Megatrends

Six forces shaping Asian institutional real estate investment

by Benjamin Cole

The old saying in real estate is three factors determine property values: location, location, location.

Certainly, the locale of a parcel remains key, given the vagaries of property zoning and undulations of metropolitan markets. Unlike an equities manager, an institutional property investor needs to see the product and cannot buy or sell with a nose buried in a computer screen.

Yet as capital markets and commerce become globalised, the megatrends enveloping the Asian property scene must be acknowledged — sweeping, market-altering shifts in demographics and environmentalism, for example, or the actions of national governments. For better or worse, politics can make a nation an investable option or an international pariah for money managers of all stripes, including real estate titans.

Certain megatrends will frame the investment environment for Asian property buyers for decades to come. A property investor might outwait a business cycle, but fighting a megatrend could lead to a financial Waterloo.

That being the case, institutional property mavens say they will keep a close eye on Asian megatrends in the following categories: (1) demographics, (2) politics, (3) regional economic growth, (4) business sectors, (5) global macroeconomics and (6) environment.

1 DEMOGRAPHICS

Most investors know the short story: Japan is ageing and has a shrinking population, and China, Singapore, South Korea, Taiwan and Thailand will follow suit, while India, Indonesia and the Philippines still have growing workforces and populations.

For institutional real estate investors, the prospect of declining national populations could translate into vacated towns and lesser demand for housing or other real estate. "However, such decreases could be offset by higher incomes, the desire for better and larger quarters or for investment homes, increased need for lifestyle and experiential retail amenities, medical facilities, and hospitality properties," says Christina Tan, CEO, Keppel Capital and managing director, Alpha Investment Partners.

That being the case, institutional investors must adapt and selectively seek opportunities. In Asia, with an ageing but more prosperous population projected, there will be demand for new and emerging asset classes, such as senior housing, medical or healthcare facilities, as well as wellness resorts.

In addition, large parts of Asia continue to urbanise, creating investable opportunities, says Harry Tan, head of research, Asia Pacific, with TH Real Estate. "Many gateway Asian cities continue to be buoyed by rising urbanisation, positive net migration, and more youthful and productive workforces."

Japan is a case in point. "Tokyo's population grew by close to 1 percent per year from 2001 to 2015, even while the general population stagnated and started to decline in 2011," adds Harry Tan. Yet most of Japan's prefectures are shrinking population-wise, clearly a warning sign for investors who stray from Tokyo.

But also on a positive note, societies and nations can and have adapted to effectively-shrinking civilian work forces before. The artificial labour shortages of World War II, for example, encouraged rising labour participation rates for women and informal labour participation by children. Today, many Asian countries have mandatory retirement ages that appear low by Western standards, such as age 60 for men and age 55 for women in mainland China. Easing up labour standards could free up labour supply.

And while child labour in general may not be palatable, it is likely more teenagers could be brought into the part-time Asian labour force.

On paper, the demographic projections of an older, greyer and smaller Asia, naturally more dependent than productive, can be unsettling. But by increasing labour participation rates of certain groups, and increasing the use of robotics and other labour-enhancing devices, the Asian demographic outlook need not hinder economic growth and property values.

Indeed, the incomes of Asians may rise so much that institutional buyers will find increased competition from wealthy individuals for property, says Benett Theseira, managing director and head of Asia Pacific for PGIM Real Estate. "High-net-worth investors will be a factor in the regional landscape, providing both capital for real estate investment and growth and, at the same time, increased competition for quality assets," he predicts.

2 POLITICS

Every nation is a mix of negatives and positives for real estate buyers, who, as long-term investors, must heed the powers that be in capital cities. A publicly-traded stock can be sold with the click of a mouse; a multi-use development not so easily, while a redevelopment parcel might require overt political cooperation, not mere tolerance.

Perhaps of surprise to Westerners, Vietnam is being perceived as more investable. "The nation of Vietnam stands out in terms of political stability and drive to restructure and reform its economy…. GDP growth is expected to remain healthy and will continue to attract significant inflows of foreign direct investments," says Christina Tan. Moreover, Vietnam has young demographics, ongoing urbanisation and a drive toward industrialisation, she adds.

Often noted, Vietnam seeks both political and economic alliances to counterbalance the behemoth to its contiguous north, China.

In addition, the fact global corporations view Vietnam as a "cost-effective alternative to China for manufacturing activities" is helping Vietnam experience "an economic revival, which creates demand for all subsectors of real estate," says Marc-André Flageole, portfolio manager, Presima.

Meanwhile, the Sino giant remains a puzzle, with increasing political rigidity married to a steadily-growing economy, though one constantly criticised by Westerners for excessive, yet nontransparent, debt and too-heavy government involvement. Recent geopolitical tensions add to the brew. "Escalating conflict in the South China Sea — between China and Japan and China and the Philippines — could evolve into a worrisome scenario," suggests Harry Tan.

Still, most Asian institutional real estate professionals include China's major cities when planning their portfolios, given the urbanising population and increasingly-sophisticated business scene — indeed, the Chinese model of force-feeding money into scientific development may yield dividends for some investors.

"If projections like those made by the Battelle Memorial Institute are correct, China will substantially overtake the US and Europe in R&D spending over the next decade," remarks Dr David Rees, regional director and head of research for JLL in Australia. Similarly, investment opportunities in R&D hubs in China should outpace those in the United States and Europe. These Silicon Valley–type business constellations will include not only advanced-warehouse parks, but also related — if prosaic — real estate plays, such as offices for marketing departments, housing, or ground-floor retail services.

On a more conventional note, institutional property investors said they still highlight major gateway cities — such as Hong Kong, Singapore, Sydney and Tokyo — for good governance and, being positively-positioned, are expected to grow in value as Asia itself becomes more prosperous. Even famously-expensive Singapore draws praise. The city-state may be world class in property costs, yet "at the same time, Singapore has a low-tax regime, highly-efficient bureaucracy, and is one of the most competitive and business-friendly economies in the world," says Harry Tan.

Indeed, Singapore's famous rents may have adjusted down to a level spurring a positive long-term outlook, explains Theseira of PGIM Real Estate. "With grade A office rents at 30 to 40 percent below the pre–global financial crisis peak … Singapore is now broadly affordable to tenants across sectors," he asserts.

No other continent offers such a vast range of political cultures, business opportunities and risks as Asia, from steady Japan to progressive, pro-business Singapore, from the colourful Philippines to the giant and often-opaque China. No doubt Asian property investors will run their spreadsheets and position their properties, but they must also keep one eye on events in Beijing, Manila, Mumbai and the Korean Peninsula.

3 REGIONAL ECONOMIC GROWTH

Despite political and global concerns, the emerging "Asian economies, such as China, India and Vietnam, are set to grow at a faster pace than developed countries such as Japan, South Korea and Singapore, given their higher propensities to invest and consume," notes Harry Tan.

As mentioned, demographics play a key role. "It's hard not to see countries with large, but young, populations as potentially high-growth, such as the Philippines and Indonesia. India is also a candidate for strong growth, provided deregulation policies are maintained," says Rees of JLL.

In general, institutional property investors say they seek core properties in established gateway cities but look for edgier and possibly more-lucrative opportunities in China, India and Vietnam.

The good news is no nation in Asia is expected to enter into economic decline, although institutional real estate professionals are keeping close eyes on the outcome of Abenomics — a mix of monetary and fiscal stimulus, with deregulation — in Japan, and national economic policies in mainland China. Chronic missteps in either nation could result in economic fizzles, say experts, with attendant results for real estate owners.

4 BUSINESS SECTORS

As Asia ages, modernises, urbanises and climbs up the income ladder, different business sectors will emerge and prosper, creating corresponding opportunities in institutional real estate.

Many point to tourism as an obvious beneficiary of demographics and income trends, and already Chinese tourists are flooding regional travel markets. The numbers of annual overseas Chinese tourists is expected to grow to 220 million in 10 years from 120 million today, reports Goldman Sachs.

Perhaps surprisingly, office buildings may also benefit from the greying trends. "The evidence is that cities with older populations also have larger and more-expensive office stock, and that is consistent with rising wealth and rising demand for financial and social services," says JLL's Rees. The idea of a Wall Street — a financial district but with a healthy component of space devoted to retail investors — may be replicated on ever-grander scales in Asia.

In manufacturing, Japan is already eyeing offshore production (another answer to demographic imperatives), which could lead to profitable industrial-warehouse plays in Southeast Asian nations. Recently, Japan indicated plans to train up to 30,000 workers in ASEAN nations to higher skill levels.

And while the usual association of modernity is for relatively-more services, the advent of e-commerce may result in shipping booms and the need for extensive and advanced logistics facilities and data centres.

"The growth in e-commerce is just one example of data centre demand," notes Christina Tan. "With other burgeoning business trends like big data analytics, artificial intelligence, financial technology and data centre outsourcing, digital information will experience exponential growth and enterprises will require more quality data centres to seamlessly support financial operations, cloud computing, and data storage and processing."

But do not overlook the obvious, says Theseira: "Retail will benefit from rising wealth and tourism."

Investors should note, though, "malls not transforming into lifestyle centres — as opposed to pure shopping destinations — are likely to struggle, as younger generations tend to spend more on experiences and less on durable goods," adds Presima's Flageole.

In sum, tourism, infrastructure and logistics, senior and health facilities, R&D parks, and even office and retail assets make up some of the enticing property prospects in a more-prosperous Asia.

And, even now, residential property values are soaring in parts of China, as seen by 20 percent or greater house-price jumps in many

Sino cities in the past year. Major Asian cities have become famous for housing prices and, as incomes rise, that trend looks likely to continue.

5 GLOBAL ECONOMICS

With increasingly-globalised capital markets, a sniffle in Hong Kong can cause a sneeze in Europe and a cold in the United States, and vice versa.

A recent example: The proposed US government fine of US$14 billion on the German lender Deutsche Bank sent Asian stock markets down for days on the prospects the bank would lack capital, while dark rumours swirled of jammed derivatives markets and hedge funds abandoning the Teutonic financial ship. Indeed, the Lehman Bros meltdown of 2008 and the Long-Term Capital Management fiasco of 1998 remain haunting milestones in global capital markets.

Moreover, since the 2008 global financial crisis, the world's economy has been lacklustre, with both global inflation and interest rates trending toward zero, if not lower.

The megatrend outlook is generally for more of the same, although the low interest rates, per se, are hardly a bad thing for institutional property, according to experts.

Indeed, "the current low-rate environment, combined with limited inflation and limited economic growth, seems like a Goldilocks story for real estate — not too cold, not too hot, but just right," says Vincent Felteau, portfolio manager at Presima.

Many conclude the persistence of low interest rates and bond yields has led to the hunt for returns outside the passive ownership of securities, and so tends to benefit property. "Investors have started to increase allocations to alternative investments, such as real estate and infrastructure, in pursuit of yields," observes Koichiro Obu, head of research and strategy, Asia Pacific, with Deutsche Asset Management.

Others say inflation and interest rates have been falling for decades, a secular trend that has boosted bond values but is likely to bottom out, if only because private-sector issuers probably cannot issue negative-rate bonds. "It's not surprising, therefore, that many investors are now looking to diversify into other asset classes, such as infrastructure and real estate," says Rees of JLL.

In general, say Rees and others, investors and economists are looking at a sustained global outlook of low interest rates and inflation, and so-so economic growth.

Christina Tan remains optimistic, though, that Asia's above-average growth and macro trends, such as urbanisation and rising consumerism, will underpin fundamental real estate demand over the medium to long term.

6 ENVIRONMENTALISM

Oft noted is the penchant of nations to heavily pollute the environment in the rush to prosperity, and then seek remediation after incomes rise.

Perhaps thanks to leads taken in North America and Europe, Asia is already embracing sustainable, or green, development. For property investors, this may translate into building or retrofitting structures to consume fewer resources, or the construction or purchase of assets near mass-transit stops, among other considerations.

But perhaps more important, institutional property investing may soon require a calculus on the liveability of a region surrounding an asset.

Some property mavens even surmise metropolitan prosperity may become somewhat connected to the quality of the environment — as nations grow richer, residents actively will migrate *away* from polluted cities. "Probably a large proportion of the capital outflows from China toward Vancouver, Sydney, New York or San Francisco is driven by desire to live and raise families in places where air quality is good," says Felteau.

In addition, property investors or managers may find opportunities in working with Asian governments to create green developments.

Keppel Capital's Christina Tan notes her parent company, Keppel Corp, is leading the Singapore consortium overseeing the design and construction of the Sino-Singapore Tianjin Eco-City, a planned 350,000-resident metropolis near Singapore that is expected to become a model for sustainable development across China.

Property developers and owners who can present green credentials to Asian governments likely will have a leg up in the future, and capital may soon be loathe to align with real estate projects not seen as sustainable, in Asia and around the world.

Building potential

With selective adaptation to demographic realities, these megatrends, in general, favour Asian institutional property investing in the years and decades ahead. Asia should become more prosperous, and business is likely to concentrate in growing urban centres.

Political uncertainties remain in the region, along with the potential for failure of Japan's Abenomics or China's economic reforms. And a rising tide of environmentalism may cramp the freewheeling development schemes of yesteryear, introducing new costs.

But where some see risk, others see opportunity. In the future, Asian institutional real estate likely will offer much of both. ❖

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