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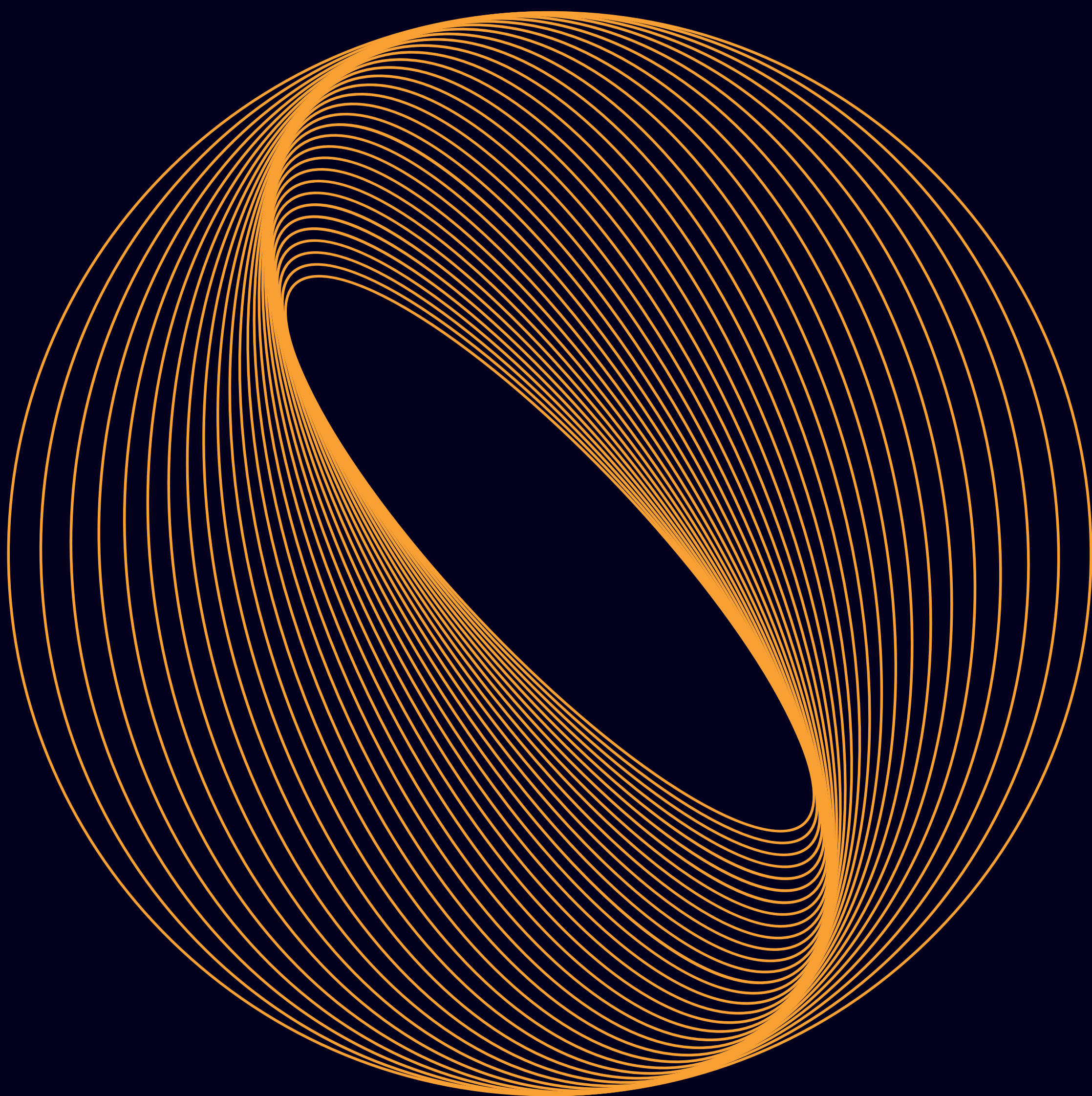

2021 UK roundtable

ROUNDTABLE

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UK real estate freed from the 'penalty box'

Participants in PERE's UK roundtable describe a market emerging from the shadow of Brexit and covid. But the pandemic debt hangover portends a painful recovery. By Stuart Watson

As Britons shivered outside bars and restaurants during a chilly spring of outdoor-only drinking and dining, participants in this year's *PERE* UK roundtable concluded that British real estate is back on the menu for private capital.

In 2020, investment activity was suppressed, as it was practically everywhere else, by the pandemic. But fears of a cliff-edge Brexit as the UK's divorce from the European Union was decreed final on December 31 also played a part in keeping investors standing on the sidelines last year. Now, however, with that risk removed and covid vaccination proceeding apace, the roundtable participants suggest that capital providers increasingly feel they have a green light to invest in the UK again.

"There was no cliff edge. Life goes on, and the UK has done a terrific job with vaccination and getting covid under control," says Frank RoccoGrande, co-founder of London-based pan-European private equity house Deutsche Finance International.

"When it comes to emerging from the pandemic, the US is probably in pole position and the UK is not far behind. When I see what my peers and colleagues are putting up with still in some European nations, we should all be thankful we are here."

While investors have not seen the back of Brexit, it will not hinder deployment to the same degree it once did, suggests Paul Tebbit, manager of BlackRock's UK property fund. "Brexit is still an ongoing process. But hopefully it will become more technocratic and less politicized. Once we get equivalence with the EU for financial services, as I hope we will, that will be a big step forward and reduce risk further.

"Unfortunately, we will probably see a myriad of small flashpoints like the rows over vaccine distribution and fishing, which will continue to create headlines. However, we saw the UK coming out of the penalty box for investors when the Brexit deal was reached on Christmas Eve. The country has become completely investable again because the worst-case cliff edge has been taken away."

Lloyd Lee, managing partner at London-based manager Yoo Capital, says that financiers' past hesitancy over Brexit has created conditions that will now support investment performance. "Brexit caused the credit markets to

£7bn

Estimated unpaid commercial rents during the pandemic, according to the British Property Federation

Frank RoccoGrande
Founding partner, Deutsche Finance International

RoccoGrande co-founded DFI in 2016. The London-based pan-European private equity firm manages around €3 billion of real estate in Europe, and is a part of global real estate investment manager Deutsche Finance Group, for which RoccoGrande leads the life sciences platform worldwide. In the UK, DFI focuses principally on large scale mixed-use projects and a variety of residential sub-sectors.

Paul Tebbit
Managing director, BlackRock

Tebbit is fund manager for the BlackRock UK Property Fund, a £3 billion open-ended balanced fund that invests across all sectors, covering core to value-add strategies. He is also chief investment officer for the EMEA real estate business of global asset manager BlackRock, which manages around £20 billion of property globally, of which £4.5 billion is located in the UK.

Matthew Bird
Head of UK, Cromwell Property Group

Bird is responsible for growing Cromwell Property Group's business and managing the local team in the UK. The Australian-listed investment manager with operations on three continents and a global investor base has assets under management of around €7.3 billion worldwide, around half of which is located in Europe, where it focuses mainly on the office, industrial and retail sectors, investing across a variety of risk profiles and strategies from development and repositioning to core.

Lloyd Lee
Managing partner and co-founder, Yoo Capital

Lee co-founded Yoo Capital 11 years ago. The private equity manager specializes in the UK with London as its primary focus, managing around £2.7 billion of mixed-use assets, concentrating on sectors including creative industries, hospitality, life sciences, healthcare and multi-generational living. Its Yoo Capital Fund II, a closed-ended opportunistic real estate vehicle, had a first close in April 2020, giving it £200 million of investment capacity.

Steven Cowins
Partner, Greenberg Traurig

Cowins heads Greenberg Traurig's London-based private equity real estate team of 50 lawyers and is global co-chair of the firm's real estate funds practice. The team divides its activity evenly between capital raising and deployment, advising clients on investments and establishing funds and joint ventures, and structured acquisitions and dispositions. Cowins' pan-European client base includes fund managers, funds, family offices and financial institutions.

pull back in the UK, so the supply pipeline of real estate has been dampened. In 2019 investors were already waking up to the fact that UK markets were undersupplied. But then covid came along and everybody froze. But once covid is unlocked, we are still in a fairly undersupplied situation.

"We are near the front of the queue looking toward the light at the end of the tunnel, even if we are not there yet, and many institutional investors are starting to say that if they have to deploy in 2021-22, the UK market looks pretty good."

> *"A lot of capital recognizes that the UK, and especially London, is a global market and a gateway city"*
>
> **MATTHEW BIRD**
> **Cromwell Property Group**

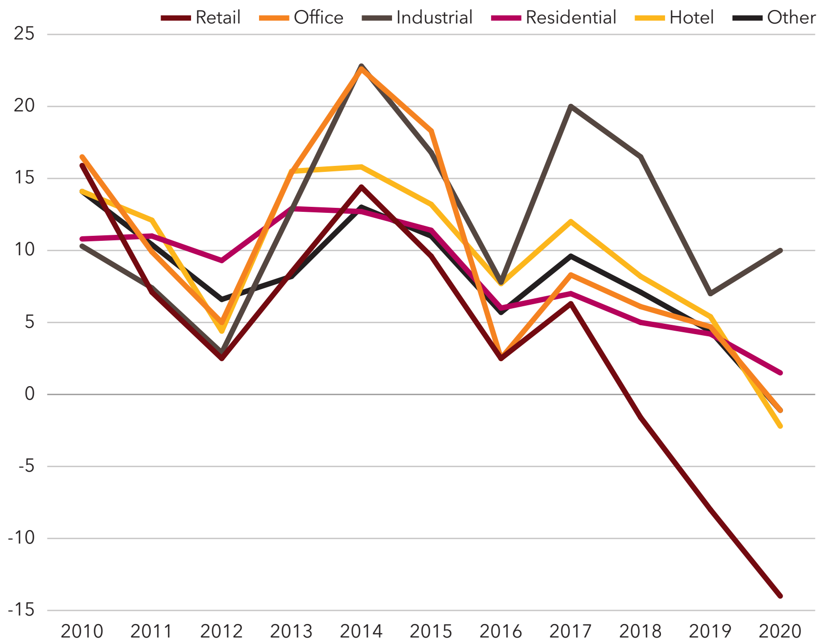
Post-Brexit framework

Matthew Bird, head of UK at Australian-headquartered Cromwell Property Group, has seen his own global investment management business change its UK weighting in response to the improving outlook. Cromwell listed a Singapore-based REIT, the Cromwell European REIT to invest in European real estate in 2017, and with UK investment paused due to Brexit risk, all of its subsequent growth in AUM, from €1.4 billion upon listing to €2.3 billion today, has been through purchases in continental Europe.

"Then, at the back end of last year and the beginning of this, we did a lot of work on re-presenting the UK within a post-Brexit framework, and we now have support from the CEREIT Board to source for acquisitions in the UK for their behalf. A lot of capital recognizes that the UK, and especially London, is a global market and a gateway city, and those strengths outweigh some of the concerns they might have about how things will shake out post-covid and post-Brexit," he says.

Covid travel restrictions have hindered fundraising, especially for new and emerging managers, and combined with covid-related uncertainty, that has prevented investors from allocating some of the large pools of capital still available for real estate investment,

Performance was negative across all sectors in 2020 except for industrial and residential, according to the MSCI UK Annual Property Index's total returns (%)



Source: MSCI

> *"We saw the UK coming out of the penalty box for investors when the Brexit deal was reached"*
>
> **PAUL TEBBIT**
> **BlackRock**

says Steven Cowins, head of the London-based private equity real estate team at global law firm Greenberg Traurig.

Instead, investors keen to deploy more money with their existing managers are turning to innovative structures. "We are now working on two double-down sidecars. The logic behind them is that the managers do not want to launch a new fund, but they know that their existing and loyal investors have a lot of capital to deploy because many of them were under-deployed last year.

"It gives that capital the ability to scale up this year with a manager where there is an established relationship and take advantage of some of the opportunities that they hope are coming."

Covid and Brexit have had a visible effect in London, where activity in the city center is still subdued in comparison with pre-pandemic levels. Meanwhile, the shrinkage of the capital's population is estimated by various sources at 300,000 and 700,000 people. Nevertheless, it remains a strong draw for institutional capital, argues Lee. "London was one of the biggest attractors of core real estate money in the last 24 months. That means when it comes to the time for safe havens and a flight to quality, London continues to be one of those places."

Major employers in the creative industries, technology and life sciences continue to seek space in London because it is still where they can recruit the best talent, he says. "These sectors that do not care much about Brexit. What they care about is the talent pool. Since that is in London, then they have to be in London."

Aggressive assumptions

RoccoGrande observes that core buyers have largely priced out value-add players in London offices. "We have bid on 10 to 12 projects and been blown out of the water every time. You have to underwrite some really aggressive assumptions to get near the pricing. We do not think there is a lot of value in that segment of the market right now. That is why we focus more on living sectors. The UK, and London in particular, needs more affordable housing."

Cowins adds: "Our clients include some of the best-known office developers. Some of them would love to buy a value-add office with a bit of short-term income to do a complete refurbishment or ground up development. But I am hearing from some of them that it is just too competitive out there."

The participants agree that the "beds and sheds" theme already ubiquitous across property markets worldwide is equally prominent in the UK. "Logistics is an area we still fundamentally believe in given our 40-year heritage and expertise. You only have to look at the capital that has come into the market from GIC and others, recognizing the undersupply. There is deep occupational demand, which drives returns," says Bird.

"I think if I had a shed in my back garden and wrote the word 'logistics' on the side, I could sell it at a 3 percent net initial yield," quips Cowins.

Student housing and life sciences are also agreed to be sectors for which investors are clamoring to provide accommodation. "In life sciences the UK government does a great job to stimulate innovation and create ecosystems, and you have the London-Oxford-Cambridge 'golden triangle.' The benefits of investing in that sector in the UK are miles beyond anywhere else in Europe right now," says RoccoGrande.

Covid and increased e-commerce have wreaked havoc on British high streets, and the participants note the

> *"Investors have a lot of capital to deploy because many of them were under-deployed last year"*
>
> **STEVEN COWINS**
> **Greenberg Traurig**

UK deals of the year

The four manager participants select the most telling transactions of recent months, and the deals they wish they had done

RoccoGrande: *US private real estate manager Harrison Street and life sciences operator-manager Trinity acquire UK science incubator BioCity Group. The £120 million ($170 million; €139 million) deal will see Trinity and BioCity merge to create a 2.6 million-square-foot platform.* "Biocity provides space that fosters smaller users in the life sciences and academic-related industries. We looked at it a couple of years ago, and it is a terrific platform that will provide good growth if they can lever off it to grow further scale in the sector."

Bird: *Investment firm Sun Venture buys office buildings at 1&2 New Ludgate in the City of London and One New Oxford Street in the West End.* "In lockdown, this sophisticated Singaporean investor was able to deploy c£750 million into two central London deals which underlines London as a core market and that technology has evolved to make this feasible. Twelve months ago, we did not think that would even be possible."

Tebbit: *Irish developer Ballymore acquires The Broadwalk in Edgware, a 190,000-square-foot shopping center on a 13-acre site in north London, from Aberdeen Standard Investments for around £75 million.* "One of my favorite investment themes at the moment is buying big chunks of London land currently encumbered by retail. The price reflected about £5.5 million an acre, a level at which strong returns should be possible once planning permission is secured for a residential-led mixed-use scheme, and they will get a 5-6 percent running yield while they work through the planning process. It would probably work for urban logistics too. That transaction was probably a starting-gun moment for others to start looking at similar change-of-use plays in London."

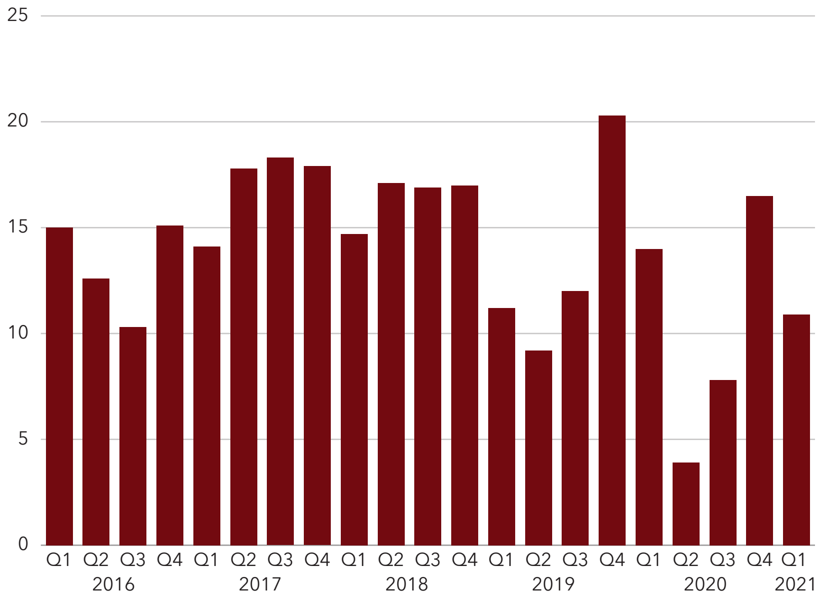
Lee: *Supermarket group Morrisons sells its Camden store and eight acres of surrounding land to housebuilder Berkeley Homes for £120 million for residential-led mixed-use redevelopment.* "We fought hard to buy that site. It is right next door to Camden Market with its 48 million visitors a year. We wanted to develop a mixed-use scheme with facilities for creative industries, to make it a grown-up sister to Camden Market. But unfortunately, Morrisons wanted to do mainly residential, so Berkeley picked it up for a pretty good price and I am sure they will do well."

> *"When it comes to emerging from the pandemic, the US is probably in pole position and the UK is not far behind"*

FRANK ROCCOGRANDE
DFI

plethora of boarded up units, even on some of London's most famous shopping streets. "If you look at Oxford Street, Regent Street, Marylebone High Street, they are shuttered. I don't mean 'temporarily closed and will open on May 17.' I mean 'shuttered and I threw the keys back.' I did not see this many boards-up in 2010 or 2001. It is pretty bleak out there. But that is where the opportunity lies, because the high street is still great real estate," says Lee. All agree that widespread repurposing will be required. But they also concur on the formidable difficulties involved in carrying it out.

Market activity rallied at the end of 2020 and early 2021 from the subdued performance seen in mid-2020 (£bn)



Source: CBRE

Enormous unwind

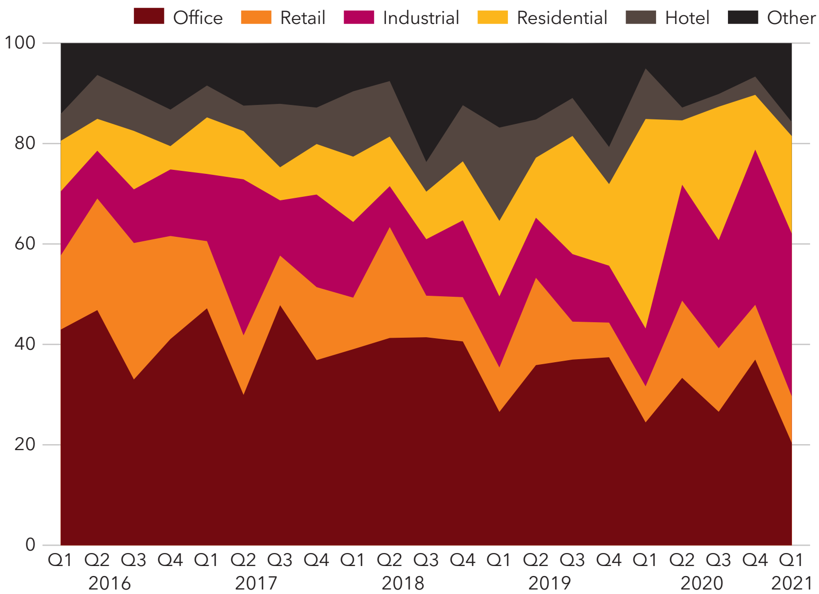
For all the optimism suffusing the UK property market, covid has left a fearful hangover of business debt. The British Property Federation estimates that unpaid commercial rents during the pandemic could amount to £7 billion ($9.9 billion; €8.1 billion). The UK government's moratorium on evictions was due to expire at the end of May, prompting calls for an extended grace period.

The first examples of landlords taking action against non-paying tenants are beginning to emerge. In April, AEW UK REIT won a court case against retailer Sports Direct and leisure operator Mecca to recover unpaid arrears, and in the same month judges also ruled in favor of Westfield London owner Unibail-Rodamco-Westfield in a suit against one of its tenants.

"There is an enormous unwind to figure out," says Tebbit. "We will continue to find ways to work with our tenants as the re-start plays out. But there is a risk that some landlords will not be long-term in their outlook. The UK government will not want to suddenly end forbearance and unleash the hounds, just when they are desperately

> *"Many institutional investors are starting to say that if they have to deploy in 2021-22, the UK market looks pretty good"*
>
> **LLOYD LEE**
> **Yoo Capital**

The office market finished 2020 strongly despite the pandemic, but was outstripped by a surging industrial sector in Q1 2021 (£bn)



Source: CBRE

keen for these businesses to be generating economic activity and employing people."

When they reopen, many tenants are unlikely to be trading at their full capacity, notes Bird. "Covid's impact will continue to play out. In the hospitality sector, for example, staff may have found alternative employment, or may have left the UK. Some restaurants and other businesses will have increased costs. We have to continue to listen to our tenants and work with them."

In September, Yoo Capital bought the majority stake in west London's Shepherd's Bush market, home to over 100 small traders, and immediately waived all outstanding rent payments for March to October. "We wanted to make a statement that we were not simply going to kick the can down the road. We were going to work with every single tenant and we were not going to put the axe over their necks and hold it there," explains Lee.

"But then, in January, we told them that each of them had to come and see us personally. We believe that gave us a much more granular understanding of our cashflows. But it also built a level of relationship and trust with our tenants. That loyalty is already starting to pay dividends as rent collections pick up. In addition, those conversations help us understand how, by investing in our real estate, we can also invest into the fabric of that community."

Yoo's Shepherd's Bush approach represents something of an industry outlier, however, geared toward a specific group of small tenants. Investors would rightly question a blanket write-off policy that also included large and successful businesses, argues Tebbit. "It is not our money. It belongs to our investors. I have to be a fiduciary to my clients and protect their interests as well as help those tenants truly in need. These investors are often pension funds which need that rental income to meet their payments to pensioners."

The participants agree that it is rarely possible for a manager to have a one-size-fits-all policy on enforcement, which should be considered on a tenant-by-tenant basis.

Meanwhile, some form of government intervention to prevent widespread business collapse is deemed likely. In any case, property owners will have to continue to bear in mind their ESG commitments as the unwinding continues, says RoccoGrande. "It is a complex issue and it will take quite a bit of time and collaboration between government, industry and end users to reach a result that is fair to each of the counterparties. As institutional franchises we are all going to be judged on how we have behaved. It will never be black and white. But at the end we all want to be good corporate citizens and good people."

Trading data

The need to achieve a deeper understanding of tenants' businesses to determine whether they require continued support, coupled with the increasingly operational nature of the real estate business, highlights a weakness of the UK market, observes Cowins. "My colleagues across the Atlantic tell me that in the US you can get trading data for a specific shop showing whether that business is profitable and sustainable based on the level of rent. In the UK that data has not been available. As more real estate switches to an operational model, managers will be able to get more up-to-date information and we will gradually pivot towards that more transparent position," he says.

Tebbit says that BlackRock often puts trading data sharing covenants in its long-lease contracts. However, he concurs: "We are far behind the US, and Europe as well, in having asset-level data. In future, a lot of investments will require a mix of real estate skills and a private equity mentality. There is some catching up to do both in terms of skill set and the ability to collect that operational data through lease contracts."

Improved transparency will eventually translate into higher value, suggests Bird. "As we collect data and learn how to share it better, then those assets for which data is available ought to be worth more. At the moment, as an industry, we rely too much on anecdotal evidence. But if we can share data that demonstrates rent collection has been excellent, and voids minimal, that underlines the stability of cashflow. Furthermore, ESG and wellness are key in investment principles as demonstrated when we secured M&G on a new UK office pre-let which Aviva are now forward-funding."

With a high, and increasing, proportion of its citizens vaccinated, the weather improving, Brexit largely settled – at least in headline terms – and businesses beginning to reopen, there is growing optimism in UK real estate markets that the dark days of 2020 may soon become a distant memory. But further trials undoubtedly lie ahead, and at present neither the roundtable participants, nor anyone else, can offer definitive solutions to the questions that the post-covid recovery will undoubtedly pose. ■

UK investors college-bound

Favorable demographics and certainty of income are powerful draws for equity and debt capital, say roundtable participants

A record £6 billion ($8.5 billion; €6.9 billion) of UK student accommodation traded in 2020 despite covid disruption that saw some students complaining of being "held hostage" in their campus accommodation and others carrying on their degrees by remote learning. While that figure was inflated somewhat by Blackstone's acquisition of the iQ portfolio for £4.7 billion in Q1, and activity tailed off in 2020 thereafter, CBRE data show the market made a strong start to 2021, with £1.1 billion of deals in the first quarter. Several roundtable participants single out the sector as a target market.

Changing demographics that will see predicted demand for an additional 40,000 full-time higher education places in England by 2035 due to rises in the 18-year-old population have whetted investor interest, says Tebbit. "Plus, the international students will come back, and with student housing you know that in September 2021 universities will restart, which gives you certainty over when the cashflow will recover to pre-pandemic levels.

"Meanwhile, the customer base is probably the most resilient cohort of the adult population in terms of the health impact of covid, and they are desperate to get back to normal student life. I think we will see an enormous snap-back of students wanting to study in the UK."

"There is an abundance of fundraising and transactional activity in the sector," adds Cowins. "There is not a day that goes by when our team does not have something on that is student-related. That market went through a period of near-distress last year. Anyone that held their nerve and invested then, it is likely that they will have come out this year feeling very happy with their decisions."

DFI has invested extensively in student housing in recent years, and RoccoGrande observes that debt providers also want exposure to the segment. "We have just closed a student deal in the UK, and there was a deep pool of potential lenders offering tremendously attractive terms," he says.