March 2019

Insights

Real Estate

Swiss Life Asset Managers

Investing in French residential –
Is the French market about to follow the German?

Active Swiss asset management –
Plug and play? How tenants are being enticed with new features

A shift to UK mixed-use –
Which new investment strategies are needed?

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Editorial

Dear readers,

As we move further into spring, thoughts turn to the direction markets and trends will take. Despite the initial uncertainties, there are many positive avenues to explore both for active asset management and investment opportunities, all of which raise value and generate attractive returns in the long run.

The first stop on our tour will be France. Here, investors are looking to buy into the residential sector, taking advantage of asset safety, low volatility and large institutional investment strategies. Next we move on to Germany, where we will examine the potential of corporate real estate, looking at performance by comparison with other asset classes and the risk vs. return factor. In Switzerland, where supply is large and demand subtle, tenants are increasingly choosy about where they establish business premises, and the market is adapting to meet these increased expectations. In the UK, meanwhile, lines are blurring as the notion of property locations providing any single utility recedes: "mixed-use" urban locations are further on the rise, leading to a polarisation of returns for landlords.

We hope you enjoy this issue as we move through the unique set of circumstances that current market conditions offer.

Stefan Mächler
Group Chief Investment Officer Swiss Life

Economic change prompts action rather than reaction

Economic slowdown and the spectre of recession are looming in both the United States and the Eurozone as 2019 begins. But rather than doom and gloom, the current climate calls for steady nerves and a willingness to change in step with evolving market needs.

Francesca Boucard, Economist Real Estate, Swiss Life Asset Managers

Is the US heading into a recession? This is a question that more and more people are discussing with ever greater frequency. While we foresee tighter financial conditions over the course of the coming year plus a fading of fiscal stimuli during the same period, we expect the US economy to slow gradually without falling into outright recession. A cyclical economic slowdown in terms of potential growth is what we also expect for the rest of the world. For the Eurozone, 2018 ended with a growing basket of concerns mainly due to political shake-ups and uncertainty. Overall, we expect economic growth to reach 1.2% in 2019 – down from 1.8% in 2018 – owing to a deterioration in both the economic and the inflation situation.

We are keeping our spirits high while watching further developments, and the expectation of "lower for longer" remains. This interest rate environment supports the attractiveness of real estate investments. At the same time, rising employment rates plus a shortage of supply will keep rental growth up. Stepping into 2019, we are entering another year in the real estate cycle where the end is one year closer but still hidden.

In this environment, one thing is certain: investors, portfolio managers and owners have to keep their game up. In a changing environment, action rather than reaction is important and there is growing interest in a broader investment universe.

Do we need to prepare for a recession?

Google searches for keyword "recession" in the US   Recession   Source: Google Trends

This is why French investors are looking at the residential sector while the potential of commercial real estate in Europe is still a given. Switzerland sees itself faced with an already highly mature real estate cycle triggering the implementation of active asset management. And in the meantime, real estate uses are blurring. It is not only in the UK that the rise of mixed-use properties is calling for new investment strategies: the challenging yet interesting environment we are facing in 2019 is an international phenomenon. ■

01 February 2019

Overall, we currently expect economic growth in the Eurozone to reach 1.2% in 2019.

Positioning for a shift towards French residential

French residential is an attractive asset class for diversifying risk over the medium to long term. The sector is sought-after, given both its strong resilient stance and socially responsible investment opportunities. A major deal in 2018 has paved the way for the Private Rental Sector. Swiss Life REIM (France) is a pioneer in the field.

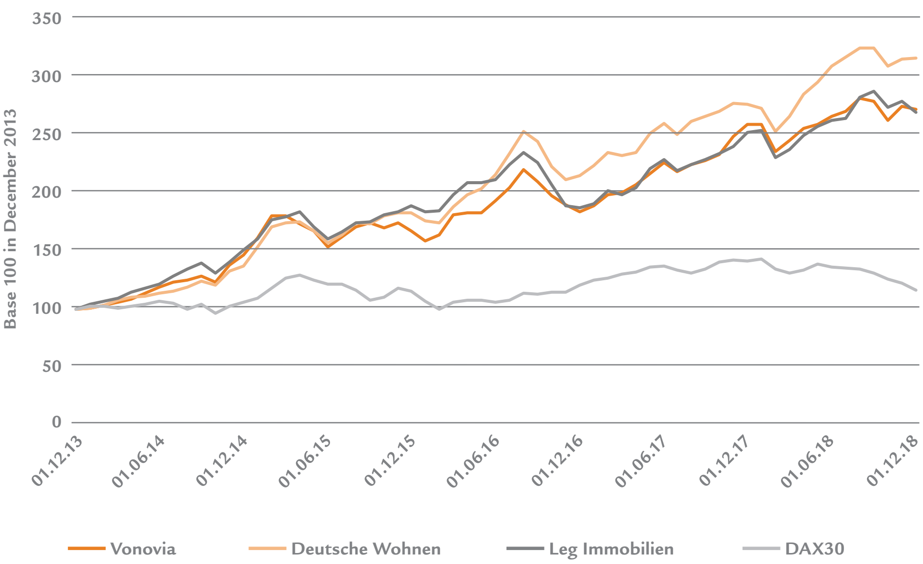
Beatrice Guedj, Head of Research & Innovation, Swiss Life REIM (France)

From the US to Asia, multifamily living has become very popular both in terms of equity raised and funds launched in 2018. In the US, the listed Private Rental Sector (PRS) is well established, comprising 22 companies with a market capitalisation of over $150 bn (14% of the total REIT market cap) and providing an average total return of 15% p.a. since 2009. In Europe, Germany is probably ahead of the game with large pure players such as Vonovia (with a market capitalisation of € 23 bn), Deutsche Wohnen (€ 15 bn) and Leg Immobilien (€ 6.3 bn). Despite challenging markets, these companies have again outperformed the DAX 30 – just as their US peers have outperformed the S&P 500.

In terms of PRS, France seems to lag behind Germany, but things might change in the near future given the "defensive" stance of the residential asset class, which has exhibited low volatility over the long term. Housing is a well-established sector in France (totalling 20% of the MSCI property universe). Empirical evidence shows that, compared to other asset classes, French residential has produced a high risk-adjusted return (1.4) over the long term, with low volatility of both income and capital returns. Housing has provided a steady return of 9.8% p.a. since 1999, and its low correlation to offices, retail or logistics makes it attractive as a way to diversify risk. It comes as no surprise that, in a theoretical portfolio of French assets, an Asset Liability Model with any duration will favour a larger allocation of residential compared to offices. Moreover, with interest in responsible investment strategies on the rise, investors tend to target "demographic assets" such as residential to sustain inclusive growth. So far, the lack of exposure to PRS on the part of key institutional players in France has been due to the shortage of a scalable investment.

However, 2018 has been a game changer on the French residential market with the completion of a very large PRS deal. Swiss Life REIM (France), for real estate funds it manages, and the French Ampere Gestion – a subsidiary of CDC Habitat (Caisse des Dépôts' public interest real estate subsidiary specialising in housing) – teamed up to acquire 80% of an existing property subsidiary of the French rail company SNCF (4,000 housing units in 136 buildings lo-

German Residential REIT versus DAX 30



Source: YahooFinance and Swiss Life REIM (France)

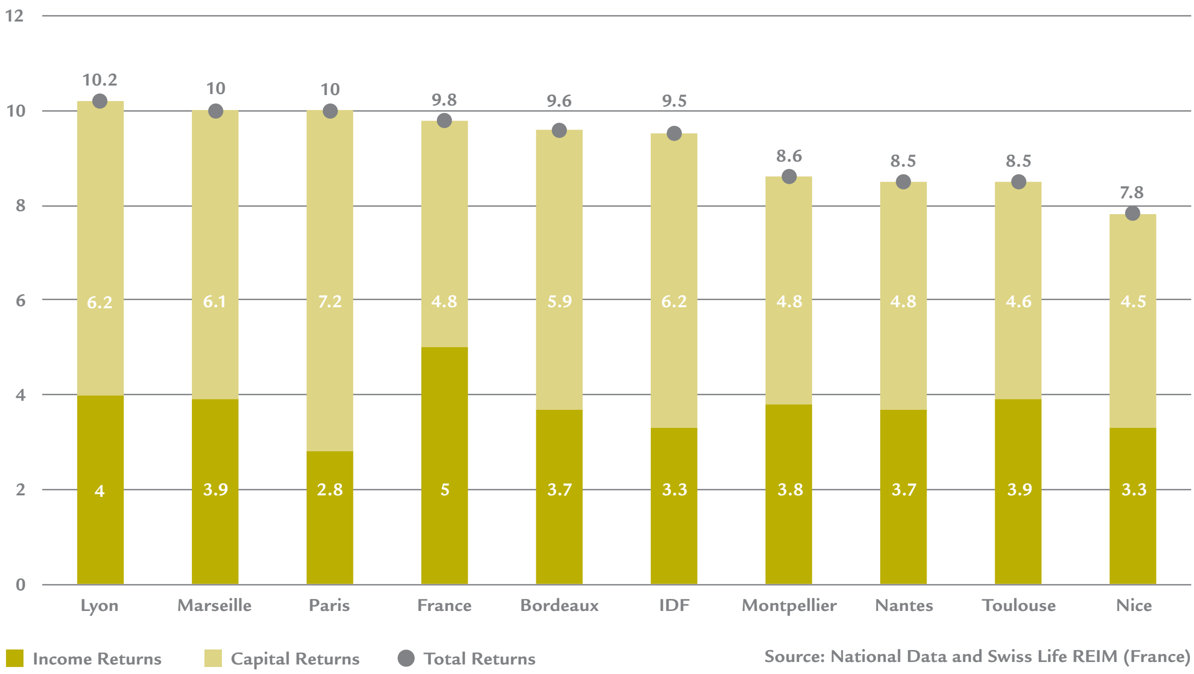
French residential provides a high risk-adjusted return ratio along with low volatility in both income and capital returns. It is definitely a socially responsible investment.

cated near the main transport hubs of major cities) on behalf of institutional investors. The top 15 metropolitan cities currently contribute more than 75% of economic growth in France as well as making up 50% of the total population. Unsurprisingly, Paris, Ile-de-France and other key cities have exhibited the highest residential returns over time. Consequently, and as an urbanisation effect in favour of major cities has boosted household demand, investor appetite for PRS should expand in the near future. The SNCF selloff is probably the first of a number of deals to come. Investors will be keen to acquire defensive assets such as residential as the peak of the commercial real estate cycle is likely to be behind us. ■

Tradition and stability: more than half of French people live in the country's top 15 cities

Source: Swiss Life REIM (France)

Residential total returns (%) (1999–2017) by city in France per annum



Source: National Data and Swiss Life REIM (France)

The rise of corporate real estate in institutional portfolios

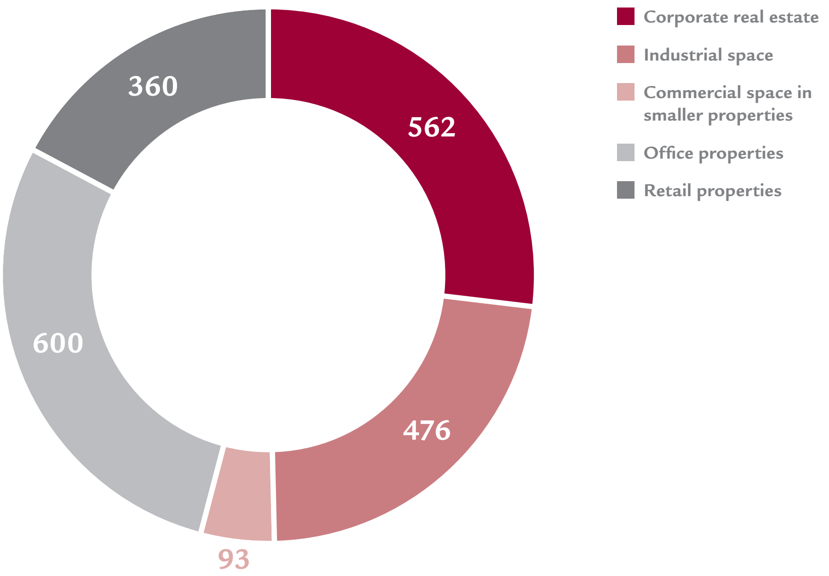
Long underrepresented in the German real estate investment markets, corporate real estate is now a well-established asset class in its own right. The decisive advantages: diversification and performance – provided the assets are managed professionally.

Martin Czaja, Member of the Executive Board, BEOS AG

For some years now, German corporate real estate (Unternehmensimmobilien) has been attracting growing attention from institutional investors. Mixed-use commercial properties, which combine office, logistics, production and service space, are exceedingly popular because they offer a significant yield premium over traditional commercial properties. According to bulwiengesa's latest study ("Fünf-Prozent-Studie"), the yield prospects on investments in office and retail properties in Germany's major metropolitan regions, as calculated on the basis of their internal rates of return (IRR), are less than three percent for a holding period of ten years, whereas corporate real estate has an IRR of five percent on average.

The probable IRR varies, however, depending on the specific type of property. In addition to "transformation properties," i.e. converted industrial properties, the four categories of corporate real estate also include business parks, logistics and manufacturing real estate. Despite some parallels, these are not really "light industrial" properties because corporate real estate has such a large proportion of office and service space, and frequently features leisure facilities, which are increasingly accommodated in repurposed urban properties in particular.

Market values of commercial real estate in Germany, in EUR billions, H1 2018



Source: Initiative Unternehmensimmobilien, Market Report No. 9, H1 2018

Diversification at property and portfolio level

A key benefit for investors is the sector's risk diversification potential – both at property and portfolio level. Corporate real estate is suitable for a broad mix of tenants, most of whom are SMEs. Strong tenant loyalty is achieved by creating synergies between the individual companies through intelligent locational strategies. However, companies need to be able to grow and implement new space concepts, for example, in response to evolving industrial production processes driven by Industry 4.0. This demands a great deal of spatial flexibility and, concurrently, an intensive focus on (re)development and repositioning. All of this makes corporate real estate a comparatively management-intensive asset class. This extra effort is, however, more than justified by the high levels of tenant loyalty and the prospect of optimising cash flow through a continuous programme of rental area upgrades.

Market with growth potential

According to "Initiative Unternehmensimmobilien", which in recent years has delivered significant transparency gains in the segment, transactions involving com-

Current developments on the investment market for corporate real estate are creating a wealth of potential – both for sellers and for long-term portfolio owners.

mercial real estate set a record of around EUR 3.0 billion in 2017. The result for 2018 is likely to be lower due to a lack of suitable properties coming to market. However, two large-volume portfolio transactions in Q3 2018 showed that the market remains dynamic, which offers property owners the opportunity to take profits and reinvest the capital. In the current market, asset managers have a distinct advantage if they have the know-how to reposition properties, redevelop them and leverage further value creation potential during the holding period. ■

In converted properties, modern workspace concepts meet historical charm

Source: BEOS AG

Revitalised industrial parks are often close to city centres – a key benefit for users

Source: BEOS AG

The era of real estate management

Real estate asset management involves planning, management, implementation and control of value-influencing measures for a property. This is increasingly important, given the maturity of the real estate cycle and in the light of megatrends such as urbanisation, demographic change and digitalisation.

Alfonso Tedeschi, Real Estate Product & Service Manager, Swiss Life Asset Management AG
Tommaso Manzin, Investment Writer, Swiss Life Asset Management AG

Residential construction activity remains vibrant in Switzerland but has been challenged by a fall in net immigration over the last few years while rental apartment vacancies have risen. Space is also readily available in the office market but oversupply is most acute in the retail market, which has been affected by structural change for years.

These developments are causing tenants to become more selective. In addition to the economic drivers, there are a number of overlapping megatrends: digitalisation, demographic change and urbanisation. As a result, it is no longer sufficient for landlords to simply provide rental space. Standing out from the competition has increasingly to do with the service package as well as the location, property quality and rent.

What tenants really want

Modern office properties are usually energy-efficient and incorporate flexible and open designs. Many office tenants are no longer prepared to organise and finance the entire office development themselves, so they must be offered development services and support from the outset. They commonly expect fully equipped premises, including IT infrastructure which works from day one ("plug & play").

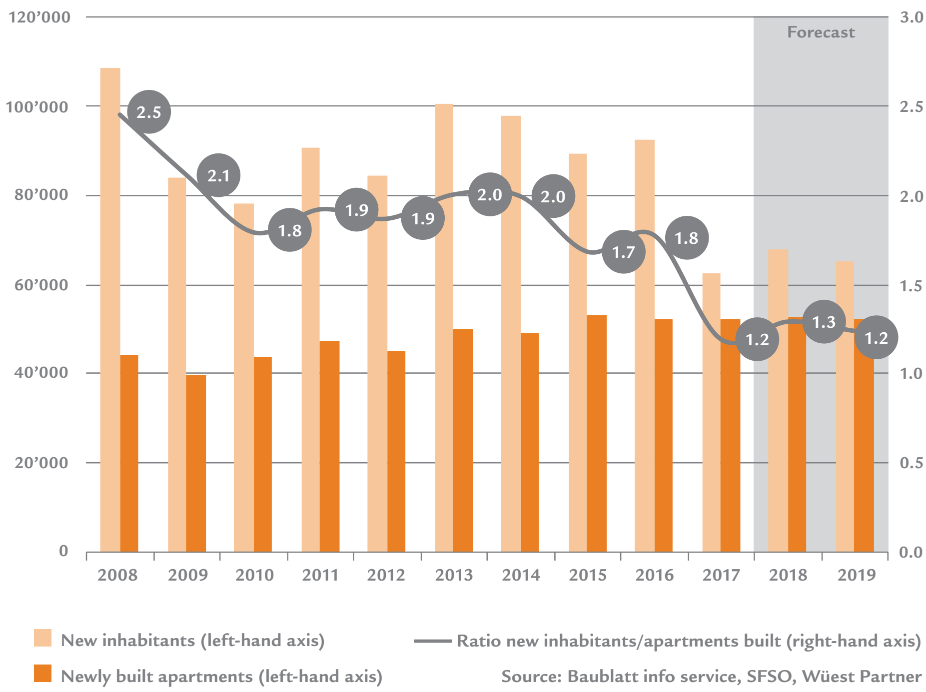
In the retail sector, the growing attractiveness of online shopping means that consumers are only prepared to leave their homes if expert advice, entertainment and experiences are offered. Shops outside of city centres are likely to encounter difficulties. At the same time, new market players and segments are appearing, such as pop-ups, municipal distribution centres and "fast and good food" concepts. Successful asset management means identifying the needs of these new trends at an early stage.

New approaches are also needed in the residential sector. Advertising properties requires appealing photos, videos and 360° tours. When offering viewings, flexibility and customer care are important. For example, home staging allows apartments to be displayed in an interesting manner whilst virtual tours enable engagement with the potential living experience.

In the midst of the transformation process

Transformation of the real estate market is ongoing and gaining further momentum from digitalisation. It is important to en-

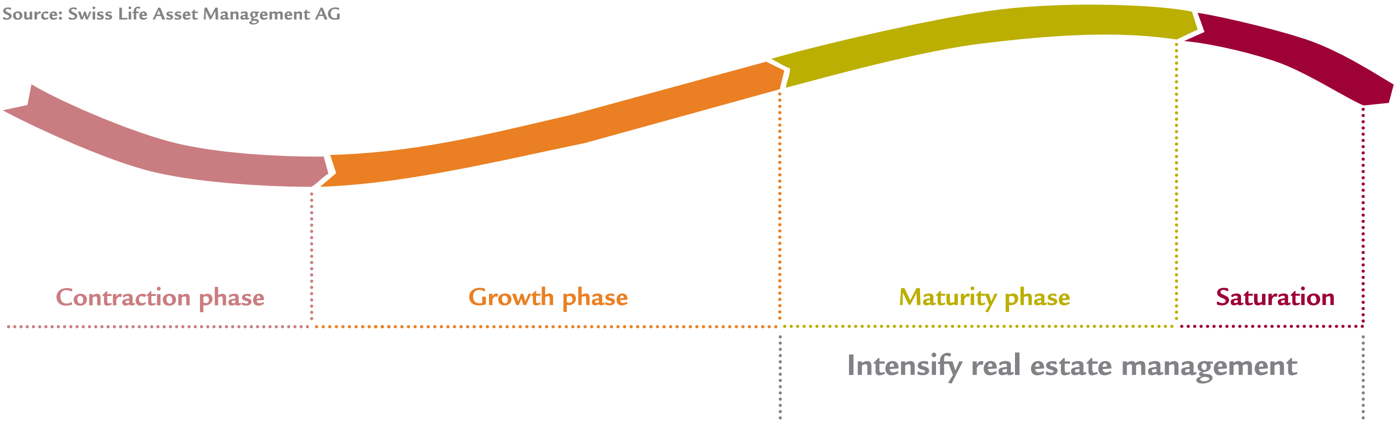
Population growth and production of new apartments



Source: Baublatt info service, SFSO, Wüest Partner sure that new market trends are actively addressed by landlords. Rental units therefore designed to be as flexible as possible. This requires construction knowledge and asset management skills as well as professional portfolio management and research. Swiss Life has always pursued active asset management. At this this stage of the market cycle in particular – with real estate conditions becoming increasingly favourable to tenants – we expect this management approach to gain in importance. ■

The real estate cycle: a strategic approach

Source: Swiss Life Asset Management AG



Home staging is becoming the standard for marketing apartments


Source: Foto Werder

A shift to mixed-use needs new investment strategies

The creation of mixed-use buildings and locations in the UK is rising. This reflects societal change and a greater desire to live, work and play in close proximity. For real estate investors, this necessitates new strategies to identify investment opportunities which are primed for outperformance.

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

Walk around a big corporate office in any of the UK's largest office markets and what will probably strike you is the large amount of non-conventional office uses provided. You may spot anything from cafes to medical suites or libraries and exercise studios replacing space that would once have been only for desks. Offices are becoming increasingly mixed-use.

This transition from single-use to multiple-use buildings is not just occurring within offices. Shops are increasingly providing logistics-style click and collect points and coffee bars. Gyms are selling food, drink and clothing. Even hotels are getting involved by offering co-working space in their lobbies.

Urban locations in the wider sense are evolving to incorporate a greater mix of uses in order to create 24/7 activation, as seen at Kings Cross in Central London or in the city centres of Birmingham and Bristol. As buildings and locations become more mixed-use, the concept of an area or an asset simply being an office location, a retail location or an industrial location is becoming outmoded.

The primary driver of this change is consumer demand for living, working and amenity space to be provided in as close proximity as possible for personal convenience. This expectation reflects the blurring of concepts such as 'work', 'home' and 'shopping' time, which have been eroded by behavioural and technological change.

On this basis, we expect that the polarisation of returns that is already evident between desirable mixed-use locations and less desirable single-use locations will widen. New strategies to capture outperformance in a more polarised world are necessary. An example is our thematic investment approach, which is shaped by structural rather than cyclical change. At Mayfair Capital, this means a focus on management initiatives and greater attention to the mix of uses provided in the immediate locality of our properties.

Opportunities to extract value through refurbishment, upgrades or management to create shared spaces or en-

Source: Shutterstock

A retail store or a café? Shops in London's West End now commonly provide coffee bars on their sales floor to diversify their offer and drive footfall.

AB InBev House, Woking. This strong thematic purchase by Mayfair Capital provides the potential to create a mix of uses within this building, which itself is in a mixed-use town centre

hance amenity are being sought. An example is our recent acquisition of AB InBev House in Woking. The strategy is for a comprehensive refurbishment to provide ground-floor café amenity, cycling facilities and flexible floorspace. This should foster capital growth by creating additional income streams, thus making the property more attractive to occupiers.

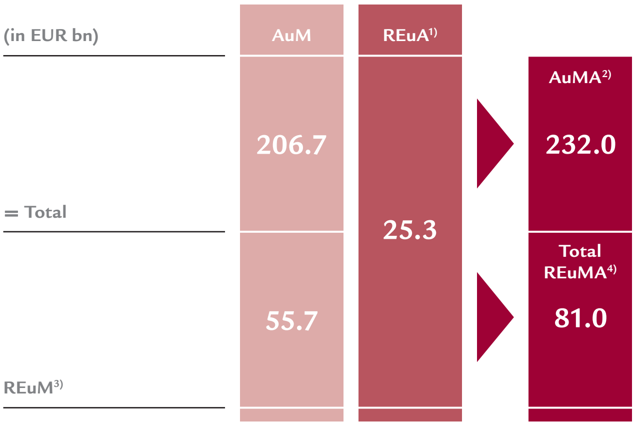
For locations, it is expected that those offering strong amenity provision will be more attractive to occupiers and attain higher values. We therefore target city-centre locations and dense urban areas rather than out-of-centre business parks. The acquisition of 31 Booth Street in Manchester is a recent example. Manchester city centre is a vibrant, growing location, with opportunities to live, work and play within walking distance – and is thus popular with tenants and their staff. Following these strategies, we expect to acquire and deliver assets that will be resilient in the future and underpin continued strong performance. ■

31 Booth Street, Manchester. This recent office acquisition by Mayfair Capital is situated in a vibrant, growing city with opportunities to live, work and play within walking distance

New strategies to capture outperformance in a more polarised world are necessary. An example is the Mayfair Capital thematic investment approach.

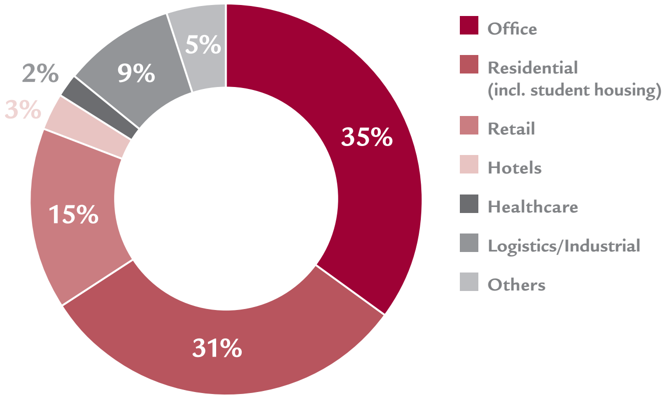
Real estate – facts and figures

Assets under Management and Administration



[1)]Real Estate under Administration (not included in Swiss Life AuM definition)
[2)]Assets under Management and Administration [3)]Real Estate under Management
[4)]Real Estate under Management and Administration

Breakdown by real estate sector



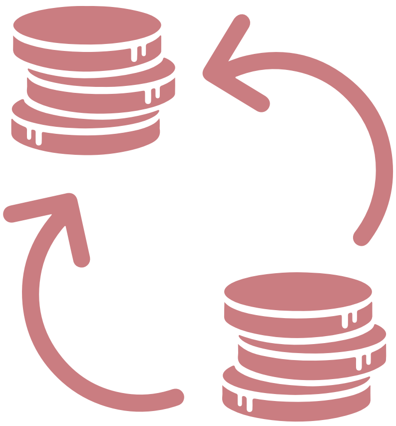
REuM EUR 55.7 bn

Transaction volume real estate

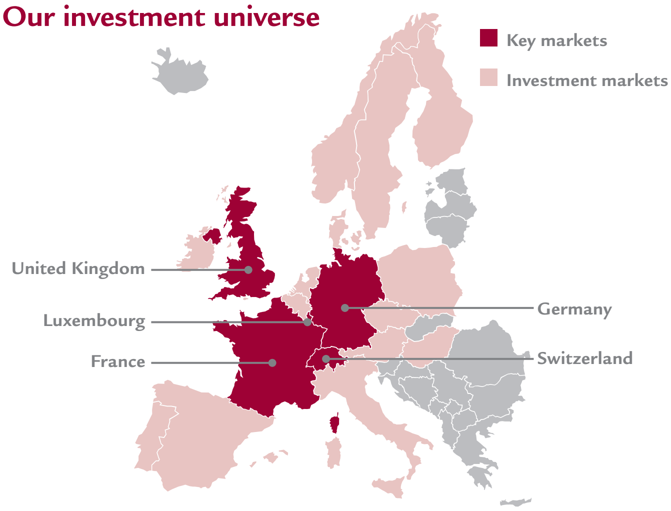
(in EUR bn)

7.0

(average 2016, 2017, 2018)



Our investment universe



All figures as of 31 December 2018, unless stated otherwise.

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