

## Private Equity Investment in Real Estate

### Interview with ZENGJUN, Chairman of the Board of Directors of Fuho Capital

When will China's real estate market reach a turning point? Opinions vary, but reductions in the number of transactions and investors' wait-and-see attitudes seem to have become fact. Challenged by repeatedly declining sales prices, real estate giants such as Wang Shi are cutting costs and preparing for a tough winter.

There are still opportunities emerging in the challenging real estate market. A private equity fund offers liquidity in a frozen real estate market, which in turn provides a great platform for a private equity fund to gain market access, to take advantage in negotiations and to seize opportunities for capital appreciation.

With these issues haunting those real estate enterprises that are left out in the cold, we interviewed Zeng Jun, a former real estate developer and the current chairman of the board of directors and general manager of Fuho Capital, a RMB500 million private equity fund that focuses on real estate investment. Zeng Jun previously served as general manager of the Hong Kong-listed Beijing Gulfland Development Co., Ltd. and created the landmark New Zhong Guan Mansion, which is located in Zhongguancun, Beijing.

**SGLA Law Journal:** As an investor, why do you choose to invest in real estate enterprises?

**Zeng Jun:** With a background in managing real estate enterprises, I developed a well-rounded knowledge of this industry. Now as an investor, real estate is an area I am more familiar with.

The cycle of real estate investment is relatively short, and it takes only three to five years to finish a single project. Taking one project as an investment unit, the investor can exit as soon as the project is liquidated. Since it is rare for a real estate project to list on a public exchange, a private equity fund can exit and continue investing in real estate projects within a relatively short time without going through the onerous regulatory procedures that are necessary in the case of an acquisition or a public listing.

**SGLA Law Journal:** In terms of profitability, what is the difference between investing in real estate and other industries?

**Zeng Jun:** The return rate on a real estate investment is quite low compared to an acquisition or a pre-IPO or VC investment. Constrained by the leveraging function of land auctions and other contributing factors, the rate of return on real estate investments usually ranges from 20% to 30%, whereas other forms of investment can be highly profitable, with return rates of 50% or even 100% in some cases. The downside of a high rate of return, of course, is the high risk that accompanies the investment.

**SGLA Law Journal:** With approximately RMB 500 million in hand, how will your private equity fund invest its money in real estate?

**Zeng Jun:** While banks are the principal source for real estate financing, private equity funds and trust companies also serve a supplemental role. I do not think it is entirely true that the real estate market will go through tough times. For now, we will wait and see, but the progress will not end. Currently, Fuho Capital is raising a real estate investment fund, which hopefully will amount to RMB400 to 500 million by the time we are finished at the end of this year, and we will be investing in real estate projects outside of Beijing. The real estate industry will need greater financing after the winter, and this will give investors including private equity funds additional investment opportunities.

20% to 30% of the investments made by our existing funds have been in growth-type enterprises,

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i.e., venture capital investments at middle and later stages, whereas 70% to 80% of the remaining investments have been in mature IPO projects. For purposes of security and diversification of risk, the RMB500 million will be divided and invested in a series of projects, with each project at about RMB 10 million and taking about five years to finish.

**SGLA Law Journal:** How do you control risk in investments?

**Zeng Jun:** First, the analyses from feasibility, due diligence, financial auditing and other procedures are prerequisites in each project, so that the risks can be minimized.

Second, we can exit short term investments by way of premium acquisition, i.e., by converting an equity interest investment to a debt investment. Therefore, the riskiest point is the capital strength of the developer.

As to operations, project selection comes first and requires investors to estimate the development of the project based on their own experience with or judgment of the economy. Then, a feasibility study is conducted with outside assistance. In the end, the efficiency of an investor's team is also key to a successful investment.

During the investment decision-making process, doubts or vetoes of a project can be made in three stages, of which the first stage is the establishment of the project, the second stage involves three due diligence investigations, including commercial investigation, financial investigation and legal investigation (the latter two are completed by accounting firms and law firms, respectively), and the third stage is a vote by the members of the investment committee.

**SGLA Law Journal:** What kind of real estate enterprise attracts investors the most?

**Zeng Jun:** Comparatively, real estate enterprises with an established brand and market reputation, as well as solid team management skills, will attract the most investors.

**SGLA Law Journal:** What are the professional requirements for private equity in China?

**Zeng Jun:** Compared to foreign private equity, what Chinese private equity lacks most is the professional team, especially professionals with experience in both industry and investment. Investors with industry experience have a broader vision and can choose among various industries open-mindedly. At the same time, they know which problems are vital to investors and which problems can be overlooked. In addition, it is a pleasure being able to help small and medium-sized enterprises to grow.

**SGLA Law Journal:** What is a lawyers' role in a private equity investment? How do you select a lawyer to help in the investment process?

**Zeng Jun:** Due to the importance of the terms and conditions of contracts in the early stage of the project, lawyers participate in the overall operation of the investment process beginning with the formation of the fund. Lawyers also play a significant role in the due diligence investigations and negotiations throughout the whole process.

When selecting investment lawyers, their experience with operating projects and their legal knowledge is our primary concern. Besides, experience in different industries is also helpful. For instance, real estate lawyers may be more familiar with investments in real estate.

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