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Last month our team traveled to Korea and Japan to meet with investors and to present at two of the leading real estate conferences: ASK 2015 Global Private Debt & Equity Summit in Seoul, Korea and the MIPIM Global Real Estate Summit Japan in Tokyo, Japan. Both countries have substantial capital to invest in U.S. real estate, are frustrated by low local interest rates (ten-year treasury yields of 2.5% for Korea and 0.5% for Japan) and are making inroads into U.S. commercial property in both equity and debt. Below are our macro observations.

- Korean and Japanese investors are committed to being long-term investors in U.S. commercial real estate. For example, a leading Korean pension fund has increased its allocation to foreign real estate nearly 50% since 2012, with a significant portion invested in the U.S.
- Given historically low cap rates, investors are beginning to favor debt versus equity, particularly in core markets, given better risk-adjusted returns and lower LTVs.
- Pension funds, insurance companies and banks typically seek returns in the 4%-7% range.
- Asset quality and sponsorship are essential with a focus on institutional quality real estate in key gateway cities such as New York, Washington D.C., Boston, San Francisco/Silicon Valley and Los Angeles.
- Japanese investors, with a large domestic real estate market and legacy investments in the U.S. from the 1980s, are now more actively investing in the U.S. market.
- Korean investors, with a comparatively smaller domestic real estate market and few legacy investments, have been quite active in the U.S. and view real estate debt as an efficient means to gain exposure to the U.S. property market without adverse tax consequences (e.g. FIRPTA).
- Korean investors, while selectively participating in commingled funds, prefer the independence of a separately-managed account or joint venture structure.
- Investment decisions typically require a longer approval process, which lags the current U.S. closing timetable.
- Investors recognize that local knowledge of real estate and capital markets is key to implementing a successful investment program and are partnering with U.S. managers to source and execute loan originations and purchases.

The U.S. market remains the top destination for foreign real estate investment. Driven by low interest rates and a flight to safety, Korean and Japanese investors who have traditionally invested in real estate equity are now allocating more AUM to real estate debt. Debt offers investors many advantages, including conservative loan-to-values, attractive returns, liquidity, and favorable tax treatment. Having established themselves as successful investors in real estate equity in the U.S., we expect Korean and Japanese investors to continue to expand their investment activities in real estate debt, working in partnership with local advisors and managers. Consistent with these trends, Talmage manages commercial real estate debt investments on behalf of leading Korean and Japanese institutional investors.

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