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# GRI Europe Summit 2013

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## *European Real Estate Investment & Development*

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*Collaborated summaries by GRI & students of the ESSEC Business School,  
Real Estate and Sustainable Development Chair -  
RICS Real Estate Track*

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**Ingrid Nappi-Choulet**, Professor and Head of the Real Estate and Sustainable Development Chair

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Over the past 16 years, the **GRI Europe Summit** has become *the* most important reunion of the industry's top leadership across Europe. Every year, over four hundred real estate investors, developers and lenders gather in Paris to discuss what the future holds for European real estate.

Find the answers to the most crucial issues in European Real Estate from a selection of 32 closed-door discussions covering the 4 asset classes; the strongest and emerging markets in Europe, Asia and America; and the financial strategies born out of last year.

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## 1. UNIVERSAL EUROPE – YIELD HUNDERS FROM ACROSS THE GLOBE?

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- Europe cannot be seen as a whole: The UK, French & Southern market are not on the same level on the investor wish-list.
- The distressed game in Europe is being led by opportunistic American investors. Yet European firms with good asset management skills are finding a way onto the playground: buying assets off them or putting expertise and a bit of cash into a joint venture with a foreign investor.
- Raising funds is easier: A lot of banks accepted to provide funds this year. If difficult assets are difficult to refinance, we can say today that there is enough liquidity. Money is raised but not invested because the available assets are not competitive enough in terms of yields.
- Local network: to successfully manage assets or to take good investment decisions, it should be a priority to have and settle local teams who know the market well.
- Meanwhile, the European CMBS industry has been tackling the structural issues that caused such problems for investors post-crisis, such as transparency and payment priority. Some believe that commercial mortgage-backed securities are the “only credible solution” to re-financing Europe’s Everest of real estate debt. “There are investors out there who want to own debt, and want to own it in note or bond form, not as loans.”
- France seems to be on a negative trend whereas all key indicators are on the green for the UK.
- Lack of core product: In the current risk averse climate, real estate investors and lenders have gravitated towards the security of income and capital preservation. Inconveniently, this strategy is getting harder to implement at present due to both limited availability of core products for sale and the scale/transaction size of many of such assets.
- Growing gap between core and other assets: Institutional investors’ aversion to risk is manifest in a near-obsession with core real estate assets. This has resulted in levels of pricing, and hence yields, which make sense principally by comparison with uniquely low interest rates that, from these levels, have only one way to go. Yet the widespread neglect of anything seen as core-plus has resulted in a vast sea of real estate orphans, of which at least a worthwhile proportion offer interesting potential at appealing prices, in search of acquirers.

### **Conclusion:**

Europe, a two-tier market.

## 2. THE EQUITY-DEBT BALANCE – IS THERE ONE PERFECT FORMULA?

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- Last year, the group discussing this topic led a core actor to state that he was no friend of the opportunistic investor sitting next to him. That same core investor is again part of the Co-Chair group this year, but he declines to renew his statement!
- A global investment manager observes that over the last year, the situation has changed: the market is flooded with capital. However, unlike the situation during the pre-crisis bubble when an investor let the bankers fight to be the chosen lender, now a long term and high quality relationship with the lender is what needs to be developed.
- It seems to be unrealistic now to hope for a maximum lending amount. Investors like them need to put at least 40% - 50% of equity in their deals today.
- A retail operator asks the financial actors how they link the debt/equity formula with the quality of the assets, locations and operators, since development investments requiring leverage have to be seen in the long-term.
- One of the Lenders in the room replies that no perfect formula exists and that the equity-debt balance is defined almost case by case depending on the kind of debt looked for (junior/senior/mezzanine) and the analysis of the projects financed (geographic coverage, underlying assets). The suitability and trust of the proposed partner is also highly important.
- Another lender observes that in France the prices of high quality real estate assets have not yet adjusted. The economic “stories” of such assets do not make sense. The funding decision often answers the question: can we seize the risk? BERLIN HYP/LBB does not take entrepreneurs’ risks.
- One participant is an active lender in France, the UK and Germany. They are seeing a lot of new players on the debt fund side appearing in the British market,.
- A multinational professional services firm points out that insurance companies are one of these new players but that they take low risks (three companies were mentioned by way of example). Debt funds are not being seen as much as was expected 2 years ago.
- A privately owned property company notes that debt is very difficult to obtain in CEE countries such as Hungary or Poland.
- The USA is 10-15 years ahead of continental Europe in terms of the debt market. Proposed regulations were discouraged by Wall Street, unlike in the European Union.

### **Conclusion:**

The group concluded that no perfect formula exists and that nowadays banks are more providers of debt than providers of deal flows due to the low interest rates.

### 3. RETAIL VISION: CITY CENTERS OR GREEN FIELDS?

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#### Legislation:

- Has tended to favour shopping centres in outskirts and suburban areas.
- A Turkey based investor takes France as an example of the European trend of satellite cities protecting historical city centres, partly by developing retail.
- Two European investors in the room note a shift in this approach, with shopping centres and retailers now brought back into the heart of cities (i.e.: Beaugrenelle in Paris; Stuttgart clearing out old railway space for new developments).
- A developer raises the issue with the “system”: for retail, big cities are harder to enter than smaller towns, which results in retail being implanted in the wrong places, away from consumers.
- The absence of legislation, however, can also be detrimental if it allows planning to be driven by private developers. This also results in retail being built in the wrong place (i.e. Budapest in CEE).

#### City characteristics:

- A German retail property specialist underlines the importance of the varied historical structures of different cities, which dictate their respective readiness for retail and shopping centres.
- An investor confirms the importance of a city’s age: younger cities in their development process, integrate retail and shopping centres.
- One European investor adds that an important factor for retail presence within city centres is the city’s wealth. Wealthy cities tend to restrict the arrival of retail and shopping centres, pushing them out to the suburbs.

#### E-commerce: What effect on location and nature of retail schemes?

- Even though e-commerce is becoming effective (gaining market share), there is still an incentive to go to retail stores. ECE stresses that the need for physical shops is different, but still present as a support of online retail.
- Another investor adds that physical shops will have to be all the more convenient and close to consumers, given the increasing ease of online shopping.
- A European investor explains that Internet retail reduces the propensity to “impulse-buy”. There is therefore a need to bring customers into stores to benefit from this type of spending. A prime example of this is the success of “Click and Collect” schemes (i.e. John Lewis).
- Another developer makes the case for a balance between e-retail and physical stores as necessary for retailers, underlining the “murderous competition” facing pure providers of Internet retail.

#### Concluding remarks:

- **“Not city centre versus green fields, but which city centre and which green field”**
- One of the asset managers in the room explains that green field locations work if they meet a demand (don’t need to be fancy). City centre locations are also great if they are of high quality.
- Consumer preferences and habits – features that vary from city to city - are crucial when it comes to deciding on location.



#### 4. RE-FINANCING: LOTS OF MEZZ, BUT WHERE DOES THE SENIOR COME FROM?

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Today's environment is very mezz-friendly because the unleveraged instruments entice investors. Mezzanine debt currently fills the financing gap in the range of 60% to 75% loan-to-values between the senior debts and the equity.

##### **Is there really a difference between the mezz loaners and the senior loaners?**

- They look alike in many ways:
  - looking at the same deals
  - having a growing appetite for bigger tickets
- Yet the pricing of the debts is different and the loan-to-value differs (around 50% for senior, 70% for mezzanine)
- In a low interest rates environment, safe senior debt on prime properties is compromised, as lenders shorten their terms in order to foresee the rise of interest rates in the future. Banks, like one European bank in the room, are returning to their local markets, chasing rare and very prime deals. Major differences between banks come from the duration proposed and their aggressive LTV that can go up to 70%.

##### **What is the trend nowadays?**

- Today, the best risk adjusted returns come from mezzanine loans employed to recapitalize high-quality assets.
  - Enjoy security derived from top quality buildings with reliable tenants and low vacancy rate
  - Most attractive yield spreads relative to their LTV positions
- A fund business and an investment manager agree that significant segments of RE assets are deemed un-fundable by senior lenders: developments & properties in Southern countries, as well as health care. Investment banks are looking at these segments but it won't be long-term and the expectation is for debt returns, not equity returns.
- The investment manager points out that a majority of investors are shying away from loaning to portfolio. They prefer to cherry-pick very prime assets.
- Who are the new borrowers? Many asset managers have successfully raised equity for debt funds covering a wide range of risk profiles. Their number is limited, as middle-eastern and sovereign funds set foot in Europe with heaps of equity cash.

##### **Conclusion:**

Mezz and senior lenders should prevail hand in hand, accelerating the decline of CMBS. The nature of the market is leading to a standardization of the legal process for the two types of loans. Indeed, in the wake of the crisis, investors, fund managers and bankers are more and more inclined to deal with each other.

## 5. PARIS ET LE DÉSERT FRANÇAIS

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### Introduction:

En référence à l'ouvrage de Jean-François Gravier paru en 1947 sur l'aménagement du territoire français et la polarisation parisienne, suite auquel la DATAR (1954) et l'agrément (1955) ont été mis en place dans le cadre des politiques d'aménagement du territoire, la conférence pose la question de l'actualité de la concentration du marché immobilier à Paris.

- Peu connus des grands investisseurs car **épars et nombreux, les marchés régionaux** français sont néanmoins **très actifs** :
  - Marché épars : rapport de 1 à 10 observé entre la demande placée de Paris et celle de Lyon – de même pour l'investissement.
  - Marché de l'investissement : 3 milliards d'euros en 2012 ; soit près de 20% du total des investissements en France.
  - Marché locatif : 1,2 millions de m<sup>2</sup> placés en 2012 ; soit 30% de la demande placée française totale.
- Les proportions entre les différentes typologies d'actifs dans chaque ville, en nombre d'actifs et non en valeur, sont les mêmes sur l'ensemble du territoire. La logistique, le retail et le bureau liquide ont leur place sur le marché régional.
- Les grands investisseurs nationaux et internationaux s'intéressent peu aux marchés régionaux pour deux raisons :
  - Un montant du **ticket d'entrée trop bas** (en dessous de 20 millions d'euros) : l'impact marginal du temps consacré à la due diligence et les coûts d'asset management deviennent trop importants.
  - Un **marché peu profond et peu liquide** pour les gros actifs : les actifs d'une valeur supérieure à 20 millions d'euros fournissent une trop grosse exposition sur la zone régionale d'investissement.
- Les grands investisseurs ont une stratégie sécurisée. Ils privilégient ainsi :
  - 4,25 %-5 % de **rendement** à Paris QCA, plutôt que 5,7 %-8 % à Lyon.
  - Les marchés plus profonds des villes secondaires des **pays décentralisés** (ex : Allemagne fédérale).
- Le marché immobilier de province est l'apanage :
  - Des **acteurs locaux** (banques, investisseurs, etc) qui ont une meilleure compréhension des enjeux de ces marchés secondaires.
  - Des **SCPI**, qui connaissent historiquement les marchés et drainent l'épargne locale.

### Conclusion:

Il existe bien deux marchés distincts en France, n'interagissant pas, et répondant à deux business models différents. Le marché régional français, moins cyclique, n'est pas le terrain des investisseurs internationaux mais jouit d'un dynamisme local.

## 6. NORDIC DREAM: REFRESHINGLY STABLE OR LACKING OPPORTUNITY?

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- Three key points make the Nordic countries an easy place to invest in: transparent markets, secure legal and political system, currency proved not to be an issue (because hedge used to be cheap).
- Norway is purely an oil state: the lack of diversification in the industry makes it a risky place to invest in.
- As for Denmark, it is a slippery slope with internal problems and some banks not lending anymore.
- Of course, there are pockets of opportunities in these regions, as with every market, but when investing, it is better to have the macro economics working on your side.

On the other hand, Sweden and Finland are very stable countries with a diversified and high-end industry fabric. However, the risk on private finances means it is not recommended to buy shopping centers for instance.

### Who are the buyers?

- The most active are local institutions that have the ability to buy quickly and do not need financing. Besides, most foreign investors only have access to the deals pipeline, after locals have been consulted and rejected the deal. This is why setting up a team on the ground or partnering up with local teams is of prime importance to gain access to network and quality information. Some investors who exited the market would come back should new opportunities arise. Otherwise, they prefer a more secure and simple allocation to other European countries.
- Availability of financing: Overall the market has improved with banks now keen to gain market shares and to offer pretty good conditions to their clients.

### Who are the lenders?

- For foreign lenders, it is a trade-off between the Nordics and other regions; GE for instance prefers to get exposure on senior tranches in the UK which are better paid. As for local lenders, they are now in better shape, like the Swedish banking system that does not currently need foreign money.
- Bonds are easy to obtain: if they prove to be good from a short term approach, their being cheap must be a warning sign for the market place. Bonds still have limited leeway because almost no real estate company is graded Investment Grade. Preferred shares is then more often considered.
- To tackle the crisis, there are two options: either the Japanese way where nobody gets poor but the country has to cope with a 30 year period of no growth; or the adjustment way where some people get poor but the country will return to growth.
- General consideration: yields will eventually go down in pure B locations for grade A buildings. Indeed, real estate exposure will have to rise from 5% to 10% in the next years, which means the ring of investment will have to expand.

### Conclusion:

The Nordics are a region where cross-border purchases are quite rare for diverse reasons and one that needs a very local approach to pick the right investment. They are very stable and show some nice opportunities with good risk return.

## 7. PRIVATE EQUITY: TOO MUCH CAPITAL CHASING TO FEW DEALS?

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### Where does capital come from? How much of it? Where to?

- A European fund manager sees no fundamental change in the main actors: traditional institutional investors (e.g. public or corporate pension funds), European capital and some high net worth investors. A global asset manager adds that new capital is coming in from SWFs and Asian investors.
- This capital is targeting real estate as a “real” asset class (no longer simply as an “alternative” class). This shift, over the past 5 years, has been occurring as investors are increasingly comfortable with investing in real estate. Investments in real estate should continue to increase during the next 10 years.
- Europe is becoming an attractive equity market: €35M out of N. American funds, €40M into European equity funds over the past months. This is happening as confidence is rising over the Euro and EU debt situation. A Pan-European investment manager sums this up by noting that the necessity of a “risk premium” for investing in Europe over N. America is slowly changing.
- As one asset manager points out, Europe is a source of relative value (compared to the US and Asia) as it is in a deleveraging cycle. Europe is “still in the early innings” and must be in it for the long term (5-6 years).
- They also note that credit hedge funds are currently entering the markets (US for now) to buy out distressed real estate assets. This could spread to British, Irish and Spanish markets.

### Characteristics of this capital:

- Two of the participants agree that, if there is more capital entering Europe, US LP's are now a lot more discretionary and selective in their approach. LP's now want relationships in Europe to work with, and to try new models (vs. Investment Banking model).
- One investment manager argues that it is not the amount of capital that is a constraint, but the infrastructure needed to deploy this capital. In addition, the EU market is rather opaque, requiring relationships and trust; need for a long term presence.
- Some feel that LPs now expect a hands-on and operational experience with fund managers.

### Geographical preference of capital:

- France and the UK are obvious targets. Germany is perfect to enter for yield investors, but difficult for value add returns. Expect a risk premium from investment in Spain.
- A European manager no longer sees CEE as a single market. It is now more ‘bifurcated’ with investment potential in Poland and the Czech Republic on one side, and frozen markets such as Bulgaria on the other.
- There is a bigger interest in Turkey than in Russia (the 2 largest emerging markets), where there are already plenty of domestic investors.

### Concluding Question:

Too much capital? Mixed views: A global asset manager argues that there is *a/ways* too much capital whilst 3 investors in the room are less categorical.

## 8. ORIGINATING & PROVIDING DEBT – WHO WILL TAKE THE LIMELIGHT?

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- A debt provider launched the discussion by observing that a lot of liquidity exists in the senior tranche. It benefits from the fact that credit spreads are coming down. More generally, the deals flow is picking up in Europe and there is a move from borrowers wanting more leverage. 60% lending proportion seems to be the new 50% for banks in senior.
- One UK bank comments that the total amount of lending in 2013 should reach € 5 to 7 bn.
- A global investor points out that in Germany the competition is tough since the market is dominated by German banks. They view the UK and Germany as key markets. France is slower to take off and Spain is becoming an interesting area. A bank adds that they are today actively and selectively refinancing in Spain. A UK asset manager agrees that Spain is an interesting market.
- A European manager states that if banks are actively lending again, other actors like mortgage REITs or mezzanine funds are to be taken into account. Junior debt funds need to be differentiated from debt funds seeking yield through allocations. For instance, an alternative debt manager is currently offering 15% flat, with a dedicated team on this field and now owning a first mover's advantage. The European manager's bet is that they will take the limelight.
- One debt provider believes that generally speaking, opportunistic actors have to be nimble and that the limelight will shine on mezzanine funds and insurance companies. Banks are going to play the biggest role in the debt market. He forecasts a situation where non banking actors will represent some 30% of the market.
- A multi-national professional services firm notices that in the USA the proportion of debt market funded by insurance companies (including pension funds) amounts to 20%. A global lender adds that the CMBS market is more mature and diversified overseas than in Europe. He thinks that it will come in time, to the UK.
- Outside multifamily offices, some participants do not see other actors for CMBS.
- A wealth management company reminds the group that the issue with insurance companies is that they benchmark the real estate debt against other asset classes. If corporate bond values surge, they will move out the RE debt market to re-enter the corporate bonds market.
- One asset manager observes that more and more banks are looking at structured opportunities on core/core+ assets (for instance shorter leases on good quality locations). A European bank in the group also expresses their willingness to look at well located regional portfolios in the hunt for volume.

### **Conclusion:**

Another bank concludes that in any case banks do not want to be seen to be the first mover.

## 9. MED SUNBELT – ONLY FOR THE HOLIDAYS OR GREAT HUNTING GROUNDS?

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### Introduction:

2 years ago, talking about southern Europe was something of a taboo. Today investors are beginning to think of these countries as potential targets.

### Spain

- A bank in the room observes that there are as many markets as cities in Spain. Indeed, Real Estate in Andalusia has nothing to do with Real Estate in Barcelona or Madrid.
- Administration issues: there is a lack of transparency in Spain which lengthens the duration of the deals
- Funding hard to find: very difficult to get financing for investment in Spain, taking at least 2/3 years to raise capital
- Resi construction remains paralyzed due to continuing house price fall, lack of transactions, & loan constraints.
- The issues affecting commercial properties are similar to those affecting housing (lack of financing, low demand, oversupply). In the absence of any short-term economic improvement, demand for new-build office properties will continue to decrease; this will in turn affect construction activity in 2013 (-20%) and 2014 (-11%).
- The fundamentals are simply not there. 36% of unemployment, the population itself has to go back to work, the country cannot thrive with only foreign investors. Investors are looking for prosperous areas where the economy is thriving and for as long as this is not the case in Spain, Real Estate investing will remain at the same point.
- The economic cycle is anticipated to return to moderate growth by 2015. At that point, occupier markets will start recovering, with a likely impact on rents and capital values.
- With the increasing amount of defaulted loans, resulting in real estate foreclosures or loans in danger of defaulting, the non-performing loan market has intensified and created opportunities for investors to benefit from. Banks left with real estate assets and non-performing loans can release them in the market one-by-one, via direct commercialisation, or in portfolios sold at a discount to entities such as value-added funds.
- Prices are not yet at the level they should be. Where there is oversupply, as is the case for the residential market in Spain, prices have to fall. There are opportunities, but not at the right price.

### Italy

- Where Spain at least seems to be on the right track to recovery, we don't really know what is happening in Italy.
- 5-star Hotels are performing well: yields are higher than 10% compared with 7% in Spain. The market is much more difficult to enter but once you have good connections, yields are definitely higher.

### Portugal

- It will take some time before investors consider Portugal in the top of their Mediterranean investments. There is no comparison to set up prices; the Real Estate market is not mature here.

### Greece

- People who own property have hard a time collecting their rents.
- Prime beach property and prime Island residential are the only assets not facing difficulties.

### Conclusion:

The crucial point is to know what is coming on the lending side; the market cannot survive on equity-only investors.

## 10.24/7 CITIES – OFFICE BEATS RESI OR OFFICE-TO-RESI?

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- The question is put forward, 'What does it mean for a City to be 24/7?'
- "24 hours a day, 7 days a week". One of the obvious ways to look at it is to consider a City where people can find whatever they need at any time. Hence it refers to megacities such as London or Paris.
- The idea is not a new phenomenon; major centers have always been active day and night, and as people keep moving into these areas, the concentration is not going to stop.
- Another member suggests that 24/7 City can also refer to the tomorrow's city, and other participants encourage this idea where the focus shifts from the place to the human being: a place where people can spend their entire day. Such a place needs to provide everything at walking distance.
- The understanding of the concept of 24/7 City is crucial for the real estate sector, in which lot of investors have a long-term time horizon. What are the trends? What kinds of assets will be needed in the coming decades?
- Most of the participants agree that office assets are more interesting than residential assets. The former provide :
  - Higher yields
  - Easier management
  - Better liquidity
  - Fewer regulatory constraints
- Which factors can favour "office-to-resi"?
  - Many office assets do not achieve the expected yield
  - Office assets built in the 1960's and 1970's are now obsolete and their Estimated Rental Values (ERV) are plummeting
  - High costs or impossibility of restructuring the asset
  - Long-term vacancy issues
- Portfolio of office assets VS portfolio of residential assets:

In most Western countries, many political measures have been adopted in order to promote the creation of affordable residential assets. Such policies have a negative impact on the IRR and on the ROI.
- The "office-to-resi" conversion is often a default choice made to deal with a vacant building.
  - Conversion works are tricky and costly because their designs are fundamentally different
  - In Geneva, the "office-to-resi" trend is linked to the local market history. For years, there was no vacancy for either office or residential assets. Today their respective average rates of vacancy are 3% and 1%. It remains for now, a niche
  - Some "office-to-resi" conversions have been made in London but the ROI and IRR were mostly interesting because it did not involve social housing (It was restructuring works that must not affect the façade in order to avoid any compulsory ratio of social housing).

### Conclusion:

The "office-to-resi" conversion is not a panacea. It might be a case-by-case solution but the aim is less to make profit, more about minimising the loss. Even if the attractiveness of the office assets is decreasing, only few "office-to-resi" conversions are to be expected.

## 11. LENDING: LE SALUT VIENDRA-T-IL DES BANQUES OU DES AUTRES ACTEURS?

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### Introduction:

Supposant un déficit d'offre de crédit, la conférence pose la question de l'apport des « nouveaux acteurs » (IE: compagnies d'assurance, les fonds de dette, etc.) dans le financement de l'investissement.

- Les « nouveaux acteurs » sont apparus sur le marché du financement pour deux raisons : **diversifier** les placements, et palier la **baisse de rendement des titres d'état** par un produit immobilier sécurisé et rentable.
- Bien que n'apportant pas d'avantage concurrentiel aux assureurs, la **réglementation** Solvency II a favorisé le développement des fonds de dette tandis que le durcissement de la réglementation Bâle III a davantage freiné l'action des banques. On ne peut néanmoins pas parler « d'effet d'aubaine ».
- Les banques et les nouveaux entrants financent majoritairement le même type de projets (entre 10 millions et 100 millions d'euros, pour des actifs core), ce qui ne fait qu'**accentuer la concurrence** et non diversifier le type d'actifs (très sécurisés) financés.
- Les banques, comme les nouveaux entrants, ne mènent pas le marché mais fonctionnent comme un **accélérateur pour l'equity** disponible.
- La réglementation interne des fournisseurs de crédit concernant les taux, n'est pas en phase avec les TRI cibles des investisseurs; ainsi, les acteurs n'arrivent à se rencontrer que sur des actifs *Core*. L'équilibre de **répartition du risque entre investisseur et prêteurs** n'est pas trouvé pour les actifs spéculatifs.
- Le financement des actifs **Core + et value-added** est le plus problématique car prêteurs et investisseurs ne savent s'accorder que sur deux scénarios : *opportunistic* et *Core*. Ces actifs **tombent très vite dans la catégorie de financement à des taux opportunistes** car il n'existe pas de taux de financement intermédiaire.

### Conclusion:

Le terme de « salut » semble abusif pour un marché du financement sur lequel l'*equity* est présente (ex : les prêts ont atteints leur niveau de 2004-2005). La question est davantage celle de la stratégie de financement puisque seul le marché du financement *Core* fonctionne. Cette situation peut-elle aboutir à une bulle sur les actifs sécurisés ?



## 12. ASIA PACIFIC CAPITAL: A NEW FORCE OR JUST THE ODD DEAL?

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- The world's savings are experiencing a massive change with Asia's rise and Chinese capital now flocking to Europe. South Korea is also more and more active in the market.
- Is this situation likely to continue? Although they could break deals with better returns in Asia, Asian investors are active in Europe because they are seeking diversification and they want to export capital to other countries.
- Asian investors can be divided into two groups:

Those who have already set up an office in London and will be likely to do deals quickly

Those who have not set up in London and therefore need more time to trust their partner and see the investment through. Trust is of prime importance in Asian culture and capital only follows trusted partners.

- Asian investors, particularly high net-worth individuals are largely focused on London which is the most liquid and mark-to-market place. London is also a good way to invest in education: an apartment in London is an entry fee for the children to go to school in the UK.
  - Social concerns can be raised when considering the rising stock of empty flats in the nicest areas of Central London. Some investments in the UK outside London should be mentioned, like in Manchester or the Tesco portfolio.
- Asian investors are also now seeking to expand to the German market and in a certain measure to Paris. We also spotted an ongoing trend from Asians to go and invest in Portugal, the gateway to cheap passports.
- Some cultural risk might arise as the Chinese always rank themselves as number 1 culturally and don't construct relationships with a partner in the same way a European does. Hence some difficulty when they don't want to share the profit with their European counterparts. The best way to thwart this difficulty is to build trust over the years and more importantly, to have very good connectivity with the local government in China.
- Asians have become active buyers and some are now entering the market as developers. For instance, one large Chinese developer is planning to carry out 20% of its operations out of China in order to widen its geographic exposure. Yet, they will focus on the areas where Chinese emigrants are living.
- One participant reminds us that the Germans are still the biggest investors in London. Asians may be gaining shares but they are just a new group of investors.

### **Conclusion:**

Asia Pacific capital is massively flocking to Europe and the trend is likely to continue in the coming years, in line with this region's growth. The capital comes from large Asian institutions or wealthy individuals. Most of the investments are still targeting London (60% of the money coming from outside of Europe goes to London) but will soon target other pockets of opportunities, for instance Germany. The market needs to adapt to accommodate this new type of investor.

### 13. "PRIME " CONTRE "NON-PRIME" - L'ARBRE QUI CACHE LA FORÊT OU LE SEUL ARBRE VALABLE ?

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- De plus en plus rares et attirant de plus en plus la concurrence, les investisseurs recherchant un minimum de risque ne peuvent plus se concentrer uniquement sur le prime. Ce contexte réduit encore plus la création de valeur possible entre l'achat et la revente de l'actif.

#### Distinguer « *Prime* » et « *Non-Prime* »:

- Définition du *prime*: Localisation, localisation, localisation ! Cela lui confère son caractère exceptionnel. Ce qu'il est ou ce qui est dedans est secondaire puisque modifiable.
- Définition du «*Non-prime*» : Beaux immeubles de qualité, ayant des locataires et des cash-flows fiables.
- 3 variables de distinction :
  - Localisation
  - qualité de l'immeuble
  - fiabilité du locataire.
- Mais selon un investisseur et gestionnaire européen en immobilier commercial, il faut également se pencher sur le marché et l'environnement de l'actif. Un conseiller en immobilier d'entreprise s'intéresse de même à la profondeur locative, la profondeur de marché et le caractère non reproductible du bien pour distinguer « *prime* » et « *non prime* ».

#### Quelle catégorie pour quelle stratégie ?

- Le « *prime* » ne porte pas toujours autant la création de valeur que le « *non prime* ». Un autre investisseur immobilier européen apporte l'exemple d'un centre commercial dans une zone quelque peu esseulée mais au potentiel certain avec une large zone de chalandise.
- Caractéristiques du « *prime* »:
  - Stabilité des valeurs
  - Bonne liquidité
  - Les actifs « *prime* » et « *non prime* » ne répondent pas aux mêmes stratégies de création de valeur des investisseurs et n'ont pas les mêmes volatilités.
- Stratégies défensives pour protéger le capital. Comme des individus fortunés de pays en développement qui souhaitent protéger leur argent de la fluctuation ou des fonds qui souhaitent se protéger des variations des taux. Très recherchés et donc très attendus, les deals « *prime* » se voient de loin et sont souvent remportés par les fonds institutionnels américains, allemands, français ou nordiques et les fonds souverains moyen-orientaux et norvégiens avec leurs immenses réserves de capitaux propres.
- Caractéristiques du « *non prime* »:
  - Potentiel de création de valeur
  - Moins liquide car très atypiques et très liés à un locataire
  - Taux d'intérêt et de capitalisation plus élevés
- Loin des étiquettes, des règles dans les banques et de celle présente dans la salle en particulier restent le cas par cas et la liquidité de l'actif.
- Le « *prime* » s'applique-t-il à tous les secteurs ? Les intervenants optaient par la négative. En effet, à même localisation, des bureaux et des boutiques ne sont pas obligatoirement tous les deux « *prime* ».
- « *Prime* » et « *non prime* » ne sont pas des qualificatifs intemporels. Un promoteur immobilier donne l'exemple d'un centre d'activité dynamique d'un centre-ville qui peut bouger avec l'élargissement de la ville ou la construction de transport.
- Dans un contexte de taux très bas qui vont inexorablement remonter, investir dans le « *non-prime* » peut être intéressant voire nécessaire. La hausse des taux va en effet faire remonter les taux de financement, même si les emprunts se font souvent à taux fixe ou couvert, et ralentir la baisse des taux de capitalisation.

## 14. FRANCE V ENGLAND: WHO ARE THE PLAYERS? WHAT ARE THE GOALS?

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- **The players involved share many similarities, being the 2 largest European markets**
  - An asset manager in the group, together with a large bank express that the UK has always been predominant and the most obvious market (more so than France). Partly due to the large amount of players in the UK market and the common language with North American investors.
  - France seen as a closed market: need the French way to enter, local partners. Also suffers, according to a wealth management firm, from its taxation policy, and slightly higher risk.
  - However, the French market is less transparent, whilst solid and liquid: offers interesting opportunities. In addition, Paris is biggest market in the Euro zone: currency advantage.
  - A commercial RE investor argues that local partners are also important in the UK. Overall, there are the same major players in both London and Paris. Yet a focus on London is undeniable.
  - One bank outlines the differences between the REIT vehicles and the French listed market, the former being more active and bullish. Different political approach: UK enhances the REIT status; France complicates it. Long way to go before French listed real estate companies catch up with UK counterparts.
  - Another lender reacts by reminding us that investment volumes in France reached €16-17bn last year, so France is “still here”, but concedes that taxation is an issue.
- **Problem of defining a “French REIT” - what are they?**
  - France’s regimen of SIICs uses the same basis as USA REITs. Foreign investors actually own a majority of SIIC capital, argues an investment manager.
  - According to a commercial RE investor in the room, the question brings up a common misunderstanding that there is a global REIT market. This is untrue, and no two national REIT legislations are the same.
  - An explanation for the lower visibility of French SIICs is the smaller stock market in France.
- **Looking at tenants**
  - One investor explains that high profile tenants now come from the media and tech industries (e.g. Google in London), whereas the finance sector is quiet.
  - Shortage of tenants, especially for prime schemes (Shard 90% vacant). Good location is key.
  - A lender disagrees with an asset manager and an investor on the fact that Paris has a more diversified tenant base; the asset manager arguing that tenants in the UK are actually more diverse.
  - A Bank believes retail tenants are more inclined to implement/test their first stores in London, over Paris
- **Why is the environment so different in France and England?**
  - Austerity in both countries, but very different approaches (UK: reduce government spending, France: increase taxes). Different “respect” for private sector.
  - An asset manager argues that French politics interfere more with the market, and that doing deals in France requires partners and links to administration, where the administrative burden in the UK is lighter.
  - A wealth management firm says that the French lease rigidity is detrimental to volume of business. UK fluidity: 200% more lease breaks than France in 2005.
  - Cultural difference: UK owners have a “Buy & Sell” culture meaning deal flow is higher than in France.

## 15. SMALL BANKS VERSUS BIG BANKS – WHO OFFERS BETTER VALUE?

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- The discussion opens by pointing out that “big banks” is a generic topic comprising large balance sheet investors as well as investment banks. Small and midsize banks therefore are the alternative investors.
- An alternative investor-lender estimates that among the alternative lenders, insurance companies’ capacities tend to reach € 8 to 9 bn. In the market in general, they see a larger flow of capital than a year ago: The number of transactions and opportunities has increased.
- A North American finance group observes that the mezzanine market has really changed for 2 years. It is split into two differentiating equity players, looking for double digit, and senior mezzanine operators which must look at single digit to get money.
- This year, one of the banks in the room has experienced a situation where they had no competitors to finance a building with a two year lease rest. They were surprised and have been able to get good rental conditions. A European bank explains that this example concerns a refurbishment within 2 years and not at the moment. It represents an increase of risk that could explain the under-rating of such an operation by traditional banks.
- A finance group believes that it’s all for London on the ‘private equity high yield debt funds’ front.
- From one bank’s point of view, Spain will present an opportunity at some point. The key is to have the ability and capacity to locally originate the amount they would like to finance. According to an institutional servicer, regulation and capital constraints tell the difference between banks in Europe.
- It is wrong to look at Madrid and Barcelona as one world. Building a potential for the future by investing in the wrong place is a risk. Madrid may illustrate this statement. A bank points out that resources are crucial. It wonders how alternative debt funds find the staff to build a platform to properly estimate the local risk.
- One European manager predicts that insurance companies will play in the long term. They are not competitive with banks in the short term, considering the possibility of not collecting on some periods.
- Another bank highlights the fact that the ‘life insurance’ population that was in its forties in the 90’s is now in its sixties: They do not have the same life expectancy which must have an impact on investments.

### **Conclusion:**

In the current undetermined period of time, both types of banks are needed: larger banks to go on larger tickets and smaller banks to pick off more alternative assets, be it for their locations or their natures.

## 16. GERMANY: THE ONE CONSTANT OR SLOWING GROWTH?

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### Introduction:

Germany registered the best economic performances in Europe during the crisis; it has a good economic framework and strong real estate fundamentals. However, German economy, as with the US economy, depends mainly on emerging countries and could become a lazy country in terms of supporting the growth with new policies.

- German residential market represents a stable environment thanks to the decentralized urbanism of the country. Nevertheless, Berlin is closed to a bubble territory.
- Investing in German core retail market, on a basis of a 4 - 5 years detention, is a good way to diversify your real estate activities.
- German logistics market is, and will, stay very active. The high returns attract foreign investors and funds, especially for development programs. However, logistics is a more risky asset in a decentralized country because of the numerous other competitive cities.
- Reasons to invest in long term core assets in Germany:
  - Stable economy / volumes / prices / incomes
  - Lower market price than Paris or London for similar assets
- Reasons to invest in value-added office assets in Germany :
  - Low interest rates
  - Presence of sellers
  - No transparent market (opportunities are sometimes hidden)
  - Good asset management can easily create value, by injecting CAPEX and thanks to the occupational traction
- The real estate actors fear a left shift during the next elections for tax reasons and possible rent cap.

### Conclusion:

- The real estate actors are positive about Germany in 2020. The country is seen to stay the 1<sup>st</sup> European economy. The real estate market would stay healthy, with good fundamentals, and should become even more professional.

## 17. LISTED CAPITAL OR PRIVATE EQUITY: STRUCTURAL CHANGE OR TEMPORARY SHIFT?

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- For external investors, assets in Europe - with the exception of GB, Germany, France and Switzerland - are illiquid. This lack of volatility is largely due to the absence of a unified European regulation for REITs. As a consequence, the real estate circle in Europe seems broken: an intense problem looking for a solution.
  - Legislation and a specific passport regime make it very complex for investors from outside the EU to bring their money into European investment structures.
  - One of the main challenges for the EU today is to unify its legislations.
- The legal framework is one thing but from an institutional investor's point of view the European listed sector is not able to offer prime retail assets. That is why the European market gathers only 3% of such investments whereas this figure reaches 17% for the US and 70% for the Asian region.
- Compared to the problems faced by the listed sector in Europe today, private equity seems to provide foreign investors an easier investment process. For a few years, markets in emerging countries like Russia experienced great success stories of private equity coming from the UK.
- The question is: are investment strategies identical for both listed capital and private equity? All participants agreed on the fact that these are two completely different industries evolving on separate investment bases. On the one hand private equity is about raising and managing funds with the acceptance of a high risk for a high expected return on a five-year plan. On the other hand the listed sector demands a lower return by taking a lower risk.
- One should not forget that some companies make the choice not to list because they do not want to see the market put a price on their assets. Private equity relies on an entrepreneur's way of thinking and dealing, while being listed is all about daily efficient communication to the markets and undertaking a complete evaluation every 3 months.
- Listed companies dispose of other tools to obtain high returns like aggregation, communication or industrial models. According to the attending REITs, the listed sector is a less crowded market and a safer business because companies need to weight at least 800mn and poses a smoothing portfolio in order to get investors interested. Private equity does not benefit from tax advantage as listed companies do, nor do they produce a day-to-day dividend. Furthermore, it takes 6 to 9 months for PE to raise money, where a listed company needs only 30 to 60 days to get the same amount.

### Conclusion:

As institutional investors are looking for liquidity and balance in easily changing the business model, transparency in Europe should be increased for the non-listed sector because it is the key to winning the trust of the markets. Transparency is all the more important for the listed sector as it gives access to corporate bonds that are considered by many as the future of investment strategies in the real estate business.

## 18. BUREAUX – MEILLEUR CHOIX OU LOYERS EN CHUTE?

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- Il y a 25 ans, les loyers des bureaux parisiens se négociaient jusqu'à 5000 Fr/m<sup>2</sup>/an. Aujourd'hui ils sont voisins de 750 €/m<sup>2</sup>/an. Les loyers parisiens ont donc stagné voire même diminué une fois l'inflation prise en compte. Les bureaux constituent-ils toujours un investissement judicieux ?
  - Les loyers faciaux se maintiennent et ont résisté à la crise mais les loyers économiques ont fortement chuté avec notamment l'allongement des durées franchisées. L'écart avec le facial peut atteindre 250 bps et s'explique par les nombreuses renégociations de bail à la baisse (loyers et surfaces),
  - Un marché français à deux vitesses :
    - Paris, première place européenne d'investissement,
    - L'Île-de-France et la province, qui comptent de plus en plus d'actifs illiquides, vacants et avec souvent des loyers en baisse. En particulier à la Défense où la demande placée a chuté d'un quart sur le premier semestre 2013.
- Quelle est l'attractivité du marché des bureaux français ?
  - Pour un investisseur immobilier, la France souffre d'une mauvaise image internationale. Les investisseurs sont en effet effrayés par la maladroite communication gouvernementale. La France est par ailleurs souvent classée parmi l'Europe du Sud.
  - Pour un autre investisseur immobilier, le marché français ne propose pas les meilleurs produits. Leurs investissements se portent plutôt sur l'Angleterre et l'Espagne.
  - Pour un troisième investisseur, le marché français des bureaux bénéficie d'une intéressante maturité, d'une forte profondeur et d'une grande diversité. Les investisseurs internationaux sont nombreux à vouloir investir en France. La vraie difficulté consiste à trouver des projets en quantité suffisante. Le *French Bashing* n'est que théorique.
  - Deux promoteurs **présents dans la salle** nuancent ce propos. Seuls les produits loués sont rares. Faire des immeubles à blanc est devenu quasiment impossible. Les dernières grandes structures livrées par les promoteurs n'ont été possibles que grâce à un travail en amont avec l'utilisateur et la signature de BEFA, idéalement de 12 ans fermes.
- La valorisation des actifs de bureaux est-elle pertinente ?
  - La valeur d'expertise est calculée par capitalisation du loyer facial. Au vue des écarts entre économique et facial, cela peut paraître paradoxal. Cependant tous les actifs européens étant expertisés selon ce procédé, l'expertise permet une comparaison cohérente de l'ensemble des actifs,
  - Les CAPEX ne sont pas toujours pris en compte, notamment ceux de restructuration. Il faut se rappeler que la majorité des actifs est louée par petites surfaces à des PME. Ces dernières sont prêtes à louer des immeubles peu performants tant que les loyers sont raisonnables.
- Comment expliquer la faiblesse des investissements en France (10-12 Milliards €) par rapport au total des investissements en Europe ?
  - Une imposition plus élevée des plus-values, qui favorise la conservation du patrimoine et réduit le turn-over français,
  - L'incertitude fiscale et réglementaire de l'immobilier français.
- Investir à Paris est-il rentable?

- Avec la faiblesse des taux de rendement locatif des actifs primes, il est en effet de plus en plus difficile de dégager un rendement locatif intéressant. Les actifs recherchés sont les plus sécurisés possibles afin de garantir une préservation du capital, même si pour cela le rendement locatif doit être faible voire nul.
- Le marché immobilier est cyclique et cette perte de vitesse, d'une partie des actifs de bureaux, rappelle celle des années 1990 qui a conduit à l'arrivée des investisseurs américains opportunistes. La situation est cependant différente car les taux d'intérêt étant plus bas, le coût de portage d'un actif vacant ne justifie plus nécessairement une vente avec décote. L'immobilier de bureau traverse ainsi une situation inédite et d'autant plus ouverte que l'émergence des nouvelles technologies conduit à une révolution des utilisateurs et de leurs attentes.



## 19. INVESTORS ON THE MOVE – WHY ARE THEY LOOKING TO MONTENEGRO?

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- With a population of only 650,000, Montenegro is the smallest country in the Balkan peninsular. This stable, independent and democratic state on the road to EU membership is one of the most attractive development opportunities in Europe. Situated on the southern tip of the Dalmatian Coast; it is an ideal tourist destination. Although compact, it has significant ecological, heritage and cultural resources, a beautiful coastline, charming renaissance towns and some of the most dramatic UNESCO protected scenery in Europe.
- The country became independent in 2006 and has leadership with a vision to create the “Monaco of the Balkans”, with a focus on luxury tourism.
- Montenegro is recording incredible economic success: GDP has doubled in less than 6 years.
- A political representative puts forward another sign of success - the number of yachts at the port. A few years ago you could not see a yacht longer than 10 metres. Today, 350 yachts are settled there, 1/3 of them being longer than 50 meters.
- Structure of equity investments: investment companies and banks make up 31.9% of total inflows and investment in real estate makes up 37.3%.
- Foreign investment comes from more than 107 countries.
- One of the most representative projects currently underway in the area is Porto Montenegro, designed as a large scale mixed-use waterfront project, totaling 200,000 sq m of GBA. The marina is planned to host maximum 800 berths, out of which 150 will be allocated for mega and super yachts. It will include approximately 950 residential units, 125 of which are already under construction (offered to the market and almost fully sold out). Regent hotel of 80 rooms will become operational, as of mid-2014. Due to its size, the development of the complex will be realized in phases, with planned completion in the next 5-8 years.
- An Azerbaijan company aims to develop a large tourist resort ‘One and Only’, at the location of former military site Orjen Battalion barracks in Kumbor. The project envisages hotels and congress facilities, serviced apartments and residential complexes, a helipad, yacht club and marina with 350 berths (1200 are working on this project).
- The government is establishing all the conditions to attract investors. A stable political climate, a total transparency on the projects the State will finance (in term of infrastructure), a good legal system (licenses and agreements are obtained very quickly, i.e. 6 months for the projects mentioned above).
- Access and transport: critical to success. Very major changes happened from investors’ point of view as soon as flights from Ryan Air came to Montenegro. The government is trying to create more new lines. Before, investors were eager to take 3 or 4 flights to come to Montenegro, now if they buy an apartment or a villa at several millions, they want to be able to come quickly only for the week end.
- The number of passengers has increased by 50+% over the last 6 months and this will continue next year. That is why the government wants to continue to make air tickets cheaper and to open up new destinations.

## 20. RENTED RESIDENTIAL: THIS YEAR'S BIGGEST CRAZE?

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- Residential is a significantly low risk investment that suits the investors looking for secure income flows. Residential is highly de-correlated to other asset classes. It even bears a low correlation with other real estate classes and has lower obsolescence. This is why up-taking the allocation in residential as a sub-strategy in real estate makes sense.
- The UK domestic market is weak, with no deep pools of capital for this asset class. The market is then driven by international pension funds which now invest in indirect vehicles (low risk and stable low return).
- After the Lehman Brothers crisis, there was a lot of opportunity but no equity available. Today, everyone is keen to purchase, with equity no longer being a problem, but the issue is finding the appropriate asset.
- The UK must be divided into two markets: London and the rest of the country. The IRR in London is quite low. But sovereign funds or pension funds don't need yearly cash, and have a long term approach with a preservation of capital goal. These investors are not about getting in and out quickly, but are looking at the long run. They are sometimes prepared to take the development risk and to contribute to building the asset so as to secure a better yield.
- Residential is not very liquid in the UK and the only way to benefit from market opportunities is to build a large portfolio with properties to buy and sell every year. One UK residential specialist in the room believes that designing the building in the right way and monitoring the running costs in advance, are keys to success in the UK residential market and to adding value to the asset. For instance, apartments designed for sharing with 2 bedrooms looking exactly the same, and a special lift in the building for people constantly moving in and out.
- Germany has an under-capitalized and under-rented stock where removing the tenants from the flat can prove to be difficult. The idea would be to change the stock to adapt to market rent and pay some tenants to move out.
- Differences between the US market and the UK: the tenant risks are different, meaning higher returns in the US.
- As the market has been bullish for a long time with an ongoing imbalance between demand and supply, should we expect some kind of correction? If interest rates rise, the risk can still be mitigated with refurbishment and value added works to the asset. The right asset management is the most important when it comes to residential.
- Some risk is also to be found in the political environment of a country, with the government putting pressure on rents, or considering taxing landlords (e.g. France). Rent control is not in the agenda in the UK.
- Financing was made more available this year compared with the year before and it is obtained more easily than for other asset classes.

### **Conclusion:**

Rented residential is a low-risk investment that suits long-term diversification investment's strategies. Equity is available today and the market is still bullish - but highly correlated to political changes.

## 21. DISTRESSED SALES – TEASING TRICKLE OR BIG BUSINESS?

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- An alternative investment firm reminds the audience that 2 years ago, barely any distressed sales existed. Banks were not selling them. A change has taken place in the last 6 to 12 months. Distressed loan portfolios and assets are coming from banks, governmental institutions or administrators.
- A closed-end PE fund focuses on Germany managing €1.2bn on the debt side and €0.8bn on the direct side with distressed offices. According to them, despite a huge supply on the direct side in Germany, most of it will not come to the market, or in case, less than international actors hope for today.
  - Another PE investor in the room who look for the assets themselves, forecasts that Germany will see a flow of deals on single credit assets for the next 10 years.
  - A global investment manager observes that in Germany, the UK and Spain, direct assets need to be core in order to get bank leverage. On the opposite loan portfolios with difficult assets in B locations can attract leverage since they represent income instruments for banks.
- Germany is experiencing a new situation: an increasing number of managers' platforms (listed or non) raising funds from institutional investors to invest in distressed funds, including residential transaction. The risk perception of German banks has changed.
- One bank in the room has seen change in the last quarter and mentions another 'bad bank' that has even started to be more liquid and put assets on the market. They have realized that they cannot hold the state for ever. Hundreds of millions of Euros are foreseen to come into the system in the next 5 years.
  - A PE investor wonders what the liquidity is for the buyer of such assets.
  - An investment manager expects growth and rents at the end of the asset management process, if it is bought at a decent yield. Investors and banks seem to be starting to look at portfolios with a fixed yield, since the properties are income producing; low but stable.
  - An alternative investor tends to disagree, expressing that it might work for pension funds with long duration of hold, but not for investors that want to get out in 3 to 5 years.
  - According to one of the banks, a lot of buyers are opportunistic funds.

### Conclusion:

To the question "Are we selling to ourselves or is the market deeper?", A multinational professional services firm wraps up by answering that the majority of buyers are financial ones; Non financial buyers (individual or family offices) cannot compete with buying entire portfolios, they need to be divided or sold out property by property.

## 22. CEE: WHERE WILL THE BUYERS PLAY NEXT?

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### **Poland: New core?**

- Less risky than southern European locations (Poland 250 bps, Spain 400-450).
- Still a small country, whose industry and services network is not yet optimally developed.
- Advantage of multiple big cities, even though it is unlikely these will ever become global cities (like Paris and London) so not same level of liquidity.
- Polish decentralisation is true for retail, but not for offices.
- Poland in 4<sup>th</sup> place (behind UK, Fr, Ger), more for lack of better options, thanks to decline of Spanish and Italian markets.

### **Czech Republic: much like Poland, but with only one hub.**

- Not as appealing: 1 or 2 possible deals is not sufficient to attract investors.

### **Hungary: Populism gone further than is acceptable for business**

- Very quiet due to regulation and political situation. Government treatment of local banks has made Hungary a very unattractive area to do business.
- At the same time, prices have not dropped that much: no lending and high prices!
- Hope for Hungary is that the fundamentals are there (demand for offices, rents relatively low), should the government change.

### **Romania**

- Very substantially overvalued (Bucharest prime at 6% instead of expected 8.5-9%).
- GDP per capita much lower than in rest of CEE and corruption reaching new heights.

### **Montenegro**

- 9% tax, € currency and drive to join Euro zone the right way.
- Beautiful coast (only Fjord in the Med): Monaco of the Balkans.
- Stable government and serious infrastructure planning: tourism for now, but bright future.

### **Russia: Significant market with huge barriers to entry**

- Booming economic fundamentals (5% growth, Debt/GDP below 10%) and enormous amount of liquidity in the market.
- Worrying political situation, but whilst don't need to be in Hungary, one needs to be in Russia as part of top 10 world economies.
- Issue is negative perception of Russia - often irrational and/or deeply rooted, according to one investment manager in the room. If an investor has a bad perception, it is very unlikely they will be convinced to invest in Russia (need unbiased investor).
- Reputation: not many non-Russian players have made money in Russia. Those that have, had a strong presence on the ground and trustworthy local partners.
- To go to Russia: need long term strategy and need to go in big (not the odd €20M here and there).

## 23. HOTEL & RESORT - TROPHY ASSETS OVERPRICED? MID-MARKET APPETITE?

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### **Trophy Assets**

- Prestigious properties and grand palaces. However risky they may be, they keep on arousing investors' desire. Institutional funds and high-net-worth individuals investing with no leverage are the biggest movers, closely followed by PE firms.
- The hotel market boasted solid underlying fundamentals with robust revenue per available room (RevPAR) - results recorded because of a kick start of tourism in Europe.

### **Mid-market assets**

- Nothing to envy as they sharpen appetite. i.e. the recent purchases of Holiday Inns and Best Westerns bought by PE firm in Germany and the US.
- Budget hotels also offer appealing performances despite low returns and no residential value foreseen according to an investment manager in the room.
- According to one hotel group, it is hard to find funds for developing assets with no track record whereas they have a strong business plan and they are profitable. i.e. their projects of converting hotels into service apartments.

### **Management perspective or franchisee perspective ?**

- Most of the hotels are asset management based but this is not the most efficient management for all hotels, according to a leading developer.
  - Franchisee is closer to the asset
  - Better cost management - new mid-market hotels are better run when a franchisee is the operator

### **Who are the investors?**

- The hotel industry is very particular and investors need to go through a thorough study of their target.
- Now it's all about finding the right type of assets in the right country and sizing up the underlying trends below the scary national trends.
- High quality foreign investors invest in trophy assets to protect their capital.
- The opportunistic funds are focused on the mid-market, and on developing branding strategy.

### **Where to invest?**

- Spain and Italy: poor economic reality but a PE firm feels there will be opportunities. There should be some movement but not right now, as there is too big a difference between the valuations and the prices. Owners are not willing to sell below their construction costs.
- Interest for Africa is growing: Nigeria, Kenya, Tanzania, Uganda and Rwanda are fertile lands that are already arousing Chinese and Middle Eastern curiosity.

## 24. FINANCER L'INVESTISSEMENT – DETTE OU CAPITAUX PROPRES ? LES NOUVELLES SOURCES CHANGENT-ELLES LA DONNE ?

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### Introduction:

Dans un marché orienté négativement, et avec une situation économique peu propice au risque, on peut se demander si le financement de l'investissement n'est pas ralenti.

- Les investisseurs cherchent de moins en moins d'opérations à fort effet de levier. Ils se concentrent sur des actifs *Core* qu'ils comparent à des produits financiers de type obligations.
- Les nouveaux acteurs du marché du financement (assureurs, fonds souverains, fonds de dette, fonds de pension, etc.) travaillent sur le même segment d'actifs sécurisés que les banques. Ils réalisent également un benchmark des taux, afin de placer leur *equity*.
- Les acteurs cherchant encore du financement sont : SCPI et promoteurs.
- Financement de l'acquisition :
  - Afflux de capitaux pour les opérations sécurisées.
  - Marché plus tendu pour les opérations risquées (promotion en blanc, restructurations, *value-added*, etc) car les TRI attendus par les investisseurs et les marges imposées par les banques sont souvent inconciliables.
- Refinancement :
  - Stress sur l'offre pour le financement d'opérations à forte LTV.
  - Stratégie des banques de conservation en patrimoine des actifs spéculatifs, créant un lissage / report du mur de la dette.
- La tendance du financement sur les 12 derniers mois a évolué : baisse des marges, financement de très gros tickets (>300M€), allongement des durées de prêts (de 3/5 ans à 5/7 ans), hausse de la LTV, syndication sur les opérations risquées.
- Un léger retour vers le financement du *value-added* s'esquisse avec des opérations significatives : Immeuble Lumière, Tour Blanche, Tour Pacifique, siège de la CACIB...

### Conclusion:

Le marché du financement est relativement équilibré. On note une très forte présence d'*equity* à investir mais qui se place toujours sur le même type d'actifs *core*.

## 25. THE UNITED STATES : BACK TO THE FUTURE

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### Introduction:

Questions about the US economy have turned from the potential downsides to the potential upsides. Commercial real estate is in a good position to benefit from the sustained economic recovery, even if interest rates rise. Demand for space is increasing, but at a modest enough rate to keep a lid on construction in most segments.

- The future strength and weight of U.S. cities should not be underestimated. The major U.S. cities will continue to act as substantial economies and real estate markets of global scale and significance.
- Investor demand for commercial properties remains robust. Prices of core properties are back to – or exceeding, in some cases – 2007 levels. Investors that are shut out of bids for top-tier properties in gateway markets are moving to class B assets in gateway markets, and secondary markets are benefiting from the search for yield and the expectation that fundamentals will improve.
- Property values are starting to rise faster in secondary markets, as financing availability improves and moves yield investors up the risk spectrum to capture yield.

### The housing market

- Favourable outlook for apartments over next several years, and debt financing is cheap and readily available.
- A 10 mn people growth is predicted over next 10 years, representing a huge opportunity for the housing market.
- The U.S. residential real estate market is now experiencing its second recovery since its 2006 top and the 2008 global financial crisis. Housing will continue to be a strong driver. Improving construction and home sales will continue to bolster job growth, and rising home prices will lead to stronger consumer balance sheets and spending activity. Additionally, stock prices have reached record territory, and consumer confidence is at its highest level in many years
- However, housing starts remain well below the lower-end of their normal historical range. Current levels of housing starts are about half of their normal long term historical average.
- The recent upturn in interest rates is sparking fears among some that the nascent economic and housing recoveries will be choked off before they produce sustained growth.
- There are markets in the US where 10,000 homes are built, but the demand is not always there (Florida, Arizona)
- Development and repositioning of class B apartments provides better risk-adjusted returns in many markets.
- Fundamentals: neighborhood must be taken into account the (schools etc.) to know if there is a need for houses.

### Office: Investors beginning to target second-tier markets

- Overall, the scarcity of large quality blocks will help urbanized Trophy and A products continue to lead momentum and rent growth during the recovery. While this has led to new construction in some geographies, leverage will likely remain with landlords for the next 18 to 24 months at a minimum.
- Construction remains weak; any new supply is focused on preleasing in markets such as San Jose and Houston that are well into the expansionary phase of employment growth.
- Even in the two most demand-challenged markets of late (New York and Washington) we began to see the prime part of the market -the Trophy segment -start to show signs of stabilizing and even rent growth.
- Nationally, office vacancy rates are inching down as demand for space barely tops new supply. While tech and energy markets see significant improvement, demand for space is increasing in nearly all of the top 35 markets.

## 26. TURKEY: THE NEXT ADVENTURE OR RISKY BUSINESS?

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### Introduction:

An asset manager reminds us that Turkey is a stable land unlike Egypt or Syria. There are several young, well-educated and qualified people. Their appetite is promising for the future of the Turkish economy. So is the quality of Turkish infrastructure and the know-how of their construction companies - for the real estate business specifically.

- For a global investor in the group and a leading developer, worries lie in the possibility for external investors to enter the office market in the coming years. It is agreed that nowadays, retail and hospitality are the only possible segments accessible for European investors; and Istanbul already faces an oversupply in retail.
- Demographically, with 15mn inhabitants living in 4mn m2 in Istanbul and with the rapidly increasing employed population, the city has strong needs for offices. There is clearly a lack of institutional products; nevertheless, we hear that a few transactions are set to take place before the end of the year.
- It appears to be difficult for foreign investors to enter the residential market in Turkey because European knowledge is not good enough in this field and it is better managed locally.
- What has to happen in order for Turkey to need international investors? According to a German asset manager, prices have been going down for 6 months and the US is pulling cash out, bringing the end of liquidity closer. GDP in Turkey, however, expanded 4.40 percent in the second quarter of 2013 over the same quarter of the previous year: above the expectations of 3.8. International investors are withdrawing their funds but it is the first time that the country can afford it. All the more so because they are still getting money from the Middle East. The new efficient saving management of Erdem Başçı, governor of the Central Bank of the Republic of Turkey since 2011, is another helpful asset for the economy.
- The difference between the Turkish and the European/American way of managing office assets: Turks can deal with 70 or 80 different owners, each of them possessing a unit or floor, which makes business discussions more difficult, as a stage by stage sell dramatically increases the yield risk. Moreover, the calculation made by European developers - in terms of yields and sustainable rents - is not the same as the one used by Turkish ones.
- For a Turkish investor, the main problem in Turkish real estate lies in the overpricing led by the owners: the cities. No foreign investor will pay such an unreasonable price.

### Conclusion:

No deals with full ownership for external investors in office buildings have yet been made, but in the next two years the growing number of empty buildings in big cities - in particular Istanbul - will lead to a higher pressure from the banks so that prices will adjust and international investors will be able to enter the Turkish office market.



## 27. THE FUTURE OF EUROPEAN MORTGAGE FINANCE - CMBS, BANKS, FUNDS OR OTHER?

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- The biggest provider of debt will remain the banks, since the principal lenders of commercial mortgages need permanent capital (opinion shared by three banks in the room).
  - The fact that debt funds are coming into the senior business illustrates the opportunities that exist for non bank players in the high leverage space (70% to 90%), or with transitional assets.
  - However, unless banks use credit front to balance their balance sheet, there will be no large opportunities for alternative providers. There is no long-time window according to one German bank in the room.
- An alternative investment firm points out that a nimble organization can have pricing power or value differentiation in comparison with a traditional banker. The value proposition for investment banks would thus be time, insuring in that way a certainty of execution to the borrower.
- A London boutique observes that the European historical policy of regulators and the current decisions of politicians shape the size of the senior lending space. It all comes down to the way they want to finance Europe (with or without speculative finance).
- An institutional manager notices that even if the mortgage market stays dominated by banks, the penetrating capital funds and insurance companies will keep on finding opportunities.
  - Their view for the future is that these alternative actors will be pooled by the banks rather than acting on their own. For instance insurance companies do not originate business but offer an exit.
  - Traditional insurance companies investing on CMBS will continue; portfolio owners will develop limited volumes.
  - Rather than being the solution for the lack of liquidity in secondary markets, they will be an alternative source of financing for quality and low risk assets.
- Addressing the question of capital permanency on the banking or fund side leads us to consider cyclicity.
  - One European bank refers to the basics of real estate (locations, sponsors) and the lesson learned from the past crisis; quality assets may have no difficulties in being refinanced, therefore investing in a quality asset will enable “one to get one’s money back”.
  - Attention must be drawn to the fact that a 20 years lease may give the illusion of no risk.

### Conclusion:

The mortgage market is going to stay bank dominated and start working alongside debt funds more. Insurance companies will find a niche. CMBS will undertake a slow but growing role. Family offices and similar actors will not play a significant part.

## 28. LONDON: CRAZY BOOM CITY WITH NO SHORTAGE OF EQUITY?

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- Overseas investors are dominating London: Asian and Middle Eastern capital is flocking to London; American opportunity funds are again buying on the market.
  - The UK domestic market is indeed weak with institutions only representing a small part of the market and being absent from the biggest assets bids.
  - London always had an international track - What is new is the broad diversity of players on the market place.
- Interesting shifts are to be expected in London with these new investors becoming keener to trade parts of assets and sell stakes, instead of getting rid of the whole assets.
- Deals outside London are quite limited for this type of investor, except where shopping centers are concerned. On the other hand, UK REITs are not particularly active in London because they understand the regions where they can achieve better returns. There is a 125/155 bps gap between London and the regions. But, Malaysians and other Asian investors may start looking at products outside London pretty soon: after considering Paris and Germany prime assets, they will eventually come back to the UK.
- There is no shortage of equity in London: in the event a £400bn asset is for sale, a buyer will be found. Equity is massively available and chasing secure investments – e.g. a Chinese life fund is currently willing to invest in London and will pay whatever it takes to get access to the London prime market.
- House and flat prices in London have soared. Only private high-end wealthy individuals can afford the super prime new residential developments that are ringed in a very limited area of Central London. But outside these areas, buyers willing to buy off plan can still be found overseas. Some social concerns are then raised however, when considering the rising stock of empty flats in the nicest areas of Central London: we can forecast a backlash from the local population who can't afford to live there anymore.
- Developers prefer to sell the apartments one by one in the Middle East rather than by blocks. The Government should install more covenants (allocate a certain amount of blocks for sale to institutionals planning to rent them).
- The market has not yet adjusted to the cross rail effect– like in Acton. Investors should be considering mid markets to boost their returns and cope with the shortage of prime assets (too few assets for too many buyers).
- London could become less attractive for a few reasons, among which treasury rates at 3% and capital value issues. There is also a large unsolved question around the sterling depreciation and its impact on the investment volumes. Turnover will undoubtedly fall in London but the asset will still be liquid.
- If the UK is not part of the EU, several headquarters will move out of London and the overall impact will be negative.

### Conclusion:

We are experiencing a boom, keep going!

## 29. EUROPEAN REAL ESTATE 2014 - IS THE OPTIMISM JUSTIFIED?

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In the light of the general capital markets state, how are the real estate perspectives?

### Capital Markets:

- According to A multi-national professional services firm and a global investor in the room, talking about optimism and recovery for the banks and the debt funds, is not yet on the agenda.
  - Large amounts of difficult and uninteresting assets on their balance sheets
  - Strapped for cash
- The debt market is on a steady and flat slope so yes we should be optimistic, and patient.
- A Pan-European investment management company pointed out that equity investors are wary of the precursory signs of recovery and remain largely risk averse. They did notice that activity grows again but it's partial and segmented to certain areas of the economy. Sustainable indicators are keenly awaited and will then turn a green light on investments.
- To sum up, both equity and debt actors will continue turning to the large, well-capitalized players. But the investors concede that they should engage with new sectors and consider riskier deals than before. They are bent on not being picky anymore.

### Real Estate:

- Prudence is on everyone's mind.
  - UK: According to a UK-European investor, we should be careful of the top transactions with top margins that don't reflect the market. i.e. the increase of vacancy rates and the stagnation of ERV and tenants. Defensive strategies are therefore undertaken with stable income returns and yields.
- Patience! Participants agree that one has to look back at the fundamentals, go lease by lease, tenant by tenant to select their investments.
  - Spain: Housing market is expected to go down 10% to 20% and the logistics market isn't yet stabilized according to Spanish specialists. That said, prime housing properties in Barcelona and Madrid can be profitable investments.
  - Italy: Has assets, but timing is crucial.
- At the moment, the best investments in Europe are defensive retail core investments in the UK, France, Germany and the Nordics.
- The opinion of a professional services firm in the room is that capital seeking safe haven should head for Europe as it follows an upward trend because of a general environment of confidence. The market is benefiting from greater interest from new international investors who see Europe as a mouthwatering market.
- A European investment firm asserts that the housing success in the US has seduced and again sparked off investors' appetite for European real estate.

### Conclusion:

Limping out of the hospital with bruises, Europe manages to entice investors and show them it is healing even though the recovery is some way off.

### 30. MARCHÉ FRANÇAIS: SURÉVALUÉ OU LE JEU EN VAUT-IL LA CHANDELLE?

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#### Introduction:

Face aux derniers indicateurs économiques positifs (inflation contenue, taux long terme et court terme bas, reprise de l'emploi dans les services, prévisions de hausse de PIB et de reprise de l'emploi en 2014, etc.), la question est de savoir si nous sommes face à des signes de reprise ou si le marché français est en berne car surévalué.

- Les fondamentaux d'un marché immobilier sain sont présents en France :
  - Marché immobilier profond
  - Marché immobilier stable et liquide
  - Forte démographie en France (1,9 enfants / femme)
- Avec l'arrivée de nouveaux acteurs, type compagnies d'assurances, sur le marché du financement immobilier, et dans un contexte économique et locatif incertain, le financement d'opérations *Core* se fait à des taux de prêts historiquement bas du fait de l'afflux de liquidités. Ce phénomène engendre une surévaluation des actifs *Core* en France.
- A l'inverse, la frilosité des bailleurs de fonds et des investisseurs à réaliser des opérations opportunistes et *value-added* crée un marché français sous-évalué pour les actifs risqués dans lequel de réelles opportunités voient le jour. Le maître mot restant la Localisation.
- Les marchés d'investissement sont en train de se réorganiser au niveau mondial : les grandes capitales européennes pour préserver le capital investi, les villes des pays émergents pour obtenir un *yield* important.
- Les marchés locatifs bureaux sont en train de se réorganiser au niveau européen, menant à des conséquences sur les niveaux de loyers : les activités à forte valeur ajoutée se recentrent à Londres, tandis que les activités de *middle* ou *back office* trouvent leur place à Paris.
- L'immobilier, industrie cyclique, voit ses cycles économiques se raccourcir. Plus généralement, la lecture de la crise actuelle, via des comparables historiques, est encore discutée.
- Le paramètre majeur pour analyser le marché actuel est celui de l'évolution de la demande ; donc des *cash flows* et des niveaux de loyers prévisionnels.

#### Conclusion:

A l'heure où la compétition sur l'acquisition d'actifs *Core* se durcit, de belles opérations restent à réaliser en France, sur des actifs *value-added* de seconde zone ou vacants.

### 31. THE INVESTOR-MANAGER RELATIONSHIP – EVOLVED FOR BETTER OR FOR WORSE?

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- **Transparency:** Private equity firms are notoriously opaque in their communications with the outside world, even with their LPs (limited partners). Yet many LPs now face increased scrutiny from their own advisory boards or oversight committees and must produce more detailed reporting.
- **Data availability:** LPs want more standardized information. In response, GPs (general partners) have augmented their customary annual and quarterly reports and annual meetings by providing additional information. We can imagine that in a near future, GP portfolio management data will need to be available on internet
- **Fundamentals:** As LPs struggle with these issues, many more fundamental questions arise around LPs' abilities to effectively develop portfolios that are well-matched to the cash flow demands they face.
- **Pressure on fees:** The majority of LPs believe that current fee structures cause an imbalance between LPs and GPs. LPs are asked to give precise details on what the fees include, but it must be noted that it is sometimes quite difficult to have an individual approach when it comes to what your package involves.
- **Future deals:** increasing the unfunded future commitments clearly requires smart and profitable investments, but LPs actively debate whether they should seek IRR/cash flow or less liquid cash-on-cash returns.
- **Flexibility:** GPs and LPs have to understand the others' expectations. Flexible relationships with mutually aligned interests are the ones which are successful.
- **Governance:** Given the long-term illiquid nature of a private equity portfolio that LPs cannot manage directly without risking their tax advantaged status, governance is a difficult matter.
- **Relationships to be reviewed:** meetings with GPs/LPs are considerably short with regards to the amounts that are at stake.
- **Understaffed teams:** there are often only 3 or 4 analysts managing a portfolio of several millions/billions. Are they really able to control and manage such funds with such limited teams, especially if we take into account the important turnover within those teams?

#### Conclusion:

The number of GPs is likely to reduce as they face increased pressure.

## 32. KEYNOTE: EUROPE UNDER STRESS

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- Looking at the present global economy, the EU is the weak link in terms of key economic indicators.
- Europe has faced a “balance sheet recession”, different from the usual recession, due to an overheating of the economy. BS recessions, where key players in the economy show losses on their BS, are deeper and force a slower and shallower recovery. Proof of this is that most states have suffered +5 years of recession, which is exceptional.
- Monetary policy (through depreciation of currency for example) is a tool to counteract the negative fiscal demand shock (from fiscal consolidation). Depreciation and reduction in interest rates are not options for Euro zone countries, an explanation for lagging Spain and Italy (vs. US setting negative interest rates to boost recovery).
- 2 speeds visible in Europe since Q1 2009: North want higher interest rates to speed up the economy, whilst the struggling South wants to keep them low to help recovery.
- Fiscal consolidation is however on track in crisis countries. Greece fiscal balance from 15.6% in 2009 to 3.8% in 2013! Ireland and Spain have also performed.
- Marked improvement in current account balances for crisis countries. Greece again has performed since 2009, reducing its deficit from €41.9bn to €5.1bn. Spain also exceeded expectations: €-104.3bn to €+16.9bn in 2013. This is not just due to lower imports, but also to “internal devaluation” (internal reduction in prices and wages).
- Government debt is still very high. Greek debt, even after €109bn private debt forgiveness, has risen to 175% GDP. 2nd round of forgiveness necessary, but this time public so problematic.
- Rise in private debt in crisis countries: private company liabilities 2 to 3 times greater than GDP in Spain, Ireland and Portugal.
- Paradoxically, private wealth is stronger in the South (issues: survey methodology and respondent reliability).
- Governance: major progress, but no “quantum leap” or game changing breakthrough. There are plenty of agreements and rules across EU member states (Six Pack, € plus pact...), but no right to intervene in each other's national fiscal policy.
- Monetary Union: shift in focus. Growing impatience of people, economic situations affecting the political balance – tipping it towards anti-reformists (5 star movement in Italy; even reluctance in France).
- Debate as to who should bear the burden of recovery? Mr. Pfister argues that “surplus” countries must help crisis countries, and that a fiscal union is crucial. “Struggle between shared liability and shared responsibility must not be won by the former”.
- 3 rules of success for reform programmes:
  - Transparency in communication
  - Necessity of “light at the end of the tunnel” to convince people to endure short term ‘pain’
  - Distribution of burden must be considered fair by voting majority
- Inflation “always a monetary phenomenon”, but money supply divided in 2: monetary base (volatile, in decline since 2009) & M3 (money held privately in the economy, stable).
- Outlook:
  - From existential crisis to chronic problem
  - Citizens in crisis countries will not start benefitting before 2015, but will political consensus last that long?
  - Political shift from “austerity” to “growth”
  - 2 major reform projects (Banking Union & Fiscal Union). Fiscal Union is disputed, probably unachievable in foreseeable future: which banks? Role of ECB?
  - Survival of € still more likely: will remain internally and externally stable (The US has own fiscal problems).

### 33. WRAP- UP: TAKEAWAYS FROM THE GRI EUROPE SUMMIT 2013

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- This year's GRI Europe Summit has seen the most positive mood for the past 5 years.
- The general opinion about the economy is balanced, but there are still strong fundamentals for growth.
- There is a lot of political and financial risk in today's world (war in the Middle East, crisis, etc).
- The real estate world has the opportunity to better know how to do business and to earn more money from the investors.
- This year's discussions on markets:
  - France & UK are comparable countries, yet with very different real estate markets.
  - Poland is Core, whilst the other CEE countries are hindered by political and economic instability.
  - The Sunbelt is experiencing a mismatch between sellers and buyers.
  - German growth is constant and has a positive future.
- This year's discussions on sectors:
  - Resi markets are diverse and collecting more and more resources.
  - For offices, controversy was raised over the difference between core and prime.
  - The Hotel market is split between 3 types of assets.
- This year's discussions on finance:
  - Europe is considered as undervalued.
  - There is a push of new capital from the US.
  - New business models are appearing among lenders and investors.

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