The implications of COVID-19 for the real estate industry

This paper provides insights into the possible **consequences of COVID-19 and its related behavioural changes** on the real estate industry with view also to the real estate market in Slovakia. This overview provides short and longer term views across the entirety of the industry from two perspectives: 1) The **perspective of real estate end-users**, in which real estate is supporting to a company's core business, and 2) The **perspective of real estate and construction companies**, for which real estate is core business.

Effects of COVID-19 on the macro-economy are impacting the entire Real Estate industry

— Strong correlation between real estate developers' financial performance and national economies' wellbeing

— Significant exposure of real estate investment managers to highly affected industries such as hotel & leisure, retail and office investments can hamper future and imminent cash-flows and pension fund returns

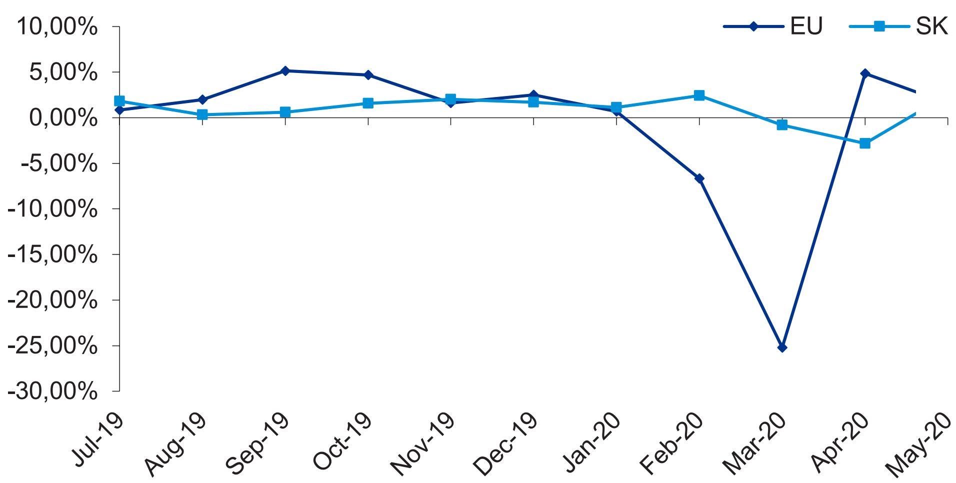
— End-users in specific sectors, primarily in retail, highly dependent on real estate for recurring revenue streams

— Retail tenants apply for rent discounts because they want to reduce the standard high fixed costs of real estate due to their loss of income.

Property owners are not unwilling to do this, but the demand for customization complicates imple- mentation

— The question that remains is whether the retail sector will ever be the same once the blow of the corona crisis is over. This crisis might very well be the end of many outdated business models.

EU & SK RE Funds



Effects and Sector Impact

Working from home experiment may fundamentally change consumer behaviour and the office-space market: Forced working from home restrictions might lead more players to reduce office space renting in the future, or to move towards renting “smart offices“. This presents a potential opportunity to corporates to rationalize portfolios and embrace enabling technologies.

Top-line cash-flows related to unearned (rent) revenue at risk: Real estate investment managers strongly exposed to at-risk categories are directly im- pacted, such as hotel and retail space and to a lesser extent office space and residential units. Expected government measures introducing rental subsidies up to the amount of the contribution of the lessors and max. 50% of rental fee, as well as the deferral of the remaining rent to 48 following months may have significant impact on cash flows of property owners.

Leveraged capital structures are at risk: Property developers and investors financing operations with debt may particularly be at risk of defaulting, exaggerating their credit lines, and struggling to maintain liquidity. Banks will very likely provide new loans only to big and stable market players and conditions for new loans may be stricter. Opinions of auditors will be of greater importance.

Digital investments seem to pay off: Sector players that invested significantly in digital capabilities seem to be better able to continue activities during crisis.

Constructions planning impaired due to international labour force: Property developers and construction companies relying on foreign labour may have their plans be hampered due to international travel restrictions. Similarly, construction plans are placed on hold and may experience delays. Incurred costs are highly dependent on contractual agreements.

Disruptions to procurement can shake the entire supply-chain: These trying times evidence the interdependence of (construction) supply-chains such that, if one entity is experiencing difficulties, this may reverberate across the chain. The supply-chain and its interdependencies must be managed in its entirety rather than in silos.

Impairments in tangible assets may lead to dete- rioration on balance sheet and income statement: For those with real assets on their balance-sheet, loss of income generated through real assets may lead to impairments and devaluations, highly impacting bottom-line and financial performance. This issue can be raised during statutory audits.

Development companies impacted by interruptions in the value chain: It was expected that property developers will be highly impacted by market uncertainties and consumer confidence resulting in fewer or delayed private sales. Due to the still high demand for residential property exceeding the offer, market disruption in this segment still did not occur.

Listed real estate companies’ stock market value and share prices have evaporated: in anticipation of deteriorating leasing fundamentals as a result of social distancing and intelligent lock-down. This situation is, however, expected to be of a temporary nature.

Players active in at-risk categories must re-strategize post-crisis: Real estate investment managers must reconsider their asset allocation strategies, contractual and financial arrangements and effectiveness of their risk management operations.

Approach and Mitigations

Assess

Assess Impact on KPIs and map Action plan

The **increased risk on business** as usual operations must be assessed, with specific attention given to **risk management**:

- Leveraged capital structures and liquidity
- Solvency of counterparties such as commercial tenants
- Portfolio dependence on at-risk industries (such as retail)
- High cost bases and inefficiencies in operating models
- Cash and liquidity management
- Tax impact analysis

Adopt

Adopt measures immediately to safeguard business as usual operations

Identify quick wins in action plan and adopt immediately to mitigate lasting effect of risks. Consider:

- Define a well strategized route to safeguard business, facilitate all stakeholders and keep your longer term ambitions targeted.
- Focus strongly on Business Continuity Planning (BCP), in line with long-term ambitions
- Rent suspensions helping tenants to survive, but act wisely in mutual interest
- Strong account management orientation to engage tenants
- Amend cost base where required to reduce operating expenses

Adapt

Adapt business strategy going forward and refine accordingly

Reassess overall business strategy including planned milestones and goals to reflect new economic reality. Consider:

- Reassessing planned investments and strategy based on industry developments
- Refining (re)financing plan and KPIs based on economic developments
- Managing banking agreements and monitor covenants
- Continuing or accelerating digital initiatives to further prepare your organisation for the new reality
- Long-term opportunities for Corporate Real Estate to rationalize portfolio given working from home

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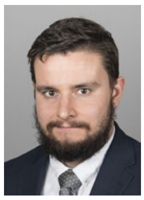

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