Invesco Real Estate

*Recently, **Alex Eidlin,** Associate Publisher of* The Institutional Real Estate Letter – Asia Pacific *and Managing Director of Asia with Institutional Real Estate, Inc, spoke with **Graeme Torre,** Managing Director and Head of Portfolio Management for Invesco Real Estate in Asia Pacific. The following is an excerpt of that conversation.*

Graeme Torre is Managing Director for Invesco Real Estate. He is the Head of Portfolio Management for the Asia Pacific region. Torre joined Invesco Real Estate in 2011 and the former AIG Global Real Estate in 2005. He has 25 years of real estate experience. Prior to that, he was a director of Henderson Global Investors based in Singapore, where he was responsible for both listed and unlisted real estate investment for Asia Pacific.

Could you please tell us about Invesco Real Estate's operations in Asia?

Invesco Real Estate started its real estate business in 2006, as a relatively modest operation. Now, Invesco Real Estate Asia has over 80 staff in the region. We have offices in Tokyo, Seoul, Shanghai, Hong Kong, Singapore and Sydney. Our team is organised by function with the portfolio management group being responsible for the management of all client mandates in the region, whether pooled or separate accounts. In addition, we have an acquisition team, an asset management team with general and specialist asset managers, a dedicated research team, an in-house finance team, a closing services team and a client portfolio management team. We also have country heads in each office who look after the business development duties in their own jurisdiction.

How does this help you with your business?

One of the things that we have learnt over the years about Asia is that certain markets are not entirely transparent. So in order to manage the risks of investing in this asset class in this region, you need to thoroughly understand real estate from the bottom up. To date, a lot of investing in this part of the world has been through opportunity funds, and it often requires relatively complicated transactions to capture the risk-adjusted returns that our investors look for. Typically, such investments might include re-tenanting of the properties, development, renovation or the repositioning of assets. In order to successfully execute such strategies, it's important to have specialists that can help you understand the risks involved in undertaking such complicated investments. That's why we utilise the full range of the specialist skills that we have in-house, including acquisitions, finance, legal, asset management, research and construction to analyse each investment we make.

Asia has traditionally required an opportunistic approach to real estate. Do you think this is going to continue going forward?

I've been investing in these markets since the mid-1990s, and my observation is that most foreign investors have the opinion that Asia offers a high-risk/high-return opportunity. That was certainly true 15 years ago, but one of the products of investment over a 15-year period has been tangible growth in the "built" environment. As cities become bigger, the quality of building stock, the number of buildings and the ownership of those buildings changes over time, and I think that's what we've seen happening in Asia. I don't think it's necessary anymore to consider Asia as a purely opportunistic investment choice.

Can you expand on that?

The markets around the region have become far more transparent and far more sophisticated, and the property systems (legal, financing, valuation, etc) are now far more recognisable to foreign investors. These markets have become more widely invested in. Instead of having four or five large property companies in each city owning the best stock, we now have a diverse range of owners throughout each city who actually trade their property. As an example of how much more diversified the ownership base has become, the Asian REIT market according to Bloomberg data grew from zero in 2001 to a market cap of about US$80 billion in 2011, and that is without China.

There's a difference between the opportunity fund model and direct ownership of properties. Do you think the real estate fund model is still appropriate for the region?

I certainly do, but I think it's changing. If you liked private equity real estate in Asia during the past decade or so, you invested through closed-end funds with an opportunistic strategy and an eight- or nine-year life. Now I don't think it's necessary to stick to that. We truly believe a core/core-plus approach to investing in the region is proven, and along with that style of investing will come long-term investors. New products to suit a core/core-plus approach are being considered, and typically those funds would be open-ended and perpetual. It's a new style of investing, and that, I think, will be a very welcome addition to a manager's product line.

How do you see this developing?

When I started in this industry, there were only about four or five real estate fund managers in the market. Over the past 15 years, I've seen many changes. Now it is taking a new direction once again, and I think it's very good for investors. If you have a need for diversification in your portfolio, you're ignoring over 30 percent of your universe if you don't invest in Asia. And you don't have to come here for the high-risk/high-return investing anymore; you can also allocate for income and core-style investing.

That should definitely bring more investors to the region.

That's what we are seeing. It's a new move for many investors, so understandably for them there's a lot of due diligence. Many investors we've spoken to have reached the conclusion independently that they want to have exposure to Asia, but they don't want the risk associated with opportunistic funds. Some of them want office buildings leased to good quality tenants to produce a steady income. They don't need the high risk anymore; they just want the exposure to the region with steady returns.

What do you think is going to continue to drive demand for Asian real estate in the short to medium term?

The story for Asian real estate is driven by the region's growth, and much of that growth is China's influence. The strength of China's economy is a product of the growth in the region's middle class. Over the next five to 10 years, Asia is expected to become a larger part of the global economy. That's pretty compelling, and that increase is expected to come from an increase in intra-regional trade. So in the short to medium term, that economic growth is likely to be a very good backdrop for an increase in property values. Of course, as markets develop, they do go through some bumps in the road as they grow.

Do you think the rise of China's middle and consumption class is going to continue? Is there anything that can derail it?

Our view is that it will continue, but conversely it can certainly be de-railed because I don't think there is any corner of the globe at the moment that could claim to be completely insulated or decoupled from the rest of the world economy. As far as something that would de-rail China's growth, I would say that one or a combination of factors could do that, much the same as any other country. The reassurance that we take at present is that it appears that much of the slowdown in China's economy not only is due to a decline in exports to Europe and the US, but also comes as a result of property policy controls introduced by Beijing.

Do you believe the current slowdown in transactions in China is just a temporary phenomenon?

I think it is. We're seeing volumes in the housing market pick up again already. Chinese developers appear to be very efficient, and they will cut prices to shift their stock. It's an extremely competitive real estate market amongst the developers, and they have been prepared to cut prices over the past 12 months. So sentiment is now repairing, and in major cities we have seen volumes pick up, though pricing has not yet come back. We see this as a very good sign, and it suggests the presence of pent-up demand.

It sounds like you have a genuinely optimistic view on the market. What is likely to upset your prognosis?

Some of the worst corrections in the Asian markets have come from an external shock — for example, the global financial crisis, SARS, the dot-com bubble bursting. So apart from something unforeseen occurring, the major upset would be a dramatic and sustained slowdown in the Chinese economy.

How do you price in all the risks of Asian real estate?

There's always a balance between risk and return, and with experience you are able to estimate and negotiate that balance into each deal. To seek to achieve the required returns, you often have to look at a type of investment that contains significant technical detail, whether it is from a tax, legal or physical perspective. As I mentioned earlier, the way we manage the risks is to employ specialists in-house — construction, finance and legal experts all dedicated to our team. With that expertise, we feel confident that we can understand the risk and return profile for any asset. It comes with experience and with having the right people.

Is it accurate to say you have a certain risk premium associated with different parts of these regions, depending on a series of factors such as transparency, liquidity, knowledge and experience?

Yes, absolutely. If we could look at these assets on a screen and see what everybody else is paying for them as well, it would be very easy to create a picture of where the market is. But in the private real estate market, pricing is what we have to do, and as such it is a bit more laborious. For example, we currently expect to see a higher return from a ground-up office development project in a second-tier city in China than we would for the same type of office development in Singapore. The simple metric here is that Singapore is a more transparent and understandable market for development; second-tier cities in China, not so much. ❖

CORPORATE OVERVIEW

Invesco Real Estate (IRE), a subsidiary of Invesco Ltd. (NYSE: IVZ), has been investing in real estate since 1983. Today, IRE is one of the largest managers of private real estate investments and public real estate securities in the world. IRE has direct real estate investments across the United States, Europe and Asia, and offices in 17 financial centres. This global presence allows us to identify and manage some of the best investment opportunities in the most attractive markets.

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