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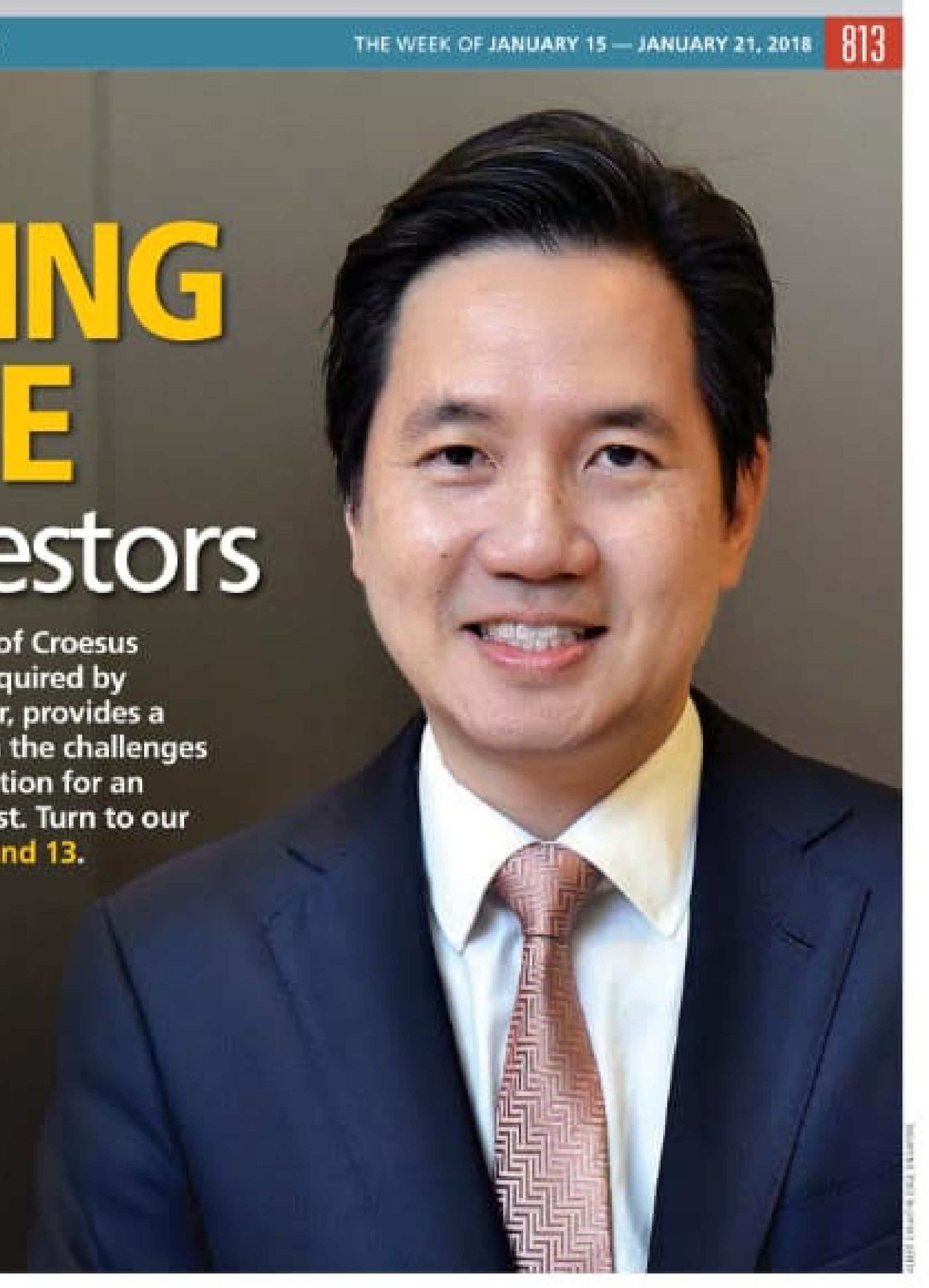
GETTING VALUE for investors



Jeremy Yong, co-founder of Croesus Retail Trust, which was acquired by Blackstone Group last year, provides a revealing retrospective on the challenges of achieving a good valuation for an independent property trust. Turn to our Cover Story on Pages 12 and 13.

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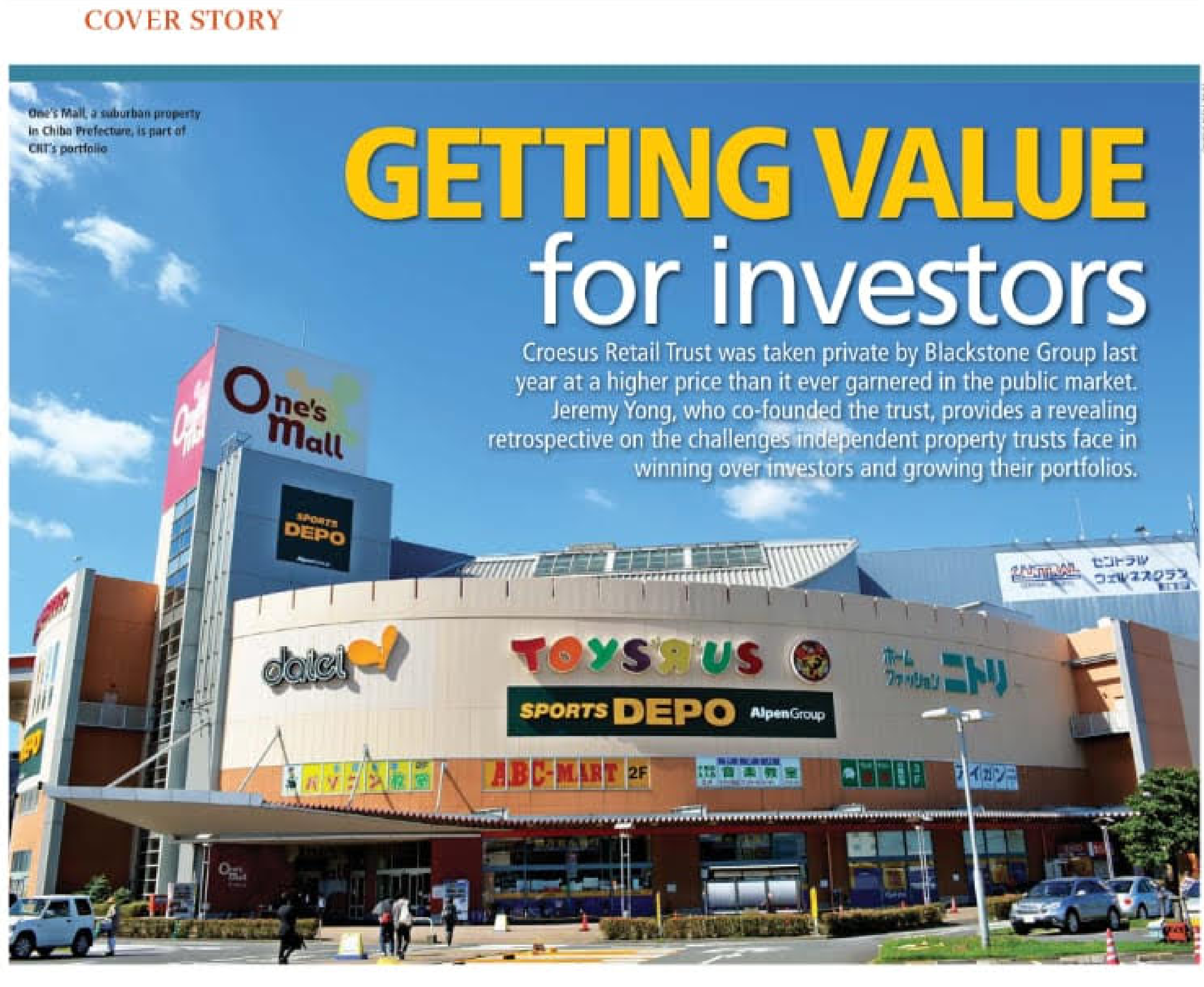
COVER STORY



One's Mall, a suburban property in Chiba Prefecture, is part of CRT's portfolio

GETTING VALUE for investors

Croesus Retail Trust was taken private by Blackstone Group last year at a higher price than it ever garnered in the public market. Jeremy Yong, who co-founded the trust, provides a revealing retrospective on the challenges independent property trusts face in winning over investors and growing their portfolios.

| BY MICHELLE TEO |

Jeremy Yong was relieved more than anything else when the deal for Croesus Retail Trust to be acquired by **Blackstone Group** was sealed last September. For most of the 4½ years it was listed, CRT had traded below its net asset value (NAV).

"I was obsessed with closing the valuation gap," says Yong, who was managing director of CRT's trustee-manager. "We promised our unitholders we were going to close this gap and we wanted to make good on this promise."

He adds, "We needed to make sure we were trading at fair value so that our acquisition currency was strong enough to acquire new assets."

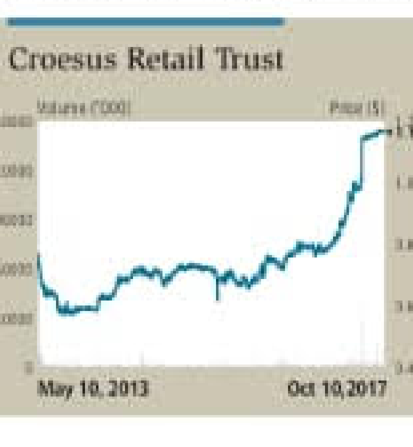
As part of his effort to achieve this, CRT worked hard to court investors and more than doubled the size of its portfolio with a string of acquisitions and capital-raising exercises. It also tested the notion that property trusts with internal managers garner better market valuations than those with external managers.

Yet, it was only when Blackstone came along with an offer to acquire CRT at $1.17 a unit, or a 20% premium to its NAV, that Yong achieved what he wanted. Investors who bought units in CRT at its IPO in May 2013 and accepted the offer from Blackstone last year would have seen a total return of 86% (with distributions reinvested). "It's a sense of relief that the board and management were able to fulfil the promise," Yong says. "Unitholders who kept the faith [got their return]."

Now, looking back on the whole experience of setting up and running CRT, Yong offers insights and viewpoints that could be useful in fostering a more vibrant and diverse market for real estate investment trusts in Singapore. In particular, one common challenge that smaller REITs face is cultivating an investor base to support their growth plans. While REITs and property trusts are often promoted on the basis of their yields, they are not passive income-generating investments. On the contrary, they are property securitisation vehicles structured to raise money to acquire assets. The larger and more diverse their portfolios, the more attractive they will be to big institutional investors.

Yet, communicating plans for growth is harder for REITs and property trusts that are not backed by major property developers with a highly visible pipeline of new assets. And, it is harder still for the ones that do not have an established, recognisable name.

"Our biggest handicap from the very beginning was being a new name," Yong says. The major shareholders of CRT's sponsor included Yong and co-founder Jim Chang, as well as Japan's **Marubeni Corp** and **Daiwa House Industry Co**. Marubeni is a Japanese conglomerate with businesses spanning energy and metals to food products, and Daiwa House is a homebuilder. "It took time — eight quarters, two years — to demonstrate to the market that [there was] no hanky-panky, the assets were good, we delivered the yields, and we were intent on growing," Yong adds. "And, even that wasn't enough."



Another problem was that many investors were not comfortable at the time with the idea of investing in Japan, where commercial rents in 2012 were growing at a much slower pace than in Singapore and China. To overcome this obstacle, Yong had wanted to include a "low-risk development" project in CRT's initial portfolio. That was the main reason that CRT was structured as a business trust rather than a REIT, he says. At the time, REITs were not allowed to have more than 10% of their assets exposed to development projects. The cap has since been raised to 25%. Business trusts have no limit, but CRT voluntarily capped its exposure to 20%.

"Back in 2011, 2012, there were still some legacy issues from the [Lehman crisis], where equity holders of development assets were still getting squeezed out," Yong explains. "We could actually step [into projects] where the development is more than 50% completed and lease agreements [are] signed." That would have provided CRT with some growth in revenue and an NAV uplift, he adds.

Things did not go smoothly, though. Yong and Chang began preparing CRT for an IPO in 2011, but found the scepticism hard to overcome. "We shanked a few investor meetings, to use a golfing term," he says. Yong also reveals that CRT aborted an IPO launch for fear of insufficient investor support. "In November 2012, we were on the verge of lodging a draft prospectus with [the Monetary Authority of Singapore], but we just didn't feel the book was strong enough," he says. "I felt that if we lodged and didn't succeed, we would never come back to the market. So, it was better to live and fight another day."

Yong subsequently decided to scale back CRT's initial portfolio. In 2012, he planned to include as many as seven properties in CRT's portfolio plus an eighth that was under development. CRT eventually came to market in May 2013 with a portfolio of only four properties, valued at ¥52.47 billion. These comprised two suburban shopping centres under master leases with Aeon Town, in Ibaraki and Mie prefectures; another suburban mall, Mallage Shobu in Saitama Prefecture; and Croesus Shinsaibashi, a retail property in Osaka city. These malls were nearly fully occupied, and had a weighted average lease expiry (WALE) of 11 years.

Forging partnerships

How exactly did the idea to form CRT come about? Yong was introduced to Chang by a mutual friend while he was working in Japan years ago. Chang had been a senior executive at Evergreen Group, the privately held Taiwanese conglomerate with interests spanning transport and shipping infrastructure, including the airline **EVA Air**. According to his Croesus bio, Chang led Evergreen's investments and management in real estate, transport and infrastructure across Asia between 1997 and 2005.

COVER STORY

Yong and Chang originally wanted to set up a trust for infrastructure assets. "We liked the yield component of this asset class and Jim, having come from Evergreen, has lots of experience in aviation and ports, and we were trying to do business in that space." Their plans changed in 2011, however, after they met an individual named Masaharu Kodaka, whom Yong describes as "a very established, retired real estate banker". Yong and Chang were also introduced to officials at Marubeni and Daiwa. "[They] had access to very high-quality retail assets at very attractive prices," Yong says.

After a number of discussions, the partners decided on using Singapore as a base to build a pan-Asia business, with an initial set of assets in Japan. "But, as time went by, we felt that our core competencies were all Japanese," Yong says. Moreover, asset prices were reasonable and the cost of debt-funding in Japan was among the lowest around. "We just never needed to move out of Japan." At the same time, Shinzo Abe had become prime minister for a second term and, with his "three arrows" multi-pronged strategy of monetary easing, fiscal stimulus and structural economic reforms, was intent on pulling Japan out of two decades of stagnation.

Battling weak valuations

Despite the cool reception to CRT in the market, the trust was soon expanding its portfolio. In January 2014, some eight months after its IPO, CRT issued $100 million in medium-term notes. A month later, it announced it was acquiring two urban retail properties in Tokyo. Then in early September, CRT placed out 78.9 million new units to raise funds to acquire a substantial suburban mall in Chiba city, Chiba Prefecture.

In 2015, CRT went on to acquire a suburban property in Fukuoka. It was even more active the following year, issuing more new units and medium-term notes to fund the acquisition of three more malls. That brought the number of malls in CRT's portfolio to 11. The properties had a combined valuation of ¥112.64 billion and an average WALE of seven years.

Meanwhile, CRT's income available for distribution had also grown. For FY2016 (it has a June year-end), it reported a 16.4% y-o-y rise in net property income and an 18.5% improvement in income available for distribution. Distribution per unit (DPU) was 11% higher. As at June 30, 2016, CRT had an NAV of ¥76.87 a unit, or 90.6 cents a unit at the exchange rate at the time.

Despite this progress, units in CRT were languishing at a discount of roughly 18% to its NAV. As Yong saw it, one problem was that CRT had not yet become large enough to attract a big institutional investor following. That, in turn, made it tough to raise money to acquire more assets on terms that would be immediately accretive to its DPU, effectively creating a vicious cycle.

"Scale, in my opinion, is one of the key criteria for a sustainable existence on the REIT market," Yong says, adding that developer-backed REITs have an advantage over independent ones. "If you were a developer, the pipeline would be visible, and you'd have scale. Then, your pricing would be good, and you could acquire [more] assets."

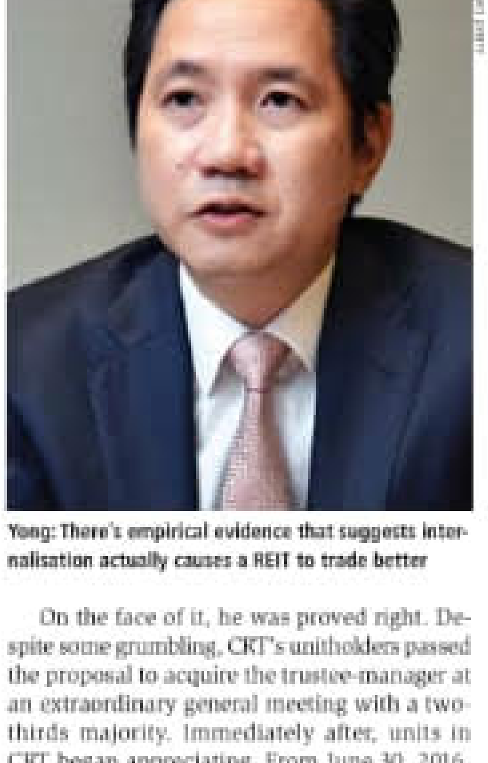
This fact was not lost on investors. David Lim, chairman of CRT's trustee-manager, says he observed resistance from some unitholders to the trust's acquisitions and capital-raising exercises. He remembers one investor raising questions at an AGM and suggesting that the deals did more for the trustee-manager than the unitholders. "He stood up and said, 'You know, I think you're acquiring property for the sake of it, because the yield doesn't increase,'" Lim recalls. "There's always this perception of conflict of interest. I cannot argue against perception."

Closing the gap

To address this issue, Yong and Chang made an audacious move. On June 12, 2016, CRT announced plans to acquire its trustee-manager for $50 million.

In its statement to the stock exchange at the time, CRT said the move would create "a stronger alignment of interests" between the manager and unitholders. Internalisation would also eliminate management fees and lower transaction costs for future investments and divestments, and therefore be DPU-accretive. In a November 2016 report, OCBC Research estimated that cost savings would amount to ¥360 million a year. And, this would increase as the trust expanded its portfolio further.

Ironically, the process of internalising the trustee-manager put Yong and Chang at odds with CRT's unitholders, many of whom objected to the proposed price tag. "There would always be pushback on these sorts of initiatives, especially when it involves valuation," Yong says. "Alignment of interest is a cliché, but it's a very powerful tool in getting CRT, for example, from undervalued to fully valued. There's empirical evidence that suggests internalisation actually causes a REIT to trade better."



Yong: There's empirical evidence that suggests internalisation actually causes a REIT to trade better

On the face of it, he was proved right. Despite some grumbling, CRT's unitholders passed the proposal to acquire the trustee-manager at an extraordinary general meeting with a two-thirds majority. Immediately after, units in CRT began appreciating. From June 30, 2016, when unitholders approved the move, to Aug 31, 2016, when the internalisation was completed, CRT units rose 6.4% in value. And, they continued trading higher subsequently.

Yong tells *The Edge Singapore*, however, that the internalisation of the trustee-manager was just one of a number of initiatives he was pursuing at the time to improve the market valuation of CRT. Among other things, he was also looking into a possible listing in Japan. "Internalisation was the first step," he says. "We were going to tap Japanese capital. We were going to make a big push into investor relations in Japan... to compress our yields, to acquire more assets."

Then came the offer from Blackstone. On April 26, 2017, CRT announced that it had received a potential takeover approach. On June 27, it called for a trading halt and, subsequently, announced a privatisation offer at $1.17 a unit. The offer price was 38% higher than the 12-month volume weighted average price per unit, and exceeded CRT's highest closing price since IPO. Despite some pushback, unitholders of CRT accepted the offer and the trust was delisted in October.

Why was Blackstone willing to pay a price well above what CRT could achieve in the public market? Some market watchers put it down to interest rates having been low for a long time and private-equity funds being able to take on more leverage than REITs, which amplifies the returns they provide. That raises the question of whether REITs such as CRT will ever be able to compete with private-equity funds when it comes to acquiring assets.

Yong points out, however, that the trade-off is that investors in a private-equity fund would not have the benefit of the liquidity of a listed property trust. "Our assets are very appropriate for a public platform. And, the biggest advantage of being traded publicly is your liquidity. So, in exchange for liquidity, you have to give up some return."

The way Yong sees it, however, Blackstone was simply attracted to CRT because it provided a means of quickly gaining broad exposure to Japan. "Owning Japanese assets, I think, is attractive to any buyer," he says. "To own real estate in the third-largest economy in the world... where there's rule of law. Once the reflationary story kicks in, you could really see prices going much higher." In addition, CRT's portfolio was spread out across the country. "For anyone, it would be a fairly instant penetration into Japan with large-scale assets."

The draw of Japan

Yong is something of an advocate of investing in Japan. "My romance with Japan goes back 20 years," he says.

He began his career at JP Morgan Singapore in the mid-1990s as an investment banker, before moving to a private-equity fund. In the wake of the Asian financial crisis, his fund was shut down and he lost his job. His boss had plans to head to Japan and asked Yong to join him. "He said Japan was really a sleeping giant, so let's go," Yong recounts. "I had nothing to lose. I was 27. So, I packed my bags and left. I told my wife not to quit her job yet because I might be back in six months."

In Japan, Yong worked at a unit of a US tech investor. "And that's where I realised that the day Japan comes out of its slumber, if you position yourself right, it could be a land flowing with milk and honey." The fund, ICG Japan, subsequently merged with ICG Asia and was listed in Hong Kong. It was later acquired by Hutchison Whampoa. Yet, Yong's time in Japan also taught him that it was not an easy market to navigate. "Japan is 10,000 shades of grey. You need good partners, [because of the] language, culture, everything."

Of course, CRT had all of this going for it. And, with its units trading at improved valuations after the internalisation of its trustee-manager, it was in a stronger position to expand its portfolio. "We had a whole pipeline of new assets. There were eight or nine potential assets we were evaluating, because the valuation gap was closing," says Lim. When Blackstone's offer came, however, the board of the trustee-manager had to bring it to unitholders. "You can plan something, but there's a lot of execution risk around it," Yong points out. "So, how could we have said no?"

What is next for Yong and his partner Chang? Would he ever attempt to set up another property trust or fund in Japan? "In the next three months, we are in the thick of helping with the transition," Yong says. "There is a lot of restructuring going on to optimise the structure for a private platform." In the longer term, he hopes that his next venture will have something to do with Japan. "I certainly have the desire to have a Japan angle. Whether I have the right components to fire it all up again, I've got to sit down with Jim to figure it out."

Lim says he would have little hesitation embarking on another venture with Yong and Chang. "[It's] a fantastic partnership between the two. [Chang's] global network is really something, and that complements the technical skills [Yong] has. It's a powerful combination." ■

How Croesus grew

2013

MAY 10 – Croesus Retail Trust lists on the Mainboard of the Singapore Exchange at 93 cents a unit
DEC 27 – Seeks extension of first right to negotiate four properties until March 2014

2014

JAN 15 – Announces issue of $100 million of 4.6% fixed-rate medium-term notes due in 2017
FEB 27 – Announces acquisition of Luz Omori and NIS Wave I malls for $176.3 million; completed on March 6
SEPT 1 – Announces plans to acquire One's Mall for $132.5 million
SEPT 2 – Closes private placement of 78.9 million new units at 91.5 cents each
DEC 26 – Seeks extension of first right to negotiate on Mallage Saga and Forecast Kyoto Kawaramachi until March 31, 2015

2015

MARCH 31 – Mallage Shobu completes asset enhancement and tenant renewal
AUG 14 – Declines offer from Marubeni to acquire retail development in Shanghai under a right of first refusal (ROFR) agreement
SEPT 29 – Announces 22-for-100 rights issue at 61 cents per rights unit; acquisition of Torius Property for $95.2 million; completed in October
OCT 19 – Declines offer from Sojitz Corp to acquire Forecast Kyoto Kawaramachi under ROFR

2016

MARCH 23 – Private placement of 70 million new units at 75 cents each
APRIL 4 – Issues $60 million 5% fixed-rate medium-term notes
APRIL 7 – Announces acquisition of Fuji Grand Natalie for $40.2 million; completed on April 18
MAY 13 – Announces acquisition of Mallage Saga and Feeeal Asahikawa malls for $74.5 million; completed on May 27
JUNE 12 – Proposes internalisation of trustee-manager
JUNE 30 – Unitholders approve internalisation at extraordinary general meeting; announces 10-for-259 preferential offering at 79.7 cents a unit
AUG 26 – Issues 27,682,070 new units in relation to preferential offering
AUG 31 – Internalisation of trustee-manager completed
SEPT 29 – Issues $50 million 5% fixed-rate medium-term notes
NOV 18 – Purchase and cancellation of $9.75 million fixed-rate notes due in 2017

2017

JAN 23 – Final redemption and cancellation of $90.25 million fixed-rate notes due in 2017
MARCH 24 – Secures ¥3 billion four-year term loan facility
APRIL 26 – Announces approach for potential takeover of trust
JUNE 27 – Trading halt
JUNE 28 – Announces acquisition of CRT by Cyrus Bid Co, a fund under Blackstone Group
AUG 30 – SIAS Dialogue session
SEPT 13 – Scheme meeting
OCT 11 – Trading of CRT units suspended
OCT 25 – CRT delisted