PRIMONIAL
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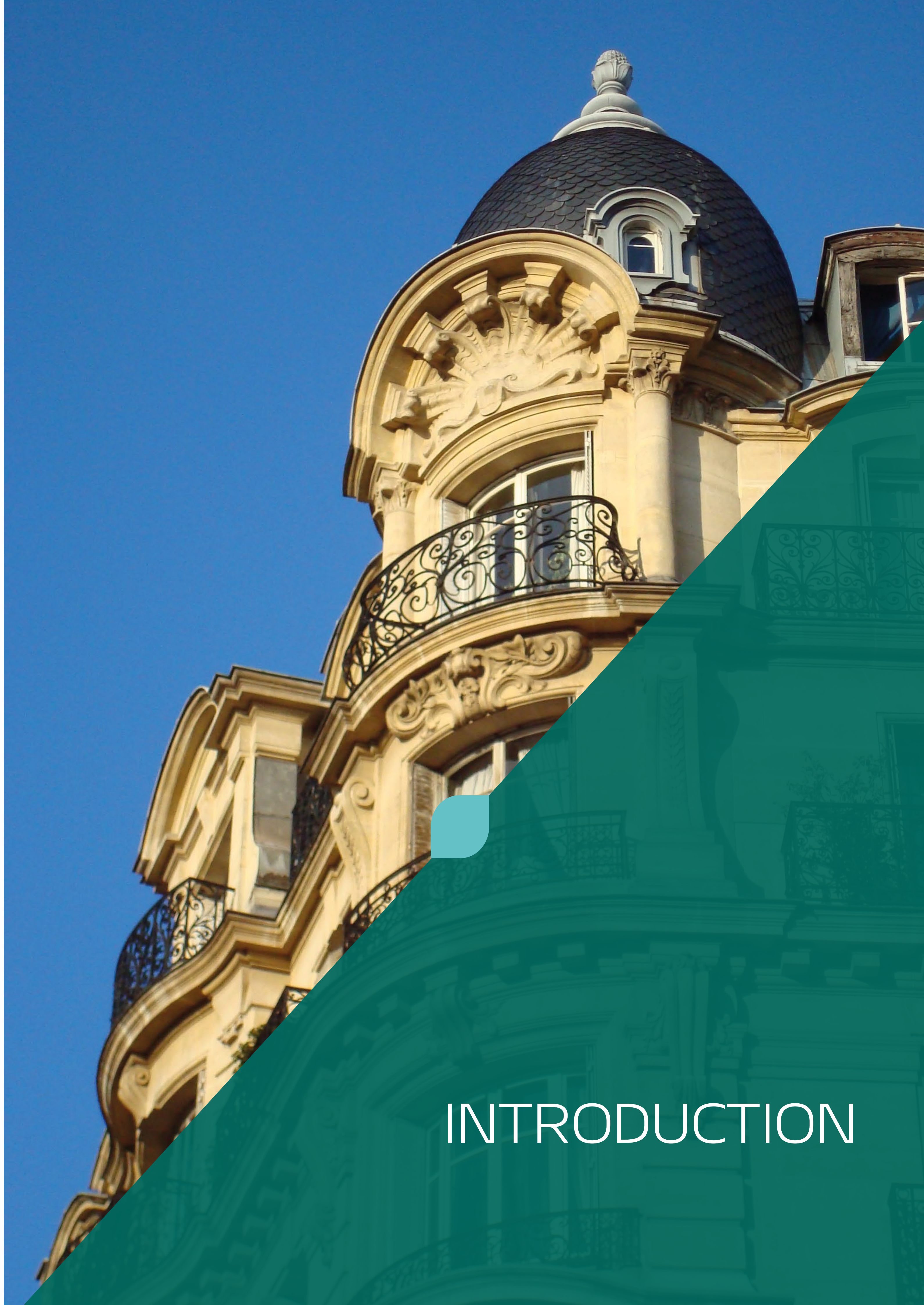
VALUE FROM VALUES

EUROPEAN RESIDENTIAL: THE GREAT ACCELERATION

NOVEMBER 2021

SUMMARY



INTRODUCTION

EXECUTIVE SUMMARY

- Whereas the economic and financial crisis of 2008/2009 and the European sovereign debt crisis both led to a drop in house prices in many countries – from which most European cities quickly recovered– the health crisis of 2020/2021 has not had the same effect. Quite the opposite; the European residential sector has seen a "great acceleration" in prices, demand, territorial positioning and institutional investment.
- European cities are seeing similar patterns that are determining their performance: construction volumes trending downwards and not having regained their levels from before the 2008/2009 crisis; demographic growth, particularly in the northern countries (including France); a lower correlation between GDP and housing prices than for other types of assets; and a growing preference to rent at a time when sustainability of the effort rate is an issue for some households.
- Confounding some predictions made during the first lockdown, we are not seeing an 'urban exodus' towards smaller towns, other than for a tiny share of the population, but rather a reorganisation within major urban centres and the emergence of the concept of the "semi-principal residence".
- We have analysed the public transport networks of 140 European cities together with 80 proposed extension projects, and highlighted the potential that exists between this infrastructure and future price growth.
- The city of today, and even more so that of the future, is multi-generational: it houses several age groups with fundamentally different housing needs (see Primonial REIM Recherche & Stratégie, Real Estate and Lifecycle, October 2020). We explore the residential models that can satisfy this new demand: co-living, Build-to-Rent, senior housing.
- The rise of institutional investment in block housing works hand-in-hand with these developments. Since 2018, residential real estate has overtaken retail to become the second most invested in sector, behind offices.
- We have analysed yield trends in more than 170 urban and second-tier city markets across Europe for the period 2011 to 2021, including non-EU countries such as the UK, Norway and Switzerland, and we set out our rankings from a point of view of a pan-European investor.
- Residential real estate currently offers a risk premium of between 200bp and 600bp, with prime yields close to those on prime office assets; residential valuations are not irrational but instead offer the prospect of stable growth, assuming an unchanged interest rate environment.

Henry-Aurélien Natter
Head of Research, Primonial REIM, MRICS

RESIDENTIAL: AT THE HEART OF DIVERSIFICATION STRATEGIES

The Covid-19 pandemic has reshuffled the cards in European residential markets, simultaneously triggering disruption whilst strengthening pre-crisis trends in the use of our living spaces. **From working from home to urban flight, the times were ripe for a renewal of the European residential market.**

In the on-going reorganisation of work, homes must allow workers to work from home by ensuring appropriate peace and quiet. As time spent at home has increased, expectations of housing have also changed, with two main themes emerging: residents' health and well-being. This new landscape has resulted in households changing their behaviours around housing.

Primarily the preserve of high-income households, second or semi-principal residences remain a niche market. This type of housing is currently seeing a degree of success, particularly amongst those who suffered during lockdowns (limited space, lack of garden or terrace in major cities). This led to a surge in prices in holiday regions, with the arrival of managerial level buyers able to work from home several days per week and with considerable purchasing power. Similarly, regional markets for **semi-principal residences** offer real buying opportunities for renting households who can not afford to buy in major cities.

This said, with a return to a more normal life, mixing office and home working, everyday concerns will return to the fore. Thus, in recent opinion surveys, households wanting to move out of the city centre to gain living space (more square metres, terrace, garden etc.) are paying attention to their commuting times. Under these circumstances, households are mainly selecting inner and outer suburbs, whilst making sure that their commute does not exceed 45 minutes. As a result, cities with good public transport coverage of their urban area will be favoured, and particularly those where new underground and tram lines are being constructed.

Meanwhile, cities in advanced economies will remain the central lynchpin of modern economies, due to the employment they generate, the growth in wealth that they produce and the concentration of services that they offer their inhabitants (public services, transport hubs, and their offerings in culture, education and real estate). Lastly, the lack of economic dynamism, weak infrastructure coverage and poor connectivity of some cities will limit their attractiveness.

What we are seeing, therefore, is a reorganisation within major urban centres rather than the urban exodus that might have been expected.

The purpose of this report is to aid understanding of the issues in residential investment in the current climate, whilst noting the fundamentals that persist despite the crisis, and to identify sources of future growth in specific markets. It has 3 parts:

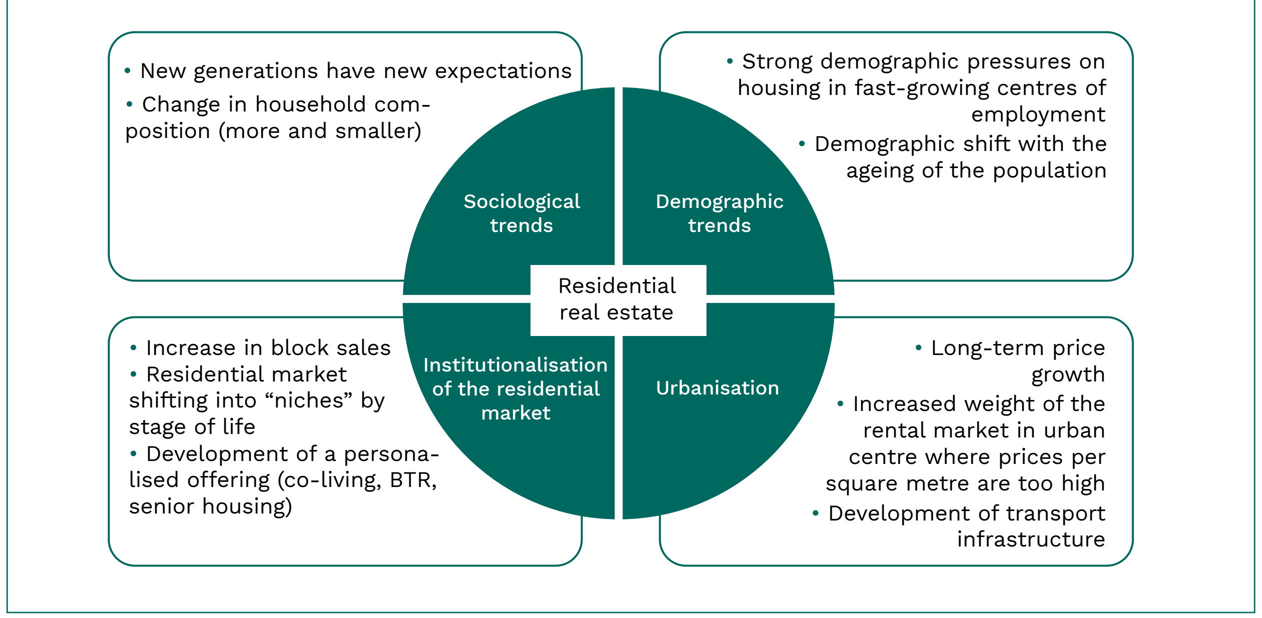
1. Domination of urbanisation post-Covid;
2. Towards a complex residential sector: the emerging models;
3. The institutionalisation of housing.

Of increasing importance, two mega-trends have appeared in the residential investment market:

- the accelerated institutionalisation of the residential market in recent years, with strong growth in block sales (from around €10bn in 2011 to €60bn in 2020). However, investors' allocation strategies vary from one European country to the next;
- the multiplication of residential niches as a function of lifecycle, opening the door to personalised use cases (co-living for singles, BTR for families, senior housing for seniors).

We are convinced that the phenomenon of urbanisation with reorganisation within major urban areas will continue, driven by the expansion and increased efficiency of public transport. Very high prices per square metre in urban centres and the tightening of access to credit for some sectors of the population means that access to ownership may remain unaffordable or be delayed for a number of years. Moreover, the fact that many households are not eligible for social housing, which is in short supply, has resulted in significant increases in rents over the past decade, causing authorities to regulate markets under considerable pressure. As a result, we believe that there is an investment market where institutional investors can play a driving role for society unsatisfied demand.

RESIDENTIAL REAL ESTATE: PRIMONIAL REIM R&S'S VISION



Source(s): Primonial REIM Research & Strategy

POST-COVID URBANISATION

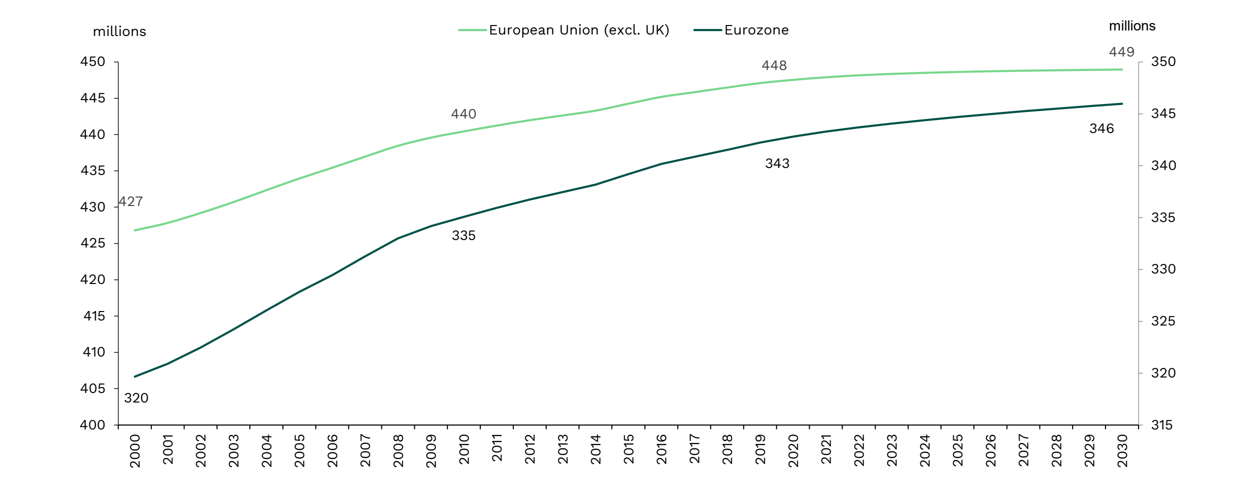
DEMOGRAPHIC CHALLENGES AND SOCIOLOGICAL CHANGES

The population of the European Union (excluding the UK) rose from 427 million in 2000 to more than 448 million in 2020.

This growth has been accompanied by profound sociological changes. Households are growing in number but diminishing in size. This trend is particularly noticeable in major European cities. In play for several years now, these changes reflect shifts in ways of life (such as rising numbers of couples separating and fewer having large families) which have stimulated housing demand.

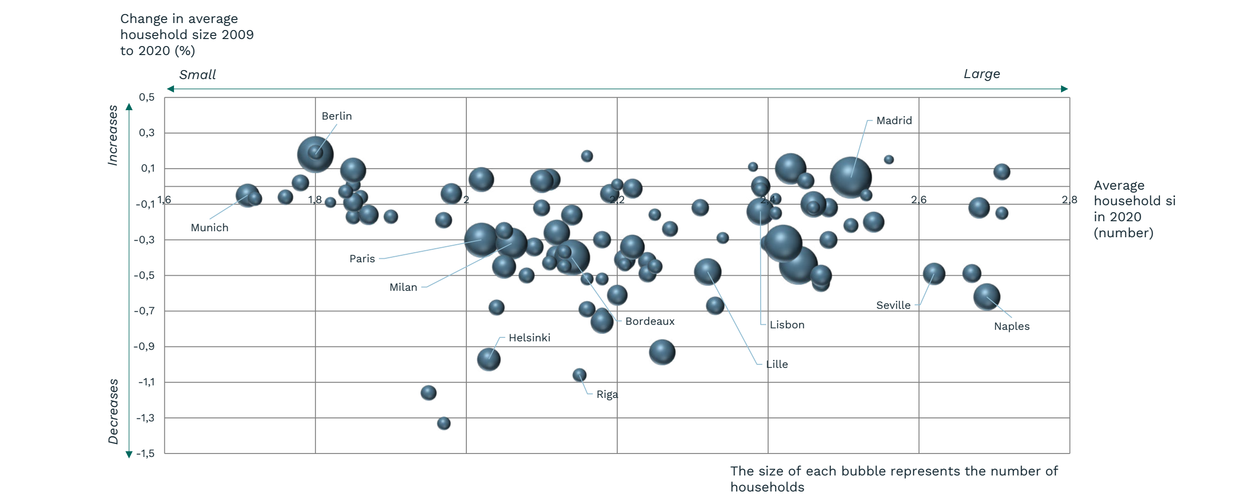
Projections of European Union population growth to 2030 suggest a small increase to a total of 449 million people. A country-by-country analysis shows that this growth will not be uniform. Populations are expected to grow in countries such as France, Spain Belgium, the Netherlands and Germany. Conversely, those of Portugal, Italy and Greece are expected to decline. In contrast to received thinking, demographic growth will come in the North.

EUROPEAN UNION POPULATION (EXCL. UK) 2000 TO 2030



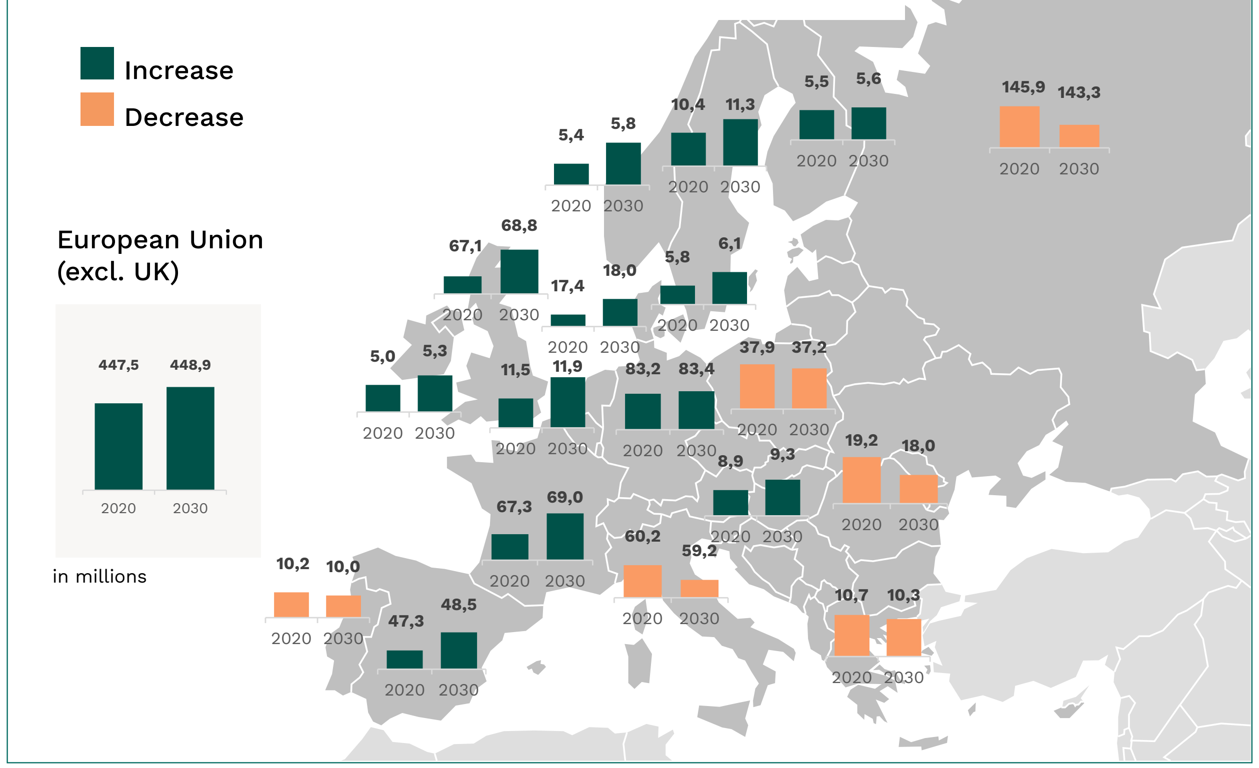
Source(s): Primonial REIM Research & Strategy after Eurostat and Oxford Economics

TRENDS IN HOUSEHOLD SIZES IN MAJOR EUROPEAN CITIES



Source(s): Primonial REIM Research & Strategy after Eurostat and Oxford Economics

EUROPEAN DEMOGRAPHIC TRENDS BY COUNTRY, 2020 TO 2030



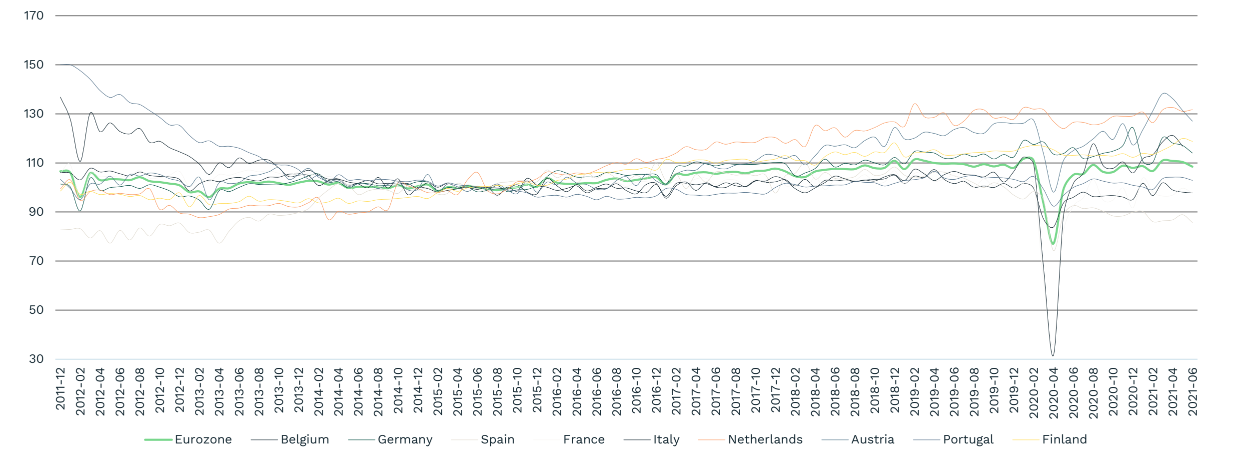
Source(s): Primonial REIM Research & Strategy after Oxford Economics, Eurostat

DEMOGRAPHIC PRESSURE CREATES CHRONIC UNDER-SUPPLY IN EUROPE

Despite growing demographic pressure in the Eurozone countries over the past decade, the volume of new buildings has seen erratic growth. The construction sector is on a declining trend: it has still not recovered its level from before the 2008-2009 crisis.

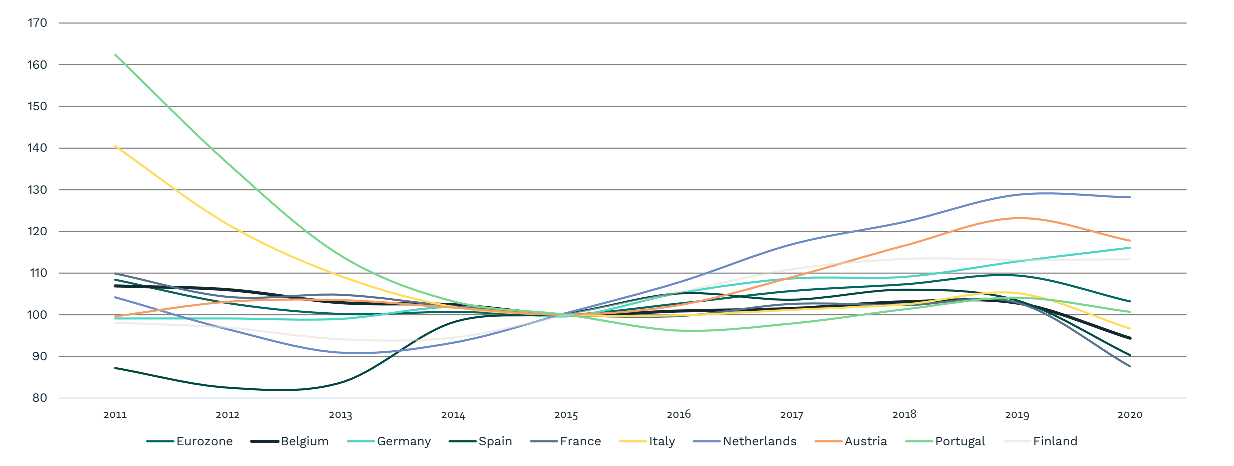
After a low point in 2015 and a marked recovery between 2016 and 2019, the health crisis of 2020 put the brakes on construction growth to a greater or lesser extent in different countries, depending on the health restrictions introduced. The resulting pressure from households seeking housing, alongside low levels of construction due to limited capacity for building in cities, have contributed to pushing up values in areas with a lack of supply and solid fundamentals.

CHANGE IN OFFERING (PRODUCTION)
IN THE EURO ZONE – MONTHLY DATA (INDEX)



Source(s): Primonial REIM Research & Strategy after Eurostat

CHANGE IN OFFERING (PRODUCTION)
IN THE EURO ZONE – YEARLY DATA (INDEX)



Source(s): Primonial REIM Research & Strategy after Eurostat

RENTING COUNTRIES VS. OWNING COUNTRIES, DIFFERENT REALITIES IN EUROPE

In Europe, three out of every ten residents rent. This proportion has been stable over recent years, with only the Eurozone countries seeing a slight increase in the share of renters. However, it is important to distinguish between countries where owner-occupiers are in the majority (eastern countries such as Romania, Slovakia, Hungary, etc.) and those with a majority of renters (including Switzerland, Germany, Austria and Denmark). Countries in line with the European average include France, Belgium, the Netherlands, Sweden and Ireland.

It is interesting to note that some countries where renting levels were already high saw an increase in the share of renters between 2015 and 2019. This was true of Switzerland, Germany, Sweden and Denmark for example. Meanwhile, certain countries, where ownership is preferred, have seen a shift towards renting; this is the case in Spain and Portugal.

Although around 30% of the population live in housing that they rent, a distinction should be drawn between tenants paying market rent (20%) and those at reduced rents or rent-free (10%). The countries with a higher share of renters paying market rates are Switzerland, Germany, Denmark, Sweden, Austria and the Netherlands.

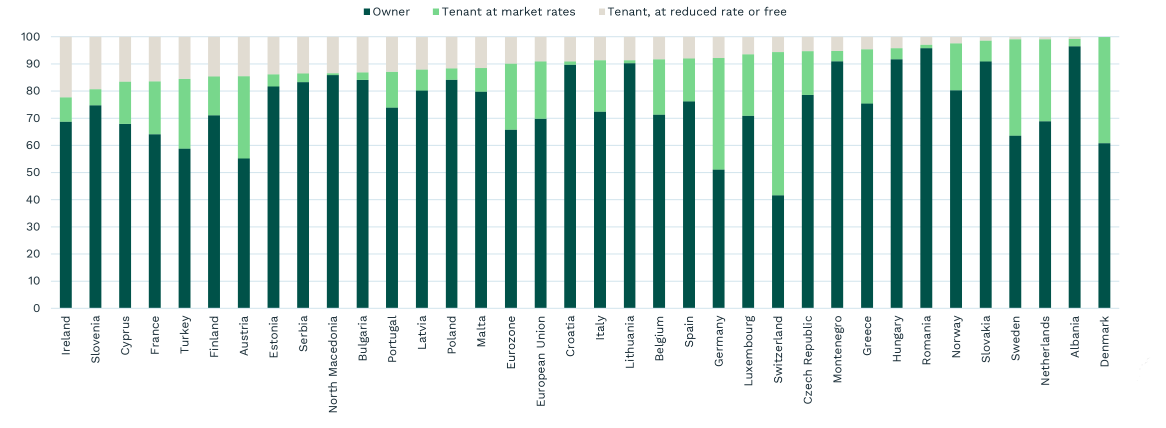
Social housing (reduced or free rent) is an important element of public policy with the support of institutionals in the area of social protection. However, a large share of people facing housing difficulties due to the high prices and rents in urban centres are not eligible for social housing.

There are significant differences between countries in terms of the definition of affordable housing when it comes to the criteria of size, the target population, and the nature of social housing providers.

Countries fall into three main categories when it comes to affordable housing:

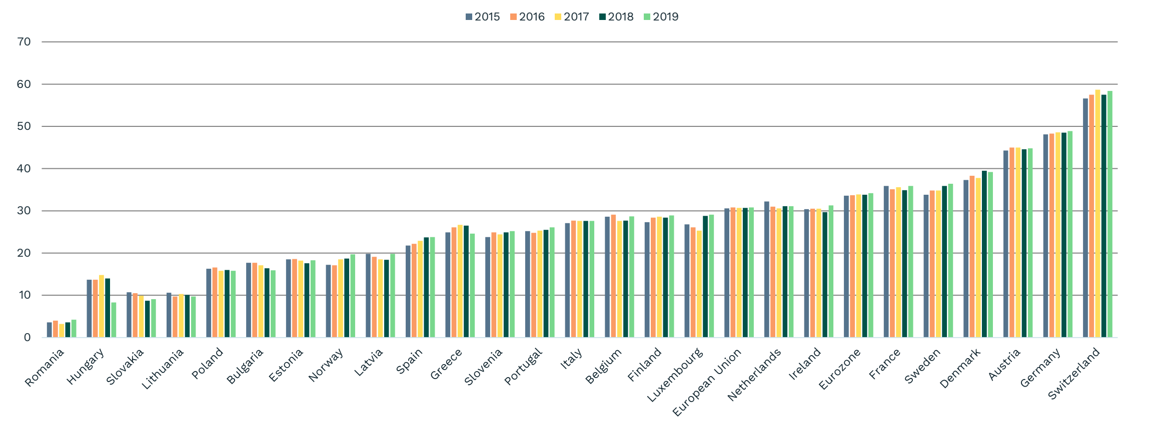
- **Countries with an extensive social housing stock** (at least 20% of total population by nature of tenure). This is the case in Ireland for example;
- **Countries with an intermediate social housing stock** (between 10% and 20%). These include Finland and France;
- **Countries with a limited social housing stock** (less than 10%). Germany, Belgium, Hungary, Italy, Norway, Portugal and Switzerland are in this category.

BREAKDOWN OF POPULATION AS A FUNCTION OF RESIDENTIAL TENANCY STATUS IN EUROPE (2019, %)



Source(s): Primonial REIM Research & Strategy after Eurostat

PROPORTION OF RENTERS* IN THE MAIN EUROPEAN COUNTRIES (%)



Source(s): Primonial REIM Research & Strategy after Eurostat

*Including tenants paying market rents and those with reduced or fixed rents

HOUSEHOLD EFFORT RATES MUST REMAIN AT SUSTAINABLE LEVELS

In recent times, the tightening of lending conditions sought by the European regulator has resulted in many households finding access to ownership unaffordable or having to delay for several years, and thus turning to the rental market. However, even here, the effort required of households can be excessive.

The indicator generally used to measure the effort households must make to house themselves is the share of total income taken by housing costs.

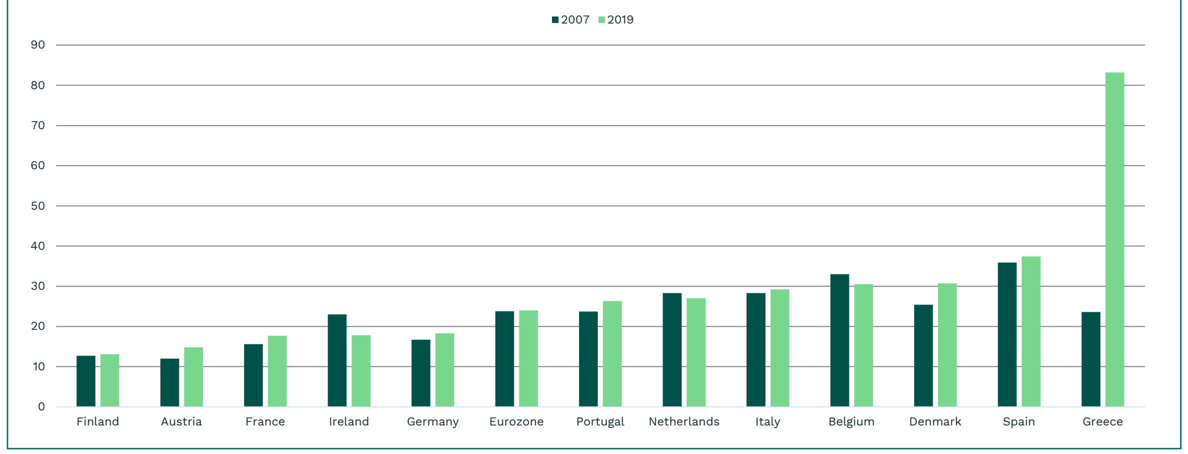
So to measure the weight of housing in household income, it is appropriate to use the effort rate, that is to say measuring the share of disposable income taken by housing costs.

The economic accessibility of housing, notably in the private sector, has seen a marked increase in excessive effort rates (rent above 40% of income). In other words, households are spending a growing share of their budgets on housing.

Thus in 2019, 9.6% of the population of the European Union lived in a household spending 40% or more of disposable income on housing. The percentage of the population with an effort rate above 40% was highest for tenants at market rates (more than 25%) and lowest amongst owner-occupiers (4.0%).

This effort is all the greater in big cities, where employment opportunities are concentrated and where public transport networks are expanding, contributing to an increase in prices and rents. The development of intermediate housing could help reduce this pressure.

HOUSING COST SURCHARGE RATE FOR TENANTS AT MARKET RENTS (SPENDING MORE THAN 40% ON RENT, %)



Source(s): Primonial REIM Research & Strategy after Eurostat

PUBLIC TRANSPORT INFRASTRUCTURE AND ITS POSITIVE EFFECTS ON PRICES AND THE DEVELOPMENT OF HOUSING SUPPLY

Research[1] has shown that transport infrastructure produces direct and uniform positive effects on the growth and development of the areas involved. This said, the positive effect on real estate prices comes into play from the time when there is a public transport zone close to a residential zone where household incomes are on a positive trend.

As a result, the creation of new public transport networks and new stations, in order to expand or strengthen existing coverage, increases demand for housing in these areas. This can result in increases of up to 40% in real estate prices in some cases. This increase can come prior to the opening of a line, with households acting in anticipation.

Building on the result of this research, we have analysed the public transport networks (metro and tram) of 140 cities in Europe, giving a sample of more than 4,000km of existing metro lines and 5,600km of existing tram lines. Tram systems are dominant in eastern countries, with extensive but ageing networks, whilst metro systems and proposed extensions are concentrated in major western cities.

We have identified 80 metro extension projects, representing more than 700km in additional track, mostly located in western European cities. In the East, metro systems are being expanded in Prague, Bucharest, Warsaw, Vilnius and Sofia.

Although trams are more widely established than metro systems, our sample only identified around forty projects in some thirty cities, with a total of 430km of future tracks. With the exception of Prague, these projects will mainly come in countries in western Europe (notably France), northern Europe, Italy and Spain.

THREE MAIN TYPES OF CITY EMERGE FROM OUR SAMPLE:

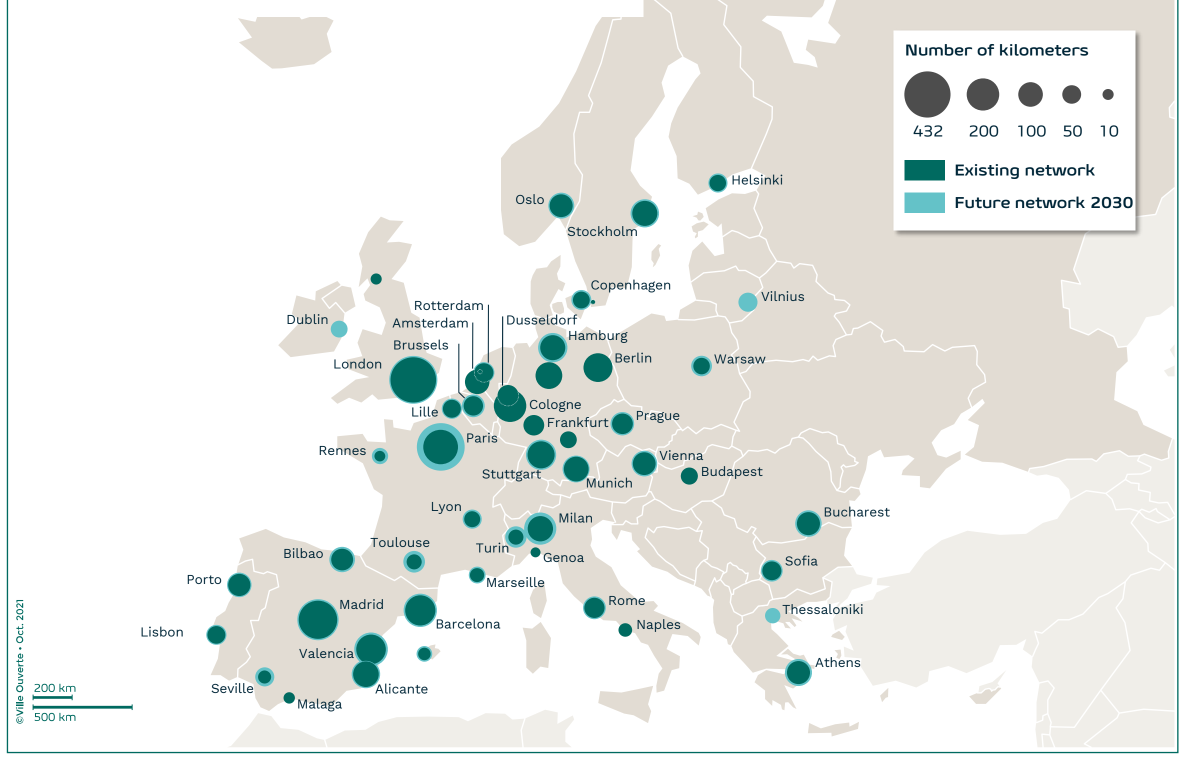
First, major international cities, with substantial economic power, experiencing growing demand for public transport. These cities are typified by a mixed transport network (metro, light rail and/or trams) with, on average, between 50km and 200km of metro and tram track. The biggest expansion plans up to 2030 include urban areas such as Greater Paris, Hamburg and Milan.

Secondly, regional cities seeing population growth and planning to expand existing networks, which do not exceed 70km of metro track or 100km for trams. Examples include Toulouse and Seville.

Thirdly western cities of all sizes that have already made an effort or are unlikely to see any significant expansion of their networks.

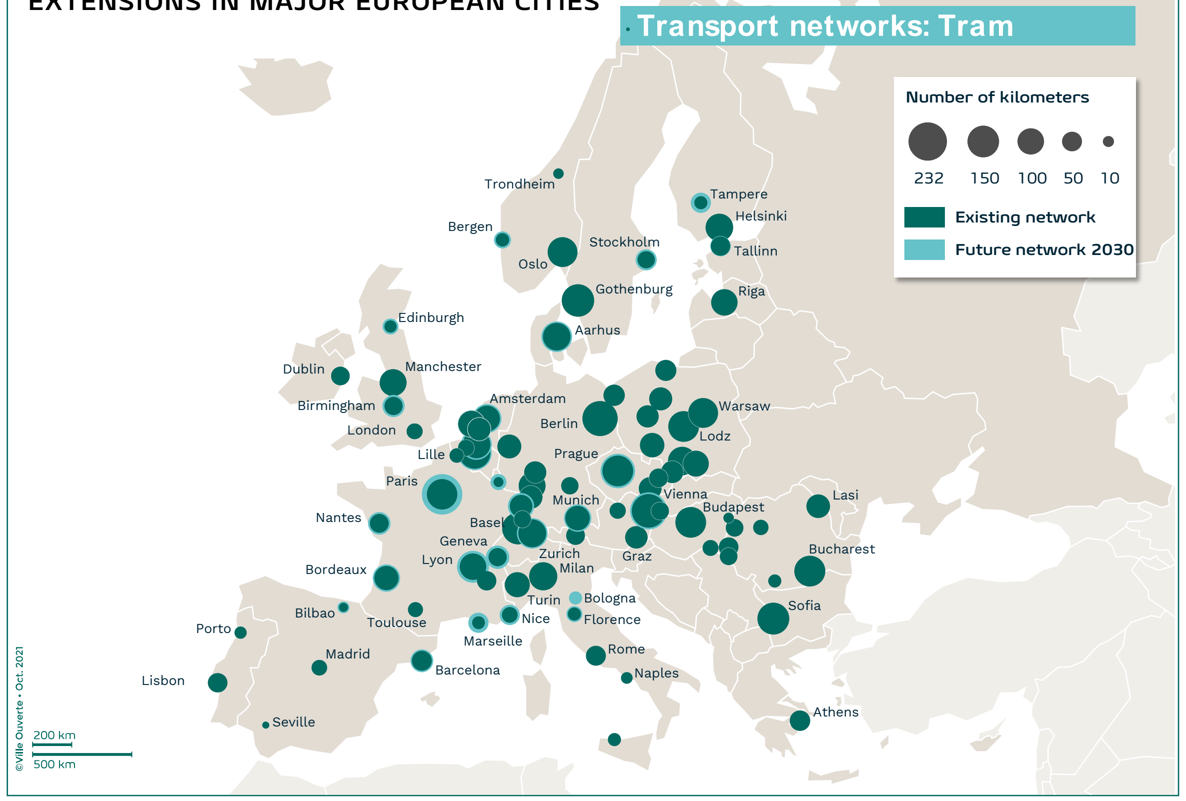
[1]Kahn, M. E. (2007), «Gentrification Trends in New Transit-Oriented Communities : Evidence from 14 Cities That Expanded and Built Rail Transit Systems», Real Estate Economics
McMillen D. P. et McDonald J. (2004). «Reaction of House Prices to a New Rapid Transit Line : Chicago's Midway Line, 1983-1999», Real Estate Economics

EXISTING UNDERGROUND RAIL NETWORKS AND PLANNED EXTENSIONS IN MAJOR EUROPEAN CITIES



Source(s): Primonial REIM Research & Strategy

EXISTING TRAM NETWORKS AND PLANNED EXTENSIONS IN MAJOR EUROPEAN CITIES

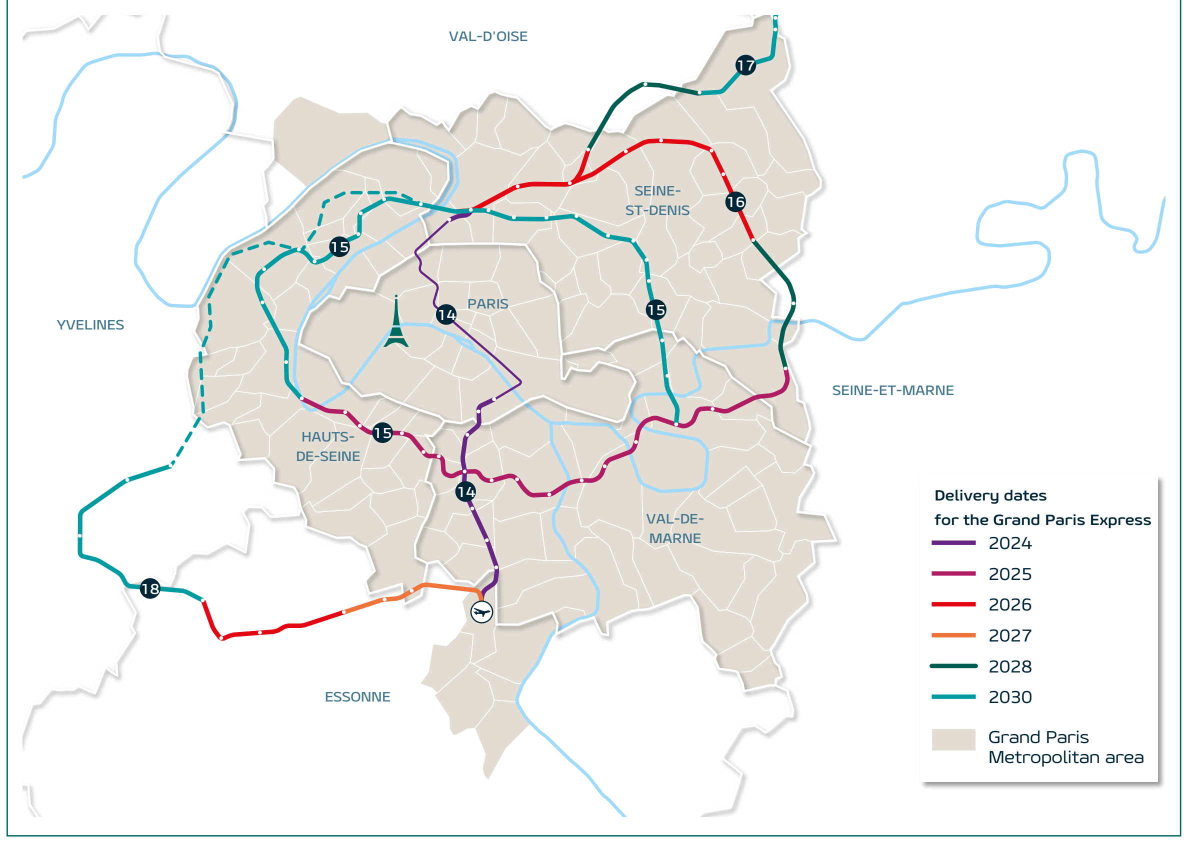


Source(s): Primonial REIM Research & Strategy

FOCUS ON DELIVERY DATES FOR THE GRAND PARIS EXPRESS

With more than 12 million inhabitants already, Ile-de-France will see continued economic and demographic growth through to 2030. Future creation of value in real estate will be largely dependent on the delivery of stations as part of the largest urban project in Europe, with 200km of metro lines and 68 new stations.

DELIVERY OF GRAND PARIS EXPRESS STATIONS



Source(s): Primonial REIM Research & Strategy

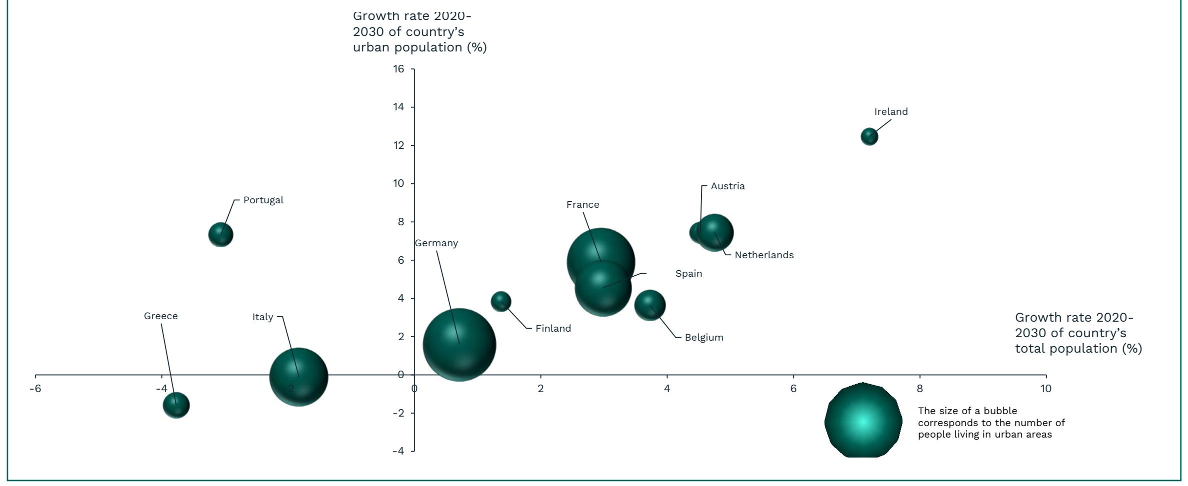
THE SOMETIMES EXCESSIVE PRICES AND RENTS IN CITY CENTRES HAVE RESULTED IN SOME SECTIONS OF THE POPULATION OPTING TO LIVE IN TOWNS AND SUBURBS CLOSE TO MAJOR URBAN CENTRES

Although the migratory balance between rural and urban areas is tending to stabilise, demographic trends are increasing the density of major urban regions. Thus, between 2011 and 2019, urban centres in the Eurozone saw growth in total populations, but this came mostly in the suburbs rather than already densely populated central districts. Several factors explain this trend. High prices and rent exclude a section of low and middle income households, notably amongst the middle classes. The desire for more space and the expansion of public transport systems (metro, trams, etc.) have led some households to opt for the suburbs of densely populated urban centres of second-tier cities. This situation has maintained the pressure on prices and rents in major European cities over the past decade.

The Covid crisis therefore fed into an already established trend, with an emphasis on outdoor space (terrace, balcony, garden) and greater floor area to allow for working from home. Households who continue to be employed in city centres are now more open to moving out of the centre; but are not abandoning major cities altogether Others have chosen a second home or semi-principal residence where they can work from home before returning to live close to their workplace in a city centre. This has helped boost prices in rural areas and second-tier cities over recent months.

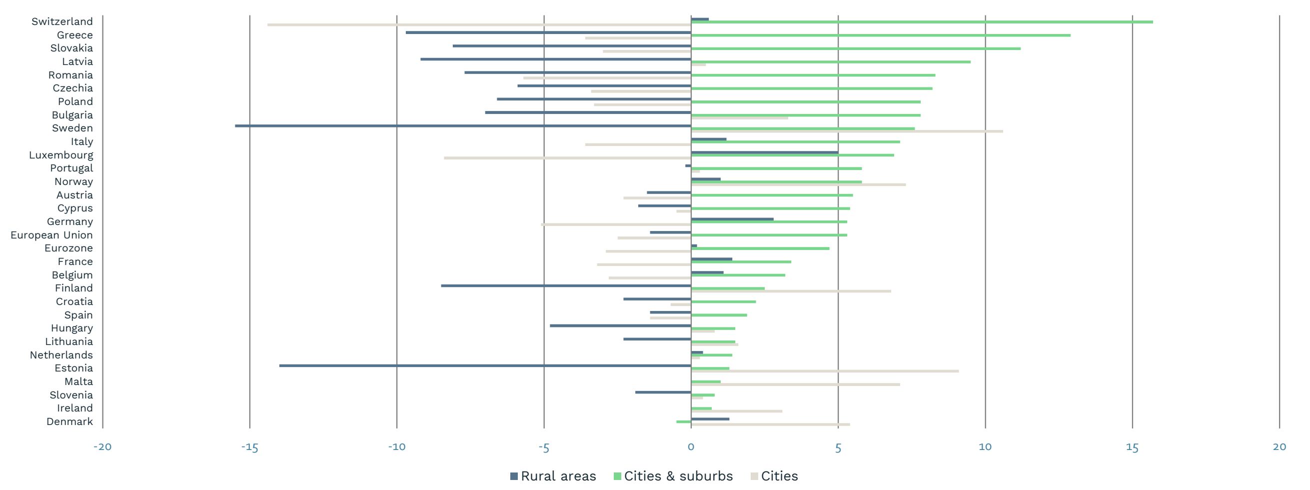
By 2030, demographic trends are likely to further increase pressure on housing in major urban regions (both central and suburban areas), due to their attractiveness in terms of employment and to shifts in family composition.

URBAN POPULATION: SIZE AND DEMOGRAPHIC TRENDS TO 2030 (BY COUNTRY)



Source(s): Primonial REIM Research & Strategy d'après Oxford Economics, Eurostat

TRENDS IN URBAN AND RURAL ZONES IN EUROPE 2011 TO 2019 (PERCENTAGE CHANGE)



Definition of level of urbanisation. The extent of urbanisation is a Eurostat classification based on the following three categories:

- *cities, also called high population density zones (central metropolitan zones);*
- *towns and suburbs, also called intermediate population density zones (metropolitan and non-metropolitan zones);*
- *rural, also called low population density zones (non-metropolitan zones).*

Source(s): Primonial REIM Research & Strategy after Eurostat

TOWARDS A COMPLEX RESIDENTIAL SECTOR: EMERGING MODELS

MULTIGENERATIONAL CITIES

The residential sector must meet a range of expectations from individuals, shaped by their needs and wants over their lifetimes. In a multi-generational society, housing must adapt to meet the needs of different generations at different stages of their life (students, working population, seniors and the very elderly).

STUDENTS

The generation that has finished secondary education may seek to continue their studies for professional reasons (improved employment prospects) and personal reasons (the 'quarter-life crisis'). Higher education potentially offers the advantage of living in an international city. This allows this generation to combine two factors that are important to it: retaining their mobility and independence, despite often limited purchasing power.

EMPLOYEES

Despite the current crisis, cities remain the lynchpin of European economies. They are a nexus of employment and make substantial contributions to national wealth. The concentration effect (of public services, transport systems, the presence of many companies, broad cultural offerings, choice of educational facilities, etc.) makes cities attractive places to live but at the same time creates pressure on the housing market, resulting in a spill-over from the centre to the surrounding areas. Thus, the current cost levels (prices or rents) per square metre for housing in densely populated central districts of major cities have pushed certain households to opt instead for more or less central suburbs, in order to improve or maintain their purchasing power and their professional mobility. This choice has been facilitated by working from home.

SENIORS AND THE VERY ELDERLY

Reaching retirement age represents a new phase of life, with new expectations and new needs. Over the coming decade, Europe will see a rapid acceleration in the ageing of its population. This phenomenon will be very marked in countries such as Germany and Italy. As a result, dependency ratios will continue to rise over the next ten years. This suggests that demand for senior housing and care homes will gradually rise. Living in good health for longer, seniors want to remain independent for as long as possible, with access to services such as restaurants and high-quality health care whilst remaining close to children, grandchildren and friends the majority of whom live in, or close to, a city.

RESIDENTIAL FORMATS OF THE FUTURE: TOWARDS THE DEVELOPMENT OF REAL ESTATE AS A SERVICE

CO-LIVING, OR THE RENEWAL OF COMMUNITY LIVING 4.0

Co-living is a housing concept suited to people in a transitional phase of their life. Co-living gives access to an immediately operational home (furnished, fitted and connected). In addition, co-living generally offers services, activities and facilities that can be used privately or shared with the community.

Shared space can take different forms: kitchens, living rooms, terraces, gardens, roof-top space, cinema rooms, gyms, co-working space, etc.

Co-living housing can be categorised as follows:

- Private studio. This accommodation normally has a bedroom, bathroom and kitchen. Shared spaces (co-working, living room, bar, restaurants, etc.) may also be available. Co-living studios are the most expensive solution.
- Semi-private room. This accommodation generally consists of a bedroom with a small kitchen and/or bathroom. In this configuration, there are also shared spaces such as a living room or dining room.
- Private bedroom and shared spaces. This arrangement provides a private, generally furnished, bedroom. This type of co-living accommodation also includes shared spaces such as a kitchen, bathroom and living room.

CO-LIVING OPERATORS' BUSINESS MODELS

Operators generally adopt one of two business models:

- The operator externalises the freehold and works under a commercial lease with the owner or investor. This approach maximises value from real estate by entrusting its management to professionals in the sector. In addition, the separation of the freehold from operations is a good way of returning and/or preserving operational cash.
- Alternatively, the operator retains ownership of the freehold. It will also operate the co-living facility. However, this situation requires the operator to make a substantial investment of cash which can not, therefore, be used for operations.

ACCELERATED EXPANSION OF « BUILD TO RENT »

As the name suggests the 'Built to Rent' concept, covers housing built to be rented rather than sold. « Built to Rent » represents an 'alternative' segment of the rental sector, but it is expected to grow rapidly in many European countries over the next few years.

The « Built to Rent » service offering represents the main difference to other concepts. The aim is to provide professional in situ management of buildings and facilities. Spaces such as gyms and co-working offices are available inside the buildings. Operators therefore supply maintenance teams to address any issues rapidly, free access to shared spaces for all residents with the option of reserving them for private events.

THE BUILT TO RENT BUSINESS MODEL

The three main business models identified are as follows:

- in the first model, the operator is the contact point for all stakeholders. The operator therefore carries the rental risk and must pay the owner irrespective of their ability to fully let the housing units or ensure rent collection. The operator also generally manages all service providers;

- under the second model, the operator is the contact point for tenants but the rental agreement is signed with the owner. The operator provides a certain number of services for the owner (marketing, rent collection, maintenance contracts, contracts with service providers, etc.). However, the rental risk is shared between owner and operator at a percentage of rent collected.
- Under the third model, the operator is again the contact for tenants, with the rental agreement signed between owner and tenant, but unlike in the previous model the owner collects the rent directly. The operator generally has the role of managing rent arrears. The rental risk is also shared.

SENIOR HOUSING

Senior housing addresses current aspirations of seniors. This group wants to remain socially, culturally and physically active. The availability of domestic services allows independent seniors to push back the age at which they need care services until the situation is truly critical. Services adapted to the needs of seniors are also available in this type of housing. Two major types of senior housing co-exist:

- The first is aimed at older people who are facing a loss of independence. They are generally aged over 75, and usually stay in this housing until their physical independence is significantly diminished. Shared spaces in these housing facilities are generally large, with a restaurant and relatively substantial staff teams. These facilities are located in city centres, secondary centres and suburban towns.
- The second type is designed primarily for seniors aged from 65 to 75. They are characterised by medium-sized shared spaces, small staff teams and little input. A restaurant space is rare in this type of housing. These residences choose to outsource the majority of services available to residents. The flexibility of this model makes it easier to find locations, whether in rural settings, the suburbs, or the centres of second-tier or major cities.

SENIOR HOUSING OPERATORS' BUSINESS MODELS

Two main types of business models co-exist:

- First, the owner-occupier model. Under this model, management of services and equipment are brought in-house. On-going costs are normally shared. The main weaknesses of this model relate to the fact that costs are decoupled from real use, preventing good visibility on costs, which, moreover, are often very high;
- Secondly, the tenant-occupier model. Services are managed by the operator. Occupants receive a bundle of basic services. This can be complemented by additional services that can be bespoke or in the form of packages. Invoicing is therefore more flexible and offers greater visibility. This also allows occupiers to adjust their costs according to their needs.

COLIVING

Image: republicainmobiliaria.com

SENIOR HOUSING

Image: Cogedim

« BUILD TO RENT »

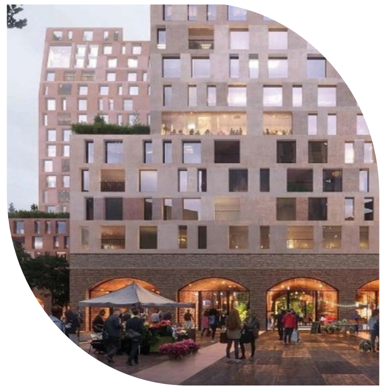


Image: standard.co.uk

A financial model whose time has come: deconstruction of ownership rights

In several European countries, it is possible to break down real estate ownership into several types of rights. The rights each have their own characteristics in performance terms and are thus well-suited to innovation in the structuring of residential investment.

The most common form of division of rights, widely used in France, is a division of bare-ownership and usufruct. Bare-ownership harks back to the Latin notions of abusus, the right to sell or alienate an asset, whilst usufruct covers fructus, the right to receive rent, and usus, the right to occupy. There are also funds that acquire bare-ownership of assets (life tenancy), which allows them to provide a fully capitalised performance to investors.

Other types of rights division are likely to be developed in future, such as a division between land and buildings, or "life ownership", giving the right to acquire an asset but not to pass it on. These approaches will allow investors to acquire divided rights at a discount to full ownership. Politically, they will offer an answer to the difficulties faced by young people and middle class households in accessing home ownership in the most highly-priced markets.

TENANT-OWNER RELATIONSHIPS IN THE MAIN EUROPEAN COUNTRIES: REVIEW OF EUROPEAN LEGISLATION

« Housing as a service » models are in greatest demand where the national culture favours renting, and where regulations do not penalise tenants excessively.

Rents have seen continuous growth in Europe over recent years, enabling investors to protect themselves against the risk of inflation. Governments and regional and local authorities have put in place legal and regulatory structures around the rental market to improve access to housing and limit excessive increases in rents due to an imbalance between supply and demand. These measures are designed to ensure transparency in rents and their correction where necessary. Such measures also ensure regular and secure rental incomes, making residential investment a good hedge against the risk of inflation whilst protecting tenants. Below we look at major countries, to help understand the specific features and also the complexity of tenancy law in each of them.

AUSTRIA

Austrian law is favourable to tenants. There is strict regulation of rent levels.

The rules are less restrictive for more recent buildings, with regulations that protect tenants, but do not control rents.

GERMANY

German law is pro-tenant. Rents may be freely set, but 'excessive' rents can be sanctioned subsequently.

Rent increases are controlled and may not exceed 20% in nominal terms (less in real terms) over three years.

In September 2021, the German Constitutional Court struck down a law regulating rents introduced a year previously by city authorities in Berlin. This signifies that it falls to the federal government to legislate on measures governing rents, if legislation is to be considered constitutional.

BELGIUM

Rent can be freely negotiated. However, rent increases above the rate of inflation may not be included in the tenancy agreement. All tenancy agreements include automatic annual indexing on the cost of living. This indexing is determined by the health index (the consumer price index excluding tobacco, alcohol, petrol and diesel) published by the Federal Public Service (FPS). Lease terms are flexible.

DENMARK

Danish law strongly favours tenants. There are five different forms of rent control in Denmark, depending on the age of the building. The system is highly complex. This said, buildings constructed since 1991 are free of rent control.

SPAIN

The Spanish housing market is favourable to tenants.

The landlord and tenant have contractual freedom in setting the rent. However, rent increases are linked to the consumer price index and limited to one increase per year. Regulated rents have been introduced in Catalonia, but the issue of their application remains outstanding.

FINLAND

Laws and practice in Finland are relatively balanced between landlords and tenants.

Rents are not generally regulated. Landlords and tenants are free to negotiate rents, but tribunals may reduce existing rents if they significantly exceed the market average for similar apartments in the same region.

FRANCE

French law is very favourable to tenants.

The initial rent may be freely agreed. However rent increases may only take place once per year, and are capped at the increase in INSEE's IRL (rent reference index).

Some regions have regulated rent when there is a change of tenant. Created by the Alur Act in 2014, the system for rent regulation was replaced by the Elan Act in November 2018. This gave communities in areas under pressure two years, i.e. to the end of 2020, to submit a request to apply rent regulation in their area.

Initially applied in Paris and Lille, rent regulation has been applied in Plaine Commune (9 towns: Aubervilliers, Épinay-sur-Seine, Pierrefitte-sur-Seine, Saint-Denis, Villetaneuse, Stains, L'Île-Saint-Denis, la Courneuve and Saint-Ouen) since 1 June 2021, and will come into force in the communities of Est Ensemble (Bagnolet, Bobigny, Bondy, Le Pré-Saint-Gervais, Les Lilas, Montreuil, Noisy-le-Sec, Pantin and Romainville), Lyon, Villeurbanne, Bordeaux and Montpellier in late 2021 or early 2022.

ITALY

Italian law leans in favour of tenants.

Initial rent can be freely negotiated, but increases are limited. Landlords may only increase rent after the initial four-year contract.

IRELAND

Tenant protection in Ireland is significant but balanced by protections for landlords.

The parties are free to negotiate rents. However, the rent must not exceed the free market level. Rents may be adjusted once per year. Rent disputes can be adjudicated by the Private Residential Tenancy Board (PRTB). In areas where the rental market was under stress in 2016 (including Dublin), rents may not be increased by more than 4% per year, unless significant renovations are carried out.

NETHERLANDS

The Dutch housing market is favourable to tenants.

Landlords are free to set rents. They may increase rents annually, but the government sets a cap on the percentage increase.

The rent paid may be freely agreed between landlord and tenants in the 'unregulated' sector. Housing in the 'regulated' sector is subject to rent control.

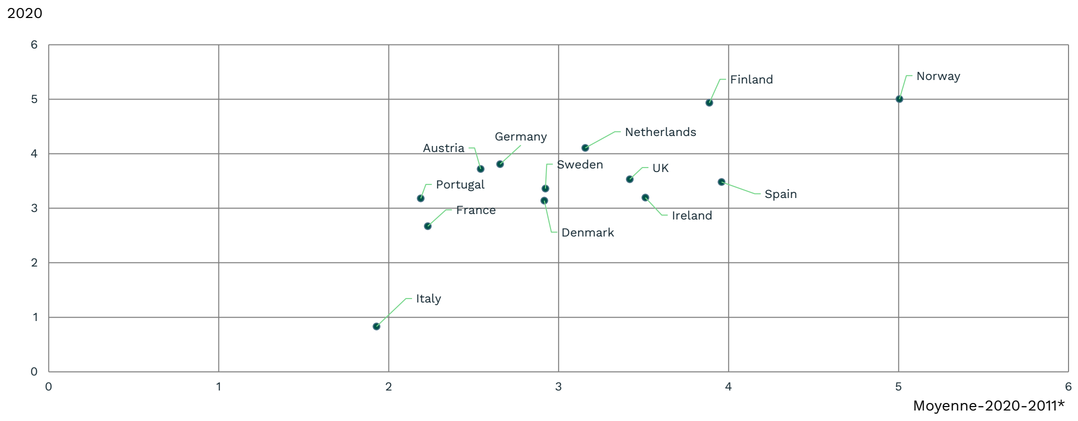
SWEDEN

The Swedish rental market is tightly regulated.

Rents are set at a level that results in fairly low yields for investors. Rents are relatively unaffected by location, with the result that those in metropolitan areas are particularly undervalued. The system is governed by rent tribunals.

It is easier to charge higher rents in residential buildings built since 2011.

GROWTH IN RESIDENTIAL REAL ESTATE RENTAL INCOME IN INVESTORS' PORTFOLIOS IN MAJOR EUROPEAN COUNTRIES (%)



*Or most recent year for which data is available
Source(s): Primonial REIM Research & Strategy after MSCI

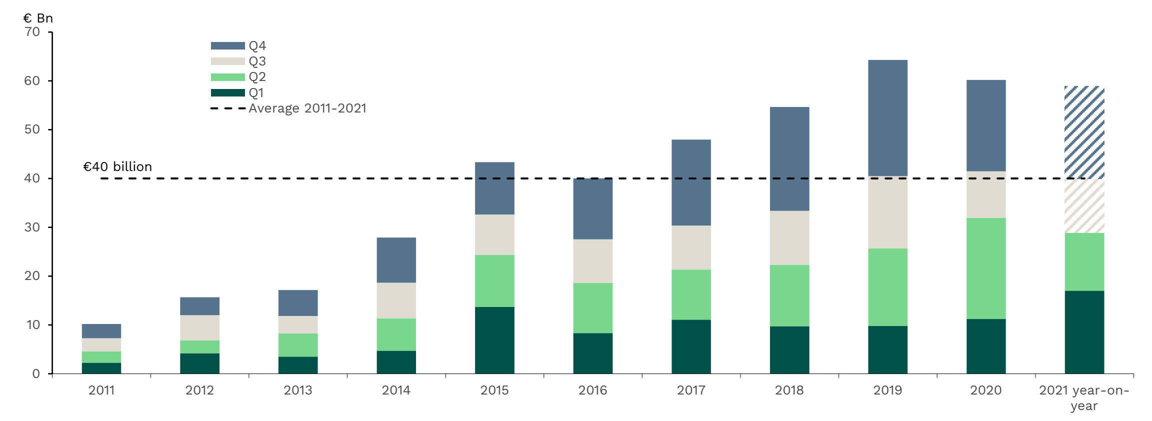
THE INSTITUTIONALISATION OF HOUSING

CONCENTRATION OF CAPITAL ON THE EUROPEAN BLOCK RESIDENTIAL MARKET

« Block » residential assets have been much sought after by investors as part of asset allocation strategies over the past decade. Between 2011 and 2021, an average of €40bn has been invested in this segment in Europe each year. Since 2018, residential real estate has become the second most invested-in sector, behind offices, overtaking retail. The European market for block residential assets, including individual and multiple-occupancy housing, is focused on Germany, which accounted for 32% of the capital invested between 2011 and 2020. The Netherlands, Sweden, Spain, France, Denmark, Austria and Finland have also been attractive destinations for investors, together receiving 34% of total capital committed.

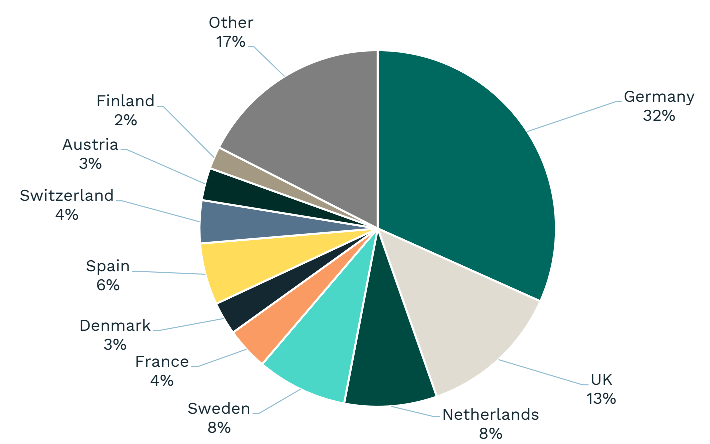
The majority of the main European cities saw a compression of 'prime' yields between 2011 and Q2 2021. Paris, Munich, Vienna and Helsinki offer 'prime' yields of less than 3%. Yields of over 5% are possible in some countries such as Belgium, the Netherlands and Ireland. The cities having seen the greatest expansion in yields are Rome, Milan, Barcelona, Athens and Dublin. Conversely, the biggest compressions have come in cities including: Frankfurt, Berlin, Amsterdam, Brussels, Antwerp and Rotterdam.

INVESTMENT IN BLOCK RESIDENTIAL REAL ESTATE IN EUROPE



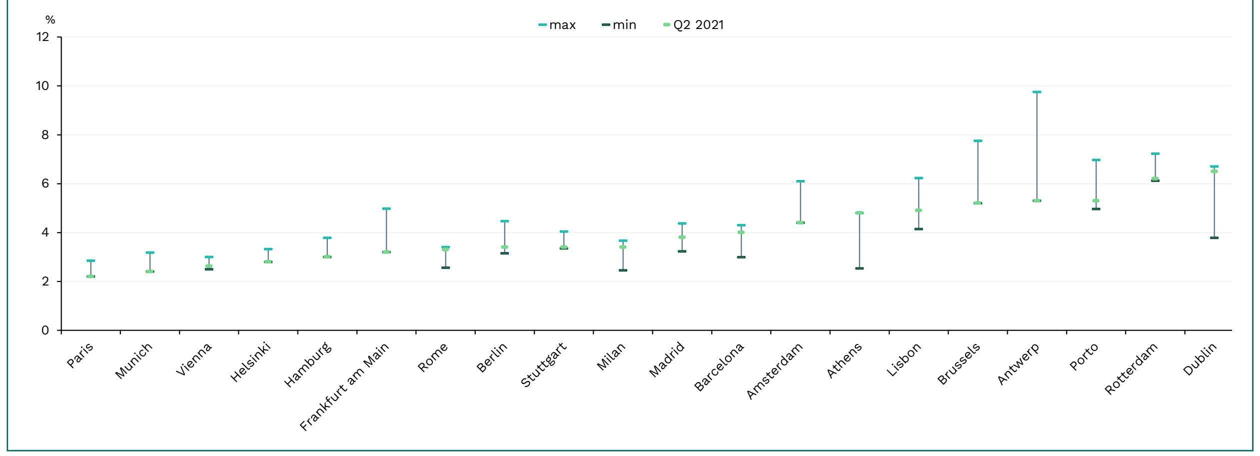
Source(s): Primonial REIM Research & Strategy after Brokers, RCA, CBRE

SHARE OF BLOCK RESIDENTIAL INVESTMENT IN EUROPE (2011-2020)



Source(s): Primonial REIM Research & Strategy after Brokers, RCA, CBRE

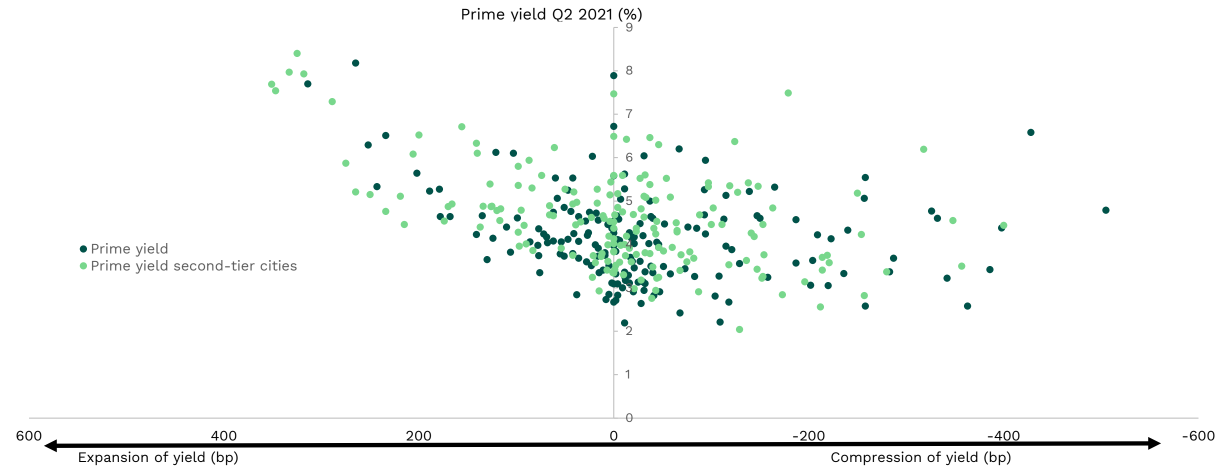
'PRIME' RESIDENTIAL REAL ESTATE YIELDS 2011 TO Q2 2021



Source(s): Primonial REIM Research & Strategy d'après Brokers, RCA, CBRE

We have analysed yield trends in more than 170 urban and second-tier city markets across Europe for the period 2011 to Q2 2021, including non-EU countries such as the UK, Norway and Switzerland. More than half of the markets considered have seen a compression of yields, slightly less than 10% have remained stable and around 40% have seen yields improve, with second-tier cities better represented in this last group. To implement an investment strategy successfully, a detailed decision support policy must be adopted.

YIELD TRENDS IN MORE THAN 170 EUROPEAN CITIES, 2011 TO 2021 Q2



Source(s): Primonial REIM Research & Strategy

THE PERFORMANCE/VOLATILITY PROFILE OF THE RESIDENTIAL SECTOR OFFERS CONTROL OF RISK, ENABLING DIVERSIFIED, OPTIMISED ALLOCATION

The overall performance of real estate in the Eurozone, based on MSCI indices (consisting of rental yield and capital returns), shows that the volatility of residential real estate is lower than that of other asset classes.

Meanwhile, over the past decade, **residential real estate delivered a total return[2] around 100bp higher on average than all other asset classes with average annual total performance (revenue + capital gains) of 7.9% between 2011 and 2020.** Having stabilised somewhat between 2017 and 2019, at around 11%, the individual and collective residential sector managed to deliver the second best performance during the full-blown international health crisis in 2020, with a return of 7.1%.

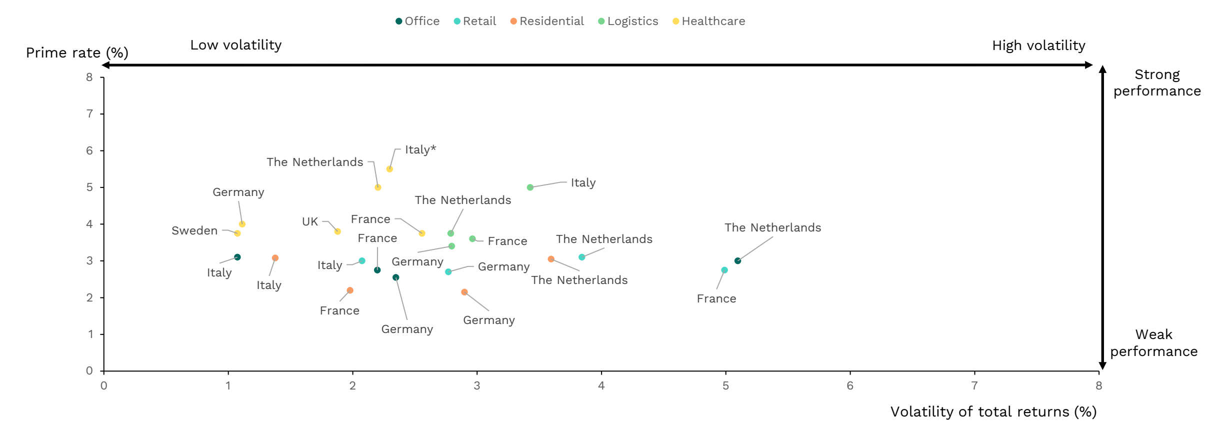
Between 2015 and 2020, residential real estate has offered a defensive performance/volatility profile. This suggests that it can be attractive to combine residential assets with those offering higher rental yields but with more volatile capital returns, in order to diversify portfolio risk and create beneficial complementarity between assets.

[2]Combining rental yield and capital gains

REAL ESTATE PERFORMANCE IN THE EUROZONE

Source(s): Primonial REIM Research & Strategy d'après MSCI

VOLATILITY/PERFORMANCE COMPARISON IN EUROPEAN COMMERCIAL REAL ESTATE



*Others, including healthcare, education, leisure, infrastructure, land
Source(s): Primonial REIM Research & Strategy d'après MSCI

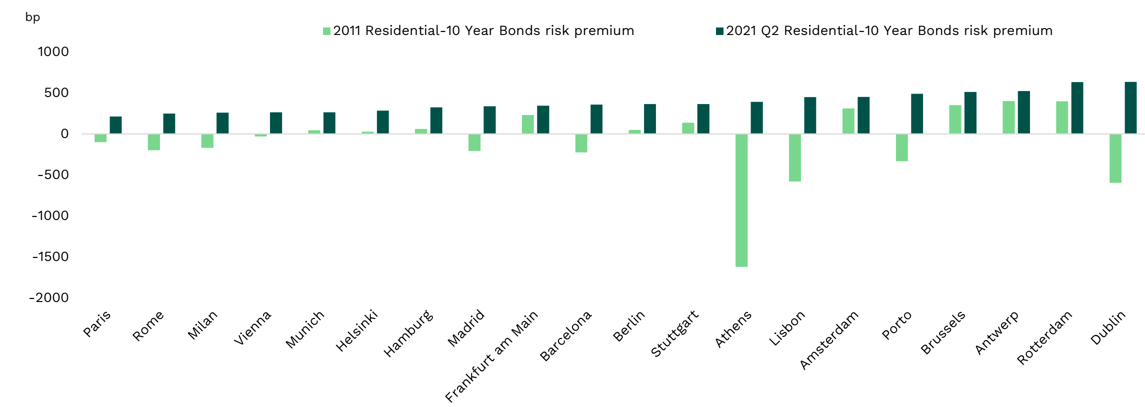
COMFORTABLE RISK PREMIUM BETWEEN RESIDENTIAL REAL ESTATE AND SOVEREIGN BONDS

Despite a compression in yields during the crisis, the risk premium between residential real estate and sovereign bonds continues to favour residential assets. In the current context, 10-year sovereign rates have remained very low due to the ECB's accommodating policy stance. Residential real estate currently offers a risk premium of between 200bp and 600bp, with prime yields close to those on prime office assets at the end of the second quarter of 2021.

Between 2011 and Q2 2021, all countries analysed saw a more or less significant compression in their sovereign 10-year rates. The risk premium for residential real estate has increased for some countries (France, Italy, Spain, Greece, Portugal and Ireland), allowing a rational remuneration of the intrinsic risks of residential real estate investment.

A large majority of mortgages are at fixed rates. This means that borrowers are protected, as repayment costs will not rise in the event of an increase in interest rates.

RESIDENTIAL REAL ESTATE YIELD VS. 10-YEAR SOVEREIGN BONDS IN THE MAIN EUROZONE METROPOLITAN CENTRES

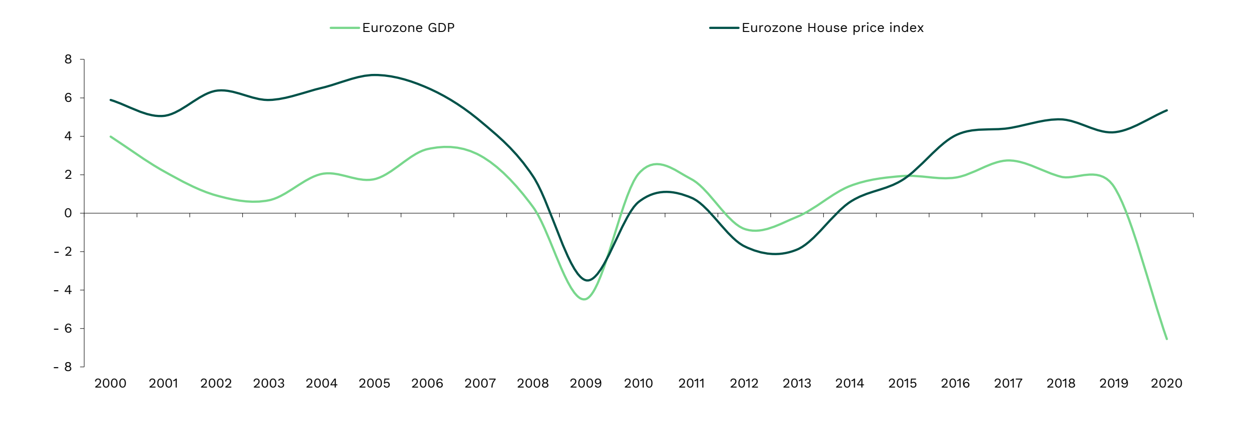


Source(s): Primonial REIM Research & Strategy, Eurostat, brokers, and national statistical services

THE INDIVIDUAL AND COLLECTIVE RESIDENTIAL SECTOR HAS BEEN TESTED BY THE HEALTH CRISIS

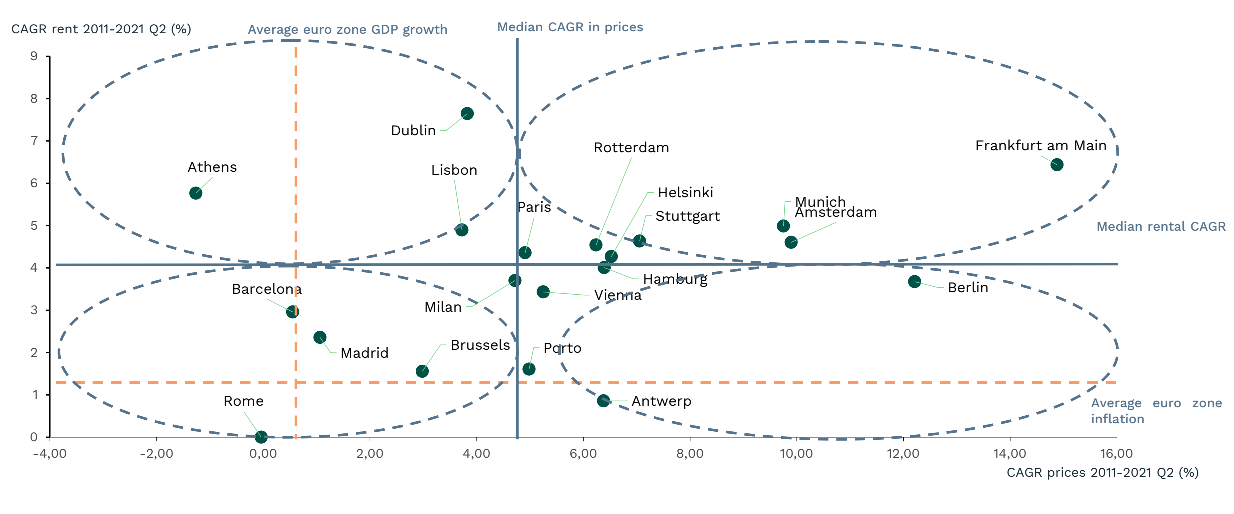
Residential real estate is generally considered as a safe-haven asset class in times of crisis, even though we can observe that the economic and financial crisis of 2008/2009 and the European sovereign debt crisis were not absorbed by all European cities in the same way. However, residential real estate is less tightly correlated to GDP trends than other asset classes and this was particularly true during the health crisis of 2020. **Thus, despite an historic economic recession, prices of residential assets did not suffer, and indeed continued to rise. Several factors fed into this trend: a reduction in the number of assets on the market; a drop in new-build increasing shortages in areas where supply is under pressure; a sharp rise in prices in certain cities driven by workers from major cities being able to work from home; and the stimulation of demand thanks to low lending rates.** The European markets with strong economic growth (Berlin, Munich, Amsterdam, Paris) saw their fundamentals (rents and prices) outperform, whilst other cities (Madrid, Brussels) saw more modest trends, and some (Athens, Barcelona, Rome) underperformed significantly over the period in question (2011 to Q2 2021).

CORRELATION BETWEEN RESIDENTIAL PRICES AND GDP



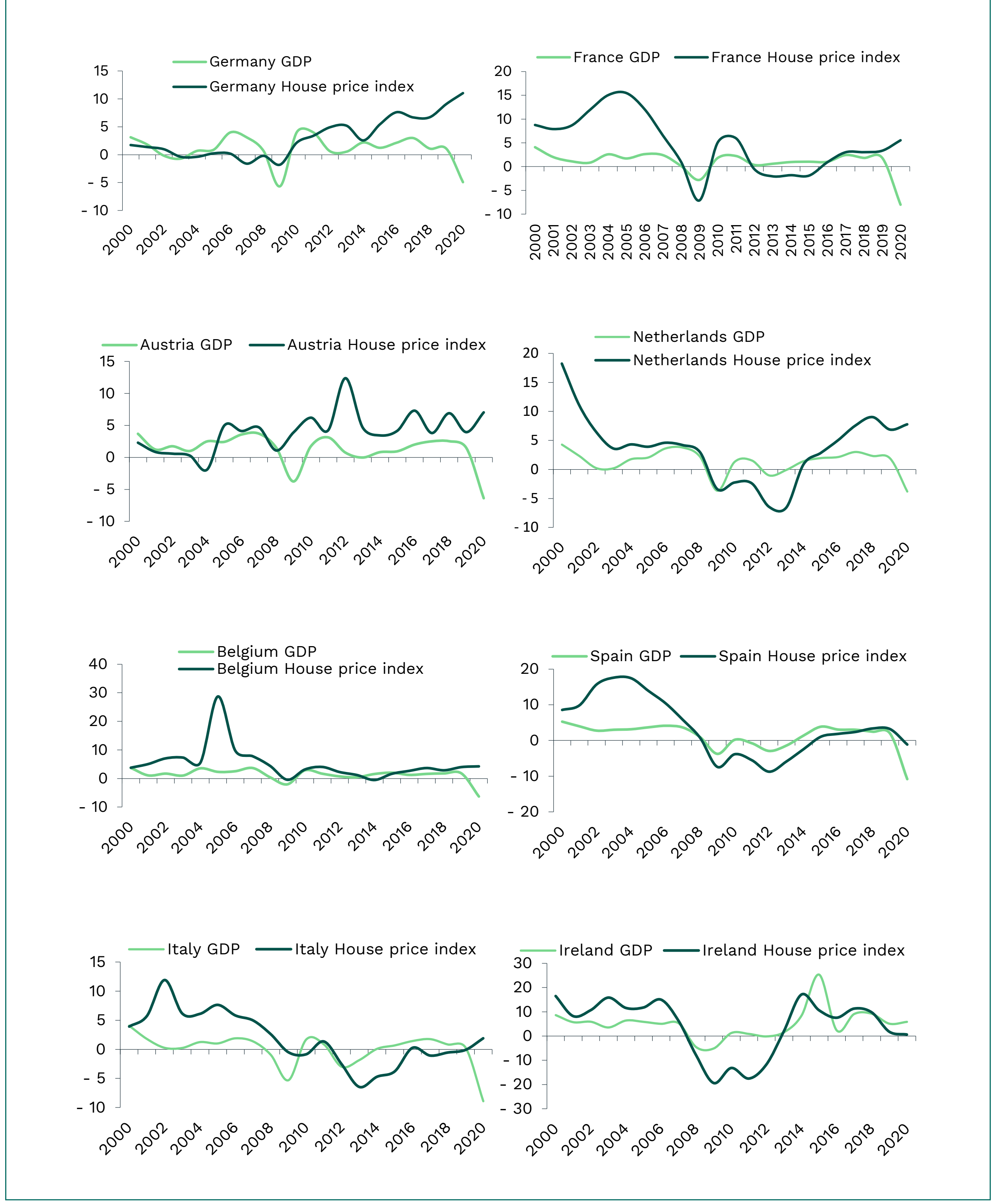
Source(s): Primonial REIM Research & Strategy after Oxford Economics, Eurostat and national statistical services

CHANGES IN PRICES AND RENTS FOR 'PRIME' HOUSING 2011-2021 Q2



Source(s): Primonial REIM Research & Strategy after Oxford Economics, Eurostat and national statistical services

CORRELATION BETWEEN RESIDENTIAL PRICES AND GDP IN THE MAIN EUROZONE COUNTRIES (%)



Source(s): Primonial REIM Research & Strategy after national statistical services

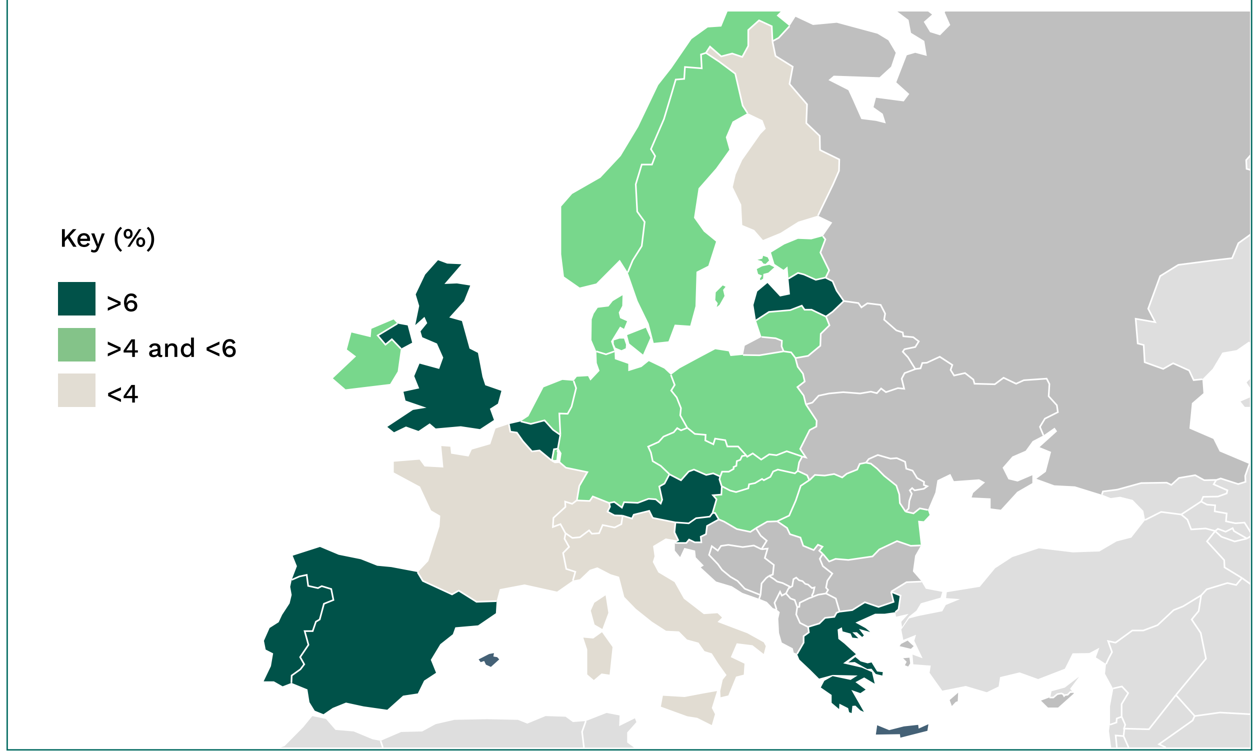
PROSPECTS FOR TOTAL YIELDS REMAIN STRONG TO 2023

Our forecasting model for total residential returns in the Eurozone suggests average annual increases of at least 4% between 2021 and 2023. While there will be substantial growth in 2021, some markets face risks of a correction in values, which has increased in recent months. This is the case in the UK from 2022 and Slovenia from 2023. However, taken as a whole, European residential markets will see positive trends in total returns between now and 2023. These good prospects are made possible by the economic recovery, economic activity that is likely to be stimulated by the European recovery package over the next few years, the shortage of supply and the attractive level of mortgage rates. These factors are likely to contribute to maintaining price growth in the Eurozone residential sector through to 2023. However, not all European markets will see the same performance.

On a conservative basis, our model predicts average total returns of between 4% and 6%. Some markets are likely to see annual total returns of more than 6%, whilst others will grow by less than 4%.

However there are risks in these projections: the possibility of a financial crisis, rapid increases in interest rates and/or inflation, the issue of European recovery and debt – not to mention the regulatory unknowns that could affect residential markets, or excessive price growth in the housing market, which could result in sharp corrections if the market starts to fall.

PREDICTED TOTAL RESIDENTIAL YIELDS 2021-2023



Source(s): Primonial REIM Research & Strategy

THE EURO CITY RANKING DEVELOPED BY PRIMONIAL REIM

Residential real estate must be analysed at a fine level of detail, as significant disparities exist across Europe. We have therefore developed a specific index to support decision-making in the implementation of an investment policy: The Euro City Ranking. We have analysed more than 130 cities in Europe.

The methodology used consists of recognising the specific features of regional trends in each European city and regional area, on the basis of a number of indicators:

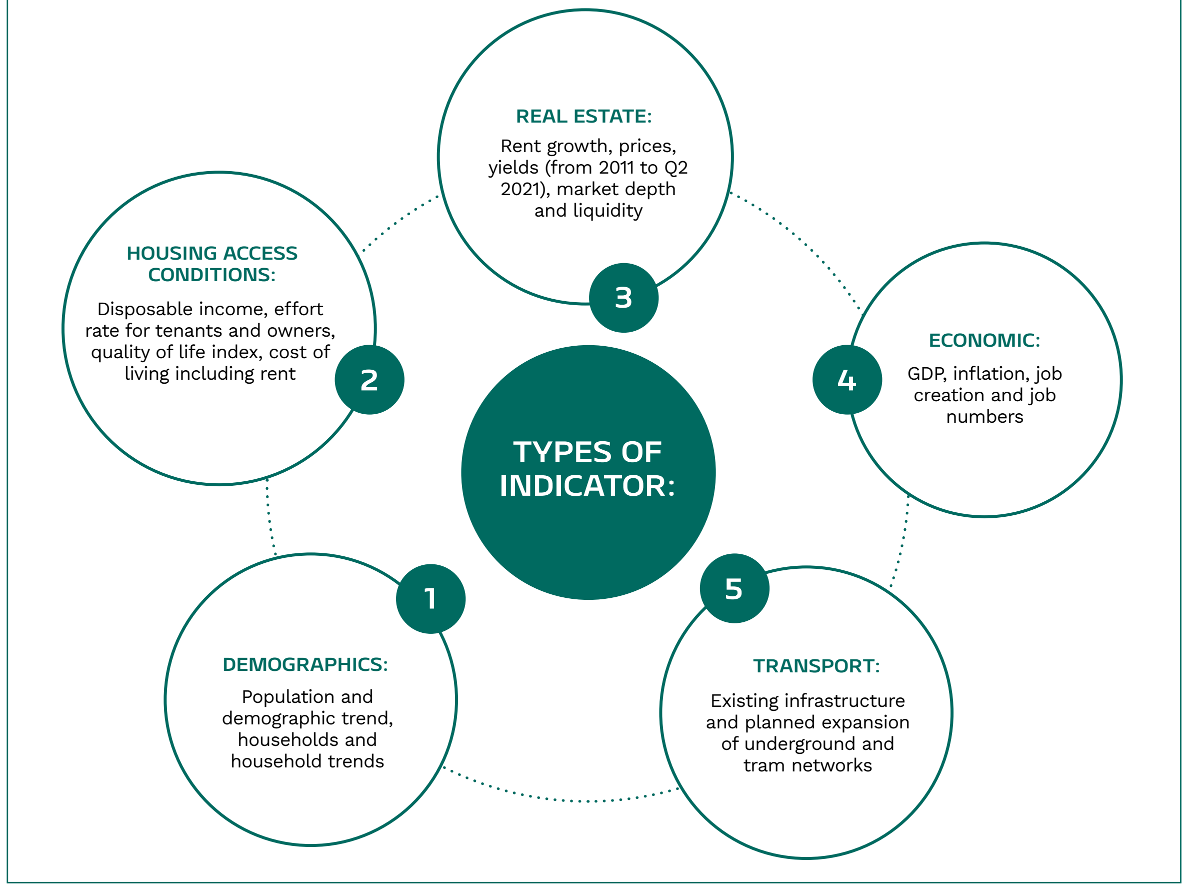
- **Demographics: population and demographic trend, households and household trends;**
- **Housing access conditions: disposable income, effort rate for tenants and owners, quality of life index, cost of living including rent;**
- **Real estate: rent growth, prices, yields (from 2011 to Q2 2021), market depth and liquidity;**
- **Economic: GDP, inflation, job creation and job numbers;**
- **Transport: existing infrastructure and planned expansion of underground and tram networks.**

These criteria have been built up with a 10-year history coupled with a projection over 5 or 10 years, depending on the relevance of the indicator.

Thus, with more than thirty criteria and 140 cities analysed across Europe, some 5,000 data points have allowed us to allocate ratings to each of the elements analysed for each market.

This methodology then allows us to attribute an overall score to each market, based on these criteria.

EURO CITY RANKING: 5 MAIN GROUPS OF INDICATORS (AROUND 30 CRITERIA)



Source(s): Primonial REIM Research & Strategy

ANALYSIS MATRIX FOR RESIDENTIAL INVESTMENT IN EUROPE

We have thus attributed scores to each of the markets analysed. The model identifies three main categories of market.

Paris-Île-de-France, Berlin, Munich, Vienna, Amsterdam and Zurich, for example, are cities where the risk/return profile is the most secure with positive prospects. These are Tier 1 markets.

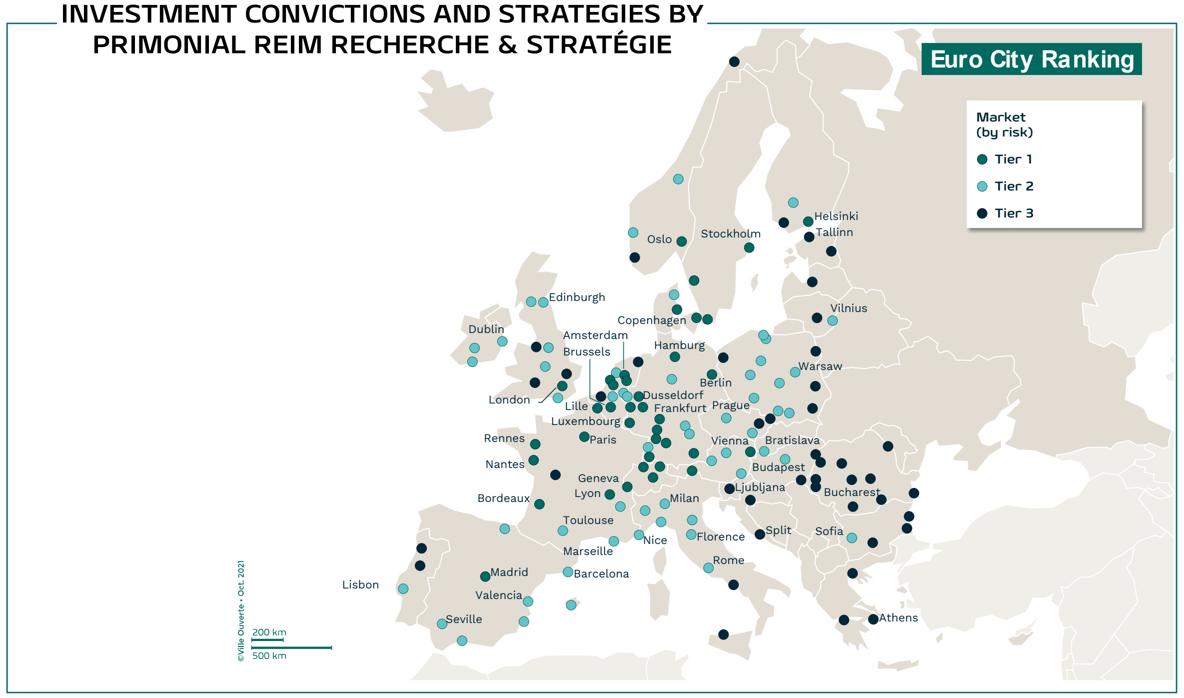
Milan, Barcelona, Lisbon and Marseille are examples of Tier 2 markets, with a good risk/return profile, but which scored lower than Tier 1 markets on one or more criteria. We have also identified cities in eastern Europe, including Prague and Warsaw, which are likely to see growth in total returns over the next few years, due to a degree of demographic pressure and the economic dynamism of these zones. However, such markets also require detailed analysis to ensure attractive total returns over the long term.

Lastly, in some markets, such as Athens, Porto and Naples, we have identified a significant demographic risk (falling population) relative to Tier 1 and 2 markets. We have also identified other types of risk in other markets: weak future growth, excessive housing costs relative to household income, a public transport network that remains poorly developed or Against this background, we recommend a focus on resilient metropolitan areas and cities, with the following characteristics:

Dans ce contexte, nous recommandons de se tourner vers des métropoles ou des villes résilientes qui ont les caractéristiques suivantes :

- a substantial population with scope for growth over the coming years;
- a deep market, in order to ensure the liquidity of residential blocks;
- potential revenue flows based on the quality of the zone in terms of employment, the population’s disposable income and good housing access conditions;
- an attractive position in the price and rent cycle;
- A good public transport network with potential for future development.

INVESTMENT CONVICTIONS AND STRATEGIES BY PRIMONIAL REIM RECHERCHE & STRATÉGIE



Source(s): Primonial REIM Research & Strategy

CONCLUSION

Despite the current health crisis and the collapse of economies in 2020, the residential market has shown good signs of resilience. We believe that over the long term the fundamentals of the residential market (supply and demand) are unlikely to change significantly. However, some risks persist.

Linking residential real estate to stages of life can also offer attractive diversification by meeting new requirements from households (co-living for singles, BTR for families, senior housing for seniors).

In recent years, the share of renters has tended to increase, even in economies where owner-occupiers have historically been in a majority. The gradual transition towards a tightening of lending conditions will also make house purchase more difficult and thus boost the share of renters.

We are convinced that the phenomenon of urbanisation will continue but with a new balance between increasing density and deconcentration being found to make cities healthier. Increasing urban density will remain a factor to meet climate and environmental challenges whilst improving the liveability of homes by increasing access to outdoor spaces (balconies, private green space and so on). Households living in urban areas where housing markets are under pressure will be keen to protect their purchasing power, whether this means choosing to rent or to buy.

Meanwhile, the benefits of socially responsible investment are real in the residential sector; such investments can provide social advantages, thus allowing investors to meet their ESG and/or SRI targets. Moreover, in recent years residential real estate has demonstrated its ability to offer regular and stable revenue flows whilst also providing attractive capital returns.

For all of these reasons, **the European scale is the most relevant for investment in residential real estate, offering a good distribution of risk.**

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VALUE FROM VALUES

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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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