PRIMONIAL REIM

JULY 2019
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REAL ESTATE CONVICTIONS

The fund manager's view of real estate markets

Henry-Aurélien NATTER
Head of Research

FIGURES

GROWTH FORECAST, FRANCE 2019

1.4 %

INFLATION FORECAST, FRANCE 2019

1.2 %

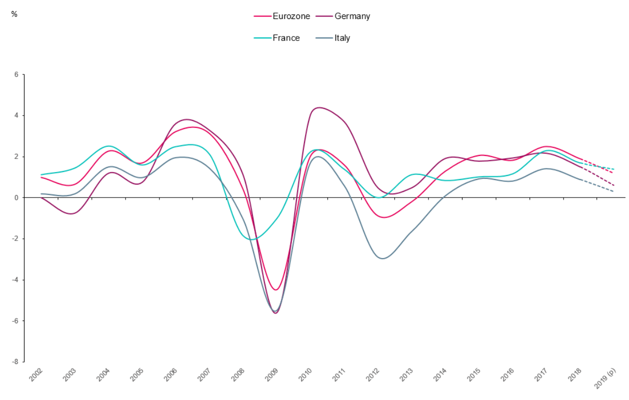
10Y TREASURY BOND FORECAST, FRANCE 2019

10Y FRENCH TREASURY BOND

0.2 %

Source: Oxford Economics

ECONOMIC ENVIRONMENT : GDP IN EUROPE



Sources: Primonial REIM Research & Strategy according to Oxford Economics

ECONOMIC ENVIRONMENT

2019, global growth at the mercy of uncertainty. As activity picked up in almost all regions of the world by late 2017 and as this momentum was expected to continue in 2018 and 2019, some potential risks became a reality and reshuffled the cards. The escalation of trade tensions between the United States and China, macroeconomic strain in some emerging economies, the sharp slowdown in the automobile industry in Germany or the normalisation of monetary policy in advanced countries, contributed to the slowdown in global expansion, after disrupting financial markets in late 2018. A further slowdown in economic growth is therefore expected in 2019.

Economic growth was slow in the first months of 2019. Tensions between the United States and China have been particularly high in recent months. Central bankers in advanced economies have opted to pursue accommodative monetary policies. Thus, the FED announced that it would not raise its interest rates for 2019 and the ECB warned that it would maintain its low interest rate policy until mid-2020 in order to support the European economy. Therefore, we have some visibility for the coming months.

In the eurozone, GDP growth is expected to decline from 1.8% in 2018 to 1.2% in 2019, before recovering to 1.4% in 2020. The factors that are expected to support the expansion of the eurozone are an accommodative monetary policy, wage increases and some fiscal easing. Germany (+0.9%) and Italy (+0.0%) will underperform the European average in 2019, while France (+1.4%), the Netherlands (+1.7%) and Spain (+2.6%) should experience a relatively dynamic rate of expansion. However, certain risk factors will persist within the eurozone, such as the outcome of a disorderly Brexit, or even a no deal (see Brexit, What's Next, Primonial REIM Research & Strategy, April 2019), the increase in trade tensions and the risk of transmission between European economies affected by the slowdown of a partner (notably economies dependent on Germany).

Apart from Italy, the main eurozone countries experienced a significant fall in their borrowing rates, further strengthening the risk premium delivered by real estate. While Germany has grown accustomed to negative rates, the French government was able to borrow below the symbolic 0% mark at the end of the first half of the year. In this context, forecasts for long-term 10-year French government bond (OAT) yields are therefore expected to fall further to around 0.2% on average for 2019 as a whole, i.e. an extremely low level. The increase in inflows on real estate funds reflects this new situation. The risk of a "Japanification" of the European economy must be taken into account as this would mean a long period of low growth and extremely low interest rates. Although the ECB is seeking to avoid this situation at all costs, the current monetary policy is also having unintended effects (deterioration of banks' profit margins, artificial support for zombie companies). In this uncertain context, the real estate risk premium appears largely to be a visibility premium for a real asset whose cash flows are monitored through medium- to long-term leases.

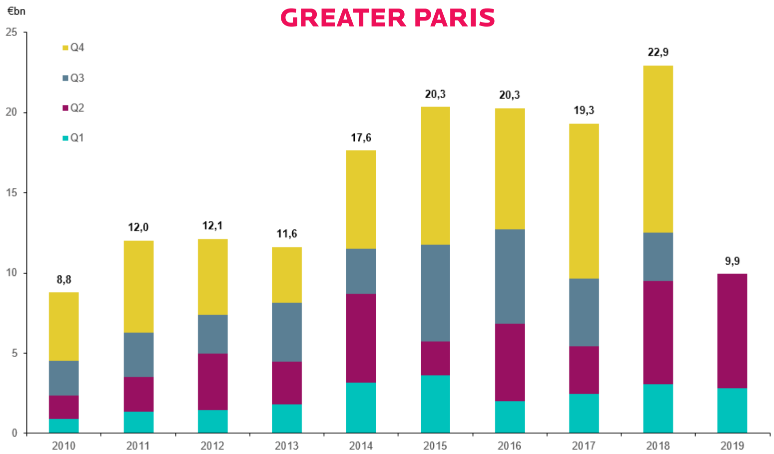
Source for figures: Oxford Economics

OFFICES

OFFICE PRIME YIELD IN THE PARIS CENTRAL BUSINESS DISTRICT	3.00 %
YEAR-ON-YEAR CHANGE IN TAKE-UP IN THE PARIS REGION	-19.00 %
VACANCY RATE IN THE PARIS REGION	4.90 %

By mid-year, international capital was boosting the French market. Investment in commercial real estate in France reached around €12 billion in the first half of 2019, including nearly €10 billion for the Greater Paris market. Offices located in Paris, the inner suburbs and La Défense accounted for the majority of volumes invested. The increased activity of international investors on the French market at the beginning of the year was underpinned by a search for security at a time when the risks surrounding Brexit have increased and the German economic context remains weak. These uncertainties have therefore brought international capital, mainly from South Korea, to the French market, considered more attractive thanks to its better oriented economic fundamentals. For example, 2 billion euros have been invested in Core buildings such as Lumière, the largest building in Paris within the city walls, or the Majunga tower at La Défense.

INVESTMENT IN COMMERCIAL REAL ESTATE IN GREATER PARIS



Sources: Primonial Research & Strategy based on FEVAD, Oxford Economics, RCA

For the first time, the 10-year government bond hit a negative level at the end of June. Thus, prime yields on Paris Region offices compared to the 10-year government bond benefited from a risk premium of around 260 bps in the first half of 2019, a compression of almost 40 bps compared to the end of 2018. This trend could continue if the 10-year government bond yield remains in negative territory. The average metric value continues to increase (+7% over one year) and stands at an average of €6,941/sqm. The Paris segment with average metric values above €8,500/sqm, even exceeding €15,000/sqm in the CBD, and the West Paris & La Défense segment at over €6,200/sqm, stand out from other areas where average values are below €4,500/sqm.

The rental market confirms the slowdown observed at the beginning of the year. The take-up volume was at 1.1 million sqm, a decrease of 19% in one year. It was the > 5,000 sqm transaction segment, which fell sharply, that weighed on growth, while transactions < 5,000 sqm remained stable. Transactions < 1,000 sqm also declined due to competition from coworking site openings. Despite the slowdown in the volume of transactions, average nominal rents increased to €384/sqm/year for rentals of previously used premises (+4% over one year) and to €400/sqm/year for new or restructured properties (+5% over one year). The scarcity of supply and the reduction in support measures (below 20% on average in the first quarter of 2019) contributed to the increase in rents. Coworking operators, who were still particularly active during the first half of 2019, contributed to the scarcity of supply and upward pressure on rents in Paris. For example, WeWork leased 13,200 sqm in the Bercy district and 12,300 sqm at 106 boulevard Haussmann while Kwerk leased 5,500 sqm on boulevard Malesherbes and 6,400 sqm on rue de Courcelles in Paris.

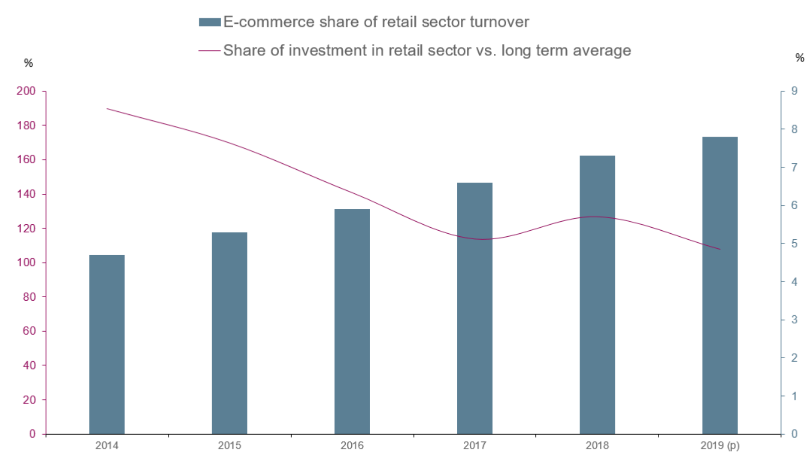
Sources for figures: Immostat, BNP PRE, CBRE, Primonial REIM

RETAIL

CHANGE IN HOUSEHOLD CONSUMPTION IN 2019 (FORECAST)	+ 1.30 %
HIGH STREET SHOP YIELD	2.50 %
SHOPPING CENTRE YIELD	3.50 %
RETAIL PARK YIELD	4.25 %

Approximately €1.4 billion was invested in retail real estate in the first half of 2019, or -20% compared to the same period in 2018. Greater Paris accounts for the majority of investment volumes. Major deals included the sale of a portfolio of 26 Casino hypermarket and supermarket properties for more than €390 million and the acquisition by Paref Gestion of 27 assets in the French regions totalling more than 50,000 sqm of retail space for €94 million. Yields on premium assets remained stable at the end of the second quarter 2019 compared to the end of 2018, while some secondary assets, often weakened by a drop in turnover, are currently undergoing readjustments. The yield on prime high street shops is 2.5% with a differential of 100 to 200 bp for shopping centres and retail parks.

IMPACT OF E-COMMERCE ON INVESTMENT VOLUMES IN RETAIL



Sources: Primonial Research & Strategy based on FEVAD, Oxford Economics, RCA

The retail industry continues to change. Online sales are still growing at double-digit rates. With €92.6 billion spent online by French consumers in 2018, e-commerce experienced a 13.4% increase in turnover over one year. In 2019, professionals in the sector expect a further increase in turnover, which should exceed 100 billion euros. At the same time, growth dynamics in the retail trade are more contained (+1.3% projected for 2019). In this context, brands or retail spaces that have not joined the digital revolution are experiencing stiff competition. Thus, some areas are seeing a reduction in footfall which is generally accompanied by a decline in turnover. In such cases, pressure resulting from the rent-to-turnover ratio becomes too heavy for some brands, which are forced to reduce their activity by favouring the most attractive areas, which has led to strong corrections in the rental values of retail spaces where vacancy rates are rising.

High street rents stable in major metropolitan areas, with further corrections observed in smaller towns and cities or secondary locations. Rents in large conurbations and the best locations for generating revenue through dense pedestrian traffic remained stable overall during the first six months of 2019, which is not the case for smaller towns and cities or secondary locations that were subject to a further correction of rents. Several business sectors experienced good momentum in the first half of 2019: sports, beauty and health, catering and home furnishings. On the other hand, clothing and footwear had a negative half-year. The formats that are currently succeeding are high street shops with dense pedestrian traffic, out-of-town retail spaces with innovative concepts, shopping centres with a central location and a reworked "customer experience" concept, but also air-conditioned shopping malls that are sought after by consumers seeking cool spaces during hot weather.

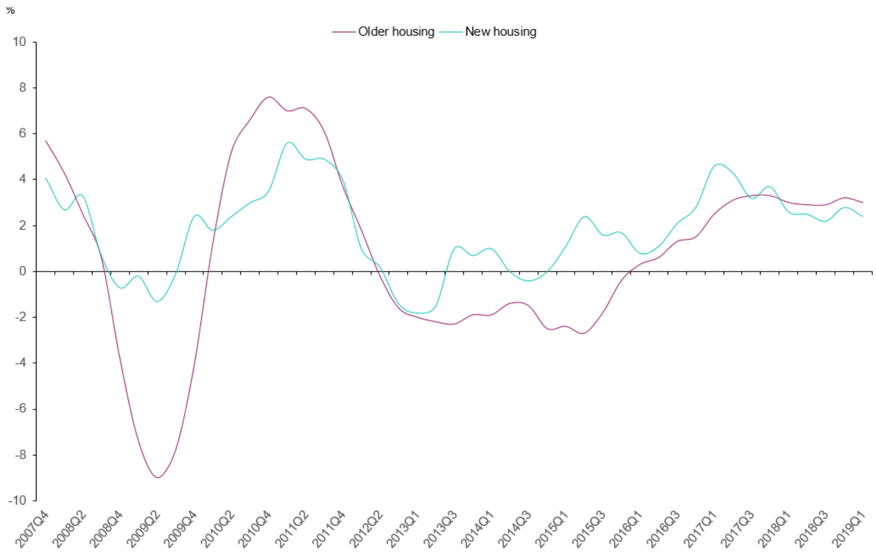
Sources for figures: Procos, RCA, C&W

RESIDENTIAL

EXISTING HOUSING SOLD AT Q3 2018	**994,000 sales (+4.4% year-to-date m/m n-1)**
RISE IN PRICES OF EXISTING HOUSING IN FRANCE AT Q3 2018	**+2.9% (year-on-year)**
BUILDING STARTS AT Q3 2018 (12-MONTH TOTAL)	**411,400 (-1.8% vs end 2018)**

Another record in number of transactions. The number of sales of older homes by May 2019 increased to 994,000 (+4.4% year-to-date m/m n-1). In the first quarter of 2019, apartment prices (+3.7% year-on-year) continued rising at a sustained pace in Greater Paris (+3.9%) and remained almost unchanged in the French regions (+2.6%). Over the first 6 months in 2019, strong increases were recorded in Nantes (+8.2%), Lyon (+5.7%), Paris (+4.6%), Toulouse (+4.3%) and Bordeaux (+2.6%) for the main French cities.

PRICE INDEX FOR MAINLAND FRANCE, YEAR-ON-YEAR CHANGE



Sources: Primonial REIM Research & Strategy based on INSEE

The decline in the number of new homes for sale is accelerating. With 411,400 housing starts launched in May 2019 (12-month total), new housing construction continues to decline (-1.8%) compared to the end of 2018. The level of sales by property developers to private individuals was comparable to that seen in the first quarter of 2018 (-0.4%). Reservations fell in the individual segment (-8.1%) and remained stable in the collective segment (+0.2%). New housing prices continued to rise over the year (+2.4%) but the trend is stabilising from quarter to quarter (0.0% Q1 2019/Q4 2018).

Increasingly favourable mortgage rates. The average mortgage rate (long-term and fixed-rate) continued to fall and stood at 1.46%. For some cases, this rate has fallen below 1%. The ECB's announcements on keeping its key rates low make mean that we can anticipate the maintenance of, or even further cuts in, mortgage rates by the end of the year. Households, and particularly first-time buyers, are thus able to go ahead with their home buying projects even though they may have been impacted by the rise in property prices. It is important to be vigilant because, according to the Banque de France, the high level of individual debt is raising the issue of sustainability of this debt, which could represent a risk that would lead to an adjustment in residential property prices in the event of a shock.

A slower institutional market after a record 2018. The block residential market for institutional investors was worth around €600 million in the first half of 2019. While French institutional investors are still active in this market, it is interesting to note the increase in the first six months of the year in the attraction of foreign investors to the French residential market. While rents have been capped in Paris, they remained between 2.5% and 3.0% for Parisian residential properties and between 3.5% and 6.0% in the French regions. Among the transactions in the first half of 2019, AMDG acquired 11 buildings totalling 10,500 sqm for €35 million

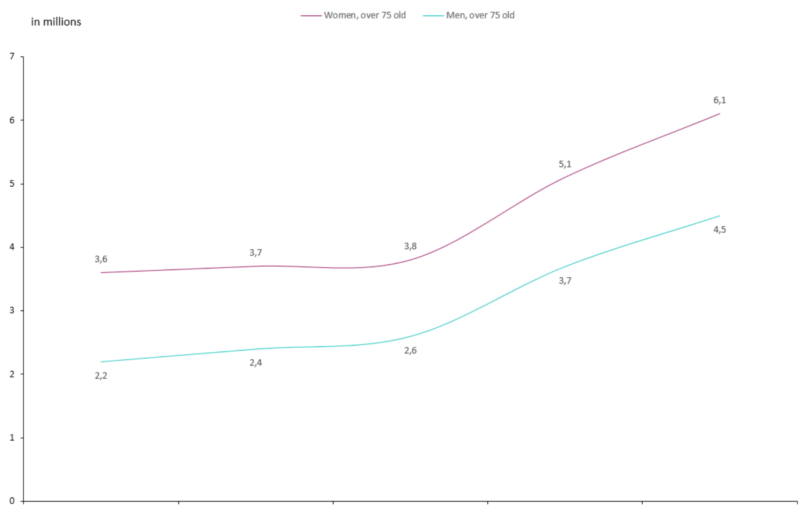
Sources for figures: BNP PRE, JLL, FNAIM, Notaire-INSEE and Soes, Sitadel

HEALTHCARE

CARE HOME PRIME YIELD	4.0 % - 5.5 %
MEDICAL, SURGERY AND OBSTETRIC CLINIC PRIME YIELD	5.2 % - 6.5 %

Portfolio sales driving the French health market. The volume of investment in healthcare real estate (nursing and retirement homes) in France was around €300 million in the first half of 2019. For the full year, the market should perform in line with its long-term average. Among the highlights was the sale of the Seniority portfolio held by the "A Plus Generation" OPCI. This portfolio consisted of 6 residences (Domitys and Les Essentielles) and was acquired by Catella RIM for 128 million euros. The other significant transaction of the first half of the year was the acquisition by Primonial REIM of two nursing homes in Greater Paris for €72 million. These two latest generation assets total nearly 10,000 sqm and have more than 200 beds. At the end of the first half of 2019, the prime yield remained at 4.0% for nursing homes and was slightly compressed for medical clinics at 5.2%.

CHANGE IN POPULATION OVER 75 BY 2040 IN FRANCE



Source(s): Primonial REIM Research & Strategy based on Oxford Economics

The nursing home sector in France consists of more than 7,500 establishments and more than 610,000 beds. However, despite the existing supply, it is considered insufficient and unsuitable since it is estimated that the sector will need 145,000 new or upgraded beds by 2025. Demographic factors are indeed responsible for the continued growth in demand for care in specialised institutions. The aging of the French population and the increase in the number of elderly people who are dependent on help is increasing the need for support for people who are losing their autonomy at home or in care homes. In France, the markets that represent the greatest development potential by 2025 are Greater Paris, the Provence-Alps-Côte d'Azur region, Eastern France and the Burgundy-Franche-Comté region.

While the top 5 operators account for 55% of private sector beds, consolidation benefitting market leaders continues.

There are around 4,000 establishments with nearly 500,000 beds covering medicine, surgery obstetrics, post-acute care, long-term care, psychiatric care and hospital-at-home. In the clinics sector, the patient profile has changed significantly. In addition to the phenomenon of an ageing population, the development of outpatient surgery and a charging system has accelerated from a rate per day of hospitalisation to a rate per type of procedure. Thus, medical facilities tend to redirect patients to post-acute clinics relatively quickly. The markets representing the greatest development potential by 2025 are Brittany, Eastern France as well as Burgundy Franche-Comté, the Centre Val-de-Loire, Normandy, New Aquitaine, Occitania and the Provence-Alps-Côte d'Azur region. Despite continuous momentum towards concentration, the top three operators account for only 25% of the number of establishments. Consolidation of the sector on a French and European scale is set to continue.

Sources for figures: RCA, operators, Primonial REIM

DEFINITIONS

10-Year French Treasury bonds: debt securities issued by the French state with a 10-year term. The 10-year French Treasury bond is widely accepted as the risk-free indicator.

Volume of investment in commercial real estate: global volume of office, retail outlet, business premises and warehouse assets acquired, by an investment buyer, for a "deed-in-hand" amount of more than €4 million.

Office take-up (Immostat): all rentals or sales to occupiers (rather than sales to investors) involving premises for office use. This is expressed in square meters of usable space.

Off plan : off-plan sales are the contractual method whereby buildings that have yet to be built are sold. Investors become their owners as construction progresses.

Incentives measures: incentives granted to tenants, such as rent-free periods and improvement works.

Yield : relationship between the gross or net income from the building and the "deed-in-hand" capital invested by the buyer (acquisition price + property transfer fees and taxes).

Shops walls: refers to traditional shops on the ground floor of buildings in city center high streets.

Shopping Centre: building containing a complex of at least 20 shops, housed in covered galleries, centered on a supermarket that ensures a customer flow.

Retail park: an open-air retail complex built and managed as a single unit. Includes at least five buildings joined together by thoroughfares. Located on the outskirts of cities.

Care home: a medically-equipped structure designed to accommodate elderly people needing care.

Medical, surgery and obstetric clinic: hospital stays to receive short-term care, with or without accommodation, or treatment for serious conditions during their acute phase.

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 and healthcare and education facility real estate,**
- **Multi-national: France, Germany, Spain, Italy, Belgium and Ireland.**

At 31 December 2018, Primonial REIM had

- **€17.2 billion of assets under management,**
- **58,920 associates,**
- **43 independent real estate advisors,**
- **Assets worth 3,817,380 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

CONTACT

RESEARCH & STRATEGY DEPARTMENT

Daniel WHILE • Head of Research & Strategy • daniel.while@primonial.fr

Henry-Aurélien NATTER • Head of Research • henry-aurelien.natter@primonial.fr

The Research & Strategy Department's role is to formalize 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.

Real Estate Convictions offers Primonial REIM's quarterly view of its markets of choice, i.e. offices, retail outlets and healthcare and residential real estate, in France (two publications a year) and Europe (European Real Estate Convictions, two publications a year).

PRIMONIAL
REIM

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REGISTERED OFFICE
36 rue de Naples 75008 Paris - Telephone: 01 44 21 70 00 - Fax: 01 44 21 71 23.

www.primonialreim.com

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