MARCH
2024

In conversation with

Unlocking Real Estate Opportunities in a Changed World

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In conver-sation with

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Falling values and disruption across the debt sector has hampered the normal free flow of global real estate investment.

However, as previous cycles have shown, this can be precisely the time that offers most opportunity for investors. Tikehau Capital has a unique specialism that combines extensive market coverage, real estate expertise and a strong track record of facilitating equity and debt investment. We asked Frédéric Jariel (FJ), co-head of the real estate department and Edoardo Crotta (EC), Portfolio manager of a newly launched real estate credit solution to give their views on how investors can engage with the sector to their advantage.

Q: How would you describe the current situation of the real estate market?

FJ : In some respects, the market is in a unique situation – not least because of the societal changes that a post-pandemic world has brought – but from another perspective, this is a familiar point in the real estate cycle where value corrections combined with a shortage of debt financing are presenting exceptional opportunities.

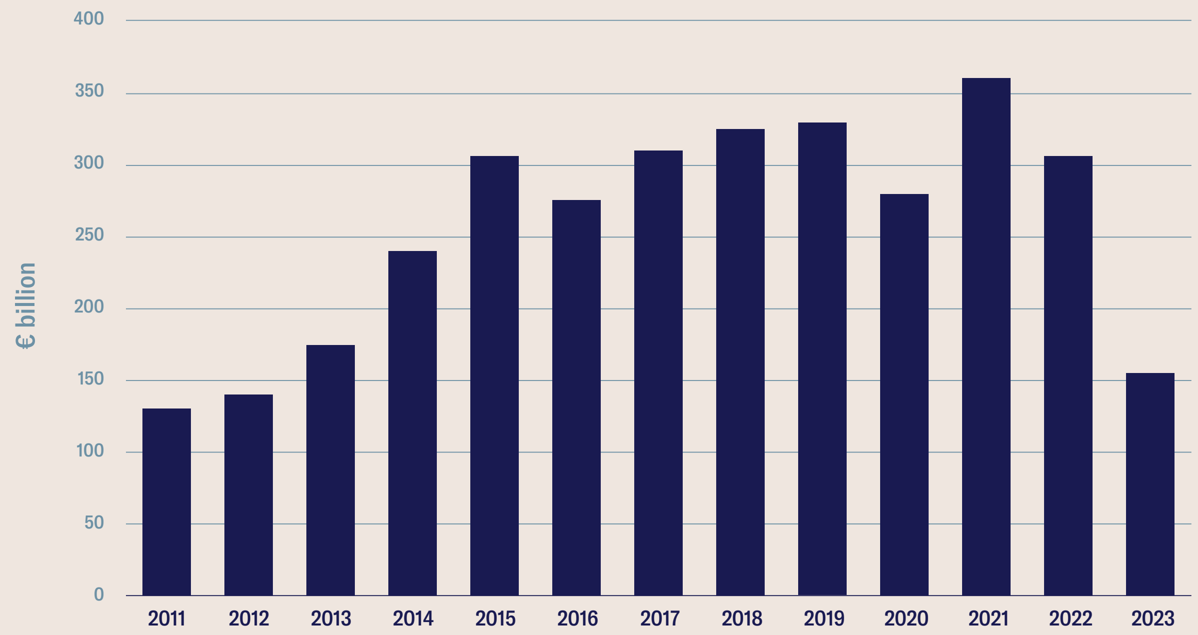
We describe it as a 'twice in a lifetime' opportunity because **real estate investment volumes are now at a level which has not been seen since the aftermath of the Global Financial Crisis.**

This indicates that the market – and the various sectors it encompasses – are now in a period of resetting. This reset is the most profound for more than a decade and, combined with negative value shifts of 20% or more in the past two years, are presenting scope for advantageous investing.

This is particularly applicable in distressed selling situations where much lower valuations enable investors to buy assets at prices which make value-add strategies viable.

CURRENT LEVELS OF INVESTMENT VOLUMES ILLUSTRATE 'TWICE IN A LIFETIME' OPPORTUNITY

EUROPEAN REAL ESTATE ANNUAL INVESTMENT VOLUME



Source: CBRE Research, February 2024

Q. Real estate debt markets have been significantly disrupted and it has become difficult in many instances to originate new debt or obtain refinancing. What do you think are the options for investors?

EC: At the outset, investors have to decide where they want to position themselves within the capital stack and, equally importantly, look to work with a partner who can provide a full range of expertise and access to debt financing.

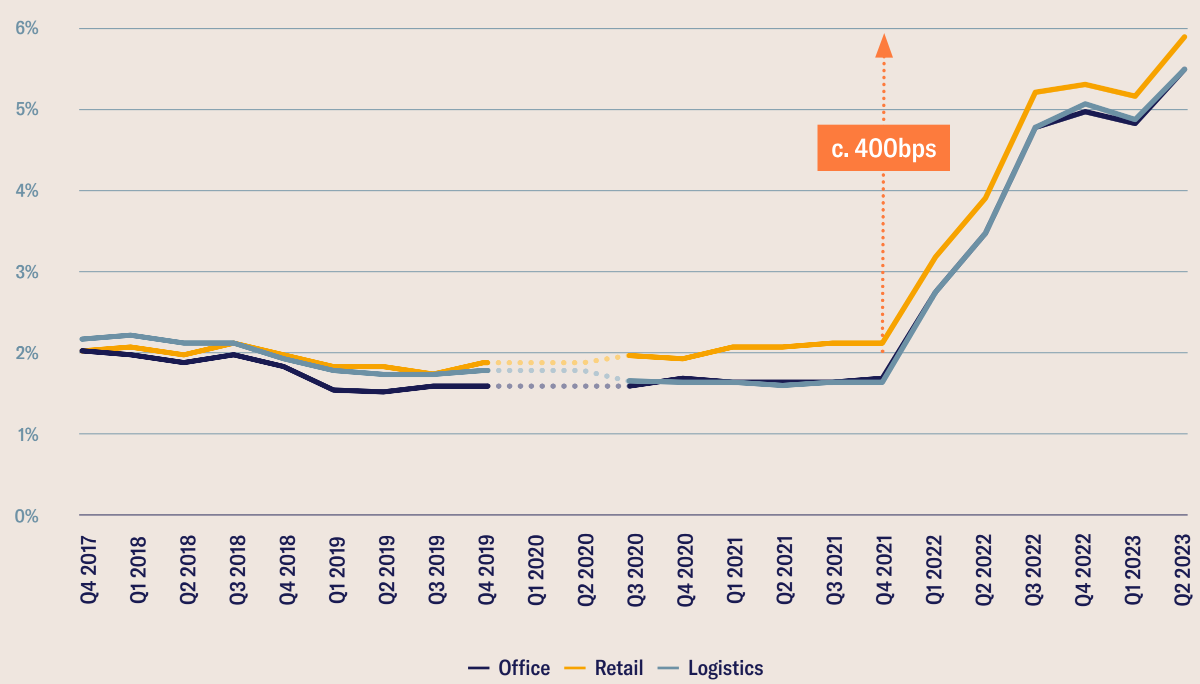
In this respect, it very much depends on the investor's objectives, the return profile they're seeking, and their appetite for risk. We work with investors who often have the options of equity involvement or will want to participate in debt finance.

Real estate sponsors and developers in Europe have historically mostly financed their assets through bank loans. However, in the face of the disruption of markets, new regulatory constraints plus more onerous liquidity and capital requirements, many of these established lenders have retrenched from certain market segments.

Real estate debt pricing and hedging costs have soared as asset values have dropped and Governments have taken aggressive financial measures to combat inflation. In addition, the European real estate financing market does not benefit from CMBS structures as it does in the US. Consequently, **financing options available to asset-owners are limited and it leaves a financing gap to be bridged by other sources of capital.**

COMMERCIAL REAL ESTATE BORROWING COSTS HAVE SOARED

TOTAL COST OF SENIOR DEBT - PRIME ASSET



Sources: Macrobond, CBRE Research; December 2023

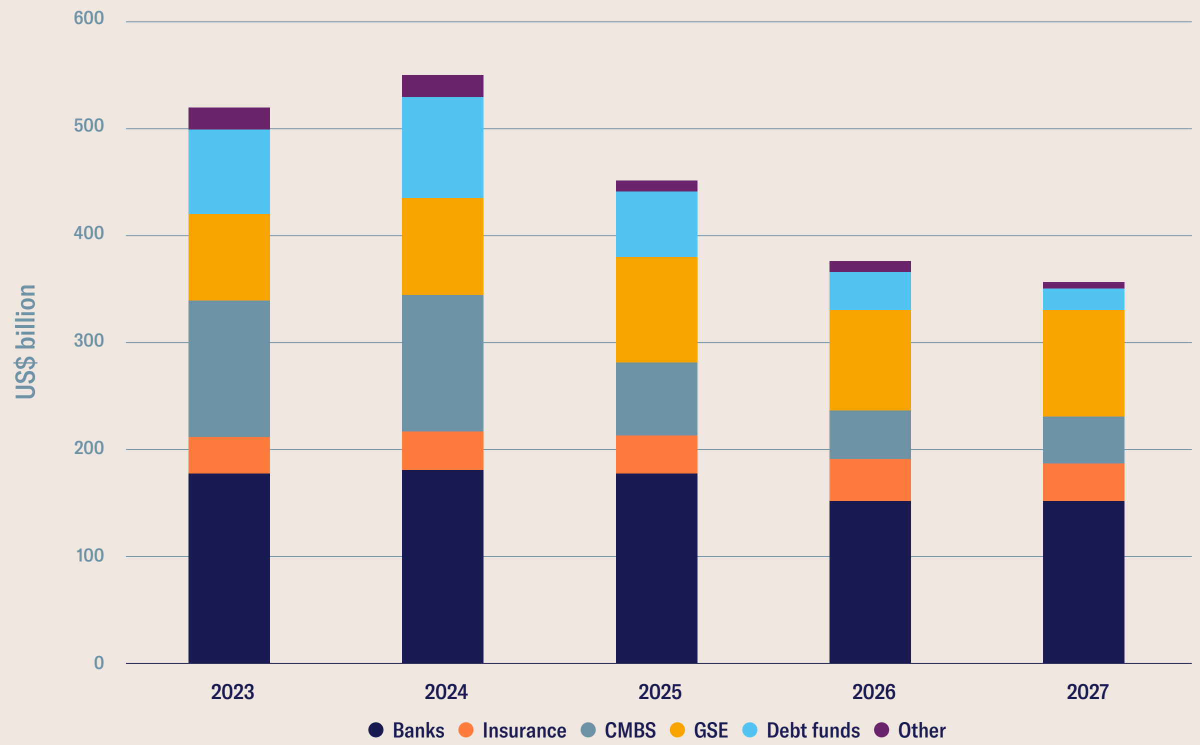
These market conditions are enabling alternative lenders to address a refinancing gap that is estimated to reach €100bn during the next four years, and to also provide financing which can capitalise on new opportunities across European real estate markets.

Lenders such as ourselves are more flexible by nature and are able to bring certainty and speed of execution to asset-owners in a market facing a debt funding gap and liquidity shortage. Solving these challenges requires expert knowledge of credit underwriting in combination with a detailed understanding of the local market and the asset type against which funding will be secured.

Real estate expertise gives the ability to identify best-in-class assets and correctly assess their values in terms of collaterals for financing. Credit underwriting and structuring expertise provides the ability to negotiate lending terms to better protect investors' capital in a market where coverage ratios are deteriorating.

Our aim is to help fill the financing void left by banks by gaining a substantial market share of the real estate financing market and creating value both for sponsors/developers and investors.

ANNUAL MATURITY WALL ON CRE LOANS BY LENDER GROUP



Sources: RCA, Goldman Sachs GIR, October 2023

> "Newly originated private real estate credit deals benefit from additional return elements driven by increased base rates and widened credit spreads

Q. Where does your newly created €1bn real estate credit strategy in partnership with Altarea fit into the new real estate finance landscape?

EC: With many traditional lenders out of the market there is an increased role for private debt funds across various financing scenarios.

Newly originated private real estate credit deals benefit from additional return elements driven by increased base rates and widened credit spreads. With the need for debt financing to remain stable coupled with valuation adjustments for the foreseeable future, this new environment will enable equity-like returns and a more senior position in the capital structure.

For stretched senior loans or whole loans, our fund offers a simple financing process from a single lending partner and with the ability to provide higher leverage than traditional debt sources.

For subordinated debt and mezzanine funding, we can also bridge the debt gap and intervene in refinancing events for which banks have no appetite. We can act as liquidity providers for complex real estate financing or portfolio refinancing with near-term solutions.

As lenders we always try to find the right balance between additional return and principal protection and mitigation of downside risk in case of potential market downturn or asset value deterioration.

The capital protection aspect of this strategy can be achieved by subordination with more conservative loan-to-value ratios acting as an equity buffer; well-negotiated documentation package including covenants; discriminating underlying asset selection benefitting from cyclical and structural trends; and work-out situation expertise with the in-house ability to operate and reposition the assets in a recovery scenario.

For investors, accessing this blend of experience, sector-specific knowledge and financial resource will be essential to capitalising on opportunities across European real estate markets.

Equally importantly, our new fund leverages the respective real estate expertise of the partners. Altarea has a proven track record of delivering the type of urban transformation projects which characterise the value-add sector and, Tikehau Capital has both extensive value-add experience and has completed more than €650m of real estate credit financing across Europe.

Q. When values have been falling for a sustained period, how can investors look to create value with enhanced returns?

FJ: Value creation is now about switching from asset allocation to asset picking. Prime and secondary properties with value-add prospects are currently available at attractive prices, but the window is narrowing as sentiment improves.

Investing capital in this new age, and even more so with a rather long-term perspective, requires having identified the sectors and assets which will be the most embedded into structural megatrends.

Among these, demographic change & urbanisation; technological innovation and the need for sustainability are among the most influential factors driving the value-add real estate sector.

Against this market backdrop, differing real estate sectors will offer varied opportunities. Granularity and selectivity will be key. For example, the conversion of single-use assets into mixed-use, hybrid, and flexible environments can enhance financial performance, and transform the relevance of assets that were facing redundancy.

One of the most important value-add factors in today's market is having control of the asset – often at an operational level. We believe having control is what drives long-term income returns and capital appreciation. For investors, this means finding an investment manager who has more to offer than basic management services.

Q. The residential real estate sector is booming with exceptional demand for every type of asset from student accommodation to later living.

Do you feel this is the sector with most potential for investors?

FJ: We see opportunity across all real estate asset types but this is defined by the particularities of the asset not just the sector it currently sits in.

Clearly, the need for places to live – of all kinds – is fundamental to society, and we're seeing **acute shortages in several markets across Europe.** A lack of housing supply, restrictive housing policies in western European cities and demographics are creating upward pressure on rents. Similar supply/demand dynamics can be seen in the purpose-built student accommodation and senior living sectors.

We have been closely involved in building rental platforms across urban areas which we feel have particular potential. A good example of this approach was an acquisition of a residential granular portfolio spread across Portugal which comprises in excess of 3,700 units. The pace of sales and rental of the units as well as the financial performance in comparison to the business plans have consistently exceeded performance expectations[1].

The sourcing of such assets and implementation of a value-add plan in the European residential subsector require financial resource, local knowledge and the ability to carry out the forensic analysis needed for an investment of this complexity.

[1] Past performance results are no indication of future results

Q. What other sectors do you feel have potential?

HOSPITALITY

FJ: We're increasingly involved in the hospitality sector. Global tourism continued its recovery last year and saw international tourist arrivals moving to almost 90% of their pre-pandemic levels. China's reopening last year marked another milestone on the road to full recovery which is expected to continue tracking upwards this year.

The European hospitality sector offers some very interesting value-add options. Hospitality operators often face the same equity and debt financing constraints as other businesses and this can produce opportunities to participate in the upgrade and repositioning of assets in prime locations.

We have extensive experience in rehabilitating and repositioning hospitality assets in prime locations. We've asset managed and sold on two hotels in Paris while our latest acquisition of another hotel asset in France has been bought at a 30% discount. The value shift is presenting opportunities but only for the investors who have access to the necessary expertise.

OFFICES

New modes of hybrid working are opening up scope to transform office spaces and diversify the income streams that flow from them.

We've been investing in secondary office buildings located in prime locations and reinventing them for alternative uses such as light industrial assets and last-mile logistics. It's an approach that can yield value and positive impact from both a financial and ESG perspective.

Our latest value-add fund aims to generate attractive returns[2] and maximise ESG impact through a 'change of use' strategy. This requires a broad range of expertise across the whole real estate spectrum from development to asset management. However, the benefits can be quick. In our first value-add fund, we have secured a building permit to transform a suburban office headquarters into a state-of-the-art, last-mile logistics centre. These are good examples of looking beyond what an asset currently is and to what it could be.

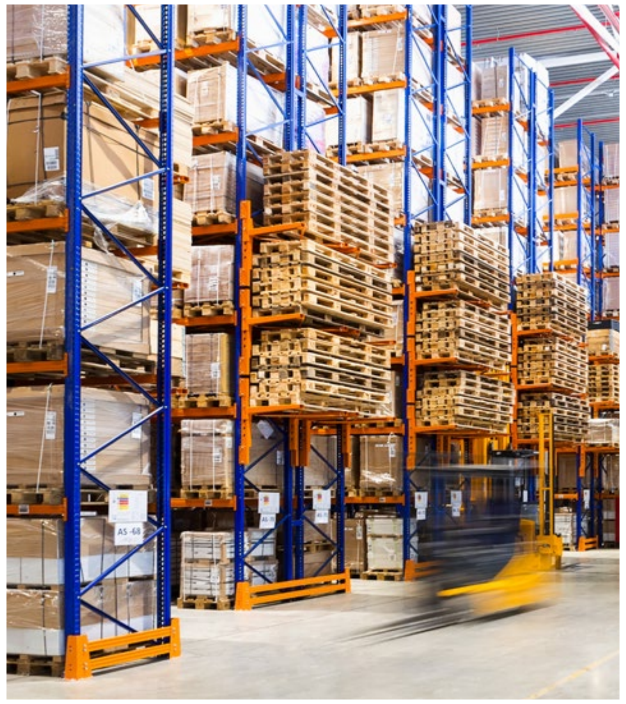
[2] Returns are not guaranteed

LOGISTICS

E-commerce-driven demand for logistics space provides opportunities for investors, especially in repurposing secondary assets through a change in use strategy and developing urban logistics.

The steady growth in online commerce is powering demand for logistics property. CBRE has estimated that for every additional €1bn of e-commerce activity, almost 100,000 square metres of additional logistics space are required to service its fulfilment[3].

Accordingly, it has become an inexorable consumer of space and benefits from the type of repurposing of redundant existing buildings or sites as referenced in the example cited in the 'Offices' section above.



RETAIL

The retail real estate sector is going through an unprecedented period of restructuring which is seeing many assets being no longer fit for the purpose that they were originally intended.

This is creating a **range of opportunities for repurposing and repositioning in both urban and edge-of-town locations.** The decline of many shopping centres presents exceptional opportunities to access and reshape large in-town areas.

In addition, lower valuations make the sector appealing and there is new potential for integrating retail into mixed-use environments which more appropriately address people's changing lifestyles and produce broader-based income streams for investors.

[3] CBRE Research, July 2023

Q. As real estate sectors – and the debt markets that service them – evolve and reorientate, what should investors be looking for in terms of a partner who can deliver on capital protection with enhanced returns?

EC: Today's market demands that you actively engage in understanding occupier demand drivers, can identify value-add potential; are able to work on a localised basis, and can access the requisite financing. This is what we specialise in.

So, in this context, we believe that investors should look for their partners to demonstrate a clear set of characteristics:

- **A highly selective investment process and extensive track record**
- **A local on-the-ground presence combined with the perspective of an international network**
- **An experienced real estate team with equity and debt expertise**
- **A strong capital base with 'dry powder' across funds**
- **Limited dependence on high leverage for return generation**
- **Symmetrical and significant alignment of interests**
- **A robust approach to impact investing and ESG**
- **A strong sense of alignment in its own strategies**

Ultimately, real investment asset selection and finding the right manager to partner with will be essential and will largely determine financial performance and value creation.

Accordingly, it's pivotal to collaborate with managers who understand what capital protection requires, how value-add can be achieved and also have both the financial and intellectual resource to successfully deliver projects with enhanced returns.

About Tikehau Capital

Tikehau Capital is an alternative asset management group with a value-add real estate strategy that encompasses a wide range of asset-types and targets opportunities across the 16 international locations where we have a local presence.

Active value-add strategies entail rebuilding, transforming, and curating assets. Tikehau Capital has the dedicated real estate teams that have what it takes to search for, acquire, and transform assets. Through its private credit offer and specialist fund it provides the finance which is essential to unlocking opportunities.

This ability to invest in, manage, and transform a wide variety of real estate asset classes creates the diversification and flexibility that are conducive to better risk management and return enhancement.

To find out more, please contact
sales@tikehaucapital.com

Frédéric JARIEL

CO-HEAD OF REAL ESTATE

Frédéric Jariel joined Tikehau Capital in 2014 and serves as Co-head of Real Estate activity. He was previously at Archon Group France, a subsidiary of Goldman Sachs, which he joined in 1996. There he held various positions at the European level. His latest appointments were as COO Europe and CEO of the French entity. He began his career with Coopers & Lybrand as an auditor. Education: Chartered accountant.

Edoardo CROTTA

EXECUTIVE DIRECTOR, REAL ESTATE DEBT INVESTMENT

Edoardo Crotta is an Executive Director at Tikehau Capital and responsible for Real Estate debt investment.

Prior to joining Tikehau Capital in 2021, Edoardo started his career at Tristan Capital Partners in 2012 based in London, where he rose through the ranks to Director level, being in charge of investments origination and execution of core+ and value-add real estate transactions.

Edoardo has a Master in Management from ESCP Europe and graduated from Bocconi University in Financial Markets.

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Associated risks:

> **Risk of Investments in Real Estate:** Exposure to real estate, exposes investors to risks such as decreases in real estate values, occupancy rates, overbuilding, increased competition and other risks related to local or general economic conditions, increases in operating costs and property taxes, casualty or condemnation losses, the impact of present or future environmental legislation and compliance with environmental laws, possible environmental liabilities, regulatory limitations on rent and fluctuations in rental income, the ongoing need for capital improvements, adverse changes in governmental rules and fiscal policies, civil unrest, force majeure, including earthquakes and other natural disasters, acts of war, adverse changes in zoning laws, and other factors which are beyond the control of the Partnership.

> **Risk of indebtedness:** Although the use of indebtedness may enhance returns and increase the number of Investments that can be made, it may also substantially increase the risk of loss. The use of indebtedness will subject the Partnership to risks normally associated with debt financing, including the risk that the Partnership's cash flow may be insufficient to meet required payments of principal and interest.

> **Additional costs/risks associated with investments in Real Estate:** There is a risk that the Partnership could face substantial loss from environmental claims based on environmental problems on properties held directly or indirectly by the Partnership as well as from occupational health and safety issues and concerns.

> **Leasing Risk:** The tenants of a property held by the Partnership may decide to terminate or not to renew a lease and in certain circumstances it may be difficult for the General Partner or the AIFM to find new tenants. The income of the Partnership may be adversely affected if a significant number of tenants were unable to pay rent or its property could not be rented out on favourable terms.

> **Sustainability Risks:** Such investments may be subject to risks associated with an ESG event or condition which, if it occurs, may have a material adverse effect, actual or potential, on the value of an investment (the "Sustainability Risks"). Three risks appear to dominate in terms of likelihood and materiality if they unfold: (i) environmental risks, (ii) social risks, and (iii) governance risks.

> **Derivatives/Counterparty Risk:** Investments in derivatives for hedging purpose could lead to counterparty derivative risk, the possibility that the other party in a transaction may not fulfil its part of the deal and may default on the contractual obligations.

> **Development Risk:** There is a risk that the Real Estate investments maybe adversely affected by face exposure to construction risks such as misspecification of property. Cost overrun and time overruns could involve significant and potentially unpredictable impacts. Both the amount and timing of expenditure will have an impact on the cash flow of the investment.

> **FX Risk:** There is a possibility that the investments could incur loss of asset value linked to foreign exchange rates variations.

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