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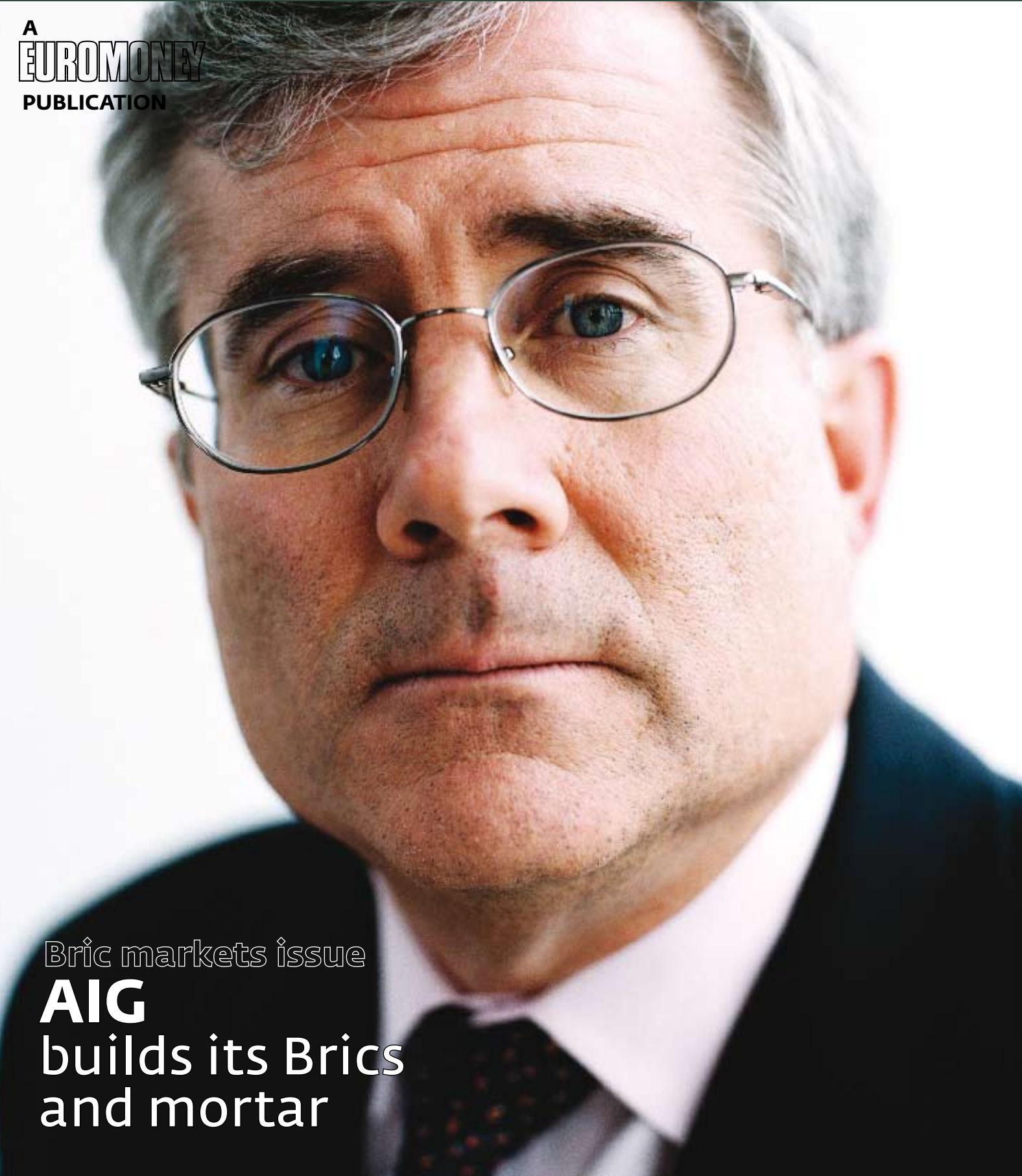
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EUROMONEY
PUBLICATION

Bric markets issue

AIG
builds its Brics
and mortar



AIG

builds on its Bricks and mortar

AIG Global Real Estate is one of the largest and most prolific investors in emerging markets. Now that Brazil, Russia, India and China are the focus of almost every big investor and developer, the US-based firm is far ahead of the pack. The group's president, Kevin Fitzpatrick, speaks to Rachel Wolcott about AIG's history in emerging markets and why enthusiasm for these markets might be overdone

Investing in emerging markets is the latest vogue among those seeking to piggy-back on the success of some of the world's most vibrant economies. However, it is nothing new to AIG Global Real Estate. While many investors and developers talk big about Brazil, Russia, India and China, the so-called Bric markets, AIG's real estate arm is already on the ground in Moscow, Mumbai, Hong Kong and Shanghai. Worldwide, AIG Global Real Estate has 500 professionals searching out opportunities.

Emerging markets are at the heart of AIG's heritage. The US insurer started out in China when in 1919 its founder, Cornelius Vander Starr, opened an insurance company in Shanghai. From there, AIG expanded into other parts of Asia, Europe, Latin America and the Middle East. So AIG is not a US or a western company that went overseas to become international but one with a global focus at the core of how it operates. As an insurer, AIG has always been huge in emerging markets, and that tradition is apparent in its real estate group.

"AIG has invested in real estate from the beginning," says Kevin Fitzpatrick, AIG Global Real Estate's president. "The founder [Starr] had a keen eye for real estate and real estate opportunities."

When Fitzpatrick joined AIG in 1987 to form the global real estate group, the firm was in the midst of developing a landmark project in China – the Shanghai Centre – a property still performing well today even amidst the city's continuing construction boom. From those beginnings 20 years ago, Fitzpatrick and his team have seen AIG's real estate business grow to manage \$18.4 billion in equity. And now, as then, the group's focus is still firmly on emerging markets, including the Bric countries – so much so that it doesn't really distinguish between emerging and developing markets in its overall strategy. In part, no distinction is made because that's the nature of the asset class.

"Real estate is local and it's conducted slightly differently in each country," says Fitzpatrick. "But, from a basic standpoint, real estate is real estate. The fundamentals of going through and building, leasing or selling a building, although it's different country to country, is to a large degree the same."

With its huge network, AIG is well positioned to delve into emerging markets, perhaps on a level its competitors can't access. That's the local level.

"We're very local in the way that we operate," says Fitzpatrick. "We have

people in-country doing the investments, not being in a situation of operating in major cities like New York and London and then making decisions on emerging markets. We actually have people on the ground doing the business."

Unless an investor or developer has a huge affinity for a country, the tedious process of commuting to and from projects in sometimes far-flung locations tends to wear people down, Fitzpatrick warns. That's where having people on the ground doing deals and understanding where the market dynamics are moving really gives AIG a competitive advantage.

Another factor setting AIG apart is its heavy orientation to development and its ability to build on a global basis. It co-invests with clients, dealing with many of the same tenants and investors worldwide. The group's position within the AIG family is another advantage. It counts AIG's chief investment officer, its head of fixed income, its head of the transaction review process, as well as colleagues from the debt markets team and Fitzpatrick as members of its real estate investment committee. This broad scope of experience and expertise gives it the ability to look at pricing and risk across different regions, as well as different real estate and investment products.

"Having the expertise of different product specialists has given us an advantage in that we are able to make sure the pricing for individual markets and individual products is the best available. As investors we're always concerned with maximizing the highest return based on the risk. Obviously we share that with our co-investors," says Fitzpatrick.

This same global structure governing its investment approval process also applies to deal structuring and risk management. When making investments in various countries, AIG's global platform enables it to understand what the risks are and to minimize them as much as possible. It uses many of the risk management techniques developed within its insurance business to mitigate risk on the real estate side.

"Emerging markets, if done properly, are not as risky as a lot of people believe," says Fitzpatrick. "Done properly they can offer superior returns without superior risk. Don't get me wrong, there is risk involved in emerging markets, but there is risk in every market."

Working with many of the same clients on property development projects over

Green roots in emerging markets

AIG Global Real Estate started going green almost 15 years ago, backing into environment-friendly practices almost by accident while working in Puerto Rico. Since those early days, AIG has imported sustainable methodology to its developed-market projects.

In Puerto Rico, AIG was developing a building one of whose selling points would be its capacity to generate 100% of its own power requirements. At the time, it believed the ability to provide a constant power supply would be a differentiator on leasing. And it was, enabling AIG to command the highest rents in the market. However, delivering the power supply turned out to be a challenge.

The idea was to build generators in the building to compensate for an unreliable power supply. In order to keep the size of the generators down, they needed to reduce power consumption. Working with their engineers, AIG came up with a solution that was new at the time, using tanks of glycol (a liquid somewhat like antifreeze), which it froze at night when power demand was relatively low. During the day the air-conditioning blew air over the glycol, which melted during the day. As it turned out, in daytime when power demand was at its highest the building's power demand was lower. That meant the size of the generators needed to power 100% of the building, not just the emergency systems, was a lot lower and more economical.

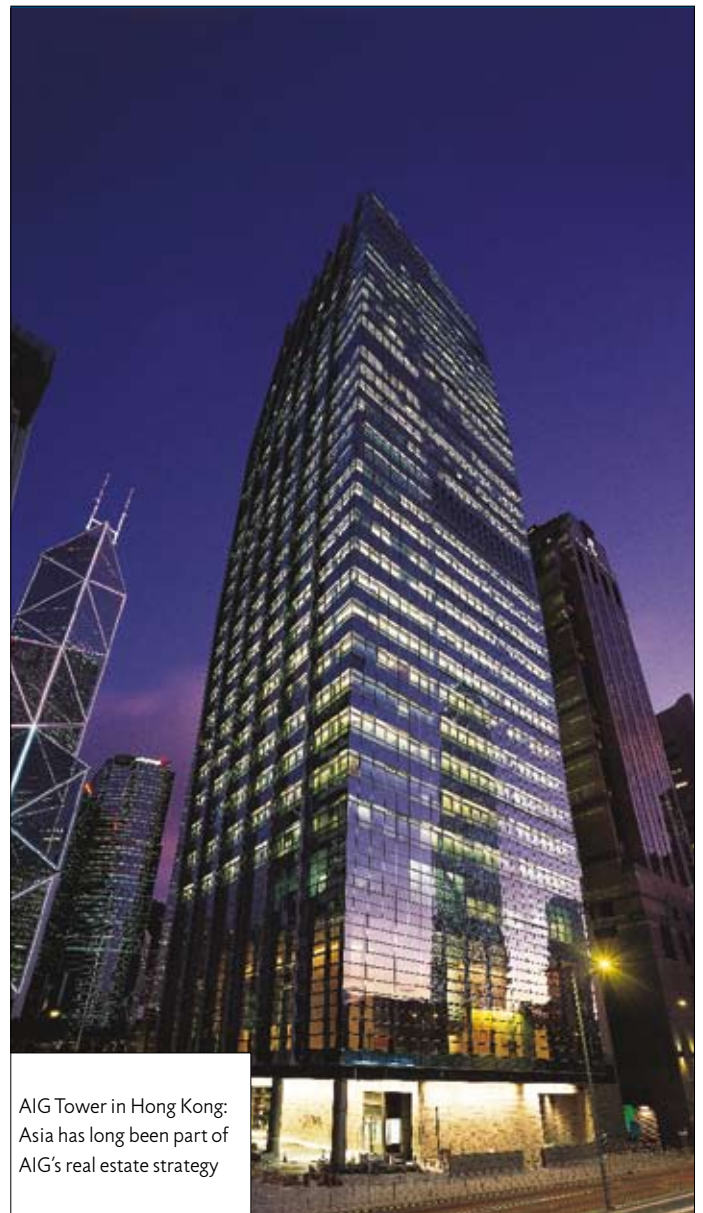
Fifteen years on AIG is applying so-called green technology to its developments all over the world. Its sustainable approach to development has attracted the US Environmental Protection Agency's attention. Its Atlantic Station development in Atlanta, Georgia, is the first US site to be sponsored by the EPA, because it deems the project to be a better alternative to urban sprawl.

the past 20 years is one way AIG can mitigate emerging market risk. So when it has a large manufacturing company that it builds for in Latin America as well as eastern Europe, it looks at whether it is taking the risk of that multinational or the risk of the individual country. And what AIG is able to do is balance that risk back and forth from the standpoint of the corporate risk together with the country risk, which makes the pricing in the emerging markets very attractive.

Since its debut investment in Shanghai in 1986, AIG has been active in the other Brics markets, albeit less so in Brazil. The Shanghai Centre, a mixed-use project including residential, office, retail space and the Ritz Carlton Shanghai hotel, marked an auspicious beginning to the global real estate group's activities. Twenty-one years ago, when construction started, the Shanghai Centre very much epitomized the way the city's landscape would develop, and was one of its tallest buildings. These days, there are many taller high-rises surrounding Shanghai Centre and it doesn't stand out on the skyline the way it used to. However, it is a testimony to AIG's staying power in that market. Its location attracts luxury retailers and, combined with the Ritz Carlton, has proven to be a long-term winner.

In Russia, AIG operates in two different ways. One is in partnership with the Dallas, Texas-based Lincoln Property Company, which specializes in commercial and residential projects. Since 1997, AIG has worked with Lincoln as AIG/Lincoln to develop property internationally. Now well established in Russia, AIG/Lincoln is at present developing a 74,000 square metre, class-A office project in downtown Moscow called White Square Office Centre. It is also working on class-A warehouse and distribution facilities.

Separate from its activities with AIG/Lincoln, AIG has purchased industrial buildings as well as residential property developments. One of its most recent ventures is a partnership with Deutsche Bank's commercial real estate group on a €176.5 million acquisition of luxury town houses in the Pokrovsky Hills



AIG Tower in Hong Kong: Asia has long been part of AIG's real estate strategy

development in the Moscow expatriate residential community, comprising 207 single-family homes near the Anglo-American School.

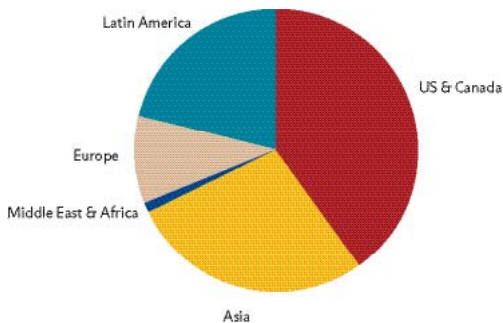
India is very much new territory for many global players, including AIG's real estate arm, which has had an office in Mumbai since 2006. It has a team of seven on the ground and already has three projects under way.

"India is relatively new to foreign investors. Recently the government has relaxed the ability for foreign investors to invest in India," says Fitzpatrick. "It just gives us a lot more opportunity, which is great, and the country provides a lot of domestic demand. The opportunities within all of the emerging markets, but India in particular, are very good."

Building on the base it has already established, in March 2007 AIG Global Real Estate announced a joint venture with RMZ Corp, one of India's leading developers. Together, AIG and RMZ will develop commercial office and retail projects in key cities and will seek out hospitality opportunities throughout India. As part of its foray into the hospitality sector, the joint venture will court international hotel operators to manage properties. The hotel and hospitality sector is one that Fitzpatrick views as being poised for growth in emerging markets such as India.

"A lot of the hospitality growth in the emerging markets is from the residents

ASIA PLAYS A KEY ROLE
AIG'S PROPERTY PORTFOLIO BY REGION



Source: AIG

in-country who, as their economic purchasing power has increased, would love to be able to travel in their own country," he says.

Some 21% of AIG's property portfolio is in Latin America and the group operates an office in Mexico City. However, of the Bric countries, Brazil is one jurisdiction in which the firm hasn't been particularly active.

"It's not a negative on Brazil but more the case of our focus having been elsewhere," says Fitzpatrick. "Brazil has a tremendous amount of opportunities and we have looked at several things but just have not found something that's perfect for us."

Looking beyond the Bric countries to other emerging markets, Fitzpatrick sees a lot of work to be done. So much in fact, that he cautions investors and developers to consider seriously their appetite and comfort level to do business in certain markets, before going in. Even though property investing and development by international groups has become more prevalent in emerging markets, it does not mean that the basics of doing business have become any easier.

In the Bric countries and the emerging markets more generally there is a massive amount of infrastructure being put into place, from office blocks to industrial parks. Those kinds of opportunities will be extremely lucrative for developers and investors. However, when going into emerging countries that are growing rapidly, it's crucial to understand the country's growth trajectory, to forecast where its cities will grow from a physical standpoint and to gauge how developments will perform over time.

"It's a situation where many times you're building a product that's better than is currently in the market. But as the market evolves, in three to five years it may be just the acceptable quality," says Fitzpatrick. "The challenge is to make sure that you don't over-improve the market, but that you are ahead of the market, so that as the market evolves from a physical standpoint you meet the market on a long-term basis. That is what's fun about it and exciting about it, but also where you can make a lot of money."

For all the opportunity, the ability to acquire land, obtain building permits and to design and build a product that's acceptable on a local basis is what is tricky for newcomers to emerging markets but is second nature to AIG.

"New investors and developers may find it a little bit difficult but normally when we enter a market we come in with more questions than we come in with

answers," says Fitzpatrick.

For all the attention the Bric markets receive today, Fitzpatrick has already observed some changes in the way business is being done. The increased interest has been a benefit in that there's more liquidity in the market, so that when investors and developers such as AIG go to sell, there are more potential purchasers. Also there is more debt available in the marketplace from international lenders, which is another advantage.

In some respects, there has been a bit of a downside. Some newcomers to emerging market property have mispriced deals by trying to price them using more of a western or developed market paradigm without fully considering the emerging market risk. The explosion of awareness of Bric and emerging market property plays means that at times the scramble for assets has put pressure on markets, forcing pricing too high. Over time, high prices should revert to the norm, says Fitzpatrick.

"By and large it's positive that there is a focus on the emerging markets because I think that they have a tremendous amount to offer," he says. "But the issue is that there are a lot of people who are in those markets who are maybe paying more than they should. There are also folks in the markets that are not able to get the deal volume and are frustrated from that standpoint, and then they may turn around and pay a little bit more than they should in order to enter the market."

Deal volume has been a challenge for new entrants but for operators such as AIG that have the benefit of a long-established local presence in several markets, it hasn't been a huge problem. In addition, AIG isn't under as much pressure to get deals done.

"We're viewed as having been in the markets for a long period of time, if not for ever. We may become more or less active in a market based on the opportunities that we see," says Fitzpatrick.

"Our people are local and are focused on where the opportunities are on a long-term basis and not just looking to take advantage of short-term market opportunities."

The Bric countries and emerging markets still offer foreign investors many prospects for achieving a greater return on capital than they might in

their home territories. But are these markets beginning to show signs of being overdone? Yes, says Fitzpatrick, but not in the sense of diminishing opportunities.

"Sometimes there's a momentum within a country and market dynamics enable it to continue developing and it becomes a market unto itself," he says. "It's not necessarily always international visitors or international jobs, it's also the issue of the country starting to serve itself. There's a lot of domestic demand in many of the emerging markets, and that domestic demand starts to create internal momentum."

After many years building, funding and investing in international property, AIG Global Real Estate is in an enviable position to benefit from the new-found enthusiasm for emerging markets. Appropriately, perhaps, after 20 years on the job, Fitzpatrick finds himself returning to a familiar project – the Shanghai Centre. As the business he started in 1987 enters its third decade, the development is undergoing renovations aimed at maintaining its position as one of the city's premier addresses.

"From the standpoint of the quality of the building, the service and the quality of the tenancy, that has really helped us," says Fitzpatrick of the Shanghai Centre. "We have some of the highest rents in Shanghai in the building, and very high occupancy. Part of that goes back again to service, which does not go out of favour."

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