The Impact of Novel Coronavirus (COVID-19) on European Real Estate Markets

March 2020

INVESCO REAL ESTATE
North America: Atlanta – Dallas – Newport Beach – New York – San Francisco
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Summary: European real estate investment context
IRE investment strategy was conservative coming into this pandemic

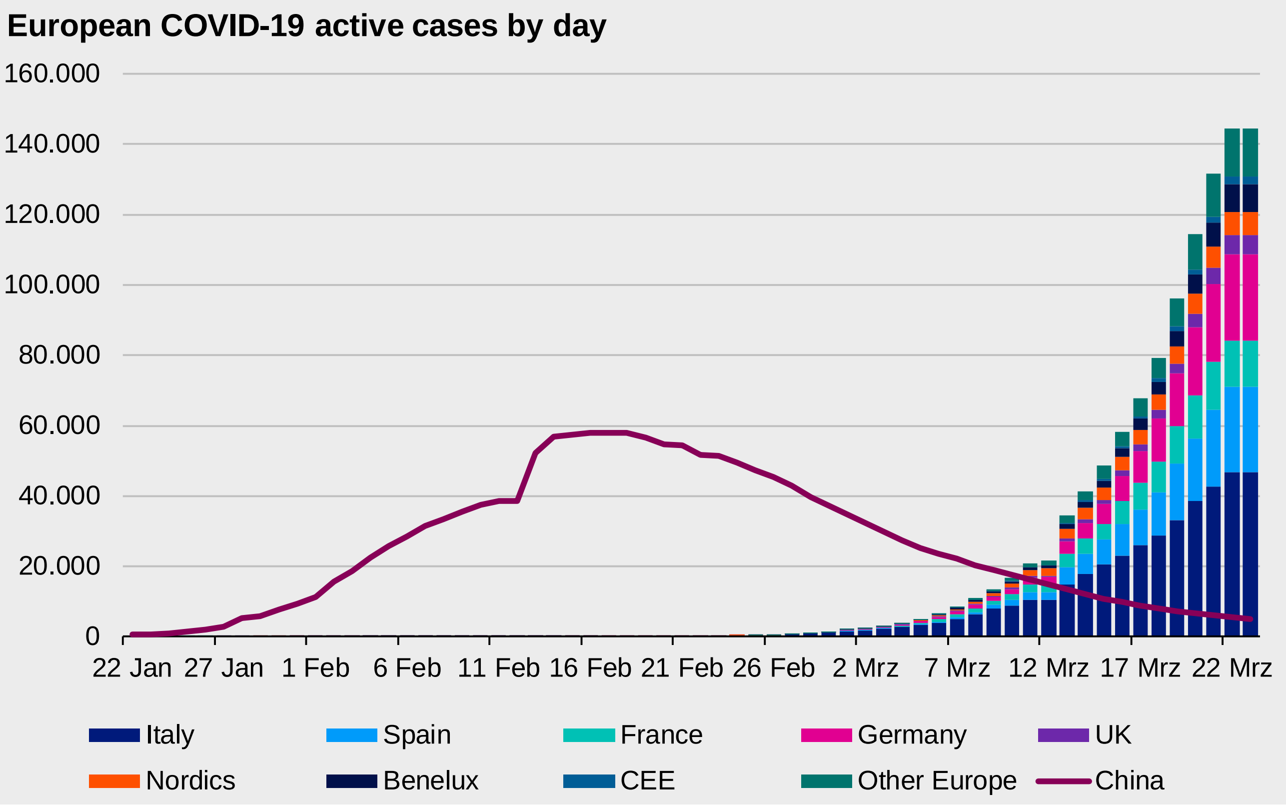
- Our focus was on strategies positioned for a lower growth environment and cyclically defensive.
  - COVID-19 is a significant downside stress on financial markets; we start from a good position.
- We were focussed on opportunities where returns are generated from active asset management.
  - Pro-active asset management becomes increasingly important in the current period of uncertainty.
- We targeted reversionary assets with potential for rental uplifts as leases renew or expire.
  - This gap to market rents provides a cushion against any potential decrease in market rents.
- We identified certain sectors with structural demand and limited supply.
  - Disrupted supply chains mean the supply of these assets is likely to fall further behind demand.
- We are cautious about mass-market retail exposure due to e-commerce disruption.
  - Reduced mobility is further accelerating the adoption of online retailing across Europe.

Certain of our long-term themes have been reinforced by the current uncertainty; we will continue to target opportunities that meet these themes, potentially at more attractive entry pricing.

We remain alert to where market dislocation may result in additional specific opportunities, including through refinancing or recapitalisation of assets in long-term conviction sectors and markets.

Pandemic: COVID-19 in Europe

A serious European outbreak, and yet to reach its peak



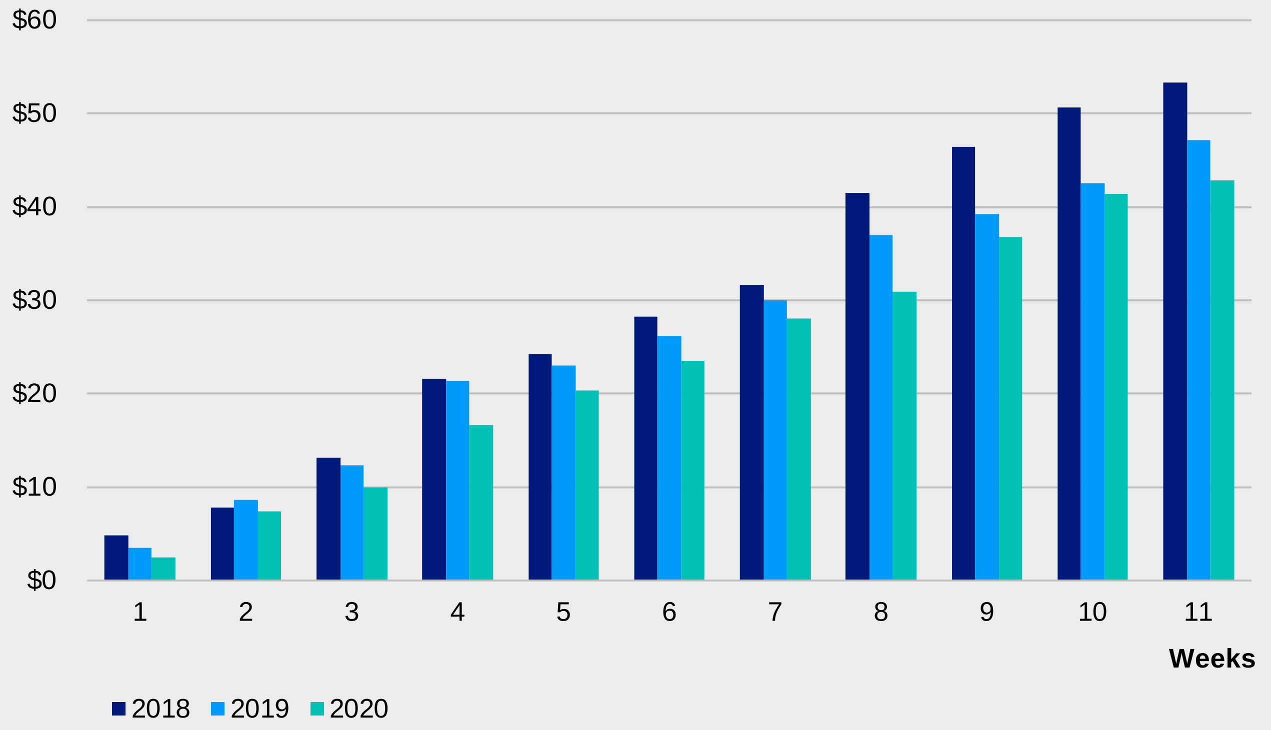
- As of 22 March 2020, 141,858 cases have been reported in the EU/EEA and the UK.
- The most affected countries are Italy, Spain, Germany, France and the UK.
- The reduction in case volumes in China following isolation measures offers hope that European case numbers will start to slow.

Source: Invesco Real Estate research using data from John Hopkins University, as of 23 March 2020
Note: The chart is an aggregation of national level data, and there is no guarantee of heterogeneous measurement across each market

Transactions: Weekly real estate volumes in Europe, 2018-20

Transaction volume in 2020 is down just 9% so far on the prior year

Real Capital Analytics all property weekly cumulative transaction volume (US$ bn)



- 2019 saw investment transaction volumes below those of 2018, and 2020 has also started more slowly than the two prior years.
- 2020 is expected to fall materially behind 2018 and 2019 as the European lockdown impacts deal flow.

Sources: Invesco Real Estate based on data from Real Capital Analytics, as of March 2020
Note: Deals $10m and greater; all major property types excluding development sites

Sectors: Potential impacts in Europe (1)
Corporate occupiers relatively less affected…

	Potential impact
Overall market	**Shorter-term** ▪ 2020 is likely to see a material decline in investment transaction volumes ▪ May see some off-market acquisition opportunities as owners sell to compensate losses, or distressed/heavily discounted opportunities in selected sectors ▪ Already seeing strong indicated prices on assets with structurally robust long term income
	Longer-term ▪ Lower economic growth is likely to reduce market level rental growth ▪ Significant further monetary stimulus should sustain pricing on long term income
Office	**Shorter-term** ▪ Weaker corporate profits in 2020 will slow occupational demand ▪ Real estate decisions may be delayed due to uncertainty ▪ Co-working operators' income will be heavily impacted by users cancelling contracts
	Longer-term ▪ Use of flexible work arrangements may accelerate, transforming demand for office space
Logistics	**Shorter-term** ▪ Demand increased by accelerated e-commerce adoption due to lock-downs ▪ Global supply chain and manufacturing disruption causing backlogs in European logistics channels
	Longer-term ▪ Increased demand due to increased "near-sourcing" and reduced reliance on just-in-time supply

Source: Invesco Real Estate, March 2020

Sectors: Potential impacts in Europe (2)

…but consumer exposed markets need more caution

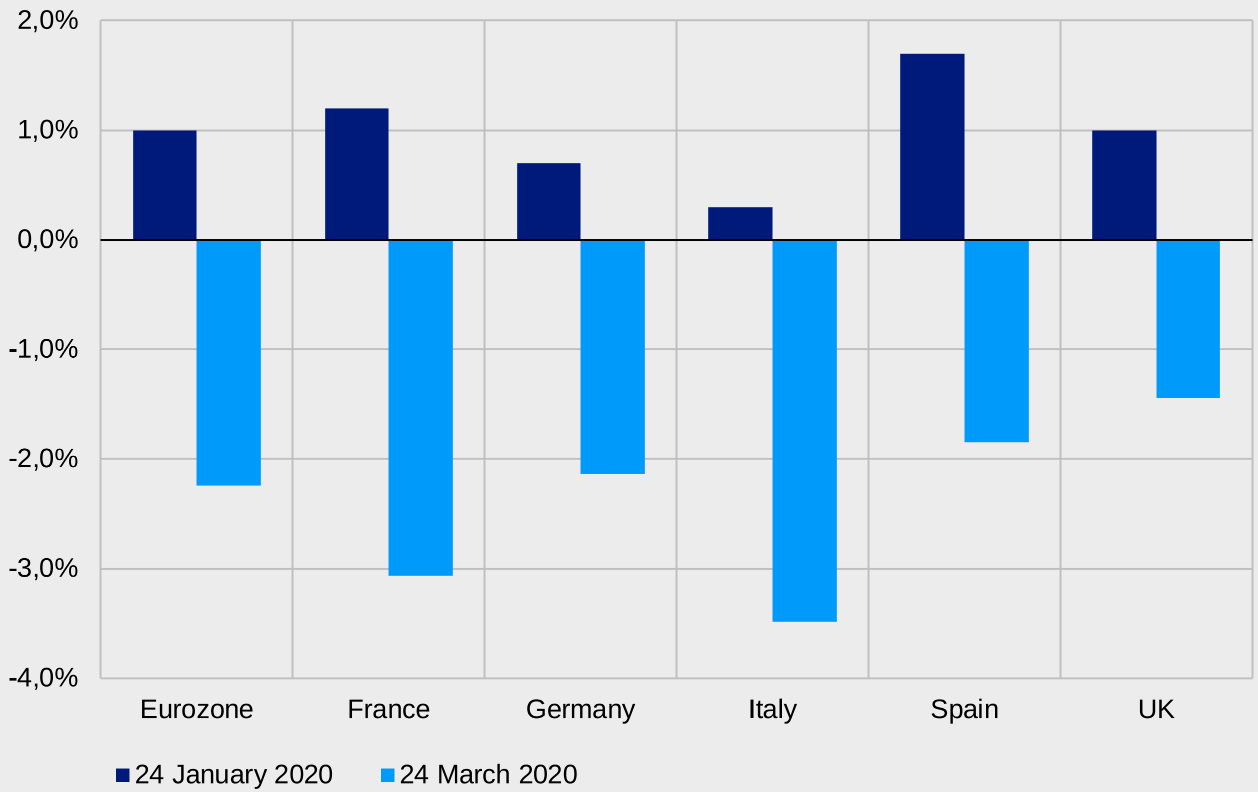
	Potential impact
Retail	**Short-term** ▪ Lockdowns and forced closure having massive impacts on mass-market retail and F&B sales ▪ Premium Outlets rely on international visitors; these are already seeing a significant decline ▪ Leasing decisions on prime street shops are already being delayed
	Longer-term ▪ Accelerated e-commerce adoption due to further weaken mass-market retail tenant demand ▪ Potential further pressure to share operational risk with landlords, through e.g. turnover leases
Hotels	**Short-term** ▪ Global travel restrictions impacting tourist and business visitor stays across Europe ▪ Cancellation of large-scale events reduces compression nights over the shorter term, impacting hotel profitability for the current year
	Longer-term ▪ Recovery of REVPAR is expected to be gradual; smaller operators likely to remain under pressure
Residential	**Shorter-term** ▪ International sales of high end apartments likely to be delayed by travel restrictions ▪ Structural undersupply of housing in key European cities still persists ▪ University students being sent home
	Longer-term ▪ Some elements of the temporary tenant protection measures may well become permanent

Source: Invesco Real Estate, March 2020

Economy: GDP growth forecasts for Europe

Downgrades will continue to come, 2020 recession for all markets

Real GDP growth forecasts for 2020 – change over time



- The GDP outlook for all European economies has been revised down sharply. Further downward revisions are expected given the age of some of these forecasts.
- Revisions are driven by supply chain disruptions, and materially weakened global consumption in 2020.
- GDP forecasts for 2021 show a partial rebound in growth.
- Whether the recovery is a V-shape, L-shape or U-shape, the long term outlook for low growth remains intact.

Source: Oxford Economics
Note: Numbers refer to the latest forecast at the specified date, not the date of the forecast

Support: Massive government response across Europe

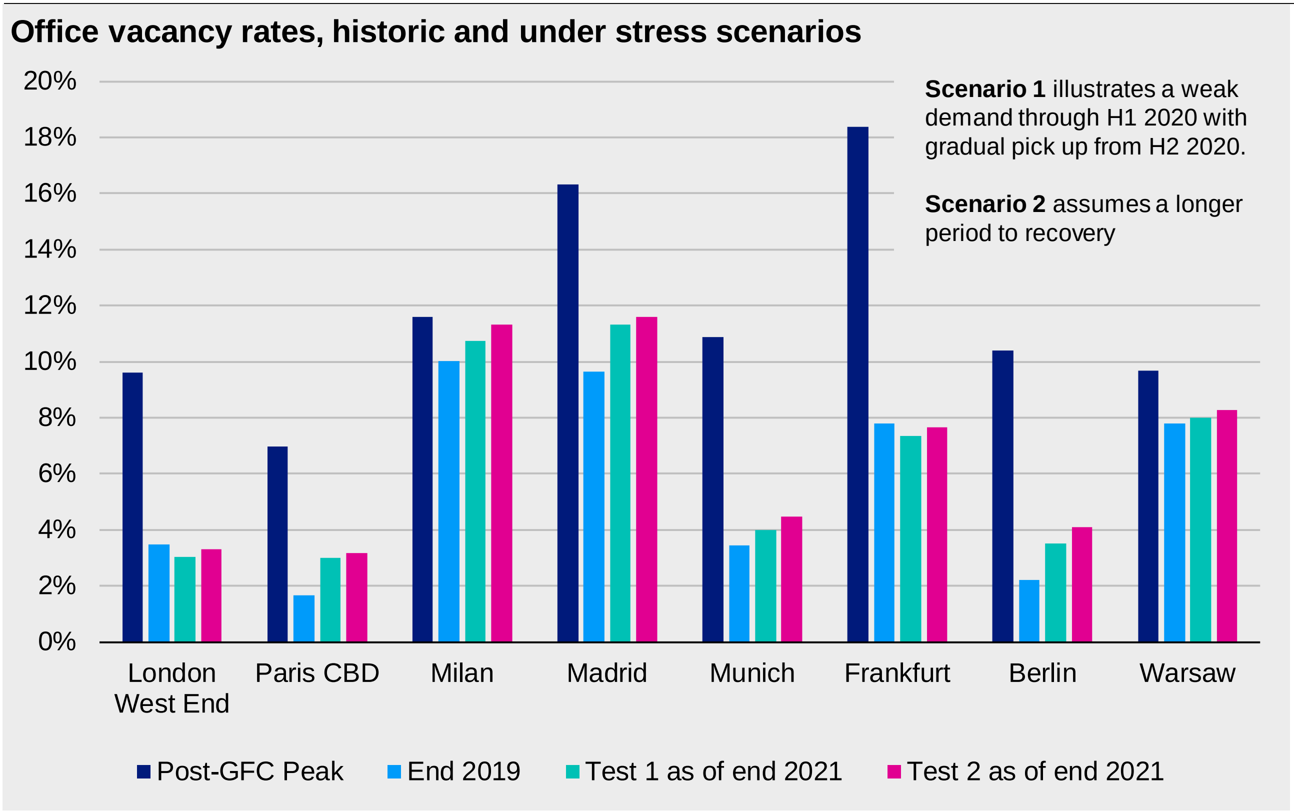
Short-term stop-gaps and a longer term low rate environment

	Monetary	Fiscal
EU / ECB	▪ €870bn asset purchases over 9 months ▪ Up to €3tn for refinancing operations @ -0.75%	
France	▪ Per ECB	▪ Unlimited State loans for companies ▪ Income subsidies for affected workers ▪ Tax deferrals ▪ Social security subsidies
Germany	▪ Per ECB	▪ €500bn federal loans for companies ▪ Income subsidies for affected workers ▪ Tax deferrals ▪ Local state specific responses
Italy	▪ Per ECB	▪ €25bn fiscal rescue package ▪ State loans for affected companies ▪ Income subsidies for affected workers ▪ Debt repayment holidays
Spain	▪ Per ECB	▪ €100bn state loans for companies ▪ Income subsidies for affected workers ▪ Tax deferrals ▪ Social security subsidies ▪ Debt repayment holidays
UK	▪ 65bps cut to base rate ▪ £200bn asset purchases	▪ £350bn state loans for companies ▪ Income subsidies for affected workers ▪ Tax deferrals ▪ Debt repayment holidays

Source: Invesco Real Estate, 23 March 2020

Scenarios: Stress testing office market vacancy in Europe

Less supply means lower vacancy risk than GFC in key markets



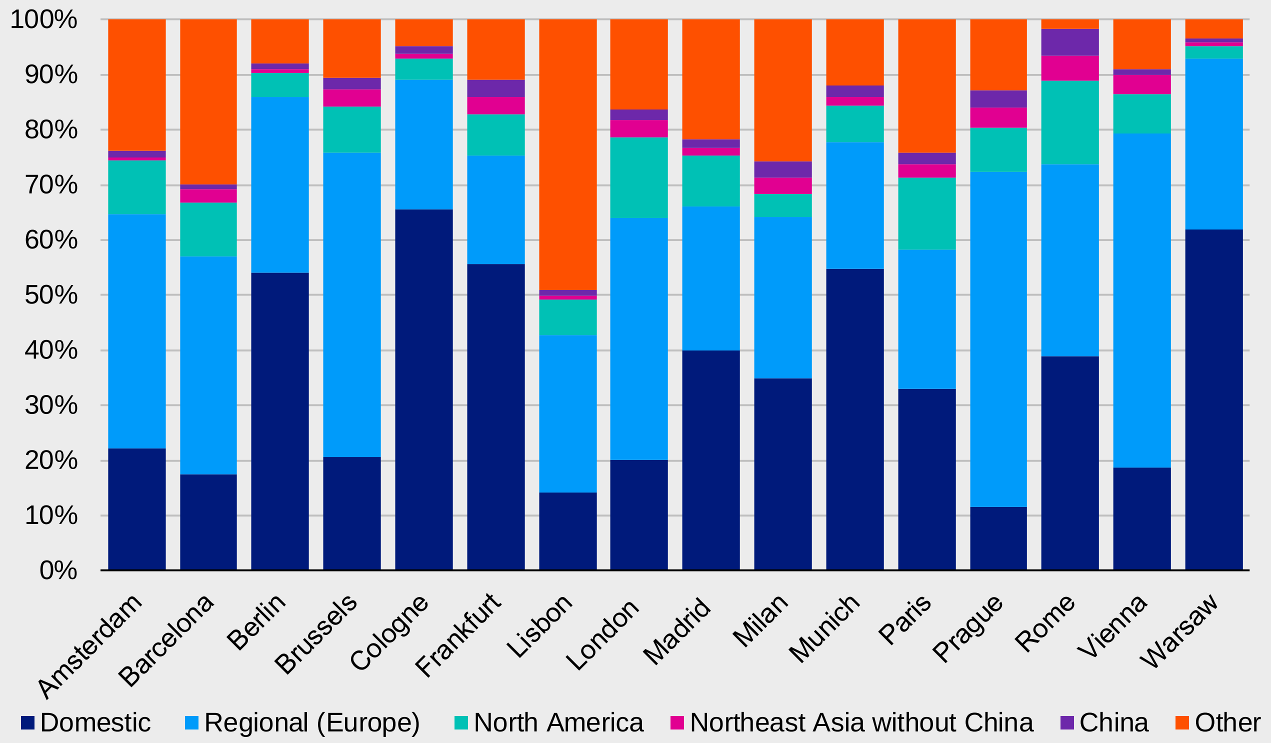
- Under our stress scenarios, vacancy rates of all these key European office markets in 2021 are below the post GFC peaks.
- Short-term supply is likely to be lower than historic levels. With prevailing economic uncertainties and financing difficulties, some new projects will delay completion, tightening new supply further.

Test 1: 2020 net absorption = 0; 2021 net absorption = base
Test 2: 2020 net absorption = 0; 2021 net absorption = ½ base
Source: Invesco Real Estate Research, using data from CBRE, March 2020

Hotels: Domestic and international tourism in Europe

Variances in visitors could influence hotels' recovery potential

Overnight stays in paid accommodation by source, as % total



The recovery in the hotels market is likely to be phased:

1. Domestic visits,
2. Intra-regional / European visits,
3. International visitors

There maybe some exception to the latter where countries have strong historic cultural and economic links.

Source: Invesco Real Estate, based on Oxford Economics, March 2020

Strategy: Current considerations in Europe

Some conviction ideas retained; some opportunities may present

Long-term conviction holds

- CBD offices in key cities
- Big-box logistics developments in strategic locations
- Edge-of-urban distribution underpinned by land value
- Apartments in low-supply markets with affordable rents

React to repricing

- Core office redevelopment / refurbishment projects
- Luxury high street retail in key city markets
- Well located gateway city hotels with strong operators
- Food retail
- Build-to-sell housing

Remain cautious

- Mass-market retail malls
- Secondary and out of town office locations
- Co-working exposure
- Student accommodation for second tier universities
- For-rent residential on the luxury end

Opportunistic sales

- Long income, market-rented offices at prime market prices
- Leased logistics in non-strategic locations

Look to divest

- Mass-market retail exposure

Repricing needs to take into account country specific risk factors.
Detailed consideration is needed of lending conditions and tenant covenants.

Source: Invesco Real Estate, 23 March 2020

Risk warnings

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. Property and land can be difficult to sell, so investors may not be able to sell such investments when they want to. The value of property is generally a matter of an independent valuer’s opinion and may not be realised.

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