

REAL ESTATE: HOW TO COPE WITH CONVERGING EUROPEAN RATES OF RETURN?

- Jean-Marc Coly, Amundi



Over the last few years, the European real estate market has been characterized by diversity. Today, however, it seems to be significantly evolving. Real estate rates of return are converging downwards in the main EU countries, which causes worry among investors seeking at least consistent levels of performance. To cope with this convergence, with the pressure on rents and with the prospect of a hike in interest rates, Amundi is convinced one needs to go back to the fundamentals of real estate investment. This means favouring high-quality core assets, while focusing on geographic and sectorial diversity, in order to provide investors with both protection and return, says Jean-Marc Coly, CEO of Amundi Real Estate.

Oliver Senchal: What is the scale of the convergence process between rates of return on the European real estate market?

Jean-Marc Coly: It can be especially observed between Europe's main markets, i.e. Germany, France and the UK, once currency-hedging costs have been removed. But it is not just happening between national markets. Rates of return are also converging between cities in the same country, especially between the capital and the other main large metropolitan areas, or even between different neighbourhoods within one city.

In addition, we also see various types of real estate assets converging downwards. Logistics is one of the most telling examples: returns have gone under the 5% threshold, which is an all-time low.

OS: How can you adapt your investment strategy to this new deal environment?

JMC: We are not changing our investment strategy, but rather we choose to focus on our key strength: selecting high-quality core assets. We set evermore demanding selection criteria. Asset imperfections can be tolerated when they can be offset by the acquisition rate. But not in a very pricey market, when premiums can no longer cover the risk those imperfections pose for long-term performance. So we pay extra attention to the fundamentals, meaning the size of the real estate market, its level of liquidity, the quality of the asset that will ensure sustainable performance and finally the diversity and depth of the rental market, which will provide consistent return.

Even though they have converged downwards to 3-5%, major European markets remain key markets, provided one focuses on quality core assets, which can preserve portfolio value, should interest rates go up. Such assets also help take advantage of rising rents, induced by the economic recovery which can be witnessed in most parts of the eurozone.

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OS: What could be the consequences of a hike in interest rates?

JMC: The more-than-probable rise of interest rates in the eurozone needs to be taken into account in any real estate strategy. Its main consequence would be a downward adjustment of real estate values. However, as the economic recovery seems to be here for good, it should positively impact both the occupancy rate in our buildings and lease payment, thus offsetting this downward trend.

The quality of our investment in high-quality core assets also helps preserve values, as we strongly believe the rise in interest rates and economic growth will not equally impact all types of assets.

OS: Is the convergence of real estate rates putting an end to geographic diversification?

JMC: It is actually the opposite. The convergence process leads us to strengthen our diversification strategy

in Europe. Let me just remind you that Amundi was one of the very first asset managers to implement a pan-European strategy for its real estate investments, through partnerships with the best local players. This has helped us create the right ecosystem to ensure quick and effective market penetration, while providing us with the flexibility we needed to change partners or disengage from a market.

In today's uncertain environment, with rates, values and rents converging downwards, we set our sights on peripheral countries, which offer interesting features. We favour countries that are close to Germany, France or the UK, such as the Netherlands, Belgium, Luxembourg, Italy and Ireland. They have booming economies and real estate rates of return that still exceed those of major European markets by 50-100 base points.

These 'middle' countries have markets that are deep enough to be liquid, and provide opportunities to capture additional return. In 2017, we invested over €6bn (with leverage), 28% of which was spent outside France, in Germany and the Netherlands mainly.

The Spanish market is attractive as well. Rates are almost similar to those of the main markets, but economic growth is stronger and should cause rents to rise more significantly and more rapidly. We think they will go back to pre-2007 levels.

The link between economic recovery and rising rents is a key element to take into account, and countries such as the UK, which will bear the negative impact of

Brexit, will be penalized. As a matter of fact, we prefer to disengage from the UK for now, while adjustments have not yet taken place. We made no acquisition in the UK in 2017 and we will not make any in 2018.

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OS: Your strategy is about favouring core assets. Does that still enable you to invest in diversified real estate segments?

JMC: In Europe, there are sectors with core assets, but in which rates of return have not been converging as much. The

first among those is the hotel business. We favour quality business hotels in prestigious locations. This has led us to invest in the downtown areas of large European cities. We have excluded the leisure business, which faces stiff competition from e-commerce platforms, such as Airbnb.

The healthcare sector also offers interesting returns, if one shows caution in dealing with public policy fluctuations and regulations. We focus on residential facilities, and especially senior-living houses, as an avenue for diversification. And we also pay attention to business parks, dedicated to SMEs, as those should quickly benefit from the economic recovery. In addition, even though it may be a complex segment to access and manage, the business park sector offers high risk premiums.

OS: Is it time to expand beyond EU borders?

JMC: It is still probably too early to expand beyond the eurozone, even just to look at mature markets such as Asia, the US or Canada. It is even harder to already consider investing in tomorrow's real estate areas, such as Africa or Russia. But we will certainly have to get there. In any case, if we expand outside Europe, we will replicate the formula that made us successful in our domestic market: signing partnerships with local players, in all areas of expertise, so we can acquire in-depth knowledge of local specificities and keep our flexibility and agility.

AMUNDI ASSET MANAGEMENT

Amundi is Europe's largest asset manager by assets under management and ranks in the top 10¹ globally. Following the integration of Pioneer Investments, it now manages over €1.4tn of assets² across six investment hubs based in 37 countries. At the end of 2016, Amundi launched a platform dedicated to real and alternative assets to provide easier access to unlisted investments. Bringing together capabilities in real estate, private debt, private equity, and infrastructure (green energy), this platform has a headcount of 200 people for AUM of €40.8bn², and offers solutions through funds, club deals and multi-management, including two innovative and ambitious partnerships with EDF and CEA. As part of this new platform, Amundi Real Estate is a company specialized in developing, structuring and managing European focus property funds. With more than €26.1bn of assets under management², the firm is N°1 in France in terms of fundraising and assets under management for SCPI and retail OPCI (IEIF - March 2018), and is part of the Top 10 Asset Managers for offices in Europe (IPE - December 2017). Amundi Real Estate is an authorized management company active in France, Germany, Italy, UK, Benelux, Czech Republic and Austria.

JEAN-MARC COLY

Jean-Marc joined Amundi Real Estate in 2015 to manage real estate investments and assets as well as the structuration & distribution of retail & institutional funds. He was previously CEO of Alta Reim, the Altarea-Cogedim division dedicated to Real Estate Funds.

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¹Source IPE "Top 400 asset managers" published in June 2017 and based on AUM as of end December 2016.

²Figures as of 31 December 2017. Source: Amundi Asset Management