PATRIZIA AG

Europe continues to offer attractive investment opportunities for those in the know

Recently, **Jonathan A. Schein,** senior vice president and managing director of global business development for Institutional Real Estate, Inc., spoke with **Mahdi Mokrane,** head of Investment Strategy & Research for PATRIZIA AG. Following is an excerpt of that conversation.

How has COVID-19 affected the economies and real estate markets of Europe?

We are looking at this through three prisms. The first is that COVID-19 is a major recession trigger, which is affecting and will continue to affect countries in very different ways. Some countries will be able to bounce back fairly quickly, with a V-shaped recovery. Germany, for example, has not only handled the tracing of COVID-19 better than some other countries, but it has launched a massive fiscal stimulus package for its economy to speed up the recovery, as well. The Nordic economies of Europe will also do better than average. In contrast, France, the United Kingdom, Italy and Spain were more severely hit and will take longer to bounce back with a more U-shaped recovery. Of course, we must be humble here given the potential resurgence of COVID-19 in successive waves.

The second prism is that we are seeing COVID-19 as a trend accelerator, especially with e-commerce and retail. Another trend we believe investors should think about is that the new cycle is going to be led by fiscal dominance as opposed to monetary policy. The immediate implication is that fixed income is increasingly becoming a dying asset class because it is not yielding anything. The silver lining is that the hunger for real assets is keener than ever. And stable income is going to be in high demand as we look forward. We think fiscal policy is going to benefit the consumer more than the businesses. For real estate, assets that have the ability to reach out to the end consumer and deliver a fundamental need or service are going to be winners — that means grocery-anchored retail, urban logistics and residential.

What about the third prism?

The third prism is that COVID-19 is a paradigm shifter. Deglobalization is beginning to accelerate. In fact, we have already been in a somewhat stagnant globalization growth pattern for some time. For example, if you sum global imports plus exports as a percentage of global GDP to come up with a globalization proxy, you'll see that this metric had been stagnating since the GFC. The China/U.S. trade war is probably here to stay, and many corporates have realized during the lockdowns how fragile their global supply chains were. To us, this means more production and storage nearshoring to Europe, which again has a positive impact on industrial and logistics. I should add that we like life science and health tech because we think they form a subsector that has strong tailwinds going forward. Finally, the hyper-urbanization trend and the emergence of the 24-hour cities, such as London or Paris, may be challenged by COVID-19. We, like many in North America I'm sure, are rethinking office-occupation demand and will continue to be selective in our office target markets.

Given these observations, what are your preferred investment themes for Europe, going forward?

PATRIZIA is well-known in North America for its value-added fund series spanning all property types and geographies, and probably as well for its Pan-European core offering. What is maybe a bit less well-known is the breadth and scope of our residential strategies across the risk spectrum — from core, core-plus, value-add, to opportunistic, and even land and neighborhood creation. Residential is in our DNA, as that's how we started over 35 years ago. We've seen residential and senior living exhibit sustained NOI growth, resilient to crises. Also, residential over a long period of time has performed very well from an income, as well as a capital preservation, standpoint.

In terms of growth sectors, we would add hub and urban logistics. We think hub, motorway logistics is here to benefit from new demand for moving goods in this region, increasingly within Europe. As I relate this to the theme of deglobalization and its implications for nearshoring, we see structural tailwinds for the sector. As for urban logistics, the sector will continue to be supported by the rise of e-commerce. In all, both motorway and urban logistics are benefiting from trends that have been accelerated by COVID-19.

Finally, I would say that we do see some opportunities within retail. For example, food-anchored retail has benefited due to social distancing rules in Germany, the United Kingdom and the Netherlands. Residential and logistics are more of a Pan-European theme. For the other property types, we anticipate opportunities as pricing adjusts, and some markets may overreact. These opportunities are more discretionary, and we will pick our spots selectively in the office, hotels and student housing sectors.

The rental market is relatively new to the U.K. market. Do you believe the pricing in housing before COVID-19 has been a benefit toward that theme?

Yes, there is a lack of quality residential in those cities that have seen strong inner migration, resulting in a pressure to find a decent home to live in and thrive within an attractive community. The United Kingdom did have a very developed residential sector owned and managed by institutional investors many decades ago, but gradually investors sold out and moved into commercial property. Now, investors are rediscovering the benefits of owning residential as a portfolio stabilizer and income-return enhancer, and this is happening not just in the United Kingdom but also across Europe. But increasing portfolio exposure to residential in the United Kingdom is often a lengthy process, because the institutional product does not exist and must be built, as opposed to acquiring whole blocks of assets, as we can do in countries with much more developed residential markets. The demand from households far exceeds the supply to date, so I think both prices and rents in key U.K. cities will be more robust than most would expect.

Relative to North America and other major regions, why should North American investors take a closer look at Europe now?

Europe has a lot to offer to North American investors, and across the risk spectrum. In the core space, if you compare long-term investment performance, say over the last 20 years, you'll conclude that Europe's residential markets are less volatile and even more rewarding in real terms than the U.S. multifamily market. COVID-19 will also offer opportunistic investments for North American capital seeking higher-octane strategies — in retail, for example, which is very distressed in a number of countries here, we are beginning to see some very interesting deals. More generally, development finance has now become a bit dry in large parts of Europe, so investors with deep pockets and available rescue capital could reap the benefits of coming to Europe and benefiting from discounted pricing from otherwise sound, very well-located assets, that need repositioning.

Let's talk about data intelligence. What are you doing with your data intelligence approach?

In terms of data intelligence to support our business, we have been running two workstreams in parallel at PATRIZIA. First, we've been an active investor in proptech for some time. We have invested in two venture capital funds, as well as in companies that are relatively well-known, such as WiredScore or Control IT, and other smart-data platforms. We see ourselves as a disruptor in being at the forefront in leading the digital transformation of our industry, a process that is already under way. Parallel to that, we know that we need to be in control of the relevant market data, so we have acquired significant amounts of data over time, and we continue to do so, in real time. We see this as an investment in our data intelligence capabilities, but more importantly, we have developed a series of tools that are cloud-based, powered by artificial intelligence and machine-learning. This helps us perform our fiduciary duty more efficiently at all levels: strategy design, acquisition, asset management and portfolio management.

How does your data intelligence approach apply beyond the residential sector?

The first step we take is to acquire live broker information, such as bid and asking prices and rents, and store this in a huge data warehouse. We then use our data intelligence and artificial intelligence solutions to help calibrate our decisions when we bring a flat to the market or evaluate a building or a portfolio. Now we are extending this strategy into the commercial space by acquiring transactional data from agents, as well as from proptech companies in a number of markets. We filter and evaluate this data — to use it as our gold mine to enhance investment performance.

The most recent addition to our suite of digital solutions is the PATRIZIA Amenities Magnet. We use this automated assessment tool across property types and across all European markets. If we're given a geo-location anywhere in Europe, a street name or an address, we can quasi-instantaneously provide a score ranging from 0 to 100 of what PATRIZIA would think the quality of amenities in and around that location is. A score of 100 would be a location that is perfectly amenitized in our view — London's West End, which is rich in terms of green space, leisure, dining and entertainment, transportation, quality schools, etc., scores very highly. The same holds for Paris's or Munich's central business district. Negative amenities would be a very busy crossroad, heavy air traffic or elevated crime rates. We can capture all these types of amenities, organize them, rank them and then attribute a score on all locations around Europe. One of our aims is to construct real estate portfolios where those amenities scores are highest, and we use machine-learning to do this.

You have talked about the general benefits of the approach of data intelligence — are there other examples that you can give us?

If you consider the whole cycle of buying, managing and selling assets, you could use our data intelligence in a number of ways. Initially, you could identify future gentrification hot spots — for example, where is the next Shoreditch-like equivalent tech hub, like in London, going to emerge? Or the next equivalent to the Media Spree in Berlin? Using our Amenities Magnet, as well as the rest of our big data platform, we think we can better inform our acquisition professionals and fund managers on future hot spots and supplement the irreplaceable "walk the neighborhoods" approach. The second benefit we are reaping is streamlining property acquisitions. Say an acquisition director sees a portfolio of six residential assets spread out across Europe land on his or her desk. Our tools are 10 to 20 times faster than traditional evaluation methods to achieve a first opinion of the attractiveness of a deal. Thirdly, our asset managers can use those tools to better calibrate pricing. Given our live streaming of information, they know exactly what appropriate level of rent to ask in any market circumstance. And, finally, forecasting. These machine-learning driven tools can help us track markets and predict their directions with a high level of confidence, particularly in the short term of one to two years.

Do you believe data intelligence will, in the long run, make experts like you and your research team obsolete?

Data intelligence will not make human expertise obsolete, at least not in our lifetimes. The machine does a great job in processing whatever data you give it, but the data we give it will never be as complete as what walking the street can give you. Blending the two together is what we do at PATRIZIA: a combination of deep local knowledge with research expertise and data intelligence tools. We have more than 800 experienced real estate professionals on the ground across 24 offices globally, and they are well placed to harness that power of big data and to use it for the benefit of our clients.

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COMPANY OVERVIEW

With 24 offices globally, **PATRIZIA AG** has been active as a real estate investment manager since 1984. The firm manages €45.0 billion ($53.4 billion) of assets for more than 400 institutional clients in the residential, office and retail sectors, as well as in the sphere of care, hospitality and logistics real estate across the risk spectrum.

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