March 2021

Insights

Real Estate

SwissLife
Asset Managers

Does COVID-19 expedite pre-Corona trends?

Examining the pandemic's real impact on structural changes

Climate change and portfolio management

Conservation makes sense from all perspectives

Shifting office occupational demand creates value-added opportunities

The future of office work in the new normal

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Editorial

Dear readers,

The long-lasting effects of COVID-19 are taking their toll, and everyone is longing for a steady recovery. The impact of the fragile and uneven economic revival on commercial real estate will be felt for some time to come. The trends which were just peaking last years have been accelerated by the pandemic. But I remain resolute in the belief that real estate is an attractive investment asset class despite strong political and economic headwinds.

Real estate investors, by their very nature, tend to view property as a long term investment, and so do we. Especially when it comes to the future of sustainable real estate. It is no secret that the construction and operation of buildings contributes to around 40% of worldwide greenhouse gas emissions. As a responsible real estate investor we will be devoting more attention and rigour to ESG policies which are already embedded in our organisational DNA. Investors, developers, occupiers, property and facility managers, we all have a role to play in the transition to a more sustainable environment.

I hope you enjoy reading this edition of Insights

Stefan Mächler
Group Chief Investment Officer Swiss Life

Don’t lose the long-term sight

For many, March marks one year of direct COVID-19 containment measures impacts, or more specifically, one year working from home, shopping online, being restricted in travelling – a year in which “my home, my castle” gained a whole new meaning. How does this impact us as real estate investors? How can we react, or – even better – act in this environment?

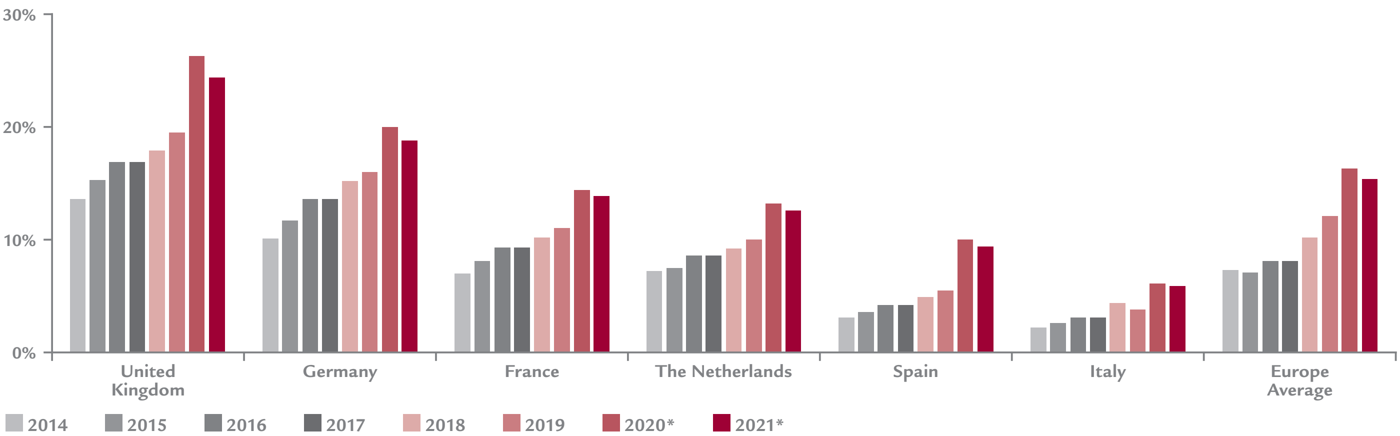
Francesca Boucard, Head Real Estate Research & Strategy, Swiss Life Asset Managers

As a matter of fact, the environment for real estate investors has not changed drastically, at least concerning the relative attractiveness of these investments: The low interest rate environment is cemented for an indefinite period, keeping up the desire for property investments. Yet the stable income stream – one of the pro arguments – needs to be analysed more closely. This in turn implies questions about changes in demand, the adaptions and new formats in real estate that have been triggered by the pandemic.

While we are monitoring a gradual recovery of the European economies, we keep an eye on time lagged developments such as bankruptcies, changes in employment growth, and especially the changes in human behaviour. The latter, being phrased in “structural changes”, is the topic of much discussion. How and especially where will we work in the future? How will we shop? And what about the outlook for business travel?

These questions are not new but need to be addressed with new urgency, as the pandemic has accelerated many of the existing structural changes. While we expect flexible working and online shopping to have a lasting (positive and negative) impact on demand for space, these changes will only take place gradually. This gives the investor time to be part of the process and invest accordingly. Yet again, the quality as well as the flexibility of the asset, along with the location, are key fundamentals. On the other hand, investors should specifically focus on long term trends – such as changes in technologies and ESG, as discussed in greater detail on p. 4 – among others. These can easily be forgotten in uncertain and disruptive times, yet a real estate investor should not lose sight of the actual investment horizon – be it 10, 20 or even more years ahead. As human beings tend to overrate and place more weight on short term events (recency bias) and forget about long term opportunities (and challenges), it’s us researchers and analysts that strive to close the gap by highlighting long-term perspectives. There is still room to manoeuvre, but one needs to focus on the how and why in order not to lose one’s flexibility.

Only one of the accelerated structural changes: Increase in retail e-commerce sales as share of retail trade



Source: Statista

*Forecast

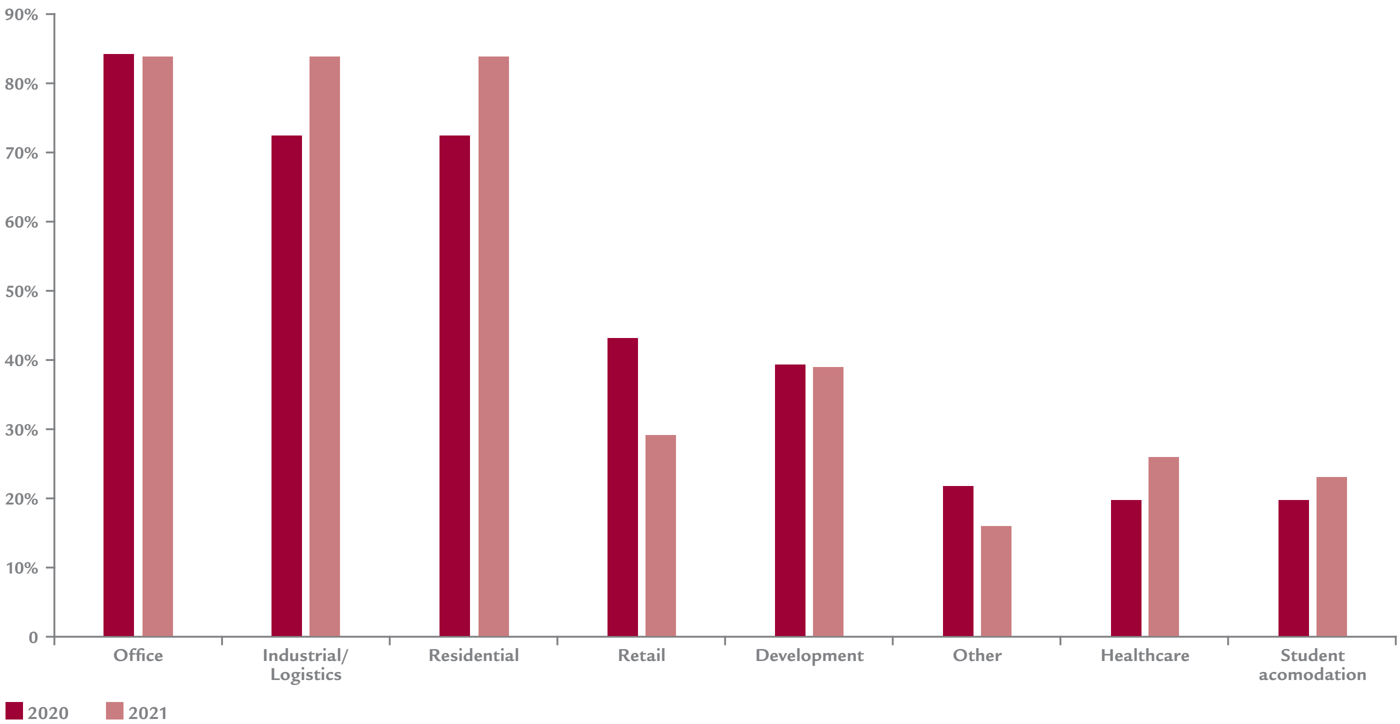
COVID-19 triggering trends leading to attractive real estate investment opportunities

COVID-19 has pushed governments to take strong measures leading to changes in travel and work habits. While restrictions will ease in future, the pandemic is likely to influence our behaviors over the long-term. We observe the impacts on the real estate market and see attractive opportunities arising.

Marion Sottas, Market Intelligence Analyst Real Assets, Swiss Life Asset Managers
Francesca Boucard, Head Real Estate Research & Strategy, Swiss Life Asset Managers

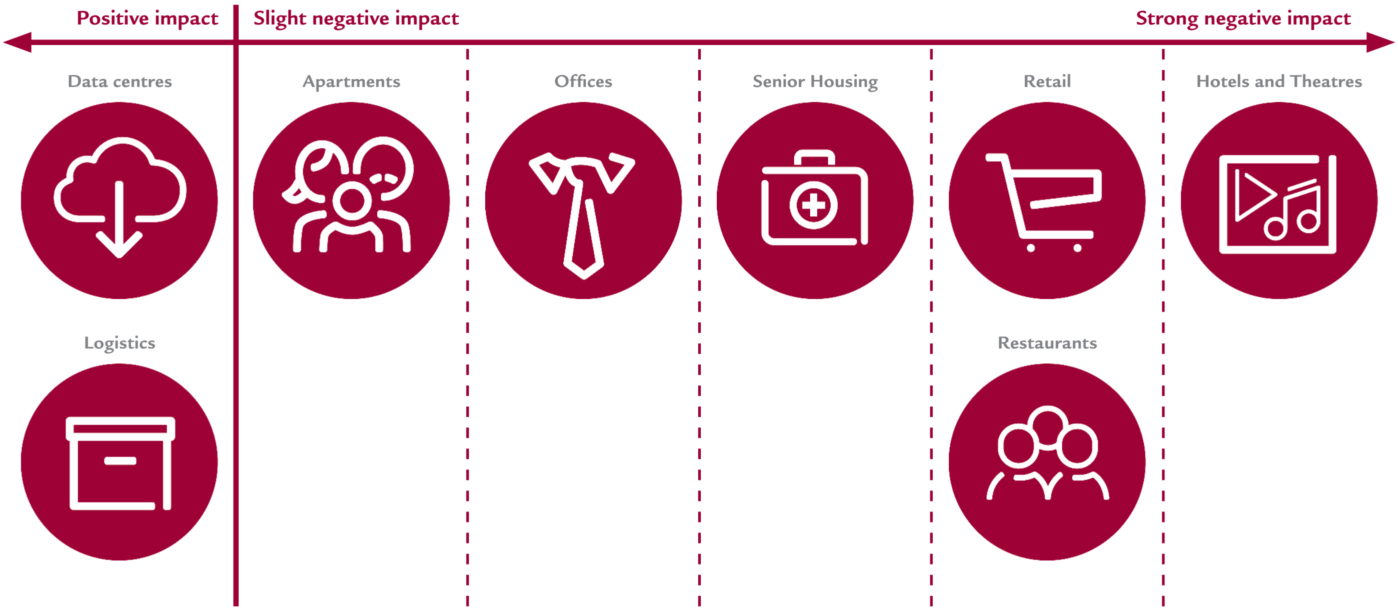
As many office workers have been working from home, office space has become widely unoccupied. Social interactions in the office will remain crucial for collaboration and innovation. Given this, flexible working arrangements are likely to be favored by employees in the future and companies will need to adapt accordingly. As an investor this means focusing on assets in well connected, urban areas. Increased home office use might also have an impact on the residential sector. As workers will spend less time commuting, they may consider living further away from their workplace. Closer to open space and nature, suburban

Chart 1: Most preferred sectors by investors in 2020 vs 2021



Source: INREV Investment Intentions Survey 2020 and 2021. Please note that 125 institutional investors participated in the 2020 survey and 84 in 2021. Although the number of participants has varied between the two years, the trend perception can be viewed as comparatively robust.

Chart 2: Analysis of the impact of COVID-19 on real estate segments



Source: Swiss Life Asset Managers, BNP Paribas WM, September 2020

residential areas offer more affordable and larger housing possibilities. Interesting investment opportunities outside bigger cities are likely to emerge from these shifts.

Travel restrictions related to COVID-19 have strongly impacted the hotel sector. Once the restrictions are eased, leisure travel is likely to resume and reach pre-crisis levels by 2022/2023. Business travel will also resume, but to what extent? With most business meetings taking place online, companies could see advantages in this time and cost-efficient method of operation. Although face-to-face meetings will remain partially necessary, the number of online meetings will be persistent. This will impact the hotel sector further and challenge operators, while opening up opportunities for investors e.g. by transforming a business hotel into a leisure destination.

The healthcare sector has been a focal point throughout the pandemic, as the crisis has highlighted the importance of adequate healthcare facilities to respond to major public health challenges. Demand for assets such as life science facilities or medical offices has been increasing. Moreover, aging populations are increasing demand for senior housing and reinforcing the overall demand for the healthcare sector. This trend is likely to persist and became evident in recent investor polls. As an example, INREV's yearly Investment Intention Survey 2021 revealed that the Healthcare sector is up 6% y.o.y. in terms of most preferred sectors (see Chart 1).

Although technologies already had a strong impact on real estate before COVID-19, the pandemic has strengthened this influence. The demand for assets, such as data centers and mobile phone towers has sharply increased. Should technologies be considered as a new "sector"? Challenging the definition of traditional real estate, technology-related assets could represent innovative opportunities for investors.

Last but not least, ESG was already gaining traction before COVID-19. This is reinforced by the pandemic, while also highlighting the importance of environmental changes. An increasing number of investors are setting climate targets and pushing investment managers to improve the carbon footprint of their portfolios. However, the ESG discussion should not be limited to climate targets. Social considerations are also discussed as the industry is expected to consider their employee's and tenant's wellbeing when developing and managing real estate assets.

While an accurate prediction of the trends emerging from COVID-19 is certainly not an exact "science", investors should monitor these structural changes. Ultimately, diligent and timely observation of arising investment opportunities will keep investors in the driver seat when proactively developing and shifting their portfolios.

Climate change means sound decision making in asset and portfolio management

Climate change is often discussed as some high-level political debate with targets and possible outcomes in 2100. Or, when more down to earth considerations are raised, it sometimes appears as a sum of economic or even moral constraints (flight shame, go vegan…). On the responsible property investment side, climate change considerations bring along sound decision making in terms of asset selection and portfolio management.

Valérie de Robillard, Head ESG Real Assets, Swiss Life Asset Managers

Long-term investment horizon and fixed assets location make real assets especially exposed to climate change physical and transition risks. Property investment with open ended funds implies maintaining or improving an asset's value in the long run, sometimes over decades. Real estate portfolios may indeed be exposed to a variety of physical risks (extreme weather conditions in some areas, flood-prone areas, sea-level rise) that could impact values. In 2019, Four Twenty Seven, a provider of market intelligence on the economic risk of climate change, estimated that 19% of retail spaces and 16% of offices in Europe were exposed to floods and/or sea level rise and that heat stress also presents significant risk to these facilities.[1] The likelihood of those risks coming to pass will increase during the 21st century, and all assets facing such risks tend to see their value decrease.

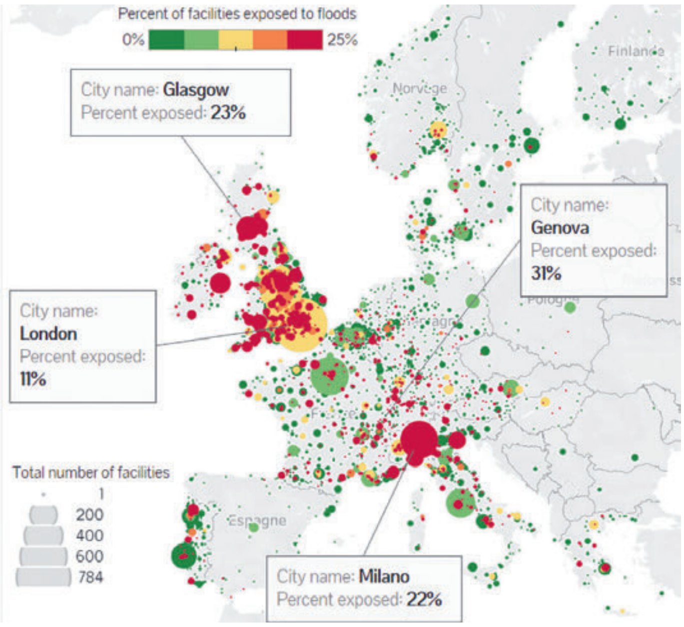
Flood-prone areas pose physical risk and could impact real estate value.

Source: Adobe Stock

Handling physical risks at property level results in fostering proper adaptation measures on existing properties while reducing, or properly anticipating, potential adaptation costs for newly acquired ones. Therefore, investors are increasingly taking climate change into account in their strategies by:

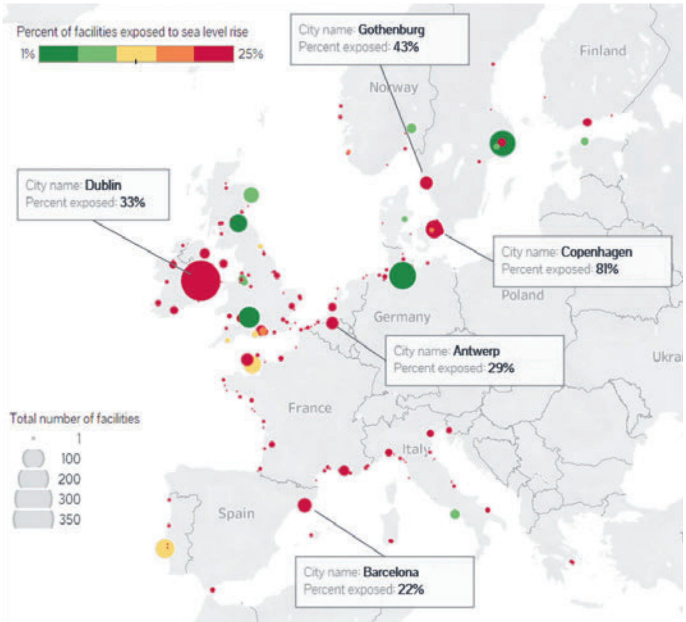
- Mapping physical risks exposure for assets in the portfolio;
- Assessing, during due diligence processes, the potential physical risks exposure for new acquisitions and deciding to invest accordingly;
- Taking physical adaptation measures for assets at risk (this can include for instance transferring all technical equipment of office buildings to floors that would not

Retail Spaces – Flood Exposure



Retail spaces' exposure to floods. A dot represents a city and its size represents the number of retail spaces in the city. The dot's color represents the percentage of retail spaces exposed to floods, with red representing the highest percentage. Source: Four Twenty Seven

Corporate Offices – Sea Level Rise Exposure



Corporate offices' exposure to sea level rise. A dot represents a coastal city and its size represents the number of offices in that city. The dot's color represents the percentage of offices exposed to sea level rise, with red representing the highest percentage. Source: Four Twenty Seven

be impacted by floods, or improving a building's resilience to heat waves thanks to sunshades, and increased vegetalization of buildings' surroundings to avoid urban heat clusters).

Simultaneously, as the pressure for mitigating greenhouse gas emissions grows and the world moves toward a low-carbon economy, transition risk may also play an increasingly important role, with investors facing potential costs from emission-reduction requirements. Managing transition risks (carbon taxation, rise in fossil fuels prices...) means preserving an asset's attractiveness. In a world of high energy prices and carbon taxation, tenants might be more selective in choosing assets, because running costs may increase significantly upon buildings' energy consumption profiles and building location (due to potential rising costs of road transportation).

Given this, sound property investment, in order to maintain returns, requires:

- Integrating, into Capex forecasts, measures that would contribute to reducing operating costs due to transition measures (e.g. replacement of fossil fuel heating systems)
- Acquiring highly energy efficient buildings and considering more complex due diligence procedures in order to address climate risks as early as possible in investment processes.

Long term perspectives and anticipations are core to both property investment practices and climate considerations. As a leading long term investor, we believe in natural synergies between the following points:

1. Improving the overall attractiveness of properties through responsible asset management
2. Pro-active climate risk monitoring and management
3. Decarbonization analysis on both asset & portfolio level

In this way, and considering the market's increased "climate awareness," we seek to set reduction potentials encompassing the whole real estate portfolio, which will ultimately allow future-proofing our assets and portfolios on behalf of our investors. ■

1 – 427 report "Real Estate Climate Risks: How will Europe be impacted?", September 2019.

On the edge of a healthy pan-European strategy

On the equity market, COVID-19 has triggered a rotation of stocks in a defensive strategy to the benefit of the healthcare sector. In real estate, this also is a buoyant sector, given its high risk-return profile over the long term. Given its successful track record in the healthcare sector, Swiss Life Asset Managers continues to push the envelope for this asset class across Europe.

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

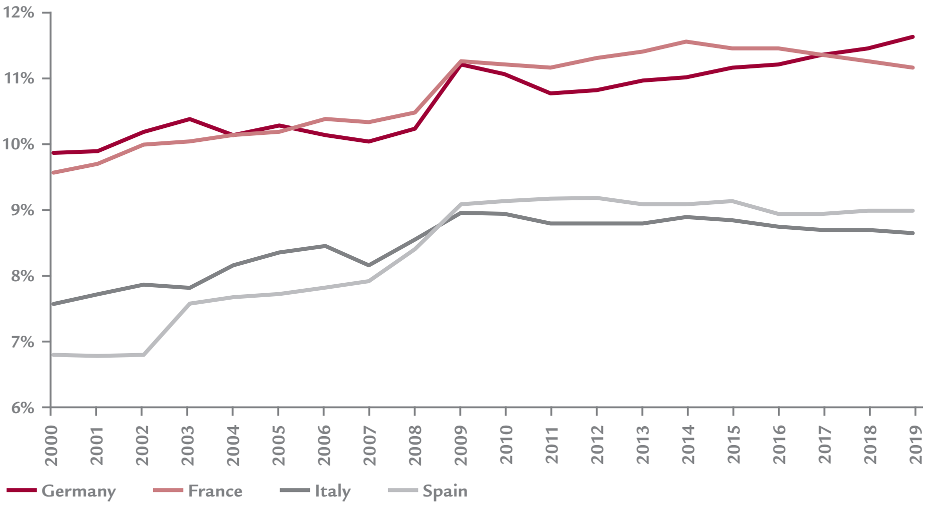
On the equity markets, the healthcare sector has been a significant outperformer since the origin of the crisis. On the property markets, healthcare has also done much better than commercial real estate across all listed property markets since the beginning of the pandemic. However, the success of the sector is nothing new, it has flourished since the Global Financial Crisis when investors were looking for alternative sectors. The appetite for healthcare real estate has primarily relied on various long-term trends, such as an increasing share of the Silver population (aged 70+). Such a silver population is characterised by diverse profiles and evolving needs over time given rising life expectancy.

In property terms this increase has a direct result in long term leases and is a strong source to secure long term cash flows. In this regard, healthcare invest-

Senior Housing in Aranjuez, near Madrid, Spain.

Source: Swiss Life Asset Mangagers

Total healthcare expenditures as a % of GDP



Source: OECD and Swiss Life Asset Managers

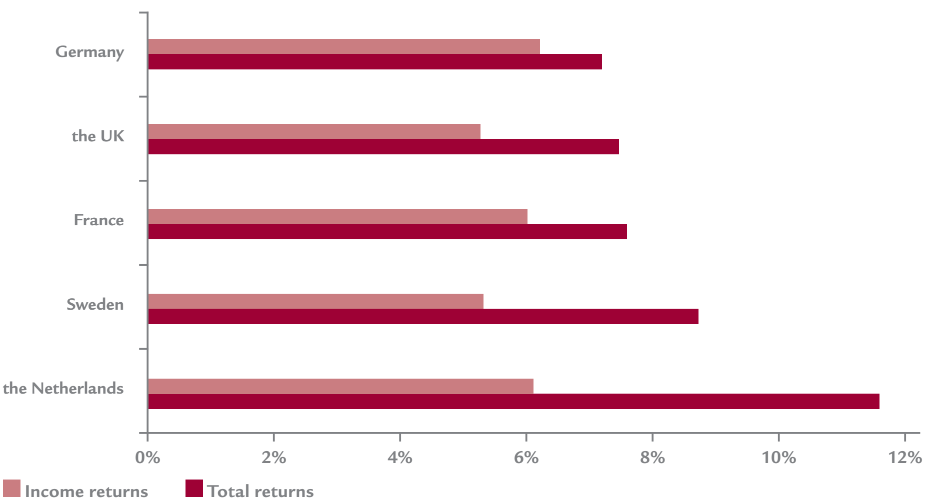
ments are likely to continue to become an increasingly important pillar for institutional investors. In terms of asset allocation, healthcare investments mostly provide for lower correlations when compared to office, retail, or logistic sectors. Therefore, and considering the healthcare property sector's recent growth and strengthened maturity, they come with diversification benefits. In terms of selection, senior housing, hospitals, post-acute care, outpatient structures, medical offices, as well as life sciences offer different sources of net operating incomes such as tenants, and operating models. In short, healthcare is key on portfolio and risk management.

In the eurozone, Germany, France, Italy and Spain are the largest countries in terms of Silver population over 70: There were 40 million elderly residents in 2020, according to Oxford Economics (OE). As of today, OECD data shows that the number of nursing home beds per 1 000 citizens is around 54 in Germany, 50 in France, 18 in Italy and 44 in Spain. Following OE projections, the Silver population over 70 is set to increase by 30% until 2035, with rises of 35% in Spain, 34% in France, 30% in Germany and 24% in Italy. These megatrends are only one side of the equation.

As a result, the property sector will have to match new demand and increasing needs with new supply. The elderly of tomorrow will not be the Silver population of today, and neither those of yesterday. Since society, the environment, and healthcare offerings will keep changing, the combination of new healthcare formats including independent, assisted living, or memory care is the most promising approach to match seniors' and families' more demanding expectations. Integrating these changing requirements into future healthcare concepts and development ensures enhanced safety and comfort for all stakeholders, the professional care community, patients and their families. In addition, fostering medical technologies and digitalisation in order to provide comprehensive services in both community care and people's homes will drive innovation and bring greater convenience and efficiency of resources. Such an approach is set to maximise the well-being of patients, while also decreasing healthcare costs on the public spending front. Therefore, Europe's healthcare sector is of increasing interest[1] to investors in search of both stable returns and responsible real estate investments. ■

1 – Source: INREV Investment Intentions Survey 2021 which showed + 6% yoy increase of investor interest for Healthcare: https://www.inrev.org/research/investment-intentions-survey#

Healthcare property returns over 5 years



Source: MSCI and Swiss Life Asset Managers

Shifting office occupational demand creates value-add opportunities in the UK

After the pandemic, workplace flexibility will be the new normal. Employees will determine where they work and when. This gives rise to new types of office demand in new locations. Investors who create the right stock in undersupplied locations likely to see demand growth are primed for outperformance.

Tom Duncan, Senior Associate, Research, Strategy and Risk, Mayfair Capital
James Lass, Head Special Transactions and Fund Manager, Mayfair Capital

The pandemic has impacted our economy in many ways. One visible impact has been on where knowledge-based work is done. Mandated office closures and enforced home working has demonstrated that work is something people do, rather than a place they go to, and it need not necessarily be done in an office.

Employees have valued the convenience of home working without the commute, whilst companies like the cost savings of leasing less office space. However, the limits of remote working are clear. Maintaining existing networks is relatively easy online but forging new bonds is hard. There are wellness and mental health concerns with home offices. Employees in small flats or with young families may find the office a far more desirable location. Training new staff is difficult. Tasks involving information free-flow, collaboration or creativity are challenging. Employees miss the social benefits of the office, the sense of team spirit and camaraderie. Repeated surveys show that most employees want to spend a significant amount of their time in the office once they can do so again.

An example of the future office: The Bonhill Building, London

Source: MCIM

The future of office work is flexible working, a trend that was already emerging pre-pandemic. In the future employees will be empowered to choose where to work and when. Few employees will commute to undertake tasks which can easily be done at home, such as sending emails or reading reports. They will be motivated to travel for innovation, collaboration, creativity or training-based tasks, and to satisfy their social needs. Employers will respond by leasing the type of space their employees want. This will be accessible, stimulating and make an enticing offer to

An example of the future office: Forge, Woking

Source: MCIM

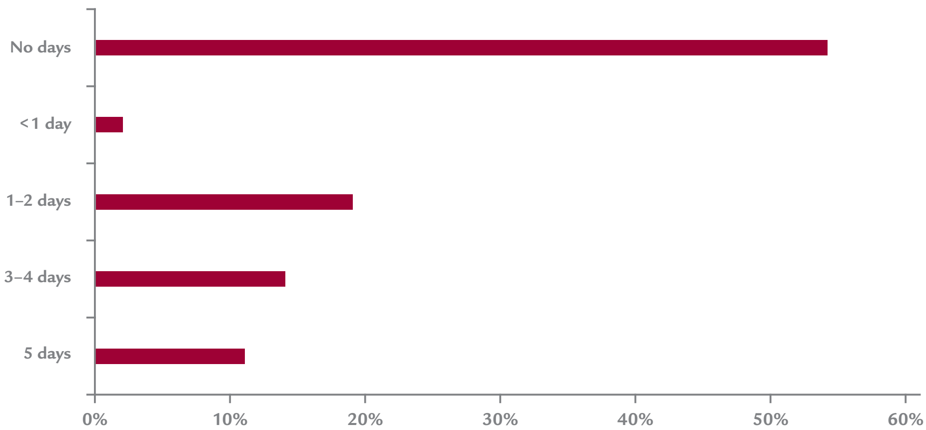
employees through amenity and design. It will be engaging, motivational, and cultivate a strong human experience.

To maximise employee choice, new 'third' spaces will emerge to complement the main central office. These will be localised, offering access to an office environment whilst avoiding a long commute. Under this 'hub, home and roam' model, greater occupier demand is anticipated for suburban flexible leasing options close to where people live. In many UK submarkets this space is either extremely undersupplied or non-existent.

Employers will lease space based on its direct impact on employee satisfaction and productivity. Because they have more freedom over how much space to lease and where, this represents a major transfer of power from landlords to space consumers – occupiers and their staff. This requires landlords to prove the benefits of their product. This implies more income risk, but those who get it right will be rewarded by higher rents and lower vacancy.

COVID-19 did not initiate these trends but it has hastened their realisation. In doing so it has vindicated a value-add investment strategy built on targeting unique buildings for office refurbishment in undersupplied locations that will benefit from flexible working. ■

Working from home post-pandemic, European employees' preferences

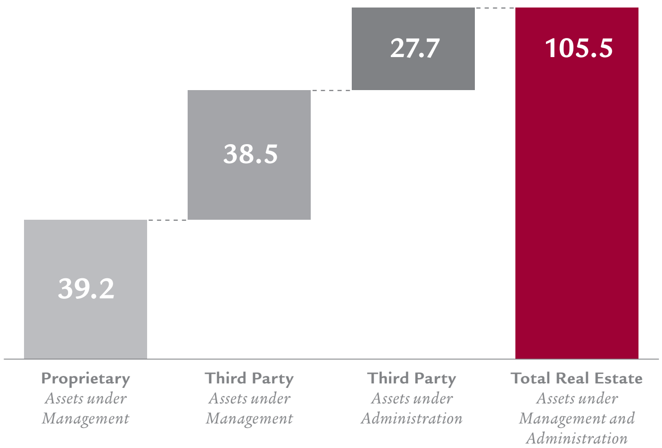


Source: The Economist, 30 October 2020

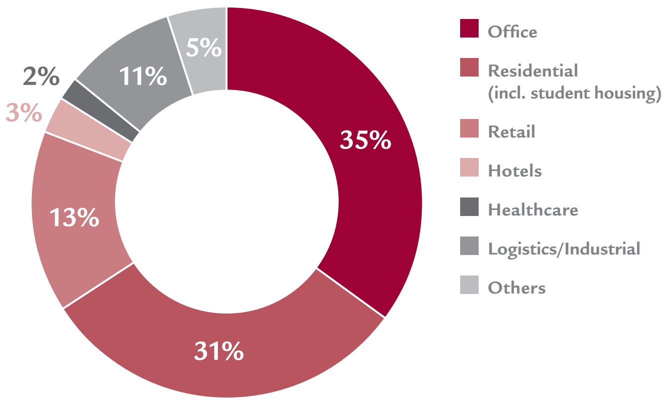
Real estate – facts and figures

Assets under Management and Administration

(in CHF bn)



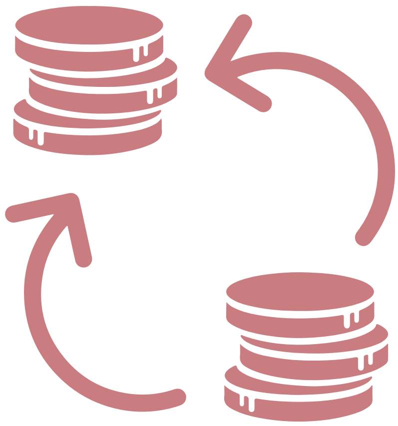
Breakdown by real estate sector



REuM CHF 77.7 bn

Transaction volume real estate

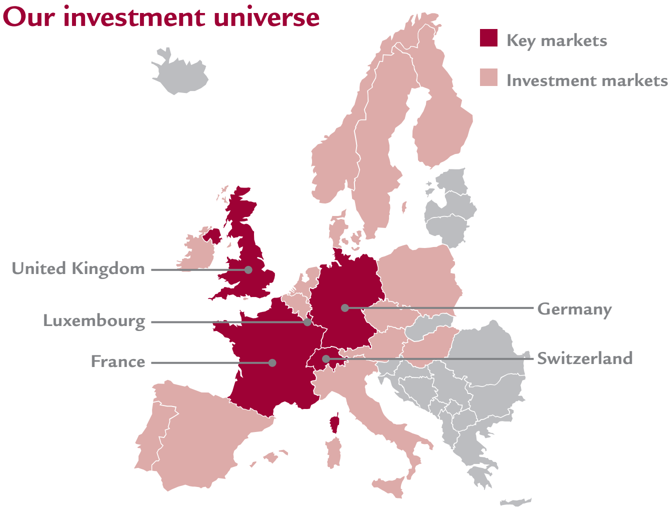
(in CHF bn)



10.6

(average 2018, 2019, 2020)

Our investment universe



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

All figures as of 31 December 2020 unless stated otherwise.

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