Partners Group

Recently, ***Geoffrey Dohrmann,*** *publisher and editor-in-chief of* The Institutional Real Estate Letter – Americas, *spoke with* ***Mark Degner*** *and* ***Thomas Mueller*** *of Partners Group. The following is an excerpt of that conversation.*

Mark Degner, Managing Director, is part of the Americas private real estate directs and primaries business unit, based in San Francisco. He is a member of the private real estate directs and primaries investment committees. He has 27 years of industry experience. Prior to joining Partners Group, he worked at Liquid Realty Partners, Morgan Stanley Real Estate and Lend Lease Real Estate Investments.

Thomas Mueller, Senior Vice President, is part of the European private real estate directs and primaries business unit, based in London. He is a member of the private real estate directs investment committee and the private real estate primaries investment committee. He has 13 years of industry experience. Prior to joining Partners Group, he worked at the European Bank for Reconstruction and Development and at Baker & McKenzie.

Who is Partners Group, and how do you approach offering real estate solutions to your clients?

Thomas Mueller: Partners Group is an independent global private markets investment manager. We were founded in 1996 and currently manage over $40 billion in assets across private real estate, private infrastructure, private equity and private debt. We have over 700 employees in 16 offices across the globe. We are a pure investment manager, not an advisory business, and we are an independent firm, not part of any broader financial services firm, and take alignment of interest with our clients very seriously. We think it is important to note that our real estate business, which today has over 50 dedicated due diligence professionals, is supported by a global investment team of more than 450 professionals and benefits from working closely with our colleagues in our other asset classes both in framing top-down relative value views as well as when performing bottom-up due diligence on investments.

What distinguishes your approach from the majority of other managers?

Mark Degner: First, we implement a global relative value approach with a thesis that we identify, create and deliver value at the asset level to our investors. It starts with having a global presence with teams on the ground in all the major markets. We utilize an integrated approach that incorporates direct property investments, secondaries — i.e. buying portfolios of assets in closed-end commingled funds — and primary investments. Not only is the capital flexible in terms of geography, but this integrated approach also allows us to take advantage of market dislocations at different stages of the real estate cycle. Finally, we have the expertise and resources to invest up and down the capital stack, which allows us to look at the relative attractiveness of opportunities on a risk-adjusted basis.

What strategies do you employ?

Mueller: Today's focus is very much on value-added strategies. This focus really stems from the fact that we believe many core assets today, particularly in gateway cities, are fully priced and less attractive on a relative basis. We are in the business of selectively acquiring assets at an attractive cost basis, working with top local operating partners around the globe to implement value-creation strategies, and selling these assets to core buyers. However, Partners Group also remains very active in secondary investments where we can buy stabilized, cash-flowing assets with core attributes and property risk, but at pricing that delivers value-added returns.

What sector or geographic focus are you working with right now?

Degner: In terms of geography, we have a truly global footprint. If you look at the distribution of our transactions, it is split relatively evenly among the Americas, Europe and Asia-Pacific. The true differentiation of our platform versus most of our competitors is that we can search for the best relative value within a particular region, but then we can also do it across the regions. We focus on all product types, so if a geographic area or property type is in our view overpriced, we aren't forced to invest in that region or sector, we just look elsewhere around the globe for that best relative value. While our real estate team has "boots on the ground" across the Americas, Europe and Asia-Pacific regions, we also draw upon our strategic relationships with over 200 top local operators globally in sourcing, executing and managing these investments on a global basis.

Where are you seeing the best relative value right now?

Degner: We are looking for situations where we can invest into quality assets at an attractive basis, execute on the value-add strategy and deliver stable, income producing assets to core buyers, and we see that in select markets and property types throughout the globe today. In terms of secondary transactions, we are looking at opportunities where we can get value-added returns with only core to core-plus property risk. We are also looking for places where there is a high return spread relative to historical spreads, so we may see anomalies in certain markets. In particular, we have seen some markets where there is a high-quality asset that is trading at a historically wide spread relative to core asset returns.

What types of vehicles do you offer to your clients?

Mueller: We are flexible in what we offer clients. We use our global reach and resources to provide a comprehensive range of solutions to our clients' investment needs. We have commingled fund strategies, and they range from broad global value programs to dedicated secondary or direct fund strategies. To meet the specific needs of certain clients, this often entails delivering customized separate account solutions.

The past few years have been a bit rocky. How has Partners Group fared since the onset of the financial crisis?

Mueller: We are pleased with how we've navigated the crisis. Because of our value-based approach and the flexibility that we have within our fund and separate account strategies, we have been able to be nimble and to capitalize on various inefficiencies we've identified. Markets have been rocky, but it has been a period that has provided or created attractive investment opportunities for us on a global basis.

We were able to be first movers on quite a few fronts over the past few years. For example, in Europe, we were first movers in German residential when it showed signs of bottoming out; we moved into that space as early as 2009, and now a lot of capital is flowing in and buying that kind of product, and we are net sellers. We were also ahead of the curve when we acquired our first U.K. retail asset in 2012 and when we started investing our light industrial program in the U.K. in early 2013. In the secondary market, especially here in Europe, this has been a period where a lot of investors have been looking for liquidity, which we have been able to provide through our secondary strategies. Secondary deal flow has only continued to grow, and we completed the largest secondary real estate transaction in Europe in 2012, and in 2013 as well.

Degner: When I hear the word "rocky" in relation to real estate, I get excited. It implies there has been some sort of distress or dislocation in the market. In the Americas, about two years ago we originated a number of preferred equity and mezzanine transactions which had an attractive risk/return profile. It was also a great time to buy in the secondary market at significant discounts to NAV — and at the same time, NAVs were basically at the bottom of the market from a historical perspective. Thus we were buying at a discount on a discounted value. As the market started picking up steam, we focused initially on U.S. multifamily, and more recently on industrial plays in select markets. More globally, repositioning strategies in select developed markets in Asia, as well as middle-class housing opportunities in Latin America, are both areas where Partners Group has been active.

You both mentioned distressed opportunities you were able to find. Is it still a good time to get invested, or has the window passed?

Degner: We strictly adhere to a relative value approach, so we are always looking to invest where we think the best opportunities lie. In the U.S., it is more competitive than it was two years ago, and we have to work harder at finding compelling situations, but they do still exist. We remain very bullish on secondaries. We are able to buy at significant discounts to NAV (and more importantly intrinsic value), and take advantage of situations where we see upside in valuations of underlying portfolios. Also, we are able to get cheap debt on individual property investments. We are investing in some transactions where we are getting double-digit cash-on-cash returns right out of the gate. Looking at U.S. trends, we like investments that focus on the urban core, such as commercial and residential plays in these very vibrant urban nodes. We are also focusing on areas where office employment has now exceeded peak 2007 levels; there are certain markets, particularly those with heavy exposure to the tech and energy sectors, where office employment is approximately 10 percent greater than it was in 2007.

Mueller: There is a strong argument that the recovery in Europe is lagging the United States by 18 to 24 months, and we are seeing more capital flowing into Europe from U.S. and Asian investors seeking a risk-arbitrage. We believe that our European roots and long-standing local relationships allow us to access opportunities many of our peers do not see. There is still a large debt financing need in Europe, creating demand for senior, mezzanine and preferred equity financing from the likes of Partners Group. Our clients like these investments as they provide them with core-like characteristics, but without having to invest in the equity of fully priced core assets. There is also a large opportunity in Europe to acquire secondaries from European financial institutions. There are regulatory pressures such as Basel III and Solvency II that force institutions, including insurance companies, to de-lever their balance sheets, effectively creating a segment of motivated sellers for secondaries buyers such as ourselves, in a largely uncompetitive space — or "blue ocean" as we like to refer to it.

What are the biggest risks for real estate going forward?

Mueller: Europe is still very much a slow-growth environment. I guess there is an argument that slow growth and low supply are better than high growth and high supply. However, with all the capital flowing into Europe from abroad, there is a potential for valuations in certain popular areas to get ahead of fundamentals.

Degner: Clearly, we are concerned about interest rates and also economic slowing as the Fed continues tapering off its quantitative easing. We are focusing on managing our risk versus managing returns. Our focus is on being a value-based investor and buying properties where we can proactively create value as opposed to just hoping there is an overall lift from the capital markets. We are targeting shorter duration plays here in the United States, including secondaries. And we are getting that cheap debt locked in right now — this really good, but moderate leverage that is accretive to our returns — because rates are at or near historic lows and we do not expect it to last forever.

If you cast your view two to five years down the road, what will Partners Group be doing?

Degner: Our roots as a company are in being a thought leader and focusing on finding the best relative value, so from that perspective you are going to see us investing in pretty much the same manner as we are today. We are going to continue to look for the best opportunities across geographies and property types, and will focus on identifying, creating and delivering value at the property level as an investment thesis. Embedded in this approach is understanding changes in our clients' real estate investment needs given changes in macroeconomic and other factors, and proactively ensuring that the solutions we provide continue to address these changing needs. I don't see us changing this fundamental approach any time soon because it has been with us from the beginning, and has proven to be successful. ❖

CORPORATE OVERVIEW

Partners Group is a global private markets investment management firm currently with over USD 40 billion in investment programs under management in private real estate, private infrastructure, private equity and private debt. The firm manages a broad range of customized portfolios for an international clientele of institutional investors. Partners Group is headquartered in Zug, Switzerland and has offices in San Francisco, New York, São Paulo, London, Guernsey, Paris, Luxembourg, Milan, Munich, Dubai, Singapore, Shanghai, Seoul, Tokyo and Sydney. The firm employs over 700 people, is listed on the SIX Swiss Exchange (symbol: PGHN) with a market capitalization of over CHF 6 billion and a major ownership by its partners and employees.

CORPORATE CONTACT

Steve Moen
Vice President
+1 415-537-8549
steve.moen@partnersgroup.com
www.partnersgroup.com