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**Asia-Pacific
Roundtable
2019**

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Brighter than expected, but cloudy in patches

A benign interest rate outlook has increased investors’ optimism about the Asia-Pacific market while localized stress points may offer opportunities. By Mark Cooper

During the Cold War, a group of atomic scientists began publishing the Doomsday Clock, a representation of how far away the world was from man-made destruction. It was originally set at seven minutes to midnight, but has since been readjusted to between 17 and two minutes to, without quite ticking on to Armageddon.

More than a decade since the global financial crisis, real estate investors are rather like the atomic scientists, moving their counter ever-closer to the top of the market, only to ratchet it back once more. In 2018, there was something of a consensus that the end was nigh for the current cycle, and the Urban Land Institute’s *Emerging Trends in Real Estate Asia-Pacific 2019* report was subtitled ‘Calling the top?’

However, one of the most significant causes of concern in late 2018, the prospect of interest rate rises, appears to have dissipated for now. After raising rates steadily last year, the US Federal Reserve Bank cut

its rates for the third time in 2019 in October. In Asia meanwhile, Australia cut interest rates twice in 2019, while Indonesia, Malaysia and the Philippines have joined the rate cut trend. The People’s Bank of China, which had kept interest rates static since 2015, in November cut the one-year rate at which it lends to banks through its medium-term lending facility from 3.30 percent to 3.25 percent.

This change in the interest rate environment has increased how optimistic Asia-Pacific investors are feeling about the region, according to the participants this year’s annual PERE roundtable held in Hong Kong.

Louise Kavanagh, managing director at London-based manager Nuveen Real Es-

tate, says: “I think we are in an elongated cycle. At the beginning of this year, I would have said we are at a late stage in the cycle. But now, given where monetary policy is, it has elongated the cycle.”

Kavanagh also points to real estate’s relative value for investors allocating capital across asset classes. “It is tougher to achieve risk-adjusted returns and to find investments, but, fundamentally, real estate still makes sense in terms of relative value: equities are volatile and bonds low-yielding. So, we are still seeing capital looking at real estate for stability and income.”

There is also confidence that Asia-Pacific offers a relatively strong proposition compared with North America and Europe. Kevin Colket, founder and chief executive of Hong Kong-headquartered Global Hospitality Investment Group, a private equity real estate firm launched this year and specializing in hospitality, says: “Across the world, it hasn’t been hard for anyone to make money over the last 10 years, especially in the US and Europe, whereas it has been more difficult in Asia-Pacific because the

\$8.15bn
 Raised for Asia-Pacific closed-end real estate funds in the first three quarters of 2019



Yingpei Wang

Chief investment officer, D&J China

Wang has been with D&J since 2014 and is responsible for investments, fund management and capital markets. The company is a developer of Chinese business parks, suburban offices and industrial property, with \$5 billion of assets under management.

John Saunders

Managing director and head of Asia-Pacific, BlackRock Real Estate

Saunders is a 30-year veteran of Asia real estate, joining BlackRock when it acquired MGPA in 2013. The US investment manager has \$23 billion in real assets under management, including \$4 billion in Asia-Pacific.

Chris Chow

Managing director, LaSalle Investment Management

Chow has been with LaSalle since 2012 after working for broker JLL in Greater China. Chicago-headquartered LaSalle has \$9.7 billion of assets under management in Asia-Pacific, out of a global total of \$67.8 billion.

Louise Kavanagh

Managing director, Nuveen Real Estate

Kavanagh joined Nuveen, the investment management arm of US pensions and insurance firm TIAA, two years ago from Invesco Real Estate. Nuveen has \$130 billion of real estate assets under management worldwide and \$3.6 billion in Asia-Pacific.

Kevin Colket

Founder and chief executive, Global Hospitality Investment Group

Colket founded hospitality private equity company GHIG in January 2019 after 20 years in real estate and hospitality, most recently at Starwood Capital, where he worked on \$5 billion of hotel deals.



“The trade war has impacted China real estate, but the real impact has come from a lack of RMB liquidity”

YINGPEI WANG
D&J China

“Asia is one of the few regions in the world where most countries still have additional room to lower interest rates if needed”

KEVIN COLKET
Global Hospitality Investment Group



markets are less homogenous here. However, achieving solid risk-adjusted returns will become increasingly difficult in the US and Europe given where we are in the cycle, and Asia is starting to look increasingly attractive given its leading long-term demand growth fundamentals.”

John Saunders, managing director and head of Asia-Pacific at New York-based manager BlackRock Real Estate, cites Asia’s heterogeneity as a strength. “One of the great things about running a Pan-Asian fund is that Asia is not homogenous and the individual economies are working to different speeds. I think it feels like a time in the cycle where there is still money to be made.

“China to a degree, and Hong Kong to a much greater degree, are slowing down. But other parts of Asia, for example Singapore, are still going through a late stage recovery. So, there are always opportunities, if you look for them.”

Chris Chow, managing director at Chicago-based manager LaSalle Investment Management, concurs. “If you just consider real estate in Japan for example: logistics, multifamily, office and retail: they are all in different cycles. This can be true even within a single sector; for example, logistics in Tokyo is in a different landscape to logistics in Osaka, partly due to the different demand and supply dynamics.”

Private real estate investors are showing as much interest in those markets that are slowing down as those on the rise. Data from property transactions research firm Real Capital Analytics show a 25 percent year-on-year rise in China transactions to \$5.7 billion in the third quarter as well as a 62 percent rise in Singapore transactions to \$2.6 billion.

The China opportunity

For all the talk about the trade war between US and China, which has seen equity markets move sharply up and down in response to each report of rapprochement or retrenchment, it is not the most significant factor in the China real estate market, says Yingpei Wang, chief investment officer at Shanghai-based business parks and logistics specialist D&J China.

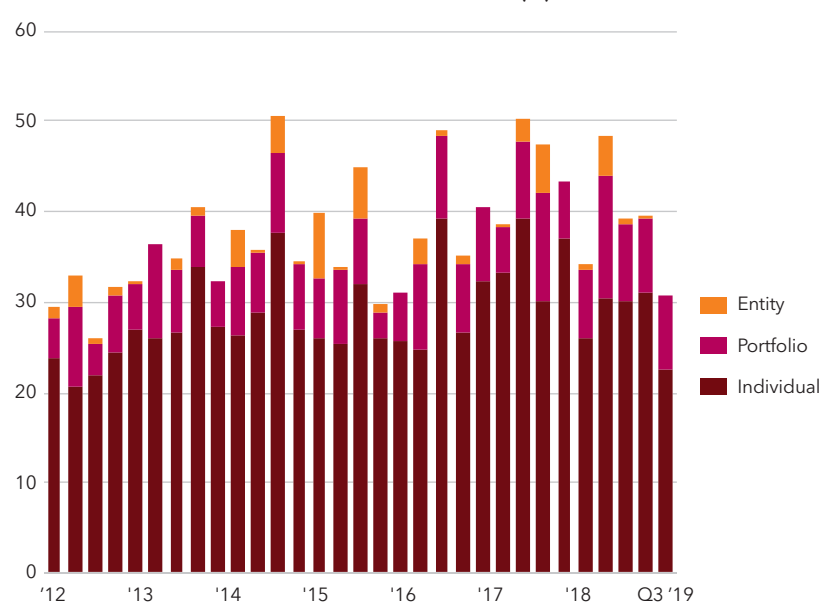
“The trade war has impacted China real estate. But the real impact has come from a lack of renminbi liquidity. So, two years ago, if you were selling a China property, your top five bidders would all be renminbi inves-

tors. Today, for the same asset, those investors would be US dollar investors,” she says.

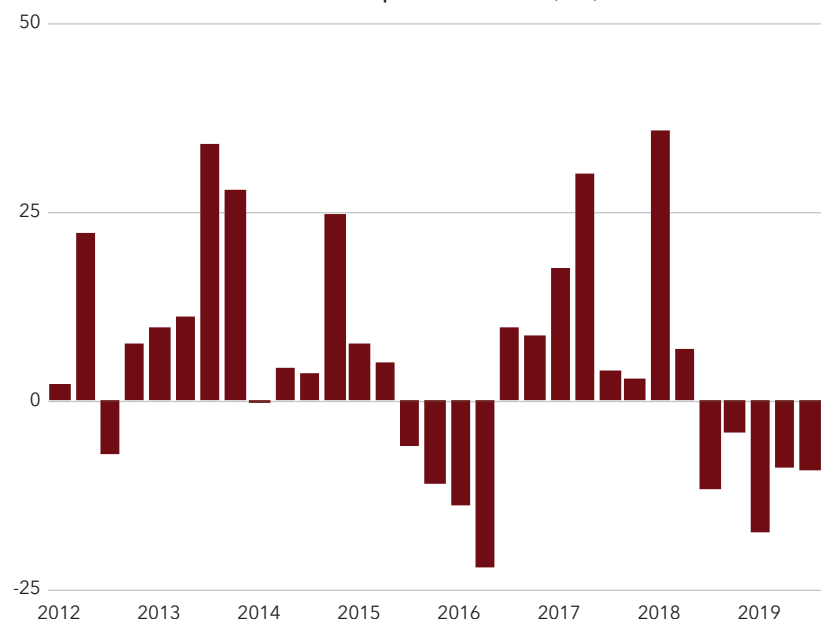
“This lack of renminbi liquidity for real estate stems from the regulators’ intention to cool down the residential sector. However, it inevitably hits all real estate sectors. The banks are highly restricted in terms of lending to the real estate sector, though bank liquidity is adequate.”

At the same time, as Chinese domestic

Asia-Pacific real estate transaction volumes declined in 2019 (%)



Annualized transaction volumes fell for five quarters to Q3 2019 (\$bn)



Source: Real Capital Analytics

“I like Japan multifamily as a sector, because it has resilience across cycles, limited volatility and high occupancy”

LOUISE KAVANAGH
Nuveen Real Estate



buyers are liquidity-constrained, the market is becoming more open to foreign investors. “Compared with five years ago, it is much easier to set up a Wholly Owned Foreign Enterprise (WOFE) structure to invest in China real estate,” says Wang. “There are

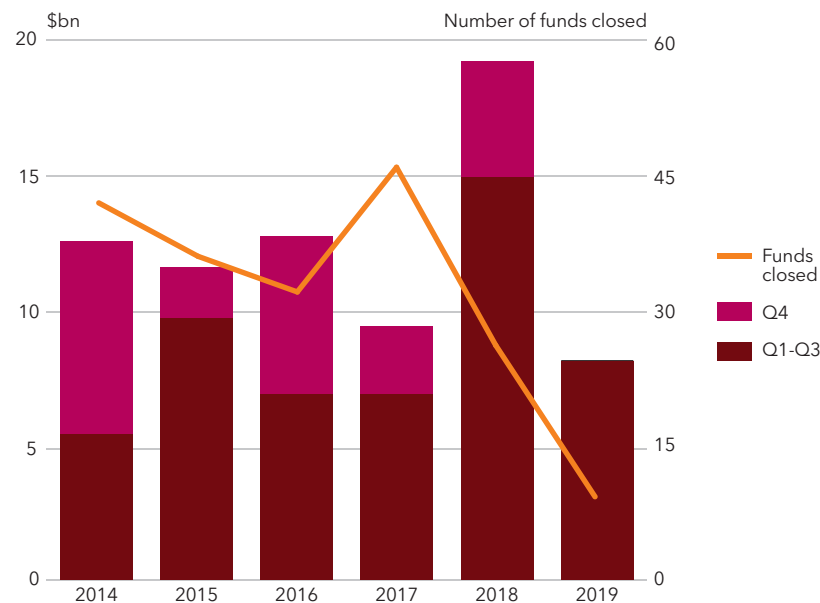
also Qualified Foreign Limited Partnership (QFLP) structures encouraged by certain cities, for example in Shanghai, that are quite flexible in allowing foreign capital to invest in China.”

The investment environment in China has encouraged some of the world’s largest real estate investors to spend substantial sums there this year. In November, Singaporean sovereign fund GIC bought a 50 percent stake in Azia Tower in Beijing from Beijing Capital Land for 3.03 billion yuan (\$433 million; €393 million), while German insurer Allianz, in partnership with Singapore manager Alpha Investment Partners, bought an 85 percent stake in Ronsin Technology Center, a six-tower office complex valued at \$1.1 billion, from D&J China.

“Renminbi liquidity will eventually come back, particularly given many banks have recently set up their own asset management companies,” says Wang. “However, right now it is a good time to invest for foreign players. We haven’t seen substantial cap rate expansion yet, but you can get better assets for the same price.”

RCA’s *Asia-Pacific Capital Trends* report for the second quarter of 2019 showed slight hikes in office transaction yields for Hong Kong, Tokyo and Seoul. However,

2019 capital raising is down on the bumper 2018 total



Source: PERE

Still loving logistics

The growth of e-commerce and a lack of modern space around the region mean logistics is still top of the list for many Asia real estate investors

As it is elsewhere in the world, modern warehousing is still the darling of Asia institutional real estate investors. While transaction volumes might lag the office and retail sectors, it is logistics global investors want to get their hands on.

In developing markets, such as China, logistics real estate performance is driven by increasing consumer spending, especially online spending. In more mature markets, there is little modern warehousing stock.

In November, logistics real estate specialist ESR floated in Hong Kong, raising \$1.6 billion. This strong showing, despite a difficult market due to the ongoing protests in the city, demonstrates the appeal of the sector.

“We still really like logistics,” says Louise Kavanagh of Nuveen Real Estate. “We anticipate the rapid expansion of e-commerce and associated third-party logistics demand in Asia-Pacific, and particularly South Korea, will underpin structural resilience in the sector. Less than 10 percent of Seoul’s logistics properties are considered to have modern specifications.” Nuveen recently bought a Seoul warehouse for its Asia cities fund.

Interest in China logistics is not slowing either, due to the

US-China trade war, nor slower GDP growth, says Yingpei Wang from D&J China. “The trade war has an impact on certain tenants, the automobile industry for example. But in gateway cities such as Shanghai and Beijing there is still a lot of demand from domestic companies and multinationals serving domestic consumption.”

LaSalle Investment Management has already invested significantly in China logistics and the sector is a key focus within the China allocation of its latest \$1.15 billion opportunistic series, says Chow: “The latest Asia opportunity series fund is heavily focused on China logistics development within its China allocation, where we still see attractive returns. It is getting harder and more competitive, but the logistics warehouse demand is still there if you can source and develop the right projects.”

Saunders says: “One of the standout sectors for us is Singapore industrial, given the much higher yields available.” Indeed, Colliers International pegs Singapore industrial yields at 6 percent, compared with 3.7 percent for Hong Kong and 4.2 percent for Beijing.



The Seoul warehouse bought by Nuveen for its Asia cities fund

the *PERE* roundtable agrees there is little evidence of yields moving out in the markets they operate in so far. Kavanagh says: “We track 17 cities across Asia-Pacific, 11 of which we consider principal, and I haven’t seen any expansion of yields in the core key gateway cities.”

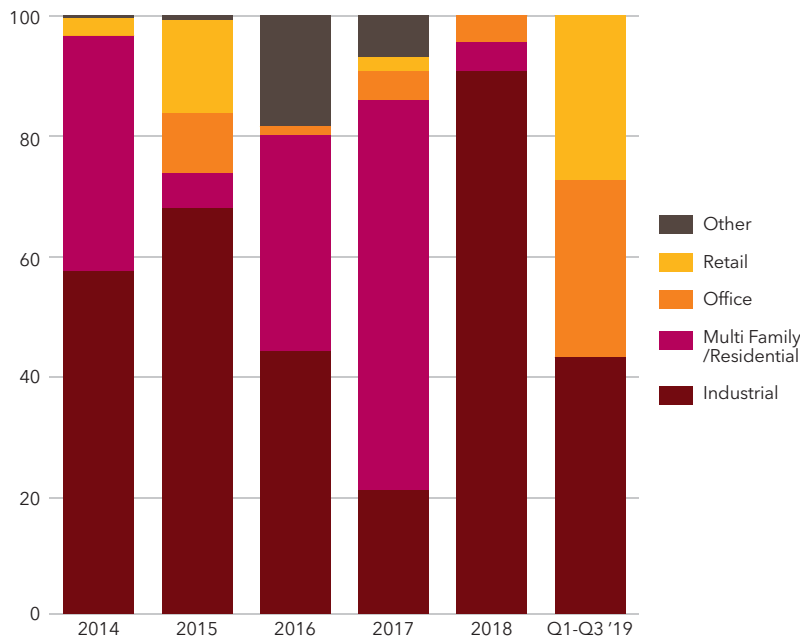
BlackRock’s Saunders adds: “In fact, in some markets I would say there is still yield compression. For example, we have seen phenomenal compression in Japan

since 2012 and even recently there has been compression in Osaka, because office supply there is much tighter than in Tokyo.”

Colket adds: “Asia is one of the few regions in the world where most countries still have additional room to lower interest rates, if needed. Australia has been significantly lowering, China could lower and a lot of emerging Asia has room to go lower as well, all providing the potential for additional cap rate compression.” Nonetheless, data from

Analysis

Industrial is currently the most popular choice for single sector funds (%)



Source: PERE

RCA show that Asia-Pacific commercial real estate transaction volumes have fallen year-on-year for the past five quarters. The question remains whether this is the start of a downturn, or merely a readjustment; for example, volumes fell for four consecutive quarters in 2016 and 2017 but recovered in 2018.

Colket at least is bullish on transaction volumes. “We are confident APAC real estate transaction volumes in 2020 will be up over 2019, as we believe that interest rates will stay low and, in some cases, actually go lower, and the enormous amounts of capital earmarked for real estate from all around the world will increasingly move to Asia-Pacific.”

Japanese hotel distress

He notes the crucial element for distress in real estate is oversupply and identifies the Japanese hospitality sector as an area where localized distress is likely to bring opportunities. “In Japan (especially in the Golden Route markets of Tokyo, Kyoto and Osaka)

The value of scale

Landmark deals across Asia-Pacific in the past 12 months show how global investors are looking to build sizeable exposures

Asia-Pacific is known for large lot sizes and global investors are increasingly looking to build scale in the region, which means more portfolio deals and cementing their position in major assets. China has been a happy hunting ground for global investors this year, with a number of landmark deals.

Singapore’s GIC bought the 50 percent of Azia Tower in Beijing’s Lize district that it did not already own from Beijing Capital Land.

In Japan, German insurer Allianz bought a portfolio of 80 multifamily residential assets from sector heavyweight manager Blackstone for ¥130 billion (\$1.2 billion; €1.08 billion), which Kavanagh cites as one of the most significant deals of the year.

“I like Japan multifamily as a sector, because it has resilience across cycles, limited volatility and high occupancy,” she says. “Multifamily is nascent in Asia-Pacific and, in some markets, there will have to be regulatory changes in addition to more attractive return yields to facilitate its growth as a sector.”

Assembling portfolios is a useful way to add value, says Saunders. “When the recovery started in Japan, you could buy a portfolio wholesale and sell the assets individually at a premium. Now people are so desperate for stock that you can do the reverse and add value by building a portfolio.”

One of the more interesting deals in the past 12 months, has been Link REIT’s sale of a portfolio of 12 neighborhood shopping



GIC bought the 50 percent of Azia Tower in Beijing it did not already own from Beijing Capital Land

malls in Hong Kong to a consortium led by Asian investment manager Gaw Capital for HK\$12 billion (\$1.53 billion; €1.39 billion), says Chow. “People talk about retail as a weaker sector, but there have been some really good investments in retail. If I have to pick one deal unrelated to LaSalle, the Link REIT portfolio is a really interesting deal which shows what you can do with retail, even in Hong Kong, if you understand the assets and can add value through the asset management.”



“The challenge in capital-raising nowadays is that investors are conscious we are late in the cycle”

CHRIS CHOW
LaSalle Investment Management

significant supply has, and will be, developed in the lead up to, and following, the 2020 Olympics.

“While we believe in long-term hotel demand growth in Japan, we think Japanese hotel cap rates are currently 50 to 100 basis points tighter than they should be if properly accounting for the inherent risk in the hotel business.”

One city that is undoubtedly demonstrating distress is here in Hong Kong, which has been paralyzed by an increasingly violent series of protests against the government. This has led to transaction volumes falling 41 percent in the first three quarters of this year, with larger deals above \$100 million most affected.

The hospitality sector has been most dramatically affected, as Chinese visitors have stayed away. In September, China Cinda Asset Management bought the Kimberly Hotel in Tsim Tsa Shui out of receivership for HK\$4.3 billion (\$550 million; €499 million). The hotel had originally been priced at HK\$6 billion.

None of the panelists’ companies are currently invested in Hong Kong. However Kavanagh says: “Despite the recent unrest, Hong Kong will remain one of the most dynamic, vibrant and transparent global real estate markets over the long term. Office rents in Central and other areas are likely

to continue falling, over the near to medium-term. This provides good opportunities for investors looking to diversify their global portfolio and enter the market.”

More demanding

PERE data show \$8.15 billion of capital raised for Asia-Pacific closed-end real estate funds in the first three quarters of this year, down on 2018 – which included the \$7.1 billion Blackstone Real Estate Partners Asia II, the largest property fund in the region’s history – but in line with the four preceding years.

While the panel agrees the appetite for Asia real estate from institutional investors remains strong, investors are also getting pickier. Chow says: “The healthy challenge in capital raising nowadays is that investors are conscious that we are in a late cycle.

“They have become very selective and look through each of our products, to assess how the team performed since the last cycle and their ability to execute and to manage risk. Overall, investors have become more sophisticated and more selective in their approach to Asia.”

Saunders says BlackRock has tempered its approach in view of the longer market cycle. “We are trying to make our returns in more risk averse ways and not doing much development at the moment. Being in the

Analysis

Top 10 Asia-Pacific-focused private real estate funds in market by target size, October 1, 2019

Fund name	Fund manager	Target size (\$bn)	Month open	Year open	Fund strategy
PAG Real Estate Partners II	PAG	2.0	January	2018	Value-add
Secured Capital Real Estate Partners VII	PAG	2.0	June	2019	Opportunistic
Fortress Japan Opportunity IV	Fortress Investment Group	1.3	January	2018	Debt
Logistics Warehousing Fund	China Life Investment Holding Company	1.2	June	2017	Value-add
CapitaLand Asia Partners (CAP I)	CapitaLand	1.0	July	2018	Value-add
Edelweiss Residential Credit Fund	Edelweiss Group	1.0	October	2015	Debt
GreenOak Asia III	BentallGreenOak	1.0	February	2019	Opportunistic
Edelweiss Distressed fund	Edelweiss Group	1.0	August	2016	Debt
Savills IM Asia Fund 3	Savills Investment Management	1.0	July	2016	Core-plus
CBRE Asia Value Partners V	CBRE Global Investors	0.9	July	2019	Value-add
Phoenix Asia Real Estate Investments VI	Phoenix Property Investors	0.9	October	2017	Opportunistic

Source: PERE

“We are trying to make our returns in more risk averse ways. Being in the market contains some risks, so the shorter your timescales the less exposed you are”

JOHN SAUNDERS
BlackRock Real Estate



market contains some risks, so the shorter your timescales the less exposed you are.”

And Nuveen’s Kavanaugh, who manages a regional open-ended fund, says: “There is a continued weight of capital which wants to come into core Asia-Pacific real estate. The structural mega-trends in this part of the world are definitely very attractive as is the income component of returns.”

Global asset management firms will be facing more domestic competition in Asia-Pacific, Wang argues. In China, “there is a lot of capital looking for local operators with good governance, who can be a reliable fiduciary. This is partially because of a better fee structure, but also investors see that local operators can source better assets than a foreign investment manager.”

One area where overseas investors in Asia-Pacific funds still need to change their perception, however, is the region’s risk profile, says Saunders. I think most people expect to come to Asia for growth which is quite right. On the other hand, people are often surprised because they think they have to take on a lot more risk.

“Our research shows that, since the GFC, Asia has historically demonstrated higher returns and lower volatility, compared with the US and Europe. This is partly because Asia was better prepared for the GFC after its horrendous moment in 1997 and since then people were very aware of the perils of over-leverage.” ■

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