

Understanding COVID-19 implications for a multi-faceted real estate business model

Featuring: **Jay McNamara** and **Nathalie Charles**

Jay McNamara: Hi everyone. Thank you again for joining us on the latest episode of MSEI Real Estate Conversations. My name is Jay McNamara. I'm head of real estate at MSEI, and today I have the great fortune of speaking to Nathalie Charles, the Global Head of Investment Management at BNP Paribas Real Estate. Nathalie, thank you for joining me.

Nathalie Charles: Hi, Jay. Happy to join.

Jay McNamara: So we are now three months in, depending upon one's physical location. Obviously our colleagues in Asia have been wrestling with this pandemic a lot longer than many of us in Western Europe and the States, but I can see that you are in the office. So how long have you been back in the office, you and the team?

Nathalie Charles: So we've been progressively back since mid-May, and currently, now I'm starting to be here every day.

Jay McNamara: Every day. Okay. And have you implemented any types of restrictions in terms of the volume of people, certain percentages, certain roles, what's the office feel like now relative to maybe February?

Nathalie Charles: So it definitely feels different because we have implemented a cap, which is currently around 30% of our staff being in the office and we will move progressively up, with the intention to go up to 50% by July. But obviously, this depends about sanitary decisions from the French government, for our headquarters in Issy-les-Moulineaux and for also the decision of the BNP Paribas Group. So we have intentions, but we adapt every week.

Jay McNamara: Right. Right. And what are the conversations like with some of your tenants right now? I've been fortunate enough to have a number of these conversations very early in the crisis we were wrestling with, in the middle and by no stretch this is the end, but as things start to slowly open up across a number of our markets that we work in. What's that been like?

Nathalie Charles: Obviously end of March, beginning of April conversations were extraordinarily tense because we still locked down with activities completely shut down on retail tenants, but also a number

of tenants in those asset classes. They we are under huge stress. So we had a lot of conversations about rent holidays or delays of payments and so on. Now we've managed a very large majority of the requests we've had in quite a, I would say, good agreement all over Europe. With a lot of differences from one country to another, because of course, between our three main countries, France, Germany, and Italy, each government has made different decisions for businesses. I would say that now the situation is quite okay in the sense that all governments have supported their businesses. We have met a number of decisions, documented them, put them in place, and now everybody is focused on, restarting the activity at a certain speed. And obviously we would probably have some more decisions in the coming months, some more discussions with, our tenants but I would say is that we are quite happy with our cash collection of Q2.

Jay McNamara: Okay. Okay. And when I think about the BNP Real Estate business, I'm always struck by the combination of the brokerage, the banking side, as well as the investment management side. How is that, inside BNP Paribas Real Estate, how is that sort of communication and how are you trying to leverage the fact that under one umbrella you have these, let's call them three legs to the stool that in other organizations aren't even options to them?

Nathalie Charles: Well, it's definitely a very extraordinary characteristics of a BNP Real Estate, and it works well and it's what makes us strong. I mean, not only by having an understanding of other angles in our business in real estate, but of course our proximity with the bank allows us to better understand what the angle is from people who finance. Obviously, we are very cautious and respect Chinese walls and make sure of having no conflict of interest, but in such a crisis when there is a lot of, I would say uncertainties, it's really great to be able to have a conversation internally to share the way the mechanics of a business goes into the head of a banker, the head of a broker, the head of a property developer or an investment manager. It helps all of us and definitely in our business model. It also helps us to be close to our investors for upstream, both, individual investors and institutional ones.

Jay McNamara: And actually when I think about, and over the years, as I've worked with, with BNP Paribas Real Estate, the diversification of your clients, right, such a large retail presence for the bank and the money manager and therefore your client base, but equally, you know, a large institutional client base. But so what have your conversations been like with the retail investors either directly or through intermediaries in terms of what's going on? Because all of them would be picking up the newspapers and, you know, rents aren't being paid, economies coming to a screeching halt. So, just for the retail side, and then I want to ask some questions about the institutional side as well. What have those sorts of conversations been like? So that people don't just freeze and panic.

Nathalie Charles: Obviously, the seams of conversation are not the same. On the retail side, for individuals, first we speak to two types of people; we speak to the people who have invested in the funds we manage, but also to our networks of other distributors. Being them, within the BNP Paribas Group or outside and these two levels are very much essential. Obviously, nobody was happy on that side with potential rent delays and very much concerned by the cash collection in Q1, Q2 and the distribution for them of revenues. So quite, initially, a short term question. And, on the other hand, after the first few weeks and months, the questions which were starting to appear was what is the future of offices tomorrow? If the product I'm invested in has a majority of offices, what does it mean?

Which is obviously exactly the same question as an institutional investment. There are also things in common between the different types of investors. The reason for that is as well that behind

institutional investors being them sovereign wage fund, pension funds, insurance company, whatever type it, is in the end, you always have the consumer, you know, it's B-B-C, but in the end, there is a consumer. So the concerns, in the end, is about the returns for the portfolios, on one hand, and the fact that we BNP manage those returns properly, which is obviously the type of question that came through. So some of them, for example, on the institutional side, very first questions were about our continuity plan of activity. How we will organize, was our IT supporting the business well and so on and a little less about the returns, but at the end of the day, it comes to the returns.

Jay McNamara: Right. Right, right, right. And when you think, when you have your investment management team, are you undertaking any extra ordinary exercises related to the income? If you think about your kind of standard core risk exposure and vehicles, are you stress testing more and in a different way than you were previously?

Nathalie Charles: Absolutely. We've done that exercise. It's very important. I would say. I'm not sure I would say we've done that more because it's absolutely part of our regulated environment and our fiduciary duty is to be able to stress test very regularly to everything we can even imagine. Of course the kind of, suddenly during your quarter you have such a lockdown all over the world, was not in the theory of stress test before this COVID period. But we've done these stress tests, liquidity tests, looking particularly at potential financing breaches and also suspects which are, in a way, it's just doing our job, classical fund management job.

Jay McNamara: Fiduciary responsibilities of sorts.

Nathalie Charles: Yeah. Yeah. But what I must say on that is that not only on what we've done internally, but you know, our relationship with investors, both retail and institutional. A key characteristic is that there has been absolutely no panic. No outflows. I think people were confident from the very first days when this became a huge crisis in Europe and in the US that's, well, they were owning real assets with a responsible fiduciary investment manager and what it would be okay. Overall okay.

Jay McNamara: Right, right. With a longer term horizon. So therefore the expectations of its outcome, the outcome it was playing in their portfolio, the overall multi asset class portfolio was known to be a longer horizon in a different exposures than a list of equity. I see. I see. I see. Now when you, as the head of the investment division, when you're thinking about, again, I hesitate to use the word exit because I think this will be around for quite a while.

Nathalie Charles: We are right in the middle.

Jay McNamara: Yeah, exactly. So, the opening. How are you positioning your portfolios, either existing or potential future acquisitions and things of these natures, to capitalize on opportunities? I know that BNP is still in the transaction space, you're still looking at properties, still acquisitions, things of this nature, but are there certain sectors or markets where you're starting to say, because we're BNP, we have a competitive advantage we can take advantage of here and get a great result for the portfolio or an end client.

Nathalie Charles: Well obviously, there are a few things that I'm not going to share with you.

Jay McNamara: This would make the conversation very interesting. It would be the most watched one we'll do Nathalie, if you could do that. But I understand, I won't push.

Nathalie Charles: No. What I would say is that I strongly believe the heart of what we do is about anticipating macro trends or understanding them more than anticipating them, and then transforming macro trends into valuable investments on behalf of our clients. So this is the definition of an investment manager. It means that behind the crisis and like in every crisis, it's always, in my view, something like going back to fundamentals, like, what is the definition of a good building? It's a leased one. What is the definition of an interesting asset class? Well, if you have a large portfolio, an interesting asset class is one you don't already have. Very simple things, very basic things. It's not rocket science to make sure what you do is compliant with the objectives of your investors. And then, again, we have two dimensions, most of retail investors, they want quarterly returns, and sometimes they want more sophisticated products.

We use a component of return, but also a component of capital gain in the long term. And most of institutional investors, they want a good combination of cashflow and capital gains. But having said that with real assets, you still have a very high risk premium compared to financial years. This was the case before the start of the crisis. This is the case now. It has changed a bit, the years for financing have changed a bit. Obviously there will be more vacancy in some areas, et cetera, but some general macro trends have not changed. I can, for example, put one in Europe where we are strong and particularly in France, Germany and Italy, the healthcare sector is very appealing and it's not because it's a health crisis. It's just because the demographics is here and this crisis, has not fundamentally change the demographics.

Jay McNamara: Right, right. Right. Those macro trends that you were talking about earlier, the role of an investment manager to see those, and then deploy capital in ways to exploit the opportunities for their investors.

Nathalie Charles: Absolutely. Absolutely. And maybe, another comment I could make is about the ESG trains, which started a few years ago, and which is definitely even more, there for tomorrow. I mean, in the past few years, we've talked a lot about the environmental aspects. I think today and tomorrow, the social aspect is going to be more important among the component and impact investing in general is one of our key targets. It is something very important because people want to understand the purpose of their investments as well.

Jay McNamara: Right. Right. Actually, it's interesting. You mentioned the S components because just yesterday I was on the, and again, I won't reveal all the family secrets, but I was on our executive committee call at MSEI. And we were talking about that same view that the S component, which sometimes may get dismissed by some, we believe that the S component is going to rapidly increase in importance in terms of clients looking to deploy or pick a manager or deploy capital, or pick a manager, whatever it may be. And, you know, again, that's part of something that was occurring, but maybe propelled forward with more velocity and speed in light of what we've been wrestling with as a global society. If we pivot a bit to Asia, right. Obviously BNP, and you've said it yourself, and that's my

view. It's such a dominant player in, in markets like France, Germany, Italy. What are your views on the Asian markets either in terms of sourcing capital, new clients, as well as deploying capital. Are there particular markets that you're looking at, or sectors and markets that you find appealing that are dominating the discussions inside BNP.

Nathalie Charles: Okay. So, two comments on that; first of all, my colleagues from the advisory branch, as you know, they have a platform in Asia, to be able to be close to Asian investors and to bring them regularly in Europe. 2019 was a record year for Asian capital in several of our countries. Which meant that 2020 started with a slower pace, with the need for Asian investors to, I would say, digest their investments. And to review the balance between North America, Asia, and Europe. Obviously because of the travel restrictions, it's almost impossible to have Asian capital allocated to Europeans right now, except for those who have teams generally based in London. But even those ones, they can't travel to France or Germany or elsewhere in continental Europe. So it's definitely kind of a period of six months probably, or a bit more where there will be a lot less Asian capital. I would say that generally speaking in all crises, you see that you have more domestic capital or close capital investing in each country. And this one is probably not going to be very different. Nevertheless, we are in 2020, which means, in a world which remains global, and on the first closing of our annual healthcare fund, recently we had some people from all over Europe and we had all sorts of pleasure to have a Japanese investor joining a pan-Euro office fund during the lockdown.

Jay McNamara: During the lockdown and allocation to the Pan-European office fund. Excellent.

Nathalie Charles: Absolutely. I've usually it just didn't appear during the lockdown, it was the result of a very long-

Jay McNamara: Well, but, but equally the fact that it continued and didn't pause is, is a great reflection of the franchise.

Nathalie Charles: The final goal was given during the lockdown and the subscription to the fund came during the lockdown. That is to me a sign that, again, macro trends are not stopped just like this, in a few minutes. Things can be postponed, they can diverge a little but the fact that there is a lot of capital in Asia and that it will, this capital will be back in the coming months and years, when exactly we don't know when, but it will be back. I'm absolutely convinced of it.

Jay McNamara: Right, right, right. I have one final question, Nathalie. And that relates to, in building on what you were talking about that, you know, BNP Paribas move into certain sectors like healthcare or the hotels or things of this nature. Are you looking at, and again, without revealing any internal secrets that you want to put into play later, but are there certain alternative sectors? Right. So obviously, within real estate, we spend a lot of time looking at retail and office and in light of what's been going on, but then data centers and industrials and logistics, but are there certain areas that you and the team are thinking this is an "alternative sector" or two that we're looking at that we might be able to... In light of those macro economic trends that you're eyeing.

Nathalie Charles: Yes. It's some things that we've done, but obviously, it's kind of niche aspect of things. It's not in huge volumes. At least I can quote one example because it is public. Which was with a French investment fund, in the sense of investing only in France on, what we call in French, 'hôtellerie de plein air', which is in fact counting. And it's a fund that we created more than one year ago. When we have invested with an operating partner and we are very happy with him, and he's very happy with us developing his business even now, cause we in June and everything is reopening in France now, on this side for the next summer. They are looking to seize new opportunity of investments and we are raising capital on this one. So yes, it is possible. This one is just a very small example but it means that, I believe each of us, we investment managers, we are capable of doing such things with very good returns to our investors when we are close to the real assets which are in those type of funds.

I mean, it's not the kind of strategies that you can do from an office tower somewhere with a fantastic, brilliant IT because it doesn't make sense. It makes sense only when you can reach the people, have an understanding of what they're doing and understand that you can bring something specific to them. And so, of course, we are looking very regularly at some of those kind of niche markets, which have the benefit to offer to investors generally higher returns, because there is so few people looking at them, and again, benefiting from certain type of trends that we can have. Nevertheless, when you look at numbers, you can see that, the office sector remains more than half of portfolios and investments in the long term over the past 30 years. Residential used to be extremely high and then was reduced, to give room for different types of assets. But, most of investment managers, and we are not a different on that side, they have more than 50% of offices, they have residential. You have currently, a kind of switch between retail and logistics. These started five years ago. It has not started three months ago. Diversification is progressing everywhere as, as a macro trend, since about 30 years.

Jay McNamara: Right. Well, I will say this from a macro economic trend standpoint, I have a number of Irish and English friends who talk about their French camping holidays going back four or five decades so that may be a trend that is accelerating.

Yeah. I don't know if I have an Irish friend or family member that doesn't talk about being a child in the camp, camping trips with mom and dad and in France. So, a trend that's been around for a while. Well, Nathalie, I want to say thank you. I really do appreciate you taking the time to speak with me. This was, I really enjoyed this and I think I, and, the listeners and watchers of this conversation will learn a lot.

Nathalie Charles: So, thank you Jay for offering me the opportunity. And to conclude, I would say is that definitely as every crisis, this one offers acceleration everywhere in all trends and we are ready for that.

Jay McNamara: Great, great. Well, this concludes another episode of MSEI Real Estate Conversations. I want to thank you all for joining us and we'll see you soon.

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