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REAL ESTATE CONVICTIONS EUROPE

The fund manager's view of real estate markets in Europe

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CHIFFRES

EUROZONE GROWTH FORECAST 2019

1.3 %

EUROZONE INFLATION FORECAST 2019

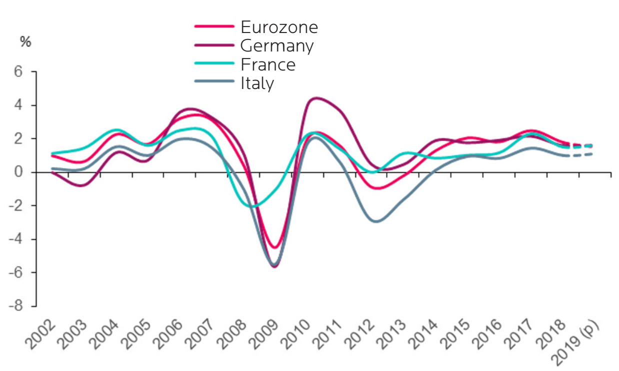
1.6 %

YIELD ON 10 YEAR GOVERNMENT BONDS IN THE EUROZONE 2019 FORECAST

1.3 %

Source : BCE

ECONOMIC ENVIRONMENT: GDP IN EUROPE



Sources : Primonial REIM Recherche & Stratégie based on Oxford Economics and national statistics institute data

ECONOMIC OUTLOOK

A global economy stuck between slowing momentum and uncertainty. GDP growth in the eurozone remained weak towards the end of 2018 and the latest indicators suggest weaker than expected activity in 2019. The escalating trade war between the USA and China began to have a negative impact on global growth and the effects will continue to be felt in the first half of 2019. Germany, which is on the brink of technical recession, suffered badly from the introduction of new anti-pollution standards and the slowdown in the global automobile industry. Italy was not spared either, with political and financial risks putting pressure on domestic demand and the financial markets. Other factors that could lead to a deterioration in current growth forecasts are the risk of a hard Brexit and a sharper slowdown in China.

Although eurozone growth has been revised down for 2019, there are still some factors that should drive a gradual recovery, such as the accommodating monetary policy, wage increases, an upturn in foreign demand and a degree of budgetary loosening. As these favourable factors gradually begin to kick in, eurozone GDP growth could rise from 1.3% in 2019 to 1.5% in 2020. Inflation is expected to fall in 2019 due to the increase in oil prices. However, core inflation will continue to rise, reflecting the regular though moderate improvement in economic activity and the labour markets.

Despite uncertainties, the real estate market is trending up in 2019. Listed real estate companies bounced back early in the year, outperforming the equity market, a logical consequence of the negative momentum in the growth outlook. Investors were awaiting the ECB's decision on interest rates and the verdict was delivered at the beginning of March: no change of direction, with the ECB leaving its interest rates unchanged to support economic activity in an uncertain environment. In this climate, the commercial real estate investment market should deliver another strong performance in 2019, not far off the excellent years in 2017 and 2018. On the user side, the number of transactions could slow down due to the economic environment. However, the record low vacancy rates in the key eurozone markets will support positive rent growth. Regarding retail assets, investors are likely to become more selective in terms of both activity and location, due to the transformation currently sweeping through the sector. Investment in residential real estate is expected to rise further in 2019, supported by the intrinsic drivers in this asset class: strong demand for housing due to increasing urbanisation, diversification, inflation hedging and the low volatility of this asset class. Residential investment should therefore continue to grow in 2019. Lastly, in the healthcare sector, the number of investors moving into this asset class on a pan-European level should continue to grow. On the tenant side, big healthcare operators continue to consolidate.

Source of data: Oxford Economics

OFFICES

INVESTMENT IN COMMERCIAL REAL ESTATE IN EUROPE* - 2018	€265 bn
TREND IN YIELDS IN 2018	→
TREND IN TAKE-UP IN THE 15 KEY MARKETS* IN 2018	↘
TREND IN VACANCY IN THE 15 KEY MARKETS* IN 2018	↘
TREND IN RENTS IN THE 15 KEY MARKETS* IN 2018	↗

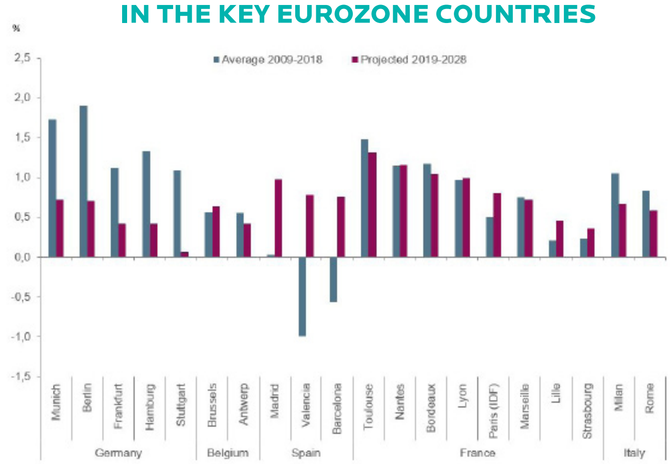
Investment remained stable in 2018. Investment in commercial real estate in Europe totalled €265 billion (-1% year-on-year). Germany, France and the Netherlands captured most of the investment in the eurozone with more than €110 billion. Conversely, investors were more cautious as regards countries with high political risk. This was the case for the United Kingdom and Italy. The office sector accounted for 45% of investment.

Pressure on yields eased slightly. Prime yields were at a record low, particularly in Berlin, Paris and Munich, with yields of 3% and less. While yields in all of Europe's major cities contracted by between 5 bp and 60 bp at the end of 2018, London's prime yield held steady at 3.5%. Investors looking for yields of 4% or more had to turn to cities such as Dublin, Brussels and Luxembourg, for example.

European take-up: a year of two halves. Although 2017 will remain the decade's record year in the 15 key European office markets*, 2018 delivered a more than honourable performance with take-up of just over 10 million m². Despite a downturn (-5% year-on-year), the Paris region remained the top market in Europe with take-up totalling of 2.5 million m² in 2018. Next but well behind Paris came London, where take-up increased to 1.4 million m², driven by small and medium businesses. With just over 3 million m², Germany's four major cities together comprise a market comparable to the large European office markets in Paris and London. Smaller cities enjoyed strong rental momentum (Vienna, Luxembourg, Lisbon and Milan).

Vacancy continued to decline, reaching a new low. The vacancy rate in the 15 key European markets* averaged 6.4% in the first six months of 2018, a decrease of 110 bp year-on-year. The 2018 rate may well be a floor level. While the vacancy rate declined in all of the 15 key European markets*, Luxembourg and the German cities recorded the lowest rates, particularly Berlin with just 1.7% in 2018. Amsterdam recorded the largest decline in the vacancy rate over one year.

JOB CREATION MOMENTUM IN THE LARGE CITIES IN THE KEY EUROZONE COUNTRIES



Sources : Primonial REIM Recherche & Strategy based on Oxford Economics data

In most European cities, office rents rose or held steady. London was once again the exception to the rule, with a 2% correction in its prime rents over one year. Madrid enjoyed the highest increase with rents up 13% year-on-year. Paris (€857 per m²), Dublin (€670 per m²) and Luxembourg (€600 per m²) recorded the highest rents in the eurozone.

Source of data: BNP PRE, CBRE
*Including the United Kingdom

RETAIL

INVESTMENT IN RETAIL REAL ESTATE - 2018	€ 46 bn
TREND IN YIELDS IN 2018	→
TREND IN RETAIL SALES IN THE EUROZONE FOR 2019	↗

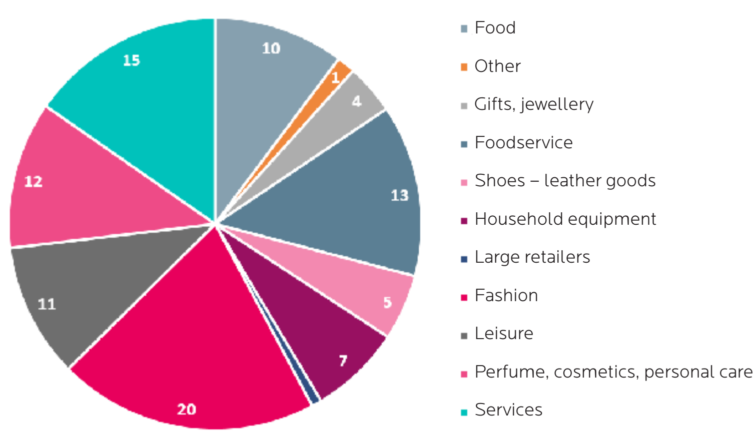
More than €46 billion was invested in retail real estate in 2018. Select deals included Hines' acquisition of the Champs Elysées Apple Store in Paris on behalf of BVK for €600 million, AXA's acquisition of the Dolce Vita Tejo shopping centre in Portugal for €230 million and the «High Street VII» club deal by Corestate for €212 million encompassing a portfolio of 24 real estate assets totalling 100,000 m² in 17 mid-sized German cities.

The vacancy rate reflects the shift towards prime retail locations. While retail sales and occupancy cost ratio are intrinsic criteria in the value of a retail business, technology is reshaping the landscape by making footfall data collected via digital tools the new strategic indicator in the retail world. Consequently, retail yields are following this new pattern; assets in prime locations are the most popular and therefore are traded at the lowest yields. In France, the Champs-Elysées recorded a yield low of 2.50%. In Germany, prime high street yields fell below the symbolic 3% mark while Milan and Madrid were around 3%. Only Lisbon recorded yields of more than 4%.

Consumer spending should drive the sector in 2019. Despite political and economic uncertainties, consumer spending forecasts in the eurozone are trending up in 2019, which should have a knock-on effect on retail sales, although not all countries will enjoy the same momentum. In addition, e-commerce has had a profound impact on retail strategies, with almost €600 billion of online sales on a European level in 2018. Retailers that have opted for an omni-channel strategy (using an optimal combination of bricks and mortar and digital) are currently the best placed to adapt to changing consumer behaviour. Although Germany and France have large online sales volumes, Spain, Italy and Portugal have much lower e-commerce penetration rates, and a shake-up in those markets could be seen in the years to come.

Fashion outlets, which dominate the retail landscape, are giving up ground to e-commerce. Regarding the 600,000 outlets followed in the key eurozone countries (Germany, Belgium, Spain, France, Italy, Netherlands and Portugal), personal goods (Fashion, Shoes, Leather Goods, Perfumes & Cosmetics) account for about 37% of high street, shopping centre and retail park space. Growth in e-commerce is typically accompanied by a shake-up in activity in bricks and mortar stores. For example, in the past few years, France and Belgium have seen a shift away from Fashion stores (less than 20% of total retail space) towards services. Other countries still rely heavily on Fashion, especially Italy with more than 30% of total retail space. The skimming of some activities has not affected the attractiveness of the most sought after locations. Paris heads the list in the eurozone with prime rents of more than €20,000 per m² per year on the Champs Elysées. Rents in German and Spanish cities are close to € 3,500 per m² per year, while Italy delivers double that amount.

BREAKDOWN OF ACTIVITY OF 600,000 STORES IN THE KEY EUROZONE COUNTRIES
(Germany, Belgium, Spain, France, Italy, Netherlands, Portugal) in %



Sources : Primonial REIM Recherche & Stratégie based on Codata data

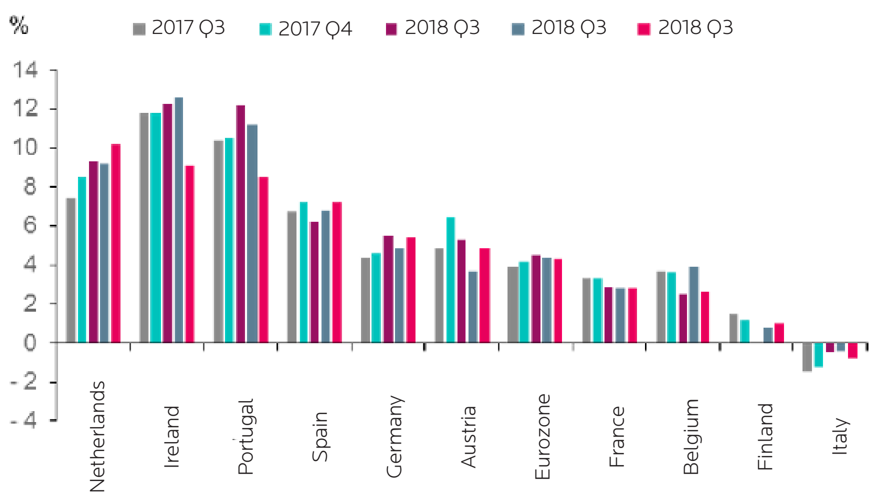
Source of data: Oxford Economics, Ecommerce Foundation, BNP PRE, C&W, Codata, RCA

RESIDENTIAL

INVESTMENT IN RESIDENTIAL REAL ESTATE - 2018	**50 Mds €**
TREND IN PERCENTAGE OF TENANT OCCUPIERS IN THE EUROZONE IN 2017	↗
TREND IN PRICES IN 2018 (Q3/Q3-1)	↗

A still highly active institutional market. The European «block» residential investment market (institutional investors) totalled about €50 billion in 2018. In the eurozone, the most active markets were Germany, the Netherlands, Spain and France, with a total of €30 billion invested in those four markets. In the Netherlands, Vesteda acquired a portfolio of 6,777 units for €1.5 billion. In France, a group of investors comprising CDC Habitat, Erafp, Ircantec, Vonovia and Swiss Life AM acquired Vesta's portfolio for €1.4 billion. Lastly, Danish pension fund PFA purchased more than €1 billion of residential assets in Germany.

TRENDS IN RESIDENTIAL PRICES IN THE KEY EUROZONE COUNTRIES (Q/Q-1)



Sources : Primonial REIM Recherche & Stratégie based on Eurostat data

An attractive risk premium. Residential yields in 2018 continued to deliver a relatively attractive risk premium compared with 10-year sovereign yields. In the eurozone, the lowest prime yields (between 2.5% and 3.5%) were in cities such as Paris, Vienna, Munich and Berlin. While yields were stable in Paris, they contracted further in other cities, including Madrid, Amsterdam and Dublin. Yields of more than 4% were confined to cities such as Lisbon, Dublin, Antwerp and Rotterdam.

Renting versus buying: significant differences within Europe. In the eurozone residential markets, almost 34% of the population rented in 2017 (up 0.3 of a percentage point year-on-year), the highest level since 2009. The percentage of renters in Germany and Austria rose slightly to almost one half of the population. Conversely, Spain and Portugal are traditionally less focused on renting with only about one quarter of their population. However, these countries have seen a resurgence of interest in renting, with 0.7 of a percentage point and 0.5 of a percentage point growth respectively year-on-year. Despite highly attractive borrowing conditions, the new price highs reached in the large French cities have certainly encouraged people to choose renting over buying (up 0.5 of a percentage point year-on-year). Conversely, in Belgium, buying proved more popular than renting (up 1.4 percentage points year-on-year).

Prices continued to rise. Despite political uncertainties and the economic slowdown, house prices in the eurozone continued to rise in 2018. In a climate of very attractive interest rates and rising inflation in 2018, the Netherlands (+10.3% Q/Q-1), Ireland (+9.1%), Portugal (+8.5%), Spain (+7.2%), Germany (+5.4%), Austria (+4.9%), France (+2.8%) and Belgium (+2.6%) recorded a further rise in their national house price index in the third quarter of 2018. Conversely, Finland recorded only slight growth (+1%), while Italy moved further into negative territory (-0.8%). Pressure on prices and urban densification in the world's large cities have prompted developers to think up new forms of city living. Co-living is one strongly emerging trend, a new urban housing concept midway between house-share, hotel and student hall of residence, mainly aimed at young working people. The question is whether this new hybrid housing concept, which includes services, will take off in cities that desperately need solutions to take pressure off the housing market.

Source of data: National statistics, RCA

HEALTHCARE

INVESTMENT IN HEALTHCARE REAL ESTATE - 2018	€6 bn
TREND IN YIELDS IN 2018	↘
NEED FOR BEDS BY 2025/2030	↗

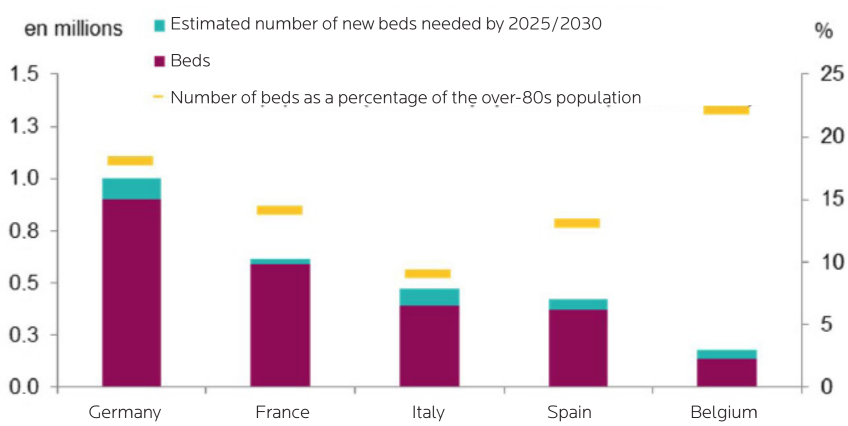
The attractiveness of healthcare real estate is growing steadily. Investment in this asset class was about €6 billion in Europe in 2018. In the eurozone, the German market delivered an excellent performance with almost €2 billion invested, followed by France with more than €800 million. One of the main deals in 2018 was Primonial REIM's acquisition of 50% of a portfolio of 71 clinics in Germany valued at €1.6 billion. The largest and most mature markets are France and Germany with investor strategies focusing on sale & lease-back or portfolio acquisitions. The markets are less mature and more fragmented in Southern and Eastern Europe. Sector consolidation is therefore expected to continue.

Continued compression of yields. Yields have been under pressure for several years now and contracted further in 2018. Prime yields in France were 4.25% for nursing homes and 5.25% for post-acute care facilities. Prime yields for healthcare real estate in Germany were between 4.75% and 5.25%. In Italy, nursing homes considered to be prime real estate, i.e. mainly those close to or in towns, deliver yields of nearly 6% while secondary assets can be as high as 7% to 9%. Yields in Spain are similar to Italy.

The public and non-profit sector dominates while the private sector is becoming more structured. There are similarities in the long-term care sector between European countries. The private sector remains highly fragmented while the public and non-profit sector dominates. Although there are still many independent operators, large European groups are beginning to emerge, such as Korian, Orpea and DomusVi. Pricing for care facilities is regulated in Europe, as the public authorities attempt to control public healthcare spending. The daily rate is broken down into two main components, one for care and medical expenses and the other broadly covering accommodation, catering and services. Germany, France, Austria, Ireland and Belgium all have an average daily rate of more than €100. Conversely, daily rates in Spain and Italy are less than €100.

Strong demand for beds out to 2030. Growth in the number of people aged over 80 has already had a significant impact on the overall ratio of nursing home beds to the elderly population. This ratio has fallen over the past 10 years. Germany and France currently have a ratio (beds as a percentage of the over-80s population) of between 14% and 18%, which is the European average. Belgium has a high ratio (22%) while Italy still needs to make significant progress with a rate of under 10%. The number of nursing home beds in the eurozone is about 3 million. The five countries with the most beds are Germany, Belgium, Spain, France and Italy. Healthcare professionals estimate that those five countries will need about 450,000 more beds by 2025/2030 and that existing care homes will have to be modernised. These substantial needs, in a context of budget discipline for public operators, should drive the private sector forward in terms of creating new beds in the years to come.

NURSING HOME BEDS



Source(s) : Primonial REIM Recherche based on operator, Eurostat and OECD data

Source of data : CBRE, RCA, Your Care, Operators, Primonial REIM

DEFINITIONS

10-year government bonds: debt securities issued by a state for a period of ten years, generally acknowledged to be a risk-free investment.

Investment volume in corporate real estate: total volume of premises acquired in the offices, retail, business premises and warehouses segments by an investor.

Take-up of offices: all leases or sales to the occupant (as opposed to sales to investors) for premises to be used as offices. It is expressed as square meters of usable space.

Sale Before Completion: sale before completion is the contractual method for selling a building before it is built. The investor becomes the owner as it is built.

Free leases: favourable measures granted to tenants (rent cuts, renovation work, etc.).

Yield: ratio between the gross or net revenues from the building and the capital committed by the buyer (acquisition price + fees and transfer taxes).

Store premises: traditional ground-floor retail premises located in town-center high streets.

Shopping center: a building containing at least 20 retail outlets housed in indoor centers around a large food store that drives customer traffic.

Retail park: an outdoor shopping center built and managed as a single unit. It comprises at least five buildings linked by lanes and located on city peripheries.

Care homes: a health facility that houses dependent elderly people.

Medical, surgery and obstetric clinics: medical facilities for short-term care, with or without lodging, or for severe conditions during their acute phase.

Primonial Real Estate Investment Management (PREIM) is a portfolio management company approved by the French financial markets authority (AMF) on 16 December, 2011. It received AIFM accreditation on 10 June, 2014. Its business consists in creating, structuring and managing long-term real estate investments by individual and institutional investors.

Primonial REIM has a comprehensive range of expertise:

- **multi-products: SCPI, OPCI, SCI;**
- **multi-sectors: offices, retail, residential, healthcare and education property;**
- **multi-national: France, Germany, Spain, Italy, Belgium and Ireland.**

At 30 June, 2018, Primonial REIM had:

- **€ 15.2bn of assets under management;**
- **55,138 associates;**
- **41 independent real estate advisors;**
- **a portfolio of 3,552,329 m² and 7,000 tenants, including a high share of large corporate tenants (Samsung, Korian, Crédit Agricole, SNCF, etc.).**

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The Research & Strategy Department's role is to formalize Primonial REIM's real estate investment strategies, based on continuous monitoring of the French and European markets. Although collective real estate accounts for a growing share of institutional portfolios and household savings, it is at the crossroads of financial (hierarchy of rates), economic (tenants' business models), demographic (the metropolisation phenomenon) and societal (changes in usage) factors. This is why a cross-cutting analysis is needed, which is also long term and therefore in keeping with the horizon of most real estate investors.

Real Estate Convictions offers Primonial REIM's quarterly view of its markets of choice, i.e. offices, retail outlets and healthcare and residential real estate, in France (two publications a year) and Europe (European Real Estate Convictions, two publications a year).

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