PRIMONIAL REIM REAL ESTATE CONVICTIONS 2023 - Q2

AUGUST 2023

An Asset Manager's View of the European Real Estate Markets

ECONOMIC AND REAL ESTATE ENVIRONMENT

"Despite persistent uncertainties, the global economy appears to be holding up better than expected in 2023. Energy prices are moderate, demand is more evenly distributed, and supply is stabilizing. This has led to an improvement in global growth forecasts, now reaching 3.0% for 2023 and 2024. However, risks persist for the Eurozone, and the ECB's monetary policy decisions will be guided by inflation developments. The ECB's decisions have already shown positive results in controlling inflation. ***Despite disparities, the healthcare, commercial, and hospitality sectors have performed well in Europe in 2023.*** *Rising interest rates have increased the cost of debt, but rental yields are supporting overall performance."*

Henry Aurélien NATTER, MRICS
Head of Research, Europe

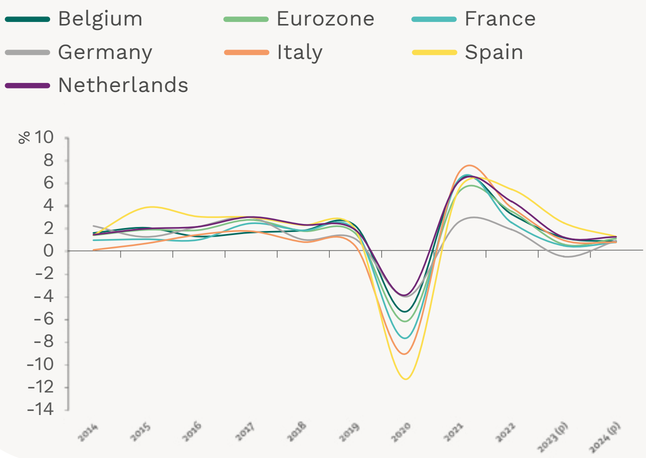
Although some economies contracted towards the middle of the year, global growth could prove more resilient than predicted over 2023 as a whole. Despite continued high levels of uncertainty, several positive factors for the economy have emerged: energy prices are more moderate, demand seems better distributed and supply-chains are being rebuilt with fewer disruptions. As a result, predictions of global growth have improved on previous forecasts and now stand at 3.0% for both 2023 and 2024.

Whilst euro zone economic activity has so far withstood the significant supply shocks, the threat of contraction remains (geopolitical tensions, high inflation, effects of higher interest rates). Euro zone GDP growth is expected to be positive in 2023 (+0.6%) and 2024 (+1.2%). However, some indicators show that the trend remains fragile. Meanwhile, significant divergence occurred over the first half of 2023, with a group of countries outperforming the European average, while others, such as Germany and Austria, saw at least one quarter of economic contraction. Looking at the main economies individually, GDP growth in Spain is expected to be +2.2% in 2023 and then +1.3% in 2024, followed by Belgium (+1.3% then +1.0%), the Netherlands (+0.7% and +1.4%), Italy (+1.2% and +0.9%), France (+0.6% and +0.8%), and Germany (-0.5% and +0.9%).

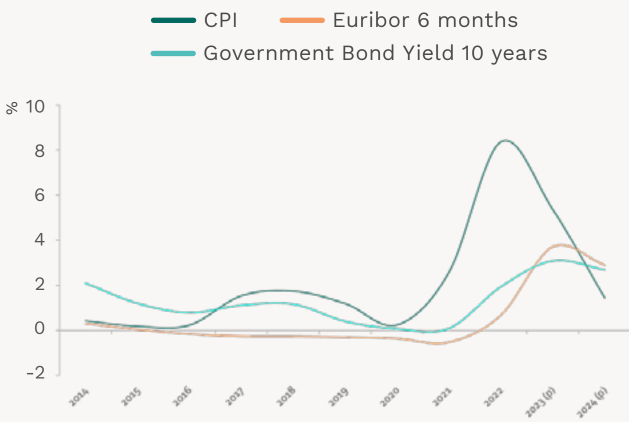
A rate hike beyond July "would at most be a possibility, but by no means a certainty", according to one of the members of the ECB's Governing Council. Euro zone interest rates are therefore approaching their upper level. Indeed the ECB has indicated that it no longer wants to make automatic rate hikes at its forthcoming meetings. The institution wants to ensure that rates are sufficiently restrictive, for as long as necessary, to produce as quickly as possible the return of inflation at its 2% medium-term target. Revised economic forecasts and the trend in inflation, particularly core inflation (excluding energy and raw materials), will therefore be key when it comes to the ECB's monetary choices over the next few months.

The ECB's decisions have been successful, as the harmonised euro zone CPI (consumer price index) fell from 8.6% in January to 6.9% in March and then 5.5% by the end of June 2023. However, by the end of the first half significant disparities between countries persisted. The Baltic states, Austria, Germany, Italy and the Netherlands were still experiencing inflation of over 6%. Countries around the average included France, Ireland and Portugal, where inflation was between 4% and 6%. Lastly, inflation was below 4% in Greece, Spain, Belgium and Luxembourg.

ECONOMIC ENVIRONMENT: EUROPEAN GDP



GOVERNMENT 10-YEAR BONDS, EURIBOR AND CONSUMER PRICE INDICES IN THE EUROZONE



Investors' wait-and-see approach caused a slowing in real estate activity, as a direct consequence of higher interest rates and the continuation of the ECB's monetary tightening.

After a lifeless first quarter, in the second quarter of 2023 the European market became stuck. However, it was investors' selective approach which held the market back. Investment volumes were low, at slightly under €70 billion of commitments in the first six months of 2023, against €160 billion over the same period in 2022. It is interesting to notice that allocation changed, towards greater diversification within real estate envelopes, to the detriment of offices in particular.

Looking at the major countries, investment volumes were over €18 billion in the UK (down 58% over the year), €14 billion in France (-28%), €11 billion in Germany (-53%), just under €5 billion in Spain (-43%), €3 billion in the Netherlands (-63%) and less than €2 billion in Italy (-74%).

Offices remained the largest asset class, with nearly €20 billion, or 30% of the market, followed by retail (€14 billion) and residential (€13 billion) with 20% of the market each, logistics (€12 billion – 18% of the market), hotels (€6 billion, 8%) and healthcare (€3 billion, 4%).

Regarding capital flows, investors have favored their domestic market (58%), led by institutional investors (22%), private investors (22%), users (10%), and listed real estate companies (4%). International capital flows outside of Europe (23%) predominantly came from the United States (15%), Canada (3%), and Singapore (2%), while European cross-border capital flows mainly originated from France (5%), Germany (4%), and the United Kingdom (4%).

Income return is still driving real estate performance. After a period of correction, the duration of which will vary from one market to the other, asset values are likely to enter a period of stabilisation due to the increasingly modest nature of interventions from the ECB. Hotels, retail and healthcare offer the highest return in Europe.

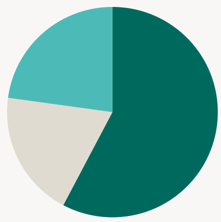
From mid-2022, the ECB adopted a drastic policy of increasing interest rates to bring down inflation. This policy resulted in a rebuilding of the risk premium on different asset classes. However, the trends vary between asset types and markets.

According to the latest total return data, consisting of rental income and capital growth, the hospitality, retail, and healthcare sectors have performed the best in the early months of 2023 in Europe.

The logistics sector decompressed the earliest (starting from the end of 2022) and most significantly. Consequently, it will provide an attractive entry point in terms of valuation, at least for modern assets adapted to the gradual automation of the industry.

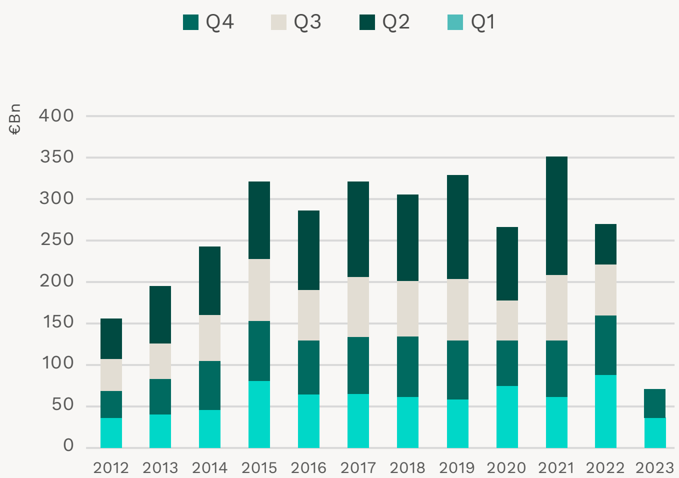
The rapid rise in interest rates has resulted in an increase in the cost of debt. It is the 'capital growth' component that is affected by an increase in the cost of money. It is also this component that will allow investors to seize opportunities once the situation has stabilised. Pending this, it is income return that contributes positively to performance. Because income return is indexed in part or in whole on the European consumer price index, income performance remains on a good track.

CAPITAL FLOWS IN EUROPE (INCLUDING THE UK) BY ORIGIN IN THE FIRST HALF OF 2023

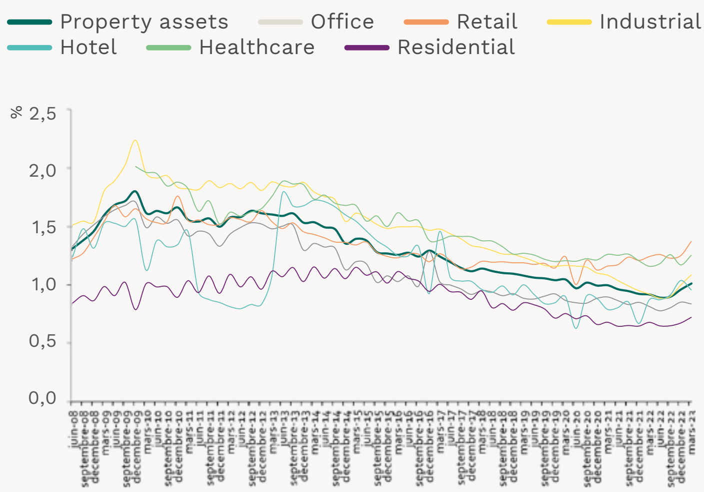


58% Domestic
23% International excluding Europe
19% Cross-border Europe

REAL ESTATE INVESTMENT VOLUME IN EUROPE



QUARTERLY INCOME RETURN OF REAL ESTATE IN EUROPE



OFFICES

Investment in European office real estate – Q2 2023 (6 months)	**€20 bn**
'Prime' yields in Europe – Q2 2023/Q4 2022	↗
Take-up in Europe – Q2 2023 (6 months)/Q2 2022 (6 months)	↘
Vacancy rates in Europe – Q2 2023/Q4 2022	↗
Rents in Europe – Q2 2023/Q4 2022	↗
Job creation – Q2 2023/Q4 2022	↗

The slowing of the investment market observed in the first quarter of 2023 was accentuated in the second. Investors opted to take their time due to the current lack of visibility on sovereign bond yields and the uncertain climate. Despite this slowdown, offices remained the leading asset class in terms of capital allocation. Total investment volume in the European office real estate sector was more than €20 billion in the first half of 2023 (down 63% over a year). Thanks to Paris, France is the country that showed the greatest resilience and became the largest office market in Europe, taking the lead with around €6.5 billion (-21%), followed by the United Kingdom with €5 billion (-65%) and Germany at around €3 billion (-67%). Commitment levels were below €1 billion in Spain, Italy, the Netherlands and Belgium.

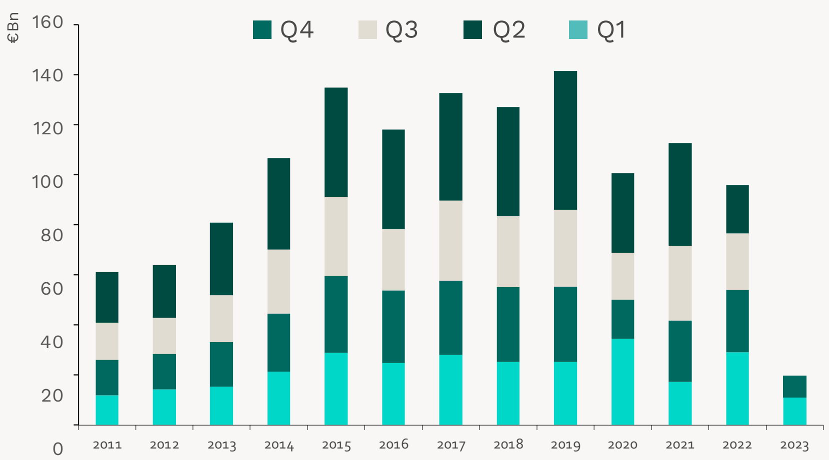
A large majority of European office markets[1] had seen a decompression of yields by the end of the second quarter of 2023 relative to end-2022, due to the sharp rise in bond rates. Decompressions of between 10 bp and 100 bp were seen in office real estate markets between the end of 2022 and the second quarter of 2023. The most 'prime' markets now have a yield of less than 4.5% in cities such as Paris, London, Munich, Vienna, Madrid, Helsinki and Milan. Markets with yields of 4.5% or above include Lisbon and Rotterdam.

Activity in the European rental market was held back by users taking their time and seeking to optimise costs, despite continued job creation. Offices take-up totalled more than 4.7 million sqm in the first second quarter of 2023, a fall on the 5.5 million sqm let in the same period in 2022. Paris saw 816,000 sqm of satisfied demand, followed by London, Berlin and Munich, where new lease volumes were between 250,000 sqm and 350,000 sqm. Mixed-use districts (offices, retail, residential) and hybrid buildings appeared to be the most sought-after by users seeking to improve the employee experience. Companies are giving priority to offices which are no longer merely workplaces, but locations where employees enjoy spending time. **There has been confirmation of user interest in central districts and modern, flexible properties meeting ESG criteria.**

Although supply increased between the end of 2022 and the second quarter of 2023, some markets saw an absorption of vacancies. In the central districts of cities such as Paris, Berlin and Munich vacancy rates remain below 5%. Conversely, Barcelona, Madrid and London City still have vacancy rates over 10%.

Rents have been rising since the beginning of the year. The Paris CBD has the highest rent levels in the euro zone, at more than €1,000/sqm for the most sought-after assets. Rents in Berlin, Frankfurt, Munich and Milan run at €500 to €700/sqm and those in Brussels, Madrid and Barcelona are around €250 to €450/sqm.

EUROPEAN OFFICE REAL ESTATE INVESTMENT VOLUMES



1/ Of nearly one hundred European markets analysed by Primonial REIM Research & Strategy

RETAIL

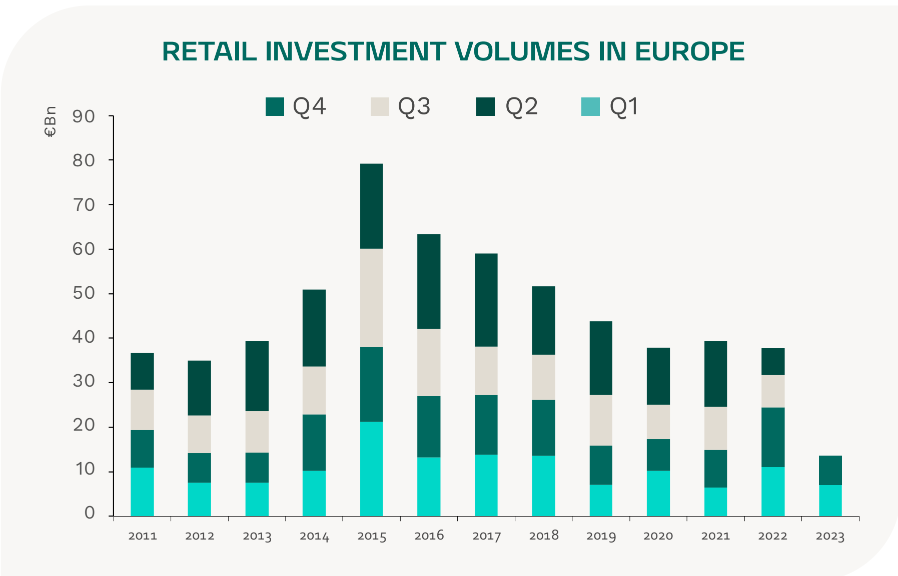
INVESTMENT IN RETAIL REAL ESTATE IN EUROPE – Q2 2023 (6 MONTHS)	€14 bn
PRIME HIGH STREET YIELDS IN EUROPE – Q2 2023/Q4 2022	↗
PRIME YIELDS IN EUROPEAN SHOPPING CENTRES – Q2 2023/Q4 2022	↗
E-COMMERCE PENETRATION RATES IN THE EURO ZONE – 2023	↗
RETAIL SALES IN THE EUROZONE – Q2 2023/Q4 2022	↗

Although transaction volumes in the retail segment were also affected, it is one of the least impacted asset classes. Total investment volume in the European retail real estate sector was over €14 billion in the first half of 2023 (down 22% year-on-year). The UK was the most active market with nearly €4 billion invested in the first half of 2023, followed by France with over €3 billion, Germany with nearly €2.5 billion and Spain with under €1 billion. By contrast, Italy and the Netherlands did not see their markets take off, with less than €500 million invested since the start of the year.

Yields on the majority of high street stores and shopping centres saw a decompression by the end of the second quarter of 2023. Yields decompressed by between 5 bp and 50 bp for high street and by between 10 bp and 30 bp for shopping centres between the fourth quarter of 2022 and the second quarter of 2023. Prime yields on high street in Paris, Amsterdam, Munich, Vienna and Madrid were 4.5% or less. Yields in Helsinki and Dublin, for example, were 4.7% or higher. In shopping centres, yields in Paris, the large German cities and Vienna came in under the 5.5% mark, whilst in Helsinki, Madrid and the major Italian cities were above this level.

Household consumption is likely to be moderated over the first six months of 2023. High levels of inflation have continued to put pressure on disposable income, whilst persistent uncertainty has put the brakes on consumer spending. Real household disposable income was on a downward trend in the early months of 2023, due to high inflation and despite the support from robust trends in the labour market. For the time being, store revenues saw year-on-year growth of around 7% by the end of the second quarter of 2023, with countries such as Belgium, the Netherlands and France outperforming. Although Germany, Italy and Spain all put in good performances, they were below the European average. Across the euro zone as a whole, retail sales volumes were once again down relative to the third quarter of 2022. This reflects the fact that increased store revenues continued to be driven by higher prices and not by volume growth.

Rental values on the majority of high street stores and the most attractive shopping centres were stable or rising by the end of the second quarter of 2023. However, some markets saw corrections. A large majority of high street stores and shopping centres saw stable rental values. **The locations most sought after by retailers had seen a fresh increase in rents by the end of the second quarter of 2023 relative to end-2022.**



RESIDENTIAL

INVESTMENT IN RESIDENTIAL REAL ESTATE IN EUROPE – Q2 2023 (6 MONTHS)	€13 billion
'PRIME' YIELDS IN EUROPE – Q2 2023/Q4 2022	↗
RESIDENTIAL PRICES IN EUROPE – Q2 2023/Q2 2022	↘
HOUSEHOLD INCOME IN THE EUROZONE – Q2 2023/Q4 2022	↗

After the strong level of activity in 2022, investment in 'block' residential in Europe remained at a low level, with the biggest impact coming in the northern countries and Italy. Variable rate loans are widely used in certain countries and continued to depress asset values (notably in Sweden). The total market was worth €13 billion in 2022, down 62% year-on-year. Within the euro zone, Germany saw total investment of over €3 billion, followed by France, Spain and the Netherlands with over €1 billion each. Outside the eurozone, the UK market was the most active, with investment of nearly €4 billion, followed by Sweden with nearly €1 billion and Denmark with €500 billion.

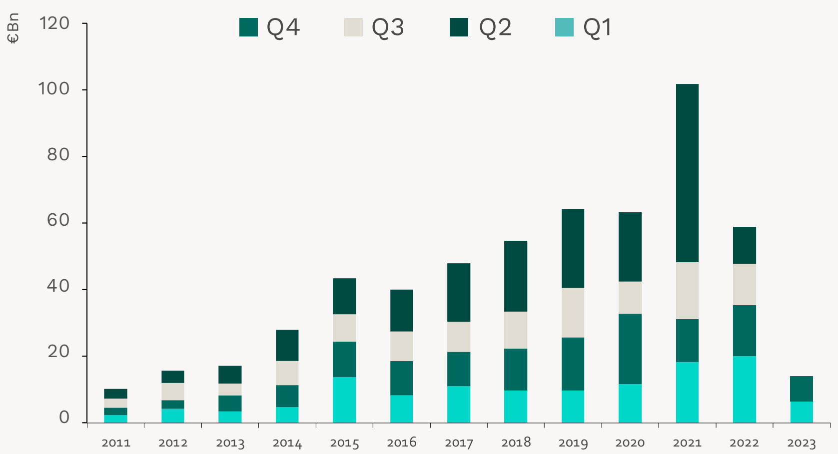
Some decompression was observed in prime yields due to the rise in interest rates. In the euro zone, Paris and Munich still have 'prime' yields below the 3.0% level, with decompressions of between 20 bp and 30 bp since the beginning of the year. Other major European cities followed a similar trend, with decompression of between 10 bp and 40 bp. Some markets have not seen a correction so far, but readjustments could come later in 2023 or at the beginning of 2024.

Euro zone consumer price inflation (CPI) remained high, but has been on a downward trend since the start of 2023. For residential real estate, CPI will be passed on, in whole or in part, through rent reviews under the indexation mechanisms in use in each country. The countries which had inflation above the European average were Austria, Germany, Italy and the Netherlands. Countries at or below the average included Spain and France. Meanwhile, rent control regulations and the carbon tax may, depending on the country, have an influence on rent trends.

Residential construction in Europe appears to have slowed in the second quarter of 2023, with different trends in different countries. Construction costs remained high in the second quarter of 2023. This background affected accessibility for households, resulting in a slowdown that can be seen in the downward trend in new building permits since the beginning of the year.

Housing prices in the euro zone continued to fall on annualised figures, but not all markets were affected. On average, residential prices in the euro zone began to fall during the second quarter of 2023 (-2.5% q/q). Prices rose in Portugal (+6.2% q/q), Spain (2.0%), Ireland (+1.4%) and Belgium (+1.1%), but saw corrections in France (-0.3%), Italy (-1.6%), Austria (-3.0%), Finland (-3.9%), Germany (-5.2%) and the Netherlands (-5.6%). Lastly, it should be noted that the introduction of energy performance standards for buildings has a direct impact on properties with poor thermal performance, with such assets selling at a discount of around 15% to the prices of better performing assets.

INVESTMENT IN BLOCK RESIDENTIAL REAL ESTATE IN EUROPE



HEALTHCARE

INVESTMENT IN HEALTHCARE REAL ESTATE IN EUROPE – Q2 2023 (6 MONTHS)	€3 billion
'PRIME' YIELDS IN EUROPE – Q2 2023/Q4 2022	↗
FORECASTS OF BED DEMAND BY 2030 IN EUROPE	↗

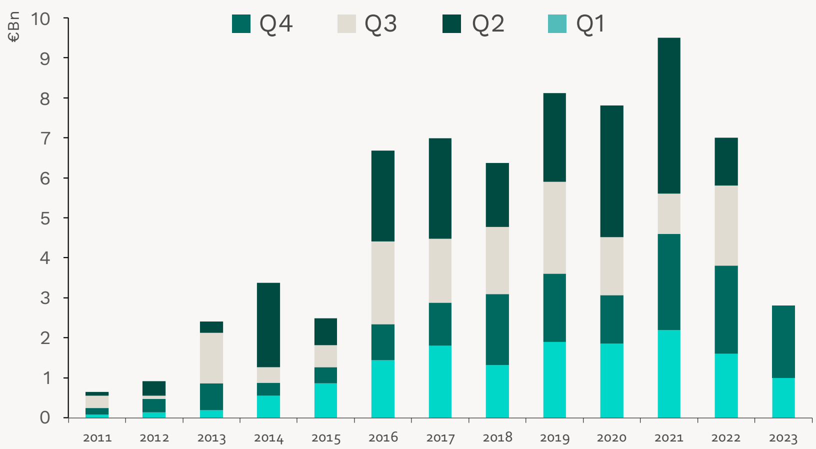
Healthcare real estate (senior residences and nursing homes) was one of the asset classes that have proved resilient, with investment volumes of around €3 billion in Europe in the first half of 2023 (-28% year-on-year). In Europe, although France recorded €200 million in investment in senior residences and nursing homes, the market was driven by Primonial REIM's acquisition of Icade Santé, whose portfolio consists mainly of clinics in France, with asset value of more than €6 billion. This was one of the biggest deals of recent years. The German market was also strong, with nearly €1 billion invested in the first half of 2023, followed by Sweden and the United Kingdom with around €500 million each. Belgium and the Netherlands each saw total investment of just under €400 million.

'Prime' yields on healthcare real estate saw a limited decompression between the end of 2022 and the first half of 2023, demonstrating that this asset class does not suffer the same vulnerabilities as the others. Some markets have already stabilised. In France, the UK, Belgium and Austria 'prime' yields were at or below 4.50% for nursing homes. 'Prime' yields in Germany, Italy, Spain, the Netherlands, Finland, Ireland and Portugal were above 4.50% for nursing homes. In the German market, financial difficulties of a number of mid-sized operators disrupted matters at the beginning of the year but this remains an isolated phenomenon. The way in which operators will respond to shortages in care staff will be decisive for growth in the sector, particularly as professional standards are likely to rise. Lastly, 'prime' yields from clinics also saw a slight decompression at the start of 2023, relative to the end of 2022, but have stabilised since then. They were 5.0% or below in France and Germany and close to 6.0% in the Netherlands.

The average price per bed in Europe was €188,000 in the second quarter of 2023, an increase quarter on quarter. The most 'prime' assets changed hands at around €230,000 per bed, with assets in the bottom quartile trading at the €145,000 mark on average over the quarter. In France prices averaged close to €195,000 per bed; Germany followed, after a rapid increase took the average to €191,000. In Spain and Italy beds traded at an average of over €115,000 for the quarter. Outside the euro zone, the United Kingdom saw transactions running at an average of €215,000 per bed, while in Denmark the average was over €155,000. Sweden saw the highest average price, at around €300,000 per bed, whereas in Poland the average was less than €100,000.

The senior population is generating growing demand in European countries. The renovation of the existing asset base and the construction of new buildings is crucial in meeting this new demand. Assistance or medical care will be needed with the loss of autonomy, especially for the number of over-75s, which will rise from 44 million in 2020 to more than 66 million in 2040 in the European Union (excluding the United Kingdom). Dependency can become critical over the age of 75. With 13 million individuals, Germany will have the largest population aged over 75 by 2030, followed by France with 10.5 million. Spain, Italy and the Netherlands follow close behind the euro zone's heavyweights, with strong growth in their population of over-75s, which will range from 3 to 10 million individuals across these countries by 2040.

SENIOR RESIDENCES AND NURSING HOMES INVESTMENT VOLUMES IN EUROPE



HOTELS

INVESTMENT IN HOTEL REAL ESTATE IN EUROPE – Q2 2023 (6 MONTHS)	€6 billion
ROOM OCCUPANCY RATES IN EUROPE – Q2 2023 (6 MONTHS)/Q2 2022	↗
REVPAR IN EUROPE – Q2 2023 (6 MONTHS)/Q2 2022	↗
AVERAGE PRICE PER NIGHT IN EUROPE – Q2 2023 (6 MONTHS)/Q2 2022	↗
'PRIME' YIELDS IN EUROPE – Q2 2023/Q4 2022	→
EXPECTED TOURIST ARRIVALS IN EUROPE – 2023/2022	↗

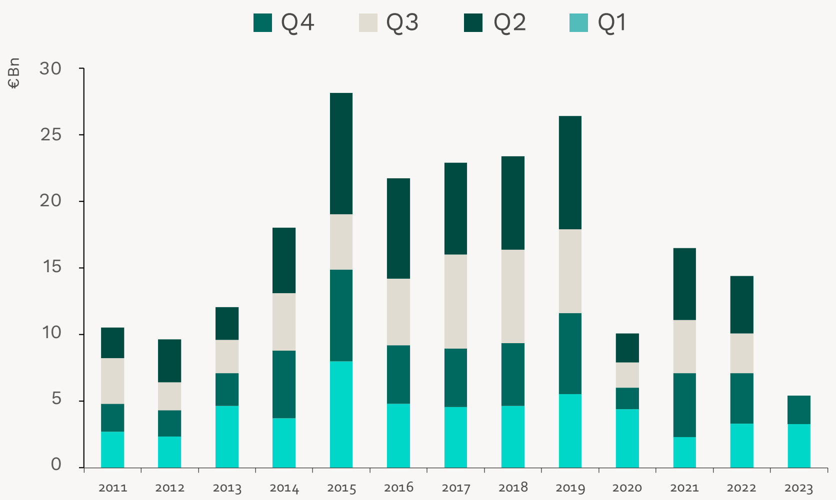
Capital committed to hotels held up well in the first half relative to other asset classes. The hotel real estate market was worth €6 billion in the first half of 2023, down 19% year-on-year. Investment was focused on France, with a volume of nearly €2 billion, followed by Spain with more than €1 billion committed and then the United Kingdom with a little less than €1 billion. Germany saw total investment of €400 million, followed by Italy and Portugal with under €300 million.

A slight majority of 'prime' yields on hotels were stable over the first half of 2023 relative to the final quarter of 2022. 'Prime' yields on leased hotels, based on rental profitability, held up very well and remained under 4.5% in London and Paris over the first six months of the year. In the big German cities along with Madrid, Milan, Amsterdam, Brussels, Lisbon and Athens yields are between 4.9% and 7.25%. 'Prime' yields for hotels under management contracts, which allow hotel owners to capture value from both the operation of the hotel and the real estate asset, offer a yield of between 5.75% and 9.5%.

The number of hotel rooms sold or let in Europe saw another solid increase in the first half of 2023 (+16% up over a year) linked to the recovery in traveller numbers in Europe, although these are still lower than in 2019. Tourist arrivals have continued to see solid growth, confirming a normalisation of travel habits across Europe. This recovery has been driven largely by travel within Europe, which is considered cheaper and lower risk given current uncertainties. Europe is also an attractive destination for US tourists, due to the current strength of the dollar. Arrivals from the Asia-Pacific region have begun to recover, and the gradual increase in their numbers will follow the recovery of tourist arrivals in Europe. For the time being, the trends observed have allowed up-scale hotels (+20% since the beginning of the year) and the luxury category (+15%) to bounce back strongly. Budget hotels, which had suffered less, continued to perform well (+7% over the year). The mid-range category also made strong gains of between +16% and +18%.

Hotel industry indicators were positive throughout the first half of 2023. Hotel occupancy rates in Europe grew by 67% year-on-year. Average prices also rose, reaching €137 per night at end-June 2023, from €121 at the same point in 2022. RevPAR continued to rise, hitting €91 from just €70 a year earlier. By category, only budget hotels stood out, with an occupancy rate of nearly 73%, with other categories at between 59% and 67%.

INVESTMENT VOLUMES FOR EUROPEAN HOTELS



Sources used throughout this document: Primonial REIM Research & Strategy, Immostat, CBRE, Savills, BNP PRE, JLL, Knight Frank, MSCI, Oxford Economics, Eurostat, OCDE, 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, STR, Operators

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 **€42 billion** of assets under management. Its conviction-based allocation breaks down into:

- **47%** healthcare/education,
- **35%** offices,
- **8%** residential,
- **5%** retail,
- **4%** hotels,
- **1%** logistics.

Its pan-European platform manages **61 funds** and has more than 100,000 investor clients, **55%** of which are **institutional investors** and **45% individual**. Its real estate portfolio consists of more than 1 695 properties (offices, healthcare/education, retail, residential, hotels) located in **10 European countries**.

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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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