Building a global footprint

Global investing will increasingly define institutional real estate markets of the future

by Benjamin Cole

As investors worldwide accumulate larger pools of capital, they are increasingly bound to seek risk-reducing diversification, not only across asset classes but within asset classes as well. Thus, even while large institutional property investors acquire a mix of property types — retail, office, industrial, mixed-use, residential — they are doing so while seeking a greater geographic spread, and even a global footprint.

Yet, unlike the bulk of the equity and debt worlds, the institutional real estate market is often not liquid and frequently involves large discrete purchases of assets that have to be managed. In other words, an institutional investor often buys a property or, even more bravely, buys into a development — in New Delhi or Hong Kong or Chicago or Brussels — with all the entanglements, risks and upside potential that such a large purchase implies. Absentee or even passive ownership of a discrete property asset is generally not a successful business plan.

To be sure, even large institutional investors can diversify real estate portfolios through the more-liquid securities side of the equation, and thus buy REIT stocks or other property equities, or even buy bonds or debt linked to overseas real estate. The securities strategy, however, is generally a less risky and thus also less rewarding way to invest — potentially much less rewarding. Returns in the universe of passive investing are currently at historic lows, with even junk-bond interest payments now in the below 5 percent range, as measured by the Merrill Lynch High Yield 100 Index in mid-May. So, for many institutional investors, the hunt for return and diversity translates into the demand to directly own real property offshore in a multinational platform.

What is a global footprint?

Music or food may come from every corner of the globe, but so far institutional real estate investors take a more circumscribed view, and generally look for very high-quality properties — grade A — in the major cities of Europe, Asia and North America. The stereotypical institutional purchase of real property across national boundaries is a trophy tower or prestigious, large mixed-use development in a gateway city.

Indeed, while the World Bank or International Monetary Fund might refer to 188 nations on the planet, even a large institutional real estate investor will normally target no more than 30 countries, and usually fewer, while the largest private equity investors might be in 10 to 15 nations, says Jacques Gordon, Chicago-based global strategist for LaSalle Investment Management.

"Real estate investing is often cross-border or multinational, but from an investment perspective it is never truly global," Gordon notes.

There are reasons for the restrictions on the global footprints of even the largest and most intrepid of investors. Foremost is the uncertain property investing climate in many nations, in which property rights, rule of law, and transparent government are not givens or are even effectively absent. Then, there are nations in which the economic outlook is so cloudy that long-term investing is daunting, such as most of Latin America.

Yet other nations, such as Thailand or Malaysia, effectively prohibit foreign direct ownership of land, even if they offer some advantages in terms of diversity and economic outlook. (Thailand did legalise REIT stocks in 2013, and those equities can be owned by non-Thai nationals within certain conditions.) And, some nations, perhaps in Eastern Europe, now have uncertain political futures, and thus are not investment-worthy either.

London

And so the "global footprint" for institutional real estate investors shrinks down to perhaps a mere 20 to 30 nations, says Gordon.

With such daunting hurdles across the world, why go global at all? Despite the near-universality of the 2008 global financial crisis and withered property values around the world, not all geographic markets rose and fell in unison. China famously dodged most of the 2008 dump, and Canada and France were less affected than most other Western nations.

And while the global financial crisis of 2008 proved to be unusually pervasive, not all recessions or future business climates can be expected to show global uniformity. It stands to reason that certain nations or cities will prosper more in coming years than global averages — or that other regions will have a "low beta", meaning they follow their own drummer, and not the world beat.

Indeed, when focusing on returns based on commercial property values rather than total returns, REITs on average had negative returns in Europe and in the United States from 2007 through 2012, while REITs in the nations of Canada, Hong Kong and Malaysia posted gains in the same period, according to a recent study released by the University of Macau, which excluded dividend returns.

New York City

Investing across borders would have reduced the chances of being concentrated in a losing market.

"We believe that real estate is less correlated geographically than other asset classes and, therefore, geographic diversification in real estate should add a lot to a multi-asset portfolio," explains Russell Platt, London-based CEO with Forum Partners.

In addition to the well-understood need for diversity, going global provides other advantages, including enhanced liquidity and a "widened opportunity" set, contends Peter Zabierek, CEO at Montreal-based Presima Inc.

If an institution is restricted to one geographic market, it may find a lack of buyers hampers a profitable or timely exit strategy. And if investors never get out of the neighbourhood, they could certainly miss superb opportunities in other lands or buying scenarios that may fit their profile of needs more exactly.

"Whether investors are looking for core, value-add, opportunistic — or office, retail, residential or other — they can find more of what they are looking for when they cast a wider global net," Zabierek says.

What makes a portfolio global?

Another way to look at the global footprint of an institutional investor — even the rather circumscribed nature of global investing cited above — is to measure the composition of the investor's portfolio by what fractions are devoted to international markets.

"A global footprint, at a minimum, translates to some level of presence in each of the three major markets — North America, Europe and Asia — with each region representing at least 10 percent of the portfolio. No region is simply a footnote," Platt says.

A good indicator of the global nature of real estate investors is the hesitation institutional investors exhibit when asked for the location of their headquarters. For organisations with strong operations worldwide, the question loses relevance, Platt states.

Ease into continental lifestyle

Yet even sophisticated and large institutional investors may balk at the prospect of plunking down serious money into a faraway nation, endowed with a unique welter of laws, taxes and regulations, all expressed in a foreign language and housed by an occasionally opaque culture.

For the justifiably cautious, a good strategy is to first ease into global markets through the acquisition of liquid real estate securities, such as REIT stocks or other property equities. This can represent a learning stage, experts say, and the securitised property market is growing.

"The listed real estate securities market is a US$1 trillion market with significant exposure to the three largest regions for institutional real estate — Asia Pacific, North America and Europe," says Presima's Zabierek.

Acquiring debt on real property is another way of gaining exposure to foreign markets, in which the hopefully solid contractual obligations of the debtor are rewarding for the investor, and yet provide a window into a potential market. Ramping up through the learning curve, the next stage can be to invest in an open-end real estate fund or fund of funds which provide greater exposure, Platt says. This is less liquid than a simple REIT stock but also provides a deeper understanding of a market, and opportunities to meet people on the ground in target nations.

Going higher in the risk scale, the next step toward globalisation is to make direct allocations to commingled funds or to co-invest with a lead joint venture partner. Finally, in the most aggressive and confident stage of internationalisation, an institutional investor can buy offshore real estate directly or even develop property offshore.

Each stage offers higher returns and more true diversity, but usually offers more risk and requires greater oversight and management, as well as a solid knowledge of local specifics and national real estate fundamentals in the target market. In some regards, even currency risks are reduced by a global stance. The more a portfolio is internationalised, the more it is inherently hedged against oscillations in the value of any particular currency.

Going global: easier than ever?

Yet for all the risks and potential of going global, the actual execution of international investing is easier than ever, Zabierek says.

The vastly improved communication systems of the past 20 years — especially, of course, the Internet — and the explosion of real estate information means investors have much more practical, industry, financial and geographically-specific knowledge than ever before, even before they conduct serious investigation into actual properties, neighbourhoods and partners offshore.

"Now, the challenge is not too little information, but instead too much information," Zabierek says. "Real value today is created by weeding through the vast amounts of data and information and processing it into a decision-making context."

Asian investors seeking to break into Europe or North America can take advantage of copious amounts of public information easily garnered by perusing the reports of listed real estate companies and REITs, Zabierek notes. This provision of public data is now becoming a two-way street as more Asian REITs become public with their founts of information also available online, meaning Western investors have windows into the East as well. Then, after information reconnaissance, Asian institutional property investors should link up with solid partners in the West who are intimately informed about local markets in Europe and North America.

"The future of investing globally lies in developing a network of contacts that are knowledgeable about the local markets. These contacts can be connected through technology to maximise the timeliness and efficiency of the information flow," Zabierek concludes.

In that sense, successful global institutional real estate investing today is a mixture of the new — the Internet and analysing the flow of information — and some of the oldest business advice of all: pick good partners. LaSalle's Gordon recommends investors take a multi-year view on branching out beyond locally-known borders: "Do your homework on countries and partners. Start with the idea that cross-border skills are acquired one country at a time, not all at once."

But Gordon cautions that while finding partners with expertise in target countries is not difficult, the challenge lies with finding those with capabilities tailored to investors' needs. In the investment world, finding organisations "that take the time to understand the nature of cross-border capital and help customise strategies that minimise tax drag, currency issues and regulatory constraints is much, much rarer," Gordon suggests.

The exit

Institutional property investors are generally seeking long-term relationships, but not marriage, and have exit strategies in mind when they acquire property or securities.

In North America, the capital markets are mature, diverse and robust, and in all but the worst times — 2008, for example — property sellers have a range of ready exit strategies, from direct sales to securitisation to refinancing. In general, the question of an exit in North America is one of timing for profits, paired against the best execution strategy. Europe is considered less liquid, with both higher transaction costs and taxes to consider, possibly suggesting that investors must think even more long term before buying, and considering an "exit" that is only a recapitalisation or refinancing. Asia has the least developed capital markets, in which the exit strategy poses the most difficulties. Still, some say a growing listed market of real estate stocks is creating a new door out.

Hong Kong

"The Asian public capital markets are surprisingly robust, including the REIT markets. IPO alternatives should always be considered," says Forum Partners' Platt. Private equity pools of capital should be courted consistently, Platt advises.

It's a small world

With property investors and managers herding ever-larger accumulations of capital, and with the world becoming linked by fluid capital markets and the Internet, it is all but inevitable that globalisation will increasingly define institutional real estate markets of the future. Whether boldly through direct investment, or more cautiously through real estate securities, the premium in the future will be placed on national and geographically-specific contacts and information that can be accessed by world-class property investors. ❖

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