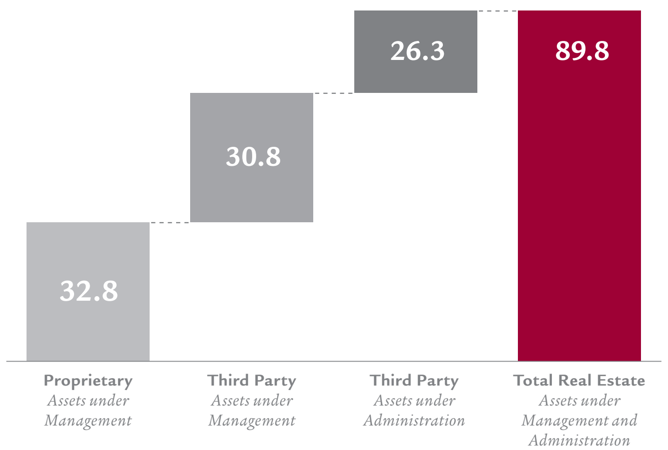
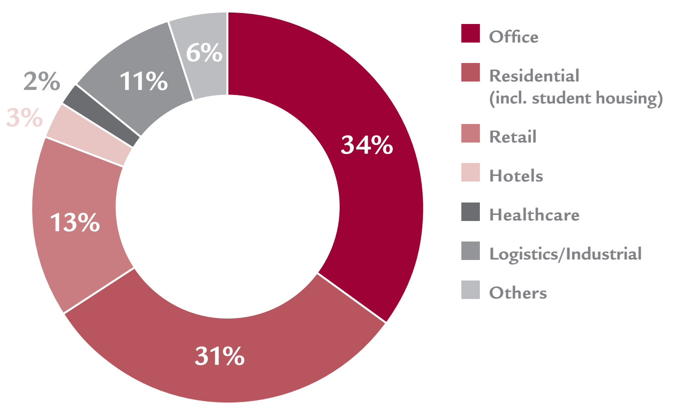
Real estate – facts and figures

Assets under Management and Administration

(in EUR bn)



Breakdown by real estate sector



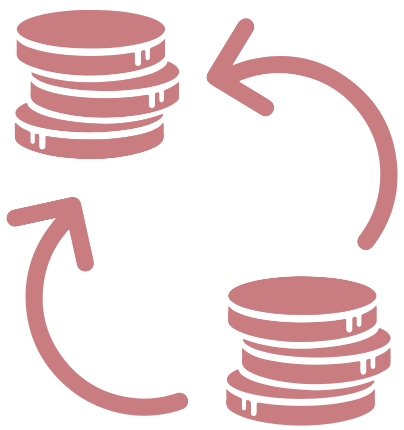
REuM EUR 63.5 bn

Transaction volume real estate

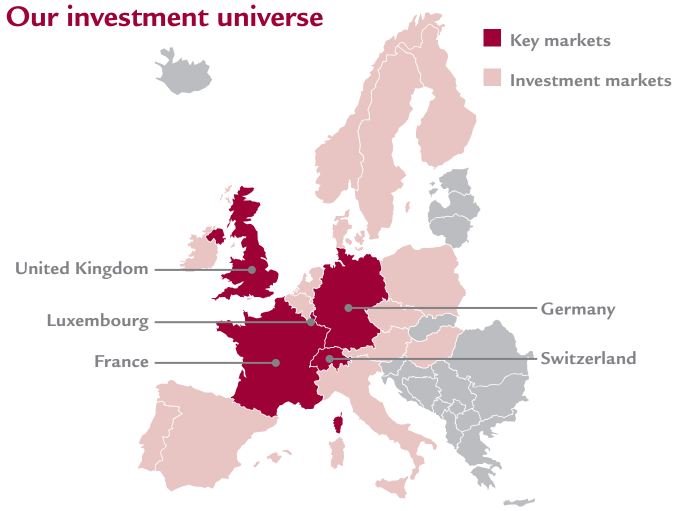
(in EUR bn)

8.5

(average 2017, 2018, 2019)



Our investment universe



Sums are based on unrounded figures and may not add up due to rounding differences.

All figures as of 31 December 2019, unless stated otherwise.

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Swiss Life Asset Management AG: General-Guisan-Quai 40, P.O. Box, 8022 Zurich, tel: +41 43 284 33 11, info@swisslife-am.com • **Swiss Life Asset Managers France:** Tour la Marseillaise, 2 bis boulevard Euroméditerranée, Quai d'Arenc, CS 50575, 13236 Marseille Cedex 2, tel: +33 4 91 16 60 10, contact-france@swisslife-am.com • **CORPUS SIREO Real Estate GmbH:** Aachener Strasse 186, 50931 Cologne, tel: +49 221 399 00-0, kontakt@corpussireo.com • **Livit AG:** Altstetterstrasse 124, P.O. Box, 8048 Zurich, tel: +41 58 360 33 33, info@livit.ch • **Mayfair Capital Investment Management Ltd:** 55 Wells Street, London W1T 3PT, tel: +44 20 7495 1929, info@mayfaircapital.co.uk • **BEOS AG:** Kurfürstendamm 188, 10707 Berlin, tel: +49 30 28 00 99-0, info@beos.net

Impressum: *Publisher:* Swiss Life Asset Management AG, General-Guisan-Quai 40, 8022 Zurich • *Editorial Board:* Francesca Boucard / francesca.boucard@swisslife.ch, Beatrice Guedj / beatrice.guedj@swisslife-am.com, Tom Duncan / tduncan@mayfaircapital.co.uk, Andri Eglitis / andri.eglitis@swisslife-am.com, Alfonso Tedeschi / alfonso.tedeschi@swisslife.ch, Andreas Mayer / andreas.mayer@swisslife.ch, Anna Sigrist / anna.sigrist@swisslife.ch • *Cover Image:* 104 rue de Richelieu, Paris, Swiss Life Asset Managers Paris – Architect: Quadri Fiore Architecture · *Translations:* Swiss Life Language Services · *Coordination/Editing:* Lemon Spark Gmbh, info@lemonspark.ch · *Layout/Design:* n c ag, In der Luberzen 25, 8902 Urdorf · *Periodicity:* Twice a year

March 2020

Insights

Real Estate

Now is the time to invest –

Why the residential market is growing rapidly in the UK

Healthy diversity in Switzerland –

Surprising offerings by institutional proprietors

Booming logistics sector in Germany –

A shortage of commercial sites creates new opportunity

Contents

Editorial

Dear readers,

As we are a few months into the new decade, it is time to take stock and to look ahead. For many, the coming months may harbour uncertainty. However, we are confident that the dynamics of the real estate market in Europe will create ample opportunities for investors and create financial confidence. Sailing through challenging times with experience and the right strategy is crucial, also in the real estate business.

In this edition, we shine light on topics that present a unique set of circumstances coupled with a unique set of solutions. Our economic outlook underlines the importance of maintaining real estate's status as a safe investment anchor during uncertain market conditions. In the same vein, in Germany we look at the necessity for an increased supply of non-residential sites, and the emergence of logistics as an asset class – all a much-needed change. Meanwhile in the UK and France, there are changes afoot, as Paris and London compete for the top spot calling on real estate investments, with a promise of innovative long-term opportunities. Finally, we will look at how in a time of increasing rents in Switzerland, institutionally owned housing could provide a solution to sustainable rent models for the future.

I hope you enjoy reading this edition of Insights.

Stefan Mächler
Group Chief Investment Officer Swiss Life

Keeping eyes open on regulations

Current transatlantic political uncertainty is still feeding into the economic outlook. Politics, in the form of higher regulation density, are also increasingly influencing real estate markets. So while real estate investors keep their demand up, they also need to rise to the economic and political challenges.

Francesca Boucard, Senior Economist Real Estate, Swiss Life Asset Managers

Political uncertainty, slowing economies and "lower for longer" – the topics discussed in 2019 continued well into 2020. Apart from Brexit, the US presidential election jumped into focus, while the trade dispute between US and China is still ongoing. For the Eurozone, we expect the economy to grow by 0.9%, slightly lower than the Consensus Forecast of 1.0%. This is marginally better than was expected. Domestic economic activity remains subdued, although the fiscal impulse in the Eurozone should be bigger in 2020 than in the year before. Unlike in the episodes of 2010 or 2017, demand from emerging markets is unlikely to add further tailwinds to the apparent economic recovery in the Eurozone. We thus expect only a gradual return to growth rates around potential until 2021.

In the current environment, it becomes once again apparent – even after 20 years of common monetary policy – that it is hardly possible to have only one narrative to describe the situation in the Eurozone. While there was fear of technical recession in Germany in 2019, France's performance was relatively strong – a similar performance will be observable in 2020 as well. The difference exhibits the export dependency of the various countries: France and the Netherlands profited from similar stronger domestic demand, while Germany, Austria and Finland, for example, felt the change in global trade.

The differences were also visible in the real estate markets. In the third quarter of 2019, Paris marginally overtook London as the biggest office investment market, showing the wait and see sentiment of investors in the UK and the search for an alternative on continental Europe. This further exhibits the correlation of the economy and the real estate markets, which is why we observe situational changes in the countries closely as the global economy is slowing.

Interst rates expected to remain low

Source: Macrobond, SLAM

Yet the low interest rate environment continues, again aggravating the lack of investment alternatives and pushing investors to buy real estate. As a consequence, it is the lack of supply rather than demand that will keep transaction volumes at bay. At the same time, the high investor demand will stabilize the real estate performance when the demand by occupiers might be dampened by the economic developments. We consider the increase in regulations to be one of the main topics keeping investors busy in 2020, mainly in the residential market. In this line, Switzerland is currently experiencing a couple of political initiatives that pick up on the topic of affordable housing. Affordability is also the reason why the built to rent sector in the UK – traditionally an owner-occupied characterized country – is gathering significant momentum. While urbanization and affordability support the residential sector, regulations may hinder investors to build where people want to live. This and other structural and political changes will force the investor, to keep the tenants' needs in mind. ■

9 January 2020

Paris office market sparks under a rainbow of innovation

"Lower for longer" has meant more exposure to real estate. Given its transparency, size, liquidity and prospects, the Paris office market is among the key targets for international investors.

Beatrice Guedj, Head of Research & Innovation, Swiss Life Asset Managers France

A continuing low interest rate environment has forced International Institutional Investors to increase their exposure to real assets. The latest Emerging Trends Real Estate Survey 2020, released last Autumn from the Urban Land Institute, shows that investors will continue to be net buyers of real estate in 2020 and beyond.

The Paris office market region remains at the top of the hierarchy of investors' target markets. Foreign direct investment (FDI), usually a good proxy of investor's expectation of economic prospects over the medium term, has increased by 12% p.a. since 2014. It reached almost €32 bn in 2018, a multiplier of 1.3 compared to its average since 2008. A large share of these FDI have targeted the Paris region, seen as the main driver of the French economic growth (with a contribution of 30% of French GDP), which benefits from a strong labour market. Despite an ongoing slowdown in the Eurozone, Paris is seen as an economy with solid fundamentals over the long term. More than 3.2 million jobs are concentrated in Paris, 11.5% of the total employment in France. Productivity in Paris stands at €100,000 per head, threefold the national average, while the unemployment rate has generally been 135 bps below the national average in the last decade. It stands today at 6.7% compared to 8.4% for France as a whole.

Entrance to 104 rue de Richelieu in Paris.

Source: Quadri Fiore Architecture and Swiss Life Asset Managers

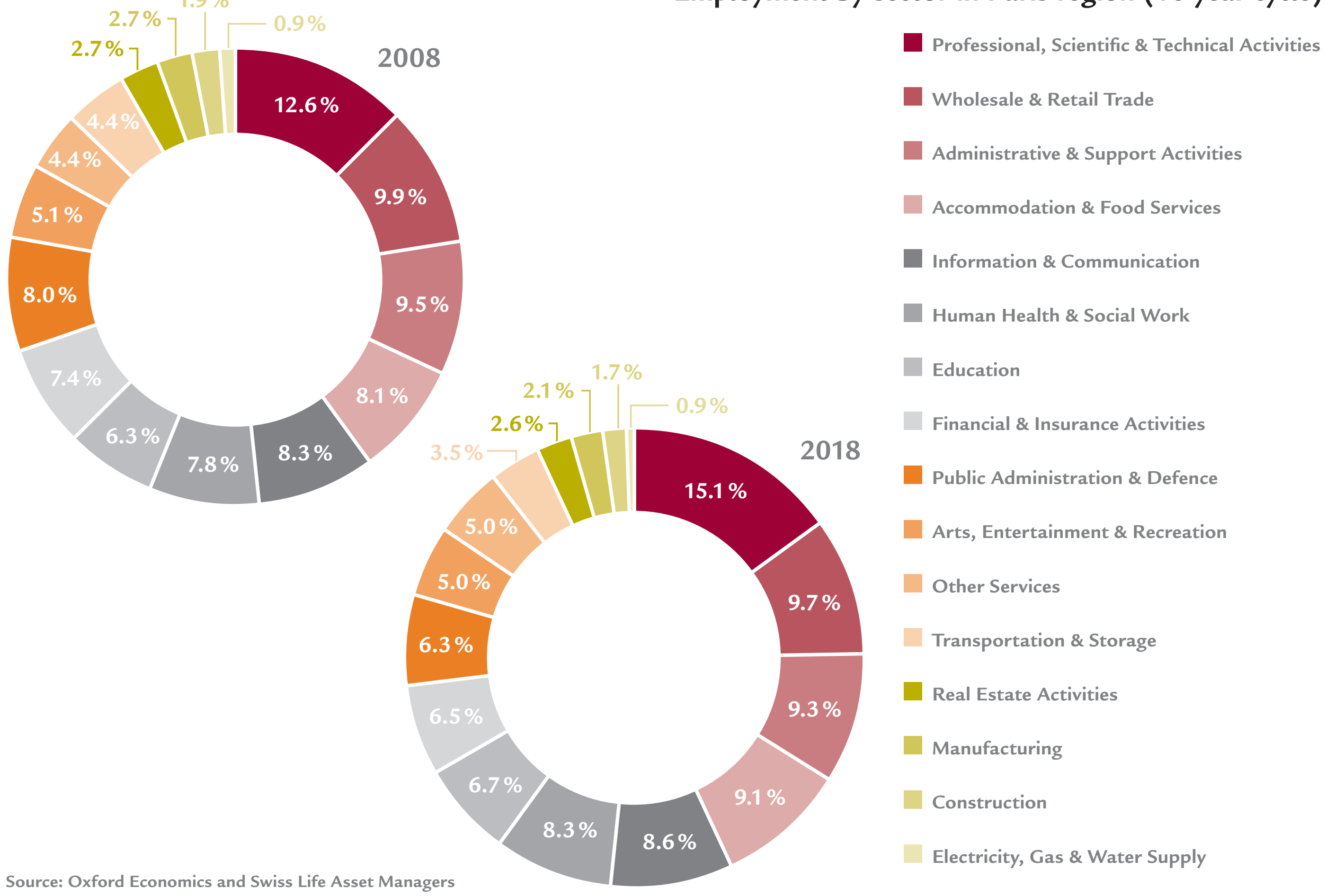
Polarisation in Paris under an innovation shield

The worldwide "metropolisation" mega trend, highly popularized by the Nobel Prize in Economics winner Paul Krugman, has reinforced inner Paris's status as an "innovation magnet." The city has increasingly attracted new (Information, Communication, Technology) corporate investment and shaped innovation clusters to appeal to high skilled workers. These are the three key ingredients for long term performance regarding the ongoing digital technology transformation. Paris has been seen as an innovation-focused city market (digitalisation, AI) with a spill over effect across all traditional tenant sectors (banking, insurance, communication, luxuries…). Such a wave of innovation garners a more tech-friendly environment, and a source of competitiveness and efficiency for both international and domestic companies.

Consequently, the office market in Paris has polarised tenant demand as well as investors' appetites over the past decade. Again, in 2018, Paris bucked the trend with a total return of 8.1%, as compared to 6.4% for the overall office market, with a strong contribution of rental value growth. Paris's inner city is the place to be to leverage on economies of scale and increase labour productivity through innovation. Other office markets outside the CBD (Central Business District) are reinforcing their position through a more differentiated tenant-base and a willingness to pay for Grade A offices. Google, Facebook and other international flagship tech names have re-located to this new spot in town, close to start-ups, but also to increase synergies with Blue Chip customers. This strong demand from tenants has extended the office market supply in new districts, with a change in the use of repositioning. Rents have started to catch up and rental growth is not yet to fade. In 2018, office total returns outside the CBD almost reached 8%, far above the 6.6% of all property sectors. The second-round effect of such a strong demand has sustained the gentrification effect in terms of residential and retail markets, apart from offices. As we are heading toward a global economic slowdown, Paris will continue to focus attention on greater resilience and attractive returns across all asset classes over the long term. ■

Paris's inner city is a key platform for the ongoing digital revolution across all sectors. The office market, outside of the CBD, is spreading in new districts through a gentrification process.

Employment by sector in Paris region (10 year cycle)



Source: Oxford Economics and Swiss Life Asset Managers

Developments provide investors with access to logistics properties

Logistics properties are firmly established as a dedicated asset class in the portfolios of institutional investors. Under current market conditions supply does by far not meet investor demand. Direct development of product by the investor and subsequent transfer to an investment vehicle provides a solution.

Andri Eglitis, Head Research, Swiss Life Asset Managers Germany

Demand for logistics space is being driven by strong e-commerce growth, as well as traditional store-based retailers, the manufacturing sector and their logistics service providers. These occupiers are seeking modern large-scale facilities for national and international transportation at strategic hubs. Driven primarily by e-commerce, these distribution centres in urban areas include new types of urban logistics buildings. Occupier take-up in Germany and Europe has risen noticeably in recent years, however, momentum is slowing. JLL, a real estate agency, has reported a 5% decline in take-up in the first nine months of 2019 in Germany. Given persistently high demand, the inadequate availability of space is a limiting factor, given that the number of sites for logistics use is decreasing. This scarcity is leading to rising rents, especially in metropolitan areas. Strong fundamentals and high initial yields, compared to other sectors, are fuelling investor appetite, and transaction volumes are reaching record levels. According to analysis by PMA, a data provider, German logistics transaction volumes rose from EUR 1.8 billion in 2012 to EUR 9.2 billion in 2017 but dropped to around EUR 7.2 billion in 2018. The figures do not reflect weakening demand, but rather a lack of quality stock. As a result, initial yields for prime assets in metropolitan regions fell by an average of 40 basis points to roughly 4% during 2018. They eased by another 20 basis points in the first half of 2019. Nonetheless, there remains a yield spread of around 100 basis points relative to prime offices, which is one of the main reasons for the continued attractiveness of logistics investments.

Source: BEOS AG

In the “Dock100”, BEOS AG developed a distribution centre of around 13,700 square metres from which Berlin's inner city districts are serviced within an hour.

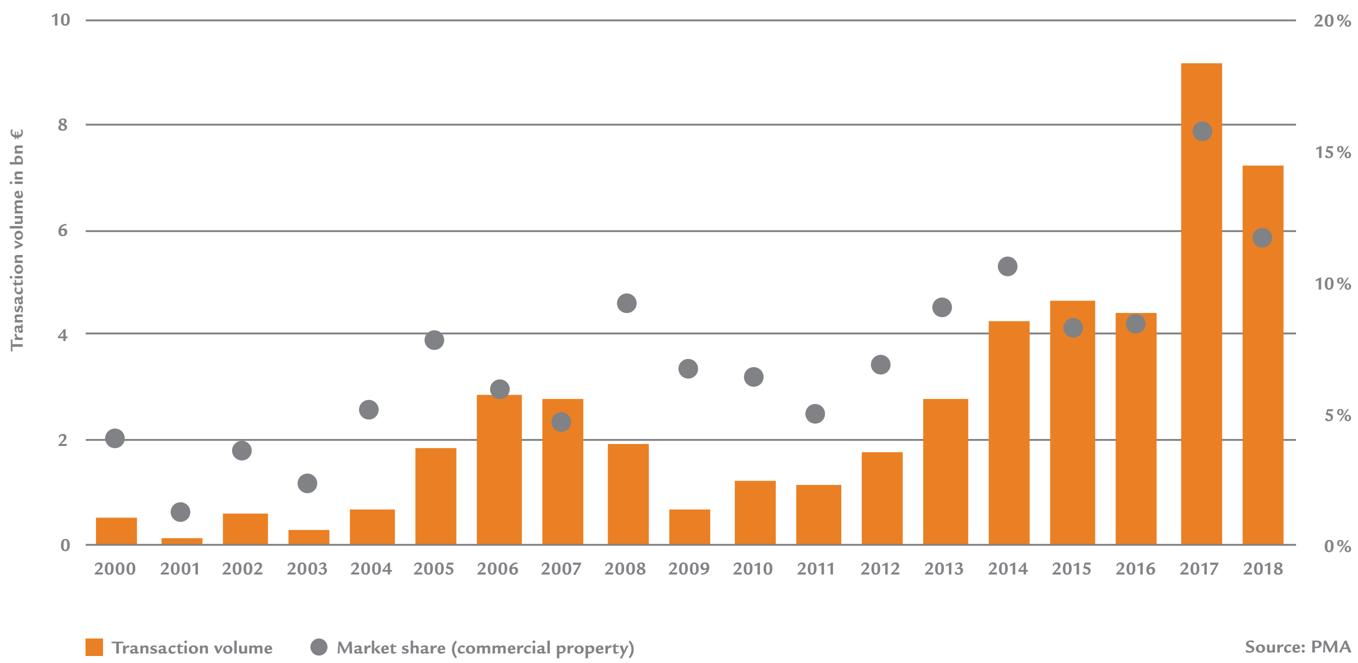
Land banking counteracts low stock availability and creates investment opportunities for logistics products.

Investors are seeking to counteract the insufficient availability of investment product by cooperating closely with developers. The purchase of development projects prior to completion in forward funding deals or joint ventures has become common practice. Developers enjoy the advantage of securing land at an early stage in strategically favourable locations (“land banking”), which is subsequently developed for the specific needs of occupiers (built-to-suit) or built on a speculative basis.

The next step for investors is to carry out project development in-house and transfer the new product directly into their investment vehicles. This strategy generates supply in a competitive market environment but requires sufficient in-house project development expertise, which is limited to a small number of investors. ■

Through its German subsidiary BEOS, Swiss Life Asset Managers will increase its European activities in project development and investment in logistics real estate. BEOS will act as a competence centre for industrial & logistics. BEOS has many years of experience in operating mixed-use industrial real estate; for example, it acquired a large part of the Griesheim industrial park in Frankfurt am Main at the beginning of 2020. The site, which has been taken over under a 99-year leasehold, provides 545,000 sqm of space in a central location in the Rhine-Main area. It offers a wide range of development opportunities for commercial use in offices, research and development, logistics or manufacturing. The property thus offers a great example of land banking, in this case a brownfield site.

Logistics transaction volume in Germany



Source: PMA

Switzerland

Institutional proprietors offering healthy diversity of rental apartments

The demand for rental apartments in major Swiss cities continues while vacancy rates remain low. Contrary to popular belief, institutional proprietors have a diverse range of apartments on offer, priced affordably for the great majority of domestic households.

Alfonso Tedeschi, Real Estate Product & Service Manager, Swiss Life Asset Managers

The current excess in demand is driving political acceptance of regulating the rental apartment market in Swiss cities. Such calls for state intervention raise a question: does the real estate market in its present form offer a sufficient number of affordable apartments? An analysis shows that in regard to rental price level and property quality, institutional owners such as Swiss Life do make a diverse range of rented accommodations available. The median rent for a four-room apartment in the Swiss Life portfolio is CHF 1400 net per month (median living space 96 m^2). For the most part, rents for institutionally owned apartments are affordable. This is due, among other things, to current tenancy laws, which allows adjustments to rental rates only in the case of changes to the reference interest rate, or the performance of value-enhancing renovations. While on the broader average asking rents are significantly higher, this affects only a small proportion of the tenant population (average rent fluctuation: 14% per year).

Rising affluence as (cost) driver

In Switzerland, rising affluence has led to greater use of space. In the period from 1980 to 2018, per capita consumption of surface area increased from 34 m^2 to 46 m^2. On the other hand, the proportion of household income used for housing costs has remained virtually unchanged despite a rising quality of housing. Also, a glance across the border indicates that Swiss apartments are not overly expensive by international comparison. According to Eurostat, the proportion of available income used for housing costs is 25%, which means that Switzerland is at roughly the same level as other high-income countries, such as Germany, Denmark, the UK or the Netherlands, or even below them in many instances.

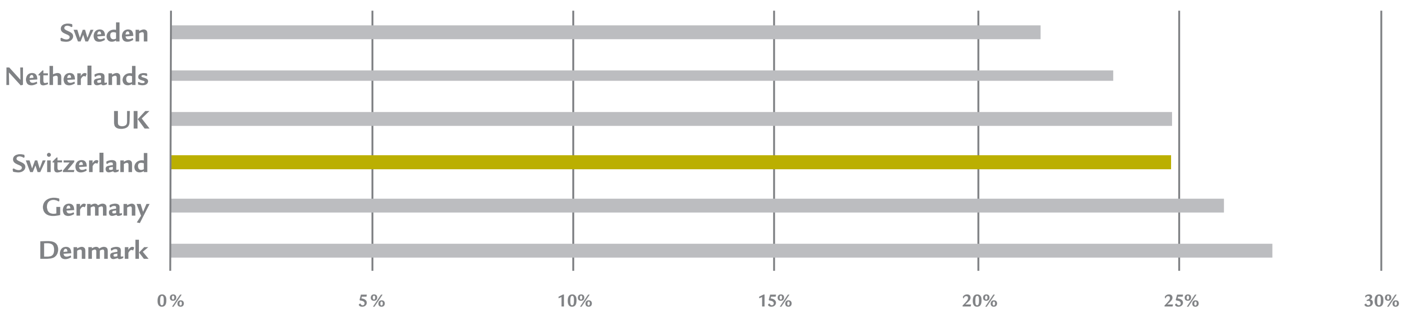
Compact floor plans and densification offer the solution

In Switzerland, it is mainly lower-income and single-person households that are confronted with affordability issues. These are the groups targeted by the construction of public housing. The proportion of public housing construction in Swiss cities is around 11%; in Zurich it is perhaps as high as 20%. Providing affordable apartments, however, is not the exclusive purview of the public sector or the cooperatives. With demand as it is, institutional investors are building ever more compact apartments with optimised floor plans and relatively low rents. This same trend has been evident throughout Switzerland in the reduced surface area per apartment built since 2006.

More compact apartments are affordable for lower-income and small households and are very easily let. Swiss Life is successfully engaged in a number of projects in this investment segment – not least because it affords an opportunity to diversify real estate portfolio risk. A further approach to increasing the residential portfolio is consistent densification of surface space. This serves the interests of sustainability and creates residential space where there is tenant demand. To this end, a more stringent and closer-knit cooperation between communes and builders will be called for in near future. ■

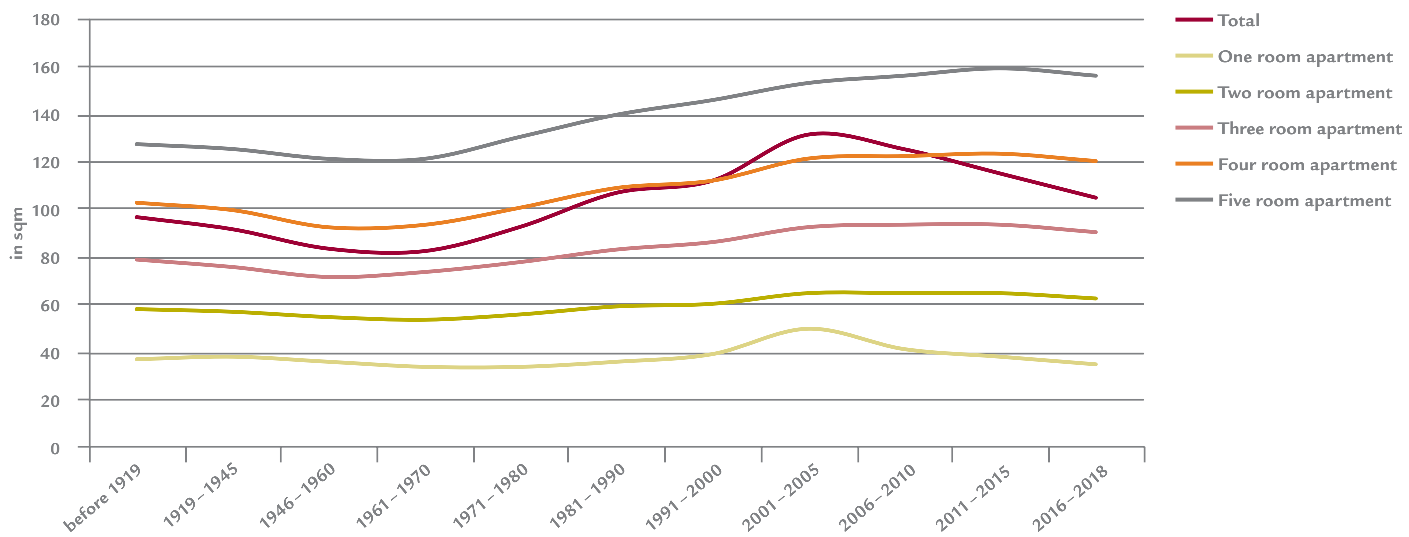
The project "Stahlgiesserei" in Schaffhausen convinces with efficient floor plans and an urban flair combined with an attractive pricing.

Proportion of available income used for housing



Source: Eurostat and Swiss Life Asset Managers

Average surface by construction year and number of rooms



Source: Federal Statistical Office and Swiss Life Asset Managers

United Kingdom

The UK's Build to Rent sector is rapidly gaining investor interest

Fundamentals in the UK's Build to Rent sector are sound due to increasing population, rising numbers of renting households and a lack of supply. The sector offers major growth potential to investors seeking a secure, long-term income stream. It is attracting significant capital as a result.

Tom Duncan, Research, Strategy and Risk, Mayfair Capital Investment Management

The UK has traditionally been a nation of home-owners, but structural change is driving more households towards the private rented sector (PRS). In 2018, 4.5 million UK households were in PRS, a rise of 1.7 million since 2008, according to the Office of National Statistics *(Graph 1)*. Government data indicates that UK home ownership fell from 68% in 2008 to 63% in 2018.

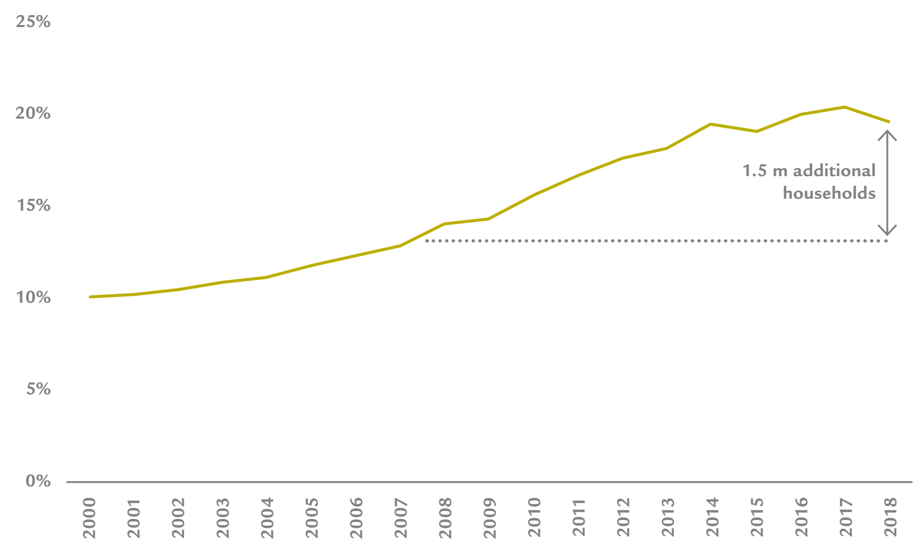
Demographics are perhaps the dominant driver of this shift, with rapid population growth, urbanisation and rising single-person households fuelling demand.

Both push and pull factors

For decades, new housing supply has failed to keep pace with demand, exacerbating housing affordability issues. In Q3 2019, for example, the first time buyer house price to earnings ratio stood at 5.0 in the UK and 8.9 in London, according to Nationwide. Growing unaffordability is pushing more households towards renting. At the same time, some households increasingly desire lifestyle flexibility, and the geographically mobile nature of modern labour makes PRS appealing. Thus, push and pull factors conspire to drive demand for PRS product. These trends are only gathering momentum.

Proportion of English households in the private rented sector

Demand for PRS has risen over the last decade



Privately renting households

Source: English Housing Survey 2017/18

PRS is ripe for institutionalisation

Historically, the UK's PRS supply has been provided by individuals or small companies managing a few dozen properties. Given the long-term growth potential, the UK's Build to Rent (BtR) sector is now gaining major interest from institutional investors for whom it can offer a stable, long-term income stream. For tenants, BtR offers a professionally managed solution, high-quality product with greater assured tenancy length. The rise of BtR thus benefits investors and tenants.

Significant BtR capital investment

Analysis by CBRE indicates that UK BtR investment totalled approximately €1.7bn in H1 2019, a 20% increase on the previous year. Research by Savills suggests that the UK's BtR sector today comprises 30,400 units with a further 110,000 in planning or under construction, but it has capacity for 1.74 m units at full maturity. The future growth trajectory and compelling demographic support – with significant population growth expected in the UK's major cities *(Graph 2)* – are reasons why investors like Mayfair Capital see so much opportunity.

Careful selection needed

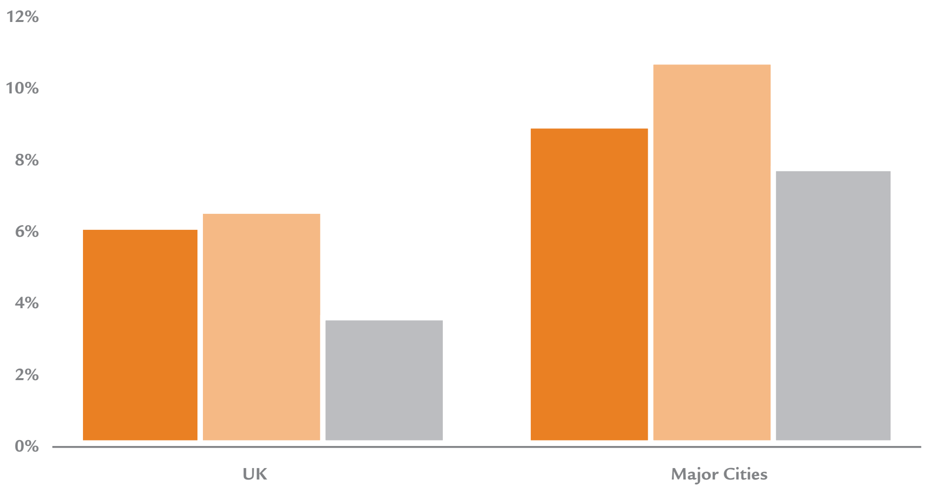
The UK's BtR sector is evolving rapidly. UK providers are developing stock dedicated to specific demographic groups. BtR schemes targeting young professionals, for example, might include provision for flexible office space within the building. Product targeted towards young families may include communal play areas and offer babysitting services.

BtR increasingly uses modular construction where buildings are constructed off-site. This enables a shorter build period and delivers income to investors earlier. Standardised units allow for easier repair and maintenance too.

The range of products on offer and the rapid pace of change means investors must be careful to select the best stock coupled with a high quality management platform in every location. ■

UK and city population growth forecasts

Population growth is concentrated in cities



2001–2010 2011–2020 2021–2030

Source: Oxford Economics (November 2019)

Professionally managed BtR product is highly attractive to tenants.

Source: Shutterstock