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REIM VALUE FROM VALUES

REAL ESTATE PERSPECTIVES

Research & Strategy

OCTOBER 2024

HAS ALTERNATIVE REAL ESTATE BECOME THE NEW CORE REAL ESTATE?

“We’ve been through a series of repeated crises over the past four years. The unprecedented market context has reshuffled the cards between asset classes, and alternative real estate has emerged on the back of favourable fundamentals.”

Henry-Aurélien Natter
MRICS, Head of Research - Europe

While a violent recession and financial crisis were avoided despite the historic rise in key interest rates by the world’s major central banks, the economies experienced a soft landing in 2023.

The euro zone is part of this trend and continues to hold up well. We therefore continue to expect growth to improve in 2024 and 2025. Recent data from leading indicators also seem to confirm this trajectory, which could indicate a turning point, especially as the disinflation process continues. We therefore expect inflation to reach its 2% target by the end of this year and to remain under control in 2025.

Consequently, we are maintaining our view that the policy of cutting key rates will continue in 2024 and 2025.

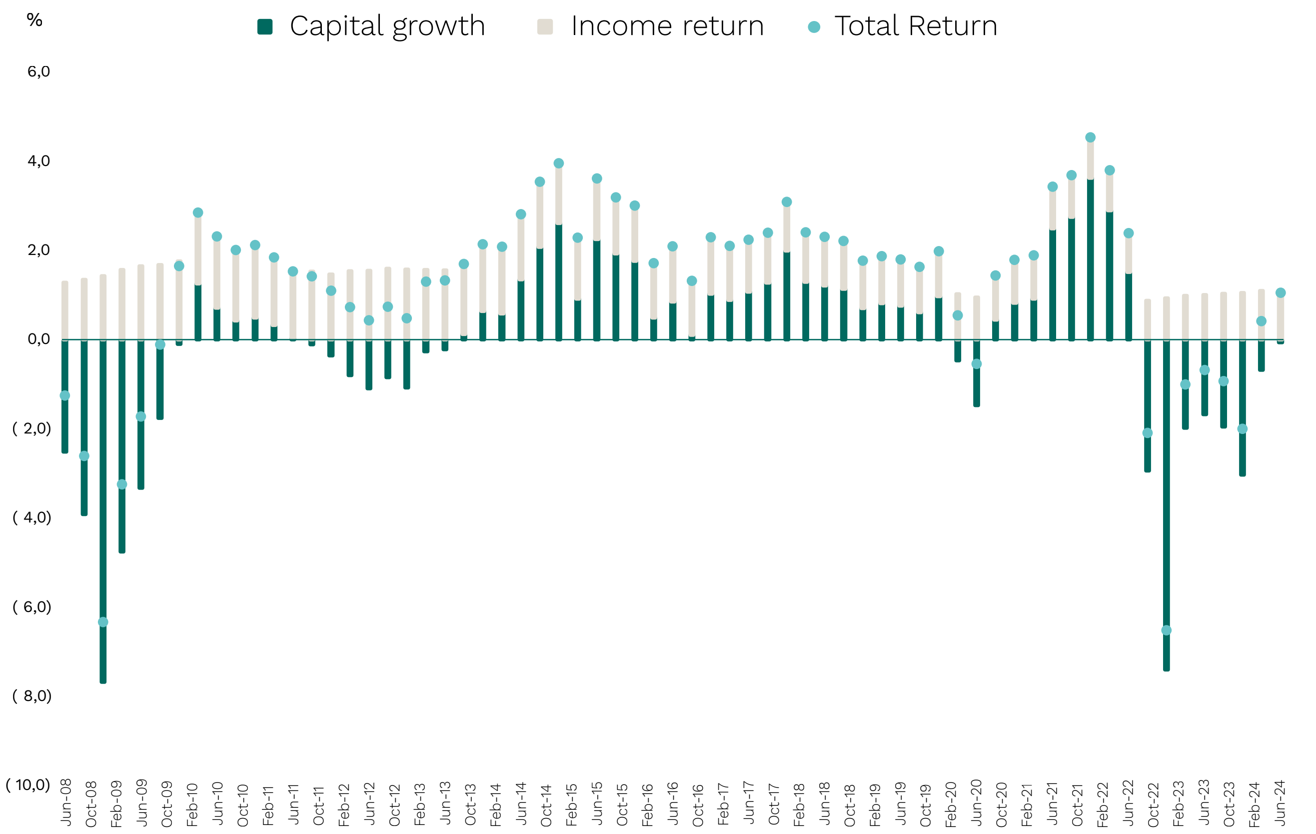
In terms of real estate performance, the historic rise in interest rates in 2022 has led to the first value revisions. The total return gradually moved into negative territory, as the growth of income return alone could no longer offset the value adjustments.

From one quarter to the next, 2023 saw corrections across all asset classes. The end of the ECB rate hike in October 2023 allowed the real estate market to catch its breath and gradually move towards a phase of stable capital returns.

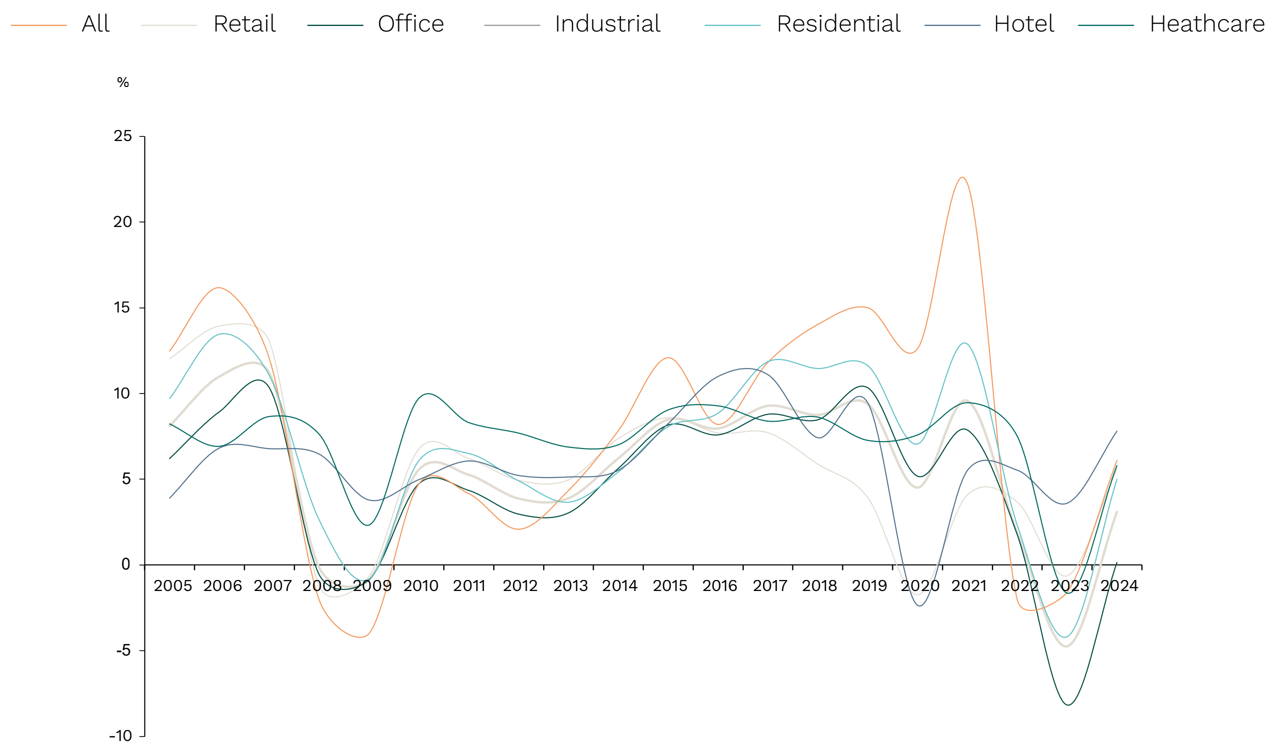
After this lull, the European Central Bank decided to initiate the first cut in its key rates in June and then September 2024. This change in policy should make 2024 a pivotal year for the European real estate market, with total returns edging back into positive territory after several consecutive quarters of negative performance.

Finally, while the issue of debt sustainability and the risk of further downgrades cannot yet be completely ruled out, there was some good news from the other side of the Atlantic, with the Fed announcing a 50bp cut in its key rates at the end of September 2024, confirming the start of the downward cycle in the key rates of the main international central banks.

QUARTERLY REAL ESTATE PERFORMANCE IN EUROPE



TOTAL RETURN BY ASSET CLASS IN THE EURO ZONE



OUTLOOK FOR THE MAIN EUROPEAN MARKETS (EURO ZONE)

	Characteristics	Short term 2024	Medium term to 2029
OFFICE	Central markets	Attentive to selective	Selective to positive
RETAIL	Depending on format and area	Selective to positive	Positive
LOGISTICS	Class A, urban logistics	Selective to positive	Positive
RESIDENTIAL	Metropolitan and suburban	Attentive to selective	Selective to positive
HEALTHCARE	National, recent or new assets	Selective to positive	Positive
HOTEL	Business and leisure	Selective to positive	Positive

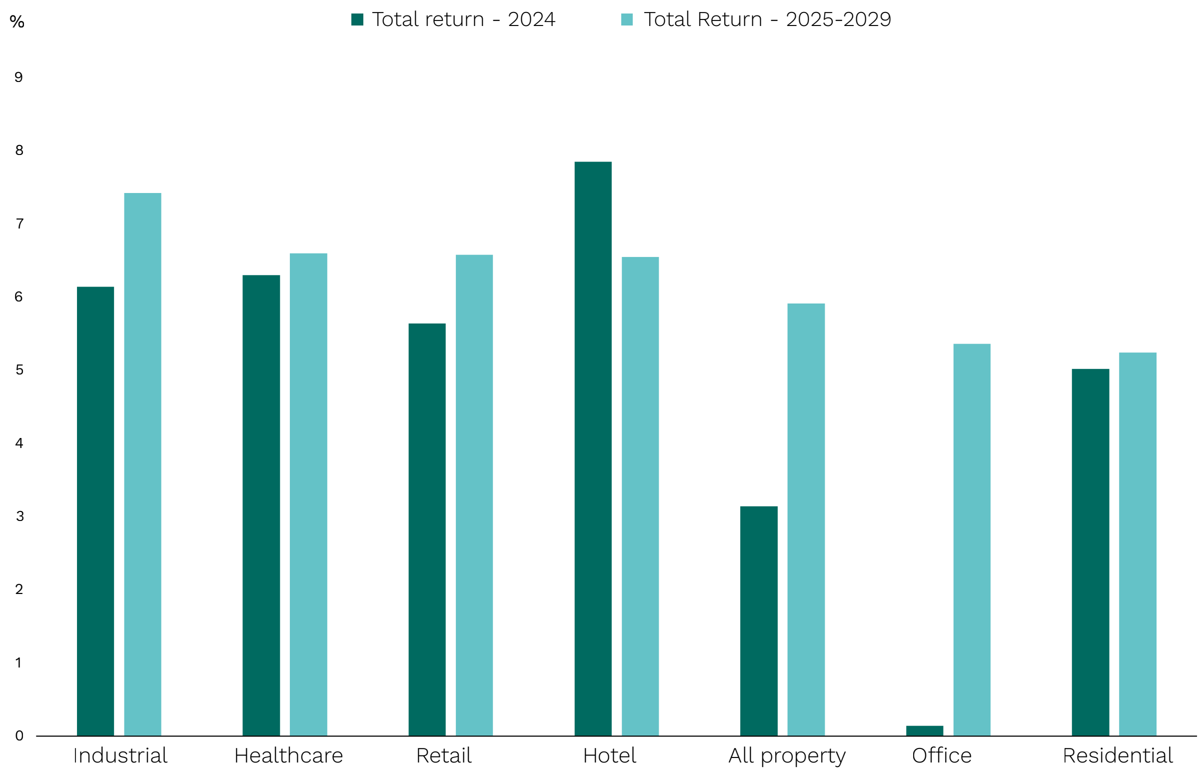
While we were expecting adjustments for as long as the ECB pursued its policy of monetary tightening, our expectations have gradually improved with the end of automatic rate hikes and the first-rate cuts. In terms of real estate performance, we therefore expect 2024 to be a year of transition, with total returns reverting to positive territory after several quarters of readjustment. The risk premium gradually rebuilt itself thanks to the easing of yield rates. Another part of the journey will have to be made when an easing on government bonds begins, while they remain at high levels due to budgetary and political uncertainties in some euro zone countries. On the other hand, we expect total return to be driven by income return than capital growth over the period 2024-2029.

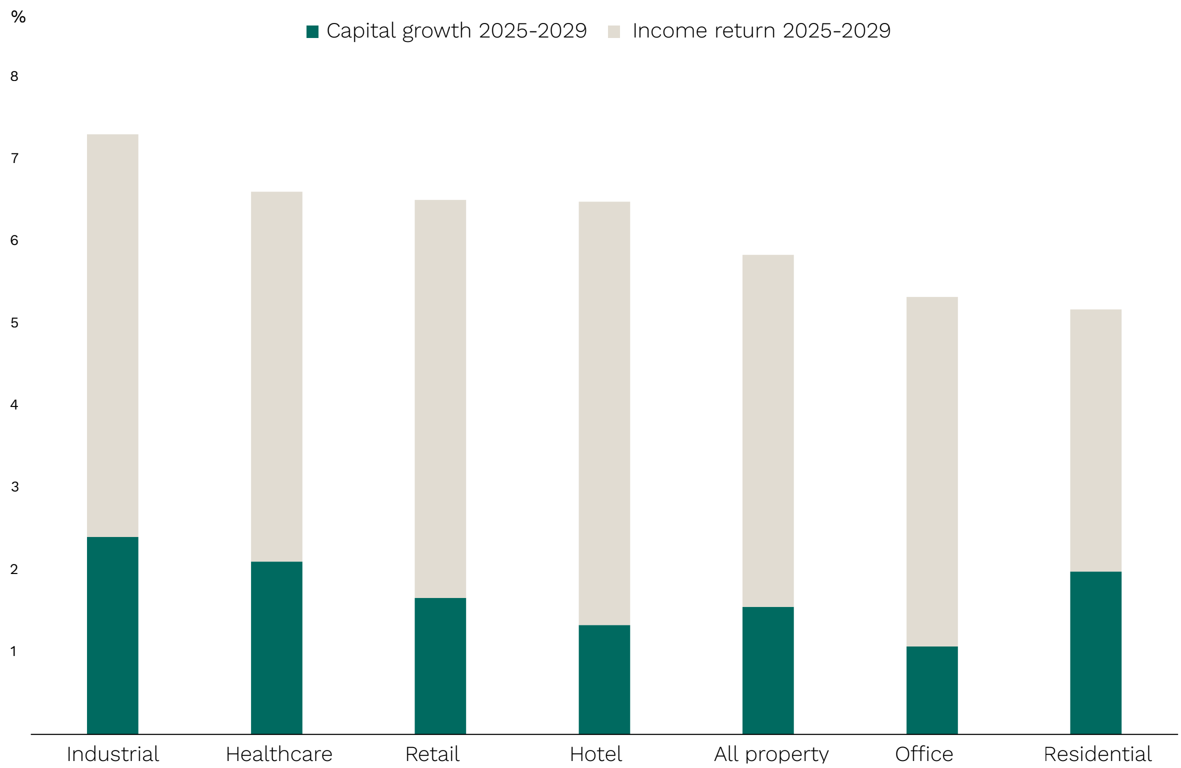
As a result, well-located properties with the potential to appreciate in capital and with strong tenants should be able to deliver good returns over the period. For all our real estate assets, we estimate that income return will be between 3.5% and 5% for the period 2024-2029. The capital growth should rebound in the second half of 2024 but could remain negative on average over the year as a whole. We estimate that the capital growth could be between 0% and 2% on average per annum over the entire period. We forecast an average total return for all asset classes of between 4% and 7% per annum by 2029.

In the short term, we expect strong overall performance from hotels, healthcare, logistics and retail. In terms of capital growth, all asset classes should end 2024 in positive territory, except for office property, which could still suffer from value adjustments that are not offset by income return. By 2029, all asset classes will manage to deliver a positive average performance. Rental yields will remain in positive territory for all asset classes over the entire period.

Overall, we also found that green/sustainable buildings do not suffer rent and price discounts compared with comparable non-green or non-sustainable buildings in the same locations. To better quantify the green value, we have noted that it is appropriate to include an impairment risk premium that considers the risk of climate transition. This premium is based on annual estimates of renovation costs to extend the economic life of a property (5 years, 10-15 years, 20+ years). The new depreciation risk premium is currently around 100-150 basis points for Europe, all sectors combined. The climate transition risk premium, which corresponds to the difference between the annual costs required for renovation and past spending on building improvements, requires an average supplement of 70 basis points on real estate yields in Europe. These elements will most likely be refined over time.

PROJECTED TOTAL RETURN BY ASSET CLASS IN THE EURO ZONE 2024-2029





PERFORMANCE AND RISK: AN ALPHA AND BETA ANALYSIS

Alpha and beta are terms commonly used in market finance. Alpha-beta analysis in market finance is used to assess the performance and risk of an investment. Alpha measures the outperformance of an asset or portfolio relative to a risk-adjusted benchmark. Beta measures the sensitivity of an asset or portfolio to market movements. It shows whether an asset is volatile than the overall market. Alpha-beta analysis is used to diversify a portfolio by understanding the sources of return (alpha) and market-related volatility (beta). This makes it possible to choose assets that maximise return while managing overall risk.

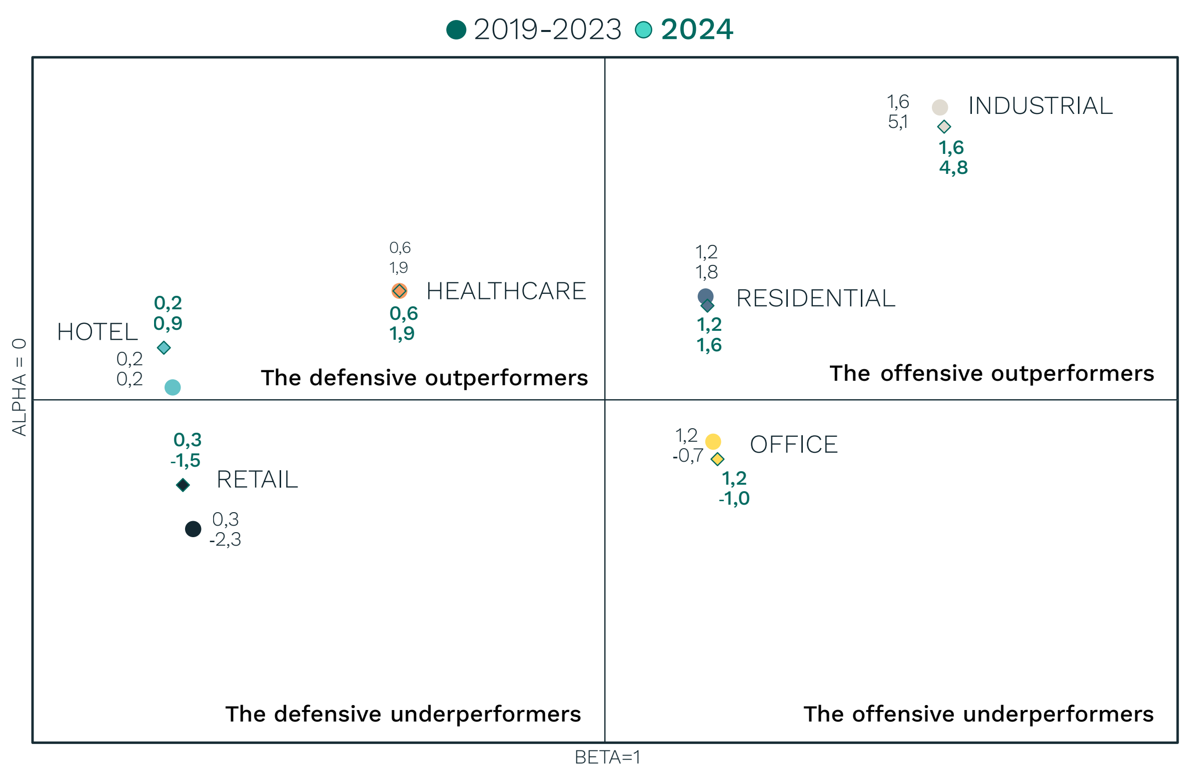
We have calculated alpha and beta over a historical period from 2019 to 2023 to analyse the movements of the cycle we are in.

Over the period analysed, it emerged that residential and logistics were asset classes that were able to capture the market's rise. Hospitality and healthcare are defensive asset classes. Losses in the event of a market downturn were more limited than in other asset classes. In all the European countries studied, healthcare and logistics outperformed the market, while logistics experienced significantly higher volatility than the benchmark. Retail and office underperformed the benchmark and were respectively defensive and offensive asset classes over the period. Retail underperformed in all the European countries studied, but its volatility is lower than the market. This also suggests a rebound capacity for this asset class, which we are beginning to see. Because of the many challenges it has faced, offices have tended to underperform, and residential has tended to outperform, with a lower risk of loss in the event of a market downturn.

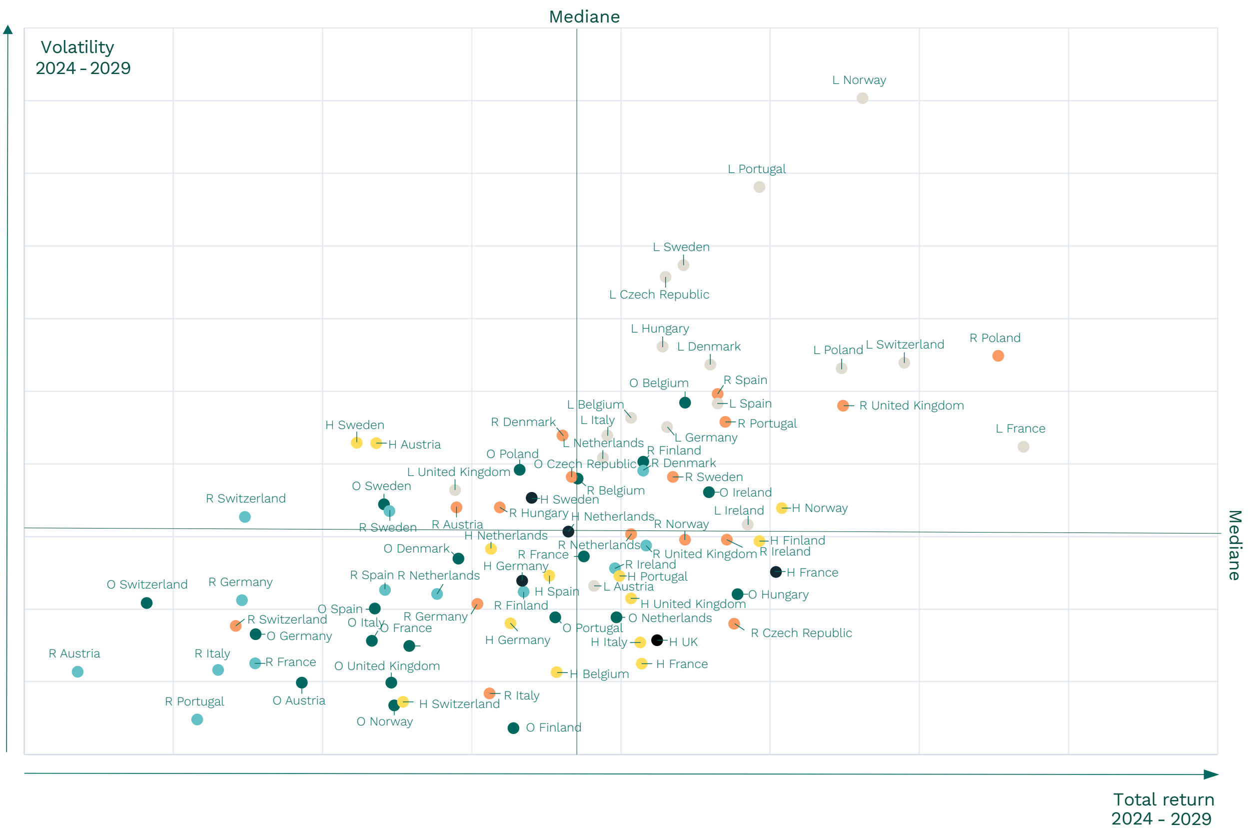
In 2023, more than half the asset classes outperformed the benchmark in the euro zone. The asset class that outperformed the benchmark the most was logistics, followed by healthcare, then residential and hotels.

When the 2024 total return projections are included, alpha and beta remain stable for each asset class.

ALPHA AND BETA OVER THE PERIOD 2019-2024



PERFORMANCE/RISK PROJECTIONS FOR EUROPE'S REAL ESTATE MARKETS 2024-2029



OFFICE SPACE

We expect the total return on office space in the euro zone to average between 4% and 5.5% per annum over the period 2025-2029. As take-up improves and vacancy levels remain high, vacancy rates have begun to stabilise. Central districts have confirmed their attractiveness to users, with vacancy rates remaining at low levels in major cities such as Paris, while conversely some markets are posting vacancy rates in excess of 10%. In terms of performance breakdown, the rental yield will be between 4% and 4.5% due to the fundamentals of the user market over the period 2024-2029. While a negative return is still expected for 2024, capital growth should average between 0% and 1% between 2025 and 2029.

The job market remained resilient in Europe last year, mainly in the major cities; at the same time, the flex office normalised in Europe. After peaking in 2021 during the pandemic and declining in 2022, the proportion of people working from home appears to have stabilised in 2023. However, it is interesting to note that there are disparities in terms of practice in the various European countries. While the UK, the Netherlands and the Nordic countries have high levels of people working from home, the proportion is lower in countries such as France.

The European office market is facing a period of adjustment with:

- flex office organisation (shared workstations);
- the rise of generative AI, with the risk that this new technology represents for traditional office employment, underlining the importance of robust employment growth to support occupier demand;
- and finally, the sustainability of offices.

RETAIL

Our forecasts for the performance of the retail sector in the euro zone between 2024 and 2029 are between 5% and 7% on average, with the major price adjustments seen over the period 2019-2023 explaining this trend. Rental yields, at between 4% and 5% according to our estimates, should drive the performance of the business between 2024 and 2029. While the capital return was negative in 2023, we still expect it to move into positive territory in 2024. By 2029, we expect capital appreciation to average between 1% and 2%.

With the euro zone labour market holding up well, wage growth and savings levels still solid, household consumption will support retail revenues. Private consumption will benefit fully from the fall in inflation, helping to boost purchasing power. However, while we are optimistic about sales, many challenges remain for the sector due to persistently high borrowing rates, household incomes eaten away by hyper-inflation, and rising bankruptcy rates. We believe that the winning cities of tomorrow will be those with a strong appeal to international travellers and those hosting major events. We believe that the outlook for retailer sales growth in these markets will support rental growth. Physical retailing will continue to have to coexist with e-commerce.

LOGISTICS

We expect logistics performance in the euro zone between 2024 and 2029 to average between 5% and 7.5%. It is the rental yield that will drive performance over the period, which we expect to be between 4% and 5%. We expect the capital return to be between 1% and 3%

In addition, the European and national authorities have expressed their desire to develop certain industries related to green energy, batteries, semiconductor production, and advanced technologies locally. Retail users should continue to benefit from the dynamism of e-commerce, even if the growth in the penetration rate is likely to be slower after the peak observed during the pandemic. Logistics will face several challenges over the next few years. Firstly, investment will need to be made in both digitisation and robotics to improve supply chain efficiency and space optimisation. The obsolescence of certain buildings that have not made the transition will accelerate. Secondly, the ESG transformation of logistics will be a challenge because the sector is driven by costs, which could quickly become a negative point for obsolete buildings.

RESIDENTIAL

Our forecasts for the 2024-2029 period point to an overall return of between 4% and 5.5% in the euro zone, up on the 2023-2028 period. Easing borrowing rates, limited supply, a resilient labour market and recent wage dynamics have all contributed to price growth in some countries. Conversely, markets where prices are still on a downward trend can be explained by persistently sluggish demand. Indexation automatically contributes to the stability of residential rental performance, guaranteeing recurring income. By country for 2024, we anticipate that France, Germany, Finland and Austria will see values fall throughout the year. Conversely, Italy, Belgium, Portugal, Spain, Ireland and above all the Netherlands will see residential property prices rise. The medium-term outlook (5 years) remains positive for all the markets analysed. Belgium, Germany, the Netherlands and France all have the potential to bounce back.

The housing market has favourable fundamentals. Indeed, the imbalance between supply and demand for housing will fuel price growth under the combined effect of an easing of conditions for access to credit, a normalisation of inflation on real household income and a gradual fall in lending rates, in line with ECB policy. On the other hand, the growth in the number of households is a factor that supports both rented and purchased properties. In terms of ESG challenges, the residential sector is facing tougher regulations to meet the challenges of reducing energy consumption and decarbonisation. Finally, because of national and local legislation, the European residential market is regulated to protect tenants. Indexation, generally linked to the consumer price index, provides total or partial cover against inflation, depending on the country.

HEALTHCARE

In terms of our forecasts for the period 2024-2029, we expect total returns on healthcare assets in Europe (euro zone) to average between 5% and 7%. The overall return will be driven by the rental yield, which we estimate at between 4% and 5%, and to a lesser extent by capital growth, which will be between 1% and 2%. In terms of the risk/return trade-off, it is worth noting that healthcare is a diversification asset that should be incorporated into a portfolio for optimum diversification, both in terms of volatility and with a view to reducing the portfolio's exposure to economic cycles.

The imbalance between supply and demand for healthcare services and accommodation for the elderly will continue in the years to come. We know that demographic pressure will remain strong and will continue to increase well after 2029. What's more, many European countries have a high level of public and/or private coverage of healthcare costs. The sector therefore has solid fundamentals in its favour. The obsolete part of the nursing home stock will have to be renovated to meet ESG criteria and to protect its occupants, particularly in the event of heat waves. Finally, the lack of supply on the market is a factor in favour of investing in recent, well-located products with a solid operator.

HOSPITALITY

Our forecasts for European hospitality performance in the euro zone over the period 2024-2029 are between 5.5% and 7%. Overall returns will be driven by rental yields, estimated at between 4% and 5%, and by capital growth of between 1% and 2%. We believe that mixing leisure and business hotels allows risk to be diversified and a good level of performance to be achieved. We continue to expect international visitors to continue to grow. What's more, the low level of unemployment and buoyant job market are helping to sustain demand for tourism. By 2029, major international events and the return of tourists to pre-pandemic levels will fuel the sector.

We believe that hotel performance indicators have returned to satisfactory levels. For example, we expect occupancy, average price, and RevPAR to grow more moderately over the next few years than in the post-pandemic reopening years. Regarding ESG challenges, selectivity should drive investors' allocation strategies. The sector will be forced to make major changes to reduce its high energy consumption, with decarbonisation issues at stake.

EFFICIENT REAL ESTATE PORTFOLIOS - THE SMARRT© MODEL BY PRAEMIA REIM RESEARCH & STRATEGY 2024-2029

The following graph illustrates the global allocation recommended by SMARRT©, our allocation model which enables us to steer our real estate investment strategy according to changes in the macroeconomic context.

Our model has identified a few efficient portfolios with a total return of between 4.0% and 5.5%, a slight improvement on last year due to the readjustment of values. It favours geographic and asset class diversification across Europe.

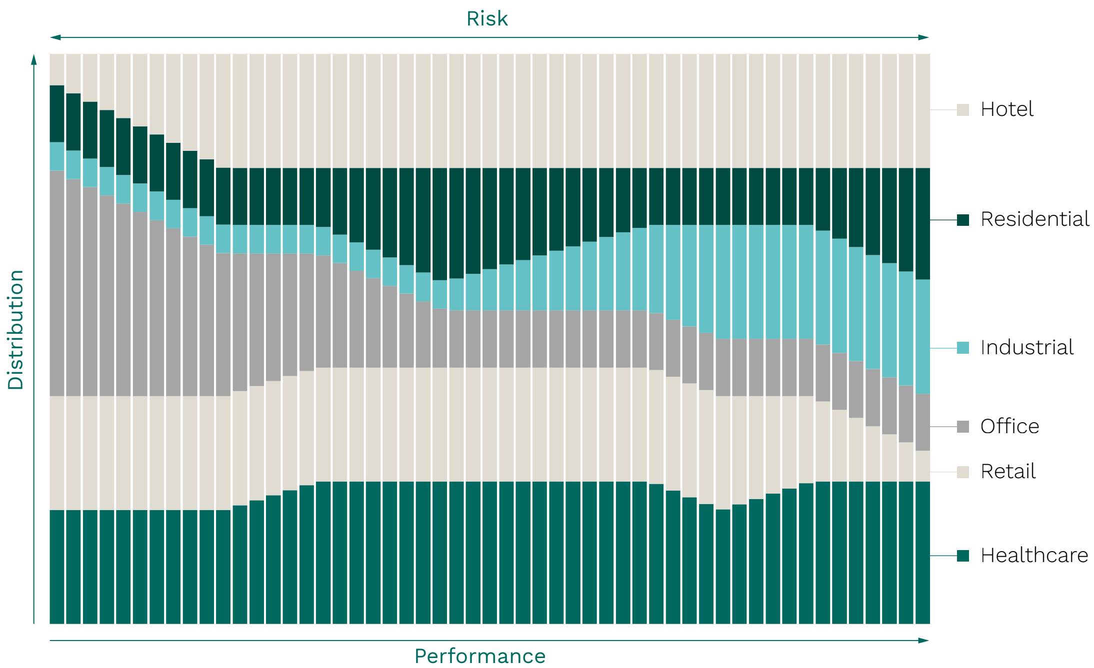
When analysing data to 2029, the model allocates an almost equal share according to strategy between hospitality (20%), healthcare (20%) and retail (20%). The shares of office (10% to 40%), logistics (10% to 20%) and residential (10% to 20%) vary much more according to their own cycle, and therefore their risk/return ratio.

It is interesting to note that the allocations proposed by SMARRT have diversification (60% and 90%) and alternative assets (between 30% and 60%) as their common denominator. The algorithm considers that these asset classes offer an attractive risk/return profile up to 2029.

These data represent reality at a given moment and cannot be frozen in time. An allocation policy must take account of the real estate cycle in each market, to invest at the most appropriate time. The model therefore needs to be adapted to each new situation, so that the allocation changes to maintain the desired risk/return balance. It should also be noted that this is a theoretical model and that allocation constraints have been imposed for each asset class to ensure that the shares allocated correspond as closely as possible to market reality, while avoiding the various human cognitive biases that can have an impact on the investment strategy (confirmation bias, anchoring bias, herd bias, loss aversion bias, overconfidence bias and disposition bias).

The main risks we have identified that could destabilise the global economy and therefore impact our assumptions are an escalation of tensions in the Middle East or in the Russia-Ukraine war, higher interest rates for longer, a financial crisis, an economic crisis or the occurrence of a ‘rare event’.

PROJECTED EFFICIENT PORTFOLIOS BY ASSET CLASS IN THE EURO ZONE OVER THE PERIOD 2024-2029 BASED ON THE SMARRT© MODEL



About Praemia REIM

Praemia REIM brings together 550 employees in **France, Germany, Luxembourg, Italy, Spain, Singapore,** and **the United Kingdom**. The company leverages its values of conviction and commitment as well as its European-scale expertise to design and manage real estate funds for its national and international clients, whether individuals or institutions.

As of December 31, 2023, **Praemia REIM** holds **38 billion euros** in assets under management. Its conviction allocation is composed of:

- **48%** healthcare/education real estate,
- **33%** offices,
- **8%** residential,
- **5%** retail,
- **5%** hospitality, and
- **1%** logistics.

Its pan-European platform manages **61 funds** and comprises over **96,000 individual** and **institutional investors**. Its real estate portfolio includes more than 1,600 buildings spread across the main asset categories and located in **11 European countries**.

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The Research & Strategy Department's role is to formalise Praemia 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.

Sources used throughout the document: Statistical models Praemia REIM Research and Strategy, CBRE, Savills, BNP PRE, JLL, Knight Frank, MSCI , Oxford Economics, Eurostat, OECD, IMF, 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.

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