COVID-19 Impact on Real Estate

Weekly PwC Expert Session via WebCast
27th May 2020, 10:00-11:00 am

Topics:
• Scenarios Real Estate - today: Logistics real estate
• Transport & Logistics Industry - Strongly affected, both positive & negative!
• Market overview Real Estate - Poland (English)
• Real Estate outlook – Germany in comparison
• Relaxation measures: - Return to work – employer obligations
  - Update Legal – reopening of the gastronomy
• Q&A Session

Questions to the PwC experts via e-mail to: de_covid19_pwc_real_estate@pwc.com
Updates and further information on https://blogs.pwc.de/real-estate/


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Bye, bye Home Office?

- **Back to Office** - As surprisingly fast as the retreat to the home office worked out at the beginning of the crisis, the return is now as complicated and varied. In view of the relaxation in many areas of life, the question now increasingly arises: *When will we actually return to the office? And above all, how?*

- **Forever Home Office** - Apple and Google announced that they will allow home office until the end of the year, Twitter even "forever" – *What impact will this have on office planning?*

- **Return plans** - For some Corona task forces still draw up return plans, measure *table distances* and divide their employees into *shifts* and *groups*. Others consider the pandemic to be largely over and have already ordered a *local presence* – *What do employers have to consider?*

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Scenarios Real Estate – networking with the real economy

Real Estate – Real Economy

- **Real Estate as a means to an end** - A weakening real economy has an impact on the demand for and provision of space. The impact of many sectors will gradually affect the various asset classes.

- **Asset classes** - There is hardly an asset class that does not have to react to the pandemic risk in the short, medium or long term, so we look at the scenarios and effects step by step - today *logistics real estate*. Like hardly any other asset class, they are dependent on the *functioning real economy*.

- **Supply chains** - The lockdown has particularly affected manufacturing companies. These in turn were dependent on globally *operating suppliers*. Closed borders have interrupted supply chains. The *overall process* was disrupted.

- **Lessons learned** - What influence do changes in the real economy have? How will the *logistics market develop*? More *resilience*? *Local* or *global*? *Further growth* for logistics real estate?
The transport & logistics industry is strongly affected

**Air. Rail. Ship.**

- **Air transport** - There are lasting negative effects for **passenger airlines**. IATA expects a global loss of 48% of RPK (revenue passenger kilometers) in 2020. **Air freight** with rising prices due to **capacity shortages** caused by the **loss of volume** of passenger aircraft.

- **Rail transport** - Long-distance **rail and bus transport** is suffering **considerable revenue losses**; **regional transport** is operating at greatly reduced capacity. **Road transport** is experiencing **reduced demand** due to the shutdown of industrial production and **reduced sea freight traffic**.

- **Shipping** - Shipping is strongly affected by **short-term volume declines**. On many important routes, **capacity cuts** are evident or have been cancelled altogether. Shipping companies estimate that global container shipping volume will shrink by 20% in the second quarter.

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B2C sector booms – B2B sector weak

**Courier, Express, Parcel.**

- **Courier, express and parcel services** - CEP business sees increasing parcel volume in the **B2C sector**, but a strong decline in **B2B**.
- **B2B** – BdKEP expects a decline in business parcel deliveries of about 70 percent in **Germany**.
- **B2C** – Exemplary **German Post**: In the B2C business, around 9 million parcels are currently transported each day. That is 40 percent more than in the same period last year.
Many logistics companies are working at full capacity - recovery after "China collapse"; medium-term demand at risk

**Industry impact:** Freight transport/ logistics

**V-Scenario (mild)**

**U-Scenario (severe)**

**L-Scenario (drastic)**

Companies included:
- Freight transportation (incl. trucking, air freight, rail) and warehousing
- Freight forwarders, 3rd party logistics providers, CEP operators
- Pipeline transportation, specialized freight management, ports

Overall rationale:
- Parcel delivery companies enjoy counter-cyclical effects, benefitting from strong demand for online retail
- Logistics companies build on full order books for Q2; effects of Asia contraction arrive with 4-6 weeks delay (sea freight)
- Capacity crunch in air cargo due to reduced passenger air travel – rates increasing
- Supply chain disruption could force some shippers to shift towards airfreight transportation to keep production moving along during crisis
- Negative effects from potential medium-term supply chain disruption and slower economy (demand of clients)

Impact (1):

Source: Strategy& analysis

1) Impact Scale: Positive = More output/ growth than w/o COVID-19 | Neutral: Normal 2020 growth; no COVID-19 impact | (Slightly/ Very) Negative: (Much) less output than w/o COVID-19
Many industries are strongly affected by COVID-19 - dependencies and resiliencies are crucial for business development

Impact on industries: overview

Impact scale

- **More GVA/growth** than without COVID-19
- **GVA/growth unaffected** by COVID-19
- **GVA/growth (slightly/very) impacted** by COVID-19, i.e. contraction vs. base case

**Additional uncertainty** from global supply chain

**Symptoms** (exemplary)

- **Increase consumption** due to pandemic (e.g. mask sales)
- **Stable B2C consumption** as consumers stay at home
- **Workforce availability** and/or productivity at risk
- **Production stops** or output reduction throughout lockdown
- **Point-of-sale closure** and order cancellations through lockdown

**GVA = Gross value added, i.e. an industry's contribution to the GDP**

Source: Strategy& analysis
The automotive industry as an example: the crisis will affect production over a long period of time

**Industry impact: Automotive**

**V-Scenario** (mild)  
**U-Scenario** (severe)  
**L-Scenario** (drastic)

Impact Scale: Positive = More output/ growth than w/o COVID-19  
Neutral: Normal 2020 growth; no COVID-19 impact  
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Overall rationale:  
- COVID-19 containment measures have immediately cut demand (esp. for Germany) – OEMs hope for postponement of car purchases rather than cancellations (e.g. towards 2021)  
- Synchronous closure of car manufacturing in Western Europe may be prolonged by supply shortages – restrictions to supply chain, especially inputs from China, expected until Q2  
- Short-term financial impact strongly related to production output; costs elasticity lower, leading to profitability slump  
- 2nd wave infection of China could lead industry into prolonged crisis (i.e. L-Scenario)

Companies included:  
- Automobile manufacturing, incl. unmanned and robotic automobile manufacturing  
- Passenger cars, chassis, electric cars, hearses assembly  
- Automobile parts suppliers

Source: Strategy& analysis

Impact: VERY NEGATIVE

Impact Scale: Positive = More output/ growth than w/o COVID-19  
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Source: Strategy& analysis

PwC Real Estate | COVID-19 WebCast

PwC
Glocalization - More local less global?

Change in supply chains

• Impact of e-commerce

• According to the logistics methods, globalisation is not questioned in principle. Large quantities will continue to be moved on international transport routes (procurement, sales).

• Shortening and redesigning supply chains and logistics networks.

• Increased risk management will influence the design of logistics networks.
Logistics will change - sustainable supply chains are in demand


Despite its serious impact, the Covid-19 crisis may also create opportunities for the industry by becoming a driver for future issues and strategic investments:

- Digitization and innovation
- New business models
- New mobility concepts
- Investments in public transport and infrastructure
- Shift towards more sustainable supply chains
- Investments in logistics real estate
After last month’s first COVID-19 shock, the PwC Real Estate Index for German residential property companies jumped (+15.2%) almost to its “pre-Corona” level before the outbreak of the COVID-19 crisis.

The Commercial Index also increased (+8.7%), but can’t yet recover its last month’s losses.
German and global WACC increased significantly

WACC

• Both **German** as well as **global WACC increased** significantly since the outbreak of the COVID-19 crisis.

• Compared to last month, in April the **average Real Estate WACC** for **German property companies remained stable**, while its global counterpart slightly fell.

• However, the **German WACC** of **3.2%** is almost on Y-o-Y level (3.0% in 5/2019), and **global WACC** increased significantly higher to **5.2%** compared to last year’s **4.4%**.
Explored multiples significantly decreasing

**FFO 1 multiples and Price/EPRA NAV ratios**

- The table on the right shows the individual FFO 1 multiples and Price/EPRA NAV ratios of our peer group by segment.
- The ratios relate to financial years 2018 and 2019 and their year-end closing prices. In addition, the current share prices (as of 4 May 2020) were put in relation with the 2019 key figures.
- The FFO 1 multiple decreased for both, commercial (-23.7%) and residential (-6.1%) real estate companies.
- The Price/EPRA NAV ratio also decrease for commercial (-24.0%), residential (-6.8%), especially significantly for commercial since the global outbreak of the COVID-19 crisis.
Germany outperforms global real estate market

Real estate companies worldwide with declines

• Commercial real estate companies are particularly affected by the COVID-19 crisis.
• Since the global outbreak, commercial real estate companies have lost -15 PP more than the MSCI World. In contrast, the shares of global residential real estate companies are at the level of the MSCI World.

German residential almost at pre-crisis level

• German residential real estate companies in particular have outperformed the market since the beginning of the crisis.
• Uncertainties regarding residential real estate companies initially prevail, especially with regards to potential rent deferrals.
Poland – pandemic stops 28 years of uninterrupted growth

Current situation of Covid-19 in Poland

• Poland’s 28 years of uninterrupted growth (longest in Europe, without recession since 1992), was disturbed by the outbreak of the pandemic.

• Forecasts of the European Commission show that the Polish economy is set to be the least affected in the EU by the Covid-19 pandemic.

• Polish GDP is forecasted to drop by 4.3%, compared to a drop of 6.5% in Germany and more than 9% in southern EU states.

• A strong decline in private consumption in 2020 is expected due to a decline in labor market activity and prevailing uncertainty.
Limited impact of Covid-19 can be observed within the Polish RE Market

Current situation on transactions

- The first quarter of 2020 was **significantly better** than the same period of 2019 – it was not yet really impacted by the Covid-19 outbreak.

- The **investment market** in 1Q2020 was driven by the **industrial sector** (4 out of 5 top deals were big logistic portfolios).

- In 2Q2020 investors adopted „**wait and see” approach** and we see multiple deals put on hold.

Prime yields

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<th>Office</th>
<th>Retail</th>
<th>Industrial</th>
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<tbody>
<tr>
<td>Q1 2018</td>
<td>4,3%</td>
<td>4,75%</td>
<td>5,75%</td>
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<td>Q2 2018</td>
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<td>Q3 2018</td>
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<td>Q4 2018</td>
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<tr>
<td>Q1 2020</td>
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</tbody>
</table>

volume of transactions on the polish commercial property market per quarter [in bn EUR]

- Q1 2018: 2.00
- Q2 2018: 1.00
- Q3 2018: 1.65
- Q4 2018: 2.38
- Q1 2019: 1.09
- Q2 2019: 1.91
- Q3 2019: 0.9
- Q4 2019: 3.8
- Q1 2020: 1.72
Short-term and long-term trends on the Polish office market are similar to those observed in other countries

Developments in the office markets

Outlook – shortterm

• Review of tenants’ expansion plans
• Searching for temporary solutions for space arrangements, meeting the requirements of flexibility and the need for quickly adapting of sanitary recommendations
• Investment market – significant slowdown associated with high uncertainty about the future and investors’ focus on monitoring liquidity

Outlook - longterm

• Delays in expansion plans / renegotiations of lease agreements or reductions in occupied space. Rental rates for new contracts will be subject to pressure to reduce
• Tenants’ preference for flexible lease contracts and using temporary offices
• Reorganizing the occupied space so that it is ready to respond to changes in functioning
• We can expect the introduction of Covid-19 clauses in lease agreements
About 50% of customers returned to shopping malls after their re-opening in May 2020, while malls operate without footfall boosters like cinemas, restaurants or gyms.

“We were expecting big drops in visits. In China at the beginning there were on average 70 percent fewer clients. We have 50 percent fewer clients in the first week after the opening. However, the number of visitors is growing day by day. So we are in a completely different place than Asia. And let's remember that a large part of the galleries - cinemas, fitness clubs, etc. - is still out of use.

*It is worse in big cities, in modern galleries, where there is a large share of entertainment space: cinemas, restaurants, play parks for children. These facilities started more slowly.*

*Visiting is one thing. However, conversion is at a record level.*

- Mark Noetzel (member of the board of NEPI Rockcastle which owns 12 shopping malls in Poland) for Wyborcza
Restart after lockdown - what employers need to know now

Return to work

Employers' duties of care:

• Compliance with the principle of equal treatment under labour law / short-time working
• Duty of care, information and notification
• Obligation to take certain protective measures, e.g. distance signs, hygiene measures, disinfection, entrance controls

Possible courses of action for occupational health and safety:

• Moving desks
• Reallocation of rooms
• Thinning of floors/employees
• Introduction/Change of shift times
• Job sharing offers
• Spacers and "social distancing" in coffee kitchens, lounges, training courses etc.

Cooperation / information services:

1. Federal Institute for Occupational Safety and Health (BAuA)
2. Company health insurance, company doctors
3. Works council/severely disabled persons' representative committee

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Measures to ensure occupational health and safety

BMAS occupational health and safety standards of 16.04.2020

Principles:

• Supplementation of special occupational health and safety measures to protect against the corona virus and dynamic adaptation of the measures to the course of the pandemic
• Active internal communication of the principle "health first"!

Preventive measures:

• "Priority" of home office in particular for office work
• Maintaining a safety distance of 1.5 m in buildings, outdoors and in vehicles (as far as possible)
• Involvement of occupational health and safety experts and company doctors, expansion of occupational health preventive measures
• Organisation of work processes that are as contact-free as possible
• Ensuring additional protection in case of unavoidable direct contact (especially "mouth/nose masks")
• Additional hygiene measures (washing hands)
Update Legal - Gastronomy

Reopening and Covid-19

- "Patchwork" country regulations
  - Registration at the entrance, distance requirement, cutlery disinfection, ventilation systems etc.
- Operating obligation tenant
  - Economic risk of use by the tenant himself; regularly no right to shut down operations in case of loss of turnover due to a decline in customers
- Operator responsibility with regard to hygiene and infection protection standards
- Payment of rent subject to recovery (see § 814 BGB)
- Legal uncertainty requires contractual adjustments
  - Interference with the basis of the business (see § 313 BGB)
  - Rent reductions / rent deferrals
  - Right to set the operation
- ESG "in return" for contract adjustments

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Your questions to the PwC experts

Scenarios Real Estate

Logistics

Germany in comparison

Market overview Poland

Return to work – Employer obligations

Update Legal – Reopening of the gastronomy

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PwC information on COVID-19 and its impact on the real estate industry can be found here:

- Current information about Real Estate and also COVID-19: [https://blogs.pwc.de/real-estate/](https://blogs.pwc.de/real-estate/)

- Central email address for questions to PwC experts: de_covid19_pwc_real_estate@pwc.com

- PwC Plus - All the information about real assets with push message function: [https://pwcplus.de/](https://pwcplus.de/)

- Weekly expert session via WebCast on current topics always Wednesday 10:00 to 11:00
PwC COVID-19 Services

Operations
- Management of the tenant and service portfolio
- Support in daily business
- Crisis Management

Liquidity/Financing
- Monitoring the liquidity status
- Review of the loan portfolio
- Support review grants and loan options
- Dealing with tax deferrals

Scenario Analysis
- Development of scenarios for dealing with the COVID-19 crisis
- Changes in the business model to ensure sustainable cash flows

Strategic Impact
- Expansion of IT systems & digitization
- Further development of the value chain, business model & assets
- ESG implementation

PwC COVID-19 Real Estate Taskforce
- Experienced, interdisciplinary team (Legal, Tax, Operations, Financials)
- Pragmatic and efficient project approach
- Possibility of short-term support and ‘Ready-to-Go’ support with a proven IT communication platform

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COVID-19 Impact on Real Estate

Weekly PwC Expert Session via WebCast

3rd June 2020 from 10:00-11:00 am

Registration via Link or via E-Mail: