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Deals

Deep Dive: How to invest like a contrarian

For seven private real estate managers, breaking away from the crowd is equal parts risk and reward.

PERE Staff - 4 December 2023

In private real estate, the herd mentality prevails: no one ever gets fired for investing in the most in-demand sectors, strategies and managers. But the herd mentality has no place in contrarian investing.

“It’s lonely to be a contrarian,” says Saul Goldstein, chief executive and chief investment officer of pan-European manager ActivumSG. “Opportunistic investing at its core is contrarian... the guys who do opportunistic, they have an individualistic streak. They don’t really care what anyone else thinks about what they’re doing.”

Although contrarians can invest during any part of the market cycle, “in this kind of market, the contrarian bet is that you’re calling the bottom before other people are willing to call the bottom,” he says.

The downside to contrarian investing is it invariably involves greater risk than following the crowd. “You’re running into a burning building and you’re trying to find something to save, and you’re trying to not get burned

“the way,” says Goldstein. At the same time, “you have to be really convinced, and you have to also be willing to admit when you’ve made a mistake.”

Goldstein is one of seven contrarian investors featured in this month’s cover story. They fall into two main camps: those betting on out-of-favor geographies and sectors, and those eschewing popular investment themes. For every Bain Capital going all-in on China, a JST is hitting pause on the US, the world’s largest property market, or a PIMCO is looking to cash out of an emerging investment destination like India when other global organizations are stampeding in. For every Gaw Capital buying up San Francisco office properties or AEW on the hunt for discretionary retail assets, an ActivumSG is staying out of the in-demand logistics sector.

The *PERE* team spoke with each of these investors about their contrarian plays and how they thrive on bucking the consensus view.

1 Betting on San Francisco office

San Francisco is the poster child of the US office sector’s fall from grace, with grim statistics to match San Francisco’s office vacancy level climbed 210 basis points to a record high of 30.4 percent during the third quarter, according to broker JLL

That is enough for **Gaw Capital Partners** to make a contrarian bet. The Hong Kong-based manager has agreed to buy North Park, an office complex near the city’s Embarcadero waterfront, for a cut price of \$85 million from mega-manager **Blackstone**. Gaw is familiar with the 300,000-square-foot, two-story workspace, having sold it to Blackstone for \$245 million in 2018.

Critical to Gaw’s thesis is time, founder Goodwin Gaw tells *PERE*. He will not discuss deal specifics, but he believes that although occupancy will continue to suffer short-term, the fast-growing artificial intelligence and life sciences sectors will

turn the city's office market around. "The amount of capital going into these two sectors should create a catalyst for the rebound of San Francisco."

Because the timing of a turnaround is difficult to predict, selecting both the right type of vehicle and leverage for such an investment are critical, Gaw says. "Contrarian plays are very difficult to figure out on timing," he explains. "Ultimately, this strategy should yield the right result. But I don't want to be restricted by the timing of a fund so we're doing this on a separate account basis."

Gaw is leading the investment in North Park using its balance sheet, *PERE* understands, incorporating other investors in a bespoke vehicle. It is believed the deal represents a 9 percent-plus entry yield, meaning the capital outlay is covered by cashflow from the property's leases. Debt can be injected when the investment becomes accretive to an IRR-driven strategy. At that stage, the asset can be sold or transferred to one of Gaw's funds.

The asset, which is currently 45 percent vacant, is expected to be upgraded to make it a desirable future workspace, without the timing pressures ordinarily associated with a private real estate fund.

2 Shopping for discretionary retail

The retail sector has faced one headwind after another in recent years, including the rise of e-commerce, pandemic lockdowns and rising interest rates

With a potential recession on the horizon for many economies, discretionary, non-grocery-anchored retail is not on every manager's shopping list. Having largely repriced prior to the rate hikes of the past 18 months, however, the sector has kept out of the spotlight as of late.

Manager **AEW** sees the current price correction as a favorable market entry point. The Boston-based firm has taken a cautious approach to the sector over the past five to seven years, but is building its retail books again throughout Europe. Acquisitions in the sector this year include the Passy Plaza shopping center in Paris, two retail parks outside Madrid and Valencia, and a prime retail asset in Cannes city center.

“I’m not expecting a huge increase in investor interest in the sector in 2024. But hopefully the retail-bashing period is now behind us,” says Raphael Brault, AEW’s chief investment officer Europe and head of France. As of 2022, rental values had returned to 2008 levels across Europe, he says, providing investors with downside protection.

As such, he is confident the sector will withstand limited economic growth over the next two years – or a recession, were one to occur. “Consumer savings have been strong, which should sustain retail sales altogether,” he adds.

Brault also believes the impact of online shopping on physical retail has been “somewhat overplayed,” saying consumers increasingly value a blend of physical and online shopping. He adds the pricing edge of online shopping should diminish over time as more online retailers charge for product returns. Coupled with limited new construction for prime shopping centers and high street units, this creates an attractive proposition for acquiring existing assets.

In the quiet deals market, the lack of competition for retail assets is also aantage, says Brault, “because the bargaining power is much more on the buyer side.”

3 Saying no to logistics

Industrial is one of the favored sectors in private real estate, but not all investors are following the trend

Industrial accounted for 37 percent of the total raised for sector-specific funds in Q1-Q3 2023, according to *PERE* data. **ActivumSG**, however, has stayed away from investing in logistics for the past few years. According to chief executive Saul Goldstein, logistics is not compatible with the firm’s opportunistic real estate strategy. “I don’t think we’ve ever gotten paid for taking on a beta strategy,” he says. “You need to use a lot of leverage to get a higher return.”

The change in pricing has put a greater emphasis on rental growth.

“Logistics assets traditionally were typically priced at a 7-8 percent yield and were a sleepy asset class for many years,” Goldstein explains. “These days they price at a much, much lower yield – around 4 percent – which means high rental growth is needed.”

Prior to the pandemic, ActivumSG had acquired logistics sites in Spain but saw “construction costs and asset pricing get pretty crazy relative to potential rents,” Goldstein recalls. The firm ended up selling the sites as data centers “worth multiples more of what they would be as logistics properties.”

The logistics space has become crowded with competitors partly because of the lack of barriers to entry. “It is not a hard-to-supply product,” he explains. “Warehouses have a simple design: a solid concrete pad, four walls and a roof.”

Those barriers to entry in turn lead to another challenge, which is the accelerated pace of obsolescence, Goldstein adds: “You get a product that becomes obsolete pretty quickly, because it’s pretty easy to put something new up.”

4 Staying out of the US

The US remains the most attractive overseas real estate market for Japanese investors, but the high interest rates are a deterrent to some

Almost half (49 percent) of Japanese investors consider the US as their top destination for outbound investment, according to CBRE’s *Asia-Pacific Investor Intentions Survey 2023*. However, The Japan University Fund, the country’s biggest university endowment fund managed by the Japan Science and Technology Agency, has grown cautious about investing in the US property market because of its high interest rates.

“[The] interest rate is something that we look at very closely. We are trying to hear the views from various managers,” Ayaka Takimoto, executive director and head of real estate and infrastructure investments at JST, said at the PERE Network Tokyo Forum in September.

But JST is not alone. A growing number of Japanese investors have expressed concerns about US interest rates, according to Yukihiro Ito, managing partner at Japanese capital advisory firm Asterisk Realty & Placement Agency.

“Many Japanese investors hedge the currency risk when they invest in the US,” he explains. “The sharp climb in US interest rates represents more volatility in their investments and has become a growing risk factor for them.”

Another source of worry for Japanese investors is the negative impact of the work-from-home trend on the US office market, Ito adds. This is because office has traditionally been the favored sector among Japanese investors

committing capital overseas. The sector attracted \$2.48 billion of the total \$3.5 billion of Japanese outbound real estate investment in 2022, according to a CBRE report.

As for JST, the investor has opted to build its core portfolio in Europe and Australia, with a particular focus on the logistics and residential sectors, in lieu of investing in the US, Takimoto says.

5 Passage from India

Among Asia's emerging private real estate markets, India has stolen the limelight in 2023

As other markets have seen declines in transaction volumes, institutional-level investment in India totaled \$4.6 billion from January through September, up 27 percent year-on-year, according to research from broker Colliers. Furthermore, institutional capital inflows for the nine-month period had already reached 93 percent of the total inflows recorded in 2022.

Taking a contrarian position on India, however, is Munich-headquartered **PIMCO Prime Real Estate**. The asset management behemoth views the surge in investment appetite for India as an opportunity to reduce its exposure to the country. In October, PIMCO agreed to sell Waverock, a 2.4 million-

s foot office property in Hyderabad, to Singaporean sovereign wealth f C in a deal valued at approximately \$258 million.

The asset, which counts Apple, Accenture, DBS and Tata among its tenants, will be sold from a joint venture between PIMCO and local real estate firm **Sharpooji Pallonji Group** after four years of joint ownership. The transaction is awaiting government approval to complete.

PIMCO's head of Asia-Pacific real estate Scott Kim tells *PERE*: "This is a great opportunity to take profits and reduce our exposure to a market where we have enough." Indeed, a sale is expected to produce a small profit for the firm when currency is considered, with GIC understood to be paying about 19 percent more than PIMCO's original purchase price in rupee terms.

PIMCO's assets under management in Asia amounted to approximately \$12 billion as of June, representing about 10 percent of PIMCO's overall real estate exposure. Of the firm's Asia holdings, India accounted for about \$900 million. The conclusion of this deal will reduce the manager's Indian assets even further.

6 Why not China?

Many US and European institutions have pulled back on investing in Chinese real estate due to ongoing geopolitical issues and the debt crisis in the country's property sector

Cross-border investments represented 12 percent of China's total transaction volume in Q3 2023, down from 15 percent in Q3 2022, according to broker CBRE. This represented a significantly smaller amount compared with the annual average of 20 percent from 2020 to 2022.

But while many of its peers are shying away, US private equity firm **Bain Capital** continues to see China as a “core” market in the region, according to Kei Chua, partner, special situations in the firm’s Hong Kong office.

“We’ve exited a lot of things in China over the last few years, so we’ve realized profits and returned capital, which is why our investors trust us to keep making investments in China,” Chua says. The exits include its shares in Chinese logistics company CNLP and all its non-performing loans in the country. The firm declined to disclose specific return figures, but its Asia flagship fund **Bain Capital Special Situations Asia II** generated an 18.03 percent IRR as of June 2023, according to *PERE* data.

Meanwhile, Bain Capital is focusing on more “bespoke” and “defensible” sectors in the country, including data centers, industrial parks, modern manufacturing facilities and warehouses.

In October, the firm announced a \$250 million joint venture with **Warburg Pincus**-backed Chinese new economy infrastructure and property firm **DNE** to develop and operate manufacturing parks in China. The firm is also in the process of privatizing Chinese data center company Chindata, according to an announcement in August.

“Nobody could predict what would have happened to the Chinese real estate market three, four years ago,” Chua says. “But maybe there’s an opportunity for us to come in and take off some of the assets from

- ies with liquidity issues. And that could create a whole lot of
- inity for us to invest in China again.”

7 Core values

Core real estate has fallen out of favor with many investors, as it becomes more challenging to achieve attractive returns in a higher interest rate environment

Only 1 percent of capital raised for private real estate funds in Q1-Q3 2023 went to core strategies, per *PERE* data. Against that backdrop, it is no surprise that only three open-end core real estate funds have launched globally in 2023, and only one of these has a focus on North America.

The vehicle is the **US Cities Diversified Fund**, which caps off New York-based manager **Nuveen**'s sector-specific US Cities open-end core series that began with the US Cities Retail Fund in 2018. Multifamily, industrial and workplace iterations followed in subsequent, consecutive years.

According to Shawn Lese, Nuveen's chief investment officer and head of funds management for the Americas, the firm developed the Diversified Fund in response to demand from both new capital sources with emerging real assets allocations, such as defined contribution pension plans, and overseas investors with no or limited exposure to the US.

“Some of these investors are less familiar with US investment dynamics and consequently feel less comfortable making allocation decisions themselves, or they might be smaller investors that don't have extensive investment teams and want to leave that responsibility to us,” he says. “I think the US market still presents the best risk-adjusted return on a global spectrum, especially with the recent repricing.”

Despite low fundraising numbers and the redemption queues across NCREIF ODCE funds, Lese is “very optimistic” for the strategy in the medium term,

€ sizing that current sentiment is no different from how it typically is
€ point in every market cycle.

“I think in the future we will look back on 2024 and realize it was the beginning of a terrific vintage for core real estate,” he says.

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