ImmoFin RE

ImmoFinRE Investment Outlook
"one year on"

April 2021

Overview

We are expecting to see rising capital flows into the real estate market this year, as the property market offers attractive performance again, after a tough twelve months. It is true that while over the last year investors have experienced outsize returns notably from the stock market and especially from resilient tech companies in the Nasdaq, property has been perceived as an old economy asset class behind the times. We see the pendulum swinging back, with investors recognising the value of real assets in their portfolio, particularly when offering attractive real yields compared to long term bonds and short-term cash.

The pandemic has highlighted how very specialised types of real estate can see highly divergent performance, which tends to catch the press. At one extreme, the traditional shopping mall, designed originally for 1950's suburban America, has become functionally challenged as consumers move online for convenience and only the best experiences will encourage them back. Overcapacity and distress in the hotel sector is leading to conversion to residential uses. At the other extreme, highly specialised distribution facilities with limited alternative uses have become desperately sought by investors, as they seek to capture the value change as a consequence of the switch to e-commerce.

Behind the headlines, and between the extremes, there lies the bulk of real underlying demand for residential (including senior living), essential retail, working office space and light industrial assets. Much of this real estate is located within the urban environment and where land value is a high proportion of the asset value, enabling cost effective change of use where necessary as well as asset upgrading and enhancement. For example, the UK has seen significant reconfiguration of obsolete office space into residential apartments, with government policy and market forces working well to efficiently utilise the existing built environment.

Unfortunately, while the pandemic has accentuated structural existing trends already in motion, its longevity has wrought serious cyclical damage to the property market, particularly to the leisure and hospitality sectors but also to the office market where headcount reductions, although mitigated by schemes such as furlough, are an inevitable consequence of this forced recession. Our economic advisor Capital Economics do not see developed markets reverting to trend growth until the end of 2022, and that covers of course a wide disparity between sectors of the economy.

ImmoFinRE's Approach

Since the inception of our investment period for Fund IV in July 2019, and commitments soon after in Canada, Germany and the US, we have been able to utilise our existing and developing manager relationships to steadily commit capital during the last year, with allocations to the logistics and light industrial markets in the US, Europe and the Nordics, and urban / office markets in Tokyo and Paris. One question we are often asked is whether we can diligence new managers deeply enough given the reduced travel and face time usually required to build relationships. Fortunately, many of the longer-term relationships we have developed over the years have been crystalised during this time – so over the last year we have closed commitments with new managers in France and Germany, alongside the new commitments and co-investments with existing relationships.

Currently we are seeing many value opportunities emerging from the stresses caused by the pandemic. We are therefore likely to complete our investment period in 2021 ahead of schedule as a result. These opportunities are emerging from two main sources – firstly, many institutional managers have been gating their products as they seek to find liquidity. Their position is further compromised by high weightings in retail property which have become very difficult to sell anywhere near historic valuation levels – although simpler retail formats such as big box retail, easily adapted for service and essential retail and supermarkets, are maintaining strong income performance even through the pandemic and look arguably oversold. Secondly, many corporate entities whose balance sheets have been damaged by the crisis are looking to sell non-core assets to raise capital quickly.

Arguably, the high yields offered by many real estate sectors at present are very favourable compared with long bonds and real interest rates, which are likely to continue to be suppressed even if inflation rates should increase – likely in the short term as prices normalise relative to last year's price shock, even if the longer term picture is more benign. Cost pressures and a more fractured international trade environment will be likely offset by weak demand conditions for some time to come. As a result, a conservative level of leverage would make sense, with a low cost of debt capital matched by high income yields and a reflating economy.

Our allocations to Fund IV to date have been favourable, with high weightings to residential, industrial, logistics and grocery retail. While we continue to maintain our weighting in these sectors, with residential a particular target in our pipeline, this year we are likely to increase our exposure towards value opportunities in specific urban office markets, high yield and performing retail, and other high yield assets coming to market at depressed prices due to the liquidity stresses noted earlier.

Internationally, our focus remains - as noted in previous outlooks – on those developed economies where a combination of deep fiscal stimulus and monetary easing are merging well with vaccination and public health policies designed to reduce substantially the peaks of further pandemic waves. Our pipeline includes allocations to the US and UK, while we are keen to increase our allocation to Asian markets such as Australia, Japan and South Korea.

We have seen that our prudent portfolio planning undertaken in recent years has been crucial in maintaining values and liquidity through black swan events such as this pandemic. Indeed, the investment portfolio of ImmoFinRE III, fully allocated in developed countries since mid-2019, is holding remarkably well through the pandemic crisis as it was built with the same principles that guide us for the ImmoFinRE IV portfolio:

- High diversification in terms of geographies, real estate segments and investment strategies
- Limited allocation to traditional retail and hospitality
- 70%+ of resilient existing assets, with high potential for added value, a large majority of which are leased and provide a regular, recurrent yield
- Reasonable financial leverage at under 55% LTV on a weighted average basis at the underlying asset level, with no Fund leverage
- Reliable specialist partners, well positioned to take advantage of the numerous acquisition arbitrage opportunities that appear in their markets.

We expect that the pipeline we are now executing for ImmoFinRE IV will blend in well with the existing allocations to deliver an outcome well in line with our investment objectives – a good balance of resilient markets and value adding assets.

It is also worth noting that our principles of ESG are integrated into our investment process at many levels. We have kept to our developed markets strategy, as we wish to invest into markets which have a democratic and rights-oriented framework within which to work – it may not be a perfect system by all measures but we also believe that these basic principles are more important than chasing returns at any cost. At the asset level, a significant proportion of our investment capital is devoted to repositioning, regeneration and refurbishment strategies on existing assets with existing infrastructure, which improves the environmental envelope of these buildings and avoids expensive and often environmentally costly new development.

We look forward to debating these issues with you all (in person where able and online where not) and elaborating on our current strategy and pipeline. Our contact details are below for your convenience.

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