



2013
Emerging
Trends
in Real Estate[®]

Asia Pacific



Emerging Trends in Real Estate® Asia Pacific 2013

A publication from:



Emerging Trends in Real Estate® Asia Pacific

20
13

Contents

- 1 Executive Summary**

- 2 Chapter 1 The Price of Value**
 - 4 Prices Turning?
 - 7 Core Is King
 - 7 Whither Opportunity?
 - 9 Few Alternatives
 - 10 Second Tier Draws Buyers
 - 10 Distress Arrives, Sort of
 - 13 Frontier Markets: New Kids on the Block
 - 15 Regulations Target Residential Sector
 - 16 Speculators Focus on Strata
 - 16 Foreign Regulations Have Minor Impact
 - 16 Investors Focusing on Long Term
 - 17 Risky Times
 - 19 A Housing Bubble?

- 22 Chapter 2 Real Estate Capital Flows**
 - 24 Local Money Takes Over
 - 25 Hot Money Flowing In?
 - 26 Sovereign Funds Arrive in Force
 - 27 Raising Funds Is Still Difficult
 - 28 Hedging Currency Risk
 - 29 Bank Finance: Cheap and Cheerful
 - 30 Alternative Financing: China's Entrusted Lenders
 - 31 The Rise of Debt
 - 31 Capital Markets: Feast and Famine
 - 32 CMBS Defaults: Still Playing Hard to Get
 - 33 REITs Rebound

- 36 Chapter 3 Markets and Sectors to Watch**
 - 38 Top Investment Cities
 - 50 Property Types in Perspective

- 52 Interviewees**

Editorial Leadership Team

Emerging Trends in Real Estate® Asia Pacific 2013 Chairs

K.K. So, PwC
Patrick Phillips, Urban Land Institute

Principal Author

Colin Galloway, Urban Land Institute Consultant

Senior Advisers and Contributing Researchers

Stephen Blank, Urban Land Institute
Charles J. DiRocco, Jr., PwC
Anita Kramer, Urban Land Institute

Senior Advisers

John Fitzgerald, Urban Land Institute
Dean Schwanke, Urban Land Institute

Contributing Researchers

Brandon Sedloff, Urban Land Institute
Michael Owen, Urban Land Institute

ULI Editorial and Production Staff

James A. Mulligan, Managing Editor/Manuscript Editor
Betsy VanBuskirk, Creative Director
Anne Morgan, Cover Design
Deanna Pineda, Muse Advertising Design, Designer
Basil Hallberg, Senior Research Associate

Emerging Trends in Real Estate® is a trademark of PwC and is registered in the United States and other countries. All rights reserved.

PwC firms help organizations and individuals create the value they're looking for. We're a network of firms in 158 countries with close to 169,000 people who are committed to delivering quality in assurance, tax, and advisory services. Tell us what matters to you and find out more by visiting us at www.pwc.com.

Learn more about PwC by following us online: @PwC_LLP, YouTube, LinkedIn, Facebook, and Google +.

©2012 PricewaterhouseCoopers LLP, a Delaware limited liability partnership. All rights reserved. PwC refers to the U.S. member firm, and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details.

©November 2012 by PwC and the Urban Land Institute.

Printed in Hong Kong. All rights reserved. No part of this book may be reproduced in any form or by any means, electronic or mechanical, including photocopying and recording, or by any information storage and retrieval system, without written permission of the publisher.

Recommended bibliographic listing:

PwC and the Urban Land Institute. *Emerging Trends in Real Estate® Asia Pacific 2013*. Washington, D.C.: PwC and the Urban Land Institute, 2012.

ISBN: 978-0-87420-253-3

PwC Advisers and Researchers

Australia Andrew Cloke
Brian Lawrence
James Dunning
Kirsten Arblaster
Liam Collins
Manuel Makas
Marco Feltrin
Mark Haberlin
Tim Peel

China/Hong Kong Allan Zhang
Andrew Li
Kathleen Chen
K.K. So
Paul Walters
Sally Sun
Sam Crispin

India Anish Sangvhi
Divya Kumar
Gautam Mehra

Japan Hideo Ohta
Julien Ghata
Misako Himeno
Raymond Kahn
Shinichi Okamoto
Shunichiro Wakabayashi
Takahiro Kono
Takehisa Hidai
Takeshi Sudo
Takashi Yabutani
Tomokazu Makida
Tomomi Kawa
Yoshihiko Toda
Yuji Sato
Wataru Wada

Korea Jin-Young Lee
Taejin Park

Luxembourg Anna-Charlotta Thiele
Kees Hage
Kenneth Iek
Robert Castelein

Malaysia Jennifer Chang
Philippines Malou P. Lim
Singapore Boon Chok Tan
David Sandison
Eng Beng Choo
Gautam Banerjee
Jim Chua
Jiunn Siong Yong
Oon Jin Yeoh
Magdelene Chua
Pei Jun Tok
Soon Bee Koh
Soo Teng Ng
Wee Hwee Teo

Taiwan Richard Watanabe
Shuo-Yen Lin

Thailand Paul Stitt
Vietnam David Fitzgerald

Executive Summary

Investor sentiment across many markets in Asia has grown increasingly uncertain towards the end of 2012, with caution over fading global economic prospects tempered by ongoing strength in asset pricing and persistently compressed yields. The lack of conviction has been underlined by the divergent approaches of foreign and local investors to property pricing, with Asian buyers often willing to pay up for properties at rates foreigners find prohibitive.

Given the ambivalent mood, there is little surprise that investors are opting for bigger, more liquid markets where there are plenty of core assets and greater confidence in long-term price stability. Tokyo and Australia, therefore, have been particularly favored. The former has benefited also from ultra-low interest rates and a widespread belief that pricing is about to bottom out, while the latter continues to feature high yields, a shortfall of domestic capital, and a growing conviction that homegrown institutional investors are about to increase investments in real estate assets.

Opportunistic investors, meanwhile, are having a hard time finding assets that will provide returns Western-based investment committees expect from this type of play. There are some possibilities, however. Many foreign investors are looking for Japan to produce distressed assets, especially from commercial mortgage-backed securities servicers. Australia has seen some distressed portfolios coming to market (especially from European banks), while China also offers possible distress plays from cash-strapped developers in need of capital to complete projects.

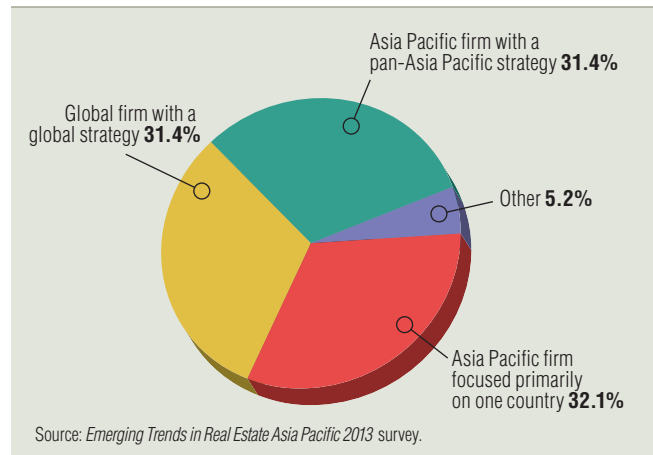
The difficulty in sourcing good returns has meant investors have become more adventurous in seeking out yield, with particular interest in niche sectors such as logistics and seniors' housing facilities, as well as assets in secondary locations such as Indonesia, Malaysia, Thailand, and China's secondary cities. Indeed, all these emerging locations ranked at or near the top of the *Emerging Trends* survey of top investment and development destinations.

On the financing side, Western-sourced capital remains below pre-crisis levels, and fund raising today is focused increasingly on tapping sources from within Asia. Therefore, not only is Asian real estate investment now dominated by Asian capital, but also a growing proportion of capital finding its way into global real estate funds for investment in Western markets is being raised from within the region.

Indeed, the volume of new regional capital sourced from big institutional players, including sovereign wealth funds, is becoming increasingly apparent, with funds from every major Asian economy now either actively deploying capital outside their home markets or planning to do so. Sovereign wealth funds from outside Asia are now also active in the region, with some opening their own offices in order to invest directly.

Bank lending remains the major source of Asian real estate finance, as it has been traditionally. By and large, leverage in the 50 to 60 percent range remains both widely available and fairly cheap (if marginally more expensive than last year). There are a couple of notable exceptions—in particular China, where the government remains committed to reeling in local home prices by keeping a tight leash on bank lending to developers.

Survey Responses by Geographic Scope of Firm



The capital markets, meanwhile, have seen widely contrasting fortunes. With share prices down substantially across the region, few developers have had any incentive to raise equity. On the debt side, the story has been quite different, with Asian markets raising more real estate debt in 2012 than in any previous year. Cost of debt for investment-grade players is commonly below 5 percent for 30-year terms. In the second half, the focus shifted to the high yield side, with Chinese developers prominent in the market. Finally, Asian real estate investment trusts (REITs) have also seen exceptional demand since around the middle of the year. With share prices rising strongly, many REITs across the region now trade at a premium to net asset value. Although yields have been compressed, they remain generally competitive compared with cap rates for individual properties in most markets. Because REITs are now more easily able to make accretive purchases, many interviewees anticipate they will be active buyers in 2013.

In the *Emerging Trends Asia Pacific* investment prospects survey, respondents nominated several second-tier markets among the top choices, as noted above. In addition, Shanghai, Singapore, and Sydney were preferred destinations. While the popularity of the more developed markets comes as no surprise, the choice of Jakarta as top pick is perhaps unexpected. Certainly, Indonesia has turned in strong economic performance in the past couple of years, and office rents in particular have surged in 2012. Still, Jakarta lacks the enterprise, scale, and infrastructure of its more developed peers, and, perhaps more important, lacks the capacity to absorb large amounts of real estate investment. In the *Emerging Trends Asia Pacific* sector-by-sector ratings, industrial/distribution remains the top-rated prospect for the second year, followed closely by retail, hotel, and office assets.

Notice to Readers

Emerging Trends in Real Estate® Asia Pacific is a trends and forecast publication now in its seventh 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 2013*, 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 2013 reflects the views of over 400 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 130 individuals, and survey responses were received from over 275 individuals, whose company affiliations are broken down here:

| | |
|---|-------|
| Private property company, investor, or developer | 25.2% |
| Real estate service firm | 24.8% |
| Institutional/equity investor or investment manager | 21.1% |
| Other | 16.3% |
| Equity REIT or publicly listed property company | 8.9% |
| Bank, lender, or securitized lender | 2.2% |
| Homebuilder or residential land developer | 1.5% |

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.



The Price of Value

“As soon as we get past the crisis in Europe and North America, where’s the growth going to come from? Asia will benefit first, it will benefit strongest, and it could benefit for quite a long while.”

As markets around the world enter what is now a sixth year of economic adversity, real estate investors in Asia could be forgiven for experiencing crisis fatigue. While regional economies continue to live in the shadow of a seemingly endless stream of calamity in the West, growth in Asia remains in place, incomes continue to rise, property values have not collapsed (and in some cases they have soared), and, for the most part, the sun continues to shine. No surprise, then, that interviewees exhibit equal degrees of indecision and frustration as to how to approach investment decisions.

On the one hand, sentiment in the region is fairly positive, with the *Emerging Trends Asia Pacific* survey reflecting a positive bias towards profitability (see exhibits 1-2 and 1-3). At the same time, however, finding assets to buy at a price that reflects what is perceived to be a good risk-adjusted return is another matter altogether. “There’s just a lot of uncertainty about what is the right thing to do and where are the real opportunities,” said one interviewee. He compared current sentiment to that at the height of the market in 2006, when “airports were full of all the domestic investors going somewhere else to look for property and for value, passing all the internationals coming into your market to look for the same thing.” Said another, “I’m just in a not-very-excited mood about buying stuff. For selling, I’m very excited. On the other hand, I do need to feed the monster.”

This overall lack of conviction seems consistent with transaction data, which shows a decline during the first half of this year. According to statistics from Real Capital Analytics (RCA), sales of commercial properties in Asia amounted to US\$65.3 billion in the first half of 2012, after backing out steep declines in local government land sales in China, down 11.8 percent year-on-year. That compares with figures of US\$78.1 billion and US\$31.3 billion for comparable periods in the pre- and postcrash years of 2007 and 2009, respectively. Probably the main reason for investor uncertainty is ongoing concern with overpricing. Though Asian cap rates ticked up slightly in the third quarter, yields remain more compressed than in Western markets that historically have been regarded as safer bets. An average yield of 6.6 percent might seem fine given a generally low cost of capital, but yields in major markets (with the notable exception of Australia) are mostly much lower than that and have been for years, especially for prime assets.

EXHIBIT 1-1
Survey Responses by Country/Territory

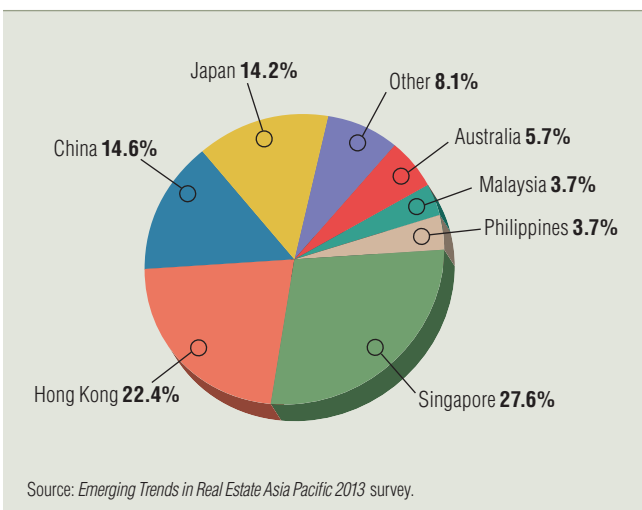
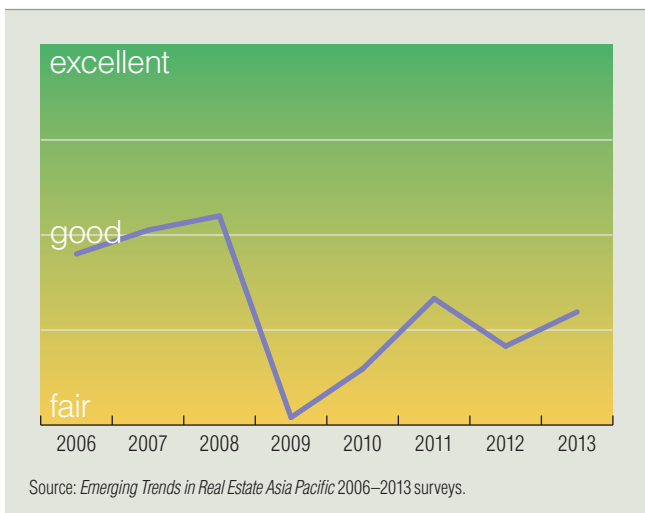


EXHIBIT 1-2

Real Estate Firm Profitability Trends



Core office stock in Tokyo, for example, returned about 4 percent in mid-2012, according to RREEF, whereas similar assets in Beijing, Hong Kong, or Singapore can return as little as 2 percent.

That makes no sense to Western investors looking at a deteriorating macro scenario at home and shaky fundamentals regionally. According to one Hong Kong–based fund manager, “Demand drivers are drying up in terms of retail spending and office demand, just as rents are pretty much as high as they’ve ever been and yields are pretty much as low as they’ve ever been. That doesn’t feel like a good time to be buying to me.”

That means deals can be hard to sell to Western-based limited partners (LPs) or investment committees that often have little exposure to Asia other than (often negative) press reports and that are inclined towards a defensive posture because of local macro conditions. “If you’re buying in China at a yield well below your cost of borrowing, and if you look at the historical price graph and it’s already gone up like a rocket, it’s hard to get that past your investment committee,” observed a locally based fund manager. “Because even if the

guys on the ground have got their China blinders on and are drinking the Kool-Aid, the guys back in Europe are looking at a price graph that looks pretty ugly and at cap rates that look pretty tight, and they’re saying, ‘Hmm, I’m not sure about that.’” As a result, the standoff between sellers and, in particular, foreign buyers in many regional markets has continued.

Why do cap rates remain compressed when perceived risk has increased? Certainly, low borrowing costs help. Perhaps more important, though, is that Asian investors tend to see the market through a different prism. Often willing to pay prices foreigners are unwilling to match, they can crowd out international players at a time when deal flow is already tight. There are a number of reasons for this:

- A compressed yield in real estate (especially for core assets) is better than many low-risk alternatives. In particular, sovereign bonds are not competitive, and regardless, if interest rates rise (which ultimately they must), bondholders will face losses. As a result, real estate is now being priced off sovereign bonds.
- Fear of inflation resulting from endless rounds of global monetary easing is driving capital into hard assets despite low yields.
- Asian investors perceive local markets to have less risk than do foreigners.
- Culturally, real estate has always been a preferred asset class and is seen as the ultimate defensive play.
- Regional players often enjoy lower costs of funding.
- Asia has accumulated an ever-growing volume of capital needing an investment home.
- Perhaps most important, Asian investors have innate confidence that the region’s high rates of economic growth will continue to lift all boats, driving the long-term trend of higher rents and, ultimately, higher capital values.

Prices Turning?

Whatever the merits of these competing viewpoints, a developing consensus that prices in some of Asia’s biggest markets are set to rise may help bridge the gap.

EXHIBIT 1-3

Firm Profitability Forecast for 2013

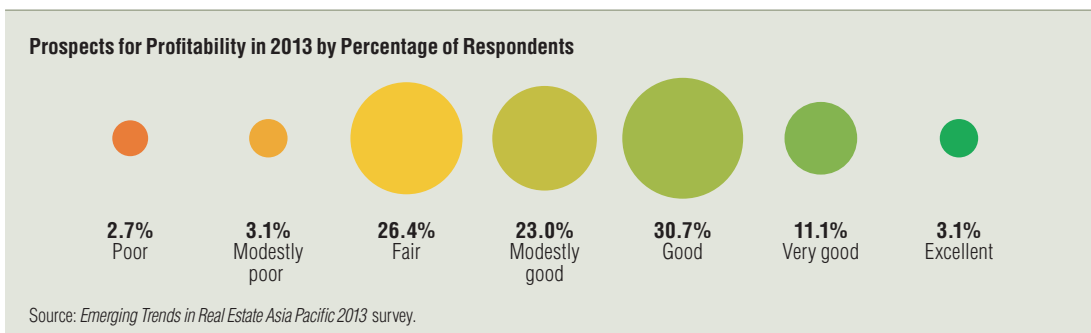
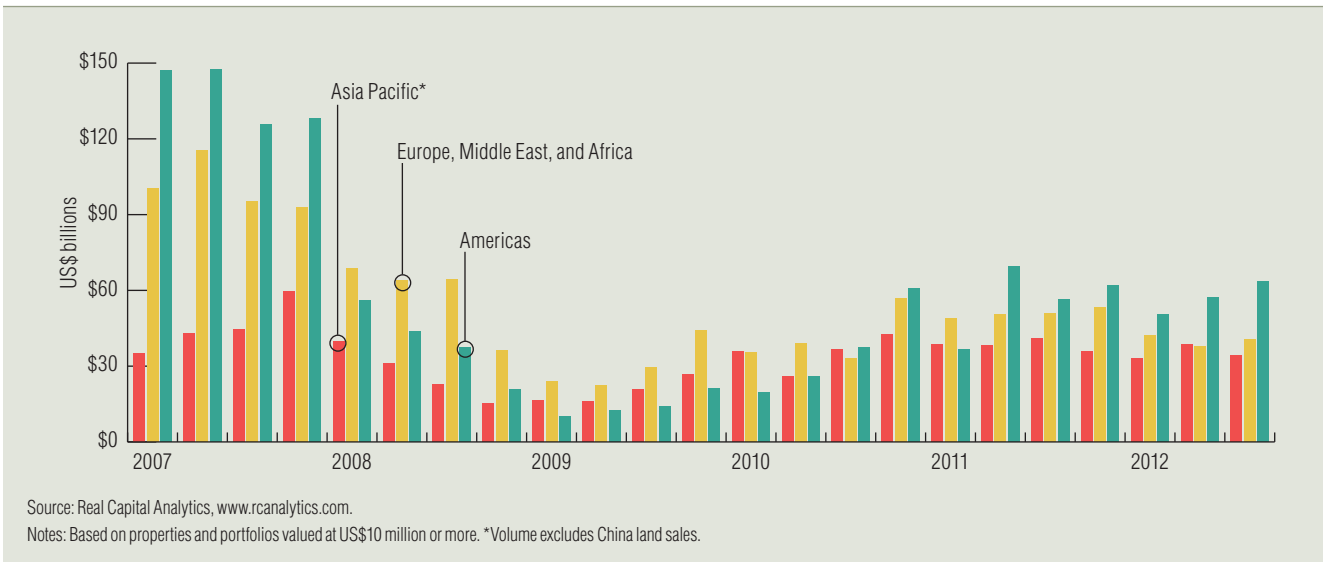


EXHIBIT 1-4
Global Sales Volume



Japan

Japan, which has seen more than three years of office and residential rent declines, received repeated positive comments from interviewees, although the exact reasons for optimism were elusive. “Tokyo has hit the bottom,” said one Japan-based fund manager. “Everyone has realised that, and data are starting to support the theory. Japan provides a level of stability that really doesn’t exist in [some] other markets.” Although many foreign funds have shut down their Japanese operations in recent years, new arrivals are now putting feet on the ground. Average cap rates on cross-sector completed transactions moved out to some 6 percent in mid-2012, according to RCA, the highest level in five years. With banks providing cheap and readily available debt, investors currently enjoy yield spreads of as much as 500 basis points, one of the highest levels of any major market in the world, translating to net offshore double-digit cash-on-cash yields.

That said, interviewees were not universally positive about Japan. Transaction volume remains weak, largely due to ongoing reluctance by Japanese banks to call in nonperforming loans, which creates little pressure for sellers to lower asking prices. In addition, according to one fund manager, “A lot of people are focused on the office market, which they say has bottomed, but from an offshore-investor standpoint, it seems a lot of people just follow the herd. From our standpoint, it’s tough to make that call because you can’t necessarily see where the growth and demand are coming from.”

Australia

Another market that continues to be a magnet for international investors is Australia. According to one pan-Asian analyst, “If you strip out Hong Kong money going into China and vice

versa and [a recent big] logistics deal in Japan, Australia’s left as the dominant cross-border destination in the last 12 months.” In fact, Australia has received about half of all real estate capital placed by funds in Asia in 2012, according to consulting firm CBRE, with cross-border capital snaring some 40 percent of all deals done by the middle of the year. There are various reasons for this popularity:

- As in Japan, cap rates in Australia are high (over 7 percent) and offer a big yield spread. After three 2012 base-rate cuts, the prime rate has fallen to a three-year low of 3.25 percent. As a result, funding costs have also fallen, though not yet

EXHIBIT 1-5
Quarterly Cap Rates for Commercial Property Transactions by Zone

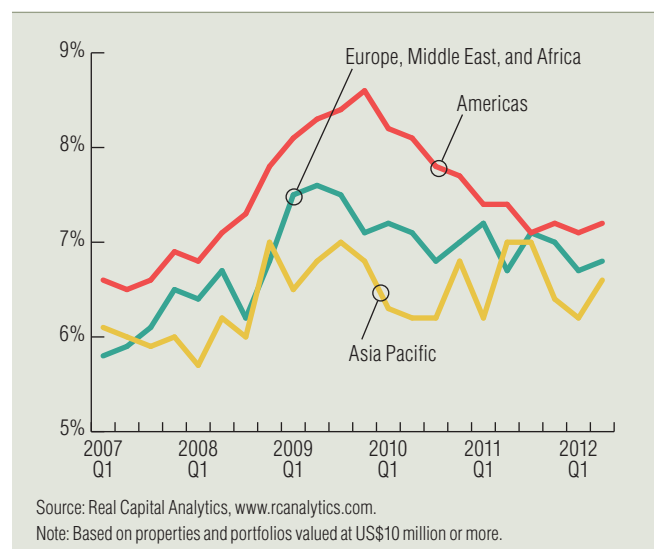
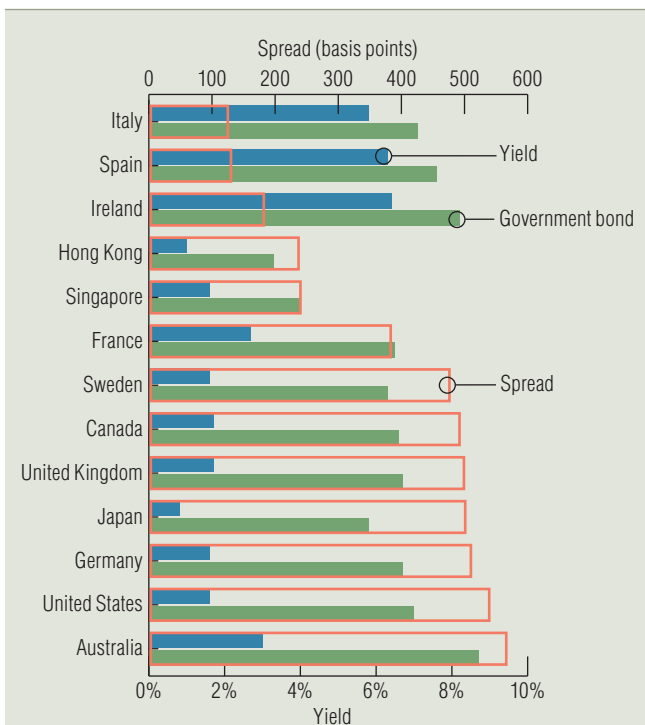


EXHIBIT 1-6

Yield Spreads to Government Bonds



Source: Real Capital Analytics, www.rcanalytics.com.
 Notes: Yield is for office properties over past 12 months. Ten-year government bond yields are for period ending June 2012.

to the same extent. Current interest-rate swap prices suggest more rate cuts may be in the pipeline.

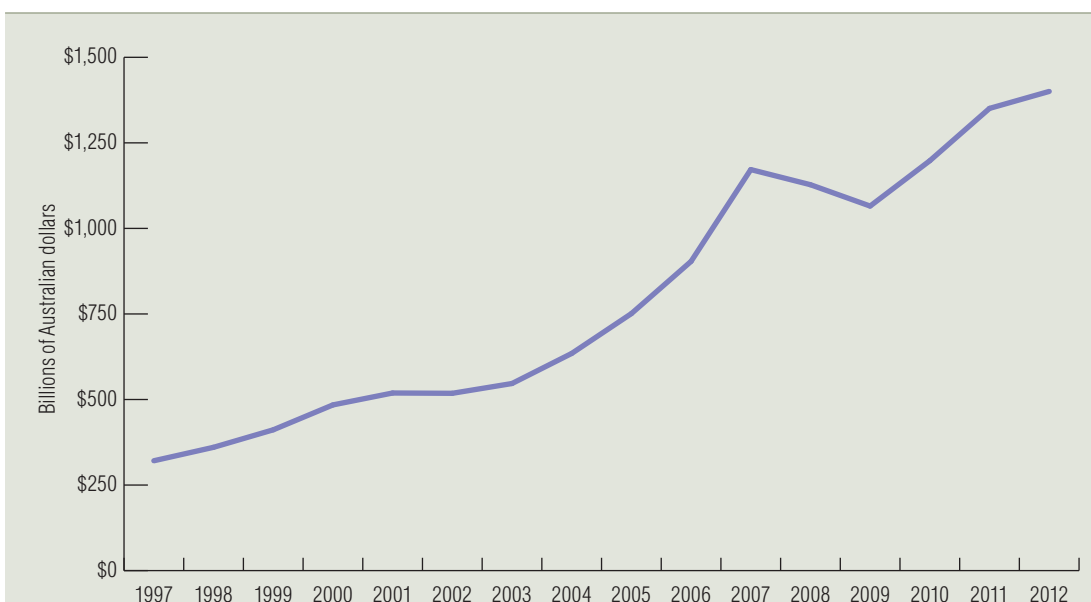
■ So far, local money has not been actively competing for deals. As one interviewee put it, “[Australian] investors still seem to me extraordinarily pessimistic. You look at the bits of the economy that aren’t resources based, and they’ve been struggling. But from a cyclical point of view, there’s no surprise there unless you think this is some kind of terminal decline. So surely it’s a cyclical opportunity to buy.”

■ Australian banks are notoriously conservative and, regardless, are not anxious to finance domestic real estate deals, meaning that “debt is difficult to find and expensive.” This is partly due to a funding squeeze caused by a shortfall in the domestic savings base, but it also stems from wariness of real estate as an asset class because of past losses in the commercial property market, where Australian banks continue to have significant exposure. Australian banks have cut outstanding loans to commercial property by 15 percent since 2009, according to Reserve Bank of Australia figures.

■ Australia’s superannuation funds are once more in the market buying property. After backing out new contributions received since late 2008, the funds have now clawed back balance-sheet losses suffered during the global financial crisis, which means rebalancing rules requiring them to be net sellers of real estate no longer apply. With some US\$937 billion in assets as of mid-2012 (of which about 5 percent is in cash), the superannuation funds certainly have the weight of capital to move prices if they start buying in quantity, which they have vowed to do. According to an executive at one

EXHIBIT 1-7

Total Assets of Australian Superannuation Funds



Source: Australian Prudential Regulation Authority.
 Note: Data are for June of each year.

large opportunity fund, “That’s our bet. They’re quite shy on international real estate investing. They did it in ’05 to ’07 and blew up, so our guess is that they’re going to start redeploying [domestically], and that cap rates will come back in.”

■ The recent recovery in Australian real estate investment trust (REIT) share prices means AREITs are once again able to make accretive acquisitions. This should also contribute to upward pressure on prices.

Singapore

Singapore may also provide prospects for bottom fishing. The local office market is plagued by both lack of demand (as financial companies reduce payrolls) and oversupply (as big tenants migrate to new stock). With further new supply due in 2016, prospects for the sector appear bleak. However, rents have fallen 15 to 20 percent in 2012, according to one interviewee’s estimate, and capital values have followed to an extent, although cap rates remain compressed. The question is whether they now represent value. Opinions differ. Said one Singapore-based analyst, “I think [prices] may not fall much [farther] because it’s come to this psychological level where they say, ‘that’s enough,’ so people are looking around for a place to buy.” However, another locally based interviewee saw just “one or two buyers kicking tires for assets that are available or will come available soon. They tend to be a lot of high-net-worth [players], a lot of Indonesian money, Malaysian players. It’s a bit like Hong Kong, where you’ve always got some unknown individual that comes from Macau and pays in cash. But there aren’t that many foreign funds, and I can’t think of other people actively looking to buy.” The best prospect over the short term, therefore, may be for Singapore’s cash-rich REITs to start deploying their capital.

Core Is King

Another reason for the enduring popularity of the Tokyo and Australian markets, apart from their very positive yield spreads, is that both tick the boxes for depth, liquidity, asset quality, and transparency—basically, all the characteristics of core markets. The migration, if not a stampede, of investors towards the safety of core assets noted in last year’s *Emerging Trends* report, therefore, has continued in 2012.

This is hardly surprising given that risk remains so pervasive. Investors fear both a global macro crisis and (if not more so) a hard landing in China. Many also have a Pavlovian fear of losses incurred in the recent past. According to one interviewee, “A lot of big investors got their fingers burnt in a leveraged opportunity-fund scenario in the last cycle, so they’re now moving down the risk spectrum and taking safer bets.”

Another catalyst for increasing demand for core assets is a growing tendency for big institutional players to invest directly, without using investment funds. Apart from the fact that many of these investors may be running core money anyway, they are “naturally inclined to go for something that has a degree of yield and a slightly longer time horizon, just to

give you that comfort factor, rather than buying something at a 2 cap, kicking all the tenants out, and refurbishing.”

The core market has become a crowded space, however, with more investors chasing limited assets. Cap rates in most markets remain extremely compressed at the top end, with buyers justifying purchases either by way of ambitious assumptions as to rental growth (or, by extension, capital values) or by lowering expectations for yield. As one analyst put it, “Core product in core markets is attracting a premium, and pricing in most of those markets looks unattractive in anything other than a relative-to-government-bonds sense, because that’s where they’re being priced at the moment.”

Deal flow in this space is also very tight, although a trickle of deals regularly emerges from international funds as they exit investments and recycle their capital. As one investor noted, for example, “There are some very big assets about to come up for sale in China that would fit into that 4 percent, 5 percent gross yield range, which is core return, although you’d have to say core-plus risk.” However, the buy-and-hold mentality of most local investors means really prime properties rarely appear on the market, especially in places such as Hong Kong or Singapore, where central business districts are geographically confined and assets tend to be closely held by big domestic players.

Most action, therefore, takes place around the margins, even in places like Tokyo, which on paper has a huge inventory of prime office stock. This problem is only likely to worsen as REITs in Asia, many of which are now trading at or above their net asset values (NAVs), enter the market looking to buy properties.

Whither Opportunity?

The flip side to the drift towards core is that opportunity plays are becoming correspondingly harder to justify—first in principle, and second because the lack of leverage and the extent of cap rate compression today mean opportunistic plays no longer generate the kinds of numbers they once did. Notwithstanding this, Western LPs often still expect high returns. As an executive at one large opportunity fund said, “If I marched into a big pension fund in the U.S. and told them, ‘I’m doing greenfield retail development in China with 16 percent [internal rate of return (IRR)] and a 2.4 cash flow multiple over 12 years; it’s a great proposition,’ they would go, ‘Wait a minute: in the U.S. and Europe, I have guys telling me they can do an 18–20 IRR, so shouldn’t we be doing a 20–22 or a 21–24?’ That is still the mindset.”

The problem with buying with IRR expectations that high, as another investor noted, is that “it’s just hard to find a compelling equity play. If your team is telling you to go down the opportunity route where you’d get 20 percent-plus returns, there’s just a world of difference from the West: a 20 percent–25 percent return in Asia is not the same as a 20 percent–25 percent return in the U.S. Here, you’re taking risks

EXHIBIT 1-8

Contributors to Global Growth of Commercial Real Estate Value

| | | Real estate value in 2011 (Billions of U.S. dollars) | Growth 2011 to 2021 (Billions of U.S. dollars) | Contribution to global real estate growth |
|----|----------------|---|---|--|
| 1 | China | 1,863.9 | 7,877.4 | 35.5% |
| 2 | United States | 6,752.7 | 3,537.0 | 16.0% |
| 3 | India | 350.4 | 1,279.6 | 5.8% |
| 4 | Russia | 619.6 | 1,078.7 | 4.9% |
| 5 | Brazil | 883.7 | 1,054.3 | 4.8% |
| 6 | United Kingdom | 1,370.3 | 582.2 | 2.6% |
| 7 | Indonesia | 189.1 | 563.0 | 2.5% |
| 8 | South Korea | 467.4 | 465.9 | 2.1% |
| 9 | Canada | 784.4 | 431.6 | 1.9% |
| 10 | Japan | 2,678.0 | 394.7 | 1.8% |
| 11 | Germany | 1,614.6 | 362.7 | 1.6% |
| 12 | Turkey | 239.8 | 339.2 | 1.5% |
| 13 | Singapore | 241.1 | 304.6 | 1.4% |
| 14 | France | 1,247.9 | 280.4 | 1.3% |
| 15 | Mexico | 369.6 | 258.4 | 1.2% |
| 16 | Australia | 656.1 | 235.8 | 1.1% |
| 17 | Poland | 186.3 | 198.4 | 0.9% |
| 18 | Others | 6,044.0 | 2,920.7 | 13.2% |
| | Total | 26,559.0 | 22,164.0 | 100.0% |

Sources: EIU, IMF, Pramerica Real Estate Investors Research.

you're not even aware of." As another investor commented, "When you get to things that are north of 20 percent, typically something's giving. It's either a partner you're not 100 percent sure about or there's some issue with the deal."

Some Asian markets, therefore, appear to have few viable opportunity plays left, apart from distress, and even then may not deliver opportunistic yields. In Japan, for example, development risk provides returns "only in the high single digits to low double digits." In addition, while both domestic banks and commercial mortgage-backed securities (CMBS) servicers have recently begun to push some distressed assets onto the market, pricing remains in the core or core-plus range. Said one locally based investor, "It doesn't appear they're going to trade at a discount suitable for the opportunity funds—[that is,] not something that's going to generate a 20 percent return. So it's really important you have the right capital with the right return requirements to play in Japan, because the opportunistic days—I don't see them coming back anytime soon."

The combination of lower available leverage, risk-averse LPs, ongoing cap rate compression, and moderated expectations for rental growth has translated to fewer opportunistic possibilities from both the supply and demand points of view. It has also resulted in the recasting of assumptions as to where opportunity can be found. In China, for example, "it would be difficult for foreign funds to buy existing assets at an attractive price unless you are making a huge gamble on which way the market is going to move," one interviewee

said. As a result, foreign investment in Chinese commercial property assets fell to US\$447 million in the first half of 2012, representing 22 percent of total Chinese commercial property sales, compared with US\$2.73 billion for all of 2011, which represented 44 percent of the total, according to CBRE.

That said, appearances can be deceptive. Emerging markets such as China can and often do see large and unexpected price moves, as evidenced by the recent surge in mainland major-city office prices. This has meant, as one investor observed, "the market has gone up so significantly in Shanghai and Beijing that anyone who bought two years ago is now easily sitting on a two-times return."

While investors are obviously reluctant to buy into a market after such a move, it does suggest that the prospects for China's office sector need to be viewed in the context of local conditions rather than strictly by the cap rate book. Shanghai, for example, currently has Class A or B office stock amounting to 50 million square feet, compared with 450 million square feet in New York City and about 800 million square feet in Tokyo. That suggests continuing long-term growth. As one investor points out, "When you look at the matrix of office space against a GDP unit, suddenly you think, wow, given the level of commercial activity in Shanghai, it's structurally under-officed."

It is true that Chinese central business districts (CBDs) remain plagued by periodic bouts of extremely high vacancies. But this is largely a consequence of waves of new supply that are absorbed as they hit the market—in Tier 1 cities at

least. For example, 35 percent of Beijing office space was vacant at the start of 2010, but by mid-2012, vacancies in Class A space in the city were just 3.3 percent, according to consultants Knight Frank. Though Chinese property market statistics can set warning lights flashing for Western investors, therefore, they are not necessarily indicative of the same issues they might suggest in other countries.

At the same time, the dynamics of Chinese markets can be affected by issues that might seem obscure in the West. For instance, one reason why Chinese residential prices are so high in relative terms is that these properties have traditionally been delivered on a bare-shell basis—that is, not fitted out. This has contributed to the rise in home prices because the properties tend to be regarded by default as speculative investments, especially at the higher end of the market, and often sit empty for years. An ongoing move away from the bare-shell concept, caused at least in part by a downturn in speculative buying as a result of government measures, may change this practice, bringing more properties onto the rental market, with a consequent depressive impact on housing prices.

Few Alternatives

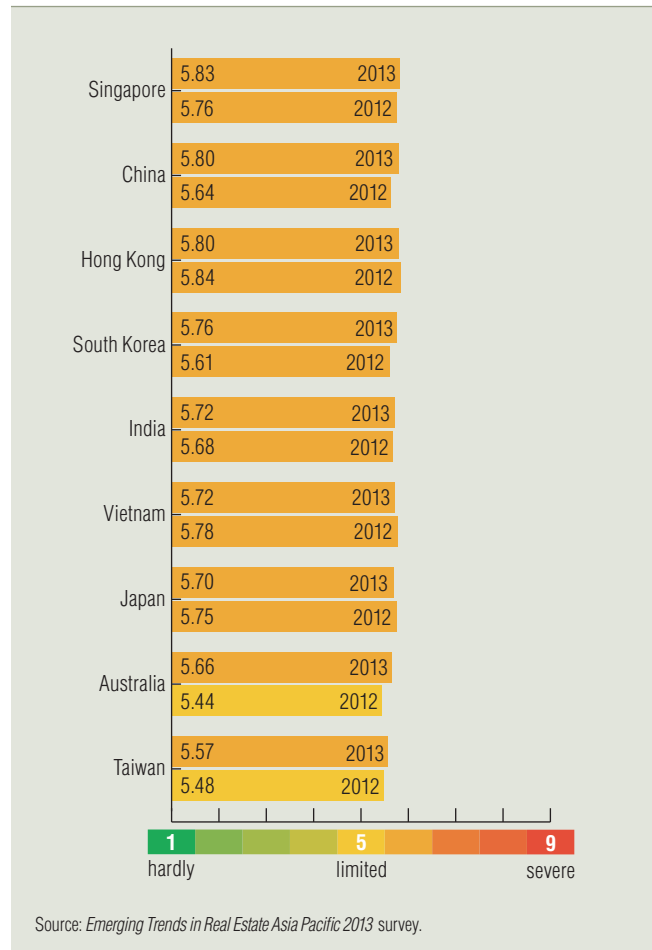
The overall dearth of investible options across Asian markets has led some opportunity players to migrate towards more focused strategies in niche sectors, especially where these require an element of expertise that domestic players lack. These alternative asset classes provide not only a measure of protection against cheaper local money, but they also are relatively sheltered from economic volatility. As one investor observed, “They’re less cyclical in nature because the demand drivers are more necessity driven. Senior housing, for example, is necessity driven, whereas office is much more cyclical because of the demand drivers.”

The logistics sector was mentioned favorably by several interviewees, especially in Japan, where distribution infrastructure has been reorganised in the wake of last year’s earthquake, and also in China, where the requirements of domestic consumers, especially in the e-commerce arena, continue to outpace the capacity of local logistics networks that have traditionally been oriented towards meeting exporter demand.

Another sector attracting increasing interest is housing for seniors. Although efforts to develop this niche in other countries have not gained much success, this is an obvious play on Asian demographics applying equally to developed economies like Japan and emerging ones like China. The related field of health care also has huge potential. One fund manager referred to upcoming trades in Japanese hospitals and nursing homes involving the consolidation of health care operating companies. “That obviously has an operating component and a real estate component, and potentially you could see some opportunity money coming in and playing in that space,” as assets are folded into an operating entity such as a health care REIT.

EXHIBIT 1-9

Levels of Impact of Global Financial Distress

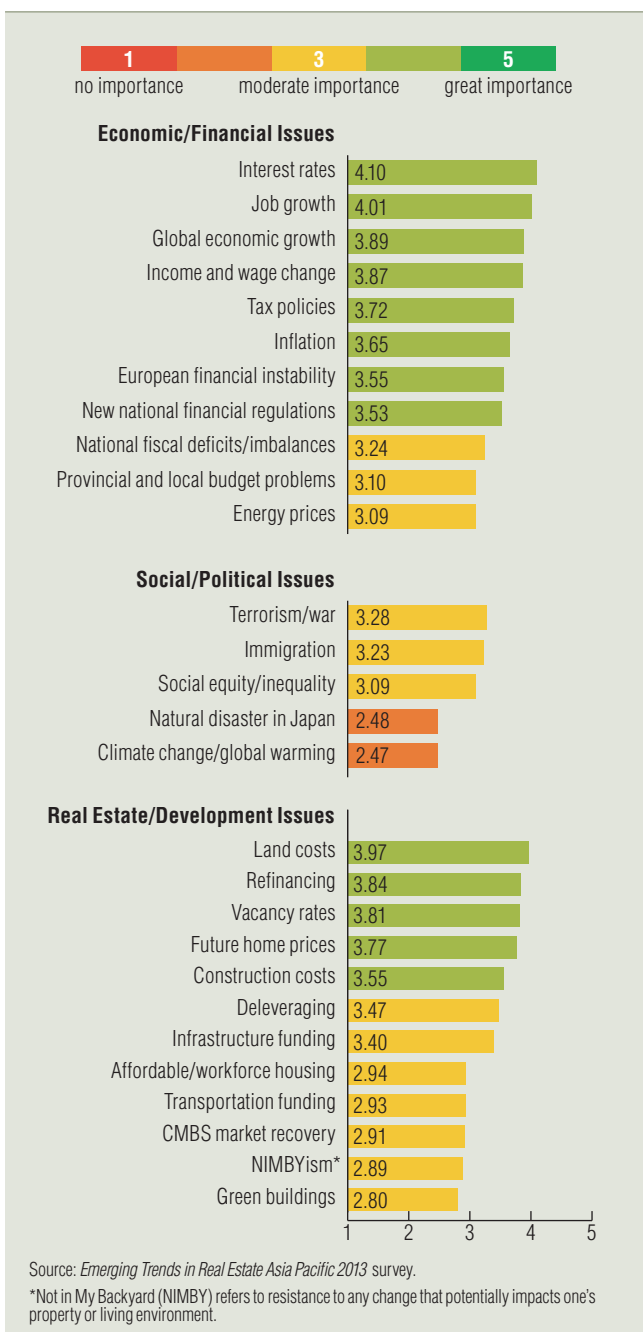


Nonetheless, investments in these emerging asset classes have issues of their own relating partly to yield and partly to availability. The logistics sector, for example, has now received mainstream acceptance and is increasingly regarded as more of an institutional than an opportunistic play. As a result, returns are being squeezed. In China, development yields for logistics assets are now about 9 percent. That is higher than for offices, but with little prospect of rental growth, it can hardly be defined as a true opportunistic play. In addition, said one investor, “It isn’t rocket science, no matter what the big players say, and because it’s not difficult to get into, the price tends to get bid up for the land,” which in turn tends to erode returns.

Another issue is that the niche markets generally function on a much smaller scale than do other sectors, in terms of both yield and absolute size. This means “the volume of activity is tiny compared to the office, retail, and residential markets. So it’s all very well talking about them, but actually to do them on any sort of scale is quite difficult unless you are a specialist.”

EXHIBIT 1-10

Importance of Various Issues for Real Estate in 2013



Second Tier Draws Buyers

As investors become more adventurous in seeking yield, there is renewed interest in secondary assets and locations. Several interviewees noted a drift towards buying assets outside Tokyo, for example, where yields increase with distance travelled. Said one, "If it's a great centrally located B office building right in the five central wards, it might trade at a 6

cap; if it's in the periphery of central Tokyo, it might trade at a 7.5 cap; if it's in Osaka, it might trade at a 9 cap; and if it's somewhere in the regions, it could trade double-digit cap."

In China, the drift towards second- and third-tier locations has been well established for years. There seems to be an increased wariness today, however, as investors come to grips with the complexities of working in these locations. In particular, office assets in second-tier locations have now become off-limits. According to one fund manager, this is because "the [office] supply in Tier 2 or 3 cities is increasing so much it's difficult to see where demand is coming from." Retail and residential development, however, remain popular. As one consultant active in China commented, "The important thing from a profitability point of view is that we haven't seen any major adjustment in [residential] prices in the second- and third-tier cities. If there's a concern, it's with buildup of inventory and cash flow challenges, but we're not yet seeing them cutting prices to get rid of their inventory." The most recent data now indicate a slight softening of residential pricing in these outlying areas, but in the absence of the huge run-ups seen in top-tier cities, there seems less risk of a major downturn.

Hong Kong, meanwhile, has seen a steady stream of transactions for commercial properties in Kowloon, a secondary market that is receiving increasing attention as the traditional business areas in Hong Kong's Central District run out of space. "They're building good-quality, Grade A buildings that can offer big floor plates—which you don't get in Central—at far lower rents," said one investor. This is helping drive take-up on the less fashionable side of the harbor, and although ticket sizes are smaller—in the US\$80 million to US\$100 million range—it does provide investors a chance to place money in an environment where there have otherwise been very few transactions.

Another catalyst for the Kowloon trade, according to a fund manager active in both Hong Kong and Singapore, is that "in Hong Kong people like to trade, so if there's a bit of bad news globally, people start selling, whereas in Singapore people tend not to do anything and the only kind of distress or sales you see are basically foreign funds that need to exit." He noted an increase in sales from local investors, in particular "private high-net-worth individuals and retailers that had bought podium retail throughout Hong Kong that are getting a bit nervous about the fall in mainland tourist numbers."

Distress Arrives, Sort of

Asian investors have been waiting since 2008 for the remnants of failed pre-crisis investments to arrive on the market, and it is as good a testament as any to the slow-motion pace of real estate turnover across the region that these assets have only recently begun to appear in any volume. The type of distress available differs widely from market to market, both in type and volume. According to one pan-Asian opportunity fund manager, "In the mature, developed markets, it's really

about creating value on the buy, and buying it at a big enough discount that you're comfortable you're going to hit the returns. In Japan and Australia, we're looking to do nonperforming-loan deals, acquisitions of existing assets, repositioning plays, and so on. In China, it tends to be much more ground up development or redevelopment deals with a very heavy development component."

Japan

The types of opportunity available in Japan today typically comprise deleveraging events called "flow deals," which involve the unwinding of a bank loan or CMBS. Although local banks are believed to hold a vast reservoir of bad loans on their balance sheets, historically there has been little political pressure for them to write these down, and because the banks remain relatively sound financially, there has been little commercial incentive for them to act either. Some deals, however, are beyond the pale, and therefore a modest but steady flow of assets is appearing on the market—"like what comes through a coffee filter," as one investor involved in the deals put it. Pricing is generally discounted 30 to 40 percent from the peak, though much less from current values. With a yield spread of about 500 basis points, investors are seeing decent leveraged returns. The other type of distress stems from a long tail of defaulted CMBS assets that predate the global financial crisis. About US\$12 billion worth of CMBS was believed to be in default as of the end of 2011, with a further US\$6 billion due to mature in 2012, according to Moody's Investor Services. Again, some of these assets have already appeared on the market at discounted prices.

There are several issues with these deals, however. First, as noted above, although yields are attractive given the wide spread with Japanese government bonds, they are not trading at levels normally considered opportunistic. Second, most of these assets have been cornered by well-positioned Western and local funds, and the complexities involved in negotiating their purchase means the chances of this becoming a play open to all comers is remote. Third, and perhaps most important, while both the bad loan and CMBS defaults represent "very productive" opportunities as distressed-investment plays, and some foreign funds "are raising big money on the simplistic pitch of high cash-on-cash [yields] and tons of distressed debt," the actual value of assets that have come to market so far remains comparatively small. What's more, for many interviewees, there is little prospect of a more thorough purge in the offing. Said an executive at one large opportunity fund, "There's plenty of bad debt sitting on the Japanese banks' books, but because the cost of financing is so low, it's part of the DNA of Japan that they tend to kick the can [down the road]. So the opportunities are there; it's just much less fertile than people would have you believe, and it's just very hard work."

Another locally based fund manager was more positive, but only slightly. "I think maybe next year you will start to

see stuff that's going to come out and will just have to trade because enough's going to be enough. Trying to pick up the CMBS deals—that's probably where the opportunity funds will see the deal flow that will get them close to their return requirements. But it's going to be very competitive, so again, while there will be discounts off par, it's not going to be huge discounts off market value."

Australia

Opportunities in Australia, meanwhile, are similar to those in Japan insofar as they involve buying into pockets of distress that have been lingering since the global financial crisis. The main source of deals in 2012 involves loan portfolios of European financial groups that had entered the Australian market at its peak pre-2007 and are now looking to exit, usually at a substantial loss. As a result, the commercial property exposure for European banks in Australia is now down about 65 percent from its 2009 high, according to official figures. For the most part, their books comprise senior loans for asset types that are out of favor with domestic lenders—in particular residential (a sector described as a "scary proposition" by one interviewee) and second-tier assets in second-tier markets.

These secondary properties were mentioned more than once in interviews because their spreads have widened relative to prime properties, where most attention is now focused, and they are now being eyed as opportunistic plays, distressed or not. Said one Sydney-based analyst, "It's too early to call secondary-market improvement, but investors who want to move up the risk spectrum and make a play on an improvement in global risk sentiment will be looking at those secondary areas and assets. Spreads have widened because there hasn't been strong demand, but it's a critical indicator for when there's a change of sentiment, because that's when those types of assets will move."

Finally, possible distress plays remain from within the Australian fund universe. Though the AREIT sector was for the most part successfully recapitalized in 2009, smaller and unlisted local funds lack the clout to obtain further funding and have been selling assets since the second half of 2010. Said one fund manager active in this area, "There are still some situations from both the public and private sides. The wholesale funds are a mixed picture: some are changing strategies, selling assets; some are in buying mode." A substantial amount of capital is chasing these assets, however, so bargains may be in short supply.

China

Because China continues to see extreme cap rate compression for stabilized assets, the potential for distress plays lies mainly in development. The Chinese market has its own idiosyncrasies, however, and there are many ways in which deals can go wrong. Said one fund manager, "My mantra is: you're looking for a really good partner you can trust, you're looking for really good real estate, and you're looking for conditions

that allow an attractive entry price or structure.” In the words of another investor, “Having the right partner is more important than having the right property.”

The Chinese development space offers opportunities for distress because the government is continuing to enforce regulations limiting developer access to bank borrowing, especially for land purchases, as well as for construction. Because they tend to be poorly capitalized, Chinese developers have been forced to generate cash flow by cutting product prices to sell inventory. Smaller players have been more seriously affected, because they are the first to be cut adrift by the banks. As a result, since the beginning of 2012, developers have been actively, and in some cases desperately, seeking alternative sources of finance.

Interviewees identified various ways in which to participate in these deals. Some look to buy land at auction, then develop with their local partner. Residential plays are generally preferred because they are self-liquidating. Because “there’s not much competition for the land, there’s somewhat of an opportunistic element to it. Often, that type of residential deal will pencil to a midteens-type IRR.” On the other hand, if the deal involves a developer that has run out of cash on a specific project, foreign investors will often come in on a preferred-equity basis: “We need to get our money back together with a return, so they need to subordinate their capital because their cost basis is different than ours.”

The main problem for foreigners is that although Chinese authorities remain adamant about their commitment to reducing home prices by maintaining a stranglehold on bank lending (as well as imposing other rules aimed at the demand side), they are

acutely aware of the threat posed to the greater economy by a property market crash. This means, perversely, that developers welcome reports of Chinese macro deterioration because they reason it will result in an easing of current restrictions.

Indeed, that is exactly what happened in mid-2012, when Beijing loosened the credit embargo for large and medium-sized developers just enough to relieve cash flow problems. As a result, as of October, construction activity had picked up and “developers under a ton of balance-sheet pressure are hanging tough and not giving us the opportunities we need—either for re-caps of their projects or by selling their land outright at levels that would make the numbers work.” Several interviewees suggested that authorities would continue to drip-feed credit to developers as required and that distress levels are therefore unlikely to deteriorate further.

Another issue to bear in mind in China is the very high tax rates applied to real estate investments. These have crept steadily higher in recent years and can cut IRRs in half. As one investor pointed out, “There are so many taxes at every level—your revenue gets taxed, there’s business tax, there’s land appreciation tax—so the net you’re actually taking offshore afterward can be very skinny, even though you’re looking at some pretty large growth upstairs.”

India

On paper, India should be a prime candidate for opportunistic investors. Public markets are “more or less stagnant,” and because banks remain reluctant to lend to developers, borrowing costs are high. As a result, according to one investor, “If you want to [list] your real estate business and you missed the window, then you’re in a bit of trouble, so to recycle capital you have to sell off assets. We’re seeing a lot of distress there: pricing has come off dramatically and people are hurting.”

However, views about India were very polarized. One interviewee at a large opportunity fund gave India as his favorite investment destination. It was, he said, “tough from a regulatory perspective, there are transparency issues, inflation is an issue, interest rates are high. But we’re buying Grade A income-producing assets at 15 percent cap rates. That’s unbelievable.” Another interviewee said good developers are currently raising money at rates as high as 18 to 22 percent for three-year paper.

Others were less positive. Many private equity investors who entered deals between 2005 and 2008, and are now looking to exit are having problems finding buyers for their projects due to lack of liquidity in the market. Meanwhile, other funds that invested more recently have been burned and are now gun-shy. A few investors have moved out altogether. Said one foreign developer, “India is a bit of a bridge too far. We find the system very opaque; we find it’s just a very difficult place to deal for us geographically.”

Problems in India stem not so much from the lack of potential deals as they do from difficulties in navigating the investment maze. In particular, concern has focused on various instances in which retroactive changes have been made to existing regulations to the disadvantage of foreign investors.

EXHIBIT 1-11

Prospects by Investment Category/Strategy for 2013

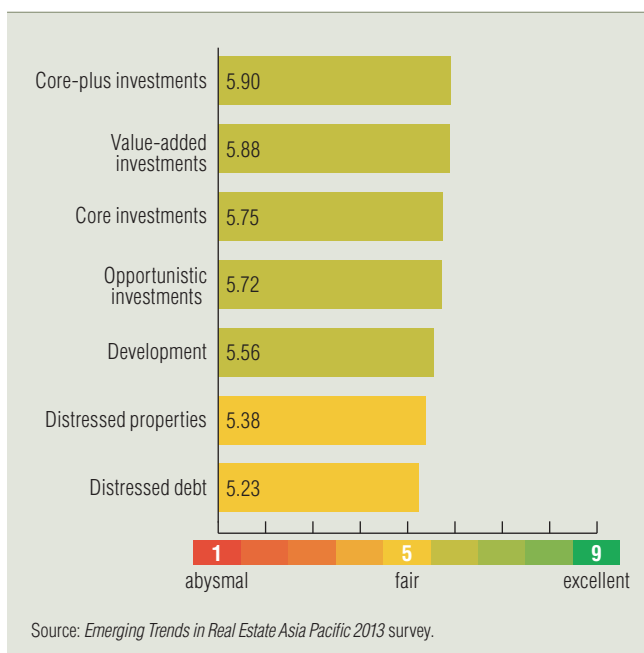
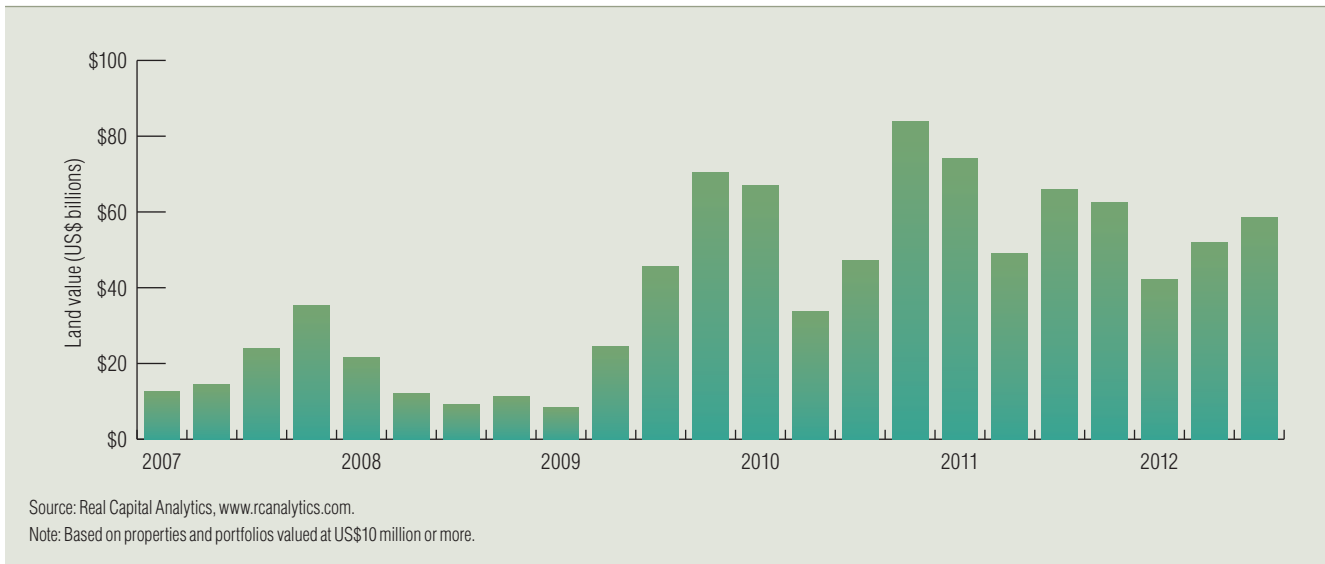


EXHIBIT 1-12

Quarterly Land Transactions in China

Specifically, deals structured with local developers using pre-initial public offering put options, which allow foreign investors an exit via a promoter buyback of shares, are not looked at favorably by regulators. This has created significant concern. More recently, the government has introduced various reforms to foreign direct investment rules that are apparently more favorable for foreign real estate funds. In particular, the government's decision in September to allow up to 51 percent foreign direct investment in multibrand retail projects may provide scope for partnerships with international retailers in Indian shopping center investments. The proposal has provoked considerable political controversy, however, and implementation is uncertain. The situation remains in flux, therefore, and just how it will be resolved in practice remains to be seen. Notwithstanding these problems, India is perceived to be a market with "a lot of low-hanging fruit" that investors are loath to ignore, especially compared with China, where the easy money has already been made and which many real estate investors now consider to be less friendly to foreign capital because "they don't really think they need the foreign investor any longer."

Frontier Markets: New Kids on the Block

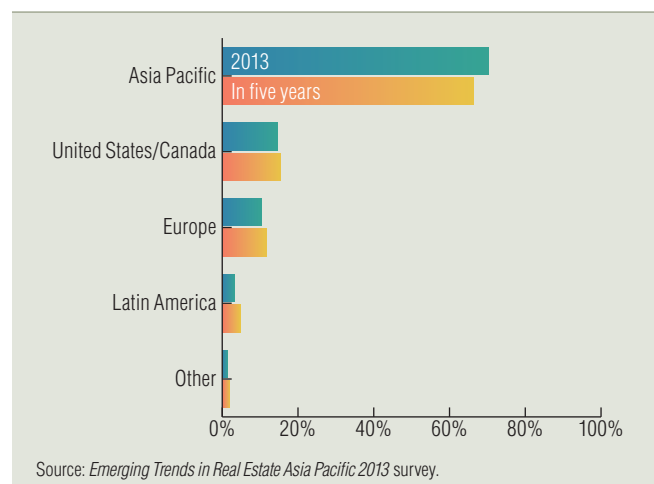
Another way for investors to push the envelope on returns is to look to frontier markets such as Indonesia, Vietnam, and the Philippines. More recently, a few intrepid investors have also begun moving into far-flung regions such as Cambodia, Mongolia, and even Myanmar, where international sanctions were removed only in 2012.

In many if not most cases, these destinations are for neither the faint of heart nor the inexperienced. Risk will be high, scale (usually) small, bureaucracy the norm, corruption (often)

rife, legal systems opaque, holding periods long, exit (probably) difficult, and finance hard to get or nonexistent. Almost all investment will require use of a development strategy, and local laws will probably restrict international participation in one way or another.

Though that is a long list of drawbacks, the potential is also obvious: access to prime land, high IRRs, good local contacts, and the promise of low-hanging fruit only entry-level opportunities can offer. The likely prospect of high economic growth over time means that long investment horizons make sense in these markets: not only will locals take a dim view of foreigners coming in and flipping assets, but also there may be few easy opportunities to sell. As one developer active in

EXHIBIT 1-13

Asia Pacific Investors' Regional Allocation Percentage

Cambodia observed, “It’s not high on the investment radar, so if you need to transact there—to build a development and sell it on—you’re going to find life difficult.”

All of these markets have their strengths and weaknesses.

The Philippines benefits from strong growth (partly a result of accelerated infrastructure spending) and a new-found reputation for transparency. In particular, it offers good opportunities in the business-process outsourcing (BPO) sector, which provides services (primarily voice customer relations) outsourced by foreign multinationals. BPO currently accounts for 70 to 80 percent of new office take-up. However, placing money in the Philippines can be difficult for foreign investors because Philippine law requires a local partner, and currently little incentive exists for domestic players to enter an alliance. As one local investor commented, “If you’re looking for opportunistic investments, you’ll be waiting a long time because there’s no need for money here. The experience is that since money is available, to have an international partner would just slow you down.” The situation may change if moves now underway succeed in amending the constitution to remove the requirement for local majority ownership, or if recently mooted changes to tax laws allow a local REIT sector to take root. However, interviewees suggested these changes may take several years to push through and will possibly be postponed until the next administration, which is not due to take office until 2016.

Indonesia also received multiple favorable recommendations from interviewees, and Jakarta was, in fact, named Asia’s top investment destination by respondents to the

Emerging Trends survey. With inflation down and investment-to-GDP levels now returning to those seen before the 1998 Asian financial crisis, Indonesia certainly presents good prospects for growth. One interviewee also noted the relative ease of “getting things done” there, compared with other frontier markets, in particular Vietnam. However, not all opinions were positive. According to a representative of a large regional developer, Indonesia suffers from deep-rooted problems over establishing title to land and other rule-of-law issues, making “development risk too high for us to chew on.” While buying stabilised assets may be less risky, so far few buildings of institutional quality are available for purchase.

Finally, Vietnam has fallen off investors’ radar screens over the past year as a result of a string of political and economic gaffes. One in-country developer noted “very serious problems related to the real estate market and nonperforming loans.” He referred to “distress out there all over the place,” although it was unclear whether foreigners will be able to get access to these distressed assets, or even how they will be recycled back onto the market given the lack of any framework for administering the assets of bankrupt companies. These events have “spooked not only foreign investors, but also local buyers to the extent that now they are just playing a wait-and-see game.” Operationally, the country is notorious for a suffocating bureaucracy, but rule-of-law issues are not as bad as they are in Indonesia. One suggested that sentiment was currently so negative it could prove a good opportunity for countercyclical buying, although “these cycles can play for quite a long time in Vietnam because they take a while to resolve.”

EXHIBIT 1-14

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-transparency | 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 | N.A. |
| | India (Tier 1 cities) | 48 | 3.07 | 3.11 | 3.44 | 3.90 |
| | Vietnam | 68 | 3.76 | 4.25 | 4.36 | 4.60 |
| Low transparency | | | | | | |

Source: Global Transparency Index, Jones Lang LaSalle.
N.A. = not available.

Regulations Target Residential Sector

Governments in the West have long been ideologically opposed to using direct regulation to manipulate real estate prices, relying instead on free market principles to let prices find their level. Though these views may now be changing, Asian governments have never hesitated to apply macro-prudential policies—officially or otherwise—to reel in overheated markets, especially in recent years as price volatility has increased. Intervention has continued in 2012, mainly in order to curb rising residential prices in several markets across the region.

China is the most obvious example. A crackdown in place since early 2011 has pressured the market on both the supply side, by curbing bank lending to developers, and the demand side, by keeping individuals from buying more than one home. In the past, heavy-handed implementation of similar rules has resulted in roller-coaster price swings. This time, however, authorities are proceeding with a surer touch and have achieved moderate price declines of about 15 percent in major cities while avoiding both a meltdown in the development sector and an outright economic crash. The consensus among interviewees was that authorities will remain committed to price controls for the foreseeable future. As one investor put it, “The government clearly understands it needs to ease from time to time to stop things going too far, but it doesn’t mean they’re going to lift the measures. They’re not going to do that for a long time.”

Other jurisdictions have also moved to address residential price rises, although not quite as forcefully as China. In 2011, for example, the Hong Kong government began introducing a series of demand-side taxes. In the wake of the latest round of measures introduced in October, the government now imposes a tax of up to 20 percent on properties sold within three years of purchase, limits mortgage loan-to-value (LTV) ratios, has increased the supply of land for new housing, and has imposed a further 15 percent tax on nonresident buyers (measures aimed primarily at mainland Chinese), whose buying in the primary market reached 40 percent of the total at one point in 2011. Similar rules have also been introduced in Singapore, Indonesia, Malaysia, and Taiwan.

Perhaps surprisingly, the rules have had little impact in holding back prices in Hong Kong and Singapore. This is largely because interest rates in both places are tied to the U.S. base rate and are therefore exceptionally low, leaving authorities with no monetary lever to combat inflation. The passage of a third round of quantitative easing (QEIII) in the United States in September 2012, therefore, sparked a further round of residential price rises in the third quarter.

Some interviewees questioned whether easing measures in the West would attract substantial flows of hot money to Asian assets, but in Hong Kong the impact has been significant and immediate. House prices increased 4 percent in the six weeks following the introduction of QEIII (they have almost doubled since 2009). In October, the Hong Kong government

EXHIBIT 1-15

Hong Kong Residential Property Price Index, All Classes, 1993–2012



Source: Hong Kong Rating and Valuation Department.

Note: Data for June through August 2012 are provisional figures.

EXHIBIT 1-16

Asian House Price Changes (Nominal)

| | Year-on-Year Change | | Qtr-on-Qtr Change |
|-----------------------|---------------------|---------|-------------------|
| | Q2 2011 | Q2 2012 | Q2 2012 |
| India–Delhi | 33.64% | 17.01% | 2.38% |
| Hong Kong | 26.86 | 7.35 | 7.70 |
| Indonesia | 4.53 | 3.68 | 1.17 |
| New Zealand | 1.08 | 3.38 | 2.43 |
| Singapore | 10.21 | 1.87 | 0.39 |
| Taiwan–Greater Taipei | 13.70 | 0.90 | 0.28 |
| China–Shanghai | 0.74 | -0.68 | -0.15 |
| Thailand | 2.97 | -1.15 | -1.81 |
| Japan–Tokyo | -0.25 | -1.98 | -2.24 |
| Australia (8 cities) | -2.67 | -2.06 | 0.49 |

Source: Global Property Guide, August 29, 2012.

intervened in the currency market for the first time in three years to defend the currency peg. For the Singapore market, the story is much the same, with home prices and transactions reaching record highs in the third quarter. Whether these measures can rein in sentiment remains an open question, especially at the higher end of the market where speculation is strongest.

Speculators Focus on Strata

One result of the restrictions has been the rotation of some capital out of the residential sector. According to one Hong Kong–based fund manager, “The strata-title market in Singapore and Hong Kong has been very active in the last couple of years because of increasing taxation [of the residential market] and limitations on being able to sell quickly. Investors are buying en bloc a significant proportion of a building, chopping it up, and selling it in small portions.” High-net-worth money is also active in this space, though some have questioned whether returns are worthwhile. This phenomenon has also been seen in China.

Foreign Regulations Have Minor Impact

Other regulations that are having a significant impact on regional markets are the multilateral Basel III accord and the Dodd-Frank Act in the United States, both of which apply to banks. Interviewees reported that difficulties in getting access to debt in some markets (notably Australia) were caused in part by banks hoarding capital in order to meet Basel III requirements, which require them to meet specified capital-adequacy ratio targets by the end of 2013. One interviewee also suggested that Japanese banks were not anxious to realize losses

on their balance sheets because of Basel III, and that this may reduce the likelihood of more distressed assets being flushed out of the system over the next year or so. The Dodd-Frank rules, meanwhile, are having a minor impact on the Asian operations of international investment banks, which are no longer able to co-invest with their clients. This is regarded more as an inconvenience than a deal breaker, however.

Investors Focusing on Long Term

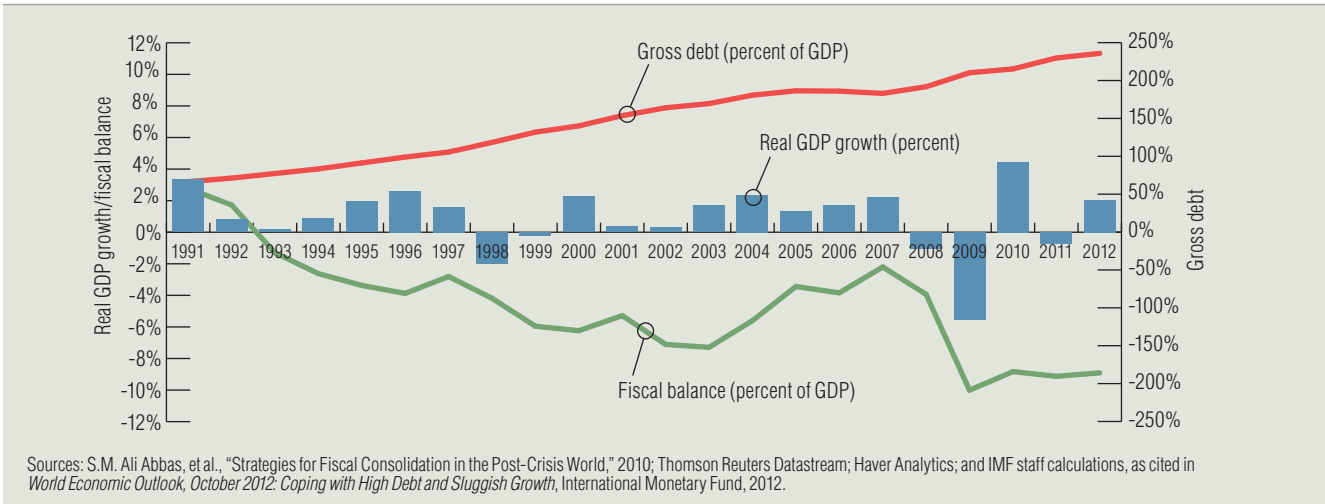
Before the global financial crisis, the weight of foreign capital circulating in Asia was a significantly higher proportion of the whole than it is today. With Asian capital now dominating the market, foreign funds are increasingly competing for deals against local money willing to pay more for the same asset because it calculates value and discounts risk in different ways.

This is causing some foreign fund managers to question whether their standard analytical models are appropriate for Asia. Said one, “I think Asian capital gets the joke that there shouldn’t necessarily be a significant risk premium because you have underlying demand that exists in the region that you don’t have in the U.S.” Said another, “Looking at the initial yield you’re getting on a property today is not the right way of thinking about it because retail turnover is going to go through the roof, industrial performance is going to be much stronger, and locations are going to change dramatically. So almost whatever you pay today is going to look good at some point, probably in the next five to ten years, or at least in the next ten to 15 years. Even if it takes that long, you’ll still get a big boom.” This implicit assumption that long-term growth will take place makes locals more willing to hold through downturns in the belief the market will soon rebound even higher. It applies especially to core properties.

The conflict between differing investment philosophies is driving a gradual shift by foreigners towards longer investment horizons. At between five and seven years, the lifespan of a typical opportunity fund leaves little margin for error in calculating exit assumptions, especially given Asia’s sometimes volatile economies. In Singapore, for example, several foreign funds nearing the end of their mandates are now facing losses on large office assets that must soon be sold into a deteriorating market. Bought as prices peaked several years ago, these buildings now struggle to compete in an environment where financial tenants have retrenched and the office sector faces a strong pipeline of new supply.

By extending their exit windows, funds can both avoid that scenario and potentially cash in on higher profits from future rental growth. According to one Hong Kong–based fund manager, “Development yields in China for retail or office are probably about 3 percent or 4 percent, and the same for cap rates. That’s quite low compared to elsewhere in the world, so it’s tough to feel you’re getting a good risk-adjusted return.” The real money, he says, comes from tapping the stabilized development yield—particularly in well-run retail plays—which arrive only after leases have turned multiple times, typically in

EXHIBIT 1-17
Japan's Growing Debt



three-year increments. After nine years, “that’s where you’re really humming: you have a double-digit yield on cost and an asset you can sell at a 4 cap rate. So a 15-year fund which is build and hold, offering a long-term cash multiple and a mid-to low-teens return—that’s just a no-brainer.”

Longer plays will also be preferable in markets that remain sensitive to perceptions of foreigners “stealing the national wealth,” as one South Korea-based investor put it, adding, “There are cultural and political implications an investor must be sensitive to here in conducting a business as opposed to buying a deal opportunistically and selling it in short order.”

Risky Times

The perception and management of risk have become an increasingly central concern for real estate investors in Asia, just as they have globally. Risk in Asia is arguably harder to analyze, however, because it so often relates to events in the West that can seem abstract from a distance. For most interviewees, therefore, the dangers of the U.S. fiscal cliff or the prospect of European sovereign default took a back seat to issues closer to home.

For some, this translates to a possible spillover into the economic arena of a Chinese/Japanese territorial dispute in the East China Sea. For others, there were dangers stemming from the soaring fiscal deficit and government debt crisis in Japan, which may generate fewer column inches but is at least twice the size of Western equivalents. Still others mentioned the “demographic time bomb,” another long-term structural disconnect that relates to aging populations in many countries around the region, in particular those with larger populations such as China, Japan, and South Korea. Falling birth rates have caused a shortfall in premium incomes just as liabilities for benefit payments rise.

As in previous years, however, the biggest concern by far is related to the potential for economic problems arising

in China. At the most basic level, these worries focus on China’s GDP growth trend, which has decelerated to the 7 to 8 percent range from a 10.4 percent rate in 2010. Any further deterioration would have a negative impact not only on demand within China but also worldwide, given that the mainland currently contributes about 40 percent of global economic growth, according to estimates from Deutsche Bank. From a regional perspective, a China slowdown would erode demand for commodities and other imports from neighboring countries that are now closely integrated with the mainland economy, creating a knock-on effect for local real estate markets.

EXHIBIT 1-18
China's Share of Expected 2012 Global Economic Growth

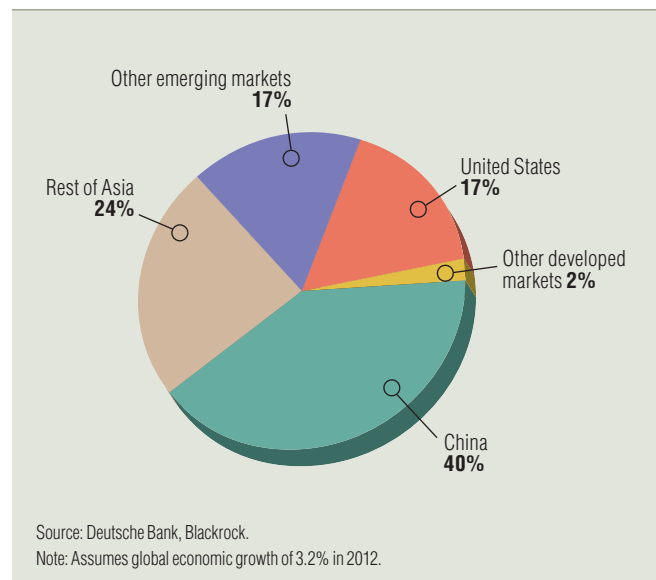


EXHIBIT 1-19

Forecast for Real GDP Growth Rate

| Country/Territory | 2010 | 2011 | 2012* | 2013* | 2014* | 2015* | 2016* |
|-------------------|--------|-------|-------|--------------|-------|-------|-------|
| China | 10.45% | 9.24% | 7.83% | 8.23% | 8.51% | 8.54% | 8.54% |
| Indonesia | 6.20 | 6.46 | 6.04 | 6.34 | 6.54 | 6.64 | 6.74 |
| Thailand | 7.78 | 0.05 | 5.57 | 5.99 | 4.50 | 4.60 | 4.80 |
| India | 10.09 | 6.84 | 4.86 | 5.97 | 6.39 | 6.74 | 6.89 |
| Vietnam | 6.78 | 5.89 | 5.11 | 5.88 | 6.42 | 6.76 | 7.20 |
| Philippines | 7.63 | 3.91 | 4.84 | 4.78 | 5.00 | 5.00 | 5.00 |
| Malaysia | 7.15 | 5.08 | 4.40 | 4.70 | 5.00 | 5.00 | 5.00 |
| Taiwan | 10.72 | 4.03 | 1.31 | 3.87 | 4.47 | 4.70 | 4.79 |
| South Korea | 6.32 | 3.63 | 2.69 | 3.63 | 3.95 | 3.95 | 3.95 |
| Hong Kong | 7.09 | 5.03 | 1.84 | 3.48 | 4.28 | 4.31 | 4.36 |
| New Zealand | 1.82 | 1.35 | 2.23 | 3.07 | 2.67 | 2.59 | 2.27 |
| Australia | 2.51 | 2.14 | 3.31 | 3.00 | 3.25 | 3.32 | 3.20 |
| Singapore | 14.76 | 4.89 | 2.08 | 2.90 | 3.59 | 3.72 | 3.78 |
| Japan | 4.53 | -0.76 | 2.22 | 1.23 | 1.08 | 1.15 | 1.07 |

Source: International Monetary Fund, World Economic Outlook Database, October 2012.

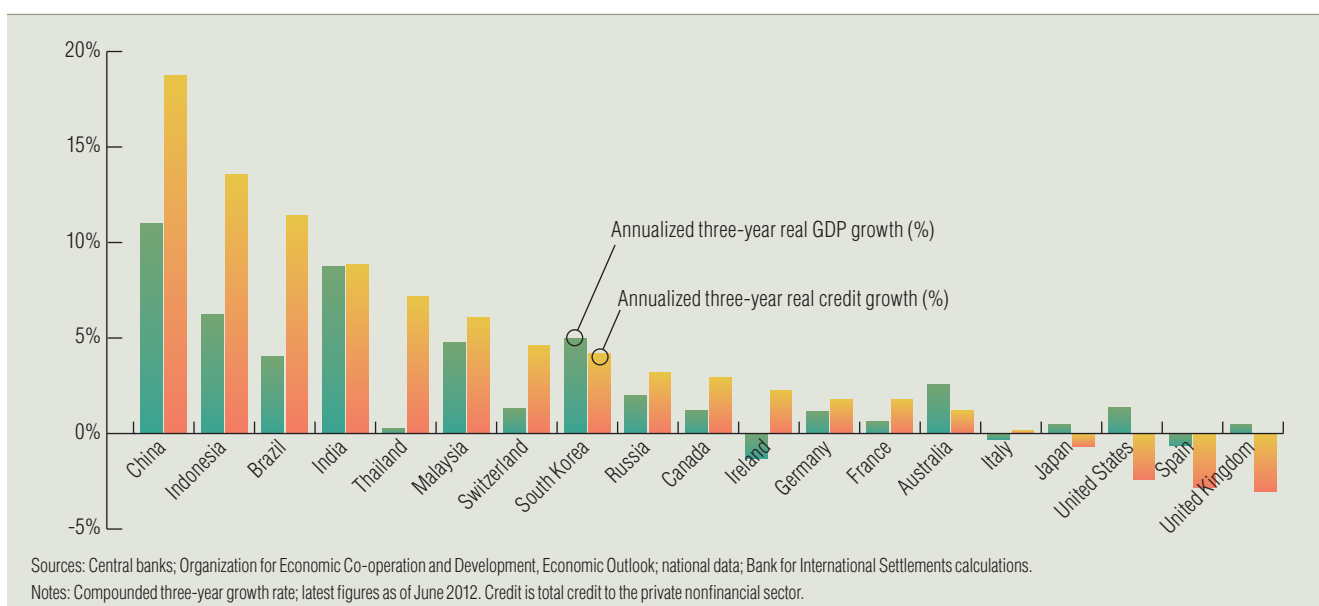
* Forecasts.

Statistical data, however, suggest that carefully calibrated stimulus measures introduced by Beijing in the first quarter of 2012 have now met with a degree of success. Crafting an effective policy has proved difficult because too much stimulus could rekindle the fire in domestic real estate prices and otherwise attract inflows of hot money from outside China. At the same time, however, some relaxation in real estate policy has been necessary because urban residential real estate investment makes up at least 8.5 percent of China's GDP,

according to independent research firm Capital Economics.

Although the extent of easing evident in China so far this year has been nowhere near the level seen in 2009 to 2010, it has been sufficient to generate a mild bounce. Third-quarter GDP grew 7.4 percent year-on-year, lower than the second-quarter year-on-year figure of 7.6 percent, though growth from the second to third quarter was stronger at 9.1 percent. In particular, consumer spending, on which China will increasingly rely to pick up slack from infrastructure investment, continued

EXHIBIT 1-20

Growth in Credit and GDP

to show strong growth, with retail sales up 14.2 percent year-on-year. As a result, risk of a Chinese hard landing appears to have receded, sentiment has turned more positive (including among real estate developers), and a consensus has emerged that GDP growth will rebound in the final quarter. The latest projection by the International Monetary Fund (IMF) is for 7.83 percent annual growth in 2012 and 8.23 percent in 2013.

Over the longer term, concern about the Chinese economy continues to center on China's growing, but largely unquantified, levels of public and private debt. Real credit grew almost 20 percent annually in China over the past three years, according to the IMF, although it has slowed recently as the government tightened controls on banks. No one—probably not even in Beijing—knows the true extent of outstanding debt in China, but conventional wisdom suggests that although it has not yet reached unsustainable levels, it probably has been growing at an unsustainable pace. Concern over this issue is only likely to increase in the future.

A Housing Bubble?

Investor concerns about China risk are not limited to the generalized impact slower economic growth may have on real estate markets, either in China or regionally. More specifically, they also focus on the risk of a crash in China's property markets caused by a bubble in pricing, particularly in residential property. For the most part, this is more a concern for investors in the West, be they LPs or investment committees, than it is for investors on the ground in Asia. As one Hong Kong-based fund manager observed, "This explains why most of the world still sees China as requiring a significant risk premium. The Western view is that 'This is what happened to us. You guys are just in denial. You're in the bubble, so you can't see it.'"

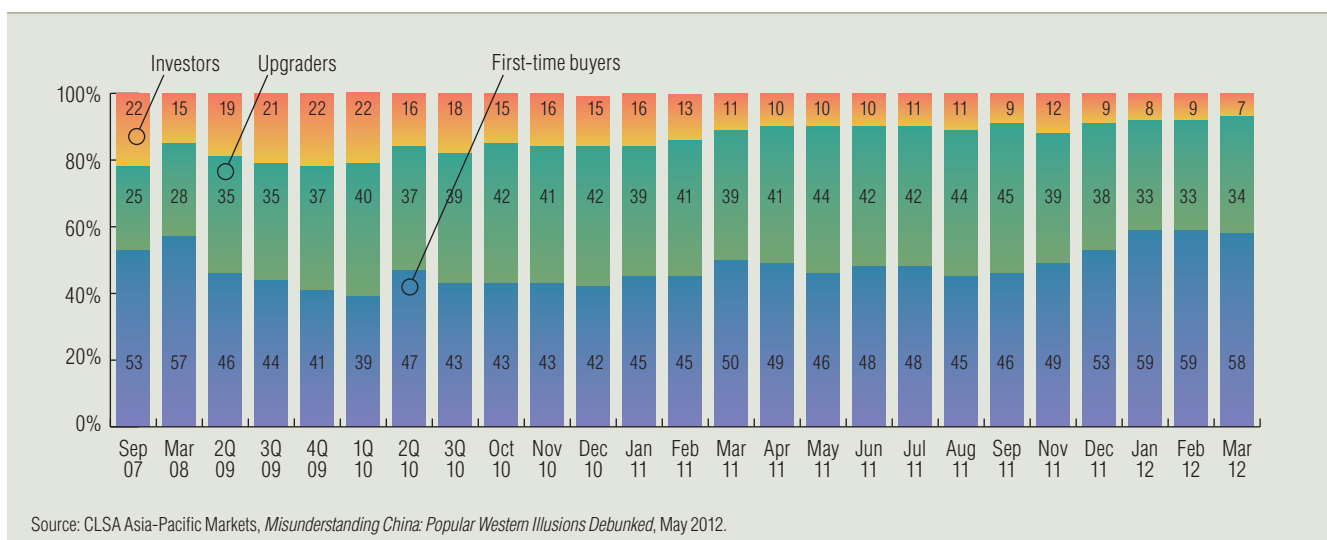
The thesis for the existence of a bubble in the Chinese housing market has been in place for many years and is premised upon various types of statistical analysis, some of which is eye-opening but not necessarily relevant, and some of which is regarded as reliable when back-tested against historical events in developed markets.

There are almost endless examples of the former. They include, for example:

- The fact that construction of residential housing in China in 2011 accounted for 10 percent of GDP, compared with 6 percent in the United States at the peak of the housing boom in 2005.
- The fact that property assets represented 40 percent of urban household wealth in China in 2010, according to a study by the Peterson Institute, double the rate in 1997.
- The fact that huge numbers of apartments in China bought for "investment" purposes stand unused in the expectation that values will rise.

In this last example, while the true extent of China's vacant housing stock is impossible to verify, there is little doubt it exists in large quantities, and is both inefficient economically and now a political and social issue given the large numbers of people in China who cannot afford a home. While it certainly implies a speculative tendency, it also reflects a historical shortage of investment options in China, an environment of negative real returns on bank deposit rates, and a cultural affinity for buying real estate. As one fund manager put it, "They think of it as a long-term savings account as opposed to speculation." However, quite apart from the fact that the government measures have now drastically curtailed such purchases, it is hard to see how empty homes in themselves suggest a bubble, and therefore an inevitable decline. In reality, and as recent events in the West suggest, the direct cause of house price collapses invariably comes back to affordability.

EXHIBIT 1-21
Sales Managers' Estimated Breakdown of Homebuyers in China



Source: CLSA Asia-Pacific Markets, *Misunderstanding China: Popular Western Illusions Debunked*, May 2012.

This in turn leads to the more interesting of the models used to support the bubble thesis. The rule of thumb in the West is that house prices expressed as a ratio of household income are affordable at a level of about 1 to 4. The equivalent statistic for households across all of China peaked at a ratio of 1 to 8.1 in 2009 and dropped to 1 to 7.4 in 2011, according to Shanghai E-House, a domestic research group. It should decline again this year, as home prices fall and incomes rise. In major cities, however, the ratios are significantly higher: 1 to 12.4 in Shanghai, 1 to 11.6 in Beijing, and 1 to 15.6 in Shenzhen.

While on their face these statistics suggest that Chinese housing is alarmingly unaffordable, they have to be seen in context. First, they are almost certainly wrong. Extended families, for example, are often willing to contribute towards the mortgage costs of a single child. Also, given the ubiquity of China's underground cash economy, official statistics may understate the real level of household income by about 50 percent, according to a 2010 study sponsored by Credit Suisse. What's more, some 63 percent of this "grey income" is in the hands of the wealthiest 10 percent of urban households, who are the ones most actively buying properties.

This points to another, related issue—the widening divide in China between the haves and have-nots. In the end, average incomes are not really relevant in determining housing affordability because the median level of demand for urban housing is not represented by the 50th percentile of income earners, either in China or elsewhere. In reality, most commercially developed housing in China is bought by those with higher incomes, and given the extent of income disparity, that translates rapidly to a much higher figure as you move up the income ladder. While this is undoubtedly a social problem, it does not suggest a housing bubble.

Another factor concerns leverage. Chinese banks require at least a 30 percent downpayment before providing a mortgage (60 percent for buyers of second homes). In addition, buyers are usually not highly levered and home equity loans are rare, so few Chinese use their homes as ATMs. Nor does China allow mortgage securitization. All three issues militate against the creation of high rates of debt, which tend to go hand-in-hand with real estate bubbles.

Add to this the fact that underlying demand for homes remains strong. As one investor said, "If developers say, 'We have a real liquidity squeeze, so we're going to give 15 percent discount on pricing,' they sell 400 units in a weekend. If local governments said, 'We're lifting ownership restrictions,' the market would go nuts."

Finally, and perhaps most important, the saving grace for Chinese housing prices has been the continuous and rapid rise in urban household incomes. Between 2006 and 2011, according to official figures, urban incomes rose at an average annual rate of 13 percent, compared with average annual home price increases of 9.7 percent. Over time, therefore, incomes have always been able to reel in home prices if they

balloon to apparently unaffordable levels. If these figures are accurate—and official real estate statistics in China are admittedly questionable—Chinese house prices appear sustainable at the current level, given especially that urban housing prices have declined at least 15 percent from their peak as a result of government tightening policies, which have so far functioned as an effective control mechanism. In the words of one investor, "I see the market as more rubber balloon with an air valve. The risk of it exploding is not as great."



Real Estate Capital Flows

“There’s no question that in the right markets there is absolutely no shortage of equity and money around.”

Just as the uneasy union of crisis abroad and growth at home has clouded investor views on assessing risk in Asian real estate, so too has it led to tidal movements of capital into, around, and out of the region.

Perhaps the main obstacle to finding order in the chaos of competing fund flows is that they are often structured in ways that are hard to track. In the past, funds tended to obtain capital from identifiable jurisdictions and invest it directly. Today, “a lot of the flows are stronger than we’re picking up on because they’re happening below the radar.” Either they are not coming via conventional fund vehicles at all or they enter Asia indirectly as part of large funds that pool capital from a number of different sources. One analyst referred to Singapore as a center through which money is commonly channeled before it is invested elsewhere in the region via locally based funds. “Over the last 12 months, Singapore has been far and away the dominant if not source of capital, [then] the last destination before boarding this plane of capital moving around the region,” he said. “But where that money is coming from [originally] we have no way of knowing.”

Another problem in working out the origins of regional fund flows is that they move through a revolving door of money coming in and going out. Indeed, the amount and origin of capital leaving Asia is probably even more opaque than it is for capital arriving. As one interviewee said, “How much of the money being created around Asia is flowing through private banking and hedge funds that then filters down into listed or unlisted funds? When we look at the flows back to Europe and into North America, I think they are hugely underrepresenting the flow of money that’s coming through.”

It is clear, however, that the amount of Asian money targeting Western assets has increased dramatically over the past

year or so. As one fund manager observed, “There’s this burgeoning institutional investment sector in Asia now. If you’re a global fund manager raising money for a global fund, whereas your last fund was 5 percent raised from Asian investors, now you’re probably targeting 20 percent.” Most of this capital will be targeting distressed assets in the West. Channels that have been especially prominent in 2012 have been Malaysia to the

EXHIBIT 2-1

Breakdown of Aggregate Capital Raised by Primary Regional Focus, 2005 to Q2 2012

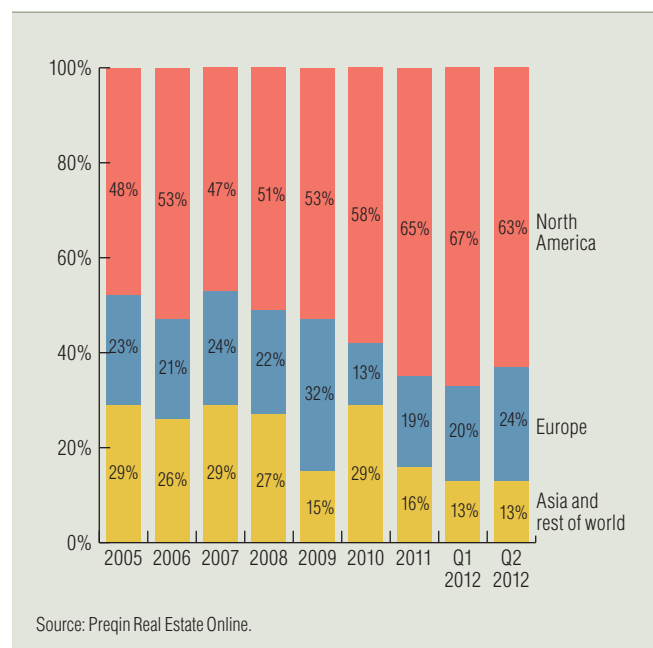
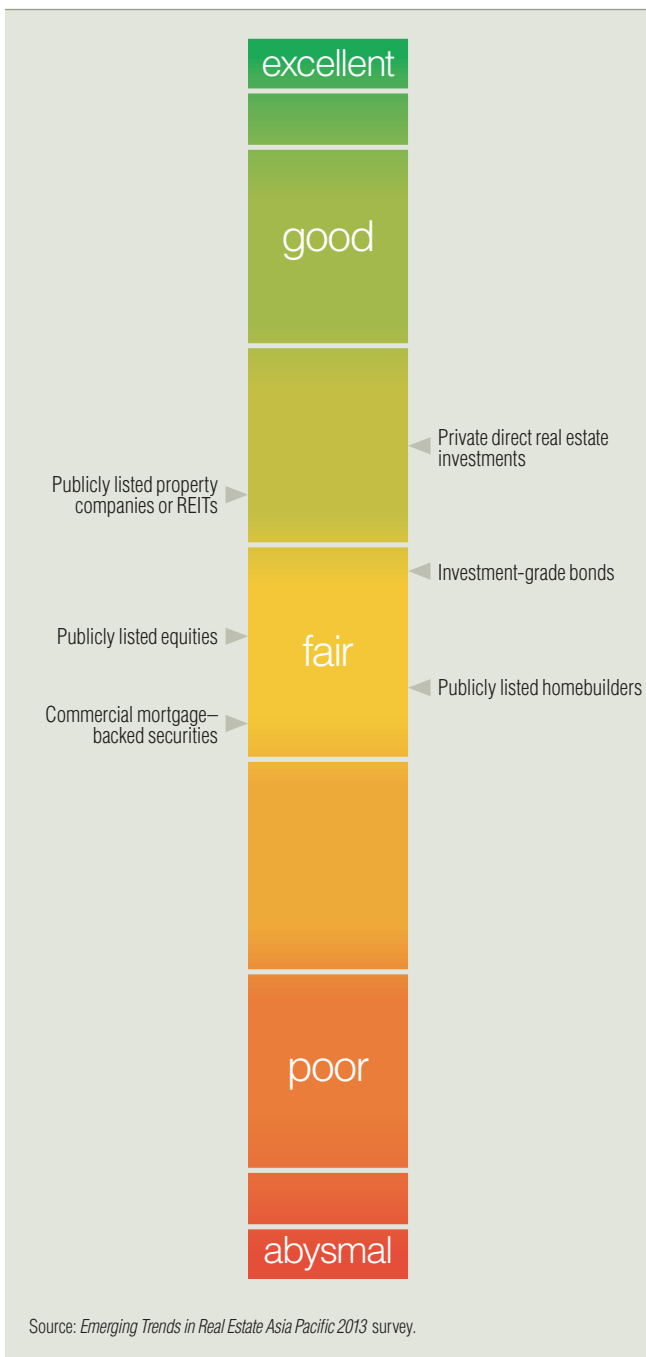


EXHIBIT 2-2

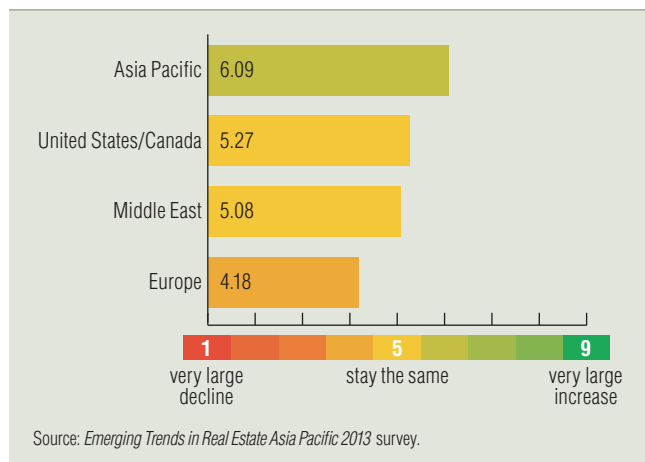
Investment Prospects by Asset Class for 2013



U.K. and China to the United States. While the events of the past 18 months, especially in Europe, are creating what can probably be regarded as once-in-a-generation opportunities there, the migration of so much capital from East to West is rather ironic given the mantra heard so often today—that Asia is the only market with the growth and dynamism to attract new capital.

EXHIBIT 2-3

Change in Availability of Equity Capital for Real Estate in 2013, by Source Location

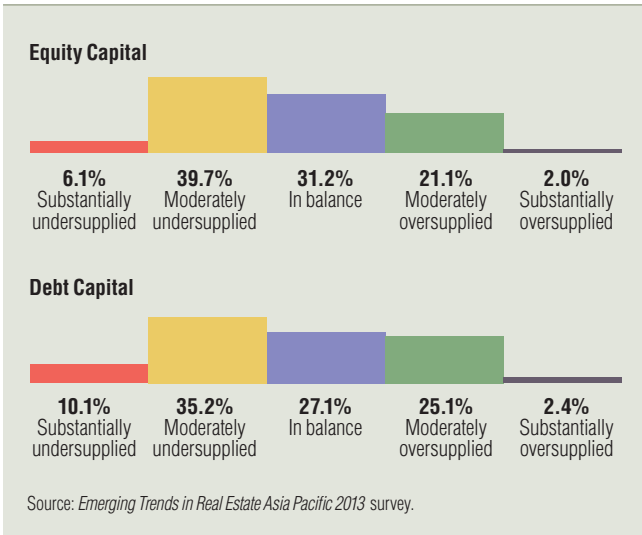


Indeed, notwithstanding that mantra, the reality is that the volume of real estate investment coming to Asia recently has been significantly lower than it was before the global financial crisis. Given the difficulty of analyzing the source of these funds, investors' anecdotal comments, though unscientific, are interesting. Said an executive at a global opportunity fund, "The general observation I have is that on the debt side, the European lenders are retracting. On the equity side, there's no growth in Europe, so they're coming back, looking to Asia, and trying to deploy capital here." A Japan-based fund manager commented, "What I don't see a lot of are U.S. players coming in, either with renewed interest or with new money. It's much more European and other Asia-based investors." And a Singapore-based REIT manager said, "The Americans don't seem to be in in a big way. They are subscribing, but most of the demand is coming from Asia." These comments were echoed by other interviewees, some of whom noted that in many cases U.S.-based players were opting to play at home rather than send capital abroad.

Local Money Takes Over

The global financial crisis marked the high tide for foreign real estate investment in Asia. As the international flows have ebbed, the slack has been more than picked up by local money, which is both "more aggressive and more bullish than those who are more internationally exposed." Although again hard to quantify, Asian capital is abundant. In part, this is simply a reflection of the extent of new wealth piling up across the region, but it is probably also due to the mixed success many funds have had deploying capital in the current environment. Even local funds with lower risk thresholds, therefore, are finding it hard to place capital, which says something about the amount of cap rate compression across the region. In any

EXHIBIT 2-4
Real Estate Capital Market Balance Prospects for 2013



event, “there’s no question that in the right markets there is absolutely no shortage of equity and money around.”

The weakness of recent foreign private equity flows in Asia comes as a surprise to those who expected them to rebound post-crisis as they did for foreign direct investment. As one interviewee observed, “If you look at the exposure that a lot of these Western businesses have in Asia as a percentage of their global business, it’s enormous. But the big Western investors,

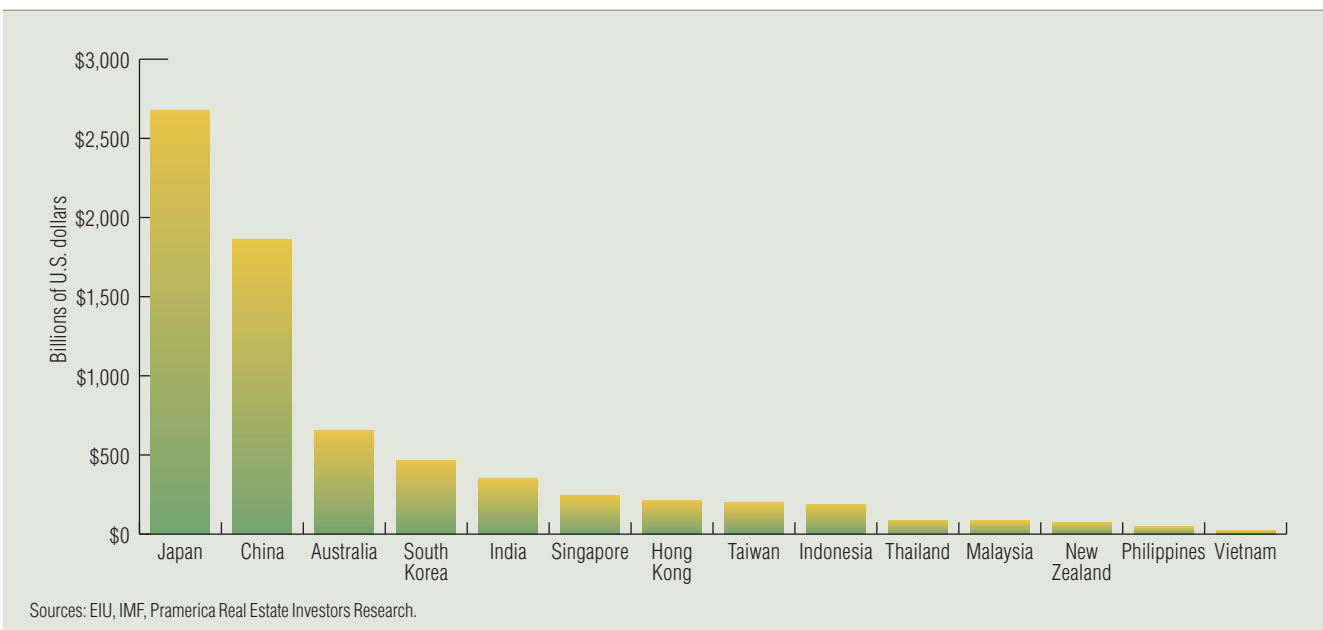
the limited partners, are actually underinvested in Asia by comparison.”

Why is this? The simple answer seems to be that money managers in the West are more conservative than their corporate counterparts. As discussed in chapter 1, their concerns in particular center on the demand for a risk premium that the market refuses to provide. As a result, “there’s a strong appetite for Western LPs to be in Asia but, on the equity side, it’s just harder to deploy capital.” At the same time, views are evolving. “The whole world has gotten smaller, and investors are more sophisticated. They have generally taken the view that they prefer to pick their regions, pick their asset types, sometimes even pick their deals. But their endgame is to knit together a portfolio of deals and funds that is global. They’re not saying, ‘For the next ten years we’re going to be long the USA [market] and not anywhere else.’ In theory, that should eventually lead to bigger allocations to Asian markets.

Hot Money Flowing In?

If unfavorable risk/reward assessments have until now been responsible for keeping foreign capital out of Asia, the dynamic may have changed somewhat as a result of QEIII launched by Washington this September. Though some interviewees were skeptical QEIII would have a significant impact on Asian asset prices—one noting the diminishing returns generated from each bout of easing—the signs so far are that significant flows of “hot” money are arriving in the region. The impact has been most immediate in Hong Kong and Singapore, where interest rates are pegged to those in the United States. House and equity prices in both markets rose

EXHIBIT 2-5
Estimated Size of Institutional-Grade Real Estate by Country/Territory, 2011



strongly in the month following the introduction of the easing. Asian currencies have also come under pressure.

There are various reasons why QEIII may prove more inflationary for Asia than did the last round of easing, in November 2010: its open-ended nature; reduced concern over Europe's debt crisis (though, admittedly, this reduction may be temporary); the weakening U.S. dollar; and the existence of concurrent easing measures in Europe and Japan. Taken together, these appear to have convinced investors to push funds into assets previously considered too risky and, in particular, into emerging-market plays.

China, in particular, appears to be the target of large flows of capital, at least partly because domestic equity markets have remained suppressed in 2012 despite rallies in developed economies. The extent to which this money may be directed to real estate assets is unclear, but the fact that hot money is arriving at all is an indication that asset values generally will benefit, especially for assets that are more liquid. As one investor said, "I think definitely [money is flowing] to the public side more than the private side. You can't really compare buying corporate bonds to buying real estate because of the liquidity difference."

Sovereign Funds Arrive in Force

Another source of new liquidity in the region is big institutional funds, both Asian and international. Many of these are sovereign wealth funds (SWFs). Until recently among Asian institutional players, only Singaporean SWFs and Australian superannuation funds have been active participants in world markets, and investment from the latter dried up after they suffered large losses on foreign holdings during the global financial crisis. This is now changing, however, in a big way.

EXHIBIT 2-6

Sovereign Wealth Funds by Region

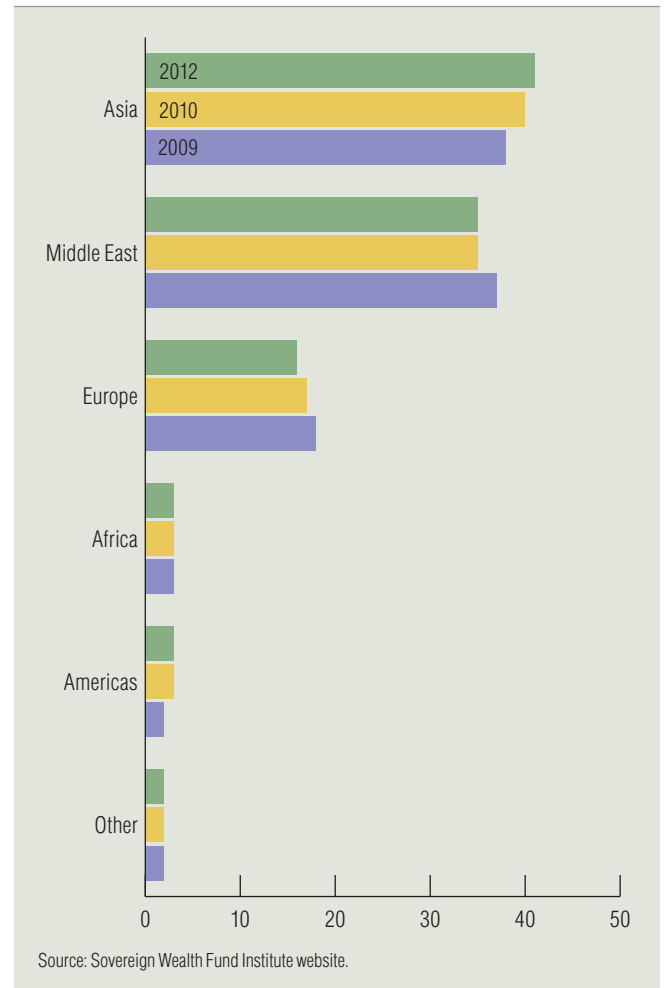


EXHIBIT 2-7

Largest Sovereign Funds by Assets

| Country/territory | Fund name | Assets (US\$ billions)* | Inception |
|-------------------|---|-------------------------|-----------|
| Norway | Government Pension Fund—Global | 656.2 | 1990 |
| UAE—Abu Dhabi | Abu Dhabi Investment Authority | 627.0 | 1976 |
| China | SAFE Investment Company | 567.9** | 1997 |
| Saudi Arabia | SAMA Foreign Holdings | 532.8 | N.A. |
| China | China Investment Corporation | 482.0 | 2007 |
| Kuwait | Kuwait Investment Authority | 296.0 | 1953 |
| Hong Kong | Hong Kong Monetary Authority Investment Portfolio | 293.3 | 1993 |
| Singapore | Government of Singapore Investment Corporation | 247.5 | 1981 |
| Singapore | Temasek Holdings | 157.5 | 1974 |
| Russia | National Welfare Fund | 149.7*** | 2008 |

Source: Sovereign Wealth Fund Institute.

Notes: *Data as of September 2012. **Best-guess estimate. ***Includes the oil stabilization fund of Russia. N.A.=not available.

As assets under management increase and the need for higher returns grows, institutional players from almost every major Asian economy are now either actively deploying funds outside their traditional remit of domestic sovereign bonds or are planning to do so. Their targets include alternative investments (including real estate) in domestic, regional, and international markets. On top of this, SWFs from outside Asia are now buying real estate assets in the region. Some have begun investing directly (possibly in syndicates or club deals with other SWFs), and a few have opened local offices. Even Australia's superannuation funds have announced plans both to rebalance portfolios to include more real estate assets and to venture again overseas, including Asia (though they have yet to arrive). Sovereign funds from Singapore, China, South Korea, Taiwan, Malaysia, Thailand, Norway, Holland, Abu Dhabi, Qatar, Canada, and elsewhere currently have mandates to buy Asian real estate assets.

Homegrown institutional funds have made some acquisitions in Asia, but for now are focused mainly on placing money in Western markets. Said one interviewee, "The [Asian] SWFs say, 'We're really long Asia already, so we want to invest in the rest of the world.'" That said, having made some acquisitions in Europe and the United States, "they're now starting to talk about China because they're going to grow this book of deals somewhat in step as opposed to going long one region rather than the other. So they've been thinking about doing things in their own country or region, and now they're a lot closer to actually doing it."

Sovereign funds hailing from outside the region have already made several notable acquisitions and are likely to become more adventurous over time. Said an executive at one such fund, "We'll probably become more tactical, looking for more specific returns where we see opportunity, as opposed to just for the sake of getting flags on the map." Already one Middle Eastern sovereign fund has reputedly been buying into CMBS defaults in Japan.

Japan's Government Pension Investment Fund, the world's largest such fund with assets under management (AUM) of US\$1.4 trillion, is currently studying how to implement a shift towards alternative assets and will probably become a buyer by 2014, with other Japanese pension funds likely to follow suit. However, interviewees did not expect Japanese institutional money to be quick to migrate outside Japan. Said one, "You're starting to hear talk of Japanese investors looking abroad, which would make sense when you look at where the yen is and given the growth prospects of the economy. But to be honest there hasn't been a ton of Japanese capital looking abroad in terms of pure passive investor-type capital."

China's China Investment Corporation (CIC), meanwhile, with some US\$482 billion AUM, is expected to ramp up private equity and alternative allocations to between 60 and 70 percent of holdings over the long term, according to a recent report from Shanghai-based analysts Z-Ben Advisors. It had invested about 60 percent of its assets in the United States by the end of 2011.

The AUM of Chinese sovereign funds is expected to balloon in coming years as additional mandates are provided from a range of state institutions, including large state-owned enterprises and pension accounts of various large provincial governments within China. Again, much of this new capital will probably be allocated to private equity investments outside China.

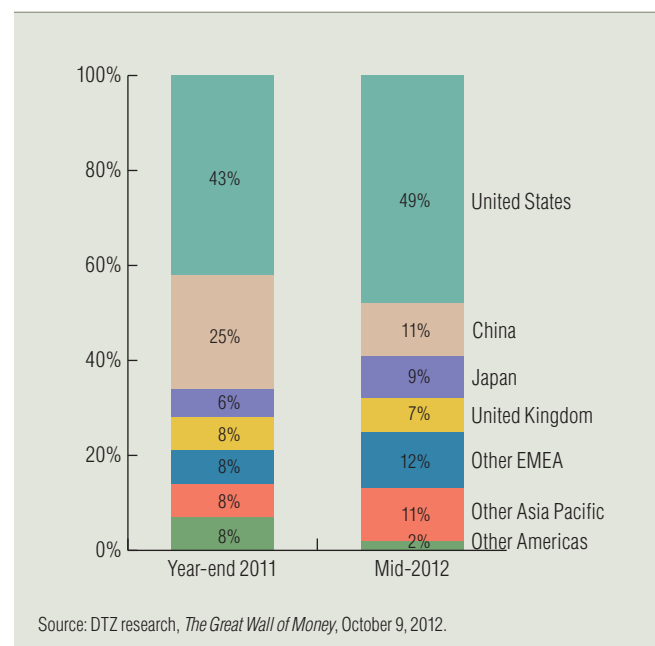
Raising Funds Is Still Difficult

The environment for raising new money remains predominantly gloomy. "No one is raising capital easily, except a few standouts," said one investor. "Still tough" and "a lot more difficult," were other comments. LPs were showing "a lot more caution" and "concern about who are my coinvestors," among other concerns. Although many legacy funds are still working through existing investments, their approach to raising new funds has changed. Said a Hong Kong-based fund manager who had recently closed a new fund, "Today, they are looking more at doing joint venture partnerships, or more club deals, or more working for specific capital providers, as opposed to going back on the road and raising another billion-dollar blind-pool discretionary fund."

For those on the road, LPs have become more demanding than in pre-crisis days, with institutional investors unwilling to participate in the old-style vehicles. "I don't think too many people can go out today and raise blind-pool funds, except international track-record holders," said one investor. Another, recently returned from a roadshow, commented, "They were quite adamant about leverage. Anyone playing a high-leverage strategy wasn't going to get money out of institutional investors

EXHIBIT 2-8

Targets of All Funds Being Raised (Single-Country and Multicountry Funds), 2013



who'd lost money in the past." Instead, LPs are more likely to demand a say in major decisions such as asset acquisition and divestment or use of leverage. This has also led to the evolution of various creative fund structures oriented, for example, towards separate accounts and investment clubs aimed at preselected targets.

Beyond this, the capital raising environment has become polarized in favor of either the biggest or smallest specialist players. Various global funds, therefore, have received some enormous commitments in the past couple of years, often from large institutional investors, many of which hail from Asia. Equally, boutique funds with particular specializations have also been in demand. As one fund manager said, "It's the middle block—the billion dollars, plus or minus, with a more pan-geographical focus and not sector specific—that is more challenging."

Another trend is an increasing preference for single-country—or at least more targeted—funds. This again provides for a degree of tighter control over investment decisions. Also, because the story is clearer, it becomes an easier package to sell. Funds being raised for Japan have increased as of mid-2012—presumably for reasons set out in chapter 1—according to consultants DTZ, while those targeted at China have decreased significantly, apparently as a result of the successful closing of several China-oriented funds that are now deploying capital. It may also reflect recognition that buying stabilized assets in China has become less appealing due to cap rate compression.

One reason raising capital has become more difficult—even though fewer funds are now active in the market—is that, as noted above, more and more large foreign institutions are opting to invest directly. Eliminating the middleman allows big funds to be faster to market and more flexible in deploying capital. "Often there's a huge lag: you raise the money, the market shifts, and then somehow [the mandate] doesn't quite work." Nonetheless, the fund will continue to deploy capital according to its brief because "if you've got a hammer, everything looks like a nail. So I think it's smart for these larger pension funds to set up separate accounts and say, 'This is the kind of thing we should do, but if the environment changes, let's sit down and talk about it.'"

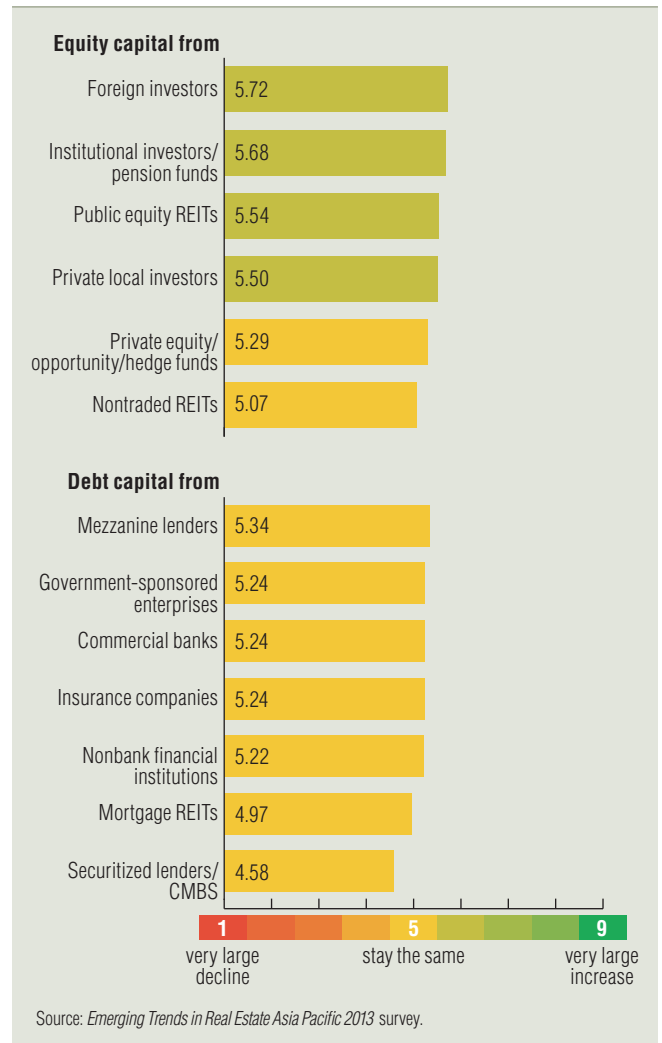
Hedging Currency Risk

The ongoing strength of local currencies in Asia has created significant exchange rate risk for investors bringing money into new jurisdictions, especially given that the various easing measures introduced by governments in both Asia and the West threaten to create a volatile exchange rate environment. Some of the bigger funds no longer attempt to hedge for currency movements, leaving this to the discretion of their LPs. Others do hedge, although this has become expensive given the currently opaque outlook.

In Australia, therefore, recent base rate cuts have led to surprisingly little depreciation of the local currency, and although

EXHIBIT 2-9

Change in Availability of Capital for Real Estate in 2013



"international capital has been buying down there, it has been tempered by the Aussie dollar—no question about it."

The same applies for the Japanese yen, which may currently be trading near historic highs but has little reason to do so given the country's enormous sovereign debt burden and an ever-widening trade deficit. Indeed, some analysts expect the yen to depreciate in coming years because the government will soon be unable to fund the carry cost of its debt by tapping domestic investors. Because it cannot afford to let interest rates rise, it will have no choice but to print money, with inflationary consequences that will filter down to the exchange rate. As one interviewee said, "Let's be honest: it's only because the rest of the world has so many problems that Japan looks good. It's nothing to be proud of."

Bank Finance: Cheap and Cheerful

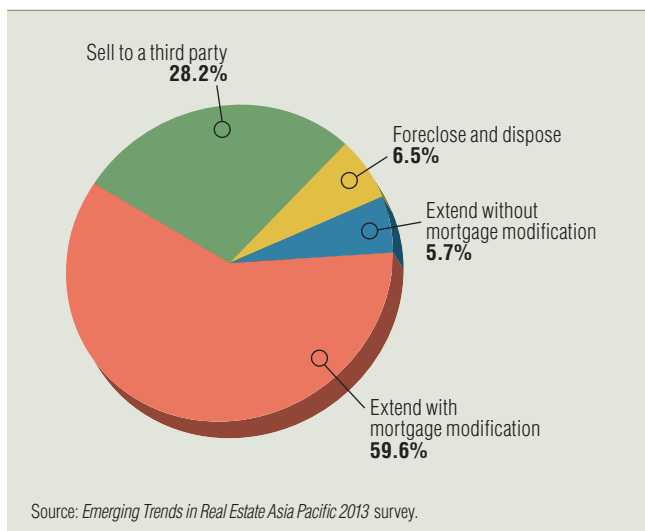
Local banks continue to carry most of the load for funding regional real estate deals. Compared with Western banks, they remain quarantined from turmoil and highly profitable. Because they use almost no wholesale funding, they are largely insulated from volatility in global funding markets. In addition, nonperforming loan ratios have now declined to historically low levels.

Lending volumes to Asia from international banks fell in 2012 as a result of financial-sector deleveraging in the Eurozone. Syndicated bank lending to developing countries generally was more than 25 percent below 2011 levels, according to the World Bank, although flows rebounded in August and September as this process unwound. The absence of the European banks created shortfalls of debt in some markets, notably Australia, where local banks have long relied on foreign debt to fund borrowing demand. However, Asian banks, particularly from Taiwan and Japan, moved quickly to fill the gap, and liquidity remained abundant.

In Hong Kong, banks were reluctant to finance deals during the first half of 2012, mainly because of a shortage of liquidity caused by Basel III and caution created by European macro problems. However, this problem ended around the middle of 2012, according to a locally based fund manager, and the market is now back to business as usual. In China, the government has maintained a tight leash on access to bank finance since early 2011, especially for land purchases. However, interviewees reported a slight softening of the lending embargo starting around the middle of 2012, providing some breathing room for medium-sized and large developers.

EXHIBIT 2-10

Maturing Loans: Preferred Strategy for Lenders by Mid-2013



China and India aside, bank debt continues to be easily accessible throughout most of Asia. Borrowing costs run the gamut from exceptionally low (Japan) to prohibitively high (Vietnam), but for the most part remain low by historical standards and generally comparable to price levels from last year. Said one interviewee, “It’s coming back to life, but it depends on the bank and the whereabouts, and I think relationships are quite important at the moment.” A (highly unscientific) sampling of interviewee comments about the bank funding situation in various markets includes the following:

■ **Japan:** “God, it’s easy. It’s actually gotten easier.” “We did a big [US]\$300 million refi [refinance] recently, and the [original] financing rates were 4.6 percent, which we reduced to 1.45 percent, no additional covenants, no paydowns. The banks are a lot more aggressive.” “We can still get 65 percent–70 percent [loan-to-value (LTV) ratio] at 2 percent all in; really happy with that.”

■ **China:** “Very hard to get onshore financing. Banks lend to your offshore vehicle, then you get permits to bring the money in and pay it back offshore. But it’s expensive: you’re looking at 6 percent–plus, and you’re not buying [the property] above 6 percent [cap rate], so it’s not accretive.”

■ **Australia:** “As the economy started to slow, they have eased up on interest rates by 150 basis points, so we’ve now got 3.5 percent [base rate] plus 2.25 percent. Call it 6 percent, all in, on your cost of funds.”

■ **South Korea:** “You’re probably looking at about the 5.5 percent–6.5 percent range.”

■ **Taiwan:** “Just awash with cash, we’re getting 80 percent–85 percent [LTV] and working capital loans on top of that at 2.5 percent–2.75 percent, all in. Very easy terms, with no prepayment penalty.”

■ **Hong Kong:** “Probably HIBOR plus 250 [basis points] would be the minimum, and 350 would be the most expensive.”

■ **Singapore:** “Some of the banks treat us differently because we’re an overseas fund, but we’re still competitive, and we think we could get from around 4 percent, all in.”

■ **Vietnam:** “Almost impossible. If you’re getting finance there, it’s going to be [mezzanine]-type private equity at 13 percent–14 percent.”

■ **India:** “Banks have been reticent about supporting Indian real estate. But you can do what is essentially senior secured debt at between 18 percent–22 percent.”

■ **Philippines:** “Funding is very easy if you’re a good corporate client with a good track record with the bank. You can get seven- to ten-year money at between 6 percent–8 percent.”

Leverage remains widely available at similar (but perhaps slightly lower) ratios than a year ago—usually in the 50 to 60 percent range. Very little immediate concern seems to exist over the prospects for higher interest rates in the foreseeable future.

Alternative Financing: China's Entrusted Lenders

With banks willing to lend and interest rates remaining at historic lows, most investors are happy enough to borrow from banks for their financing needs. But where bank funding is not available for one reason or another, developers and/or investors have been quick to look elsewhere for innovative solutions.

China is the most obvious example. The evolution of the local entrusted lending sector since 2010 was sparked by official attempts to reel in domestic housing prices by preventing developers from borrowing from banks. The industry rapidly took off, in effect evolving as a self-created private equity financing channel funded by high-net-worth individuals or companies. Said one consultant active in the China market, "There may not be a great deal of formality to it; it's a private club of wealthy individuals who come together. I know of instances where a few phone calls have been made, people throw in 50 million Rmb, 100 million Rmb [US\$8 million to US\$16 million], deals are done, and off we go." Borrowing costs typically range between 10 and 20 percent annually. The volume of entrusted lending rose rapidly to reach US\$108 billion in AUM by mid-2012. Since then it has plateaued as new rules cut back the number of new trusts formed.

Inevitably, problems have emerged. Because trusts are structured with relatively short terms of two or three years, at least US\$35 billion in trust lending is due to mature in 2012, followed by an additional US\$44 billion in 2013. At the same time, the ongoing property sector downturn means growing numbers of developers have no money to repay their obligations and have defaulted, or are about to. To make matters worse, trusts are far less willing than banks to extend the loans; indeed, government regulations have recently barred them from doing so.

EXHIBIT 2-11

Equity Underwriting Standards Forecast, 2013

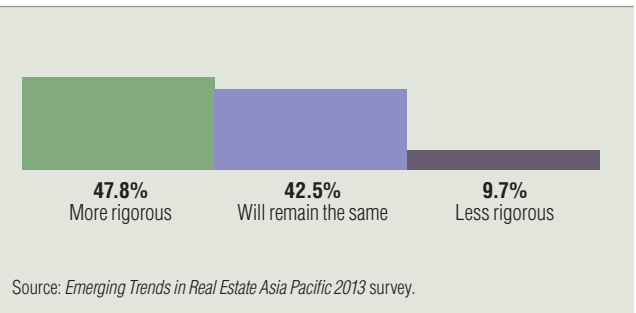
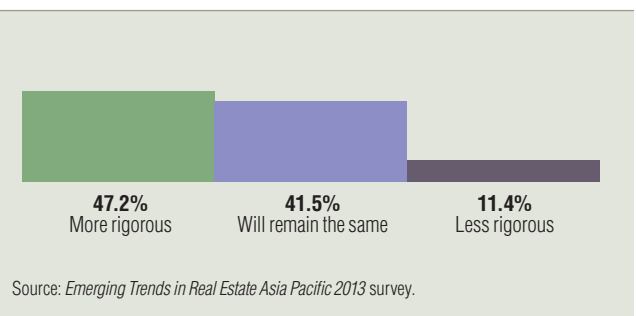


EXHIBIT 2-12

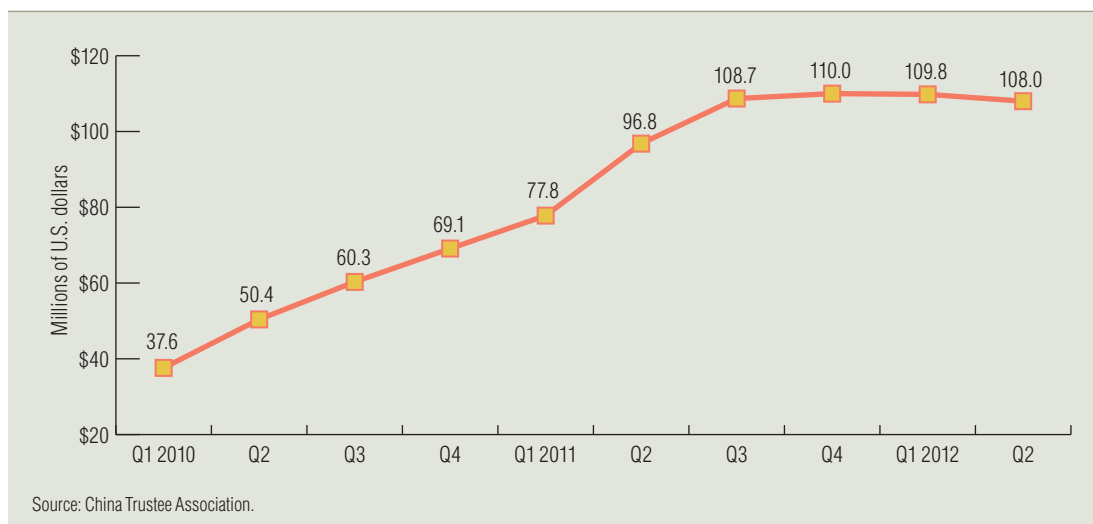
Debt Underwriting Standards Forecast, 2013



To head off a glut of forced liquidations, a new batch of domestic real estate investment funds has sprung up. Together with China's existing asset management corporations—established more than ten years ago to dispose of bad debts at Chinese state banks—they have refinanced large volumes of trust company loans in 2012. Interestingly,

EXHIBIT 2-13

China Real Estate Trust Products: Assets under Management



these new funds—which are reportedly buying trust assets at discounts of 30 to 60 percent—are exactly the type of distressed-debt vehicles foreign investors would like to set up in China. However, there seems to be no foreign participation in this niche yet.

The Rise of Debt

Another shift in the way deals are being put together involves growing use of debt (though not mezzanine) instead of equity, or at least using a structure that ranks further up the capital stack. “The big trend for private equity guys is to try to do debt-structured deals. Typically they used to do pure equity investments. Now it’s about ‘here’s a bond with warrants’—privately structured but always with some kind of guaranteed-return coupon.” The catalyst for this change is a growing realization that conventional opportunistic returns are unattainable in today’s market. “A lot of these guys are willing to give up on truly underwriting a 20 percent IRR; it’s now more high teens. So they want to see something in the low teens, in terms of a coupon or guaranteed return, and then have a little bit of upside.”

In other cases, there may be more practical reasons for avoiding equity structures. Said one New Delhi–based consultant, “I don’t think investors today see India as an equity play, because if you go out and lend with adequate collateral and protection, you can get an Indian rupee–denominated return of 18 percent–20 percent.” Another reason why debt is preferred in India is that “the Indian developer community doesn’t respect equity for what it is. Essentially, when money

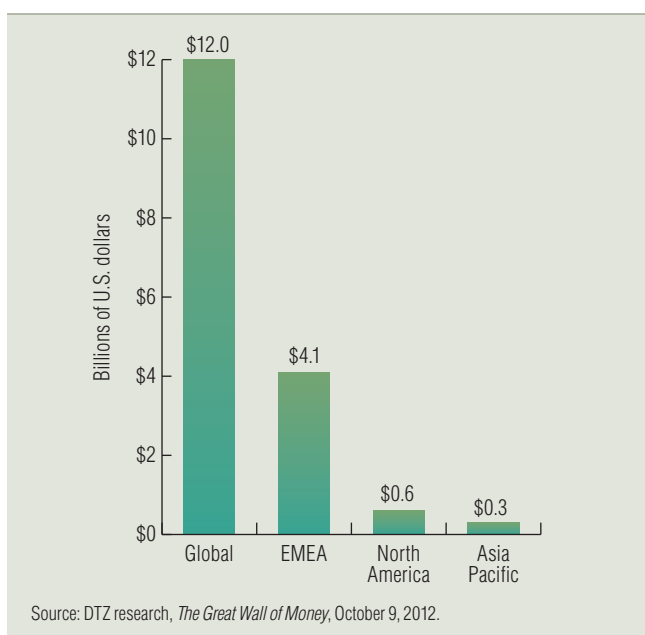
comes in as equity, as one developer said to me, ‘Equity is funding that doesn’t have to be refunded.’” Debt, on the other hand, tends to be treated as a higher priority, with many loans paid back before maturity. As a result, “the lesson is that Indian markets are not ready for real estate private equity. We are more used to debt; we understand the concept. And while it creates stress in the system, unless the Indian markets grow up, I think the way forward for foreign investors will continue to be real estate lending.”

Said one Asia-based consultant, “It does look more attractive to be doing debt in many markets. You’ve got for debt a historically good spread, and if you can secure funds that are locked in with equal-term liabilities, you are effectively taking an equity-type return but with a debt position in the stack.” Admittedly, this type of debt remains a tiny part of the market, but it is growing, especially in major jurisdictions. In Australia, for example, “there are people out there playing that market segment, but a lot of the funds are investing at the low end of the market—so, [US]\$20 million to \$30 million property values, which are not large amounts to place.”

Nonbank debt is also available in Japan. Said one investor, “What you’re starting to see, which I think is very positive, is life companies coming in and utilizing their balance sheets, their general accounts, to go into real estate lending. They’re willing to do seven- to ten-year fixed-rate financing at up to 65 percent–type LTVs. Its old-school real estate lending rather than any type of securitization or CMBS play. So in terms of new deals, development deals, you’re starting to see some limited debt financing—less so on speculative developments, more build-to-suit type of things, at least where you have an anchor tenant.”

EXHIBIT 2-14

Announced Equity Raisings by Debt Funds (Current)



Capital Markets: Feast and Famine

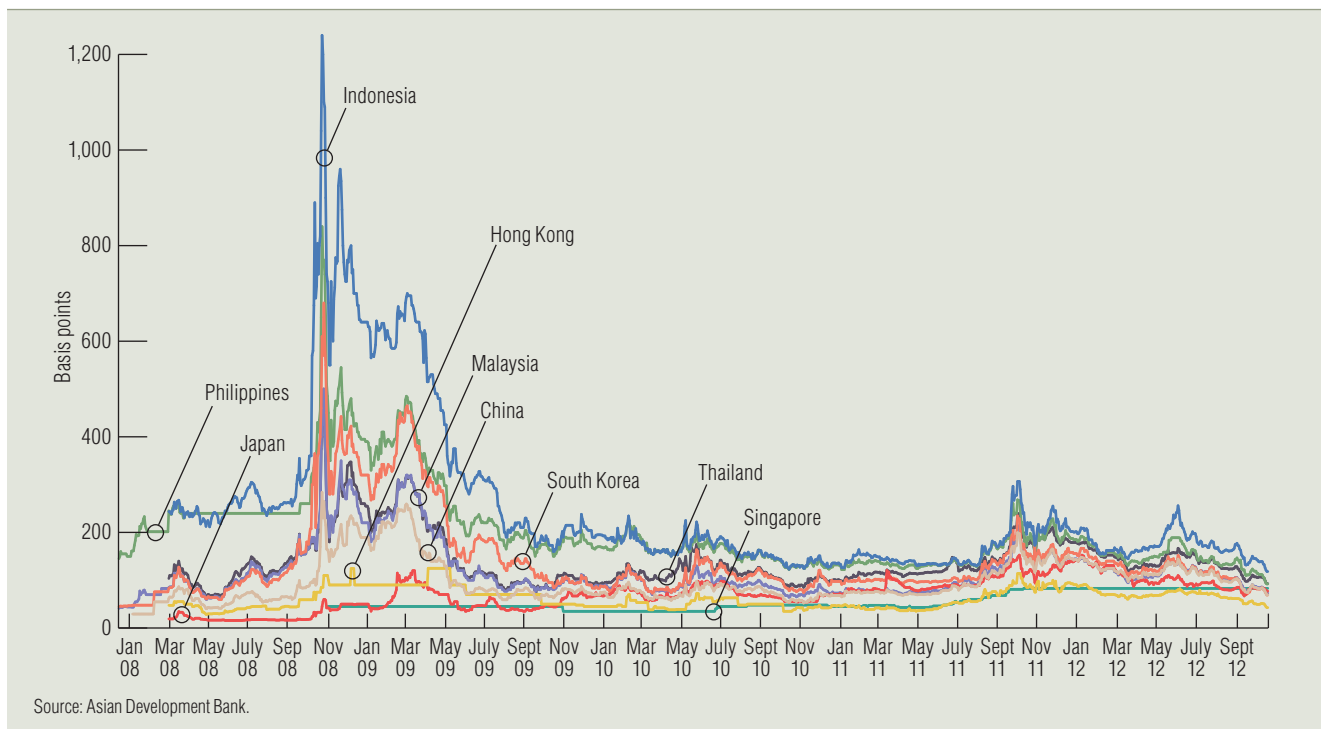
Despite a weakening outlook globally and sometimes chaotic movement of spreads on global bonds, sentiment in Asia’s capital markets has remained positive, as evidenced by pricing of regional credit default swaps.

The proportion of real estate deals financed by Asia’s equity and debt capital markets remains tiny compared with those funded by banks, but the window of opportunity tends to open and close quickly for real estate plays, so what the markets lack in size, they make up for in volatility.

On the equity side, sentiment has been poor in 2012. As one Hong Kong–based investment banker observed, “Until recently, the run rate of equity in Asia for property was the slowest on an annualized basis since 2011.” This is because the two areas seen as drivers for real estate equity—offerings from Hong Kong–listed Chinese developers and REITs in various Asian markets, especially Singapore—have been slow. As the banker continued, “That first pot has been almost nonexistent because there continues to be an overhang in the markets from uncertainty surrounding [Chinese] regulatory overhang; everyone is waiting to see when home purchase

EXHIBIT 2-15

East Asia Credit Default Swaps: Senior Five-Year



restrictions will be reversed.” With Chinese developers’ share prices—whether listed in Hong Kong or Shanghai—now trading at significant discounts to net asset value (NAV), developers have little incentive to raise capital at current levels. “I talk to a lot of developers about raising equity and they say, ‘Listen, I’ve got a billion, 2 billion dollars in cash; I just don’t have a use for the proceeds.’ Even if on the surface they look like they might have relatively high gearing, if they have strong cash flow, there’s no impetus to do anything that’s too cheap on the equity side.”

That said, sentiment can change quickly in this type of stock, and should Chinese residential transaction volumes pick up or government policy ease, the rebound could be rapid. “When the pendulum does swing back the other way, I think it’s clear the valuations are extremely cheap and there’s a ton of money sitting on the sidelines waiting to be reinvested in the space.” Indeed, sentiment for developers listed on the Hong Kong and Singapore markets reversed rapidly around midyear and accelerated in September following the introduction of further easing policies in the United States.

On the debt side, the story has been quite different. Issuance is again small by international standards, but Asia’s capital markets raised more real estate debt in 2012 than in any previous year. The market was led in the first half by investment-grade developers in Hong Kong and Singapore, many of which raised as much as US\$500 million to US\$1 billion, with demand strong enough for second offerings a

week or so later. Cost of debt was below 5 percent for 30-year terms. The reason for this surge in offerings was, first, strong demand for yield, and, second, the fact that banks had hiked developers’ borrowing costs, creating a price differential sufficient to persuade some developers to issue debut bonds. In the second half of the year, the focus shifted to the high-yield side, again tracking market demand.

Appetite for debt from mainland developers remains very strong, and those without listings in Hong Kong are looking at novel ways to tap the market. One potential route for doing so is via what is effectively a backdoor listing. One Chinese developer was able in 2012 “to issue bonds with a rating through a Hong Kong subsidiary that only has a small percentage of the assets of the company, but with certain keep-wells and make-wholes from the onshore parent.” Other mainland developers have now also taken an interest in creating alliances with some of Hong Kong’s smaller developers, presumably with this type of play in mind. “It’s a great relief valve for some of these A-share listed companies that have found [lack of a Hong Kong listing] a huge competitive disadvantage versus their red-chip listed competitors.”

CMBS Defaults: Still Playing Hard to Get

Foreign investors have been waiting for years for a chance to exploit the long tail of broken Japanese CMBS deals left

EXHIBIT 2-16

Shanghai Stock Exchange Property Subindex (China Developers)

over from the global financial crisis, much of which is deeply underwater and hopelessly compromised. However, so far the market has refused to disgorge more than small chunks of the US\$18 billion in CMBS deals believed to be in default.

In theory, CMBS defaults are supposed to create inflexible scenarios, because once a default occurs, responsibility for the bond is transferred to a special servicer whose role is then to liquidate assets and distribute the proceeds. Unlike bank loans, there is no discretion to extend. In Japan, however, various factors combine to obstruct liquidation. First, according to one Japan-based fund manager, the process is often stalled at the outset because of vested interests within the system. In particular, “the servicers don’t want to sell these assets because then they lose out on their management fee; they’re taking on a persona as a competing asset manager [instead of] a servicer.”

Second, the senior tranches of Japan’s big CMBS deals are invariably held by Japanese banks, which are often not inclined to allow default. The lower-ranking, higher-LTV tranches, meanwhile, are held by a variety of players ranging from international banks to various categories of more speculative capital whose positions are usually worthless as a result of the decline in Japanese property values. Once the loan defaults and the special servicer is appointed, the loan passes through a series of “control periods” during which each tranche, beginning with the most junior, has the right to dictate what actions may be taken for a period of, usually, several months. Often in Japan, the owners of each tranche will wait out the entirety of their control period, which means it can take a year or more to burn through the capital stack up to the point at which value—if any—resides.

At this point, a Japanese bank will often end up controlling the asset at a much less distressed level. Said one investor

active in this market, “What the banks have been doing, especially with these big situations, is to buy themselves time by bringing in a very small sliver of equity. Basically it’s like buying an option on capital values rebounding. So they do kick the can down the road that way.” Opportunity players are also looking at this scenario and will sometimes try to buy into the stack at this same “fulcrum” position; currently, they are rumored to be looking for yields in the range of 10 to 15 percent. However, these moves are vulnerable to competing bids from banks often willing to accept a lower return.

As a result, though a steady trickle of assets from CMBS defaults has been bleeding into the market, local banks have been able to avoid a scenario in which all the assets enter the market at more or less the same time. Therefore, although some foreign funds have raised considerable amounts of capital in an effort to pick up defaulted CMBS assets, there is no guarantee they will appear soon or even at all, especially if capital values pick up.

REITs Rebound

After suffering huge losses during the global financial crisis and some humiliating recapitalizations in 2009, the region’s REITs bounced back strongly in 2012. Investors looking for a safe place to park cash and earn a good yield find that REITs tick all the right boxes. As a result, share prices have risen and yields have compressed in most markets. Many REITs that traded for years at steep discounts to NAV are now back at par or at a premium to NAV, meaning they can now make accretive purchases more easily. Most interviewees expect buying by REITs to step up as a result.

The exception to this may be in Japan, where “JREITs are not really active because of their lack of ability to raise

capital.” There are a number of reasons for this. Because most of Japan’s investment-grade property assets remain in the hands of local developers, the JREIT market cap is a relatively modest ¥3.9 trillion (US\$48.8 billion), with AUM representing about 4.5 percent of all Japanese income-producing stock—less, for example, than the equivalent REIT asset base in Australia. Also, because JREITs are closely aligned with their sponsors, which are usually developers, “they have massive conflicts of interest: managers are only interested in keeping their sponsor happy, not the unitholders in the REIT.” This creates a disincentive to invest on both the debt and equity sides because “there’s just not a lot of comfort with the management.” JREITs therefore remain too small and illiquid to attract large institutional investors.

Despite these problems, JREIT prospects have improved in 2012. Share prices have risen strongly—27.6 percent for the first three quarters of the year—driven by both foreign institutional buying and government policy stimulus, with the Bank of Japan purchasing US\$1.54 billion in JREIT shares as part of its monetary easing program during the year. As a result, more JREITs are now able to make accretive purchases. In addition, a number of private REITs have sprung up, two new REITs have listed since the beginning of the year (the first in five years), and others had made public offerings totaling almost ¥246 billion (US\$3.2 billion) by the beginning of October.

That said, total equity issuance is expected to be only modestly higher for the year, while JREIT purchases should be in line with last year’s ¥714 billion (US\$8.9 billion) figure—about half the amount purchased in 2007. As one fund manager said, “I’m still a strong believer in the JREIT market,

but it’s going to take two or three years for the market to come back and for them to find confidence on the capital side [for investors] to want to go back in and play. I think there has to be more consolidation; a number of things have to change. For now, they’re pretty capital constrained.”

The big problem in most REIT markets is a shortage of suitable and/or available properties. Said a REIT manager in Singapore, “It’s just too crowded. We’re 23-odd REITs now, seven in the industrial space alone, so there’s a lot of competition for the same product.” The problem with crowding is only likely to worsen as more REITs get ready to list. “For the moment, the appetite is very much [for] risk-averse value investing, where REITs are perfect, so there’s quite a healthy pipeline of other REIT sponsors queuing up.”

As a result, some Singapore REITs are looking overseas for new assets to buy, although most still lack a mandate to do so. Hong Kong’s REITs are also known to be looking in other markets for new properties. In Japan, JREITs have yet to venture offshore, despite rule changes that have allowed them to do so since 2008. “They’re allowed to go buy overseas assets, but they continue to be discouraged to do so by the FSA [Financial Services Agency] because the FSA is scared they can’t regulate those deals overseas.” That said, however, a number of JREITs are known to be currently working on overseas investment opportunities.

Many of the new REITs are likely to come from countries that have historically lacked their own REIT market. More Indian and Indonesian assets, therefore, are likely to be listed in Singapore, although “everyone’s going to be a bit cautious of overseas assets in terms of looking at the underlying real

EXHIBIT 2-17

Hang Seng Properties Subindex (Hong Kong Developers)

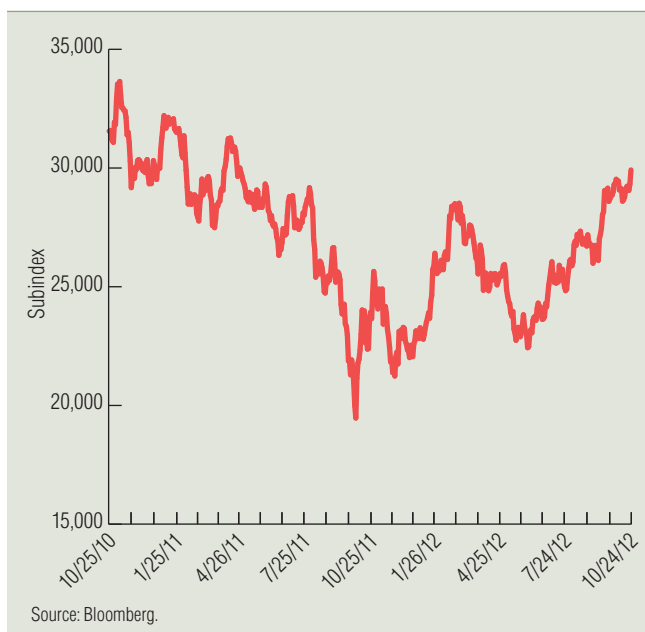


EXHIBIT 2-18

FTSE Singapore Real Estate Developers Subindex



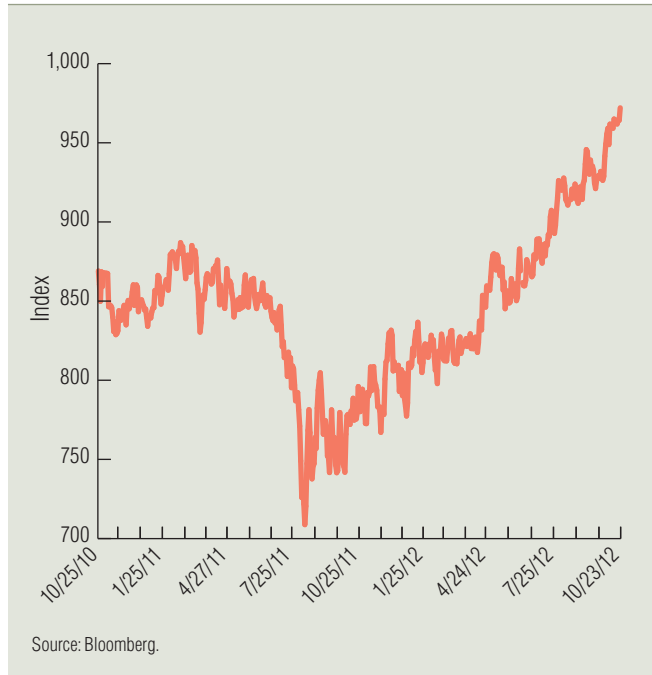
EXHIBIT 2-19

Tokyo Stock Exchange REIT Index



EXHIBIT 2-20

S&P/ASX Australian REIT Index



estate, at credit or leasebacks, or the fundamentals of that market, and probably just as important, the manager and the qualifications.” Another problem with REITs listing assets from emerging-market countries is that investors are likely to get much better returns investing in physical assets in those markets rather than settling for a REIT-like yield from similar property. As one Indian investor pointed out, “If you really want to play the Indian real estate story, why would you settle for that? It’s not what the emerging market story is about.”

In addition, new REIT markets are rapidly evolving across the region. Malaysia’s REIT industry was tiny and illiquid until 2010, after which five REITs were listed in quick succession. These have become wildly popular with both domestic and international investors, trading at “unbelievable valuations” ranging from 40 to 50 percent premium to NAV. As a result, Malaysian REITs now trade at by far the narrowest spread to risk-free rate of any Asian market. Thailand, which until recently was very quiet and for the time being uses a rather primitive type of REIT infrastructure, has also seen some amazingly successful listings of retail assets that are now also trading at big premiums to NAV. The Philippines, meanwhile, is also moving towards introducing a REIT framework, and has a number of big developers that could act as sponsors. However, negotiations with the government over the required tax breaks appear to have bogged down. According to one interviewee, this issue may not be resolved until a new administration is in place.

EXHIBIT 2-21

FTSE Strait Times Singapore REIT Index





Markets and Sectors to Watch

“Investors who want to make a play on an improvement in global-risk sentiment will be looking at secondary areas and assets.”

Although the overall tenor of investor sentiment for this year’s *Emerging Trends Asia Pacific* interviews reflected a degree of apprehension over real estate investment prospects for the coming year, the mood as indicated by survey ratings of individual cities was rather more bullish, with higher scores awarded this year for most surveyed markets than one or two years ago. This perhaps is an indication of ongoing higher prices and cap rate compression despite growing macroeconomic headwinds both regionally and globally.

Taking this into account, the top trends emerging from the survey include:

- Several second-tier cities have emerged as favored investment and development destinations—including, in particular, Jakarta, but also Kuala Lumpur, Bangkok, and secondary cities in China. This is probably at least partly a result of ongoing yield compression in the bigger, more developed markets. However, while these second-tier locations may provide more possibilities for opportunistic returns, market penetration is generally more difficult and opportunities are limited. In addition, these locations usually carry a significantly higher degree of implied risk. In practice, therefore, most investors will find opportunities in these destinations restricted.

- Previous investor favorites such as Shanghai and Singapore continue to attract attention.

- The industrial/distribution sector ranks highest for both investment and development prospects, while retail also scores highly.

Also, leading buy and sell ratings for property types are:

- retail: buy, Jakarta; sell, Osaka;
- office: buy, Jakarta; sell, Osaka;
- hotel: buy, Sydney; sell, Shenzhen;
- apartment: buy, Jakarta; sell, Hong Kong; and
- industrial: buy, China; sell, Osaka.

EXHIBIT 3-1

City Investment Prospects

generally good fair generally poor

| | | |
|----|------------------------|------|
| 1 | Jakarta | 6.01 |
| 2 | Shanghai | 5.83 |
| 3 | Singapore | 5.78 |
| 4 | Sydney | 5.69 |
| 5 | Kuala Lumpur | 5.68 |
| 6 | Bangkok | 5.67 |
| 7 | Beijing | 5.65 |
| 8 | China—secondary cities | 5.60 |
| 9 | Taipei | 5.58 |
| 10 | Melbourne | 5.56 |
| 11 | Hong Kong | 5.56 |
| 12 | Manila | 5.52 |
| 13 | Tokyo | 5.42 |
| 14 | Seoul | 5.39 |
| 15 | Guangzhou | 5.30 |
| 16 | Shenzhen | 5.24 |
| 17 | Auckland | 5.07 |
| 18 | Ho Chi Minh City | 5.02 |
| 19 | Bangalore | 5.01 |
| 20 | Mumbai | 4.94 |
| 21 | New Delhi | 4.86 |
| 22 | Osaka | 4.82 |

Source: *Emerging Trends in Real Estate Asia Pacific 2013* survey.

EXHIBIT 3-2

Historical Investment Prospect Rankings

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

Source: *Emerging Trends in Real Estate Asia Pacific 2007–2013* surveys.

Note: China—secondary cities and Shenzhen are included for the first time in 2013.

EXHIBIT 3-3

City Development Prospects

| | generally good | fair | generally poor |
|--------------------------|----------------|------|----------------|
| 1 Jakarta | 6.10 | | |
| 2 China—secondary cities | 5.79 | | |
| 3 Singapore | 5.66 | | |
| 4 Shanghai | 5.65 | | |
| 5 Kuala Lumpur | 5.60 | | |
| 6 Bangkok | 5.59 | | |
| 7 Beijing | 5.58 | | |
| 8 Taipei | 5.49 | | |
| 9 Manila | 5.47 | | |
| 10 Hong Kong | 5.47 | | |
| 11 Shenzhen | 5.36 | | |
| 12 Guangzhou | 5.32 | | |
| 13 Sydney | 5.31 | | |
| 14 Melbourne | 5.17 | | |
| 15 Ho Chi Minh City | 5.14 | | |
| 16 Bangalore | 5.06 | | |
| 17 Seoul | 5.05 | | |
| 18 Tokyo | 5.02 | | |
| 19 Auckland | 4.95 | | |
| 20 Mumbai | 4.91 | | |
| 21 New Delhi | 4.87 | | |
| 22 Osaka | 4.53 | | |

Source: *Emerging Trends in Real Estate Asia Pacific 2013* survey.

Top Investment Cities

Jakarta (first in investment, first in development). Jakarta's billing as this year's number-one investment and development destination comes as a surprise, given the city's relatively low rankings in previous surveys, a lack of investment-grade building stock,



and an economy that may be growing rapidly but lacks the enterprise, scale, and infrastructure of its more developed peers. Jakarta attracted a modest US\$660.5 million in commercial real estate investment in 2011.

Nonetheless, the turnaround seen in Indonesia in the past couple of years has been impressive. Interest rates and inflation are under control, and while GDP is growing at around 6.5 percent annually, foreign direct investment is increasing at a much higher rate—39 percent in the first half of this year. Driven by increased demand from foreigners and locals alike, office rents shot up 29 percent year-on-year in the third quarter, according to DTZ.

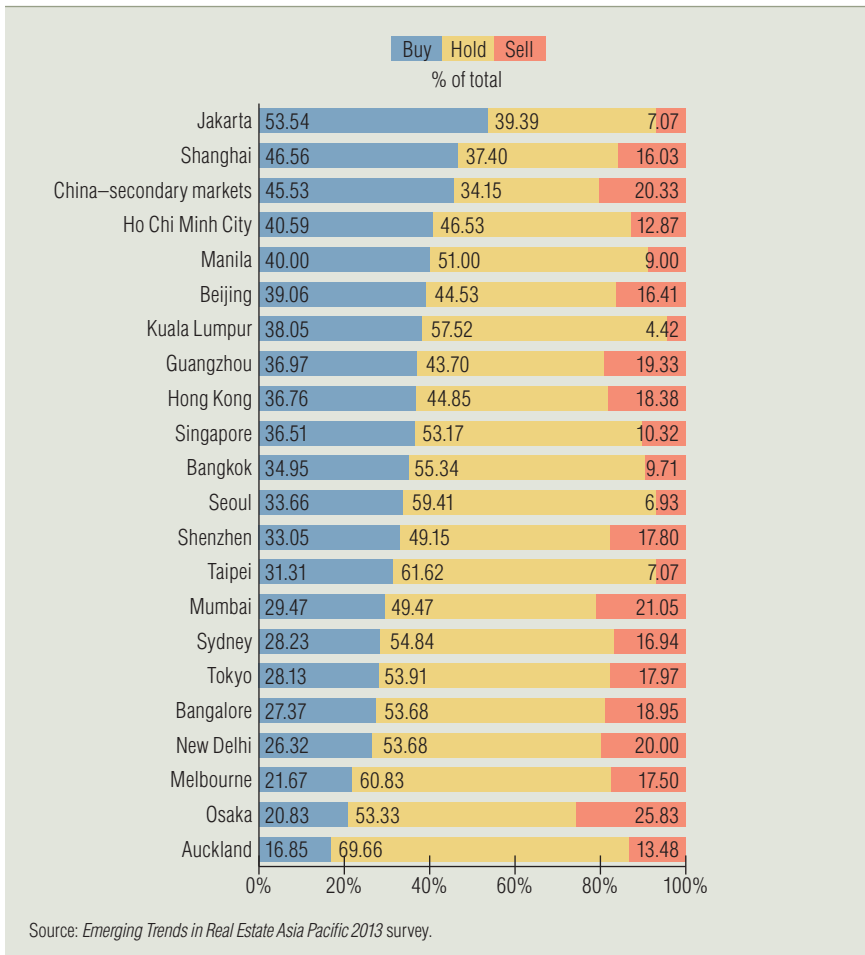
Although Indonesia has always been more of a play on natural resources than exports, optimism on the manufacturing side has been generated by the likely relocation of significant factory capacity away from China as mainland costs continue to rise. Said an execu-

tive at a large developer who identified Indonesia as his favorite emerging market location, "It's really boom times in Indonesia now, and everyone is looking at it very aggressively. The demographics look good, it's a country as big as America in terms of head count, and corruption seems to have been at least partly reined in."

But while growth promises to remain strong, Indonesian operating conditions are difficult, reflecting its status as a frontier economy. Bank loans are expensive and hard to find. Identifying reliable local partners willing to work with foreign investors is even more difficult because most have no need for the type or cost of capital provided by foreign investment funds. Most worrying are reservations about rule-of-law issues, which have turned some investors off Indonesia completely. "We cannot get clean land," noted one developer whose company pulled out of Indonesia after repeated land title disputes. For funds

EXHIBIT 3-4

Retail Property Buy/Hold/Sell Recommendations by City



reasons. First, there has been a general rotation of capital from the commercial to residential sector. Housing continues to be an investment magnet for those developers who can find funding to build because of its self-liquidating nature. More important, however, is that there are very few investment-grade commercial buildings currently for sale in Shanghai. High prices are still being obtained for the few properties that appear on the market, and demand continues to be strong at local land sales, suggesting that transaction numbers would be stronger if there were more supply available.

Although sales in the Shanghai commercial sector dropped significantly in the first three quarters of 2012, the city remains firmly on the radar for both domestic buyers and the many foreign funds with a mandate to invest in Chinese real estate.

Singapore (third in investment, third in development). Singapore is another longtime favorite destination, having ranked in the top three in the *Emerging Trends Asia Pacific* survey every year except one since it started in 2007. As one investor said, “You don’t get astronomical returns, but it is a very safe place to be.” In part this is because, as a financial hub, the city will generate ongoing demand for high-grade office space. In addition, there is always a steady stream of government land sales and a strong pipeline of new projects. That has been “good for developers, but is less so for opportunistic investors with

buying stabilized properties, lack of transparency will probably not be such a problem. However, with commercial property yields hovering around the 10 percent mark, returns are not especially high for investments in this type of location. Though Indonesia may have promise, therefore, it will continue to be a risky play: caveat emptor.

Shanghai (second in investment, fourth in development). Shanghai, and in particular its office market, has been the bread-and-butter investment for foreign funds in China for many years. More recently, investor attention has shifted also to the retail market. Both sectors remain popular in principle, given Shanghai’s relatively user-friendly environment, its growing volume of institutional-grade properties, and

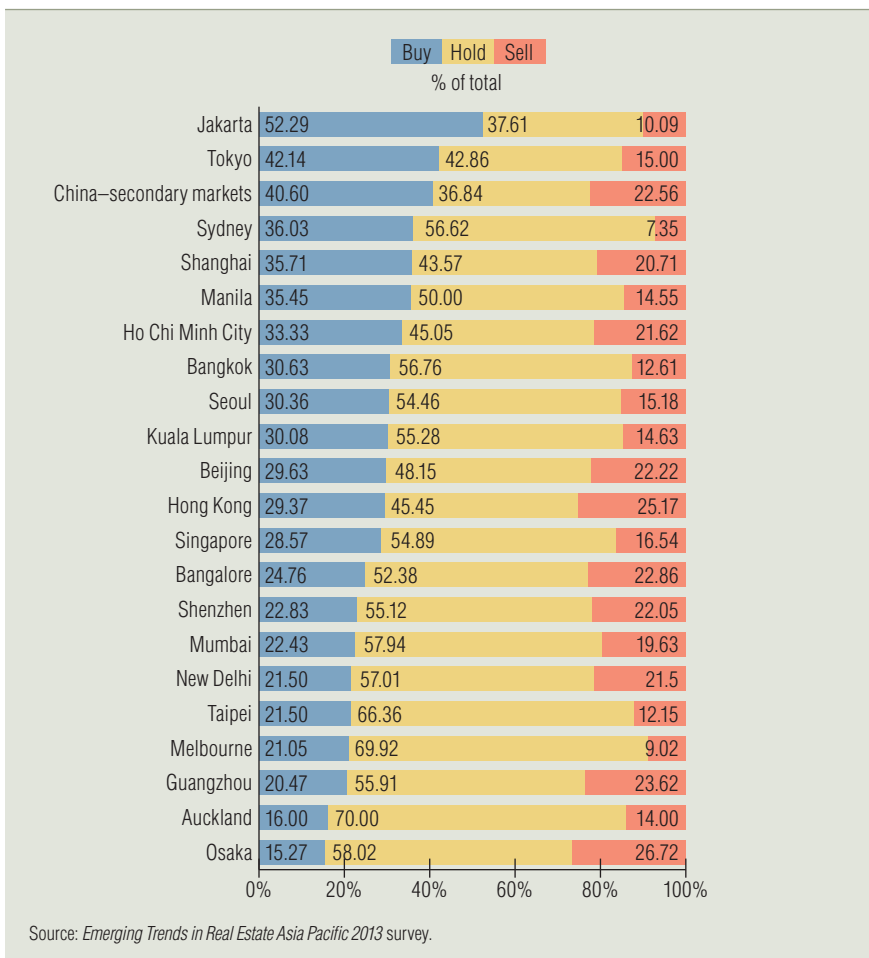
the profitable track record of previous investors, some of whom are now exiting deals made several years ago.

However, Shanghai is not as appealing to foreigners today as it was. This is partly because markets have become saturated. Partly, too, it is because Chinese regulators are now not as welcoming to foreigners as they once were. Said one consultant, “They [regulators] feel domestic developers are capable now of delivering the quality of product that’s required for it to have an international reputation, and also believe that the required funding can be generated domestically.” Given also their natural disinclination to buy at currently high prices, foreign investors are not buying as actively as in previous years.

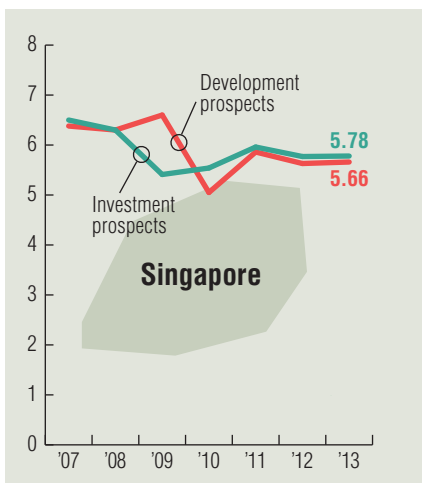
Sales to local investors have also been thin on the ground, though for different

EXHIBIT 3-5

Office Property Buy/Hold/Sell Recommendations by City



a short-term horizon because it means almost unlimited supply down the track as the government will release land to ensure that businesses have what they need.”



Recently, the commercial market has run out of steam. A batch of new Grade A offices has drained tenants from existing buildings, a problem compounded by shrinking head count in the local financial sector. This has led to rising vacancies and falling rents—never a good combination for those looking to sell assets. Therefore, a handful of international funds now looking to exit investments is having trouble finding buyers.

Though capital prices have fallen, cap rates remain elevated, meaning that buildings are still “quite fully priced,” creating a standoff between buyers and sellers. There is some speculation that local REITs, which are now actively looking for opportunities to invest, may show interest in these properties, but there is as yet no indication they will do so, given

that they are not the type of prime assets the REITs normally look to acquire.

For now, therefore, the focus has shifted to other areas. Strong interest in strata-title properties has been boosted by new taxes aimed at an overheated residential sector (so far, to little effect) that has seen many high-net-worth individuals and private companies rotate away from housing. Demand for these strata properties is strongest for off-plan units sold by developers.

Sydney (fourth in investment, 13th in development).

Australia remains at the top of the list for many international funds investing in the Asia Pacific area. This year it again absorbed more international real estate investment than any other market in the region. As a commodity-driven economy, Australia is an indirect play on continued Chinese economic growth because mainland companies soak up iron ore, coal, and other natural resources. There is plenty of institutional-grade stock, and the country continues to show good—if slightly below-trend—economic growth.

The biggest draw, however, is the wide yield spread, which today has become the holy grail for institutional real estate investors. Factor in ongoing divestment by Australian institutional and international sellers, as well as difficulties local investors have had in borrowing at competitive rates from onshore banks, and it is easy to see why foreign funds have enjoyed a bonanza buying Australian assets.

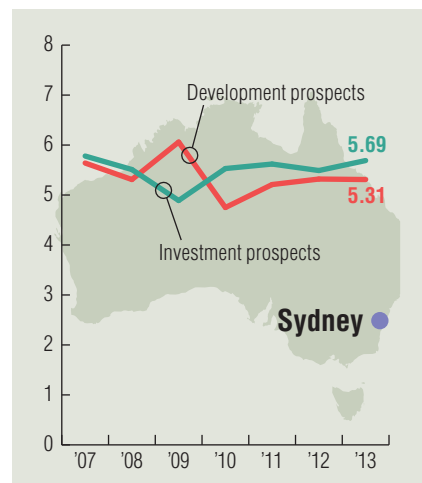
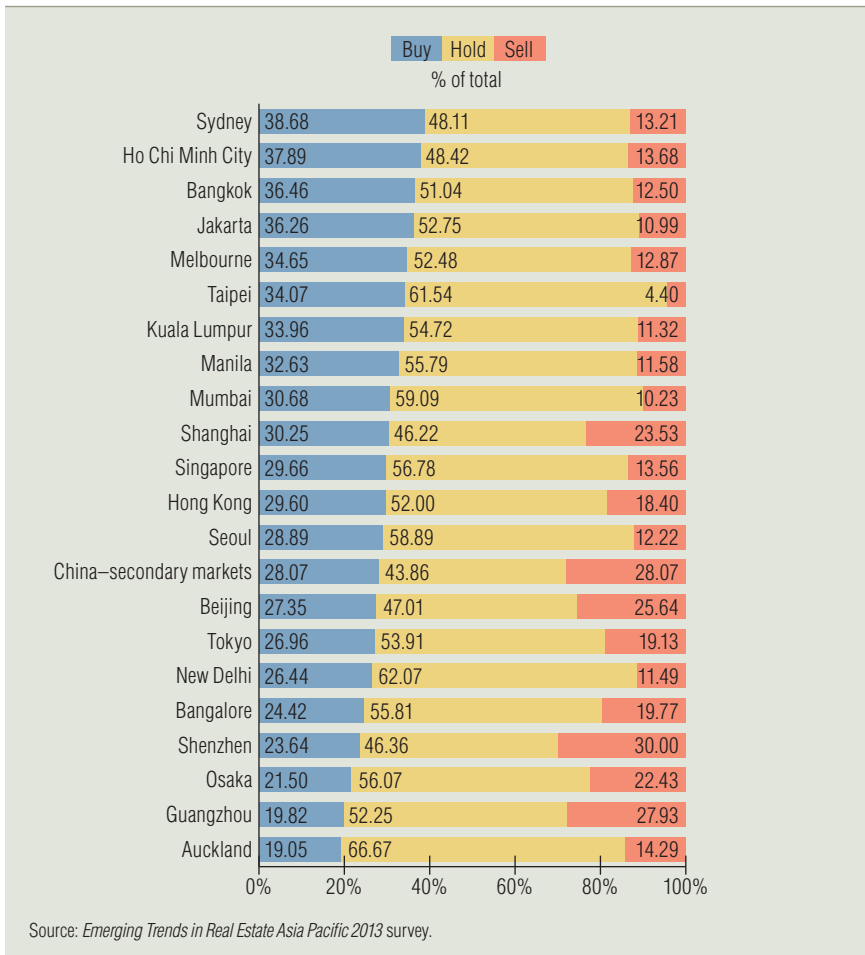


EXHIBIT 3-6

Hotel Property Buy/Hold/Sell Recommendations by City

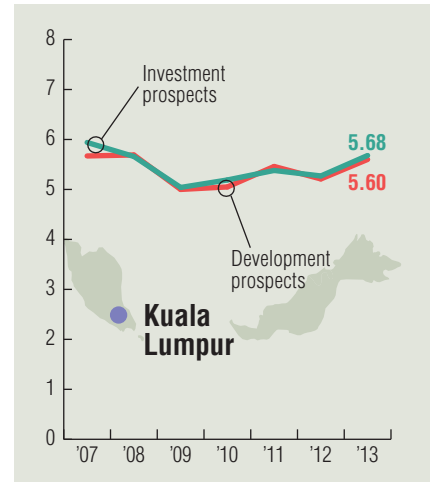


In particular, the Sydney market for several years has seen a limited amount of new supply, although a glut of office and retail inventory is in the pipeline and due to hit the market in 2015, when the Barangaroo development arrives on Sydney’s western shore. For now, the shortage of institutional-grade inventory in Sydney continues to suppress sales volumes. At the same time, the shortage has kept prices buoyant, driving total returns for office assets 20 percent higher in 2011, according to Credit Suisse.

Office assets remain a popular target for foreign funds. “We are still seeing in 2012 around 30 percent of office transactions coming from foreign investors,” one local analyst said. Still, risks are not insignificant. The potential for currency volatility remains one con-

cern; continuing economic stagnation in China is another. Experience has shown that when China sneezes, Australia catches a cold. Although the steep drop in Australian iron ore sales in the first half of 2012 seems now to have been reversed after the Chinese government introduced new measures to stimulate the economy, this is a scenario that cannot be discounted should China’s economy again face problems.

Kuala Lumpur (fifth in investment, fifth in development). After languishing for years as one of Asia’s marginal markets, Kuala Lumpur has now entered the limelight, seen as relatively stable but with good potential for opportunistic returns. “The tower cranes are moving and real estate is selling,” said one investor. “China may be slowing, but in



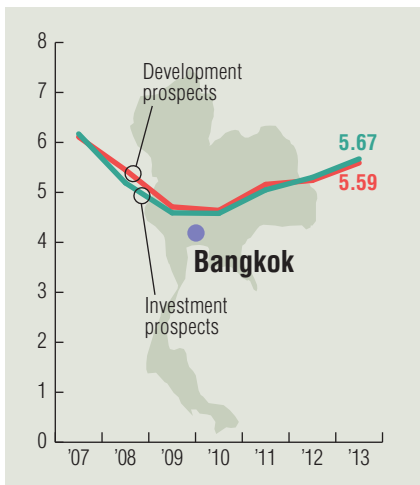
the past year I have not seen a slow-down in KL.”

Though sales slowed noticeably in most Asian markets in the third quarter of 2012, Kuala Lumpur was a standout in terms of activity. Admittedly, this resulted from the listing of a single large REIT featuring just two flagship properties. However, with Malaysian REITs continuing to trade at substantial premiums to NAV, listing activity will remain strong.

Existing REITs will be looking to purchase new properties, which should help soak up a strong pipeline of office supply described as “scary” by one developer. Despite this, tenant demand for new space is questionable, so it will probably suppress rents.

Compared with cities such as Singapore and Hong Kong, Kuala Lumpur has relatively low penetration of global brands, so the sector can expect rapid ongoing growth as international retailers arrive in the market. Prospects for retail property are therefore “good, both in the city as well as the suburbs, if they are well managed; there are those that are not managed well that will sink.” Over the longer term, prospects for the commercial property sector are regarded as strong, given that the government’s Economic Transformation Programme is proving successful at drawing foreign investment.

Bangkok (sixth in investment, sixth in development). Like Kuala Lumpur, Bangkok has emerged from



Bangkok has never been an easy place for foreign investors to make money. Recently they have been whiplashed by an unstable political environment, a string of natural disasters, and a lack of transparency in the legal and regulatory framework. “There’s still a lot of uncertainty because there are rumors about new taxes, and also the king’s health is still questionable,” said one interviewee. “It would be the first time there could be a change in monarch in modern times.” Bangkok’s condominium sector has seen less supply emerge over the past year as existing inventory is digested and developers diversify towards resort destinations on the coast.

Unsurprisingly, the real potential in Bangkok and, indeed, Thailand lies in the tourism and hospitality sector.

The office market benefits from a lack of new supply—no significant new facilities are set to open until 2014—but demand is problematic because, as one interviewee said, “I don’t see it as a big financial center or a center that would draw a lot of international business.” That said, health tourism continues to be a big draw, with large numbers of foreign patients, especially from the Middle East, attracted to low-cost/high-value medical facilities. As in Kuala Lumpur, rising consumer demand is expected to draw a significant number of international retail chains over the near term, helping boost rents across the retail sector.

the shadows this year, at least partly on the back of a newly vibrant REIT market and the opportunistic yields afforded by a growing economy. At the same time,

Beijing (seventh in investment, seventh in development).

Beijing’s office sector has seen some amazing rent and price increases in the past three years, successfully absorbing an enormous pipeline of new supply that most analysts had expected would swamp the market. CBD prices have increased by at least 45 percent over the past two years while rents have risen 6.6 percent per quarter for the past 10 quarters, according to consultants Savills.

To an extent, this reflects strong demand by businesses of all stripes, foreign and domestic. However, the prime mover of the market has been take-up by Chinese state-owned enterprises. Said one interviewee, “A lot of it has been enterprises from cities and provinces taking over major parts of buildings, or whole buildings, and putting a stake in

EXHIBIT 3-7

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

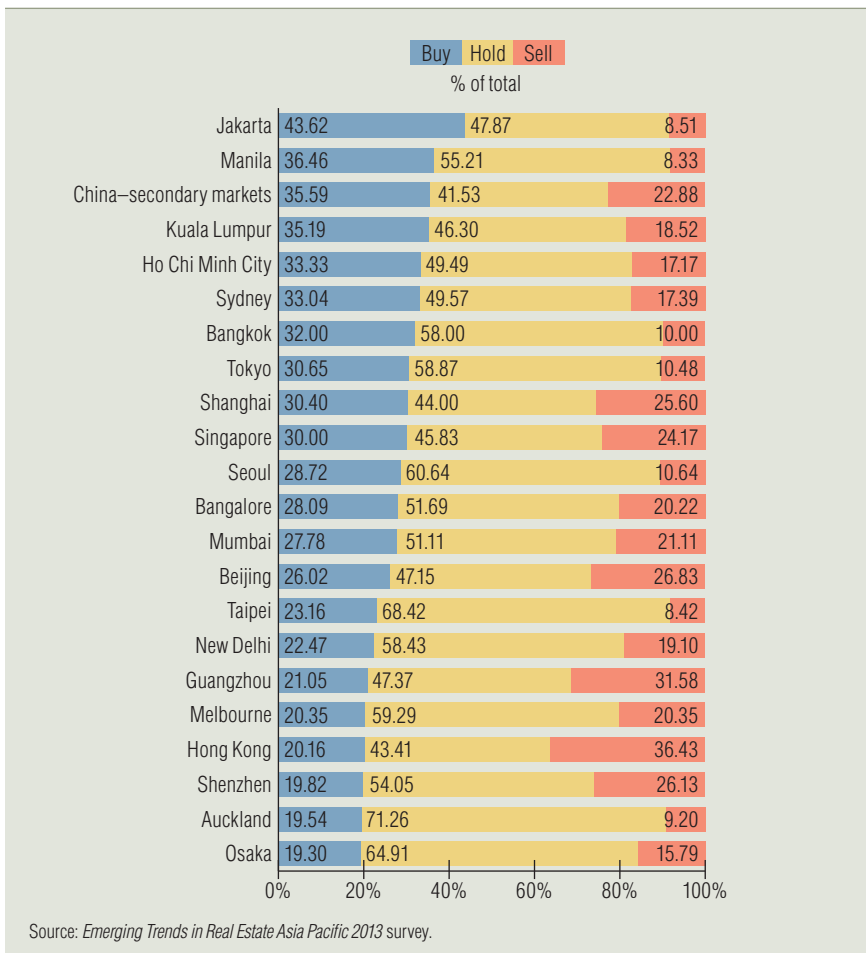




EXHIBIT 3-8
Leading Asia Pacific Cities

Investment prospects

- Generally good
- Fair
- Generally poor

the ground with Beijing, saying, 'We're committed.' There's been a fair bit of pressure on them to do so because the government was seriously concerned about the oversupply."

But because the demand has not always been market driven, there is now concern as to how long it will last. Anyone looking to buy into one of these office buildings should be concerned about the staying power of tenants. "I'd be looking very closely at the occupier. If my building was occupied by only one state enterprise, or several, I think I'd be a bit cautious."

Still, with vacancy rates now very low and an equally small pipeline of new supply coming in, the market can probably stave off pressure for the foreseeable future. Said one investor, "I can see an adjustment coming probably in about two years' time, perhaps 18 months."

China—second-tier cities (eighth in investment, second in development). Interest in China's second- and third-tier cities has grown quickly in recent years as the low-hanging fruit in major metropolises has disappeared. It is a testament to the strength of interest in what is an essentially opportunistic play that the second tier is ranked so highly in the survey despite the general preference among investors for stable, core returns.

Internal rates of return of 20 percent-plus have made development plays

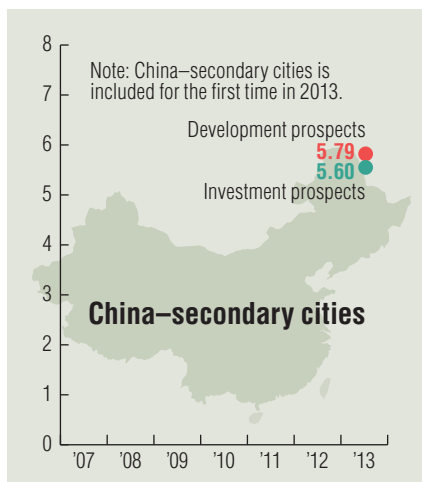
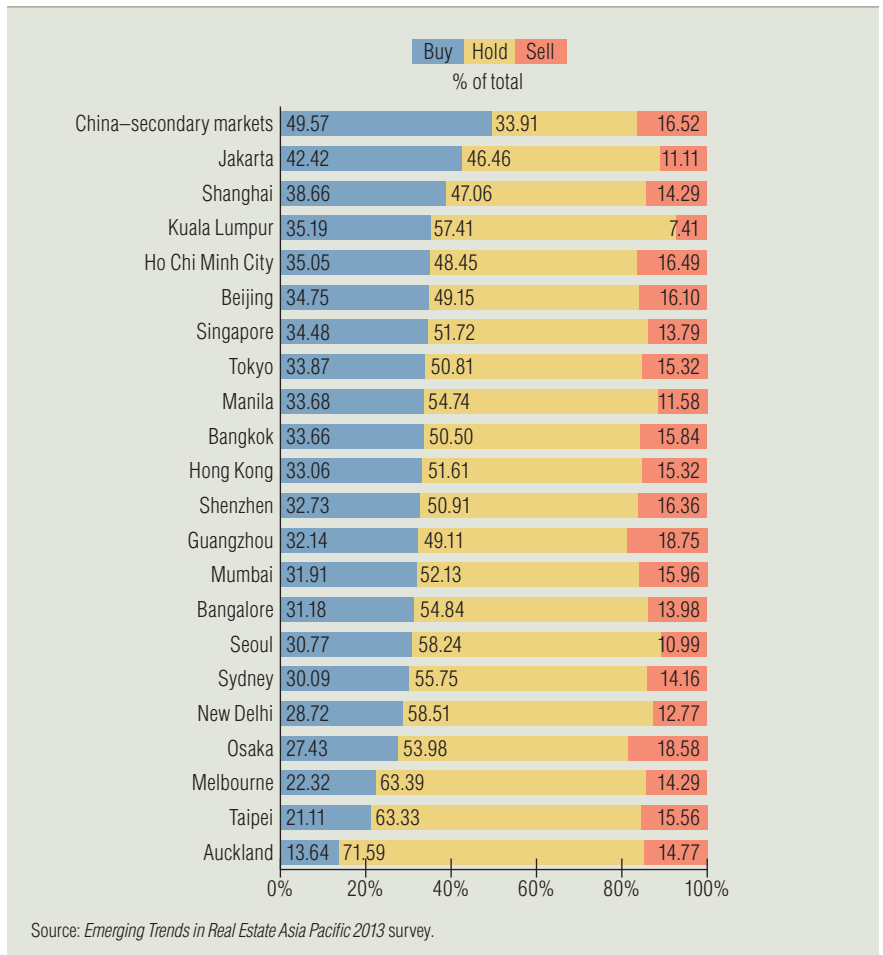


EXHIBIT 3-9

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



popular, especially so given the overall lack of good-quality, institutional-grade assets. Also, residential and retail plays tend to be preferred over office, given a widespread glut of new office space in secondary cities. Chongqing, Tianjin, and Shenyang have become especially popular destinations. By getting in on the ground floor in these cities, investors have the opportunity to pick up prime city-center sites that will have long-lasting value as core assets.

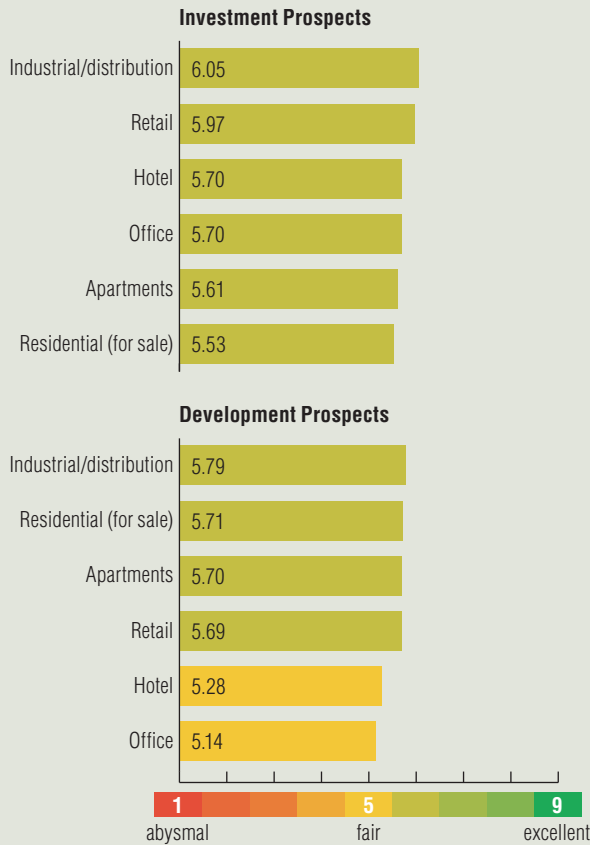
Residential plays can sometimes be difficult to sell to international investment committees that read endless press reports of the ongoing crackdown by the Chinese government in this sector. This is one reason why retail plays continue to be a major draw. As one investor put it, "For the retail sector,

the sky is the limit. If you don't do well, you have only yourself to blame." This perhaps rates the sector too highly—there have been many examples of failed Chinese retail projects—but it is probably fair to say that the main reason for failure is lack of expertise in positioning, developing, and operating this type of project.

However, investing in these peripheral locations is not for the faint of heart. Working conditions can be difficult and cooperation with local government officials unpredictable. More than ever, finding a good local partner is essential in this type of play. In addition, this type of investment is more likely to be regarded as long term. As one retail developer said, "If you want maximum returns, going to second- and third-tier

EXHIBIT 3-10

Prospects for Major Commercial Property Types in 2013



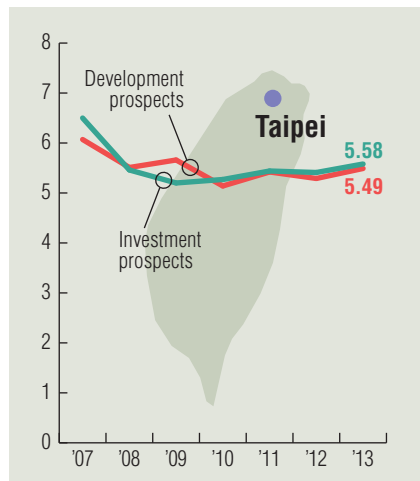
Source: *Emerging Trends in Real Estate Asia Pacific 2013 survey.*

cities is a good call, but you'd probably have to take a look at a five- to ten-year horizon, and maybe have to get the mall repositioned along the way."

Taipei (ninth in investment, tenth in development). Measures introduced by Beijing to cool China's property sector have created a spillover effect for Taipei as mainland investors look offshore to place capital. Quantitative easing measures in the United States have added to this effect. With a low base rate creating good yield spreads and local life insurance companies also piling into the market, excessive liquidity has caused transaction volumes in Taipei to balloon. In the commercial sector, sales rose 78 percent year-on-year in the first half of 2012, according to Savills. Retail sales, meanwhile, have

also boomed on the back of growing tourism from mainland China.

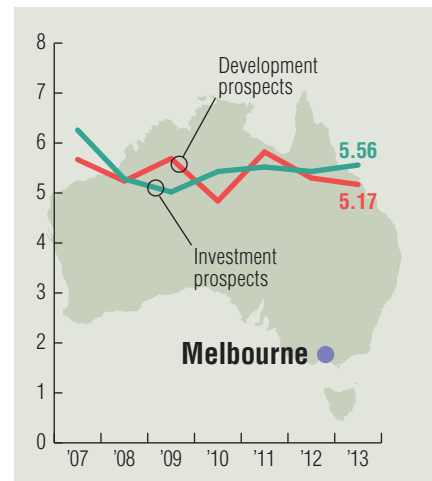
Prices in all sectors have risen strongly as a result, leading the Taiwanese government in August



to impose various new measures to discourage speculation, including restrictions on bank lending and requirements for higher LTVs. As a result, transactions have slowed, although prices have yet to decline. With liquidity remaining high and interest rates low, there seems little reason to suppose prices will fall significantly in the near term.

Melbourne (tenth in investment, 14th in development). Like its counterpart in Sydney, Melbourne's office market continues to show strength, with foreign funds being major buyers. However, significant new stock is coming to market over the next two years that could change the investment dynamic. "You'd need to see quite a material shift in the trajectory of demand from where we are today for the markets to fully digest that load of stock that's coming up." Over the longer term, however the supply-side risk may be overblown. Said one investor, "You look at the potential supply that's been approved in Melbourne and it's enormous. But the reality is that most of it will never get financed because whilst the planning approval guys might be real easy, the banks are not."

Meanwhile, the local residential and retail markets have been in the doldrums. Retail is suffering from an abundance of caution from consumers, as well as rapid development of e-commerce platforms. At the same time, Melbourne's residential sector "is



just very stagnant now,” under siege from a number of sides. “There’s been a 20-year climb in residential values, so affordability is low, there’s a lot of leverage in the system, and if you look at the consumer numbers and the average debt-per-household type of figures, they look a lot like the USA did at the peak, which gives you the heebie-jeebies.” Most investment interest, therefore, continues to focus on core office assets.

Hong Kong (11th in investment, tenth in development). The latest round of quantitative easing in the United States has generated significant capital flows into Hong Kong’s real estate sector. These have been seen mostly on the residential side, where prices rose about 20 percent in the year to November. Hong Kong housing prices are now the world’s highest. However, the government has now introduced further tax increases aimed at curbing speculative housing investment, which may switch the focus of hot-money investing to commercial property assets, in particular second-tier (especially in Kowloon) and strata-title properties.

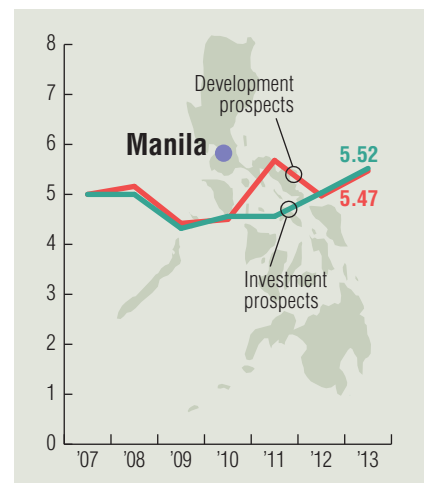
This will add momentum to a shift already underway as businesses begin to move away from the traditional CBD area, which has become so crowded that “banks and finance companies are taking a longer view and saying we actually need to have X thousand staff in a secondary location where the rents aren’t going to just keep popping every two years.”

Hong Kong’s Grade A commercial property is among the world’s most expensive, although the shine has come off somewhat this year as weakness in the financial sector has led to falling rents and some softening in capital prices. However, buying prime institutional-grade properties in the city remains extremely difficult because most stock remains closely held and seldom appears on the market. When it does, pricing is sky high.

Hong Kong’s retail sector has been booming for several years as a result of the large numbers of mainland Chinese tourists arriving in the city. With local rents rising 35 percent annually, “it’s just crazy what people are paying for retail units.” Hong Kong’s main shopping districts are closing in on New York’s Fifth Avenue as the world’s priciest locations. However, tourist arrivals have flagged slightly this year, and there are now concerns that pricing may have peaked.

Manila (12th in investment, ninth in development). Markets in Manila have performed well in the past couple of years as a result of the growing economy, a transparent and business-friendly government, and the country’s ongoing success—an “eye-opener”—in attracting foreign corporate clients to its business process outsourcing (BPO) facilities. Bureaucracy has declined and transparency has improved considerably over the past few years. It is, therefore, currently “the best market I’ve seen in my life,” according to one local investor. As a result, Manila’s appeal as an investment destination climbed from the near bottom of the rankings in previous years’ polls.

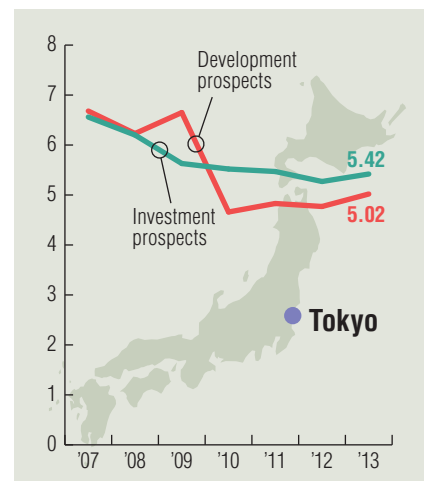
A large casino development underway in Manila has provided impetus to the development sector and is expected to boost tourist arrivals as it is completed in phases over coming years. However, though investment prospects appear bright in the Philippines across all sectors, government regulations that bar foreigners from holding majority landownership continue to deter international investment. What is more, local developers



have little incentive to partner with foreigners, given the availability of ample liquidity from domestic sources. Foreign opportunities, therefore, are likely to remain restricted to the gaming and BPO sectors. Admittedly, both present large opportunities, with the latter currently accounting for some 70 percent of new office take-up in Manila.

Tokyo (13th in investment, 18th in development). Tokyo’s lackluster showing in this year’s survey comes as a surprise, given its current function as something of a magnet for foreign investors looking to invest both in core assets and opportunistic plays. The bullish impression has been helped by the fact that “the perception is that it’s hit the bottom and it’s a good time to go in.”

Though there are “definitely fewer investors than previously,” a variety of foreign capital is making its way



to Japan, with several funds opening offices and putting teams on the ground. There is no single preferred play, but core investors are leaning more towards office assets, where “we may be able to look to some rental increases in 2013,” whereas opportunity money is tending towards the residential and other sectors. In addition, there has also been a move into more niche areas, such as logistics or seniors’ housing. Investments have been helped by copious liquidity, cheap loans, and a wide yield spread that gives good returns on a cash-on-cash basis.

Another opportunistic-type play in Japan arises from CMBS defaults as the tail end of the failed Japanese experiment with real estate derivatives begins coming to market. However, though investment potential appears good, investors have found deal flows restricted by the ongoing reluctance of local banks to clear bad debt from their balance sheets. A wide bid/ask spread has also limited transaction volumes. In addition, yields on the opportunity side so far have not met expectations. “The pricing has come down, but returns are still core, core-plus range.”

Seoul (14th in investment, 17th in development). While South Korea remains the biggest real estate market in Asia outside Japan, China, and Australia, foreign investors have long had problems getting a foothold there. This is partly a result of the fact that most core property assets tend to be

traded between domestic players. “It’s very insular—much more so than Japan—and it’s also hard to find the transparency you can expect in other markets,” said one local fund manager. As a result, most of the big foreign funds that had a presence in Seoul before the global financial crisis have now exited.

Another problem is that there are “limited assets available to buy, making it difficult to come in with scale at any particular time.” Noted one investor, “On average, there may be a dozen transactions of prime office buildings that are finalized on an annual basis.” In addition, the market has become dominated by the emergence of the country’s pension funds, which have more capital to place than the market can absorb and are accounting for “pretty much all transactions in Korea over the last 36 months.” This has driven a lot of South Korean capital out of the country. Cap rates average about 6 percent, but there is “an expectation there will be a further slight drop in rates.” Cost of funding makes for a yield spread of 100 to 150 basis points.

Guangzhou (15th in investment, 12th in development). The Closer Economic Partnership Arrangement between Hong Kong and mainland China triggered a surge of foreign investment in Guangzhou’s real estate market in recent years, and with a full supply pipeline, office rents have been on the decline since 2007. Another problem has been the hollowing out

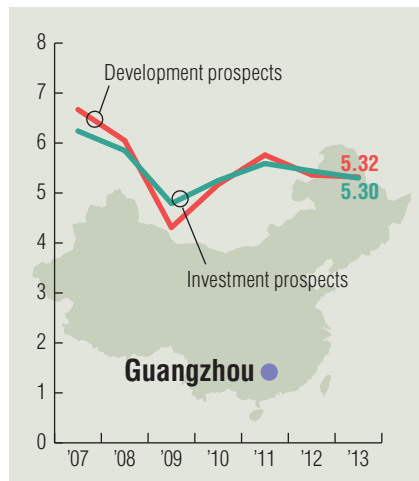
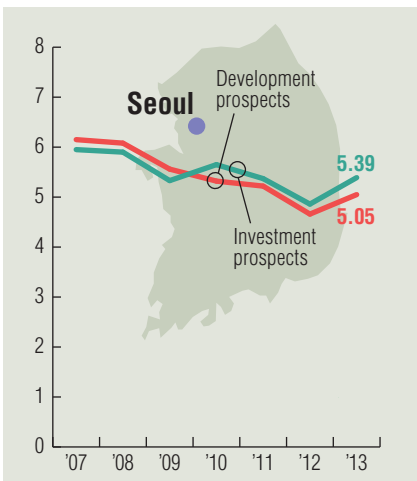
of the local manufacturing base in the Pearl River delta as factories migrate to cheaper destinations in China’s interior, or possibly the Yangtze River delta.

This probably helps explain the city’s relatively low rating in the *Emerging Trends Asia Pacific* survey. That said, however, and despite the supply glut, prices for many CBD office properties have risen strongly in Guangzhou, as they have elsewhere in China. Said one investor, “In the past, people were very concerned about oversupply of office buildings in Guangzhou, especially in the Pearl River new city. But if you’d invested four or five years ago in that place, you’d have made a lot of money.”

On the retail side, an influx of foreign and domestic retailers over the past few years has acted as a catalyst for expansion. However, the sector continues to digest a glut of supply from 2010 and 2011, and with more retail space still to come, rents will continue to come under pressure as vacancies rise.

Despite these problems, Guangzhou has been the slowest of China’s major cities to develop, and rents remain low compared with those in other major urban areas in China. The market, therefore, still is considered to have good long-term prospects.

Shenzhen (16th in investment, 11th in development). Shenzhen is another location where prospects have dimmed as a result of the decline of the local manufacturing base in the Pearl River delta. However, the city has been some-



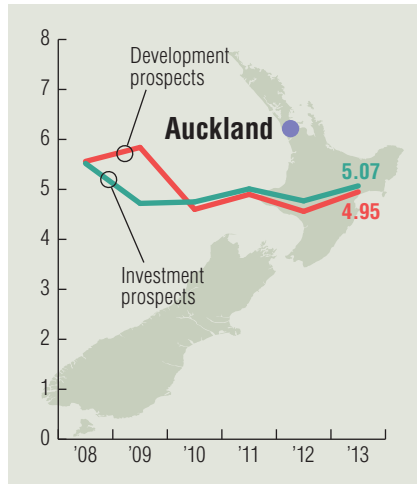
what sheltered due to its status as a high-tech hub, which means it continues to receive investment as the Chinese economy makes a slow transition away from its roots in textiles and other light-industry manufacturing.

Shenzhen has a reputation for big swings in its residential property prices, at least partly because it has historically been the focus of speculative investment from Hong Kong, just across the border. Chinese government measures banning foreigners from buying homes in China, therefore, have had a disproportionate impact on local prices, which fell 15 percent in 2011, although both prices and transactions had rebounded slightly by mid-2012.

The office market has continued to thrive in recent years, with prices rising more than 50 percent since the beginning of 2009, before plateauing this year. Net additions to prime office space will increase existing stock about 40 percent in Shenzhen, however, according to Credit Suisse, which in theory should depress rents and prices, especially given that vacancy rates are already north of 15 percent. However, a similar supply glut had no impact in Beijing over the past several years as domestic state-owned enterprises stepped in to take up space. How it affects Shenzhen remains to be seen.

Auckland (17th in investment, 19th in development). New Zealand is an investment backwater in Asia, geographically removed and of relatively small scale. Nonetheless, the local market has some interesting assets, not least because it is generally considered to be at the bottom of the investment cycle. Interest rates are low and banks are reasonably accommodating in providing leverage.

Auckland continues to be the most popular investment destination among New Zealand's cities—first, because it is the country's major commercial center, and second, because it is not exposed to earthquake risk in the same way as Wellington and Christchurch. In a sense, its remoteness can be seen as its biggest strength, making it a safe

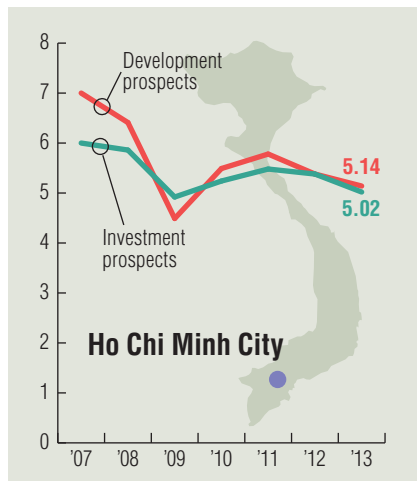


harbor in a volatile investment climate. The fact that “you’ve got slightly higher pricing because of the lack of liquidity” indicates fewer people competing for deals, which also indicates a measure of stability.

Most buying activity is restricted to local funds and private investors; New Zealand sees little of the international fund flow attracted by nearby cities in Australia. As usual, prime CBD properties remain the most popular type of investment, especially given lack of incoming supply.

Ho Chi Minh City (18th in investment, 15th in development).

Vietnam's ratings in the *Emerging Trends* survey have plunged this year as a result of the country's economic problems. Until 2010, the economy had been growing at a rate topping 7 percent annually, leading some to

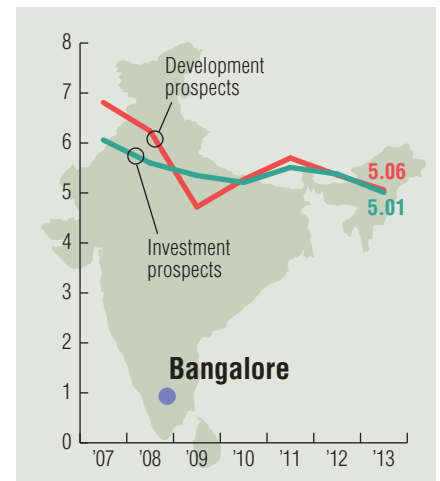


predict that it would follow the Chinese model of economic reform. The wheels have come off in the past year, however, with GDP growth dropping to 5 percent in 2012, inflation soaring to a peak of 23 percent (now 7 percent), and a disastrous state-bank lending spree that has left the country awash with billions of dollars in nonperforming loans, many of which relate to the property sector.

This has left even seasoned investors unsure of where to turn. “Everything is good except the macro economy,” said one investor. “We’re scratching our heads a bit about the country right now,” admitted another. He added that with the exception of a couple of large Japanese projects, “the Singaporeans, the Hong Kongers, and the funds are all out of the market right now.”

All things being equal, however, interviewees mentioned the residential, hospitality, and manufacturing sectors as potential plays. In particular, although “there’s an oversupply of badly construed industrial parks, I think if you choose the right industrial park format, you’d be okay.” The office sector is likely to remain stagnant because of oversupply, apart from high-end properties, and a shortage of financial-sector tenants willing to lease investment-grade offices. Retailers, meanwhile, have become bogged down by excessive bureaucracy.

Bangalore (19th in investment, 16th in development). In its heyday in 2006 and 2007, Bangalore's leasehold absorption of Grade A office and



commercial space topped 15 million square feet per year, most of it by way of business parks or office space related to technology companies. Today, however, growth has subsided, and though the city can be considered a stable, mature market, it remains “a one-trick pony” whose prospects are tied closely to the fortunes of the global information technology industry. Therefore, there are “no fireworks expected.”

The challenge with Bangalore today, according to one local investor, is that it lacks other demand drivers, “so while it will continue to be India’s third-strongest market for the next three to five years and it will still account for the largest amount of A grade office absorption,” there is unlikely to be any spark that will again create strong growth. In addition, quite apart from the fact that the outsourcing trend to India has probably peaked, south India is a more conservative culture less prone to the type of speculative investments common in northern parts of the country.

Mumbai (20th in investment, 20th in development). Although Mumbai has traditionally suffered from undersupply in all property sectors, more recently the opposite has been true. However, a recent political scandal in the state government has paralyzed new development over the past 12 months. As one investor said, “In a way, it has been a blessing in disguise because it has also allowed the city to work out much of its oversupply problem.”

Nonetheless, the overhang continues to be significant, so valuations are unlikely to rebound until the issues are fully worked out. In the meantime, local developers are “more aggressive and, so, more stressed.” Because they appear willing to borrow money at expensive rates, Mumbai is likely to be a good destination for opportunistic capital looking to leverage against developer stress.

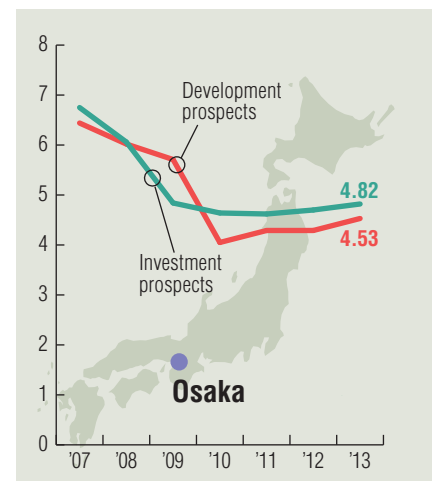
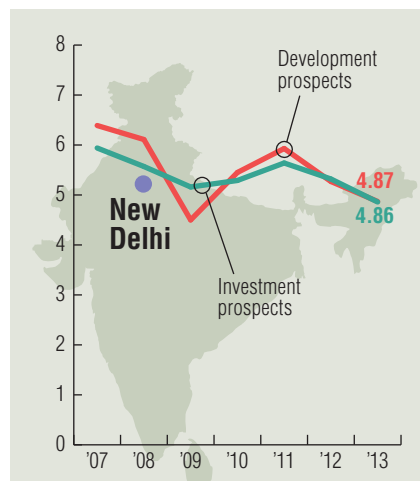
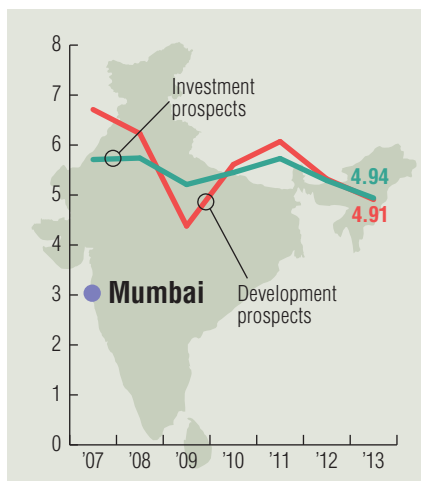
Delhi (21st in investment, 21st in development). Although it lies near the bottom of the *Emerging Trends* rankings, Delhi and the satellite zones of the National Capital Region (NCR) may be set for a comeback, a prospect underlined by the fact that “a lot of Mumbai-based financial investors are now looking at Delhi to invest.” Though Delhi has traditionally been seen as a difficult place to do business—leading foreign real estate capital to invest in western and southern India instead—a series of huge new development projects are about to gather steam.

In particular, the passage of new master development plans for Delhi and the surrounding zones of Gurgaon and Noida will bring to market a huge amount of new land that will be developed for a variety of residential and commercial purposes, leading to a “strong investor, speculator, as well as end user–driven market.” The Delhi master plan alone will see almost 32,000 acres allocated for residential development, with equally large plots nominated for commercial and other

uses. As one interviewee observed, “This will probably become the largest single real estate play across all of Asia.” And because much of the land is also located close to the city center, “your bang for your buck is much better in NCR than in Mumbai,” where most strategically situated land has already been developed.

Osaka (22nd in investment, 22nd in development). Though Osaka was an investment darling in the *Emerging Trends* survey as recently as 2008, its star has fallen in recent years. It currently ranks at the bottom in most survey categories, from investment and development prospects to office buy/sell recommendations. According to one investor, this is because “it has had a lot of Class A [office space] coming to market over the last four years that is still moving through the pipe.” The city still resides at the bottom of investor rankings. Another problem with Osaka—and indeed other Japanese cities outside Tokyo—is that “in smaller regional cities, people aren’t sure where the bottom is [due to uncertain] demand.”

Recently, however, investors are taking a second look at Osaka and other regional cities, partly because the Osaka supply glut is almost over and partly as a result of a general drift in favor of Japan’s second-tier markets as investors seek higher yields. While cap rates for Grade B offices in central Tokyo currently trade at about a 6 percent yield, therefore, the equivalent in Osaka is probably 9 percent,



according to one investor. With rent declines now leveling out, “that’s when buying at a 9 yield is a good proposition. If you can get 65 percent–70 percent LTV debt at 2.5 percent [interest], you’re well into the double digits [on return]. So that deal pencils.”

Property Types in Perspective

Industrial/Distribution

This space has seen its popularity rise partly because investors are fleeing lower-yielding assets for higher returns, and partly because of a general re-rating of the sector. In addition, “It’s because there’s a structural shortage of good-quality logistics. There’s been a lot of rejigging of logistics networks in Japan following the earthquake. China logistics is another market a lot of people are more interested in.”

Industrial and logistics facilities were the only asset class in Asia to see an increase in sales activity in the third quarter of 2012, according to DTZ, with transactions rising 15 percent quarter-on-quarter. Australia, China, Hong Kong, and South Korea all saw 50 percent increases quarter-on-quarter.

Best bets: China’s secondary cities are top-ranked in the survey’s buy/sell ratings for Asian industrial/distribution projects, with almost 50 percent of those surveyed recommending acquisitions there. This no doubt reflects the need for improved logistics facilities in China’s western provinces as factories migrate increasingly away from established manufacturing sites. Jakarta, Shanghai, Kuala Lumpur, and Ho Chi Minh City round out the top five. Apart from Shanghai, these are all cities with emerging economies in an early stage of industrial development. By contrast, the ranking of Osaka at the bottom in this category was perhaps surprising given current plans to develop new logistics facilities in Osaka Bay, as well as news of a number of major logistics deals completed recently in Japan, some of which included properties in Osaka.

Residential

For-sale residential space dropped steeply in this year’s survey to last place from last year’s number-two spot due to ongoing issues across several Asian markets. In China, the government’s ongoing crackdown in the residential sector is targeted at reducing home prices, as well as the risk of a flood of nonperforming loans appearing in the banking sector. In several other jurisdictions—Hong Kong, Singapore, Taiwan, Indonesia, and Malaysia—governments have also introduced regulations aimed at preventing further home price increases caused by an influx of capital into the sector in response to inflationary pressures.

In the long run, however, fundamental demand for housing remains strong across all markets. Besides, sentiment among interviewees was not necessarily downbeat, with many continuing to look at the residential sector as a preferred play. “We love the format because it self-liquidates,” said one fund manager, allowing easy exits in markets where this can sometimes be problematic. In China, residential assets are also seen as a popular option because it is a likely source of distress among cash-strapped developers. Some opportunistic investments have already been made and others will probably emerge, depending on how government policy pans out over the next 12 months.

Best bets: Focus on markets near the bottom of the cycle (Tokyo) or on less-developed markets (Jakarta, Manila, Kuala Lumpur). Otherwise, distressed plays (China) hold promise for opportunistic investors.

Office

Interest in office assets remains muted again this year, the sector registering third in the survey after a fourth-place finish in the 2012 report. This lukewarm response does not indicate lack of interest in the sector—which actually remains very strong—as much as a lack of suitable buying opportunities. The views of one Shanghai-based investor are typical: “If you’re trying to buy an

office building in Shanghai, there are very few decent buildings for sale to start with, and then a relatively larger number of interested buyers, so that tends to drive up the price beyond what investors are willing to pay.”

Best bets: Jakarta is again a favorite buy/sell choice, though very much a niche play, given lack of available stock. Otherwise, Tokyo continues to attract strong interest, reflecting a surge of investors focused on core assets and a general belief that the Japanese market may be nearing a cyclical low. “A lot of people now are getting bullish on the office market and saying it’s bottomed.” Sydney continues to be a strong draw for institutional investors. Otherwise, investors would be happy to buy office assets in any of the big markets if they could find them at the right risk-adjusted returns, which is currently proving very difficult.

Retail

Asia’s strong economic growth means that consumer spending is continuing to increase throughout the region. Nowhere is this more the case than in China, where the rise of the middle class coincides with a change in government economic policy to rebalance towards consumer, rather than infrastructure-led, growth. It is little surprise, then, that in a recent global poll conducted by CBRE, 70 percent of all shopping centers currently under construction throughout the world were found in Asia, with an astonishing 50 percent of those in China alone.

At the same time, however, there are many poorly conceived retail plays in Asia and arguably too many investors targeting the sector. As one investor said, “You just cannot invest in retail because you think that retail shopping centers will benefit from the growing consumption. There are too many factors that are unique to each asset or unique to the developer and investor. So even if the economy is going well, if you don’t do a good job of managing or designing or developing or producing the asset, you will do poorly.”

Best bets: Jakarta again takes the top spot. But while it certainly has growing consumer spending power, this market will prove tough for the average investor to tap. Shanghai and China's secondary cities also feature strongly, again as witness to the rise of the mainland consumer and a government policy favoring consumer-led economic growth over the old model relying on infrastructure construction.

Hotel

Ongoing growth in tourism both from within Asia and elsewhere continues to create strong demand for hotels. The biggest pool of tourists is from China, and mainland tour groups are now ranging much farther afield than their traditional stomping grounds in Hong Kong, Macau, and Thailand.

Indeed, in some markets, such as Vietnam, where economic conditions have stifled growth in other real estate sectors, hotel and tourist plays remain very profitable. In addition, hospitality assets often can prove an easier way to enter emerging markets—such as the Philippines, Indonesia, and Thailand—than the traditional office/residential-type play.

Best bets: Sydney and Melbourne both rank highly in this year's hotel recommendations, reflecting record Australian hotel sales by Asian buyers attracted by rising occupancy and room rates from both the business and tourism sectors. Unsurprisingly, countries with tropical climates and good beaches—Vietnam, Thailand, and Indonesia—rounded out the top five places.

Interviewees

Abacus Property Group

Rod de Aboitiz
Gavin Lechem

AD Investment Management

Kenji Kousaka

AEW Asia

David H. Schaefer

AIG Global Real Estate

Trey Freeman

AIP Japan Co., Ltd.

Barry Hirschfeld

Altis Property Partners

Alastair Wright

Angelo, Gordon International

Jon Tanaka

Aoyama Realty Advisors

Haruyuki Shinya

Ascendas Pte. Ltd.

Jonathan Yap

Asian Development Bank

Alessandro Pio

Aviva Investors

Matthew Woodman

AXA Real Estate Investment Managers Japan

Tetsuya Karasawa
Takahiro Tokunaga

Baring Private Equity Asia

Mark Fogle

BEI Capital

Collin Lau

The Blackstone Group Japan

Akira Kosugi

Brookfield Multiplex

Kurt Wilkinson

Cache Logistics Trust

Dan Cerf

Canada Pension Plan Investment Board

Guy Fulton

Capitaland Limited

Boaz Boon
Lim Ming Yan

CBRE

Nick Axford
Chris Brooke
Stephen McNabb

CBRE Global Investors

Richard T.G. Price

CBRE Global Investors Japan

Tetsuya Fujita

Century Bridge Capital

Thomas R. Delatour

CFS Global Asset Management

Charles Moore
Michael Gorman

Challenger Financial Services Group

Trent Alston

Charter Hall

David Harrison

Chongbang Group

Henry Cheng

CLSA

Wayne Spice

Colliers International

Piers Brunner
Alan Liu

Deutsche Bank

Hugh McDonald

Dexus

Ross DuVernet

Diamond Realty Management

Takashi Tsuji

Eureka Funds Management

Bob Kelly

Far East Organisation

Philip Ng Chee Tat

Folkestone Group

Adrian Harrington

Forum Partners

Andrew Faulk

Franklin Templeton

Glenn Uren

Fukuoka Realty

Etsuo Matsuyuki

GE Capital Real Estate

Simon MacDonald
Francois Trausch

GenReal Property Advisers

Anckur Srivastava

GIC Real Estate Pte. Ltd.

David Dickinson

Goldman Sachs & Partners Australia Pty. Ltd.

Alexi Antolovich

Goodman Group

Anthony Rozic

The GPT Group

Mark Fookes

Grosvenor

Yu Yang

Grosvenor Japan

Koshiro Hiroi

Halifax Asset Management

Alec Menikoff

Henderson Global Investors (Singapore) Limited

Chris Reilly

Hines

Michael Purefoy

Hong Kong Land

Raymond Chow
Cosimo Jencks

HSBC

Jason Kern

Huhan Advisory

Ken Rhee

Industry Superannuation Property Trust

Rob Pepicelli

Invesco Global Real Estate Asia Pacific

Ryukichi Nakata

Investa Property Group

Scott MacDonald

Ivanhoe Cambridge

Richard Vogel

Jones Lang LaSalle

Graham Coutts
Christopher Fossick

J.P. Morgan

Craig Smith

J.P. Morgan Investment Management

Tyler E. Goodwin

J.P. Morgan Securities (Asia Pacific)

Bryan Southergill

K&L Gates LLP

Amy Sommers

Kenedix Realty Inc.

Taisuke Miyajima

Knight Frank

Colin Fitzgerald

LaSalle Investment Management

Yasuo Nakashima
Mark N. Gabbay

Lend Lease

Mark Menhinnitt

LUCRF Super

Duncan Graham

M3 Capital Partners

Daniel Krefman

Macquarie Bank

Antony Green

Mercer

Padraig Brown

Merrill Lynch Japan Securities

James J. Haines

MGPA

Christopher Andrews
Connie Peng

MGPA Japan

Shigeaki Shigemasa

Mirvac Group

Stephen Gould

Mitsubishi Corp.–UBS Realty

Takuya Kuga

Mitsubishi Jisho Investment Advisors

Tetsuji Arimori

Mitsui Fudosan Investment Advisors

Akira Ikeda

Moelis & Co.Julian Biggins
Ben Wong**Morgan Stanley**

Paul Snushall

Morgan Stanley Real Estate

Hoke Slaughter

Mori Building Co., Ltd.

Hiroo Mori

The Net Group

Charlie Rufino

Nippon ResCap Investors

Ken Fridley

Oaktree Japan

Toshi J. Kuroda

Orion Partners

Steve Bass

PamfleetDougie Chrichton
Andrew Moore**Payce Consolidated**

Brian Bailison

Pramerica Real Estate Investors

Henry Chin

Professional Property Services Group

Nicholas Brooke

Prologis

Hamid R. Moghadam

Property Council of Australia

Peter Verwer

Prudential Property Investment Management Private Limited

Erle Spratt

RREEF Real EstateLeslie Chua
Koichiro Obu
Kurt W. Roeloffs**Sabana Shari'ah Compliant Real Estate Investment Trust**

Kevin Xayaraj Tay

Savills Japan

Christian Mancini

Secured Capital Investment Management

Naoya Nakata

SilkRoad Property Partners

Peter Wittendorp

SIMCO

Neil Matthews

SM Prime Holdings

Hans Sy

Standard Chartered BankBrian Chinappi
Mark Ebbinghaus**Starr International**

Alison Cooke

Stockland Group

John Schroder

Sumitomo Corporation

Yukimune Hanamura

Sumitomo Mitsui Trust Real Estate Investment ManagementMitsuo Kimura
Takeshi Fujita**Telstra Super**

Greg Lee

Tokio Marine Property Investment Management

Masashi Hirano

Tokyu Land Capital Management

Hitoshi Maehara

Tokyu Real Estate Investment Management

Masahiro Horie

Touchstone Capital Management

Fred Uruma

UBS

Grant McCasker

Valad Property GroupJennifer Lambert
Nic Lyons**VFMC**

Pete King

Westmont Japan Investments

Naritoshi Minami

Wyndham Hotels

Regina Wu

Sponsoring Organizations



PwC real estate practice assists real estate investment advisers, real estate investment trusts, public and private real estate investors, corporations, and real estate management funds in developing real estate strategies; evaluating acquisitions and dispositions; and appraising and valuing real estate. Its global network of dedicated real estate professionals enables it to assemble for its clients the most qualified and appropriate team of specialists in the areas of capital markets, systems analysis and implementation, research, accounting, and tax.

Global Real Estate Leadership Team

Kees Hage

Global Real Estate Leader
Luxembourg, Luxembourg

Uwe Stoschek

Global Real Estate Tax Leader
European, Middle East & Africa Real Estate Leader
Berlin, Germany

R. Byron Carlock Jr.

National Real Estate Practice Leader
Dallas, Texas, U.S.A.

Mitchell M. Roschelle

National Real Estate Advisory Practice Leader
New York, New York, U.S.A.

Timothy Conlon

National Real Estate Assurance Leader
New York, New York, U.S.A.

Paul Ryan

National Real Estate Tax Leader
New York, New York, U.S.A.

K.K. So

Asia Pacific Real Estate Tax Leader
Hong Kong, China

www.pwc.com



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

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

Established in 1936, the Institute today has nearly 30,000 members worldwide, representing the entire spectrum of the land use and development disciplines. ULI relies heavily on the experience of its members. It is through member involvement and information resources that ULI has been able to set standards of excellence in development practice. The Institute has long been recognized as one of the world's most respected and widely quoted sources of objective information on urban planning, growth, and development.

Patrick L. Phillips

Chief Executive Officer, Urban Land Institute

ULI Center for Capital Markets and Real Estate

Dean Schwanke

Senior Vice President and Executive Director
www.uli.org/capitalmarketscenter

ULI Asia Pacific

John Fitzgerald

Senior Vice President and Executive Director
www.uli.org/asia

Urban Land Institute
1025 Thomas Jefferson Street, NW
Suite 500 West
Washington, DC 20007
202-624-7000
www.uli.org

Emerging Trends in Real Estate®

Asia Pacific 2013

What are the best bets for investment and development in 2013? Based on personal interviews with and surveys from more than 400 of the most influential leaders in the real estate industry, this forecast will give you a heads-up on where to invest, which sectors and markets offer the best prospects, and trends in the capital markets that will affect real estate. A joint undertaking of PwC and the Urban Land Institute, this seventh edition of *Emerging Trends Asia Pacific* is the forecast you can count on for no-nonsense, expert insight.

Highlights

- Tells you what to expect and where the best opportunities are.
- Elaborates on trends in the capital markets, including sources and flows of equity and debt capital.
- Indicates which property sectors offer opportunities and which ones to avoid.
- Reports on how the economy and concerns about credit issues are affecting real estate.
- Discusses which metropolitan areas offer the most and least potential.
- Describes the impact of social and political trends on real estate.
- Explains how locational preferences are changing.

ISBN: 978-0-87420-253-3



www.uli.org



www.pwc.com