réflexions

LA REVUE DE L'IEIF

IMMOBILIÈRES

N°88 - 2e TRIMESTRE 2019

Dossier

L'IMMOBILIER COTÉ, UNE INDUSTRIE INNOVANTE

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A REAL ESTATE VIRTUOUS CIRCLE: THE LISTED STORY

by **Dominique Moerenhout** CEO, EPRA

Les sociétés immobilières cotées ont de multiples facettes qui se déclinent dans des typologies d'actifs variés et à travers des immeubles emblématiques. D'investisseur à opérateur urbain, leurs performances ne sont pas uniquement liées à leurs bons résultats financiers mais aussi à leur implication sociétale.

Investissant sur le long terme et respectant une réglementation spécifique, elles sont à la fois acteurs de l'innovation technologique et de la croissance économique. Pour les accompagner dans leur développement et optimiser leur impact sur la société, l'EPRA représente le secteur immobilier européen coté en Bourse auprès des instances dirigeantes et des investisseurs.

Un rappel bienvenu des atouts et des enjeux portés par l'industrie immobilière cotée.

Listed real estate companies are the guardians of many of the highest quality assets in European cities in all types of traditional and non-traditional real estate portfolios. They are companies owning, operating and developing income producing assets, including some of the most iconic buildings in Europe, such as le Forum des Halles or the Tour Mirabeau in Paris.

They are also pioneering transparency and sustainability in the built environment, by means of meeting our responsibilities towards local communities and the demands of shareholders to safeguard their investments. They serve businesses and the society alike, by actively improving the built environment where we all live, work, shop and relax. They also play a crucial part in providing retirement security to millions of people, by offering pension funds recurring income through dividends.

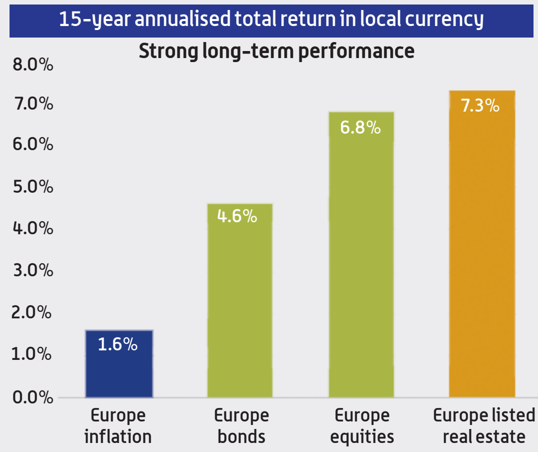
THE INVESTMENT CASE

The annualised total returns of listed real estate companies within the FTSE EPRA Nareit Index have outperformed general equities and government bonds in most of the last 20 years. Interestingly, the French FTSE EPRA Nareit Index provided a 12.3% total return over this period, against the benchmark for Europe at 8.4% and UK at 4.5%, clearly outperforming its European peers and reinforcing the view that listed real estate provides strong performance to long-term investors (see graphic 1).

A cost-efficient asset class. Against a backdrop of low interest rates, that are expected to remain lower than historic norms for longer, and an ageing population, that will require income in retirement for longer, yields that are significantly higher than government bonds are particularly attractive to pension funds. The Dutch pension funds market being the most developed in Europe, listed real estate produced the second highest average institutional investment returns in the Netherlands (2005-2016). The study commissioned by EPRA and undertaken by CEM Benchmarking which looked at over EUR 2.6 trillion of assets under management, found that listed real estate was one of the most cost-efficient asset classes in European pension fund portfolios over private equity.

GRAPH 1

European listed real estate offers strong long term performance



	Europe listed real estate	Europe government bonds	Europe general equities
1 year	8.3%	2.3%	4.7%
3 year	5.3%	1.7%	9.2%
5 year	9.9%	4.0%	6.2%
10 year	15.3%	4.6%	8.3%
15 year	7.3%	4.6%	6.8%
20 year	8.4%	4.8%	4.6%

Sources : ECB, FTSE, EPRA, Nareit, data as of March 29,2019

Analysis from 'Listed and private real estate: putting the pieces back together' by MSCI (2017)[1] demonstrates that listed real estate is closely correlated to other forms of real estate. It takes about 18 months for an investment in listed real estate to shed the influence of the general equities market and to start mirroring the performance of the companies' underlying portfolio. The study shows that medium to long-term ownership of listed real estate provides investors with much higher liquidity and lower costs than direct property investments once the background price volatility caused by the general equities market fades. Intuitively it makes sense that listed real estate's long-term returns reflect direct real estate returns because the investments are in the same underlying bricks and mortar.

DIVERSIFICATION AND GROWTH OPPORTUNITIES

Listed real estate investments enable access to high quality assets, together with geographic and sector diversification, allowing efficient capital allocation to traditional real estate sectors and also niche sectors such as healthcare, student housing, hotel and lodging. In this context, efficiency describes both the low cost of investment as well as the speed and flexibility of allocation.

In fact, large, and accelerating, investment flows into alternative property sectors, such as logistics, industrials, healthcare, hospitality and self-storage, are forecast to drive a doubling in the size of the benchmark FTSE EPRA Nareit Developed Europe real estate index to around EUR 500 billion within the next five years, from its current approximately EUR 250 billion market capitalisation, as estimated by Kempen. In the US, alternative real estate sectors already represent about 40% of the listed sector, compared with 10% in Europe. If the European alternative sectors were to match the market share of their US peers, that alone could add 50% to the size of the European sector.

Residential liftoff. The rise of the European listed residential sector has been driven by the advance of the German companies after the organic growth and acquisitions that followed a string of stock market flotations generated from previous private equity investments. As a result, Germany has emerged as the largest listed European real estate market overall, after overtaking France and then the UK last year.

Interestingly though, in France, with a few notable exceptions such as Covivio's hotel assets, Icade's healthcare and Gecina's student housing, the alternative sector has not played such a large part as in the UK or Germany. When combined, residential companies with alternatives represent around 40% of FTSE EPRA Nareit Developed Europe's market capitalisation. In France however, where there are no listed pure play alternative asset companies, alternatives represent less than 15% of the index. Whilst the residential sector is more tightly regulated in France than in other European jurisdictions, we can again see there is plenty of room for growth. In addition, with migration and other societal factors, the need for affordable, quality and sustainable housing is more acute than ever. Institutional investments in housing is a sensible and long-term solution to the housing crisis (see graphic 2).

1. A Study of the Drivers of European Listed Real Estate Performance in Association with the European Public Real Estate Association – free download.

BUILDING COMMUNITIES THROUGH SUSTAINABLE DEVELOPMENT

France's commercial real estate sector accounts for USD 1.2 trillion against a French GDP of USD 2.8 trillion; this is a familiar pattern in other developed European markets including the UK and Spain where we see the sector accounting for 35-45% of GDP. However, in all these markets the listed sector accounts for under 6%. In comparison, in markets like Sweden and Switzerland we see the overall listed sector at 24% and 16% respectively. Nevertheless, the size of UK and French economies of course means that the size of the listed sector is much larger in EUR terms.

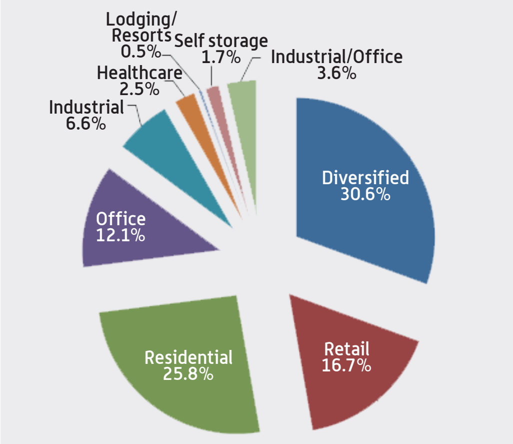
Long-term quality assets. Why is all of this so important? The simple answer is that the built environment owned and managed by these companies is where we all live, work and play, and these companies are part of the community providing quality assets for the long-term, benefiting all of society. Indeed, it is why listed real estate companies and their investors have played such a large part in the climate debate and the Environmental, Social and Governance (ESG) issues that have become so important in recent years. Companies like Gecina are at the forefront of ESG; last year they signed a EUR 150 million loan with the margin linked to ESG performance. The company ranks fourth globally amongst office REITs (Real Estate Investment Trusts) with a GRESB score of 93% for ESG compliance. This is a trend we also observe among other companies in the sector. French CeGeREAL for example supports its tenants in their approach of sustainable development with their 'Upgreen your Business' strategy.

Because listed real estate companies typically hold the assets for the long-term, unlike say a fund with a 10-year mandate, they have a financial interest in maintaining the buildings for an extended period. It is for this reason that listed companies have redeveloped and regenerated large parts of Europe's cities in turn providing jobs and spaces for the citizens.

Social impact. In fact, Europe's listed property companies are a catalyst for job creation in the European Union. Research carried out by EPRA and PwC showed that listed companies represented one million jobs in the EU in 2017. What is also particularly noticeable, is the part they play in urban renewal and regeneration. Just to mention a few examples, think about Klépierre's award-winning transformation of the Gare St. Lazare, Unibail-Rodamco-Westfield's contribution to the Olympic Park in London, UK Hammerson's Les Terrasses du Port in Marseille or Covivio's recently awarded 'Vitae' urban redevelopment project that will be created in Milan. These companies and projects are completed to the highest environmental standards, and provide excellent spaces for Europe's population to work, live, shop and relax.

GRAPH 2

Developed Europe Index sector share



Source : FTSE EPRA Nareit Developed Europe Index, Data as of April 30, 2019.

THE FUTURE OF RETAIL AND TECHNOLOGICAL INNOVATION

These days no conversation about real estate would be complete without mentioning retail. The subject is of course not just limited to the listed sector and while large store closures may be more associated with the Anglo-Saxon economies of the US and the UK, it would be unwise to think France and the rest of continental Europe will be immune.

This is mainly a result of the growth of internet shopping and the falling footfall in some high streets. Does this mean that retail is dead, and things will only get worse? In EPRA's view not at all. First of all, there is about 25 square feet of retail space in the US for every citizen, compared to 2-6 square feet per person in the European Union. In addition, gross lettable area respectively per inhabitant and for department store is five times lower in Europe than in the US. Moreover, e-commerce penetration in Europe is increasing, but is still much lower than in North America. All of this means that there is less oversupply of retail space in Europe and therefore less likelihood of a major impact on European shopping centres.

French shopping malls are even better placed, in that they often have a hypermarket as an anchor-tenant providing a strong footfall. Carmila, which owns and manages shopping centres adjoining Carrefour hypermarkets in France, Spain and Italy, is a great example of a successful local strategy to ensure a leading position for each of its shopping centres.

Retail is evolving and becoming more of an experience drawing shoppers to malls for more than just a shopping trip. FREY for example, with their recently developed Shopping Promenade® concept, combines open-air shopping and leisure for families including picnic tables, playgrounds and pétanque terrains. So, old fashioned retail might die, but those companies who embrace change and provide consumers with reasons to use physical retail should thrive.

Here again listed companies are providing a lead. Innovation and harnessing technology are at the forefront of all the listed retail companies, again due to their long-term time horizon. Unibail-Rodamco-Westfield for example has its own incubator lab spun out of the group last year in a EUR 250 million listing. Its aim is simple: to provide physical retail with as much data and ease of use for consumers as the internet giant retailers. Another example is Klépierre, who recently invited start-ups to co-create the shopping centre of 2030 using the themes of customer experience and CSR.

It is not only technological disruption that is at the forefront of all CEOs' minds at present, with political disruption causing as much concern. From the 'Gilets Jaunes'[1], to Brexit, to the rise of a populist government in Italy, political uncertainty haunts all European countries. At a set of EPRA events at the start of the year in London and Brussels all the panellists agreed political uncertainty was their biggest fear. EPRA will further address this issue at its Annual Conference in September in Madrid, with former two-time President of the European Commission and Prime Minister of Portugal José Manuel Barroso and former Greek Minister of Finance Yanis Varoufakis both discussing the rise of populism.

THE REGULATORY ENVIRONMENT

Whilst political uncertainty helps no-one, better regulation does. EPRA is active in the regulatory field working with legislators and policy makers to devise better regulations that will help listed property companies deliver even more of the benefits discussed in this article to Europe's citizens. One such area that EPRA is advocating hard for at present is the Solvency II regulation. Set up after the Global Financial Crisis, the regulation was an attempt to limit the capital exposure insurance companies face and thus reduce their risk profile. EPRA has been arguing that the regulation was unnecessarily restrictive for long-term investments in listed real estate companies and the capital requirement should at least be held at the same level as for non-listed investments in real estate. A relaxation of the rules could see a large capital inflow to the sector.

Following the successful advocacy by EPRA and other stakeholders, the European Commission has recently recognised that equity capital charges are currently too high for insurers taking a long-term approach to investment and amended the regulation. EPRA expects that this will have a significant impact on the listed real estate sector, its investors and prospective investors for whom high capital requirements are a major barrier to increased investment.

Assistance to economic recovery. We believe REIT regimes were key in building the recovery in Europe, as it enabled companies to return distressed assets to income-producing and investable vehicles. In France, the legislation for a REIT regime (so-called 'SIIC') was the second in Europe and dates back to 2003. Since then, the popularity of REIT regimes across Europe, which have now been introduced in 14 EU countries, has assisted with the economic recovery and urban redevelopment post the financial crisis, as well as leading to a number of new entrants to the market through IPOs. In France, the latest IPO was Carmila, who raised over EUR 600 million following a reverse merger with Cardety. There has also been a number of mergers and acquisitions consolidating the market, such as Unibail-Rodamco acquiring Westfield to create the world's leading platform for global retailers or Société de la Tour Eiffel absorbing Affine to create a EUR 1.7 billion portfolio. Many of the mergers and acquisitions in Europe are cross-border, allowing diversification and capital flows across the continent. The most recent example of this being Spanish Colonial's 80% stake in French Société Foncière Lyonnaise.

To summarise, listed real estate companies in France and across Europe are prudently managed, invest for the long-term, are innovative and provide high quality buildings to rigorous environmental standards for Europe's citizens. At the same time, they provide strong dividends and total returns to their shareholders in a liquid and stable manner.

A real estate virtuous circle.

Au sujet de l'EPRA

L'EPRA, European Public Real Estate Association, est la voix du secteur immobilier européen coté en Bourse. L'association compte quelque 275 membres, couvrant l'éventail complet des acteurs de l'industrie immobilière cotée (sociétés, investisseurs et leurs conseillers). Elle représente plus de 450 milliards d'euros d'actifs immobiliers et 94 % de la capitalisation boursière de l'indice FTSE EPRA Nareit Europe.

Grâce à son engagement actif auprès des investisseurs pan-européens et globaux, son implication dans le débat public et politique et la promotion des meilleures pratiques en termes de transparence financière et de responsabilité sociétale, l'EPRA s'emploie à encourager l'accroissement des investissements dans les sociétés immobilières cotées en Europe.

1. A grassroots citizens' protest movement named 'Gilets jaunes' (yellow vests) because protesters wear the fluorescent yellow high-vis jackets that all motorists must by law carry in their cars. What began in November 2018 in France as a fuel tax protest has progressively morphed into a wider protest of social inequalities and anti-government movement.

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