KPMG
Private Enterprise

Spotlight on Family Offices

A newsletter series by KPMG China's Private Enterprise team sharing insights on developments in the family offices market

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Buy low sell high in the context of real estate investment for family offices

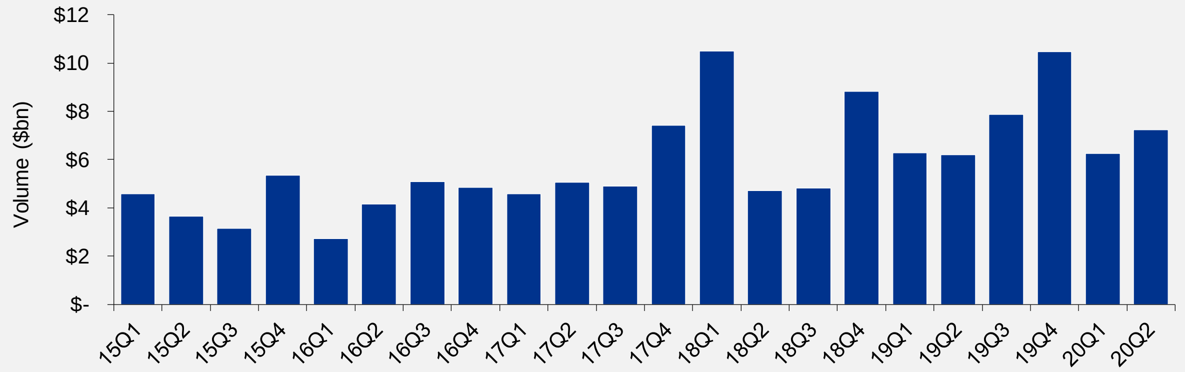
Opportunities in an uncertain market

2020 has been a year of turmoil for investors with COVID-19 being the biggest factor of uncertainty. In the real estate market, while most investors are busy dealing with asset management challenges in the wake of the pandemic, many are also actively looking for investment opportunities. The opportunities mainly stem from three emerging trends.

1. On the macro level, the property boom in many markets over the past decades means that the markets have been moving towards the peak of a cycle, with yields for many traditional property classes reaching historic lows. So far, the impact of the pandemic has put a halt to or even reversed this trend in many markets, creating cheaper entry tickets for investors who hold a long-term view.

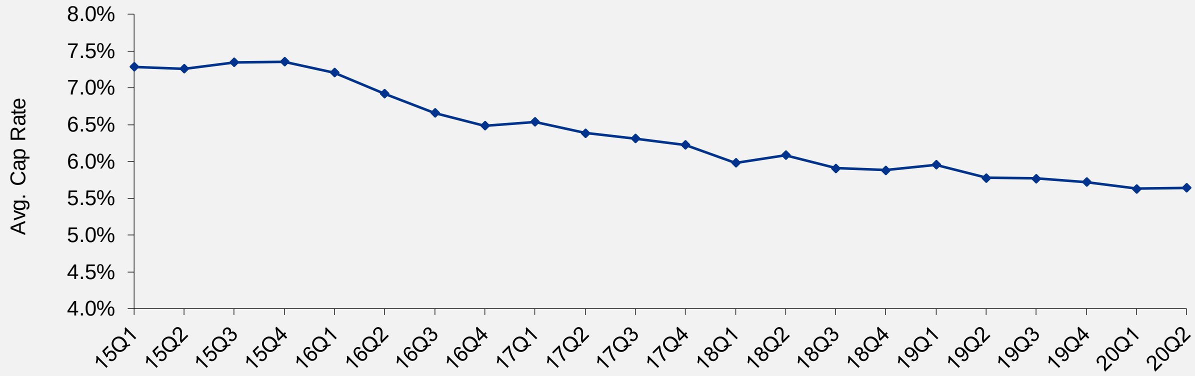
2. While many traditional asset classes such as retail have been hit hard in many markets, some sectors are expected to benefit from the disruption. Logistics properties are becoming even more sought after, even as the yield has compressed significantly over the past few years, thanks to the rise of e-commerce. According to Real Capital Analytics, annual investment volume in warehouse properties in Asia Pacific has increased nearly three-fold since 2016. Driven by booming demand for technology infrastructure, data centre assets are increasingly looked at by telecom companies, developers and investors alike, with total investments volume increasing more than five-fold over the past three years.

Asia Pacific Industrial Investment Volume



Source: Real Capital Analytics

Asia Pacific Industrial Cap Rate



Source: Real Capital Analytics

3) From a geographic viewpoint, the domestic property market in China is expected to benefit from the muted outbound investment volume, which has been on consecutive years of decline as capital controls tightened and the economy deleveraged. China's rapid recovery from the coronavirus also has become a pull factor for domestic and foreign capital.

According to Real Capital Analytics, China's real estate investment volume recorded a 95% YoY increase in Q2 2020, when the rest of the APAC was down by 67% and the world down by 51%. Office, retail, and industrial transaction volume in China all went up in the second quarter.

The value of real estate investments for family offices

Value creation and preservation

Real estate has traditionally been an attractive asset class for family offices thanks to its ability to generate stable income streams and to preserve value. The real estate boom in Asia over the past decades, on the backdrop of strong economic growth in the region, has also attracted private capital looking for value appreciation. In Hong Kong, real estate, private or public, has been a major component of the portfolio of many family offices.

Return spectrum

Real estate investment allows family offices to cover a range of investment strategies based on their risk and return appetite, from core to core plus to value-add to opportunistic. Direct real estate investment, particularly through core plus or value-add strategies, typically generates higher returns. But such investments usually require extensive ownership experience and broad market access. Family offices would usually "outsource" certain functions, such as deal sourcing and screening, market research, valuation and return analysis, to professional services firms, because they are usually a small team with limited research power. The outsourcing is particularly helpful in the current volatile market environment given the increased effort and time needed to manage existing investments and to identify and screen new investments.

A few observations on buy low sell high in the current market

Potential for capital growth has always been a major consideration for investors looking at real estate assets. Such growth is usually achieved through a combination of market upside and property level improvements.

On the market level, investors should search for sectors supported by favorable demand and supply dynamics

Over the past few years, we have seen forward-looking investors diversifying from traditional asset classes into emerging sectors, such as logistics, data centre, education and senior housing, where there have been trends of demand outstripping supply.

A unique factor to take into account for family offices that operate as the investment arm of the parent group is that some of the emerging property classes are more likely than traditional real estate assets to generate synergies for the parent business, such as logistic properties for distribution businesses and data centres for cloud computing service providers.

Opportunistic and value-add investors would sense a greater buying opportunity as the pandemic has forced underperforming assets onto the market when their owners are faced with cash drains. In the private market, investors are eyeing distressed assets with restructuring opportunities, such as those owned by over-leveraged developers or assets whose operations are badly hit for the time being, such as hotels, some of which recently transacted at as much as 30percent discounts to asking prices in Hong Kong.

When looking at a universe of assets, investors can typically find cheaper entry tickets for assets located outside of core urban areas where competition for prime assets pushes up prices and drives down yields. These assets located at the peripheral areas are more impacted by the economic downturn than their centrally located counterparts, while their long-term performance is still supported by the economic and demographic prospects of the core urban area, providing angles for core plus approaches such as improving space efficiency, or value-add strategies such as repurposing or redevelopment.

The lower entry price, coupled with upside income potential and capital appreciation, could produce a meaningful boost to returns.

How KPMG can help

Our clients have always found our one-stop services covering corporate finance, restructuring, due diligence and valuation and modelling helpful in identifying and executing potential investments. After the pandemic hit, we have recognized our clients' emerging needs and are striving to add value from multiple angles.

We have been engaged in more projects where we helped clients achieve cost savings under the current down market, such as re-evaluating and appealing for rateable value or benchmarking the rents the client is paying to the market level.

Valuations that are supported by in-depth market insights can also be used to support transaction pricing and narrow down the expectation gap between buyers and sellers, or to help crystalize the stabilized value of a distressed property.

We have also seen an increase in valuation engagements for financing purposes, with clients ranging from developers finding themselves short of capital during the downturn to investors ready to take advantage of the current low financing cost environment. Our real estate advisory practice allows us to help the client unlock the potential of their assets and achieve more optimized financing results.

When doing underwriting, investors should adopt a more holistic approach to factor in additional flexibility in costs for fixes / upgrades, changes in the capex schedule, projections of incremental cash flows, uncertainty in financing, alternative deal structures, etc. Such analyses need to be enabled by best-of-the-class financial models, which our team is skilled in building.

We have helped start-up family offices screen and evaluate assets and platform investments in mainland China, Hong Kong and other countries within and outside Asia, aided by sophisticated and agile models. For cross-border investments, our cross-disciplinary expertise and global network has given us abilities to offer one-stop services and to make meaningful contributions to our family office clients across multiple stages of their acquisition and asset management cycles.

KPMG Private Enterprise

Drawing on our knowledge and experience in audit, tax and advisory, the KPMG Private Enterprise team helps FOs as they address sustainable corporate governance, risk management, asset protection, tax compliance and much more.

We hope you find this newsletter insightful, and we look forward to supporting your needs. Please reach out to us if you wish to discuss further.

If you have any questions about the matters discussed in this publication, please feel free to contact us.

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