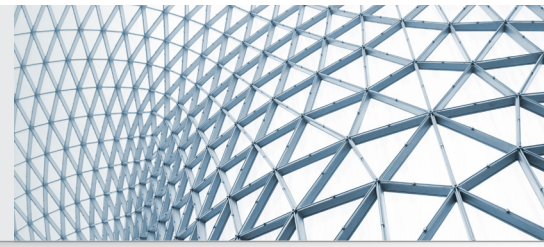


# The HUB

NEWS AND VIEWS FOR INSTITUTIONAL INVESTORS



> Find out more:  
[im.natixis.com/en-institutional](http://im.natixis.com/en-institutional)

## Real estate debt is the real deal

Why economic uncertainty need not deter investors from real estate, explain Arnaud Heck and Cyril Hoyaux in a Q&A.

### Key Takeaways

- Real estate debt from non bank lenders is growing rapidly, and has a lot further to go before it plays a full part in the financing of the built environment
- Debt instruments are particularly attractive to investors as protected from an equity cushion and bring regular income stream (i.e. not dependent upon capital gains) and offer stable valuation
- Real estate market dynamics are changing, with some core European assets now looking expensive.
- Adapting to a changing environment requires experience and skill. The powerful combination of Ostrum AM in credit and AEW in real estate is designed to unearth new opportunities in secured debt.

### What's changed in real estate debt over the last years?

**A.H.:** The non-bank market for real estate debt has deepened considerably. The trend for banks to focus on short-term lending has continued, so long-term lending to real estate projects is increasingly falling to investors. There were 37 debt funds for real estate last year, up from a low 10's when we started investing in 2012. As a proportion of the market, funds and insurances, represented just over 3% of all lending to real estate back then, and that has risen to around a quarter of all lending to the sector now. But it's still not enough to finance all the projects out we are seeing. The debt issuance remains generally, in markets addressed by our strategies, between €200b and €240bn each year. The increased portion from non bank lenders should be playing a bigger part of a market worth around €1 100bn and growing. The landscape is still in construction.<sup>1</sup>

### Remind us again how real estate debt works?

**C.H.:** Real estate debt is different to investing directly in real estate although benefiting from strong common points. The loans are backed by real estate assets, including office buildings, retail properties, residential properties, student housing, senior housing, hotels, light industrial assets and logistics.

The difference is that direct real estate investments can be volatile and capital is at risk, whereas real estate debt tends



**Cyril Hoyaux** and **Arnaud Heck**

are the co-heads of the AEW/ Ostrum real estate debt platform. Ostrum AM (formerly Natixis AM) and AEW are affiliates of Natixis Investment Managers

to provide predictable returns and low volatility. We invest in senior real estate loans, which are the first to be paid if something goes wrong.

By limiting the loan-to-value (LTV) of a real estate debt portfolio to 65%, investors get further downside protection. That's to say, the real estate asset would have to lose about 35% of its value before a senior loan strategy with an LTV of 65% would start eating into investors' capital.

### Isn't the real estate market risky just now?

**C.H.:** Yes and no. There is plenty of investment acquisition activity in Europe and then increasing needs for financing, which is positive for us. But the market may have reached a peak for some segments. These include logistics and offices in core Western European

<sup>1</sup> : Source : AEW/Ostrum (31/01/2019)

# The HUB

NEWS AND VIEWS FOR INSTITUTIONAL INVESTORS



locations such as Paris, Frankfurt and Amsterdam. But many core assets in stable European locations such as Belgium and Spain still offer value. Thanks to our network of 12 offices across Europe and to our research capacities, we cover 95 different local real estate markets. We have then to invest in submarkets with positive trends.

Economic uncertainties strengthen the argument for approaching real estate through debt. Recovery rates in the case of default are high compared with senior secured bonds and way above subordinated debt. In any case, with secured debt, default rates are close to zero. In fact, we have never had a default in seven years of real estate debt investing.

## Have you changed what you invest in?

**H.A.:** We have been investing in this asset class a long time now and we are used to adapting to new situations. In fact, we have raised more than €1.5bn since Ostrum AM and AEW launched a real estate debt platform in 2012, and have made repayments of approximately €500m to investors.

We have decided not to invest in UK for the moment as we offer our clients stability and visibility, what is difficult to predict for UK deals. This was not an easy decision, but we have stringent criteria for our investments and we can't expose our clients to unknowable risks on the Brexit, real estate market, currency or refinancing risk.

However, thanks to the combination of Ostrum AM's credit expertise and AEW's reach, we have research and transaction capabilities on the ground across continents, particularly in Europe and there is a world of opportunity out there. We examine assets in all the major jurisdictions and some of the smaller ones too, searching for robust risk-return opportunities.

While Germany, France and the Benelux is still perceived as the core bulk of our investments, we see our lending

levels increasing from here, leading to even higher levels of selection and diversification within our portfolios.

## Has your investment approach changed?

**C.H.:** No. But we have refined the process and how we explain it. In essence, we divide the universe of real estate debt opportunities into two buckets, and select assets from each.

The main bucket, from which will represent 70% of our investments, consists in financing standardised assets such as offices, retail space and logistics, in core countries such as France, Germany, Benelux and Spain which have stabilised cashflows.

The "enhanced" bucket, on the other hand, contains financing on alternative asset classes such student or senior housing, hotels or light industrial, or assets that produce less stable cashflows or, assets which are situated in slightly less economically-stable countries. This bucket has the potential for higher returns and is about 30% of the portfolio.

## Every asset is different in real estate – how do you know what you're buying?

**H.A.:** In a changing environment you need flexibility, a sound risk approach, and experience. Experience is not just about grey hairs but also about know how as well as mastering a subject from each and every angle and having a deep network of skills and contacts. This is definitely not an asset class for first-time investors.

By pairing Ostrum AM, a global fixed income expert, with AEW, a world-leading real estate investment and asset manager, we think we have almost limitless flexibility to adapt to different situations. Ostrum AM has 51 portfolio managers, a credit research team and 12 financial engineers, while AEW has 186 investment managers on the ground

in 10 European countries as well as a real estate research team.

Besides the uniqueness of combination, strong sourcing capacity has allowed us to create a proprietary database that gives us access to a huge range of deals and pay the right price for them. It is possible to invest in real estate loans by relying on third-party data providers, but having our own, market-leading database allows us to see how the market is moving in real-time and compare this to historical data to create more accurate valuations and return expectations.

As well as unearthing deals, the value of a proprietary database is to help us see how the market is moving ahead of competitors, with the aim of protecting our investors from sharp changes in market trends.

## What returns are possible today?

**H.A.:** We think we are in the part of the economic cycle that is good for debt relative to equity. With good recovery rates on senior secured loans, returns are likely to be attractive versus other debt assets. On investment grade portfolios, expected returns are 125bps above the risk-free rate<sup>1</sup>, which is the average of a number of government bonds across the eurozone. When compared to investment grade liquid bonds, the difference is even more striking, with little volatility of valuations in our asset class versus a significant one on liquid assets.

## What would you say to first-time investors in this asset class?

**C.H.:** We understand that investors are cautious about real estate. We believe that real estate transactions will still be strong in the years ahead, but maybe focused on slightly different assets than in the past. Flexibility and diversification should allow real estate debt investors to access strong returns with considerably less volatility than for many other debt instruments.

Written on 5 March 2019

# The HUB

NEWS AND VIEWS FOR INSTITUTIONAL INVESTORS



## ADDITIONAL NOTES

This material has been provided for information purposes only to investment service providers or other Professional Clients, Qualified or Institutional Investors and, when required by local regulation, only at their written request. This material must not be used with Retail Investors.

**In the E.U. (outside of the UK and France):** Provided by Natixis Investment Managers S.A. or one of its branch offices listed below. Natixis Investment Managers S.A. is a Luxembourg management company that is authorized by the Commission de Surveillance du Secteur Financier and is incorporated under Luxembourg laws and registered under n. B 115843. Registered office of Natixis Investment Managers S.A.: 2, rue Jean Monnet, L-2180 Luxembourg, Grand Duchy of Luxembourg. **Italy:** Natixis Investment Managers S.A., Succursale Italiana (Bank of Italy Register of Italian Asset Management Companies no 23458.3). Registered office: Via Larga, 2 - 20122, Milan, Italy. **Germany:** Natixis Investment Managers S.A., Zweigniederlassung Deutschland (Registration number: HRB 88541). Registered office: Im Trutz Frankfurt 55, Westend Carrée, 7. Floor, Frankfurt am Main 60322, Germany. **Netherlands:** Natixis Investment Managers, Nederlands (Registration number 50774670). Registered office: Stadsplateau 7, 3521AZ Utrecht, the Netherlands. **Sweden:** Natixis Investment Managers, Nordics Filial (Registration number 516405-9601 - Swedish Companies Registration Office). Registered office: Kungsgatan 48 5tr, Stockholm 111 35, Sweden. **Spain:** Natixis Investment Managers, Sucursal en España. Serrano n°90, 6th Floor, 28006, Madrid, Spain. In France: Provided by Natixis Investment Managers International – a portfolio management company authorized by the Autorité des Marchés Financiers (French Financial Markets Authority - AMF) under no. GP 90-009, and a public limited company (société anonyme) registered in the Paris Trade and Companies Register under no. 329 450 738. Registered office: 43 avenue Pierre Mendès France, 75013 Paris. **In Switzerland:** Provided for information purposes only by Natixis Investment Managers, Switzerland Sàrl, Rue du Vieux Collège 10, 1204 Geneva, Switzerland or its representative office in Zurich, Schweizergasse 6, 8001 Zürich. **In the British Isles:** Provided by Natixis Investment Managers UK Limited which is authorised and regulated by the UK Financial Conduct Authority (register no. 190258) - registered office: Natixis Investment Managers UK Limited, One Carter Lane, London, EC4V 5ER. When permitted, the distribution of this material is intended to be made to persons as described as follows: in the United Kingdom: this material is intended to be communicated to and/or directed at investment professionals and professional investors only; in Ireland: this material is intended to be communicated to and/or directed at professional investors only; in Guernsey: this material is intended to be communicated to and/or directed at only financial services providers which hold a license from the Guernsey Financial Services Commission; in Jersey: this material is intended to be communicated to and/or directed at professional investors only; in the Isle of Man: this material is intended to be communicated to and/or directed at only financial services providers which hold a license from the Isle of Man Financial Services Authority or insurers authorised under section 8 of the Insurance Act 2008. **In the DIFC:** Provided in and from the DIFC financial district by Natixis Investment Managers Middle East (DIFC Branch) which is regulated by the DFSA. Related financial products or services are only available to persons who have sufficient financial experience and understanding to participate in financial markets within the DIFC, and qualify as Professional Clients or Market Counterparties as defined by the DFSA. No other Person should act upon this material. Registered office: Office 603 - Level 6, Currency House Tower 2, PO Box 118257, DIFC, Dubai, United Arab Emirates. **In Japan:** Provided by Natixis Investment Managers Japan Co., Ltd., Registration No.: Director-General of the Kanto Local Financial Bureau (kinsho) No. 425. Content of Business: The Company conducts discretionary asset management business and investment advisory and agency business as a Financial Instruments Business Operator. Registered address: 1-4-5, Roppongi, Minato-ku, Tokyo. **In Taiwan:** Provided by Natixis Investment Managers Securities Investment Consulting (Taipei) Co., Ltd., a Securities Investment Consulting Enterprise regulated by the Financial Supervisory Commission of the R.O.C. Registered address: 34F., No. 68, Sec. 5, Zhongxiao East Road, Xinyi Dist., Taipei City 11065, Taiwan (R.O.C.), license number 2018 FSC SICE No. 024, Tel. +886 2 8789 2788. **In Singapore:** Provided by Natixis Investment Managers Singapore (name registration no. 53102724D) to distributors and institutional investors for informational purposes only. Natixis Investment Managers Singapore is a division of Ostrum Asset Management Asia Limited (company registration no. 199801044D). Registered address of Natixis Investment Managers Singapore: 5 Shenton Way, #22-05 UIC Building, Singapore 068808. **In Hong Kong:** Provided by Natixis Investment Managers Hong Kong Limited to institutional/ corporate professional investors only. **In Australia:** Provided by Natixis Investment Managers Australia Pty Limited (ABN 60 088 786 289) (AFSL No. 246830) and is intended for the general information of financial advisers and wholesale clients only. **In New Zealand:** This document is intended for the general information of New Zealand wholesale investors only and does not constitute financial advice. This is not a regulated offer for the purposes of the Financial Markets Conduct Act 2013 (FMCA) and is only available to New Zealand investors who have certified that they meet the requirements in the FMCA for wholesale investors. Natixis Investment Managers Australia Pty Limited is not a registered financial service provider in New Zealand. **In Latin America:** Provided by Natixis Investment Managers S.A. **In Uruguay:** Provided by Natixis Investment Managers Uruguay S.A., a duly registered investment advisor, authorised and supervised by the Central Bank of Uruguay. Office: San Lucar 1491, oficina 102B, Montevideo, Uruguay, CP 11500. The sale or offer of any units of a fund qualifies as a private placement pursuant to section 2 of Uruguayan law 18,627. **In Colombia:** Provided by Natixis Investment Managers S.A. Oficina de Representación (Colombia) to professional clients for informational purposes only as permitted under Decree 2555 of 2010. Any products, services or investments referred to herein are rendered exclusively outside of Colombia. This material does not constitute a public offering in Colombia and is addressed to less than 100 specifically identified investors. **In Mexico:** Provided by Natixis IM Mexico, S. de R.L. de C.V., which is not a regulated financial entity, securities intermediary, or an investment manager in terms of the Mexican Securities Market Law (Ley del Mercado de Valores) and is not registered with the Comisión Nacional Bancaria y de Valores (CNBV) or any other Mexican authority. Any products, services or investments referred to herein that require authorization or license are rendered exclusively outside of Mexico. While shares of certain ETFs may be listed in the Sistema Internacional de Cotizaciones (SIC), such listing does not represent a public offering of securities in Mexico, and therefore the accuracy of this information has not been confirmed by the CNBV. Natixis Investment Managers is an entity organized under the laws of France and is not authorized by or registered with the CNBV or any other Mexican authority. Any reference contained herein to "Investment Managers" is made to Natixis Investment Managers and/or any of its investment management subsidiaries, which are also not authorized by or registered with the CNBV or any other Mexican authority.

The above referenced entities are business development units of Natixis Investment Managers, the holding company of a diverse line-up of specialised investment management and distribution entities worldwide. The investment management subsidiaries of Natixis Investment Managers conduct any regulated activities only in and from the jurisdictions in which they are licensed or authorized. Their services and the products they manage are not available to all investors in all jurisdictions. It is the responsibility of each investment service provider to ensure that the offering or sale of fund shares or third party investment services to its clients complies with the relevant national law.

The provision of this material and/or reference to specific securities, sectors, or markets within this material does not constitute investment advice, or a recommendation or an offer to buy or to sell any security, or an offer of any regulated financial activity. Investors should consider the investment objectives, risks and expenses of any investment carefully before investing. The analyses, opinions, and certain of the investment themes and processes referenced herein represent the views of the portfolio manager(s) as of the date indicated. These, as well as the portfolio holdings and characteristics shown, are subject to change. There can be no assurance that developments will transpire as may be forecasted in this material. Past performance information presented is not indicative of future performance.

Although Natixis Investment Managers believes the information provided in this material to be reliable, including that from third party sources, it does not guarantee the accuracy, adequacy, or completeness of such information. This material may not be distributed, published, or reproduced, in whole or in part.

All amounts shown are expressed in USD unless otherwise indicated.

## Ostrum Asset Management

An affiliate of Natixis Investment Managers  
French Public Limited liability company with board of Directors  
Share capital €27 772 359  
Regulated by the Autorité des Marchés Financiers (AMF) under  
no. GP 18000014  
RCS Paris n° 525 192 753  
43 avenue Pierre Mendès France - 75013 Paris  
www.ostrum.com

## AEW Ciloger

A simplified joint-stock company with capital of €  
828,510, register under the RCS number Paris 329  
255 046.  
Registered office: 22 rue du Docteur Lancereaux  
75008 PARIS  
AIFM Licensed by the Autorité des Marchés  
Financiers on July 10, 2007 under number GP-  
07000043  
www.aew.com

## Natixis Investment Managers

RCS Paris 453 952 681  
Capital: €178 251 690  
43 avenue Pierre Mendès-France  
75013 Paris  
www.im.natixis.com

WEBINTAR32-0319

## MARKET INSIGHTS

DOCUMENT INTENDED EXCLUSIVELY FOR PROFESSIONAL CLIENTS (IN ACCORDANCE WITH MIFID)