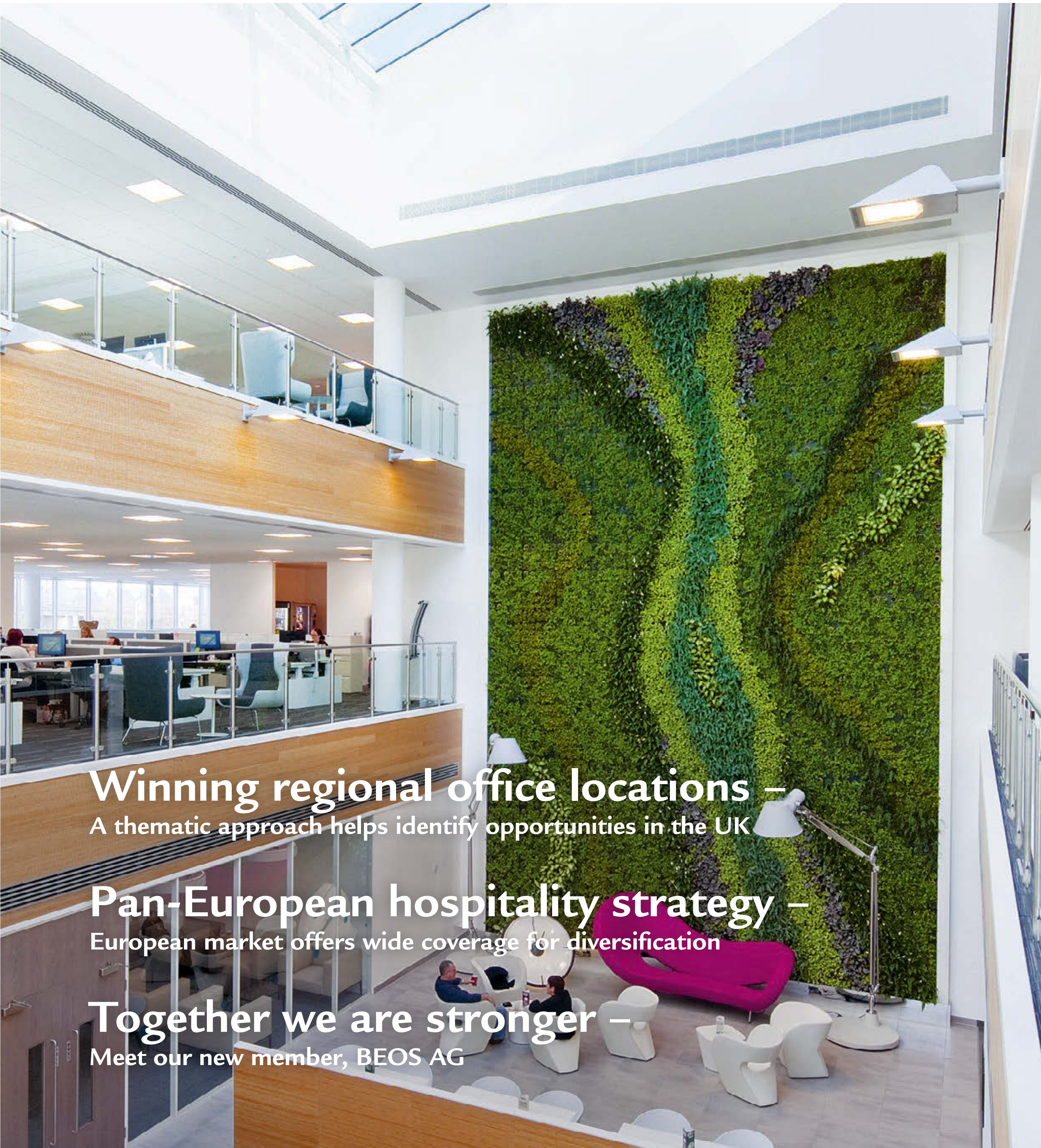
October 2018

Insights

Real Estate

Swiss Life Asset Managers



Winning regional office locations –
A thematic approach helps identify opportunities in the UK

Pan-European hospitality strategy –
European market offers wide coverage for diversification

Together we are stronger –
Meet our new member, BEOS AG

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Editorial

Dear readers

The circle is closing – we seem to have entered the late stage of the economic cycle. As a result, real estate investors are now looking for profitable niches.

In this edition of Insights magazine, we explore some of them for you: learn more about the risk diversification opportunities offered by the pan-European hospitality market in gateway cities. In Germany, an ageing society is driving the need for independent senior housing, which offers sustainable demand. For Switzerland, we look into secure income return strategies fitting the current market environment. And our UK team shares their thematic approach on the search for winning locations within the regional office market and the drivers for future success.

We are also pleased to introduce you to our new member, BEOS AG, and to tell you how we plan to exploit market opportunities together.

I wish you an enjoyable read and fresh insight into current market trends.

Stefan Mächler
Group Chief Investment Officer

Cyclical upswing has passed its peak

Cyclical momentum is moderating across European economies as well as real estate investment markets. This is triggering an intensive search for income growth opportunities.

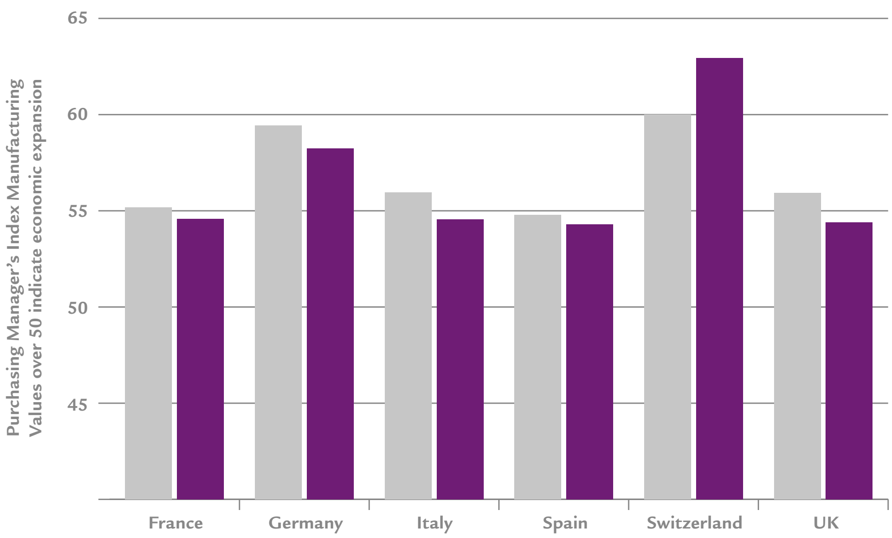
Francesca Boucard, Economist Real Estate, Swiss Life Asset Managers

The European economy witnessed a period of exceptionally high growth rates from late 2016 until late 2017, supported by the synchronous global upswing. Since the beginning of 2018, growth moderation has been the number one topic. But while entrepreneurial spirits are dampened at present by protectionist disputes and the cyclical slowdown is ongoing, growth rates are to remain above potential well into 2019. The exception is the UK, which grew only modestly in the first quarter and is expected to expand below its potential growth rate. At the same time, consumer confidence in the eurozone is still strong, labour markets continue to heal and wage pressures are building in certain countries.

Cyclical momentum is moderating not only in the economies but also in European real estate investment markets. Here uncertainty is slightly higher as the cycle is already quite extended and investors are increasingly unsure where the momentum is heading. Overall, however, the market environment for real estate is still positive. Investment volumes were moderate in early 2018 but we expect this year's levels to be in line with previous years, given the lack of alternative investments, the relatively high risk spread and the economic fundamentals supporting demand.

Growth rates are to remain above potential well into 2019.

Cyclical momentum is moderating



Mean value 2017 | Mean H1 2018 | Source: Macrobond

Nevertheless, with the cycle already well progressed we expect potential from capital growth to be limited. In this environment, the focus of investors is increasingly shifting to alternatives and to properties with strong income characteristics. They may be looking to the healthcare sector, driven by changing demographics, or to cities expected to profit from increased tourism. There is also a greater focus on regional cities, which are expected to grow in attractiveness due to changes in infrastructure, accessibility and an overall increase in quality of life, among other things. ■

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Focus of investors is increasingly shifting to alternatives and properties with strong income characteristics.

The rationale for a pan-European hospitality strategy

Portfolio asset allocation modelling clearly demonstrates the rationale of including a hospitality strategy over a medium to long-term horizon. Exposure to this sector in Europe presents broader geographic coverage and the possibility for greater asset diversification, both of which are key to minimizing risk.

Beatrice Guedj, Head of Research & Innovation, Swiss Life REIM (France)

2017 was another record year for international tourism. According to Eurostat, of the 1.323 billion tourists recorded, 51% visited Europe. Identifying structural drivers will underpin outperformance.

Europe offers a wide spread of "hotspot" cities in historic and/or sunny destinations. This equates to broad geographic diversification in terms of leisure demand and income streams. Commercial exchanges both within and outside Europe drive business travel, with Germany, one of the largest export-led countries, identified as one of the most significant destinations. Targeting both leisure and business markets across the largest countries in Europe (i.e. the "Big 4", Germany, France, Italy and Spain) is therefore a smart diversification strategy. These countries account for almost 60% of total nights spent by non-EU visitors across a wide spectrum of assets, from small and medium to large hotel units of varying star ratings, either for leisure or for business. Our in-house research shows the low correlation between nights spent across these markets: 0.49 between France and Germany, 0.50 between Germany and Spain and 0.12 between France and Spain. An optimal strategy would target the major cities among these "Big 4", as a low correlation across markets diversifies risk and delivers lower volatility of returns.

Bandwagon effect for European cities based on structural drivers

Tourism in Europe has been experiencing an upward trend since 2014, sustained by the recovery of the worldwide business cycle and a structural change related to terrorism risk. France is ranked the most popular destination, with almost 89 million visitors last year. Apart from being a key destination for business travel, France has cities, such as Paris, that boast history, romance and "savoir-vivre". Considering tourism intensity as defined by the number of visitors per inhabitant, the picture is compelling: 18 in Paris compared to 5.4 for France overall. In terms of nights spent in each country, Spain is the most popular, with almost 300 million

Best Western Premier Opéra Faubourg, Paris

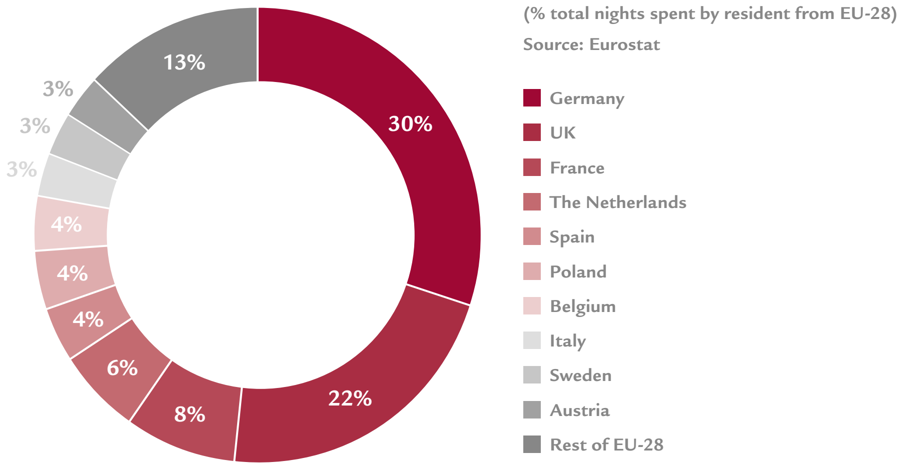
Source: Swiss Life REIM (France)

A pan-European hospitality strategy offers wide coverage in terms of both geographic and product diversification, which is key to minimising risk and delivering stable long-term returns.

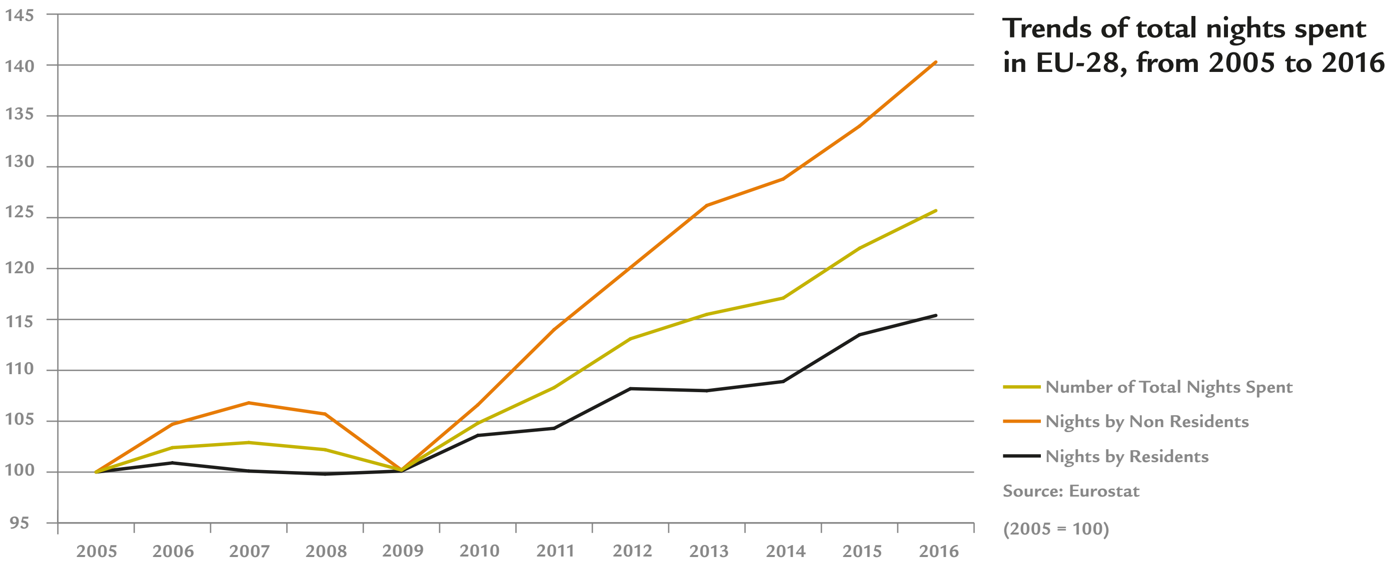
visitors: the Canaries & Balearic Islands along with Catalonia comprise 70% of total nights spent, with a tourist intensity of 22 for Palma and 12 for Barcelona. Italy, with its business and leisure-city anchors such as Milan, Rome and Florence, comes in second as a key destination with 200 million nights spent. Florence is the top performer in terms of tourist intensity in Italy with 24 visitors per inhabitant, far higher than Rome at 9.1 or Milan with 7.3. Finally, German cities are compelling locations to target given their business orientation, which ensures a high level of commercial tourist intensity: 12 visitors per inhabitant in Frankfurt, 9.8 in Munich and 8.7 in Berlin. Germany's business leadership in Europe explains both domestic and international visitors.

In our view, Europe will remain the world's leading destination for both leisure and business travel. Investing in a pan-European strategy, focusing on the key cities of the "Big 4" to optimise portfolio diversification, is tangible and feasible. ■

Share of nights spent abroad by resident 2016



Trends of total nights spent in EU-28, from 2005 to 2016



Ageing society drives demand for senior housing in Germany

As they grow older, elderly people often become less able to manage independent living but many are still in good health and not in need of nursing care. Senior housing offers the opportunity to live in a private household and to make use of services – if required. Not surprisingly, given our ageing society, demand is rising.

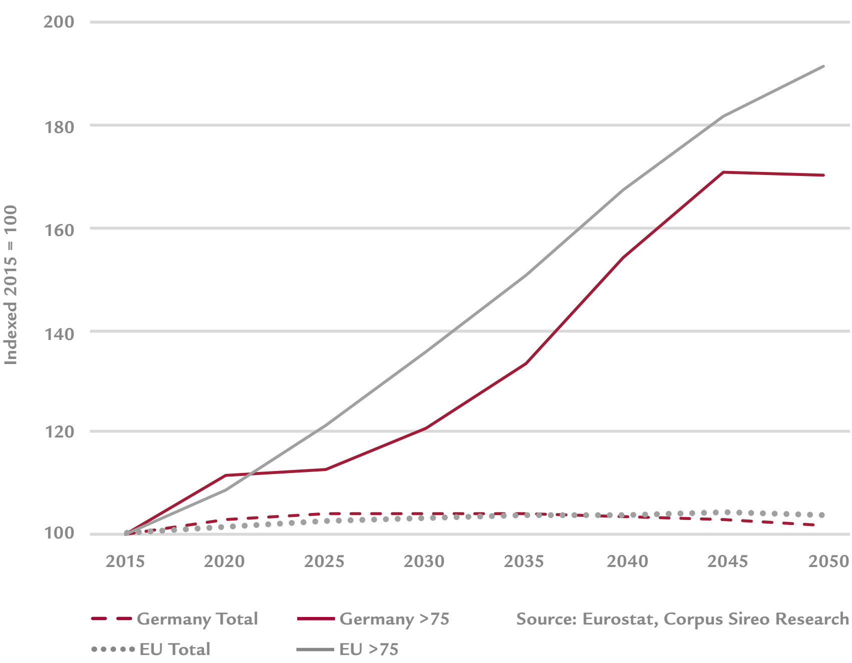
Andri Eglitis, Head of Research, Corpus Sireo

By linking housing and care services, senior housing supports the residents' desire to remain independent but take advantage of housekeeping or healthcare services if needed. In addition, senior housing and nursing homes often allow residents to adjust services if their care requirements change, without forcing them to move and get used to a new environment.

Predicted increase in demand: 70% by 2050

Growing demand for senior housing is a function of a marked increase in the number of elderly people as a result of demographic change, a lack of age-appropriate housing and the ambition of senior citizens to lead self-determined lives in their own apartments. In Germany, the number of people aged 75+, considered the main target group for senior housing due to their increasing health restrictions, was around 8.6 million in 2015 and is predicted to increase by almost 2 million by 2030, and by 70% or 6 million by 2050 – a significant increase, predicted to be even greater across the EU as a whole.

Growth in the number of elderly people in Germany and Europe



Source: Eurostat, Corpus Sireo Research

Enormous supply deficit offers opportunities

At the same time, there is a limited supply of senior housing: the current stock is estimated to be around 350,000 units, in contrast to a demand for at least 500,000 units as recently calculated by Prognos research institute. Even under conservative assumptions, an additional need of around +20% is predicted by 2030. However, actual demand is likely to be much higher. Surveys conducted by the Socio-Economic Panel, a representative longitudinal study of private households, show that the majority of people in need of care do not live in apartments with step-free access. With around 12 million households consisting of senior citizens, some 25% of whom suffer from health restrictions, there is a need for around 2.9 million homes suitable for the elderly. The share of apartments with step-free access is estimated at 1% to 5% of the 42 million flats in Germany. If a share of 3% is assumed we would have a current stock of approximately 1.3 million flats – or a deficit of 1.6 million step-free units, which should grow to around 2.5 million in 2030 in parallel with the ongoing increase in senior households. These figures underline further opportunities for senior housing.

Senior housing as the desired and self-determined way of living

Surveys of the desired form of living in old age reveal a preference for one's own home but also an openness to moving to a new, external institution such as senior housing. Both cases permit independent living but senior housing could be considered more attractive as it offers the ability to downsize to a more manageable apartment size along with additional services and avoidance of the high cost of rendering one's home step-free. A substantial increase in demand for this type of residence can therefore be expected in the medium term. ■

Potsdam Burgstrasse, senior housing

Source: CORPUS SIREO Real Estate

Meet our new member, BEOS AG

"Together, we will be able to exploit market opportunities even faster and to a greater extent"

Interview with the Executive Board of BEOS AG
Hendrik Staiger, Dr. Christoph Holzmann, Jan Plückhahn, Holger Matheis, Martin Czaja

At the end of June 2018, we announced the acquisition of BEOS, the leading investment manager of corporate real estate in Germany. The acquisition provides both companies with potential for growth and underscores the ambition of Swiss Life Asset Managers to expand its property business further.

Please tell us more about the business model of BEOS and where you come from.
With our interdisciplinary team of over 150 employees, we develop and manage corporate real estate. This is mixed-use commercial real estate in the office, manufacturing, service and logistics sectors, which is primarily let to medium-sized companies, but also to large corporates. Founded in 1997, BEOS was the first company in Germany to systematically focus on corporate real estate and establish it as a distinct asset class from 2002. In 2010, we established an Asset Management division and launched the first special fund for corporate real estate in Germany, paving the way for institutional investors to invest in what was, at the time, an entirely new asset class. We now serve our investors in all of Germany's major cities.

Why is the acquisition of your company by Swiss Life Asset Managers the next step into the future?
Together, we will be able to exploit market opportunities even faster and to a greater extent – and make them available to investors via Swiss Life's investment management company (KVG). This in turn opens up excellent growth opportunities for us as BEOS.

How will BEOS complement Swiss Life Asset Managers and what does this mean for the clients?
The German market for corporate real estate offers immense investment potential and it is also one of the most stable real estate asset classes. As a specialist and market leader in this segment, we complement Swiss Life Asset Managers not only with our expertise, but also with our network of investors, banks, corporates and portfolio managers, which is unique in the industry.

Wanted: investment strategies for a mature real estate cycle

The Swiss investment property market has been in a growth phase for a long time. This raises the question of how one can continue to invest profitably in real estate at this late phase of the cycle. Investment strategies focusing on a secure income return offer one option.

Alfonso Tedeschi, Real Estate Product & Service Manager, Swiss Life Asset Managers

Swiss real estate investments have experienced an extraordinary growth phase over the past 20 years. Not even the banking and financial crisis could stop Swiss property market price growth. This contrasts with most European real estate markets, where we have seen major price corrections since the crisis.

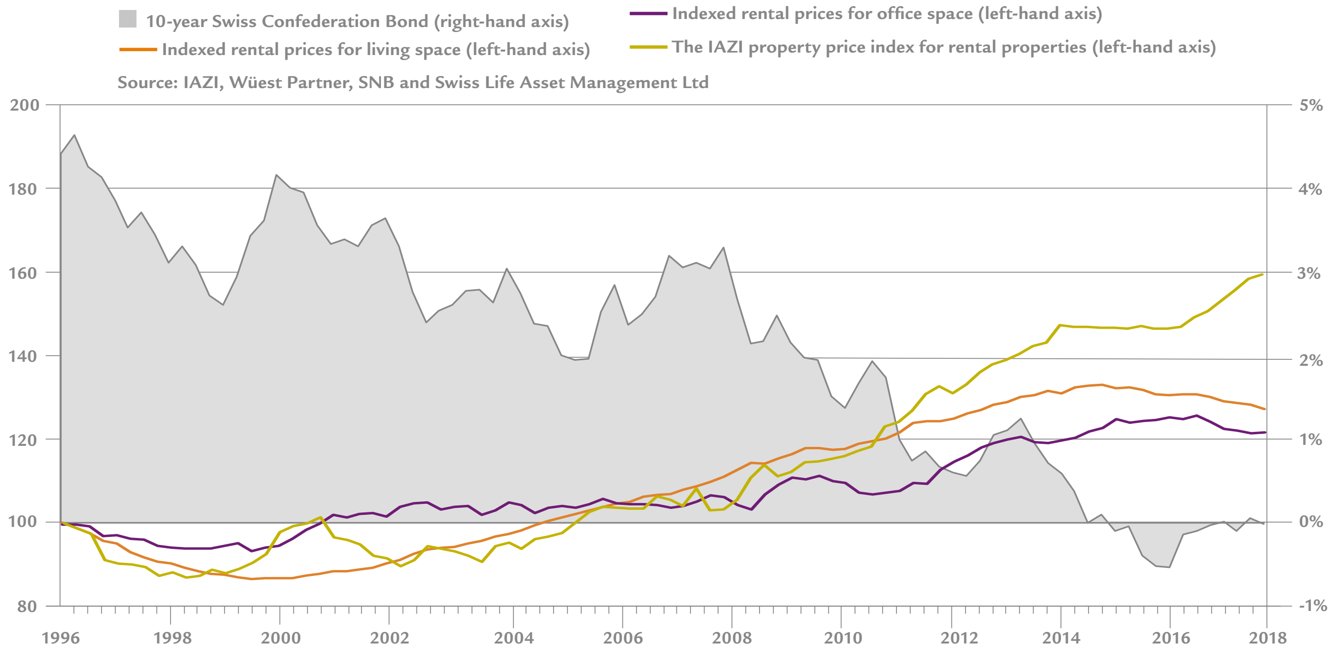
Unlike previous cycles, the Swiss property market boom results from investment pressure due to the low interest rate environment rather than from rising rental income and falling vacancy rates. Since 2009, a decoupling has been apparent between rental growth and investment property prices (see chart).

The risk premium for real estate investments remains very attractive at about 300 basis points. As long as this premium does not come under substantial pressure – due to rising interest rates or a significant fall in rental income – a marked and consistent price correction in real estate assets is unlikely. However, the cycle of strong capital gains is likely to come to an end.

Focus on secure income return

Capital gains have accounted for about 30% of total Swiss property investment returns over the past ten years. A 6.4% average overall return was observed during that period. The total return was still 5.9% last year. Further capital gains remain possible, although

Property prices and rental price development for investment properties, interest rate development



they are unlikely to apply across the entire market. Income return will become more important and account for a major share of total earnings. Properties offering a secure return on income are therefore in demand.

A question of investment strategy

From an investment perspective, identifying segments and locations that will remain profitable over the long term regardless of the interest rate situation is key in this market environment. The decisive factor here is that the supply of available space meets the demand of the tenants, in which case it is reasonable to assume high occupancy rates and constant rental income. Interest rates are of secondary importance here. Influencing factors such as the economic climate, employment development, the demographic structure, immigration and construction activity are a lot more important. We consider the following investment strategies to be particularly promising in the current market environment:

- **Investment in existing properties and construction projects in central locations with high accessibility, which benefit from urbanisation and demographic development**
- **Emerging micro locations within large and medium-sized cities**
- **Affordable living space for a broad cross-section of the population**
- **Niche segments with solid growth prospects, for example student apartments, healthcare properties, coworking spaces and urban logistics properties**
- **Enhancement of existing properties by the addition of another storey or demolition and new construction**

Bellerivestrasse 241/245 in Zurich: acquisition of a property at a top location

Source: Studio 12

Source: Foto Werder

Wesemlinstrasse 2/4 in Lucerne: realisation of potential in the built environment

Identifying winning office locations in the UK regions

Regional offices are one sector in the UK where we see investment opportunities in the current stage of the cycle. Guided by our thematic approach, we use key criteria to help identify preferred cities for investment, including infrastructure change, urban environment and catalysts for cluster formation.

Frances Spence, Head of Research and Investment Strategy, Mayfair Capital

The UK real estate market is moving into the late stage of its cycle. Competition for good quality stock has compressed yields, making the search for value challenging. Income and income growth will be the primary drivers of performance in the medium term.

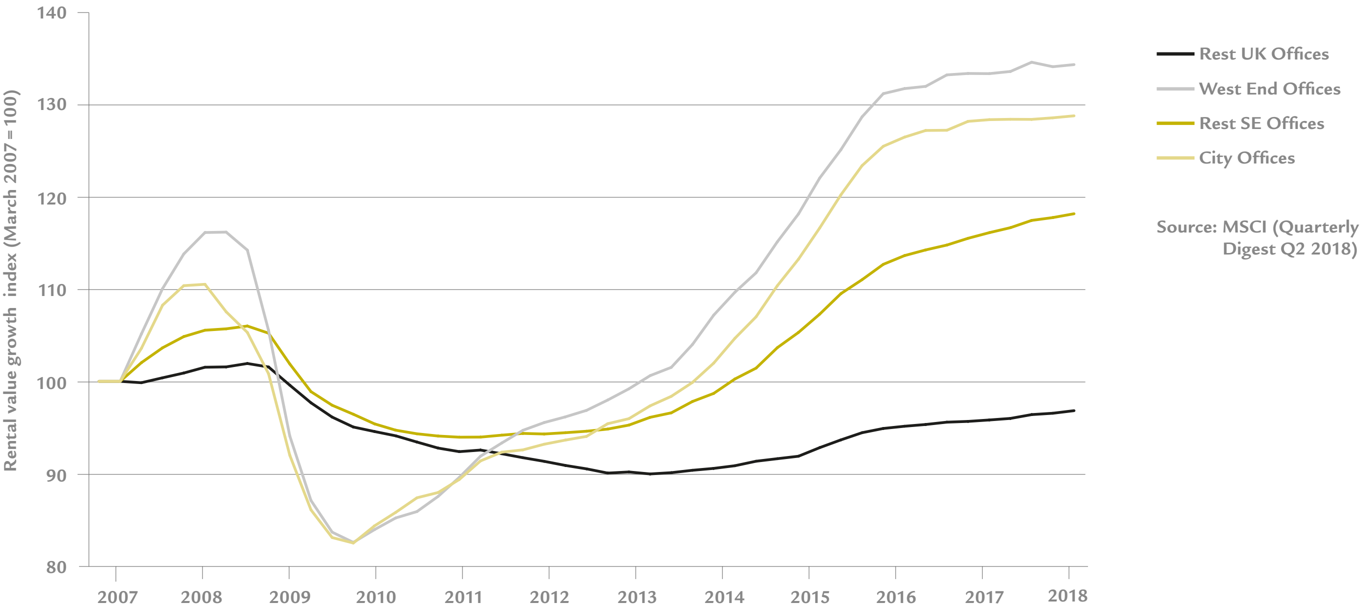
Opportunities in the regional office market

In this environment we see opportunities in regional offices. This is partially due to the sector's relatively high income return, which was 5.4% in 2017, but also because there is scope for rental growth. Nominal rental values remain below their 2008 peak and there has been limited development in many mid-tier cities, resulting in shortages of good-quality space.

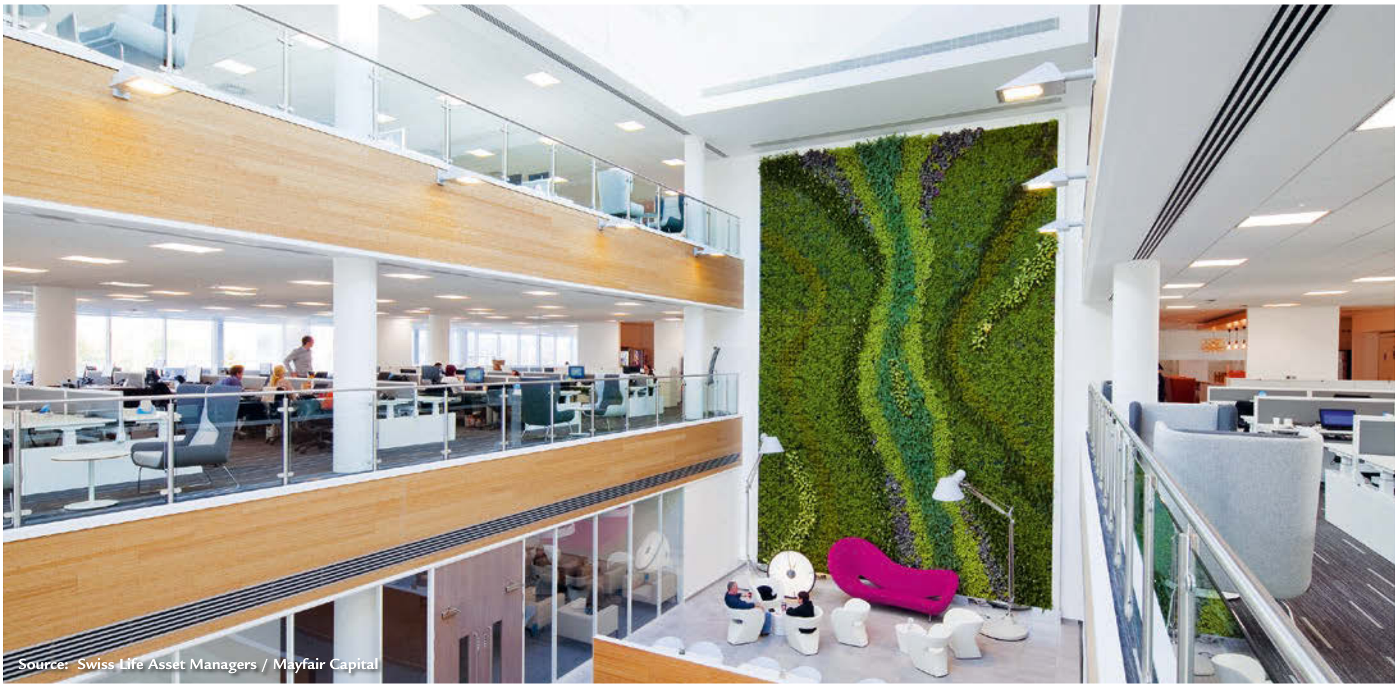
However, this rental growth will not be uniform. Occupier demand varies greatly between cities and within them. To identify winners, we adopt a thematic approach to our strategy. This enables us to understand how disruption driven by technological, demographic and infrastructure change will shape long-term occupational demand. Our conclusions guide us towards the cities and buildings where occupiers will want to locate.

Implementing this approach requires careful analysis to determine which cities have the attributes we believe are markers of future success. Some of this analysis is data driven but much is qualitative. For the latter, our primary focus areas include:

Rental values in "rest of UK" offices remain below their previous peak



Source: MSCI (Quarterly Digest Q2 2018)


Source: Swiss Life Asset Managers / Mayfair Capital

Interior of office building in Oxford acquired by Swiss Life Asset Managers in 2018

1 **Improving connectivity:**
Improving physical and digital connectivity can dramatically alter the attractiveness of a location. Most cities are anticipating infrastructure change but it is critical to understand the ability of the local authority to deliver it. Our preference is for cities with local authorities that have agreed the transfer of certain powers and funding from national government, providing them with the focus and financial control to deliver projects.

2 **Urban environment:**
Amenity provision and an attractive public realm are increasingly important. Areas undergoing urban renewal or newly created districts can be expected to outperform, particularly as rents are likely to be growing from a low base. A good example of this is the emerging Knowledge Quarter in Liverpool, home to facilities such as the Science Park, Sensor City and Health Campus.

3 **Catalysts for cluster formation:**
There are a number of catalysts that can support the formation of a business cluster. The relocation of a major anchor, such as the BBC in Manchester, is one and engagement between the university and the private sector is another. Bristol, among others, has benefited from university support for start-up businesses, which have grown and expanded. Indicators we look for include the range of facilities and initiatives for collaboration as well as access to incubator space and accelerator programmes. Newcastle Helix, which will be a bridge between the university and businesses, and MK:U, a new university in Milton Keynes focused on science, technology, engineering and mathematics, are both potential catalysts for the formation of clusters that will support future office demand. ■

Identifying our preferred cities for investment requires careful analysis guided by our thematic approach to investment strategy.

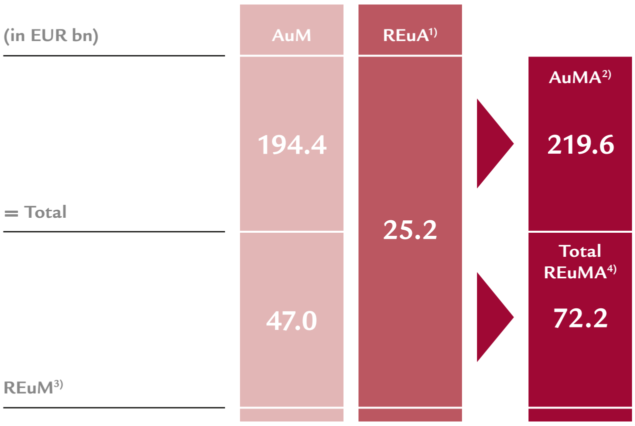
Source: Mayfair Capital

Office asset in Leeds acquired by Swiss Life Asset Managers in 2018

Swiss Life
Asset Managers

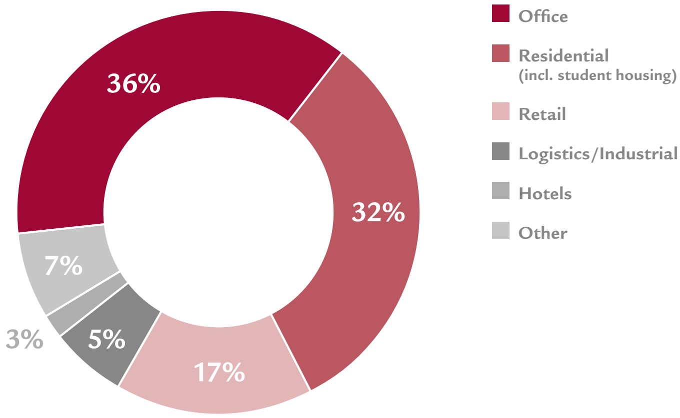
Real estate – facts and figures

Assets under Management and Administration



1)Real Estate under Administration (not included in Swiss Life AuM definition)
2)Assets under Management and Administration 3)Real Estate under Management
4)Real Estate under Management and Administration

Breakdown by real estate sector



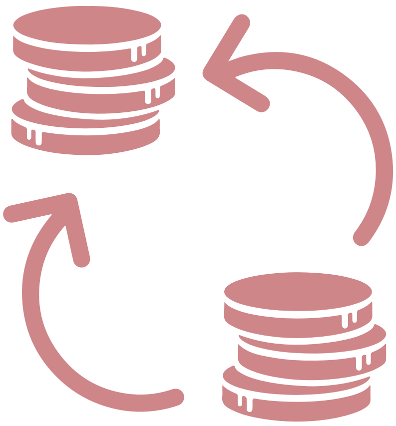
REuM EUR 47.0 bn

Transaction volume real estate

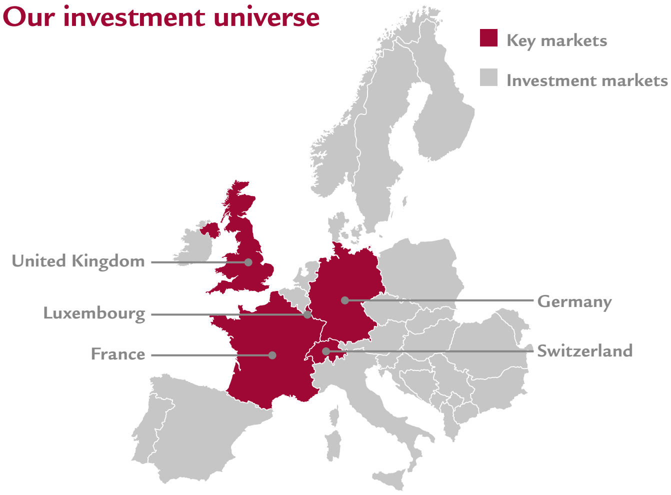
(in EUR bn)

7.1

(average 2015, 2016, 2017)



Our investment universe



All figures as of 30 June 2018, unless stated otherwise

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