09/27/2024 05:00:00 [BN] Bloomberg News

Europe's Battered Listed Landlords Are Preparing for a Rebound

- Landlords have raised €18 billion, nearly double 2023 levels
- Investment revival signals brighter mood, through risks remain

By Jack Sidders

(Bloomberg) -- A dormant construction site visible from the back door of Berlin's grand Hotel Adlon is emblematic of the boom turned bust in Europe's real estate markets, but investors that gathered recently at the five-star establishment have started to look past symbols like the hole in the ground across the street and toward a nascent recovery.

At the EPRA conference in Berlin last week, publicly traded landlords and their financiers enthused over the prospects for the commercial property sector. It was a noticeable change after two years of gloom, when a collapse in real estate stocks foretold an impending plunge in valuations.

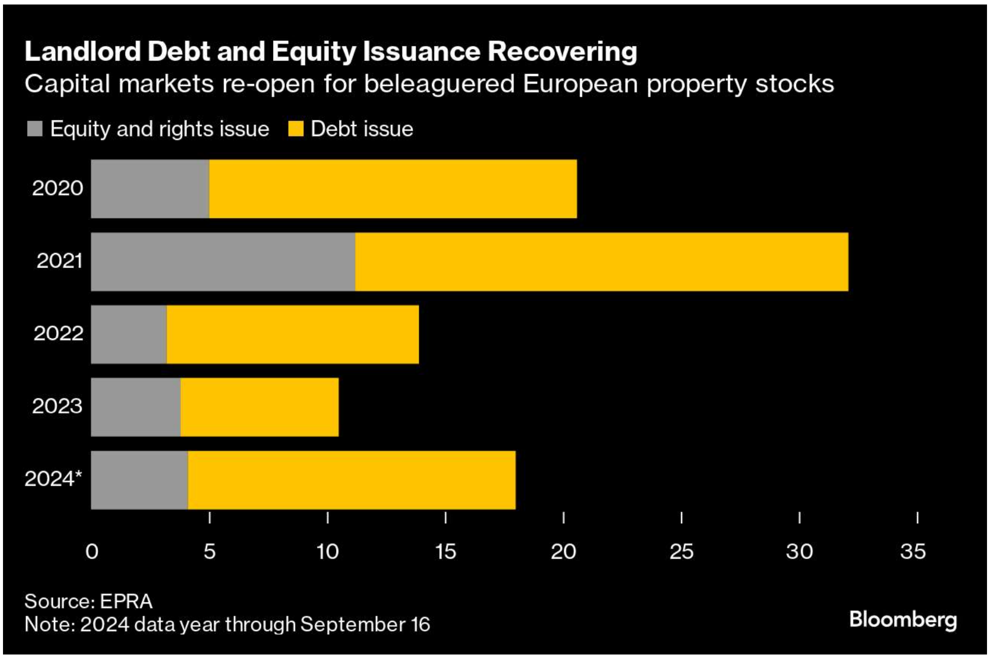
Now, public markets are thawing, even though asset values haven't yet followed suit. That's helped underpin the biggest cash rush since at least 2021 and put listed landlords are at the forefront of the prospective turnaround, just as they were at the leading edge of the collapse.

The Hotel Adlon.

The sudden end of the cheap-money era in 2022 forced a bitter reckoning on Europe's property sector. A flood of debt and buoyant valuations had fueled aggressive expansion by landlords across the sector for over a decade, but the change in fortunes pushed high flyers like Adler Group SA — the company behind the long-stalled Wilhelm project near the Hotel Adlon — into turmoil. That's starting to change as a lack of construction, especially in housing, is keeping rents high and opening the door to a rebound.

"The last two years we had to take care of our balance sheet," said Rolf Buch, chief executive officer of Vonovia SE, Europe's largest publicly traded landlord. "But I think this phase will soon be over and then we can continue our growth."

Public markets were frozen to most landlords for much of the past two years, but they've become unblocked. So far this year, European property companies have raised €18 billion ($20 billion) of debt and equity, nearly double the roughly €10 billion raised in the whole of 2023, data compiled by EPRA show.



At the conference in Berlin, bankers and executives were pitching a range of potential new opportunities to real estate investors. These included a proposal by Knight Frank Investment Management for a publicly traded vehicle that would invest in properties with extremely long leases, according to people with knowledge of the proposals. A spokesperson for Knight Frank Investment Management declined to comment.

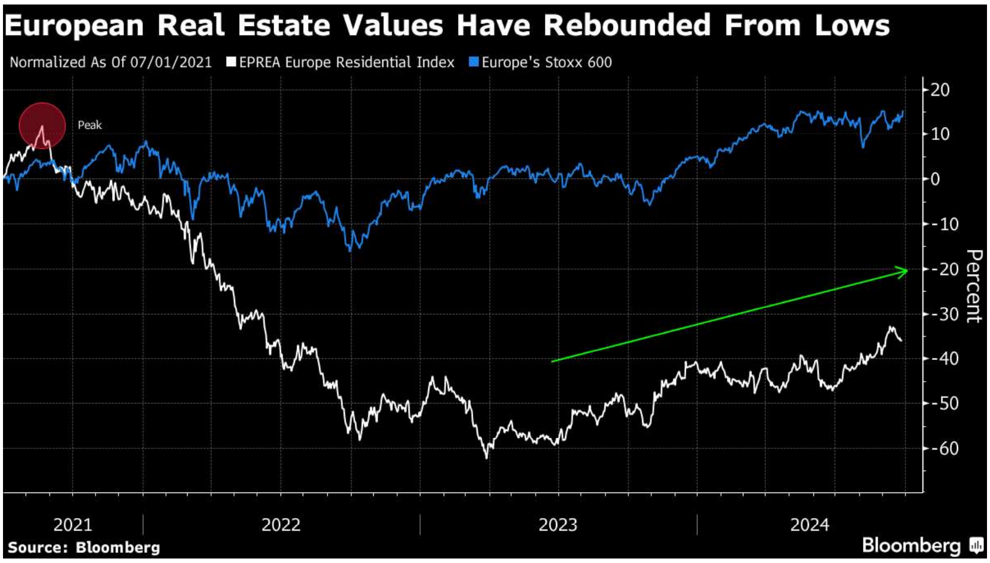
"All the ingredients are in place," said Matthew Norris, head of real estate securities at investment firm Gravis Capital. "Supply is going to moderate, there is rental growth and interest rates are coming down. You would be bonkers to sell out to private equity when all of those headwinds are becoming tailwinds."

In many European markets, there are signs that valuations are stabilizing or that the rates of decline are at least slowing. That's stoking optimism. The proceeds from initial public offerings and share sales in listed companies exceed the amount for the same period in 2023 more than three times, according to Bloomberg calculations. In the latest deal, beleaguered Swedish landlord SBB is offering 49% of the shares in its residential unit Sveafastigheter AB.

British Land Co. is set to be reinstated to the UK's top tier after being demoted to the FTSE 250 in June last year, according to a statement from FTSE Russell on Thursday. The UK real estate investment trust, which has seen its shares rally more than 36% so far this year, will join the FTSE 100 on Oct. 1.

In the three months through June, MSCI's Europe Quarterly Property Index recorded an eighth straight quarter of capital value declines — albeit with a fall that was more than offset by rising rents to give a total return of 1.1%. In the UK, commercial property values were flat in August after three months of modest gains, according to CBRE Group Inc.'s monthly index, bolstering confidence that most property sectors have hit bottomed.

But there's still a ways to go. The FTSE EPRA Nareit Developed Europe Index remains more than 25% below its 2021 peak, even if the real estate benchmark has recovered about half the value lost over the past 12 months in the selloff.



European public property companies are trading at an average discount to net asset value of 21%, almost double the gap at which the sector traded at over the past 25 years, according to Dominique Moerenhout, head of the European Public Real Estate Association. Still, in the right sectors like warehouses, student housing and medical properties, there are signs that the window is opening for more initial public offerings and capital raises.

"Some of the super-large vehicles that are private, they need an exit and they would struggle to find an exit in the private market today," Moerenhout said, noting plans by some private equity firms to list parts of their real estate portfolios. "There are things in the pipeline."

The sudden willingness of investors to snap up bonds from landlords that were until recently shut out of the market is being driven by the simplistic view that falling rates will lift all boats, said Robin Usson, a senior research analyst at Neuberger Berman. A focus on debt-to-asset ratios, rather than earnings, masks some issuers' true creditworthiness and raises echoes of the boom years before rates spiked higher, he said.

Many delegates at EPRA predicted that the winners of the next cycle will have to operate very differently to those of the last when the cheap-money era meant financial engineering could drive returns.

"The challenge for the public listed sector is the mindset of the leadership of these companies," said Andrew Coombs, chief executive officer of German and UK business park landlord Sirius Real Estate Ltd. "For too long, what's happened is people in real estate have been able to sit with a very low cost of debt and ride the cycle even though net operating income is barely growing. Clearly that's not the phase that's before us now."

The Adler Group's Wilhelm project in Berlin, Germany, on Nov. 2, 2021.

The recovery is also uneven. Despite the optimism in Berlin, Germany remains a laggard in adjusting to the crisis. Capital values are still falling and the spread between price expectations of buyers and sellers of offices in top German cities is the widest since 2008, MSCI data show.

The delayed reaction is in part due to the country's approach to valuations, which is driven by actual transactions and ignores wider sentiment. With deals for offices in central German business districts 79% below their 10-year average, that's made write-downs slower than elsewhere.

Still, even some of those brought to the brink during the cycle of rapid rate increases by central banks see glimmers of hope. Embattled Adler completed a recapitalization last week, gaining further time to find buyers for projects like the halted Wilhelm development.

--With assistance from Isolde MacDonogh.

To contact the reporter on this story:
Jack Sidders in London at jsidders@bloomberg.net

To contact the editors responsible for this story:
Shelley Robinson at ssmith118@bloomberg.net
Chris Reiter