IMMOFINRE GROUP

SHORT VIEW
ON THE DEVELOPED COUNTRIES REAL ESTATE MARKETS

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By Elliot GLAUSIUSZ, Chief Investment Officer

CAVEAT

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Near the end of 2019, when the outlook for 2020 and beyond seemed reasonably optimistic, a foresighted investor remarked that when we view the world through rose tinted spectacles, red warning flags are just flags. We did not expect then that our rosy outlook would be so illusory.

Although the outlook is highly uncertain, and making predictions might appear arrogant, the investment team at ImmoFinRE is still responsible for making informed choices to protect our existing investment portfolio and for deciding where and when we should be allocating new investment capital. What is guiding our current thought process?

While it is true that real estate values somewhat lag real time, there are many signals from the capital markets and real economy which give us a truer picture, albeit sometimes a confusing one. While the flood of new government debt issuance would typically come at a high cost, the deflationary fears of investors have lowered interest rates and bond yields into negative territory in Europe and Japan, and below 1% in the US and Canada. In turn, the value of perceived low risk income producing assets, such as the equity of pharma companies and tech behemoths, has risen (the Nasdaq index is over 12% higher YoY).

This effect is also priced into the real estate sector, with a very wide differentiation in the market which is set to continue. Within listed European real estate stocks, the research house Greenstreet show that while industrial properties (mostly logistics and light industrial premises) have seen an 11% stock price fall since mid-February, continental Europe retail properties (mainly shopping centres and retail parks) have fallen 52%. Even within retail, the differential is stark, with grocery retail suddenly in vogue after being generally ignored for years, while shopping centre owners and lenders are struggling to find a floor value.

There is – perhaps with some guilty feelings alongside – a view in the private equity market that the time is right to build "treasure chests" to deploy in the inevitable distress that lies ahead. Although this sounds tempting, we would argue that given the real uncertainty over the duration of this downturn and the shape of the recovery, it would be better to err on the side of caution, particularly in those sectors which appear highly discounted. For example, ImmoFinRE funds have had very limited exposure to shopping centres and retail parks in the last five years, as we considered how e-commerce was undermining the value of retail real estate, and we did not like the cyclical risk of reliance upon one industry sector. Office and Industrial properties are more resilient in our view because they serve a whole range of industries, from the public sector through to media, tech, pharma, logistics, etc. Investable residential asset classes such as multi-family and senior housing are essential for daily living, even if the values may fluctuate.

We are looking to differentiate between structural changes to the way we work and shop, and cyclical economic swings. We expect that most real estate types (with some exceptions such as grocery retail and data centres which have in fact benefited from this crisis) will inevitably see value falls as underlying tenant demand is diminished, as some companies fail and others seek to preserve cash rather than invest. The light industrial and logistics sector has been in favour for a number of years, as supply chains evolved with the growth of e-commerce and rising world trade. It would seem that this will continue to evolve and possibly grow in European and US markets, as manufacturers look to refocus to some degree away from cheap but distant locations to more secure and resilient local production.

So we will continue to invest in these sectors as prices fall, which we believe are fundamentally sound even if we go through a downturn. We also expect to see little new supply, as the availability of development finance is curtailed. It is important to closely monitor the listed real estate sector, as we believe that although the current repricing is broadly fair, the sector will also be swung on occasion by wider equity volatility. We are selecting income resilient stocks which we would like to acquire at the right price in those fluctuations.

Contact
ImmoFinRE Capital Partners S.A.
9 Rue des Trois Cantons
L-8399, Windhof, G-D de Luxembourg
info@immofinre.com
www.immofinre.com