PRIMONIAL REIM
VALUE FROM VALUES

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REAL ESTATE PERSPECTIVES

By Primonial REIM Research & Strategy

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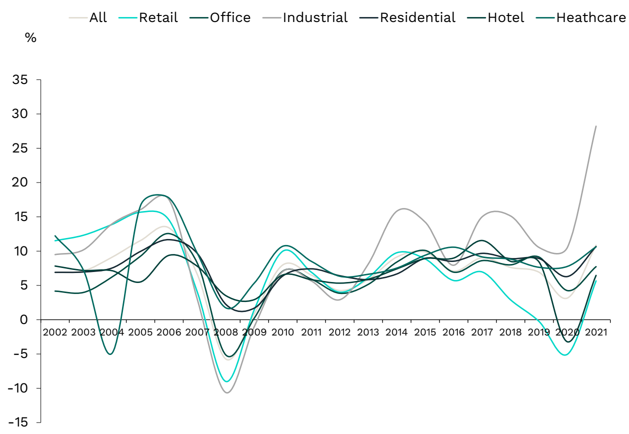
With a deteriorating economic outlook, against a background of geopolitical tensions and high inflation, Europe faces a growing risk of recession. Predicted eurozone GDP growth for 2022 has been downgraded from 4.0% at the beginning of the year to 3.0% in September 2022. Caught in the dilemma between the risk of high inflation and the risk of a recession, the ECB opted to tighten monetary policy, raising its policy rates by 75bp in September 2022, an additional turn of the screw following July's 50bp increase, to tackle inflation.

These factors may have consequences for real estate valuations. We believe the market will remain on track in 2022 but 2023 could be a tougher year due to high inflation, weaker economic growth and rising bond rates which could affect real estate values. We also believe that an adjustment in certain markets or for certain assets could be healthy and create attractive entry points. In the rental market, the imbalances observed between supply and demand in central districts are likely to maintain the rise in rent levels. However, there is user risk caused by rising defaults.

In contrast to their approaches over the past decade, which have been driven by falling yields, some investors could shift their strategy to a focus on value added (i.e., creation of value by restructuring assets) in the absence of "automatic" capital gains from falling capitalisation rates.

With reduced prospects and greater uncertainty over capital growth, quality and the ability to add value could make all the difference when seeking performance, particularly if the market sees corrections over the next few months.

TOTAL RETURNS IN EUROPE BY ASSET CLASS



THE REAL ESTATE PERSPECTIVES IS A BI-ANNUAL REPORT PUBLISHED BY PRIMONIAL REIM RESEARCH & STRATEGY. THIS REPORT HIGHLIGHTS PRIMONIAL REIM'S 5-YEAR PROJECTIONS FOR ALL MARKETS AND ALL ASSET CLASSES IN EUROPE. IT COMPLEMENTS OUR QUARTERLY REAL ESTATE CONVICTIONS.

FORECASTS 2022-2026

Primonial REIM Research & Strategy uses statistical models to apply the latest official macroeconomic forecasts to all classes of real estate assets. Clearly the findings are indicative and do not represent advice.

In the short term, we expect that overall market performance will be driven by logistics, residential and healthcare real estate, three asset classes previously considered as alternative options but for which investor appetite has increased strongly in recent years.

Hotels are also likely to see a positive trend, thanks to the recovery in leisure tourism. Operating figures from the summer season have been encouraging on this front. However, business tourism still faces difficulties and is unlikely to see a rapid return to pre-pandemic levels. We would therefore expect the sector as a whole to see a mixed performance.

After sharp corrections during the pandemic, we believe that 2022 will bring an automatic rebound for retail assets, before a period of calm in 2023 and 2024.

When it comes to offices, the performance will be weaker than that seen over the past decade, taking into account a potential adjustment in satisfied demand due to hybrid working and the discount on non-green buildings. Let offices that are well located, meet tenants' new requirements and respect ESG (Environmental, Social and Governance) standards should escape any discounts and are likely to enjoy the best yield prospects in this asset class.

Overall, we believe that projected yields for 2022 will remain at around their 2021 level. This said, there will be adjustments but these will be restricted to certain types of asset and location.

It will, of course, be the transactions completed over the coming months that will give a real indication of the scale of any corrections.

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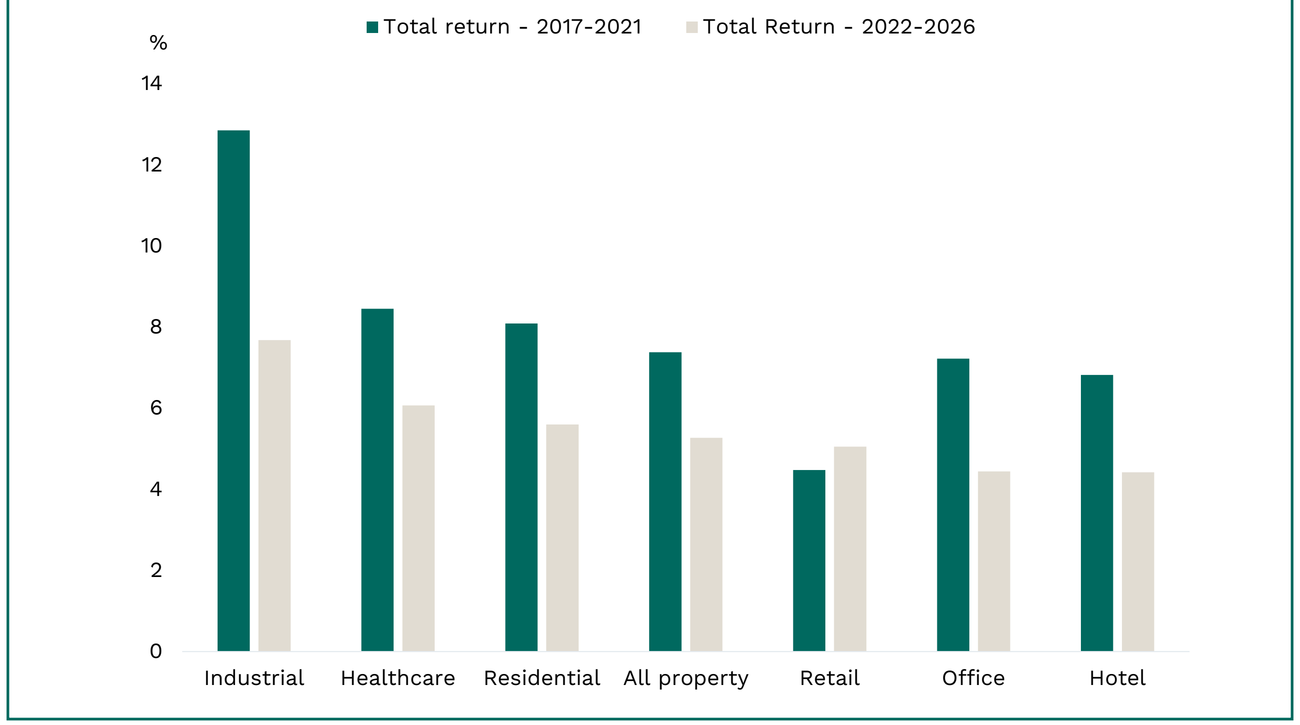


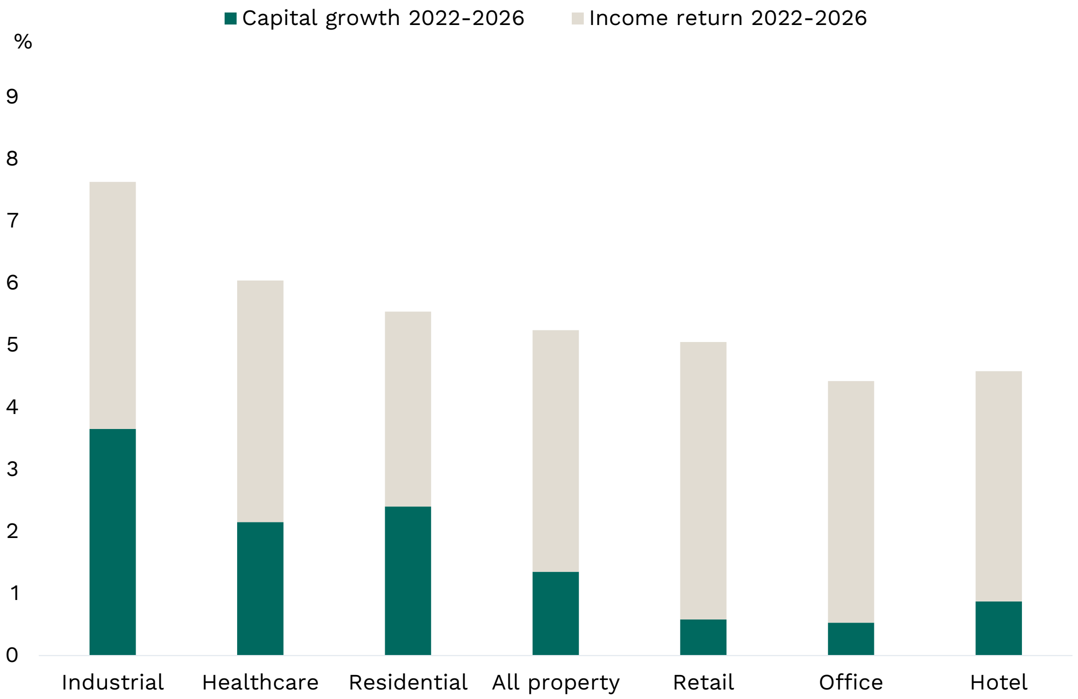
PROSPECTS IN THE MAIN EUROPEAN MARKETS

	Features	Short term 2022	Medium term to 2026
OFFICES	Central markets	Positive to selective	Positive
RETAIL	Depending on format and zone	Selective	Selective to positive
LOGISTICS	Class A, urban logistics	Positive to selective	Positive to selective
RESIDENTIAL	Cities and suburbs	Positive to selective	Positive
HEALTHCARE	National, recent or new assets	Positive	Positive
HOTELS	Business and leisure	Wait to selective	Selective to positive

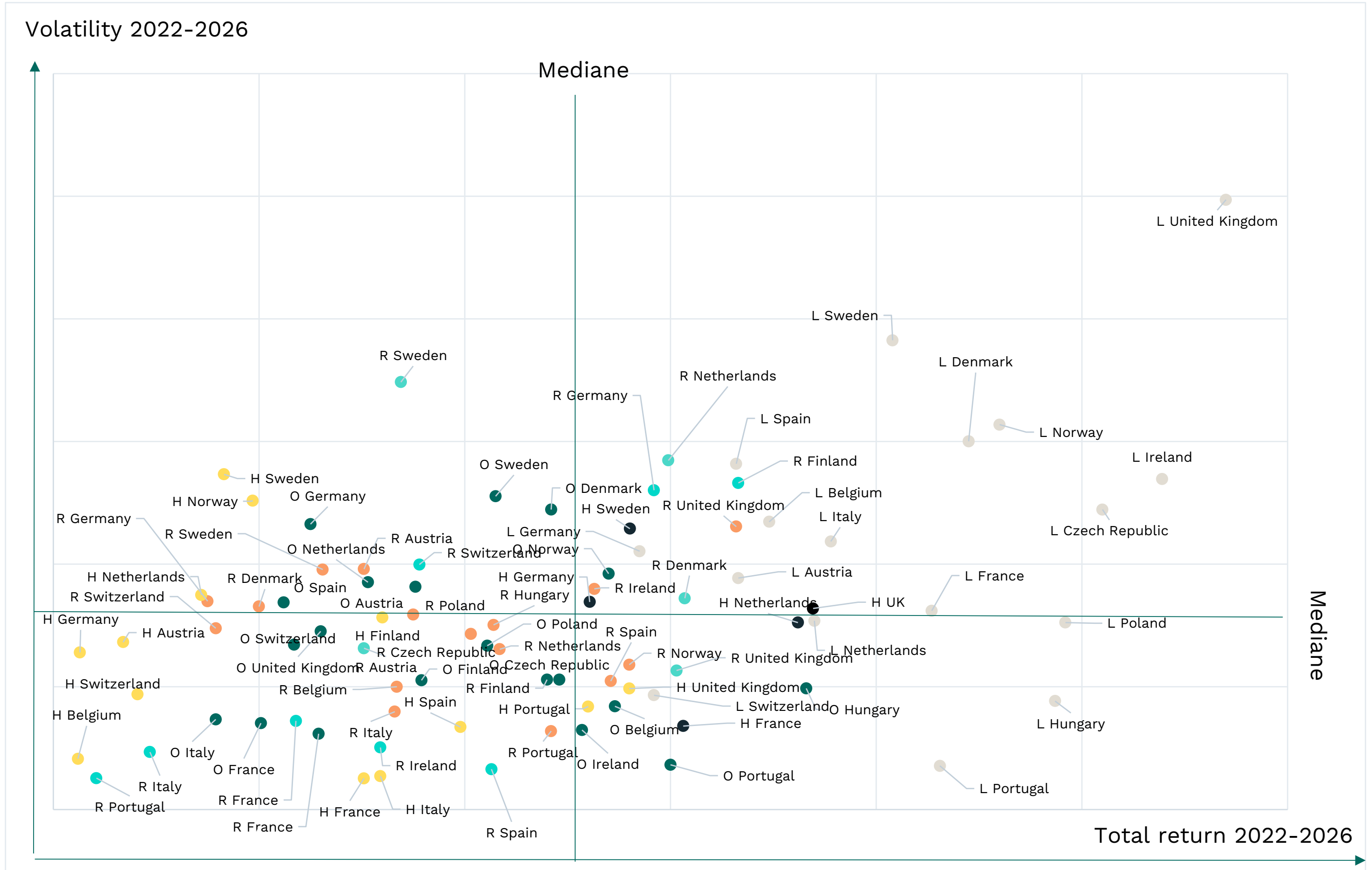
According to our estimates, real estate yields for certain types of asset could see decompressions between now and the end of 2024, counterbalancing the rising yields on government bonds. The consequences of this situation therefore imply a reduction in the prospects for capital gains, which are likely to be less strong over the coming period than in the past decade. Conversely, we expect income returns to ensure the strength of overall performance. Thus, well-located assets with the potential for added value and solid tenants should be able to ensure strong returns looking towards 2026.

We predict an average total return for all asset classes of between 3% and 6% per year, still at the meeting point of bond and equity markets, both in terms of volatility and returns. At the same time, it is important to note that the gradual introduction of restrictive regulations and the shift in investment strategies will work in favour of assets meeting ESG criteria, which will have a negative impact on the overall performance of energy-hungry, high carbon footprint assets: assets not meeting ESG criteria could, over time, face corrections in their resale value and a reduction in liquidity.

PROJECTED TOTAL RETURNS IN EUROPE BY ASSET CLASS 2022 TO 2026



PROJECTED REAL ESTATE MARKET PERFORMANCE/RISK IN EUROPE 2022-2026



OFFICES

Turning to our forecasts for 2022 to 2026, we believe that total returns for offices in Europe are likely to average between 4.0% and 5.5%. This projected performance is lower than the 8.6% seen over the past decade. Total returns will be driven more by income returns (between 3% and 4%) than by capital growth (between 0.0% and 1.5%). Adjustments to rates of return should be expected in 2022 and 2023. Turning to individual markets, we think that Madrid, Amsterdam and Vienna are examples of markets that could offer strong total returns through to 2026. Large and liquid markets, such as some sectors in Paris or major German cities, will also offer a solid performance over time whilst retaining lower volatility than in shallower markets.

By 2026, the office real estate sector will be facing several challenges. One of these will be the energy transition. We believe that assets and markets adapted to the new landscape of workplaces and meeting ESG criteria, with solid tenants and long leases are likely to see better prospects for growth in prices, rents and space let. The question of renovating certain assets needs to be addressed due to the increase in cost of raw materials and the cost of financing. One of the other challenges will be the consequences of hybrid working on office demand over the short to medium term. Thus, markets able to maintain or guarantee strong economic growth and with the capacity for significant job creation will have the greatest need for space.

RETAIL

We forecast average returns from retail assets of between 4% and 5% from 2022 to 2026, a level relatively close to the 5.4% seen between 2012 and 2021. After an automatic rebound in capital gains in 2022, we expect to see more modest performance levels, driven by income returns, in 2023 and 2024. Street level shops in cities such as Berlin, Paris, Lisbon, Brussels and Munich have relatively strong prospective total returns between 2022 and 2024.

Although high inflation is likely to hit consumer spending in the short term, strong savings levels will provide a buffer that will feed into household budgets. Meanwhile, forecast revenue growth at store chains is likely to underpin rental growth. In general terms, "bricks and mortar" retail will need to continue to manage the growth of on-line sales, which will produce contradictory trends in Europe.

LOGISTICS

We forecast average returns from logistics assets of between 6.5% and 7.5% from 2022 to 2026, lower than the 12.9% seen between 2012 and 2021. Income returns will drive performance, whilst capital gains could see a slowdown or adaptations from 2023 onwards. However, the sector's solid fundamentals and limited supply will allow logistics to generate very good overall performance levels. We think that markets including Brussels, Berlin, Düsseldorf, Milan, Paris and Rotterdam offer the prospect of strong income returns in the years ahead. In addition, these are markets with the potential to increase capital gains looking towards 2026.

In recent years, the penetration of e-commerce has increased significantly, particularly in the UK, the Netherlands and Germany. These countries saw very strong growth between 2012 and 2021. The logistics segment also faces a number of major challenges. First, over the next few years investments will have to be made in digitalisation and robotics in order to improve the efficiency of the supply chain. The second major challenge is the ESG transformation of logistics. Because construction costs for logistics facilities generally lower than for other assets, the costs of renovating buildings to improve performance also tend to be lower. However, in a cost-driven sector, this can rapidly become a negative factor.

RESIDENTIAL

Our forecasts for 2022 to 2026 suggest overall returns of between 4% and 6% in Europe, slightly below the average of 8.5% over the past decade. **In the short term, the sector could continue to be driven by its capital performance, but there could be a rapid reversal in certain markets.** Indexation will pick up the running to boost yields via rents to offset the increase in interest rates. By country, we think that the Netherlands, Germany, Spain, Austria and France are amongst the markets which offer a reasonable risk-return profile.

The imbalance between housing supply and demand is feeding into upward pressure on residential prices. Growth in the number of households remains a factor in favour of the European residential market, particularly in large cities. This situation helps underpin demand both for the rental and home purchase markets. The rental market will also benefit from the build-to-rent strategy, a source of real estate supply which meets current household needs. Regarding ESG issues, the residential sector already faces tighter regulations to meet standards for reduced in energy consumption and carbon reductions (with a ban on letting apartments where the energy performance audit is below a certain level). Lastly, the European residential market is highly regulated at the country level to protect tenants. Indexation, which is generally linked to the consumer price index, provides total or partial protection against inflation.

HEALTHCARE

We believe that total returns for healthcare assets in Europe are likely to average between 4.5% and 6% between 2022-2026, which is below the average of 8.25% over the past decade. Total returns will be driven by income returns and to a lesser extent by capital growth. By country, we think that the markets in France, Germany, the UK, Spain, Italy, the Netherlands and Sweden are the deepest and most liquid markets and will have the ability to deliver the best performances.

The coverage of a significant share of healthcare expenses by the public and/or private sectors, together with demographic growth in the older population, are factors favouring healthcare real estate. The imbalance between supply and demand will persist, especially as demographic pressure will remain strong over the next five years and then continue to increase over the following decade. The obsolete part of the existing care home stock in terms of ESG criteria and the lack of supply in the market make a powerful case for investment in recent, well-located assets with a solid operator.

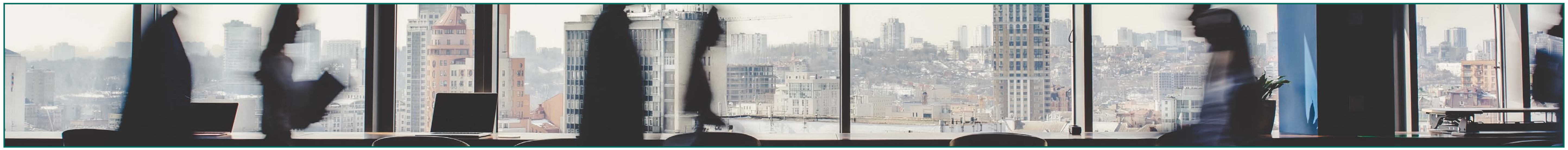
HOTELS

With tourism and travel starting back up in 2022, our forecasts for the performance of the European hotels sector between 2022 and 2026 are for average total returns of between 3% and 5%, lower than the 8.4% of the past decade. At the same time, rising interest rates could rapidly affect capital performance in 2023 and 2024. By country, we believe that the leisure hotel segment (Spain, Italy, Portugal) and business hotels (the Netherlands, Germany) in markets that will recover in the run-up to major events, such as the Paris Olympics in 2024, offer a diversification of risk and thus better performance.

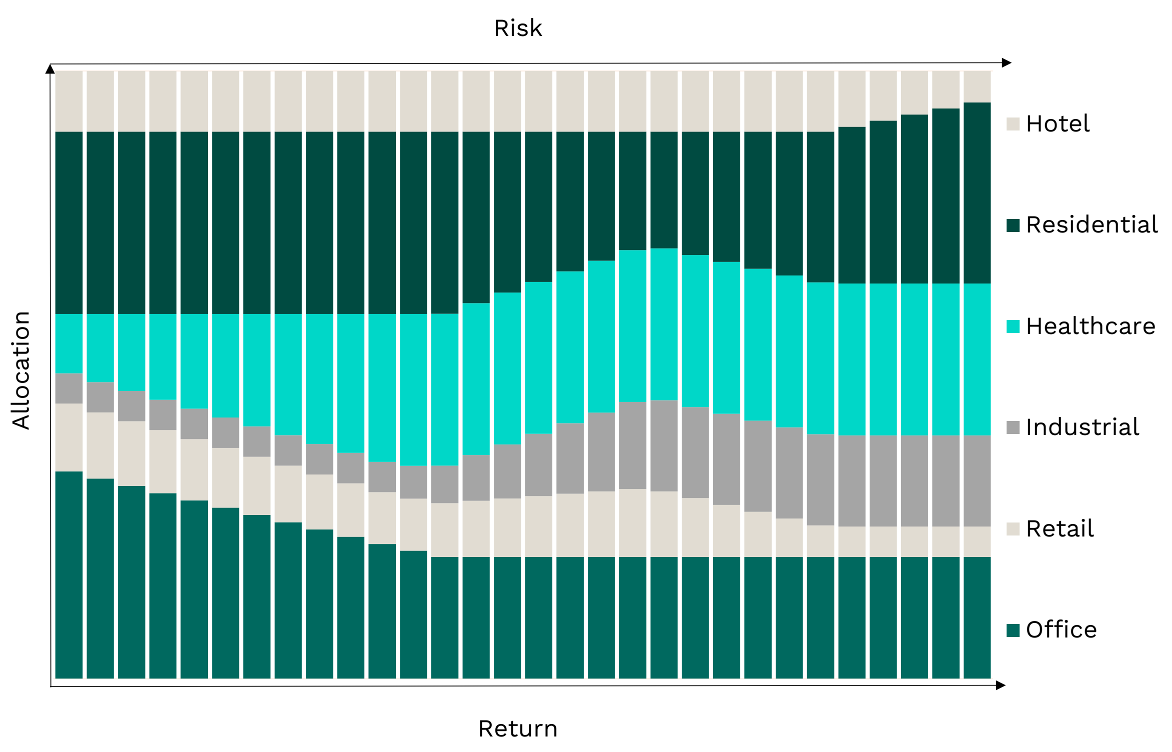
Although considerable uncertainty remains due to the deterioration of the geopolitical situation, hotel performance indicators are likely to continue to rise, driven by the sector's strong recovery. For the time being, one can assume that occupancy rates, average prices and RevPAR will oscillate between stability and growth for those markets least affected by geopolitical pressures and the pandemic. Inflation could disrupt sector performances as the widespread increase in prices (transport, hotels, food) reduces consumer budgets. Consumers may therefore elect to delay or limit their travel. When it comes to ESG matters, a selective and patient approach should guide investors' allocation strategy. The sector will need drastic changes to reduce its high levels of energy consumption and its decarbonisation challenges are amongst the greatest in the real estate industry. An extra-financial risk premium could therefore emerge as sustainability considerations are included in valuations.

EFFICIENT REAL ESTATE PORTFOLIOS – THE SMARRT© MODEL FROM PRIMONIAL REIM RESEARCH & STRATEGY 2022-2026

The chart below shows the overall optimal allocation according to SMARRT©, our allocation model that allows the management of real estate investment in accordance with changing macroeconomic conditions. The model is described in our June 2022 report "European real estate in asset allocation: new world, new model".
Our model has identified various efficient portfolios with a total return of between 4% and 6%. It favours geographical and asset class diversification at the European level.
Analysing future results by projecting real estate returns over the period from 2022 to 2026, the model favours offices (20% to 40%) for their good liquidity, residential and healthcare (10% to 30%) for their defensive attributes, and overweights logistics (5% to 15%) to increase performance albeit in exchange for an increase in risk.
It is interesting to note that on a defensive approach the model recommends virtually equal holdings of logistics and retail, two asset classes that are linked to consumption and can be substituted for each other depending on consumer behaviour.
Finally, it also recommends incorporating hotels, at between 5% and 10%, to take advantage of the sector's recovery.
These findings are those of a specific moment and must not be viewed as fixed over time. An allocation policy must take into consideration the real estate cycle for each market in order to invest at the most opportune time. The model must be adapted to each new situation, adjusting the allocation to ensure that the desired risk-return profile is maintained.
The structural risks identified are as follows: a worsening of geopolitical instability resulting in further downgrades in economic prospects, an increase in interest rate spreads between countries, a financial crisis or lastingly high inflation.



PROJECTED EUROPEAN EFFICIENT PORTFOLIOS BY ASSET CLASS 2022 TO 2026 ACCORDING TO THE SMARRT© MODEL



Sources used throughout this document: Primonial REIM Research & Strategy statistical models, CBRE, Savills, BNP PRE, JLL, Knight Frank, MSCI, Oxford Economics, Eurostat, OECD, FMI, Stabel, NSI, CZSO, DST, Destatis, Stat, CSO, Statistics, INE, INSEE, DZS, ISTAT, CSB, Statistics Lithuania, Statec, KSH, CBS, Statistik Austria, Stat Poland, INE, INSSE, Statistics Finland, SCB, SSB, BFS, ONS.

DEFINITIONS

10-year government bonds: debt securities issued by a state for a period of ten years, generally acknowledged to be a risk-free investment.

Investment volume in corporate real estate: total volume of premises acquired in the offices, retail, business premises and warehouses segments by an investor.

Take-up of offices: all leases or sales to the occupant (as opposed to sales to investors) for premises to be used as offices. It is expressed as square meters of usable space.

Sale Before Completion: sale before completion is the contractual method for selling a building before it is built. The investor becomes the owner as it is built.

Free leases: favourable measures granted to tenants (rent cuts, renovation work, etc.).

Yield: ratio between the gross or net revenues from the building and the capital committed by the buyer (acquisition price + fees and transfer taxes).

Store premises: traditional ground-floor retail premises located in town-center high streets.

Shopping center: a building containing at least 20 retail outlets housed in indoor centers around a large food store that drives customer traffic.

Retail park: an outdoor shopping center built and managed as a single unit. It comprises at least five buildings linked by lanes and located on city peripheries.

Care homes: a health facility that houses dependent elderly people.

Medical, surgery and obstetric clinics: medical facilities for short-term care, with or without lodging, or for severe conditions during their acute phase.

RevPAR: abbreviation for Revenue Per Available Room. It corresponds to the turnover on accommodation of an establishment divided by the total number of rooms RevPAR also corresponds to Occupancy Rate multiplied by ADR

ADR: abbreviation for Average Daily Rate. It is calculated (excluding breakfast) by dividing total revenue by the number of occupied rooms.

Hotel Occupancy Rate (OR): ratio of the number of occupied rooms to the total number of rooms in a hotel.

About Primonial REIM

Primonial REIM has a workforce of 400 employees in **France, Germany, Luxembourg**, **Italy, United Kingdom** and **Singapore**. Its values of conviction and commitment as well as its expertise on a European scale are used to design and manage real estate funds for its national and international clients, whether they are individuals or institutions.

Primonial REIM currently has €33,5 billion of assets under management. Its conviction-based allocation breaks down into :

- **45 %** offices,
- **34 %** healthcare/education,
- **10 %** residential,
- **7 %** retail,
- **4 %** hotels.

Its pan-European platform manages **61 funds** and has more than 96,056 investor clients, **53%** of which are **individual investors** and **47% institutional**. Its real estate portfolio consists of more than 1,526 properties (offices, healthcare/education, retail, residential, hotels) located in **11 European countries**.

www.primonialreim.com

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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.

Real Estate Convictions Europe offers Primonial REIM's quarterly view of its markets of choice, i.e. offices, retail outlets and healthcare and residential real estate, in the Eurozone.

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