PRIMONIAL REIM

MARCH | 2020

GLOBAL PANDEMIC: IS REAL ESTATE A SAFE HAVEN?

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1. THE SITUATION AT 12 MARCH 2020

Since December 2019, the world has been grappling with a vast and unexpected event: the Covid-19 virus. The epidemic began in the city of Wuhan in China and has since spread, infecting people in over 120 countries. Based on the information available at 12 March 2020, we can make the following observations. The main sources of the virus are China (70% of cases), Italy, Iran, South Korea, Spain, France, Germany and the USA. This is a new disease, so little is known about how serious it is: its actual mortality rate, the number and age of those who may potentially be affected, how well the virus will hold up against the summer heat, etc. The characteristics of this virus make it particularly difficult to quantify because of the large number of carriers who show no symptoms.

The countries affected have introduced various precautionary measures: populations have been confined, airports, schools and universities shut, events cancelled, bans placed on travel, road and rail transport suspended, borders closed, etc. The aim of such measures is to slow the spread of the virus and thus buy enough time to prepare a treatment, while at the same time "smoothing out" the impact on the health system's available capacity.

These precautionary measures themselves have an economic cost. This comes on top of the direct costs of slowing Chinese output[1] and diminishing Chinese tourist flows. Amid all of this, the world's financial markets have plunged by 15% to 25% year-to-date.

Over the months ahead, governments will focus on preventing the health crisis from triggering an economic and financial crisis. There are three factors to watch in particular:

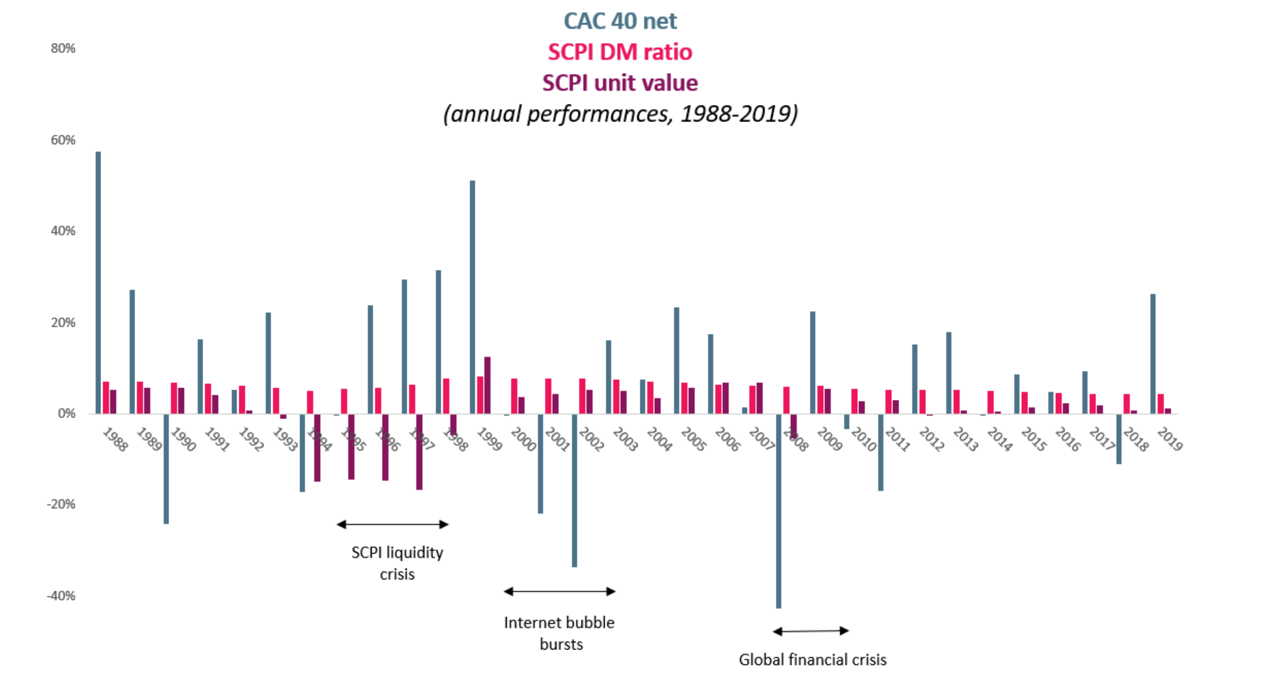
- Monetary support from central banks. They will want to do whatever it takes to avoid another credit crunch, i.e. tighter credit conditions for businesses. The aim here is to prevent a series of bankruptcies among SMEs that may have experienced revenue setbacks or taken on additional debt due to the consequences of Covid-19.
- Fiscal stimulus from governments. This can take various forms, such as spreading loan payments over longer periods or making use of short-time working, as already announced by France's government.
- Household confidence and its impact on consumer spending. The massive media coverage given to Covid-19 has already created panic, including a jump in purchases of staple goods. Positive or negative newsflow as regards the outcome of this health crisis will be decisive in this respect.

2. HOW WILL THIS AFFECT THE REAL ESTATE MARKETS?

It is worth noting that **a slump in share prices does not, itself, impact on property yields**. SCPI (real estate investment company) yields have not fallen during previous major stockmarket panics (such as the crash of 1987, the Internet bubble of the early 2000s or the global financial crisis of 2008). When SPCIs did encounter a liquidity crisis in the mid-1990s, it was at a time when the stockmarkets were rallying. SCPI units lost 5% in value in 2008, before then making up the ground lost, but SCPI yields held steady. So there is no reason to think that today's stockmarket performances will necessarily feed through to real estate performances.

[1] *Affecting the production chains that depend on it.*

SCPI UNIT VALUES



If the real estate markets do end up being affected, it will be via the real economy. It seems reasonable, for instance, to expect property investment to fall steeply in the first half of 2020 as institutional investors are feeling unsure about the situation and the MIPIM has been postponed. Property investment might then catch up in the second half of the year, which will largely depend on the degree of uncertainty prevailing at that time.

Our second projection is that **the Covid-19 crisis will likely keep interest rates low for longer.** The Fed cut its interest rates on 3 March 2020 in anticipation of the difficulties created by this health crisis. The ECB is expected to take a similar approach, at least by buying corporate debt; such action would be justified as responding to a temporary external shock is within the ECB's remit. All else being equal, permanently low interest rates help to support the real estate market (cf. Primonial REIM Research & Strategy, L'immobilier dans un monde à taux zéro, September 2019).

How will the current crisis affect different categories of real estate? Here we consider the crisis as it has developed so far, i.e. it has taken off on a large scale but over a short period of time[2]. The main direct impacts on real estate are as follows:

- High operating costs for businesses
- A slump in tourism, especially in the number of Chinese tourists
- The suspension of certain means of transport and freight and associated supply chains.

Offices: difficulties among SMEs. The precautionary measures (confinement, widespread use of remote working, cancellation of events) affect different businesses to varying degrees. The most affected are those that have not established procedures (business continuity plans, remote working capabilities) to help them absorb the effects of confinement, and those that depend on events (entertainment, trade fairs, transportation, etc.) or specific supplies. And let us not forget those businesses whose staff visit other businesses (accountants, consultants, etc.), only to be refused access to their clients. From the real estate market's perspective, these factors mostly concern office properties dedicated to SMEs and in narrow markets. Large firms all have business continuity plans and have generally already experimented with remote working on a large scale, especially those located in the Paris region. And such firms are diversified enough not to depend too heavily on any one event or supply chain.

Retail: income from tourism brought to a halt. Here again, the impact looks unevenly distributed if we analyse different types of retail premises. Footfall in the big shopping centres is already dropping. Italy has decreed that all shops must close, except food stores and chemists. What we do not yet know is how such measures will affect consumer confidence. In France, purchases of staple goods have already increased as the public adopts "survivalist" behaviour. In France's case, and especially its capital city, we can already single out those retailers that are "China-dependant" and make their living largely from Asian tourists. Spending by Asian holidaymakers plays a crucial role in the capital's shopping tourism segment. The CROCIS and Comité Régional du

[2] *At 10 March 2020, the OECD had revised its 2020 GDP growth forecast for France to 0.9%.*

Tourisme worked out[3] that the economic rewards reaped from durable goods purchases (luxury, leather, souvenirs, clothing, etc.) in the Paris region amount to €3 billion, of which €2 billion generated from international clients. The Chinese are the biggest contributors, having spent a cumulative €265 million in 2018. So this retail segment is on the front line.

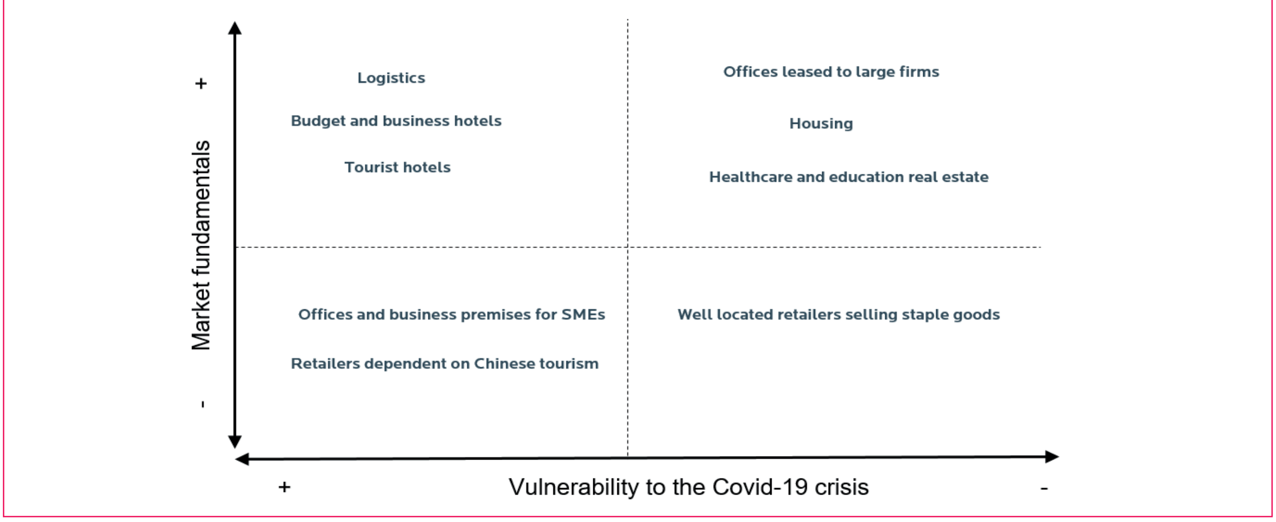
Logistics: supply chains on hold. One of the most immediate and abrupt consequences of the current crisis is that many means of national and international transportation have come to a halt. The scale of the impact on this sector is estimated to be similar to that of the financial crisis of 2008, with the air traffic industry's revenues tumbling by 20% according to the IATA[4]. Many industries (e.g. automotive, textiles, pharmaceuticals) now find themselves on a weaker footing because of China's prominence and role as the "workshop of the world" for numerous components (e.g. lithium batteries). In addition, once the crisis ends, it is highly likely that political questions will be asked about certain supply chains considered too long for environmental reasons but also for reasons that are economic and strategic to the French economy. So we may see some upheaval in the logistics sector[5].

Residential: resilient so far. The housing sector so far appears to have been among the most resilient since the crisis took off. Although building permits have slowed, this is largely attributable to the local elections due to be held imminently. This sector's indicators have all been extremely healthy over the past 2 years thanks to favourable borrowing rates: existing home sales have reached record highs, metropolitanisation has stepped up and property valuations have risen accordingly, low interest rates have made households more solvent, and institutional investors have gradually moved back in. Here again, the only real hurdle facing residential real estate in the short term would be a widespread crisis of confidence as we saw in 2008 – although that proved short-lived. The underlying factors propping up this segment, such as population growth and an objective shortage of land, remain intact[6].

Hotels: taking a temporary hit. The hotel industry is, of course, affected by the current crisis directly. France is the world's leading tourist destination, with 90 million arrivals in 2019. The hotel industry had been enjoying rather favourable conditions (occupancy rates and revenues trending upwards, growth prospects in the run-up to the 2024 Olympics), but it must now absorb a temporary hit to its revenues, particularly in the tourist hotel segment. However, budget hotels are also being affected because of the impact on freight transport and the slump in the events industry. The sector was already in the process of becoming more concentrated, with the number of hotels falling and major operators scaling up, so it would be reasonable to expect the big hotel chains to prove more resilient against this shock whereas family hotel operators will no doubt struggle.

Healthcare and education real estate: an operational challenge but healthy fundamentals. The healthcare and senior accommodation sector is naturally on the front line when it comes to Covid-19, as is the education sector. The precautionary measures taken have been radical: visits to nursing and retirement homes have been banned, preventive measures have been introduced, schools and universities have been closed. The public authorities are taking such action to avoid overwhelming intensive care facilities. Based on the latest information, we can expect the epidemic to peak within the next 4 to 6 weeks (i.e. late April/early May 2020). However, from the real estate market's perspective and that of investors, we need not fear any negative repercussions since the revenue bases of the big operators are not under threat. In the specific case of Italy, which has been hit very hard, its health system operates on a regional level and has proved inadequate; this could trigger an awareness of the need for large-scale investments by institutional investors in the sector.

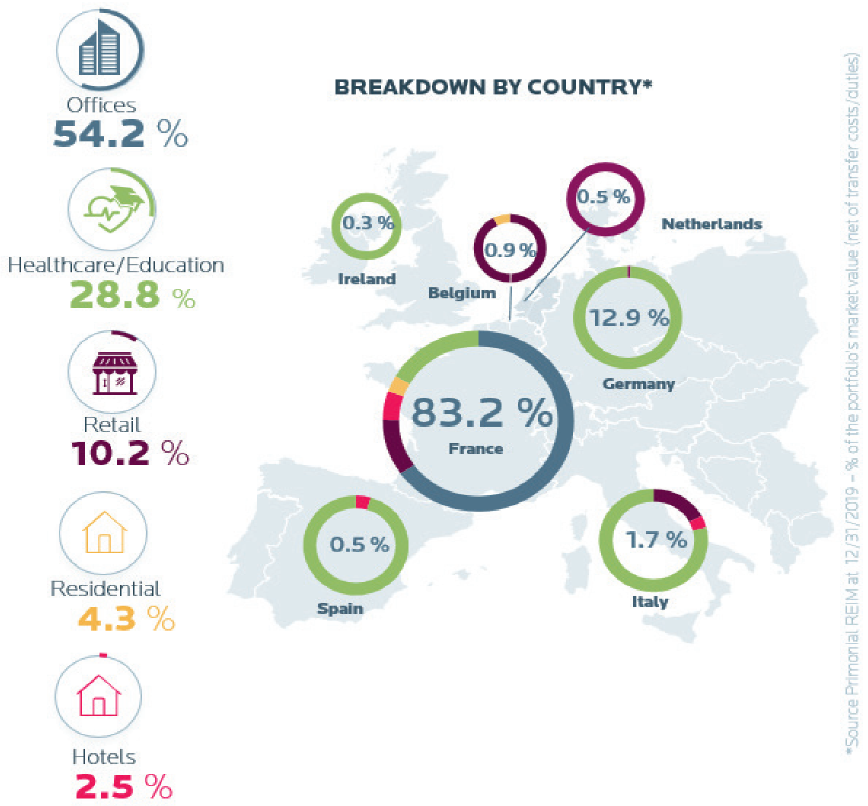
MAPPING OF IMPACTS BY REAL ESTATE SEGMENT



3. PRIMONIAL REIM'S PROPERTY PORTFOLIO

From the very start, our investment and allocation policies have been designed to face up to unexpected shocks. We are convinced that quality locations provide the best protection against any kind of risk.

DISTRIBUTION BY SECTOR AND COUNTRY AT 31/12/2019



In light of the above analysis:

- Our office portfolio is purely French. Over 80% of assets are in the Paris region and are mostly occupied by large firms, with many of the premises serving as head offices. It accounts for most of our assets under management.

- Healthcare and education real estate accounts for a third of our total portfolio.

- Retail real estate represents 10% of our portfolio, 60% of which consists of retail freeholds with the lion's share involved in food retailing. Luxury Paris brands, which depend on international clients, account for little to none of our retail assets.

- Residential real estate represents 4% of our exposure.

- Hotels account for only 2.5% of our exposure, mainly via long-term partnerships with leading budget hotel operators. Moreover, our hotel exposure represents only a minority share of a retail investor fund – SCPI Primofamily – which otherwise consists mostly of residential assets.

- We hold no logistics assets.

An analysis by region shows that our portfolio in Germany (among the countries hardest hit economically as its industries are so heavily dependent on China) consists almost exclusively of healthcare facilities and senior accommodation. Italy accounts for 1.7% of our portfolio, consisting mostly of healthcare facilities.

So assuming our analysis of the situation is accurate, this unexpected global pandemic appears to have validated the strategic real estate choices we have made. Our choices should enable our funds to meet their performance targets and absorb such a significant but temporary economic shock.

Report finalised on 12 March 2020: the opinions expressed herein reflect Primonial REIM's analysis at the time of writing and may change.

Footnotes from page 3:

[3] CROCIS, October 2019, Le shopping, un enjeu pour l'attractivité touristique de l'Ile-de-France. [4] International Air Transport Association. [5] Cf. interview with Bruno Le Maire in Supply Chain Magazine, 24 February 2020: "This epidemic raises questions about a certain number of value chains in which supplies depend too heavily on overseas sources". [6] Cf. Primonial REIM Research & Strategy, January 2019, L'immobilier résidentiel européen, de la métropolisation à la stratégie d'investissement.

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).

www.primonialreim.com

PRIMONIAL REAL ESTATE INVESTMENT MANAGEMENT

A Société Anonyme (public limited company) with Management and Supervisory Boards and share capital of €825,100. Registered in the Paris Trade and Companies Register under No. 531 231 124. A portfolio management company authorised by the AMF on 16 December 2011 under No. GP 11 000043. AIFM authorisation granted on 10 June 2014. Professional licences "Real estate and business asset transactions" No. T15813 and "Real estate management" No. G6386 issued by the Paris Préfecture de Police and guaranteed by the company CNA Insurance Company Ltd, located at 37 rue de Liège - 75008 Paris.

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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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Ref.: Research & Strategy Letter - PREIM - March 2020 - DC03285 - 032020. Photos: Primonial and Shutterstock