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Secondaries & Recapitalizations

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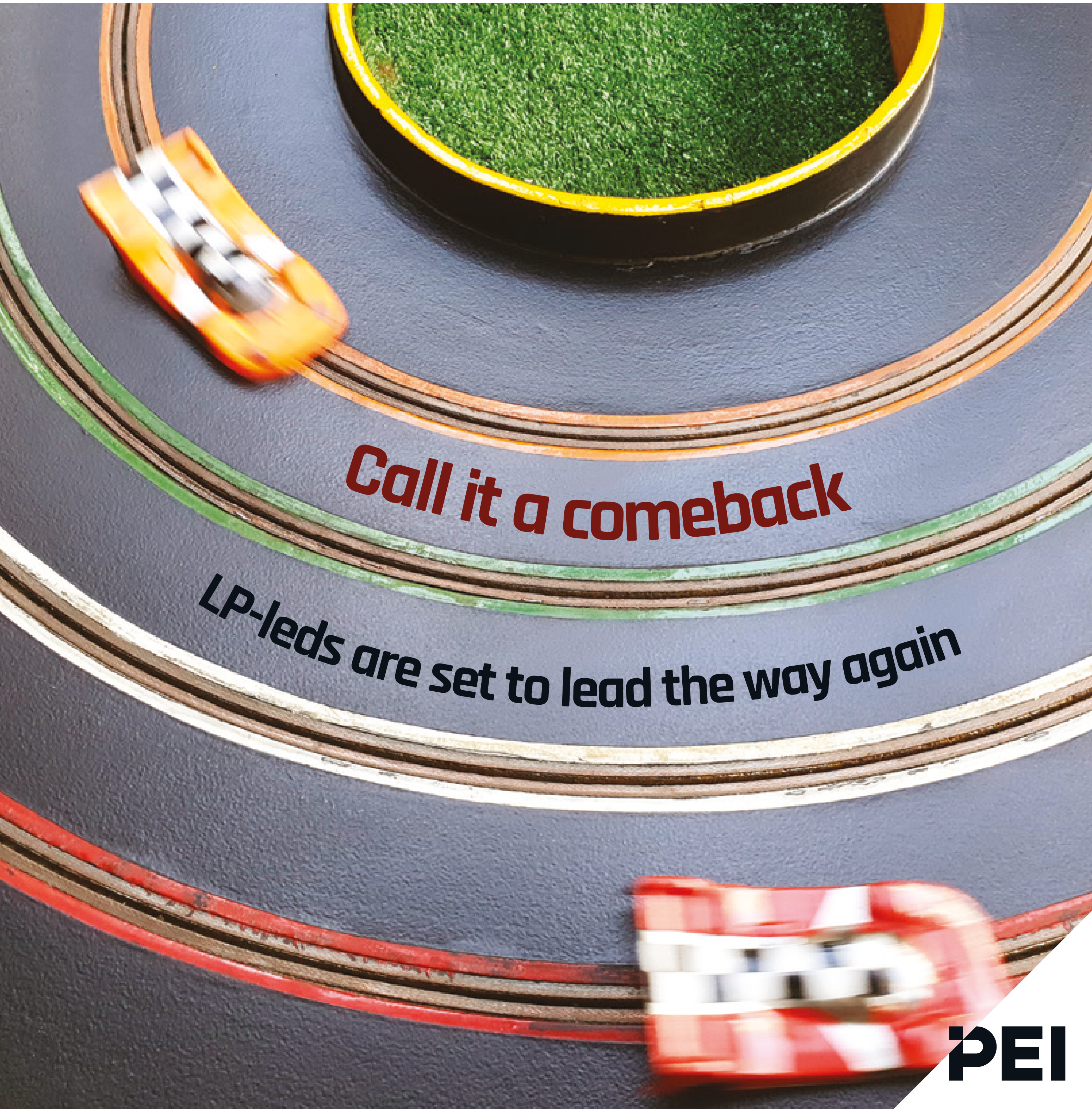

Call it a comeback

LP-leds are set to lead the way again

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KEYNOTE INTERVIEW

Asia is gaining ground in secondaries

More investors and managers are considering secondaries as a solution for their portfolios, but the diverse nature of the region makes transactions more challenging, say Bastian Wolff, Christian Keiber, Anthony Wong and Jonathan Olier

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The real estate secondaries market may not yet be so developed in Asia-Pacific as in North America or Europe, but this fast-growing and evolving market means more investors and managers see it as a solution for their portfolio challenges. A less experienced manager and investor base and the complexities of a multi-jurisdictional region mean resourcing, technical expertise and local knowledge are crucial.

Bastian Wolff and Christian Keiber, founding partners of Asian secondaries specialist Aquilius Investment Partners, and Jonathan Olier and Anthony Wong, partners at law firm White & Case, share their thoughts on how the market is developing.

Q The real estate secondaries market in Asia is tipped to grow. What is driving this from the investor side?

Bastian Wolff: There are several factors creating a growing volume of secondaries transactions in Asia. One is the denominator effect, in particular for US and UK investors. Sell-offs in bond and equity markets have left those investors overallocated to private markets.

Related to that is a general portfolio rebalancing across major LPs. In times of uncertainty, investors tend to gravitate towards their home markets, so LPs from the US and Europe are reallocating away from Asia, which is far away for them.

Finally, there is a regulatory driver as insurance companies and banks are disposing of non-core real estate holdings to reduce risk-weighted assets.

Christian Keiber: There is also an opportunistic driver, which is the financial stress for some investors who have immediate liquidity constraints, although these opportunities are few and far between and distress is rarely the reason a deal happens.

It usually tends to be a particular problem other than immediate liquidity that drives these transactions. In the vast majority of situations we come across, we are solving a very specific headache for an institution, rather than just a cash crunch.

Anthony Wong: These real estate funds tend to be closed-end and so have a fixed term, and a lot of the investors are underwriting with that fixed term in mind. This means that when these exits are not happening within the scheduled life of the fund, some of those investors need to find liquidity solutions because they have plans to redeploy that capital elsewhere. Obviously, they can stick around as well, but they do prefer to have as many options as possible.

Q Why are GPs looking for fund recapitalizations and continuations in the region?

CK: The big driver is the lack of exit liquidity at the asset level for a lot of these GPs. During the pandemic, it was incredibly tough to exit and now higher rates and a very challenging debt market are making it difficult for buyers to finance asset acquisitions in a value-accretive way.

Even for the highest-quality assets, it is quite tough to divest these through a direct sales process in the current environment. So, GPs are looking for alternative ways to create liquidity.

Fund recaps and continuation funds allow GPs to proactively manage liquidity in an environment where there is essentially none. The reason the secondaries market is taking off in Asia is that it is a win-win, offering exit liquidity to LPs while allowing GPs to continue to drive value creation for these assets. For a secondary buyer like us, we come in as a problem solver, and in return, we are getting exposure to quality assets, managed by reputable GPs with a known track record.

Jonathan Olier: The secondaries market in Asia is still quite new compared with North America and Europe. As such it offers real opportunities for participants with the right sophistication and mindset, for both investors and managers alike. This trend reflects an increased sophistication of the Asian fund market even if not all Asia-based or Asia-focused GPs are yet familiar with executing complex recaps, GP buyouts or continuation funds, including the legal issues surrounding them.

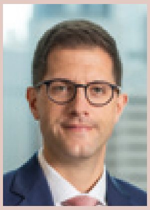
The market is evolving and advisers like us are able to import deal technology and solutions from more sophisticated markets and apply it to Asia, taking into account the particularities of each market.

Q What is behind the recent rise in 'GP-led' transactions in Asia? Will LP-led deals continue to grow as well?

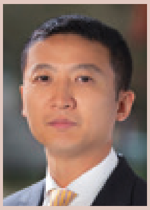
BW: We are very confident about the growth of the market in Asia-Pacific. LP-leds are the bedrock of the secondaries market and will continue to churn 2-3 percent of the primary market every year.

For GP-leds, there is a substantial tail of unresolved NAV that needs to be liquidated in the coming years. When we are on the road meeting sponsors in this region, every one of them has at

Bastian Wolff
Founding partner
Aquilius Investment Partners



Christian Keiber
Founding partner
Aquilius Investment Partners



Anthony Wong
Partner
White & Case

Jonathan Olier
Partner
White & Case

> *"There is a real need for a [secondaries] product that not only addresses diversification from a global perspective, but also more regionally for the Asia-Pacific market"*
>
> **BASTIAN WOLFF**
> **Aquilius Investment Partners**

least one headache to solve currently in their portfolio.

That tells us that there is some real pent-up demand for GP-led solutions in Asia. The more GPs hear about the different solutions that secondaries transactions can provide to them, the more they are keen to explore them. Looking at our pipeline, there are several very complex opportunities including fund recaps, GP spinouts and situations that wouldn't have been on the agenda in the past two or three years.

AW: There will still be plenty of demand for LP-led transactions too, for all the reasons we have talked about that make LPs motivated sellers. And from the perspective of a secondaries buyer, these transactions are very different in nature.

An LP-led deal can be executed relatively quickly. A recap is a longer and more complicated process, but gives a secondaries buyer more options in customizing the investment. There is appetite for both types.

Q What are the complexities and challenges of the Asian real estate secondaries market?

CK: There are three broad areas of complexity. First, sourcing and deal generation because the market is highly disintermediated. On one hand, this is good for secondaries-focused funds such as us because this creates a breeding ground for very attractive deals for our LPs, on an off-market basis, but it also means you need to create these transactions yourself, through your network, and that is not always easy and is time-consuming.

Secondly, due diligence can be more challenging because there is less access to information. Without boots on the ground, it is much harder to get context on certain of the underlying assets and source the information required for the rigorous bottom-up underwriting that these transactions require.

Finally, execution is challenging

Q How much does the approach to GP-led secondaries vary around the region in Asia-Pacific?

BW: Generally, LPs in these funds tend to be sophisticated institutional investors from the US or Europe and are familiar with the concept of a GP-led transaction. However, not all regional GPs here in Asia have come across the full toolbox of solutions yet because the US has been blazing the trail over the past years and Asia is catching up. The market here is disintermediated. In the US or Europe, you have the brokers calling managers weekly and pitching to them, but that does not happen to the same extent in Asia-Pacific.

AW: When we speak to managers in Asia, most have heard of GP-led transactions as an idea, but not many of them have gone through the actual process themselves and executed on GP-led secondaries. The markets in Asia do not function homogenously, and that includes how regulations work in different jurisdictions, both at the asset level as well as the manager level in terms of how things like conflicts of interest need to be approached. That regulatory element needs to be managed carefully, in addition to the commercial aspects of executing a GP-led transaction.

because you are working on portfolios that cross geographies and jurisdictions, each with their own tax and legal structure. It is therefore critical to harness deep technical expertise both in-house and through external advisers.

JO: The legal side definitely adds complexity due to the number of different jurisdictions involved, especially in a world moving back towards increased restrictions on foreign ownership regulations. Foreign ownership can become a significant issue for structuring secondaries transactions as the LP base of the exiting fund will not be the same as for the acquiring or continuation fund. This analysis will need to be done for each jurisdiction in which underlying assets are located.

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ANTHONY WONG
White & Case

BW: That means secondaries transactions in Asia-Pacific require much more experience and resources than you would need to put to work in other parts of the world. We had to build out our team accordingly in order to meet these sourcing and execution challenges. That of course requires a significant investment, which not many global players are willing to make because they have economies of scale in their home markets.

Q How is demand growing for Asian real estate secondaries as an investment product?

BW: We see a lot of demand, not least because of the diversification that secondaries can provide. You avoid concentration risk if you invest in a secondary portfolio because you will be broadly diversified across sectors, strategies, geographies, managers and fund vintages.

There is a real need for a product that not only addresses diversification from a global perspective, but also more regionally for the Asia-Pacific market, which frankly hasn't really existed previously. On top of that, investors want the usual benefits of secondary strategies, such as investing at a margin of safety, typically investing at a discount to intrinsic value and avoiding a J-curve.

JO: There is also a counter-cyclical element to it for some investors who see secondaries in Asia as a way to benefit from the market cycle. Additionally, we are seeing certain large institutional investors, who traditionally would not allocate capital to secondaries strategies in Asia, seriously thinking about deploying capital in this industry in Asia. It becomes a virtuous cycle as more transactions and experience leads to more options and therefore more secondaries transactions. ■