"BLACK SWANS" IN DEVELOPED COUNTRIES REAL ESTATE

AN UPDATE FROM IMMOFINRE

April 15th, 2020

By Elliot GLAUSIUSZ, Chief Investment Officer

CAVEAT
The views expressed herein are largely judgmental and therefore their past, current or future accuracy cannot be guaranteed. This document does not constitute in any way a solicitation nor an offer to subscribe in any investment product sponsored by the ImmoFinRE Group.

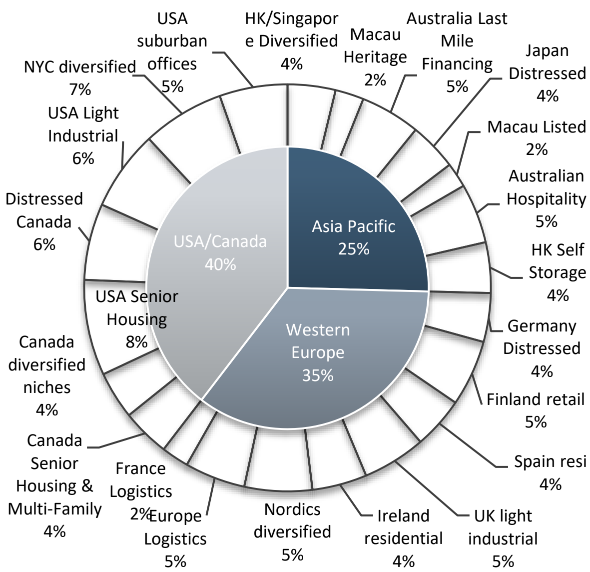
Should the diversity of a multi manager real estate portfolio protect investors from "black swan" events such as the current pandemic, or are these shocks, by definition, too difficult to protect against? Certainly, at first glance the global reach and effects of this outbreak has meant little support from country diversification, with most developed countries affected to various degrees both due to the immediate direct local impact, and indirectly due to the interlinked nature of the modern international economy.

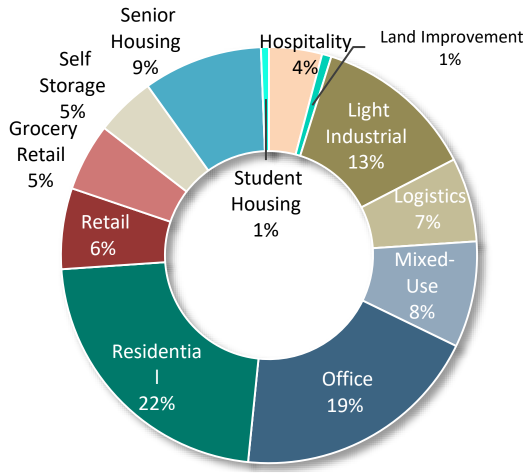
ImmoFinRE funds seek a balance between higher absolute returns of the one hand, and risk mitigation and security of capital on the other. Our approach has thus been to find alpha generating active managers in real estate while diversifying at several key levels, namely countries; sectors; style; duration; and leverage.

<u>ImmoFinRE III SCA SICAV FIS portfolio</u>

ImmoFinRE III
Commitments by Regions

ImmoFinRE III
Tentative Diversification by Segments





21 COUNTRIES	**c. 50%** LEVERAGE	**>300** PROJECTS
18 MANAGERS	**c. 30%** DEVELOPMENT	**12** SEGMENTS

Aside from the limits of country diversification in the current crisis, the other diversifying characteristics are to date proving valuable as we will explore. Before that, it is important to note that one of our key strategic decisions in place for many years was to be very underweight in the retail sector, and selective within that allocation towards grocery and supermarkets real assets which we felt were undervalued and unconsolidated. We had believed for some time that the retail real estate sector had surplus space, given the ever-increasing volume of online sales, and particularly vulnerable to a cyclical slowdown. Clearly, we hadn't expected to see the scale of disruption being wrought upon the retail sector currently and aside from any portfolio consideration issues this is tough to watch from a society perspective.

Furthermore, although our portfolios as a result have not seen the immediate distress being experienced by consumer-facing markets such as retail, hospitality and tourism, the impacts of rising unemployment and economic distress are certainly going to impact the wider commercial and residential markets, while alternative property types such as senior and student housing, self-storage will have their own challenges.

As international investors we have access to some of the best-in-class real estate managers and we can share some of our observations to date with you. One of the key measures right now has been rent collection statistics for the second quarter, and so far the collection statistics for office and industrial properties appear reasonably strong at 75%+, compared with the typical collection rates of 30%+ in the retail sector and hotel occupancy rates sharply down to 20-30% (of those not shuttered).

One of our observations has been that managers with focused, sector specific, larger portfolios seem to be better placed and able to handle this crisis better than more opportunistic, deal-driven managers. For example, our high yielding office and industrial portfolios in the US, light industrial in the UK, residential land bank in Ireland seem to be holding well – it should indeed be the case that specialist sector skills come to the fore in this environment, and the high level of diversification at the tenant level is an advantage.

In particular, our exposure to sectors where operational management is a major influence are holding up well so far, albeit we are monitoring closely. There is a lot of concern internationally about the management of senior living given the vulnerability of our seniors to this pandemic. To date, our managers in the US and Canada have held up well, with established protocols for managing contagious outbreaks, and early lock down measures have been effective so far. In fact, although occupancy may fall due to income related issues, the demand for space in well-managed homes has not gone away, as seniors appreciate the value of being well cared for in a managed seniors facility compared with being home alone. Our portfolio of self-storage properties is generating income in line with budget and this appears consistent with other markets. We are not taking anything for granted in this uncertain time, but so far, the operational assets are performing well.

Fortunately, some of our more consumer facing positions, such as the hotel development investment in Australia / New Zealand, and our heritage retail developments in Macau, are still in the development stage and are not dependent upon day-to-day cash-flow. While development timelines may be impacted, the immediate concern is lessened.

Our more geographically focused opportunistic managers are facing some challenges, as typically they invest in more deal-driven opportunities in their home markets and have less diversification. We are seeing this at the moment in New York City, which has been hit very hard by the pandemic, and to a lesser degree in Hong Kong. The rapid concurrent fall in oil prices is likely to impact our office exposure in Calgary to some extent.

Importantly we have had some significant capital distributions this year, to date from the sale of a large European logistics portfolio, and expected in the near term further to the sale of part of our UK light industrial portfolio, and the final exit of our exposure to Finnish grocery stores and of a mixed-use portfolio in Germany. However, many of the portfolios which have distributed quarterly income are likely to prudently reserve this until the outlook improves.

One of the important judgements to make in the current market is the timing and level of new investments for ImmoFinRE IV and possible add-on investments for ImmoFinRE III. We are cognisant of many investors caution on deploying capital at this time and are only considering limited opportunities. In particular, while it could be argued that listed equities (including real estate stocks) have repriced in a meaningful way, property valuations and direct deal pricing has not adjusted accordingly. As ever, while listed equities portray forward pricing, the property market relies upon dated valuations.

It will become difficult for managers to come to market with new funds in the current climate, but there are a number of funds in the midst of capital raising which will be well placed to deploy capital. We are considering committing to some of our well-established relationships who are able to access assets at appreciably discounted values, from sellers seeking liquidity. We also may be able to source secondary positions in existing funds at an attractive discount to current (and more importantly, implied) value.

Although the outlook for rental values and income remains very uncertain (in contrast to a more typical real estate or economic cycle there is no obvious exit route from this pandemic in the near term) there has been a massive fiscal stimulus in many markets, combined with monetary easing. If room for the latter is more difficult, with hardly much of an interest rate cycle since the financial crisis, bond yields are likely to continue to remain low at least for a while, and this is in turn keeping lending rates low. With the banking sector relatively strong going in to the downturn, to date we are seeing good terms on refinancing and even on new term sheets in markets such as Japan where the pandemic has been less damaging to date. Crucially, the debt service cover ratio (DSCR) on most of the portfolio positions is robust, with limited exceptions.

We are not making any predictions as to the path of this crisis and its longevity, or the depth of economic distress which the global economy will dip this year. This note is written based on what we know today, and this will evolve. To date the structure of our portfolio in developed markets is broadly well positioned and is performing well. This crisis has amplified the downside structural risk in retail real estate but our exposure is low; it has expanded the cyclicality inherent in the hospitality industry but we expect this to adjust in the next two years. Logistics and offices will not be immune from the economic downturn but fortunately a disciplined development cycle in the upturn will limit oversupply. Residential property sales are at a standstill at present which will hit developers, and prices are likely to fall given the economic recession – rentals are probably more secure and the recurrent cashflow is defensive. The performance of our senior housing positions is highly dependent upon the operational excellence of our selected managers who may possibly see their brands become more sought after, as some of the smaller operators will unfortunately be more affected.

To date, the wide diversity of our portfolio is proving a strength, as it works on many factors and is not only country dependent. We have always invested at a measured pace, preferring a mixed duration of timelines on our investments, and this is more important than ever in today's unprecedented time.

Opportunities of acquisition below real value are likely to become available also.

CONTACT

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