October 2019

Insights

Real Estate

SwissLife
Asset Managers

High Street Retail in France –
Smart is the new high

London Well Positioned for the Future –
Real estate continues to provide attractive long-term investment opportunities

Digitalisation of the Real Estate Industry –
A teaching moment for the sector?

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Editorial

Dear readers,

The rapid speed of change over the past year has shown no signs of abating since our last edition of Insights. Low interest rates have continued and further reductions are being priced in by the market. This is expected to preserve the relative attractiveness of real estate investments in Europe, although variations between individual countries must be considered.

In the UK we look at how London's status as a global city could ensure its long-term resilience and consider what characteristics investors should look for to identify submarkets with the strongest growth potential. In Switzerland, alpine hotel visitor numbers were slowing while tourism demand shifts towards city breaks. New hotel developments are likely to follow this trend. In France high street retailers are making a comeback and could comfortably compete against online retail, with significant players in the digital market starting to move to bricks and mortar outlets. In Germany we examine why further digitalisation in the industrial and logistics sector may not change real estate demand, underpinned by examples in the automotive industry.

Change, with both its positives and negatives, is the broad theme of our current edition and I hope you will find its contents timely and informative.

Stefan Mächler
Group Chief Investment Officer Swiss Life

Changing while not changing

The economic environment has gone from an upswing at the beginning of 2018 to possible patches of recession in the second half of 2019. While the economy changes, one thing persists: the demand for real estate investments.

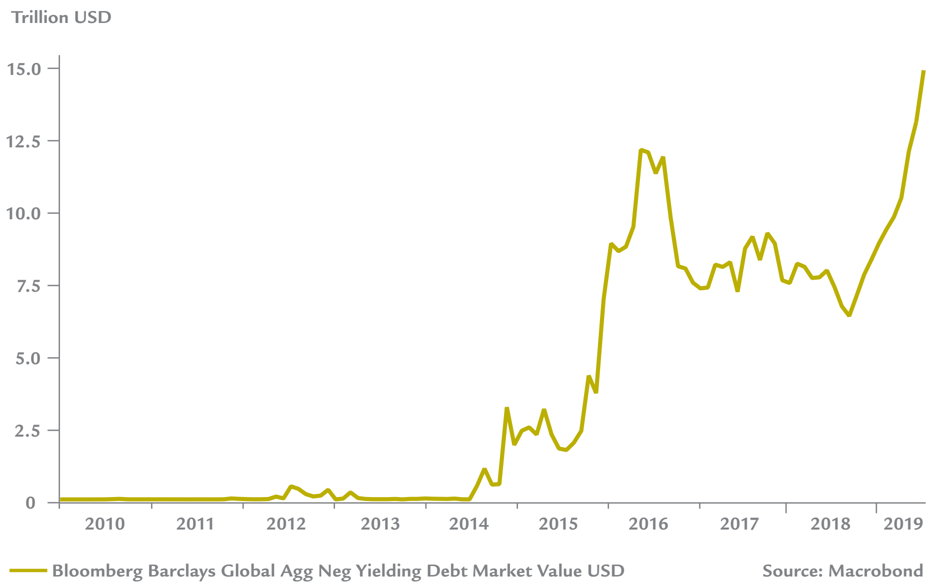
Francesca Boucard, Economist Real Estate, Swiss Life Asset Managers

It was in the summer of 2018 when discussions about a possible recession started, after markets experienced a synchronous global upswing and the prospects were not as gloomy anymore. A year later, the global economic dynamics have indeed slowed down and the probability of patches of recession has further increased. In the eurozone, Germany has emerged as a problem child due to its struggling industry sector; forward-looking indicators show signs of lasting reduction in industrial production over the third quarter. Given the sheer size of the German economy, the risk of a shallow recession outweighs positive trends elsewhere in the eurozone. Italy, another large euro member, has become increasingly likely to see a temporary recession as well. More positively, France appears less affected by global headwinds. Consumer confidence recovered during the second quarter and the PMI has held around the 50-points expansion threshold. The uncertainty about Brexit in the UK remains unchanged: Boris Johnson, the new Prime Minister, will soon start another attempt to re-negotiate the Brexit Deal. However, with only little time left and apparent unwillingness from the European side to grant meaningful concessions, uncertainty regarding the final Brexit outcome is set to increase in the near term.

As if that were not enough, a comparison of the FED's interest path forecasts in 2018 and 2019 reveals a striking difference. A year ago, hikes were expected in 2019, yet the outcome is different: in July, the FED cut interest rates for the first time since 2008 and there is another cut expected in the third quarter of 2019. While the reasoning remains controversial, there is currently no economic scenario in which rising interest rates are expected. This very strongly supports the case for real estate investments. Nevertheless, the first half of 2019 has seen a decrease in transaction volumes as well as, partly, in yields. The reason for this is a combination of a slowing economy and high prices, but mainly the lack of good quality assets. In such an environment asset selection is key, especially since "real estate" cannot be lumped together. Although the retail sector is struggling due to structural changes, opportunities in very good locations are still available across Europe – especially in countries where the retail sector still dominates, such as in Spain and Italy. At the same time, we strongly believe that London's real estate market will prove resilient in the current environment, considering the variation across the markets and the polarisation among different submarkets. When investing, the story behind the sustainable income stream of each and every asset is the one to be told. ■

12 August 2019

Global aggregate negative yielding debt (USD)



Source: Macrobond

Shift from alpine to urban

After a long slump, the Swiss hotel sector is seeing an uptick in overnight stays, driven by the growing streams of tourists in the major cities. Alpine tourism, on the other hand, is in the midst of a protracted structural change. This divergence must be kept in mind when investing in hotels.

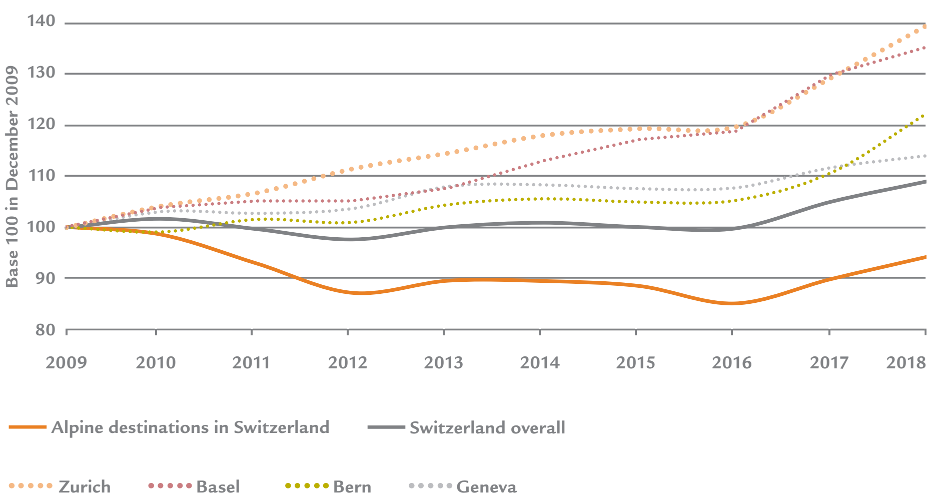
Alfonso Tedeschi, Real Estate Product & Service Manager, Swiss Life Asset Managers

According to the Swiss Federal Statistical Office, hotels in Switzerland hosted 16.7 million overnight stays during the winter tourist season (November 2018 to April 2019), the best result since the 2007/2008 winter season. An increase of 0.7% (+117,000 overnight stays) was recorded over the same period of the previous year. The outlook, too, is positive again for the first time in a while. The Swiss Economic Institute (KOF) is forecasting a rise of 2.7% and 2.4% in overnight stays country-wide for 2019 and 2020, respectively.

Business trip instead of skiing

The short-term increase in overnight stays cannot erase the fact that Swiss tourism has taken a hit over the past years. The strong Swiss Franc and structural changes, including competition from the sharing economy (e.g. Airbnb), are weighing on traditional hoteliers. But the sector as a whole isn't suffering: in major Swiss cities, the number of overnight stays has increased by almost 30% since 2008. The growth has been particularly pronounced in Zurich (+40%) and Basel (+35%), but somewhat more moderate in Bern (+22%) and Geneva (+14%). Hotels in urban regions benefit especially from a higher share of business travellers, as well as from a growing trend towards city tourism. During the same period, the number of overnight stays in Alpine destinations fell by around 6%.

Development of overnight stays in Swiss tourist destinations



Source: FSO and Swiss Life Asset Managers

International hotel chains on the rise

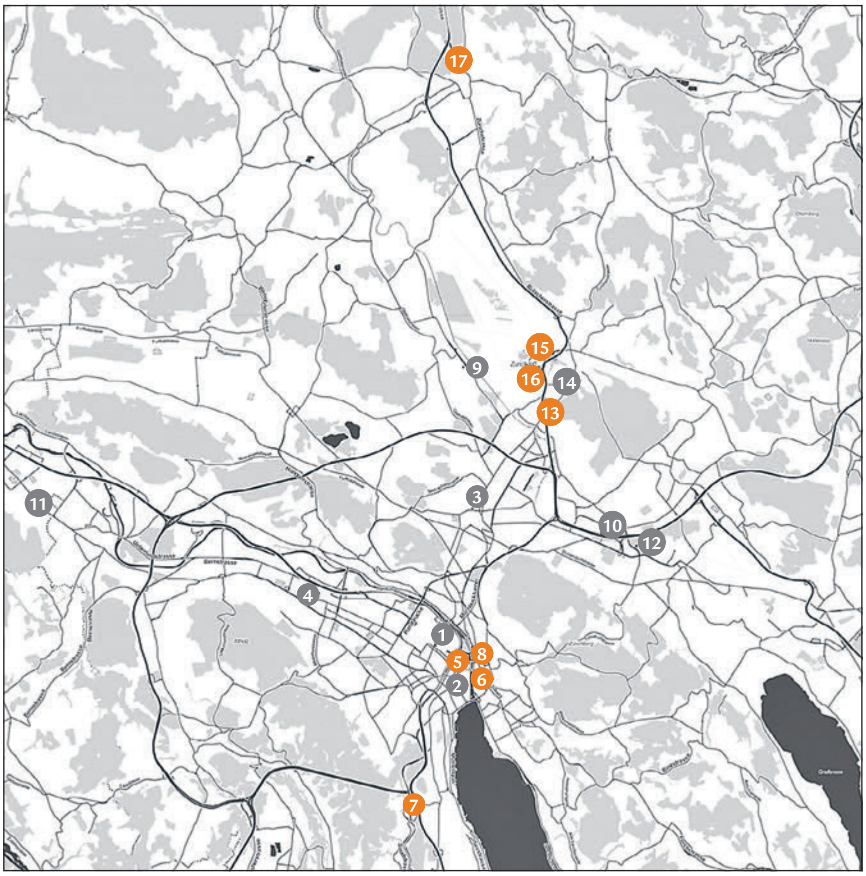
The pleasing figures posted for Swiss city tourism have not gone unnoticed abroad. Numerous international hotel operators have been looking to enter the Swiss market since 2017. As the example of Zurich reveals, the Swiss hotel industry is in a state of flux. Since 2017, eight new hotels with almost 1,600 rooms have opened in the Zurich region alone. At least nine further hotels with a total of 1,600 rooms are in planning for the end of 2021. The great majority of these hotels are run by international chains. The new offerings are concentrated in the city of Zurich and the conurbation communities near the airport. As at the end of 2018, there were some 120 hotels with 15,000 rooms in the city of Zurich. The planned project pipeline is to expand the offerings by over 10% in terms of the number of rooms.

Smart in the city

The market entry by new participants will intensify competition and create individual winners and losers. In addition to a strategically good location, clear positioning and specialisation are of pivotal significance. We believe innovative hotels with moderate prices and modern design in central locations continue to be promising. We are sanguine about the hotel projects of experienced providers, whose concept and immediate proximity to the airport specifically target the growth segment of business travellers. But established luxury hotels, too, are likely to continue enjoying very high booking rates in view of their unique selling propositions and clear focus on a particular clientele. In contrast, properties in peripheral areas with outdated concepts are in danger of being pushed aside. In such a challenging environment, precise coordination of customer needs and the services on offer, the selection of an experienced operator and meticulous location scouting will be critical success factors for hotel investments. ■

Swiss Life's European Hotel strategy is building up a Core/Core+ pan-European portfolio of mainly 3-star and 4-star hotel assets in urban locations, targeting stable income through indexed long-term leases and attractive returns for investors. The investment focus is on Western and Southern Europe. The strategy is supported by secular trends as e.g. increased travel to European gateway cities or millennial consumer trends and targeting international institutional investors.

Hotel projects in the Zurich region



City Center	Number of rooms	Year of opening
1 25 Hours, City District 4	170	2017
2 Motel One, City District 2	394	2017
3 Acasa Suites, City District 11	140	2017
4 a-ja Resort Zurich, City District 9	319	2018
5 Citizen M, City District 9	160	2019
6 Sorell Hotel St. Peter, City District 1	100	2020
7 Green City Hotel, City District 2	170	2021
8 Hotel Ruby, City District 1	210	2021

Outside City Center	Number of rooms	Year of opening
9 B&B Hotel Zurich Airport, Rümlang	170	2018
10 B&B Hotel, Wallisellen	142	2019
11 Hilton Garden Inn, Spreitenbach	119	2019
12 Hotel Harry's Home, Wallisellen	123	2019
13 Hyatt Place, Kloten	300	2020
14 Hyatt Regency, Kloten	250	2020
15 Intercity Airport West Gate, Kloten	250	2020
16 Leonard Hotel Zurich Airport, Kloten	116	2020
17 Niu Hotel, Glasquartier, Bülach	131	2021

● recently opened ● opening planned

Source: htr.ch and Swiss Life Asset Managers

Smart high street retail is the new high street in France

Retail bashing has been popular in Europe of late, but the high street retail sector in large French cities is performing well, despite the solid growth of online shopping. The combination of online and offline retail has enhanced profitability for retailers, as well as property returns for owners.

Beatrice Guedj, Head of Research & Innovation, Swiss Life Asset Managers France

In Europe, retail REITs are trading at an average discount of 30% below NAV due to an enduring risk aversion for shopping centres. However, according to MSCI, total returns for high street shop submarkets in wealthy European capitals held up well in 2018. In Paris for instance, total returns for these submarkets averaged 7.4%, while shopping centres overall were underperforming. High street shops in other large French cities remain in good shape despite an online sales growth trend of 14% p.a. since 2011.

Today, retail is multichannel and has gone "m-line" for mobile phones: m-commerce now represents 25% of the total turnover of e-commerce in France, according to Fédération e-commerce et vente à distance (national body which tracks digital retail turnover). In cities, synergies between online and offline are optimal for both consumers and retailers.

A lively area at 31, Boulevard Sébastopol in Paris.

Intelligent mix of online and offline

On the retailer side, online is a driver to enhance competitiveness. It also increases traffic in stores – by "click and collect" for instance. As such, digitalisation across the whole retail value chain enables retailers to optimally manage logistics and spread predictive algorithms in stores – and more specifically in high street shops where the storage space is limited. In Paris for instance, both luxury and mass market brands are able to customise ex-ante the right offer per district, street and shop. By profiling clients through quantitative techniques, using neural networks or artificial intelligence, brands are able to adapt algorithms and enhance their turnover per square meter across their high street shops' portfolio.

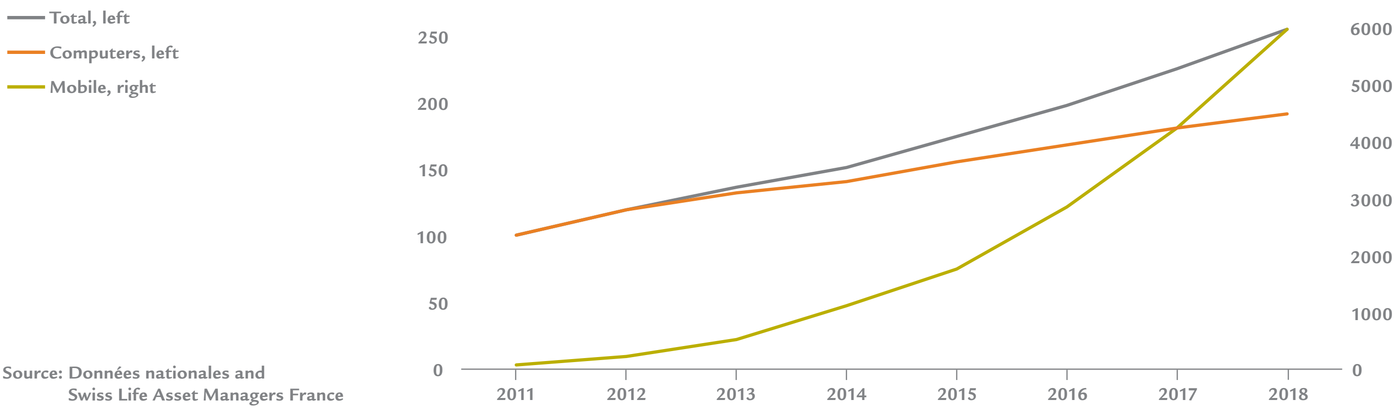
Major players in online market: unexpected changes

The high street shop market in France overall is being increasingly chased by pure players which struggle to fight against the exponential cost of reverse logistics: this is the other side of free delivery for consumer's loyalty. Last December, ASOS, the top British fashion online pure player, released an unexpected profit warning: its shares fell by almost 40%, triggering a domino effect on other major online brands in the wake of an increasing marginal cost of reverse logistics. Simultaneously, many online players announced a change in their business model, targeting more high streets. In France, major online retailers such as Fnac, Leclerc and Carrefour, representing 24% of the top 10 according to FEVAD, are optimising their high street portfolio, combining online and offline. Amazon, Vente privée, C-discount and Groupon (50% of online demand) are now looking for high street premises in France to boost their profitability as a whole, in addition to the traditional click and collect.

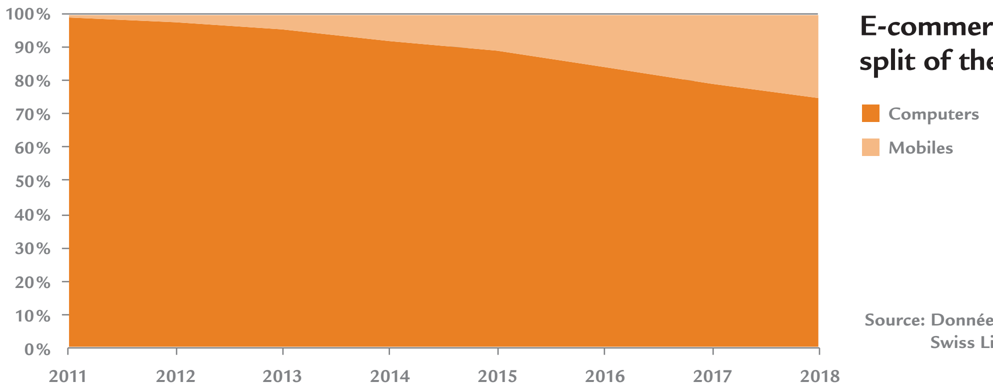
High street is also changing in other countries. Zalando, the German online fast fashion retailer, is probably ahead of the game in terms of online shopping experience, delivery and high street synergies with logistics. Although logistics has been the backbone of its operations, Zalando is now leveraging a wide network of high street retailers in Germany to offer a larger retail experience in terms of both products and delivery efficiency. Such a new business route tends to minimise reverse logistic costs whilst reinvigorating high street shops in secondary or tertiary cities. "Phygital" is the new retail high street reality. ■

Top online retailers are chasing high street shops to boost their profitability, given the high cost of reverse logistics. Phygital is the new retail high street reality.

Turnover trends overtime
Base 100 in 2011



Source: Données nationales and Swiss Life Asset Managers France



E-commerce – split of the turnover

Source: Données nationales and Swiss Life Asset Managers France

London offers attractive long-term real estate investment opportunities

London is well positioned for the future. It has many strong thematic characteristics; connectivity, networks and demographics, that augur well for long-term occupational demand. Supply of good quality space is set to remain constrained. Together these conditions should support rental growth.

Frances Spence, Research, Strategy and Risk, Mayfair Capital Investment Management Ltd

The EU referendum result sparked concerns about the London real estate market. Whilst the UK has not yet left the EU, so far London has proved very resilient. Job creation has been strong and numerous international corporates, including Google and the European Bank for Reconstruction and Development, have made major new commitments to the city.

A more diverse tenant base

London's tenant base has become increasingly diverse in recent years as its employment growth has been weighted towards knowledge-based roles in the professional, scientific and tech sectors at the expense of the financial and insurance sector. These industries operate in a worldwide marketplace where access to talent is the primary locational driver. On this basis, London competes with other global cities rather than being considered within simply a UK or pan-European context. This suggests that London will be less exposed to political risks arising from Brexit than originally feared.

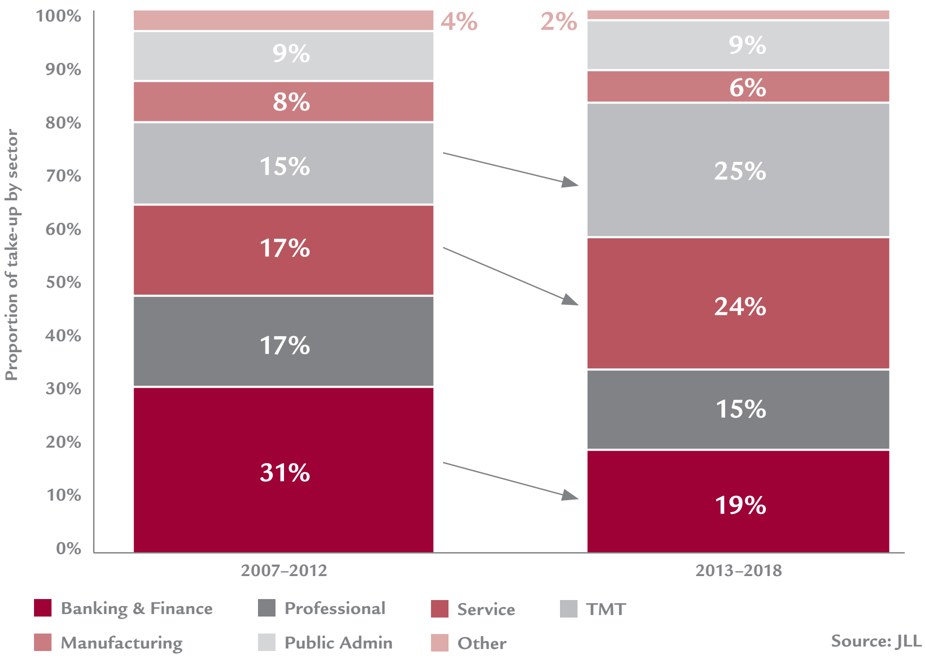
London's long-term competitiveness will be undiminished

Furthermore, London is expected to remain a popular destination for talent and occupiers regardless of the Brexit outcome, as much of its attraction is tied to factors that are independent of the UK's EU membership. These include location, timezone, language, workforce, infrastructure and culture. Recent occupational leasing activity and global talent surveys demonstrate London's enduring popularity even since the referendum. For long-term capital seeking a secure asset, the investment case for London remains compelling.

Risk of short-term volatility

London is expected to be more resilient to Brexit than widely forecasted, but it will not be immune to a change in the UK's relationship with Europe. Financial and insurance services are most exposed given their reliance on regulation, but job migration to date has been fairly muted. It is anticipated that Brexit-related uncertainty will create some volatility in the market in the shorter-term. For those prepared to take a longer-term view, this volatility may present a buying opportunity.

Office leasing activity in London has become more diverse



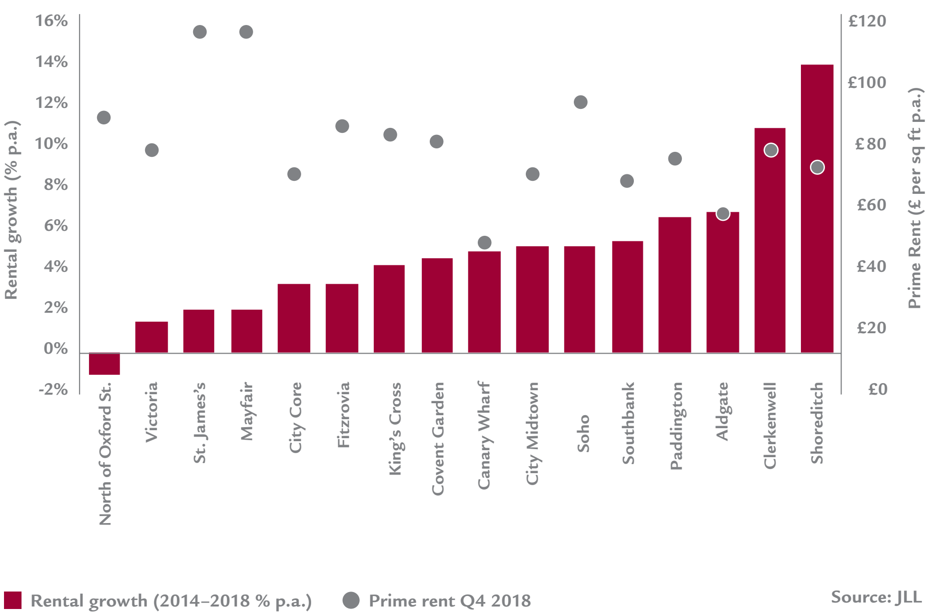
Source: JLL

Performance will vary between submarkets

While occupational market conditions at a headline level have been positive in London, there are significant variations between submarkets and rental growth has been uneven. In part, this is due to differences in the supply/demand dynamics, but it can also be attributed to the transformative impact of investment in new infrastructure and urban realm improvements. A number of submarkets will benefit from transport improvements, such as the new Elizabeth line, and broader urban renewal. Resultantly they are well placed to outperform as increasing occupational demand underpins strong rental growth potential. These submarkets include Paddington, the Southbank and the fringe of the City core. As a consequence, detailed and localised analysis to understand the dynamics within a submarket is essential when evaluating opportunities. ■

Prospects for the London property market are strong, but performance will not be uniform across the city. Understanding submarket dynamics is critical.

Office rental growth across London has been uneven



Source: JLL

The Bonhill Building, Shoreditch, London – recently acquired by Swiss Life Asset Managers.

Source: Colliers International

How much digitalisation does the real estate industry actually need?

Everyone is talking about blockchain, big data and smart leases. At the same time, we all want simple, sustainable products and digital detox. How can we square this circle? The real estate industry needs answers. And inspiration could well come from an unlikely source: an iconic off-road vehicle.

Holger Matheis, Member of the Executive Board, BEOS AG

It is only natural for everyone to want their company to be hailed as an innovator, a thought leader. At the same time, it is important to ask to what extent digital technology is actually helpful. After all, more is not always better. Instead, companies should first decide whether they would be better off with an analogue or a digital product. Secondly, they should apply this question to analysing their own processes.

The automotive industry as a source of inspiration

The importance of distinguishing between products and processes can be clearly illustrated with an example from the automotive industry. Various models of the Land Rover Defender were produced for well over 70 years, and the vehicle changed very little over time. The Defender's engineers made the most of the vehicle's sturdy but simple design and overwhelmingly analogue components. And this simplicity undeniably paid off. Right now, roughly three-quarters of the Land Rover Defenders ever produced are still roadworthy. Another major factor behind the vehicle's success is its versatility. The Defender is not only a fantastic off-road vehicle, it also makes a great fire engine or ambulance.

While the product has hardly changed over the years, the same cannot be said of the Defender's production processes. In the years before automated production, Defenders were produced by hand. The subsequent introduction of industrial robots led to higher precision, increased productivity and lower costs.

Source: BEOS AG

The Küpferhütte in Cologne's Carlswerk prior to modernisation...

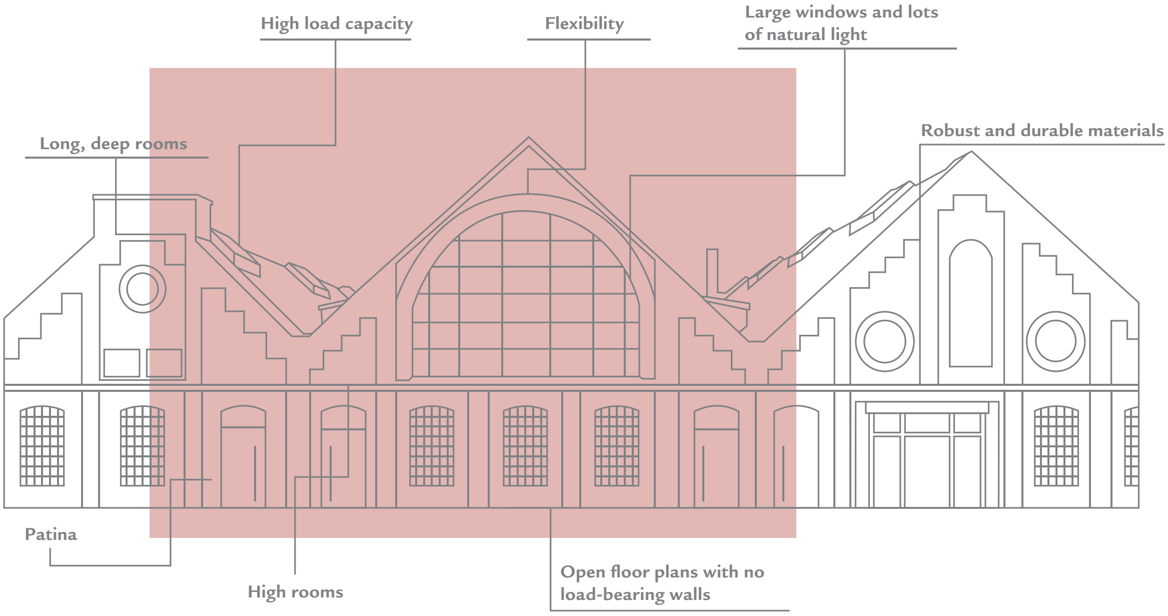
A "teaching moment" for the real estate sector

The parallels between the Land Rover Defender and the real estate industry are unmistakable: rather than robotic arms, our focus is on how digital asset managers and other players can best coordinate their processes, and whether the "Land Rover philosophy" can also be applied to real estate as a "product". The principle of building simple, robust and flexible real estate would seem to stand in opposition to the trend towards "smart buildings", where ceiling lighting adjusts autonomously and heating systems report damage without human involvement.

When a real estate company needs to decide to what extent digitalisation makes sense, the following questions should be considered: how flexible, variable and scalable is the analogue or digital product? How often is a new digital service actually used? Does it offer its target users real added value? As a rule of thumb, wherever the analogue solution is more sustainable, companies should remain consistently analogue.

Taking all of these factors into account, we are convinced that a middle way between analogue and digital is currently the best option for the real estate industry – you could even refer to it as "phygital". On the one hand, buildings should be simple (and analogue) enough to ensure that they can be flexibly divided and repurposed to satisfy the evolving space requirements of the future. But on the other hand, there are so many administrative processes – from document management to tenant communication – which are crying out for new digital approaches to increase both efficiency and service quality. ■

... and after its transformation into a state-of-the art business centre.



Simple, robust, flexible, modular, low-tech and cost-effective – a building that meets these and other criteria is not only sustainable, it also creates added value.

Source: BEOS AG

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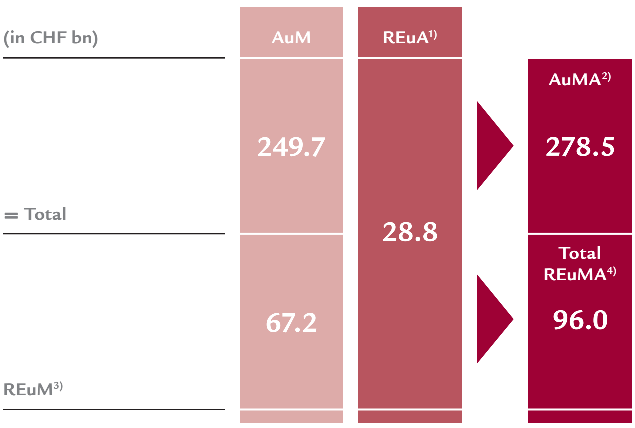
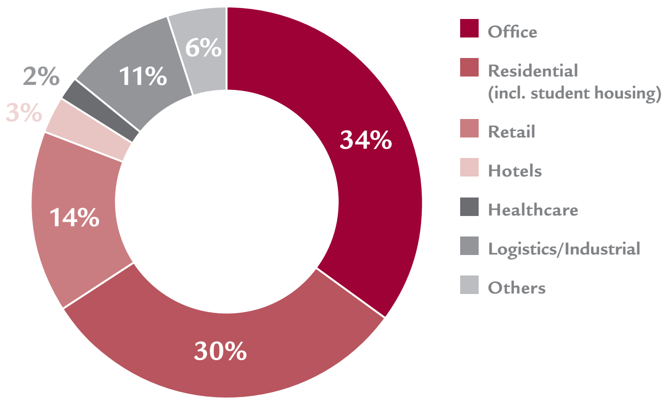
Real estate – facts and figures

Assets under Management and Administration



[1)]Real Estate under Administration (not included in Swiss Life AuM definition)
[2)]Assets under Management and Administration [3)]Real Estate under Management
[4)]Real Estate under Management and Administration

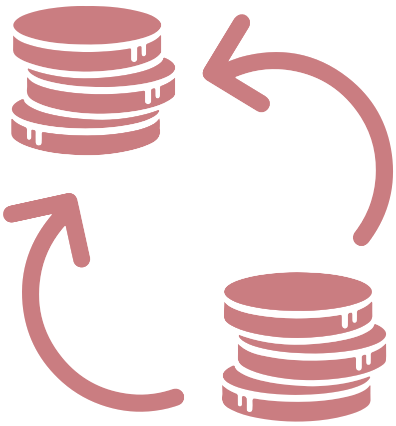
Breakdown by real estate sector



REuM CHF 67.2 bn

Transaction volume real estate

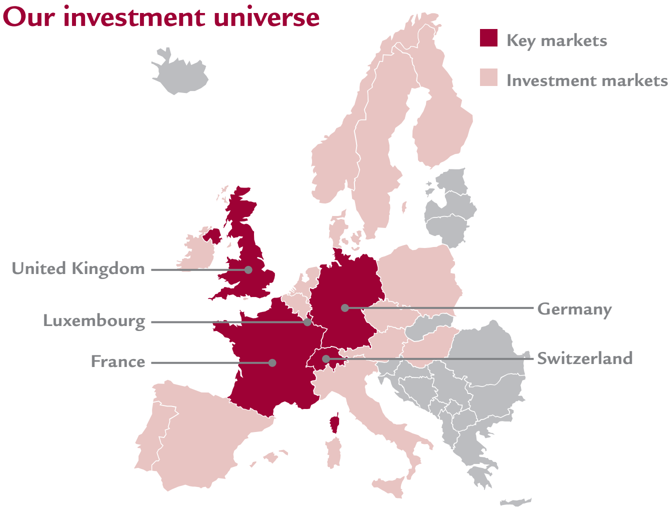
(in CHF bn)



7.9

(average 2016, 2017, 2018)

Our investment universe



All figures as of 30 June 2019, unless stated otherwise.

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