November 2023 | Rothschild & Co Asset Management

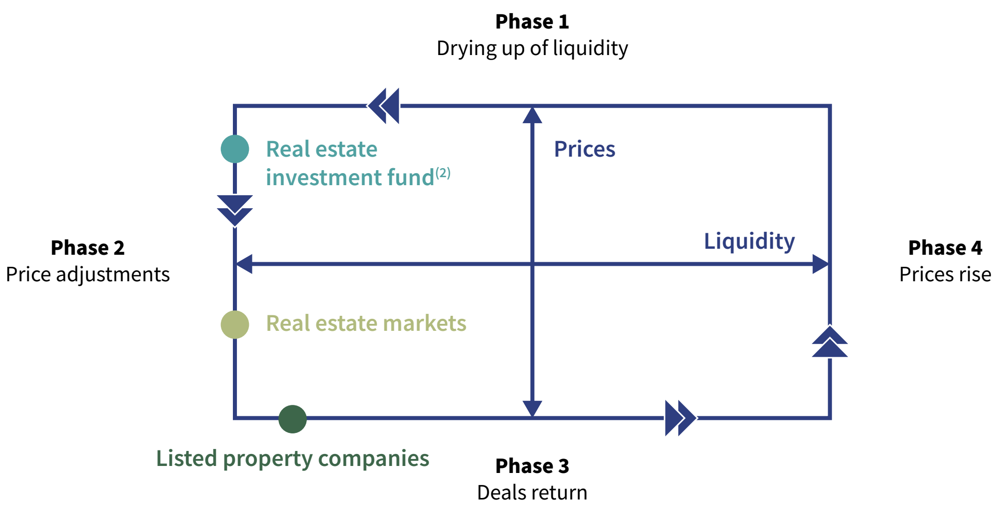
Liquidity crisis and price adjustments, what's the current state of real estate markets?

Paul Reuge
Fund Manager of
R-co Thematic Real Estate

Each time the cycle turns, for whatever reason, what follows is a rather similar sequence that can be broken down into four phases.

The first is a drying up of liquidity as buyers and sellers fail to agree on a price due to a shift in the paradigm (in the present case, rising interest rates). Next comes the actual decline in prices (phase 2) until a new equilibrium point is reached that brings buyers back (phase 3), followed by the start of a new upward cycle (phase 4). The speed of adjustments depends on the type of vehicle used to invest in real estate. Naturally, the more liquidity there is, the faster the adjustment. That's why listed property companies were the first to be sanctioned by the markets in 2022 via the sector's significant correction (-37.57%[1]). Liquidity didn't begin to dry up on the real estate markets until the second half of 2022. Real estate investment fund[2], meanwhile, saw their inflows adjust between six months and one year after the start of the crisis (in the first half of 2023).

The four phases of a cycle turnaround



Source: Rothschild & Co Asset Management, November 2023.

(1) Source: Institut de l'Epargne Immobilière et Foncière (IEIF) - Euro Zone (net dividend reinvested) - full-year performance 2022.
(2) unlisted.

Past performance is not indicative of future performance.

An analysis of the two previous major real estate crises (in 1990 and 2008) shows that, on average, property companies begin their correction, and then rebound, one or two half-years before real estate markets do. In other words, if we assume that the real estate markets will bottom out in 2024, listed property companies should be close to a rally.

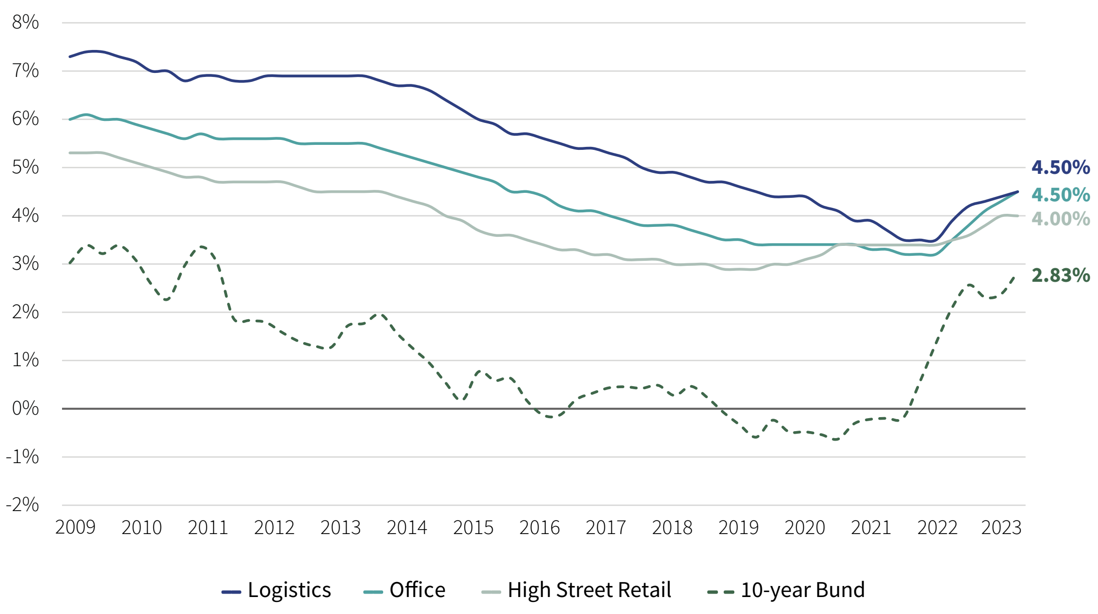
	Listed property cos.		Real estate markets		Real estate investment funds	
	Peak	Trough	Peak	Trough	Peak	Trough
Global Financial Crisis (2008)	Mar. 2007	Mar. 2009	Q1 2008	Q4 2009	Aug. 2008	Mar. 2009
Lag			~ +12 mths	~ +8 mths	~ +18 mths	-
1990 crisis	Dec. 90	~ 1995	Q1 1991	1996	Dec. 92	1997
Lag			+ 3 mths	~ +12 mths	~+ 24 mths	~ +24 mths
Current crisis	Dec. 2021	[Mar. 23- Oct 23]	Q3 2022	Estimated H1 2024	Q2 2023	?
Lag			~ +7/8 mths	~ +7/8 mths	+ 15 mths	

Sources : Epra, Immostat, BNP Real Estate, IEIF, Rothschild & Co Asset Management, november 2023.

2024: the year that real estate bottoms out?

The average increase of yields by 100 to 150 basis points since the start of monetary tightening[3] was not enough to restore the complete risk premium of the previous decade. However, that was in an inflation-free world. The additional return that buyers can target, if rates do not decline (under a "higher-for longer" scenario) would therefore come from the inflation captured in rents:

Average prime yields in Europe[1]



Source: BNP Paribas Real Estate Research, October 2023.

(1) Based on 16 cities: Amsterdam, Berlin, Brussels, London, Paris, Dublin, Frankfurt, Hamburg, Lisbon, Luxembourg, Madrid, Milan, Munich, Prague, Vienna and Warsaw.

(3) Source: Bloomberg, 31/10/2023.

Past performance is not indicative of future performance. The above information does not constitute investment advice or a recommendation.

So much of the adjustment to yields has already occurred, and the resiliency of rental markets (depending on the types of assets and location) has made it possible to limit the overall impact on the decline of market values. These have corrected since the market peak on average by -10% to -20%[4]. Real estate brokers are thus expecting the decline to slow and to truly bottom out next year. The still significant discount on listed property companies (above 40%[4]) has provided additional room for depreciation, except in the case of logistics, where valuations are skewed by major development projects:

	Average value adjustment of prime asset between H1 2022 and H1 2023.	**Estimated overall adjustment**	**Implicite value decline priced** by the stock market since the peak
Asset class			
Offices	-15 %	[-20 % ; -25 %]	**-30 %**
Shopping centers[1]	-15 %	[-15 % ; -20 %]	**-25 %**
Logistics	-20 %	[-20 % ; -25 %]	**-10 %**
Healthcare	[-5 % ; -105 %]	[-10 % ; -15 %]	**-20 %**
German residential	-10 %	[-15 % ; -20 %]	**-30 %**

Source: Rothschild & Co Asset Management, CBRE, JLL, Companies - November 2023.

(1) Average adjustment of premium asset values between H2 2019 and H1 2023

17 consecutive months of extreme discount: a new record!

Listed real estate has been trading at extreme discounts (of between 40% and 45%) since June 2022[4]. This is the first time since the 1990s that we have experienced such a long phase of devaluation without a significant uptick. The constant postponement of the pivot (i.e., the end of monetary tightening) and the US regional banking crisis are why investors have waited so long to return to listed real estate. Property allocations in institutional portfolios are at a low[5].

Has the sector gotten through the worst of it?

In light of the above, there is reason to hope that this is so, barring a new crisis that might have (indirect) repercussions on property financing. In a less pessimistic scenario, the long maturity of companies' liabilities (6 years on average), the available liquidity and the above-average quality of assets have enabled disposal programmes to continue in the current context (Unibail-Rodamco-Westfield has completed 90% of its €4 billion European disposal plan initiated in 2021, Covivio has sold €718 million since the start of the year, with a target of €1.5 billion by the end of 2024, Gecina €1.1 billion, etc.[6]) continue to provide strong security.

Completed writing on 7 November 2023

(4) Sources: Companies (last reported net asset value) - Bloomberg 31/10/2023.
(5) Source: Exane, October 2023.
(6) Sources: Companies, October 2023.

Performance	Since the beginning for the year	2022	2021	2020	2019	2018	Volatility 1 year
R-co Thematic Real Estate C EUR	-1.0 %	-23.5 %	6.6 %	-22.8 %	21.6 %	-7.5 %	20.9 %
IEIF Eurozone net coupons reinvested(1)	-4.8 %	-34.6 %	2.1 %	-10.7 %	21.5 %	-9.9 %	22.3 %

(1) Benchmark index
Sources: Rothschild & Co Asset Management, 28/04/2023.

Risque SRI : 5/7
The synthetic risk indicator makes it possible to assess the level of risk of this product compared to others. It indicates the probability for this product to record losses in the event of market movements or our inability to pay you. We have classified this product in risk class 5 out of 7, which is a medium to high risk class and mainly reflects its positioning on the French real estate and European property company stock market of shares of French companies. In other words, the potential losses linked to the future results of the product are between medium and high and, if market conditions were to deteriorate, our ability to pay you would likely be affected. The risk indicator assumes that you hold the product for 5 years; if you don't, the actual risk may be very different, and you may get less in return. Other important risk factors not adequately taken into account by the indicator: credit risk, impact of techniques such as derivatives. This product does not provide market protection or a capital guarantee, you could lose all or part of your investment. For more information on the risks, please refer to the prospectus of the UCI.

Main risks: risk of capital loss, discretionary management risk, market risk, sector risk, risk linked to extra-financial criteria (ESG), sustainability risk, credit risk, interest rate risk, currency risk, risk linked to the use of derivatives.

Before any investment, it is imperative to carefully read the PRIIPS DIC and the prospectus of the UCI, and more particularly its section relating to risks available on the Rothschild & Co Asset Management website: am.eu.rothschildandco.com

Disclaimer

Advertising communication. 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.

R-co Thematic Real Estate is a sub-fund of the French Société d'Investissement à Capital Variable "R-Co", whose registered office is at 29, avenue de Messine - 75008 Paris, registered under number 844 443 390 RCS PARIS. The information does not presume the suitability of the UCI presented to the profile and experience of each individual investor. 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 9 European countries, we manage more than 27 billion euros and employ nearly 160 people. More information at: www.am.eu.rothschildandco.com

Join us on
LinkedIn

For further information
am.eu.rothschildandco.com

Rothschild & Co
Asset Management