PERE

March 2021 • perenews.com

Europe roundtable 2021

ROUNDTABLE

SUPPORTERS

ARES MANAGEMENT CORPORATION • BC PARTNERS • KENNEDY WILSON EUROPE • PICTET ALTERNATIVE ADVISORS
SAVILLS INVESTMENT MANAGEMENT • SIGNA FINANCIAL SERVICES

Covid rings the changes for European real estate

As the initial shock of the pandemic recedes, participants at the Europe roundtable survey an altered investment landscape.
Stuart Watson reports

In 2020, the fallout from the coronavirus pandemic jolted Europe's real estate market and induced temporary paralysis. The result was a significant fallaway in investment volumes. According to real estate deal data firm Real Capital Analytics, Q4 2020 deals plummeted to €75.8 billion, 44 percent below the region's peak volume recorded in the last three months of 2019. In a fate compounded by a third slew of lockdowns, that meant the total European investment volume for 2020 was 27 percent lower than the previous year.

Now, with the initial shock fading, the industry is beginning to assess the lasting effects of the crisis. Meeting by videoconference from work and home offices across the continent, the six participants at *PERE's* Europe roundtable buckle down to the task of addressing the front-of-mind questions for investors in the region.

They agree that European real estate is in a better shape to recover from the pandemic-induced downturn than it was after the global financial crisis. "This time there was not overbuilding in most sectors, or overlending because banks were still unable to participate," observes Bill Benjamin, head of real estate at global alternative investment manager Ares Management.

"There was a world of difference in the policy response this time round compared to the GFC," adds Peter Collins, president of Kennedy Wilson Europe. "The European Central Bank was much quicker to react and so was the European Union on the fiscal side."

Thus, following a brief hiatus in the spring, capital kept flowing into real estate, notes Zsolt Kohalmi, global head of real estate at Swiss-based Pictet Alternative Advisors. "When you have open-ended funds getting capital every month, that means that the propensity to deploy is going to remain. And as a core buyer, your returns are being measured against the risk-free rate, which is only going one way. So, on a relative basis, core looks better and better, and you keep deploying."

While funds continued to flow into perpetual life vehicles, closed-end fundraising in Europe was a different story with plenty of instances of fundraising extension requests by managers unable to reach a final close amid travel restrictions imposed by governments. According to *PERE* data, $25.4 billion was raised for European closed-end

Bill Benjamin

Partner and head of real estate group
Ares Management Corporation

Based in London, Benjamin is head of real estate at global alternative investment manager Ares, where he oversees the real estate group's investment activity worldwide. The firm manages around $179 billion of assets, primarily in the private markets, including $14.4 billion of real estate in opportunistic and value-add strategies in Europe and the US, and in US real estate debt.

Kiran Patel

Global chief investment officer and deputy global chief executive officer
Savills Investment Management

Patel joined Savills IM, the investment management arm of global real estate services provider Savills Group, eight years ago. The business manages around $25 billion of real estate assets, employing a team of 300 professionals located in 16 offices across Europe and Asia.

Peter Collins

President
Kennedy Wilson Europe

Collins has been with global property company and investment manager Kennedy Wilson since 2011 and now leads its European business. Quoted in the US, the firm has $17 billion of assets under management in strategies that span the risk spectrum from development to core-plus and sectors including offices, multifamily and industrial.

Zsolt Kohalmi

Global head of real estate and co-chief executive officer
Pictet Alternative Advisors

Kohalmi joined Pictet from Starwood Capital two years ago to build the Swiss financial services firm's real estate business. Pictet manages €560 billion overall, including around €4 billion of real estate. The company closed its first direct real estate fund, Elevation I, at its hard-cap of €700 million in February 2020.

Stéphane Theuriau

Partner and head of real estate
BC Partners

Paris-based Theuriau joined BC Partners in 2018 to launch the company's real estate business, and has led an €800 million fundraise for its first real estate vehicle. The London-headquartered firm manages around €25 billion of assets overall, principally in private equity and credit strategies.

Richard Johnson

Managing director and head of international capital markets
SIGNA Financial Services

Johnson joined SIGNA two years ago to expand the Austrian-headquartered group's connections among non-German speaking institutions. The privately managed investment and holding company's real estate division manages around €18 billion of standing assets and is undertaking €12 billion of development in Austria, Germany, Switzerland and Italy.

funds, 12 percent more than in 2019 but 44 percent down on the region's peak fundraising year in 2017.

Nevertheless, participants Pictet and BC Partners both raised first-time funds in 2020. Pictet closed its vehicle in February before the pandemic started. But BC Partners head of real estate Stéphane Theuriau endured the challenges of fundraising during the pandemic.

"As a new entrant our experience is that there is a lot of available capital for existing players. We raised money exclusively from existing relationships. The large managers have disproportionately benefited during this period, because it is such an easy decision for an investor to re-up based on past performance," he says.

Capital providers were very selective about which strategies to back, however, notes Kiran Patel, global chief investment officer at Savills Investment Management. "The core end of the market became even more expensive, because people saw that as providing stability while everyone was waiting for price discovery on the more distressed areas, which did not really materialize."

Favored sectors

As the pandemic drags on, the initial expectation of a V-shaped recovery across the whole market has been replaced with a growing realization that there will be long-term consequences for some sectors, argues Richard Johnson, head of international capital markets at investor-developer SIGNA. "This year, we are going to be saying that the economy has split into winners and losers, which will recover at different rates, and that will affect investment flows going forward."

The residential and logistics sectors, with their powerful narratives of resilience, have accounted for an increasing share of investment volume, says Patel. "Real Capital Analytics' 2020 figures show that industrial has increased from 12 to 15 percent – everybody wants logistics, and that is

> *"We are social animals. I think productivity and morale is better in the office"*
>
> **BILL BENJAMIN**
> **Ares**

being reflected in pricing. Residential has gone from 20 to 24 percent. Office came down from 44 percent to 40. But it was still a significant portion of the market. Retail was the big loser."

The glut of capital demand for a few favored sectors presents investors with a dilemma, argues Kohalmi. "The real choice is which poison would you like to take? A fully priced bet where the macro drivers are right? Or an asset that faces slightly adverse conditions where you can get a better entry point? Making general calls is tough in a market with such elevated prices. We all need to find the individual deals that make sense."

Collins senses a window for acquiring distressed assets will open briefly during the next two years. "For example, a lot of hotel operators have suffered so that could shake out some opportunities," he says.

"But you have to get your timing right. Retail has the potential to be oversold. There are elements that will survive like convenience and retail warehousing. Overall, distress and repositioning will be the main value-add themes that everyone is playing across sectors."

> *"The core end of the market became even more expensive, because people saw that as providing stability"*
>
> **KIRAN PATEL**
> **Savills IM**

Offices under pressure

While there is broad agreement among the participants about the prospects for most asset classes, the office sector is the subject of vigorous debate. Theuriau argues that it is not only retail that will be impacted by the acceleration of technology-led disruption during the pandemic. He notes that investment activity in the office segment halved in 2020, and predicts that many occupiers will radically rethink their occupational strategies. "Technology is also attacking offices. This does not appear to be a real estate cycle or something that is driven by low GDP. If you look at offices pre-covid, it was pretty clear that there was an accelerated obsolescence, and that what qualifies as core will be a smaller proportion of what exists."

Benjamin expects to see "a 10-15 percent erosion of demand in rents and capital value for the time being, perhaps even 20 percent." However, he adds: "Zoom has helped our businesses during the pandemic. But we are social animals. I think productivity and morale is better in the office, and if you are starting out in any business, I do not see how you advance in your career from home."

Nevertheless, even a 15-20 percent decline in office take-up could potentially cause huge value destruction, says Theuriau. "Cap rates are so low and rents are so high. It does not take much of a change in underwriting assumptions to get to a pretty dramatic repricing."

Patel says Savills IM will still consider office opportunities. But he predicts the sector will go through a

> *"Making general calls is tough in a market with such elevated prices. We all need to find the individual deals that make sense"*
>
> **ZSOLT KOHALMI**
> **Pictet**

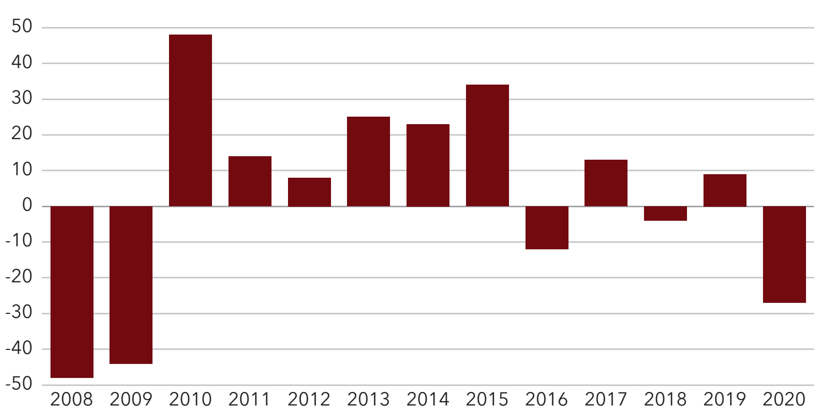
period of adjustment. "We do expect a price reduction, and the office sector does need to evolve. The model may become more like the retail one, moving towards turnover-based rents and shorter leases."

While bond returns remain low, investors seeking steady cashflow and comparatively high returns have a powerful incentive to invest in core real estate. But with clouds hanging over the office sector, what constitutes a core investment in the post-pandemic market? "There are some assets that people believe in, that are priced as core, with underlying operational challenges that are not core because it is the story everybody believes. What qualifies as core now is basically residential and industrial with a huge cap rate compression," says Theuriau.

"The more operationally intensive it is – hotels, leisure, anything where it is as much about the quality of the manager as the bricks – the less appropriate it is for core," argues Benjamin.

The nascent multifamily residential sector in the UK and Ireland has proved its robustness when tested by covid, suggests Collins, and therefore deserves the designation. "The pandemic has proved private rented sector residential as an emerging asset class that has some of the credentials for core. It is very resilient, sticky income."

European commercial property sales activity, year-on-year change (%)



Symptoms of change

Pictures of deserted streets in some of Europe's capitals during covid lockdowns have led to speculation there will be an exodus from big cities and a revival of suburban fringe areas. The roundtable participants doubt there has been a lasting reversal of the urbanization trend in Europe, however.

"What was obvious traveling in Europe last summer was that as soon as people could go back to living as close to how they were living before covid, they did," observes SIGNA's Johnson. "People returned to offices and restaurants became full again. When considering the most resilient investments, well-located buildings in vibrant city centers like Berlin, Munich, Hamburg, Vienna and Zurich are at the core of the answer."

"Young people who work in tech want what large cities have," adds Benjamin. "They want good food, good nightlife, interesting streetscapes. In Europe, for the most part, those are the capital cities."

Kohalmi argues that in Europe,

"The economy has split into winners and losers, which will recover at different rates"

RICHARD JOHNSON
SIGNA

unlike the US, the virus has had little impact on the which cities are favored as investment locations. "The discounts in most sectors in New York right now show a clear belief among investors that the city will take a long time to recover. We do not see that in Europe."

He agrees with Collins that distress and repositioning will be crucial strategies in the post-coronavirus environment, and while investors may not see as much distress as they would like, repositioning will certainly be on the agenda. "There will be some fundamental shifts coming out of covid. I like the analogy with how previous pandemics have affected real estate. Central Park and the wide avenues in Paris were created to avoid the transmission of disease."

BC Partners is hoping to harness the same trend. "If you believe the nature

Brexit gets real

Boris Johnson's government signed a last-gasp trade deal with the EU just days before leaving the bloc on January 1. Now that more is known about the true shape of Brexit, the participants consider the impact on UK and European real estate

Benjamin: There is a free trade deal for most goods. But then there is anecdotal evidence of delays at the border and rotting meat. We really don't know yet what the full impact of Brexit will be on the UK economy. However, if you are from an unstable but wealthy part of the world, Brexit is not as much of a concern, and we continue to see capital inflows looking for a home in London.

Patel: Only the goods side has been agreed. Services has not been part of the negotiations yet, so the UK has lost its passporting right of access to EU markets, and it will take time to figure out the full impact, particularly on the financial services side. That uncertainty is built into cap rates. For the first time, London prime office yields are higher than the likes of Paris, Amsterdam and Munich.

Johnson: While some of the impact of Brexit on European markets has already happened, particularly on the financial services industry in the UK, there will be more displacement toward the more attractive and well-positioned continental European cities.

Collins: The EU authorities have an ambition to make the bloc more self-sufficient in financial services. They will try to move some activity to Europe. Instead of one European market emerging as a clear winner, that displaced demand is getting dispersed around. Some of it is going to Dublin, some to Luxembourg, some to Amsterdam among others. Relocations will be positive for those smaller cities. But given the scale of London, I doubt that any major financial services impact of Brexit will be visible there over a one to three-year period – 10 years is more likely.

Theuriau: We are seeing the fundraising activities of some very large players move to the EU. Luxembourg, which has been very successful as a domicile to provide EU substance, will benefit further. The big loss for London is its tax advantage for bankers and fund managers. However, I believe its appeal will endure because of its finance culture and talent pool. Also, Boris Johnson has no choice but to make London attractive, so he will probably bring back the tax advantages.

Coveted properties: the Südkreuz office development in Berlin (left) and a Peach Property Group asset

The envy list

Which deals did the participants wish they had done in 2020?

Kohalmi: Ares pays SFr150 million ($169 million; €140 million) to become a 30 percent shareholder in German residential manager Peach Property Group. "I will give Bill's firm my vote. Accessing real estate through the public markets was quite attractive in 2020 because there were discounts available and it was a way to play in markets that were paralyzed for a time."

Collins: AXA Investment Managers Real Assets' purchase of Dolphin Square, a neo-Georgian private residential complex in London's Pimlico, from Westbrook Partners. "For long-term capital it was a great deployment. Multifamily is all about scale and they have more than 1,200 units there. London will survive and thrive in the long term; the rents look like they can be grown, and there is clearly a long-term refurbishment play there as well."

Theuriau: Real estate investor Léon Bressler and French telecoms billionaire Xavier Niel win the support of Unibail-Rodamco-Westfield shareholders, who vote to halt the shopping center operator's €3.5 billion rights issue and grant their consortium three seats on the company's supervisory board. "The way they played the chessboard so rapidly to convert a difficult position into taking control of what used to be a €30 billion market-cap company was fantastic."

Patel: German investor Deka Immobilien buys the Südkreuz office development in Berlin for around €270 million. "That was one that got away. It was part pre-leased, which would have enabled us to take some leasing risk, and had a very high ESG rating. But our exclusivity period ran out and we lost out to Deka, which ended up paying 15 percent more for it, which shows what a good deal it would have been."

Benjamin: Brookfield Asset Management buys a £264 million ($365 million; €301 million) stake in British Land, one of the largest UK REITs. "I wish we had bought British Land and [fellow UK quoted property company] Landsec when their shares were at their nadir. The paper was definitely cheaper than the bricks at that point."

Johnson: AXA Investment Managers Real Assets acquires Kadans Science Partner, a developer, operator and owner of European science parks, from Oaktree Capital Management for around €500 million. "Any investor expanding into life sciences pre-covid, before the pricing went up, would pat themselves on the back. It is a really interesting new type of asset that could well become core over time."

"Distress and repositioning will be the main value-add themes that everyone is playing across sectors"

PETER COLLINS
Kennedy Wilson

"Technology is also attacking offices. This does not appear to be a real estate cycle or something that is driven by low GDP"

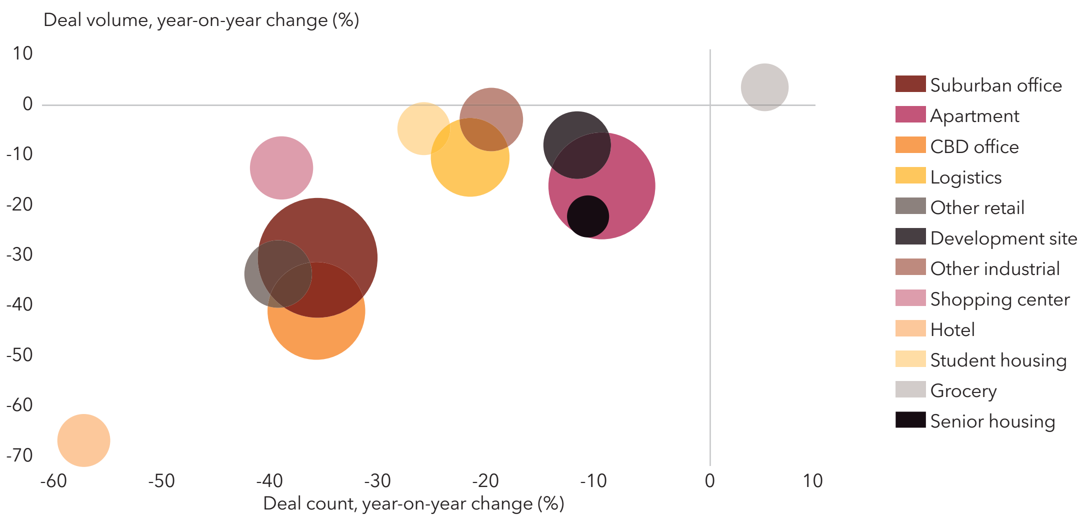
STÉPHANE THEURIAU
BC Partners

of demand is changing, you have to believe that investing to convert those assets is a way to protect yourself," says Theuriau. "We raised our fund on the thesis that we were at the beginning of a big repositioning and cap-ex cycle. It is more carbon efficient than building new space, and old assets tend to be better located."

That is "almost our business plan," adds Johnson. "There will be effects from covid. We can see some of the symptoms of change. But we do not yet know the direction of change. If you own large blocks in the heart of cities, you control locations that are irreplaceable. It is then about finding what uses fit best for the next 10-20 years. That is where you create value."

A hot market meant that it was already testing to deploy capital in European real estate before the pandemic. But while the crisis has further reduced the menu of palatable choices available in European real estate, and raised questions over the future of some assets, investor appetite remains strong nonetheless. For managers, meeting return expectations has rarely been so challenging. ■

2020 European sector subtype deal trends



Apartments exclude student housing
Source all charts: Real Capital Analytics

Experienced Leadership. Investment Discipline. Dependable Partner.

The Ares Management Real Estate Group manages comprehensive public and private, equity and debt strategies.

We maintain a time-tested and consistent approach across our equity and debt strategies focusing on major property types that we believe have value creation opportunities, located in liquid markets with diversified economies.

Ares Management's global platform has approximately $179 billion of assets under management with more than 1,400 employees operating across North America, Europe and Asia Pacific*

For more information, please visit aresmgmt.com

ARES

* As of September 30, 2020. AUM amounts include funds managed by Ivy Hill Asset Management, L.P., a wholly owned portfolio company of Ares Capital Corporation and registered investment adviser. All investments involve risk, including possible loss of principal; no guarantee is made that investments will be profitable. This material is for informational purposes only, and does not constitute investment advice or an offer to buy or sell any security, financial instrument or service.
REF – AM-00834

Disclaimer

These materials are being provided for informational purposes and as part of a sponsored interview conducted by PERE and are neither an offer to sell, nor the solicitation of an offer to purchase, any security, the offer and/or sale of which can only be made by definitive offering documentation. Any offer or solicitation with respect to any securities that may be issued by any investment vehicle (each, an "Ares Fund") managed or sponsored by Ares Management LLC or any of its subsidiary or other affiliated entities (collectively, "Ares Management") will be made only by means of definitive offering memoranda, which will be provided to prospective investors and will contain material information that is not set forth herein, including risk factors relating to any such investment. Any such offering memoranda will supersede these materials and any other marketing materials (in whatever form) provided by Ares Management to prospective investors. In addition, these materials are not an offer to sell, or the solicitation of an offer to purchase securities of Ares Management Corporation ("Ares Corp"), the parent of Ares Management. An investment in Ares Corp is discrete from an investment in any fund directly or indirectly managed by Ares Corp. Collectively, Ares Corp, its affiliated entities, and all underlying subsidiary entities shall be referred to as "Ares" unless specifically noted otherwise. Certain Ares Fund securities may be offered through our affiliate, Ares Investor Services LLC ("AIS"), a broker-dealer registered with the SEC, and a member of FINRA and SIPC.

In making a decision to invest in any securities of an Ares Fund, prospective investors should rely only on the offering memorandum for such securities and not on these materials, which contain preliminary information that is subject to change and that is not intended to be complete or to constitute all the information necessary to adequately evaluate the consequences of investing in such securities. Ares makes no representation or warranty (express or implied) with respect to the information contained herein (including, without limitation, information obtained from third parties) and expressly disclaims any and all liability based on or relating to the information contained in, or errors or omissions from, these materials; or based on or relating to the recipient's use (or the use by any of its affiliates or representatives) of these materials; or any other written or oral communications transmitted to the recipient or any of its affiliates or representatives in the course of its evaluation of Ares or any of its business activities. Ares undertakes no duty or obligation to update or revise the information contained in these materials.

The recipient should conduct its own investigations and analyses of Ares and the relevant Ares Fund and the information set forth in these materials. Nothing in these materials should be construed as a recommendation to invest in any securities that may be issued by Ares Corp or an Ares Fund or as legal, accounting or tax advice. Before making a decision to invest in any Ares Fund, a prospective investor should carefully review information respecting Ares and such Ares Fund and consult with its own legal, accounting, tax and other advisors in order to independently assess the merits of such an investment.

These materials are not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation.

These materials contain confidential and proprietary information, and their distribution or the divulgence of any of their contents to any person, other than the person to whom they were originally delivered and such person's advisors, without the prior consent of Ares is prohibited. The recipient is advised that United States securities laws restrict any person who has material, nonpublic information about a company from purchasing or selling securities of such company (and options, warrants and rights relating thereto) and from communicating such information to any other person under circumstances in which it is reasonably foreseeable that such person is likely to purchase or sell such securities. The recipient agrees not to purchase or sell such securities in violation of any such laws, including of Ares Corp or a publicly traded Ares Fund.

These materials may contain "forward-looking" information that is not purely historical in nature, and such information may include, among other things, projections, forecasts or estimates of cash flows, yields or returns, scenario analyses and proposed or expected portfolio composition. The forward-looking information contained herein is based upon certain assumptions about future events or conditions and is intended only to illustrate hypothetical results under those assumptions (not all of which will be specified herein). Not all relevant events or conditions may have been considered in developing such assumptions. The success or achievement of various results and objectives is dependent upon a multitude of factors, many of which are beyond the control of Ares. No representations are made as to the accuracy of such estimates or projections or that such projections will be realized. Actual events or conditions are unlikely to be consistent with, and may differ materially from, those assumed. Prospective investors should not view the past performance of Ares as indicative of future results. Ares does not undertake any obligation to publicly update or review any forward-looking information, whether as a result of new information, future developments or otherwise.

Some funds managed by Ares or its affiliates may be unregistered private investment partnerships, funds or pools that may invest and trade in many different markets, strategies and instruments and are not subject to the same regulatory requirements as mutual funds, including mutual fund requirements to provide certain periodic and standardized pricing and valuation information to investors. Fees vary and may potentially be high.

These materials also contain information about Ares and certain of its personnel and affiliates whose portfolios are managed by Ares or its affiliates. This information has been supplied by Ares to provide prospective investors with information as to its general portfolio management experience. Information of a particular fund or investment strategy is not and should not be interpreted as a guaranty of future performance. Moreover, no assurance can be given that unrealized, targeted or projected valuations or returns will be achieved. Future results are subject to any number of risks and factors, many of which are beyond the control of Ares. In addition, an investment in one Ares Fund will be discrete from an investment in any other Ares Fund and will not be an investment in Ares Corp. As such, neither the realized returns nor the unrealized values attributable to one Ares Fund are directly applicable to an investment in any other Ares Fund. An investment in an Ares Fund (other than in publicly traded securities) is illiquid and its value is volatile and can suffer from adverse or unexpected market moves or other adverse events. Funds may engage in speculative investment practices such as leverage, short-selling, arbitrage, hedging, derivatives, and other strategies that may increase investment loss. Investors may suffer the loss of their entire investment. In addition, in light of the various investment strategies of such other investment partnerships, funds and/or pools, it is noted that such other investment programs may have portfolio investments inconsistent with those of the strategy or investment vehicle proposed herein.

This may contain information obtained from third parties. Reproduction and distribution of third party content in any form is prohibited except with the prior written permission of the related third party. Third party content providers do not guarantee the accuracy, completeness, timeliness or availability of any information, including ratings, and are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, or for the results obtained from the use of such content. THIRD PARTY CONTENT PROVIDERS GIVE NO EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. THIRD PARTY CONTENT PROVIDERS SHALL NOT BE LIABLE FOR ANY DIRECT, INDIRECT, INCIDENTAL, EXEMPLARY, COMPENSATORY, PUNITIVE, SPECIAL OR CONSEQUENTIAL DAMAGES, COSTS, EXPENSES, LEGAL FEES, OR LOSSES (INCLUDING LOST INCOME OR PROFITS AND OPPORTUNITY COSTS OR LOSSES CAUSED BY NEGLIGENCE) IN CONNECTION WITH ANY USE OF THEIR CONTENT, INCLUDING RATINGS. Credit ratings are statements of opinions and are not statements of fact or recommendations to purchase, hold or sell securities. They do not address the suitability of securities or the suitability of securities for investment purposes, and should not be relied on as investment advice.

Coronavirus and Public Health Emergency Risks

As of March 17, 2020, there is an outbreak of a novel and highly contagious form of coronavirus ("COVID-19"), which the World Health Organization has declared to constitute a pandemic. The outbreak of COVID-19 has resulted in numerous deaths, adversely impacted global commercial activity, and contributed to significant volatility in certain equity and debt markets. The global impact of the outbreak is rapidly evolving, and many countries have reacted by instituting quarantines, prohibitions on travel and the closure of offices, businesses, schools, retail stores, and other public venues. Businesses are also implementing similar precautionary measures. Such measures, as well as the general uncertainty surrounding the dangers and impact of COVID-19, are creating significant disruption in supply chains and economic activity and are having a particularly adverse impact on transportation, hospitality, tourism, entertainment and other industries. The impact of COVID-19 has led to significant volatility and declines in the global public equity markets and it is uncertain how long this volatility will continue. As COVID-19 continues to spread, the potential impacts, including a global, regional or other economic recession, are increasingly uncertain and difficult to assess.