

# Real Estate House View

## Europe

First half of 2021

### Key takeaways

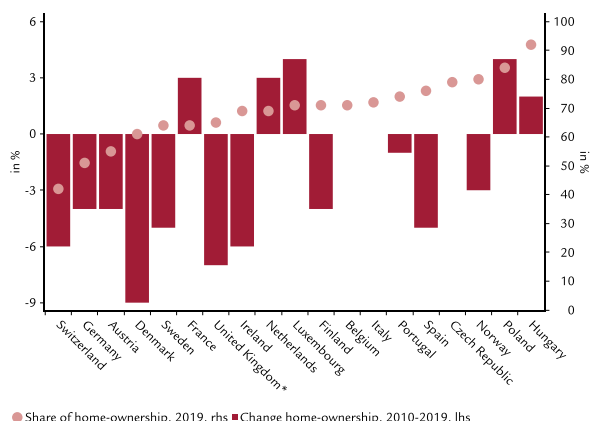
- **The COVID-19 crisis continues to exert an impact on real estate:** prime yields will decrease over the medium term, leading to a flattening of the risk-return curve. Real estate investors are hunting for returns.
- **Uncertain future for offices:** companies could reduce their office space, but we still believe offices will remain a place for employees to meet, socialise and innovate.
- **Remarkable shifts in retail:** the good performance of supermarkets is supported by online shopping, which does not entail demand for floor space. High street locations have suffered as people stay at home.
- **Logistics as winners:** rents remained stable in most European markets in 2020 and limited land availability should further support this development.
- **Hotels remain under pressure:** we do not expect a recovery of investments to pre-crisis levels before 2024. Companies will become much more selective with regard to post-pandemic business travel.
- **Residential encountered a slowdown:** the impact for investors of the economic development (with an expected increase in unemployment and a surge in regulations) will become apparent in the medium term.

### 电子商务 – How to learn e-commerce in Chinese?

While e-commerce growth in Europe is thought to have averaged at around 10% in 2020, China may have experienced up to 30% growth. It is all about live streams, interaction via social media and being part of the product and its use over the phone. There is a “consumer-centric” vibrancy in China’s e-commerce market, while the west has a “tech-driven”, top-down approach.

As a result, the top three US firms (Amazon, Shopify and eBay) account for 50% of the US e-commerce market share, while China’s top 3 (Alibaba, JD.com and Pinduoduo) account for 90% of the Chinese domestic market. Moreover, the mobile share of e-commerce in China currently amounts to 90% (compared to 43% in the US). These are developments to screen.

### Chart in focus



● Share of home-ownership, 2019, rhs ■ Change home-ownership, 2010-2019, lhs

Source: EUROSTAT, \*Latest data for the UK from 2018

Home ownership in Europe is not only heterogeneously spread – from 42% and 51% in Switzerland and Germany to 84% and 92% in Poland and Hungary – but it is also changing: from 2010 to 2019, the rate declined by 2.1% on average. Home ownership is falling particularly in Denmark and the United Kingdom. Astonishingly, the rate is not only decreasing in countries such as Germany and Austria with home ownership rates below the average (69%) but also in countries with historically pronounced home ownership such as Spain (76%). This reduction points towards a growing rental market offering opportunities for investors.

Renewed containment measures to fight the second pandemic wave interrupted the economic recovery in Europe, which started in May last year. Once again, the service sector has been hardest hit while the manufacturing industry benefits from both functioning supply chains and strong demand from abroad. With vaccinations now starting, investors and policy makers see light at the end of the tunnel. For example, up to the general election in September, Germany's ruling government plans particularly strong incentives to continue its generous fiscal policy support for businesses affected by the shutdown. Thanks to the anticipated improvement of the medical situation, we expect the recovery at EU level to resume in Q1 2021. Nevertheless, the worst recession in decades is set to leave its mark in the form of rising unemployment, corporate bankruptcies and negative effects on medium-term growth potential.

## Hunt for returns

Following the initial shock, investors are trying to get back on their transaction target track with some strategic adjustments. Regarding the relative attractiveness, nothing has changed: the low interest rate is set to remain indefinitely. However, the additional fundamental advantage of property – its secure income stream – is less certain than before and investors need to take this into account. Most investors are focusing their demand on prime assets, which are in short supply and caused the volume of transactions in Europe to decrease by 27% y-o-y in 2020. Despite being keen to invest, not all investors are willing to pay just any price. The yields for prime assets will nevertheless decrease over the medium term, leading to a flattening of the risk-return curve. In a decreasing return environment, investors are seeking to maintain their return expectations and/or benefit from higher risk-adjusted returns. This could move investors up the risk curve and flatten it so that the risk is no longer compensated. However, if investors are risk-averse and focus on core/core+, this will lead to a steepening of the curve with higher compensation for more risky strategies. Consequently, some investors may consider a higher risk in order to fulfil their return targets.

## Office: an uncertain future

The income stream is decisive for maintaining returns. Currently, all sectors are facing challenges in one form

or another. As we are continuing to experience renewed lockdowns and their long-term effects such as bankruptcies and increased unemployment, there are still various risks to be forecast, with the greatest uncertainty stemming from structural changes and changes in human behaviour, which are hardest to predict and depend on a range of factors. The question remaining for many property owners is whether offices are set to retain their focal point in business activity. It seems that companies are willing to reduce their office space, thereby saving money and fulfilling the desire of employees to continue working partly from home in the future. This could lead to office space savings of 10-20% on average, which will exert an impact on rents in the medium term. At the same time, we still expect the office to remain a place to meet, socialise, innovate and have a sense of company belonging. Rents will not respond immediately in view of ongoing contracts and the slow reaction to economic changes. Furthermore, brokers are trying to obscure the actual decrease by concealing the increase in incentives. We nevertheless expect rents to continue responding in 2021 after already having done so in 2020, before subsequently recovering in line with the economy. In the markets of Madrid and Milan, rents decreased by 6.5% and 5.5% respectively in 2020. London as a volatile market saw decreases of up to 5% but is set to stabilise again in 2021. All other markets are expected to fluctuate at around -2% in 2021. With regard to yields, investor demand is having a stabilising effect on prime net yield, with more volatile markets such as Warsaw and Budapest set to see an increase. A more negative picture for rents and yields is anticipated in secondary markets. With companies focusing on well connected, central locations, all others will face a challenge.

## Retail: an exceptional experience

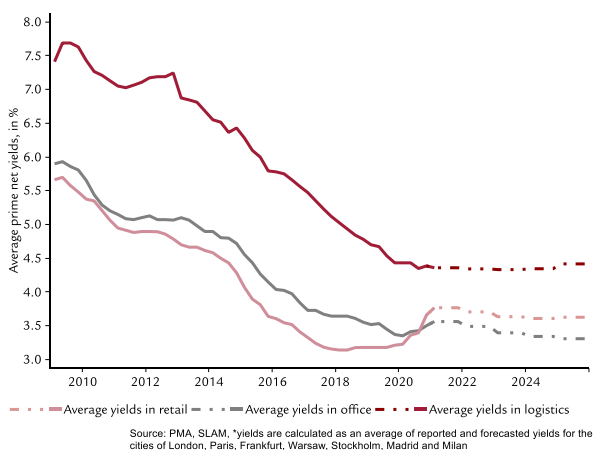
The pandemic has accelerated the structural changes already discussed and largely concerning the sharp growth of online shopping. Even countries that historically have been considered laggards (such as Spain and Italy) are seeing a surge and many obstacles to online shopping (such as payment methods and delivery times) have partially improved across the states. We expect this to remain the case. Nevertheless, the polarisation between subsectors and locations has once again grown markedly. Regarding subsectors, supermarkets are expected to emerge from the crisis as winners. We consider this too short-sighted: supermarkets have benefited from their privilege of being able to stay open

while restaurants were closed and people were obliged to cook for themselves. Also, we saw healthy retail sales figures for 2020 but these were supported by online shopping, which does not trigger demand for floor space. So far, retailers are restricted by the high costs of timely delivery particularly of fresh produce, but once these issues have been resolved, we have no doubt that customers will increasingly be buying online. While the experience for fresh produce will partially remain in the shops, everyday (bulky) goods are simply easier to buy online. In addition, and for the first time in many years, high street locations have suffered more than periphery locations as people have stayed at home. We hope this has given the operators of such high street locations time to rethink how they intend to attract customers in the future. In summary, this will impact rents negatively, with up to -15% possible in many European markets in 2020/21 before levelling off in the medium term.

## All eyes on logistics

The sector has established itself as the perceived winner of the pandemic. Rents remained stable in most European markets in the first three quarters of 2020 and continued to see an upward trend in extremely tight markets. Limited land availability will support this development further. Nevertheless, regional differences are likely to become apparent between logistics core markets such as London and more decentral areas such as Poland, which are suffering from the pandemic and its economic consequences.

**Chart 1: Average yields since 2009 versus average forecasted yields until 2025**



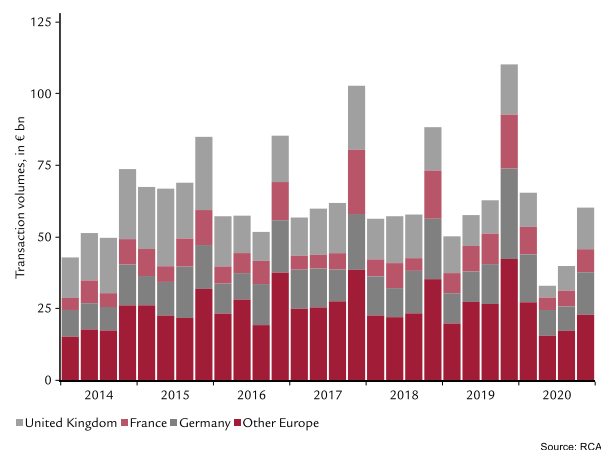
## Hotels: recovery not before 2024

Following an investment volume decrease of 84% y-o-y in 2020, we do not expect a recovery to pre-crisis levels before 2024. The vaccination programme will have a major impact on this sector, which is keenly awaiting this relief and a renewed economic upturn. There is no structural change expected as people start travelling again for holiday purposes, except that companies will be more selective when it comes to business travel. The sector should not be abandoned completely but monitored closely or even considered if risk is taken into account.

## Residential as a solid foundation

Keenly described as a “safe haven” sector within the current crisis, figures reveal a 35% decrease in transaction volumes by Q4 2020 (-15% y-o-y in 2020). This underlines the fact that investor demand is not always as readily available as supply and some figures in early 2020 were significantly boosted by big deals. Nevertheless, the sector is holding up better than others as there are also no structural changes expected. However, the economic impact with an increase in unemployment and surge in regulations will only be revealed in the medium term.

**Chart 2: Commercial property transaction volumes**



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