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Fingers on the Trigger: Foreign investors are ready to buy

The United States is the preferred locale for foreign investors looking to place capital in commercial real estate, and the proposed Real Estate Revitalization Act of 2010 would make it even easier for foreign investors to seek out U.S. property investments. (See Foreign Exchange to read more about the Act.)

According to the most recent survey from Association of Foreign Investors in Real Estate (AFIRE), 51 percent of respondents identify the United States as providing the best opportunity for capital appreciation; this compares to 37 percent in 2008, 26 percent in 2007 and 23 percent in 2006. The last time respondents' perceptions of U.S. real estate were this strong was in 2003, when the percentage once again reached 51 percent.

Moreover, two thirds of respondents plan to increase their investment in the United States in 2010 compared to 2009, and one half of respondents ranked the United States as the number one country for capital appreciation compared to only 25 percent in 2006.

"When we were at MIPIM, we certainly saw more interest from people who had never been interested in the United States," says James Fetgatter, AFIRE's chief executive officer. "The options in other places in the world are not that great... the Euro doesn't look too good, China might have a bubble, London is very competitive... then you've got the United States, which has a reputation of resilience and a lot of opportunities."

Waiting for the right time

So far this year, for example, foreign investment activity has been muted. During the first quarter 2010, foreign investors acquired nearly $1.4 billion in U.S. commercial property, according to Real Capital Analytics (RCA). If investment activity continues at this pace, total volume for the year will reach $5.6 billion – an increase over 2009's $4.4 billion, but a paltry sum compared to 2007's $40.9 billion and 2008's $11.9 billion, according to RCA.

"The issue is not whether they want to come or whether they have the capital, but it's a question of timing," Fetgatter says. He points out that last year's survey indicated that foreign investors planned to place additional money in the United States, yet they didn't because they felt the market was going to continue to devalue, similar to what happened in London's property market.

"But, the United States really hasn't decreased that much," he adds. "There are signs that yes, maybe it will, so they don't want to get in too early. On the other hand, they don't want to miss the opportunity. They have a fear of being foolish in either case."

Recently, U.S. property has become even more attractive as global investors have become concerned about the fiscal health of many European countries – Greece, in particular – and the stability of the Euro, according to Kurt Maerschel, vice president of Encore Capital LLC, a subsidiary of Dallas-based Encore Enterprises.

"The Greek crisis has really shaken confidence in the Euro and has had a fundamental impact on the valuation of the dollar," he explains. "Psychologically, the world now sees the dollar as more stable than the Euro. I think the currency situation has given investors the push they need."

Newly active investors

Rumors of foreign investment in U.S. property are always somewhat overblown. In fact, cross-border investors historically have accounted for less than 10 percent of all property acquisitions, according to Real Capital Analytics. In contrast, 40 percent of U.K. property acquisitions are made by foreign investors.

Still, in terms of overall volume, foreign buyers have sunk a significant amount of capital in U.S. property markets. From 2005 through 2008, foreign investors claimed at least $100 billion of commercial property.

Historically, investors from Australia, Canada, Germany, Japan and the U.K. have been the most active over the past two decades, and earlier this decade, investors from Ireland and the Middle East had voracious appetites for U.S. property.

Last year, however, foreign investment shifted, both in terms of origin and strategy. Australia, for example, invested $5.8 billion in 2005, $4.2 billion in 2006 and $10.4 billion in 2007, only to see its fortunes wane. In 2008, Australia invested only $161 million and nothing in 2009. Australian owners have become sellers of U.S. property, along with Irish investors.

Likewise, Middle Eastern investors have pulled back significantly, although Kuwait Finance House invested $450 million with REIT UDR to buy high-quality apartment properties in primary markets. Israel has made some opportunistic purchases of distressed properties including bulk condos in Florida, along with the $330 million acquisition of HSBC's NYC headquarters.

"Interest from Israel has been building over the past three to four years," Fetgatter says. "We're starting to see a lot of fund-raising from high-net worth Israelis."

In 2009, British and German investors were still active. In fact, Germans were the most active cross-border property buyers in 2009 with roughly $933 million in acquisitions. For example, Allianz SE and Deka Immobilien Investment GmbH inked a deal for 1999 K Street in Washington, D.C. In addition, some German organizations made company-level investments such as The Otto family's investment in retail REIT Developers Diversified Realty Corp.

Last year, Canadian investors continued to buy U.S. assets, again focusing on apartments. So far this year, they have acquired $80 million in apartment assets, such as Stonebrook Apartments in Florida, for 27 percent of foreign activity in the sector. Recently, Manulife contracted to buy its first U.S. asset in years with a deal for an office property in Atlanta.

Additionally, U.S. commercial property markets attracted a handful of foreign investors that were new to the market in 2009. Dutch pension giant PGGM, for example, acquired seven apartment properties for $328 million last year. The institution has already made its first 2010 deal – a joint venture with Dallas-based Behringer Harvard on a senior living complex in Orange County, Calif.

Growing interest from Asia

Beyond Japan, Asian investors have made great strides in U.S. property acquisitions. In 2009, non-Japanese Asian countries accounted for $317 million in acquisitions or 15 percent of all foreign property investments, according to Real Capital Analytics. Singapore's Keck Seng, for example, acquired the W Hotel San Francisco for $88 million, while South Korea's Kumho Investment Bank purchased AIG's Manhattan headquarters.

"Interest among Asian investors is extremely high," says Greg Karns, a partner with global law firm Cox Castle & Nicholson, which manages the firm's Pacific Rim Group. "Whatever recession occurred in most of Asia was brief, and has been followed by strong economic performance. As a result, the investor crowd did not have the chance to pick up well-priced assets. However, the impression is that the U.S. real estate downturn will be more pronounced and of longer duration, and the opportunity to pick up real estate assets here is very enticing to Asian investors."

Chinese investors are just beginning to dip their toe into the property markets. Most activity has been through mortgage debt, but some U.S. funds are raising money from high-net worth Chinese individuals, as well as banks.

"For the first time, interest is much stronger from China and other Asian countries," Maerschel says. In fact, his firm's most recent acquisition was made with funds raised from China and Europe. In February, Encore Retail bought a 360,000-sq.-ft. retail complex in Cincinnati. The property, Governor's Point, includes a 161,061-sq.-ft. center anchored by a 128,747-sq.-ft. Lowe's and a 198,940-sq.-ft. center anchored by a 157,791-sq.-ft. Bigg's

Supervalu supermarket.

Clear property and market preferences

Foreign investors continue to rank multi-family as their preferred property type, followed by office, industrial, retail and hotel properties, according to the AFIRE survey. This is the second year in a row in which multi-family topped investors' product preference.

"More notably, the gap between the top preference and the least-favored product, hotels, has not been this wide since 2000," Fetgatter says.

Interestingly, foreign investors have sunk more capital into other assets over the past several years. Last year, for example, foreign investors acquired more office assets than any other group, spending $2.2 billion on office properties. Multi-family followed at $914 million, according to Real Capital Analytics.

Last year, foreign investors also showed a marked preference for coastal markets, with 20 percent of acquisitions located in New York City, 18 percent in Washington, D.C. and roughly 13 percent in California.

Among U.S. cities representing the best investment opportunities, AFIRE survey respondents firmly selected Washington, D.C. and New York City. San Francisco moved into third place, while Boston made a significant climb into fourth place, and Los Angeles fell one spot into fifth place.

"You could make a correlation between the most attractive cities for foreign investment and the cities that have direct flights from Europe and Asia," notes Norm Miller, Ph.D., vice president of analytics at CoStar. "Foreign investors are worried about liquidity and, as a result, they typically want to invest in major markets if they are investing directly. They do not want to look at second- and third-tier markets."

Asian investors prefer gateway U.S. cities that have significant Asian populations such as Los Angeles, San Francisco and New York, Karns notes. Even with that limited scope, they have unrealistic or overblown concerns, he adds.

"I work with a very sophisticated investor group from Hong Kong that has purchased large assets all over the world; however, they are hesitant to invest in Los Angeles," Karns says. "When I discuss this with them, I find that they are concerned about the possibility of riots and social unrest. Part of this is fueled by the Rodney King riots years ago and partly by concerns over the substantial diversity in our population, coupled with high local unemployment. But whatever the cause, I think most would agree that this is not something to be overly concerned about, and yet it has kept this group out of Southern California real estate."

To that end, experts contend that it is increasingly difficult for foreign investors to identify investment opportunities. "The biggest complaint in the United States is the lack of opportunities," Fetgatter says. "They're all looking for an opportunity to buy at a good price, and they're finding that sellers are not motivated. Foreign investors want to buy distressed opportunities, but most are not good at negotiating with banks and lenders. Domestic investors are much better at that."