This year the development of our three-year outlook was the most challenging we have faced in 27 years of producing the *Investment Strategy Annual.* During our analysis, significant information flowed daily relating to COVID-19 infection/hospitalization rates, lockdown/re-opening policies, vaccine trials, U.S. election results, EU–U.K. trade relations, and how the property markets are responding to these fast-moving events.

In the regional summaries in Chapter 2, we try to convey the uncertainty in the forecasts that look beyond the dominance of COVID-19 in our lives. Yet, investors always face uncertainty when making decisions. Perfect information is not an option in normal times, nor will it be in the transition from COVID-19 economics to the post-COVID-19 economy. Our investment recommendations express our conviction that there will be plenty of interesting opportunities during the next three years. Uncertainty is often an excellent breeding ground for opportunity.

Asia Pacific has come through the pandemic in stronger shape than any other region to date. In Chapter 2, our research team discusses the reasons behind this relative success, and the rapid changes that are likely to occur as both “return to work” and the “new normal” are most advanced in this diverse region. Trends we have identified in the past—the rise of intra-regional trade and the steady rise of transparency—are also accompanied by relatively predictable political regimes and high trust in local institutions. These stabilizing influences help reduce the effects of post-pandemic uncertainty.

Europe has been hit hard by the pandemic and by fractured attempts to limit the spread of the coronavirus. It has also been on the forefront of the scientific breakthroughs that are most likely to control the worst effects of COVID-19. The diversity of Europe is a striking feature of our regional outlook, with pockets of growth and strength interspersed among slower-growing economies and weakened property markets. The EU has also shown a surprising ability to develop a pan-European fiscal stimulus system, even as it has avoided, along with the U.K., a similar cooperative stance to the fast-approaching day of Brexit reckoning. Other significant trends covered in the *ISA* include the rise of the “living” sector, as residential properties emerge as a viable investment.

North America shares the same public health mistakes as Europe, but on an even larger scale. It is gearing up for a large experiment in rapid vaccine deployment. The possible success of this technical (and behavioral) feat will likely determine the pace of both economic and property market recoveries across the U.S. and Canada. In our outlook in Chapter 2, we describe how relatively healthy capital markets are likely to discern between sharply contrasting fundamentals. Favorable tailwinds in the warehouse and suburban residential markets are likely to attract even more capital in the years ahead. Headwinds in urban apartments, retail, and office fundamentals could lead to capital shortages and eventually discounted pricing.

CHAPTER 2
REGIONAL RECOMMENDATIONS

Asia Pacific

BIFURCATED COUNTRY PROSPECTS: STRONG RECOVERY YET UNCERTAINTY LINGERS

Uncertainty will remain a dominant theme in 2021, although there are signs of bifurcated economic and real estate market performance in the region. China, in particular, is exhibiting relative strength amid the pandemic-led recession. There is widespread belief that conditions in the region are more positive today than six months ago due to the stabilization of the number of COVID-19 cases, positive vaccine news, ultra-accommodative monetary policies, and the record size of fiscal stimulus packages (except in China). All of these factors are fueling an unusual combination of risk-on sentiment in the stock markets, while safe haven indicators are indicating plenty of risk-off behavior with gold prices near their 10-year high and government bond yields near all-time lows.[1] The juxtaposition of risk-on and risk-off sentiment indicates the nervous nature of the capital markets in Asia Pacific as investors oscillate between optimism and risk-averse behavior.

Abhijit Banerjee and Esther Duflo, winners of the 2019 Nobel Prize in Economics, explain in *Good Economics for Hard Times* that people's core beliefs on issues such as trade, immigration, and the role of government are better predictors of how people make economic choices than neoclassical economic assumptions about utility-maximizing behavior. These beliefs are often based on the affirmation of personal values or deep-rooted cultural norms. Understanding these cultural beliefs is necessary as they ultimately drive economic and investment activities. In our *2020 ISA Mid-Year Update*, we discuss the high level of trust that domestic populations place in a majority of the Asia Pacific governments and the important role that this plays in reducing the pandemic risks. This governmental support is facilitating China's nascent V-shaped recovery (see V-shaped Recovery in China below). China's recovery, in turn, puts other major Asia Pacific countries in a favorable position in the post-COVID-19 economic outlook. LaSalle expects that economic conditions in Asia Pacific will remain weak by historical standards in the near term, but are well-positioned in the global context, all of which is beneficial to the real estate market recovery in the region.

Tenants' and investors' core beliefs as revealed in surveys can also provide insight on the outlook for the real estate sector. As shown in the Asia Pacific Leasing Survey on page 29, tenant activities improved in Asia Pacific in September, even though downside risk remains as evidenced by elevated incentives. In an environment where leasing and buying/selling transactions are limited, these surveys may offer forward-looking views on the performance of real estate assets/portfolios, and identify potential risks.

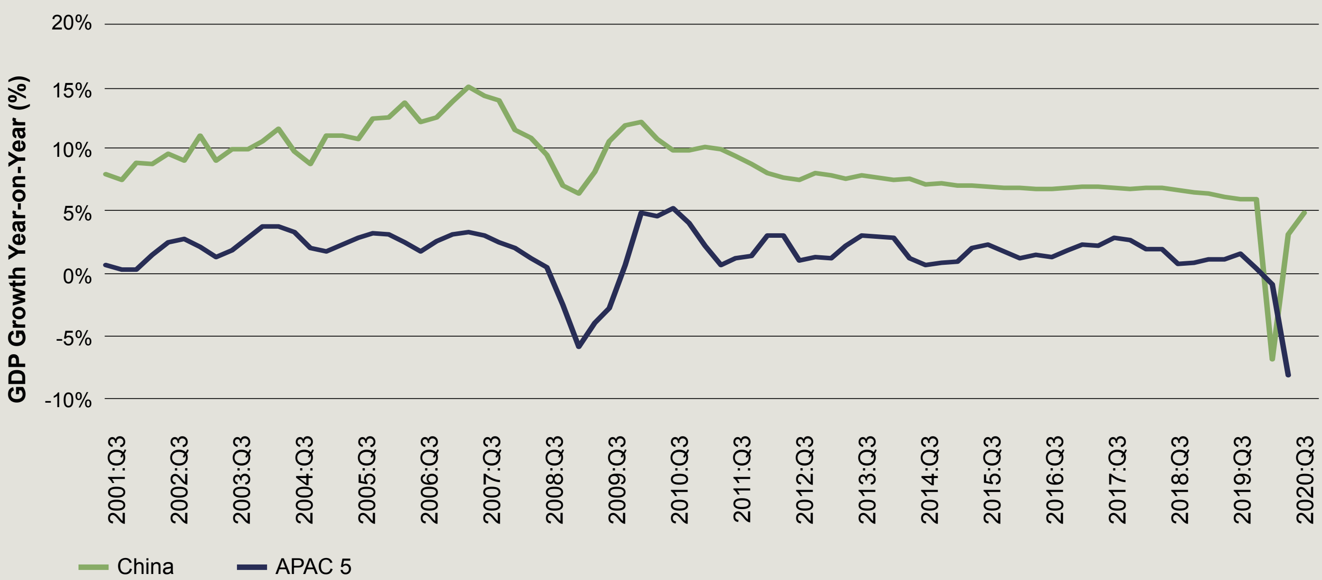
RELIANCE ON CHINESE ECONOMY AND DOMINANCE OF DOMESTIC AND INTRAREGIONAL CAPITAL

The tensions between the U.S. and China are unlikely to go away (especially in trade), but may de-escalate over time under the new Biden administration in the U.S. It is impossible today for a country to become entirely self-sufficient. In the first six months of 2020, the U.S. was the biggest buyer of Chinese goods.[2] In response to the U.S.–

1 Bloomberg, November 24, 2020.

2 The General Administration of Customs of China, as of June 2020.

V-Shaped Recovery in China

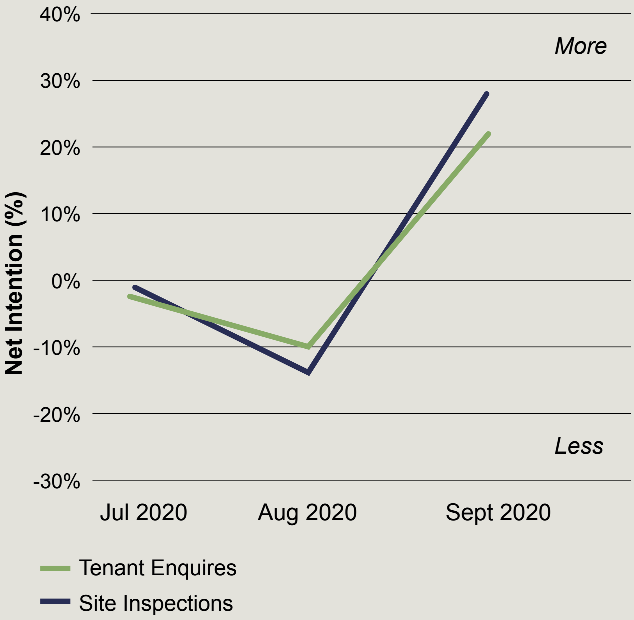


Note: APAC 5 comprises Australia, Hong Kong, Japan, Singapore, and South Korea.

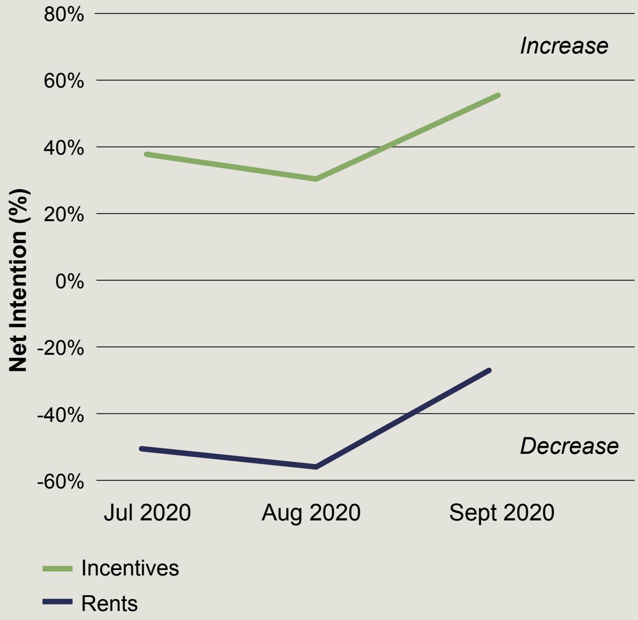
Sources: CEIC (APAC5, as of 2020:Q2) and CEIC (China, as of 2020:Q3).

Asia Pacific Leasing Survey

TENANT ENQUIRES AND SITE INSPECTIONS



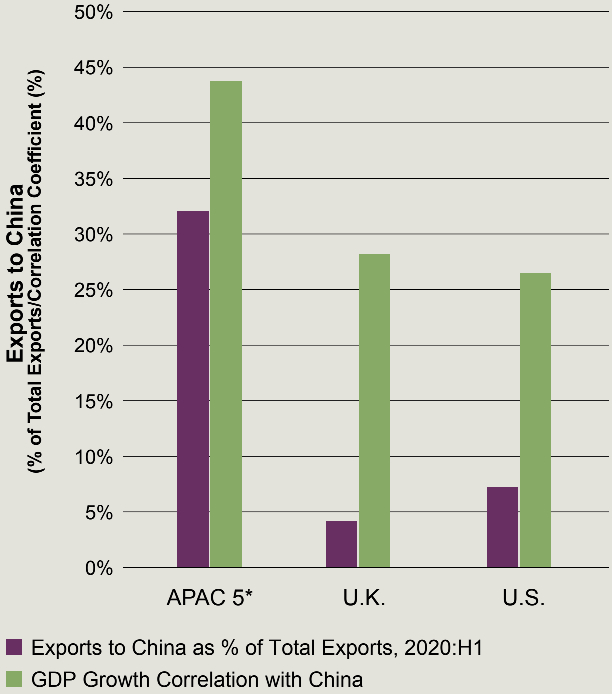
RENTS AND INCENTIVES



Note: Net intention is calculated as the net percentage difference between positive and negative answers.
Source: CBRE, as of October 2020.

Reliance on the Chinese Economy

EXPORTS TO CHINA AS A % OF TOTAL EXPORTS AND GDP GROWTH CORRELATION BETWEEN CHINA AND OTHER COUNTRIES/REGION



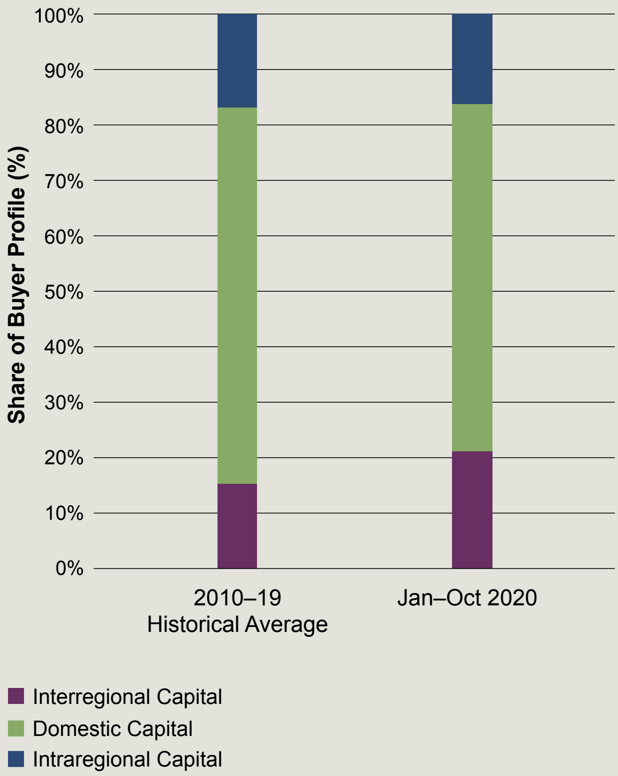
*APAC 5 comprises Australia, Hong Kong, Japan, Singapore, and South Korea.

Exports to China as a percentage of total exports is based on the amount of exports during the first half of 2020. GDP growth correlation is calculated using the real GDP growth of each country/region on a quarterly frequency year-on-year from 1992:Q1 (U.K.), 1992:Q4 (France and Germany), 1995:Q4 (Asia Pacific), and 2003:Q4 (U.S.) to 2020:Q2.

Source: CEIC, as of October 2020.

Domestic and Intraregional Capital Dominates in Asia Pacific

ASIA PACIFIC REAL ESTATE TRANSACTION VOLUME BY BUYER PROFILE



Data are based on independent reports of income properties and portfolios valued at U.S.$10 million or greater. Income properties include the following types: apartment, office, retail, industrial, and hotel in Australia, China, Japan, South Korea, Hong Kong, and Singapore.

Source: Real Capital Analytics (RCA), as of October 2020.

China trade war, the Chinese government announced the "Dual Circulation" strategy in May 2020 to expedite the transition to an economy supported mainly by domestic demand and supplemented by external demand. This strategic change was reinforced in the 14th Five-Year Plan (2021–25) released at the end of October and is anticipated to drive domestic consumption in China to grow faster than exports over the next five years. This new economic strategy is expected to have a positive effect on real estate sectors, particularly warehouses, as demand is largely domestic-driven. Additionally, increasing household income is emphasized in the 14th Five-Year Plan. Higher income drives more consumer spending, higher retail sales, and more demand for warehouses.

The surge in exports in 2020 demonstrates that China's supply chain is relatively intact and pressure-resistant. Most notably, China's trade with other countries in the region is leading the recovery of global exports (see Reliance on the Chinese Economy on page 29). The structural trend of the dominance of domestic and intra-regional capital for Asia Pacific real estate is expected to continue (see Domestic and Intraregional Capital Dominates Asia Pacific on page 29). As China likely continues to recover, its leading position and domination in intraregional activities could benefit the rest of the region's economies and real estate markets going forward.

STABLE POLITICAL LANDSCAPE

Yoshihide Suga became Japan's Prime Minister on September 16. He has pledged to continue his predecessor's fiscal and monetary policies. The "Abenomics" policies are expected to continue as "Suganomics" (see Suganomics to Provide Policy Continuity in Japan). The Bank of Japan left its aggressive monetary policy unchanged on PM Suga's appointment, which instilled confidence in the global capital markets. By the end of October 2020, Japan had announced fiscal stimulus of more than 40% of GDP, with a focus on infrastructure spending and financial support for corporations and households to cushion the pandemic's impact.

In China, Presidential Xi Jinping can remain "president for life" as term limits were removed in 2018. The stability of the political leadership should help ensure the balance of monetary and fiscal measures in mitigating the impact of COVID-19 in the short term and the economic reforms in the long term. While the People's Bank of China (PBOC) continues to focus on reducing the debt problem (by not further reducing interest rates), the Chinese government in April 2020 announced that substantial investments would be made in new infrastructure (including high-speed rail and subway systems, 5G, data centers, etc.), equivalent to a total of 15% GDP for 2020–25.[3] All of these measures should drive a sustainable recovery of the domestic economy and real estate occupier demand, particularly from the tech industry, and should provide infrastructure support for the logistics sector in China.

In South Korea, President Moon Jae-in and his governing Democratic Party (DP) won the parliamentary election in April 2020 riding on the successful response to the pandemic. The historically strong support for the DP has allowed the government to announce stimulus packages of about 15% of GDP. Despite the recent decline in public support for the president and the government, the parliamentary majority would allow South Korea to step up pandemic containment measures and additional stimulus packages if needed.

Suganomics to Provide Policy Continuity in Japan

FROM ABENOMICS TO SUGANOMICS

Aggressive Monetary Policy
- No major change from Abenomics

Expansionary Fiscal Policy
- No major change from Abenomics

Structural Reforms
- Promote digitization
- Promote women in the workforce
- Strengthen local economies
- Promote market-based competition

Economic Growth and Inflation

Source: LaSalle Investment Management, as of November 24, 2020.

Logiport, Osaka Taisho, Japan

3 Source: Goldman Sachs' estimation, as of October 2020

Synchronized Monetary and Fiscal Stimulus in Asia Pacific

	Announced Monetary Stimulus			Announced Fiscal Stimulus					
	Current Interest Rate*	Monetary Stimulus since 2019:H2		Estimate Fiscal Stimulus (as a % of GDP)	Short Term (to mitigate exogenous shocks like COVID-19 and bushfires)		Medium to Long Term		
		Rate Cuts/Other	Liquidity Injection		Households	Corporates	Households	Corporates	Infrastructure
Japan	(0.10)%		✓	42.5%–44.0%	✓	✓	✓	✓	✓
Australia	0.10%	✓	✓	24.5%–25.5%	✓	✓			✓
Singapore	0.25%	✓		20.0%–21.5%	✓	✓		✓	✓
South Korea	0.50%	✓		15.0%–16.0%	✓	✓	✓	✓	
Hong Kong	0.86%	✓	✓	11.5%–12.5%	✓	✓	✓	✓	✓
China	Shibor: 2.64% MLF: 2.95% LPR: 3.85% RRR: 9.4%	✓	✓	16.5%–19.0%	✓	✓	✓	✓	✓

*Interest rate movements are as of November 20, 2020, based on the Reserve Bank of Australia's cash rate; China's two-week Shanghai interbank offered rate (Shibor), one-year medium-term lending facility (MLF), one-year loan prime rate (LPR), and reserve requirement ratio (RRR) for financial institutions; Hong Kong Monetary Authority's base rate; Japan's key short-term interest rate; Singapore's one-month interbank offered rate; and the Bank of Korea base rate.

Sources: The Services Australia (as of October 6, 2020); the Singapore Ministry of Finance, the Monetary Authority of Singapore (as of August 18, 2020); the Hong Kong Monetary Authority (as of September 15, 2020); the Cabinet Office of Japan (economic measures announced on December 5, 2019); the Cabinet Secretariat of Japan (fiscal stimulus and financial support on COVID-19, as of May 27, 2020); the Ministry of Finance of Japan (social welfare spending due to consumption tax hike, as of December 20, 2019); the Ministry of Economy and Finance of South Korea (as of September 22, 2020); and the Ministry of Finance of the People's Republic of China and the People's Bank of China (as of September 4, 2020).

In Singapore, the People's Action Party has dominated the political environment since 1959. Its strong leadership and strong fiscal balance sheet enable the government to issue strict lockdowns and implement fiscal stimulus packages amounting to ~20% of its GDP.

In Australia, the JobKeeper Payment scheme is a subsidy for businesses and not-for-profit organizations that were significantly affected by COVID-19 but made an effort to retain employees. The measure is an effective way to support the labor market and real estate demand.

In major Asia Pacific economies, most fiscal stimulus packages are directed toward small and medium enterprises as they contribute to 70%-90% of total employment. Major countries in the region have the capacity to release more fiscal stimulus (particularly China) if a resurgence in COVID-19 infections threatens the economic recovery (see Synchronized Monetary and Fiscal Stimulus in Asia Pacific above). This is another reason why the region is likely to be stronger and more resilient coming out of the pandemic.

ECONOMIC OUTLOOK

We have finetuned our Relative Framework for the Asia Pacific Economic Outlook Post COVID-19 that we introduced in the *2020 ISA Mid-Year Update.* Countries with relative success in keeping the pandemic under control, a significant domestic economy, effective monetary and fiscal stimulus packages, and room for more stimulus are expected to lead the economic recovery in the region. The ranking of the relative strength of major Asia Pacific economies remains the same as six months ago, with China leading, followed by Japan, South Korea, Singapore, Australia, and Hong Kong (see Asia Pacific Post-Pandemic Economic Outlook on page 32). This framework reinforces our conviction that domestic and intraregional recovery in Asia Pacific will contribute more to the economic recovery in the region than external influences from outside the region.

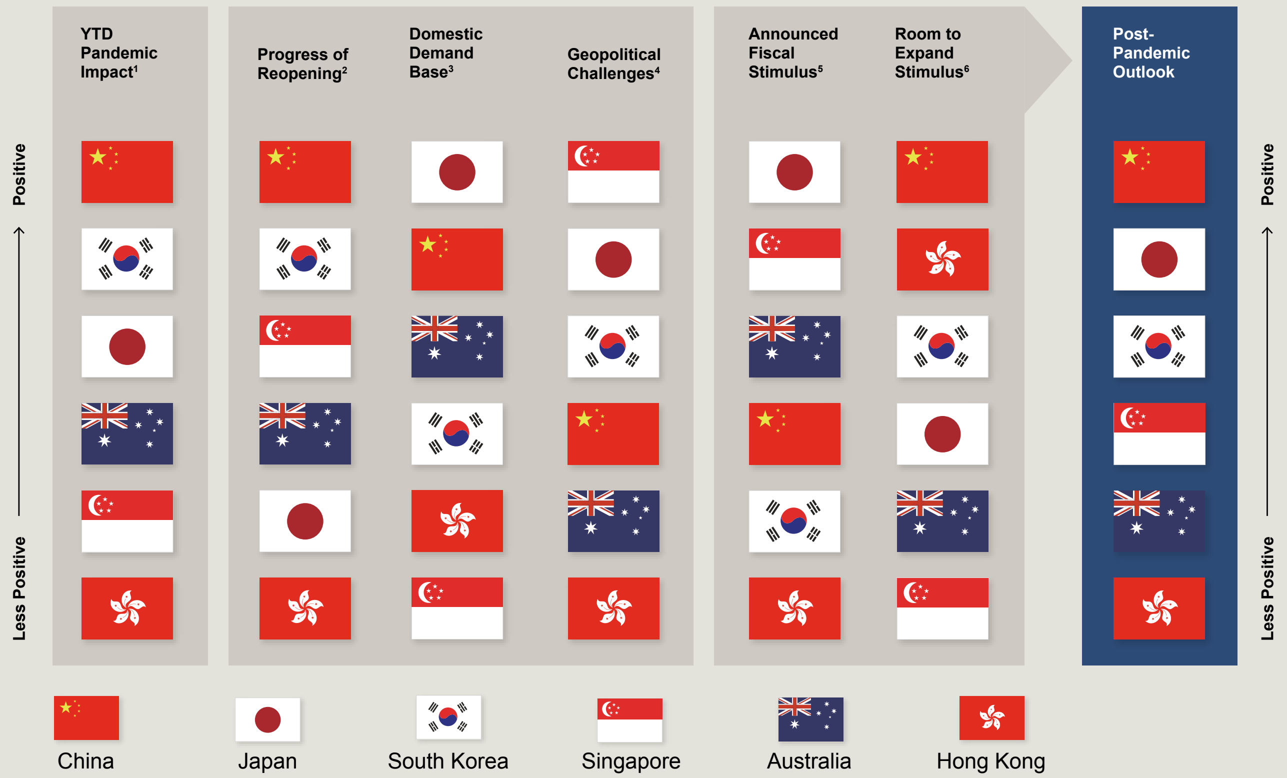
REAL ESTATE SECTOR SHIFT

Private equity and institutional investors are driving investments in the industrial sector across the region. The pandemic has accelerated the shift toward online retailing, enhancing the strong demand for industrial assets. The industrial transaction volume as a share of the total Asia Pacific real estate transaction volume has gradually increased over the past 10 years.[4] The increase in industrial transaction volume is primarily at the expense of the retail sector. We find a similar trend for the amount of funds raised for sector-specific strategies in Australia, China, Hong Kong, Japan, Singapore, and South Korea, where the share of industrial-specific strategies increased tenfold from 2010 to 2019.[5]

4 The Asia Pacific real estate transaction volume data are sourced from RCA, as of 2020:Q2.

5 The funds raised refer to the fund size at the final close. The funds raised by real estate sector-specific strategies data for the Asia Pacific 6 are from Preqin, as of 2020:H1.

Asia Pacific Post-Pandemic Economic Outlook



1. YTD Pandemic Impact: The impact on GDP and employment since the start of the pandemic in each country.
2. Progress of Reopening: The 14-day rolling average of new COVID-19 cases per 1,000 population, the cumulative COVID-19 deaths per 1,000 population, and Google Mobility Index. Google Mobility Index covers movement trends over time by geography, across different categories of places, such as retail and recreation, groceries and pharmacies, parks, transit stations, workplaces, and residential.
3. Domestic Demand Base: Gross domestic production excluding exports.
4. Geopolitical Challenges: Potential impacts on trade due to the U.S.–China trade war, Hong Kong unrest, Japan–South Korea, China–Australia tensions, etc.
5. Announced Fiscal Stimulus: Existing and planned COVID-19-related fiscal stimulus.
6. Room to Expand Stimulus: Takes into consideration whether there is room for additional monetary stimulus (e.g., further rate cuts) and fiscal stimulus, the health of the government fiscal balance sheet in each country, whether the country has a reserve currency, etc.

Sources: Oxford Economics, World Health Organization, International Monetary Fund, and LaSalle Investment Management, as of November 2020.

Asia Pacific Investment Recommendations: 2021

	Core	Higher Return
LaSalle's Best Opportunities	Modern warehouses in well-located and supply-constrained submarkets	
	(China Tier 1 and satellite cities, Seoul, highly selective in Australia Eastern Seaboard, Tokyo, and Osaka)	(China Tier 1 and satellite cities, selective China Tier 2 cities, Seoul, Tokyo, Osaka, and Nagoya)
	Multifamily (Japan)	Highly selective office locations/specifications with flexible exit timing (Tokyo, Osaka)
		Multifamily (Japan, China Tier 1 cities, Seoul, Sydney, Melbourne, Hong Kong, Singapore)
Other Opportunities	Modern warehouses (highly selective in Singapore)	
		Opportunities with pricing adjustment (Beijing, Shanghai CBD, Melbourne CBD, Sydney CBD, and Singapore CBD offices; Shanghai retail; conversion to multifamily)

Source: LaSalle Investment Management, as of December 2020.

The robust investor demand for industrial logistics facilities across the globe and the region in recent years is expected to expand the investable universe of the industrial sector in 2021 and beyond. The ongoing sector shift in transaction and fundraising activities is likely to drive investors, particularly asset allocators, to broaden their real estate portfolios to include more industrial assets in Asia Pacific as a way to complement other property types.

MARKET/SECTOR OUTLOOK AND INVESTMENT STRATEGIES

The impact of the pandemic on Asia Pacific real estate markets/sectors has been uneven. In Japan, the office, logistics, retail, and multifamily sectors remain the most resilient in the region, while China and Singapore logistics sectors show the earliest signs of recovery. Australia offices and Asia Pacific retail and hotels have been the most negatively impacted. While there is abundant liquidity, the Asia Pacific real estate market/sector recovery is expected to continue to be uneven in 2021. Bifurcation of total returns is expected to continue. Our market/sector recommendations for Asia Pacific are highlighted in Asia Pacific Investment Recommendations: 2021 on page 32).

Office: Despite the relative success of working remotely, it is likely to be just one work option, not a permanent replacement for corporate office space in major Asia Pacific markets. The progress of workplace re-opening across Asia Pacific has been stronger than in other regions. Many office markets in the region have achieved high return-to-office ratios of leased space, which signals the willingness to return to offices is much higher than anticipated. In China, where the pandemic has largely been under control since April, the estimated return-to-office ratio was more than 90% in September 2020, while the ratio was 70%–80% in South Korea. In office markets where government restrictions on office capacity were stringent (e.g., Melbourne and Singapore), return-to-office ratios were lower (see Asia Pacific Return-to-Office Ratio of Leased Space). These return-to-office ratios are important to track. The sooner people can and are willing to return to work in their offices (or offices with a kind of "new normal"), the smaller the permanent impact of remote working on the future of offices.

The relatively high return-to-office ratios in a large number of markets are partly due to the Asian business culture and local dynamics. Face-to-face encounters are viewed as essential business rituals in China, Japan, and South Korea. Furthermore, the relatively low average living space in highly urbanized Asian cities (particularly in Japan and Hong Kong) also makes remote working challenging. There are also technical challenges for remote workers (reliable Internet access) and for businesses to protect information security and confidentiality. In 2021, we expect bifurcation of performance among office markets in Asia Pacific, partly driven by the uneven impact of remote working, with Japan office markets to continue to outperform the rest of the region, because remote working is less attractive and supply remains relatively constrained. In the meantime, we expect office demand to continue to decline in markets such as Australia and Hong Kong, as demand dwindles due to the worst recession in decades.

Asia Pacific Return-to-Office Ratio of Leased Space

Country	Market	Back-to-Office Ratio (%)
China	Shanghai	> 90%
	Beijing	> 90%
South Korea	Seoul	70%–80%
Japan	Tokyo	82%–88%
	Osaka	88%–90%
Hong Kong	Hong Kong	50%–70%
Australia	Brisbane CBD	61%
	Sydney CBD	40%
	Melbourne CBD	7%
Singapore	Singapore	30%–35%

Sources: JLL (all markets except for Australia and Japan), as of September 2020; the Property Council of Australia (Australia), as of October 2020; for Japan cities, the ratio is sourced from the Google mobility index for workplace from Google COVID-19 Community Mobility Report, monthly average as of November 17, 2020. The percentage represents the mobility trend for places of work that returned to the baseline. The baseline is the median value for the corresponding day of the week during the five-week period from January 3, 2020 to February 6, 2020.

We expect CBD offices in major Asia Pacific office markets (e.g., Tokyo Central Kus and Singapore CBD) to remain relevant in the post-COVID-19 era as locational attributes (e.g., amenities and access to skilled workers) remain important to companies. All these factors suggest that CBD offices remains attractive. Nevertheless, pandemic fears could influence some companies' decisions to relocate some operations to selective decentralized offices, but likely to limit to those with good locational attributes and affordable rents.

In the current market cycle, tenant profiles are increasingly important in mitigating operating income risks. For core strategies, we recommend caution in the near term, due to the disconnect between weakening office fundamentals and robust capital markets. For core and non-core strategies, we continue to favor offices in Tokyo and Osaka due to the size of these markets, the depth of liquidity, and the relatively healthy occupier markets. Investors with a high risk tolerance should monitor Shanghai, Sydney, Melbourne, and Singapore CBDs and Beijing office markets as the weakening fundamentals could provide opportunities at reasonable prices.

Industrial: We continue to favor investments in Asia Pacific logistics. The resiliency of logistics demand during the pandemic suggests that it is primarily supported by

Qingpu, Shanghai, China

domestic consumption in Asia Pacific markets, particularly e-commerce, more than global trade. The need for more timely deliveries has also intensified the demand for logistics facilities in infill locations to be close to consumers. These changes in logistical needs are expected to continue to support logistics demand, particularly in China and South Korea, where domestic consumption is driving the recovery. For core strategies, we continue to favor logistics markets in the Eastern Seaboard of Australia (i.e., New South Wales, Queensland, and Victoria), Tokyo, Osaka, and Tier 1 and their satellite cities in China due to their relatively large populations. Strong investor demand for logistics facilities has been driving prices to historic highs. The good news is that ultra-low interest rates are making the yield spreads of stabilized logistics assets wider and more attractive than a year ago. For high-return strategies, we continue to favor build-to-core logistics markets in Tier 1 and their satellite cities and highly selective Tier 2 cities in China, the Greater Seoul area, Tokyo, Osaka, and Nagoya supported by the attractive logistics development yields.[6]

The increasing adoption of online grocery shopping in the region is expected to raise demand for cold storage facilities. Online penetration rates for grocery shopping were high in China and South Korea before the pandemic. In the first eight months of 2020, online grocery sales in China and South Korea grew by 16% and 43%, respectively, from the same period in 2019.[7] There is potential for further growth, as consumers have started to shift their food shopping from offline to online, seeking convenience and to avoid in-store shopping. This trend is expected to support temperature-controlled warehouses, particularly in China and South Korea. However, investors need to be mindful of the risks associated with investing in this niche sector. The rents, construction, and operating costs of temperature-controlled warehouses are higher than those of traditional venues. However, the depreciation of refrigeration equipment usually reduces the total return over a long holding period. Additionally, capital market liquidity and exit strategies have not been fully tested. Investors with a higher risk tolerance may want to consider developing cold warehouses or converting older warehouses to cold storage facilities in appropriate locations. In these instances, investors should have a well-defined exit strategy, as well as experienced leasing and asset management teams.

Retail: In 2021, we expect the retail sector to remain weak in most Asia Pacific markets due to cyclical weaknesses and the structural disruption of e-commerce. While e-commerce sales growth is expected to taper from the peak of the pandemic, the structural disruption to the sector will continue. The downward pressure on traditional retailers' profits is expected to force more retailers to move to or add online platforms. The reduction in liquidity for retail assets globally is another headwind for the sector. Therefore, we are not in favor of retail assets for investors with a low risk tolerance.

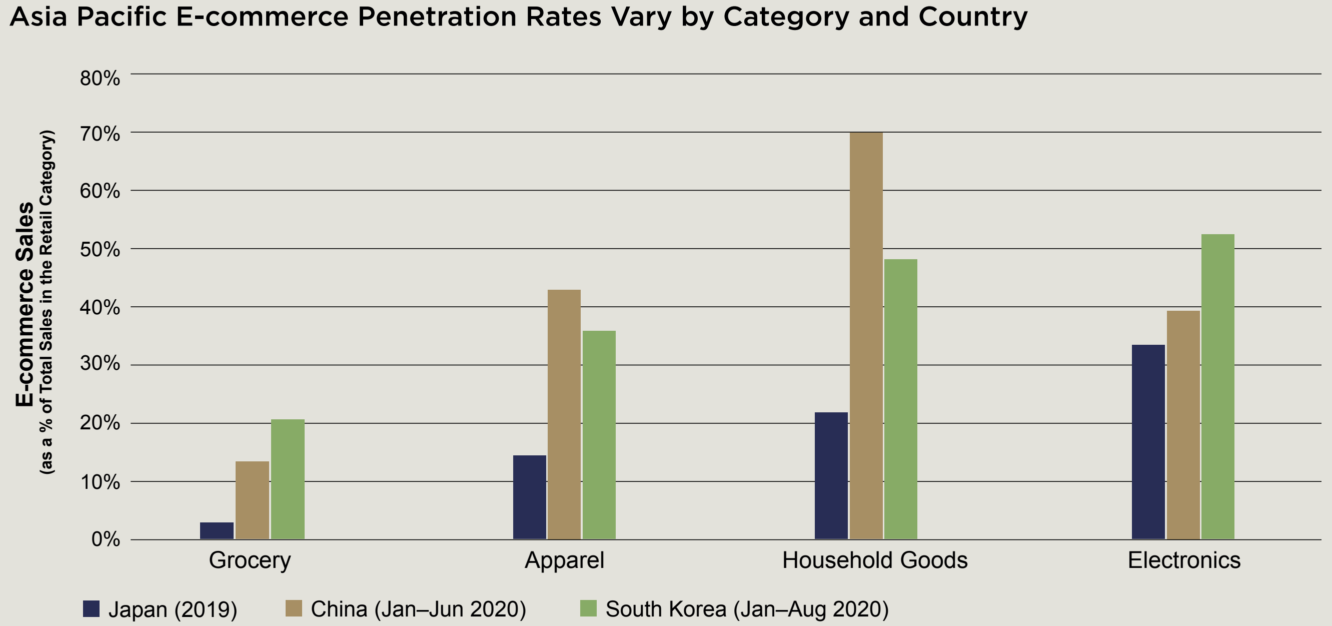
Despite these headwinds, the retail sector in the region is evolving, particularly in China where the e-commerce penetration rate is one of the highest globally. The retail sector in China has been the most advanced in adapting to the e-commerce disruption in Asia Pacific. We expect it to perform relatively better than other retail markets in the region over the short term, due to China's early containment of COVID-19 and the large domestic consumption base. Additionally, the increasing share of experience-based tenants (e.g., health and beauty, education, foods, and online retailers' offline showrooms) demonstrates the transformation of retail formats in China. Relatively low vacancies and low levels of projected supply, especially for infill shopping malls, support the retail sector's performance in China.

Japan is another area of resiliency within the region. Offline retail demand from some apparel and household goods tenants remains relatively healthier compared to global peers (see Asia Pacific E-Commerce Penetration Rates Vary by Category and Country on page 35).[8] Investors who can tolerate risk should be highly selective when evaluating retail investments, and only if repricing opportunities arise. Additionally, curating the tenant mix could reduce the negative impact on incomes. Grocery, food and beverage, entertainment, and pharmaceutical tenants are less vulnerable to the disruption from e-commerce. Nonetheless, in 2021, any occupancy improvement from shifting the tenant mix is expected to be at the expense of rents.

6 The logistics development yield data are based on LaSalle Investment Management estimates as of October 11, 2020.

7 The online grocery sales growth data are from the National Bureau of Statistics of China and Statistics Korea, as of August 2020.

8 The data for the online penetration rate for apparel are from the Ministry of Economy, Trade and Industry of Japan, as of December 2019.



Sources: The Ministry of Economy, Trade and Industry of Japan, as of 2019; the Ministry of Commerce and the National Bureau of Statistics of China, LaSalle Investment Management, and Statistics Korea, as of August 2020.

Multifamily: We continue to favor the multifamily sector in Japan, the only country with an institutional multifamily rental sector in the region. We target Tokyo, Osaka, and Nagoya where demand for multifamily properties is expected to remain stable in the post-COVID-19 era. They are the largest metropolitan areas in Japan. Between 2014 and 2019, 75% of the new jobs created in Japan were concentrated in these three metros. Job opportunities in these metros are expected to continue to drive demand for multifamily properties. In-migration, a key driver of occupier demand, is expected to slow temporarily due to the pandemic. However, our stress test shows that occupancy rates for multifamily assets in these metros are expected to remain resilient even if in-migration declines by 25% in the next 12 to 18 months.

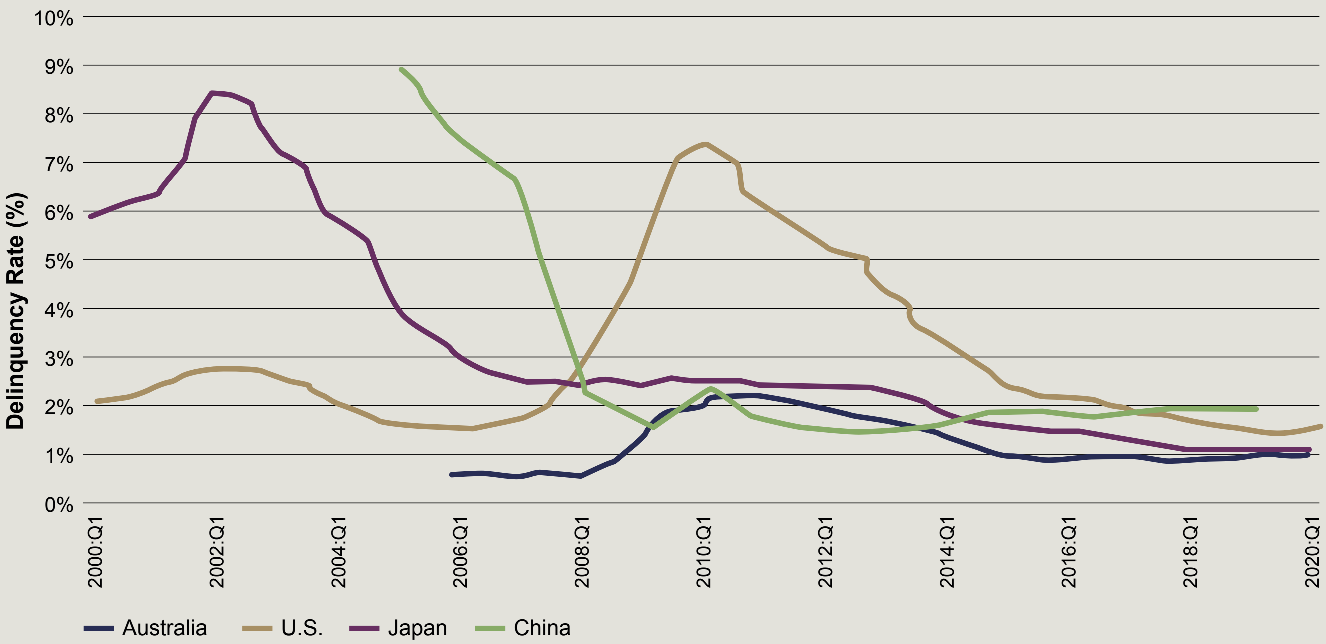
KW Residence Kojimachi, Tokyo, Japan

For higher-return strategies, we favor build-to-core strategies or conversion to multifamily in Australia and China. The growing pool of renters in Australia and China due to unaffordable housing ownership is expected to support demand for multifamily properties. In Tier 1 cities in China, demand is also supported by high urbanization rates and restrictions on housing purchases by in-migrants. Well-managed multifamily rental assets in the post-COVID-19 era could experience accelerated demand. However, the multifamily sector in Asia Pacific (except Japan) is not yet institutionalized. Headwinds for the sector include lack of operating expertise, capital market liquidity, and untested pricing evaluation.

Lodging: The hotel industry remains the hardest hit sector in the region due to pandemic-related travel restrictions. In 2021, travel restrictions combined with domestic economic stability are likely to increase domestic travel more than international travel. Despite growing numbers of bilateral travel agreements signed or currently under negotiation, global travel is not expected to return to pre-pandemic levels until 2024.[9] This trend is expected to benefit hotels targeting domestic visitors as the re-opening in several Asia Pacific countries progresses. It is still too early for investors to consider this sector, unless there are substantial pricing discounts or business plans for

9 Source: International Air Transport Association, as of November 24, 2020.

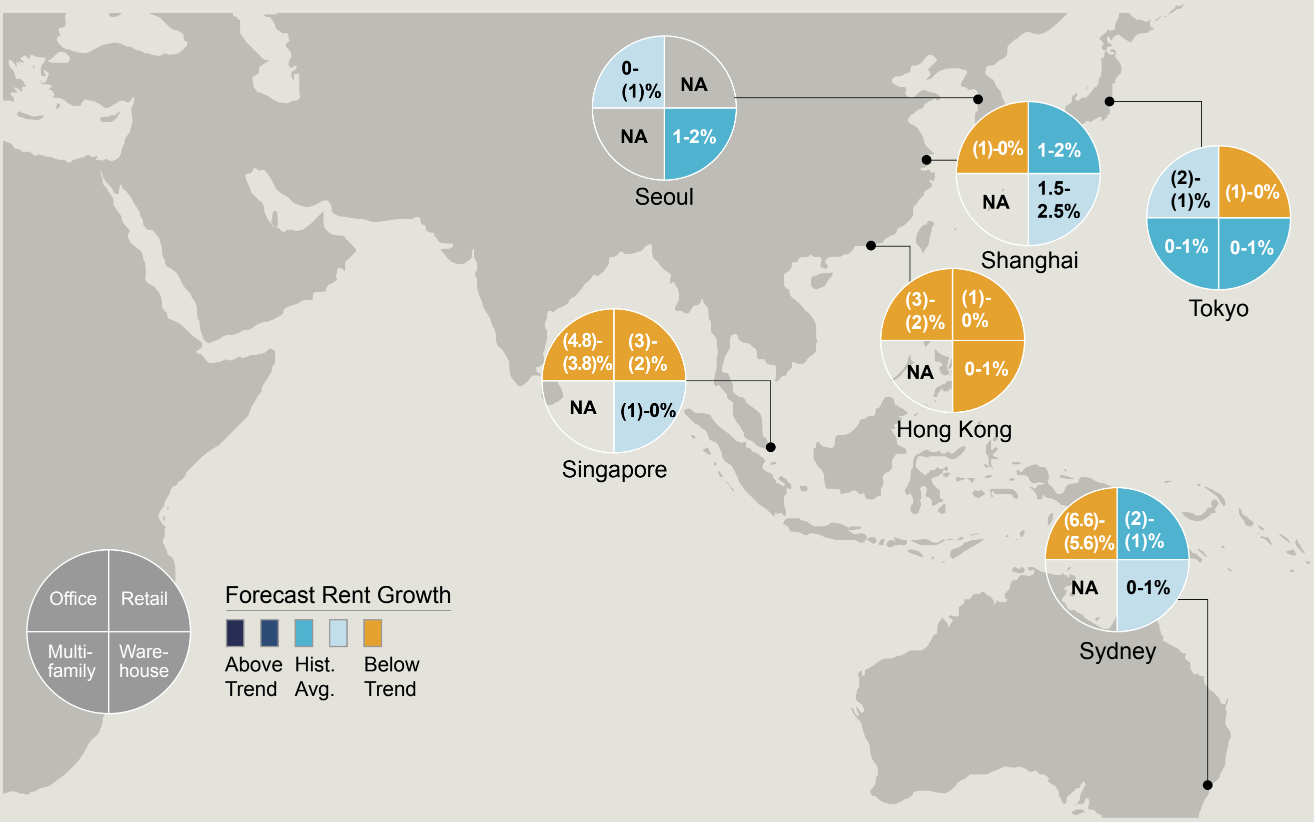
Bank Loan Delinquency Rate



Sources: CEIC, as of 2019 (China); as of 2020:Q1 (Australia and Japan); and as of 2020:Q2 (U.S.).

Real Estate Fundamentals—Asia Pacific

FORECAST ANNUAL AVERAGE NET EFFECTIVE RENT GROWTH: 2021–23



Note: The color coding for each market is based on each respective market's/sector's historical net effective rent growth performance. Light blue indicates that the forecasted net effective rental growth is in line with the historical long-term average, while above/below trend ratings indicate that they substantially exceed/trail their respective historical averages.

Source: LaSalle Investment Management, as of November 2020.

alternative usages to compensate risks. The various governmental support measures (e.g., China's subsidies and tax exemption program, Japan's Go-To Travel, and SingapoRediscovers) for the Asia Pacific hotel sector also suggest that distressed opportunities are still limited in the near term.

CAPITAL MARKET OUTLOOK

In 2021, as most central banks in Asia Pacific are expected to keep interest rates near historical lows, capital market liquidity remains abundant. Accommodative monetary policies, the hunt for yields, and the region's leading position in the pandemic recovery are the key reasons why we have not seen substantial real estate pricing discounts in the worst recession in decades.

Bank loan delinquency rates also provide insight on why we have not seen substantial pricing discounts or distressed sales. In Japan, the bank delinquency rate is at a 20-year low, leading to healthy real estate capital market liquidity (see Bank Loan Delinquency Rate on page 36). Although delinquency rates have increased slightly in Australia and China, they are still substantially lower than those during the early 2000s or the Global Financial Crisis. In China, it is unlikely that the PBOC will further loosen monetary policies in 2021. The Chinese government recently took serious measures to cut leverage among real estate developers. The borrowing costs for these developers are relatively high in China as compared to other countries. This phenomenon could create capital stack opportunities for equity investors who have a higher risk appetite. However, broad-based distress is unlikely in China, as the Chinese property market remains resilient and continues to attract various sources of capital.

In Australia, monetary policies are expected to remain accommodative for an extended period. The accommodative loan repayment moratoriums and other emergency measures that have helped forestall bankruptcies in 2020 are expected to decline as businesses reopen. The withdrawal of these measures could increase financial distress amid the weak economic environment, which could result in opportunities for risk-tolerant investors. We also do not expect widespread distress in Australian real estate markets, as real estate is well-supported by domestic superannuation capital and cross-border capital due to the country's highly transparent real estate market characteristics.

Some companies that are benefitting from government stimulus measures might not survive once these measures end. Economic realities like this remind us to continue to focus on tenant credit. In 2021, most companies are expected to evaluate their hiring plans. In a normal economic environment, it typically takes about six months for macroeconomic trends to filter through to real estate fundamentals (see Real Estate Fundamentals—Asia Pacific on page 36). The pandemic has accelerated structural trends in both positive and negative ways. There is a probability that rental revenues and occupancies (or rental income) could deteriorate in 2021. In turn, pricing movements could be driven by the anticipation of rental income movements. The performance of assets that are inherently weak in terms of location, specifications, and tenant profiles is expected to be further bifurcated from the performance of assets with strong characteristics. Thus, risk-averse investors should remain defensive in the near term. Their approach should be to actively manage their tenants to secure their income and to recycle weak assets while liquidity is abundant. Risk-tolerant investors could consider strategies to support tenants who are better positioned to survive the pandemic. Asset and liquidity management are critical. However, due to uncertainties in the macro environment and global capital markets, it is too early to take on duration risks.

Europe

A FRACTURED RESPONSE

Europe's COVID-19 pandemic experience will one day provide fertile ground for comparative studies on the efficacy of its governments' widely varying public health and economic strategies. On the public health side, responses have ranged from extremely strict lockdowns in

Manhattan Loft Gardens, London, United Kingdom

France and Italy to a laissez-faire approach in Sweden. The U.K. has taken a more reactive path, lurching between a relaxed stance and renewed lockdowns. In terms of economic support, many continental European countries ramped up long-established "short work" schemes that subsidize wages over potentially extended periods of reduced demand. The U.K.'s vast furlough scheme, by contrast, represents a much larger one-off stimulus, but came with a cut-off date that ended up being dropped and the arrangement extended through the first quarter of 2021.

These differences matter for real estate. European countries with better control over the pandemic, and sustained support for the individuals and firms impacted by it, exhibit a greater sense of normalcy. The starting point is also important. Just as a COVID-19 infection is more severe for people with pre-existing conditions, countries with pre-existing economic malaise are in a worse state to manage the fallout. For example, Italy's higher unemployment and debt levels constrain its potential for resilience. At the time of writing in November 2020, many European countries had entered second lockdowns. Of the major economies, Germany seems to be doing the best at sustaining some semblance of normal life, while the U.K., France, and Spain face the tightest restrictions. But these relativities can change rapidly. The European winter is typically long, damp, and chilly—this one is likely to feel especially so.

Yet there are reasons to be optimistic about Europe in 2021. As Winston Churchill famously stated, "Never let a good crisis go to waste." The unrelated and unresolved ailment of Brexit elevates uncertainty for the U.K. in 2021.

Allegro Living, Birmingham, United Kingdom

But it has also caused a shift in the balance of power within the European Union, which has allowed a major and welcome step toward European fiscal integration, in the form of its first joint borrowing and spending program. Like the European policymakers who brokered this ground-breaking deal, real estate investors disciplined enough to temper undue optimism, but also creative enough to overcome excessive pessimism, will do best in this complex environment.

UNITED KINGDOM

CONTINUAL CRISIS MANAGEMENT

Prime Minister Boris Johnson's new Conservative government had barely three months to settle in before the COVID-19 pandemic necessitated difficult decisions. Many of its public health choices were criticized as Britain's death toll rose above that of its European neighbors. But the decision to provide fiscal and monetary policy support, which initially ranked among the most generous in the world, mitigated the worst of the job losses and company insolvencies. The scale of this support is a key reason that Oxford Economics projects a recovery in GDP in excess of the eurozone's over 2021–22. Nevertheless, uncertainties as to the shape, duration, and size of government support persist. The expiring furlough scheme will eventually transition to a less generous replacement in 2021.

While the second wave of the pandemic ensures that all European countries face a significant headwind as they move into 2021, the U.K. has another entirely of its own making. The Brexit issue—and most significantly the Northern Ireland conundrum—was largely overlooked during the first half of 2020. Stumbling trade negotiations over the summer brought the problem sharply into focus, and the risk of no trade deal before the year-end deadline is once again a topic of debate. Whether a full or partial agreement will be reached at the final hour is unknowable. Nonetheless, senior government officials espouse the desire for full sovereignty, which implies a willingness to walk away from trade negotiations and suggests a greater likelihood of a "No Deal" Brexit. The collapse of the economy due to the pandemic would act as a screen for the worst of the fallout, obscuring its impact amidst the broader malaise.

One effect of the Brexit negotiations is to compound real estate occupier and investor uncertainty triggered by the pandemic. Spikes in Brexit uncertainty since 2016 have temporarily but meaningfully depressed both leasing demand and purchasing activity. This threat will manifest most acutely between now and the second quarter of 2021.

In the short term, the economic impact of Brexit will be hard to discern amid the shorter and sharper effect of the pandemic. Estimates from the London School of Economics and Oxford Economics suggest the pandemic could cost between 2%-4% of GDP over two years. By contrast, the drag from Brexit could ultimately cost between 3.7% (deal) and 5.7% (no deal) of GDP, but realized over a number of years. The U.K.'s success in striking trade deals and reorienting its economy away from the EU over the next few years will be the determining factor in whether these Brexit projections come to fruition. Much will hinge on the strength and adaptability of London, both as a global financial center and as a leading city for technology and other services. Other regions in the U.K. may also play an important role on the international stage; for example, the pandemic is highlighting the country's strength and capacity in pharmaceuticals and biotechnology.

CONTINENTAL EUROPE

A SURPRISING SHOW OF UNITY

Given the consternation over Brexit in the U.K., it is perhaps ironic that having the British out of the negotiating room was likely the factor that allowed EU leaders to strike a precedent-setting "recovery fund" deal in July 2020. While the €750 billion fiscal package represents only around 4% of the bloc's GDP, it breaks a long-standing taboo in triggering the joint issuance of mutually guaranteed debt. Brexit, by ejecting the perennially intractable U.K. from the discourse, could have been a turning point in favor of further European integration. This would be a strong structural positive for the EU as a whole, and for its more indebted members like France, Spain, and Italy.

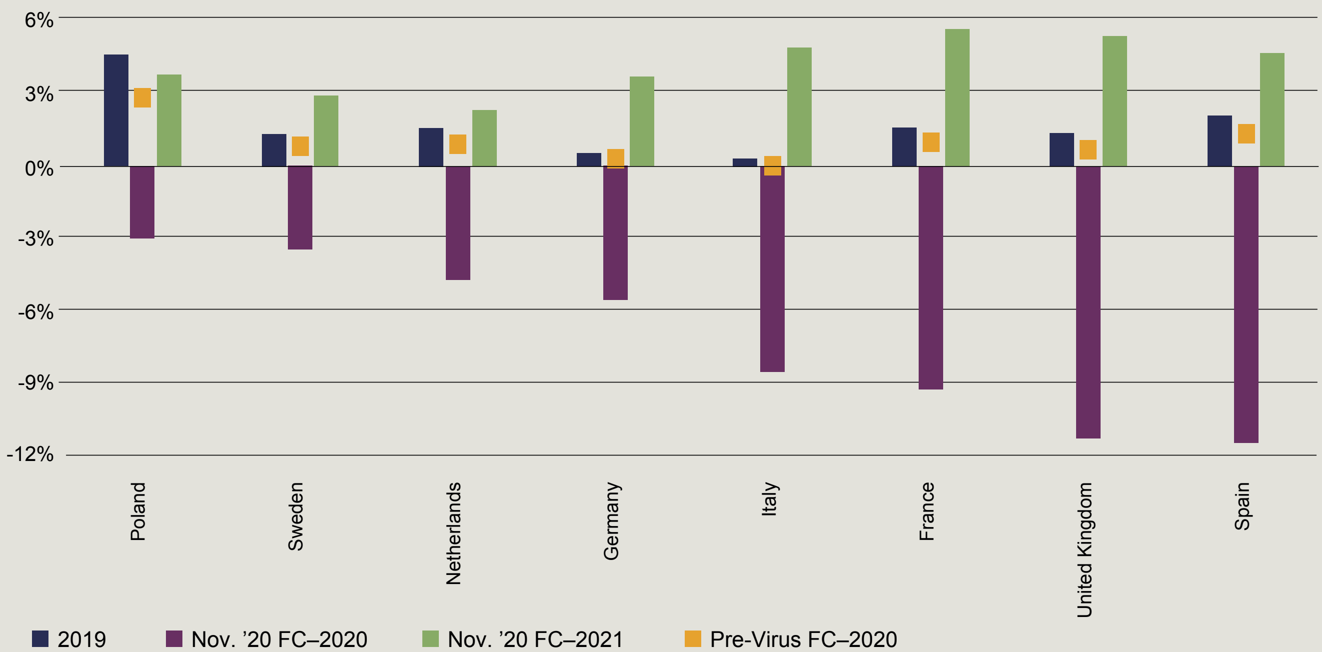
But despite this act of unity, Continental Europe remains fragmented across a range of economic, policy, and COVID-19-related dimensions. As is often the case, an aggregate view of the continent conceals considerable variation among countries (see Economic Outcomes Vary Widely Across Europe below.) The pandemic caused the European economy to collapse, with eurozone GDP projected to decline by 7.5% in 2020, the largest fall in the eurozone's history. At the national level, the GDP decline estimates for 2020 range from just -2.2% for Norway and -3% for Poland to -11.4% for the U.K. and Spain. The public health disparities are even greater. COVID-19 deaths per million in Belgium, the worst-hit major country in Europe, are running more than 7.5 times higher than the rate in Germany, and more than 14 times higher than in Finland.

The key drivers of variation in economic outcomes are the degree of exposure to the worst-hit industries and the scale and duration of governments' economic support. As is the case across the globe in 2020, the sectors that saw a particularly large and sustained hit are the retail and hospitality industries. Europe's manufacturing-driven economies suffered a short but sharp decline early in the year, as the globe's China-centric supply chains ground to a halt. But the eurozone's manufacturing PMI has since recovered to levels last seen in 2018, as goods flows have resumed even while people remain at home. It is now clear that Spain, France, and Italy are experiencing the worst conditions among the major economies, while Germany, the Nordics, and the Netherlands are faring better. Central and Eastern European economies have held up relatively well so far, though their recoveries have been reliant on strong consumer spending, rather than their usual driver of manufacturing output.

Economic Outcomes Vary Widely Across Europe

DISPERSION TIED TO ECONOMIC STRUCTURE, VIRUS CONTROL, AND POLICY RESPONSE

European GDP Growth Forecasts
(Pre-Outbreak vs. Latest; %)



Sources: LaSalle Investment Management (November 2020) and Oxford Economics (January 2020 and November 2020).

Lindenstrasse, Berlin, Germany

In 2021, a critical channel to watch is the labor market; a surge in unemployment in Continental Europe would cause lasting damage and slow the recovery. Eurozone unemployment has been cushioned by government support schemes, such as Germany's long-standing Kurzarbeit (short-time working), which allows employers to keep workers on their payrolls despite weak demand. The recovery path for GDP and household incomes will be largely determined by the ultimate damage done to the labour market, but this will only become clearer as public support is scaled back.

The European Central Bank continues to provide ample monetary stimulus, easing financial conditions. Given the substantial weakening in the inflation outlook, the ECB could expand its asset purchase program in the coming months. The weak growth and inflation outlook for 2021 means that monetary conditions are still expected to remain ultra-loose for an extended period; Oxford Economics does not expect interest rates to start to rise until 2024.

In summary, the impact of the pandemic will vary given the different policies put in place and as a result of different economic structures across the region. Eurozone GDP growth is forecast to pickup to 4.3% in 2021, but it is not expected to return to its pre-crisis level until 2022, with the hardest-hit countries seeing slower recoveries. Real estate investment flows have largely followed the contours of this variation, with the strongest economies attracting the most investor activity.

CAPITAL MARKETS: A NARROW WINDOW OF INEXPENSIVE DEBT

The pandemic and associated lockdowns are contributing to a period of subdued investment activity, with commercial real estate investment in Europe dropping to its lowest level since 2014. Cross-border capital has been disrupted the most given the lack of in-person meetings and an inability to tour assets. Even so, total investment activity in Europe has been surprisingly resilient throughout the year; volumes have declined by 17% year on year in 2020, slightly better than in North America or Asia Pacific.

But as with many things this year, variation abounds. In some of Europe's smaller markets—Belgium, Denmark, Portugal, and Switzerland—transaction activity was slightly up this year. In Germany, Europe's largest investment market, transaction activity fell by 15% in the first nine months of 2020. The main factors supporting Germany's relative resilience are its safe-haven status; the size, scale, and sophistication of the domestic investor base; its more effective response to the COVID-19 pandemic; and its strong public finances. Germany's activity stands in contrast to the U.K., the second-largest investment market in Europe, where volumes were down 30% over the same period. The U.K.'s investment volumes have been soft since the Brexit vote, as cross-border investors remain cautious on its impact. Elsewhere, investors have adopted a wait-and-see attitude; investment volumes declined substantially in France, Spain, Italy, and the Netherlands.

Despite the emergence of non-traditional lenders, Europe remains largely reliant on the banking system for debt capital. Many banks have adopted a more risk-off approach,

Bergère, Paris, France (click on photo for video tour) scaling back leverage, increasing loan margins, and focusing on prime assets. In addition, the low interest rate environment will continue to suppress already fragile bank profitability in an industry that has struggled to recover from the GFC. That said, loan-to-value (LTV) ratios were relatively conservative prior to the pandemic, suggesting a smaller hit to balance sheets than during the GFC. LTVs range from 50%–55% in the U.K. and France for senior loans on a prime office asset, 55%–60% in Germany, and 40%–45% in Spain. The low cost of commercial real estate debt and conservative LTVs means borrowers face rather comfortable interest coverage ratios.

Moreover, due to the recent fall in swap rates, the all-in cost of debt has fallen sharply to record lows. With this in mind, we expect lending activity to pick up in 2021 as confidence returns to the market, both for traditional and higher-return opportunities. And yet there are likely to be remaining financing gaps in 2021, which will bring opportunities for alternative lenders. Banks will continue their risk-off approach and will likely continue lending at lower LTVs, and focusing on core, stabilized assets. They are likely to exhibit limited appetite for transitional development or operating assets. And while more risk-averse traditional lenders may continue to abstain from the market in 2021, mezzanine, higher-leverage whole loan strategies, and transitional financing will likely play an increasingly important role in the liquidity of the real estate market, and we see attractive risk-adjusted returns in this space.

SECTOR FUNDAMENTALS AND STRATEGIES

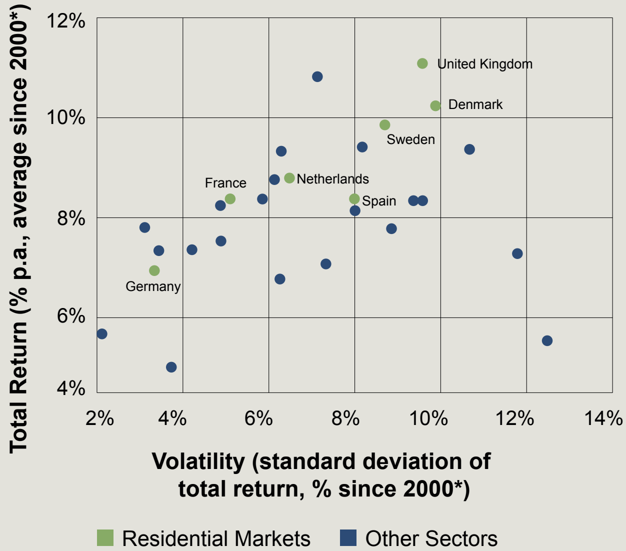
The pandemic has intersected with and intensified an already ongoing and vast—but heretofore gradual—transformation of European real estate portfolios.

New Loft, Amsterdam, Netherlands

European Residential Offers Strong Risk-Adjusted Returns

HISTORICAL PERFORMANCE HAS BEEN STRONG

Total Return vs. Volatility Across Property Sectors
(Average % p.a. since 2000* and Standard Deviation*)



*Data for Spain is since 2004.
Sources: LaSalle Investment Management, MSCI, and ONS, all from September 2020.

Traditionally, institutional property in the U.K. and Europe has been dominated by the office and retail sectors. A look at the Pan-European Property Fund Balanced Index from MSCI, which tracks diversified pan-European open-ended funds, is telling. As of the second quarter of 2020, 72% of its capital value was made up of office or retail assets, leaving just more than a quarter for everything else, including logistics, residential, and alternatives. In contrast, 49% of the corresponding NCREIF ODCE Index for the U.S. was comprised of office and retail.

But the dominance of office and retail in the region has been fading. For at least several years before the pandemic, investors have sought to increase their exposure to European logistics and residential assets—“sheds and beds” in the lingo. Both sectors have been rightly identified as beneficiaries of compelling secular trends (e.g., e-commerce growth and urbanization) and a growing investable stock. They have also demonstrated their value within portfolios. Evidence from MSCI underscores residential’s excellent risk-adjusted return and downside-resilient income characteristics (see European Residential Offers Strong Risk-Adjusted Returns above). Meanwhile in the logistics sector, long known for flat real rents, recent rental growth is being sustained at high levels in many markets.

The trends driving the growth in the logistics and residential sectors have only been accelerated by the pandemic. With concerns about the future of offices adding to longer-standing worries about retail, TINA

European Investment Recommendations: 2021

INVESTMENT THEMES PLAY BOTH SIDES OF CAPITAL MARKETS "CHASM"

	Core	Higher Return
Best Opportunities	Urban logistics and modern motorway logistics (Well-connected big box and dominant hubs)	Logistics development and multi-let industrial
	Residential (Urban build-to-rent (BTR), affordable, and family housing)	Residential development (Includes for-sale, urban BTR, family housing, and retirement housing)
	Secure long-term income offices (Prime in key centers with low vacancies and strong, well-connected micro-markets)	Office refurbishment and build-to-core (Strongest locations only; avoid near-term office leasing risk)
	Inflation-linked with high site value; ground leases and income strips (Primarily a U.K. opportunity)	
	Affordable housing, retirement housing, healthcare, educational facilities	Niche sectors (Emerging sectors such as self-storage)
Other Opportunities	Long-term income-producing retail warehouse/retail parks (Food-anchored retail in demographically strong markets)	Repriced retail repositioned to alternative use
		Repriced hotels (With strong covenant and/or operational manager)

Source: LaSalle Investment Management (November 2020).

(There Is No Alternative) has joined FOMO (Fear of Missing Out) as reasons investors are targeting European logistics and residential.

This has created a chasm between logistics and residential on the favored side of a great divide, and office and retail on the unfavored side. The former are manifestly strong, but aggressively bid, especially in relation to the amount of stock available for investment in the less mature European context. There is far less competition in the office and retail sectors, where the outlook is murky and investors are seeking pricing discounts. While this sector bifurcation is not unique to Europe, the legacy positioning of portfolios in this region means the desired portfolio rotation is especially great, putting strains on both sides of the divide.

In our view, the investors in European property that will be most successful in 2021 will be those who can be active on both sides of the chasm (see European Investment Recommendations: 2021 above). They must avoid overpaying for logistics and residential, while cautiously taking advantage of mis-pricing in the more traditional sectors. When buying logistics and residential assets, investors must determine when and where it is appropriate to embrace bullish rental assumptions to win a bid. Logistics and residential assets have performed strongly, but it is quite possible to overpay for a good thing, especially when there are pockets of potential oversupply. Likewise, it may pay to be contrarian in the less favored sectors, but this will require waiting for pricing to adjust, as well as a high degree of conviction in the location and the asset itself.

OFFICE: CHALLENGING NEAR TERM, OPPORTUNITY LONG TERM

The near-term outlook for the European office sector is considerably less certain than it was prior to the pandemic. Business leaders largely view remote working as a success and overall will likely require less office space in the future. Precisely how much less space and over what time period these changes occur will vary by market. Given the rate at which leases are due to expire or break in the short term, an accelerated transition to remote working will not impact office rents immediately. Other market factors such as cyclical vacancy will be more influential in the immediate future.

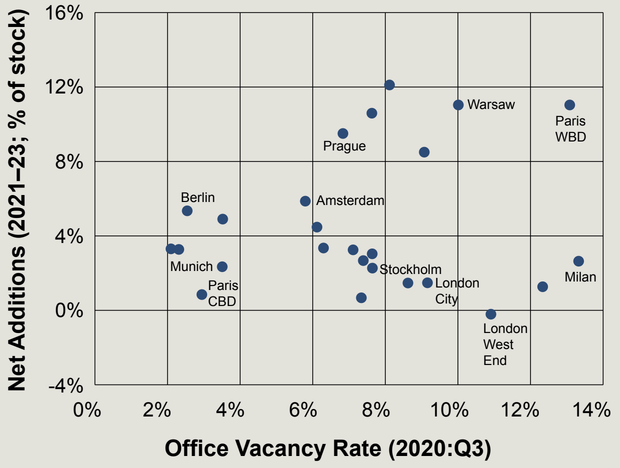
Different preferences and attitudes toward work will lead to variation by country. For instance, there are several reasons why offices in Continental Europe may not be impacted by remote working as much as offices in the U.K. Continental Europe offices generally have lower density (i.e., more office space per worker), shared cellular offices where spaces are shared with only a few close colleagues, and openable windows for natural ventilation. Meanwhile, workers in larger metro areas reliant on long commutes by public transport, such as London and Paris, will be less keen to return to their desks than those in more compact cities in the post-COVID-19 era.

During the most challenging period of the lockdown, there was almost no leasing activity. These low levels should not persist throughout 2021, but we do expect a drop in demand. The depth of tenant demand from a wide variety of sectors and companies' preference for high-quality

Collaboration-Driven "Front Office" Markets Offer Strong Fundamentals

UNDERSUPPLY IN STRONG DTU+E LOCATIONS TO PREVENT SHARPER RENTAL DECLINES

Current Office Vacancy vs. Future Supply



Note: Paris submarkets are JLL future supply as a percentage of stock rather than PMA net additions. Vacancy rates for Brussels, Helsinki, Milan, Luxemburg, Amsterdam, and Stockholm are as of 2020:Q2.

Sources: PMA (October 2020), JLL (2020:Q3), and LaSalle Investment Management (November 2020).

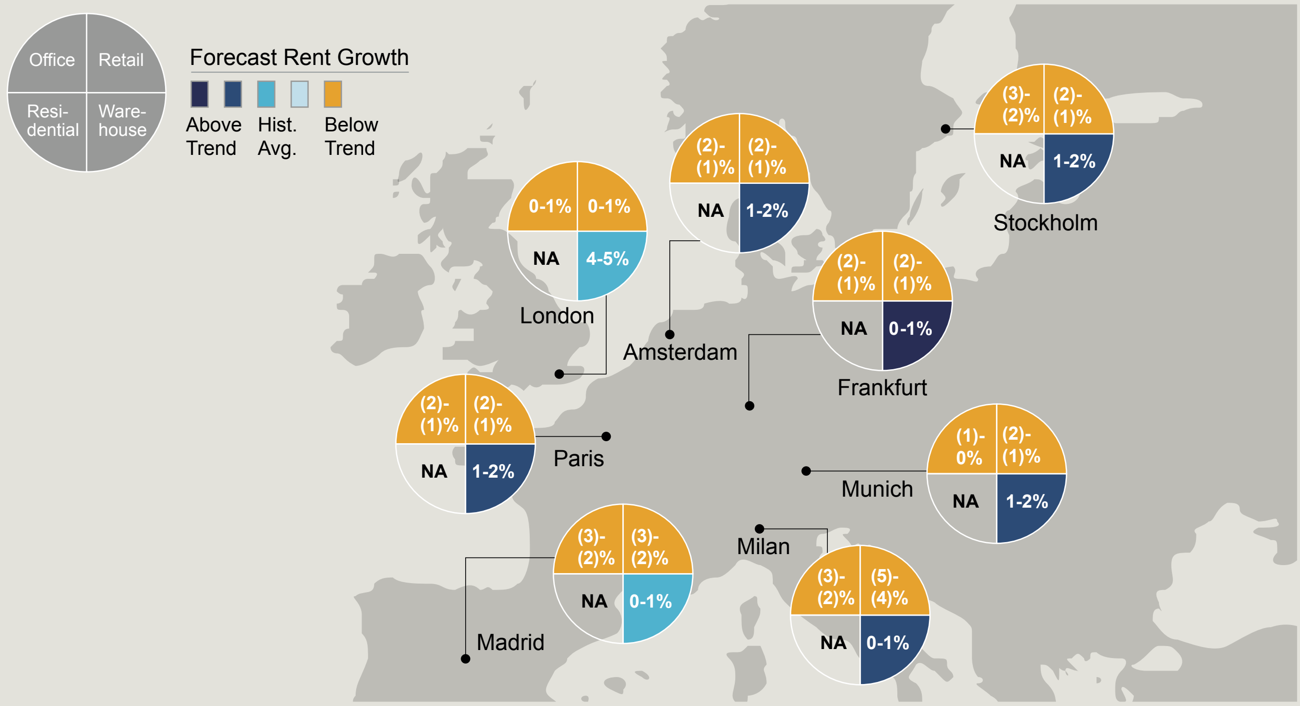
office space in accessible locations are both expected to persist.

The key difference between the pre- and immediate post-pandemic periods will be the significant amount of second-hand space we expect to come onto the market. This will be particularly apparent in fast-moving markets like London. While we do not believe this will depress demand for the best space, it may limit its future rental growth potential, as the balance of power will shift from landlord to tenant. After years of declining office vacancy rates to historically low levels, we have seen a reversal over the past few quarters. Many of Europe's most creative key cities are at least entering this period from a position of strength, with low vacancy and relatively small pipelines (see Collaboration-Driven "Front Office" Markets Offer Stronger Fundamentals). In 2021, we expect the emergence of an office market in Europe that is polarized by quality.

Coworking and flexible offices are a known risk to the office sector in Europe, especially in cities where they make up a large share of demand, like in London. These operators have been severely impacted during lockdown, and for some the damage may prove to be terminal. However, there is a growing acceptance that flexible working goes hand-in-hand with remote working. These operators likely will still play a pivotal role in the evolution of the office sector.

Real Estate Fundamentals—Europe

PRIME RENTAL GROWTH, 2021–23 (% PER ANNUM)



Note: The color coding for each market is based on each market's/sector's historical net effective rent growth performance. Light blue indicates that the forecasted net effective rental growth is in line with the historical long-term average, while above/below trend ratings substantially exceed/trail their historical averages. Office is prime (not net effective in Europe); retail is high street shops (Central Europe forecasts are based on country prime, not city); and warehouse is motorway logistics (forecasts and history; not urban logistics).

Sources: LaSalle Investment Management, PMA, and JLL, as of November 2020.

London's pricing discount to other global markets persists and may even grow in 2021 depending on how the pandemic and Brexit issues evolve. This could be reached through both higher asking yields and, for foreign investors, a weaker pound sterling. We may even see long-held assets put onto the market by over-leveraged investors or open-ended funds seeking to meet their redemptions. Long-term investors will see this as a rare window of opportunity. By contrast, pricing for prime office assets across Europe has remained stable, with yields continuing to sharpen in Germany's major cities (see Real Estate Fundamentals—Europe on page 43).

With the twin challenges of a major recession and the more widespread adoption of remote working hanging over office markets in Europe, office investment opportunities in 2021 will need to be priced carefully. Should European markets avoid the downside scenarios for these challenges over the first half of 2021, we would expect the strong fundamentals in the major markets to re-emerge broadly intact. Older readers may well recall that the "death of the office" has been predicted a number of times before, yet the sector has bounced back in an adjusted form.

RETAIL: THE HARDEST HIT SECTOR

The fate of retail across Europe is likewise a story of variation. Heading into 2020, U.K. retail was arguably already under more stress than any other real estate sector in the world. The year is on track to see the U.K.'s highest ever number of store closures, notwithstanding extensive government support. Retailers have the upper hand in virtually every negotiation with landlords, even in the best performing schemes.

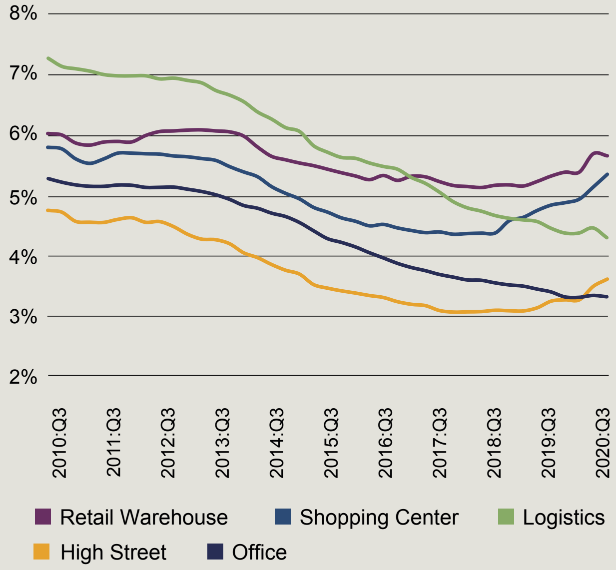
By contrast, the retail sector in Continental Europe began 2020 in a relatively stronger position and has performed better so far. There are two key structural differences between the Continent and the U.K. that likely contribute to these differences. First, shopping centers in the U.K. tend to be anchored by department stores, which are undergoing structural decline, while malls in Continental Europe are typically anchored by more convenience-oriented supermarkets or hypermarkets. Second, e-commerce penetration remains much higher in the U.K. than on the continent.

But it remains unclear whether retail prospects in Continental Europe will ultimately deteriorate in-line with the U.K. experience. Indeed, the pandemic is prompting e-commerce growth in places where it had lagged. For example, Southern Europe's historically low e-commerce penetration was once chalked up to a supposedly cultural preference for in-person shopping. But it may have had as much to do with customers lacking familiarity with retailers' websites. Tighter lockdowns in France, Spain, and Italy made online shoppers out of many holdouts, as learning how to buy online became a necessity.

Increasing Divergence Between Retail and Other Sectors' Yields

LOGISTICS YIELDS ARE COMPRESSING, RETAIL IS EXPANDING, AND OFFICE IS STABLE

Prime Yield by Sector
(All Europe; %)



Sources: LaSalle Investment Management (November, 2020) and JLL (2020:Q3).

The European retail market is customarily segmented into shopping centers, high streets, and retail warehousing. But these traditional divisions are not necessarily the fault lines along which market conditions are fragmenting. Instead, retail destinations that are patronized disproportionately by international tourists and city center office workers are struggling. Retail locations surrounded by residential rooftops and catering to daily necessities have been more resilient. These patterns have upended historical patterns among retail subsectors. Normally the most resilient U.K. market segment, Central London high streets, are experiencing the impact of fewer office workers and a near total lack of foreign tourists. This decline in people has affected Europe's smaller cities less than the larger ones, due to the latter's reliance on public transport.

The capital markets have responded to the challenges faced in the retail sector by largely seizing up (see Increasing Divergence Between Retail and Other Sectors' Yields above). According to JLL, since 2017 prime yields for all U.K. retail have expanded by 155 basis points, and by 155 bps for U.K. shopping centers. Continental Europe has fared better, with a 25 bps expansion for all retail and a 60 bps expansion for shopping centers. However, these figures, based on valuers' estimates for a theoretical prime asset, likely understate the magnitude of the true repricing, given transaction volumes are so low as to obscure liquidity and

Euskirchen Logistics Unit, Euskirchen, Germany {click on photo for video tour)

price discovery. Initial yields implied by public market signals suggest a pan-European retail yield expansion of around 220 bps over the same period, according to Green Street.

From what limited evidence there is, asking yields for certain retail assets are approaching levels that would generate attractive returns from income alone. The key questions investors should ask about an asset are whether its income and tenant line-up are sustainable, and if yield compression will be forthcoming for properties that weather the storm. In 2021, we anticipate the strongest urban retail parks moving into fair value territory, followed by the best high streets in top towns. Due to their physical limitations, complexity and, in part, tenant homogeneity, secondary shopping centers will lag behind unless there is a strong case for redevelopment (see The Future of Retail Real Estate sidebar on page 17).

While we expect to see the bottom of the current cycle for prime retail pricing in 2021, lesser quality retail may take longer to find a floor. Fundamentals will continue to be under stress, even in the post-COVID-19 era. This is because more fundamental changes still need to be made, not least the removal or conversion of a considerable part of the retail stock. We may see more government time devoted to major issues regarding the outmoded business rates system in the U.K. and online sales taxes across the region. However, what, when, and if such changes will happen is unknown.

LOGISTICS: EVERY INVESTOR'S FAVORED SECTOR

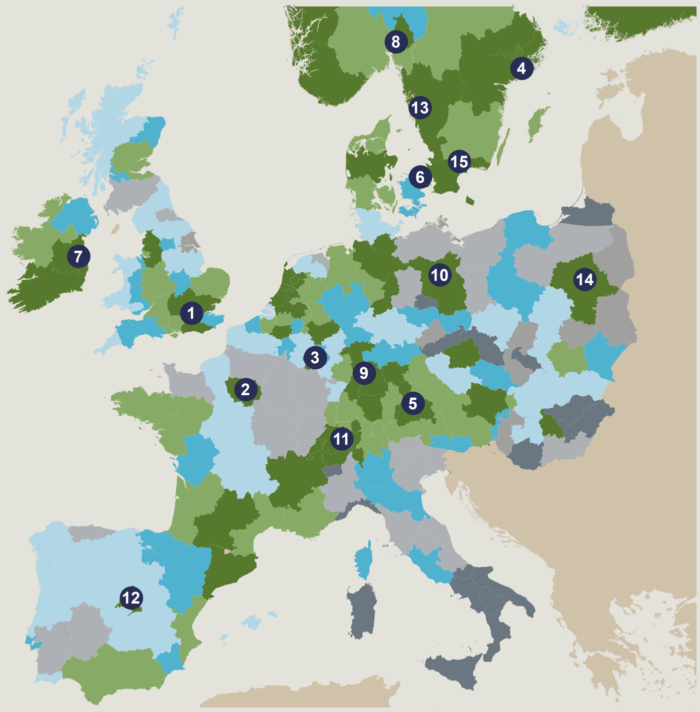
In Europe, as elsewhere, logistics has been the stand-out sector for occupier fundamentals throughout 2020. A sharp increase in e-commerce, nearshoring of manufacturing, and stock buffering, triggered by the pandemic, will bring long-term gains to the sector. Given the temporary closure of non-essential retail stores, e-commerce has been the biggest part of this story in 2020. Over 20% of European logistics take-up in the second quarter was by e-commerce users, the highest on record. Moreover, the events of 2020 highlight the need for resilient supply chains, with demand spiking in order to house just-in-case inventory. We anticipate that inventory building and back-filling orders will lead to highly resilient demand prospects in 2021.

The big question in underwriting logistics investments today is more about supply than demand. The supply of logistics property in typical out-of-town "motorway" locations has historically been quite elastic, with construction quickly ramping up in response to real rental growth. Prior to the pandemic, we identified the risk of speculative supply creeping back into the European market, especially in parts of the U.K., Spain, the Netherlands, and Poland.

The most robust rental growth potential is in urban infill locations, where there is strong demand and competition from other land uses reduces the supply reaction. Last-mile and urban logistics occupiers require proximity to customers and business partners, which reduces transport costs and enables them to pay higher rents. The value of an infill logistics location is a function of its surrounding density and congestion, which is why the biggest spikes in urban logistics rents have been recorded in London and Paris. Investors able to appropriately balance optimism for further growth with realism about the potential supply response in a given location will be best placed to realistically price logistics assets.

Brexit will impact the logistics markets in the region. Should the U.K. government fail to agree to a trade deal with the EU, in early 2021 the short-term demand close to ports of entry will be unprecedented, as new customs checks are suddenly introduced, triggering stockpiling and temporarily increasing demand in northern French and Dutch markets, as well as the U.K. and Ireland. However, this interim issue is unlikely to generate enduring investment opportunities of scale, given that the disruption to trade flows will eventually be eased through technology and greater screening capacity. In the longer term, however, Brexit is likely to reshape goods flows enough on the margins to influence logistics demand, but the impacts will be diffuse and difficult to predict.

E-REGI Index 2020—Headline Results



LaSalle E-REGI 2020

1. London
2, Paris
3. Luxembourg
4. Stockholm
5. Munich
6. Copenhagen
7. Dublin
8. Oslo
9. Stuttgart
10. Berlin
11. Zurich
12. Madrid
13. Gothenburg
14. Warsaw
15. Malmo

- Very Strong
- Strong
- Good Medium
- Poor Medium
- Weak
- Very Weak
- No Data

Source: LaSalle Investment Management, as of August 2020.

RESIDENTIAL: COMING INTO ITS OWN

For the first time in the history of the *ISA*, we cover European residential as a sector unto itself, rather than under the banner of "niche" or "alternatives." This reflects the tremendous gains this market has made in terms of liquidity and the scale of the investable stock. The investment case, broadly speaking, remains compelling. The residential sector in Europe is characterized by persistent undersupply and demographic-driven demand. While aggregate, European-level demographic trends are lacklustre, the cities richest in human capital (see E-REGI Index 2020), are likely to resume their role as magnets for economic migrants as the pandemic ebbs.

But the residential sector in Europe is hot, and risks can be hard to spot amidst the glow. So much of the investment activity in the sector in recent years has taken place in the form of forward-funded, build-to-rent properties targeting young professionals. There are pockets of clear oversupply, especially in parts of Manchester, England. Even where supply is less of an issue, submarkets catering to office workers will see their fortunes tied to the return to workplaces in 2021. Investors who assumed big rental premia were attainable by packing properties with amenities the market had not seen before may get caught out by pandemic-induced penny-pinching. In contrast, middle-market and affordable housing segments, especially those targeting young families, remain chronically undersupplied.

Another issue to watch in 2021 is the impact of changing rental regulations. Limits on pandemic-related tenant evictions have joined other recently imposed restrictions to constrain landlords. But investors should not necessarily fear all rent regulations. Continental European markets have been regulated for many years, under relatively transparent systems accepted by investors. We broadly view them as "a feature, not a bug" of the market. Regulations make income stickier and moderate volatility; for example, renters in Germany typically stay in a property for around seven years, compared to an average of around 18 months in the U.S. Investors who understand the nuances of regulatory systems can work within them to identify value-creation opportunities, while creating resilient income streams.

NICHE ALTERNATIVES: CONTRASTING SECTOR CHOICES

The pandemic has had a polarizing effect on Europe's niche sectors. For example, self-storage and healthcare have proven resilient, while the hotel and leisure sectors, and to a much lesser extent the student housing sector, have suffered due to government-imposed restrictions on movement. As a result, the investment opportunities in 2021 for the more resilient niche sectors are based on strong fundamentals, while those in the worse affected sectors will be driven by attractive pricing.

Both the self-storage and healthcare sectors are characterized by resilient, needs-based demand and growing investor interest. In the self-storage sector, product awareness and investable stock is growing, albeit from a rather small base. While there was a slight drop-off in tenant demand for care homes in 2020, these and other healthcare facilities have solid long-term demand drivers. We also expect the pandemic to spur interest in the emerging life sciences property sector in 2021.

By contrast, there is no undersupply of hotels, leisure properties, and U.K. student housing. Weak demand in 2020 has therefore been felt more keenly and thus values have fallen farther. These sectors are not facing the same existential threats as retail, although we do expect some lasting impact in 2021 due to the decline in international tourism, business travel, and global student mobility. Their outlook is closely tied to the duration and magnitude of the pandemic. Investors with a positive view on these sectors may view the current discounted pricing as a short window of opportunity. Hotels in strong tourist locations or those catering to the burgeoning domestic "staycations" trend will be most in demand in 2021.

LONG INCOME: A FIXED-INCOME SUBSTITUTE

The reason for the continued expansion of the long-income strategies lies in its primary purpose: to act as a bond-like substitute when bond and index-linked bond yields are at record lows. As such, there is as much focus on covenant strength, lease length, and capital requirements as there is on the asset itself. This is most evident for income strips, the lowest-risk opportunities, where the physical attributes of the asset are more-or-less inconsequential. Long-income investors are largely ambivalent of the sector in which the tenant operates, except for where the outlook for that sector threatens their solvency.

Pricing at the core end of this sector has remained remarkably resilient in 2020, with no outward movement in yields. Appetite from investors remains, and we see further yield compression in 2021. This demand has been further bolstered by the downward shift in bond yields, making pricing on these bond-like substitutes appear even more attractive on a relative basis. While long income has predominately been a U.K. strategy, activity is increasing in Continental Europe, especially for some niche asset types such as healthcare properties.

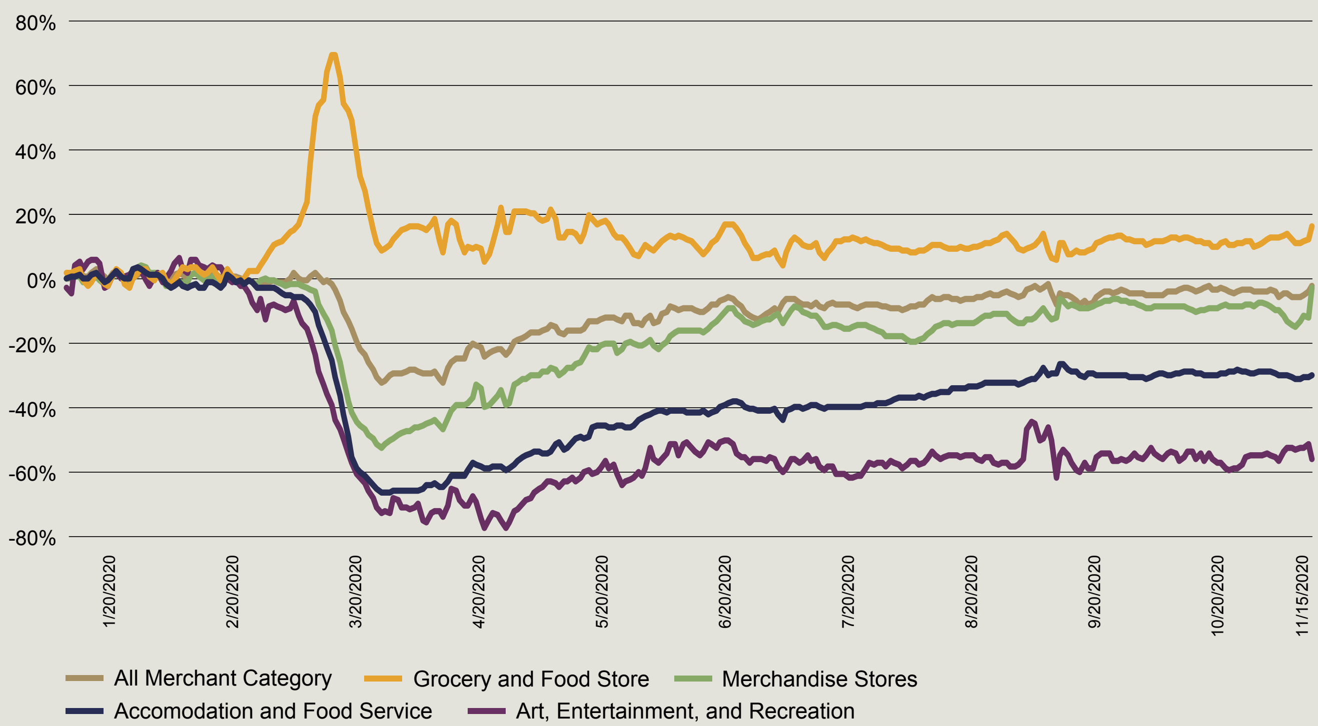
North America

PANDEMIC ENDS PERIOD OF TRANQUIL MARKET CONDITIONS

Nearing the close of a turbulent year, we reflect on the damage done to the U.S. and Canadian economies and real estate markets and discuss our outlook for the future. Perhaps obvious, but worth highlighting: We fully expect 2021 will be better than 2020. There have been enough

U.S. Spending By Merchant Category Shows Stability and Even Growth in Goods Categories During Pandemic

HOTELS, FOOD SERVICE, AND ENTERTAINMENT REMAIN DEPRESSED



Note: Data are through November 15, based on the most recent update as of December 1, 2020. The change is compared to January 4–31 and is seasonally adjusted.

Source: Affinity Solutions via Opportunity Insights from collaboration of Harvard University, Brown University, and the Bill & Melinda Gates Foundation.

scientific advancements in fighting and controlling COVID-19 that we believe 2021 will be the year the pandemic will be contained in North America. This prospect underpins our views and if it takes longer, that would certainly have a material impact on our outlook.

Joe Biden will be inaugurated as the 46th President of the U.S. in January 2021. And while it is not certain, it seems likely there will be a divided government with Republicans retaining control of the U.S. Senate. Divided government means we do not expect major changes in policies that will impact the economic outlook. Major spending or tax reform initiatives are unlikely and the outlook for containing COVID-19 is going to have more impact on the economy than policy.

The remarkable stability in economic growth, vacancy rates, capitalization rates, property values, and transaction volumes we highlighted in recent editions of the *ISA* came to a halt as the pandemic erupted across North America. This led to a record decline in GDP, higher vacancy rates, a collapse in transaction activity, and a lack of visibility on property values in 2020.

In the U.S., COVID-19 infection rates and mortality rates are among the world's highest. Canada's infection and mortality rates have been comparably lower but this is not sparing the country from lockdowns, economic decline, and significant impacts on real estate. While the pandemic is posing a greater challenge to the U.S. from a public health perspective, Canada has a second challenge to deal with in terms of sharply lower energy prices. Although both countries had strong starts to their recoveries from the shutdown phase of the pandemic, the pace of recovery slowed in late summer and fall. The spread of COVID-19 has ebbed and flowed throughout 2020, but despite rising numbers of new cases in the late fall/early winter, shutdowns have been only selectively implemented at a local or regional level.

The U.S. and Canada appear to have found a level of economic activity that can be sustained during the pandemic. Sectors most linked to bringing people together are depressed, while sectors oriented around goods—both necessity and otherwise—are closest to normal. The U.S. Spending by Merchant Category chart on page 47 shows that home improvement store sales are up significantly year-on-year while hotel, entertainment, and restaurant spending remain depressed; the data on Canada are very similar.

CYCLICAL RECOVERY EXPECTED

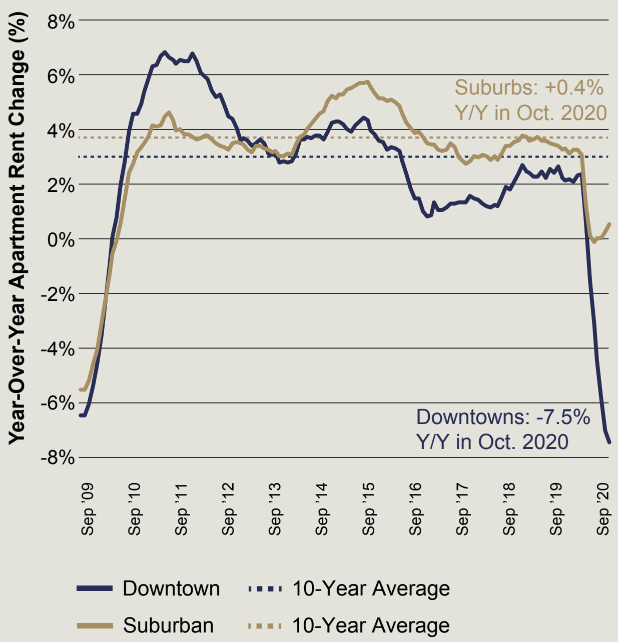
Looking to 2021 and 2022, there are both cyclical and secular dynamics to consider. The U.S. and Canadian economies are poised for a solid cyclical recovery once the health and safety issues are under control. GDP is projected to recover to prior peak levels by the end of 2021 and job growth to follow by 2022–23, with Canada leading the U.S. in terms of jobs recovery. We expect a virtuous cycle of increased spending on services leading to business expansion and hiring in late 2021 and into 2022. However, this view may change if depressed conditions in hard-hit sectors persist and additional fiscal support is not provided. Both the U.S. and Canadian economies were helped by large and effective stimulus measures in the shutdown phase of the pandemic. As the pandemic persists, there is a need for additional support for unemployed workers, provincial/state and local governments, and the travel and hospitality sectors. If this does not occur, there may be a decline in overall economic activity and more permanent economic damage. In the U.S., despite the ongoing partisan rancor, some fiscal stimulus measures are expected in early 2021.

A strong cyclical recovery also depends on the flow of credit. The credit markets are currently very supportive, and both the Federal Reserve and the Bank of Canada are committed to maintaining liquidity. But there is a tipping point where economic damage overwhelms that support. It is hard to determine when that could be reached, but recent news on effective vaccines makes it likely the pandemic will be controlled before debt defaults drive a vicious downward cycle in credit availability, further defaults, and job losses.

TEMPORARY AND PERMANENT PANDEMIC-DRIVEN SECULAR SHIFTS

Real estate investment in 2021 and beyond will be driven as much by secular shifts as the pandemic-driven cycle.

U.S. Suburban Apartment Rent Growth Has Stabilized While Downtown Apartments Continue to See Dramatic Rent Declines



Sources: RealPage and LaSalle Investment Management. Data through October 2020. Latest available as of November 2020.

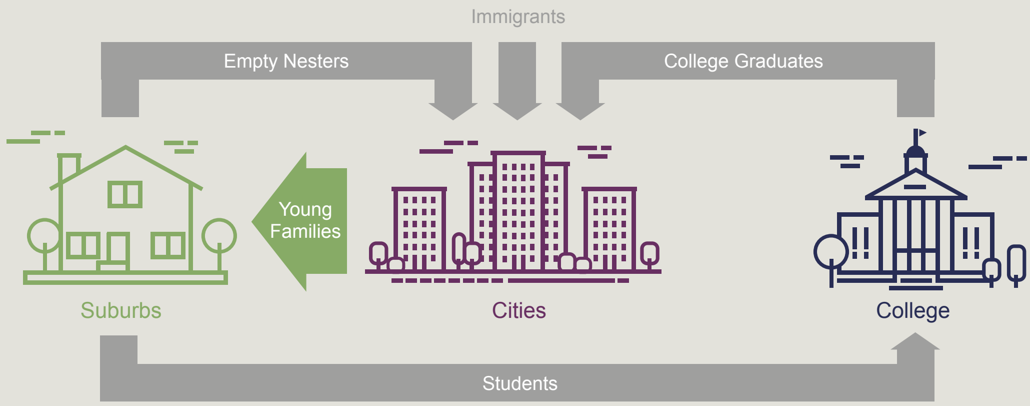
Two key secular questions that impact real estate investment strategy are location preferences for urban relative to suburban locations and the economic growth outlook of different metro markets. A feature of the U.S. and Canadian markets is that a large share of the population, and institutional real estate investment as well, is in suburban locations. These locations are less dense than traditional urban core areas but denser than rural areas and with a significant population base. Many U.S. metros developed during the post-World War II automobile age and thus lack robust mass transit systems, so many markets are best viewed as primarily suburban rather than urban. In Canada, urbanization within the major metros has been a significant growth driver in recent years, but the pandemic is driving a renewed interest in suburban locations among companies (i.e., office tenants) and individuals (i.e., apartment and condo residents). The pandemic is stalling the re-energization of urban cores in the near term, with apartment demand and rent growth in urban areas severely lagging suburban locations (see the U.S. Suburban Rent Growth chart on page 48).

Real estate investors are right to ask if these are temporary or permanent changes. Pre-pandemic, we believed there was greater value in suburban apartments in the U.S. than in urban apartments. There were no great supply constraints on urban apartments and no reason to accept the lower yields/higher pricing that urban assets seemed to command. In addition, shifting demographics means population growth of the young family cohort is going to become a tailwind for suburban locations in 2021 and beyond after demographic trends were a tailwind for urban locations during much of the last decade. This dynamic is framed in the Migration Dynamics During Pandemic Favor Suburbs graphic below. We nonetheless expect a recovery for urban locations, which will drive demand for urban apartments, offices, and to some extent retail.

The appeal of urban places is driven by a desire to be close to a place of employment and to have proximity to lifestyle amenities (restaurants, bars, entertainment, etc.). Currently, the amenities of urban living are no longer an attraction due to the need for social distancing. The schematic and table show how the pandemic created temporary trends that accelerated migration out of urban areas and slowed migration to those urban areas. But in the post-COVID-19 era, we expect previous trends to resume and demand for urban living to recover. Thus, if real estate pricing reflects a sustained period of depressed urban apartment rents, we view that as a buying opportunity.

Real estate investors in the U.S. are also faced with a market selection call. This can be framed both in terms of some traditional dimensions and some unexpected ones. In the 2020 *ISA*, we highlighted the increasing attractiveness of what we called "secondary" markets. This has been reinforced during the pandemic. The so-called "primary" or "gateway" markets in the U.S. (e.g., Boston, New York City, Washington DC, Chicago, San Francisco, and Los Angeles) have underperformed in terms of

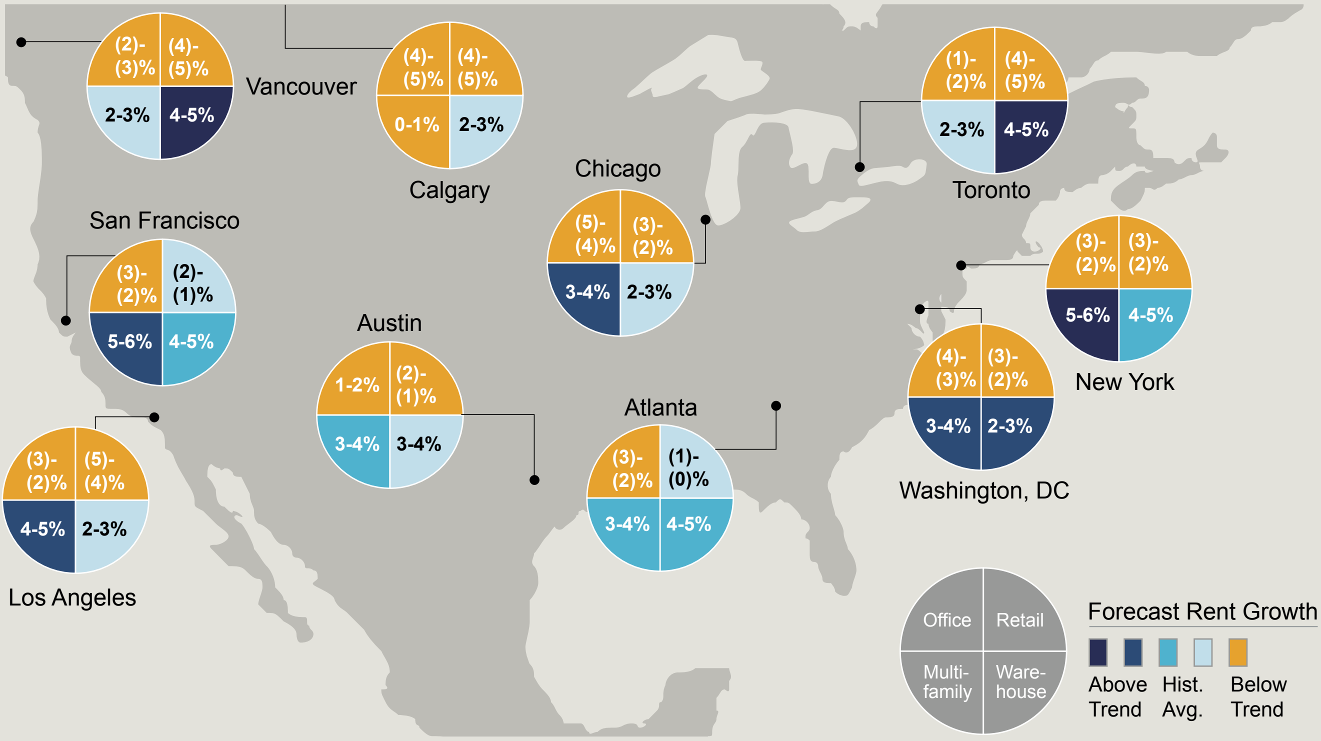
Migration Dynamics During Pandemic Favor Suburbs, but Shift Expected to be Temporary



	Pandemic Migration Impact	Post-Pandemic Outlook
Immigrants	Flow of new urban residents reduced.	Rebound in flow, with upside from immigration reform.
College Graduates Starting Careers	Closed offices and amenities leading some to move back home.	Rebound in urban migration when offices and amenities open again.
Young Families	Suburban migration accelerated as yards and more living space have greater appeal during pandemic.	Pandemic is pulling forward future demand but will not impact long-term flows.
Empty Nesters	Limited amenities remove reasons to move to cities.	Migration will resume, with lower costs for urban living a potential upside.

Source: LaSalle Investment Management.

North American Rent Growth, 2021–23
(THREE-YEAR AVERAGE)



Note: The color coding for each market is based on each market's/sector's historical rental growth performance. Light blue indicates that forecasted rental growth is in line with the historical long-term average, while above/below ratings substantially exceed/trail their historical averages. Retail consists of community and neighborhood centers. San Francisco warehouse is Oakland market; New York warehouse is Northern New Jersey market; and New York retail is Long Island market.

Sources: CBRE-EA, MPF Research, JLL, and LaSalle Market Tracking System as of 2020:Q3.

economic activity, real estate occupancy, rent growth, and returns. These markets are more urban, so part of their lackluster performance is due to the headwinds on urban areas discussed above. In addition, the regulatory burdens, climate risks, and growth challenges of the gateway markets are increasing. Investors favoring primary markets should consider shifting more activity toward markets with a stronger growth outlook and less regulatory and climate risk. Historically, investors have viewed stronger growth in Sunbelt markets as balanced by limited supply constraints. In 2021, the increased risks of regulations and higher costs of living in primary markets suggest a more balanced approach to these two market categories. The rent growth outlook for several of the primary markets and two of the higher growth Sunbelt markets (Austin and Atlanta) is shown in North American Rent Growth, 2021-23.

In Canada, the pandemic has thus far had a relatively equal negative impact on the economies and market fundamentals of Montreal, Ottawa, Toronto, and Vancouver. Calgary and Edmonton, however, are also being disproportionately impacted by sharply lower energy prices. A sharp increase in e-commerce purchases is boosting industrial demand and fueling the growth of necessity (food and drug) retail sales. Office demand in the near term remains questionable as an increasing number of tenants return space to the market directly or through subleases. However, eventual control of the pandemic will partially reverse this trend. Immigration, which had been a substantial driver of population growth and apartment demand by extension, is being sharply reduced by various travel restrictions. As a result, apartment fundamentals are weaker, but this is likely to quickly reverse as the pandemic wanes. Mis-pricing in this sector will create good acquisition opportunities in 2021–22.

A new lens to put on market selection in the post-COVID-19 era is industry mix. Tourism has been one of the hardest hit industries during the pandemic, which has disproportionately impacted specific U.S. markets (e.g., Orlando and Las Vegas). We expect these markets will experience a strong rebound when the pandemic is controlled. We saw in the initial reopening phase that people desperately want to travel, dine out, and broadly consume experiences. Until the pandemic is controlled, tourism-based economies will struggle severely, but in our view this is purely pandemic-driven and not secular.

The outlook for energy markets including Houston, Calgary, and Edmonton is clouded by sharply lower energy prices and reduced demand for oil and gas. Longer term, these markets are likely to somewhat recover as economic growth resumes and energy prices become more supportive of office demand. In the meantime, opportunistic plays are possible for best-in-class, well-located assets as these markets gradually reduce their economic dependence on energy and shift towards tech, life sciences, and other sectors to drive growth.

CAPITAL MARKETS SUPPORT REAL ESTATE INVESTMENT

The rapid and effective intervention of the U.S. Federal Reserve and Bank of Canada stabilized markets early in the pandemic. With capital remaining broadly available and credit flowing in the financial system, the ingredients for a strong rebound are readily available. In both the U.S. and Canada, interest rates dropped sharply in 2020 for both government and corporate bonds, which made the return available from real estate investments relatively more attractive to investors (see Real Estate Income Yield Spread to Corporate Bonds below). The stabilization of the financial markets also enabled lending to real estate to resume rather quickly, especially for properties where there is greater confidence in future cash flows.

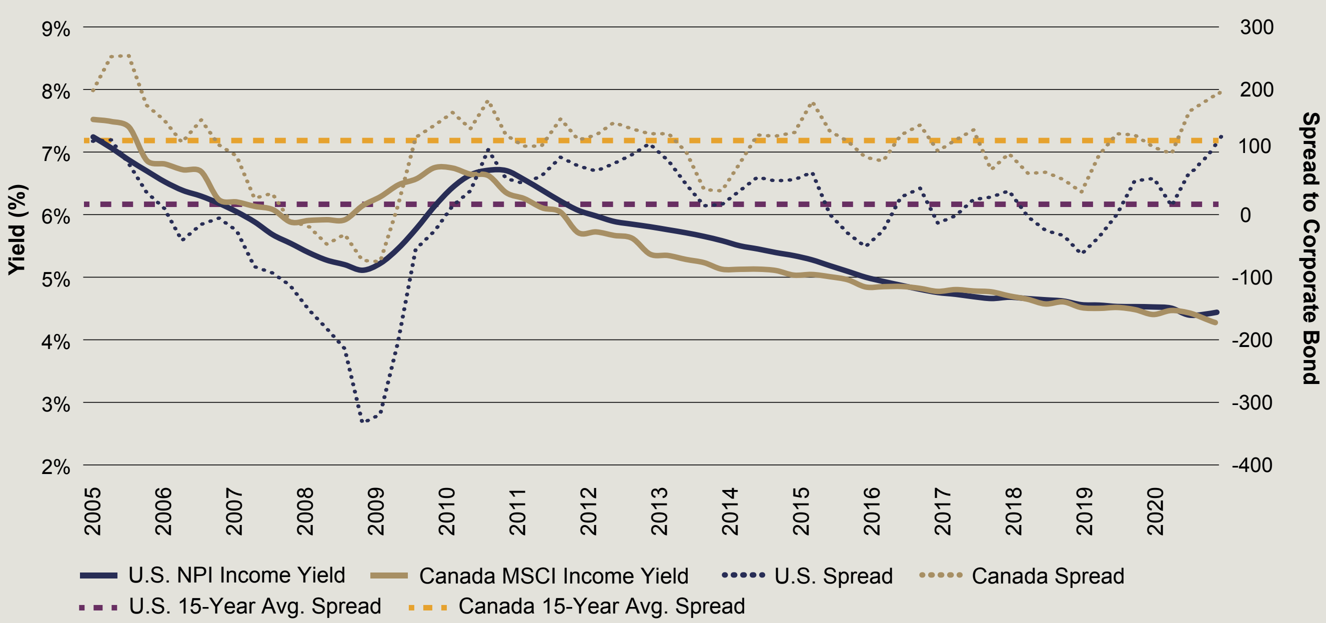
Despite healthy debt availability for real estate, there has been a rapid and significant decline in transaction volumes. Economic uncertainty and lack of visibility on pricing are the key contributing factors, in addition to the logistical challenges of conducting building tours and inspections during a pandemic. Some of these issues have been resolved, but remain a challenge relative to normal times.

Following the rapid shift in the economic outlook as the pandemic expanded, a process of price discovery was required in the private real estate market. This has been occurring slowly since the spring when shutdowns ended. While the public REIT market indicated sharp value declines, most private real estate owners rejected the public market pricing as not indicative of private real estate values. This has proven largely correct as segments of the market where trades have resumed support a view that private real estate values have been more stable and are potentially even higher. Following the positive news in November on the effectiveness of the first COVID-19 vaccine candidates, public REIT pricing further improved. Our expectation is that as market activity resumes, pricing will be closer to pre-pandemic levels than the initial, sharp declines in the public REIT market indicated.

Uncertainty about values is weighing on capital flows to real estate, but in 2021 and 2022 we think this will be resolved and we expect robust flows of equity capital to real estate. Real estate's relative value compared to other asset classes is strong due to the low interest rate environment, with low borrowing rates further boosting real estate returns even as pricing for some assets sets new records. This will attract new capital to real estate, particularly from high and ultra-high net worth investors. Domestic real estate investors with diversified portfolios are seeing value gains in their stock and bond portfolios,

Real Estate Income Yield Spread to Corporate Bonds is Wider Than Average in Canada and U.S.

INDICATIVE OF ATTRACTIVE REAL ESTATE VALUE RELATIVE TO OTHER ASSET CLASSES



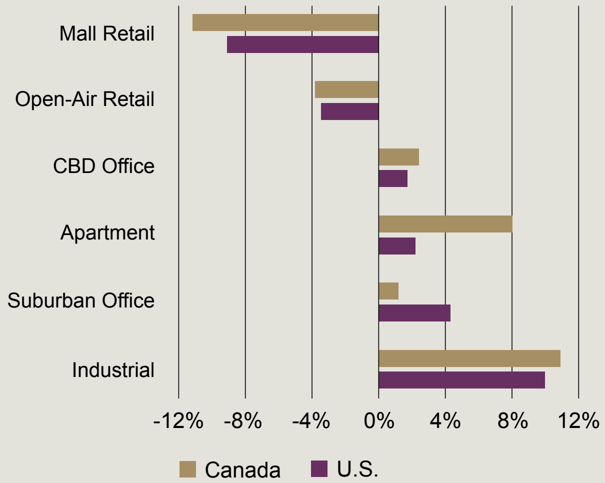
Sources: NCREIF, LaSalle Investment Management, Moody's Economy.com, Bloomberg, and MSCI Canada Property Index. Baa yields through December 2020. NCREIF and MSCI data through 2020:Q3.

prompting a need to shift capital to real estate to maintain allocation targets.

Real estate in the U.S. and Canada is also looking more attractive to foreign investors, especially to those hedging these investments as lower interest rates reduce hedging costs. Getting this capital invested, however, may have to wait until global travel resumes. The one mixed source of capital is the REIT market, where some sectors are at net asset value (NAV) discounts that give a signal to sell assets in the private market, while others are at NAV premiums, which is a signal to buy assets on the private market.

Wide Gap in Property Type Returns, with Industrial Leading and Retail Lagging

2020:Q3 Trailing-Year Unlevered Total Return by Property Type



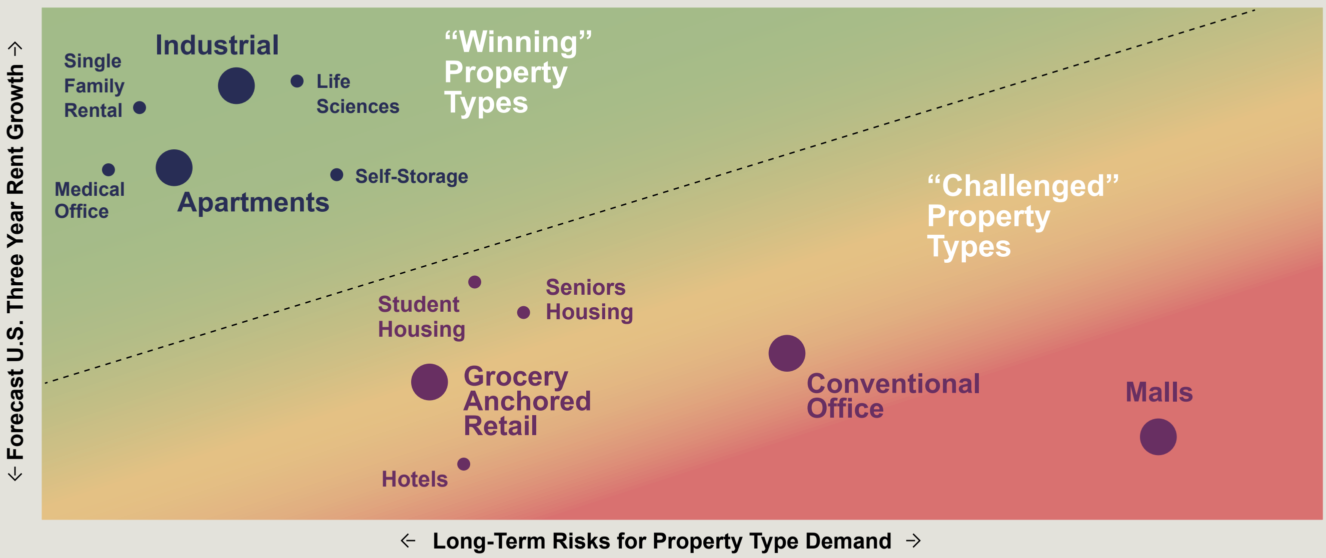
Source: LaSalle Investment Management. Data as of December 2020.

WINNING AND CHALLENGED PROPERTY TYPES

There are currently vast and perhaps even historically wide differences in fundamentals, pricing, and investor interest between real estate property types (see Wide Gap in Property Type Returns). This is underpinned by two competing market dynamics: historically low interest rates and an uncertain demand outlook due to both the pandemic and structural shifts. The low interest rate environment makes real estate income attractive relative to fixed income alternatives and lower borrowing rates, boosting leveraged income and returns given current capitalization rates and pricing. Historic spreads between corporate bond yields and real estate income yields are one data point indicative of this value.

The competing dynamic is the short-term and potential long-term headwinds for real estate demand during and after the pandemic (see Divide Between "Winning" and "Challenged" Property Types). While the interest rate dynamic impacts all property types, the demand challenges are playing out to different degrees for different property types, which is creating a large spread between property types. In the U.S., the "winners" include industrial, suburban apartments, and some specialty property types, such as medical office, life sciences real estate, and self-storage. In Canada, industrial has been the clear winner, followed by apartments, which have seen a modest weakening of fundamentals but are still preferred by investors who like their long-term stability. For these sectors, the short-term demand shift has been limited and there is confidence in the long-term income. Thus, investors are willing to put high values on those cash flows, sustaining and even boosting real estate values. While competition for stabilized assets continues to rise,

Divide Between "Winning" and "Challenged" Property Types Drives Performance, Investor Appetite, and Investment Strategy



Note: Traditional sectors shown in large font. Specialty sectors shown in smaller font.
Source: LaSalle Investment Management as of December 2020.

Illumina, San Diego, United States

the solid fundamentals outlook increases the appeal of value-creation strategies such as lease-up or development.

The “challenged” property types of retail, office, hotels, senior housing, and student housing are experiencing more severe short-term demand shocks and there are structural questions on long-term tenant demand. Consequently, investors lack confidence in the ability of these sectors to generate stable cash flow. This limits equity investor interest and as lenders share the same concerns, debt spreads are widening. These factors lead to depressed deal flow with most investors looking for discounts relative to pre-pandemic levels to take on the risk associated with long-term cash flows.

Individual assets in these challenged sectors do not always fit within the property type narrative. For example, long-term, single-tenant retail or office, especially with a credit tenant, can achieve strong pricing. Conversely, an urban apartment building with falling occupancy and declining rents may not generate investor interest. While aggressive values make sense for some assets, our view is that higher returns should be required from most assets in these challenged property types to compensate for the higher risks. These decisions are nuanced to specific property type and asset situations and are among the most important decisions investors will make in 2021.

Our outlook on office, retail, and industrial from a fundamentals perspective broadly matches with our views in The Future of... sidebars on pages 13–23. For industrial, ongoing new supply in 2021 will temper long-term rent growth, but demand tailwinds will maintain strong investor interest and sustain property level cash flows. For office, we see the demand headwinds as leading to an extended recovery.

REAL ESTATE RETURNS DISPARATE, WITH PRICING VARIED AND UNCERTAIN

An outlook on real estate returns for 2021–22 requires a clear view on fundamentals, capital needs, current pricing, and future pricing. This is extremely challenging in times of rapid change. And that challenge is increased by the wide dispersion in property type outlooks discussed above.

For the winning property types, new investment returns will trend lower. As this occurs, it will boost values for held properties and index returns. We expect the NPI and MSCI returns to include positive appreciation in 2021 and beyond as growing income and higher valuations improve property values. In some cases, these increases are happening fast, but there may still be some opportunities for investors to get ahead of them. For these property types, unleveraged, property-level new acquisition returns are moving below 6% to 5.5%. NPI and MSCI index returns, however, are expected to fall into the 6%-7% range in the coming years as this market move gets reflected in appraised values.

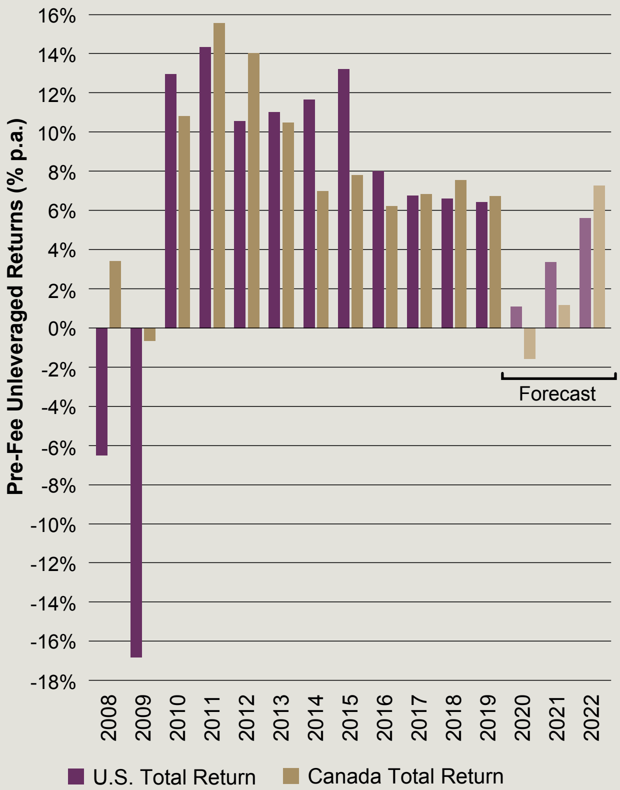
For the challenged property types, the dynamics are different as there is limited visibility on current pricing, so it is difficult to provide a new investment return. Our expectation is that these will be higher than the winning property types as investors conservatively underwrite and expect more return to compensate for the higher risk. For the two Indices, we expect both deteriorating fundamentals and higher capitalization rates to lead to continued negative appreciation. This leads to Index returns close to 0% in 2021 as negative appreciation offsets the income return; and in subsequent years, returns of 4%-5% as appreciation remains flat (see U.S. and Canada Total Returns Forecast to Recover Following 2020 on page 54).

Bringing together the outlook for the winning and challenged property types implies overall index returns of 3%-4% in 2021 before moving up to around 5%-6% in 2022–23. However, the dispersion in property type returns means specific portfolios are likely to show meaningful differences from the Indices based on property type and sub-property type allocations.

PANDEMIC IS THE DOMINANT, BUT NOT ONLY RISK FOR INVESTORS TO NAVIGATE

In an environment of elevated uncertainty, there are numerous risks. They start with the pandemic. The failure to contain the pandemic by mid-2021 will delay the timing of our recovery projections. In addition, the potential reimplementation of economic lockdowns amid the current rise in COVID-19 cases could lead to further economic damage (more permanent business closures, higher unemployment), and would extend the timeline for an economic recovery in the U.S. and Canada beyond 2021–22.

U.S. and Canada Total Returns Forecast to Recover Following 2020



Sources: NCREIF, MSCI, and LaSalle Investment Management. Data as of November 2020.

There are also tail risks around growing deficits or an economic recovery that could lead to higher interest rates and inflation. Higher interest rates in the next two years would be a major surprise, but economic outperformance could lead to higher interest rates than the market is pricing in 2023 and beyond. This would likely be associated with higher inflation and real estate can play an inflation hedging role in a multi-asset portfolio. In the U.S., risks around social and political cohesion will persist in 2021, while in Canada, the outlook for the energy sector is a key risk. There is a lower risk that relaxation in U.S. immigration policy could reduce immigration as a growth driver in Canada.

The largest real estate-specific risk is the outlook for office demand. The range of impacts that structural shifts could have on demand is remarkably wide. The assumption is more working from home will be a long-term headwind for office demand, but one that growth will be able to overcome in most markets in 5–10 years. However, the structural headwinds might lessen or be severe enough to lead to historically high vacancy rates for an extended period of time. This breaking one way or another would impact office returns and overall real estate returns.

Retail also presents a wide range of potential outcomes, but these hinge more on investor attitudes than demand. Even before the pandemic, investors were leery of retail. If this accelerates across a broader part of the retail sector, it would be a negative, but investors might also view the pandemic as a severe shake-out, and surviving assets might be viewed as long-term winners.

INVESTMENT RECOMMENDATIONS

The best real estate investment opportunities in the U.S. and Canada in our view are the winning property types with steady and even growing tenant demand (see North American Investment Recommendations: 2021 on page 55). In the warehouse sector, this is very broad, with a variety of attractive and stabilized physical formats (big box, multitenant, shallow bay). Stabilized warehouse assets with long-term income are attractive, but development and lease-up situations to create those kinds of assets are even more attractive.

Rental residential demand has held up well in some markets and locations in the U.S. and Canada, presenting opportunities to access stable income streams. In the U.S., there are emerging opportunities to access rental residential income in emerging physical and investment formats, such as single-family homes for rent, build-to-rent single-family subdivisions, and age-restricted/active-adult apartments. In both the U.S. and Canada, there are other specialty property types that fit this profile of steady tenant demand leading to stable cash flows, including self-storage, medical office, data centers, and life sciences. Across all these winning property types the demand outlook is positive and pricing is the investment challenge. Our view is that pricing is still attractive, especially relative to other asset classes and given low borrowing rates, which will help sustain investor interest despite record pricing (see U.S. and Canada Recommended Tilts Reflect Bias Toward Property Types with Stronger Fundamentals Outlook on page 55).

Opportunities in the challenged property types will come by finding deep value whenever asset pricing falls to a meaningful discount to pre-pandemic levels for fundamentally strong properties. The impact to fundamentals in office, retail, and some specialty property types like hotels and senior housing is material. Value adjustment is required for these sectors to present opportunities in 2021. With transaction volume limited in these sectors, it is difficult to determine whether the required value is available, but we expect more opportunity to emerge as highly leveraged owners start to experience pressure from lenders. Another potential opportunity is in the segments of these sectors with less cash flow impact but where values decline due to broader investor sentiment. This might include long-term leased offices and grocery-anchored retail.

North American Investment Recommendations: 2021

BEST OPPORTUNITIES LARGELY IN "WINNING" PROPERTY TYPES, WITH POTENTIAL INCOME OPPORTUNITIES IN SEGMENTS OF "CHALLENGED" SECTORS

LaSalle's Strategy Recommendations

Property Type	Core	Higher Return
Multifamily	U.S. and Canada: Durable suburban markets, off-price urban	U.S.: Development, single-family, and other residential alternatives Canada: Urban and suburban repositioning, build-to-core
Office	U.S. and Canada: Select long-term leased assets	U.S.: Deep value on strong assets Canada: Suburban renovation/lease-up
Retail	U.S.: Top STARS* centers with leading supermarkets Canada: Urban grocery-anchored, best-in-class super regionals	U.S.: Deep discount power and community centers Canada: Mispriced urban, repositioning (conversion, densifying, adding mixed use)
Warehouse	U.S.: Secondary markets with credit tenants Canada: Large bay warehouse/logistics	U.S. and Canada: Modern warehouse development Canada: Major market lease-up, Alberta recovery plays
Niche	U.S.: Medical office, self-storage, life sciences Canada: Data centers, self-storage, student housing	

■ Best Opportunities ■ Secondary Opportunities

*Supermarket Trade Area Ranking System. Proprietary LaSalle Investment Management ranking of more than 40,000 U.S. supermarket-anchored shopping centers.

Source: LaSalle Investment Management, as of December 2020.

U.S. and Canada Recommended Tilts Reflect Bias Toward Property Types with Stronger Fundamentals Outlook

Property Type	U.S. Core Tilt*	Canada Core Tilt*	Positives	Cautions
Apartment	↑	↑	Demand strong and asset-level cash flow stable.	Near-term fundamentals softening in urban locations and not clear that pricing has similarly adjusted.
Industrial	↑	↑	Strong demand and investor interest.	Pricing and long-term supply risk. Small bay at higher risk.
Office	↓	↓	Select assets offer stable income and potential for discounts.	Elevated risk associated with long-term demand outlook.
Retail	↓	↓	Grocery-anchored demand durable. Potential for mispricing.	High level of tenant defaults and over-supply of competitive spaces.
Niche	↑	↑	Good risk-return balance and under-represented in indices.	Pricing and operational skill set required.

■ Canada Only ■ Applies to Both Markets

Note: Tilts are recommendations on acquisitions at current market pricing for delivering outperformance over the next three to five years. They are relative to index weights.
Source: LaSalle Investment Management.