JLL Research Report

Global Capital Flows

A strong year for global real estate but catalysts for caution building

Contents

Executive summary

- Buoyed by healthy economic fundamentals and positive investor sentiment, the fourth quarter brought about its usual uplift in investment as volumes picked up by 21% from the third quarter to reach US$212 billion. While this is 11% lower than Q4 2017, full-year 2018 transactions totaled US$733 billion, 4% better than the 2017 level and the strongest annual performance globally since 2007.
- Regional activity mirrored the trend seen over the course of 2018 with the Americas leading the way. Outperformance was driven entirely by the strength of the U.S. market with regional full-year volumes rising by 13%. After a relatively slow third quarter, Asia Pacific bounced back and ended the year robustly as the full-year total climbed by 7% to a new all-time high. EMEA witnessed a 6% decline in annual sales activity despite growth in core markets such as France and Germany.
- Paris recorded its best annual performance in over a decade as a wave of foreign capital boosted volumes. Meanwhile, Warsaw joined the list of top recipients of cross-border capital for the first time, as foreign investors looked to capitalise on the growing demand for office space by occupiers in the Polish capital.
- Outbound investment by Chinese groups in 2018 was only a fraction of what it was the year before. At the same time, investors from Singapore have stepped in to provide liquidity in global real estate markets as they became the biggest exporters of capital.
- We expect global investment activity in commercial real estate in 2019 to dampen slightly, by 5% to 10%, to around US$680 billion. In addition, we expect to see emphasis on indirect investment, entity-level transactions, recapitalisations and debt. However, greater investor caution due to geopolitical risks and market volatility may ultimately lead to softer transaction volumes.
- Despite the more cautious overall trading environment anticipated for 2019, the industrial sector is expected to perform the strongest of the different property sectors from a year-on-year standpoint. Meanwhile, the office sector is anticipated to see a slight decline globally given the continued low-yield environment. The retail sector is likely to face the biggest challenges as investors rebalance their portfolios to reflect changing dynamics in the space.

Direct commercial real estate transaction volumes, Q4 2017 – Q4 2018

US$ billions	Q3 2018	Q4 2018	% Change Q3 2018 – Q4 2018	Q4 2017	% Change Q4 2017 – Q4 2018	FY 2017	FY 2018	% Change FY 2017 – FY 2018
Americas	74	75	2%	66	15%	249	281	13%
EMEA	65	94	43%	119	-21%	310	293	-6%
Asia Pacific	36	43	20%	52	-18%	149	159	7%
TOTAL	175	212	21%	237	-11%	708	733	4%

Source: JLL

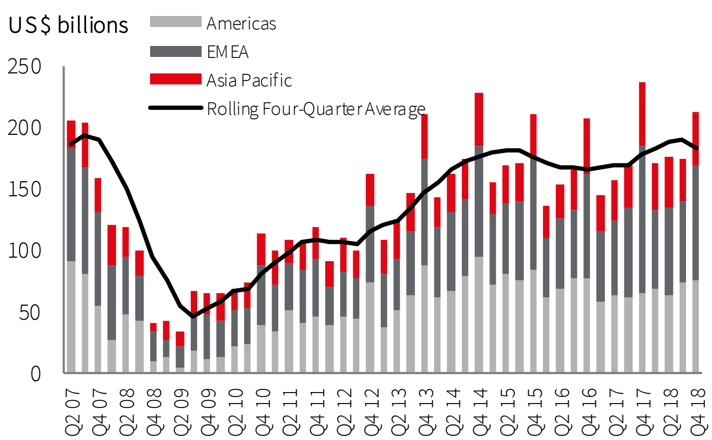
Global & regional

Global real estate investment reaches new cyclical high

Volumes lifted by fourth quarter uptick

Buoyed by healthy economic fundamentals and positive investor sentiment, the fourth quarter brought about its usual uplift in investment activity as volumes picked up by 21% from the third quarter to reach US$237 billion. While this is 11% lower than Q4 2017, full-year 2018 sales totaled US$733 billion, 4% higher than that seen in 2017 and the strongest annual performance since 2007.

Direct commercial real estate transaction volumes



Source: JLL

Global growth driven by the Americas and Asia Pacific

Rounding off what was a year of outperformance in the Americas, Q4 2018 volumes rose by 15% year-on-year to US$75 billion. This, combined with the robust start to the year, brought full-year 2018 activity to US$281 billion, 13% better than 2017's mark. Growth in the Americas was driven entirely by the U.S., with Brazil, Canada and Mexico all posting year-on-year declines in sales. The U.S. market finished the year on a high note as annual investment sales increased by 16% from 2017 to reach US$260 billion. Growth was mainly propelled by the office and industrial sectors; activity in each grew by 11% and 22% respectively. While cross-border trading remains muted relative to previous years, domestic liquidity has rebounded and is at the highest level seen this cycle.

Even though Q4 2018 volumes in EMEA were 21% lower than in 2017, the US$94 billion in activity seen in Q4 was the second highest on record. This brought full-year investment to US$293 billion, 6% lower than 2017. While concerns related to Brexit stymied growth in the UK market, which was down 6% from 2017, the region's next two largest markets, Germany and France, continued to experience robust growth. Full-year 2018 totals in Germany were up 6% while activity in France rose by 10%.

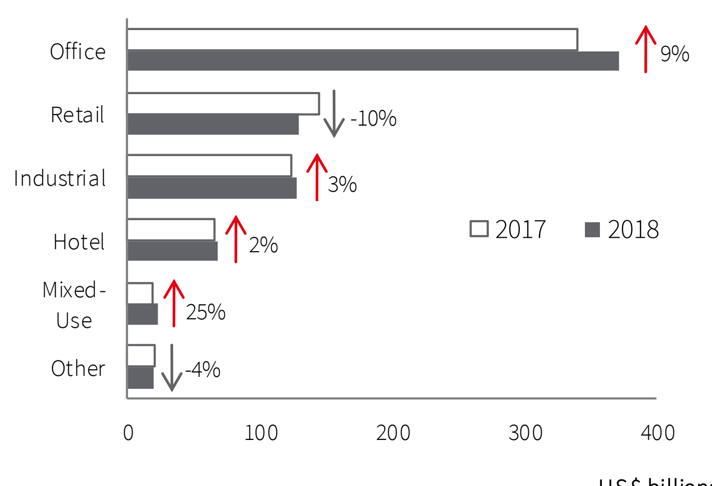
Among the largest contributors to the region's overall decline in 2018 volumes were regional markets such as the Netherlands, Norway, Sweden, Finland, Spain and Italy. On the other hand, some of the year's healthiest performances came from markets such as Portugal, Poland and Ireland, where structural reforms and bright macroeconomic prospects supported investment growth.

While Asia Pacific was unable to match the record fourth quarter from 2017, volumes in Q4 2018 reached US$43 billion, 31% above the long-run average. This helped boost full-year investment to US$159 billion, 7% higher than 2017 and the best annual performance on record. For just the second year, China overtook Japan as the most liquid market in the region, as volumes grew for the fourth consecutive year. While Australia, Japan and Singapore all posted declines in year-on-year investment sales, double-digit growth in Hong Kong and South Korea drove both markets to new highs in annual activity.

Industrial growth cools down from sizzling highs

Investor demand for industrial assets did not let up in 2018 as liquidity in the sector increased by 3%. However, year-on-year growth in quarterly investment slowed from an average of 37% in 2017 to a lesser 8% in 2018. While many investors have undertaken large-scale portfolio acquisitions to gain immediate access to scale, this has made it even more difficult for some new investors to enter the sector as many groups find themselves competing with an ever larger pool of bidders for an increasingly limited number of assets.

Global transactional volumes by sector



Source: JLL

Cross-border investors turn to European markets

New York rebounds and moves into second place

For the second year in a row, London emerged as the most liquid real estate market in the world as volumes increased by 14% to US$36.3 billion in 2018. While concerns over Brexit remain front and centre, both foreign and domestic investors have remained committed to the market, with a particular focus on the office sector which attracted 74% of all investment.

After falling to fourth position in 2017, New York jumped back to second place as 2018 volumes picked up from the cyclical low-point seen in the previous year. While the average quarterly investment in 2018 was 50% higher than the average during 2017, it was also 13% lower than the long-run average, indicating that activity has not fully returned to the levels seen earlier in the cycle.

The rebound in New York was driven mostly by domestic groups, who provided 72% of all liquidity in the market in 2018, as offshore capital flows were 38% below the average annual volume seen since 2014. Among the main reasons for the decline in offshore investment has been the reduction in outbound investment by Asian investors. Capital flows from Asia fell dramatically in 2018 with just US$1.4 billion invested by groups from the region throughout the year; between 2015 and 2017, annual Asian capital flows to New York averaged US$5.5 billion. Most notable is the drop in Chinese investment, which plunged from an average of US$3.1 billion between 2015 and 2017 to just US$216 million in 2018.

Most active cities

Rank 2017	Rank 2018	City	2018 (US$ bn)	2017 (US$ bn)
1	**1**	London	**36.3**	31.9
4	**2**	New York	**31.4**	20.9
3	**3**	Paris	**28.5**	22.5
8	**4**	Seoul	**21.7**	14.0
5	**5**	Shanghai	**20.5**	16.7
6	**6**	Hong Kong	**18.4**	16.4
2	**7**	Los Angeles	**18.0**	22.9
7	**8**	Tokyo	**17.9**	15.4
15	**9**	Chicago	**13.1**	8.1
9	**10**	Washington, D.C.	**12.7**	11.5

Source: JLL

Paris records its best performance in over a decade

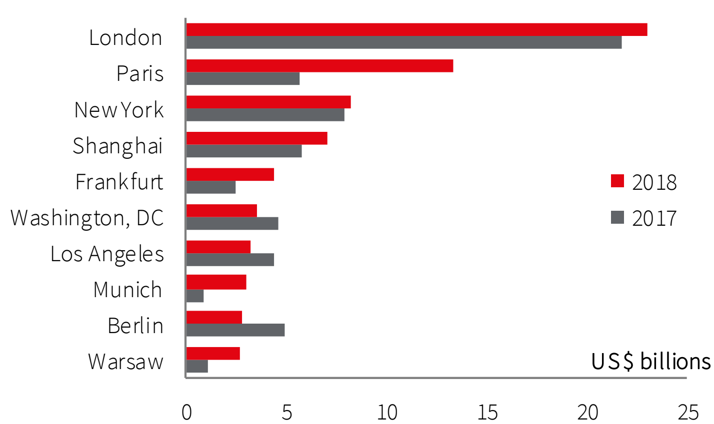
Paris posted its best annual performance since 2007 as 2018 volumes increased by 27%. This was largely propelled by a wave of foreign capital which accounted for 47% of all investment in the city in 2018. Over half of the US$13.3 billion invested by offshore groups came from global funds, German institutions and Canadian pension funds. These groups primarily targeted office assets, both in the CBD, where an imbalance between supply and demand has elevated rents, and in the La Défense submarket where vacancy rates are among the lowest in the capital.

Foreign investors make an impact in Warsaw

A new entrant to the list of largest recipients of cross-border capital, Warsaw emerged as the tenth most liquid market for foreign investment in 2018 as volumes reached a record US$2.7 billion. Cross-border activity gradually increased each quarter throughout the year, culminating in the fourth quarter during which foreign investors made acquisitions totalling US$1.3 billion. While global funds were the most active offshore group, investors from the U.S., Austria, Germany and Malaysia were also among the biggest investors in the city.

Nearly 80% of all foreign investment in Warsaw went to the office sector in 2018; notably, three cross-border transactions over US$200 million closed in the sector during the year, compared to just five such transactions between 2014 and 2017. Underpinning these capital flows are solid occupier fundamentals in the office market where robust demand from corporates, flexible space operators and public sector entities alike has spurred increased take-up. This has led to falling vacancies and rising rents, particularly in the CBD where much of the foreign investment has been concentrated.

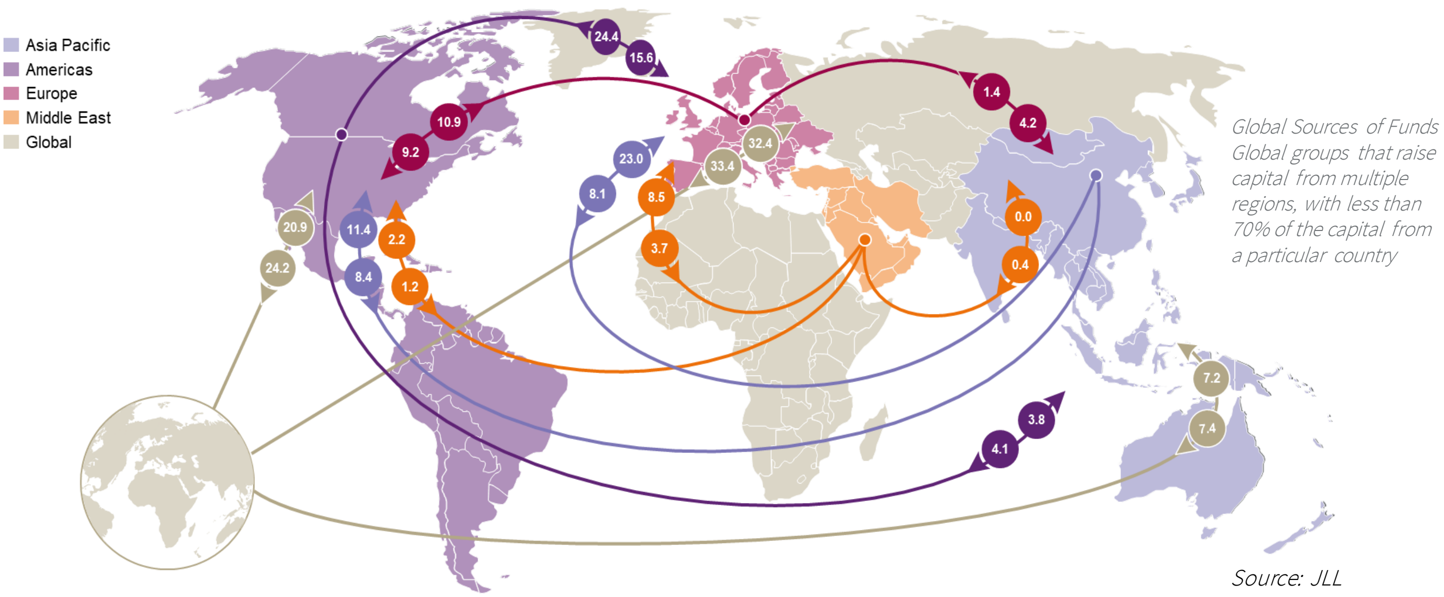
Top 10 largest recipients of cross-border investment



Source: JLL

Cross-border

Inter-regional flows, FY 2018 (US$272 billion in total)

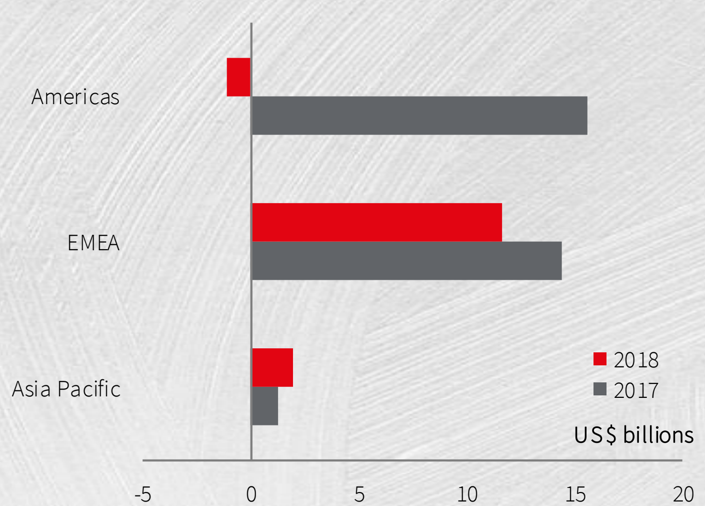


Source: JLL

Europe remains the epicentre for global capital flows

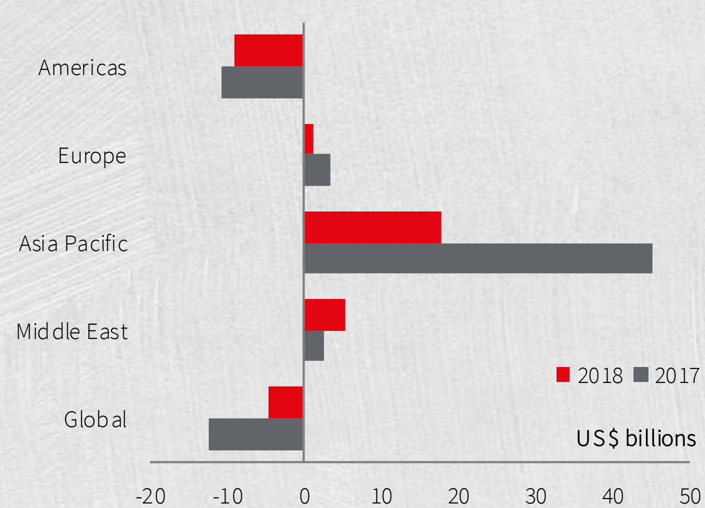
With US$11.7 billion in net inter-regional capital flows in 2018, Europe was the largest beneficiary of global capital flows. Despite being net sellers of European real estate, global funds were the most active buyers with US$32.4 billion in acquisitions in 2018, spending more in Europe than in any other region. While 58% of the investment by these groups was in the UK, France and Germany, where property yields are among the lowest in the region, Poland, Spain and Italy were their next three most popular destinations as they look to provide higher returns for their investors. Asian groups, who were the second biggest investors in Europe, were also the largest net-exporters of capital globally with US$17.8 billion more in inter-regional purchases than sales over the course of 2018. While the majority of investment from Asia was focused on the office sector, the industrial sector has quickly become the second most favoured asset class as investors look to gain access to scale in the sector.

Net inter-regional flows by asset region



Source: JLL

Net inter-regional investment by source of capital



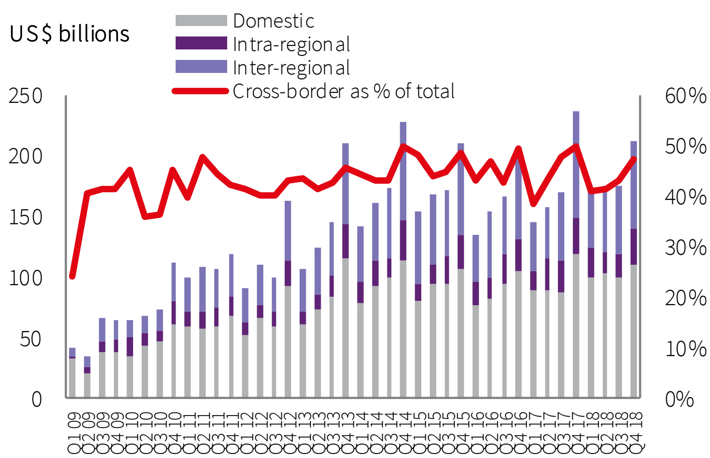
Source: JLL

Global funds remain active in all three regions

Inter-regional flows reach new highs

Growth in cross-border flows matched the broader market in Q4 2018 as transactions involving a foreign buyer or seller picked up by 21% from Q3 to reach US$100 billion. Capital flows between regions made up US$72 billion of that total, which brought full-year inter-regional volumes to US$229 billion, 2% up on 2017's volume and the highest level seen in the current cycle.

Global cross-border transaction volumes



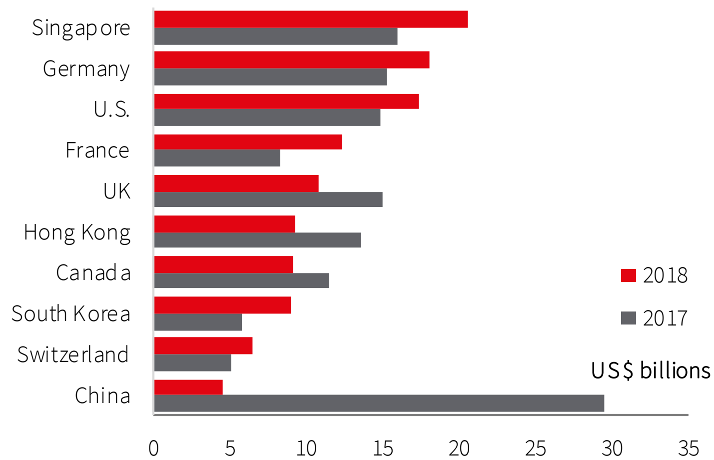
Source: JLL

Singapore rises to the top while China falls to the bottom

Among the most notable trends of 2018 was the reduction in outbound capital flows from China. Cross-border investment by mainland investors totalled US$4.6 billion in 2018, a decline of 84% on 2017. Government imposed capital controls and increased regulatory scrutiny on overseas investments have significantly curtailed cross-border investment, which had averaged US$19.7 billion annually between 2014 and 2017. The precipitous drop in capital flows from China stands in contrast to the notable increase in outbound investment by Singaporean groups. As the biggest exporters of capital in 2018, with $20.7 billion in cross-border acquisitions, Singaporean investors spent 30% more on foreign real estate than they did in 2017.

Investors from Singapore continue to favour the office sector which accounted for 43% of all cross-border purchases in 2018. Investment peaked in Q4 with a number of high-profile acquisitions such as GIC's purchase of Tour Ariane in Paris and CDL's purchase of 125 Old Broad Street in London. Singaporean groups also spent US$6.1 billion on cross-border industrial acquisitions, primarily in the U.S., Poland and Germany, making it their second most targeted asset class.

Top 10 cross-border purchasers by source of capital



Source: JLL

Large-scale trades in China and the U.S. top the charts

Among the most significant cross-border transactions of the fourth quarter was Blackstone's US$1.2 billion acquisition of an office and retail complex in Shanghai. It was not the only major deal completed by the group in Q4, as Blackstone also acquired a US$950 million industrial portfolio, which included a number of last-mile assets, from MDH Partners and Harvard University's endowment fund. The transaction was one of several large-scale industrial purchases made by Blackstone in 2018, including a number of entity-level deals such as the US$7.6 billion privatisation of Gramercy Property Trust, a U.S. industrial REIT.

Notable cross-border transactions, Q4 2018

Property name	Location	Sector	Sale price (US$ mn)	Purchaser	Purchaser source of capital
Mapletree Complex	Shanghai	Mixed-Use	1,200	Blackstone	Global
MDH Portfolio	U.S.	Industrial	950	Blackstone	Global
Capital 8	Paris	Office	897	Invesco	Global
Trianon	Frankfurt	Office	765	IGIS AM & Hana Financial	South Korea
Itis Shopping Centre	Helsinki	Retail	589	Morgan Stanley	Global

Source: JLL

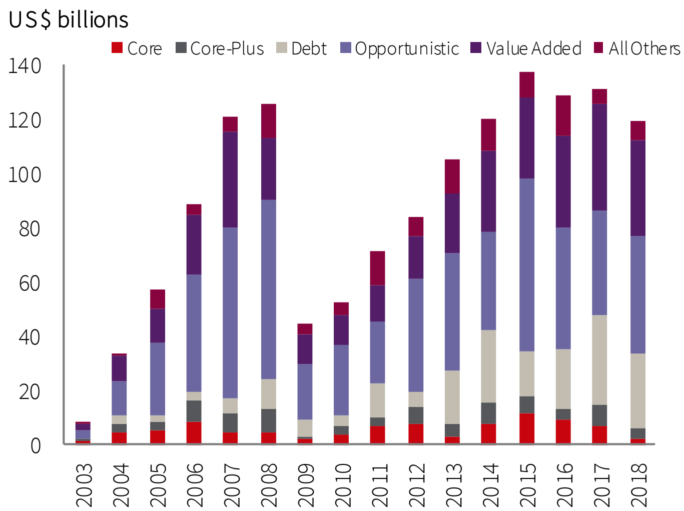
Fundraising

Investors move up the risk-return curve

Fundraising slows down in 2018

Fundraising by closed-end private real estate funds reached nearly US$120 billion in 2018, 9% lower than 2017's total and the lowest annual volume recorded since 2013. More significant was the 23% drop in the total number of funds closed during the year, down from 403 in 2017 to 258 in 2018. Core and core-plus funds were the most impacted, as combined fundraising for both strategies totalled just US$6.4 billion, 46% lower than the average volume raised throughout this cycle and the lowest level since 2009. Investors in private real estate funds have gravitated away from low-risk strategies in search of greater returns.

Closed-end private real estate fundraising



Source: Preqin, JLL

Capital flowing to higher-return strategies

Fundraising by opportunistic and value added funds totalled a combined US$79 billion in 2018, an all-time high. Notable is that the number of closes by both opportunistic and value added funds declined in the year, indicating that capital is concentrating in the hands of a smaller number of groups as LPs flock to the biggest and most experienced managers. Indeed, three out of the four largest funds to close in 2018 were opportunistic funds managed by Starwood Capital, Blackstone and Carlyle, and all exceeded their target sizes. The overall influx of capital into higher-risk strategies has been felt by the majority of managers of opportunistic and value added funds that closed in 2018, with 65% closing with more capital than initially targeted and 30% closing with at least US$100 million more.

Investors look to Asia for new opportunities

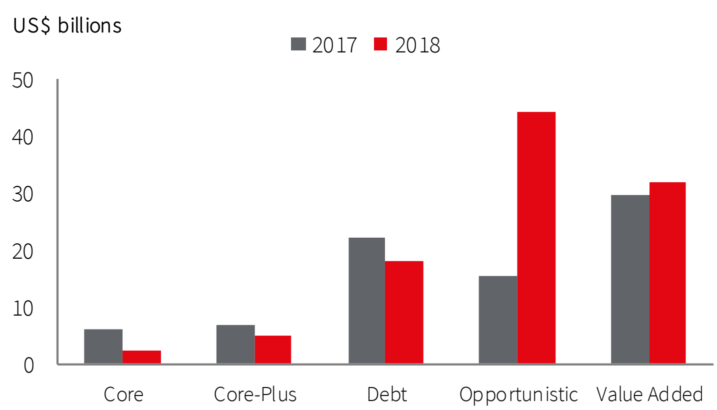
Funds focusing primarily on Asian real estate raised US$15.4 billion in 2018, the most ever in the current cycle. Of this total, 81% was raised by opportunistic funds, the largest share of any geographical region, highlighting the movement of capital outside of North American and European markets in search of greater returns.

Though the majority of the funds targeting Asian real estate do not have a specific sector focus and are diversified across a variety of asset classes, 2018 saw US$3.4 billion raised by funds focused specifically on the industrial sector. The largest of these was GLP's 'Japan Development Partners III' fund which closed with over US$2.2 billion raised, making it the largest ever Japan-focused industrial fund. In India, developer Indospace closed its 'Indospace Logistic Parks III' fund, raising US$580 million to develop and acquire high-quality industrial assets. Both funds were oversubscribed, showing the sustained investor demand for industrial real estate in Asia and the weight of capital seeking to enter the sector more broadly, mirroring the trend we have seen in direct investment markets.

Lower-risk strategies challenged to deploy capital

Funds with lower-risk strategies generally deployed less dry powder than those on the other end of the risk-return curve in 2018. Core and core-plus funds deployed the least of their capital reserves, with US$2.3 billion and US$5.0 billion in dry powder spent respectively. Conversely, opportunistic and value added funds were the most successful at deploying capital as they actively acquired assets.

Net deployment of dry powder



Source: Preqin, JLL

2019 Global market Outlook

2019 expectations continuum by property sector

Bubble sizes represent total sector liquidity

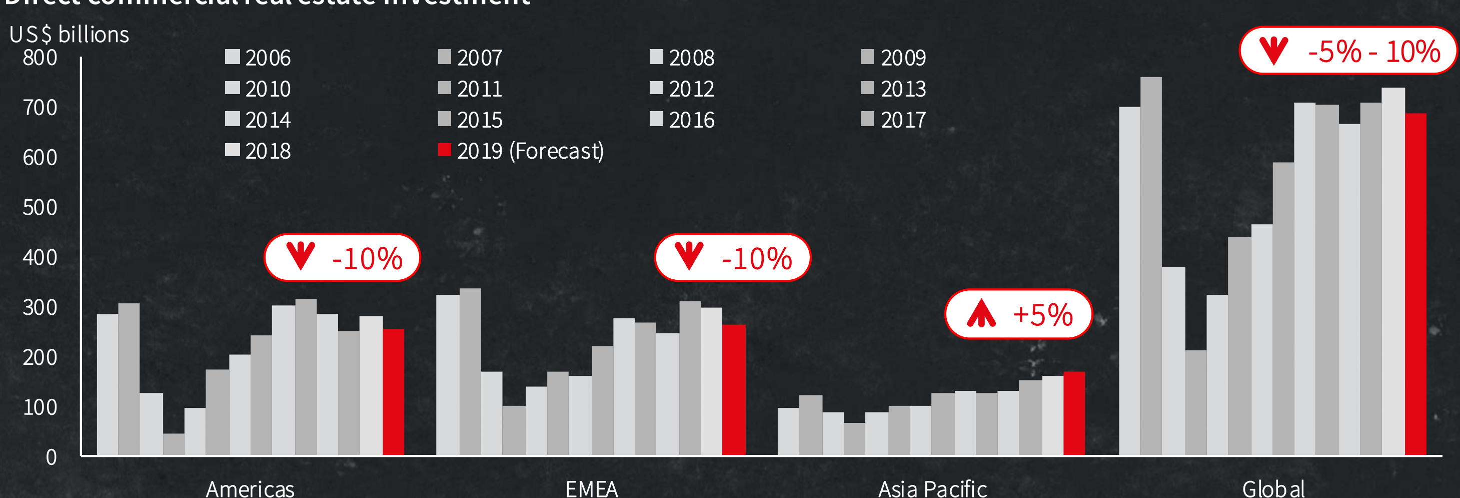
Source: JLL

Activity expected to moderate in 2019

Renewed equity market volatility, the U.S. government shutdown and a slowdown in China were just a few of the new major events that investors had to contend with in late 2018, while the danger of a 'hard Brexit' and continuing global trade tensions have lingered since the start of 2019. With the U.S. now seemingly pausing its trend of monetary tightening and Europe preparing for the end of crisis-era stimulus, economic and political uncertainty remain a key concern for investors across the world with monetary policy and central bank independence in particular at the forefront.

In the context of rising uncertainty and volatility, global commercial real estate is well positioned to continue its strong performance. Assets with stable tenants and long leases remain highly sought-after as investors maintain their pursuit of steady sources of income. Though yields are at or below cyclical lows, with limited scope for further compression, fundamentals are still supportive and rents are forecast to grow moderately in 2019. With this in mind, we expect that global investment activity in commercial real estate in 2019 will dampen slightly, by 5% to 10%, to around US$680 billion. In addition, we expect to see emphasis on indirect investment, entity-level transactions, recapitalisations and debt. However, greater investor caution due to geopolitical risks and market volatility may ultimately lead to softer transaction volumes. Globally, we predict that the industrial sector will again see significant activity in 2019 due to strong underlying demand drivers. Meanwhile, the office sector is anticipated to see a slight decline globally given the continued low-yield environment. The retail sector is likely to face the biggest challenges as investors rebalance their portfolios to reflect changing dynamics in the space.

Direct commercial real estate investment



Source: JLL

Notes and methodology

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

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