To Combat Value Destruction, Core Assets and Diversification

Not swayed by the potential of a price collapse, Jean-Marc Coly, CEO of Amundi Real Estate, sees an opportunity to adjust market value scales and underlines the importance of European diversification against the erosion of performance

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How has the COVID-19 crisis impacted the fundamentals of the real estate market in Europe?
The effects of the crisis are some way off, as it takes six months to see the first transactions and another three months for rentals. The consequences will therefore be measurable only at the end of 2020. That said, the crisis has occurred in a healthy market with few vacancies, and concerns about a possible rise in interest rates have been swept away. We believe that the adjustment of prices and rents should therefore be moderate.

We expect office real estate to be refocused on core assets and remain relatively unscathed, as should be residential housing, managed residences, and logistics. Shops, on the other hand, already weakened by the boom in online sales, may be harder hit. Retailers are no longer prepared to pay high rents. And lastly, the hotel industry is expected to suffer the effects of the crisis for a longer period of time, assuming its entire model is not called into question. We believe this could result in lower valuations.

What impact on price levels is to be expected?
We are not expecting a scenario similar to 1995 or 2008, when real estate collapsed. The low interest rate environment will continue to support the economy, and we are starting from historically high risk premiums on real estate, between 250 and 300 basis points. This should make it possible to contain the decline in values, which may fall by only 2-3% in offices and 10% in retail and hotels.

More than sales price, it is rents for vacant premises that are set to fall, especially for properties on the periphery and those not dedicated to a specific business sector. We expect to see a scale of value among properties, especially according to location – something that had been dissipating before the crisis.

Should we anticipate that real estate funds will reduce income distribution?
The valuation of our assets, which are essentially core assets, should not be penalized. However, we will have less income than expected due to the impact of the crisis on rents. We have agreed to defer rents and granted some waivers – particularly for very small businesses – and so anticipate a 20-30% drop in revenue for this year. However, our real estate investment products will continue to distribute income, unlike some companies, which have not paid dividends.

We expect to be able to collect deferred rents in 2021 and 2022, which will ensure revenues through to the economic recovery that is forecasted in 2022. We also have reserves to support our distributions until then, if necessary.

Real estate is doing a good job of fulfilling its role as a shock absorber in the crisis and we remain confident in our ability to deliver on our promises to our clients. We intend to launch a product aimed at individuals and the retail network, which will be marketed throughout Europe. This will enable investors to access the European real estate market, despite differing regulations in various countries, something that was previously impossible to such an extent.

What is the best investment strategy in this context?
More than ever, we are targeting core assets, which allow us to forestall the destruction of value and performance in times of crisis. Thanks to low rates, we will continue to use leverage, at 30% or 40%, in our retail funds.

We should be able to boost performance by focusing on development strategies, which benefit from a risk premium that is 100-200 basis points higher. We call this strategy "manage to core." We aim to transform existing buildings into core ESG assets that comply with the highest environmental and energy consumption standards, avoiding commercialization risks.

Diversification is fundamental, as demonstrated by the varied reactions observed in European markets. In Northern European countries, for example, rent collection rates have remained very high. We are thus continuing our strategy of geographic and sectoral pooling, with a high proportion of offices and increasing weightings in healthcare, residential, and logistics.

How do you see the COVID-19 crisis impacting office real estate?
It's important to keep enthusiasm for telework in perspective. We should expect to witness a transformation of the office. There is a desire to bring housing closer to the workplace in order to save travel time and improve quality of life for employees. Hence, new locations for offices. The use of space is also being reviewed: smaller individual offices, but more meeting rooms, concentrated on a single floor, with top-of-the-line services. And lastly, coworking spaces are poised to develop as individuals seek to establish a clear separation between their personal and professional lives, a separation that is sometimes difficult to maintain when teleworking.

Is the crisis impacting the integration of ESG standards in real estate?
This process has so far been driven by players in the sector without need for legislation. This trend should actually accelerate further. Integration of ESG standards in the construction industry is now a reality and it is time to promote reductions in energy consumption through individual action. Thanks to the ability to collect data on the habits of tenants, we can help them manage their consumption, improve behaviors, and so achieve the objectives of COP 21. Nor are we ignoring the social aspects of real estate. We emphasize collective wellbeing, as well as sites that enable return to the workplace or quality intermediate housing. Lastly, we place great importance on governance. In fact, we aim to extend the governance system established in one of our SCPIs: every three years, all product holders may vote to determine the candidates in charge of auditing the management company.

Environmental issues are crucial, but in real estate today, they are only a good start – we must go further.

Amundi is the leading European asset manager, ranking among the top 10 global players[1]. Created in 2010 and listed on the stock exchange in 2015, Amundi manages €1.6tn of assets[3] across six international investment hubs[2]. Amundi counts 4,500 employees in nearly 40 countries. On the back of multi-decade expertise in private markets, Amundi launched a Platform dedicated to Alternative and Real Assets (PARA) in 2016. Real estate, private debt, private equity, infrastructure are all part of a single integrated business, bringing together 200 professionals in origination, structuring and management of private assets.

Today with AUM of €55bn[3], PARA has a European ambition in financing the real economy with more than 1,000 assets across 13 countries, leveraging strong synergies with Credit Agricole's banking networks on the continent. With strong convictions in terms of transparency, deal execution and responsible investment, PARA provides innovative and long-term investment solutions for both professional and retail investors through funds, separate accounts, club deals, co-investments and multimanagement.

Jean-Marc joined Amundi Real Estate in 2015 to manage real estate investments and assets as well as the structuration and distribution of retail and institutional funds. He was previously CEO of Alta Reim, the Altarea-Cogedim division dedicated to Real Estate Funds.

[1] *Source: IPE "Top 400 asset managers" published in June 2020, based on assets under management as at 31/12/2019.*
[2] *Boston, Dublin, London, Milan, Paris and Tokyo*
[3] *Amundi data as at 30/06/2020*