2005
2015

A DECADE
THE FIRST 10 YEARS

PEI Alternative Insight

PERE

THE INSTITUTIONAL INVESTOR'S PERSPECTIVE

Opportunity amidst the chaos

Contrarian assumptions and conviction during troubled times was the key to investing well in the aftermath of the global financial crisis, writes Collin Lau, ex-global head of real estate at China Investment Corporation

Boom and bust is part of life. But in just the last decade they have been exemplified at a scale many investment professionals will never experience during their professional lifetimes. Those active in the last ten years have experienced a period of exuberance turn to widespread panic and darkness, and then shining light again.

In retrospect, it was an unforgettable experience investing in global real estate just after the global financial crisis from 2009 onward. As I recall, it was mostly about restoring confidence, in calculated steps. Let me tell you about my experience.

The first challenge for us investing in those moments of darkness was about whether we would be catching the proverbial falling knife. As for any institution, if the first investment is bad, it would be hard to gain trust within the organization afterwards. Assessing and mitigating risk was a delicate combination of science and art. It went with deal and intelligence networking, laser-precise deal screening, accurate analysis of fundamentals, pricing the risks, getting the right partners to execute well, and systematically bringing multiple stakeholders on board, including internally the investment committee, externally investees, banks, tenants and ultimately the market itself.

"In moments of widespread panic, we were presented with the opportunity of investing in industry leading platforms with broken capital structures, and these would become our focus"

In moments of widespread panic, we were presented with the opportunity of investing in industry leading platforms with broken capital structures, and these would become our focus, be it Goodman, Canary Wharf or General Growth (or others which were less public). We realized relatively quickly we could not fix any property company with poor management or properties in terrible locations. But if they were burdened by temporary illiquidity, we could give them staying power. Needless to say, we had to price the risks by applying a good margin of safety. We had given deep discounted value to the underlying assets, and often paid virtually nothing for the platform, or the operating company.

I'd like to think we took the contrarian approach to the hegemony. Not just from the point of cap rates and other numerical data points. But also the decisions to adopt a direct investment approach and to choose geographies that chimed with our view of the world's recovery. It was contrarian too to focus on platforms that blended a portfolio of assets and which possessed their own operating capabilities and so became our de facto extended arm. We placed emphasis on picking the right partner - that has turned out to be a winner - to execute successfully amidst competing alternative offers.

Value investing is fundamentals-driven, but we should not be regressive. Instead the visions behind the scoping of fundamentals are essential. Back in 2009, we had the benefit of seeing how e-commerce had been emerging and its impacts on the supply chain in China. We saw too how thriving urbanization would gradually convert city-fringe industrial land into higher and better use property. These factors inspired our call for a significant allocation to logistics against the traditional advice at the time of always seeding a property portfolio with 'institutional' assets like offices and retail property. Logistics, for example, paid higher yields, and it was music to my ears to know that someone is paying you in the interim to wait for the land to be worth more at the end.

Common sense should prevail over a rigid application of asset allocation boundary. Do not seek a Ph.D. in 'Check-the-Boxes'. For an illustrative example, we had the opportunity to invest in the whole of Canary Wharf at a cap rate of 250 basis points to 300 basis points higher than we were offered to buy a single asset there at the same time. That did not even count the benefit of diversification, plus the potential of building further influence in a rarely available platform. Our motto was: we should be a long-term but opportunistic investor – opportunistic entry, manufacture core and with the optionality of a long-term hold.

It's highly desirable to put yourself in a position that you could compare notes with credible sources one against another, and that's what we call being 'a great statistician'. But don't be afraid of losing your job for the right conviction. Execution is the key, in particular the ability to deal with complicated process such as buying distress in the midst of chapter 11 bankruptcy. Structuring techniques do help, but ultimately a perfect term sheet without backing the right horse is not very useful.

In moments of darkness, one has to believe civilization will move on, the economy will normalize at some point, and people will spend or invest money again. There is no rocket science in that, and I have to humbly admit we were fortunate in having the opportunity to invest at the right time, with the right people and at the right space. I'm glad we did.