COVID-19 Impact on Real Estate

Weekly PwC Expert Session via WebCast
03. Juni 2020, 10:00-11:00 Uhr

Topics:
- Scenarios Real Estate: European Market Outlook
- France
- Spain
- Financing beyond COVID-19
- Update Legal
- 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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Build Back Better – EU Recovery Programm

„Build Back Better“is the motto: The EU Commission combines the proposed € 750 billion recovery programme with the Green Deal.

- Countries with a high CO2 footprint should be supported in their plans for a green transition.
- Research reports from the major banks already show buy recommendations for companies that particularly benefit from the investments triggered by the programme.
- Ideas for counter-financing are manifold, e.g. levies on non-recycled plastics, on an EU contribution to national CO2 taxes or customs duties on CO2-intensive imported goods.

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Next Generation EU - Construction strategy for Europe's economy

750 billion € - Next Generation EU

• The "Next Generation EU" programme aims to revive the economy after the Corona pandemic. Among other things, it is planned to strengthen the European Green Deal and invest in key infrastructure such as renewable energies.

• These appropriations are intended to complement the overall long-term budget of EUR 1.1 trillion and the three budgets of EUR 540 billion already agreed by Parliament and Council. EUR 2.4 trillion would then be available for reconstruction.

• Highly energy-intensive, but Real Assets Investments can benefit from this.
Greening the Financial System

Thoughts. Expectations. Reality.

• The Network for Greening the Financial System (NGFS), an initiative of central banks and financial supervisory authorities founded in 2017 (15 of the G20 countries are now members) has taken stock of how banks and insurance companies analyse and assess the climate risks of their financial assets.

• Status is sobering - there seems to be a lack of understanding and will in some cases. The main issues are missing data and common classifications (whereby the taxonomies of the EU or even China provide a good basis). Stranded assets endanger financial stability, so regulators will not give in here.

Executive summary

A point-in-time survey of how financial institutions are tracking green, non-green and brown risk profiles…

…shows that the institutions have not established any strong conclusions on a risk differential between green and brown.
Measuring the Financial Impact of ESG


• The measurement of financial impact is complex - multi-dimensional and for E, S and G criteria in development along the EU taxonomy. The real estate industry will have to set the standard for itself.
  
  – Freely available tools have already been developed and tested, e.g. the Carbon Value Analyser for measuring climate risks in building valuation (DENEFF, BPIE, PwC, Finanzforum)
  
  – S and G standards for measurement are emerging or can be derived from existing certificates or ratings
  
  – The disclosure of data is already scheduled by the Disclosure Regulation for regulated products - implementation date March 2021.

• The technological provision of the necessary reporting for investors and sales, as well as the publication on the homepage will be a challenge - less than a year - time to act!
Our series COVID-19 Impact on Real Estate Europe goes on

Perspectives – TODAY France & Spain

- **Repair** – Fiscal policies helped to mitigate the CORONA shock, Global central banks have drastically lowered key interest rates, Companies try to protect their business and stabilize in the short term.

- **Rethink** – Trends to rethink and reshape business models are crisis-induced (if already critical before COVID-19) and crisis-catalyzed like ESG.

- **Reconfigure** – New normal has to be defined if business models or asset classes are not resilient enough for future requests and behavior.

- **France** – Insights from **Arnaud Burillion**, Partner, PwC Real Estate France, Paris

- **Spain** – Insights from **Marco García Guerra**, Director, Spain PwC Real Estate, Madrid
France
Knocked but not out!

**A slow-growth country hit hard by COVID-19**

- Comparable **low number** of infections and death
  - 151,753 total cases or 0.226% of population
  - 28,802 death as of 31 May
- GDP Q1-2020: decline of 5.8%, a level never seen since 1949
- France (2019 to 2020): GDP decline of **8.2%** (vs. +1.3% 2018 to 2019)
- France (2020 to 2021): GDP recovery of **7.4%**
- France’s unemployment rate was **7.8%** at end of Q1-2020 (-0.9%pt year-on-year)
- **No major job losses** so far but no hires either, so unemployment on the rise

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**Development of GDP-growth since 2007**

Source: Institut national de la statistique et des études économiques

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Support for Individuals & Households

- **Major issue**: schools / kindergarten closed from mid-March to mid-May and (very) progressively reopening
- Partial **unemployment granted** to households that can neither work from home nor have their children go to school / kindergarten
- Temporary **freeze of legal proceedings** (incl. evictions)
- **Est. €55bn of cash not spent** by household during the lockdown: will they spend it or save it?
Support for Businesses

- **Partial unemployment**: the employer pays 70% of gross salary (the employee earns ~84% of its net wages) and is **fully reimbursed** by the state up to 4.5 times of the minimum wage. **Reimbursement** will go down to **85%** as from 1st June. Total cost so far: €24bn.

- **Bank loans guarantied by the state**: amount up to 3 months of 2019 revenue, service deferral by 1 year, reimbursable over 5 years

- **3-month delay** on payment of social charges

- Possibility to **negotiate a delay** for the **payment** of taxes

- Small companies: **payment deferrals** for rents and utilities

- New measures to **kick-start the post-lockdown** economy:
  - **Stimulus package** to **boost car sales** (increase of premium from €3k to €5k if you dump an old car to purchase a new one, depending on its carbon footprint)
  - Easing of the use of **meal vouchers** that people have stockpiled during lockdown
Impact on Real Estate

**Investment**

- **Transactions** still happening but most of them had been negotiated prior to the lockdown, in a booming market (the 4 last quarters were all record-breaking)
- Numerous processes put **on hold**, especially in Retail and Hospitality
- **Retail repricing** expected to accelerate; yield compression expected to halt for other assets
- **Short term:** “wait & see”
  - Half-year valuation of listed REITs
  - Credit terms deemed to change: LTV down, margin up
- A broker study (end of April) highlighted:
  - €47bn of **dry powder** to be **invested**
  - €17bn of **assets** deemed to be **for sale**
Impact on Real Estate

Assets

• **Retail properties** hit hard:
  – Rent deferral / waiver granted; how will stores ramp up now that lockdown is eased?
  – Fragile retailers have entered receivership (Alinea, Orchestra, Camaieu, La Halle, Naf Naf, André, …)

• **Hospitality**:
  – Hotels and restaurants: how sustainable is the reopening as from 2 June with reduced capacity in restaurants, after “yellow jackets” and train strikes?
  – Care homes: waiting lists have emptied

• **Office** harmless so far but questions raised on:
  – **short-term-demand**: slow down in job creation?
  – **long-term-demand**: home / remote office?

• **Rent renegotiation** vs. **longer lease** to maintain value?
Global Impact of COVID-19 on Spanish Real Estate Markets

COVID-19 economic impact

Spain will suffer a very notable recession, expected to be shortened and mitigated by fiscal and monetary expansion

- Spain is facing an unprecedented health crisis that is forcing confinement measures that will plunge the economy into a severe recession.
- Average GDP in 2020 could contract by ~6-10% depending on the length of the confinement and the success of plans to mitigate job and business destruction.
- In the base case, the simultaneous collapse of consumption and business activity would reduce domestic demand ~8% by 2020, adding to the fall in tourism.
- Systemic risks are much lower than a decade ago given the support of the ECB, the solvency of the banking sector, the absence of Real Estate bubbles and the balance of payments surplus. Measures to control capital or radically increase the tax burden are out of the question.
- The tourism sector will suffer the most persistent damage and is in the process of structural adjustment. This will cause Spain to recover more slowly than other countries but to grow more in 2021.
- Even temporarily, almost two million jobs could be lost, pushing unemployment up to 20%. Income replacement measures are crucial to avoid severe and permanent social and economic damage (and deterioration of public accounts).
Sanitary Impact of COVID-19 in Spain

COVID-19 sanitary impact in numbers

Spain has been one of the most affected countries by the pandemic

- 239,932 infected: 11.2% of all reported infections in Europe
- Infections concentrated predominantly in larger cities with more than 50% of cases concentrated in Madrid and Barcelona (c. 28% in Madrid, c. 23% in Catalonia)
- Death toll of 27,940 as of June 2nd
- Mortality rate of c.11.5%
- C. 58 deaths per 100,000 inhabitants: 3rd in ranking behind Belgium and UK.
The Spanish Real Estate Market will suffer a deep decline, mainly affecting the retail and tourism sector

COVID-19 Spanish RE impact

- Confinement is causing a notable recession and significantly increasing unemployment. We expect consumption and investment to recover during the last two quarters of 2020 but leisure and tourism will take longer to recover.
- The crisis is accelerating some structural changes, such as e-commerce and e-banking, working from home and domestic entertainment, with deep implications for the Real Estate market.
- Office and retail tenants will reassess their space needs and investors will reduce their appetite for leisure and tourism assets.
- The residential market will suffer a moderate decline due to the rise in unemployment. We expect the average price to fall by ~5-10% in 2020 (slightly less in large cities and more in secondary locations) to recover between 2021 and 2022.
- Rent levels will fall in 2020. Their magnitude and subsequent recovery will depend on specific supply-demand. In Spain, we prefer prime assets to secondary assets; housing and offices to retail and tourism assets.

China’s lessons learnt

- Office
  The return-to-office rate varies by city, with 80-100% in Shanghai and 75-80% in Chengdu and Chongqing. Leasing volumes have slowed and renewal has become the preferred choice of tenants.
- Logistic
  The logistics sector exhibited a degree of resilience during the outbreak due to e-commerce.
- Retail
  Shopping centers are slowly coming back to life, although with precautionary measures including temperature checks and social distancing measures. Leasing activity remains passive and it is possible that there will be further impacts from lockdown in following periods.
- Hotels
  In Q2, 87% of hotels in China have reopened, although most are reporting low occupancy rates (below 30%).
Office – limited downfall in rent levels due to limited supply and high occupancy rates with a return to growth in 2021

COVID-19 impact – Office segment

- Segment with a more positive outcome from this crisis in comparison with other segments produced by current high occupancy rates, limited new supply and social distancing restrictions.

- Physical social distancing restrictions, which are expected to last a few months (and to be present until a vaccination is in place), will force companies to at least keep the current office space they are using.

- Very high occupancy rates and the limited new supply in prime offices will prevent a substantial drop in rents and produce a slight upturn in yields.

- CBD valuations could fall 8%-10% in 2020 and return to a moderate upward trend in 2021 due to a reduction in demand produced by higher unemployment and working from home trends.

- This reduction in demand could be accentuated in suburban areas.
Logistics – strong performance sectors due to significant online sales growth

**COVID-19 impact – Logistics segment**

- One of the **best performing sectors during the crisis** thanks to online sales spike during confinement.
- Within logistics, the fundamental services such as **food, cold chain logistics and e-commerce** (including last mile distribution) are the best positioned, receiving less impact in this crisis.
- Rent levels have not yet suffered the impact of the current situation, even after considering that 20% of tenants are already unable to pay rent.
- Availability of logistic areas in Spain (4% in Barcelona and 6% in Madrid) has remained stable, and logistic asset performance has remained solid.
- **Investment in industrial and logistic assets remains strong**, with investors behaving differently from the crisis of 2008. Many investors are looking into this sector since it offers assets with stable income, especially those within e-commerce, first need, cold logistics and last mile.
Retail – Yields will rise

COVID-19 impact – Retail segment

• Double negative impact by drop in retail consumption and increasing e-commerce activity.

• Consumption has halted significantly during confinement but is expected to recover strongly but will not return to the 2019 level until 2022 due to the sharp rise in unemployment.

• Expected substantial drop in rent levels and prices (>10% in rent and >30% in prices) even on prime shopping streets, caused by lower consumption and tourism, higher unemployment and increased e-commerce.

• Shopping center yields were already reverting the generalized yield compression in the pre-COVID period. Shopping center yields will continue to rise and prime high street yields could also rise by 0.5%-1.0%.

• Staggered recovery – once the situation is normalized, shopping centers will still be below the pre-crisis normalized inflows.

Source: CBRE, UBS, PwC
Hotel – Potential increase in Real Estate deals due to downward pressure on asset prices

**COVID-19 impact – Hotel segment**

- **The most impacted** industry by the Covid-19 crisis.

- This crisis could **speed up the sale of these Real Estate assets** so that hotel operators can focus on solving cash flow problems.

- **Highly dependent sector on the international market** (66% of overnight stays are from international tourists), so its recovery does not exclusively depend on the political measures taken by Spain.

- **The impact and recovery by type of hotel and area will be diverse** (urban hotel versus vacation hotel).
Residential – Moderate temporary decline due to unemployment

COVID-19 impact – Residential segment

- **Price falling around 6%** in 2020 and recovering by 2022 due to the temporary rise in unemployment
- Impact will have a **mixed effect** – with less significant impacts where demand already exceeded supply (Madrid, Barcelona, Canary Islands and Baleares and prime areas along the Mediterranean coast)
- **Investment in residential property for rent** is expected to continue to rise, prioritizing investment in existing and leased building for cash flow generation.
- **Rent reductions** of around 2-3% may occur, specially in secondary locations
Financing beyond COVID-19

Stabilisation and long-term planning

- **Short-term measures completed** - KfW refinancing
- **Insolvencies and other problems**
  - "Half-time" for suspension of application obligation - wave of insolvencies expected for autumn
  - Extension of the suspension of the termination of rental contracts under discussion
  - Covenant breaches expected in Q2/2020
  - Refinancing: Limits at house banks and earning power can pose problems even with good LTVs
- **Check alternative forms of financing**
  - Consortium financing, possibly with KfW
  - Alternative financiers (debt funds)
- **Time is of the essence**: Especially because of COVID-19, financing requires time in advance - (3 - 6 months) planning!
Opening measures in a European comparison

Implementation measures

- General rules (e.g. safety distance 1.5 - 2 meters) still apply
- Masks are compulsory in most countries (except Austria since 1 June)
- Further rules of conduct (e.g. home office if possible, sneezing and coughing labels, etc.) are binding in many countries
- Gradual opening to all countries, but with very different forms
- In the UK, France and Italy independent risk assessments and hygiene concepts are required for open farms; other countries operate with strict requirements (e.g. Netherlands)
- Despite the opening, restrictions still apply across all sectors (access to shops, occupancy rates in hotels, seats in cinemas)

Responsibility

- Specific measures may require the involvement of building owners (e.g. changing ventilation, opening or closing access routes)
- Often unclear which party bears responsibility and costs
- Infringement may result in compensation and fines

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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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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/

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

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

Weekly expert session via WebCast on current topics always Wednesday 10:00 to 11:00
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10th June 2020 from 10:00-11:00 am

Registration via Link or via E-Mail: