

# PERE

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FOR THE WORLD'S PRIVATE REAL ESTATE MARKETS



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The \$10bn real estate equity business you didn't know about

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Cautious optimism, but the caution and optimism look different

### NEGLIGIBLE NIPPON

Japan's institutional investors mobilize, but have invested little

### INVESTOR CHECK-IN

The hotel sector is attracting greater institutional attention

### MEGA-DEARTH OVER

The sector's biggest guns hold final closings

# CONFIDENCE

A soccer goalkeeper in a green uniform is diving to catch a ball in a goal. A player in a red uniform is in the foreground, partially visible. The background shows a large crowd of spectators in a stadium.

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# Machines for core, humans for more



Once again, the discussion around the opportunities and challenges facing private real estate centers on changing habits in the face of technology-led advances. As far as panelists at the 500-plus delegate PERE Asia Summit last month were concerned, technology was the primary disruptor.

Key to the debate was the role big data plays for investment managers as they underwrite outlays. The overriding consensus was as long as humans require real estate, humans will be the ultimate judges when it comes to working out what to pay for it. Even Goodwin Gaw, the event's day one keynote speaker, and one of the sector's more progressive thinkers, declared tech couldn't replace a gut thesis.

While the expanding reams of data at their fingertips were playing an increasingly important role in optimizing how they buy real estate, panelists refused to accept investment processes could become entirely automated. In reality, we're still some way from them being even majority automated. Data collection is improving but aggregation and standardization is still challenging, making universal, institutionally acceptable validation a mid-to-long-term proposition.

Nevertheless, in the future, core real estate might be one area where machine-learned pricing could happen and transactions begin to lose the human touch. It is hard to envisage how asset management can be automated, but transacting the sector's most bond-like commodity will surely become something that requires decreasing manpower.

Thus, we're effectively talking about the lion's share of real estate investment as potentially subject to technological takeover. Of the approximately \$650 billion of investment in 2018 predicted by broker JLL, it is a safe bet to say the vast majority will go to low-risk, low-return strategies. We're talking about a hell of lot of bricks and mortar, therefore, with the potential to change hands without much human involvement.

That still leaves the likes of Gaw with work to do as they continue to rely on their intestinal instincts to make property core. But what was heard on PERE's biggest stage could mean a future where big data has core real estate selling like exchange-traded funds – containers for much of the equities markets' capital – even if property's hedge fund equivalents continue their quest to find the asset class's alpha.

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 Senior Editor





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Boardroom at Goldman Sachs' London headquarters on Fleet Street.

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## Gaw Capital Partners

Gaw Capital Partners is a real estate private equity firm and has raised five commingled funds targeting the Greater China and APAC regions since 2005. The firm also manages value-add / opportunistic funds in Vietnam and the US, a hospitality fund targeting the Pan-Asia region, a UK creative office vehicle, and also provides services for separate account direct investments globally. Gaw Capital currently commands assets of over US\$17 billion under management.

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## CBRE accuses executive of stealing data

A retail broker allegedly downloaded more than half a million files as he formed a rival firm

A longtime CBRE broker founded a firm based on stolen trade secrets and run by staff from his former employer, the world's largest commercial service provider said in a March lawsuit.

Richard Rizika led a CBRE retail group before forming Beta Retail, a retail-focused brokerage, with colleague Mitchell Hernandez.

The day after he left CBRE at the end of February, Rizika hosted a party at his house, where he violated a CBRE agreement by asking his former colleagues to join his start-up, the lawsuit said. The following day, a CBRE executive ordered Rizika to stop soliciting employees and downloading information, which he denied doing.

Nine employees resigned from CBRE, but before they left, some used firm emails and programs to work on behalf of the new company, according

to the lawsuit. They downloaded half a million files from CBRE, including financial information, rent rolls and other proprietary content. Rizika also invested in a data company called Placer, which used some of the stolen data, it is claimed.

Three days after the party, Rizika tried to return hard drives with CBRE data to an executive with a note that said "we agree not to use any CBRE proprietary information."

CBRE, which reported at least one client that switched to work with Beta, is suing Rizika, his business partner, their companies and 10 former employees for misappropriation of trade secrets; breach of contract; intentional interferences with business relationships; violation of the Computer Fraud and Abuse Act; and unfair competition.

The defendants have not yet responded in court. □



**Mega-theft:** CBRE saw half a million files stolen

## Toxic real estate cleans up

The EPA is working with private companies to remedy Superfund sites for commercial use

The US's Environmental Protection Agency is making a pitch to ultra-opportunistic investors: real estate development at former toxic cleanup sites.

EPA administrator Scott Pruitt has prioritized cleaning up contaminated areas called Superfund sites, and the organization has sent new reassurances about liability risks. These factors are motivating investors to re-examine building on some of the most toxic real estate sites in the country, according to a *Bloomberg* report.

The environmental organization is courting companies that deal specifically in toxic real estate and environmental insurance to buy, clean up and build on Superfund sites. Some of these companies said the EPA's approach could catalyze demand for contaminated site redevelopment.

One developer said she was wary of a colleague's proposal to build a crude oil terminal on a toxic Texas lot she characterized as a "Superfund site on steroids." But she became more comfortable with the idea when she saw an EPA document that said the site, last used in 1991 as a copper smelter, was ready for redevelopment.

"Everything that we're seeing in the Superfund task force



**Superfund:** one of the contaminated sites in the US

recommendations is designed to move cleanup forward, and ultimately, development has a role in that," Randall Jostes, chief executive of Environmental Liability Transfer, a company that helps with the cleanup process, told *Bloomberg*. "Not all Superfund sites are candidates to be developed, but many are, and they can be significant wins for the community, for the municipality in which they're located, for the local government and the state government." □

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# REITs benefit from women on board

A new study shows that boards of directors with no women underperformed their peers over 11 years

Real estate investment trusts are slowly becoming less of a boys' club, leading to better performance, according to a study from Wells Fargo Securities.

After analyzing 165 equity REITs from 2006-17, the bank found that those with a higher than average number of women on their boards "achieved higher average price and total returns over that period."

REITs with more women than average outperformed REITs with all-male boards by 2.3 percentage points over five years.

Real estate is making progress, with the average representation of women on REITs boards rising to 15.5 percent from 8 percent in the last 10 years. But the asset class still trails the general equities pool: boards for S&P 500 companies average 22 percent women, according to the report.



**Report:** women make a difference

"Our purpose here is to shine a spotlight on board diversity in real estate and highlight that the performance benefits of inclusion found in companies globally, applies to real estate companies domestically," Wells Fargo said.

Of the REITs analyzed, 34 lacked any women on their boards, while women made up at least 25 percent of boards at 40 REITs.

Wells Fargo found that REITs for prison, advertising and energy-infrastructure had the most women on their boards, with over 20 percent representation last year. On the opposite end, industrial, single-family residential and healthcare REITs had the fewest women, at 11-12 percent.

"Timber and data centers actually have a lower percentage of women on their boards today than they did in 2006, a step backwards," the report said. □

## Quotable

"An investment management business a lot of the time relies on gut. And gut instinct comes from a collection of a lot of different data points that may seem irrelevant sometimes"

**Goodwin Gaw** tells *PERE* that big data cannot replace instinct in real estate

"He's that right combination of somebody you want your daughter to bring home when she's going on dates, somebody you trust with your money, and somebody with steel balls"

**Thomas Saylak**, former co-head of Blackstone real estate, highlights new president Jon Gray's strengths in *Bloomberg Businessweek*

"Even if they were there ready to wire the money, we would not have taken it"

**Charles Kushner** told the financing head of Qatar's sovereign wealth fund that he would not accept capital for a troubled project three months after Donald Trump's inauguration, according to a report in the *Washington Post*

"We are not rushing to raise a [value-added] fund right now. We have enough capital to keep us going and play the waiting game if necessary. So, we will get there when we get there"

M&G Real Estate Asia chief executive **Ng Chinag Ling** tells *Deal Street Asia* that her firm is branching out from the core space in Asia

"There are a lot of things to worry about geopolitically, but investors have a little bit of a fatigue sentiment"

**Peter Hayes**, global head of investment research PGIM Real Estate, said at *PERE*'s conference in Hong Kong

"Managers are calling capital, and that's giving investors more comfort they should be committing capital"

**Doug Weill**, co-founder of placement agency Hodes Weill, tells *PERE* about market differences between last year and 2018

"Only 10 percent of CEOs in real estate believe that the industry will be seriously disrupted by technology, compared to 38 percent in other sectors"

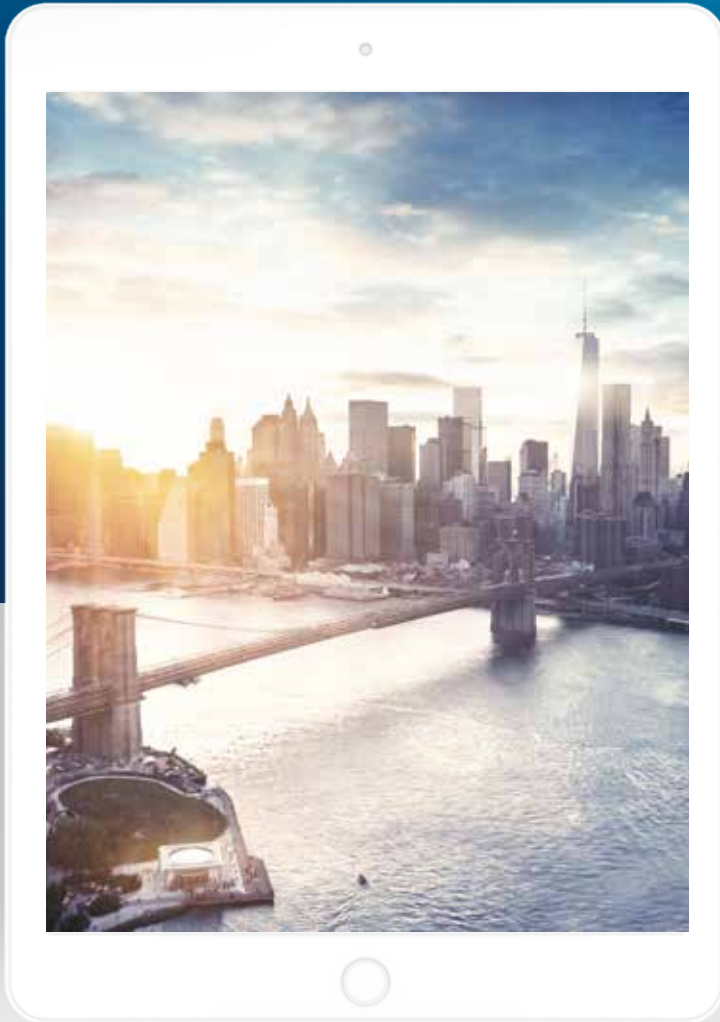
**Lisette van Doorn**, chief executive of ULI Europe, speaks at MIPIM about how innovation in property still lags other industries

"People in the real estate industry underwrite a project based on what the brokers tell them about the rent and they budget for that. But they never understand the value to the user. If you understand that value, you'll understand future rental growth much better"

**Ming Mei**, chief executive and co-founder of GLP tells *PERE*'s Asia Summit that occupier preferences will become paramount for underwriting investments

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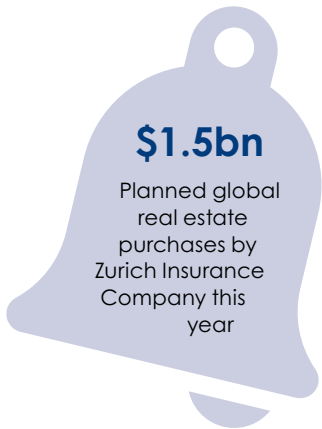
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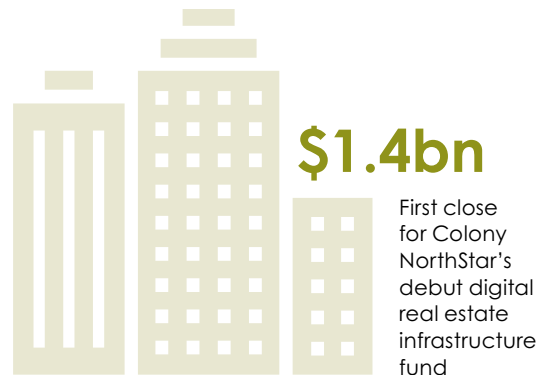
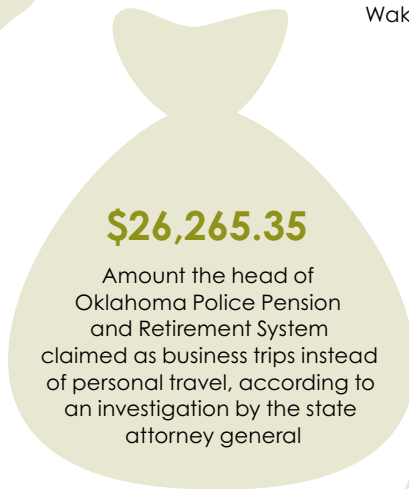
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# Hotels grab the headlines

The sale of AccorInvest and VBI Real Estate's ambitious growth target were among March's headline numbers



Final close for Blackstone Real Estate Partners Asia II



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# NEWS ANALYSIS

## FUNDRAISING

### Mega-fund closings underscore a polarizing market

Sizeable closings by private real estate's biggest managers demonstrate again their pulling power among the world's top institutional investors. *By Jonathan Brasse*

After a distinctly quieter 2017, the mega-fund managers of private real estate came roaring back last month with almost \$24 billion of equity reaching final or near final closes.

In the space of four days at the start of the month, *PERE* reported major closings by Brookfield, Starwood and Blackstone, the aggregation of which eclipsed the top five final closings combined in 2017.

Starwood was first, calling time on a fundraising effort that saw the Miami-based firm attract \$7.6 billion from investors for its Starwood Global Opportunity Fund XI. The firm blasted past its \$5 billion-\$6 billion target and outraised its Fund X by \$2 billion.

Days later, Brookfield neared a final close for Brookfield Strategic Real Estate Partners III after two quick successive closings, bringing its total to \$9 billion. With a final target of \$10 billion, the vehicle is expected to be the biggest to close in 2018.

Not to be outdone, Blackstone, the sector's biggest post-global financial

crisis fundraiser and perennial leader on the *PERE50* ranking of private equity real estate firms by capital raised, has kept pace with a final \$7 billion closing for its second pan-Asia fund, Blackstone Real Estate Partners Asia II. Like Starwood, Blackstone beat its prior haul in the series by \$2 billion.

These three funds have garnered more capital than the biggest five to hold final closings in 2017, including Blackstone's fifth European fund, Brookfield's fifth real estate credit fund, Kildare's second fund and two European funds by logistics specialist GLP.

#### Polarized market

The closings are demonstrations of a polarizing fundraising market in which the largest institutional investors are increasing their backing of the sector's largest managers. The California Public Employees' Retirement System, the biggest US real estate institutional investor, for example, has almost halved its active manager count since the crisis, today backing just 30 managers, but to

greater extents than before. Ivanhoé Cambridge, the real estate subsidiary of Canadian pension La Caisse de dépôt et placement du Québec, meanwhile, committed \$200 million to BREP Asia I and returned with a \$300 million check for its successor.

Investors have been captivated by mega-fund managers' ability to drive strong returns in a low-yield environment. Starwood's Fund VIII and IX are regarded top quartile in their vintages, projecting net IRRs of 13 percent and 24 percent and equity multiples of 1.6x and 1.8x respectively, according to documents from US pension Connecticut Retirement Plans and Trust Funds.

BSREP I, meanwhile, generated a net IRR of 19.5 percent and 1.6x multiple, while the more recent BSREP II had already returned its equity, generating a 1.1x multiple against a 12 percent IRR, per November documents from consultancy NEPC. Blackstone's BREP Asia I is generating IRRs north of 20 percent, one of its investors told *PERE*. □

#### March's mega three trumps 2017's high five

Starwood, Blackstone and Brookfield were able to surpass the biggest fundraisings of last year

Fund	Strategy	Close	Total
Brookfield Strategic Real Estate Partners III	Global diversified	Third	\$9bn
Starwood Global Opportunity Fund XI	Global diversified	Final	\$7.6bn
Blackstone Real Estate Partners Asia II	Asia diversified	Final	\$7bn
Colony NorthStar Digital Bridge Fund	US data centers	First	\$1.4bn
Pennybacker IV	Southern US diversified	Final	\$510m



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## EXPANSION

## ARA expands brief to include infrastructure

The Singapore-based real estate investment manager is setting up a dedicated platform. *By Arshiya Khullar*

ARA Asset Management is becoming one of the first few pure play real estate-focused Asian investment managers to venture into the infrastructure sector, aiming to take advantage of the growing institutional demand for the asset class.

According to sources familiar with the matter, ARA is currently in the process of hiring a team of investment professionals to run the infrastructure business based out of Singapore. While the core infrastructure team will initially consist of a handful of people, *PERE* understands it will be supported by the firm's private real estate funds management, legal and research functions.

The move is partly driven by Asian investors' growing preference toward increasing their global infrastructure allocations, given the stable, long-term income streams offered by the asset class. This strategy would also help to tap Chinese investors' overseas investment appetite by directing some of their capital into international infrastructure deals, one source said.

While outbound deals in real estate, listed as a 'restricted sector' by Chinese regulators, continue to be deeply scrutinized, more strategic investments tied to China's ambitious 'Belt and Road' global infrastructure initiative are being encouraged.

Asia and Europe will be ARA's target investment markets for infrastructure deals, *PERE* understands. ARA's decision to foray into infrastructure investing is also part of the Singapore-headquartered manager's aggressive global expansion strategy involving a push into new geographies and asset classes, as well as product types.

Last month, the firm, which manages S\$40 billion (\$30.5 billion; €24.6 billion)



**Lim, Ebbinghaus:** ARA's founder has charged the ex-Standard Chartered executive with growing the business in Europe

of assets, and has so far focused on investing within Asia-Pacific real estate markets, announced its expansion in Europe with the appointment of Mark Ebbinghaus as a senior advisor.

Ebbinghaus, formerly the global head of real estate and global head of industries at Standard Chartered Bank, will be based in London and will drive "ARA's business expansion initiatives in Europe moving forward in the form of REITs, private funds and other fund management-related platforms via merger and acquisitions," said John Lim, the firm's group chief executive.

### On the ground

Elaborating on its Europe strategy, Moses Song, group chief investment officer at ARA, told *PERE* the firm is looking to tap both local European capital as well as facilitate cross-border investments from Asian capital. "Having a team on ground will also

help us take advantage of the growing Asian investors' demand for investing in Europe," he said.

Song added that the firm will be looking at expanding its presence in Europe through M&As or platform acquisitions, in addition to standalone real estate transactions.

One early deal was its purchase of a 19.5 percent stake in Cromwell Property Group, the Australian real estate investment manager, in February. Cromwell runs a number of European strategies, including private funds and REITs, which are responsible for approximately €4 billion of assets.

ARA's ambitious plans to become a global real estate fund manager have been put in fast motion after the completion of its privatization process last March. A consortium led by the global private equity firm Warburg Pincus, Chinese investment and trust manager AVIC Trust and ARA's management now owns the firm. □



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## Korea Post's New York delivery

The \$110bn investor relocated a senior professional to the Big Apple to oversee its international push. *By Evelyn Lee*

During a panel discussion at PERE's Investor Forum in Seoul in December, Sehyeong Seong, deputy director at Korea Post, said with real estate prices and interest rates rising, the postal agency was seeking to diversify its investment portfolio internationally.

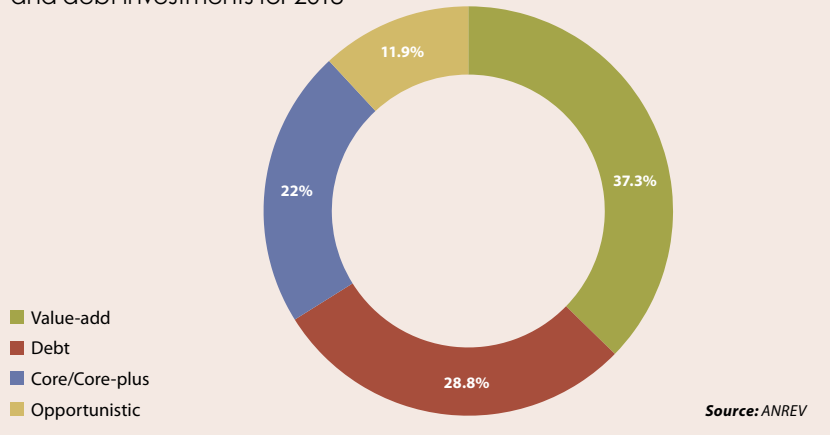
So it may have come as little surprise when the Sejong-based investor moved the executive to its New York office two months later as part of a shift to making that aspiration a reality. As PERE exclusively revealed, Seong will be the representative for Korea Post's investment office in New York, which opened in mid-2015 and includes two other investment managers.

All three investment professionals will be covering all US alternative investments, including real estate, on behalf of Korea Post's savings and insurance divisions. Additionally, Seong will be overseeing all of the overseas investments of both groups.

Seong began working with Korea Post in 2012, when he joined the risk management team of Korea Post Insurance. He then moved to the

### Investment preferences

The majority of Korean investors would prefer value-add and debt investments for 2018



alternative investments team of Korea Post Savings in 2014, covering real estate, hedge funds and structured products, among others.

The postal giant has been active in real estate debt overseas, having reportedly awarded approximately \$436 million in real estate debt mandates to three US managers in 2016. Its equity investments include a 47 percent stake on 7 West 34th

Street; an office and retail building in New York City through a managed account with CBRE Global Investors; and the Natixis headquarters building in Paris, purchased in 2016 through an account with La Française Real Estate Partners.

During the panel discussion, Seong said that with real estate prices and interest rates rising, Korea Post was seeking to diversify its portfolio and was interested in pursuing opportunities, specifying the Nordic countries as well as logistics and student housing as among its preferred regions and sectors.

Korea Post is one of the few Korean institutional investors with an overseas location in the US. The National Pension Service of Korea also has a New York office, which it opened in 2013. It is a government agency associated with South Korea's Ministry of Knowledge Economy, employing 32,000 workers across approximately 2,800 post offices in the country. The institution currently has approximately \$110 billion of assets under management, with more than \$2 billion in real estate. □

### Korean investors opt for riskier bets

Over 50% of delegates attending ANREV's Korea conference want to increase their real estate investments, with a majority favoring value-add and debt investments

More than half of the Korean investors surveyed at a conference in Seoul organized by the Asian Association for Investors in Non-listed Real Estate Vehicles said they planned to pursue value-add and debt investments in 2018, a shift in risk appetite from last year when a majority were more interested in core strategies. Among the 170 Korean

institutional investors and global real estate industry experts attending ANREV's conference, more than 37 percent expect to invest in value-add investments and 29 percent in debt deals this year, compared with 22 percent which favored core and core-plus investments. This was despite interest rates and pricing risk continuing to be a key concern.

## Ivanhoé Cambridge's new double act

Six months after the firm's president transitioned to a strategic advisory role, the Canadian investor has named a new president and new head of business units. *By Meghan Morris*

Ivanhoé Cambridge, the real estate subsidiary of Caisse de dépôt et placement du Québec, has been operating without a president since Bill Tresham transitioned from the role into a strategic advisory position in September.

At the time, Ivanhoé Cambridge said his role was not being replaced. Instead, the five presidents of its business units – Sylvain Fortier, head of residential, hotels and real estate investment funds; Rita-Rose Gagné, head of growth markets; Arthur Lloyd, head of the North America office; Claude Sirois, head of retail; and a still-to-be named new head of Europe – would report to Daniel Fournier, Ivanhoé Cambridge's chairman and chief executive.

But last month the firm appointed Nathalie Palladitcheff as its president and Alfonso Graceffa as head of business units, a newly-created role. Both Palladitcheff and Graceffa will report to Fournier.

The two roles are supposed to be complementary: as president, Palladitcheff will be responsible for ensuring Ivanhoé Cambridge's global investing strategy is aligned with its growth and performance targets, and consequently will assist the company's business units with sourcing and



**Palladitcheff, Graceffa:** CEO Fournier's new lieutenants

### London calling early for QuadReal

The real estate company of pension plan bclMC is opening its first overseas office in H1 2018

QuadReal appears to have established a London satellite office earlier than anticipated. In May last year, Jonathan Dubois-Phillips, the firm's president of international real estate, told *PERE*: "We'll look in the future at opening offices outside of Canada. Right now, it looks like the first office will be in London; that's probably 24 to 36 months out from today."

Dubois-Phillips added that Europe was expected to become a bigger part of QuadReal's portfolio. At the time, the company's holdings were heavily weighted to the Americas, but Dubois-Phillips anticipated that the firm's property holdings would become more balanced, with 50 percent allocated to the Americas, 25 percent to Asia and 25 percent to Europe.

The opening of the London location will follow QuadReal's hire of its new head of Europe as part of an expansion of its international team. The company tapped Jay Kwan to serve in the role. Kwan, who will be based in London, comes from TPG Real Estate, where he had been a managing director covering Europe since mid-2016.

QuadReal is an independent property company managing the C\$123 billion (\$95.8 billion; €84.9 billion) pension plan's more than C\$24.5 billion in real estate assets.

analyzing opportunities. She joined in April 2015 as chief financial officer, where she was responsible for information technology and human resources, in addition to finances and strategic planning.

Graceffa, meanwhile, was placed in charge of the firm's business units to help to define and execute the investment strategies of those businesses. Additionally, he will develop and manage Ivanhoé Cambridge's partnerships and also oversee the company's operations and investment processes. He will remain chief executive of Otéra Capital, the pension's real estate debt subsidiary which he joined in 2008 as vice president of construction loans and workouts.

"Nathalie has made a significant contribution to the transformation of Ivanhoé Cambridge," Fournier said in a statement. "As president of Otéra Capital since 2012, Alfonso was instrumental in delivering strong results year after year, all while refocusing the company's activities with strong governance rules and business practices. Together, they will play a strong part in developing the talent we need and in executing on the business priorities we have identified to meet the returns expected by our shareholders."

Tresham, meanwhile, is focusing on "out of the box alternatives," he told *PERE* in November, particularly on larger entity-level opportunities, something he had less capacity to do managing day-to-day operations as president.

Ivanhoé Cambridge is not done hiring. The firm is also looking to add a chief innovation position later this year, a spokesman told *PERE*. □

## TOP 5 FUNDRAISING STORIES IN MARCH

**1 Starwood holds largest final close**

The Miami, Florida-based private investment firm hauled \$7.6 billion for Starwood Global Opportunity Fund XI, in what is expected to be one of the largest real estate fundraises this year.

**2 Greystar launches next US fund**

Greystar Real Estate Partners is coming to market with its next US value-add real estate fund, Greystar Equity Partners X. The multifamily-focused fund has a target size in the \$1.5 billion range, slightly larger than its predecessor fund.

**3 Brookfield moves BSREP III toward final close**

The Toronto-based alternative asset manager has held an interim close on its third global opportunity fund, Brookfield Strategic Real Estate Partners III, raising a total of \$9 billion, according to a filing with the Securities and Exchange Commission. *PERE* understands that a final close at \$10 billion is now expected during the second quarter.

**4 Blackstone shatters Asia records**

At press time, Blackstone was poised to close its latest pan-Asia opportunistic real estate fund at around \$7 billion, the biggest closed-ended real estate fund ever raised in the region. In less than one year since the fund's launch, the New York-based firm will be closing Blackstone Real Estate Partners Asia II at its hard-cap target, sources confirmed to *PERE*.

**5 Colony corrals \$1.4bn for RE infra**

Colony NorthStar raised \$1.4 billion in a first close for its debut digital real estate infrastructure fund, the firm said in its fourth-quarter earnings results last month. The Los Angeles-based real estate investment trust is working with Digital Bridge, a Boca Raton-based infrastructure company. The partners are seeking \$3 billion in total.

## CARLYLE'S EUROPE FUNDRAISING

**All forgiven**

Carlyle's Euro comeback fund attracts legacy investors from the ill-fated third fund in the regional series. By Jonathan Brasse

Carlyle has enticed investors that previously backed its faltering European opportunity real estate fund series to return for its latest effort in the region, *PERE* revealed last month.

The Washington, DC-based private equity firm was once one of the biggest fundraisers for private real estate's highest risk and return strategy in Europe, raising €2.2 billion in equity for the third fund in the series in 2008.

Alongside numerous peers which launched large opportunity funds shortly before the global financial crisis, Carlyle Europe Real Estate Partners III performed poorly. Indeed, in 2014, investors were understood to be looking at a return of 12 cents on the dollar for the fund.

Since then, however, a new-look management team, led by ex-Blackstone senior managing director Peter Stoll, have reversed the fund's fortunes and, when *PERE* last reported on it last July, the vehicle's performance had improved: the assets were understood to be generating an internal rate of return of 1-2 percent and a 1x equity multiple, meaning investors would at least receive their equity back.

This improved performance has enabled the firm to shift its focus from asset managing CEREP III to marketing a fourth vehicle, Carlyle Europe Realty Fund I.

Carlyle declined to discuss its fundraising but it is understood that a proportion of CEREP III investors have returned with new commitments. Their commitments are among the approximately €300 million Carlyle has raised for the fund's initial close.



**Stoll:** overseeing a turnaround

Further, when *PERE* previously reported on the fundraising, a target was expected to be lower than €1 billion, but had not been set. However, the equity goal is now understood to have been fixed at €500 million, meaning the firm is well past the halfway mark in its capital raise. A final closing is thought to be slated before June.

For a number of reasons including CEREP III's performance, the firm's lengthy absence from the commingled fundraising space in Europe, significant personnel changes and the objective of bringing the vehicle's identity more in line with its US counterparts, the firm's European opportunity funds were rebranded Carlyle Realty Europe. □

**1-2%**  
Third Euro fund's  
IRR as of July



MIPIM: economic growth cheered delegates

## Same MIPIM mood, but different

Cautious optimism has characterized the event for the last few years, but the reasons for the caution and optimism have now changed, as [Evelyn Lee](#) reports

**T**welve months ago, real estate professionals congregating along Cannes's main La Croisette strip for the annual MIPIM conference were wary about Europe's economy, but rosy about property valuations. Now, the sentiments have reversed, says Martin Towns, head of capital solutions at London-based real estate fund manager M&G Real Estate. "There's now a recognition that we're further in the cycle, and cap rates are slightly lower, so people are more cautious about rates. But there's optimism about the economy," he remarks.

Europe's economic growth consistently beat expectations last year, with gross domestic product growth reaching 2.7 percent, according to M&G's March European market outlook report. This far exceeded the European Central Bank's 1.7 percent forecast and marked the eurozone's fastest growth rate since 2007.

Improving economic fundamentals was one factor cited

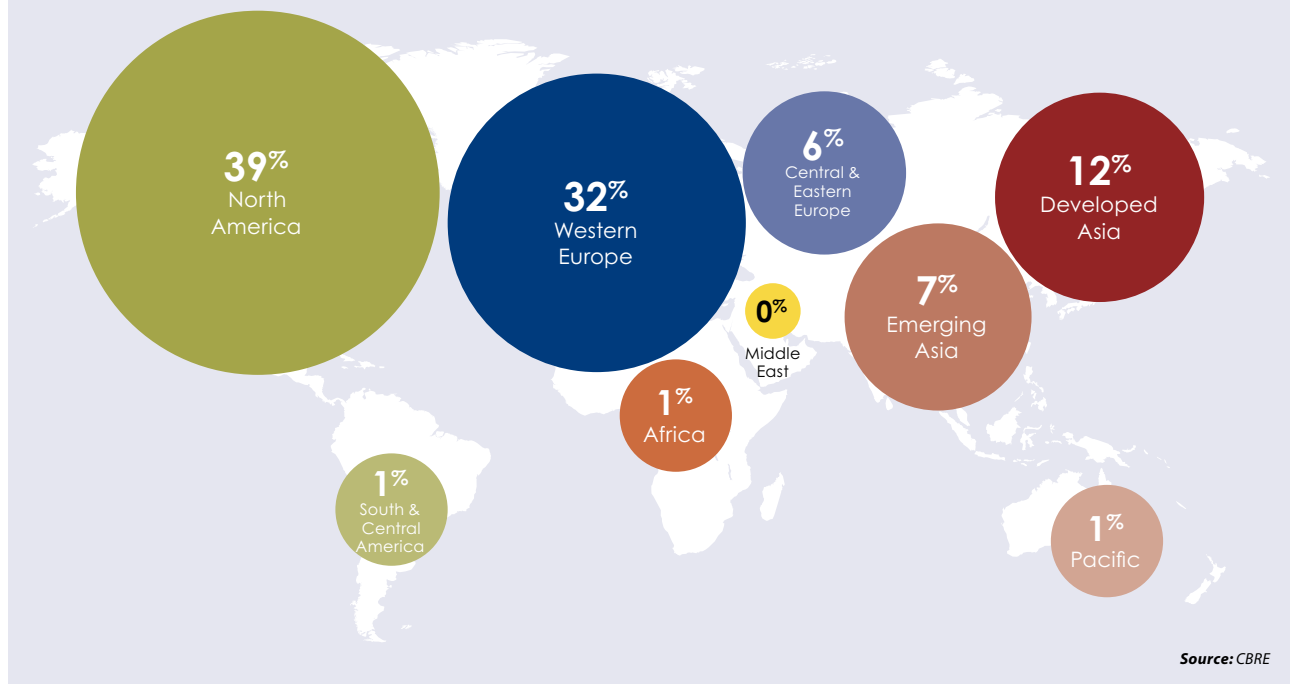
for the rise in Europe's popularity as a real estate investment destination, according to the latest CBRE *Global Intentions Investor Intentions Survey*. Europe is considered the most attractive regional market for 32 percent of investors, a close second to North America, which was most favored among 39 percent of investors, the report said.

Europe attracted \$173.7 billion in cross-border inflows in 2017, an increase of 27 percent, both the highest such volume and percentage increase among the regional property markets, according to the Cushman & Wakefield *Global Investment Atlas 2018*, which also was unveiled at MIPIM.

When discussing the eurozone's positive economic prospects, nearly all the MIPIM delegates that spoke with *PERE* identified one strong driver of that optimism: the resurgence of France, which has transformed from an economic laggard to one of Europe's strongest economies during the course of the year.

## Overseas investing

Which region is most attractive for property investment outside your region?



The country's GDP growth reached 0.6 percent in the fourth quarter of last year, the fifth consecutive quarter where it exceeded 0.5 percent, according to the European Commission. Annual GDP growth rose to 1.8 percent in 2017 from 1.2 percent in 2016, and is expected to increase to 2 percent in 2018.

This turnaround is happening after years of sluggish growth and is attributed in part to President Emmanuel Macron's economic reforms, which seek to promote labor freedom and a market-driven economy.

"Economic growth in France had been held back by low productivity growth. This can be linked to relatively rigid labor markets and elevated public spending, rather than private investment, and in part, depressed consumer and business sentiment," says Raimondo Amabile, head of Europe at PGIM Real Estate. "Macron is tackling these issues, providing positive economic impulses in France."

Adds Amabile's colleague, Germany head Sebastiano Ferrante: "You can see how political change can have positive effects on the investment environment. Companies are starting to invest again, and real estate demand is following suit."

One of the strongest endorsements at MIPIM for France's real estate market

came from Zurich Insurance Group, which is eyeing a return to the country following the sale of most of its French business to Italian insurer Generali in 2004.

"For the first time in many years, we are considering the French market," says Cornel Widmer, Zurich's head of group real estate. "We did not have the appetite for France before, but we are quite positive about what's going on there now. The overall economy is improving and has the potential to be picking up quite nicely."

To mark its re-entry, Zurich is in the middle of the selection process for an asset manager for France and hopes to award a mandate by the end of the first half of the year. The insurer expects to invest \$300 million-\$400 million of equity by the end of the year, with the goal of building a core and core-plus portfolio in the country before long.

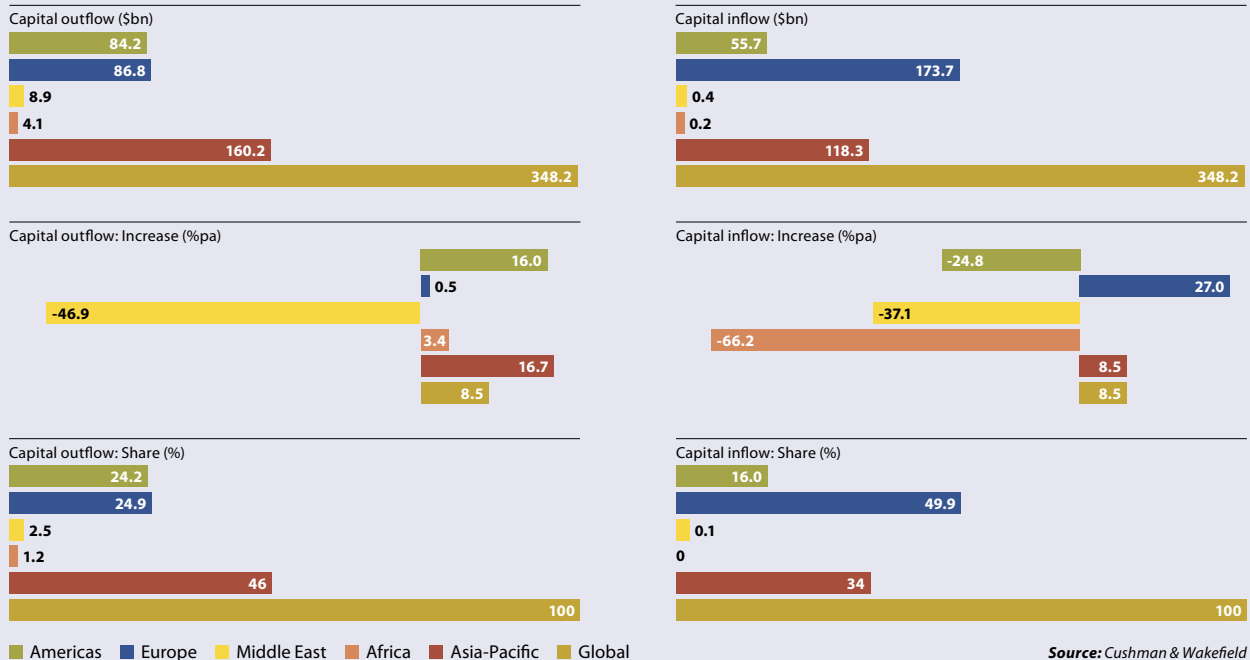
Zurich is far from the only investor seeking to ramp up its exposure in France, however. During the same week as MIPIM, Swiss Life and MAPFRE, the largest multinational insurance company in Latin America, announced plans to launch a real estate vehicle that will invest in the prime office locations in major French cities, with a first size target of up to €150 million of equity.

**"For the first time in many years, we are considering the French market. We did not have the appetite for France before, but we are quite positive about what's going on in France"**

**Cornel Widmer**

## Shifting sands

Europe attracted more capital than other regions in 2017 when comparing cross-border capital flows



### Caution ahead

But tempering that optimism was a fair amount of caution about the later-stage real estate cycle in Europe, as well as changes to European Central Bank's monetary policy.

"The biggest concern is the changes and the potential pace with the monetary policy from the European Central Bank," says Gunnar Herm, UBS Global Asset Management's head of real estate research and strategy. Quantitative easing by the ECB ended this year, which means that bond rates could rise as soon as the end of 2018.

The impact of a rate increase is potentially worrisome for the prime real estate segment, says Herm. In Berlin, for example, the prime cap rate for a prime office property is currently 2.9 percent. "If interest rates rise and cause cap rates to rise to say, 4 percent, that's a significant loss in value, and can hardly be compensated by income growth," he says.

Herm has reason to be concerned, as multiple major European investors are understood to have already been impacted by interest rate increases. Among them is Bayerische Versorgungskammer, Germany's largest pension fund, which is scaling back on US real estate investing for 2018 because of rising interest rates as well as a dramatic increase in hedging costs.

Over the past two years, BVK's hedging costs for its US real estate investments have surged from approximately 50-70 basis points to 280bps, according to Rainer Komenda, head of real

estate funds at BVK. "If it's a normal core, core-plus deal that produces a 5 percent cashflow, you end up with a 2.2 percent return," he says. "It's too small to support our overall portfolio."

The rising hedging costs are partly the result of disparity between interest rates in Europe and the US, Komenda notes. While the US Federal Reserve has raised the target range for the US federal funds rate from 0.75-1 percent to 1.25-1.5 percent over the past year, the ECB's interest rates have remained unchanged at zero, 0.25 and -0.40 percent for the past two years.

The increased costs of making a property investment in the US have led BVK to scale back its investment drive in the market. "It's not to say we'll completely pull out of the US, but we will slow down," says Komenda.

Chiming with BVK's plans are some of Cushman's projections in this year's *Investment Atlas*, which projected the likelihood of "new patterns of risk taking" among investors, as some seek to de-risk portfolios while others seek more growth-driven, rather income-focused, strategies. "Overall therefore, we will see a more dynamic market as investors switch targets between sectors and regions," the report said.

In other words, it is unlikely to be business as usual for the European real estate market in 2018. While the overall mood at MIPIM is considered an industry barometer every year, what is shifting beneath the surface is also warranting attention. □



## Bracing for big data

*PERE's* Asia Summit debated the growing relevance of data collection on doing business, with the consensus believing that the industry isn't ready for automated investing

**A**s is fast becoming the norm at *PERE's* onstage offerings, the conversation at the *PERE* Asia Summit last month was dominated by contemplations on the impact of disruptive technology on real estate occupation and investment.

A US-China trade war was sporadically identified as a real threat to business at the summit, but it didn't displace technology as the primary disruptor for the 500-plus delegates at Hong Kong's Grand Hyatt hotel.

Key to the debate was the role big data had to play for investment managers as they underwrite their outlays. The overriding consensus was that as long as people require real estate, humans will be the ultimate judges when it comes to working out what to pay for it. "I just can't see robots making investments," said keynote speaker Goodwin Gaw.

While the expanding reams of data at their fingertips were playing an increasingly important role in optimizing how they buy real estate, panelists refused to accept investment processes could become automated.

Other reasons for that were offered, too. On one panel, Sung Lee, an executive vice-president at Altus, a software solutions provider, pointed out that while data collection among investment managers was improving, data are still being collected from disparate sources, which makes aggregation and standardization a challenge, and, in turn, a less effective underwriting tool. Capitaland's Ervin Lim, meanwhile, argued that data still require human interpretation in order to make decisions. His firm is one of the more bullish prop-tech investors, running a dedicated venture capital platform.



**Defender of the gut:**  
keynote Gaw convinced robots cannot make investing calls



**Mei:** data-led pricing is coming

But not everyone was so certain that data wouldn't lead to automated real estate investment. While Starwood Capital Asia's managing director Kevin Colket labeled it "past-looking," "unable to predict black swans" and "a tool that will never replace people's judgment and desire to get together," he also conceded that, in the future, core real estate might be one area where machine-learned pricing could happen and transactions might lose the human touch.

Another convinced that automated pricing would prevail in the near future was GLP's co-founder and chief executive Ming Mei, day two's big interview subject. In fact, Mei told *PERE* senior editor Jonathan Brasse and the audience that his own firm was already trialing data-led pricing based on through-put in certain GLP properties – a complete departure from traditional fixed-rent leases. Pointing out such pricing models already exist in hotels, he said: "Everything is moving toward being as close to the customer as possible. Businesses want as few fixed costs as they can have. If we can capture mass value for each and reduce their risks, we should be doing it." □



**Trouble-shooters:** the panel debates the impact of data

# Penalty time for Chinese insurers

Regulators have taken harsh action against local investors that have failed to toe the line on cross-border investments. *By Arshiya Khullar*



**T**he Year of the Dog did not start on a prosperous note for China's insurance investor community. Within just 48 hours at the end of February, the China Insurance Regulatory Commission took stringent action against four major local insurers, its harshest public strike on Chinese cross-border investors to date.

First came the takeover of Anbang Insurance Group for one year by a special committee comprising five financial regulatory bodies, and the prosecution of its former chairman Wu Xiaohui for "alleged economic crimes." Anbang says it fully supports the decision and remains committed to the development of its overseas subsidiaries.

The next day, CIRC sent separate notices to Ping An Insurance, New China Life Insurance and China Re Asset Management, part of the state-owned China Reinsurance. The regulator called out the firms' overseas investment businesses for breaking provisional rules regarding cross-border deals issued in 2012, directing them to rectify the violations within one month.

CIRC did not specify which transactions flouted the rules, but the global private real estate industry will nevertheless pay attention. After all, these investors are behind some of the biggest outlays in recent years.

Last June, mega state fund China Investment Corporation stole the headlines when it paid €12.25 billion to acquire Blackstone's pan-European logistics platform, Logisor. Receiving less press was the fact that CIC later brought other investors into the deal. According to a November stock exchange announcement, a subsidiary of China Reinsurance agreed with a CIC subsidiary, New China Life Insurance and others to back a holding company investing in the platform. China Reinsurance paid an aggregate €5.79 billion in cash for a 10 percent ownership.

The overseas exploits of Anbang and Ping An Insurance are better known. According to property deals research house Real Capital Analytics, the two groups have invested \$14.5 billion in real estate outside of China. Highlights for Anbang include Waldorf Astoria and Strategic Hotels & Resorts, acquired

from Blackstone, and a stake in Vancouver's Bentall Centre from the Canadian investor Ivanhoé Cambridge. Meanwhile, Ping An Insurance, one of the earliest Chinese insurers to invest abroad, teamed up with Mitsubishi Estate to finance the \$1 billion Circular Quay Tower project of Sydney-based property group Lendlease. It also invested over \$300 million in a logistics development partnership with e-Shang Redwood in Japan in 2016. All these deals were completed before the capital controls were intensified.

The number of Chinese groups to come under fire has increased amid Beijing's attempts to rein in financial risk arising from over-indebted conglomerates and speculative investments. Last year, regulators reportedly began probing Anbang, Fosun, HNA and Dalian Wanda.

The rationale behind why each of these groups is being scrutinized is different, but the scale of holdings and China's deepening controls on cross-border deals in restrictive sectors, including real estate, hotels and

hospitality, should lead the industry to further question the limits of Chinese investors' overseas appetites.

It would not be unreasonable to go a step further and anticipate that some of these once-acquisitive investors will become net sellers this year. After all, isn't selling the quickest way to rectify a non-compliant investment? We are already collecting anecdotal evidence of vultures circling: one North American group that sold an asset to a penalized insurer told *PERE* it would be natural to consider buying the property back – if offered at an attractive price, of course.

There are others who still believe that not all doors have been shut and groups that toe the official line – in terms of the chosen investment sectors and getting the right approvals – will still be allowed to invest overseas. As things stand, however, such a belief seems more rooted in hope than actual reality. □

**"It would not be unreasonable to anticipate that some of these once-acquisitive investors will become net sellers this year. After all, is not selling the quickest way to rectify a non-compliant investment?"**

## In the CIRC sin bin

- × Anbang Insurance
- × Ping An Insurance
- × New China Life Insurance
- × China Re Asset Management

# Ignore at your peril

The US government's influence over deals relating to national security is not something to ignore when transacting with international counterparties. *By Meghan Morris*



**F**oreign capital loves US real estate, but the US is less keen on the foreign buyers it thinks may pose a threat to national security. To counter that perceived threat, the government is debating a bipartisan bill that could impact the asset class well beyond the mega-deals typically considered.

From conversations with industry observers, including lawyers who worked for the cross-department government body that scrutinizes these transactions, the Committee on Foreign Investment in the United States (CFIUS), it has become clear that even real estate firms which previously ignored CFIUS – technically voluntary, but effectively mandatory for sensitive assets – need to pay attention. The legislation being debated in Congress, called the Foreign Investment Risk Review Modernization Act, will focus CFIUS's attention on real estate in ways that could impact landlords of all sizes and buyers from all corners of the world, not just China. Unlike most legislation, FIRRMA has a good chance of clearing Congress by the end of the year.

Previously, major concerns for real estate centered largely on proximity to sensitive sites and, for hotel deals, data and privacy. Chinese insurer Anbang's 2016 acquisition of a hotel portfolio from Blackstone came under scrutiny, for example, because one of the luxury resorts was located close to a major naval base. CFIUS also analyzed the firm's 2014 purchase of New York's Waldorf Astoria hotel because the US president typically stayed in the luxury property, and the US ambassador to the UN maintained a residence there. As hotels and other businesses collect more data on guests and tenants, CFIUS may continue to broaden its scope of inquiry, one lawyer tells *PERE*.

FIRRMA codifies some of CFIUS's previous considerations, such as how the group understands a transaction that would result in foreign control of a US business. CFIUS currently gives 'control' a broad

reading and can include transactions in which minority investors have veto rights over business decisions, such as the appointment of key managers. CFIUS also assesses the investor's record of compliance with US laws and if its investment portfolio includes properties involving persons, entities or countries under US trade sanctions. That could make it more difficult to transact with an investor with a significant footprint in Russia, for example, underscoring the need for sellers to conduct due diligence on their buyers.

## Path of lease resistance

The legislation also adds more stringent protocols to the review process, particularly for real estate. For the first time, FIRRMA dictates that leases should be considered a matter of national security. That aspect is "unprecedented" and, as one lawyer told us, "hugely significant."

If the bill is passed in its current form, the CFIUS review could be triggered, for example, if a government agency is leased on a floor in an office building that a foreign interest also wants to lease space in. Landlords with sensitive tenants, particularly in government-heavy Washington, DC, could find leasing more

difficult, as foreign companies may not want to undergo the hassle and expense of filing for CFIUS review just for a lease. Under FIRRMA, the CFIUS process also has a price tag for the first time: the lesser of \$300,000 or 1 percent of the transaction value. Depending on FIRRMA's final form, managers may consider including CFIUS approval as a closing condition when transacting with foreign buyers.

Blackstone, already stung by CFIUS's reviews in the past, added FIRRMA to its list of business risks in an annual filing with the Securities and Exchange Commission last month. Smaller managers, both those which transact with foreign buyers and those which simply lease space to ex-US entities, likewise cannot afford to ignore the potential costs and time associated with the national security review process. Whatever the political underpinnings at play here, market practitioners bent on sticking to a risk-adjusted philosophy should adjust to this risk. □

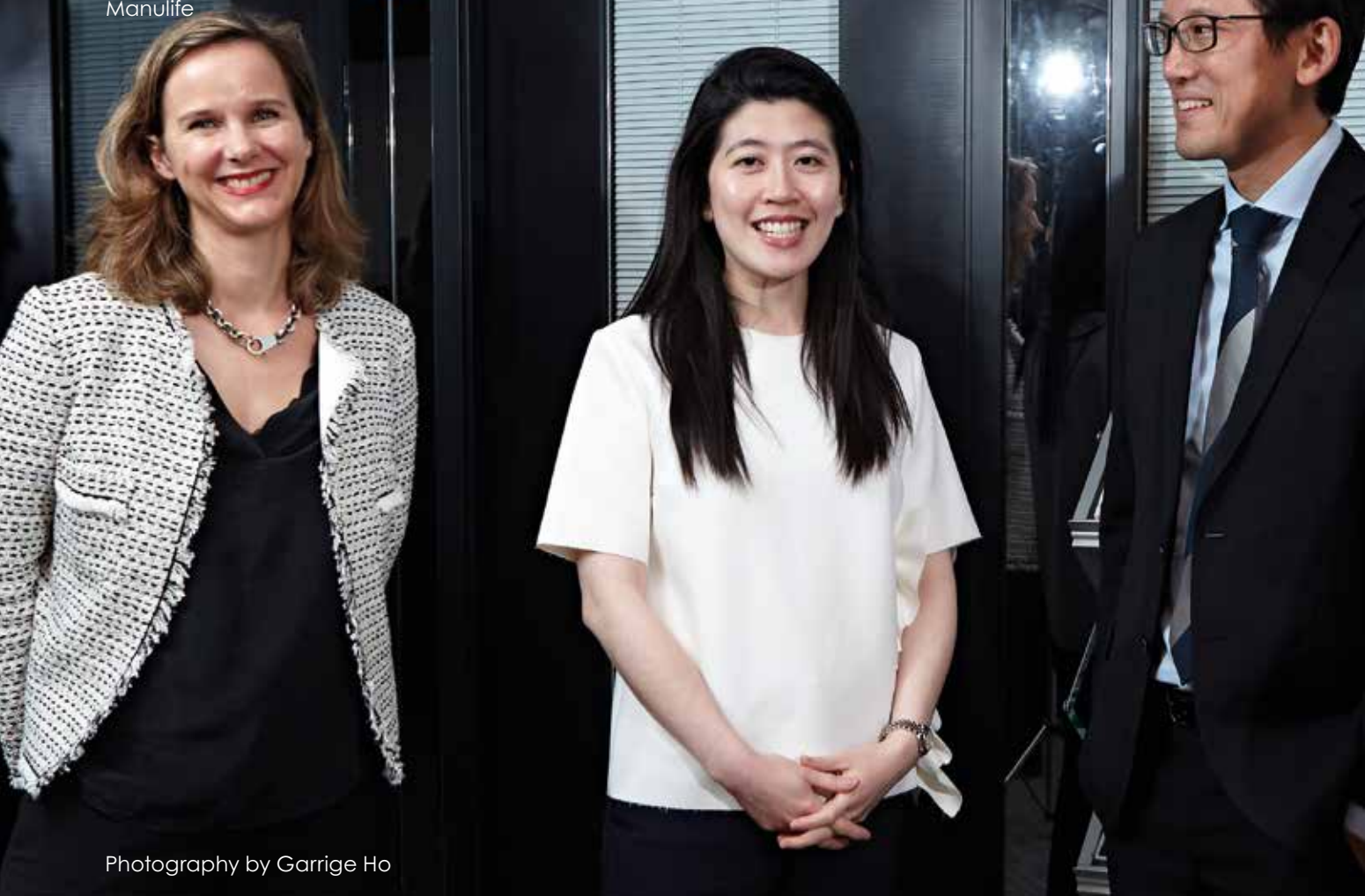
**"Depending on FIRRMA's final form, managers may consider including CFIUS approval as a closing condition when transacting with foreign buyers"**

**\$300,000**

**or 1% of the transaction value**

**Fee intended to be levied via CFIUS on foreign investments in the US**

**Sponsors:**  
Gaw Capital Partners  
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Photography by Garrige Ho

## All eyes on Japan's 'whales'

As the big Japanese institutional investors prepare their forays into real estate investing, they are faced with challenges around their complex internal decision-making processes, costs of investing overseas and access to core deals in the domestic market. *By Arshiya Khullar*

**A**lmost three years ago, the world's biggest pension fund, Japan's Government Pension Investment Fund, kickstarted the re-entry process of Japanese institutional investors into global real estate investing by starting to look for alternative investment professionals. That eventually resulted in Hideto Yamada being appointed

as director of real estate last February. And it was only last December the investor hired Mitsubishi UFJ Trust and Banking Corporation as funds of funds managers to implement its Japan core real estate strategy.

Last year was an active one for GPIF and peers like the \$185 billion Pension Fund Association for Local Government



**From left:** Amelie Delaunay, Isabella Lo, Shusaku Watanabe and Hidetoshi Ono

Officials, known as Chikyoren, in terms of finalizing their managers ahead of a big push into the marketplace. The next step – the one the global real estate industry has long been waiting for – is the push itself. When, where and how much equity these investors end up deploying is front of mind for senior industry figures the world over, including the four executives sitting at *PERE*'s annual Japan roundtable.

That these debut investments have been a long time in the making does not come as a surprise to the participants. Shusaku Watanabe, director of capital transactions for Asia at the global real estate fund manager TH Real Estate, says many of these investors still have a relatively small and new investment team, and often don't find it easy to evaluate the

real estate investment opportunities including site visits.

"Institutional investors in Japan have not recognized real estate as a core asset class in the past and have been under allocated due to the speculative investments made in the late 80s and early 90s in overseas real estate. But it is different now. Japanese institutional investors today are more sophisticated and strategic, seeking to appropriately allocate capital in the real estate space to diversify its portfolio blending. Further, international real estate markets are recognizing this dynamic shift. This is happening at a much faster and sophisticated way than what the market initially anticipated from Japanese investors," he says.

"They have hired people who are experienced and knowledgeable in the global real estate market with aspirations to make good investments and rebalance their large portfolios."

But the bigger question on everyone's mind is how these investors and their managers will access core deals – both in domestic and overseas markets – at the current point in the cycle, where even seasoned real estate investors are having to think of creative ways to deploy their dry powder in markets like Tokyo which is awash with liquidity. What compounds the deployment challenge is the distinct investment style of some of these Japanese investors.

Hidetoshi Ono, managing director for Japan real estate at the Canadian insurer Manulife Insurance, says the two tiers within the Japanese institutional investor universe have different investment theses. He says the bigger and more sophisticated groups like GPIF and Japan Post, generally have a ticket size of \$50 million-\$100 million and are interested in club deals, while the smaller investors want to invest around \$5 million-\$10 million per deal.

"Japanese institutional investors hate the blind-pool model," Ono says. "They want to see the property first and then make the investment decision, which becomes particularly difficult when you are investing overseas. And then underwriting the property rather than the strategy is also difficult."

Amelie Delaunay, director of research and professional standards at the industry body Association for Investors in Non-Listed Real Estate Vehicles, says she has anecdotally heard of cases where Japanese investors have asked US core managers to show them the underwriting of all properties in one real estate fund.

"The real estate market is competitive," adds Isabella Lo, managing director, investments for Hong Kong-based private equity real estate firm Gaw Capital Partners. "And one needs to be fast. If an investor takes too long to go through its approval process, the opportunity may no longer be there."

Another challenge is the cost these investors will incur while investing overseas. Explaining the trade-off situation,



**Isabella Lo**

**Managing director – Investments,  
Gaw Capital Partners**

Lo spearheads Gaw Capital’s investments in Japan. She has over 15 years of experience in real estate and investment advisory, and prior to joining Gaw she was part of Deutsche Bank’s real estate investment banking group.



**Shusaku Watanabe**

**Director of capital transactions, Asia,  
TH Real Estate**

Watanabe is responsible for evaluating, structuring and originating acquisitions across the Asia region for TH Real Estate. He joined the firm in 2016 from JPMorgan Asset Management where he was the fund manager for the Tokyo Recovery Fund.



**Amelie Delaunay**

**Director - Research and Professional  
Standards, ANREV**

Delaunay is responsible for the development and implementation of ANREV’s research, performance measurement and professional standards programs in Asia-Pacific. She has more than 16 years of experience in the real estate industry, including real estate consulting experience at EY.



**Hidetoshi Ono**

**Managing director, Japan real estate,  
Manulife**

Ono joined Manulife in 2015 to manage the firm’s real estate investment portfolio in Japan as well as the corporate real estate needs for life insurance operations nation-wide. He has more than 25 years of real estate and management experience working for AXA, ING (now CBRE Global Investors), GE and Mitsui Fudosan.

Ono says major gateway cities in the US, including New York, will typically be the first pick for Japanese investors, but then the asset prices and other costs would reduce the total returns, making such outlays less attractive.

“If they hedge back to the Japanese Yen, along with other taxes and structuring losses, the expected net return would end up being the same, if not lower, than investing within Japan. That is why investors have not been as fast as they wished in deploying capital,” he says.



As returns for core assets in the US fall, some Japanese institutions are turning their attention to Asia-Pacific. According to last year’s annual ANREV index, non-listed real estate funds in Asia-Pacific returned an average of 10.6 percent in 2016, more than the 8.49 percent returns in their US counterparts and just above 6 percent in the European vehicles. The Australian core funds were listed as the best performers, with 13.5 percent returns. Delaunay says investors are starting to look at open-ended fund investments in Australia as well as investments in South Korea, Hong Kong and Singapore.

**Dilemma of domestic investing**

Some of these investors, especially the ‘two whales,’ Japan Post and GPIF, as Watanabe calls them, are also eyeing domestic deals.

However, even then it is hard for such a magnitude of capital as held by Japanese investors to find an investment outlet domestically, creating a chicken-and-egg situation.

“Traditionally, they have been investing in private REITs, which now give a 4 percent distribution yield. But even private REITs are finding it hard to buy in the current domestic market, which is why they are pushed out to explore foreign investments,” Ono explains.

This investing dilemma is not limited to Japanese investors. Manulife and other roundtable participants are also grappling with similar deployment challenges.

“We are optimistic about exits, but not so sure about acquisitions,” says Lo. “Exits are not a problem given the large amount of capital chasing deals. We hope we will outperform underwriting.”

Ono says he has not closed any acquisition since he joined Manulife about three years ago and blames today’s ultra-competitive marketplace.

He says even the opportunistic funds have now become



**Top constraint:** buying in Japan at the current prices amid growing competition is challenging for the participants

competitors for core assets, given their ability to take on leverage. On the exit side, the firm sold three assets in the past year. Ono adds that some of these assets were in fact sold at over a 40 percent higher price than the appraised value. “As a long-term investor looking for a long-term return, the current total return is not enough to meet the long term target,” he says. “So, there is a trade-off – either buy now or wait for a few years to get better pricing. But then, one ends up losing that yield during the waiting period.”

He acknowledges there is pressure to invest, but at the same time he says Manulife’s investment horizon is regional, so a 3 percent cap rate in Tokyo may not be as attractive as a 5 percent cap rate in Sydney. This is why Manulife, as of last year, has moved toward investing from a regional capital pool to build a diversified Asia portfolio, instead of a country-by-country allocation. As part of this plan, the insurer is looking to invest about \$2.5 billion in Asia-Pacific over the next couple of years. The firm is also planning to consider indirectly investing via pan-Asia core funds.

Meanwhile, TH Real Estate made its debut Japan investment

in late 2016 with an \$82 million Tokyo commercial property buy, but has since not made any new investment. Watanabe agrees that Japan has not been an easy market to unravel for quality core assets, with offshore investors like GIC and Norges Bank Investment Management, two more whales, becoming more active making landmark investments in Japan in 2017.

He sees potential investment opportunities arising from off-market deals or other deals related to corporate restructuring. He has been seeing some interesting deals from corporates beginning to offload their quality assets to focus on their main businesses or through M&A or restructuring this year.

TH Real Estate is currently in the process of closing such an off-market deal of around \$200 million.

“The theme in Japan is different from China or Australia, where there is more growth and high inflation,” says Watanabe. “Japan is more of a stable income play for us, especially with its attractive yield gap relative to risk free, especially for core assets underpinned by high credit tenants as both corporates and individuals are financially sound and reliable. We focus

**“We are optimistic about exits, but not so sure about acquisitions”**

**Isabella Lo**

## Readying their debut

The past two years have seen some of Japan’s biggest investors actively carve out a real estate strategy

Investor	Event	Date
Government Pension Investment Fund	Appointed Mitsubishi UFJ Trust and Banking Corporation for core domestic real estate mandate	December 2017
Government Pension Investment Fund	Appointed Hideto Yamada as head of real estate	February 2017
Pension Fund Association for Local Government Officials	Appointed Invesco Asset Management for overseas real estate mandate	July 2017
Japan Post Insurance	Launched alternative assets division	September 2016
Japan Post Bank	Appointed Kazunari Yaguchi to head the newly-created real estate investment division	March 2016

our investments on key cities based on a long-term basis and see Tokyo as one of the key core markets globally. As an investment person on the ground in Asia, if I can invest in a quality, well-located asset in central Tokyo, I can count on a long and durable income flow so I can sleep well at night.”

Quoting data from Real Capital Analytics, Delaunay says around 33 percent of the overall property transactions in Japan were done by offshore capital last year. While the country received the largest volume of cross-border capital in absolute dollar volumes across Asia-Pacific last year, the market is still dominated by local Japanese institutions and real estate investment trusts.

Lo says her firm therefore also strategically builds relationships with local players – by using trust banks as property managers or getting dealflow from them – to gain access to some of the off-market investment opportunities.

Agreeing with the other participants on the constraints of deploying capital, she says: “As an opportunistic investor, we are good at finding and turning around distressed assets.

**“They have hired people who are experienced and knowledgeable in the global real estate market with aspirations to make good investments and rebalance their large portfolios”**

**Shusaku Watanabe**

But the market is so fundamentally healthy and there is so much institutional capital chasing assets here that we have not found any distressed opportunity in the past 12-18 months.”

Blackstone is one example of an opportunistic manager using a creative approach to finding deals in

Japan. The New York-headquartered manager completed two privatization deals in Japan last year, Croesus Retail Trust and a takeover of Astro Japan Property Group.

On whether the trend of a REITs takeover will become more popular this year, Lo says the execution process is hard: “There are a few undervalued REITs that we are eyeing. But J-REITs are difficult to privatize because they are heavily regulated. Hostile takeovers will be near impossible. Friendly deals, maybe.”

Japan continues to be one of the key investment spots in the region. Like ANREV’s Delaunay says, it has nearly always featured in the top three investment destinations in its annual Asia-Pacific investor intentions survey for the last 11 years. What is less certain is how foreign managers and domestic investors will deploy their capital in the current cycle. □

## Singapore’s Tokyo sling

PERE asked the roundtable participants for their pick of the most-talked about real estate transactions in Japan last year. They opted for GIC’s S MAYNDS Tower purchase

Late last year, Singapore’s sovereign wealth fund GIC announced the acquisition of around a 43 percent stake in Shinjuku MAYNDS Tower for ¥62.5 billion (\$590 million; €480 million). The interest in the Grade A office property was purchased from Daiwa Office Investment Corporation, a Tokyo REIT owned by Daiwa Securities.

The co-ownership deal, which is understood to reflect a yield of less than 3 percent according to the roundtable participants, diverged from GIC’s standard investment strategy.

Manulife’s Ono says that typically the state investor prefers to retain majority decision-making power in the assets it acquires, which was not the case in this particular transaction. One seventh of the asset is said to be owned by a life insurance company, while one sixth is owned by a REIT.

At the time of making the announcement, GIC’s chief investment officer Lee Kok Sun said the investment was a “unique opportunity to acquire a sizeable and stable income-producing asset.”

Indeed, the roundtable participants all agree that a strata



**Shopping in Shinjuku:** GIC’s latest Tokyo acquisition was a departure from its typical kind of investment

office deal is the only way to buy a quality core asset in Shinjuku, one of Tokyo’s largest commercial centers. Apart from being home to the Shinjuku station – among the world’s busiest stations, with 3.5 million passengers daily – the district is also being transformed with more Grade A office development.

PHOTO: VILLE MIETTINEN

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**Bits and Atoms**

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Photography by Marcus Rose

## League on its own

In serving the bank's capital, Goldman Sachs Merchant Bank Division's Real Estate Group has found its equity investing business is without peer. By [Jonathan Brasse](#)

In 2013, when *PERE* last shone its spotlight on the principal real estate business of the Wall Street investment bank Goldman Sachs, the declarations from the sidelines were of a spent force in the industry.

A combination of poor performances from its flagship Whitehall Street fund series, stemming from investments made immediately prior to the global financial crisis, and regulation curtailing the bank's co-investment in the vehicles had hands ringing the death knell. "They are done," one executive at a rival platform said then. "They're out of the business," said another.

Those determinations proved both right and wrong concurrently. It has been a decade since \$2.3 billion was raised for Whitehall International 2008, the last fund in the series. The journey for Goldman Sachs' Real Estate Principal Investment Area since has seen it morph into an altogether different proposition.

For one, its identity has changed: the REPIA brand is today more colloquial than actual, with official correspondence coming from the Goldman Sachs Merchant Banking Division's Real Estate Group instead. More significant than branding, all external fundraising activity has been for its Broad Street Real Estate Credit fund series. In January, \$4.2 billion was raised for the third fund in the series from investors that one time might have backed a Whitehall fund. Including leverage, the Broad Street series has accumulated more than \$13 billion for a variety of real estate debt investments in the US and Europe.

The series has done much to exorcise Goldman's ghosts in the private real estate marketplace. Despite running for two decades and producing some stellar returns along the way, Whitehall investments being written down to zero cents on the dollar in the aftermath of the financial crisis remain fresh in some memories. Successful turnarounds are understood to have been executed by the team since then.

Nevertheless, the final installments of the series are still understood to be cases of rescuing value versus turning a profit and the bank is not keen to share performance numbers. That is not the case for Broad Street, on the other hand, which it says has consistently generated gross returns of around 16 percent, 13 percent to investors. Such performances have seen investors queue for the series' next

**Garman:** MBD Real Estate Group is not an asset manager but an investing business

installment, punting MBD Real Estate Group higher in the estimations of many in the industry.

### An altogether smaller audience

Given its availability to external investors and its strong performances, Broad Street is courting the most attention among Goldman Sachs' real estate endeavors today. As a consequence, MBD's Real Estate Group equity business has had an altogether smaller audience. And yet, \$10.4 billion of the bank's capital has been invested by the platform since James Garman and Alan Kava presented the bank with a plan to turn the business around in 2011 – a fundraising effort competitive with most private equity real estate businesses out there. Indeed, with \$9.2 billion, or 88 percent, of that money funneled into equity transactions, compared to just \$1.2 billion alongside the Broad Street funds, the platform is every bit more the equity player – despite external misconceptions.

The Volcker Rule of the US Dodd-Frank Wall Street Reform and Consumer Protection Act curtailed US financial organizations from committing more than 3 percent to some of their own private equity funds. Goldman Sachs was previously a 25-30 percent investor in its equity funds, and, keen to benefit from the almost global post-crisis recovery, the bank decided to move to a balance sheet-led funding model for its equity deals. The discernible difference in approach came in the capital structure: gone were fund co-investments. These were replaced with commitments to joint ventures with operating companies and other investors able to complement the needs of its capital. In short, MBD's Real Estate Group had one backer for its equity deals – the bank.

An unintended consequence of this shift in dynamics has been MBD's Real Estate Group shedding its former categorization as a private equity real estate business. Subsequently, its positioning in the marketplace has become challenging, benchmarking nigh on impossible. Today, the platform is just as likely to compete on opportunistic deals with former rivals Blackstone or Lone Star as it might with a CBRE Global Investors or AEW on core-plus or value-added deals. On another day, it could be taking on an Abu Dhabi Investment Authority or Canada Pension Plan Investment Board for a position in a multi-billion-dollar club transaction. Investor, manager, GP, LP: MBD Real Estate Group can nowadays be regarded as none and all of the above.

### Tentative on a revival fund

“When we had the Whitehall product, there was a target return of approximately 20 percent. Whereas, by using the balance sheet, we have far more range in terms of the types of things we do,” Garman tells *PERE* at Goldman's London office on Fleet Street. “Some things, we'll underwrite to, say, a 20

## From Whitehall to Broad Street

MBD Real Estate Group's history is stapled to one of the longest-running opportunistic equity real estate fund series in history. But since 2008, the fundraising story has been all about providing debt





**Garman:** evaluates further equity funds from time to time

percent to 30 percent return because it's a risky development project. Other things, we might look for a low to mid teens return because it's more of a value-added opportunity."

Nonetheless, while co-head Garman declines to specify the results of MBD Real Estate Group's equity investments, he is happy with its performance: "We think our track record, if we were to line it up against others, would look very good. In most of the things we've done, not everything, we've materially outperformed what we thought we'd do when we made our investment."

Unsurprisingly, Garman is tentative on the topic of reviving a private equity real estate fund series. "Should we do an equity fund again? We evaluate it from time to time but nothing has been decided. We have rebuilt our equity investing business on the balance sheet. It's been much bigger than we thought. And then we've added this credit strategy, which we didn't have in the previous cycle. That's a whole range of things for us

to do. In certain strategies we also co-operate closely with our colleagues in the firm's Special Situations Group, which has worked out very well."

MBD Real Estate today has about 30 professionals in the US, 20 in Europe and another 300, if you count the Goldman Sachs Realty Management Division, the asset management and loan servicing shop previously known as ARCHON. That is a far cry from the 130 executives on the roll during REPIA's peak (plus 1,500 at ARCHON). But despite the headcount reduction, the platform Garman and Kava preside over today is far more nimble and, critically, it has a dependable source of capital in its parent and its affiliates. He speaks openly about life at REPIA in the immediate aftermath of the financial crisis. It was a darker place he would rather not return to.

"In 2009, our source of funding was unclear, our platform was in disarray and the opportunity set wasn't there. By 2012, our platform started stabilizing, we got the right team in place and we started getting capital from the firm. Then the opportunity set started. Now, our platform is in great shape, we have a great team and our capital sources are properly funded between the credit fund and the balance sheet."

### Different kinds of partners

One example of the opportunity set materializing, both in terms of assets and also partners, came in the UK student housing sector. In 2016, it formed a joint venture with charitable foundation the Wellcome Trust valued at £2 billion (\$2.79 billion; €2.26 billion) to take on the country's then-underserved market.

Peter Pereira Gray, managing partner and chief executive of its investment division, admits he would have been reticent to recommend a union with the investment bank platform in its prior form. He has turned down a Whitehall fund marketed to the foundation before and would have done so again. "We wouldn't have done this deal with Goldman if it has been fund money. It would have come in a structure with a required liquidity point and that might, or might not, have lined up with the cycle. But we did this happily with Goldman on the basis it was balance sheet money."

Alongside residential specialist Greystar, the partners formed IQStudentAccommodation by combining iQ, the student housing business of Wellcome Trust, and Prodigy Living, which was owned by Goldman Sachs and Greystar, in a deal that saw the formation of a business with 23,500 beds across 25 UK towns and plenty of firepower to expand with the addition of the £850 million-plus Pure portfolio of assets in December. IQSA is now one of the

**"In 2009, on source of funding was unclear, our platform was in disarray and the opportunity set wasn't there. By 2012, our platform started stabilizing, we got the right team in place and we started getting capital from the firm"**

**James Garman**

largest players in the UK. Pereira Gray says the tie-up solved a growth issue for iQ and an operational challenge for Prodigy Living, but was only possible because of the nature of Goldman Sachs' equity. "Goldman can make long-term decisions and that puts them in an exceptional place to take on complex deals."

Another came in the form of the purchase and redevelopment of the Pascal Towers in Paris-La Défense in a joint venture with French real estate developer and fund manager Atarea Cogedim. The project required the revitalization of almost 700,000 square feet across two buildings at a cost of about €200 million in equity, split equally between the partners.

Stephane Theuriau, Atarea Cogedim's chief executive at the time recalls that while limited life capital was not an issue, MBD Real Estate Group's ability to operate on such a product at a far more modest gearing level than before was a key attraction. "We took a five-year view on La Défense and a big position," Theuriau recollects. Unlike Pereira Gray, he says the firm might have partnered with a Whitehall fund "because effectively they're discretionary so, from a governance standpoint, it's the same thing. But if they had told us they want to do it at 70 percent LTV we would not have done the deal". The leverage level for the venture is around 50 percent but Theuriau still projects an IRR north of 20 percent from the venture, even if it is currently at the construction phase.

### Defiant in insolation

Neither Pereira Gray nor Theuriau envision MBD Real Estate Group will revert to raising third-party, commingled funds anytime soon. "I think they are very good at what they're doing and I would encourage them to stick to their knitting," Pereira Gray says. "If it's not broken, don't fix it," adds Theuriau. "Why change? This team is very disciplined and people seem to be happy with how they're doing."

Should the platform stick to its knitting, it would mean the institutional investor universe at large would not directly be able to benefit from its investing acumen beyond the Broad Street series, which by virtue of their credit focus, means capped returns. *PERE* posited the notion the bank might one day push for a return to private equity fundraising to accommodate client demand, and drew a comparison with fellow investment bank Morgan Stanley's platform, Morgan Stanley Real Estate Investing, which suffered similar headwinds but has since restored its fortunes with two successful global fundraises.

Garman is resolute in his response: "It's not an asset management business. It's an investing business. The people that run the firm know we are deploying the firm's capital and they don't want us to feel pressure. They want us to make good investing decision.

"If we did decide to do an equity vehicle, it would probably be aligned to a specific strategy. And we would want to ensure

we could invest meaningful capital alongside our clients." MBD Real Estate Group might be better known in the market for its credit funds than its equity outlays, but as the platform has no distinct peer group, that does not seem to matter to its co-head. Serving the bank and its investing clients is what counts most. "I think we're the only ones doing it the way we do it," Garman concludes, "and everything we do is complementary to other parts of the firm." □



**IQ student accommodation, Tour Pascal:** investments from partnerships that might not have happened if Goldman Sachs used Whitehall money

SOURCE: DANIEL RODET



## Mixed reviews

Hotels are attracting more capital as investors aim to diversify property exposure, but tech-based disruption and occupancy headwinds temper the sector's prospects

Private real estate capital markets have seen a meaningful upswing in preference by institutional investors for particular asset class strategies. Single asset class strategies accounted for 31 percent of the world's total available capital, up 55 percent over the past three years, according to the latest iteration of global property advisory firm Cushman & Wakefield's flagship report *The Great Wall of Money*.

While multifamily residential continues to be the primary pick outside of property's staple food groups, hotels and 'other' strategies, including leisure-oriented property types, accounted for 20 percent collectively, a proportion that has steadily grown as greater numbers of investors have become comfortable with diversifying their property exposures.

Why do these investors back these assets? There are both

push and pull reasons for this. With abundant capital allocated to private real estate investment strategies – \$435 billion, according to the report – traditionally prime markets today face record low cap rates, forcing investors to seek higher returns (and accept higher risks) in non-prime markets, geographically, but also via non-mainstream asset classes. However, hotels and other leisure properties are also increasingly being recognized as able to match the recurring liabilities many institutional investors must meet.

The hotels sector is facing plenty of headwinds, however, particularly the high end of the sector. This is calling into question the long-term sustainability of cashflows from such properties. Terrorist attacks have impacted the attractiveness of French luxury hotels, for example. According to French government statistics, in the wake of the 2015 attack on a Paris



concert venue, occupancy rates in the city for the half year fell from 77 percent to 32 percent; in the weeks after the lorry attack on a main road in Nice months later, revenues reported by the city's hotels dropped 45 percent.

Meanwhile, the rising popularity of home-sharing technology such as Airbnb in countries like the US has become a mounting threat to hotel performance, both at the luxury and affordable ends. Airbnb has seen its guests rise from just 21,000 in 2009 to more than 80 million last year and its use trajectory shows no signs of abating. Hotels in Manhattan, for example, saw revenue per available room drop from 2014 from \$180 to around \$160 in 2016.

Regardless, where there are headwinds, there is also opportunity. In this Investing in Hotels special report, both aspects will be evaluated. □



# Major investors check into €4.4bn deal

Saudi Arabia's sovereign wealth fund and other institutions are investing in what has been billed as 'the last major opportunity to buy into a hospitality carve-out.' By Meghan Morris

**A**ccorHotels is the latest hospitality company to go on a real estate diet, providing an opportunity for investors hungry for the lodging space.

The Paris-based company, which spun off its 891-property real estate portfolio into AccorInvest last summer, agreed to sell a 55 percent stake in the real estate holding company in late February. In the long-anticipated deal, Accor follows its hospitality peers in paring down real estate holdings to focus on the underlying business.

The consortium of AccorInvest investors includes sovereign wealth funds from Saudi Arabia and Singapore, insurer Credit Agricole Assurances, asset manager Amundi and longtime Accor partner, the real estate investment manager Colony NorthStar. The sale of the majority stake, which is expected to close in the second quarter, values the company at €6.25 billion and gives AccorHotels €4.4 billion in cash.

Accor's investors, which included Colony NorthStar's predecessor entity, Colony Capital, pushed the company for years to follow other major hospitality companies in selling off its real estate assets. Colony's head of European investment, Nadra Moussalem, was on the board of Accor until Colony sold its stock in January 2017 and helped conceive the plan to go asset-light.

PERE understands Accor's founders were reluctant to give up the real estate that they, as developers, had built and pieced together through acquisitions since the company's 1967 founding. Investor pressure and the hospitality industry's move toward investing capital formerly tied up in real estate into business operations tipped the scale.

While the deal was in the works for years, one source says some of the investors decided to participate in the buyers' consortium just weeks before the transaction was agreed. The various partners have largely equal shares in the deal, though after closing, some investors will take more active roles than others.

## Varied investors

Some of the AccorInvest investors have a deep familiarity with hospitality. Colony NorthStar, for example, held 167 hotel properties in its portfolio as of December 31, according to its fourth quarter earnings, while Singaporean sovereign wealth fund GIC has invested



**The Savoy:** 267-room London hotel

in the property type for over a decade. Colony, through its predecessor, has a long history with Accor, too. The firm, which declined to comment, first worked with Accor in 1999, when the pair, plus private equity real estate giant Blackstone, bought a 48-property hotel division of Vivendi.

In 2005, Colony subscribed to a reserved €1 billion issuance of bonds and mandatory converts, which gave it two seats on the board. These instruments were converted into 10 percent of Accor's shares in 2007, and Colony and partner Eurazeo bought 10 percent of the company each in 2008, owning 30 percent of Accor at the peak. Colony began selling down its shares in 2011, ultimately exiting its remaining 5 percent stake and leaving the Accor board in January 2017.

Other investors in the group are newer to hospitality and even to real estate. Through the deal, Saudi Arabia's Public Investment Fund inked one of its first global real estate investments. The sovereign wealth fund announced an ambitious plan in October to expand its assets under management to \$400 billion by 2020 through investments in real estate, among other asset classes.

AccorInvest's investor roster is betting on a European-centric portfolio largely comprising budget and mid-scale hotels less exposed to the volatility of the luxury hotel segment. The diversity of buyers shows demand for hospitality from multiple investor types, an analyst said.

**"The markets are flush with debt and equity chasing yield. These types of investments, particularly on a risk-adjusted basis, offer superior returns"**

**Dan Lesser**

## Asset-light approach

One investor called the deal a win-win for the consortium and Accor in what he predicted was the last major opportunity to buy into a hospitality carve-out. Marriott started the trend in the early 1990s by splitting into a hotel management company and a real estate company. The company continued the push after its 2016 acquisition of Starwood Hotels & Resorts, selling its long-term leasehold interest in the Hawaii's Westin Maui Resort and Spa, a Starwood property, in April 2017 to a joint venture of Oaktree Capital Management and Trinity Investments, among other deals.

Hilton, meanwhile, completed its property spin-off in January 2017, creating a company for its timeshare business and one for its real estate holdings. Hyatt, meanwhile, announced last fall that it, too, would pursue an asset-light strategy, with a goal of selling \$1.5 billion of assets over three years.

David Guarino, an analyst at Newport Beach, California-based Green Street Advisors, explains that the now-ubiquitous hospitality brands were built from the ground-up, spending their own capital to create hotels and name recognition. Because of the high costs of hotel operations, brands began to invest less in real estate ownership and more in franchising and management. Brands also need more capital to compete against threats to their businesses that did not exist two decades ago, such as home-sharing platforms, including Airbnb, and the meteoric rise of online travel agencies, such as Expedia.

"The decision for Accor, and other hotel brands, to move to an asset-light strategy makes sense both financially and strategically," Guarino says. "Rather than putting their own capital at risk to build and maintain a hotel, the hotel brands can now focus on franchising their name to another hotel owner, and instead receive franchise/management fees at much higher profit margins."

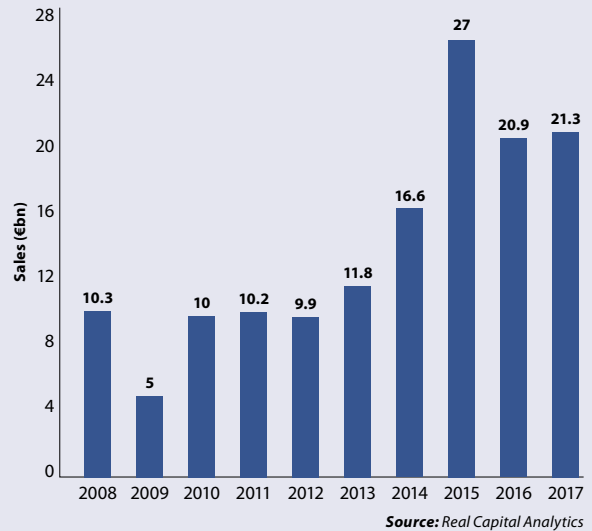
AccorInvest sold its stake during what hospitality consultant Dan Lesser says is the start of a new cycle after the market



**Swissotel Berlin:** 316-room German property

## Picking up

European hotel sales volume has steadily increased since 2009



bottomed out in 2016. "The markets are flush with debt and equity chasing yield," Lesser, the founder of New York-based LW Hospitality Advisors, says. "These types of investments, particularly on a risk-adjusted basis, offer superior returns. If you believe that inflation will rise in the near future, investing in lodging is a great hedge against inflation because there's a continuous repricing of hotel rooms – you have daily leasing and the pricing of those units changes by the nanosecond."

In a statement to *PERE*, a GIC spokeswoman highlighted AccorInvest's "resilient cashflows and opportunities for value creation" when detailing why it was an attractive investment.

The investor consortium buying into AccorInvest has the added benefit of valuations completed at the end of 2016, when the hospitality market was dampened in the wake of European terrorist attacks and the Brexit vote. Since then, the business has improved significantly, but the deal was priced according to those depressed values, says one investor.

Going forward, AccorInvest plans to continue its real estate optimization plan that began in 2013 for another four or five years. During that time, the platform may also buy or develop assets with other operators in a bid to become the dominant European hotel owner.

Accor plans to reduce its 45 percent stake in its real estate company down to 30 percent, providing opportunities for existing investors to double down or for new investors to check into the consortium. Should that happen, there will be one more chance to buy into the sector's supposed 'last major carve-out.' □



**Warmer reception:** investment in hotels is expected to pick up pace in coming years

## Stop worrying and learn to love the hotel

A real estate asset you need to re-lease every day sounds too risky for many institutional investors – but they are beginning to check in. *By Mark Cooper*

**A**quip once attributed to various investment managers was “I always have one hotel in the fund, just to remind me why I don’t own more,” but this is far from the case today.

Global hotel investment volumes have been fluctuating in recent years; last year saw \$62 billion of deals, according to Real Capital Analytics, below the post-GFC high of \$90 billion in 2015. However, institutional investors, including pension funds, endowments, insurance companies and sovereign wealth funds have been taking a growing share of the market.

JLL Hotels data show institutional investors are expected to account for nearly 15 percent of global hotel acquisitions in 2018, compared with less than 4 percent in 2014. This trend has continued in 2018. Just two months into the year, one of the sector’s biggest transactions occurred, including some of the biggest institutions active in the market. Investors GIC Private, Saudi Arabia’s Public Investment Fund and Crédit

Agricole Assurances featured prominently in the consortium that bought a 55 percent stake in AccorInvest for €4.4 billion in February. AccorInvest is the real estate arm of the French hotels group AccorHotels and owns 891 hotels, mainly in Europe. The group operates all AccorInvest hotels under a 50-year contract for the luxury properties and a 30-year contract for the mid-range and budget hotels.

The deal generates capital that will help Accor boost market share while the new shareholders in AccorInvest “gain exposure to AccorInvest’s large and well-diversified portfolio, with resilient cashflows and attractive opportunities for value creation,” GIC said in a statement.

Surveys of investors have pointed to a growing pace of investment in the hotel sector in coming years. For example, German investment manager Universal Investment’s annual investor survey, published in October 2017, found a target allocation of 14.5 percent to hotels, double the figure for 2016. However, Universal also found only 2 percent of transactions in

the year to May 2016 were hotel deals, suggesting investors are making slow progress in hitting their allocation targets.

### Balancing performance

Diversification is an important driver for institutional investment in the sector. Mike Batchelor, Asia chief executive for JLL Hotels, says: “Hotels play an important role in balancing investment performance in a mixed real estate portfolio. Furthermore, hotels consistently trade at a higher cap rate than other income generating assets.”

Higher yields are a consequence of increased volatility: a hotel is re-leased every day, while an office property might only need a letting agent once every two years.

However, as investors become more familiar with hotels they also become more comfortable and adept at dealing with the risks, says George Nicholas, global head of hotels at Savills. “Hotel ownership and operations have become more sophisticated; investors and GPs understand ways to mitigate the market risks involved. Leases and management agreements are evolving to allow investors to share the upside and to limit their downside risk.”

The frequency with which hotel rooms are leased and re-leased also has a value for investors, as this means prices are matched to demand almost instantly, he adds. “Hotels are a great and natural hedge against an inflationary environment. So it’s a great sector in a rising market.”

The AccorInvest transaction was atypical in its size and in that the institutional investors in the buying consortium took the lead, but the type of asset acquired – branded, corporate properties – was typical of the institutional preference.

Christophe Vielle, managing director of GCP Hospitality, the hotels platform of Gaw Capital Partners, says: “Generally, first tier cities remain the priority for investors and, in general, larger corporate properties. It is usual for hospitality real estate funds to have a restriction on the number of resort properties they can acquire as investors may have liquidity concerns about this type of asset – although from the operator’s point of view they are no less desirable and profitable.”

Institutions are also expected to be allocating capital to hotel real estate funds. Only a few small hotels funds closed in 2017, none attracting more than \$500 million.

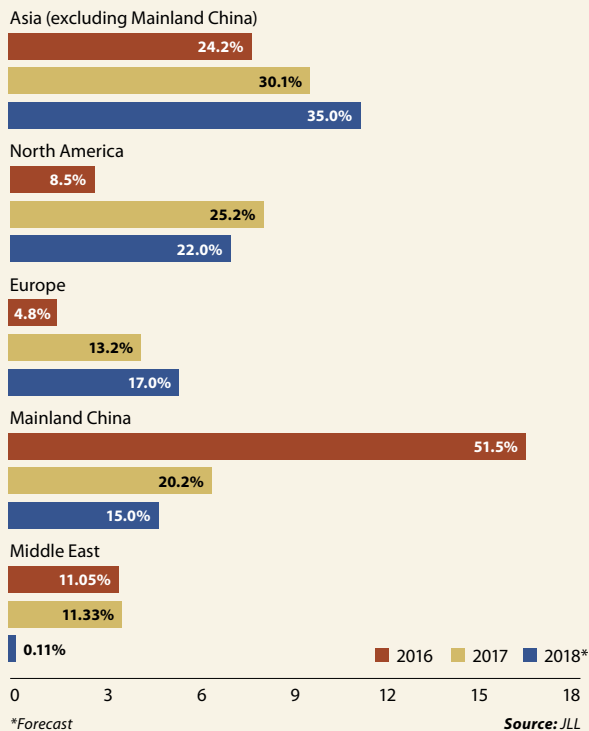
However, managers are launching new vehicles in response to increased interest in the sector. In August, hotels specialist Trinity Investments and Oaktree Capital Management formed a \$3 billion joint venture to invest in Hawaii, Japan, California and Mexico. Henderson Park, whose backers include Kuwait Investment Authority, raised

**“Hotels play an important role in balancing investment performance in a mixed real estate portfolio. Furthermore, hotels consistently trade at a higher cap rate than other income generating assets”**

**Mark Batchelor**

### A more even affair

Investment in hotels is expected to be more equally spread across the regions this year



€950 million at the first close of its debut fund in October and a large proportion of its equity has been allocated to hotels transactions in the UK and France.

UBS, meanwhile, plans to raise \$400 million to invest in Japanese hotels, while Internos Global Investors raised €113 million at the first close of its second hotel fund in June. Invesco Real Estate launched an open-ended European hotels fund with initial capital of €179.5 million in July.

Perhaps more significant than the institutional capital being invested in specialist funds is the increasing participation of generalist funds in the hotels market. Batchelor says: “The past few years have marked an increase in buying activity from private equity and institutional investors, signalling a growing trend of hotels being purchased by investors with portfolios involving multiple asset classes, as opposed to specialist hotel investors. In 2017, over 70 percent of hotel transactions (around \$45 billion) were purchased by these generalist investors, compared with 62 percent back in 2014.”

Investment managers such as

Blackstone – the largest buyer of hotels in the past 12 months according to Real Capital Analytics – Apollo Global Real Estate and Starwood Capital are investing substantial capital in the hotels sector. The vast majority of this capital has been raised from institutional investors in the US and further afield.

**Buyers of an Asian persuasion**

A significant proportion of the institutional capital invested in cross-border hotel deals this year will come from Asia, says Batchelor. “In 2018, Asian investors, notably from South-East Asian countries, are expected to dominate the offshore investment landscape. This is all driven by renewed interest in diversification, both in terms of location and product.

“Despite government crackdowns on outbound investment, Chinese investors still have the appetite to invest in mature markets across North America, the UK, Western Europe and Australia. However, their investment criteria have changed considerably. While overseas investments under \$300 million are still permitted, we expect there to be a big decline in the acquisition of high-profile trophy assets and large-scale portfolios in the short term.”

While there is widespread institutional interest in hotels around the world, a number of markets are attracting more attention. In the Asia-Pacific region the key markets are Australia and Japan, which have been popular destinations for capital for a few years. This is likely to remain the case,

**“Vietnam is finally beginning to realize its potential and there are some good properties being built in Ho Chi Minh City. Da Nang is booming and we see a lot of tourists from Hong Kong and Korea. The potential for Chinese tourism there is huge”**

**Christophe Vielle**

but locations such as Vietnam are also piquing investor interest.

Japan has seen visitor numbers rise dramatically to a record 28.6 million last year, four times the level of five years previously. Next year’s Rugby World Cup and the 2020 Tokyo Olympics are expected to boost those numbers further and the nation is tipped to see 40 million visitors by 2025.

GCP Hospitality’s Vielle says: “Japan has seen significant growth in tourism

numbers, driven by more visitors from China and the weaker yen. There has also been some restructuring in the industry, which has improved management overall.

“Over the past four or five years or so cap rates have fallen to 3 percent from 7.5 percent due to demand from investors. Japanese real estate investment trusts have been big buyers and their low cost of capital makes it hard for overseas investors to compete.

“Vietnam is finally beginning to realize its potential and there are some good properties being built in Ho Chi Minh City. Da Nang is booming and we see a lot of tourists from Hong Kong and Korea. The potential for Chinese tourism there is huge.”

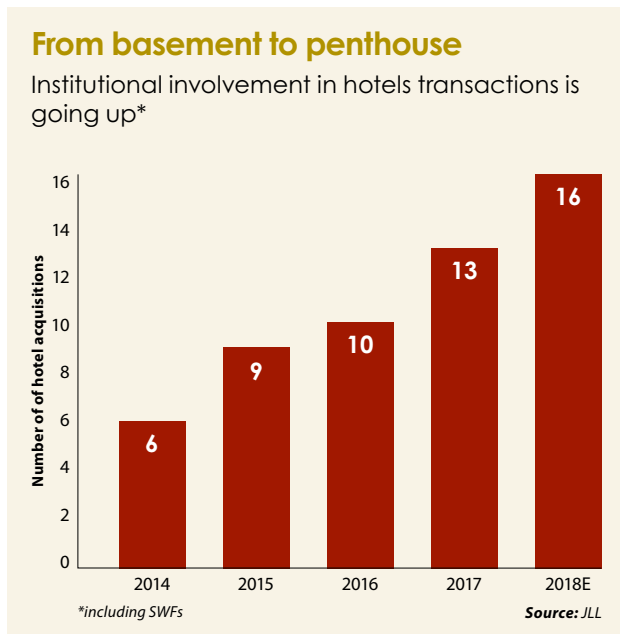
Natural disasters struck the US hospitality market with a number of blows last year and investor interest has been flat. Mark Woodworth, head of US research at CBRE Hotels, says: “We are not seeing a significant volume of institutional capital coming into US hotels at present. However, the top 10-15 largest markets continue to attract investor interest, as have resort destinations.

“Hawaii, because of the expansion of inbound traffic from the Asia-Pacific region, remains an extremely attractive market for investors.”

Sean Hehir, chief executive of Trinity Investments, also sees institutional interest in Hawaii, where his firm bought the \$230 million Hilton Garden Inn Wakiki Beach and the \$317 million Westin Maui Resort and Spa on behalf of institutional capital last year. “There is no new supply of hotels in Hawaii but demand remains strong,” he says.

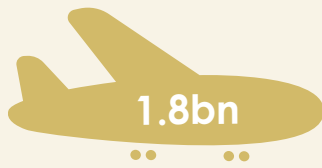
Activity in Hawaii suggests resort hotels are gaining popularity with investors and this is also the case elsewhere. In September, GIC bought a 51 percent stake in the Sheraton Grand Tokyo Bay, which is next to Disneyland Tokyo, for \$900 million. Savills’ Nicholas adds that “investors have become more interested in resort properties, in locations such as Mexico, California, Queensland and Southern Europe.”

Investors are also interested in leisure park properties, as well as “sun and sand” resorts. Nicholas says: “There is growing



## Checking in

Tourism by the numbers



Number of international tourist arrivals worldwide by 2030\*



Average growth of international tourism arrivals between 2010 and 2030



Tourism's share of global GDP



Chinese tourists traveled overseas during the Lunar New Year holiday in February

\*Source: World Tourism Organisation

Source: Deloitte 2018 Travel and Hospitality Outlook

demand for leisure park properties, such as Centerparcs and Parkdean in Europe and the UK. Investors like these because they are extremely resilient in a downturn. Families that might normally holiday abroad will use leisure parks at home to keep costs down.”

Europe remains a popular destination for institutional capital, unsurprising as six of the most popular nations with overseas visitors are in the region and France is the most popular tourist destination in the world, with 89 million visitors last year.

JLL Hotels cites France as a more popular destination for institutional capital this year, as investors will be reassured that terrorist attacks in recent years have not deterred visitors. Meanwhile, Vielle expects more institutional interest in southern European markets such as Spain and Italy. He adds: “The UK is an easy market to understand for investors and thus it has been popular, but there are very few opportunities and only for long-term core capital.”

The most significant trend in the hotel industry in the past few years has been the increase in tourist arrivals from China and professionals in the hotel real estate business seem to agree it will be the main driver of growth going forward, but the general outlook for the sector is fair.

As allocations to real estate have grown over the past five years – Hodes Weill now puts the average institutional allocation at 10.3 percent, up from 8.9 percent in 2013 – capital has been invested in a wider range of real estate sectors. However, professionals argue that the tap to this capital is unlikely to be turned off, even if market circumstances change.

Supply of hotel rooms worldwide is increasing, but modestly, according to JLL data, with rooms equivalent to only 0.1 percent of total stock under construction in 2017. Most of the growth is in Mainland China and the Middle East and Africa, with growth elsewhere below the global average, suggesting oversupply will not be a major concern for investors.

As such, M&A in the hotel sector is set to continue as operators drive for supply growth, operational efficiency and profitability through scale, which, in turn, ought to present opportunities for hotel real estate investors.

Trinity’s Hehir says: “We expect to see more transactions like the AccorInvest deal and more large transactions generally. They work well for investors as they give them tremendous diversified cashflows and they allow the hotel operators to invest in building market share.

“As the whole business of hotel real estate matures, we will see more core capital in the market worldwide.” □

## Investing in hotel debt

Institutional investors in real estate debt are increasing, and the hotels sector is no exception

This follows a tightening of loan issuances from traditional banks, which are now more risk-averse. Debt funds provide more flexible capital requirements and higher loan-to-value levels compared with traditional bank lending.

George Nicholas, global head of hotels at Savills, says: “The debt side of the hotels real estate market is growing, with private equity investors and institutions allocating more capital, primarily to Europe and the US. Typically, a debt investor would offer whole loans of up to 70-75 percent LTV

and then sell down the senior portion.” Debt investment offers downside protection and lower frictional costs (such as transaction costs) but is largely undertaken by investment managers rather than institutions directly. Some larger institutions have also backed debt platforms: Japanese insurance company Tokio Marine has backed Acore, a US real estate debt platform with around \$2 billion of capital, for example. It is understood that about one quarter of Acore’s loans have been backed by hotel assets.

# Assessing the digital threats to hospitality

Todd Soloway, the chair of law firm Pryor Cashman's hotel and hospitality group, considers what should be on the minds of private equity real estate investors



Airbnb, VRBO, Homeaway, Tripping.com, Homestay and Wimdu: the proliferation of home-sharing services is undeniable. Airbnb alone proclaims itself to be present in 191 countries with an excess of four million listings worldwide – more than the top five hotel brands combined. Recent estimates assume home-sharing will

reach about 155 million room nights in the US in 2018.

The impact on the hotel industry is real. In high-density cities, compression – a common industry measure of demand driving rates – is elusive. Now add to the mix extensive hotel development across major markets, plus high-cost union expenses that show no signs of abating. Just last year, the Standard Hotel in New York City sold for over \$50 million less than it went into contract for in 2014, and the James Hotel sold for \$20 million less than it sold for in 2013.

Whether these prices are reflective, in part, of the evolution of home-sharing services is subject to debate. But any private real estate investor evaluating an investment in hospitality assets has to ask the question: 'Is this the new reality or is this temporary?'

While over-development can and will be absorbed, the home-sharing business cannot. Indeed, home-sharing is an undeniable headwind for the industry and must be taken into account when assessing the valuation and potential for repositioning assets.

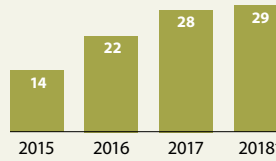
A recent Morgan Stanley report indicated that the industry is factoring in 40-50 basis points of negative impact for the US's lodging industry revenue per available room growth in 2018 and 2019, coupled with an approximately 25 basis point drag on occupancy. This is the formula for a deterioration in compression, which has been a significant trend across the US from 2016 to 2017. Occupancy deterioration tends to feed rate deterioration as hotels compete for business.

While a contrarian view is that home-sharing

and online travel agencies (OTAs) introduce more travelers to the industry, the downward pressure on performance and valuation of hospitality assets is an objective fact. And these numbers may very well grow as the younger generations, which use these services in far greater numbers than older generations, age up. Furthermore, in cities like New York – by far Airbnb's largest market – the impact is greater and investors will have to evaluate that impact on a regional as well as local basis.

## Hot Airbnb

Travelers' use of Airbnb doubles in two years (%)



\*projected

Source: Morgan Stanley research

## Crystal ball-gazing

An added layer of complexity to the private equity model is timing. With typical funds focused on a five- to seven-year window for their investment cycles, and the concurrent ever-shifting nature of the digital economy, predicting the impact of home-sharing and other factors such as the

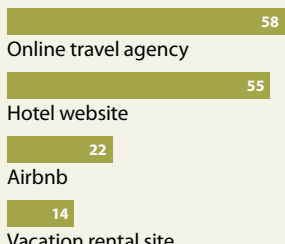
proliferation of OTAs is a tricky game. In just the last 10 years, these market influences not only emerged but became a major factor affecting the industry. How can we possibly predict where home-sharing and OTA influences will manifest themselves five years from now? Perhaps there is a technology out there that we know nothing about that will emerge in the next 10 years.

OTAs present a conundrum for hotel owners and managers. They bring a lot of volume, but they tend to be highly discounted rates and furthermore, the associated fees for taking those reservations make these OTA reservations by far the most expensive type of business. And there is empirical evidence that lower-cost reservations tend to spend less on ancillary services such as spa, food and beverage and retail shopping. Simply put, OTAs are a fact on the ground with real impact on investment strategies – cost structures and gross revenue being directly affected. Further impacting underlying asset value, OTA reservations may not fit the profile of guests that ownership is shooting for – a factor which may cause the property to stray from the established business plan and impact long term profitability.

Private equity analysts evaluating hospitality assets have no choice but to incorporate a predictive value for the impact of the digital economy on their prospective and existing assets. Where it goes from here? Well, that's why we all play the game. □

## Checking in

How consumers booked leisure travel last year (%)



Source: Morgan Stanley research

# Investors check out

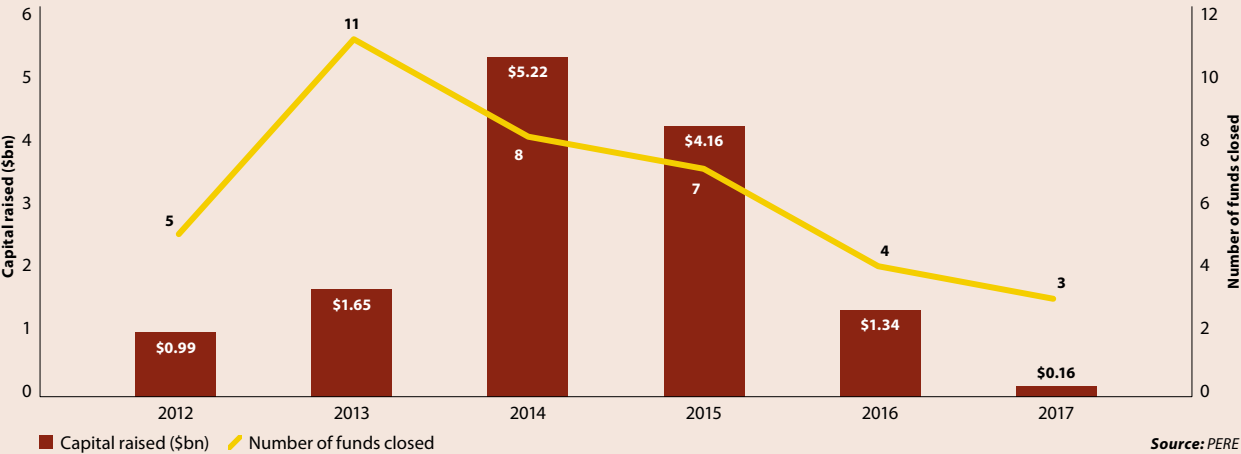
The figures point to diminishing interest in hospitality-focused real estate funds

Fundraising for hospitality-specific real estate funds has decreased dramatically since 2014 when eight vehicles attracted more than \$5 billion, according to PERE data. However, with many hotel transactions occurring within sector-agnostic funds, or outside of fund structures, such a reduction only

provides a glimpse of general institutional demand for the asset class. Real Capital Analytics, the real estate transactions research firm, has also tracked falling investment volumes. Since 2015, when nigh-on \$90 billion of hotels traded, there has been a 37.2 percent decrease in just two years.

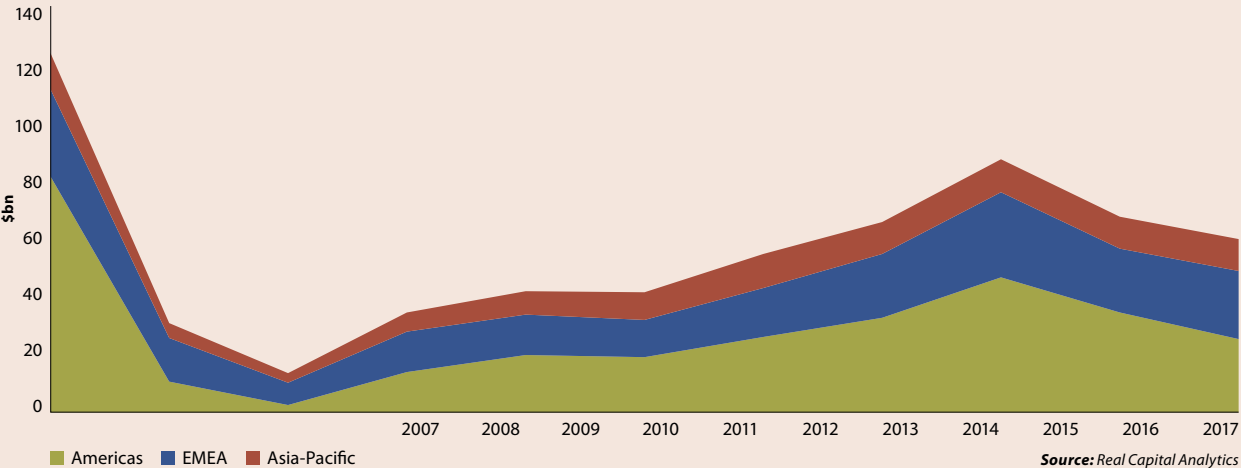
## Fewer funds, less money

It has been three years since the sector's banner year for hotel-focused private equity real estate funds when \$5.22bn was collected for eight vehicles



## America loses its sparkle

While investment in European hotels has picked up and in Asian hotels remained consistent, US volumes have dwindled, albeit from greater totals



# Google search results in foodie playground

Jamestown's bet on a formerly crime-ridden block of Manhattan pays off handsomely as the tech giant agrees to buy a mixed-use building for \$2.4bn. *By Meghan Morris*

**F**rom iconic cookies to gristly murders to hordes of selfie-snapping tourists, the walls of New York's Chelsea Market have seen it all.

The brick building currently housing tech tenants, and one of New York's hottest tourist destinations, was constructed a century ago as part of the National Biscuit Company Complex in west Chelsea. Some of the site, which covered multiple city blocks, was built on a landfill where excavators uncovered the timbers, chains and anchor of a two-masted schooner, according to the *New York Times*. To facilitate easy shipping, architect Louis Wirsching Jr designed a building with an elevated freight railroad viaduct for trains to drop off flour and other goods for Oreos, Mallomars and other treats.

The company, later known as Nabisco, moved out of the city in 1959 and kept the property, at 75 Ninth Avenue, as a warehouse. Irwin Cohen, a developer now in his 80s, teamed up with "a few Russian guys in the aluminum business" to buy the foreclosed mortgage to the building in 1993, he told the *New York Post*. At that point, the building had a few manufacturing tenants in a largely empty space. Outside, the neighborhood was dominated by the business of the Meatpacking District a block south, with butcheries then active where high-end restaurants now sit.

"There were gangland murders in the basement," Cohen said. "Three people were shot in their knees with their hands tied behind them." Keen to move considerations of the space from these daunting episodes, he envisioned a food market that would make the building more attractive to office tenants. He convinced a local wholesale fruit company to set up shop and worked with an architect to install a novelty: a water-spewing ceiling pipe in the middle of the floor that is still a tourist photo attraction today.

As the food market developed and the neighborhood became less centered on manufacturing, Cohen inked media tenants looking for cheap office and studio space, including the Food Network, a local television station and Major League Baseball.

Ultimately, the burgeoning hot spot drew Atlanta, Georgia-based Jamestown Properties' attention, and in September 2003, the firm bought a 75 percent stake in Chelsea Market in a deal valuing the property at \$278 million, according to data provider Real Capital Analytics. A joint venture comprising New

York-based investment manager Angelo Gordon, New York-based private investment firm Belvedere Capital and San Francisco-based operator ATC Partners held the minority stake.

Jamestown expanded the popular food hall to first-floor retail and saw a huge jump in foot traffic from the connected High Line park, an elevated greenway built in 2009. In 2016, nearly eight million visitors walked the High Line, while Chelsea Market attracted about six million people.

In June 2011, Jamestown bought out its partners' minority stake in a deal valuing Chelsea Market at \$793.5 million. Capital for Jamestown's stakes came from its open-ended core fund, Jamestown Premier Property Fund. The office-focused vehicle, valued at \$19.6 billion as of the second quarter, had returned 11.1 percent net as of Q2, according to the Sacramento County Employees' Retirement System, one of its investors.

## Alphabet moves in

Now, the building is under new ownership with a huge gain for Jamestown. The property company sold Chelsea Market to Alphabet, Google's parent company, for \$2.4 billion in a deal that closed last month. A spokesman for Jamestown declined to comment, and Google could not be reached.

Google has cornered the neighborhood, helping change its character and enrich Jamestown over the years. The tech giant leased part of 111 Eighth Avenue, establishing its local headquarters, then bought the building from Jamestown and partners in 2010 for \$1.9 billion. It leased 300,000 square feet at Chelsea Market and 360,000 square feet at 85 Tenth Avenue, which could be next on Google's shopping list.

Google has, as with most of its deals, kept quiet about its plans for Chelsea Market. In a statement announcing the deal close, Jamestown said it will continue to operate the food and retail parts of the 1.2 million square foot building.

As part of the deal, the property company keeps the branding rights to Chelsea Market, with an eye toward exporting the concept outside Manhattan. Jamestown is reportedly looking at emerging neighborhoods in both Europe and the US, capitalizing on the name-brand success for future walls that might tell an arguably less boring story than those of the original Chelsea Market. □



**Chelsea Market:** attracts six million visitors annually



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**Wolfgang Egger**

Founder and CEO  
**PATRIZIA**

Wolfgang will discuss how PATRIZIA's recent M&A deals have doubled their AUM and consolidated their position as the leading real estate investment manager in Europe.

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Source: Oxford Economics, 2017

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