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NEWS

Conversation with Anita Mustac – LaSalle Investment Management

Funds Management partner Langton Clarke chats with Anita Mustac, Managing Director of the LaSalle Investment Management Client Capital Group, about whether ESG is just a marketing label, some ramifications of low interest rates, regulatory restrictions, and what she sees as the most significant investment risk in the current market.

LC The hottest acronym in asset management is ESG. Is ESG just a marketing label or is it the real deal? Will it become more prominent?

AM LaSalle Investment Management (LaSalle) believes environmental issues will exist as long-term demand and supply drivers and must be considered as an investment manager's fiduciary duty to investors. LaSalle has had an ESG policy since 2009, and in 2016 added environmental factors to the 'megatrends' that guide investment strategy (Demographic, Technology, Urbanization and Environment).

ESG is important in capturing a 'green premium' by improving the ESG credentials of the assets acquired and managed by LaSalle. There is value clearly associated with accretive initiatives implemented during the ownership period where they either reduce operating expenses of the landlord or increase the rent tenants are willing to pay because of green benefits (eg lower costs, healthier and more resilient buildings).

Further, implementing financially accretive or neutral ESG initiatives is part of LaSalle's fiduciary responsibility to strive towards investment management best practice. All else being equal, a greener, more sustainable building is likely to have stronger performance (eg lower vacancy, less downtime, higher rents), particularly in a weaker market.

The LaSalle-sponsored *PERE ESG Investor Survey 2019* clearly demonstrates that ESG is also very important to investors. A resounding 95 percent of participants said ESG plays a role in their investment decision-making and 86 percent of participants agreed it was important for managers to evidence a clear ESG policy to their investors during due diligence.

As the public and private sectors now look to climate risk and decarbonisation in line with the Paris Agreement, my view is that ESG will continue to grow in its focus and importance until it becomes mainstream in investment management, at least in developed countries.

LC What ramifications does the current low interest rate environment have for the funds management and real estate industries?

AM Globally over the course of 2019, we have seen a significant amount of capital flowing to core assets. Towards the end of last year, core real estate was relatively less attractive when interest rates were rising globally and the spread between bond yields and real estate income returns too narrow. That trend was expected to continue until it reversed in early 2019.

Interest rates have now fallen to the point where 20 percent of sovereign bonds globally are yielding negative rates. From a real estate perspective, this means core assets are relatively more attractive to investors. LaSalle has seen increases in capital flows into both our US and European flagship core open-end funds this year, with both funds expecting 2019 will be a record year for capital raising since their inception (in 2010 and 2006 respectively).

Demand for stable, income-generating assets has increased significantly, with investors hunting for safe yield that is not available via fixed income products.

In these uncertain times, investors are also increasingly focused on diversification and sectors with drivers that are less cyclical. We have been seeing increased interest in more defensive asset classes, such as multi-family and the medical office sector. While these are nascent sectors in Australia, both are established institutional asset classes in the US. Medical office is particularly interesting since demand for this asset class is being driven by both favourable demographics (a rapidly aging population) and the preference for services to be provided in medical office buildings rather than hospitals, as this is a much less expensive way of administering treatment and has been enabled by technological advances in healthcare.

LC What is the most significant investment risk in the current market?

AM LaSalle has an industry-leading Research & Strategy group with more than 30 research professionals globally. This team consistently gathers market data and intelligence across both real estate and macroeconomics from around the world.

The current house view is that the most significant global risks are in the political sphere—and the concern is that these could spread into economics, capital markets and eventually to real estate. This includes Brexit, trade wars and the instability we are seeing in Hong Kong.

Even if these risks are resolved, the concern is that erratic policies and uncertainty undermines the confidence to make investment and consumption decisions. This in turn weighs on growth and impacts the demand for real estate, particularly the traditional sectors of office, industrial and retail, which are closely linked with business confidence and consumer spending.

Our team has not identified any major global property-specific risks at this point. The fundamentals in real estate markets themselves remain relatively robust. Supply and demand is generally balanced in most major markets and leverage levels remain relatively conservative. The one exception to this is the retail sector, which our research and strategy team is flagging as having negative returns in some countries and generally needing to be restructured to respond to the structural changes, particularly related to online shopping.

LC If you could make one change to regulatory restrictions what would that be and why?

AM The nascent build-to-rent sector has been a topic of much interest and discussion in Australia over the last year or two. The residential sector is well-established in the US and Europe and is a significant part of many developed countries' institutional investment universe. In the US alone, the core private institutionally-owned multi-family sector is estimated at ~US$167 billion (based on NCREIF Property Index, data to 2Q2019).

In Australia, however, it is difficult to get the returns to stack up in the current regulatory and tax regime. GST credits on land and development costs cannot be claimed (no GST is paid on build-to-rent apartments) and high land tax costs apply for institutional investors (with an additional surcharge in some states for foreign investors). Further, foreign investors are not eligible for the concessional withholding tax on residential housing income.

In the UK, the Government introduced a number of measures to encourage institutional investors to enter the private rental sector (PRS) market over the past decade. This included the introduction of a PRS taskforce in 2013 to identify barriers to institutional investment and promote solutions. The Government also amended the land tax provisions to put portfolio buyers on equal footing with smaller investors acquiring single units. As a result, 32,000 units have been built by institutional investors over the past five years, and is recognised as one of the avenues to easing the housing affordability crisis in the UK.

It is widely recognised that Australia has an issue with housing affordability. Build-to-rent is an asset class with the potential to deliver an attractive risk-adjusted return driven by demographic fundamentals. More supportive government policy would help institutional investment in this sector thrive in Australia, as it has done overseas.

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