LINK WEALTH

What Asset Type is the ‘Next Big Thing’?

December 2019

2018 Real GDP	YOY (%)
Germany	1.50
France	1.70
Italy	0.80
Spain	2.40
UK	1.40

Indicator	Data	Trend
Mortality Rate Infant per 1000 Live Births Germany (As of Dec 31, 2018)	3.10	▼
Germany Unemployment Rate (As of June 30, 2019)	3.1%	◀▶
Germany GfK Consumer Confidence (As of Nov 26, 2019)	9.7	▲
Germany Building and Construction Work Permits (As of Sep 30, 2019)	19,047	▼
Germany Building Permits for Dwellings (As of Sep 30, 2019)	29,387	▼

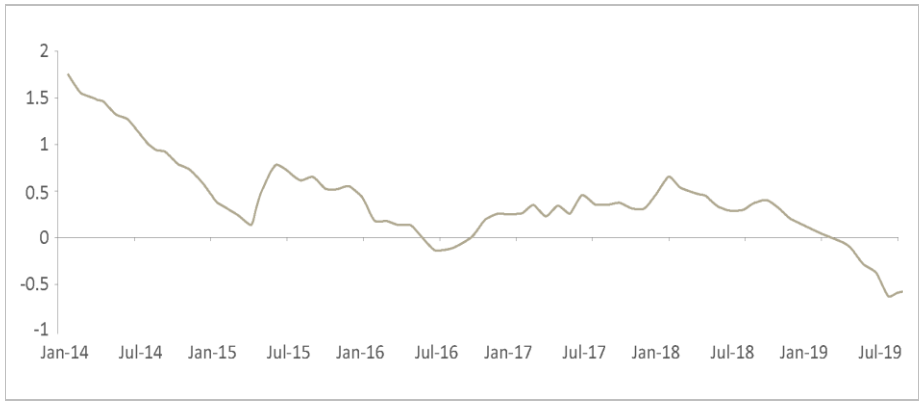
Germany Rental Yield	Data
Residential Yield (July 2019)	2.95%
Shopping Center Rental Yield (Sep 2019)	3.85%
Out Of Town Retail (Frankfurt, Sep 2019)	4.45%
Out Of Town Retail (Munich, Sep 2019)	4.25%
High Street Shops (Berlin, Sep 2019)	3.10%
High Street Shops (Frankfurt, Sep 2019)	3.30%
High Street Shops (Munich, Sep 2019)	2.80%
Prime Office Yields (Berlin, Sep 2019)	2.90%
Prime Office Yields (Frankfurt, Sep 2019)	2.80%

Source: OECD

Logistics Continues to be an Attractive Proposition

Over the years, falling interest rates have provided investors access to cheap credit, in-turn, opportunity to expand their investment portfolio. Moreover, expectations of interest rates continuing in same territory and a lack of compelling alternatives have driven significant investments in the German logistics real estate space. The relatively lower land prices, central location in Europe and technological sophistication make Germany a logistics hub. Moreover, with the Euribor rate slated to remain in negative territory, financing is likely to remain benign as well.

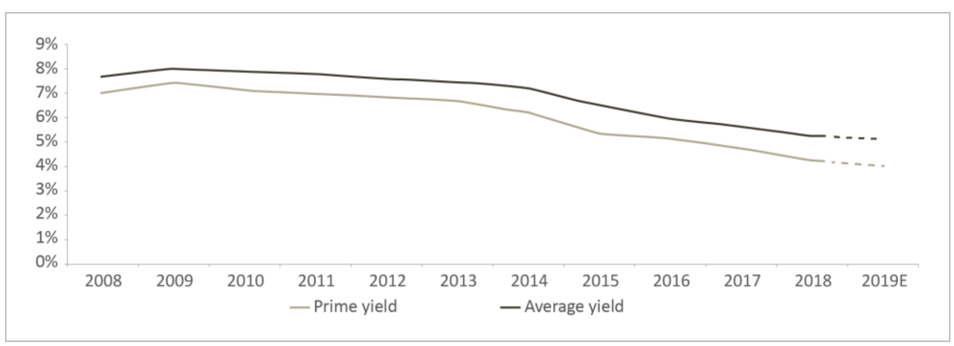
Germany long-term interest rate (ECB Harmonised, % per annum)



Source: CEIC (https://www.ceicdata.com/en/indicator/germany/long-term-interest-rate)

The advent of e-commerce and the subsequent need for logistics assets has also led to a jump in asset prices, although yields have been impacted as a consequence. According to Savills, in the previous five years, prime yields in Germany have fallen by ~300 basis points (bps) to just above 4%, due to strong investment interest, even as Germany remains the most attractive logistics investment destination in Europe. The rise in asset values mirror investor expectations of rental growth. Despite the ongoing fall in prime yields, logistics still remains one of the highest yielding real estate asset categories in Germany.

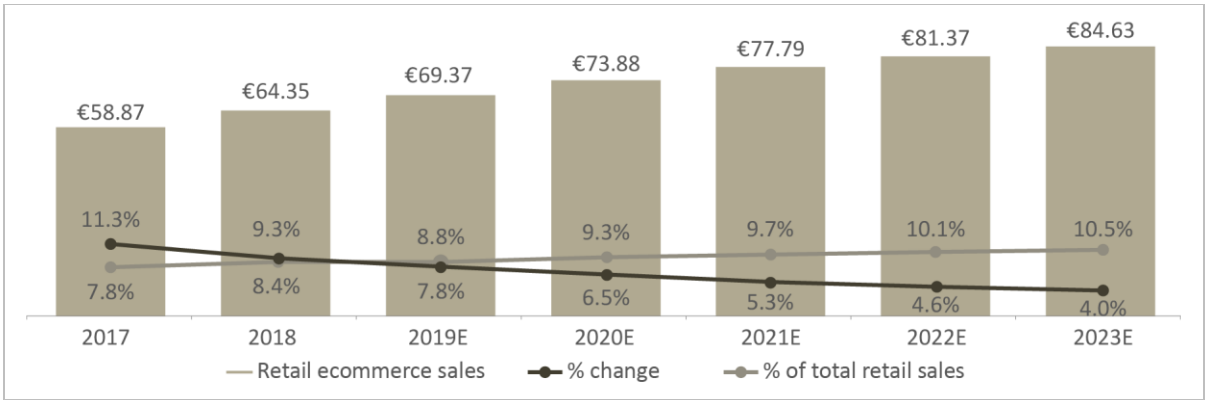
Germany: Average logistics yields (%) of top 7 markets



Source: Savills (February 2019)

According to eMarketer, Germany's retail e-commerce sales are expected to jump to €84.6 billion by 2023 from €64.4 billion in 2018. Moreover, with retail e-commerce sales as a proportion of the total retail sales in Germany expected to be very low (10.5% vs. 22.0% globally), we believe significant potential exists for further growth, which could subsequently drive demand for logistics assets in Germany.

Germany: Retail e-commerce sales (€ bn and % of total retail sales)



Source: eMarketer, May 2019

According to Savills, warehouses in Europe witnessed increased leasing activity, reaching a record level in 1H 2019, amidst growing demand from retailers. The UK, the Netherlands, Germany and France generated significant leasing interest during the period. Germany's major logistics regions include Berlin, Düsseldorf, Frankfurt, Cologne, Leipzig, Hamburg, Munich and Stuttgart. Since real estate availability for new warehouses and logistics assets within city limits is scarce, the rental gap between existing facilities in cities versus those in neighbouring areas is high. However, availability of land and the rising demand for logistics assets may lead to traction for assets located outside city limits.

Having established how logistics assets in Germany have been in a multi-year boom and provided investors with strong returns, we will now shift our focus to those asset classes within real estate, which offer lucrative growth opportunities. In view of the same, we consider investments in multi-use properties, data centers, student accommodation, medical facilities and schools. We reckon that the public private partnership (PPP) model is already being deployed in some of these asset classes, although potential exists for execution on a much larger scale.

Multi-use Properties

Urbanisation led by growing population across all major cities in Germany, well supported by influx of migrants has prompted the demand for office and retail space across major cities in Germany. This reflects on the resilient fundamentals of the real estate sector in the country, despite regional economic ambiguity and subdued business environment. Buoyed by this relative strength in local market, various local as well as international real estate focused funds are making selective acquisitions across attractive locations that hold long-term growth prospects.

Most of these investments are aimed at acquiring old property and refurbish or redevelop it into a high demand asset offering office, retail or storage space. This strategy offers direct access to strategic high growth location where generally new supply is scarce. Further, rapid urban regeneration in neighbourhood has brought the theme of mixed-use properties in forefront where a single property caters to office, retail and/or storage requirements.

We opine that with growing influence of technology, multi-use property would continue to attract more investments in coming future. Multi-use property's ability to dissect across different real estate classes offers better cushioning against business cyclicality through a diversified yield compared to single category property with a concentrated yield.

Data Centers

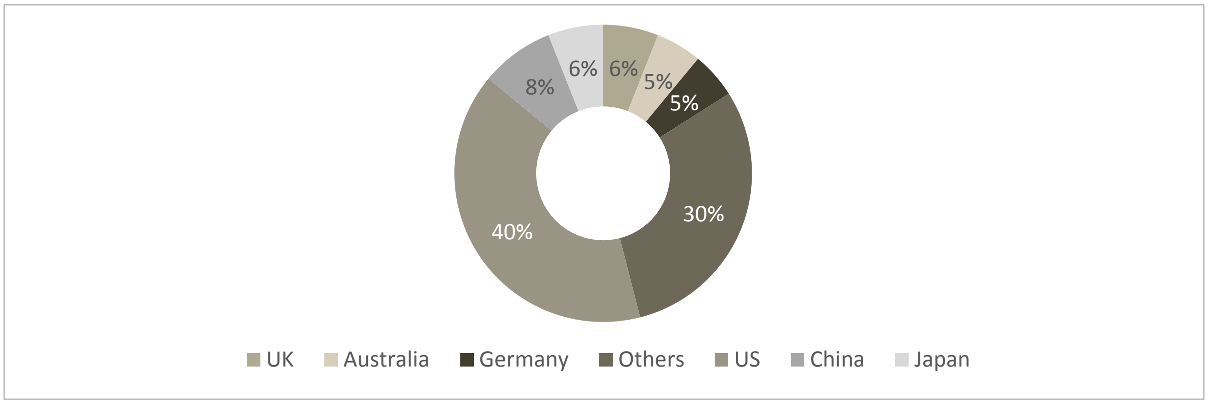
In Germany, data center investments may be fuelled by the implementation of General Data Protection Regulation (GDPR). The country's data center market is likely to be further boosted by IoT and Big Data applications, as well as increasing use of data analytics by companies. In order to ensure European data stays within the continent, governments from the region are already taking steps. In August 2019, French Finance Minister Bruno Le Maire stated that over the coming months, France and Germany will make proposals to invest public funds in data storage facilities. The objective of the move would be to reduce dependence on foreign data centers (especially in China and the US), ensure protection of European data and encourage investments in Artificial Intelligence (AI). According to market research firm Reportlinker, for 2018-2024 the Europe data center construction market should clock a CAGR of more than 4% to reach ~$13 billion. By the end of 2019, Western Europe was expected to start 20 new data center projects with capacity of more than 10 MW.

Private datacentre locations in Germany

Source: DC Byte and German Datacenter Association

Since most of the hyperscale data centers are in the US and given the need for local proximity for quality of experience, multiple greenfield opportunities abound in EMEA and Asia Pacific. Equinix, a leading colocation and data center operator globally, entered into a $1 billion joint venture (JV) with GIC, Singapore's sovereign wealth fund with 20% and 80% stake, respectively. The JV plans to initially own and operate six hyperscale data centers in Europe, including two new ones in Frankfurt. This in our view, showcases an opportunity for the German government to follow a similar PPP (public-private-partnership) model to attract data center investments in the country.

Hyperscale Data center locations by Country (December 2018)



Source: Synergy Research Group

Founded in 1995, DE-CIX Frankfurt is the world’s largest internet exchange point and peak traffic exceeding 7 Terabits per second, making the city the most ideal location in Germany for data center investments. We think the need to follow strict data protection laws in the country may compel companies based in Germany’s business hub, Frankfurt to store their data in data centers located in and around the city. Moreover in case Brexit were to happen, businesses could expand their operations in Frankfurt, in turn driving higher demand for data centers in the city’s periphery. The global data center M&A activity has been robust, with two of the largest players, Equinix and Digital Realty Trust scouting for inorganic growth opportunities. Apart from sector consolidation, one of the drivers of the M&A activity was companies hiving off data center facilities and shifting to the cloud amidst operational expenses. In a major deal announced in November 2019, US-based Digital Realty Trust agreed to acquire European colocation and data centre services provider Interxion at an enterprise value of $8.7 billion. We opine that the key motivation for the primarily US-focused Digital Realty Trust was to diversify its operations and expand in Europe, including Germany. Apart from a Frankfurt campus, Interxion also has a Düsseldorf data center campus located at the internet highway between Amsterdam and Frankfurt, positioning it strategically to serve the Rhine-Ruhr metropolitan area.

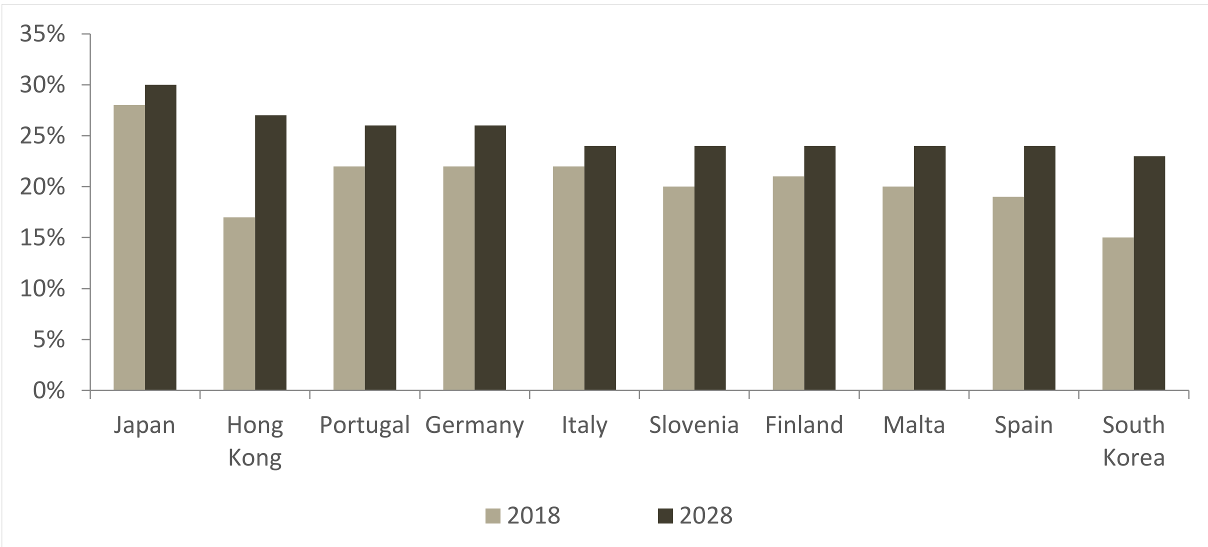
In October 2019, Hamburg-based Garbe Industrial Real Estate and Munich-based NDC Data Centers announced a joint venture to build green data centres in Europe. The deal appears to be symbiotic, providing Garbe with portfolio diversification opportunities, with NDC gaining access to Garbe’s project development expertise and land bank. According to IDC (November 2018), the volume of worldwide data will grow at a compounded annual growth rate (CAGR) of 61% to 175 zettabytes (ZB) by 2025. The surge in data will require heavy investments in data centers, although ResearchAndMarkets estimates Germany’s data center market to grow at a relatively modest CAGR of 5% for 2018-2024. Some of the private data center operators in Germany include maincubes (data center location: Frankfurt am Main), Keppel Data Centres (Frankfurt; Am Martinzehnten Industrial Park close proximity to the city centre and airport) and Grass Merkur (Hanover).

Given their high growth potential, long-term leases and steady cash flow, we believe data centers provide a compelling investment alternative, although high energy expenses could be a major area of consideration while investing.

Medical Facilities

Currently, Europe's largest economy, Germany has in excess of 14,000 nursing care facilities and more than 800,000 nursing beds. By 2040, Germany will need 300,000 incremental nursing beds, according to Deutsche Care Property Consulting as the country's demography shifts to a higher proportion of aged population.

Share of aged (65+) as % of total population



Source: Savills

According to data from World Bank, Germany's life expectancy at birth has risen gradually from about 78 years in 2000 to about 81 years in 2017. The country has the largest elderly population (7.8 million of 70-79 year olds) in Europe with a relatively high savings rate and wealth compared to other countries. Consequently, an ageing population should lead to a rise in demand for healthcare services and a corresponding rise in investor interest in care facilities. These factors make senior housing and healthcare a market with high growth potential.

According to Savills, in the first eight months of 2019, the estimated care real estate properties were traded for EUR 264 million, higher than the levels achieved in each of 2017 and 2018. The attractiveness for care properties amongst investors is the long-term leases of 20 or more years (unlike that for office or logistics spaces) and a steady income stream, offering investors with substantial visibility. In 2018, care facilities transactions reached EUR 2.9 billion, although 2019 witnessed many small transactions.

In January 2019, ActivumSG Capital Management (ASG) announced the acquisition of WirtschaftsHaus, having already acquired Wi-Immo-Group in 2016. ASG combined the two companies in June 2019 into a new company, Carestone to become the largest senior housing developer with a pipeline of EUR 1.4 billion. The rationale for the acquisitions and their subsequent merger was to build scale rapidly amidst the impending acute supply shortage in a fragmented and niche market.

Although most of the nursing home ownership rests with operators or private investors, institutional investors such as real estate funds possess in excess of 15% of the ownership. Also, a number of properties are separated and sold as individual, self-contained care apartments and sold to retail investors.

Link Wealth SA
Rue du Rhone 114
1204 Geneve
Switzerland

Tel: +41 22 552 25 03