

Intelligent Investment

Market Outlook 2022

REPORT

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Introduction: recovery with risks

2021 was punctuated by periodic restrictions in a number of European markets, but was not dominated by the Covid pandemic to quite the same extent as the previous year. The recent increase in case numbers, and adoption of new restrictions in parts of Europe, highlight the continuing risks. In the short term the uncertainties associated with the Omicron variant mean that the range of possible outcomes is still wide.

More positively, higher levels of vaccine-driven immunity, and stronger economic momentum, signpost a return to more normal levels of activity. Against that background, real estate markets go into 2022 with some measure of optimism.

The euro area economy has been growing strongly since the summer and is within touching distance of its end-2019 GDP level. Supply bottlenecks and price increases are key risks but consumer spending looks strong enough to sustain the recovery, with business investment and manufacturing also starting to contribute. Stable short-term interest rates should support confidence.

Investment turnover and leasing levels are already well into the recovery phase and set to rise further through 2022. We expect investment to increase by up to 5% - with the logistics and residential sectors again prominent - and opportunities in a range of subsectors such as co-living, data centres, healthcare and self-storage.

In the occupier markets, office leasing is set to rise further over the year, taking it back closer to pre-pandemic levels. Logistics markets will be spurred by e-commerce players and third party logistics companies. Physical retail still faces challenges, with rental recovery likely to be more gradual and investors focussing mainly on convenience-led assets.

The events of the past two years have sharply raised the profile of the ESG agenda, and we expect 2022 to mark a step change in the role of ESG across the full range of real estate decisions. This will also accelerate some of the necessary data enhancements needed to support decision-making.



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Strong demand picture with an increasing focus on affordability. Lack of product will push investors into forward-funding projects and mergers and acquisitions, which is likely to propel sector investment volumes to a new record in 2022.

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2022 will see record levels of M&A activity. Most parts of the sector have emerged positively from Covid and investors are seeking to capitalise on positive demand signals for these sectors.

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01

ESG

Outlook

Investors and occupiers will focus on refining their strategies to prepare for a carbon-constrained world and the likelihood of increased regulation. This will have a profound impact on property selection, for both acquisition and occupancy.

Trends to watch

01

The implementation of the Regulatory Technical Standards (RTS) supplementing the SFDR, which was scheduled for July 2022, has been postponed to January 2023. This is a second delay, resulting in rules coming into place a year later than the original planned date.

02

Going into 2022, the spotlight will be increasingly on building owner, operator and occupier strategies to deliver net-zero targets. As commitments to decarbonise rise, demand for sustainable buildings are expected to follow suit.

03

The occupier role in ESG will continue to evolve. There will be a growing emphasis on seeking common ground with investors and developers to acquire, develop and occupy sustainable buildings.

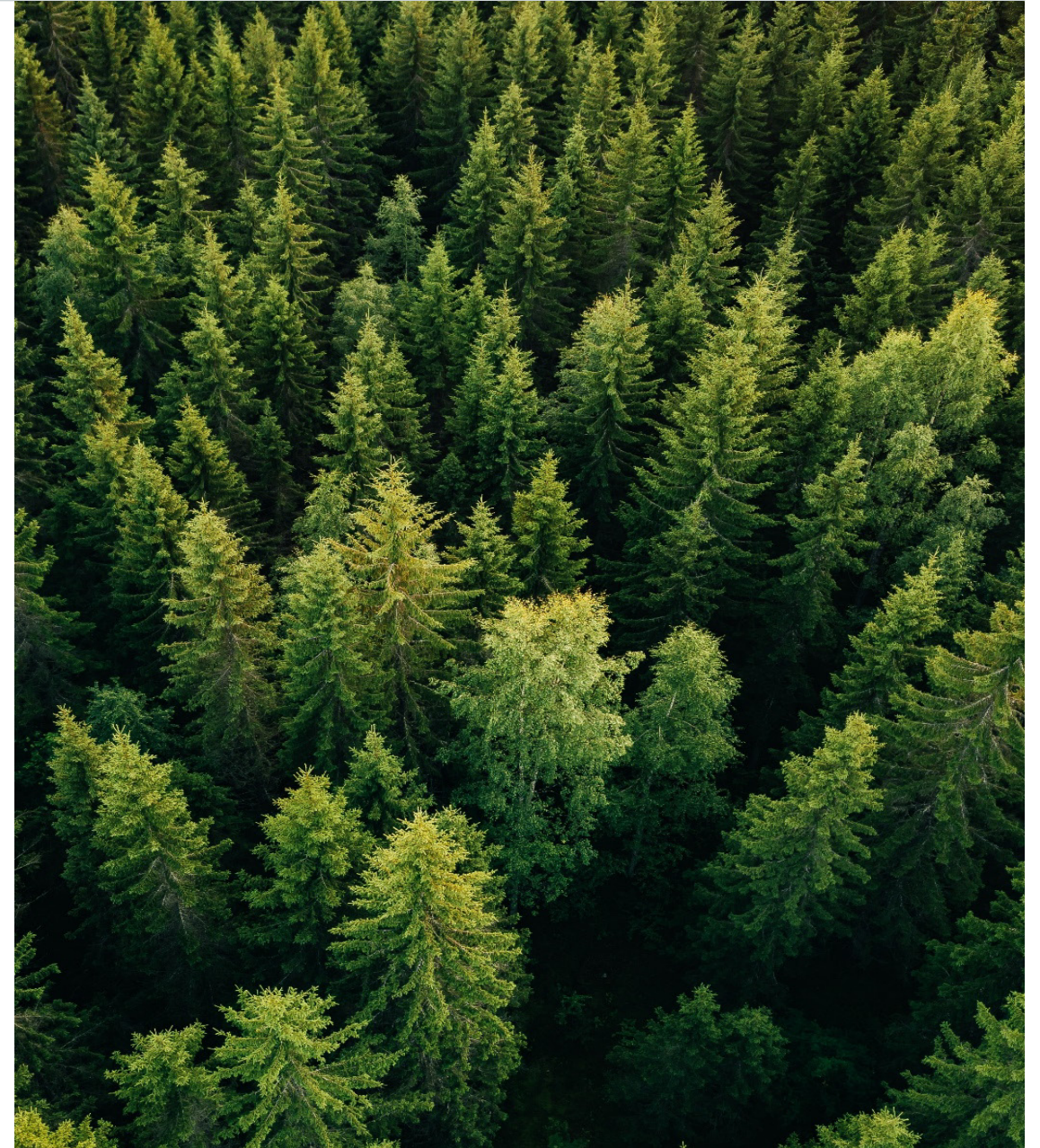
04

Rental premiums for sustainable buildings, currently only discernible in the office sector, will appear in other sectors as tenants and end-users start to demand higher levels of environmental performance.

05

Reclassification of existing funds and the launch of new ones that meet Article 8 and Article 9 requirements will intensify. Asset managers will refine their strategies to achieve higher asset ratios for funds categorized under these two articles.

Source: ¹CBRE, Is Sustainability Certification in Real Estate worth it?, November 2021



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Increasingly,
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Dragana Marina
Sustainability Research Lead
Continental Europe, CBRE

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A combination of events has sharply raised the profile of the ESG agenda in real estate – namely the Covid-19 pandemic, severe weather events and the COP26 conference, and businesses need to become accountable in new and different ways.

ESG is evolving from a peripheral balance sheet issue to a key component of investment decision-making. The availability and quality of ESG data remains a challenge for strengthening links between strategy and action.

Europe is at the forefront of regulatory efforts to channel capital towards sustainable assets. The growth in European sustainable mutual funds was bolstered by the introduction of the Sustainable Finance Disclosure Regulation (SFDR) in March 2021. A continued increase in assets and capital flows into sustainable funds is expected in 2022.

De-risking capital allocations

Reducing and optimising risk is one of the main considerations for investors. There is a real threat of value erosion on carbon-intensive assets, due to increasingly stringent regulations but also pressure from financial institutions, stakeholders, and occupiers. As occupiers and investors are drawn to properties that are more sustainable, these will generate positive value benefits.

European real estate markets will face changes, both physical and through the transition to a green economy. For investors, the goal is to be resilient to these changes, and the question is how this can be achieved. Increasingly, investment strategies will start to revolve around diversification across various sources of risk rather than across different asset classes.

Going into 2022, markets with a proactive approach and a continuous focus on sustainability and climate risk mitigation strategies will be frontrunners as investment destinations. Assets and locations that are considered less affected by climate change, or more resilient to it, will start to benefit from a pricing premium.

\$3.5tn

is the combined value of assets in global sustainable mutual funds¹

88%

is the share of European sustainable mutual funds in the combined global volume¹

2/3

of European investors have already adopted ESG criteria into their investment practices and processes²

Source: ¹Morningstar, October 2021, ²CBRE Global Investor Survey, 2021

With increased scrutiny on ESG issues, CRE stakeholders need to understand, enhance, and leverage their ESG performance to drive value and stay competitive. However, many are still unsure how their ESG performance may be affecting business — or even exactly what ESG entails. More data-backed ESG strategies for CRE will start to emerge in 2022.

Holistic approach to risk and opportunity

Across Europe, we expect to see a continued awareness with businesses rapidly integrating ESG criteria into decision-making. The essential question is no longer what to do, but rather how to do it. Saying the right thing is not enough – the goal is to ensure that actions are credible.

One of the most important considerations will be the cost analysis of action vs. no-action, and how this is reflected in short-term profit. The core elements driving company strategy will need to be reassessed, and their ESG implications measured.



In 2022, ESG will increasingly be seen as part of risk management rather than an add-on to normal business operations.

02

Economy

Outlook

The 2022 backdrop is secure for real estate with stable short-term rates, and modest changes in long rates against improving rents. Downside risks exist if elevated inflation becomes established, or the pandemic regains momentum requiring further lockdown restrictions.

Trends to watch

01

Consumer spending will drive the recovery. Pent up demand, and the unwinding of the stock of accumulated savings, is set to drive 4.7% GDP growth in the Euro area in 2022.

02

Inflation to prove transitory. Supply-side constraints, labour shortages and high energy prices will dissipate in the second half of 2022, bringing inflation back down towards 2%.

03

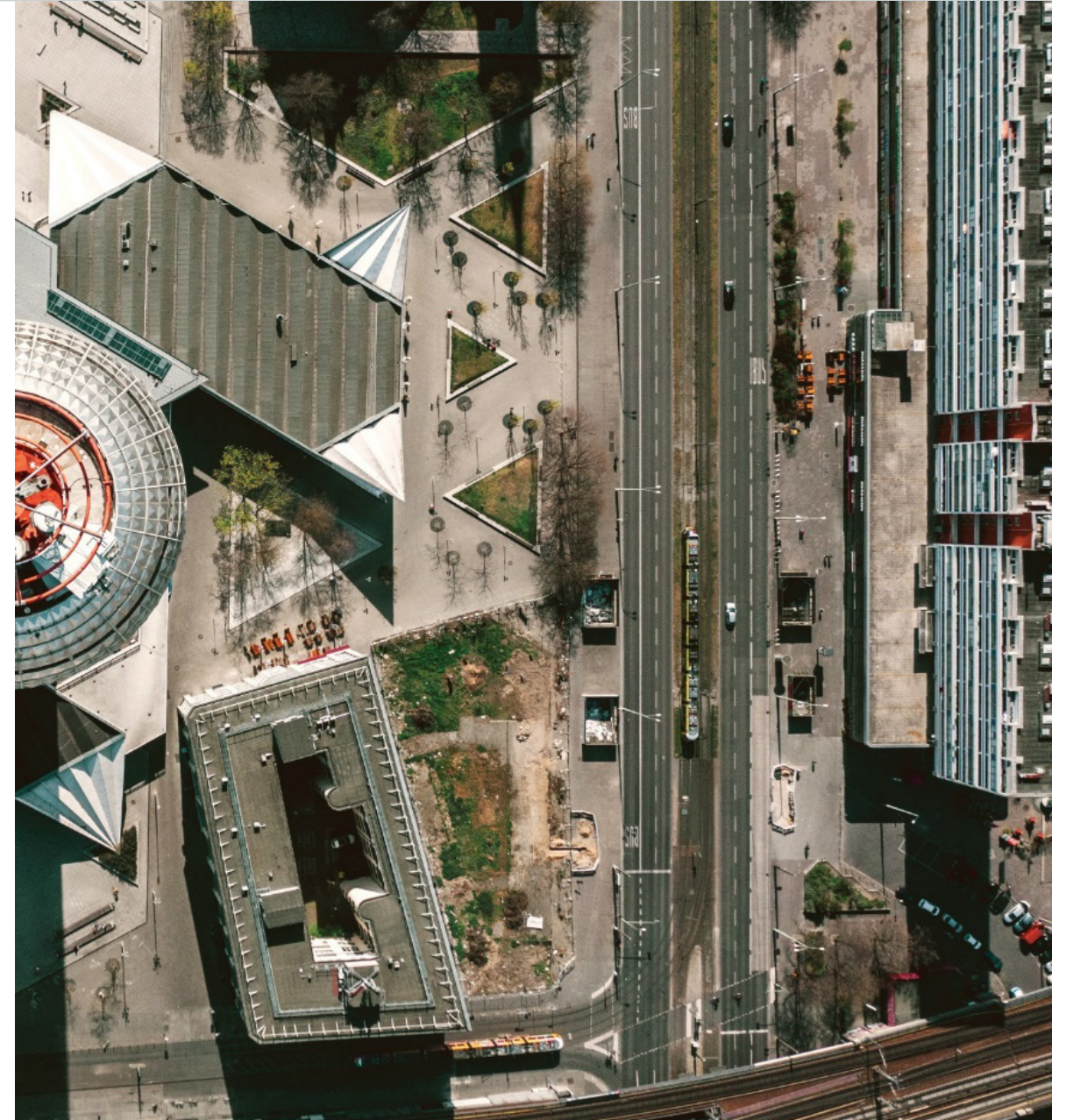
We expect the European Central bank to keep short-term policy rates on hold until at least 2023, opting instead to begin phasing out Covid-related QE programmes in December 2021.

04

QE tapering and a robust economic recovery mean long-term interest rates will drift up from historically low levels. Strengthening rental growth will be sufficient to offset any slight rise in the cost of capital, and so prime property will remain an attractive asset class in 2022.

05

The evolution of the pandemic will be crucial in the progression of the recovery. During 2022 supply bottlenecks and rising energy prices are the other main risks to the robustness of recovery and the outlook for inflation.



Consumer spending to drive the recovery in 2022 despite some headwinds

The euro area has been recovering strongly since the summer. Real GDP grew by over 2% in each of the second and third quarters, leaving it only 0.5% below the Q4 2019 level.

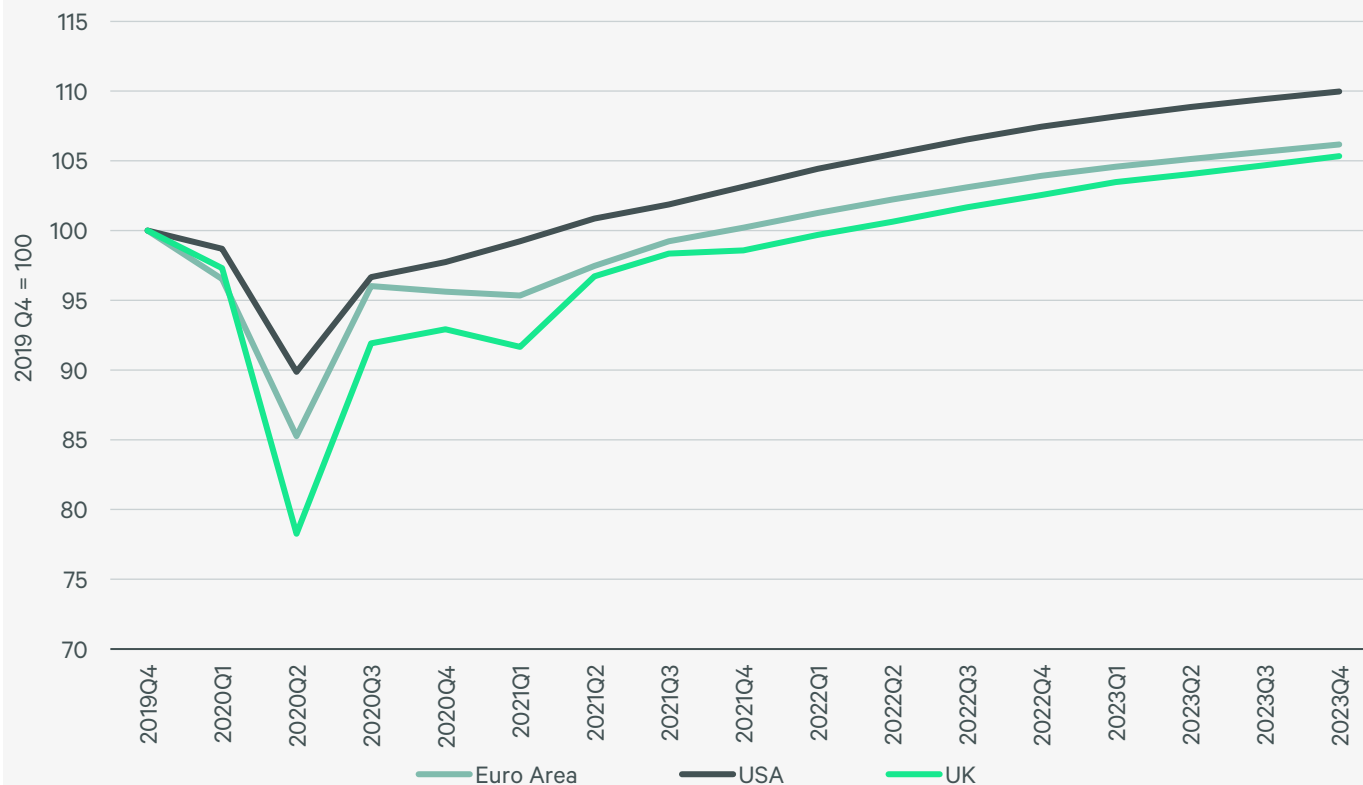
Some momentum was lost in the fourth quarter. Leading indicators, such as the purchasing managers' index (PMI), show a gradual but persistent slowdown in economic activity - as supply bottlenecks and product and labour shortages weigh on industrial production. On the other hand, survey measures of household confidence remain supportive of consumption growth in the fourth quarter – a critical quarter for retailers' earnings.

Looking ahead, we remain confident that the recovery will continue in 2022. Consumer spending will drive the recovery, as pent-up demand and the rotation of expenditure from durable goods into reopened services drive services output. Business investment and manufacturing will also bounce back as supply chain issues ease towards the second half of the year.

The recovery still depends on the evolution, and policy management, of the pandemic which is subject to continuing uncertainties. The CBRE house view is that the euro area will see GDP growth of 5% in 2021 and 4.7% in 2022. In the near term, the main risks to the pace of recovery and inflation are rising Covid cases and renewed lockdown restrictions, supply bottlenecks and rising energy prices. If supply shortages and rising energy prices persist, they will slow the recovery.

There are upside risks. Consumers have amassed a large stock of savings during the pandemic and, as uncertainty eases, consumers may run them down faster than we have assumed. This would boost consumption growth even further.

Figure 1: Real GDP, 2019 Q4 = 100

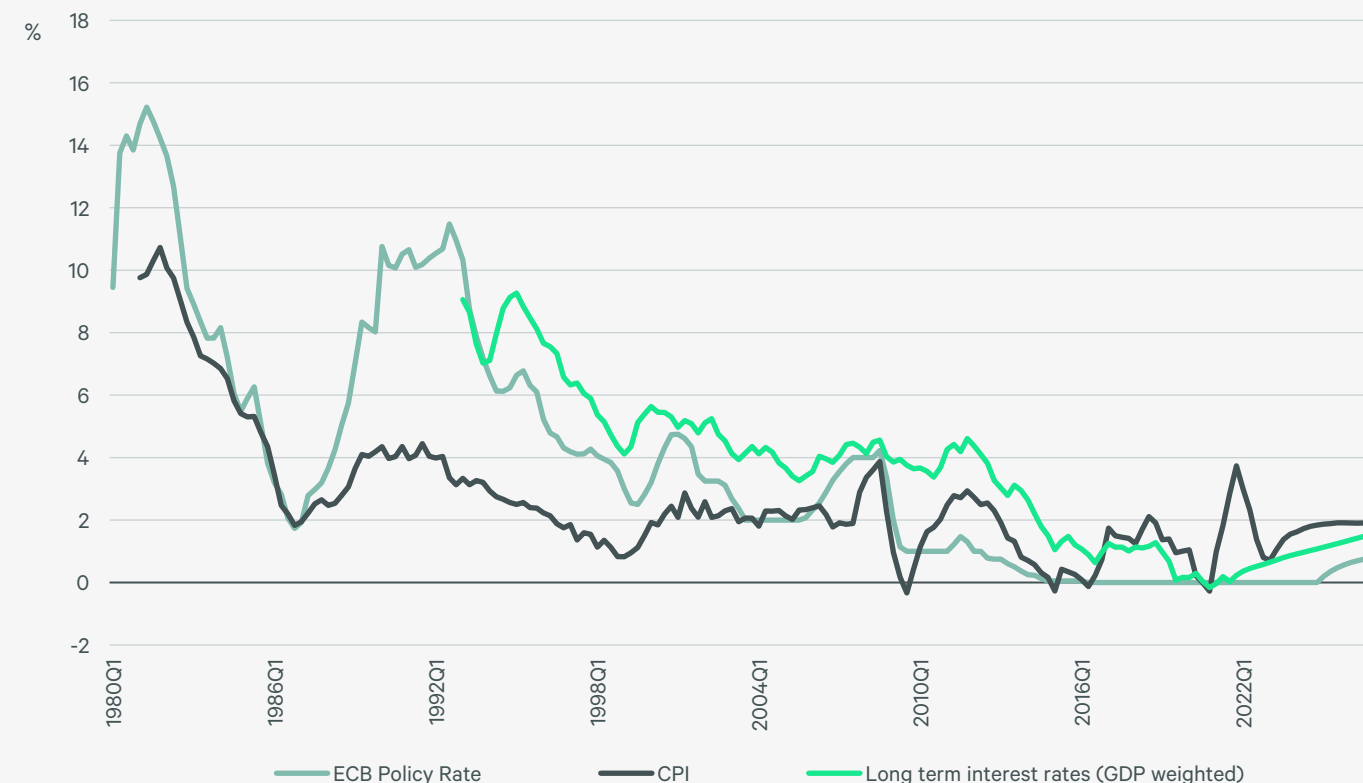


Source: Oxford Economics, CBRE Research

Inflation and interest rates

- Euro area inflation rose to 3.4% in September and will increase further by the end of the year. Rising energy prices, supply constraints and base effects are the three main causes, and we expect them to either moderate in 2022 or to drop out of the year-on-year calculations.
- Because of this, we expect inflation to peak in the fourth quarter of 2021 and remain elevated in the first half of 2022, before gradually returning towards 2% in the second half of the year.
- This view means that we expect the European Central Bank (ECB) to ‘look through’ inflation - keeping short-term policy interest rates on hold until at least 2023. Instead, the ECB will begin tapering its Covid-related QE programmes in December 2021.
- As a result, longer term interest rates will drift up from the very low levels seen during the height of the pandemic. This is driven primarily by real interest rates rising due to a strong recovery and a reduction in asset purchases (QE), and not because of rising inflation expectations.
- The current outlook remains broadly favourable to prime property. Even with a modest rise in long-term interest rates, we expect prime property yields to sharpen in the near term as economic recovery drives rental growth, offsetting any small increase in the cost of capital.
- There are risks to this view. In particular, if energy price inflation or supply constraints become more persistent than we have assumed, it could have second-round effects that raise inflation expectations and become embedded. This would require faster and more aggressive monetary policy tightening and would have ramifications for financial assets, including real assets such as property.

Figure 2: Inflation and interest rates



Source: Macrobond, Oxford Economics, CBRE Research

03

Investment

Outlook

Investment volumes to rise by up to 5% in 2022, posting a return to pre-pandemic levels by mid-year. Logistics and residential sectors will remain popular.

Trends to watch

01

We expect investment volumes to increase by up to 5% 2022, with further upside potential. This would represent a return to pre-pandemic levels in 2022. The residential and logistics investment markets will remain especially strong.

02

Strengthening occupational demand and limited stock for prime logistics and office assets will further fuel investor demand. Rental growth and lower yields across these sectors is expected in 2022.

03

Investors are expected to bid-up prime logistics and multifamily assets. Buyer and seller price expectations should start to converge, notably across the retail and hotel sectors.



Investment recovery underway: return to pre-pandemic levels by H1 2022

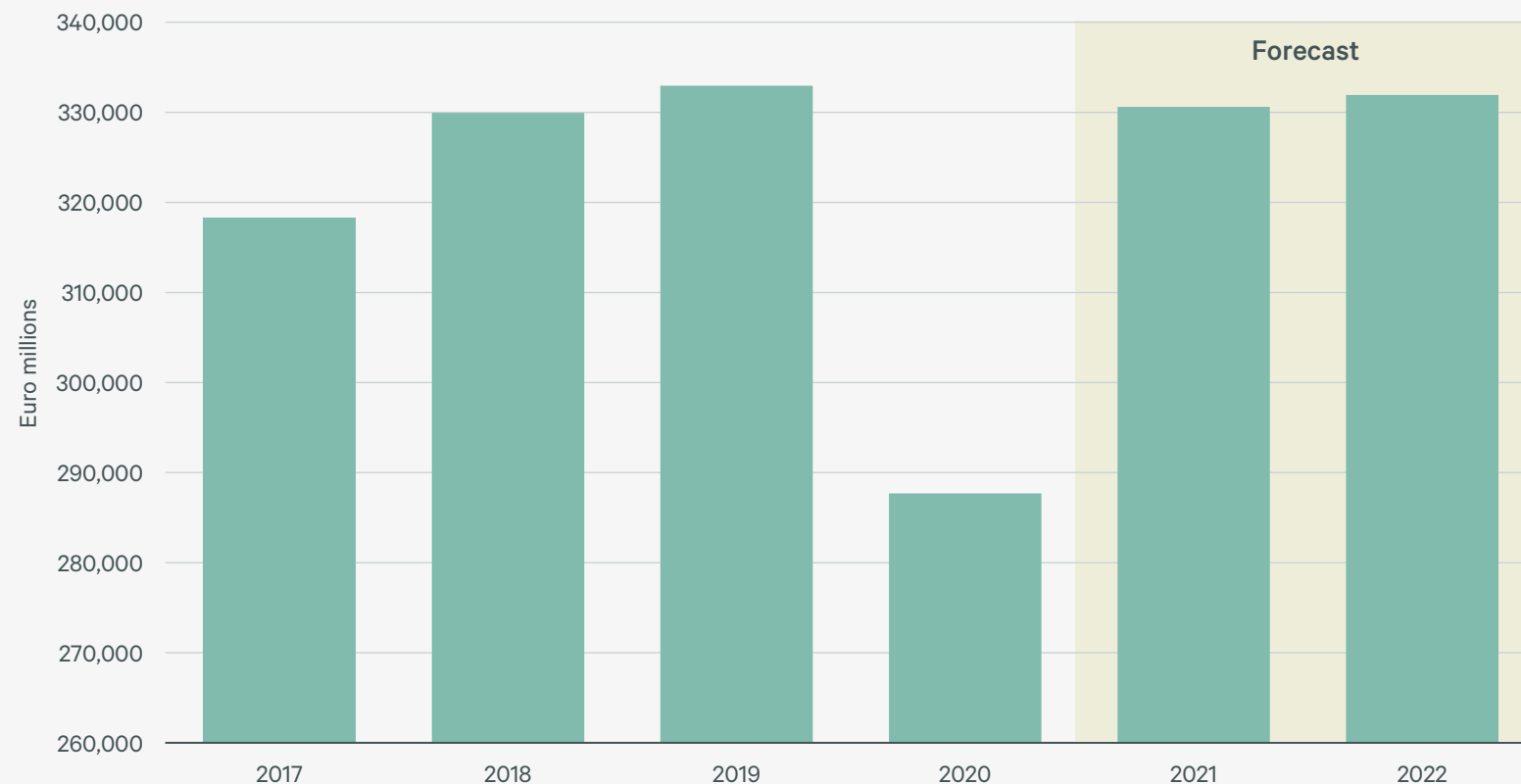
We expect 2022 investment volumes to increase by up to 5% over 2021, with further upside potential. Excluding two exceptional deals that boosted activity in 2021 (see below), the underlying increase in 2022 will be closer to 10%, marking a return to pre-pandemic investment levels.

This follows a 10% year-on-year increase in 2021, which is higher than initially expected - in part because of the Heimstaden/Akelius Eur €9.1bn acquisition of a major residential portfolio and the €21.4 bn Vonovia acquisition of Deutsche Wohnen.

The logistics and residential markets are expected to remain strong in 2022, although it may be difficult for residential to match an exceptional 2021, which was driven by very large portfolio deals. The office market is also set to continue its recovery as more corporates start to encourage at least partial returns to the office, and appetite to retain physical space has strengthened. Rents for premium office space are rising and look set to continue doing so over the short to medium term.

Distressed sales in the hotel sector have largely been absent. We expect the hotels sector to close 2021 and 2022 with positive y-o-y investment activity figures. As for the retail sector, while store revenues remain under pressure, there are various factors in play that will support deal flow. These include a narrowing of pricing expectations between buyers and sellers, attractive yields compared to other sectors due to earlier repricing, and the potential for asset repositioning in some markets.

Figure 3: Investment volume forecast



Source: CBRE Research

Bid-ask spreads to narrow

Convergence in the pricing expectations of prospective buyers and sellers is necessary for investment activity to rise in the way we expect.

Our most recent Cap Rate Survey (Q2 2021) indicated that a mismatch in pricing expectations was the biggest obstacle to closing deals. This stems from owners being reluctant to sell at large discounts in the hotel, retail, and value-add office sectors.

Investors have shown a willingness to bid up prime asset prices in a range of sectors including office, logistics and multi-family housing. Pricing for class A offices, for instance, has largely stabilized around pre-pandemic levels, and stronger occupational trends and a rise in rental growth will sustain upward pressure in pricing.

Multifamily and logistics assets will continue to see moderate price increase in the short to medium term. Prime Grade A office assets will also see strong pricing, albeit to a lesser extent. In general we expect bid-ask spreads for prime retail and hotel assets to continue to tighten.

Figure 4: Prime yields, selected markets, CBD offices and logistics



Yields for prime assets to edge down in 2022

Limited supply and strong demand for prime urban logistics assets have put upward pressure on rents across many major markets.

Occupier trends in the office market are more uncertain, but there are signs that stronger demand and limited stock at the prime end of the market are fuelling investor interest. In the coming year, more widespread rental growth and some limited falls in yields should become more widely visible.

While yields for prime retail and hotels rose in the first half of 2021, they have largely stabilized. We expect modest but more widespread yield compression for prime pitch high street in 2022 and some initial movement to lower yields for good quality shopping centres.

Prime hotel assets in the capital cities of several major markets, such as the UK, France, and Italy, have experienced slight falls and may continue to do so in 2022.

04

Offices

Outlook

Office markets are taking positive leasing momentum into the new year, and we expect this to strengthen through 2022. Availability will edge lower, particularly for high-quality space, fuelling moderate rental growth. Growing adoption of new working patterns will drive both a general flight to quality and rising demand for flex space.

Trends to watch

01

Growth in office-based employment will support an increase in leasing levels and moderate rental growth. Markets will still be operating at below pre-pandemic activity levels, but much of the ground lost in 2020 will have been made up by the year-end.

02

Available supply already looks to have peaked in some markets and we expect a more widespread tightening in 2022. Occupiers with appetite to expand or upgrade should expect reduced choice. Investors may find value in over-discounted near-prime assets.

03

We will see clearer evidence emerging in corporates' intended shift towards hybrid working policies. Occupiers should evaluate the role and suitability of their assets in this light. High-amenity buildings that support wellness and sustainability goals look favoured.

04

Flex space markets will expand and broaden. There is an opportunity for occupiers to assess the role of flex space in their portfolios, and for investors to explore more innovative structures with flex providers.



A further year of leasing recovery

Office-based employment, having dipped in 2020 and bounced back this year, is set to rise by a further 1-2% in 2022. Technology-intensive sectors and parts of professional services are likely to lead - London, Dublin, Stockholm and Amsterdam are among the cities set to see above-average increases.

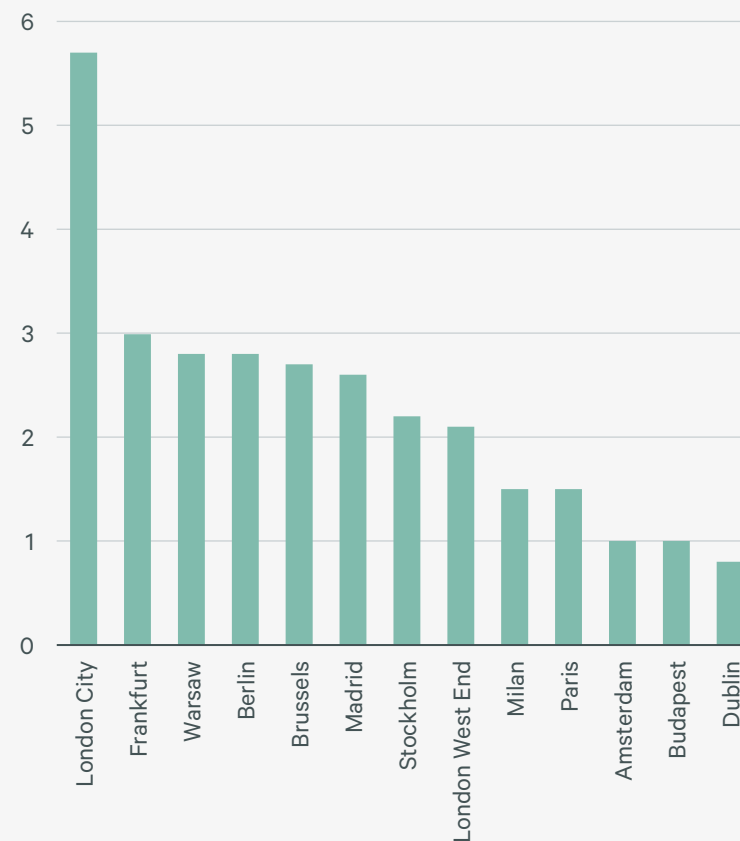
This is already generating some movement in leasing levels. With a number of markets taking positive leasing momentum into 2022, we anticipate further leasing growth of 20-25% in aggregate. This will still leave the market operating at below pre-pandemic levels, but reflects a more balanced demand profile, including the financial services sector recovering some lost ground. London, Dublin, Warsaw and Madrid are among the markets likely to see a sharper bounce in take-up – with Paris, Berlin and Moscow flatter.

Vacancy: peaking and polarising

We will see clearer signs of supply tightening in 2022, with vacancy levels falling in many of the major markets. Occupier choice of core, prime assets is particularly likely to tighten, with greater availability of secondary space in most markets.

Vacancy rates had been rising through most of the past two years, but already look to have peaked, or even started falling, in a number of markets including Paris, Dublin and Milan.

Figure 5: Forecast prime office rental growth (%), 2022



Source: CBRE Research, November 2021

Development completions will rise from their recently-subdued levels across Europe in 2022, and again in 2023 - although less than half of this two-year pipeline is likely to reach the market as speculative space. **Vacancy rates should edge at least 0.5-1.0 percentage points lower over the course of 2022.** Some CEE markets, such as Moscow and Budapest, will retain higher vacancy levels because of continuing development activity.

Rents: gradually upwards

Prime office rents have been generally resilient recently, with the CBRE prime office rent index up by 1.3% y-on-y in Q3 2021. In some cases - such as Germany and parts of the Nordics - this represents a continuation of growth that started pre-pandemic. In others such as London, Amsterdam and Dublin, it marks a stabilisation after declines in 2020.

With markets tightening through 2022, we expect more generalised rental growth in the main office markets, typically at somewhere between 1.5-3% (see Figure 5).

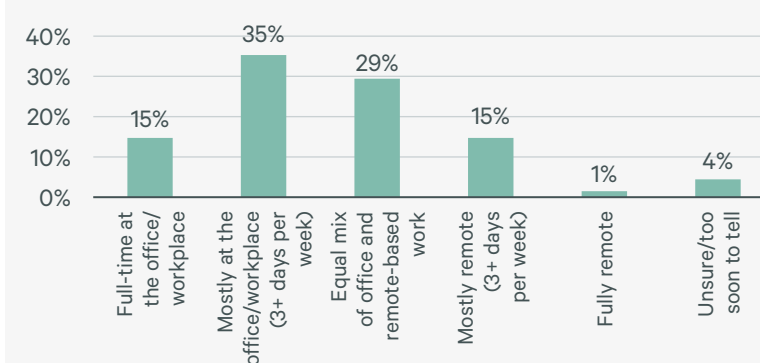
Hybrid working and a flight to quality

Corporates' adoption of new working patterns is clearly not a one-year process, so we expect to see clearer signals in this area in 2022. While home-based working represents a headwind for office demand, our most recent indicators (EMEA Occupier Survey 2021) show occupiers focussing on the physical office to a degree that seemed unlikely at the start of the pandemic.

In 2022 we expect:

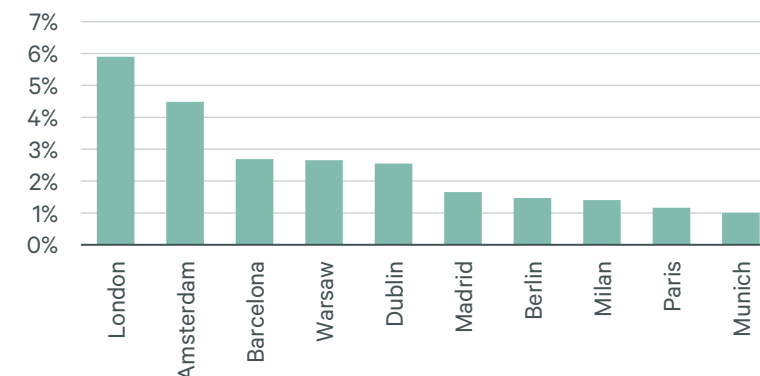
- Corporates will move further towards steady-state occupancy levels in the first half of the year
- Details will emerge on the shape of occupiers' intended hybrid working policies as these become implemented more widely
- More corporates undertaking full asset audits to gauge the role and suitability of buildings in their portfolios
- Further evidence of occupiers favouring high-quality buildings that satisfy their wellness, amenity and sustainability criteria.

Figure 6: Future workplace policy intentions



Source: CBRE Research, EMEA Occupier Sentiment Survey, 2021

Figure 7: Flexible offices as percentage of total office stock



Source: CBRE Research

Momentum building in the flex sector

Flexible offices are becoming increasingly important, both as a response to demand uncertainty and to satisfy occupiers' needs around workplace strategy, and employee choice. As we head into 2022, we expect the following trends to materialise:

- Alongside rising demand, the occupier base will become more diverse. We expect to see more traditional sectors, including law and finance, increasing their use of flex space
- Occupier demands for services and amenities will evolve and become more precise. This will both push up currently-low penetration rates and force a widening in the range of available flex solutions
- Operators will look to secondary and tertiary markets to expand their international networks
- More collaboration between operators and landlords through both the rise of management agreements and innovation around product expansion and diversification.

05

Retail

Outlook

In-store sales are recovering, but downside risks remain in the form of further Covid-19 disruption, global supply chain issues and consumer price inflation. Rents are forecast to recover over the coming years, but generally not to pre-pandemic levels. Investors will continue to favour convenience-led assets in the short term.

Trends to watch

01

While footfall and retail sales have recovered, in-store sales are still below pre-pandemic levels. Regaining these levels in 2022 is a possibility, but downside risks remain, notably a resurgence in Covid-19 cases across Europe in the final months of 2021.

02

Supply chain disruption will continue to produce inflationary pressures for both retailers and consumers. The pandemic saw freight rates and material costs rise, with a number of large retail groups already announcing price increases.

03

E-commerce penetration increased sharply during lockdowns. Though it has since moderated, it remains above pre-pandemic levels and will continue to rise in 2022. A clear omnichannel strategy will be vital for retailers looking to attract consumers to their stores.

04

A shift in consumer preferences has seen household goods sales remain healthy, while fashion sales have declined. As a result, grocery and convenience-led retail, including retail parks and warehouses, have been among the stronger parts of the sector.

05

Retail investment activity has started to recover, as pricing in the sector has reached attractive levels. Investment has been led by retail parks and retail warehouses, which have eclipsed shopping centres and city centre retail for the first time. We expect this trend to continue, at least in the short term.



EMEA Retail Outlook 2022

Retail recovery on track

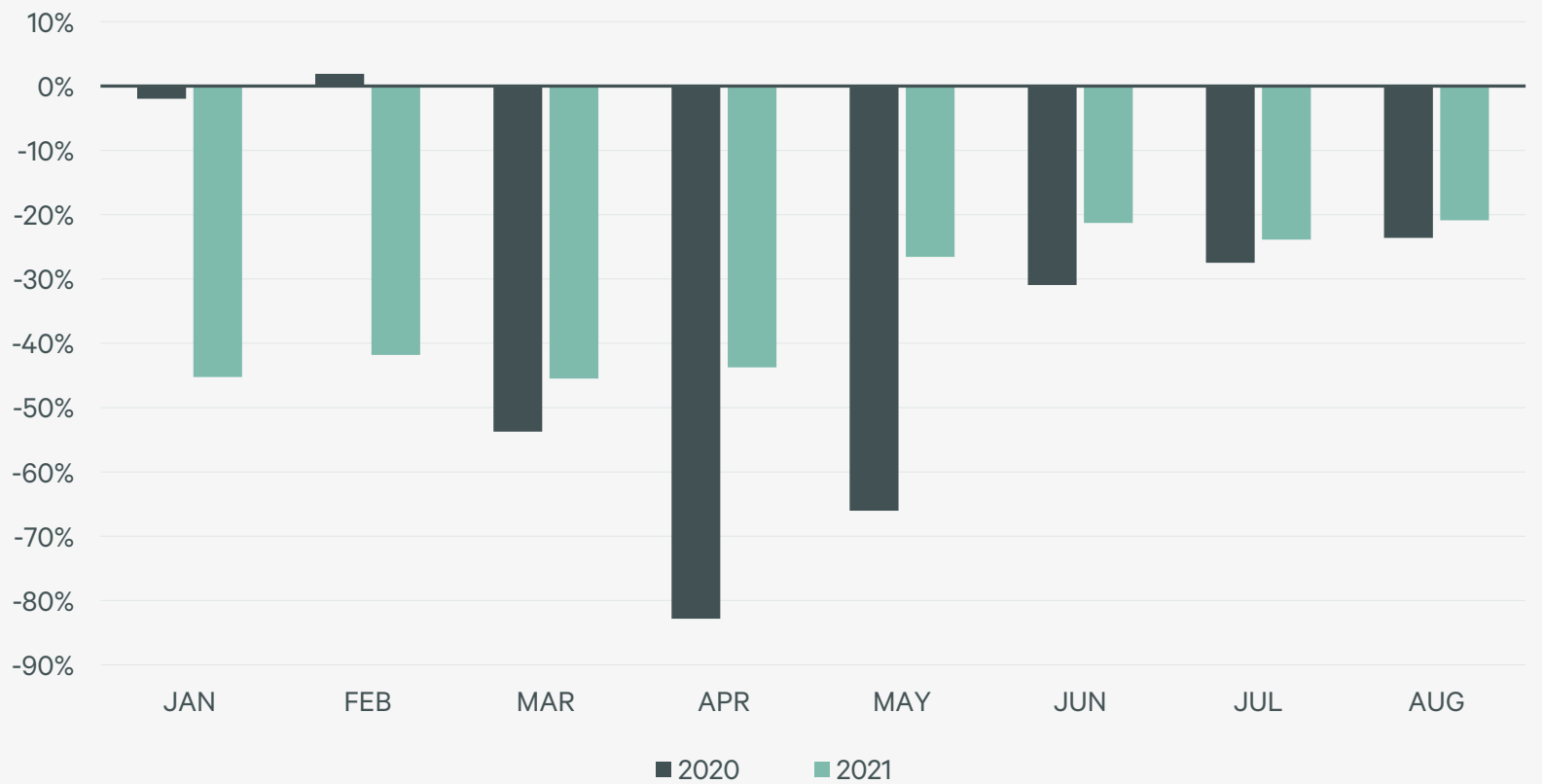
After a severe contraction following the initial lockdown in early 2020, overall retail sales in the euro area have recovered strongly. They now stand slightly above pre-pandemic levels, fuelled by a combination of pent-up demand and use of increased savings. This is mainly down to an increase in online sales, in-store sales and footfall are both below their pre-pandemic levels in most markets. In-store sales are closer to 2019 levels than footfall, suggesting that consumers are making fewer trips to stores, but spending more each time.

E-commerce penetration set to rise further

While e-commerce penetration rates have moderated, they remain above pre-pandemic levels. We expect further increases, particularly given the latest wave of Covid infections in Europe and the re-introduction of restrictions in some countries.

Uncertainty about the pandemic makes it difficult to predict whether in-store sales will recover to pre-pandemic levels in 2022. Much depends on whether pharmaceutical interventions to treat symptomatic Covid-19 lessen the need for further lockdowns, and hence support store-based retail in its recovery.

Figure 8: Footfall at CBRE managed retail assets compared to 2019 levels, EMEA average



Source: CBRE, KPIs Index, Note: data is an aggregate of CBRE managed retail assets in the Czech Republic, Finland, Hungary, Italy, Poland, Portugal, Romania, Slovakia, Spain and Switzerland

Moderate rental recovery and yield compression

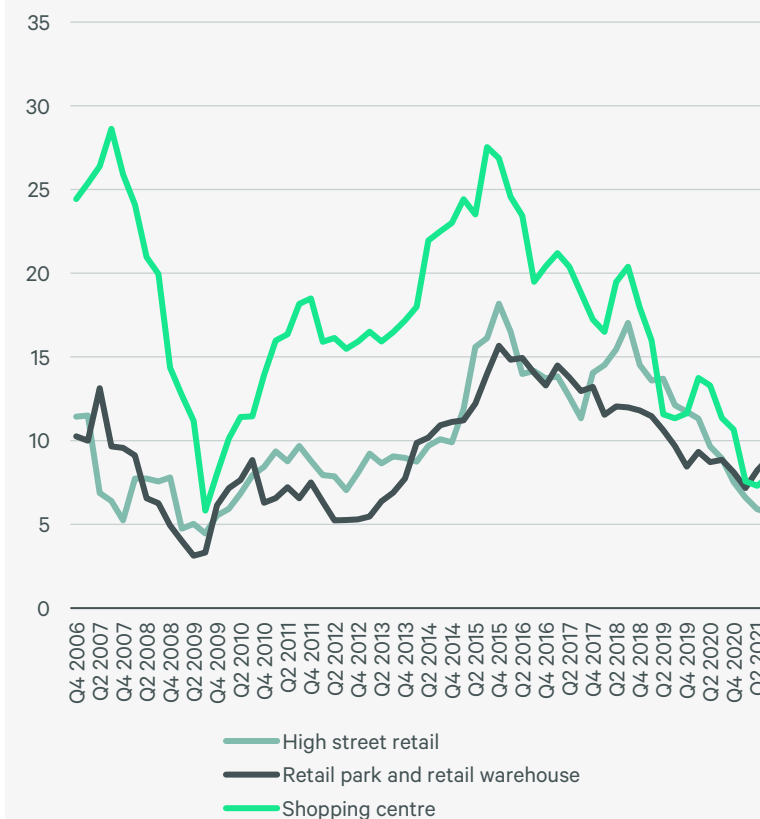
A selective recovery in high street and shopping centre rents is likely over 2022, led by the CEE region and Spain. Weaker performance is expected in France and the Netherlands. Following yield increases throughout the pandemic, selective yield compression is expected, most strongly in the UK where yields are already relatively high. High street yields are expected to be closer to their pre-pandemic levels than shopping centre yields by end-2022.

Investors to continue favouring retail parks and convenience-led assets in the short term

Investors have favoured retail parks and grocery-anchored, convenience-led assets in 2021. While shopping centres typically accounted for the majority of investment in the sector, 2021 has seen a dearth of shopping centre deals, with most major transactions being partial sales.

This rise in prime yields has not been observed in the retail park sector. Investment in this sector has now overtaken city centre retail and shopping centres for the first time. This trend looks set to continue into 2022, as a result of changing consumer habits and greater spending on household goods. Moreover, investment into the retail sector as a whole is on the increase, which we expect will continue in 2022, as investors respond to attractive pricing in the sector.

Figure 9: Retail investment volumes, Europe, moving four quarter totals (€bn)



Source: CBRE Research

Recovery set to continue, though downside risks remain

Store-based retail sales will continue to recover, though whether they will return to pre-pandemic levels in 2022 remains uncertain. Downside risks include increased consumer goods prices caused by rising inflation and supply chain cost escalation, and interest rate rises as a response, both of which would suppress discretionary spending.

Omnichannel strategy is key

The success of store-based retail will rely on a strong omnichannel strategy, and closer integration of the online and offline experience. Innovative solutions recently implemented by retailers include rapid buy-online-pickup-in-store options, sometimes within half an hour of ordering.

Some clothing retailers have implemented in-app functionality which allows customers to locate a product in a store, and book a changing room in advance. Consumers have become used to a digital-first experience during the pandemic, and a robust omnichannel experience will be key for retailers to entice consumers back to their stores.

06

Logistics

Outlook

Supported by growing occupier demand, the logistics sector will remain the preferred choice for investor portfolios.

Competition to secure land and the best assets will continue to be aggressive, with accelerated rental growth to support low yields.

Trends to watch

01

Demand for logistics space will remain strong. The macroeconomic recovery should boost traditional demand sectors, adding to take-up from the online channel.

02

The supply response has so far not been enough to move the vacancy rate needle upwards. However, with warehouses having a relatively short lead time, this is something to monitor closely.

03

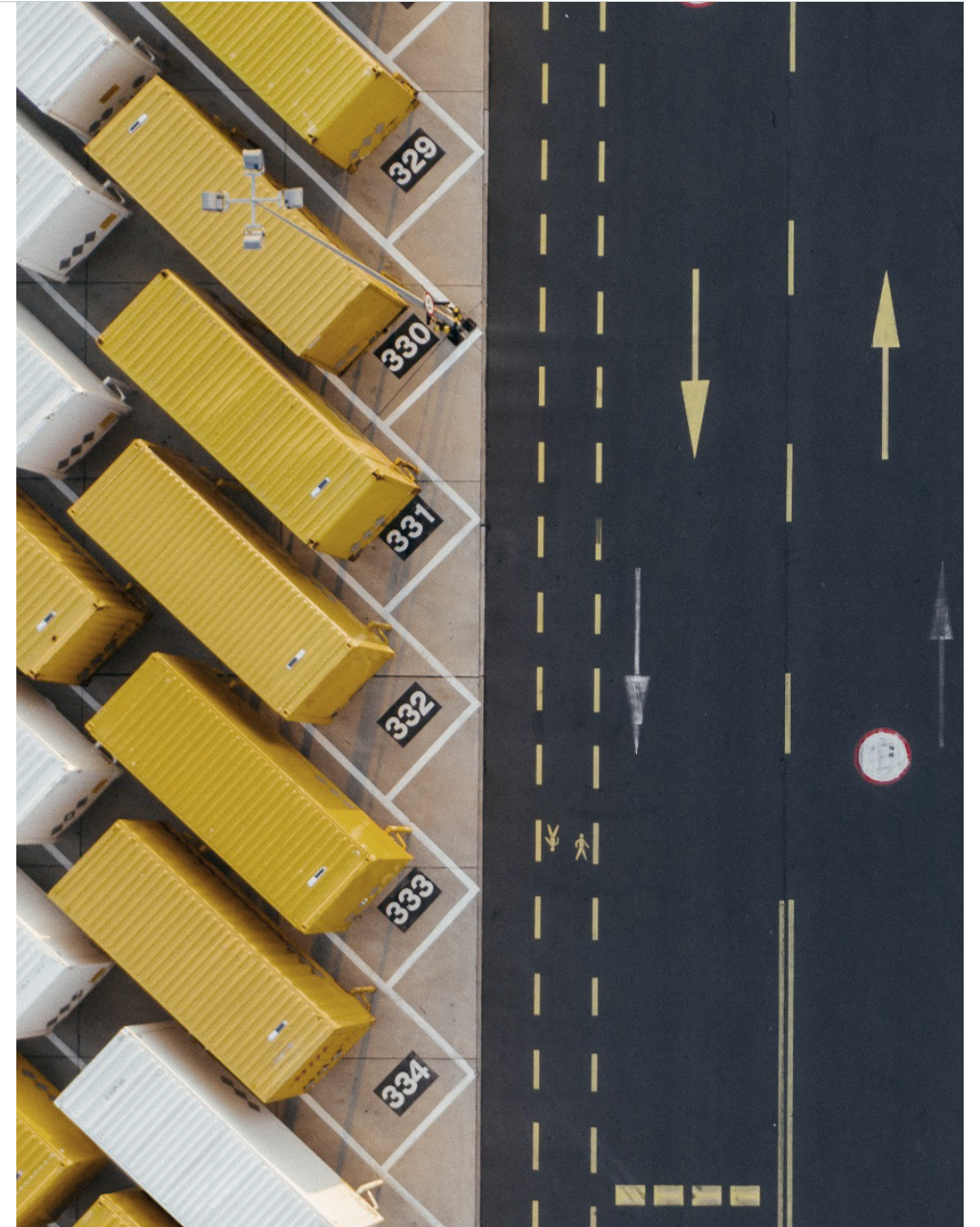
The escape valve for the supply-demand imbalance has accelerated rental growth, which is likely to continue for the next couple of years.

04

Sustainability is starting to become a priority for logistics occupiers, strongly influencing the current wave of speculative development.

05

Capital targeting logistics continues to pile up, which is expected to compress prime yields even further towards 3% in some markets.



Adding heat to the market

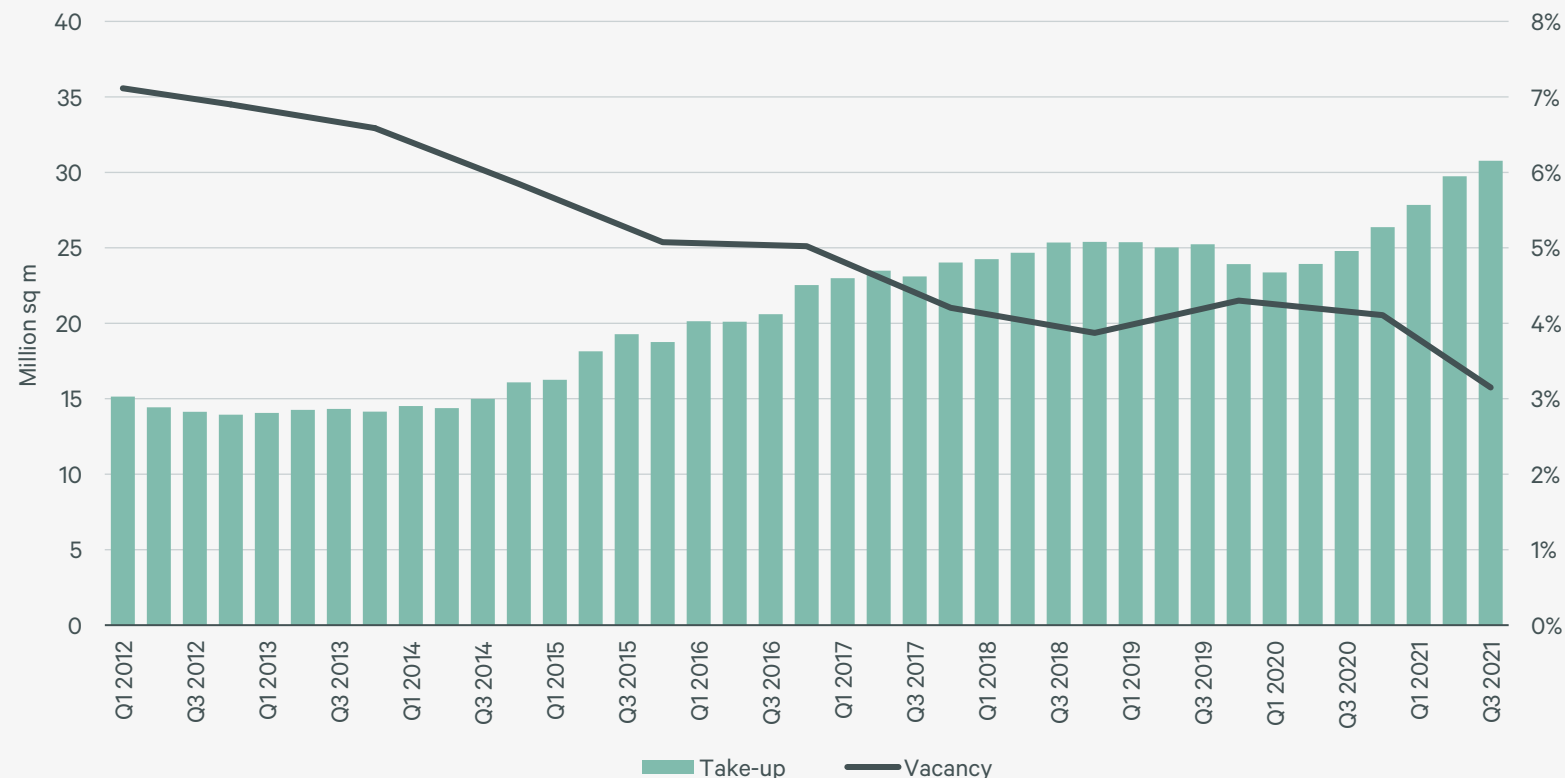
The macroeconomic recovery and strategies to tackle global supply chain disruptions are adding heat to an already booming logistics market. Particularly during the second half of 2021, physical retailers, 3PLs and manufacturing companies have intensified their requirements for additional logistics space in Europe. This is a result of returning to more normal operations and a need to increase inventories and prevent further shortages. However, some growth forecasts are already being revised down, due to the current shortages and transportation bottlenecks, which are likely to persist well into 2022.

Supply chain reconfiguration takes shape - and space

Major clothing retailers are rethinking their global supply chains, often designed around low-cost manufacturing hubs in Asia. Moving some production closer to European consumers has benefits, such as reduced dependence on one supplier and shorter transportation times, but it only works if costs can be kept under control. Central and Eastern European countries are receiving most attention, together with Turkey and Morocco. The near-shoring trend is worth monitoring closely, as it contains potential opportunities for both occupiers and investors.

At the same time, e-commerce players and 3PLs continue to acquire space to serve growing consumer demand from the online channel. We expect urban logistics demand to continue to proliferate, particularly in mature e-commerce markets where competition requires offering faster delivery times and better service.

Figure 10: Rolling 12 months take-up and vacancy rate



Source: CBRE ERIX (countries included: Germany, UK, France, Italy, Spain, the Netherlands, Belgium, Poland, Czech Republic and Slovakia).

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We expect the positive momentum to continue in 2022 after a record year for both take-up and investment volumes. The emphasis is also switching from yield compression to income growth.

Mark Cartlich
Head of EMEA Logistics Capital Markets Strategy
CBRE

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Prime rents take-off as supply struggles to keep pace

With high demand and record low vacancy rates, supply is responding, with developers becoming more risk-inclined and pushing the button on speculative schemes. However, the response has not been enough so far, as it is limited by site availability and the difficulty of achieving planning permission in most countries. The resulting supply-demand imbalance has prompted a stronger increase in prime rents than initially expected.

The acceleration in rental growth will continue in 2022, with high single-digit annual growth rates in the most severely supply-constrained markets, such as the UK, the Czech Republic, Germany and Belgium. The development of new stock will dictate if and when rental growth slows down, although our forecast does not show any sign of it in the short term. Opportunities are emerging again for owner-occupiers to sell and lease back their facilities, a trend we saw during lockdowns last year and which is now expanding to smaller urban units.

The sector will continue to outperform in 2022

Developers will not be tempted to use the low supply situation to build poorer quality buildings and expect them to be absorbed. On the contrary, new speculative developments are clearly embracing ESG standards, not just to satisfy stakeholders and release green financing, but because occupiers are increasingly demanding sustainable warehouses. Greener facilities are quicker to lease, can attract tenant partners with better credit records, and lower functional obsolescence risk, thereby improving performance.

Investor interest remains particularly high, with industrial and logistics representing over 18% of total real estate investment during the first three quarters of 2021, compared with 14.5% in 2020 and 10.9% in 2019. Volumes are likely to remain high in 2022 due to the amount of capital targeting the sector, although the proportion may decrease due to a recovery in other sectors, and limited availability of tradeable stock.

3.6 months

Vacancy at the end of Q3 would sustain less than four months of demand based on last 12 months take-up

4.1%

YoY prime rental growth in Europe at the end of Q3 2021, 35th consecutive quarter of positive rental growth

€39 Bn

Industrial and logistics property investment in Europe during the first three quarters of 2021, **66% more than 2020**

07

Residential

Outlook

Strong demand picture with an increasing focus on affordability. Lack of product will push investors into forward-funding projects and mergers and acquisitions, likely to propel sector investment volumes to a new record in 2022.

Trends to watch

01

The residential sector is robust and resilient, especially the multifamily segment. The sector is expected to continue growing in 2022, both in volume and as a share of the total investment market.

02

Lack of existing product will push investors towards forward-funding purchases, as well as mergers and acquisitions, leading to larger deal sizes in both established and emerging countries.

03

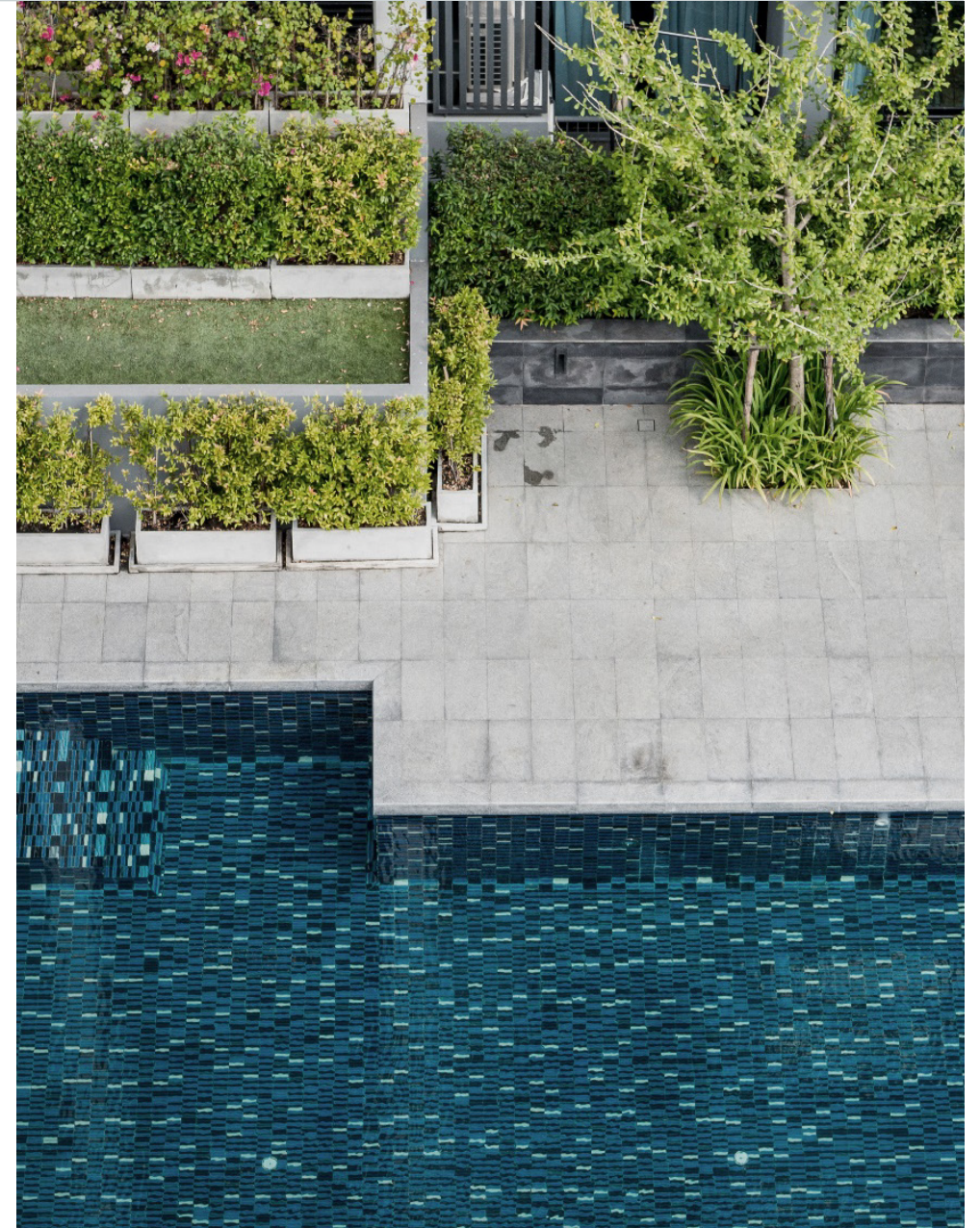
Opportunities are arising because of broadening demand, both geographically and in terms of product type. Secondary cities and single-family rentals in established markets will gain further momentum.

04

Assets with ESG elements are increasingly the only assets that are future proof, from both an operational and a tenant perspective.

05

Regulation will continue to be a restraining factor, especially regarding rental growth. However high tenant demand and the overall favourable outlook for the sector will outweigh these restrictions.



Residential

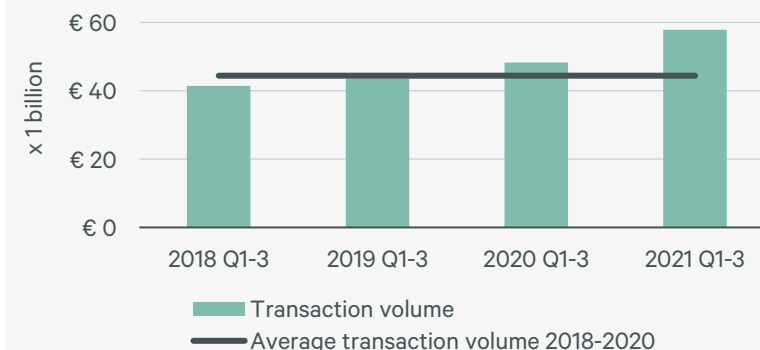
The residential sector continues to display resilience against the Covid-19 crisis and performed exceptionally well in 2021. Investment volumes grew significantly, and the sector's share of total investment rose - to the point where it is now the largest investment sector in several European countries.

Multifamily is the most active segment. High tenant demand is ensuring high and stable occupancy rates and rent collection rates, and underpinning investor confidence. With both established parties and new entrants eager to invest, there is an abundance of capital available. This will continue to put downward pressure on yields.

Due to limited availability of built product, more investors are increasing their exposure through forward-funding deals. Forward sales will become dominant in 2022, and we will also see more mergers and acquisitions, with several platform deals in the pipeline and funds that are nearing their exit. The stability of the multifamily product translates into ever-larger portfolio deals and makes the financing of large-scale multifamily development projects less challenging.

The urban exodus that was discussed at the beginning of the Covid-19 pandemic did not materialize, but we do expect growing investor interest in secondary cities. This is driven by a demand for more affordable accommodation and a lack of available land. While rents outside capital cities are lower, high demand combined with higher yields makes this an interesting long-term investment opportunity.

Figure 11: Residential investment volumes – Europe



Household demand is broadening geographically, but also in terms of product type. Demand for larger homes, which can accommodate remote work, is particularly increasing. This, along with rising house prices that represent a barrier to home-ownership, is driving demand for single-family rental housing. High land and construction costs make this product challenging for investors and developers but, with a lower turnover rate than multifamily, this product delivers more stability in the long run.

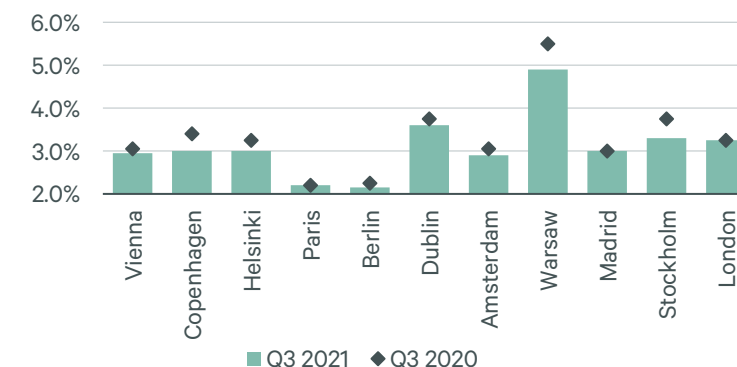
Co-living

Co-living struggled during the Covid-19 pandemic as it is based around the idea of shared living space. Yet as the product becomes more widely-known, it is generating investor interest. Investment characteristics are attractive because the optimal use of space and larger number of units increases the net operating income, and the range of tenants reduces income risk. The fundamentals of this segment look strong for years to come assuming that Covid impacts continue to recede.

Student housing

With students across Europe having largely returned to their campuses, and many universities resuming in-person teaching, occupancy levels have broadly returned to pre-pandemic levels. This segment is, however, heavily undersupplied. Investor sentiment remains strong, but a lack of investment or development opportunities is constraining investor activity. Opportunities lie in joint ventures, by working together with local developers to source suitable sites.

Figure 12: Prime yields multifamily – selected cities



ESG is growing in importance in the residential sector. It is no longer a case of considering if you can afford to integrate ESG elements in a project, but rather whether you can afford not to. Both national and EU regulation, as well as requirements from asset managers and funds make ESG compliant assets the only future-proof type of assets. Examples include buildings that mitigate carbon emissions, reduce their energy consumption and harvest rainwater. Incorporating ESG elements also makes sense from an operational perspective, as this leads to lower operational costs and higher tenant demand.

To tackle housing shortages, many governments are introducing, or considering, stricter regulation. This typically focuses either on barriers to investors buying existing stock, or on rental regulation such as rental caps. These restrictions are very country- or even city-specific and are crucial for investors to understand, especially given the high proportion of cross-border capital in the sector.



ESG compliant assets are increasingly the only future-proof type of assets

08

Operational Real Estate

Outlook

2022 will see record levels of M&A activity. Most parts of the sector have emerged positively from Covid and investors are seeking to capitalise on positive demand signals for these sectors

Trends to watch

01

2022 will see record levels of M&A activity in Operational Real Estate (OPRE). Most parts of the sector have emerged positively from Covid and investors are seeking to capitalise on positive demand signals.

02

Major trends on the capital side of the market will include: (1) preference for direct investor participation, (2) organic and platform growth by existing operators, (3) injection of new private equity, (4) emergence of a broader range of acquisitive specialist sale and leaseback and net lease funds, (5) growth in the use of ground rent financing in continental Europe and (6) re-emergence of new lending from the traditional banks and a reassessment of existing facilities and terms.

03

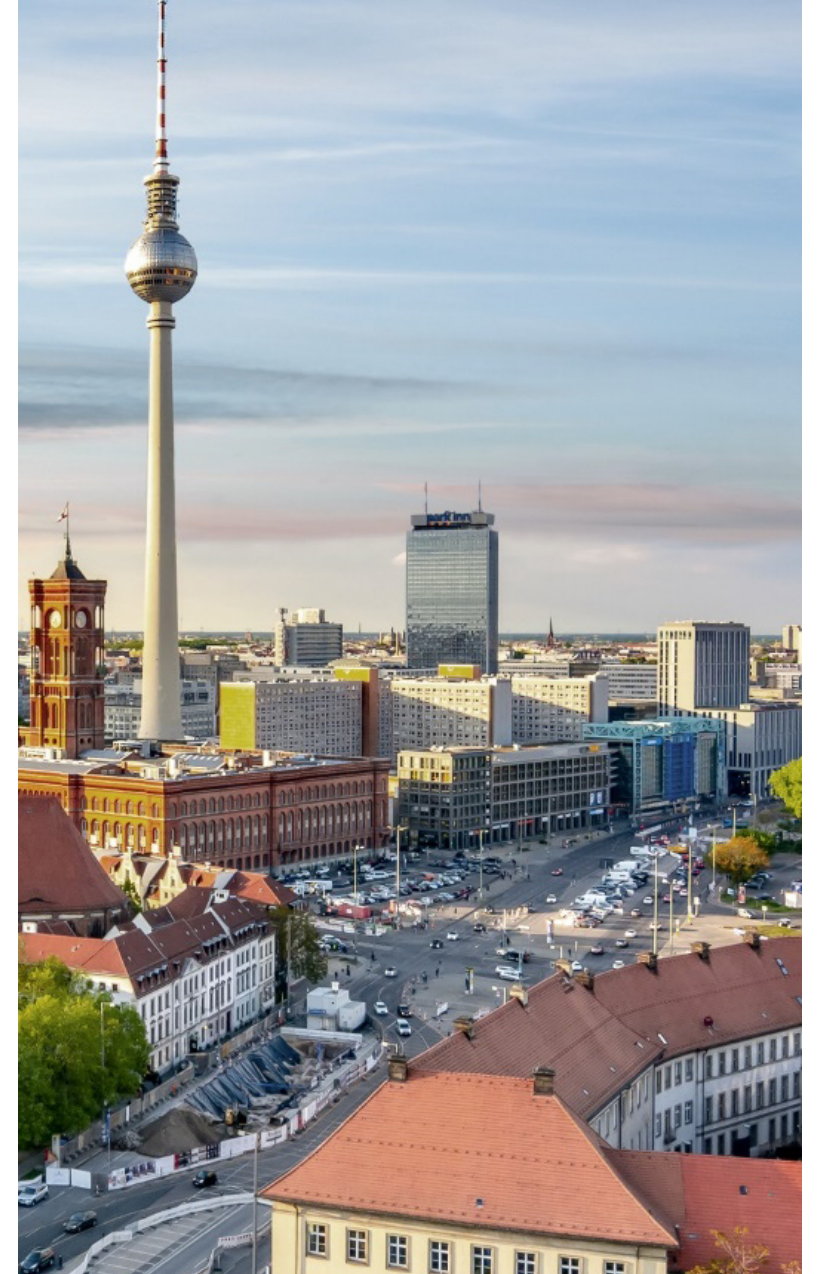
In the **leisure** segment, operators are showing more confidence both in anticipated trading outturns for 2022, and longer-term trends. Consumer decisions around travel and the environment will increasingly affect leisure market patterns, and any re-tightening of travel restrictions remains a risk.

04

Public and private **healthcare** funding mechanisms have remained mostly intact. This will support recovery in the operational market and support investor confidence with the sector's existing defensive characteristics and favourable demographics. We see the UK and Ireland as key growth markets.

05

Strong operational performance in **self-storage** will fuel interest from investors and from operators looking to consolidate. The sector is currently undersupplied in Europe and will expand, but investment opportunities remain limited particularly for those looking to invest at scale, hence keeping yields under pressure.



Leisure: a strong year ahead

A good start

Operating markets in leisure and entertainment are at varying stages of recovery from a disrupted 2021, but there is optimism for strong 2022/23 trading outturns, and emerging longer-term trends. Consumers are making clearer decisions around travel, and environmental and wellness habits will increasingly influence the shape of leisure businesses in 2022. Any Covid-related re-tightening of travel restrictions remains a notable short-term risk.

Demand outstrips supply

Pre-pandemic positive investor demand trends have continued and the imbalance between high demand and restricted supply will remain evident through 2022. New equity and funds are competing to set up operational platforms, recognising that it is sometimes necessary to start small in a large and fragmented marketplace.

Pricing pressure

There will continue to be upward pressure on pricing in sectors where demand has demonstrably grown, such as holiday parks and film studios. This is likely to be extended as recovery, growth and value relative to other markets is understood. Participants who can assess underlying operational performance and growth potential in each sub-sector will be at an advantage.



Pent up consumer demand for most leisure activities



Impact of COVID varies by subsector



In high demand sectors trade drivers have aligned with pandemic-accelerated trends



Holiday park pricing at all time highs



Pricing has recovered close to 2019 levels where recovery is visible



Strong demand for regional destination lifestyle, health and fitness investments



Large 'bid/ask spread' where recovery is difficult or subjective to predict



Opportunistic investors to target cinema sector as recovery crystallises

A growing range of real estate structures

We anticipate the emergence of a broader range of real estate structures across Europe. Large-scale specialist sale and leaseback and net lease funds are looking to establish a pan-European base in the leisure sector-predominantly with North American REITS and pooled funds. The use of ground rent structures is also likely to increase in continental Europe.

A combination of strong operating fundamentals, long term growth opportunities, investment return prospects and the broadening of funding platforms looks set to produce record levels of M&A activity in Operational Real Estate markets in 2022. Existing owners looking for potential exits will have a wider range of options, and will be able to take advantage of the significant pool of investor capital in the market.

We will see an increase in re-financing activity for those that don't take this route and continue to grow existing platforms. Lenders will look to re-balance their books and re-establish normal lending criteria in a competitive landscape. Financing options are growing, and traditional lenders are starting to venture back into new lending markets. This is likely to result in strong growth in operator/lender movements following a fairly benign 2021.

Healthcare: in recovery

Elderly and specialist care

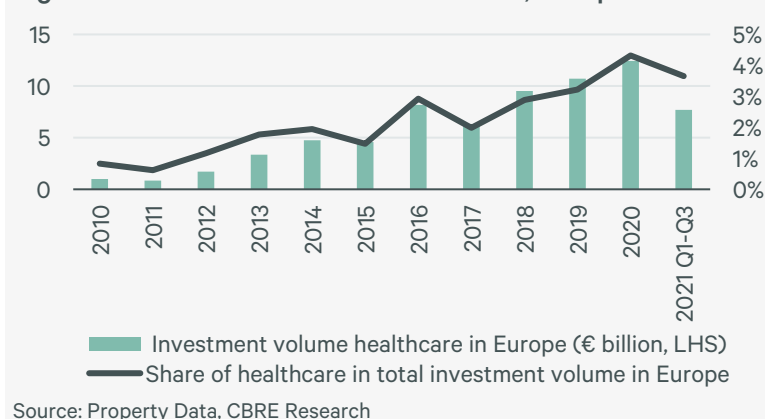
The recovery of the long term care sectors has gained momentum across European markets. National and local variations in restrictions will determine the pace of occupancy re-build through new admissions. Demonstrable government support - along with existing defensive qualities, favourable demographic trends and supply-demand imbalances in both public and private pay segments - is a positive signal for investors in long-term care.

Specialist care is mainly publicly-funded across Europe and the UK, and revenue mechanisms remained mostly intact despite the impact of the pandemic on public finances. New and continued overseas capital flow was a feature of 2021, with the UK and Irish markets standing out as key investment geographies and growth markets. Both German and Belgium care home markets have also reported record low yields - in Germany prime net lease yields strengthened to 4% and in Belgium to 3.75%.

Market activity is characterised by a mix of forward funding and standing investments, mainly the former due to the lack of existing opportunities to align with investors drive for improved ESG credentials.

Aedifica's acquisition of 19 German care homes operated by Azurit Group (€245m) marked one of the largest net lease transactions of 2021. In addition, one of Europe's largest healthcare operators, Korian SA, acquired its first UK care platform, Berkeley Care Group.

Figure 13: Healthcare investment market, Europe



Although these were different deal structures, both demonstrated market-leading pricing for experienced operator groups. Our outlook for 2022 is for further investment growth in key geographies (UK and Ireland) with new investor entrants following the lead of existing overseas funds.

Retirement living

The retirement living sector is now an integral part of wider residential strategies. Institutional investors, funders and traditional property investors are drawn by the demographic trends and growing need for alternative senior housing options.

Opportunities across continental Europe are either smaller in scale than those in the UK, or yet to gain traction. Post-pandemic, as demand from the end consumer grows, we expect investment to accelerate in 2022, limited only by the availability of opportunities.

Acute Hospitals

The private acute hospital sector is typically either an established part of the national healthcare system through outsourcing and institutional reimbursement, or funded in parallel by discretionary health insurance.

In most countries, government support mechanisms remained in place in 2021 with the aim of clearing waiting lists for elective care. Notably, the UK government agreed a new four year funding agreement prioritising the backlog of NHS cases, and the French government extended the revenue guarantee decree issued in April 2021 for a further eight months. Where countries have benefited from centralised interventions of this type, operational cashflows remain strong, with public-private partnerships strengthened for the long term.

European market activity was down on the previous year, although UK growth proved a key target. We anticipate renewed platform sales in the UK and continental Europe in 2022.

Self-storage: a growth sector

Operational performance is likely to be strong in 2022 although there is some uncertainty that current record levels of occupancy and revenue growth can be sustained. In the UK, for example, the concerns include a possible cooling of the residential market with the ending of the Stamp Duty holiday, and the termination of furlough schemes.

Persistent undersupply

On the other hand, European markets are significantly undersupplied, with around 0.25 sq ft of self-storage space per head of population compared with Australia (2 sq ft) and the US (9 sq ft). Even the UK, which is one of the more mature markets in Europe, only has approximately 0.75 sq ft per head of population.

New supply will come on stream across all markets, driven partly by growing consumer awareness of the product and new concepts and technologies. However, the pace of growth is limited by competition for suitable property, particularly in the major conurbations, as well as by planning and funding constraints. The longer fill periods in this sector make a rapid roll-out difficult, except for those with access to solid longer term capital.

Pressure on pricing

UK investment volumes, £125-150m in 2018-19, dropped significantly in 2020. 2022 is expected to be materially up on pre-Covid levels but a lack of investment stock is likely to be a feature of the market for some time to come. Strong operational sentiment and the weight of investment capital available will continue to exert downwards pressure on yields in 2022.



Arbitrage against traditional industrial rents



EBITDA margins typically in excess of 70%



Low break even cost – profitable from c.30% occupancy



Sticky income profile



Diversified ‘tenant base’ capturing consumers and businesses



Predominantly freehold backed businesses



Supply side barriers to entry



Fragmented market – Major operators own less than 50% of European facilities

09

Hotels

Outlook

Hotel performance will strengthen in 2022, led by demand from leisure travellers. Corporate demand is likely to remain more subdued in the medium term and a re-tightening of restrictions remains a general risk.

Trends to watch

01

ESG will be a key area of focus for hotel operators, owners and investors as they look to develop sustainability initiatives through operational and development changes.

02

The winter and summer resort markets in Europe have been disrupted for two seasons, but the loosening of international travel restrictions is likely to boost demand, with many resort operators already reporting strong books of business for 2022. Government responses to the new Covid variant represent a significant short-term risk for this sector.

03

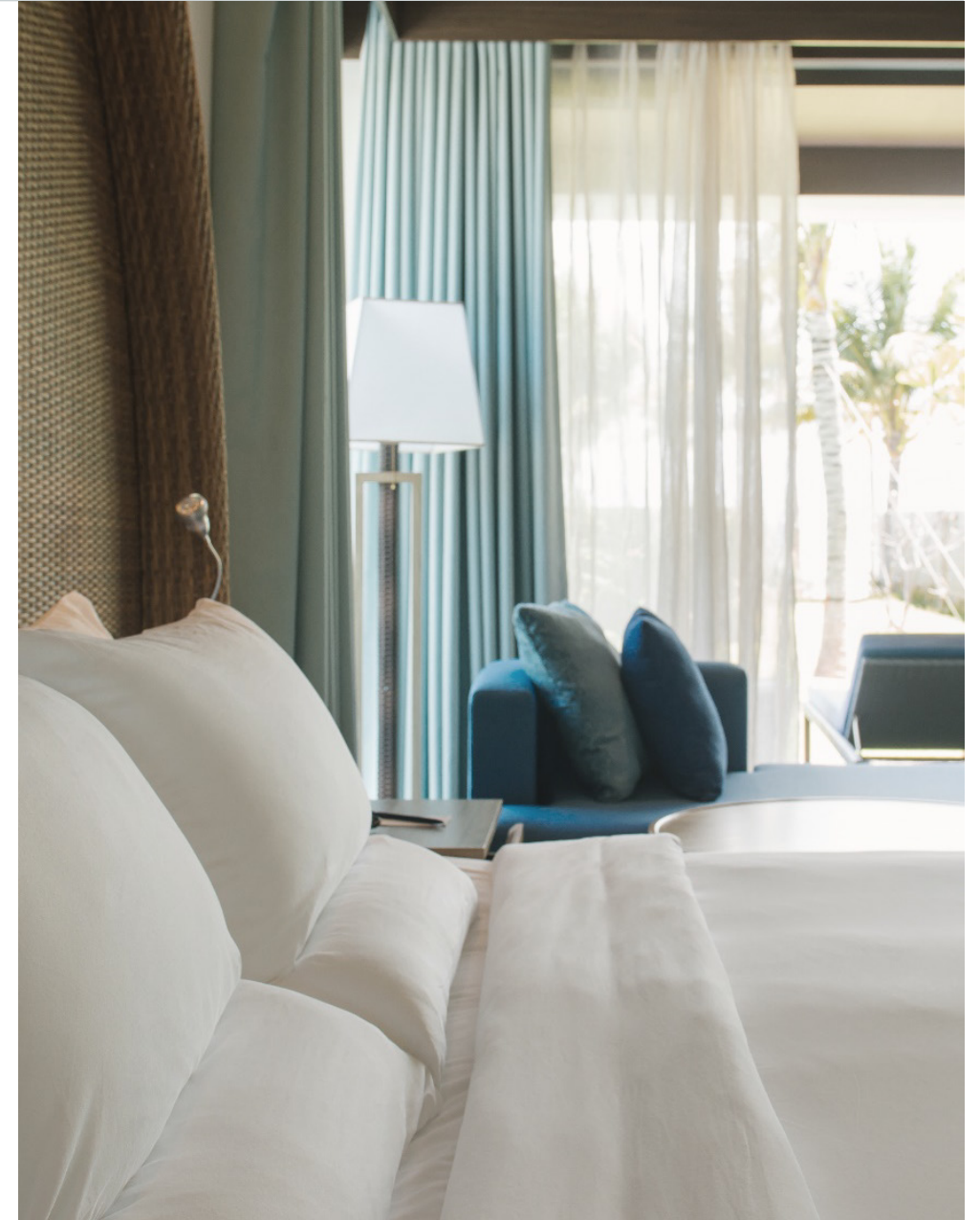
Removal of travel restrictions to and from the USA will provide a boost for European hotel demand in both the business and leisure segments. We also expect growing demand from Asia via Vaccinated Travel Lanes in 2022.

04

Hotel operators remain cautiously optimistic for 2022, due to lighter travel restrictions and strong domestic demand. Recruitment and retention of staff remains a pressing challenge for many.

05

Despite the pandemic, operators have been active in pursuing development opportunities and we expect this to continue in 2022. The main focus will remain on major Western European markets, but with increased attention on the Nordics and CEE regions. We also expect increased interest for resorts, greater flexibility on terms and a push for increased transparency on trading performance.



Return of international travel

Domestic leisure demand has been the main driver of hotel performance across Europe during the pandemic due to international travel restrictions. This is expected to change as borders re-open and people are again able to enjoy overseas travel, although there are clearly still short-term risks to this view.

A significant rebound in international travel is expected in 2022, led by short-haul travel with mid- and long-haul destinations recovering more slowly (see Figure 14). The recent re-opening of the United States and the introduction of Vaccinated Travel Lanes to several European destinations from Singapore has helped open more long-haul destinations, with demand from the USA especially strong and, in some markets, already returning to pre-Covid levels.

After two years of disrupted trading, we anticipate recovery of both winter and summer resort markets across Europe, with many operators already reporting strong business on the books going into the 2022 season.

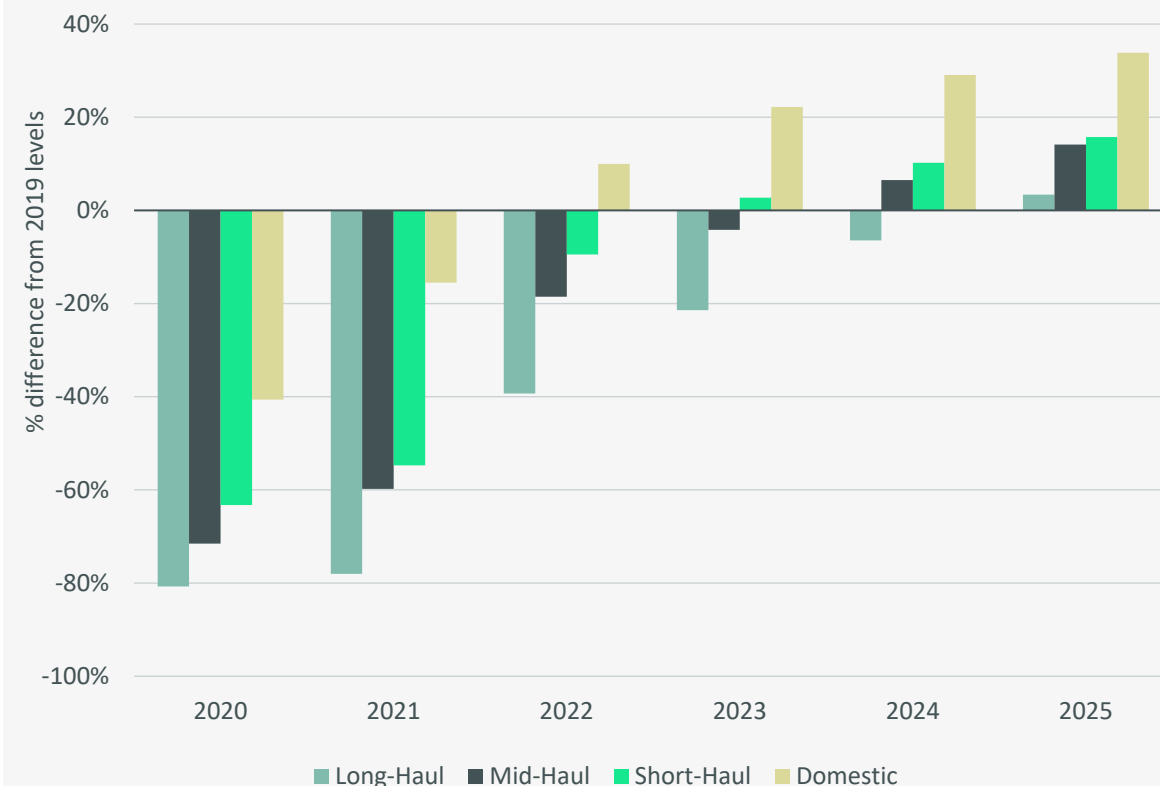
Barring significant or prolonged further restrictions, all international travel is forecasted to fully recover to 2019 levels by 2025. Leisure is expected to continue to lead the way, recovering to 2019 levels by 2023. However, the adoption of virtual working and a stronger focus on ESG means business travel is likely to take far longer to recover.

Growing Importance of ESG

ESG is increasingly a focus for many hotel operators, developers and investors. Commitments are being made to achieve Net Zero Carbon and other sustainable improvements by changing the way hotels are built and operated.

Many global hotel brands are leading the way with ESG initiatives, and we expect this to remain a key focus area in 2022 and beyond. Intercontinental, Hilton and Marriott all have ESG programmes in place, and smaller operators are recruiting specialist teams to focus on developing ESG across their platforms.

Figure 14: Europe: international versus domestic arrivals 2020 - 2025



Source: Tourism Economics

10

Data Centres

Outlook

Cost and margin pressure for operators will force increases in customer pricing in 2022. Despite further growth in capacity, vacancy rates in some key markets will reach multi-year lows, and M&A activity will accelerate.

Trends to watch

01

Providers' margins are under pressure in the main markets due to increased power, construction and build costs. Some colocation providers will raise prices, and more will attempt to deliver operational efficiencies in a bid to maintain margins at current pricing.

02

Vacancies across the Frankfurt, London, Amsterdam and Paris (FLAP) markets will reach multi-year lows as demand for space rises across Europe's largest data centre markets, boosting the value of supply that comes online.

03

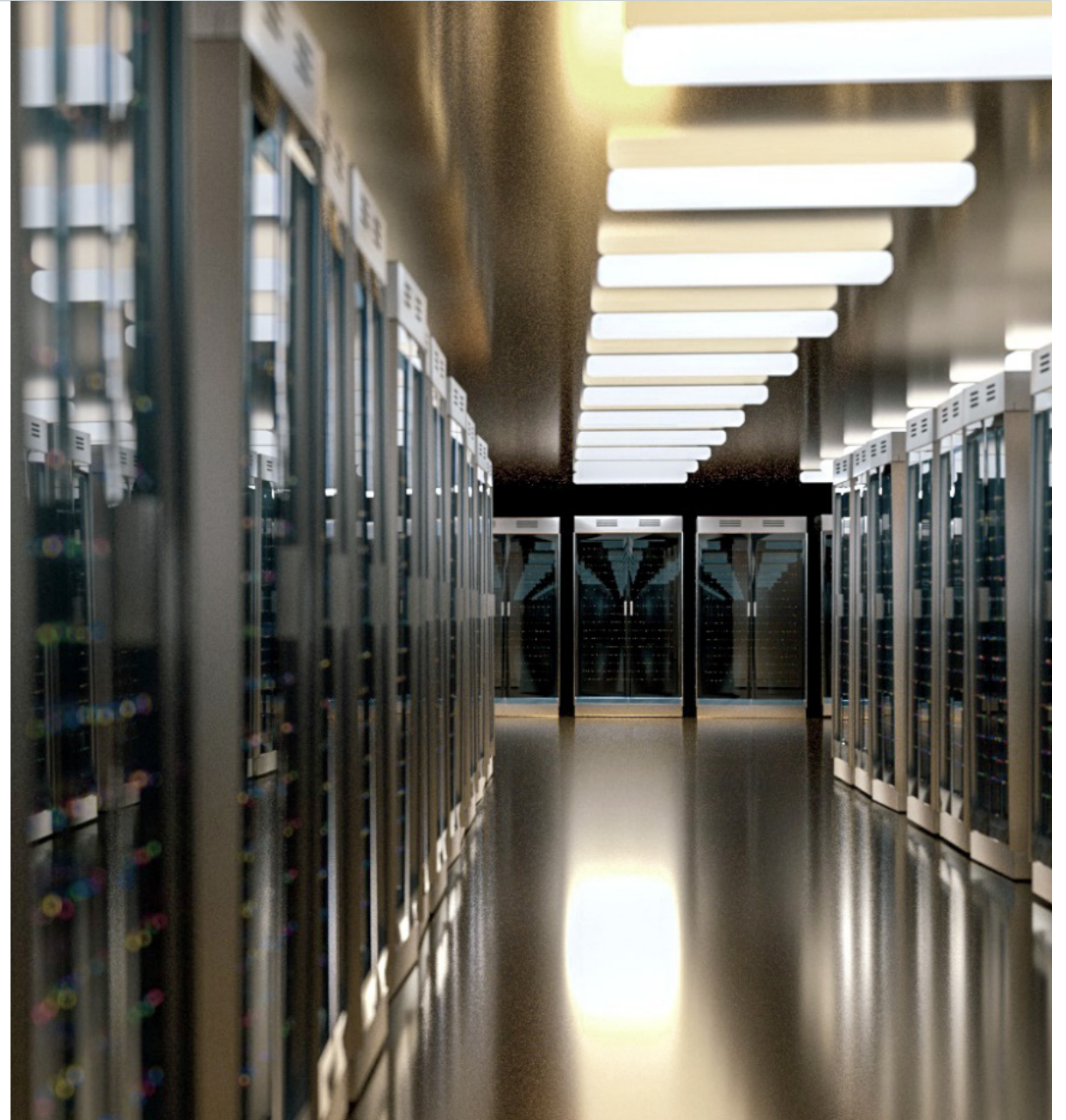
Supply capacity will continue to rise in 2022. By the end of the year FLAP market capacity will have more than doubled from its 2017 level.

04

M&A activity will grow as interest in the sector remains high and supply limited.

05

Several colocation data centre operators have made pledges towards sustainability, efficiency and renewable energy use. Expect more providers to turn these promises into action in 2022.



Colocation pricing to rise in 2022

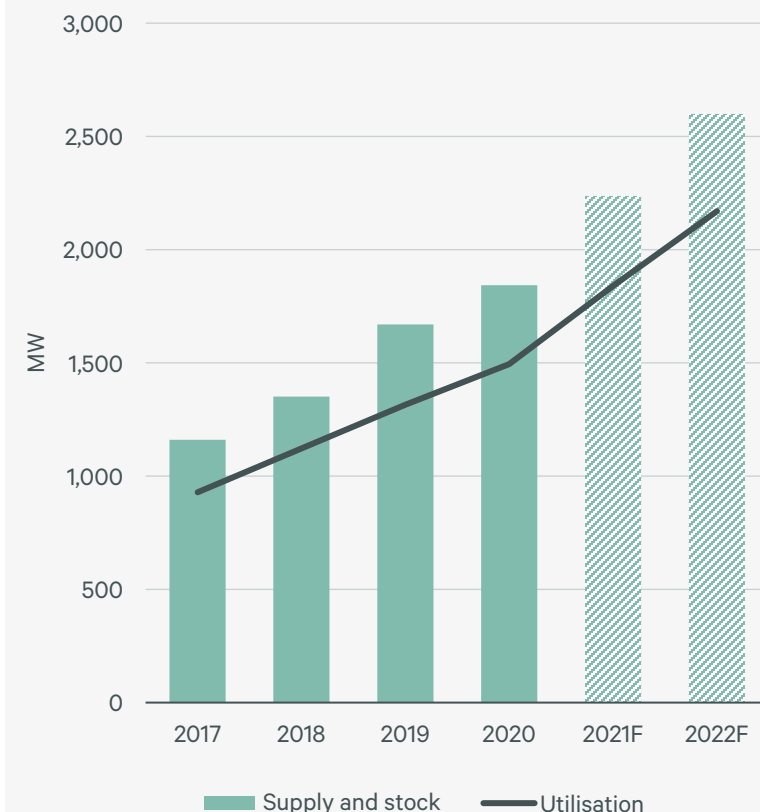
Colocation providers have reported energy cost increases of 20% or more – and as a result margins are under pressure. Many larger providers have hedged a portion of their power costs with long-term contracts. However, providers due for energy contract renewal, and smaller providers on metered power, expect to pass on higher energy costs to customers or risk lower margins. As a consequence, we expect many providers to raise customer pricing over the coming year by at least 5%. Though rental rates are likely to increase for tenants, demand for data centres in London and the rest of the UK, will remain high given the limited supply in the market and continued high demand for public cloud offerings.

Stock growth expected across FLAP markets

Despite the expected price hikes, there will be more than 2,600MW of data centre stock across the FLAP markets by the end of 2022, an increase of 124% over the total capacity in 2017.

We expect an additional 323MW of new stock to be added to the market in 2022. This is despite economic pressures that have led to cost increases (e.g. materials, shipping, fuel, labour, land and equipment), as well as supply-chain challenges that have hindered access to IT. These factors have contributed to a delay in deals and deployments.

Figure 15: FLAP Data Centre Stock, 2017-2022F



Source: CBRE Research, 2021

Vacancy rates hit multi-year lows

Vacancy rates are expected to dip to 16.4% across the FLAP markets as leased data centre supply remains limited relative to demand. In Amsterdam, for example, Schiphol-Rijk remains supply-constrained due to high demand, even though excess capacity is available in other parts of the market. Frankfurt typically operates with lower vacancy, but the market remains particularly tight. Providers will continue to build speculative supply in Greater London as they have in the past.

M&A activity volume to grow

We expect mergers and takeovers of data centre operators to hit new highs in 2022 as we see continued interest from investors looking to better understand the European data centre market and capitalise on its strong performance. Investors are drawn to the positive underlying occupational story and defensive nature of revenue streams, illustrated by the fact that capital values generally held firm during the pandemic.

Infrastructure is increasingly important to enterprises that want to digitize estates, and the limited volume of leased data centres will only heighten the appeal of data centres to investors.

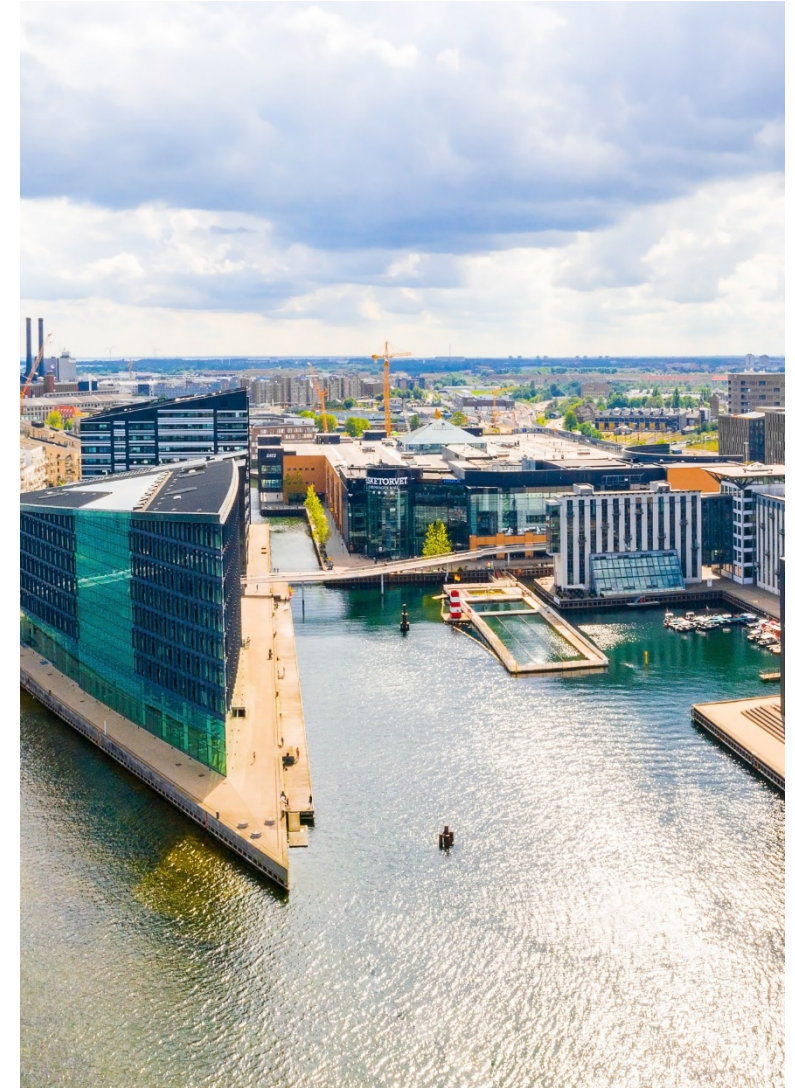
As such, we expect to see an increase in activity next year as financial institutions look to capitalise on the yield compression and growing demand for leased data centres.

Sustainability to become ingrained

Several colocation data centre operators across Europe have made pledges towards sustainability, efficiency and renewable energy use. Expect more providers to turn those promises into targets in 2022 and move towards sustainability-related clauses in their agreements with key customers.

This all reflects the growing importance of sustainability for customers of data centre operations. Increasingly, these efforts are being sewn into corporate social responsibility programmes, suggesting that ethical priorities are as significant as the IT benefits.

To that end, Frankfurt's government is looking into ways to curb or control the development of data centres due to concerns over energy use and location given the shortage of residential and commercial developments in the city. There has not been any mention of a moratorium similar to Amsterdam's, but the industry has had discussions around where future data centres should be located. We may see changes in the sector's locational pattern as a result.



Contacts



This report was written by CBRE's multi-national cross border EMEA research team comprised of commercial real estate professionals located across Europe. If you have any questions regarding the content of the report, the contributors listed below are ready to assist you.

EMEA RESEARCH

Jos Tromp

Head of Research,
Continental Europe
Head of Data Intelligence
Continental Europe
jos.tromp@cbre.com

GLOBAL RESEARCH

Richard Barkham, Ph.D, MRICS

Global Head of Research/
Global Chief Economist
richard.barkham@cbre.com

Henry Chin, Ph.D.

Global Head of Investor
Thought Leadership
henry.chin@cbre.com.hk

Julie Whelan

Global Head of Occupier
Thought Leadership
julie.whelan@cbre.com

ECONOMIC

Neil Blake, Ph.D.

Global Head of Forecasting and EMEA
Chief Economist
neil.blake@cbre.com

Aaron Hussein

Associate Director
EMEA Forecasting Team
aaron.hussein@cbre.com

Ruth Hollies

Senior Director
Research
ruth.hollies@cbre.com

INVESTMENT

Benjamin Pipernos

Senior Analyst
EMEA Capital Markets Research
benjamin.pipernos@cbre.fr

RETAIL

Tasos Vezyridis

Executive Director
EMEA Retail and Logistics Research
tasos.vezyridis@cbre.com

Alex Ozga

Senior Research Analyst, EMEA Retail
Research
Alex.ozga@cbre.com

OFFICES

Richard Holberton

Head of Occupier
Research EMEA
richard.holberton@cbre.com

Jordan Rainey

Senior Analyst
jordan.rainey@cbre.com

LOGISTICS

Tasos Vezyridis

Executive Director
EMEA Retail and Logistics Research
tasos.vezyridis@cbre.com

Pol Marfà

Associate Director
EMEA Logistics Research
pol.marfamiro@cbre.com

HOTELS/LEISURE

Joe Stather

Associate Director
OPRE Hotels – Advisory Services
joe.stather@cbrehotels.com

Julian Kemp

Senior Director
Hotel Advisory Services
julian.kemp@cbre.com

Claire Gent

Director
Hotel Advisory Services
claire.gent@cbre.com

RESIDENTIAL

Jennet Siebrits

Head of UK Research
jennet.siebrits@cbre.com

Melissa Verhoef

Associate Director, EMEA Multifamily
Research
melissa.verhoef@cbre.com

DATA CENTRES

Kevin Restivo

Head of Data Centre Research
Advisory & Transaction Services, EMEA
kevin.restivo@cbre.com

OPERATIONAL REAL ESTATE

Andrew Surgenor

Senior Director, Healthcare Valuation
andrew.surgenor@cbre.com

ESG

Dragana Marina

Head of Research, Denmark & Sustainability
Research Lead Continental Europe
dragana.marina@cbre.com

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