



“THERE ARE QUEUES AND IT MAY TAKE NINE TO 12 MONTHS TO GET CAPITAL DRAWN DOWN. AT UBS, WE’VE BEEN APPROACHING FUND MANAGERS WITH EXISTING STABILIZED REAL ESTATE PORTFOLIOS AND WORKING WITH THEM TO CREATE NEW OPEN-END CORE FUNDS.”



MATT JOHNSON

Head of Multi-Managers
Real Estate Americas, Portfolio Manager
and Managing Director,
UBS Asset Management



AS THE PORTFOLIO MANAGER OF A GLOBAL REAL ESTATE FUND WHO HAS TOURED COUNTLESS PROPERTIES AROUND THE GLOBE, DO YOU HAVE A FAVOURITE BUILDING?

I have a favourite story about a building, 151 Front Street West in Toronto. It is not an aesthetically pleasing building, but it is a great asset. When I toured it, Northam Realty Advisors Limited owned it. It’s a data centre that they bought in 2003 from a distressed owner for about CDN\$72 million. The building’s location is ideal for a data centre. It is along the

rail line where the coaxial cable was laid and near two power grids so if one power grid goes out the other power grid can service the building. It also uses water from Lake Ontario to help cool the building, which lowers the cooling cost. The building was producing around an 18 percent cash yield. Northam sold the building for more than 2.5x the purchase price. My understanding is that the building is worth more than CDN\$400 million, so it has continued to perform well. It’s a great example of “don’t judge a book by its cover.”



WHAT’S THE TOP CHICAGO EXPERIENCE YOU RECOMMEND TO OUT-OF-TOWNERS?

Chicago Architecture Foundation River Cruise.



WHAT’S YOUR GO-TO APP?

Fabulous: Motivate Me (www.thefabulous.co).

THE PERFORMERS

✕ CANADA’S INFLUENTIAL THOUGHT LEADERS ✕

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MATT JOHNSON FIRST SHARED HIS PERSPECTIVE ON GLOBAL REAL ESTATE WITH THE PERFORMERS IN JUNE 2016. WE’RE FOLLOWING UP NOW TO FIND OUT HOW RECENT DEVELOPMENTS ARE AFFECTING INSTITUTIONAL INVESTMENT OPPORTUNITIES IN THIS SECTOR.

How did the past year compare to the way you thought things would shake out in real estate?

We expected certain areas to do well, and property-level returns for Continental Europe, Australia and the industrial sector in Japan did perform strongly. The U.S. was more resilient than we expected, though returns for the core real estate fund index, the NFI-ODCE, moderated from double-digit returns experienced since 2010. We didn’t expect the Brexit vote or Trump presidency, but to date the impact on real estate hasn’t been severe.

What was the effect of the post-Brexit decline on the value of the British pound?

The U.K. currency took a big hit right after Brexit, and there were a lot of outflows from retail real estate funds that made headlines. Institutional real estate funds didn’t have the same experience. We saw some write-downs on the values of their properties, but they came back fairly quickly because foreign buyers were attracted to the 15 to 25 percent currency discount and remained long-term bullish on London. By the end of the year, institutional funds were again trading at a premium to their net asset value [NAV].

Last year, you highlighted opportunities in Continental Europe, Australia and Japan – are these still areas of focus?

Continental Europe is still interesting to us. We’re watching elections there,

and navigating the challenge that many funds are structured specifically for local institutional investors. We still like Australia, though the interest rate differential drives up our foreign exchange hedging costs. Japan is less appealing now. We’ve liked industrials in Japan, but are cautious about the supply coming online in 2018. We have seen an increase in Japanese investors looking to invest in real estate outside of Japan as well.

Is there sufficient core real estate available globally to meet institutional investors’ increasing demands?

UBS estimates there is USD\$400 billion worth of open-end core real estate funds globally, and growing. Some funds restrict investment to certain investors, so that narrows the universe to USD\$250 billion to USD\$300 billion – but that’s still a very large universe. However, there is also a lot of demand for core real estate right now, particularly from investors in countries with a negative interest rate environment, so there are queues and it may take nine to 12 months to get capital drawn down. At UBS, we’ve been approaching fund managers with existing stabilized real estate portfolios and working with them to create new open-end core funds. For example, we participated as a founding investor in Colony NorthStar’s industrial open-end fund. Our clients benefit because, as a founding investor, we get a lot of capital deployed right away and we benefit from attractive founding investor economics.

How is UBS responding to increased discussions of co-invest and secondary strategies for real estate?

We’ve done a number of co-investments for our separate account clients, and we are active in secondary trading in the core space to mitigate transaction costs associated with investing in funds in Europe and Asia. We haven’t done co-investments in our global open-end core fund of funds vehicles as we want to maintain as much liquidity in those vehicles as possible. With co-investments you normally don’t control the exit, so they are less liquid positions. Also, co-investment opportunities normally require a quick decision. We plan to roll out a discretionary fund that would focus on co-investment and secondary opportunities. Since we will have discretion over the vehicle we will be able to respond quickly to the many co-investment opportunities we see.

How is the interest rate landscape affecting your investment decisions?

The biggest way we’re impacted by interest rates in our vehicles is through the costs of foreign exchange hedging. When we’re considering investing in a country like Australia, with a big interest rate differential to rates in Europe, Switzerland, Japan, etc., the added cost may be 200 basis points or more. Even if you are looking at net returns of 9 percent, that 200 basis points of FX cost makes the investment less attractive.

