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Sizing up the opportunity: Opportunistic strategies are on the move again — but they remain as risky as ever

BY CHRIS ANDERSON

How often do investors find the perfect entry point in real estate – that moment when you can buy cheaply during a downturn yet still feel confident of a healthy return when prices bounce back, which they could do fairly quickly? In truth, very rarely.

Now, however, could be one of those junctures in the current cycle. Recent changes in the real estate landscape are now creating these opportunities, and this, in turn, is shining a spotlight on opportunistic funds.

Robert Červinka, head of special situations at ActivumSG, outlines what has happened in the market. “There is a repricing going on,” he says. “Valuations have fallen as much as 25 percent due to a number of reasons.

“We had valuations rising rapidly over the past few years, fueled by low interest rates. Many in real estate that benefitted initially from this ultra-low-rate environment overleveraged, only to now find themselves confronted with a steep reversal in monetary policy. This has translated into a lot of distress across European markets. It’s happening in Germany, in Scandinavia and in the United Kingdom, though the United Kingdom has a stronger debt market and therefore adjusted quicker to new market conditions. Germany is taking a little longer due to the banking and valuation systems. We are still waiting for the market bottom there.”

Keith Breslauer, managing director at Patron Capital, explains how this is creating a window for opportunistic funds. “The reality is that anybody who made an investment in the last five to 10 years, except for residential, is now sitting on loan-to-value ratios that are worse, or higher than they were when they acquired the asset,” he says. “Will the lenders force some kind of default? Can they get some of that money paid off? And if a building needs refurbishment for ESG purposes, how will that get funded? It’s a really big issue.”

The situation is ripe for a solution, with opportunistic funds starting to sweep in, providing rescue capital for those in need. Petri Valkama, deputy CIO and head of strategic transactions at Nrep, says a lot of opportunistic activity has been accessed through disposals by forced sellers, open-end funds with redemptions, closed-end funds with exit pressures or the more highly levered players who have found themselves in an unworkable position upon refinancing.

“At this stage in the cycle, a well-capitalised investor doesn’t need to resort to secondary or less attractive assets, as even prime-location offerings have been repriced to a convincing entry point for opportunistic strategies,” says Valkama.

Distress often results from refinancing pressures rather than underperformance of the fundamental real estate, he adds, underlying the fact that the properties are not always necessarily operationally distressed. Many assets have retained resilient income streams for their owners, but they are coming to market due to pressure from the equity side.

This means that while it’s a distressed situation for the seller, it’s not considered high-risk from the buyer side, says Valkama. “If the underlying real estate is healthy, such a situation enables well-capitalised players to access desirable opportunities at typically more attractive terms, supporting the investment case.”

Christina Forrest, head of EMEA value-add funds and fund manager responsible for the European value-add strategy at CBRE Investment Management, shares her view of what happens next. “We’re really excited about the current cycle because we’re seeing a huge repricing in real estate across the board,” she confirms. “If we compare Europe to Asia and the United States, for once Europe has led the way, and repriced first and fastest, so that’s attracting capital. But unlike other times of economic uncertainty, rent prices haven’t fallen alongside capital values, and have actually been steadily increasing, giving opportunistic buyers added confidence.”

Opportunity knocks

Opportunistic funds are usually seen at the higher end of the risk spectrum, and often talked about in the same breath as value-add, with the current market conditions allowing both to come to the fore. But there remains a clear difference between the two.

“Value-add typically gives a return in the early to mid-teens, percentage-wise, with opportunistic higher, potentially over 20 percent,” says David Pearce, fund manager of Nuveen Real Estate’s European value-add strategy. “But to get those higher returns, there is more risk associated, and an opportunistic fund might, for example, have greater development exposure, take on enhanced planning risks and look to utilise higher leverage.”

ActivumSG’s Červinka agrees. “With value-add investment, you’re probably not using as much leverage as you would with an opportunistic strategy,” he says. “Value-add looks primarily at an underfunded, underperforming asset which may require a refurbishment to unlock its potential. Opportunistic usually deals more with supply-demand imbalances in the market and mispricing due to rapid changes in market conditions. We are seeing a lot of opportunistic situations arise as a result of market distress, which creates opportunity to capture mispriced assets.”

The SOM Multiespai, a 388,000-square-foot (36,000-square-metre) shopping centre in Barcelona, was sold by ActivumSG along with two other shopping centres in Spain, for a combined fee of €140 million in May 2024. After ActivumSG's initial acquisition, the asset was subject to an intensive transformation as it was underutilised and undermanaged. The manager continues to look for similar opportunistic plays in Spain.

Europe's moment

Where should those investors seeking to benefit from opportunistic strategies be looking, then?

Spencer Corkin, head of value-add strategies at AEW, is eyeing a number of key sectors. "We see opportunities in the market that have structural demand drivers, including logistics, self-storage, purpose-built student accommodation, private-pay seniors and single-family rental, and data centres," he says. Capital deployments in these sectors will be supplemented with tactical investments in office repositioning in strong locations as well, says Corkin, who has identified the United Kingdom as a favoured location due to the speed of its repricing, with Germany also appearing on AEW's radar, given its potential to reprice further.

Paul White, head of the European value fund series at Hines, is also looking to Europe. He says values have corrected much faster than in the United States or Asia, allowing the manager to buy "quality cheaply".

"Values have fallen, but rents are rising, and this is the case for the best buildings, including offices," says White. "If you have a prime office space in a city like London or Paris, modernised inside, close to transport links and amenities, then you know rents will always stay strong, but at the moment you can buy that asset cheaply."

Rafael Cerezo, chief investment officer at Stoneweg, has spied other opportunities. "A key strategy for us is hospitality, finding assets in need of material capital expenditure and an operational turnaround or repositioning, such as changing a hotel from four- to five-star," he says.

Cristina García-Peri, senior partner and head of strategy and corporate development at Azora Group, meanwhile, is a huge advocate for southern Europe, including Spain. She says that although the general price correction has not been as high as in other parts of Europe, when you look at the absolute entry point it is still more attractive.

"We didn't have the same price rallies as in other markets, so levels are still not back to pre-COVID levels, or even those before the financial crisis," says García-Peri. "Plus, we believe that southern Europe will lead the economic growth in Europe over the next few years, and when you look at real estate, there's more fragmentation, more lack of quality supply and very strong tailwinds, all of which should help us deliver strong double-digit returns."

Embracing risk

By their nature, opportunistic funds and strategies embrace risk, so what should investors be mindful of when channeling this form of investment in such uncertain times?

The key risk remains timing, says Breslauer. "Can you execute whatever strategy you do, and can you get it done in three to four years? Because if you don't, you'll lose your return," he says, prompting him to argue that the biggest challenge facing almost every manager right now is how to estimate duration risk.

While timing can be one element, another is choosing the right fund manager, with lots of new outfits springing up and offering value-add and opportunistic funds to take advantage of their current popularity.

For Pearce, the experience and knowledge of an established company cannot be beaten. "Sector-specific knowledge is critical in this environment," he says. "You need to be able to navigate the investment market and have dedicated specialists, with the ability to draw on their expertise. And we're very much a believer of diversified funds in terms of it providing a wider investment universe, so we can be nimble and pick deals in a range of different sectors, as opposed to being tied to just one market."

CBRE IM's Forrest advises being mindful of a fast-changing environment. "It's still volatile," she says. "We don't know how quickly interest rates will come down, so it's difficult to forecast the market, which can be tricky when looking at exit yields."

There is also the changing nature of requirements from occupiers, given sustainability regulations and ambitions, that need to be factored into deals. "You want to make sure the asset will stay in demand in the future, so you need the foresight of what the market needs and wants," she adds. "We can't just sit on that good price and wait for a return – you need to drive your asset management capabilities hard."

García-Peri also recommends being proactive. "You need to be comfortable with the operational risk and work with managers that have the teams to manage those risks, using it as a source of additional value creation," she says, pointing out that different sectors have different tailwinds.

And it is paramount to remember that compromising on quality or location is a dangerous game, warns García-Peri.

"Not everything cheap is worth buying."

Chris Anderson is a UK-based freelance journalist.