Insights

Real Estate

October 2016

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Editorial

Dear readers,

The Brexit vote in the United Kingdom surprised us all and unleashed intense speculation about Europe's political and economic future. In this issue of “Real Estate Insights” we report on the economic consequences and how they could affect the European property market. We anticipate that the British real estate market will remain attractive to foreign investors. You can read more from page 2 onwards.

We also include our assessment and forecasts for the European real estate market from page 4. One of our main features is on the residential market in France, which is currently undergoing a renaissance due to the low interest rate environment and an attractive risk-return profile. Moreover, in Germany, investor demand is growing in the up-and-coming retail centre investment area.

You can also find about “The Circle”, which will bring a completely new and extremely varied world to Zurich Airport.

I hope these topics will provide you with some interesting insights.

Stefan Mächler
Group Chief Investment Officer

Macro outlook

European financial markets have calmed down again after the Brexit vote. In the UK, however, the sharp devaluation of pound sterling does indeed have implications for the economy, over the longer term as well.

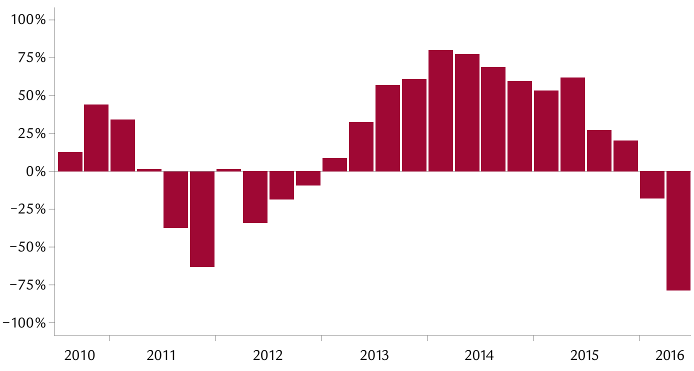
Francesca Boucard, Economist Real Estate, Swiss Life Asset Managers
Sylvia Walter, Senior Economist, Swiss Life Asset Managers

The surprising outcome of the EU referendum in the UK leaves room for an array of opinions as to how the political and economic landscapes in the UK and Europe as a whole might develop over coming years. The quick nomination of a successor prime minister, Theresa May, and the swift forming of a new government were broadly welcomed. Financial markets stabilised after an initial shockwave in the days immediately following the Brexit vote. Pound sterling is most affected by the consequences of the vote. The external value of the British currency had slumped by almost 12% on a trade-weighted basis at the time of writing.

In the meantime, the Bank of England (BoE) delivered a measures to loosen monetary policy further, and thus support economic growth. Notwithstanding, we view a stagnation in the UK in the quarters to come as likely. At the same time, the strong depreciation of the British currency will cause a rise in the rate of inflation. Growth in the UK will be restricted by weak investment. Businesses are liable to relocate abroad in the long run. Purchasing managers’ indices briefly indicated a slowdown in activity in manufacturing, the service industry and the construction sector, but they have risen again in the interim. Deloitte carried out a CFO survey before the vote, which depicts the effects of Brexit on major decision makers’ mind set in the British corporate world (see chart, page 3).

At the same time, investors doubt the ability of the UK economy to attract the foreign capital necessary to finance a massive current account deficit, which is at 7% of GDP. This and the ongoing policy easing by the BoE will keep the pound under downward pressure. On a more positive note, this depreciation makes investments for foreigners more affordable.

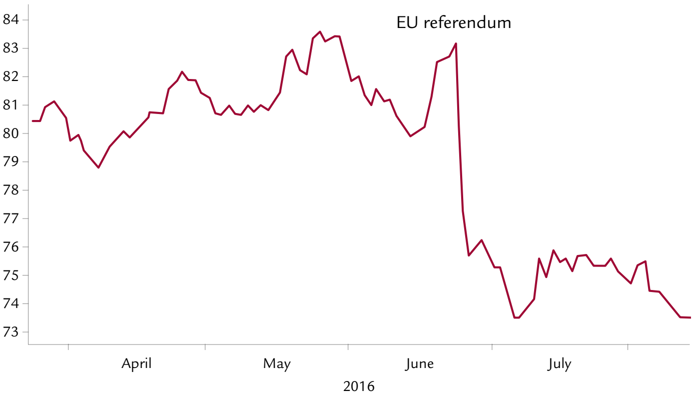
UK: Deloitte CFO survey



■ Capital expenditure plans (balance of responses)

Source: Macrobond

Development British Pound



▬ British Pound, trade-weighted index

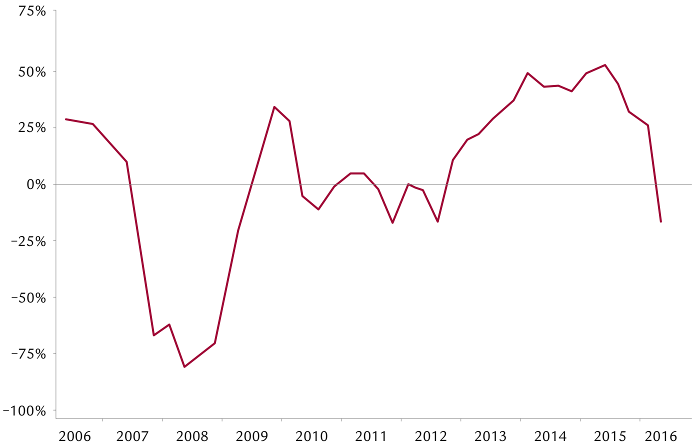
Source: Macrobond

Continental Europe will feel fewer economic repercussions. As a matter of fact, survey data held up astonishingly well across the Eurozone after the UK vote. Indeed, the purchasing managers' indices for France and Germany surpassed the mean value reached in the second quarter of this year. Domestic demand continues to keep the Eurozone at its 1.5% rate of growth. We have slightly reduced our outlook for quarterly growth rates until end of 2017, but see no need to reassess our inflation projection. Due to the strong basis effect emanating from the energy prices, headline inflation readings will climb up around the globe without actually causing a noticeable increase in bond yields in our view.

Bond yields slumped right after the Brexit vote and have not yet regained the levels of 23 June 2016. The 10-year yields on French, German and Swiss government bonds are still between 10 and 20 basis points lower. For the UK, the fall has been 50 basis points to date. Since mortgage rates followed suit in many economies, this renders investments in real estate yet again attractive, certainly from a relative valuation point of view. In the case of the UK property market, however, the Brexit vote has put pressure on property prices.

Actual price declines could not be depicted at time of writing: in the run-up to the referendum, transactions in London markedly declined in comparison to the year before and are expected to remain subdued. Furthermore, investors' interest in commercial property fell sharply in the second quarter of 2016, showing the worries over a potential hit to business confidence.

RIC S UK Commercial Market Survey



▬ Investment Enquiries

Source: Macrobond

Immediate reactions were seen in the first week after 23 June, as seven property funds were frozen. This should be considered a proactive response on the part of investment managers, to prevent as far as possible a price erosion due to panic selling of fund units. The house-price trend is expected to slow, as the effects of Brexit dampen domestic demand. As noted before, the plunge of the pound makes real estate investments attractive for foreigners again. So there is a possibility that demand, to date strong, will only decline slightly. It remains to be seen what consequences arise in coming months. Investors will likely continue to wait it out for the moment, since much depends on the course of negotiations.

Editorial deadline: 12.08.2016

European Real Estate – General Overview

Although uncertainty about the outcome of the British referendum affected European real estate markets during the first half of 2016, it did not move them in a new direction, with European investment markets developing in increasingly disparate ways and losing some momentum, while rental markets remained robust.

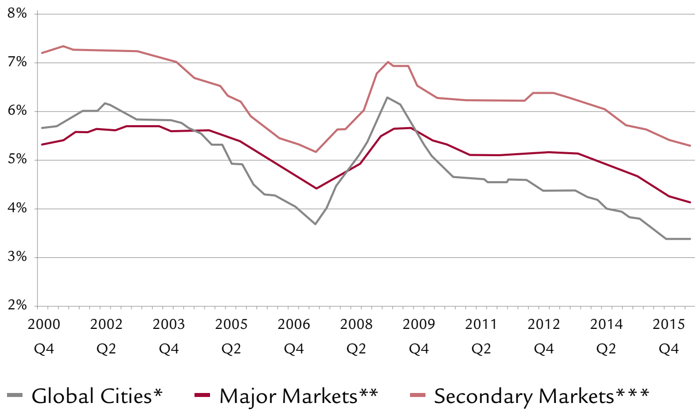
Andri Eglitis, Head of Research, Corpus Sireo

Commercial real estate investments softening at a high level

The transaction volume of commercial real estate in Europe decreased in the first half of 2016 by some 15% compared to the previous year's corresponding period, to around EUR 105 billion, but remains at a high level by long-term comparison. The overall value masks a more nuanced picture, with Germany as well as the United Kingdom softening significantly against 2015, the Scandinavian countries (except for Norway) growing strongly and France's volume – particularly in Ile-de-France – markedly gaining in the second quarter. On aggregate, these varied trends mean that Europe without the United Kingdom saw a transaction volume in the first six months of 2016 slightly above that of the corresponding period in the previous year.

Minus the situation on the British real estate market in the run-up to the referendum, it is evident that the investment market was not hampered by sinking demand but by a lack of appropriate properties. Owners are less inclined to sell, what with zero yields on secure government bonds, which is why they are tending to modernise their holdings going forward. On the other hand, proprietors looking for buyers can take advantage of intense competition to demand very high prices, and thus investors are obliged to scale back their projected returns or increase their risks. When significant portfolios or large individual properties were brought to market, transaction volumes did increase, as for instance in Ireland, Poland or Sweden, while from Germany of all places there were reports of a deficit in supply.

Development of net initial yields on European office property markets



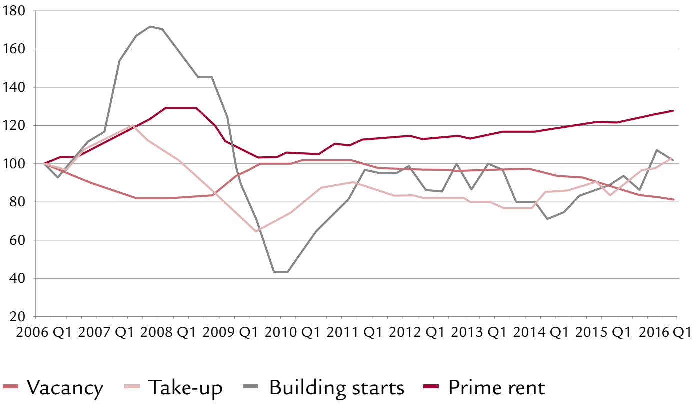
*London, Paris
** Berlin, Frankfurt, Munich, Stockholm, Madrid, Milan, Brussels, Amsterdam
*** Birmingham, Manchester, Edinburgh, Lyon, Lille, Rotterdam, Prague, Budapest, Lisbon

Source: PMA

The continuing robust demand is reflected in the development of, as shown by the office sector: in London and Paris, both global cities, prime yields stabilised in 2016 at a low level – to put it mildly in the case of London, since prices in the UK have been generally under pressure. Meanwhile, some second and third-ranked European markets posted continuing price hikes, driven in part by a shift of capital from the UK to the continent. Initial yields decreased particularly in markets such as Prague, Budapest or Stockholm, as well as Brussels and Vienna; furthermore, during the second quarter the German markets saw additional price rises due to strong competition among investors.

Supply and demand parameters on main European office markets

(indexed to Q1 2006 = 100)



(Representation of parameters as unweighted average for markets in London, Paris, Berlin, Frankfurt, Munich, Stockholm, Milan, Madrid, Brussels, Amsterdam)

Source: PMA

Office rental markets remain profitable

Office rental markets remain the beneficiaries of healthy economies in most European countries. The take up during the first half of 2016, aggregated across the main European office space markets outreached slightly the level of the previous year's period – with a negative trend in the UK, in particular London. With completion figures remaining low, vacancies continued to decline. There is a shortage of mainly modern, centrally located office space, which is putting upward pressure on rents. Increasing demand from tenants and investor appetite for new-build projects, however, will see completion figures rising over the quarters to come, especially in Dublin and the City of London. The trend in rental rates profited from the market environment during the first half of 2016, with prime rents increasing on many markets and Stockholm, Barcelona, Berlin and Dublin posting especially significant growth. Meanwhile rents on other markets continue unchanged.

After years on the up, the European real estate markets are faced with growing uncertainty, and the expected weakening of the British economy will likely have an effect on the rental markets, and lead to declines in demand, and in rents. The financial sector is expected to move some of its business from London to the EU, to the benefit of selected office markets, such as Dublin, Frankfurt or Paris. That said, the economic cycle, and with it the office rental markets in continental Europe, is probably headed for a general slowdown. Despite greater macroeconomic risks, the forecast is for plenty of capital to continue to flow into European real estate, which will keep initial yields at a low level over the medium term, particularly on the main markets of economically robust western European countries.

Returns continue under pressure on many international office markets

French residential market

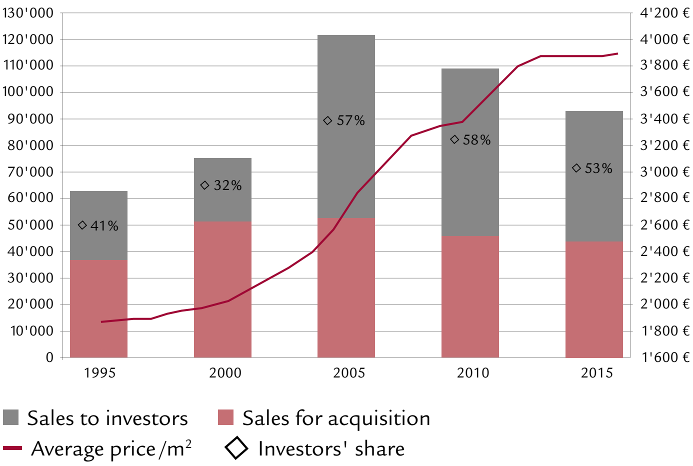
The residential market is on the rise again in France: The current low interest-rate environment and the optimal risk / return profile make residential real estate an attractive investment category. What is more, the growing population demands more residential space.

Claire Djian, Research Analyst, Swiss Life REIM (France)

French institutional investors regain interest in the residential asset class

Following a period of decline in the share of residential properties in the institutional investors' portfolio, which dropped from 20% in 2004 to 13% today (source: IPD 2014), we are seeing a regain of interest for this asset class among French institutional investors. This is mainly due to an attractive risk-return ratio in an environment of low interest rates, as well as to demographic growth, which is creating an imbalance between residential supply and demand.

Share of sales to investors in residential transactions in France

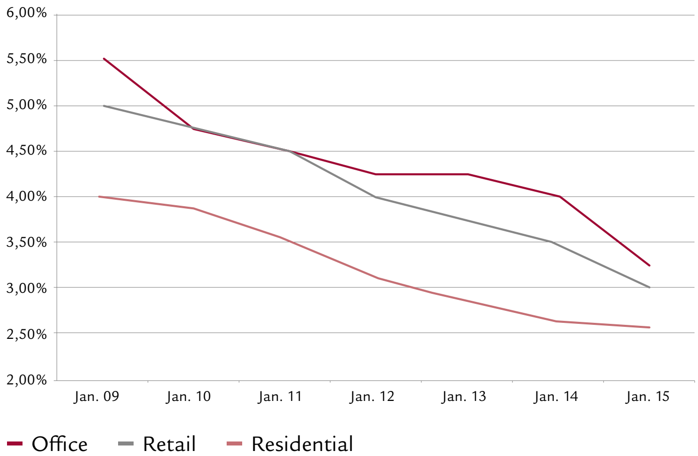


Source: Observatoires FPI France

Attractive risk-return ratio

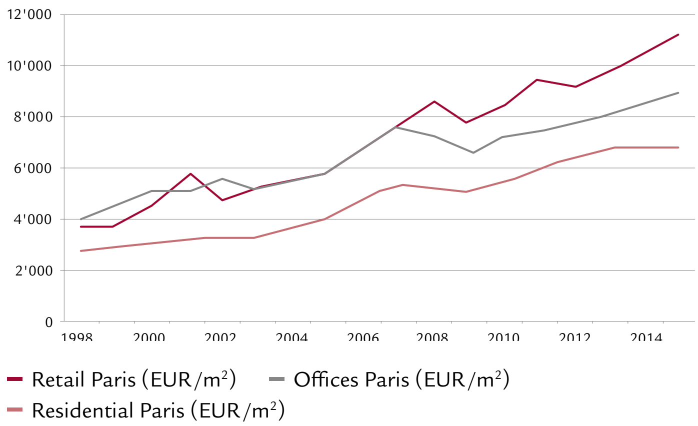
Due to its low return profile, the housing market has not been considered as much attractive so far. However, in the current context of low interest rates and declining returns of other asset classes, particularly office and retail, it seems to be more and more appealing. Indeed, residential housing offers a historically higher risk premium than government bonds. Furthermore, with a low vacancy rate and isolated rental risks, the residential market appears to be less risky than other asset classes, such as office, retail or logistics. Residential portfolios have also proven to be quite crisis-resilient since 2008, and therefore less cyclical, and less sensible to economical risks than other asset classes. With returns growing ever closer to those of other asset classes, and less volatile prices, residential housing thus offers an increasingly attractive risk-return ratio over the long term.

Prime Yields in Paris



Source: IPD

Market values in Paris



Source: IPD

Supply / demand imbalance as a structural support factor

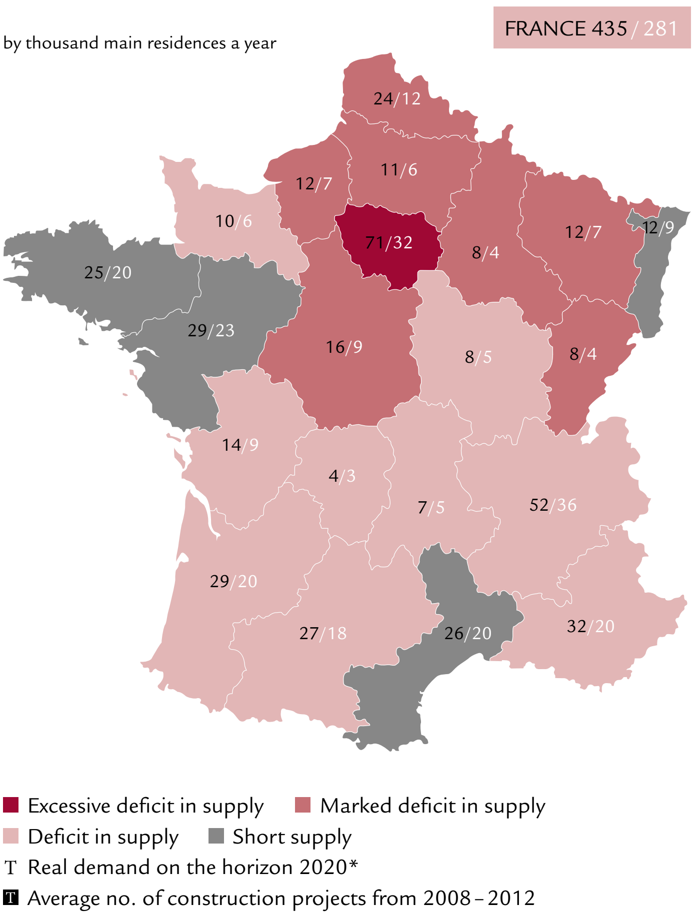
France's demographic dynamics is also a decisive factor in the attractiveness of residential housing as an investment. The French birth rate is high, longevity is on the rise and the country has a positive migration rate. In addition to these demographic developments, the number of households is growing as the average household size decreases and the urbanisation rate keeps increasing. All of these factors create an ever-rising demand for residential housing, which contrasts with a lack of home construction in certain regions. This creates an imbalance between supply and demand, which is expected to put pressure on prices over the long term.

Where to invest in France?

In Ile-de-France, residential under-supply is very high. Annual housing construction (average over 2008 – 2012) would only meet 45% of the real demand for residential housing (growth of households and renewal of existing stock) between 2015 and 2020 (sources: IEIF). Such strong demand pressure should support the prices of residential real estate throughout Paris and the region.

The residential markets are associated with low risk and favoured by structural demand.

Supply / Demand Imbalance in Greater Paris

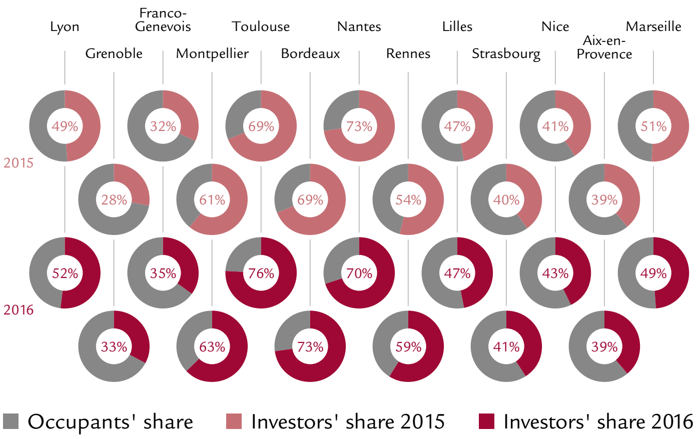


*growth in the number of households + required renewal of current housing stock

Source: IEIF based on INSEE data, CGDD / SOeS

In the provinces, some conurbations seem to be very attractive for residential investments. Cities such as Marseille, Montpellier, Toulouse, Bordeaux, Grenoble, Nantes and Lyon show robust growth and productivity (and thus generate job opportunities for young people), a highly positive migration rate and a strong GDP. In consequence, these markets benefit from a low risk profile and a structural demand, which should support the housing market over the long term.

Investors' share



Source: FIL Scor'marché

Student housing

Sub-segment of the residential market and acyclic product with rates of return superior to typical residential investments, the student housing's market is booming. This is a highly undersupplied market, which ensures its performance in the long term. In addition, its returns are visible: properties are let to operators who ensure that rent is paid over the entire course of the investment. Moreover, the vacancy risk is supported by the operator since leases are usually of long term (generally nine years).

Following the launch of Viveris Campus Immo in 2011, now fully invested, SL REIM (France) launched Club Campus Immo 2, an OPCI, (French real estate Fund dedicated to professionals), in June 2015, with the goal to create a real estate portfolio specialised in student housing in France. The fund aims at building student houses for the 2017 – 2018 academic year.

Retail centres in Germany – investing in retail for the future

The German economy boasts rising employment, salaries and purchasing power. Retail sales rose in 2015 by a nominal 2,8% – conditions for retail have not been this favourable for years. At the same time, rents are under pressure in many high streets and shopping centres, and space remains vacant. Nevertheless, the retail sector continues to offer very attractive investment opportunities.

Andri Eglitis, Head of Research, Corpus Sireo

The retail industry was in great demand as an investment category in Germany in 2015, with its transaction volume (EUR 18 billion) doubling that of previous years. A glance at the various commercial segments reveals: in 2015, retail parks accounted for around a third of the market, and thus the largest share, followed closely by high street and shopping centres. In other words, the trend of past years continued, as classic investments in shopping centres and high street have become less important, demand for retail space offering everyday products and services is growing. The retail park segment was long considered a niche investment for specialists, but has now reached broad investors' attention. Indeed, in the first half of 2016, just under half of investment volume was in this type of retail space.

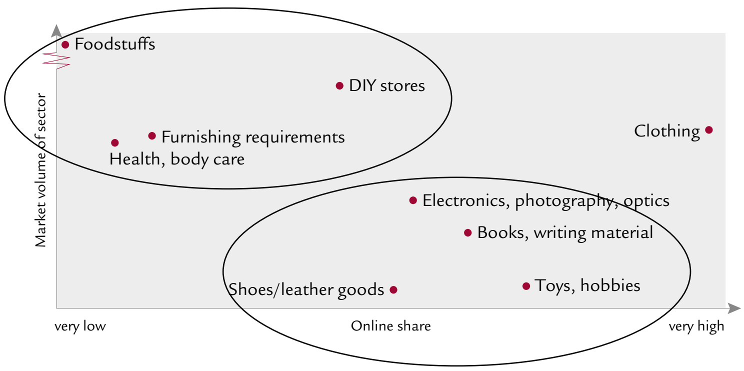
Transaction volume by retail segment

Source: CBRE

Investors are thus reacting to the growing polarisation of consumer behaviour, between satisfying basic needs and treating shopping as a leisure activity. Pedestrian zones in large cities, along with shopping centres, continue to show potential, as long as they offer an appealing range of shops as well as enough food and leisure attractions. Retail occupation of metropolitan inner cities and large centres are being driven by the demands of customers in quest of an experience, among them a rising volume of tourists, along with modern shopping centres with regional dominance. On the other hand, large and medium-sized cities are becoming less attractive as shopping destinations, even if purchasing power for everyday needs remains strong locally, since the focus in that case is on efficient procurement.

Retail destinations with a focus on basic services thus offer investors considerable potential, with calculable risk. While these properties are subject to less trend fluctuation than in the world of leisure and experience shopping, competition with online providers in these sectors is also less pronounced than for instance among fashion, consumer electronics and electrical goods.

Significance of product ranges for online trade



Source: GfK

Some half of all retail sales in Germany stem from the trade in everyday products, as currently 2% of groceries are bought online. Forecasts predict that share not to rise above 10% long term, although they do note significant growth potential specifically among under-30-year-olds and in conurbations, where delivery can be offered at a profit. So stationary providers of everyday products are likely to remain the first choice. Nevertheless, priorities are changing and focus on time-efficient shopping and thus a concentration of shops is a real must, which means that stand-alone supermarkets or speciality stores are becoming less attractive, as are smaller retail parks. On the other hand, retail parks with an expanded range of goods are satisfying customer requirements and establishing themselves as an autonomous investment category – the retail centre.

Retail centres are retail parks that offer small and medium-sized stores in an interior mall alongside large-sized units with direct exterior access from a central parking lot. They should contain a minimum of 15 rental units, of which one must be grocery-anchored as well as anchors from the DIY or furniture sector. They may also include discount-oriented brands especially from the fashion segment, which do not face much competition from online providers. These centres easily adapt to changing trends and requirements of tenants and technology with their flexible construction style.

The success of these investments depends on the predominance of a given centre in its region, and thus its attractiveness to customers and retailers. Due to their large-sized stores and wide range of goods, retail centres are subject to a restrictive approval process – a significant barrier of entry.

Corpus Sireo classifies some 200 properties in Germany as retail centres. With an average size of some 20 000 m² sales area and EUR 50 million in market value per property, the retail-centre market can be estimated at around EUR 10 billion – and thus though limited, is a segment with future potential. What is more, compared with classic investment products like high street assets and shopping centres, retail centres present a more attractive return: in summer of 2016, the net initial yield for prime properties is between 4,5% and 5,2% – a range that reflects regional disparities in economic health. Returns on shopping centres with market dominance, by comparison, are around 4,2%, while for excellent properties in pedestrian zones in main real estate markets they are usually well below 4%. That said, in a commercial environment of constant change, the expected stability of the retail centre segment is an essential investment criterion alongside more favourable returns.

Weisseritz Park Freital

Ostsee Park Rostock

Interview with Karsten Burbach

From the German to the European retail centre market

Karsten Burbach
Head of Asset Management Retail, Corpus Sireo

In which European countries have retail centres been established?

Karsten Burbach:
Retail centres, or large retail parks, have established themselves throughout Europe. After all, basic conditions and challenges for retail are pretty similar all across the continent: customers want to be able to buy everyday items or bulky products as comfortably and efficiently as possible, but modern, large-sized store units with parking are hard to find in many inner cities. Nonetheless, countries with restrictive building rights, like Germany, do still have potential, since older properties can be upgraded and extended through refurbishment.

What differences do you see on the European markets?

Karsten Burbach:
Compared to Germany, Switzerland and Austria, this investment category is in fact much more important in other European countries, mainly due to the lack of space in inner cities and the laissez-faire approval process adopted in the past, which facilitated project developments. From the investor's point of view, however, this approval process needs to be revisited in individual cases, since restrictions currently in place also shield the property in question from future competition.

What is the outlook for the retail centre investment segment?

Karsten Burbach:
The defensive character of retail centres as a shopping format for basic services and their low degree of complexity compared to shopping centres increases investor interest, even in economically uncertain times – in fact, precisely during such periods. The initial yields from retail and shopping centres are likely to keep growing closer. Moreover, opportunistic investors can enjoy the very attractive likelihood of higher yields by identifying speciality shopping malls with optimisation and expansion potential. And finally, in contrast to shopping centres and high-street properties, retail centres are uniquely capable of adapting to changes in consumer behaviour driven by online shopping‘s growing market share, and can use flexible layouts to integrate new shopping concepts.

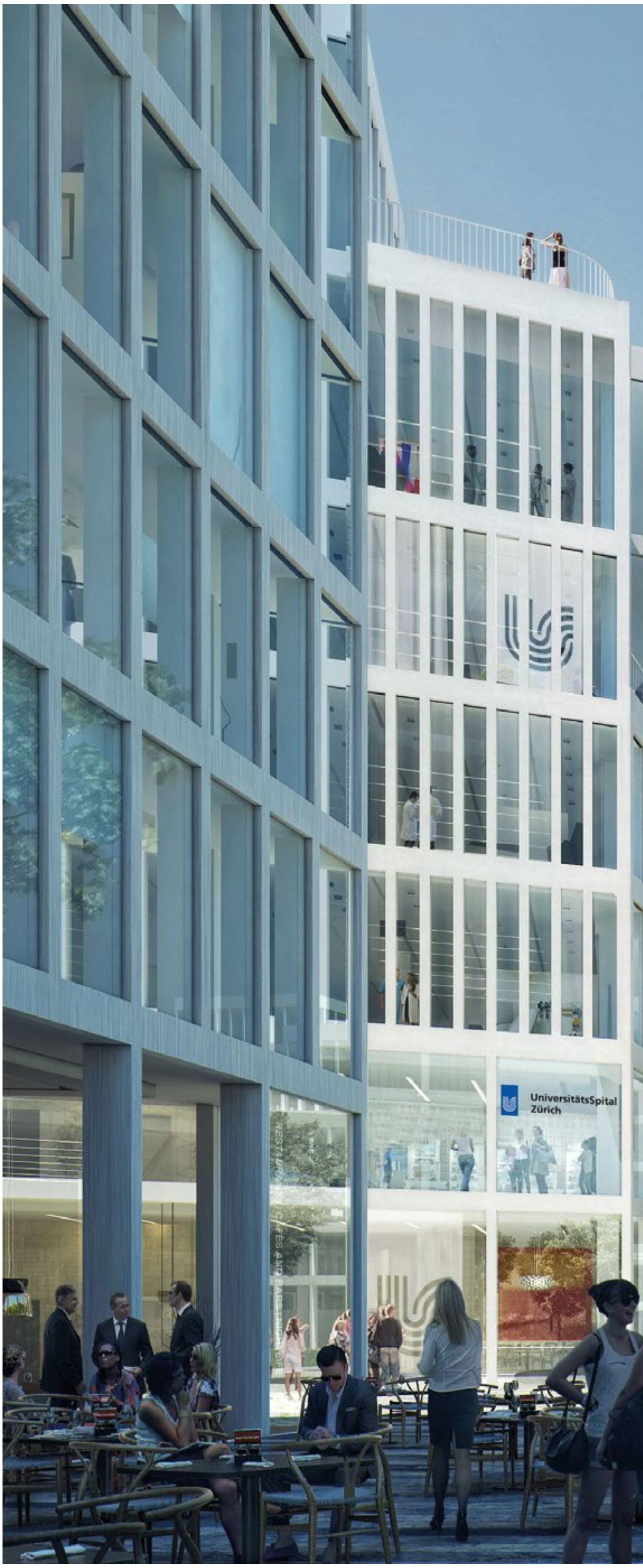
“The Circle” at Zurich Airport

Switzerland's largest skyscraper is currently being built at Zurich Airport. An entirely new district is planned, complete with convention centre, hotels, restaurants, a health centre, offices, showrooms for well-known brands and much more. Construction has been under way since January 2015.

A new service centre on 37 000 m² of land (180 000 m² of floor space) is planned within walking distance of Zurich Airport's terminals. It will be unique in Switzerland: “The Circle” will become a business and leisure centre. Two hotels, a convention centre, office space, a health centre and educational, cultural and entertainment offerings are planned. A total of some CHF 1 billion will be invested.

Zurich's second centre

In recent years, Zurich has become so large and important that it needs a second city centre. This second centre is likely to be in the new expanded district in Zurich-North / Glattal. “The Circle” will play a key role in this new district. Today, most commuters only use Zurich Airport – one of the most frequently used transit hubs in Switzerland – for transfers or for shopping. Many offices and services are located near Zurich airport, not to take advantage of flight connections, but rather because land near the airport is an attractive location for offices. The aim of “The Circle” is to give this “informal” centre a face, a sense of location.



Diverse uses

"The Circle" is divided into seven modules: The University Hospital of Zurich (USZ) was secured as an anchor tenant for the "Health & Beauty" module, which will offer various medical services. The USZ will create a walk-in clinic occupying about 11 000 m^2 of space. International hotel chain Hyatt will operate two hotels in the "Hotels & Convention" module. One will be a Hyatt Regency with 250 rooms and the other will be a Hyatt Place with 300 rooms. The convention centre, which will also be operated by Hyatt, will be large enough for about 2 300 people. The two modules comprise some 60 000 m^2 of space. The "Headquarters & Offices" module will occupy 75 000 m^2. The core of the "Brands & Dialogue" module will be company and brand presentations as well as dialogue between companies and their customers and partners.

"Brands & Dialogue"

Stores, showrooms and corporate embassies representing prominent companies and brands are spread over 17 000 m^2 in the most-frequented area of the building complex. Experiencing a brand and its history will become much more sought after as the pace of change increases in the retail business and in consumer behaviour. New concepts and formats are required to meet these demands. The "Brands & Dialogue" module offers companies and their brands the perfect platform to engage in dialogue and network in a novel way with an international and discerning public. After all, brands in the future will not just use physical locations for sales, but rather for dialogue, interaction and the brand experience.

"The Circle" provides space for showrooms, corporate embassies and brand worlds almost as a standard in an attractive setting. "The Circle" is thus preempting a trend that will explode over the next few years. Digitalisation and a markedly stronger relationship between consumer and producer, company and brand will require new solutions in the future. "The Circle" already offers these solutions as a core component in its content mix.

An international atmosphere pervades the squares and corridors of "The Circle" , which stems from the international atmosphere caused by the gastronomy, entertainment, art and culture and, in no small measure, the two Hyatt hotels and Convention Centre.

The entrances to the spaces will be located at the main level along the streets and squares. They will therefore be in the most frequented and liveliest area of the building complex. The space will be let vertically – known as brand houses – with several storeys available. This gives the companies maximum flexibility in sorting out sales, exhibition, meeting and office

space as well as other uses. The tenants are free to choose how many floors they want. It is the ideal place to build a strong and independent brand world. The free design of the facade with its squares and lanes also gives the brands a lot of scope to show their individuality.

The possible concepts for such a "brand house" range from retail stores, brand presentation and a brand experience to portraying the entire corporate and brand message.

For example, Swatch has let a two-storey brand house right on the main square, where it will present its Omega brand. As part of its presence at "The Circle", Swatch will also focus on innovation and Swiss watch-making, in addition to its range of watches. This concept makes the Swatch Group the ideal addition to the "Brands & Dialogue" module.

There will also be an "Education & Knowledge" module and a "Counsel & Arts" module: The "Education & Knowledge" module is a development of the concept of executive education hubs with international offerings. The "Counsel & Arts" module offers space for art-related products and services. Finally, the "Culture & Events" module includes a multifunction event space as well as ten different restaurant concepts spread across the entire complex.

Long-term investment for Swiss Life

Swiss Life – as a sustainable and long-term investor – is confident that "The Circle" represents a very profitable investment thanks to its excellent location and unique project quality. "The Circle" is thus an ideal fit for the Swiss Life investment strategy. Its long-term experience in carrying out large new construction projects is ideally complemented by the airport-specific expertise of its co-investor, Flughafen Zürich AG. The two partners are co-owners of the project, with a 51% stake held by the airport and a 49% stake for Swiss Life.

"The Circle"

Investment volume:	approx. CHF 1 bn
Floor space:	180 000 m²
Co-owners:	Flughafen Zürich AG (51%) Swiss Life AG (49%)
Architect:	Riken Yamamoto & Field Shop (Japan)
Project partner:	HRS Real Estate AG
Further information:	www.thecircle.ch

SwissLife
Asset Managers

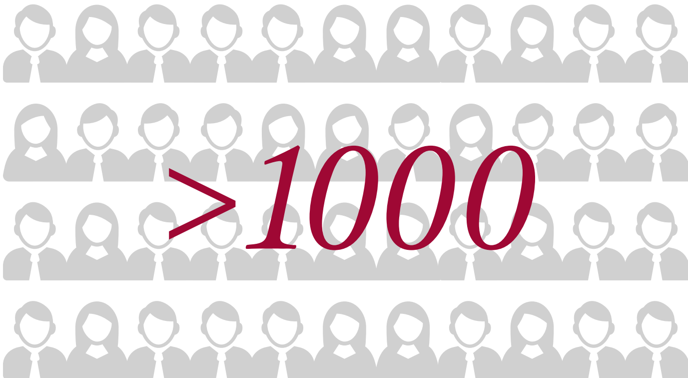
Real Estate – Facts and Figures

Assets under management and administration

(in CHF bn)	AuM	REuA[1]	AuMA[2]
Total	202.2	28.4	230.6
			Total REuMA
REuMA[3]	40.0	11.3	
Livit		17.1	68.4

[1] Real Estate under Administration (not included in Swiss Life AuM definition) [2] Assets under Management and Administration
[3] Real Estate under Management and Administration (Swiss Life Asset Managers, incl. Corpus Sireo)

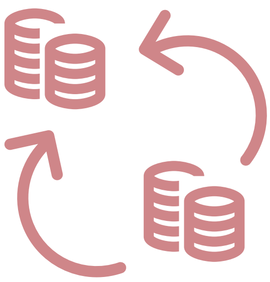
Employees



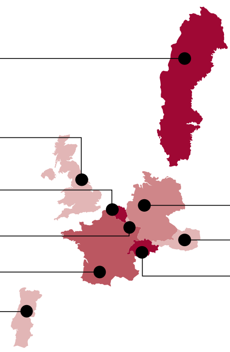
Transaction volume real estate *(in CHF bn)*

10.9

(as of 31.12.2015)



Strong footprint in Europe – our investment universe



21 locations in Europe

All figures as at 30 June 2016, unless stated otherwise

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