IReit: ABBA is the name of the game

Reit shares its strategy of investing in "A" assets in "B" cities and "B" assets in "A" cities for higher yields

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THE three clocks displaying the different time zones of Israel, Singapore and Germany in IReit Global's conference room aptly sum up the cross-border composition in the seven-month-old office Reit.

It is run by Itzhak Sella, an Israeli and the CEO of the Reit manager; the Reit was listed in Singapore last August, raising S$369 million; and the Reit's four properties are in the German cities of Bonn, Darmstadt, Munich and Münster.

As at December 2014, the Reit's portfolio is worth 291 million euros (S$425 million). Mr Sella hopes to double its asset size and net lettable area in the next 12-18 months. It will continue to invest in Germany and the rest of Europe, including the United Kingdom, if prices are right.

IReit adopts an "ABBA" investment strategy, investing in "A" assets in "B" (second-tier) cities and "B" assets in "A" (first tier) cities. Since such assets have not risen as quickly in capital values as their more prime counterparts, they are cheaper and give higher yields.

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Analysts have noted that German office rents and values are at the start of an upcycle, as the country's economic recovery fuels more office demand.

"Given tight grade A office supply in tier-one cities, demand for business space from corporations will trickle down to better tier-two cities, and this should result in the outperformance of rents of prime office spaces in tier-two cities relative to tier-one cities," DBS analyst Derek Tan has said.

Adina Cooper, IReit's chief investment officer, said the strategy gives the Reit an advantage. Joining the interview with Mr Sella through Skype, Ms Cooper told The Business Times: "The strategy to buy assets that are not core - not in the centre of town or in the main cities - and to buy good quality assets in secondary cities can only be deployed by more knowledgeable market players."

In this regard, she believes Mr Sella and her fit the bill, given their combined half a century of real estate experience. "The advantage of (investing in) Germany is that even though it's a really big market, it's less conducive to foreign investors, especially for the kind of non-trophy assets we're buying. This is because you have to really understand the legal system and real estate and lease structures, and you have to know German. It's not as investor-friendly as the UK."

Most foreign investments in Germany have tended to be partnership deals and club deals, while local players still make up the bulk of German property acquirers.

Because of the contacts Mr Sella and Ms Cooper already have in the German real estate industry, vendors also contact them directly with assets that they are planning to divest from their soon-expiring funds. This way, the Reit is also able to acquire assets that are not in the market.

IReit's unique investment strategy allows it to boast a comparatively higher yield (versus most other Singapore Reits) of more than 7 per cent, based on analysts' estimates. Ms Cooper clarified that this is not a reflection of a higher-risk portfolio. "Our yield reflects the kind of very secure income that you can find in the German market. The benefit of investing in the German market is that the assets give you a strong yield but very low risks, as compared to the

same yield offered by an Asian Reit... Obviously the inexpensive cost of debt also gives a very strong mark-up in yield without any major gearing."

In comparison, prime property in a first-tier city would yield a lower 4.7 to 5 per cent net property income yield, Ms Cooper estimates.

The Reit sponsor is Sella Holdings, which is 100 per cent owned by Mr Sella who does not own any real estate that can be injected into the Reit. Asked if this poses a problem for its acquisition pipeline, Ms Cooper said it's actually a good thing. "I'm not tied up in an obligation to buy an acquisition from a party who wants me to buy it. Rather, I have the opportunity to buy what I think suits us at the market price," she said. "And we have the advantage of being in Europe, a large market that has a lot of good quality assets. Perhaps in Asia, you may be in a position where you have to create income-producing assets to put into the Reit, but you don't need that in Europe."

But why list in Singapore when all the Reit's properties are 6,000 miles away; had the Reit considered a Europe listing instead?

"I tell you the truth: no," Mr Sella said. "The reason is because their Reits segment did not pick up in most of Europe," he added, referring to how the continent's property owners and stock investors have been slow to embrace this asset class.

In contrast, Singapore is the second largest Reits hub in Asia after Japan, and enjoys abundant market liquidity, a stable political and economic climate, tax-efficient structures, and has a pool of Reit-savvy investors.

Singapore-listed Reits are also allowed to invest in overseas properties, unlike those in Israel which can't, and thus have to compete domestically for a limited pool of assets.

Mr Sella would know; he had listed a publicly traded Reit in Israel, Sella Capital Real Estate, in 2008. He continues to hold a 24.6 per cent stake in the manager and has a non-executive seat on its board.

In fact, he had played a big role in developing Israel's Reit framework, including supporting the introduction of Reit legislation, creating relevant financial models, and advising Israeli government officials on legal and tax implications of the Reit structure. But the Reit market in Israel today remains undeveloped because many of the regulations are still not conducive for Reit listings.

Mr Sella and Ms Cooper have done business together for two decades, from the time Ms Cooper was a partner in a real estate firm that provided property management services to his Israel Reit.

When asked if the Reit is worried about possible exits of eurozone members from the currency bloc and the slumping euro, Ms Cooper said, unfazed, there is nothing that they hadn't already factored into their worst-case scenario while they were preparing to list the Reit.

Even if for some reason the euro split up, the Reit would still be in a great position, given Germany's fiscal discipline and strong economy. Meanwhile, the weak euro is beneficial because the Reit is acquiring assets, she said.

The Reit has also entered into forward forex contracts to hedge the currency risk for distribution to unitholders for 2015.

IReit is a thinly traded stock, with just about 23 per cent of its 419 million shares on float. This is partly because it is 57 per cent owned by low-profile Chinese property tycoon Tong Jinquan, who was introduced to Mr Sella through a "reputable" third party in Singapore.

Mr Sella said he believes Mr Tong liked the idea of investing in IReit because it would save him money and time otherwise needed to do his own research to enter the European market.

Mr Tong, who sits on the board of IReit's manager, has said that his investment in IReit is for the long term. He had subscribed for the units at the initial public offering stage, after liking what he saw following a trip with the Reit management to visit the German properties. In fact, he continues to accompany Mr Sella to view potential acquisition targets and offer his own professional opinion on them.

Mr Tong caught the market's attention after reports of his large investments in Singapore Reits surfaced. He has considerable stakes in Viva Industrial Trust, Cambridge Industrial Trust, OUE Commercial Reit, and smaller stakes in Lippo Malls Indonesia Retail Trust, Sabana Reit, Soilbuild Business Space Reit, Ascendas Hospitality Reit and Croesus Retail Trust.