REAL ESTATE

May 09, 2022 12:00 AM
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Cambridge Associates touts fleeting China opportunities

By DOUGLAS APPELL

Johnny Adji said the investment window is about 18 to 24 months.

Cambridge Associates LLC, the Boston-based investment firm and adviser to some of the world's biggest endowment funds, is urging clients to consider what it's calling an unusually attractive tactical opportunity now — lending directly to embattled Chinese real estate developers.

But not just any developers. The firm is focusing on real estate companies with founders who can offer up properties they own in markets such as the U.S., Canada and Singapore as collateral.

The opportunity comes against the backdrop of a regulatory squeeze by Beijing on local real estate companies that's left a number defaulting on outstanding bonds, and billions of dollars in additional loans coming due later this year.

That strategy allows investors wary of taking on Chinese property or the shares of listed developers as collateral, despite being able to pick up another 550 to 700 basis points of spread over what they can get in the U.S. or Europe, a way of squaring the circle, said Johnny Adji, Singapore-based senior investment director with Cambridge Associates.

"We're able to augment the risk and return profile" by lending directly to the individuals — often multimillionaires or billionaires — who own these real estate development firms against property they own privately in creditor-friendly jurisdictions such as the U.S., Canada, Hong Kong or Singapore, Mr. Adji said.

The pitch? "We're ready to help you solve your problem … but with a caveat. We don't want to take your listco share collateral. That can be suspended, and we've seen a number of the Hong Kong-listed shares be suspended. But we want to take collaterals of your luxury villas in Beverly Hills that your mother-in-law happens to live in," Mr. Adji said.

If the private corporation is basically founded by a single individual who is the 100% shareholder, there's little difference between lending to that shareholder personally or lending to his company — it's all "intermingled and intertwined," he said.

For asset owners allocating to direct lending managers, meanwhile, "you're getting paid essentially an emerging market credit spread by taking the collateral risk of a developed market," he said.

Bloomberg

China Customs officers raise a Chinese flag during a rehearsal for a flag-raising ceremony in front of buildings in the Lujiazui Financial District at sunrise in Shanghai.

Good fit

In an environment where asset owners increasingly say they're on the lookout for fast-evolving, time-limited opportunities to secure investment gains, Mr. Adji said Chinese real estate firms fit the bill now.

With tens of billions of dollars of debt coming due and large banks in the region constrained in their capacity to extend fresh loans, direct lending managers have become "the only game in town" for stressed Chinese real estate developers, he said.

And for the coming year or more, the pickings should be lush. With the ranks of real estate company founders looking to "pull a rabbit out of their hats" as those loan repayments come due, and the number of direct lending managers with the capabilities needed to compete effectively in the space still limited, "we're getting into a market whereby you can name your price," Mr. Adji said.

The current moment can be seen as the "first innings" of a game that could well be played out in as little as 12 to 18 months, with the bulk of the mountain of debt these companies hold coming due over the next 12 months, Mr. Adji said.

Against that backdrop, developers on the mainland who previously would have only offered up their office assets in Beijing or Shanghai as collateral are asking, "What do I need to give you (in exchange for a loan) … and what we're telling them is we want your assets in America, in Canada, in Hong Kong and Singapore. Do you have any? That's what's happening on the ground" now, he said.

And the clock, Mr. Adji contends, is running. "We think that the opportunity is likely to significantly diminish in about 18 to 24 months … or at least the lowest of the (low) hanging fruits, so we're telling our clients that the time to act is now," he said.

At present, demand still significantly outstrips supply and first movers should be rewarded, Mr. Adji said. "When you see the wall of money coming" in 12 or 18 months, "We'll pull back. It's all about being tactical … this is not a multicycle opportunity," he said.

Cambridge Associates, meanwhile, has identified between five and 10 direct lending money managers with the "very different skill set" needed to identify and execute multijurisdictional deals, said Mr. Adji. He declined to name them, calling that lineup his firm's "secret sauce."

One quality those managers share is an ability to be nimble and make quick decisions."When you're talking about lending to these borrowers at … up to 15% interest, they typically need the money yesterday (and) you need to be able to disburse the capital in two weeks," Mr. Adji noted.

That leaves big managers, with multiple committees that need to sign off on a deal as well as headquarters in New York or London that need to weigh in, at a disadvantage, he said, noting that a number of managers on Cambridge Associates' list broke out of bigger fund companies in order to put a more streamlined structure in place.

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Limited expertise

Dan Simmons, a partner with Singapore-based OCP Asia, a direct lending boutique that's completed roughly $5 billion in multijurisdictional deals since 2004, said probably only a handful of managers at present have the expertise needed to do direct lending deals involving offshore collateral.

Those deals aren't served up on a silver platter, Mr. Simmons said. They're generally accessed through relationships with a company's founder or the chief financial officer and figuring out how the company's obligations are structured is where the complexity lies. Managers just getting off the sidelines now to enter that space will have a tough time competing with the incumbents, he predicted. But he agreed that Chinese real estate — and deals involving founders' overseas properties as collateral — present a significant opportunity set now.

By contrast, multijurisdictional deals focusing on the overseas property assets of the real estate development company itself should be harder to come by at this point, Mr. Simmons said. A lot of analysis in the sector has already been conducted and companies' relevant assets have been picked over, making it unlikely that managers will be uncovering a "treasure trove" of otherwise unencumbered offshore assets at this point, he said.

But "as it relates to the founders, absolutely I do believe that's a strong opportunity set," he said.

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