Deutsche Asset Management

Deep in the core of Asia Pacific

Recently, **Amey Dixit,** managing director–Asia Pacific at Institutional Real Estate, Inc, spoke with **Victoria Sharpe** and **Chris Robinson** of Deutsche Asset Management (Deutsche AM). The following is an excerpt of that conversation.

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It has been awhile since we've talked. Can you give me an update on what Deutsche AM has been doing in Asia?

Sharpe: Deutsche has been investing here since the mid-'90s, and has been investing in the core space since 2003. Back then, core investing wasn't the most popular strategy, especially when it came to investing in Asian markets. Fast forward to today, and a lot has changed. Core investing in Asia is definitely a hot topic. To meet the demand for core, we've been very active across the region for our separate accounts, which are primarily European separate accounts, in the mature economies in Asia — Japan, South Korea, Singapore and Australia.

Robinson: We also have a strong listed-securities platform that investors from all across the globe can use to enter the Asian real estate market. Listed real estate securities can offer clients a means to gain real estate exposure. It also gives investors who aren't ready to capitalise on a separate account or choose a closed-end fund the ability to take advantage of potential Asian real estate opportunities.

Your traditional investor base has been the large European institutional investors. Why might others find Deutsche AM attractive?

Sharpe: A lot of Asian investors are gravitating toward Deutsche AM because we are truly a global investment manager and can move their capital not only around the Asia Pacific region, but throughout Europe and the United States, as well. When I say truly global, I mean that we have deep roots and long-time offices in all the major markets around the world. We have been in Asia for more than 20 years, the United States for over 30 years and in Europe for even longer. Our offices are staffed with local professionals. We speak the language of the local investors. We understand the culture because we are part of that culture. We are deeply embedded in the various markets throughout Asia, which creates a very different dynamic than managers who open a small office in an Asian city and staff it with professionals from their home office.

Robinson: Our local knowledge should give confidence to foreign investors that they are investing with local experts, while our track record provides an additional layer in approaching this difficult market. The Asia-Pac real estate markets are complex, as you are dealing with many different economic and real estate cycles, as well as different cultures and levels of transparency. Investors rely on partners with deep roots in the market who have been here for a long time and who have got extensive experience investing in the region.

Sharpe: No matter where the capital is sourced or where it wants to go, we can provide solutions for exposure across the global markets in both private and listed real estate, as well as debt and equity. Investors are not having to build a staff internally. They don't need to underwrite closed-end vehicles here and there. They don't need to try to pick their stock and their region. We can move capital around the region and the world to where we believe the underlying macro environment could create the best opportunities. Having the ability to provide access points to take advantage of those potential opportunities is the underlying foundation of what we're about.

Do you have some examples of where your long-term commitment to the region is paying off?

Sharpe: One example is South Korea, where we have been investing for a long time. We now have several South Korean investors who use our platform to invest locally, as well as take their capital outside the region to Europe and the United States. Japan is another good example. Because Deutsche AM is such a long-time part of the landscape, we believe Japanese investors are comfortable investing with us, both domestically and internationally.

Why are investors outside of Asia looking at Deutsche AM for their Asian investments?

Sharpe: Particularly since the financial crisis, a lot of European investors have cut back on their staff and simply don't have the inhouse resources to choose a region, a city, a strategy or an asset in markets outside their domestic market. This type of investor should feel confident that our team can research the appropriate markets for their portfolio and overall strategy, and then source the right assets to execute the strategy. We are able to move capital in and out of all three regions, which is really what these investors may want to be able to do but often don't have the resources to do it.

Outside of Asian investors, where do you see most of the interest coming from?

Sharpe: European capital has had a long and continuing interest in Asia, where some investors have been active for decades. They appreciate the type of returns they can get from their core Asian investments. American core investors, on the other hand, have an extremely large and diverse domestic market, so there is not as much need to move capital outside their own country. However, we are beginning to see an increasing interest from US investors looking for diversification, which they will find in Asian markets.

Robinson: Most investors have been investing in the mature markets of the United States and Europe for a long time, but I generally think they are underinvested in the Asia-Pac region. This market has grown very quickly, and it has been hard for most investors to get capital invested or maintain allocations. Plus, accessing the Asia-Pac real estate market has traditionally been a little bit more difficult for institutional investors than other markets. But that is changing as firms like Deutsche are able to seamlessly move capital around the three regions to the benefit of their investors.

What makes Asia a good diversification story for core investors?

Sharpe: Asia has very different macro drivers and economies than other regions of the world. China is slowing but still growing at a substantial rate. Japan has been stagnant for years but appears to be on a slow path to growth. We are seeing huge migrations to the cities, meaning prime institutional-grade assets are in demand. Adding these growth stories to a core portfolio helps cushion the downward trends we expect to see in the next couple of years in the United States and Europe.

You mentioned that investors are using securities to diversify. Can you explain the benefits of going that route?

Robinson: There are a number of benefits to using securities to access Asian real estate, diversification being just one. Real estate securities have quite a low correlation to other asset classes, so the diversification benefit is obvious. Because they are liquid, investors can get set quickly, rather than having capital on the sidelines. They also give you access to high-quality assets that may not really be available anywhere else. Listed real estate securities can provide attractive dividend yields but also provide capital growth potential. Because of these characteristics, we are seeing increasing interest from a lot of investors to complement their direct real estate or broader portfolios with real estate securities.

Do investors use securities as a complement or as an alternative to direct real estate?

Robinson: The answer is both. Listed securities can complement, and they can provide an alternative, as well. They generally provide a good proxy to direct real estate investing, and typically it's a good way to access some real estate assets that you can't buy in the markets. We're working with clients to help them use listed securities to get access to some of those high-quality real estate assets. Some of the best assets in the world and in the region can only be accessed through listed real estate securities. We've also found that a combination of both direct investment and a portion of listed real estate could potentially improve an investor's overall risk and return so it may actually be complementary to add listed to direct.

Are you seeing a slowdown in commitments to global real estate?

Sharpe: Overall, I would say no. In fact, there has definitely been an increase this year. All things being equal, I expect that there will continue to be, if not an increase, at least a healthy flow of capital from the Asia Pacific regions into all markets, be it Asia, Europe or the United States. If there is a pullback, it will be for the same reason that everybody is pulling back — pricing. Pricing has gotten very tight around the world, but we have continued to be quite active in the Asia Pacific markets, in spite of the pricing pressures.

How will rising interest rates affect listed securities?

Robinson: Real estate stocks and, particularly, REITs are seen as a bit of a bond proxy because they are somewhere between a bond and an equity. But, from our work, we have found that REITs perform relatively well in a rising interest–rate environment, and they actually outperform non–real estate equities and bonds in the year or two after interest rates start to rise. But there are some caveats. REITs have historically performed well when interest rates are gradually rising, but they have been hurt when rates rapidly increase. We believe interest rates will increase gradually, so we expect REITs will hold up reasonably well. Besides having history on our side, we also have current pricing on our side. Listed stocks are already factoring in a rise in interest rates, so when they actually do go up, it shouldn't result in any meaningful underperformance.

China is obviously a huge force in the region. What have you done to access that market?

Sharpe: One of the most important things we've done is get ourselves qualified as a QDLP, or qualified domestic limited partnership, which is a program sanctioned by the Chinese government to match offshore investment strategies with onshore capital. This is the only onshore vehicle that Chinese institutional capital, or anybody, can use to invest outside of China. So far, only 15 institutions have been granted QDLP status, and that is for all asset classes — equities, fixed income and alternatives.[1] Chinese capital has been very anxious to get US dollar exposure. The only way to convert the currency from renminbi to US dollar is by securing a foreign exchange quota from China's State Administration of Foreign Exchange, which this vehicle provides. The vehicle is attached to our ODCE fund strategy in the US, which we've found to be very popular with Chinese investors. We wouldn't have succeeded in our petition if it hadn't been for our Chinese national investment professionals on the ground who helped guide us through a very complicated process.

Besides equity real estate, where do you see opportunities?

Sharpe: One opportunity is debt. We are investing Asian capital in debt in the United States and Europe. We are also doing a lot of investment through liquid real assets, which includes listed infrastructure. There is also a huge opportunity in direct infrastructure, as well as buying infrastructure-related companies. In addition, across real estate and infrastructure we are developing strategies that combine both our liquid and direct investment capabilities.

CORPORATE OVERVIEW

Deutsche Asset Management – Real Estate

Deutsche Asset Management's real estate investment business has been investing in real estate assets for more than 45 years. As part of the Alternatives platform, this business has more than 410 employees around the world and US$57.6/€48.8 billion in assets under management, as at 30 September 2017, and offers a diverse range of strategies and solutions across the risk/return and geographic spectrums, including core and value-added real estate, real estate securities, real estate debt and opportunistic real estate. To learn more about our real estate investment capabilities, go to www.deutscherealestate.com.

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[1] Source: Asian Investor, as at 23 October 2015