777 View #3

Dialog with Ralph Winter

Ralph, your family office was focused on investments in the USA over the past few years. What has led you to become more involved in Europe again?

Europe with its 740 million inhabitants is and remains a very interesting investment market. A combination of investment properties in the USA and Europe leads to a balanced diversification of the different asset classes. One buys, so to speak, one's own insurance against unforeseeable risks within the individual countries, for example with regard to the different development of the currencies. There is another aspect that speaks for the regional diversification. While in the USA you earn your money with real estate, in Europe it is the financing structure that counts, due to the zero interest rate policy of recent years. I now know both markets very well. The Corona crisis has brought with it a whole series of distortions, and we are trying to profit from them. The successful management of real estate is once again more in the spotlight, and we have a lot of experience in this area.

Given the current complex situation in Europe, where do you see the best opportunities for 777 Capital in the market?

We focus on taking advantage of investment opportunities in the innovative residential sector and retail properties with development potential. I assume that the current situation will open a limited window of opportunity for non-performing and opportunistic investment opportunities. This, in turn, will lead to a reluctance on the part of banks to provide real estate financing, as they seek to minimize their own risk.

What do you think makes 777 Capital so special?

The real estate business is inherently very inefficient. There is a high, albeit hidden, upside potential, but a good network and a lot of trust are required to carry out interesting transactions. I have known Thomas Landschreiber and the team for more than 25 years and we know very well what we are looking at and if it is profitable.

You have already successfully built up several companies. Why do you now take the trouble to do something completely new again?

I am a full-blooded entrepreneur and feel comfortable enough to tackle new tasks. I have a great base in the USA with offices in Miami and New York, and Europe is more of a home game for me. Considering the good acquisition opportunities, my expertise in the market and the opportunity to be very successful with my business partners again, I simply had to say "yes". I think every entrepreneur can understand this step.

By the way, what is the name component "777" all about?

(smiles) This has no academic background... The three of us thought about it. 777 is a lucky number and means in a broader sense, "to be on the way to something positive". We needed a cool and modern name. You can pronounce the sequence of numbers "tripple-seven", and so we decided on it without further ado.

777 Market Note

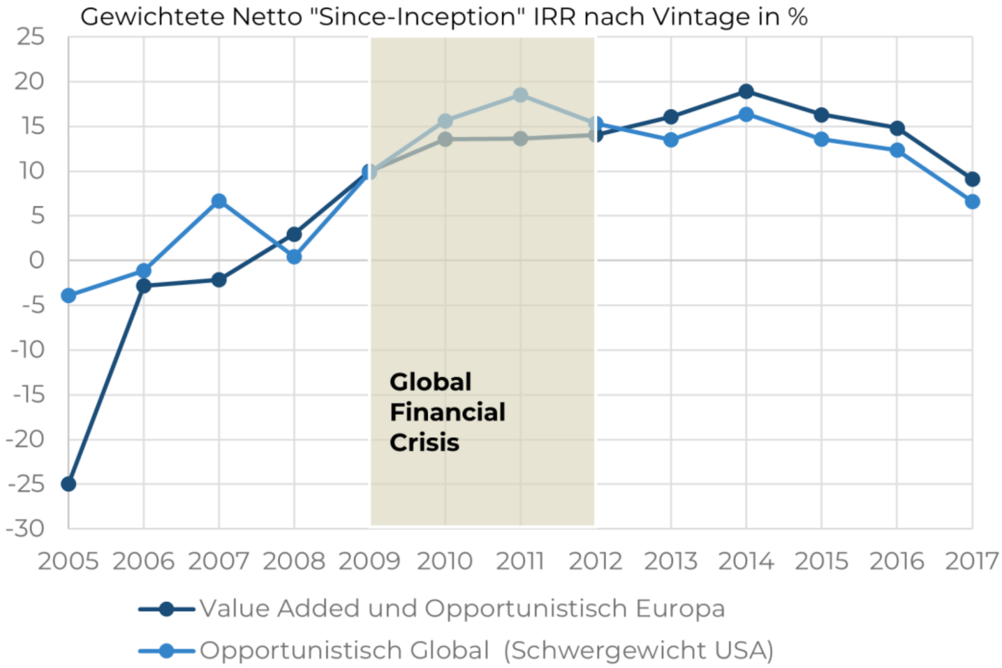
Zoltan Szelyes (Macro Real Estate AG)

- The second wave of the Covid 19 pandemic again brings with it significant government restrictions. Threatening insolvencies will soon lead us to see value-added and opportunistic deals at attractive entry valuations. However, these are often only available exclusively via off-market sourcing.
- The vintage effect, historically demonstrating higher IRRs after recessions, suggests that 2021 should be a good year for investment.
- Optimization strategies across sectors are promising investment opportunities in the current environment. The conversion of city hotels into co-living offers also promises potential.

Active real estate strategies in the DACH

The decline in core returns over the years is leading more and more investors to turn to "value-added" and opportunistic investments. Through active management, these strategies can achieve an excess return over bonds and core investments. This is also where the so-called "vintage effect" comes into play. A decline in valuations and the emergence of sellers in distressed situations creates interesting entry opportunities, especially during periods of recession. The following chart shows the IRRs of active investment strategies after the "closing" year of such vehicles. The vintages after a recession realize the highest IRRs. Considering that we are in the most severe global recession since World War II, we believe that 2021 will be a good vintage year for active strategies.

Vintage effect in opportunistic and "Value Add" real estate strategies



Source: Macro Real Estate AG based on private real estate databases

Currently deceptively stable situation...

With the exception of the retail and hotel real estate sector, developments in the rental and capital markets of the DACH region in the first ten months of 2020 were characterized by a relatively high degree of stability. The vacancy rates for residential, logistics and office space remain at historically low levels. Net initial yields and rental price levels have hardly moved at all since the end of last year. This appears to be a contradiction to the economic development. Regulatory hurdles and the uncertain COVID 19 dynamics currently have a dampening effect on changes and price adjustments.

Typically, such a macroeconomic situation affects the real estate markets with a delay of nine to twelve months. Currently, this delay is further accentuated by short-time working and stabilizing measures, such as the prevention of insolvencies. But the second Covid 19 wave is also higher than the first in the DACH region and could lead to an "economic double dip". We therefore expect that the pressure of suffering will increase.

… moved is not cancelled

In the USA, we have already seen deals with discounts of more than ten percent in the third quarter of 2020, even outside the hotel and retail property sectors. These negative effects of the recession will also reach the DACH region. Above all, we expect an increase in the number of insolvencies among companies in the retail and restaurant sectors.

For office properties, we expect a cumulative decline in rents of between eight and ten percent by the end of 2021 and ultimately lower transaction prices. Rents for logistics and residential space should continue to develop positively due to the tailwind from structural factors such as online consumption or demographic changes. By contrast, we expect a stronger correction for hotel properties. We would not be surprised if assets can change hands here at lower valuations of 20 to 30 percent

Off-market deals and outside-the-box strategies

Every structural adjustment has its own character. We are currently observing a situation in which certain sectors are likely to come through the crisis robustly, while others are facing their greatest challenge in modern times. We recommend combining these two opposing trends in investment strategy, with investors taking advantage of the strength of one sector and the weakness of another.

The opportunity is greatest when a seller who finds himself in liquidity difficulties can approach the potential buyer directly. Since sellers want to handle such deals without much fuss, access to off-market deals is crucial. To benefit from such a situation, a network of real estate owners and access to financing is crucial. Value-add real estate expertise is required, as such investments require higher capitalization at the beginning. The anticipation of structural changes, active asset management and outside-the-box thinking is match-critical in this situation and the central success factor.

First Opportunities: Co-Living and Fast-Moving-Consumer-Goods

City hotels have been hit hardest by the loss of international tourists and business trips. By contrast, we are observing vacancy rates of less than one percent in most cities in the DACH region. Since many city hotels are located in attractive residential areas, conversion can be considered selectively. Co-living concepts require an infrastructure similar to that of the hospitality sector, since in addition to residential space, community areas are required above all. Accordingly, city hotels are selectively suitable for conversion to co-living, but this requires major capital measures, as the buildings must be optimized to meet the needs of medium-term living.

Despite the tense situation in retail, we also see select opportunities in the sector. Households' needs and budgets for food have increased. Retail properties with a strong "food" share and/or in particular with a local supply character often even showed increased demand. Even though online orders are structurally and significantly changing the retail sector, everyday consumer goods do not fall into the top 10 commodity groups in online retailing among Germans1. Local supply centers will become an even more interesting asset class in Germany over the medium term.

1) German E-Commerce and Mail Order Association, H1 2019