

SPECIAL BULLETIN #5

STRUCTURAL THEMES CREATING OPPORTUNITIES IN CORE REAL ESTATE



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Many of the long-term structural changes that had been shaping real estate markets for several years became sudden and dominant drivers of demand as the pandemic took hold in 2020.

The result is an entirely new status quo for real estate investors, one in which uncertainty is a seemingly permanent fixture of the investment landscape. Many pre-pandemic norms relating to how we live and work are likely gone forever, while some may return as COVID-19 becomes less of an economic and public health concern.

Core real estate investing has evolved alongside these shifts. Prior to the pandemic, our team identified a number of structural themes that will drive future investment performance. These “DIGITAL” themes (demographics, infrastructure, globalization, and innovation & technology) remain highly relevant and instructive, especially considering many were greatly accelerated by COVID-19.

The manifestation of these themes creates new opportunities for real estate investors in 2022 and beyond.

Today’s DIGITAL drivers of demand

Secular shifts are creating both headwinds and tailwinds for different industries. Real estate has seen a significant rise in niche, or non-traditional, sectors as a result of tailwinds from e-commerce and changes to demographic and migration patterns. While industrial and residential are poised for growth given strong DIGITAL demand drivers, retail and office properties are likely to face a more uneven environment going forward given the structural shifts underway.

This shift is creating new opportunities in sectors that are experiencing an increase in market share as they grow in parallel with trends. Examples include data centres, life science, and single-family rentals—all non-traditional property types that benefit from lifestyle and demographic shifts and exhibited a high degree of growth and resilience during the pandemic and are well-positioned over the longer term.

But opportunities should not be viewed solely as traditional versus non-traditional. More broadly, the thematic drivers shaping the core real estate landscape include the following:

Technology developments. The pandemic immediately shifted our existing patterns of work and home life. For those employed in the professional and business service industries,



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DIGITAL themes accelerated by COVID-19

- The widespread adoption of technology in our home and work lives
- Changing consumer trends such as the continued saturation of online retail
- Supply chain disruptions and the move toward localization
- Continued strong performance of the logistics sector

video conferencing and other technologies led to the majority of office workers being able to do their jobs from home. What was surprising was how effective and seamless this transition was for most businesses, a realisation that spurred many businesses to make remote working a more permanent fixture.

Changing consumer trends. The retail investment landscape echoes many of the structural themes we are seeing, including convenience, necessity, and value. This had led to a preference for online shopping and value-oriented brick-and-mortar retailers. Demographics are also altering the retail environment, as baby boomers are becoming net spenders rather than net savers, and many millennials are buying their first homes, which will lead to increased aggregate spending.

Supply chain issues. Global supply chain disruptions have touched many sectors of the economy, but demand for industrial spiked during the pandemic as shopping moved online and more space was needed to facilitate the moving of these goods. The expansion of the industrial sector will likely continue as companies look to mitigate the risk of disruption through establishing domestic supply chains and distribution nodes closer to major population hubs, a process referred to as onshoring.

Strong logistics performance. We anticipate the continued robust performance of the logistics sector and are favouring key global gateway markets as well as select port cities such as Rotterdam and Hamburg. There is strong demand for warehouse logistics, particularly from e-commerce and third-party logistics companies. Amazon has dominated leasing in this space since 2019 and could be a marginal risk for demand and valuations as its expansion plateaus. In addition to XXL logistics, we also see a fast-growing last mile sector, especially around major population hubs.

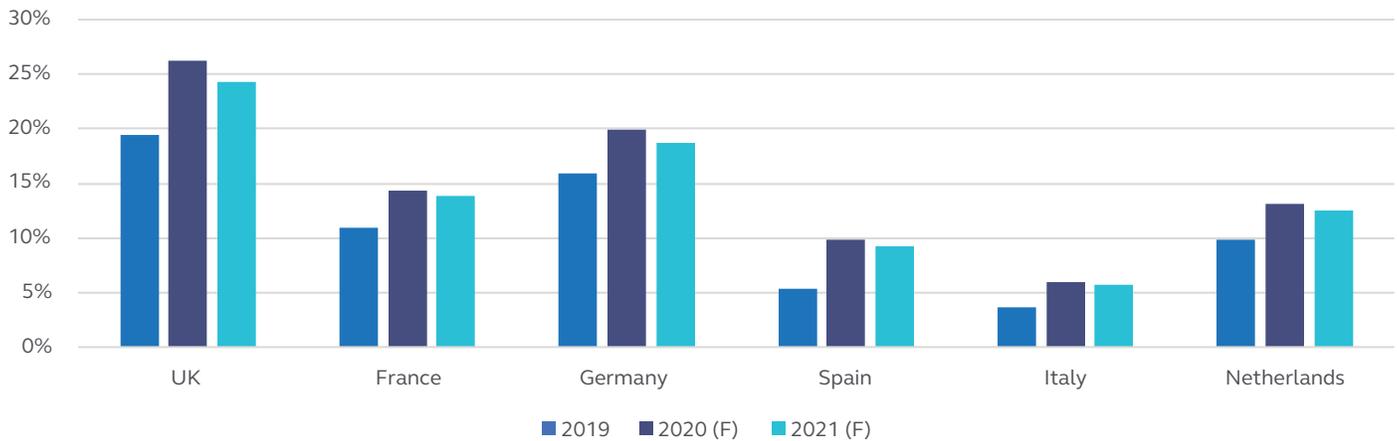
Case study: Italian logistics

To help bring these structural themes to life, consider a real-world example of how the DIGITAL framework can help understand where opportunity may be present due to pandemic-related shifts as well as longer-term secular tailwinds. A good example is the opportunity we see in Italian logistics.

The average age of the population in Italy is 47, one of the highest in Europe. This means that most Italians did not grow up with the internet, personal computers, and smartphones. It is no surprise

then that the percent of online retail sales in Italy is significantly below the major economies within the European Union, as shown in Exhibit 1. Nevertheless, as the sub-40-year-old age brackets have intricate knowledge of the internet, as well as the knowledge and confidence to shop online, Italy is poised for incredible growth potential given the country is working from a very low base in terms of online retail sales compared to other countries.

Exhibit 1: Online retail sales as a % of total retail sales across Europe

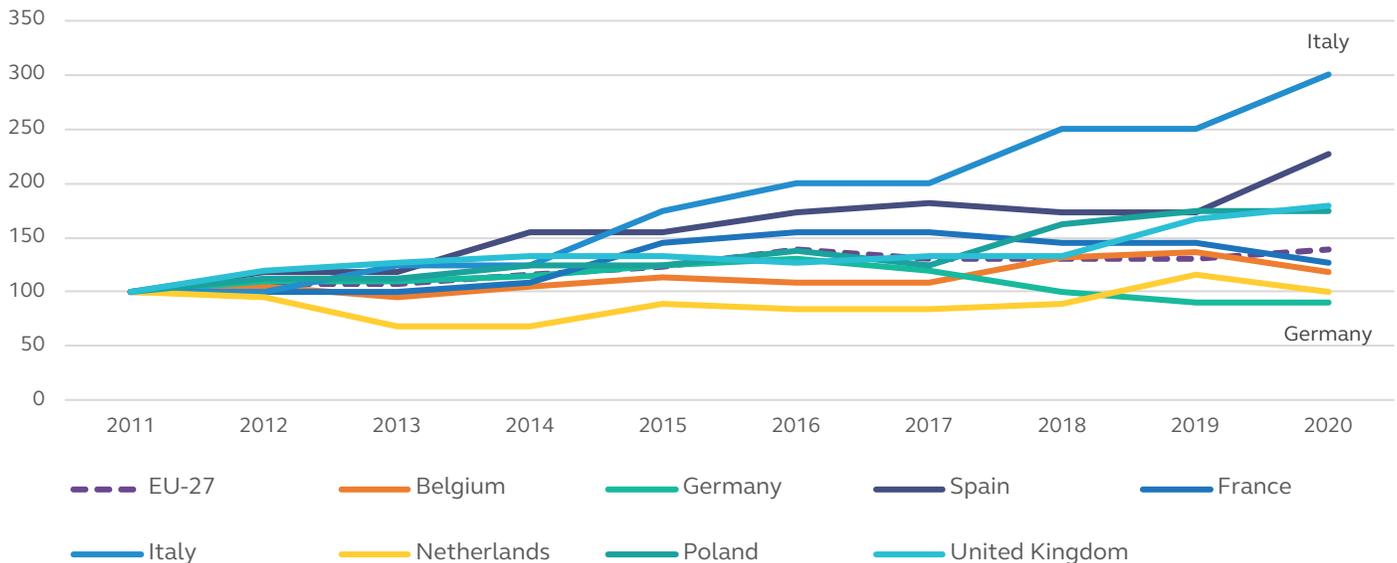


Source: Centre of Retail Research, July 2020. (F) forecast results

Currently, e-commerce sales in Italy are growing at a faster rate than any other country in Europe. We believe this is helping to position the Italian logistics market for substantial growth compared to its European counterparts.

Exhibit 2: Growth in e-commerce as a % of retail sales

Index 2011 = 100



Source: Eurostat, November 2021

Italy is also Europe's fourth largest country by population. The ports of Genoa and Gioia Tauro are growing in importance and now have a strong position as two of Europe's Top 20 logistics ports. Despite demographics and infrastructure dynamics pointing to a logistics hotspot, Italy has some of the lowest levels of stock within the European logistic markets. Additionally, prime yields are, in general, 50 basis points higher than other core European markets and investment volumes have been subdued.

Also, supply chain issues are impacting European regions and industries differently. Germany, an industrial manufacturing powerhouse, has been harder hit by supply chain disruptions, for example. As a result, on a relative basis, other countries are performing better, including having healthier recent manufacturing production. Labor costs in the southern European countries are more attractive than in the north and due to massive infrastructural projects, the southern countries are more accessible than in the past, making the region an interesting alternative for production of goods.

Going forward: New challenges and opportunities

Structural shifts, such as the preference for e-commerce, have been dramatically catalyzed by the pandemic. At the same time, other shifts, such as the movement from gateway markets to the suburbs, may fade or reverse over time. However, the pre-pandemic "normal" is not returning, and investors will continue to face unprecedented challenges in trying to determine the direction of specific real estate markets. The continued evolution of the growth of Europe's main distribution corridors is also a result of the enlargement of the EU and infrastructure projects

like new highways and train connections. This dynamic will continue to impact the locations of logistics over the next decade and create new opportunities for investors that are able to adjust to these changes.

This dynamic is creating new opportunities that can be uncovered through a selective core approach strengthened by regional expertise and resources. Regardless of the performance of individual regions or sectors, having resources on the ground to understand and access these markets opportunistically will remain key for any core investment approach.



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