October 2020

Insights

Real Estate

Swiss Life Asset Managers

Industrial and Logistics –
Risk-adjusted investment opportunities across Europe

Residential –
How the crisis has and hasn't affected the market

Diversification –
Resilient returns despite uncertain times

Contents

Editorial

Dear readers,

We revamped our latest issue of Insights, going forward we will keep you informed about the latest trends shaping the real estate sectors and important events affecting these markets. We all observed that COVID-19 has been a catalyst for real estate as it accelerated various trends and the knock-on effect is still ongoing. We feel it is ever so important to analyse, understand, and be prepared for the changes to come.

One of the topics we focus on is diversified real estate investment strategy. By having the latitude to acquire European assets across the full risk spectrum, allows investment throughout market cycles in myriad ways. We continue to underline the stability of residential assets through the turbulent times of COVID-19 and its resilience to current market fluctuations. We also look at developments of major industrial and logistics clusters in Europe in the economically strong metropolitan areas, making them preferred investment locations and how smaller regions are establishing themselves as modern, tech-based industry hotspots. Our gratitude goes to operators of our healthcare assets, mastering the challenging times during the pandemic and ensuring the safety and well-being of the tenants. It proves once more that when we come together and support each other we build upon a positive and sustainable outlook for the real estate sector as well as the communities we operate in.

I hope you enjoy reading this edition of Insights.

Stefan Mächler
Group Chief Investment Officer Swiss Life

Does COVID-19 change everything?

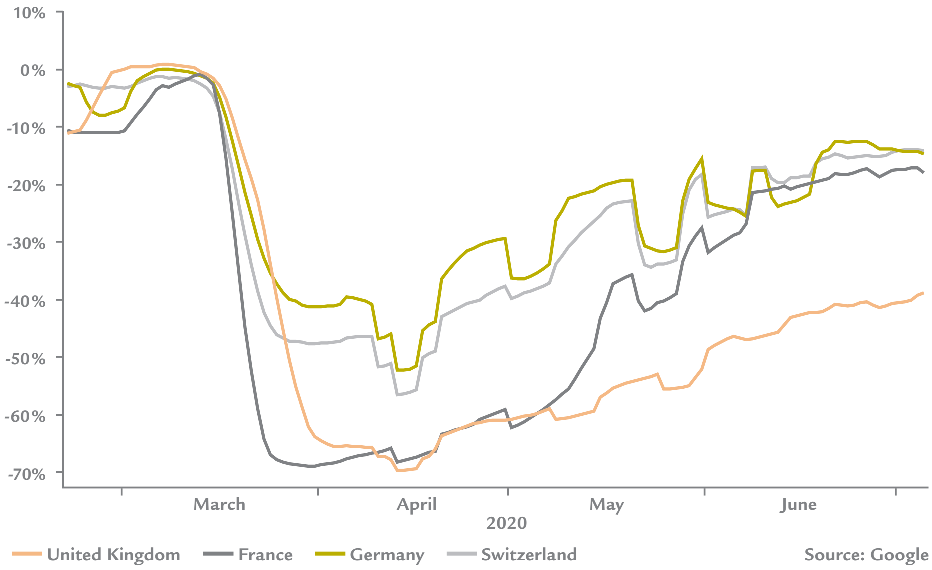
During spring and well into summer, Europe was marked by closed shops and unattended offices. At the same time, apartments – usually vacant during the day – were in full operation. Now that at least in Europe some measures have been eased, one question arises: will the real estate market remain as we knew it?

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

Unlike the great financial crisis (GFC), the outbreak of the pandemic is an exogenous shock that has affected the real economy. State interventions with the closure of shops and borders, travel bans, and people working from home instead of commuting to the office – everything has changed in a very short time. The global economy is in a deep recession. But unlike during the GFC, fiscal and monetary support has been made available – rapidly and in larger quantities. The prolonged low interest rate environment is supporting the investors' need to spend money on real estate. What remains to be answered is at which risk profile, which sectors and in which conditions?

The retail, gastronomy, and hotel sectors are most immediately affected by the pandemic. In retail, while greater online penetration with some sort of habituation effect is likely to bring a lasting change, lower quantities of physical retail floorspace and more demand for logistics can be assumed. Also, occupier demand for physical retail will be focused on the provision of convenience (your groceries on the way home...), value (...at a discounter), and experience (introducing some sort of social distancing yoga). Restrictions in movement increased spending shifts towards local retail facilities. While local spending might be beneficial for some retailers, hotels depend on free travel and international traffic. We think the appetite for hotels will be subdued for some time further. Once people can freely move across countries again, the recovery of the hotel sector could be equally fast.

People's frequency of visits and length of stay of workplaces



Source: Google

The office sector is the one that poses the biggest question mark. Aside from some companies rethinking their expansion plans, the question of permanent home office solutions lingers. While companies will be forced into accepting remote working possibilities for their employees whenever feasable, the office will still be an environment of innovation and human interaction. With a fit out orientated more towards user experience rather than functional desk-based working, the office will still be used as point of attraction for companies to appeal to employees.

The residential sector was once more a safe haven during the crisis, investors relying on the need of shelter for everyone. While this is true in the short term, recessional tendencies across the globe may impact the purchasing – or in that case rental – power of tenants, bringing back affordability issues in urban areas and possible political regulations.

Overall, the COVID-19 crisis has not unveiled unknown changes or new topics in the real estate markets, but it has accelerated already well-known structural changes. With this, the markets have once again turned more into tenant markets, forcing investors to get to know their (future) tenants. If both sides are flexible and open for innovation, we will see only a short hiccup in the European real estate cycle – at least on the transaction side. ■

4th August 2020

A diversified real estate investment strategy supports income and growth

All physical buildings differ, making real estate a unique asset class with substantial diversification benefits. Varied, responsible investment creates enduring income and capital growth throughout cycles if investors focus on resilient or counter-cyclical sectors, occupiers, locations and assets.

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

Traditionally, real estate was often viewed as an investment portfolio diversifier due to its low return correlation with equities and bonds and its inflation-linked income streams. The sector has rapidly matured over the last decade to become more global, institutional, transparent, liquid and sophisticated. Today, real estate is much more than just a downside hedge within a multi-asset portfolio. It offers attractive opportunities independent of other asset classes.

Every building is unique. Its structure, specification, occupancy profile and utilisation are individual. So too are its macro and micro location aspects, such as transport access, adjoining land uses and demographics. This uniqueness offers investors access to a near limitless range of product types at a varied risk profile, as each building provides exposure to different underlying economic, social and geo-political trends.

Occupier granularity varies too as landlord relationships and asset management have a significant influence on occupier attraction, retention and chargeable rents. Informed landlords can actively protect, create and grow income regardless of wider economic conditions in a way rarely

Kustermannpark, Munich: A resilient office attributable to macro, micro and asset-specific factors.

Source: Atchain Art Technology

available in bonds or equities. Another benefit is the ability to invest responsibly and, in so doing, make a tangible impact on achieving broader ESG objectives.

Adopting a diversified real estate investment strategy, for example, by having the latitude to acquire European assets across the full risk spectrum, allows investment throughout market cycles in myriad ways. During downturns, investors can preserve and grow income by accessing resilient prime assets and counter-cyclical sectors. In upswings, they can shift towards sectors, assets and locations more closely aligned to cyclical economic performance and pursue opportunistic asset repositioning to drive capital returns.

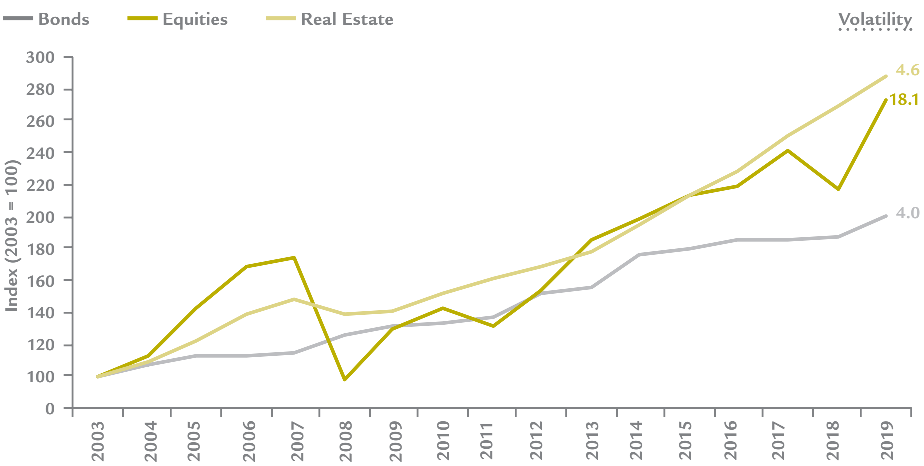
An example of a counter-cyclical sector is logistics. Rising e-commerce penetration and ongoing supply chain renationalisation means sustained occupier demand for well-located logistics stock. An example of a resilient asset is the Kustermannpark. It is situated in a vibrant submarket in the growing city of Munich, which has strong knowledge-based employment. The long-let government anchor tenant and its scope for value-add creates rental growth prospects throughout the cycle.

Operating a diversified real estate investment strategy can ensure consistent returns whilst mitigating the downside risk of overexposure to a single country, sector or occupier. Pan-European funds with a diversified strategy can be nimbler than other strategies in adapting and acting upon new trends or changing market conditions. Building specification and asset management styles can be readily adjusted to constantly maximise rental growth potential. Recognition of the benefits that a diversified strategy can offer explains rising capital allocations being directed towards real estate. ■

Divergence: European real estate sectors have different cycles

Source: MSCI Global Intel – Pan European (Annual), December 2019

Solid performance: Total return index by asset class (2003 = 100)



Source: Macrobond; MSCI Pan-European Index 2019; Bloomberg Barclays EU Government Bonds

Risk-adjusted investment in logistics and industrial

Logistics has become more popular with investors, but following substantial price increases it is low yielding. Driven by similar fundamentals, a combination of small-scale industrial properties and large-scale logistics offer higher returns and more investment opportunities than logistics alone.

Andri Eglitis, Head Research, Swiss Life Asset Managers, Germany

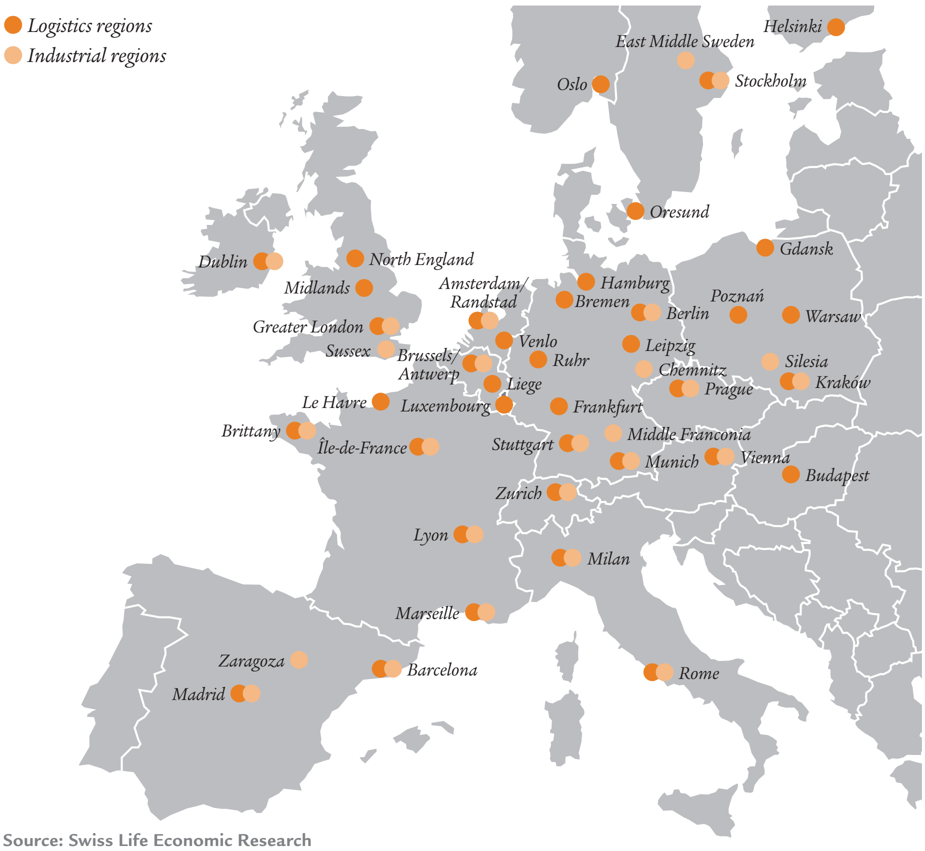
Industrial and logistics is a major economic pillar and the supplier of goods to companies and households. The sector comprises large-scale logistics assets of at least 10,000 m² located in metropolitan areas and logistics hubs situated in more remote locations. Industrial assets include mixed-used commercial properties (storage, office, manufacturing, R&D) with a multi-tenanted, multi-use structure typically located within or near to economically strong conurbations.

Industrial and logistics demand benefits from long-term structural trends. Firstly, rising e-commerce requires more space for goods storage, delivery, and returns. Secondly, last mile delivery is becoming crucial and due to limited urban space the co-location of logistics utilities with other uses is gaining importance. Thirdly, smaller and decentralized production sites are replacing large factories as the basis for modern manufacturing (Industry 4.0). Fourth, trade conflicts and COVID-19 related global supply chain disruption is likely to prompt more companies to relocate production and supply components to Europe.

The major industrial and logistics clusters in Europe are the economically strong metropolitan areas, making them preferred investment locations. In addition, some smaller regions have been established as modern, tech-based industry hotspots. Large-scale logistics facilities, on the other hand, are spread across strategically favourable locations.

Total industrial and logistics stock is significant, accounting for around 30% of all European commercial real estate. However, large parts of the market, especially in the industrial sector, are not investable, as assets still belong to owner-occupiers. Historically, companies have been reluctant to rent rather than own their space. This attitude is now changing.

Top regions for I&L property in Europe



Source: Swiss Life Economic Research

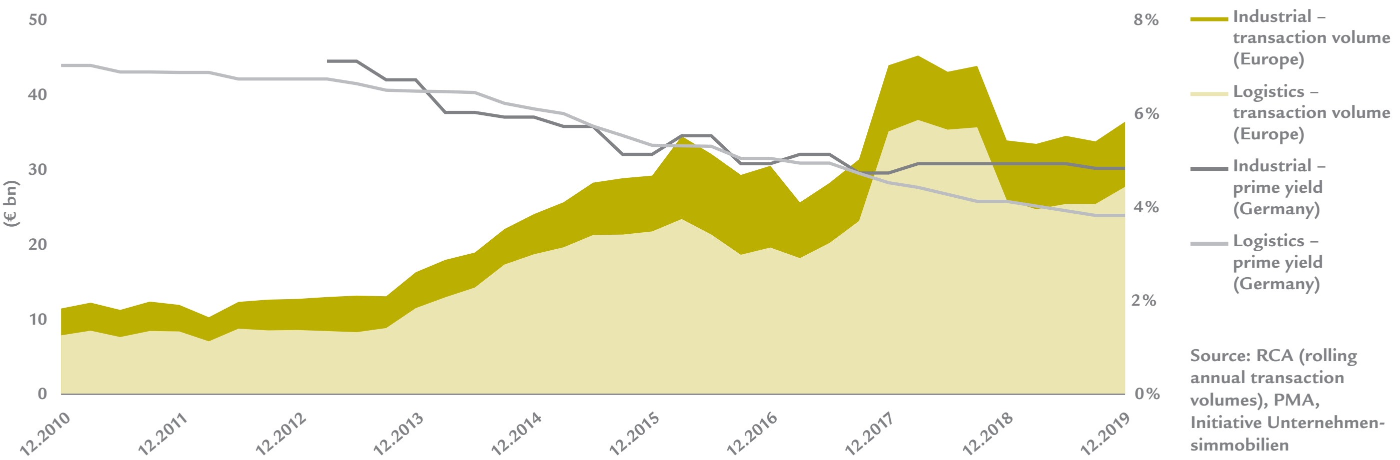
Business Park Q-Park in Maisach near Munich: Production site for high-tech companies representing the trend in Industry 4.0.

From an investor perspective, logistics is an established sector, whereas industrial is more fledgling. European transaction volumes in both segments have risen steadily over the last few years from EUR 11.4 bn in 2010 to EUR 36.4 bn in 2019, according to RCA. The most popular markets are the UK, France, Germany, and the Netherlands, which have attracted over two-thirds of capital.

Investors have achieved strong performance through industrial and logistics in recent years. According to MSCI, European annual total returns averaged 10.3% in the past 10 years (and 8.8% since 2001), with a high income return of 6.3%. Given current pricing, however, such returns are unlikely in the future. Prime average European logistics yields compressed from 7.1% in 2010 to 4.5% at the 2019 year-end (PMA). Yields have fallen below 4% in Germany and the UK. Industrial average prime yields remain around 5%, with light manufacturing or business parks higher-yielding.

Combining logistics and industrial in one portfolio offers investors the chance to generate attractive returns and reduce risks. There is a larger, growing pool of investable stock and, via mixed-use industrial properties, a diverse occupational profile including companies with varied economic exposure. ■

Transaction volumes and yields in Europe's industrial and logistics market



Source: RCA (rolling annual transaction volumes), PMA, Initiative Unternehmensimmobilien

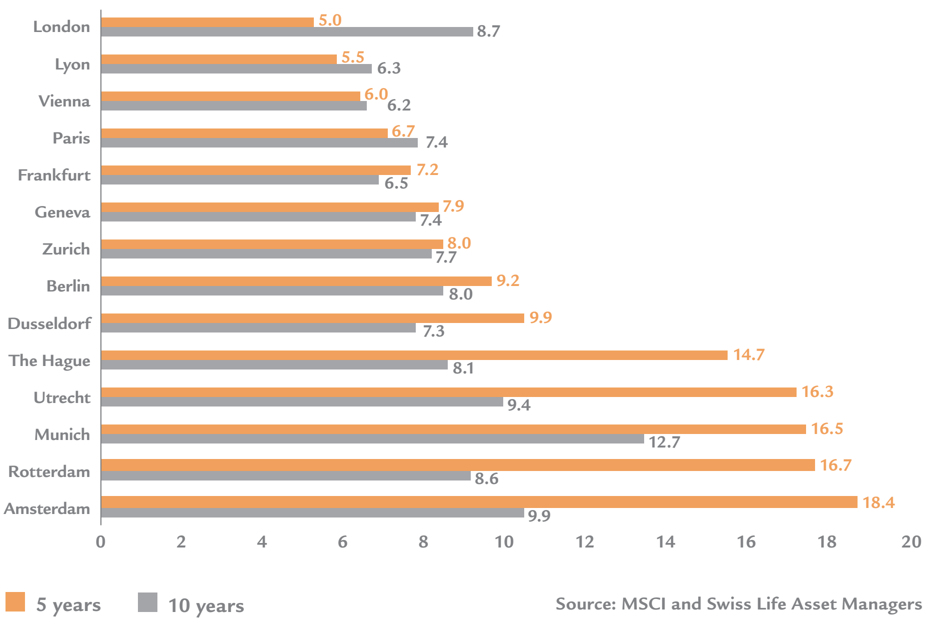
Residential sector remains countercyclical

COVID-19 has been a great catalyst in real estate by accelerating existing trends and ongoing changes. As residential ensures resilience, the sector's attractiveness will continue given its risk-return profile. A pioneer in the field and given its large platform, Swiss Life Asset Managers is strongly active across Europe.

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

On the European listed markets, residential has been one of the most resilient sectors since the onset of the crisis: the EPRA residential index used for the European Real Investment Trust vehicles observed a smaller drop compared to peer sectors. As of today, the EPRA residential index has almost totally recovered to its pre-crisis level, a similar feature to both US and Asian listed markets. Worldwide, the residential property sector outperformed other asset classes. Mainstream sectors such as offices and retail are still in the doldrums, well below their level before the market turmoil. The residential asset class is definitely the stronger contestant of the COVID-19 era, reiterating its defensive nature, over-performance during downturn, and diversification effect; the low correlation of residential with equities and commercial property continues to make the sector attractive in portfolio construction.

Total Returns (%) across Main Cities in Europe



Source: MSCI and Swiss Life Asset Managers

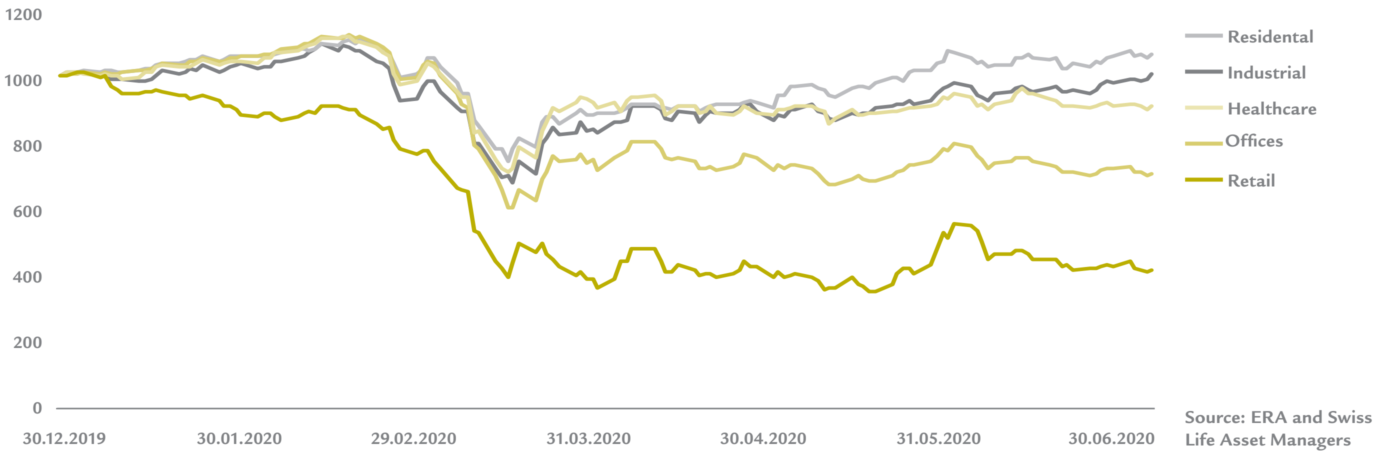
In the European sphere of MSCI, including non-listed vehicles, the residential sector has provided 7.8% p.a over the past 10 years, compared to 10.4% p.a over the past five years. Unsurprisingly, across all European countries, the residential sector, given the low volatility of total returns compared to other real estate asset classes, offers a risk-adjusted return well above 1, meaning the return strongly compensates for the risk. In key cities, risk-return ratios are above national equivalents given the strong imbalances between supply and demand. In European cities, with the largest labour markets, income returns have been driven by steady rental growth over the past 10 years: 2.6% p.a in cities like London, Paris, Lyon; 3.1% p.a in German cities (Berlin, Dusseldorf, Frankfurt, Hamburg, Munich); 3.5% p.a in Dutch cities; and 3% in Geneva, compared to 3.4% p.a in Zurich. Unsurprisingly, capital returns in almost all cities have been on an increasing trend, except London, where capital returns have sharply slowed down since the Brexit.

Residential returns' profile and stable earnings related to both Private Rental Sector (PRS) and Affordable Housing (AH) are perfect to match liabilities to annuities from both insurers and pension funds over the long term; they both rely on demographics and urbanisation trends. Even though Europe's population growth is essentially flat, cities exhibit large differences and metropolises tend to anchor an increasing demand for PRS and AH. Both asset classes are complementary and indirectly ensure economic competitiveness and social equilibrium for the post COVID-19 era.

The equity or funds raised related to residential property has been on an increasing trend in Europe since 2018, and the appetite is not set to fade given the countercyclical feature of the asset class residential. Also, there is a clear opportunity for positive environmental and social impact in investing across housing asset classes. Firstly, urbanisation is good to minimise carbon footprint. Secondly, residential fits into various types of demands and therefore can be instrumental to bringing institutional capital and responsible investment into affordable and social housing markets. The jobs and cost of living dynamic equation needs to be solved. Finally, investors with a strong platform across Europe benefit from a competitive edge in terms of skillsets, economies of scale, and knowledge of regulations, especially when it comes to both private rental sector and affordability of housing. ■

The newly constructed high-rise block of flats in Zurich Altstetten has set a benchmark in urban development.

EPRA: European Index Share Prices Base 1000 late 2019



Source: ERA and Swiss Life Asset Managers

Together we can mitigate the Corona crisis – auxiliary kit in times of COVID-19

Our healthcare funds show how landlords and tenants can master the challenges of the Corona crisis together. When our portfolio and asset management got in touch with operators at the beginning of the pandemic in order to understand the impact of the virus, it quickly became apparent that many needed help.

Marc-Philipp Martins Kuenzel, Head of European Health Care Competence Center, Swiss Life Asset Managers

The first step was to understand what is being done by nursing homes and assisted living operators to prevent the virus from spreading and to isolate residents where necessary. Swiss Life Asset Managers collected the measures in place from all its operator partners, summarized them in one document and shared them back with all. This created broader transparency, trust, and a sense of togetherness in difficult times. As such, each operator had useful information about 20 other operators dealing with the same topic. Our COVID-19 taskforce started an intensive search for immediate deliveries of protection masks, disinfectants, gloves, and safety goggles. Hundreds of companies were contacted to find the necessary and much needed material. In addition, air purifiers for public areas in the medical office buildings and some nursing homes of Swiss Life Asset Managers were installed, and specialised companies were instructed to frequently disinfect public spaces and surfaces like handrails in the medical office buildings.

After intensive work, in addition to ordinary daily business, the fruits of this extraordinary commitment could now be harvested. Here are just a few examples of the reactions of various operators:

“Thank you very much for the respiratory masks that we urgently needed. I never thought that I would be so happy with protective masks in my life. Have a nice time and stay healthy.”

“Thank you very much for your help & support. We very much appreciate this measure. I have never seen such a great gesture from a landlord in my professional life. Currently everything is running smoothly in the care facility. The house is fully occupied, almost all employees are on board. Corresponding emergency plans are running in the background. Connected with another thank you from the facility management, I send you many greetings from Bünde”

"It is really unbelievable what you are currently providing us with. I would never have believed that me and my colleagues would be so happy about mouth protection articles and disinfectants. This is almost like Christmas in the current situation. Many thanks to all of you! I didn't register that the air purifier was delivered by you. In any case, I would like to thank you on behalf of all employees and residents and wish you the very best. Please stay healthy!"

"Yesterday the two additional air purifiers arrived. The mouth-nose masks and the disinfectants were delivered as well. Thank you very much for this. Now we are very well positioned thanks to your help."

We are very happy to have helped but at the same time we want to make clear that it was only an initial support during the crisis and that our contribution is only a minor part of what the operators themselves have done and are still doing.

In 2050, there will be one person over 60 for every two of working age. This presents a substantial challenge for European societies, which we want to help solve. Our aim at Swiss Life Asset Managers is to create a continuity care plan, which begins at home and helps individuals live a longer self-determined life.

Several sociodemographic megatrends are identified which will continue to underpin the demand for investment in healthcare real estate. An ageing population in Europe is increasing the burden on healthcare infrastructure, while the dependence of elderly persons is creating a shortage of adequate housing. Although the coronavirus pandemic appears to have brought about a shift in priorities, public finances are strained and there is a dearth of public commitments to healthcare infrastructure. ■

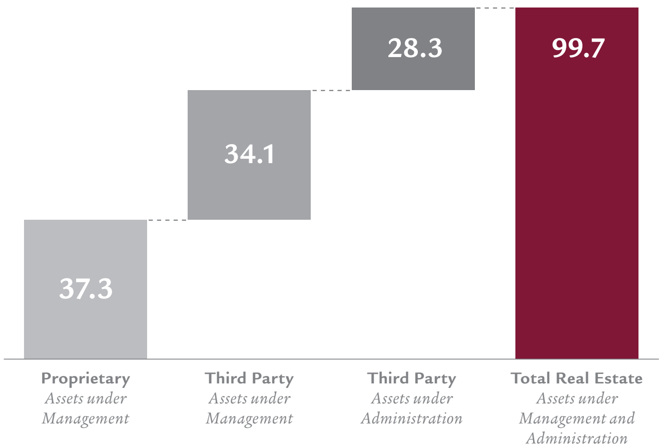
Together we are strong!

Source: Shutterstock

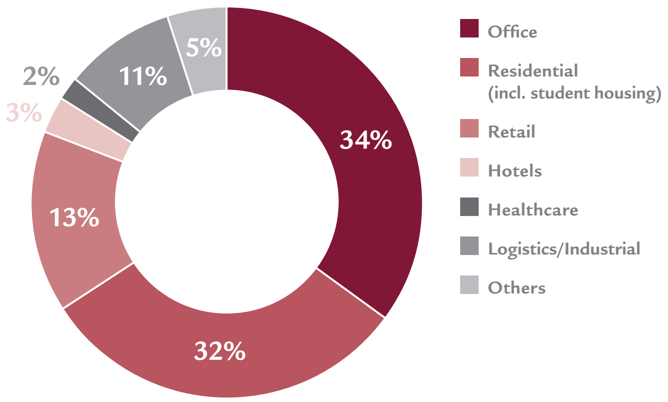
Real estate – facts and figures

Assets under Management and Administration

(in CHF bn)



Breakdown by real estate sector



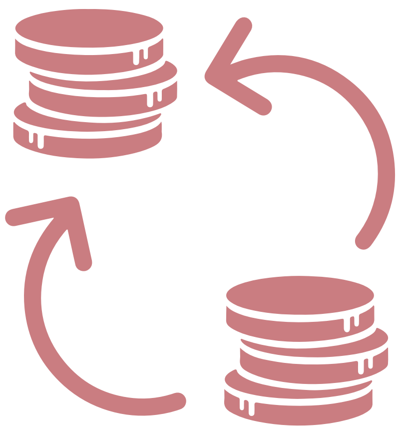
REuM CHF 69.0 bn

Transaction volume real estate

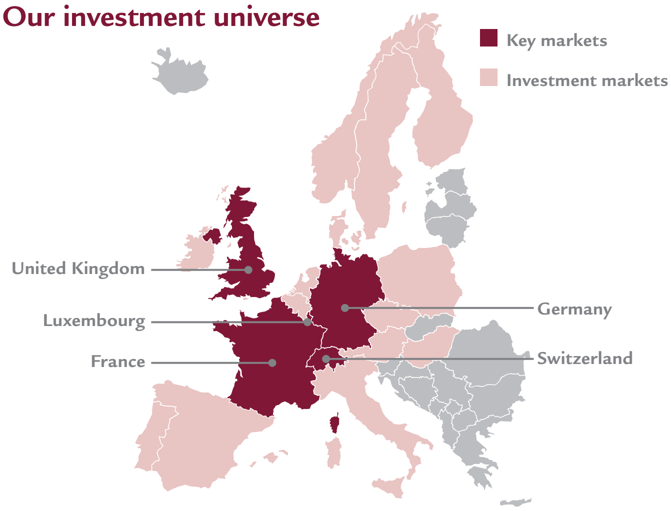
(in CHF bn)

9.2

(average 2017, 2018, 2019)



Our investment universe



All figures as of 30 June 2020 unless stated otherwise.

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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, Marc-Philipp Martins Kuenzel / marc-philipp.martins-kuenzel@swisslife-am.com, Andreas Mayer / andreas.mayer@swisslife.ch, Anna Sigrist / anna.sigrist@swisslife.ch • ***Cover Image:*** Kustermannpark, Munich, Source: Atchain Art Technology • ***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