UNDER THE MICROSCOPE: 08 JUNE 2021

Seize the Real Estate opportunity

Key Messages

1. **Pandemic provides Real Estate opportunities:** the global economic dislocation that has resulted from lockdowns provides excellent entry points into Real Estate from a long-term valuation viewpoint. Certain pandemic-hit equity sectors like Travel & Leisure and Retail have rebounded sharply since March 2020; in contrast Real Estate has lagged.

2. **Don't be scared of Offices:** the remote working trend is not the death of the office. Do not ignore the deep psychological need for colleagues to collaborate physically, including networking and boosting creativity as well as supporting psychological well-being. Prime location is key.

3. **Several current property hotspots:** in sector terms, residential, industrial/logistics and specialist (mobile phone masts, data centres, self-storage) combine structural demand growth with good rental yields. Regionally, a number of European prime city locations perform well with low vacancy rates, including Amsterdam, Berlin and Munich.

4. **But Retail assets may not have stabilised yet**: the Real Estate sector we hold back from is Retail, where the long-term effects of the pandemic plus the ongoing trend towards online shopping may put pressure on rental yields and occupancy rates for some time to come. While there may be value, we await stability.

Real Estate has a key role in a diversified portfolio: in an increasingly low-yield world, Real Estate can play a key role in diversifying away from equities and bonds/credit, providing income that is generally inflation-hedged and which is hard to find today in fixed-income. Since 2001, global listed Real Estate has outperformed global equities, sovereign bonds and credit, delivering an annual average 6.3% euro return.

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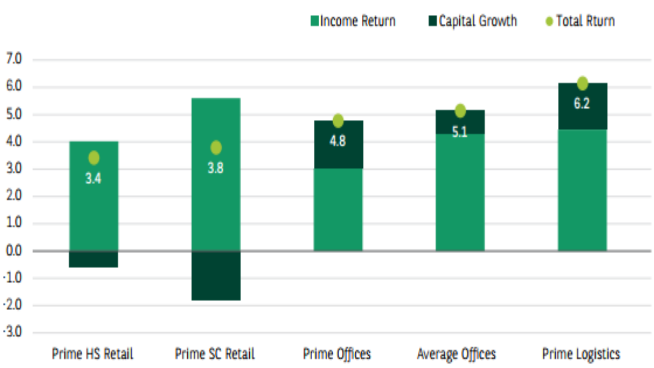
BNP PARIBAS RE RETURN FORECASTS 2021-2025 FAVOUR LOGISTICS AND OFFICES



Source: BNP Paribas Real Estate

Edmund Shing, PhD
Global CIO
BNP Paribas Wealth Management

Post-Pandemic Real Estate opportunities

US and European economies recover faster than expected: ultimately, the Commercial Real Estate (CRE) market is geared to nominal economic growth (real growth plus inflation). Growth/recession drives vacancy rates, rental demand and thus rental growth, and cost of debt financing in real estate.

In mid-2021, vaccination programmes have advanced quickly, with the US and UK close to achieving herd immunity, and Continental Europe catching up quickly. Asia was first to suffer from COVID-19, but was also the first region to recover subsequently, with China's Q1 2021 GDP growth hitting an incredible 18.3% annualised growth rate!

With 6%+ GDP growth forecast for the US and the UK, and 4%+ for the eurozone this year, followed by 4%+ growth again in 2022, the next 18 months should be see a strong recovery in Commercial Real Estate demand, driven by employment gains and strong growth in both manufacturing and services sectors.

Commercial Real Estate (CRE) values have recovered almost back to pre-pandemic levels: according to Green Street, by April 2021 European CRE values had almost returned to pre-pandemic levels, while US CRE prices were only 3% below the February 2020 level.

Commercial Real Estate values have grown much faster than the economy: nominal economic growth (including inflation) has averaged 3.7% in the US and 2.2% in the eurozone since 2010. Over the same period, US commercial property has averaged a much faster 6.1% annual growth rate, and a strong 3.9% in the eurozone. To this we can add rental yields.

Commercial REITs returned > 6% p.a. in Europe, 12% in US since 2010: since 2000, the low interest rate environment has been a strong support for listed CRE total returns, with the combination of dividend yield and price growth delivering an average annual return since 2010 of 6+% in Europe, and 12% in the US.

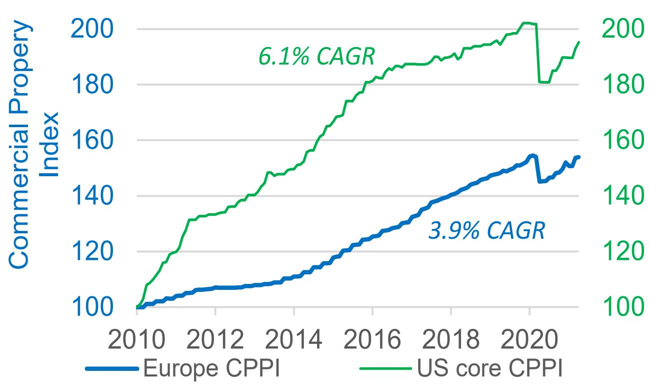
Real estate has delivered solid long-term returns too: if we examine Real Estate returns going back over 30 years, we see a similar strong pattern of returns (price growth + rental yield). Listed European Real Estate has delivered over 7% annual average returns in euro terms since 1993, while the S&P USA REIT index has returned 10% on average per year in US dollar terms since 1990.

Real Estate performs especially well following recessions: in the two years following the 2007-09 Great Financial Crisis, US REITs returned 140% and European REITS 89%, while over the two years following the 2000-03 technology bubble and bust, US REITs returned 80% and European REITs 74%.

For comparison in this cycle, European REITs have only recovered 31% from their late March 2020 lows, suggesting far more upside potential for Real Estate returns..

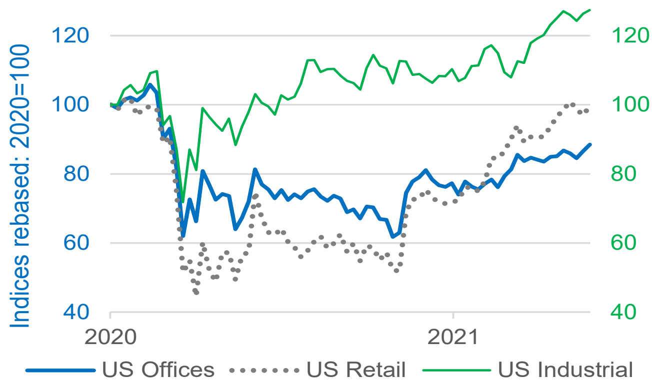
Solid Commercial Real Estate returns forecast: in Europe, BNP Paribas Real Estate forecast **6.2%** average annual returns from logistics and **5.1%** from offices over 2021-25, of which around **4.5%** in rental yield. In the US, BlackRock forecast an average annual return of **6.2%** for core Real Estate over the next 5 years.

EUROPE AND US COMMERCIAL PROPERTY VALUES HAVE INCREASED WELL AHEAD OF INFLATION SINCE 2010



Note: commercial property price indices. Source: Green Street

US INDUSTRIAL REITS NOW OVER 20% ABOVE PRE-PANDEMIC LEVELS, OFFICES AND RETAIL ALSO RECOVERING FAST



Source: Bloomberg

The Death of the Office is greatly exaggerated

Clients are concerned about Real Estate exposure: a number of clients have expressed their uncertainties over Commercial Real Estate exposure, expressing their fears that remote working will render offices redundant, driving vacancy rates sharply higher and putting pressure on office rents. We believe that these fears are greatly exaggerated, for a number of reasons.

Company surveys point to a continued office need: according to recent CBRE surveys, the vast majority of organisations surveyed will continue to require significant amounts of office space, with only 3% of companies anticipating 75%+ of their employees working from home permanently in future.

Companies understand the limits of teleworking: creativity and productivity are high on the list of companies' reasons for wanting to welcome employees back to the office, while employees' mental wellbeing and a need to use an attractive office environment to attract talent are also very widely recognised.

CRE investment has collapsed, cutting new supply: according to BNP Paribas Real Estate, Commercial Real Estate investment in Q1 2021 fell **40%** compared with Q1 2020, with only Ireland escaping a sharp fall. This will inevitably cut the new supply of offices and retail space available in major European cities, supporting the value of existing prime office space.

Office vacancies remain very low in certain cities: Berlin, Hamburg, Munich and Luxembourg all have office vacancy rates well below 5% in Q1 2021 despite the pandemic, with Europe overall at a 7% average vacancy rate for the period.

We will still need offices: companies have many good reasons to keep hold of office space, despite the obvious economic attractions of reducing rental costs:

1. **Boosting team creativity and productivity**: working can get done more quickly when you see colleagues in person. Being creative in teams is far easier in person and on an informal basis, than over videoconference, text chats and email.
2. **Clean separation between work and home life**: a physical office – one that is separate from our homes – implements a much-needed barrier between work and home life. Remote working, on the other hand, gives way to an unhealthy and imagined pressure that we ought to be constantly available; that the 9pm problem must be tackled immediately because our laptop is with us.
3. **Promotion prospects more limited when full-time remote working**: visibility in the workplace is extremely important for career progression. This is a very good reason for ambitious employees to want to return to the office on a regular basis.
4. **Employees may be too distracted when working at home**: not everyone has the discipline to work productively from home, potentially being distracted by a partner, flatmate, children or pets.
5. **Social interaction, mental wellbeing**: we are social creatures, we thrive on feeling connected to a wider network. Loneliness and depression are some of the most pervasive complaints among remote workers. Shared office space can go a long way in helping us feel connected.

PHYSICAL OFFICES TO BE STILL REQUIRED IN THE FUTURE

% of organisations anticipating different levels of remote work

	Sept	June
No remote work (< 10% full-time remote)	14%	10%
<25% full-time remote employees	25%	27%
25%-75% full-time remote employees	49%	38%
> 75% full-time remote employees	3%	5%
Unsure	9%	20%

Note: Global surveys conducted in June, Sept 2020. Source: CBRE

THE ROLE OF THE OFFICE EVOLVES TO MEET NEW NEEDS

% of organisations: role of the office is important because:

	Sept	June
Provides a place for employees to collaborate, innovate and be productive	100%	95%
Provides a place for the company to reflect its brand and culture	100%	80%
Provides a place for employees to experience community, social interaction	100%	70%
Provides a place for the company to engage and attract talent	87%	80%
Provides a place for managers to oversee employees	6%	20%

Note: Global surveys conducted in June, Sept 2020. Source: CBRE

Real Estate growth focus: Residential, Logistics, Specialist

Real Estate not just Office and Retail: the benefits of a diversified Real Estate exposure via a fund is that investors can also gain exposure to structural growth segments within the Real Estate universe, including:

1. **Industrial/logistics**: warehouse demand is very high in the US, UK and Continental Europe thanks to structural growth in online retail, and also due to higher required inventory levels in manufacturing post COVID-19 supply chain disruption. The sweetest spot is in warehouses and distribution centres on the outskirts of major cities such as London, Paris, Amsterdam and Berlin.

   Everyone wants warehouses: the continued expansion of online retail and now the click-and-collect hybrid retail model remains the key driver of warehouse demand in the UK and Continental Europe. Industrial/logistics still offers a strong combination of positive rental growth and a 5% yield in Europe.

2. **Specialist – datacentres, mobile phone towers**: the advent of 5th generation super-fast mobile internet has boosted the value of mobile phone towers, which are increasingly being spun out of telecoms operators like Vodafone into separate Real Estate entities. Equally well, demand for datacentres in this era of Big Data is another specialist Real Estate segment that is growing quickly. A third fast-growing segment is self-storage, which offers attractive yields and growth potential.

3. **Residential**: in many countries there is now strong growth in "build to let", with long-term apartment building rental demand remaining robust due to structural growth in the number of households and non-nuclear families in the Western world. The solid rental demand is also due to worsening affordability for first-time buyers as house prices rise, forcing young people to rent for longer while saving up for a deposit.

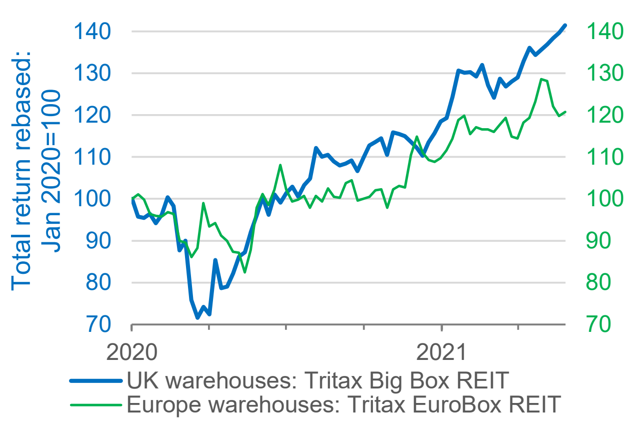
Huge pension fund demand for "build to let" to replace bond income: in a low/no-yield era in sovereign and corporate bonds (particularly in Europe), pension funds with long-duration pension liabilities look for similar long-duration, income-generating assets to replace their bond allocations as their bonds mature.

Building and then letting out residential multi-family apartment buildings is one such attractive alternative for pension funds, alongside allocations to infrastructure and traditional Commercial Real Estate.

The majority of Western European countries continue to suffer from a shortfall of residential housing units, in many cases due to the lack of new construction of additional social housing units by governments and local authorities, as is the case in the UK.

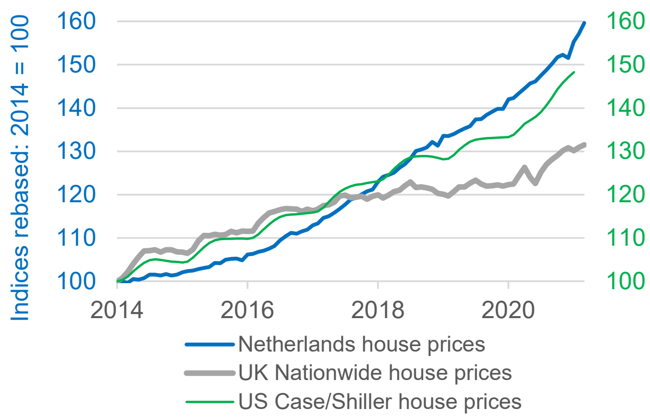
This long-term under-investment in rental residential housing is also an opportunity for institutional investors to make ESG-positive investments in social housing, while building up income alternatives to fixed income.

UK, EUROPEAN WAREHOUSE REITS HAVE PERFORMED VERY STRONGLY



Source: Bloomberg

RESIDENTIAL HOUSE PRICES RECEIVE A HUGE BENEFIT FROM ULTRA-LOW RATES



Source: Bloomberg

But too early to prospect in Retail; wait for stability to emerge

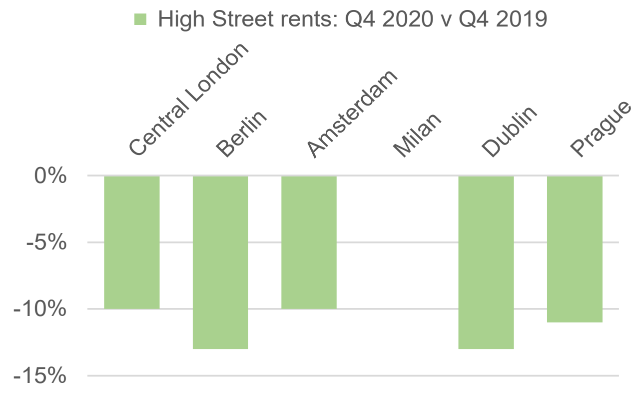
Since sanitary measures were implemented to curb the epidemic, consumers have had to adapt the way they shop. Shopping is now constrained by a number of required new safety protocols including a limit of shopper numbers per square metre and social distancing rules.

The delayed impact of lockdowns on retail revenues and cash flows is likely to result in a greater number of bankruptcies in the retail sector over the next few months.

Overall, prime retail locations are likely to suffer least, while secondary and locations with lower footfall could see sharp downwards revisions in achievable rents over the next 12 months. Overall, with an uncertain outlook for retail tenants despite re-opening, we would remain cautious on retail sector Commercial Real Estate exposure, preferring the industrial/logistics, specialist, residential and office segments.

Despite high current rental yields, BNP Paribas Real Estate forecasts further falls in retail sector capital values in the 2021-25 timeframe, with office and industrial segments offering a better mix of rental yield and positive forecast capital growth over the next few years.

EUROPEAN HIGH STREET RETAIL RENTS FALL IN MOST MAJOR CITIES



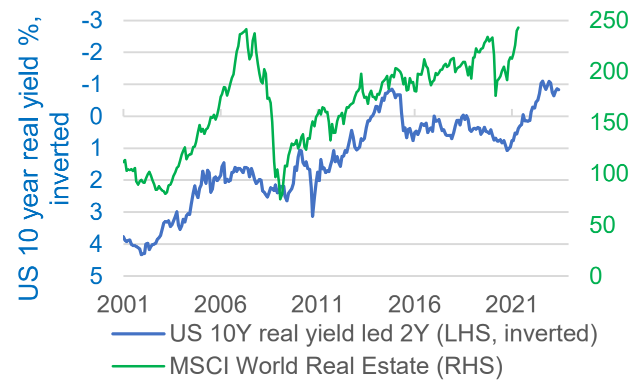
Source: BNP Paribas Real Estate

The role of Property in a diversified long-term portfolio

Real Estate profits from negative real yields: the major central banks will, in our view, be obliged to maintain long-term bond yields at low nominal levels to support governments' ability to finance interest costs. Together with higher inflation, this points to real yields that will remain negative, and perhaps fall further. Historically, this has been a key driver for Real Estate values.

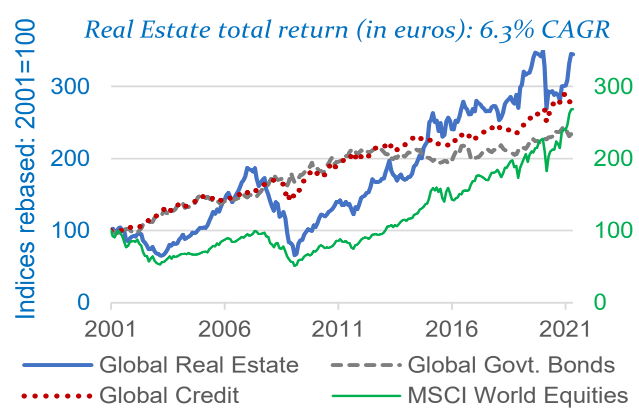
Real Estate has a key role in a diversified portfolio: in an increasingly low-yield world, Real Estate can play a key role in diversifying away from equities and bonds/credit, providing income that is generally inflation-hedged and which is hard to find today in fixed-income. Since 2001, global listed Real Estate has outperformed not only sovereign bonds and credit, but global equities too. Given the valuation dislocations that endure in this asset class, active fund managers can add value over the long term by exploiting the combination of Real Estate yield and capital growth.

NEGATIVE LONG-TERM REAL YIELDS SUPPORT REAL ESTATE VALUES



Source: BNP Paribas Wealth Management, Bloomberg

SINCE 2001, GLOBAL LISTED REAL ESTATE HAS BEATEN EQUITIES, BONDS, CREDIT



Note: total return indices in euros. Source: Bloomberg

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