NATIXIS
INVESTMENT MANAGERS

FIRST PERSON

The HUB

NEWS AND VIEWS FOR INSTITUTIONAL INVESTORS

Real estate: what is the best way to diversify?

Core assets, transparency and ease of access are often sought in the early phases of international diversification

Olivier Bluche is Head of Institutional Sales for French-speaking Switzerland. Based in Geneva, he is responsible for driving the growth of Natixis Investment Managers' institutional business with an emphasis on real assets and sustainable solutions. Olivier previously worked at Lombard Odier Investment Managers where he was Head of Institutional Sales for French-speaking Switzerland. Prior to that, he worked for Russell Investments as an investment consultant for pension funds and corporates. He has a degree in Management & Finance from Paris-Dauphine-PSL University and an MBA from the City University of New York.

At Natixis Investment Managers, we are convinced that diversification into international real estate makes sense for European pension funds. Although real estate is popular with institutional investors, international diversification is still relatively low. Take Switzerland, where most of my own clients are based: more than 88% of the real estate assets of Swiss pension funds – CHF185 billion out of a total of CHF209 billion (according to provisional data for 2020 from the Swiss Federal Statistical Office) – is made up of domestic real estate, both direct or indirect. This lack of diversification has not actually been detrimental given the steep rise in Swiss real estate valuations over the last couple of decades. In fact, most Swiss institutions are highly satisfied with the performance of their concentrated real estate portfolios. But this performance is unlikely to be repeated and concentration of assets may no longer be beneficial. A decline in yields, excessive prices and the difficulty in finding attractive assets in the Swiss market now make a strong case for new money to flow to markets with higher yields and more affordable prices. So how can institutions achieve better geographical diversification and an improvement in yields?

Four ways of diversifying real estate

Pension schemes with substantial assets and investment resources can diversify through direct investment in foreign real estate. For the majority of schemes, however, international diversification is only possible through a variety of collective schemes. There are four main types of collective investment vehicles:

1. Real Estate Investment Trusts (REITs), which top allocations among Swiss institutions.
2. Private Equity Real Estate funds
3. Diversified funds of real estate funds
4. Open-ended real estate funds

The first three options have their advantages, but they also have serious disadvantages, which in our view explain the still limited development of this asset class within Swiss pension funds.

Pros and cons of each approach

REITs have the advantage of liquidity but, being listed real estate companies, they also have the disadvantage of volatility. Thus, it was not unusual to see REITs lose 25% to 30% of their value in the first quarter of 2020, even though the funds were counting on real estate to stabilize their assets and, by extension, their coverage level.

Meanwhile, private equity real estate has the advantage of providing access to specific real estate segments such as value-add and opportunistic. These segments often have high performance potential, aiming to create value through the transformation or conversion of buildings, or even the complete redevelopment of sites or districts.

The disadvantages of these funds are the lock-up periods which tend to be 10 to 12 years and, above all, the high levels of leverage which can exceed 50%. These factors make it impossible to classify them as international real estate in an asset allocation, but rather as private equity, which resides in the alternative investments pocket.

In our view, private equity real estate is generally suitable for large institutions

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

that are able to deploy capital in a highly-targeted manner in specific sectors or regions, but less so for medium-sized institutions or those with limited resources taking their first steps towards international diversification.

Then there are diversified funds of funds. These have the advantage of simplicity of implementation and a degree of liquidity, but the disadvantage of piling up management fees. These fees range from 1.5% to 2% or even more if the TER of the underlying funds is included. There can also be a geographical or sectoral diversification that is sometimes much greater than that initially sought by the fund. Would a pension fund wishing to expand its real estate investments beyond the Lake Geneva region wish to invest in shopping centres in Florida, offices in Barcelona or logistics warehouses in South Korea? Not necessarily because, for the trustee boards, without necessarily being hostile to this type of diversification, it is difficult to assess the risks involved.

The case for an open-ended approach

In our opinion, simple open-ended funds dedicated to core or residential real estate can be an efficient way to meet the desire for international diversification of real estate investments in the current uncertain economic environment. However, they currently represent only a small part of the available offer to institutions.

This shortage of supply is why we have developed, together with our real estate affiliate AEW, a new approach tailored to European institutional investors, focused on quality European residential real estate.

It has quarterly liquidity after the initial two-year period. It aims for a stable and regular, yet attractive, return and has a degressive pricing structure in line with Swiss equivalents. The debt ratio will usually be just 30% to 35%, with a maximum 40%, which is in line with the Swiss rules on the classification of real estate investments.

AEW's broad platform

The investment team is based in Paris where AEW Europe has its headquarters. With more than 40 years of experience in the industry, including 25 years in Europe, AEW is one of the world's leading real estate investment companies. It has more than €77billion of real estate assets under management, including approximately €37billion of European real estate and €4 billion of European residential real estate.

AEW employs nearly 800 professionals worldwide, with 440 based in 10 European countries. The group's size and experience give it privileged access to off-market transactions (40% to 60% of completed transactions), which favour low acquisition costs.

Furthermore, AEW is a member of the Global Real Estate Sustainable Benchmark (GRESB) and its approach integrates concrete sustainability objectives (objective: Article 8 SFDR/4 GRESB stars on a scale of 1 to 5, 5 being the maximum).

Diversification and future-proofing

The strength of AEW's resources mean it can invest across sectors and countries in Europe on a single platform. The team will invest primarily in Germany and France (50%-60%), but also in the Benelux countries (10%-20%), Italy, Portugal and Spain (0-15%) and possibly in other countries in the eurozone (0-15%).

Investments will be mainly in quality residential real estate in sought-after areas (80%), plus a maximum of 20% in student housing, senior housing or co-living in urban areas benefiting from regeneration.

It is expected that 40% of the investments will be made into existing real estate and 60% will be into ongoing projects. This combination allows the construction of a real estate portfolio which corresponds to both current and future environmental standards.

Expected yield designed to meet institutional needs

So will an open-ended approach with international diversification provide the yield and consistency of return that institutions need?

We think so, particularly if we look at a previous, similar strategy launched by AEW, which raised and deployed some €600m. The target size of the new approach is a minimum of €1bn, with deployment of capital over a four-year investment period.

The investment team targets a rental yield of 3.5% and an internal rate of return (IRR) of 6%*. We believe this meets the income needs of a great many Swiss and European pension schemes.

Published in January 2022

* Investment strategies mentioned include a risk of capital loss. Target returns are indicative and not guaranteed.

Find out more:
im.natixis.com/en-institutional

NATIXIS
INVESTMENT MANAGERS

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.

To obtain a summary of investor rights in the official language of your jurisdiction, please consult the legal documentation section of the website (im.natixis.com/intl/intl-fund-documents)

In the E.U.: Provided by Natixis Investment Managers International or one of its branch offices listed below. Natixis Investment Managers International is 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. Italy: Natixis Investment Managers International Succursale Italiana, Registered office: Via San Clemente 1, 20122 Milan, Italy. Netherlands: Natixis Investment Managers International, Nederlands (Registration number 000050438298). Registered office: Stadsplateau 7, 3521AZ Utrecht, the Netherlands. Sweden: Natixis Investment Managers International, Nordics Filial (Registration number 516412-8372- Swedish Companies Registration Office). Registered office: Kungsgatan 48 5tr, Stockholm 111 35, Sweden. **Or,** 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. Germany: Natixis Investment Managers S.A., Zweigniederlassung Deutschland (Registration number: HRB 88541). Registered office: Senckenberganlage 21, 60325 Frankfurt am Main. Belgium: Natixis Investment Managers S.A., Belgian Branch, Gare Maritime, Rue Picard 7, Bte 100, 1000 Bruxelles, Belgium. Spain: Natixis Investment Managers, Sucursal en España, Serrano n°90, 6th Floor, 28006 Madrid, Spain.

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: Unit L10-02, Level 10 ,ICD Brookfield Place, DIFC, PO Box 506752, 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 investment management business, investment advisory and agency business and Type II Financial Instruments Business as a Financial Instruments Business Operator.

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 2020 FSC SICE No. 025, Tel. +886 2 8789 2788.

In Singapore: Provided by Natixis Investment Managers Singapore Limited (company registration no. 199801044D) to distributors and qualified investors for information purpose only.

In Hong Kong: Provided by Natixis Investment Managers Hong Kong Limited to professional investors for information purpose 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 Colombia: Provided by Natixis Investment Managers International 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 Latin America: Provided by Natixis Investment Managers International.

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, 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 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.

In Brazil: Provided to a specific identified investment professional for information purposes only by Natixis Investment Managers International. This communication cannot be distributed other than to the identified addressee. Further, this communication should not be construed as a public offer of any securities or any related financial instruments. Natixis Investment Managers International is 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.

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. The analyses and opinions expressed by external third parties are independent and does not necessarily reflect those of Natixis Investment Managers. 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.

Natixis Investment Managers may decide to terminate its marketing arrangements for this product in accordance with the relevant legislation

AEW
An affiliate of Natixis Investment Managers
Privately-held French “Société anonyme à conseil d’administration”
Real-estate investment manager under n°T 8324 delivered by the Prefecture de police de Paris
Share capital: €17,025,900
RCS Paris: B 409 039 914
22 rue du Docteur Lancereaux 75008 Paris, France
www.aew.com

Natixis Investment Managers
RCS Paris 453 952 681
Share Capital: €237 087 487
43 avenue Pierre Mendès-
France 75013 Paris
www.im.natixis.com