On October 22, 2003, the Program on Alternative Investments, under the aegis of the Center on Japanese Economy and Business and in cooperation with the Paul Millstein Center for Real Estate and the Japan Business Association, hosted a seminar entitled “Investing in Distressed Real Estate: The Morgan Stanley Experience in Asia.” The seminar featured Sonny Kalsi, Managing Director at Morgan Stanley and Head of Morgan Stanley Realty, Asia.

Dr. Mark Mason, Director of the Program, moderated the seminar. Mr. Kalsi began with a discussion of the market for distressed assets in East Asia, and the effects of macroeconomic and political trends on the development of these markets. He went on to discuss the strategies and opportunities available to institutions investing in distressed assets in East Asia, focusing most particularly on Morgan Stanley’s experiences. Excerpts from Mr. Kalsi’s presentation are set forth below, together with highlights from the subsequent question-and-answer session.

The Program on Alternative Investments analyzes several major alternative asset classes—including hedge fund, private equity, and real estate—in Japan and elsewhere in East Asia. The Program meets its substantive goals through a combination of research projects and seminar presentations by leading practitioners in each of the alternative asset classes, under the direction of Dr. Mark Mason. For a schedule of upcoming seminars and other Program activities, consult the Program’s Web site at http://www.gsb.columbia.edu/japan/alternatives. Dr. Mason can be contacted by e-mail at mm412@columbia.edu.
The Scope of the Market in East Asia

I can tell you, as someone who has been going back and forth to China for the last seven or eight years, the growth that you hear about there is real. I remember going to Shanghai in the early or mid-1990s and Pudong, one of the major districts of China, was basically farmland. Now, there is more than 50 million square feet of office space there, most of which has been built in the last five years.

Goldman Sachs put out a report about a year ago saying that they thought the 8% growth was understated by the Chinese because they were afraid that people would not believe it if they reported the real growth. I believe that. I believe that the growth on the coast in China, in Shanghai, in Beijing, in Guangzhou is probably closer to 12%–15% per annum.

Is that sustainable? Who knows? Many people are talking about a slowdown in the next 6 to 12 months, but a slowdown in China is probably 4%–5% growth. For our business, being a bit counter-cyclical, in several places where you have this kind of growth, there would not be opportunities for us.

The good news, if you are a distressed investor, is that China has a US$500 billion bad loan problem in their banking system. It is not as big as Japan’s, but it is pretty big and it is a pretty big opportunity.

Many of the people who have spoken to you have talked to you about what they are doing in some different markets such as South Korea or Taiwan, for example, but you could argue that the rest of Asia outside of Japan really does not matter. If you think about it from a GDP perspective, meaning the size of the economy, the size of the opportunity, you can add up everything else in Asia, including China, and it is about 60% of Japan’s GDP. Certainly, if you take Japan and China as a total and look at the rest, it is inconsequential. That is a dramatic statement, and I cannot tell you that we have completely shied away from everything else, but this is how we spend our time. This is why Tim Collins and Lou Forster and many of the players that we compete against have focused so much of their time on Japan. It is where the action is.

Japan has a big real estate problem. Prices and rents are probably down 70%–80% from the bubble in the early 1990s. One of the things that still always surprises people when they come to Tokyo, is that this is a country that has been in a recession/depression for 12 years, and yet there are cranes up all over the place. In every direction you look, there is new office construction going on.

This is a function of a couple of things. One, land prices are low. The cost to add new inventory to the market is a fraction of what it used to be. If you are a developer and you have to build to stay alive, you can easily rationalize that decision.

Two, in the late 1990s, there were actually many reasons for hope. People built very big projects because multinationals wanted a lot of space, especially in the IT (information technology) sector, but also in the financial services sector.

The hard thing about real estate is that if you are a developer, you are trying to time companies’ real-time decisions and yet you have a three- to five-year lead time on actually putting a product into the market. It is a terrible dynamic to be in, and to do well requires a lot of luck.

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It is hard to generalize, as China is such a large country, but generally, the real estate fundamentals in China are okay. There are definitely some cities where you have oversupply, especially in the residential sector, but Shanghai, which was relatively spared the tough consequences of SARS, continues to grow very aggressively. Residential prices are up; office rents are up; vacancy continues to come down.

That creates an opportunity and, from our standpoint, we say, “We like the real estate fundamentals. We think there is a lot of distress. How do we take advantage of that?” It is definitely easier said than done, but that is what we get paid for.
To put that in context, the worst the United States ever got at the height of the RTC (Resolution and Trust Corporation) problem in the early 1990s was US$250 billion. In China’s case, its GDP is going in the right direction. There is still a great deal of aggressive action that needs to happen in Japan.

Resona Bank, which was the fifth largest banking group in Japan, was nationalized this past spring, although the government is not really calling it an accounting firm to scrub down the loan portfolio and it says, “Hey, if you do a net present value analysis on this thing, this paper is only worth 50 cents on the dollar,” and Resona has to write that down to market, guess what? The rest of the banks’ auditors, at some point, are going to make them write that down. The last time that happened in size was when LTCB was nationalized (Ripplewood ended up buying it and it is now Shinsei Bank). If you want to narrowly define it from our perspective, that creates a big buying opportunity because when these banks have to write this stuff down, they generally will get rid of it.

From a more macro standpoint, it is a very simple problem to understand;

China is, for lack of a better term, a scary place to do business. My investors are always pointing to the rule of law and the legal system and asking, “How does this all work; how have you gotten comfortable with it?”

The usual answer is, “Well, we’re still working on some of it.” I would add that, given the scale of our fund, which is a global fund with US$5 billion of equity, you leverage that up, and it is US$1.7 billion worth of buying power. It is a big fund, so to put US$500 million into China may seem like a lot of money. I know that it is a lot of money, but it is 5% of our fund. That is the approach we are taking; we are putting a toe in the water—we happen to have a really big foot, so our toe is pretty big. From the standpoint of getting in over our knees, we are not going to do that until we have a higher degree of comfort that China is a place where we can make money. Most of what we have been buying are NPLs, so we can buy these loans, pursue our creditor rights, get our money back, and then actually get it out of the country. We are still in the process of doing all of that.

With regard to the macroeconomics of what is going on in Japan, I am going to focus on what it is that impacts our business. One, there were a series of LDP (Liberal Democratic Party) elections about a month ago, and, in our view, there was a very favorable outcome: Koizumi won by a big margin. In most people’s view, he had a mandate to do what he wanted to do; he reshuffled his cabinet. Many were outsiders to politics and this reaffirmed his stance as a reformer. I am not Japanese, but having lived there for six years, and having followed politics for even longer than that, it is pretty remarkable. It is the closest thing, I think, Japan has probably had to grassroots change in a long time.

The financial institutions are probably in better shape today than they were five years ago. That is a relative statement; they still have, by some estimates, US$1.7 trillion of NPLs, and some estimates are a trillion and a half.

To put that in context, the worst the United States ever got at the height of the RTC (Resolution and Trust Corporation) problem in the early 1990s was US$250 billion, which amounted to approximately 2.5%–3% of the U.S. economy, maybe 5% in the maximum case. In Japan, even if it is a trillion dollar problem, that is 25% of the annual GDP, so it is a big problem. To further put that into context, China—at US$500 billion—reaches 50% of China’s annual GDP but at least China’s GDP is going in the right direction. There is still a great deal of aggressive action that needs to happen in Japan.

Resona Bank, which was the fifth largest banking group in Japan, was nationalized this past spring, although the government is not really calling it nationalization; they are calling it an equity investment. That is sending a very strong message to the financial community. The other banks are very focused. When the government puts money in, what it means is that management has to take the responsibility to resign and then the government puts the FSA (Financial Supervisory Agency) in to basically rewrite those loan portfolios to market, and that causes a huge ripple effect.

What the Japanese banks have been able to do thus far is ignore the problem by basically saying, “Look, this borrower is continuing to pay interest on their debt and they can make that payment on a regular basis, even if there is no chance they are ever going to be able to repay their debt, banks can generally carry that as a performing loan.

When Resona Bank blows up and the FSA comes in and they hire an accounting firm to scrub down the loan portfolio and it says, “Hey, if you do a net present value analysis on this thing, this paper is only worth 50 cents on the dollar,” and Resona has to write that down to market, guess what? The rest of the banks’ auditors, at some point, are going to make them write that down. The last time that happened in size was when LTCB was nationalized. If you want to narrowly define it from our perspective, that creates a big buying opportunity because when these banks have to write this stuff down, they generally will get rid of it.
1.5%–2%. You look really smart, as long as things work out, if you can buy something for 100 that has a 6% or 7% current yield and finance 80% of it at 2%. ... internal rates of return. You can do that, but it is a tricky business. It is the reason we have a team as big as this.

What are the bright spots in the property market? One is definitely the J-REITs (a derivative of the U.S. REITs: simplistically put, it is the public equity ... world, for anything, but they have outperformed not only the broader real estate index, but also the overall stock market.

Why? Because you can get a 5% to 7% dividend yield in a country where the average dividend yield of the Nikkei is less than 20 basis points; so it is a very attractive current yield.

Because these are all new vehicles and have to have new appraisals done on a Western discounted cash-flow basis, there is a view that these assets are being marked down to market when they are then being sold into the market. There is also definitely a lot more transparency than there has been historically, which is also why these companies have done so well. I fundamentally believe that this business is going to take off.

In 1998, there had never been a non-recourse loan made to finance real estate in Japan. That has changed significantly and the CMBS (commercial mortgage-backed securities) market has grown consistently over the last five years.

Compare and contrast China and Japan. Japan is a lot less scary; it has a legal system that works, a rule of law; there is case precedent; there is real estate, you can buy it on a fee-simple basis, you can foreclose on a borrower, you know how the court process works. That is the good news. The bad news is that Japan has been in 12 or 13 years of recession. There are definitely liquidity issues in a number of places outside the major cities. Frankly, even though Koizumi and the government are doing a much better job now, there is still a fundamental lack of clarity on how the problem will get resolved. China has very strong direction. There is a huge commitment to getting the NPL problem sorted out. I think they are still trying to figure out what they ... are doing a much better job now, there is still a fundamental lack of clarity on how the problem will get resolved.

One question I am always asked by investors is, “If you have a market like this, how do you make money in it? If you are buying distressed assets, how do you make money in a deflationary environment?” The answer is, “It is hard.” One thing that is absolutely critical is that you have to have pricing power, you have to have the ability to buy assets at a price that is below what the clearing price is on a retail basis in the market.

One person who has invested in distressed real estate in Japan, or in any real estate, and bought at anything close to market price has lost money; they have either monetized that loss or are sitting on a loss on their books. So, first you have to find unique situations where you can buy assets on an off-market basis. You have to look for complicated situations, where you buy a company, for example, you strip it apart, you pull the assets out of it, and because you are buying the entire package (and if you are willing to put up with the difficulties associated with stripping the assets out of it), you can get better pricing.

Second, you must have the ability to add value. We have 150 people on our real estate team in Japan. 120 of them manage real estate assets or work out NPLs, so it is a very hands-on, labor-intensive business. We have to take the view that we have the ability to outperform. We can buy an asset that has been undervalued. The owner has been distressed, been in bankruptcy, the building is 50% vacant because they have not had the money to spend to bring the tenants in. That is definitely another part of our thesis.

A third part is to borrow as much money as you can possibly borrow. That is probably the scarcest part of the thesis. It is not uncommon for us to be able to borrow 80% or 90% of our purchase price on anything we buy at interest rates of about 1.5%–2%. You look really smart, as long as things work out, if you can buy something for 100 that has a 6% or 7% current yield and finance 80% of it at 2%. That is a great cash-on-cash equity yield, and, in fact, we have had a number of assets that we have bought on that basis, held for three years, sold for what we have bought them for, but because we made such a big cash-on-cash equity yield, we did very well. The targeted ERIs (internal rates of return) are 20%. plus leveraged internal rates of return. You can do that, but it is a tricky business. It is the reason we have a team as big as this.

What are the bright spots in the property market? One is definitely the J-REITs (a derivative of the U.S. REITs: simplistically put, it is the public equity securitization of real estate). These are tax-efficient vehicles here in the United States and they are definitely tax efficient in Japan as well. They got off to a slow start because the first two J-REITs listed soon after September 12, 2001. As you can imagine, that was not the best time to be going into the equity markets anywhere in the world, for anything, but they have outperformed not only the broader real estate index, but also the overall stock market.

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Questions and Answers:

Q: Among the NPL portfolios that you have invested in, which asset classes have monetized more quickly than others?

Kalsi: Fundamentally, Japan is a deflationary place. This is not going to change for some time. The pace of deflation has slowed down, but it has also shifted a bit. Anything that we own outside of Tokyo and Osaka is pretty troubling. The regional markets in Japan are getting fatter and fatter. There are so many cities in Japan with a population of 500,000–1,000,000 people that have no reason to exist at all. There is no indigenous industry. There may be a heavily subsidized rice farming business, but these cities are in a lot of trouble. Anything we have held in Osaka or Tokyo has been a better investment.

Yields have held up better; capital values have held up better and been more liquid. Our average hold period on a real estate position has been 18 to 24 months. If you are in a deflationary environment and you are holding long term, you are not going to get your money back. If the real estate has been a dominant part of your portfolio, there is much less of a bid in the market, so there is less liquidity and the real estate fundamentals are much worse.

Q: How did you structure your first deal in China in order to deal with the legal and currency issues?

Kalsi: We made our bid subject to 10 or 12 things, which included getting comfort on taxes, holding structure, ability to actually own the loans and own the real estate if we decided to credit bid an asset and actually take the real estate back, and then also the ability to repay trade money. The deal took 15 months to get approved. We had to go to the central state agencies to put the enabling legislation in place to get all this done. We paid substantially less than 30 cents on the dollar in the portfolio we bought.

Q: Are you allowed to service your own loans [in China] or does the government still control that? How does that differ from Japan? Also, how close are the Japanese to getting the idea of selling close to market?

Kalsi: On the servicing side, technically, you are not allowed to service assets in China. That was another thing that we made our bid subject to—we have 45... there are actually very few restrictions on what you can do from a servicing standpoint once you have a licensed servicer.
On your second question, where are the Japanese on market-clearing prices? The individual institutions are more or less there. There is a difference, though, between their ability to accept a market-clearing price and their realization that they would have to sell at a market-clearing price. We have bought a large pool of assets there and mind you, at least when we bought all of them, they were marked to market. We think that there has been US$20 billion to $25 billion worth of assets that have traded, and presumably, Goldman Sachs, Loeser, Ripplewood, Cerberus, and Lehmann Brothers are also buying access at a market-clearing price. They get it. You need one or two things to happen. You are a bank in Japan and you have a loan book that is worth 50 cents on the dollar, so, you need to come up with capital. You can do it in a couple of ways. You can get someone to put that capital in. In the spring of this year, a number of Japanese banks actually went to their borrowers and basically said, “You’re a good borrower. We’d love to keep extending you credit. By the way, we know you can’t repay your loan, so we’ll keep rolling over your low-interest rate loan, so that you don’t have to go into default; but you need to buy some stock in the bank.” They raised US$16 billion doing that. You can do that once and they did do that.

Another way to get capital is to get a government injection, but that is bad because then management is out of work and banks get nationalized. Finally, there is regulatory forbearance. That is starting to happen more and more. The BERJ is an example of how the government is trying to fill the gap, one way or another. Some combination of regulatory forbearance and capital injection, both from a public and a private standpoint, is why it is going to be a 10-year issue. The good news is that the Japanese realize there is a problem and they have a game plan in place, but the bad news (or maybe the good news from a business standpoint) is it is a 10-year issue.

Q: What sort of cash-on-cash IRRs have you been achieving in the three markets that you are operating in?

Kalsi: What we have told our limited partner investors is that we will try to get 20% internal rates of return on their capital. From a bottom-line perspective, we have been able to do that. My view on real estate is really simple: I never get excited about anything I buy until the day I sell it. How does that break down across countries? Thus far, we have been able to hit it and even exceed it in Japan, which is purely a function of financing.

Regarding Shui-on, we have only made two hard asset investments in mainland China, one of which is a development project, which we are doing with the Shanghai municipal government; so this is typical in China. Shui-on, which is a big Hong Kong-based construction concern, comes in, builds this huge project in the middle of Shanghai, and spends a lot of money on infrastructure. They are in the middle of a 10-year development plan. Then, the municipal government comes in and already controls the parcels around the site, and then gets the benefit of all the infrastructure and everything else that has gone in, without having to pay for it; and then they undercut the market in terms of pricing the units.

Q: My understanding is that the Japanese distressed market opportunity has been around and firms have been participating in it for five to seven years. How have the returns varied over time?

Kalsi: For the most part they have been pretty consistent. In the early days, absolute returns were higher. There was more risk, more uncertainty in the market; people did not have experience; they did not have 15-person teams on the ground. On the flip side, they also could not borrow a lot of money, or any money! They were getting 20%–25% returns on an unlevered basis. Now, those unlevered returns are probably closer to 8%–10%, but on a leveraged basis they are still in the 20% range. There probably was a brief period of time when things were a little wider than that, but it was short lived and the Japanese did not sell a whole lot. That is when everyone showed up.

Q: Assuming the Japanese GDP will move up a good bit, to the 2% or 3% range for the next two or three years, do you anticipate a bottoming of the national land prices within a year or two?

Kalsi: I hope so, but I am not going to bank on it. I think most market watchers have been surprised by how the market has been able to absorb this new space. There are a couple of different things going on. Vacancy rates have gone up fivefold, if you look at it on a relative basis. They have gone from 2% to 10%. On an absolute basis, maybe it is not as
bad as people thought it would be, but on a relative basis, it has gone up fivefold. Rents have probably come down 20% from early 2001 to now, if you look at Class ‘A’ rents in Tokyo. Capital values have not moved that much, which means that people’s yield expectations have come down. That is a function of a couple of things. One, financing rates are low and there is more financing available. Two, the J-REITs are a natural buyer and accumulator of assets. There are seven of them in existence right now, with four more in registration. It is a $5 billion or $6 billion market-cap business right now. I personally think it will be $12 billion to $15 billion by the end of 2004.

So, at the same time, while some of the real estate fundamentals have been difficult, there has actually been more capital going into real estate, both through the capital markets and institutionally. The Japanese insurance companies are now starting to go back in and buy real estate again in Tokyo, at least in good locations. There are a number of government pension funds. One of them has US$80 billion, which is rolling over in the next few years, and they want to have a 10% allocation in real estate, so that is US$8 billion that is not in real estate right now. That has kept prices firm.

I still think that most of the Japanese participants in the market believe that the turnaround is a ways off. I also believe most of the foreign investors believe that. Some of my competitors are taking the “back-up-the-truck-and-load-up-everything-you-can” strategy, thinking they have the ability to time the market here. If they are right, they are going to do really well. I think that is tough. Real estate is a lagging index. There is much more data on this in the United States than there is in Japan. In the United States, the real estate market hits bottom 12 to 24 months after the economy does. I would argue that in Japan, it is pretty comparable to that, especially in an artificially low interest rate environment.

Q: You mentioned you expected a lot of growth in J-REITs. Can you shed a little more light on that and also talk about K-REITs?

Kalsi: With the J-REITs, the first two had very bad timing in terms of when they listed, and I think, between them, they had a market cap of US$700 million or US$800 million. The first two that were listed were sold 70% or 80% domestic retail. The positive way of saying that is that Mom and Pop were looking for yield and they bought this. There have been many issues with the way the J-REITs were set up. They have external management, which means it is hard to align the interests of the management company and the asset-owning company. Here in the United States, most of these REITs are internally managed. It is the best way to align interests, in terms of fees and performance. What has changed is that the first two have done okay, and therefore more were incrementally added on and people have listed. The other thing that has changed is that the first two are now 70% or 80% held institutionally. If you are an institution, the problem is that if there is a US$700 million or US$800 million sector, it is not worth your time to take one of your people, put them on the desk, and say, “You’re going to follow the J-REIT sector.” From the broker/dealer standpoint, it is not worth it to take one of your research analysts and say, “Please start research on the J-REITs.”

As the business has grown slowly, however, and now you have US$5 billion or US$6 billion in market capital, with the view that that is going to double, then the institutional investor can put a guy on the buy side, saying, “Please look at this sector, think about putting capital into it.” Likewise, if you are an underwriter, you can say, “Let’s get our equity research analysts to spend a little less time on some of the traditional property companies and focus on the J-REITs.” I think that whole combination of things is what is accelerating things. When clients ask me what they should expect from a listing standpoint, I tell them that if they did a J-REIT today, it is over US$500 million in size. I think 50% to 60% we sold institutionally right off the bat, and that is a significant change.

K-REITs are stillborn. Fundamentally, the structure does not work. There are many reasons why. They are mostly mechanical; they should be relatively easy to fix and address. The Koreans, surprisingly, have not been able to get their act together between the National Tax Authority (NTA) and the Ministry of Finance. There are a couple of different government entities involved in regulating the K-REITs, and there are still a number of conflicts between them in terms of how these things should work. K-REITs are not very tax efficient. They do not allow for much flexibility in terms of owning assets, and therefore, they cannot really offer a yield that is attractive. That is why they have been slow to grow; there are only a handful of them. They have a micro-cap in terms of market cap. However, I have been working with the Koreans long enough to know that they will figure that out and they know what the issues are and need to get their political act together. They will get it sorted out.

The big issue there is that Japan is such a huge economy and there is so much foreign capital that comes into Japan regularly that there is always a bid in the market for yield. I am not sure there is a bid in the market for Won paper. The size of that market is going to be limited because I do not think there will be as much foreign interest in the paper. I do not think the domestic market is big enough to support a fully-hedged industry.

Q: You referred briefly to an interest rate environment that you described as “artificially low.” To the extent that leverage is so crucial to you at this point, how concerned are you about a rise in interest rates, and what do you see as the timing of any potential rise in interest rates?

Kalsi: I am not an economist, but most economists’ views in Japan, at least, is that interest rates are not going anywhere, anytime soon, because they cannot. If you look at spreads, they have clearly widened in Japan over the last year or so, on a relative basis. Percentage-wise it is a lot, but on an absolute basis, it is nothing. If you add 20 basis points to 20 basis points, you are doubling it, but you are at 40 basis points. The Japanese cannot afford to raise interest rates.

Most people now believe that Japan is stable enough, so there is very low risk for a bond market blow-up that would cause rates to spiral out of control. As a buyer, we are probably 80% hedged, either through taking fixed-rate financing or by buying caps. That being said, our view is that our investors do not want us to speculate on interest rates and currency, so we are fully hedged on currency and 80% protected on interest rates. The bigger impact will...
not be on our financing cost; it will be on a take-out in the market if interest rates do go up 2%–3% over time. It will have an impact on liquidity and it will definitely have an impact on real estate values, although for that to happen, for interest rates to go to 2% or 3%, Japan is going to have to be doing really well. Smarter people than I have done all sorts of statistical regression analysis and game theory analysis to show that if interest rates double in Japan, then that means that GDP has to be growing by 5%, and if that happens, all this great stuff is going to be happening. The reality is, who knows? That is part of the reason, from the reality standpoint, that our average hold period has been shorter. We are just not willing to go long on real estate in Japan because there is more downside than upside.

Q: Could you tell us a bit about problems Morgan Stanley has had putting capital to work in Japan in distressed real estate? To what extent is capital overhang a problem with the industry overall, in the same way it is with private equity?

Kalsi: Ironically, there is probably more demand for distressed assets in Japan than there is supply, which does not make any sense. To oversimplify it, someone has to write the check; someone has to fill the gap on the balance sheet for the Japanese to be able to turn around and sell the assets. That does not really exist in size right now. Therefore, in any given distress situation, there are definitely multiple capital parties that are interested in them. It all comes down to access. Everyone has a different strategy and approach. Ripplewood has clearly been focused on big operating businesses like LTCB and like some other less distressed, more private equity type turnaround opportunities. LoneStar has also been very focused on financial institutions. We have been focused on more traditional real estate opportunities, driven by our corporate clients. One big competitive advantage that we have is that we have, by far, the biggest investment banking division within Japan. We have a hundred investment bankers that cover a couple of hundred accounts with whom they have very good relationships. I do not think anyone has the track record that we do of actually doing negotiated transactions with our corporate customers. There are not many people who can do that, who have that scale of relationships, but who also have the ability to commit large amounts of money very quickly.

Q: You mentioned that in your first and only Chinese deal so far, the government granted you some very important conditions that you negotiated for, specifically, not only ownership of the loans, but if foreclosed upon, ownership of the real estate. That is contrary to the current laws—a distinct advantage. Do you think that will remain a limited opportunity for big players like yourself, or do you think that this will eventually trickle down and perhaps change property ownership realities in China?

Kalsi: No one owns land in China. Everything is done on a land-use right basis, and there are two types of land-use rights: allocated and granted. It is very complicated, but with a granted land-use right, you can do whatever you basically want with it as long as it is granted to you. With allocated, you can do it as long as you are doing a specific function and only you can do that function. Application is always more important than what is said in the legislation, and whether this is something that fundamentally changes from a market standpoint, I do not know. Interestingly, there is going to be a second auction at the end of this year, and they still have not come out with what we, as investors, should be underwriting to in terms of what we can get. I think we will get 80% or 90% of what we are able to negotiate over a year and a half, but I do not think we will get all of it. Real estate, land, is still very dear to the Chinese and certainly to the government, and it is definitely a way for them to control resources, so I do not see a fundamental, significant change in that any time soon.

Q: There are presumably Japanese firms that are also doing business in distressed real estate. Why are you and other foreign firms doing so much better? The answer is true or not, but I assume it is. What is your explanation, aside from hubris, as to why you are doing so much better?

Kalsi: Five years ago, there was not one Japanese investor in distressed assets. That market has grown significantly. I would say that 10% or 20% of the market now is probably Japanese capital and that is growing. I am not sure that we have necessarily done better as it relates to the returns that we have made. Certainly, we have been prepared to take more risk. On a risk-adjusted basis, I would say that the intelligent Japanese capital that has gone in has probably done just as well as we have. They have probably taken less risk, and therefore, their returns are lower.

Part of the issue is: how do you go out and raise capital or convince your management to go along with distressed business when you have a big distressed problem yourself? From a mentality standpoint, it is hard to get them to turn around. In 1991–92, Chase Manhattan Bank and Bank of America were not buying many distressed assets in the United States. In turn, traditionally, the securities firms in Japan have always been relatively reluctant to commit large sums of capital to that business. They have been much more in the agency business than they have been in the principal business. That means it leaves it to entrepreneurs, to people who are setting up smaller funds, and I would say that the average size of a foreign investor’s capital allocation, whether it is through a fund or through balance sheet, is several billion dollars. The average Japanese private equity fund, on the other hand, is probably US$50 million to US$100 million. From a scale standpoint, there is only so much they can do. I think that we (and other foreign investors) ultimately will get priced out of the distressed business in Japan by local capital, well before there is an economic recovery in Japan. It is just an incremental chipping away at our business. At the better end of our business, the J-BETIs are chipping away at it right now. On the more distressed end of our business, these small funds are chipping away at our business. That is part of the cycle. I started my career here in the United States, spent some time in Europe, and got priced out of those markets. We will get priced out of the Japan market eventually. Who knows what is next?

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不動産投資：モルガン・スタンレーのアジアでの経験

東アジア市場の現状は、不況の世界には習慣的なものと思える。しかし、不動産業界での不況は景気循環に反比例するので、成長の中国では経済は向上に思える。しかし、不動産業界のの不況は、5000億ドルを超える銀行セクターは、日本の経済を支える重要なセクターである。多くの人が、日本や台湾はどういう話をしているが、GDPの成長は東アジアで重要なので、日本と中国市場の二つが大きく影響する。

日本の不動産業界は大きい（供給過剰）問題を抱えている。売買価格や賃料はパネル間の8割弱である。不況の時期は、不況が12年も続いているのに、まだ建設ラッシュが続く。不況の時には地価そのものが低いために開発業者が上手に建てることが難しい。私の考えは、2009年の間に不況が続いた不況が続いた理由が多めにあたる。90年代の終わりには、多くの不況企業が高リスクパースを低リスク企業に売却する動きを見せていたが、それは現実だった。不動産業界が開発業者の直面している困難はまさに、このタフな業界の問題で、長期的に市場が回復するまで5年から5年半かかっている。こうした業界でうまくやるには、投資家は重要である。

供給過剰な日本市場を比べ、国が広い中国の不動産市場は、ファンドメタルが思いのほか、うまくいっている。都市の内では供給過剰を問わないが、上海など，在宅事務所に賃貸料は上がり、空室率が下がっている。都市部で、どうやって安穏に生活しているか、高いファンドメタルからの価格上昇で売却されるか？答案は易しに行うことが難しいが、我々は主にそれが起こっているプロである。

中国、日本、韓国における投資状況と展望

東アジア市場全体を見ると、我々は日本市場に8割の時間を割いている。その3分の1が不動産で、6割が不動産、残りの1割が在宅機材の付帯としていう場所である。特に不況の経済においては厳しい市場である。法整備などの問題は我々も未だに満足しているわけではない。中国投資者に対する内需は決して少ないが、我々のファンドは5％くらいしかせめていない。我々は市場に少し大きい企業が、中国ビジネス環境が整っているまで期待していない。もっと内需が急になっている。

日本では、市場が見直され、税制の対策で在宅機材の税制を全て含むことが必要である。長期的には期待できる。核心的機会を、あくまで相対的な話だが、5年は強く希望している。いったい、1ドルの不動産投資があることには変わりはない。日本での不動産市場の間隔はこの低金利のもも利、利益だけでも安定している価値をもって、より元本まで返済し難くても不動産投資は続けないで問題を先延ばししている。

日本における不動産セクターの需要をみると、非常に高い。数年前に1.2％だった空室率はまだやや10％に迫る勢いである。さて、この不況時の中国で不動産業界でにできるのはどうするべきか？答えは難しいが、3つにまとめられる。一つは、価格設定能力を持ったこと。市場の外での販売のような状況を見つければならない。二つ目は利益価値を付加する能力を持つこと。潜在利益の収支の問題、能力を発揮させるための付加価値を育む。三つ目は、利益価値を付加するためだけに貯金を増えることである。あとは、不動産関連の市場で明るい材料は不動産の証券化のJ-REITsである。もう6年この市場を日本でやっているが、まだまだ不動産、不動産業界を進化させていくだろう。

中国と日本を比べると、日本が不況であることを抜け、法整備の整って不確実性の少ない日本の方がビジネスをやるうえで大きく違う。ただ、日本のファンドシステムは方向性を失っている。一方、中国の方は、方向性はしっかりと、不動産問題解決の態度で、日本より強固で、経済成長基盤にいただく。中国の問題点はその法制度の不整である。これが理由で、不況の下での不動産投資は日本の不動産市場の全般的な取引を止めた。

投資はアジアの不動産市場でもちろんリスクに対する対策が必要だが、日本並みの法制度を持った経済状況は日本より高い。短期的には（1）北米での貿易、（2）消費者の過剰債務問題、（2）二つが問題としてお努力される。最後に、モルガン・スタンレー・アジア不動産部門のビジネスをまとめる、次の4つに集約される。一つ目の不動産顧問業務であり、顧客のためにJ-REITsなどで経済を増大する。二つ目は日本不動産市場での海外投資としてももっとも大きく貯蓄（常に100億円程度）の貯蓄。三つ目はMSRFプログラムという不動産ファンド。最後に我々自身の、あるいは第3者の資産運用である。