Navigating the Storms of Distressed Ventures:
South Korean Investments in US Office Real Estate

by

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BA in Economics

Boston University, 2016

Submitted to the Center of Real Estate in partial fulfillment of the requirements for the degree of

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ABSTRACT

During the early to mid-2010s, Korean investors flooded into the US office real estate market, enticed by the promise of higher returns in an era of low interest rates. At this time, the Korean base interest rate exceeded the Fed funds rate, minimizing losses from currency hedging. The allure of investment was further magnified by the "herding effect" – a phenomenon driven by headlines of Korean institutions achieving success in the US office market. Fear of missing out (FOMO) and pressure from executives propelled a wave of Korean investments into the same sector.

Today, Korean investors face distress in this market. The aftermath of COVID-19 has led to a significant decline in demand for office space, with employees reluctant to return to physical offices. Furthermore, the distress extends beyond demand dynamics; it encompasses financial turmoil caused by the Federal Reserve's rapid interest rate hikes. These hikes have created a double-edged sword, adversely impacting both equity investors struggling to meet loan obligations and lenders unable to recoup their loans.

This thesis explores potential solutions through real-life case studies, drawing from the author's experience working at a number of real estate private equity firms. The path to resolution, though, is fraught with challenges, including but not limited to: information asymmetry, moral hazards, a lack of experience in US office market distress, complex investment committee approval procedures, and the entanglement of numerous investors in single deals. This thesis sheds light on these complexities while offering insights into navigating the distressed landscape of US office real estate investments for Korean investors.

Thesis supervisor: Albert Saiz

Title: Daniel Rose Associate Professor of Urban Economics and Real Estate with tenure; Faculty Director, Urban Economics Lab

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I dedicate this thesis to my unwavering source of support, my wife, Daeun Chung. From the inception of this journey, you have stood by me, believing in every decision I have made. I consider myself incredibly fortunate to have you in my life. Without your support, I would not have been able to complete the thesis or successfully navigate the MSRED program.

My heartfelt gratitude goes to my mother, San Ho Kim, and my sister, Kyung Eun Lee, for their financial and emotional support. I also want to honor the memory of my father, Sung Woo Lee, who now rests peacefully in Heaven. Dad, I miss you and love you. I believe you watch over me from above, proud of the person I have become. I have strived to fill your large shoes since your passing and will continue to do so.

Special thanks to Albert Saiz, my thesis advisor, for providing intellectual guidance throughout this process. I am also appreciative of the individuals from various investment firms, institutional investment firms, private equity firms, etc., whose names I cannot disclose for confidentiality reasons. Your invaluable information significantly enriched my thesis. Gratitude extends to interviewees Joseph Oh and Edward Glickman for sharing profound insights and honest opinions, enhancing the depth of my work.

Lastly, to my newborn daughter, Hannah Lee, you are the greatest gift of my life. I pledge to fulfill my role as your father to the best of my abilities. I will always love you unconditionally.

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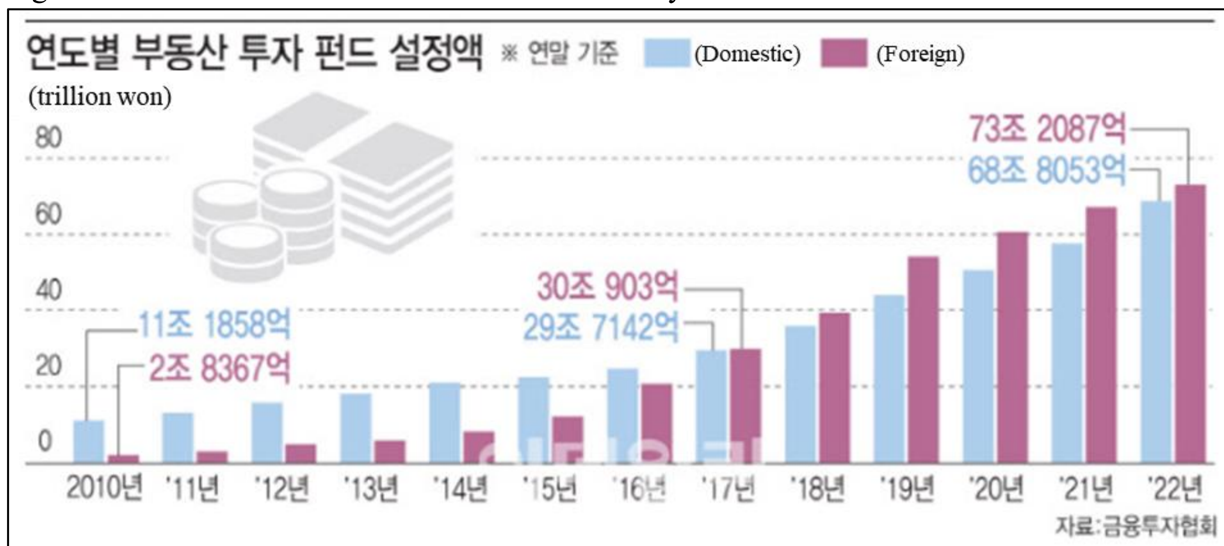
I. Introduction

In the early to mid-2010s, shortly after the global financial crisis, Korean institutional investors were in search of investment opportunities that would substitute their traditional investments in stocks and bonds. With interest rates at historic lows and stocks exhibiting high volatility, conservative institutional investors naturally turned their attention towards commercial real estate. However, the domestic real estate market was too small and competitive, so they wanted to expand their exposure to foreign markets. In 2010, the size of domestic real estate funds was 11 trillion won (approximately USD 8.3 billion), dwarfing the size of foreign real estate funds of only 2.8 trillion won (approximately USD 2.1 billion). Fast forward 12 years, by 2022, the size of foreign real estate funds had grown to 73 trillion won (approximately USD 55 billion), beating the size of domestic real estate funds of 68 trillion won (approximately USD 51 billion).

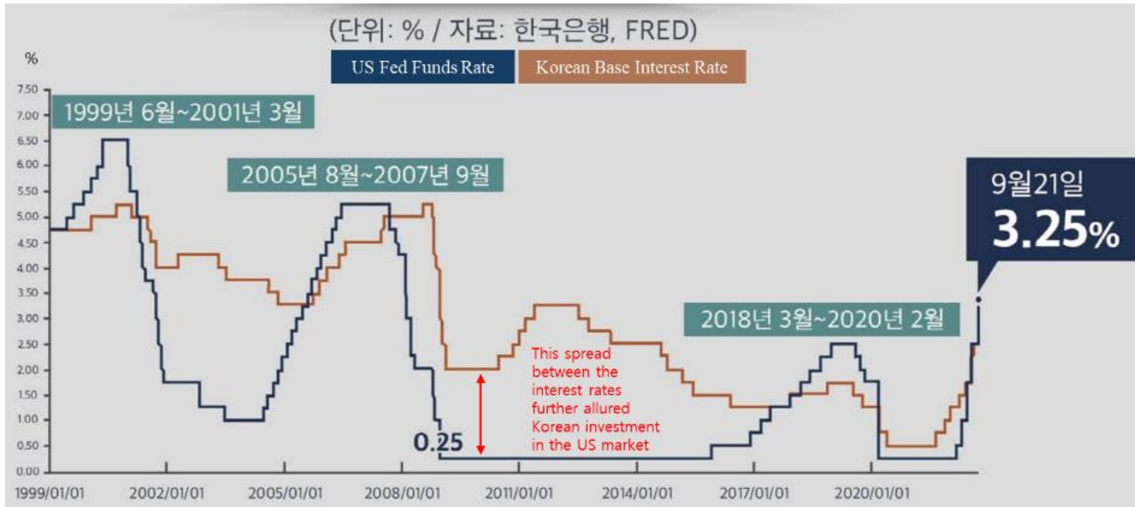
Figure 1: Size of South Korean Real Estate Funds by Year



Source: Korea Financial Investment Association

Among different foreign markets, Korean institutional investors were mostly interested in the US market because of the advantages it had with the huge size, high liquidity, and transaction transparency. Counterintuitively, they were also enticed by the Fed funds rate that was lower than the Korean base interest rate, which further safeguarded their returns with currency hedging. When Korean institutional investors invested in overseas real estate, they almost always hedged their currency risk by employing derivatives such as forward contracts or cross currency interest rate swaps. Because the Fed funds rate was lower than the Korean base rate, the Korean investors usually received a foreign exchange premium from their foreign exchange bank on the last day of the currency exchange because of that interest rate spread. In other words, that foreign exchange premium compensated for the lower interest rate of the investment target country. Loss from currency volatility was a risk that the investors desperately wanted to avoid, so earning a premium while hedging the currency was very attractive to them.

Figure 2: US Fed Funds Rate vs. Korean Base Interest Rate

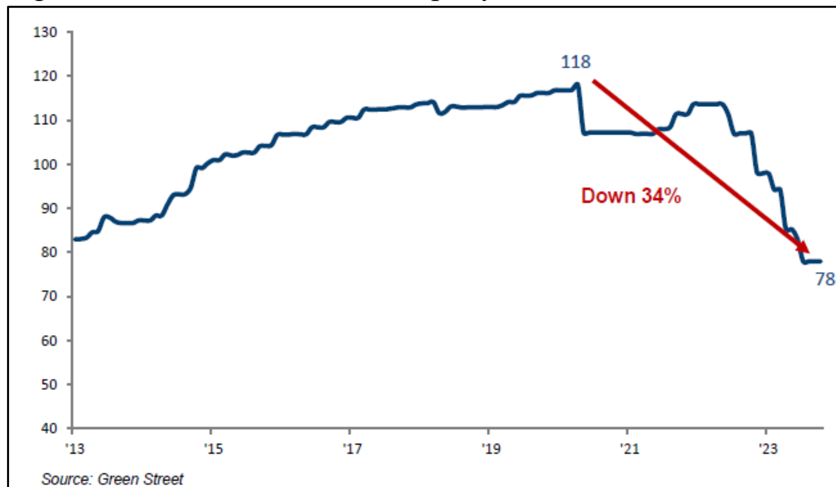


Source: Bank of Korea, FRED

According to South Korea's Financial Supervisory Service, at the end of 2020, the majority of South Korea's foreign real estate funds were invested in the US real estate, constituting 42.1%, followed by Europe at 27.4% and Asia at 6.7%. By sector, office comprised the majority at 53.2% followed by hospitality at 10.7% and multifamily & retail at 7.1%[1].

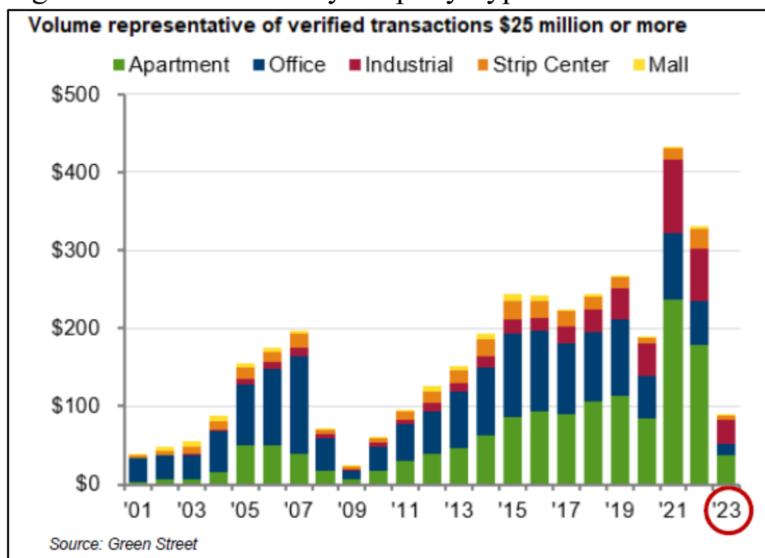
Today, the US office sector is facing distress due to a combination of i) the downsizing of physical office space since the COVID-19 pandemic and ii) the rapid interest rate hikes carried out by the Federal Reserve. Office prices have dropped by 34% since the inception of the pandemic, and office sales volume has dropped from 2015-2019 annual average of $97 billion to $56 billion in 2022, a more-than 40% drop.

Figure 3: Green Street Office Property Index



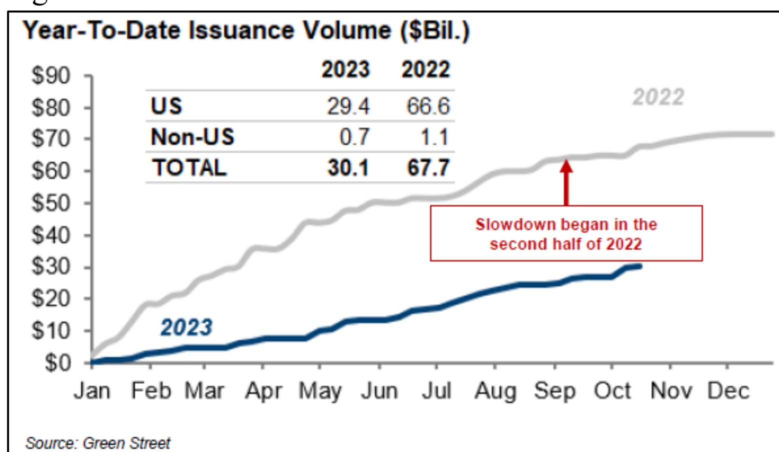
[1] Korea Development Institute (2020). Current Status and Countermeasures of Overseas Real Estate Funds. https://eiec.kdi.re.kr/policy/materialView.do?num=208393&topic=

Figure 4: Sales Volume by Property Type in the US



The recent interest rate hikes have dramatically increased the cost of debt with first mortgages often at interest rate of 8~10% or more, which is beyond historic highs over the last 35 years. The reality is that very minimal or no new financing is available for office collateral today as liquidity has dried up for the commercial real estate, in which office had the most significant impact.

Figure 5: Worldwide CMBS Issuance Volume



For South Korean real estate private funds, because of the nature of confidentiality, it is hard to estimate the exact magnitude of the distress they are facing with US office investment. However, the industry is well aware of the significant challenges facing overseas real estate investments, as it is a topic of daily discussion. Some major investments in trophy office buildings in the US and Europe have already realized losses, making headline news. Many experts say this is only the initial phase of the office distress we will see in the coming days. In the case of public real estate funds, the data is transparent due to its public nature: over 60% of these funds focused on overseas real estate are generating negative returns, with the lowest

performing at a negative 82% return[2]. Korean regulators and the institutional investors themselves are clearly aware that they are walking into a hurricane of defaults and losses. An article[3] by Invest Chosun explains well the fundamental reasons behind the current distress in office investment in foreign soils, including the US:

"*The crisis narrative of overseas commercial real estate is gradually becoming a reality. Even in the densely populated United States, where high-quality tenants abound, the decline in commercial real estate prices is accelerating. The situation is further exacerbated by an increase in vacancy rates due to weakened consumer demand, and a vicious cycle of sharp declines is unfolding, aggravated by sudden rises in interest rates leading to a significant reduction in new capital inflows…. During the course of the COVID-19 pandemic, companies based in the United States and Europe, where remote work became widespread, have not returned to the offices even after the pandemic. Office vacancies have increased, and the rising interest rates have become a factor causing companies to gradually vacate their office spaces. The atmosphere is quite different from the post-pandemic prosperity enjoyed by the office market in South Korea.*"

The article further suggests one possible reason why Korean investors have not yet witnessed multiple defaults and losses on US office investments:

"Institutional investors are gradually approaching the timing for realizing losses. Every chairman and Chief Investment Officer (CIO) of pension funds are well aware of this situation. It is reported that discussions about this situation consistently arise during recent gatherings of pension fund CIOs.

As potential losses continue to mount, and with challenges in making additional investments, the situation involves a continued dilemma. Institutional investors are not obligated to proactively confirm losses unless an Event of Default (EOD) occurs or there is action required for fund recovery.

Domestic pension fund CIOs can extend their formal terms of office by one year at a time, with a maximum extension of two or three years. Many CIOs were appointed in 2021 and 2022, and from 2024, they will be at a crossroads for replacement or term extension. The backdrop of embracing overseas real estate also seems to play a role in this scenario.

Last August, the Board of Audit and Inspection conducted a thorough investigation into the alternative investments of pension funds and mutual aid associations. It is also understood that the Financial Supervisory Service requested overseas real estate data through the Ministry of Strategy and Finance."

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[2] Ira Song (2023). Continuous Decline in Overseas Real Estate Mutual Funds... 6 out of 10 Show Negative Returns. Sedaily. https://www.sedaily.com/NewsView/29X7HUYG63

[3] Jiwoong Han, Head of Corporate Finance (2023) Overseas real estate insolvency accelerates... Pension Funds and Mutual Aid Associations Start to Deal with Hot Potatoes. Invest Chosun. https://www.investchosun.com/site/data/html_dir/2023/11/09/2023110980191.html

While both investors and regulators are cognizant of the significant distress in overseas office investments, they remain uncertain about the magnitude of the challenges they are confronting and which prudent steps to undertake. Certain decision-makers, including CEOs and CIOs, are delaying decision-making processes due to political considerations and personal interests.

This thesis delves into potential solutions through expert interviews and real-life case studies, leveraging the author's experience at various real estate private equity firms. However, the journey towards resolution is riddled with challenges, encompassing issues such as information asymmetry, moral hazards, a dearth of experience in handling distress in the US office market, intricate investment committee approval processes, and the involvement of multiple investors in singular deals. The thesis illuminates these intricacies and provides valuable insights to assist Korean investors in navigating the challenging terrain of distressed US office real estate investments. While this thesis may not offer perfect solutions, it aspires to serve as a guiding light during a challenging, dark period in US office investments for South Korean investors.

II. Interviews

Interview with Joseph Oh

Joseph Oh is currently the CEO of Mastern America, a US subsidiary of Mastern Investment Management. Mastern Investment Management is the third largest real estate investment firm in South Korea in terms of real estate investment under management. Joseph is also a former CIO of Meritz Alternative Investment Management, one of the largest cross-border real estate investment firms in South Korea. Joseph is a seasoned professional with extensive experience in both investing and managing real estate debt and equity investment in the US. He has provided some of his honest opinions on potential reasons behind the current distress the Korean investors are facing in the US commercial real estate landscape, suggestions to weather today's storm, and insights on ways to prevent similar distress in the future. The following answers convey the main conclusions from the interviews and are not exact quotations.

Question 1: What motivated the Koreans to invest so much in US commercial real estate in the 2010s up to the recent COVID-19 pandemic?

The Korean investors had invested quite significantly in cross-border commercial real estate from 2006 to 2008 before the Global Financial Crisis, but the focus was more on the Southeast Asian market rather than on the US or European markets. The business model or the investment theme was to invest in real estate development projects in developing countries such as Malaysia, Philippines and Vietnam. After the Global Financial Crisis, most of these development projects failed miserably, so the Korean investors had to suffer great losses on their investments. This was a wake-up call for the Korean investors who realized that they needed to shift their focus to investing in stabilized core assets in developed countries in order to reduce investment risk. They believed that allocating funds to stabilized real estate assets in developed markets would, at the very least, shield them from the substantial losses they experienced with investments in developing markets. This started a new paradigm in commercial real estate investment, with the reallocation of capital to developed countries, of which the US was the most popular. When the global economy started to rebound in 2010, Korean investors started investing again. The interest rates were too low, so bonds were not their target investment type, and stocks had too much volatility. Therefore, Korean investors concentrated their investment in the relatively more stable US commercial real estate market, which also yielded good returns for the medium risk they had to bear.

Question 2: Why was the office sector particularly more attractive to the Korean institutional investors?

The office sector was the only sector that had been "verified" to the Korean institutional investors. They had no real experience with or track record of investment in the multifamily and industrial sectors before. Retail sector was a target for the giant South Korean conglomerates, but not for the institutional investors such as pension funds or insurance companies. Naturally, the institutional investors chose to concentrate their fund allocations into the office sector because it was the easiest, most convenient, and most familiar sector to invest in. There was also the herding effect where when one investor invested in the office that generated good and stable returns, others followed and invested in the same sector. However, I

do not believe that the herding effect would have been nearly as prominent in sectors other than the office.

Question 3: Do you think Korean institutional investors are facing more distress today than other international or domestical investors? If so, why do you think that is?

I do think that the Korean institutional investors are facing more distress because they concentrated too much in one sector, the office. But there are also other structural and cultural problems that prohibit the Korean institutional investors and investment firms from resolving the current distressed situation. Firstly, the current investment structure restricts the investment firms from proactively tackling the problems. For example, the investment vehicle is usually the K-trust, or the Korean fund, that has no additional committed capital that can be called from the investors after the initial investment. This means that the capital that is needed to, for example, refurbish and renovate the building, or incentivize tenants to sign new leases cannot be called from the fund's investors. There are also too many investors behind each K-trust, rendering a unanimous approval exceptionally challenging, and at times, unattainable. Secondly, most real estate investment firms have separate acquisition and asset management teams, where the acquisition team receives a substantial amount of upfront acquisition fee while the asset management team tends to receive a comparatively small asset management fee and no additional fee on resolving distressed investments. In fact, some investors even ask asset managers to reduce or eliminate asset management fees when the investments become distressed. Such an unfair fee structure disincentives the asset management team from being proactive and aggressive on matters regarding distressed investments when in fact they are the ones who need to be most incentivized. Therefore, the investment firms' executive teams or the fund's investors are doing what is the exact opposite of incentivizing the asset management team by providing a small asset management fee and providing no additional fee or even reducing it on resolving the distress. Additionally, they sometimes blame the individual junior-level asset managers for all the problems when the fault may belong to the higher-ups. Finally, the more fundamental problem is that the Korean investment firms and institutional investors have neither the knowledge nor the will to resolve the current distress. This is the first time they are facing the distress with US real estate investment, so they have no experience or know-hows. Moreover, the C-suites at the investment firms are unwilling to fix the problems proactively and aggressively because in order to do that they need to visit each of the fund's institutional investors and persuade them, which is too difficult and time consuming. Even if they successfully do so, the reward is very little compared to the trouble they need to go through. There is also another moral hazard problem, which is that they believe that the weight of the problem is spread among many instead of the few C-suite individuals. Because they feel that the weight is spread among many, the C-suites who should take the responsibility and make prompt decisions delay their actions.

Question 4: What are some general suggestions you could give to the Korean investors to navigate their way out of this distress?

It is critical for Korean investors to partner with local firms in the US. The partners can be loan specialists who can sell distressed loans, or for equity investments they can be local private equity firms who have sufficient capital. So far, most Korean investors have partnered with only a few firms in the US that have only Korean managers. They rely on these firms that have Korean employees because it is easier and more convenient to communicate in both written and spoken form. Because of this language barrier, they miss the opportunity to partner with

US firms that have more expertise, experience, specialty, capability and understanding of the distressed situations and the current market. This is a huge setback for the Korean investors in navigating their way out of the current distress. In fact, most so-called experts in South Korea in the overseas commercial real estate investment industry lack the expertise or knowledge that are required in the industry. They neither understand real estate investment in foreign soil nor fluently speak the foreign language. This is because the overseas commercial real estate industry grew and became popular too rapidly, attracting everybody with the news of swift prosperity. While it is true that Korean investment firms have since started to hire well educated international students who speak English, understand the American culture, and possess the basic background knowledge in finance and real estate, the decision makers still lack such attributes and capabilities. The decision makers are hardly able to express their own opinions not only because of the lack of language skills, but also because of the old culture. For a long time in South Korea, people have frowned upon people who were well spoken and had strong voices. This held truer for individuals who were higher up the corporate hierarchy, where owners or CEOs often spoke a few words of command without engaging in thorough discussions. This trait of reservedness in the investment world is very problematic today because Koreans refrain from debating or aggressively negotiating with the opposite party, such as the lender, borrower, or equity partner. This is why Koreans are already at a disadvantage from ground zero even before the negotiation begins. To sum up, Korean investors should partner with US firms and the decision makers should either become more aggressive themselves or hire ones who can do so fluently in English.

Question 5: What are some suggestions you could give to the Korean investors to avoid a similar distressed situation in the future?

As I have said in my last answer, Korean investors need to change both culturally, educationally, and strategically, partnering with US firms. But there are additional factors they should take into account from an investment perspective. Korean institutional investors should allocate their capital in commercial real estate funds managed by local US firms, known as a fund-of-funds (FoF) investment. While there are some sophisticated Korean institutional investors that may have the expertise and confidence to invest directly in US commercial real estate, most do not have such capabilities. Therefore, they should rely on real estate funds managed by the local US firms that understand the market and assets, have great relationships with local banks, private equity firms, brokers, etc., and have decades of track record. Of course, allocating too much capital in fund-of-funds is not great news for the Korean investment firms (the general partners) because they receive much smaller fees compared to those on direct investment funds. This is because Korean institutional investors (the limited partners) are essentially paying fees on both the Korean fund and the US fund. They are also unwilling to pay a high fee to Korean investment firms who are essentially passive managers themselves relying on the US firm for active management. So, while fund-of-funds may not be the most lucrative business model for Korean investment firms, in today's environment, both Korean investment firms and institutional investors should rely on the US firms if they wish to avoid being trapped in a similar distressed situation in the future. Eventually, in order for Korean investors to become more skilled, experienced and mature in US commercial real estate investment, they will need to spend their own capital on value enhancement initiatives, obtain development approvals from the local governments and build from scratch, and deal with unexpected problems. Of course, this is a very difficult task and should be a long-term plan. The best option would be to

directly hire American employees, but this is unrealistic because Americans are unlikely to turn down offers from American firms to work for Korean firms. This is why the future for Koreans in US commercial real estate investment is stark. For the Korean investment firms, they may want to start considering expanding their client pool instead of having only Korean institutional investors such as pension funds and insurance companies. For example, there are high-net-worth individuals who are willing to invest in development and redevelopment projects or acquire individual assets. There are also investment firms in Singapore, Japan and other Asian countries who seek co-GP opportunities with Korean investment firms. These clients are usually willing to pay that extra fee because of the asymmetry of information and reliance on expertise.

Interview with Edward Glickman

Edward Glickman has over thirty years of experience in real estate finance and is currently the Executive Chairman of the AIP Asset Management, New York. At AIP Asset Management, Edward provides insights on the US market trends and advises on investment and asset management strategies. AIP Asset Management is a South Korea-based investment firm specializing in real estate and venture capital. It is one of the first firms to have obtained the license for investing in foreign commercial real estate. Edward is also a former Clinical Professor of Finance and Executive Director of New York University Stern Center for Real Estate Finance Research and taught Principles of Real Estate Finance and Real Estate Primary Markets in the MBA program. He also developed the core course in Corporate Finance for New York University's Master of Science in Real Estate program. Edward has served as a C-level executive at multiple public companies, including serving as the President and a Trustee of the Pennsylvania Real Estate Investment Trust (PREIT) for almost 20 years. He is the author of *An Introduction to Real Estate Finance*.

Similar to Joseph, Edward has contributed insights into the factors contributing to the current challenges faced by Korean investors in the US commercial real estate market. Additionally, he has offered suggestions on strategies to navigate through these difficulties. The following answers convey the main conclusions from the interviews and are not exact quotations.

Question 1: What motivated the Koreans to invest so much in US commercial real estate in the 2010s up to the recent COVID-19 pandemic?

The motivation for them was to achieve yields on real estate that were higher than what they could on bonds. In other words, real estate was a bond substitute. In particular, the Korean investors chose real estate assets with single, high credit long-term leases. The original thesis was that they could invest and earn more on real estate than on bonds, and also be able to potentially gain on the upside if the value of the asset increased. However, the motivating factor was the high yields and not the capital gain. They chose the US market because it was and still is the largest market in the world. It is also one of the most liquid and credible markets. They were able to lever their investment in the US real estate markets with debt that was available in the US. Unlike many other countries, the US has respect for property rights and has clear

rules for buying, selling, and paying taxes. It was an easier place for them to put large sums of money with liquidity, which is exactly what they needed to do at the time.

Question 2: Why was the office sector particularly more attractive to the Korean institutional investors?

When the Koreans first started investing in 2010, US residential markets had just suffered a calamity, so investment in residential and multifamily were less popular. There were many questions and skepticism regarding large-scale retail due to the rise of online shopping. On the other hand, office markets were big and liquid with large assets, which were easier to invest large sums of money into. Moreover, for residential, there were concerns regarding potential harm for local citizens, such as fire and shooting. Korean investors did not want to deal with such risks that could lead to reputational damage. Korean investors also had appreciation for large cities, so they focused their investment in the top 10 markets in the US. They also searched for Korean expatriates in these cities whom they could partner with for co-investment and asset management.

Question 3: Do you think Korean institutional investors are facing more distress today than other international or domestical investors? If so, why do you think that is?

Korean investors may be more distressed because their investments are more concentrated in single tenant office assets. The perception was that single tenant buildings were easier to manage in distance, where the assets were located on the other side of the Earth. The problem is that when these buildings become empty, they become totally empty. The investors need to invest again for re-tenanting, which was not part of their original plan. The original plan was to invest and sell in a short period of time. The Korean investors did not perceive that this investment paradigm would need to change so quickly, so they started to lock into their investments for a longer period of time. They did not perceive the risk of real estate operations, and instead only perceived the capital gain risk. They did not consider the economic risks, re-tenanting risks, and other risks associated with real estate operations. Today, this is the first time in the US office market that the downturn is fundamentally based on the lack of usage of office space. The way people are using office space is changing rapidly, leading to office obsolescence. In the past, as the market cycle evolved, the market would naturally right itself after a market recession. However, the notion or the fear today is that a property would never have its use again, which leads to the asset's obsolescence. This is the first time the US is experiencing this type of market challenge on such a large scale. The real problem for the Koreans is that they do not want to spend another dollar on distressed investments. Obviously, they are angry and embarrassed because they are wrong, and their investment is losing money. But they do not relate to it in the cultural aspect because most Koreans are still going to the office, so office usage has not changed much for them. Lacking cultural reference points, they struggle to comprehend the issue from a cultural standpoint, leaving them bewildered and unsure of how to address the current distressed situation with office. Furthermore, the market for attracting tenants to office space is very competitive, but Koreans are falling behind in this competition. Unless the landlord invests money for tenant incentives, leasing commissions, and other expenses needed to attract tenants, the landlord will be left with an empty building and eventually lose it. However, Koreans are reluctant to invest such money in distressed office. One reason is the structural problem, in which partnerships between Korean investment

management firms and institutional investors are formed in such a way that capital is usually raised only once at the very initial point of investment. On top of the structural problem, now that the investment management firms have failed to fulfil the promises they made with their investors, it is even more difficult to ask for money. It is as if they are saying "by the way, we did not do a good job and may lose your money, but give us more money, which we cannot guarantee we can give back to you again." The fund managers cannot say with certainty that putting in more money can save the investors' investment. Therefore, both the inflexible investment structure and the uncertainty with the success of the new capital injection prohibit investment firms from asking for money from their investors. The reality, however, is that if the better funded buildings are competing for tenants with Korean investors who are not funding their buildings, the well-funded buildings will win the tenants and Koreans will be left with empty buildings. Of course, after spending 13 years working with the Korean investors, I am quite aware of how they think. If I were investing money in Korea, I would feel the same. I understand their psychology. They do not have many natives, the local people in the US, who work with them. These are the local people who know the market and understand how it behaves. Korean investors rely too much on Koreans who are expatriates. Working with expatriates adds one or two layers that obscure their view. They cannot understand completely the local culture or the market. The Koreans get taken advantage of because of this weakness. They insist they know better, but they really do not. People who live in the US, who are native to the market, take advantage of foreign capital. For example, from the lender's perspective, the banks in the US may not act in the best way that would be aligned with the interest of the Korean investors because Korean capital is foreign capital with no real local representative. So, the Koreans are not helping themselves by working with expatriates; rather, they need native talent. I understand that this is cultural, but it is still not very helpful.

Question 4 & 5: What are some general suggestions you could give to the Korean investors to navigate their way out of this distress? What are some suggestions you could give to the Korean investors to avoid a similar distressed situation in the future?

In general, they need deeper, strategic planning around the future of the buildings that they have with the help of people who are deeply embedded in the markets. I also believe there is an advantageous tradeoff in multi-tenant building management; multi-tenant buildings are harder to manage but they entail less fundamental risk. Single tenant buildings are easier to manage, but they have more digital risk: 0 or 1. In other words, it is either a win or a loss relying on only one tenant, which poses a binary risk situation. To avoid such digital risk, Korean investors need to buy and hold more multi-tenant buildings, lease up to the point at which the assets are ready to be sold, and sell. On the other hand, single tenant building investment is riskier and could be harder to exit. Outside of the procedural problems I mentioned, which is essentially having more native people who understand the markets they are operating in, they also need to think about the tail risks. You can never anticipate the timing of the appearance of the Black Swan. You can never plan for a global crisis or an advent of internet. These are beyond our ability to plan. In equity investment in the US, the bottom price is debt. Because most real estate investments are non-recourse, neglecting frictional costs, you can usually exit at the debt level, which sets the equity level to zero (author: this would render the initial equity investment a sunk cost). Therefore, in each investment, the investment committee needs to decide whether exiting at this bottom price and setting equity at zero is the best strategy or they should instead invest more to protect their initial investment. This poses the question: if the

decision is to go forward and new money is required, is there a way to capitalize it in Korea rather than in the US? Empty buildings that used to be single tenant buildings require large sums of cash for re-tenanting. Raising capital from the Koreans investors is very difficult because of the reasons we discussed. An alternative option would be to raise that capital in the US, but it is going to be extremely expensive. The providers of such rescue capital, the US investment managers, will ask for large fees and large promotes. Hence, I think Koreans should come up with their own type of rescue capital, for example, as a distressed fund, that can help each other. To sum up, Korean investors need to work with US natives, shift focus to multi-tenant buildings to avoid the digital risk, and come up with their own rescue capital. I have been surprised to some extent that I have not received more outreach from Korean investors who have properties that are failing in the US, asking for available strategies. These strategies may or may not work economically, but in some cases they probably do.

III. Case Study 1: Gray Park Avenue

1.1 Background

Gray Park Avenue (alias) is an iconic Class A office building located in Park Avenue. It is arguably located in one of the best locations in Manhattan near the new JP Morgan Headquarters that is under construction. The building was built in the 1960s and was renovated in the early 2010s. It is almost fully leased with credible financial and professional services firms, with a WALE (weighted-average lease expiry) of over 6 years. The owner of the building is one of the largest office landlords in Manhattan, El Blue (alias), who had been known to be reliable and transparent as a listed American company. Since the mid-2010s, El Blue had successfully closed numerous deals with Korean institutional investors, establishing a strong reputation as a reliable partner. Through these transactions, El Blue acquired knowledge about the traits and preferences of Korean investors, while also uncovering potential loopholes in the Korean investment system and procedures. These insights ultimately led to a reduced bargaining position for Korean investors when negotiating with El Blue, a topic that will be explored in more detail. The Korean investor is Sunday Investment (alias), who has invested $120 million in the Mezzanine Loan tranche in 2017. Considering the solid fundamentals of the building in an excellent location, coupled with a seemingly dependable partner, it is difficult to dispute that the Korean investor's decision to invest in 2017 was unwise.

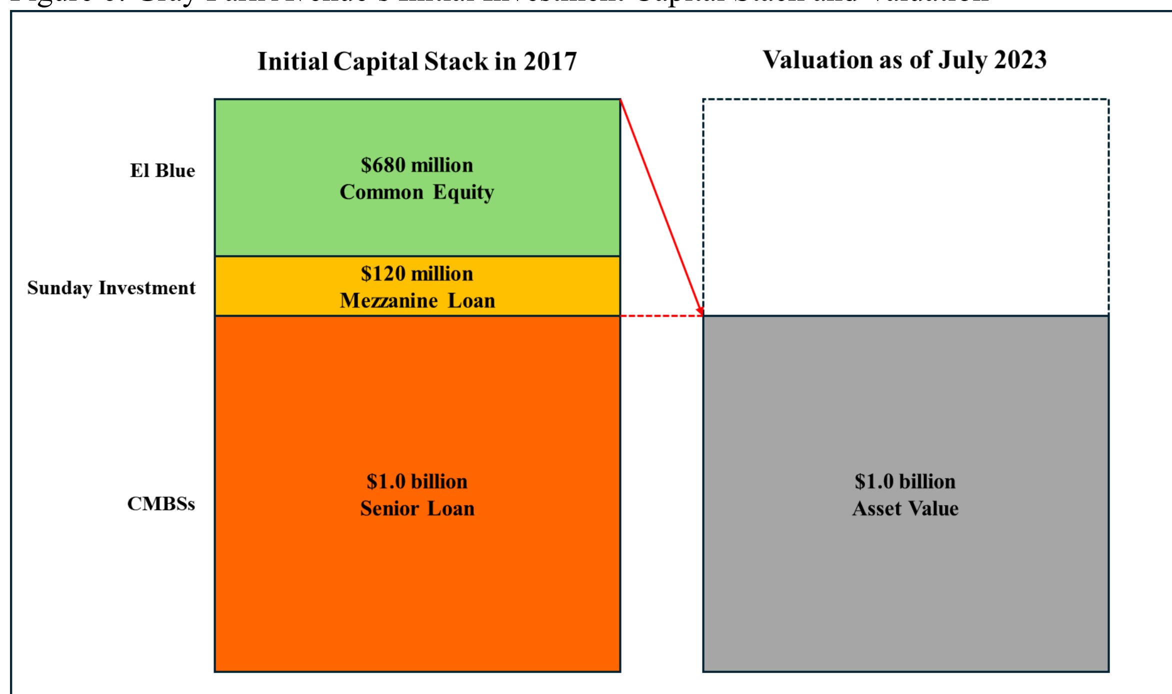
The building, however, was no exception to the brutal fate of the severe distress that struck the office market today. Some of the major tenants are poised to leave in the next 2 to 3 years as they plan to downsize their physical office space. The occupancy is expected to drop to below 70% without signing new leases. The building’s original value at acquisition in 2017 was roughly $1.8 billion, but as of July 2023, it stood at around the Senior Loan’s value of $1 billion.

Sunday Investment is an asset management company fully owned by one of the largest non-life insurance companies in Korea. As mentioned above, in 2017, Sunday invested $120 million in the mezzanine tranche of the Gray Park Avenue investment capital stack, which is not an insignificant amount, but is tiny compared to the $1 billion first mortgage loan (Senior Loan) that is senior to the Mezzanine Loan. The enormous size of the first mortgage loan was a concern for Sunday Investment, because the bigger the Senior Loan, the more difficult it is for the junior lender to buy out the Senior Loan, even at a discount. What complicated this even further was the fact that shortly after the acquisition, the first mortgage was split into many different pieces, securitized in different commercial mortgage-backed securities (CMBSs). When loans are securitized in CMBSs, it is usually much more difficult to start negotiations, because the master servicer, who is the lender representative of the CMBSs, is reluctant or prohibited to start any negotiations unless the loans go into special servicing. Although there may be exceptions, it is when the loans go into special servicing and the special servicer takes charge that true in-depth negotiations can start. In this case, the loans were still performing loans, so no special servicing had taken place.

Nonetheless, the loan maturity was coming due in the next few months, which meant that Sunday Investment had to start negotiations as soon as possible, unless Sunday wished to

somehow exit the investment now. Exiting the investment would mean proceeding with either a discounted loan sale or a complete write-off of the loan on their balance sheet. If, however, Sunday wished to proceed with loan modification negotiations, it would need to settle on any combination of the following with both El Blue and the Senior Lender: the number of years of the Mezzanine and Senior Loan extensions, modifications of cure rights, interest rate readjustments, amount of capital plans for the asset turnaround, the party who would bring the needed capital to the table, etc.

Figure 6: Gray Park Avenue's Initial Investment Capital Stack and Valuation

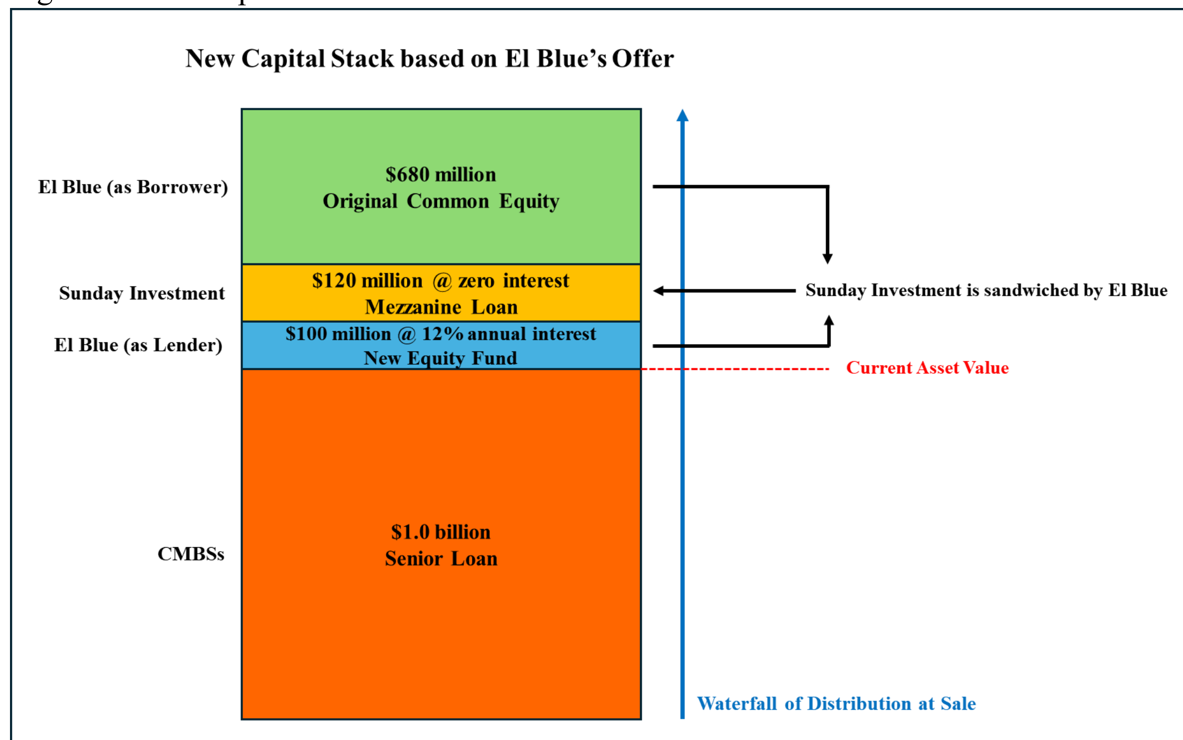


1.2 The Offer by El Blue

Several months before the loan maturity, El Blue had sent an offer letter to Sunday Investment, which outlined the terms of the extension of the Mezzanine Loan maturity date. Without the loan extension, the Mezzanine Loan would be in default when the maturity date came, and Sunday Investment's mezzanine tranche would be wiped out unless Sunday proceeded with their exercise of their cure rights. The terms were aggressively in favor of the Borrower, El Blue. According to the letter, Sunday would have to forfeit their right to receive any interest payments during the 4-year extension, with no accrued interests, either. El Blue would also inject $100 million of their own money in the new tranche called "New Equity Fund," which would be senior to Sunday's current mezzanine tranche. The $100 million would be used for tenant incentives, leasing commissions and capital expenditures to attract new tenants. Unlike the Mezzanine Loan, which would now be essentially an empty "hope note" that received no returns, El Blue's New Equity would receive interest at an annual rate of 12% or more, which would be accrued until the end of the extension term. At the end of the 4-year extension, if the building is sold, the sales proceeds would be distributed in the following order: Senior Loan, New Equity Fund and its accrued interest, Mezzanine Loan, and any excess cash to the common equity holder, El Blue. This meant that Sunday would receive zero repayment on their initial

$120 million of Mezzanine Loan unless the value of the asset rebounded above at least $1,100 million (original Senior Loan principal plus the New Equity Fund). Not to mention, Sunday would receive no returns during the four-year extension term.

Figure 7: New Capital Stack based on El Blue's Offer



1.3 The El Blue Sandwich: Conflict of Interest

El Blue's offer to inject the New Equity in a tranche senior to Sunday's original mezzanine tranche was extremely unconventional and would create many conflicts of interest that would be alarming for Sunday. Although in a distressed investment situation it was not uncommon for the Borrower to offer their own capital to save the asset and avoid a default, the problems lay with the fact that the New Equity Fund would be senior to the Mezzanine Loan. The first and obvious problem was that the Mezzanine Lender would now fall behind the new capital in the order of waterfall distributions at sale, which directly conflicted with the fundamental investment principle of "higher compensation for higher returns." In a normal investment situation, the equity holder, or the Borrower, is paid last because it receives all returns *beyond* any liabilities it has with the lenders. El Blue's offer, however, suggested that it would transfer to the Mezzanine Lender the risk of the probability of not recouping the newly injected capital. However, as if this problem was not enough, more serious problems lay with the issue of control.

Should Sunday accept the offer, Sunday would be sandwiched by El Blue in the capital stack: El Blue, who is the controlling party of the entire capital stack, would now become both junior and senior to Sunday's mezzanine tranche. This would cause many conflicts of interest. Some examples are listed below. Keep in mind that El Blue is both the Borrower and the lender of

the New Equity (or New Equity Holder) in these cases.

1. The Borrower would have less incentive to maximize rents and sign leases as long as the asset value generated covers their New Equity (i.e. the asset value is at or above $1,100 million).
2. At sale, the Borrower would have an incentive to manipulate the sales price by having seller appraise the value at just above their New Equity, allowing El Blue to credit bid, leaving Mezzanine Lender with nothing. For example, if the Borrower offered to sell the asset at an appraisal value of $1,100 million, El Blue, as the New Equity Holder, could offer a bid price of $1,000 million, outbidding all other bidders, since $100 million is already an intrinsic value of the New Equity. In this case, El Blue would become the full owner of the asset with no liabilities attached, including Sunday's Mezzanine Loan.
3. If the Borrower created a default under the Senior Loan, the New Equity holder might have the right to cure the default and foreclose out Sunday.
4. If the Borrower created a default under the New Equity, the New Equity holder might have the right to cure the default and foreclose out Sunday.

On another note, the Borrower is also one of the biggest office landlords in Manhattan, and a publicly traded company. This meant that because they had other distressed office buildings near Gray Park Avenue, they had a fiduciary duty to attract tenants to not just Gray Park Avenue, but also to other distressed office buildings. It was unclear whether Gray Park Avenue was at the top of El Blue's priorities in this sense. What was clear, though, was that El Blue was incentivized to minimize the losses of the shareholders, which meant that attracting the best tenants to Gray Park Avenue until the building was fully leased might not be their strategy. Rather, they might want to attract tenants to each one of the distressed office buildings, just enough to avoid foreclosures or defaults. Such nature of El Blue created significant leasing conflicts.

One might argue that some of these hypothetical situations are far-fetched given that El Blue is a globally recognized institutional player who might refrain from such controversial activities that could ruin their reputation. However, it is still undoubtable that when the Borrower also becomes a lender within the same capital stack, the party that is sandwiched between them should be extremely concerned as it has limited or no control in the investment structure. Moreover, Gray Park Avenue was such an iconic asset located in an amazing location that El Blue had all the incentives to avoid losing control, or ownership for that matter. It was possible that El Blue might take drastic measures in such a drastically dire time.

1.4 Sunday Investment in a Checkmate?

One might question why Sunday did not rip apart the offer letter at first glance and proceeded with the UCC (Uniform Commercial Code) foreclosure as the Mezzanine Lender with its full power and right to do so. After all, the terms offered by El Blue were too aggressive and would be deemed offensive to any lender. It may also be worthwhile to mention that it took at least a month for Sunday to truly understand that their tranche was potentially wiped out; for a month,

they thought that the value was at least $1.6 billion, until they received additional appraisals from brokers that were at $1 billion or below. While Sunday was still struggling to understand what kind of predicament they were mired in, El Blue had already figured out a plan.

El Blue was a sophisticated real estate player with a great knowledge of and experience with Korean investors, which they gained over the last decade or so. El Blue understood that Korean institutional investors and asset managers such as Sunday had long and complicated investment committee procedures that might take months to approve a matter of this magnitude. Especially for big asset management firms such as Sunday, the real estate department was usually a small department within the company, because stocks and bonds usually took the bigger portion of the investment portfolio pie. This meant that reporting a problem with just one real estate investment might have to go through ten or more reporting layers until the news finally reached the CIO, if it could be reached at all. Furthermore, Sunday invested in the Mezzanine Loan tranche via a Korean fund, which had several end investors, such as pension funds and life insurance companies. This meant that even if Sunday finally reported the problem within their own company, they still needed to report to the investors of the fund. The reporting was usually bottom-up rather than top-down, meaning that, again, the C-suites who actually made the decisions heard the news last. Even if all the C-suites finally became fully aware of the problem and were ready to make decisions, the decisions usually varied among the investors. For example, one pension fund might want to accept the offer, whereas others might want to proceed with a foreclosure. Unlike the market practice in the US, the general partners and asset managers in Korea had limited or sometimes no decision-making power; the power lay with the actual investors, the limited partners. In other words, the limited partners used the asset managers as mere vehicles or tools for investment and wanted to keep full control of the investment even during the investment period. This was especially true for cross-border real estate investment, which had long been a discussed issue and the subject of heated criticism in the Korean real estate investment world.

Moreover, El Blue knew better than anyone that the Koreans would most likely be unwilling to put in their own additional capital to save the investment. Most commercial real estate funds in Korea were closed-end funds, meaning that it was extremely difficult to both put in or take out capital from the funds once the investment was made. Such would take, again, long and dreadful procedures to get approvals within the institutions. In addition, most institutional investors had specific capital amounts allocated to each investment sector. For example, if a pension fund had decided to allocate 20% of its capital to alternative investment sector, of which 15% would be in real estate for a particular year, it was extremely difficult, if not impossible, to authorize additional capital allocation over that 15% hurdle during that year.

Therefore, instead of calling capital from Sunday, El Blue was suggesting from Day 1 that they would be using their own money in their own favorable terms, because they knew that Sunday would not be able to put money on the table for the reasons discussed above.

1.5 Solving the Conundrum: Strategy 1 – Loan Sale

Sunday's immediate reaction was to find a potential buyer for their Mezzanine Loan. However, the investors were willing to take only a 5% to 10% haircut on the loan, when the circumstances were suggesting that the loan might have zero value as of today. They also could not find any potential buyers given that the maturity was due in just a few months. Even if they could, they would have to disclose all the ugly information about the asset including the fact that major tenants were poised to leave the building in 2 to 3 years. This could further bring down the price. In fact, one loan broker valued the asset at $800 million, which was even lower than the Senior Loan principal of $1 billion. The fact that Sunday was trying to sell the loan so abruptly also signaled to the market that the loan was a fire sale, further diminishing the slim possibility they had with the loan sale strategy. A buyer who would buy a loan at any discount in this situation would have to be an extremely risk-loving, vulture-type investor who had the capital to pay off the $1 billion senior loan within a few months and had the capability and additional capital to improve the asset. No such buyer showed up. The last hurdle was for the Senior Lender to approve such a transaction. The buyer of the loan would have to be a Qualified Transferee within the Intercreditor Agreement and other loan documents; otherwise, the Senior Lender would have the right to stop such a transaction. One major reason that the Senior Lender usually has such a right under the loan documents is that a Mezzanine Lender is also a potential equity holder, i.e., the new Borrower of the Senior Loan. In the end, Sunday failed to sell their Mezzanine Loan.

1.6 Solving the Conundrum: Strategy 2 – Capital Call

Instead of using El Blue's capital, one of the better solutions was for Sunday to call capital from its four investors and put their own money in the New Equity tranche. This would solve all conflicts of interest. Moreover, if the plan were successful, the investors would be given an additional return on the New Equity while also recouping their original $120 million investment at exit. However, as mentioned earlier, reporting the problems to the decision makers, and making sure that they understood what they were going into took many persuasions and a long time. Besides, Sunday's fund itself was a closed-end fund with an investment guideline to specifically invest in a core asset, meaning that capital calling for the purposes of value-add would take multiple investment committees and paperwork procedures. In fact, the Senior Lender as well as Sunday agreed to extend the maturity date by a few months to allow for more time for the capital call discussions. When the institutional investors were finally ready to agree to inject an additional $50 million of capital in the New Equity, after another round of thorough analysis, they concluded that at least $80 to $100 million would be needed to have any meaningful change in the asset to attract tenants. Because the Korean investors were unwilling to take an additional risk of loss above $50 million, the capital call plan went sour.

1.7 Solving the Conundrum: Strategy 3 – UCC Foreclosure

Sunday could also exercise the UCC foreclosure as the Mezzanine Lender. Unlike a normal foreclosure by the Senior Lender in which the Senior Lender would be foreclosing on the building itself, in a UCC foreclosure, the mezzanine lender would foreclose on the *borrower*

entity that owns the building. This is because the senior lender's collateral is the mortgage in the building, whereas the mezzanine lender's collateral is the pledged equity in the borrower entity (mortgage borrower), and not the building itself. This mechanism is employed as a way to clearly separate the collaterals between the senior lender and the mezzanine lender. After a UCC foreclosure, the building would still be subject to all liens and encumbrances, including the mortgage loan. In other words, from the senior lender's perspective, nothing would change except that: the mezzanine lender would now become the new borrower, and the mezzanine loan would be erased from the capital stack.

From Sunday's perspective, a UCC foreclosure was one of the last cards they wanted to pull out. The reason was that once Sunday became the new Borrower, Sunday would immediately assume a giant loan of $1 billion dollars. Sunday would also need the additional $100 million, anyway, if they wanted to improve the building and attract new tenants. The only non-monetary benefit to this plan, if successful, would be that Sunday would be able to say to El Blue: "You greedy American, you are no longer the owner of the building. We Koreans are taking over." However, the plan seemed to entail no economics benefits. In the end, although Sunday did contemplate this plan, they quickly abandoned it.

1.8 Solving the Conundrum: Strategy 4 – Co-invest in the New Equity

Sunday proposed to El Blue that they would invest 50% of the $100 million in the New Equity tranche. Sunday and El Blue would be co-investors with a ratio of 50:50. Sunday thought that if they could become a co-investor in the New Equity tranche, it would be much more difficult for El Blue to act in ways that would cause conflicts of interest and potentially foreclose out Sunday. El Blue, however, was adamant that they wanted to be the sole investor in the New Equity tranche and could not agree on a co-investment scheme. Their response made Sunday become more suspicious of El Blue's intent.

1.9 A Real Solution: Finding a Reliable American Partner

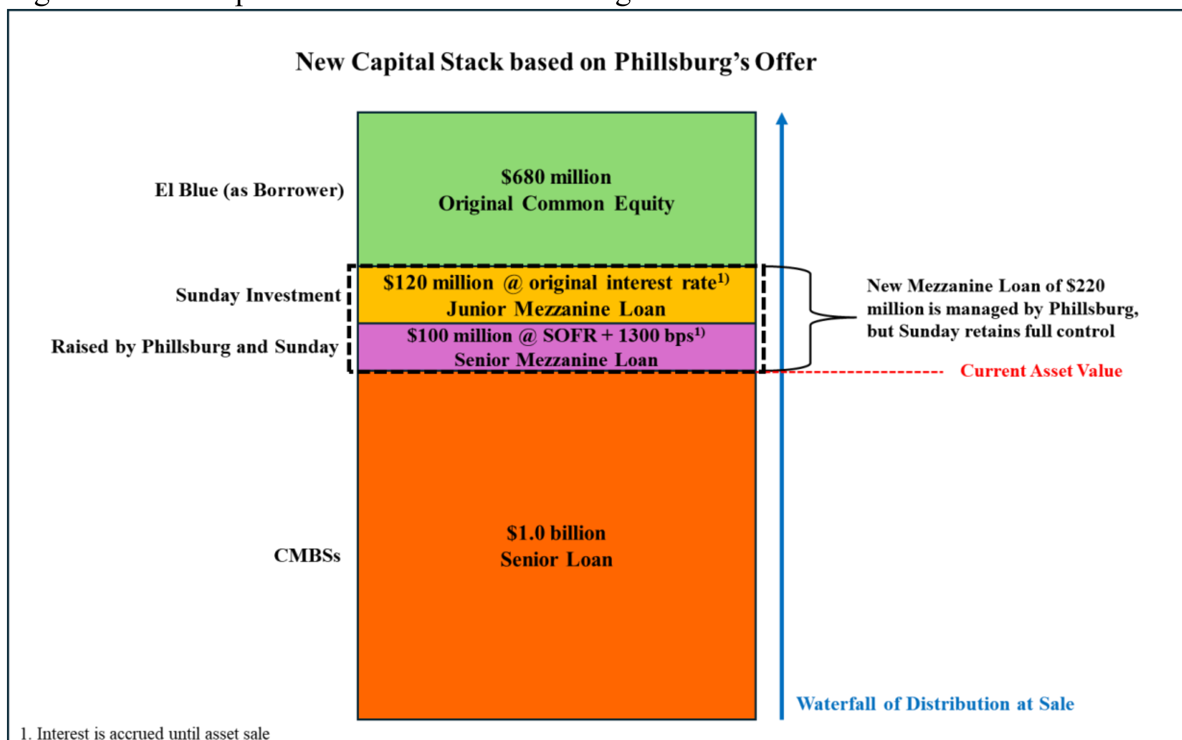
Given that Sunday was dealing with an American adversary, it might seem ironic that Sunday's real solution would be to find a reliable American partner. However, the four strategies Sunday contemplated failed, so they had a choice to either accept El Blue's aggressive offer, or to find an alternate solution. Finding another solution would not be possible without a partner, but a Korean partner would not be very helpful in this situation. Sunday needed to find a US based partner who had capital and a sophisticated knowledge of financial engineering, real estate, and lender negotiations.

Indeed, a potential partner with such descriptions approached Sunday. The firm, Phillsburg Partners (alias), was a real estate a private equity firm with 60 years of specialized expertise in value-add office. After signing a non-disclosure agreement with Sunday, Phillsburg received the materials from Sunday, and analyzed the situation. After a few days of analysis, Phillsburg concluded that the value of the asset was just at or above the Senior Loan principal amount ($1 billion), and that at least $100 million would be needed to renovate/refurbish the building to attract new tenants. The analysis was in line with those of El Blue and Sunday.

Phillsburg's proposal was the following:

1. $100 million would be raised by both Phillsburg and Sunday. Sunday had the right to raise any amount from $0 to $100 million, and Phillsburg would fill in the gap.
2. Expand the original $120 million of Mezzanine Loan to $220 million of Mezzanine Loan by injecting the newly raised $100 million.
3. The original $100 million would be named the Senior Mezzanine Loan, and the $120 million Junior Mezzanine Loan. Both combined would be called the New Mezzanine Loan.
4. The Senior Mezzanine Loan would accrue interest at a rate of SOFR (Secured Overnight Financing Rate) + 1300 bps per annum, while the Junior Mezzanine Loan would accrue interest at its original rate.
5. The Senior Mezzanine Laon would be superior to the Junior Mezzanine loan in economic terms. This meant that at the sale of the building, the repayment waterfall would be: 1) Senior Loan, 2) Senior Mezzanine Loan and its accrued interest, 3) Junior Mezzanine Loan and its accrued interest, 4) any excess cash to Sunday.
6. The New Mezzanine Loan would be managed by Phillsburg, but Sunday had full control of the New Mezzanine Loan. Full control would mean control of any material decisions regarding the Mezzanine Loans, such as a loan sale, extension, modifications, etc.
7. In case Sunday took ownership of the asset, Phillsburg would be in charge of the asset management, as it had its own asset management, property management and construction teams.

Figure 8: New Capital Stack based on Phillsburg's Offer



Phillsburg's proposal would not only resolve the issue of conflicts of interest apparent in El Blue's proposal, but also establish a formidable alliance with a partner who could represent Sunday. It was now up to Sunday to make that decision.

1.10 Sunday's Final Decision? Back to Point A

In the end, even though the managers at Sunday understood that Phillsburg's proposal was legitimate and might be the only economically viable option given that they had struck a dead end, Sunday did not accept Phillsburg's offer. The decision was based more on politics than economics.

Firstly, Phillsburg was a relatively small, local private equity firm with less than $3 billion of assets under management (AUM). Sunday was not confident that they could convince the end investors, the limited partners, who were more used to working with giant general partners with tens or hundreds of billions of dollars of assets under management. Besides, Phillsburg did not have any previous experience working with any Korean partners. Even though Phillsburg's business proposal was economically sound, Sunday was not fully confident that Phillsburg could execute the plan seamlessly. Secondly, there was still disagreement among the investors. Some investors did not understand the conflict-of-interest issue with El Blue sandwiching them, or simply did not see it as a real threat. These investors were adamant that El Blue should use its own capital to fix the asset, as any borrower should. Other investors who understood the conflict-of-interest issue insisted that the Korean investors should use their own money to avoid such conflict of interest and should not be swayed by El Blue's evil scheme. One investor urged Sunday to find other potential loan buyers who would bid at 90% to 95% of the original principal amount, but no such buyers showed up. Some managers simply wanted to kick the can down the road until they moved to a different firm or retired, i.e., extend and pretend. It seemed as if Sunday circled back to the starting point where any of the discarded strategies was again an option. Amid the confusion and chaos, the loan maturity date was approaching quickly, so El Blue and Sunday met again at the negotiating table. Sunday demanded that El Blue inject the $100 million of New Equity as promised but come junior to Sunday's Mezzanine Loan tranche. El Blue counter-offered by suggesting that the New Equity would still come senior to Sunday's Mezzanine Loan tranche, but Sunday would receive a certain annual interest rate, given that the New Equity would also receive a higher interest rate than originally suggested. The negotiations are still ongoing as of today.

1.11 Takeaways from Case 1

In hindsight, many of the problems seen in Case 1 could have been avoided if Sunday had invested in the Mezzanine Loan together with a reliable, sophisticated American investor with the capability of injecting capital when in distress. Of course, finding such a partner with the alignment of interest is not always easy. However, Korean investors are still in the nascent stage of commercial real estate investment in the US when compared to the US investors themselves. Koreans have barely experienced one US commercial real estate market cycle. This means that it is strongly advisable for Korean investors to form an alliance with an American partner, not merely a consultant, who could co-invest so that their interest would be aligned with that of the Korean investor. Another solution would have been for Sunday to have

the Korean investors commit to a capital call in a distressed situation, but such was and still is not a realistic approach. Most of the Korean investors who invested in Mezzanine Loans in the 2010s did not seriously consider the fact that they could one day have to make the decision whether to invest additional capital to exercise cure rights, such as buying out the senior loan, or use the funds to stabilize the asset in a distress. Most of them saw mezzanine loan investment as a mere debt investment product that had a higher risk but higher return than a senior loan.

Given that Sunday had not either partnered with an American firm or had the Korean investors commit to a capital call, their best option would have been to accept Phillsburg's offer. Phillsburg's offer would have solved the following problems: conflict-of-interest problem with El Blue's sandwich, the lack of capital from the Korean investors, the weak bargaining power against El Blue, and the lack of an asset manager in case El Blue gave up the asset.

In order for South Korean investors to be more advanced and sophisticated investors in commercial real estate, they need to disregard the politics and prioritize on the fundamentals of the asset and the economics of the investment.

IV. Case 2: Narrow Way

2.1 Background

Narrow Way (alias) is an office building located at the heart of the Denver CBD, with an occupancy rate near 90% with credible pension fund, government, and financial tenants. The WALE (weighted average lease expiry) is approximately 6 years. However, one pension fund tenant that was leasing 40% of the space was likely to leave at the end of its lease term in 7 years, and there was no guarantee that others would not follow suit given the severe distress in the CBD office market. Moreover, although the building was renovated in 2019, it was built in 1980. The age of the building was also a big concern because nationwide, buildings that were built in 2015 or after had been faring much better since COVID-19 compared to those built before that year. Trophy assets had also increased their rent levels over the last few years while the average or old assets had reduced them. Due to these multiple and intertwined factors, the asset was in severe distress.

Figure 9: Office Net Absorption by Year of Delivery (millions of square feet)

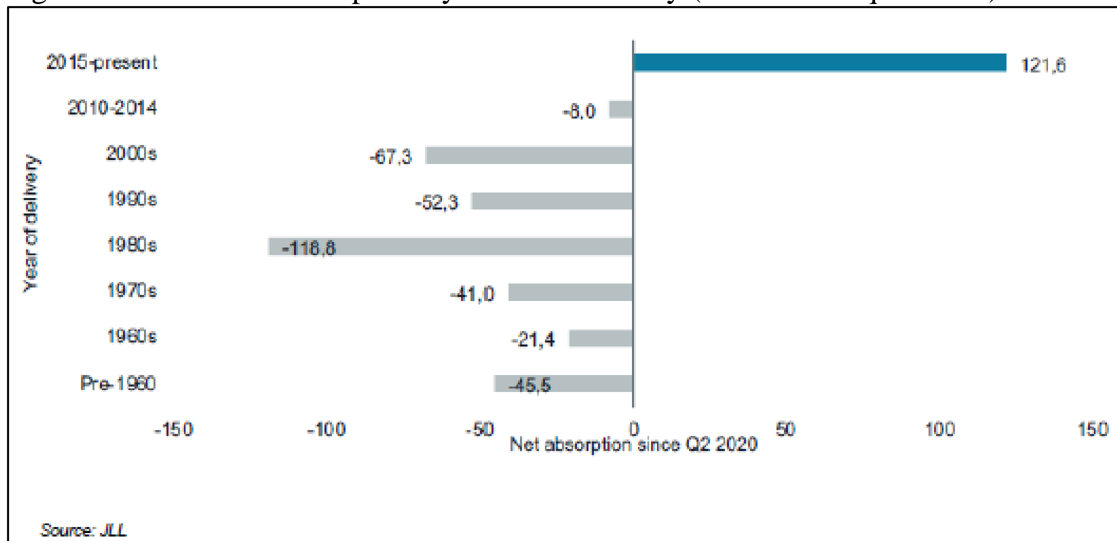
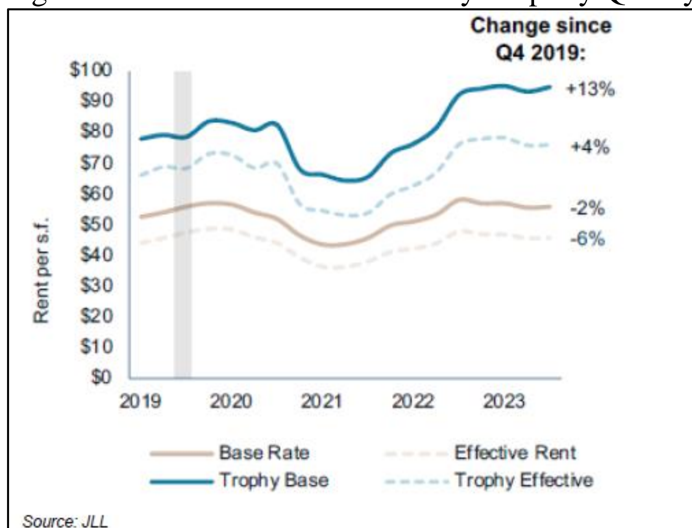
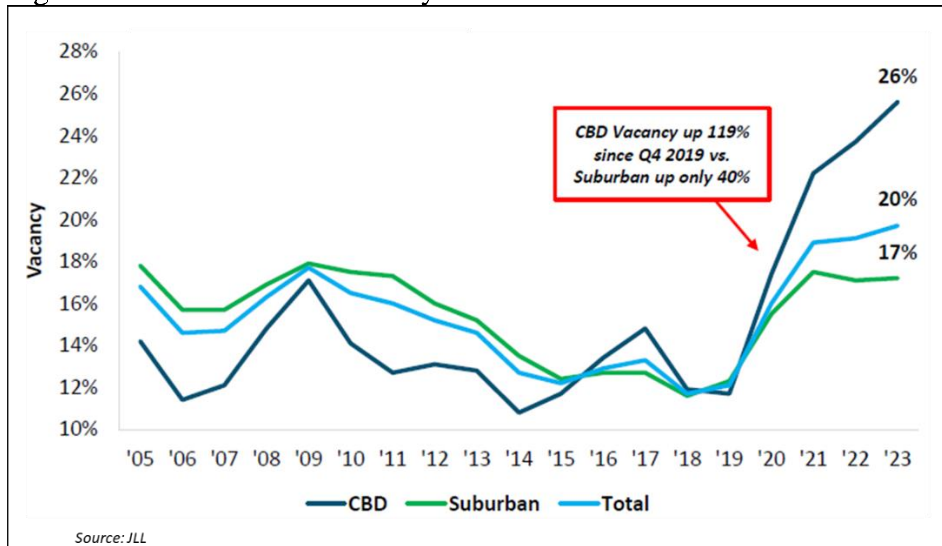


Figure 10: Effective Rent Growth by Property Quality



Denver CBD was one of the locations in the US that were most severely affected by the distress in the office market. As of Q2 2023, since COVID-19 office vacancy rate has increased by 119% in CBD, whereas it increased by 40% in the suburban area.

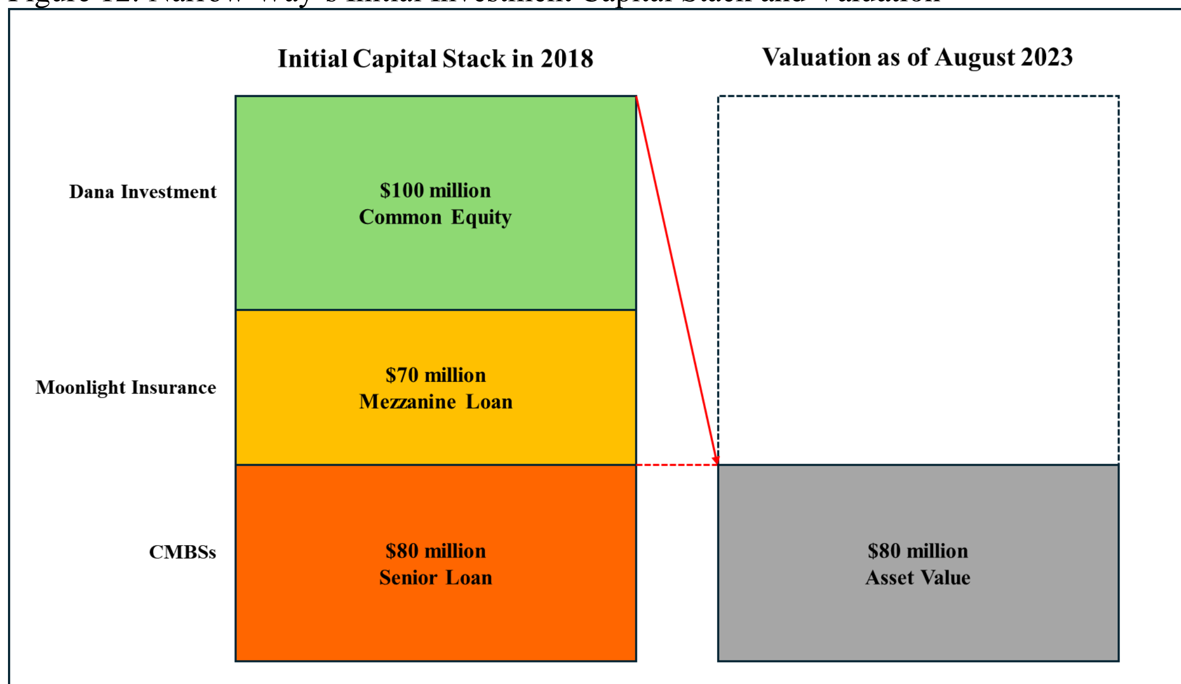
Figure 11: Denver Total Vacancy Rates



One major reason for the higher vacancy in the suburb was the bifurcation between the two office markets, which were the CBD market and the suburb area known as the LoDo market (Low Downtown). For the past several years, residents, retail tenants and office tenants have been shifting away from CBD to relocate near LoDo where Union Station, Ball Arena, and Coors Field were located. The vibrancy in the LoDo area had created positive feedback in which the vibrancy attracted more people and more people led to more vibrancy. This bifurcation had even widened since the onset of COVID-19. Workers who now worked 3 to 4 days at home preferred office locations that were in the suburban area because it was easier to commute, had more vibrancy, and was safer from street violence compared to CBD.

The investor, Dana Investment (alias), is one of the largest securities firms, which are equivalent to investment banks in the US. It is also a subsidiary of one of the largest financial groups in Korea. Dana purchased the building in 2018 at around $250 million, financed with $80 million of senior loan and $70 million of Mezzanine Loan, leaving Dana with $100 million of equity exposure. Due to the impact of the COVID-19 and the office market bifurcation discussed above, the value now stood at around $80 million, which meant that both the Mezzanine Lender and Dana's tranches in the capital stack were wiped out. The Mezzanine Lender, Moonlight Insurance (alias), was a Canadian insurance company. The original Senior Lender, ESC (alias), was a Swiss investment bank. The Senior Loan was also split into many pieces, securitized in CMBSs. The loan maturity was coming due in a few months, so Dana had to come up with a plan quickly.

Figure 12: Narrow Way's Initial Investment Capital Stack and Valuation



2.2 The Inconvenient but Inevitable Conversation

Unlike the Gray Park Avenue case where the protagonist investor was a lender, in this case the investor was a borrower and owner of the building. This meant that Dana was the one who needed to devise a plan and initiate the discussions with the lenders. Both the Senior Lender and the Mezzanine Lender were well aware of the distress in the market and the significantly reduced implicit value of the asset. At Dana's request, a third-party real estate private equity firm had given a valuation of $80 million. This meant that even if Dana somehow managed to sell the asset today, Dana would salvage nothing from the sale.

Dana had a few options, which all inevitable involved negotiations with the lenders: 1) they could buy out both the Senior and Mezzanine Loans, hopefully at a discount, and hold the asset 2) they could negotiate loan extensions with both Senior and Mezzanine Lenders, and hold the asset 3) they could try to sell the asset at a discount, hopefully at a price high enough to pay off both the Senior and Mezzanine Lenders, and be free from all liabilities. Option 3 was the only option in which Dana would completely forego any chance of recouping its original equity investment. However, if Dana chose options 1 or 2, Dana would also have to come up with funds for capital expenditures associated with enhancing the asset and attracting or retaining tenants.

2.3 Acknowledging the Problem

Similar to the Gray Park Avenue case, internal reporting of the problem was not a smooth process for Dana Investment. Dana was already struggling with many other distressed investments, so the top managers and C-suites were too preoccupied and not fully aware of the problem with Narrow Way. There were also disagreements among the managers on what the

real value of the asset was today. The consensus, however, was that their equity exposure in Narrow Way was unlikely to be wiped out. The top managers and C-suites in particular could not understand how a core office building in a great location in the heart of CBD could drop to a third of its acquisition value in just five years. In the end, they refused to believe the valuation given by the third-party firm. The situation was similar to one in which a patient would refuse to acknowledge that she had an illness, even though the first step to curing any illness would be acknowledging that she had one. This was a common issue among Korean investors, as they tended to evade the stark reality and refrain from acknowledging the raw distress they were confronting.

2.4 Bluecliff Partners

Amidst the turmoil, an American real estate private equity firm extended a helping hand to Dana Investment. It was the same firm, Blucliff Partners, that provided the third-party valuation of Narrow Way. Even though Bluecliff did not have any previous experience working with an Asian partner, the company had extensive experience in lender negotiations and debt restructuring. Moreover, the CEO of Bluecliff was a good friend of the CEO of Moonlight Insurance, the Mezzanine Lender, as they grew up in the same neighborhood.

2.5 Bluecliff's Rescue Plan

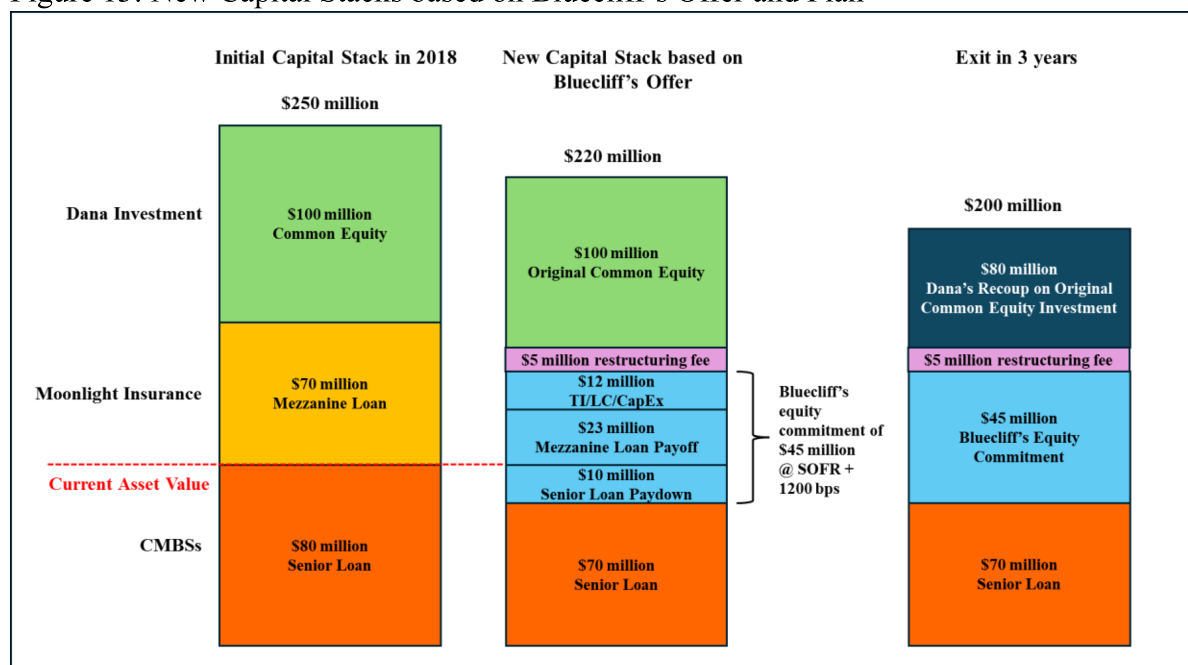
Bluecliff believed that if they could somehow extend the Senior Loan at the original fixed interest rate, which was lower than the current market rate, Bluecliff had a chance of stabilizing and selling the asset in a few years. Bluecliff believed that because the anchor tenants were poised to leave in 5 to 6 years, the business plan's time horizon should be 3 years, so that the asset could be sold with the certainty of the anchor tenants being in place. Bluecliff's assumption in the underwriting was that there was a 50% probability that the anchor tenants would leave at the end of each of their leases, but Bluecliff was confident that as long as the right tenant incentives, leasing commissions and other capital expenditures were used, new tenants could lease the vacant spaces after a 12-month downtime.

Bluecliff's business plan was comprised of two phases. The first phase was loan restructuring. In order to implement Bluecliff's 3-year business plan, the loans also had to be either extended for 3 years or be paid off. Bluecliff believed that since the Mezzanine Lender and the Senior Lender were well aware of the distress in the market, they would be reluctant to take over the asset for themselves, especially when they had no experience in real estate operations. They would rather negotiate with the Borrower and either extend the loans until the market rebounded or be paid off at a discount on the loan and exit the investment once and for all. Most lenders who extend the loan in this situation, however, request either a small or large paydown of the loan and some commitment of equity from the Borrower. This is exactly what Bluecliff planned to suggest to the lenders: 1) pay down $10 million of $80 million Senior Loan to the Senior Lender and extend the Senior Loan for 3 years at the original interest rate and 2) pay off the Mezzanine Lender at a third of the original $70 million Mezzanine Loan principal. Taking the Mezzanine Lender out of the picture was an important part of the whole plan because while the Mezzanine Lender existed, it could exercise its cure rights and replace Dana, which posed a great threat. Furthermore, taking the Mezzanine Lender out would

simplify the negotiation process because Bluecliff could now directly talk to the Senior Lender without that extra layer of communication barrier. Bluecliff was confident that the Mezzanine Lender would accept such an offer given that Moonlight was a sophisticated investor who understood the economic benefits: Moonlight could either i) accept the offer and salvage a third of $70 million with certainty or ii) deny of the offer and risk salvaging nothing from an asset in a city with a severe distress in the office market.

Bluecliff also offered to commit $45 million equity on behalf of Dana, which was the estimated amount of money required for the loan paydown, loan payoff, tenant incentives, leasing commissions, and other capital expenditures needed for 3 years. The second phase of the business plan was rather simpler. Once the loan restructuring was finished, Bluecliff would manage the asset on behalf of Dana, from property management, leasing, lender relations, to the final sale of the asset. Bluecliff suggested SOFR (Secured Overnight Financing Rate) + 1200 bps of annual interest to be paid from Dana to Bluecliff on the $45 million equity, plus $5 million for the restructuring fee. If the plan were successfully executed, in the base scenario, the asset would be sold at $200 million in 3 years, meaning that Dana would recoup $80 million of its original $100 million equity investment, after paying off the Senior Loan and Bluecliff's equity plus fee.

Figure 13: New Capital Stacks based on Bluecliff's Offer and Plan



2.6 Dana Investment's Reaction

Bluecliff's rescue plan was initially well received by the Lead Restructuring Team (LRT) at Dana. These were the people who were in charge of finding or devising solutions for many of Dana's distressed investments. Therefore, they understood better at a more detailed, granular level of each distressed investment than the top managers did. They found Bluecliff's approach viable and assumptions legitimate. LRT suggested, however, that Dana would use its own

capital instead of Bluecliff's $45 million, which they found to be too expensive. Bluecliff replied that it would agree to it as long as the restructuring fee of $5 million was paid.

Unfortunately, reporting the restructuring plan to the top management took two months, which left Dana with less than one month before the loan maturity date. More importantly, even though the decision makers understood the hypothetical economic benefits of the restructuring plan, they believed that it would be helpful only if their equity tranche was truly wiped out. However, they were still not convinced that Dana's original equity tranche was wiped out even though the market indicators and the valuation suggested otherwise. They also hinted that they felt being taken advantage of by an American vulture type private equity firm, Bluecliff, who wanted to earn a high fee without having any skin in the game. This of course did not make sense because Bluecliff originally suggested investing its own funds above the Senior Loan where Bluecliff believed had zero value now. Bluecliff would not have suggested such a plan unless they truly believed and had confidence that they could turn around the asset with the funds invested. Regardless, under the great pressure of the impending loan maturity and the fear of realizing the loss on the equity investment, Dana decided to talk to the lenders while completely disregarding Bluecliff's offer.

2.7 Dana Investment's Final Decision

Even though Dana did not fully disclose the details of their final decision, they had announced that they had negotiated with the lenders loan extensions for both the Mezzanine and Senior Loans without any discount on the loan principal amounts. They did not disclose any information on the new interest rates, extension periods, capital expenditure plans, tenant incentives, leasing commissions or any aspects of the business plan for the asset. What we do know, however, is that Dana did not negotiate any discounts on the loans and that they did not find any equity or debt partner to finance the expenses for the asset enhancement and tenant attraction. This meant that Dana had to either i) spend its own funds for the asset turnaround or ii) be provided with new financing by the original lenders (or by a new lender). Either choice would be excruciatingly painful for Dana because injecting additional equity into a totally impaired asset without an asset manager with a solid business plan would be a substantial risk of "throwing good money after bad," while executing new financing would also be extremely expensive. So why did Dana make such an evidently irrational decision?

2.8 Inefficiency in the Reporting Process and the Asymmetry of Information

Many of the core themes we see today in the distressed landscape of Korean investors' commercial real estate investment mirror in nature: inefficiency in the reporting process and the asymmetry of information. As observed in both Case 1 and Case 2, communicating the issue and possible solutions to decision-makers within a Korean asset management company is overly complex and involves unnecessary delays. Reporting is usually done bottom-up with multiple layers, for example, from the asset managers who understand the daily operations of the real estate asset to the fund managers to the heads of investment or asset management to the C-suites such as the CIO or the CEO. As the reporting moves up the ladder, naturally more asymmetry of information occurs where the original reporters understand the problem best while the last to hear, who are usually the decision-makers, understand the least. Even after the

reporting process is finished, it sometimes takes as much time for the decision-makers to fully digest both the problem and potential ways to navigate out of it because problems of this nature are extremely complicated in the aspects of economics, finance, politics and real estate operations. If such decision-makers do not have real estate background as can be commonly seen in investment firms that invest in many types of assets other than real estate, the digesting process can take longer. Once the decision-makers of the asset management company fully digest the issue, they then need to talk to the real end investors behind the investment vehicle, which is usually a fund. Within these end investors, who are usually large institutional investors such as pension funds or insurance companies, they again need to go through the exact same reporting process all the way up to the C-suites. Finally, once the C-suites of all end investors and the asset management have digested every aspect of the issue, they need to agree on a solution, which could take several months or more. In addition, within any of these layers of reporting process, there could be more unnecessary delays because of the fear of being a scapegoat. The first reporters usually get the most attention and can possibly be blamed for at least some aspects of the problem even when the reporters have not caused it. For example, because real estate investment is a long-term investment, it is not uncommon for the new asset managers or the acquisition team to take the blame for an investment that had been made before they even joined the firm, when the distress could be due to a lack of implantation of protection mechanisms at the time of the acquisition or due to mere changes in the market forces. Therefore, some managers simply choose to "kick the can down the road" or "put it under the rug" until the problem is not theirs anymore. Korean culture further complicates matters, as the deeply ingrained and rigid Confucian-based hierarchical structure makes reporting up the chain a challenging endeavor. Moving to another company for C-suites is also relatively easy especially when they have the right network. This creates further moral hazard because it gives more incentives for the C-suites to delay the problem until they can move to another firm.

For Dana, the same problems with the inefficiency and asymmetry of information explained above likely existed with the case of Narrow Way. Even though the Lead Restructuring Team at Dana was on the same page as Bluecliff in terms of the legitimacy of the business plan, the reporting process took too long. It was most likely also very difficult to convince the top management at Dana the likelihood of success of Bluecliff's business plan given that Bluecliff was not a known name in South Korea. With the short time window they had before making a decision, the decision makers at Dana were faced with two choices: i) taking additional risk by partnering with an unknown American firm with a business plan that had not been thoroughly analyzed or ii) extending the loans without incurring a cost and deferring the potential realization of loss into the future. The latter was an easier choice for them.

2.9 Takeaways from Case 2

Similar to Case 1, Dana could have avoided some of the core problems if they had co-invested in the asset with an interest-aligned American partner who knew the market, had the capital to deploy in a time of distress, and had experience with loan restructuring. Dana should also have assigned an asset manager who had the capability and experience with office value-add in order to successfully implement the asset enhancement initiatives including refurbishments, re-tenanting, tenant incentives, leasing commissions, etc. Given that Dana had not done any of

the above, their best option would have been to accept Bluecliff's offer, but with enough time in advance to fully analyze and digest the business plan. Of course, in this case Dana's decision makers did not have enough time to review the business plan and conduct the due diligence on Bluecliff because they had been given only a month before the loan maturity date. In hindsight, Dana should have shortened the internal reporting process by first simultaneously sharing from Day 1 the known information on the distress problem with all layers within the reporting chain, and held meetings both to discuss the suggested solutions and to devise new plans. Instead, Dana delayed and wasted invaluable time because of the inefficient reporting process, time that could have otherwise been used more efficiently by analyzing the issue, plans and conducting due diligence on Bluecliff. Had Dana chosen to partner with Bluecliff, Dana could have paid off the Mezzanine Loan at a significant discount with the help of Bluecliff's lender negotiating experience and leveraging the CEO's close relationship with the CEO of the Mezzanine Lender. Additionally, Bluecliff could have executed the value-add business plan that Bluecliff was confident in implementing. Although it is not known, there may have been also political complications as were seen in Case 1. Inefficient reporting process and moral hazard lurking in political complications are commonly seen in today's Korean real estate investment world. In order for South Korean investors to be more advanced and sophisticated in commercial real estate, they need to first simplify the reporting process and disregard the politics, prioritizing on the fundamentals of the asset and the economics of the investment.

V. Case 3: Metro Tower

3.1 Background

Metro Tower (alias) is a multi-tenant office building located in CBD, Minneapolis, and is one of the skyscrapers of the city. The building was built in 1983 and renovated in 2005. The anchor tenant, occupying 60% of the leasable area, is the so-called "back office" department that deals with accounting, payrolls, and other administrative business, of a retail corporation called Magnet (alias). Magnet had announced a couple years ago that it would be vacating the entire space at the end of its lease term, as part of their physical space downsizing plans.

The investor, Ransom Asset Management (RAM) (alias), is a real estate investment firm in Korea that is also a subsidiary of a large life insurance company. The insurance company is part of one of Korea's Chaebol groups.

RAM purchased Metro Tower from a Chinese conglomerate at the end of 2017 at a price just over $300 million, leveraged with $200 million of debt. The investment was also one of the four office investments in RAM's largest blind fund ($500 million), which they used as a marketing tool at a time when blind funds were not common in South Korea. In fact, RAM was the first real estate investment firm to have launched a real estate blind fund at such magnitude when blind funds were barely existent.

The loan maturity was coming due sometime in the next year, but the lender was unlikely to extend the loan with the news of Magnet vacating the building. Even if the lender agreed to extend the loan, the interest rate would be much higher than the original fixed rate. In that case, the asset would not be able to generate enough operating cash to cover for the interest rate payments, yielding a DSCR (Debt Service Coverage Ratio) of below 1.0x. The lender was also likely to ask for a big paydown as part of the extension agreement. The value of the asset today was likely to be much below the Senior Loan's principal amount.

3.2 Anchor Tenant Risk

The anchor tenant, Magnet, was a retail corporation. In the year preceding the acquisition, Magnet had renewed its lease for a duration of 10 years, with an additional option for a 5-year extension. It was also a listed company on the New York Stock Exchange. Magnet's headquarters was also located only 3 blocks away from where Metro Tower was located.

During the COVID-19 Pandemic, Magnet's sales volume actually increased thanks to its strategy to give customers the ability to choose different ways to shop. In order to meet the surge in online shopping demand, Magnet used the existing stores as hubs to ship online orders or let customers pick up their orders from the parking lots. This also saved Magnet significant costs that could have been incurred from constructing or acquiring a massive network of warehouses. Magnet also introduced drive-up service, which allowed orders to be carried directly to a customer's car. This service grew by 500% in 2020, and by 80% in 2021. Magnet's successful adaptation during the pandemic allowed the sales volume to increase to over $100 billion in 2022.

Given that Magnet had a long lease term in place at Metro Tower, that Magnet had its presence in Minneapolis since 1960s, and that it fared so well during the pandemic despite being in a

potentially vulnerable industry sector, it was hard to imagine that RAM would have to be dealing with an anchor tenant risk with Metro Tower. However, Magnet announced in 2021 that it would adapt the hybrid model, which allowed both working from home and working in the office. Magnet planned to reduce its office space in Minneapolis by a third, and as part of this plan, it announced that it would be physically vacating Metro Tower and not renew its lease. Because the lease term had some years left until 2027, Magnet would give the space to subtenants. The 3,500 employees who had worked at Metro Tower would be relocating to another adjacent city.

The news was not only a shock to RAM, but also a strong signal to the market that Minneapolis was not an attractive location for office tenants; if Magnet could leave, who else could not? Landlords and developers were scared of a ripple effect on other tenants. Office net absorption turned from positive to negative and hit its trough with an astonishing number of negative 2 million square feet in the third quarter of 2021. Quarterly office space under construction dropped from 2 million square feet to 500 thousand square feet from 2020 to 2021.

Figure 14: Minneapolis Historical Construction Deliveries, Net Absorption and Vacancy

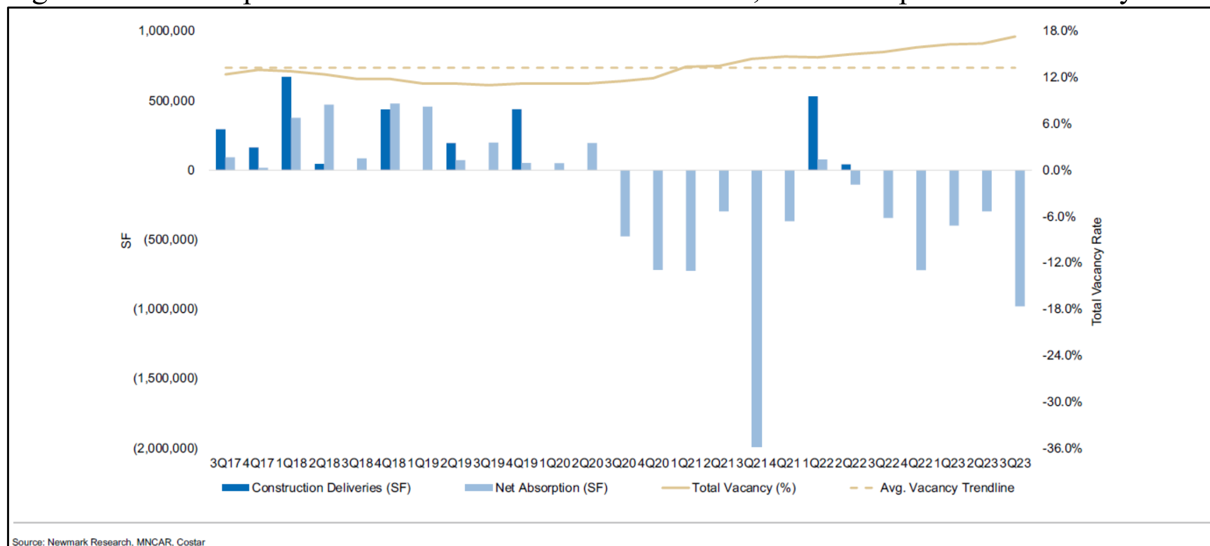
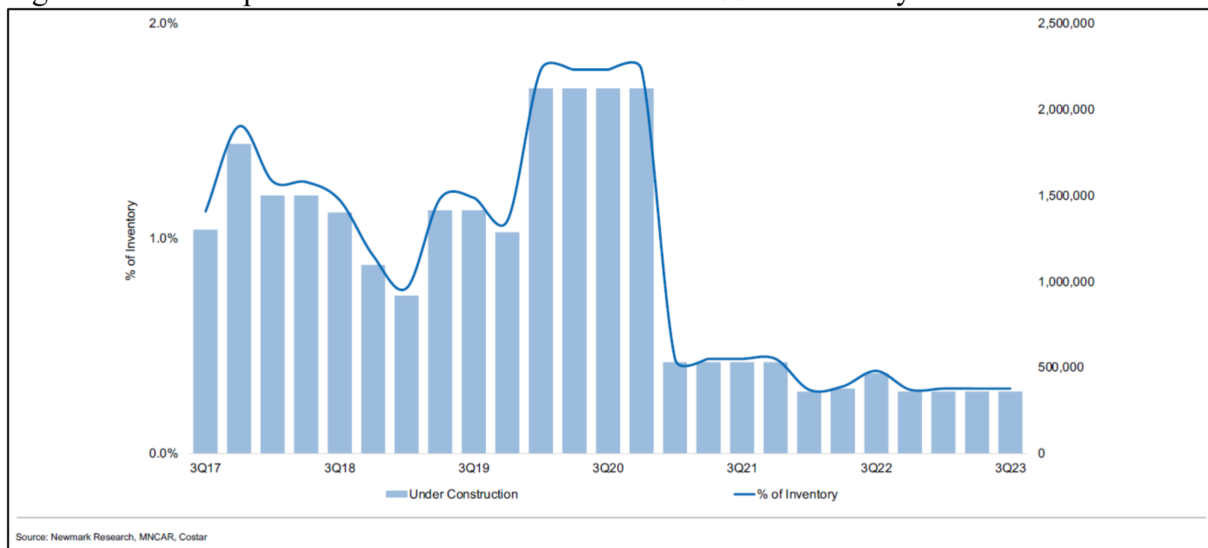


Figure 15: Minneapolis Office Under Construction and % of Inventory



Office investors were worried that Metro Tower would be essentially an empty building in several years. Despite having a few years remaining on its lease, there were no Magnet employees physically occupying the office space because Magnet had opted to make its lease available for subtenants. Even if Magnet successfully filled the space in with subtenants, it would have no obligation to do so after 2027 when the lease ends. To save costs, RAM might have to cut costs on building maintenance and repair, which would ultimately render the building less attractive for tenants. This would create a vicious cycle where vacant space would lead to more deterioration, which would lead to more vacancy. Moreover, the building's WALE (weighted average lease expiry) was only 4 years without Magnet's lease. It was highly unlikely that other tenants would want to renew their leases when the building was becoming emptier and less inhabitable.

Anchor tenant risk and single-tenant risk were commonly overlooked themes for South Korean investors. In fact, Koreans generally preferred large office buildings with single tenancy and long leases because such investments were much easier to understand, digest, and report, compared to multi-tenant buildings. From the perspective of asset management teams, handling single-tenant buildings with long term leases was simpler. This was due to the absence of concerns about lease renewals or re-tenanting, provided that the lease duration was sufficiently long and lacked a pretermination clause allowing the tenant to depart with minimal or no penalty. Furthermore, because of the structure of the Korean funds, Korean investors disliked uncertainty in cash flows. Most Korean funds were closed-end funds that did not allow additional capital call for asset enhancement expenses such as tenant incentives, leasing commissions or other capital expenditures. Because multi-tenant buildings had multiple leases with many variations in the leases, they led to more fluctuations in the cash flows compared to those with single-tenant buildings.

In the case of Metro Tower, even though the building was not a single-tenant building per se, RAM's investment theme and success relied heavily on Magnet's promise to remain in the building, and also on the seemingly high likelihood of the exercise of the 5-year extension option at the end of the lease term. While one may argue that the combination of COVID-19 pandemic, work-from-home phenomenon and the unprecedented rapid hikes in interest rates

was a perfect storm and a six-sigma tail risk that no investor could have avoided, such risks are systematic hazards that are uncontrollable; on the other hand, investment asset selection is controllable. In other words, had RAM chosen a multi-tenant building with tenants from different industry sectors occupying relatively evenly distributed leasing spaces, RAM might have smoothed out this shock. Multi-tenancy is similar to diversification in investment portfolio management, in which diversifying investment asset types that have low correlation among themselves leads to higher risk-adjusted returns, i.e. higher return with same risk or lower risk with same return.

3.3 Political Concerns

Ransom Asset Management was a more complicated investor than most other Korean institutional investors because it was a subsidiary of Ransom Group, one of the larger Chaebol groups in South Korea. Chaebols are some few family-controlled conglomerates that essentially control and dominate South Korean economy. Because Chaebols compete among themselves in many industry sectors and are associated deeply with politicians, naturally they have many enemies. Eager eyes among journalists, politicians and rival groups were waiting for Ransom Group to make missteps. Ransom Group even had a specialized department that had only a few roles including monitoring news related to Ransom, upholding the brand name, and preventing employees from leaking information to the public that could potentially harm Ransom Group's reputation.

Ransom Group was concerned that the news of the potential loss of equity investment in Metro Tower could put the group under the rain of media firestorms and government scrutiny. Metro Tower was one of the four assets within RAM's second office blind fund, ROBF 2, where most investors were institutional, such as pension funds and insurance companies. Therefore, these pension funds and insurance companies had a responsibility to safeguard the funds for the pension holders and insurance policyholders, who were ordinary, hardworking average citizens of South Korea. Therefore, it was unlikely that the South Korean government would take a potential loss of $500 million, the size of ROBF 2, lightly. RAM was also under a significant amount of pressure to generate fund performance on ROBF 2, especially after the failure of its first office blind fund ROBF 1. ROBF 1 was comprised of two European office buildings and one US office building. While the two Europeans office buildings were generating the dividends and performance that were initially promised to the investors, the problem lay with the US office building where the single tenant who had remained as a tenant for more than a hundred years surprised the market by announcing its relocation. The tenant exercised the early termination provision it had in the lease contract, leaving the building with 100% vacancy. The expected IRR (internal rate of return) for ROBF 1, therefore, ranged from a negative number to 0% while the initial target IRR was at around 6%. RAM was hoping that it could redeem its failure with ROBF 1 with the success of ROBF 2, but the market forces were not in RAM's favor. ROBF 2 was comprised of two US office buildings, including Metro Tower, and two European office buildings. The three buildings other than Metro Tower were also dealing with significant problems with vacancies, debt covenants, debt repayments and downward pressure on asset valuations. Should RAM choose to execute a rescue plan for the three office buildings, *excluding Metro Tower*, the estimated required funds would be an additional amount of $200 million, which was 40% of the amount of money initially invested in the fund. In other words, RAM would have to ask investors to commit an additional 40% of what they initially invested in ROBF 2 without the assurance that they would recoup any of it. ROBF 2 was also one of the

only few blind funds in South Korea that targeted investment in commercial real estate and was also one of the largest real estate funds in South Korea. Therefore, both RAM and the investors behind the fund were under great pressure because the size and fame of the blind fund led to unavoidable attention from the media, industry, and government. Now RAM had to also deal with Metro Tower, which required additional $130 million of funds to stabilize the building in 5 years according to a third-party analysis. This meant that RAM would need a total of $335 million to implement the rescue package for ROBF 2, which would be more than two thirds of the investors' original invested capital in ROBF 2. According to one of the fund managers at RAM that were in charge of managing ROBF 2, Metro Tower seemed to be at the bottom of the investors' list of concerns, because the loan maturities for the other three assets were much more imminent. Given that Metro Tower was at the bottom of the investors' list and that the investors were already asked to inject additional $200 million into the blind fund, it was very unlikely that the investors would agree to invest additional $130 million for Metro Tower. In fact, because of the failure of the first blind fund, ROBF 1, investors expressed great disapproval of any further capital calls. Consequently, whether there would be any additional capital called at all for ROBF 2 was uncertain. Therefore, RAM had to devise a plan that would allow RAM to repay $200 million debt for Metro Tower due in January 2024 without calling capital from the investors.

3.4 Lease Buyout

RAM's best option was to negotiate a lease buyout, in which Magnet would pay a one-time lumpsum payment to RAM as part of an agreement to terminate its lease. The valuation of the lease would be the sum of the present value of the future cash flows that would have been generated from the lease until the lease expiry. RAM was hoping that the funds would be enough to pay off the debt of $200 million. The problem remained that after debt repayment, the building would be largely empty without Magnet, which meant that RAM would need to spend a significant amount of capital expenditures, tenant incentives and leasing commissions in order to refurbish the building and attract new tenants. However, as mentioned in the previous section, the limited partners, the investors behind the ROBF 2 fund, were reluctant to spend an additional dollar on the asset. Even if they spent the funds, there was no guarantee that RAM would successfully sign leases with new tenants any time soon. The team computed the cumulative present value of all cash flow components, including rental revenue and expense recoveries throughout the lease term. The resulting total amounted to $150 million, falling $50 million below the $200 million debt RAM needed to repay. This meant that RAM either had to negotiate a 25% discount on the loan payment or sell Metro Tower at a price of at least $50 million. After this analysis, RAM initiated the discounted loan payoff with the lender and the negotiations are still ongoing today. Although negotiating a lease buyout might be the best option for RAM given the complicated nature and background of the investment that was discussed, there remained the political concern that criticism would follow from the public and media that RAM had not fulfilled its fiduciary duty by, for example, investing additional funds to save the investment or initiating a bidding process to find the highest bidding buyer. Therefore, RAM has so far not considered any public or private sale of Metro Tower due to concerns regarding media attention. The lease buyout and loan discount negotiations are being conducted with utmost secrecy and caution.

3.5 Takeaways from Case 3

Again, similar to the takeaways from Case 1 and Case 2, RAM should have co-invested in the asset with an interest-aligned US partner who knew the market, had the capital to deploy in a time of distress, and had experience with loan restructuring. Given that lender negotiation has now become a key issue, RAM should partner with a US firm with a specialty in loan modification negotiations.

What is different in Case 3 compared to Case 1 and 2 is that the Korean asset manager, RAM, was involved in tremendously complicated political concerns that prevented RAM from considering all options that were available in the market. For example, RAM could have searched for and partnered with an office value-add specialist firm that would both co-invest and execute value-add initiatives on the asset. However, RAM and the investors behind the blind fund were reluctant to invest additional capital expenditures on an asset with the least impending debt maturity in the blind fund, when the other three assets in the blind fund clearly required rescue funds almost immediately. Ransom Group also wanted to avoid as much media attention as possible and prevent additional government scrutiny, so RAM did not contemplate initiating the public sale process. Lastly, had the first blind fund, ROBF 1, been an exceptionally lucrative and successful fund, RAM and the investors might have considered the capital call option more positively. Many times, these political complications prevent Korean investors from making the best investment or disposition decision in economic terms. In the case of Metro Tower, negotiating the lease buyout, paying off the debt, and recognizing the loss on Metro Tower in the blind fund without seriously stirring up the public or upsetting the government might have been the only option for RAM.

Finally, anchor-tenant or single-tenant buildings with long term leases and high credit were popular among Korean investors because the simplicity allowed easier reporting and easier management. Nevertheless, it might be more prudent for them to now begin redirecting their attention toward multi-tenant buildings to mitigate potential tenancy risks, similar to one observed in this case. Investing and managing multi-tenant buildings might be more costly in terms of time, human resources and fees for third party management, but multi-tenant buildings might allow investors to bear less fundemantal risk and have more flexibility in a distressed situation.

Conclusion

As South Korean investors are trying to navigate the storms of distressed office investments in the US, their ships are stuck in a dangerous and dire zone where one misjudgment could lead them into a whirlpool that would suck them into the bottom of the ocean. As we have seen in the three examples presented, each case is unique and has complicated problems that need to be addressed with customized solutions. However, there are some common ideas that have resonated in both the interviews and the cases.

Firstly, Korean investors need to partner with US firms with local natives. So far, both Korean investment firms and institutional investors have preferred to work with Korean expatriates in the US because of the ease with communication and shared culture. This was not recognized as a problem until the market faced the distress we are seeing today. Without the native talent in the US, the Koreans are lost and easily being taken advantage of by the ones who understand the US market, culture, real estate, financial engineering, and the behavior of each party involved. It is as if the Korean investors have been navigating the foreign seas with a compass that only works in their domestic waters. South Korea has some of the brightest minds in the world, but still lacks experience with US commercial real estate investment. Once these bright minds are combined with experience and expertise in the market, South Korean investors will be able to both weather the storms and navigate new territories. Therefore, Korean investors need to start shaking hands with US firms that have an aligned interest and have capital, to both help them exit the current distress with as little damage as possible and to co-invest in new opportunities in the future.

Secondly, Korean investors need to simplify and shorten their reporting process. As seen in all the three cases, internal reporting had taken so long that the decision makers had too little time to digest the problems and make the best economic decisions. Other problems that are worth noting are the political issues that hinder the investors from making economically sound decisions, the concentration of investment in the office sector with single tenant buildings, the lack of discretional power of general partners, the moral hazard of the decision makers who continue to kick the can down the road and refuse to confront the problem, lack of expertise of the C-suites, language barriers, cultural barriers, and so forth. The list can go on.

While there may be other problems not mentioned in this thesis, the key for the Korean investors is firstly to focus their energy on the fundamentals of the asset, the investment structure, and the market, and secondly to spend less to no time on the superficialities such as internal reporting chain process and politics. As long as they do so, they will most likely be able to successfully come out of the storms and continue to navigate the seas of commercial real estate investment with more confidence and energy than they had before. As CEOs of global firms enforce stringent directives for employees to return to physical offices and as the Federal Reserve hopefully adopts a more dovish stance in the upcoming years, investors may have the opportunity to exit the distress sooner than anticipated.

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