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EXTRA
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Insight

US election Private real estate watches as Trump and Biden square off

Next month's presidential contest carries significant implications for US real estate investment, particularly considering the two final candidates' conflicting views on taxation and housing creation, ***writes Kyle Campbell***.

"This is the most important election we've seen in the last 20 years, specifically as it relates to real estate," says Craig Bernstein, chief investment officer at Washington, DC-based manager OPZ Capital.

As the election nears, the outcome is too close to predict, especially in a landscape radically upended by the covid-19 pandemic. Polling suggests Democrat Joe Biden maintains a modest advantage in the popular vote, but Republican incumbent Donald Trump is within striking distance in several key states that could swing a winning outcome.

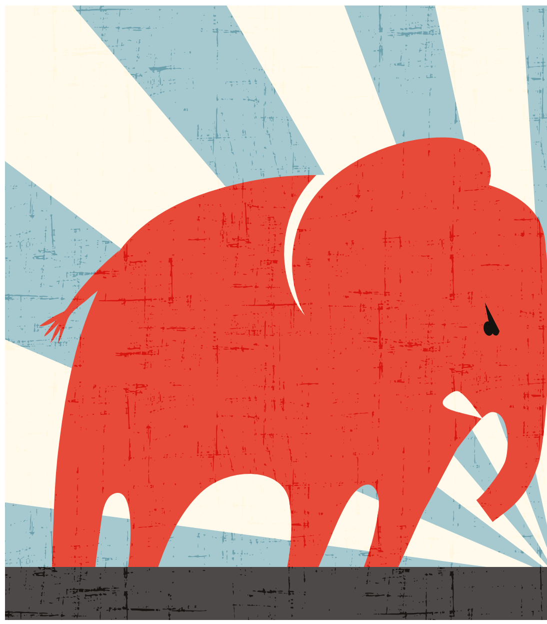
For investors, the greatest concern going into November 3 is not that one candidate or the other emerges victorious, but rather, that neither side concedes defeat. Christopher Ailman, chief investment officer of the California State Teachers' Retirement System, flagged the possibility of a contested election during the pension's September board meeting. The worry stems, primarily, from the threat of tampering, but Trump's refusal to promise acceptance of the outcome has fueled speculation. As a result, 90 percent of real estate professionals surveyed by the law firm Morrison & Foerster in July felt he would do something other than agree a quiet transition of power in defeat.

"We saw that in 2000. It was peaceful," Ailman says of a contested election. "Obviously, there was some excitement in Florida. But the markets managed through it because they were not looking at such extreme points of view as we are today."

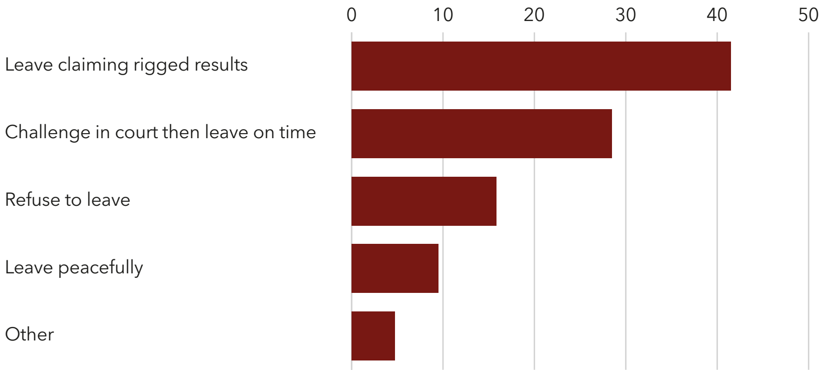
Stark differences

At face value, Trump's stance on taxation appeals more to real estate investors. The signature achievement of his first term, the 2017 Tax Cuts and Jobs Act, made temporary cuts to personal and estate taxes, and permanently slashed the corporate rate from 35 percent to 21 percent. Real estate gained from the preservation of longstanding policies on capital gains and like-kind exchanges, and only modest changes to carried interest rules. The TCJA also created the Qualified Opportunity Zone program, which has been a boon to real estate investors and developers.

Biden, on the other hand, vowed to raise taxes on individuals making more than $400,000, corporations



Most real estate executives do not expect Trump to leave quietly (%)



Source: Morrison & Foerster

and long-term capital gains for those earning $1 million-plus. He would also end the 1031 exchange program for real estate, which allows sellers of property to avoid paying taxes on their proceeds by rolling them into another property investment. Bernstein, whose firm focuses on tax-based strategies, says this could have a chilling effect on transactions. "If 1031 exchanges were to be eliminated, the effects would be widespread," he tells *PERE*. "Not only would real estate investors need to revisit their overall investment strategy to ensure it conforms with the revised tax code, but over the long term, we would also see a significant decrease in overall investment sales transactions."

Jeff DeBoer, head of the Real Estate Roundtable, the industry's top advocacy group, tells *PERE* that while Biden's plan to use tax increases to finance social programs is "well intentioned," it would be an area of concern if he were elected. He says: "We look forward to having that debate."

Not everyone in the industry is as concerned about a Biden administration. In early August, Barry Sternicht, chief executive of Miami Beach-based Starwood Capital, told investors that the former vice-president's proposals to end 1031 exchanges would have minimal impact on his firm. "It isn't required. It isn't helpful and it's unique to real estate," he said. "That's an easy loophole for them to fill. I've never used it in my life, by the way, so I have never been affected."

Biden is likely to find more industry support for his plan to address affordable housing, which calls for spending $640 billion over 10 years to grow the national housing stock. This includes providing support to rent-burdened tenants, expanding the Low-Income Housing Tax Credit, a critical financing component for affordable housing investors, and giving direct assistance to first-time home buyers.

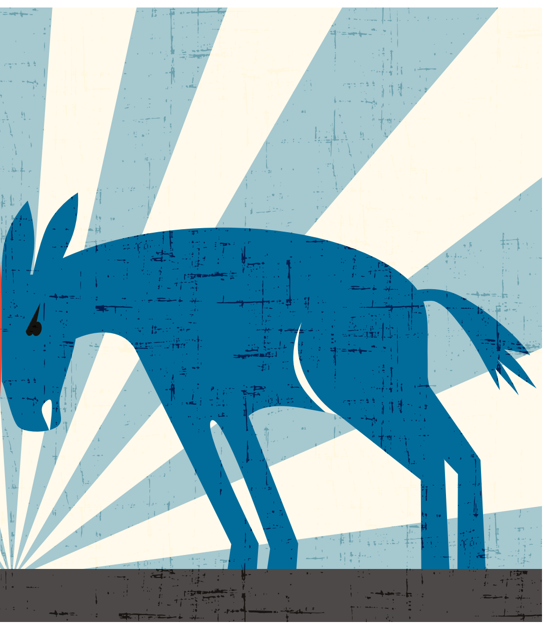
Trump, despite his storied career in the real estate industry, does not have a formal plan for housing. This summer, he said policies aimed at increasing multifamily development in low-density areas would "destroy the suburbs," which is out of step with the industry's effort to remove barriers to new housing development. "If we want a more equal-opportunity world and society, we can't be opposed to these kinds of things," DeBoer says. "It's all about having the opportunity to educate yourself and be exposed to every opportunity that everyone else is. If you can't live in certain areas, you don't get that. So, I did not find [the president's] comments or actions on this front appropriate."

Industry preferences

While private real estate professionals have made individual contributions to each campaign, the industry's senior leaders have, by and large, remained on the sidelines this election cycle. One noteworthy

> "This is the most important election we've seen in the last 20 years, specifically as it relates to real estate"

Craig Bernstein
OPZ Capital



exception is Blackstone chief executive Stephen Schwarzman, who donated $355,000 to the Trump Victory Fund this election cycle, according to online filings with the Federal Election Commission. Overall, he has spent $3.9 million backing Republican candidates.

Blackstone chief operating officer Jonathan Gray, on the other hand, has donated more than $1.1 million to Democrat political action committees. However, he has avoided candidates at the top of ticket, aside from a $2,800 donation to the short-lived campaign of former Colorado governor John Hickenlooper, a moderate Democrat.

Related Companies chairman Stephen Ross, an active donor who drew criticism for his friendship with Trump, skirted the presidential contest too. His donations total almost $200,000 to candidates and PACs from both parties, according to the FEC, though the lion's share has gone to Republicans.

> **$640bn**
>
> **Size of Joe Biden's proposed housing plan**

Firms that run their own PACs have taken a similar tack, donating to both sides. The Carlyle Group, for example, has raised nearly $430,000 this cycle, according to the non-partisan Center for Responsive Politics, distributing $46,000 to Democrats and $17,500 to Republicans running for the House of Representatives.

The Real Estate Roundtable also spends its own PAC money on a bipartisan basis. DeBoer says an ideal outcome for this election would be a continued divided government. "Just like in a business, university or any type of governing structure, if everybody has the same opinion, it might not be as well informed as it could be," he tells *PERE*. "If you can get things done in a divided government, the policies tend to be more sustainable over time."

Volatility ahead

While the long-term implications of the election remain to be seen, market participants can expect a slowdown in the weeks ahead as they wait for the fallout.

Lisa Knee, a head of the national private equity real estate group at accounting firm EisenerAmper, says sales activity always hits a lull ahead of presidential elections. She says this year is likely to be worse because of the disruption brought on by the pandemic. "In any election cycle people are going to look at their overall investment strategy and business strategy, and they're especially doing so today because of everything else that's going on," she says. "People are looking at their back of house and making sure they have a disaster recovery plan in place with the infrastructure to execute it."

In his address to the CalSTRS board, Ailman said he expects volatility to pick up by mid-October, especially in the public equities markets. Overall, the pension will adopt a "defensive" approach while continuing to take advantage of opportunities created by monetary policy.

"These markets are at all-time highs, mostly due to the Federal Reserve and this put [option] they've almost put on the market," he said. "It will be challenging, and we will have longer discussions with the committee…and then a lot of communication with you in October." ■

M O S T • R E A D

News also trending on PERENews.com last month

■ Round Hill in €200m multifamily first close
The residential manager's European Residential Income Fund II garnered commitments from pension funds, insurance companies and asset managers across Asia, North America and Europe.

■ GLP's first open-ended private logistics vehicle
Launched at the end of 2019, GLP Japan Income Fund is currently the largest such vehicle in the country, having reached ¥280 billion ($2.6 billion; €2.3 billion) in assets under management to date.

■ Ceberus's head of international real estate dies
Ron Rawald, senior managing director and head of international real estate at Cerberus Capital Management, died in August, at 56.

■ Nuveen raising second Euro open-ended logistics fund
Since the fund's launch in July, the firm raised €250 million of equity so far from German institutional investors.

■ How US banks have kept alternative lenders afloat
The alternative lending market in the US has so far weathered covid-19. As *PERE's* sister publication *Real Estate Capital* explored in a deep dive analysis, US banks have been accommodating debt fund lenders by offering flexible terms, including holidays for their own credit lines.


MACQUARIE

Predictions **Brookfield's Flatt sees bids at higher valuations**

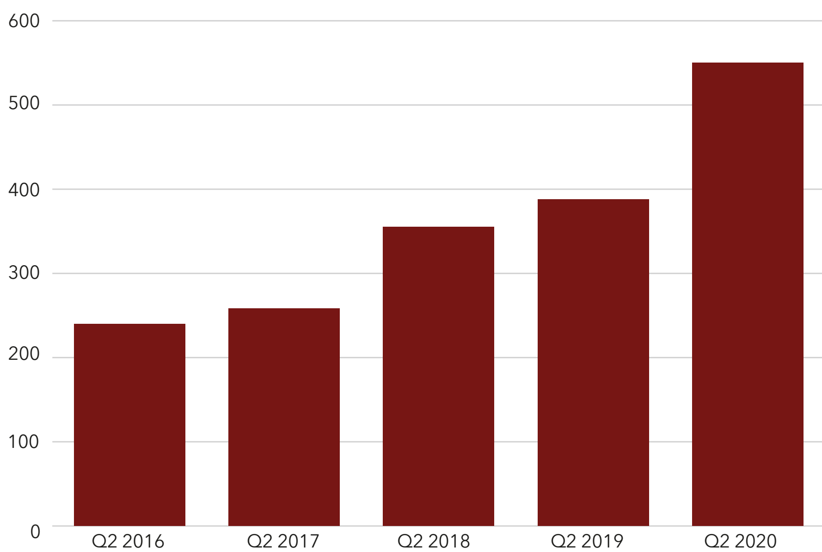
Brookfield Asset Management's chief executive Bruce Flatt expects the low interest rate environment to bode well for private market assets, particularly real estate and infrastructure, ***reports Arshiya Khullar***.

In the firm's second-quarter earnings call in late August, Flatt said just in the previous few weeks, he was starting to "see bids for real estate and infrastructure assets at higher multiples than pre-covid."

In March, the US Federal Reserve cut interest rates to near zero to support the economy during the coronavirus pandemic. In its September meeting, the Federal Reserve also said rates would remain near zero until the economy reaches full employment and inflation tops 2 percent, which economists believe could take four to five years.

"With a zero-interest rate environment here and it increasingly looking like it will be here for five years-plus, this will also have a meaningful impact in a positive way on the real assets that we already own," Flatt said. "The majority of our assets today have long-term, fixed contracts, either long-leased property, contracted power or utility or utility-like assets. And with interest rates dropping, the value ascribed to these cashflow streams increases significantly."

Despite market uncertainty, the last quarter became the firm's strongest-ever fundraising period (AUM, $bn)



Source: Brookfield Asset Management's quarterly reports

Fundraising boost

Alongside higher valuations, the benefits of low rates also extend to stronger fundraising momentum as institutional investors look to increase their non-fixed-income allocations to meet their return objectives.

"The floodgates have only started to open, and the reason is that if you are trying to earn 5-8 percent within an institutional pool of money, there really is no hope to do that with traditional fixed income," he explained. "And as a result of that, other than holding cash for liquidity purposes or short bonds for liquidity purposes or some form of long bonds just for safety, all other pools of former fixed income allocations are going to come to lower risk alternatives, and therefore that is going to enhance private credit opportunities. It is going to enhance real estate, infrastructure and all the products that we offer."

Brookfield Asset Management raised $23 billion across various pools of capital, including $12 billion for its latest flagship distressed credit fund, making the second quarter the firm's strongest-ever fundraising period. The fundraising momentum also included a €725 million first close for Brookfield Premier Real Estate Partners Europe, a European perpetual core-plus real estate fund. Brookfield's total assets under management have increased to approximately $550 billion, up from $519 billion in Q1 2020. ■

> "The floodgates have only started to open"
>
> Bruce Flatt
> Brookfield Asset Management

Read *PERE*'s interview with Brookfield Property Partners' Brian Kingston about the firm's approach to troubled real estate sectors amid covid-19 from p. 34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Data centers

ADIA powers Gaw's vehicle

Gaw Capital Partners has corralled $1.1 billion for a data center platform in China, ***writes Christie Ou.*** The Hong Kong-based private equity real estate manager is seeking to capitalize on growing internet usage and data storage in the country after the outbreak of covid-19.

Alongside that capital haul, *PERE* revealed last month how the firm's Internet Data Center platform was expected to grow to $1.3 billion in the coming weeks. Gaw has not publicly disclosed the target size of the vehicle.

PERE further understands the United Arab Emirates-based sovereign wealth fund Abu Dhabi Investment Authority is the largest of up to five global investors in the platform.

Two sources said the capital has been fully committed to five projects. Targeting an opportunistic return of over 20 percent, the IDC platform can be invested in both development projects and existing assets in China.

Gaw declined to comment on the platform's fundraising progress and its return target. But Christina Gaw, managing principal and head of capital markets for Gaw Capital Partners, said: "The demand for data centers has been accelerated after the outbreak of covid-19 and the market has obviously become more competitive than before."

"We are fortunate to be one of the earlier batches of real estate managers to enter the market and to be able to partner with top operators in the country." ■

For more on private real estate
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Ups & downs

↑

"Research shows that diverse teams generate better performance, so there's no downside to increasing diversity, it can only be positive"

Alfreda Delle, *managing director of LaSalle Investment Management, on the importance of building a more diverse recruitment pipeline.*

↓

"We can't recover until people actually return to New York. That won't happen until the people who work in our offices come back"

In a Wall Street Journal article, Related Companies chief executive ***Jeff Blau*** *calls for New York workers to return to their offices.*

The big numbers

Reducing investment numbers, office occupancy levels creeping northward and first closes were among the numbers to stand out in the last month

$11.6bn

Total foreign investment into the US in H1 2020, according to CBRE

127

Number of new hotels projected to open in Canada in 2021, according to a March report by Lodging Econometrics

55%

Year-on-year drop in global hotel transactions in H1 2020, according to RCA

$10bn

Target size of GLP Japan Income Fund, launched by logistics specialist GLP

€200m

Amount raised by residential manager Round Hill Capital for the first close of its European Residential Income Fund II

$5bn

Size of Brookfield's Retail Revitalization Program, aimed at steadying distressed retail companies

41%

Occupancy levels for the flexible office space sector in Europe as of July, according to Workthere

$6bn

Volume of South Korea's retail transactions as of September 1, according to RCA.

€120m

Capital raised by Swiss Life Asset Managers for its new European industrial and logistics fund

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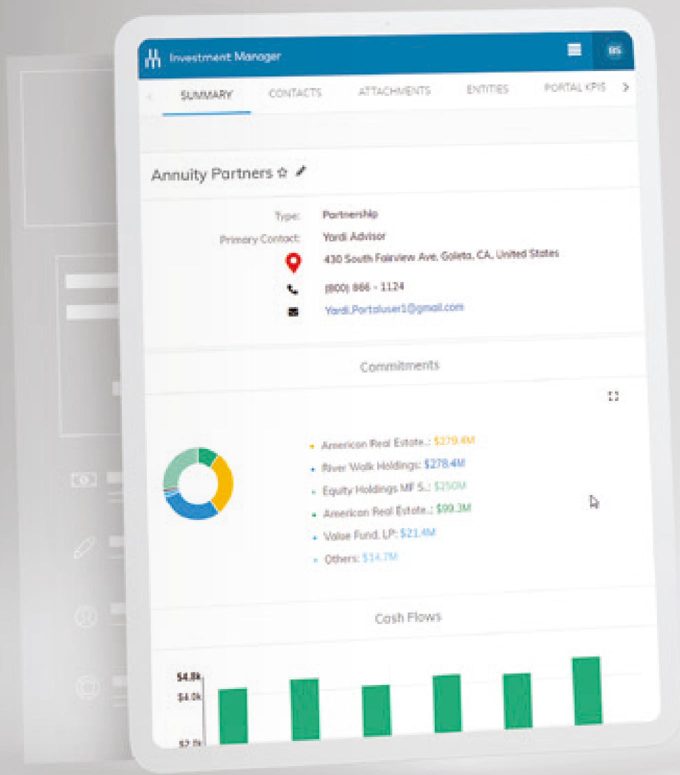

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YARDI

Participants in PERE Japan Korea Week in September discuss how they have been coping with the fallout from the pandemic

PERE Japan Korea Week **Due diligence issues top investors concerns**

Although real estate investment volumes in Asia-Pacific dropped 32 percent in the first half of 2020, the region is expected to be the first to recover, with a gradual loosening of lockdown measures and restrictions, according to JLL, ***writes Christie Ou***. Meanwhile, the number of covid-19 cases continues to spike elsewhere, led by the US with close to 7 million confirmed cases. In September, more than 300 delegates around the world gathered online for *PERE*'s first virtual conference, PERE Japan Korea Week, to discuss how they have been coping with the impact of the pandemic. Here are the event's four key takeaways.

Due diligence

The inability to conduct physical due diligence due to travel restrictions remains the top concern for both South Korean and Japanese investors. Janghwan Lee, executive director, head of the alternative investment division at South Korea's Lotte Insurance, said the proposal of "untact" – or contactless – due diligence was disapproved by the local financial authority. "We saw this as a window to buy quality assets at discount prices," he said. "But we received negative feedback from the authority." The issue is even more severe for Japanese investors, which have traditionally been very "process-oriented," according to Masaki Arimura, executive director at PGIM Real Estate. He believes time allowance is critical for Japanese investors to feel comfortable in making investments during such an unprecedented time.

Importance of managers

Given their inability to conduct on-site due diligence, investors have become more reliant on managers for overseas investments to address the uncertainties of doing business in foreign markets. "We believe the pandemic will bring new revenue and new risk to the market. But we don't have enough resources to figure out everything. It's more practical to have your fund managers handling it," said Takeshi Ito at Japan's AISIN Employees' Pension Fund. Harry Song, head of overseas real estate at South Korea's Public Officials Benefit Association, also planned to work more closely with managers for overseas investments going forward. The investor is currently in talks to set up separately-managed accounts and Song expects this to be the main channel for the firm's overseas investment next year.

Strategy polarization

Investors have further polarized their preference for sectors and strategies since the outbreak of covid-19. The pandemic has accelerated investors' interest in logistics and data centers, for instance. Meanwhile, they are further shying away from retail and hospitality, which have been directly impacted by lockdown restrictions. In terms of strategy, investors are either embracing the strategy "with highest stability" or "highly leveraged and speculative strategies," says Lee. This also corresponds to POBA's approach of constructing its portfolio with core and opportunistic investments. POBA is looking at the residential sectors in the US and Japan for safer returns, and has recently invested in distressed property loans.

Switching from equity to debt

With today's macroeconomic uncertainties and due diligence challenges, some investors with lower risk appetite are switching from real estate equity investments to debt issuance or infrastructure projects. For example, Japan's Orix Life Insurance paused its first real estate equity fund commitment earlier this year due to the pandemic and invested the capital into debt/infrastructure products instead, according to Kiyosei Sugioka, head of alternative investment at Orix. But he noted the insurer will continue to monitor the situation and resume real estate equity investments once the pandemic stabilizes. "They don't need to do site visits and they can communicate with managers online for debt investments," said Doyle Kim, managing director and head of the real asset investment finance department at Hana Financial Investments. He also agreed that investors can return to equity investments with managers once the pandemic subsides. ■

Diversity **How LaSalle is building a more diverse recruitment pipeline**

LaSalle Investment Management has committed up to $500,000 to building its pipeline of Black and Latinx recruits, ***Kyle Campbell reports***.

The Chicago-based manager has created a five-year program to provide college sophomores from those underrepresented racial groups with $10,000 scholarships and a mentor from the firm's executive team. Alfreda Delle, LaSalle's managing director who oversaw the creation of the initiative, said the goal is to bring on at least one scholar per year as a summer intern and ultimately hire them into full-time positions.

"When we think about increasing diversity and improving recruitment, it's really about exposure, as well," Delle tells *PERE*. "We wanted to start earlier on, before individuals have entered their careers, while they're still in their studies, and expose them to commercial real estate as an option."

LaSalle has been trying to diversify its ranks since 2014, when it launched its Growth Through Inclusion program, which has had more success advancing women than minorities. This disparity has been common among private real estate managers. While the share of women in leadership positions grew modestly from 12 to 16 percent between 2017 and 2019, according to the National Association of Real Estate Investment Managers, the share of top executives who identify as Asian or African American remained stubbornly low, at 4 percent for men and 2 percent for women.

Earlier this summer, the National Multifamily Housing Council hosted

" Now is the time to not just talk about [racial inequity], but to act "

Alfreda Delle
LaSalle Investment Management

a webcast called *The Diversity Pipeline Challenge* to address the struggles of attracting minority applicants in real estate. Jeffrey Hayward, head of multifamily at the government-backed lender Fannie Mae, said one reason few Black graduates are drawn to real estate is because the sector is historically insular. "Our business is a fascinating and rewarding business, but most people don't know it," he said. "If your parents weren't in it, you have no clue. If your parents didn't own a commercial building, if your parents didn't own a house, they probably just didn't know."

$500K

Amount LaSalle has committed to Black and Latinx recruiting

Scholarship program

The idea for the LaSalle Real Estate Scholarship for Black and Latino minorities stems from the national reckoning over racial inequity in the US brought on by the high-profile police killings of Black Americans this year. Delle, who is also deputy portfolio manager for LaSalle's flagship, open-end US Property Fund, noted the current spotlight on these issues inspired LaSalle to seek ways of making a tangible difference. "Now is the time to not just talk about [racial inequity], but to act. In forming this scholarship program, we thought about what could be impactful now and in the long run as well."

LaSalle granted scholarships this fall to one student at each participating institution, including Roosevelt University in downtown Chicago and the historically Black colleges of Morehouse and Spellman in Atlanta, where LaSalle has another office. Given the emphasis on mentorship – scholars must have at least quarterly contact with their mentors – Delle said proximity was a bonus for those schools, but not a necessity. The fourth school is Florida A&M, a historically Black university in Tallahassee, Florida.

Delle said the firm hopes to add more universities throughout the country and award as much as $100,000 per year. She added that LaSalle views the initiative as a broader recruiting tool beyond those who participate directly in the program, in that one student's positive experience with the firm will help to improve its reputation more broadly. ■

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Stephen Tross, Managing Director International Investments, Bouwinvest
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High flyers The appointments and promotions that mattered in private real estate in the past month

BlackRock

Marcus Sperber, the former global head of BlackRock's real estate business, has founded NorthCroft Capital, a London-based property investment and advisory business. NorthCroft Capital will undertake balance sheet investing alongside partners and provide strategic business management advice to real estate-related investment managers and property companies. Before starting his new venture, Sperber had spent more than 17 years at Blackrock.

Prior to being made global head of real estate, he was head of the firm's EMEA real estate business and a portfolio manager of its UK property fund. Sperber will run the new platform with co-founder David Bearman. Bearman is also the co-founder of London-based property investment firm Firefly Capital, where he leads its real estate investment activities.

Amundi Asset Management
Dominique Carrel-Billiard, the deputy chief executive officer of the French asset manager, has taken over the firm's real and alternative assets unit after the departure of former head Pedro Antonio Arias. Carrel-Billiard was managing director of La Financière de l'Echiquier before joining Amundi in 2016.

Bouwinvest
Bert van den Hoek has been named senior portfolio manager at the Dutch pension investor. He will head its New York City satellite office to strengthen the investor's presence in North America. The pension manager plans to increase investments in the region by $350 million to $2 billion by the end of 2022. Hoek has over three decades of experience in real estate and has worked at Partners Group, Deutsche Bank, PGGM, GIC, Morgan Stanley and Westbrook Partners.

CA
Jimmy Hwang and Jesse Ostrow have been named executive vice-president of investments and senior vice-president of investments, respectively. Joining from JLL's equity advisory team, Hwang is responsible for investment management activities across the medical office and life sciences division, as well as the firm's industrial and residential verticals. The former chief investment officer of medical real estate investment platform MedProperties Group, Ostrow is responsible for defining and implementing the firm's vertical's investment activities and overseeing acquisition, financing and sale transactions.

CBRE
Rita Wong joined as head of valuation and advisory services and consulting businesses across Greater China. She replaces Danny Mohr, who has been promoted into the newly-created role of head of international valuations, Asia-Pacific. Wong has over 27 years of industry experience. Previously, she was head of Hong Kong-Macau valuation advisory services at JLL.

CPP Investments
Deborah Orida has been named head of real assets at the Canadian pension, replacing Edwin Cass, who was promoted to chief investment officer. Orida joined CPP in 2009 and has held a number of senior roles since, most recently the global head of active equities. Before that, she was head of private equity in Asia and head of relationship investments internationally.

INREV
Iryna Pylypchuk has been appointed director of research and market information, replacing Henri Vuong who is leaving after six years. Pylypchuk joins INREV from Fidelity International where she was a senior market analyst. Prior to this, Pylypchuk spent over a decade as director of EMEA and global research at CBRE.

La Française Real Estate Managers
Philippe Depoux has been appointed chairman, taking over from Marc Bertrand. In his new role, Depoux will develop and diversify the group's real estate business in France and internationally. He will oversee all real estate business line activities as well as the group's innovation platform. ■

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Editor's letter

Flying under the radar

Evelyn Lee
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On the geopolitical front, China has remained a fixture in global news headlines, with its high-profile deteriorating relations with the US and its clashes with pro-democracy protestors in Hong Kong. The world's second-largest economy, however, is taking a markedly different tack with its real estate investment activities in the West.

Gone, for now, are the days when China was snapping up glitzy office towers, luxury hotels or vast logistics portfolios at record-shattering prices in the US and Europe. But that does not mean what had been one of the most significant sources of overseas capital in US and European real estate has gone away, as this month's cover story reveals. Chinese investors are now pursuing more low-profile property transactions, opting for smaller ticket sizes and assets in non-core, non-gateway markets.

> **"Chinese investors are not the juggernaut force they once were in private real estate. But that by no means indicates they have been inactive"**

This under-the-radar style of investing has a couple of major implications for the private real estate market. First, it means more Chinese capital will be directed away from prominent destinations like the US, UK and France, where regulatory hurdles or other factors will make property investment more challenging. The beneficiaries will instead include smaller, but more receptive, markets in Europe, such as countries that have partnered with China on its Belt and Road Initiative.

Second, the private real estate market can no longer expect Chinese investors to continue to be trophy hunters. Indeed, sellers can no longer expect these institutions to help drive up pricing for assets by outbidding the competition.

Chinese investors are not the juggernaut force they once were in private real estate. But by no means does that indicate this capital source has have been inactive in the sector – only that it is staying out of the spotlight for the time being.

Evelyn Lee

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Performance **Welcome to the 'equitization' of private real estate**

Expert analysis by **Dr Paul Kennedy**, managing director, JPMorgan Asset Management

The covid-19 crisis has led to speculation over temporary and permanent changes to the underpinning factors that drive returns on real estate assets. We may be seeing an evolution where more real estate return characteristics start to resemble the return patterns of equities more so than bonds.

Recent events highlight the importance of real estate's ability to offer 'bond-like' returns. Unprecedented purchases of government and corporate bonds by monetary authorities have kept interest rates low and supported pricing of assets offering long-duration, high-quality credit at relatively high yields.

That is not new; monetary policy support has bolstered real estate pricing consistently since the global financial crisis. It is more about the asset class's ability to provide high-quality income based on long leases, robust demand and controlled supply. But changes to the nature of these returns have implications for the role real estate assets play in multi-asset portfolios.

To this end, covid-19 has been associated with an extended shutdown of most economies, an experiment with home working and an acceleration of the trend towards online retailing. Each of these changes may impact the consumption of real estate – specifically lease contracts – drivers of market pricing and characteristics of the asset class.

In the office sector, an increase in home working may result in occupiers reconsidering space requirements and their procurement. While the jury is out on the impact on aggregate demand, changes to other elements of the traditional leasing model are more certain.

Shorter leases and an increasing requirement for 'flex' space are evident, suggesting a greater emphasis on active asset management. Further, a shift to 'space as a service' could lead to higher but more volatile rents, enhanced landlord capital expenditure and greater gross-to-net rental spreads. These effects could erode the bond-like characteristics of real estate income streams.

Trends are similar in retail, where the growth of e-commerce continues to disrupt the economic model of physical retailing. This has multiple implications; shorter leases, higher yields, lower rents and more uncertainty. And capital expenditure requirements have increased. Consequently, some landlords have agreed to a temporary shift to turnover-based leases. One consequence may be a shift toward more equity-like return characteristics.

These effects have not been universal, nor necessarily negative. The logistics sector continues to benefit from the shift to e-commerce, robust demand for a range of distribution facilities, as well as the continued availability of long-duration leases backed by high-quality credit and attractive demand drivers. In addition, the residential sector benefits from the relative stability of demand drivers compared to offices and retail, as well as strong diversification benefits. Although leases are typically short, underlying cashflows are stable.

An adapted approach

Real estate always had the ability to play multiple roles in portfolios. Given its inherent diversity, the asset class will retain that optionality.

However, a shift to shorter and more flexible leases and rents linked to occupier turnover will enhance the ability of real estate investors to participate immediately in both the upside and downside of changes to rental markets. This has important implications for both pricing and asset allocation.

There will be positives, particularly as investors seek to offset the impact of low bond yields on overall portfolio returns via exposure to higher-yielding versions of the asset class. However, the ability of parts of the market to offer the stable income returns commonly associated with the higher-quality end of the asset class could reduce.

Investors may have to focus on an increasingly narrow subset of the office and retail sectors and rely more heavily on logistics. This could reinforce recent pricing trends in the asset class, particularly the relative pricing of logistics. These trends may also contribute to an erosion of the historical dominance of offices and retail. Awareness of these trends will help investors to identify – and profit from – mispricing. ■

Net leases **Fast becoming real estate's bond replacement**

Comment

Expert analysis by **Kyle Campbell**

While transaction volumes have been lower during the pandemic, net lease strategies have been finding outsized success. Last month, Apollo Global Management led a group of investors in acquiring a $5.5 billion portfolio of properties in Abu Dhabi on one such contract. Fellow private equity giant KKR is pursuing a similar strategy in Japan.

Deals like this are propping up investment volumes for the private real estate sector. In the US, sale-and-leaseback arrangements made up a record 20.2 percent of commercial real estate transactions last quarter, according to a report by CBRE, nearly double the long-term average.

The environment is ideal for triple-net lease acquisitions. Companies languishing under the strains of the pandemic can sell their underlying real estate to generate much-needed liquidity. Real estate investors, meanwhile, get something almost as hard to come by: bond-like returns.

Real estate's primary appeal since the global financial crisis has been as an alternative to fixed-income instruments. With benchmark interest rates near zero for the foreseeable future, the need for reliable yields has only increased during the covid-19 era.

Yet, at the same time, traditionally structured real estate deals are trending more toward the cyclical fluctuation of stock markets than the steady income flow of bonds. This is most evident in the two longstanding pillars of core real estate: office and retail. The rise of flexible offices and e-commerce has upended the long-term leasing models that made these assets so attractive to investors. The relative ease with which people adjusted to working and shopping primarily from home has only made matters worse for the property types.

Logistics focus

Investors seeking high quality, stable income may have to focus more on logistics. That is already playing out in the net lease market, where industrial properties accounted for 48 percent of transactions last quarter, up from 34 percent the year prior, according to CBRE.

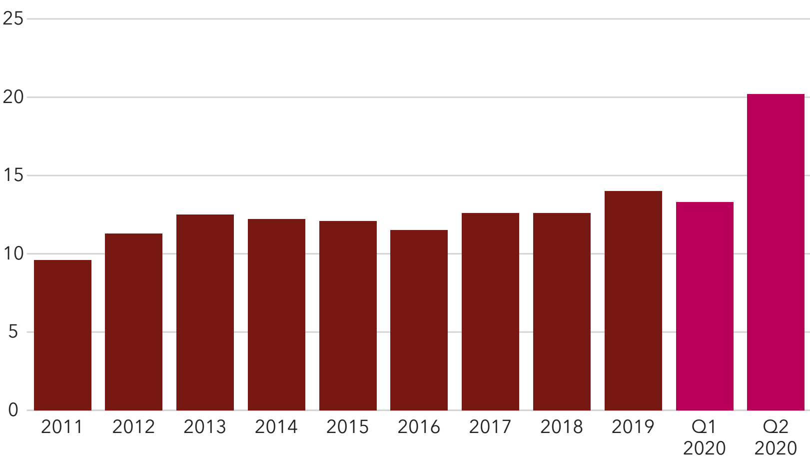
A successful sale-and-leaseback strategy is an extension of the seller-tenant's creditworthiness, which can offset broader market volatilities. In retail, for example, managers can cherry pick successful businesses – such as fast food restaurants, drug store chains and auto repair shops – backed by strong parent companies.

Managers have also shown a greater willingness to invest in non-traditional markets on a net-lease basis. An example of this is Apollo in Abu Dhabi, which is more often a source of investment capital than a destination. For 24 years of income from a reliable tenant – the Abu Dhabi National Oil Company – the arrangement seems well worth any location risk. For its part, ADNOC gets an immediate injection of $2.7 billion to bolster it through a lull in petroleum demand.

KKR's Japanese playbook is similar. It will source deals from railway companies, manufacturers and other corporations with large, underutilized property holdings. In the US, sale-and-leasebacks have played a larger role in the market since 2016, a trajectory that tracks closely to the rise of industrial net leases.

So long as investors remain starved for steady income-producing assets and companies stay equally in need of capital, look for net lease strategies to continue having their day in the sun. ■

Net leases made up a record share of commercial real estate transactions in Q2 2020 (%)



Source: CBRE

Diversity **Kalsi's BentallGreenOak has set a hard bar on diversity**

Comment

Expert analysis by **Jonathan Brasse**

It was inevitable that once Sonny Kalsi's incoming recruitment policy saw the light of day, via *PERE's* exclusive interview with him published last month, it would provoke debate. That was the minimum the newly-installed BentallGreenOak boss hoped for, after all.

Whether we see a subsequent slew of copycatting is another matter. For most, the implementation of a hard rule dictating 66.7 percent of all new recruits be minorities or women represents an admirable effort by one of private real estate's highest-profile individuals and mega-managers to fight against systemic inequity in the western world.

Corporate America was under pressure to respond to the police killings of Black people this year and public statements of condemnation and unity are no longer enough. Tangible action by people who might make a difference is required and, in private real estate, Kalsi has ensured that.

For some folks, the concurrent implementation of self-imposed penalties in the event BentallGreenOak misses its own recruitment targets is a bridge too far. Debbie Harmon's Artemis Real Estate Partners, for instance, managed to achieve the same two-thirds diverse recruiting numbers in 2018 and 2019 by using carrots over sticks – albeit her firm's 60-strong headcount is a fraction of BentallGreenOak's 1,300-strong operation and was diversely designed from the start.

> "Conscious that the enthusiasm for implementing such trajectory-changing policy might wane, he ensured he tied the firm's colors firmly to its mast"

Harmon is a long-time ally of Kalsi and collaborator with him on projects including the PREA Foundation, which partners with Sponsors for Educational Opportunity on a US initiative aimed at helping Black, Hispanic and Native American undergraduates receive real estate training and full-time employment. The fact that she would adopt a more celebratory tack over penalizing missed targets tells us that, even among private real estate's diversity champions, there is plenty of nuance.

But while Artemis had no legacy bench to contend with, too many organizations are in similar shape to the white, male-heavy BentallGreenOak that Kalsi has inherited. Indeed, as *PERE*'s interview highlights, 78 percent of executives at managers covered by the Pension Real Estate Association are men; 88 percent are white. That is quite the mountain to climb.

66.7%

BentallGreenOak's minimum diverse candidate recruitment rule going forward

And it would be naïve to assume racism and diversity issues will continue to dominate headlines, and thus the public consciousness, to the degree it has this summer. Certainly, Kalsi does not think so. That is why he wants to strike hard – and strike now. As he admitted to *PERE* during the interview, he considered not sharing BentallGreenOak's recruitment policy before it had taken proper shape. But, conscious that the enthusiasm for implementing such trajectory-changing policy might wane, he ensured he tied the firm's colors firmly to its mast.

The specifics of the policy might change slightly over time. But the target number is now out there and would be problematic to remove. Even if others implement hard quotas far smaller than 66.7 percent, these actions would still make a significant difference, given most firms in the industry had no such targets before.

Private real estate has some way to go before it can meaningfully contribute to the fight against societal inequity. And Kalsi's BentallGreenOak cannot hope to do more than lead by example. But whether you agree with its penalties or not, this firm is unequivocally standing out by using the momentum of this summer's protests against racial injustice to execute a long-needed strategic shift. For that, it should be recognized and applauded. ■

How much are flex office assets worth now?

The covid-19 crisis has accelerated two different shifts in how properties with a space-as-a-service component will be valued, writes Evelyn Lee

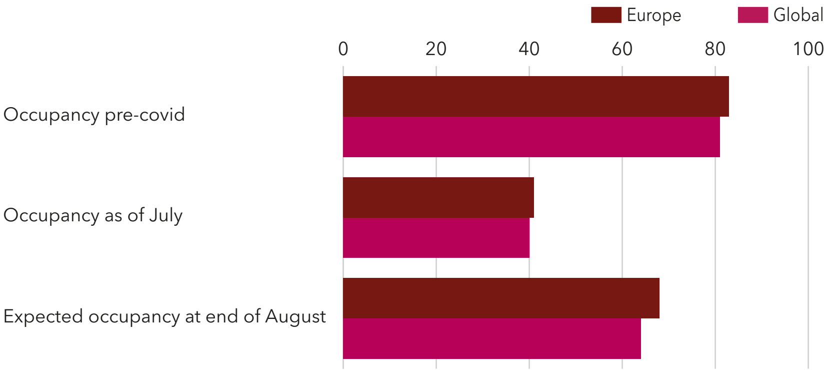
As workforces return, flexible office space is also making a post-lockdown recovery.

Occupancy levels for the sector stood at 41 percent in Europe and 40 percent globally as of July, according to a report from Workthere, the flexible office business of real estate advisor Savills. Meanwhile, contract occupancy – the percentage of total desks that were occupied by paying members – was expected to reach 68 percent in Europe and 64 percent globally by the end of August, the report stated.

The uptick in demand is expected to continue amid the covid-19 crisis. "Signing a monthly or a six-month contract that fully integrates all the services – that's going to be probably even more relevant going forward," notes Stéphane Theuriau, head of BC Partners Real Estate, the property arm of the London-based alternative investment firm. "Since we're going to be in a world of uncertainty for at least a couple of years, taking a flexible solution, even if it's more expensive, is probably going to be the right way to go."

Office assets with a space-as-a-service component are currently valued less favorably than the traditional trophy office properties that are 100 percent leased to long-term blue-chip tenants. Emma Swinnerton, EMEA head of flexible leasing solutions at Chicago-based property services firm Cushman & Wakefield, says: "You're unlikely to get the same covenant out of a flex workspace operator than you would out of a FTSE 100 corporate, for example, so comparatively, it's seen as being riskier." She explains that a co-working

Projected end of August numbers were approaching pre-pandemic levels (%)



Source: Workthere

operator frequently sets up an individual special-purpose vehicle for each flex location it runs and consequently can walk away from the SPV without any impact on the wider business.

"There's more volatility in that income stream, and there's more risk associated with that as well," adds Richard Kalvoda, head of the advisory practice at commercial real estate services and software company Altus Group. Similar to the hotel sector, "with space-as-a-service, it could go up or down tomorrow; whereas the traditional office space [is] pretty consistent."

"Traditional valuers are going to be more sensitive to the classic model and probably discount the space-as-a-service model," says Theuriau. However, he anticipates the industry's attitudes toward flex assets will begin to shift.

Theuriau notes that many property firms have become more cautious about owning a large building leased to a single tenant, which puts a landlord at risk of having a vacant asset for an extended period. He believes that such a property will increasingly be viewed as riskier than an asset with multiple users on leases of varying maturities and with a space-as-a-service component: "That solution is going to look more resilient to long-term investors than your single-tenant, single asset, which was the model for your best deals historically.

"I have a feeling the valuation industry and the professionals are going to try to go for a more diversified cash-flow base – and if that comes with shorter-term revenues, but a lot of diversification, they're probably going to be okay with it. I don't think there are going to be a lot of discounts versus your traditional lease model."

Kalvoda agrees that, in the longer term, properties without a flex component will be valued lower. "I think the trend definitely will go towards more space-as-a-service," he says. "If that's where the trend is going and that's where the demand is, landlords need to future-proof their portfolio, because now there might be a premium. But at some point, there could be a discount if you don't incorporate some form of that in your building."

He likens space-as-a-service to LEED or other sustainability certification programs for buildings: "It used to be there might be a slight premium. Now there could be a discount because it's expected and demanded by the market."

From leases to partnerships

The pandemic is not only accelerating a shift in how flex assets are perceived in the market, but also in the relationship between landlords and flexible workspace operators. Swinnerton estimates 60 to 80 percent of operators are currently on traditional leases with landlords. However, she expects covid will trigger a shift from leases to management contracts, profit-sharing

"I think the trend definitely will go towards more space-as-a-service"

RICHARD KALVODA
Altus Group

Does brand matter?

The importance of the operator's brand on a building's valuation is up for debate.

Swinnerton maintains that most office occupiers will not place heavy emphasis on branding. "If you're a normal business on the street, very few people will know who the different flex workspace operators are at all," she says. "All they're concerned about is, 'I need an office for this many people, it needs to be in this location and I want to pay this much money.' Obviously each of them will have different merits, in terms of the design and the amenities that are offered and the feel of the place. But customers are not making their decision based on how the space is branded."

Kalvoda, however, believes the branding of the space-as-a-service provider will have a generally positive impact on valuation and will become more valuable as flex space becomes more popular. He notes that Altus Group itself is a flex-space occupier in some of its locations around the world: "We'd like something standard, we'd like to have a known experience. If we're renting in five different cities across the world, it's much easier to deal with one operator, knowing there's consistency of delivery in what the services are. That's the consistency you see with hotels, where you generally tend to one brand, or even one hotel within a brand, because you know the experience you're going to get."

"When you lease an asset to WeWork on a 10- or 15-year lease, you've effectively lost control of your asset, because you've lost control of the final client"

STEPHANE THEURIAU
BC Partners Real Estate

partnerships or landlords delivering in-house offerings.

"It's sharing of risk with the owner, fundamentally," explains Swinnerton, whose firm has its own white-label flexible workspace service known as Indego. "What you see at the moment is the sector is somewhat challenged and the operators who are finding it harder are those actually on a fixed-lease arrangement because they've got a fixed-cost base. They're getting asked for concessions by their end customers in terms of terminations or rent reductions or holidays. There's only so far they can go without going into the red, and then what happens is they are unable to pay rent to their landlord."

Theuriau concurs: "If you think about it, when you lease an asset to WeWork on a 10- or 15-year lease, you've effectively lost control of your asset, because you've lost control of the final client, because the final client is actually going to WeWork."

By contrast, if a landlord and operator are in a profit-share or management agreement, both parties are sharing in the performance of the flex space, whether it be the upside or downside. "It's a fairly new model for the office space," says Swinnerton. "But if you look at the hospitality industry, this is the model that hotels have been operating on for a long period."

Theuriau observes that, similar to a hotel owner, an office landlord can negotiate more favorable terms with a management contract than with a lease. "If you have a Four Seasons with a service contract, you're probably going to be better off than if you have a lease with Four Seasons long term," he says. "With Four Seasons having a lot of leverage because of the quality of the brand, the lease has been negotiated more favorably to Four Seasons than a profit-sharing service contract."

He adds that in addition to being able to negotiate better terms, a service contract provides the office building owner with much more flexibility: "I can get rid of the operator if I'm not happy with the performance, because I think most of those companies have no credit."

New valuation methodologies

This shift away from leases towards partnership structures will necessitate a different way of valuing flex assets, according to Swinnerton. However, to date, "there hasn't been a defined methodology for how you value that," she says, noting that the UK's Royal Institution of Chartered Surveyors – a standard bearer for property valuations in Europe – has yet to provide specific guidance on this topic.

In response, Cushman & Wakefield released in early September a white paper outlining its own valuation methodology for flexible offices that are owned and operated by the same party or operated by a third-party being paid a management fee. The methodology would adopt a hybrid approach that would take into account both the trading performance of the asset as well as the capitalization of two income streams – the net operating income equal to the market rent if the space was on a traditional lease; and the NOI greater than the market rent and attributable to the space-as-a-service operation.

"We wanted to drive some momentum in this area, so that all parties can have some confidence about the approach you take to valuing flexible workspace," Swinnerton says.

Kalvoda says that when the landlord has a lease or partnership with a third-party flex space operator, and it represents less than 20 percent of the building's cashflow, there is no major difference in pricing compared with a traditional office building. However, if that percentage exceeds 20 percent, or if the landlord provides the space-as-a-service directly, then the valuation pricing parameters may change due to the added risk or income volatility compared with a traditional office building.

"As space-as-a-service becomes more in demand and you see more of your building being allocated to that, and directly to the landlord, I think you'll see more of that become split out, because that becomes a big part of the cashflow then," Kalvoda says.

What results is two separate income streams with two separate types of investors: a lower-risk, lower-return investor that is seeking a stable cashflow from the traditionally leased component, and a higher-risk, higher-return investor comfortable with potentially more volatile cashflow from the space-as-a-service component.

Theuriau does not have any hard-and-fast rules about whether he would value the flex component differently than the traditional office component of a building. "It depends on who the operator is and the quality of offering," he explains. "If I feel the operator is weak and it's overpriced, and it's not sustainable, then I'll price it differently. On the other hand, if I feel that operator is bringing a competitive advantage to my asset, and it's priced right, I may value it even more. It's very much on a case-by-case basis."

Theuriau would adopt three different methodologies to value an asset with a space-as-a-service component: a comparison between a property's current cashflows and its projected cashflows if the flex component were to be re-leased under a standard lease; a discounted cashflow based on the amount of capital expenditures needed for a lease renewal; and assessment of the performance and growth potential of the service component. The final valuation for the asset would be a combination of all three values using the discounted cashflow approach.

"We definitely need a clear consensus around methodology," says Swinnerton. "That will drive further confidence in this part of the business, particularly from the investment and banking communities. There will always be certain assets that you might need to look at in a different way for specific reasons, but I think in general, there should be a consensus." ■

"We definitely need a clear consensus around methodology"

EMMA SWINNERTON
Cushman & Wakefield

Cover story

Has Chinese capital been beaten out of Western markets?

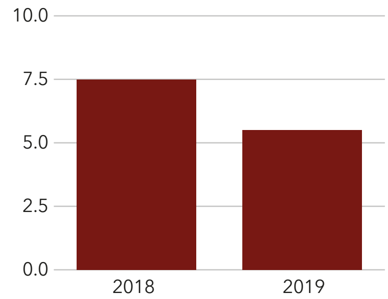
Strained geopolitical relations have pushed Chinese foreign direct investment in private real estate to historic lows. Yet, as Arshiya Khullar finds, not all Chinese investors are stopping their activities in the West

US President Donald Trump was on US Air Force One, returning from a rally in Florida on August 1, when he declared war on TikTok. Within two weeks, he signed an executive order banning the Chinese viral video app. Chinese technology firm Tencent, which owns the WeChat messaging app, was simultaneously banned from doing any US transactions.

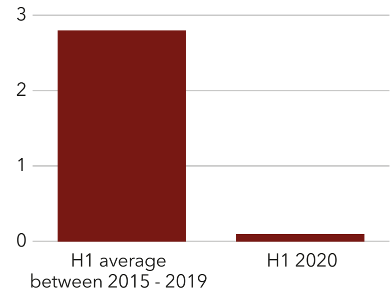
TikTok and Tencent are the latest casualties in a bitter US-China feud that has raged over issues from trade to finance, from technology to infrastructure, to Hong Kong's national security law – even the origins of the coronavirus pandemic. The consequences have been far-reaching. Chinese investment in North America overall hit its lowest point in a decade in 2019 with just $5.5 billion of completed deals, according to analyses by law firm Baker McKenzie and research provider Rhodium Group.

Geopolitical tussles combined with heightened regulatory scrutiny of international deals involving Chinese capital and Beijing's own restrictions on outbound investment have

Chinese direct investment in Canada and the US cumulatively fell 27% in 2019, reaching its lowest level in a decade ($bn)

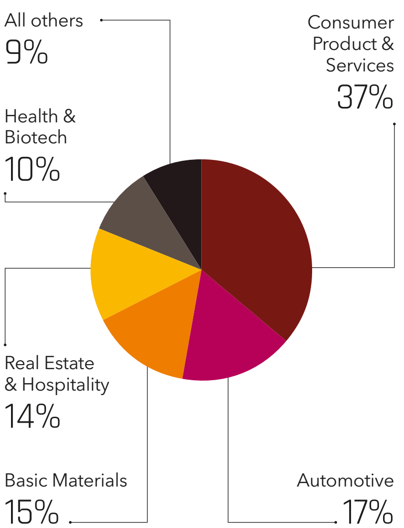


Chinese capital inflows into real estate specifically have dropped precipitously, with H1 2020 transaction volume down 97% from the last five-years' H1 average ($bn)



Source: Annual survey by Baker McKenzie in partnership with research provider Rhodium Group, January 2020

Real estate and hospitality deals only represented a fraction of the total Chinese foreign direct investment in North America in 2019



Source: US Inbound & Outbound Investment Trends, H1 20, CBRE (figures have been rounded)

diminished Chinese capital's participation in global financial markets in the latter years of the last decade. But has a death knell sounded for China's buying in the West?

PERE asked this question of the private real estate industry, which has closely tracked the rise and fall of Chinese investors' high-profile transactional pursuits, and the collateral damage to their credibility as a major capital source. The answer, explored in this deep-dive piece, might surprise.

To be sure, the days of Chinese investors' trophy purchases in Manhattan and Canary Wharf are over for now. State-owned enterprises are no longer the most prominent outbound investor group. But a more measured, low-profile and strategic capital base from China is still investing through more regulatory friendly approaches. Critically, while deal activity is down to low triple-digit million figures, it is not at zero. If anything, fraying US-China relations could ultimately redirect Chinese capital to Western countries with friendlier ties to China than those stateside.

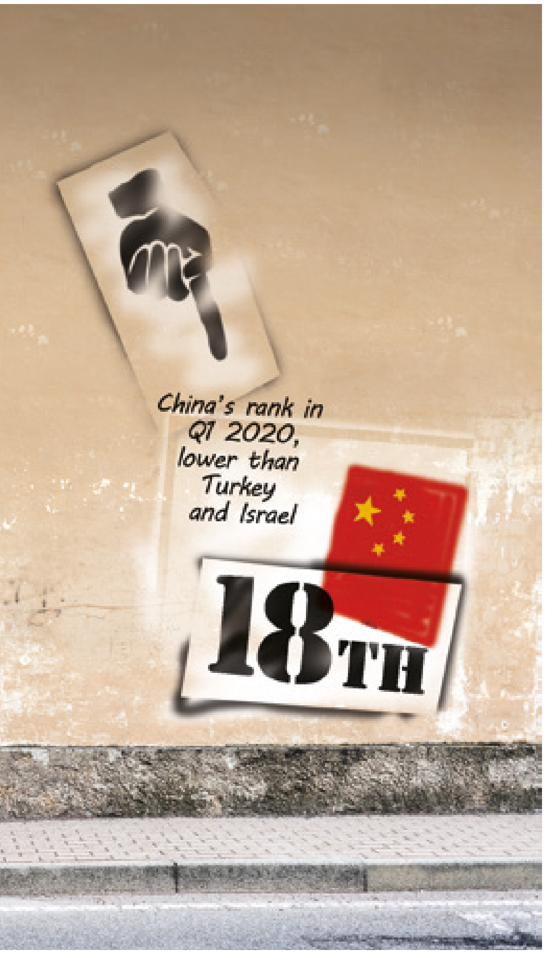
CFIUS and other US roadblocks

During the peak of Chinese merger and acquisitions activity from 2014 and 2016, the likes of conglomerates Anbang Group, Dalian Wanda and HNA amassed a property empire of Hollywood studios, insurance companies, luxury hotels and office skyscrapers. Anbang, the poster child of this shopping spree, invested nearly $18 billion across a pool of assets.

These investors have since wound down most of their overseas portfolios. But the fallout of that aggressive approach continues. In August, the Chancery Court of the State of Delaware completed an acrimonious five-day trial involving Anbang and South Korean asset manager Mirae's failed $5.8 billion deal for 15 high-end US hotels. After agreeing to acquire the portfolio in September 2019, Mirae terminated the deal in April, citing issues around fraudulent deeds of some of the hotels, according to a Bloomberg report. Anbang counterclaimed the pandemic's impact on the hospitality sector made Mirae pull the plug. Both parties sued each other for breach of contract. A court verdict is expected this fall.

People who actively partnered with Chinese capital in the heydays of the last decade admit the Anbang saga prompted both the industry and US regulators to reevaluate their due-diligence approaches, especially against the backdrop of changing bilateral relations.

"It has been a decade in transition in US-China relations. Some of these



> *"At the peak of Chinese interest in prime global real estate assets, it was almost 'mandatory' for agents and vendors to incentivize these buyers to participate and bid at the top range of the pricing"*
>
> **PRIYARANJAN KUMAR**
> **Alvarium Investments**

marquee real estate deals mark that transition nicely," says Mario Mancuso, a partner heading the international trade and national security practice at law firm Kirkland & Ellis.

Mancuso says while there has been press focus on the Trump administration's role in escalating tensions with China, structural changes within China are less discussed. "The Xi era has, in part, cracked down on certain economic practices by Chinese companies and state-owned enterprises, which have contributed to a slowing down in activity. But the Xi era has also been marked by a highly personalist and authoritarian approach. This shift in China has catalyzed a CFIUS agency practice skeptical of distinctions once held between SOEs, sovereign wealth funds and private companies in China for the purposes of assessing a Chinese buyer's fitness to acquire a US asset," he explains. "So, the Xi change is really a sea change. And, it has had a practical impact on how CFIUS has evaluated various categories of Chinese buyers."

Real estate historically was exempted from the Committee on Foreign Investment in the United States. But, in the last few years, the interagency federal body has widened its review of foreign deals for national security implications to include the sector. Simultaneously, acquisitions by Chinese investors accounted for the largest proportion of CFIUS notices filed by any country between 2017-19. Indeed, 51 of the 140 Chinese covered transactions were in the US finance, information and services sector, in which real estate falls.

A new regulation passed in February 2020 further expanded CFIUS's jurisdiction to non-controlling investments in US real estate. Regulators are now also inquiring about non-notified transactions, including deals that closed years ago. CFIUS's investigation into ByteDance's 2017 acquisition of what became TikTok, for example, was only launched in November 2019. Lawyers say they are aware of CFIUS actively seeking to scrutinize some previously closed real estate deals, too.

Fewer Chinese investors are transacting in the US as a result. According to property services firm CBRE, inbound Chinese capital in H1 2020 was \$98.5 million, accounting for 0.8 percent of total foreign investment.

But this is not the whole picture. What such data cannot accurately capture are indirect transactions, including fund commitments and minority interests in joint venture partnerships, which are rarely publicized, as well as non-institutional deals. On the day Jay Neveloff, who chairs law firm Kramer Levin's real estate practice, spoke to *PERE*, for example, he was working on a "mid-sized" transaction in the US involving a Chinese entrepreneur. He says he has also advised Chinese developers, that already have assets and capital within the US, for their condo development projects.

"We are seeing the sovereigns continue investing as LPs, with no rights and not doing co-investments, which could potentially raise CFIUS concerns," adds Ivan Schlager, international trade and national security partner at Kirkland & Ellis.

In March, for example, a Chinese sovereign wealth fund invested in a "club" joint venture partnership with another Asian sovereign fund and a US manager. The venture acquired a portfolio of last-mile distribution centers in secondary and tertiary US markets. *PERE* understands the parties elected not to make a CFIUS filing due, in part, because none of the assets were located within close proximity to any sensitive government facilities or urban areas.

"I think some sovereign investors view these 'lower-profile' deals as a win-win. They are still able to achieve stable, core-type returns from long-term, triple net leased properties with investment grade tenants, and also have less of a CFIUS spotlight shining on them because they are not buying multi-billion dollar skyscrapers or hotel portfolios in downtown Manhattan or other major coastal markets," says Jack Creedon, partner and global co-head of Ropes & Gray's real estate investments and transactions group.

Average ticket sizes have also changed. The deals Creedon has worked on recently have all been on the smaller side, more in the $100 million-$300 million range. "I do not think some of the perhaps perceived transactional challenges involving certain Chinese investors over the past year or so has been a total turn-off for US investors wanting to do deals or JVs with sovereign wealth funds," he says. "To be sure, overall transaction and investment volume is significantly off the high-water mark set a couple of years ago. But I have seen deals get done, albeit different styles of deals: less high-profile and more private, club-JV types of structures in non-core or non-gateway markets."

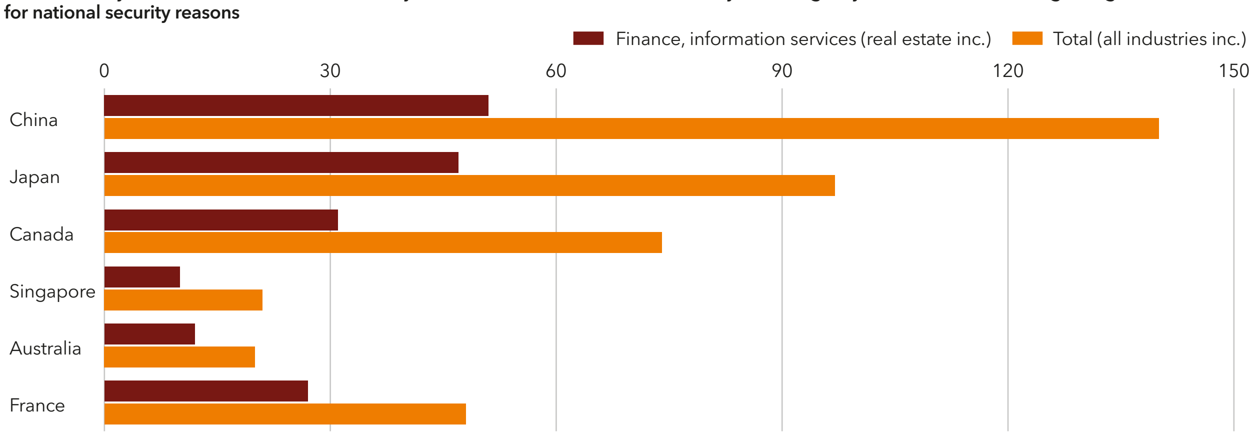
> *"The Xi change is really a sea change. And, it has had a practical impact on how CFIUS has evaluated various categories of Chinese buyers"*
>
> **MARIO MANCUSO**
> **Kirkland & Ellis**

Chinese deal-making 2.0

This strategy aligns with Beijing's mandate, too, given the government's continuing clampdown on speculative overseas investments through foreign exchange controls since 2016. Non-speculative investments, however, especially in sectors such as healthcare and senior care, are still approved. Beijing-based Cindat Asset Management is one well-known investor in this space. As of January, the firm's total exposure to senior care assets was north of $1.5 billion in net asset value, which included portfolio acquisitions in the UK and US.

"In terms of senior care investments, we are the largest Chinese buyer in the US," says Greg Peng, the firm's CEO and co-founder. "These types of transactions are not specifically 'forbidden'. In fact, some Chinese insurance companies were still keen to invest into our deals at the beginning of this year. But the attitude changed once covid-19 hit."

CFIUS scrutiny: Between 2017-19, China had, by far, the most transactions reviewed by the US agency tasked with monitoring foreign transactions for national security reasons



Source: Committee on Foreign Investment in the United States, Annual Report to Congress

While the politically charged atmosphere in the US is a limiting factor for cross-border deals, things are playing out differently in Europe. China's souring ties with the UK over the crackdown in Hong Kong and Chinese capital controls contributed to a 40 percent drop in Chinese M&A investment in Europe last year, according to Baker McKenzie's survey. But the $13.4 billion investment in the continent was still twice the North American volume.

"The sentiment in the US towards China is likely more critical than perhaps from Europe, where it is appreciated that foreign investors in general, including the Chinese, improve the liquidity of the market," says Hans Vrensen, head of research and strategy at investment manager AEW Europe, adding that the relevance of Chinese capital in European property markets has not changed in the past two years.

Private capital, for one, continues to chase UK assets for diversification and wealth preservation purposes. Eric Zhao, a director and Chinese capital markets specialist at property services firm Savills, sees the same type of Chinese investors investing consistent amounts of capital this year to last. "They are transacting less openly, but still transacting," he says.

The other active investor group are mainland Chinese and Hong Kong developers. A prime example is CC Land, a developer in Western China, which in 2017 acquired London's 'Cheesegrater' office tower from REIT British Land and Canadian investor Oxford Properties for £1.2 billion ($1.5 billion; €1.3 billion). Today, CC Land's UK portfolio totals assets of roughly $5 billion in gross development value, which includes two residential developments and office assets in the UK.

"One's appetite to risk changes as a foreign group gets to know a territory better. When we started, we were buying conservative, fully-let assets. We have gone up the risk curve and now will also buy opportunistic development, albeit with planning," says Adam Goldin, head of CC Land's UK business.

The firm remains acquisitive, targeting high-quality, large scale prime assets with gross development values of around £1.5 billion. "The overarching determining factor for us is whether we want to own the asset. Our driving force has always been the quality, more than the returns it generates over a five-year hold," he explains. "If we do like a trophy asset, like many other high net worth and trophy hunter investors, we will find a way to buy it and to access the capital."

Hotel del Coronado: San Diego hotel's sale to Anbang was scrapped after a CFIUS review

Goodwin Gaw, chairman of Hong Kong-based private equity real estate firm, sees European deals by Chinese investors ticking up as a consequence of current US-China relations: "You're going to see Chinese capital in the US drop off significantly. Europe especially, with countries that show openness to Chinese investors, will probably benefit."

Gaw Capital partnered with consortiums including Chinese investors on major US and European deals in the past decade, most prominently the $711 million purchase of the Columbia Center in Seattle in 2015 and the Lloyds of London building in London for $321 million two years earlier. But it will be previously less fancied parts of the latter region where he expects continued notable investment from China.

"The UK has no choice but to take a similar tack to the US," says Gaw. "France probably also. But Germany could take a more independent stance and there are smaller countries that can take advantage of being friends with both sides. So, now we're seeing Chinese interest in other European markets, particularly those with bilateral arrangements in place."

Elsewhere in the continent, positive bilateral relations due to China's One Belt One Road policy, is drawing more Chinese capital toward places like Hungary, Poland, Slovakia and Italy. In August, the Chinese investment firm Fosun acquired an office asset in Bucharest through Resolution Property, a London-based manager in which it owns a majority stake. Of such buyers, James Burke, associate director at broker Savills, says: "They have the ability to do both stable, income-driven transactions as well as more opportunistic ones."

Chinese-to-Chinese trade

The past few years have also seen significant asset sales by cash-strapped Chinese groups, many of which are under government pressure to repatriate capital. Chinese investors were the biggest sellers of US properties in 2019, offloading $20 billion more than they bought, according to Real Capital Analytics. One active seller was Dalian Wanda, which agreed to sell its 90 percent stake in Chicago's 101-story Vista Tower for $270 million, believed to be its last-remaining real estate asset in the country.

Yet Chinese asset management companies like Cindat could become beneficiaries of this divestment spree. "Chinese asset management companies are the army of distressed solution providers," says Peng. "If they buy an asset to help a Chinese owner solve a financial situation, and to repay loans to Chinese banks, and later on work on some restructuring to sell the asset locally, it is still considered an approved transaction."

The asset management arms of China's four state-owned 'bad banks' can buy these assets, often sold at a discount, on more flexible terms. For instance, they can give sellers participatory positions in the profits generated from the asset. Or they can provide a loan back in China equivalent to the purchase price, removing any foreign currency requirements.

"They have access to the decision-makers back home, which makes things a lot easier," Peng says of the asset managers. "Most of the US groups will be dealing with the US teams who don't have decision-making powers and can make the market quite confused. They usually also have other dealings with those Chinese owners back in China, therefore have more ways to negotiate a deal with them on their US assets."

Skyscrapers: no longer the 'trophy' targets for Chinese capital

No more trophy hunts

Tracking Chinese transaction activity is tricky as many deals are completed off-market. It is also challenging measuring fund-level commitments by Chinese investors, or detecting beneficial ownerships. Indeed, *PERE* has previously reported on the circumventing measures often used to bypass capital controls.

A Singapore-based agent *PERE* spoke to completed a large Sydney office acquisition this year for a Singapore-based investment firm on behalf of a Chinese investor, the identity of which was never reported.

What is evident from transaction data, however, is the absence of any billion-dollar deals by Chinese investors in recent years: 2017 was the last banner year in Europe, for example, including CIC's €12.2 billion purchase of the Logicor logistics property portfolio from Blackstone.

If Chinese investors are no longer trophy hunting, the industry will need to readjust its perception and treatment of this pool of capital, believe marketing agents. Chinese capital, especially first-time overseas buyers, have long had the reputation of being premium payers. Sources involved in the 'Cheesegrater' deal, for instance, say CC Land was never even on the shortlist of bidders to buy the 46-story office tower. The original plan was for British Land to sell its 50 percent interest while Oxford Properties would retain its half share. CC Land's unsolicited bid was for the full 100 percent stake in the asset at a trumping price considered "top of the market", *PERE* was told.

"Transactions such as Cheesegrater and Walkie-Talkie stand out because if the 'premium' was not offered by the buyers, the access and pole position granted to complete the transaction would have been missing," says Priyaranjan Kumar, managing director, head of Singapore at multifamily investment firm Alvarium Investments. "That premium often was the price vendors demanded for taking on an element of execution risk with unknown and first-time buyers."

What many Western sponsors and marketing agents are reluctant to publicly acknowledge is the strategic thinking behind selecting a bidder shortlist. The story of Chinese investors' splashy bets is as much a story about the inner workings of auctions and the cross-border capital dependency.

"Every seller wants that special buyer who can pull up pricing for the top bidder in the market. You then get firms to scour the planet looking for that special bidder," says Kumar, who brokered several cross-border deals during his time at broker Cushman & Wakefield.

"You don't care where the investor comes from or assess early on how executable they are or not, as long as they

Who's buying? Chinese sovereign wealth funds such as CIC and developers like Fosun and CC Land continue to be active overseas investors, albeit at a significantly lower scale than before

Investor	Date	Asset	Country
Fosun International	Aug 20	Floreasca Park	Romania
	Jun 20	PEP Torgau	Germany
	Jun 20	OBI Duren	Germany
	Jun 20	25 Rue Garnier	France
China Investment Corporation	Dec 19	Rue Francois Arago	France
	Oct 19	Vorstengrafdonk 39-41	Netherlands
C C Land Holdings	Dec 19	Whiteleys	UK
	Apr 19	85 Spring Street	Australia

Source: Press reports, RCA data

"The sentiment in the US towards China is likely more critical than perhaps from Europe, where it is appreciated that foreign investors in general, including the Chinese, improve the liquidity of the market"

HANS VRENSEN
AEW Europe

can put a reasonably diligenced price on a piece of paper that can support the asset selling at a valuation delivering real GP profit."

For a while, Chinese investors were a prime target for that. Kumar says at the peak of their interest in prime global real estate assets, it was "almost 'mandatory' for agents and vendors to incentivize these buyers to participate and bid at the top range of the pricing."

"It kept domestic buyers honest. The industry had a bias to conclude deals with known domestic buyers unless a foreign buyer offered a pricing differential that mitigated that risk."

In addition, Chinese firms gained market know-how. CC Land now has a dedicated five-person team in the UK covering investment, development, and asset management operations, including Goldin, who joined the firm in late 2017. Goldin was not there when the Cheesegrater deal closed, so did not comment on its specifics, but agrees the firm evolved its approach as it gained presence and experience in the market. "Our aim was to become a first-class custodian of real estate in the UK. We employed a team to execute that, and our profile in the UK now is higher and better," he says.

Chinese investors 2.0 may not be as trophy-oriented as before. But certain types of investors from the country will likely remain active on the international deals circuit.

Shifting political winds, however, will influence cross-border capital flows between China and rest of the world more than ever before. The outcome of the November presidential elections in the US could be a crucial deciding factor, with some observers optimistic a Joe Biden victory could reset bilateral relationships. Kirkland & Ellis's Mancuso agrees while the relationship may be different at the margins under the Democratic candidate's presidency, the US-China bilateral relationship is also structurally changing.

"There have been episodes before in US-China history, whether it was the accidental bombing of the Chinese embassy in Belgrade, the Taiwan crisis of mid-90s or the downing of US aircraft in the South China Sea," he says. "There have always been instances of US-China friction. But the difference these days is the friction is systemic, not episodic, and that the power balance between China and the US is different."

This shifting power balance is also why China's – and its financial markets' – place in the world is irrefutable.

"The obvious growth and increasing competition in the Chinese economy from a service, information and technology standpoint means, at some point, there needs to be a closer collaboration between the West and China," says Justin Curlow, global head of research and strategy at AXA IM – Real Assets.

"This must be more of a two-way, similar level playing field surrounding information, trade and investment."

Nearer term, however, the gap between the two is discernably wide. While conflicts continue to rage in other sectors, private real estate deal volumes will remain unlikely to reach the highs of the last decade. ■

Additional reporting by Merle Crichton

Brookfield's contrarian view

Chief executive of real estate Brian Kingston tells Kyle Campbell why the $550bn manager remains keen on retail and New York offices despite the many questions raised by covid-19

PHOTOGRAPHY: JUSTIN SHOCKLEY

It is September 1, and while many of New York City's office workers are somewhere other than New York City, working somewhere other than an office, Brian Kingston sits in a Lower Manhattan conference room. On the table in front of him, a green checkmark says it is OK to sit there. Red Xs by the seats next to and across from him mean they are off limits to promote social distancing. Occasionally, masked colleagues walk past his glass enclosure. These sights, along with infra-red temperature checks, daily health screenings and monthly viral tests, have become fixtures for Brookfield's chief executive of real estate, since the Toronto-based manager reopened its New York outpost in June.

The office is sparse this morning, Kingston tells *PERE* via teleconference, though only slightly more than a typical Tuesday before Labor Day weekend. He hopes the end of summer will bring additional colleagues back to 250 Vesey Street and spark a broader return-to-office movement in the US. But he does not evangelize about it. If other nations are an indication of what is to come, he will not have to.

"If you ask the average person on the street in New York when they're going back to the office, they'll say they don't want to or they're unsure, and that's natural," he says. "We have a unique perspective because we have offices around the world in cities that are at different places on the recovery spectrum and when it turns, it does turn. In China, for example, it's as though it's 2019 again. People are going to restaurants, kids are back to school, workers are back in the office. That part of the world is getting back to some semblance of normalcy."

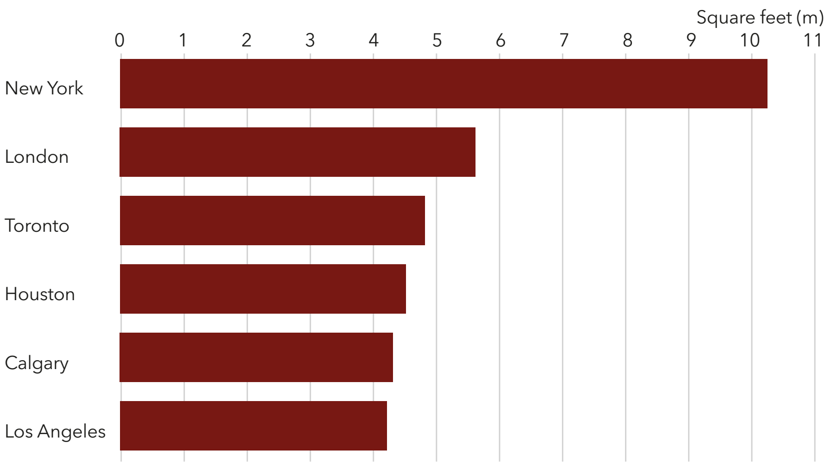
As the head of Brookfield Property Partners and Brookfield Property Group, both of which fall under the $550 billion Brookfield Asset Management umbrella, Kingston oversees the largest office portfolio in the world. It consists of 140 million square feet across 253 properties – 134 of which are core holdings on the Property Partners balance sheet – plus a half dozen more under development.

It is a precarious time for office owners, especially in the gateway markets where Brookfield is most active. After the relative success of the mass work-from-home experiment, many investors and managers are asking if a permanent shift toward this new style of work will hurt office demand. Some also believe the pandemic will accelerate the migration of companies and individuals away from traditional US office hubs to lower cost metros such as Austin, Nashville, Charlotte and Raleigh-Durham.

Prashant Tewari, a partner with the Townsend Group, a Cleveland-based advisory and investment firm, notes that remote work does not have to be widespread to have a material effect on valuations. "Some part of this work from home is here to stay and, in real estate, you don't need 20, 30, 40 percent of people to go a certain way for it to have an impact," he says. "It could be 1 or 2 percent and, all of a sudden, you start to see an impact on rent growth and, consequently, the value of properties."

Kingston is not worried about remote work or secondary cities siphoning demand from major markets. If anything, he wants to use Brookfield's $15.6 billion of real estate dry powder to add more exposure to the likes of London, Sydney, Toronto and Los Angeles, not only through offices, but also apartments, condos, hotels and other distress-driven prospects. The most acute opportunities, he predicts, will be

Brookfield's top core office markets are gateway cities and energy hubs



Source: Brookfield Q2 Supplement Disclosure

in New York, a deep and historically resilient market in which a lot of institutional capital has lost faith.

"We have lots of dry powder and our clients have lots of capital they're asking us to put to work in intelligent ways," he says. "New York is a tremendous contrarian opportunity at the moment."

Making office work

Brookfield is not the only large landlord to take a lead-by-example approach to office re-openings. But there are not many others. A July survey of roughly 500, mostly New York-based real estate professionals conducted by the law firm Morrison & Foerster, found that just 9 percent of respondents were regularly going into their offices, up from 7 percent two weeks earlier. The majority, 66 percent, did not expect to return until 2021.

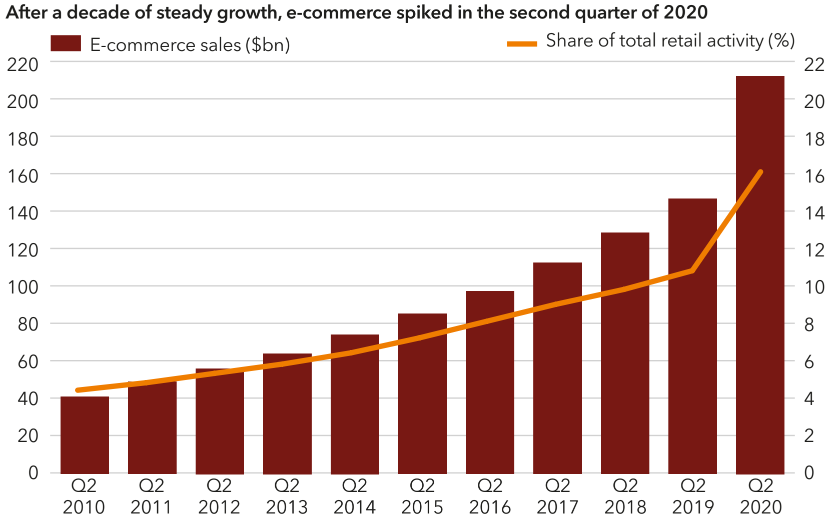
Announcements from prominent office occupiers have fueled concerns. Last month, Bloomberg reported Google walked away from 200,000 square feet in Dublin. In May, Twitter issued a statement saying workers would have unlimited remote privileges and the social media company Pinterest announced it would pay $89.5 million to terminate a pre-lease on a 490,000-square-foot office in San Francisco. Concerns are emanating from the investment banks too, including Barclays, JPMorgan and Morgan Stanley, which said in April and May they are considering smaller New York footprints. Even real estate groups that had planned to be back in the office by early September have delayed returns because of health concerns, Mark Edelstein, head of Morrison & Foerster's real estate group, tells *PERE*.

"Many employees in cities that rely heavily on mass transit, and with high-rise buildings requiring elevator usage for large numbers of tenants, are nervous about health risks in getting to the office, and that is weighing on the minds of employers," Edelstein says. "Companies making it voluntary for their staff to go into the office have found that many are opting to work from home."

New York is Brookfield's largest office market at 27 million square feet, which is 19 percent of its global office space and more than a third of its US exposure to the sector. For the core office holdings on Brookfield Property Partners' balance sheet, Manhattan offices account for 28 percent of net operating income, according to a financial disclosure from the company. It has also spearheaded several large developments in the city in recent years, including the $5 billion Manhattan West complex, which includes four office buildings, a hotel, a luxury apartment high-rise and 200,000 square feet of retail. The final piece of that project, the $2.4 billion Two Manhattan West office tower, is slated for completion in 2023. As of late July, just 25 percent of its 1.9 million square feet have been pre-leased.

Despite New York's status as the epicenter of the US covid-19 outbreak and the concerns about its future appeal, Kingston is undaunted by the prospect of finding office tenants in the years ahead. He views the current environment as a temporary disruption to a long-running influx of companies into

After a decade of steady growth, e-commerce spiked in the second quarter of 2020



Source: US Commerce Department

the city, such as Amazon, which signed a 360,000-square-foot lease at Brookfield's Five Manhattan West property in 2017. He acknowledges more workers will likely split time between home and office, but believes physical locations will remain essential for attracting young talent.

"The beauty of New York City is the critical mass here, the talent pool to draw from. This is where workers want to live, so if you want to attract 24- and 25-year-olds that are coming out of college on a fast track, you have to come here. Other places just don't have the infrastructure or the energy of a place like New York. Over the past 20 years, things have become more and more concentrated here, and I don't see that getting disrupted on a long-term basis."

"There is clearly disruption happening in the market. But, ultimately we take a long-term view that high-quality real estate assets will hold their value and recover when the economy recovers"

Indeed, just as there is evidence contradicting this assertion, there is evidence supporting it too. Facebook and Amazon both renewed vows to New York during the pandemic. Facebook finalized a long-rumored 730,000-square-foot lease at the newly-renovated Farley Building, while Amazon said it would bring 2,000 more workers to the city and turn the former Lord & Taylor department store on Fifth Avenue into 660,000 square feet of office space. For its part, Brookfield's core New York office holdings are well positioned for the years ahead, with 96 percent occupancy and an average remaining lease duration of 10 years. By comparison, the firm's overall core

office portfolio is 92 percent leased, while the growth-oriented offices in its funds are just 81 percent leased.

Lenders remain confident in Brookfield's ability to execute in the office sector. In late August, the firm refinanced the construction debt on One Manhattan West – a 2.1 million-square-foot office tower opened last year – with a $1.8 billion permanent facility underwritten by Deutsche Bank, Wells Fargo, Barclays, Citi and JPMorgan. The bulk of the financing came from a $1.5 billion commercial mortgage-backed security conduit, which Kingston says was oversubscribed: "At a time when people are worried about New York office, the debt markets are clearly there for it."

At one point, as covid-19 spread across the US and triggered a wave of forced closures in March and April, all 170 of Brookfield's malls were dark at the same time. Unprecedented as it was, Kingston says the company was able to draw from one-off closures during natural disasters across all its properties as the shutdown orders rolled in. "One of the benefits of having such a large presence is that we're able to invest in systems and processes that make us more efficient," he says. "We may have been closing a mall in Idaho for the first time, but we're applying all the learnings from what happens when we prepare for hurricanes to go through Florida, for example."

"This is not playing defense where we're trying to prop up co-tenancy, this is playing offense"

The real challenge came weeks later, when it was time to get tenants up, running and paying rent again. Between forgiveness granted to smaller tenants and lost revenue from retailers that have gone out of business, Kingston anticipates roughly 20 percent of outstanding rents from the covid closures will go uncollected. Roughly 85 percent of Brookfield's mall tenants have now re-opened. But footfall is still only about half of what it was pre-pandemic – though Kingston says that mall visitors are now more likely to buy instead of just browse.

Kingston says the current discourse around retail mirrors that of 2010, when it brought General Growth Partners out of bankruptcy before later acquiring the mall REIT outright eight years later. "People were saying the same things they're saying today: nobody's ever going to go to a mall again, every retailer is going to go bankrupt, etcetera, and that allowed us to make that investment in a very opportunistic way at a very attractive basis," he says. "We're looking at this period of time the same way. There is clearly disruption happening in the market. But, ultimately we take a long-term view that high-quality real estate assets will hold their value and recover when the economy recovers."

Still, e-commerce is a far bigger threat to traditional retail now than a decade ago. While brick-and-mortar

$15.6bn

Brookfield's real estate dry powder

€725m

Closed for Brookfield Europe Real Estate Partnership in Q2 2020

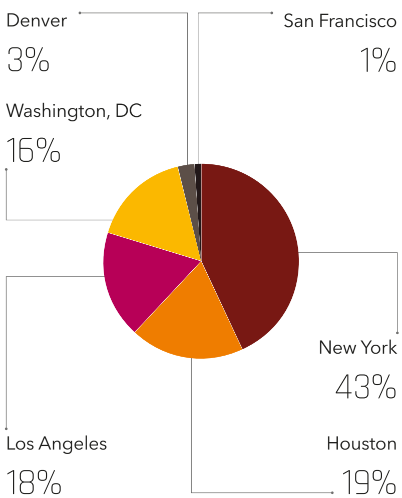
centers were closed, online sales hit a record $211 billion during the second quarter, accounting for 16 percent of all retail activity, the US Commerce Department estimates. But Kingston sees a need for both online and in-person shopping channels, even for digitally native brands. In addition to providing rescue capital, a $5 billion retail revitalization program introduced by Brookfield Asset Management in May will also help traditionally successful brands that have been slow to modernize.

Landlords purchasing their retail tenants has become evident during the pandemic. Simon Property Group, the largest mall owner in the US, has formed a joint venture with the brand management company Authentic Brands Group to buy troubled retailers like Brooks Brothers and Lucky Brands. Brookfield has partnered with those two groups on similar acquisitions in the past, including Aeropostale in 2016 and Forever 21 this past February. The three companies also reportedly made a bid to buy the bankrupt department store chain JC Penney, though an acquisition has yet to take place.

There are several reasons why a landlord would want to acquire a retailer, Eric Rapkin, chair of the real estate practice group at the law firm Akerman, explains, especially an anchor tenant such as JC Penney. Not only would this allow them to keep the lights on and continue drawing in shoppers, but it would also avoid triggering co-tenancy agreements that would allow smaller, in-line tenants to dissolve their leases if the anchor leaves. Owning an anchor tenant could also allow a landlord to make changes to a property that would otherwise be vetoed by an anchor. "Ultimately, controlling your real estate has value," Rapkin says. "I don't think the mall owners are looking at this as an opportunity to get into the fast fashion business or the department store business. This is a real estate owner saying there's real value to us controlling our own real estate."

However, Kingston says Brookfield's retail revitalization is more opportunistic. "This is not playing defense where we're trying to prop up co-tenancy, this is playing offense," he says. "There are some brands that are worth saving. Take Aeropostale as an example. That was a hugely successful investment because you had a very valuable brand that had just gotten itself overextended, needed to have its capital structure reset and then get relaunched. We think there are numerous opportunities to do that."

The bulk of Brookfield's core office holdings are in Manhattan



Source: Brookfield Q2 Supplement Disclosure

The way forward

Like other prominent managers, Brookfield has, in a way, benefited from pandemic-imposed travel restrictions. With investors eager to capitalize on dislocated pricing, but unable to meet with new managers, many have focused on increasing positions with existing partners. Across all its strategies, Brookfield Asset Management raised $23 billion during the second quarter, its best fundraising period ever. More than half of that went to Oaktree's latest distressed debt fund.

Since March 15, Brookfield has raised $1.8 billion across its various real estate funds, primarily from existing partners, including €725 million closed during the second quarter for its first European core-plus fund, Brookfield European Real Estate Partnership. Kingston says record low interest rates have been the driving force behind real estate commitments as investors look for secure ways to replace diminished yields in their fixed-income portfolios. And, historically speaking, Brookfield's convictions have served it and its investors well. Its flagship opportunity fund series, Brookfield Strategic Real Estate Partners, has delivered a gross internal rate of return of 18 percent across three vehicles, the latest of which still has roughly $4.5 billion to deploy.

"There's a lot of capital that's on the sidelines in cash or cash-like investments that wants to get invested," he says. "Investors are looking at the world and seeing a good buying opportunity. Prices have clearly come off from where they were in recent years and this window may not last forever." ■

ROUNDTABLE

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Germany stays resilient, but future worries persist

German real estate has ridden out the pandemic, so far. But managers are keeping a wary eye on the impact of economic distress still to come. Stuart Watson reports

While other European real estate markets have foundered in the wake of the pandemic, covid-19 appears only to have sharpened investor appetite for Germany. Real Capital Analytics calculates that the German market accounted for more than a quarter of European dealflow in June, and the country outperformed in absolute as well as relative terms. Deal volumes for both the first half of 2020, at €35 billion, and the second quarter, at €16.2 billion, exceeded those for the same periods last year.

RCA explains this as a consequence of three factors: the size, scale and sophistication of Germany's domestic investor base, which accounted for more than half the activity in H1 2020; a more successful response to the pandemic than rival nations; and strong public finances that have increased the scope for an effective fiscal stimulus – six months into 2020, Germany's response amounted to 13.3 percent of the country's GDP, compared with 8 percent in the UK and 4.4 percent in France.

But government support will not continue indefinitely, and the economic consequences of the pandemic, in Germany, as elsewhere, are likely to be far-reaching. One of the most pressing questions facing the four managers participating in *PERE*'s 2020 Germany Roundtable is how long, and to what extent, will the hitherto relatively robust performance of German real estate assets be maintained?

Low visibility of virus impact

"That is a difficult question to answer because at the moment it is a bit of a black box," muses Florian Geistmann, head of asset management at Munich-headquartered manager GLL. "Warren Buffet said it is only when the tide goes out that you see who was

Christoper Garbe

Managing partner, GARBE

Hamburg-based GARBE Group is best known as a developer, owner and operator of industrial and logistics buildings. But it also comprises property management business Fontenay, a development arm focused on constructing residential and office properties in Germany, and investment manager GARBE Institutional Capital. The group employs around 230 people, manages around €5.5 billion of real estate assets and is currently carrying out €1.5 billion of development.

Bernd Haggenmüller

Managing director, Ardian

Frankfurt-based Haggenmüller, who has more than 20 years' experience in the real estate industry, joined Ardian in 2016. The firm is the largest European private equity house with total assets under management of around €100 billion. Its 30-strong real estate division was formed five years ago and manages around €2 billion in core-plus and value-add funds.

Andy Watson

Fund manager, Europa Capital

Paris-based Watson is a partner at manager Europa Capital and fund manager of its core Europa Diversified Income Fund. The firm, which is 75 percent owned by Japanese institutional giant Mitsubishi Estates, manages around €4 billion of European real estate assets. The firm employs 65 staff and mainly raises capital for value-add investment strategies.

Florian Geistmann

Head of asset management and regional head DACH and the Nordics, GLL (a Macquarie Group company)

Geistmann joined Munich-headquartered manager GLL four years ago. The firm was acquired by Macquarie Infrastructure and Real Assets (MIRA) in 2018 to act as its European real estate equity platform in Europe and the Americas. GLL manages around €8 billion of assets and employs more than 150 people globally.

swimming naked, and at the moment the government is holding the water back."

The participants' assessments of their success in collecting rents since the onset of the virus appears to vindicate the government response and speak to the relative health of the German economy. Bernd Haggenmüller, managing director at private equity firm Ardian, pegs the collection rate across its office portfolio at 96 percent, with the delayed 4 percent expected to be repaid with interest. Geistmann says GLL's figures are similar in the office segment, while 100 percent of logistics rents have been paid.

Christoper Garbe, managing partner of GARBE Industrial Real Estate, which oversees a €3.5 billion portfolio in the segment, adds that in a survey of its tenants only 18 percent said it was possible that they might ask for a rent reduction. "About 10 percent did ask if they could reduce the rent. But only half of them actually did it. So, 3-5 percent took the opportunity of reducing the rent under the government restriction. But most of them were SMEs and start-ups. Not one of our larger established tenants have done it," he says.

Andy Watson, fund manager at Europa Capital, has been favorably surprised by the resilience of the German market. "There were some real worries about tailspin in March that have not come to pass. The resilience of our core fund, in particular, has been pleasing, with tenants paying over 99 percent of the rent," he says.

However, he concedes that gauging the impact of the pandemic on occupier stability over the longer run is difficult. "We have no visibility. So we adopt the common sense asset management approach of talking to the tenants."

He reveals that Europa has also adopted a proptech tool designed to provide an early warning when tenants default on payments to their suppliers.

"We have had a bull ride in German offices over the last 10 years. That is coming to an end now"

BERND HAGGENMÜLLER
Ardian

> *"At the moment, we do not see it. But the next 12-18 months will show what the reality is"*
>
> **CHRISTOPER GARBE**
> **GARBE**

Haggenmüller says that while Germany's short-time work scheme, under which the state tops up the wages of workers whose hours have been reduced, has functioned very well so far, the economic impact of the pandemic will be significant nonetheless. "We will still be affected by this in all aspects of our economy, just as we were in the financial crisis. We hope this crisis will not go on too long and the impact will not be too hard. But if you look at what is happening in the US, there is reason to be pessimistic."

A major economic downturn could even impact the popular logistics sector, says Garbe. "At the moment, we do not see it. But the next 12-18 months will show what the reality is. Car industry suppliers are under scrutiny. Everybody expects manufacturing to suffer most. But, in reality, manufacturing tenants are still signing leases at the moment. There is no clear picture of what is happening. We will observe the market closely and talk to our tenants, keeping a close watch on rental collection rates."

Demand for office space has already diminished, says Haggenmüller. "Take-up in the first half of 2020 was about one-third below the 2019 figure. But, if you look at the second quarter in isolation it was 50 percent down on 2019. We have had a bull ride in German offices over the last 10 years with tenants catering for their expansion programs. That is coming to an end now. Occupiers are asking themselves twice if they want to expand or not."

Buy sheds, or hold fire?

Your last euro – would the participants invest theirs now, and if so, where?

Geistmann: City logistics.

Garbe: Logistics development.

Watson: Last-mile logistics is a good 10-year bet.

Haggenmüller: I would wait for opportunities in the next 12-18 months in value-add offices.

Domestic capital winning the day

Reflecting on continued demand for German real estate, Geistmann says: "With only low interest available on fixed-income, we are still seeing investors expanding their real estate portfolios. Return spreads have been maintained through the crisis, and, as such, there is a lot of equity chasing deals, particularly on the core and core-plus side."

He notes that demand in Germany and France has been more resilient than in central and eastern Europe. "That is driven by markets which have lots of domestic capital being stronger through the crisis than markets that do not have as much," he says. "We currently see less international capital looking at those markets."

Travel restrictions have played a role in dampening overseas demand, suggests Watson. "There is often a need for a certain group of decision makers to visit the real estate and, for the moment, they cannot always do that. There is an obvious trend of domestic capital winning the day at the moment."

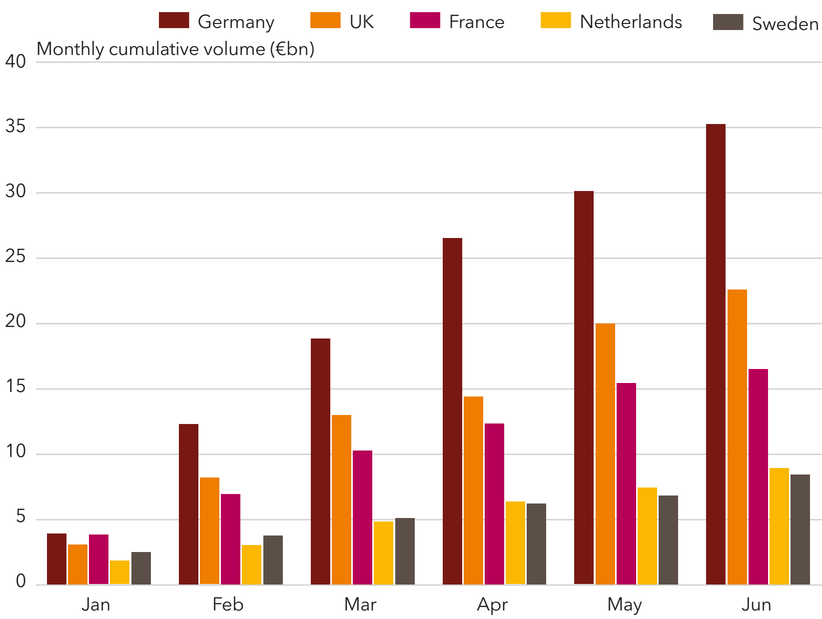
Value-add transactions falling

While Germany is attractive compared with other European markets, strong capital demand is not evenly replicated across all segments and strategies. The participants agree that although logistics and low-risk office investments retain their popularity, retail and value-add office strategies are a much harder sell to investors.

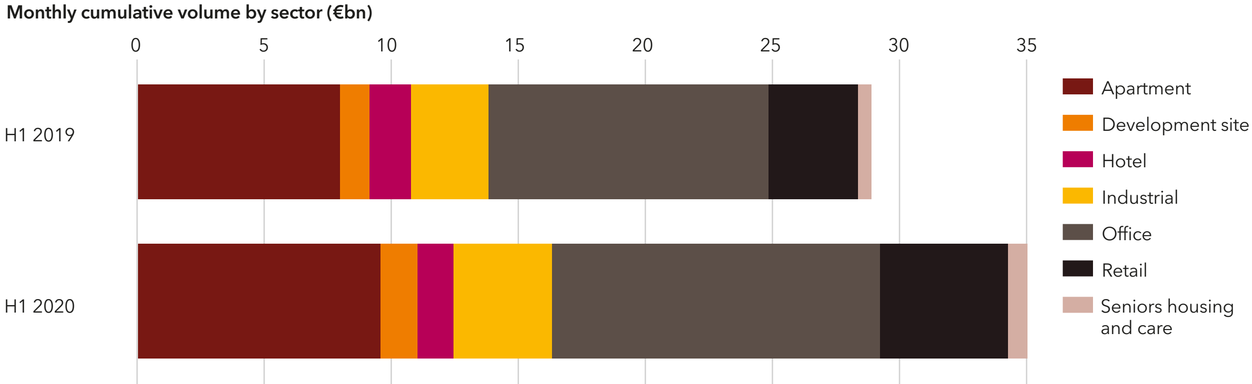
"For logistics in Germany we are inundated with money at the moment," says Garbe. "We see a real run on the asset class, with multipliers we have not seen before and record pricing because logistics has been seen as a safe haven among asset classes, while Germany is seen as robust, too. The rental growth in logistics in the last two years has been low compared with offices, so I still believe there is some potential for increases and therefore some justification for higher pricing.

"We also raised a discount food retail fund, and those assets have been very robust in the Covid crisis. Fundraising for that was a bit more difficult, however, because investors were

Germany outstripped other major European markets in H1 2020



Monthly cumulative volume by sector (€bn)



Source for both charts: Real Capital Analytics reluctant to back something labeled as retail."

The pandemic has created sharply contrasting demand dynamics between core and value-add office investments, observes Haggenmüller: "Core offices in Germany are extremely resilient. So far, the few transactions we have seen are at similar yields to before the crisis, and if you have exceptionally good tenants you can even command higher prices now because everyone is looking for that kind of product. On the value-add side, the impact of weaker leasing markets is beginning to show. That will eventually have a price impact. But sellers and buyers have not yet adjusted to that new dynamic and, therefore, we see value-add transaction volumes dropping. I wouldn't say the value-add market has come to a standstill. But it has slowed significantly."

The office debate

While the participants agree that slowing economic growth means short-term pain for office markets, there is less consensus over whether structural trends accelerated by the pandemic will cause permanent disruption and reduce the need for space.

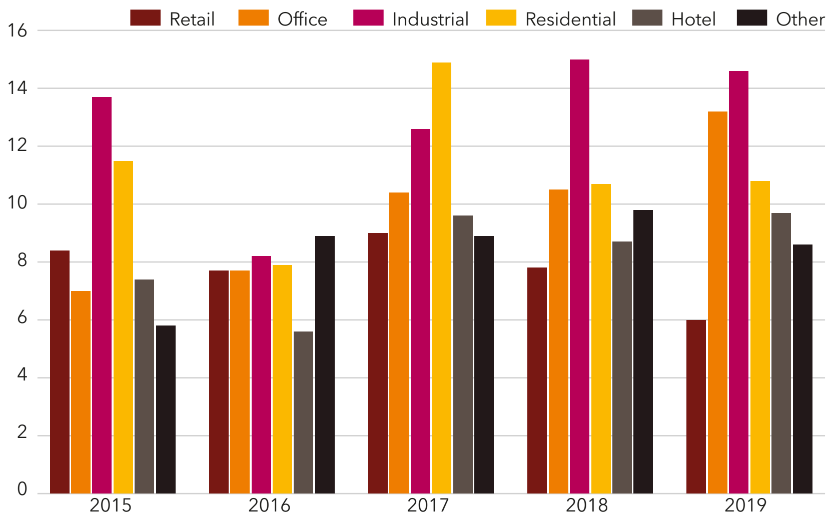
Geistmann notes that the tech industry was driving a "voracious" hunger for offices before the pandemic. But, since then, examples from the US present a mixed picture, with app Pinterest paying to relinquish a lease in San Francisco, while Facebook has taken a huge new building near New York's Penn Station. "More people may work from home. But you could argue that, to have more flexibility, tenants will need more space so that the need will reach a sustainable level. After six months of working from home, we think people are really seeking the social element that is enabled by offices. As a result, we still believe there are strong fundamentals underpinning office as an investment class."

Haggenmüller also takes a bullish

"Return spreads have been maintained through the crisis, and, as such, there is a lot of equity chasing deals, particularly on the core and core-plus side"

FLORIAN GEISTMANN
GLL

Pre-covid returns in Germany were highest in the office and industrial sectors, while retail returns were already falling away (%)



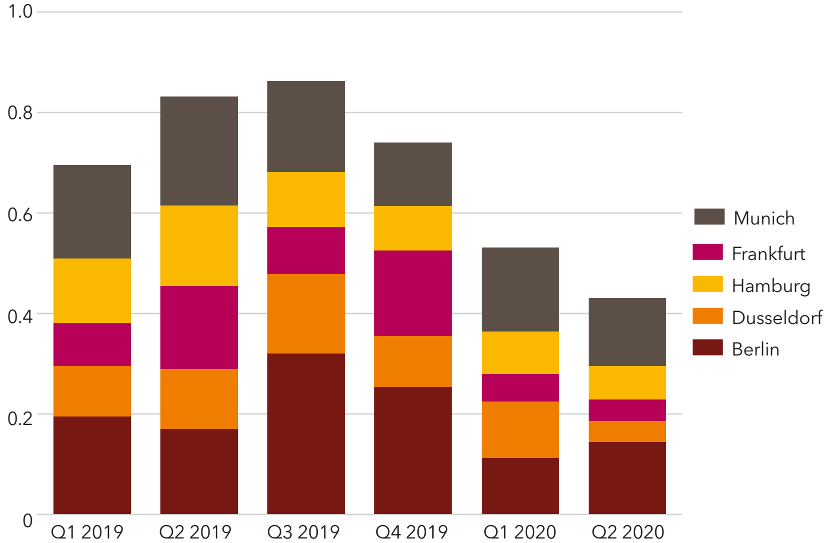
Source: MSCI

stance on offices. "This reminds me somehow of the situation after 9-11 when there was a big debate over whether companies would still want to locate to high rises. Humans tend to exaggerate from their current very significant and dramatic experience how the future will evolve. It is clear that office use will have to respond to new needs. But the need to bring people together for a creative process will not go away. Whether there will be a shift in the proportion of flexible space and long-term space that big corporations occupy I do not know. But nothing will make office buildings obsolete," he argues.

However, Garbe offers a dissenting perspective. "The true question is not, 'Do we need offices or not,' but, 'How much office space do we need?' We did a survey of our employees and the clear result was that they do want to come into the office two or three times a week to meet their peers. But they also want one or two days at home. In Germany, that will not have as much impact as it will in cities like London where you have packed open-plan offices and long commuting times. But it will have an impact. When economic growth returns, it may not have as great a positive impact on office take up as it would have done before, so we need to think about the office in a new way."

Some analysts have suggested that increased home working will provide a boost to suburban office and residential locations. However, Watson dismisses that as a "fashionable" idea. "Right now, and perhaps for the next year or two until we get a medical solution, the de-urbanization discussion will continue. But the long-term trend is to continue with urbanization," he argues. "It is expensive for governments to put infrastructure out of town, and the other factor that speaks in favor of the downtown office is that there will be a

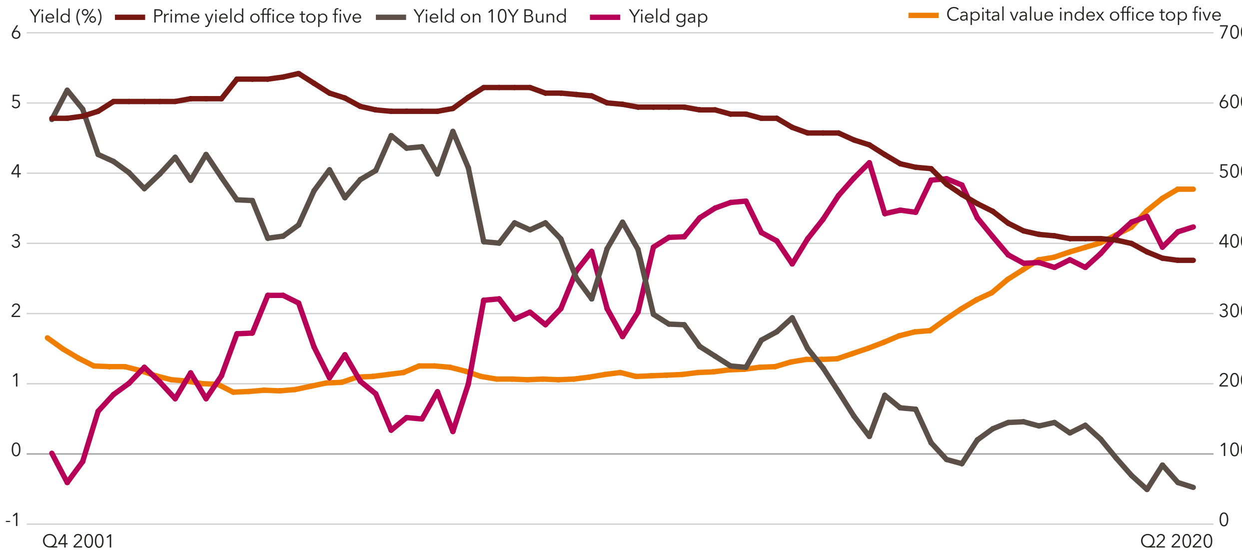
The pandemic led to falling office take up in the top five German markets in Q1 and Q2 2020 (square meters)



Source for both charts: CBRE

> *"We are in no hurry to get that dry powder out of the door. Sticking around for another six months is not going to hurt"*
>
> **ANDY WATSON**
> **Europa Capital**

Prime yields in the German top five office locations maintained their Q1 levels in Q2, while the yield gap with bonds remains attractive



Lenders favor core offices, logistics development

In some segments, real estate finance remains plentiful and the rates low. But German banks are wary of higher-risk investments, say the roundtable participants

Geistmann: At the beginning of the lockdown, we saw the risk margin on lenders' interest rates expand. But that was just a blip and they have compressed again already for assets with strong income.

Haggenmüller: Banks are fighting for the few core transactions that you see. But value-add is difficult to finance at the moment. We have seen margins increase by at least 100 basis points in Germany for the speculative repositioning of offices with no income, and more in other countries.

Watson: We are going to take modest leverage of 25 percent on the seed portfolio for our core fund and the margins for that are probably 50 basis points higher right now than they were six months ago. We expect that to compress a little, so we are in no massive hurry. On the value-add side some assets are unfinanceable and that is translating into a repricing of secondary deals in that space.

Garbe: In the logistics market banks are quite concerned about the steep increase in capital values because 60 percent LTV at the new values would have been 90 percent at the values of three years ago, so they are reluctant to lever up to rates of over 50 percent LTV on market values as they stand. However, and this is a specifically German trend, for development we are getting extremely aggressive offers from lenders, sometimes 80-90 percent LTV, even for speculative development, at highly competitive rates.

deeper pool of potential occupiers, and not just for offices, but for residential and restaurants as well."

Will economic pain create investment opportunities in Germany? "Not yet," is the response from the panelists. "In the sectors we are actively targeting, beds and sheds, both for value-add and core, we see very little distress," says Watson. "Europa has raised €600 million of equity for our latest value-add fund. But we are in no hurry to get that dry powder out of the door. Sticking around for another six months is not going to hurt. There is still plenty of time on the clock."

"It is still early days," agrees Haggenmüller. "Price adjustments have not yet happened to the extent necessary to make investments attractive again. It will be interesting to see how much price adjustment has to happen before we and our peers are back in the market, because there is a lot of liquidity."

With German real estate still at the top of many investor wish lists, there are likely to be plenty of buyers waiting to pounce upon any re-priced opportunities that emerge. Meanwhile, existing owners will undoubtedly keep a sharp eye on the stability of their income as a fuller picture of the economic damage wreaked by the virus begins to emerge. ■

Uncertainty in occupier demand reduces investor appetite for offices

Expert analysis by **James Jacobs**, head of real estate for Lazard's private capital advisory group

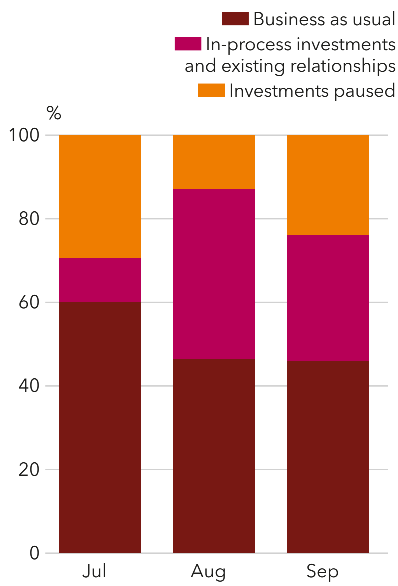
Investors are finding underwriting office demand a challenge in the current environment. But once social distancing subsides that should change

While offices have traditionally been the largest sector exposure in institutional real estate portfolios, many investors are reluctant to allocate further capital to the sector at present. Demand is directly correlated to the economy and so, given this recession, it has fallen. Furthermore, the potential impact of covid-19 on office requirements, lease terms and location preferences are making it increasingly difficult for investors to underwrite the asset class at the moment.

Corporate occupiers in many countries have had the majority of their employees working from home over the past six months. Meanwhile, technology has enabled many firms to migrate, often seamlessly, to the virtual office. This does not, however, mean the end of the physical office as a place of work. Many employees, including those who do not have the luxury of appropriate workspaces at home, are keen to return. In addition, there are clear benefits of the office to businesses in terms of building client relationships, collaboration and training.

The demand for corporate space and the way in which offices are used will be driven by several considerations.

Investor sentiment by type: the last month has seen more investments paused



Source: Lazard

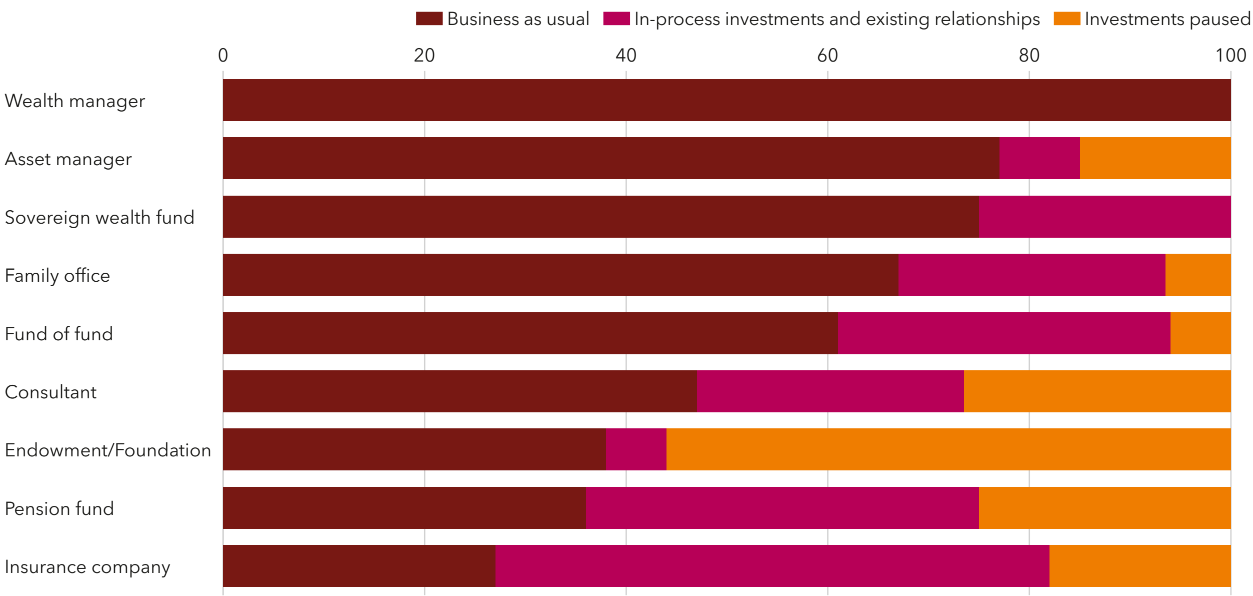
Lower occupancy density, necessitated by social distancing rules, is likely to have a significant impact on the amount of space needed, as well as on the design and layout of offices. Many employees may adopt a hybrid working pattern, undertaking more solitary tasks from home and coming into the office for collaborative working. Given the possible evolution of these requirements and considerations over the next few years, we may also see a move to shorter, more flexible leases, which is challenging for core investors needing to meet longer term liabilities.

In terms of location, demand is likely to remain robust in the urban core. Many companies are expected to continue to cluster around suppliers, customers and clients and a central location will also enable businesses to attract talent from a wider catchment area.

Notwithstanding such demand, public transportation concerns and limited lift capacity in high-rise offices are likely to remain issues for as long as social distancing persists.

Given the current difficulties in forecasting occupational demand, investors may be hesitant at present to invest in offices. However, offices will almost certainly remain a fundamental part of corporate culture, to foster teamwork, collaboration and innovation. In due course there should be greater visibility over how offices will evolve, and increased investor appetite should follow. ■

Investor sentiment by type (%): endowments are proving most cautious, while wealth managers are more bullish

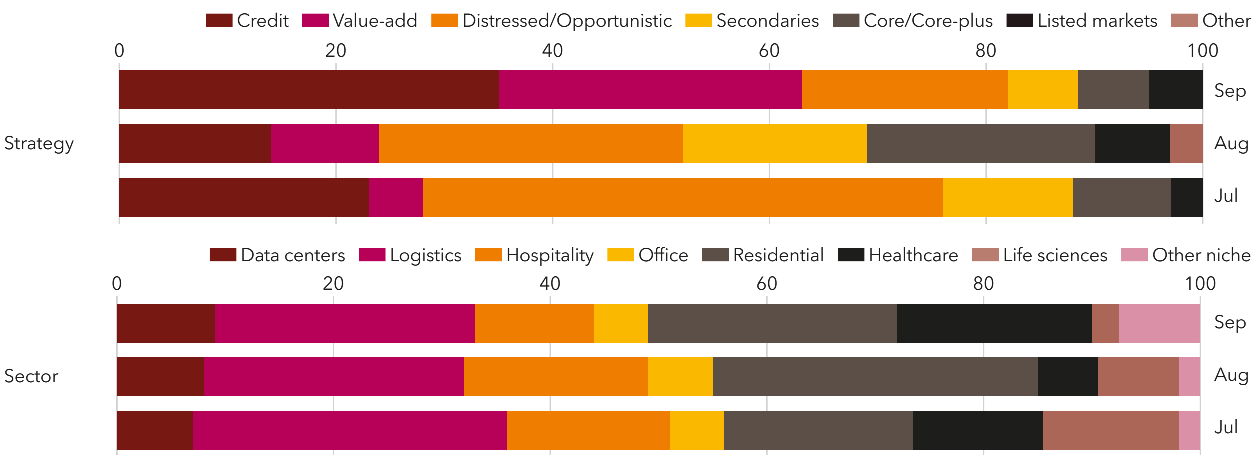


> *"Our IC is increasingly cautious about the office sector; they feel there is too much uncertainty in the space at the moment"*
>
> **US INSTITUTION**

> *"[Our] focus [is] on managers which demonstrate fundraising momentum as it will be important in the current market"*
>
> **EUROPEAN PENSION FUND**

> *"Our clients remain interested in strategies focused on distress and sectors that have experienced some form of dislocation"*
>
> **US CONSULTANT**

Investor sentiment by strategy and sector (%): appetite for office investments stayed low while credit exposures ticked up

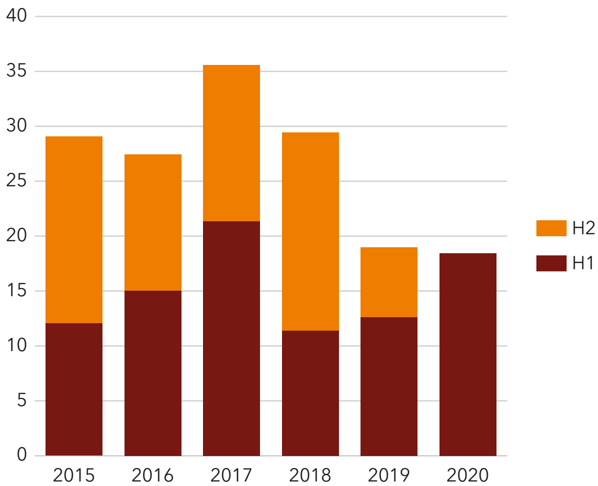


Data and investor sentiment analysis in all charts sourced and compiled solely from Lazard communication with investors

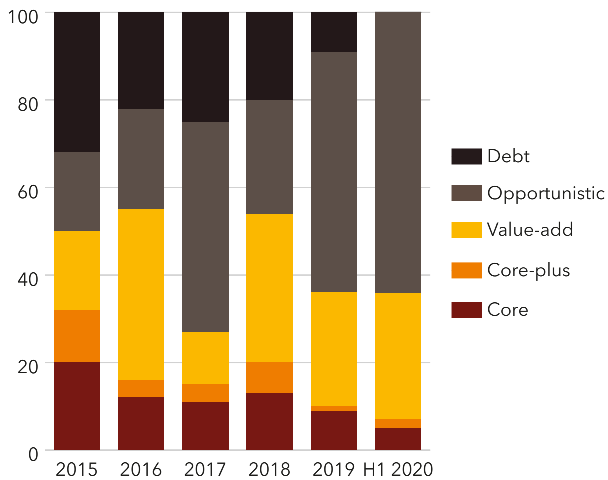
American firms drive European fundraising pile

US mega-managers continue to prop up Europe's opportunistic private real estate coffers. But the region's wider bench remains distinctly European

Blackstone's sixth European opportunity fund, flanked by $1bn-plus raises by Angelo Gordon and BlackRock, pushed up closed-end fundraising in Europe over the last two years ($bn)



Strategy preferences have polarized, with opportunistic strategies garnering increasingly more capital while core and debt funds attracted less (%)



While US mega-managers raised the lion's share of the capital for Europe in the first half of 2020, they accounted for just three of the top 10 fundraises in the period

Fund name	Manager	Strategy	Target ($bn)	Current size ($bn)
Blackstone Real Estate Partners Europe VI	Blackstone	Opportunistic	10.29	11.03
AG Europe Realty Fund III	Angelo Gordon	Value-add	1.20	1.50
Blackrock Europe Property Fund V	BlackRock Real Estate	Value-add	1.25	1.29
PATRIZIA TransEuropean VII	Patrizia	Value-add	0.56	0.84
RoundShield Fund IV	RoundShield Partners	Opportunistic	0.37	0.84
Elevation I	Pictet Alternative Advisors SA	Value-add	0.45	0.79
AREIM Fund IV	Andersson Real Estate Investment Management	Value-add	0.56	0.60
TSC Eurocare Real Estate Fund	Threestones Capital	Core	0.34	0.51
British Strategic Investment Fund	Gresham House	Core	0.37	0.37
RLI Logistics Fund – Germany II	RLI Investors	Core-plus	0.45	0.28

Source for all data: PERE

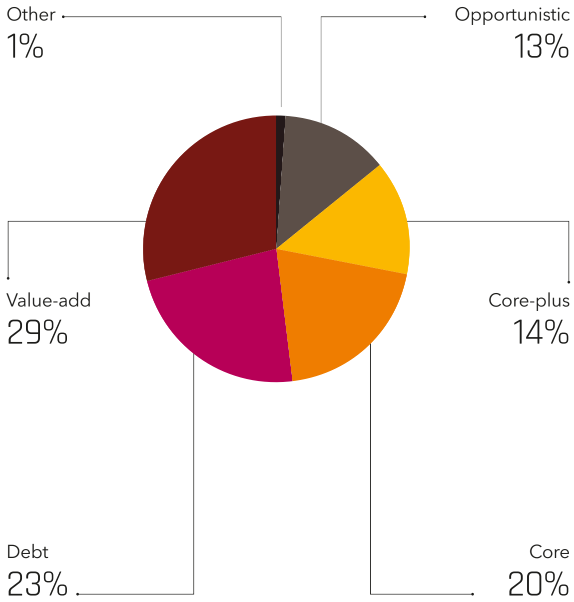
+46%

More capital raised in H1 2020 than the same period last year

1

Stepstone Real Estate Partners IV Europe is the only opportunistic fund in the region's top 10 funds in market

Current opportunistic fundraising efforts lag those for value-add, debt, core and core-plus strategies



61%

Amount of H1 capital raised for opportunity funds

13%

Amount of capital currently sought for opportunity funds

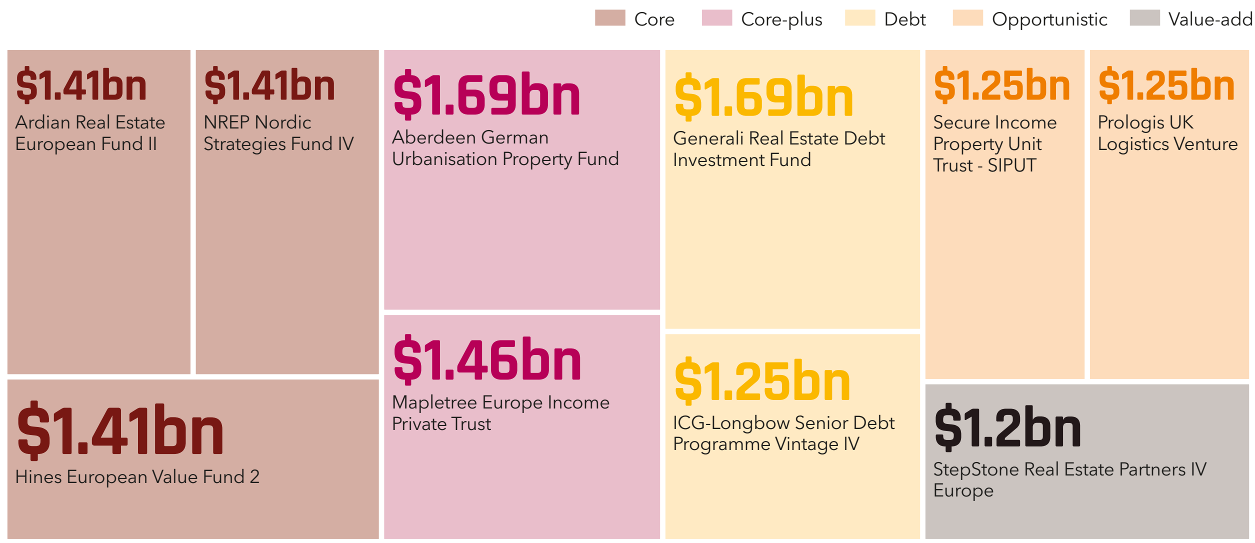
$11bn

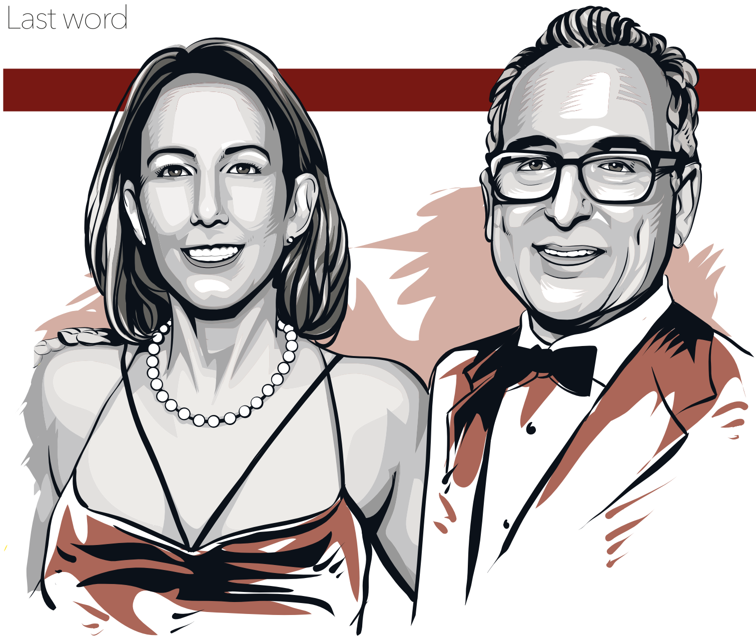
Amount raised for the region's biggest-ever fundraising, Blackstone Real Estate Partners Europe VI

$1.69bn

Amount sought for the region's biggest fund currently in market, Generali Real Estate Debt Investment Fund

Current trends could reverse if Europe's largest private real estate funds now in market reach final closings, with notably fewer US-sponsored funds and more debt and core vehicles seeking investor support





In memoriam 'Trish Barrigan was all about empowering people'

It has been just weeks since Trish Barrigan, one of the founders of London-based private equity real estate firm Benson Elliot, succumbed to a year-long fight with cancer. She was 47. Co-founder Marc Mogull lost one of his best friends. He tells ***Jonathan Brasse*** how Benson Elliot has also lost a managing partner able to wear both senior investment and COO hats, complete more jobs in a day then either he or fellow senior partner Joseph De Leo could ever manage, and the one person able to deliver the sort of constructive criticism he knew he and his colleagues needed.

Tell us something important to know about Trish Barrigan.

Mogull: She was very commercial. But she was also a people-person and great at managing people. It's tough to deliver criticism, especially to someone you work with. But Trish had an ability to tell people what they didn't want to hear in a completely sincere, constructive and not personal manner. That made her better at managing people. And it made her better at managing deals. She had the ability to build phenomenal relationships and still be tough. Trish was no pushover.

Did that apply to being able to criticize you?

Mogull: I'm a better professional and person because she was my partner. I'm generally too thin-skinned. I never wanted to go through the performance appraisal system, so what we used to do was run the whole process with everyone feeding their appraisals of me into Trish. We'd go to our local Starbucks on a weekend and she would distill the critical comments down to the three things I'd have to change. Maybe because I'd grown up taking orders from strong women like my wife, mother and sister, I knew what she was telling me always was for my own good and for the good of the organization.

One of the things that has distinguished Benson Elliot is the training and education people get is unrivaled. People constantly want to poach our people. That's because of the systems she put in place. The irony was it was my job to do the same for her, give her criticism. I struggled all the time to do it. I'd sit down in that same meeting in Starbucks and say, "I don't feel I'm your equal. I'm not comfortable giving you criticism." I remember something my father used to say: don't criticize unless you can do better. I couldn't do better than Trish. And so, it always felt uncomfortable for me to tell her anything critical. She'd have to pull it out of me.

How did Benson Elliot regroup after her passing?

Mogull: Three became two the day Trish got her diagnosis. I probably took it hardest. I refused from the beginning to acknowledge that this potentially could be a death sentence. But, in a typical Trish way, in the first months, when I would cry, she comforted me. That's not supposed to be the way this works. My relationship with her was as much of a big brother-little sister thing as anything else. I was incredibly proud of her and I was not going to acknowledge the possibility I was going to lose her.

But at the same time, Trish was a realist and a pragmatist, and again she spent the next year or so reconstructing the organization, taking all of her responsibilities and handing them off. She brought in new people. In particular, she made sure she had someone to cover the COO-type stuff. By the time she left us she had made herself functionally redundant, though she could never be replaced.

Even before her diagnosis, she was all about elevating and empowering people. She trained them and created an environment that enabled them to realize their potential. So while it was a personal tragedy, Trish made sure the organization will be fine. ■

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