

Diversification benefits of investing in European real estate markets



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*Forward by Anthony MacGuinness,
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As Ireland's largest investment manager, ILIM is continuously focused on delivering high-quality and innovative investment solutions for our clients. We're results focused, striving to find new ways

to maximise value for our clients and with a key mission of achieving this in a sustainable way.

Two years ago, we recognised the opportunity to invest directly in European Real Estate. The key investment rationale at the time was the enhanced level of diversification,



together with the long-term sustainable return profile of the asset class and the added benefit of offering defensive inflation linked return features. Furthermore, the sheer size of the market provides enormous investment opportunities and enhances liquidity options.

These features, coupled with the challenges investors face today in terms of rising volatility and mounting concerns over inflation, make the case for investors diversifying into this market even stronger. Here, my colleague Paul Baragwanath, Senior Fund Manager - European Real Estate, shares his thoughts on why now is the time to consider investing in Europe and the strength of our investment proposition for clients.

A changing landscape

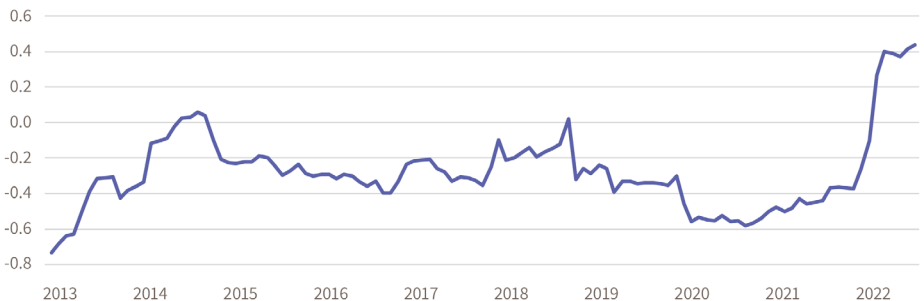
The diversification benefits of real estate can be significantly enhanced for investors in broader European real estate markets. To put the scale of the market and activity into context, the

investment transaction levels in 2021 for European Real Estate reached €360bn. The equivalent figure for Ireland was €5.5bn in the same year, with Dublin CBD accounting for the largest proportion of transactions.

2022 has been a timely reminder of the importance of being well diversified within an investment portfolio. Heightened inflation levels, aggressive tightening of monetary policy, the crisis in Ukraine and prospects of lower economic growth have all negatively impacted on both equity and bond markets. Against this backdrop, European real estate has delivered a relatively stable performance year to date and illustrated its long-term defensive attributes.

Over the course of the last decade, equities and bonds have performed strongly, supported by an ultra-accommodative monetary policy. However, the onset of inflation has changed the landscape significantly and is reason to take stock of how

Rolling 2-year Equity-Bond Correlation



Source: ILIM / Bloomberg August 2022

our portfolios are positioned going forward. Equities have declined over the course of 2022 as central banks have tightened policies and we have transitioned into a rising interest rate environment, to curtail inflation. At the same time, bond yields have risen (resulting in negative returns) and economic growth forecasts have fallen. The graph above illustrates the recent increase in the equity-bond correlation that has recently transpired.

Over time, differing market conditions will change the relationships between assets. A well diversified multi-asset portfolio offers protection for investors. While it won't eliminate market risk, it serves as an effective risk management tool for investors to manage asset-specific risk. Over a long-term horizon and different economic cycles, it will help to deliver a smoother journey.

Over a 10yr time horizon, adding a 15% property allocation to a typical 60-40 equity-bond portfolio would have reduced volatility by a factor of 14% (with 10 year volatility reducing from 8.6% to 7.4%)¹.

Diversification at home and abroad

At home in Ireland, we have witnessed our domestic real estate strategies in both the Irish Commercial and

Residential Sectors reaffirming the diversification benefits of having a tactical allocation to real estate. Against a backdrop where equities, bonds, credit and high yield have all fallen, we have seen positive real estate returns. The performance is underpinned by a resilient income yield from rental collections and stable valuations in the face of significant economic and geopolitical uncertainty.

The additional diversification that can be achieved in a European market, by investing in different geographies, sectors and strategies can further generate attractive risk-adjusted returns for investors. However, achieving this diversification and spreading of investment risk does come with some potential barriers. Having the right expertise, team with the "boots on the ground" in key cities and a long-term investment focus are all critical to overcoming these.

Balanced European Asset Allocations

The Pan-European Quarterly Property Fund Index ("PEPFI") measures net property returns with a Net Asset Value of €51.5bn as at June 2022. The PEPFI delivered a net return year to date of 5.9%. Over a longer 10-year time horizon, the

¹ Assumes a pro-rata basis split across equities and bonds. 10 year quarterly data from MSCI World, the ICE BofA Euro Government Index and the MSCI Pan-European PFI Funds Quarterly Property Index.

net annualised total return was 5.5%, which compares favourably to the comparative data for equities and bonds (see table below).

These returns are generated from diversified asset allocations across a range of sectors including office, industrial, retail, residential and alternatives. From a geographical diversification perspective: Germany, France and the Benelux regions in Central Europe comprise close to 60% of the geographical allocations. Performance within these sectors and countries will vary and evolve over time but the PEPFI highlights how diversification can be enriched further within the European market.

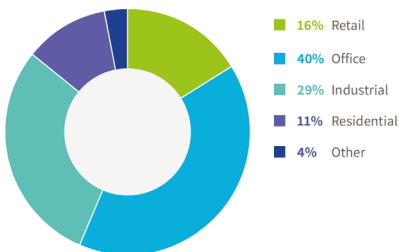
The ILIM Approach

At ILIM, our direct European real estate investment strategies focus on primary markets in continental Europe, with sector exposure diversified across the main market segments. We target a combination

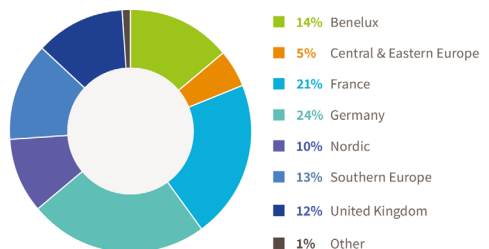
of income assets, which benefit from index linked rents, and value add assets requiring active asset management. More recently launched open-ended diversification strategies, with no legacy properties, are very well positioned to (i) provide investors with returns from assets with strong inflation linked and sustainability credentials and (ii) seek out tactical opportunities in preferred sectors, where polarised market themes persist.

In continental Europe, ILIM's real estate team is supported by abrdn, one of Europe's largest real estate investment managers. Acting on behalf of ILIM, abrdn uses its extensive local resources and market insights for deal sourcing and asset management. The combined real estate strength of ILIM and abrdn enables our direct European real estate strategy to capture and capitalise on evolving European real estate opportunities. This

Sector breakdown



Geographic breakdown



Data Source: MSCI as at 30 June 2022. Pan-European Quarterly Property Fund Index

expertise and local knowledge in key cities, provides the foundations for diversification to enhance returns. Having strong governance structures and robust investment processes in place, allows investors to achieve this in a risk controlled way.

Rent Indexation Benefits

European real estate investment benefits from a strong link between rents and inflation protection through indexation clauses in lease contracts. It is typical for leases in European countries (such as Germany, France, Netherlands, Belgium, Spain and the Nordics) to be 100% linked, on an annual basis, to a consumer price index or similar national index. It is important that pension savings keep pace with inflation and therefore investing in strategies that provide some protection is valuable.

This rent indexation together with sustainable rental growth in specific European sub-markets, has

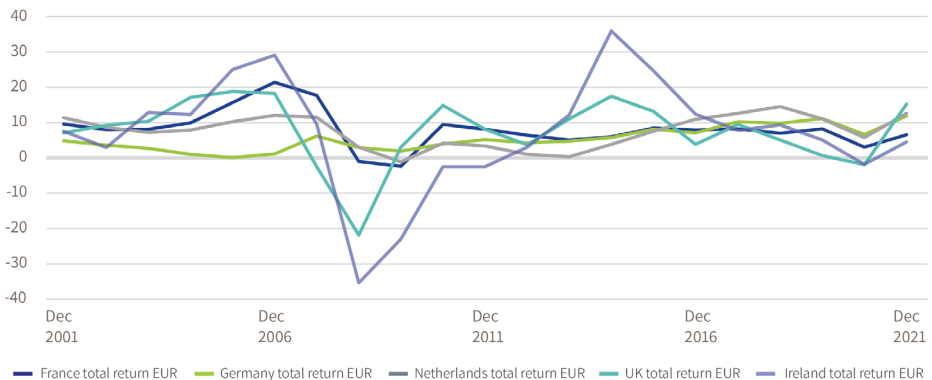
contributed to the steady historic performance of real estate markets in continental Europe. It can also act as a mitigant against any short-term upward pressure on real estate yields and as a natural hedge against interest rate increases.

The indexed nature of the rents in most continental markets is a strong attraction for investors in the current environment. Market disruption from interest rate and inflationary pressures, combined with the emerging paradigm shift in investor and occupier real estate sustainability requirements, is creating opportunities which we believe will deliver attractive risk adjusted returns and diversification benefits for investors.

The importance of sustainability

As a responsible investor, ILIM seeks enhanced exposure to more sustainable companies and a

European Country Returns 2001 to 2021



better alignment to the low-carbon transition economy. This philosophy is embedded into our investment design and we have taken active steps to manage the impact of our investment decisions on the environment across our proprietary portfolios, which form part of €40 billion of assets managed in a sustainable way.

With the requirement under IORP II to now explicitly state how ESG (Environmental, Social, Governance) factors are integrated in making investment decisions, we have seen a greater focus on the Article 8 nature of our various property funds.

ILIM adopts an active ownership approach across its real estate assets, which aims to maximise the medium to long-term value for all stakeholders, including tenants and investors. ILIM uses its ownership to constructively engage with property managers, encouraging better standards and management processes covering financially material ESG risks.

As part of our acquisition process, a complete technical assessment is undertaken for all material ESG themes. These result in action plans to improve ESG impacts and put each asset on ILIM's Net Zero Pathway. This will provide a framework for the reduction of greenhouse gas emissions, energy use, energy

intensity targets, renewable energy use, and the use of circular economy principles in new developments.

If we do not take the climate transition into account when building out our diversification strategies, we are likely to suffer losses over the longer term. Massive transformation is still required and the asset management industry has a vital role to play.

Looking Forward

In one of the most challenging investment markets we have faced in decades, we continue to advocate staying diversified across and within asset classes. European Real Estate can serve this purpose well in a portfolio context and can assist in delivering a smoother performance journey over the long term.

In particular, European Real Estate can provide pension investors with enhanced diversification benefits, a natural hedge against inflation and access to a resilient and highly liquid market.

If you would like to learn about investing in European Real Estate with Irish Life Investment Managers, then please contact your usual relationship manager or Jennifer Richards at Jennifer.richards@ilim.com

MSCI Pan-European Quarterly Property Fund Index

Index Performance	TOTAL RETURN INDEX					ANNUALISED TOTAL RETURN (%)			
	Mar 2022 Dec 2003 = 100	June 2022 Dec 2003 = 100	Total return 3 Months (%)	Gross Debt % GAV	12m Distribution Yield (%)	1 yr	3 yr	5 yr	10 yr
All Property Funds	279.4	290.2	3.9	19.5	2.3	17.8	10.4	10.1	8.9
Balanced funds	162.2	166.3	2.5	20.0	2.2	11.8	6.4	6.3	5.5
Direct Property	371.6	379.6	2.2	-	-	15.1	10.4	10.2	9.3

Index Profile	NAV (€m)	GAV (€m)	Index Weight (%)	Capital Value	Number of Assets
All Property Funds	51,528.1	68,514.0	100	62,413.9	1,527
Balanced funds	33,418.0	44,575.9	65	40,090.6	904

Source: MSCI Pan-European Quarterly Property Fund Index

Comparative Data	TOTAL RETURN INDEX			ANNUALISED TOTAL RETURN (%)			
	Mar 2022 Dec 2003 = 100	June 2022 Dec 2003 = 100	Total return 3 Months (%)	1 yr	3 yr	5 yr	10 yr
Equities	348.7	319.6	-8.3	-6.8	4.0	4.4	8.2
Property Equities	247.2	183.3	-25.9	-29.1	-7.0	-4.9	3.7
Bonds	217.5	202.4	-6.9	-12.7	-3.4	-0.4	2.5

Data sources: MSCI, J.P. Morgan GBI 7-10yrs.



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