BUILDING, CONSTRUCTION & REAL ESTATE

Asian capital: investors still investing in Asian property

KPMG INTERNATIONAL

Asia's fast growing economies have to date appeared to be a safe haven from the credit crisis, still attracting a flow of real estate funds from foreign investors.

Asian real estate has made an impressive recovery from its own financial crisis of the early 1990s. Investment in the region has benefited from the unparalleled volume of global liquidity combined with cheap debt, with investors looking to escape the falling yields in other major real estate markets.

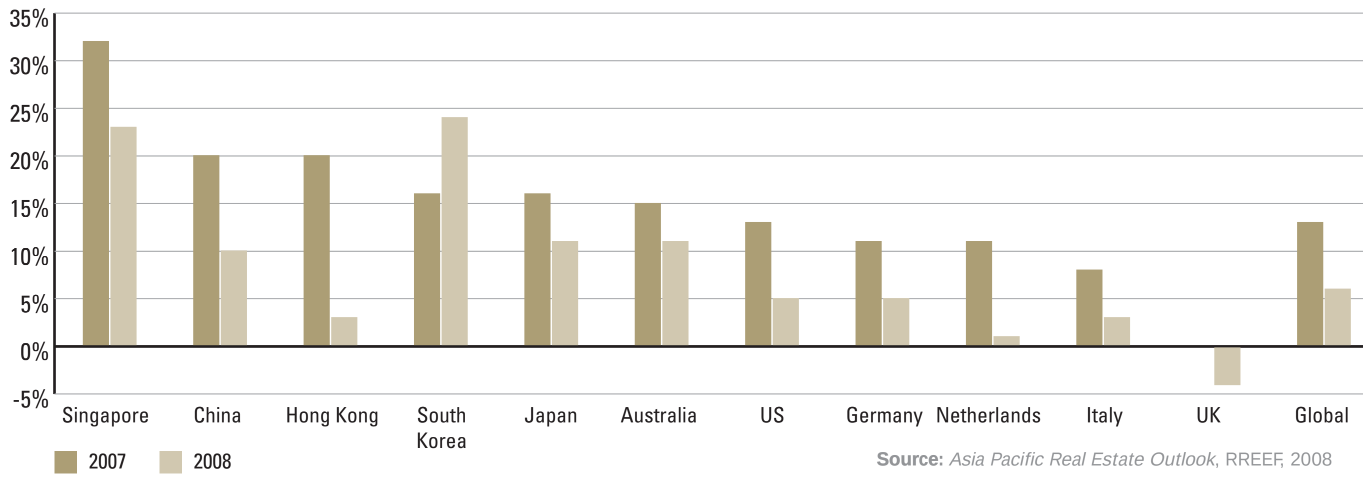
The region has also been insulated from the worst effects of the slowdown in the US and Europe, thanks to increasing economic independence and inter-regional trade. Indeed, half of all real estate transactions in Asia are cross-border, with Japan investing heavily in Vietnam and China, and further capital movements out of Korea and Taiwan.

Real estate has clearly been boosted by the overall economic resurgence in the regional powerhouses of China, and India. China's GDP has been growing at 8-9 percent a year and together with India has a combined young, aspiring middle class of around 300 million. Property investment in Asia grew by 27 percent to US$121 billion in 2007 and continues to build, according to a 2008 report published by KPMG in China, the Asia Pacific Real Estate Association and index provider FTSE.

Real estate continues to perform well

Unlike Europe and North America, where investment slowed dramatically in the second half of 2007, investment in Asia was evenly allocated over the first and second halves of 2007. Many Asian markets recorded direct real estate returns above the global average of 10 percent in 2007, and this was forecast to continue in 2008, albeit at a lower rate.

Direct real estate returns, 2007 and 2008



Source: *Asia Pacific Real Estate Outlook*, RREEF, 2008

Property markets in the region, while not immune, have stood up fairly well when compared with the US and Europe. And although the average global performance of Asian funds has fallen from a 33 percent gain in 2006 to a 14 percent loss in 2007, Asia is the only region expected to give a positive twelve-month return for 2007.[1] The rental index in Asia is also currently higher than in other parts of the world.

"Asia has some of the fastest growing economies in the world" says Dr. Henry Chin, Global Real Estate Strategist, RREEF; "Real estate will continue to benefit from this growth – particularly as Asia comes into its own and becomes less reliant on trade with the US and Europe."[2]

Many Asian banks did not get involved in sub-prime borrowing so are still offering mortgages although naturally it's a little tougher to get financing than in 2006/07, with a slower approval process, gearing down from 70 to 50 percent and pricing up by around two percent.

Foreign investors still moving into the region

The credit crisis has reduced the options in traditional western markets and accelerated the flow of capital into Asian property from outside the region.

KPMG firms have witnessed a period of aggressive fund-raising activity for new global property funds, many of which are raising allocations to Asia to gain exposure to economies that have avoided the worst ravages of the credit crisis. Institutional funds, recognizing the low levels of institutional ownership in Asian real estate, have been particularly active. And it's not just US and Europe that have been making moves: Australia is also becoming a big investor in the region.

In June 2008, MGPA, the private equity fund manager part owned by Australia's Macquarie Bank, launched a global fund that will invest mostly in Asia. It has secured US$3.9 billion in equity for Asian investment, giving it a potential buying power in the region, with leverage, of US$15.6 billion.

The fund has committed US$2.2 billion to investments in Singapore, Japan, China and Thailand, and is looking at South Korea, Malaysia, Taiwan and Australia. North American investors make up 40 percent of the fund.

Credit problems and softening real estate prices in the US and Europe mean that investors are focusing more on Asia both for long-term returns and opportunistic investments.

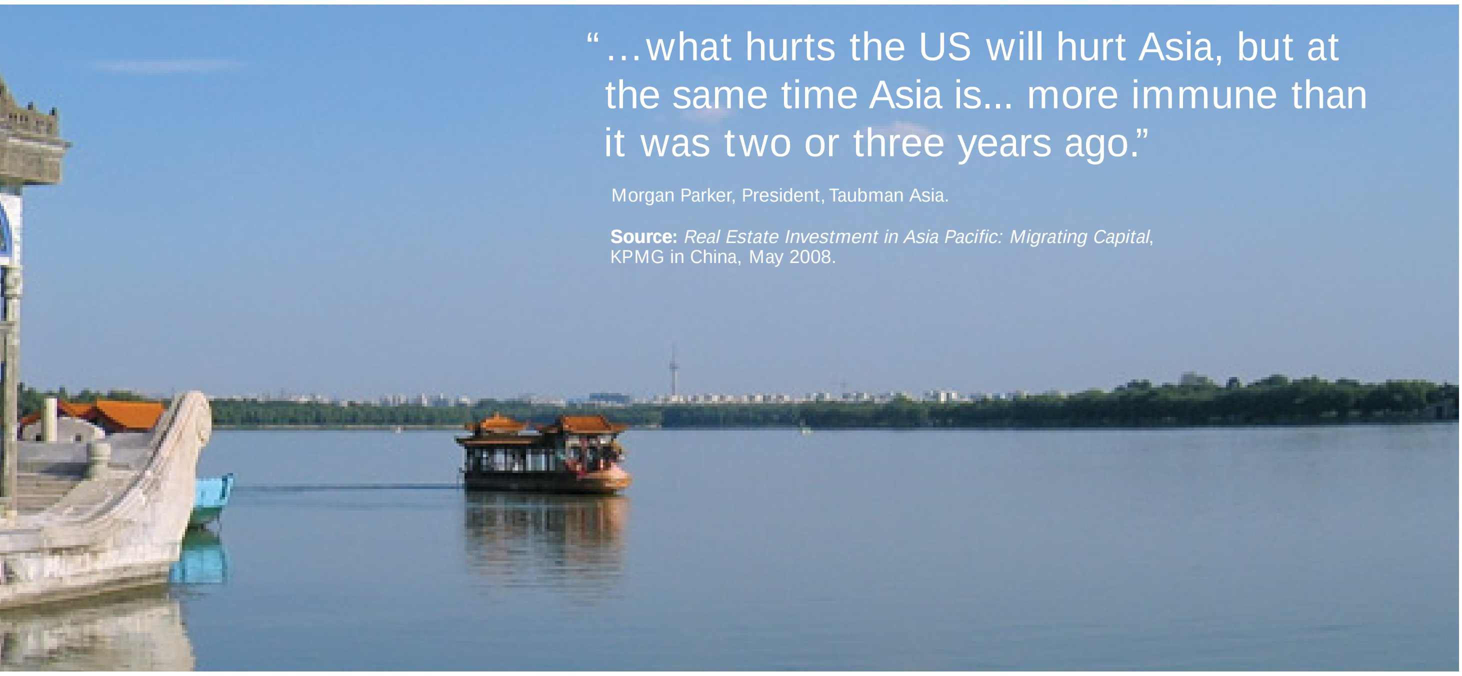
Exciting prospects remain for real estate products

Since the first Real Estate Investment Trust (REIT) was established in Japan in 2001, they have proved a resounding success in Asia, and by the end of 2007 the market contained over 100 funds with a total value of US$82 billion. And with India and China only just starting to develop such instruments, the potential could be three to four times what it is now. Not surprisingly, at present many of the top ten REITs are Japanese.

These funds provide real flexibility to invest in different properties, in different locations, with a variety of lease terms and tenant profiles. Furthermore, liquidity is higher and transaction costs lower, making them a cost-effective method of gaining exposure to real estate. The annual dividends of up to 90 percent are a further attraction and returns from REITs have been higher than in Europe and US.

Andrew Weir of KPMG China feels that the opportunity for REITs in Asia is huge, as shown by the success of the Singapore REIT market in recent years: "Korea and Thailand now have nascent REIT markets, while the Philippines and India have REIT legislation under discussion. And this is before taking into account the massive potential of China-based REITs."

[1, 2] *Real Estate Investment in Asia Pacific: Migrating Capital*, KPMG in China, May 2008.



“…what hurts the US will hurt Asia, but at the same time Asia is... more immune than it was two or three years ago.”

Morgan Parker, President, Taubman Asia.

Source: *Real Estate Investment in Asia Pacific: Migrating Capital*, KPMG in China, May 2008.

In addition to unlisted equity, a dominant source of capital in Asia is real estate funds, which are either opportunistic or long-term. Main sources of equity capital are private equity/opportunity/hedge funds or institutional investor/pension funds.

Private equity will continue to be a key source of finance for Asia’s emerging REIT and CMBS markets, fuelled by low interest rates. And while debt may be less freely available globally, equity is expected to remain in healthy supply. Indeed there are many Asian companies with low gearing, as well as unlisted corporates and individuals with no need to borrow.

Widely touted as the next big thing, the first Asian real estate derivatives trade was made in Hong Kong in February 2007 between ABN Amro and Sun Hung Kai Financial.

Fran Thompson, Director, Asia Pacific, FTSE Group, feels that within two to three years the region will be ripe for such products: “The data and information in markets around Asia is improving. As a result, quality indices are being developed for the region which will support the development of a property derivatives market.”[3]

Standing strong

The strength and the independence of the Asian real estate and investment management market has been demonstrated by its ability to hold firm against the global credit crisis, although inevitably it has experienced a degree of short term pain. Morgan Parker, President, Taubman Asia notes, “There is no question at all the US slowdown is impacting Asia: financing options are extremely limited. It’s not that you can’t obtain financing, even for large developments, it’s that banks are being much more cautious and it’s taking longer to secure and close the deal on terms that are different from before.”[4]

There has been a tightening of credit controls, although this is more to do with temporary uncertainty of lenders rather than wider problems in the region’s real estate market.

Furthermore many feel that such restrictions will lead to improved bank controls, which in turn will bring better equity returns.

The traditional debt leverage model is being challenged, with debt unlikely to be a primary source of capital in the near future; private equity, REITs and real estate funds will be predominant.

Overall the market prospects look more positive than traditional markets, with in flows of funding from within and outside of the region still eager to take part in the structural growth story.

”The flow of capital into Asian property from outside the region is accelerating as a result of the credit crisis in the US.”

Source: *Financial Times*, June 18 2008.

[3,4] *Real Estate Investment in Asia Pacific: Migrating Capital*, KPMG in China, May 2008.

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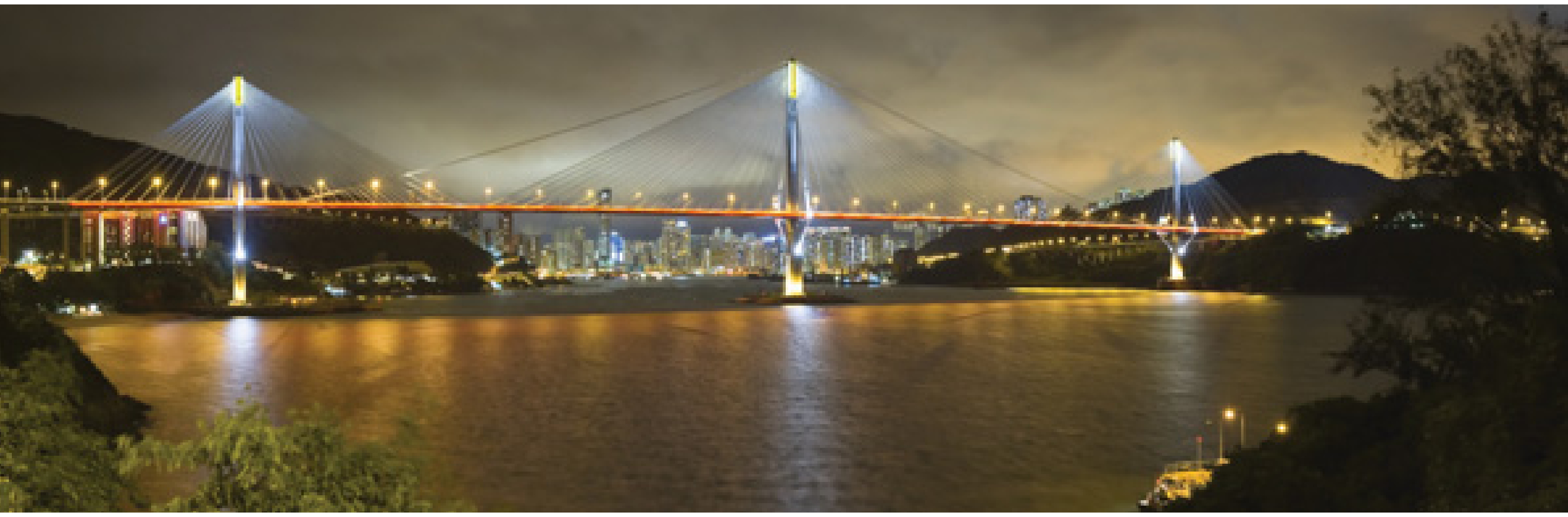

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