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TRANSCRIPT

COVID-19 and investment management

Featuring: ***Jay McNamara***, Head of Real Estate and ***Kiran* Patel**, Global CIO and Deputy CEO, Savills Investment Management

Jay McNamara:

Hi, everyone.

Jay McNamara:

Welcome to the latest episode of MSCI Real Estate conversations. My name's Jay McNamara. I'm Head Of Real Estate at MSCI. I'm joined today by Kiran Patel, CIO and Deputy Chief Executive Officer for Savills Investment Management. Kiran, great to see you.

Kiran Patel:

Hi Jay. Nice to see you as well.

Jay McNamara:

So I appreciate you taking the time to talk to us. I'm interested in hearing from you as to how, now that we're two-plus months into this lockdown, things are starting to ease. How are things going with the employees at Savills? How are you and the Global Team, across the 16 offices, coping now? Are things changing? Is everybody getting into a groove?

Kiran Patel:

I think we were getting used to it. It was a bit of a challenge to begin with. Not everybody has the proper IT tools and software so we had to get everyone equipped. But, as you say, working out of 16 offices in three Continents, getting us all working in the same format, timeframes, etc, has been a challenge. But it's worked very well. We've had a lot of support from our HR colleagues as well as various colleagues in terms of making sure we get the right work-balance. People are resting, taking breaks, being not too much glued to their laptops all the time, but also getting a more, what we would call a "social friendly" approach to it as well. We introduced what we call a "Virtual Water Cooler." A sort of meeting point called Yammer. This allow people to share, connect, learn, celebrate achievements, share recipes, come together to solve difficult tasks, common interest. And that's worked very well, very well indeed.

Jay McNamara:

So how are things going with some of your partners? Obviously there's thousands of tenants in the buildings that you're involved with, but equally some of the partners, the managers on the ground, constructions sites are starting to open up again. How are those sorts of conversations? Have you found some of your partners being able to adapt quite quickly? Has there been similar learnings, stages where people slowly get up to speed? How is it going outside, as you reach back out and try to return to some semblance of normalcy?

Kiran Patel:

It does come back to obviously different partners, different countries, different rules, different stages of evolvement. Each one is different in that respect. But again, they're in the same boat as us. I think the virtual communication works, we've started to use technology a lot more, in a number of cases we've used drones to go around our buildings. Starting back up again, we're very much in line with what local governments and authorities are advising us [to do]. The social distancing rules are a challenge but we're pleased that some of our refurbishments and development sites are back on-site now. There are new rules and practices we've got to put in place and that's not just for those buildings, but also for our Standing Investments where we have multi-let tenants and we have shopping centres where the public come in as well. So we've got to adapt to that.

Jay McNamara:

Right. And what about your clients? How are you finding the hundreds of allocators to the Savills funds and vehicles, how are those conversations going? Are they asking for insight, analytics or engagement in ways that was different than previously? Or is it business as usual for a lot of them as they've adapted themselves?

Kiran Patel:

No, I think initially it was obviously about their ongoing transactions: "What should we do? Both acquisitions and disposals are taking longer. We've got the market uncertainty clause to deal with. We're all trying to discover where price is." And they're all, again, individual cases, step by step. Some of those transactions are still going ahead because they make sense in the long term. Others, where we're just seeing there's a bit too much more volatility or uncertainty, are taking a pause and seeing how things evolve. But then it really comes back to their own properties and their own portfolios. We've been doing a lot of stress testing. We've looked at revenues, at risk; it's not a static picture. A lot of tenants have come to us who are wanting some form of rental concession, but we know that may not be the only conversation COVID-19 will take us into months more, and it will adapt. It will change. So we've done a lot of stress testing on their portfolios in terms of looking at income security, how that income changes, how that impacts liquidity and how that impacts other liabilities like LTVs, covenant ratios, dialogues with our banks (because any amendments you're making to a lease or helping out a tenant requires your banking support), we've engaged with them as well. It's more about their existing assets rather than hugely new strategies today.

Jay McNamara:

Speaker 1: Right. And do you find some of the clients, to use the proverbial dry powder term, seeing this as an opportunity? Or do you still find that in those initial stages, where everybody just freezes and goes to the high-ground, is still the case, where it's workout within the works, but nothing new? Are there some clients that are coming to you saying, "hey, maybe this is an opportunity to do something we've talked about before but either the price wasn't right," or whatever else it may be? Is this allowing anyone to go on the offensive rather than just retrenching in a defensive manner?

Kiran Patel:

No, I think there are some who are going on the offensive, particularly if they're underweight in Real Estate, they're cash rich and they don't have the huge denominator-effect. They're looking at other mediums like Real Estate Securities and how far they've dropped. Despite them coming back a bit, everybody exaggerates the short term effect and we've seen that in Real Estate Securities. There's been some sort of increase since April and I think most of them have been up 15-20% where they dropped 30-40% to begin with. With some dry powder they're looking for opportunities, they're looking for those distress players in the market where they could step in and we're having some of those discussions. But I would say, in the main, we're still at the very early stages of this pandemic and its impact in terms of the fundamentals, or when it comes down to supply, demand and pricing. So I don't think investors are in a rush to get out there, in the main, but they will obviously keep an eye open for opportunities.

Jay McNamara:

Now, the CIO functional role. Take me inside the Investment Committee discussions. You talked a bit about the types of stress testing and analysis that you're doing, which may be slightly extraordinary alongside what you would do in the normal course of the investment process, but inside these Investment Committee meetings are you looking at different factors? Is climate and ESG taking on a lesser or more of an importance? Things of these natures, the factors that you're considering, either in an acquisition or a disposal, is that "steady as she goes" or are things changing there?

Kiran Patel:

No, I think that's "steady as she goes". I would say we are putting a lot more emphasis on short term income and credit strength because that's where we see the biggest impact. Even some big corporates, because they've got a business interruption it affects their ability to pay their ongoing liabilities. If your business shuts down for two to three months, that has an impact. But then if you've got new rules to adhere to which changes your operating model, that affects your ability to pay income. That is the short term effect. I think we are concentrating much more on the income quality, availability and the durability of that income. So that's a stronger push.

Jay McNamara:

Now, when I think of Savills I think a lot of presence in Asia. A brand very well known with our Asian investor clients and our mutual clients. Are you noticing, whether it be the large Sovereigns or the Government pensions, any behaviours that they are demonstrating? Are some markets more conservative and holding back or are you finding a few that are eager to get going, knowing that Asia was what, 90 days, maybe even 120 days ahead of all of us either in Western Europe or in the States?

Kiran Patel:

Definitely. They're ahead of the curve. They have seen a bit more stress, I would say. In terms of some of the smaller markets, by nature, they are more volatile anyway and there've been other nuances. Hong Kong had obviously some of the difficulties of last Gen. You add to that the pandemic and the prices have fallen a lot more in some of these markets. I think the long-term dynamics of Asia doesn't disappear and if you get a pandemic like this and you get a price correction, given the availability of stock everywhere, it's getting more and more difficult. This is an excellent way to look at a Continent with such a large population, urbanisation dynamics and demography. Those trends are still there so if you can get in now it's a good entry point. Not just our European clients, but our Asian clients want to put more money into the Asian markets. That's for sure.

Jay McNamara:

Right, the deployment of capital, not just always the raising of capital. And if we shift gears a little bit too and talk about ESG and climate and things of that nature, talk to me a bit about how you're looking at, in the course of the investment process, the acquisition or the disposal. How do you factor in things like carbon emissions in a building relative to other assets that are inside of a vehicle? Is this becoming the norm for you and is any of what's been going on in the last few months changing that?

Kiran Patel:

Well, I think the challenge is to make it the norm. We want to incorporate it as part of the ongoing investment process. Seven, eight years ago we used to have a separate ESG committee. Three years ago, we took it away because we just said "it's part of the same process." We want to look at that like we do with any risk or value assessment. We're already part of the PRI Signatory. Last year we proactively decided to follow the optional Task Force for Climate Related Financial Disclosure, the TCFD, and we have just produced our first report in April. In terms of measurement and benchmarking to get to net-zero carbon targets, it's early days for us. We're managing to measure 30% of our AUM and I think that's a good start for us. We want to definitely get to a hundred, but starting this measurement is a good first step for us. By doing this, Savills IM can set carbon reduction targets, such as the Better Building Partnership, the BBP, which is also something we'll tie into. All of this we want to wrap up in staff objectives, training, development and ongoing engagement so it is part of our day-to-day activity.

Jay McNamara:

Yeah. It's been remarkable for me personally, a decade ago I ran a Global pension and sovereign Wealth Coverage Team, to see the slow-moving nature of Environmental and Social Governance standards come into the investment process. It started as a tick-the-box and reporting, and then slowly moved to the quote-unquote "Front Office" on the investment side. It's been amazing being part of the Real Estate space now for a couple of years and to see how quickly it moves immediately to the Front Office and the Investment Committees and it becoming part of an integral investment process that previously may have taken, in other asset classes, multiple years, if not half a decade. In Real Estate it seems to have moved so quickly due to the nature of the assets. I know for us, we're spending a lot of time talking about both Real Estate-specific climate solutions for our clients. Equally, because of the nature of MSCI being a multi-asset class provider of Investment Management tools, the idea of helping Equity, your Fixed Income Book, your Real Asset Book and being able to cohesively go across those asset classes like you would with a total fund-level Risk Management Process, they'd now want that and won't accept anything that's either deeply siloed, or only covers a portion of their portfolio. So it's been amazing for me personally to watch how quickly this has leaped to become such an integral part of the investment process in Real Estate.

Kiran Patel:

Now I think all stakeholders are aligning. Joe Public down to corporates, which can be tenants to investors, to managers like us. I think we've all got similar objectives here. I think what we've struggled with in our industry is measurement. With Houses like yourselves and others coming into this field, once you can start to price and assess and record, that's the first step, and with any form of measurement, no matter how small or weak it is, even if it's one out of a hundred, the challenge is to get to two. Once you get to two, getting to four, et cetera, et cetera. So I think this is a very good step, but make it part of your day-to-day activity as you would assess any form of risk and any form of value creation because if you don't you're going to be on the wrong side of the curve. This is obsolescence in another form if you don't deal with it.

Jay McNamara:

Yeah. We obviously see, as you all do at Savills IM, the allocators, the pensions, the sovereigns, the large Government entities, demanding it of their managers and including it in RFPs and things of this nature. But equally it's just as exciting and interesting for managers like yourself being able to provide tools that allow you to differentiate. You have a baseline accepted norm from a reputable provider, whoever it may be, being able to say that "look, this is the type of outcome we can give you with the following parameters and it's been measured" and things of this nature, allowing a lot of our manager clients to better articulate the value proposition that they have to these allocators.

Kiran Patel:

Yeah. Absolutely.

Jay McNamara:

Yeah. One other question for you here. Obviously coming into this, for years we've been talking about the death of retail and the rise of Industrial and Logistics and things of this nature. Nobody has a crystal ball, nobody knows how this is all going to take shape either in the next three to six months or the next one to three years. But, when you and the investment team at Savills IM are thinking about it, are there certain sectors, some of the more alternative spaces that you are looking at, whereas previously they weren't as attractive? Is there anything interesting on that sort of sector allocation process underway?

Kiran Patel:

I think some things do come out in this environment and it only accentuates what you and maybe others have already been doing. I think in any crisis, new forms of investment create themselves. So in the U S when you have the Savings and Loan Debt, investing took off. Global financial crisis debt started to take off, and this, again, would help debt investing going forward, certain sub-sectors of where I see very strong demand which is in the logistics, building on the eCommerce trend. So urban-type fulfilment centres, distribution centres. Because, again, every logistics provider is trying to minimise the time they spend on the road and that is a big part of their cost and not just in ESG terms of what we were talking before. So we see that maybe data centres is an interesting area. Again, if we're all going to be more using our laptops to communicate and less physical travel, then I think any technology-related activity should increase. I personally don't think we're going to see the death of retail either. Yes, I think we may be slightly over-shocked in certain parts of the world, but the retail format still has a value, still has a proposition. If you go to places like in Asia, they are air-conditioned centres where you do your leisure-type activity. They're not totally dead and buried. I think it comes down to price and sustainability for the tenants, in terms of what is a sustainable rent for their business model when they are in bricks and mortar. And they're the aspects we've got to look at.

Jay McNamara:

Yeah. And knowing that in a number of cases, some of these organisations or companies were struggling well before the crisis, right, and so some of this is COVID-19 induced, but in other cases it requires a little more analysis to reveal that in some instances these were struggling entities to begin with.

Jay McNamara:

Yeah. Very much so. I think we will focus on those types of sectors I've talked about and while I still don't think office is, again, we exaggerate the short term effects, I think you still need a place to come together to do business and therefore to me, the office isn't totally disappearing either. We're not all going virtual. So that as a sector still has opportunity.

Yep. Well, listen, Kiran, I want to say thank you. I appreciate you joining me in this conversation.

About MSCI

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