EPRA
EUROPEAN PUBLIC
REAL ESTATE ASSOCIATION

AMP Capital looks to the North and South of Europe for the best returns in the continent's real estate markets

The Nordic region and Southern Europe, chiefly Spain, currently offer the most attractive returns in the continent's markets, said James Maydew, Head of Global Listed Real Estate at AMP Capital, the Sydney-headquartered manager of AUD 6.5 billion (EUR 4.3 billion) of property securities.

"The fundamentals in the Nordics are phenomenal and they are delivering some of the strongest results globally that you can get exposure to," said Maydew, speaking in a video conference interview from Hong Kong. "Southern Europe was so beaten up for such a long period of time. Supply completely dried up in Spain for an extended period. It's in an early cycle recovery - what we have seen in other parts of the world five or so years earlier. It's still very much yet to play out. We've seen that coming through in results, which have been reasonably strong."

The two regions are the bright spots in terms of rising rents, occupancy and higher capital values as economic growth gathers momentum across Europe, supported by historically low interest rates. With an investment strategy honed since 2002 that assesses listed companies in a global rather than regional or national context, Europe generally gets a neutral rating from AMP in its search for property stocks offering the best risk-adjusted returns.

Certain sectors or submarkets within the main "core" Western European markets – France, Germany and the UK – also interest the manager of listed real estate funds, whose client base comes predominantly from the Asia Pacific region. Maydew said that what AMP finds attractive in the core markets are listed companies with a focus on logistics warehousing in supply-constrained markets like the UK, or certain locations of Germany, as well as specialists in 'alternative' real estate outside the industrial-office-retail sectors.

AMP cut its "massive overweight" allocation to the UK in late 2015, when it became clear that the property market was at or near its peak, Maydew said. The investment house is sceptical about the outlook for French REITs with exposure to the Paris office market, which faces over-supply issues and is unlikely to benefit substantially from any relocations of large corporate tenants out of London following the UK's decision to leave the European Union.

Germany is certainly of interest, although its listed property market is too shallow in its range of sectors outside the attractive residential sector, he said.

"If there were more opportunities in the office markets, we would be interested," he commented. "Part of the logistics markets there are strong, but you can't own a core logistics exposure in the markets that we want, so we have to do it through a more convoluted fashion."

AMP's global approach allows it to gain exposure to sectors like logistics warehousing or data centres in Europe through the shares of companies headquartered in the US or Australia, which have large portfolios of assets on the continent. The US market has led the way in developing a broad array of listed real estate companies operating in sectors like healthcare, data storage, self-storage and student housing, Maydew said.

"The 'alternative' real estate sectors are no longer alternatives," he explained. "In the US over the last 10 years these sectors have become an institutional product with world class capabilities in delivering strong risk-adjusted returns over a real estate cycle. The challenge is the limited number of ways of playing it in Europe," he observed.

The underperformance of US mall REIT shares, following a succession of weak department store earnings reports and store closures by major chains, highlights how online retailing is changing the way that consumers shop. This will have consequences for landlords in Europe, particularly in national markets where the penetration of online retailing is relatively low, while the continent also faces other challenges from an ageing population and urbanisation, he said.

"There's quite a few headwinds that concern us and we don't think that these have been priced in to the European market yet," Maydew said. "Broadly that's a bearish message about retail real estate in Europe, but you will have winners within that.

"We made a conscious decision that our portfolio should only own the true, highest quality retail assets in the world," he said, adding "The secular trends that are under way have got a long way to play out and you have to be in bricks and mortar that is truly different and will deliver productivity in sales to the underlying tenant."

His frank assessment of Europe extends to improvements in environmental, social and corporate governance, which underpins AMP's three-step investment process.

"It's not just lip service. We want management teams to change… there is more work to do in Europe," he said. "One of the biggest frustrations that we have is in alignment of interest. The number of times that I have sat opposite a CEO of a European company and asked them how they are aligned to the company that we're investing in, and the response is always very disappointing to me."

He added that this can be addressed in a relatively short time frame, pointing to how companies in Australia "have cleaned up their act since the Global Financial Crisis from being the posterchild of what you didn't want to be."

Looking ahead, Maydew expects investing in listed real estate will be less about buying markets or sectors and more about stock-picking and a "differentiated approach to portfolio construction."

In Europe, as concerns about political risk recede following the Dutch parliamentary and French presidential election results, attention is switching to how central banks will respond to inflation. Maydew doesn't expect interest rates to rise as high as average levels of a decade or more ago because of high household and government indebtedness. Europe's ageing population and the continued strong demand for higher-yielding assets will support investment in listed real estate in Europe, he predicts.

"The rubber will hit the road when we get through, perhaps the German elections (in September) or perhaps the first commentary from the European Central Bank that is hawkish. Then people will take a fresh look at listed real estate and say 'that's interesting. Where can I get good, long-term, risk-adjusted returns?'"