Real Estate Trends Q1 2021

***by* Amundi Immobilier**

Confidence must be earned

Real Estate

Covid-19 resulted in segmentation of the real estate markets

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Economy

2020 was marked by the Covid-19 pandemic, which caused a drop in global GDP due to lockdowns and travel restrictions, which varied from country to country.

Europe in particular was affected, with an estimated y-o-y drop in GDP of approximately 7% in the eurozone. The job market stalled significantly, although this effect was mitigated by the extension of job protection measures, which prevented the unemployment rate from soaring (8.3% in December versus 7.4% in January). Inflation reached -0.3% y-o-y in December 2020, unchanged from the previous month.

The budgetary and monetary policies were particularly active, in light of Covid-19.

We should also note that an agreement on Brexit was signed between the United Kingdom and the European Union at the end of 2020.

Real GDP growth (%)

	2020 (bracket, forecast)	2021 (bracket, forecast)
World	-3.9/-3.3	5.0/5.7
Eurozone	-7.0/-6.8	3.0/3.5
Germany	-5.1/-4.9	2.7/3.2
France	-8.5/-8.3	4.4/5.0
Italy	-8.9/-8.7	3.2/3.6
Spain	-11.1/-10.9	3.9/4.4
United Kingdom	-11.1/-10.5	3.0/3.5

Source: Amundi Research (January 29, 2021)

Leasing markets

Covid-19 did not affect all European commercial real estate the same way. Hotels and non-food retail assets were most affected, with temporary closures as well as a significant decline in tourism. Overall, the rental values on the retail market were revised downwards.

Leasing activity in logistics was nevertheless very resilient due to online retail activity, which is a driver of leasing demand. Prime headline rents in Europe were roughly stable in 2020, with some occasional increases. It should be noted that logistics is also partially tied to physical retail, which means that the dynamics are not homogeneous.

For office space, lettings were down sharply in 2020, at around 40% y-o-y on average for a sample of 28 markets in Europe. After several years of high take-up, the economic and health context sharply reined in leasing activity. First, the lockdowns and travel restrictions naturally limited visits and shifted companies' attention towards ensuring the continuation of their businesses during the lockdowns. The lack of visibility on health and economic matters made companies less inclined to make real estate decisions, all the while that issues relating to working methods increased. As a result, companies took a "wait and see" approach. Some cancelled or postponed certain projects and opted instead to renegotiate or extend their leases.

In light of the strong slowdown in leasing activity, office vacant space increased in 2020 on many markets, and subleasing was also observed.

At the end of 2020, the average vacancy rate in 15 European countries was 7.8% according to CBRE, reaching levels similar to those seen in 2017. It is significantly below the ten-year high with, it should be noted, a pre-Covid vacancy rate that was nearly 100 pb lower than the one prior to the great financial crisis of 2008. Of course, there are major differences depending on the city as well as across geographic sub-sectors. For example, the average vacancy rate in Paris region is around 6.5%, while it is less than

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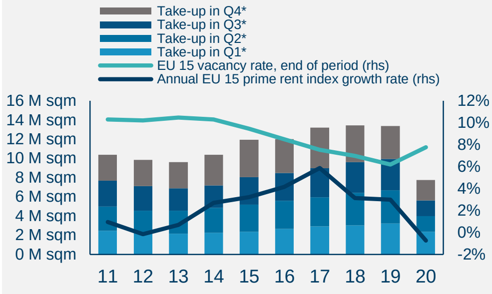
3% in Berlin and more than 9% in Milan, with a significantly lower rate in the centre of the capital of Lombardy.

The rent dynamics were changed significantly by Covid-19 and its consequences: after a slowdown in growth of prime headline rents in 2019, these were generally stable y-o-y, with, however, a slight decline on average in the EU-15, with differences across cities, sectors and asset features. More generally, Covid-19 increased the negotiating margins on new leases in tenants' favour, which is reflected in particular by higher commercial incentives, although, once again, there are geographical disparities.

European office market



*Take-up in 28 European markets
Source: Amundi Immobilier on CBRE Research (Q4 2020)

Investment market

The European commercial real estate investment market has been more resilient than the leasing markets, with a decline of around 22% compared to 2019.

With more than 210 billion euros invested, the volumes are actually close to the ten-year average. This activity shows that investors' demand for commercial real estate has not dried up, unlike during the great financial crisis of 2008: the 2007 volumes were nearly cut in half in 2008, and only around 80 billion euros were invested in 2009, compared to the approximately 70 billion invested in Q4 2020 alone. Similarly, real estate lending continues, although it is more selective than before Covid-19.

Germany has maintained its leading position on the European market in terms of volume invested in commercial real estate, followed by the United Kingdom and France. In particular, we note the relatively strong activity in Belgium, driven by a large transaction, and in Portugal and Norway.

In light of the travel restrictions, a decrease in foreign investment was seen in 2020.

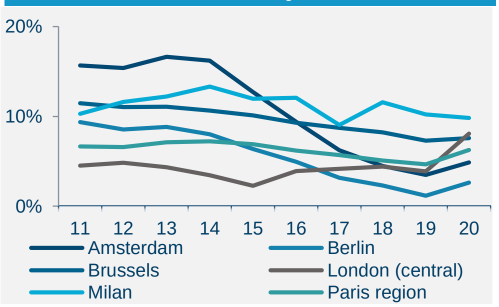
Although down a little more than 30% y-o-y, offices remained the leading asset class. We are seeing increased investor appetite for residential (not counted here) and logistics. The volumes invested in logistics and business premises exceeded by a small margin the volumes invested in retail assets. We would like to note that food retail, considered fairly resilient in the face of Covid-19, have been the subject of some enthusiasm in France, for example.

A significant development in 2020 was the increase in investor risk aversion. This emphasis on the visibility of rental payments favoured an even more vigorous analysis of tenants' financial strength and a certain divergence in terms of market yield, both between asset classes and between assets of the same category.

In terms of asset classes, hotels and non-food retail assets overall saw an increase in market yields, and decreases in prime yields were seen on several logistics markets, which at the end of 2020 were reporting historically low income returns. For offices, which are expected to remain a key element for companies, investors are incorporating into their thought-process the acceleration in trends such as remote working, particularly in terms of flexibility of surface areas. Prime yields were generally stable in 2020, with slight declines in Germany, for example. This highlights that investors have a certain degree of confidence in prime office spaces.

More generally, the greater focus on quality assets, with long lease terms and strong tenants, was an element that helped keep prime yields low, which led to resilient prices. However, assets with vacancies, short-term

Office vacancy rates*



*at period end
Source: Amundi Immobilier on CBRE Research (Q4 2020)

Key takeaways

- Covid-19 did not affect all European commercial real estate the same way. Hotels and non-food retail assets were particularly affected
- Leasing activity in logistics was nevertheless very resilient
- For office space, lettings were down sharply in 2020, at around 40% y-o-y on average
- At the end of 2020, the average vacancy rate in 15 European countries was 7.8% according to CBRE, reaching levels similar to those seen in 2017 and significantly below the ten-year high
- The rent dynamics were changed significantly by Covid-19 and its consequences
- The European commercial real estate investment market has been more resilient than the leasing markets, with a decline of around 22% compared to 2019

leases or fragile tenants often saw their yields increase, resulting in a decrease in values, sometimes even significant decreases.

2020 was therefore synonymous with a certain re-segmentation of the investment market, after several years of convergence.

2021 Outlook

Our likely but not certain central economic scenario is an increase in global GDP in 2021; however, the recovery may be bumpy, with epidemic outbreaks and lockdown measures through the fourth quarter of 2021.

In the eurozone, the extension of the lockdown measures and the very incremental roll-out of the vaccination campaign are constraining our forecasts for the first half of the year. We are anticipating much stronger growth in the second half of the year thanks to increased confidence, unleashing of pent-up demand, lifting of major restrictions on mobility and the support of the European recovery plan. Inflation should be modest in the short-term before progressively increasing in 2021, while remaining largely below its objective.

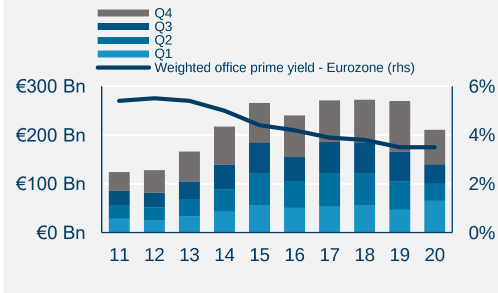
Given this economic scenario, leasing market activity may increase in 2021 after a very slow 2020 but is expected to continue to be restricted. We are expecting an increase in office take-up in Europe in 2021, although it will not regain its pre-Covid level. As long as they are in place, lockdown measures or travel restrictions should negatively impact travel; similarly, a "wait and see" attitude is expected to predominate as long as pandemic and economic visibility is limited. The economic improvement in the second half of the year may encourage decision-making, depending on the health situation. We think that companies will be dealing with greater needs for cost control, and some will seek out central locations close to transportation and quality spaces. This latter trend could make the central areas more resilient, many of which had relatively limited vacancy at the end of 2020. Completions of office spaces should be significant in 2021 and lead to an increase in vacant spaces in 2021. Changes in rent should remain dependent on supply/demand and in particular the vacancy rate, which should promote a certain degree of heterogeneity between cities and geographic sub-sectors. Commercial incentives granted should increase, and prime headline rents should be more resilient in the under-supplied sectors than in the over-supplied sectors, where decreases are expected in 2021.

Logistics should continue to be energised by the growth of e-commerce, although it may remain pluralistic, and increases in market rent are conceivable in 2021 in the under-supplied sectors. Hotels and non-food retail assets should continue to be impacted by probable waves of the virus during the first half of the year.

In 2021, investors' appetite for real estate should remain strong, driven in particular by a gap between the prime real estate yields and 10-year government bonds which is above its long-term average at the end of 2020, and by a 10-year yield environment that should remain low in 2021: for example, the 10-year German government bond yields would still be negative (within a range of -0.5%/-0.3% at 1 year, as at 26/01/2021). Long-term investors may also see real estate as a way to protect against inflation, since rent is generally indexed.

Nevertheless, the context should preserve the trends observed in 2020, with, in particular, a certain risk aversion as well as segmentation in terms of asset classes and asset characteristics. Those with demographic

Real estate investment* in Europe



*commercial real estate
Source: Amundi Immobilier on CBRE Research data (Q4 2020)

Estimate of office prime yield at Q4 2020*

		q-o-q change
Amsterdam	3.00%	→
Berlin	2.65%	→
Dublin	4.00%	→
Düsseldorf	3.00%	→
Frankfurt	2.80%	→
Hamburg	2.70%	↓
London (West End)	3.50%	↓
Madrid	3.25%	→
Milan	3.20%	→
Munich	2.60%	→
Paris region	2.70%	↓
Prague	4.25%	→
Vienna	3.30%	→
Warsaw	4.50%	→

Source : Amundi Immobilier (Q4 2020), brokers
*indicative data, for prime assets let at market rent (Q4 2020)

Key takeaways

- A significant development in 2020 was the increase in investor risk aversion
- Our likely but not certain central economic scenario is an increase in global GDP in 2021; however, the recovery may be bumpy, with epidemic outbreaks
- We are expecting an increase in office take-up in Europe in 2021, although it will not regain its pre-Covid level
- In 2021, investors' appetite for real estate should remain strong, driven in particular by a 10-year yield environment that should remain low in 2021

fundamentals such as residential or health should continue to be particularly attractive to investors, who see them as a more defensive investment in an economic environment negatively impacted by Covid. The prime yields should remain low, with compression margins for logistics as well as offices in locations that are deemed more resilient and of higher quality. Risk aversion should continue to promote price differences between secure assets and other assets, creating, however, opportunities for certain investors who are willing to accept risk.

Therefore, in 2021, the key words in real estate investing should be segmentation and selectivity.

Lexicon

Take-up

Spaces leased or acquired for own use. This does not include lease renewals.

EU-15

Germany, Belgium, France, Italy, Luxembourg, the Netherlands, Denmark, Ireland, United Kingdom, Greece, Spain, Portugal, Austria, Finland and Sweden.

Prime rent

Rent of the most sought-after assets relative to available supply. This is the highest rent for a given asset class and geographical area.

Office vacancy rate

Proportion of unoccupied office space immediately available relative to all existing office space.

Prime yield

Yield provided by leasing under the market conditions of the assets - sometimes few in number - most sought-after by investors relative to available supply. This was the lowest yield for a given asset class and geographic area.

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SOURCES

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