ROUNDTABLE

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Staying ahead of the Brexit curveball

UK market participants tell Stuart Watson which strategies generate value in a private real estate market buffeted by political turbulence

St George's Day was an auspicious date for the *PERE* UK roundtable. Anyone taking in the scene as the participants gathered for photos in front of the Coal Drop Yards shopping center, one of the highlights of the district being developed at London's King's Cross, would have been forgiven for thinking all is well.

Politically, at least, that is far from being the case. The discussion took place just shy of a month after the day that was supposed to mark the UK's exit from the EU. That deadline was pushed back until October amid frantic negotiations with Brussels that even the most ardent Brexiteer would be hard-pressed to call anything other than national humiliation. Meanwhile, the uncertainty over the country's eventual relationship with its neighbors continues to disrupt its economy to a greater or lesser degree, depending on which of the two increasingly polarized 'remain' or 'leave' camps the analyst belongs to.

Meeting to consider the impact of the unsettled state of the nation on its real estate investment market were Alex Hamilton, lead investment manager at hosts Argent Related, the UK developer spearheading large developments at London's Tottenham Hale and Brent Cross South, lawyer Steven Cowins, a shareholder at Greenberg Traurig, and three investment managers: Artie Ioakim, head of Europe at MIRA Real Estate; Frank Roccogrande, founding partner of Deutsche Finance International; and Paul Tebbit, a fund manager at BlackRock.

Red lines

Transaction volumes show the Brexit situation has impacted investor sentiment. In the last quarter of 2018, data provider Real Capital Analytics noted the €17.6 billion of real estate transacted in the UK was comfortably eclipsed by Germany's total of €23.3 billion, the latter's strongest-ever quarterly performance. And while the UK saw a greater volume of deals done in the first quarter of 2019 than Germany, the €12.5 billion of UK transactions still marked the lowest quarterly figure since Q3 2016.

Tebbit, who manages BlackRock's £3.5 billion ($4.56 billion; €4.06 billion) UK Property Fund, notes that investor uneasiness only began to manifest strongly as the planned Brexit date drew near: "It is a surprising and a positive reflection of the UK that we got all the way through to the back end of 2018 with a pretty normal real estate market. We didn't really see volumes drop off; we saw money continue to come in from around the globe and tenants taking space. It has really polarized in the run up to the end of the fourth quarter last year and continued into early 2019."

Greenberg Traurig's Cowins says he noted a rush to close funds by the end of last year as managers anticipated a slowdown in capital markets as Brexit day approached. "Fundraising has taken up more of our time than transactions in recent months and a much higher proportion of our work at the moment is in continental Europe. A number of investors have adopted a risk-off strategy from a UK perspective," he observes.

DFI co-founder Roccogrande remarks capital originators on either side of the Atlantic have reacted to the uncertainty in different ways. "When we have been fundraising, among the more forward-thinking LPs from the US there has been far less pushback.

"Among European LPs it is a very different picture. Opinion there is polarized between German institutional investors and pan-European investors. The latter are OK to look selectively at the UK for certain

PHOTOGRAPHY: **MICHA THEINER**

Paul Tebbit

Fund manager
BlackRock

Tebbit is fund manager of the £3.5 billion BlackRock UK Property Fund, a balanced vehicle which, although weighted towards assets producing long term income, complements this with a number of value-add strategies. He also sits on the European real estate investment committee at New York-based asset manager BlackRock, which manages $6.5 trillion of assets, including $25 billion of real estate. The firm's real estate team has a global headcount of 210.

Frank Roccogrande

Founding partner
Deutsche Finance International

Roccogrande is co-managing partner, head of investor relations and a member of the investment committee at DFI, a boutique private platform with a 15-strong team based in London which invests in value-add real estate strategies across Europe. The firm is part of global investment manager Deutsche Finance Group, which manages €2 billion of equity.

Steven Cowins

Shareholder
GreenbergTraurig

Cowins is a shareholder in the London office of GreenbergTraurig, a law firm that employs around 2,000 attorneys globally. His practice is focused on private equity and fund formation with a concentration in the real estate sector, advising clients on establishing funds and joint ventures, as well as structured acquisitions and dispositions.

Alex Hamilton

Lead investment manager
Argent

As lead investment manager, Hamilton heads an underwriting team that leads analysis of the viability and capitalization of both prospective and existing projects. Argent's 160-strong team typically undertakes large inner-city multiphase regeneration projects, and in 2015, entered into a long-term partnership with US developer Related, forming Argent Related to pursue development opportunities.

Artie Ioakim

Head of Europe
MIRA Real Estate

Ioakim leads the European real estate team at Macquarie Infrastructure and Real Assets Real Estate, an integrated global real estate business focusing on listed and unlisted funds and asset management, real estate platform and direct investment and private capital markets transaction services. The platform has more than 230 people in 18 countries and, as of 31 March, 2019, managed assets of A$27 billion ($18.9 billion; €16.8 billion).

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>
> **STEVEN COWINS**
> **Greenberg Traurig**

asset classes, but the large German institutions drew a lot of red lines for quite a long time. Over the last four to five months three or four big LPs just put everything on hold and said they were not making any decisions until after Brexit."

It has been investors willing and able to take a long-term view that have continued to invest, says MIRA Real Estate's Ioakim. "It is very easy not to make a decision at the moment. Investors who can look through the volatility and uncertainty and say: 'The fundamentals of this particular investment or that asset class are really attractive when I take a medium or long-term view,' are the ones that have deployed capital."

Cause for pause

The participants agree that Brexit has not seriously damaged sentiment among office occupiers. A large-scale 'Brexodus' of office tenants from central London has yet to materialize and the market is more vigorous than one might assume from media coverage, argues Roccogrande: "We are seeing very healthy activity on the leasing side, at rents that are in excess of our base case underwriting. With cap rates moving out a little in the City of London, multi-let offices are starting to look more interesting for value-add returns. Maybe some activity that might have come to London is now being taken up by cities like Dublin and Amsterdam, but by no means is London dying out."

Leasing activity also remains strong in some regional cities, adds Hamilton: "Argent is building a new regional HQ for PwC in Birmingham and we are seeing strong demand for new buildings, including projects that are not yet out of the ground," he says. "The Brexit uncertainty has encouraged investors to step back and look at the fundamentals of each deal. Whilst this has led to capital retrenching from some locations, the cause for pause may have helped some less obvious investments."

At this point in the real estate cycle, capital would normally have started to spread out to more secondary markets, as managers look for extra yields and seek to invest in higher risk opportunities. Negative Brexit sentiment has suppressed this and controlled the tendency to over-leverage and over-develop, argues Tebbit. "You have to take care to pick the right micro-locations in those markets where it is easier to develop and drive a strong supply response like logistics and student housing, but, overall, the market doesn't look oversupplied at the moment," he says.

Building a platform

UK all-property returns were 5.1 percent in 2018, according to analytics provider MSCI, down from 9.6 percent the year before. CBRE reported a 0.6 percent decline in capital values for UK commercial property in the first quarter of 2019. Tebbit expects returns to moderate further in 2019: "I have the feeling it will be somewhere around 3 percent this year across the market with enormous variances depending on which asset class you choose to invest in," he says. "For all property we will be relatively happy if we see an income-ish return and the market not lose more capital value from here on in."

In such market conditions, managers and their capital backers have to be patient and to work hard for their returns, argues Ioakim: "In our view, investors that will outperform are the ones with specialist skills and operating partners because this isn't a point in the market when there is a rising tide."

Managers are creating open-ended vehicles that can invest in asset classes that will be underpinned by structural trends over the long term, such as logistics and private rented sector housing, Cowins says. "A trend we are seeing in the fundraising market is that people are wanting permanent capital vehicles to sit alongside their closed-ended, fixed-life funds because the ability to take a longer-term view, especially on larger projects, is valuable when you are investing late in the cycle," he says.

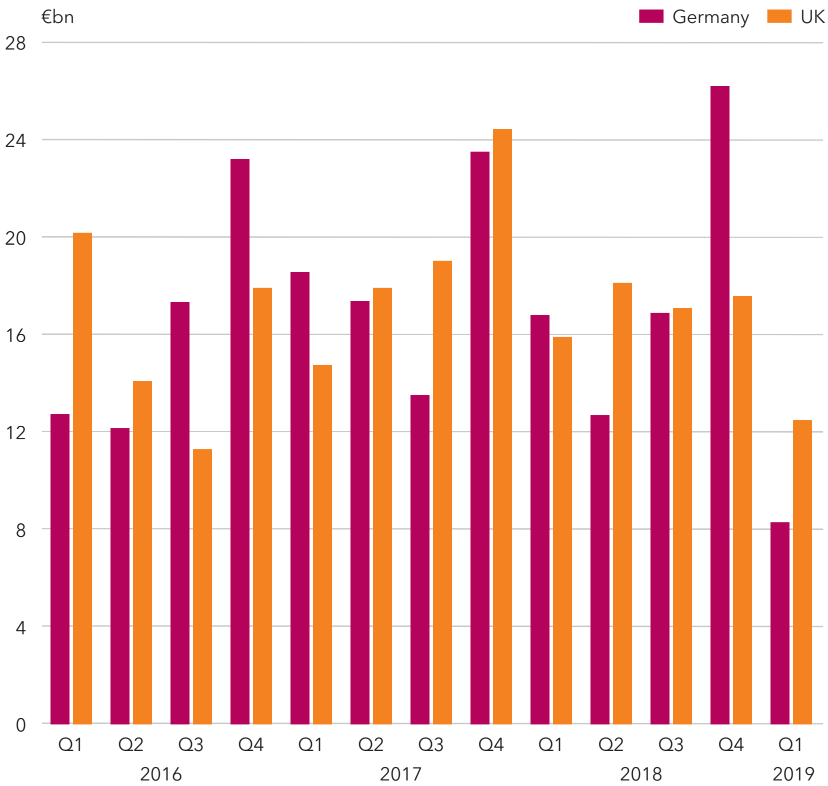
Investors in the UK and European markets are still tending to focus on income, but not as acutely as in recent times, observes

Roccogrande. "Everyone realizes now that the market is so tight you have to create alpha in different ways, so, in the end, it is about rolling up your sleeves and putting together an effective strategy that is differentiated from everyone else, building a platform, aggregating small and mid-cap assets into larger portfolios."

There is consensus around the table that managers and investors are increasingly open to investing in more operationally intensive assets as a means of driving returns. The UK's burgeoning purpose-built rented residential sector, which has seen increased capital allocation, is among them, says Hamilton: "It has been spoken about for a long time and it is beginning to transition into action. Previously, there were not a huge number of completed assets, which has been problematic for underwriting. But there are now trading assets that demonstrate the margin you can produce with modern build-to-rent."

Logistics remains a popular sector, although prices are high in some locations. "At the yields that developments need to be underwritten to in the south-east and the Midlands, the risk-return equation relative to just buying standing stock is tight," says Ioakim. "Our PLP Logistics platform has been focused on the north in the last 12

In Q4 2018, total transaction volumes in the UK were comfortably eclipsed by a record level of investment in Germany. However, the UK bounced back in Q1 2019

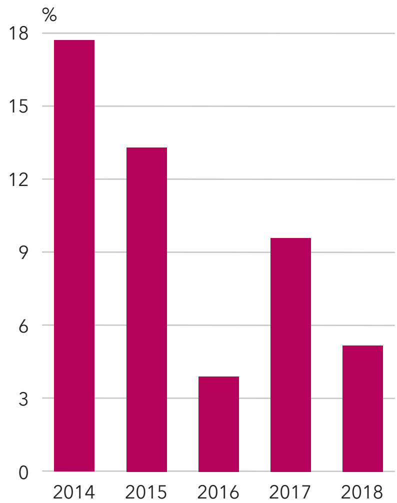


Source: RCA

"It is a surprising and positive reflection of the UK that we got all the way through to the back end of 2018 with a pretty normal real estate market"

PAUL TEBBIT
BlackRock Real Estate

UK all-property returns declined markedly in 2018, according to MSCI UK Annual Property Index. And the potential for negative or flat cap rate movement means they may be even lower this year, predict the participants



Source: MSCI

months because the relative value spread is attractive. We have been able to secure some interesting sites, but you need to have the right skillset to create value. You can lose money in the UK logistics sector today if you develop or buy the wrong product."

Interesting pricing

Despite the political situation, UK real estate debt markets have remained "completely liquid" says Cowins. "There is debt for anything that is a decent project and it is a way more diverse market of participants than it was 10 years ago. Sovereign wealth funds are in there, we are seeing a much greater weight of insurance money, and you have a whole host of private debt funds filling up every niche of the market."

DFI is currently in the market for a loan of around £900 million ($1.18 billion; €1.05 billion) to finance Olympia London, which includes building 670,000 square feet of offices. "That will probably be the largest single-tranche loan for a development project in the UK this year," says Roccogrande. "I was a bit worried because we went out with our books 60 days ago, but now that we have come out the other side of Brexit day we have seen very strong demand. The sovereign wealth funds and global private equity players have been very aggressive in their pricing."

There is still a huge volume of capital seeking a home in the real estate sector, and with the UK now looking relatively cheap compared with some European markets, investors could soon identify a buying opportunity, argues Tebbit. "Unusually, you have very interesting pricing compared with what you see in continental Europe, where prime office yields are trending towards 3 percent and below. There is 100 to 150 basis points of extra yield in London right now. Because investors have been deterred by Brexit, a lot of global capital that would have been invested in the UK now has one less major market

"Maybe some activity that might have come to London is now being taken up by cities like Dublin and Amsterdam, but by no means is London dying out"

FRANK ROCCOGRANDE
Deutsche Finance International

"Investors that will outperform are the ones with specialist skills and operating partners because this isn't a point in the market when there is a rising tide"

ARTIE IOAKIM
MIRA Real Estate

UK: Key deals, key points

The participants pick transactions from the past 12 months that demonstrate market trends

Cowins: London-listed Industrial specialist Tritax Big Box REIT acquires an 87 percent interest in UK logistics platform db Symmetry in February.

His analysis: That is an example of a platform – created by UK property companies Delancey and Barwood Developments – which has gone through its life cycle and successfully exited to a permanent capital vehicle. It has a 2,500-acre land bank, so for the buyer it is an opportunity to get a lot of scale in one go.

Hamilton: In April, Goldman Sachs issued its first UK build-to-rent development loan, providing £118 million to fund the construction of Apache Capital Partners and Moda Living's 42-story residential skyscraper in Birmingham.

His analysis: There is a significant amount of debt capital keen to go into the build-to-rent residential sector, which reflects the trend of capital focusing on income and operational real estate.

Ioakim: Shopping center developer and operator Unibail-Rodamco-Westfield partners with Canadian institutions Public Sector Pension Investment Board and QuadReal Property Group, in March, to develop a £670 million, 1,200-unit PRS scheme next to Westfield Stratford City in London.

His analysis: That is an example of sophisticated foreign institutional capital willing to take a long-term view on the UK economy and the PRS sector, despite the near-term uncertainty associated with Brexit.

Roccogrande: In October 2018, Blackstone buys the National Exhibition Centre Group, operator of facilities including Birmingham's NEC, in a deal worth a reported £800 million.

His analysis: It was a good vindication for us buying the Olympia exhibition hall in London two-and-a-half years ago. Real estate doesn't get any more operational and esoteric than exhibition centers, and when we bought Olympia, we struggled with the debt financing because few lenders really understood that business.

Tebbitt: Private real estate giant Blackstone and UK private property company Telereal Trillium acquire a portfolio of 5,200 properties, chiefly consisting of converted former railway arches from infrastructure operator Network Rail for £1.46 billion in September 2018.

His analysis: Blackstone and the Pears family, which owns Telereal Trillium, coming together will be a great combination. I have seen the Telereal machine in action and they are so good at granular asset management. There will be a large amount of operating cost they will be able to cut while investing capital to bring this large portfolio of quirky business space to life.

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>
> **ALEX HAMILTON**
> **Argent Related**

Trouble in store

PERE's UK roundtable participants consider the fallout from a dreadful period for UK retail

Investors are used to gloomy news from the UK high street, but even by recent standards, the start of 2019 was downbeat. First quarter figures from data provider CoStar showed an investment market in a state of paralysis as just £20 million of shopping centers changed hands, against a 10-year quarterly average of £783 million.

That is because many retail assets are sitting in private equity funds that have not yet reached maturity, observes Roccogrande: "When the time does come to sell, we can be sure values will reflect a cap rate different to what it is today, but until then you won't see a lot of squeezed sellers hitting the market. If it is creating income and they don't have to sell, why would they?"

Retail parks will return to investors' buy-lists before shopping centers do, predicts Tebbit. "It will potentially be a very long time before institutions buy back into shopping centers. You need a big team to run them and, even if you do that very well, as the sector-specialists do, we have seen that you can still find your capital value going backwards. Retail parks are out of favor right now, but I can see them suddenly looking rich in terms of yield, particularly compared to industrial, and institutions will come back in as they can be run effectively and for the right assets have strong levels of tenant demand."

Although the sector has found itself in the doldrums, Roccogrande believes there are bargains to be had among malls that serve the community and convenience market, catering to everyday shopping for staple goods. "When everything is oversold, that is when you should be taking a look," he argues. "We have been bidding on a lot of those schemes over the past two years. They have great alternative uses and you can get them at prices right now that you can come in and make most of your total return strictly through income."

Potential buyers must select investments that will remain viable despite the sector's rapid evolution, says Hamilton: "Anyone who doesn't think we are at a pivotal moment in the future of retail needs to speak to a teenager quickly because shopping trends are changing fundamentally, and as the younger generation matures that is likely to accelerate dramatically. Some retail assets may struggle to make that transition."

in which to play at a time when there is an enormous compounding weight of global pension fund money that needs a place to invest. But I could see this capital returning if the fog of Brexit starts to clear."

Cowins agrees with that view: "It feels like there is a weight of capital that will return once the conditions are right. If you look at the fundraising market it has been on fire. Pan-European, UK and global funds are being raised. There is plenty of dry powder out there. "

Ioakim feels this period might be a time an investor looks back on and says: "I should have been allocating capital." Some investors with a more opportunistic bent have been doing just that, observes Hamilton: "There has been an uptick in the distressed fundraising market over the past six months in expectation of there being a few more motivated sellers, but we haven't seen much of it deployed yet."

Roccogrande adds: "Things are looking a lot more attractive if you are seeking value-add returns in the UK as opposed to other European markets, especially Germany."

The turmoil of Brexit, or at least of a near-miss Brexit, has somewhat restricted the stream of capital into the UK in the short term. However, it remains one of the largest, best-established and most transparent real estate markets in a world where a vast amount of capital must go somewhere. For the panelists, the fallibility of the UK's political culture is unlikely to hinder the flood for long. ■