REAL ESTATE CONVICTIONS

The fund manager's view of real estate markets

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FIGURES

GROWTH FORECAST, FRANCE 2020

1.2 %

INFLATION FORECAST, FRANCE 2020

1.2 %

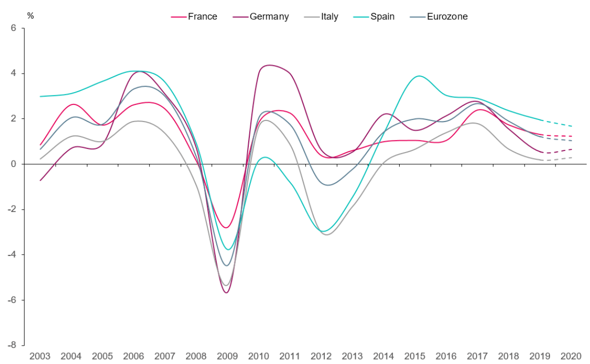
10Y TREASURY BOND FORECAST, FRANCE 2020

10Y FRENCH TREASURY BOND

0.1 %

Source: Oxford Economics

ECONOMIC ENVIRONMENT : GDP IN EUROPE



Sources: Primonial REIM Research & Strategy according to Oxford Economics

ECONOMIC ENVIRONMENT

Global economic growth stalled in 2019. Having peaked at around 4.0% in 2017, global economic growth then slowed to 3.6% in 2018 and the latest estimates suggest it will come out no higher than 3.0% in 2019. The global economy was said to have experienced a synchronised slowdown during the last few months of the year, and greater uncertainty about the economic climate indicated that growth would be weaker in 2020. Yet certain risks appear to be easing off. The US and China have signed a "phase 1" trade deal, pointing to a truce in the trade war between the two economic powers that began in 2018. Beijing has agreed to purchase 200 billion dollars of US agricultural products, which is causing concern in Brussels as this could greatly undermine Europe's access to the Chinese market. The European Union has said it will go to the WTO if the deal distorts global trade.

Timid signs are emerging of economic stabilisation in 2020. Global economic growth is expected to stabilise in 2020. Uncertainty prevails, however, despite encouraging signs on the trade front, the orderly Brexit scheduled for 31 January and the potential of emerging countries to spur global economic growth. For instance, trade tensions still exist between the US, China and the European Union, which will also have to lay the foundations for its future trade relations with the United Kingdom. Trade tensions aside, geopolitical risks are also on the increase and social unrest is intensifying. This could result in tougher financing terms for certain states, threatening the global economy's current pace of growth.

GDP growth is expected to be sluggish in the eurozone, slipping from 1.2% in 2019 to 1.0% in 2020. Germany (+0.7%) and Italy (+0.3%) are set to underperform the European average in 2020, while France (+1.2%), the Netherlands (+1.3%) and Spain (+1.7%) are expected to deliver above-average economic growth. The European Central Bank (ECB) has signalled that it will maintain a highly accommodative monetary policy of low interest rates in order to shore up Europe's economy (cf. "*La BCE à la croisée des chemins*", Primonial REIM Research & Strategy, January 2020).

Some 277 billion euros were invested in European commercial[1] real estate in 2019, which means that the volume of capital dipped slightly (-6% year-on-year). France managed to maintain the amount of capital flowing into its commercial real estate sector (€39bn), whereas Europe's two biggest markets experienced downturns compared with 2018: -6% in Germany and -18% in the United Kingdom. France's real estate sector has a number of things going for it: robust economic growth projected for 2020, healthy domestic demand, and forecasts that French 10Y Government yields (OAT) will remain low (at an annual average of 0.1%).

Source(s) for figures: Oxford Economics, RCA

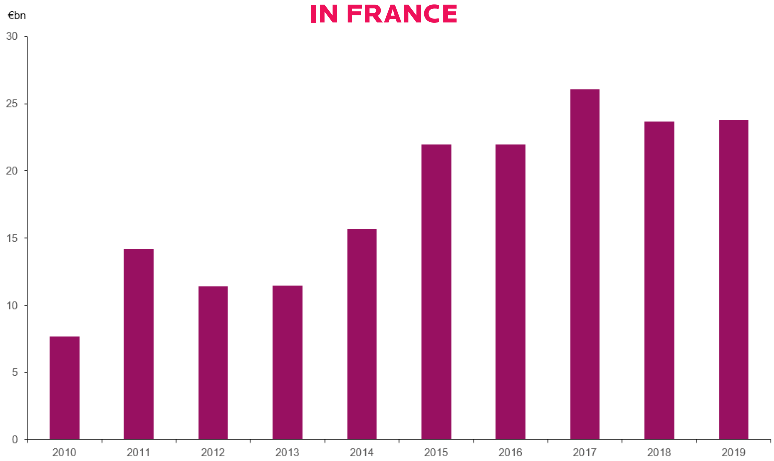
[1] Commercial real estate refers to offices, retail outlets, logistics, services and residential assets aimed at institutional clients.

OFFICES

OFFICE PRIME YIELD IN THE PARIS CENTRAL BUSINESS DISTRICT	<3.00 %
YEAR-ON-YEAR VARIATION IN TAKE-UP IN THE PARIS REGION	-10.00 %
VACANCY RATE IN THE PARIS REGION	4.70 %

Stable volumes invested in office real estate, driven by international capital. Investment in France's office real estate sector amounted to around 24 billion euros in 2019 (stable versus 2018), of which about 20 billion euros in the Paris region alone. Office properties located in Paris, the Inner Rim and La Défense accounted for the lion's share of volumes invested. International investors invested heavily in the French market over the year, seeking security in the country amid Brexit-related uncertainty in the UK and a disappointing economic climate in Germany. Such concerns drove international capital (primarily from South Korea, Switzerland and the US) towards the French market thanks to its sound economic fundamentals. The property investment market was driven above all by "Core" deals, such as Lumière (the biggest building in inner city Paris), and by new assets, such as the sale-before-completion deals signed for Metal 57 in Boulogne and Sways in Issy-les-Moulineaux.

VOLUME INVESTED IN OFFICE REAL ESTATE IN FRANCE



Source(s): Primonial REIM Research & Strategy according to RCA

Further yield compression in prime office space in the CBD amid low borrowing rates. Prime office yields in the Paris region benefited from a 270bp risk premium at end-2019 (relative to the 10Y OAT), corresponding to 40bp compression versus 2018. So low interest rates triggered further yield compression in prime real estate. Average values per square metre in the Paris region soared (by +19% year-on-year) to €7,774/m². It is worth mentioning in particular the Paris sector, with average values of over €10,000/m² (even exceeding €17,000/m² in the CBD), along with the Western Crescent and La Défense sectors, with values of around €7,000€/m². These figures compare with average values of less than €5,000/m² in other regions.

Rental activity slower but still satisfactory. Take-up volumes came out in line with the ten-year average at 2.3 million m² (-10% year-on-year). Transactions in the >5,000 m² category slowed growth down with fewer than 1 million m² taken up, while the <5,000 m² category held steady with around 1.5 million m² taken up. Despite slower deal volumes, average nominal rents rose to €400/m²/year for second-hand office space (+5% year-on-year) and to €397/m²/year for new or redeveloped office space (+4% year-on-year). Rents were driven up by a shortage of supply (2.7 million m² available at end-2019) and lower incentive rates (averaging less than 20% in the third quarter of 2019). The focus in 2020 will be on new and redeveloped office space coming on the market. The market may well be shaken up by rapid growth in the amount of quality office space available in La Défense, the Inner Rim-North and the Western Crescent. With so much renewed office space gradually coming onto the market in these sectors in 2020 and 2021, occupants may be encouraged to review their real estate policies to take advantage of this available supply of quality office space and thus turn their attention away from less attractive assets.

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

RETAIL

CHANGE IN HOUSEHOLD CONSUMPTION IN 2019 (FORECAST)	+ 1.30 %
PRIME HIGH STREET SHOP YIELD	2.50 %
PRIME SHOPPING CENTRE YIELD	3.75 %
PRIME RETAIL PARK YIELD	4.55 %

Some 5.7 billion euros were invested in retail real estate in 2019 (+19% year-on-year), with capital flows into this market reaching their highest level for 4 years. The vast majority of transactions went ahead in the Paris region and Lyon. These included the sale by ADIA to Amundi Immobilier and Crédit Agricole Centre-Est of 35,000 m² of retail space along the main shopping areas of Lyon's Presqu'île, and the shareholdings purchased by AXA IM in the Italie 2 and Passage du Havre shopping centres in Paris from Hammerson and Eurocommercial for 676 million euros. Yields on prime ground-floor retail assets remained stable year-on-year at 2.5% at end-2019. On the other hand, shopping centres and retail parks recorded yield decompression of respectively 55bp and 10bp, so the gap with ground-floor retail space now exceeds 200bp.

CONSUMER SPENDING 2019-2024 IN FRANCE (WIDER METROPOLITAN AREAS)

Source(s): Primonial Research & Strategy according to Oxford Economics

Paradigm shift still underway in the retail segment. E-commerce has continued to gain ground consistently in recent years, and consumers have changed their habits and their expectations. The consumer has become omni-channel and wants to consume less but better, while also having fun during the buying process. With this in mind, bricks-and-mortar retail continues to overhaul itself to offer new concepts based on a mix of retail, leisure and catering facilities. So the retail segment is now focused on three areas: convenience for day-to-day shopping, e-commerce for a deeper selection, and an emphasis on the buying experience. The aim is to draw consumers into premises not only to do their shopping but also to take advantage of leisure facilities (restaurants, cinemas, games, etc.), thus making the catchment area more attractive.

Revenues in the non-food retail segment are rising, but not in all formats. Cumulative data for January to November was slightly positive for non-food retail revenues, but the trend was negative for city-centre shopping centres according to Procos. And although the ongoing social unrest appears to have had more of an impact on retail revenues in Paris, the effect will be devastating for certain retailers in the provinces that had not yet recovered from the repercussions of the "yellow jackets" movement. Consumer spending is expected to pick up in 2020 as households will gradually begin to consume more following measures introduced by the government to bolster purchasing power (+1.3% projected in 2020).

Rental values for ground-floor retail premises have risen in the most attractive shopping areas, whereas they have fallen in locations where footfall is drying up. France's retail real estate map seems to reflect the country's social and territorial divisions. The market is split between Paris and the big regional cities on the one hand, with low yields but bright prospects, and peripheral areas on the other, with high vacancy rates and shrinking rental values.

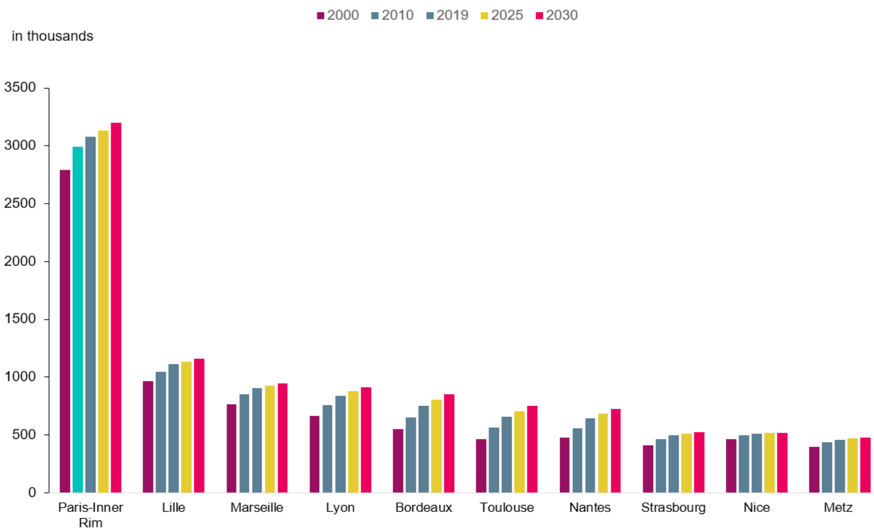
Source(s) for figures: BNP PRE, Procos, RCA

RESIDENTIAL

EXISTING HOUSING SOLD AT Q3 2018	**1,059,000 sales**
RISE IN PRICES OF EXISTING HOUSING IN FRANCE AT Q3 2018	**+3.2% (year-on-year)**
BUILDING STARTS AT Q3 2018 (12-MONTH TOTAL)	**409,800 building starts**

Record sales of existing housing in 2019. The number of existing housing transactions (cumulative data over a twelve-month period) rose to 1,059,000 sales in the third quarter of 2019 (+4.4% over twelve months, i.e. Q/Q n-1). Housing prices (+3.2% year-on-year) continued to climb at a solid pace in the Paris region (+3.5%) and in the provinces (+2.9%) over the first 9 months of the year. They increased significantly in France's main metropolitan areas in 2019: Lyon (+11.0%), Nantes (+9.5%), Paris (+8.0%), Toulouse (+7.3%) and Marseille (+3.5%). Prices in certain cities like Bordeaux (+0.9%) and Nice (-0.9%) are stalling after having grown rapidly for a number of years.

NUMBER OF HOUSEHOLDS 2000-2030 IN FRANCE (WIDER METROPOLITAN AREAS)



Source(s): Primonial REIM Research & Strategy according to Oxford Economics

Renewed tension in the new housing market: sales are falling. There were 409,800 housing starts recorded in 2019 (in November on a 12-month trailing basis), which means that the construction of new homes continued to decline (-3.3%) during the previous 12 months. The number of homes put up for sale to private buyers by property developers was much lower than in the third quarter of 2018 (-20.2%). Orders are falling in the single-family housing segment (-2.6%) and holding rather steady in the multi-occupancy housing segment (-0.8%). New home prices, on the other hand, have risen further year-on-year (+3.5%), although the pace is slower when considered from quarter to quarter (+2.0% Q2/Q1 2019).

Downward pressure on mortgage rates. Average interest rates applied to mortgages (long-term and fixed-rate) slid further and stood at 1.20% in November 2019 (-44 points year-on-year). The ECB is keen to leave its key interest rates unchanged in 2020, which should keep mortgage rates low in France over the coming months. This floor level for borrowing rates has enabled many households to fulfil their dreams of buying a home, but it has automatically increased the risk of overindebtedness. The HCSF (France's High Council for Financial Stability) has issued prudential recommendations on the length of mortgage loans (maximum of 25 years) and on debt service-to-income ratios (maximum of 33%). However, not only is there a huge risk that households will find themselves unable to repay their mortgages, the authority is also concerned about the risk of a widespread slowdown in consumer spending.

After an exceptional 2018, the market for institutional investment contracted in 2019 although it remains buoyant compared with the ten-year average. The residential block market for institutional investors saw investments totalling 1.5 billion euros in 2019 following a record year in 2018 including two deals signed in excess of a billion euros. Rent caps were reintroduced in Paris in 2019, and prime yields averaged between 2.0% and 3.0% for Paris residential assets compared with 3.0% to 6.0% in the provinces. Highlights in 2019 included Primonial REIM's acquisition of a mixed-use portfolio of 14,350 m² of housing, retail and office assets in Lyon for 85 million euros from ADIA.

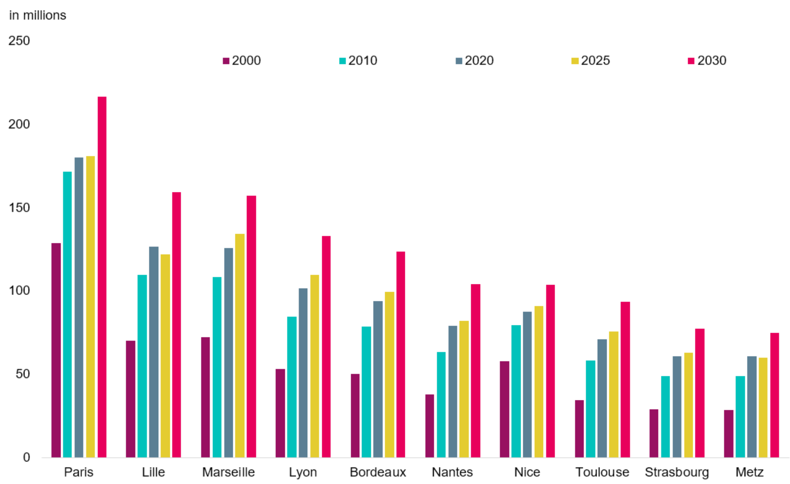
Source(s) for figures: Banque de France, Meilleurs Agents, Notaire-INSEE, RCA, Soes and Sitadel

HEALTHCARE

CARE HOME PRIME YIELD	**<4.0 % - 5.5 %**
MEDICAL, SURGERY AND OBSTETRIC CLINIC PRIME YIELD	**5.15 % - 6.5 %**

Competition is on the increase due to a lack of opportunities in the market. The volume invested in healthcare real estate (nursing homes and retirement homes) in France totalled around 600 million euros in 2019. Although the amount invested was much smaller than in 2018 (-47% year-on-year), the market remains in line with its long-term average. As expected, new entrants moved into the healthcare real estate market, such as M&G Real Estate which invested 47 million euros in a building to be developed as a senior services residence. Primonial REIM invested over 130 million euros and once again proved to be a key player in the market, carrying out emblematic transactions such as the two latest-generation nursing homes it bought in the Paris region for 72 million euros. There was a little more yield compression on prime assets in 2019, with yields moving below 4.0% for nursing homes and to 5.15% for MSO clinics.

POPULATION OF OVER-80s 2000-2030 IN FRANCE (WIDER METROPOLITAN AREAS)



Source(s): Primonial REIM Research & Strategy according to Oxford Economics

In France, physical and psychological dependency care is organised according to short-term, medium-term and long-term needs. It starts with home services/care and senior services residences. As they become more dependent, patients are mostly steered towards medically-equipped retirement homes (Alzheimer units, large dependency units and daycare facilities) or post-acute/rehabilitation care and psychiatric clinics (post-acute/rehabilitation specialisations include musculoskeletal disorders, geriatrics, addictions, cardiology, nervous system, respiratory and oncology). Technological innovation is a fundamentally important issue when dependency increases. The main areas of innovation include artificial intelligence and the safety and well-being of residents/patients.

France's nursing homes sector consists of over 7,500 facilities and more than 610,000 beds However, France's ageing population is putting pressure on this sector, as is the growing number of elderly dependent people. So it is estimated that the sector will need 145,000 beds to be added or upgraded by 2025. In France, the markets with the most development potential out to 2025 are to be found in the Paris region, the PACA region, the East and the Bourgogne-Franche-Comté region. The top 5 operators already account for 55% of beds in the private sector and the consolidation continues, benefiting the leaders further.

The MSO/post-acute and rehabilitation/long-term/psychiatric care sector consists of around 4,000 facilities and about 500,000 beds. The main development in the clinics sector is that MSO facilities are tending to steer their patients quite quickly to post-acute/rehabilitation clinics. The markets with the most development potential out to 2025 are to be found in Brittany and the East, but also in the Bourgogne Franche-Comté, Centre Val-de-Loire, Normandy, Nouvelle-Aquitaine, L'Occitanie and PACA regions. Although the sector continues to consolidate, the top 3 operators currently account for just 25% of the number of facilities. The sector will consolidate further across France and also across Europe.

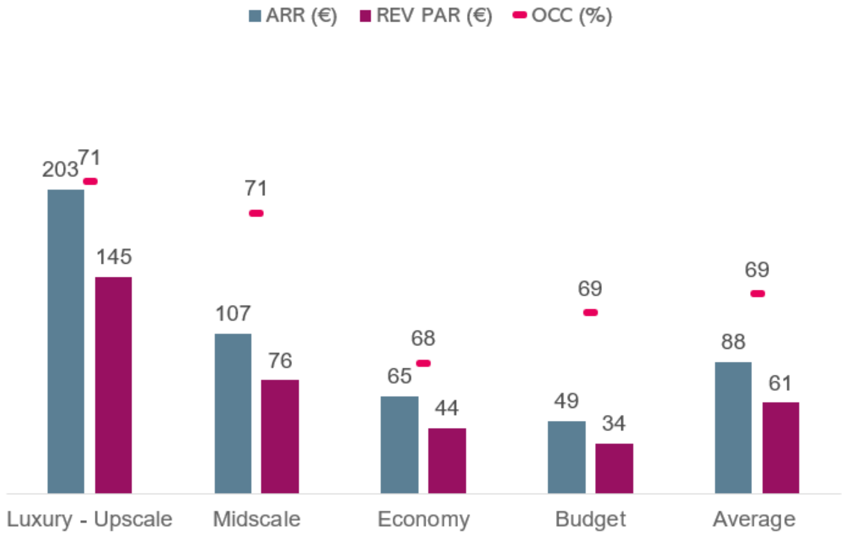
Source(s) for figures: RCA, healthcare operators, Primonial REIM

HOTELS

NUMBER OF HOTELS IN 2019	18,000
NUMBER OF ROOMS IN 2019	654,000
PRIME HOTEL YIELS IN PARIS	4.0%-5.0%

2019 saw an upturn in investment in the hotel sector. The period spanning 2012 to 2016 was a favourable one for the sector, with 2 billion euros invested in it. But investment then levelled off in 2017 and 2018 and failed to exceed 1.5 billion euros. 2019 proved to be a good year, with around 2 billion euros being invested. Most of the amounts committed went to the Paris region and Côte d'Azur region. For instance, Covivio bought a stake in a portfolio of 32 Accor hotels in France and Belgium for 176 million euros, and Primonial REIM purchased 59 B&B hotels from Covivio for over 250 million euros including a fixed 12-year lease agreement. Prime hotel yields in Paris ranged from 4% to 5% at end-2019 compared with 5%-6% for pure real estate in the provinces and 7%-10% for deals involving premises and business assets.

THE HOTEL SECTOR'S PERFORMANCE IN FRANCE IN 2019 (CUMULATIVE DATA FROM JANUARY TO OCTOBER)



Source(s): Primonial REIM Research & Strategy according to KPMG

France's hotel sector consisted of around 654,000 rooms in about 18,000 hotels in 2019, according to the latest provisional figures. Non-classified hotels (hotels with no stars) accounted for 23% of all hotel establishments, 1-star and 2-star hotels for 30%, 3-star hotels for 34%, and 4-star and 5-star hotels for 13%. France remains the world's top tourist destination in terms of tourist arrivals, with over 90 million arrivals in 2019 according to the latest projections. The authorities still aim to draw in 100 million tourists but this target, initially set for 2020, has been pushed back by two years on account of the "yellow jackets" demonstrations and the Brexit effect. Tourism revenue is thought to have totalled 1,700 billion dollars worldwide. France (67 billion dollars in 2018) ranks below the US (214 billion dollars) and Spain (74 billion dollars). These three countries alone account for 21% of global tourism revenue. We can see new trends emerging in the hotel sector: hotel stays are being transformed into experiences; there is a surge in coworking in hotels; and office towers are being reconverted to hotels, especially in the Paris region, such as the Mercuriales towers converted by Marriott International and the Pleyel tower converted by H-Hôtels.

The hotel sector is enjoying broadly favourable conditions as regards the economy and tourism.
France's hotel occupancy rate stood at 68% in October 2019 (cumulative data for January to October, +0.3% year-on-year), the average daily room rate was €91 in the first 10 months of 2019 (+1.4% year-on-year) and RevPAR (a measure of accommodation revenue) was 1.8% higher year-on-year at €62. These key hotel activity indicators are expected to continue climbing between now and 2024 thanks to the strong impetus provided by the renewal of France's hotel sector and major international events (Rugby World Cup, Olympic Games).

Source(s) for figures: Primonial REIM, KPMG, RCA, INSEE, WTO

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.

RevPAR: abbreviation of revenue per available room. It corresponds to a hotel establishment's accommodation revenue divided by the total number of rooms. RevPAR also corresponds to the occupancy rate multiplied by ARR.

ARR: abbreviation of Average Revenue per Room. It is calculated (excluding breakfast) by dividing total revenue by the number of rooms occupied.

Hotel occupancy rate (OCC): ratio between the number of rooms occupied and the total number of rooms in a hotel.

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 and the Netherlands,**

At 31 December 2019, Primonial REIM had

- **+ €21 billion of assets under management,**
- **+ 67,000 associates,**
- **46 independent real estate advisors,**
- **Assets worth more than 4,200,000 sq. m. and 7,000 tenants, including a large share of major corporate tenants (e.g. Samsung, Korian, Crédit Agricole and SNCF).**

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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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