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INVESTING IN REAL ESTATE

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The global real estate market is diverse and dynamic. In the U.S. alone, the estimated value of the commercial real estate market is between US$14 and 17 trillion. The market is enormous enough to accommodate a number of investment strategies with their respective benefits and risks.

Through this paper, we hope to provide you an overview of real estate investing and the rationales behind the approach that Acies adopts.

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Investing in Real Estate

What is Real Estate?

Real Estate, in essence, is tangible property. It consists of land and the buildings on it, along with the underground rights below the land.

Investors generally divide real estate investment into two categories: commercial and residential. Commercial real estate is created to produce income, which include office, retail, logistics, warehouse, self-storage and rental apartments. On the other hand, residential real estate is created to provide dwelling space for individuals and families, which comprises condominiums and single-family and multi-family homes.

The global real estate market is enormous, while the U.S. commercial real estate market alone is estimated at US$14-17 trillion.

Why investing in Real estate?

Real Estate, as an asset class, is widely recognized as an investment vehicle that delivers passive rental income, superior capital appreciation, inflation protection, and low-to-moderate correlation to other asset classes.

1) Passive Income at Lower Volatility

Due to the rental-generating nature of real estate, real estate investment generates passive cash flow income for investors. The income return is generally around 5-10% across all property types. One key benefit of this type of return is its low volatility compared to other income sources.

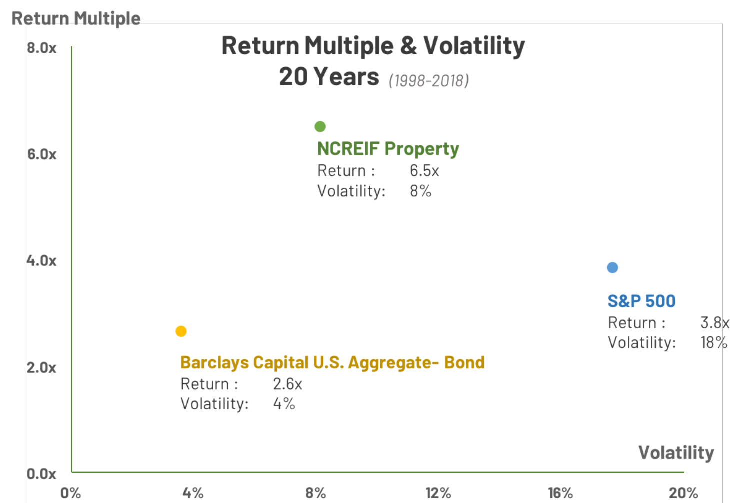
According to the Federal Reserve Bank of San Francisco publication – The Rate of Return on Everything - volatility, as measured the by standard deviation of rental income, is 2.0%, while that of other type of investment is 10.4%.

2) Long -Term Superior Capital Appreciation at Lower Volatility

Apart from rental income, capital appreciation is another source of investment return in real estate.

Capital appreciation is the increase of an asset's market value, relative to its purchase price or cost basis. The NCREIF Property index (as noted in table 1) clearly demonstrates the superior capital return delivered by real estate sector.

Table 1: Return Multiple & Volatility – 20 Years (1998-2018)



Source: Acies Research

3) Inflation protection

The value of real estate generally increases as inflation climbs.

The value of real estate is generally decided by two critical components: its ability to generate net positive cash flow, and the capitalization rate used to discount future cash flows from the underlying property.

When inflation incurs, rental incomes increase along with the capitalization compressed. As a result, the value of the real estate increases.

Generally, inflation and interest rate have an inverse relationship. When the interest rate is low, the economy grows and inflation increases. Interest rates in the United States have hovered at a historical low for a multi-year period, with the 10-year treasury remaining below 2.5% for several years. Recently, due to the COVID-19 pandemic, the U.S. central bank said it would maintain its current interest rate target between 0% and 0.25%.

With these low interest rates, we expect rising inflation in the next few years, ultimately leading to higher asset price.

4) Diversification

Real Estate, especially private real estate, has historically displayed a low correlation to stocks and bonds. It rises and falls well after the rest of the economy.

This characteristic of real estate makes it an ideal investment option when investors think about their portfolio strategy and capital allocation.

Table 2: Correlation matrix- Annualized Return, 20 Years (1998-2018)

Correlation (Annualized Return) 1998-2018	S&P 500	Barclays Capital U.S. Aggregate	NCREIF Property
NCREIF Property	0.18	(0.04)	1

Source: Acies Research

How to invest in Real estate?

Investors have many options when investing in real estate assets. And the offerings differ in terms of its risk and return profile. We will exam these offerings one by one.

A) Real Estate Investment Trusts (REITs)

REITs can be in both public and private forms. By law, they are required to distribute at least 90% of their taxable income as dividends to their investors.

Most investors are familiar with publicly-traded REITs. They typically own high quality properties and are professionally managed. These REITs have access to capital markets for debt and equity financings, which generally allow them to benefit from a lower cost of capital.

Returns & Risks – Public REITs

Public REITs trade on an exchange, and they are the most liquid form of real estate investment. As they are public, they are required to provide timely report of their activities and financial results.

These pubic REITs are suitable for investors seeking indirect and/or passive investment to institutional-quality, professionally managed real estate with daily liquidity.

The dividend yield of majority of public REITs falls between 5-7%. According to the MSCI US REIT index, the REITs generated 10.6% per year since 1995.

Meanwhile, it is generally believed that there are three major downsides related to public REITs:

1) High-Correlation with the Stock Market
   As public REITs are traded at the exchange, their performance historically moves together with the general trend of the market.
2) Higher Volatility
   Because they are exposed to the equity market, return volatility is increased.
3) Valuation Uncertainty
   Over the past several decades, REITs generally have been traded -20% to +20% of its underlying net asset value (NAV), depending on the market situation. The capital market exposure adds another layer of uncertainly to REITs' valuation in addition to

the value of assets owned by REITs. When REITs are traded at a premium to their NAVs, investors are betting on the strength of the management and its ability to grow the REITs in the future. When REITs are traded below, investors are betting that the future of the REITs will be worse than what its current NAV suggests.

Returns & Risks – Private REITs

Private REITs are generally issued to accredited investors in private.

As its name indicated, these REITs are not publicly traded and can't be liquidated daily. However, because of private issuing, private REITs are not exposed to the volatility of the public market.

The NCREIF property index is a good indicator of private commercial real estate value. As demonstrated in Table 1, private REITs deliver higher return at a lower volatility, as compared to S&P 500.

B) Direct Real Estate Investment

Another way to own real estate assets is direction acquisition. This often requires established networks and costly infrastructure to start asset acquisition. For the majority of investors, access to financing, market intelligence and deal work are all challenging.

Returns & Risks – Direct Real Estate Investment

As direct real estate investment is privately owned, we believe that the aggregate return of this category of investing should fall in line with the NCREIF property index, which delivers higher return at a lower volatility, as compared to S&P 500.

However, depending on each individual investor's' experience, knowledge, and skill in acquiring, negotiating and managing assets, the investment return on individual deal could varies dramatically from deal to deal.

In addition to the risks mentioned above, other major risks include:

1) Disproportionate concentration
   The investments and corresponding risks are concentrated in a few large transactions, given the limited resources owned by most direct real estate investors.

2) High Cost of Investing and Operation
   Via direct investing in real estate, the cost of investing and operation is high mostly because its lack of scale can make it hard for investors in this category to source

the most cost-effective solutions at each step, from acquisition to asset management services.

3) Illiquidity
Compared to public REITs, direct real estate investment is illiquid. Moreover, the sales process is long and sometimes unsuccessful.

C) Private Real Estate Investment Fund

Investors can also participate in real estate investment via private real estate investment funds. Such funds typically pool the capital of investors and hires professionals to pursue a specific investment strategy for superior investment return.

The fund normally has a fund life of seven to ten years. In its first two to four years, fund managers focus on asset acquisitions. After that, active management is carried out on acquired assets in order to increase asset value. The holding and liquidation periods vary depending on the market situation and investment strategy. At the end of the fund life, all assets are sold. Realized profits are then distributed to investors and fund managers. With certain investment strategies, periodical income is distributed out to investors while the fund is active.

The fund manager is typically paid a management fee for managing the assets and has the right to earn an incentive fee (also called "carried interest"). In this case, investors and fund managers have a mutual agreement on the hurdle rate, beyond which carried interest can be distributed.

Investment Strategies: a) CORE, b) VALUE-ADD, and c) OPPORTUNISTIC

In private real estate investment, there are three main investment strategies: CORE, VALUE-ADD, and OPPORTUNISTIC.

These three strategies differ from each other in terms of exposure to leasing and development risks, along with the different level of embedded leverage. With a riskier strategy, a greater proportion of returns are expected to come from capital appreciation.

Table 3: Perceived Risks & Return

Source: Acies Research

a. CORE

The core strategy is generally perceived to be of lower risk and return. Fund managers employing core strategy acquire fully or almost fully stabilized assets with low to moderate leverage, usually around 40% or less.

The majority of the expected return is likely to be generated through cash flow from the property, rather than from appreciation. Numerically, the Investment return objective of CORE strategy is CPI + 3% per year over the long-term.

b. VALUE-ADD

The value-add strategy is generally perceived to produce mid-level risk and return. Fund managers employing value-add strategy identify and acquire assets that can be improved to deliver higher return, applying a leverage between 40% and 70%.

The value-add strategy tends to generate annual returns between 10% and 15%. The execution of the value-add strategy depends on highly skilled fund managers who can identify and realize value creation opportunities.

For many investors, value-add projects provide a good balance of risk vs. return, which offers cash flow income, with upside potential in the form of value appreciation.

c. OPPORTUNISTIC

The opportunistic strategy is generally perceived to produce high-level risk and return. Fund managers employing opportunistic strategy identify and acquire assets that need significant rehabilitation in order to realize their potential, applying a leverage between 60% and 90%.

If opportunistic business plans are successful, they generally achieve higher returns than core or value add strategies through substantial appreciation in value. An opportunistic type project is generally expected to deliver annual return of 15% or more.

As the improvement plan under this strategy tend to be much more complicated, the experience and skills demanded from the fund managers are at a much higher level.

Acies's Approach to Real Estate Investing

As an investment firm with a deep root in operation, Acies thinks of "buying low and selling high" differently.

The global real estate market is enormous. And the commercial real estate market of the U.S. alone is estimated at US$14-17 trillion. **In such an enormous market, Acies choose to focus on where our operational expertise adds most value.** Based on our senior executives' operational background in the logistics business and real estate development, **we specialize in logistics real estate.** This way, we have the highest possibility delivering superior performance with less-than-commensurate risk.

Specifically, we pursue real estate investment opportunities by levering three layers of our expertise and capacity:

Operational Expertise in the Logistics Business

The value of logistics property comes from its abilities to serve logistics business. To identify under-valued logistic property with potential, it means discovering opportunities in improving the property's abilities to serve logistics business.

The logistics business, in itself, is very dynamic and local, as its available capacity and shipping rates change on a daily basis. As senior executive at Acies has been operating in the logistics business for more than two decades, we understand the nuances of the industry first-hand. That gives us an edge, compared to most typical financial investors in identifying under-valued assets and discovering "hidden gems".

As discussed earlier in the paper, buying low is of paramount importance at Acies because a margin of safety is a built-in cushion to deliver superior return in both good and bad times.

Real Estate Development Expertise and Network

Identifying value-add opportunities is not enough. The ability to plan and execute value-add activities is of no less importance than identifying them.

At Acies, our senior executives also have more than two decades' experience in real estate financing, construction, and development. With in-house expertise, Acies is able to evaluate financial and operational feasibilities in value-add opportunities as early as the due diligence stage.

According to McKinsey research, 98 percent of megaprojects suffer cost overruns or delays. The average cost increase is 80% of original value, and the average additional time is 40% of its original plan. The budget-overrun and time-overrun issues are even more pronounced in smaller projects because project owners of smaller projects have fewer resources to hire best-in-class designers, engineers and contractors who can avoid costly mistakes. However, our in-house development expertise in design, engineering and construction enable us to develop realistic value-add plans that are realize itself on-time and on-budget.

Technology Development Capacity

As mentioned earlier, the value of logistics property comes from its abilities to serve logistics businesses. Post-acquisition, via technologies, we are able to further improve the property's utilization rate at a minimal cost, ultimately contributing to the increased net operational income of the property.

All our executives are active investors and advisors in tech start-ups and have accesses to top talents in the space. Our executives have also successfully developed proprietary system to manage and dispatch trucking fleet according to market movements.

With these technologies put in place, we would be able to optimize space arrangement in order to generate highest possible rental income, while minimizing operational cost. For example, at trucking terminals, our smart parking system would be able to provide "just-go", ticket-free parking experience, which would not only prevent revenue loss from inaccurate manual parking-time monitoring but also reduce operational cost, as no employee is required on site. Furthermore, the system would collect and analyze data regarding each vehicle's parking occupancy and generate the best parking plan according to vehicle size and parking-slot occupancy pattern.

CONCLUSION

The global real estate market presents numerous investment opportunities. Among them, Acies chooses to focus on where we add the most value. Due to our deep roots in operations, we are committed to fully leveraging our expertise in the logistics business, real estate development and technology development know-how in order to generate superior investment return with less-than-commensurate risk.

We look forward to speaking with you should you have any questions or feedback.