EMA Asset Management’s Valuation Webinar Series

Valuation of Real Estate

How the COVID-19 pandemic is affecting the market environment and the valuation of real estate in selected major countries in Europe

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Economic development since the outbreak of COVID-19

“UK GDP falls by record 20.4% in April as lockdown paralyses the economy setting the country on course for the worst recession in more than three centuries”

UK, Guardian, June 2020

“CDC Habitats to launch 40,000 housing units post crises.”

France, Les Echos, March 27th, 2020

“More than 1,000 partnerships and corporations filed for bankruptcy in May”

Germany, Handelsblatt, 5 June

“The French automaker PSA wants to see its employees in the office at most one and a half days a week in the future. They should no longer have to justify why they work at home - but why they want to come to the office.”

Germany, FAZ, 7 May 2020

“France’s state-backed investment bank BPI joins coronavirus fight”

FRANCE, FT, March 18th, 2020

“Corporate tax collection plunges 70% in April “

Spain, CincoDías, June 2020

“The entry of international tourists in Spain was null during the month of April as a consequence of the closure of borders determined by the state of alarm to tackle the health crisis of the coronavirus.”

Spain, CincoDías, June 2020

“Four in five retailers won’t pay full rent”

UK, The Times, June 2020

“UK debt now larger than size of whole economy “

UK, BBC News, June 2020

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### Selected economic indicators

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<th>Germany</th>
<th>United Kingdom</th>
<th>France</th>
<th>Spain</th>
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<tr>
<td><strong>Nominal GDP in 2019</strong>&lt;sup&gt;1&lt;/sup&gt;</td>
<td>3,436 EUR billion</td>
<td>2,523 EUR billion</td>
<td>2,419 EUR billion</td>
<td>1,245 EUR billion</td>
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<tr>
<td><strong>GDP growth</strong>&lt;sup&gt;2&lt;/sup&gt; Δ Q1 2020/ YE 2019</td>
<td>-2.2%</td>
<td>-2.0%</td>
<td>-5.8%</td>
<td>-5.2%</td>
</tr>
<tr>
<td>Outlook FY 2020&lt;sup&gt;3&lt;/sup&gt;</td>
<td>-6.5%</td>
<td>-8.3%</td>
<td>-11.4%</td>
<td>-9.4%</td>
</tr>
<tr>
<td><strong>Unemployment</strong>&lt;sup&gt;4&lt;/sup&gt; April 2020, rate in %</td>
<td>5.8%</td>
<td>3.8%</td>
<td>8.7%</td>
<td>14.8%</td>
</tr>
<tr>
<td>Outlook FY 2020</td>
<td>↗</td>
<td>↗</td>
<td>↗</td>
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<tr>
<td><strong>Mortgage interest rates</strong>&lt;sup&gt;5&lt;/sup&gt; December 2019, %</td>
<td>1.3%</td>
<td>2.1%&lt;sup&gt;6&lt;/sup&gt;</td>
<td>1.2%&lt;sup&gt;6&lt;/sup&gt;</td>
<td>1.8%</td>
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**Sources:**
Current challenges in the real estate market

**Office**
- Ability to social distance in offices
- New normal for office workers → reduction in demand?
- Flexible office concepts
- Business park revival?

**Residential**
- Rent collection levels
- High relative rental burden
- Housing shortages
- Construction cost uncertainty rearding new buildings and refurbishment measures

**Hospitality**
- International travel restrictions
- New normal → less business travel?
- Survival in the near term = cash and liquidity

**Retail**
- Decline in consumer spending
- E-commerce trend exacerbates oversupply
- Tenant default risk
- Landlord cash flow pressure
- Move to turnover rents?
Market value impact for major countries in Europe

During the past 10 years the real estate market was on the rise. How deep is the valley ahead of us? When do we reach the next peak?
Real estate market value outlook - Germany

Office
- Strong correlation with the general economy
- Risk of vacancy is rising
- Decrease in rents
- Long-term recovery

Hospitality
- Operational performance and rents strongly affected but on the rise again
- Operator consolidation to support real estate values in the long-run

Residential
- Generally less volatile than other sectors
- Short-term decrease in rents due to regulatory framework
- Positive long-term outlook

Retail
- Insolvencies cause loss of rents
- Less floor area is needed due to structural change
- Short-term decrease in rents
- L-curve recovery
Real estate market value outlook - United Kingdom

Office
- Short-term increase in vacancies and minor value hit
- Undersupply in London
- The office is still important

Hospitality
- UK in-bound quarantine problematic
- CVAs likely
- Steady recovery over the next 2-3 years

Residential
- Lack of supply and fundamentals remain
- Short term revenue loss
- Long term expectation is positive

Retail
- Accelerated transformation that was already occurring
- June quarter rent collection is key
- Alternative use options for poor assets
Real estate market value outlook - France

**Office**
- Unprecedented decrease in occupancy rate: -90% with a shift towards working from home
- Potential increase in companies’ default rates might result in a significant rise in vacancies
- Strong question marks about tenant needs in the future and market rents

**Hospitality**
- Strong impact due to border closure and international clientele drop in 2020 (~75% in occupancy)
- Diverse situations depending on MICE Vs Leisure mix / Economy class Vs Luxury hotels
- French market proved to be resilient with quick recovery following the previous crisis

**Residential**
- Strong fundamentals with a structural lack of supply and interest rates remaining at historical lows
- Delays in construction of new housing
- Potential temporary decrease in values for class-B assets

**Retail**
- Situations differ from food retailers to specialized brands
- Crisis acts as a catalyst for existing trends affecting the sector: phygital vs. physical, bankruptcy of historical national retailers
- Structural vacancy of class-B/C assets

* : A mixed-use building is a type of property that includes both commercial and residential space.
Real estate market value outlook - Spain

Office
- Linked to GDP evolution
- Impact of teleworking and health measures
- Expected increase of Flex Spaces

Hospitality
- Impact of international travel restrictions
- Delay in recovery for vacational hotels vs. urban hotels
- Expected high occupancy rates in the mid-term

Residential
- Linked to GDP and confidence
- Impact delayed in time
- Strengthening of the rental market

Retail
- Limited impact for food stores / pharmacies
- Impact of health measures
- Short-term decrease in rents
Major valuation risk factors

1. Cashflows entering a time of turbulence (i.e. rent reductions and losses, increasing vacancy rates, index variations).

2. Due to the increasing uncertainty in the market, the risk profile of investors may change leading to higher expected yields.

3. Marketability of properties could be put into question due to changed behaviours of the users.

4. Liquidity: In contrast to the financial and real estate crisis in 2008/09 there is in general no lack of liquidity in the current environment.

5. Avoid the double counting of risk in both cash flows and discount rates.
Five essential recommendations for valuation

1. Increase the frequency of your valuations and reporting as appropriate in response to increased scrutiny by regulators and shareholders.

2. Consideration of the short-term, medium-term and long-term impacts of the crisis is also essential (from high volatility to back-to-normal – or new reality).

3. Consider scenarios adjusted based on market evidence in your business plans by integrating what is known and knowable at the valuation date.

4. Challenge data and assumptions, produce robust documentation and monitor variations over time.

5. Widen the range of your valuations using sensitivity models. The ranges may be subject to volatility as the regular valuations will rely on projections that are subject to constant changes.
Q&A
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