



Emerging Trends in Real Estate®

Asia Pacific 2015



Emerging Trends in Real Estate® Asia Pacific 2015

A publication from:



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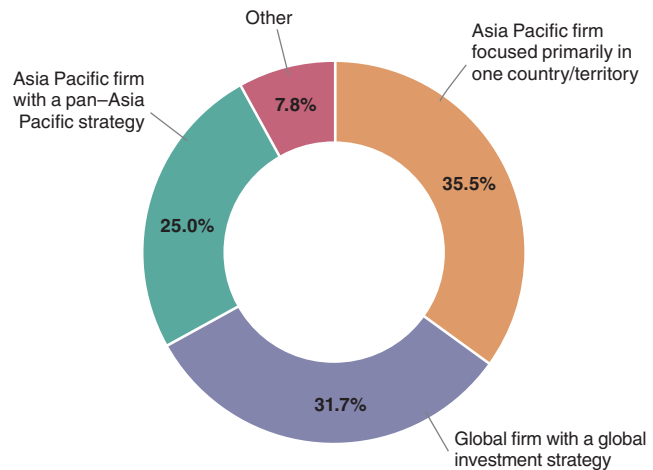
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Executive Summary

Asia's real estate markets are beset by an abundance of riches. Whether derived from new sources of institutional capital that continue to build across the region, or from almost six years of global central bank easing, a seemingly endless stream of money is now pointed at real estate assets across virtually all jurisdictions and asset classes, pushing up prices and further compressing yields. For now, despite the prospect of impending U.S. interest rate rises, there seems little prospect of that flood of liquidity ending. Too much capital, however, has the tendency to distort markets, and in this case there have been a variety of consequences.

- **Investors are opting not to buy.** Transaction volumes across Asia fell 24 percent year-on-year in the third quarter of 2014, compared with significant gains in the United States and Europe. Although much of the decline is due to lower sales (in particular, sales of land) in China, transactions have dropped in most Asian markets, with the notable exception of Australia.
- **Product is scarce.** The structural shortage of investment-grade assets across the region is compounded by growing volumes of capital held by local institutions and the lack of incentive to sell, given that relatively little commercial real estate is held by investment funds that will recycle their assets into the market after a few years.
- **Investors seek other asset classes.** With core product both expensive and hard to source, investors are looking for alternative strategies. This includes value-add deals and, in general, more-complicated asset management situations, and finding specific types of assets that may have been left behind by the market.
- **Investors are wary of secondary locations and assets.** Given the lack of trust in the current market, most investors prefer to remain in gateway cities, where they have more confidence in the resilience of pricing and liquidity. This applies especially in Australia. In China, many buyers are avoiding secondary locations because of a spate of overbuilding. Japan is the exception, with competition from local real estate investment trusts (REITs) forcing investors to branch out to cities other than Tokyo. Meanwhile, secondary assets such as retirement homes, self-use storage, and student housing have proved to be less investable than previously anticipated due to difficulties of working in specialist sectors. Logistics, however, remains one area where investors are unreservedly bullish. Conversion plays—for example, from office to residential—are also popular in some markets.

Survey Responses by Geographic Scope of Firm



Source: *Emerging Trends in Real Estate Asia Pacific 2015* survey.

- **Interest in emerging markets cools.** Fast-growing markets such as the Philippines and Indonesia remain on investors' radars, but the attraction has dimmed somewhat this year as investors become cautious over the potential for capital outflows in the wake of upcoming U.S. interest rate hikes.
- **Investors are increasingly willing to adopt development risk.** Forward-funded and build-to-core strategies are popular, especially in Australia. In Japan, however, development is less attractive given increased construction costs.
- **Distressed developers provide opportunistic returns in China.** As a government-mandated squeeze in debt financing for developers takes effect, small and midsized Chinese developers will seek rescue capital or other types of private equity to make ends meet.
- **Strong asset prices compare with weak rentals.** Occupational markets are weak in many countries, especially Australia and Japan. Many investors project that further upside will come from improving rentals rather than from more price rises.

On the financial side, Asia has seen a structural shift in the last couple of years in the role that local institutional capital (i.e., from sovereign wealth funds, pension funds, and insurance companies) is now playing in real estate, with a big increase in local money being directed into both regional and global markets. For now, much of this new capital is sourced from China and South Korea. In the future, it is likely to be supplemented

by substantial amounts of pension fund capital emerging from Japan and potentially Australia.

Another major change to the capital flow scenario (and one reason transaction volumes in Asia have been lower this year) is that funds are now increasingly directed to U.S. and European markets. At the moment, this money tends to be targeted at core assets by way of direct investments in gateway cities in the United States and the U.K. New patterns are evolving, however. As more capital crowds into these cities and as Asian investors become more experienced in operating internationally, new investments are now being directed at assets in second-tier locations such as cities in Germany and France (primarily Paris) and into U.S. cities such as Atlanta, Chicago, and Houston.

Another new trend is an increase in the volume of private capital originating from Asian markets. This has been led by a group of large Chinese developers (although Singaporean, Hong Kong, and Malaysian players also are prominent) that invest mainly in residential projects both regionally and globally, whose products are aimed largely at buyers from mainland China. While these forays appear to have been largely successful so far (with a lot of activity this year in Australia), some interviewees questioned whether the migration of Chinese developers has been too large, too fast.

Meanwhile, Asia's banks continue to provide plenty of debt capital to fund both real estate investments and development (China and India being notable exceptions). In addition, while Asia's public capital markets remain immature compared with those in the West, issues of both bonds and equities remained surprisingly strong in 2014.

Regional REIT share prices also have proved resilient. Although REITs are not buying as actively in 2014 compared with the previous year, they remain the biggest buyers in Japan and Australia. In the case of Singaporean REITs, they are also increasingly looking to buy outside their home markets (in particular, in China).

In this year's Investment Prospects survey, Tokyo remains the investor favorite by a wide margin, featuring as a clear winner in both investment and developer categories and followed closely by Osaka, which as recently as our 2013 report ranked next to last.

Other major survey findings include the rise of Australian cities into leading positions, reflecting the appeal of the high cap rates still offered by Sydney and Melbourne in an otherwise yield-challenged environment across Asia. They also include a fall in popularity of China. Although the two most important mainland cities—Beijing and (especially) Shanghai—continue to show reasonable strength, the three other mainland Chinese destinations featured in the survey, together with Hong Kong, have been herded into positions at the bottom of the ladder. Sentiment toward China has been affected by an ongoing slump in the residential sector, a slowing economy, and low cap rates across almost all sectors and locations.

Finally, the industrial/logistics sector remains the most popular in terms of sectoral preferences, again by a wide margin. This is testament to chronic shortages of logistics capacity in most markets and the relatively higher yields still offered by logistics plays.

Notice to Readers

Emerging Trends in Real Estate® Asia Pacific is a trends and forecast publication now in its ninth edition, and is one of the most highly regarded and widely read forecast reports in the real estate industry. *Emerging Trends in Real Estate® Asia Pacific 2015*, undertaken jointly by PwC and the Urban Land Institute, provides an outlook on real estate investment and development trends, real estate finance and capital markets, property sectors, metropolitan areas, and other real estate issues throughout the Asia Pacific region.

Emerging Trends in Real Estate® Asia Pacific 2015 reflects the views of 385 individuals who completed surveys or were interviewed as a part of the research process for this report. The views expressed herein, including all comments appearing in quotes, are obtained exclusively from these surveys and interviews and do not express the opinions of either PwC or ULI. Interviewees and survey participants represent a wide range of industry experts, including investors, fund managers, developers, property companies, lenders, brokers, advisers, and consultants. ULI and PwC researchers personally interviewed 115 individuals, and survey responses were received from 270 individuals, whose company affiliations are broken down as follows:

Private property company, investor, or developer	30.0%
Institutional/equity investor or investment manager	20.4%
Real estate service firm	27.0%
Equity REIT or publicly listed property company	7.4%
Homebuilder or residential land developer	0.7%
Bank, lender, or securitized lender	2.6%
Other entities	11.9%

Throughout the publication, the views of interviewees and/or survey respondents have been presented as direct quotations from the participants without attribution to any particular participant. A list of the interview participants in this year's study appears at the end of this report. To all who helped, the Urban Land Institute and PwC extend sincere thanks for sharing valuable time and expertise. Without the involvement of these many individuals, this report would not have been possible.

In for a Penny . . .

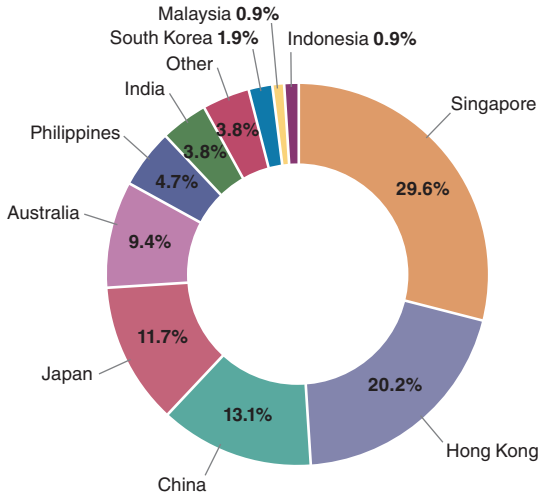
“It’s getting more **difficult** to find attractive risk-adjusted returns without structuring, or higher leverage, or all the things that start to sound risky and toppish.”

If investor sentiment in last year’s *Emerging Trends in Real Estate Asia Pacific* report reflected a degree of bemusement at how regional markets had remained so resilient in an environment of weakening economic fundamentals and apparently ever-compressing cap rates, the tone this year is more one of resignation. With asset prices across the region now setting new highs, cap rates plumbing new lows, and economic conditions as weak or weaker than in 2013, real estate buyers appear to have embraced a new normal, where, as one investor put it, “investment markets are now well ahead of fundamentals—they’re pricing in a recovery that just isn’t there.”

The main reason behind this now-longstanding tension between economics and pricing is clear enough: Asian real estate is struggling to absorb a seemingly endless stream of new money arriving from a variety of sources, both outside Asia and (for the most part) within. They include sovereign wealth capital, regional pension funds, real estate investment trusts (REITs), and accumulated high-net-worth money from across the region.

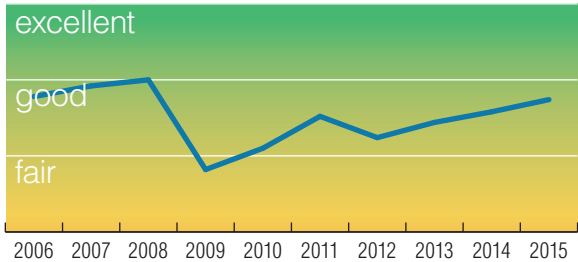
In addition, and perhaps of greatest importance, Asian asset prices have been boosted by the trickle-down impact of almost six years of global central bank easing. While the U.S. Federal Reserve has now ended its most recent bond-repurchase program, rising aggregate stimulus from other global central banks has more than filled the resultant gap. The European Central Bank (ECB) announced new programs in September 2014 that will expand the ECB balance sheet by €500 billion (approximately US\$625 billion) per year. After a new round of stimulus in late October 2014, Japanese central bank easing will now contribute another US\$720 billion per year. And with Chinese central bank purchases of U.S. Treasury bonds estimated to come in at around US\$560 billion in 2014, current increases in global central bank easing now exceed the €1 trillion rise in government-sponsored stimulus seen annually since 2010. As a result, according to

Exhibit 1-1 Survey Responses by Country/Territory



Source: *Emerging Trends in Real Estate Asia Pacific 2015 survey.*

Exhibit 1-2 Real Estate Firm Profitability Trends



Source: *Emerging Trends in Real Estate Asia Pacific surveys.*

a recent J.P. Morgan analysis, excess liquidity throughout the global economy is now “the most extreme ever in terms of its magnitude.”

Secular or Cyclical?

The question now is the extent to which inflated prices created by this flood of newly minted money are sustainable. Last year, buyers in many markets were able to make the numbers add up by factoring anticipated price rises into their underwriting—a strategy that, by and large, has been justified by recent market movements. Today, though, the stakes are that much higher. Anecdotally, yields in most major markets across Asia compressed by 50 basis points (bps) or more in the first three quarters of 2014. For office assets, they now approximate or exceed pre-global financial crisis (GFC) levels of compression. Can buyers justify underwriting still more compression into their investments?

Given that U.S. interest rates are expected to rise in 2015, the obvious answer is no. According to one investor, “It’s getting more difficult to find attractive risk-adjusted returns without structuring, or higher leverage, or all the things that start to sound risky and toppish.” But in an environment where prices are more a function of liquidity than of underlying value, and with most major economies (including the U.S. economy) apparently too weak to tolerate significant upward movement in rates, many interviewees accept that yields may continue to decline anyway. This perhaps explains why investors can be bullish over profits (see exhibit 1-2) and uneasy over pricing at the same time. As one broker active throughout the region put it: “If I was talking to research people in Western markets, they’d think I was mad if I said that cap rates are going to compress even more. How can they? But the truth is that they will probably at least remain where they are, even in a rental market that’s going to be falling, because people just won’t sell.”

Over the long term, a more fundamental question is how long the current glut of liquidity is likely to last. According to a manager at a large global fund, “The common theme today is that there is a lot of liquidity in the world trying to tap nondiversified, stable, and growing income streams—everyone is looking for more yield at a time when equities are fairly expensive and bonds are probably going to go the wrong way. That search for yield is inexorable, and alts [alternative

investments] are probably right in the middle of most people’s targets. So if interest rates go up, pricing may move around a bit, but we view markets as back to a midpoint return between stocks and bonds, albeit at lower levels—we’re not envisioning a scenario where there’s a dramatic contraction of liquidity absent a shock.”

This means, in general, that expectations over yields have shrunk. As one fund manager said, “The way we look at it is that you’re trying to take some operational or leasing or construction risk, hoping to generate 300 to 600 bps above core. So if core is mid- to high-single digits, then 300 to 600 [bps] over that is low- to mid-teens, and you can put some debt on that and take it a bit higher. So I think you’re seeing a lot more groups talking about mid-teens returns as opposed to 20s.”

Transactions Fall

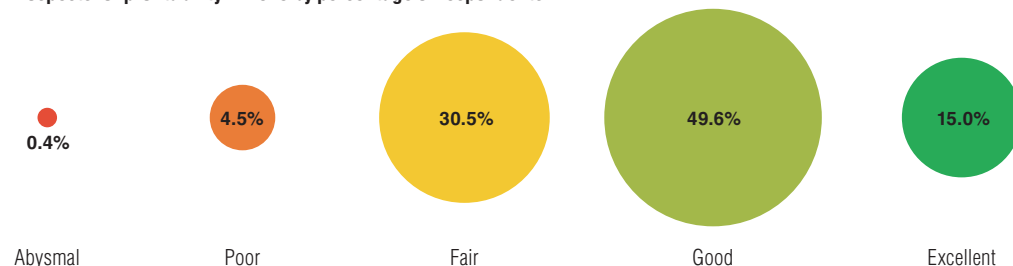
Whatever the answer to the fair value debate, the reality on the ground is that growing unease over pricing means investors are increasingly opting not to buy. This mentality is reflected in this year’s *Emerging Trends* survey results, where buy/hold/sell ratings (see chapter 3) showed a marked shift toward the sell side across almost all assets classes and geographies. According to one investor, “I am more skittish for sure, and I’m certainly going up the risk curve in terms of the deals we’re looking at to make the same kind of returns.”

Transaction volumes in Asia have therefore fallen (admittedly from last year’s post-GFC highs) even as they see big increases in the United States and Europe. As one interviewee observed, “I think the market in Asia is pretty flat—we’ve had pretty much a ten-year bull market and rents are softening, so why buy in Shanghai at 4.5 percent net yield when I can buy in London and other markets at 5 percent to 6 percent? So I think we’re going to see a very slow Asia for the next 12 months.”

According to data providers Real Capital Analytics (RCA), commercial transactions across the region slowed across almost all markets in 2014—in some cases significantly.

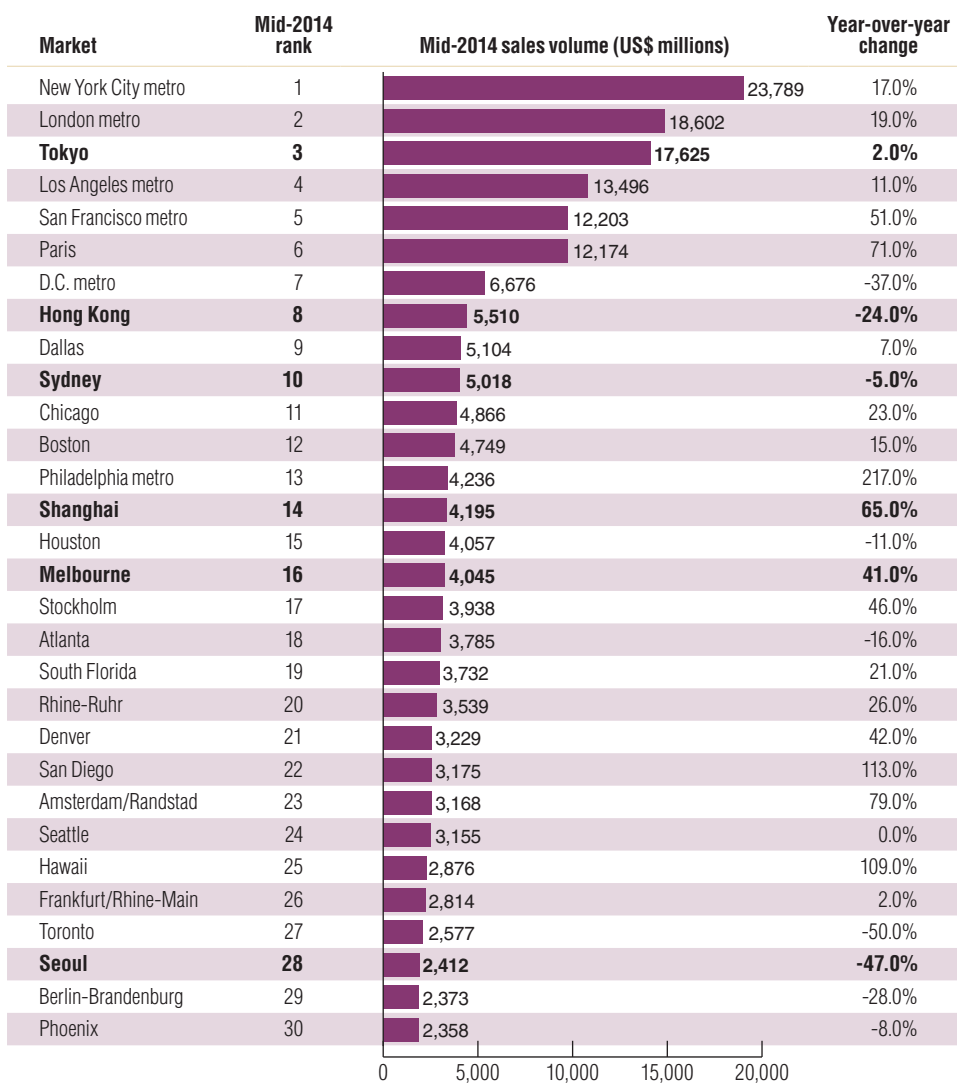
Exhibit 1-3 Firm Profitability Forecast for 2015

Prospects for profitability in 2015 by percentage of respondents



Source: *Emerging Trends in Real Estate Asia Pacific 2015* survey.

Exhibit 1-4 Top 30 Global Markets



Note: Property types included are office, industrial, retail, apartment, and hotel. Based on properties and portfolios valued at US\$10 million or more.

Source: Real Capital Analytics, www.rcanalytics.com, August 2014.

Overall, transaction volumes across Asia were down 24 percent year-on-year in the third quarter, and as much as 55 percent if China land sales are included. This contrasts with significant gains in European and North American markets.

In particular:

China has seen dramatic declines in transactions, largely as a result of lower land sales, with volumes down by about 50 percent year-on-year in the third quarter of 2014, according to official figures. However, net yields as low as 4.5 percent for prime assets have created an element of “nervousness” in Shanghai’s commercial office sector: “People aren’t exactly rushing to buy,” said one locally based fund manager. “It’s not a frenzy like it was two years ago.” With soft demand from

international firms and a big pipeline of new supply, “right now it’s a bit tough to have much conviction in the market.”

Japan saw the highest transaction volumes in 2013 since 2007. According to RCA, transactions in the first three quarters of 2014 declined 7 percent year-on-year, but investor sentiment remains generally positive. As one investor commented, “Everyone’s sipping from the same Kool-Aid at the moment, and you might as well get on the bandwagon because everyone else is there.”

Australia has bucked the trend and is now the strongest market in the region, with investment volumes up over 15 percent year-on-year to A\$18.3 billion in the first nine months of 2014, according to brokers DTZ. “A lot of people are running there and starting to price it really tight,” said one fund manager.

“Australia’s really benefiting, so this year, in terms of transactions, it’ll be like Japan was last year.”

Hong Kong/Singapore transactions saw big declines. In the first half of 2014, Hong Kong retained its number-eight ranking despite a 24 percent drop in volume, while Singapore dropped out of the top 30 altogether, despite featuring at number nine last year. The common theme is that investors are avoiding stagnant capital values and some of Asia’s most compressed cap rates (although with rental growth at 15.9 percent year-on-year, yields in Singapore are now moving out). In addition, government measures aimed at cooling local property prices have had a depressive impact on both markets. According to one Singapore-based fund manager, “The issue for sellers is securing the pricing they want, and all of that comes down to liquidity, which has been very low.” One reason is that “there has been a reallocation of capital moving to America or other places here in Asia.” This has been fueled not only by relatively unattractive pricing of Singaporean assets, but also by the fact that local developers have access to some of the lowest borrowing costs in Asia, which they are using to fund record purchases of overseas assets.

Shortages Rise

If buyers are reluctant to bid because assets are currently pricing in a recovery that has yet to happen, sellers see few reasons to offer discounts. According to one interviewee, “There’s no incentive to part with a good asset for anything other than full price because interest rates haven’t gone up, there’s no stress, no pressure, and because banks have opened their pocketbooks and put debt out there like it’s going out of style.” This standoff is creating a scarcity of suitably priced product—especially in the core space, where Asia’s growing club of institutional investors tends to congregate.

The problem is compounded by the fact that the region has always been short of investment-grade stock, both in absolute terms and as a proportion of assets circulating in the market. In the words of a Hong Kong-based broker: “The theme that underwrites the whole Asian real estate platform is that 98 percent of it is owned by locals, so there is no requirement for turnover because locals will keep it for their grandchildren, whereas in London a lot of it is owned by funds, where it trades every five to seven years. And when it provides such a good return, where they have bought it well and held it for a long time, that’s not a big surprise—even if they do sell it, what else will they do with their money?”

In China, for example, according to one Shanghai-based investor, “in terms of high-quality, core-related assets, there’s not much that’s owned by institutional investors trading in the marketplace, and most of that is owned by domestic companies that are self-use real estate, who don’t want to sell. You now see some of the domestic insurance companies acquir-

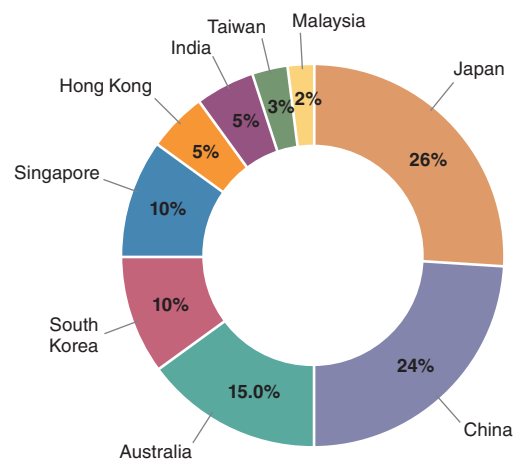
ing assets to own long-term, but there still isn’t a significant stock of product that trades in any of these cities.”

The situation is similar in Australia, where so many of the best assets are locked up in listed vehicles, leaving little left for investors to buy. This compares to equivalent owner-occupation figures of 36 percent in the United States and 59 percent in Germany. As a result, “the issue for the big overseas funds is trying to find an asset that probably an existing Australian fund wants to sell.”

The ever-shrinking availability of core product in traditional markets possibly explains the resurgent interest among international buyers in South Korea, which had long remained something of a backwater for foreigners despite being Asia’s fourth-biggest real estate market. Activity in 2014 has been led by private equity firms and at least one large sovereign player. Interviewees offered few tangible reasons for the renewed interest in South Korea apart from the idea that returns could be worse. According to one fund manager active in Korea, “It’s a reasonably robust economy where yields are high compared to government debt and interest rates—it’s not as positive as Australia or Japan, but cost of debt is at 4 percent and you can buy assets at 5 percent to 6 percent.”

Despite the overall shortage of core product regionally, rising prices and demand in both Japan and Australia mean that some assets are now being recycled onto those markets. According to one Tokyo-based fund manager, “You’re going to see both domestic and foreign people looking to divest because of how far the market has come. Even projects

Exhibit 1-5 Distribution of Assets Available for Disposals by Funds Entering the Termination Phase, by Country



Source: CBRE Research, September 2014.

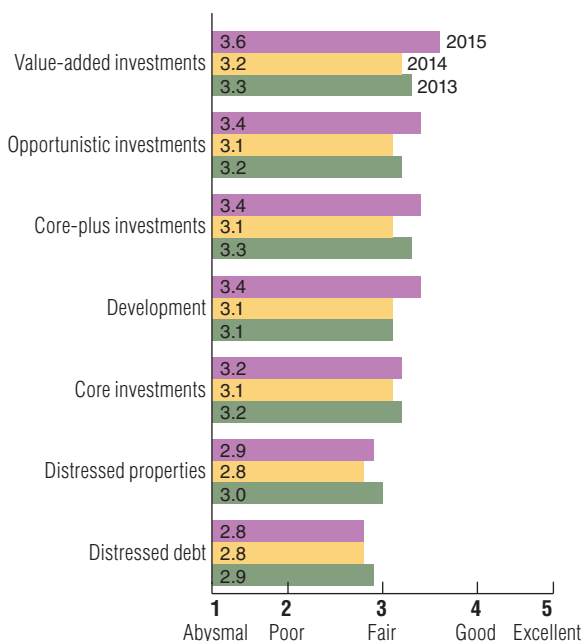
where they invested pre-global financial crisis are going to be put out now because they're able to see what they think is somewhere near the top, or anyway at a number that works for them. Quite a bit of that is coming to market, and I think we'll see more of it this year."

In addition, a sizable number of closed-end funds with fixed life spans that raised capital in Asia between 2005 and 2008 are now approaching their end-of-fund lives and will have to begin selling assets, beginning in 2015 (see exhibit 1-5). According to brokers CBRE, some US\$40 billion worth of assets (compared with US\$15 billion in a normal year) will have to be recycled in the market as a result. Most of these relate to opportunistic purchases located in Japan, Australia, and China. Given the strength of demand in the first two markets, only China-oriented funds are expected to face any problems disposing of assets, and then mainly in secondary and tertiary cities.

Finding an Angle

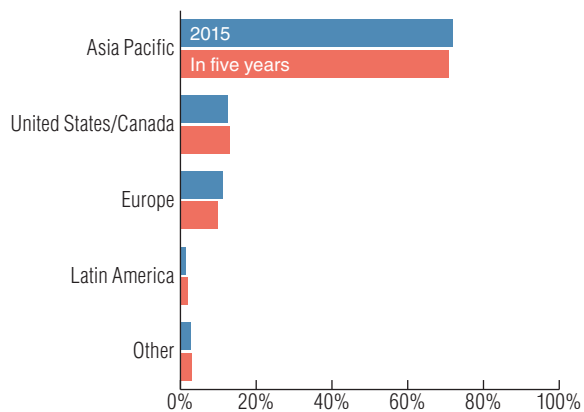
With pricing too rich, product too scarce, and little to suggest much upward momentum in the markets, investors are turning increasingly to less conventional strategies. In general, this means more focus on value-add, which in our survey featured as the most popular investment category, with sentiment improving significantly over last year's rating. Within that context, however, there are a number of themes, and in particular a greater reliance on defensive plays and income growth. As one analyst said, "The guiding principle is that if things

Exhibit 1-6 Prospects by Investment Category/Strategy for 2015



Source: Emerging Trends in Real Estate Asia Pacific surveys.

Exhibit 1-7 Asia Pacific Investors' Regional Allocation Percentages



Source: Emerging Trends in Real Estate Asia Pacific 2015 survey.

might be going to turn in the next 12 to 24 months, you look for projects that if things do turn you'd still be happy to hold until markets stabilize." Until last year, that included plays such as China logistics and Australian residential, but as the supply response has now kicked in for both, "we find we are moving into more complex asset management situations—heavy lifting or retenancing/redevelopment—as the only way to make it work."

According to another fund manager, in the current environment "we don't think there's going to be a huge increase in occupancy or rents, or a substantial reduction in cap rates, so you're not going to get a strong tailwind to drive performance." As a result, "we're telling our guys: don't rely on market movements, beta isn't going to bail you out. You have to do something with an asset that creates value on a hands-on basis." In general, this means "being very opportunistic about how you buy and how you provide liquidity in a place that's not oversupplied with liquidity—for us, that means getting into specific, more-complicated types of deals."

As an example, according to an investor in Japan, "The megatrend [in Japan] is not good, so you have to find those niches of investments within the megatrend. That means we have to pick if not the submarket, the specific asset class—for example, multifamily, Tokyo, one-bedroom, studios. Because the number of households goes up in Japan as the demographics go down [i.e., fewer marriages and children]. Or maybe mid-sized office buildings, because they haven't recovered much."

Japanese suburban retail also was suggested as an example of a sector that remains mispriced or which hasn't yet had a recovery: "You have to be very careful about location as you have all the demographic factors to take into account, but

there are areas that are growing and where cap rates are still at post-GFC highs.”

Secondary-Market Wariness

Another response to compressed cap rates—especially where investment committees are inflexible over hurdle rates—is to move up the risk curve, focusing on secondary geographical markets offering higher yields. While these are attractive in principle, however, investors currently view secondary markets with a degree of ambivalence. Liquidity in regional destinations tends to dry up quickly in a downturn, and the lack of trust in the ongoing bull market means that buyers are wary of straying far from gateway cities.

Japan, however, appears to be an exception. This is mainly because investors have a mandate to buy, and Tokyo is both expensive and crowded with local institutional players who can outbid almost everyone. In addition, there is historical precedent suggesting “where Tokyo goes, everywhere else will follow.” At around 5 percent, cap rates in provincial cities are at least 100 bps higher than in Tokyo, and they offer more scope for compression. Osaka and Fukuoka seem the most popular destinations, with the proviso to “not take too much risk on the asset side, given you are already taking risk going regional in the first place.”

In Australia, local investors continue to be more cautious than their global counterparts, showing little inclination to move

Japan: Key Themes

Japanese transaction volume rose 38 percent in 2013 to US\$49.4 billion—its highest level since 2007, according to RCA. However, by late 2014, in the words of one investor, “the bloom has come off a bit” as the cycle becomes a bit long in the tooth. Still, with US\$26.3 billion in deals in the first nine months of 2014, Japan ranks as the fourth-biggest market globally, according to Jones Lang LaSalle.

Consensus estimates among interviewees had cap rates for prime commercial and residential properties in Tokyo contracting around 100 basis points in 2014, to around the 3.5 percent mark (and sometimes lower). Grade B assets, which in practice are what foreign investors tend to buy, would trade at around 5.5 percent. According to one interviewee, that means that “prices have now gone up so much that we’re not wandering around gagging to get into the Japanese market, because it’s really expensive.” Investors expect that Tokyo can still deliver compression, “but not to the same degree, unless the cost of debt continues to go down.” That seems unlikely given where rates are now.

Still, most investors remain quite positive about the Japanese market—partly because the economic stimulus story still has room to run, partly because at least in the medium term it offers limited downside risk, and partly because, compared with other destinations in the region, levered returns remain compelling.

With prime-asset values now some 15 to 20 percent below pre-GFC peaks, a positive spread with the risk-free (i.e., sovereign bond) rate of some 300 to 350 basis points, and rents continuing to bump along a multiyear bottom, most interviewees see potential upside coming in an uptick on the occupancy side rather than through further yield compression. As one investor said, “Cap rates could compress another 25 basis points, but what will probably pick up more is rental growth.”

For most of the current upswing, the commercial market (especially Grade A office) has been so dominated by Japanese REITs (JREITs) and local developers that foreign funds have found it hard to get a foot in the door. Echoing a theme that has become common throughout Asia, one investor commented: “Tokyo is well positioned, but you have to do a lot of work to find product. Big assets are usually traded among Japanese players, and though that may change going forward, putting money to work is not easy.”

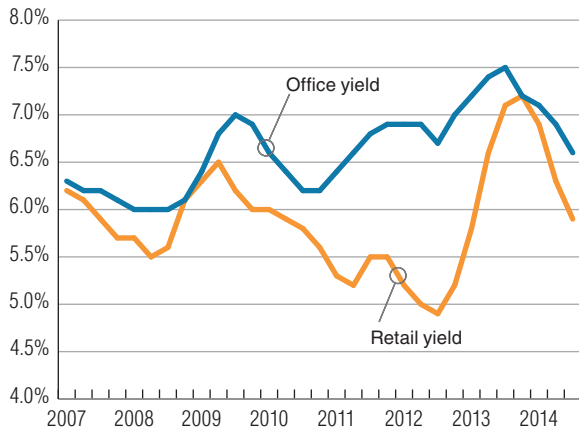
This means that capital is being pushed into fringe assets or into areas outside Tokyo, where cap rates are higher and still have room to compress. According to one foreign fund manager, “Once the local guys start piling in, the foreigners can’t keep up. They buy very quickly, with very short DD [due diligence] periods, and they don’t have all the structuring that we do, so they’re much

quicker to act—it can sideline the foreign players quite a lot.”

Foreign funds have probably been able to get away with more deals in 2014 than in the previous year, but the JREITs still accounted for some 50 percent of total transactions in Tokyo in the first half of the year, according to Deutsche Asset & Wealth Management, with some 16 percent going to foreign capital. Some investors expect JREIT activity to decline in 2015. As one said: “The amount of activity we saw from them last year is unlikely to be replicated, because they were able to access the markets quickly, before other people.” According to another: “In general, as the [supply of] investable assets drops, equity raising will be around 50 percent of this year’s [level].”

One of the main attractions of the Japanese market is easy access to debt, which is cheap (at about 1 percent or less) and very available (at LTV ratios of 70 percent or more). According to one fund manager, “In some cases, the levered returns are so high you don’t need to sell the asset because you can get 18 percent, 19 percent, 20 percent IRR in perpetuity—some people are now buying seed assets that are really high-yielding, putting as much debt as they can against them and getting huge levered returns. They might never be able to sell them, but they don’t care. Ultimately, it becomes the bank’s problem.”

Exhibit 1-8 Asia Pacific Yield Rates, Q3 2014



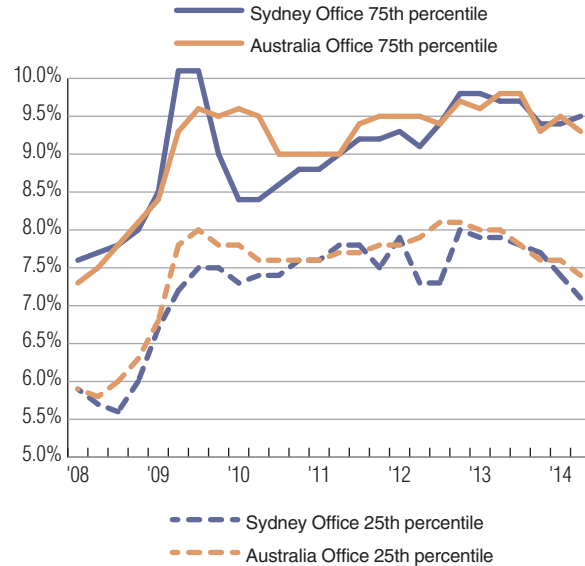
Source: Real Capital Analytics, www.rcanalytics.com.

far from the Sydney/Melbourne inner areas and are also—for the most part—unwilling to move out much on the asset side. Partly, this is because investors are still gun-shy after their experiences during the GFC. Also, according to one local investor, “there’s pretty limited appetite for core-plus, value-add, and opportunistic real estate because that sector of the market here is even smaller [than the core space], and on a risk-adjusted basis investment returns aren’t all that compelling.” Recent attempts to raise capital for a fund focused on local suburban office assets met with a lukewarm response from investors, confirming the limited appeal of fringe strategies.

Ultimately, though, a shortage of stock means they may be left with little choice—especially given that secondary assets in major Australian cities have so far seen little if any cap-rate compression (see exhibit 1-9). A few superannuation funds have recently begun investing in outlying areas of Sydney and Melbourne. Quite likely activity will increase going forward, though whether buying picks up traction is hard to say. Foreign investors may be more willing in principle to venture into secondary locations and assets, but are less familiar with local operating conditions and so tend to adopt a conservative stance.

In China, “people are now focused on primary [cities], because they are scared by the statistics and by what they’re hearing in secondary and tertiary cities,” which now feature high levels of oversupply in both residential and commercial stock. This is due mainly to local governments’ aggressively selling land without considering whether local markets can actually absorb that level of supply. Because residential assets are self-liquidating, surplus stock can simply be sold into strong local demand by cutting prices, even at a moderate loss. But commercial sites are another matter, and many second-tier cities now face years of high vacancy rates and a glut of poorly maintained strata-title commercial buildings as a result.

Exhibit 1-9 Yield Movements in Australia



Source: Real Capital Analytics, www.rcanalytics.com, August 2014.

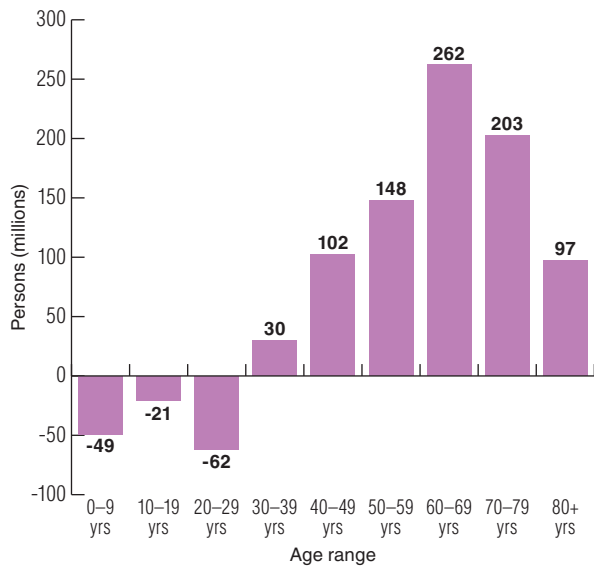
At the same time, and despite the fact that Shanghai occupies a respectable sixth place in this year’s city investment prospects survey, China’s first-tier cities are not necessarily the answer either, because while oversupply may not be a problem, pricing is prohibitive. As a result, “you’ll have a hard time finding value because the big players in those markets typically are not under significant cash-flow pressure, as are some of the players in the second and third tier.” In fact, good opportunities do exist outside the big four Chinese cities, but they are probably not for the inexperienced and will invariably require good local partners, who are always thin on the ground.

Niche Plays Blow Hot and Cold

An alternative route up the risk curve is to migrate toward niche sectors. Such specialty investments have obvious appeal in Asia because their appearance in the region lags that of the West. As a result, according to one interviewee, “you have people targeting everything from campgrounds to [homes for the aged] to self-storage to medical office to student housing, but in all of them the capital targeting them probably exceeds the investable universe.”

Last year, interviewees were bullish about exploring such higher-yielding plays. This year, the view is that value propositions are often more apparent than real. While interest remains high, in practice investors without specialist knowledge are finding niche sectors are too small, are short on product, or—in particular—lack enough qualified local partners. As one interviewee commented: “I think there’s more prospecting than actually looking—the only area I’ve seen real activity is logistics.”

Exhibit 1-10 Net Change in Population in Asia over the Next 20 Years, by Age Group



Source: Global Demographics Ltd.

Still, some areas are more investable than others. Student housing, which in the West is now an institutional asset class, is “maturing quickly and attracting capital.” Self-storage also is seen as strong and relatively accessible, though in some markets (such as Japan) it is now threatened with oversupply.

Senior care is another sector that has flattered to deceive. Long seen as a potential goldmine given Asia’s aging demographics, it has made little progress in the absence of a viable

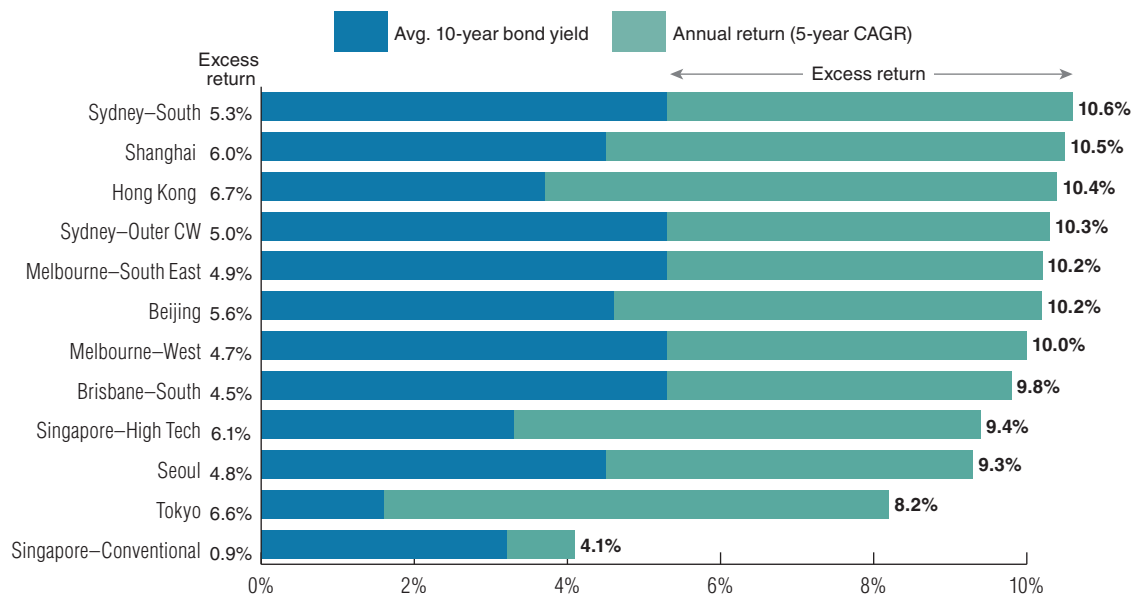
business model. That might now be changing, at least in some markets. In Japan, the listing of the first health care REIT in November 2014 means that “senior housing is happening now,” according to one locally based fund manager. Given the demand, most investors believe a solution is only a matter of time. “At some point, someone will find the answer. A professional operator will enter the market or will get big enough to work with institutional capital, and that will manage the operating risk. Pricing will become transparent enough that institutions will start to go in, and that will manage the exit risk. Because when you have a fundamental demand on the scale of aging populations in markets like China, Japan, and Korea, there’s a rationale to make that work.”

In Australia, the industry has a longer and more successful history, although cultural differences mean it is unlikely to provide a model for other regional markets. Besides, even in Australia the industry is evolving. According to one local developer, “There has been a whole lot of shifting of the deck chairs in the aged-care business, with listing of companies, merging of companies, and people re-strategizing their retirement as the population ages. Most of the big boys in the retirement business are looking at new business models because the baby boomers are now reaching that point where they are looking for one of these lifestyle-retirement villages.”

Logistics Markets on Fire

The one alternative investment category that has undoubtedly enjoyed success in Asia is logistics. The sector now represents about 10 percent of total commercial real estate transactions in the region, according to Deutsche Bank,

Exhibit 1-11 Industrial Sector Projected Annual Return, by Country



Source: Deutsche Asset & Wealth Management, August 2014.

although the supply of new product in 2014 was down about 30 percent on the previous year. Although logistics yields remain higher than in other sectors, they continue to compress and are now as low as 4.5 percent to 6 percent in Singapore and Japan. The acute shortage of modern distribution facilities will last for years, especially given the rocketing popularity of internet shopping across Asia.

Demand is especially strong in Australia, Japan, Singapore, and especially China, where one fund manager described it as “the hottest, most-crowded trade right now in Asia.” Compared with other niche sectors, it has relatively few barriers to entry and enjoys the advantage of being “the only sector that looks obviously undersupplied in the country. The problem is that there are just a handful of guys [who] are really good onshore doing it and there’s a lot of capital chasing it, so yields are starting to get bid down to crazy levels.”

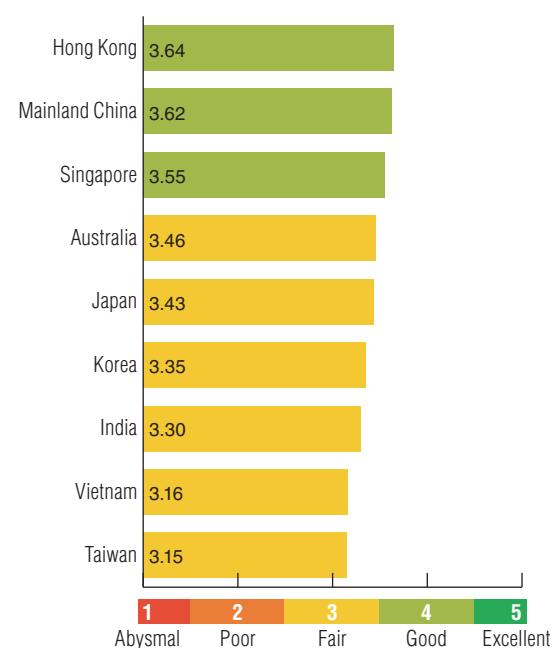
Emerging Markets Still Tough

Foreign real estate investors have been looking in the shop window at emerging-markets opportunities for at least the last three years. But while they continue to covet the product, in practice they have found limited scope to buy. Asia’s emerging markets offer little depth, no real need for foreign equity or debt, and plenty of risk. In addition, this year brings an added complication—the potential for capital outflows volatility as a result of rising interest rates in the West. According to one interviewee, “They’re small, specialist markets, and when cycles turn they tend to be relatively illiquid. So the inexperienced investor heading into those at the peak of the market is the one that tends to get caught out when things turn around.”

Foreign investor interest has therefore cooled somewhat this year. “I heard more talk about it 18 to 24 months ago than I do now,” an investor in Singapore said. The view of one large opportunistic fund manager is probably typical of the current tone: “At the moment, our view is that you don’t get a sufficient risk premium for taking a lot of risk that is not underwritable or under our control.” That could change, however, if there is an economic dislocation. “I think the time you would go into these places is if you had a major capital markets meltdown, when all the local capital is frozen. But while that might happen, our view would be that any investment strategy relying on a capital markets dislocation may keep you waiting a long time.”

On the ground, however, growth within these markets is mostly still strong, driving rents and capital prices higher. In the Philippines, gross domestic product (GDP) growth continues to see strong momentum (a 6.5 percent increase is projected for 2014), fueled by rising remittances from its army of expat workers and a booming business process outsourcing (BPO) industry consisting of both call centers and back-office facilities. As a result, surging demand for new commercial properties continues, with office rents in the

Exhibit 1-12 Levels of Impact of Global Financial Distress



Source: *Emerging Trends in Real Estate Asia Pacific 2015 survey.*

Makati central business district (CBD) now regaining pre–global financial crisis highs. Cap rates have declined recently from 9 to 10 percent to 7 to 8 percent, and internal rates of return (IRRs) also have come down, “so if people can get 15 to 20, they’re pretty happy.” Borrowing costs are in the 5 percent–to–6 percent range.

Although the outlook remains positive for all major real estate sectors in the Philippines, foreign investors still have limited opportunity to participate. Most that do are focused on BPO facilities. In the core space, properties usually remain closely held. Large-scale development projects, meanwhile, are subject to land ownership restrictions that have deterred foreign participation, although some foreign investors (notably, developers from Singapore and Hong Kong) will structure entries using long-term leases and local partners. Moves to address this problem by amending the Philippine constitution appear to have petered out. Similarly, authorities have yet to implement tax exemptions that would allow the emergence of a local REIT industry. According to one Manila-based interviewee, “The government thought it might be too early, because it would cause too much tax leakage. So the REIT sector will eventually happen, but it’s on the back burner at the moment, probably until [the next elections in] 2016.”

Indonesia continues to enjoy popularity in our survey, with Jakarta ranking second this year as an investment destination. According to one investor, “Indonesia is the one market where I still hear the same amount of interest as before.” The new

administration, led by President Joko Widodo, is expected to introduce measures aimed at attracting more foreign investment into real estate, though it remains unclear what these will be. The same basic issues apply to Indonesia as in the Philippines, however, with strong economic growth on the one hand counterbalanced by well-financed domestic players, high risk, and lack of transparency on the other. According to one fund manager in Singapore, “It’s tough to get your foot in the door, and it takes a long time to figure out who you should be getting your foot in the door with, and what door you should be getting into.”

Another investor said that the prospects of more foreign investment in Indonesia “really depend on what happens in China. People are looking, and if they can’t get invested in China, they look for other markets, and Indonesia is one of them. But if things turn around quickly in China, I think a lot of the capital that’s looking at Indonesia will go back to China, because for a lot of people China is a place they have to be, whereas Indonesia isn’t.”

Vietnam has suffered a string of calamities in the last three years that have hurt its economy and hobbled its real estate markets. High inflation, a systemic bad-debt problem in the banking system, and, most recently, geopolitical conflict with China over ownership of parts of the South China Sea have all contributed to a deep freeze in property investment activity. This year, for the third year in a row, investors are suggesting that Vietnam “really is on the turn.” This time, though, they seem more likely to be right.

The banking crisis effectively put a stop to domestic bank lending to real estate projects for at least the last two years, which has had a chilling effect on both developers and resi-

dential purchasers. But the establishment of a national asset management company at the end of 2013 aimed at clearing up bad debts has now improved confidence at the banks, which are now motivated to restart lending. On top of that, the cost of debt has dropped significantly, from around 20 percent—plus two years ago to 9 to 11 percent today.

The biggest opportunity in Vietnam is probably development of midmarket residential, where demand continues to grow and oversupply is now being sold off. The commercial office sector remains tiny, partly because the government owns its own buildings and therefore is not a tenant. High-end retail, meanwhile, has been overbuilt. The other interesting area is industrial. This is partly for logistics purposes, but also because Vietnam is now a major manufacturing and assembly market.

Predictably, risks remain high, quite apart from the macro economy. In particular, licensing rules are excessively bureaucratic and time-consuming. According to one locally based investor, “You need to have a feel for how the system works and then make sure you manage that process carefully, or it can take a lot longer than you expect. Land clearance is also a factor that can cause delays.” As a result, development projects are multiyear exercises. “With smaller projects, you could do it in five years. But if it’s larger, mixed-use, you’re looking at, say, seven to ten years, and if you have to go back and revise your master plan, that takes six to nine months each time—it can blow out your development time frame.”

Development Risk Guns Returns

Another way to eke out better returns is to participate in development. In particular, many are now looking at forward-funding strategies, where investors acquire sites before

Exhibit 1-13 Real Estate Transparency Scores: Asia Pacific

Transparency level	Country	2014 rank	2014 score	2012 score	2010 score	2008 score
High transparency	Australia	3	1.4	1.36	1.22	1.15
	New Zealand	4	1.4	1.48	1.25	1.25
Transparent	Hong Kong	14	1.9	1.76	1.76	1.46
	Singapore	13	1.8	1.85	1.73	1.46
	Malaysia	27	2.3	2.32	2.30	2.21
	Japan	26	2.2	2.39	2.30	2.40
Semi-transparent	Taiwan	29	2.6	2.60	2.71	3.12
	China (tier 1 cities)	35	2.7	2.83	3.14	3.34
	Philippines	38	2.8	2.86	3.15	3.32
	Indonesia	39	2.8	2.92	3.46	3.59
	Thailand	36	2.8	2.94	3.02	3.21
	South Korea	43	2.9	2.96	3.11	3.16
	China (tier 2 cities)	47	3	3.04	3.38	3.68
Low transparency	India (tier 1 cities)	40	2.9	3.07	3.11	3.44
	Vietnam	68	3.6	3.76	4.25	4.36

Source: Jones Lang Lasalle, *Real Estate Transparency Asia Pacific*.

construction begins and fund development as it occurs. Although it involves assuming development risk, this type of approach is particularly suited to big investors willing to adopt long buy-and-hold strategies. According to one fund manager, “At the moment, the capital that wants long-term holds can buy [into one of the big developers]. I think that will change—some of the emerging sovereigns really do want to be long-term holders of high-quality assets in these markets, with an understanding that there’s going to be a lot of volatility. So that [strategy] will probably increase.”

Forward funding has become especially popular in Australia, where the big banks can be reluctant to lend for development. One catalyst has been an influx of Asian developers into the market, particularly from Singapore and China, who are now aggressively pursuing development strategies. According to one investor, “In Australia, it makes sense because forward-funded projects also create real savings in terms of tax, so it’s a good way to get into core when assets are fully priced or overpriced.” According to CBRE, the value of forward-funded deals in Australia quadrupled in 2013 to A\$2.2 billion.

Investors are also interested in development strategies elsewhere in Asia, although rising construction costs can make them marginal plays. In Tokyo, for example, construction costs rose 11 percent year-on-year by mid-2014, and are expected to continue to appreciate rapidly. According to one Tokyo-based interviewee, the current “exorbitant” cost of Japanese development is due partly to younger Japanese workers shunning the construction sector, and partly to developers holding out for an expected wave of better-paid public works projects as Japan begins tackling a backlog of tsunami-

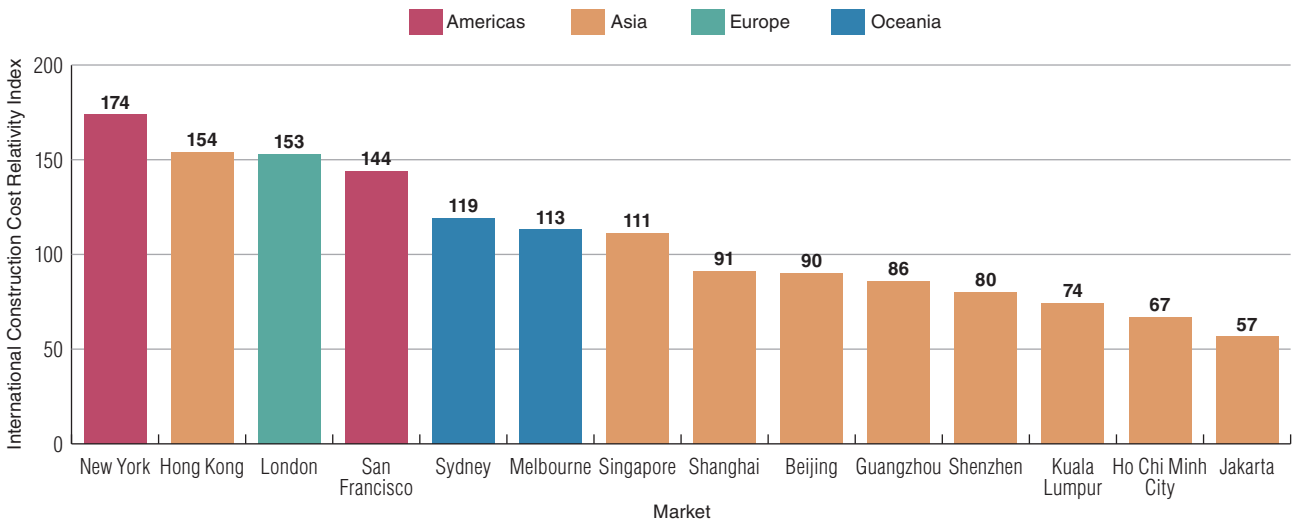
related reconstruction and gears up for the 2020 Summer Olympics. As a result, “there’s no way you could build now to residential rental rates, and in other sectors it’s also becoming more difficult as construction costs continue to go up.”

Hong Kong, meanwhile, has seen construction costs soar 12 percent year-on-year in the first nine months of 2014, and by some 50 percent since 2009, according to construction consultants RLB. Analysts expect that development margins may fall this year to 20 percent, down by half in 2009.

In other markets, high land costs also create problems for development projects. The rising price of land in Singapore has seen development margins narrow to 10 percent from as much as 20 percent three years ago, according to brokers CBRE.

In China, land prices in first-tier cities remain high, even though developers are reluctant to buy. This is mainly to control gearing levels, but also because “local governments have not readjusted valuations to reflect the slowdown in transactions or overcapacity.” A chronic shortage of suitable development sites in the inner cities doesn’t help to encourage that readjustment. According to one Hong Kong-based consultant, this may create problems over the longer term: “We think there is much greater vulnerability around the bigger cities because of affordability and costs of entry for development—affordability if you are buying a unit, costs if you are a developer, particularly with costs of construction also now becoming a major factor.” Margins in the main cities have now dropped to 10 to 15 percent from 25 to 30 percent a few years ago.

Exhibit 1-14 Relative International Construction Costs



Source: Rider Levett Bucknall, *International Construction Market Report*, third quarter of 2014.

China: Key Themes

Sentiment toward the Chinese market is currently at a low point due to a slower economy (GDP growth fell to 7.3 percent year-on-year in the third quarter of 2014, a five-year low) and an ongoing slump in local property markets. Given that real estate investment accounts for about 16 percent of mainland GDP (and as much as 25 percent when related sectors are included), property-sector weakness accounts for a big part of China's current economic slowdown.

Residential sales volumes have weakened significantly since late 2013, and by the start of October 2014 had dropped 10.3 percent year-on-year, according to official figures. More recently, prices also began falling. Although the extent of declines is hard to gauge, going into the fourth quarter interviewee consensus was that pricing was off between 10 and 15 percent from the 2013 peak. The problem is more severe in second- and third-tier cities, where oversupply has become a significant issue. One interviewee said, "We see inventory continuing to build," and estimated unsold stock nationally at between 16 and 18 months' average uptake, compared with a norm of nine to 12 months. Activity has been confined to first-time buyers rather than upgraders, who remain on the sidelines waiting for prices to drop further.

Despite these problems, interviewees did not see current weakness turning into a market collapse, for various reasons:

China has the region's least-leveraged household sector, and with buyers paying a minimum 30 percent downpayment, there is little negative equity.

Demand remains strong and will build up as the downturn continues. As one investor observed, "When developers are more realistic and reduce prices, product begins to move. So there *is* demand in the market, it's just very sensitive and value focused."

The government has many levers to manage residential housing demand and has plenty of experience using them. Until recently, authorities had imposed strict limits on mortgage availability and downpayment levels in order to dampen what as recently as late 2013 was a much-overheated market. These have now been relaxed in most cities. According to one Hong Kong-based consultant, "Cities are now being allowed to set aside some of the rules that had been imposed, and as long as they are discreet, Beijing seems willing to tolerate that."

As a result, most interviewees expect the residential market to stabilize before the end of 2014, although it may not see a fuller recovery for another 12 to 18 months, given the extent of overbuilding and Beijing's reluctance to introduce further substantial stimulus into the economy.

On the commercial side, a big pipeline of supply in the context of a slowing economy is a concern, especially with oversupply issues already evident in many secondary and tertiary cities. According to one investor, "The problem is that Chinese developers are extraordinary at building very efficiently and very quickly in large quantities. The largest developer in China does over 130 million square feet of completed real estate space of all types every year; you pick the largest developer in the U.S., and they've probably built that amount in the last 50 years." Should the economy slow more than expected, it could create a nationwide supply glut as stock under development comes to market.

In addition, prime office yields that are "probably less than 4.5 [percent] on an NOI basis" now appear unattractive on a risk-adjusted footing. Unlevered yields are at a level similar to those in Japan, but (unlike Japan) high Chinese interest rates create a negative yield spread, and leverage is anyway harder to find.

As a result, prime rents and capital values may be set to decline. According to one fund manager, "Something has to give. Values have to get cheaper, interest rates have to come down, or the whole equation has to get easier in order to continue to attract capital in the absence of the growth that attracted the capital in the last decade." Beyond that, as another fund manager said, "I've never been a believer that core is workable in Shanghai or Beijing, mainly because lease terms are short and there's always potential for rollover of tenants—I think this market has always tended to be more opportunistic development and value-add."

At the moment and for the foreseeable future, the big opportunistic play in China involves provision of rescue capital to highly geared local developers (see "China Developers under Stress," page 15). As one investor said, "We're looking at more secondary assets, looking at buying small [development] companies, buying land banks from companies. Those are the types of transactions where you have a better chance of finding value." In addition, "there's a move toward build-to-core. People are looking at that, but it really depends on having the right capital and wanting that exposure over the long term."

A final issue that cropped up repeatedly in interviews relates to investor concern over structuring investments to allow for a smooth exit, given the increasingly complex environment regarding tax liabilities and foreign remittance provisions. According to one consultant, "Virtually all the conversations I have with foreign investors now focus on exit, and often involve a presale to an institution, which is common in the West. This is where a lot of people have found themselves in difficulty in China, either getting locked in or taking a lot longer to get money out. It's a little unusual to start with the exit, but that's the real world."

China Developers under Stress

At the moment, however, high land prices are the least of Chinese developers' worries. More important is lack of cash. For the last several years, mainland banks have become increasingly reluctant to lend to developers for construction purposes, and are barred from lending for land purchases. On top of that, authorities more recently have been cracking down on gray-market (i.e., shadow bank) lending. Given that the development sector is, for the most part, poorly capitalized and that commercial development projects are not usually preleased before construction, cash-flow problems can appear quickly if transaction volumes fall, which is what has happened in the current slump.

Growing numbers of developers are now struggling to pay off high levels of debt, and interviewees suggested that conditions would deteriorate going forward. As one said, "Vulnerability is undoubtedly in terms of the gearing. It's not unusual to find people 100 percent geared. You can rationalize that when things are on a roll, but things aren't on a roll at the moment, so I think we're going to see a lot of rationalization."

As a result, after many years of waiting, foreign investors now have real prospects of striking project- and entity-level deals with cash-strapped developers—an expectation that has recently led to a significant increase in private equity funds' raising opportunistic capital to deploy in China, according to DTZ. This theme is especially significant because China is now probably the only true opportunistic play left in Asia now that potential distress deals in Japan have been killed off by rising real estate prices. Says one fund manager, "It's going to be a pretty significant opportunity, I think, whether it's in residential or other property types over the next two years, maybe longer."

Different types of opportunity are likely to arise. For now, straight project-level deals are the most common. According to one interviewee, "Midsized players are the most vulnerable. Large developers will be able to survive, because it has become a volume game and that's what they do. Niche will be able to survive, because they do things differently. But your three- or four-project type of developer, operating in three cities, that's the sort of scale where I think they're vulnerable."

In the future, though, more entity-level deals are also likely to be struck. In part, this is because even some of the bigger developers have dug themselves too deeply into debt. According to a manager at a large opportunistic fund, "I think the interesting thing for us is the large listed and unlisted companies whose performance is not as good as it was a few years ago. Some of the bigger guys are beginning to hurt, so we're looking to provide a bit of rescue capital for large corporates where they need, say, a few hundred million and we take a big minority stake."

Beyond that, though, even big, well-capitalized players are now more open to dealing with foreign investors for reasons other than simply tapping a source of cash. As China's big developers become increasingly sophisticated, they are looking to form mutually beneficial relationships with foreign peers as a means to tap industry expertise, be it construction or asset management, and potentially to cooperate in projects both domestically and globally. As one fund manager said, "The big issue for me is that local developers are just a lot more open to suggestion than they were. Before, when they had excess capital, it was more like a partnership of convenience than a real strategic partnership. Today, I think it's the other way around."

Capital Markets Strong, Occupational Markets Soft

One reflection of how far investment markets have now run ahead of fundamentals is the way that strong asset pricing contrasts with relatively weak occupancy figures. However, with cap rates now believed to offer limited upside, many investors have zeroed in on an upturn in occupancy markets as a source of future gains. In Japan, therefore, office rents have been flat for years, despite significant price rises in 2013–2014. However, office vacancies are now falling in Tokyo (to 6.45 percent in mid-2014, down from 8.46 percent the previous year, according to Deutsche Asset & Wealth Management), and with business activity picking up, according to one investor, "there is a widespread belief that rents are low and will increase—constraint on supply is driving both the office and residential markets."

In Australia, too, occupancy markets are strengthening. In Sydney and Melbourne, vacancies declined to around 8.5 percent in mid-2014 from double-digit rates a year previously, according to the Property Council of Australia, driven by a service-sector rebound and significant conversions of old office stock to residential or hotel use. As a result, according to one local fund manager, "occupational markets in both the office and the retail sectors have bottomed, we're seeing signs of improvement, particularly in Sydney and Melbourne, and that's putting more confidence in the underwriting for some of this cap-rate compression."

Rents have started to pick up in the cyclical markets of Hong Kong and Singapore, too. In Hong Kong, according to one local fund manager, "earlier this year, the jury was out on whether rents in Central were going down 5 to 10 percent or up 5 to 10 percent. But they've demonstrably now bottomed and started to increase—at least partly because of an increase in mainland financial services tenants, particularly brokers, wanting to grow their presence in Hong Kong. That could be an important theme and a leading indicator of what's to come."

In Singapore, “prices remain high—too high, artificially high—so we’ve not seen too many transactions. But gradually, the market is coming up to meet price expectations.” Commercial rents in Singapore are expected to rise some 15 percent in 2014, with more tenants seeking longer lease terms of up to five years in order to lock in current rent levels.

That said, positive sentiment about rents may be somewhat self-serving and is not taken for granted by all. Opinions tended to be more bullish among foreign investors in any given market than among locals. In Japan, for example, several locals voiced skepticism over rental growth prospects for commercial assets, particularly for the highest-quality assets.

In Australia, vacancies remain high despite a recent upturn, with unoccupied office space in Sydney currently representing some seven years’ worth of supply. A recent trend toward hot-desking and otherwise rationalizing use of office space may reduce demand going forward. Some interviewees also raised concerns about how cap-rate valuations tend to reflect face rents only, ignoring “perennially high levels of incentives” that make cap rates significantly lower if calculated on an effective-rent basis.

Plenty to Worry About

The current year has thrown up no shortage of risk scenarios to keep investors awake at night. Political tensions created by conflicting claims to various parts of the South China Sea continued to escalate in 2014. Whether they involve an ongoing war of words between the Chinese and Japanese governments over the Diaoyu/Senkaku islands or disputed oil prospecting in the Paracel Islands that led to rioting in Vietnam, friction shows no signs of abating. The risk of escalation may be higher in 2015.

Probably the biggest concern on investors’ minds, though, is the possibility of an economic hard landing in China. Recent economic data coming out of the mainland have been soft,

partly as a result of the ongoing property market slump. In addition, the government seems committed to following through on structural reforms to tackle high levels of public and private sector debt (especially in the non-bank finance sector) rather than introduce further rounds of easing as a short-term patch. This means tackling a long list of seemingly intractable issues. According to a recent World Bank analysis, “Measures to contain local government debt, curb shadow banking, and tackle excess capacity, high energy demand, and high pollution will reduce investment and manufacturing output.”

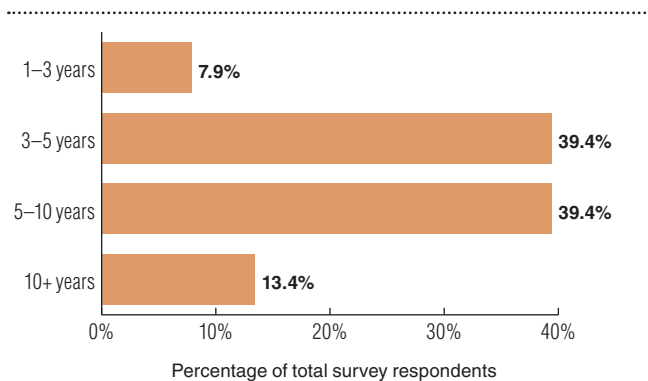
While the consensus among economists is that Beijing still has plenty of firepower to deal with unforeseen dislocations, an unexpectedly large downturn in growth rates would have a knock-on impact on other Asian economies. According to one investor, “If China does slow in a far more significant way than people are expecting, there is going to be nowhere to hide in Asia, except for maybe India, because India is predominantly still a domestic-consumption-oriented story. At the same time, it’s not such a great place to hide.”

Another hot-button issue concerns the long-term prospects for Japan’s huge economic stimulus program known as Abenomics, which seeks to end years of stagnation by creating an inflationary environment where the value of government debt will be eaten away. Although Abenomics initially made impressive progress, its impact faded in 2014. Inflation and GDP growth have come up short, and the cheaper yen has failed to make much headway in boosting exports. Meanwhile, the upcoming “third arrow” of the reforms, focusing on structural issues (in particular, boosting the labor supply), is seen as perhaps its most important component, although for political and cultural reasons it probably will also be the hardest to implement.

At the end of the day, most investors were dubious about Abenomics’ prospects over the long term (one described it as a “slowly sinking ship”) but remain confident that the government can keep the balls in the air long enough for them to exit profitably within the time frame of their current investments, especially given a likely boost to construction activity in the lead-up to the Tokyo Olympics in 2020. As one investor said, “Long-term growth prospects aren’t nearly as attractive as in some other countries, so we see Japan more as a trading market than a long-term hold.”

Another issue creating concern relates to U.S. interest rates, which the U.S. Federal Reserve has indicated may move higher in 2015. In principle, higher base rates should lead to higher cap rates, and many investors are now factoring in a 200-basis-point rate rise over the next two years, together with a 50- to 100-basis-point rise in cap rates. Others are buying protection via rate swaps, hedging against any rise to over 2

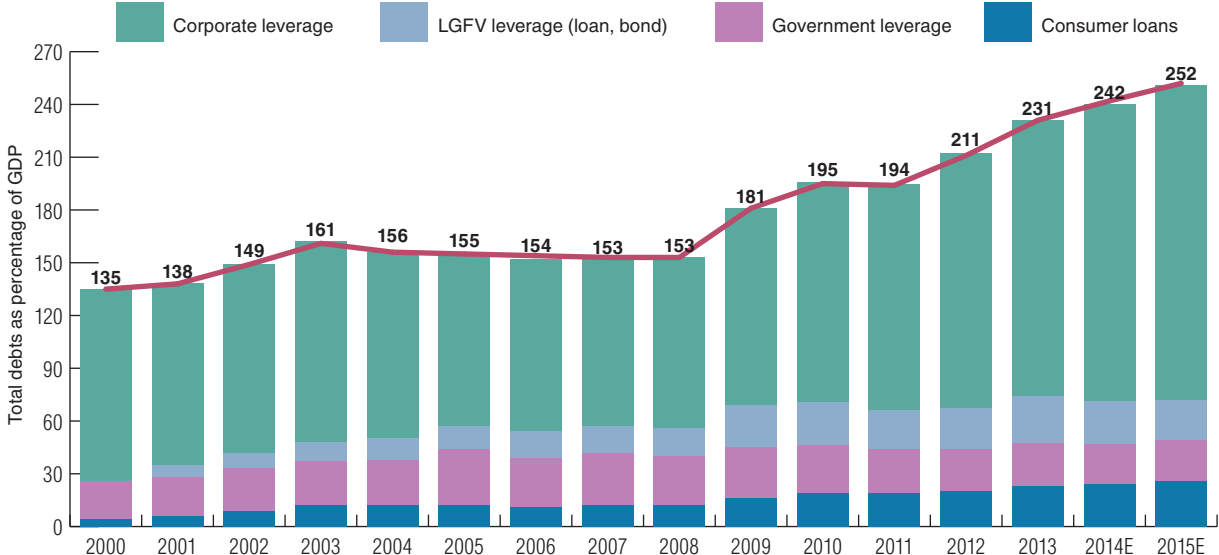
Exhibit 1-15 Time Horizon for Investing



Source: *Emerging Trends in Real Estate Asia Pacific 2015* survey.

Exhibit 1-16 Rapid Increase in Leverage in China since the Global Financial Crisis

Outstanding debt as a percentage of GDP by type of debt



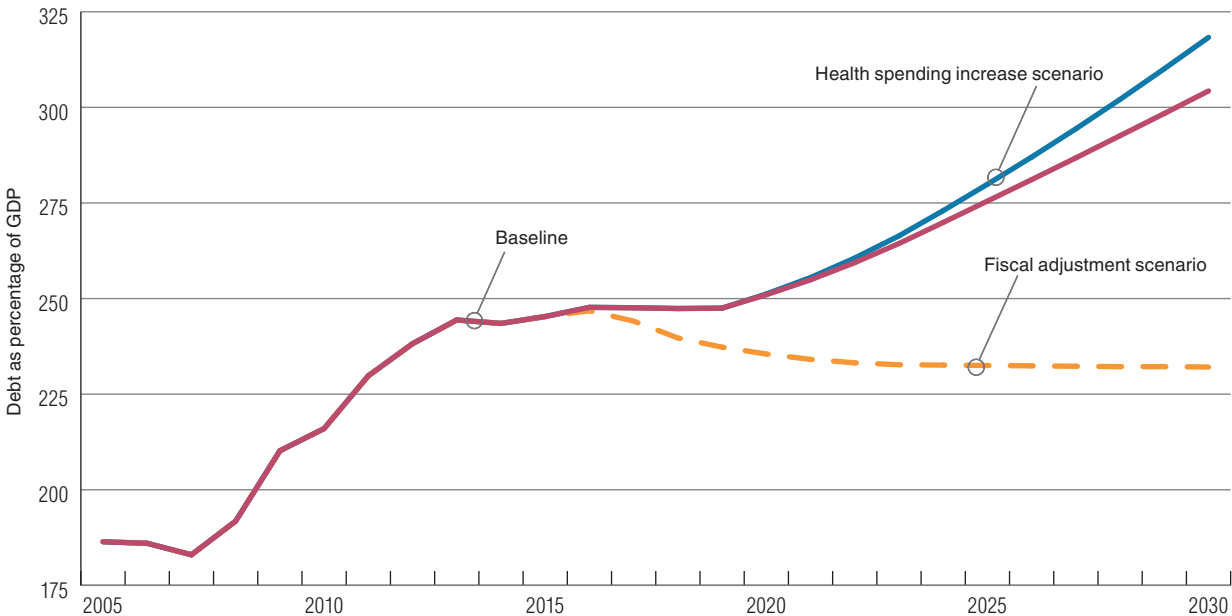
Source: PBoC, Goldman Sachs Investment Research.

percent. At the same time, still others seem unimpressed at the prospect of impending rate hikes, with a significant body of opinion believing that any increase will remain marginal. As one said: “Europe has fallen over, Japan is falling over again, China is slowing down, so who can raise rates in that environment? Nothing is booming, and inflation more or less is not a problem unless you’re in Argentina. So I believe we’re in for an almost perpetually low-rate environment as governments try to

get themselves off the government debt fix in Japan, the U.S., and Europe.”

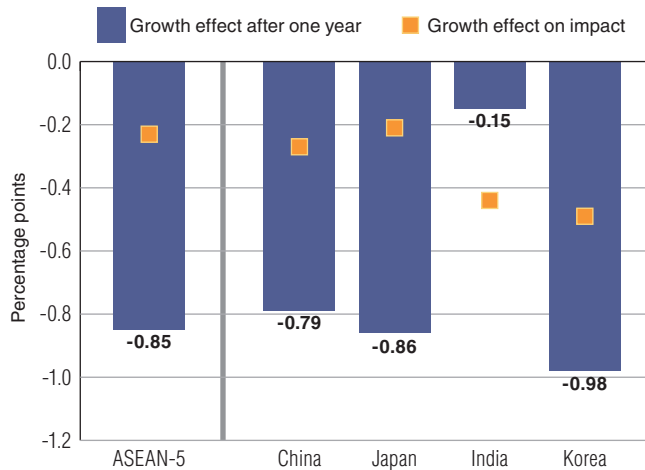
In any event, rising base rates in the United States will have only an indirect impact on Asian markets. Chinese rates are more likely to fall than rise in the current environment, and Japan’s are ultra-low and unlikely to change. In Singapore, rates are indirectly influenced by those in the United States,

Exhibit 1-17 Japan Gross Public Debt



Source: International Monetary Fund.

Exhibit 1-18 Impact on Asia of a Combined 1 Percent U.S. Growth Rate and 100-Basis-Point Interest Rate Shock



Source: International Monetary Fund.

but, in the view of one local investor, the government is more likely to devalue the local currency than to let rates rise significantly because so many Singaporean households are already highly levered. The one Asian market where U.S. base rates are likely to have the biggest impact is Hong Kong, where the currency peg ensures that U.S. base-rate movements will be absorbed directly by the local banking system.

Conversion Plays Popular

As Asia's already crowded cities become ever more crowded and begin to evolve from industrial centers into wealthier, service-oriented hubs, urban authorities are working increasingly to convert inner-city industrial areas to either commercial or residential uses.

In China, larger cities are beginning to run out of greenfield sites altogether, bringing a sense of urgency to the transformation. Beijing, for example, is believed to have just 124 square kilometers of land left for development, and the local government is now holding back new land plots from the

market. According to one interviewee, "One of the big issues beginning to surface is regeneration. The discussion to date has been about urbanization, greenfields, how we deal with the migrants. But a lot of the urban fabric is literally falling apart, so they are going to start getting their heads around revitalization, rejuvenation, and regeneration and start thinking about compensation formulas." Urban renewal is now becoming a theme in both primary and secondary cities.

The genesis of this long-term policy shift is already evident in cities such as Shanghai, where conversion of industrial land to commercial use is occurring in parts of the city. As part of this, authorities are increasingly reluctant to allow new industrial or logistics projects to be built.

Other cities across the region are seeing similar trends. In Hong Kong, for instance, conversion of old industrial buildings to new office stock has been supported by authorities since the introduction of a revitalization policy in 2010, especially in areas slated for development as new business districts such as East Kowloon. All former industrial land in urban Kowloon has now been rezoned and is ready for conversion, either through redevelopment or renovation. Repositioning plays in Hong Kong are now attracting an uptick in investor interest, according to one locally based fund manager, at least partly because they are seen by some as a proxy for mainland China, where investor interest has flagged.

Another hot market for conversion plays is Australia, where there is "massive appetite"—in particular, among Chinese developers—for buying aging B-grade office buildings at well above commercial book value near city centers in Sydney, Melbourne, and Brisbane and converting them to high-end residential use. More recently, this theme has extended to industrial assets, too. A low cost of capital and the ability to sell many, if not most, new units off-plan to Asian buyers both inside and (especially) outside the country have allowed the foreigners to outbid domestic developers. According to one local fund manager, "For an Australian residential developer, an Aussie bank will generally put a cap on the number of

Exhibit 1-19 Australian CBD Vacancy and Key Indicators by Market

Market	Vacancy rate January 2014 (%)	Vacancy rate July 2014 (%)	Supply additions* (sq m)	Withdrawals* (sq m)
Sydney CBD	9.0%	8.4%	29,430	35,948
Melbourne CBD	8.7%	8.5%	30,534	5,894
Perth CBD	9.0%	11.8%	8,195	0
Canberra	12.9%	13.6%	28,318	8,215
Adelaide CBD	12.4%	13.8%	6,788	0
Brisbane CBD	14.2%	14.7%	9,979	9,118
Total (all CBD markets):	10.4%	10.7%	113,244	59,175

Note: * = six months to July 2014.

Source: Property Council of Australia, July 2014 Office Market Report.

Australia: Key Themes

Both domestic and international investors remain big buyers in Australia given its high yields, mature economy, and greater transparency. Overseas players have become increasingly visible in Australia, accounting for some 42 percent of US\$18.3 billion in deals in the first nine months of 2014, according to Jones Lang LaSalle. They generally have a lower cost of capital, lower expectations over yield, and higher tolerance for leverage, allowing them to outbid local buyers much of the time.

According to one local fund manager, “We’re at a unique point in the cycle where pretty much every capital source is looking for opportunities. So we’ve seen Australian private investors, syndicators, the REITs, the unlisted funds, and then all the offshore groups, too, all participating at the same point in the cycle—for this market, that’s pretty unusual.” One trend resulting from this is that partnering between foreign and local players has become common, with foreign investors often opting to create joint ventures with a local manager rather than buying directly.

With competition fierce, opportunities in the core space have become harder to source—especially in the office sector, where foreign money tends to be focused. Even so, the tide shows no sign of turning. According to one investor, “Pricing is looking right, interest rates are looking right, the regime is there, covenants are there. And [lease] tenures are also quite nice—usually longer than you

get elsewhere, which adds to the appeal because with that longer tenure from big credit you get a bondlike instrument.”

Australian assets have seen significant yield compression in the last couple of years, while a falling base rate has helped investors maintain a positive yield spread. Cap rates for the very best properties are now pushing the 5 percent barrier, although more generally prime yields are in the sub-6 percent range. That said, cap rates may be artificially high in Australia because they fail to reflect the pervasive level of incentives available to tenants. Calculated on an effective-rent basis, yields would be lower than they appear, though still higher than elsewhere in Asia.

While most interviewees expected that a further 25 to 50 basis points of compression may still be on the table, the consensus was that, for the most part, further upside probably lies on the occupational side. Currently weak vacancy and rental figures are expected to improve over the medium term, driven by the reweighting of the economy away from commodity-led growth and toward more traditional drivers such as finance and business services.

The cost of debt remains reasonably low (at about 4.5 percent). Investors indicated that domestic banks, in a reversal from previous years, have become “very aggressive” in lending to real estate projects. According to one, “If you have reasonably high-quality credit, you will

have banks queuing up to lend to you.” Marginal increases in gearing also were reported, with foreign investments averaging 50 percent LTVs, extending to 70 to 75 percent for the right type of borrower.

Residential markets, meanwhile, have been energized by incoming Asian buyers and are now “astronomically high.” Chinese, Singaporean, and Malaysian developers are purchasing inner-city land, often for office-to-residential conversion projects, while individual Asian purchasers are picking up the new supply of high-end apartments. However, activity has become so intense that “residential is starting to feel pretty peakish,” as one investor observed, although “it might last longer than you think, because Chinese money might keep coming in and buying—perhaps because there’s flight of capital out of China.”

The main concern for local investors centers on macro issues, both domestic and foreign. From a domestic point of view, the question is whether Australia can successfully transition from an economy where growth is led by investment in the commodities sector to one led by white-collar service-sector jobs. From an international point of view, the question is whether China will continue buying Australian commodities on something like the scale it has in previous years. Both of these are unknown quantities, although at the moment neither is giving cause for alarm.

apartments you can sell to an offshore buyer because of completion risk around presales. Chinese developers don’t have those restrictions—they have a particular set of drivers that are unique, and I think they will continue to exploit them.” Given high office vacancy rates in the big Australian cities, the trend is seen as positive insofar as it reduces current oversupply. Total office stock in Australian CBDs contracted by some 1.3 percent in 2013 as a result, according to an analysis by Investa Property. The strategy has attracted some controversy within Australia on the basis (probably wrongly) that it is driving up residential pricing. In any event, the conversion play shows no signs of slowing.

Residential Restrictions Now Common

Asian governments continue to intervene actively in regional property markets as a means of stimulating or cooling residential pricing and transaction volumes. In fact, recent levels of intervention across the region are probably greater than they have ever been, reflecting how much home prices have risen across various markets. New property-related measures have recently been introduced in the following countries:

- Indonesia, which imposed lower loan-to-value (LTV) ratios on mortgages for second homes in March 2013, as well as slowing bank lending to the housing sector;

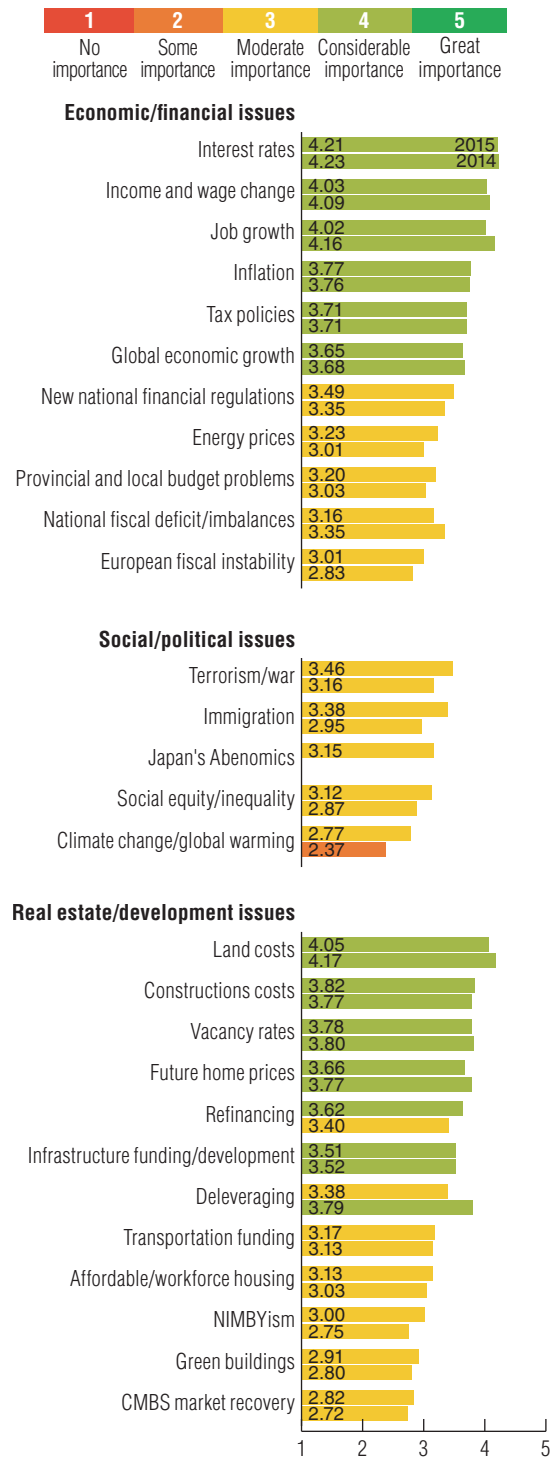
- Malaysia, which in 2013 tightened LTV rules and ended a popular developer incentive scheme for buyers. These were followed by turnover taxes introduced in 2014;
- The Philippines, which rolled out stricter capital requirements for real estate lending in July 2014 and introduced bank stress tests for institutions involved in the real estate sector;
- New Zealand, which introduced LTV rules in October 2013;
- Taiwan, which passed both capital-gains taxes and holding taxes aimed at discouraging buyers from holding real estate as an investment, and
- South Korea, whose housing market was the only one in Asia to not rebound after the GFC, saw the government introduce tax incentives for homebuyers in August 2013 aimed at stimulating the market.

China is the probably the biggest and arguably most effective proponent of interventionist policies. Its current round of macroprudential regulations was introduced in 2010, and was aimed at containing animal spirits in local residential markets, primarily through taxing speculative purchases and limiting availability of bank finance for consumer mortgages. This time last year, analysts were speculating whether the government would introduce further restrictions given how overheated home prices had become. It is testament to the volatility of mainland markets that just 12 months later, the focus is now on easing the rules amid talk—probably overblown—of a market crash. By the beginning of October, almost all major Chinese cities had acted to ease or remove homeownership restrictions, with tacit approval from the central government. Transaction volumes improved significantly as a result, though price trajectories have yet to change going into the fourth quarter.

In other markets, regulations have had mixed success. Hong Kong, which introduced types of restrictions similar to those in China in early 2013, saw a rebound in residential pricing for little obvious reason in May 2014, since which time the market has gone from strength to strength, with residential transactions in the third quarter of the year rising to their highest level since 1995. This has resulted in speculation that more tightening measures may be in the works. According to one Hong Kong-based interviewee, “I can see them making the ability to borrow more difficult, requiring maybe 50 percent LTV or only 40 percent [compared to the current 60 percent level].”

By contrast, in Singapore the introduction in mid-2013 of cooling regulations involving restrictions on bank lending and higher stamp duties has produced modest price declines in

Exhibit 1-20 Importance of Various Issues for Real Estate in 2015



Source: *Emerging Trends in Real Estate Asia Pacific surveys.*

the broader market, and a “disaster” at the high end. Local media talk about luxury property prices that are down some 20 percent from their 2012 peak (and as much as 40 percent on Sentosa Island), but the true extent of the decline is hard to measure, because “there are just no transactions, so people can ask what they want, but who knows what the real price might be?” With few transactions, looming oversupply, and a government committed to lower prices, prospects remain dim. As one fund manager put it, “Residential in Singapore is the market with the avoid sign at the moment.”

Government measures are not necessarily aimed at domestic capital, nor is the impact necessarily restricted to local markets. High-net-worth (HNW) money originating in mainland China has been chased out of various Pacific Rim markets—in particular, Hong Kong, Singapore, and Canada—since the beginning of 2013 in response to its inflationary impact on local housing prices, and is now surfacing in significant volumes in countries throughout the world, including the United States and the United Kingdom. In particular, Australia has become a favored destination for mainland Chinese HNW capital. Its impact remains restricted to the high-end market, but with Chinese capital responsible for some US\$4.4 billion in Australian residential purchases in 2013, representing 12 percent of new supply nationally (and as much as 18 percent in Sydney), speculation is now rife that the Canberra government may impose rules of its own (such as maximum LTV ratios) to limit the impact of imported capital.

Another unintended impact of government manipulation of local property markets is that it can create an exodus of local investment capital from the affected markets into other jurisdictions. According to one Singapore-based investor, “The government cooling policy imposed on the Singapore residential market has proven a catalyst for Singapore capital to look offshore because of the constraints it places on development and investment activities. Many of these groups are diversified developers that operate across both the commercial and the residential sectors, and as the residential market slows, their development activity has slowed as well. So in the first half of this year, Singapore was the biggest net exporter of capital in Asia as a source of capital, bigger even than China.” Hong Kong also has seen a substantial level of investment capital move to other destinations.

Real Estate Capital Flows

“We’ve just begun a structural shift as far as the role that Asian capital will play in real estate, both within the region and, increasingly, globally.”

The 5 percent year-on-year decline in Asian real estate transactions during the first nine months of 2014 might seem a fairly modest dip bearing in mind that it came in the wake of record-high figures from the previous year. But when Asian sales are measured against equivalent 2014 figures registered in the United States and Europe, where volume jumped a heady 36 percent and 29 percent, respectively, according to Jones Lang LaSalle, it’s obvious there is more to the story than meets the eye.

Although there is more than one reason for the decline (including, in particular, a large drop in activity in China), one of the main causes is relative valuations. According to one analyst, “Fundraising has done well, and there are plenty of people out there with ambition to buy, but there is an element of concern about when all of this will turn around, because the recovery isn’t that strong in a lot of the [local] economies. Beyond that, pricing is ahead of what people want to pay, given the risks and fundamentals out there.” Simply put, assets in the West currently offer better risk-adjusted returns than can be found in Asia.

Asian Money Keeps Coming

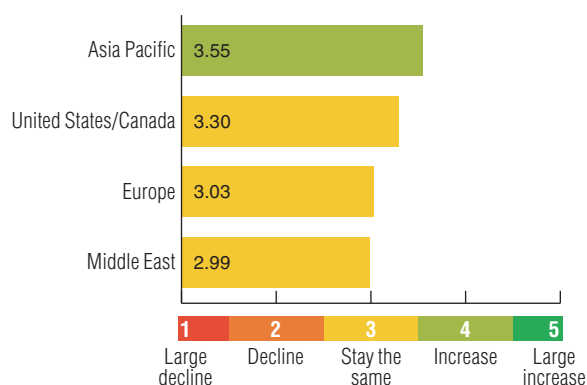
Certainly, the issue has nothing to do with a shortage of capital. In fact, so much new capital looking to find a home in real estate is currently emerging from different sources around Asia that, in the words of one investor, “we’ve just begun a structural shift as far as the role that Asian capital will play in real estate, both within the region and, increasingly, globally.” As another investor put it: “We’re actually only at the tip of the iceberg.” These sources of new capital are coming most notably from China and South Korea, and they join other institutional players from Asia—in particular, from Singapore—that have already been in international markets for some time.

The new players consist of large institutions such as sovereign wealth funds (SWFs), pension funds, or insurance companies, that either have new capital to deploy, that want to invest in real estate for the first time, or that are increasing existing allocations.

So, for example, Asia-based investors on average currently have allocations to real estate of some 6.9 percent, according to data providers Preqin, a relatively low figure that is moving incrementally upward toward thresholds common in the West (in Europe, average allocations are currently 10.2 percent). As one investor noted, “They’re coming from a much lower base relative to Western peers who have been at this for a lot longer—my sense is that ultimately they’ll be aiming to get to about 12 percent as a benchmark against global peers.”

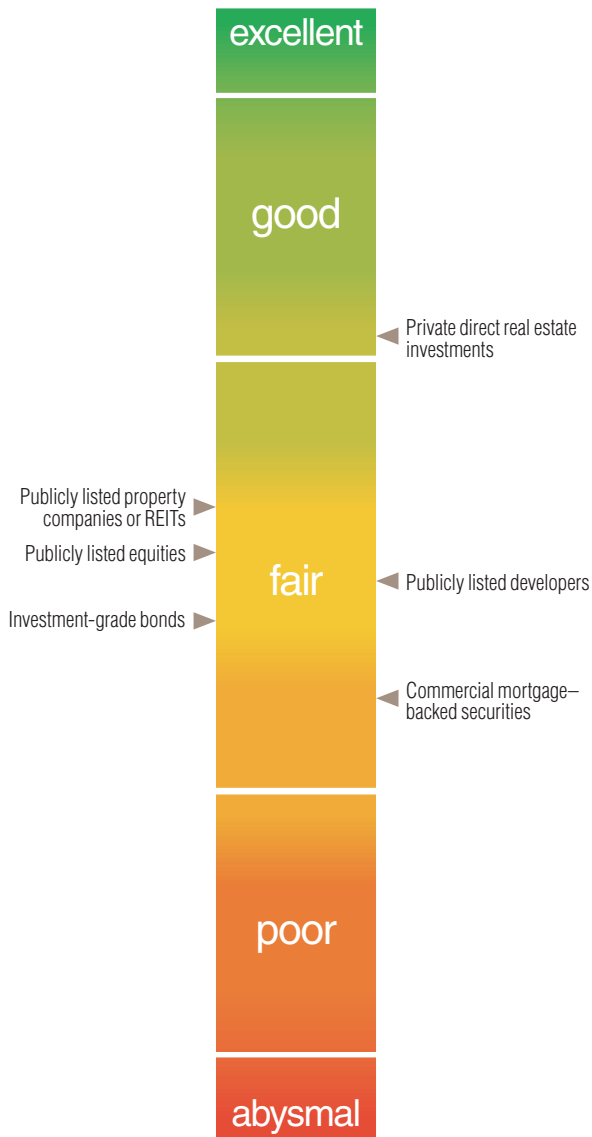
Another reason so much new Asian capital is suddenly in international circulation is that some of these institutions have accumulated more capital than can be safely deployed at home without distorting their local markets. South Korean pension funds fall into this category (the US\$300 billion National Pension Service is the world’s third-biggest public pension fund), as do Taiwanese insurance companies, whose asset base is so large it currently accounts for some 40 percent of domestic commercial real estate turnover. After Taiwanese law

Exhibit 2-1 Change in Availability of Equity Capital for Real Estate in 2015 by Source Location



Source: *Emerging Trends in Real Estate Asia Pacific 2015 survey.*

Exhibit 2-2 Investment Prospects by Asset Class for 2015



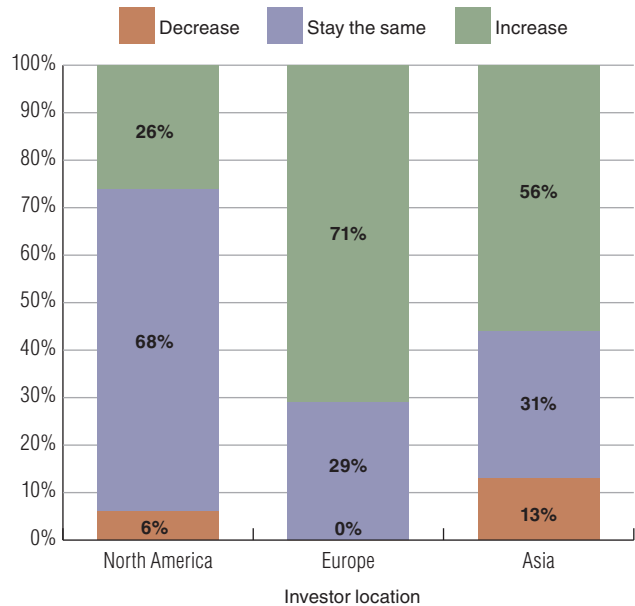
Source: *Emerging Trends in Real Estate Asia Pacific 2015 survey*.

was changed in mid-2013, insurers are now allowed to invest abroad. These types of institutions are now inching their way out of domestic jurisdictions and into international markets.

More to Come?

Despite the flood of new money these groups represent, there are still two Asia Pacific countries where big institutional investors have so far been largely absent from international markets, although that may soon change. Japanese pension funds—in particular, the US\$1.2 trillion Government Pension Investment Fund (GPIF)—hold some of the largest pools of capital in the world today, mostly in the form of low-yielding Japanese government bonds (JGBs). Changing demograph-

Exhibit 2-3 Investor Intentions for Private Real Estate Allocations, by Geography



Source: Preqin Ltd., *Real Estate Spotlight*, October 2014.

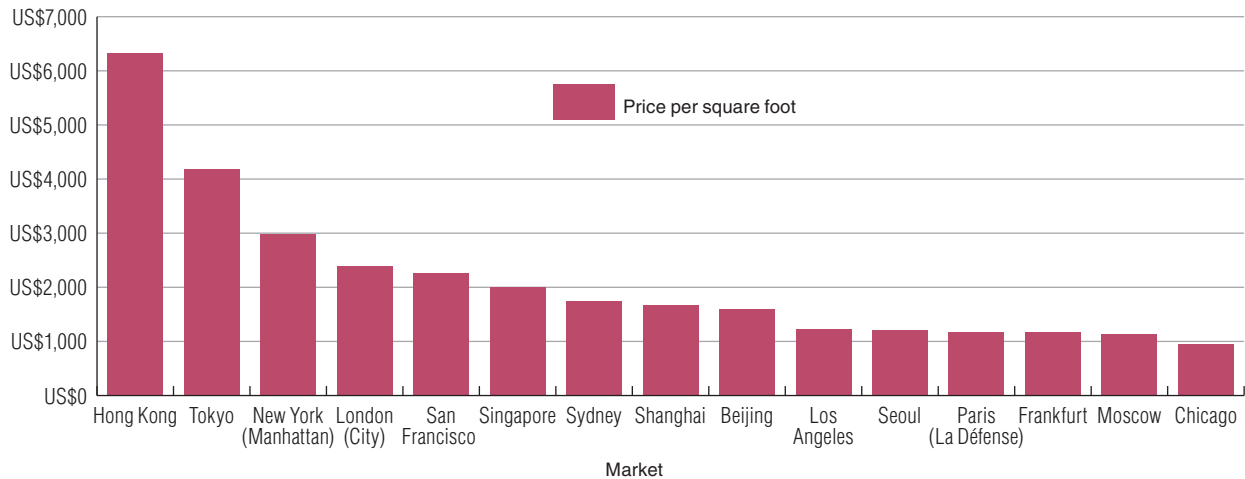
ics in Japan mean these funds must now boost income beyond what they earn via JGBs. At the end of October, the GPIF announced a new investment strategy featuring radically different asset allocations. Among other changes, the fund will shift fully 26 percent of its assets currently held as JGBs into Japanese and overseas equities. It will also create a new 5 percent allocation into alternative investments, including real estate. The extent to which any of this money will be directed to foreign real estate assets is unknown, but because the GPIF's asset base is so large, the change will probably have significant implications for asset prices around the region—especially given that other public and private Japanese institutional funds are likely to follow the GPIF in rebalancing their portfolios.

The other market where pension funds have yet to venture far from home is Australia. Local superannuation funds have remained inward-looking in recent years after efforts to diversify internationally in the run-up to the GFC left the industry with a large hole in its pocket. But that approach may have to change. According to one investor, “If you look at the wall of money that’s going into those superannuation funds and then at the capacity of the local real estate market to absorb it, there’s a structural imbalance between supply and demand. So I think ultimately they will have to look offshore.”

For now, though, there seems little inclination to do so, and not only because higher Australian yields provide little incentive to look elsewhere. Although local pension funds are increasing allocations to real estate at a rate of about US\$3.5 billion each year, according to the Australian Bureau of Statistics, this com-

Exhibit 2-4 Skyscraper Index, 2015

Prime capital value



Source: Knight Frank, *Global Cities: The 2015 Report*, Autumn 2014.

compares to an annual pipeline of newly completed nonresidential development worth some US\$35 billion. That deficit will erode over time, but for now it leaves a large funding gap that must be filled by private investors, and in particular those from international sources. It also means there is not as much pressure on superannuation capital to move abroad as there appears.

Looking West

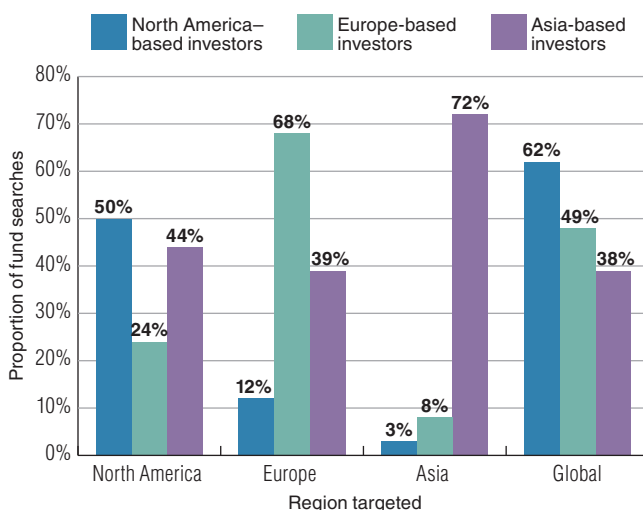
Another reason transactions in Asia were lower in 2014 was that so many regional investors are now looking to buy assets in the Western markets rather than in Asia. In a mid-2014 poll conducted by Preqin, Asia-based investors were more

inclined to pursue geographical diversification than their peers in the United States and Europe, with 44 percent and 39 percent of respondents from the region expressing interest in North American and European real estate respectively, and 33 percent targeting global funds. Asian purchases of European real estate totaled US\$7.5 billion in the first nine months of 2014, according to Jones Lang LaSalle, with a further US\$4.9 billion heading to the United States.

What do they buy? According to one internationally active broker, the approach is a standard one: “For the most part, when it comes to Chinese insurance groups or Korean pension funds or Taiwanese insurance groups, they want to buy direct, they want to buy 100 percent interests, and they want to buy core office buildings in gateway cities.” Over time, though, strategies are beginning to change. First, as investors become more familiar with the dynamics of foreign markets, there is a natural migration to second-tier cities as cap rates compress in gateways. In Europe, that now means various cities in Germany and France (in particular Paris). In the United States, it means destinations like Chicago, Houston, and Atlanta. Traditionally, office has been the target asset, but this has again changed as investors move more toward hotel and ground-up development.

Another natural evolution in investment trends involves deal structures. While direct investing remains popular, use of separate account mandates with an appointed fund manager is now growing. According to one interviewee, “It falls into the middle ground between direct and indirect. They can be used to invest in different types of assets where the operating partner brings a level of experience, technical know-how, expertise on delivery, and asset management—what we’re not

Exhibit 2-5 Breakdown of Regions Targeted in the Next 12 Months by Private Real Estate Investor Location



Source: Preqin, *Investor Outlook: Alternative Assets*, H2 2014.

seeing yet is huge demand for these new sources of capital in Asia to go into blind-pool funds.”

Private Investors Join the Crowd

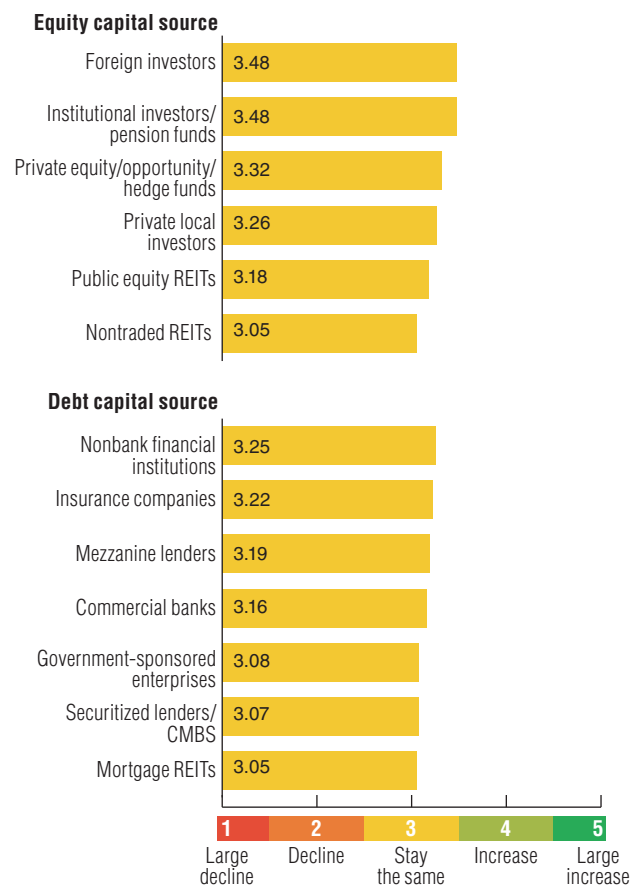
While Asia’s sovereign and institutional players have been the biggest sources of new cross-border money from Asia, privately owned capital—both corporate and high-net-worth—is now also prominent. Singapore developers, for example, spent almost US\$10 billion in foreign purchases in both Asia and the West in the first nine months of 2014, according to official figures, as they sought alternatives to a slowing market at home. In addition, many of China’s largest developers are now seeking foreign alternatives to their domestic programs, as development returns in China shrink and local operating conditions deteriorate. The thinking behind the move, as explained to an investor at a large foreign fund in discussions with one such developer, was: “We are long residential, we are only in one product, we are in one country, we are rich, and we need to diversify, so we’ll go into different sectors and different countries just to mitigate our risk.”

Chinese developers are now surfacing in markets all over the world. In Australia, they are redeveloping old inner-city office stock into high-end residential. In Malaysia’s Johor Bahru, across the border from Singapore, at least three big developers are building tens of thousands of apartments in a series of massive projects. And in the United States and Europe, they are focused on hotel and luxury condominium projects, often aimed at a Chinese clientele.

While many of these early projects have enjoyed success, some interviewees questioned whether the scale of the Chinese migration to foreign markets has been too large and too fast. According to one interviewee, “Traditionally, developers don’t travel well, whether or not they are Chinese, and I think we are going to see a series of woes around what they loosely call brand diversification.” Various potentially problematic issues arise:

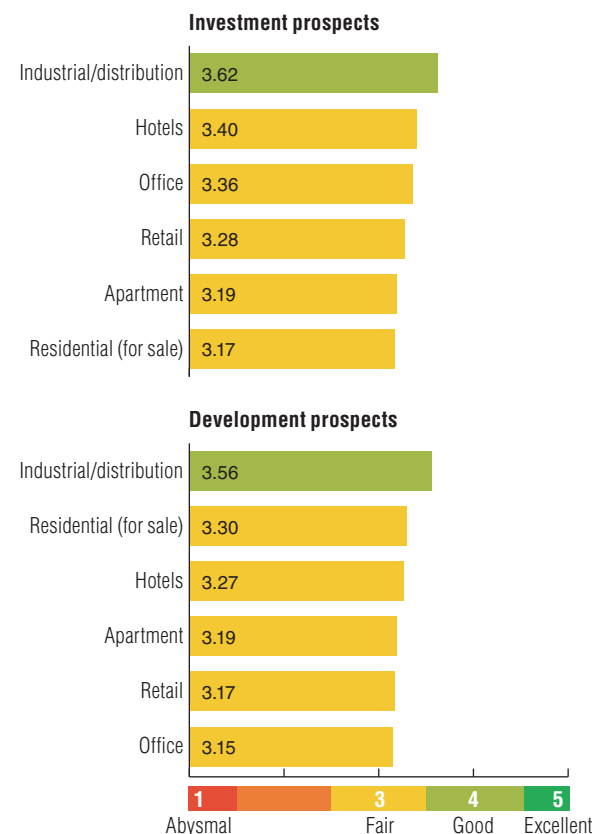
- Many operate without local partners. This is a risky strategy in the best of times, but especially so here given cultural differences between China and the West. In the mainland, for example, developers can often use political clout to get results quickly. As one interviewee said, “The

Exhibit 2-6 Change in Availability of Capital for Real Estate in 2015



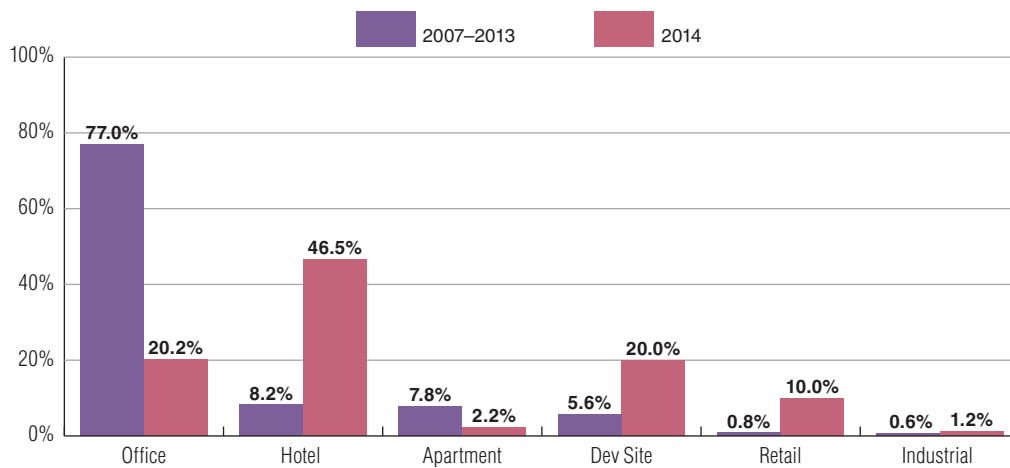
Source: Emerging Trends in Real Estate Asia Pacific 2015 survey.

Exhibit 2-7 Prospects for Major Commercial Property Types in 2015



Source: Emerging Trends in Real Estate Asia Pacific 2015 survey.

Exhibit 2-8 Chinese Investment Activity in U.S. Commercial Real Estate, by Property Type



Source: Real Capital Analytics, Q3 2014.

rules of the game there are very different—China is a lot to do with relationships, it's to do with access to money and access to the decision makers." In an international context, however, developers are subject to bureaucratic and documentation requirements that can take years to navigate. In addition, operating practices differ. According to one Hong Kong-based interviewee, "Very often, you start a development in this part of the world when your drawing is about 70 percent complete. If you do that in the West, the contractors will see you coming—it's an invitation to submit claims and make extra charges that can end up costing you three times the original budget."

- A large proportion of these newly built flats is commonly presold to mainland Chinese buyers. This can be both good and bad. According to one investor, "In doing that, they are taking their buyers with them, and while it doesn't underwrite the success of the scheme, I think it reduces the downside." At the same time, however, it does nothing to build up local branding, it prevents developers from learning local tastes, and it would create problems if the supply of foreign buyers were to dry up.
- Several investors questioned whether mainland developers are overpaying for their land. In part, this may be due to their lower cost of capital and the ability to presell so many units. But there is an ongoing suspicion that it may also be due to a lack of familiarity with foreign markets. According to an investor based in Australia, "Most of them don't have the decades of experience of riding the roller coaster here, so their expectation of how fast they can sell out a project and use those funds to do the next project may be a little more optimistic than I would pro forma when I underwrite."

Currency Volatility on the Rise

Recent exchange-rate volatility caused by expectations of U.S. base-rate increases and Japan's ongoing stimulus efforts is a reminder of the extent to which Asian currencies have in the past been held hostage by global economic events. The recent further bout of easing in Japan and in particular the impending privatization of Japanese pension fund assets is likely to result in further currency volatility going forward, many analysts believe.

Despite this, most investors seem fairly comfortable with currency volatility. In part, this is because the two major currency risks in the region—Japan and Australia—have already seen steep declines against the greenback. The yen and Australian dollar were down about 29 percent and 15 percent respectively over the last 24 months as of the end of October 2014. In addition, Japan risk can be offset by both low hedging costs and the ability lever up using local currency debt. "I don't see it being that much of an issue," said one Tokyo-based fund manager. "It's a concern, but I'm not convinced it's going to have a great impact on investment decisions. And with the yen, you have to ask how much further [down] can it go? I don't see it going to 120, so I think it's in a range where people can deal with it."

In Australia, a large proportion of incoming capital is coming from big institutional funds that have no need to hedge because they invest in assets on a global basis, meaning it "all comes out in the wash," as one interviewee put it. However, for smaller private equity players, the risk is taken more seriously, with numerous interviewees identifying currency as their biggest single risk for their Australian investments. According to one local fund manager, "Those forced to hedge volatility in the Aussie dollar have hedging costs back to the euro,

for example, of anywhere from 250 to 350 basis points per annum. So clearly that's pretty penal for a 6 percent yield."

Fundraising a Bit Easier

Raising new capital has been a major issue for most Asian fund managers since the onset of the global financial crisis. Not only have limited partners (LPs) in general been reluctant to commit new capital to investment funds, but when they have, it often came with various strings attached, providing them with greater control over decision making.

This year, however, while no investor was willing to say that capital raising was easy, a marked improvement in sentiment seems evident. According to one Hong Kong-based fund manager, "It's not easy, but it's easier than, say, 12 months or two years ago, for sure. There are more bureaucratic hurdles with European and U.S. regulations that people have to comply with, but on the ground here in Asia, the real problem today is not so much the sourcing capital, it's sourcing deals." As usual, the biggest players with the best track records are having an easier time, with a stream of closings through the year, often above target. Five Asia Pacific funds managed to raise in excess of US\$500 million in the year to September 2014.

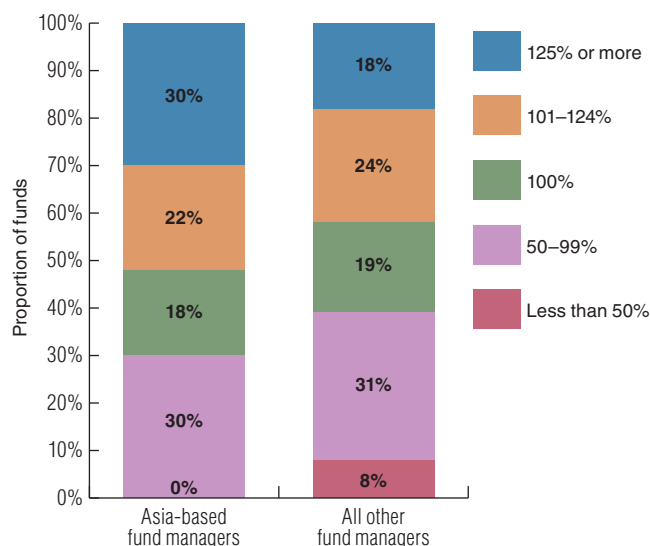
Local funds also have been able to tap fast-growing reserves of regional wealth held by institutions, sovereign funds, and high-net-worth individuals. In China, for example, local-currency-denominated private equity funds raised US\$8.1 billion in capital in 2013—more than double the figure from the previous year. In addition, according to one fund manager, "We've seen increased interest from asset management firms and securities firms, particularly in Korea and China, looking for partnerships in the U.S. and in particular in taking stakes in existing platforms or making outright acquisitions." Another trend is for developers to seek additional capital from private equity players for their international investments.

As one fund manager said, "What we are seeing, particularly around development projects in the U.S. and U.K., is that developers want to find a strategic partner to share the risk, share the exposure on these projects, [and] provide equity and, in some cases, debt."

In general, LPs this year have been looking for funds that:

- Focus on value-add and core-plus returns, given that core or opportunistic assets have become hard to locate;
- Are increasingly specialist, with more focus on particular geographical areas or asset classes; and
- Cater to separate accounts for sophisticated investors with big ticket sizes.

Exhibit 2-9 Private Real Estate Funds Closed in 2013–2014 by Proportion of Target Size Achieved: Asia-Based Fund Managers vs. All Other Fund Managers



Source: Preqin Ltd., *Real Estate Spotlight*, September 2014.

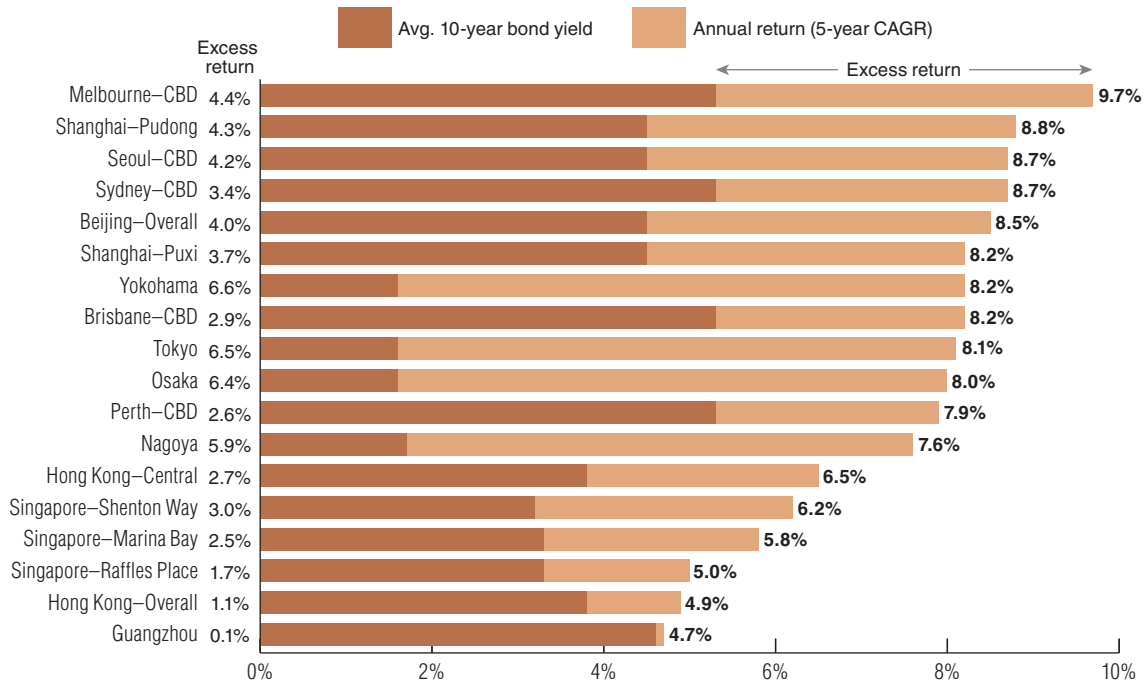
Easy Money from the Banks

The banking sector continues to dominate real estate lending in the region. The very low cost of debt in Asia has contributed to the downward march of cap rates because investors still get positive yield spreads even with tightly compressed yields. That would change, of course, if interest rates were to rise significantly, which is one reason many investors are avoiding markets such as Hong Kong, where prime cap rates commonly stand at 3 percent or less.

Over the last 12 months, credit has remained freely available across Asian markets at loan-to-value ratios of 60 to 65 percent (and even higher in Japan). Japan in particular is offering even lower rates than last year, with cost of debt commonly under 1 percent. Notable exceptions to the easy-credit rule are China and India, where the government has enforced policies discouraging bank lending to the real estate sector for several years. In Vietnam, where banks had been refusing to lend to real estate projects for more than two years as the government tries to resolve its huge portfolios of nonperforming loans (caused mostly by property sector bad debt), lending has now restarted, giving hope the market will rebound. According to one local investor, "Bank loans for real estate development vary depending on project and location, but you would pay between 9 percent and 11 percent. Two years ago it was 20 percent, so that's a big improvement."

One interesting new development is a greater willingness among regional banks to export their capital. Lenders in some countries, therefore, are willing to support Asian institutional and private equity investors as they migrate into international

Exhibit 2-10 Projected Compounded Annual Return, Excess Return, and Government Bond Yields



Source: Deutsche Asset & Wealth Management, *Asia Pacific Real Estate Strategic Outlook: Mid-Year Review, August 2014*.

markets. This is effectively a carry trade, providing low-cost capital from Asia to higher-yielding investments in other parts of the world, and is facilitated by longstanding local relationships between banks and their customers. According to one Singaporean interviewee, “We’re now seeing the marriage of Asian equity with Asian debt, as investors move into international markets, with local banks providing debt that’s more competitive than [that provided by] banks in markets where they are investing. We’ve seen that in London, for example, from Singaporean banks going into residential development.”

Japan is another market where banks are flush with capital but have little chance to make money. This is partly because cost of debt is so low and partly because banks have less opportunity to invest in JGBs now that the government is buying up so much supply for itself. At the moment, Japanese

banks are not especially active in international markets except in corporate merger-and-acquisition deals, but that will probably change. With the yen likely to depreciate further going forward and the big Japanese pension funds now committed to exporting large quantities of investment capital to foreign markets, Japanese banks will probably follow suit, providing debt to investors making cross-border deals.

Access to cheap bank finance has largely squeezed other potential sources of debt from the market. Insurance companies have lending operations selling senior debt in some markets (in particular Japan and potentially in Australia) but have found headway difficult because, as one executive admitted, “competing with the banks is really hard.”

Exhibit 2-11 Commercial Lending Terms, by Country

Country	LTV (%)	Reference rate	Spread (bps)	Interest rate (bps)
Australia	40–60%	Australian BBSW rate: 3.25%	175–200	500–525
China	50–60%	3- to 5-year base lending: 6.4%	150–200	790–840
Hong Kong	50%	1-year HIBOR: 0.85%	300–350	385–435
Japan	50–70%	5-year JPY swap rate: 0.3%	55–100	85–130
Singapore	50–70%	3-year swap offer rate: 1.00%	200–225	300–325
South Korea	50–60%	5-year KTB: 2.73%	150–200	420–470

Sources: CBRE, S&P Capital IQ, and various central banks and monetary authorities, August 2014.

In Australia, some interviewees mentioned favorable terms available on the U.S. private placement (USPP) market, which offers long-dated debt (i.e., 13 to 15 years) that offers pricing with the shorter-term debt (i.e., three to four years) commonly available from domestic Australian (not to mention Asian) banks. Longer-term (i.e., seven- to ten-year) fixed-rate debt is now also available in Japan.

China: Shadow Banking Keeps Growing

The one market in Asia where the plain-vanilla world of cheap and easy debt has been turned upside down is China. The government moved in 2011 to impose strict limits on developer access to bank credit in order to protect bank-sector solvency and cut off liquidity that had fueled the mainland's overheated property sector. This resulted in the rapid emergence of a shadow-banking industry that has succeeded not only by providing funds to a large base of capital-constrained builders, but also by generating high returns for large pools of domestic capital that has few other investment alternatives.

The most important component of the shadow-banking market is the trust and entrusted lending sector. Beginning around 2010, trusts acted as an off-balance-sheet source of funding arranged by mainland banks to provide credit to borrowers—many of them developers—who no longer qualified for loans. Cost of funds is currently in the area of 9.4 percent, according to industry figures. Trust products were originally sold to bank retail customers, but following a spate of insolvencies in 2011 that revealed systemic problems with mismanagement and credit risk assessment, the government issued regulations banning banks from selling trust products to their retail bases.

That did not stop the industry from flourishing, however. Its high yields soon drew other willing investors, including

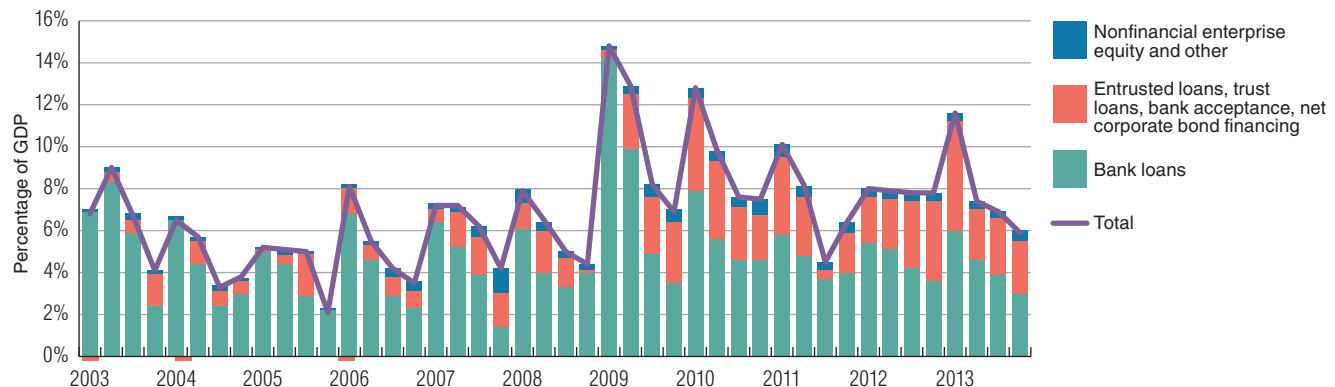
high-net-worth and corporate clients. Even hot money from international sources is believed to have migrated toward Chinese trust products via inflows to China from Hong Kong and Singaporean banks.

Government efforts to rein in trust products have had limited impact in a market that adapts quickly to adopt new structures as soon as existing ones are targeted. Banks continue to use them as off-balance-sheet financing vehicles. In addition, much activity has been pushed underground, making it hard to track. Most recently, China's fast-growing insurance sector also began structuring loans to developers using trust schemes, with total lending standing at almost US\$15 billion by mid-2014. The mainland's asset management industry, originally created by the government to dispose of bank-sector bad debt, has also become a major provider of real estate finance, borrowing from banks before relending at a markup via trust structures.

The ongoing property slump, rising numbers of insolvent trusts, and a record volume of upcoming trust repayments due in 2015 have made trusts increasingly discriminating when lending to the development sector. Developers unable to access trust products can still find other types of private equity, often in the form of domestically sourced mezzanine debt, although costs can be prohibitive. According to one investor, "What they're charged depends on the entity—I've seen rates as high as 30 percent, which really isn't sustainable, but more typically I'd say it's in the mid-teens, though that's also very difficult." According to one Hong Kong-based consultant, "That type of money is largely being used for land purchases, which otherwise the banks would be faced with providing, or the developer would have to use his own resources. So at the moment, it seems to be tolerated [by the government]."

Exhibit 2-12 China Social Financing Flows

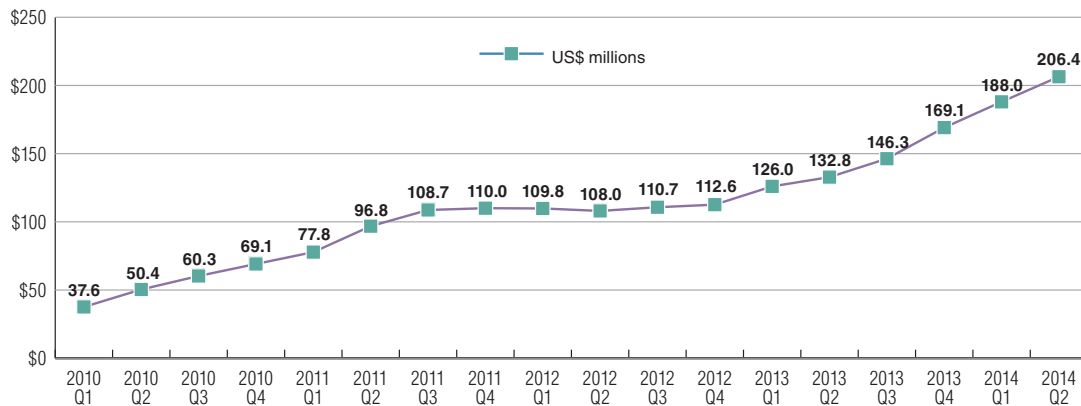
In percentage of GDP



Note: In percentage of four-quarter rolling sum of quarterly GDP.

Source: International Monetary Fund, *Regional Economic Outlook: Asia and Pacific*, April 2014.

Exhibit 2-13 China Real Estate Assets Under Management



Source: China Trustee Association.

In the second half of 2014, Chinese authorities again stepped in to curb borrowing through trust structures, and new issuance has dropped sharply as a result. Nonetheless, the regulatory framework governing China's shadow-banking sector is seen as inadequate to prevent equity moving one way or another into developers' pockets. In particular, Chinese insurers in 2014 began selling new products known as "union-link policies" as a further channel of shadow-bank funding. While questions have again been raised about underwriting standards (described as "awful" by one interviewee), analysts expect them to become an important future channel for nonbank funding.

India: The Mezzanine Play

One theme that surfaced repeatedly in interviews was that "too much equity and not enough debt" across the region has been a major factor contributing to high prices and compressed yields. Still, there is one market where real estate finance remains firmly rooted in the world of debt. Banks in India remain reluctant to lend to developers for most projects, and charge high rates when they do. At the same time, an opaque regulatory environment has led to legal problems for investors—especially foreigners—when they have tried to deploy equity.

The result has been a focus for the last several years on debt as the main medium for investments. With returns on debt falling firmly into opportunistic territory, choosing it over equity is a "no-brainer." As one foreign fund manager commented: "In the past, we were doing straight-up equity deals when the market was super-hot and losing everything. Then we did structured equity and ended up in arbitration in London. Then we end up doing debt using an NBFC [nonbank financial company], where suddenly it works—so that's where a lot of capital has gravitated."

Last year, investors' favored route was senior-secured lending, which offered equity-like internal rates of return (IRRs) of 23 to 24 percent. Today, according to one India-based consultant, "having digested the risk, people are seeing a lot more fundamental strength in the market and are willing to move a step away from senior-secured toward the equity side. They're still not willing to do pure equity, but we are seeing more and more mezz [i.e., mezzanine] structures."

The few pure-equity deals that occur in India are happening at around 25 percent, mezzanine fetches 21 to 23 percent, while pure debt—which is still popular—is now in the sub-20 percent bracket. Mezzanine deals are currently favored because while improving sentiment means that developers are eager to restock land banks, there is no way to project when the rebound will actually arrive. As a result, investors are hesitating to commit to fixed returns for debt on a long-term basis. As the consultant observed, "What if the markets take 12 or 18 months to recover instead of six months? Investors don't want to be in a situation where they are saddled with the pain of servicing a debt coupon. That's why mezz—which has an equity kicker built in—seems a good structure; after seeing the pain of the last five years, nobody feels confident enough to time the market."

However long the market takes to turn, the change in sentiment toward India from both domestic and international investors is evident. One reason for this is the election of a new government, for which investors have high hopes. Another is that growing economic confidence is creating an upturn in demand. According to one interviewee, "Clearly there is now a demand/supply mismatch in commercial property, because over the past four to five years not many developers embarked on new developments or added to the new stock of supply. And that means that with the recovery on the demand side you have a situation where rentals are firming, for the first time in years."

Currently, real estate funds focused on India are reportedly seeking to raise some US\$6 billion in new capital, on top of US\$1.6 billion raised in the first seven months of the year. Most of this is aimed at residential projects. In addition, there has been a significant increase in interest from large sovereign and foreign institutional players over the course of 2014. According to one interviewee, that is because India favors those willing to take a longer-term view. “I don’t think we’re seeing what we did in 2006–2007, where smaller funds or investment banks were lining up to put in a few million dollars,” he said. “I just think India risk is still a little too much for those kinds of people to comprehend and get their heads around.”

Strong Bonds, Weak Equities

As in 2013, the action in Asia’s listed markets has been mainly on the bond front, which, in turn, is composed mainly of Chinese developers selling debt in Hong Kong. Given the Chinese government’s ongoing efforts to reduce developer access to domestic bank funding, demand for offshore debt has been strong in 2014. The bigger surprise, according to one interviewee, “in a year that was supposed to feature higher rates and a rotation into equities, is that demand has mostly been met by buyer appetite.”

In the year to October 2014, Chinese developers had issued a record US\$22 billion in offshore debt at generally tight pricing levels, up from US\$20 billion in the same period of 2013, according to data providers Dealogic. That compares to a grand total of almost \$57 billion in offshore debt secured by Chinese developers since 2011.

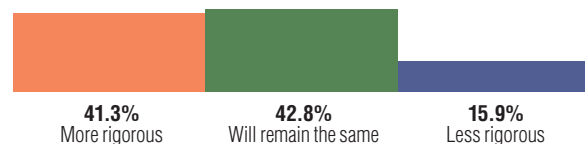
How long that appetite lasts, though, is open to question. Yields paid by Chinese borrowers in Hong Kong currently “offer significant spread over comparable U.S. issuers,” but risks are also growing steadily as Chinese home prices and transaction volumes continue to fall and developer gearing continues to rise. According to Bloomberg, 133 out of 334 listed Chinese developers had liabilities that exceeded their assets as of October 2014.

Recently, in order to circumvent an official ban on purchasing land using “debt,” some developers have been issuing ‘perpetual bonds’ which, for accounting purposes, if structured appropriately, can achieve equity classification. These perpetual bonds generate returns ranging from 10 to 11 percent in the first two years and even higher rates after five years. Although, classified as equity they are essentially debt in nature. If they are adjusted for the purpose of computing economic gearing, the developers’ gearing ratios could even be higher than current rarefied levels.

In the current environment, offshore developer bonds are now significantly less appealing to foreign investors. As a result, yields are rising, especially for lower-rated notes. At the same time, however, developer access to onshore debt has again opened in 2014 following a five-year hiatus. After an initial batch of local developers restarted bond sales in April, authorities in September opened the domestic interbank market to allow AA-rated developers to sell local currency (i.e., renminbi) bonds. Previously, access to the interbank market had been tightly restricted. By the end of October, at least 12 developers, including some of China’s biggest non-state-owned builders, had announced plans to raise US\$12.5 billion worth of interbank market bonds. With renminbi bonds generally cheaper to issue than recent comparable foreign currency deals in Hong Kong, the onshore market appears set to become the dominant platform for Chinese real estate debt issuance. Onshore issuance is therefore likely to be double that of foreign currency deals in 2014.

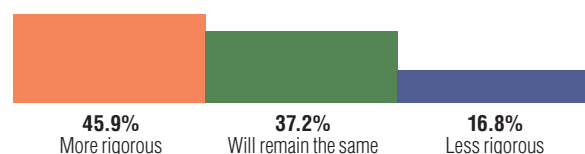
Given their high levels of gearing, some Hong Kong-listed Chinese developers have sought to raise money via rights issues instead. These may be unappetizing for developers, given that they are offered at steep discounts to share prices already trading well below net asset values, but there may be little alternative if they are unable to raise capital elsewhere. It means, however, that with Beijing now apparently committed to providing a level of support to the real estate sector, there may be a buying opportunity. As one fund manager said, “If you think about prices resetting, in terms of the office and retail space, they haven’t really reset at all—apart from residential, just a little bit. But when you look at the public space, shares have reset enormously, they’re really cheap compared to where the private space is trading.”

Exhibit 2-14 Equity Underwriting Standards Forecast



Source: *Emerging Trends in Real Estate Asia Pacific 2015 survey.*

Exhibit 2-15 Debt Underwriting Standards Forecast



Source: *Emerging Trends in Real Estate Asia Pacific 2015 survey.*

REITs Still Active

The market cap of Asia's REITs (including Australia) reached some US\$250 billion in the third quarter of 2014, up about 16 percent on the year. Asia's REITs have therefore had a surprisingly strong run given that the global macrostory has been dominated by the prospect of higher U.S. base rates—an environment in which yield-sensitive REIT investors are more likely to sell than to buy. Fundraising by REITs across the region exceeded US\$20 billion in 2013 and reached all-time highs in both Singapore and Japan. As a result, REITs have become the main purchasers of commercial property in major markets over the last two years. In 2014, however, equity raised by Asian REITs is expected to be a fraction of the previous year's total.

Japan

The Japanese REIT (JREIT) industry has been a big beneficiary of the easing policies of Prime Minister Shinzo Abe, which have directed large volumes of capital into the sector either directly (via a specific mandate for the government to buy REIT shares) or indirectly (by encouraging investors to buy real estate assets generally). Since Abenomics began in October 2012, the Tokyo Stock Exchange's JREIT index rose by 36 percent in 2013 and a further 18 percent year-on-year in the first ten months of 2014, at which point the sector was trading at a 25 percent premium to net asset value (NAV) and a 3.4 percent yield. With a new round of government stimulus announced shortly before this report went to press that effectively triples the level of government JREIT share purchases compared with the previous easing, JREIT stocks are likely to rise further going forward. At the same time, according to one

investor, "as the investable assets get scarcer, the equity raising will be around 50 percent of this year's [level]."

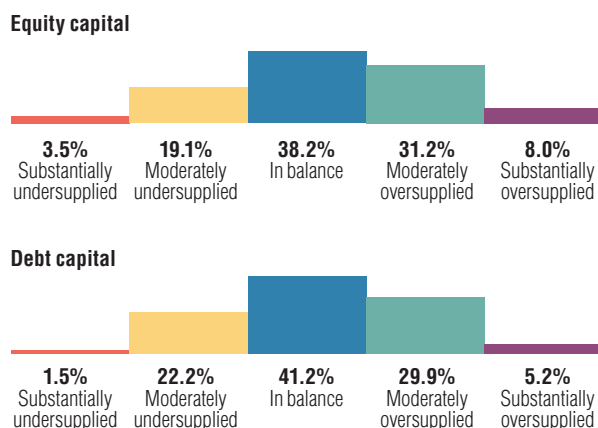
One unsurprising result of the influx of new capital into JREITs is that they continue to be heavy buyers of real estate assets. While total investment of some US\$9.1 billion during the first nine months of 2014 is down from almost US\$14 billion for the same period in 2013, JREITs continue to dominate buying in the core space, muscling most of the competition aside.

According to a former JREIT manager in Tokyo, "The positive sign is that REITs are now using longer debt instruments. Before, they were tied to three and five years, but now they are looking at going longer, so a few JREITs are now doing seven to ten years, and also starting to use more fixed-rate financing." At the same time, "you still have the issue with conflict of interest between REITs and sponsors—that's the inherent problem here that doesn't appear to be going away. But I think the REIT market is starting to mature more in terms of how it's being managed and also in terms of size because there's more money coming in." Interviewees still expect to see consolidation within the sector, although the market improvement over the last two years has meant that "some of the weak REITs that probably would have consolidated had the market not picked up are now—while not thriving—certainly alive and well."

Singapore

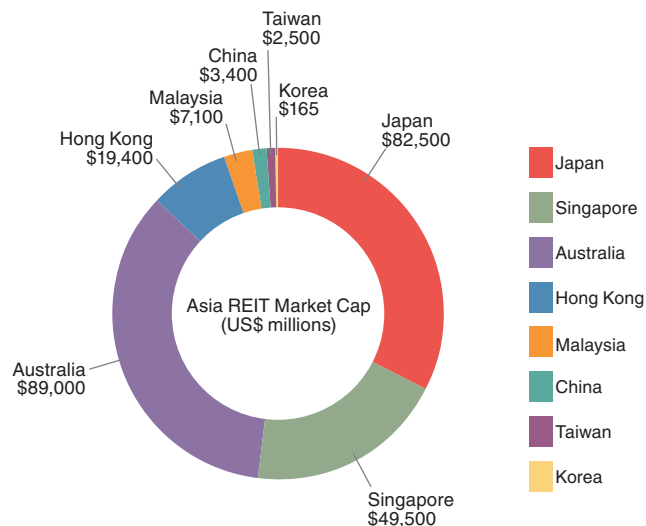
Concern over rising interest rates led to a slowdown in REIT listings in Singapore and a "pretty lackluster time in the capital markets for the year." Still, the overall market remains reasonably strong, with shares up 2.3 percent year-on-year at the

Exhibit 2-16 Real Estate Capital Market Balance Prospects for 2015



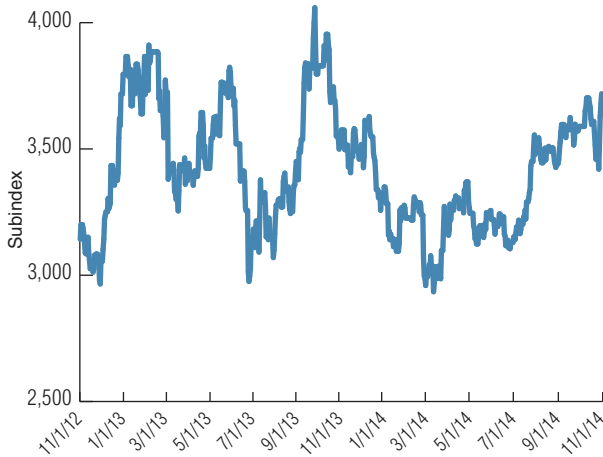
Source: *Emerging Trends in Real Estate Asia Pacific 2015 survey.*

Exhibit 2-17 Asia REIT Market Cap



Source: Lazard Asset Management, *Asia REIT Report.*

Exhibit 2-18 Shanghai Stock Exchange Property Subindex (China Developers)



Source: Bloomberg.

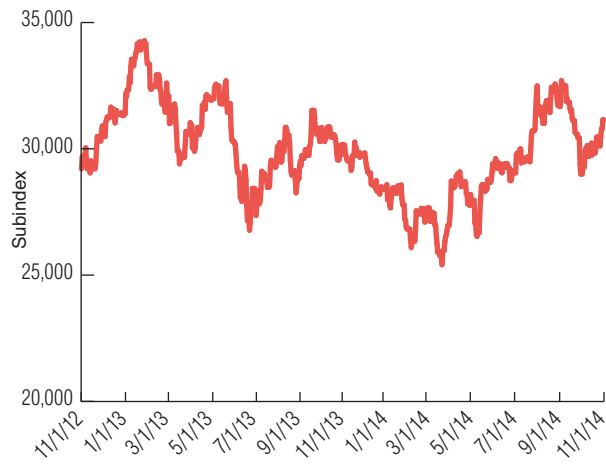
end of October 2014 and sector yields averaging between 6 and 7 percent.

One of the problems faced by the Singapore REITs (SREITs) is that they continue to be victims of their own success, with so many trusts now crowded into an already overpopulated market (an additional two filed initial public offerings [IPOs] in 2014). Having doubled in size from five years ago, and with much of the investable stock already securitized, the logical path for SREITs has been to look elsewhere to acquire assets.

Investors have therefore reported SREITs kicking tires of assets all over the region, from major markets such as Japan, Australia, and China to emerging economies such as the Philippines, Indonesia, and Vietnam. According to one Singapore-based REIT manager, “Some have been more successful than others, and a lot of that has been to do with the sponsors’ ability to have more or less matured some of their own assets so they can easily inject them [into the REITs]. Because investors want to see support in these far-off countries, where they don’t have that big of a presence.”

The overall success of these overseas forays in bringing higher-yielding assets into SREIT portfolios has been one of the main reasons for the sector’s strong performance during the last year. Until recently, most of the action has been in northern Asian countries and in particular Japan, China, and, to a lesser extent, South Korea. Today, however, “you’re finding a lot more interest primarily in Australia, mainly because pricing is looking good.” In any event, the migration of Singapore’s REITs across Asia seems set to continue.

Exhibit 2-19 Hang Seng Properties Subindex (Hong Kong Developers)



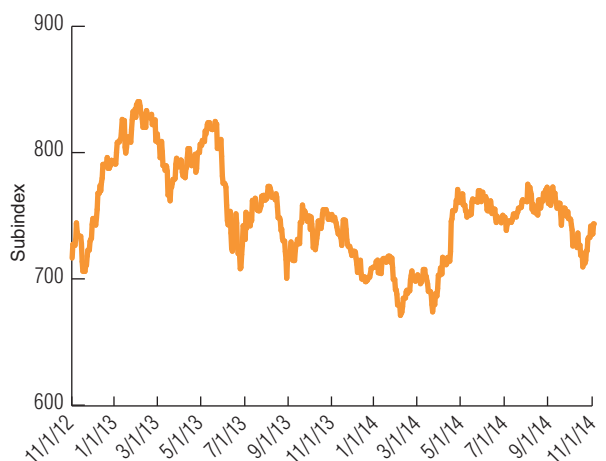
Source: Bloomberg.

Australia

Shares of A-REITs have trended steadily upward over the last year, rising 10 percent year-on-year in the first ten months of 2014. With A-REITs trading at an 8 percent premium to NAV, the industry is healthier than it has been in years, with values “pretty full right now,” as one Australian fund manager commented. Still, the 5 percent yield is approximately equivalent to prime yields, which seems a supportable level.

However, A-REITs have not been able to raise significant capital over the last year, which reflects intense competition for assets, poor rental growth in the market, and REITs’ generally higher hurdle rates (although these now appear to be dropping). The

Exhibit 2-20 FTSE Singapore Real Estate Developers Subindex



Source: Bloomberg.

Exhibit 2-21 REIT and Listed Real Estate Market Comparison, Q3 2014

Market	Number of listed REITs	Weighted avg. dividend yield	10-year govt. bond yield	Spread	Number of listed real estate companies	Listed real estate market cap (US\$ millions)
Japan	46	3.40%	0.53%	2.87%	162	\$203,140
Singapore	33	6.07%	2.47%	3.60%	75	\$113,100
Hong Kong	7	4.69%	2.02%	2.67%	145	\$357,360
Malaysia	15	4.84%	3.92%	0.92%	96	\$37,230
China	2	6.97%	4.01%	2.96%	195	\$237,330
Taiwan	6	2.87%	1.72%	1.15%	40	\$15,840
South Korea	8	n/a	2.88%	n/a	11	\$1,340
Total	117	—	—	—	724	\$965,340

Source: Lazard Asset Management, *Asia REIT Report*.

lack of capital raising among A-REITs contrasts with the track record for wholesale funds, where currently “a wall of money is looking to invest in unlisted funds,” both from domestic and offshore sources.

India REITs and CMBS

A new REIT regime now emerging in India has generated positive feedback, although in practical terms Indian REITs are unlikely to list for some time until regulators clarify REIT tax status, which may take some time. That’s because although India’s regulators released guidelines in the second half of 2014 detailing how domestic REITs can be structured and granting tax benefits on REIT income streams, other branches of India’s central and state governments must still sign off on further tax exemptions and other aspects of the required regulatory framework. This is the type of process that in India can take a long time. As a result, according to one India-based consultant, “the regulatory ambiguities will hopefully get sorted out in the next year or so, but my fear is that nothing is as simple as it appears on the face of it in India.”

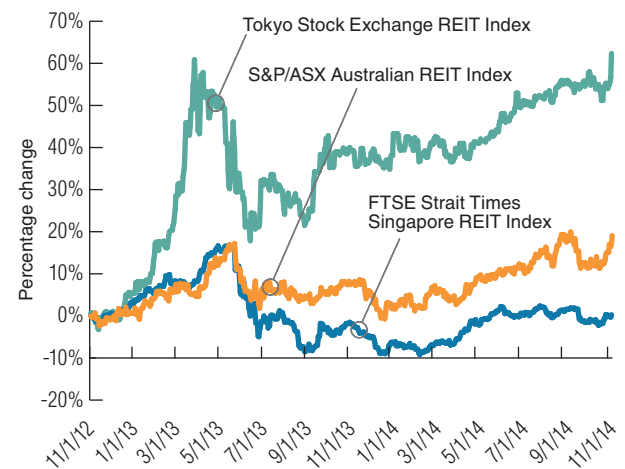
Another interesting development that may dovetail with the creation of an Indian REIT industry is the recent introduction of an Indian commercial mortgage-backed securities (CMBS) facility. Indian CMBS differ from the conventional Western model in that they are used as an alternative avenue for developer funding rather than a way for mortgage lenders to clear out their mortgage inventories. In the single CMBS issue seen so far in India, a large developer issued bonds backed by rental income from two of its retail assets. While appetite remains limited for now, CMBS structures are expected to offer both higher leverage and lower costs than conventional borrowing strategies. According to one India-based interviewee: “In most cases where banks in India are giving loans, the LTV would be between 55 and 60 percent, while in the case of CMBS, we expect LTVs to begin crossing 70 percent. But

certainly the cost of raising capital via a CMBS—and you can do a ten-year CMBS, too—is 100 to 150 basis points lower than the cost of raising money from the banking system.”

Given that uncertainty over tax benefits means Indian REITs are unlikely to become a reality for at least a year or two, there is potential in the meantime for investors to use CMBS structures to refinance projects with lower-cost capital, maximize cash flows, and then eventually list assets as REITs at a cap rate that provides a positive spread over the cost of debt—something that is currently difficult to achieve in India. This would be an important step forward for Indian REITs because experience has shown—in particular in markets such as Indonesia and Thailand—that merely legalizing REITs is no guarantee of success.

Exhibit 2-22 Percent Change in Asia Pacific REIT Markets

Change as a percentage of 11/1/2012 values



Source: Bloomberg.



Markets and Sectors to Watch

“The hottest, most-crowded trade right now in Asia probably is **Chinese** logistics.”

If an abundance of liquidity has been the most pervasive theme to influence Asian real estate pricing and capital flows over the last several years, it is perhaps appropriate that the country most responsible for so much of that liquidity—Japan—should again prove the most popular overall destination in the region. Two years after the introduction of the massive economic stimulus package known as Abenomics, Tokyo has again ranked first in our 2015 survey as both an investment and development prospect, followed closely by Osaka, which ranked third for investment purposes and fourth for development. The fact that Osaka featured next to the bottom in our survey as recently as 2013 illustrates just how much Japan’s stock has risen over the last couple of years.

Other top trends to emerge from our survey include the following:

- The rise of Australian cities into leading positions, reflecting the appeal of the high cap rates still offered by Sydney and Melbourne in an otherwise yield-challenged environment across Asia.
- The fall of China. Although the two most important mainland cities—Beijing and (especially) Shanghai—continue to show reasonable strength, the three other mainland destinations featured in the survey, together with Hong Kong, have been herded into positions at the bottom of the ladder. Sentiment toward China has been affected by

Exhibit 3-1 City Investment Prospects, 2015

	generally poor	fair	generally good
1 Tokyo			3.50
2 Jakarta			3.44
3 Osaka			3.35
4 Sydney			3.33
5 Melbourne			3.31
6 Shanghai			3.30
7 Seoul			3.30
8 Manila			3.21
9 Singapore			3.16
10 Beijing			3.11
11 Mumbai			3.11
12 Kuala Lumpur			3.09
13 Ho Chi Minh City			3.09
14 New Delhi			3.06
15 Auckland			3.05
16 Bangkok			3.01
17 Bangalore			3.01
18 Taipei			3.01
19 Shenzhen			3.01
20 Guangzhou			3.01
21 Hong Kong			2.97
22 China—secondary cities			2.89

Source: Emerging Trends in Real Estate Asia Pacific 2015 survey.

Exhibit 3-2 City Development Prospects, 2015

	generally poor	fair	generally good
Tokyo			3.50
Jakarta			3.44
Sydney			3.33
Osaka			3.33
Melbourne			3.31
Seoul			3.28
Shanghai			3.26
Manila			3.23
Singapore			3.16
Ho Chi Minh City			3.12
Mumbai			3.11
Kuala Lumpur			3.11
Beijing			3.07
Auckland			3.05
New Delhi			3.04
Bangalore			3.03
Taipei			3.02
Shenzhen			3.01
Guangzhou			3.01
Bangkok			2.99
Hong Kong			2.97
China—secondary cities			2.84

Source: Emerging Trends in Real Estate Asia Pacific 2015 survey.

an ongoing slump in the residential sector, a slowing economy, and low cap rates on offer across almost all sectors and locations.

- The industrial/logistics sector remains strongest in sectoral terms—a testament to chronic shortages of logistics capacity in most markets and the relatively higher yields still on offer.

Leading buy/hold ratings for the various property types are as follows:

- Residential: buy, Tokyo; sell, Auckland
- Office: buy, Tokyo; sell, Taipei
- Retail: buy, Tokyo; sell, Taipei
- Hotel: buy, Tokyo; sell, New Delhi
- Industrial: buy, Shanghai; sell, Auckland.

Top Investment Cities

Tokyo (first in investment, first in development). Tokyo will probably continue to prove a big draw for real estate investors for as long as Japan continues its huge program of economic stimulus. And with Prime Minister Shinzo Abe introducing a new round of easing as recently as the end of October 2014, there seems to be plenty of room for

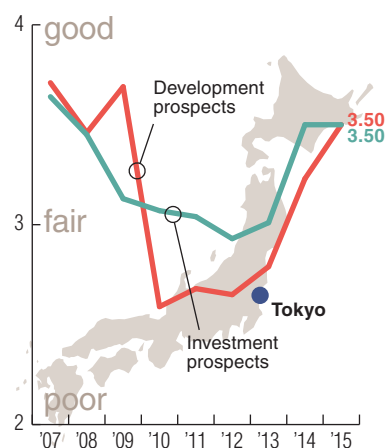


Exhibit 3-3 Historical Investment Prospect Rankings

	2015	2014	2013	2012	2011	2010	2009	2008	2007
Tokyo	1	1	13	16	12	7	1	3	3
Jakarta	2	3	1	11	14	17	20	20	19
Osaka	3	9	22	21	19	18	15	4	1
Sydney	4	5	4	3	6	6	14	15	16
Melbourne	5	13	10	7	9	9	11	17	6
Shanghai	6	2	2	2	2	1	5	1	2
Seoul	7	15	14	19	16	4	6	7	13
Manila	8	4	12	18	20	20	19	19	18
Singapore	9	7	3	1	1	5	2	2	4
Beijing	10	8	7	5	7	3	12	6	9
Mumbai	11	23	20	15	3	8	7	10	17
Kuala Lumpur	12	14	5	17	15	15	10	11	15
Ho Chi Minh City	13	19	18	10	11	13	13	8	12
New Delhi	14	21	21	12	5	10	9	13	14
Auckland	15	17	17	20	18	16	17	14	–
Bangkok	16	11	6	14	17	19	18	18	8
Bangalore	17	20	19	9	10	14	4	12	10
Taipei	18	16	9	8	13	11	8	16	5
Shenzhen	19	10	16	–	–	–	–	–	–
Guangzhou	20	6	15	6	8	12	16	9	7
Hong Kong	21	18	11	13	4	2	3	5	11
China—secondary cities	22	12	8	–	–	–	–	–	–

Source: *Emerging Trends in Real Estate Asia Pacific* surveys.
 Note: – = no data.

markets to run. But Tokyo's attraction lies not only in its prospects for asset price inflation but also in its status as a gateway city featuring—for now, at least—low levels of perceived risk, together with levered returns that compare favorably with those on offer in other parts of Asia.

While Tokyo has seen significant cap-rate compression over the last two years, yields have now reached a level (about 3.5 percent for prime properties) where significant further compression seems unrealistic. At the same time, the fact that commercial rents have been stagnant for several years means that investors are now looking for a rebound on the occupational side as a source of future profits. Commercial rents have now begun “inching up,” and there is expectation of more upside. As one fund manager commented: “A lot of people are pricing future rent growth into their numbers, and frankly you have

to in order to be competitive—if you don't, you'll never buy anything.”

One of the problems facing investors in Tokyo is that local real estate investment trusts (REITs), having raised large amounts of cash over the last two years, have been busy buying as many new assets as they can, and their lower cost of debt and undemanding hurdle rates make them tough competition. Says one investor, “Once the local guys start piling in, then you know the foreigners can't keep up. The REITs buy very quickly, with very little due diligence, and they don't have all the structuring that we do, so they're much quicker to act—it sidelines the foreign players quite a bit.”

Still, with easy access to cheap debt, foreign funds have been able to get more money into the market in 2014, often by picking up assets in secondary locations and sectors.

Jakarta (second in investment, second in development). Jakarta has enjoyed considerable support in our surveys over the last three years, and although its popularity has at times caused some head scratching among interviewees, its star this year continues to shine. The city's appeal has been predicated on Indonesia's booming economy as well as strong asset price growth over several years, although both have fallen off over the past 12 months. Land prices for residential and office assets rose 11.6 percent and 8.3 percent year-on-year in the first six months of 2014, but prices for high-end residential have decelerated and office rents have plateaued since the start of the year. Office cap rates have been fairly steady at around 7.8 percent, according to Jones Lang LaSalle.

The election of a new government in mid-2014 has brought improved business sentiment generally to Indonesia. New regulations are expected that should be more friendly to the real estate sector, although it is unclear at this point what they may be. This should be helped by very low vacancy rates and a very limited pipeline of new supply, especially for prime assets. In general, real estate prices remain low compared with those in other large Asian cities.

As always, however, plenty of issues make investing problematic. For one, the market remains opaque.



Interviewees expressed reservations about both land title and the court system, with one investor commenting: "I would really only want to pull the trigger if I had offshore security in Singapore, or perhaps something from a local Indonesian developer."

Concern also exists this year about the prospect of interest rate hikes in the West causing a sudden exodus of foreign capital back to the United States and Europe, as has happened on previous occasions. Beyond that, there are issues in gaining access to the market. On one hand, most property is closely held, with few investment-grade assets available for funds to buy. On the other, locals have plenty of cash and therefore little need for foreign capital.

Osaka (third in investment, fourth in development). One byproduct of the fierce competition for assets in Tokyo is that many investors have been pushed out into Japan's secondary markets. Osaka is the only such city included in our survey, but investors were also bullish about prospects in other destinations such as Fukuoka and Nagoya.

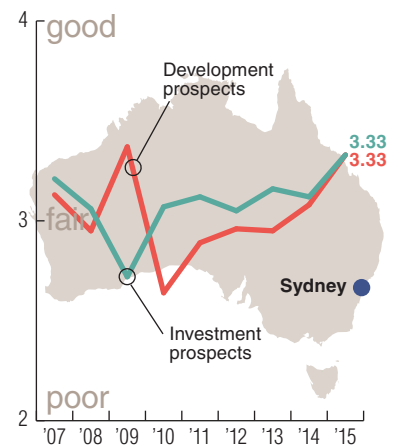
For several years, Osaka languished at or near the bottom of our survey rankings, mainly as a result of oversupply issues in the office sector. As recently as 2013, it ranked next to bottom in the table. Much of that overhang has since been absorbed, however, and vacancy levels are declining, although they still register in the area of 9 percent. With new supply in 2014 amounting to only 20 percent of the last ten years' average, vacancies will continue to decrease, which should in turn help the recent rebound in capital values ongoing since the beginning of 2013. According to one investor, "Osaka has double the GDP of Hong Kong and a fantastic international airport with good access—I think it is a great market with huge potential."

With cap rates for commercial properties in Osaka standing at around



5 percent in fall 2014 (down about 50 basis points from the end of 2013), there is still potential for more compression. At the same time, because JREITs are not as active outside Tokyo, there is less competition for core assets. Indeed, most foreign investors are gravitating toward core anyway because of concern about price stability in outlying cities should the economy slow. Hotels were mentioned by some as an attractive opportunity in Osaka given its proximity to the tourist hubs of Kyoto and Nara.

Sydney (fourth in investment, third in development). High yields and a mature economy remain a big draw for international investors, and with a "wall of money" from Australia's pension and wholesale funds also targeting local assets, competition for product can be intense. The action in Australia is focused on the two major markets—



Sydney and Melbourne—where more sophisticated service sectors are outperforming the commodity-oriented economies of other cities such as Perth and Brisbane.

Despite competition over deals, a significant amount of stock is now being recycled into the Sydney market as funds take profits from ongoing price gains. Said one fund manager, “The market seems quite liquid. Right now in Japan I see probably one or two deals per month, but I am seeing a deal there virtually every week.”

While cap rates for prime properties in Sydney have compressed at least 150 basis points since last year’s report, rents have remained soft and vacancies relatively high, mirroring a similar theme in Tokyo. But with the ongoing rebound in the local service sector, investors are now counting on an improving occupational environment to squeeze extra profit from the current market.

At present, there is a strong focus on development in Sydney. This often involves conversions of old office stock into residential, especially by developers from Singapore, China, and Hong Kong who are looking for alternatives to somewhat-downbeat environments in their home markets. Profits from conversions can be substantial, although some are questioning whether they can continue, given the astronomical prices that foreign developers are now willing to pay for the land. However, in the words of one local fund manager, “if you can pick up an old office building at, say, \$6,000 to \$7,000 per square meter, spend \$6,000 to \$7,000 per square meter redeveloping, then it owes you \$4,000 to \$8,000, but you can sell it at \$20,000 to \$22,000. So there is still money to be made, and that is what’s driving this office/residential style.”

Another focus in Sydney is a trend toward forward-funded plays, which have been quite successful in recent years and are often seen as a way

to bypass the shortage of stabilized assets.

Melbourne (fifth in investment, fifth in development). In many ways, Melbourne is seen as a similar investment environment to Sydney. There is a strong development theme, lots of capital looking for investments, much of it from abroad, fast-compressing (but still attractive) yields, and a weak occupational market.

Going forward, investors expect moderate yield compression from rising prices but more upside from improving fundamentals. As one investor said: “We are definitely seeing absorption pick up, we are seeing positive sentiment, and we are seeing vacancies drop effectively for the first time in a while. And those improved fundamentals absolutely will drive cap rates, although weight of money is going to drive it as well.”

As with Sydney, there has been relatively little interest among investors or tenants in migrating to areas outside the central business district (CBD). In part, this is a reflection of a lack of confidence in the current global bull market, with investors reluctant to commit to more risky strategies. It’s also a result of still-elevated vacancy rates, with plenty of tenant incentives to remain in the CBD. In addition, tenants are drawn by the modern facilities that are now being created in the inner cities. According to one developer, “Space-per-person requirements

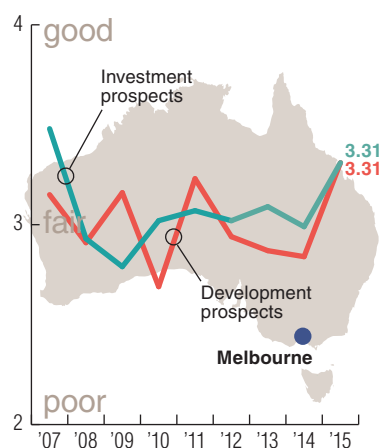
are getting smaller because of the new trends in hot-desking that the big groups are pursuing—so where it used to be one [person] per ten square meters, that is now declining—that means you don’t need as much office space.”

Again, like Sydney, Melbourne is seeing Asian capital from foreign developers flooding into office conversions—a practice that is becoming controversial. According to one interviewee, “There’s a perception that the money coming in is buying at crazy prices. They often don’t want to develop, they just sit on it, which means you can’t get product on the ground because major land sites are being taken out. So there’s a lot of lobbying going on over that at the moment.”

Finally, residential pricing is looking “pretty peakish,” which has created some concern, given the amount of new product in the pipeline should there be a sudden rise in interest rates or some other economic event. As one investor commented, “If people are churning out product with the idea that interest rates are going to remain low in the longer term and all the sudden that’s not there, you could be left holding a lot of product.”

Shanghai (sixth in investment, sixth in development). Although Shanghai has fallen from last year’s number-two ranking, its sixth place this year is still relatively impressive given the general lack of enthusiasm toward China this year. It also underscores how the mainland has become a bifurcated market, with most attention now directed toward Shanghai and Beijing rather than other less traveled cities.

One reason for this is that it remains one of six or eight key gateway cities in Asia and will therefore always have an allocation from international funds targeting it. In addition, it offers a deep pool of investment-grade product, it has a stronger economy and greater transparency than other domestic cities, it remains a magnet for foreign compa-





nies looking to set up offices in China, and it has been the source of numerous successful investments by foreign funds over the last ten years. Finally, although a fairly large pipeline of new office supply is looming, Shanghai has in the past proved capable of absorbing supply gluts, and remains, in fundamental terms, structurally undersupplied. In any event, there is no question of oversupply on the scale that is now affecting many second-tier cities in China.

That said, the commercial property market in Shanghai does suffer from one major drawback—cap rates that have compressed to the point where they are seen as poor risk-adjusted returns compared with those offered by other regional and global markets. In addition, Chinese insurance companies and other institutional buyers are now major purchasers of prime assets in Shanghai, meaning that competition for product has become intense and sellers are largely unwilling to reduce prices. That helps explain a big drop in transaction volumes in 2014, as well as a pickup in investor interest for assets in decentralized locations.

It seems, however, that investment activity may be set to rebound. According to one broker active in China, “Talking to our guys in Shanghai or Beijing there is currently a strong expectation that, while volumes may not get back to 2013 levels, there are certainly a lot of deals

that hopefully are going to drop by [the end of 2014].”

Seoul (seventh in investment, seventh in development). Over the last several years, South Korea has remained something of a black box for real estate investors, with funds looking for ways to get a foothold in Asia’s fourth-largest market finding little opportunity because of a shortage of deals, difficulty in competing with local buyers, and a general reluctance to allow foreign funds to compete in the market. That has changed in 2014, however, with a significant uptick in foreign transactions and a number of funds queuing up to make purchases, attracted by a robust economy, decent yields, and a healthy, positive spread over the cost of debt.

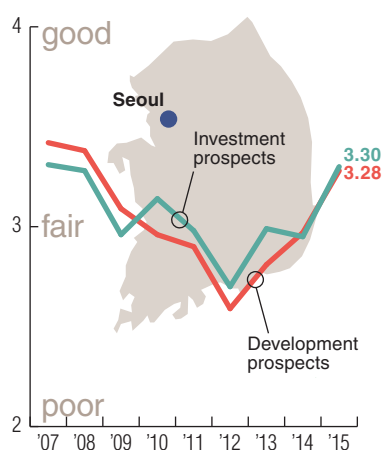
According to one fund manager active in Seoul, “Traditionally, [South] Korea is a bit one-dimensional from an institutional real estate perspective, because the only things available to buy or sell are office towers. There’s no multifamily sector, retail assets rarely trade because they’ve been strata titled, and until recently hotels didn’t trade either.” Another issue that dampens transaction volumes is the high rate of owner-occupation, mainly by large corporations that are not interested in trading their properties.

One issue that has become problematic in Seoul this year, as it has in other cities across the region, is the dislocation

between high capital prices caused by buyers chasing assets and weak occupational markets. This weakness is largely the result of a glut of newly built office stock. It has particularly affected Seoul’s financial district in Yeouido, which featured a 25 percent vacancy rate as of mid-2014, according to Savills. Meanwhile, average vacancies throughout Seoul stood at 13.6 percent. The situation is expected to worsen as more new office stock arrives by the end of 2014, but should improve in 2015.

Manila (eighth in investment, eighth in development). Strong economic growth and ongoing investment in the offshoring sector—both business process outsourcing (BPO) and financial back office—continue to underpin Manila’s popularity, although its fall from fourth to eighth probably reflects investors’ wariness of the possibility of capital outflows in the wake of impending interest rate rises in the United States.

Office sector leasing demand in the BPO sector is the mainstay of Manila’s real estate market. According to one Philippines-based interviewee, “The real driver now is multinational companies that are taking five-, ten-, and 15-year leases. And they keep expanding, so the biggest challenge is keeping up with demand.” Vacancy rates remain at a low 3.4 percent, but although capital values rose almost 15 percent year-on-year in the first half of 2014, rental growth has been moderate, given copious new

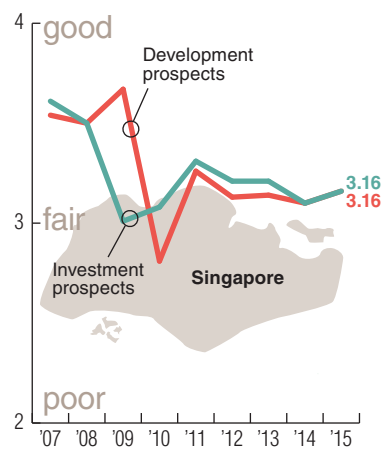


supply and the need to minimize costs to attract new business. Growth in the outsourcing industry has also created a multiplier effect leading to strong growth in other sectors, in particular retail and housing.

Although the Philippines is “no longer the sick man of Asia,” it is by no means an easy market for foreigners to target. In particular, there is no shortage of local capital and therefore limited demand for private equity investors. While some foreign players are active there, mainly in the form of sophisticated Singaporean- and Hong Kong-based investors and developers, regulations that restrict foreign ownership of land have dampened interest in development plays, and there remains ongoing concern about transparency and arbitrary bureaucratic conduct. Chronic shortcomings in local infrastructure also are a longstanding concern. Failure to get a REIT industry off the ground also has limited the attraction of the market for institutional investors. Still, economic prospects going forward appear to be strong, and should the next government (due in 2016) improve the regulatory environment for foreigners, there could be more opportunities for international money in the future.

Singapore (ninth in investment, ninth in development). The introduction in 2013 of stricter government cooling measures to curb a multiyear trend of price increases in Singapore’s residential markets was the trigger for a turn in sentiment that remains in place today. That has yet to be seen in terms of pricing and rents—except at the high end, residential prices have fallen only marginally from their peak in the third quarter of 2013, while on the office side, pricing has been static and rents have risen significantly as a result of supply shortages.

At the same time, however, transaction volumes have slumped in both residential and in particular big-ticket commercial transactions, as foreign



and international investors alike turn to foreign markets to look for deals. This is the reason why, in the words of a locally based finance expert, “in the first half of this year [i.e., 2014], Singapore was the biggest net exporter of capital in Asia.”

According to one local fund manager, “You are seeing this not only from traditional managers like ourselves, but from developers, too—there are so many restrictions now in Singapore, Hong Kong, and China that everyone is looking offshore for deals.” Although current prime cap rates in the area of 4 percent will probably rise somewhat as rents continue to increase, there seems to be little sign of a change in investor sentiment, given especially the recent comment from Singapore’s finance minister, Tharman Shanmugaratnam, that property curbs are unlikely to be eased until “a meaningful correction” has taken place.

Beijing (tenth in investment, 13th in development). If Shanghai has become the main target for foreign investors looking to get exposure to the China market, it is probably fair to say that Beijing has recently become the major focus for local institutional investors (in particular, domestic insurance companies) as they begin to build real estate portfolios. In addition, Beijing has until now proved to be a magnet for large domestic corporations seeking to set up national headquarters. As a



result, and even more so than Shanghai, the capital has shown an impressive ability in recent years to absorb large amounts of oversupply as they come to the market.

That probably explains why, unlike other cities in China, there is apparently little concern over Beijing’s full pipeline of new office supply, especially given that city-wide vacancy rates are currently the lowest in China at 3.5 percent. Given also the limited amounts of developable land remaining in the CBD, rents are likely to remain on a stable-to-upward trajectory.

The residential market also has shown reasonable resilience despite a steep decline in transaction volumes in 2014. With the government now seemingly intent on supporting the real estate sector rather than holding it back, volume picked up significantly going into the last quarter of the year. Most interviewees suggested that the market will begin a slow recovery over the next 12 to 18 months.

If there is a downside in Beijing, it lies in the worsening air pollution situation, which is deterring both foreign companies and wealthy Chinese from moving to the city and has depressed luxury residential rents to just 70 percent of the level of equivalent properties in Shanghai. This is certainly another rea-

son Beijing continues to lag Shanghai as a target for foreign real estate investors.

Mumbai (11th in investment, 11th in development). Sentiment toward India has picked up significantly this year, mainly as a result of the election of a new government. This has created expectations among local businesses of an improved domestic economy and hope among foreign investors that they will be able to operate on a more-level playing field than in previous years. Mumbai's position is therefore much improved from its last-place position in 2014.

On the ground, the situation in Mumbai is largely unchanged. Office prices remain stable. Rents have been stagnant for several years, but are now showing signs of inching up as local businesses become interested in rolling out expansion plans. Given the lack of interest among developers in recent years in building new projects, expectations exist that vacancies (currently standing at around 20 percent in Mumbai) will fall and prices and rents will rise, especially for high-quality, well-located premises.

Overall, while markets have yet to move significantly since the elections, there is clearly a more positive vibe than in previous years and an expectation that fundamentals will improve. As one local investor put it: "Since 2005, which is when the government first allowed foreign direct investment into India, I don't

think we've seen a single year where so many things have changed at the macro level and so many tailwinds have been created in favor of Indian real estate."

Kuala Lumpur (12th in investment, 12th in development). Big price rises in local residential markets over the last several years led the Malaysian government in 2013 and early 2014 to roll out market-cooling measures similar to those seen in other Asian countries. These imposed a 30 percent tax on net gains on properties sold within three years for both local and foreign purchasers. While demand remains strong, therefore, the rules have dampened buying. Builders are deferring launches, although prices remain largely unaffected.

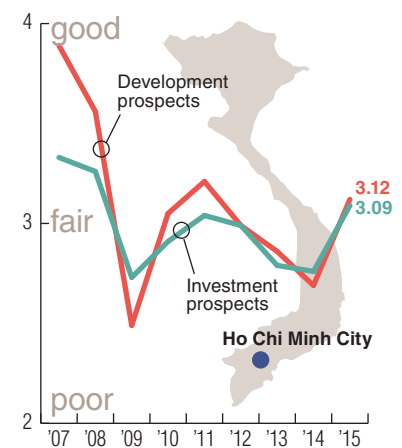
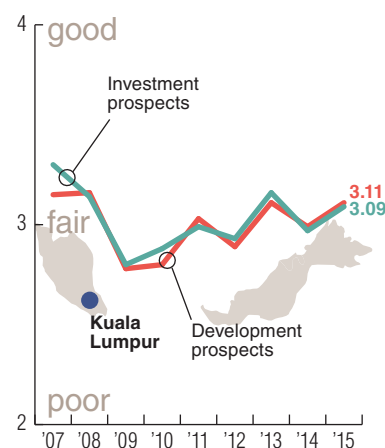
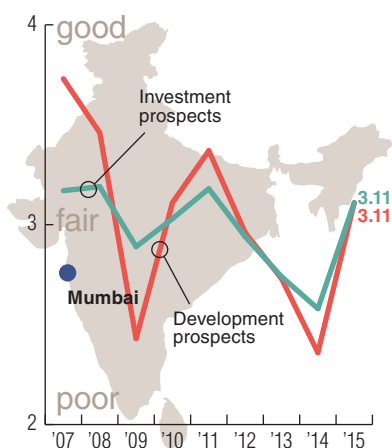
On the office side, Kuala Lumpur has seen a huge increase in new stock over the last few years, which the market has struggled to absorb. Although vacancies had declined to a more manageable 13.8 percent in mid-2014, according to Jones Lang LaSalle, new supply continues to arrive, despite the fact that some developers have again deferred projects. However, capital prices are expected to rise over the medium term, given limited amounts of office stock available for sale.

Chinese developers have been very active in Malaysia over the last year, in particular in Johor Bahru, near the border with Singapore. Land prices

are lower in Malaysia than in most other Asian countries, while Chinese political disputes with Vietnam and the Philippines have ruled out for now any serious moves into those markets. The developers see Johor Bahru as a satellite for Singapore in the same way that Shenzhen provides services for Hong Kong.

Ho Chi Minh City (13th in investment, tenth in development). In addition—and perhaps more important—it reflects hope that the country's banking system will soon be able to digest huge volumes of bad debt created by years of inadequate risk controls, enabling it to resume lending to both consumers and local developers.

Given the limited scale of Vietnam's investment-grade office and retail sectors, the main opportunity in Vietnam today is ground-up development of residential projects, described by one investor as a "good medium- and long-term strategy because of population and urbanization growth—it's the same as in China." He continued: "You can do quite well in mixed-use commercial, too, but not the giant high-end projects, because in retail you have to target the Vietnamese who want affordable products—there's too much high-end retail that's come in here in the last couple of years, and it's really starting to struggle." Industrial parks and logistics depots also have been popular plays recently, especially among Japanese,



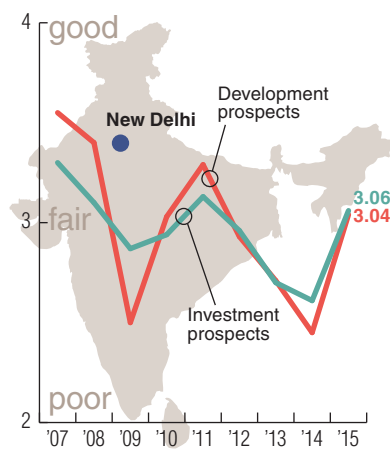
Taiwanese, and South Korean investors who favor an alternative to existing facilities in China.

Still, while Vietnam remains an interesting destination for foreign developers, the difficulty in getting money into the market remains. This is not only because of low transparency and excess bureaucracy, but also because there just aren't many assets available to buy. As one investor said: "These are small real estate markets—your total investable real estate in all of Vietnam is smaller than one subsector of Hong Kong."

New Delhi (14th in investment, 15th in development). Residential development has historically been an important focus for real estate investors in the three zones that make up the National Capital Region (NCR). Demand stagnated in 2013, however, and is only beginning to recover. According to one interviewee, "In mid-market residential we can see a pickup visually, so 12 to 18 months down the line there should be a strong recovery in that segment. But upmarket residential NCR will continue to suffer for at least the next 12 to 24 months."

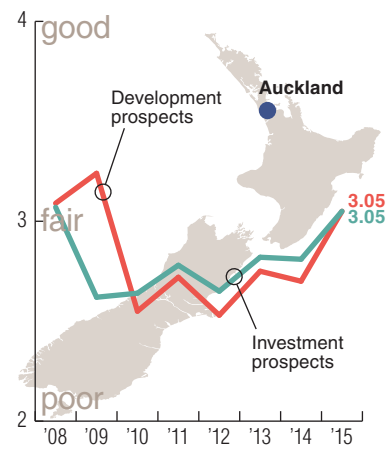
Meanwhile, leasing activity in the office sectors of the NCR has enjoyed a rebound since the 2014 national elections. Although overall vacancy rates in the NCR remain high, one Delhi-based interviewee spoke of an upcoming supply/demand mismatch for office and commercial space generally in the area. With developers slow to address this, he expected to see new demand arriving in 2015 but little product to satisfy it. As a result, "from a private equity investment perspective, development of corporate office space would be an important trend over the next 12 months."

Another area that may provide interesting investment opportunities is the Delhi-Mumbai Industrial Corridor (DMIC), a state-sponsored industrial development project spanning six states



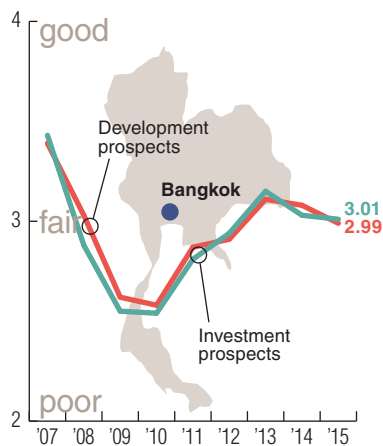
between the two cities. Because the DMIC was initially sponsored about a decade ago by the newly elected Bharatiya Janata Party, it is now expected to enjoy more backing. With the Japanese government as a co-sponsor, the idea is to create a series of "smart cities" focused on large-scale manufacturing across several major industries supported by modern logistics facilities. The government is therefore "very actively encouraging foreign investment into manufacturing," according to a consultant familiar with the project.

Auckland (15th in investment, 14th in development). Prime office yields in Auckland have historically been high, and although they have compressed more than 100 basis points since mid-2013, they remain in the area of 7 percent, according to CBRE. Offshore investors—principally Singaporeans—are active in New Zealand just as they are in Australia, with interest mostly directed at office and retail assets in the CBD. But with prices of prime properties having climbed steeply over the last three years, many offshore investors are now targeting B-grade properties. New supply remains minimal for the time being, so rentals are rising strongly and development opportunities exist for building new stock. Chinese investors have also been actively buying land on the outskirts of the city for residential development.



On the residential side, New Zealand in general and Auckland in particular have seen steep price increases in recent years, with Auckland now rated as the seventh-most-unaffordable housing market among 85 markets globally, just after Sydney and Melbourne. This resulted in the New Zealand government introducing market-cooling measures in October 2013 requiring banks to increase their loan-to-value (LTV) borrowing ratios for home purchases. With new supply expected to arrive following efforts by authorities to stimulate new homebuilding and four interest rate rises in 2014, house price inflation has now begun to ease.

Bangkok (16th in investment, 20th in development). Bangkok's fall in the rankings over the last two years is probably a result of investors' ambivalence toward the Thai market following a long period of political upheaval that ended with a military coup in May 2014. While military coups are not usually a sign of economic stability, in Thailand they occur with monotonous regularity and generally have little impact on day-to-day business. However, according to one fund manager active in Southeast Asia, Thailand's political theater has diverted investor interest to neighboring Indonesia instead because "there's then no need to explain what happens when there's another coup in Thailand to a board of directors in New York who



can't understand that's just the way things work."

In reality, Bangkok should feature higher up in the rankings given that strong recent growth in the economy and in the stock of investable assets means "it's the one that's graduating into the middle group, with a larger, more diversified property universe," as one investor said.

Appetite for residential land in Bangkok has recently increased dramatically, with prices up 18 percent year-on-year in the first half of 2014, according to Knight Frank. Condominium development is seen as the most profitable use of land in the city and represented most of the land transactions in Bangkok during the year.

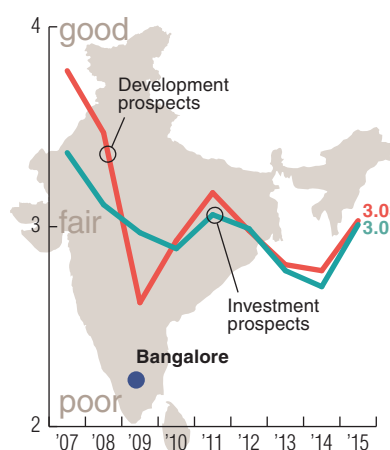
On the commercial side, both capital values and rentals have risen strongly since 2011 and show no signs of easing. Office vacancies stood at a reasonable 8.2 percent in mid-2014, according to Jones Lang LaSalle, and cap rates at 7.1 percent. Still, while the fundamentals remain strong, Thailand remains a difficult place to operate, with fairly low transparency and lots of bureaucracy. Regulatory restrictions on foreign ownership can be hard to navigate. As a result, many foreign investors targeting Thailand focus on the resort sector near the beach.

Bangalore (17th in investment, 16th in development). Business park facilities for multinational outsourcing

purposes have long been the dominant theme in Bangalore, with both rents and capital values increasing steadily over the last few years. New projects continue to appear, with completions of almost 1 million square meters expected by the end of 2014, according to Jones Lang LaSalle. Some areas remain more popular than others. In particular, the corridor along the outer ring road is attracting a lot of attention, including a substantial investment from a Middle Eastern sovereign wealth fund.

But the IT story is not the only one in town. Mid-market residential development has seen an ongoing success, even as residential markets elsewhere in India have faltered. According to one interviewee, "In 2014, Bangalore was perhaps one of those few markets in India where we've seen residential absorption numbers consistently maintained."

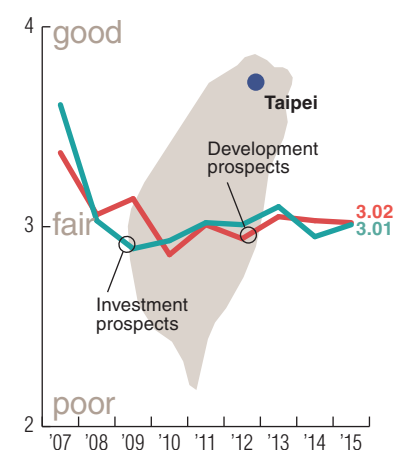
In addition, Bangalore's logistics facilities also have been thriving due to large volumes of online purchases made by tech-savvy workers staffing the city's many software and technology-related businesses. "Some of the large e-commerce firms have been building distribution centers because Bangalore continues to be their first target market. And that's also been visible in Mumbai and NCR, too—e-commerce has emerged as one of the large space occupiers not just for office space, but also for logistics and warehousing."



Taipei (18th in investment, 17th in development). High prices for both residential and commercial property in Taipei have made investors increasingly wary of buying local assets. Home prices have almost tripled in the last decade, for a number of reasons. To begin with, the government relaxed rules preventing locals from repatriating capital from mainland China. In addition, the central bank has cut interest rates, making mortgages cheaper and prompting a flood of money out of bank deposits and bonds into real estate. Finally, incoming capital from mainland China has been buying up local assets, much as it did in Hong Kong and Singapore, despite regulations meant to restrict investment from the mainland.

On the commercial side, prices have been rising steeply for several years, largely because domestic insurance companies until recently have had few places to invest their large base of accumulated assets other than domestic real estate. With commercial rents increasing only moderately over the same period, cap rates for prime properties in Taipei have compressed to just 2.1 percent to 2.3 percent.

High prices have now forced the government to act. On one hand, it has passed new laws that restrict Taiwanese insurance companies from investing in commercial properties. On the other, it has allowed them to invest their capital abroad. In addition, in May 2014 it



introduced further regulatory measures, consisting of higher capital gains taxes and holding costs aimed at reducing interest in using property as a long-term investment option. Further rules are expected over the near to medium term. As a result, prices have plateaued and transactions have fallen as buyers wait for the market to fall.

Shenzhen (19th in investment, 18th in development). Three of the bottom four cities in our survey rankings this year are in mainland China, reflecting a degree of negativity toward mainland investments as a result of a slump in the local residential sector, compressed cap rates, and chronic oversupply in almost all sectors across mainland China (although problems vary greatly from location to location).

Shenzhen's lowly ranking in this year's *Emerging Trends* survey contrasts with a more positive take on the city in a survey conducted for the *ULI Mainland China Cities Report*, released in the middle of 2014. While many of China's secondary and tertiary cities are facing serious issues, therefore, it is probably fair to say these are not felt to nearly the same degree in first-tier locations (with the exception of compressed cap rates). In reality, most interviewees indicated that market conditions in the biggest cities remain fairly positive, although transaction volumes are generally down from previous years.

In particular, Shenzhen saw the highest office rental growth in China (up 5.6 percent quarter-on-quarter) in the third quarter of 2014—a result of strong demand from companies flocking to set up a presence in the city's Qianhai economic zone. Historically, the city has suffered from a shortage of investment-grade assets, and with many buildings sold off strata title, foreign investor activity in the city has been limited. Ongoing development in Qianhai should therefore help the creation of a larger base of investment-grade assets.



Shenzhen's wider real estate markets are supported by a healthy economy and a relatively limited supply of land. Although the city has initiated work on a huge program of urban renewal projects involving redevelopment of old factory premises into modern office and residential facilities, these projects are more expensive than greenfield development, as well as being time-consuming to execute. They are therefore unlikely to have a direct or immediate impact on asset prices.

That said, however, a large pipeline of new office supply is being built in the Houhai area of the city that is set to arrive in 2015–2016. This is likely to have an impact on rentals until absorbed by the market.

Guangzhou (20th in investment, 19th in development). Guangzhou has seen a large volume of new office stock arrive on the market in recent years, with both a new financial center (the Guangzhou International Financial Town) and another new business area (Pearl River New Town) arriving in quick succession. The market has struggled to absorb all this incoming supply, especially as tenants are hesitating to commit to new space in a sluggish economy. Landlords have been actively preleasing upcoming office stock, offering discounts and other incentives, but rents in existing office buildings have now come under pressure. With more

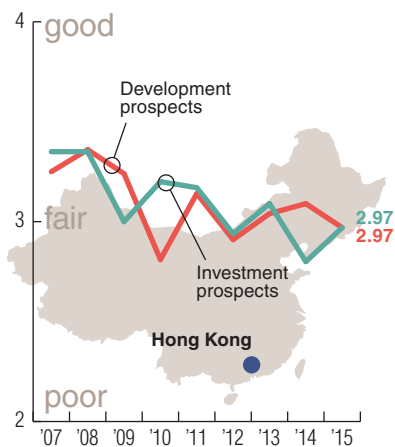


new office stock set to come to market in 2015 and 2016, this pattern seems set to continue.

Meanwhile, as economic growth in China has continued to lag, confidence among developers has declined. Although values in Guangzhou land auctions during the first quarter of 2014 hit record highs, the market cooled considerably in the following months, with nine failed auctions in June alone.

Residential prices in Guangzhou have been on a tear for many years, especially in downtown areas, where they have tripled since 2008. But although downbeat sentiment has had the effect of slowing transactions and arresting price increases, there seems to be little sign of a major reprise in pricing. The government has eased purchase restrictions and developers have offered (sometimes significant) discounts to shift stock, but the higher end of the market seems resilient to any major correction, as in China's other first-tier cities.

Hong Kong (21st in investment, 21st in development). Hong Kong's ranking has plunged in the last few years, falling from next-to-top in 2010 to next-to-bottom this year. Unsurprisingly, the general tone has been quite downbeat, and there have certainly been plenty of headlines that might appear to justify a negative take—last year's government cooling measures, some of Asia's



lowest yields (at 3 percent or under), impending interest rate rises, lower LTV mortgage lending, the slowing economy in China and lower retail spending by mainlanders.

That said, Hong Kong's markets have enjoyed a remarkable renaissance in the second half of 2014. Although the government measures initially had a big impact on transaction volumes, pricing in both the residential and commercial sectors proved largely immune to the downdraft. They rebounded strongly in the second half of the year, bringing both buyers and sellers into the market. On top of that, a general hesitancy among investors to place money in China this year has led to more interest in Hong Kong from those who see it as a proxy for buying in the mainland. As a result, there has been a significant increase in commercial (noncore) transactions in the third quarter, with Hong Kong ranking 16th by transaction value among global cities in the first nine months of the year, according to Jones Lang LaSalle. That's down from tenth for the same period in 2013, but hardly a disaster.

Hong Kong developers have been aggressively clearing stockpiles of unsold homes in 2014, with analysts projecting the highest level of sales since 2007. Over the next three years,

developers will bring some 74,000 homes to market, according to government projections, as they rush to complete new projects. This is viewed as a strategy to cut debt levels in preparation for renewed land purchases in the expectation of falling land prices. As one consultant said: "Ultimately, they see prices softening, driven largely by rises in interest rates, and there is always concern that government may intervene further to make it more difficult for people to borrow, particularly for investors."

China secondary cities (22nd in international, 22nd in development).

When China's secondary cities were first included in our survey two years ago, they received a respectable eighth-place ranking, reflecting the rising potential of less-traveled markets that were beginning to receive substantial investment flows as manufacturers migrated away from rising costs in first-tier cities. Both land and property costs were an order of magnitude cheaper than those available in cities such as Shanghai and Beijing.

Today, however, although second- and third-tier cities have successfully built up their local economies, real estate prospects have deteriorated rapidly after local governments sold too much land too quickly, resulting in oversupply in almost all sectors. With China's real estate markets already suffering from a slump in the residential sector caused largely by strict enforcement of government cooling regulations following the 2013 bull market, secondary cities now face a perfect storm. Liquidity has dried up, and many undercapitalized developers are suffering as they struggle to sell off properties to pay debts. With new product continuing to arrive on the market, many cities face years of oversupply, particularly of office and retail assets.



Cities such as Shenyang, Chongqing, Tianjin, and Chengdu, for example, have been particularly affected. Other cities have had fewer problems. In general, however, according to one consultant active in second-tier markets, "there are concerns about developer inventory—at the half-year stage [of 2014], most developers had sold about 40 percent of their annual target, and were hoping to make up the rest in the second half. We don't see that, we see inventory building up—inventory across the developers we were mapping is [currently] between 16 and 18 months."

Given that this problem is now nearer the beginning than the end, this is likely to create significant opportunities over the next 12 to 18 months for both foreign and domestic funds. According to one fund manager, "There is an opportunity potentially to provide rescue finance or some kind of private capital. But it's a little bit like catching the falling knife—you have to make sure you don't come in too early with your rescue finance because then you might need to be rescued yourself."

Property Types in Perspective

The most striking feature of our survey's buy/hold/sell ratings this year is the way they reflect a major shift in sentiment, with a much larger proportion of investors favoring hold and sell strategies as opposed to the buy strategies that were abundant in 2014. This most likely is a result of investors' wariness at ongoing cap-rate compression and the overall lack of competitiveness in many Asian markets compared with what are perceived to be better risk-adjusted returns in other parts of the world.

Industrial/Distribution: Investors Can't Get Enough

The logistics sector is the only property type that received near-universal endorsement in our interviews. Unsurprisingly, it also featured as the clear winner in our survey as both an investment prospect and a development prospect. The appeal of logistics assets is based on a number of factors.

First, modern logistics facilities are chronically underrepresented in almost all markets in Asia, and the cost savings

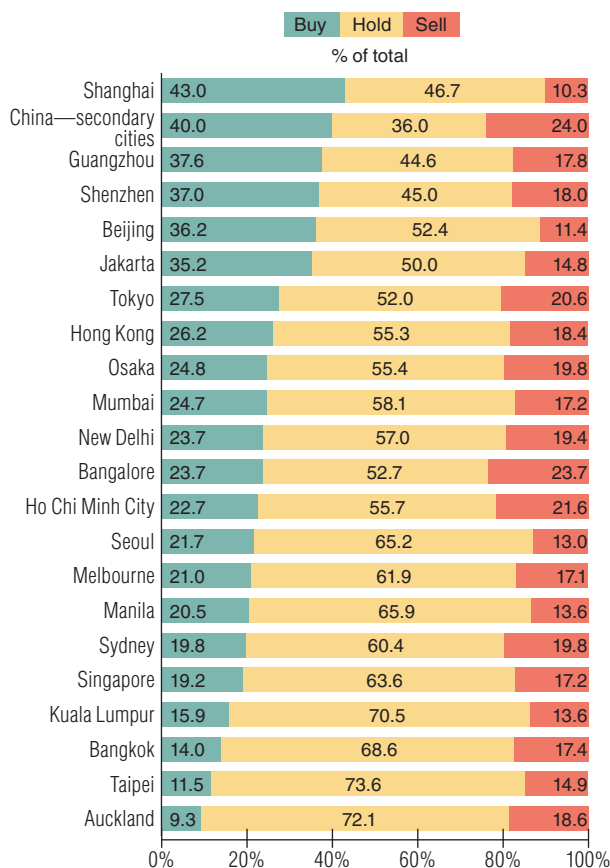
inherent in creating more-efficient networks is now universally accepted. Also, building logistics infrastructure is relatively straightforward (although only a few specialist players do it really well).

Second, the boom in Asian e-commerce sales over the last few years has not only underscored the seriousness of the shortages, but also required that altogether new networks be created—ones that face inward and can serve the domestic requirements of countries that traditionally have been focused on building distribution infrastructure to serve export markets.

Third, yields are more attractive than in other sectors, given how far cap rates have compressed. That said, logistics facilities also are now subject to tightening yields. In mature markets like Singapore and Japan, interviewees were talking about cap rates that had fallen to as low as 4.5 percent to 6 percent.

Best bets: China is the undisputed winner, with the five mainland destinations included in our survey occupying the top five spots. Its popularity is largely attributable to the reasons set out above. However, some interviewees had reservations about the logistics play in China, taking the view that if everyone likes it, there must be something wrong. As one investor said: "There is a herd mentality in the market. Two years ago, retail was hot and people jumped into it. Today, it's logistics. My sense is that in two or three years, we'll be talking about how pessimistic people are about logistics because of the overinvestment and overbuilding. Currently there may be a huge undersupply, but we're seeing a lot of domestic entrants into the market, and I think in a couple of years they're going to provide the same competition they're now providing in the office/retail/residential sectors—it's only a matter of time."

Exhibit 3-4 Industrial/Distribution Property Buy/Hold/Sell Recommendations, by City



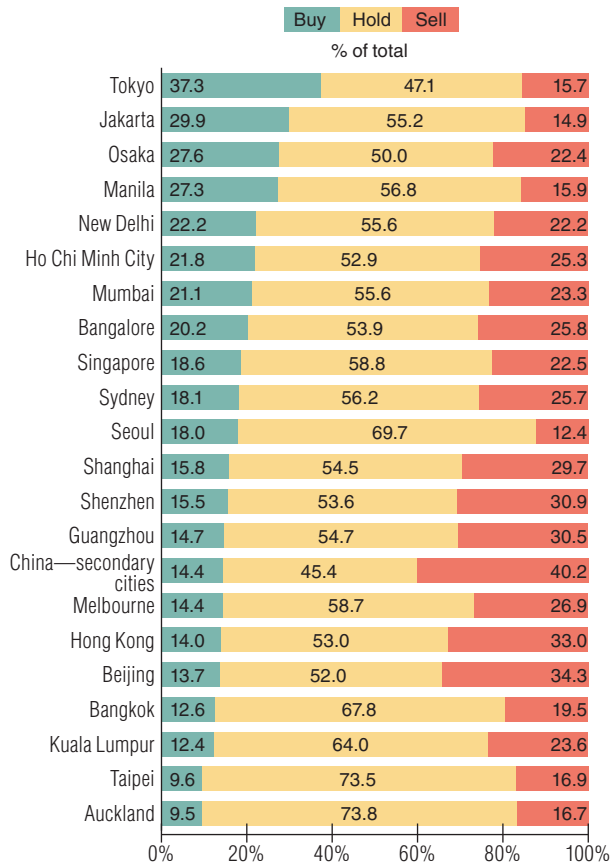
Source: Emerging Trends in Real Estate Asia Pacific 2015 survey.

Residential: Overheated

Asia's residential markets have plummeted in popularity in this year's survey after prices were bid up in many parts of the region to apparently unsustainable levels. The main catalyst for this has been—once again—the sheer volume of liquidity in circulation, resulting in ultra-low mortgage rates and a flight of capital out of bonds and banks and into hard assets. But with interest rates in the United States now seeming set to rise for the first time in more than five years, the path of least resistance may now be on the downside.

As a result, residential markets in many countries have now attracted the attention of regulators intent on bringing them down to earth. In particular, regulations are now in effect in Hong Kong, Singapore, Malaysia, Taiwan, New Zealand, and China (though these have now been temporarily lifted in most cities). Nonetheless, with interest rates remaining low and fundamental demand high, the impact has often been to depress transaction volumes without having a big impact on pricing.

Exhibit 3-5 Apartment Residential (Rental) Property Buy/Hold/Sell Recommendations, by City



Source: *Emerging Trends in Real Estate Asia Pacific 2015 survey.*

In at least one case—Hong Kong—both pricing and transactions have since rebounded, taking the market to new highs.

Best bets: Two types of markets remain in favor—those in Japan and those in emerging markets of Southeast Asia, in particular Indonesia and the Philippines. In fact, it is noteworthy that, apart from Japan, cities in emerging markets occupy all the top spots in this year’s residential buy/hold/sell ratings.

In Japan, to be fair, investors are looking favorably at just about all types of property. However, according to one local fund manager, “the supply/demand equation in the residential sector here is still very strong. People are still migrating to Tokyo and that’s going to continue, and you’ve got very limited supply, which will also continue because construction costs continue to rise. In fact, there have been some condo projects by large developers that have started construction and which have been stopped because construction costs have risen so far.”

In Southeast Asia, meanwhile, the key factors are a young demographic, booming economies, and a rapidly rising

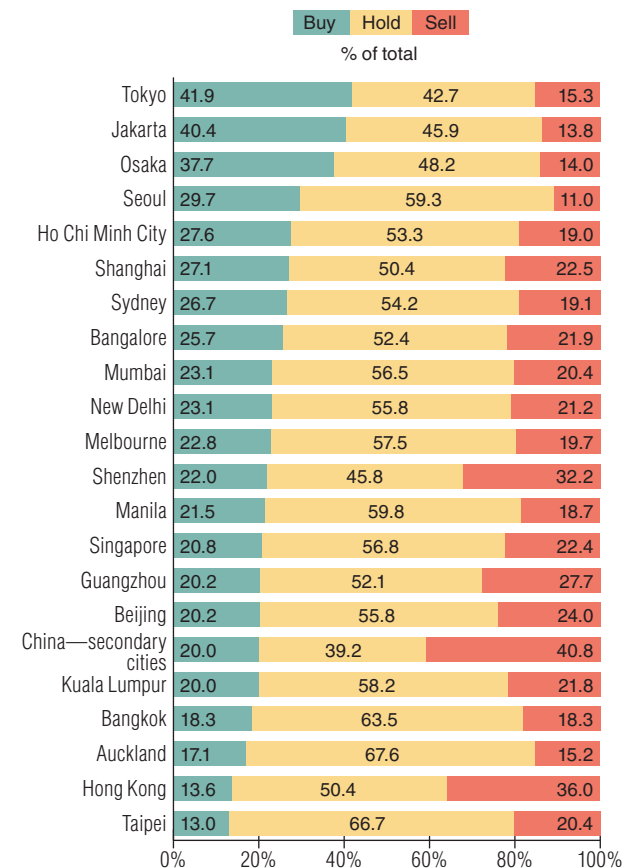
middle class whose members will be buyers of residential property simply because they can now afford it.

Office: Evergreen, but a Crowded Play

The office sector continues to be the go-to asset class of many investors in today’s market, partly because it is the most conservative property type in a market nobody trusts and partly because there are now so many institutional buyers in the mix that are traditionally looking for conservative investments.

The problem, as usual, is that there is more money available than there are assets to absorb it—at least at the top of the market, where most people are congregated. That has led to a situation where cap rates are now so tightly compressed (Australia being a notable exception) that it becomes difficult to underwrite still more compression in order to justify making the investment in the first place. One result of this, according to many interviewees, has been an increase in the popularity of forward-funded projects, which boost returns by taking on development risk. Given this, it is somewhat surprising (apart from in Australia, which is oversupplied with office assets) that

Exhibit 3-6 Office Property Buy/Hold/Sell Recommendations, by City



Source: *Emerging Trends in Real Estate Asia Pacific 2015 survey.*



development prospects for the office sector were not rated very highly in our survey.

Best bets: Tokyo emerges once again as the top pick in this sector, and it is certainly true that most investors active in Japan would like to put their money into prime office assets. In reality, however, competition from the local REITs in Tokyo makes this ambition very hard to realize. Most investors have therefore targeted B-grade office, or perhaps higher-quality offices in secondary locations, including other Japanese cities such as Osaka and Fukuoka.

The appearance of Jakarta high up in the table mirrors its rankings from the last two years. Although its popularity is probably predicated on very steep increases in capital gains for Jakarta office properties recently, investors should note the difficulties of operating in Indonesia and of even finding investable assets there. Seoul's high ranking also is worthy of note. With cap rates in the 5 percent range, Seoul may seem an unexciting destination, but it offers the dual benefits of a 200-basis-point spread over the risk-free rate and a deep and stable economy—two features that are increasingly hard to find in Asia today.

Retail: Off the Boil

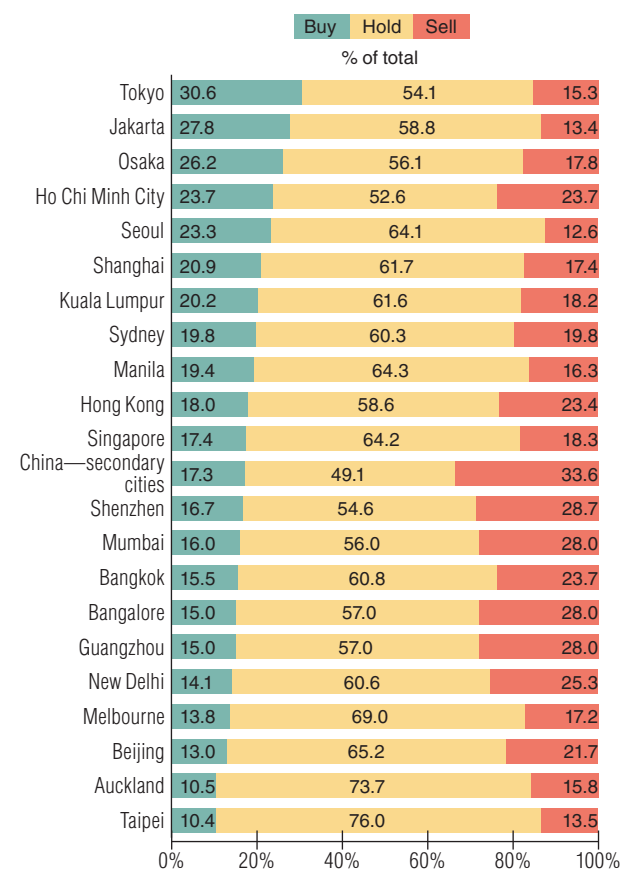
Investors have long been bullish about the retail sector in Asia. It is a surefire play based on the emergence of a growing middle class willing to brandish its newfound spending power. Nonetheless, retail's star—apart from the nondiscretionary sector—has dimmed recently across the region as it struggles with a number of issues. As a result, as one fund manager put it, “we still like retail, but on a relatively guarded basis.”

First is the problem of oversupply. Although one interviewee characterized the sector as “saturated” across the region, it is hard to make sweeping generalizations—different projects in the same city may have widely varying experiences depending on a number of intangibles.

In China, for instance, oversupply is certainly evident, especially in second- and third-tier cities. In addition, sales of high-end retail have been hit by a government crackdown on corruption (which has also affected retail sales in Hong Kong). Besides that, according to one interviewee, “the greater worry around retail is where a lot of centers have been built without any regard to how retail centers operate—there's no real planning or thought given to the organization of space.”

Another problem concerns the rapid emergence of e-commerce culture in Asia. Business-to-customer (B2C) sales in the Asia Pacific region are expected to reach US\$525.2 billion in 2014, according to internet analysts eMarketer, up 21 per-

Exhibit 3-7 Retail Property Buy/Hold/Sell Recommendations, by City



Source: *Emerging Trends in Real Estate Asia Pacific 2015* survey.

cent on the year and exceeding North American e-commerce sales for the first time. Some 60 percent of this total is spent in China, by far the fastest-growing market. Growth in internet sales means lower spending in brick-and-mortar stores. According to one investor, “A lot retail projects, especially in China, have been predicated on low base rents, and then turnover rents. Retailers are very happy with that, but if the selling is all online, and the shops are just showrooms, which is increasingly the case, your turnover rent disappears and you're left with completely uneconomic rentals.”

One result of this is that retail centers across the region are increasingly changing their mix toward food-and-beverage and lifestyle-oriented tenants as they seek to increase footfall. According to one India-based consultant, for example, “We are involved in planning a large mall project in the Noida region, and compared to the way we were looking at the product three years ago, we are clearly biased more toward F&B [food and beverage] and entertainment than we were.”

Best bets: The appearance of Japanese and Indonesian cities in the top three places is perhaps unsurprising given their high rankings in the other category types.

Vietnam is a more interesting pick in the number-four spot, and especially so given that the country is only just emerging from several years of economic and bank solvency problems. The vote is perhaps best seen as an indicator that Vietnam is once again on investors' radars, although in reality the retail sector suffers a number of issues. Although nondiscretionary retail or any facilities that target the mass market can do well, the luxury market is better avoided. As one local fund manager explained, "There's a bit too much high-end retail that's come in over the last couple of years, and it's really starting to struggle—the big retail malls that have been built in Hanoi with 200,000 square feet are far too big and high-end; they're going to be in trouble."

Meanwhile, Seoul's fifth-place ranking also comes as something of a surprise given that, according to one investor active there, "retail assets rarely trade—a lot of the retail assets have been strata titled, so they don't trade in an institutional form."

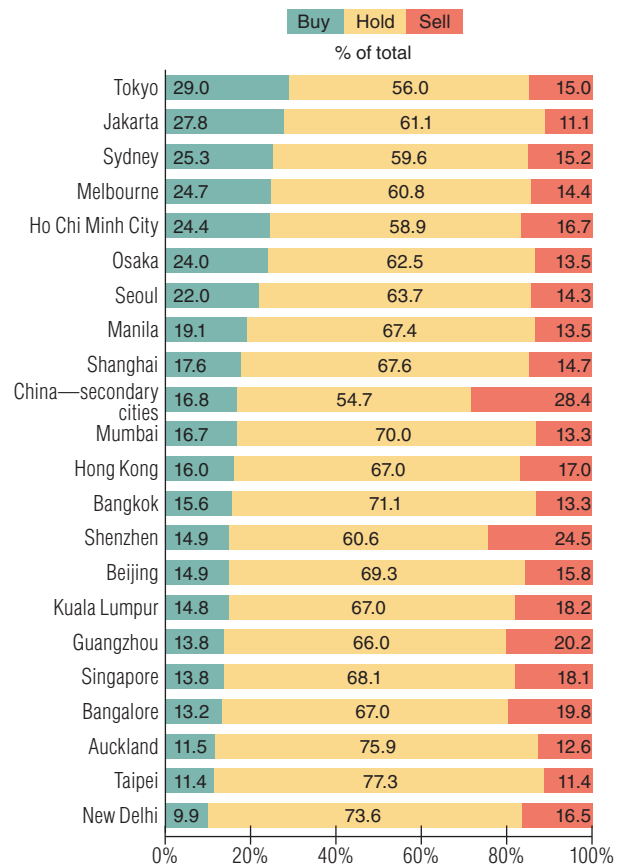
Hotels: Asian Tourism Booming

The hotel sector in Asia has enjoyed something of a revival this year after its last-place ranking in the 2013 survey. With hotel occupancy rates rising to more than 80 percent in major gateway cities, profits are increasing and interest from investors is rising. Although Asian hotels have traditionally been the domain of high-net-worth individuals and families, the emergence of a mid-tier hotel category in many Asian markets has followed the growth of regional low-cost airline industries that have opened up international tourism markets for more Asian (and especially Chinese) tourists. As a result, the hotel sector across Asia has become more accessible to institutions and private equity investors.

Best bets: Interviewees in Japan repeatedly mentioned positive prospects for hotels. According to one: "Supply is following demand and there is clear NOI [net operating income] growth. We have several thousand hotel rooms, and we've seen an increase in revenue per room of 25 percent." Another investor commented: "I love hotels, they're a very good investment. Tourism is the only thing working in Abe's so-called third arrow. The government is focused on the travel sector, and laws related to it will continue to deregulate it."

In Australia, "tourism seems to be on the up, and there's been a refocus by the federal government because the Japanese numbers dropped dramatically over the last decade and the Chinese have taken over. There is a good growth in Chinese visitation, which then says that we need to upgrade our tourism infrastructure." That will include casinos, several of which are now in the pipeline.

Exhibit 3-8 Hotel Property Buy/Hold/Sell Recommendations, by City



Source: *Emerging Trends in Real Estate Asia Pacific 2015 survey.*

Finally, Vietnam also is seeing big increases in Chinese tourism, partly because it is so close to China and partly because of the lure of a growing (though still small) domestic casino industry. As one locally based investor said, "Chinese tourism has really started to pick up in the last 12 months, they're filling the hotels up. There are also a couple of large gaming casinos, and there will be a number of new large ones in the next three, four, five years."

Interviewees

360 Capital

Tony Pitt

AD Investment Management Co., Ltd.

Kenji Kousaka

AEW

David H. Schaefer

Altis Property Partners

Alastair Wright

AMP Capital

Andrew Bird

Tim Jarvis

Angelo, Gordon International LLC

Jon Tanaka

Aoyama Realty Advisors Inc.

Haruyuki Shinya

Apollo Global Real Estate Management Asia Pacific, Ltd.

Peter Succoso

Asia Pacific Real Estate Association

Peter Verwer

Asian Association for Investors in Non-listed Real Estate Vehicles (ANREV)

Alan Dalgeish

AXA Real Estate

Frank Khoo

AXA Real Estate Investment Managers Japan K.K.

Tetsuya Karasawa

BlackRock

Jack Chandler

Hamish McDonald

BlackRock Japan Co., Ltd.

Rio Minami

Blackstone

Stuart Grant

Brookfield Multiplex

Kurt Wilkinson

Cache Logistics Trust

Daniel Cerf

CBRE

Henry Chin

Rick Santos

CBRE Global Investors

Richard T.G. Price

CBRE Global Investors Japan K.K.

Tetsuya Fujita

CBRE New Zealand

Brent McGregor

Cbus Property

Adrian Pozzo

Challenger

Trent Alston

Challenger Financial Services Group

Trent Alston

CLSA Capital Partners

Wayne Spice

Colliers International

Nerida Conisbee

David Faulkner

Daiwa House Industry Co., Ltd.

Tetsuo Suzuki

Daiwa Real Estate Asset Management Co., Ltd.

Akira Yamanouchi

Deutsche Securities Inc.

Minxuan Hu

DEXUS Property Group

Ross Du Vernet

Diamond Realty Management Inc.

Takashi Tsuji

Fortress Investment Group (Japan) G.K.

Akio Yamashita

Forum Partners

Andrew Faulk

Franklin Templeton Real Estate Advisors

Glenn Uren

Fukuoka Realty Co., Ltd.

Estuo Matsuyuki

Yukitaka Ohara

Future Land Development Holdings, Ltd.

Xiaoping Lv

GE Capital Real Estate

Jason Kougelis

Francois Trausch

Genkai Capital Management Co., Ltd.

Masatoshi Matsuo

GenReal Property Advisers

Anckur Srivastava

GLP Japan Advisors Inc.

Masato Miki

Goldman Sachs Asset Management Co., Ltd.

Hiroyasu Kaizuka

Goodman

Anthony Rozic

The GPT Group

Mark Fookes

GreenOak Investment Management K.K.

Fred Schmidt

Grosvenor Ltd. Japan Branch

Koshiro Hiroi

The GPT Group

Mark Fookes

Halifax Asset Management

Alec Menikoff

Invesco Asset Management Australia

Ian Schilling

Invesco Global Real Estate Asia Pacific, Inc. Japan Branch

Ryukichi Nakata

Investa Property Group

Jonathan Callaghan

Campbell Hanan

Jones Lang LaSalle

Richard Fennell

Christopher J. Fossick

Alistair Meadows

J.P. Morgan

Craig Smith

Kenedix Inc.

Masahiko Tajima

KKR

Bryan Southergill

Landsea Group Co., Ltd.

Ming Tian

LaSalle Investment Management

Mark N. Gabbay

Paul Guest

Lend Lease

Tarun Gupta

Rod Leaver

LUCRF

David McCusker

Macquarie Group

Brett Robson

Markham Investments

James Markham

Marubeni Asset Management Co., Ltd.

Tetsuo Saida

Mercer

Padraig Brown

Mirvac

Susan Lloyd-Hurwitz

Mitsubishi Corp.—UBS Realty Inc.

Toru Tsuji

Mitsubishi Estate Co., Ltd.

Kazuhiko Arahata

Mitsubishi Jisho Investment

Advisors, Inc.

Masami Amano

Mitsubishi UFJ Trust and Banking Corporation

Yutaka Imai

Mitsui Fudosan Investment Advisors, Inc.

Ikuo Mori

Morgan Stanley

Chris Tynan

Mori Building

Hiroo Mori

Nippon ResCap Investors

Ken Fridley

Novion Property Group

Michael Gorman

ORIX Asset Management Corporation

Tetsuya Yamashita

ORIX Real Estate Corporation

Tetsuro Masuko

Pamfleet

Andrew Moore

Payce

Brian Bailison

Pramerica Real Estate Investors

Steve Bulloch

Professional Property Services Group

Nicholas Brooke

Property Council of Australia

Ken Morrison

**Prudential Real Estate Investors
(Japan) K.K.**

Morgan A. Laughlin

Samurai Capital Co., Ltd.

Ken Aoyama

Savills (Hong Kong) Limited

Frank Marriott

SCA Property Group

Anthony Mellowes

Mark Fleming

Secured Capital Investment Management

Naoya Nakata

Shinsei Bank, Ltd.

Tadashi Miyano

SIMCO

Neil Matthews

Springfield Land

David Henry

Standard Chartered Bank

Marc Bosnyak

Brian D. Chinappi

Starr International

Alison Cooke

Stockland

Jane Lloyd

Stockland Corporation Limited

Simon Shakesheff

TIAA Henderson Real Estate

Chris Reilly

Tishman Speyer

Ryan Botjer

**Touchstone Capital Management
Co., Ltd.**

Fred Uruma

**Tokio Marine Property Investment
Management Inc.**

Shinji Kawano

Tokyu Land Capital Management, Inc.

Hitoshi Maehara

UBS Australia

Grant McCasker

Unisuper

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**Victorian Funds Management
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Peter King

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Global Real Estate Leadership Team

K.K. So

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The mission of the Urban Land Institute is to provide leadership in the responsible use of land and in creating and sustaining thriving communities worldwide. ULI is committed to

- Bringing together leaders from across the fields of real estate and land use policy to exchange best practices and serve community needs;
- Fostering collaboration within and beyond ULI's membership through mentoring, dialogue, and problem solving;
- Exploring issues of urbanization, conservation, regeneration, land use, capital formation, and sustainable development;
- Advancing land use policies and design practices that respect the uniqueness of both built and natural environments;
- Sharing knowledge through education, applied research, publishing, and electronic media; and
- Sustaining a diverse global network of local practice and advisory efforts that address current and future challenges.

Established in 1936, the Institute today has more than 33,000 members worldwide, representing the entire spectrum of the land use and development disciplines. ULI relies heavily on the experience of its members. It is through member involvement and information resources that ULI has been able to set standards of excellence in development practice. The Institute has long been recognized as one of the world's most respected and widely quoted sources of objective information on urban planning, growth, and development.

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