COVID-19 & EUROPEAN REAL ESTATE LOGISTICS: DEALING WITH NEW MARKET DYNAMICS

July, 2020

Logistics in the COVID-19 world

The lockdown measures implemented between the end of Q1 and beginning of Q2 2020 in most of the developed countries created a strong impact on consumers' behaviors and habits that has ultimately affected the way companies run their businesses and distribute their products or services.

The nature of the crisis materialized with differing intensity and duration across countries and businesses; **the extent of the decline in economic activity has been mostly influenced by the type of need covered by operators and also depended on the existence of any "socially distant" alternatives** to satisfy the relevant business or social need1 (i.e. primary, covering basic needs as food, pharmacy and fast-moving consumer goods, and secondary, namely clothing, electronics and other goods, such as luxury and leisure products and services).

In this scenario, **logistics operators have generally shown more resilient fundamentals, due to their ability to provide goods to final consumers with reduced physical/human interaction**.

During the Covid-19 emergency, the **logistics market has reacted differently depending on the sub-type of underlying business**:

- **Business-to-Consumer logistics** (mainly e-commerce business model aimed at delivering goods directly to final customers): physical lockdown has accelerated the household e-commerce/digitalization process that was already underway. During the lockdown, e-commerce fully replaced physical retailers for the purchase of non-primary goods, but also saw an increase in food and pharma-related deliveries in order to avoid contagion situations/long queues at physical supermarkets. Now, as the situation is normalizing, **some customers continue to purchase on-line as a time-efficient alternative to traditional shopping, opening up new opportunities for players willing to increase the on-line distribution channel**

- **Business-to-Business logistics** (traditional supply chain infrastructure): the shutdown of production chains for most industries has slowed down trade, commercial and manufacturing activities in general, preventing businesses from receiving their goods in a timely manner. **Signs of fragility in the global supply chain have materialized, exacerbating elements of complexity that were less visible during the business-as-usual scenario.** At the current time, the post-emergency implications are not yet available, as international trade has not fully recovered, and such recovery in trade and manufacturing is not uniform across countries and regions

This paper is designed as an interview to analyze the main trends expected to emerge following the coronavirus outbreak, based on a scenario where no further large-scale lockdown measures would be imposed

What trends do you observe and anticipate after the lockdown period in the logistics real estate asset class?

COVID-19 has materialized with unprecedented strength and the related lockdown measures have caused a series of remarkable changes in consumption in terms of items/product mix, volumes and distribution methods.

1. Please refer to GRE Covid-19 white paper published in April 2020 for further details

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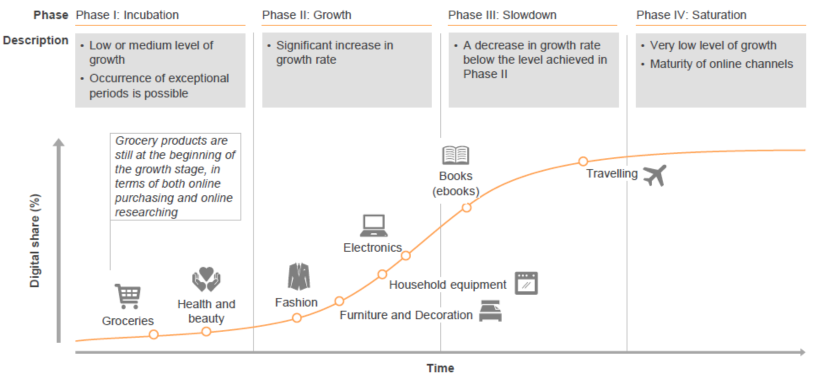
When locked down, consumers changed their consumption behavior, leading to an accelerated penetration of e-commerce sales. In general terms, as **on-line shoppers and purchased volumes have increased and companies have allocated or are allocating relevant budget to developing virtual offers** (in terms of enhanced websites, product catalogues available on-line, and improved logistics), **logistics demand is expected to grow over the short term. Take-up will increase significantly also due to space/sqm absorption of on-line vs. traditional brick-and-mortar sales, estimated at 3x.** Food and pharma have experienced an increase in volume sold and a shift in distribution channel.

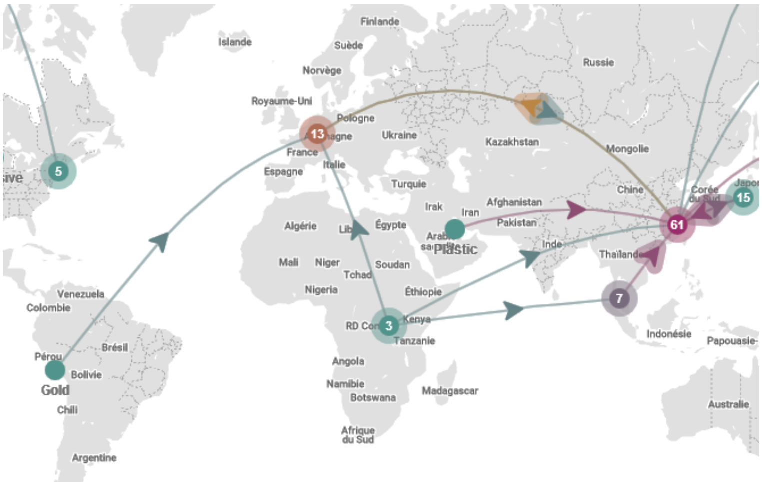
Figure 1 – Different product categories progressing in online penetration phases[1]



The exponential acceleration of on-line penetration of groceries and health products, typically sold physically due to strong dependency on cold chain maintenance, **is a trend expected to last over the long term**, although moderately compared to the growth rate experienced during the health crisis. Given the **technical characteristics of the dedicated "cold chain" logistics and their "compulsory" location next to residential areas, a further strengthening of the dedicated real estate logistics market is expected.**

The lockdown measures imposed largely across Europe have demonstrated the need for continued reconfiguration of supply chains. The recent fall in global trade has simultaneously frozen both the supply and demand chains, with already shipped goods getting stuck in the middle of their journey and no new demand for additional items. Given the difficulties in the procurement process of various types of sanitary equipment (above all masks), **the crisis has stressed the fragility of the global supply chain**. Since primary goods cannot be subject to delay, **some countries have internalized the production of critical goods, further reconfiguring supply chains between these nearby production areas and their consumption basis.**

Figure 2 – Example of supply chain complexity



For some types of goods, potential shortage might be overcome with increased levels of storage/overstock in the long term, although warehousing costs would thereby increase.

Focus on efficiency, certainty and timeliness of delivery might replace the current view aimed at decreasing costs and maximizing financial efficiency in logistics. In a nutshell, for **certain supply chains, some overstock might replace the just-in-time business model.**

1. Five Forces Transforming Transport & Logistic, PriceWaterhouseCoopers, 2019

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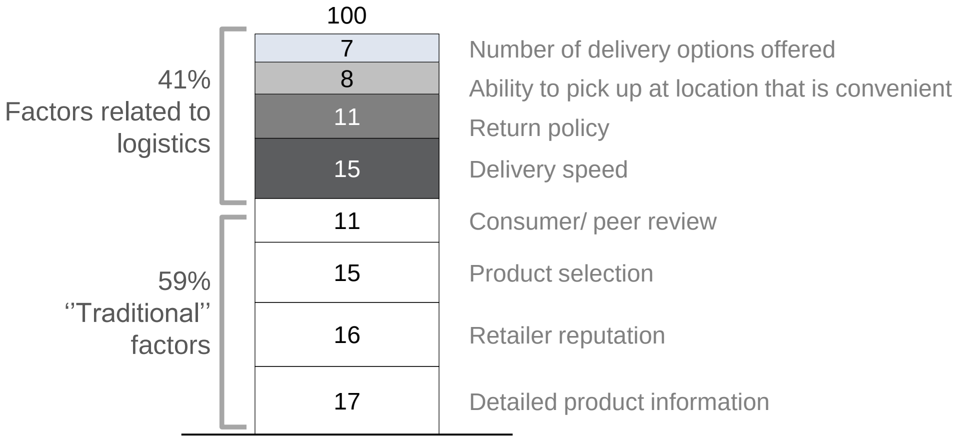
Is the logistic shift from commodity to strategic asset for users and investors confirmed?

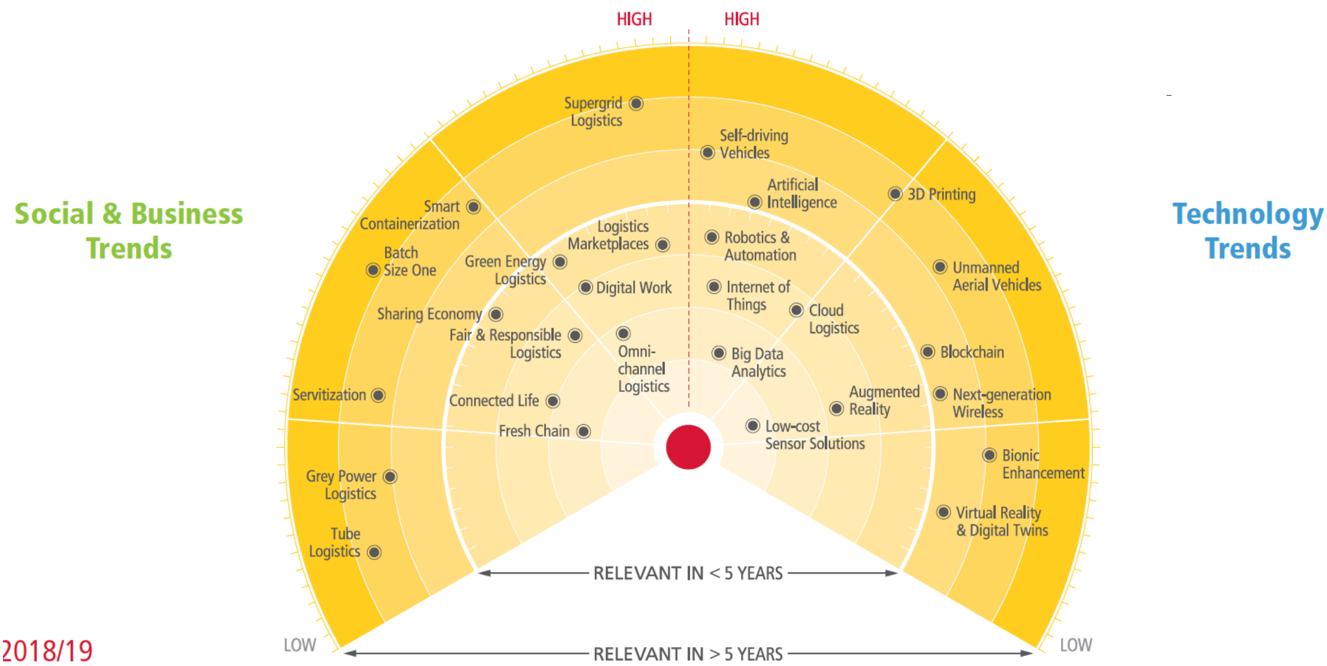
We can answer this by looking at consumer trends, which are the most powerful driving force. Nowadays, factors related to logistics are growing in relevance as part of the purchase decision, directly or indirectly accounting for more than 40%. This trend was already in place before the COVID-19 crisis, which essentially acted as an accelerating factor for logistics.

Figure 3 – Factors take into considerations when choosing a retailer[1] [%]



In addition to consumer trends, **technology trends** such as big data analytics, cloud logistics and low-cost sensor solutions **are becoming increasingly accurate and more affordable, making them available to the industry in the medium term**, including to medium-sized players. In the meantime, big players continue to work on the development of new/game-changing innovations able to shake up the industry. According to DHL, within the next 5 years, the industry will be impacted by self-driving vehicles, artificial intelligence and aerial vehicles. In this context, the **supply of state-of-the art and up-to-date real estate logistics able to constantly dialogue with technology infrastructure is paramount to delivering an improvement of the overall supply chain performance.**

Figure 4 – Logistic trends radar[2]



1. Five Forces Transforming Transport & Logistic, PriceWaterhouseCoopers, 2019
2. Logistics Trend Radar, DHL Trend research 2018/2019

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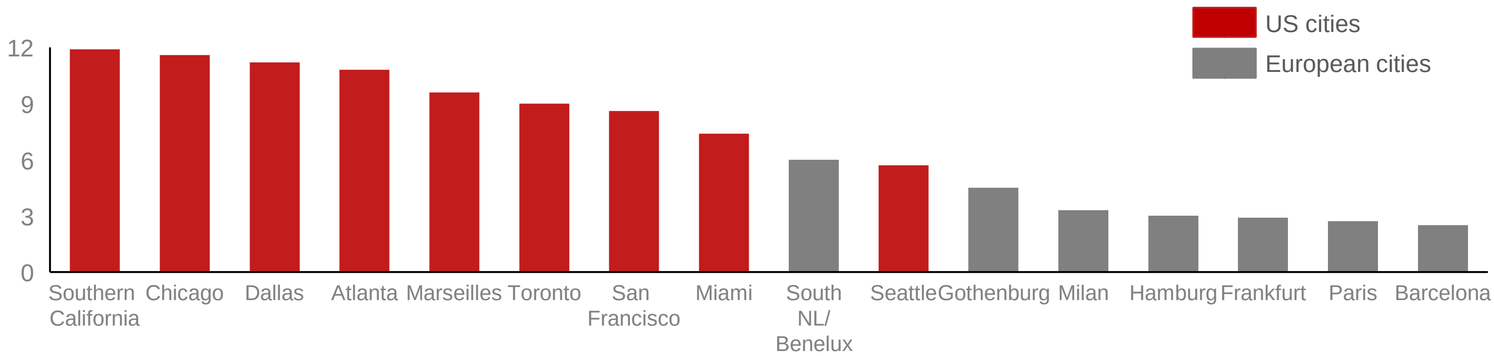
Lockdown and expected GDP reductions to follow in the next few months will likely create some solvency issues for certain logistics operators, as this industry survives on tight margins. Nevertheless, **European logistics**, given its strong unexploited potential when compared with US logistics, **is expected to keep growing at a significant pace and to offer operators relevant opportunities mostly dependent on further reconfiguration of B2B supply chains and increased on-line sales.**

Figure 5 – Warehouse spaces per household [sqm][1]



Going forward, governments are expected to have an active role in the developments of the industry, as most countries have already **allocated large budgets to strengthening the economy through a direct stimulus to infrastructure development**; as of today, there exists a series of outstanding proposals at the national and European level for several billion euros of investments.

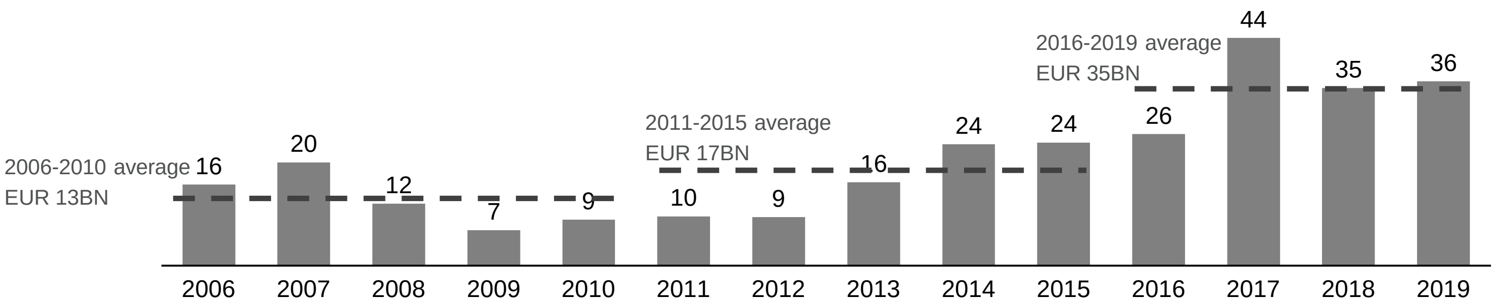
What are Generali Real Estate plans for logistics sector?

In 2019, Generali Real Estate launched its logistics core+ pan-European fund ("GRELF"). The fund aims to reach approximately EUR 2BN in the next three years, targeting high-quality assets located in prime logistics hubs, with some flexible allocation based on long-term convictions and market shifts.

As of today, the fund amounts to around EUR 500 million, diversified across the most resilient logistics sub-markets in France and Italy. Fund strategy is twofold, with sizeable recurring income generated by resilient prime assets actively managed in the long term and dynamic value creation generated through built-to-core/forward-funding projects, also working on repositioning triggered by vacancy reduction and location/corridor consolidation

Generali Real Estate plans to grow the fund in the coming months without compromising location and building specifications. This will take place also by taking advantage of the repositioning of the asset class, whose liquidity has greatly improved over the last few years.

Figure 6 – Annual investment volumes in EMEA logistics [EUR/BN][2]



1. GRE research on Colliers International, Global Industrial and Logistics trends
2. GRE research on Erix databse platform

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In your opinion, what contribution can the logistics asset class, and more specifically the GRELF fund, make to the sustainable development issues, that are becoming increasingly important in our developed European countries?

Logistics real estate often raises eyebrows when discussing sustainability.

At Generali Real Estate, we aim to be proactive in reducing the environmental impact of our portfolio, as well as by integrating environmental, social and governance (ESG) metrics and monitoring into our business operations. Through Generali, our parent company, we have committed to continuous improvement in both our real estate operations and within our industry (please find below a short-list of associations to which we actively belong).

As far as "GRELF" is concerned, the fund has taken real and tangible actions on its own assets, such as improvement of energy performance through LED retrofitting, data analytics (identifying savings) or by assigning an energy manager to the assets.

The asset energy manager has proven to be strongly effective in order to **reduce annual heating costs by 30-60% on several pilot projects.** Such remarkable results have been possible through a strong alignment of interests between tenants and landlords.

Facilitating hydrogen distribution to power forklifts/vans/trucks, supported with energy production

Additionally, ''GRELF'' is seeking to create **renewable energy on site, whether through photovoltaics** on building roofs/parking coverage or **wind turbines** installed on site.

Generali Real Estate is also working to facilitate carbon emissions reduction, through the roll-out of a green hydrogen infrastructure allowing the de-carbonization of heavy duty transport. GRE recently signed a "Joint call for the development of Fuel Cell trucks'' alongside Hydrogen Europe, a trade association representing >100 industry companies, 68 research organizations and 13 national associations.

Generali Real Estate actions to face Covid-19 emergency

Generali Group has created a fund of up to EUR 100m for the Covid-19 emergency (please visit https://www.generali.com/it/media/press-releases/all for further details).

Generali Real Estate has contributed to face the Covid19 by making the hotel "The Square" in Milan available for healthcare personnel and quarantined people.

Moreover, Generali Group is currently liaising with the European Commission and a number of other key leaders of the European institutions about the recovery package proposed on the need for effective solutions to fuel a sustainable economic growth following Covid-19.

'I underlined once more Generali's strong will to be part of this effort, financing investments in infrastructure and the green transition, and I also took the opportunity to propose the creation of a pandemic fund set up together with national governments and the EU institutions' – Mr. Philippe Donnet CEO of Generali Group, 17 June 2020

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Generali Real Estate

Generali Real Estate ("GRE") is a real estate asset management specialist currently managing assets for €30.7bn

GRE is part of Generali Group, one of the leading European insurance companies

GRE has a unique Pan-European footprint, with a team of 438 deployed in 9 European offices

Historically, GRE has mostly managed the entire Real Estate value-chain process developing unparalleled industry capabilities

GRE, coherently with Generali Group strategy, serving the Group (eleventh investor in Real Estate in the World) is expanding its product catalogue thanks to 9 cross-border vehicles and targeting also external clients, institutional ones in particular