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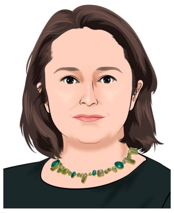
Exploring Real Estate Investments and Opportunities for Asian Private Clients

On July 6, in partnership with Janus Henderson Investors and specialist debt provider Katch Investment Group, Hubbis hosted a virtual discussion focusing on the world of real estate investment opportunities. The mission was to scan the world of international property and how best for private investors to access opportunities through various financial sector instruments and markets, both public and private. The panel highlighted some interesting trends, drilled down into some specific sectors and markets of interest, and shone a light on some worthwhile pockets of value and yield for private clients to consider. However, they also explained that while, in general in developed markets, valuations are quite attractive, in a world where there is no longer a rising tide of QE-driven liquidity hunting down assets, and in economies where higher bond yields offer appealing alternatives to income from real estate, it is especially vital to conduct detailed research, to project well into the foreseeable years ahead, and to diversify, including to leading Asian markets where the dynamics are often considerably different.

SPEAKERS

XIN YAN LOW
Janus Henderson Investors



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THESE ARE SOME OF THE QUESTIONS THE PANEL TACKLED IN THE DISCUSSION:

- What is happening in the mainstream world of commercial property and which segments, sectors and geographies offer the best opportunities?
- In a world in which interest rates have risen very rapidly and sharply in the major economies (excluding Japan and China), does real estate income look less appealing, or are inflation and a shortage of new builds driving property sector yields higher in some sectors?
- Which avenues of public market access should private clients in Asia consider – direct equity in commercial property companies, or via actively-managed funds, REITs, or passive funds such as ETFs?
- Should private clients be considering exposure to real estate via private debt/credit, if so what types of deals are out there?
- Which countries or geographical regions should private investors be looking at and why?
- How should the wealth management community be curating the optimal real estate investment opportunities?
- How does property investment factor into private clients' approach to their Residency and Citizenship by Investment plans?

Setting the Scene

Commercial real estate investing can take many different forms, and there are many different levels at which investors can participate. The experts reviewed the potential avenues available, including via direct private market equity, or publicly traded REITs representing equity, they looked at how actively managed mutual and other funds are faring and where the best opportunities might be today, or in the years ahead. They touched on private property sector debt and public market fixed income that allow investors access to yield higher up the capital ladder than equity.

They looked at the different types of property sector investments such as leisure, retail, offices, logistics, technology-related (data centres, for example), healthcare- facilities, and so forth. And they scanned the globe for the most interesting opportunities for Asia's private wealth clients, as well as focusing on how property investment factors into Residency and Citizenship by Investment for Asia's wealthy as they spread their assets and family members across the world.

The experts considered the typical time horizons that investors should consider for the different types of investments, from the public market trusts and REITs that offer continuous price points and liquidity to the less liquid types of assets that might require investors to lock up their funds for longer periods.

And the panel highlighted some of the challenges, risks and drawbacks that investors might consider as they factor in the right levels of commitment to the different types of real estate assets.

In Asia, the property sector is dear to people's hearts, as it has for so long been the gateway to private wealth creation

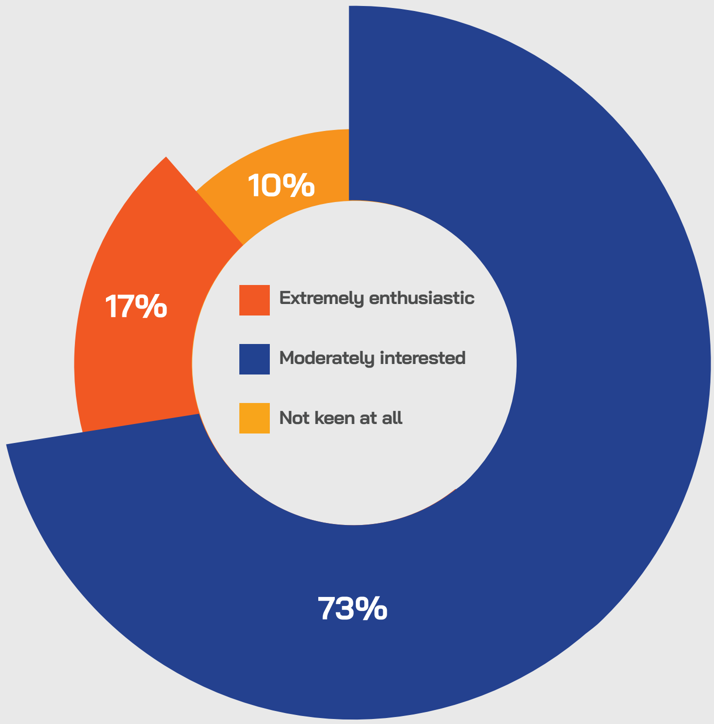
Anyone from Asia or who has lived in Asia appreciates that property – both residential and commercial – is akin to the lifeblood of any individual, family and to many private or public companies. As soon as anyone has the wherewithal, they will buy some residential property. As soon as they have considerably larger wealth, they might try their hand at property development. As soon as their family businesses have the scale, they will build or buy their own office and other commercial buildings.

"Our clients in Asia view property from a very emotional perspective because so much wealth in the region derives from property," a banker reported. "You have significant private wealth tied into your home property base, be that Singapore or somewhere else in Asia, and at the same time, they understand the wider property market, as most people have been involved in it. Accordingly, they are often receptive to investing in other places. In Singapore, they can obtain mortgages for many parts of Europe, or Australia and other recognised markets. And one key feature of private banking is to be able to facilitate mortgages across the world."

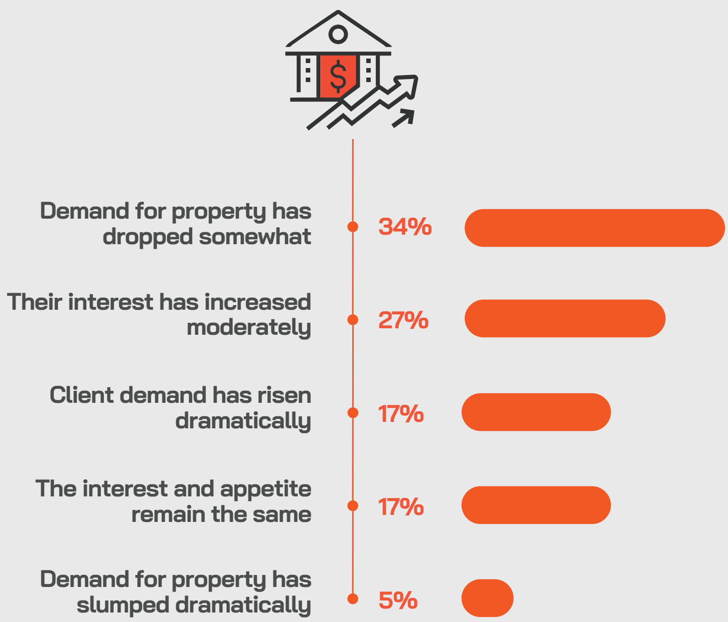
He explained that Japan offers some compelling prospects, but there are numerous opportunities around the globe, and many means of accessing those investments, whether directly, or via REITs, perhaps private equity or private credit, actively managed vehicles and so forth.

The Hubbis Post-Event Survey

HOW INTERESTED ARE YOUR ASIA-BASED PRIVATE CLIENTS IN THE PROPERTY SECTOR?



CHARACTERISE ASIAN PRIVATE CLIENT INTEREST IN PROPERTY INVESTMENTS SINCE EARLY 2022



The market conditions in the major Western economies have changed dramatically, but opportunities still exist

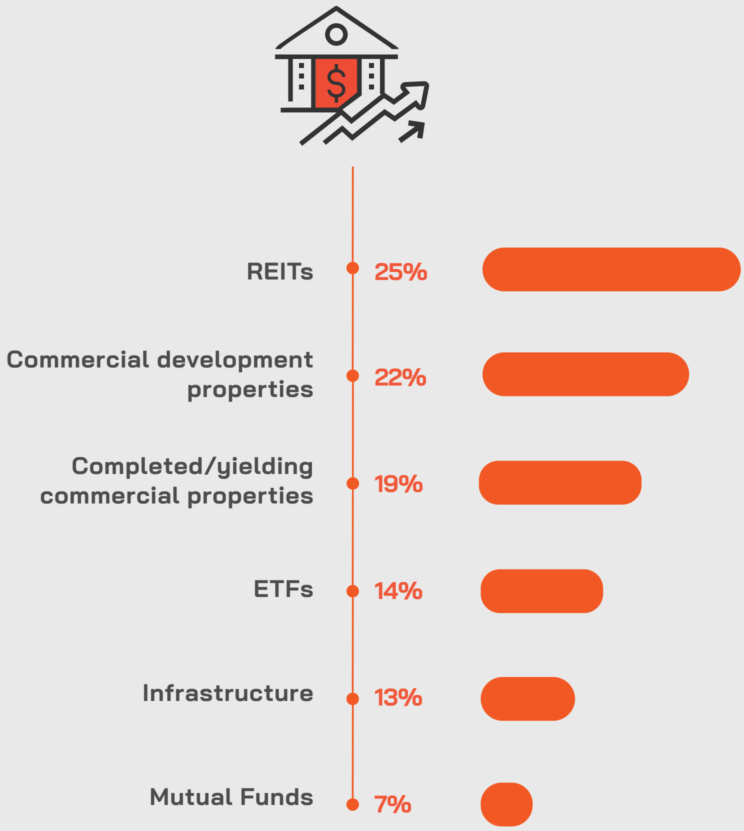
An expert said the reality in the US and in leading European economies is that the past 12 to 18 months had been challenging, with a macro narrative of rising rates impacting negatively on underlying real estate prices. She said the speed with which rate rises have piled one on another and the overall uncertainty in the air had, understandably, impacted the availability of credit, exacerbated by the tremors felt in the US banking industry this year.

"But we need to look beyond the headlines, and we see that some sectors of the commercial property markets continue to demonstrate very robust rental growth," she told guests. "There are many high-quality portfolios, which have been able to enjoy and sustain fairly high occupancy levels and demonstrate operational resilience. In short, in the listed space, the companies that we look at are still producing good earnings growth, indeed better than the wider markets."

She added that around mid-2022, the expectation was for broad-based S&P 500 earnings growth to be in the high single digits, but that has reversed to an expectation of a fall for 2023 as a whole. "But real estate is rather resilient, and earnings visibility remains robust," she said.

She did however concede that on a relative basis, property yields look less attractive compared to risk-free rates from bonds or compared to high-grade corporate paper. "Excepting Japan, the spread [of listed

WHAT TYPES OF PROPERTY INVESTMENTS DO YOUR CLIENTS LIKE?



Expert Opinion

MARIA RYAN, Portfolio Manager at Katch European Secured Lending Fund, Katch Investment Group

"With banks retrenching from real estate lending, a large volume of value-added projects needs to be financed. In the current environment of uncertainty, it is important to be selective both with regards to the asset class and jurisdiction, as well as carefully scrutinising the sponsor and the associated professional team. A funding gap is driving up the 1st mortgage whole loan pricing market, in addition to the increase in base rates. At Katch, we can be very selective and conservative on the projects we support, thereby achieving double-digit returns with safe LTVs in the 50%-70% range."

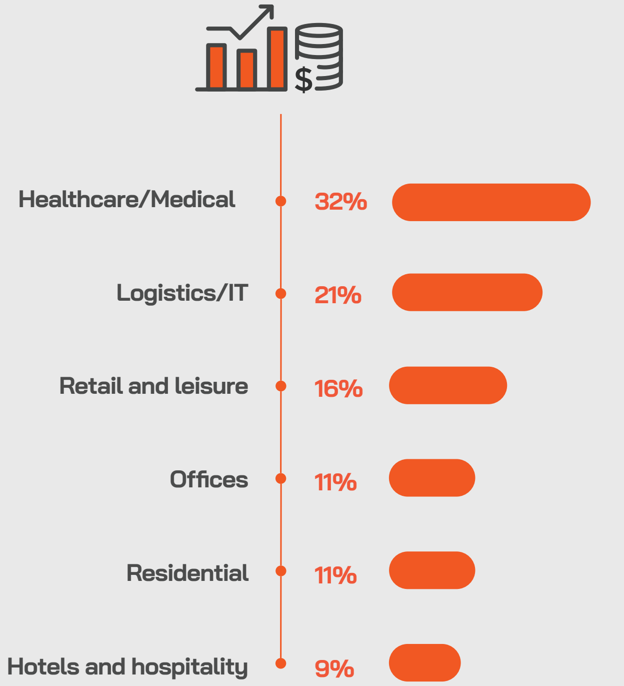
property] against 10-year bonds are now far below what they were for many years," she reported. "But that has been quickly reflected in the traded price of listed real estate, falling nearly a quarter in 2022 and today trading at roughly 20% below NAV."

She explained that this actually leaves certain REITs in selected markets at yields that are still above 10-year bonds. "For example," she elucidated, "dividend yields for Singapore, Hong Kong and Japan listed REITs are on average trading at a roughly 250 to 350 basis points positive spread. Investors are therefore able to buy in at deflated prices that already reflect the wider economic and financial concerns around. We believe there is now limited downside to overall asset values."

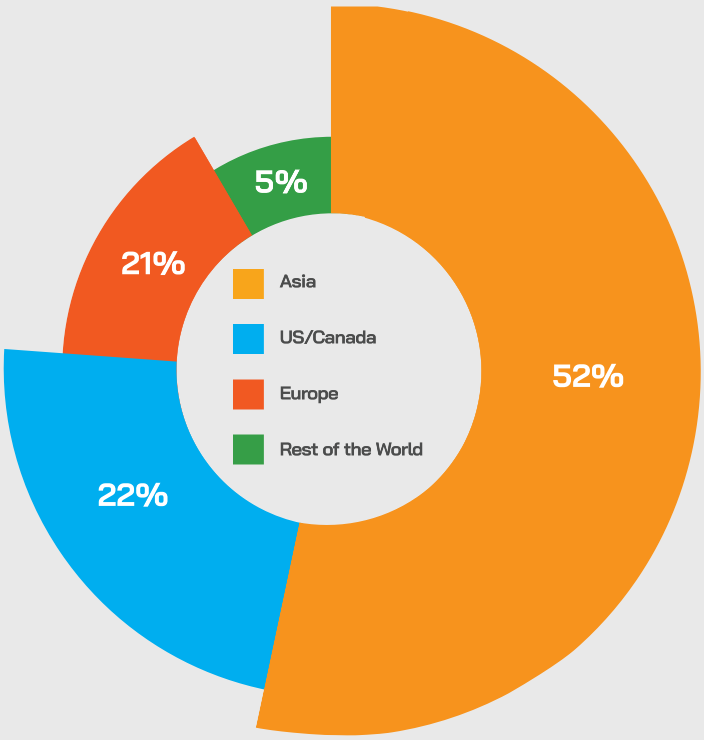
There are some excellent short-term funding gaps in the property development markets across Europe that can be captured in specialist funds for private clients

A panellist explained how their firm, which is less than six years old, had spotted the opportunity to invest in shorter-term private property sector debt where sponsors are challenged in obtaining their funding from the banks, which were already reluctant due to the due diligence effort required for relatively small deals (USD5-15 million) and are even more reticent today due to rising rates and economic uncertainties. But the niche they had spotted is sufficiently large in Europe to have allowed them to build a portfolio of six funds with some USD750 million in AUM today.

AMONGST REITS, WHICH SECTORS DO YOUR CLIENTS PREFER?



WHICH GEOGRAPHICAL REGIONS DO YOU AND/OR YOUR CLIENTS THINK OFFER THE BEST PROPERTY INVESTMENT OPPORTUNITIES?



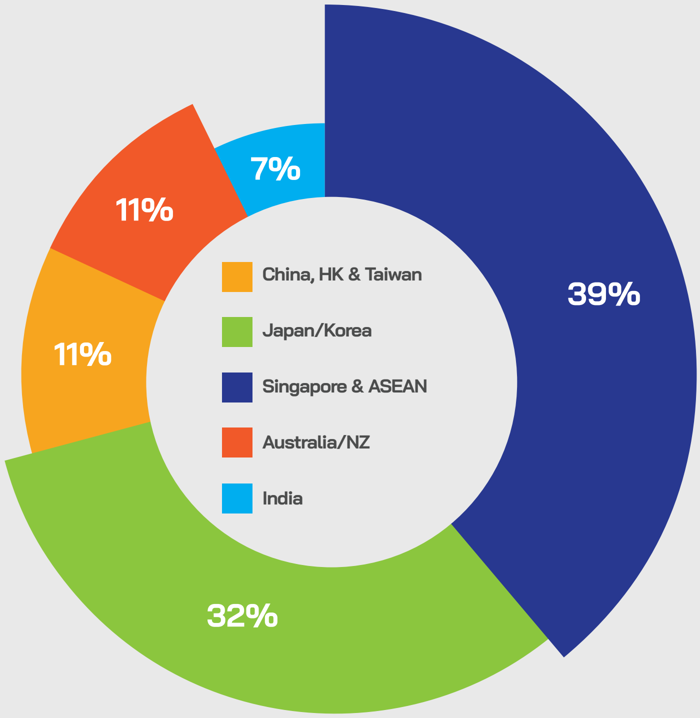
The firm is dedicated to liquid, senior-secured private debt, focusing on investment strategies mostly in Europe where capital is scarce with relatively high and stable returns. According to its website, in the aftermath of the global financial crisis, major central banks' liquidity injections inflated traditional asset classes, while new regulations reduced the banks' appetite and capability to lend to smaller businesses.

The firm's founders identified these trends and decided to launch funds that invest in short-term lending and financing opportunities for businesses and smaller institutions that offer strong guarantees. All these investment vehicles deploy capital in short-term funding opportunities, the safest and most liquid area within private debt with strong guarantees, such as real estate bridge lending, factoring, litigation funding, and others.

They deploy capital mostly for up to 24 months, but the vast majority of what they do is shorter than 12 months. The capital therefore very often returns to the platform on a regular basis, and with rising rates, the platform is nowadays recycling investor funds into higher-yielding opportunities. And everything they do is backed by collateral, which 95% of the time is real estate in the form of land or buildings.

This guest told delegates that they concentrate on the first-mortgage, value-added, opportunistic, small ticket space, with deal sizes of between USD5 million and USD15 million. "In this niche, we really see a dislocation in the market in terms of little or no bank lending, very limited fund lending, and with the market populated by

WHICH MARKETS OFFER THE BEST OPPORTUNITIES WITHIN ASIA PACIFIC?



Expert Opinion

THOMAS SCOTT, Group Head of Real Estate, Henley & Partners:

"Investment migration real estate is not really impacted any differently than traditional real estate in these market conditions. In capital cities and key markets, real estate remains very desirable and is often in short supply. Real estate is a safe haven in this kind of economic environment. We are also seeing rents in capital cities and outside of capital cities having some significant increases. When a property acquisition is linked to an alternative residence or citizenship, it needs to be super attractive. Benefits can be the appreciation in value, and the rental yield. But adding in the other investment migration benefits of global mobility, increased security, better health care, or a hedge against political and economic stability, it quickly becomes very compelling."

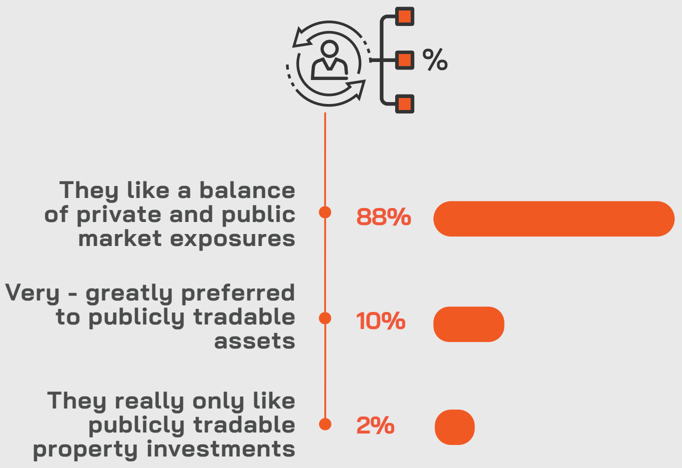
smaller professional sponsors and developers that we can back," she said.

As to sectors, she reported that the hotels and leisure sector had really bounced back since the end of lockdowns, and there is a shortage of rooms, licences and new projects in many cities in Europe. They also like the healthcare sector, where the market has been relatively stable and where there remains a significant structural under-supply of care homes in Europe, and long waiting lists. "We particularly like more sophisticated, high care, smaller homes, because hospital beds cost about EUR1000 per day in major European cities and the governments do not want to have their beds blocked up, so there is strong demand for space in those care homes," she explained.

Offices, however, are another story. "We are not brave enough to venture back to offices," she said. "Actually, in the UK and the US, it is rather like office Armageddon, although in Europe, working from home is not as established, partly because the commutes from nice leafy suburbs are quite short and pleasant, and there are nice bike lanes and so forth. In London, where I live, the commute is horrendous! But all-in-all we remain wary, and part of that is the pressure on ESG metrics, with regulations driving more sustainability and that means additional cost."

Finally, she added that they spread their assets across a broad geography in Europe and also make sure they have a good mix between income generating and 'dry' assets, and between commercial and residential.

HOW INTERESTED ARE YOUR HNW AND UHNW CLIENTS IN PRIVATE MARKET PROPERTY ASSETS?



Expert Opinion

MARIA RYAN, Portfolio Manager at Katch European Secured Lending Fund, Katch Investment Group

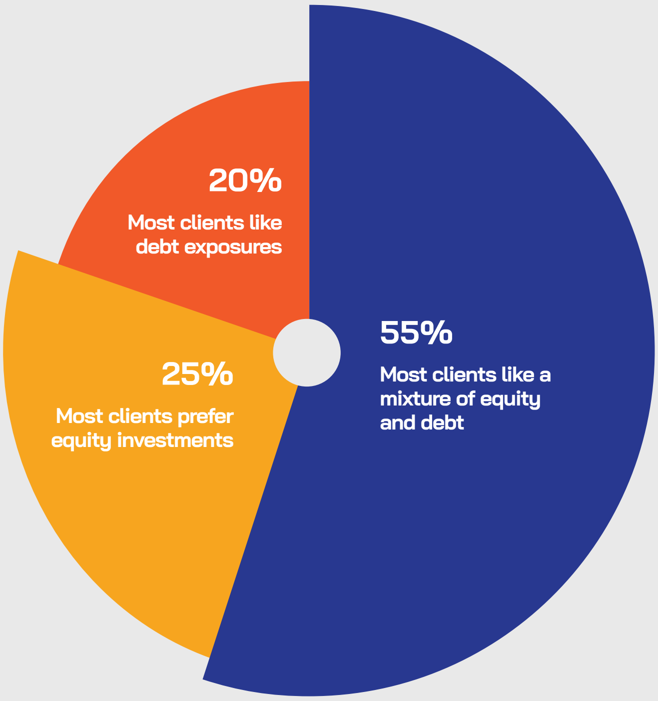
"If lenders effectively manage their macro risk, back solid sponsors with professional business plans and ensure there is sufficient equity cushion (30% to 40%, at least) to weather a downside, this vintage of first mortgage whole loans will be the best since 2012 due to the combination of lower leverage and higher returns."

Japan offers some interesting opportunities for those prepared to put in the effort and research, while in Singapore demand is particularly strong but entry levels are high

A guest highlighted how across Asia the return to office had been seamless and that in Japan, office space remains in high demand, especially in Tokyo, but also noted that demand is strong in the hospitality industry and across a variety of areas, with demand from Asian travellers remarkably high, buoyed in part by the relatively weak yen.

He added that the Singapore market is also strong, with numerous new businesses and investments coming in, including rapid growth in the family office space. "Demand might be off the absolute peak, but is still very high," he reported. "In short, when people look at having a diversified property portfolio, they do not need to focus so heavily on the US or Europe – there is a strong argument for more allocation to Asia. Indeed, our clients see that, and we are seeing strong interest from them."

WHAT ABOUT EQUITY OR DEBT EXPOSURES IN THEIR PROPERTY INVESTMENTS?



Nevertheless, he added that entry levels for Singapore are very high and careful research and bottom-up analysis should be conducted to ensure the right investment. Overall, he said they feel Japan offers a great cocktail of opportunities, liquidity, regulatory certainty and a diversity of types of assets.

Some segments in mainstream markets shine bright, with logistics, healthcare and hospitality performing well, and diversification globally is well advised due to different economic and financial market realities

A property market specialist then highlighted how there are certain sectors in selected markets around the world where top-line rental growth has actually been able to offset the significant rise in the cap rate. "Across the board globally, we see most industrial logistics assets being able to buffer their cap rate expansion with top-line rental growth. That is an example of selective sectors where owners do actually have the requisite bargaining power to pass through their higher overall costs."

She turned her thoughts to the office sector, which since the pandemic has been deeply out of favour. But she said the return to the office protocol was not at all challenging in some markets, for example in selected European markets, and especially not in Asia. "This region [Asia] was the last to reopen globally, but we were amongst the first to return to offices, and we estimate that 90% or more of the traffic across the region is back to what it was. Australia, by the way, is a bit of an outlier."

In the listed space, she told guests that she had seen a lot of very high-quality office landmarks dragged lower as the investment tides receded. "However, many vehicles can hold some of the best quality assets in specific locations," she reported. "For example, in Japan, the listed Japanese developers are winning over many tenants to their new projects, with those occupants in a flight to quality, moving away from the older grade B stock. In short, there are some very good pockets of assets if you dig a bit deeper."

She expanded on the industrial logistics segment, which she said continues to enjoy what she called "extremely strong structural demand". She explained that the increasing penetration of E-commerce over the past decade had been exacerbated by the pandemic lockdowns and was returning gradually to more normal growth levels.

"You might have heard of potential weakness in previously very strong markets like California, but we do still expect that the high-end beta rental reversionary potential will continue to support very attractive rent growth over the next few years," she reported. "In fact, in the US, you have market rents today, which are 60% to 70% higher than existing portfolio rents. Accordingly, should headline market rents weaken slightly, there is still a lot of headway for strong rental growth. Moreover, the supply of new space will be more limited as funding and other costs are higher and perhaps continue to rise, scaling back capital deployment to new projects."

She added: "If we fast forward to this time next year, we could find ourselves actually back in extremely tight markets."

Nevertheless, she said investors must be selective. She pointed to markets such as Hong Kong, where demand has fallen sharply and where appetite amongst tenants is more likely to fall further. She said the firm is still negative on that market, even in the historically tight real estate market of Central. "Landmark new buildings coming on stream there are taking longer to find tenants, but on the other hand, there are other more positive trends, such as decentralisation, as secondary locations absorb demand that is even coming from the financial sector," she explained.

Linking property investment to overseas migration opportunities can offer HNWIs the best of both worlds

Another guest reported how most of the international residence- or citizenship-by-investment programmes around the world offer these clients real estate as a qualifying investment component. He explained that people are familiar with real estate and the opportunity to achieve a capital gain and/or rental income over the years ahead alongside obtaining residence or citizenship overseas for themselves and their families is a very appealing cocktail.

He said that their firm not only guides clients towards their residence or citizenship of choice, but they also advise on the best real estate opportunities in each of the key markets, whether that might be Switzerland, Portugal, Cyprus, Malta or other destinations.

He advised delegates and their clients not to delay decisions on these fronts, as demand for key programmes – Portugal or Greece, for example – are high and the governments are increasingly stipulating higher levels of investment and also shifting more investment away from prime to less developed areas as part of the national efforts to enhance economic development.

Another guest pointed to interesting markets for property, citing Mallorca as appealing to a wide range of private investors and across a wide variety of types of property. He pointed to the liquid market, the growth in the local and regional economy, and the strong legal support for investors under the Spanish regulatory system. Combined with the Spanish Golden Visa programme and also the digital nomad visas on offer, the inward demand remains robust. Moreover, the political shifts in Spain and Europe away from the left were encouraging investors of all types to become more proactive.

The property sector has quite significant buying power, new investments will be curtailed for some years helping drive rental demand, listed sector valuations are appealing, and the timing for investors to expand allocations is rather good

A guest explained that taking more of a big-picture perspective, investors should be encouraged by listed valuations, but they also want to be ahead of the game for the next growth opportunities that will be emerging in the coming 5 to 10 years.

"Generally, real estate companies are amongst the few buyers out there that are able to acquire," she said. "They generally have stronger balance sheets and also good access to capital, both on the corporate bond market as well as on the equity markets. We are seeing listed REITs taking the opportunity to buy up private funds. In fact, there is the same sort of shift taking place after the real estate market collapse of the 1980s that led to banks being more reticent to lend to commercial real estate in the early 1990s, which in turn fuelled what has become the modern REIT sector today. It is a shift of capital and assets and buying power from private to public markets."

She explained that in the US alone, there are numerous mature, very well-managed and well-capitalised public companies that can take advantage of distressed situations amongst other real estate owners.

And she closed her commentary by pointing to the value of active management of property investments. "There are such different fundamentals across different segments of the property markets," she stated, "and many differences and nuances within each of those segments. If you were to invest in ETFs, you'll be owning all companies in the relevant index. But our approach is to select the best-in-class companies from the right sectors and in the right markets." ■