2021 ISA MID-YEAR UPDATE

CHAPTER 1

The Great Re-Opening

The re-opening of the world economy, the re-emergence of leasing activity, and a sharp upturn in capital market transactions have all brought a strong sense of optimism to real estate investors at the midway point in 2021. Listed real estate prices have rebounded and posted year-to-date returns higher than broader stock indices. Private equity real estate indices have also turned the corner, and first quarter performance has been strong after weaker third and fourth quarters in 2020.

All told, investors can breathe a sigh of relief. Rent collection has made nearly a full recovery. Values are reaching new highs in the favored sectors. Transaction activity in out-of-favor sectors is beginning to show solid support for values reasonably close to pre-pandemic

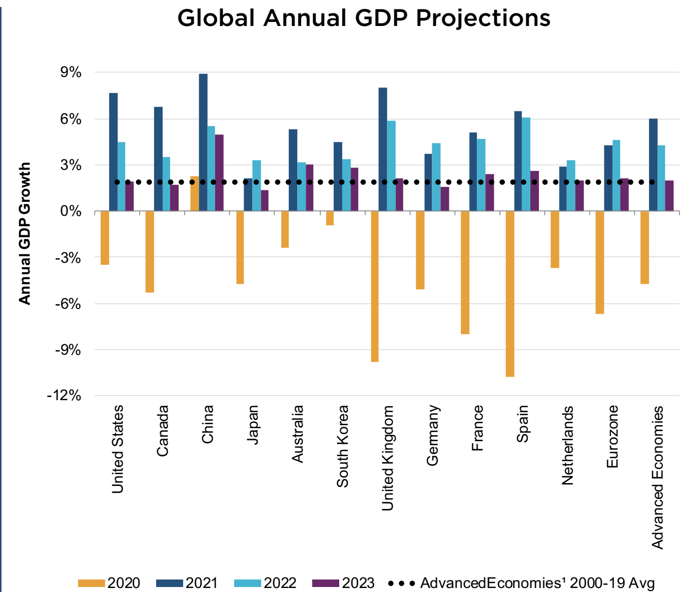
levels, provided that asset-level and market occupancy have both held up. This is an important caveat, given rapid upturns in market vacancy in several major office markets around the world, and for many Class B regional malls. Yet, with each month that passes, the likelihood of cratering benchmarks, as occurred after the Global Financial Crisis, appears to be more remote. Specific assets may have experienced sharp value drops, but the asset class has held up. In fact, the biggest challenge, once re-opening hurdles are overcome, is that so much capital is trying to find a home in real estate—in effect picking up the plot right where 2019 ended and 2020 began.

In our ISA 2021 report, issued in early December 2020, we foresaw surging demand for vacant space, a record amount of capital unleashed, and an acceleration of investor interest in "alternatives" once COVID was contained. All three of these predicted trends have kicked into gear, especially in countries where vaccine deployment has been high. Like people who survived the pandemic but continue to experience lingering symptoms, parts of the real estate universe are likely to suffer from "long-COVID". The early optimism of 2021 has been tempered by a start-stop pattern of re-opening. For every property sector with robust demand, there is another off-setting sector facing serious headwinds and even existential questions. Moreover, while pent-up demand is leading to rapid recovery of fundamentals, it is also (as expected) leading to higher inflation in many countries and expectations of higher interest rates. Finally, snags in the supply chain needed to get economies back to full recovery keep cropping up. The real estate construction industry is right in the middle of these bottlenecks in many countries.

01

Sharp Decline in 2020, Followed by Strong Recovery in 2021-22

Near-term growth rate forecasts well above the 20-year average



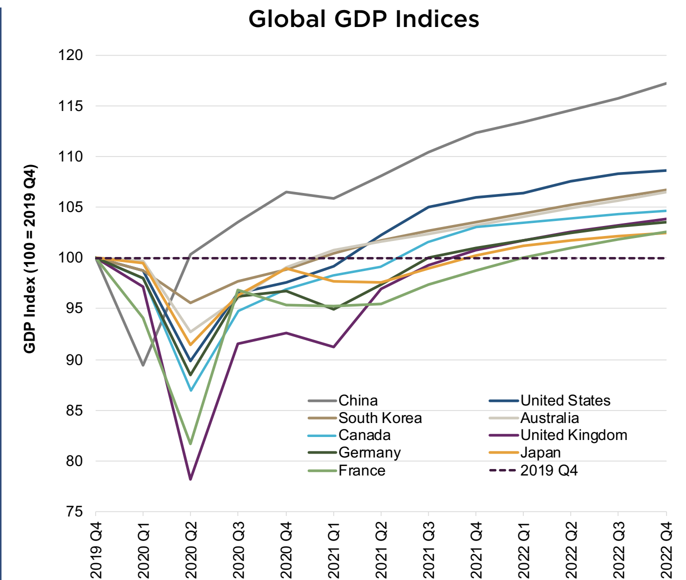
[1] Aggregation based on Oxford Economics country classification

Source: Oxford Economics Forecast as of June 2021.

02

Global Economy to Return to Pre-Pandemic Levels by 2022

China, S. Korea, Australia, and the U.S. have already replaced GDP lost during the pandemic

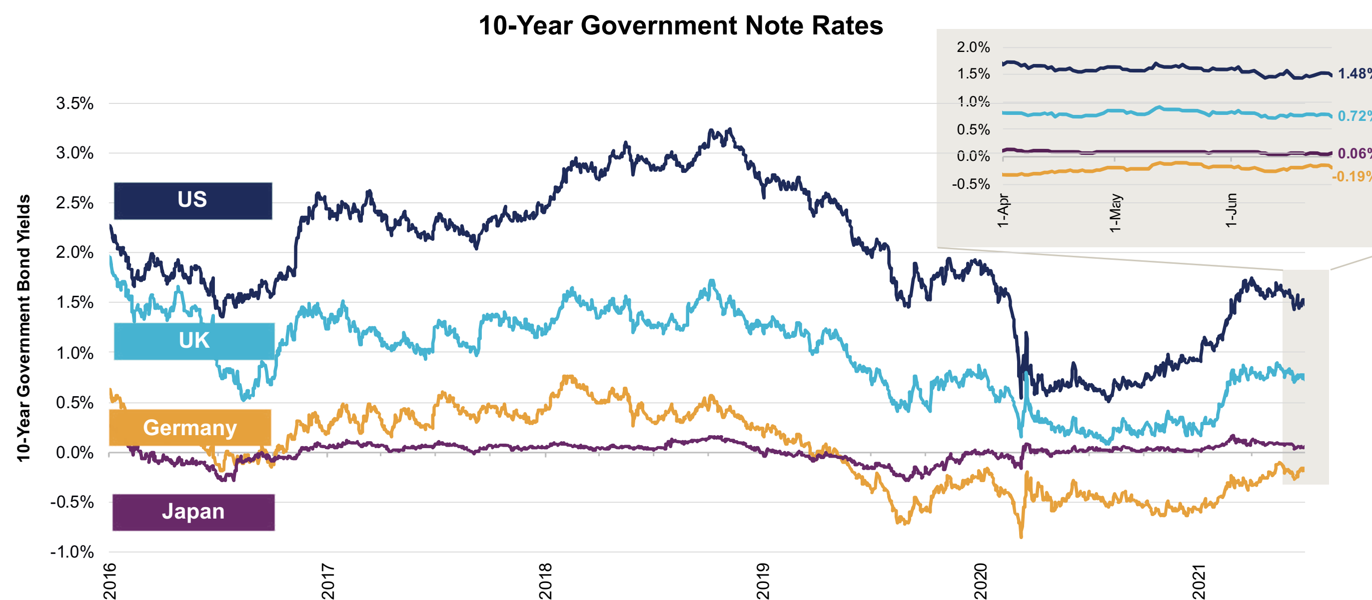


Source: Oxford Economics. History and forecast most recent as of June 2021

03

YTD 10Y Risk-Free Rates Are Up Across Major Economies

Rates are near or back to pre-pandemic levels



Source: Bloomberg, LaSalle. Data through 28 June 2021.

An Asynchronous Recovery

As shown above in figure 2, the backdrop for investing in the second half of the year includes some of the highest GDP growth rates seen in the last 70 years. The replacement of lost GDP shows that Asia Pacific's productive capacity is already exceeding 2019 levels by a considerable margin, while parts of Europe will not replace GDP lost during the pandemic until 2022 or 2023. North America will have replaced its lost GDP by the end of 2021. The diversity of recovery paths around the world have much to do with how each country handled COVID. Not shown in these forecasts, though, is the lingering uncertainty that 2020 COVID management experiences (either success or failure) will continue or be reversed as Phase II "Living with COVID" and Phase III "COVID contained" are likely to require very different skills. The countries that did the best in Phase II might find that without vaccines, they remain at risk.

Other macro-economic factors that exhibit a high degree of diversity around the world include inflation and interest rate trends. Although COVID hit all the major economies of the world at about the same time in 2020, the recovery is turning out to be anything but synchronous. Nowhere is this more evident than in the different approaches to stimulus spending and monetary policy management undertaken by the major economies of the world. The common feature is that stimulus spending is at an all-time high in both absolute terms and as a share of GDP in nearly all countries. Yet, the mix of stimulus programs varies greatly by country, and by region. For example, stimulus is at an historic high for EU, but the stimulus levels relative to GDP are much higher in Japan and the US. China is a notable exception. The CCP's 14th five-year plan, announced in March 2021, emphasizes self-sufficiency, innovation, technology and quality-of-life goals rather than massive stimulus spending to grow the economy or to achieve specific growth targets that dominated these 5-year plans in the past. In Western economies, Australia, Japan, South Korea, and Singapore, stimulus spending is being viewed as necessary to help repair damaged economies and to make up for drastically reduced international tourism and bottlenecks in other industries created by computer chip scarcity or shortages of dock workers.

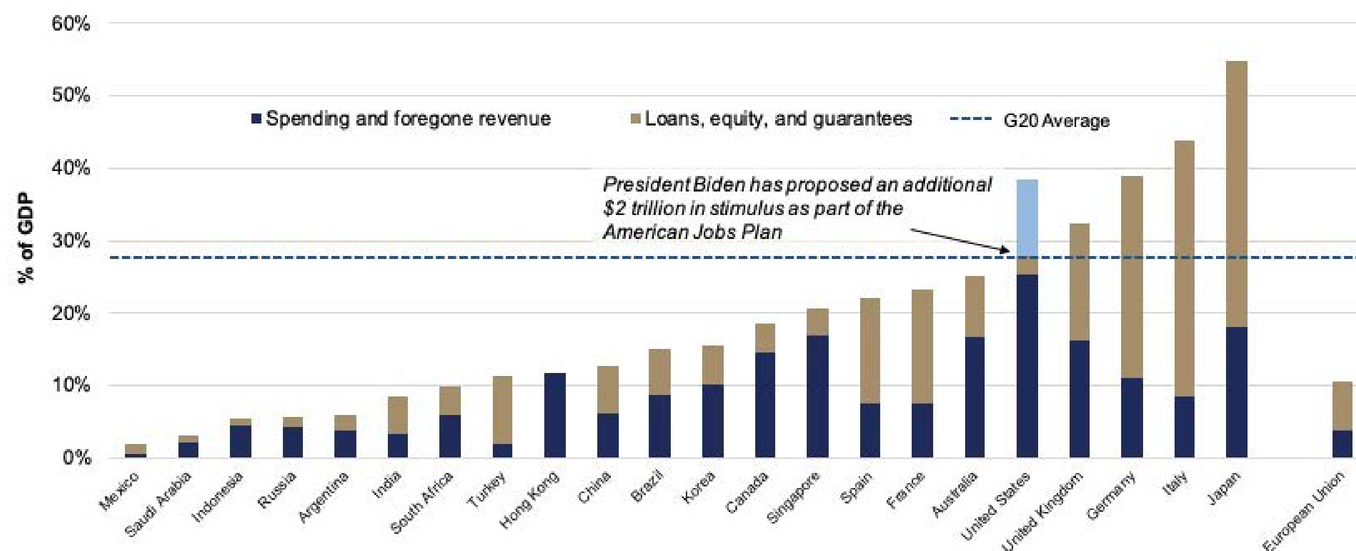
Greater diversity also shows up in terms of the rise of inflation and interest rates, which are literally all over the map. Countries like the U.S., the U.K., Canada, and Australia are facing rising energy prices, shortages of labor, and a combination of both cost-push and

04

Fiscal Stimulus Equal to 27% of G20 GDP

The highest Level since WW II

Source: IMF, LaSalle. Latest data available as of May 2021. IMF data available at https://www.imf.org/en/Publications/FM



demand-pull inflation. Other countries, like Japan and most of the EU, show few signs of broad inflation or rising interest rates, despite spikes in commodity prices or worker shortages. In sum, the diversity of national economic trends will be greater than usual for the remainder of the year, and so real estate markets will reflect this diversity.

In our firm's global seminar, we advised colleagues and clients to underwrite top-line net operating income aggressively in the next 18 months, but also to underwrite capital expenses conservatively. The re-opening of real estate will require extra spending to accommodate health precautions and changing tenant approaches to common areas, private spaces, and air circulation. Basic upgrades like signage, touchless sensors, and ventilation upgrades are also accompanied by an uptick of interest in ESG-related spending to make buildings more energy efficient, and in some cases, to start on the path to achieving net zero carbon goals.

The pandemic put a lot of direct investment programs on pause in 2020-21. Yet, asset owners and investment managers were not sitting idly by. Even with work-from-home and travel restrictions, a lot of new investment policies were developed or expanded. The rapid sorting of property types into "in favor" and "out of favor" sectors also led to portfolio re-evaluations across the industry. The striking importance of sector selection and thematic factors to drive portfolio performance was, for many, the biggest area of focus and analysis[1]. But, two other topics also consumed a lot of time and attention during the pandemic. First, there was a renewed focus on data analytics to improve both efficiency and performance, as well as a new-found need to track asset-level activity in buildings during COVID[2]. Second, ESG investment policies took center stage for many more asset owners.[3] Investors that had previously focused only on the "E" or "G" factors also added "Social" factors to their list of priorities. The pandemic opened conversations at many institutions about how all asset classes, including real estate, could make a positive contribution to society at large, and specifically in the communities where assets are located.

1 Homer Hoyt Institute Proceedings: http://hoytgroup.org/weimer-school-presentations/ "Macro Drivers and Thematic Investing" May 10, 2021

2 See LaSalle Macro Indicators for January-June, 2021. https://podcasts.apple.com/us/podcast/lasalles-may-2021-macro-indicators/id1482565181?i=1000519518796

3 "ESG ThemesTake Center Stage" April 2021, a joint effort by LaSalle Strategy & Research and the Global ESG team.

Challenges and Opportunities Ahead

COVID delivered a series of body blows to cities in 2020 and these setbacks continued in early 2021. The second half of 2021 will likely track euphoric re-opening in many cities alongside worrying, persistent outbreaks. Despite continued public health concerns, most of real estate's financial performance has been insulated by lease contracts, which kept income streams intact during the height of the pandemic. However, as lease terms expire, buildings will be exposed to either stronger (e.g. warehouses) or weaker (e.g. office) markets, relative to when legacy leases were originally secured.

The variability of these market conditions, and the different tenor of lease stacks in each building, make underwriting post-pandemic real estate challenging. The rise of alternatives that require specialized operating skills and the demands of tenants for more landlord services to support safe conditions inside buildings – these factors also add complexity. Finally, sthe debt markets have also grown more sophisticated and offer a wider variety of fixed and floating-rate debt, alongside senior, mezzanine, "stretch senior", and securitized debt products. Owners have more decisions to make on the level and type of debt that they want to use to enhance returns.

These higher levels of complexity offer more opportunities for the mispricing of assets. In other words, buyers and sellers in the second half of 2021 could be more likely than usual to take different views on what an asset will be worth several years from now when market volatility eases. As markets reopen and travel restrictions are lifted, we expect the September-December transaction season to be extremely active, with many more properties trading compared to a year earlier.

The next chapter summarizes our global views on the various property sectors in a continuation of our well-received "future of" sidebars in the 2021 ISA. We have added a "future of alternatives" section that covers a diverse collection of emerging property types, many of which require high levels of operational expertise (like data centers or senior care). The last chapter also expands on the rapid changes in portfolio construction topics that were propelled by the pandemic. Finally, we end with a short review of the importance of data analytics for real estate investors—a rapidly-evolving discipline that brings many new tools to portfolio managers and investors.

ESG Takes Center Stage

Real estate has been at the center of the Environment, Social, and Governance (ESG) investor movement for many years. Yet, industry-wide attention to these issues accelerated in the first half of 2021.

The ESG approach is based on the proposition that investors can improve the world for future generations without sacrificing financial returns. Research compiled by the LaSalle Research and Sustainability teams found strong evidence that positive financial outcomes and environmental benefits can be highly correlated. In other words, under the right conditions, improving a property's environmental credentials can be consistent with superior investment performance[4]. Since this study was completed, LaSalle has confirmed that a "green premium" is quantifiable in many markets. We also found that by taking active steps to improve a property's environmental credentials, we can improve the financial performance of an asset and capture this green premium. We have documented two types of financial benefits: 1) Improved Net Operating Income through expense savings fromenergy efficient lighting, heating, and cooling, often combined with an increased ability to attract and retain tenants with sustainable and healthy spaces. 2) Lower borrowing costs and lower cap rates apply to buildings with strong green credentials in many markets. Moreover, analysis suggests that more markets will see experience this type of "green premium" in the future.

Our April 2021 "ESG Themes Take Center Stage" described the ways that real estate investors can improve the "S" and "G" factors associated with a real estate portfolio as well as its "E" credentials. Our securities teams and indirect investing teams—LaSalle Investment Management-Securities (LIMS) and Global Partner Strategies (GPS)—have long recognized the importance of good governance and alignment of investor interests in their evaluations of companies that they invest in or partner with. Our direct private equity teams have also made sure that the governance of LaSalle-run vehicles meet or exceed the requirements of financial regulators and of clients' expectations.

In recent years, the "S" factors have risen to the fore, as LaSalle's DEI initiatives[5] have expanded beyond our own workforce to include criteria for our partners, vendors, tenants and all the parties who are part of the "supply chain" that is used to develop, manage and lease assets—extending even to the interns we hire and scholarships contributed to HBCUs[6]. LaSalle's emphasis on being a positive force in the communities where we invest was reinforced throughout the pandemic in our partnership with the American Red Cross. LaSalle's buildings hosted blood drives and vacant industrial spaces were used for PPE storage. Vacant spaces in buildings were used for blood drives and PPE storage. Outreach to COVID-vulnerable populations became part of how the firm approaches tenants, on-site management and communities that interact with the buildings in our portfolios. Although these "S" factors were important for the professional management of property at many firms prior to COVID, the industry's heightened awareness about contributing to local communities is likely to be a lasting benefit of the pandemic.

Close collaboration between LaSalle's ESG, Legal, Research, and Risk Management teams has led to several initiatives that improve the entire firm's awareness of the long term value of sustainable assets, as well as the potential impacts of climate risks—both physical risks and transitional/regulatory risks.

These efforts include:

- In-depth analysis of climate risk data and how to integrate this information with investment decisions and target market analysis.
- Commitments to three different Net Zero Carbon pledges aimed at reducing greenhouse gas emissions at properties we manage.
- Continued improvements in GRESB reporting and TCFD compliance to meet the expectations of clients and regulators.
- Participation and leadership in health and wellness asset management practices, as evidenced by earning WELL certifications at buildings we manage and the more than 150 buildings where we are pursuing the Well – Health and Safety ratings.

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4 Environmental Factors and Real Estate Demand (2017) https://www.lasalle.com/company/news/environmental-factors-drive-long-term-real-estate-demand-lasalle-finds

5 https://www.perenews.com/how-lasalle-is-building-a-more-diverse-recruitment-pipeline/

6 Historically Black Colleges and Universities

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Major Property Types

In the ISA released last December, we undertook a review of the major property types and how they are changing as a result of secular trends accelerated, in many cases, by COVID. We do not claim to have perfect foresight, nor do we yet have all the information needed to make definitive predictions.

However, the exercise of imagining the future of these real estate portfolio mainstays reveals insights that we and our colleagues find valuable. The global teams that worked together on these “future of” profiles update their work in the summaries that follow.

The Future of Office

The Future of Office analysis in the 2021 ISA concluded that investors should expect a slightly negative outlook for office demand and rents globally, but with significant differences across markets and an elevated level of uncertainty. This outcome was driven by the impact remote working will have on office demand, structured analysis on how that might play out, and acknowledgement that much remains unknown about employee and employer plans. At the mid-point of 2021, there might be more upside to demand than we expected, but the direction of travel remains the same. And while it is still early days in the recovery, our global relative outlook for office demand is playing out as expected.

The investment outlook for offices is driven by tenant leasing dynamics, which in turn are driven by employee behavior in terms of returning to the office and the rollout of new protocols for hybrid work. Significant uncertainty persists in many markets around the level of future office usage and how firms might become more efficient in their leasing of office space if employee usage of the office is reduced from prior norms. The improvement in the health situation in some markets has been accompanied by an incomplete return to the office, with the caveat of “so far”. There are still restrictions in many places on office capacity and how workers are permitted to circulate. It is hard to expect people to return to the office in full force when so many questions remain about the lingering and diverse health concerns of vulnerable populations. Some companies (including our own) have plans for the return to the office, but those plans are based on a full return in the months ahead, and are not effective immediately. LaSalle’s policy of re-affirming the office as the primary place for doing business and using the summer to “re-acquaint” with the office seems to be close to the norm, but is by no means a universal approach. Other firms are taking different approaches: some have endorsed more flexibility in remote working, some have taken the opportunity to mandate remote working to save on real estate costs, while others have emphasized that the workforce is expected to be back full time, barring any extenuating circumstances.

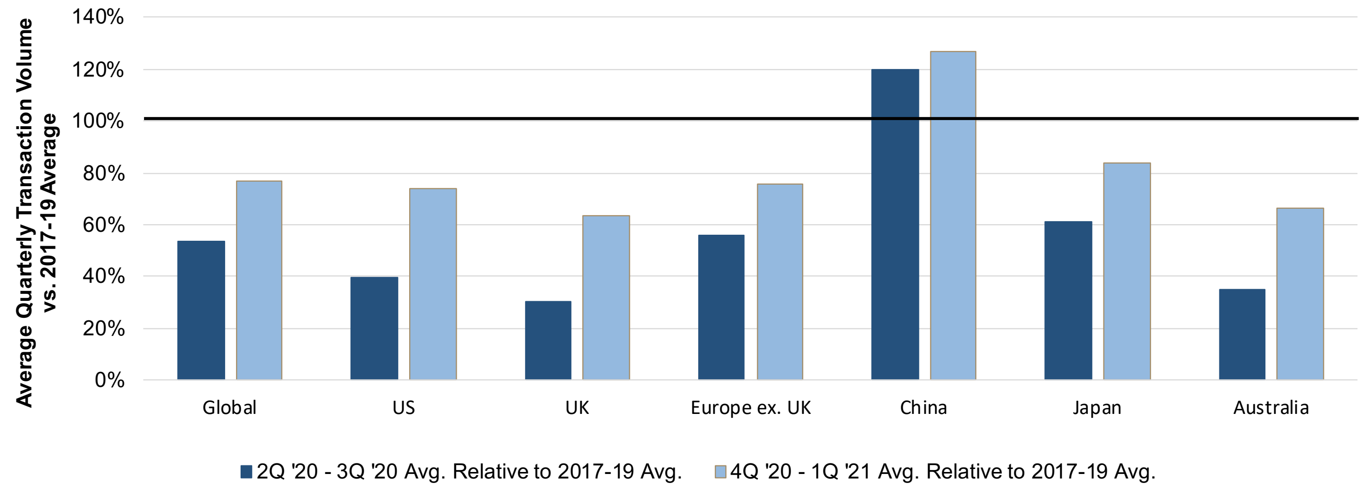
Two of the countries we thought would be more adversely impacted by the growth of remote working were the U.S. and U.K. The major markets there are also leaders in vaccinations in the first half of 2021. Nevertheless, neither country reverted to “normal” office conditions; and Google Workplace mobility data shows activity 25% below pre-pandemic levels. Some of the markets we expect to be more insulated from long-term remote working impacts are in Asia, and these markets saw less vaccinations and Google Workplace mobility data shows activity 14% below pre-pandemic levels. China is an exception, however, with office activity back to pre-Pandemic levels. This set of diverse responses supports our previous outlook, but it also reinforces a “wait and see” approach to a final outcome.

01

Global Office Transaction Volume

Transaction volume up in china, down elsewhere. Activity matches investor outlook globally

Source: LaSalle analysis of Real Capital Analytics (RCA). Data through 1Q 2021.



Transaction volume broadly tracks with our views on the market outlook. There is significant divergence in terms of how close to "normal" different markets are in transaction volume. Globally, office activity fell sharply in 2Q and 3Q relative to average quarterly volume from 2017-2019, but it started to recover in 4Q 2020 and 1Q 2021 even though overall it was at less than 80% of the pre-Pandemic norm. The strong performance and outlook that investors have for the Future of Office in China comes through clearly, with this being the only major market with transaction volume above pre-Pandemic norms. Japan and Europe also fell less than the global average, and in the recovery were above the global average. Falling below the average are the U.S., U.K., and Australia, which are all markets we identified as having higher risks of negative impacts from remote working. This analysis does not tell us what will happen, but it is a gauge on investor sentiment of what might happen, and largely matches with what we have been expecting.

Flexible office was a focus of our commentary on the office market a year ago, and this sector is largely playing out as expected. A severe downturn caused a shake-out of many co-working operators. But as the recovery starts to materialize, the early stages of a rebound in flexible office demand is what we expected. There were several co-working operators that could not withstand the financial stress of the pandemic, and several have either closed or been acquired by other operators and even brokerage firms. It is a surprise to us that WeWork appears to be among the survivors, which is due to a combination of leasing through SPE (Special Purpose Entities), allowing the parent company to walk away from many lease agreements; and being the "too big to fail" player in the space, with landlords willing to restructure leases or move to operator models to keep them as future tenants. Going forward, we still expect co-working to move away from the lease model and towards an operator model that will share risk and upside with landlords.

Looking ahead further, beyond either a complete or incomplete return to the office, we continue to see divergence in the investment outlook for office, with prospects much brighter for some offices than others. In Europe, higher-quality offices are viewed as well positioned to outperform and escape the structural headwinds. In the U.S., offices are expected to remain an underweight in core portfolios due to high capital costs and elevated volatility. In Asia, the overall more positive outlook and the depth of investor interest make office a continued sector of interest.

A final changing dynamic for offices globally that we will explore more in the coming months is the impact that increasing tenant and investor attention to ESG factors will have on office investment. Europe is leading the other regions in this regard, and the importance of ESG is one of the reasons for the strong tenant tilt towards modern offices.

Retail

The early and rapid response to the onset of COVID-19 in Asia Pacific combined with the more recent successful roll-out of vaccinations in North America and Europe have laid the groundwork for a strong rebound in retail sales. Pent-up demand for services, elevated savings rates, and increasingly mobile consumers are driving recent and still-to-come improvements.

Green shoots have already emerged in many countries, as non-essential retail has mostly re-opened to trade. Retail mobility indicators are currently running at 10-15% below pre-pandemic averages in most countries but are almost at parity in the U.S. and Asia Pacific.

Consumers in the U.S. have benefitted from strong government stimulus and a successful vaccination campaign, leading to a release of pent-up demand and a year-over-year surge in retail sales of 28% in May 2021, especially at restaurants and other service-oriented retail sales. The re-opening in Europe is currently led by the U.K., where a similar vaccine success story and a recent easing of lockdown restrictions generated a month-on-month increase in sales volumes of 9.2% in April 2021. The indirect economic benefits of the consumer boom will be seen during the second half of 2021 and into 2022.

In a reverse of the shift during the pandemic, physical retail will likely benefit from the spending boom to the detriment of online retail in the short term. The proportion of retail sales that is online in the U.K. peaked at 36% at the start of 2021 but has since fallen back slightly. Most other countries recorded online proportions far below this (10-20%), although China and South Korea were higher at 20-30%. Nevertheless, with more consumers using online channels for a wider range of services than before the pandemic, e-commerce penetration rates are higher than they would otherwise be had the pandemic not occurred.

Global comparisons of retail markets are fraught with complications, given the many different ways in which people shop due to reasons spanning population density, culture, weather, technology, the shape of the built environment, land costs, and regulatory factors. This diversity and fragmentation of retail, which manifests in part across a large number of different retail subtypes and property layouts, was a key theme of our 2021 ISA sidebar on the Future of Retail. Halfway through 2021, we check in on how our analysis across these many subtypes holds up.

Due in part to government-enforced closures and restrictions on mobility, large fashion-dominated shopping malls performed poorly during the pandemic. The ICSC estimates that U.S. occupancy rates have fallen by nearly 500 bps since the end of 2019. Prime rents have fallen by over 10% in Canada and up to 20% in Europe over the same period. Even as economies begin to re-open, the enclosed design of shopping malls continues to deter some shoppers whilst concerns over COVID transmission persist. Yet the format has held up slightly better in some countries, such as Canada and China. Indeed, with Chinese consumers unable to travel overseas, China has seen strong growth in demand for domestic fashion retail. Generally, grocery-anchored shopping malls in Europe and Asia and those

with a better balance between discretionary and non-discretionary goods have proved more resilient than apparel-led schemes.

High street retail units have also generally fared poorly during the pandemic, with the exception of local convenience shopping. However, they tend to be more accessible than shopping malls and have lower running costs, and have not undergone as sharp a decline in occupancy or rents. Fundamentals have been particularly weak in the U.K., U.S. and Hong Kong, and moderately stronger in Canada, Australia, Japan and much of Continental Europe. At the prime end of the market, high street stores are often tourist destinations and so they have suffered from a sharp drop in footfall. Densely populated cities with wealthier domestic consumers have seen their luxury retail markets hold up better. These locations should also see mild recoveries as social distancing measures are lifted, whilst tourist destinations may take longer to return to their pre-pandemic levels of footfall.

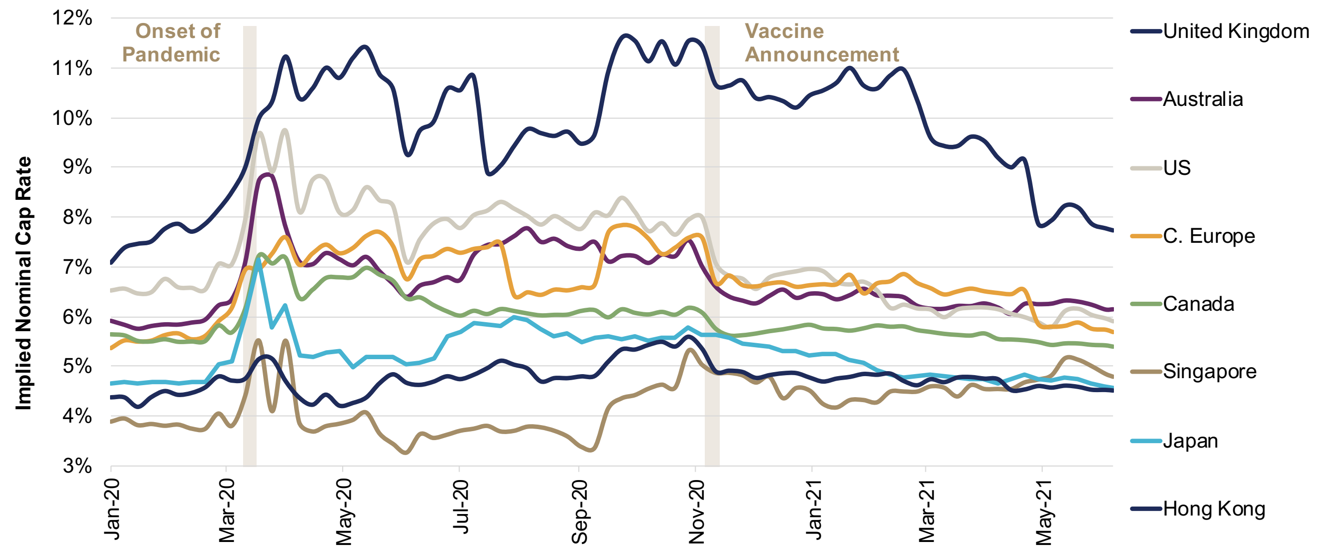
Retail parks and power centres (open-air centres in the U.S.) have proved to be among the most consistently resilient subtypes across Europe and North America during the pandemic. Their large, unenclosed format and higher concentration of necessity retailers has ensured that physical restrictions on shoppers were relaxed here sooner than for most other retail property types. That is not to suggest that open-air retail formats escaped unscathed. Open-air retail occupancy rates in the U.S. fell by 240 bps since late 2019 and rental declines have been observed in most countries. Exceptions to this are neighbourhood and community centres in the U.S., where rents are remaining relatively flat. They are now seeing a slowdown in the pace of tenant space surrendered in recent quarters. Demand for space in these centres has rebounded strongly. Expect vacancy to be re-leased quicker than other formats.

Around the world, the recent success of open-air formats has depended on the tenant mix, with those let to necessity, home goods or DIY amongst the best. As economies recover, higher return investors target this sector in search of both high income and the potential for yield compression. Those investors with a long-term view may prefer to hold the attractive income until a repurposing strategy becomes viable in the future. This was a focus of our ISA 2021 sidebar on the Future of Retail, and retail redevelopment activity appears to be accelerating in 2021.

01

Global Retail REIT Implied Cap Rates Compress from Pandemic Highs

Source: LaSalle Securities. Data through 8 June 2021.



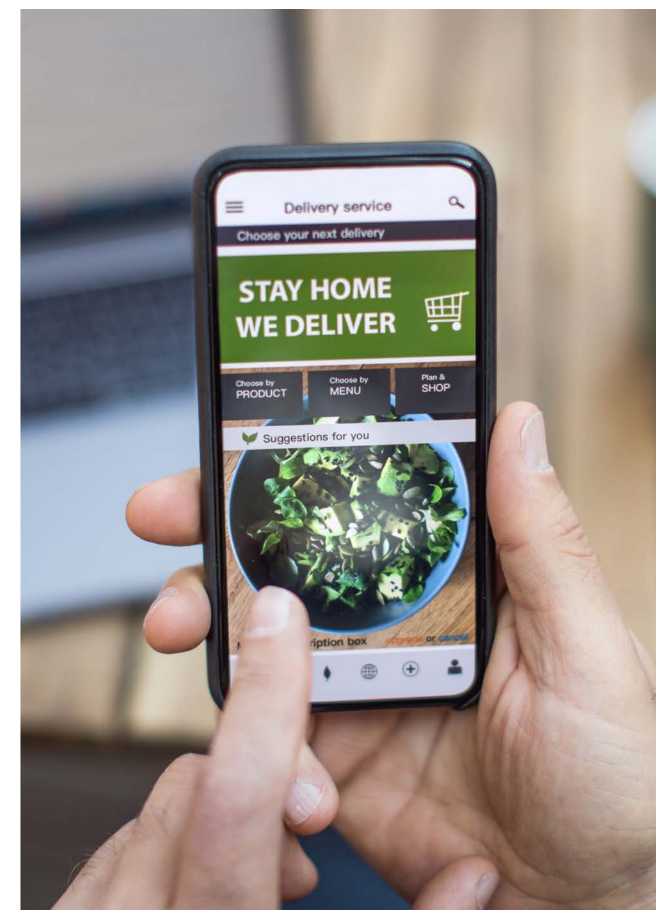
We see a mix of push and pull factors for core investors to consider retail assets

As the archetypal non-discretionary goods format, **supermarkets and other grocery-anchored assets** have outperformed since the onset of COVID-19. Many consumers embraced online food shopping, demand for which was met through a combination of the existing store and e-commerce logistics. Nonetheless, occupancy, sales, and rental rates generally held up better here than in any other store format. This has kept investors interested, particularly where strong covenants and, in some countries, long leases are available. Yet prices are generally similar or higher to pre-pandemic levels, which limits their performance upside potential.

Retail investment volumes are still very low, with ongoing travel restrictions compounding a pre pandemic risk-off attitude towards much of the sector in many countries. According to RCA, global transactions of retail assets were 60% below the 2015-19 quarterly average in Q1 2021. As a result, little evidence points to whether the recent improvement in the occupier fundamentals and the expectation of much more to come is being priced in by investors. Some evidence can be gleaned from the listed market. In the public markets, a very strong V-shaped recovery in the stock prices of shopping centre companies took place in the first quarter of the year. In 2021, the U.S. has led with malls (+57%) outpacing open-air shopping centers (+49%). Canadian shopping centers have also performed strongly (+33%). European retail landlords have lagged (+25%), but have caught up somewhat in the past quarter as vaccinations improve and restrictions ease. Implied cap rates from REITs moved in sharply around the time of the announcement of successful vaccination trials in November 2020. They fell from summer highs of 8% in North America and Europe to their current levels of slightly below 6%. Following a similar trend, implied cap rates in Asia Pacific fell from a high of just over 6% to 5%. Over the same period, discounts to gross asset value rose from c.-25% in Europe and Asia Pacific to between -5% and -10% more recently. North America, however, saw discounts turn into premia, rising rapidly from -20% to +7% in the space of nine months.

Whilst much of these swings can be explained by the inherent volatility of COVID shopping restrictions and the recent strength of the global equity markets, they nonetheless point to a turning point in investor sentiment towards the retail sector. For example, increasing activity from higher return cross-border investors is appearing in Europe. This is currently focussed on the U.K., where pricing for high-quality retail softened more than in any other market. Investors focus on the most resilient subsectors as outlined above; open-air retail parks and grocery-anchored schemes.

We see a mix of push and pull factors for core investors to consider retail assets. On the one hand, they will be pushed to invest in retail by record high values in the favoured residential and logistics sectors. The pull factors will focus on surviving, top-tier retail. These survivors can also thrive, as the inventory of under-performing retail is removed from the inventory and can earn a role in a long-term portfolio.



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Logistics

Review of Last Year's Predictions and Outline of Future Expectations

Warehouse sector trends we identified at the beginning of the pandemic are playing out as we anticipated:

- The sector, although not immune to the impact of the pandemic, remains a relative winner.
- E-commerce sales growth rates taper from peak levels as economies re-open, but penetration rates remain high because online shopping behaviour is sticky.
- The accelerated e-commerce sales growth has been the key contributor of robust demand for warehouse space during the pandemic.
- Although still an emerging sector, growth in online grocery sales boosted demand for temperature-controlled warehouses particularly in Asian markets, such as China and South Korea.
- The pandemic has accelerated the rising share of industrial transactions globally.

What surprised us to the upside?

- Despite high levels of supply, vacancy rates in several Asia Pacific markets continue to trend down, driven by strong demand.
- Some e-commerce tenants in North America are willing to pay top rents for spaces that meet their requirements, contributing to strong rent growth.
- In Europe, last mile and urban logistics continue to record strong rental growth.

E-commerce Growth Drives Warehouse Demand Across Regions

As we anticipated in the 2020 ISA Mid-Year Update, e-commerce sales growth rates have tapered from the exceptionally strong pace seen during Phase 1 of the pandemic "Lockdown", as many economies across the globe re-opened. Despite the normalization of online sales growth and some rebound in brick-and-mortar sales, e-commerce and online grocery penetration rates across most of the world remain higher than those of pre-pandemic levels .

E-commerce sales in Asia Pacific grew by 26% in 2020, a much faster pace than the annual average growth rate seen in the three years prior. As we predicted, consumers are more accustomed to online shopping now than before the pandemic. E-commerce platforms and 3PLs have been the key tenants in taking up additional warehouse space, including temperature-controlled warehouses, to meet the increase in delivery demand in the midst of the pandemic. Even brick-and-mortar retailers in Sydney and Shanghai took up additional space by the end 2020, as the pandemic conditions in these markets have been well managed. Greater Tokyo registered the most amount of logistics space take-ups during the pandemic among major logistics markets in the region, with Amazon and Rakuten being the top tenants in 2020.

Accelerated e-commerce growth rates also contributed to strong warehouse demand in North America. E-commerce sales in the US grew by 32% in 2020

and a whopping 78% in Canada, as stay-at-home orders and brick-and-mortar retail closures pushed consumers to online shopping. This rapid growth drove demand for warehouse space among companies within the e-commerce industry such as 3PLs. In the US, for example, e-commerce leasing surged in 2020, and accounted for 35% of total leasing volume. This was up from 15% in the prior year. E-commerce driven demand surpassed logistics and distribution driven demand, which has historically outpaced both e-commerce and traditional retailer users. Between January 2020 and June 2020, e-commerce penetration reached 13.5% in US and 6.3% in Canada, both up over 250 basis points from their 2019's levels.

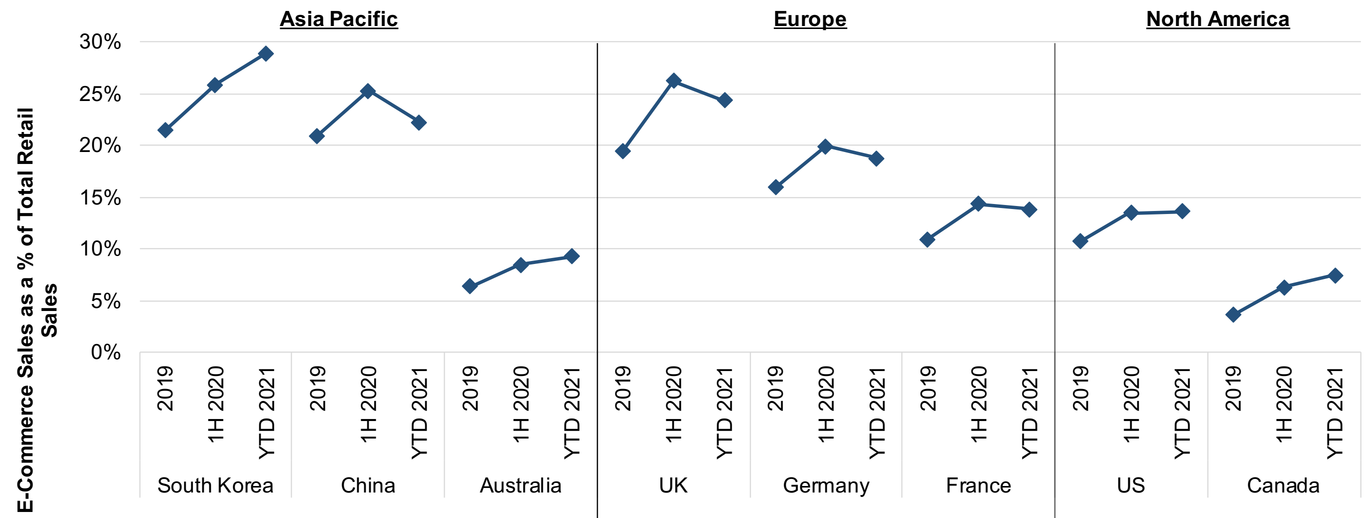
In Europe, the accelerated growth in e-commerce has also been a key reason for the success of the logistics

01

Pandemic Accelerates Global E-Commerce Penetration

YTD Online sales share moderates in some markets but remains elevated vs 2019

Source: The US Census Bureau, Statistics Canada, Statista (France and Germany), the Australia Bureau of Statistics, the National Bureau of Statistics of China, Statistics Korea, and the Office for National Statistics of UK. Year-to-date data through April 2021 for South Korea, China, Australia, and UK, data through March 2021 for Germany, France, US, and Canada.



sector. In 2020, 20% of European logistics take-up was driven by e-commerce users, the highest on record. Compared to more mature markets like the UK, the e-commerce share in most Eurozone countries is still far less pronounced. Over the next three years, European e-commerce revenues are expected to grow by 19%, translating into additional e-commerce demand of 6% of the current stock along. As a result, logistics demand is projected to remain strong driven not only by e-commerce growth but also nearshoring prospects and stock buffering.

Online Grocery Sale Trends and Cold Storage Demand

While a similar trend was also observed in online grocery sales, the relatively low online grocery sales penetration suggests that there is more room to grow in most Asia Pacific countries and in North America. In Asia Pacific, South Korea and China are two most mature online grocery markets where online grocery sales have been driving growing demand for temperature-controlled warehouses. Take South Korea as an example – online grocery sales grew by 79% y-o-y at the peak of the pandemic. Although the pace of online grocery sales growth has tapered since the end of 2020, South Korea continued to register the highest growth rate in the region (at 35% y-o-y) . In South Korea, major online grocery delivery players such as Kurly, Coupang, and SSG.com, took up additional temperature-controlled warehouse space to strengthen their overnight and night-time delivery capacity amid the growing demand for online grocery deliveries during the pandemic. Tenants of temperature-controlled warehouses tend to sign longer leases than dry warehouses, with typical lease terms of 5 or 10 years in Asia, partly because they usually need to invest in mechanical and electrical systems (M&Es) for temperature control. We continue to favor temperature-controlled warehouse for both development and core strategies in Asia Pacific, particularly in South Korea and China, going forward. In North America and Europe, online grocery sales make up a smaller share of total online sales than in South Korea. In the US, online grocery sales grew 54% in 2020 but made up only 12% of total e-commerce sales. As a result, temperature-controlled warehouse is still an emerging sector in most part of North America and Europe, despite the rapid growth in 2020.

Supply-Demand and Rent Dynamics

In Asia Pacific, pipeline projects that were projected to be delivered in 2020 in Shanghai, Greater Tokyo and Greater Sydney were largely completed by the end

of 2020, although with a few months of delay due to the shock of the pandemic. In Greater Seoul, Greater Tokyo, and Sydney, robust occupier demand exceeded new supply by the end of 2020, driving vacancy rates to be lower than their pre-pandemic levels. Shanghai was an exception among major markets in Asia Pacific, but consistent with North American trends. Despite strong demand supported by e-commerce-related tenants, new supply in 2020 exceeded net absorption and drove the overall market vacancy rates to be above the pandemic levels. Vacancy rates have since fallen in US and Canada and as of Q1 2021, are currently below early 2020 levels. Nonetheless these supply-demand dynamics highlight the importance of location selection when evaluating investment opportunities.

In Europe, the logistics sector has been the stand-out sector for occupier fundamentals in 2020. Despite the Covid-19 pandemic disrupting supply chains and global demand, European logistics take-up reached peak levels in 2020. Vacancy rates are very low in a historic context at 4.9% on average. Differences between individual countries are evident. Germany for example combines a low vacancy rate of 3% with limited supply prospects. At the end of 2020, 4.6 mil sqm of space were under construction, of which only 9% of the space was speculative. In other markets risks of oversupply may arise, where demand is saturated. At 4.8% and 5.8% respectively, the vacancy rate in the Netherlands and Spain remains below the historic average, but speculative investment is picking up. In the Dutch market it accounts for 40% of the current pipeline for example.

Nonetheless, the logistics sector is not immune to the impact of the pandemic. Rent growth in most Asia Pacific markets slowed from the continuing record-high pace during three to four years prior to the pandemic. The rent growth deceleration in 2020 was in part due to tenants' being cost conscious or reluctant to pay for the historically high rents amid the global recession. With that said, logistics rental growth continues to outperform other sectors in most Asia Pacific markets. In North America rent growth remained strong despite supply outpacing demand in 2020 because availability rates in the US and Canada are at record lows, and these tight market conditions are pushing rents higher. Another factor driving the strong rent growth is e-commerce tenants who are proving to be not very price sensitive and willing to pay top of market rents for space that fit their needs best. In Europe over the past three years, the strong demand-supply dynamic has led to low availability and increasing rents for urban logistics assets in many markets and rents have risen by almost 8% on average, urban assets have even grown by 13%. Last mile and urban logistics having proximity to customers and business partners can reduce transport costs and consequently demand higher rents. This is particularly true of urban logistics in London, which has much more severe supply constraints and so is recording exceptional rates of rental growth.

Near-term Outlook

We expect the logistics sector to continue to be a relative winner in the next few years, as demand continues to be supported by the continuing growth of e-commerce sales albeit at a slower pace. Nevertheless, as economies re-open and demand begins to experience a more broad-based recovery, we begin to see slight divergence on occupier fundamentals. The demand-supply dynamics in each market is increasingly important to monitor.

The strength of the occupier fundamentals is reflected in the weight of capital. Despite of the pandemic and the limitation on cross-border travel, private equity and institutional investors continue to drive investments in the sector across the globe. The global industrial transaction volume increased from 10.3% of the total global real estate transaction volume before the pandemic to 12.2% in 2020, and further increased to 14.1% in Q1 2021. The rising share of industrial transaction activity has primarily been at the expense of the retail sector. We find a similar trend on the amount of funds raised for warehouse sector-specific strategies. The robust investor demand for warehouse facilities across the globe in recent years has been boosted by the pandemic, and is expected to expand the investible universe of the industrial sector in years to come. The ongoing sector shift in transaction and fundraising activities is likely to drive investors, particularly asset allocators, to broaden their real estate portfolios for warehouse assets to future-proof their portfolios.

In Europe, the logistics sector has been the stand-out sector for occupier fundamentals in 2020

LaSalle

Residential

Dynamic Capital Markets, Costs, and Government Policy

In Chapter 1 of the 2021 ISA, we highlighted three globally-applicable residential themes:

- Institutional Under-allocation to Residential
- Expansion into New Niches
- Changing Investor (and Tenant) Perceptions

Two quarters later, these themes continue to exert a powerful influence on capital markets and residential investment performance. And they have been accompanied by significant changes in construction material costs and housing policies.

Capital Markets & Performance

Residential comprised a larger share of transaction activity in major markets during the first half of 2021, as many sought to increase their allocation to the property type. In Europe, residential sector liquidity is rising; volume has doubled over the last five years. In 2020, €58.2 billion was transacted, representing a quarter of all real estate transactions in Europe. Equally, the stock of European institutionally invested and managed residential has doubled since 2010, accounting for 18% of the total investable universe. In China, more investors are also targeting residential investments, with the Shanghai market recently recording a large multifamily investment by an overseas property fund. And in the US, apartments accounted for 44% of 2021 volume year-to-date, compared to a 20-year average of 30%.

The weight of capital is reflected in residential's rising share of activity, which, combined with resilient fundamentals, has led to upward pressure on residential values. U.S. suburban apartment cap rates have declined by 50 basis points or more over the past year. Yield compression in European cities over the same period ranged between 10 and 30 basis points, which is a strong result given that no material outward cap rate movement was recorded in the depths of the pandemic.

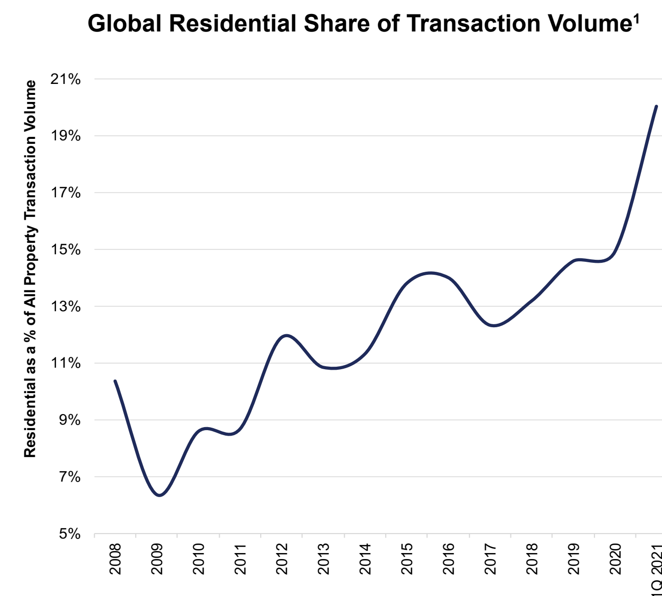
At the same time, the pandemic created large performance differences between residential subtypes, notably urban and suburban apartments in the U.S. and an international pause on the development of co-living strategies. In the early months of 2021, U.S. urban apartment markets reached an inflection point and began to improve, while suburban markets continued to strengthen. Globally, markets with tighter regulation of rent levels have also seen major performance divergences, with more regulated markets weathering the pandemic with much less volatility. More on these key market shifts is covered in the Regional Outlook section of this Mid-Year Update.

01

Global Residential Share of Transaction Volume Rising

[1] All property types include Office, Industrial, Retail, Apartment, Hotel, Land, Senior Housing & Care.

Source: LaSalle analysis of Real Capital Analytics (RCA) data to Q1 2021.



02

Residential Returns Exceeded or Matched Overall Returns in Most Markets During the Pandemic

[1] Trailing four quarter total returns through 1Q 2021 for US, UK, Netherlands, and Canada. 2020 annual total returns for Japan, France, and Germany.

Source: US NCREIF, MSCI. Data latest available as of June 2021.

03

Rising Construction Materials Costs

Source: WIND, Bloomberg. Data to 26 May 2021..

Expansion Into New Niches

The residential sector, collectively the largest form of global real estate, takes many shapes and forms – and many of the niches within the sector around the world are quite early in the process of institutionalization. The U.S. Single Family Rental (SFR) market saw record 98% occupancy rates and 6% rent growth in early 2021, a strong performance which continued to drive investor interest in the sector. Consistent with LaSalle's "Going Mainstream" framework, SFR pricing is converging with core apartments. LaSalle has been actively investing in U.S. SFR during 2021.

By comparison, the SFR sector in Europe is very much in its infancy, largely because the region mostly avoided the mass foreclosure wave that helped early U.S. platforms quickly gain scale in the wake of the Global Financial Crisis. SFR investors in Europe, and especially the U.K., have started to grow quickly, but have had to skip over standing stock and go directly to the single family 'Build-to-Rent' model. Investor interest in other residential subsectors continues to strengthen and broaden across Europe. Rented Senior Living remains a small part of the housing market in absolute terms, but is strongly supported by positive demographics, limited supply and investor appetite for resilient income.

Rising Construction Costs

Costs for building materials have risen surprisingly quickly in 2021 across major markets. Steel and lumber are two of the most notable examples, but above-inflation increases have also occurred for everything from concrete to flooring and appliances. Surging demand in 2021 from both builders and DIY-ers, on top of constrained capacity during the pandemic, has proved a perfect storm for pushing materials prices higher.

This has in turn put upward pressure on development budgets. In the U.S., the recent downward shift in apartment cap rates has helped offset construction price increases, but this risk has underlined the need for careful underwriting and generous budget contingencies. In China, while steel prices are up sharply, more stable cement and labor costs have made overall increases manageable.

Government Policy Changes

The first half of 2021 saw several policy developments, notably in China and Germany, with potentially far-reaching implications for housing markets. In the 14th Five Year Plan, the Chinese government set a goal to provide full recognition of renters, who have long been denied the access to some essential public services, such as enrolling their kids in local public schools. The improving policy support for renters is expected to boost multifamily tenant demand.

Germany's recently introduced CO2 tax may burden owners of older residential properties with increased Capex to meet stricter energy efficiency standards. Although the tax is currently paid by tenants, futureproofing of existing residential stock will be required to maintain occupancy and is unlikely to be accretive to values or passed on to tenants via higher rents, owing to national rent regulations. Green Street Advisors estimates that costs could be in the range of €475-€525/sqm, which would equate to roughly 30% of capital values nationally. Whilst the legislation is currently limited to Germany, the EU and U.K. both have ambitious CO2 reduction targets, creating a material risk of similar taxes being introduced elsewhere. At the same time, limits to regulatory control were established when German courts ruled that Berlin's Mietendeckel (rent cap) was unconstitutional. During COVID, many countries acknowledged that landlords were put at risk as much as tenants by rent deferral or abatement programs. This led to a more balanced approach that meant asset owners as well as renters received temporary subsidies.

Residential markets, thanks to their combination of size and higher frequency of leasing, are an excellent barometer for economic reopening. As we look ahead to the 2022 ISA, we look forward to examining how the residential green shoots of 1H 2021 have matured.

LaSalle

Alternatives Going Mainstream

A Retrospective and Prospective View

In February 2016, LaSalle released a paper, "Going Mainstream: Niche Property Types and Their Path to Market Acceptance", outlining our model for how non-traditional sectors move along a path toward maturation and earn their way into institutional real estate portfolios.

Five years on, even our bullish predictions have been exceeded, with numerous niche sectors making great progress toward maturity, including several newer property types that were barely on investors' radar screens at the time.

The pandemic has accelerated this mainstreaming process. Sectors such as single-family residential and data centres, seen to be beneficiaries of the impacts of COVID-19, have thrived during the crisis; strong occupier demand has prompted a deepening and broadening of investor interest in them. Even property types which suffered obvious, deeply negative impacts early in the pandemic, such as senior housing and student accommodation, have demonstrated resilience by outperforming initial expectations of lasting impairment. Investors have also been pushed toward niche sectors by structural concerns about the future of office and retail real estate.

"Going Mainstream" Goes Global

Notably, the continued maturation of niche sectors has not been primarily a U.S. story, but has played out in all the geographies where LaSalle invests. Indeed, our Going Mainstream framework has been, from its beginning, designed to be relevant globally. But to apply it on a global basis requires awareness that what is considered "mainstream"—and thus what is not—varies across the world. In the U.S., niche sectors traditionally comprised anything other than America's "four food groups" of office, retail, industrial, and apartments, encompassing property types such as self-storage, medical office, student housing, life sciences, and various others. There has also been growing acceptance of sub-sectors of more mainstream property types, such as co-living within residential, and cold logistics within industrial.

But in Europe and Asia-Pacific, we have found our Going Mainstream framework to be just as pertinent to sectors that are fully institutional in the U.S., but happen to be less so locally. For example, LaSalle has been an early participant in the mainstreaming of once highly immature sectors such as U.K. rented residential, and China and South Korean logistics real estate. Today we are actively investing in the growth

of currently emerging sectors or sub-sectors, such as European self-storage, South Korean cold logistics, and life sciences real estate.

Blurring Lines

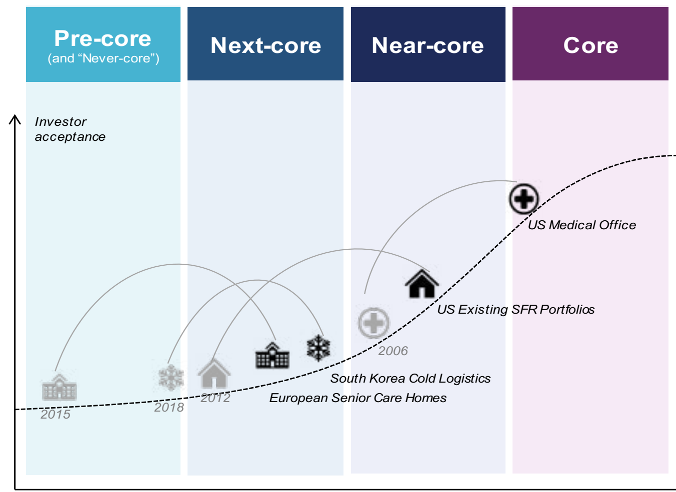
One indication of how far the various sectors have come is increasing confusion about how exactly they should be labelled. Widely used terms such as "specialty", "non-traditional", "alternative", and "niche" (LaSalle's preferred moniker) all conjure an image of small, specialised markets set apart by their quirkiness as set against traditional real estate. But this is, to a large extent, an outdated perception. Indeed, sectors other than the "four food groups" now make up more

01

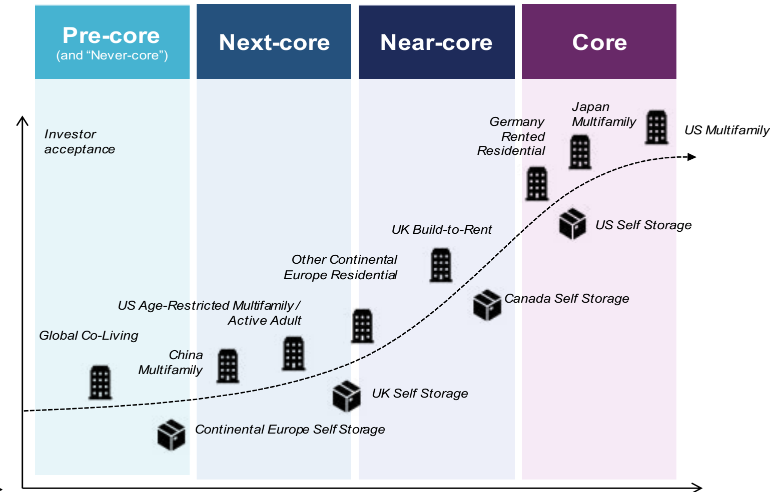
Many Emerging Sectors Make Big Gains in Maturity

Sectors that are mature in some markets are still emerging in others; sub-sectors often at different stages

Rapid Leaps in Acceptance



Diversity of Acceptance around the World



Source: LaSalle. As of June 2021.

than half of the US REIT index. At the same time, traditional sectors such as offices are seeing lease lengths shorten as the landlord's value proposition morphs toward "space as a service".

The supposedly mainstream sectors are thus taking on more of the operationally intensive characteristics that were historically associated with niche asset types, blurring lines between mainstream and niche property types. While some have used the term "operational real estate" as if it were a synonym for specialty sectors, LaSalle's view is that operational intensiveness is not necessarily a characteristic inherent to an investment in a specific property type.

Investors are increasingly able to mix-and-match a broad range of sectors with a similarly wide spectrum of operational intensiveness. For example, it is entirely possible to invest in niche sector assets in a "long income" format, with long duration, triple-net leases to capable operators insulating the investor from the ups and downs of day-to-day operations. This is an especially interesting strategy in the U.K. and Continental Europe, where healthy yield premia are available over conventional types of long-let property. At the same time, some types of assets once considered conventional have become more operational than some niche sectors. For example, sustaining a successful retail scheme today can require active curation of complimentary brands and experiences, with lease duration taking a backseat to the duration over which a given fashion or food concept is fashionable.

Portfolio implications

The continued maturation of niche sectors globally, along with the blurring of lines between niche and conventional sectors, will continue to reshape real estate portfolio construction in the years ahead. Investors will have to balance allocations among a larger number of sectors than previously, adding complexity to an already difficult process. Unfortunately, investors are not yet fully supported in doing so with transparent data; benchmarks still have a long way to go in tracking the performance of niche sectors, particularly outside of the US REIT market. And finally, investors will have to consider their preferred balance of real estate that is operationally-intensive versus less-operational complex, along with the traditional question of property type allocations.

To be successful, the impact of adding specialized sectors must be accretive to financial performance. The chances of achieving this goal are improved by understanding every step in the "going mainstream" process. One of the lessons learned in five years of observing this process unfold is the important role that investors themselves play. Within the institutional investment community, information travels fast. Market acceptance of a specialty sector happens quickly when financial transparency occurs and sheds light on formerly opaque cash flows.

LaSalle

The European Macro Context

From “Photo Finish” Race to Pentathlon

Tracking which European countries are ahead and which are behind in the race to the end of the COVID-19 pandemic has been like watching well-matched runners compete in a marathon. Each contender employs different strategies at different points of the race, and experiences unique spells of good and bad luck, resulting in a constantly-changing leader board.

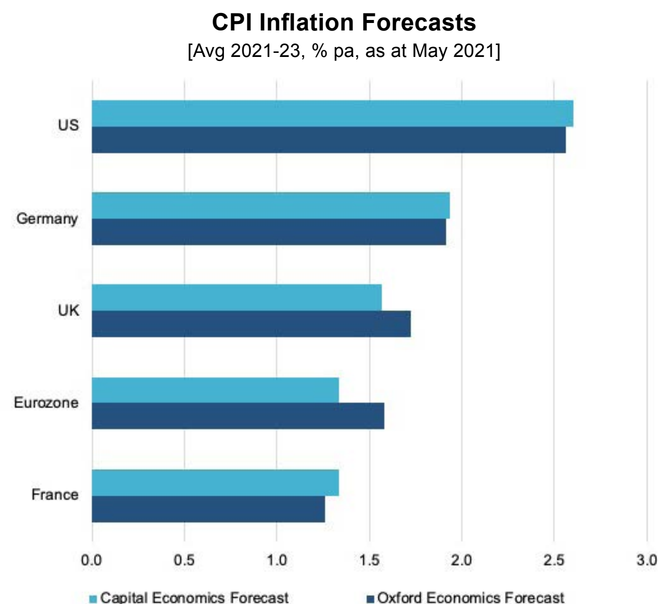
For example, since the publication of the 2021 ISA in December 2020, the U.K. has alternated between leader and laggard status in the fight against the virus. After a tough winter, lengthy lockdowns and one of the world’s earliest and quickest mass vaccination programmes had, by early spring, driven down the UK’s COVID case rates to among the lowest outside Asia-Pacific. At the time, the European Union looked jealously across the English Channel as its own vaccination efforts got off to a comparatively slow and rocky start. Observers had begun to contemplate the financial and economic consequences of divergent recovery paths for the U.K. and EU. However, by

01

Inflation does not represent high risk to European real estate

Inflation forecasts are up but central bankers to stick to bond-buying plan

Source: LaSalle (06/21), Capital Economics (05/21), Oxford Economics (05/21)



the time of writing this Mid-Year update, the U.K. was grappling with resurgent cases blamed on the so-called Delta variant, while the EU's vaccination programme had substantially caught up with Britain's. Relativities between U.K. and Continental case rates have inverted again.

Of course, the broader economic path that matters to real estate performance is measured over quarters and years—not days and weeks. From the longer-term perspective, the conclusion of the pandemic marathon is likely to look like a "photo finish", with the U.K. and Continental Europe exiting the public health crisis at roughly the same time as one other (and as the US). Which contender manages to cross the finish line first may seem salient now, but in the end it's only important that they finish in the leading pack of runners. Barring unforeseen circumstances, both the U.K. and Continental Europe are likely to cross the finish line into the "post-COVID" phase by late summer, positioning the entire region for a robust economic and property market recovery.

Indeed, picking winners among property markets will depend on a range of factors beyond the course of the virus. In essence, the competition goes beyond a simple foot race to encompass multiple events. Outcomes for European real estate, like Modern Pentathlon , depend on at least five very different contests; other than the end of COVID, we are tracking four of these:

- We are closely following the ways in which **structural change** shapes the future of the European property sectors, especially office and retail, and how this varies across the region. For example, Continental European cities are likely less exposed to remote working than the U.K., while Southern European countries are characterised by lagging e-commerce penetration rates.
- There remains considerable uncertainty as to how **capital markets polarisation** between favoured and unfavoured sectors will play out. This is particularly an issue in a European context where offices and retail still dominate the overall investable universe, resulting in a large amount of capital chasing assets in relatively small sectors. Our assessment of relative value points to a strategy of both more risk-taking in favoured sectors, as well as a quest for value in unfavoured ones. But recent anecdotal evidence suggests that investors are capitulating, and stepping up to pay at least pre-COVID pricing for office assets and retail parks.
- **Inflation** is currently elevated across Europe—if at varying levels by country—and there is a risk that it might become more entrenched over the longer term, impacting borrowing costs and property yields. This is not our base case; some of the recent high CPI readings are distorted by unusual year-over-year comparisons and the unwinding of supply chain idiosyncrasies. Moreover, Europe's lower level of stimulus and weaker underlying price pressures suggest a lower risk of inflation in Europe than the U.S.
- The **political complexity** of Europe continues, as ever, to be a risk factor. Elections that will decide their nation's direction of travel loom in Germany and France. Meanwhile, Brexit has moved from an acute to a chronic phase, with the Northern Ireland issue clouding relations at the time of writing. It also remains to be seen how well U.K. service sectors, and especially financial services, will fare post-Brexit.

02

Hotels & offices saw largest falls in investment over 2020

Popular “beds & Sheds” strategies widen the pricing gap

CEE covers Czech Republic, Hungary, Poland, Romania and Russia
Source: LaSalle (06/21) JLL (03/21) RCA (03/21)

European Investment Q1 2021 vs Q1 2020
[12-months rolling totals; % y/y change]

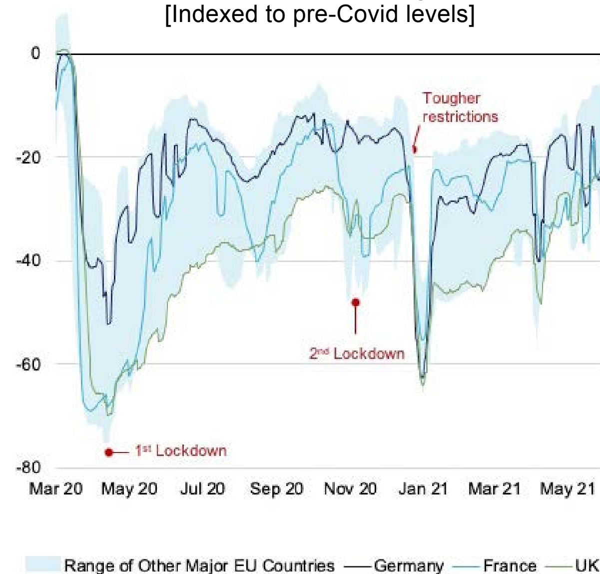
	Logistics	Residential	Retail	Office	Hotel
Nordics	-4%	-4%	-31%	-44%	-50%
Netherlands	-14%	1%	-36%	-45%	-88%
United Kingdom	57%	43%	-6%	-51%	-88%
Germany	-28%	5%	-41%	-49%	-78%
CEE	32%	327%	-57%	-47%	-46%
Italy	57%	175%	-90%	-28%	-63%
France	-58%	29%	-36%	-45%	-77%
Spain	-35%	-77%	8%	-81%	-38%
Total by Sector	-4%	-2%	-36%	-48%	-73%

03

Robustness of return to office between lockdowns bodes well for future

Sentiment across Europe above pre-pandemic levels for the first time

Source: LaSalle (06/21) Google (03/06/21)



Shortly, the vaccination race will be history in Europe. Differences between the performance of sectors and geographies will soon be driven by forces other than COVID, especially the four outlined above. Identifying winning assets will, like the byzantine scoring of Modern Pentathlon, require a complex assessment of a range of factors. The sections that follow covey our observations and recommendations for the major European property sectors.

Office: Still Early Days

The clear and immediate positive effect that the re-opening of European economies has had on sectors most severely restricted by lockdowns, such as Retail and Leisure, has been less apparent in Offices. The ability of many financial and service sector workers to be productive remotely throughout the pandemic has meant that there has been no pressing economic reason to return to the office before health and safety concerns are largely alleviated. Government guidance can change quickly, but at the time of writing, most European countries continue to advocate remote working over a return to the office.

As vaccination numbers rise, we expect restrictions to loosen further and the return of office workers to accelerate, boosting both office attendance and benefitting city centre Retail and Leisure that rely on office workers for trade. Assuming current vaccination trends continue across Europe, and no further setbacks from COVID variants, a broad-based post-summer return to offices across the region is likely. We would anticipate that larger cities reliant on public transport may lag smaller cities where walking, cycling or driving are the dominant forms of getting to work. For example, since the onset of the pandemic, workplace mobility

04

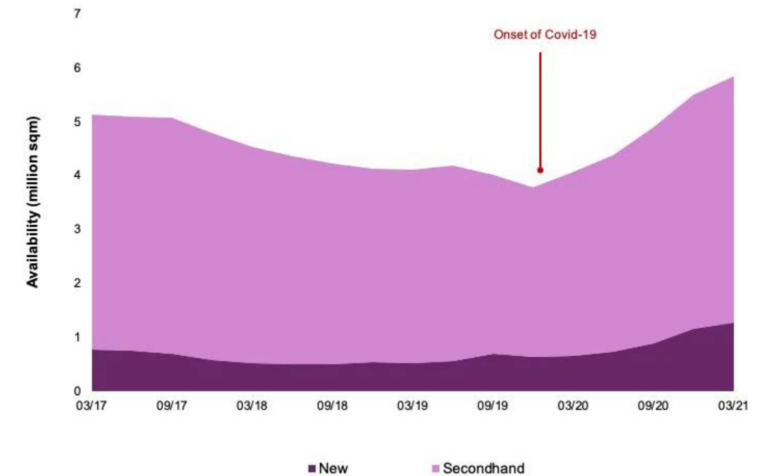
Office availability rising, but still relatively low in historic context

Demand focussed on limited high quality space

Source: LaSalle (06/21) JLL (03/21)

European Office Demand & Vacancy
[Rolling annual take-up & vacancy rate]

European Office Availability
[London, Paris & Amsterdam]



trackers have recorded the CBDs of both London and Paris running at 15 to 30 percentage points below their greater metropolitan areas, and 30 to 40 percentage points below their country averages.

Despite the positive outlook, the fundamentals of the European office market have not escaped unscathed. Whilst the region's vacancy rate remains low by historic standards and only rose by a modest 120 bps over the year to Q1 2021, this masks more extreme increases of 300-400 bps in London and over 500 bps in Paris La Défense. Certain European cities are expected to feel a short-term impact from large volumes of speculative completions due this year, although most have moderate development pipelines.

Most cities will also see a yet-to-be-determined amount of secondhand space deemed surplus to post-pandemic requirements returned to the market. It is still too early to be precise about how much less office space tenants may require, or indeed how occupied space will be repurposed to better suit the needs of the workforce that will continue to interact in person. We expect these themes to play out over two or three years, as contractual leases come to an end.

What remains clear from a plethora of industry surveys, however, is that physical office space will remain important to a corporate's strategy and identity, that flexibility of space and lease terms will be embraced by many tenants and landlords alike, and that both ESG and wellness will feature high on the list of occupiers' priorities. Pricing will bifurcate by quality and location, and we predict continued downward pressure on prime office yields in most markets, particularly in the U.K., where there remain pockets of value relative to the Continent. Investors wishing to stay ahead of the curve will focus on delivering Net Zero Carbon office buildings, anticipating the increasingly demanding expectations of sustainability from occupiers and capital markets. This is to say nothing of European regulators, who are leading the world in new carbon regulations, and we anticipate further tightening over time.

Retail: Open Again, But Still Pressured

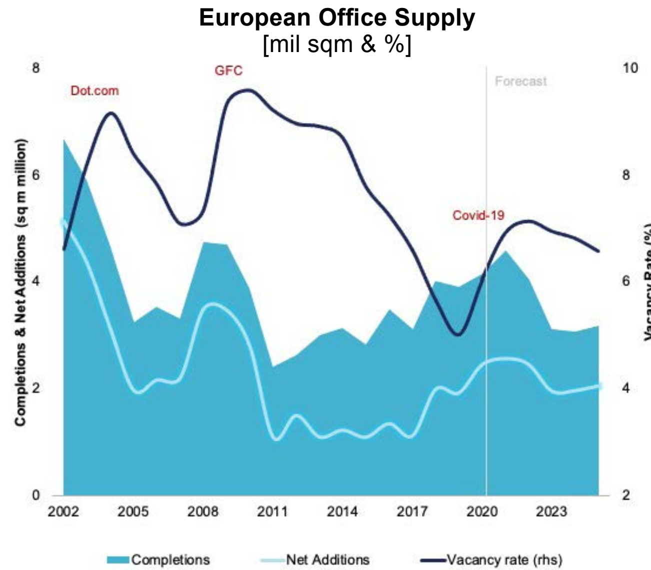
European governments' strong support for retailers has persisted throughout the pandemic in various forms, from employee furlough schemes through to moratoria on evictions. This has prevented a much

05

Completions picking up, but net additions show much lower supply risk

Office vacancy forecast to peak in 2021-22 before gradually falling

Source: LaSalle (06/21) JLL (06/21) PMA (03/21)

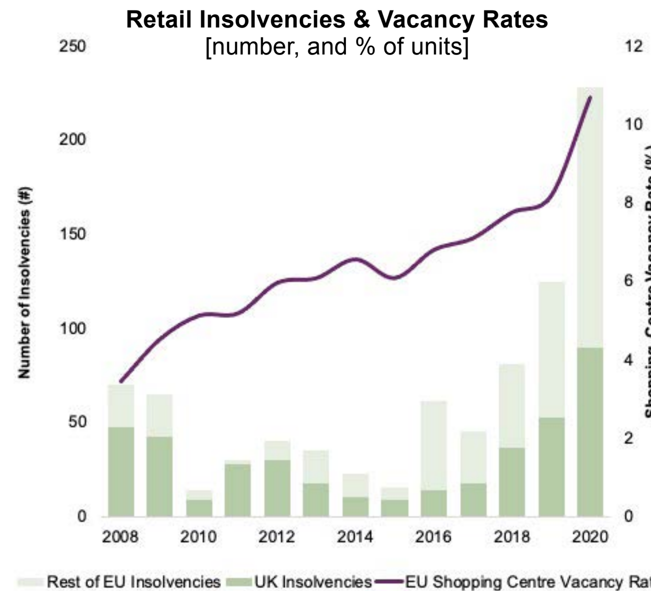


06

Retail occupier fundamentals hit hard during pandemic

More challenges ahead when government ends pandemic support

Source: LaSalle (06/21) PMA (04/21)



worse outcome for the Retail sector than had been initially envisaged at the onset of the pandemic. But very strong online sales have not fully compensated multichannel retailers for much reduced in-store sales and higher costs. As a result, what was a challenging 2020 for this sector continued into 2021, despite the lifting of retail-related lock down restrictions in most countries.

Insolvencies and store closures have remained elevated in most European countries and market segments, with deleterious impacts on retail rents. Rental falls have slowed in 2021, but there are still modest corrections taking place in Germany, the Netherlands and regional U.K. The exception is Retail Warehouses/Retail Parks, where prime rents appear to have bottomed out. This hardy sector has seen stronger footfall, in part due to its open-air nature and out-of-town location. As in other parts of the world, supermarkets and other grocery-anchored retail have also proven more resilient due to the non-discretionary nature of underlying demand.

The robust post-pandemic recovery that is emerging across the region should result in a welcome boom period for the embattled European Retail sector in the latter half of 2021 and into 2022. Renewed consumer confidence combined with excess savings and increased mobility all point to a strong bounce-back in retail sales. In effect, actual shots in the arm for consumers should translate into a proverbial shot in the arm for retailers. For many, this will come just in time, given dwindling cash reserves. These survivors will still face the structural challenges that dogged the retail sector prior to the pandemic, and so long-term success is not ensured. And for others, the expected withdrawal of government support towards the end of this year may bring about their demise. For these

07

Logistics take-up supported by high share of e-commerce demand

C.EU Countries to benefit from Catch-up effect, but traditional retailing poses downside risk

Take up is for Units >5000 sq m in Belgium, Czech Republic, France, Germany, Hungary, Italy, Netherlands, Poland, Spain, UK

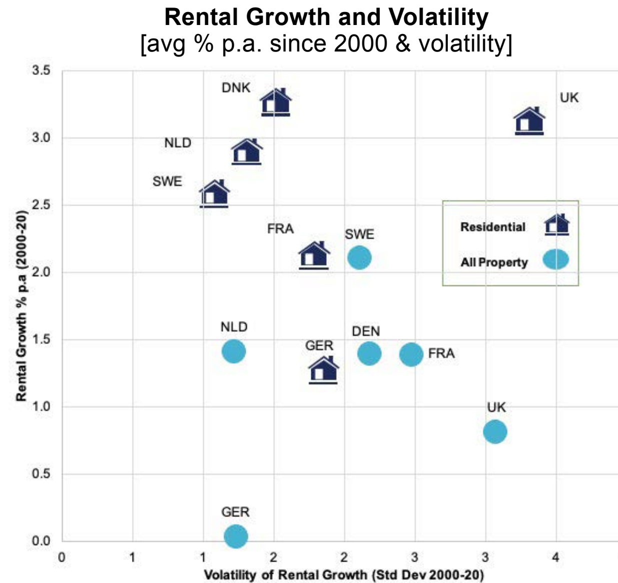
Source: LaSalle (06/21) JLL (03/21) PMA (03/21)

08

Residential rental growth has typically been stronger than All Property

More strictly regulated markets typically give more stable income growth

Source: LaSalle (06/21) JLL (03/21) PMA (03/21)



reasons, we remain cautious around the prospects of retail that is poorly located or not fit for purpose. The exception to this might be where repurposing the asset into an alternative use class is viable, though our experience shows that conversions are normally not economically viable in secondary locations due to high build costs.

Investors will be cautious about upweighting their exposures to European Retail given the sector's short- and long-term challenges. Yet one compelling investment opportunity is evident in spite of the many challenges: Prime urban retail warehouses or stand-alone units are seeing considerable interest from counter-cyclical purchasers across Europe. They are attracted by these assets' robust fundamentals and high income yield and, in some instances, high residual value that allows a future redevelopment angle.

Logistics: Bright Prospects, But Scanning for Risks

For the European logistics market, the unrivalled success that was 2020 continued largely undiminished into the first half of 2021. Occupier demand remains strong, although we envisage that the gradual re-opening of physical retail over the second half of the year may result in a commensurate easing in logistics leasing activity. There is already some evidence of this–online sales in the U.K. peaked at 36% of total retail sales in January 2021, but have since fallen back to 27% by May. Our position on post-pandemic e-commerce is unchanged, in that some of the shift online seen during the pandemic will remain. Precisely how much will differ by country, and there is currently a wide range of adoption in Europe; from highs in the densely populated U.K. and the Netherlands, to lows in cash societies such as Spain and Italy.

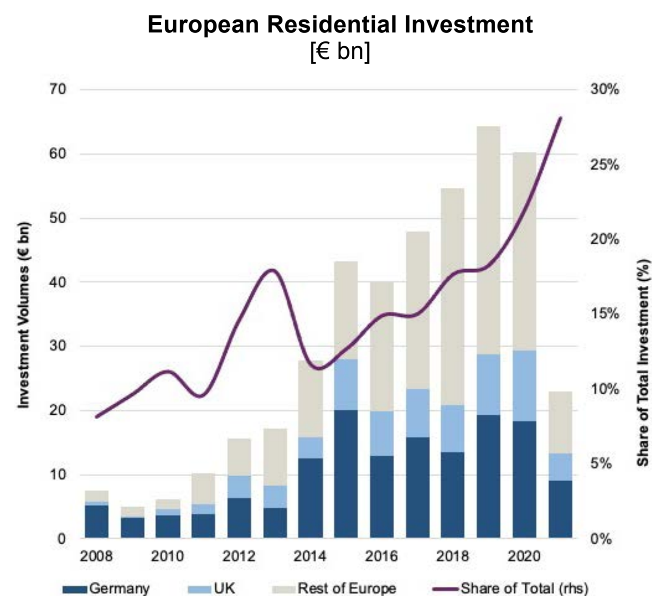
09

Residential investment has climbed steadily since 2016

Over a quarter of all Deals to date in 2021 have been within the sector

Take up is for Units >5000 sq m in Belgium, Czech Republic, France, Germany, Hungary, Italy, Netherlands, Poland, Spain, UK

Source: LaSalle (06/21) JLL (03/21) PMA (03/21)



The U.K. left the EU with a limited goods trade deal at the end of 2020, which removed much of the uncertainty generated by Brexit since 2016. Issues remain regarding the Northern Ireland border; and within the real estate market, this will be reflected most clearly in the logistics sector. However, after January 2021's dramatic fall in both U.K. imports from and exports to the EU, normal service in cross-Channel supply chains has largely resumed. A more interesting development for the U.K. logistics sector may prove to be the return of freeports announced in March 2021, which will see tax breaks introduced for key ports around the country.

With the prospect of demand easing from record highs, investors' focus should be on the supply-side risks. These can be significant in a sector where development is fast and responsive, and land supply for motorway distribution warehouses is plentiful in many countries.

But the growing speculative construction pipeline observed towards the end of last year remains under control. In absolute terms, the largest pipelines are in the U.K. and the Netherlands, although these are at seven percent or less of total stock, and rates of pre-letting remain high. By contrast, Poland's pipeline sits at ten percent and suggests caution there is merited. Elsewhere, vacancy rates are low and we remain confident of the prospects for speculative development as an investment strategy.

The clamour for urban logistics units to facilitate last mile deliveries in the largest cities is as strong as it has ever been. The underlying premise is that tenants are willing to pay higher rents to operate from locations that allow them to save money elsewhere in their supply chains. We therefore expect rental pressure for urban logistics will continue until such time that affordability of rents becomes an issue for occupiers, which will not be for several years. As such, we predict the strongest rates of rental growth for this sub-sector. Motorway logistics will also see robust growth rates in rents; these have been shown to be strongly correlated with the general cost of construction, and the latter is rising rapidly due to global supply pressures.

Resilient fundamentals and prospects for strong and enduring rental growth mean that logistics is one of the top strategies for investors in European real estate. Yet, as record lows for yields are broken almost as soon as they are set, investors are being forced to take increasing risks with location or development. Whilst we still recommend being overweight to this sector, we nonetheless advise caution where downside risks cannot be mitigated; for example, through alternative land use potential.

Living/Residential: A Mostly Cloud-Free Horizon

Like Logistics, the European residential market continues to go from strength to strength. Capital value growth strengthened again into early 2021, driven by a combination of real rental growth and yield compression. Improvement was noted in virtually all European cities, not only those which have been perennially strong, such as Munich and Berlin, but also markets that had experienced a period of softness prior to COVID, such as Stockholm, Helsinki, and London.

Of course, European Living assets have not been immune to the challenges of COVID-19. Care homes and student housing were the most directly impacted by the pandemic, although both have proven far more resilient than initially feared. On the residential side, locations characterised by high tenant mobility, such as London and other urban U.K. build-to-rent markets, suffered occupancy declines as young professionals

suddenly found they didn't need to be close to the office. There are initial signs of these migration patterns reversing, with urban demand returning on the back of reopened restaurants and bars, if not yet due to reopened offices. Further improvement can be expected once office workers return in earnest, but amenity-poor submarkets whose unique selling points were adjacency to office jobs will suffer in a world where attendance at the office is not a daily chore.

Bidding for residential assets remains fierce, with expectations of net initial yields falling up to 50 basis points during sales processes; this represents a big shift in absolute capital values given yields already in the 3% range. Despite the low absolute yields, we continue to see strong value in residential on a risk-adjusted basis, given the minimal downside volatility exhibited by the sector, especially during economic downturns. Reflecting this, residential yields have more potential to move downward, in our view.

As with logistics, investing in residential today requires scanning an almost uniformly upbeat landscape for hidden sources of risk. Pockets of oversupply are possible in the less regulated markets, but in general, European residential supply is far less elastic than that of motorway logistics. The greater risk is of increased regulation, as politicians attempt to respond to housing affordability challenges with tighter restrictions. We do not necessarily view regulations as a problem, especially when they engender stability in rents and returns. But sudden changes in rules can trigger equally sudden adjustments in valuations.

The most notable regulatory news of late has been in Germany. Since we published the 2021 ISA, the German Constitutional Court struck down the Berlin rent cap legislation, adding a stipulation that regulating rents is a capability of the federal government, not individual states. While on its face a positive development for German residential, the Green Party's polling strength in the lead up to September's federal election suggests national level changes cannot be ruled out. Meanwhile, the largest landlords in Berlin, Deutsche Wohnen and Vonovia, have proposed a massive merger partially motivated by regulatory risk. The move would create one of the world's largest listed real estate companies, and as a part of the merger the combined company has pledged to voluntarily limit rent increases to a level less than what would be allowed by law.

Regulatory considerations notwithstanding, we expect the strong performance of European Living assets to continue and investment mandates to widen to include secondary markets and emerging sub-types of space. For example, momentum in the Continental European student housing market has returned as it continues to catch up with the UK. And in Britain, the single-family rental sector remains embryonic but shows strong potential. We recommend diversifying portfolios to increase Living sectors exposure, starting with conventional residential and expanding to less established sub-types as they emerge.

10

European Investment Recommendations for the Second Half of 2021

We continue to recommend being active on both sides of the divide be-tween favoured and unfavored sectors

	Core	Higher Return
Best Opportunities	**Urban logistics & modern motorway logistics** *well-connected big box and dominant hubs*	**Urban logistics development & multi-let industrial** *with local partners, incl. planning risk*
	Residential *urban build-to-rent, affordable & family housing in secondary markets*	**Residential development** *in primary markets, incl. planning risk*
	Modern, green offices *prime in key centres with low vacancies and strong, well-connected micro-markets*	**Office refurbishment & NZC* development** *strongest locations only; avoid near-term office leasing risk*
	Inflation-linked with high site value; ground leases & income strips *primarily a UK opportunity*	**Repriced retail parks / warehouses**
	Affordable housing, retirement housing, healthcare, educational facilities *primarily a UK opportunity*	**Niche sectors** *emerging sectors such as self-storage*
Other Opportunities	**Long-term income producing retail parks/warehouse** *especially food-anchored retail*	**Long-term repositioning of retail to alternative use**
		Repriced hotels *with strong covenant and/or operational manager*

* Net Zero Carbon

Source: LaSalle (05/21)

North America Re-opens for Business

The North American recovery is largely playing out as predicted through the first half of the year. However, the pandemic has taught us great respect for the inherent unpredictability of life on this planet, so we stay alert to a number of tail risks that linger in the background as the momentum of the recovery builds.

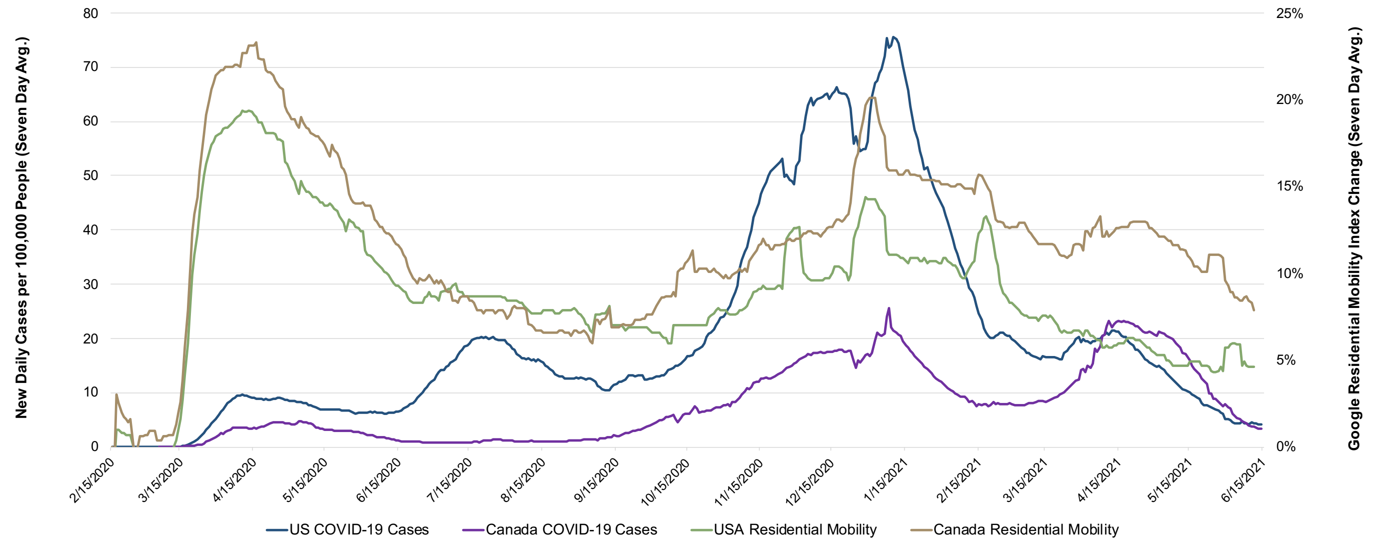
The containment of COVID, through massive vaccination efforts across Canada and the United States, has been the catalyst for a rolling series of re-openings across both nations. Canada's pace of vaccinations initially lagged the U.S., but is now catching up quickly, with an economic recovery gaining momentum on the same path as the US, but a few months behind. Neither country experienced permanent scarring through irreversible economic setbacks and the government stimulus programs in both countries appears to provide a strong launching platform for a robust recovery. The control of COVID has enabled a process of re-opening that is without precedent in modern times and which brings economic and social life back to the real estate sectors hit hardest by the

01

Decline in COVID Cases Allowing Economic Activity to Return

US is leading Canada, but with cases falling in Canada rapidly Mobility is also recovering

Source: Google. Data to 11 June 2021. Latest available as of 14 June 2021. Based on Google users opting into the Location History setting.

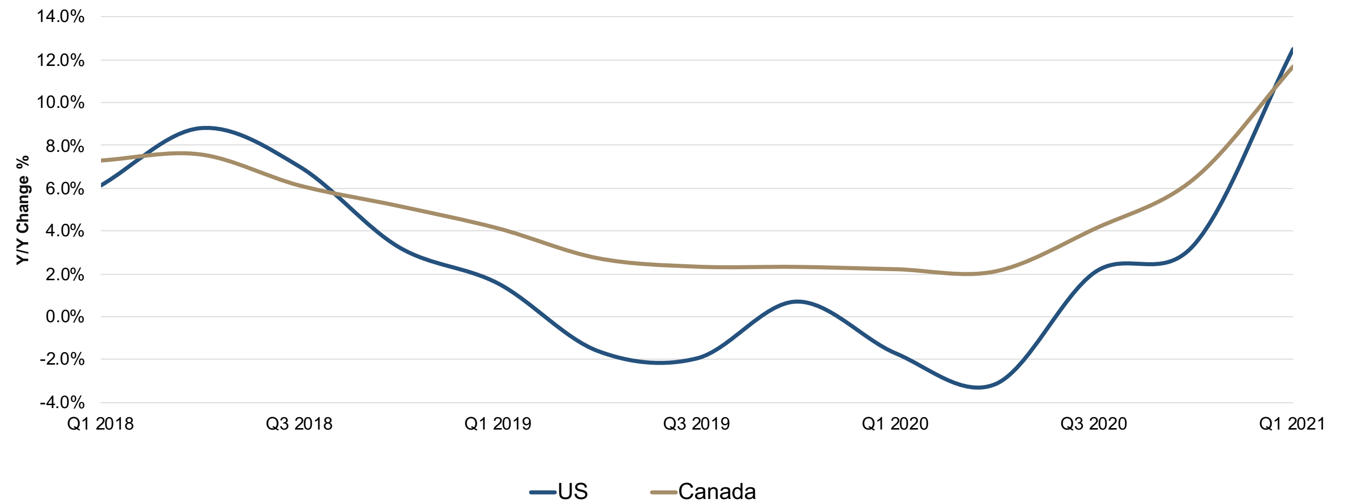


02

Construction Costs Spike in 2021

Q1 Construction costs were up 12.5% and 11.7% in US and Canada, respectively, from a year ago

Source: FRED, U.S Bureau of Labor Statistics: Producer Price Index by Commodity: Net inputs to Residential Construction: https://fred.stlouisfed.org/series/WPUIP2311001 , Statistics Canada: https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1810013501 Most recent as of 16 June 2021.



pandemic. In the 2021 ISA we identified inflation as a tail risk for North America and noted that real estate can serve as a valuable inflation hedge in a rising inflation environment. Today we see the risk of inflation higher than six months ago; but accelerating inflation is not our base case outlook. As mentioned in Chapter 1, there is global diversity in terms of inflation concerns, but both the U.S. and Canada are experiencing higher short-term inflation and greater risk of rising inflation than many other markets around the world. Both the U.S. Federal Reserve and the Bank of Canada have taken a view that increases in inflation are transitory and do not require an immediate policy response. This means short-term interest rates have remained low, but it also raises the risk that inflation will be higher for longer if the policy makers' views are proven incorrect.

Construction costs are a significant element of the higher inflation readings,and real estate investors are focused on what these increases mean for investment broadly and development in particular. In recent years,cost overrun risks in new developments were often passed to general contractors (GCs) through guaranteed maximum price (GMP) contracts during the planning and construction stages of a project. However, norms that prevailed in a lower inflation environment may not apply as inflation risk rises and GCs are no longer willing to absorb the risk of materially higher inflation. GCs will look to either pad budgets, increase contingencies, or carve out input cost increases, all of which essentially shift the risks of higher costs back to the investor. Construction budgets are already an estimated 5-10% higher than six months ago, and much more uncertain, because of huge volatility on lumber and steel prices. Development risk is higher when the costs are less certain, which is something investors need to account for in their required returns. The real estate market will have to adjust and that will occur through a combination of: 1) Investors accepting a lower yield on cost; 2) Rejection of development projects that do not deliver an acceptable return; 3) Underwriting higher rents to counter the impact of higher costs; or 4) Land values declining to compensate for the higher costs. As the first half of the year unfolded,we observed cap rate compression for "in-favor" sectors like apartments and industrial. This suggests investors have room in their pro-form as to accept lower yields on cost to accommodate higher construction costs. In addition, assuming higher levels of rent growth and more accretive leverage are reasonable responses to the unusual market dynamics of 2021 where spiking economic growth is accompanied by ultra-low interest rates–a rarity in financial markets.

Turning to the U.S. policy environment, we did not foresee Democrats taking control of the Senate in 2021 and the potential for meaningful legislative changes that could impact the economy and real estate in particular. The most tangible impact thus far is the larger-than-expected stimulus bill, which set the stage for stronger economic growth than previously anticipated in 2021 (see p. 5). Looking ahead, it has raised the prospect for some material policy changes on infrastructure investment and taxes. At this point, these initiatives are still in the proposal stage and it is uncertain what will become law. The economic impact will hinge on the positive impact from more spending and infrastructure investments and the drag from higher taxes and tax policy uncertainty. In terms of real estate impacts, we are focused on investment opportunities that might benefit from infrastructure investment plans and are taking a look at what proposed changes to 1031 deferrals on real estate capital gains may mean for the real estate market now and in the future.

The overall economic backdrop in both the U.S. and Canada remains very positive. Forecasts are for GDP to not just replace GDP lost during the recession by year-end, but to exceed the pre-pandemic forecast trajectory. Job growth is lagging, as expected, but this appears driven more by labor supply than demand.

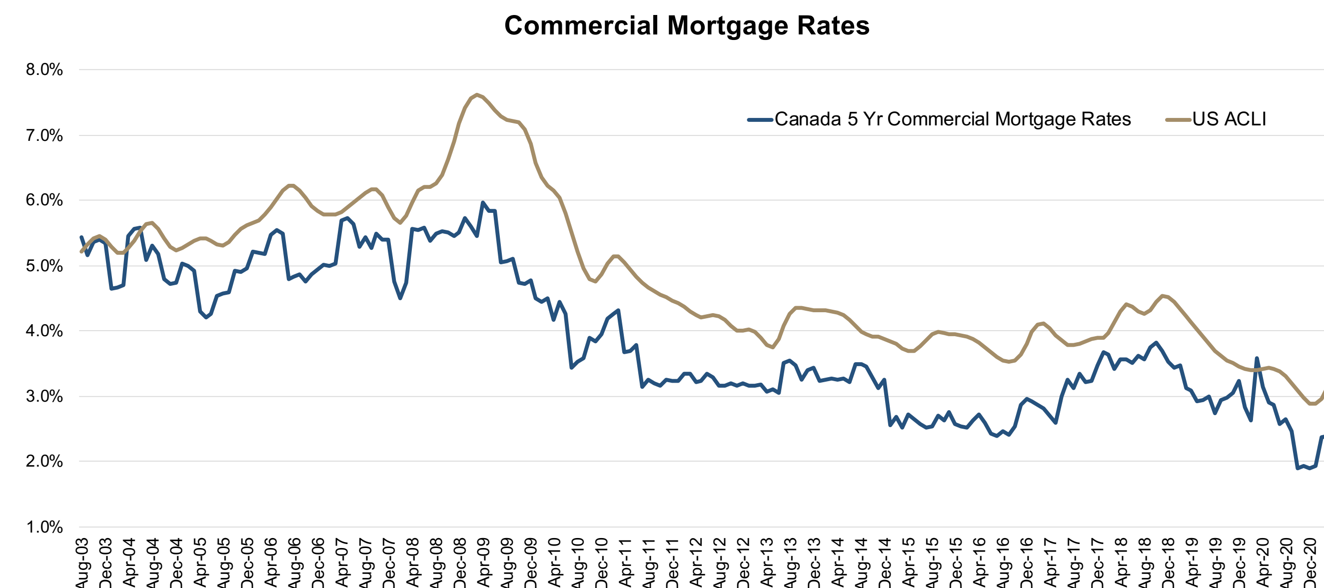
In the 2021 ISA, we also touched on our expectations for urban versus suburban growth, market selection and industry growth. Largely, our views have been reinforced by the last six months of economic re-opening. Lower density, suburban markets have thrived, especially for residential sectors. But urban areas have also started to recover in the U.S. and Canada with activity rebounding in amenity-rich areas of cities. However, expectations for an urban rebound have become a consensus view, limiting the investment opportunity to take advantage of depressed urban apartment fundamentals. The recovery is starting to show up in urban apartment data, with monthly effective rent growth stabilizing in January and then seeing an accelerating recovery in April and May. The long-term demographic forecasts continue to favor the suburbs, and that is where we see greater relative value on the apartment side.

03

Borrowing Rates At Historical Lows

Low-Rate environment expected to boost returns for leveraged buyers

Source: ACLI, JLL Canada, CBRE Canada, Bloomberg. Most recent as of 15 June 2021.



For market selection we continue to recommend that investors diversify into a broader set of markets than the traditional “Gateway” largest markets, especially in the US where many more markets provide institutional sized investment opportunities. While markets such as New York, San Francisco and Washington DC are experiencing demand recovery as people are attracted back to urban amenities,we don’t see compelling value there. In the past an argument for investing in the largest cities was superior liquidity; but in this downturn liquidity has been greater in growth markets like Atlanta, Dallas and Phoenix as compared to the Gateway markets.

The regional economic growth story is a bit more nuanced relative to our expectations. People are eager to travel again, and that is providing a boost to markets like Orlando and Las Vegas. Energy markets were flagged as laggards by many investors last year. While their recovery is early there are reasons to be positive as oil prices are experiencing a rebound. The transition to a low-carbon economy will take several decades to accomplish in North America, but the entrepreneurial talent in places like Houston, Dallas, Denver, and Calgary will remain an asset that will likely lead to more, rather than less, economic activity. The short-term outlook for Canadian energy markets is clouded by a shortage of pipeline capacity, which limits the ability for producers to significantly expand output, with shipping by rail and other means at or near capacity. Yet, the natural resources of Canadian markets include many other commodities that are in high demand—including lumber, gold, and iron ore.

Capital Markets

Rising investor interest in real estate, which we anticipated in the 2021 ISA, has started to materialize in the first half of the year. REIT prices in North America are up significantly thus far in 2021 with the US and Canada seeing the highest global returns at 24% and 26%, respectively as of mid-June. Lenders remain aggressive and spreads for real estate borrowing remain low, indicative of the positive outlook for the sector. Even though 10-year interest rates moved higher from November to March they have stabilized in both markets in the 1.4-1.7% range, a level that keeps real estate attractive on an income basis and supports accretive leveraged returns. Furthermore, real estate borrowing costs remain extremely low on a historic basis in both markets, as the chart on the following page shows.

In the private market investors are still faced with the wide gap between the favored and unfavored property types (or “winning” and “challenged” as we labeled them). Transactions, bidding, and pricing have been

very robust on the winning side of this equation. Cap rates for industrial and suburban apartments have compressed perhaps 50 bps or more in the first half this year and are at all-time lows. This dynamic extends to several specialty property types, notably medical office, self-storage, single family rentals, and life sciences, to the point that investors are clearly valuing these cash flow streams with the same confidence as other favored sectors in recognition of the core qualities they provide. Activity for the more challenged retail and office sectors has not been nearly as robust as the fundamentals, rent, and income outlook for these property types remains uncertain. For fully leased properties with less uncertainty there is aggressive bidding, but deal flow for these remains limited.

Property Sectors

As alluded to above the key question for investors in the current environment center around property type. Are the favored sectors over-valued? Are there contrarian opportunities in challenged sectors? These questions of value extend to the urban versus suburban and market selection choices. Applying rigorous analysis that is grounded in financial theory to how we think about value across these segments leads us to conclude that there is still limited value in U.S. office at this time. Certainly this could change if liquidity returns to the office market at pricing significantly lower than what we expect. Based on the limited trades that have taken place thus far we have the same view of core office that we held prior to the pandemic, specifically that the high capex load and elevated risk lead us to recommend an underweight allocation.

Retail is more nuanced in terms of sub-type characteristics and idiosyncratic property performance. Clear challenges face many retail properties, but the asset level dispersion in expected performance means some properties will outperform the median by a wide margin. This is an important caveat to our overall caution on the sector. Office has some of the same asset-level dispersion in performance, with modern, energy-efficient, well-ventilated offices poised to outperform, but asset level dispersion is much greater in retail. And in retail, we believe our data analysis tools related to location and foot traffic analysis help us identify winners with confidence.

The outlook for apartment and industrial fundamentals remains robust. Apartment demand this spring was record setting, which sets the stage for the strong rebound we expected late last year, to come even sooner. The industrial sector is also continuing to experience very robust demand. For both property types the interruption to development associated with the pandemic was relatively brief. Apartment development in urban areas is likely to be slowed a bit more than in the suburbs, but the more extended development timeline for urban apartments means it will be next year before it shows up in occupancy rates.

Investment Recommendations

Consistent with 2021 playing out largely as expected, we are making few changes to the investment recommendations and tilts in the 2021 ISA. For the US the one change is the urban apartment opportunity was based on those assets starting to trade at discounts; that has yet to materialize and seems unlikely to do so.

For Canada, we maintain our view that long-term leased office, urban grocery-anchored retail and new generation logistics remain the best core opportunities. In both countries, our recommendations have not changed, despite the continuation of the bifurcation in pricing. While we wish we could acquire apartment and industrial assets at higher cap rates, even those prevalent six months ago, we still think those sectors are better value at current pricing than office and retail.

04

North American Investment Recommendations: Mid-Year 2021

Best Opportunities Largely in Winning Sectors, with Potential Income Opportunities in Segments of Challenged Sectors

*Supermarket Trade Area Ranking System. Proprietary LaSalle ranking of over 40,000 US supermarket anchored shopping centers.

LASALLE'S STRATEGY RECOMMENDATIONS

BEST OPPORTUNITIES

SECONDARY OPPORTUNITIES

	CORE	HIGHER RETURN
MULTIFAMILY	**US & Canada: Durable Suburban Markets, Canada: Off-Price Urban**	**US: Development, Single Family and other residential alternatives**
		Canada: Urban & Suburban Repositioning, Build-to-Core
OFFICE	US & Canada: Select Long-term leased assets	US: Deep value on strong assets
		Canada: Suburban Renovation / Lease-Up
RETAIL	US: Top STARS* Centers with Leading Supermarkets	US: Deep Discount Power and Community Centers
	Canada: Urban Grocery-Anchored, Best-in-Class Super Regionals	Canada: Mispriced Urban, Repositioning (Conversion, Densifying, Adding Mixed Use)
WAREHOUSE	**US: Secondary Markets with Credit Tenants**	**US and Canada: Warehouse Development**
	Canada: Large Bay Warehouse / Logistics	Canada: Major Market Lease-Up, Alberta Recovery Plays
Niche	**US: Medical Office, Self-Storage, Life Sciences**	
	Canada: Data Centres, Self-Storage, Student Housing	

Return Outlook

Both fourth quarter and first quarter US private real estate returns exceeded our expectations. This outperformance was driven by more robust appreciation for industrial and more limited write-downs than we expected in office. Solid appreciation for industrial remains in our forecast, but we see more upside than downside surprises in this outlook. And while we don't see value in offices it seems appraisers and some investors are taking a "nothing has changed" view, so we no longer expect negative returns from that sector. Putting those dynamics together our outlook for 2021 returns is a bit stronger than it was previously.

In Canada private returns appear to have bottomed as of 4Q 2020, with 1Q 2021 starting to show positive momentum based on the results of the MSCI Canada Property Index. Retail malls, which were hit with sharp NOI declines in 2020, could see a sharp rebound as the Canadian economy more fully reopens and in-store shopping restrictions are lifted, boosting sales and retail demand. With household savings rates elevated due in part to government stimulus measures, retail sales have quickly rebounded to all-time highs. We expect a wide delta between industrial and apartment returns, which are leading the Index; and we also expect that office and particularly retail will continue to lag.

LaSalle

Asia Pacific

Asia Pacific Advances from Economic Repair to Growth

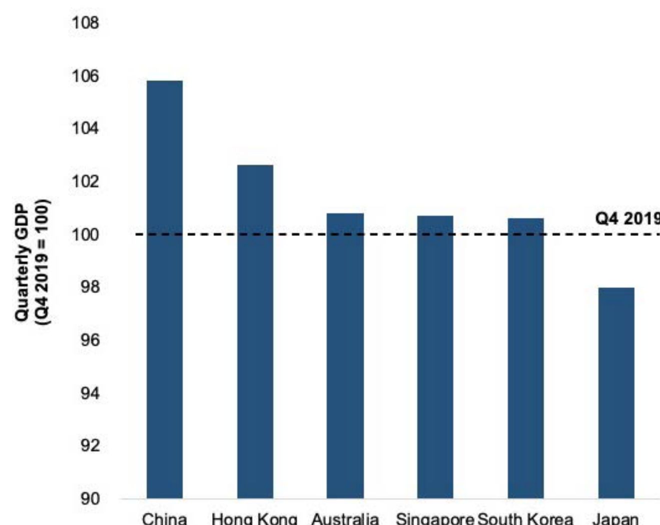
The region's rapid containment of the initial COVID-19 outbreak, along with a series of fast fiscal stimulus actions, facilitated economic recovery in Asia Pacific earlier than other regions. This success occurred even without the higher rollout of vaccines achieved in other countries. In the months ahead, this success will be tested repeatedly: coping with another round of travel restrictions in Australia, or pockets of resurgence of the pandemic in the region.

Yet, the overall Asian COVID-19 resilience story is remarkable. Economic growth will likely moderate later in the year, relative to this early success. For instance, it is only rational for China's GDP growth to decelerate from the exceptional 18.3% (year-over-year) seen in the first quarter of 2021, as the low base year falls away. Yet, the accelerating recovery in North America and Europe could provide a tailwind for Asia Pacific.

01

Most Asia Pacific Countries have Replaced GDP Lost in the Pandemic

Source: Oxford Economics, as of 21 June 2021.



02

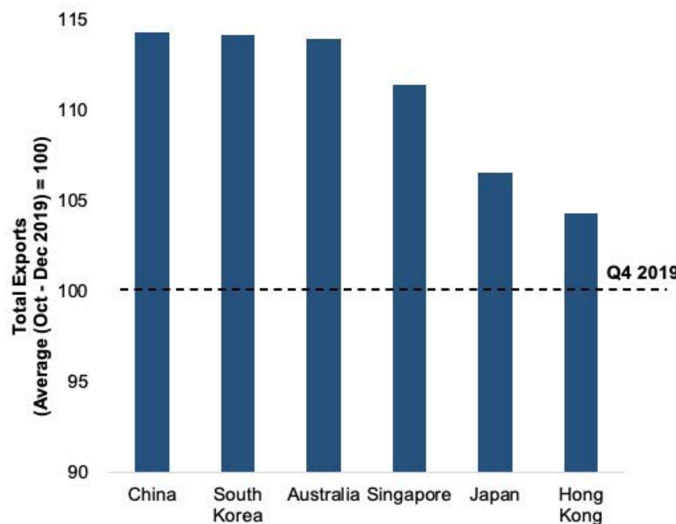
Asia Pacific Countries are all Exporting more than before the Pandemic

Note:

Total exports are based on local currencies for all countries except South Korea and China, which are based on USD.

The rolling 3-month averages of total exports are as of May 2021, except Hong Kong, which is as of April 2021.

Sources: The Statistics Department of Hong Kong, as of April 2021; the Australian Bureau of Statistics, the General Administration of Customs of China, the Ministry of Finance of Japan, the International Enterprise Singapore, and the South Korea Customs Service, as of May 2021.



For most of the last year, Asia Pacific has led the economic recovery. A year and a half after the first cluster of COVID-19 cases was reported, major Asia Pacific economies, particularly China, South Korea, Australia, Singapore, and Hong Kong, have fully recovered to, or exceeded, their pre-pandemic GDP and export levels (Exhibits 1 and 2). Japanese exports also exceed the pre-pandemic level; however, the overall economic recovery in the country has been slower than anticipated, partly due to COVID-19 resurgences and the slow vaccine rollout. However, the Japanese labor market, which is the indicator most closely tied to real estate demand, is exhibiting stronger resiliency than the overall economy (Exhibit 3). This resiliency is contributing to the low vacancy rates in major real estate markets in Japan, which are the lowest among major Asia Pacific markets. We expect the Japanese economy to improve later this year as the vaccine rollout accelerates, the ultra-accommodative monetary policy remains, and the government's financial support for firms and households is extended.

China's leading position in the region and the world that we identified at the beginning of the pandemic is playing out as anticipated. As global industrial capacity was constrained, China's business sectors were able to provide much-needed goods for exports around the world, mainly due to the country's early containment of COVID-19 and its strong domestic supply chain (Exhibit 4). China's economy is expected to continue to benefit from its strategic role in global supply chains—the country provided most of the PPE and equipment for vaccinations that the world required last year. In the second half of the year, Chinese leadership in electronics, telecommunications, computer chips, optical and medical devices will feed both domestic and international demand.

03

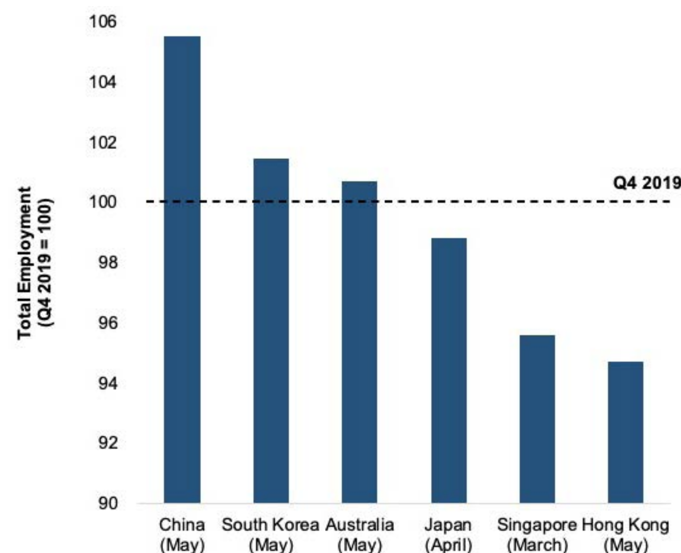
Employment is above Pre-Pandemic Levels in China, South Korea and Australia

The only major countries to achieve full recovery of lost jobs

Note: China's employment data are based on urban employment. Since only annual data series are available for urban employment in China, LaSalle estimates the YTD 2021 urban employment by adjusting 2020's annual urban employment data with the monthly urban employment data in the first five months of 2021. Please note the monthly urban employment data series include jobs created (either permanent or temporary) in the first five months of 2021.

Sources: The Ministry of Manpower of Singapore, as of March 2021; the Statistical Bureau of Japan, as of April 2021; the Census and Statistics Department of Hong Kong, LaSalle Investment Management based on data sourced from the National Bureau of Statistics via WIND (China), the Australian Bureau of Statistics, and the Statistics Korea, as of May 2021.

Exhibit 3: Total Employment (Q4 2019 = 100)

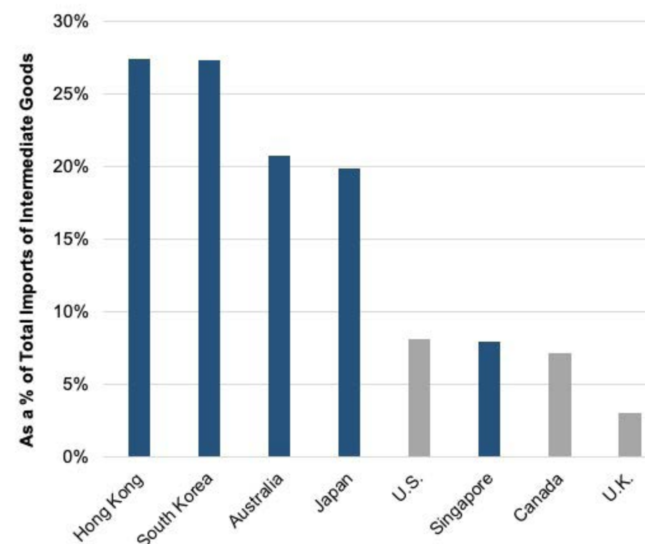


04

China's Exports are Embedded in the Supply Chains of Many Countries

Source: The World Bank, WITS, as of 2019.

Exhibit 4: Imports of Intermediate Goods from China
(as a % of Total Imports of Intermediate Goods)



The South Korean and Australian economies are also rebounding much faster than anticipated. The strong recovery in South Korea is primarily driven by semiconductor and automobile exports and investments in machinery and equipment. By April 2021, employment and retail sales in Australia had exceeded their pre-pandemic levels, underscoring the country's strong growth supported by fiscal and monetary stimulus and filling in for losses in cross-border economic activity.

Singapore and China are currently leading vaccine rollouts in the region (Exhibit 5). Although Asia Pacific countries started vaccine rollouts later than in North America and Europe, the major countries we target will reach vaccine goals in about the same time frames as in the West.

Before the pandemic is fully controlled or the world reaches herd immunity, economic recovery for most countries is expected to continue to rely on domestic demand. We updated[1] our ranking of the Asia Pacific economic outlook for the next three years presented in the 2021 ISA (Exhibit 6). Our outlook continues to have China and Japan leading, followed by Australia (which has replaced South Korea in third place), primarily driven by better containment of the pandemic in Australia in the first half of this year. The economic recovery in the region is expected to continue to support the real estate demand recovery.

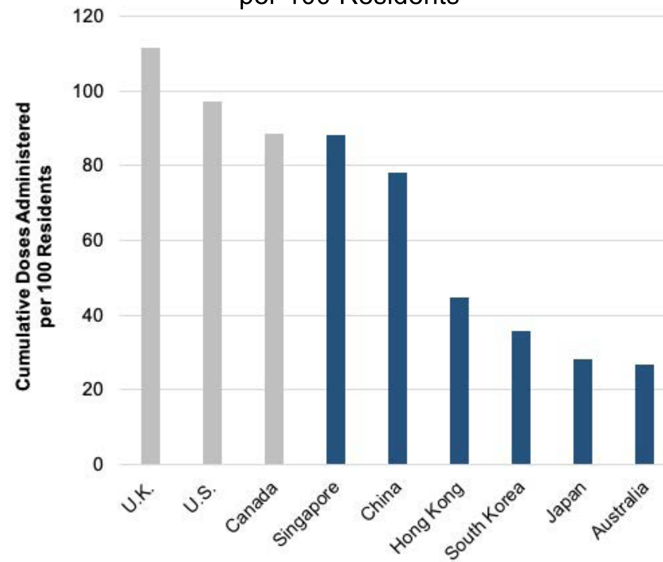
1 Updated as of 25 June 2021

05

Vaccine rollout in Asia Pacific has lagged, but will catch up in major countries by year end

Note: Cumulative vaccine doses administered per 100 residents are based on 2019 population.

Sources: CEIC (population), as of 2019; Our World in Data (number of doses administered), as of 23 June 2021.



Risks to Monitor

Besides the continuing threat from new strains of COVID-19, the key risks to the region's economic outlook are a potential escalation of the geopolitical tensions between the U.S. and China, and rising construction costs.

The U.S.-China Tensions: A complete decoupling between U.S.-China trade is unlikely, even if disputes threaten specific sectors. The U.S. imports more goods from China than any other country. And the U.S. exports more to China than any other country besides Canada and Mexico[2]. Both countries recognize and value the importance of this relationship. Most importantly, China has a vested interest in attracting foreign direct investment to grow its economy. The U.S. is seeking fair competition with Chinese companies, but

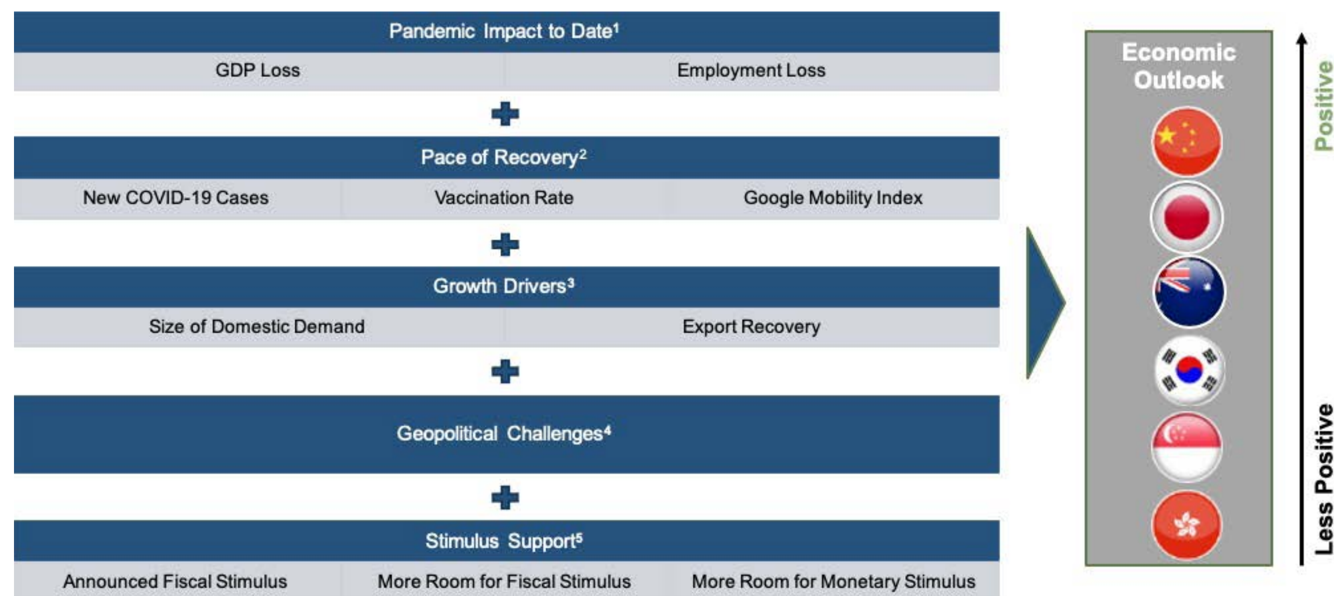
2 The Census Bureau of United States, as of April 2021

06

The Economic Outlook for Asia Pacific Countries Ranked Using Five Factors

Australia Now in Third Place Behind China and Japan

Exhibit 6: Asia Pacific Economic Outlook over the Next Three Years



Note: 1) Pandemic Impact to date: The impact on GDP and employment since the start of the pandemic in each country. Data sourced from Oxford Economics, as of June 2021; 2) Progress of Recovery: The 14-day rolling average of new COVID-19 cases per 1 million population, sourced from WHO (all except China and Hong Kong), the National Health Commission of China, the Centre for Health Protection of Hong Kong, as of 7 June 2021; 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. The rolling monthly average of the Google Mobility data, as of 7 June 2021. The mobility index for China is based on LaSalle Investment Management's estimate. Vaccination Rate is sourced from Our World in Data, as of 6 June 2021; 3) Growth Drivers: Gross domestic production excluding exports sourced from Oxford Economics, as of 2019; Export Recovery: export by region, February – April 2021 compared to October – December 2019, sourced from each country's statistics bureau via CEIC, as of June 2021; 4) Geopolitical Challenges: impacts on export due to the U.S.-China trade war, Hong Kong unrest, Japan-South Korea, China-Australia tensions, etc. Data sourced from IMF, as of 2019; 5) Stimulus Support: Announced COVID-19-related fiscal stimulus. Data sourced from various government announcements, as of 16 June 2021; Room for more fiscal stimulus or accommodative monetary stimulus: Take into consideration of whether there is room for additional monetary stimulus (e.g., further rate cuts) and fiscal stimulus, the health of government fiscal balance sheet in each country, whether the country has a reserved currency, etc. Data sourced from CEIC and LaSalle Investment Management, as of 25 June 2021.

not a complete breakdown of its economic relationship. Additionally, China is a more important trading partner for most Asia Pacific countries than either the U.S. or the European Union (Exhibit 7). As the recovery in China is expected to continue, active trade within the region will likely continue to benefit the rest of the region and its real estate markets.

Rising construction costs could lead to declining profit margins and a lower yield-on-cost for development projects. Yet, at the same time, it should also lead to higher exit prices as rents rise. Producer and consumer inflation in several countries are rising due to pandemic shutdowns and disrupted supply chains. Although the prices of construction materials, especially steel and lumber, moderated considerably in June, they are still significantly higher than at the beginning of the pandemic. The high steel prices can be attributed to the recovery of global demand, especially from the U.S. and China, rising energy costs, and the tight emission restrictions in the steel-producing provinces of China. As long as the costs of other construction components, such as cement and labor, remain contained, the impact of rising steel prices should be manageable.

Ride the Pandemic Recovery, Amidst Uneven Real Estate Performance

Our empirical study shows that the real estate fundamentals recovery in Asia Pacific usually lags the economic recovery by one to three quarters. As real estate markets recover, the region should offer a broad range of opportunities for investors. Our investment recommendations remain generally in line with those in

07

China is the Most Important Trading Partner for Major Asia Pacific Countries

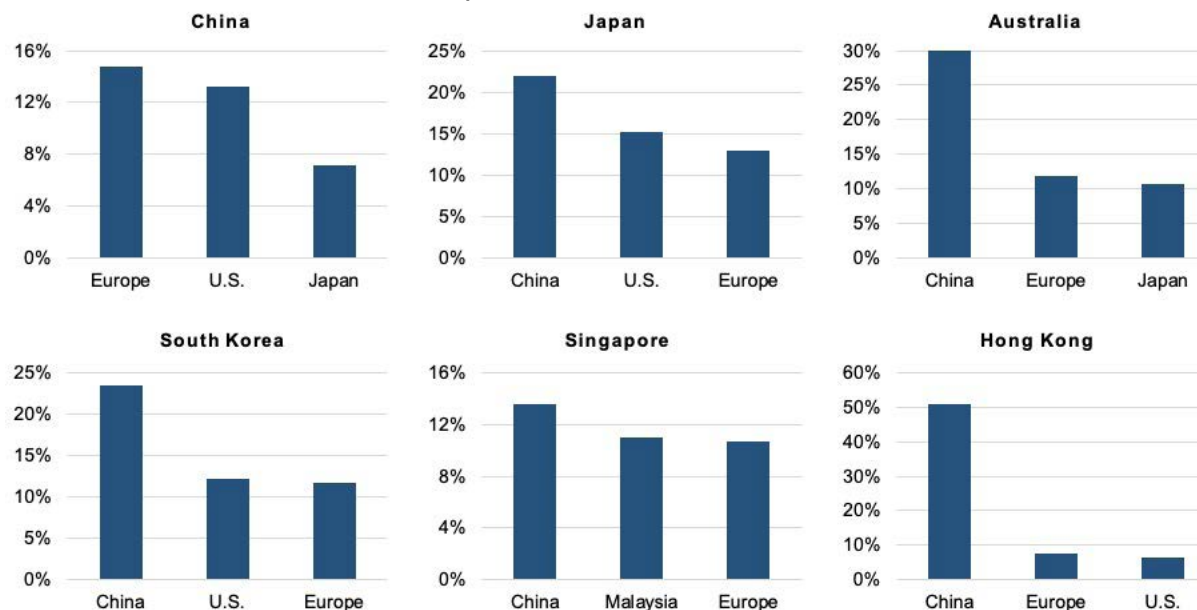
Note:

The total trade volume includes exports and imports.

Europe consists of the 27 European Union countries and the United Kingdom.

Source: The China General Administration of Customs, the South Korea Custom Service, the Australian Bureau of Statistics, the Census and Statistics Department of Hong Kong, the Ministry of Finance of Japan, and the International Enterprise of Singapore, as of 2020.

Exhibit 7: Total Trade Volume with Key Trade Partners (Proportion of Total Trade Volume, 2016 – 2020)



the 2021 ISA, with some minor adjustments (Exhibit 8). For core investors, we continue to focus on our favored sectors, particularly logistics, multifamily, and major real estate markets and sectors in Japan. In addition, we favor investment opportunities in select office markets to ride the recovery. For risk-tolerant investors, we focus on finding relative value in less favored sectors such as hotels and retail.

Environmental, social, and governance (ESG) considerations are expected to play a larger role in the Asia Pacific region. Many countries have announced their roadmaps to carbon neutrality. As a result, investors and occupiers are paying more attention to ESG standards. A 2020 survey by CBRE shows that 57% of occupiers in Asia Pacific favor green buildings[3]. However, the green building adoption rate in Asian cities, such as Shanghai, Hong Kong, Beijing, and Singapore, is still low at about 20%, according to JLL. We expect green buildings in Asia Pacific to outperform those that are not compliant with ESG standards, as they are increasingly attracting government and tenant support. A focus on ESG initiatives when implementing investment strategies is expected to boost returns and help future-proof real estate portfolios.

Office: The office sector in Asia Pacific has been surprisingly resilient. Office net absorption turned positive in several markets as early as the third quarter of 2020. On an aggregate basis, in 2020, major Asia Pacific office markets only posted one single quarter of negative absorption in the fourth quarter, before turning positive in the first quarter of this year (Exhibit 9).

The willingness to return to offices continues to set Asia Pacific apart from other regions. For instance, return-to-office ratios in Japan and South Korea were higher during the recent COVID-19 resurgence than during the 2020 lockdowns, even though rates of infection have been higher recently. Companies are finding it difficult to maintain the benefits of cultural and workplace collaboration when their employees are not at the same location. These challenges reinforce our view that working from home (WFH) and remote working is unlikely to be a permanent option in most parts of

3 2020 Asia Pacific Occupier Survey – Mainland China, CBRE Research, April 2020.

08

Investment Recommendations for Asia Pacific Favor Major Warehouse and Residential Markets

Source: LaSalle Investment Management, as of June 2021.

Exhibit 8: Asia Pacific Investment Recommendations

	CORE	HIGHER RETURN
LaSalle's Best Opportunities	**Modern warehouses in well-located and supply-constrained submarkets**	
	(China Tier 1 & satellite cities, Seoul, select cities in Australia's Eastern Seaboard, Tokyo, and Osaka)	(China Tier 1 & satellite cities, select China Tier 2 cities, Seoul, select cities in Australia's Eastern Seaboard, Tokyo, Osaka, and Nagoya)
	Multifamily (Japan)	**Highly selective office locations/specifications with flexible exit timing** (Tokyo, Osaka, Singapore)
		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; Shanghai retail; Conversion to multifamily)

09

Office Demand Across the Region Experienced Just One Quarter of Negative Absorption

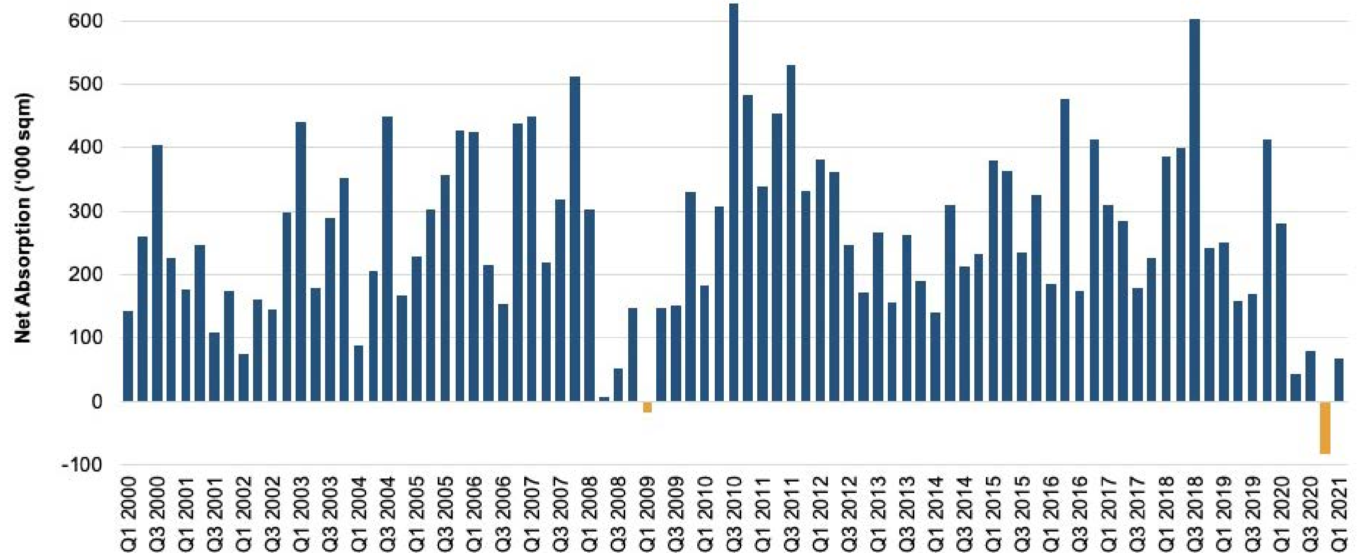
Note:

The aggregate office net absorption of Asia Pacific includes the following office markets: Prime offices in Sydney CBD, Melbourne CBD, Brisbane CBD, Tokyo 5-ku, Osaka, Seoul (including CBD, Yeouido, and Gangnam), and investment grade offices in Beijing (including CBD and Finance Street), Hong Kong Central, Shanghai CBD (including Pudong and Puxi), and Singapore CBD.

The net absorption data are from Q1 2001 except Osaka, which is from Q1 2008.

Source: JLL REIS, as of Q1 2021.

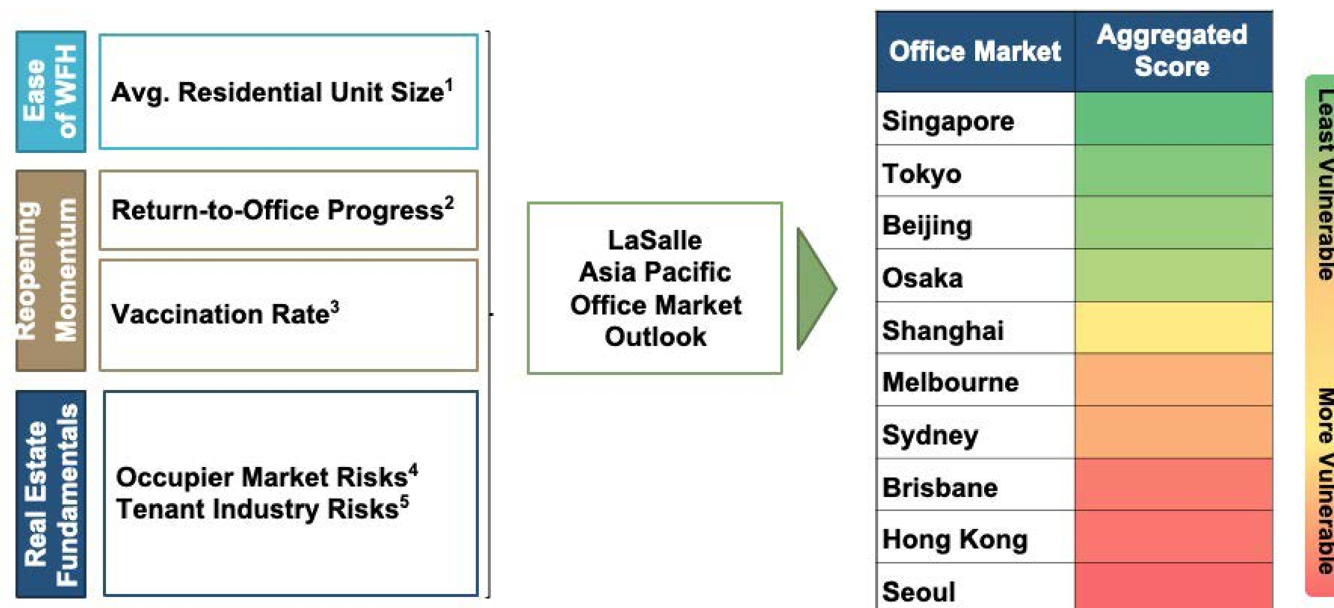
Exhibit 9: Aggregated Office Net Absorption in Asia Pacific (Q1 2000 – Q1 2021)



10

The Office Outlook Across the Region is Highly Diverse

Exhibit 10: LaSalle Aggregated Score on the Outlook of Major Asia Pacific Office Markets



Note: LaSalle Aggregated Score on the Outlook of Major Asia Pacific Office Markets is a framework that LaSalle developed to monitor major Asia Pacific office markets since the start of the pandemic. This framework is expected to evolve as the pandemic conditions and the office market fundamentals change. Please note the update is as of 25 June 2021.

Source: 1) The average residential unit size (in sqm per capita) is a proxy for ease of working from home (WFH), from various local sources, as of May 2021; 2) The return-to-office progress (all cities except China), is based on the rolling monthly average of the Google Mobility - Workplace sub-index, as of April 2021. The progress of returning to office for China is based on LaSalle's estimate, as of 15 June 2021; 3) The vaccination rate is based on the cumulative vaccine doses administered per 100 residents is based on various government released data of vaccination dose administered and 2019 population from CEIC, as of 15 June 2021; 4) The occupier market risk scores are based on a factor model that takes into account the respective market/sector's current vacancy rate by region (comparing to all AP markets/sectors included in this analysis), the respective market/sector's current vacancy rate by historical comparison (comparing to the respective market/sector's historical high and low), projected supply as a percentage of the respective market/sector's historical net absorption, current gross face rent in comparison to the respective market/sector's historical high and low, and disruption in the market/sector (e.g., e-commerce or geopolitical events), LaSalle Investment Management, as of May 2021; 5) The Tenant Industry Risk Score evaluates the vulnerability of the tenant's respective industry to COVID-19, based on the following criteria: i) Change in Employment/ MSCI stock index during COVID-19; ii) Do they rely on tourism or supply chain for their respective sector recovery; iii) How likely these industries will continue to work-from-home post COVID-19?; iv) Are they benefiting from any stimulus or additional demand post COVID-19? The Tenant Industry Risk Score is as of 11 May 2021.

Past performances is not a guarantee of future results. No assurances are given that these trends will continue or materialize as expected. Nothing herein constitutes a guarantee or prediction of future events or results.

this region. We expect a hybrid work model that allows employees to work both in the office and remotely to stay as a popular option post-pandemic. The reduction in office demand on an aggregated basis due to WFH or remote working could be much less than initially anticipated. The trend supports our view that office will remain relevant in Asia Pacific in the post-pandemic era.

The pandemic halted projects slated to commence in 2020 and 2021, which alongside increasing demand, facilitates the stabilization of occupancies. Nevertheless, some volatility can be expected across the region, as new workplace policies come into effect. In our current outlook of major Asia Pacific office markets (Exhibit 10), we continue to favor offices in Tokyo and Osaka for core and non-core strategies. While the vacancy rates in these two office markets have increased, they remain the highest-occupied office markets among major Asia Pacific office markets. For high-return strategies, we continue to monitor Singapore, Beijing, Sydney, and Melbourne CBDs for opportunities at reasonable prices. A caveat for this strategy is that older office buildings could become functionally obsolete and require significant capital expenditures to meet new energy efficiency requirements.

Warehouse: The trends in the warehouse sector we discussed in the 2021 ISA are playing out as anticipated. Domestic consumption, particularly e-commerce, is

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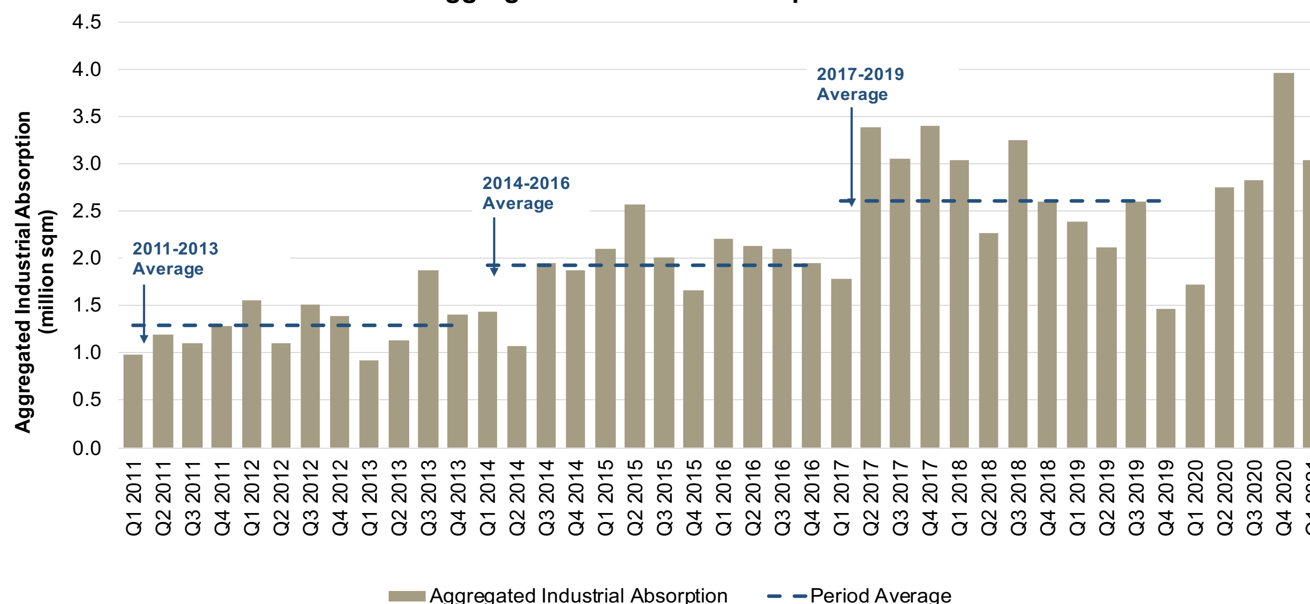
Warehouse Demand across the Region Remains Very Strong



Note:

The aggregated industrial absorption in Asia Pacific comprised of Hong Kong, Singapore, Seoul Capital area, Greater Bay Area (Guangzhou and Shenzhen), Greater Shanghai (Shanghai, Suzhou, Jiaxing, Kunshan, Taicang, and Changshu), Greater Beijing (Beijing, Tianjin, and Langfang), Chongqing, Chengdu, Nanjing, Shenyang, Wuhan, Xi' An, Greater Tokyo, Greater Osaka and Greater Nagoya, and Sydney, Melbourne and Brisbane.

All absorption data are from Q1 2011 onwards except Hong Kong, which is from Q3 2014 onwards; Seoul Capital area, which is from Q1 2012 onwards; Greater Shanghai (Changshu and Taicang), which are from Q1 2016 and Q2 2016 respectively; Greater Beijing (Langfang), which is from Q1 2016 onwards; Wuhan ,which is from Q1 2013 onwards; and Xi' An, which is from Q4 2012 onwards.

All Asia Pacific countries are based on net absorption, while Australia is based on gross absorption.

Sources: JLL REIS (all countries except Japan) and Ichigo (Japan), as of Q1 2021.

expected to continue to drive warehouse demand in the region. Therefore, our investment recommendations have not changed. The rebound of brick-and-mortar retailers' demand for warehouse space surprises us to the upside, as economies reopen in the region.

For core strategies, we continue to favor logistics markets along 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 consumption base. We also favor value-added and build-to-core strategies in Tier 1 and their corresponding satellite cities and highly selective Tier 2 cities in China, Greater Seoul, Greater Tokyo, Greater Osaka, and Greater Nagoya.

We also continue to favor temperature-controlled warehouse for both core and development strategies in Asia Pacific. The growing online grocery sales penetration in the region is expected to raise demand for temperature-controlled warehouses. In addition to the risks associated with investing in this niche sector, investors need to understand the nuances in local markets. For instance, in Greater Seoul, warehouses with 100% temperature-controlled space are rare, due to the relatively high cost and complexity of construction. It is also difficult to secure tenants that only require temperature-controlled warehouse space, as most e-commerce and third-party logistics tenants are involved in both dry and cold distribution. Therefore, recent pipeline projects in Greater Seoul are often mixed-use facilities with dry and cold components. In contrast, warehouse buildings with 100% temperature-

controlled space are common in Australia, as occupier demand is dominated by major supermarket chains and temperature-controlled warehouse providers. However, this is a niche sector dominated by owner-occupiers in Australia, and it requires creativity to position investment strategies. Given the nuances in each local market, investors should have a well-defined exit strategy and experienced leasing and asset management teams when investing in this niche sector.

Multifamily: The multifamily sector in Japan has retained high occupancy rates since the beginning of the pandemic, although with slight rental declines. Central locations in Japan with close proximity to train stations remain attractive to renters. Once the economy begins to recover and vaccination rates reach herd immunity, the in-migration to urban locations in Tokyo, Osaka and Nagoya is expected to recover, which in turn should drive demand and rent recovery for multifamily properties, especially those with high standards of health and wellness or green amenities. The strength of multifamily fundamentals has been priced in, which makes a core strategy less attractive than higher return strategies. We favor conversion from office or hotel assets or repositioning of multifamily properties to support WFH or remote working.

Although the multifamily sector could take some time to institutionalize in Australia and China, we remain positive on the long-term outlook for the sector in both countries. Macro demand drivers for multifamily remain supportive. Meanwhile, recent changes in government policies provide additional encouragement. In Australia, supported by changes in land taxes and the foreign investor surcharge exemption, multifamily investment and development activities have increased over the last six months, with almost two-thirds of pipeline projects securing equity capital from investors based in North America and Europe. In China, the government's decision to offer the full range of local public services to renters is expected to boost demand for rental properties. The supply of multifamily properties in suburban areas is projected to increase in China, although the supply in urban infill areas is expected to be limited. We, therefore, favor conversions or re-developments in urban infill locations. Headwinds for the sector include lack of operational expertise, capital market liquidity, and limited evidence on exit pricing.

Retail: The retail sector remains relatively weak in most of Asia Pacific due to cyclical weaknesses and the structural disruption of e-commerce. The low appetite of investors for retail assets continues to be another headwind for development, although it may open up some buying opportunities. Despite some mild recovery in retail sales in the first four months of 2021, border closures and social distancing measures have continuously impacted brick-and-mortar retail locations, especially large-scale malls requiring a large amount of foot traffic. Non-discretionary retailers are demonstrating the most resilience, particularly in Japan and Australia.

We do not favor retail assets for low-risk investors. However, for risk-tolerant investors, there could be repricing opportunities in highly selective locations and tenant mixes, particularly in markets with relative resiliency, such as China and Japan. In the next 12-18 months, China is expected to continue to lead retail performance in the region, supported by the relatively low vacancies and positive rental growth prospects. Japan retail is also expected to remain resilient. Most importantly, curating the tenant mix with less vulnerable retailers (e.g., grocery, food and beverage, entertainment and pharmaceutical tenants) could reduce the negative impact of e-commerce.

Hotel: Although the hotel industry is the hardest hit sector in the region, the pent-up demand can be unleashed as soon as herd immunity is achieved. Until then, domestic travel and international travel bubbles (among countries with well-managed public health) are expected to recover faster than broad-based global travel. The International Air Transport Association (IATA) projects that global travel is unlikely to return to pre-pandemic levels until 2023-2024. In the interim, there could be distressed opportunities that emerge from financially pressed owners. Going forward, most firms should be well-adapted to conduct their activities virtually, which could lead to reductions in business travel. Leisure travel, on the other hand, is expected to drive hotel demand in the near and medium term. Hotels targeting domestic leisure travelers could benefit more going forward.

The Wall of Capital vs. Rising Interest Rates

The pandemic is an extraordinary shock that has accelerated almost all capital market trends in a short period of time. Stock markets have fully priced in a broad-based economic recovery, well ahead of the actuality. In contrast, real estate capital markets have only priced in the strength of favored sectors and markets. Thus, investment opportunities at reasonable prices in the office, retail and hotel sectors could emerge in the near term.

Interest rates in most Asia Pacific countries have been kept at or near their historical lows, offering abundant liquidity for real estate. Therefore, there are good reasons for investors to be concerned that central banks will raise interest rates, if inflation increases beyond target ranges. Rising commodity prices and construction costs are reflected in the producer price index (PPI), but have yet to be passed along to consumers in most Asia Pacific countries, with the exception of South Korea and Singapore (Exhibit 12). Even without the supply disruption, it is rational for inflation to rise and for central banks to adjust the yield curve to normalized ranges, supported by the record-sized stimulus packages and the gradual vaccine rollouts in the region. The U.S. Federal

Reserve Board signaled in early June that interest rate hikes could come as soon as 2023, triggering several Asia Pacific countries to give similar guidance. The Bank of South Korea could be the first major central bank to raise its policy rate, albeit gradually, with an uptick in the first half of 2022. The Reserve Bank of Australia has repeatedly emphasized that it does not see conditions warranting a rate hike until 2024 at the earliest.

The Bank of Japan is expected to maintain its ultra-accommodative monetary policy for an extended period of time, as core inflation is still substantially below its 2% target. We expect the low interest rate environment to continue in Japan, which creates a highly supportive environment for the domestic demand for income-generating real estate assets. The lending environment in Japan remains the most attractive in the region.

The People's Bank of China (PBOC) is expected to maintain a neutral and stable monetary policy, as the consumer price index (CPI) is well contained and the yuan remains strong against the U.S. dollar. There is no incentive for the PBOC to raise rates in the near term, and it maintains a wider cushion to let rates fall, if needed. Some highly-levered Chinese residential developers are among the list of companies targeted for tighter credit by the PBOC. Loan spreads to base rates could increase for mid-sized residential developers. Looking forward, there could be opportunities to acquire residential, office and/or retail assets (owned by residential developers who encounter liquidity problems) at attractive pricing.

The big picture remains that central banks and policy makers in Asia Pacific countries are mindful not to increase interest rates or tighten monetary policies too soon, in order to maintain momentum in the economic recovery. Gradual increases from the zero to ultra-low interest rate environment over the next 2-3 years would be a healthy move for the real estate capital markets. It would lessen the capital pressure that targets the favored real estate sectors/markets and create better pricing for investors.

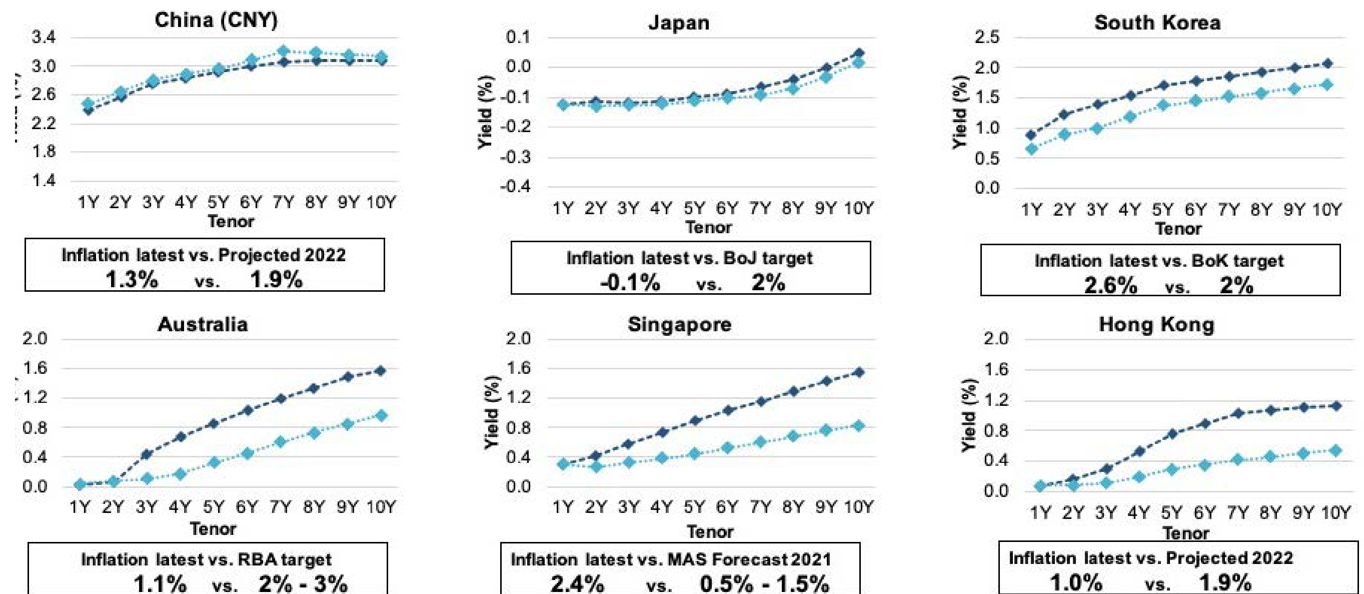
12

Gradual Interest Rate Increases Are Healthy for Real Estate Capital Markets

Sources: Yield curves sourced from Bloomberg, as of 24 June 2021.

The spot inflation rate for Australia is from the Australian Bureau of Statistics, as of March 2021 and is the latest available data. Spot inflation rates for China, Japan, Singapore, South Korea, and Hong Kong sourced from each country's statistics bureau, as of May 2021. Inflation expectations for China, Japan, South Korea, and Hong Kong sourced from the IMF, as of April 2021. Inflation expectations for Australia and Singapore sourced from RBA and MAS respectively, as of April 2021.

Exhibit 12: Yield Curves and Inflation



As of 24 June 2021 — As of 31 Dec 2020

LaSalle

The Asset Class Perspective

Real estate was hit harder than other major asset classes during the pandemic. The table on the following page (Real Estate's Relative Performance) shows how stocks and bonds out-performed private real estate indices through the first quarter of 2021.

It also shows the dramatic recovery of REIT prices from their lows in Q1 2020. Moreover, the numbers reveal that the 10-year track record of both listed REITs and core, unleveraged private equity real estate remains between stocks and investment-grade bonds, which is where asset allocators expect it to be.

The 20-year history shows real estate securities and unleveraged real estate out-performing both large-cap stocks and investment-grade bonds as the "lower-for-longer" interest rate era gradually and persistently unfolded across the world. Yet the next 20 years are not going to see this yield-lowering trend repeated. The parallel processes of lower interest rates and cap rates are asymptotic, which means there is an effective lower bound, beyond which we should not expect either to fall.

01

Real Estate's Relative Performance

Trailing period returns by asset class and country[1]

	To 1Q 2021										To 4Q 2020
Average Annual Total Return	Global Stocks[2]	Global RE Securities[3]	Global Corporate Bonds[4]	Global Gov't Bonds[5]	US Direct Property (NCREIF)[6]	US Core Funds (ODCE)	UK Direct Property (MSCI/IPD)[7]	Canada Direct Property (MSCI/IPD)[8]	Australia Direct Property (MSCI/IPD)[9]	Japan Direct Property (IPD)[10]
1 Year	51.5%	37.4%	8.9%	-1.5%	2.6%	2.3%	0.9%	-2.7%	1.7%	4.2%
3 Years	13.9%	7.6%	5.1%	3.0%	4.9%	4.9%	1.5%	3.1%	5.6%	5.8%
5 Years	14.0%	4.9%	4.1%	1.9%	5.8%	6.2%	3.8%	4.3%	7.9%	6.4%
10 Years	11.5%	7.6%	4.8%	3.4%	8.8%	9.7%	6.9%	7.5%	9.3%	6.1%
20 Years	7.0%	9.6%	5.3%	3.6%	8.2%	7.5%	6.8%	9.0%	9.8%	-
Standard Deviation [11]										
20 Years	16.5%	20.5%	4.7%	3.5%	4.6%	6.5%	6.2%	3.7%	2.8%	2.4%

Notes:
1 Stocks, REITs, bonds and private real estate data through 1Q 2021, expect Japan MSCI quarterly returns which is through 4Q 2020.
2 MSCI All Country Gross World Total Return Index in Local Currency.
3 S&P Global Developed Index in US Dollars.
4 Citigroup World Corporate Bond Index Total Return in US Dollars (Local Currency History Not Available Prior to 1999).
5 Citigroup World Government Bond Index All Maturities Total Returns in Local Currency.
6 US NCREIF Property Index Total Returns in US Dollars.
7 UK MSCI Quarterly Standing Property Total Returns in British Pounds, data prior to Dec 2001 is MSCI Annual. UK MSCI Quarterly Index used in all time periods available.
8 Canada MSCI Quarterly Standing Property Total Returns in Canada Dollars.
9 Australia MSCI Quarterly Standing Property Total Returns in Australian Dollars.
10 Japan MSCI Quarterly (Based on monthly index) Standing Property Total Returns in Japanese Yen.
11 This standard deviation is based on quarterly returns over the past 20 years, then annualized (except in the case of Japan, where it is based on returns since inception). Note that appraisal smoothing contributes to the lower volatility of direct real estate indices.

The strong performance of corporate bonds during the pandemic puts international real estate in the unusual position of underperforming high quality, fixed income securities. We fully expect this to be a temporary situation, not a permanent one. The ten-year numbers shown above are a better guide to where real estate is likely to settle, once the pandemic year of 2020 gets blended with the upcoming years of 2021-2023, when we expect real estate to once again out-perform investment-grade bonds.

Three negative financial effects eroded real estate returns in 2020. First, COVID-related income collection issues cropped up when some tenants simply stopped paying rent–mainly at retail properties. Second, fundamentals deteriorated rapidly in sectors like the office market, which hurt a forward-looking view of rent levels. Third, the capital markets reacted to the income interruptions and weakening fundamentals by either selling listed real estate at whatever the market would bear or waiting on the sidelines in the case of private equity buyers. The sharp drop in REIT prices turned out to be one of the best buying opportunities for real estate securities in over a decade, as shown in the Q1 trailing annual returns. The sharp drop in private transaction activity did not spawn an equivalent buying opportunity, as there was very little panic selling. Private equity buyers could no longer easily travel to inspect properties, nor could they be sure how long the

first two effects would last. So, the direct transaction market ground to a near-halt until a sharp pick-up occurred in December 2020, when year-end selling and buying took place, and it has continued to build as COVID restrictions are lifted in many countries.

The Way Forward

Despite mild disruptions to income streams in 2020, real estate's overall performance has held up remarkably well. We believe the asset class will continue to perform well in the second half of 2021. There are many reasons for this resilience, which we have already described in both this mid-year ISA and last December's year-end view. These include:

- The rapid recovery of tenant demand as countries emerge from the pandemic.
- The persistence of low interest rates, which makes real estate yields attractive and keeps the cost of borrowing low.
- The plentiful supply of capital looking to find a home in real estate as target allocations continue to rise. However, booming stock and bond markets have put real estate well below this target allocation for many large investors.
- The mismatch between where a bulk of the inventory of real estate is located—in the largest, gateway cities—and where tenant demand is growing fastest in secondary markets, with higher quality of life or lower housing costs.

02

20 Year Quarterly Total Return Correlations

By asset class

Correlations - 20 Year Quarterly	Global Stocks[1]	Global RE Securities[2]	Global Corporate Bonds[3]	Global Gov't Bonds[4]	UK Direct Property (MSCI)[5]	US Direct Property (NCREIF)[6]	Canada Direct Property (MSCI)[7]	Australia Direct Property (MSCI)[8]	Japan Direct Property (MSCI)[9]
Global Stocks[1]	1.0	0.7	0.3	-0.5	0.3	0.2	0.1	0.1	0.1
Global REITs[2]		1.0	0.5	-0.1	0.5	0.2	0.1	0.2	0.1
Global Corporate Bonds[3]			1.0	0.5	0.0	-0.3	-0.2	-0.3	-0.2
Global Government Bonds[4]				1.0	-0.2	-0.1	-0.2	-0.2	-0.1
UK Direct Property (MSCI)[5]					1.0	0.6	0.3	0.6	0.4
US Direct Property (NCREIF)[6]						1.0	0.6	0.8	0.8
Canada Direct Property (MSCI)[7]							1.0	0.6	0.5
Australia Direct Property (MSCI)[8]								1.0	0.8
Japan Direct Property (MSCI)[9]									1.0

Correlations between asset classes highlight the diversification benefits of property within a mixed asset class portfolio.

20 Year Quarterly Annualized Correlations to 4Q 2020.
Notes on Sources
1 MSCI All Country Gross World Total Return Index in Local Currency.
2 S&P Global Developed Index in US Dollars.
3 Citigroup World Corporate Bond Index Total Return in US Dollars (Local Currency History Not Available Prior to 1999).
4 Citigroup World Government Bond Index All Maturities Total Returns in Local Currency.
5 UK MSCI Quarterly Standing Property Total Returns in British Pounds, data prior to Dec 2001 is MSCI Annual. UK MSCI Quarterly Index used in all time periods available. Unleveraged, pre-fee.
6 US NCREIF Property Index Total Returns in US Dollars. Data is unleveraged and pre-fee.
7 Canada MSCI Quarterly Standing Property Total Returns in Canada Dollars. Data is unleveraged and pre-fee.
8 Australia MSCI Quarterly Standing Property Total Returns in Australian Dollars. Data is unleveraged and pre-fee.
9 Japan MSCI Quarterly (Based on monthly index) Standing Property Total Returns in Japanese Yen. Data is unleveraged and pre-fee..

- The realization that the asset class is well-suited to helping meet the “ESG” goals of many investors.

Inflation and the threat of rising interest rates has become a growing concern of asset allocators in the first half of the year, especially in the US and Canada. The Central Banks in other countries have not yet signaled the need for rising interest rates, as has occurred in the US. Yet, consumer and producer prices have also crept up in Germany, the UK, and Poland.

Inevitably though, investors should expect inflation and interest rates to normalize (i.e. rise) over the next two to three years. And the so the question becomes: How will real estate perform in a higher inflationary environment. The evidence on this is not definitive. Inflation above 6% or so has not been a feature of most G20 economies in over 40 years. Private equity indices show a fairly clear pattern of inverse correlation with investment grade bonds over the past 20 years. (see correlation table below). This implies that, unlike other fixed income instruments, real estate confers a reasonable degree of hedging ability to rising interest rates and inflation at a very macro level. When bond prices fall, their yields rise.

The negative correlations between bonds and real estate suggest that this frequently happens when economies are strong, which usually boosts real estate’s ability to stay fully leased and to achieve rent growth that tracks or exceeds inflation. But, this macro view can be misleading: 1) In the case of specific assets with long, flat leases that cannot keep pace with inflation and are as vulnerable as fixed income instruments to rising inflation or 2) When micro-market dynamics of supply and demand supersede the general ability of real estate cash flows to keep pace with inflation.

The main take-away for the second half of 2021 is that many investors believe that real estate will be a better inflation hedge than bonds, and are likely to rotate money out of fixed income allocations and into real assets like real estate, infrastructure and commodities. Whether this belief is strictly true or not, may not matter. The investment flows to real estate are likely to grow and short-duration leases are likely to be able to participate in a robust economic recovery that also boosts inflation to levels above the 2% targets of many Central Banks.

Re-opening Accelerates in 2021

As the second half of 2021 unfolds and metropolitan areas come back to life, we expect real estate markets to participate in a robust, but an uneven, recovery. We expect the divide between the favored and the unfavored sectors to continue. We are bullish on many of the alternative property types as they progress from niche to mainstream status. However, the service-intensive nature of many of these specialized sectors requires the full attention of investment deal teams. The major cities of Asia-Pacific (especially Beijing, Shanghai, Seoul and Tokyo) show westerners what is possible—a reasonably high degree of COVID control alongside the re-opening of places to work and shop in highly urbanized areas.

Nevertheless, we also anticipate changing mobility and density preferences to register in real estate markets through a modest re-distribution of economic activity across urban and suburban landscapes. Businesses and employees are likely to shift slightly to a select group of livable, secondary markets at the expense of the world’s largest and most expensive cities. This is not the end of the urbanization trend that we have followed so closely for many years. Instead, it is a rebalancing of populations and economic activity towards a model that favors cities and suburbs capable of delivering healthy, less stressful lifestyles, and with dependable infrastructure that can be counted on as climate change accelerates. Not every business or resident will move to a suburban setting, but we expect that on the margin, walkable suburban nodes and neighborhoods along the urban fringe are potential out-performers in the next 5 to 10 years.

Our portfolio construction guidance continues to favor a balance of income stability alongside a strong set of growth-oriented positions to take advantage of the robust 2021-22 economic prospects. We expect to see relatively few severe dislocation opportunities around the world, although a handful could emerge as debt comes due on out-of-favor properties that cannot be refinanced. Finally, we expect that climate change will become an increasingly important topic for real estate investors. We expect to see two strands to the rising attention paid to this topic: 1) An acceleration of regulatory changes and peer-group benchmarks designed to slow the rate of greenhouse gas emissions; and 2) A growing awareness that regardless of success or failure of the first strand, climate change is happening now. Moreover, insurance coverage for climate risks in the future may not look like, or be priced the same as, insurance coverage in the past.

The Rise of High Frequency and Alternative Data During the Pandemic

During the first phase of the pandemic, disruptions to economies and the resulting responses by national and local authorities created highly unusual conditions where traditional indicators of economic activity were no longer entirely relevant or reliable.

The speed of changes and the very specific local effects created by lockdowns and social distancing measures led LaSalle's Research team to employ high-frequency, high-volume real-time alternative data sets to monitor these events, mitigate risks and support our investment decisions.

In the early days of the pandemic, we quickly learned to distinguish all the different types of COVID-19 epidemiology data that became available on government and university websites. By building pandemic tracking tools for case counts, hospitalizations, mortality, and vaccinations, our data scientists assisted asset managers to visualize the rapid geographic spread of the disease. We even used data[1] from the European Space Agency (ESA) to gauge the level of economic activity in an area. In China, emission levels dropped in late January 2020, suggesting that strict measures impacted economic activity. However, by late March 2020, emission levels began to recover, even though they were still low in the rest of the world. This gave us the conviction that China would lead the post-pandemic recovery.

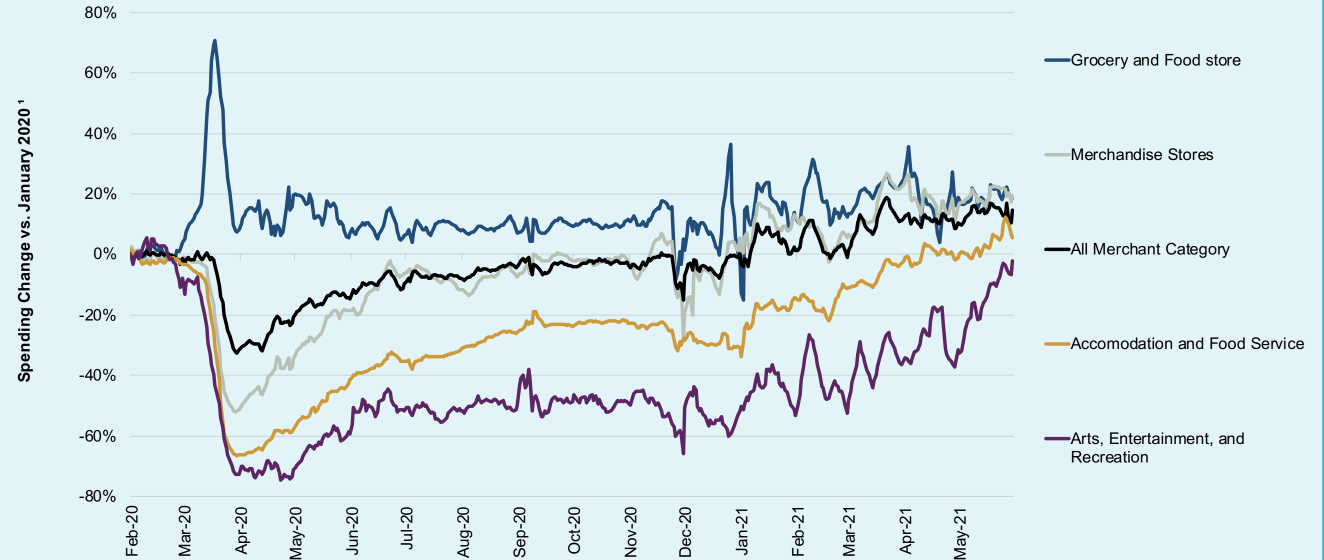
As the economies re-open, analytical tools and dashboards using data sources like mobile location data from Safegraph, Placer.ai, Google and Apple help LaSalle track the spatial distribution of economic or social activity across a metro area or an entire country. Through these tools, we can estimate the effects of social distancing on retail tenants. For example, credit card data is useful for assessing specific impacts on various industry categories (see U.S. Spending chart above). Airlines and restaurants were two of the most affected sectors during the first year of the pandemic. Using information from FlightRadar24 and OpenTable bookings, the magnitude and speed of the recovery for both sectors

1 The data measure the concentration of nitrogen dioxide, a pollutant found in emissions from vehicles and power plants. Economic activity generates nitrogen dioxide. As such, the concentration of nitrogen dioxide can provide a proxy for economic activity.

01

Daily Retail Sales Data Shows Patterns of Volatility and Convergence

US Spending By Merchant Category



[1] The change is compared to 4 January – 31 January 2020 and seasonally adjusted.

Source: Affinity Solutions via Opportunity Insights from collaboration of Harvard University, Brown University, and Bill and Melinda Gates Foundation Data through 30 May 2021. Latest available as of June 2021.

can be seen. In non-retail service sector jobs, we see more people returning to offices (according to Google Mobility Workplace, Metrikus Office Occupancy Index and Kastle data). Similar signals are recorded by proptech data aggregators like VTS: office demand has recovered to 80% of the pre-pandemic level in a few gateway cities.

While it is too early to predict secular shifts brought about by the pandemic, cities with industries that are more "remote-friendly" will likely need additional time for office demand to recover. Data providers like LinkedIn provide timely insights in understanding these new job market dynamics. By tracking job postings on sites like Adzuna in the U.K. (see below), we can see clear trends in which sectors are recovering faster: recovery in wholesale retail is lagging behind the rest of the market, while demand for workers in Transportation and Logistics has skyrocketed. In the U.S., the pool of tech and engineering talent has been more resilient and growing at a faster rate in secondary and tertiary markets like Madison, Colorado Springs, Raleigh, Pittsburgh, Austin and Denver metro areas.

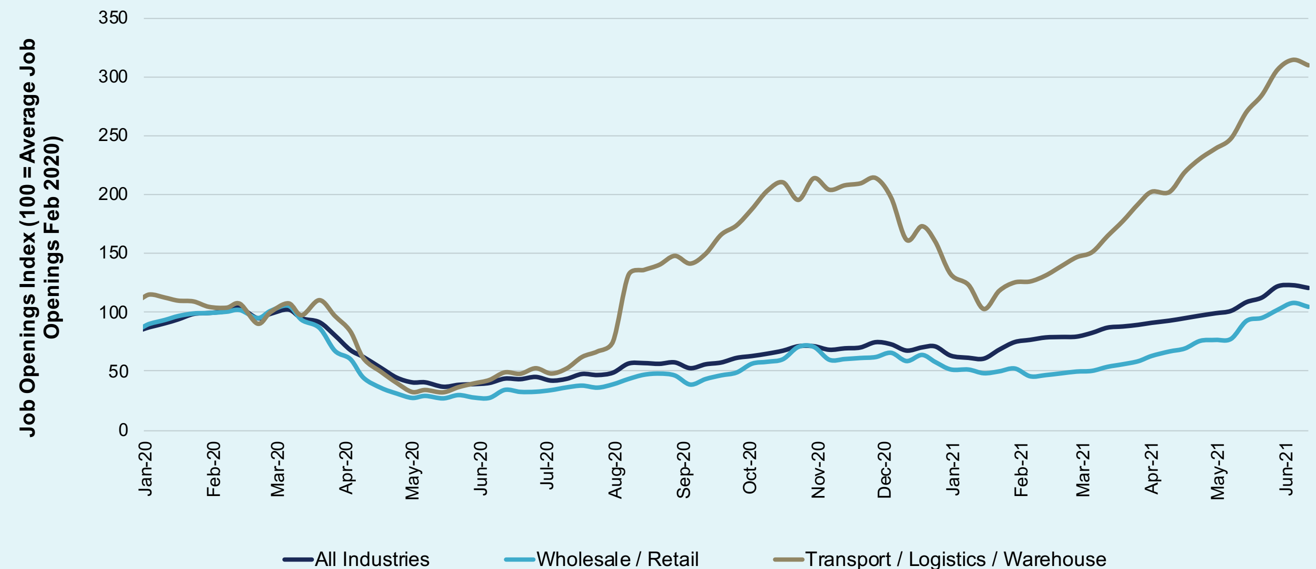
The Lasting Contributions of Data Science

Reliance on LaSalle's data science skills during the pandemic accelerated our use and understanding of high-frequency spatial data. Many countries recorded both the fastest economic contractions and the fastest economic expansions in their histories. This allowed us to study the almost-never-observed 'tails' of the distribution of possible outcomes, and the unique supply-chain challenges that exist there. Extreme events are exactly the circumstances in which otherwise-stable relationships (widely used for statistical forecasting) are likely to break down. The appropriate response for building economic forecasting models is to accept that we face both quantifiable risk and unquantifiable uncertainty. Thus, we must acknowledge that even vast amounts of new data may not help us predict the future with a high degree of accuracy. However, this data may turn out to be quite useful in simply understanding the present—a highly important contribution during the height of the COVID-19 crisis.

02

Daily Job Openings in the UK Show Sectors Where Labour Shortages Might Occur

Job Openings by Industry



Source: LaSalle Analysis of ONS & Adzuna data. Data to 11/06/2021

Research and Strategy Team

Managing Editors

Jacques Gordon,
Global Strategist

Richard Kleinman,
Head US Research & Strategy
and co-CIO

Brian Klinksiek,
Head of European Research & Strategy
and Global Portfolio Strategies

Elysia Tse,
Head of Asia Pacific Research &
Strategy

Contributors

Petra Blazkova

Mary Burke

Zuhaib Butt

Simone Caschili

Jade Cheong

Amanda Chiang

Ryan Daily

Jake Fansler

Eduardo Gorab

Heidi Hannah

Kayley Knight

Mari Kumagai

Chris Langstaff

Ben Lentz

Tobias Lindqvist

Daniel Mahoney

Simon Marx

Frances OseiBonsu

Chris Psaras

Wayne Qin

Hilary Salter

Dominic Silman

Sophia Sul

Fred Tang

Dennis Wong

Manuel Zapata

Sabrina Zimmermann

Additional Contributors

Elena Alschuler

Sophie Carruth

Alexandra Constantin

David Devos

Tom Miller

Joe Oslawski

Kevin Scroggin

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