One-On-One

# Adam Gallistel

Adam Gallistel is Head of Real Estate Equity and Debt investment activities in the Americas for GIC, Singapore's sovereign wealth fund. He is also a member of GIC RE's Global Investment Committee, is Head of GIC's New York office, is on the Executive Committee of the Zell/Lurie Real Estate Center at the Wharton School of the University of Pennsylvania, and is a PREA board member. He talked with Lionstone's Hans Nordby about GIC's real estate portfolio.

PREA thanks Hans Nordby and Adam Gallistel for sharing their insights and expertise.

**Hans Nordby**
Lionstone Investments

**Please tell us about the GIC real assets portfolio and how you operate and make allocations across property types and strategies globally.**

Within real estate, GIC is a four-quadrant real estate investor, meaning the firm invests in public, private, debt, and equity—basically, all security types. GIC is agnostic on placement in the capital structure—public versus private, geography, and asset class. Simply put, GIC invests in anything the term *real estate* applies to and does so on a global basis.

**How does GIC's outlook impact the determination of which assets are appropriate for the portfolio in North America versus other global markets? Is the view consistent globally?**

There are certain nuances on a regional versus a global level. Many US sectors dubbed "niche" or "nontraditional" have achieved much greater scale in the US than they have in the rest of the world, so GIC's US portfolio has a lot more exposure to these sectors compared to its portfolio in the rest of the world. This also means that GIC's US portfolio looks a lot more like the Green Street coverage universe than a traditional ODCE portfolio, with roughly half of GIC's US assets invested in niche sectors.

Globally, GIC invests in a lot of these sectors but on a much smaller scale. It also continues to evaluate housing solutions in various forms and industrial.

**That is interesting. What percentage of the global GIC portfolio is US or North American real estate, and how do you arrive at the allocation?**

The US represents somewhere between 35% and 40% of GIC's real estate exposure. Across the world and across asset classes, GIC's largest investment exposure is in the US simply because it is the largest, most liquid market in the world.

GIC's portfolio exposures are more an output of bottom-up investment analysis. GIC is different relative to a lot of other institutional investors in that it has no home-country bias. Given its mandate, the only place GIC can't invest is in Singapore. Unlike many domestic pension funds that have a US bias, with more than half to nearly all their assets in the US, GIC's portfolio is far more geographically balanced with significant weights in Europe and Asia.

Over the past decade, having a long-only view in the US has served many pensions well but that may not always be the case. GIC looks to preserve and enhance the long-term purchasing power of the reserves under its management and to have diversified, noncorrelated exposures. Country diversification is one of the strongest ways to construct a portfolio of noncorrelated exposures in the real estate sector. The GIC portfolio has much greater exposure to both emerging and developed Asia than typical domestic pension funds. Markets such as Japan and Australia have been some of GIC's best-performing investment markets for decades. In China, GIC is more constructive on the market than most US investors.

**How has the pandemic changed GIC's investment strategy or execution? What's different now versus three years ago?**

What has changed relevant to the past two years is that money is no longer free. The Federal Reserve used to tell us, "Hey, the pool is warm, come swimming." Asset owners of all kinds heeded that call and drove up prices to arguably irrational levels. Fast-forward to today: the Fed is saying, "the pool is cold, no lifeguard is on duty, and swim at your own risk."

Relative to the past 12 to 24 months, having capital means something. GIC is set up to excel in this kind of environment because it is more liquid than virtually any investor on the planet and can be a liquidity provider in periods when capital is dear, as it is now.

The biggest pivot in GIC's book recently has been a lean into credit. Two things are going on in credit right now: relatively high base rates and elevated spreads. By historical standards, base rates are not crazy high—they are actually a return to normal. What's compelling to GIC right now is that spreads are elevated relative to almost any other period historically, which is a function of bond mutual fund outflows, banks tightening, and regulators suggesting that access to credit should be less available. In real estate, there is always a need for credit. GIC is stepping into the void created by the high demand for credit with a tightened supply. The single biggest change in GIC's US approach in the past 12 months is the level of credit investing it is doing.

Today, given the limited pool of buyers, GIC can buy more assets with high free-cash-flow conversion at yields at or above the cost of debt.

### How have property-type allocations changed over the past five years?

GIC is not an allocation-driven shop; it's interested in more specific idiosyncratic opportunities. In a world where base rates have generally risen and capital has become dearer in both emerging and developed economies, GIC has an enhanced focus on developed economies because they generate very good returns without the attendant risks that come from emerging economies. Globally, GIC continues to favor sectors with the wind at their back, such as the housing and industrial sectors.

Unlike many investors, GIC also continues to pursue select opportunities in out-of-favor sectors, such as office and retail. The office sector has its challenges, and the firm is quite cautious in the space, more so in the US than in other major markets. With that said, GIC believes that the sector is too big to ignore and that reports on the death of office are overblown. GIC is being patient while expecting interesting idiosyncratic opportunities to present themselves as loans mature.

### Within the many property types and strategies you pursue—value-add, opportunistic, or core—or even within property types or development, which arrows in your quiver besides credit have become more or less interesting in today's higher interest rate environment?

GIC eschews categories such as "core," and others, given that they act like a Rorschach test: everyone defines and sees the terms differently. I prefer terms that are more concrete, such as "development."

On balance, GIC's appetite for development has declined. Development offers a relatively slow speed to cash flow. In a world of increasing uncertainty on both the cost and the revenue sides, waiting three, four, or five years for pro forma yields on cost that are predicated on earning a spread on yesterday's low interest rate–driven stabilized valuations tends to be a less-compelling value proposition than buying existing cash flow. Although GIC is doing some development, the activity has gone down substantially globally.

On the flip side, the company's interest in cash-flowing assets that are driven by fewer cyclical demand drivers has increased. Today, given the limited pool of buyers, GIC can buy more assets with high free-cash-flow conversion at yields at or above the cost of

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debt. This profile allows GIC to create solid current dividends that provide a hedge against the inevitable mark to markets that will come. Regardless of the asset class, GIC is pivoting to profiles that produce higher current dividend yields.

**Can you share any shop or personal views on real assets as an inflation hedge, besides the cash flow aspect?**

The data shows that real estate is a decent inflation hedge over the very long run. However, in the short term, inflation hedges cannot protect investors if an owned asset is overvalued going into an inflationary period and/or in a location or sector that is oversupplied. Further, depending on the asset class, inflation may hit expenses well ahead of the ability to pass it through to the tenant.

GIC believes that the markets were in a bubble due to negative real interest rates. Now that base rates have a positive real interest rate component in them, there will inevitably be value destruction for investments that were predicated on the assumption that zero to negative real risk-free rates could exist in perpetuity.

Existing portfolios, either by original conception or through the appraisals they were marked at, were constructed around a lower-for-longer thesis. There are different types of diversification: geographic diversification, asset-class diversification, and financial diversification. If the financial risks that are already owned are all constructed on a lower-for-longer basis, shouldn't the industry collectively think about how to construct portfolios predicated around the idea of higher-for-longer?

Today's financial risks suggest that pricing needs to be adjusted to reflect the current interest rate environment—to have cap rates that are accretive to the financing on day one. People may say, "that is never going to happen; low rates will come back." And they might be right, but GIC's investment philosophy is "prepare don't predict." With an increasing body of evidence that suggests a higher-rate regime may last for longer, being prepared means adding financial risks to a portfolio designed to capitalize on that environment. GIC cannot sit around waiting for a return to a regime that existed 12 to 24 months ago. Put simply, hope is not a strategy.

**What prompts people to say, "That's interesting about GIC; I didn't know that"?**

What I find interesting about GIC is that people think a large sovereign wealth fund would be very slow and very bureaucratic. GIC is not only the fastest elephant, it is an elephant that sometimes looks like a gazelle. The fact that GIC can operate at the scale it does while maintaining an entrepreneurial environment continues to surprise me.

I'm also impressed with how levelheaded the firm is; GIC's long-term approach allows us to look past the current pervasive pessimism and see opportunity while many others are on the sidelines.

**That's a great message to end our interview on—thank you, Adam.**

*Hans Nordby is Head of Analytics and Research at Lionstone.*

The views expressed are those of Adam Gallistel at GIC as of the interview date, may change as market or other conditions change, and may differ from views expressed or implemented by Lionstone Investments or its associates or affiliates. Neither GIC nor Lionstone Investments make any endorsement or representation with respect to the other.