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LaSalle Investment Management

Recently, ***Geoffrey Dobrmann****, publisher and editor-in-chief of* The Institutional Real Estate Letter – North America, *spoke with* ***Simon Marrison*** *and* ***Amy Aznar*** *of LaSalle Investment Management. The following is an excerpt of that conversation.*

Why should US institutional investors consider investing in Western Europe?

Marrison: We believe most, if not all, of the markets in Western Europe have reached or are near the bottom of the cycle and have become fully repriced. The U.S. is a few quarters behind with most markets still on a downward trend line. So for investors who want to get back into the investment market now, the mature, very transparent markets of Western Europe are a good place to start.

The U.K. is attracting a lot of capital. Is that market in danger of becoming overpriced already?

Marrison: The U.K. tends to lead the Continental market. It had already repriced substantially by the end of 2008 and the first few months of 2009 with values decreasing by up to 50 percent. We have all heard about the quickly increasing values during the course of the year, but values really only increased in certain sectors. And even within those sectors, it was only well secured core real estate that really attracted investor interest. The price rises were therefore more due to a lack of product to satisfy investor demand in that very specific niche. The underlying market and the wider market are still showing values that are substantially below long-term pricing and fair value.

What core sectors are the most attractive?

Marrison: On the equity side, our strategy team identified retail as being the sector to focus on, particularly in the U.K. We bought about a third of the U.K. retail market last year when the market absolutely hit bottom. We ended up selling some those assets at a substantial profit. At the time we bought them, investing in retail assets was counterintuitive given the rising unemployment and other consequences of the recession. But it came down to basic real estate fundamentals. Dominant retail is very difficult to replicate, so quality tends to hold up and, as such, the income streams tend to hold up. In our view there are still opportunities in U.K. retail, although the low hanging fruit of 2009 is behind us.

What about offices?

Marrison: Investors need to be very selective when looking at offices. The only sector attracting substantial capital right now is absolutely prime core assets in central London. Nothing else has seen a significant rise in values and, in our view, there is opportunity in London and the southeast, particularly where income is not yet secured long term.

Where are the best opportunities outside of the U.K.?

Marrison: The different countries and economies are recovering at different rates, but we are beginning to see opportunities in those big markets with the most transparency. Besides the U.K., we have seen some very compelling opportunities in France, with Germany just slightly behind in the repricing train. The opportunities in Germany tend to be on assets with two to three years remaining on the lease, as well as in the retail sector. In France super prime offices have seen a marked increase in pricing recently. Offices that are on the edge of the prime CBD in Paris are looking attractive. The really big dominant shopping centers never really lost value during the downturn because they're so rare, and in our view there are more compelling opportunities in sectors that investors have forgotten, such as big box retail with secure income streams and good out-of-town locations. Logistics, which lost about 200 basis points when repriced, now looks to be a good value as well.

Are there markets you are avoiding?

Marrison: We remain cautious on Spain because of the huge consumer debt and unemployment, and the way that the economy has had the twin engines of construction and tourism taken out of it. We think that the recovery there will be long, and there is probably still more downward pressure on pricing to come. Although we are not investing in most of Central Europe, we do see Poland as a standout market. Poland is the one Central European economy that consumes from within — its population tops 40 million — and so the growth is coming from within. It's not just down to cheap manufacturing.

Simon Marrison, head of Europe, joined LaSalle Investment Management in October 2001. Since that time, Marrison has been responsible for investing over €3 billion throughout Continental Europe. During the same period, he has overseen the divestment of €1.5 billion of assets throughout Continental Europe.

Amy Aznar is head of Special Situations. Aznar has a 15-year track record working for some of the world's top financial institutions analyzing and executing structured equity and debt investments and corporate transactions. In 2008 she joined LaSalle, where she focuses on investing in structured debt and equity, strategic entity-level investing, large transactions, joint ventures and other Special Situations across the United Kingdom and Europe.

CORPORATE OVERVIEW

LaSalle Investment Management is one of the world's largest real estate investment managers, with approximately $36 billion of assets under management. LaSalle is a wholly owned subsidiary of Jones Lang LaSalle (NYSE: JLL).

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Are there other markets that you are either looking at or avoiding?

Marrison: The Czech Republic is the only other possibility that we see for investment in the CEE. It is a smaller country that was later into repricing than the Western European markets, but that will come onto the radar screen progressively. Eastern Europe for us is still a no-go area. We just don't see the reward for the incremental risk that you have to take to go into very opaque markets where you don't control planning or currency, and your tax environment changes regularly — especially when compared to opportunities in Western Europe now.

There has been a lot of talk about investing in debt. Do you see opportunity there?

Aznar: Absolutely, we are seeing interesting risk-adjusted returns available today investing in structured investments and real estate debt. In general, real estate is severely over leveraged at the moment, and a lot of the real estate is owned or controlled by banks. We're looking at joint ventures with banks where we bring both investment and real estate asset management to the partnership. We're also looking at opportunities to fill the equity gap that exists as real estate is deleveraged and the markets adjust to lower leverage levels. This can be achieved by recapitalizing real estate assets or originating mezzanine loans to fund new acquisitions. We are also seeing some interesting opportunities to buy real estate debt, often working together with borrowers and lenders on solutions to more challenging situations. There are a number of opportunities in this space, and we think combining our structuring expertise with fundamental real estate knowledge provides an advantage in terms of accessing and investing in real estate debt and special situations.

Everyone has been waiting for the banks to release their real estate. Do you see that happening soon?

Aznar: The banks are trying to balance a number of sometimes competing objectives. At the same time, a lot of them have been using the past year or so to get organized internally and figure out what their strategic priorities are. Since the end of 2009, we've seen a lot more movement by banks to replace borrowers who are not performing and sometimes taking control of the real estate themselves, either through ownership or through de facto control. It has been much slower to commence than most of us thought it would, but we have seen an increase in activities, and momentum seems to be building. The banks are also often looking for partnering solutions to their real estate loan positions as opposed to sales in order to retain an element of the recovery value.

When the banks begin to sell all of this real estate they hold, will values be further depressed?

Marrison: I don't think values will see a marked fall, but they may be suppressed a while. Up until now, deal flow has been extremely low because there were so few assets for sale. Now, with prices stabilizing, nearly every potential seller is looking at the market and noticing that there is a lot of capital looking for a home and not getting satisfied. When the banks release their real estate, it is going to flush the markets with deals again. That will probably suppress pricing a little bit during the course of this year, but much of the real estate going on the market will be balanced by capital trying to get in.

How are buyers sourcing assets today?

Marrison: There's a blend of deals out there. There are classic full market deals and there are some competitive bid situations on prime core assets. Bidding can be quite thin on anything that doesn't quite fit that category. The most interesting deals we are seeing are off-market deals. Just this week I saw a well secured, well leased, brand new office building at probably 200 basis points above fair value.

Can core be riskier than some investors expect it to be?

Marrison: Core can certainly carry more risks than some investors underwrite for. The trap that many investors fall into is looking at core in terms of the pure physical and locational characteristics of the building and putting less focus on the underlying rental stream. Across all markets, and in the office sector particularly, we're anticipating rental declines for the rest of 2010. So if the yield at which you're buying reflects that rent could soften a little bit then yes, that's a smart play. But finding the right asset at the right price requires local skills. Anything bought in a competitive bid is probably going to end up with a price that doesn't reflect that there could be softening in the rental rates. The smart play today relies on sourcing property with less competition and investor focus, but that will get focus as the capital comes into the market and the parameters are widened. We call this "future core."

Is it still possible to get accretive debt?

Aznar: Yes. A number of lenders, particularly German banks, are quite active and willing to lend on the assets that we're purchasing. We're now able to get debt at the 50 to 65 percent level sub-200 basis points. That's quite an improvement over a year ago. And when you put that together with five-year swap rates in the U.K. at 3 percent and the Euro five-year swap at 2.5 percent, you have some very interesting debt funding levels possible. Now clearly it's easier to get financing on the longer-income, good-quality assets than on the more tricky assets, but we are finding good availability of debt, particularly if you have a strong sponsor like LaSalle in place.

What lessons were learned in the past couple of years?

Aznar: Deep asset management platforms and local real estate knowledge are really going to be critical in the next phase of recovery because it's going to be an uneven recovery, with not all real estate assets recovering at the same speed. Before the recession, a lot of financial engineering fueled by oversupply of debt created substantial over-leveraging within the real estate sector. The underlying real estate fundamentals sometimes took a back seat. Today, the reemergence of the real estate fundamentals as key drivers of value is very much at the forefront of everyone's mind.

Are U.S. investors going to lose out if they don't invest in Europe now?

Marrison: Recent history has shown that those investors that were slow to make a decision missed out. The low hanging fruit of the repriced core was certainly the opportunity in 2009. Those who didn't grab it are probably regretting it today but that doesn't mean that there aren't attractive deals still out there. To be able to get the very best opportunities, you need to be the one with the capital and ahead of the pack. If you're coming at the same time as the pack, you'll probably be forced higher up the risk curve to try and get your returns. ❖