2017 edging ahead of last year; USA showing signs of late cycle fatigue

Global Capital Markets Research Q2 2017

Executive Summary

- Second quarter global transactional volumes are inline with what JLL recorded at the same time last year at US$153 billion* (Figure 1). This brings H1 2017 volumes to US$297 billion, 2% higher than the first half of last year.

- Asia Pacific recorded the largest uptick with half year volumes climbing by 13%. Europe also saw an impressive first half gain as volumes rose 7% while the Americas volumes slid by 6%.

- London kept its crown as the worlds most traded city after surpassing New York, for the first time in two years, last quarter. Meanwhile, Boston has emerged as a new favorite for cross-border investors in 2017 attracting more than US$3.7 billion in cross-border capital in the first half, the third most of any city globally.

- The Germans took over as the largest cross-border investors in H1 2017 after spending over US$8.2 billion in the first half of the year. Among the most active buyers were the big open-ended funds who have splashed out on property thanks to growing demand from retail investors.

- The weight of capital from Asia continues to grow; inter-regional investment is up 71% and Asian investors now make up 5 of the 10 biggest cross-border spenders.

- Multifamily investment in the US picked up in the second quarter, but volumes were down 19% on Q2 2016. New York saw a dramatic pullback in activity while the Sunbelt continues to shine.

- If we've learned one thing so far this year it's that geopolitics will continue to play a major role in determining investor sentiment and market activity in 2017. Nevertheless real estate investors have remained confident and active around the world. Despite the bigger than expected pullback in the U.S., the supply of investment stock that is coming to market continues to grow, setting the stage for a solid second half of the year. And even though yields are at their cyclical low the weight of capital seeking access to the sector continues to grow. Given this, we anticipate that 2017 transactional volumes will be more or less in line with the US$650 billion we recorded in 2016.

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Figure 1: **Direct Commercial Real Estate Volumes, Q2 2016 – Q2 2017**

US$ Billions	Q1 2017	Q2 2017	% change Q1 2017–Q2 2017	Q2 2016	% change Q2 2016–Q2 2017	H1 2016	H1 2017	% change H1 2016 – H1 2017
Americas	58	64	10%	69	-7%	130	122	-6%
EMEA	56	58	3%	56	4%	106	114	7%
Asia Pacific	29	31	6%	28	10%	54	61	13%
TOTAL	144	153	7%	153	0%	290	297	2%

*All currency figures in this report are in US dollars, unless otherwise noted. These are converted from local currencies using a quarterly average rate.

GLOBAL AND REGIONAL

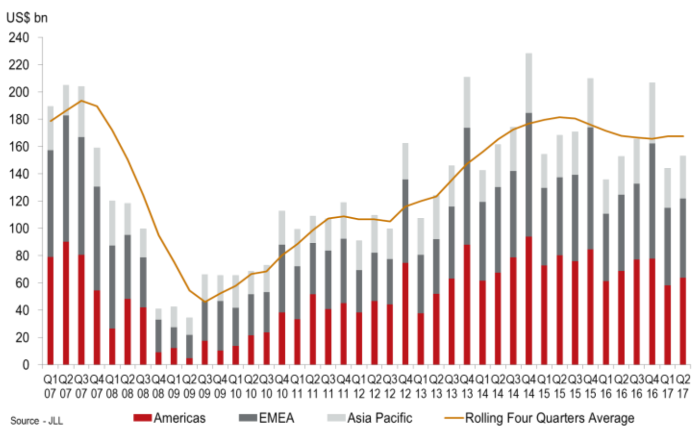
Global volumes tick up in the first half

Momentum builds after a positive first half

Politics continued to make headlines in the second quarter and while tensions eased in Europe after French elections passed without much tumult, concerns over the Trump administration's policy agenda and central bank balance sheet normalization still obsess global markets.

In spite of these challenges, real estate continues to perform, as the second quarter saw volumes of US$153 billion, level with the performance we saw in the second quarter of 2016 (Figure 2). This brings H1 2017 volumes to US$297 billion, 2% higher than last year's tally.

Figure 2: **Direct Commercial Real Estate Volumes By Region, Q1 2007 – Q2 2017**



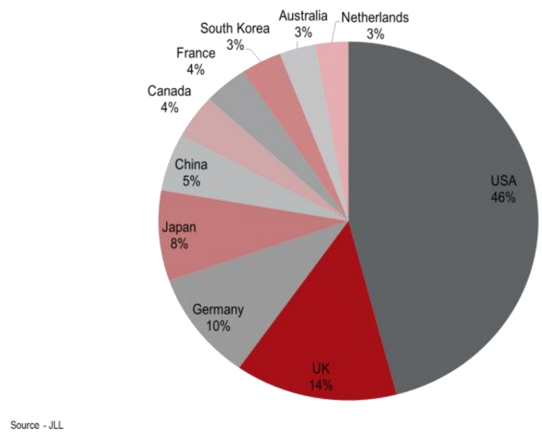
Despite the politics, business as usual in Europe

After much anticipation, voters soundly rejected populism and euro-skepticism in the French presidential election, propelling President Macron to power. Across the channel, snap elections in the UK did not yield the result that Prime Minister Theresa May hoped for as her Conservative Party lost their slim majority in parliament. Nevertheless, European volumes edged up in the second quarter, with the UK leading as the region's top market, and the second largest globally (Figure 3). On the continent, Germany continued its strong performance as half year volumes rose to their third highest on record. The Netherlands also posted an impressive second quarter, as volumes jumped by 66% in the second quarter to bring first half investment activity to an impressive US$6.2 billion, 57% better than last year.

Keeping with its hot start to the year, investment activity in Asia Pacific picked up even further as volumes rose by 10% in the second quarter, helping first half volumes reach US$61 billion, 13% better than a year ago. While Japan remains the region's top market, China closed the gap after a flurry of investment in the second quarter. Elsewhere in the region, gains in South Korea and Hong Kong were offset by modest declines in Australia and Singapore.

The biggest news in the Americas comes from the US where the market continues to cool as quarterly volumes dipped by 7%, bringing the total decline for the first half of 2017 to 10%. In contrast, the hot Canadian market posted another strong quarter as half year volumes reached their highest level on record, surpassing US$9.5 billion.

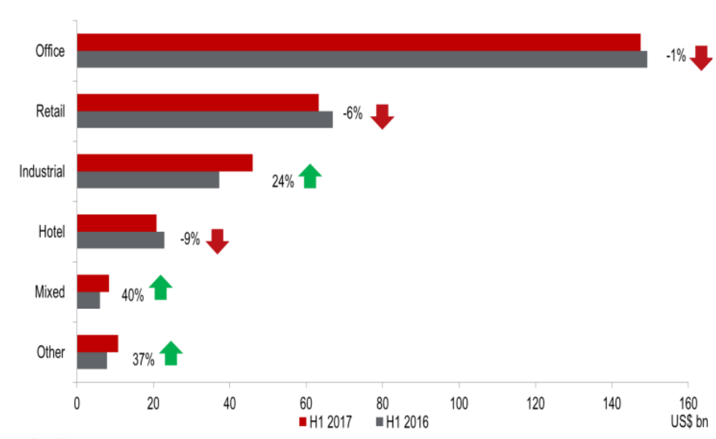
Figure 3: **Largest Markets for Transactional Volumes, H1 2017**



Industrial volumes remain elevated

Industrial has quickly become one of the most sought after asset classes, as sustained demand led to a 24% surge in H1 2017 investment volumes (Figure 4). Investment growth averaged 25% across the three regions highlighting the global nature of investor demand for the asset class. The US, UK, Germany, Japan, and Canada led as the five largest industrial markets.

Figure 4: **Global Transactional Volumes by Sector, H1 2016 & H1 2017**



CITIES

New York climbs back up

London keeps its crown

After two years of playing second fiddle to New York, London has kept its spot as the world's most traded city for the second quarter in a row (Figure 5). While domestic investors have continued to favour London, cross-border investors, particularly those from Germany and Hong Kong were especially active, accounting for nearly 60% of all foreign investment in the second quarter.

Boston, which did not make the top 10 list last year, has emerged as the world's 4th most traded city as first half volumes reached record highs.

New York, which slipped to 5th in last quarters rankings, made its way back up the standings to end the first half of 2017 as the world's second most traded city. The second quarter saw a dramatic pick up in domestic investment activity, a 62% increase on the first quarter, with local developers and property companies making up more than 46% of domestic investment. Even though cross-border investment remains below average for the first half, HNA's purchase of 245 Park Avenue for over US$2.2 billion helped bring offshore volumes back up from their first quarter lows.

Figure 5: **Most Active Cities, H1 2017**

Rank H1 2016	Rank H1 2017	City	H1 2017 (US$bn)	H1 2016 (US$bn)
2	**1**	London	**17.5**	13.1
1	**2**	New York	**11.2**	24.3
3	**3**	Los Angeles	**10.3**	11.3
11	**4**	Boston	**7.6**	4.6
5	**5**	Tokyo	**7.4**	6.8
16	**6**	Shanghai	**6.2**	3.3
7	**7**	Washington, D.C.	**6.2**	5.6
6	**8**	Seoul	**6.1**	5.7
8	**9**	Hong Kong	**5.2**	5.1
9	**10**	Singapore	**4.9**	5.1

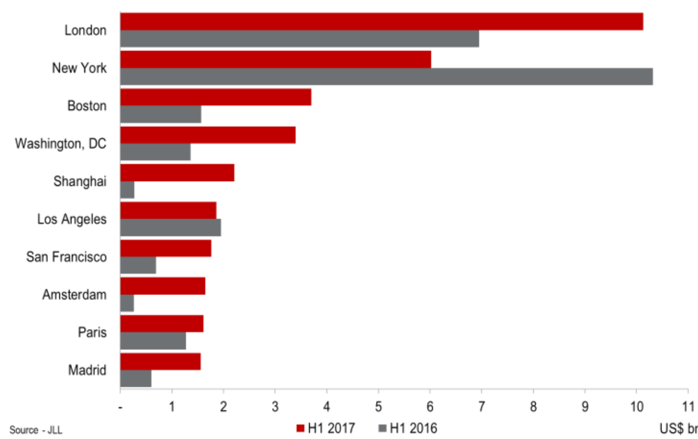
Source - JLL

Germans favor London

Even though many of the questions around BREXIT still remain unanswered, investors from around the world seem unfazed as cross-border investment picked up by 46% to reach US$10.1 billion in the first half of 2017, 13% higher than the long run average. Purchasers from Hong Kong are still the most active foreigners in the British capital followed by the Germans, who have spent over US$2.3 billion in the first half of the year. More than 75% of that total came in the second quarter, bringing total quarterly and half year purchases by Germans in London to their highest level on record.

The second quarter saw two new European cities break into the top 10 as Amsterdam and Paris joined Madrid among the top recipients of cross-border investment in the first half (Figure 6). In Amsterdam, Amundi completed the purchase of the 'Atrium' office complex for US$510 million, breaking the record for the largest single asset deal in the Netherlands. Paris benefitted from a first half influx of capital, mainly from German and global funds, as investors returned to the French capital which led to a 27% increase in cross-border investment compared to last year.

Figure 6: **10 Largest Recipient Cities of Cross Border Investment, H1 2016 & H1 2017**



European cities still miss the mark

Once again, Europe is sorely underrepresented in the list of the world's most active cities (Figure 7). While the continent is home to 4 of the 10 largest real estate markets in the world, portfolio transactions that span multiple cities in Germany have kept a number of major German cities off the list yet again. As usual the list is overwhelmingly made up of the large urban centers in the US and Asia.

Figure 7: **Top 20 Cities for Transactional Volumes, H1 2017**

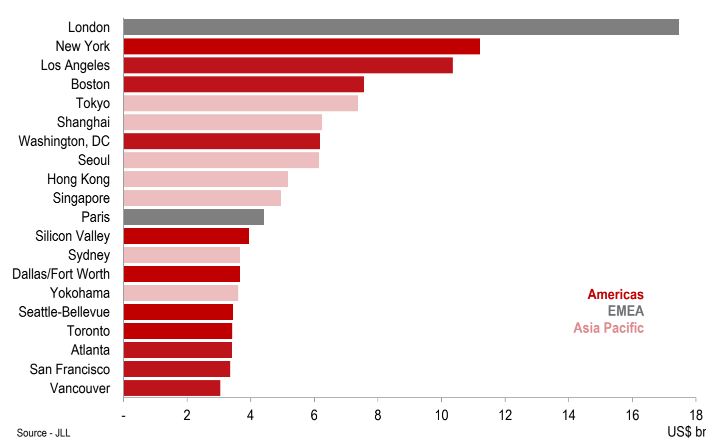
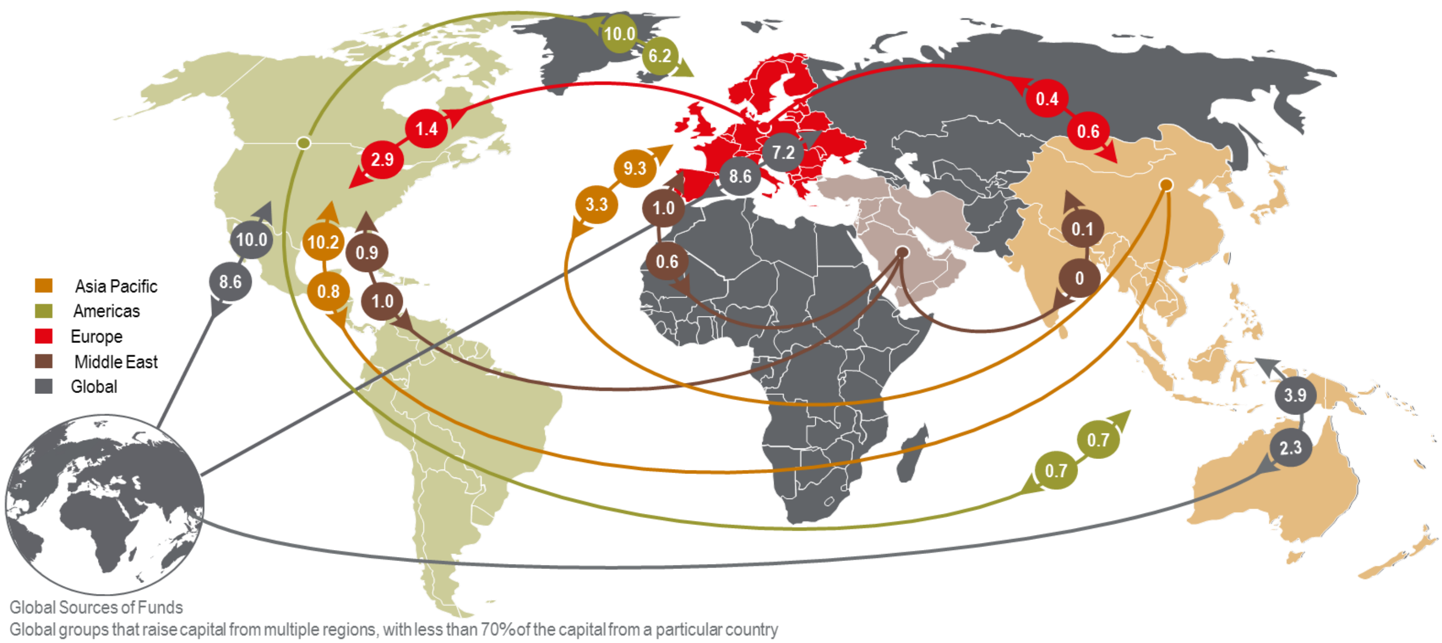


Figure 8: **Inter-Regional Flows, H1 2017 (US$83 billion in total)**



Source: JLL Property Data (UK); Real Capital Analytics (USA)

Asians spend around the world while North Americans sell out of Europe

Inter-regional capital flows from Asia reached record highs in the first half of 2017, totalling US$19.5 billion and up 71% from the same period last year (Figure 8). Almost all of that capital targeted the world's three largest real estate markets - the US, UK, and Germany. The biggest inter-regional spenders were from China (US$6.2 billion), Hong Kong (US$4.9 billion), Singapore (US$4.1 billion), South Korea (US1.9 billion), and Japan (US$1.6 billion). Meanwhile, North American investors, mainly from the US, continued to sell out of Europe, particularly the UK and Germany. Since 2014, North Americans have sold an average of US$9.9 billion worth of European property in the first six months of the year, the highest such volume of any group of investors globally. No region saw net capital outflows after the first half of the year as global funds and European investors remained net purchasers of property (Figure 9). As we discussed last quarter, Middle Eastern investors have continued to pull back after spending heavily in recent years; net purchases of property have fallen to US$1.6 billion, their lowest level since 2009 (Figure 10).

Figure 9: **Net Beneficiaries of Inter Regional Flows, H1 2016 & H1 2017**

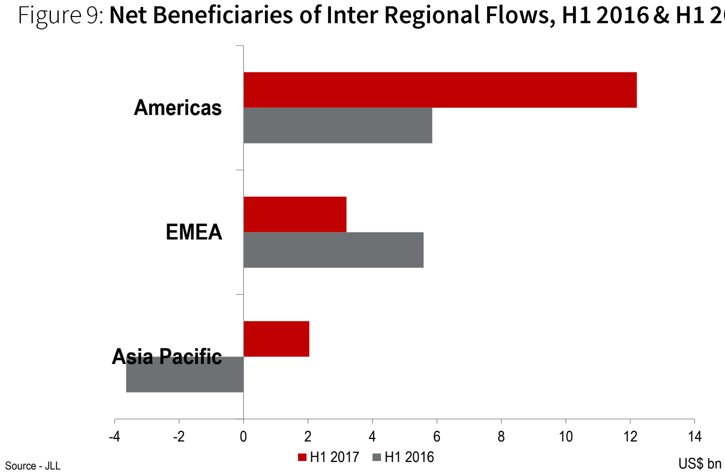
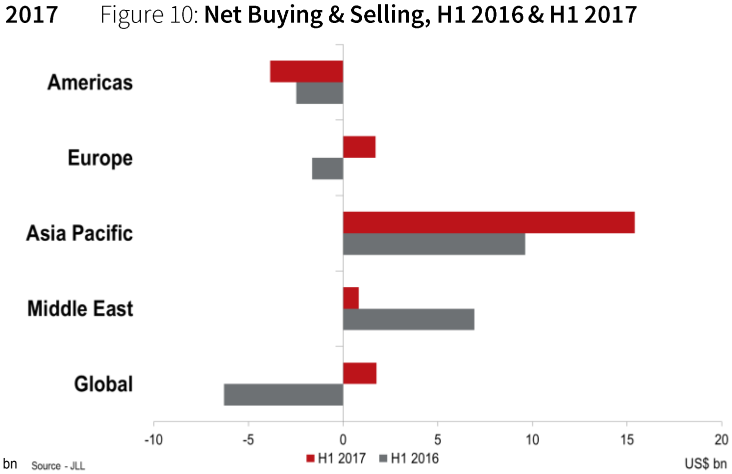


Figure 10: **Net Buying & Selling, H1 2016 & H1 2017**



CROSS BORDER

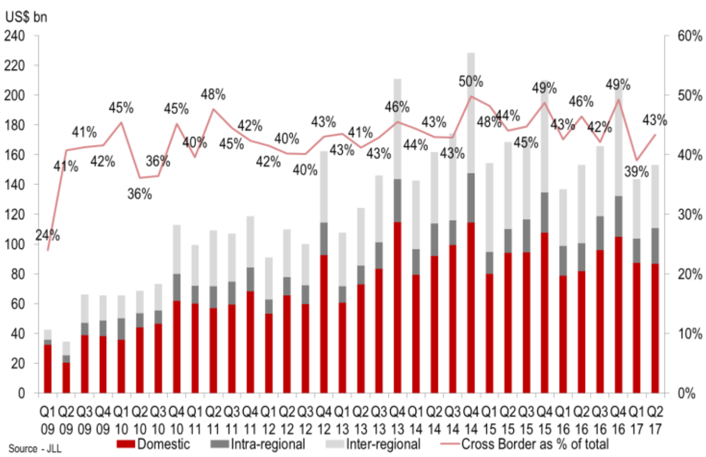
Americans slash foreign purchases

Intra-regional activity drives cross-border flows up

As global transactional volumes picked up in the second quarter so did cross-border activity, rising to 42% of all deal activity. Intra-regional flows jumped by 18% compared to a 6% increase in inter-regional movements (Figure 11).

Cross-border capital flows picked up in all three regions during the second quarter; Asia Pacific (48%) saw the biggest spike while EMEA (15%) and the Americas (12%) also made significant gains.

Figure 11: **Global Cross Border Transactional Volumes, Q1 2009 –Q2 2017**



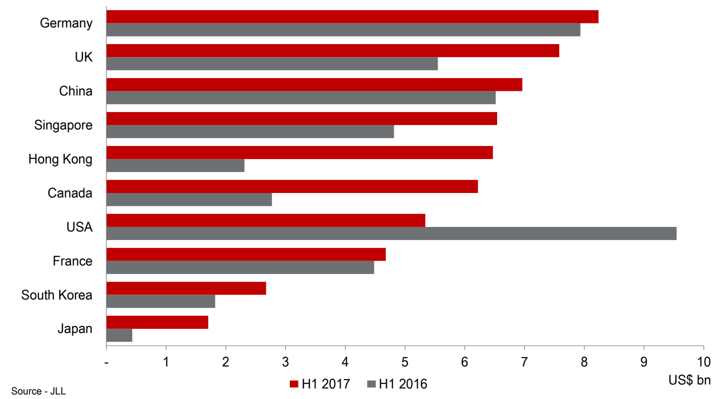
Germans take the lead

The second quarter ended with Germans taking the lead from the British as the biggest movers of capital after exporting over US$8.2 billion in the first half of the year (Figure 12). Unsurprisingly most of their acquisition activity took place in Europe, but the US also featured prominently, receiving US$1.6 billion in German capital, most of which came in the second quarter.

Among the most active group of German investors in the first half of the year were property funds; Commerz, Deka, and Union alone have made acquisitions totalling more than US$3.5 billion. Driving the acceleration in acquisitions is a boom in the number of retail investors who have piled into German property funds in recent months, and with more cash on hand these funds have been eager to spend. Two high profile deals executed by German funds include the acquisition of Cannon Place in London by Deka and Commerz Real's purchase of the Pacific Beach Hotel in Hawaii. Given that interest rates in the Eurozone remain stubbornly low and 10-year German bond yields are still well below those of commercial property, it makes sense that the big funds are spending more on real estate as they look to provide their investors with steady returns.

The other big story of the second quarter was the pullback in cross-border purchases by American sources of capital. Outbound capital flows fell to their lowest level since 2012 as first half volumes fell to US$5.3 billion, a 44% decline on last year.

Figure 12: **Top 10 Cross Border Purchasers by Source of Capital, H1 2016 & H1 2017**



HNA moves into Park Avenue

In what could be the biggest single asset deal of the year, Chinese conglomerate HNA acquired 245 Park Avenue, a Midtown office tower, for US$2.21 billion (Figure 13). The purchase underscores the continued prominence of Chinese capital in global real estate markets despite capital controls at home.

The second largest deal of the quarter saw Credit Agricole and EDF Invest, the investment arm of the French utility, each acquire a 20% stake in an Italian investment vehicle that owns an extensive portfolio of assets that are all leased out to Telecom Italia.

Figure 13: **Noteworthy Cross Border Deals in Q2 2017**

Property Name	Location	Sector	Sale Price ($ US m)	Purchaser	Purchaser Source of Capital
245 Park Avenue	New York	Office	2,210	HNA	China
Telecom Italy Portfolio	Italy	Other	988	Credit Agricole/EDF Invest	France
85 Broad Street	New York	Office	673	Caisse de Depot	Canada
Cannon Place	London	Retail	565	Deka	Germany
Metropolitan Plaza	Guangzhou	Office	528	Link REIT	Hong Kong

Source - JLL

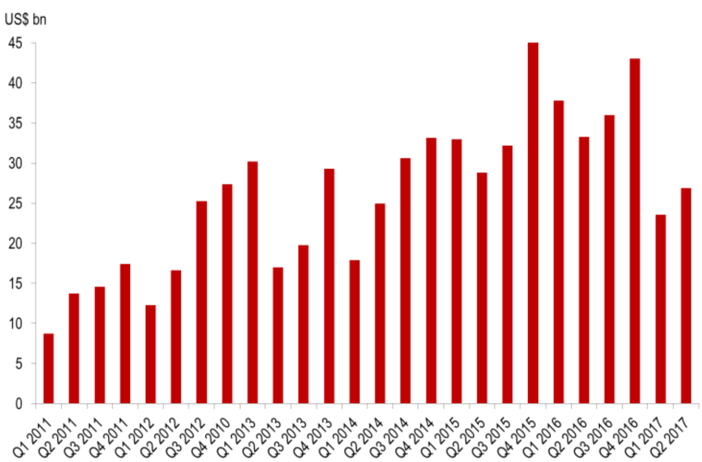
US MULTIFAMILY

Volumes fall after sustained growth

US multifamily investment slower, yet healthy

Rental apartment property investment in the United States reached US$27 billion in the second quarter of 2017 (Figure 14). This was a modest rebound from the US$24 billion in the first quarter, but volumes are still down 19% from last year. Following the record-setting transaction volumes of 2015 and 2016, there is, in several cities, a comparative lack of Class A product on offer for the buyer pool. In response, some investors have shifted focus toward pursuing value-add deals generally outside of urban core locations. In a macroeconomic environment of measured, but steady growth, the multifamily sector appears poised to continue an anticipated healthy pullback in investment activity following the recent decline in effective rent growth given surging completions alongside some deceleration in occupancy gains.

Figure 14: **US Residential Transactional Volumes, 2011 – Q2 2017**

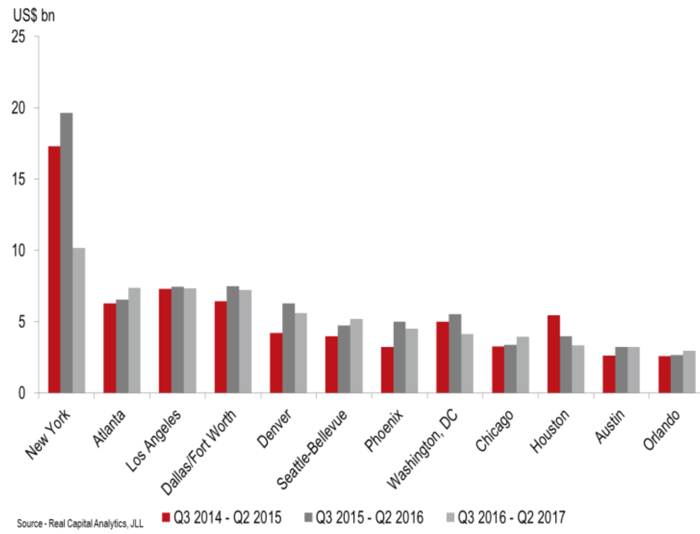


Source - Real Capital Analytics, JLL

New York slows, other markets exude strength

Although several primary and secondary cities in the U.S. saw a decline in trailing four-quarter multifamily transaction volumes, New York stands apart for the severity of its pullback and impact on the national market. Investment volumes in New York were just over $10 billion for the 4 quarters ending in Q2 2017, down nearly 50% from the same period ending last year (Figure 15). Fewer core opportunities and domestic investor re-evaluation of market prospects going forward, in light of the robust run-up in rental rates and capital values earlier in the cycle, are in large part behind the slower pace of the market in 2017. At the same time, many Sunbelt markets are seeing volumes at or modestly above peak-year levels, with Atlanta and Dallas being prominent examples. In addition, the West Coast markets of Los Angeles and Seattle-Bellevue have also entirely maintained their footing from 2015 and 2016, as investors are recognizing the highly positive employment trends in both cities.

Figure 15: **Most Active US Cities for Multifamily Transactions, Q3 2014 – Q2 2017**

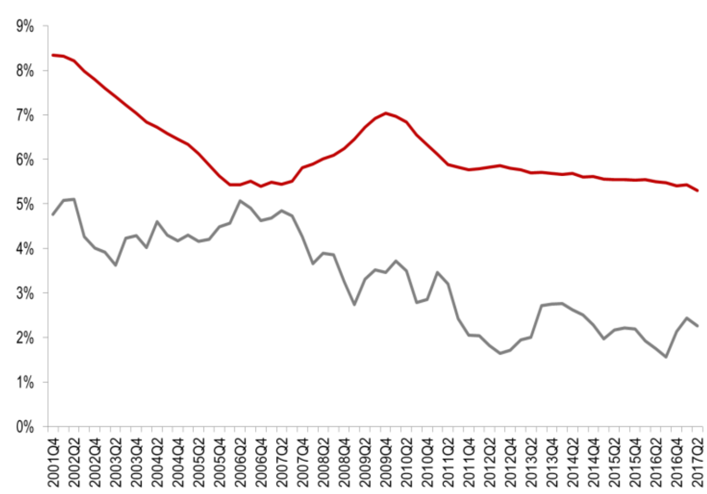


Source - Real Capital Analytics, JLL

Fed hikes again but property investors brush it off

For just the fourth time this cycle, the Federal Reserve increased its short term policy rate by 25 basis points in June. However, bond investors pushed longer-term benchmark Treasury yields down again during the second quarter, as inflation receded in recent months and economic growth has not accelerated as many had anticipated. Meanwhile, initial yields for multifamily properties still enjoy a historically healthy spread above 'risk-free' rates, as cap rates remain relatively steady, even though they are at near-record low levels (Figure 16).

Figure 16: **US Residential Spreads: Initial Multifamily Yields over US Treasuries, Q4 2001 - Q2 2017**



Source - JLL, Federal Reserve

Outlook

Politics continue to influence global markets

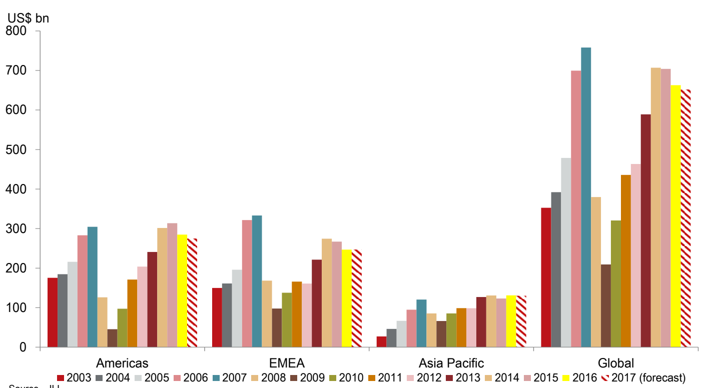
2017 volumes look set to keep pace

Transactional volumes in second quarter of 2017 show that global real estate markets have been able to brush aside much of the political drama that has characterized the last 12 months.

Despite hurdles in the form of diplomatic tensions in the Middle East, a continually changing legislative landscape in the US, and the looming threat of central bank tapering across the developed world, investors have maintained their confidence in global real estate.

Even though yields are at their cyclical low, the weight of capital seeking access to the sector has continued to grow. Given this, we anticipate that 2017 transactional volumes will be more or less in line with the US$650 billion we recorded in 2016 (Figure 17).

Figure 17: **Historical & Forecast Global Transactional Volumes by Region, 2003 - 2017**



Global industrial markets stay hot

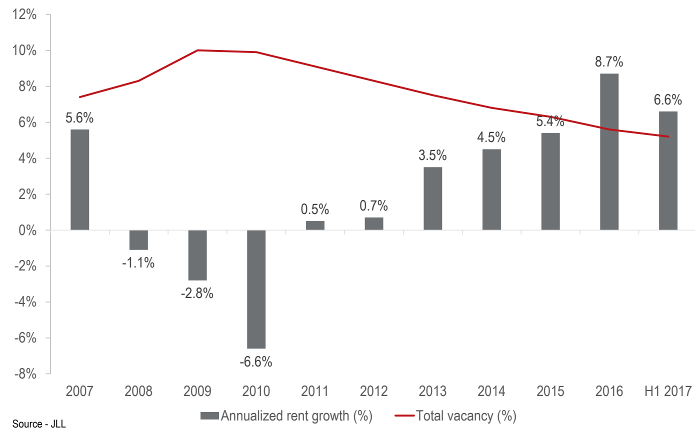
As we have already discussed, the industrial sector experienced the most significant investment growth of any established sector over the first half of the year, as volumes climbed by 24%. Investors just cant get enough of the sector thanks to structural shifts in the global economy. The rise of automation, e-commerce, and 3PLs have all helped drive the growth of the industrial sector worldwide.

In EMEA, demand for industrial space continues to outpace construction and with the majority of new supply remaining firmly build-to-suit driven, vacancy rates in Europe are expected to tighten further.

The story is similar in Asia Pacific where strong demand from 3PLs and e-commerce firms are driving the sector. While rents remained flat across the region, Sydney showed the strongest growth due to increasing demand from occupiers.

National vacancy rates continue to fall in the US, and now stand at just 5.2% (Figure 18). Rents also grew by 6.6% on an annualized basis thanks to tight supply and sustained occupier demand. These factors have contributed to the investment frenzy in the sector and first half volumes are at their cyclical high.

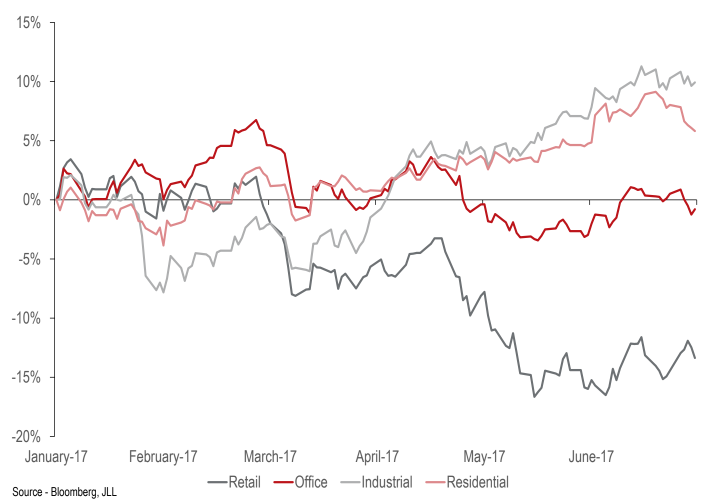
Figure 18: **US Industrial Vacancy and Rent Growth, 2007 – H1 2017**



Industrial REITs outperform in the US

Mirroring what we have seen in the physical market, industrial REITs in the US have outperformed peer sectors on a total return basis so far in 2017. As of the end of the second quarter, US industrial REITs have returned 9.93%, the highest of any sector (Figure 19). As we have just discussed tight vacancy rates and accelerating rent growth have helped to solidify income streams, while total net absorption continues to outpace deliveries. In such a landlord favorable environment it is no surprise that industrial REITs have jumped ahead.

Figure 19: **US REIT Total Returns by Sector, H1 2017**



Notes and Methodology

Direct Real Estate Investment	Refers to the purchase of individual commercial property assets or portfolio of assets (or shares in special purpose vehicles that own assets). Includes: • All transactions over US$5m • Sectors covered are office, retail, hotels, industrial, mixed-use and 'other' (includes nursing homes, student accommodation, etc) The data includes property company M&A, including REIT formations, where the following conditions are met: • The transaction is essentially a Real Estate transaction • Significant assets over and above the real estate assets (e.g. workforce, intellectual property, "goodwill" etc.) are not transferred • 70% + of revenues come directly from rental income • Transactions involve a significant changes of ownership • Transaction must be at 'market price' • Only includes the percentage sold to new investors at the IPO price Excludes: • Entity-level transactions; development deals; and multi-family residential investment
Entity Level Deals	Refers to corporate acquisitions, where significant assets over and above the real estate assets are transferred (e.g. workforce, intellectual property, "goodwill" etc). E.g. REIT privatisation 'Transaction churn' – e.g. where a company sells real estate assets to a majority-owned subsidiary
Development Deals	Refers to transactions categorised as 'forward funded' development and 'land' transactions
Asia Pacific	Varying coverage of the direct real estate investment markets in Australia, China, Hong Kong, India, Indonesia, Japan, Macau, Malaysia, New Zealand, Philippines, Singapore, South Korea, Taiwan, Vietnam, and Thailand
Europe	Varying coverage of the direct real estate investment markets in Belgium, Bulgaria, Croatia, Czech Republic, Finland, France, Germany, Hungary, Iceland, Italy, Luxembourg, Netherlands, Poland, Romania, Russia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey and the UK
Middle East and Africa	Varying coverage of the direct real estate markets in Bahrain, Israel, Kuwait, Lebanon, Qatar, Saudi Arabia, and UAE In Africa, we cover South Africa with varying coverage across the rest of the continent.
Americas	Detailed coverage of the direct real estate investment markets in Canada and the USA and partial coverage of Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Panama and Peru
Exchange Rates	We convert transaction values into US$ at the average daily rate for the quarter in which the transaction occurred
Grossed-up Figures	Volumes are grossed-up to reflect market coverage

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