PROPRIETARY RESEARCH

2021 Outlook: Transitioning to the Next Cycle

HinesView
INSIGHT FROM INVESTMENT MANAGEMENT

The world economy today is quite different from what it was pre-COVID. While we knew the risk of a market correction was elevated heading into 2020 as detailed in last year's outlook, no one could have predicted a global pandemic and its wide-ranging impact on the communities in which we live and work. We have learned in real time how to safeguard our health and protect our livelihoods. Despite being thrown into uncharted territory in 2020, there are certain metrics we can assess to help us gain insight into what's to come.

So, what do we know?

- From an economic perspective, this downturn has been unprecedented in its suddenness and magnitude. As such, the recovery is likely to be unlike any other as well.
- We know that people were already changing the way they interact with real estate prior to the pandemic and the virus has accelerated that shift further.
- We know a significant portion of the built environment is no longer well-suited for post-pandemic ways of living, working, and shopping.
- We know the dissemination of the various vaccines should help combat the spread of the virus and its toll on our communities, bringing optimism and hope for better days soon.

2021 is largely going to be dominated by a narrative of transition. We expect to see a gradual shift from a world gripped by the pandemic to one that can see through to the other side. The differences between the first and second halves of the year are likely to be meaningful, not only in the data but in tone. The impact on animal spirits and tolerance for risk-taking will likely be significant.

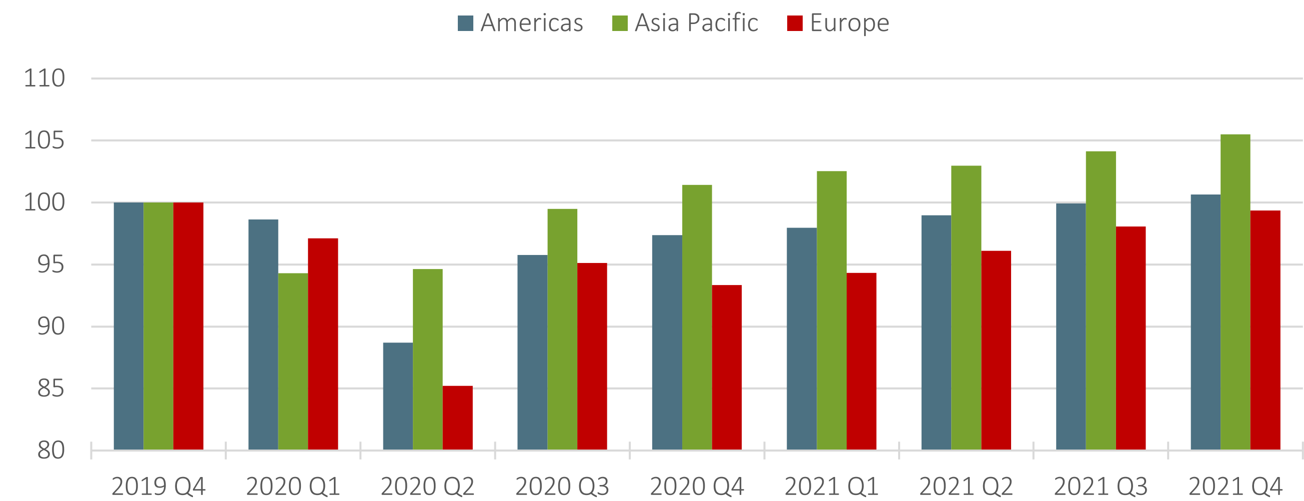
FULL MACROECONOMIC RECOVERY IS STILL ABOUT A YEAR OUT

The good news is that the recovery started off strong in the third quarter of 2020 as economies began to come back online. And though masking, social distancing, and continued safety measures still limited the strength of the rebound, the emergence from full-scale lockdowns increased economic output and employment. The bad news is that the rebound has already begun to slow in the fourth quarter as another wave of infections stifled economic activity once again, whether by formal lockdowns or by consumer choice. Indeed, real-time data on indicators such as mobility and restaurant reservations show a consumer who is retreating once again in a bid to combat the virus. While we don't put a lot of stock in economic forecasts, some of the more bearish analysts are expecting that many economies began to shrink again in the fourth quarter and that the contraction will continue into the first quarter, particularly in Europe and the United States.

The consensus is more along the lines of what is shown in Exhibit 1 where the pace of recovery slows in Europe and the U.S. but continues, nonetheless. In both scenarios, expectations are that growth will accelerate in the summer, and we should expect to see record-high year-on-year growth rates in the second quarter as we predicted in our initial recession forecasts released in April 2020. By year-end 2021, levels of output should return to somewhere near pre-pandemic marks in both major regions of the western world.

The Asia Pacific region is a bit of a different story, having been more aggressive in combating the virus in both authoritarian regimes such as China but also in democracies such as New Zealand and Australia. As such, output didn't contract as much in the region relative to the U.S. and Europe. However, the unemployment rate in many Asian economies did rise a bit more than it did in Europe given the aggressive employment support that European countries included in many of their stimulus packages.

Exhibit 1: Real GDP Index (19Q4 = 100)



Source: Oxford Economics; as of 2020Q3

As a result, Asia Pacific is further along in its recovery and should surpass pre-pandemic levels of output as soon as the fourth quarter of 2020. While the region is not free from the virus, recent outbreaks have been fairly well contained and the region will likely avoid the sort of widespread surges that are impacting the recoveries in Europe and the Americas.

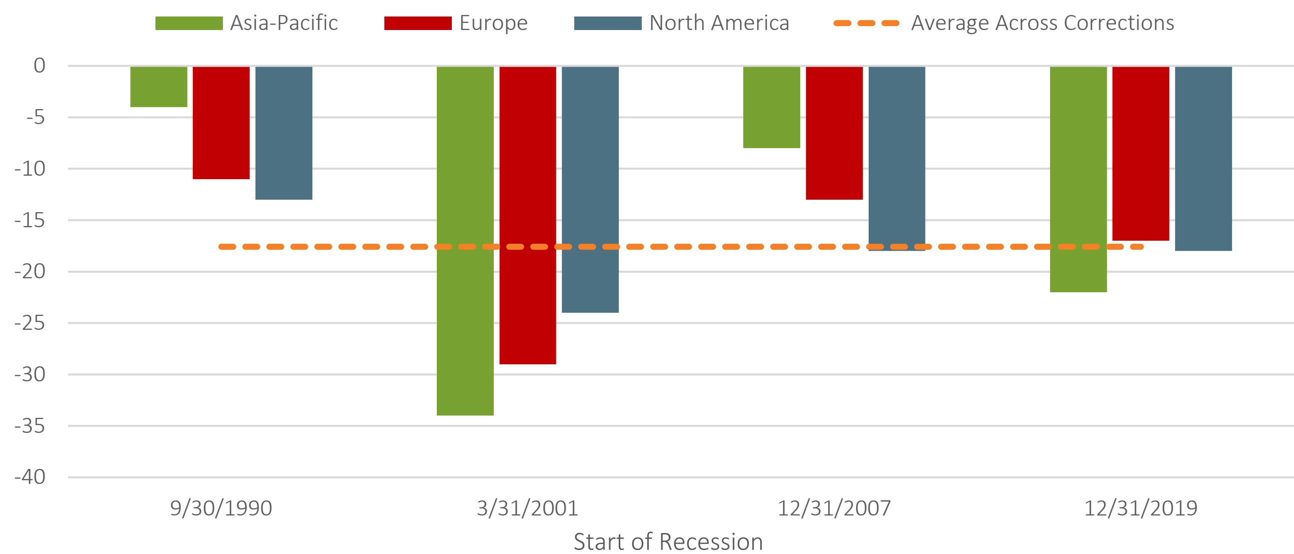
From an employment perspective, traditional office-using employment has held up well in all three regions and the largest impact on jobs has been in the so-called "face services" sectors. Businesses such as restaurants, beauty salons, and probably most importantly, travel and tourism-oriented outfits have suffered disproportionately. Meanwhile, the technology, transportation, warehousing, and living sectors have actually been boosted by the pandemic given the jump in telecommuting, e-commerce, and investment in homes, as those who can stay home are doing so.

While some of these trends may persist, the second half of 2021 could see a reversal of many of them. Pent-up demand for travel and personal services is likely to be significant as the virus is largely eradicated, at least in developed economies. Given the failure of many hotels throughout the pandemic, the overall room inventory in operation has declined. As demand returns, hotel occupancies could approach record highs by the end of next year as both personal and business travel resumes and the conference industry emerges from its virtual reality slumber. The return to office that we are already seeing in Asia Pacific may not be as strong in Europe and the U.S. as western companies adopt more of a hybrid approach to where their employees work. That may have a marginal long-term impact on office demand on the order of 10% to 15% but it will be an important trend to watch in 2021 as we should have more information by the end of the year on what the potential impact could be. Certainly, there will be near-term pent-up office demand under existing leases for the types of things that are difficult to accomplish virtually such as mentorship, team building, and interactive collaboration with colleagues and customers that will support a fairly robust return-to-work movement in the second half of the year.

THE IMPACT ON REAL ESTATE FUNDAMENTALS THUS FAR

To have a better understanding of where we are headed in 2021, we need to take stock of where we are. The last three market corrections were caused by very different types of recessions with varying economic severity. Despite those differences, it has taken roughly two years for real estate fundamentals to find their bottom following the start of each of them. Three quarters into this downturn, fundamentals are behaving similarly to prior recessions as illustrated in Exhibit 2.

Exhibit 2: Changes in the Leasing Environment Health Score Three Quarters After the Start of Recession



Source: Oxford Economics; as of 2020Q3

Across the three major regions, declines in the average Leasing Environment Health Score[1] have been on par with the average of the last three recessions and much more in line with one another thus far than in the prior three downturns.

Within Asia Pacific, Japan has held up well and continues to enjoy quite strong fundamentals in its major office and warehouse markets. But Indian, Australian, South Korean, and Singaporean office markets have seen fundamentals deteriorate from above-average levels pre-pandemic to relatively weak levels as of the third quarter. China and Hong Kong were already contending with fundamentals that were well below average in the fourth quarter of 2019 and they've weakened further in 2020. In mainland China, this was the result of overbuilding, particularly in Shanghai, while Hong Kong was already contending with weak demand in 2019, primarily due to political unrest and uncertainty.

In Europe, following decades of steady and strong rent growth, high-street retail markets were slammed by lockdowns, the disruption to tourism, and the accelerated growth of e-commerce. Single-digit LEHS's across most European high-street retail markets speak to a fundamentals environment that is in the lowest 10th percentile of each market's history with virtually non-existent demand and rising vacancy rates forcing landlords to cut rates.

Within the European office sector, only German office fundamentals remained above average as of the third quarter with an average LEHS score of 52. However, this was a significant decline from an average value of nearly 80 pre-pandemic. French office markets saw a slightly larger decline while the Amsterdam office market held up better but

[1] The Leasing Environment Health Score (LEHS) is a composite indicator on a scale of 0-100 of three important fundamental real estate indicators: trailing annual demand growth, occupancy rates, and trailing annual rent growth with higher scores indicating stronger fundamentals and score of 50 equal to the long-term average.

started from a slightly weaker, though still very good, position. Both ended the third quarter with slightly below-average fundamentals, although Paris's Western Business District and La Defense submarkets are suffering significantly more than its CBD. The average LEHS in most other European office markets fell below 40, and in Warsaw, Dublin, and Milan, it slipped under 30. Despite these declines, it should be noted, however, that the average European office market's fundamental health is still significantly above the lows seen following the Great Financial Crisis when the average LEHS across Europe fell to 12 at the end of 2009. Today, the average is 40.

Though weaker than they were pre-pandemic, European warehouse fundamentals generally remain well above average. The acceleration in e-commerce penetration during the health crisis, particularly in countries with previously low levels such as Spain and Italy, has boosted warehouse demand across the continent. A few European warehouse markets are positing LEHS's in excess of 90, including Birmingham and Dusseldorf. Madrid, Hamburg, Munich, Frankfurt, and Paris are each in the top 20th percentiles of their market's historical levels with scores in excess of 80. Notable pockets of weakness include the previously hot Warsaw and London markets. Warsaw's softness is due to a bit of overbuilding, while rent growth in the broader London market has slowed following several years of heady growth. That said, urban infill submarkets within London remain tight.

In the U.S., fundamental trends across apartment markets have diverged tremendously. Most of the major coastal gateway markets are experiencing historically weak demand as renters flee dense, urban submarkets in search of larger living spaces in more suburban submarkets and/or other markets altogether. As of the third quarter, single-digit LEHS's were recorded in Chicago, Boston, the Bay Area, Los Angeles, New York, and Washington D.C. And while many former renters in these markets are leaving for lifestyle metros such as Austin, Nashville, and Boulder, overbuilding in those markets along with the economy's impact on existing renters has pushed fundamentals to alarming lows as well. Meanwhile, many smaller secondary markets have experienced a significant uptick in fundamental strength. Notable among them are the Inland Empire, which is benefiting from in-migration out of L.A., Sacramento (in-migration from the Bay Area), and Phoenix (in-migration from California). The rest of the U.S. apartment markets span these two spectrums and, in fact, the standard deviation of the LEHS across U.S. apartment markets hit a record high in the third quarter that was 68% higher than its historical average.

In U.S. office markets, the average LEHS has fallen from a slightly above-average level of 57 in the fourth quarter of 2019 to a below-average value of 35 as of the latest third quarter 2020 data. Some smaller markets are holding up better but few of notable interest. Like the apartment sector, some of the largest gateway markets experienced the biggest deterioration in fundamentals since the end of 2019 with New York, San Francisco, and the East Bay experiencing declines of more than 50 points in their respective LEHS's. In short, nearly all U.S. office markets saw an abrupt slowdown in leasing, a drop in occupancy rates, a material increase in sublease availability, and a decline in asking rents.

Suffice to say, none of the four major property sectors has been more negatively impacted by COVID-19 than the retail sector. On average across U.S. retail markets, fundamentals were slightly above average prior to the pandemic but well below average in late 2020. Retailer bankruptcies have trickled down to several sizeable landlord bankruptcies and further pain is likely given the proliferation of online shopping during the holiday season. Over the long term, retail inventory will likely decline through redevelopment and adaptive re-use but that will take years to play out and the sector is likely to struggle in general, with only the strongest centers able to survive.

In contrast to the retail sector, the industrial sector has benefited from the accelerated adoption of e-commerce shopping necessitated by the pandemic. However, the sector has not been immune to the economic disruption. While fundamentals remained above average in the third quarter of 2020 with an average LEHS of 59 across U.S. industrial markets, that was down from 73 at the end of 2019. Among the strongest markets in the country in the latest data, East Coast markets stand out with Harrisburg, the Lehigh Valley, Trenton, New Haven, Savannah, Scranton, and

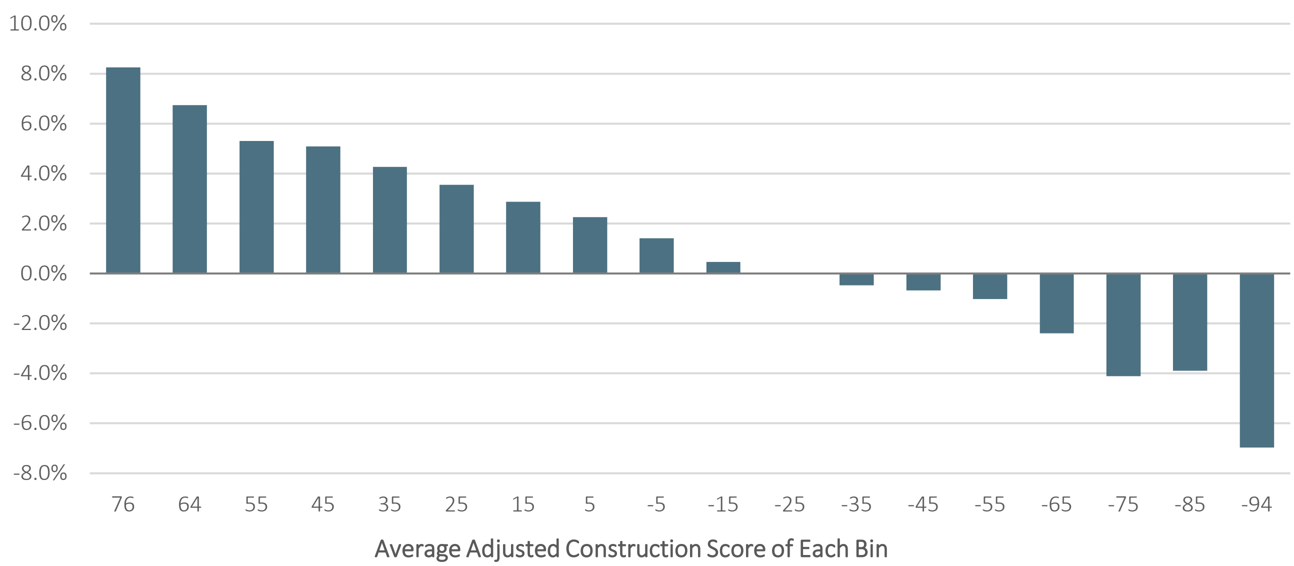
Northern New Jersey all posting LEHS's in excess of 90. In general, the industrial sector in the U.S. has moved from a dramatically undersupplied market that was driving historically high rent growth just about everywhere to one closer to equilibrium with still-high demand being met with higher levels of deliveries. The result has been healthy rent growth slightly ahead of inflation in most markets but down from the high single-digit levels that existed two to three years ago.

ASSESSING NEW SUPPLY AND THE IMPACT ON RENTS IN 2021

In general, construction activity since the financial crisis has largely been kept in check but there are pockets of concern where new supply will add to fundamental distress in 2021. Utilizing a similar methodology to how we assess the state of fundamentals, we can examine space under construction as a percent of a market's inventory and compare that to its history using scores on a scale of 0 to 100 to quickly assess the risk of oversupply. Furthermore, we can subtract that result from the existing LEHS to get a sense of how well (or not) that oncoming supply is likely to be absorbed as it delivers in the coming quarters. We'll refer to this metric as the Adjusted Construction Score or ACS for short. Naturally, it can range from -100 to 100 but 85% of historical observations lie in the -50 to 50 range.

In Exhibit 3, we've broken the historical data into 10-point bins with the horizontal axis depicting the average ACS of each bin, and illustrated how the ACS has impacted future rent growth across 51,674 observations in the 445 markets where we have adequate estimates of space under construction throughout history.[2] As is evident, when the ACS has exceeded 70, rent growth over the following year has been quite strong, averaging more than 8%. As the ACS falls from left to right in the exhibit, average rent growth over the following year has historically decelerated, with values of less than -30 historically equating to rent losses over the next year. In addition to the following year, the ACS can inform us about the shape of rent growth over several years. Historically, average rent growth has been strong but cooling over the following five years when the ACS is high. When it is low, rent losses in the near term have slowly abated and given way to relatively strong growth in years four and five. That has important implications for underwriting and lease rollover analysis.

Exhibit 3: Average Rent Growth over Following Year by ACS Range



Source: CoStar; CBRE; PMA; JLL; as of 2020Q3

[2] There are some historical observations with scores in excess of 80 so the bin with an average score of 76 on the far left of Exhibit 3 actually includes all observations with score in excess of 70. Given its average score of 76, however, it's clear that most of those observations are in the 70-80 range.

Across the major regional property sectors globally, the inventory under construction score is generally low with average scores in the 20 to 30 range for Asia Pacific property markets, 34 in both European and U.S. office markets, and mid-teens for both European and U.S. retail markets. In U.S. warehouse markets, the average score rises to 60 and in U.S. apartment markets, it averages 65. While holistic data on European warehouse supply is too opaque to analyze systemically, anecdotal evidence suggests that construction is likely somewhere around U.S. levels relative to European market's respective histories.

As previously discussed, it's not necessarily the level of supply but the level of supply relative to existing fundamentals that impacts the following year's rent growth. Using the Adjusted Construction Score, on average, only the U.S. apartment market produces a strong negative reading. But at an average value of -19, it would still indicate positive rent growth over the following 12 months for the regional property market as a whole. European office markets check in with an ACS of 6 indicating relative equilibrium while Asia Pacific warehouse markets have an average ACS of 11. U.S. warehouse markets have a current ACS of 0 while European warehouse markets would post a -3 assuming similar levels of construction that the U.S. is experiencing. So, all in all, one could say the market is absent supply issues in general.

However, if we peel the onion, there are some markets that will need to contend with new supply in the face of already challenged fundamentals while others remain relatively insulated. In Asia Pacific office markets, Tokyo's ACS leads the region with an average in excess of 60, and several submarkets in Mumbai and Sydney have positive and healthy ACS's as well. However, there are submarkets in Sydney and Melbourne with high single-digit percentages of inventory under construction with ACS's well below the threshold that would indicate modest rent losses over the next year. Shanghai's office market overall also has an ACS just below the 30 threshold while Guangzhou's office market sits at −40.

In the Asian Pacific warehouse markets we currently track, we see a similar dichotomy between Japan and China with Tokyo leading the region with a healthy overall ACS of 25, but a strong 73 in the Bay Area submarket and a comforting 52 in its Inland submarket as defined by JLL. None of the ACS's in China's warehouse markets are low enough to indicate rent losses but other than Shenzhen, they are all in negative territory.

Moving to Europe, most of the European high-street retail markets have ACS's in negative territory but that is primarily due to exceptionally weak fundamentals relative to their histories and only modest amounts of new supply. Paris leads the region with a score of 20.

In Europe's office markets, already weak U.K. fundamentals will need to absorb additional supply over the near term and while the level of inventory under construction is average at best, it's enough to push London's overall ACS to -16 metro-wide with the West End and Midtown submarket at -29, the Docklands at -14 and London City at -10. Outside of the U.K., slightly below-average levels of new construction in La Defense are enough to push its ACS down to -27, while Dublin, Copenhagen, and Milan have slipped into the -10 to -15 range. On the positive side, the supply-constrained Paris CBD remains solid, and most German office markets maintain ACS's in excess of 10. The lone exception is Berlin where fundamentals remain exceptionally strong with an LEHS of 83 – amongst the strongest office fundamentals globally – but an under construction score of 91, pushing its ACS into slightly negative territory.

In U.S. office markets, construction activity is highest in the markets where fundamentals have been most impacted by the pandemic. With an LEHS of just 16 and an under construction score of 80, San Francisco's office market's ACS is the lowest in the country, coming in at -64. This would indicate not only falling rents in 2021 (on top of the declines we have already seen in 2020) but sluggish growth in 2022 as well. Fundamentals have held up better in a number of lifestyle cities such as Austin, Salt Lake City, and Nashville, but high levels of construction in these smaller markets push their ACS's into the -50 to -60 range. Los Angeles, New York, Miami, and Boston also have ACS's below the threshold that would indicate rent losses in 2021. As with the LEHS analysis for U.S. office markets, it is mostly small-cap markets that lead the nation in terms of the ACS metric. There are a few standouts however of interest. Durham and Phoenix have moderate positive ACS's while Seattle is only slightly negative.

The dichotomy between large and small U.S. markets is quite similar in the apartment asset class. Here, we see significant negative readings in many major markets with single digit LEHS's coinciding with under construction scores in the high 90s. As a result, San Francisco, Boston, Washington D.C., and New York have ACS's below -90. Historically this would equate to significant rent declines over the following year and continued, though more modest, losses in 2022 and 2023. Other major apartment markets with ACS's below 30 that could see rent losses in 2021 include (in order of worst to least bad) the rest of the Bay Area, Miami, Chicago, Los Angeles, Seattle, Nashville, Austin, Minneapolis, Houston, and Denver. Notable U.S. apartment markets with stronger supply/demand balance include Sacramento, where construction is just gearing up to meet exceptionally strong fundamentals, Tucson, Phoenix, Jacksonville, and Atlanta.

In U.S. warehouse markets, supply and demand are more in balance than they have been in several years. On average, the ACS of U.S. warehouse markets fell to exactly zero in the third quarter for the first time in nine years. This was down from a record peak of 35 in 2015. While we don't anticipate distress in the U.S. industrial market – at least not nearly to the degree that we may see in the other three property types – there is risk of some near-term oversupply in a handful of markets, including Houston, San Antonio, Columbus, Pittsburgh, and Denver. In each, fundamentals have softened with LEHS's under 40 while the level of construction remains elevated with under construction scores in excess of 75. But the majority of markets have strong fundamentals that are being met with appropriately high levels of construction. In a handful of mostly smaller markets, fundamentals remain strong while construction levels are low. Boston is on that list as well as, surprisingly, the Inland Empire where land is increasingly difficult to come by, particularly in the metro's more sought-after western submarkets.

CAPITAL MARKETS

A distinguishing characteristic of this recession is that the marketplace immediately recognized it. Typically, market participants spend the first six to nine months of a recession debating whether we are in one before the data overwhelmingly confirm that the recession started six to nine months prior. During those initial six to nine months, investors across all asset classes can make a lot of mistakes as previous assumptions about the future fail to come to fruition and are then ultimately revised as conditions deteriorate. That was not the case this time as many investment committees, including our own, immediately ceased reviewing deals as the lockdowns unfolded and the initial economic data shockingly confirmed a significant contraction, the likes of which had never been seen in modern recorded data. In addition, the relative immediate recognition of economic trouble also informed policymakers and both central banks and governments were able to enact swift and sizeable policy responses. As interest rates plummeted and cap rates in most markets remained relatively stagnant given a lack of transactions and the resultant increase in valuation uncertainty, real estate quickly got cheaper just by the simple fact that cap rate spreads widened. That said, over the first three quarters of this correction, valuations have begun to fall in many retail and office markets, albeit relatively modestly in the latter.

As discussed earlier, the decline in fundamentals in the first three quarters of this correction is right on par with the start of previous corrections as shown in Exhibit 2. The decline in prices over the first three quarters of this correction as measured by Hines Research's proprietary Composite Capital Markets Score (CCMS)[3] has actually been the most severe of the past four downturns. The CCMS is down 9 points on average in Asia Pacific markets, 10 points in European markets, and 11 points in U.S. markets. In previous downturns, the decline in the CCMS in the first three quarters of a correction has averaged just 2.5 points.

If we set aside the sudden and substantial drop in interest rates and focus the analysis solely on absolute prices relative to their long-term trends, the pricing data looks fairly similar to prior downturns. On average, while fundamentals as measured by the Leasing Environment Health Score have fallen 18 points in the first three quarters of a downcycle, the decrease in the price-to-trend scores has averaged 6 points. In this cycle, the price-to-trend scores in Asia Pacific and the U.S. have fallen an average of 5 points while the average was off 12 points in European markets, primarily due to a 32-point average decline in Europe's high-street retail markets. But European office markets have also experienced a 7-point drop, while Asia Pacific and U.S. office markets have declined by 6 points on this important metric. Even warehouse markets have seen some modest deceleration in this metric, with Europe and the U.S. down one point as prices are simply growing a bit more slowly than their generally accelerated trends. In Asia Pacific, warehouse price-to-trend scores are off 7 points.

Much of the pricing data in the early part of a correction are relatively speculative. With few transactions to provide market comparables, valuations are largely derived by discounted cashflow models whereby valuers are relying on known changes in NOI and/or adjustments to discount rates given heightened uncertainty. However, as fundamentals typically continue to deteriorate into year two of a downcycle, delinquency rates begin to build, resulting in heightened distress and an increase in transaction activity. Based on past cycles, 2021 should be that second year in most markets, with perhaps the exception of industrial markets which have continued to enjoy relatively healthy fundamentals. While valuations weren't as high heading into this downturn as they were heading into the GFC, high transaction volume amid low interest rates over the last several years did bid asset values up and many owners are sitting on assets at fairly lofty appraisals, particularly in U.S. gateway markets. In addition, for value-add investors who made the mistake of underwriting a continuation of previously healthy rent growth and leasing activity on acquisitions made in the 2017 to 2019 timeframe, those assumptions almost certainly missed for 2020 and will likely miss in 2021, thereby disrupting business plans and straining IRR expectations. That also tends to lead to opportunities for new investors as those value-add business plans are converted from value creation strategies to value preservation ones.

So, in a typical downturn, most of those trends would be playing out throughout 2021, and it's certainly not unreasonable to think that won't be the case this cycle. However, despite the fact that the first three quarters of this downturn look surprisingly similar to prior downturns in terms of fundamental and pricing impacts, could the remainder look different as the economic recovery gains momentum in the second half of the year? As of late 2020, transaction volume has begun to tick up for core assets with high-quality income streams and there is an abundance of both equity and debt for that profile of asset. But for assets with hair, particularly in more marginal or fundamentally impacted locations, there appears to be very little liquidity and a significant bid-ask gap has developed on the order of roughly 15% to 25% from the anecdotal evidence. Some asset classes such as office and retail have existential demand-side questions that are probably overblown but not without some merit either.

[3] The CCMS measures both the absolute price per square foot (or meter or unit) relative to each market's long-term trend as well as the cap rate spread relative to each market's long-term average along with several minor factors.

While there will be a palpable uptick in distressed sales in 2021, a sudden unleashing of pent-up demand in the second half of the year could prevent as many distressed sales as traditional models expect. For example, if fundamentals in the U.S. continue on the typical path of downturns that they are currently on, anywhere from $150 to $215 billion of commercial mortgages could become delinquent in 2021 (up from about $30 billion as of the third quarter of 2020). But lenders could be more willing to work out loans with existing borrowers if the light at the end of the tunnel begins to get exceedingly bright as the year progresses. The truth will likely lie somewhere in the middle, and be highly dependent on the economic trajectory. Should the economy stumble more than expected and the recovery arrive in fits and starts rather than the steady and significant acceleration most are expecting, distressed selling will likely continue to increase well into the second half of the year and potentially into 2022.

CONCLUSIONS

Just as 2020 started normally enough but then quickly changed, particularly in Europe and then the U.S., 2021 may be as equally different between the start of the year and the end. Certainly, Asia Pacific provides some guidance with life back to relatively, though not full, normality at the end of 2020 following lockdowns at the start of the year. Fundamentals are likely to remain under stress in the near term, though the degree of deterioration, stabilization, or even growth is going to vary significantly by region and property type. Capital markets are bit more of a wild card and subject to the whims of animal spirits that are likely going to be heavily influenced by the pace of eradication and economic recovery. In any event, we look forward to closing the book on 2020's challenges and embracing the transitions that 2021 should deliver.

ABOUT THE AUTHOR AND HINES PROPRIETARY RESEARCH

Joshua Scoville, Senior Managing Director – Research, reports to Hines' Chief Investment Officer and works closely with the firm's Chief Risk Officer and Strategy Group. Josh Scoville and his team are responsible for constructing the Hines macroeconomic view and outlook for commercial real estate market fundamentals and pricing; assisting with the development of investment strategies for the firm's investment programs; working closely with the local and fund management teams, clients and partners; and supporting U.S. regional and international country heads in identifying market/submarket opportunities and risks. The views of the local and fund management teams on the latest market developments are exchanged regularly via biweekly conference calls and quarterly market updates and are essential for reviewing investment strategies and fund portfolio allocations.

The Hines Proprietary Research team includes Michael Hudgins, Ryan McCullough, Farhaz Miah, Michael Spellane, and Erik Thomas.

A view from the "Boots on the Ground"

TOMMY CRAIG, SENIOR MANAGING DIRECTOR
SPOTLIGHT: NEW YORK TRI-STATE AREA, U.S.

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As with the last three major crises, New York City has been at the epicenter of the COVID-19 pandemic. Our expectation is that the market will initially follow the speed and effectiveness of efforts to roll out a vaccine. A few things are already clear in the near term, including a modest population shift out of New York City, affecting residential pricing in suburban communities and escalating demand related to the e-commerce space.

Once people return to work, the workplace will perhaps be utilized with a greater focus on collaborative work, with solitary work having the optionality to occur elsewhere. We expect to see vacancy rates continue to go up but with a pronounced shift as tenants selectively favor either better buildings or better locations. Hines expects our projects at One Vanderbilt Avenue and One Madison Avenue will be advantaged by their proximity to Grand Central. For many major tenants, there will also be a shift to buildings with a typology that is more horizontal. Anticipating this demand, Hines is underway on a project combining an existing building (345 Hudson Street) with a new building (561 Greenwich Street) to create larger floor sizes (80,000 square feet), allowing for more lateral circulation and environmental systems that can more readily satisfy health and wellness considerations.

Opportunities

We expect to continue to build upon our success in the living sector, as well as the industrial sector with a project underway providing potential for 3.0 million square feet of industrial space in Hazelton, PA. The work-from-home phenomenon will provide an opportunity to create housing just beyond the traditional boundaries of the New York suburbs in lower density areas that become more palatable when daily commutes are reduced in one form or another, such as by number of days. We are actively looking at large-scale projects in such locations. There will be opportunities in areas with good school systems and local employment, particularly related to higher education and healthcare, to create mixed-use or residential communities with multigenerational appeal.

Challenges

It will be interesting to see the type of equilibrium achieved between the human connection offered by the physical workplace versus the convenience of eliminating a lengthy commute. One of the biggest challenges in the immediate future will be to advance discussions with tenants to the point of actual decisions and commitments. This will require an intelligent and balanced approach, as the historical data and market comps will not provide a reliable guide to achieving this new equilibrium.

STEVE LUTHMAN, SENIOR MANAGING DIRECTOR
SPOTLIGHT: CHICAGO, IL, U.S.

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We expect 2021 to be a year of “bottoming-out” in which additions to sublease space will slow, delayed 2020 leasing decisions will be made, and tenants will start to define their principal needs. The large Chicago-based law firms will likely be bellwethers for next-generation space configuration. While the last cycle office layout was defined by tech, this cycle could be defined by professional services firms’ existential need to entice their revenue-generating workforce to come back to the office. The Chicago multifamily market should stabilize in the spring after a very tough year caused by occupants scattering to work remotely.

Opportunities

Industrial development opportunities will remain attractive to meet demand caused by the secular rotation from retail to industrial. We expect to begin to see stress caused by the pandemic and demand shock, which should create value-add redevelopment investment opportunities in the multifamily and office sectors. Hines is keenly interested in the future re-imagination of shopping centers, where we are seeing major distress and corresponding redevelopment opportunities in our Midwestern markets.

Challenges

Overall the fiscal health and tax policy in our city and state will continue to be a concern for investors and employers.

PAUL TWARDOWSKI, SENIOR MANAGING DIRECTOR
SPOTLIGHT: SOUTHERN CALIFORNIA, U.S.

The rocks and hard places will come together in 2021 and force some owners of real estate to sell or be foreclosed. Such pressures will be focused on obsolete product and/or highly levered assets, which may provide significant opportunity for repositioning or redevelopment. Some stable assets may be available at more modest discounts, and expectations of strong recovery in certain submarkets may make such acquisitions fortuitous for those willing to have faith in long-term stability.

Opportunities

Many owners of retail will be forced to reconcile the challenges presented by the long-coming evolution of retail together with the shorter-term cashflow drop presented by the COVID-19 shutdowns. Hines sees significant opportunity to right-size shop space and add symbiotic uses (office, multifamily, senior, etc.) to retail properties in supply-constrained Southern California markets.

COVID-19 has accelerated the office sector's evolution as well. Office tenants in 2021 and beyond will want buildings with healthy infrastructure, vibrant on-site amenities and collaborative workspace. We see opportunity in purchasing older office buildings, now made obsolete by this recent evolution, at a low basis and significantly renovating and repositioning them.

With housing in high demand and continued development constraints, multifamily should continue to perform well in Southern California. Development activity will likely continue unabated in the strongest submarkets due to the continued high demand.

Challenges

Fundamentals will likely cross their nadir in 2021. Making acquisitions and securing development sites in the face of correcting fundamentals will take fortitude and a conviction in the long-term health of the Southern California economy.

SYL APPS, SENIOR MANAGING DIRECTOR
SPOTLIGHT: CANADA

Vancouver had exceptionally strong office and residential markets going into the pandemic, and those markets have held up relatively well. British Columbia was impacted early on by COVID-19 cases and thanks to a swift response, Vancouver has not been as greatly affected as other cities. Many people were able to return to their workplaces beginning in May. While dampened in the near term by the pandemic, we see mid- to long-term strength in both the office and residential asset classes.

In Toronto, life has gone on pause to a greater degree due to the pandemic with new office leasing in particular having been put on pause. We expect to see an increase in leasing activity through the end of 2021 as we begin to see COVID-19 in the rearview mirror.

Opportunities

Post-pandemic, people are going to want to come into high-quality, highly amenitized buildings in premium locations, and we believe Hines can deliver on these needs. To that end, we are actively pursuing projects in the Toronto and Vancouver markets. We think T3, Hines' innovative mass timber development initiative characterized by attractive sustainable design, is a great fit for both markets and for the objectives and values of our tenants and their employees. We will be active with that effort in both Toronto and Vancouver in 2021.

Challenges

In Vancouver, a perpetual challenge is the disproportionate amount of international capital relative to the size of the market. We see these pricing distortions particularly on the residential side. For 2021, we expect that our biggest challenge in Toronto and Vancouver will be navigating the near-term uncertainty due to the pandemic. A lot of demand in both markets is currently sitting on the sidelines and we need to ensure we are meeting their evolving requirements as we move forward in 2021, especially in helping them best attract and retain talent in what is still a very competitive labor market.

ANTONIO FERREIRA ROSA, SENIOR MANAGING DIRECTOR
SPOTLIGHT: BRAZIL

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From 2014 to 2018, Brazil had its worst recession with a negative GDP of 8% in this four-year period. Different from other countries in the world, Brazil was on an economic recovery path prior to the hit of COVID-19. In 2021 it is expected that economic activity will continue to recover from the sharp declines registered earlier in the pandemic. The recovery process will be driven by low interest rates, easing social isolation measures, a rebound of the global economy and fiscal stimulus from emergency aid. Important reforms are expected to be approved in Congress, such as tax reform. The combination of economic growth and reform approvals will foster investments and should attract foreign capital to the country.

Opportunities
The greatest opportunities in 2021 will be in the residential for sale and industrial/logistics sectors. Driven by lower mortgage costs due to the historic low interest rate in the country, the residential market had an excellent performance in 2020, and is expected to continue outperforming in 2021. On the industrial side, the pandemic accelerated the growth of e-commerce in Brazil. As a consequence, occupancy levels in logistics parks are over 90% in the major cities. New developments will be needed to meet the future demand that lies ahead.

Challenges
There are lingering uncertainties surrounding the Brazilian fiscal risk. The risk of fiscal unsustainability is a negative factor for economic activity. The estimated primary deficit for 2021 is 2.5% of GDP (BRL 200 billion). If Brazil’s federal government does not show control of spending and the deficit, investors’ confidence will decrease and investment plans should be reviewed, delaying the economic recovery and directly affecting the real estate market.

ROSS BLAIR, SENIOR MANAGING DIRECTOR
SPOTLIGHT: UK

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I think in 2021 we will really see the impact of the past 12-months unfolding. Focusing on London, despite a slow-down in activity in both leasing and investment volumes, headline rents and values held up surprisingly well over the past nine months, but I think cracks are now starting to show in the leasing market with deals being shelved. For investment turnover, London has become such an international market over the past decade that pandemic-related travel restrictions have had a huge impact on viewings. As those restrictions are lifted, I expect a resurgence in appetite from overseas investors and a strong rebound.

Outside of London offices, I expect there to be more repurposing brought about by further value decline in the hardest hit sectors such as retail, and a continued flow of new capital into the residential sector where “Build-to-Rent” continues to gain traction.

Opportunities
2020 has been a record-breaking year for industrial take-up across the UK and there are no signs of that slowing down. The tide is definitely turning in the residential for rent sector and the challenge is how to deliver affordable product in high land value markets like London and surrounding areas where demand is greatest. We are excited by the opportunity this presents and expect this to become a major sector during the next decade. In the London office sector, I expect the tone to become more positive next year as occupiers announce offices remain very much a part of their future strategy even if on a re-worked basis. Quality of office space will be more in focus than ever before, presenting refurbishment and redevelopment opportunities.

Challenges
The speed at which lockdown and movement restrictions are lifted is the number one variable that will influence our industry in the year ahead. Beyond that, I expect the office leasing market will be tough as large corporate occupiers slow down to consider how to operate their portfolios. Additionally, despite a Brexit trade deal now being reached, much uncertainty exists around the specific detail for different sectors so we need to monitor this as the year unfolds. Removing the “no-deal” risk is a real plus though.

ANDY SMITH, MANAGING DIRECTOR
SPOTLIGHT: THE NETHERLANDS

The high attention to the logistics sector will bring record volumes for 2021 in the Netherlands, a European logistics gateway market, with yields further compressing. Brexit-related increases in population and corporate activity will have meaningful impact. Amsterdam especially will continue to attract foreign talent and capital, as well as foreign students.

The densely populated Randstad area should further solidify its position in the broader European market. The real estate opportunity in the wider economic region may have better risk-weighted outcomes, especially for income yields.

Opportunities

Premium offices defined by their quality of location and design should offer great opportunity in 2021 with market attention focused generally elsewhere; (re-) development of spaces catering to larger-than-average tenancies are the most attractive. On the basis of occupier demand and rising rents, the logistics sector has continued to attract capital, but it is an extremely crowded sector. Land creation and land control strategies offer the most value with rents rising, yields falling and construction prices stabilizing. The creation of portfolios suitable to core investors from the pool of average-sized deals that are generally not suitable is an opportunity.

The demand for high-quality, purpose-built rental accommodation in all sectors including student and senior housing offers very low-risk returns, but on tight spreads. Here again, land creation and land control strategies perhaps offer the most value for those able to manage the risks with local teams.

Challenges

Naturally at this time, business leaders are concerned about their people and their mental health and wellbeing. This environment makes decision-making exceptionally difficult for long-term space commitments in any sector, though location quality will prevail in the long term for investors. Capital availability is at an all-time high, but the general perception of risk is high as well, and therefore the bid-ask spread is a challenge to overcome, especially as quality product is more scarce than available capital. Finally, in an election year, the threat of residential rent controls following several years of rapid rent growth in Dutch cities should be closely monitored.

CLAIRE THIELKE, MANAGING DIRECTOR
SPOTLIGHT: HONG KONG

Political unrest in the second half of 2019 and a full year of COVID-19 in 2020 has made the last 18 months in Hong Kong particularly historic. As the first global market outside of Mainland China to enact a formal pandemic response, Hong Kong's swift actions prevented wide-spread infections, but the sequential impacts of protests and lockdowns brought leasing and transaction volumes to all-time lows.

2021 will present unique opportunities to unlock value in market dislocation as pandemic conditions improve, new infrastructure projects take hold, and Hong Kong further integrates into the Greater Bay Area – the Pearl River Delta metro-zone comprised of nine Chinese cities, the Hong Kong and Macau Special Administration Zones, and over 70 million people therein. As home to major operations for Alibaba, Tencent and other major tech players, the Greater Bay Area is China's Silicon Valley, and Hong Kong's role as a key hub should drive innovation in its next chapter.

Opportunities

Looking forward, we see opportunity across Hong Kong and the Greater Bay Area on tailwinds of China domestic demand, regional population growth, and a focus on New Economy goods and services. In particular, cold storage, data hubs, and e-commerce logistics properties present strategic opportunities. As demand for tech and new economy talent continues, young professional housing and office value-add/redevelopment in key Hong Kong / Greater Bay Area transit nodes are also key areas of opportunity.

Challenges

For now, COVID-19-related measures will continue to include rolling lockdowns and restricted travel into Hong Kong and across the Mainland China border. As of January 2021, Hong Kong remains closed to non-residents and inbound citizens face 21 days of quarantine. As has been accomplished to date, however, companies, operators, and investors will find ways to best operate across the Greater Bay Area's bisected border. Though the virus has created numerous challenges of business continuity, the Chinese and Hong Kong governments have continued to enact policies to spur integration and growth within the region.

DAVID WARNEFORD, MANAGING DIRECTOR
SPOTLIGHT: AUSTRALIA

Australia has managed to effectively contain COVID-19. As a result, as we closed in on the end of 2020, consumer confidence was at 10-year highs and business confidence was back to levels higher than pre-COVID-19. With unemployment lower and GDP higher than initially forecast when the pandemic struck, the Australian economy appears likely to perform better than most developed nation peers in the coming few years.

In the office sector, we expect to see a rebound in transactions. Values have held up strongly despite the uncertainty, and we believe owners will see an opportunity to cycle out of assets. We also expect to see more leasing transactions. An increase in activity in the last quarter suggests that tenants are seeing sufficient certainty to make commitments and prepare for the next cycle. The logistics sector has attracted an enormous amount of capital in the past 12 months as Australia's relatively low e–commerce penetration rates have started to rise rapidly. Structural headwinds will continue in 2021 for the retail sector, although with consumer confidence and economic conditions improving, it is likely that some counter-cyclical investors will emerge.

Opportunities

For Hines Australia, in the next year we will be focused on the office and living sectors. Quality of the workspace will become of even greater importance to tenants. At the same time, we believe new development is best placed to deliver health, safety and wellness outcomes in the post-COVID-19 world. In the living sector, we will be focused on advancing our "Build-To-Rent" platform as there is a strong business case for professionally managed rental housing with high-quality amenities, security of tenure and occupant flexibility. Investor interest in the sector is strong, with office uncertainty and structural headwinds in retail, as well as record-high pricing in logistics causing investors to consider new and alternate asset classes.

Challenges

Office uncertainty, and the question of when tenants will have enough certainty to confidently make key business decisions such as new leasing commitments, will be a challenge. Additionally, the competitive business environment, especially in the logistics sector, will make it more difficult to find compelling investment opportunities.

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