PRIMONIAL REIM

JULY 2020
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REAL ESTATE CONVICTIONS

The fund manager's view of real estate markets

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FIGURES

GROWTH FORECAST, FRANCE 2020

-10.2 %

INFLATION FORECAST, FRANCE 2020

0.4 %

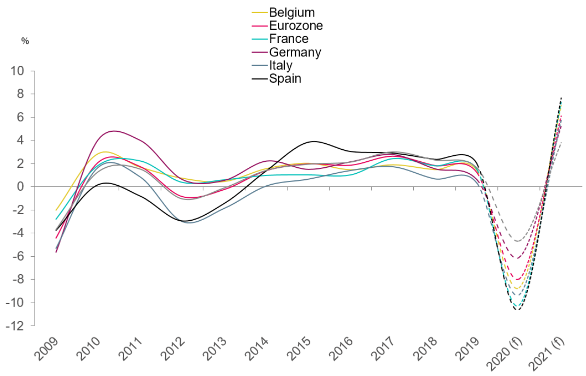
10Y TREASURY BOND FORECAST, FRANCE 2020

10Y FRENCH TREASURY BOND

0.1 %

Source: Oxford Economics

ECONOMIC ENVIRONMENT : GDP IN EUROPE



Sources: Primonial REIM Research & Strategy according to Oxford Economics

ECONOMIC ENVIRONMENT

The "Great Lockdown" following the Covid-19 pandemic had an extremely negative impact on global activity during the first six months of 2020. The health crisis, which is already considered to be unprecedented, will inflict a deep recession on the world economy in 2020 (-4.9%) before GDP growth ticks up again in 2021 (+5.4%), according to the IMF. In the eurozone, Europe is facing major economic difficulties after the first wave of the epidemic, although activity is starting to show positive signs of a recovery. GDP forecasts for the eurozone point to a 8.0% contraction in 2020 before a strong 6.1% rebound in 2021. As the various countries have not been affected in the same way by the pandemic and governments were unable to coordinate their responses, the recessions will differ in their intensity in 2020 within the eurozone, with the Netherlands at -4.6%, Germany at -6.1%, Italy at -9.3%, France at -10.2% and Spain at -10.6%.

Many unknown factors could challenge these projections, however, such as a second wave of Covid-19 or sluggish household consumption in Europe. At the same time, there are also factors supporting a stronger recovery. One of these is the ECB's policy of unlimited intervention to ensure the liquidity of the capital markets and the banking sector. The agreement reached on the €750 billion European stimulus plan, which combines the pooling of €390 billion of debt (subsidies) with €360 billion of loans, is an EU-wide stimulus instrument the like of which has never been seen before. It includes subsidies of €40 billion for France, €60 billion for Spain and €81 billion for Italy.

With nearly €113 billion of investment in the first half of 2020 (-9% year on year), of which €72 billion for the eurozone (-7%), the European commercial[1] real estate market has seen only a limited fall in investment volumes. Germany (€30.1 billion in the first half of 2020, up 19% year on year) has continued to capture capital, France (€15.0 billion, down 9%) is holding up well despite a strict lockdown, and the UK is continuing to be the focus of investors' mistrust due to Brexit and its management of the health crisis (€20.1 billion , down 16%). With a reduction in investment volumes and the return of risk averse strategies, a new hierarchy of yields has emerged in Europe. Overall, based on the transactions observed, the ***prime*** residential yield for the major European cities has held steady. Likewise, the prime office yields for the most core assets have changed little, whereas the retail outlet yield has risen particularly steeply for shopping centres and retail parks. High street shops and grocery shops have been spared. Finally, the hotel yield has mostly risen in Europe.

Source(s) for figures: CBRE, FMI, RCA and Oxford Economics

[1] Commercial real estate refers to offices, retail outlets, logistics, services and residential assets aimed at institutional clients.

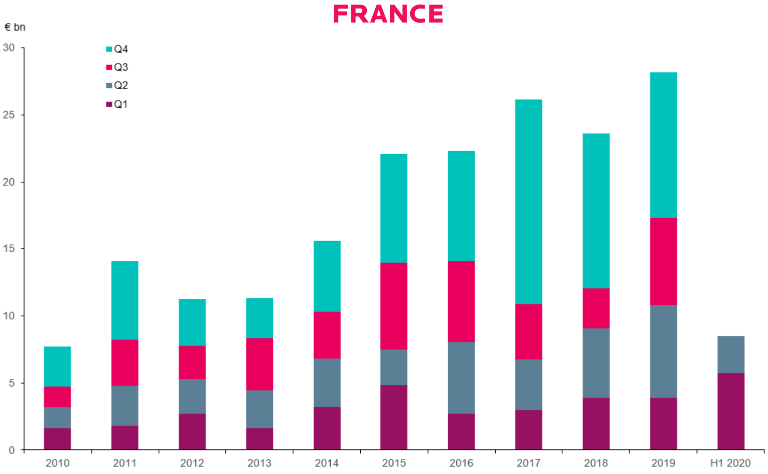
OFFICES

OFFICE PRIME YIELD IN THE PARIS CENTRAL BUSINESS DISTRICT	2.80 %
YEAR-ON-YEAR VARIATION IN TAKE-UP IN THE PARIS REGION	-40.00 %
VACANCY RATE IN THE PARIS REGION	5.10 %

Although the lockdown reduced the volume of investment in office real estate, the amounts invested still far exceed the ten-year average. Investment in office real estate in France totalled €8.5 billion in the first half of 2020 (down 22% year on year), of which around €7.2 billion is accounted for by the Paris region alone. Offices in Paris, the Inner West Suburbs & La Défense represented a large majority of investments. There was a particularly active market for deals exceeding €200 million. This includes the purchase by LaSalle IM of the current headquarters of BNP Paribas Asset Management on rue Bergère in the 9th district of the French capital. East Paris was also an active presence in the market with the purchase of the Valmy building, mainly occupied by BNP Paribas, by Primonial REIM, for more than €216 million.

The Central Business District *prime* office yield is staying below the 3% threshold. The low interest rate environment (10-year French treasury bond) will continue in the coming months, allowing the offering of a still very attractive risk premium for *core* office real estate (270 bp at the end of June 2020). The average value per square metre has grown substantially (up 16% year on year) to €8,105/sq. m on average. Central Paris is a stand-out segment, with average values per square metre of more than €10,000€/sq. m, now exceeding €18,000€/sq. m in the Central Business District and standing at €7,400/sq. m in La Défense, whereas the average values for the other regions are around €5,000/sq. m.

VOLUME OF INVESTMENT IN OFFICE REAL ESTATE IN FRANCE



Source(s): Primonial REIM Research & Strategy according to RCA

Take-up is falling, as a result of the lockdown period. The caging of the economy brought take-up to an artificial halt in the second quarter of 2020, with less than 200,000 sq. m changing hands. The transaction volume for the full half-year was 667,500 sq. m (down 40% year on year). The > 5,000 sq. m segment has been the most affected, with around 200,000 sq. m changing hands (down 40% year on year), compared with deals of less than < 5,000 sq. m, which also fell sharply, with 450,000 sq. m leased (down 39% year on year). Despite this fall in the transaction volume, average headline rents were at €412/sq. m/year for second-hand space rents (up 7.5% year on year) and €408 sq. m/year for new or refurbished properties (up 2.5% year on year). Immediate supply grew, to 2.99 million sq. m available at the end of June 2020 (up 5% year on year). Incentive rates grew very slightly, to 20.9% during the second quarter of 2020, versus 20% the year before.

The health crisis has been an eye-opener. While the lockdown period linked to the Covid-19 health crisis was an opportunity to try out 100% telecommuting, it also became clear that electronic working could not be practised over the long term by all organisations. Although people were able to keep business activity going, limitations appeared when it came to the organisation of work and the digitalisation of human relations. The health crisis cast doubt on certain principles, but also demonstrated that the concept of use should become a central factor in upholding real estate value. The office is in fact a necessary place for exchanges of ideas, for maintaining a social connection and for creating a sense of cohesion within teams. In addition to location, design and transport hubs, the concept of intended use, probably combined with higher health-related standards (social distancing, etc.), will therefore increase the discrepancy between efficient and more obsolete buildings.

Source of quantified data: Immostat, BNP PRE, CBRE, RCA and Primonial REIM

RETAIL

CHANGE IN HOUSEHOLD CONSUMPTION IN 2020 (FORECAST)	-11.70 %
PRIME HIGH STREET SHOP YIELD	3.00 %
PRIME SHOPPING CENTRE YIELD	4.10 %
PRIME RETAIL PARK YIELD	5.25 %

Nearly €2 billion were invested in retail real estate in the first half of 2020 (up 19% year on year), as the market's capital flow outstripped its ten-year average. The great majority of deals were once again in the Paris and Lyon regions. The highlights for the half-year include the creation of a partnership between Unibail-Rodamco-Westfield (45.8%) with Crédit Agricole Assurances and La Française (54.2%) relating to a portfolio of five shopping centres (Aéroville, So Ouest, Rennes Alma, Toison d'Or and Confluence). The total value of these assets comes to €2 billion. This transaction alone therefore contributed nearly half of the volumes for the half-year. Every retail asset class saw a rise in yields, except for the grocery shop segment (e.g. supermarkets). The high street shop prime asset yield rose by 25 bp quarter on quarter to 3.0% at the end of June 2020. Shopping centre and retail park yields gained 25 bp and 50 bp quarter on quarter, reaching 4.10% and 5.25% respectively at the end of June 2020. Note that this trend began in the fourth quarter of 2019 and is not as extreme as expected by some.

PROJECTED CHANGE IN CONSUMER SPENDING UP TO 2024 IN FRANCE (EXTENDED METROPOLITAN AREA)

Source(s): Primonial Research & Strategy according to Oxford Economics

The health crisis has revealed the strategic importance of combining e-commerce with shops. During lockdown, while traditional retailers' shops were closed, their online sales grew much more strongly than the revenue of e-commerce pure players. This shows that digitalisation is a key factor for success. It was found that retailers who have opted for an omni-channel strategy were able to count on the productivity of their logistics tools and digital technology to ensure the resilience and redeployment of their activities. The retail segment should therefore continue to develop along three lines: convenience stores for everyday purchases, e-commerce for depth of choice and a focus on customer experience during the purchasing act.

Specialised retail outlet revenue fell during the first half due to the lockdown. Aggregate specialised retail activity from January to April fell steeply, by 37%. Retailers with a multi-channel distribution network were able to count on e-commerce revenue, which rose by 59% over the same period. A 32% fall was recorded across all channels during the first four months of the year. French households reined in their spending as a result of the lockdown. The savings rate was therefore much higher than the average for 2019 (around 15% of income on average), at 20% in the first quarter of 2020 and 30% in the second quarter. The environment of health-related uncertainty may consequently have a big impact on purchasing behaviour. The savings rate should fall considerably during the second half-year, but stay high (22.3%) in 2020, which is consistent with the drop in consumption expected for the full year (down 10.7%). If a sustainable cure is found in mid-2021, the French savings rate should return to normal by 2022, boosting consumption.

High street shop rental values held steady for the main streets in the most attractive major cities, whereas corrections were once again observed for locations in secondary towns where footfall was already drying up before the crisis. The lockdown period seems to have acted as a catalyst for the polarisation of the market between Paris and the main regional cities, with values that are holding up even in secondary locations, and towns or peripheral zones with a high vacancy rate and rental values subject to major corrections. Lastly, for the time being, the lockdown has not had an impact on the values of convenience stores and grocery shops.

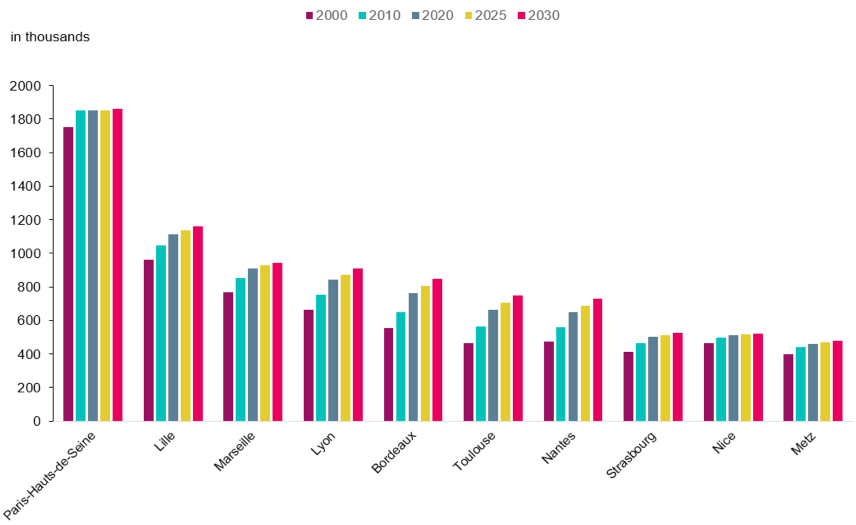
Source of quantified data: CBRE, Procos and RCA

RESIDENTIAL

EXISTING HOUSING SOLD AT MAI 2020 (12-MONTH TOTAL)	**998,000 sales**
RISE IN PRICES OF EXISTING HOUSING IN FRANCE AT Q1 2020	**+6.4% (year-on-year)**
BUILDING STARTS AT MAI 2020 (12-MONTH TOTAL)	**368,800 building starts**

Sales of existing housing are dipping slightly, while staying at a high level. The number of existing housing units sold was stable at 998,000 transactions (down 0.5% on aggregate for the 12 months to May 2020/y-1). However, due to the halting of real estate transactions during lockdown, and despite French people's strong interest in housing, the market could see a fall in activity over the full year equal to 10 months of volume according to initial estimates. For the moment, existing housing prices do not reflect the crisis. In the first quarter of 2020, apartment prices continued to climb steadily (+6.4% year on year), in the Paris region (+6.8%) and in the other regions (+6.0%). Significant rises were recorded in cities such as Rennes (+20.5%), Nantes (+14.8%), Marseille (+12.3%), Lyon (+10.7%) and Paris (+8.0%). The scarcity of housing partly explains this strong growth in prices. After the reopening, prices remained unchanged overall (change of between 0% and 1% over the month of June 2020 versus May 2020). The market currently enjoys sound fundamentals that will help it to weather the economic risks that may emerge in the autumn. A price correction cannot be ruled out in the short to medium term, but the market is not without long-term rebound factors.

PROJECTED CHANGE IN THE NUMBER OF HOUSEHOLDS UP TO 2030 IN FRANCE (EXTENDED METROPOLITAN AREA)



Source(s): Primonial REIM Research & Strategy according to Oxford Economics

The general lockdown brought activity to a halt and releases for sale dropped for new housing. With 368,800 building starts in May 2020 (12-month aggregate), the two months of general lockdown had a large impact on new housing (down 10.2%) compared with the end of 2019. There was a steep slide in the real estate released for sale to individuals by real estate developers in the first quarter of 2020 (down 27.9% year on year). The trend was the same for reservations, with a more pronounced decline in the individual segment (-29.3%) than in the collective segment (-23.9%). While new housing prices continued to increase year on year (+3.9%), a decrease was recorded quarter on quarter (-0.2% Q1 2020/Q4 2019), which could accelerate in the coming months.

Rise in real estate loan interest rates during lockdown, an effect considered to be temporary. The average interest rate for (long-term, fixed-rate) housing loans rose during lockdown, but this was a temporary effect, as rates are trending downwards (-19 points year on year), and stood at 1.25% on average in May 2020. The ECB's policy of keeping its key rates unchanged in 2020 will hold housing loan interest rates down at record low levels in France. Access to loans may be deteriorating, especially for first-time buyers, but this is due more to the recommendations of the HCSF (Haut Conseil à la Stabilité Financière - High Council for Financial Stability), which has imposed safeguards to prevent French household debt from becoming a systemic risk.

The block residential market's appeal is increasing in this period of uncertainty. The market for block residential real estate targeted at institutional investors saw around €2 billion of investment in the first half of 2020 (up 72% year on year). French investors were the most active. Following the reintroduction of rent controls in Paris more than a year ago, yields have been squeezed slightly for ***prime*** assets versus the end of 2019 and are now at between 2.2% and 2.8% for residential real estate in Paris 3.4% and 6.0% for the regions. The main deals in the first half-year of 2020 include a highly active Caisse des Dépôts et Consignations with its off-plan purchase of 92 housing units in Asnières-sur-Seine from Cogedim and Coffim, and of 238 housing units from the Réalités group. Primonial REIM also made its mark, with its €109 million off-plan purchase of a mixed programme, including 362 housing units, in Ivry-sur-Seine.

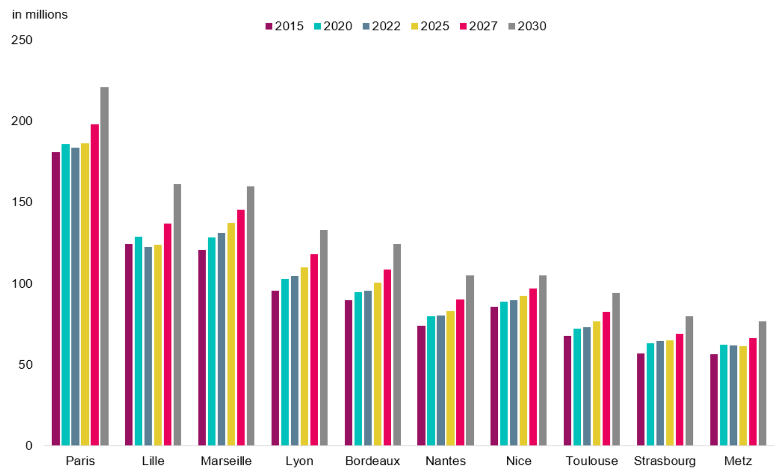
Source of quantified data: Banque de France, CBRE, Meilleurs Agents, Notaire-INSEE, RCA, Soes and Sitadel Notaire-INSEE, RCA, Soes and Sitadel

HEALTHCARE

CARE HOME PRIME YIELD	<4.0 % - 5.5 %
MEDICAL, SURGERY AND OBSTETRIC CLINIC PRIME YIELD	5.15 % - 6.5 %

The current healthcare crisis has revealed the importance and the vital need in our societies for healthcare infrastructure. Since the start of 2020, the French authorities have tried to meet the challenges of old age and independence with the launch of the “Vieillir en bonne santé 2020-2022” (Ageing in good health) plan. Prevention is key to this strategy whose aim is to keep senior citizens independent for as long as possible. To guarantee the independence of our elderly population the living environment must change (transport, urban spaces, housing, facilities, etc.). We are seeing a shift in the demographics of our society, as the population ages at a much faster rate as baby boomers get older, with a tipping point in 2030.

PROJECTED POPULATION AGED OVER 80 UP TO 2030 IN FRANCE (EXTENDED METROPOLITAN AREA)



Source(s): Primonial REIM Research & Strategy according to Oxford Economics

The volume of investment in healthcare real estate (nursing homes and retirement homes) totalled around €150 million in the first half of 2020. The fall in the investment volume compared with the same period in 2019 (-45% year on year) is down to the lack of products available for sale during lockdown. The market should experience a degree of momentum by the end of the year as many operators have expressed their wish to allocate large volumes of capital to healthcare real estate in the coming months across Europe. The main deals that have driven the market include the €109 million off-plan purchase by Primonial REIM of a mixed programme, including an assisted living facility containing 111 housing units, in Ivry-sur-Seine. In the first half of 2020, the *prime* yield stayed at around 4.0% for nursing homes and 5.15% for medical, surgery and obstetrics clinics.

The management of physical and psychological dependency is a major challenge. It starts with home services/care and assisted living facilities. When dependency increases, patients are moved to nursing homes (Alzheimer’s units, high dependency units and day centres) or rehabilitation and recuperative care and psychiatric clinics (rehabilitation and recuperative care specialisations: musculoskeletal system, geriatrics, addictology, cardiology, nervous system, respiratory system and oncology). Technological innovation offers vital benefits in cases of increased dependency. The main innovation fields currently identified are: artificial intelligence, security and the well-being of residents/patients.

The care home sector in France encompasses around 7,500 establishments and 610,000 beds. It is estimated, however, that because of the pressure created by the ageing of the French population and the growth in the number of dependent elderly people, the sector will need a further 25,000 beds over the 2015-2025 period. Very few new permits have been issued for the nursing home sector through, which may create tensions between supply and demand. The number of beds per capita is the same for the large majority of regions. While the five biggest operators already own 55% of the beds in the private sector, the consolidation by sector leaders is continuing.

The medical, surgery and obstetrics/rehabilitation and recuperative care/long-term care/psychiatric care sector accounts for around 4,000 establishments with nearly 500,000 beds. In the clinic sector, the main development is that medical, surgery and obstetrics establishments are tending to quite quickly move their patients on to rehabilitation and recuperative care clinics. Although there is a uniform bed density across the country for medical, surgery and obstetrics clinics, there is a shortage of intensive care beds. The private sector is very buoyant, but the three leading operators own only 25% of the total number of establishments. The sector’s consolidation across France and Europe will therefore continue.

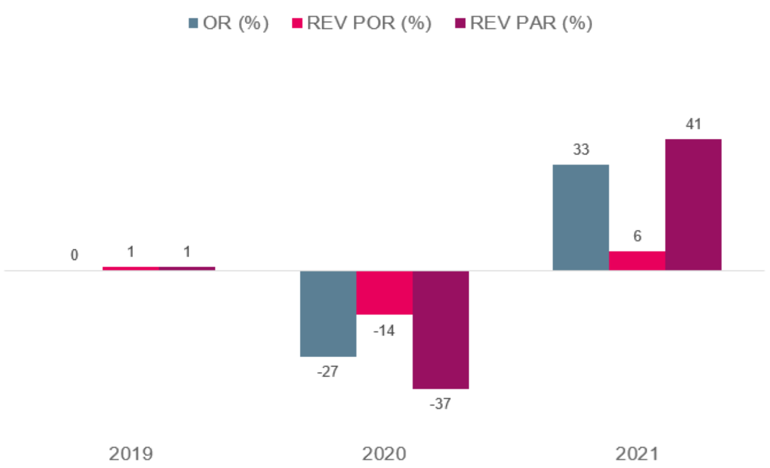
Source of quantified data: RCA, Operators and Primonial REIM

HOTELS

NUMBER OF HOTELS IN 2019	18,000
NUMBER OF ROOMS IN 2019	654,000
PRIME HOTEL YIELS IN PARIS	4.25%-5.25%

The year may have had a promising start, but the health crisis greatly slowed the volume of hotel sector transactions during the second quarter of 2020. Hotel sector investment in France totalled €528 million during the first half of 2020 (-39% year on year). The market's mid-year counter-performance given the ten-year average was a direct result of the Covid-19 pandemic, the closing of borders and the lockdown period, which produced a wait-and-see attitude in investors. The majority of investments were made in the Paris region. At the end of the second quarter of 2020, the prime hotel yield in Paris was between 4.25% and 5.25%. The wait-and-see attitude of investors does not yet actually reflect the market, however. A repositioning of yields is foreseeable in the coming months, but the number of distressed assets should clearly be very limited. It is more likely that investors will adopt a flight-to-quality approach, turning to hotels with secured leases, high quality locations and resilient operators.

HOTEL PERFORMANCE PROJECTIONS* FOR EUROPE FOR 2019-2021



Source(s): Primonial REIM Research & Strategy according to In Extenso and STR

Hotel capacity in France in 2020 is around 657,000 rooms in nearly 18,000 hotels. Unrated rooms (hotels without stars) and 1-star rooms make up 18% of supply, 2- and 3-star hotel rooms account for 58%, and 4- and 5-star rooms for 24%. Regarding tourist arrivals, France was the world's leading tourist destination, with more than 94 million arrivals, in 2019, but the health crisis put a stop to travel. The lockdown period, then the easing of lockdown, the outbreak of the epidemic, then the gradual opening of borders, should have a major impact on tourist arrivals in France in 2020 (-54% year on year) prior to a strong rebound in 2021 (+55% year on year). In terms of tourism receipts, France ($66 billion in 2019) is the world number three behind the United States and Spain. Tourism receipts are expected to collapse in 2020, falling by 59%, before rebounding in 2021. Domestic tourism (business and leisure) revenue should hold up better and grow again quite quickly. International tourism arrivals and receipts will not return to their pre-crisis levels until at least 2022.

The crisis will not affect everyone equally. The hotel occupancy rate in France was 56% in February 2020 (aggregate data from Jan. to Feb., +0.9% year on year), the average price was €86 over the first 2 months of 2020 (+1.3% year on year) and the RevPAR (revenue per available room) grew by 2.2% year on year to €49. Due to a time lag, however, the data, which will be gradually consolidated, and particularly the data for the lockdown period, will show a dramatic fall in every indicator. France should therefore follow the downwards trend that is expected for every European market in 2020 prior to a strong rebound in 2021. Some post-lockdown factors in support of a recovery are beginning to take shape, however. Domestic demand, from both business and leisure customers, will play a key role in sales growth, but there will be no catch-up effect. The signs all seem to point to a faster exit from the crisis for the budget segment, whereas the rebound in the high-end/luxury segment will come from the reopening of borders and the revival of international tourism.

Source of quantified data: CBRE, KPMG, RCA, INSEE and WTO

*Average performance of the 31 major European cities.

DEFINITIONS

10-Year French Treasury bonds: debt securities issued by the French state with a 10-year term. The 10-year French Treasury bond is widely accepted as the risk-free indicator.

Volume of investment in commercial real estate: global volume of office, retail outlet, business premises and warehouse assets acquired, by an investment buyer, for a "deed-in-hand" amount of more than €4 million.

Office take-up (Immostat): all rentals or sales to occupiers (rather than sales to investors) involving premises for office use. This is expressed in square meters of usable space.

Off plan : off-plan sales are the contractual method whereby buildings that have yet to be built are sold. Investors become their owners as construction progresses.

Incentives measures: incentives granted to tenants, such as rent-free periods and improvement works.

Yield : relationship between the gross or net income from the building and the "deed-in-hand" capital invested by the buyer (acquisition price + property transfer fees and taxes).

Shops walls: refers to traditional shops on the ground floor of buildings in city center high streets.

Shopping Centre: building containing a complex of at least 20 shops, housed in covered galleries, centered on a supermarket that ensures a customer flow.

Retail park: an open-air retail complex built and managed as a single unit. Includes at least five buildings joined together by thoroughfares. Located on the outskirts of cities.

Care home: a medically-equipped structure designed to accommodate elderly people needing care.

Medical, surgery and obstetric clinic: hospital stays to receive short-term care, with or without accommodation, or treatment for serious conditions during their acute phase.

RevPAR: abbreviation of revenue per available room. It corresponds to a hotel establishment's accommodation revenue divided by the total number of rooms. RevPAR also corresponds to the occupancy rate multiplied by ARR.

ARR: abbreviation of Average Revenue per Room. It is calculated (excluding breakfast) by dividing total revenue by the number of rooms occupied.

Hotel occupancy rate (OCC): ratio between the number of rooms occupied and the total number of rooms in a hotel.

Primonial Real Estate Investment Management (PREIM) is a portfolio management company authorised by the Autorité des Marchés Financiers (AMF - French Financial Markets Authority) on 16 December 2011.

It received AIFM authorisation on 10 June 2014. Its business consists of creating, structuring and managing long-term real estate investments for individual and institutional investors.

Primonial REIM has a comprehensive range of expertise:

- **Multi-product: SCPI, OPCI and SCI funds,**
- **Multi-sector: offices, retail outlets, residential assets, hotels and healthcare and education facility real estate,**
- **Multi-national: France, Germany, Spain, Italy, Belgium, Ireland and the Netherlands,**

At 31 December 2019, Primonial REIM had

- **+ €21 billion of assets under management,**
- **+ 67,000 associates,**
- **46 independent real estate advisors,**
- **Assets worth more than 4,200,000 sq. m. and 7,000 tenants, including a large share of major corporate tenants (e.g. Samsung, Korian, Crédit Agricole and SNCF).**

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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).

PRIMONIAL
REIM

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