

Politics, relationships and how to future-proof the portfolio

In late October, **Tell Media Group**, in cooperation with **Aviva Investors**, **Invesco** and **M&G Investments**, invited Finnish investors to discuss real estate investing. Tell Media Group founder **Niklas Tell** and FBNW editor **Janina Sibelius** moderated the roundtable.

By: **Niklas Tell** Photo: **Christer Salling**



MIKKO ANTILA - ILMARINEN, ANDREW HILLS - INVESCO, MARJA TÖRNROOS - VARMA, NIKLAS TELL - TELL MEDIA GROUP, JANINA SIBELIUS - TELL MEDIA GROUP, GASTON BRANDES - AVIVA INVESTORS, JOHANNES EDGREN - VER, THE STATE PENSION FUND OF FINLAND, PETER RILEY - M&G INVESTMENTS.

To kick off the roundtable discussion, which was held at Hotel Kämp in central Helsinki, Niklas Tell asked the investors to talk about the development of their real estate portfolios.

MIKKO ANTILA: "We currently have some EUR 6.7 billion in real estate investments, which account for 14.4 per cent of the total investment portfolio. Some 26 per cent is invested overseas and the remainder is in domestic assets. The domestic assets are mainly in direct real estate, such as the building we are sitting in right now. With regards to our international exposure, we historically looked to get diversification through fund investments and we had built a sizeable fund portfolio from 2004 up until the financial crisis. After that, we selectively invested in funds but stopped the program in 2012. We haven't sold any of the funds but new investments have been direct investments in joint ventures with other investors. We're still looking to improve the international diversification and our target is to push the 26 per cent of international real estate to 40 per cent by the end of 2020. We have sought scalable strategic partnerships in Europe and in the US to invest directly with likeminded institutions. Real estate debt is a new area for us where we hope to be more active next year. That's now handled by the real estate team, which is a structural shift internally."

NIKLAS TELL: SO DOES INCREASING YOUR INTERNATIONAL ALLOCATION TO 40 PER CENT INCLUDE REAL ESTATE DEBT?

MIKKO ANTILA: "Yes, it does."

MARJA TÖRNROOS: "We started to invest internationally in 2005. Before that, we only had direct domestic investments. In 2011, we started to be very active on the international side and today we have investments in 50 different real estate funds. We have at the same time been

active in transferring our directly owned domestic assets into funds. Now we have a good international and domestic real estate portfolio. That said, we are again looking at direct domestic real estate."

JOHANNES EDGREN: "We're not allowed to own any real estate directly and since 2005 we've invested mainly in real estate funds. We have about one-third in domestic exposure and two-thirds in international real estate funds and it's a mix of listed and unlisted funds. We also have some real estate debt investments but they don't sit in our real estate portfolio but rather in our private credit portfolio. It's, however, managed by the same team. Going forward, we're looking to increase our real estate allocation slightly."

NIKLAS TELL: ARE THE EXPERIENCES FROM THE FINNISH INVESTORS HERE SIMILAR TO WHAT YOU HEAR FROM OTHER INVESTORS?

GASTON BRANDES: "Yes, I think so. It really depends on where the client is in terms of their real estate investing experience. Many investors start with a domestic portfolio and then the first international exposure is taken through funds or even fund-of-funds. Then as investors get more sophisticated, you see more club deals or joint ventures, just as we've heard here. It's a higher risk strategy but you also gain more control of the investment."

ANDREW HILLS: "I think it depends very much on where you're coming from and how big your domestic market is. If you look at Dutch investors, they tend to invest more globally compared to UK investors that have more of a domestic bias, just because it's a bigger market."

NIKLAS TELL: WHAT DOES 'INTERNATIONAL' REPRESENT TO YOU AS INVESTORS? ARE YOU LOOKING GLOBALLY OR IS IT MORE OF A FOCUS ON EUROPE?

JOHANNES EDGREN: "For us, that was first Europe and since 2009 we've also invested in Asia. We haven't invested in the US but that has been due to tax and structuring issues. But every time you take on a new market, it means a lot of work to understand both the market and potentially also new managers. For Asia, we first invested in a fund-of-funds in order to learn the market and then we invested directly into single funds."

MIKKO ANTILA: "I guess we're global ex Asia Pacific. We've been very active in the US over the last four or five years. In the longer term, we would like exposure in Asia as well but we're a fairly small team and as Johannes was saying, every market has its own peculiarities. It takes time to understand each market, especially as we apply this more direct approach. We need to understand the dynamics of each market and we want to find a likeminded institutional investor that we can work together with. That said, we do have limited exposure to Asia through funds today."

MARJA TÖRNROOS: "We're monitoring markets globally but our main focus so far has been on Nordic markets and the UK. As mentioned earlier, we're also focusing again on the Finnish market. It's easier to invest in European markets compared to taking on a global exposure. We need to know what we're doing and that research, which includes site visits, is easier to do for markets close to our home market."

ANDREW HILLS: "I think for a lot of investors looking to diversify globally, it's two steps forwards and one step backwards. A lot of investors are looking to gain a more global portfolio but the trouble is there are headwinds such as tax issues and hedging costs. With that, it doesn't give you the reward you're looking for."

JANINA SIBELIUS: HOW EASY IS IT TO FIND THE RIGHT MANAGERS AND PARTNERS WHEN YOU ARE TAKING ON A NEW MARKET?

MIKKO ANTILA: "It's a lot of networking involved in finding the right partners. I think we've been lucky so far with the partnerships we've established. It's cumbersome, especially with our approach. We visit each asset, even on the debt side. Opportunities come up quickly and it's not easy to get from Helsinki to let's say Portland within a couple of days' notice. From that point of view, Helsinki is not the most logical place to run a global real estate investment program from."

JOHANNES EDGREN: "Relationships are important and once we've found a manager we're comfortable with, we tend to do more with that same manager. You build trust over time and we've been invested with some managers for more than ten years. Over that time, you build an understanding of each other. We meet some managers over several years before investing with them. It takes time but real estate is also a long-term investment."

GASTON BRANDES: "I agree. Real estate is, or at least should be, a long-term investment and it's therefore very important to do the due diligence from both sides because you will be in a partnership for five or ten years or even longer. You need to make sure that you've found the right partner and I think this is a difference from equities and bonds where you can trade in and out on a daily basis. In real estate, that's usually not the case."

MIKKO ANTILA: "Also, having too many partnerships is cumbersome in its own way as that means you must put time and resources into relationship management. We want to have a small number of big relationships so before we enter into partnerships, we ask ourselves if it can be long term and scalable."



MIKKO ANTILA
Ilmarinen

Head of international real estate investments at Ilmarinen, responsible for both real estate equity and debt investments. He joined Ilmarinen as a real estate analyst in 2007 focusing initially on domestic real estate investments.



JOHANNES EDGREN

VER, the State Pension Fund of Finland
Senior portfolio manager at the State Pension Fund of Finland. He is responsible for indirect real estate, real estate debt funds and REITs.

JANINA SIBELIUS: SHOULD WE JUMP INTO THE QUESTION OF ESG INTEGRATION, WHERE MANY OF THE LARGE FINNISH INVESTORS HAVE DONE A LOT OF WORK?

MIKKO ANTILA: "Corporate responsibility has certainly been a focus area at Ilmarinen and at pension companies in Finland in general. With real estate having such a big impact with regards to ESG, we've put a lot of resources into defining what it means. We're measuring our carbon footprint and we're much more diligent with regards to energy efficiency."

NIKLAS TELL: DO YOU ALSO WORK ON YOUR EXISTING PORTFOLIO TO MAKE SURE EVERYTHING IS ALIGNED WITH YOUR ESG AMBITIONS?

MIKKO ANTILA: "We've been lucky in a way as a lot of our portfolio is right here in Helsinki and we've worked in a very systematic way to certify our core buildings here. Obviously, if your portfolio is very fragmented, it does create a problem if you want to harmonise your ESG policies."

PETER RILEY: "I think it's worth pointing out that it's not only the environmental credentials of a building that should be considered. We integrate ESG into our underwriting to know what we need to upgrade on each specific building from an environmental point of view but it's also about the wider social wellbeing. That's slightly outside the physical bricks and mortar and as owners of key assets in communities, there are things we can do and we have programs in place for that. It's a very broad agenda."

GASTON BRANDES: "I think from a manager perspective, most of our investors and clients expect us to not only sign the PRI but that we integrate these issues in everything we do, from how we select buildings to which tenants we attract. One of the struggles, however, for investors as well as asset managers is how to quantify the output of the ESG work. If you have a green building, does it mean that you can charge higher rents? Does it mean that you get better quality tenants into that building? Does it mean that you get a higher price if you want to sell that building? You would hope so but you need to be able to quantify that. The other challenge is that ESG mean a lot of different things to different people. There isn't one clear definition, especially in real estate."

ANDREW HILLS: "However, a lot of these issues are down to the tenant and the landlord only have partial control over the tenant."

NIKLAS TELL: WOULD YOU SAY THERE IS MORE FOCUS ON ONE OF THE LETTERS - E, S OR G?

JOHANNES EDGREN: "I would say there's more focus on the environmental impact because that's something you can measure. You can measure things such as electricity consumption and water consumption. It also makes economic sense as there will be cost savings if you're able to reduce these things."

NIKLAS TELL: WOULD YOU AGREE THAT CLIMATE RISK IS ONE OF THE BIGGEST RISKS, OF COURSE DEPENDING ON WHERE YOU HAVE YOUR BUILDINGS?

PETER RILEY: "Being part of an insurance company, that's obviously one of the things we look at in scenario analyses. These are, however, by their very nature rare events and very difficult to predict. You may in certain geographies have an additional risk premia for being more exposed to certain events."

ANDREW HILLS: "We did an interesting study about a year ago in the US just after the hurricane hit Houston. We own a lot of real estate there but we didn't



get hurt at all. We surveyed the whole of the US and the most at-risk area for us was Boston."

GASTON BRANDES: "In general, I think it depends on the investors you talk to. Here in the Nordics and also in the Netherlands, ESG is a very big topic. There are, however, other places where ESG does not feature as high on the agenda. I saw a study recently from Mercer on Swiss pension funds and they don't put as much focus on ESG as they think it's too expensive and too difficult to measure. They don't see the benefits yet."

PETER RILEY: "I think if governments don't see the reaction they're looking for in this area, regulation will come into force and that could be a potential threat to returns. That will grab the attention of those who don't yet focus on ESG."

JANINA SIBELIUS: IS THE THREAT OF UPCOMING REGULATION AN ARGUMENT FOR GREEN BUILDINGS IN THAT IT'S BETTER TO BUILD THEM TODAY RATHER THAN HAVING TO MAKE ADJUSTMENTS LATER?

MARJA TÖRNROOS: "I think that green buildings are good buildings. When we are making new investments, we prefer good locations, good public transports, energy efficiency and quality. It means a lot and Varma has decided that all our directly owned commercial properties should have an environmental certification in the near future. Work has started and we already have part of the portfolio certified. We prefer buildings with certifications but we can also invest in buildings without where will renovate and get a certification."

MIKKO ANTILA: "I fully agree with Marja that green buildings are good buildings. They are future proofed in many ways."

JANINA SIBELIUS: HOW IMPORTANT IS POLITICS IN REAL ESTATE?

MARJA TÖRNROOS: "I think that politics is increasingly

important, especially as we have unclear and uncertain situations in many western countries such as currently in Sweden and also in the UK. This creates risks for us as investors."

GASTON BRANDES: "Politics should be there to set the parameters on how to conduct business, be that real estate or any other business. If there's a lack of parameters, it creates uncertainty. A good example is Brexit in the UK. I speak to a lot of investors that have made significant investments in the UK, especially in London. They still like the UK and London but currently they're waiting on the sidelines because they want to see how this whole Brexit scenario plays out."

PETER RILEY: "I agree. The political environment in which we're operating is very important and you want to align your solutions with the big trends we're observing. That could be an ageing population in Europe or an increased propensity to travel. We need to ask ourselves what the built environment should look like to face those challenges."

NIKLAS TELL: WE TALKED EARLIER ABOUT DUE DILIGENCE ON PARTNERS. DOES POLITICS COME INTO THAT AS WELL IN THAT YOU WOULD LIKE TO PARTNER WITH SOMEONE WHO KNOW THE LOCAL POLITICAL LANDSCAPE?

GASTON BRANDES: "I think there are two sides to that coin. Being too politically connected could be a negative as well. In some geographies, it does play a big role but as a manager you shouldn't be too close."

NIKLAS TELL: BUT I GUESS YOU WOULD LIKE TO PARTNER WITH SOMEONE WHO IS BIG ENOUGH TO KNOW THE POLITICAL LANDSCAPE?

GASTON BRANDES: "Yes, and this is why international investing is difficult, which Mikko mentioned earlier. You would like to partner with someone who knows the area



MARJA TÖRNROOS

Varma

Investment manager at Varma, responsible for international and domestic real estate investments. She joined Varma in 2006 from Catella Property.



GASTON BRANDES

Aviva Investors

Managing director and head of business development real estate at Aviva Investors. He joined the company in 2016 and is responsible for capital raising from institutional investors for closed- and open-ended real estate funds, separate accounts, club deals and JVs.

that you are looking to invest in. That's key. I think that we at Aviva Investors are savvy when it comes to real estate but I must also acknowledge that we don't have expertise everywhere. This is why investors usually don't only have one manager but select several to gain the right partner for the right area."

NIKLAS TELL: IS THIS MORE IMPORTANT WITH NEW BUILDS OR IS IT EQUALLY IMPORTANT IF YOU BUY AN EXISTING BUILDING?

PETER RILEY: "I think it's equally important. We're working on a listed building in Milan, which means there are several hurdles you must go through and that's when you need a local partner. It's not about trying to gain favours but rather having a partner that knows what needs to be done to get things achieved."

JOHANNES EDGREN: "I think it's important to highlight that we don't like markets where you need political connections to succeed as that would imply corruption. That said, you obviously need partners who understand the local market and knows that is happening or changing."

MIKKO ANTILA: "One thing that we're struggling with is navigating the political landscape right now. Correctly quantifying political risks is challenging and the UK, which has already been mentioned, is obviously a prime example. There's a lack of transparency and everything is in a state of limbo. Everyone has an opinion but no one really knows what will happen, which makes it hard for a foreign investor like us to implement investments right now. The same goes for the US to some extent."

NIKLAS TELL: DOES THAT MEAN THAT YOU HOLD BACK AND INVEST ELSEWHERE?

MIKKO ANTILA: "With regards to the UK, we've been on the fence. We've been active to some extent but we've held back due to Brexit."

ANDREW HILLS: "If there's a shakeout, there's an opportunity as well but I agree that you don't want that uncertainty for your core holdings. But when I talk to my value-add managers, the one thing they are disappointed by following the referendum is that prices didn't fall."

MIKKO ANTILA: "I was going to mention that - it's strange that the increased lack of transparency hasn't led to reduced valuations."

ANDREW HILLS: "I think that one of the biggest risks that's playing out in Europe right now is the changes in tax regimes in a lot of places. That's a challenge when you're buying long-term assets such as real estate."

NIKLAS TELL: IF WE TALK ABOUT DIFFERENT SEGMENTS OF REAL ESTATE, WHICH AREAS ARE MORE INTERESTING RIGHT NOW?

GASTON BRANDES: "We're very keen on the long-lease space at this stage of the cycle. It gives you access to lower risk real estate. I don't have a crystal ball but I think the consensus is that we will see a market correction sometime in the next 12 to 24 months. Then you want to be positioned so that your assets can move through that cycle. There will be a re-valuation of your property and there will be yield movements but when you focus on long-leases, you at least have that income. Many of the investors I talk to today are more interested in that income stream than the total return."

PETER RILEY: "Different markets are at different stages but I agree that it's all about income, including long-lease vehicles. I also think that at this point in the cycle we're going back to property fundamentals of supply and demand in

particular locations. We look at the macro drivers that will have an impact on properties, such as the rise of e-commerce and the challenges for retail. We're also looking at alternatives such as hotels, given the increased propensity to travel and the fact that millennials put an increasing share of their disposable income on experiences. So there are areas that we can tap into."

ANDREW HILLS: "Different markets are at different stages, which is an argument for more global diversification. There's also an argument to diversify across different vehicles, such as real estate debt."

MIKKO ANTILA: "I agree with that. The opportunity to invest across the capital structure is certainly something we view as a positive risk management tool. We agree that we're in the late stage of the cycle and this is typically when mistakes are made. We need to be extra cautious and it's a reason why we're moving more into the debt space. That said, there are always opportunities in real estate if you look across different geographies and different parts of the market, such as the alternatives that Peter mentioned."

JOHANNES EDGREN: "We strive to have a balanced portfolio. That means core funds that should perform ok in a downturn together with value-add investments. There are opportunities especially in locations where there haven't been much new additions or where you've seen conversions from commercial to residential. There can be an opportunity to buy, refurbish and let. In those cases when we take on a higher risk, we strive, however, to be in good locations."

NIKLAS TELL: YOU MENTIONED THE TREND OF E-COMMERCE AND THE CHALLENGES THAT POSES TO THE RETAIL SECTOR. DOES THAT CHANGE THE CONCEPT OF CORE LOCATIONS?

GASTON BRANDES: "It's already having a big impact and if

you look at high streets in certain big cities, they're really struggling. There are, of course, positive impacts as well, such as logistics. Digitalisation is another disruptor and I think "prop-tech" will have a big impact, as there are still large inefficiencies in real estate. Prop-tech will also increase transparency, which in turn will have an impact on pricing going forward."

JANINA SIBELIUS: HAS THIS HAD AN IMPACT ON YOUR INVESTMENTS?

GASTON BRANDES: "Absolutely. At Aviva Investors, we have a significant logistic and office exposure and both are impacted by the trends that we're talking about. There are changes to how and where people work today with hot-desking and working from home. We also have shared spaces, such as WeWork, which is now the biggest tenant in London."

NIKLAS TELL: HOW DOES THAT BUSINESS MODEL WORK BECAUSE THEY HAVE A LONG-LEASE ON A BUILDING AND THEN THEY RENT OUT SHORT TERM?

GASTON BRANDES: "I think it remains to be seen and I suspect we will learn that if or when there's a more substantial correction in the market. Also, coming back to corrections and retail, I think a core portfolio ten years from now will be very different from today."

MIKKO ANTILA: "Coming back to co-working spaces, I think you need to manage how much you're willing to allocate to that in your buildings. There are, however, positives as it usually vitalises your building and it brings a certain buzz. But you don't want half of your building allocated to a co-working operation and certain markets are becoming saturated, such as New York."

MARJA TÖRNROOS: "At Varma, we have started VarmaWorks together with an operator in the Finlayson development in Tampere. We will see how it works."





ANDREW HILLS

Invesco

Senior director of client portfolio management at Invesco Real Estate where he is responsible for developing and managing client relationships with a focus on the UK and Europe, the Middle East and South-East Asia.



PETER RILEY

M&G Investments

Director at M&G Real Estate. He specialises in creating long-term sustainable cash flows from real estate assets for the vehicle he co-manages, the M&G European Secured Property Income fund.

NIKLAS TELL: PETER, YOU MENTIONED ALTERNATIVES EARLIER. WHAT DOES THAT MEAN AND IS EVERYTHING OF INTEREST TO YOU?

PETER RILEY: “I think alternatives in general are of interest. Again, from a real estate perspective, it comes down to identifying the long-term drivers of demand, so understanding what your long-term customer base will be. If you look to Europe, there are three things that stand out. One is the increased building of homes and the UK is particularly undersupplied, which means that we have a rental sector that’s becoming more institutional. Then, there’s the health care segment where the demand driver is the ageing population in Europe. For me, the most exciting area at the moment is hotels. We’ve seen increased demand following the global financial crisis but there’s still room for more beds.”

NIKLAS TELL: MIKKO, WITH YOUR FOCUS ON DIRECT INVESTMENTS TOGETHER WITH PARTNERS - IS ALTERNATIVES SOMETHING THAT YOU’RE LOOKING AT AS WELL?

MIKKO ANTILA: “Yes, increasingly so. As we started with a blank canvas, we’ve initially looked predominantly at core assets in city centre locations. Now that we have invested over a billion into direct assets, it’s a good time to get more diversification across property types. The portfolio is quite skewed to office properties at the moment. Finding the right partner for any of these property types, be that hotels or student housing, is very high maintenance so it will take some time.”

GASTON BRANDES: “For all of these segments, it’s also not enough to find a good manager or investment partner but finding a good operating partner is really key. The due diligence will probably need to be even more intense on the operating partner than the management partner.”

PETER RILEY: “But at the end of the day, it comes down to the location of the asset. If the location is right, you can always change the operating partner.”

JOHANNES EDGREN: “We’ve invested in alternatives over the last ten years and we currently have some 20 per cent of the portfolio in alternatives and it’s mostly residential and hotels. If you look at our residential holdings, they’re all in Finland and this is probably the sector that differ the most between markets. Our hotel holdings are typically strict property holdings where we have a long-term lease agreement to an operator.”

ANDREW HILLS: “We’ve been in hotels in Europe for some 12 years now and last summer we launched our third fund and the first open-ended fund. It’s a big part of our business and we’ve seen a huge interest over the last couple of years and it comes back to the fact that investors are looking for income and getting long-leases are difficult. You can have a good hotel in a good location and a 15-year or sometime a 25-year lease on a guaranteed rate. When you invested some ten years ago, you didn’t have access to the trading records. That’s changed and now it’s industry practice. We recently bought a big hotel in Munich and we had the trading records going back 25 years. We know exactly what happened to occupancy during the global financial crisis. It gives a lot of transparency.”

NIKLAS TELL: WE TOUCHED ON A CORRECTION FOR REAL ESTATE EARLIER. DOES THAT MEAN THAT INVESTORS NEED TO KEEP SOME DRY POWDER TO BE ABLE TO INVEST AT MORE FAVOURABLE VALUATIONS?

GASTON BRANDES: “One trend that I see is that investors are looking to de-risk their portfolios in terms of leverage and also where they are invested. But at the same time, you have investors looking to take advantage of uncertainties.” ●