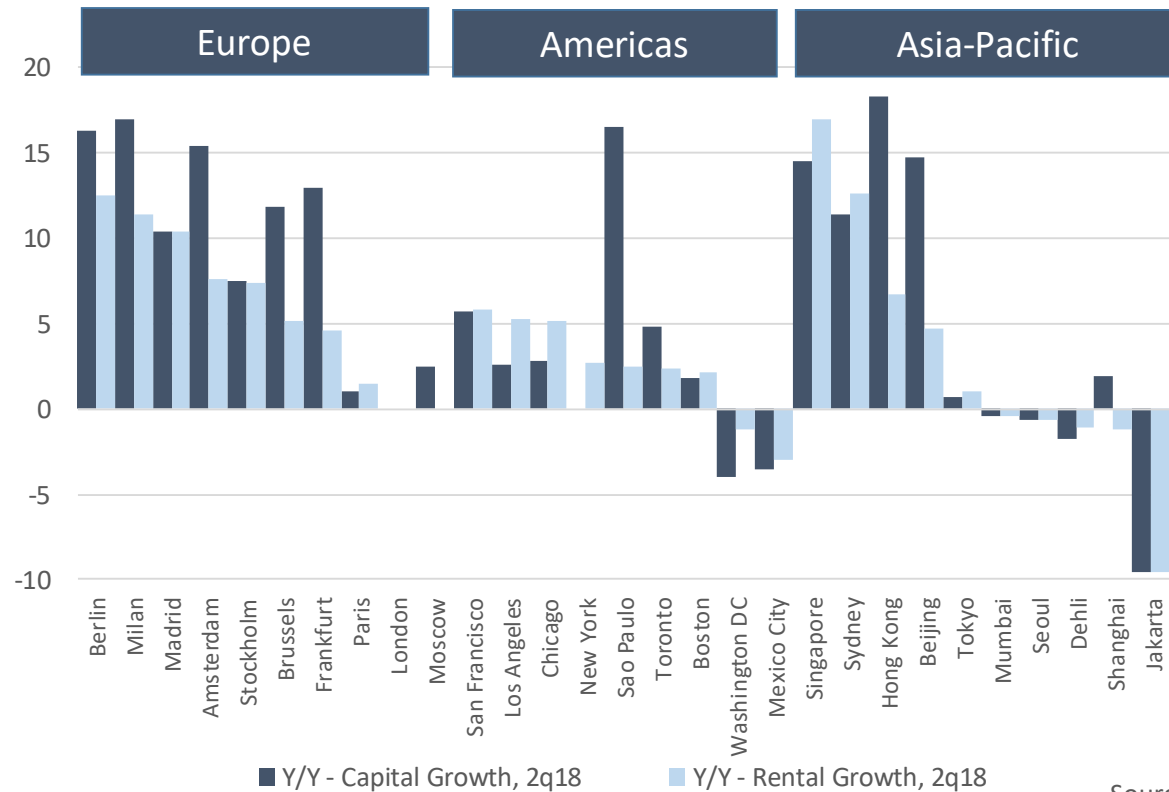- Robust demand-side factors: tight-labour market, income and population growth
- After a long phase of moderate construction activity: some markets near development cycle peak
- Only few advanced markets with risk of oversupply. Local differences in supply-demand balance: Oversupply rather in emerging market cities like Sao Paulo, Jakarta, Dehli, Shanghai.
- Liquidity at all-time high AND initial yields at all-time low.

Office Market Vacancy Rates

- Office market vacancy rates in advanced countries very low, construction activity hardly exaggerated, with most markets showing a tight supply-side. This supports further rental growth.
- Large amounts of vacant office space in some emerging markets like Brazil (Sao Paolo), Indonesia (Jakarta) and India (Dehli) with huge oversupply.

Investment Cycle: Office market rental and capital values

Europe | Americas | Asia-Pacific

Source: JLL

Legend:
- Y/Y - Capital Growth, 2q18
- Y/Y - Rental Growth, 2q18

X-axis labels: Berlin, Milan, Madrid, Amsterdam, Stockholm, Brussels, Frankfurt, Paris, London, Moscow, San Francisco, Los Angeles, Chicago, New York, Sao Paulo, Toronto, Boston, Washington DC, Mexico City, Singapore, Sydney, Hong Kong, Beijing, Tokyo, Mumbai, Seoul, Dehli, Shanghai, Jakarta

Investment Cycle: Office market Prime Yields

Europe

Americas

Asia-Pacific

in %

■ Prime Yields 2018 ■ Prime Yields 2013
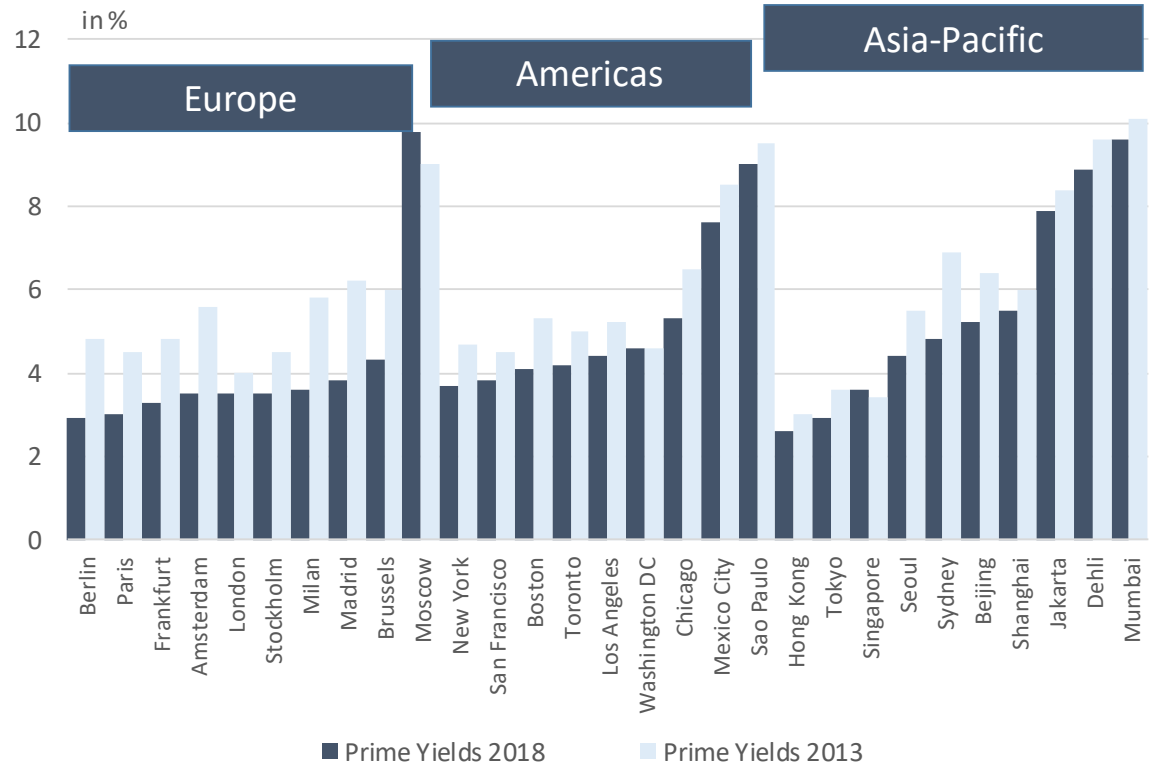
Source: JLL

Global Real Estate Markets
GREMM - Office Market Cycle: It's all about rental growth

Low Risk GREMM-Score **> 70**		Chicago Amsterdam Sydney Brussels	München Berlin Frankfurt Hong Kong	Paris Vienna San Francisco Stockholm	New York Houston Washington London
Low to medium Risk GREMM-Score **60-70**	Seoul	Madrid Singapore Milan	Tokyo		
Medium to High Risk GREMM-Score **50-59**	Warsaw	Prague			Shanghai
High Risk GREMM-Score **< 50**	Mumbai Mexico City				Jakarta Delhi

Office Market Cycle →

Negative to Low Rental Growth Decreasing Vacancy Rates

Medium to High Rental Growth Decreasing Vacancy Rates

High to Medium Rental Growth Increasing Vacancy Rates

Low to Negative Rental Growth Increasing Vacancy Rates
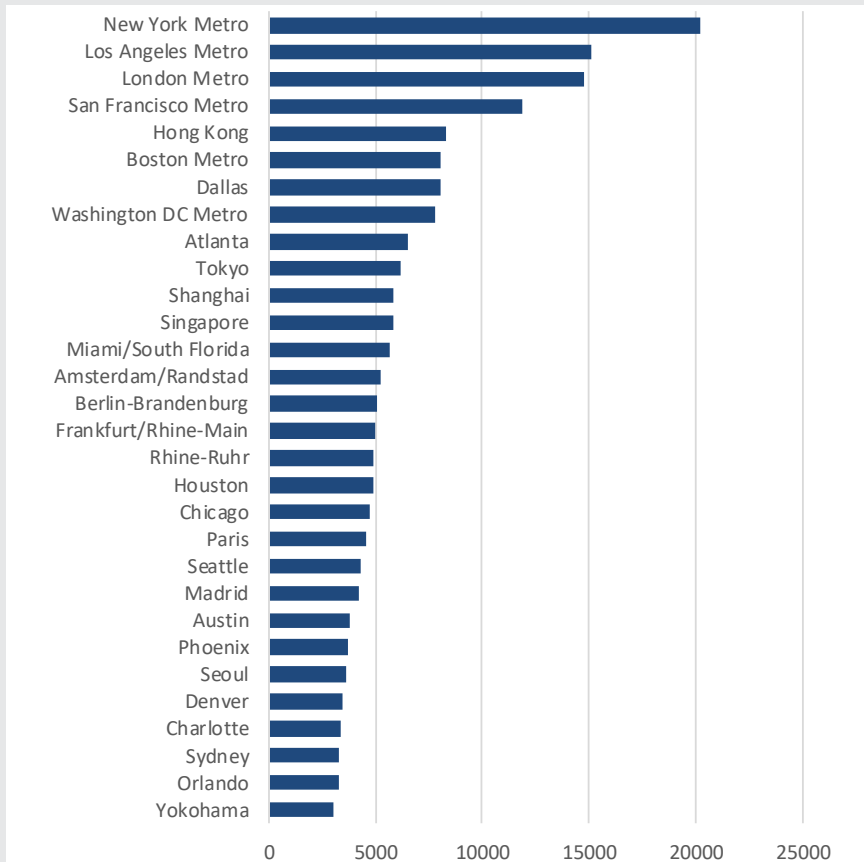
Global Real Estate Markets
GREMM – Cyclical Indicators: Global Sales Volume

Sales Volume, USD, millions

Source: RCA/ULI

GREMM-Scores

Sales volume for most active global real estate markets, first half 2017
Source: RCA, Emerging Trends in Real Estate 2018, p. 5

Scope-GREMM-Scores
- USA (78)
- Australia (78)
- Germany (77)
- Netherlands (77)
- UK (76)
- Hong Kong (70)
- Singapore (69)
- Japan (68)
- South-Korea (66)
- Spain (60)
- China (54)

Global Real Estate Markets
GREMM – Conclusion

How cautious RE investors can/should behave in a mature property market cycle…

1. Reducing risk trough shock-proven diversification approaches (f.i. MFH, medical offices)

2. Taking long-term and structural risk/return characteristics into account to cushion possible markets corrections (Safe Havens like Germany)

3. Countries/Cities which best adopt secular trends like urbanization, technological change, amenities, environmental and social criteria.

4. Take cyclical positions of different markets into account based on workable valuation metrics/benchmarks like Fair-Value estimates based on rental forecasts.

5. Watch the current risk map: trade tensions, political uncertainty, monetary policy (tight labor market > inflation > interest rate up-cycle)