Aumentando o capital imobiliário em larga escala de investidores oportunistas de valor profundo no exterior

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RESUMO

Este documento é agnóstico de mercado, o que significa que é aplicável a qualquer mercado emergente e está focado na mentalidade do investidor. Seu objetivo é fornecer aos buscadores do capital uma janela para a mentalidade do investidor. Muitas vezes, particularmente em mercados fora dos EUA e da Europa, os gerentes de ativos imobiliários e desenvolvedores geram uma oportunidade de investimento interessante e depois saem e encontram capital. O objetivo deste documento é que os gerentes de ativos imobiliários emergentes e os desenvolvedores de mentalidade de investidores aprendam a trabalhar de maneira colaborativa com os investidores globais para gerar e fechar oportunidades de investimento. Alem, este documento fornecera aos gerentes de ativos imobiliários de mercado emergente e aos desenvolvedores de investimentos um roteiro de como pensa o investidor global em grande escala de valores profundos. A hipótese é que os gerentes de ativos imobiliários nos mercados que estão passando pela transição são melhor atendidos como organizações de desenvolvimento de produtos para um cliente grande e específico: o investidor global oportunista. Este documento irá abranger os cinco W's que aprendemos nos EUA na escola primária. Quem? O que? Onde? Quando? Por quê? E, claro, o mais importante, como? A metodologia deste relatório não é pesquisa secundária baseada em pesquisas ou já pesquisadas. Baseia-se em pesquisas primárias, como entrevistas com investidores estrangeiros e desenvolvedores locais. O autor é um participante e facilitador ativo das estratégias descritas neste documento. A pesquisa conclui que, neste momento, o ciclo, existem enormes oportunidades para os gerentes de ativos imobiliários e os desenvolvedores de investimentos que trabalham em um formato colaborativo com investidores globais de grande valor global.

Palavras-chave: Mercado Emergente, Imobiliário, Investimento, Brasil, Oportunista

Raising Large-Scale Real Estate Capital from Opportunistic Overseas Deep Value Investors

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ABSTRACT

This document is market agnostic, meaning that it is applicable to any emerging market and is focused on the investor mindset. Its objective is to provide seekers of capital a window into the mindset of the investor. Often, particularly in markets outside of the US and Europe, real estate asset managers and developers source an interesting investment opportunity and then go out and find capital. This document's objective is for emerging market based real estate asset managers and investor mindset developers to learn to work in a collaborative way with global investors to source and close investment opportunities. In addition, the document will provide emerging market real estate asset managers and investment minded developers a roadmap of how the global large-scale deep value investor thinks. The hypothesis is that real estate asset managers in markets that are going through transition are better served to think of themselves as product development organizations for a large and specific customer: the opportunistic global investor. This document will cover the five W's that we learn in the USA in elementary school. Who? What? Where? When? Why? And of course the most important, how? The methodology of this report is not secondary research based on published or already researched. It is based on primary research such as interviews with foreign investors and local developers. The author is an active participant and facilitator of the strategies outlined in this document. The research concludes that, at this time the cycle, there are tremendous opportunities for local real estate emerging market real estate asset managers and investment minded developers who work in a collaborative format with large scale global deep value investors.

Keywords: Emerging Market, Real Estate, Investment, Brazil, Opportunistic

1. INTRODUCTION

What is "deep value real estate" investing? Think of it as buying a dollar for fifty cents. It is an investment orientation that focuses on the following: one, protection of principal; two, purchasing assets with a significant margin of safety; three, the ability to achieve significant returns; four, purchasing assets below replacement costs; five, purchasing assets below fair market value in an orderly sale process.

These deep value investors currently have strong interest in Brazil based on its unique situation in 2017 and 2018.

2. WHO ARE THESE OPPORTUNISTIC DEEP VALUE INVESTORS?

To understand who global opportunistic deep value investor are, it is important to know who they are not.

2.1. The Deep Value Investor is NOT the Momentum Investor

We find momentum investors when the economy has turned. Things are getting better and there is positive press. These investors are highly motivated by a positive trend in pricing and demand. This investor is often very comfortable with development risk. Often this investor will desire to build a very, very close relationship with the local sponsor and they are "long-term" oriented. This investor will likely hire a local team and staff an office as well in their target market. They will stop by your office to get to know you as they believe that time is on their side.

During the last cycle in 2005 to 2013, this momentum investor did not hedge the currency. Much of this type of investor's return depends on a well-timed exit of the currency trade before the party ends. The investors that are large-scale at this level tend to live off of fees and assets under management.

In the last real estate cycle of Brazil, the investors that were able to quickly get in and get out with good timing did very well. However, from a US dollar perspective many were crushed on currency. These investors are the easiest for the Brazilian sponsor to reach and to interact with as their underwriting practices are less rigorous and they are more optimistic in outlook.

Many of these investors have left Brazil based on the downturn. The same group of investors active last real estate cycle will not return even when the economy turns and there is positive press. Their returns and experience were extraordinarily negative. However, there will be another group of "happy" investors that come to Brazil. This group has nothing in common with the opportunistic deep value investors that are prevalent in Brazil at this time.

2.2. The Opportunistic Deep Value Investor is NOT the Sovereign Wealth Fund with an Office on Faria Lima or Cidade Jardim

Sovereign Wealth Funds make a decision to be in-market indefinitely. These investors are extremely smart and possess top-tier staff and resources. These sovereign wealth funds will usually seek to partner with the largest operators in the market. Everyone goes after this capital, particularly if the sovereign wealth fund is staffed by local team with deep and relevant experience in the local market. Importantly, this type of group is long-term committed to the country's real estate market and their urgency to execute a trade or a specific strategy is usually less than deep value investors based on their long-term perspective.

2.3. The Opportunistic Deep Value Investor is NOT the Local RE Private Equity Fund

Local real estate private equity funds are exactly that: local and active in the real estate market in Brazil. These groups raised money from overseas investors, usually North American and European pension funds and often have money from Asian or Middle Eastern pension funds. In Brazil most of these funds were started in the 2006 to 2008 time frame and raised based on a Brazil story that included an investment-grade rating, demographic boom, commodities supercycle, and Brazil serving as the darling and poster child of the emerging markets. Remember the good old days!

These investors are smart, very local, and tend to be active in all parts of the cycle. Importantly, for local real estate asset managers and sponsors, these investors are actually competitors for mid-sized opportunities. In addition, these firms, over time, often vertically integrate. They do not "need" the local real estate asset manager to execute an investment. These investors are not interested in focusing on one sponsor per trade but want to maximize their platform in Brazil as this is their focus.

3. DEEP VALUE OPPORTUNISTIC INVESTOR - THE INVESTOR WHO ONLY SHOWS UP AT CERTAIN TIMES IN THE CYCLE

A very special type of investor shows up when things are uncertain, liquidity is low, and valuations are down. This investor has a "deep value" orientation. This investor is very analytical in nature and is completely location agnostic. This investor does not "bet" on Brazil but is more focused on a specific time in Brazil's real estate cycle, a particular asset class, and a purchase below replacement value with a significant margin of safety. This investor is very motivated to buy existing assets and is wary of the word development unless under a strongly proven demand scenario. The investor is also highly data driven and will want and need to prove all assumptions. He will invest when everyone is either running towards the exits or standing still waiting for things to improve.

Importantly, this investor provides an opportunity for a real estate asset manager to change their platform in a larger way than the other types of investors. Why?

- This investor is willing to commit large-scale capital rapidly.
- This investor tends to have the best reputation and the highest credibility with institutional investors.
- Executing a trade with this investor provides tremendous credibility with the "Happy Investor" when the cycle returns.
- This investor will usually only partner with one sponsor during the trade, therefore limiting competition and encouraging rapid scale in the relationship.

Given that Brazil's current situation matches this global opportunistic investor's sweet spot, what types of investments are of interest?

- Existing Cash-Flow-Producing Assets
- Yields 150 bps to 250 bps above what assets are trading in an orderly exit
- Scale
- Below replacement cost
- Opportunity to gain from cap rate compression
- High unlevered returns of 20%+
- Unnatural Large-Scale Events, Forced Sales
- No development risk, development risk will require proven demand
- Long-Term Leases or Unnatural Stickiness of Assets

This investor desires a documented track record in the sector of focus and can move relatively fast, 60 to 90 days. They desire to move fast in and out of markets as they are likely to sell as the situation improves. This investor's orientation is medium, not long-term.

4. WHERE: ON WHICH COUNTRIES DOES THIS INVESTOR FOCUS?

It is important to note that these opportunistic investors do not have a location mandate. These investors seek the best risk-adjusted return wherever it can be had. What this means for the local sponsor is that the transaction is in competition with global investment opportunities.

For example, the momentum investor in 2011 and 2012 was predicting a relatively stable Brazilian Real environment or predicting that the nominal IRR returns would cover the currency variation. This did not work. This current wave of investors will be factoring in the cost of hedging, which investors currently model at 6% to 8% IRR per year.

Hence, currently investments conservatively must underwrite to an unlevered nominal IRR of at least 20%. These investors will struggle with regions outside of the state of Sao Paulo (preferably Metropolitan Sao Paulo) and the state of Rio de Janeiro (preferably Metropolitan Rio de Janeiro). To be clear, that great BTS or Sale-and-LeaseBack from a top-tier client that you found in Fortaleza is not the transaction to start a relationship with an opportunistic investor. If they do not invest in Kansas City, it is unlikely they will invest in Fortaleza, at least as a starting point in Brazil.

4.1. When: Be Fearful when others are Greedy, and Greedy when others are Fearful

Not one of these opportunistic investors even glanced at Brazil during Brazil's boom. They were extremely nervous that assets were overpriced. They did not see the productivity growth to justify investors' expectations. The opportunistic deep value investor felt that the currency was overvalued. Most importantly, assets were not cheap. During the boom period, those who came to Brazil believed that Brazil was perhaps the next South Korea or Singapore. They believed it was a country that perhaps had a chance over the next twenty years to go from middle income to rich nation status.

The opportunistic deep value investors only arrive when the local investors, particularly the retail non-professional investors, are most fearful. For example, there is still a significant amount of Brazilian wealth that believes that NTN-B at the current high yields is a better bet than real estate investments. In addition, the REIT market is effectively closed currently. Finally, the bank credit market at this time remains restricted. Although the forward yield curve shows improvement and inflation has gotten under control, there is still caution in the air.

This is the moment, quite honestly perhaps the only moment, when large-scale opportunistic deep value investors enter the market.

5. WHY DO THESE INVESTORS BEHAVE THIS WAY? GROWTH VS. VALUE INVESTMENT STRATEGIES

Growth investors are also more comfortable with ground-up new development strategy and are much more comfortable to determine the potential future value of a property. The current value of an existing asset is less important than the potential future value of assets to be developed. There is nothing wrong with this approach and it has been successful for several investors.

Value Investors, particularly for the real estate investor group, focus on the mispricing of assets. In real estate, this is usually tied to a liquidity crisis given real estate's high capital component.

Value investors in general stay consistent to their investment theme. They are extremely price disciplined and will not stretch to close a deal. Once a value investor starts stretching above the intrinsic value, their investment approach does not work and they walk away from the deal.

6. HOW TO RAISE MONEY FROM THESE DEEP VALUE INVESTORS - AVOID THE TOP TEN MISTAKES!

6.1. Return Expectations- #10

Money is global and goes to the place with the highest **risk-adjusted** return. Risk-adjusted return is the key term. No large-scale opportunistic investor is entering Brazil to achieve an unlevered nominal return that is not at least 20% IRR. Why? That investment is competing with all the other investment opportunities in the world, Europe, USA, Australia, Argentina, etc. and in currencies with significantly greater stability.

Currently, hedging, a necessary action to convert Brazilian real returns to USD returns, lowers Brazil nominal IRR returns by 600 bps to 800 bps per year according to large-scale investor estimates. For value-added acquisition strategies, the returns unlevered need to be 20% to 25%++. This creates a dollar unlevered return post hedging well north of 10%. which is the absolute minimum for investors currently interested in Brazil.

A 15% to 19% unlevered nominal return transaction in Brazil has very little interest from large-scale investors currently.

Action Plan: Seek Transactions with Unlevered IRR returns of 20%+

6.2. IRR vs. Total Profits- #9

In Brazil, debt is used to lower the equity need. However, given the high cost of debt at this time it is often not net accretive on a real basis (the leverage cost is often higher than the actual yield). For example, on many BTS transactions the objective is to lever the transaction as much as possible to achieve the highest IRR and lower the capital needed.

Correspondingly, the equity size is very small and the potential profits are very small (even with a large IRR). There is very little interest from opportunistic investors in opportunities that do not generate at least US$15M to US$20M in **profits.** Leverage actually lowers this actual profit number.

Action Plan: Only Seek Leverage in two cases, one, single assets of significant scale; two, a portfolio of assets that together provides scale.

6.3. Investment Thesis Match- #8

Changing large-scale opportunistic investor behavior is difficult if not impossible. For example, a Brazilian real estate asset manager may believe that now is the right time to buy raw land pre-approval or residential units in mid construction and generate an investment opportunity based on that strategy. This actually could be very accurate and the right strategy.

However, most opportunistic investors looking at Brazil now are focused on the forward yield curve (current income-producing assets) and how a potential tightening capitalization rate can create substantial value. Hence, before even talking about a transaction with an investor, if a sponsor pursues a strategy whose investment thesis the investor has not bought into, there is a fundamental disagreement before the conversation even starts.

Action Plan: Verify the investor has interest in the strategy before sending an investment proposal. A sponsor seeking capital may have to discuss and attract interest in the theme of the investment first before talking about the specific investment opportunity.

6.4. Push vs. Pull- #7

The usual method an emerging market real estate asset manager would use to start looking for capital would be to find a great deal and then go find money. Basically, this is a push strategy. If the asset manager is lucky, the asset he has found matches the investment thesis of a large-scale global investor. Great! If not, the real estate asset manager will start to "push" this transaction onto an investor, usually with a nice PowerPoint (we will cover PowerPoint fundraising in another newsletter soon to come). Once an asset manager starts this approach of pushing a deal, there is a tendency to "double down" and ignore investor feedback and keep pitching "the idea."

A pull strategy, finding opportunities that investors seek, requires a deeper investor relationship, humility, and time, or a strategic partner that is already in constant touch with these investors. Open dialogue about what is of interest to an investor is where all strategies need to start. Importantly, a pull strategy can result in investor interest in looking at deals **with** the asset manager. That is when things truly get exciting.

Action Plan: Find methods to develop relationships with investors before you need capital. This development of an investment theme with firms that assist in this investor pre-selling work is vital.

6.5. Lack of Proprietary Deal Flow - #6

Deep-value investors tend to avoid competitive auctions. Why? Because a significant part of the value creation of this deep value investor is an actual mispricing. An auction by its very nature tends to reduce this mispricing opportunity. Hence, without proprietary deal flow there is little chance to achieve a price that justifies global investors' return expectations. Showing a pipeline to an opportunistic investor where each asset is a competitive auction is largely a waste of time.

Action Plan: Source proprietary deals no matter what is required. Avoid professional auctions for these type of investors as it will waste everyone's time.

6.6. "There are No Comparable Transactions" - "Believe Me" - "Voodoo" and Other Forms of Mysticism and Magic - #5

Often Brazilian investors and family offices, due to their local knowledge, will not ask for comparable transactions to determine the value of an asset. Comparable transactions are actual transactions that occurred in the last two years with similar quality asset types and in similar regions. This provides a factual basis for comparison. Deep-value investors do not want opinions of value but actual proof. Proof is defined as money moving from an investor's pocket to a seller's pocket to purchase a similar asset in a relatively recent timeframe (2 years).

Therefore, when a large-scale investor asks for comparable transactions, a Brazilian asset manager will assert that it is difficult to find but that they "believe" that X is the market price. This is the definition of mysticism and Voodoo to an opportunistic investor.

This type of response will not attract capital from large-scale opportunistic investors. Global investors understand that information quality in Brazil is not at the level of NYC or London. However, to provide no comparable transactions and expect a "belief system" or "feeling" to convince an overseas investor is not too different from telling the investor that a fortune teller in Centro Sao Paulo told you the value of the asset. Opinions are worthless. All that matters is facts to prove value, that is comparable transactions.

Action Plan: Build data sets of comparable transactions. No excuses, if you have to go to the cartorio and build the information from scratch then do it. If you have to pay for the data then do it. No excuses.

6.7. Pipeline and Scale - Is it worth the Investor's Time - #4

While each deal does not need to be US$50M to US$100M, the investment opportunity needs to have this type of scale. For example, if a real estate asset manager is in discussion with three assets that are each US$15M dollars and the assets are not professionally auctioned, this is a conversation. Trying to find foreign capital for less than US$15M is not a productive use of time for all parties involved.

Action Plan: Think Big or Go Home! Go after larger transactions minimum equity need US$15M

6.8. Skin in the Game - Local Sponsor Capital Missing in Action - #3

A large-scale opportunistic investor will require control well over 50%; however, very few successful large-scale investors have become successful investing in transactions far from NYC, Boston, Los Angeles, or London without some local sponsor capital showing alignment and proof of concept. A 10% commitment of capital will provide proof of alignment and keep investors interested. Investors are not as concerned that all of the capital comes directly from the sponsor's pocket, but the investor does need to see a significant commitment from local capital.

Action Plan: Source local capital from family offices, if necessary share sponsor promote. Alternatively find firms that raise capital and also co invest.

6.9. No Direct Experience In Target Sector - #2

Often a real estate manager or developer will have deep experience in one sector, perhaps residential but then decide to build a strategy in another sector, perhaps logistics. Although everything works on paper, this lack of direct experience in the sector, particularly if a new partner with that direct experience is not immediately recruited, will often cause problems in due diligence, the bid strategy, or the ability to source proprietary transactions. If a sponsor wants to change strategies, it is best to bring in a partner or an executive with significant experience in the target sector. No one wants to invest capital of scale for someone to try a new sector.

Action Plan: Start with what you know. Period.

6.10. Process and Procedures - Work Style Method - #1

A large-scale global investor has processes and procedures. During the investment process and due diligence, the local sponsor is actually demonstrating its capability to execute. Sourcing a good deal is only the beginning. It has been our experience that the best sponsors have some type of internal task management system ***before*** engaging foreign capital. If the sponsor does not have this type of system, it is highly recommended to either start using one or, in InDev Capital's case, we can create a system to track all of the tasks because dropping the ball after having investor interest can change the investor's perception of the management team and make it more difficult to close a transaction.

Action Plan: Get Organized and if you are not, find someone to help you get organized.

7. CONCLUSION

Emerging market real estate asset managers and investment minded developers have a unique window of opportunity currently. In some special situations assets are mispriced and a rapid deal closing along with a 100% cash offer from a large-scale investor can make a difference to execute a transaction.

Understanding the investor mindset and avoiding the mistakes that usually occur by emerging market real estate asset managers and investor minded developers seeking capital can really help local sponsors close large scale at this unique period of the real estate cycle.