

China Life recaps \$950m ElmTree portfolio

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25 May, 2017

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A wholly-owned subsidiary of **China Life Insurance Group** has invested \$950m to recapitalize a portfolio of properties owned by **ElmTree Funds**, a private equity real estate firm. The transaction will replace financing from a consortium of institutional investors, including pension and retirement funds, and allow ElmTree to advance its core focus on single-tenanted industrial, office, and healthcare properties in secondary and tertiary markets.

A single-tenant, net-leased property requires its sole tenant to pay a portion or all of the taxes, fees, and maintenance costs for a property in addition to rent. The arrangement typically comes with a longer-term lease, and property owners may use the structure to shift the responsibility for paying taxes onto the tenant, who may then pay less rent.

Due to the single-tenant nature, net lease buildings can have higher tenant risk but when combined in a larger fund structure, the diversity of the credit should mitigate those risks. "There's predictability and certainty that you get from that [long-term] lease," said **Jim Koman**, managing principal at ElmTree. "If you think about how to be defensively hedging in a rising interest rate environment, you should look at contractual rental obligations." Other benefits of the structure include annual rent increases that are baked into contracts and a normalized cash flow.

Focusing primarily on net lease properties within a fund can have some drawbacks as well. "You could have a long-term lease and the market rent could change," said Koman. "But for three to five years, you'll be locked in [to that rent]." The property type, however, can still provide value as part of a diversified investment strategy. "There is a home [for net lease] in most people's portfolios," he added.

Bringing an investor like China Life to a fund that targets secondary and tertiary markets is unique, as many foreign players prefer investments in gateway cities, favoring trophy assets in recognizable locations. But the recent influx in foreign capital, combined with the focus of that capital on the same handful of cities, has caused property valuations to skyrocket, making it difficult for investors to make opportunistic investments in those markets.

"Working with [Chinese investors] is not just business-related, but cultural. We've been spending time with them over the last few months to get them comfortable with who we are, what our insight is into the local market experience, where our relationships are, and how we operate in secondary and tertiary markets," said

Koman. Part of the challenge was educating the group about opportunities in non-gateway city markets. “[Our portfolio offers] the same credit and the same [company] names at a much higher return [than a gateway market] over a long-term lease period,” he added. This partnership represents the first time that the two firms have worked together.

ElmTree will retain a 5% ownership stake in the \$1bn portfolio and will continue to serve as asset manager and employ a core/core plus investment strategy. The portfolio also has about 60% of its debt in place, which was put together by **JPMorgan** via the commercial mortgage-backed securities market. The transaction was arranged by **Eastdil Secured**, which acted as a credit adviser to ElmTree. **Hodes Weill Securities** acted as the firm’s exclusive financial adviser.

The joint venture’s portfolio will initially comprise 48 single-tenant properties aggregating more than 5.5m square feet across 20 states. The transaction agreement provides for the acquisition of two additional single-tenant net lease properties from *ElmTree Net Lease Fund II* under certain conditions, and the structure is in place should the two companies want to continue working together. “We believe that as this relationship blossoms, we will move along strategically to increase those opportunities together,” Koman added.

China Life is the largest financial insurance corporation in China – at the end of 2015, consolidated total assets of the group company exceeded RMB 3trn.

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