INVESTCORP

INSIGHTS

NOVEMBER // 2019

European Real Estate Trends and Updates

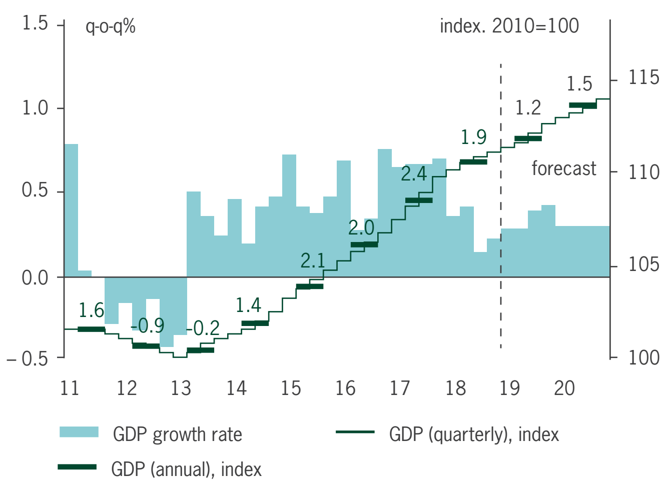
Market Overview

European Union (EU) Economy

Economic activity in the European Union grew at a slower pace during the second half of 2018 compared to previous years, and continued during the first half of 2019. However, there is increased optimism heading into the second half of the year. Employment and wages are projected to grow despite trade pressures and policy uncertainties, including Brexit.

- Unemployment across Europe is projected to improve from 6.8% in 2018 to 6.2% in 2020.[1]
- Wages are anticipated to continue to grow during 2019 and reach 1.5% by 2020.[2]
- GDP in the EU is expected to grow 1.4% in 2019 and GDP rate projections remain positive through 2020 in all 28 EU nations.[3]

Figure 1: **Real GDP, euro area**

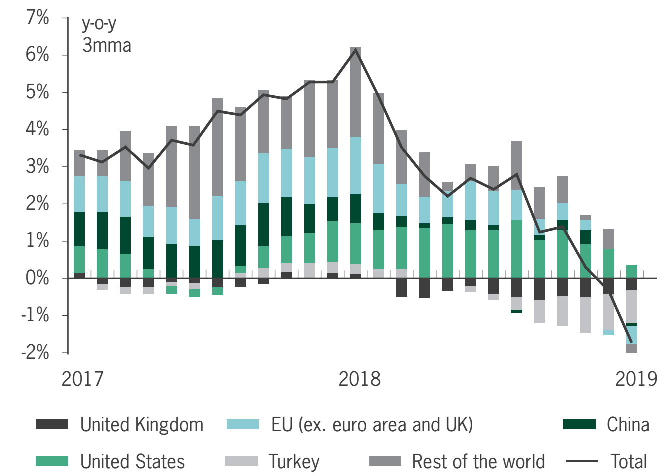


Source: European Commission, European Economic Forecast, Spring 2019

Trade deficits have been one of the challenges for Europe in the past few quarters. European net exports almost halved in 2018, mainly due to lower demand from China. However, economic indicators signal a turnaround in European trade by 2020. The current Eurozone expansion has lasted six years and is still young. There may thus be more room for growth. Historically, the longest expansionary cycle on record lasted 14 years, from 1993-2007.[4]

The slowdown in European trade is mirrored by a softening in manufacturing with industrial activity weakening since early 2018.[5] This is partly due to weakness in other economies (mainly China), U.S. trade disputes leading to lower demand for capital goods, and new car emission standards in Germany affecting the automotive business. Global economies are highly intertwined, so pressures in foreign economies have had a direct impact on European economic health.

Figure 2: **Volume of euro area exports outside the euro area, total and composition by destination**



Source: European Commission, European Economic Forecast, Spring 2019

"Real estate fundamentals across Europe are healthy, and Investcorp continues to believe that excellent investment opportunities exist in today's European real estate markets."

Jon Dracos
Global Head of Real Estate

[1] European Commission, European Economic Forecast, Spring 2019
[2] European Commission, European Economic Forecast, Spring 2019
[3] European Commission, European Economic Forecast, Spring 2019
[4] Cushman & Wakefield, Europe Economic & Commercial Real Estate Outlook, September 2018
[5] European Commission, European Economic Forecast, Spring 2019

In 2018, private consumption slowed, leading to household savings increasing. In 2019, private consumption is expected to rebound again with expected growth of 1.3%, due to continued job creation and wage growth.[6]

Economic conditions are starting to ease, led by the decline in yields within Europe. The German 10-year sovereign bond yield reached negative territory towards the end of March 2019 and corporate bond spreads narrowed, resulting in lower financing costs. In addition, net lending has been positive in 2019, mainly due to the lowering of interest rates on loans. Credit standards have been stricter than in the past, leading to a generally strong housing market across the EU.[7]

European Central Bank ("ECB")

The ECB announced at its March 2019 policy meeting that it will provide further monetary easing. Interest rates are expected to remain at current negative levels through the end of 2019. The ECB also announced a new series of targeted longer-term refinancing operations (TLTRO-III) spanning from September 2019 to March 2021 to preserve favorable bank lending conditions. ECB Council members have suggested that the first rise in interest rates is now further away than had been previously anticipated and may not occur until mid 2020 at the earliest.

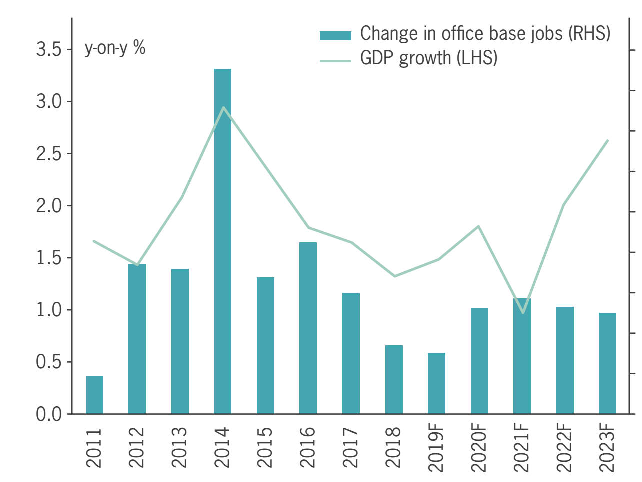
Quantitative Easing (QE) was implemented in the Spring of 2015 to help stimulate economic growth and avoid inflation by injecting liquidity directly into the economy. This program was ended at the end of 2018. During its years in existence, almost $3 trillion was spent buying up government debt, corporate debt and asset backed securities to strengthen the European economy.

Mario Draghi, President of the ECB since 2011 has overseen the ECB during an economic upswing and has led pro-growth initiatives such as those discussed above. Draghi's term as President is coming to an end in October 2019 and he is being replaced by Christine Lagarde, who has served as the Managing Director of the International Monetary Fund (IMF). To date, Lagarde's appointment has been widely welcomed by the financial markets, as many believe that she will favor similar policies as her predecessor.

Brexit and the United Kingdom ("UK") Economy

The UK economy has had nine consecutive years of economic expansion, which is expected to continue into 2019 despite Brexit concerns. In addition, employment is at its highest level since 1971 and a tight labor market has led to increased wages. Earnings, excluding bonuses, rose by 3.3% in 2018, the largest growth since 2008.[8]

Figure 3: **UK GDP growth and change in office based jobs**



RHS - Right Hand Side
LHS - Left Hand Side
Source: CBRE, United Kingdom Real Estate Market Outlook, 2019

Since the Brexit referendum passed in 2016, the world has awaited the terms of departure of the UK from the EU. As we inch closer to the current Brexit deadline of 31 October 2019, there remain more questions than answers. With the deadline fast approaching, there is still significant uncertainty regarding the ultimate outcome of Brexit, let alone its impact on the UK, EU and global economies.

A broad range of outcomes is still possible including:

- "No deal" Brexit
- Managed Brexit, based on a negotiated agreement between the UK and EU
- No Brexit

[6] European Commission, European Economic Forecast, Spring 2019
[7] European Commission, European Economic Forecast, Spring 2019
[8] The Office for National Statistics, January 2019

A “no deal” Brexit would mean a sudden and complete break from the EU, without any agreement in place regarding the UK’s terms of exit and its future relationship with the EU. Among many consequences, the free trade of goods and services with EU member states would end, as would the free movement of people to and from the EU. The UK government’s own scenario planning foresees significant disruptions to the UK economy, such as long delays at border crossings and a shortage of certain goods, including critical medical supplies, in the event of a “no deal” Brexit. A “no deal” Brexit scenario appears unlikely, as the UK Parliament has passed legislation to prevent it.

The main alternative to a “no deal” Brexit would be some form of managed Brexit, based on a negotiated agreement between the UK and EU. However, until recently, there was no consensus in the UK’s Parliament as to what form such an agreement should take, with no Parliamentary majority for any one of the proposals put forward by former UK Prime Minster Theresa May in early 2019 that were in turn based on the agreement she had negotiated with the EU in November 2018. This ultimately led to her resignation as Prime Minister.

Only on 22 October 2019, i.e. within 10 days of the Brexit deadline of 31 October 2019, was a Brexit proposal finally approved with a narrow Parliamentary majority. The proposal was agreed with the EU by Theresa May’s successor Boris Johnson only a few days earlier and builds upon the earlier proposals of Theresa May. It envisages continued economic co-operation between the UK and EU, particularly during a transition period until December 2020, while the UK will leave the EU single market and customs union and the free movement of people between the UK and the EU will cease. Northern Ireland will retain closer ties to the EU than the remainder of the UK. The proposal is yet to be passed into legislation, and Parliament has ruled out doing so prior to the 31 October 2019 Brexit deadline as there is insufficient time for proper scrutiny. An extension to the Brexit deadline has been requested and, if granted by the EU, will in theory allow the legislation to be implemented.

However, there have also been calls for a general election, given the gridlock in Parliament and the level of disagreement between and even within the UK’s political parties over the future direction of the country and over the shape and form of Brexit. With some parties supporting a second referendum on Brexit and others promising to cancel Brexit altogether, any number of outcomes is therefore still possible at this stage.

German Economy

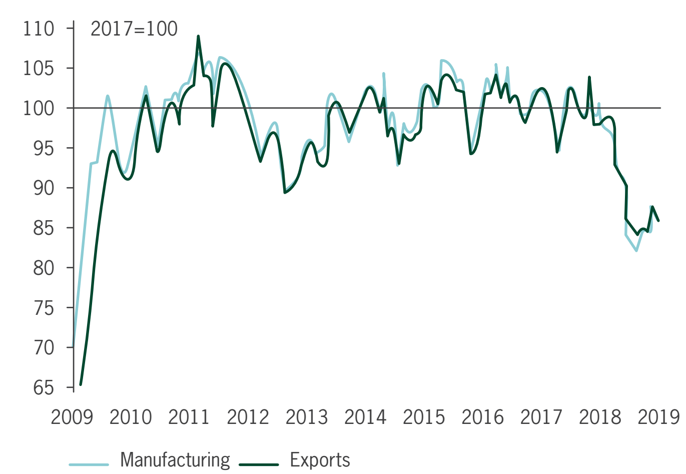
The German economy has experienced softening over the past year. Nevertheless, Germany remains stronger than other European counterparts in terms of GDP per capita, unemployment rate, and continues to be the largest producer and exporter of manufactured goods in the EU.

In 2018, unemployment in Germany declined by 0.3% to 3.3%, and employment rose 1.3% over the year, reaching a post-unification of Germany high. So far in 2019, unemployment has declined by 0.2% to 3.1%, the lowest level since 1980. GDP growth in 2018 was 1.5%, which was above the ten-year annual average of 1.2%, and marked nine years of continued expansion.[9]

In March 2019, business confidence (as defined by the Ifo Business Climate Index, one of the leading indicators for economic activity in Germany) rebounded, having weakened somewhat in the previous six months. The rebound was greater than expected, which has strengthened economic growth forecasts. GDP grew by 0.5% in Q1 2019, buoyed by domestic demand, employment growth, and a decrease in the unemployment rate.

The automotive industry, which is Germany’s most important export product (accounting for 20% of the country’s exports), has recently struggled with vehicle output having declined in 2018. This trend has continued into 2019. A new regulatory emission test (Worldwide Harmonized Light Vehicles Test Procedure) was implemented during the third quarter of 2018 and manufacturers have had issues complying with the new standards, which has adversely affected exports.[10]

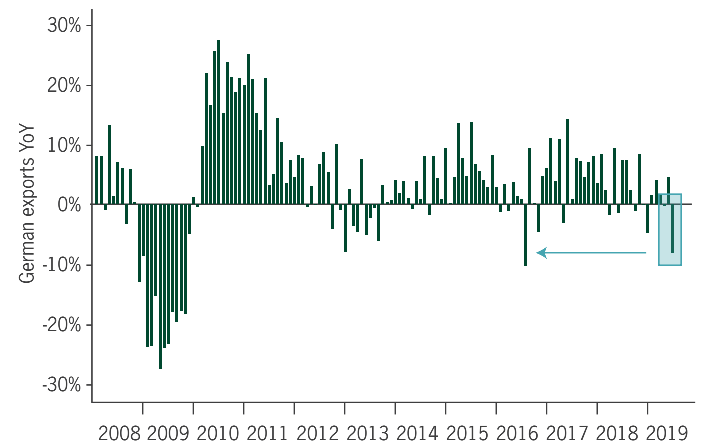
Figure 4: **Germany – volume of manufacturing and exports of passenger cars**



Note: Seasonally adjusted.
Source: German Association of the Automatic Industry (VDA).
Source: European Commission, European Economic Forecast, Spring 2019.

[9] Knight Frank, The Germany Report, 2019
[10] European Commission, European Economic Forecast, Spring 2019

Figure 5: **Export Slump – German manufacturers suffer from US - China trade war**



Source: Bloomberg, August 2019

A flipside of Germany’s strong economy and low unemployment rate has been a shortage of a qualified workforce, with more than 1.2 million skilled jobs vacant in Germany. This is being addressed by easing immigration policy to attract skilled workers from outside the EU into Germany to help boost the economy.[11]

Netherlands Economy

The Dutch economy has outperformed all major European economies following four years of strong economic growth that has continued into the first half of 2019. Economic indicators remain positive and the political environment is comparatively stable. In the first quarter of 2019, Dutch GDP growth was 1.7% year-over-year and business investment increased by 4.5% year-over-year. Unemployment declined to only 3.3% as of May 2019, a record low. GDP per capita exceeds Germany’s and the Dutch economy is more service oriented and less exposed to manufacturing than Germany’s.

The Dutch government has been heavily focused on infrastructure investments which has helped fuel the real estate market. €17 billion was spent in 2018 on transportation infrastructure (2.1% of GDP and €1,020 per capita), almost 50% more per capita than in the UK and in Germany.

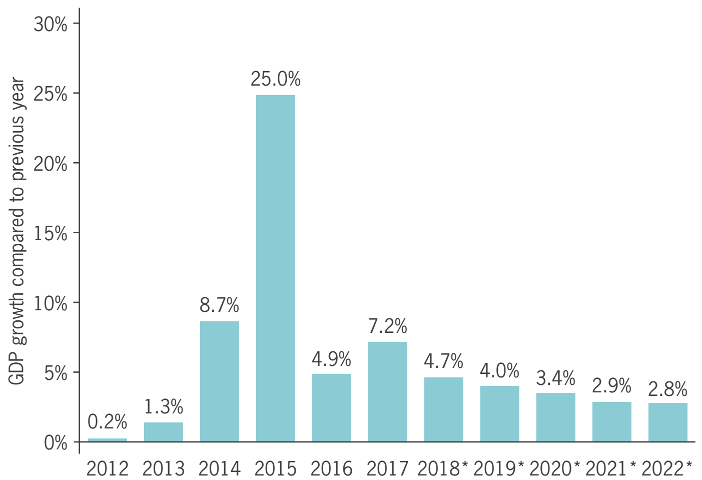
[11] The Guardian, Germany passes immigration law to lure non-EU skilled workers, December 19, 2018

Irish Economy

Ireland has a growth economy that has bounced back favorably since the Global Financial Crisis, having outperformed most other European economies in recent years. GDP is projected to grow by more than 4% this year and the unemployment rate has decreased to 5%, while real wages have risen by more than 3% in the last year.

Ireland has a very favorable corporate tax rate, which has led to many global companies transferring their patents and IP assets to the country. This has led to strong capital flows into the Irish economy.

Figure 6: **Ireland – Growth rate of the real gross domestic product (GDP) (compared to the previous year)**



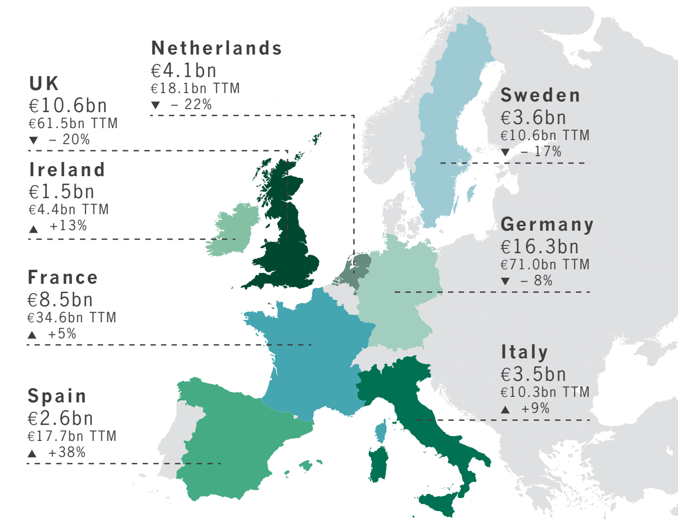
Source: World Economic Forum, March 2019

With the UK being Ireland’s most significant trading partner, the Irish economy is more exposed to Brexit than most. Some economists believe that an unmanaged exit may have a greater impact on Ireland than the UK.

Real Estate Fundamentals

Real Estate Transaction Activity

Real Estate investment in Europe was €293 billion in the twelve months leading up to Q2 2019, representing a 8% decline from the same period the previous year mainly due to Brexit uncertainty.



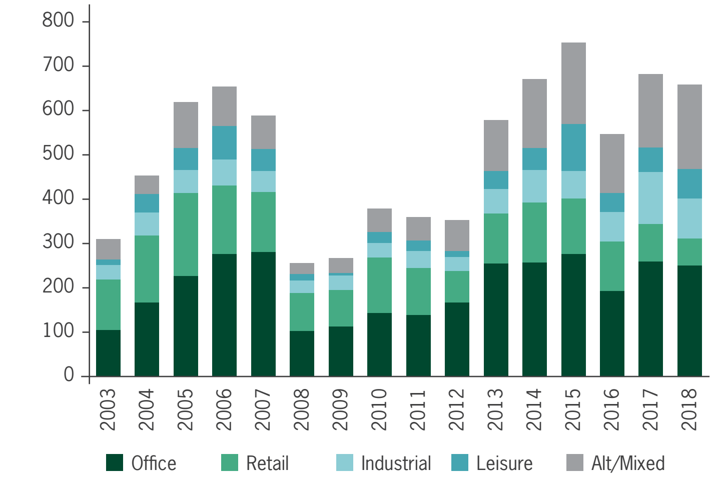
Source: CBRE European Investment Market Snapshot, Q2 2019

European commercial real estate investment volumes reached a record high in 2018 and were up 0.3% over 2017 levels. France, Netherlands, Poland, Portugal and Spain all contributed to this increase, seeing record levels of investment during 2018. Office was the largest investment sector in Europe, increasing 6% from the prior year. The Industrial sector also attracted significant investment in 2018.

Germany saw €78 billion of transactional volume in 2018, according to Ernst & Young, representing a 25% share of the European total, followed closely by the UK at 24%.[12] Despite a slight annual volume decline in 2018, UK transactional volumes remained strong, and above the peak reached in the previous cycle. There is a scarcity of prime product in major capital cities, driving yields to record lows.

Chinese capital investment in Europe has been curtailed in recent years due to restraints the government has implemented on international capital investing. However, it is expected that investment from Asia overall will increase, with Japan and South Korea becoming more active through both institutional and retail capital sources. There has also been a trend for U.S. based investors with a historically opportunistic risk/return profile to start looking more at Europe in both core and core-plus offerings. This is a trend that is expected to continue.

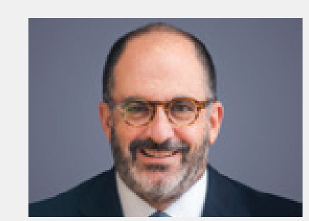
Figure 7: **UK investment volumes (GBP '000)**



Source: UBS Asset Management, 1H 2019

USD-based investors have benefited when hedging their currency against both the Pound Sterling and the Euro due to the interest rate differential between the currencies. This is projected to continue for the short-term future and to contribute positively to real estate investment demand.

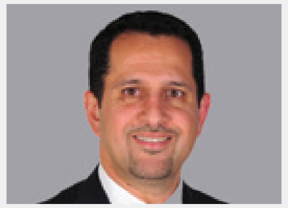
"Despite Brexit uncertainty, real estate transaction activity across Europe remains robust, as investors are attracted by buoyant occupier markets and a healthy spread between real estate yields and risk-free rates."



Neil Hasson
Managing Director,
Head of European Real Estate

[12] Knight Frank, The Germany Report, 2019

"Investors continue to favorably view the European real estate market as one with strong investment opportunities which can be further bolstered by attractive currency levels."



Babak Sultani
Managing Director,
Real Estate Specialist

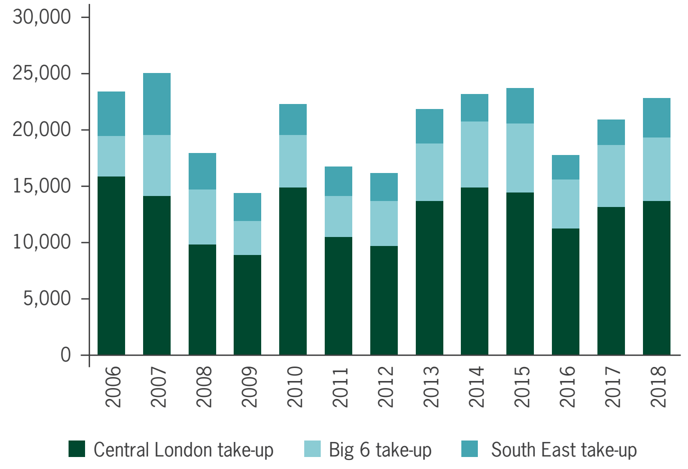
The Netherlands is one of the largest European real estate markets with over €20 billion of transactional volume in 2018, a record year.[13] With the Netherlands being a relatively small, open economy, foreign capital has made up 50% of the transaction volume, targeting primarily the office market as well as the residential market, which is a significant institutional investment sector in the Netherlands.

Ireland has become a key destination for foreign real estate capital in the last few years, backed by a high growth economy, strong labor force and continued growth in the technology sector. Over the past year, Ireland has seen €4.4 billion of real estate investment, which is up 13% over the prior year.[14] Across all sectors, office made up approximately 40% of the year's real estate investment volume, and Dublin has accounted for 85% of the Irish real estate investment volume.[15]

UK Office Market

The office market in the UK remains very healthy, backed by fundamentals of strong employment growth driving increased demand and meeting constrained supply. During 2018, take-up in major UK markets rose by 8.8% from 2017.[16] This was partly due to major transactions including Publicis Groupe taking 210,700 square feet at the former BBC Headquarters in White City and Virgin Media taking 121,350 square feet at Green Park in Reading. Central London alone saw an increase in take-up activity of 4% during 2018 versus 2017.[17]

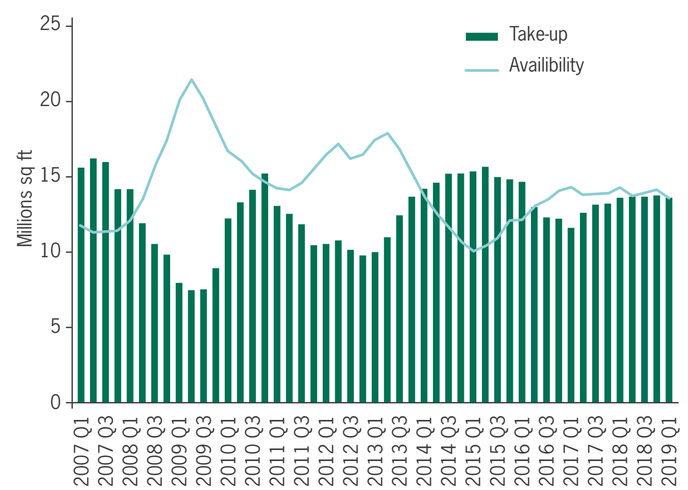
Figure 8: **Annual office take-up ('000 sq ft)**



Source: CBRE, Erix & UBS, Q4 2018 (from UBS report)

However, the first quarter of 2019 saw a return to more historical levels of transaction volumes, which are expected to pick up again in the second half of 2019 as Brexit outcomes become clearer. Leasing activity in the major UK markets during the first quarter of 2019 totaled 1.1 million square feet, which was consistent with the 10-year quarterly average. Office availability across the UK is at its lowest level since 2008. 8.2 million square feet is available to lease, equating to a vacancy rate of 7.7%.[18] A major trend in recent years has been the re-development of dated office buildings into modern residential units, which has been encouraged by government policy. This has contributed significantly to the reduction of available supply.

Figure 9: Central **London 4-Quarter Rolling Take-up vs Availability**



Source: CBRE Research, Q1 2019

[13] CBRE, Netherlands Real Estate Outlook, 2019
[14] CBRE, European Investment Market Snapshot,Q2 2019
[15] JLL, Ireland Real Estate Report 2019

[16] UBS Asset Management, UK Real Estate Outlook,1H'2019
[17] UBS Asset Management, UK Real Estate Outlook,1H'2019
[18] Cushman & Wakefield, UK Office Market Snapshot,Q1'2019

For the past ten years, London office demand has been mainly driven by financial service companies, business service companies and creative businesses. This trend is expected to continue in 2019, with flexible space operators continuing to ramp up activity, having made up 16% of take-up in 2018.[19] Traditional landlords are offering more soft-services, community break-out areas, and co-working spaces to remain competitive with current needs of tenants.

In the UK office market, Investcorp favors multi-let refurbished assets in central locations of the UK's major regional cities, as well as quality assets in established business parks and office submarkets surrounding London. These locations tend to attract businesses that are largely focused on the UK domestic economy and, therefore, less exposed to Brexit, while offering accommodation at an economical rent where we believe demand will be better sustained in the event of an economic downturn.

For its core-lite strategy, Investcorp is monitoring opportunities in the key central London office markets, where we believe that pricing is currently attractive by historical standards, relative to other global cities and relative to other asset classes. Tenant selection will be key, carefully avoiding businesses and sectors that may be directly impacted by Brexit.

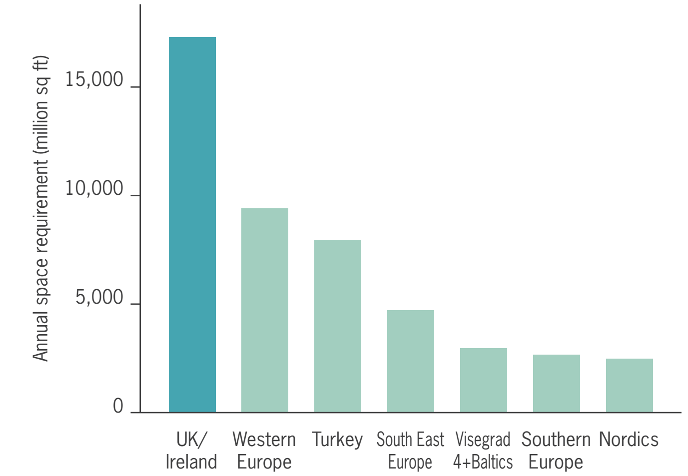
UK Industrial Market

The UK industrial real estate sector has been one of the strongest performing sectors of UK real estate, backed by strong market fundamentals, rental rate growth, and a continuing strong investor interest in the asset class. Take-up in 2018 of industrial space greater than 100,000 square feet increased by over 80% versus the prior year, mainly due to online retailers requiring additional space to keep pace with e-commerce. Distribution warehouse rents increased by 3.4% during 2018 versus 2017, while standard industrial rents rose by 5.1%. However, leasing and investment activity has slightly slowed during Q1 2019, due to investors waiting to see the outcomes from Brexit negotiations. Activity is expected to pick up during the second half of 2019.[20]

The UK has the greatest e-commerce warehouse space requirement in Europe, needing approximately 17 million square feet of additional space per year until 2020.

Investor demand for units of 50,000+ square feet rose to the highest quarterly level since 2016, based on Cushman and Wakefield's tracking of investor inquiries. This increase has led industry experts to believe activity will pick up in the second half of the year, ultimately driving rental rate growth to 2.2% per year for the next five years.[21]

Figure 10: **The UK has the greatest e-commerce warehouse space requirement in Europe**



Source: World Bank, Colliers International OECD, Various

In the UK industrial market, Investcorp favors modern distribution warehouses that meet the requirements of e-commerce distributors, in established logistics locations near motorway junctions and within proximity of the major conurbations. We see good relative value in the Glasgow-Edinburgh corridor, the Manchester-Liverpool conurbation, West Yorkshire (centered around Leeds) and the West Midlands (centered around Birmingham).

"The UK industrial market remains very attractive. Tenant demand has been sustained at high levels, defying Brexit concerns, while new supply is naturally constrained, keeping vacancy rates low and resulting in strong rental growth."

Dennis Kehrberg
Principal,
European Asset Management

[19] JLL, UK Report, Q1'2019
[20] UBS Asset Management, UK Real Estate Outlook,1H'2019
[21] Cushman & Wakefield, UK Industrial Market Snapshot,Q1'2019

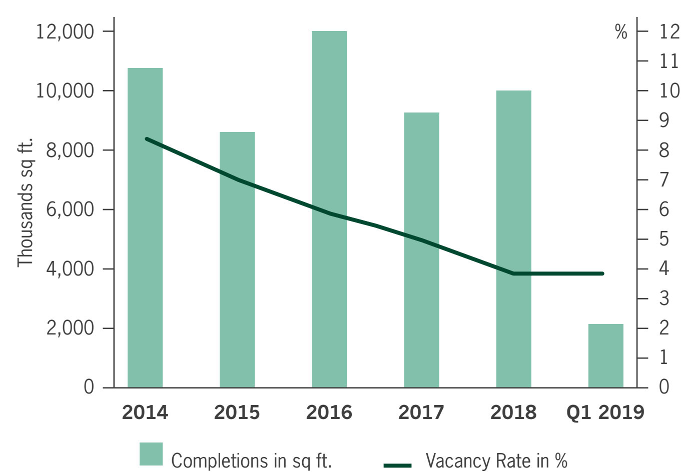
German Office Market

In Q1 2019, office investment volume of €5.8 billion in Germany made up nearly 50% of all commercial real estate transaction volume, demonstrating that office is the most desired asset class by investors. According to Real Capital Analytics, office investment made up nearly 56% of all commercial real estate investment during full-year 2018, and 80% of this office investment volume occurred in the top seven markets of Berlin, Frankfurt, Hamburg, Munich, Dusseldorf, Cologne and Stuttgart.[22]

There is a shortage of modern office space in central business districts ("CBD"), with the vacancy rate in the top seven markets at an all-time low of 3.9%, down from 4.6% one-year prior. This has led to higher rents. The JLL Prime Office Rental Price Index has increased for the ninth consecutive year, rising by 6.4% since last year, reaching its highest level since 1992.[23] There has also been a trend to convert older office buildings to residential units, to help with the shortage in quality housing.

Vacancy as of Q1 2019, was almost 3 million square feet less than last year and take-up volume in these top seven markets in Q1 2019 was 3% higher than the five-year average. Companies are seeking modern space with the ability to expand if needed in the future. Flexible office space is continuing to grow in Germany, making up 6% of the overall take-up volume in Q1 2019 in the German top seven markets, or 170,000 square feet.[24]

Figure 11: **Completions and Vacancy Rate Big Seven**



Source: JLL Office Market Overview, Q1 2019

Strong demand for office space and the decline in vacancies have led to increased new construction, although it remains low by historical standards and is largely concentrated in a single market, Berlin. Over 13 million square feet of office space is currently under construction in the top seven markets, of which 5 million square feet will be completed by year end 2019, a 60% increase from 2018 levels.[25] These figures are modest when considered against a total top seven office market size of approximately 300 million square feet.[26]

Investcorp believes that a combination of historically low vacancy, a limited supply pipeline and a resilient underlying economy make the German office markets an attractive investment prospect. Rental growth is accelerating, and incentive packages are becoming more favorable to the landlord, thus improving net effective yields. Our focus is on refurbished, multi-tenanted office buildings in established submarket locations of the top seven markets. Whereas pricing in the core markets has tightened considerably, such assets are still available at comparatively reasonable yields, and even the best quality tenants are extending their searches further afield as availability in the prime CBD markets is very restricted.

"Fundamentals in the German office market remain strong with record low vacancy rates, and although development has recently increased, it remains modest compared with the ongoing robust take-up."

Pierre de La Rochefoucauld
Vice President, European Acquisitions

[22] Cushman & Wakefield, German Office Snapshot, Q1'2019
[23] JLL German Office Market Overview, Q1'2019
[24] JLL German Office Market Overview, Q1'2019
[25] JLL German Office Market Overview, Q1'2019
[26] JLL German Office Market Overview, Q1'2019

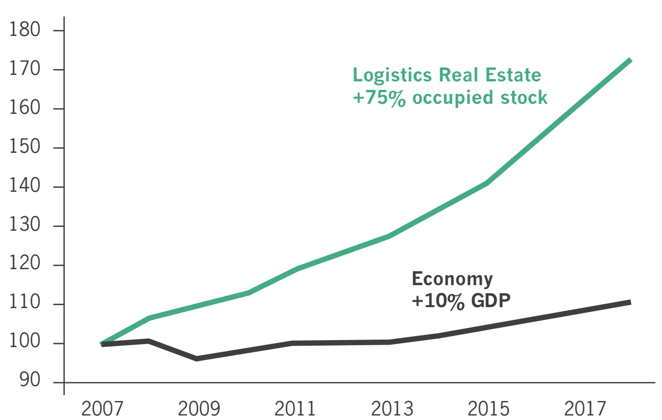
Pan-Europe Industrial Market

E-commerce and globalization are two key themes that are changing the industrial and logistics market across Europe. Since 2007, the European logistics real estate market has grown by 75% while the economy grew by only 10%.[27]

Two factors are paramount when identifying where the industry will be moving in the future. The first is location and access to developed transport networks and the second is having local access to high-quality, flexible labor. These trends are particularly evident in Germany and the Netherlands.

Market fundamentals across Europe remain robust with strong demand that is expected to expand in the future as e-commerce and last-mile logistics continue to grow. Strong demand is met by limited supply, due to a scarcity of available and suitable land, elevated land costs and increasing construction costs. Low vacancy rates are therefore expected to remain at current levels. Rents are consequently expected to grow.

Figure 12: **Growth comparison logistics vs. economy, Europe** (indexed to 100 in 2007)



Source: Prologis Research

Trends in the market such as urbanization, e-commerce and optimization of supply-chains will likely lead to increased demand for urban logistics assets in the next decade. Supply chain optimization has led companies to increase their focus on infill logistics locations in order to provide optimal service to their end-consumers and lower costs. This often causes the underlying real estate to be viewed as a value creator, rather than a cost factor.

The warehouse and logistics market is booming in Germany, fueled by the growth of business, changes in distribution networks, and online retail expected to grow by 9% in 2019 to €60 billion. Industrial transaction volume in Germany was almost €7.5 billion in 2018, the second-highest volume ever, and was 60% above the 6-year average. 2019 volume is expected to build on the momentum generated in 2018.[28]

Due to Germany's central location, size, and commitment to the sector, it is often viewed as the most important logistics market in Europe, with 25% of total European logistics turnover occurring in the German market.[29] There has been a trend towards single-asset deals, which has increased by 31% year-over-year. This has been partly driven by Amazon's growth of its German network as it continues to expand globally with more last-mile distribution centers located in the vicinity of major markets.

Germany was listed as the world's top location by the Logistics Performance Index (LPI), which is produced every two years by the World Bank and measures the ease and efficiency with which products can be moved into and inside a country. This ranking demonstrates the government's recognition of the importance of trade facilitation and logistics, led by the German government enacted "Logistics Masterplan" in 2008.

In the Netherlands, take-up of industrial and logistics space has outpaced industry projections, increasing by 32% in the first half of 2019, versus the same period in 2018.[30] Supply in the market remains limited, and construction costs remain high. The Netherlands is at a crossroads of trade in Europe and has one of the more developed transportation systems, easing the move of goods through the country and across the rest of Europe.

The French industrial and logistics market has seen an increase of take-up in recent years, driven by a large economy, quality road infrastructure, and central location to the rest of Europe. Take-up in the first half of 2019 increased by 2% from the prior year due to a re-shaping of France's supply chain to support omni-channel strategies and a shift towards e-commerce which has increased by 14% year-over-year.[31]

Poland has been the fastest growing logistics market in Central Europe due to strong economic fundamentals, a growing e-commerce market and improving infrastructure. Third party logistics companies have driven much of this growth, accounting for 72% of total demand in Q1 2019.[32]

Another interesting market from a logistics perspective is Spain, which has seen an uptick in industrial investment, with 2018 investment volumes reaching a record high. Madrid and Barcelona represent 50% of the investment volume. However, Spain is not centrally located in Europe, which inherently limits transit volumes.

In the industrial and logistics sector, Investcorp is monitoring investment opportunities in all the major logistics corridors across north western Europe (including Germany, the Netherlands and France), with a focus on assets that are compatible with e-commerce fulfilment requirements and that are located in established industrial parks with good motorway access in the vicinity of large conurbations. At present, we have not been successful in finding the appropriate opportunities in continental Europe, but we are continuing to monitor transactions and pricing.

[27] Prologis "Continued Momentum for European Logistics Real Estate in 2019", January 2019
[28] JLL German Logistics Property Report, Q1'2019
[29] Cushman & Wakefield, Germany is Europe's Most Important Logistics Real Estate Market Article
[30] Cushman & Wakefield, The Netherlands Industrial Market Snapshot, Q2'2019
[31] JLL France's Industrial Market, June 2019 & CBRE Real Estate Market Outlook, 2019
[32] JLL Poland's Industrial Market, May 2019

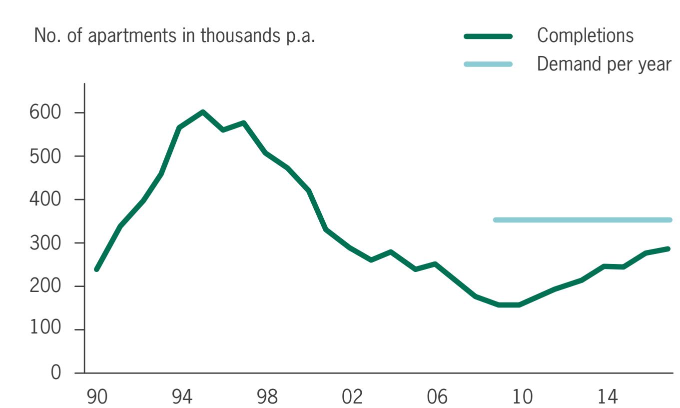
German Residential Market

The German residential real estate market is the largest rental apartment market in Europe and has seen strong performance since the Global Financial Crisis. This has been facilitated by population growth in the major urban centers, household income growth and a low unemployment rate. With a home ownership rate of approximately 45% (compared with 64% in the United States and 85% in Spain), Germany has comparatively low home ownership, and accordingly the market for long-term rentals is very well established. Since 2009, employment has increased by almost 10%, the unemployment rate has fallen by 3%, and wages have increased by 20%. These trends support the demand for home rentals and have led to growing rents. We expect these trends to continue.[33]

During the current real estate cycle, housing prices have increased by 95% in large metropolitan areas, and by 70% in smaller cities.[34] Third party forecasts do not expect this growth to end soon. The Bundesbank projects net immigration of 400,000 per year for both 2019 and 2020, which will exacerbate an existing housing shortage. As the top seven German markets are very expensive and have limited available housing supply, immigration may increasingly shift to other geographical regions within the country.[35]

There is a gap between supply and demand, with a million residential unit shortage, primarily in the top seven markets. Apartment prices have risen by greater than 15% for existing apartments and 10% for new apartments in 2018. Some of the reasons for the lack of supply are the small number of available construction plots, and a shortage of qualified construction workers.[36]

Figure 13: **Building completions**



Source: Deutsche Bank, Germany Monitor, March 2019

Growth in housing prices have outpaced rent growth. As such, yields on rental properties are at historical lows, particularly in the seven largest conurbations. With direct investments into German residential real estate currently being very low yielding, Investcorp is investigating alternative investment structures to participate in the market, such as backing PropTech platforms that operate in this sector.

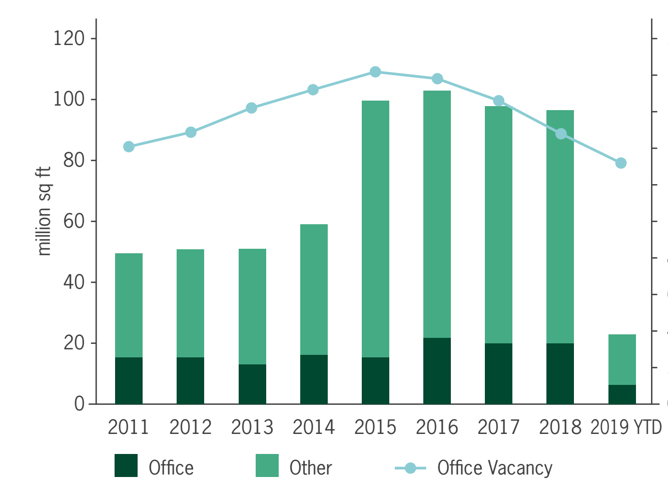
Dutch Office Market

The Dutch office market has performed well in recent years, driven by strong economic performance leading to increased demand for office space in prime urban locations. Unemployment remains low and job creation is continuing to grow, which will lead to an increase in demand for office space.

There is a shortage of high-grade office space in the strongest locations, which is causing tenants to consider locations further afield. This is helping sectors of the market that have historically suffered from high vacancy following over-development during the "dot com" boom in the late 1990s/early 2000s. Moreover, some of this vacancy has already been converted to other uses such as residential in recent years, and outdated properties have been renovated.

After a decade of relative weakness, the Netherlands' outstanding economic performance is now finally being reflected in the office market, with rapidly decreasing vacancy, rising rents and falling incentives.

Figure 14: **Ongoing demand for office space leads to dropping vacancy rates.**



Source: Savills, Netherlands Office Market, June 2019

[33] Deutsche Bank, Germany Monitor, March 2019
[34] Deutsche Bank, Germany Monitor, March 2019
[35] Deutsche Bank, Germany Monitor, March 2019
[36] Deutsche Bank, Germany Monitor, March 2019

In the Netherlands, Investcorp favors modern office buildings in the major Randstad markets of Amsterdam, Rotterdam and Utrecht. As vacancy remains higher here than in other major European markets, asset quality is even more important than elsewhere, so there is a focus on buildings with outstanding architecture, amenities and access. In our view, the Netherlands is an office market that still offers significant upside potential.

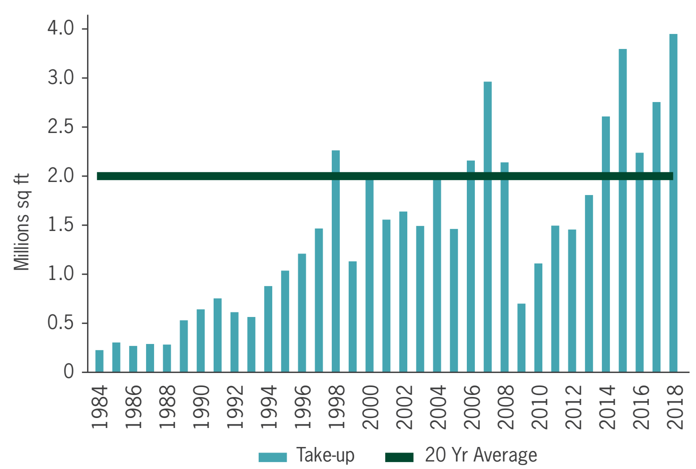
Irish Office Market

Driven by strong employment, the Irish office market has seen strong performance in the first half of 2019, coming off an encouraging year in 2018, where office take-up across the country exceeded 5.5 million square feet, the highest total to date. The FAANG 5 (Facebook, Apple, Amazon, Netflix and Google) helped drive much of this growth, with Facebook announcing their plans for a new Europe, Middle East & Africa (EMEA) headquarters in Ireland, representing the largest office deal in the country's history. Google and Apple have also opened new office locations in Ireland, and many other large global technology companies may follow suit.

Total employment is rising at 3% per annum, with almost half of these new jobs based in Dublin where employment is growing at almost 5% per annum. Approximately 40% of the jobs being created in Dublin each year are office-based positions. Dublin itself saw 4.7% growth in 2018 office-take up, a new record for the city.[37] Even if not including the large Facebook deal, the year would have been the fourth largest in Dublin's history. As demonstrated with the FAANG transactions, deal sizes are also growing in the city, with over 20 deals completed on space totaling over 15,000 square feet.

There has also been a shift in the profile of tenants. As the country becomes more global, the average tenant has shifted from domestic banks and professional service firms to international firms looking to increase their presence in the Irish market. In addition to its low corporate tax rate, Ireland also has a natural advantage with global firms with the country's main language being English. The median age in Ireland is one of the lowest of all European countries, providing an inexpensive labor pool and youthful atmosphere, making it attractive for global technology companies. Unsurprisingly, flexible space operators have continued to grow in Ireland, having grown by over eight times in the past two years, primarily in Dublin.

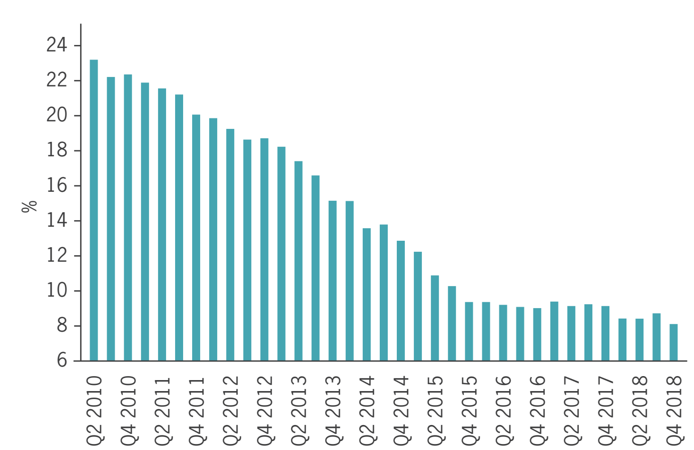
Figure 15: **Dublin Office Take-up**



Source: Savills Office Ireland, February 2019

There is also well-controlled supply in the city, with new supply projected to be down 13% in 2019 versus the prior year. Vacancy rates have tightened, with Q4 2018 vacancy rates of 8% versus 20% eight years prior.

Figure 16: **Vacancy Rate Dublin Office Market**



Source: Savills Office Ireland, February 2019

While smaller than other European office markets, Ireland is a growth market with strong fundamentals that Investcorp is monitoring for attractive investment opportunities.

[37] Savills, Offices Ireland, February 2019

Conclusion

The real estate occupier market in Europe continues to be very attractive and healthy, while the investment market remains stable. This is particularly true in Investcorp's main focus markets: the office and industrial asset classes in Germany, the Netherlands, the UK and Ireland. Despite the slowdown in the European economy in 2019 and concerns surrounding Brexit, real estate markets have remained resilient. Real estate supply/demand dynamics are highly favorable by historical standards, and the underlying fundamentals that drive real estate demand are projected to remain positive, including employment and wage growth.

Industrial has continued to be one of the most preferred asset classes by investors across Europe. The urban logistics sector is booming due to the rise of e-commerce and globalization, while supply in suitable locations is constrained. Office performance in the UK, Germany, Netherlands and Ireland remains strong, despite Brexit concerns. The German residential market remains buoyant, although difficult to access from an investment perspective.

Through its upcoming real estate investments, Investcorp will remain committed to its investment strategy which includes the following:

- Emphasis on assets that generate strong cash flow. While value accretion is always a part of our investment strategy, return generated from cash flow is expected to represent the majority of the overall return generated from our investments.
- Focused on modern stock in established urban markets in the UK and Germany, supplemented by higher growth markets such as the Netherlands and Ireland.
- Focus on multi-let assets and portfolios with inherently diversified income streams.
- Focused on opportunities of £/€50m – £/€100m in asset value.
- 5 to 7 year investment periods.
- Utilize 60% – 70% leverage, with favorable financing terms.
- Will work with local operating partners with a proven track record to source and asset manage investments.

About Investcorp

Investcorp is a leading global manager of alternative investments. Led by a new vision, Investcorp has embarked on an ambitious, albeit prudent, growth strategy. The Firm continues to focus on generating value through a disciplined investment approach in six lines of business: private equity, real estate, absolute return investments, infrastructure, credit management and strategic capital.

As at June 30, 2019, the Investcorp Group had $28.2 billion in total Assets Under Management ("AUM"), including assets managed by third party managers and assets subject to a non-discretionary advisory mandate where Investcorp receives fees calculated on the basis of AUM.

Since its inception in 1982, Investcorp has made over 185 Private Equity deals in the U.S., Europe, the Middle East and North Africa region and Asia, across a range of sectors including retail and consumer products, technology, business services and industrials, and more than 675 commercial and residential real estate investments in the U.S. and Europe, for in excess of $60 billion in transaction value.

Investcorp employs approximately 430 people across its offices in Bahrain, New York, London, Abu Dhabi, Riyadh, Doha, Singapore, and Mumbai. For further information, including our most recent periodic financial statements, which details our assets under management, please visit: www.investcorp.com.

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