PRIMONIAL REIM

23 TO 27 MARCH | **2020**

WEEKLY REPORT COVID-19

PANDEMIC AND REAL ESTATE MARKETS: IMPACTS IN THE EUROZONE

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The world is experiencing an unprecedented crisis. Information is evolving continually, and we therefore deemed it useful to provide a weekly update on our view of events and of their impact on the real estate markets. Such is the purpose of this report which we will send you each Friday. It is a non-binding document and exclusively reflects Primonial REIM's market sentiment based on the information available at the time of writing. You can find all the reports written by Primonial REIM's Research & Strategy department at https://www.primonialreim.com/etudes and all our reports on the subject of Covid-19 at https://www.primonialreim.com/covid-19-coronavirus.

Week spanning 23 to 27 March 2020

After attempting to map out the impacts of Covid-19 by real estate category (see our report from 20 March 2020), we are now doing the same by eurozone country. This first assessment can be fine-tuned by increasing the number of indicators and factoring in the economic and real estate data that will be released over the coming weeks.

Economic environment: the latest information

- **Europe is currently the epicentre of this pandemic**[1]. Over 200,000 cases have been detected in the region, i.e. 40% of the world's total. Italy, Spain, France and Germany account for 77% of cases detected in Europe, and the number of cases is growing exponentially. Meanwhile, for the first time since December 2019, China has announced that no more new domestic cases are being declared. Given that the number of cases detected in the USA is growing ever more rapidly, the consensus among specialists is that it will probably become the next epicentre of the pandemic.
- **European strategies are becoming synchronised if not coordinated**. The UK recently adopted the same health strategy as that applied in Italy followed by France, Belgium, Spain and Germany, which is to slow the spread of the virus by quarantining the population in order to avoid overwhelming the health system. Sweden and the Netherlands are exceptions, although perhaps only temporarily, and are so far planning on herd immunity being achieved rapidly without mandatory lockdowns.
- **Over in the USA, Congress passed a massive business support plan ($2,000 billion) on Tuesday 25 March**, triggering a rebound in the stock markets. The plan shows that the USA is becoming aware of the gravity of this health crisis and leaning towards similar lockdown strategies as those seen in Europe. It also confirms that the USA will use not only its monetary arsenal, which the Fed has already used on a large scale, but also its fiscal firepower to curb this global crisis. This is one of the big differences with 2008.

Real estate markets in the eurozone

How are Europe's main real estate markets positioned as regards the Covid-19 crisis? Although all four of the eurozone's biggest real estate markets – Germany, France, Italy, Spain – have been hit hard by the pandemic, they are each in a different situation.

We compared the following aspects:

- **The real estate market's fundamentals before Covid-19**, at 31 December 2019. To do so, we examined :

o the Offices risk premium in each of the four markets relative to its sovereign bond yield, which is a gauge of its capacity to absorb a shock to asset valuations.

o the liquidity of the real estate market, as measured by investment volumes (offices, logistics, retail, hotels, healthcare, residential) in 2019.

o the fluidity of the rental market, as reflected in Office vacancy rates in the main cities.

[1] *Source: World Health Organisation, press conference given by Dr Hans-Henri Klugge on 19 March 2020.*

- **The vulnerability of the health system** in the main eurozone countries. Although we cannot predict how the virus will behave, we can see that trends currently differ from one country to another[2]. Moreover, the availability of intensive care beds varies significantly between countries, and this aspect is key to managing the health crisis. Last of all, the proportion of over-65s (a population found to have an above-average mortality rate) also differs between Germany, Spain, Italy and France.

- **The economic momentum pre-crisis**, as reflected in GDP growth forecasts for 2020. These forecasts are bound to prove mistaken, but they do give an idea of economic momentum in each country. Germany was already struggling, largely because of the trade war between China and the USA and its dependence on the automotive industry. Italy was already on the verge of a recession. France more or less reiterated its economic growth rate of 2019, while Spain's was above the eurozone average. It is interesting to note that even before the coronavirus crisis, the eurozone's GDP growth outlook for 2020 (+1.03%) was weaker than in 2019 (+1.21%) and 2018 (+1.89%).

KEY INDICATORS FOR EUROPE'S 4 MAIN MARKETS

	France	Italy	Germany	Spain
Real estate fundamentals pre-crisis				
Office risk premium versus 10Y sovereign bond yield[3] at 31/12/2019, in basis points	268	187	292	278
Volumes invested in commercial real estate[4] in 2019	€41.6bn	€11.6bn	€69.4bn	€15bn
Office vacancy rate (tension in the rental market)[5] at end-2019	5.0%	9.9%	3,8%	9.1%
Vulnerability of the health system				
Number of Covid-19 cases detected at 25 March 2020	25.233	74.386	37.323	47.611
Over 65s as a share of the total population in 2019	20.2%	23.0%	21.7%	19.5%
Number of acute intensive care beds per 1,000 inhabitants	3.09	2.62	6.02	2.43
Economic momentum				
GDP growth forecast for 2020 established pre-crisis	1.23%	0.29%	0.66%	1.67%

Source: Primonial REIM Research & Strategy according to RCA, BNP Paribas Real Estale, JLL, worldometers.info, Oxford Economics, OECD

On first analysis, we can draw the following findings about the real estate markets. For the purposes of this report, "investment property" is taken as a whole all categories combined.

- **Italy's real estate market is expected to be hit the hardest**. Italy combines a risk premium that was already too low pre-crisis (less than 200 basis points) and a relatively high office vacancy rate. Its growth prospects were already poor (0.29%) and it is the country that has been hardest hit by the virus so far, with twice as many deaths as in China and a record mortality rate (154 deaths per million inhabitants).

- **Momentum in Spain's real estate market cut short**. Pre-crisis, Spain's risk premium was significant and its economic growth had been well above the eurozone average for several years, making it a favourite destination for French property investors. But Spain's health crisis is increasingly becoming a cause for concern as the number of cases detected is accelerating faster than in Italy and it has the lowest availability of hospital beds.

- **Germany's real estate market is the most resilient** as regards its fundamentals. It boasts the deepest real estate market, even though the market is split between 4 key cities of medium size (Hamburg, Berlin, Frankfurt, Munich). Its risk premium is the highest thanks to the negative Bund yield (Germany's sovereign bond). Moreover, valuations are relatively low. Germany's challenge post-crisis will be to reform an economic model that is based on generating trade surpluses, heavily dependent on the Chinese market and was already beginning to show its limitations.

- **France's real estate market is resilient** for various specific reasons including a sizeable risk premium, a Paris region market of unequalled depth, Europe's

[2] Certain anomalies, such as Germany's low Covid-19 mortality rate, have yet to be scientifically explained.
[3] France: office risk premium in Central Paris; Italy: office risk premium in Milan; Spain: average office risk premium in Madrid-Barcelona; Germany: average office risk premium in Hamburg-Berlin-Frankfurt-Munich. [4] Commercial real estate includes offices, retail, logistics, hotels, healthcare and residential. [5] France: office risk premium in Central Paris; Italy: office risk premium in Milan; Spain: office risk premium in Madrid; Germany: average office risk premium in Hamburg-Berlin-Frankfurt-Munich.

biggest business district (La Défense), tenants from a wide range of different sectors and office rents that have been rising for the past 2 years. These strengths drew in a significant amount of international capital in 2019 amid the Brexit saga. The French market's comparative advantages look set to last.

Note that the health and economic measures taken by Europe's four biggest countries may be similar in terms of approach but differ considerably in terms of scale. Germany has opened up the sluice gates on credit to the tune of €550 billion for businesses that are in difficulty. Spain, like France, is combining state guarantees and direct support for businesses. Despite imposing a stricter lockdown, the support measures introduced by Italy are on a smaller scale, although they do apply to both businesses and individuals. There are plans to provide an additional €350 billion.

	Main lockdown measures (at 20 March 2020)	Main economic support measures (at 20 March 2020)
France	Closure of schools and non-essential shops Population placed under mandatory quarantine State of Health Emergency Act	Financial aid for businesses: €45bn State guarantee for business loans: €300bn
Italy	Closure of schools Population placed under mandatory quarantine	Support for businesses and individuals: €25bn Planned "Cura Italia" economic stimulus programme: €350bn
Germany	Closure of non-essential shops Quarantine recommended Closure of national borders	State guarantee for business loans: €550bn
Spain	Closure of non-essential shops Population placed under mandatory quarantine	Financial aid for businesses: €100bn State guarantee for business loans: €100bn

Conclusion. Once their values and rents have corrected, and if confidence is re-established, investors may return to the market segments that are currently under big strain. In particular, there is a growing awareness that healthcare systems are inadequately equipped in Southern European countries but also in France; this is likely to translate into a (necessarily Europe-wide) stimulus plan when the pandemic ends, with private facilities being developed to complement public facilities. The announcements made by President Macron on 25 March regarding a "massive investment and career upgrading plan" for hospitals are a step in this direction.

We can still remember how the 2008 financial crisis led to disputes between Southern and Northern European countries, specifically with Germany accusing Greece of letting its debt spiral out of control and endangering the euro. This time, we can assume that the public accounts of all European countries will be in such a state once the 2020 health crisis ends that only a collective response will be up to the task.

Next meeting

You will soon be able to listen to our upcoming podcast, in the meantime please send your questions to : communicationpreim@primonial.fr

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, Netherlands.

At 31 December 2019, Primonial REIM had:

- More than €21 billion of assets under management,
- 67,841 associates,
- 46 independent real estate advisors,
- Assets worth 4,251,623 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 formalise 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.

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