PATRIZIA AG

Value-add strategies provide attractive opportunities amid continued COVID-19 uncertainty

Recently, **Jonathan A. Schein,** senior vice president and managing director of global business development for Institutional Real Estate, Inc., spoke with **Paul Hampton,** managing director and head of International Funds for PATRIZIA AG. Following is an excerpt of that conversation.

How resilient have PATRIZIA AG's value-add funds, such as TransEuropean, been in the face of COVID-19?

The effects of COVID-19 on the real estate industry will probably not be fully understood for some time, so it is probably a little early to draw too many conclusions. Having said that, the pandemic has accelerated a number of trends that we have been embracing for a while — for instance, the growth of e-commerce and the importance of sustainability.

In this context, PATRIZIA's Pan-European flagship fund, TransEuropean VII, has a sector bias toward logistics and a significant portfolio in parts of Europe where, two or three years ago, e-commerce was in its infancy. Looking at the growth in occupational demand during 2020, this bet has, so far, served us well. Meanwhile — TransEuropean has an aspiration, as does the entire PATRIZIA platform, to be carbon neutral. This is something that is touching and concerning the majority of managers at the moment and is absolutely central to how we have been and will be investing. Finally, for some time we have pursued a dual investment strategy focusing partly on NOI and partly on appreciation. Historically, the income element has served us well in tough markets — over the years, we have distributed between 5 percent and 6 percent on a net basis.

Your flagship value-add fund, TransEuropean VII, was oversubscribed in its final close. What has been the secret to your success in raising these funds?

Over the years, and particularly since the GFC, investors — prospective investors, as well as investors who have been with us for many years — have talked to me about the three Ps — people, performance and process. I would like to think our success has something to do with the fact that we have done pretty well in each of those areas.

In terms of the *people,* the fund leadership team we have on the TransEuropean funds has been together for about 15 years, which is quite unusual. What this team offers its investors is a degree of stability, as well as experience — we often talk about what we have learned from our mistakes, as much as what we have learned from our successes! In terms of *performance,* as a fund, we know we live or die based on our track record. We are proud of the fact that we have strong overall gross returns across the TransEuropean series of more than 22 percent per year since the GFC — and I hasten to add that these are returns we have generated from a relatively low-risk approach to value-add. On average, for example, we have operated with around 45 percent leverage. The final point on *process* is transparency and ensuring investors have confidence that they are partnering with a responsible group. PATRIZIA being a listed entity plays very well into our governance structure.

In terms of ESG, U.S. investors are now putting a lot more emphasis on the S, or social aspect, which means diversity and inclusion. Is that part of the plan as well?

It is, and you are absolutely right. For some time in Europe, out of the E, S and G, the E was really the only item on the agenda. The G, the governance aspect, is now very much in focus, along with the social aspect, too. In thinking about TransEuropean and the way it has been designed — its approach, investment thesis, the team and its governance — we try to take into account each of those three aspects in the way we go about doing our business.

In terms of property types, what traditionally has been in the TransEuropean fund portfolio?

We used to have a strong leaning toward retail. Until six or seven years ago, around half of the TransEuropean funds would have been invested in various retail property types. But we reoriented that. In 2012–2013, when Fund V was launched, we deliberately up-played logistics and then, to a lesser extent, selective office markets. On a relative pricing basis, we felt that both offered exciting growth opportunities, particularly from a rental progression standpoint.

How do you and your team typically find noncore, hidden gems for your funds?

Everything we do here is a team effort. We are very lucky to be one of the largest real asset platforms in Europe, with 19 offices here employing some 75 transaction professionals. In 2019, we registered something like €326 billion ($385 billion) of potential deal opportunities on our books.

But it is not just about our originations team. We work hand-in-hand with our research division of 14 people, so everything we do is macro-informed. We also pride ourselves on doing a lot of the asset management and value-creation work ourselves — and this is where our local teams have been invaluable. Some 60 percent of the business we have done in TransEuropean VI and VII has been off market, and a very good portion of that has been with local, private owners. So being local, being trusted, being part of the community makes a huge difference. It is a collegiate effort.

It looks like you are focusing on assets in Barcelona. What is going on in Barcelona, and do you see an end to the urbanization megatrend due to COVID-19?

TransEuropean has been investing in Spain since the mid-1990s, through a number of different market cycles. We are fortunate to have a talented local team, which has helped enormously in trying to make sense of the markets and adopt the right investment approach. In relation to Barcelona, our team felt that the 22@ District encapsulated everything that the fund wanted to be part of. The city has a population of about 1.7 million people; it is one of the key cultural, economic and financial centers in Southwest Europe; it is also a biotech melting pot, which is particularly interesting in the current COVID-19 environment. But what caught our eye was not just the basic economics and demographics — people wanting to live in the city, the universities expanding — it was the fact that the city is increasingly regarded as a smart city. It is focused on communities, quality of life — interestingly, there are something like 12,000 sensors throughout the central business areas that collect information on weather, traffic and air quality, which informs cityscape planning. We felt it is a city that is going to move to the next level, and we wanted to be investing as part of that.

You asked whether we are seeing an end to urbanization. To some extent, there has been evidence of a pause, but our view is that urbanization has not come to a grinding halt. Businesses are built on young talent fresh from universities, and it's our view that this talent is going to continue to want to be located in amenity-rich cities, cities that are smart and progressive.

You are based at a large office in London. Does this mean London is still a hot real estate market for investing?

London has proved to be a highly liquid gateway market and a global hub, particularly since the GFC, and ultimately I don't think Brexit is going to change that. I am not for one minute suggesting that Brexit is ideal, but I think a lot of investors are convinced that London is going to continue to attract talent and businesses, come what may, and will continue to reinvent itself. Of course, real estate is also seen by many as a longer-term play, too, and so perhaps what's important is not so much what London will look like in 2021, but more what London will look like further down the track. So yes — it remains a competitive, sought-after market.

As we move into 2021, what do you think will be the main value-add real estate investment trends to watch?

As a team, we very much believe in the "K-shaped" economic outlook that has been widely reported — and expect to be investing "along that K" in the months ahead, with some mispriced and quasi-distressed opportunities at the one end, together with some growth opportunities at the other. We expect the United Kingdom to be very much in focus. With more than €1 billion ($1.2 billion) to deploy, it's an exciting position for TransEuropean to be in.

CONTRIBUTOR

Paul Hampton
Managing Director,
Head of International Funds
M +44 7921 282 550
Paul.Hampton@patrizia.ag

CORPORATE CONTACT

Robert Bilse
Head of North America, Capital Markets
M +1 973 868-0558 | Robert.Bilse@patrizia.ag

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 senior living, hospitality and logistics real estate across the risk spectrum.