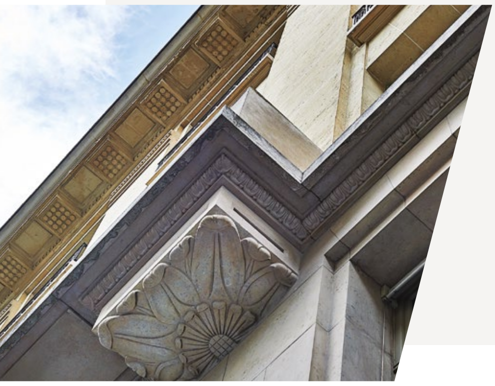


September 2022 | Rothschild & Co Asset Management Europe

Sector note: listed Eurozone real estate

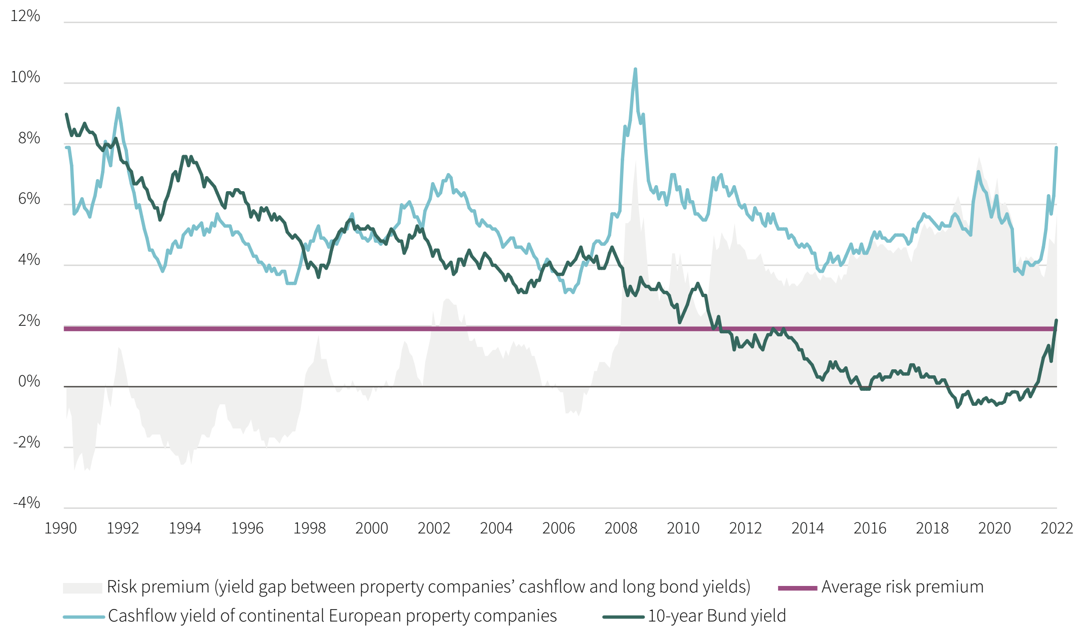
Paul Reuge
Manager of
R-co Thematic Real Estate

The steep drop in property companies' shares so far this year has raised their discounts to net asset value (i.e., based on the valuations on direct real-estate markets) to almost 45% as of the end of September(1), a high since the great financial crisis of 2008. So, when subtracting debt, a market-listed building is worth 30% less than its appraised value on the property market(2)!

Why this gap?

Through the current discount, the financial markets are pricing in both the spectacular rise in financing costs on the year to date (from 1% to more than 4% within nine months on the bond markets(3)) and the decline expected to occur in building prices to align rental yields with higher government bond yields.

Cashflow yield over the past 32 years



Source: Datastream, EPRA, September 2022.

(1) Sources: Bloomberg, companies, Rothschild & Co Asset Management Europe, September 2022.
(2) Real-estate appraisals by companies, July 2022.
(3) Source: Bloomberg, September 2022.
Past performances are not a reliable indicator of future performances.

When applied blindly to property companies' P&Ls, higher financing costs would lower cashflows by about 30%(4). This would lower their cashflow yields from 8% to 5.6%(5) as of 29 September. As the sector's average risk premium since 1990 is 1.9%, this would imply a valuation of 10-year government bonds of 3.6% (vs. 2% currently)(6).

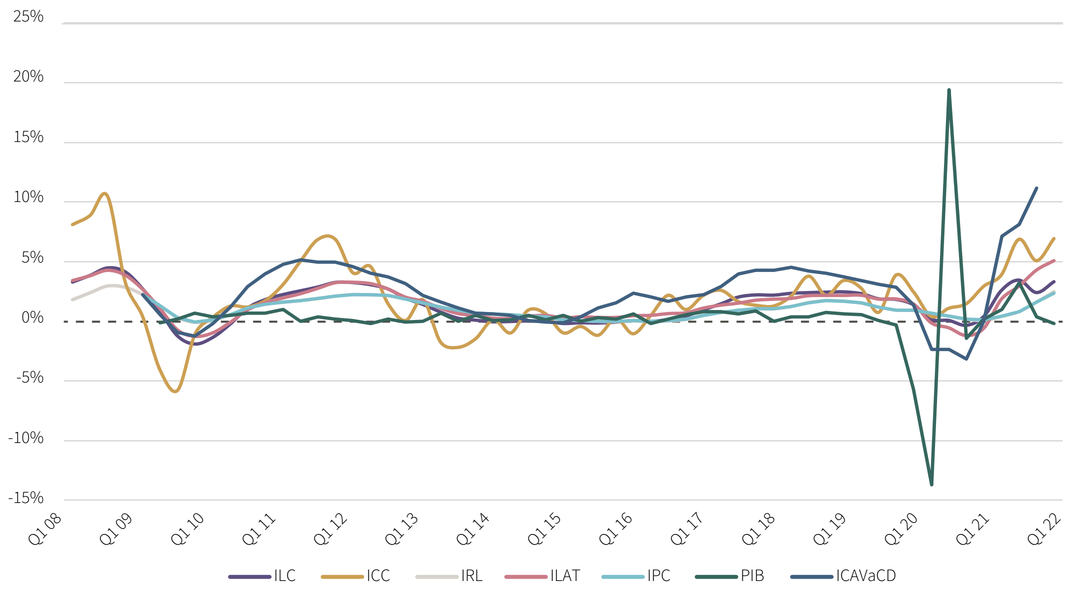
It is quite hard to call a peak in long bond yields, but current valuations do look overdone in several ways. First, property companies' debt is covered and has an average maturity of 6.5 years(7). Assuming that financing costs currently seen on the bond markets were to become the new norm, full dissemination of those costs into cashflows would be spread out over time. And second, property companies are able to diversify their sources of financing. Covivio, for example, announced the signing of a 485 million euro credit line in early September at an average cost of 2.5%, far below the bond market rate(8).

So, there is little likelihood that cashflows will be driven down by 30% by the impact of higher financing costs. Moreover, the market seems to be forgetting that higher interest rates go hand-in-hand with inflation, which property companies capture in part through their indexation clauses.

Have the markets forgotten indexation?

Indexation of leases will be a powerful driver of rents next year. Property companies will benefit even as increases in financing costs are moderated for the aforementioned reasons.

Rent indices and their components



Sources: INSEE, September 2022.

Cashflows will therefore rise automatically. Even in the event of a major economic downturn, we estimate that it would take a 30% reduction in renegotiated rents to erase +3% indexation (based on an annual 10% renewal of the rental base)!

(4) Source: Rothschild & Co Asset Management Europe, September 2022.
(5) Source: Rothschild & Co Asset Management Europe, September 2022.
(6) Sources: Rothschild & Co Asset Management Europe, Exane, Bloomberg, September 2022.
(7) Sources: Companies, Rothschild & Co Asset Management Europe, September 2022.
(8) Source: Company, Bloomberg, September 2022.

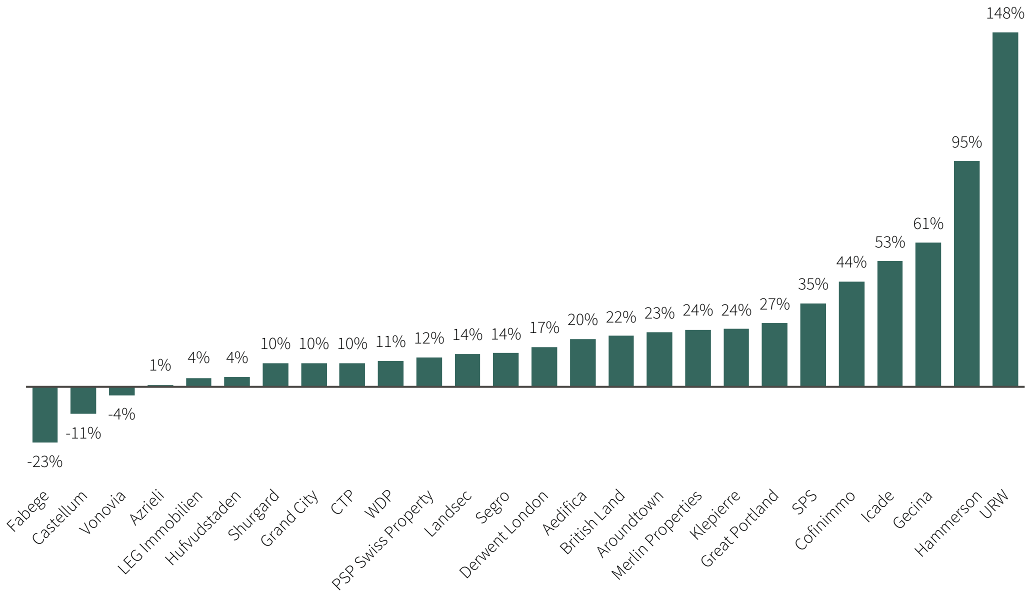
The above information does not constitute investment advice or a recommendation to invest.

Is liquidity risk scaring the markets even more than the cost of money?

Less than 20% of the sector's debt matures by 2024[9]. Only Northern European property companies outside the Eurozone, are facing stretched balance sheets that are likely to lead to dilutive recapitalisations.

Liquidity within the sector

Excess liquidity on 2022-2023 maturities as a percentage of market cap



Sources: Companies, UBS, Rothschild & Co Asset Management Europe, September 2022.

Debt ratios are, on average, acceptable at 40%[10] for the loan-to-value[11] and 10.7%[10] for net debt/EBITDA[12] and leave enough room to avoid breaching covenants[13] and precipitating a dilutive market call.

A risk to capital that the discount tends to lessen, combined with attractive carry

On average, dividends account for 6% of the sector's market cap and more than 10% in the case of some companies[14]. This distribution is economically sustainable and will benefit from indexation.

The current discount will most likely serve as a parachute to falling valuations. Higher interest rates will, without a doubt, show up in private market valuations, like it is implicitly priced in public market while rents will benefit from indexation, is highly pessimistic and leaves some upside on the sector, once bond market stress has receded.

(9) Sources: Companies, Rothschild & Co Asset Management Europe, September 2022.
(10) Source: UBS, September 2022
(11) A risk indicator used for debt financing of a real estate asset; it is the ratio of debt to the value of property assets.
(12) Source: Bloomberg, September 2022.
(13) Earnings before interest, taxes, depreciation, and amortisation
(14) Clauses inserted into loan contracts requiring that the borrower comply with specific commitments such as financial ratios.

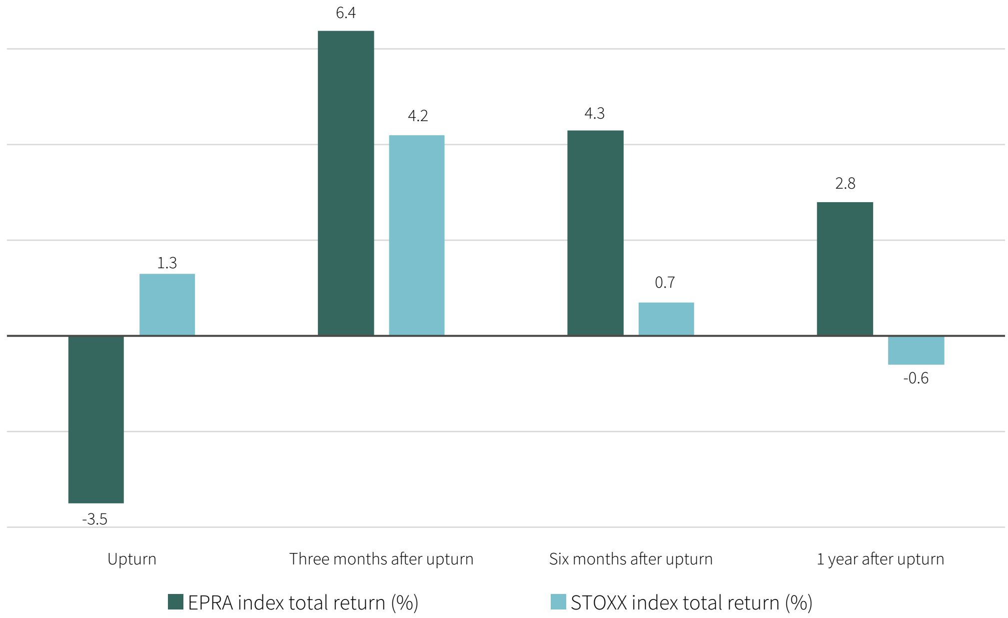
The above information does not constitute investment advice or a recommendation to invest.

The sector's performance relative to conventional shares during previous periods of rising interest rates, suggests a return to better days

An analysis of property companies' performance vs. the broader market during previous phases of rising interest rates shows that the companies initially tend to underperform "conventional" shares and then to outperform them in the three, six and 12 months following the rate increase. This is what seems to be happening now.

Broad equity market performance vs. the property sector in yield periods

As a %



Source: Kempen, September 2022.

Conclusion

Listed property company valuations are close to their all-time lows. The markets are paying undue attention to higher interest rates while ignoring the positive side of those rates – inflation, as they assume that the economic slowdown triggered by the end of accommodative monetary policies will not allow landlords to pass inflation on to tenants.

We believe that this view is overly pessimistic. While property companies will not be able to pass on all of inflation, they will be able to put through a generous indexation, which will support cashflow growth in 2023 and should accordingly be reflected in company valuations. Meanwhile, patient investors can benefit from the fund's attractive 5.9% carry[15].

Completed on 29 September 2022

(15) Source: Rothschild & Co Asset Management Europe, September 2022.

Performance	Since the beginning for the year	2021	2020	2019	2018	2017	Volatility 1 year
R-co Thematic Real Estate C EUR	-16.0%	6.6%	-22.8%	21.6%	-7.5%	18.9%	20.2%
IEIF Eurozone coupons nets réinvestis[1]	-26.7%	2.1%	-10.7%	21.5%	-9.9%	16.6%	19.7%

(1) Benchmark index
Sources: Rothschild & Co Asset Management Europe, 31/08/2022.

The risk level of this fund is 6 (volatility between 15% and 25%) and mainly reflects its positioning in the market of French real estate companies and European real estate companies. The historical data used to calculate this synthetic indicator may not be a reliable indication of the future risk profile of the fund. The risk category associated with the fund is not guaranteed and may change over time, both upwards and downwards. The lowest category is not necessarily risk-free. The fund is not capital guaranteed. Other important risk factors not adequately taken into account by the indicator: credit risk, liquidity risk, and the impact of techniques such as derivatives. The occurrence of any of these risks may cause the net asset value of the fund to fall. Please refer to the prospectus for more information on the risk profile and its main contributors.

Before investing, it is imperative to read the DICI carefully, and the prospectus of the UCI, and more particularly its section on risks and fees, available on the Rothschild & Co Asset Management Europe website: am.eu.rothschildandco.com

Past performances are not a reliable indicator of future performances.
The above information does not constitute investment advice or a recommendation to invest.

Disclaimer

Advertising, simplified and non-contractual document. The information, comments and analyses in this document are provided for information purposes only and should not be construed as an investment or tax advice, or as an investment recommendation from Rothschild & Co Asset Management Europe. The information/opinions/ data mentioned in this document considered legitimate and correct on the day of publication, in accordance with the economic and financial environment in place at that date, are subject to change at any time.

Although this document has been prepared with the greatest care from sources that Rothschild & Co Asset Management Europe believed to be reliable and in good faith, no representation or warranty, express or implied, is made as to information accuracy or completeness, which are indicative only and are subject to change without notice. Rothschild & Co Asset Management Europe has not independently verified the information contained in this document and cannot be held responsible for any errors, omissions or interpretations of the information contained in this document. This analysis is only valid at the time of writing of this report.

Furthermore, given the subjective nature of certain analyses, we draw your attention to the fact that any information, projections, estimates, anticipations, assumptions and/or opinions are not necessarily put into practice by the management teams of Rothschild & Co Asset Management Europe, or its affiliates, who act according to their own convictions. Certain forward-looking statements are prepared on the basis of certain assumptions, which are likely to differ either partially or totally from reality. Any hypothetical estimates are, by their nature, speculative and it is possible that some, if not all, of the assumptions relating to these hypothetical illustrations may not materialise or may differ significatively from current determinations.

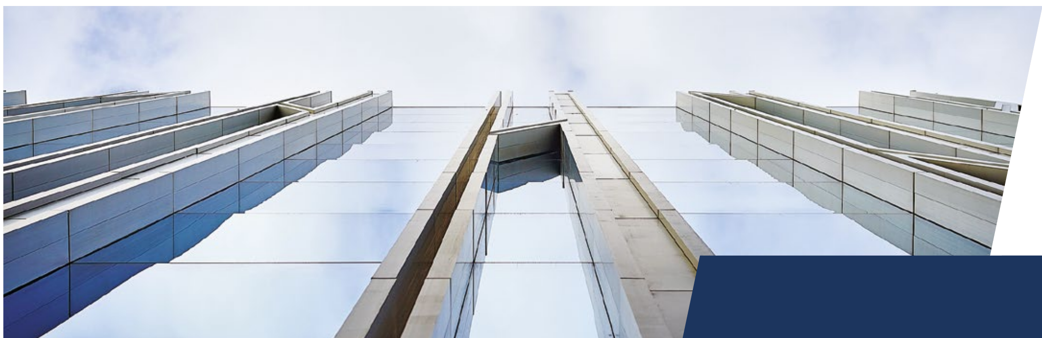
The information does not presume the suitability of the UCI presented to the profile and experience of each individual investor. Rothschild & Co Asset Management Europe shall not be liable for any decision taken on the basis of or inspired by the information contained in this document. In case of doubt, and before making any investment decision, we recommend that you contact your financial or tax advisor. The Undertaking for Collective Investment (UCI) presented above is organised according to French law and regulated by the French financial markets authority (AMF). Any investment is always subject to risk. Before any investment, please imperatively read the key investor information document (KIID) and prospectus of the UCI carefully, especially its section relating to risks. Each investor must also ensure the jurisdictions in which the UCI is registered. The KIID, the full prospectus as well as the net asset value (NAV)/net inventory value (NIV) are available on our website: www.am.eu.rothschildandco.com. The information presented is not intended to be disseminated and does not constitute in any way an invitation for US nationals or their agents. The units or shares of the UCI presented in this document are not and will not be registered in the United States pursuant to the U.S. Securities Act of 1933 as amended ("Securities Act 1933") or admitted under any law of the United States. These units or shares may neither be offered, sold in or transferred to the United States (including in its territories and possessions), nor directly or indirectly benefit to a "US Person" (within the meaning of Regulation S of the Securities Act of 1933) and equivalent persons (as referred to in the US "HIRE" Act of 18 March 2010 and in the FATCA provisions).

Figures provided relate to previous years. Past performance is not a reliable indicator of future performance and is not constant over time. The value of investments and the income derived from them may vary both upwards and downwards, and is not guaranteed. The value of investments and the income derived from them may vary both upwards and downwards, and is not guaranteed. It is therefore possible that you may not recover the amount originally invested. Exchange rates variation may increase or decrease the value of the investments and the resulting income when the reference currency of the UCI is different from the currency of your country of residence. UCIs whose investment policy is aimed more specifically at specialised markets or sectors (such as emerging markets) are generally more volatile than common and diversified allocation funds. For a volatile mutual fund, the fluctuations may be particularly large, and the value of the investment may therefore fall sharply. The performances presented do not take into account any fees and commissions received on the subscription and redemption of units or shares of the UCI herein. The portfolios, products or securities presented are subject to market fluctuations and no guarantee can be given as to their future development. The tax treatment depends on the individual situation of each investor and may be subject to change.

Rothschild & Co Asset Management Europe, organized under the laws of France, registered with the Trade and Companies Register of Paris RCS Paris 824 540 173. A management company licensed by the Autorité des Marchés Financiers under N° GP 17000014, having its registered office 29, avenue de Messine, 75008 Paris, France.

About the Asset Management's division of Rothschild & Co

As the specialised asset management division of the Rothschild & Co group, we offer personalised asset management services to a broad client base of institutional investors, financial intermediaries and distributors. Our development is focused on a range of open-ended funds, marketed under four strong brands: Conviction, Valor, Thematic and 4Change, and leveraging our long-term expertise in active management with conviction as well as in delegated management. Based in Paris and established in 10 European countries, we manage more than 22 billion euros and employ nearly 150 people. More information at: www.am.eu.rothschildandco.com



Join us on
LinkedIn

For further information
am.eu.rothschildandco.com

Rothschild & Co
Asset Management