



# The Return of Private Equity Investors

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During the peak of the credit crisis, the value of the world's commercial real estate markets fell in a highly-synchronized fashion. Eighteen months later, property markets are now moving in very different directions across the world. The diversity of the world's major property markets has re-asserted itself.

In some countries — Greater China, South Korea and the UK — investors are targeting real estate again, well ahead of a recovery in fundamentals. Private equity prices in these countries rose by 10 to 20 percent last year and we expect continued appreciation in 2010. Share prices of listed REITs in Singapore and Hong Kong have doubled in value from their March 2009 lows, but in Japan they fell 3.7 percent in 2009 and are flat so far this year.

Private equity values in Australia, Canada, France and Germany have now stabilized at levels 20 to 30 percent below pre-crisis levels. By contrast, private equity pricing in many of the growth-addicted markets of the last decade — Dubai, Dublin, Budapest, Las Vegas, Madrid, Miami, Moscow, Phoenix — are still searching for a floor. Landlords in the world's three biggest office markets — London, New York City and Tokyo — are still reeling from the blows taken by the financial services sector. Yet, international investors are already showing interest in iconic buildings, well ahead of any improvement in the leasing markets. Commercial real estate is a late-cycle recovery play, in terms of earnings growth. Yet, the capital markets are already anticipating economic growth well ahead of any line-of-sight recovery in rental income.

So, is property in danger of an “echo bubble”? The de-leveraging process and re-pricing process took

place at a brutally fast pace in 2009, especially in the listed sector. The rapid recovery of property share prices is evidence that panic selling last year created a genuine buying opportunity. In the world of private equity, by contrast, re-pricing still has a long way to go. Control of private equity is early in the process of shifting from borrowers to lenders and, ultimately, to a new generation of lower-leveraged owners. Private equity prices have been propped up by the “pretend and extend” policies of lenders in the Anglo-American markets. The downside of this policy is that few great bargains are going to surface in the US or the UK, the two countries with the greatest legacy debt issues.

The capital-intensive property sector depends on diverse sources of financing to function effectively. An abundance of cheap debt caused unsustainably high asset pricing and stimulated overbuilding. Too little debt leads to bankruptcies and under-investment in the building stock needed to serve a modern economy. In the last four years, commercial real estate debt has moved from one extreme to the other, which has been highly detrimental to the performance of real estate as an asset class. Borrowers and lenders alike have been hurt by the boom-bust nature of these debt flows. The current restrictive lending environment for real estate debt insures against another property pricing bubble, for now. The least restrictive debt market (Greater China) recently announced its intention to tighten. But, the possibility of another pricing bubble is building, as yield-driven investors comb the asset markets in search of wider spreads. We caution all investors against yield-driven investing in property that ignores the weak fundamentals that prevail in many markets today. ★



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