AF | Advisory

REAL ESTATE DEBT & EQUITY

AF Advisory - MIPIM 2018 Review

MIPIM 2018 was more professional and restrained than in the past, in part due to the fact that more attendees than usual sported high-end cameras with powerful zoom lenses; probably the result of a sudden, wide-spread realisation how beautiful the Côte d'Azur is and a desire to capture that special moment/view... Honi soit qui mal y pense.

Late cycle:

Other than that, MIPIM 2018 had all the hallmarks of a late cycle event:

High prices, requiring strong future rental growth and calculations building on it

Prices have reached levels that often make significant rental growth essential for underwriting. Of course, there are quite a few supply constrained markets, where rental growth is not unlikely and investors hope to time their delivery and exit accordingly.

Construction cost inflation and capacity constraints

This is a very significant issue at present. Interestingly, both issues are prevalent in all jurisdictions we cover (Germany, UK, Netherlands and Spain) with effects rippling up from labourer to sub-contractor, contractor and ultimately the investor, even with fixed price contracts.

Investors adjusting their risk positions and two walls of money (equity and debt)

With many forecasters predicting real estate returns in the mid-single digits for the next few years including slow, if any, capital growth, flexible investors are starting to increase their exposure to real estate debt, capturing most of the income stream, while avoiding much of the capital exposure. This is a good late cycle risk adjusted strategy, as most of the capital losses occur at the end of a cycle.

Note, here is a significant difference to earlier cycles in that two walls of money exist: 1) a wall of equity that drives asset prices higher and 2) a wall of debt, financing these acquisitions. Therefore, once interest rates turn and money gets reallocated from real estate to other sectors, there will again be a drop in the availability of equity and debt.

<u>Everything that makes sense, can get financed at very competitive terms – if explained well!</u>

Everything sensible we had on our desks in 2017 got several, very attractive debt offers with record low margins and wide covenants. This was the result of us creating competition for the financing and our advisory approach, explaining to and convincing the lenders that asset/borrower/business plan were a good match.

Most lenders suffer from highly competitive margins and pressure on covenants, making the lenders more focussed/selective/difficult in their underwriting. The stiff competition also pushes lenders into new areas, from development to very long-term loans or loans to operational businesses to receive a higher margin. Investors and lenders are both actively "hunting" for extra returns, sharing a "shrinking cake".

<u>Pricing is becoming ever more important to boost distributions</u>

In the early phase of the cycle our clients asked us "Can you find us finance?"

Now the instruction is: "We are acquiring this asset at a very high price and we need you to find us the most competitive finance, so that we can hit our distribution targets!"

Even for core assets financing has become a significant competitive advantage, as it can make the difference between getting the asset or not and between a meagre and an attractive return.

While margin pressure is intense, only convincingly prepared proposals receive broad interest and best terms. This is where our structured process and our advisor approach greatly benefits our clients.

Please contact us if you would like to find out more about how we can help you achieve better returns. All approaches are treated in strictest confidence.

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