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Emerging trends in Real Estate
A global view

Key themes for global investing in 2013.

June 2013

pwc

A global view

New York

Emerging Trends described the amount of foreign capital in the city last year as "breathtaking" and the early months of 2013 have proved no different. But new buyers are facing a competitive market and, as in London, will need to take more risk to get capital invested. Condominium development is likely to be popular for those seeking high-powered yields as demand for luxury apartments outstrips supply.

ETRE 2013 US ranking
2nd for investment and development

London

London remains the pre-eminent investment destination for safety-seeking global capital. Despite a competitive investment market and low office yields, valuations remain positive compared to bond rates; offices offer a spread of 218 basis points over 10-year government bonds. London's West End market is especially attractive, where capital values for offices increased 0.8% and total returns improved by 1.1% in March, according to consulting firm CBRE.

ETRE 2013 Europe ranking
3rd for investment and development

Munich

German cities scored highly in *Emerging Trends*' European top 10, a confidence re-enforced by almost $9bn of investment in the market since the survey was conducted. Offices and hotels have been a focus of investor's attention. Munich real estate is seen as a strong, liquid market for global capital and investors can find yields of up to 300 basis points over 10-year government bonds. Office rents increased 3.3% over the year to March 2013 .

ETRE 2013 Europe ranking
1st for investment and development

Tokyo

Tokyo's office market is recovering after three years of decline. Landlords reported rental increases in central wards of 13% in the last quarter of 2012, positive news that's anticipated to continue. The market is performing well against 10-year government bonds; spreads are around 353 basis points – making real estate an attractive option for investors.

ETRE2013 ranking
2nd best office location

San Francisco

This US city topped the league table in *Emerging Trends* on account of growth and a strong jobs outlook. Retail space was identified as a good buy, as well as apartments. But in recent weeks, San Francisco registered a 40 basis point decline in vacancy. First quarter transactions showed foreign investors to be net sellers in favour of select secondary markets such as Houston, Seattle, Phoenix and Hawaii.

ETRE 2013 US ranking
1st for investment and development

Jakarta

A robust Indonesian economy is boosting business and consumer confidence. *Emerging Trends* interviewees rated the city as the top destination in Asia Pacific for 2013; a prediction that has been borne out during the first quarter of the year as rental increases continue. Central Business District (CBD) office development is an attractive investment at present; demand for prime offices from banks and international companies are rising.

ETRE 2013 Asia Pacific ranking
1st for investment and development

Sydney

Australia received about half of all real estate capital placed by funds in Asia in 2012, according to consulting firm CBRE. Wide yield spreads combined with divestment by institutional and international sellers are big draws. The prognosis for 2013 is also positive; interest rates, cut to record lows, are likely to help drive yield compression in its real estate markets.

ETRE 2013 Asia Pacific ranking
4th for investment and development

Confidence Monitor

Ever since the collapse of Lehman Brothers, businesses around the globe have been focused on survival. But this year's Emerging Trends 2013 showed confidence is returning. Here's how interviewees' expectations for the months ahead shaped up

U.S. & Canada

Then*

"Interviewees seem to [have] come to terms with the market's 'muddling-along pace,' expressing 'cautious optimism' while abandoning hopes for 'a big bounce.'"

Now**

"Investment volumes are on the rise in the United States, with the hotel sector seeing a particular resurgence. Multifamily housing also continues to outperform, accounting for 37% of all deals in Q1 to Q3 2012."

Asia

Then*

"On the one hand, sentiment in the region is fairly positive. At the same time, finding assets to buy at a price that reflects what is perceived to be a good risk-adjusted return is another matter altogether."

Now**

"Deal volumes (excluding Chinese land deals) are running at around the average since 2007 of $26bn per quarter. Within that, however, there has been a shift away from offices toward retail."

Europe

Then*

"Respondents are more at ease about the economic picture. Last year, interviewees were fearful to act, concerned Europe was on the "precipice of absolute implosion". But businesses now believe it's now important to focus on the day-to-day and to navigate the market as best they can."

Now**

"London attracted 30% of Asian exported capital in the first three quarters of 2012, up from the average of 25%. This could reflect the fact that heightened risk in the Eurozone has driven capital flows to the UK."

*Emerging Trends in Real Estate

**CBRE Global Investors, Global Vision, Q1 2013

Leader

The *Emerging Trends in Real Estate* reports - produced annually by PwC in association with the Urban Land Institute for the U.S, Europe and Asia Pacific - represents a crucial barometer of sentiment towards the outlook for real estate. It is based on hundreds of interviews with the most senior property professionals, and stands as the market leading insight into the industry across the globe.

Here, for the first time, we have drawn together those regional insights into one publication. The aim is to focus on the most relevant trends and investment opportunities for the benefit of those organisations with a truly global perspective.
As capital flows into real estate are forecast to reach $500bn by the year-end, it seems an appropriate moment to understand where that equity is heading, and why.

Global funds are most prominent in this surge in activity, and were the largest cross border purchasers in the first quarter of 2013. Increased investment has been recorded by Real Capital Analytics in Europe and the U.S during that time – rising by $15bn on the same quarter last year. But this growing interest and confidence presents new challenges to those seeking to access the worldwide market.

Many global investors remain focused on prime assets, but, in cities like London and New York, competition is fierce – particularly for core product. Which strategies, therefore, should investors now adopt to navigate both their target markets and those they may not have considered before?

This publication is an exploration of some of the ways investors are working today. As a truly global firm, our Real Estate team is the ideal partner to help ensure strategies are well designed and effectively executed in a joined up way; whether that is help with strategy, structuring acquisitions, finance, due diligence, legal, tax, reporting or cost mitigation.

I very much hope our insights will provide you with useful ideas. We are committed to help our clients to identify and take advantage of the market opportunities and look forward to the chance to explore these with you.

Finally, I would personally like to offer thanks to Jan Muysken, PwC's Global Sovereign Wealth Fund Leader and his team for their support in making this project possible.

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Briefing: strategy
Moving the needle

Across the globe, investors are inching along the risk spectrum. But where are the best opportunities?

Almost five years on from Lehman Brother's collapse, global institutional capital's confidence appears to be returning.

Higher risk strategies have returned or are being explored; value added vehicles have become the most sought-after fund type by private real estate investors and markets across the US and Asia are registering increasing investment volumes outside capital cities.

Almost half of investors in new funds are looking to commit to vehicles that follow an opportunistic strategy over 2013, according to Preqin. While, value added funds raised almost one fifth of the total capital secured by all closed-end private property funds last year.

This emerging trend follows a five-year focus on core assets and locations. But Andrew Moylan, Manager, Real Estate data for Preqin, says concerns over the pricing of prime assets, combined with improving performance of value added funds have boosted confidence. Value-added property investments are pro-cyclical investments, so they benefit from an economic recovery, however weak," says Monika Ward, Deputy Head of Research and Strategy at Axa Real Estate. "Typically, the tactic is to hold over a period of three to seven years, with leverage ranging between 40-70% loan to value and to target a net return of 10-14%."

Investment trends in the U.S. markets reflect that capital is being more exploratory. Alistair Meadows, Director of International Capital Group, Asia Pacific at Jones Lang LaSalle says Asian capital is "struggling" in New York and San Francisco because the returns don't hit required hurdle rates. "Investors have therefore started to focus on the second tier markets like Chicago, Houston, Seattle."

Spotlight: strategies for 2013

Europe

Interest in higher-risk assets or locations in the UK converted into deals during the first quarter as sales outside of London rose by 11% on the previous year to $1.3bn, according to LSH Research.

For large global investors, moving beyond safe cities and prime product is not easy. However, recent data suggests some of these gateway centres are offering good secondary opportunities.

Over the last eight months, yield spreads between prime and secondary in London have narrowed – from a 450 basis point gap in 2010 to 300 today, according to CBRE.

"It shows that, not only is appetite there for secondary stock, there' s debt available to buy it," says Joe Valente, head of research and strategy at JP Morgan.

DTZ is predicting improved fortunes for the UK's wider secondary property market too, where it foresees that increasing comfort with risk will lead to an improvement in values and capital growth for that market "outperforming prime" from 2015.

On the continent, the picture is different. Pricing of secondary assets has not yet adjusted enough. "In many markets, secondary property needs to de-price by a further 10-20%. This will take a while to work through," says Monika Ward.

+11%

$1.3bn

Sales outside of London rose during the first quarter on the previous year

Second-tier locations ranked highly in this year's Emerging Trends, including Jakarta, Kuala Lumpur and China's secondary cities.
Alistair Meadows, Jones Lang LaSalle

Spotlight: strategies for 2013

Asia Pacific:
Second-tier locations ranked highly in this year's *Emerging Trends*, including Jakarta, Kuala Lumpur and China's secondary cities, as investors hunt for opportunistic returns.

The confidence in value added strategies is reflected in Preqin's latest data. One hundred and eight funds based in Asia Pacific have an interest in value added vehicles, particularly those that are investing in Asia. Almost half (41%) of those institutions were superannuation schemes based in Australia.

"The long-term nature of value added property funds complements the long term investment horizon of a typical superannuation scheme," it said.

Emerging markets such as Taiwan and India all experienced strong growth rates in 2012, according to DTZ.

"The majority of investors expect positive returns of between 0-9% across all regions [globally]. This is more skewed towards higher returns across North America and in particular Asia Pacific where 42% of respondents expect returns of between 10 and 19%," says Kate Barrow, DTZ Head of Asia Pacific forecasting.

Expansion tactics: Oxford Properties Group

Europe

Investors on a European expansion trail tend to follow a traditional journey - beginning in London, then to the continent, without stopping at regional markets along the way.

But when Canada's Oxford Properties purchased Reading's Green Park for around £400m in November 2011, it showed it was determined to be original in its approach.

The investment in the out of town business park – Oxford Properties' first investment outside London since entering Europe five years ago - required active management over the 1.4m sq ft of space, a large proportion of which was unoccupied for a decade.

The real estate arm of the OMERS Worldwide Group - which is developing London's Leadenhall Building in a joint venture with British Land and St James' Market with the Crown Estate – purchased the business park as a complement to its Central London portfolio.

Oxford Properties believe the Thames Valley – which describes the counties and towns between Oxfordshire and London – delivers a "middle way" for overseas investors seeking to secure yield advantage while minimising increases in risk. The figures support this; data shows vacancy in this region is 16%, with prime space at 4.3%.

Paul Brundage, Executive Vice President, Senior Managing Director, who opened the London office in 2008 says: "There is a different occupier profile in the Thames Valley. We were thoughtful about what the opportunities might be as opposed to just buying assets that came up for sale.

"The area has a higher income yield than London, an educated workforce and proximity to great transportation," he adds. Since acquiring the park, Oxford Properties has registered 21 leasing transactions at Green Park from IT, telecoms and pharmaceuticals firms, including the Cisco surrender and a 139,000 sq ft letting to Chinese telecoms company, Huawei.

But its investment in Reading does not necessarily herald the start of a wider European strategy; Brundage says Oxford firmly believes in having "boots on the ground" before investing in new markets, even core capital cities.

Diversified European portfolio strategies

- **German offices** Buy in fringe-CBD locations in Munich, Berlin, and Hamburg
- **Paris 20-District offices** A deferred cyclical play. Strategy based on the deterioration in tenant demand in the CBD having a geared negative impact and then a rapid recovery. Proposed entry at the end of 2014
- **Amsterdam office investment** Vacancy and economic risks are already starting to improve in the CBD
- **UK regional and South East prime office investment** takes advantage of demand rippling out from London and the stronger regional office markets
- **Italy and Spain** offer opportunities to buy as the markets rapidly-approach a cyclical market trough. This applies to both offices and shopping centres, but only at the prime end (quality and location)
- **Dublin office investment** is a recovery play as the market bottoms out from an historic low. Only buy the best-occupied properties in the CBD, given the high vacancy risks
- **A European logistics investment strategy** capitalises on the changing demands brought about through internet sales. Acquire smaller units in growing conurbations that will be supported by the rise in demand

Source: Axa Real Estate

Three emerging markets

1

Kuala Lumpur:
Industrial is Kuala Lumpur's best performing sector. It registered 7% of rental growth and 6% of capital value growth in 2012, according to Colliers International. The most active sectors are logistics and small and medium enterprises. Foreign firms, especially from Singapore, are meanwhile setting up operations in well-established industrial parks that have good infrastructure and connectivity.

2

Houston:
Houston's fast-expanding energy hub is attracting buyers seeking higher returns from U.S. property. Non-U.S. firms - including Allianz and Tel Aviv's Menorah Mivtachim Holdings - have acquired $2.83bn of offices in the past three years, according to Real Capital Analytics.

3

Chicago:
South Korean investors have been active buyers in Chicago, driven by their search for the high yields that New York offices can't offer. Investors from the country accounted for the second-largest volume of acquisitions in the city in 2012. In May, John Buck Co teamed up with a syndicate of South Korean investors to buy the high-rise office tower at 161 N. Clark Street for $348m.

Briefing: debt
Loan terms

Despite global interest in real estate lending, debt strategies require specialised skillsets, bringing together real estate, finance and fiduciary capability. Emma Huepfl a Principal at Laxfield Capital explains how to navigate the landscape

It seems there's never been a better time to be a lender in the commercial real estate market, and a wide range of international investors continue to examine the opportunity.

Latest data demonstrates interest in debt is increasing. Globally, 34% of investors are now looking to allocate capital to debt funds, compared to just 8% in 2011, according to Preqin.

This interest is heavily focused on Europe, but is most apparent in the UK, where a combination of higher margins, greater transaction volume and ease of execution, make it a natural first step for new European commercial real estate mortgage investors.

But converting interest into deals is not straightforward. Much of the new capital targeting the UK has fixed rate and longer duration requirements of between five and 20 years. The standard bank market, by contrast, was based around five-year floating rate loans with interest rate risk hedged via swaps.

Market take up of new capital has been slow because many borrowers consider fixed rate - with yield maintenance provisions - a trading encumbrance.

Another barrier is route to entry. The most successful new entrants have been established overseas lenders such as the US life companies with a specific allocation to private debt. These investors are transferring proven lending skills from an existing platform, often with the help of local intermediaries or a local team.

Slower to capitalise have been institutions without recent lending experience. Setting up a team, a strategy, a credit process and gaining credibility in the market is a time consuming, expensive process.

Allocating capital to a professional manager is an alternative route that has seen the creation of various debt vehicles and existing institutional investors setting up third party management vehicles.

The investor must then satisfy itself on the alignment, specialised capabilities, allocation and diversification strategies of its chosen partner. These are not straightforward decisions in a market that is at the early stages of development, where rating, benchmarking and performance analysis is lacking and market data on lending is limited and difficult to prove for accuracy.

What's on offer?

Opportunities for private debt investors start with core real estate lending where loan assets are backed by large real estate investments with predictable, often rated income streams. European banks rarely compete for the very large financing requirements of these sorts of assets.

Mortgage providers who can fund amounts of £100m or more and have an appetite to hold these investments are better positioned to take this business. All in yields for these core loans (margin priced over 5 or 10 year gilts or swaps) currently trade at between 3 and 4%.

For more modest appetites, there is a middle ground of funding where individual loans vary from £10m to £75m and banks still form a substantial part of the market. Risk positions top out in the senior market at between 55 and 65%. Gaining market share in this area depends as much on deliverability as price competitiveness; those with a straightforward decision-making structure have much to gain.

Returns in the mid-market reflect the divided nature of the commercial real estate sector, where the gap between prime and secondary has spread to exceptionally wide levels. Funding for London offices in good locations, even with relatively short income streams is widely available – and even where the assets are transitional.

News in brief: Finance

Asia Pacific:
Attractive debt terms are continuing to support investment volumes in the Asia Pacific region, with all in costs for a prime borrower in markets now as low as 1.5% in Japan and 2.5% in Hong Kong and Taiwan.

Paul Guest, Head of Research and Strategy at LaSalle Investment Management says: "Debt is readily available in Japan and banks are competing quite aggressively."

But Guest adds that Japanese banks are also increasingly releasing assets where interest is not being serviced and value is being eroded. "This is an opportunity for value added investors to return and pick up properties; the majority of buyers coming back to Japan are not focused on these assets and are looking for core instead."

Interest rates have also fallen sharply in Australia, with the Reserve Bank of Australia cutting interest rates to a record low of 2.75% in May. "The reduction has made REITs more competitive," says Alistair Meadows, Director, International Capital Group Asia Pacific, Jones Lang LaSalle.

UBS reported in March that domestic banks in the region remain well positioned to administer further credit support. "Even in China, where the government has imposed a lending embargo, domestic banks have been subsequently allowed to resume their credit expansion," it said.

United States:
The US real estate finance market may be returning to health but institutions remain committed to vehicles focussed on debt.

As CMBS issuance hit $48bn in late 2012, Prudential Real Estate Investors raised $805m of discretionary capital for a US-focussed debt fund.

The firm expects "$1.8trn in mortgage loans coming due over the next several years as property owners search for reliable and trusted sources of capital."

Oaktree Capital Group also kicked off the year with fundraising for a vehicle aimed at $3bn that will seek to take control of companies through the purchase of loans and equity stakes, primarily in the US.

As *Emerging Trends* 2013 predicted: "Recapitalizing well-leased, good-quality assets, owned by overleveraged borrowers, who are upside down financially [are good investment bets]. This ongoing 'feast of opportunities' has plenty of legs because banks continue to engage in 'extend and pretend' loan strategies as more mortgages reach their maturities.

'"Lots of real estate has income-generation potential but has been compromised by distressed capital structures.' 'Look for distressed borrowers, not distressed properties.' 'Mezzanine debt and preferred equity positions will offer particularly good risk-adjusted returns.'"

"Debt is quite freely available in Japan and banks are competing quite aggressively"

U.S. investors, driven to seek investments in the UK by yield compression in their own mortgage market, are likely to continue to increase their presence.

By contrast, lenders are largely avoiding regional offices or retail (except the very best), and trading volumes indicate that a margin premium of 100-200 basis points does not yet offset the negative sentiment and refinancing risk around these sorts of assets. Yields on these mortgages also vary markedly depending on the sponsor quality.

The distressed and secondary loan markets offer higher yield, but suit only those with risk appetite and real estate capability. Large portfolio sales from banks attract many bids and suit specialised investors with large resources for analysis and the management teams required for detailed documentation analysis and asset strategy.

A disparate range of funding has targeted the mezzanine sector, raised through funds, public issues and via direct allocations. Target returns in excess of 10% do not make this natural funding for a well-capitalised investor buying secure, well-let assets. So investors need to be positioned to deal with exit risk and have a strategy for working with, or replacing the existing management if the equity position is heavily eroded.

Debt - the next chapter:

There were two fixed rate lenders in Europe in 2007. But there are now more than ten. Despite this, overall lending volumes were lower in 2012 than in 2011.

There is a bottleneck around the entry point for new investors seeking conservative prime assets to gain traction and experience. Margin compression has been significant as new entrants price first deals to win business. This is slowing new lenders, as they must compete with lenders who have proven execution skills and are targeting well-capitalised investors with access to a wide range of financing relationships.

US investors, driven to seek investments in the UK by yield compression in their own mortgage market, are likely to continue to increase their presence, subject to deal opportunities and continued yield uplift.

More European institutions that have expressed an interest should undertake deals, creating a further pool of liquidity. Asian capital, particularly from low yielding markets, is showing strong interest. Like the global equity pool targeting London assets, the range of debt investors circling the UK market is extraordinarily wide.

How to create a successful debt product

1 Be realistic and patient; the market is adjusting carefully and investments are slow to book

2 Expect caution from borrowers jaded by dealing with retreating lenders and the inadequacy of CMBS structures to deal decisively with problem loans

3 Expect scrutiny before take up. Ensure that the combination of new skills required - detailed knowledge of real estate, lending, and fiduciary capability - are all satisfactorily represented in your platform.

4 Avoid the pay structures that rewarded origination over long-term performance

5 Be prepared to shift strategy as pricing changes and opportunities develop. This needs to be a multi-year strategy with flexibility around returns that allow you to be patient in a thin market and act quickly when transaction levels rise.

Laxfield Capital is a commercial mortgage investment management business. Clients include leading global investors, US Life Companies and European Banks. It recently announced the Laxfield Lending Programme with initial capital from GIC.

Analysis: markets
Going local

Emerging Trends reported that thinking "micro" is a growing trend. But how do those with global strategies master local opportunities?

"Capital seeking European real estate is becoming ever more global in nature, but also more local within key markets as it seeks safety and growth."

Emerging Trends' description of the ambitions of global capital looks evermore prescient as 2013 nears the halfway mark.

Overseas investment in property seemed set to top levels seen in 2012 by the first quarter of the year. Outbound Chinese investment into real estate alone, according to Jones Lang LaSalle, could reach $5bn this year. While U.S. investors are, once again, seeking higher returns abroad, moving $2.6bn into funds targeting commercial real estate during the first quarter; the largest inflow since 2007.

Diversification and yield profiles preferable to those of stocks and bonds continue to make real estate an attractive asset class though for many looking at new markets, approaching them from a macro perspective may not be appropriate.

It's an approach especially crucial to finding returns in the mature European market, as *Emerging Trends* explains:

"Being the big wizards of the world is not the aim. We want to be better locally, build teams and expertise in specific places. It is a question of depth."

Joe Valente, Head of Research and Strategy at JP Morgan agrees that looking behind the macro picture is a crucial strategy in today's low growth environment: "When economies were growing, investors were buying assets just to be invested in a specific country. Now most aren't going to be rewarded for taking a macro position and relying on growth across the board."

This local thinking – which demands investors drill down to the granular details relating to the property itself - is a strategy being employed by JP Morgan. The firm is interested in residential property in Berlin and parts of the UK industrial market. But to establish which "micro" opportunities to pursue, the firm employs a dedicated team.

"You need asset management skills to generate value. We had a closed team that worked in the London office for five years and then set up offices in markets in Germany and France."

In the local markets in which it invests, the firm uses local partners, which aid them with planning, re-zoning issues and sourcing off market deals. "Most of our deals in the opportunistic space are organised this way," says Valente.

But a shift in the way fund managers are working with investor capital risks making it difficult to execute deals efficiently. Single asset management transactions and high levels of investor discretion may be at odds with the increasingly competitive nature of the investment market.

As Simon Marrison, Chief Executive Officer, Europe at LaSalle Investment Management explains: "The key for any new investor is getting to know and trust people with a local knowledge base; the biggest challenge is moving quickly enough when opportunities arise."

Partnerships: accessing local sources of capital

Teaming up with local operators is a tactic often used to source deals in new markets. But "localisation" is helping fund managers access new sources of capital that would be otherwise difficult to reach.

CBRE Global Investors has recently teamed up with an Italian firm to target Italian institutions as part of their plans to significantly increase their exposure to non-listed real estate funds.

It's a joint venture with fund manager Fabrica Immobiliare, which will set up co-branded Italian regulated property funds aimed at investors in that market, and eventually help take that capital abroad.

The move follows INREV research showing Italian institutions were set to increase current real estate allocations from $50bn to $64bn within three years.

While Fabrica will act as fund manager, it will introduce CBRE Global Investors to Italian institutional capital seeking to invest abroad.

"We haven't done anything like this before," explained Florencio Beccar, Country M anager at CBRE Global Investors. "Fabrica can help us prepare investor presentations and the team gave us insight into what institutions need. It has its finger on the pulse where these investors are concerned.

Beccar says the partnership will allow the firm to take capital around the globe; less than 1% of current allocations to real estate are outside Italy. "Italy has a large investor community, but one without great experience of investing abroad so we can help provide a global allocation.

"The fact that Fabrica was based in Rome, where many big pension funds are found, appealed to us. And through the partnership, we can swiftly access capital, rather than taking time to set up a new platform ourselves.

"This new trend within the investment community is developing fast and we wanted to position ourselves quickly."

"This new trend within the investment community is developing fast and we wanted to position ourselves quickly"

Florencio Beccar, Country Manager, CBRE Global Investors

Q&A

Routes into Asia

What's the best way for newcomers to get exposure?

If you're going into the market for the first time, it is best to be low risk. The easiest way is through the indirect route. We've seen UBS and Aviva running fund of funds to get exposure. REITs in Singapore or Japan have done well in last couple of years.

Are investors seeking direct deals too?

We've had conversations about that with European groups that are new to the region. But to establish from scratch is costly. Investors need to find a joint venture partner with an existing platform to undertake either a specific fund strategy or broader tie-up.

What strategies are best?

Pan-Asian strategies are difficult at the moment unless you have deep pockets. Specific markets and sectors are very in favour, so finding a focused operating partner is advisable.

How are investors approaching diversification?

Economic growth will be different across the region. So investors want to make sure they get exposure to that. Increasingly, investors are adopting combined strategies – investing in core markets in Australia and seeking opportunistic returns in China.

Alistair Meadows is Director, International Capital Group, Asia Pacific, Jones Lang LaSalle

Pan-Asian strategies are difficult at the moment

Alistair Meadows, Jones Lang LaSalle

Fresh capital flows

$10bn

State-run wealth funds from China to Norway made 38 property investments valued at almost $10bn in 2012, accounting for 21 percent of all sovereign fund investments last year.

$1.7bn

Azerbaijan's state oil fund has said it intends to allocate around $1.7bn property investment in cities including London, Paris and Southeast Asia.

$2.6bn

U.S. investors moved $2.6bn into mutual funds and exchange-traded funds that primarily invest commercial properties abroad during the first quarter of 2013.

$19.8bn

Taiwan insurers' real estate investment assets have grown by 13% a year in the past six years to $19.8bn.

Micro trends

London

- Investors like local economies such as the West End, a destination for growing numbers of TMT firms and international shoppers.
- The regeneration of King's Cross is widely seen as a success story, providing a new hub for creative industries.
- Investors are watching values in Stratford, where opportunities exist at the former Olympics site and surrounding areas.

Stockholm

- Sweden's population is expected to reach 10 million by 2018. This growth is prompting a $40bn investment in the city's infrastructure and strategic development.

Hamburg

- New mixed-use district Hafen City is expected to double the city centre population. Rental increases of 4 percent were recorded there over 2012.

Vienna

- Constrained city centre retail space is expanding and new shopping centres are emerging at rail stations. Retail warehouses are benefiting from improved-quality assets and demand from tenants previously focused on shopping centres.

Boston

- An increase in high-technology and biomedical R&D employment continues to take the lead, increasing investor interest in the Boston market.

Typical countries for regional funds to target would be Japan, China and Australia

Paul Guest, Head of Research, LaSalle Investment Management

Q&A

Investment trends: Asia Pacific

What are the key investment trends in Asia Pacific at present?
The region remains dominated by regional investors, while European and U.S. investors have been net divesting. Institutions previously not committed to real estate, or those that had low commitments, are seeking to increase exposure.

How do global investors see the region today?
Activity has been heavily focused on the U.S. because of its perceived value and on Europe due to its distressed opportunities. But over the last five years, Asia's share of the investment universe has risen to 30% and there are very few investors with that level of allocation to the region. If growth continues then being under-invested means you're going to underperform. Global funds are beginning to acknowledge that.

What are the current trends in non-listed funds?
In the last couple of years investors have sought sector specific vehicles and smaller funds had been more successful. Chinese logistics and Indian residential are popular areas of focus.

The benefit of sector specific funds is that investors have direct control and there is less chance of strategy drift. What has changed is there are more regional funds emerging. LaSalle has been raising capital for a regional fund. Typical countries for regional funds to target would be Japan, China and Australia.

Australia is seeing increasing investor interest. Why is that?
From a valuation perspective it is quite attractive. There's a lot of competition for core assets, while the wholesale funds are experiencing inflows so big domestic groups will be back buying. But we think the next step is a move up risk curve; that market is not very crowded at the moment.

What are the best opportunities?
LaSalle's top picks are neighbourhood retail – retail centres in good catchment areas focused on non-discretionary spend and good quality offices with smaller floor plates in or near to the Central Business Districts which need some management. Hotel development hasn't kept up with Australia's tourism market. There has been very little development of three and four star business hotels in main markets like Melbourne and Sydney.

What is the most exciting trend for the foreseeable future?
Historically Chinese insurance funds have not been able to buy property. But are now able to invest domestically. If they seek to invest between 5 and 10% of their assets in real estate, then that would mean $42bn of investment. That is 2.4 times the average annual turnover of the commercial real estate market in China. This could present a big opportunity for both domestic and international investors to team up with a major core buyer group that needs to invest in new product in china.

Paul Guest is Head of Research for LaSalle Investment Management

Analysis: markets
Swinging London

Emerging Trends 2013 reports a growing need for investors to consider how social trends are changing real estate. London is one city already seeing the transformation

Much of the global capital that's been buying London real estate in recent years has been pre-occupied with the prime, core markets.

As a safe and transparent city with a diverse occupier and investment base, London has attracted enthusiasm for its real estate assets from global investors in the European market. But in recent months, transactions have declined as competition rises and available stock depletes.

However, a quiet revolution has been underway in recent years that's helping reposition the city for long-term growth, creating increased opportunity for London investors.

An evolution of trends – from the rise of tech companies to sustainability - will widen the remit of opportunities for institutional, long-term capital. What is more, UK domestic institutions are busy creating the right product to deliver new types of properties to serve these trends.

Here, we explore some of the key trends shaping London's investment market.

Mobile and tech:
When Google signed up for a 999-year lease on 1m sq ft of space at London's King's Cross, it showed London was well on the way to re-inventing itself in the wake of the global financial crisis.

The telecommunications, media and technology (TMT) sector is now the tour de force in London's leasing market, as demand for computer equipment, online remote access, and cloud computing fuel growth.

The sector – which encompasses broadcasting, publishing, new media, advertising, marketing, PR, information technology, telecoms and media continued to grow its overall share of Central London office take-up last year according to Jones Lang LaSalle - which reported a 2% increase to 22% over 2012.

How long-term this demand may be is up for debate. But these occupiers are having a positive impact on rents and supply in the city's sub markets. While companies such as Derwent London and Canary Wharf Group are developing product to court this new class of occupier.

Advertising and media companies, which require close proximity to clients, as well as a thriving neighbourhood for its young workforce, are focused on districts such as Soho, Noho and Covent Garden. While areas such as King's Cross, Farringdon and Clerkenwell are also experiencing increasing activity.

David Marks, co founder of Brockton Capital, believes these firms present developers with a long term opportunities. "Google's letting proves that physical interaction is still important despite services such as Skype. Buildings are places for people to meet and exchange ideas.

"As fast as real estate can change, it is changing. TMT companies desire buildings that attract the best people, that make them happy and productive and which don't look old fashioned.

"Investors are buying warehouse buildings and making them attractive to this type of occupier in return for long leases. They're choosing these over glass and steel blocks let to a different tenant on each floor"

Student accommodation:
London's universities have become a focus of attention in recent months, as data shows the asset class to be the best performing asset in the UK property markets.

UK student housing funds have returned close to 12 per cent since the start of 2012, compared with 1.2 per cent for all property and 4.9 per cent for gilts, according to IPD. While numbers of international students coming to the UK universities is also on the rise.

US private equity group Carlyle is currently developing three student housing developments in central London. While in January, Legal & General Property agreed to forward fund a student accommodation scheme in Finsbury Park, north London.

Legal & General is backing the development, pre-let to the University of Arts London on a 25-year FRI (full repairing and insuring) lease from completion.

Bill Hughes, Managing Director at Legal & General Property, explains that there are "many opportunities" to develop and forward fund sites for the city's growing population of overseas students.

"This sector offers our funds the opportunity to invest in index-linked income on very long leases to strong covenants, while also providing relatively higher yields than the traditional real estate sectors. Our focus remains on funding quality developments that are backed by premium universities and located in first class locations."

LaSalle Investment Management is also focusing on this asset class in London, as well as other cities in the UK.

Simon Marrison, Chief Executive, Europe

Investors are buying warehouse buildings and making them attractive

David Marks, co founder of Brockton Capital

Connectivity to the internet and security are top priorities for occupiers

Simon Marrison, Chief Executive, Legal & General

for the firm says: "Our view is that there is still a shortage of this type of accommodation in the UK and a huge change in terms of what students, especially those from overseas, require.

"Connectivity to the internet and security are top priorities for occupiers.

"With student housing it's possible to get scale. But it's also important to team up with operators that can help piece together sites too," he adds.

Crossrail:

It's impossible to tell what Crossrail, one of the biggest infrastructure projects the city has seen, will bring to London's standing as a global city when it opens in 2018. But recent research puts the value of its impact on property at around $8.5bn.

Research conducted by GVA for Crossrail, said the value of commercial buildings near Crossrail stations would likely increase by 10% during the next decade, above already rising projections. Residential values near the stations are projected to increase by 25% in London and 20% in the suburbs.

Anticipating the uplift in values, Brockton Capital has recently invested £95m in the former Royal Mail sorting office on New Oxford Street. David Marks, co founder of the firm says; "The asset has been vacant for several years but its proximity to Crossrail means there will always be demand for that building."

"Understanding what a city needs in terms of space and price allows you to build the right space in the right place and at the right time," he adds.

London – the view from *Emerging Trends*

"We're looking at asset management initiatives] that seek to refurbish good assets with green credentials."

"Tech companies don't want to operate out of office towers; it's not cool."

"This is a workforce which has grown up with climate change; it wants responsible buildings that are edgy, too."

"They want local experiences, places that are individual and quirky. They aren't looking for globalised streetscapes."

"These [tech] firms will seek underspecified buildings that they can adapt to their needs... Outside, they look for buzzing neighbourhoods where clients can be entertained in hip bars or cafés."

"Sustainability is the only thing tenants want to talk about…We are designing room for bikes and doing everything else we can."

Spotlight Jakarta

Indonesia's economy is fast becoming one of the most exciting growth markets in the Asia Pacific region.

GDP growth of 6.4% is set to double the middle class population by 2020, from 74 million to 141 million. As a result of such positive socio-economic trends, Indonesia's capital city ranked as Asia Pacific's best investment destination in *Emerging Trends*.

But while a range of REITs, sovereign wealth funds and developers have doubled investment volumes from $150m to $350m in three years, placing capital remains difficult as domestic firms seek to retain assets in the rising market.

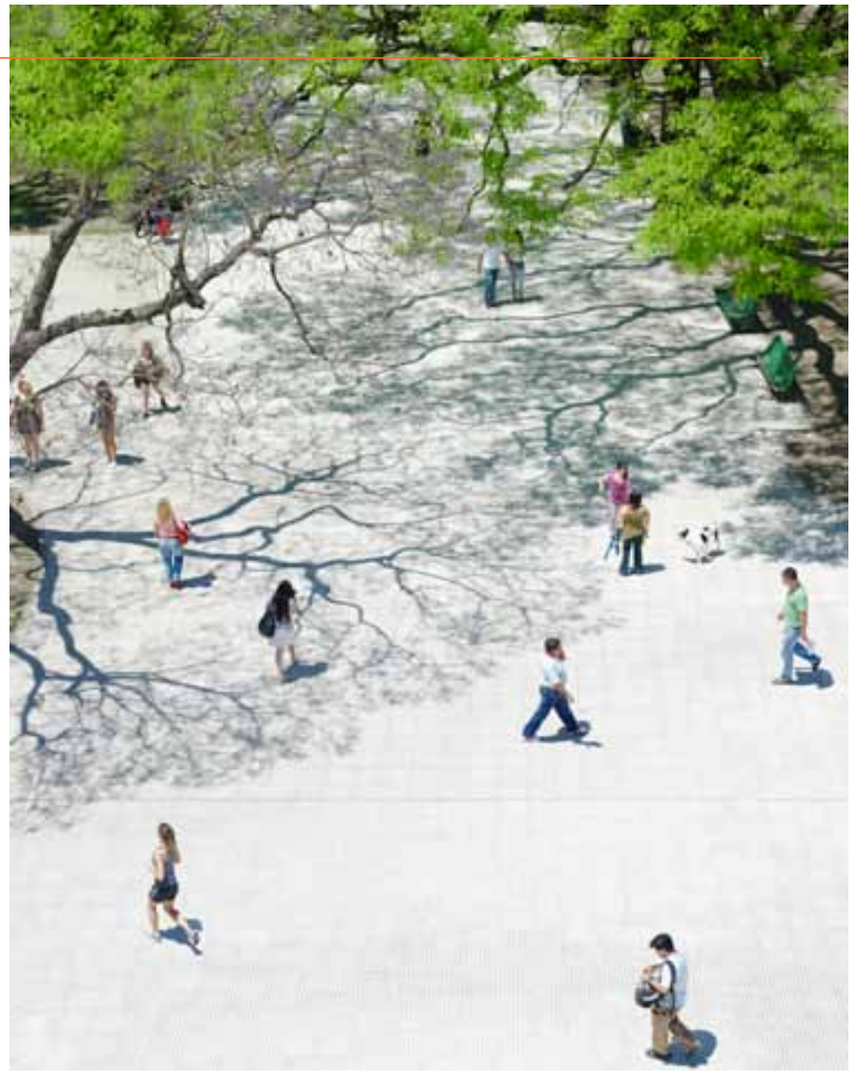
"Investors have been seeking a local Indonesian partner to develop or forward purchase an office development," explains Alistair Meadows, Director, International Capital Group, Asia Pacific, Jones Lang LaSalle.

"Domestic firms have strong balance sheets and no need for debt. So investors need to offer something other than capital, like development expertise or a corporate tenant relationship."

After offices, Indonesia's logistics sector currently offers best growth rates as regional manufacturers, especially from Japan, seek to locate facilities in the country. Industrial rents grew 18% in 2012, while capital values grew by 24.5%, according to Colliers International.

Viewpoint
Green link

Sustainability is rising up the agenda, and good relationships between landlord and occupier are vital to success



During the global financial crisis, *Emerging Trends* has reflected a range of attitudes towards key aspects of the market. But one theme that has continued to evolve over the past five years has been sustainability.

This year's reports revealed attitudes to "green" issues are becoming evermore central to investors and lenders in their decision-making processes. And it's a trend particularly evident in cities like London and New York, where change is being driven by the rising influence of technology, media and telecommunications firms in the leasing market.

The increasing emphasis on occupiers is being embraced at Legal & General Property, which is putting tenants at the centre of its asset management strategy.

This, it argues, enables the firm to deliver continual improvements in the environmental performance of buildings through the adoption of best practice.

But the firm - which has £10.6bn funds under management in the UK - believes "communication and dialogue" can be just as crucial to performance as the latest technologies.

As Debbie Hobbs, Sustainability Manager of Legal & General Property, explains: "On a daily basis, we are doing as much as we can with our tenants. It's embedded in everything we do and part of everyone's job. We recognise that, as owners of real estate, we are only one part of the solution."

To foster better dialogue with occupiers, the firm is creating an asset sustainability plan for every building in its portfolio (set to be in place by the end of 2013). The plan will enable asset managers to establish targets to improve sustainability on an annual basis. "This information will help us when talking to a building's agents, as well as set service budgets that will then be agreed with the occupier."

Legal & General's managing agents are also using handheld tools to record conversations with tenants to make sure issues and ideas are shared, especially with L&G's asset managers. Common questions an agent will ask the tenant are if it is prepared to share data, or if capital is an obstacle to improving aspects of their building.

"Sometimes occupiers have changes they would like to make but internally they can't get approval for them because there is no capital to fund it," says Hobbs. "But, for the right situations, we have access to cash to fund upgrades, such as replacing lighting, for instance. That could be the difference between a tenant re-signing a lease or not."

Improved dialogue has enabled the firm to offer occupiers advice around reducing energy usage in their units, or on how to more effectively recycle waste. It also puts forward standard Green Lease clauses in every lease to "provide an early introduction to sustainability and co-operation for occupiers".

"We discovered that lawyers would often strike out these clauses because they didn't understand them, even though the tenant had requested them. So we have found that better dialogue with tenants at all levels of the organisation is crucial in helping to avoid this," says Hobbs.

There is no doubt, she says, that sustainability impacts value and the firm now targets BREEAM 'Excellent' for all new development.

Bill Hughes, Managing Director of Legal & General Property, adds: "We firmly believe in the financial benefits of sustainability; it offers us more secure and longer-term income. Aside from the legislative drivers that are making it evermore important to plan ahead, the best occupiers are demanding green buildings.

"Indeed, we now see it as our fiduciary responsibility to go above and beyond property industry norms. We are thinking ahead in implementing sustainability initiatives across our portfolio, well in advance, to protect long term asset values and enhance our investors' returns."

Provide an early introduction to sustainability and co-operation for occupiers

Debbie Hobbs, sustainability manager, Legal & General Property

Data hub
Sectors

Real estate equities

Global property stocks returned almost 30% last year, beating the MSCI World Index by over nine percentage points. As they gain popularity with pension and endowment funds, Credit Suisse predicts further upside, given attractive dividend yields and near-zero interest rates. Its top regional pick was US REITs. But Emerging Trends identified other Australian and Singaporean REITs among its most attractive. In Europe - where returns were 29.5% last year - interviewees cited German residential as a good bet.

30%

Global property stocks returned almost 30% last year

New wave offices

Tech companies are demanding a different kind of office space, while large corporates are seeking headquarters that match their Corporate Social Responsibility credentials and lower costs. Is the end in sight for the glass and steel office block? Emerging Trends identified growing demand for efficient designs and green-rated projects and owners who say sustainable buildings provide good returns.

Alternatives

Pension fund allocations to alternative asset classes are rising fast. Investor demand is growing for assets such as healthcare and student accommodation because these asset classes offer long, index-linked and government or government-backed leases. In the UK in the first quarter of 2013, £1.95bn of £2.76bn of deals completed were for commercial assets other than offices, retail and industrial, according to Lambert Smith Hampton. Globally, Emerging Trends interviewees spotted opportunities for investors in China, Japan, Belgium and Germany. In the US, investors picked "bite-sized speciality types" in alternatives like self-storage and medical offices.

£1.95bn

of £2.76bn of deals completed were for commercial assets other than offices, retail and industrial

Industrial

Industrial is the most attractive sector in Europe with attractive income returns forecast for the next five years, according to DTZ. Emerging Trends echoed these predictions on the basis of changing patterns in global trade and consumption. Investors are encouraged to look for upgrade and refurbishment opportunities in the US and in China, where e-commerce is outpacing the capacity of local logistics networks designed for meeting exporter demand. In Europe, amassing large platforms could be an opportunity to serve a fragmented market and build a business suitable for the public market.

Lending

Global investors have been eyeing opportunities to lend to European markets over the last five years. As capital constraints continue to weigh heavily on banks, ten new players entered the market in 2012. U.S. investors are anticipated to increase their presence in the UK market this year as well as a wide range of institutions. But while competition is increasing, margins are still substantially above those of 2007. There are also opportunities to fund deals outside of the prime markets as investors get more comfortable with value added deals opportunities (for more, see page 10).

Margins are still substantially above those of

2007

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