Phoenix Property Investors

Uncovering the "special situations" — Opportunistic, core-plus and debt investing in Asia Pacific

Recently, **Geoffrey Dohrmann,** president and CEO of Institutional Real Estate, Inc., spoke with **Samuel Chu,** co-founder, managing partner and chief investment officer, and **Benjamin Lee,** co-founder and managing partner, of Phoenix Property Investors about the current opportunities in the Asian and Australian real estate markets. The following is an excerpt of that conversation.

How did Phoenix Property Investors come about?

Chu: I gained a sense of the real estate market through my family's business at a very young age. Ben and I both attended the University of Chicago Booth School of Business, and afterwards we both worked on Wall Street. Then we each moved back to Hong Kong. After the 1997 Asian Financial Crisis and Internet bubble, I thought it was the right time to invest in real estate again by 2002, so we started the first fund.

Lee: We evolved from a $12.3 million Fund I. Now over the last 16 years, we have invested more than $8.8 billion in gross real estate assets with three different strategies, from opportunistic to core-plus to debt.

What do you think makes Phoenix different from its competitors?

Lee: A very single-minded focus on generating alpha for our investors. We generate a stream of return that is relatively stable. We try to do three things: We buy in markets with the best real estate fundamentals in terms of demand/supply; we buy below market; and then we add value.

Chu: We are all locals. Our seven regional offices in Asia Pacific are in Hong Kong, Tokyo, Shanghai, Taipei, Singapore, Seoul and Sydney, and all of them are run by local experts — because we truly believe that real estate is a local business. At the same time, we are an operator ourselves. We have a fully-integrated internal team from acquisition to project management to asset management that allows us to add value post acquisition.

What were you doing before 2002, and how did your career path bring you to the point of where you are today — being in multiple countries throughout the Asia Pac region with your three-pronged investment strategy?

Chu: I had been working for major international banks and financial institutions with postings in Hong Kong, New York, Frankfurt and Tokyo. By the end of 1990, I was asked to return to the headquarters of Deutsche bank in Frankfurt. Since I wanted to stay in Hong Kong, I decided to step out on my own. I started advising a real estate family that had a public company and some investments both in Hong Kong and China. The owner needed to move back to his home country, so I helped him to divest his public company, and I bought some of their properties. That is how I got started in the real estate business. In 1991, I started investing in Hong Kong and China, as well as in the US. At that time, I took advantage of the savings and loan crisis, bought properties from the Resolution Trust Corporation in Houston, as well as distressed assets in New York. In 1997, I believed there was a tremendous amount of speculation in the market — properties in Hong Kong at that time had a negative carry, the capitalisation rate was around 4 percent and the borrowing cost was nearly 7 percent. It was ubiquitously believed at the time that the mainland Chinese would flood the market with high demand and buy above market. As a result, I sold my properties. Wisely, the last asset I sold was in September 1997, prior to the emergence of the Asian Financial Crisis. But in 2002, I thought the market had bottomed and it was a good time to get back into the market. Benjamin helped to organise Fund I and joined me full time when we launched Fund II in 2004, and we started investing in Japan. It is not that we had a vision in 2002 that we were going to have a three-pronged strategy. Rather, it has been all about opportunities. The growth of Asia Pacific, especially the Chinese economy and the capital dislocation going on in Australia — we see a lot of opportunities, but it is a "special situation" in all parts of Asia. The market is not efficient, so we have been able to explore many ways to take advantage of the inefficiencies.

How would you characterise your investment philosophy?

Chu: First, we want to find the best sector to invest in, where there is the strongest demand and limited supply. Second, we want to buy cheap. We find different ways to buy below market — from nonperforming loans, distressed assets, to a variety of special situations. Most of our acquisitions are off-market deals, and we study different asset requirements, to decide whether redevelopment, renovations or even change of use would work best to maximise the returns for our investors.

Why do you focus on core-plus, debt and opportunistic investment strategies, specifically?

Lee: We have traditionally been in the opportunistic business. Starting about five years ago, we became very interested in investing in Southeast Asian markets such as the Philippines and Indonesia. We found special situations and opportunities to invest in debt that allow us to obtain returns of 20 percent or more. We are able to invest in US dollar–denominated debt that allows us to avoid the currency volatility.

Chu: We like the narrative of the rising middle class, young populations in Southeast Asia. One way to tap that is equity, another way is debt. Debt is a great way to understand a market from a prudent, risk-adjusted basis, and we are not taking any currency risks.

What do you see as the important trends in the Asia Pacific real estate markets?

Chu: There are a couple of megatrends: First, the China growth story. China GDP growth is now 6.5 percent; this is still a higher growth than the other major economies in the world. China is now home to the most billionaires, so that makes a strong demand for consumption upgrades and investment diversification. Secondly, tourism is growing in the APAC region. For example, in 2016, 25 million tourists arrived in Japan. 2017 is supposed to be closer to 30 million, and the Japanese government is targeting 40 million annually by 2020, and 60 million by 2030. A third major trend is the rising middle class in the entire region, which is providing opportunities in residential, office and other property sectors. The high-tech growth, especially in China and Korea, likewise creates investment opportunities.

You mentioned the financial dislocation in Australia. What is going on there?

Chu: There is a dislocation going on in terms of credit. In the past, there were many banks in Australia. Post all the bank mergers, there are only four major banks left in Australia after GFC. Historically, these four major banks accounted for around 65 percent of all real estate lending in Australia, but now the real estate lending for these four banks has increased to more than 83 percent. At the end of 2016, Australian Prudential Regulation Authority, the financial regulator in Australia, mandated the banks to cut real estate lending to the historical level of 65 percent. So there is a huge capital gap of around A$45 billion to A$50 billion needed to fund the real estate lending side. We saw this as an opportunity to raise a mezzanine debt fund.

How do you determine which properties and which countries to invest in?

Chu: Every year we look at more than 1,000 deals across Asia and Australia. On average, we make investments in six or seven deals. We are extremely selective. We have four major core markets: Japan, Hong Kong, China and Australia. The rest of the APAC markets, including Korea, Singapore, Indonesia or the Philippines, are more opportunistic for us. We seek out properties that deliver optimal risk-adjusted returns.

Lee: Generally, we are looking to invest in gateway cities. For instance, in China we look at Shanghai, Beijing and perhaps Shenzhen, because it is very important that, as we invest on behalf of institutional capital, we must be investing in markets that are liquid, transparent and represent a level playing field for both domestic investors and foreign investors. To the extent these cities pass these tests, the next thing we look for are the sectors with the best medium-term demand-and-supply fundamentals. Eventually, when we get to the asset level, we look for special situations.

What characteristics of a special situation would attract your attention?

Lee: The common characteristics of our special situations are: (1) Because of the special situation, the property could be purchased below market price, and (2) we can add value to the assets.

Chu: They come in different situations. For example: distressed sellers, bankruptcies, family feud, site assemblage, nonperforming loans, corporate divestments, etc. For example, we bought a relatively new grade A office building in Osaka, Japan, which we considered as a core asset, and sold it to a Tokyo REIT six months after we raised the rent to market level.

You have had experience investing elsewhere in the world, but now you are focused exclusively on the Asia Pacific region. Why?

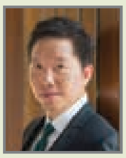
Lee: We look for competitive advantages. Asia Pacific is our home region, we know the region really well, and we are based here. In Asia, we have higher growth, less competition, and greater opportunities because of the rapid emergence of the middle class in big economies like China down to the smaller ones in Southeast Asia. Asia Pacific is really the region that has the best growth potential, compared to the US and Europe. We have a lot of opportunities to deploy capital, coupled with the fact that for 16 years now we have a track record of a perfect credit history — we never defaulted, even through the GFC. That has created an element of trust between us and a number of players in real estate that gives us access to opportunities and financing, which makes us very competitive in the marketplace.

Chu: Since we understand the markets very well, we can react very quickly, which gives us greater advantages. I believe the competition as compared to other regions is significantly less — for example, the number of real estate investment managers based in New York City alone is probably more than the whole of Asia Pacific investment managers combined.

A last word?

Lee: Most of our professionals are locals, but many of them are also Western trained. Many of us were educated in the US and worked for major international organisations prior to joining Phoenix. We are an SEC-registered investment adviser, so we understand very well the standard and the best practices that are expected of an organisation like Phoenix.

Samuel Chu
Co-Founder, Managing Partner and Chief Investment Officer
Phoenix Property Investors



Benjamin Lee
Co-Founder and Managing Partner
Phoenix Property Investors

CORPORATE OVERVIEW

Phoenix Property Investors

Phoenix Property Investors is an innovative independently-owned and managed private equity real estate firm. Founded in 2002, Phoenix has a successful track record of creating value and delivering attractive results for its investors and stakeholders by developing exceptional real estate investment opportunities in the residential, retail, office and commercial sectors across 12 first-tier, Pan-Asian cities, including Hong Kong, Beijing, Jakarta, Kyoto, Manila, Seoul, Shanghai, Singapore, Sydney, Taipei, Tokyo and Osaka. Phoenix has more than 160 talented specialists operating from seven offices in Hong Kong, Seoul, Shanghai, Singapore, Sydney, Taipei and Tokyo.

CORPORATE CONTACT

For more information, contact:
Investor Relations
+852 2589 3600
ir@ppinvestors.com
www.ppinvestors.com