Real Estate House View
Strategy Implications

SwissLife
Asset Managers

First half of 2022

Key takeaways

- **Fishing in the same pond threatens opportunities:** Demand is focused on Core/Core+, and there are limited prime opportunities available in many markets.
- **Monitor price developments**: In sectors and subsectors that are considered "safe", i.e. Logistics, CBD office, Residential and Healthcare, there is a tendency for price to become decoupled from fundamentals. Higher returns can be found away from the most crowded parts of the market.
- **Rebalance portfolios**: This would take the focus of where to deploy capital away from industrial/logistics, residential and retail parks. Some retail may already have bottomed out, but central office and multi-family housing continues to look promising despite price developments, along with more "niche" sectors such as self-storage, life science and data centres ("beds, sheds and meds").
- **Prevent "stranded assets":** Fulfilling ESG requirements and repurposing well-located city-centre space to meet future demand can protect values (vs secondary markets).

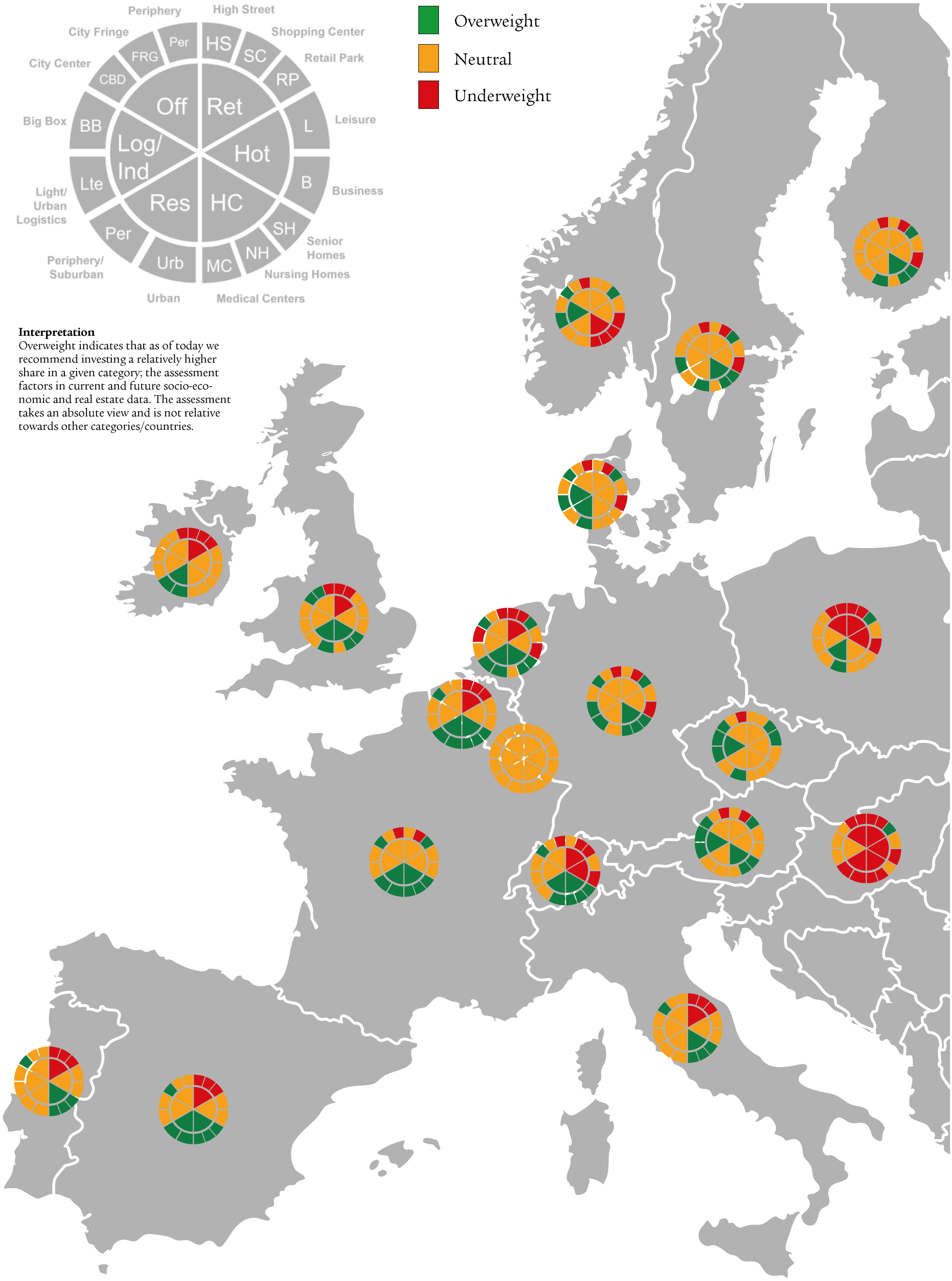
Strategy implications – *type of use and regional focus*

	Office	Retail	Industrial/ Logistics	Residential	Hotel	Healthcare
What	Well-connected location, "new work" standard, ESG labelled	Convenience shops, local supply	Urban logistics, 'big box' logistics in relevant logistics regions with access to traffic infrastructure, light industrial, self-storage	Metropolitan areas with favourable socio-economic fundamentals, overweight in multi-family properties	Main metropolis with exposure to leisure and domestic travel	Focus on care in old age, later living, good operators
Where	European capitals, peripheral locations only with excellent connections	Selected cities across Europe	Metropolitan areas/regions with good traffic infrastructure in Germany, France, the UK, Benelux, Nordics	Germany, Switzerland, France, the UK and the Netherlands	Selected cities such as Barcelona, Vienna, Amsterdam, Berlin and Paris	Around wealthy populations in Germany, the Netherlands, France, the UK

European environment

COVID-19 measures are being eased almost everywhere in Europe. This raises the question of what the "new normal" means for the real estate sector. Are we really going to see hybrid working only? What will happen to business trips? And what new non-sectors will emerge in 2022? After all, investments will continue. Yields continue to fall, and prices continue to diverge from fundamentals. At the same time inflation is coming into play, which will have an impact on interest rates. As a result, it may be that some "too low" returns from 2021 are revealed, and the real risk of a property becomes apparent. In addition, demand – and thus the required resources – for ESG is high, which will influence some existing business plans.

Market investment – *overview*



Interpretation
Overweight indicates that as of today we recommend investing a relatively higher share in a given category; the assessment factors in current and future socio-economic and real estate data. The assessment takes an absolute view and is not relative towards other categories/countries.

Office sector – *neutral*

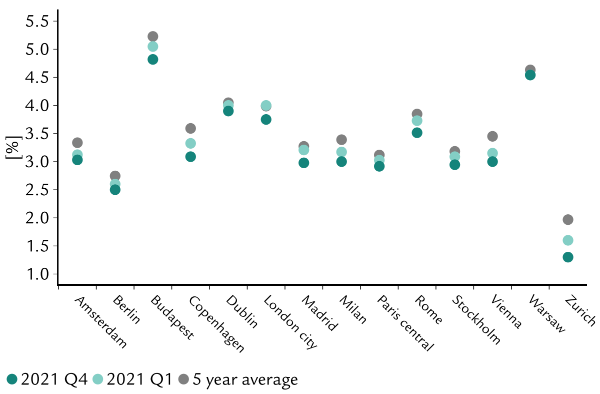
Favoured strategy:

- Well-connected location, "new work" standard, ESG labelled
- European capitals, peripheral locations only with excellent connections

The impact of changing working practices continues to create significant uncertainty within the sector. It is anticipated that the mix of office and home-based working will result in less demand for space overall, but a far greater emphasis on quality and service as well as ESG aspects. These will have significant implications for capital expenditure requirements, which could impact returns. As a result, we remain neutral overall. Moving forward, demand is expected to converge on modern, well-connected, flexible, amenity-rich accommodation with strong ESG credentials. Asset selection will be key when investing, as occupiers become more demanding, and there will be increasing polarisation between assets within the sector. For some investors it might be a good idea to act as smart sellers.

At the same time, office is probably one of the sectors where investors' "herd-like" behaviour is most visible: everyone striving for the same quality of assets reduces opportunities and increases prices. In order to achieve a good performance, it may make sense to consider less metropolitan, more secondary markets (B-cities), but focusing on A-locations within these markets. This way we have the amenities we want in an asset, but are investing slightly away from the crowd. In doing so, due diligence of the asset quality and the tenant (prospects) is even more important.

Prime net yields office



Source: PMA, RIWIS, Wüest Partner

United Kingdom – *neutral*

Occupational demand is picking up as employees return to the office in greater numbers. Several requirements that were shelved at the start of the pandemic have been reactivated. Yet uncertainty about the future of work seems to be highest in the UK, most likely due to its well-known fast adaptation to new trends. In light of this, well-connected, amenity-rich locations such as London and the "big six" markets are expected to perform well, and we would favour centrally located assets in these markets. Asset specification will be critical. High-quality offices with strong ESG performance and a good service offering should deliver rental growth.

France – *neutral*

Both the letting and investment markets are highly polarised, with letting activity gaining traction in Paris compared to outer sub-markets characterised by historic vacancies. This means that rents and prices are moving in different directions: rising in Paris, stabilising or continuing to fall elsewhere. The city of Paris and the recently built prime assets that include all the required features (ESG) need to be overweighted. Investment activity is low due to the shortage of products, with the exception of value-add and build-to-core strategies. Regional markets such as Lyon and Marseille continue to be defensive, with potential upside and attractive returns.

Germany – *neutral*

Focusing on top-quality properties in prime locations highlights the well-known top 7 cities. We would advise caution particularly when it comes to Stuttgart due to its high dependency on the automotive industry. Berlin's momentum is being driven by a number of developments, meaning that state-of-the-art space is coming onto the market (with high quality and ESG conformity). That is why Berlin has a higher valuation than Munich for the moment, as Munich has fewer ongoing developments. Germany is also a good market in which to take a closer look at A-locations in B-cities, as there are quite a few well-established regional office markets.

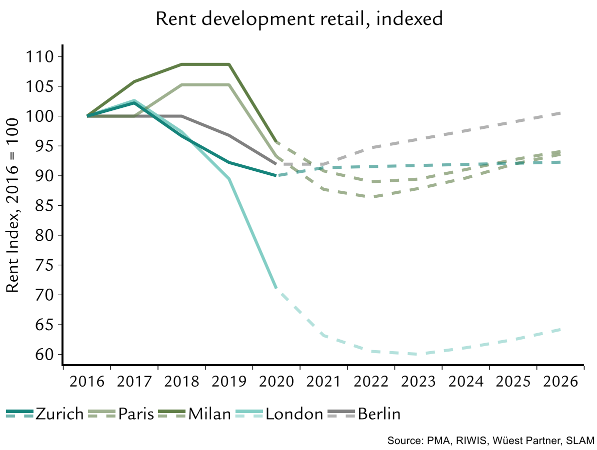
Retail – *underweight*

Favoured strategy:

- Convenience shops, local supply
- Selected cities across Europe

Is now the time for opportunistic retail investment? The fact is that some retail has become very cheap – for very good reason. Investing in these assets needs a lot of experience and maybe a crystal ball to predict how retailers will present themselves and, even more, how consumers will behave. The latter depends on travel activities, inflation and the change in e-commerce (or even quick commerce, driven by an increasing need for convenience). Core/core+ investors will focus on existing retail, and managing future expectations is one way to go, but also investing in retail that we consider a little more robust. That includes food retailers that are easily reachable locally, as e-commerce needs a little more time to be implemented. Retail parks may also offer a good opportunity depending on the number of people within reach. Additionally, a few more opportunities are emerging on high streets as travel picks up again, yet we are cautious regarding future retail formats.

Our prudence regarding future retail formats and the yet unknown possibilities of e-commerce are also the reasons why we are keeping our weighting of the sector at "underweight", possibly with some exceptions in the retail park sub-sector across Europe. Thinking strictly from a consumer's (convenience) perspective and figuring out your retailer's strategy is mandatory in this time of constant change.



United Kingdom – *underweight*

Retail performance continues to lag behind, and is expected to continue to do so as the sector adjusts to the increased share of purchases moving online. While there will always be a place for physical retail the market is oversupplied, and more repurposing of units is needed before the sector stabilises. The weak outlook for rental growth means that we remain underweight. Our weighting is driven by our expectations on the high street and in shopping centres. Our rating for retail warehousing would be neutral. Parks in urban or sub-urban areas are expected to be the net beneficiaries of structural change due to their ability to service home workers and support online fulfilment, as the availability of car parking supports the servicing of click and collect orders. In larger urban centres there is also a nascent trend towards repurposing retail parks for urban industrial units. The falling income yield means that we are neutral rather than overweight.

France – *underweight*

More local retail destinations have been doing better than larger ones. Store-based retailing on the high street and in shopping centres is becoming more polarised and concentrated, as traditional players retrench or go out of business altogether, leading to a fall in store numbers, rising vacancies and falling rents. Overall, big box formats have suffered less so far. Central Paris heavily depends on tourist spending, with the pandemic lowering this demand. There is a sharper increase in vacancies as some retailers scaled back their store networks or simply ceased trading. We expect yields to soften again over the short-term, particularly for out-of-favour shopping centres. Combined with falling rents this is generating low single-digit total returns for both city shops and malls.

Germany – *neutral*

Germany seems to have reached a turning point, with prime yields for classic retail (high street and prime/dominant shopping centres) stabilising, while investment volume is still low. Retail parks and everything grocery-related are still performing well, and investors are seeking this "safe haven" in this uncertain sector. Yet these few opportunities are expensive as demand is high, possibly leading to yields that do not correlate with the fundamentals. Inner-city areas will remain the preferred location in the long run.

Industrial/logistics – *neutral*

Favoured strategy:

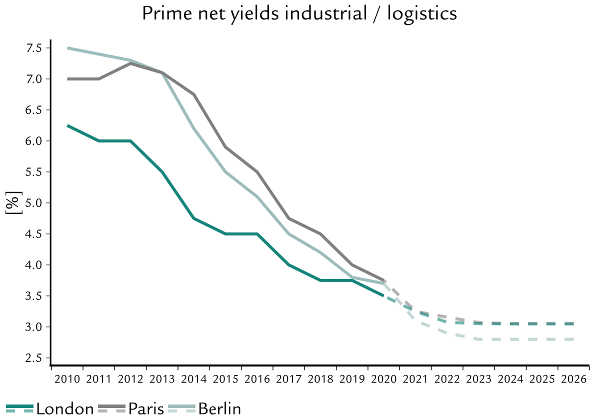
- Urban logistics, 'big box' logistics in relevant logistics regions with access to traffic infrastructure, light industrial, self-storage
- Metropolitan areas/regions with good traffic infrastructure in Germany, France, the UK, Benelux, the Nordics

Everybody has warmed up to industrial/logistics. And 2021 has shown that this disposition has its rewards: the logistics sector continued to outperform the wider market as it benefits from structural changes accelerated by the pandemic. These include the sharp increase in e-commerce and associated requirements for warehouse space and supply chain reconfigurations to accommodate more inventory and mitigate the risk of supply chain disruption. These trends should continue to support demand, and while there has been some development response, a lack of supply should be supportive of further rental growth. However, investor demand has driven yields down to record lows, and we are seeing an increasing risk of mispricing.

This is also why we are now advising caution. Some of the pricing we have seen seems to be decoupled from the fundamentals and purely driven by investor demand. Therefore, for some portfolios it might be a good time to consider rebalancing industrial/logistics. For others, a very selective approach is advised, as we still consider the fundamentals to be supportive.

A new sub-segment that we are currently observing is "self-storage". While some formats are emerging in the UK, these are scattered and hard to get. Yet we believe that this is a trend to watch in continental Europe too.

Prime net yields industrial / logistics



Source: PMA, RIWIS, SLAM

United Kingdom – *neutral*

Industrial remains the outperforming sector as its occupational market continues to be supported by structural changes. Investor appetite for logistics and industrial assets is strong. Investment volumes have more than doubled, and yields have fallen to their lowest recorded level. Key locations to target will be inner-city locations in London and the "big six" markets that are able to service last-mile logistics; peripheral/out-of-centre locations with good accessibility to large conurbations, and sites adjacent to an infrastructure hub, such as significant UK airports, seaports and railway links. We remain neutral across the sector, but asset specification will be critical to determining future performance and should be assessed in detail.

France – *neutral*

The French logistics market has observed record take-up driven by high demand from various types of tenants (e-commerce, distribution, industrial) while the development pipeline is limited. The positive letting market, i.e. the strong interest in logistics from institutional investors and fierce competition, have generated significant yield compression over the past six months. A potential low point will be reached within the coming quarters. For large logistics assets, we are focusing on the main axis of Lille-Paris-Lyon-Marseille and the main regional cities outside of the axis: Bordeaux, Nantes, Toulouse, Strasbourg etc. Parcel delivery and industrial or light industrial assets could be revealed in other locations.

Germany –*neutral*

As one of the main logistics markets in Europe, Germany now finds itself in the midst of the investment hype. Take-up is high and rental growth almost certain, as most rents are inflation-indexed. As construction costs have also been increasing, even rents in secondary markets cannot be considered cheap anymore. Again, asset selection is important with regard to overpaying. Concerning the regions, we favour Hamburg, Bremen, Berlin, Leipzig, Frankfurt and the Ruhr region when it comes to the fulfilment of e-commerce demand, as well as Middle Franconia, the Munich region, Stuttgart and Wesel (due to harbour access). In secondary markets we are observing an "area expansion" (secondary markets also have catch-up potential).

Residential – *overweight*

Favoured strategy:

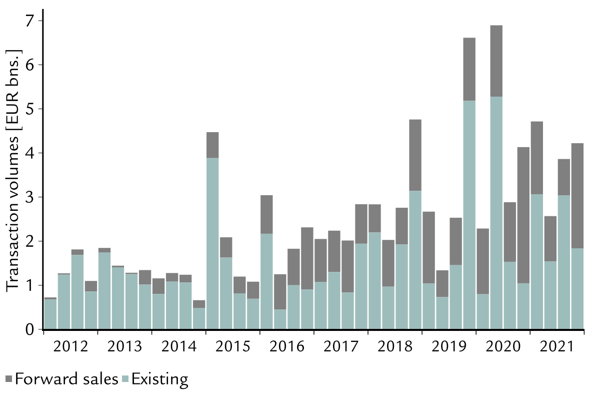
- Metropolitan areas with favourable socio-economic fundamentals, overweight in multi-family properties
- Germany, Switzerland, France, the UK and the Netherlands

As there is ongoing demand for the relatively stable residential sector in Europe, the question of whether yields at hand (sometimes well below 2%) are enough to fulfil return targets is becoming more pressing. At the same time the implementation of sustainability measures for existing stock usually comes with unplanned CAPEX requirements that further impact the overall performance.

In most markets, however, especially the ones that were not originally residential markets such as the United Kingdom and France, the sentiment towards residential is very positive. This stems from the fact that house prices have been surging and people are increasingly moving into rental apartments. But this in turn will also increase rental values, to the extent that at some point the question of affordability will have to be tackled. Overall, the residential markets in Europe are the most prone to regulations which we will need to monitor in order to figure out the possible impacts when investing and on investment sentiment overall.

That said, we are keeping our overall assessment for the European residential sector at "overweight", given the income stream stability and strong tenant demand.

Residential transaction volumes France and UK, quarterly



Source: RCA

United Kingdom – *overweight*

Underlying demographic trends are supportive of this sector. Rising house prices combined with a growing preference from some types of consumer for rental product are underpinning sustained levels of demand. Furthermore, due to tax changes there has been an exodus of private landlords from the market, thus reducing supply. Demand continues to outpace supply as a result, creating scope for strong rental growth. London has been underperforming the regional markets as there is more rental product available. There are signs that demand is improving, and the outlook is strengthening. The higher volume of supply in London, however, means that opportunities are likely to be greatest in the regional markets, particularly given the yield discount. Locations with strong socio-demographic characteristics and an under-supply of good quality assets, such as the "big six" and affluent M25 towns, are expected to be most attractive.

France – *overweight*

The French residential market is very positively viewed by European investors, yet the main demand is still coming from domestic investors. The letting sector is new compared to other peer markets, and the supply is very tight across all key cities. The French market is beginning to see consistent yield compression, though it remains modest. Yet French net initial yields are the lowest among the major European markets at 2.2%. The lack of products should call for build-to-rent strategies and other alternatives such as co-living.

Germany – *neutral*

As this is an established residential market, our neutral assessment stems from uncertainties regarding regulations and other political interventions such as the reduction of the modernisation apportionment, restrictions on the conversion of rental apartments into owner-occupied apartments, and the anticipated division of the CO_2 levy. Furthermore, the political direction of the new government is not yet clear. With regard to locations, we prefer catchment areas over (top seven) metropolises as there is less regulation and more room for rental growth as they start from a lower level.

Hotel – *neutral*

Favoured strategy:

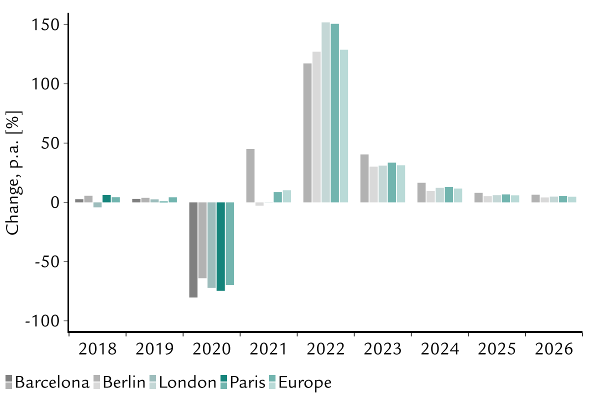
- Main metropolis with exposure to leisure and domestic travel, average of 100-200 rooms
- Selected cities such as Barcelona, Vienna, Amsterdam, Berlin and Paris

After the vaccination rates did not provide the desired travel simplification, the current virus variants seem to allow a clearer outlook for the hotel sector. Assuming that future variants also behave in a similar way, we anticipate that the hotel market will get back on track in 2022, although we expect overall travel figures to only return to pre-pandemic levels by 2026 (if at all, as the question of the future level of business travel remains). Leisure travel is already seeing a sharp upward trend. Large fairs and conferences might remain a thing of the past, or of the distant future.

In view of this, hotels are facing a shortage of staff which is limiting their operating facilities. Digitalisation would help to reduce (operating) costs and to increase staff and guests' satisfaction, and will become essential in the future. Budget hotels are expected to be most resilient to rising costs, given their limited food and beverage offering and lower staff headcount.

Overall, we are keeping our assessment at "neutral" as we believe the repricing has already been done, although many uncertainties remain, and investing in hotels comes with selective investment behaviour.

Development of hotel total overnight stays



Source: PMA

United Kingdom – *neutral (previously: underweight)*

Hotel trading has been strong due to high levels of domestic demand, and the sector offers attractive inflation-linked income that may offer an inflation hedge given the current economic backdrop. However, the sector faces headwinds from rising costs, and there is still considerable uncertainty related to the pandemic and the potential for new restrictions over the winter that would have a significant impact on the short-term prosperity of the sector. Core, city-centre locations in markets that offer a diverse clientele such as business, leisure and university-driven demand are expected to offer the best prospects.

France – *neutral*

Most hotels reopened over the summer of 2021, showing improvements in occupancy figures. However, performance is expected to decline in the winter period until corporate business and air travel conditions improve. Domestic demand is the main driver at the moment and, apart from Paris, some regional markets have also seen the return of leisure visitors. The investment market remains quiet as no products are being offered. On a positive note, there have been no distressed sellers and values have not fallen markedly.

Germany – *neutral*

In the German Top 7 markets we are seeing a relatively high pipeline within the next two to three years. This is putting pressure on existing operators, which are generally already struggling with occupancy and finding it difficult to cover their costs. Lower operational costs are also the reason why serviced apartments are sometimes competing with hotels in some markets. At the same time, investment volumes are showing signs of recovery, mainly driven by the recovery in domestic demand. Some investors are discussing the potential transformation of vacant/struggling hotel properties into healthcare properties. According to Colliers, 1500 hotels in Germany would be suitable for such a conversion. As regards the regions, we would focus on city tourism magnets such as Munich and Berlin, B/C-cities that are popular with domestic tourists (such as Heidelberg, Dresden and Nuremberg) plus holiday regions (benefiting from a large share of domestic travellers and the staycation trend)

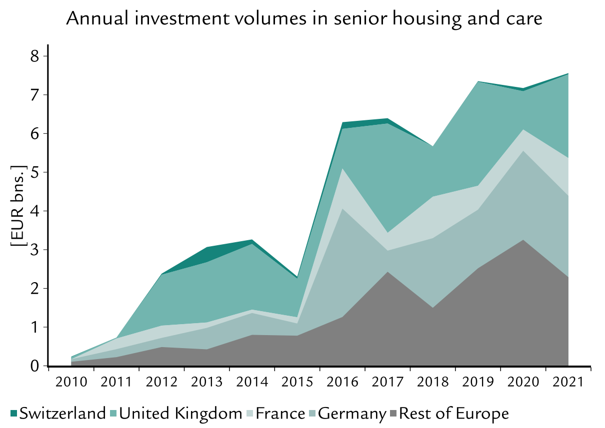
Healthcare – *overweight*

Favoured strategy:

- Focus on later, longer and self-determined living, good operators
- Germany, the Netherlands, Belgium, France, the UK and southern Europe

"Operator, operator, operator" might be the bon mot when it comes to investments in the sector. While the fundamentals remain a clear given (aging population, demand for medical services), operating these facilities poses a greater challenge. Due to the pandemic, a lot of health-care personnel reached their energy limits, and "work-life balance" is also a big topic in this sector. Having enough staff on hand is a good investment criterion, as well as choosing locations near vocational schools. Making sure that the operator treats their staff well should also be on the checklist. In addition, the financial situation of potential occupants is an important consideration, as most later living facilities still require relatively high payments.

We are keeping our assessment at "overweight" as we strongly believe in the fundamentals driving the sector. Yet the challenges in getting a healthcare product onto the market that fulfils the requirements of the operator are higher than in other sectors. Furthermore, regulations are also tightening here, which is leading to investors shifting their focus towards senior housing rather than care facilities.



Source: RCA

United Kingdom – *overweight*

There is a compelling investment case for good quality and well-located elderly care and later living stock in the UK. This reflects its chronic undersupply and ageing demographic. Therefore, the strongest prospects are likely to be focused on affluent catchment areas that are under-supplied with good-quality properties. Elderly care acquisition must involve careful stock selection based on location and specification as well as covenant, as cost pressures are increasing for operators. Later living is an emerging sub-sector which has limited provision at present. It is expected to see rising demand as an alternative to elderly care, and will be viewed more favourably given its successful handling of the pandemic. In view of the lack of provision, accessing investment-grade stock will be challenging, and forward funding is likely to be needed.

France – *overweight*

The sector has been seen as very defensive, with investors again pouring in over €1.1bn across all sub-asset classes (nursing homes, senior housing and clinics) in 2021. However, the publication of a book called "The Gravediggers" in January 2022 acted as a bombshell for the nursing home sector. Share prices of French operators have plummeted and the government has launched investigations. We expect such turmoil to put pressure on the investment market as a whole.

Germany – *overweight*

The intact fundamentals are supporting the sector in developing into a mature rather than a niche sector in Germany. Stable cashflows attract investors, yet a shortage of supply is limiting investment opportunities. We recommend investing in both nursing homes and assisted living, as there is a need for 300-500 thousand beds up to 2040. To summarise, the location is not that important as long as the socio-economic factors (such as purchasing power, positive demographics and catchment area) are intact. However, the proximity of vocational schools is important since this helps to secure the availability of employees, as healthcare employees seem to remain in the region where they received their education.

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