
AVISON
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2020

2020 FORECAST

2020

GERMANY

FRANKFURT

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Ten trends you need to know about for 2020



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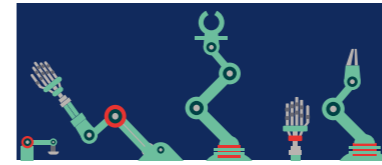
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#1 Lower for longer

LIVING WITH LOW INTEREST RATES

With inflation seemingly nailed to the floor across most of the western world, there are few signs that interest rates are set to rise any time soon¹. “Lower for (even) longer” remains the mantra for investors.

On the surface it’s a great environment for property investing; low interest rates offer a warm bath for real estate, keeping it competitive against other asset classes². Capital continues to flow into the sector, as investors seek out the unique combination of income return and capital preservation that real estate offers over time³.

But with the real estate cycle slipping into its second decade, the uncertainty felt by many investors about whether current pricing is sustainable seems justified. Real estate might be enjoying an extended period of popularity, but in large part this is due to the backdrop of economic weakness (hence low interest rates) and heightened political uncertainty across the globe – issues which also bring risks for the property sector.

A slowing global economy, with few signs of a sustained pickup in global trade, will impact occupier demand. Productivity growth has been low and while unemployment levels have fallen sharply in many countries, inflation has not risen meaningfully⁴.

Central banks currently have little ability to raise interest rates, robbing them of room to manoeuvre if – or more likely when – a slowdown turns into a recession⁵. With governments seemingly devoid of effective policy initiatives, the impact on rental income in the event of a protracted recession could be significant and prolonged.

So, what’s the answer for real estate? Avoid investing at these historically high prices? We think not, for several reasons.

First, while risks are apparent, a significant recession does not look imminent. Downturns are most often triggered by interest rate rises, following a bout of inflation due to excessive growth, which is hardly the case at present⁶. Shocks are always a possibility – but the risk of an all-out trade war seems to be receding. Markets may fluctuate, but a huge pool of Asian capital lies waiting to invest in good quality assets when the opportunity arises, which will help provide a floor for values⁷. Conditions hardly appear “set fair” but the external drivers pushing investors towards real estate are likely to remain in place for a while yet. Second, in most markets there are few signs of overbuilding or “irrational exuberance” in the structuring and financing of real estate transactions. The triggers for the periodic self-destruction that characterised many previous real estate cycles are largely absent. Real estate remains vulnerable to economic and political events, globally and at home, but the same is true of other asset classes. Income is king, so investors should go “back to basics” with a laser focus on managing properties and tenants well, and stress-testing their financing against future turmoil in the credit markets.

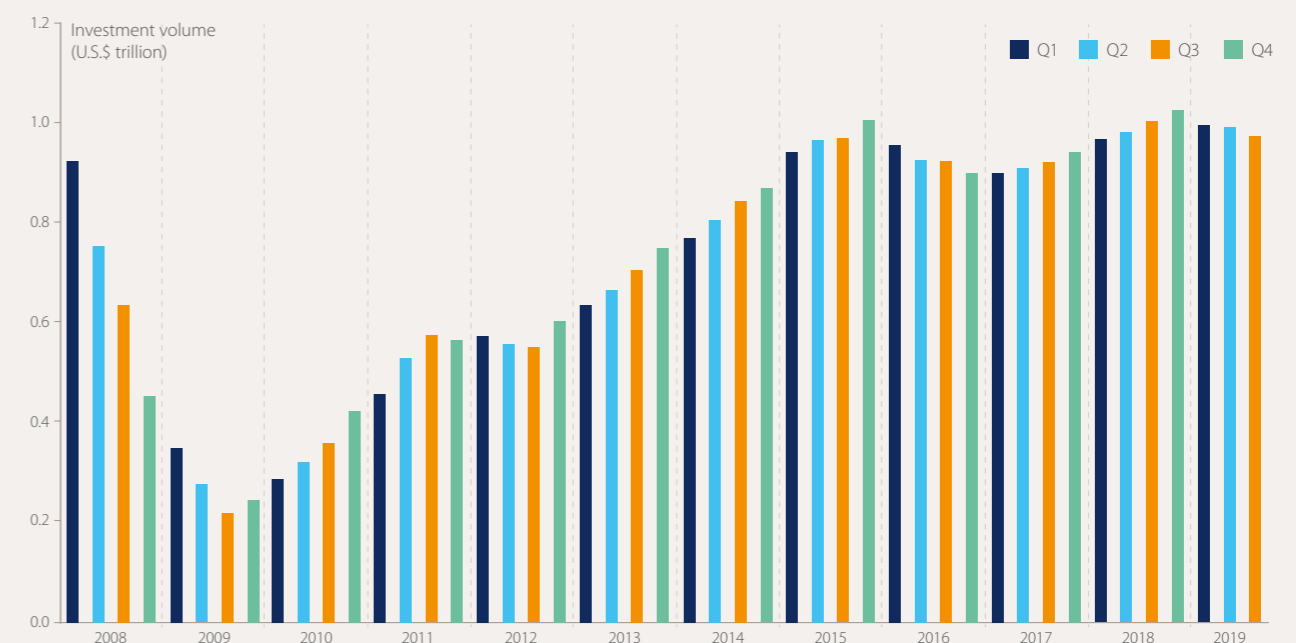
Third, savvy investors are seeking out new channels of opportunity. Climate change, impact investing, placemaking, the technological revolution and a host of other issues are reshaping our economies and cities.

They bring new challenges, but also new opportunities to create sustainable long-term value in the built environment⁸. Those who accurately detect the current shifting of the tides, and swim with the stream rather than against it, will prosper.

The search for yield continues. Indeed, further yield compression is expected on secure, long-duration assets that still look attractively priced relative to fixed income. But investors need to enter the market with their eyes wide open to the potential downsides, and with clear strategies in place to weather the turbulence that may be lurking over the horizon.

On the surface it’s a great environment for property investing; low interest rates offer a warm bath for real estate, keeping it competitive against other asset classes

12 MONTH ROLLING GLOBAL INVESTMENT VOLUME



Source: Real Capital Analytics



#2

Power to the people

HOW POPULISM IS CHANGING THE WORLD

With the U.S. in election mode, Britain still struggling with Brexit negotiations and discontent still rife across huge swathes of the global political landscape, 2020 will be another year when the fallout from populism will be distracting governments from attending to some of its root causes.

When the Developed World Populism Index concluded in 2017 that populism was at its highest levels since the late 1930s¹, many feared an impending avalanche of political extremism. The successes of U.S. President Trump and Nigel Farage, leader of the U.K.'s Brexit Party, gave new impetus to the populist coalitions emerging across a range of countries – but a series of subsequent national elections failed to deliver the dramatic changes of government that once looked likely². Europe, in particular, breathed a sigh of relief.

The sense that a bullet had been dodged was, and remains, misplaced. The underlying issues which drove populist movements haven't gone away – quite the opposite. Populist politicians typically prosper during periods of general discontent by focussing on one or two key issues that resonate most strongly with the electorate: big business, big government, immigration, regional independence, climate change... whatever happens to be the issue du jour³.

This explains why populism often creates coalitions which transcend conventional political divides; the far Right and far Left coalesce around something they have in common, albeit for different reasons - politics does indeed make strange bedfellows. If anything, the range and strength of populist groups is increasing.

The fact that such movements rarely end up forming a national government misses the point. Mainstream parties are scrambling to claw back support, and thus the populist agenda becomes incorporated into mainstream manifestos. The objectives may be watered down a little to appeal to a broader cross-section of the electorate, but the populists are succeeding in changing the focus of the political agenda.

Where the shift in position is measured, thoughtful and strategic in nature, this process should be welcomed. However unpalatable the rhetoric may be to some, this is democracy in action: politicians responding to the “will of the people”. But problems can arise when knee-jerk policies are introduced to tackle specific issues, not recognizing – or wilfully ignoring – the unintended consequences that may follow.

Real estate often finds itself caught up in this process, which is increasingly playing out on the local rather than national stage. City authorities are stepping in where central governments fear to tread. Housing affordability is a case in point: Berlin has already announced a residential rent freeze for five years and New York has expanded its housing rent controls to cover around one million units⁴. In London, Mayor Sadiq Khan intends to make rent controls a cornerstone of his 2020 re-election campaign⁵.

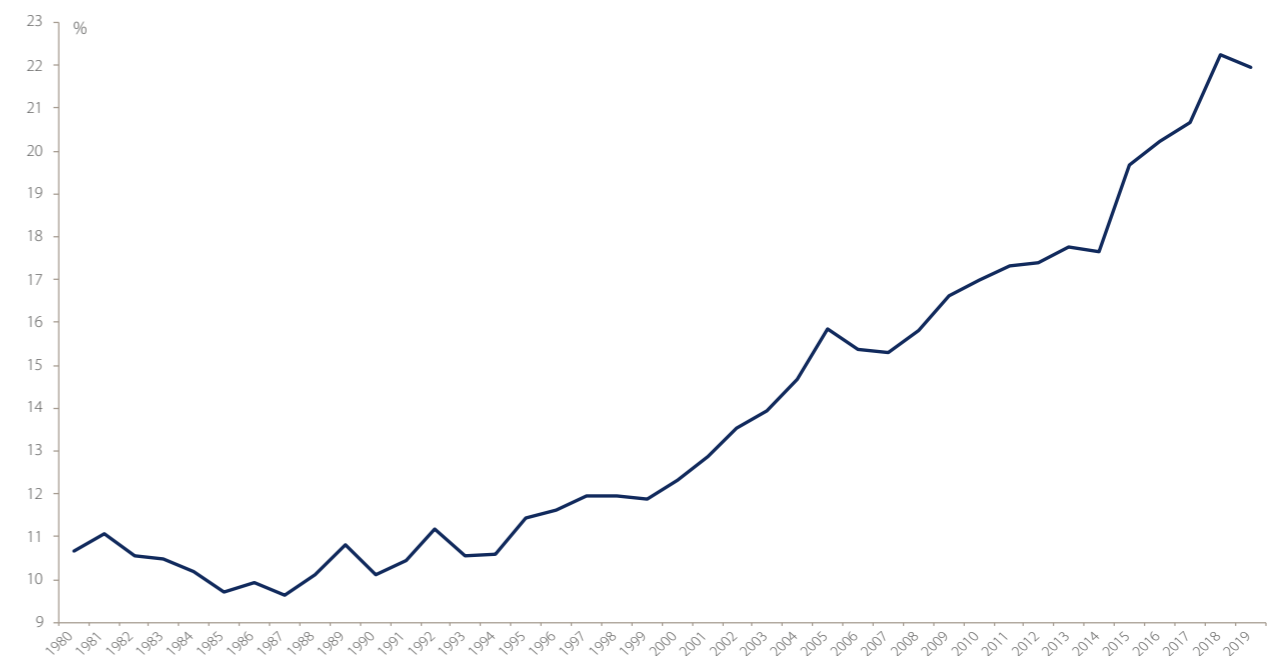
Economists may continue to debate the effectiveness of such measures – the research evidence is mixed⁶ - but landlords are left dealing with the immediate impact on the market.

Cities will also continue to take the lead on climate change, bypassing central government inertia on the topic. CDP, a non-profit organization, which supports environmental reporting by cities and corporates, notes that five cities including Paris, San Francisco and Canberra have set 100% renewable energy targets city-wide, while thirteen cities including Boston and Sydney plan to be climate or carbon neutral by 2050⁷.

Whatever their views on the issues concerned or the effectiveness of particular policies, landlords, developers and occupiers need to pay increasing attention to local political activism, as today's street protests increasingly signal tomorrow's policy initiatives.

Landlords, developers and occupiers need to pay increasing attention to local political activism, as today's street protests increasingly signal tomorrow's policy initiatives

AVERAGE VOTE SHARE OF POPULIST PARTIES IN ELECTIONS ACROSS EUROPE



Source: Timbro Authoritarian Populism Index (2019)

#3 (De) globalization

A PARADIGM SHIFT?

Globalization's most significant impact on the real estate sector has been the rapid growth in cross border flows of capital into investment markets around the world¹. While they may fluctuate in the short term, these flows are set to accelerate over the coming years as rising wealth in Asia targets investment grade real estate in the west.

Occupational markets have also been transformed. Globalization has been the defining feature of the business environment of the last 50 years, as corporates have expanded into new markets, production and back-office functions have been offshored and supply chains have internationalized. Here, however, the longer-term trend may be shifting. Heading into 2020, multinational companies are rethinking global footprints to find a new balance between cost-efficiency and business effectiveness². Consumer demands for greater social and environmental awareness from the companies they buy from are encouraging a shift in priorities³.

On average, affluence and living standards have benefitted hugely from the rapid internationalization of almost every aspect of trade and commerce⁴. But averages can be misleading. Many parts of Western Europe and North America continue to struggle with the impacts of de-industrialization. The benefits of economic growth have not been uniform; perceived inequality has risen sharply⁵ and the financial crisis has left lasting scars.



Reactions against the "globalization of culture" used to be viewed as a distinctly xenophobic phenomenon – yet consumers across the globe are seeking out authentic local products and pushing back against the uniform array of multinational brands that typify many shopping centers. The frustration of dealing with a call center halfway round the world is felt by many.

Even from a purely economic standpoint, globalization feels past its peak⁶. The world has already wrung most of the "quick wins" from expanding the reach of World Trade Organization (WTO) rules. The same can be said of the efficiencies to be gained from off-shoring manufacturing and streamlining global supply chains⁷.

Political calls to "bring home our manufacturing" play well to a populist audience, but they echo thinking already taking place in many boardrooms⁸. The fact that those new facilities may house more robots than traditional employees gets less publicity. But global companies who are seen as destroying jobs in their home country, unfairly avoiding taxes or ignoring the carbon footprint of their activities are damaging their brand in the eyes of a new generation of customers.

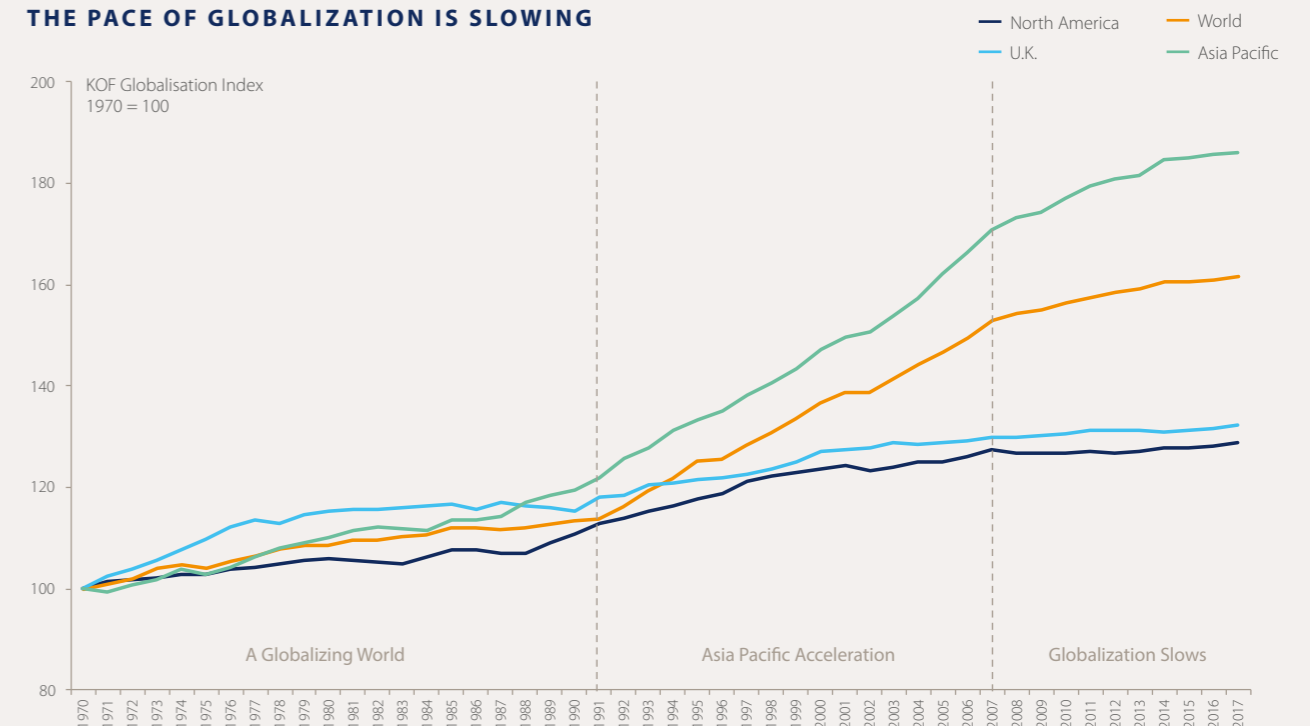
The resulting shift in favor of localization – or at least regionalization – of activities may only be evident at the margins for now, but it is gathering pace. Nearshoring has a commercial imperative; it enables shorter delivery times and greater localization of products, allowing companies to meet consumer demands and react to trends more quickly.

The implications for real estate are profound. Manufacturing facilities (if not necessarily employment) will see renewed demand. Logistics networks will focus more on integrating local and regional hubs, rather than simply connecting efficiently to major ports that are the gateways from Asia. Shopping centers offering a wider range of locally sourced food and beverage, products and services will be differentiated from their competitors, breathing new life into a retail sector desperately in need of reinvigoration.

Globalization is not dead, but it is changing. Investment capital will continue to flow around the globe. But for occupiers, integrating operations in different parts of the world will focus on maximizing quality, access to talent and innovation rather than solely on cost reduction⁹.

Nearshoring has a commercial imperative; it enables shorter delivery times and greater localization of products, allowing companies to meet consumer demands and react to trends more quickly

THE PACE OF GLOBALIZATION IS SLOWING



KOF Globalisation Index¹⁰, Avison Young

#4 Building resilience

CITY RESPONSES TO CLIMATE CHANGE

As warning signs of an ongoing climate emergency are becoming more dire and harder to ignore, it is no longer just the scientific community sounding the alarm. Radicalized social protest movements, climate activists young and old and even municipal politicians and bureaucrats are joining the vast majority of the world's climate scientists in reaching a consensus and understanding of the potential social and economic costs of climate change.

The demand for a response is growing, and cities around the globe are developing urban resilience strategies to ensure economic, social and environmental sustainability. They are recognizing their responsibility to mitigate the impacts of extreme weather events on local people, property and infrastructure. By 2030, according to the UN, unless there is significant investment to make cities more resilient, natural disasters may cost cities worldwide \$314 billion annually and climate change could push up to 77 million more city residents into poverty¹; lower income groups tend to be worst affected by climate change, and least able to recover from the effects².

Urban authorities also need to adopt meaningful regulation to compel more sustainable development, and to champion the use of technology to measure and reduce energy consumption and emissions from buildings.

Cities have started working together on the issue. The C40 Cities Climate Leadership Group, comprising 94 cities around the world that represent a quarter of the global economy and 70% of the global CO₂ emissions³, is one such powerful agent for change. Canadian cities including Montreal, Toronto, Vancouver and Calgary have appointed chief resilience officers (CROs) and are developing localized strategies thanks to their involvement in the 100 Resilient Cities Network⁴.

The World Green Building Council and the International Energy Agency have highlighted the need for the built-environment sector to significantly reduce its carbon footprint and emissions⁵. New York City's Climate Mobilization Act, which was passed in April 2019, could prove a game changer for North America. It sets a carbon emissions limit for large NYC buildings, and will provide a model for other global cities to emulate⁶. In 2019, the U.K. became the first major economy in the world to pass laws mandating net zero greenhouse gas (GHG) emissions by 2050 and cities such as Nottingham, Bristol, Oxford, Cambridge and Manchester all have ambitions to reach net zero GHG emissions through more localized initiatives⁷.

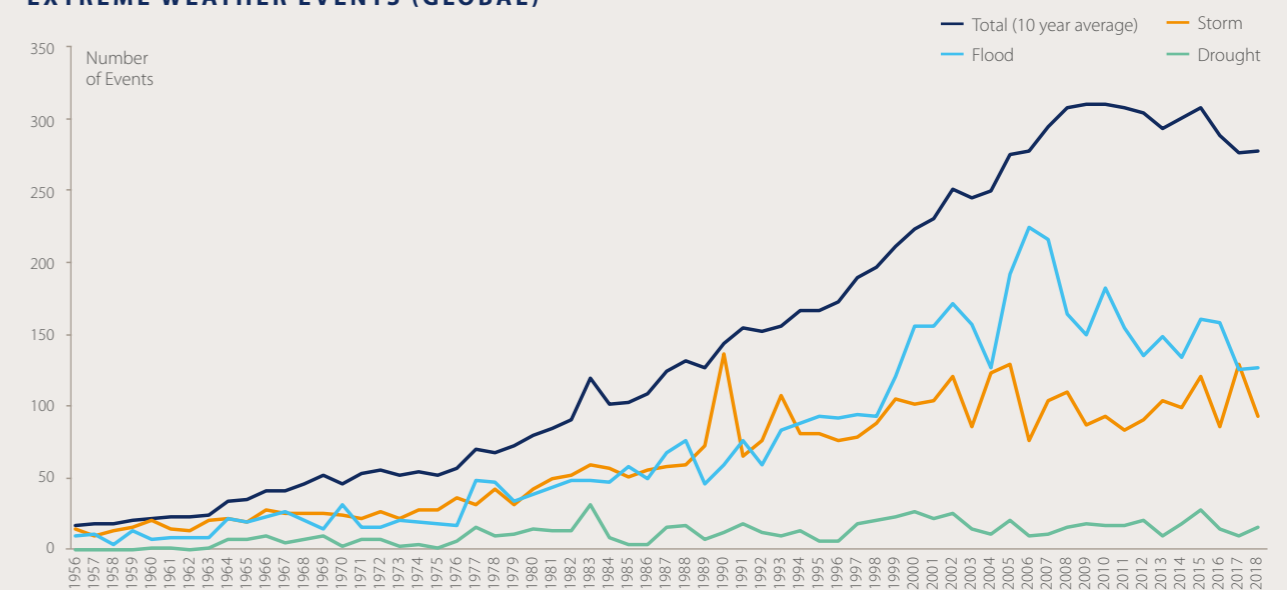
Adopting urban resilience strategies represents a fundamental shift in how we build cities. It will require substantial funding from both the public and private sector, creating significant finance and investment opportunities for private and institutional real estate investors.

It will also need specialized construction and project management expertise to tackle new technologies, building codes and materials⁸. Existing assets will need to be refurbished and retrofitted to meet updated emissions targets. All this will drive demand for new service offerings; from benchmarking of new technology and construction standards to educating the investment industry on which assets will not only deliver strong returns but contribute to the sustainability and health of our built environment.

The introduction of new policies and regulations may be a challenge for the unprepared. However, the real estate industry is perfectly placed to lead a major component of our response to the climate emergency. Around 70% of the global population will live in cities by 2050⁹, yet 60% of that new urban settlement has yet to be built¹⁰. The challenge is also a huge opportunity.

The demand for a response is growing, and cities around the globe are developing urban resilience strategies to ensure economic, social and environmental sustainability

EXTREME WEATHER EVENTS (GLOBAL)



Source: The Emergency Events Database (2019)



#5 (Place)making an impact

SOCIALLY RESPONSIBLE INVESTING

In recent years, we've seen growing recognition of the power of good placemaking in creating vibrant and successful developments and neighborhoods. In 2020 the focus on "place" will increase, accelerated by an emerging priority amongst institutional investors: impact investing.

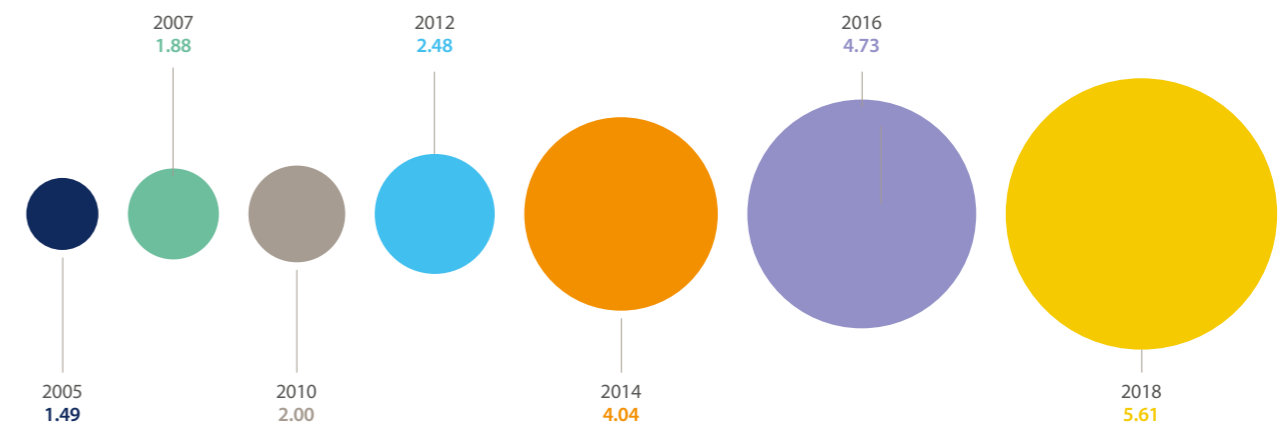
Successful placemaking requires a deeply considered, multi-dimensional response to the factors that come together to create liveable, sustainable and vibrant neighborhoods that are embodied by – and rooted in – the built environment¹.

Mixed-use schemes have long sought to capitalise on the potential benefits of combining multiple occupational uses within a single development. Contemporary thinking now recognizes that a new property development offers opportunities to go further in providing a local response to issues of growing community concern².

They can address concerns such as the environment and climate change; housing affordability and social exclusion; and a pushback by corporate occupiers and individuals against inauthentic, sterile environments with no "sense of place".

Private sector recognition that this can enhance rather than detract from return on investment parallels a shift in government policymaking on both sides of the Atlantic. In the U.S., the government is encouraging investors to consider social impact by offering tax breaks for development in 8,700 "opportunity zones" to support underserved communities³.

ASSETS MANAGED UNDER ESG* CRITERIA BY U.S. INSTITUTIONS (U.S.\$ TRILLION)



Source: US SIF Forum for Sustainable Investing (2018)

*ESG: Environmental, Social, Governance

In the U.K., the Social Value Act commands the public sector to deliver social, economic and environmental benefits with each project⁴. As a major client and partner for placemaking and regeneration projects, the public sector is beginning to influence the delivery of social outcomes at scale.

More broadly, we are seeing a societal shift in attitudes towards the very nature of capitalism. The ongoing aftermath of the financial crisis coupled with rising concern over climate change and social equality are fuelling a surge in populist politics that is challenging conventional free-market economics⁵. Consumers, clients and employees – particularly from younger generations – increasingly demand that the organizations they deal with recognize their wider obligations to society⁶. Companies that have a "sense of purpose" embedded in their culture will increasingly be at an advantage. Last year, over 180 top U.S. CEOs signed up to a new Statement on the Purpose of a Corporation, committing their companies to operate not just for their shareholders, but for the benefit of all stakeholders – including customers, employees, suppliers, and communities⁷. Corporate attitudes are clearly changing.

Interestingly, this parallels a shift which is starting to occur within the real estate investment community. The growing interest in socially responsible investing is now being focused on "impact investing" – investment undertaken in order to generate specific social or environmental benefits in addition to financial gains⁸. At present, investors seeking such opportunities are leaning into sectors such as later living, affordable housing and healthcare, all of which have obvious social outcomes but are still within the traditional sphere of investing.

More individuals are now focussing on the SRI credentials of the funds and organizations they choose to invest their savings and pensions with. As the level and sophistication of scrutiny increases, institutional investors seeking to tap into this growing pool of funds will have to make genuine efforts to balance social outcomes with financial ones.

The interests of various players therefore seem to be converging. Schemes and neighborhoods where placemaking has created positive environments, combining multiple uses and respecting local communities, are likely to be more commercially successful^{9,10}. Where they are also seen as socially and environmentally responsive, they will be doubly attractive to the talent occupiers are competing for. They therefore offer the kind of investments that tick multiple boxes for institutional investors desperately searching for yield in a market short on opportunities.

Impact investors seeking to capitalise on a growing pool of socially-aware investors could soon become the champions of social and environmental change in our cities.

Companies that have a "sense of purpose" embedded in their culture will increasingly be at an advantage



#6

The rebirth of retail

THE REINVENTION OF THE RETAIL SECTOR

Shopping is no longer just about getting goods into the hands of consumers. Retailing has grown to encompass a fully immersive and integrative experience that invites and holds the public's attention. It stimulates their desire to engage with brands, embark on sponsored journeys of the mind and body and interact with a like-minded community of fellow customers¹.

A reimagining of what retail engagement means for consumers has returned us to the modern equivalent of the traditional town square, a central destination that intentionally blends uses including retail, workspace and leisure with residential space and accessible rapid transit options².

The impersonal and transaction-focused nature of e-commerce, while efficient and appealing to cost-focused customers, has left many shoppers seeking to re-engage with experiential retail in search of a renewed sense of community³. This has sparked a renaissance of what it means to be a retailer in the age of online shopping.



Microsoft's first European store, in London, allows you to sit in a McLaren for a virtual driving experience

Experiential retail is incorporating digital and mobile technologies such as virtual and augmented reality and social media platforms in ways unheard of just five years ago

Experiential retail is incorporating digital and mobile technologies such as virtual and augmented reality and social media platforms in ways unheard of just five years ago⁴. These tools are being used to keep people engaged - specialized showrooms are integrating multiple offers, from food and beverage areas to hands-on opportunities for in-store product personalization. Curating brand experiences that build and reinforce customer loyalty in immersive environs represents a new phase of retailing the public is only now beginning to perceive⁵.

While online activity remains a comparatively small portion of total retail sales⁶, its impact on traditional storefront retail has been dramatic. Vacated shopping centers, high streets, strip malls and big-box power centers serve as highly visible victims of the rapidly evolving retail landscape. Yet many of these assets have appealing characteristics - from site configuration and building construction to proximity to rapid transit lines, arterial roads and high-density residential or employment areas⁷. Much of our former retail space is therefore ideal for adaptive reuse or redevelopment.

While retail generally remains a key component of any reimagining of the local environment, a complete community of complementary uses is required to boost public and consumer engagement. Investments in the public realm and a focus on walkability produce improved returns across the whole spectrum of stakeholders⁸.

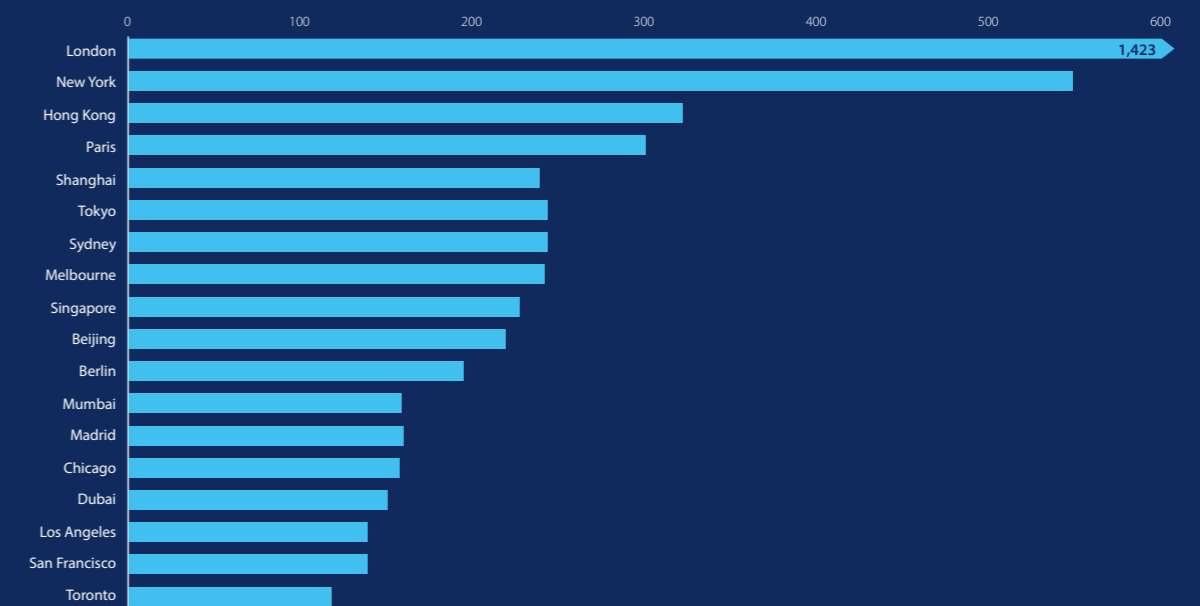
While internet sales will continue to expand, many pure-play online retailers are discovering the need for bricks-and-mortar locations as an essential part of an omni-channel strategy. While unlikely to roll out a traditional large-scale store network, many e-tailers are turning to physical locations as a way to promote and showcase new products, and as a channel for reverse-logistics⁹.

Pop-up stores in a variety of forms are also driving demand for physical retail outlets. Short-term leases provide flexibility, with opportunities to experiment and to exploit unique spaces. Where these are tied to holidays, product launches or celebrity involvement they can attract publicity and boost consumer appeal substantially.

The ongoing evolution of existing retail-focused assets towards more complete communities of activity that better integrate residential and commercial uses will likely be the most influential retail trend for the next five years. Ongoing investment and visionary thinking are being employed to put communities back at the heart of projects in ways that will deliver long-lasting value for a wider range of stakeholders and facilitate the rebirth of retail.



NUMBER OF FLEXIBLE OFFICE CENTERS BY CITY



Source: The Instant Group (2019) Instant Insight.

#7 Let's talk about flex

THE FUTURE OF FLEXIBILITY

Forget anything you've read in the newspapers, flexible offices are here to stay and will remain one of real estate's hottest growth areas in 2020. The world is in the early stages of a transformational period as the technological revolution takes over from globalization as the primary driver of business change. For all sorts of reasons, workplace flexibility is at the forefront of occupiers' minds.

As a market disruptor, it's not surprising that WeWork received disproportionate levels of attention for cancelling its public offering. But we all know its instincts are correct. With shorter business cycles, innovation at a premium, and talent expecting workplaces that more seamlessly integrate with their lives, how office space is being used is in a major state of flux¹.

Flexible offerings currently account for up to 5% of space across most major office markets². Within ten years, this is expected to make a transformative leap to 15-30%. That's because this is no longer just about freelancers and start-ups, this is smart thinking across all businesses. For occupiers and institutional owners, the future is the core-and-flex combo.

The talented individuals that employers want to target are increasingly drawn from the Millennial and Gen Z cohorts³. Like it or not, this talent is making new demands for, amongst other things, work/life integration and a more dynamic work environment⁴. Occupiers are having to respond by securing the right types of spaces in the right places, then managing them effectively to create the environments, plural, that the best employees are looking for. Cellular offices, cubicles, open-plan desks and quiet meeting spaces are not mutually exclusive; each is suited to a particular type of work¹. Staff are looking to employers to provide the type of space they need, when and where they need it⁵.

There is also a growing need for occupiers to flex in and out of space to react to economic cycles, to reconfigure it to drive efficiencies and to remain nimble by adapting space to special projects or assignments⁶. Integrating short-term solutions into their portfolio mix will generate efficiency savings, facilitate business responsiveness to new opportunities, fuel growth and reduce operational risks. Occupiers are willing to pay a premium for space that helps put this strategy into practice.

For institutional owners, the threat is not that core leases will be consigned to history, but that the market is now more nuanced; 'space as a service' requires a combination of offerings – not just in terms of lease length, but in the level of landlord servicing provided⁷. A string of major owners including Tishman Speyer, British Land, EQ office, WashREIT, Landsec, Irvine Companies, Boston Properties and Hines have already turned over parts of their portfolios to flexible offices, and more will follow⁸.

We think owners will eventually commit up to 20% of their portfolios to flexible space, and at these levels the capital markets don't currently think it materially impacts valuations. Certain institutional owners will push deeper than others into the sector; those that get it right can expect to reap the rewards. New products, operating models and partnerships are evolving to support diverse business needs and provide differentiation around factors such as workplace experience, branding and security. While the lease arbitrage model at scale might have been called into question, new management/partnership agreements are likely to smooth the way for future opportunities. Additionally, we predict more operators will look to own the real estate.

Flexible office providers already account for more space take-up than any other sector in every major market around the globe. At some point, consolidation is inevitable. During 2020, this transformation of the office sector will continue apace.

Flexible offices are here to stay and will remain one of real estate's hottest growth areas in 2020



#8 AI

AUGMENTED INTELLIGENCE?

Get ready to make new friends in 2020 - your cobot will soon be on its way. Robotic process automation (RPA) won't – necessarily - take your job, but it will transform it. A collaborative robot will make your life easier, helping you work quicker and smarter by willingly taking on those lower-value tasks clogging up your working day.

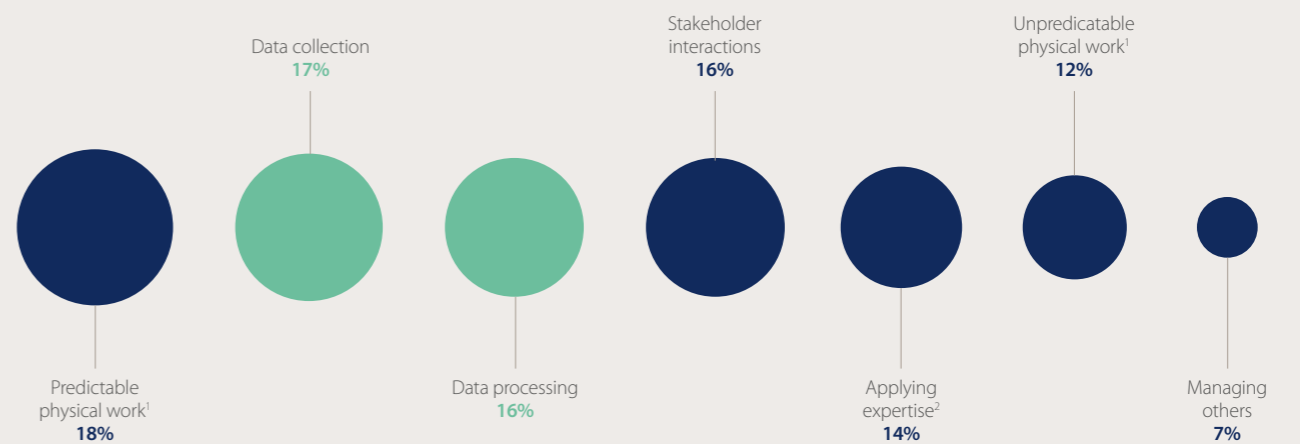
Disappointingly, not everyone will be sitting next to their very own C-3PO or BB-8. There will be some physical automation, akin to the robots we already see in warehousing and manufacturing. But for workers who focus on knowledge rather than products, most RPA is likely to be software or app based, enabling you to automate workflows across multiple interfaces¹. Either way it's near future now... RPA is getting cheaper, more efficient and more embedded in cutting-edge organizations with every passing year.

RPA adoption is a fast-emerging trend that crosses all industries², with major real estate implications due to the cumulative effect on the type and number of jobs required across different businesses. The McKinsey Global Institute estimates about 30% of the activities in 60% of all occupations could be automated³.

Back-office functions, which tend to be clustered in more cost-effective secondary and tertiary cities around the world, will be significantly affected; think of the routine information processing that goes on within banking, insurance and accounting⁴. Hot-bed offshoring locations will also be substantially impacted; offshoring is not going away, but robotics will replace some elements of human behavior and activities.

Less obvious is the impact on organizations, or individual jobs, where such processing is currently intertwined with more client-facing tasks. Separating the wheat from the intellectual chaff of everyday work will boost productivity and creativity, with as yet unforeseeable implications for organizational structures and working practices.

TIME SPENT IN ALL U.S. OCCUPATIONS



¹Unpredictable physical work (physical activities and the operation of machinery) is performed in unpredictable environments, while in predictable physical work, the environments are predictable.

²Applying expertise to decision making, planning and creative tasks.
Source: McKinsey & Co (2016)

A collaborative robot will make your life easier, helping you work quicker and smarter by willingly taking on those lower-value tasks clogging up your working day

For real estate in particular, the scope and pace of these advances should cause us to focus on the processes embedded in our industry. From research and investment decision-making to project management and building engineering, our use of technology and automation to process and manage information is in its infancy⁵. That's in addition to staple company activities where opportunities to deploy RPA abound - such as financial management, invoicing, recruitment and HR. One of the big four management consultancies already uses RPA in the onboarding of thousands of new employees each year⁶.

Before the real estate sector can benefit from the transformative efficiencies and profitability improvements that RPA and AI will deliver, there is some less glamorous blocking and tackling required. As an industry we need to be much better at collecting and taking back control of the data we have access to, and combining it with third party sources in order to unite the currently fragmented real estate data landscape.

Technology will help, but the first step is a change in mindset. Transparency of data about our urban environment has a long way to go. As an industry, we don't yet have clarity over what meaningful information we have and what other data potential strategic partners within real estate might own. The increasing availability of such data has seen prices fall, and the current focus on Smart Cities is rapidly accelerating the range of public and private providers⁷.

If the industry is going to optimize its use of automation and artificial intelligences, it needs to start assessing its data needs and acting on them. Within those organizations that are already doing so, the robots are coming...

#9 Wishing well

THE NEW FRONT IN THE WAR FOR TALENT

This is how it used to work just a few years ago: the real estate industry provided the building, the tenant provided the people to put in it every day. The office was a shell within which people got on with their jobs. At the end of the day the workers went home – maybe via the gym, depending on their personal choice. Coffee machines and on-site canteens helped reduce time “wasted” away from the desk. Hours worked was the unofficial metric of employee commitment¹. Employers were concerned about absence, but mainly in the context of productivity and efficiency.

Not anymore. In recent years, revolutions in working practices have driven a radical shake-up in office design and fitout, forging new relationships between landlord and tenant². Changes in technology and the rise of the sharing economy have transformed our thinking about the nature of work and the workplace. “Space as a service” is now in common parlance³, but most often thought of in the context of flexible lease terms. In truth, offices are now a joint venture partnership within which owners and occupiers collaborate to provide workspace as a service to their most important customer: the employee.

As the “war for talent” heats up, wellness has become the new frontier for HR departments around the world. Property managers and landlords are becoming their key allies. Employees generally, and younger generations in particular, are becoming more health conscious. The global wellness market has expanded to be worth U.S.\$4.2 trillion⁴.

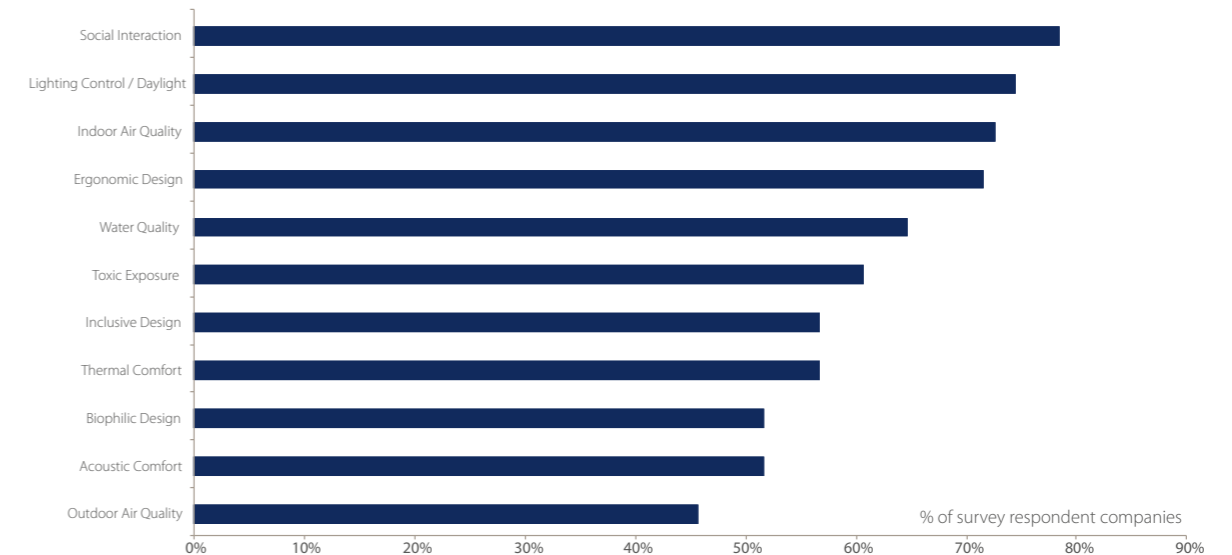
Lifestyle, diet, exercise and work-life balance are recognized as key contributors to mental as well as physical health.

As the boundaries between our work and private lives have become more blurred, so we now expect our employers not just to focus on our wellbeing, but to really care about it. The physical structure and location of a building have a huge part to play in helping companies look after their staff. This includes the creation of spaces that support neurodiversity and those with neurological differences or mental health issues⁵.

Good natural light and air quality – preferably using environmentally friendly natural ventilation – are essential⁶. Buildings should also support active lifestyles: an attractive staircase to encourage people away from elevators, cycle racks and showers, maybe a gym⁶.

This is particularly crucial in multi-tenant buildings where occupiers have limited opportunities to tailor space to their needs. Catering outlets that provide a range of healthy products are increasingly valued – either within the building or close by – accommodating individual dietary preferences and sustainably sourced from local suppliers rather than multinational chains.

STRATEGIES TO PROMOTE EMPLOYEE HEALTH AND WELLBEING

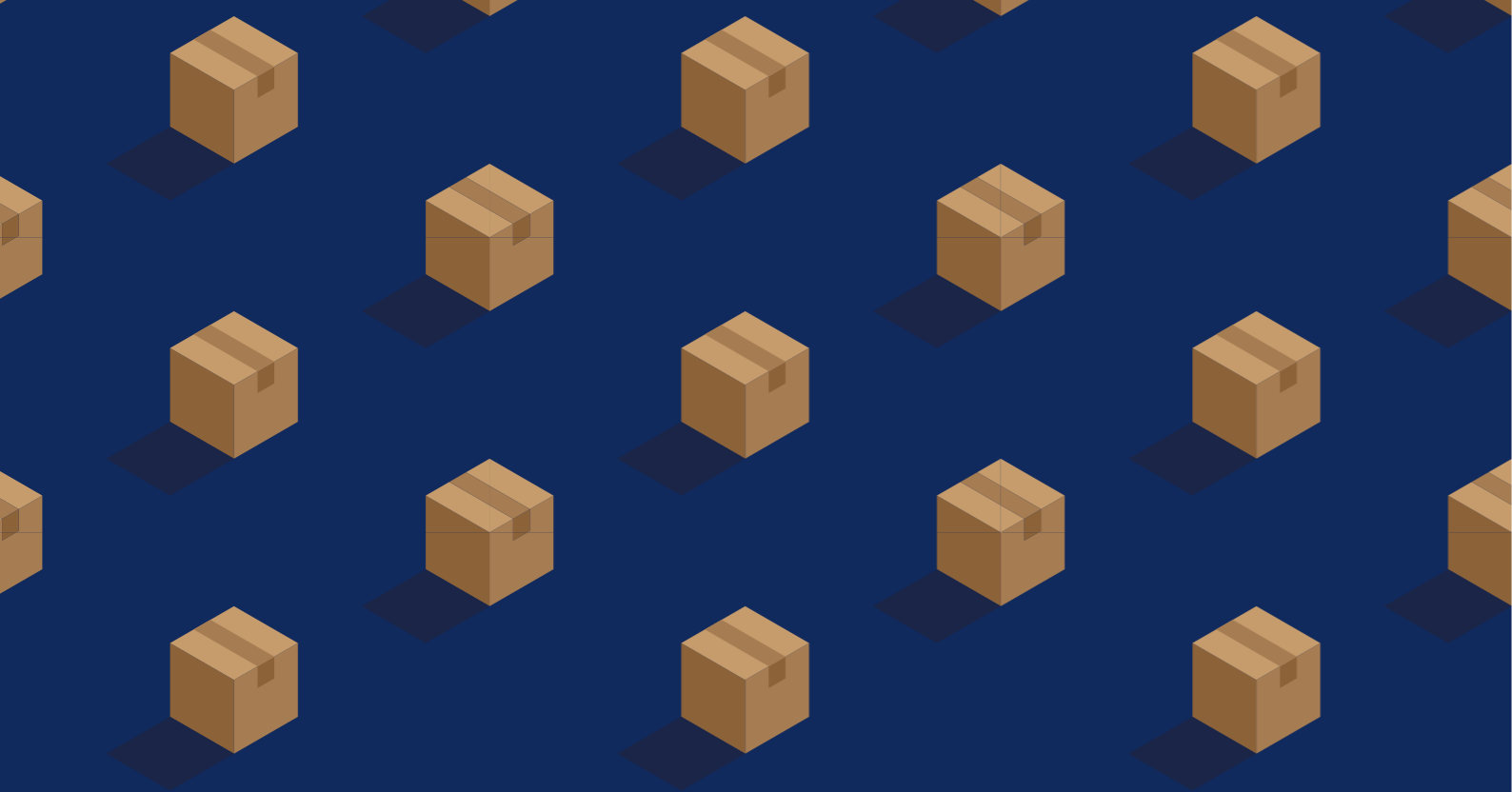


Source: Green Health Partnership & GRESB (2019)¹⁰

Community building is also critical⁷. It's predominantly been mixed-use buildings that have understood that connectivity of people is key to the holistic success of places. But now we see single occupier and multi-let offices striving to create a sense of place and community. Companies want spaces that instil a sense of pride in their workforce and provide an environment in which people thrive⁸.

It is easy to be cynical about corporate initiatives to improve employee wellbeing. But “enlightened self-interest” is a true win-win for both forward-thinking employers and their staff. Happy, healthy employees are more engaged, more productive and less likely to leave⁹. Happy companies are less likely to walk away from a co-operative landlord and a building that supports their efforts. For owners and occupiers alike, a focus on wellness will be increasingly key to maintaining a healthy bottom line.

The physical structure and location of a building have a huge part to play in helping companies look after their staff



#10

Heavy lifting

LOGISTICAL CHALLENGES

Logistics may be the darling of the investment market but, as we all know, it's tough at the top. Viewed superficially, it seems a simple story: booming demand for robot-filled warehouses to support an ever-expanding array of online retailers. The reality is more complex.

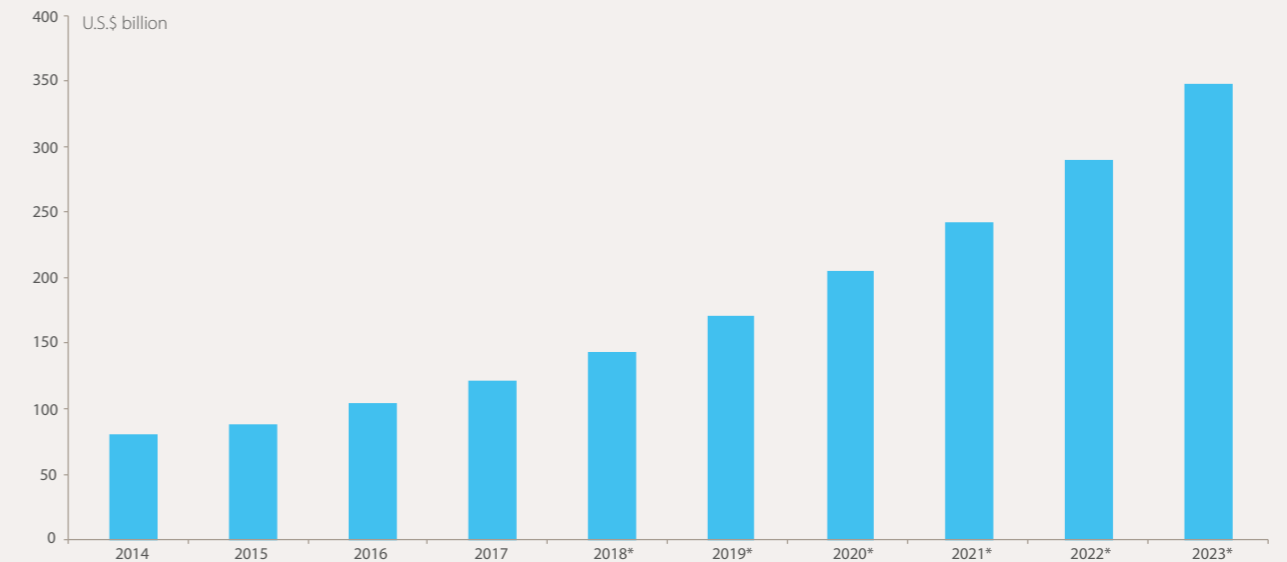
Automation is undoubtedly coming but, for now at least, e-commerce warehousing is a labor-intensive business ... and it's short of people¹. In the U.S., the largest facilities need 2,000 to 3,000 FTE workers, which is difficult to sustain with unemployment at record lows². The U.K. is already short of warehouse workers - and with eastern Europeans making up 15% of the workforce³, this is likely to worsen with immigration levels falling sharply ahead of Brexit⁴.

Alongside "last mile" delivery, the current hot topic is reverse logistics - the process of dealing with unwanted goods returned by online purchasers.

These can run to 40% or more of goods sold in some segments, representing a huge financial and operational headache for retailers⁵.

Some run dedicated warehouses or outsource the process to specialist operators. Reintegrating returns into the supply chain is highly labor-intensive, requiring careful handling of goods that arrive in various conditions and irregular volumes. Where processing costs are simply too high, products can end up being discarded⁶.

VALUE OF U.S. E-COMMERCE PRODUCT RETURNS



Source: Business Insider Reverse Logistics Report (2018)

*estimate/forecast

Retailers are recognizing the problem and starting to take action. Some price the costs into their products or charge for returns, others block customers with a history of "excessive" returns⁷. Consumer sentiment is changing, recognizing the carbon costs associated with deliberate over-ordering of goods - but this will take time to permeate through the population as a whole. Ease of returns is currently a key factor in consumer willingness to shop online, so the problem is likely to get worse in the years ahead.

Logistics companies are addressing their employment problem by shifting their attention to locations offering cheaper and more available labor. The trend of moving to non-prime locations is set to continue, securing access to new labor pools as well as greater pre-let property opportunities. In the U.K., Amazon has been responsible for 20% of all distribution space of over 100,000 sf leased in the past three years, and most of this has been outside core locations⁸.

Companies are also adopting new initiatives to make logistics facilities more attractive places to work. Health and wellbeing may be discussed more often in an office context, but concern has rightly spread to sheds⁹ with many now offering exercise areas such as outdoor gyms and running tracks, and better access to healthier food via in-house restaurants or food trucks¹⁰. In the warehouse environment, there is a growing focus on better ventilation and air quality, in some cases including the use of moss in "living walls" to absorb airborne contamination.

With labor shortages and cost reduction a perennial challenge in an industry where margins are tight, many companies are already looking at investments in automation and robotics. Both technologies are growing fast; the logistics sector accounts for almost two thirds of all robotics units sold globally, a market which is forecast to grow rapidly.

The technology is now easier to install, helped by modular building designs, and continual software advances are rapidly making all forms of automation more effective and energy efficient.

The technology is not yet at a stage where it's materially reducing staff numbers - and the investment required is not small. Further moves towards automation could prompt consolidation as those companies with stronger balance sheets operating at scale develop a competitive advantage. For the time being, the battle to attract and retain the right employees at an acceptable cost continues in the logistics sector just as it does elsewhere.

Reintegrating returns into the retail supply chain is highly labor-intensive

And finally...

One other issue we think it's important to know about going into 2020.

Future growth

THE OPPORTUNITIES AND CHALLENGES OF CANNABIS LEGALIZATION

"Oh, the times they are a-changin' ..."

In March 1992, then U.S. Presidential candidate Bill Clinton created headlines around the world with his admission that he had experimented with cannabis but didn't like it and "didn't inhale".

Fast forward to the U.K. General Election last December and the Liberal Democrats, one of the U.K.'s main political parties, pledged to legalize cannabis and tax it to raise £1.5bn to fight crime². Party leader Jo Swinson admitted smoking the drug at university, saying "and I enjoyed it"³. "The revelation barely rated a mention in the press.

With political and social easing over cannabis leading to policy changes worldwide - in particular for medical use - this presents the real estate industry with a new opportunity in 2020⁴.

Canada kick-started the process back in 2018 when it became the first G20 country to fully legalize cannabis.

Meanwhile, in the U.S., a patchwork of state legislation has resulted in 33 states and the District of Columbia legalizing the drug for medical use. Across the Atlantic, the European Union is considering harmonizing rules around a legalized medical cannabis industry - tipped to be worth €116 billion by 2028⁵.

A whole range of by-products is already filling shelves around the world. Cannabidiol (CBD), a non-psychoactive chemical extracted from the plant, is a popular ingredient in food, drink and beauty products. This market is expected to be worth \$22 billion in the U.S. alone⁶.

The big opportunity for the real estate industry in 2020 is centered on how the expansion of the drug for medical use will open up new markets. National governments are starting to issue licences; Germany agreed three in 2019, which will take the market in the country from €135 million to €1 billion this year⁷.

Where regulation allows, real estate opportunities range from research and development through to cultivation and manufacturing facilities. Science parks are likely to house sophisticated lab space and offices. There will be increased take-up of facilities to support plant growth, product manufacturing and distribution.

Canopy Growth, the world's largest publicly traded cannabis company, is a good example of the real estate potential⁸. It has 5.4 million square feet of operations in Canada, which includes indoor and greenhouse cultivation, as well as processing and manufacturing spaces for products that include vapes, food and beverages⁹.

Potential opportunities are not restricted to those countries that legalize cannabis for use - medical or otherwise.

The U.K. is currently Europe's largest exporter of the plant for medical purposes, despite its existing tough stance on usage¹⁰. Countries such as Malta, Greece, Denmark, Spain, Portugal, Israel, and Australia are expected to emerge as large exporters - but as more licences are issued, there will be more focus on domestic growing and manufacturing.

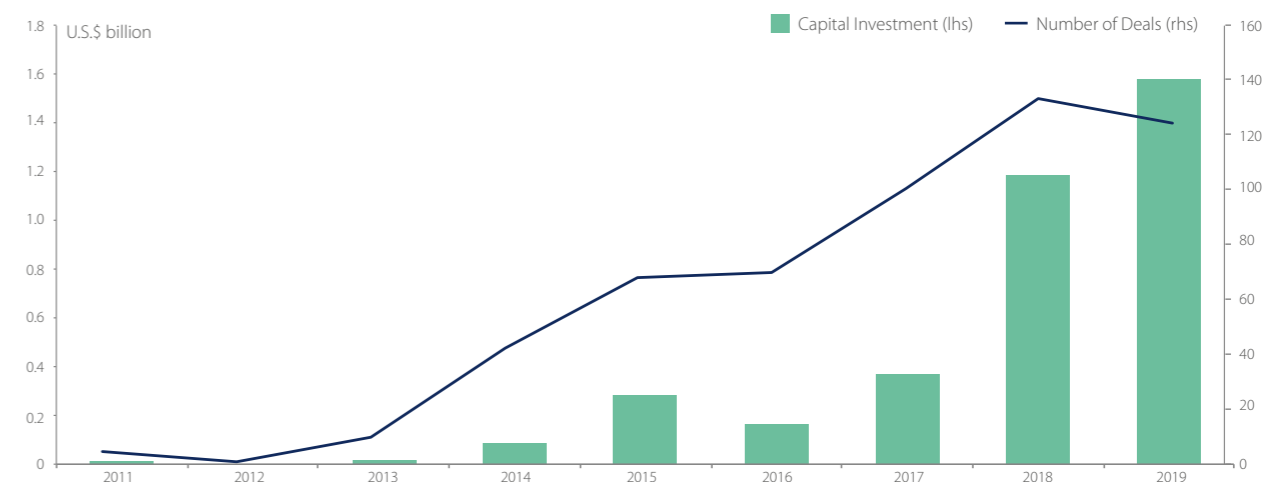
Another sign of the sector's potential is the interest from venture capital. Investments in the U.S. cannabis market hit record levels in the first five months of 2019 when U.S.\$1.6 billion was raised across 126 deals¹¹. Today's venture capital targets tomorrow's institutional investments.

For those with an eye on future opportunities, Canadian companies are the ones to watch. In 2019, Canopy Growth bought German medical cannabis company C3, Spanish producer Cafina and U.K. skincare and wellness outfit This Works¹². It also signed up to buy U.S. rival Acreage in a \$3.4 billion deal which will finalize if - or more likely when - cannabis is fully legalized in the U.S.¹³. Also last year, Canadian medical company Tilray set up a Portuguese research and cultivation campus¹⁴ while Canadian producer Aurora took over Portuguese competitor Gaia Pharma and won a tender to produce and distribute cannabis in Germany¹².

They are thinking ahead. Savvy real estate players are doing the same.

Potential opportunities are not restricted to those countries that legalize cannabis for use

VENTURE CAPITAL FUNDING FOR CANNABIS START-UPS



Source: Pitchbook (2019)¹¹

Ten Trends for 2020

Our Ten Trends commentary has been prepared based on the market knowledge and experience of Avison Young professionals around the world, along with the following sources.

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2020

NATIONAL OUTLOOK

2020

GERMANY

GERMANY



EXECUTIVE SUMMARY

- 2019 saw some economic turbulence, although the economy has started to rebound as a result of increased exports.
- Germany's office markets are booming. Driven by a growing service sector, office leasing volumes have risen to record highs in the past three years.
- Germany's logistics leasing markets continue to thrive, driven by the sustained growth of the e-commerce sector and solid economic growth.
- While many investors favour core investments in Germany's top-5 cities, lack of product across most asset classes has also encouraged them to diversify geographically and in terms of risk profile.
- Germany's retail market remains a target for internationally operating retailers attracted by above average purchasing power, considerable growth and some 80 million potential customers. However, the German retail market is in a phase of change with stable growth in the e-commerce sector.

STAYING ON COURSE

GERMANY'S ECONOMY AND REAL ESTATE MARKETS IN TIMES OF CHANGE

The world's fourth largest economy held firm in 2019. Although slowing global growth acted as a headwind for the export driven German economy, employment remained at a record high and GDP rose by 0.5% over the year.

DIFFICULT ECONOMIC ENVIRONMENT

Without doubt, Germany's economy is navigating turbulent waters. Trade disputes and a slowdown in global manufacturing have had a direct impact on Germany's export sector. At the same time, the country has also seen problems closer to home, with the systemically important automotive industry struggling to overcome the 'dieselgate' emissions scandal and a lack of competitiveness in the e-vehicles segment. The economy showed its vulnerability in Q2 when growth turned marginally negative. The decline only lasted one quarter, but impacted business and consumer sentiment throughout the remainder of the year. The 'Fridays for Future' demonstrations highlight ongoing popular concern about climate change.

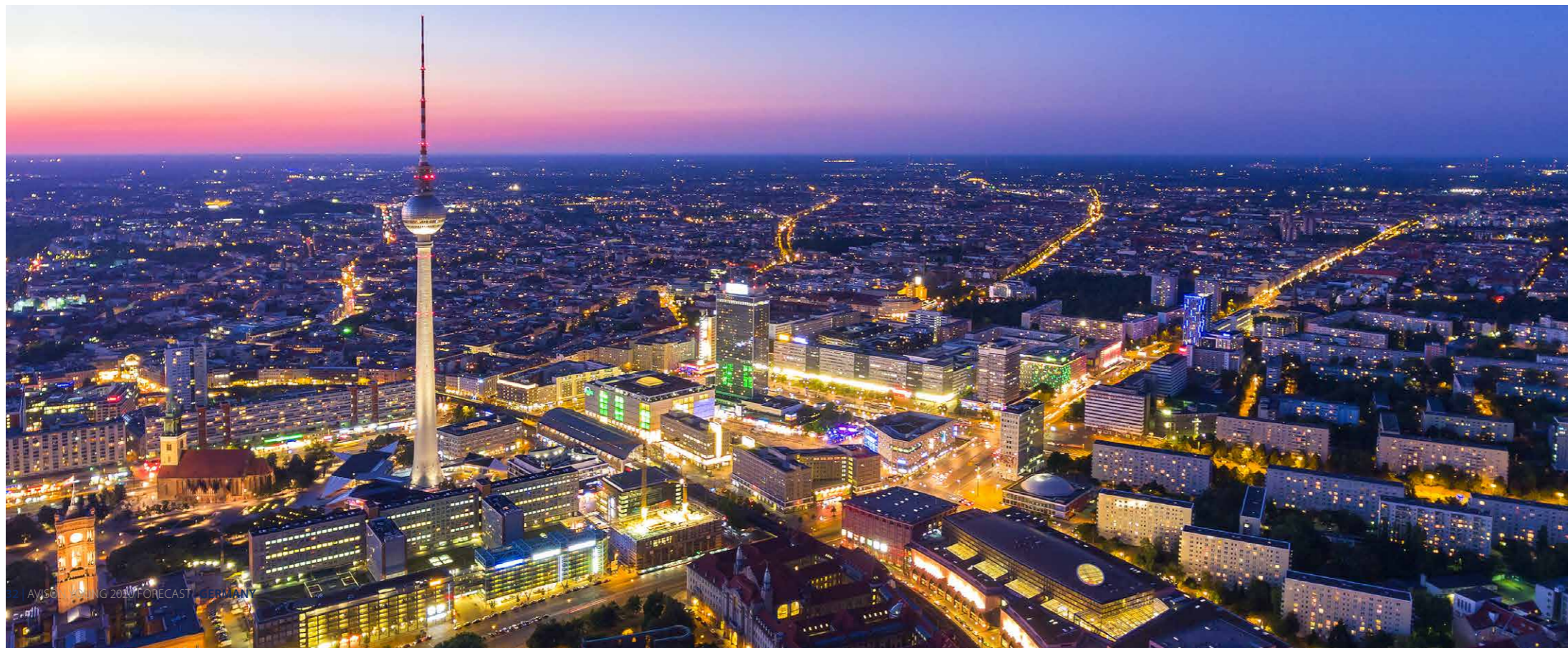
SIGNS OF IMPROVEMENT

Modest GDP Growth

Since the middle of 2019 economic growth has rebounded, with signs of improvement across much of the economy. Private consumption, government spending and fixed capital formation were all modest but positive contributors to renewed growth. This has been underpinned by an uptick in exports, and cumulatively these positive signs led to a recent improvement in sentiment.

Brexit, Tariffs and the Global Economy

Germany's economic performance in the latter half of 2019 was driven by easing global trade disputes, increasing chances for an orderly Brexit and Donald Trump's decision to postpone tariffs on imports of foreign-made cars and auto parts. These latest developments have lowered the perceived level of risk in the global economy and have stimulated investments and trade.



The country is entering a phase of longer, yet more moderate growth, albeit with less cyclical volatility.

Record Investments in Infrastructure and Climate Action Programme

2020 will be a year of record public investments, which will have positive implications for GDP growth. The German government has realised that it is high time to push through structural reforms and improve the nation's infrastructure. For 2020 a 10% rise in investment to around €43 bn is planned. Of this, some €18 bn is to be targeted towards Education and Research, €7 bn into the state's Climate Action 2030 Programme, and €1.5 bn will flow into the state-owned Deutsche Bahn (German train system) and Artificial Intelligence.

An Industry in Change: The German Automotive Industry

Germany's automotive industry is by far the nation's most important industrial sector with over 830,000 direct employees and a turnover of more than €425 bn. Overall it is estimated that over 2 million jobs and almost 5% of GDP are directly or indirectly linked to the automotive sector.

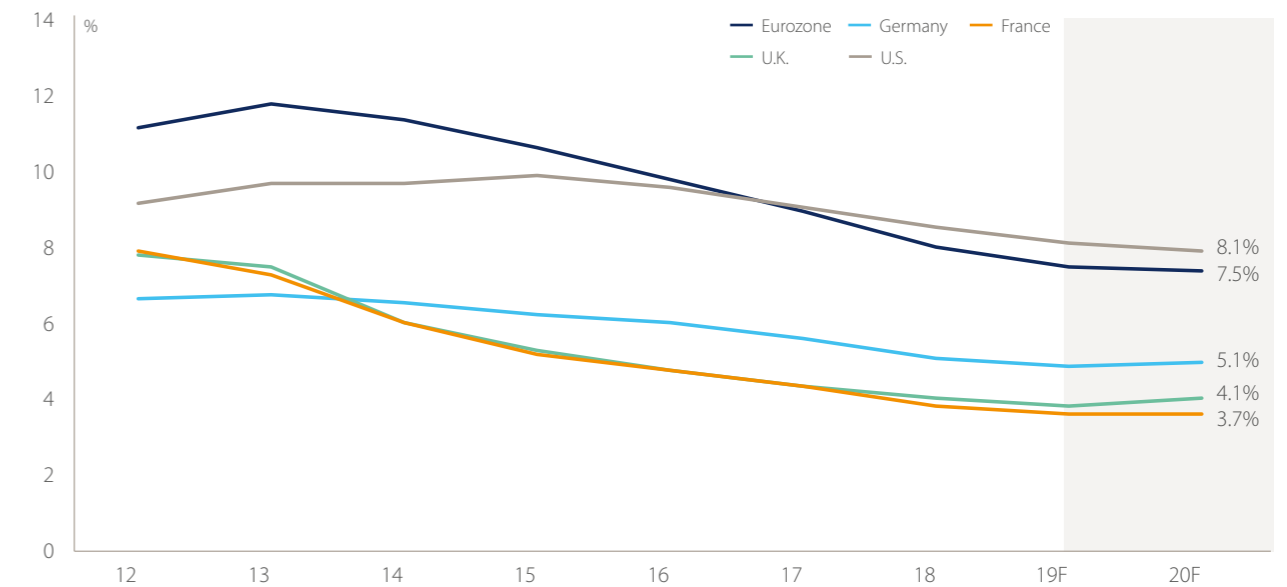
With Volkswagen (#1), Daimler (#3) and BMW (#8), Germany is home to three of the world's largest automobile manufacturers. Any underperformance by these global players therefore has a direct impact on Germany's economy and real estate markets. Given their linkages throughout the economy, any slowdown ripples through employment levels, consumer sentiment and retail consumption – with knock on impacts for real estate demand in the logistics, office and retail sectors.

All three major players issued profit warnings and announced future job reductions in late 2019. Positively, negotiations with the trade unions are ongoing to help restructure their workforces in a socially acceptable manner, and currently no enforced layoffs are planned. Major investment in e-vehicles, future mobility concepts and digitization will help create jobs e.g. 2,000 at Audi by 2025, partially offsetting reductions elsewhere. The major manufacturers have recognised their vulnerability to shifting global economic, political and social forces and have stepped up their efforts to future-proof their organisations.

2020: Moderate positive GDP growth

While continuously performing at a very high and stable level, the rate of expansion is likely to be below average for the next few years at least; GDP is expected to rise by just 1% in 2020. The country is entering a phase of longer yet more moderate growth, albeit with less cyclical volatility. In Germany, the phrase "lower for longer" is likely to apply to its economic performance as much as to interest rates.

INTERNATIONAL UNEMPLOYMENT



Source: Consensus Economics Inc.

THE OFFICE LEASING MARKET

Germany's office markets are booming. Driven by a growing service sector, office leasing volumes have risen to record highs in the past three years. For the fourth year in a row, some 3 million sq.m was let in Germany's top 5 cities (Berlin, Düsseldorf, Frankfurt, Hamburg and Munich) with Berlin and Munich being once more the stellar performers.

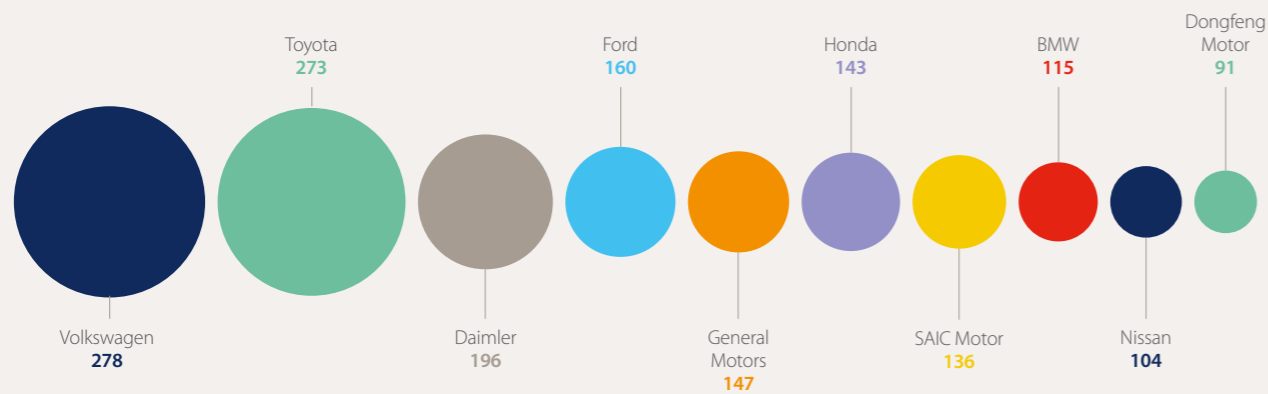
Although construction activity has almost doubled since 2016, with currently approx. 3.2 million sq.m under construction, the decline in vacancy has been remarkable. In Berlin, the office vacancy is as low as 1.3%, with availability also extremely low in Munich (c. 2%) and in Hamburg (c. 3%). All three are very much landlords' markets, with prime rents at record levels and exhibiting strong rental growth. The situation is less extreme in Frankfurt and in Düsseldorf, but rents are still rising across all submarkets.

We expect Germany's office markets to perform strongly in 2020. Office demand is likely to remain solid, the majority of space under construction is already pre-let and even if there was a rise in supply it would fail to push vacancy rates up noticeably. Accordingly, we forecast high rent levels to be sustained, with further rental growth in selected submarkets.

Demand for smart, technology driven office buildings continues to rise, a trend that will persist in the years ahead. Digital facilities management and connectivity of assets are priorities; Wiredscore, a rating and certification scheme reflecting the quality of a building's digital infrastructure, has been hugely successful in Germany. At the same time, modern office space users are looking for more space flexibility, enhanced mobility concepts (such as bike parking and e-charging stations), environmental sustainability and amenities for staff. Increased levels of co-working tenants demonstrates a societal shift towards more flexibility and the shared economy. This in turn is directly impacting on the types of buildings they want to work in.

Demand for smart, technology driven office buildings continues to rise.

AUTOMOTIVE INDUSTRY TURNOVER (€ BILLION, 2018)



Source: capital.de/wirtschaft-politik/ranking-die-groessten-autobauer

THE LOGISTICS MARKET

Germany's logistics leasing markets continue to thrive, driven by the sustained growth of the e-commerce sector and solid economic growth. Record leasing volumes in excess of 7 million sq.m were seen in 2018 and 2019, and annual take-up has averaged over 6.5 million sq.m over the past 5 years. Demand is centred on modern space, with over two thirds of take-up focused on new or modernised assets.

Germany's logistics landscape reflects the decentralised nature of the economy. In addition to the country's top five metropolitan areas (Berlin, Düsseldorf, Frankfurt, Hamburg and Munich), hubs are located in the Ruhr Valley, at major highway intersections and in close proximity to Germany's global industrial and automotive heavyweights.

A lack of modern logistics space is characteristic of many of the major markets, including Berlin, Düsseldorf, Frankfurt, Hamburg, Leipzig, Munich and Stuttgart.

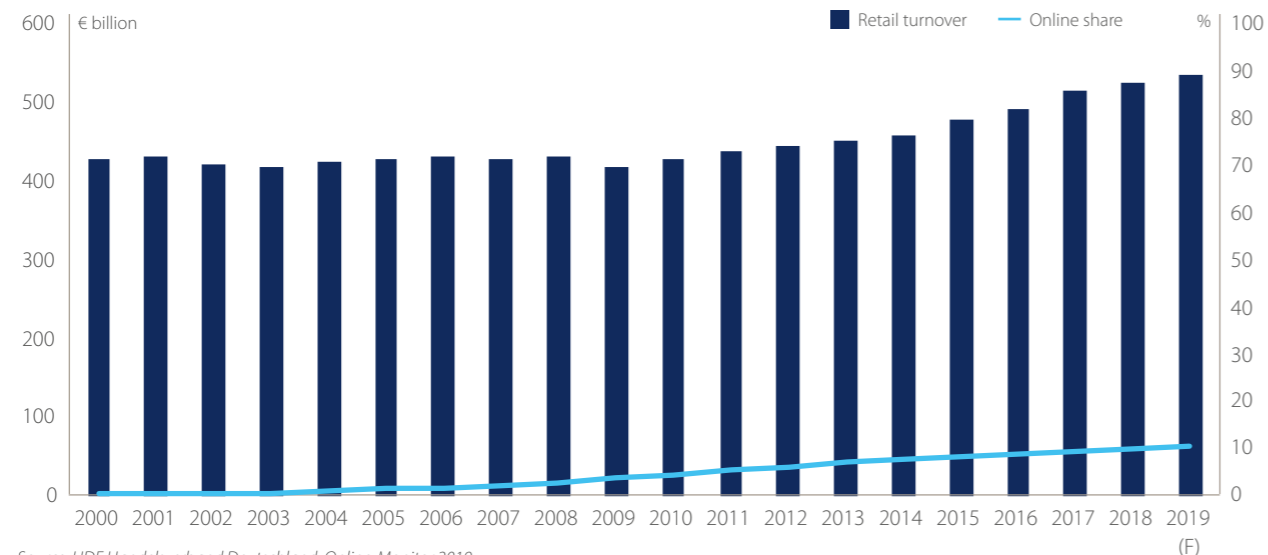
Modern space is quickly absorbed by the market, and tenants are increasingly forced to look for alternative locations in other regions, notably the Rhine-Ruhr region - one of Europe's most densely populated metropolitan areas with some 10 million inhabitants. Major tenants like Amazon helped increase total take-up within the region by around 40% in 2019.

Historically the strongest leasing markets have been seen in Frankfurt (Europe's largest freight airport) and Hamburg (the continent's third largest container port), but Berlin and Munich rose to prominence last year. The combination of high demand and the restricted supply has pushed up rents by an average of 6%, with the strongest growth in Berlin and Hamburg.

For 2020 we expect the German logistics market to be again characterised by high demand and a shortage in modern logistics space. Accordingly, there remains potential for rising rents in selected locations across Europe's dominant trading economy.

Germany's logistics leasing markets continue to thrive, driven by the sustained growth of the e-commerce sector and solid economic growth.

RETAIL TURNOVER



Source: HDE Handelsverband Deutschland; Online-Monitor 2019

THE RETAIL LEASING MARKET

Over the last decade Germany has become a key focus for international retailers. Numerous global retail chains have successfully entered the market, attracted by rapidly increasing employment, significant wage growth and strong consumer spending. According to Statista, aggregated retail turnover has risen by over 25% since 2009 and now exceeds €525 bn. Further growth is expected, albeit at a more moderate rate.

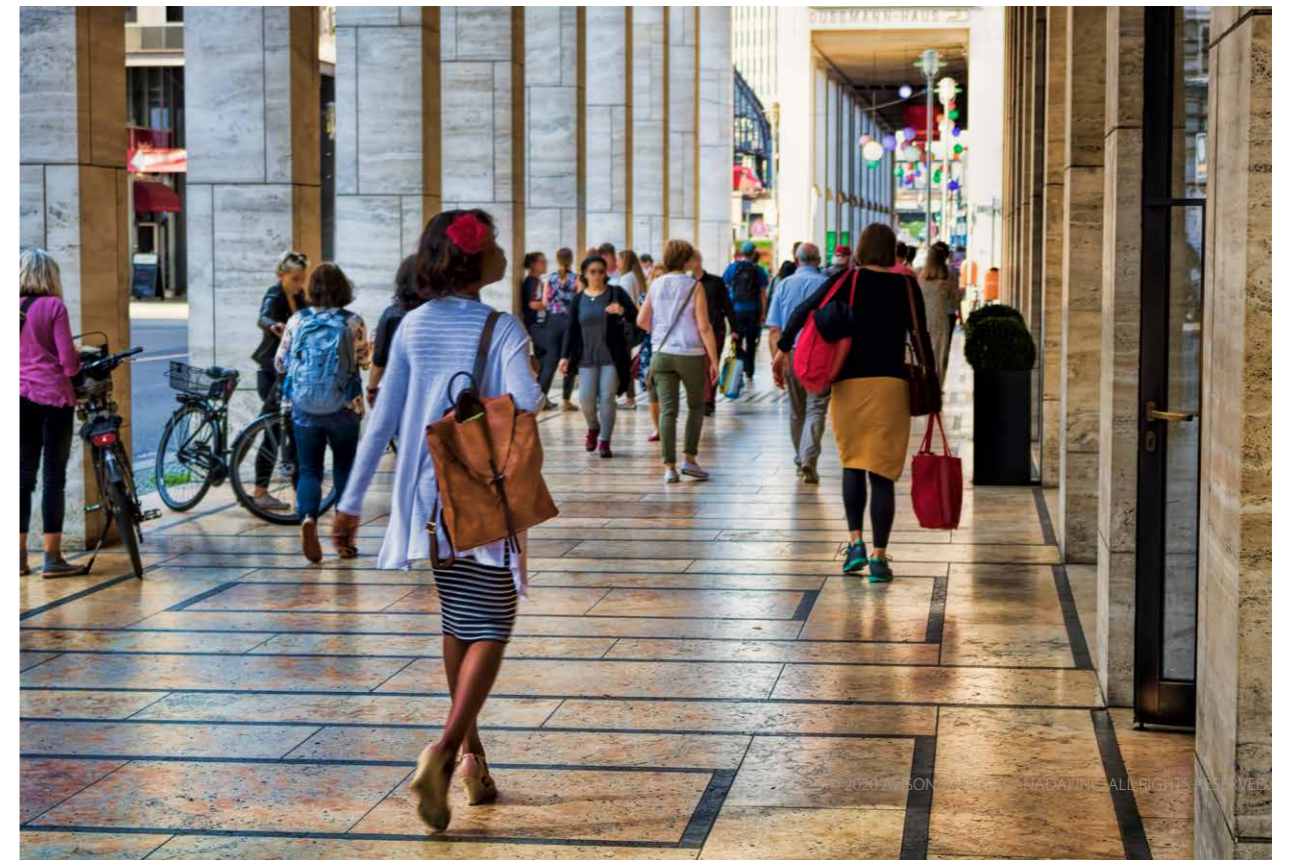
As elsewhere, Germany's retail market is undergoing fundamental change; almost all the growth is being seen in the online retail segment, which has quadrupled in size to around €55 bn according to HDE. This rapid growth is expected to continue in the years to come. However, margin pressure from online competitors and general uncertainty around the future of the high street are the primary concerns.

Demand from retailers has moderated as a result. Generally, there is less movement in the market, with attention shifting towards smaller units. However, gastronomy and food retailers are drivers of letting volume and expanding strongly. Retail space demand is also evident from the health and beauty, fitness and wellness segments. A dominant social trend towards sustainability is also having an impact, with the number of zero waste and unpackaged stores rising.

There is still a strong future for 'bricks and mortar' stores that will continue to play an important role in our cities and societies. People love to shop and to interact. They love entertainment and they love to share experiences. All of this can be offered and provided by retailers, restaurateurs and investors – but the perfect recipe for success is not yet entirely clear. In-store retail may be under pressure, however CBD retail space has risen in the past two years, driven by new retail schemes coming into the market.

Across Germany's top 7 retail cities (Berlin, Cologne, Düsseldorf, Frankfurt, Hamburg, Munich and Stuttgart) vacancy ranges from 4% in Munich to 9% in Berlin. Prime rents have moderated over the past two years, but are forecast to remain solid in 2020. Munich's low vacancy supports the nation's highest rents at around €370 sq.m/month, whilst Berlin's vibrant and dynamic local economy means retail rents are around €350 sq.m/month, despite its elevated vacancy rate.

Germany's retail turnover is forecast to grow, both online and in-store. Stronger players who are willing and able to innovate and take risks, and who have confidence in their product, will continue to find Germany an attractive growth market.



THE COMMERCIAL INVESTMENT MARKET

Germany saw Europe's largest volume of commercial investment transactions in 2019. By the end of the third quarter over €42 bn had been transacted, up slightly on 2018 and suggesting the market was heading for a record investment volume for the third year in a row. The most notable transaction was Commerz Real's €2.6 bn purchase of the Millennium Portfolio comprising 49 prime office, residential and retail assets totalling 352,000 sq.m.

National and international investors have continued to show great interest in the German real estate market. The historically solid economy with low unemployment and rising wages, political stability and strong leasing markets are key attractions, with demand bolstered by continued low interest rates.

Although the majority of demand was from domestic investors, overseas capital continued to flow from elsewhere in Europe and from North America. Asia Pacific investors remained active, closing a number of large deals and are expected to increase their market share in 2020.

Fuelled by a growing services sector and thus solid office space demand, very low vacancy rates and rising rents across most markets, demand for office buildings has continued unabated; the sector accounted for over half of all transactions by value. We expect strong demand and high investment volumes in this asset class to continue in 2020; continuing supply shortage and scope for further rent increases make the sector very attractive at a time when solid income-producing assets are at a premium.

Retail was again the second most important asset class in 2019. By the end of Q3 around €7.5 bn had been invested, a 6% decline on the previous year. Despite the understandable investor caution surrounding the sector, interest in good quality retail assets is healthy – most of all in the retail warehousing segment, but also for high street units and department stores. Shopping centre investment volumes remained well below the previous years' results, albeit the best performing centres continue to attract a lot of demand. Despite the challenges faced by the sector, purchasing power is above the European average and private consumption is set to rise. Good quality German retail will therefore remain an interesting market for domestic and international investors in 2020.

Investments in German logistics assets continued on a high level. Once more, the investment volume performed above average, reaching € 4.8bn for the first three quarters of 2019. Demand from a wide range of local and overseas players looks set to remain strong into 2020 and beyond. Germany is an inherently attractive logistics market; it is Europe's primary transit corridor and largest economy built on global export strength. Coupled with rising structural demand from a growing online retail sector, this means demand for logistics space is likely to remain high amongst both occupiers and investors.

A shortage of available product in the primary commercial asset classes helped drive increasing activity in "alternative" asset classes such as hotels, senior housing, mixed-use and land. Land banking is increasingly evident amongst investors with a long term investment horizon, patience and confidence in the medium term outlook for the market. They are searching for larger blocks of undeveloped or underused land which in the future can be developed and turned into long term income generating assets.

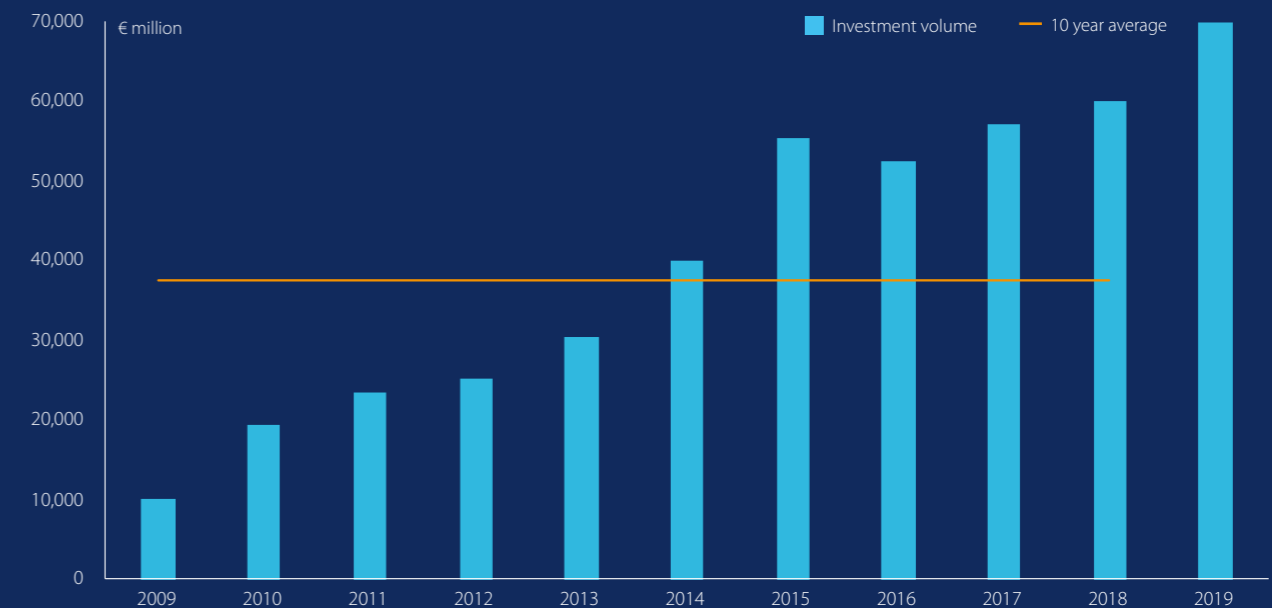
While many investors favour core investments in Germany's top-5 cities, a lack of product across most asset classes has also encouraged them to diversify geographically and in terms of risk profile. Demand for performing assets outside the top metropolitan areas has noticeably increased and will do so again in 2020. Similarly, the number of investors looking for product with repositioning potential in more peripheral submarkets of the top-5 cities will also continue to rise.

Yields are amongst the lowest in Europe with Germany's prime office yield recorded in Berlin at 2.70% in Q3 2019. The overall low yield level is reflecting the attraction of the German market as well as the amount of capital searching for investment product in real estate.

Although prime yields are already at a low, there is still room for yield compression across all asset classes in 2020. Investors' ongoing strong appetite for real estate, solid leasing markets and the ECB's decision to keep interest rates low have set the scene for another strong investment year with further declines in prime yields in 2020.

Although prime yields are already at a low, there is still room for yield compression across all asset classes in 2020.

COMMERCIAL INVESTMENT VOLUME GERMANY (2009 TO 2019)



Source: Avison Young

2020

LOCAL OUTLOOK

2020

FRANKFURT



FRANKFURT

EXECUTIVE SUMMARY

- Frankfurt's office market saw above average demand in 2019 with office vacancy rates decreasing and rents rising across all submarkets. This trend is likely to continue in 2020.
- The mismatch between demand and supply persists in Frankfurt's investment market. The lack of product kept total investment volumes in check. Yields are forecast to remain at their current low level.
- Frankfurt's strong population growth will require new solutions in urban planning to keep Frankfurt attractive and affordable. The city of Frankfurt has started to plan new neighbourhoods and is pushing forward new mobility concepts.

Frankfurt is the EU's finance and banking centre. Regardless of Brexit, Frankfurt has prospered in past years recording positive growth across the board. In 2019 office take-up was above the long-term average, with rents rising. The retail market saw a number of new entries to the market and the logistics market was again driven by a lack of supply. Investor appetite was unbroken, but limited by a lack of available product.

Frankfurt is a city of change, trade and reinvention, which is occurring at an accelerated speed. The skyline of the EU's finance and banking centre speaks for itself: Frankfurt is the only German city which has always embraced skyscrapers and striking, even daring, architecture - long before other global cities planners recognized the importance of a river to quality of life. They successfully redeveloped the Main river banks, which was a game changer for Frankfurt's overall attractiveness as a place to live.

New and creative methods in urban planning are needed again for Frankfurt. The city is currently experiencing significant population growth. While the number of inhabitants rose by 7.8% over 5 years to 747,848 in 2018, it is projected that the population of Frankfurt will grow by another 11% over the next 20 years.

Rising urban density, rising rents, increasing and varied transport requirements: Frankfurt needs smart solutions in the short to medium term to maintain the city's high quality of life, keep it affordable and make it future proof in a globalised world.

KEY MARKET METRICS – 2020 EXPECTATIONS

Annual growth rates, estimated for year-end 2020 vs year-end 2019.

	OFFICE	RETAIL	INDUSTRIAL
Rental Growth	→	→	→
Vacant Space	↓	→	↓
Construction Levels	→	→	→
Leasing Volume	→	↓	↓
Investment Volume (all sectors)	→		

Politicians and urban planners have shifted a gear in the recent past. They have developed the integrated urban development concept Frankfurt +2030. Some of the strategies defined in Frankfurt +2030 will be pushed forward in 2020. The most important ones will be:

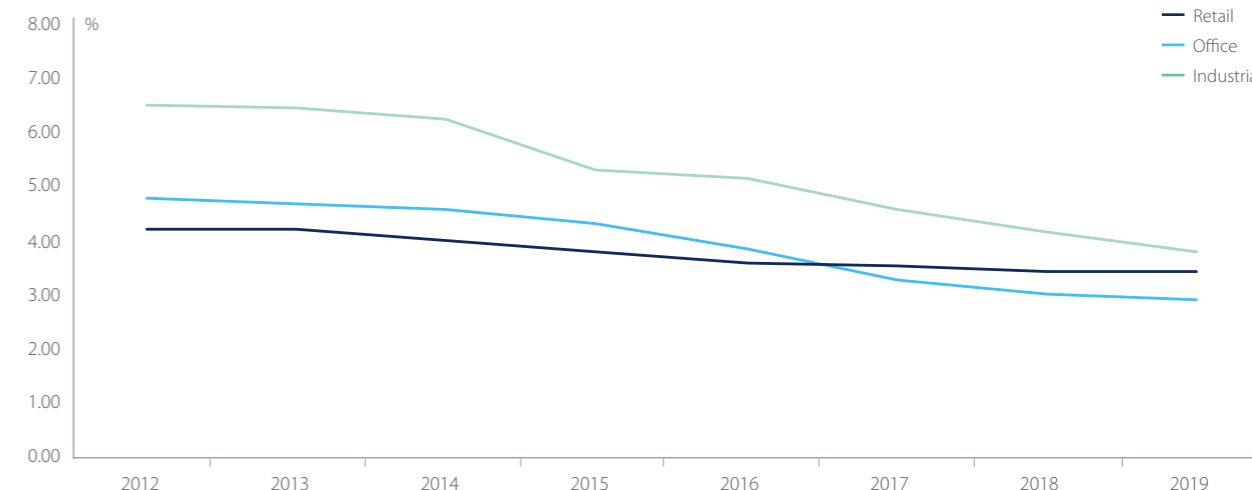
SOME OF THE KEY TOPICS TO LOOK OUT FOR IN 2020

Public Transport:

- U5: Extension of subway line U5 to both the north and south
- S6: Expansion of city train line S6 between Frankfurt Main West and Friedberg
- Regional tangent/bypass: Bad Homburg – Eschborn - Frankfurt Airport – Neu-Isenburg
- Connecting Frankfurt Airport Terminal 3 to the public transport network

Frankfurt's most important office tenant sectors, banking/finance and ITT, are heavily dependent on connectivity and the highest tech standards in buildings are key to their success. Smart buildings are their future.

FRANKFURT YIELDS



Source: Avison Young

Bike City Frankfurt:

- Bike paths: Extension and expansion of the existing network. Construction and redevelopment of 45km by 2023.
- Mainkai: until mid-year 2020, the street which runs north along the river Main in the CBD will be closed to cars and trucks. Closing Mainkai is a trial to assess the impact on the city's traffic flows of this road being closed. It is also the city's attempt to give some of its important places back to the public, encouraging people to walk, cycle and relax.

Residential Market:

- There had previously been plans for the development of a new city district in North West Frankfurt with some 30,000 residential units, the so called Josefstadt. The plan was dismissed due to Frankfurt's need for a fresh air corridor coming in from the North. In 2020 it will be a priority for the city to find appropriate development land to initiate and enable new large scale residential developments.

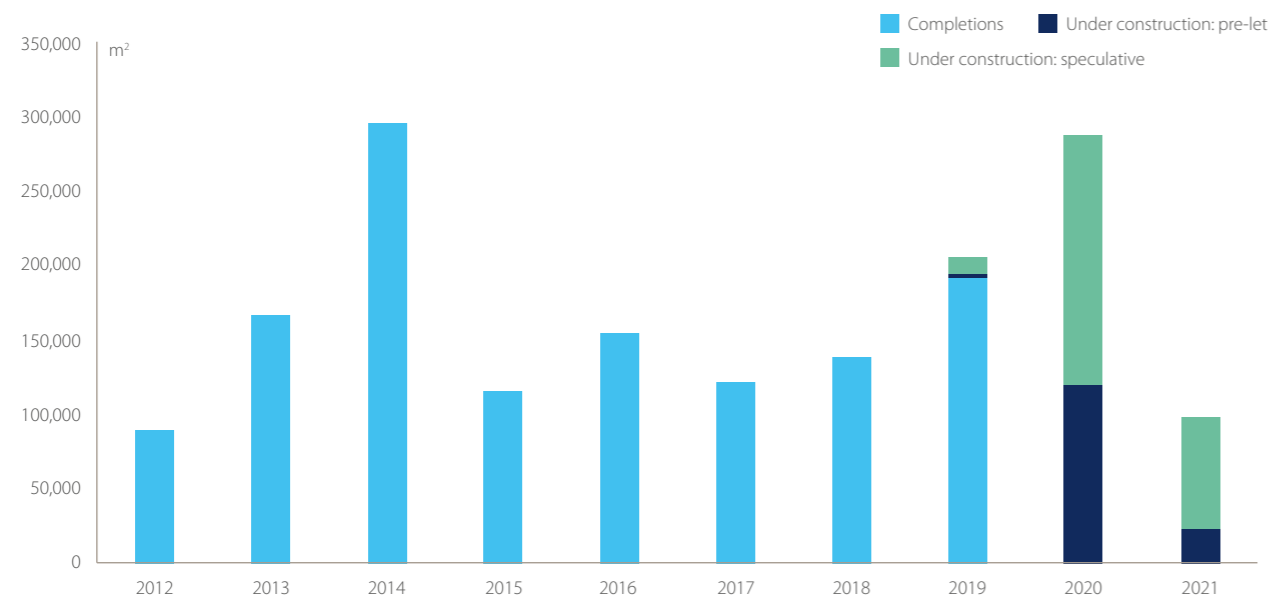
- Highrise buildings: Frankfurt is developing residential towers, the majority of which are within the luxury sector. Some striking towers like Henninger Turm have recently been completed. Driven by the shortage of affordable space, the City of Frankfurt is planning a policy which would require respective towers to comprise a minimum 30% share of subsidised housing. This can only be achieved by a change of the urban development/ zoning plan and therefore the discussion is likely to be controversial.

Office Space:

- High rise development plan: Frankfurt published its first high rise development plan to control and guide construction of high rise buildings in 1999. An update was published in 2008, and the next update is planned for 2021. In 2020 we are likely to see more discussions around Frankfurt's future as an office and commercial hub.

In 2020 it will be a priority for the city to find appropriate development land to initiate and enable new large scale residential developments.

FRANKFURT COMPLETIONS Q3 2019



Source: Avison Young

THE OFFICE LEASING MARKET

Frankfurt's office leasing market was strong during 2019, with above average take-up of c.500,000 sq.m recorded. Whilst the ten year average was exceeded, 2018's remarkable result could not be sustained as the number of large scale deals above 10,000 sq.m decreased noticeably. There has been continued strong demand from SMEs, as Frankfurt's tenant mix has diversified, along with continued demand from the financial and legal sectors.

Financial services continues to drive take-up, with DekaBank's 46,200 sq.m deal one of the largest of the year. Strong letting activity was also generated by consultants, ITT and co-working providers. Co-working providers contributed almost 10% of total take-up with Regus/Spaces being the most active acquirer. The rising importance of the shared economy and our changing working culture can be felt in Frankfurt.

Office vacancy continued on its downward trend. By the end of 2019, Frankfurt's vacancy rate was around 6.5%, which is its lowest level since the beginning of the millennium. In the CBD, modern, large scale vacant space is particularly scarce. Accordingly, a number of major deals were closed outside the CBD in 2019.

Rents rose moderately across all sectors, with prime rents growing 5% year-on-year to €44.00 per sq.m/month.

A number of exciting new projects are underway in Frankfurt, with some of them located right in the heart of the city. Overall, some 600,000 sq.m is under construction, with the bulk ready for completion in 2020. Approximately 50% of this space is already pre-let as tenants show great appetite for modern office space and face limited opportunities in existing stock given the overall low vacancy.

Frankfurt has always been the German office market with the most striking new office projects. Moreover, the city's leading banking/finance presence is heavily dependent on sophisticated tech solutions in assets. Top tech-standard in buildings is thus key to success in Frankfurt. It comes as no surprise that connectivity rating agency WiredScore rated 13 buildings in Frankfurt by the end of 2019, with 1 more currently in the rating process. We expect to see an increase in certified buildings in 2020 with pressure coming from Frankfurt's occupiers who are in turn forced to compete in the war for talent in an ever changing working world. Flexible room concepts and top-quality office space will be fundamental to future success.

For 2020 we expect demand to remain solid. The vacancy rate is likely to decrease further, mostly within the CBD. As a result there remains potential for a further rise in rents.

The urban future is mixed-use. Frankfurt's developers and urban planners know this. Some exciting new mixed-use projects are underway in the CBD.

COMMERCIAL INVESTMENT MARKET

Frankfurt is also in demand among investors. The focus is on office real estate, most of all on skyscrapers in the banking district. However, as such product is limited, investors are willing to invest in the broader sphere or in mixed-use buildings. Examples include the purchase of The Spin (hotel and office use) and 99 West (office), with both skyscrapers changing owner before completion. Overall, the office sector accounted for around 80% of total volumes in 2019, a total of over €7 billion for the year.

Although the 2019 result is significantly below the previous year's result of just under €10 billion, it is at a similar level to other recent years and volumes were limited, once, again, by a lack of product.

Under these conditions, yields remain under pressure. In the last quarter office prime yields again gave in and were at 2.90% at year-end 2019. The market also remains tight in the logistics and retail warehouse sectors.

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