

Asia Pacific

Emerging Trends[®] in Real Estate

2014



Emerging Trends in Real Estate® Asia Pacific 2014

A publication from:



Emerging Trends in Real Estate® Asia Pacific

20
14

Contents

1 Executive Summary

2 Chapter 1 Navigating the Crowd

- 4 Core: Crowded Out?
- 7 Opportunistic: Moving Up the Risk Curve
- 8 Secondary Markets Draw Attention
- 9 Smaller Deals and Secondary Assets
- 9 Distress: A False Dawn?
- 11 Lower Your Returns, but Underwrite Compression
- 11 Lengthening Investment Horizons
- 12 Speculation Is Back
- 13 Niche Markets Draw Crowds
- 16 Emerging and Frontier Markets
- 18 Regulations Chill Overheated Markets
- 19 Chinese Oversupply: Fact or Fantasy?
- 20 Tapering—What Does It Mean?

22 Chapter 2 Real Estate Capital Flows

- 24 Asian Capital Dominates
- 25 Chinese Developers Join the Exodus
- 25 Western Assets Targeted
- 25 Institutional Money Pours Out
- 27 Sovereign Money Pours In
- 28 Tokyo Draws the Crowds
- 28 Currency Risk Rises
- 29 Fundraising Still Tough
- 30 Bank Doors Wide Open
- 31 Alternate Financing in China
- 32 Capital Markets
- 33 REITs: Still Room to Run?

36 Chapter 3 Markets and Sectors to Watch

- 38 Top Investment Cities
- 47 Property Types in Perspective

50 Interviewees

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Executive Summary

Despite an uncertain economic backdrop, the fundamentals of real estate markets across Asia remained for the most part uncompromisingly strong throughout 2013, with cap rates tightly compressed and transaction volumes rising going into the fourth quarter of the year. This resilience came as a surprise to many investors interviewed for this year's *Emerging Trends in Real Estate Asia Pacific* report, given the specter of higher interest rates hanging over the market as the U.S. Federal Reserve considers when to begin tapering its longstanding policy of monetary easing.

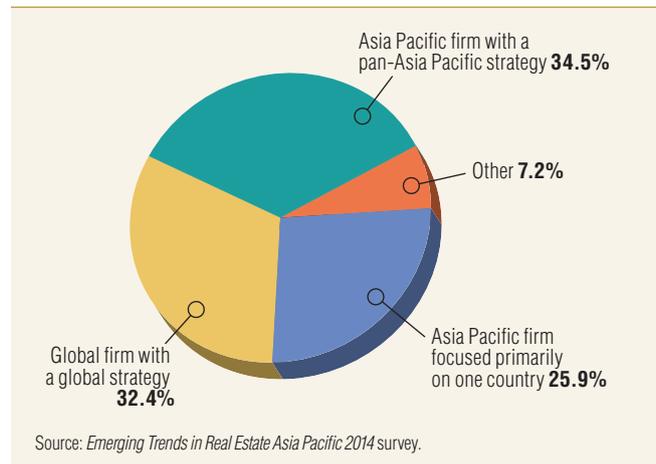
In 2014, the problem going forward will be not only fierce competition for most conventional asset types, but that historically low yields are more likely to go down than up once base rates begin to tick up. As a result, investors will move up the risk curve in 2014 as they seek out yield, looking for value in niche areas instead of the mainstream. In particular, this might mean buying smaller-sized, or B-grade, buildings, or those in secondary markets. It might also mean buying or developing assets in the logistics, senior care, or self-storage sectors, or as a green-building play. Investors are also more likely to consider taking development risk. Large institutional players, for example, are now breaking with tradition by partnering with big developers in China to build core assets.

Real estate capital flows in Asia remained robust in 2013, despite dislocations to regional portfolio flows caused by the threat of a tapering of U.S. economic stimulus. While bond and equity prices (including real estate investment trust [REIT] markets) have therefore dropped significantly from recent peaks, the physical market for real estate has so far been largely unaffected.

One reason for this is the increase in sovereign wealth and institutional capital now aimed at Asian markets. Another is that Asian capital has become increasingly dominant in the post-global financial crisis environment, especially given the substantial volumes of capital being exported from individual Asian countries (in particular China, South Korea, and Singapore) into real estate assets across the region. This can be expected to continue in 2014. One of the biggest recipients of these (and also of global) flows is Japan, where the government has begun a massive monetary stimulus program aimed at jump-starting inflation in the economy.

In addition, major real estate markets in the West are for the first time attracting large flows of Asian capital of all types—sovereign wealth, institutional, insurance company, and private money is now flooding westward in unprecedented volumes. These flows are set to continue going forward, despite increasing tightness in gateway markets.

Survey Responses by Geographic Scope of Firm



On the financial side, Asia's banks remain as accommodating as ever—if not more so—in providing credit for real estate. Terms may have tightened very slightly in some markets, but in others, and especially Japan, they have loosened. Across Asia, loan-to-value ratios of 60 to 65 percent are widely available (and even higher in Japan), while the cost of debt remains low. In China and India, however, bank credit remains tight. On the capital markets side, equities have been hit by the threat of the tapering, as foreign funds are repatriated, but the bond markets have seesawed throughout the year—the market window remained open at the end of 2013, although this may prove a last hurrah. REITs, too, have been hit by portfolio outflows, but they are mostly cashed up and will continue to be strong buyers in the coming year.

In the *Emerging Trends in Real Estate Asia Pacific* investment prospects survey, Japan reemerged by a wide margin as the top investment destination for the first time since 2009, buoyed by a wave of optimism over the positive impact of Abenomics. In addition, the survey registered continuing interest carried over from last year in assets located in Asia's emerging markets, including Jakarta and Manila in particular, despite problems of various kinds—from a lack of transparency to a lack of investable stock. In the survey's sector-by-sector ratings, industrial/distribution remains the favored play—again by a wide margin—followed by the residential, office, and retail sectors.

Notice to Readers

Emerging Trends in Real Estate® Asia Pacific is a trends and forecast publication now in its eighth 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 2014*, 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 2014 reflects the views of 250 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 120 individuals, and survey responses were received from 130 individuals, whose company affiliations are broken down as follows:

Private property company, investor, or developer	31.7%
Institutional/equity investor or investment manager	27.3%
Real estate service firm	25.2%
Equity REIT or publicly listed property company	5.0%
Homebuilder or residential land developer	4.3%
Bank, lender, or securitized lender	4.3%
Other entity	2.2%

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.



Navigating the Crowd

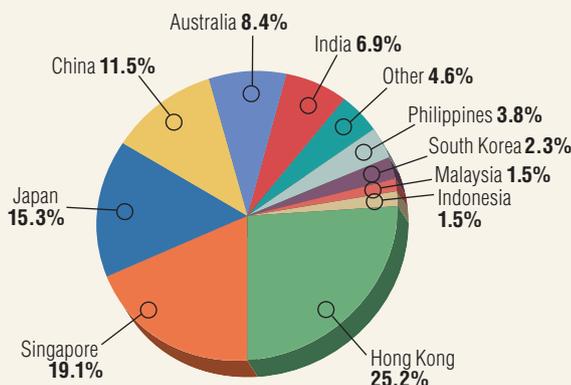
“If you can’t get returns on core deals, you have to think about going up the risk curve, whatever that may mean—so nowadays people are thinking about alternatives.”

When talk of tapering of the U.S. economic stimulus started to gain traction in global markets around the middle of 2013, the response from most Asian asset classes was dramatic. Equities markets tanked, bond yields spiked, and the region’s currencies—from the Indian rupee to the Indonesian rupiah—sold off relentlessly, as Western investors took flight at the prospect of interest rates moving back to historic norms.

As on previous occasions, however, Asia’s property markets barely flinched. Transactions and cap rates remained broadly unchanged in 2013 (and transactions, by some mea-

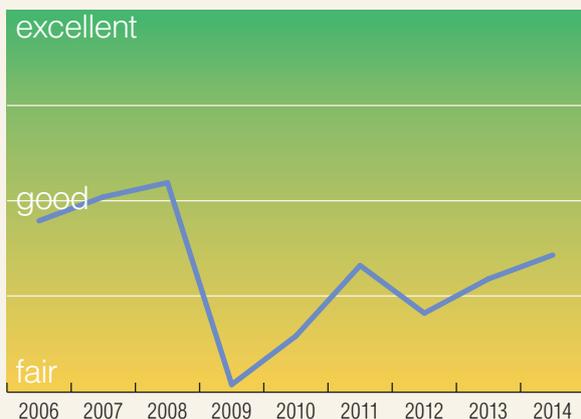
asures, rose in the third quarter), while prices continued to drift upward as they have over the last five or so years—a trend reflected by responses to ULI’s 2014 profitability forecast, which indicates a slightly upward bias to previous sentiment. This refusal of the fundamentals to react to negative news has left many analysts scratching their heads. Said one, “The driver from occupational demand—whether residential or commercial—is clearly slowing because it’s driven by the [greater Asian] economy, which has been materially slower. And if the fundamentals weaken but pricing doesn’t move, to my mind the market’s gotten more expensive. But I don’t think

EXHIBIT 1-1
Survey Responses by Country/Territory



Source: *Emerging Trends in Real Estate Asia Pacific 2014* survey.

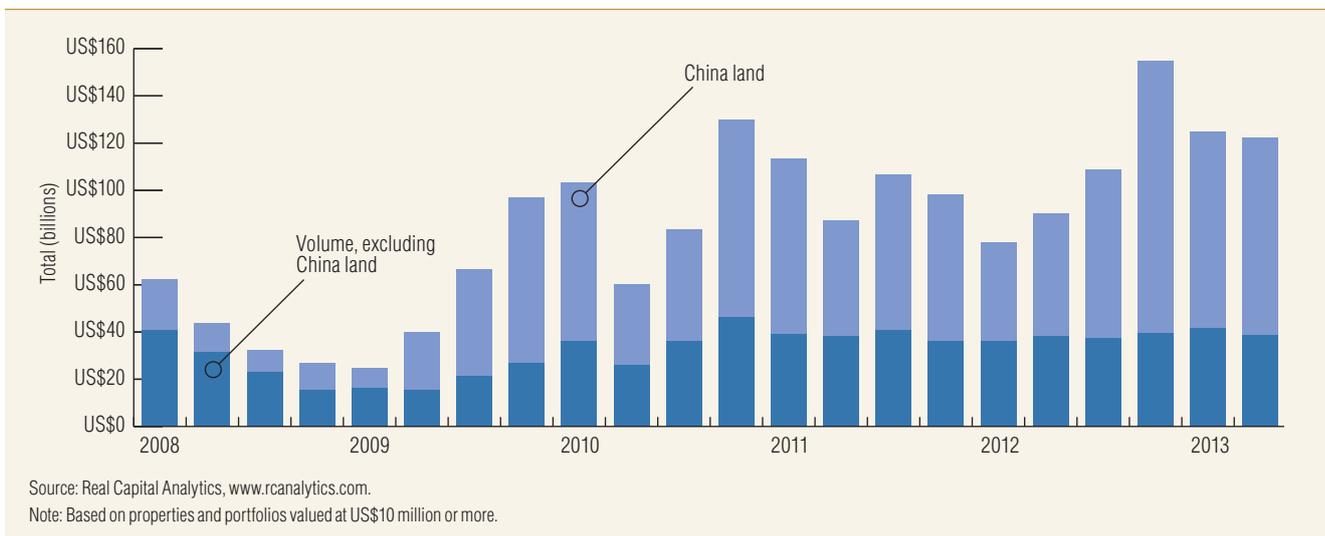
EXHIBIT 1-2
Real Estate Firm Profitability Trends



Source: *Emerging Trends in Real Estate Asia Pacific 2006–2014* surveys.

EXHIBIT 1-3

Asia Pacific Transaction Volume



people’s views on this have changed. I don’t think they’ve suddenly gone, ‘You know what, Asia is really expensive’—I’m just surprised more people haven’t made more noise about it.”

One reason may be that investors are now becoming accustomed to persistently high prices because “that’s the constant now.” Another may be that “people are pushing to put money into Asia Pacific just because they’ve not been investing over the last couple of years, so we’re probably moving into a new investment cycle.” Instead of obsessing over risk-adjusted returns, therefore, investors are finding new ways to make the numbers work. That means, said one institutional fund manager, “If you can’t get returns on core deals, you have to think about going up the risk curve, whatever that may mean—so nowadays people are thinking about alternatives.”

Investing today therefore seems less dogmatic and more flexible, with fund managers looking to squeeze as much value out of deals as they can. As one investor said, “I’m not out there with a definite mission. We trawl through a lot of deals looking for ones that will make some money on the buy

either because you’re buying it cheap, or in bulk, or in some kind of distress. Then, as well as buying it cheap, there should be something to add value to it—whether it’s development, or restructuring the tenants, or improving the planning position of the property. And hopefully, also buying into a market that has potential for growth. So you’ve got basically three legs that hopefully all stand up together. What we don’t like is just buying something that’s fairly vanilla and hoping the market goes up.”

Core: Crowded Out?

In recent years, one issue that has remained a constant is the acute shortage of investable stock. At the top end, more and more big institutional funds are crowding into major markets, mostly looking to buy core product. Many of these represent sovereign or pension fund assets that are overflowing from other countries in the region. South Korean institutions, for example, invested almost as much outside their country as

EXHIBIT 1-4

Firm Profitability Forecast for 2014

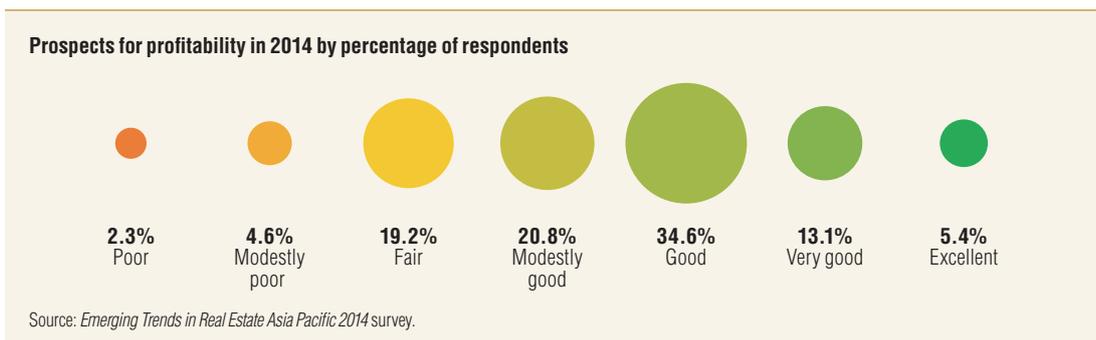
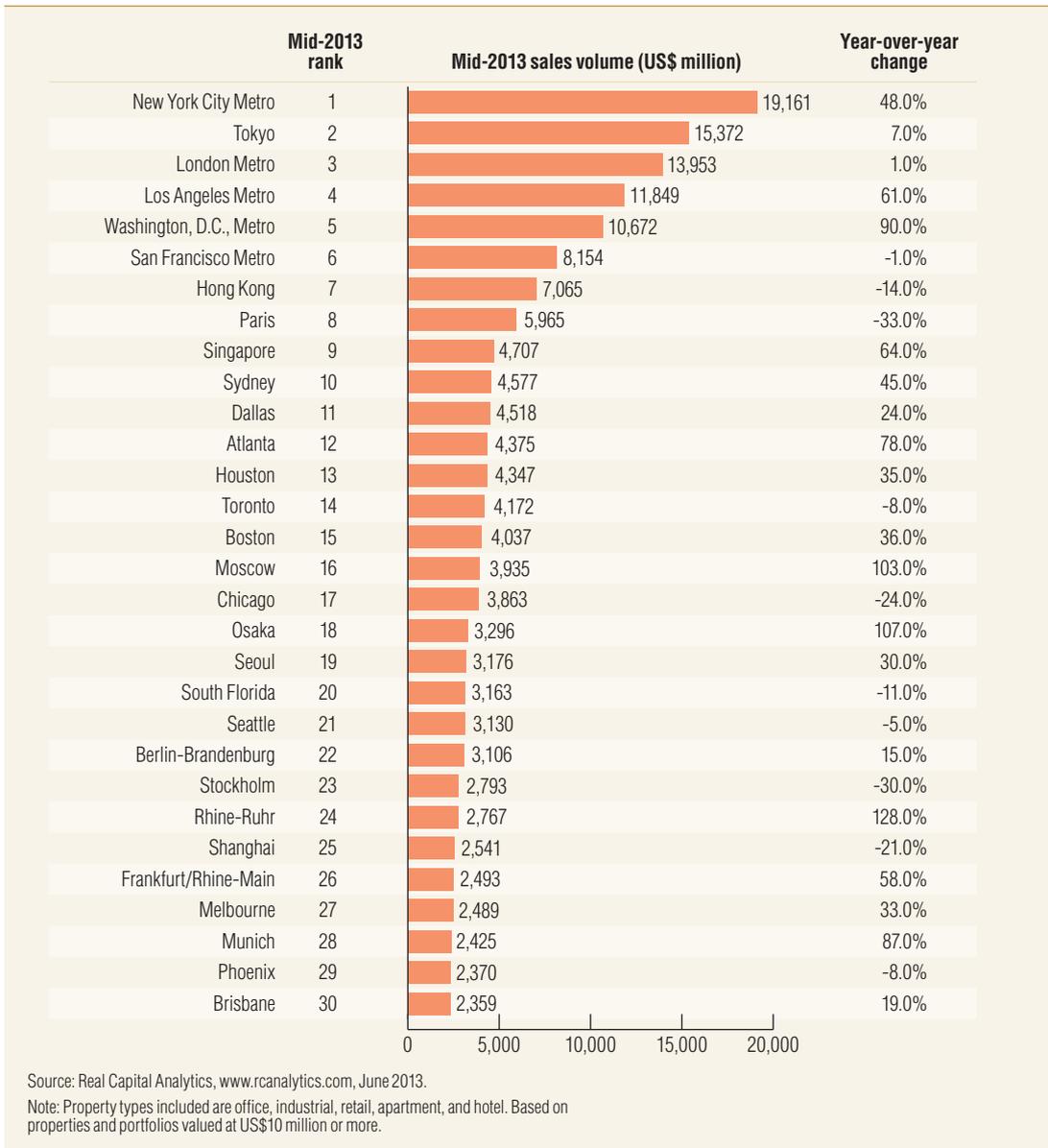


EXHIBIT 1-5

Top 30 Global Markets



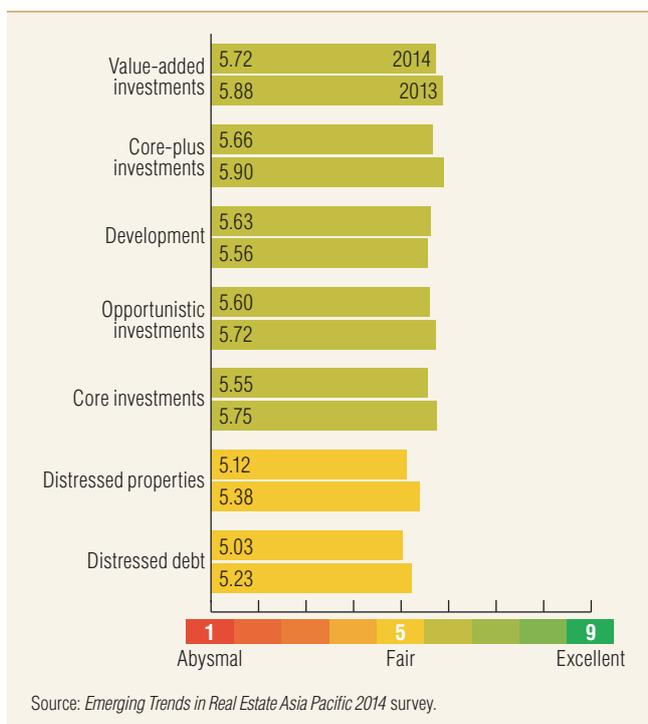
they did at home in the first half of 2013, and are continuing to boost allocations to alternatives. An increasing number of Western and Middle Eastern sovereign funds also are now active in the market. At the same time, domestic buyers, in particular Asia's resurgent real estate investment trusts (REITs), are competing actively in the core space, too. Given that the sovereign wealth funds and the REITs usually enjoy lower costs of capital and/or hurdle rates, the inevitable result is ongoing yield compression and ever-growing competition for assets. This may explain why sentiment for investment prospects in the core space declined significantly in this year's *Emerging Trends* survey results.

Japan

Relatively few of the many deals underway in Japan, for example, involve foreign funds, even though Tokyo is this year's destination of choice for international investors. Said one consultant, "If you look at quarterly reports and bar charts about total [investment] volume and divide them into foreign and local investors, the portion of foreigners in Japan shrinks to a level I've never seen before." And, as one locally based fund manager observed, "The domestic guys are still without a doubt the most active—public equity markets are up, the Japanese REITs are [trading] at a premium to NAV [net asset value]—in some cases a dramatic premium to NAV—they are flush with cash, and they're out buying."

EXHIBIT 1-6

Prospects by Investment Category/Strategy for 2014



South Korea

In South Korea, the same story has been in place for years. While the market for commercial property is both large and liquid, getting a foot in the door is difficult unless investors have a personal connection with a local player. According to one fund manager: “The issue is there’s so much domestic capital from life insurance companies and pension funds. Cap rates have compressed to 5 percent and there’s no rental growth, so it’s all basically just cap rate compression and low interest rates. You can borrow at 4 percent, or even sub-4 percent, in Korea, but there aren’t many opportunities for investors like us because on the core side you’re competing head to head with the locals.”

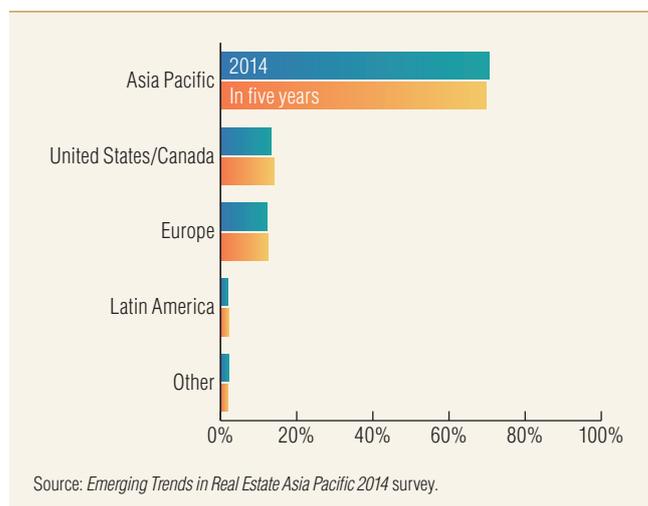
Hong Kong, Singapore, and China

A similar scenario exists in Hong Kong, where so little core product transacts that “people quite often base themselves [here] but just ignore it when it comes to looking for investments.”

In Singapore, the fundamentals may have hit bottom after several years of weakness, and in the short term should find support from a relatively modest pipeline of supply. Statistically, investment in core property rebounded in 2013, and some see it now at the bottom of the cycle. One reason for this is that “Singapore is increasingly seen as a more attractive financial center than Sydney because of its location.” Said one fund manager, “I think demand is returning; there’s not much supply, rents are firm. It’s an increasingly

EXHIBIT 1-7

Asia Pacific Investors’ Regional Allocation Percentages



popular place for mainlanders to deploy capital; it’s an easier place for Western funds to deploy than many other parts of Asia; and it’s safer.” Another fund manager commented, “I think the market has underestimated the ongoing latent demand of Singapore—each percent change in GDP [gross domestic product] here translates into a lot more demand for commercial space than it does in other markets just given the size of Singapore.”

On the other hand, most of the recent action has been driven by left-pocket/right-pocket REIT flotations and government land sales, while cap rates for high-quality buildings are now in the 3 to 4 percent range, pricing many investors out of the market. Moreover, according to one fund manager, Singapore remains exposed to both potential interest rate hikes and the possibility that the government may decide to cut the price of land, which has varied widely over the years. As he put it, “Land fluctuates anywhere from a low of about S\$270 to a high [most recently] of around S\$1,600, and it’s been doing that since the mid-1990s. I’ll bet my entire incentive fee that sometime in the next year, land will trade for under S\$1,000 per [square] foot—it’s all a timing game.”

In China, not only are good-quality, well-leased assets hard to come by, they also are prohibitively expensive. Yields of around 6 to 7 percent in 2006 have come down to just 2 to 3 percent today in terms of true net rates. In addition, with onshore borrowing costs of 6.5 to 7.5 percent, core buyers face “a negative carry for a number of years, at least until you’ve done a turn or two of the rental.” As a result, most foreign investors are shying away from core assets in China. Not all are, however. A significant minority of foreign funds is today willing to compete with domestic buyers to pick up core assets in tier-one cities (especially Shanghai) even at these yields. While some of this can be seen as speculative, it may also reflect, as one investor noted, “a secular evolution

EXHIBIT 1-8
Asia Pacific Yield

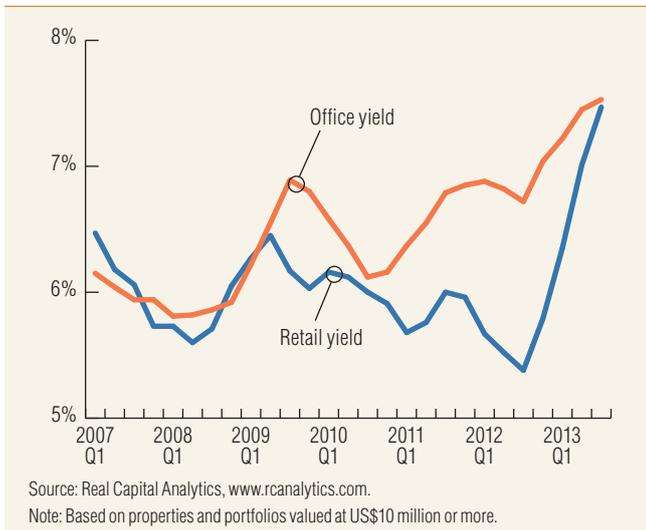
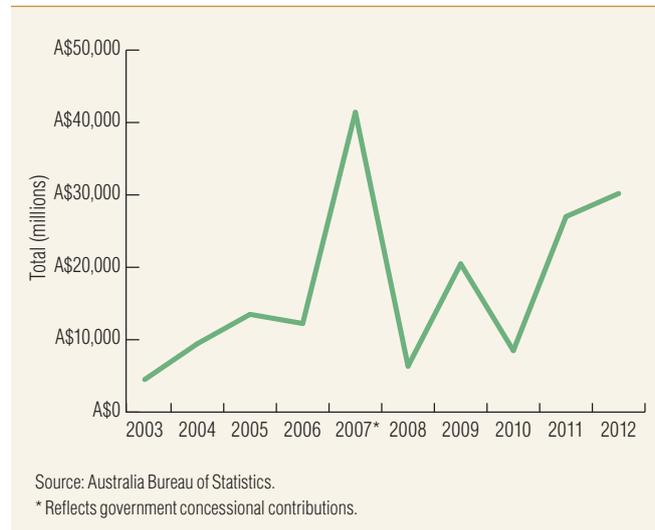


EXHIBIT 1-9
Australian Superannuation Fund Cash Inflows



in the markets here. When you look at Shanghai and see core capital—large institutional players from North America, for example—looking to invest in a market that provides bondlike returns where five years ago, nobody would have done a deal at less than 25 percent as an international investor, it’s a fascinating turn of events.” The reason? “When you’re looking to match the liability life span some of these pension funds have, they need to be here, because this is one of the only engines of growth that will sustain itself over that 20- to 30-year period.”

Australia

The dominance of regional institutional money and the general lack of available product can sometimes lead to the impression—as far as foreign investors are concerned—that Asian core no longer exists as an asset class. Said one manager at a large Western institutional fund, “To be honest, the only market where you can really buy a genuine core product in Asia is probably Australia. I’m hesitating to say Japan, maybe, but the market there just shows quite different characteristics. It’s a core market for a lot of local money, but not so much [for] the foreigner. I think by nature the rest of the region is going to be value-add or development or opportunistic.”

This probably explains Australia’s continuing popularity among global core investors. As one regional consultant put it, “It’s interesting that over the last few quarters net disinvestment [of non-Asian investors] has started to ease and came back pretty much to parity, but if we split it down further, what those international global investors are doing is really an Australian story. If you look over about the last two-and-a-half years, you see a steady trend upward, and then over the last 12 months, the uptake in Australia has been very significant.”

According to data providers Real Capital Analytics (RCA), transactions in Australia registered US\$14.4 billion in the first

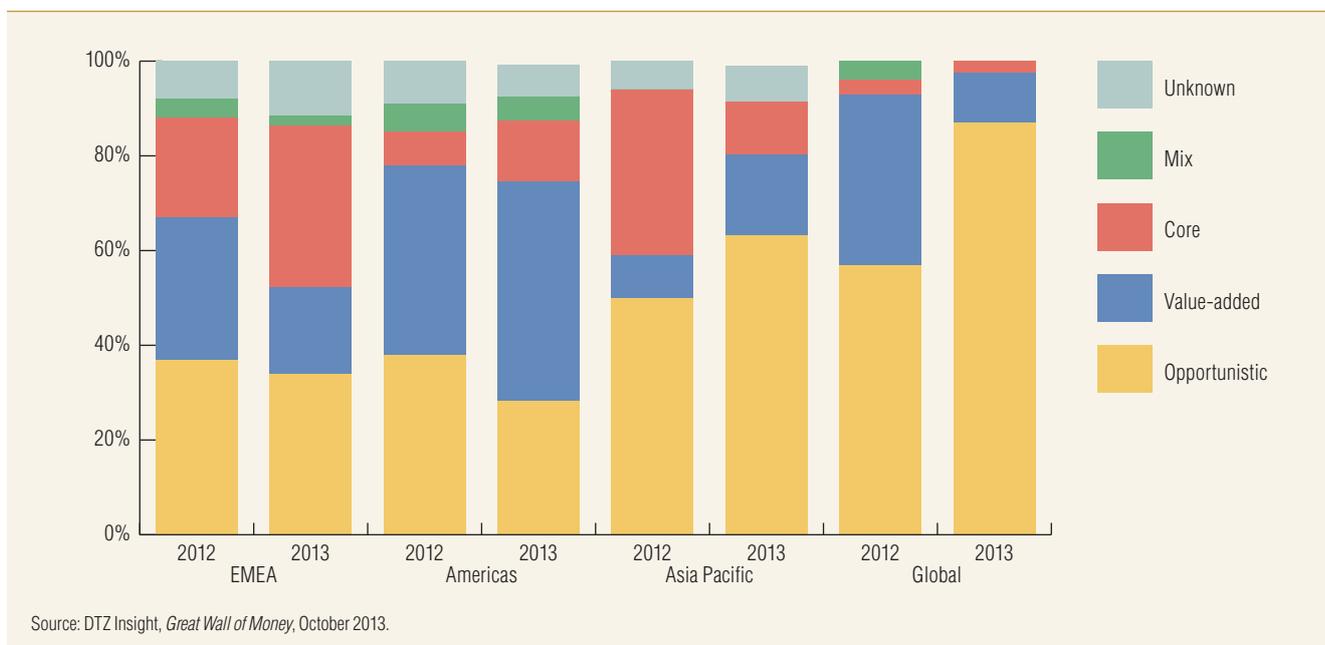
half of 2013, up 30 percent year on year. This surge in investment accounts for the apparent rise in Asian cap rates during the first half, as depicted in Exhibit 1-8. In fact, yields in Asia as a whole have not risen—the spike simply reflects increased transactions in Australia, where average cap rates of 7 to 8 percent remain significantly higher than those elsewhere in the region.

Opportunities to invest in core seem to be thinning out in Australia, though, partly because the existing pool of assets is being depleted and partly because local institutions—including wholesale funds and Australia’s cash-rich superannuation funds—are competing more actively in the market and devouring prime assets “like raw meat.” As one investor commented, “The stock market has obviously performed pretty well, so a lot more of the local institutions have money now, which they didn’t two, three, four years ago. And there’s more foreign money that has come in as well, so it’s become more competitive.” As a result, said one interviewee, “The window is closing.” The sheer weight of foreign capital aimed at Australia means that cap rates may come under pressure in the future, although foreign fund managers seemed more bullish about this prospect than their local peers. As one observed, “Foreign funds are still doing deals there because they have too much capital and they have to deploy it.”

Opportunistic: Moving Up the Risk Curve

The chronic shortage of core product in Asia probably explains why a greater percentage of the capital currently being raised by funds is earmarked for opportunistic purposes. But even then, deals featuring the standard 20 percent-plus returns remain thin on the ground for the same

EXHIBIT 1-10

Current Fund Raising, by Style and Target Region

reasons as in the past: poor risk-adjusted returns, compressed cap rates, and lack of conditions that serve to create financial pressure leading to distress. Lower levels of leverage that became the norm after the global financial crisis have not helped the opportunistic cause either. As one investor in Japan noted, “For guys trying to do that strategy, it’s very competitive and there are not a lot of deals—the opportunistic funds are clearly having trouble in trying to put money out.” In Australia, the same applied: “There’s always something out there, but it’s just harder to crack the code—I think the deal flow will thin out a bit.”

In China, meanwhile, where risk tends to push most investments into or toward opportunistic territory no matter what yields might suggest, investor attitudes reflect the difficulty of getting to grips with an extraordinarily complex and diverse market. As one investor put it: “It’s terrifying in so many ways. And the [deal] structuring is just a pain—in a market where there is good local liquidity, you’re accepting 10 to 20 percent lower returns than a local if you’re a foreigner for the same price because of the tax burden on your structure. So it is a very difficult market, but there are funds that are there, they’ve done it, they have good people on the ground, they know how the system works. It’s just about finding the right product with the right partner.”

What to do? In previous years, investors might have opted simply not to buy. But with cap rate compression now apparently baked in, the only alternative is to adapt. Investors are therefore looking at a range of approaches to get access to the market.

Secondary Markets Draw Attention

One strategy is to migrate toward secondary markets. In Japan, offshore investors who have traditionally been reluctant to buy outside Tokyo’s central wards are now willing to venture further afield, including into suburban areas. As one fund manager said, “Submarkets really matter—you need to find a submarket where you can have very low vacancy in an asset with a real supply constraint.”

Secondary Japanese cities have also reemerged as popular destinations. Said one investor, “Generally, in Japan you have to be careful when you go into the regions, but there are cities—Osaka now, Fukuoka, and even Sapporo—where we’ve done deals that actually have a fair amount of economic heft to them in a reasonably deep market. Those are ones where you can very much calibrate the cap rates you get to [those in] Tokyo—you just look at the spread between the two.”

In Australia, a trend toward suburban office purchases featured strongly. According to one interviewee, “Everyone feels core CBD [central business district] office was pretty tight already, so suburban office was something they’d consider because it hasn’t tightened as much.”

This is a strong theme in China, too. Although debate continues about the relative appeal of secondary and tertiary cities given problems with oversupply, in the first tier there has been a drift toward investment in commercial projects located in suburban districts, driven partly by high rents and partly by improving inner-city transportation networks. Said one fund manager active in China, “What we’re seeing is that anything

that's pretty central in Shanghai is exorbitantly expensive, and so one theme going forward will be the suburbanization of these tier-one cities where you're going in on a more affordable basis—that's a key trend and that's where you're seeing some interesting opportunities." This idea applies equally to satellite areas. In Shanghai, for example, a new commercial district is springing up in Hongqiao near the old city airport and Shanghai's new high-speed rail interchange, providing connectivity both nationally and regionally to cities in the Yangtze River Delta.

Smaller Deals and Secondary Assets

Another way to game the market is to target multiple smaller deals instead of single large ones. As one opportunistic investor said in reference to Australia, "You want to get out ahead of the market on buying second-tier assets in good markets or good assets in second-tier markets, although you have to be very careful [buying] secondary assets in secondary markets. Because when the debt and equity markets come back it gets very competitive for the good stuff, and people get squeezed out into the regions—squeezed out in terms of asset quality—and that stuff can really come roaring back. I'd even characterize that as what's happening right now for the smaller ticket-sized assets, and I think it's just a matter of time before the bigger assets start to see that lift also."

In Australia, smaller (i.e., sub-US\$100 million or sub-US\$50 million) assets have been subject to significant cap rate compression over the last year "because individual-investor buyers, either high-net-worth individuals or syndicators, are now back in force." The "sweet spot," however, according to one fund manager, is in hundred-million-dollar-plus B-grade assets. "These are the ones where it's still a less efficient market, and if I were an institution that's what I would want to buy," he commented. "If you can find a stable, cash-flowing B-plus building that's pretty well located, but maybe not central Sydney or Melbourne, you're going to get a pretty attractive cap rate. It's not going to be gangbusters anytime soon, but a lot of it depends on what you think about the Australian economy."

Another fund manager commented, "The spread between risk-free money and yield in grade-B assets is probably at a 20-year historic high in Australia. A lot of people don't get that, bizarrely, but I think cap rates are coming in gradually and we will sell into that over time."

Japan is another prime example. Local institutions willing to accept a lower yield have long cornered the market for Tokyo's stock of large, core buildings. But with a little imagination, investors can still access or even create less-high-profile core products. Some of the most active private equity players in Japan, therefore, are opting to buy multiple smaller assets (averaging a few tens of millions of U.S. dollars each), often out on the fringes of the market. Repositioning the right type of

building in the right location can also allow buyers to "engineer" new core assets.

In Hong Kong, tight supply in the traditional CBD on Hong Kong Island (expected to fall some 30 percent short of demand by 2020, according to brokers CBRE) has led to the creation of a second business district in Kowloon East, which has thrived despite the skeptics. Said one interviewee, "There were some sniggers when the government launched it as CBD2, but the pace is picking up, and over a five-to-ten-year plan it's going to be an important area." The flip side is that, as ever in Hong Kong, cap rate compression suggests the moment may already have passed. Although the impact of government cooling measures has moved cap rates in East Kowloon out by about 100 basis points, many properties are still yielding only about 3 percent—pretty meager even by Asian standards.

Distress: A False Dawn?

For years, opportunistic investors have been awaiting the emergence of distress in a number of markets across Asia. By and large, though, they have waited in vain. Be it Japan's commercial mortgage-based securities (CMBS) tail, cash-starved Chinese developers, or failed REITs, the reality has generally fallen short of expectations. To some extent, this reflects a cultural reluctance to allow compromised deals to be recycled by the market as they are in the West. Failed projects tend to be instead resolved via backdoor agreements with friendly entities (often bigger players) or held in limbo in the hope that market conditions will eventually reverse. In addition, said one fund manager, "There's not been a lot of corporate distress, and because there hasn't been a lot of building, occupancy levels are still sufficient to cover any debt that's on these properties, so there are no distress situations, there are no foreclosures going on."

Still, possibilities exist. Distress in Asia just tends to be harder to source, smaller in scale, and often dressed up differently than investors expect. Said one fund manager, "It's so granular in terms of some of the opportunities that come up. There are things out there, but it's difficult to find a blanket theme at the moment. You just need to be active in your local market." Or, as another investor said, "You just stay around the hoop, then something will come out." The comments of one fund manager about distress in Australia are probably just as applicable elsewhere: "Commerce begets commerce—the more deals you do on the distress side, the more people come to you and say, 'We're finally looking to move these bad positions.' So the big portfolio plays may now be much harder to come by, but we continue to see a lot of flow deals on the distress or value side, often single assets that are undermanaged or underleased. It's not like you're buying them at absolute bargain basement, but you're getting them at a devalued price."

What this implies is that distress in the Asian context does not necessarily involve picking over bankrupt projects. As one

EXHIBIT 1-11

Levels of Impact of Global Financial Distress



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

Note: Data for 2013 and 2014 are from the *Emerging Trends in Real Estate Asia Pacific 2014* survey; data for 2012 are from the *Emerging Trends in Real Estate Asia Pacific 2013* survey.

investor said in reference to China and India, “Usually, what distress means is not so much a bank selling NPLs [nonperforming loans], but more a developer in a liquidity squeeze. So you’re not going to buy an asset screamingly cheap, but you’re going to be able to negotiate good-to-acceptable terms on some sort of structured financing or recapitalization.”

Among particular types of opportunities, residential land for mass-planned projects in Australia, small cash-challenged developers in China (senior-secured deals at 15 to 25 percent internal rates of return [IRRs]), small overseas developers of luxury residential properties in Singapore, and even bankrupt development deals in Vietnam were all mentioned by interviewees as offering potential for distress in 2014.

India: Progress or Paralysis?

The market most likely to yield potential distress (as defined above), however, is India, where “a lot of arm-waving is going on” after a string of recent calamities. Government policy conflicts, slowing economic growth, falling foreign direct investment (FDI), and rising inflation and borrowing costs have had a significant impact on the domestic real estate sector, with many developers now suffering serious funding gaps. The problems have been compounded by a 20 percent collapse in the value of the rupee in mid-2013 (since retraced by about 5 percent).

A pervasive sense of nervousness in India has led the business sector to hoard its cash. In addition, according to one Indian consultant, local banks are refusing to lend for speculative commercial developments (with some exceptions, such as IT parks) and otherwise charge up to 15 percent for financing. The resulting funding gap has created demand from developers for senior-secured debt, the play currently favored by India’s nonbanking financial companies (NBFCs), the market’s dominant domestic financiers. Although senior-secured IRRs had come down to around 18 percent in mid-2013, foreign investors have now raised their asking price to 20 to 23 percent after the currency collapse.

The question with India is the extent to which these opportunities will be attractive to a somewhat cynical foreign investment community. Despite its undoubted potential, the Indian market is plagued by a combination of political, regulatory, currency, and market risk that has prompted many foreign funds to remain on the sidelines for several years. Governance issues, in particular, loom large. As one interviewee observed, “The international investor community has been burned in the past because of [policy mandates] that have been taken for granted, which, when the fine print came out, turned out to be a mirage.”

As a result, said one foreign fund manager, “The opportunity is getting bigger for the domestic players, because with this volatility usually comes distress. But for the international players, it’s probably gotten harder. You have to have a more flexible mind-set to get comfortable with things that aren’t perfect on the underwriting, taking that leap of faith as opposed

to cutting corners, or deluding yourself. And I think for international players who have been leery especially in the last five years, the last six months have made that tougher.”

Although in general interviewees displayed a degree of negativity toward the Indian market, there was also a sense that upcoming elections may mark the bottom of the cycle, with positive signs emerging on a variety of fronts. In particular:

- Domestic real estate funds and NBFCs have recently (and somewhat unexpectedly) managed to raise substantial amounts of new capital from local investors, possibly as a result of a lack of appetite, to invest abroad following the decline of the rupee.

- The government has recently proposed new guidelines that if implemented will provide for the establishment of a domestic REIT industry in the near future. This provides a potential exit for foreign investors (an issue nominated as his “main concern” by one interviewee). That apart, if the Indian government allows FDI in REITs, it will also offer a glimmer of hope for a shift to a more open environment generally for FDI flows: “In principle, the fact that you’re going to allow REITs to invest in smaller properties, income-producing assets, means that all the guidelines India has that restrict foreign capital flows into income-producing assets would be vulnerable, because not only would foreign investors then be able to put money into those assets, the quantum they could place would be as low as 200,000 rupees [about US\$3,200].”

- In addition, several other land investment-oriented bills or reforms are in the pipeline or have recently been passed. There is even talk of reforms to the FDI real estate guidelines. India has experienced false dawns on the regulatory front before, but there seems to be a greater recognition now that the former protective and dysfunctional regime was ultimately counterproductive. As one India-based consultant commented, “There’s a lot of political motivation, which is essentially the reason I think some of these things have been rolled out—the bigger picture is that India seems keen on creating a more regulated, more transparent, and more forthcoming regulatory framework for attracting investment both from foreign and Indian sources into real estate assets.”

Lower Your Returns, but Underwrite Compression

If opportunistic returns of 20 percent-plus are considered unattainable, one obvious solution is to lower the targeted return and make up the difference through increased capital values. And that is what some buyers are doing. As one Japanese-based investor said, “The straight distress, opportunistic deals—they’re just not here. So now, for some of these guys, 15 [percent] is considered the new 20.” Investors will take what may actually be a core-plus deal, increase the leverage, make the asset more efficient, and hope that cap rates compress. While that compression may not officially be part of the calculation, there is certainly an expectation of it

underlying the logic of the purchase.

As one fund manager described it, “It’s really an engineering-type play with the hope that something is going to go up in the future. The idea, basically, is to get some money out, hope the market recovers, and worst case they’ll end up with a good single-digit return, which isn’t a bad thing.” Another investor commented, “So you buy at a 7, but you think you can move it today at a 6.25, and you think ultimately you can move it at a 5.5. So yes, that is compression from 7 to 5.5, but it’s not like you’re penciling in 150 basis points of cap rate compression. It’s just that it’s very believable.”

Although plenty of investors in the Japanese B-grade office space are playing this strategy, a significant minority voiced skepticism. While on paper, for example, office vacancies have declined and rents have shown signs of stabilizing, some question whether this is a result of discounts and incentives offered by landlords. “It’s been catching a falling knife for three years,” said one. Another said that “office is still questionable because of the supply [pipeline].”

Apart from Japan, the cap rate compression thesis seems strongest in two other markets: India, where real estate fundamentals remain fairly resilient and there is an expectation that the government over the medium term will be able to overcome a wave of negativity over the economy; and Australia, which has seen two base-rate cuts in 2013 that have reduced the risk-free (i.e., sovereign bond) rate and widened yield spreads on core assets to around 400 basis points.

Lengthening Investment Horizons

Another way in which the trend toward lower opportunistic returns has been expressed is in opting for longer investment windows. One interviewee spoke of buying high-quality assets in first-tier Chinese or Indian cities with relatively low leverage (say, 35 to 40 percent instead of 50 to 60 percent) in order to protect the deal from market fluctuations. “That [translates] to a 17 and it’s not one you’re going to flip, it’s really geared more to holding ten to 12 years. So you end up getting a 15 to 17 percent IRR, but at a very attractive multiple. I’d say that does characterize the type of opportunistic investor that’s in the ‘16-to-17-is-the-new-20-and-we’re-playing-for-multiple’ category.”

That said, this “lower return/higher multiple” approach is not necessarily widespread, not least because many fund managers are confident they can still deliver the higher return. “For us, 20 is the new 20,” as one investor put it. “I’d say for some styles of investing that probably is the reality, and it’s much more the go-big portfolio-building strategy. Ours is more granular and we think we can get the 20 percent.”

Longer holding periods are also a reflection of maturing investment strategies in markets that traditionally have been focused on flipping assets for a fast buck, or where developers have had little choice but to turn their inventory as soon as possible because they otherwise lacked capital to invest

in their next deal. As one foreign developer active in China said, “There are [local] developers today who are becoming what they call ‘huggers’—so instead of selling strata, they now want to hold buildings for a longer period and probably inject into some kind of equity, or inject it into a potential REIT in the future. So you could see some of these developers beginning to hug on to their group commercial buildings—it is beginning now.”

Speculation Is Back

The type of highly structured deal so much the hallmark of the days before the global financial crisis might now seem a thing of the past, but as pressure mounts on investors in some markets both to source deals and to make the numbers add up, a sense of déjà vu is creeping in. Japan in particular is the target of a large volume of recently raised foreign capital that must now compete against cashed-up local investors with very low expectations on returns. As one fund manager said, “There’s too much money, too much liquidity in certain markets, so you have overweight capital that can’t find deals. Yet, foreign funds still place money simply because they have to deploy it—Abenomics has renewed that speculator mentality.”

Loan-to-value (LTV) ratios have inched up across Asia over the last year. They now commonly register 60 to 65 percent across Asian markets and can reach 80 to 85 percent in Japan, depending on ticket size and asset type. In fact, a few deals in Japan have been struck in 2013 with leverage as high as 90 percent—plus. As one investor said, “Some of them have been generated by European banks unwilling or unable to take writedowns on deals they did back in 2006–2007. So they bring in a new sponsor and restructure so they don’t have to take a writedown. They basically give the equity guys an option, effectively 5 to 10 percent, in the hope the market

recovers.” While these deals have made sellers “look like heroes for holding on,” the issue for buyers is not only that they are highly levered, but also that they are conceived on a basis that implies significant cap rate compression in order to reach the projected opportunistic return. As one investor put it, “Basically, it’s just a punt.”

To be fair, these highly structured, seller-financed deals are exceptional. As one fund manager observed, “The taste for most private equity players to do that with big positions is, perhaps, not a thing of the past, but there’s much less appetite for it.” Still, the fact they are happening at all has raised eyebrows. One fund manager commenting about Tokyo said, “I heard someone saying they’d bought a residential portfolio leveraged to 85, and with yield and cost of debt where [they are], it’s clearly irresistible for some opportunistic funds just to get those returns through leverage—I suspect that will continue, but it’s a risky strategy.”

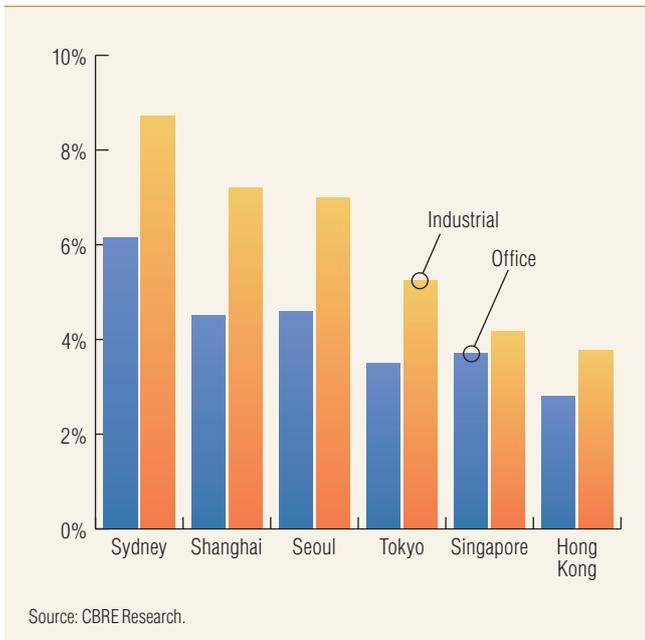
In China, speculative plays based on the assumption of ongoing price increases have long been common among local buyers, and are now increasingly so among foreigners, too. As one foreign investor tells it, “Some of the trades in Shanghai and Beijing are fully let office buildings trading at 2 percent net effective yields, although they say 4 to 5 percent gross. If those are such great deals, and now the market has opened up for the insurance companies and all they have to do is achieve 3 to 5 percent yield, why would core investors in China be buying these assets? We were shown a building last year, and I had to laugh at the broker. I said, ‘Wait a minute, it only nets me 1.5 percent yield.’ And he said, ‘But this isn’t a yield play.’ I said: ‘But it’s a stabilized asset.’ ‘Yes, but you’re going to be able to flip it for twice what you bought it for.’ And sure enough, it sold to a foreign fund.”

EXHIBIT 1-12

Transaction Volume of Industrial Properties in Asia Pacific Markets, by Biannual Total



EXHIBIT 1-13

Prime Yields by Sector, Q2 2013

Niche Markets Draw Crowds

The same reasoning that has led to a drift toward secondary locations applies equally to secondary sectors, in particular for opportunistic players. Niche sectors not only produce higher returns, but also tend to require a certain degree of specialization, which, in turn, winnows out the investors willing or qualified to compete. As a result, interviewees this year regularly cited their interest in various types of niche play, in particular in Japan, where competition for assets is intense and where alternatives are especially attractive: “Japanese domestic capital is very risk-averse, and if we can play in some of those areas where they don’t feel comfortable, that can offer some attractive opportunities.”

Logistics

The industrial/distribution sector featured strongly in last year’s *Emerging Trends in Real Estate Asia Pacific* report. Its popularity has continued into 2014, with the sector again registering the strongest sentiment among the various investment categories in survey responses. The bullish sentiment is confirmed by recent statistics, with transactions of US\$3.1 billion in Asian industrial and logistics assets reported in the third quarter of 2013, according to CBRE, up 75 percent year on year. Existing logistics facilities throughout Asia are, for the most part, fairly basic in nature and in short supply. As a result, and as distribution strategies of both international and domestic manufacturers become more sophisticated, there is growing demand for facilities able to offer more complex services and that cater to the needs of third-party logistics (3PL)

providers, who have now become the major driver of demand for new logistics facilities regionally. In addition, as internet sales in the region take off (particularly in China), demand is growing for new inward-focused infrastructure to serve domestic consumer demand, as opposed to first-generation facilities that were oriented toward exporting from Asian ports to the developed world. As a result, logistics has become one of the most sought-after sectors for real estate investors in all markets as they continue to seek higher yields.

Investors must consider various issues, however. First, there is “a huge amount of competition” because so many people are eyeing the same play and because construction costs are low. This also means that placing large amounts of money can be problematic. Second, because “it can take you a year-and-a-half to tie down the signing and get all the permitting in place,” the ideal model is to line up tenants beforehand. For this reason, logistics is often the preserve of larger, specialist players that can presell facilities to their existing clients. “Otherwise you buy it, build it, and it just sits there.”

Referring to China, one investor said, “Development yields for logistics are much higher than [those for] other property sectors within a much shorter development cycle—call it 18 months. So, from a risk-adjusted standpoint, it offers a pretty compelling proposition: mid-to-high teens over an eight-to-ten-year period. Development yields are 8.75 to 9 percent, at true NOI [net operating income]. Those other sectors have more potential for rental growth, but logistics has good rental growth, too—we’ve seen 4 to 5 percent rental bumps each year.”

In Australia, yields for logistics assets averaged 8.6 percent in the year to July 2013, according to data providers IPD. In other markets, they are lower. Japan, for example, has seen a surge in activity in the sector as new infrastructure is built in the wake of the Tohoku earthquake, and as the manufacturing sector shifts more toward an international 3PL model, “Cap rates are probably a 5 for Class-A stuff—and now you’re even seeing some assets trade sub-5.”

Several interviewees also noted increased activity in the logistics sector in South Korea, although again the market is hard to penetrate. “Foreign capital is checking out logistics opportunities, but because logistics is owned and controlled by the big corporations, they don’t use 3PLs,” said one South Korea-based fund manager. “There are a few logistics centers, but they’re not conveniently located—they’re scattered around, so when you try to divest, the question is: how are you going to exit if there’s no tenant backing you up, because it’s difficult to lease the space.”

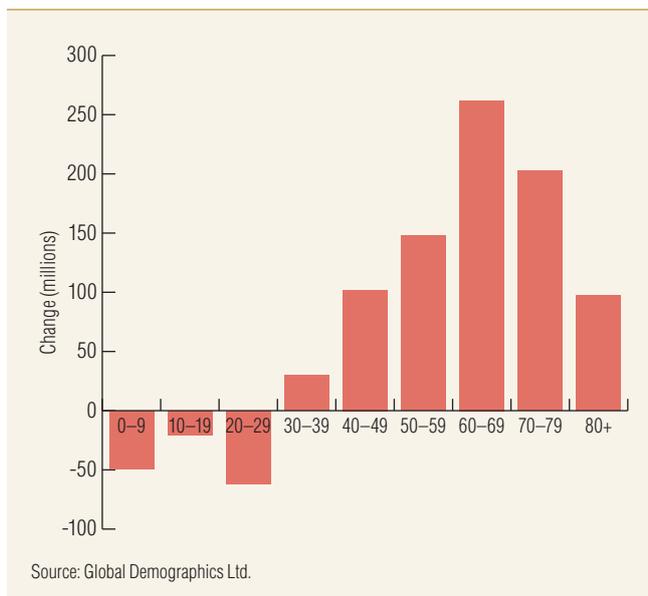
Senior Care

Senior living was another popular interview theme—a result of the universal shortage of existing product and a demographic trend throughout Asia (Japan in particular) toward longer life spans.

Senior care facilities are tricky in Asia, however, for a number of reasons. First, differing cultural expectations as to

EXHIBIT 1-14

Net Change in Population in Asia over Next 20 Years, by Age Group



the type and standards of care mean that imported Western models will likely fail. Asia must therefore find its own models. Investors must “try to figure out, for example, how a whole generation of Chinese in a certain social stratum is going to behave. Are they going to buy a retirement home the way their counterparts did in the U.S. 50 years ago? Probably not,” said one investor. Acute care-type facilities, on the other hand, are likely to be in greater demand.

In addition, as a developer with experience in senior care facilities in Australia said, “You have to take a long-term view and particularly target your demographic pretty well. So we’re not looking at moving into a part of that demographic that is probably the broadest, which actually is the demographic that can probably least afford it. It’s more likely to be into the wealthier end of the market where you can provide a pretty high standard of accommodation.”

Beyond that, the industry will have to find an investment framework for its chosen model. According to the same developer, “We’re looking at a number of models, and that is part of the problem: what is the right one—not even for Asia, but for each country? In Australia, the model has gone toward a split management fee between management and operator. In other countries that’s too complex, so it’ll be different—it might be a rental model; it might be a management-fee model; it could be a bond, like in Hong Kong; it could also be part of a health care REIT. So there is a whole raft of different approaches you could take.”

Self-Storage

Asia’s small living spaces mean that increasingly wealthy consumers are running out of space to store the things they’ve

bought, creating demand for third-party storage facilities. According to one investor active in this area, Asians use self-storage in a different way than in developed countries, where people probably have more possessions: “In the West, it’s like renting an extra garage; in Asia, it’s like renting a closet,” he said. In one recent Japanese investment, cap rates registered between 7 and 8 percent, with financing available at 2 percent. Self-storage is a possible play in other parts of Asia also, but each market has its quirks—and in some cases, these make investments problematic. In China, for instance, the market is still too early “because people with a lot of money who therefore need more space probably already have residential units that are sitting empty.” And in Hong Kong and Singapore, the alternative-use value for potential self-storage assets is probably too high to justify the purchase price of property suitable for conversion.

Sustainable Buildings

Creating sustainable commercial buildings has long been on the agenda of Asian developers, but in the past the concept failed to achieve much traction largely due to the perception that building green generates more costs than can be recouped during the lifetime of the building. That perception, however, may be starting to shift.

As a representative of a large developer operating across Asia said, “Developers who say that you don’t get extra value—I think they’re living in the dark ages. It’s a competitive advantage because tenants, investors, and governments demand it.” Those looking to flip projects for a quick profit may be less inclined to go the extra mile. But given the trend toward developers’ building and holding assets over time, “people will look for how to maximize value, and any enlightened long-term investor is going to ask, ‘How do I prevent my building from [becoming] a dinosaur, how do I continue to attract investors?’ ”

Measuring the extent to which a sustainable approach will enhance the value of a building over the long term is hard to assess. In terms of higher rents, however, the benefits—while tangible—remain modest. As one interviewee said, “There is some element of markup, or some element of credit being given now for sustainability, but it doesn’t represent the true return you would like to see—it’s a markup, but no more than that.”

Another problem is that even though countries like China and Japan have a strong regulatory focus on sustainability at the highest level, local authorities often have little inclination to enforce the rules. In China, for example, “we have a whole series of eco-initiatives that often are being driven at a country or city level in joint ventures across cities. But very few of them seem to be making any serious headway.” In Japan, “they’re very highly motivated, but there doesn’t seem to be a real push in Tokyo itself to create green buildings,” said one investor. At the same time, the national mandate in Japan to reduce energy consumption by 15 percent in the wake of the 2011

earthquake is now creating greater focus on sustainability that may, over time, translate into a more progressive approach. “It can be frustrating dealing with the Tokyo metropolitan government, but when this changes it will be a significant disruptive way to approach Tokyo and invest in existing buildings,” said a developer. “In fact, I see that as our best play into that market.”

As for the extra expense, he continued, “It has cost more, but costs have come down significantly. We can build a five-star Green Star or a Green Mark today for no more than it would have cost five years ago to build a normal building.” As one Hong Kong-based consultant said, “If you do things in a sustainable way from the outset, starting to introduce extra features and all the rest, the industry talks about a 2 percent to 5 percent premium. I would argue, though, that if you do things in an organized way from the outset, you could probably get away without any major premiums.”

In principle, retrofitting existing buildings to a green standard is a much bigger market than that for new buildings. However, the poor quality of much of Asia’s commercial stock, combined with the high cost of land as a proportion of total development value, means it is often cheaper to tear down old buildings and start again. Beyond that, governments need to do more to incentivize owners to undertake retrofitting projects, preferably via a “carrot and stick” approach, as one interviewee put it. Markets like Hong Kong, Tokyo, and Australia, where building standards are usually higher, are seen as particularly well suited for retrofitting plays.

Take Development Risk

Another way to enhance returns is to enter at the development level. Historically, codevelopment in Asia has been difficult because most Asian developers have little incentive to pay private equity-type returns when they can get cheaper capital from a bank. But an increasing number of co-invested development deals are now being struck, at least in some markets. The popularity of this development play is reflected in this year’s survey responses, where development was the only category registering a higher sentiment score than last year.

Several large institutional players that have opened offices in Asia in order to gain access to direct deals have opted to co-invest in development sites as a means of securing core assets that would otherwise be unavailable or too expensive. This is something of a departure from normal practice at institutional funds, but is being driven mainly by necessity. As a manager at one such fund said, “We do quite a lot of development in China, which is a little different from a plain-vanilla pension fund. But these days, people will take—or anyway we will take—development risk in what we perceive to be growth markets, or markets where you can’t buy core, but you can build and hold it.”

Referring to the difficulty of buying first-tier commercial projects in China, one consultant said, “The sector is attracting increased external investment and increased domestic investment—obviously the pension funds, insurance companies, and domestic institutions are beginning to get involved. The challenge again is one of product. The situation has improved in that there’s more grade A-type product, but it’s

EXHIBIT 1-15

Real Estate Transparency Scores: Asia Pacific

Transparency level	Country/territory	2012 rank	2012 score	2010 score	2008 score	2006 score
High transparency	Australia	3	1.36	1.22	1.15	1.19
	New Zealand	5	1.48	1.25	1.25	1.19
Transparent	Hong Kong	11	1.76	1.76	1.46	1.50
	Singapore	13	1.85	1.73	1.46	1.55
	Malaysia	23	2.32	2.30	2.21	2.30
	Japan	25	2.39	2.30	2.40	3.08
	Taiwan	29	2.60	2.71	3.12	3.10
Semi-transparent	China (tier 1 cities)	32	2.83	3.14	3.34	3.71
	Philippines	35	2.86	3.15	3.32	3.43
	Indonesia	38	2.92	3.46	3.59	4.11
	Thailand	39	2.94	3.02	3.21	3.40
	South Korea	41	2.96	3.11	3.16	3.36
	China (tier 2 cities)	46	3.04	3.38	3.68	—
	India (tier 1 cities)	48	3.07	3.11	3.44	3.90
Low transparency	Vietnam	68	3.76	4.25	4.36	4.60

Source: Jones Lang LaSalle, “Real Estate Transparency Asia Pacific.”

Notes: Data revised every two years; — = not available.

still not enough. So all of them—and this is where they all came unstuck in the past—are beginning to assume development risk again. They'd prefer not to get involved, but virtually all the ones we are dealing with are having to accept it."

At present, opportunities also exist to enter development deals with smaller Chinese developers caught by the government's liquidity squeeze, who may be open to some kind of structured finance deal as a quasi-distress solution.

Beyond that, it is probably fair to say that bigger Chinese developers today are more receptive to pairing with foreign players because it suits their purposes in a broader sense. It may allow them, for instance, to tap foreign expertise in particular areas such as retail management. In addition, as one fund manager observed, "A lot of these big firms want to partner with Western names because it adds credibility to their proposition in the market—basically, being associated with a good Western name doesn't do their share price any harm."

Australia is another market where development is seen as a possible play. As a Singapore-based opportunistic investor said, "There's plenty of potential on a risk-adjusted basis. And when you compare the risk profiles of Australia to China, or [to] any part of Asia, it may not punch the lights out in terms of returns, but you can deliver in the low-20s net by taking some development risk."

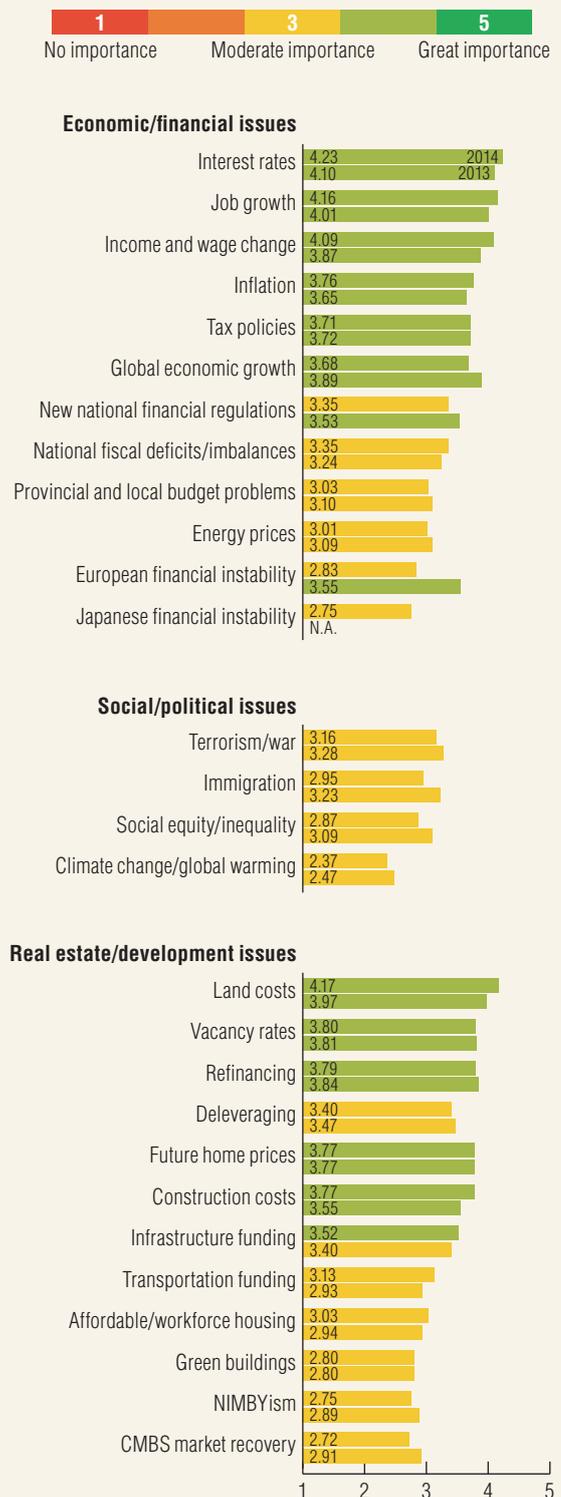
In Asia's emerging and frontier markets, development may also prove to be one of the only feasible strategies, if only because the lack of investable stock means there is very little to buy—assuming, of course, investors can navigate the market and stomach the risk. As one Hong Kong-based consultant said, "In emerging Asian markets there could be some overdevelopment, but if you want to own, for example, prime retail in Southeast Asia, I think development is one of the solutions." In addition, one opportunistic fund manager commented, "One of the few places where you actually get paid a sufficient development margin to build an office building is Jakarta. In developing countries there actually is a decent development margin, whereas in places like Singapore or Hong Kong it just doesn't make sense."

Emerging and Frontier Markets

Difficulties in gaining access to Asia's emerging or frontier economies mean that, in practice, investing is usually restricted to larger and more experienced players. Again, however, higher potential yields remain a big draw, and investor interest in these destinations remains strong. Over time, there is little doubt that these markets will become better equipped to handle investment flows, but the fact that so many investors are prepared to consider a move now was seen by some as a red flag. Said one interviewee, "It's not to say that it's not potentially attractive for certain types of investors, but in terms of the scale of the market, and your practical ability to get money in, and the risk you're taking, it reflects the fact that it's very difficult to identify

EXHIBIT 1-16

Importance of Various Issues for Real Estate in 2014



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

countercyclical plays. Overall, Asia still feels like a market with too much money and not enough opportunity.”

The Philippines

While the Philippines has long suffered from a reputation for lack of transparency, a significant number of executives interviewed for this year’s report were more upbeat about the current political environment, naming the country as their preferred choice among similar Asian markets. In addition, capital city Manila emerged as the top destination among various investment sector categories in the *Emerging Trends* survey. As one investor described it, “It’s a good niche play—it won’t register on the radar for a lot of institutional investors; it’s just too small and too accident-prone. But I think for people who are prepared to get in there and spend time and understand the market and the drivers, there is good value there.”

Until now, most foreign investment in the Philippines revolved around the business process outsourcing (BPO) sector, usually involving call centers. More recently, however, investment interest has broadened and in particular has focused on back-office functions for multinational companies, especially in the finance sector. One foreign investor active in the Philippines pointed to the huge amounts of office space absorbed in Manila in 2012, which at some 4 million square feet rivaled uptake in Tokyo, whose stock of 400 million to 450 million square feet was far bigger: “So Manila is where India was ten years ago,” he said. “Multinationals, and not just call centers, will be adding employees in Manila over the next three years, the reason being that you have an English-educated workforce who is 95 percent literate. A college-educated CPA out of school—you pay him US\$11,000 per year.”

While securing access to product in the Philippines is predictably difficult for foreigners, especially as the long-touted REIT industry has yet to materialize, there are occasional possibilities to invest in core products. On the opportunistic side, cap rates are in the 9 to 10 percent range, while development returns are 15 to 20 percent. A yield spread of 350 to 450 basis points over financing costs can generate mid-teens operating cash flow.

Another investor with experience working in the Philippines commented, “I think it’s definitely an underdog, but fundamentals there do look good. I like the Philippine economy from a demographics perspective, and they do manufacture more than people think. The problem is just a lack of political leadership and the amount of corruption, which, at the end of the day, stops infrastructure works from being completed. It creates a bit of a time warp, like Thailand before the Asian crisis.”

Indonesia

For most investors, the Indonesian market means either Jakarta or Bali, both of which continue to be popular in 2013 despite setbacks for the local economy as a result of invest-

ment outflows in response to the prospect of tapering in the United States. In addition, and although development yields are reputedly high, Indonesia is “difficult to operate in for lots of reasons.” As one developer related, “It has immense potential as far as the whole outline of land development is concerned, but the problem that prevents us from going in is that of getting clean land title.”

Beyond that, there is little incentive for local developers to partner with foreigners. As one investor said, “I suspect very few people have actually invested there, particularly the funds, the challenge being that it’s dominated by wealthy Indonesians. The locals are just so strong, and it’s a bit like the Philippines in that respect. If you’re going to develop something, these guys have vast land banks at extremely low historic cost, so assuming you’re buying at market [rate] you’re competing at a very low land cost basis. It’s scary.”

Nonetheless, the growth story is compelling and investors continue to test the waters. “It’s tough to compete, but we’d like to do more and we continue to talk and look,” said one investor. Said another, “People are talking about Indonesia as the next big mover, and we see more institutional capital coming into that market.”

Vietnam

For the last couple of years, serious economic and governance issues have kept many investors away from Vietnam. Inflation rose to a peak of approximately 23 percent in 2012, while the banking system has recently suffered problems as billions of dollars’ worth of loans made by domestic banks have gone bad. Despite these issues, however, investors are again looking at Vietnam as a possible play, partly because there is a perception it may now be at the bottom of the cycle, and partly because it has recently experienced a significant inflow of manufacturers adopting the “China + 1” model.

On the ground, according to one Vietnam-based interviewee, there are sure signs of a pickup in momentum: “This time last year there were zero launches, there was zero interest,” he said. “Potential buyers could simply put their money into the bank and get about a 16 percent return, or buy gold, which is historically a favored investment. But over the last 18 months, gold prices have declined along with interest rates, so that makes for an improved environment for real estate investment.” As a result, “you’re seeing developers restarting projects. It’s still very early days—they’re not pushing up prices, but they are able to launch second and third phases.”

There are likely to be a large number of nonperforming real estate loans in Vietnam, but foreign investors will probably have little chance to invest in distress. As one investor said, “In Vietnam, there is no word for distress. Investors may come hoping to see, if not blood in the streets, prices at least marked to market. But for various reasons, developers and land bankers still feel they won’t have to sell to cover their loans. In smoke-filled karaoke rooms there may be deals

done, but you rarely see properties on the open market. It's a bit like China insofar as distressed properties tend to change hands to connected parties rather than to outside investors."

One sector that has seen more activity recently is industrial parks, often in northern Vietnamese cities such as Hanoi and Haiphong. As one consultant said, "Vietnam is back on the radar for industrial, which is now a bigger opportunity than office. It's now the busiest time in five years, and better-quality tenants, too. We're seeing a lot of interest from the Japanese—they've been based here a long time, but things have now picked up: my telephone bill to Japan is five times higher this year than last."

Regulations Chill Overheated Markets

Governments across Asia have never been reluctant to use regulations to curb real estate volatility, at least partly because of the area's volatile economies. This is especially so in ultra-interest-rate environments like Hong Kong and Singapore.

In Hong Kong, authorities at the start of the year introduced a new round of transaction taxes and raised downpayment requirements for both the residential and commercial sectors. In Singapore, the government's four-year campaign to curb home prices continued with a further round of transaction tax increases, together with a new policy tool that caps total consumer debt available from banks at 60 percent of borrowers' incomes.

The measures have had a chilling effect on residential transactions in both cities, particularly at the high end. That said, mass-market pricing has yet to fall significantly in either place, while the strength of underlying demand is apparent in buyer responses to developer price cuts. Nonetheless, analysts and interviewees alike are now projecting price declines in both residential markets of 10 to 20 percent for 2014.

There has been an impact on the commercial side, too. As one Hong Kong-based fund manager observed, "Mathematically, you could have calculated that pricing would come off 3 to 4 percent and the market would continue. But the measures affected sentiment, and sentiment is king in Hong Kong, so there's been a massive drop in investor activity." In Singapore, sales of strata-title commercial properties, which had mushroomed in recent years as the government began to target the residential sector, fell sharply. Retail strata sales were down 60 percent quarter on quarter in the July-August period alone, according to broker DTZ.

Although the rules have been predictably unpopular in both markets, interviewees generally viewed them positively. "There was too much speculative activity, too much participation by the newer mom-and-pop investors, and too many strata-title little units being transacted across all asset classes, including industrial but also retail and office." In any event, the rules seem unlikely to be displaced in the foreseeable

future. In Singapore, for example, the government "is going to continue to implement more regulations to soften the market, which is good, and basically correct the market, which is needed."

New regulations have also been introduced in 2013 in Taiwan (limiting local insurance companies from investing in commercial property assets) and in New Zealand (restricting local banks from offering highly leveraged home mortgages).

In China, the residential sector was resurgent in 2013, despite an ongoing regulatory crackdown in place since early 2011. Home sales transactions increased 34.5 percent year on year in the first nine months, while prices increased 10.7 percent, according to SouFun, China's biggest real estate website. Land sales and prices also registered some dramatic increases, although this should not necessarily be interpreted as an endorsement of the market's future strength. According to one local developer, the buying "is coming from some of the biggest developers, and they're just recycling their profits and replenishing land banks as they always do. From a strategy point of view, they have to replenish, so it's not necessarily indicative of a bullish mentality."

Will the authorities step in again? Reading the tea leaves in China is notoriously difficult. But as one Hong Kong-based consultant said, "There's certainly concern in Beijing about the need for further cooling. The leakage is around the edges, cities paying lip service to the rules, but being somewhat relaxed in their attitudes—so my sense is that the intervention may not be extra measures, but for Beijing to police the situation more closely." Others questioned the new government's commitment to current restrictions given the generally sluggish economy and widespread resistance to existing policies from local governments financially reliant on land sales revenues. Said a representative of a large mainland developer, "People are always talking about government measures, but that's more of an outsider's point of view. An insider's point of view is that people find all sorts of ways to buy and sell anyway. My personal view is that they probably have more in mind to introduce property taxes, which are a longer-term goal."

Whatever the prognosis for further policy curbs, however, the existing restrictions had already taken some of the shine off the sector. Although housing continues to draw substantial volumes of capital, and its self-liquidating nature has long made it a favorite in a market where exiting deals can prove challenging, recent returns are down from their peaks. Nowadays, according to one investor, "it's harder than ever to make the numbers work in China residential. Land costs continue to go up, construction costs continue to go up. You've still got reasonably healthy absorption, but it's spottier than it was, and as a result developers will cut prices when they need to sell inventory, which puts pressure on the top line and squeezes your margins. So the view is that, in tier-one markets especially, the government will keep its foot on the brakes for a long time—it's just not as straightforward as it used to be."

Chinese Oversupply: Fact or Fantasy?

Rumors of real estate bubbles, oversupply, and ghost towns have been circulating for years, especially in Western media. Last year, *Emerging Trends Asia Pacific* examined the issue in relation to China's residential sector and outlined a number of reasons why the bubble thesis was generally misconceived, with ongoing demand and rising incomes continuing to drive the market going forward.

This year the position is little changed, despite the fact that Chinese home prices have once again begun to accelerate, picking up anywhere between 16 and 20 percent year on year in September 2013, according to official figures. As one foreign developer said, "I would say honestly there's not much of a fear factor. In first-tier cities, the real demand and the upgrading demand for homes [are] just enormous, and you can say that for the second tier, too. The third tier is where we don't see that many opportunities—the further away you get from first and second tier, the more of a gamble it will be."

More recently, talk of oversupply in China has become increasingly focused on the office and retail sectors, especially in secondary and tertiary cities. On the office side, interviewees described the situation as "terrifying" and "ugly" and "extraordinary." As usual in China, though, the oversupply issue is more complex than it seems. First of all, much of the glut of new office space is poorly conceived and located, with too much thought given to exterior appearance and too little to interior factors such as floor-plate efficiency. "It's quite good not to have a column in the middle of the board room," as one investor put it.

Second, and partly as a result, much of this unsophisticated new stock is eventually sold on as strata title, at which point it generally becomes poorly managed and disappears off the radar as a competitive grade-A product. As a representative of one large foreign developer active in China said, "People going into these offices will not be financial or business-services people, and a lot of it is strata-sold and rented off to small and medium-sized enterprises where it has a life of its own—so in that sense, they're playing in a very different market segment."

Finally, according to the same developer, the perception of oversupply is tempered by the fact that "state-owned enterprises are now gobbling up the underdemand," at least in the second-tier cities. This is a repeat of the experience a few years ago in Beijing, where government-related bodies also stepped in to pick up the slack following a similar glut of office supply. Fears the influx would prove short-lived have proved unfounded; today, supply in Beijing's office sector remains tight despite years of strong price and rental increases.

China's retail sector, meanwhile, is experiencing a similar glut in supply. At present, the mainland is by far the most active development market in the world for retail projects, according to CBRE, accounting for almost half of the 32 million square meters of new space under construction. Yet many projects are misconceived in type and location, with little understanding of the complexities of managing large malls. The problem is now exacerbated by an extraordinary boom in internet-sourced sales and (at the high end) by an ongoing government crackdown on official gift-giving. As a result, according to one developer, "I'd say with quite a bit of certainty that many people are going to fail—the days of trying to get in Louis Vuitton and thinking that will be enough are

EXHIBIT 1-17

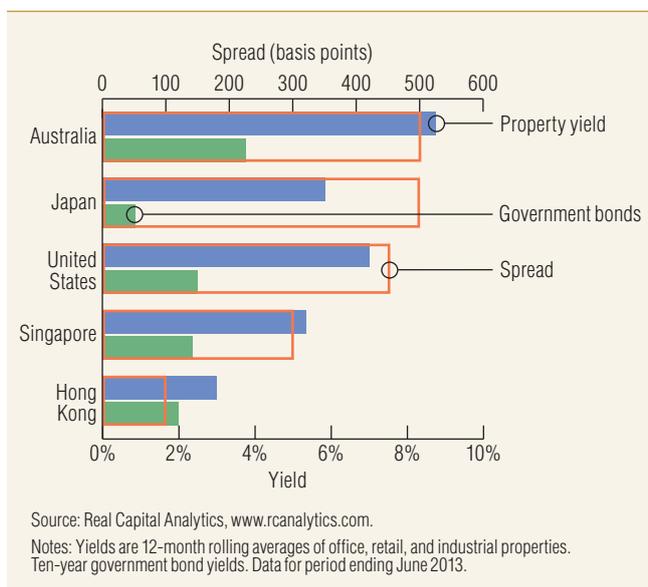
Forecast for Real GDP Growth Rate, in Percent

Country/territory	2010	2011	2012	2013*	2014*	2015*	2016*	2017*
China	10.45%	9.24%	7.70%	7.60%	7.25%	7.03%	7.01%	6.97%
Indonesia	6.20%	6.46%	6.23%	5.30%	5.50%	6.00%	6.00%	6.00%
Thailand	7.78%	0.05%	6.49%	3.11%	5.25%	5.01%	4.41%	4.68%
India	10.09%	6.84%	3.24%	3.80%	5.15%	6.27%	6.47%	6.65%
Vietnam	6.78%	5.89%	5.25%	5.30%	5.40%	5.40%	5.50%	5.50%
Philippines	7.63%	3.91%	6.81%	6.81%	6.03%	5.50%	5.50%	5.50%
Malaysia	7.15%	5.08%	5.64%	4.70%	4.90%	5.20%	5.20%	5.20%
Taiwan	10.72%	4.03%	1.32%	2.19%	3.77%	3.93%	4.16%	4.38%
South Korea	6.32%	3.63%	2.04%	2.84%	3.68%	3.96%	3.99%	4.03%
Hong Kong	7.09%	5.03%	1.50%	2.98%	4.38%	4.40%	4.49%	4.51%
New Zealand	1.82%	1.35%	2.65%	2.54%	2.94%	2.44%	2.50%	2.54%
Australia	2.51%	2.14%	3.67%	2.47%	2.78%	2.95%	2.97%	3.02%
Singapore	14.76%	4.89%	1.32%	3.54%	3.43%	3.61%	3.78%	3.86%
Japan	4.53%	-0.76%	1.96%	1.95%	1.24%	1.13%	1.17%	1.13%

Source: International Monetary Fund, World Economic Outlook Database, October 2013.

* Forecasts.

EXHIBIT 1-18

Property Yield Spreads vs. Government Bond Rates

well and truly over. China is not a market like the U.S. where you have regional malls everywhere, and it's also extremely competitive. It's going to surprise a lot of people when even projects by well-known developers may not necessarily work."

Again, however, more sophisticated players have so far remained relatively unscathed. In part, this is because a lot of the competition is unversed in retail management. As one developer commented, "Only a very small amount of this huge supply is what we call organized retail. A lot of it is strata-sold, and the moment [that happens] it's no longer our competitor—these are the shopping centers that will die going forward. Those that are professionally organized and managed are relatively scarce."

Another reason is that oversupply is often a local phenomenon that can be avoided to some extent. As one developer put it, "We look at the usual [second-tier] suspects, but some of those suspects look more oversupplied than others, so we try to go where the oversupply situation doesn't look as threatening." In addition, he continued, overarching strategy plays a big role: "We're not stretched across too many compromise sites; we take a lot of time to pick the locations; we don't pick too many; and the ones we pick we think are very, very good, according to our own criteria. So, if you have the right product and make people want to come and spend, there might be four or five competitors next door, but people just won't go—on paper it looks like you're in an oversupplied environment, but it doesn't affect everybody."

Tapering—What Does It Mean?

Although investor sentiment in this year's *Emerging Trends* survey remains strong in general, there was still significant concern surrounding two main themes.

The first relates to the possibility of a further slowing in the Chinese economy, creating a knock-on impact for the rest of the Asia Pacific region in terms of both direct and export-processing trade. This has been a longstanding source of anxiety among Asian investors that has been noted in previous editions of this report. However, there seems to be little prospect of further economic slowing in the mainland over the short term given that Beijing continues to provide stimulus whenever the economy seems on the brink of stalling. What appears to be a "mini-stimulus" took effect during the third quarter of 2013, with gross domestic product (GDP) growth rising to 7.8 percent year on year from a low of 7.5 percent the previous quarter, more or less on a par with growth in 2012. The easing has probably contributed to the strong pickup in China's residential real estate pricing and sales in the second half of 2013.

Another—and probably bigger—issue for Asian investors is concern about the consequences for local economies of a "tapering" by the U.S. Federal Reserve sometime in the near future. In mid-2013, market anxiety over the prospect of tapering in the United States had a significant impact on Asian currencies and stock markets as Western investors repatriated portfolio investments.

Although the tapering ultimately failed to materialize as expected, leaving local capital markets and currencies to retrace some or most losses, the extent to which Asia remains exposed to whiplash from capital outflows was an ominous sign. It is true that most real estate assets in Asia (with the obvious exception of those listed on local exchanges) are not directly affected by these portfolio outflows, but the indirect impact can still be considerable. As one consultant said, "The flows were coming in through emerging-market bond funds, and eventually filtered through the banking system into the consumer sector and also to the developers. So it's not necessarily hot money going into real estate [directly], but the hot money can stimulate demand, which stimulates investment and ends up coming through into real estate [indirectly]." While in absolute terms the quantum of hot money flows involved may not be substantial, its impact on the margins by way of the multiplier effect can be disproportionate to its size both on the way in and on the way out. Emerging markets are expected to be especially exposed to this phenomenon.

The biggest issue of all, however, as far as most real estate investors are concerned, is the prospect of higher interest rates. This begs the question of whether the beginning of the tapering (which involves reducing the volume of the Federal

Reserve's bond repurchase program) actually means an increase in U.S. short-term rates, and, by extension, rates in Asia. The Fed has said specifically that it does not (linking this instead to the U.S. unemployment rate), but certainly the beginning of the tapering brings the prospect of higher interest rates one step closer, which has a psychological impact on investment.

The key question is: When rates do eventually begin moving back toward historical norms, what will the impact be? One investor said, "Conventionally, if interest rates go up, cap rates have to go up as well, which means property prices fall." There are, however, various nuances to this principle, the most important of which is perhaps that when investors enjoy a big yield spread—as they currently do in many Asian markets—an increase in interest rates will simply return the yield spread to its own historical norm without requiring cap rates to move.

Rising interest rates are therefore likely to have a disproportionate impact on asset pricing in two situations:

- Where yields are already super-compressed, as in markets such as Hong Kong and Singapore; and
- In markets such as Australia, Japan, and India, where investors are already betting on an element of cap rate compression to justify projected returns. This is particularly the case in Australia, where global funds targeting core assets at rates of, say, 7.5 percent will find that shrinking Australian yield spreads will lessen the appeal of local assets relative to similar properties in U.S. gateway markets, where cap rates are expected to move out. Said one fund manager, "Australia prime assets that are at 7.5 look ludicrous—those cap rates look like outliers, and given what's happened with the ten-year [U.S. Treasury bond], in Australia you would expect real cap rate compression. But when cap rates start backing up in the U.S., that relative attractiveness starts to go away in a hurry."



Real Estate Capital Flows

“We’re going through a phase when Asia is not the right place to be—things will cool off and we’re going to be well positioned to buy assets we think are cheaper.”

The steady stream of capital inflows to Asia that was so much the hallmark of U.S. economic easing in 2012 went into reverse in 2013, as the prospect of reduced economic stimulus in the United States prompted investors to repatriate assets back to the West. So far, though, the impact of this sell-off has been mostly confined to developers and real estate investment trusts (REITs) listed on the region’s capital markets. This is partly because they are more liquid, and partly because they are more sensitive to interest rate movements than other types of assets.

The physical market, by contrast, has been left unscathed. Why? As one fund manager said, “I think people recognize that real estate cycles are longer than equity cycles, and if everyone takes their global allocation and says it all has to go to New York and Chicago, it’s going to be a very overcrowded market.” As another interviewee observed, “The notion that there was this influx of hot money making it incredibly competitive, and then a switch goes and it all closes down—it just doesn’t happen, it’s not discernible.”

However, while talk of tapering is therefore unlikely to affect allocations to Asia, most investors concede that the macro-implications of portfolio outflows—combined with the prospect of higher interest rates—are likely, over time, to trickle down to affect asset prices.

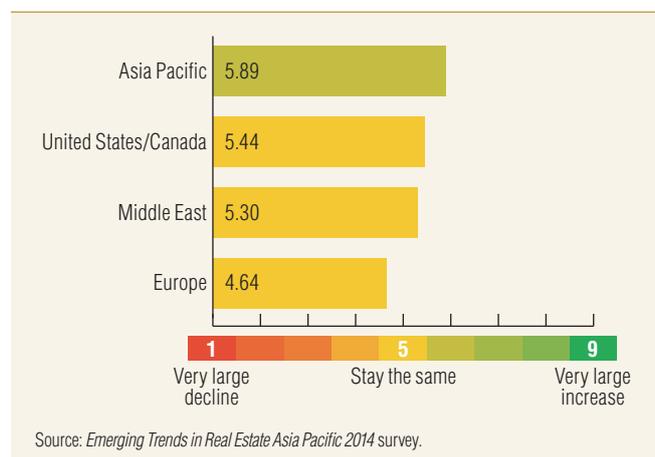
What’s more, the tapering is not the only source of potential weakness in non-Asian capital flows. To start with, U.S. investment banks—so long the dominant force in cross-border real estate investing—have now largely left the scene as a result of regulatory changes introduced in the wake of the global financial crisis. Private equity participation is growing, but has yet to pick up the slack, and foreign funds are probably net sellers in the current market anyway. In addi-

tion, recent Asian economic growth has been anemic: “Asia’s relative attractiveness has weakened because economies out here have slowed a lot more than people expected—sentiment has picked up recently, but for the first half of the year all the noise coming out of China was horrible.” Finally, real estate markets in both the United States and Europe currently offer better risk-adjusted returns. As a result, as one investor said, “If you look at capital flows, you’ll probably find there’s more money coming out of Asia than is coming into it.”

Although local fund managers continue to talk about international investors being under-allocated to Asian real estate, the appetite to increase allocations anytime soon appears weak. Still, none of this is necessarily bad news. For some,

EXHIBIT 2-1

Change in Availability of Equity Capital for Real Estate in 2014 by Source Location



in fact, it is exactly what they've been waiting for. As one fund manager at a large opportunity fund said, "We're going through a phase when Asia is not the right place to be, and money is flowing to America. There's a lag effect in real estate, but I think it will eventually affect domestic operating companies and should play through to real estate over time. We quite like that from a buying perspective, because it should affect pricing—things will cool off and we're going to be well positioned to buy assets we think are cheaper."

EXHIBIT 2-2
Investment Prospects by Asset Class for 2014



This buy-the-dip mentality—assuming a dip occurs—only underscores the confidence of many Asian investors that the long-term drivers of the market—economic growth, rising incomes, ongoing urbanization, and structural undersupply of commercial and residential stock—remain intact.

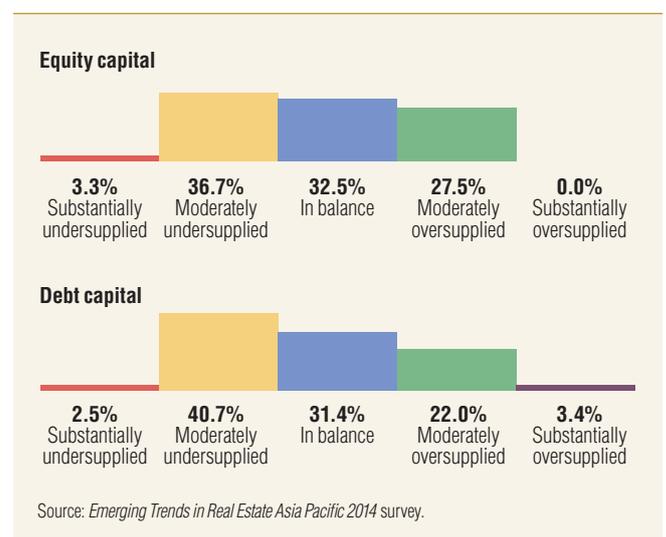
Asian Capital Dominates

If global capital is no longer the force it once was in Asia, this is at least partly because there are vast quantities of newly minted regional money that have stepped up to replace it. Asian investors of all descriptions—from institutional funds to insurance companies to sovereign wealth funds to high-net-worth individuals—are buying real estate throughout Asia in unprecedented volumes. In fact, according to Jones Lang LaSalle, about 88 percent of all Asian commercial real estate transactions originated from within the region in the first three quarters of 2013, with many of the buyers coming from China. One reason for this is that the volume of capital accumulated in many Asian countries has far outstripped the capacity of domestic markets to absorb it.

In terms of private investment, there has been a significant rotation of foreign capital away from Hong Kong, where the introduction of regulations aimed at stemming speculative investment in real estate has seen high-net-worth Chinese money move to other destinations. Interviewees reported substantially higher levels of Chinese capital in almost every major Asian market, especially for high-end residential assets (except for Singapore, where similar regulations have taken effect).

In Japan, for example, "we're seeing a lot of speculators coming from Singapore, Hong Kong, and mainland China buying individual condominium units for cash—that's been

EXHIBIT 2-3
Real Estate Capital Market Balance Prospects for 2014



happening for the last six months and they've been driving the Tokyo high-end condo market pretty hard. That's clearly going to increase because the market has changed in Singapore and Hong Kong and they see Tokyo as a value. Whether they make money is another story."

In Australia "there's been lots of talk about affordability and of a housing bubble in Sydney, and there's no doubt that affordability is now an issue. But the reality is that the demand is there—at the high end, a lot of it is Chinese money coming in." In addition, "there's been both private and institutional Chinese money coming here to buy commercial properties—the phenomenon has been around for a while, but earlier this year we saw it getting sticky and deals getting done. And in the apartment sector, I understand that Chinese developers have also been coming into the market." In particular, according to another interviewee, "there has been an upswing in interest from Chinese buyers taking well-located B-grade office assets that are overlooking parks or in a reasonable CBD [central business district] location for residential conversions."

Chinese Developers Join the Exodus

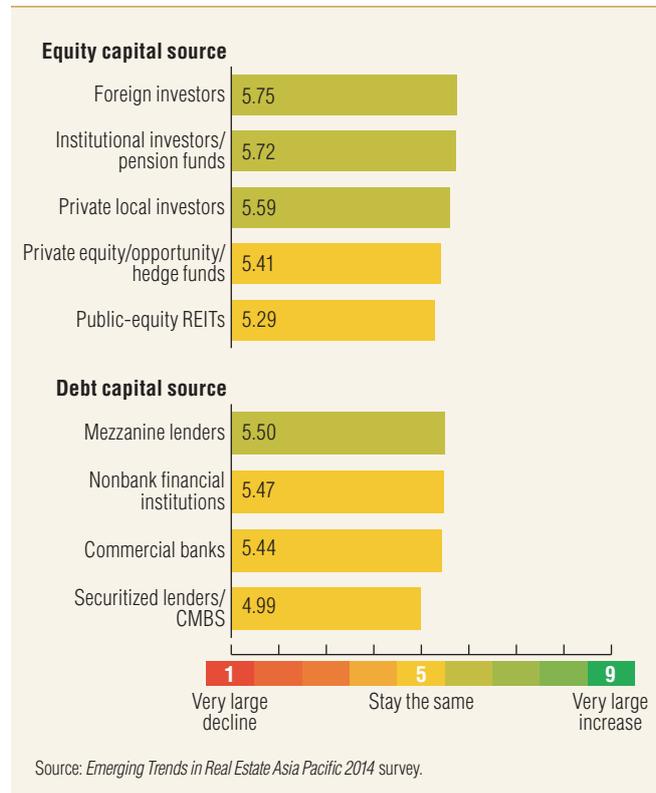
This year, the outward trend appears particularly strong among Chinese developers. As one Hong Kong-based consultant said, "I think we're going to see many more of them edge into [other parts of] Asia over the next 12 to 18 months—everyone we talk to seems to have that on their agenda. Their motive: diversification, learning how things are done outside the mainland, and becoming members of the international development community."

Often, Chinese developers will invest together with a local partner. Increasingly, too, they are willing to operate alone, generally focusing on residential projects, "maybe with a bit of retail thrown in to make things more exciting." In Malaysia, for example, according to one Singapore-based developer, "Some Chinese developers are coming here on their own. In Johor Bahru, they came over and showed Singaporean and Malaysian developers they can manage it alone. They're giants—they sold something like 6,000 units within a few weeks."

Foreign investments by Chinese developers are often aimed at a Chinese clientele. As one interviewee said, "It's about people movement, about capturing these flows of Chinese people as they go around the world, be they business visitors or people on location, and creating a whole infrastructure to support them." At the same time, he adds, "they [the developers] understand there's also a downside to that, so it's also about creating something they could also hold for investment, but with a cross-border clientele."

EXHIBIT 2-4

Change in Availability of Capital for Real Estate in 2014



Western Assets Targeted

Not all Chinese outflows are aimed at Asia, however. Nor are outflows coming only from China. In fact, perhaps the most impressive aspect of Asian capital movements is their diversity—in terms of different types of investors, different source countries across Asia, and different destinations that are targeted.

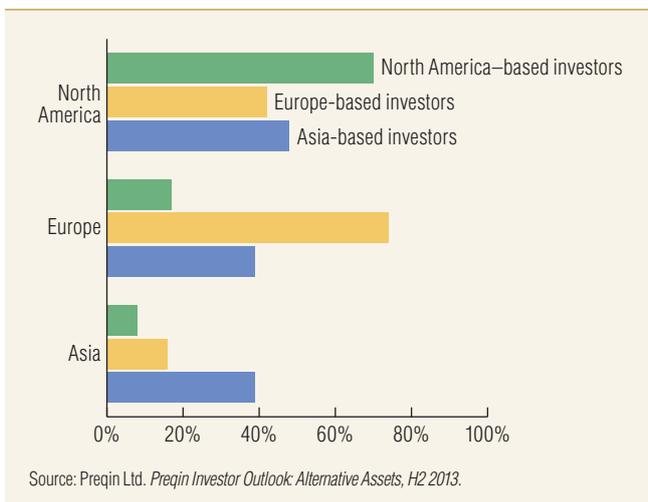
For the first time, large amounts of capital are heading to Western markets. According to Real Capital Analytics (RCA), Asian capital flowing into U.S. and European commercial real estate totaled US\$12.3 billion in the first half of 2013—almost as much as for the whole of 2012. Most capital originated from China, South Korea, Singapore, and Hong Kong and is generally targeted at core assets in tier-one destinations, with the U.K. and gateway U.S. cities currently the most popular.

Institutional Money Pours Out

As impressive as this is, there is more to follow. So far, the most active Asian institutional investors have been China's sovereign wealth funds and large state-owned enterprises, Singaporean sovereign wealth funds, and South Korean institutional players—all of which continue to raise allocations for real estate investment. A survey of South Korean institutions in

EXHIBIT 2-5

Regions Targeted in the Next 12 Months by Private Real Estate Investors by Investor Location



mid-2013, for example, found a likely further increase of 2 to 5 percent to global real estate allocations, equating to some US\$10 billion to US\$25 billion over the next two years.

There also are several huge institutional players in Asia that have yet to even begin investing abroad in significant volumes. Chinese insurers, for instance, which at the end of 2012 held some US\$1.2 trillion in assets, have a mandate under Chinese law to invest as much as 15 percent of these funds (or about US\$180 billion) in non-self-use real estate located

either inside or outside China. In terms of international investment, the first insurance company purchase took place only in July 2013 (in London). It is expected to be the first of many.

Just how much capital is heading abroad remains an open question. CBRE has forecasted that Chinese insurers will buy a total of US\$14.4 billion in international real estate, while a projection by Jones Lang LaSalle estimated US\$5 billion by the end of 2013, and US\$25 billion to US\$30 billion by 2030.

In addition, Australia's superannuation funds, which have assets under management of about US\$1.2 trillion, are once again considering international investments. The industry is still licking its wounds from the failure of huge bets made in Western markets in the run-up to 2007, but as one investor observed, "In the long term, they have to go abroad—there just isn't enough product in Australia because there's only 23 million people." As a result, the superannuation funds are expected to allocate some US\$7.1 billion to offshore real estate investments over the next few years, according to Jones Lang LaSalle. Favored destinations are Europe and the United States, although some capital may find its way to Asian markets, too.

Finally, Japan's US\$1.2 trillion Government Pension Investment Fund (GPIF), the world's biggest, may also be forced to diversify its portfolio away from Japanese government bonds (JGBs). A typical allocation to real estate of 5 to 10 percent would result in some US\$120 billion in capital, a significant portion of which would have to be sent out of the country in order to avoid distorting domestic markets—a concern the GPIF has already voiced.

EXHIBIT 2-6

Cross-Border Acquisitions by Asia-Based Investors in Europe and the Americas

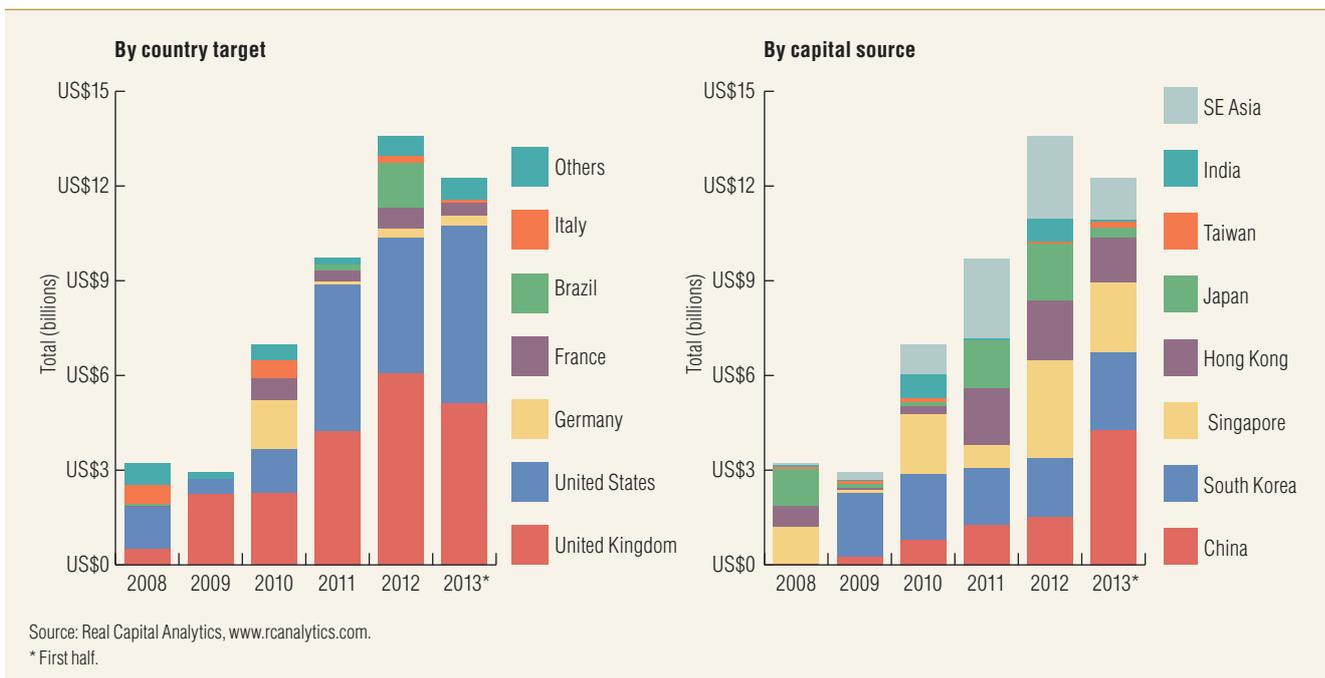


EXHIBIT 2-7

Estimated Size of Institutional-Grade Real Estate, by Country/Territory



Source: Nomura Research Institute Ltd., *Asia Real Estate Investment Market 2013*.

Put together, the collective spending power of Asia's investment funds is likely to make them the dominant global force in institutional investing in coming years. That said, however, investment opportunities in Western markets are starting to get thin on the ground, as more capital from across the globe is now targeting assets in Western gateway cities. As a result, investors there are having to move up the risk curve or migrate to secondary markets, just as they are in Asia.

Sovereign Money Pours In

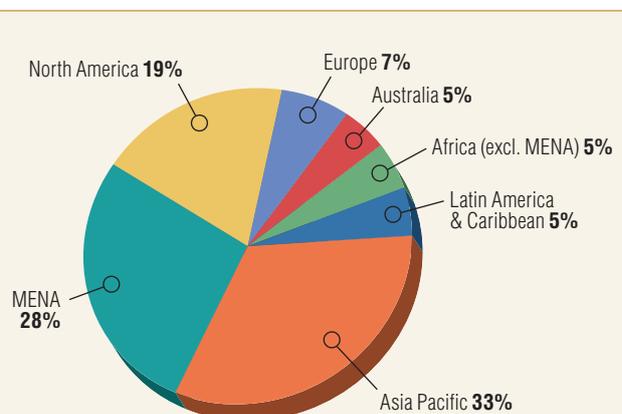
Sovereign and institutional money is not only flowing from Asian countries outward, but also arriving in growing volumes from the outside. Several such funds, especially from the Middle East, have set up offices in Asia with the intention of forgoing the traditional blind-pool model and investing directly.

Setting up a team and learning the ropes of the local markets from scratch, however, can prove tricky, and quite often these funds are opting to co-invest alongside private-equity money. There are various reasons for this. As one manager at a large private equity fund in Hong Kong said, "Opportunities for co-investing with sovereign money is certainly something that comes up, both because it allows them to build their direct investment expertise, and also because it allows them to dollar-cost-average the fees." In addition, "although they can write very large tickets, they often lack the internal bandwidth to manage and underwrite risk properly. And then, even if they do have those skills, they sometimes as an institution lack the ability to move fast enough to execute opportunities when they come across their desks."

In addition, problems in sourcing traditional core-type investments in Asia's cap rate-compressed markets are now encouraging institutional funds to take a more adventurous approach, participating in both development and opportunistic deals. More of the same can be expected as institutional players grow familiar with Asian real estate investments. For example, South Korean funds, which have been active internationally for several years, are now more open to investing in junior debt and even value-add plays. Other funds are likely to tread the same path in future.

EXHIBIT 2-8

Sovereign Wealth Funds Investing in Real Estate by Regional Location



Source: 2014 Preqin Sovereign Wealth Fund Review.
Note: MENA: Middle East and North Africa.

EXHIBIT 2-9

Largest Sovereign Funds by Assets

Country/territory	Fund name	Assets (US\$ billions)*	Inception
Norway	Government Pension Fund—Global	803.90	1990
Saudi Arabia	SAMA Foreign Holdings	675.90	N.A.
U.A.E.—Abu Dhabi	Abu Dhabi Investment Authority	627.00	1976
China	China Investment Corporation	575.20	2007
China	SAFE Investment Company	567.90**	1997
Kuwait	Kuwait Investment Authority	386.00	1953
China—Hong Kong	Hong Kong Monetary Authority Investment Portfolio	326.70	1993
Singapore	Government of Singapore Investment Corporation	285.00	1981
Singapore	Temasek Holdings	173.30	1974
China	National Social Security Fund	160.60	2000

Source: Sovereign Wealth Fund Institute.
Notes: * Data as of November 2013. ** Best-guess estimate. N.A. = not available.

Tokyo Draws the Crowds

While the big three real estate investment destinations in Asia—Japan, China, and Australia—remain the same as in previous years, the biggest change in terms of the volume of incoming flows has been in Japan, which reemerged this year as an investor favorite.

With a yield spread of about 500 basis points over funding costs, cash-on-cash yields have long been a big draw for Japan, but the real difference in 2013, and one that explains why it has risen to the top of this year's investment prospect ranking survey (from 13th last year), is the introduction of a vast program of government stimulus known as "Abenomics" (after Japan's current prime minister, Shinzo Abe). Abenomics aims specifically to reverse two decades of economic decline by creating conditions that will reintroduce inflation into the economy (including real estate). The real breakthrough in Abenomics is the realization that without inflation, the country will eventually be swamped by the remorseless rise in government debt.

Asset-value inflation is a sure draw for real estate investors. As a result of Abenomics, therefore, in the second quarter of 2013, investment in commercial real estate in Tokyo rose 78 percent year on year to US\$10.2 billion, according to brokers Jones Lang LaSalle. Although only about 15 percent of this was attributable to foreign buyers, there has been a significant increase in international fund allocations to Japan. With little sign of weakening sentiment, the flows are likely to continue. "Abenomics is producing a feel-good factor that is starting slowly to translate into demand," said one investor. "A lot of the new stock that's been overhanging the market over the last couple of years is filling up, and a lot of oversupply has slowly been taken up by consolidation at low rents."

Investors have been projecting a bottoming of rentals in Tokyo for at least the last three years, and although opin-

ions differ as to whether rent declines have in fact reversed, most interviewees report some 50 to 100 basis points of cap rate compression in Japan during 2013 as a result of rising capital values. There also is a general expectation that rising rents will create further cap rate compression in 2014. As a result, according to one investor, "people have a spring in their step, more people are looking around, sellers are more willing to sell." Another said, "Everything is going out to a bid, to some type of competition, and rightfully so—I was a seller, no question. So it's more competitive, but transaction volumes are up."

While the easing policies have so far met their short-term goals of depreciating the yen and boosting capital-market asset values, the big question in the long term is whether the solution to Japan's already enormous public sector deficit really lies in creating so much new debt that it doubles the nation's existing monetary base. Debate on this topic rages, but, in the words of one interviewee, "The one thing that is certain is that they were in an untenable situation that was simply getting worse—without growth in the economy, they are heading toward catastrophe. It's a bit like the pirates in Never Never Land—your really, really believing you can fly doesn't mean that you can, but if you don't believe it you certainly won't." Meanwhile, the consensus among most real estate investors (with a vocal minority of dissenters) seems to be that the music will continue at least over the likely life span of their investments. As one fund manager said, "I don't think I would be long Japan over ten years, but our investment horizon is four or five years, which I think will be okay as long as we hedge."

Currency Risk Rises

The extra layer of risk that investors must assume when buying assets internationally was underscored in 2013 as the

markets saw big swings in regional currencies in response to the evolving monetary policies in the United States and Japan. The Japanese yen declined about 22 percent in the year following the inception of a massive new round of monetary easing in April 2013. The Australian dollar fell almost 20 percent earlier in the year before a rebound cut losses by about half by late October. The most extreme example, though, was India, where the rupee collapsed by some 25 percent in less than four months beginning in May 2013, although it has since retraced about 10 percent of this.

Perhaps surprisingly, given the extreme nature of some of these swings, most interviewees (though not those in India) seemed relatively unconcerned about the impact of currency movements, even though in some markets the recent volatility will have wiped out several years' worth of gains for those already invested. To some extent, this is because Asian currencies have been falling, "so when it weakens, you feel more comfortable coming in," as one investor pointed out.

Currency movements can be hedged, of course, although Japan appears to be the only regional market where hedging is either affordable or actively sought. In Australia, far fewer investors have pursued hedging strategies. One reason may be that incoming investors tend to be big sovereign or institutional players who take a portfolio approach to risk, "so they are diversified in a number of countries and if they get a hit in one, they get a pickup in another." It is noteworthy, however, that the Australian government is either anticipating or promoting further devaluation in the Australian dollar—a fact noted by Australian central bank governor Glenn Stevens in a speech in October, who said, "It seems quite likely that at some point in the future the Australian dollar will be materially lower than it is today."

In India, meanwhile, hedging costs are so high that "your net return after hedging is usually the same as that after the disaster scenario," making hedging pointless. This is one reason that investors looking at India must take a deep breath before taking the plunge. As one fund manager put it, "If you look at the forward curve when you're at 62 [rupees to the dollar], that takes you out to 80. So you're thinking: should I be hedging, in which case the net returns are anemic for the risk, or do I go naked? Still, you feel a lot more comfortable going naked when the rupee's at 62 than when it was at 42."

On the plus side, currency declines translate into lower real occupancy costs for international tenants, helping to boost service industries in countries that provide outsourced services, such as India and the Philippines.

Fundraising Still Tough

Although the second half of 2013 saw a number of high-profile capital-raising announcements for Asia-based funds, the environment for most of those trying to attract new capital remains subdued. Funds are spending more time on the road trying to raise capital and many are coming up short of their

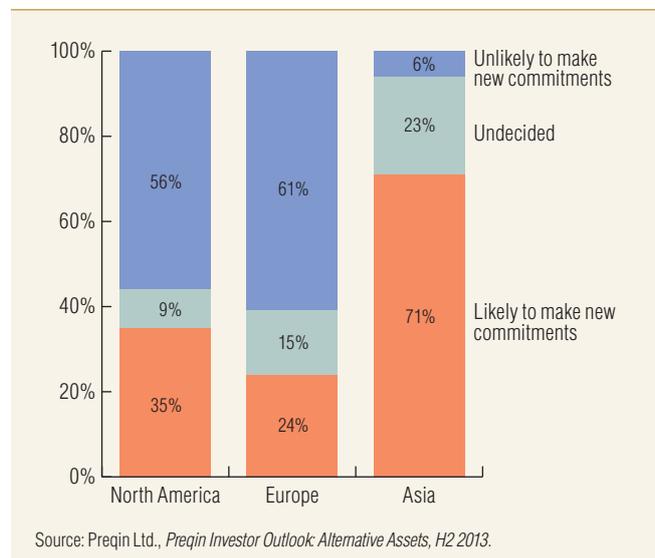
targets. "It's coming back a little bit, but it's not roaring back," as one fund manager put it. Although local funds raising local capital seem to be thriving, as evidenced by a poll published in the third quarter of 2013 by data provider Preqin in which 71 percent of Asian institutions stated that they intended to invest in direct real estate assets over the next 12 months, compared with just 35 percent in North America and 24 percent in Europe.

To a great extent, the prospects of success for raising new capital depend on the type and history of the fund. As one fund manager said, "We're at an inflection point because, on the one hand, you have the old guard that has trouble given their track record, and on the other you have the first-time funds in Asia, which have no track record, and they're also having trouble." As another manager observed, "Very specific targeted [funds] with a narrow investment focus will tend to do well because there will always be clients looking for niche strategies or regional-specific teams. And then there will be a number of global funds that also will be successful because they have a lot of experience and a proven track record. But I think the folks in the middle will have a very difficult time differentiating themselves."

One recent change that may help boost funds with established bases in Asia is that there are now fewer newly arrived institutional investors looking to set up their own offices. This became a trend a few years ago, in particular among institutions that had suffered losses on capital invested in blind-pool funds. As one Hong Kong-based fund manager said, "That is definitely what we are seeing, and there are some specific examples—I know two or three scenarios where funds came to Asia, set up teams of 50 people, and now they're down to five because they said it just didn't work."

EXHIBIT 2-10

Investor Intentions for Private Real Estate Investments in the Next 12 Months, by Investor Location



Another fund manager said, “It’s purely a reflection that managing real estate is a very local game, and if you’re a U.S. pension fund or corporate plan, you’ve probably got three or five people maximum, even for large-scale plans. Therefore, you can’t afford to have people on the ground in these national markets—you have to rely on partners, operators like ourselves.” While there are still some very large funds—often falling into the sovereign wealth category—that have the depth of human and financial resources to adopt this strategy, “I think on the whole the capital flow to Asia for funds will gain momentum pretty strongly from here on, notwithstanding the operating environment is a bit uncertain.”

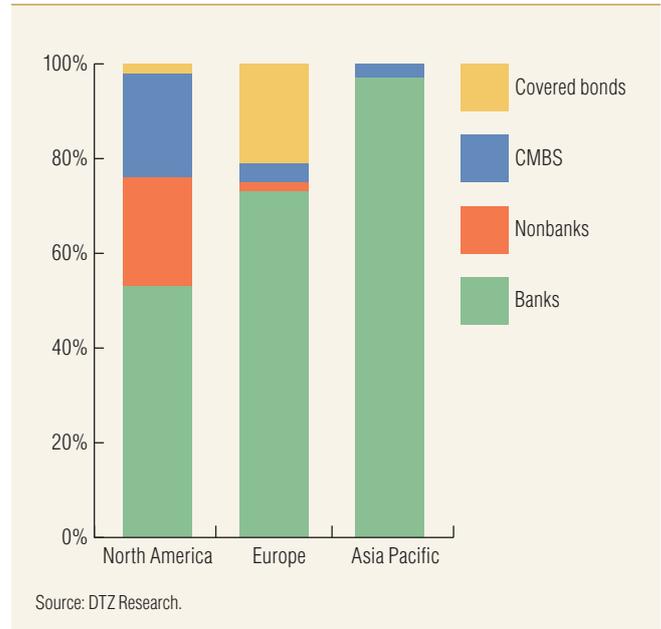
Bank Doors Wide Open

Compared with those in the United States and Europe, credit markets in Asia have long been dominated by the banking sector. There are a few foreign life insurers with offices in Japan that are running loan books. And in Australia, a niche has developed for certain asset managers also to offer credit. In addition, there is talk of the superannuation industry looking to develop loan portfolios as an alternate channel into the market. But in most places, banks remain effectively the only game in town, and that seems unlikely to change.

Over the last several years, bank funding for real estate deals has been readily available in most major markets, bar China and India, and that has remained the case in 2013. The question for the future is: How will a higher-interest-rate environment affect the way deals get financed? The obvious answer is that debt will become more expensive, but that is only one aspect. One fund manager asked, “Will there be as much liquidity in the debt market? Will banks still have appetite to grow their loan books for real estate? What kinds of spreads are going to be charged? And are they still ‘real estate-on’?” So far, there has been some talk of Asian banks tightening standards for commercial lending and increasing their rates on longer-term loans. But interviewees reported few or no signs of pressure on shorter-term rates. In fact, if anything, the environment in 2013 has been more accommodating than in previous years.

EXHIBIT 2-12

Outstanding Real Estate Debt, by Lender Type, 2013



In Japan, for example, where funding has historically been cheap, the credit markets are “unbelievable.” Finance is commonly available at little more than 100 basis points depending on the asset, and “people are still seeing spreads coming down.” Loan-to-value (LTV) ratios, meanwhile, are creeping up. Some opportunistic investors reported getting 80 to 85 percent leverage, and in a handful of seller-financed deals, LTVs exceeding 90 percent have been seen.

Another sign of easy credit is that banks are willing to offer cheap fixed-rate terms. In Tokyo, according to one investor, “we’re seeing fixed-rate financing becoming the norm. Before, there were a couple of life companies doing it using their general account, but now we’re starting to see Japanese megabanks offering five- and seven-year fixed-rate financing. People want to get locked in for obvious reasons. We’re doing ten-year fixed-rate financing on our deals at about 1.5

EXHIBIT 2-11

Equity Underwriting Standards Forecast

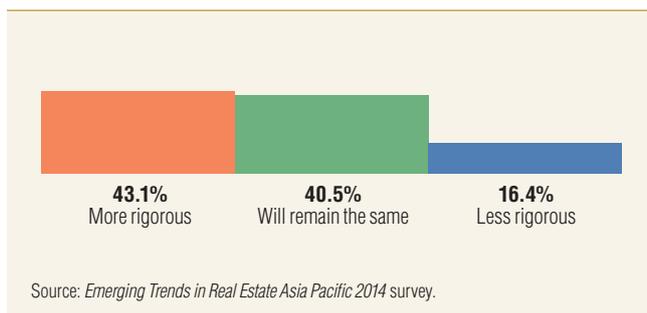


EXHIBIT 2-13

Debt Underwriting Standards Forecast

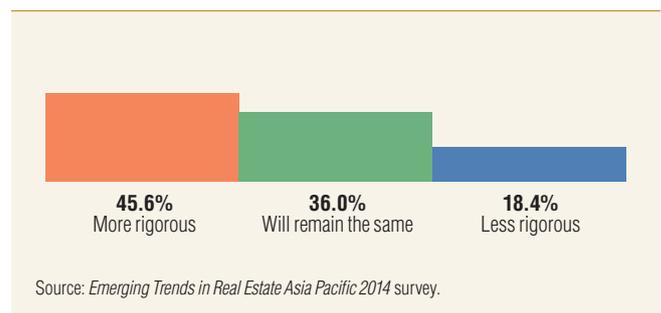
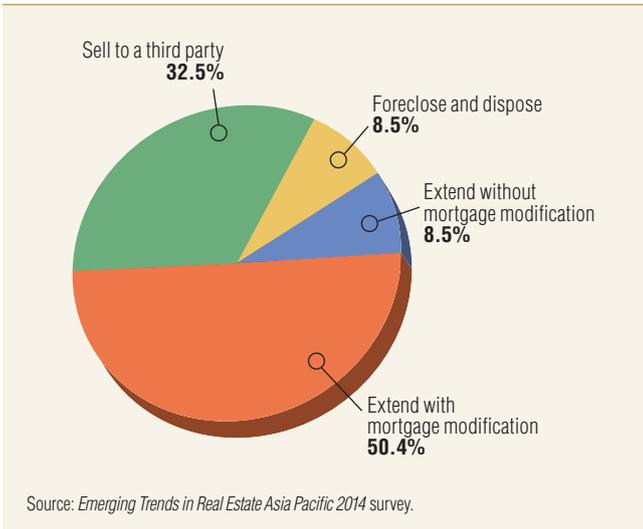


EXHIBIT 2-14

Maturing Loans: Preferred Strategy for Lenders by Mid-2014

1.7 percent. For five-year fixed-rate money, you can get in at about 110 to 120 basis points all in.” Investors in other parts of Asia also are tapping fixed-rate credit where available.

Outside Japan, lending terms may not be quite as accommodating, but credit is still easily available. In Australia, where banks have been less enthusiastic about real estate investments ever since the global financial crisis, the environment changed significantly in 2013 after top-tier REITs diversified their borrowing sources by seeking alternative financing in the United States and Europe. The resulting drop in demand for credit meant that domestic banks had problems filling their loan books, and they are now more open to providing loans. Nonetheless, one interviewee said that “they’re still pretty conservative over here, so they’ll lend against good covenants, but if you haven’t got a good covenant, it’s pretty hard.” And another investor commented, “The banks in Australia are very keen to put money out now, but at the same time they don’t get too racy on the terms—so if you have a high-quality cash flow situation, you get a lot of attention from banks. But if you’re talking about doing 80 percent LTV development financing, that’s not what they’re looking for.” Australian developers, therefore, must often source mezzanine funding to make up capital shortfalls.

In China, the government established a bank credit embargo against developers in early 2011, which has created problems for all but the biggest players in borrowing for construction and (especially) buying land. Conditions eased to some extent in 2013, however. As one consultant said, “They’re certainly more generous than they were in terms of construction loans—rates now are more competitive and clients we’ve been dealing with are now able to borrow significantly greater amounts at more beneficial terms. But it’s still very difficult to borrow for land, so this is where we

have the gray market—the trusts and private equity. Nearly all our clients are now using the gray market to fund their land purchases.”

Leverage is still readily available. Interviewees reported LTVs of 55 to 65 percent in China, 50 to 55 percent in India, 60 to 65 percent in Singapore, 50 percent in Australia, 50 to 55 percent in South Korea, and 40 percent in Hong Kong (the one market where LTV share declined, basically at the behest of the government).

Alternate Financing in China

With mainland equity and bond markets still closed to Chinese developers, and with ongoing restrictions in raising capital from the banking sector, particularly for the purchase of land, some developers are seeking novel ways to fund deals. In the past, they did so via China’s trust industry. Trust companies would take funds from high-net-worth individuals or corporations and, acting as a go-between, invest them in real estate (and potentially other) assets. The problem was that these trusts were often marketed as risk-free wealth-management products (WMPs) by banks. Unsurprisingly, given banks’ otherwise low deposit rates, interest in such high-yielding plays was high, especially as consumers were laboring under the impression that the products enjoyed an implicit government guarantee. The trust industry boomed, and assets under management reached over US\$1.5 trillion as of mid-2013. Once a few trusts began to run into liquidity problems, however, the government stepped in to tighten the rules. Today, trust companies are subject to a creeping wave of restrictions, especially for real estate development.

At the same time, the government also loosened rules that had previously prevented securities companies from offering WMPs. As a result, responsibility for this type of real estate investment product has effectively been transferred, with the securities industry moving to establish what is the equivalent of private equity funds. These now operate on a basis similar to the trusts (but without the guarantee), and are often set up to cater to specific projects. In addition, they charge significantly less. Said one interviewee, “The private equity funds that are being set up for real estate investments are probably lending at 8 to 10 percent.” That compares with rates of 15 percent or more for loans from trust companies.

In addition, however, Chinese developers are raising finance in Hong Kong where they can. Some will borrow from local banks, which “are willing to take some exposure to land in China, depending on the pedigree of the borrower. They’re borrowing 50 percent of the land costs in Hong Kong at about 8 percent, and they’re borrowing for construction costs in China.” Money raised in Hong Kong is not necessarily restricted to bank borrowing. As one Hong Kong-based fund manager said, “What some larger developers have done is to supplement onshore borrowing with offshore preferred instruments or convertible bonds. A lot of that debt is short-

EXHIBIT 2-15

Shanghai Stock Exchange Property Subindex (China Developers)



term and has an average maturity of less than three years, so it will be interesting to see whether they'll be able to roll it or [otherwise refinance] because a lot of it was issued at mid-7s to 11 percent or 12 percent—which is pretty expensive when you consider it's post-tax money.”

Capital Markets

Aside from the REIT sector (see below), action in Asia's equity capital markets (which for the most part means Hong Kong, Singapore, and Tokyo) remained subdued in 2013. Said

EXHIBIT 2-16

Hang Seng Properties Subindex (Hong Kong Developers)



one banker, “There's not much appetite for share issues at the moment because most developers have been trading at below net asset value [NAV] and don't fancy selling equity at those prices.”

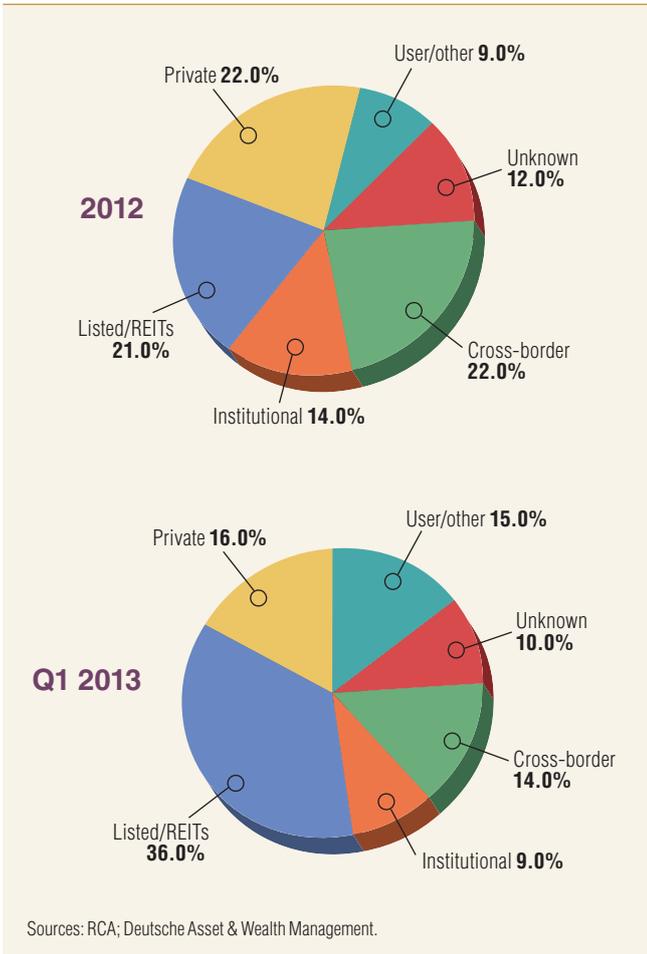
One interesting development on the equity side, though, is that Chinese developers are now increasingly involved in back-door listings in Hong Kong through the purchase of smaller listed developers. At least seven such takeovers have taken place since early 2012. They allow Chinese developers to reduce financing costs by borrowing from local banks through the shell company. In addition, the new vehicle can also be used as an operating platform for projects based in other countries—a strategy also becoming common for large mainland developers.

Bond markets have seen more action than equities in 2013. Until May, the market had continued in the same bullish fashion as in the previous year. One Hong Kong blue-chip developer, for example, was able to exploit buyer demand for yield by issuing perpetual bonds (i.e., with no maturity dates) without a step-up clause (allowing holders to hike the yield). Sentiment reversed sharply in May, however, after Western investors suddenly began repatriating capital in anticipation of tapering in the United States. As a result, after total issuance of US\$81 billion in foreign-currency bonds in Asia during the first five months of the year, just US\$7.5 billion was issued in June and July. Activity has rebounded in the second half, however, as the risk-on mood returned. This included a US\$113 million issue of four-year investment-grade bonds in Singapore by a major Chinese developer at a coupon rate of 3.275 percent. Although this was only the third time a Chinese developer had issued bonds in Singapore, it may prove a popular fundraising avenue for foreign-currency bond issues by mainland developers in the future, especially as they increase activity in other Asian countries.

The high-yield market—which, for real estate purposes, is dominated in Asia by Chinese developers—has been even more volatile. A record-breaking year for bond issuance in 2012 continued into the first half of 2013, with investors lining up to buy yield in an otherwise low-interest-rate environment. The window slammed shut in May once the prospect of tapering came into play, only to reopen when the U.S. Federal Reserve declined to tighten as expected in September. The resurgence in mainland residential property prices and transactions during the year also helped rejuvenate the market in the second half. “Profit margins may be lower, but turnover is up,” said one Hong Kong-based banker. In one transaction, a large Chinese developer raised US\$700 million in Hong Kong from a ten-year bond yielding just 7.25 percent in October.

Bond market windows tend to be especially volatile in Asia, so the roller coaster in sentiment can be expected to continue as investors digest the implications of an environment in which interest rates move inevitably back toward their norms. In the long term, bond prices seem almost certain to fall once interest rates rise. But for the moment, risk is on once

EXHIBIT 2-17
Asia Pacific Investor Profile, 2012 vs. Q1 2013



again. How long this lasts is anyone's guess, but according to one interviewee, "With tapering now in the offing, bonds will probably not be bid in the future, so this may be the window now to get bond issues away."

REITs: Still Room to Run?

If Asia's REITs have been big winners in the past from various bouts of U.S. monetary easing, it seems inevitable that their shares face downside once stimulus is cut and U.S. and Asian bond prices start to fall. This is why, after rising steadily since the end of 2011, REIT prices in Singapore and Australia fell sharply in May 2013, when action by the Fed seemed imminent. From a pricing point of view, therefore, long-term prospects appear negative. But with REITs in Singapore currently yielding in the range of 6 to 7 percent, their potential as an earnings play (which, after all, is what they are meant to be) will only grow should share prices fall.

EXHIBIT 2-18
FTSE Singapore Real Estate Developers Subindex



Singapore

Apart from rate hikes, the big issue in Singapore, according to one REIT manager, is the sheer volume of REITs in the market. "There are about 24 REITs domiciled just in Singapore," he said. "Not all of them have assets here, but the vast majority is just securitized real estate that's put to the market under a REIT regime. Some are better than others, but it seems a bit overcrowded."

What's more, the initial public offering (IPO) pipeline is full: Singaporean REITs and business trusts had raised US\$3.76 billion in IPOs in the year to September 2013, with a further US\$4 billion still to come by year-end. One result of this is that competition for investable assets in the city has risen, helping to drive up commercial property yields in a market where cap rates are already compressed. Another result is that prospective REITs need to be bigger in order to get listed: "Before, you could probably put in US\$500 million, but now you have to have critical mass, close to or over US\$1 billion in assets, to get it into the market. It's saturated, so you have to differentiate yourself by size and manager and sponsor." This means that funds seeking to use REITs as an exit strategy for their investments may have problems getting them listed.

Yet another result of Singapore's crowded REIT market is that REITs are now looking abroad to buy assets, and in particular in places such as Japan, South Korea, and, to a lesser extent, China. As one fund manager said, "Now they've started going cross-border, and what's fascinating is the yields they'll buy at given the accretion." With recently listed Singapore REITs making various cross-border purchases at compressed cap rates, the relative attraction of higher-yielding assets in Southeast Asian markets such as the Philippines is obvious. "If you're buying a [core] office portfolio there at 8 to 9 percent, I'd rather bet I can sell that at 7 to 8 percent

EXHIBIT 2-19

Capitalization and Dividend Yields of Asia REITs, Q2 2013

	Number of REITs	Market cap (US\$ billions)	Average dividend yield	Risk-free rate*	Spread (basis points)
Japan	40	\$65.5	3.9%	0.8%	301
Singapore	28	\$43.3	6.0%	2.5%	349
Hong Kong	9	\$22.1	4.5%	2.0%	250
Malaysia	15	\$8.1	4.3%	3.6%	67
Korea	1	\$0.0	10.8%	3.4%	740
Total	93	\$139.0	4.7%**		

Source: Asia Pacific Prudential.
 * Risk-free rate refers to long-term government bond yields.
 ** Weighted average based on market cap.

versus selling a 4 percent [asset] from Hong Kong or Beijing or elsewhere. So that's why you're seeing cross-border, and we believe in that."

Australia

In Australia, the REIT industry appears healthier than it has been for years. In practice, though, it faces various problems. One investor described the industry as "very inward-looking" and "too focused on managing costs, meaning they're not able to respond quickly when new opportunities arise." In addition, "they're struggling to buy because they've been unable to raise capital." Beyond that, they are often being outbid for assets because Asian institutional funds, which are competing for the same assets, often have lower hurdle rates. Finally, said one interviewee, "REITs haven't really been active buyers because most of them are still trading at discounts to NAV, so it's more beneficial for them to do share buybacks than to go and acquire assets." As a result, some REITs have opted instead to participate at the development level, aiming in particular at core office or retail assets.

Japan

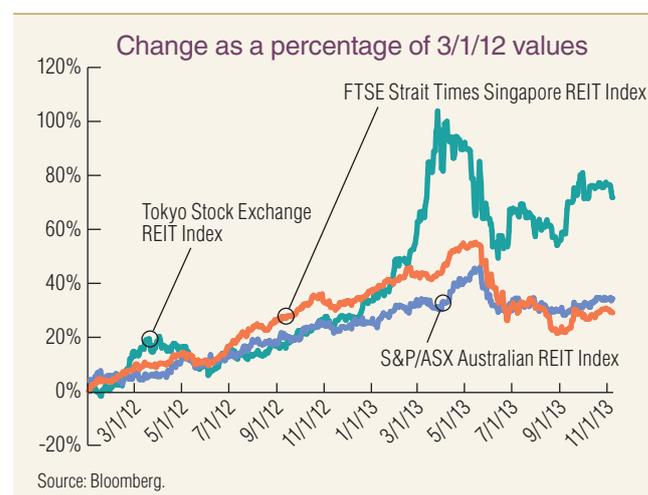
Share prices of Japanese REITs (JREITs) were relative laggards in 2012, experiencing far lower gains than REITs in Singapore and Australia. But after the introduction of the Abe government's massive program of fiscal and monetary stimulus in October 2012, which includes a mandate for the government to buy even more JREIT stocks, the JREIT index soared, registering a one-year gain exceeding 40 percent. By the end of October, JREIT shares had risen to a premium over NAV and trading yields had been squeezed down to 3.6 percent. Unsurprisingly, cashed-up JREITs have been "incredibly aggressive" buyers in the market during 2013. With real estate purchases of some US\$16.25 billion, they accounted for almost 70 percent of Japanese commercial real estate transactions in the first three quarters of the year, which explains why other buyers (especially foreign funds) have had so many problems finding investable stock. On top of that, JREITs are

on course to absorb about US\$13 billion in new capital from retail investors during the course of 2013.

Although JREITs' performance in 2013 has been remarkable, they still face several issues going forward. The most important of these are that the industry remains tiny relative to the size of Japan's overall commercial real estate market and that JREITs are often conflicted, with too many close connections among JREITs, sponsors, and management companies. In addition, many JREITs are too small to be competitive. They need to be consolidated within their larger peers, but the draconian regulations relating to corporate mergers in Japan mean that there is little incentive to make this happen. A final problem is that with Japan's office REITs now trading at sometimes very large premiums to NAV, they become more exposed to volatility in Tokyo's office market. As one investor observed, "There's so much new supply coming on line, but I just don't see the demand because the financial sector is still laying people off. What's going to happen to the sector if vacancies start to rise?"

EXHIBIT 2-20

Percent Change in Asia Pacific REIT Markets





Markets and Sectors to Watch

“We are starting to spend time in Vietnam, Indonesia, Thailand—there’s not a lot of capital focused on them and you can maybe find opportunities in core sectors.”

The big theme reflected in this year’s *Emerging Trends in Real Estate Asia Pacific* survey has been the return of Japan—by a fairly wide margin—as the region’s most popular investment destination for the first time since 2009. Although there are very particular macro-reasons why Japan should return from the rankings wilderness to top the

ULI survey once again, it perhaps comes as no great surprise that its return to popularity means that three of the top four places this year now belong to the Japan-China-Australia axis—a group that, in terms of the weight of capital, is generally regarded as the big three investment destinations in the region.

EXHIBIT 3-1

City Investment Prospects, 2014

	generally good	fair	generally poor
1 Tokyo	6.30		
2 Shanghai	5.87		
3 Jakarta	5.76		
4 Manila	5.66		
5 Sydney	5.61		
6 Guangzhou	5.60		
7 Singapore	5.57		
8 Beijing	5.54		
9 Osaka	5.53		
10 Shenzhen	5.52		
11 Bangkok	5.45		
12 China: secondary cities	5.43		
13 Melbourne	5.39		
14 Kuala Lumpur	5.34		
15 Seoul	5.32		
16 Taipei	5.31		
17 Auckland	5.06		
18 Hong Kong	5.03		
19 Ho Chi Minh City	4.98		
20 Bangalore	4.85		
21 New Delhi	4.70		
22 Chennai	4.67		
23 Mumbai	4.65		

Source: *Emerging Trends in Real Estate Asia Pacific 2014* survey.

EXHIBIT 3-2

City Development Prospects, 2014

	generally good	fair	generally poor
1 Jakarta	5.97		
2 Tokyo	5.82		
3 Shenzhen	5.76		
4 Shanghai	5.75		
5 Guangzhou	5.73		
6 Beijing	5.68		
7 China: secondary cities	5.61		
8 Manila	5.60		
9 Singapore	5.57		
10 Hong Kong	5.57		
11 Sydney	5.54		
12 Bangkok	5.54		
13 Taipei	5.46		
14 Kuala Lumpur	5.39		
15 Seoul	5.34		
16 Melbourne	5.10		
17 Bangalore	5.00		
18 Osaka	4.89		
19 Auckland	4.87		
20 Ho Chi Minh City	4.85		
21 Chennai	4.75		
22 New Delhi	4.42		
23 Mumbai	4.24		

Source: *Emerging Trends in Real Estate Asia Pacific 2014* survey.

Apart from this, the top trends to emerge from the survey include the following:

- An ongoing willingness to look at emerging markets, and in particular Indonesia and the Philippines, as alternatives to other more traditionally favored markets. The reason? Cap rate compression continues to squeeze returns, and with higher interest rates seemingly just around the corner, investors are drifting to markets and asset classes that can provide the kind of returns they are unable to tap elsewhere.
- Osaka has again climbed the rankings after several years on or near the bottom rung. This is to some extent a reflection of the Japan story, but it also is a cyclical rebound as the market works off a glut of oversupply.
- Indian cities remain in the doldrums this year as authorities there try to work out various economic and governance issues.
- The industrial/distribution sector once again tops the survey for both investment and development prospects—again reflecting a flight by investors toward less conventional asset classes.

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

- residential: buy, Manila; sell, Auckland
- office: buy, Manila; sell, Auckland
- retail: buy, Manila; sell, Auckland
- hotel: buy, Tokyo; sell, Auckland
- industrial: buy, China secondary cities; sell, Auckland.

EXHIBIT 3-3

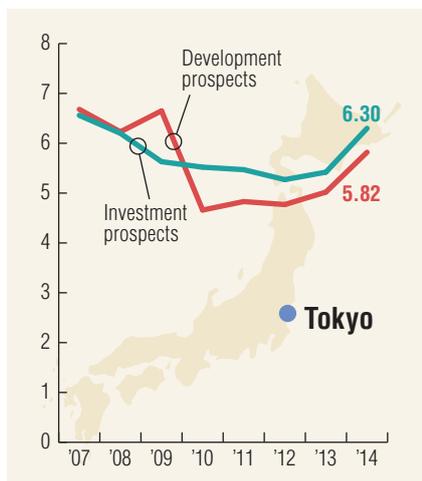
Historical Investment Prospect Rankings

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

Source: *Emerging Trends in Real Estate Asia Pacific 2007–2014 surveys*.
Note: — = no data.

Top Investment Cities

Tokyo (first in investment, second in development). In late 2012, Japan emerged as a magnet for real estate investors after the government of Prime



Minister Shinzo Abe introduced the most far-reaching economic reforms seen in that country since the 1930s. The plan aims to end 15 years of deflation by massively expanding the national balance sheet, and has investors buying real estate in anticipation of rising prices. With the yen now nearly 20 percent cheaper than it was a year ago, Tokyo's appeal is obvious. As one consultant said, "When you have a government desperately trying to stimulate inflation and that likes handing money to the JREITs [Japanese real estate investment trusts] directly to allow them to go out and spend, then you'd expect there to be some positive movement."

Transaction volume has picked up noticeably in 2013, with sales of office, warehouse, and retail space up 85 percent to more than US\$20 billion in the first half of the year—the biggest

increase in five years. Although rents have so far remained static, prices have begun to move, with investors reporting 50 to 100 basis points of cap rate compression during the course of the year. The problem for most investors, though, is that the vast majority of core assets in Tokyo are being cornered by JREITs and other local institutions, leaving little for the rest.

As a result, foreign funds are diversifying by moving up the risk curve, looking for opportunities in secondary assets and sectors, and picking up smaller buildings with the intention of repositioning and selling them on. "We're very bullish on Tokyo," said one foreign developer, "particularly around refurbishing existing assets—focusing on energy and sustainability and repositioning from a B to an A-grade." In addition, a few deals have been struck

at very high rates of leverage (i.e., more than 90 percent), reminiscent of the days before 2007.

The big question, however, is whether “Abenomics”—a vast program of government stimulus named after Shinzo Abe, the current prime minister of Japan—can successfully reverse that country’s long economic decline. The jury remains out on that, and for as long as it does, the buying in Tokyo looks set to continue.

Shanghai (second in investment, fourth in development). Shanghai is an evergreen for Asian investors. Ever since the *Emerging Trends Asia Pacific* survey began in 2007, the city has only once failed to make the top two in the investment prospects rankings, despite ongoing cap rate compression and stagnant rental growth. Interviewees reported net yields on commercial assets of just 2 to 3 percent in 2013, together with an increasingly tight regulatory environment. As one investor said, “There’s a lot of potential taxes you have to underwrite, but you’re not sure at the end of the day whether you actually have to pay them and how close to the wind you want to sail. The way the market’s going for completed assets, you might be buying at a 4 [percent] and then you’d be really lucky if you’re getting 1 percent yield actually out of the country.”

So what’s the attraction? Basically, for many international real estate investors—and, for that matter, many

foreign companies operating in the mainland—Shanghai is China. As one foreign developer put it, “We draw a very clear distinction between the office space in Beijing and Shanghai and the office space everywhere else, and that’s because we serve the market for tenants who tend not to want to travel and set up the same kind of operations and space in some of the further-down cities. So we notice there’s a clear distinction between the type of demand in Beijing and Shanghai and [the type of demand] everywhere else.”

Second, Shanghai offers a level of comfort to newly arrived funds with a mandate to place money in China, but who may be unwilling to venture deeper into the unknown. One such investor said, “If you’re local enough and you have sufficient boots on the ground, you’re able to intelligently pick the winners from the losers. We’re not there yet, and as a result we need to focus on the cities that are definitely going to be winners.” Finally, according to a fund manager with long experience in China, “Office markets in the major cities, especially Shanghai, are going to see some periods of real supply and indigestion, where rates are going to flatten or even go down. But when you look at the fact that Shanghai is structurally under-officed to a very high degree relative to other major financial centers, then the well-located assets—not even in the CBD [central business district], but also the central submarkets—should do well over time.”

Jakarta (third in investment, first in development). Last year’s surprise winner of the investment prospects survey, Jakarta garnered a third-place position this year that defied skeptics who wrote off last year’s performance as a “flash in the pan.” The city’s apparent popularity, however, is something of an enigma to experienced market-watchers in Asia, because it has always been a difficult market in which to operate.

In a nutshell, the impression of Jakarta (and by extension Indonesia, for which it serves as a proxy) is that “the macro-story is compelling, but it’s



difficult to execute.” On the one hand, capital values for prime offices continue to ramp up, with a 10 percent quarter-on-quarter increase in the second quarter of 2013 alone, according to Jones Lang LaSalle. Rentals, meanwhile, grew 37 percent on the year—the highest increase in Asia. There are a number of reasons for this. Newly released office stock in Jakarta has been higher quality than that released in the past, and there continues to be strong demand, especially from recently arrived companies looking for space. In addition, there is a shortage of upcoming supply in the CBD. Cap rates came in around 7.8 percent, and recent development yields are reputedly excellent—both of which help explain why Jakarta continues to be the survey’s number-one choice as a development destination.

At the same time, however, investors have been deterred by familiar issues. The local market is opaque, title is hard to establish, and competition from local companies and high-net-worth individuals is intense. The reality is that few foreign investors have been able to place money in the market successfully, although that hasn’t stopped them from looking. According to interviewees, some existing owners have been selling into that demand—at a price.

One investor suggested that Jakarta and some other Southeast Asian emerging markets might prove attractive over the coming year because capital



outflows of the type seen in Asia in 2013 were likely to have a disproportionate impact on those countries, which will in turn “tend to have a disproportionate impact on [real estate] pricing.”

Manila (fourth in investment, eighth in development). Manila has risen through the ranks this year, the result of a fast-growing economy, increasing popularity of the city as a destination for multinationals seeking outsourced services (both business process outsourcing [BPO] and back office), and a growing awareness that the problems long associated with lack of transparency and governance issues have improved. The country also benefits from a young demographic, strong capital inflows from local citizens working overseas, and a workforce with a cultural affinity with the West.

Prime office rents are still well below pre-global financial crisis rates, but are growing at 5 to 8 percent per year. Cap rates are between 9 and 10 percent. Office take-up hit 400,000 square meters last year, and with demand remaining high, almost all new buildings were prelet in advance.

A lot of the recent action in Manila is focused on submarkets like Fort Bonafacio, which features vacancy rates of just 1 percent. Rents there have risen from 50 percent of downtown Makati a few years ago to 80 percent today. As one investor said, “My bet is that within three to five years, rents in the suburbs will exceed downtown rents, the reason

being that downtown always floods and the suburbs don’t.”

As with the other emerging markets, Manila can be a hard place in which to invest, partly because of laws that prevent foreigners from majority ownership of land and partly because there is already plenty of domestic liquidity. Core product is therefore difficult to find, but on the opportunistic level a yield spread of 350 to 400 basis points can provide operating cash flow returns in the mid-teens.

Sydney (fifth in investment, 11th in development). Following rental declines during the first half of 2013, the fundamentals of Australia’s office and retail sectors remain “pretty weak.” Investors have concerns on a number of fronts, in particular the prospects for the financial and mining sectors, the prospects for consumer spending, and—for overseas investors, at least—the political outlook (although this may have been resolved to some extent with the outcome of the federal election in September). Nonetheless, Sydney continues to attract both foreign institutional and local investors.

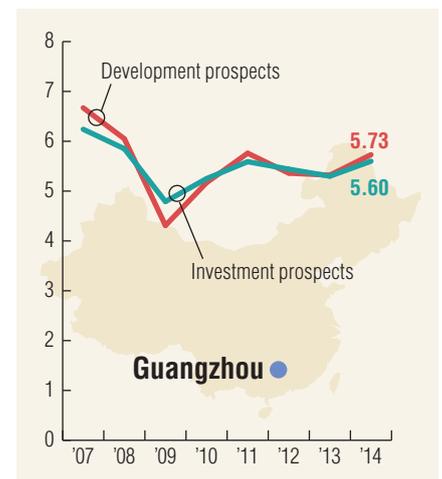
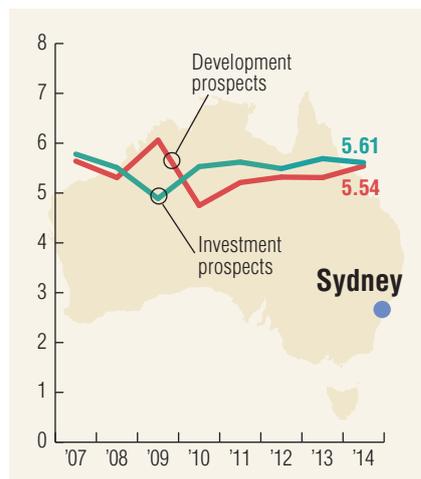
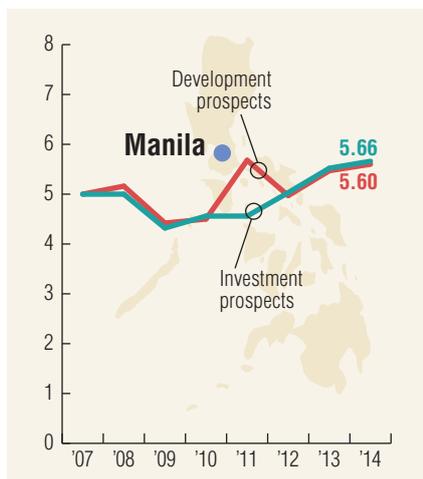
As in previous years, the appeal for foreigners has been high (by Asian standards) cap rates of around 7 to 9 percent, Australia’s mature and stable market, and a general expectation that yields will compress going forward. Local investors have not been as bullish as foreign funds in the last few years, but have also started to invest more in

2013, as superannuation funds put large cash stockpiles to work and local REITs begin to recycle capital.

One result of this is that the core CBD office market in Sydney is now “very tight,” with many investors moving instead into suburban markets and secondary assets in order to place funds. An influx of Asian (and especially Chinese) capital has also been actively pursuing these opportunities. Industrial assets, meanwhile, which were popular in 2012, have lost their luster more recently.

However, with most banks having completed their rationalizations and a limited pipeline of new supply until 2016, investors remain fairly bullish about prospects for the city’s office sector. The residential sector, meanwhile, has rebounded, and although affordability continues to be an issue, “the reality is that the demand is there,” helped by a significant quantity of new capital arriving into the high end of the market from pan-Asian (once again, mainly Chinese) buyers: “We’re seeing record weekend auction clearance rates and prices starting to go up—any release of land or residential apartments just gets sold out immediately.”

Guangzhou (sixth in investment, fifth in development). Guangzhou’s high ranking this year comes as a surprise given the extent to which China’s Pearl River Delta cities are exposed to the relatively weak export sector. While the retail market “looks pretty good from

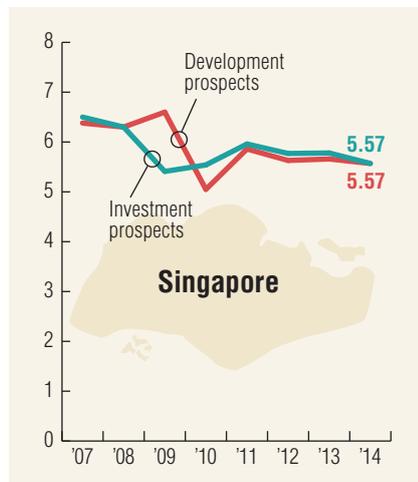


where we're sitting," the city's office market is "terribly oversupplied," with the volume of new stock exceeding take-up in each of the last three years. Office vacancies increased by 4 percentage points quarter on quarter in the second quarter of 2013 to 15 percent, according to Jones Lang LaSalle. Rental growth remains anemic. At the same time, capital prices have risen almost 50 percent since 2009, with cap rates compressing to a record low of 3.8 percent. Sales remain brisk. This is perhaps a result of the city catching up with price increases in Beijing and Shanghai, where commercial property remains considerably more expensive.

On the residential side, prices have more than doubled since 2008, and were up 20 percent year on year in the third quarter alone, according to official statistics. This can be at least partly attributed to the fact that, even though Guangzhou's status as one of China's first economic hubs means it is relatively well off, its home prices have always lagged relative to those of other first-tier cities (and especially those in nearby Shenzhen, where they are almost twice as high). Local authorities have intervened repeatedly in the past to head off an overheated residential market in Guangzhou, and the prospects for more of the same in future seem high.

In the hotel sector, "again you're seeing a picture of huge oversupply at the luxury end, with huge downward rate pressure as a result," according to one developer active in the city. "The question in my mind is what's happening to demand—we look at the Canton Fair as a proxy for that, and the last year or so has been soft. That may be reflective of the global economic picture—I hope it is, because that means it will recover."

Singapore (seventh in investment, ninth in development). The appeal of Singapore has weakened over the last year, which explains the retreat from its normal ranking in the survey's top three. But investor opinions remain quite polarized. Some saw an oversupplied market featuring excess liquidity from Singapore's growing REIT sector that



has driven prices higher and compressed cap rates to levels that will be unsustainable once interest rates rise beyond the current 2 percent. As one locally based fund manager said, "If you look at your yield, it's all leverage-based. But even if cap rates don't compress from 3.5 to 3 percent, the guy buying this five years from now is buying it with 4 percent money, not 2 percent money. We have to put ourselves in the shoes of people buying five years from now—and people just aren't doing that."

Others, however, see it differently. As another locally based fund manager said, "People continually misunderstand Singapore; it's one of the jewels in Asia. Its growth outlook is strong, given its political and social infrastructure. Everyone's all excited about the amount of supply coming in—but again, apart from one tower, the next new building is more than 13 months away. Over the last quarter, rents have increased. And if the government does [its] typical put-your-foot-on-the-accelerator and possibly recommence land sales, by the time those buildings would be completed would be another four years away."

For the moment, vacancies have declined to around 6 percent as new supply drops off, while increasing demand for small-office space has been generated by the professional services sector. Sales of strata-title office in the CBD were strong in the first half of the year, but have now dropped off as the government's market-cooling regulations begin to take effect.

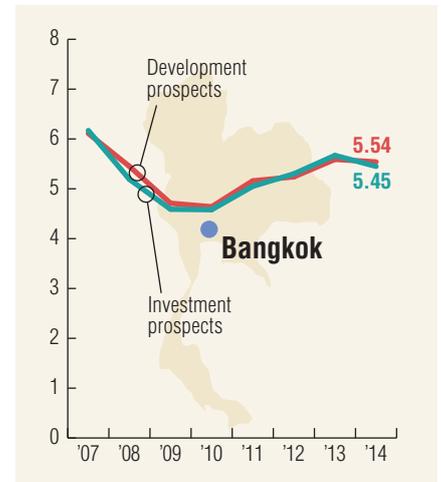
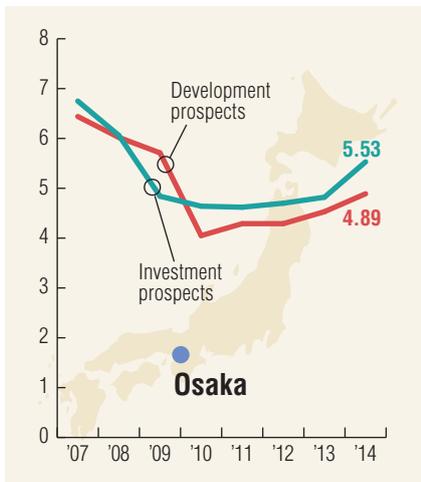


Beijing (eighth in investment, sixth in development). Although the retail market in Beijing remains strong, the city's office sector has seen both prices and rents plateau since the beginning of 2013, after three years of high growth. However, with vacancies low and a generally constrained pipeline, there seems to be little prospect of significant declines. As one consultant observed, "Beijing has some serious surpluses, particularly in terms of the office market. But people bandy around these large numbers in terms of square meters, and when you strip out the D, C, and B [grades], you get down to the real quality product, and that's limited even in the first-tier cities."

Beyond that, said a Beijing-based developer, "I think a lot of state-owned enterprises that want a headquarters, or the large insurance companies that you see [investing] all over the world are looking to put some of their funds into domestic real estate. So I don't see the situation in Beijing changing too dramatically."

As with other Chinese cities, the appeal of Beijing as a development play is significantly higher than it is on the investment front—probably a reflection of high prices pushing investors toward more opportunistic development plays.

Osaka (ninth in investment, 18th in development). Osaka has languished at or near the bottom of the survey rankings for several years but rebounded impressively in 2013, as predicted by



investors in last year's report. As one said, "I think things just got overheated on the office side, and there is still a supply issue. But they've been chipping away on that over the years, and rental rates that were inexorably going down have hopefully bottomed out. So I definitely think it's an underwritable market if you find the right asset."

Cap rates for Osaka assets have come in from 6.5 to 5.5 percent over the course of 2013, and with expectations that more compression is to come, buyers are still looking for deals, just as they are in Tokyo. The prospects for Japan's regional cities such as Osaka have strengthened over the last year because of the spillover of investment capital out of Tokyo as investors seek less competition and lower prices.

Another investor said, "They've done a really good job there revitalizing the economy. There's now positive net migration because the government improved the infrastructure, and the cost of doing business in Osaka is substantially cheaper than in Tokyo. So it's a good story, especially residential and retail, though office is still a bit questionable because of the supply."

Shenzhen (tenth in investment, third in development). Shenzhen's property markets are notoriously volatile. They have been relatively quiet in 2013, however, with little in the way of new supply or take-up. Shenzhen was one of the only markets in China to see (slight) office rental growth during the

first half of 2013. The residential sector has similarly low levels of inventory, which helped support the market early in the year, and may help explain a 20 percent-plus year-on-year rise in prices in the third quarter of the year.

Shenzhen's steep rise as a development destination in this year's survey (from 11th to fourth) was impressive. However, given a substantial pipeline of new stock due on the market in the next few years, it seems unlikely to be tied to the prospects of conventional property assets. Instead, the cause is probably the launch of the city's new Qianhai experimental zone as a pilot financial and tax-free area. Although plans call for the development of some 4 million square meters of gross floor area (GFA) in Qianhai, at the moment it remains mostly a blank page. Over time, it is expected to draw business from companies currently based in Hong Kong, as well as from other companies in southern China. Real estate prices in areas near the zone mushroomed immediately following the launch as investors from nearby Hong Kong and Guangzhou bet the new "Manhattan of the Pearl River Delta" would provide a boost to Shenzhen's property market. Whether it is able to fulfill those expectations remains to be seen.

Bangkok (11th in investment, 12th in development). Bangkok was mentioned more frequently in this year's interviews than previously, with investors seeing it as a relatively less competitive, higher-return market than Asia's more conventional destinations. As one investor described it, "There's not a lot of capital focused there, and you could maybe find some good opportunities in the core property sectors. There's obviously a lot of risk with that, but there could be attractive opportunities, too." Prices and rentals continue to rise in Bangkok's prime office space, although there remains very little investable stock. Vacancies have also been trending down for the last three years.

Still, Thailand has always been regarded as a hard market for foreigners to exploit. One investor said, "It's just difficult to get things to move quickly there—there are a lot of wheels within wheels and restrictions on foreign ownership that are a lot more draconian and hard to navigate compared to Indonesia and the Philippines."

Foreign investors tend to prefer the resort markets on Thailand's beaches to Bangkok's commercial real estate. They require a different set of management skills that international funds may find easier to exploit, "although a lot of these markets are suffering from some level of overbuilding," as one investor with experience in the sector observed.



China – secondary cities (12th in investment, seventh in development).

In the past, investors saw the second-tier cities of China as a refuge from its overcrowded, arguably overpriced first-tier cities. As more investors began to tip their toes in those waters, however, the extra risks and operational difficulties inherent in these locations have made some of them rethink their investment choices. Although each city has its own economic microclimate, oversupply is now a real issue in China’s secondary markets. As one foreign developer said, “There’s quite a lot of oversupply in Chengdu, for example, but it’s hard to generalize because that oversupply might be in certain pockets, so it’s dangerous to say, ‘Let’s avoid somewhere like Chengdu.’ If you’ve got the right location in that city, you should be fine as long as you do all the things that you normally do well.” As another developer pointed out, location is vital: “If you can get that, it’s actually the key—but it’s still not easy to get land.”

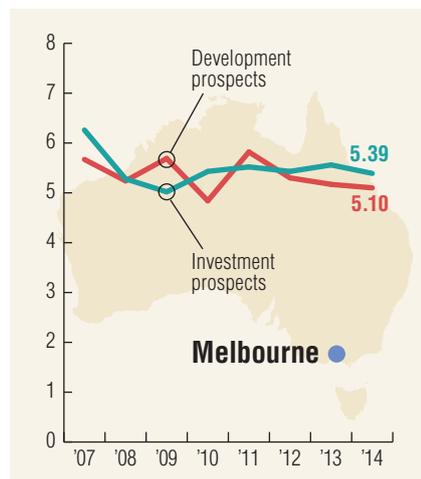
At the same time, though, returns are higher in these locations, and over the long term many secondary cities will see structural changes that should lead to higher growth than in the first tier, where future rises in value have to a great extent already been discounted. As one investor put it, “You’re seeing it in terms of the migrant labor issue, for example. Before, Sichuan labor would migrate to the big cities on the coast, but now they’re deciding to stay closer

to home. The effect on the coastal cities is that labor rates are driven up, and that some of the demand is then transferring back to the home market—Sichuan, in this case.”

Melbourne (13th in investment, 16th in development). As with Sydney, the fundamentals of the Melbourne market have been sliding recently. Net absorption was negative in 2013, and rents have been falling for the last two years. Substantial new amounts of stock remain in the pipeline, particularly in the redeveloped Docklands area.

As with Sydney, however, poor fundamentals have not prevented prices from rising as foreign institutions and local funds compete for a shrinking number of assets. As one interviewee said, “There have been a fair few transactions recently in Melbourne, and the thing that’s been a little surprising is how tight the cap rates have been for those transactions.”

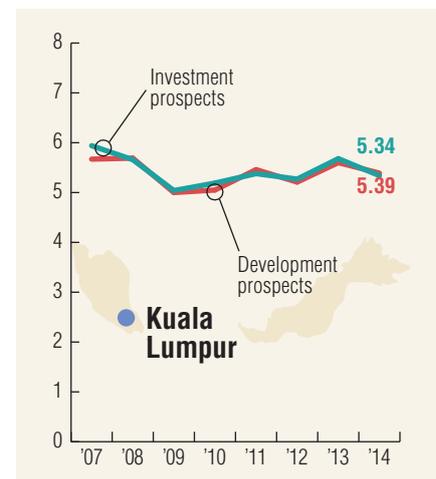
As with other Asian markets, lack of available product has led investors to turn to other solutions. First, well-located B-grade buildings just outside central Melbourne, or perhaps in the suburbs, have become increasingly popular. Second, more investors are willing to take development risk, despite the general oversupply: “A number of people are seeing a lot of value in developing assets in the more traditional parts of Melbourne along Collins Street, because they don’t like the Docklands area, where transport access is not



very good.” Going forward, the supply/demand dynamics continue to be unfavorable on the rental side. But with no end in sight to the flow of foreign investors looking to park money in prime Australian assets, cap rates could continue to come under pressure anyway.

Kuala Lumpur (14th in investment, 14th in development). Kuala Lumpur has moved sharply down in the investment prospects ranking list this year (from last year’s fifth position), mainly as a result of a glut of supply. Office vacancies now stand at almost 18 percent, though this is down from more than 20 percent in 2012. Retail is similarly overbuilt, especially in the suburbs, where much existing stock is old and poorly designed. Capital values in Kuala Lumpur’s CBD are now about 25 to 30 percent off their 2008 peaks. Because much existing stock in that area has become dated, cap rates have expanded from about 5.5 percent in 2008 to a current level of 6.5 to 7.0 percent. This is becoming attractive territory for sale to an offshore institution such as a Singaporean REIT.

Although on the positive side, while there is now less supply in the pipeline, there has been a speculative element to recent construction activity, especially in high-end residential projects. As one fund manager said, “We did residential in the last cycle. That has done okay, but today you have developers that have overbuilt and have too much inventory.” And another said, “The residential



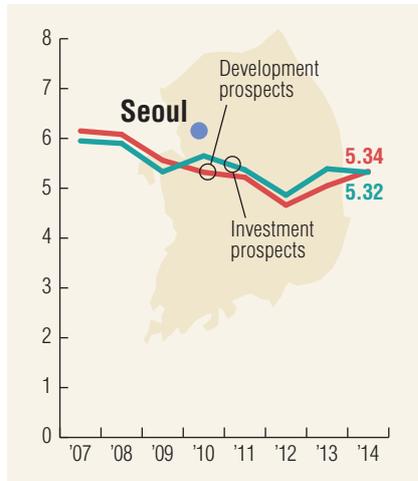
sector, though not in the major areas, has been overbuilt. Last time I went to Kuala Lumpur, you see those residential buildings, empty blocks after blocks—they are selling those to investors.”

One advantage of Kuala Lumpur is that “unlike Singapore, the market is quite soft—there are not a lot of international players; they’re all domestic.” At the same time, the Iskandar Special Economic Zone (and in particular the city of Johor Bahru) in southern Malaysia near the Singaporean border has become a favored destination for pan-Asian investors and especially Chinese developers, who have been active in residential development. The market in Johor Bahru is also now seen as frothy. Much of the stock being created there has been presold to mainland Chinese and other Asian buyers.

Local Malaysian REITs, meanwhile, continue to trade at high prices in 2013, mainly, according to one fund manager, because “there’s nowhere else to place your local currency.”

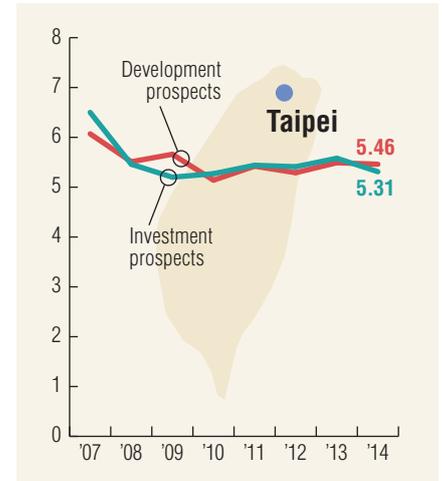
Seoul (15th in investment, 15th in development). Several interviewees in this year’s report indicated interest in the South Korean market but, as in previous years, have had problems getting capital invested. South Korea remains a very insular country in real estate terms, an issue that stems partly from cultural factors, partly from a shortage of suitable assets, and partly from the fact that there is already far more capital held by South Korean institutions—in particular local pension funds—than can be invested in domestic property assets. As one locally based fund manager observed, “It’s not that [foreign funds] don’t want to come to Korea, it’s that they can’t compete with local capital in terms of yields, and that locally, the opportunities just aren’t there.” Cap rates for commercial property typically come in at about 5 percent, having compressed about 50 basis points during 2013.

That said, a handful of foreign investors have been successful in making investments, although this has often been a result of their ability to leverage a local relationship to their advantage.



One local investor suggested that, with the core market already tightly held, value-add plays were the best option for interested investors, focusing on under-used or run-down properties. “There can be title-related issues because some buildings are sold strata-title, but there are no local institutions chasing after this opportunity—you might get about 10 to 15 percent returns.” On the opportunistic side, said a foreign fund manager, “The story’s over—you should have bought post-global financial crisis. There’s been a couple of transactions by foreign funds in the last 12 months or so, and the assets that are for sale are held by foreign funds that have lost their equity after buying at the peak of the market. Their equity is wiped out and you could buy [the building] for a dollar, but even at 50 cents on the dollar the deal doesn’t make sense—so even the deals that are out there are pretty hairy.”

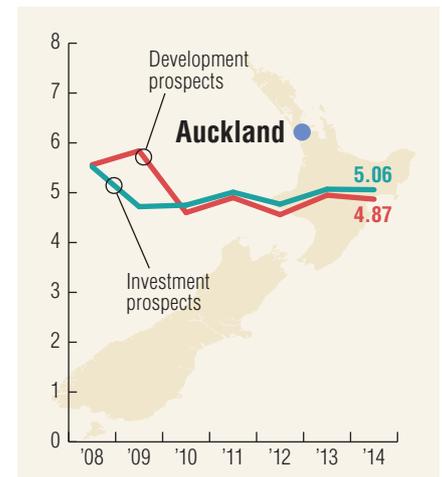
Taipei (16th in investment, 13th in development). In 2011–2012, Taiwanese insurance companies were active buyers of domestic real estate assets, at least partly because, until this year, they have been restricted from investing in foreign assets. The result has been to drive up prices, a phenomenon curbed only after the government introduced further regulatory measures to cool the market. At just 2.2 percent, according to CBRE, Taipei’s cap rates are the lowest in Asia. As a result, the market in 2013 has been quiet, although there is interest in retail and hospitality



assets based on continuing strength in mainland Chinese tourism.

For most of 2013, domestic end-users have been dominant in the market, accounting for about half of investment turnover, according to CBRE. With little new supply arriving on the market in recent years, vacancy rates have declined to around 8 percent, although this looks set to rise as more new stock is completed.

Auckland (17th in investment, 19th in development). Recently, prices across all asset classes in New Zealand have risen strongly. In the prime office sector, strong demand, cheap financing, and tight supply saw capital values increase by more than 13 percent in 2013 in an improving economy, according to Jones Lang LaSalle. Cap rates stood at 7.9 percent. Meanwhile, rents rose 6.5 percent year on year in the first half of 2013.



In addition, fast-rising home prices have made New Zealand one of the world's most overvalued residential markets, according to the Organization for Economic Cooperation and Development. With price increases averaging 13 percent per annum, the New Zealand government in October 2013 restricted banks from granting highly levered low-interest home mortgages. With the government reluctant to increase interest rates in case this further boosts the New Zealand dollar, pressure for further increases to real estate values will continue over the medium term.

Hong Kong (18th in investment, tenth in development). Hong Kong's ranking has plunged in the investment prospect rankings in the years since 2011 as steeply rising home prices and some of Asia's most compressed cap rates have stifled interest in both the residential property market and the commercial property market. The former has been tamed by new government macro-prudential rules introduced at the beginning of 2013, imposing, among other things, new taxes on home sales. As a result, although prices are down only modestly, transaction volumes have plummeted, with both domestic and foreign (principally mainland Chinese) speculators moving to other markets in both Asia and the West.

On the commercial side, demand for prime office space in the CBD has been sluggish as financial sector

demand drops and tenants move to outlying commercial districts, either on Hong Kong Island or in newly developed areas of East Kowloon. Average effective CBD rents in the third quarter of 2013 were down 20 percent from their peak two years earlier, according to brokers Cushman & Wakefield.

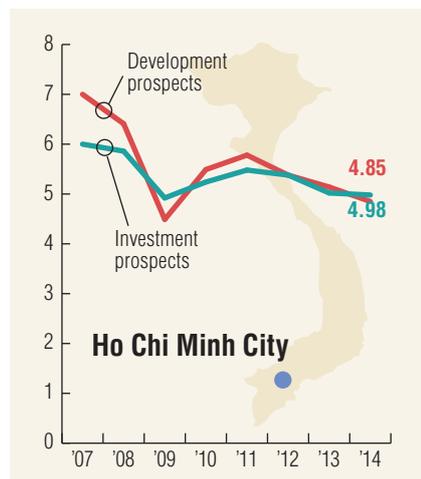
For the most part, international funds have bypassed Hong Kong recently, for a number of reasons. First, the government's cooling measures are for the first time applicable to commercial property transactions, meaning that stamp duty has doubled for that asset class. Second, cap rates may have now expanded slightly but are still in the region of 3 percent—very low even by Asian standards. Finally, given Hong Kong's currency ties to the U.S. dollar, the city is seen as especially sensitive to the impact of rising interest rates that are widely expected to materialize in 2014. Most interviewees suggested that prices in both the commercial sector and the residential sector were likely to fall in 2014.

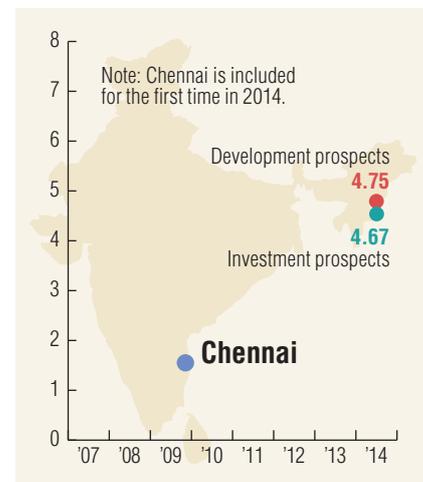
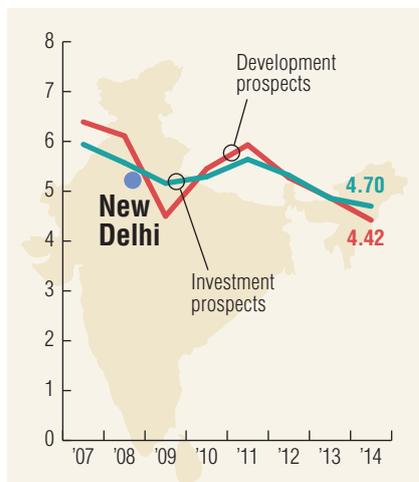
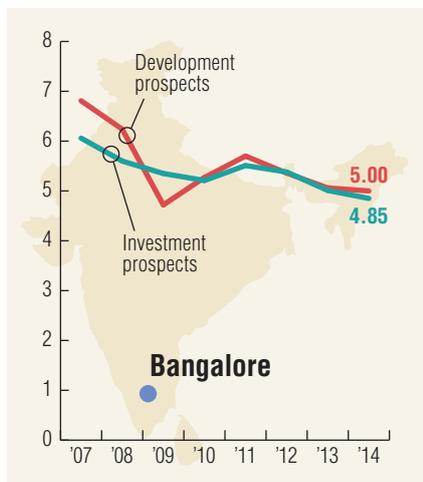
Ho Chi Minh City (19th in investment, 20th in development). Over the last two years, the Vietnamese market has been hard hit by a combination of a mishandled economy that sent inflation to a high of 23 percent in 2012, and the prospect of a wave of bankruptcies and bank bad debts after Vietnam's state banks engaged in a wave of lending, often to the property sector, without adequate credit checks or collateral safeguards.

That said, there was a feeling among many interviewees that the worst of the problems may now be behind the market and that now may be the time for countercyclical investing to begin. For one thing, there is a serious shortage of investable stock in Vietnam, with one recent study completed by property industry group Asian Public Real Estate Association estimating that it had the smallest pool of investor-grade real estate in Asia. At just US\$21 billion, it was less than half the size of the US\$48 billion worth of investor-grade real estate in second-last Philippines. The total is projected to grow to US\$65 billion by 2021, according to the report. Office supply is therefore struggling to keep up with growing demand.

Another issue is that with both gold prices and interest rates down (the deposit rate is now 8.4 percent, down from a peak of 17 percent two years ago), residential real estate is a more attractive investment than before. In addition, growing foreign investment in the manufacturing sector means there is both greater purchasing power (and therefore higher demand in the retail sector) as well as an increasing need for industrial development in business parks and factory buildings. Investor interest at the moment appears to be led by the Japanese, who have long been active in Vietnam.

Bangalore (20th in investment, 17th in development). Indian cities occupy the three bottom places in this year's survey as a result of ongoing economic problems, an uncertain currency outlook following a steep plunge in the value of the rupee in midyear, and an investment environment widely perceived to be unfriendly to international investors. Interest remains high, however. With national elections looming and reports on the ground in India suggesting that the tide may be turning in receptivity to foreign investment, many foreign funds are waiting on the sidelines to see what happens.





To some extent, Bangalore is isolated from current problems in India given its status as a major IT/BPO center. The aforementioned decline in the rupee may in fact help the city's prospects given the number of foreign service companies based there whose U.S. dollar cost basis will have been reduced as a result. Foreign participation in this market is therefore ongoing, with opportunistic funds partnering with local developers to acquire properties. As one locally based consultant said, "The [local] developers are seeing larger commitments of capital from those [foreign] players—the intent is to create platforms that will then either acquire and develop greenfield or partly developed properties, or even acquire income-producing properties if they are reasonably priced with good covenants. It's an asset-management play with the IT component to deliver the needed IRRs [internal rates of return]." This perhaps accounts for Bangalore's slightly higher ranking (17th) as a development destination.

On the ground, demand continues to be strong, with vacancies of around 2 percent, according to Jones Lang LaSalle. Rents are stable and capital prices continue to rise gradually. Supply in some of the traditional IT parks is becoming tight, requiring an expansion of facilities in the outer (especially northern) areas of the city to accommodate new demand.

New Delhi (21st in investment, 22nd in development). Both rents and capital prices in Delhi continue to rise slowly after bottoming out in 2009, although they remain well below pre-global financial crisis levels. Substantial volumes of newly completed office assets were released onto the market in 2013, boosting vacancy rates to some 27 percent, according to Jones Lang LaSalle.

However, investment opportunities in New Delhi currently lie more on the residential side than the commercial side. This has been helped recently by new guidelines released by the local government that now allow conversion of old industrial buildings into serviced apartments and other types of accommodation.

In addition, work continues on the Delhi-Mumbai Industrial Corridor, a development zone 1,000-plus kilometers in length stretching between the two cities. As one interviewee said, "After the 2007–2008 IT boom, we stopped focusing on what lies in the middle, which is manufacturing, and over the last few years that has gained traction. So, some very significant manufacturing facilities have been created that are driving a lot of industrial activity, which institutional investors are now starting to look at."

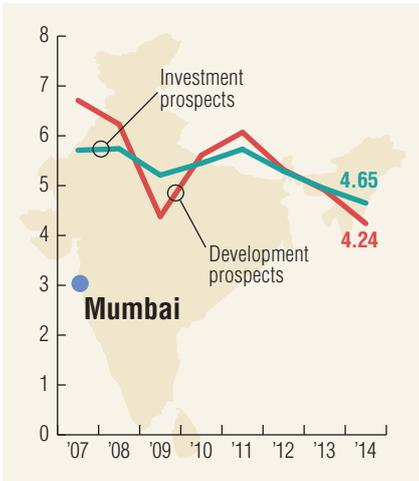
Chennai (22nd in investment, 21st in development). Compared with their peers in New Delhi and Mumbai, developers in Chennai are relatively risk-averse, leading to a market that is more fundamentally driven, with smaller

ticket sizes, less volatility, and lower return expectations. Said one interviewee, "Chennai is a more stable and end user-driven kind of market. In Delhi, if you launch a 500-unit apartment and you don't sell 200 at the prelaunch stage, you say the project has been bombed. In Chennai, you don't expect to sell 200 units until the building is at least five stories out of the ground."

Until last year, most activity in Chennai was driven by the residential market, but more recently "we have seen more activity on the ready-income-producing asset side—Chennai has always been the destination for value for money occupiers." In a market currently dominated by domestic players, institutional investors have been picking up assets tenanted by multinational companies at values lower than current depreciated replacement cost.

The other sector where Chennai features prominently is in the industrial/logistics space. Indian automakers are expanding their local footprints, but the logistics market remains underserved. As a result, "there are strong demand drivers that are beginning to settle down, and over the next couple of years we would expect Chennai to see significant demand from industrial and logistics occupiers."

Mumbai (23rd in investment, 23rd in development). The situation in Mumbai is similar to that in New Delhi. On the commercial side, prices and rents continue to bump along the bottom, overall



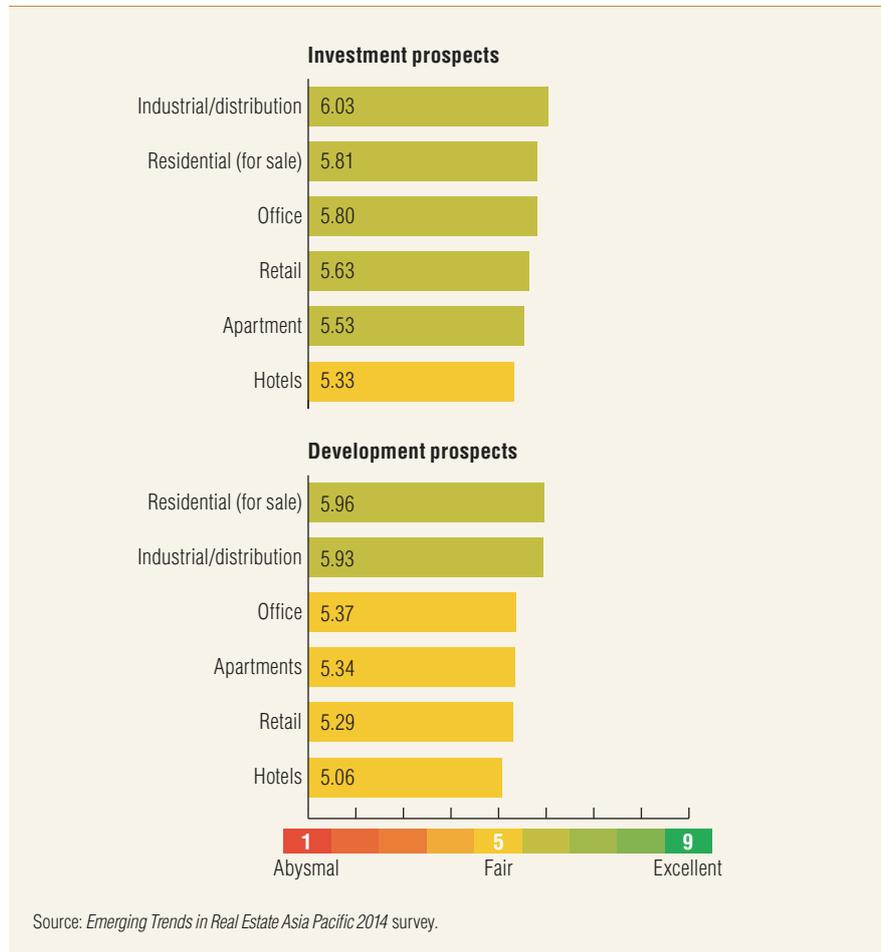
vacancy rates remain high (at around 24 percent), and the depressed economy constrains new business activity that would otherwise get the market moving.

More than one large greenfield deal in Mumbai involving foreign investors was scratched in mid-2013 after the fall in the rupee created increased risk and prompted investors to pull out. A large supply pipeline of office stock due to arrive on the market in 2013 has not helped matters. In addition, a problem that arose in relation to payment of various senior-secured lending transactions in Mumbai during the first quarter of 2013 almost led to several defaults. This also has probably not helped Mumbai's position in survey rankings, but the problems were resolved in the second quarter and payments have since resumed.

As with New Delhi, "commercial real estate continues to be a difficult area to transact, but residential continues to work." There have therefore been some big land-acquisition transactions in 2013 for large residential projects financed by institutional investors. As one local consultant said, "Primarily, investments are in the form of senior-secured transactions—people prefer deals where you already have all the consolidations, building-planning permissions, and even 25 to 30 percent of the units sold."

EXHIBIT 3-4

Prospects for Major Commercial Property Types in 2014



Property Types in Perspective

Industrial/Distribution

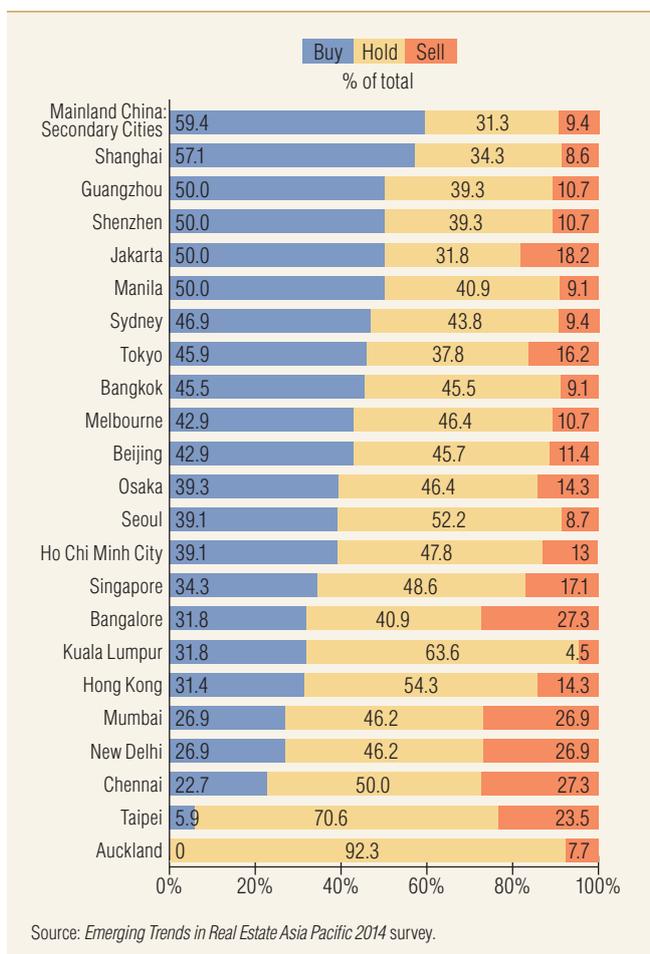
This space continues to be the most popular in terms of investor sentiment in the 2014 *Emerging Trends Asia Pacific* survey, and it was also the only sector where sentiment improved over last year. Though it arguably could no longer be classified as a niche play, logistics ticks a number of boxes for Asian investors at the moment. It offers significantly higher yields than other cap rate-constrained plays; it also offers a degree of specialization that allows investors to differentiate themselves from local competitors; and there is a

significant degree of structural under-supply, both in absolute terms and in relation to the more advanced types of distribution facilities such as those used by third-party logistics (3PL) providers, which are increasingly favored by Asian manufacturers. Finally, the extra demand being created by domestic consumer spending in Asia—especially from goods sold over the internet—is generating even more demand for appropriately positioned and equipped facilities. The problem for most investors is getting a foothold in an industry long dominated by specialist players.

Best bets: China's secondary cities—followed closely by Shanghai, Guangzhou, and Shenzhen—are for the second year running top-ranked in

EXHIBIT 3-5

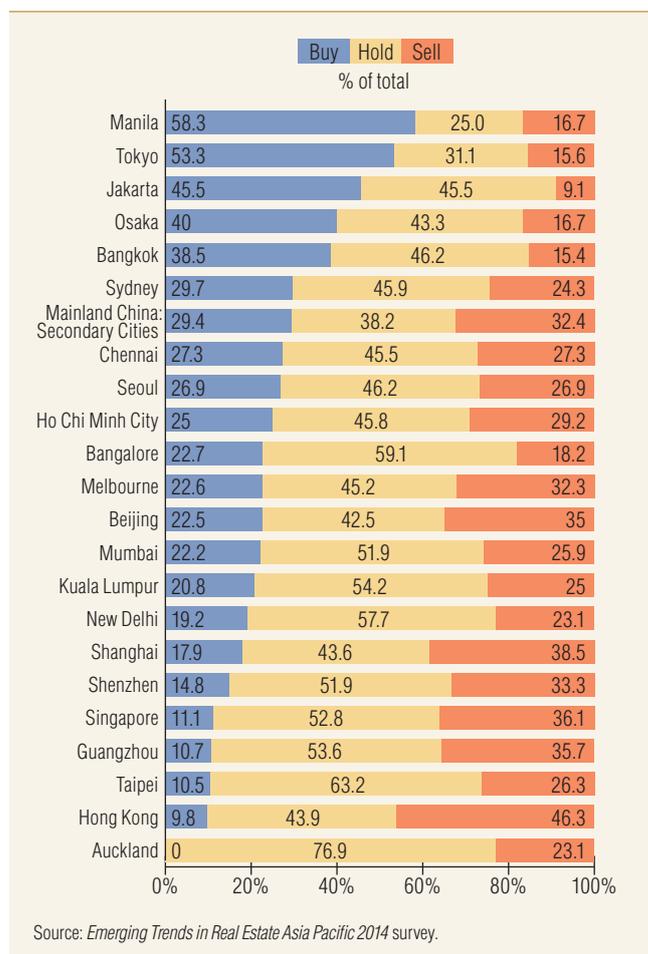
Industrial/Distribution Property Buy/Hold/Sell Recommendations, by City



the survey's buy/sell ratings, with almost 60 percent of those surveyed recommending acquisitions there. This no doubt again reflects the surge in China's internet sales, but it also underscores the inadequacy of current facilities, especially in view of the ongoing shift of manufacturing facilities from coastal cities into the country's interior. Nonetheless, actually placing money successfully in this type of asset is tricky. As one investor said, "There's a huge amount of competition for well-accessed land in sensible places, and there would typically be quite a lot of competition between logistics providers for these sites. It's quite a complicated market, and because it's competitive the returns aren't enormous." In reality, though, this is a play that is favored in many markets in Asia—in particular Japan, where there have been several large logistics-related transactions in the last couple of years, and where investors are continuing to develop new logistics infrastructure in the wake of the 2011 earthquake.

EXHIBIT 3-6

Apartment Residential (Rental) Property Buy/Hold/Sell Recommendations, by City

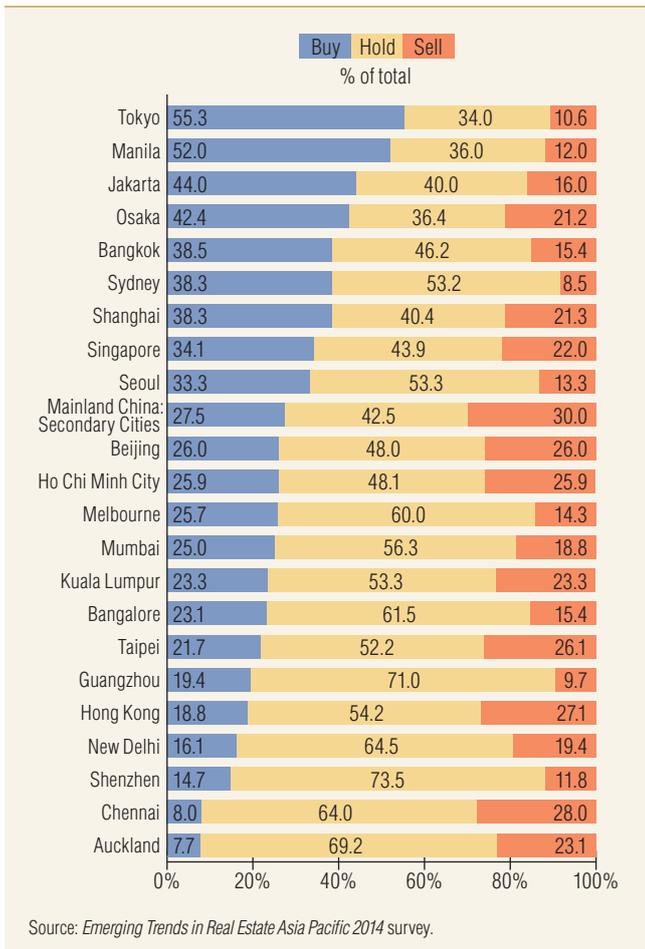


Residential

Although residential plays have long been an evergreen for Asian investors given their self-liquidating nature, they are perhaps not as popular as in previous years, for a number of reasons. First, prices in many Asian markets are very high. Second, the prospect of higher interest rates in the fairly near future will make residential mortgages less affordable. Finally, government macro-prudential measures aimed at cooling price increases continue to affect several markets in Asia. As one fund manager commented, "I think investors are a little bit nervous about residential in Asia because of the hand of the government." Markets that seem especially exposed include Hong Kong, Singapore, Taipei, New Zealand, and—arguably at least—mainland China, where home prices have again begun rising steeply in 2013 despite three years' worth of government restrictions aimed at cooling the market. The path of least resistance therefore appears to be on the downside for many, if not most, markets.

EXHIBIT 3-7

Office Property Buy/Hold/Sell Recommendations, by City



Best bets: On the other side of the coin, Manila—with a young demographic, a growing economy, low vacancies, and large numbers of expatriates from multinational companies arriving to work there—was the top investment pick. In addition, many investors favor the residential sector in Tokyo; this is partly because Japan has become an investor target in 2014 given the likely inflationary impact of Abenomics. With the office sector proving hard to break into given local competition for assets and a possible issue with oversupply, residential assets are now the number-one avenue into the market for many foreign investors.

Office

The office sector continues to be popular in principle, but in practice it suffers from a very obvious problem: fevered competition from too much investment capital fighting over the same deals, especially in core assets. As one investor put it, “There’s too much money, too much liquidity in certain markets, and yet foreign funds still do deals because they

have too much capital and they have to deploy it.” As a result, cap rates in many cities have become compressed beyond what many investors—and especially foreign funds—are willing to pay in an environment where rising interest rates threaten to undermine the viability of deals set at current price levels. Australia and Japan were the focus of attention in 2013, accounting for about half of all Asian office investment during the third quarter, according to CBRE.

Best bets: Manila is a favorite for the office sector as it was for residential, and for many of the same reasons: an influx of foreign companies has arrived on the market, supporting already buoyant sentiment in a strong economy. Manila also offers the highest prime office yields in Asia, averaging about 10 percent. Jakarta continues to show strongly following its number-one ranking in 2013, while Osaka’s resurgence after several years in the doldrums is also noteworthy.

With the exception of Tokyo, a surprising number of secondary markets feature at the top of the rankings this year, reflecting how investors are looking for alternatives to the old guard. Other options include moving further up the risk curve in established markets. In Australia, Japan, and China, therefore, interviewees indicated an increasingly willingness to invest on the development side, or to buy B-grade assets and/or to invest in suburban locations.

Retail

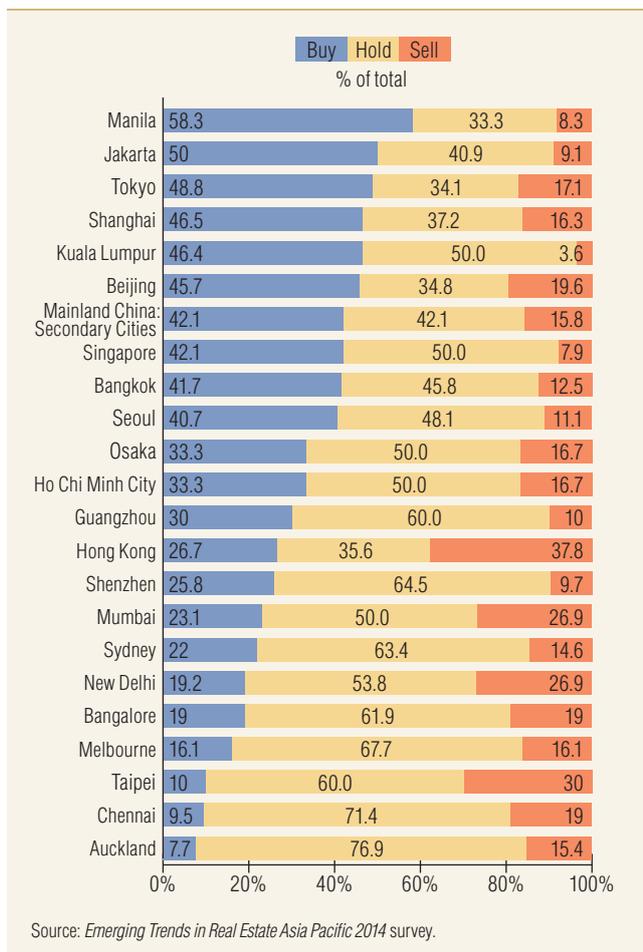
The consumer play remains one of the fundamental themes pursued by Asian investors, and it is no coincidence that retail assets feature as some of the most popular investments by the handful of big opportunistic funds that currently dominate the foreign-investor landscape. The overarching theme, as one developer described it, is that investments “are geared to what I would call sustainable demand triggered by the move toward consumption driven by urbanization.”

That said, in some markets there are questions whether retail has become too crowded a sector. In China, for instance, the explosion of retail projects in secondary and tertiary cities is likely to create fallout because demand in those markets is insufficient to support so many projects. Location, as ever, is therefore key. As one retail developer said, “Within a tier-two city, or a tier-three for that matter, you have downtown prime core location and you have suburban or new town vision location. The latter is fraught with risk, because it’s undeveloped, maybe subject to a change of vision at some stage, and really vulnerable to an oversupply equation. But even a tier-three city has its prime shopping core area, and if you can find a site that’s in that core area and it ticks all the normal criteria, it can be fine.”

Best bets: Manila again comes out as a strong favorite on the retail side, just as it did in the residential and office categories, followed by another emerging market in Jakarta, then Tokyo (an Abenomics play), and then Shanghai, which is perhaps the first obvious retail destination in the group. Once

EXHIBIT 3-8

Retail Property Buy/Hold/Sell Recommendations, by City



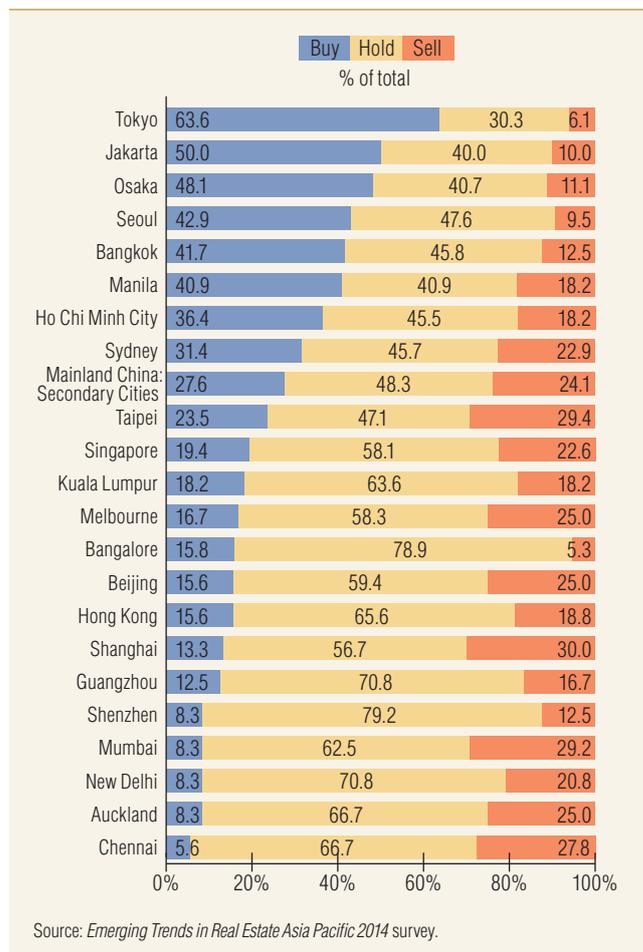
more, the recent prominence of so many markets usually on the fringes of the investment universe reflects investors' desire to move out of the mainstream in their quest for yield.

Hotels

Hotels are seen as a generally solid sector to play in Asia today, partly because yields are again higher than the norm and partly because of rapidly growing tourism in the region, especially from China. Said one fund manager active in the sector, "The broader theme in hotels is particularly the growing middle class in Asia, and the proliferation of low-cost carriers has really changed the visitation numbers—they've gone from something like 5 percent to 28 percent of the market share. So now you're getting shorter-haul Asian travelers, and the seasonality of the business has also changed substantially in some of these resort destinations."

EXHIBIT 3-9

Hotels Property Buy/Hold/Sell Recommendations, by City



Best bets: Tokyo was by far the favored destination in the hotel category. While this is to some extent a play on the Japanese macro-story, it is probably even more a play on the Japanese Olympics story, which has set off a round of possibly irrational investment in the sector. As one Tokyo-based investor said, "There's been a couple of hotel deals here recently where if you just look at the pricing, they only make sense if these guys are betting on the Olympics—but really, how much of a premium is it worth for these 30 days in 2020?" Apart from Tokyo, Jakarta also has featured strongly again.

Interviewees

Abacus Property Group

Natalia Chatalova
Gavin Lechem

AD Investment Management Co. Ltd.

Kenji Kousaka

AEW

David H. Schaefer

Altis Property Partners

Alastair Wright

Angelo, Gordon International LLC

Jon Tanaka

Aoyama Realty Advisors

Haruyuki Shinya

Ascendas Pte. Ltd.

Jonathan Yap

Asia Pacific Real Estate Pte. Ltd.

Steffen Wolf

Aviva Investors

Matthew Woodman

AXA Real Estate Investment Managers Japan KK

Tetsuya Karasawa

Baring Private Equity

Mark Fogle

BlackRock

Hamish McDonald

The Blackstone Group Japan

Akira Kosugi

BNP Paribas

Wee Liat Lee

Brookfield

Kurt Wilkinson

Brookfield Asset Management

Stuart Mercier

Cache Logistics Trust

Daniel Cerf

CapitaLand

Boaz Boon

Capital Realty Inc.

C.J. "Buddy" Ferry

CBRE

Nick Axford
Ada Choi
Marc Townsend

CBRE Global Investors

Richard T.G. Price

CBRE Global Investors Japan

Tetsuya Fujita

CBRE Global Investors Korea

Brian Ahn
Juliet Cha

CFS Global Asset Management

Michael Gorman
Charles Moore

Challenger Financial Services Group

Trent Alston

Charter Hall

David Harrison

Citigroup Australia

Robert Van Aalst

CLSA Capital Partners

Wayne Spice

Colliers

John Kenny

Colliers International

David Faulkner

Daiwa House Industry Co. Ltd.

Tetsuo Suzuki

Deutsche Bank

Clay Kinney
Hugh Macdonald
Hans Van Der Sande

Diamond Realty Management Inc.

Takashi Tsuji

Far East Organisation

Philip Ng Chee Tat

Forum Partners

Andrew Faulk

Franklin Templeton Real Estate Advisors

Glenn Uren

Fukuoka Realty Co. Ltd.

Estuo Matsuyuki

GE Capital Real Estate

Jason Kougelis
Simon McDonald
Francois Trausch

GenReal Property Advisers

Anckur Srivastava

GIC Real Estate Pte. Ltd.

Wendy Wong

Goldman Sachs

Alexi Antolovich

GreenOak Investment Management K.K.

Fred Schmidt

Grosvenor Ltd. Japan Branch

Koshiro Hiroi

Henderson Global Investors (Singapore) Ltd.

Chris Reilly

Industry Superannuation Property Trust

Robert Pepicelli

Invesco Global Real Estate Asia Pacific Inc. Japan Branch

Ryukichi Nakata

Investa Property Group

Campbell Hanan

Japan REIT Advisors Co., Ltd.

Kenichiro Oikawa

Jones Lang LaSalle

Richard Fennell
Christopher Fossick

J.P. Morgan Asset Management

Tyler E. Goodwin

Kenedix Inc.

Taisuke Miyajima

LaSalle Investment Management

Mark N. Gabbay

Lend Lease

Rod Leaver

M3 Capital Partners

Danny Krefman

Macquarie Group

Brett Robson

M&G Real Estate Japan

Katsuhiro Ishikawa

Mercer

Padraig Brown

MGPA

Simon Treacy

Mitsubishi Corp.–UBS Realty Inc.

Toru Tsuji

Mitsubishi Jisho Investment Advisors Inc.

Masami Amano

Mitsubishi UFJ Trust and Banking Corporation

Yutaka Imai

Mitsui & Co., Logistics Partners Ltd.

Takayuki Kawashima

Mitsui Fudosan Investment Advisors Inc.

Ikuo Mori

Moelis & Co.

Julian Biggins
Ben Wong

Morgan Stanley Real Estate

Hoke Slaughter

Mori Building Co. Ltd.

Hiroo Mori

Nippon ResCap Investors

Ken Fridley

Nomura Real Estate Asset Management Co. Ltd.

Eiji Enomoto

Oaktree Japan

Toshi J. Kuroda

Oclaner Asset Management Pte. Ltd.

Dharuma Tharu

ORIX Asset Management Corporation

Tetsuya Yamashita

ORIX Real Estate Corporation

Tetsuo Matsumoto

Pamfleet

Andrew Moore

Payce

Brian Bailison

Pembroke Real Estate

Mark Takeuchi

Pramerica Real Estate Investors

Henry Chin

Premier REIT Advisors Co. Ltd.

Fumihito Yasutake

Professional Property Services Group

Nicholas Brooke

Property Council of Australia

Peter Verwer

Prudential

Morgan Laughlin

Raffles Quay Asset Management Pte. Ltd.

Warren Bishop

Raysum Co. Ltd.

Takeshi Tanaka

Sabana Real Estate Investment Trust

Kevin Xayaraj Tay

Samurai Capital

Ken Aoyama

SC Capital Partners

Andrew Heithersay

Secured Capital Investment Management

Naoya Nakata

Shinsei Bank Ltd.

Tadashi Miyano

Shui On Land

Bryan Chan

SIMCO

Neil Matthews

Matt Woodland

Standard Chartered Bank

Marc Bosnyak

Brian D. Chinappi

Mark Ebbinghaus

Starr International

Alison Cooke

Stockland

John Schroder

Sumitomo Mitsui Trust Real Estate Investment Management

Mitsuo Kimura

SVP Global Asia LLC

Masatomo Zaizen

Swire Properties

Guy Bradley

Tokio Marine Property Investment Management Inc.

Nobuki Goto

Shinji Kawano

Tokyu Land Capital Management Inc.

Hitoshi Maehara

Tokyu Real Estate Investment Management

Yosuke Koi

Touchstone Capital Management Co. Ltd.

Fred Uruma

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- Explains how locational preferences are changing.

