

March 2009

Asia Pacific Real Estate Investment Update

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Introduction

The “financial tsunami” that originated from subprime lending in developed countries has since continued to rage across the world. Asian countries, which enjoyed an economic boom in recent years partly due to strong demand for their exports, recently started to see their export values plunging at an unprecedented rate as industrial production recorded a significant slowdown. Many Asian markets therefore posted GDP declines on a quarter-on-quarter annualised basis in 4Q2008.

Rents in the office market continued their sluggish performance in 4Q2008, particularly in financial centres such as Hong Kong, Singapore, Shanghai, Mumbai and Sydney where rents tumbled at double-digit rates. Capital values were also under severe pressure as risk aversion prevailed among investors amid tightened capital markets.

Meanwhile, the investment market remained quiet in 4Q2008, with investor confidence weak, the economic outlook bleak and financing scarce. Investment volumes plummeted by 56% quarter-on-quarter to only USD\$4.2 billion in 4Q2008, bringing the total for 2008 down by 40.0% over 2007.

The expectation of weak external demand, scarce liquidity, and diminished trade flows will continue to weigh on industrial production. Employment markets are therefore expected to shrink, with domestic consumption negatively affected. Consensus suggests that the Chinese and Indian economies will continue to grow, albeit at a much slower rate in 2009 before re-accelerating in 2010. The market, however, is expecting the Japanese and Singaporean economies to fall into deep recession in 2009, shrinking as much as 7.6% and 6.0%, respectively. Real GDP growth rates for Hong Kong and South Korea are also expected to continue their downward trend at around -3% in 2009.

Economists, however, are expecting a recovery in 2010, supported by a resumption of growth in the developed economies. The risk, to these forecasts however, seem to remain on the downside unless the health of the financial system is restored. It is within this context that this paper provides a timely review of the capital market and real estate performance in this region and complements the semi-annual Asia Pacific Property Cycle Monitor report that focuses on the outlook of real estate markets.

Prepared By:

Edward Huong
+852 2203 7993
Edward.huong@rreef.com

Koichiro Obu
+81 3 5156 6522
yenkeng.tan@rreef.com

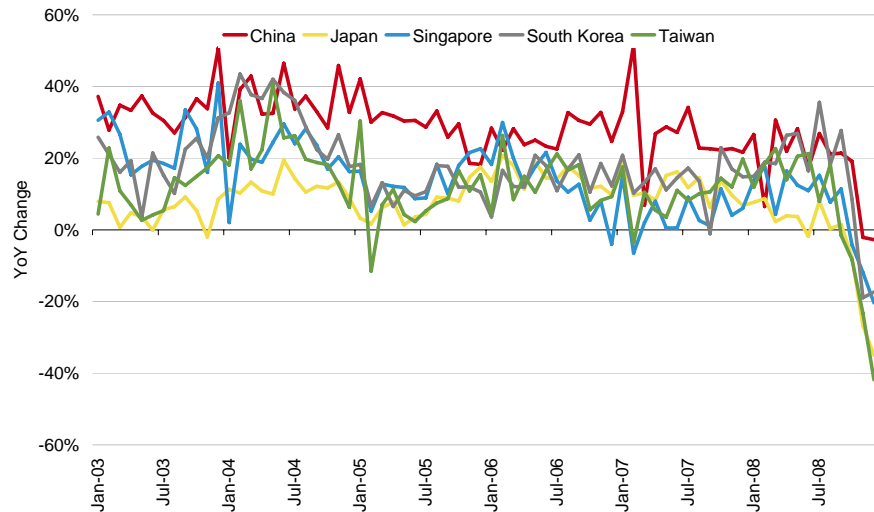
Tan Yen Keng
+852 2203 8062
yenkeng.tan@rreef.com

Economic Performance

The “financial tsunami” that originated from subprime lending in developed countries has since continued to rage across the world. The collapse of renowned financial institutions in developed economies fuelled investor sentiment to become more negative. The government bailout of troubled financial institutions has also raised concerns among investors for “capital protectionism”.

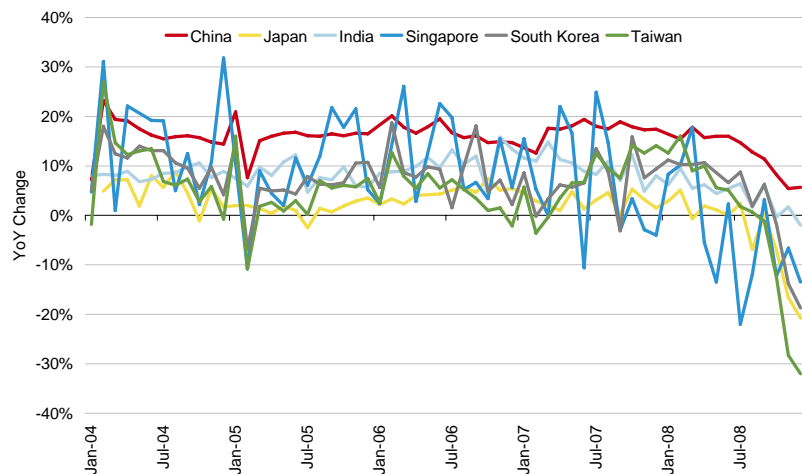
Asian countries, which enjoyed an economic boom in recent years partly due to strong demand for their exports in developed economies, recently started to see their export values plunging at an unprecedented rate. The financial turmoil has brought the global economy to “re-couple” as weakened demand from developed economies evolved into a plunge of industrial production, through the binds of international trade. Many Asian markets therefore posted GDP declines on a quarter-on-quarter annualised basis in 4Q2008.

Figure 1: Export growth of Asian countries



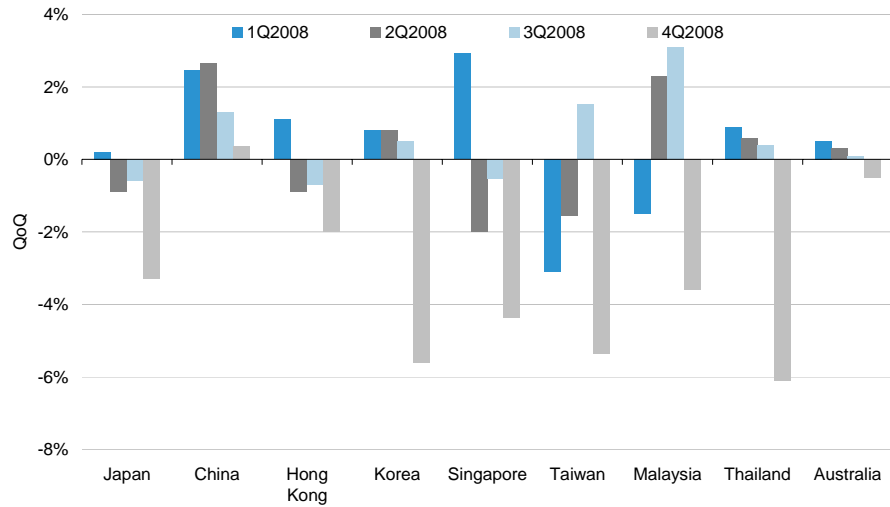
Source: Bloomberg, 3 March 2009

Figure 2: Industrial production growth of Asian countries



Source: Bloomberg, 3 March 2009

Figure 3: GDP growth of Asian countries

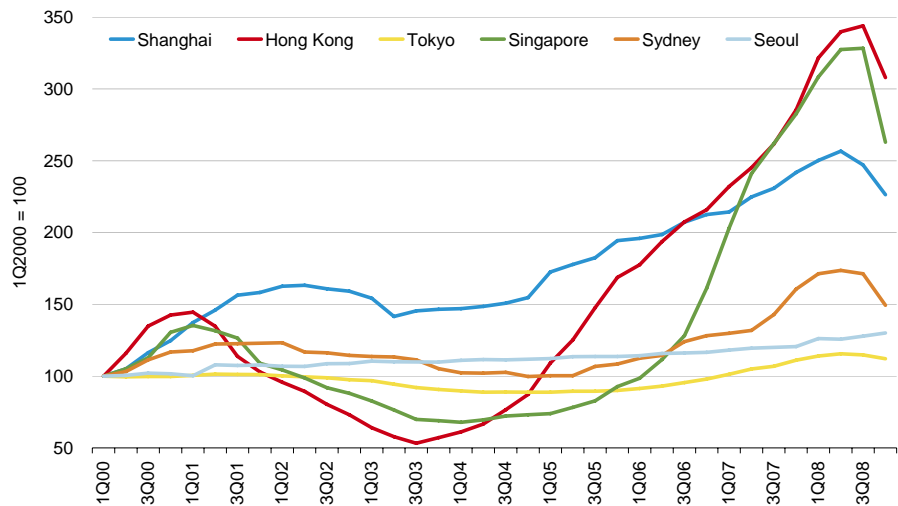


Source: Bloomberg, 3 March 2009; Deutsche Bank Global Markets

Real Estate Market Performance

Slow performance in office rents extended into 4Q2008, particularly in the financial centres such as Hong Kong, Singapore, Shanghai, Mumbai and Sydney, where rents tumbled at double-digit rates.

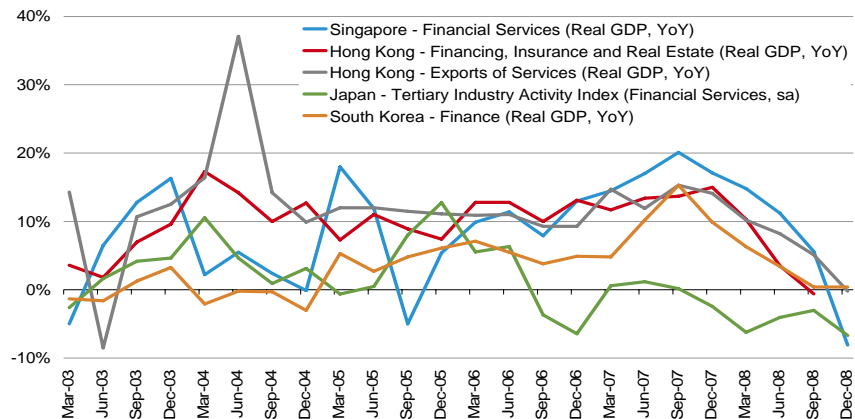
Figure 4: Office rental growth in selected Asian markets



Source: JLL REIS; Miki Shoji, RREEF Research

Business activities weakened substantially in the region as the global turmoil hit the financial sector. Transactions in capital markets dried up and fundraising activities grounded to a halt. Real output of financial services in Singapore turned sharply downward and recorded their first year-on-year decline in 4Q2008 since 3Q2005. In Hong Kong, exports of services, which moves hand-in-hand with real output of the finance-related industries, also recorded their first year-on-year decline since the SARS period in 2003. Real output of the financial industry in South Korea was flat compared with that of the same period in the previous year, while financial activities in Japan remained lacklustre in the last quarter of 2008.

Figure 5: Financial services sectoral GDP growth in Asian markets



Note 1: Real GDP growth of the Financing, Insurance and Real Estate sector in 4Q2008 in Hong Kong had not been announced as of the date of publication. Therefore, real GDP growth of Exports of Services in Hong Kong is included to serve as a proxy.

Note 2: The Tertiary Industry Activity Index in Japan is included as a proxy of the GDP. Change of the index is in nominal terms.

Source: Bloomberg, 3 March 2009

Slower growth, or even negative growth in business activities, has curtailed demand in key office markets, prompting tenants to either put their expansion plans on hold or scale back their operations. Surrendering leased office space back to landlords has been reported in markets such as Hong Kong. Most of the office markets have now changed to a "tenant market" where owners place priority on tenant retention. Hong Kong, Singapore, Seoul and Sydney all registered negative take-up in 4Q2008. Absorption in Tokyo market was minimal, leaving only the Chinese markets (Beijing, Shanghai and Guangzhou), the Indian markets (Mumbai, Delhi, Chennai and Bangalore) and Melbourne to post positive take-up in 4Q2008.

Figure 6: Office rent and capital value movements since peak

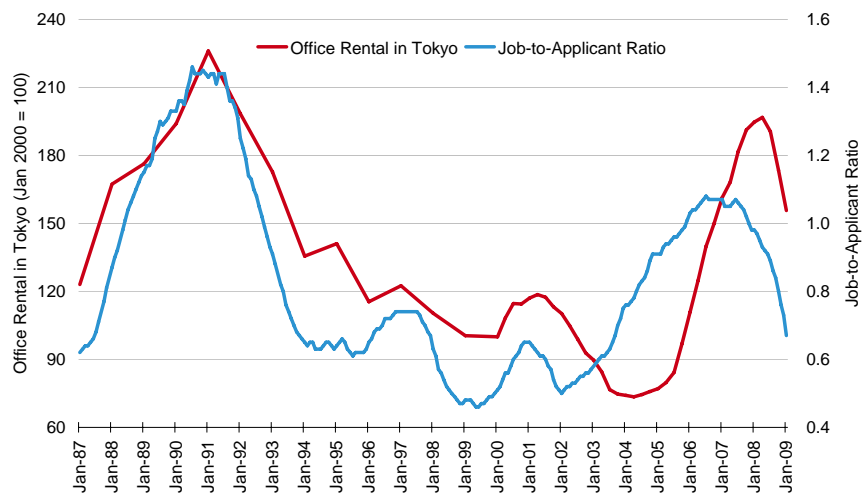
Office Market	Rents		Capital Values	
	Quarter of Peak	Decline since Peak	Quarter of Peak	Decline since Peak
Tokyo	2Q2008	3%	4Q2007	11%
Seoul	n/a	n/a	3Q2008	13%
Beijing	2Q2008	5%	3Q2008	2%
Shanghai	2Q2008	12%	2Q2008	18%
Hong Kong	3Q2008	11%	2Q2008	20%
Singapore	3Q2008	20%	2Q2008	14%
Mumbai	2Q2008	11%	2Q2008	17%
Delhi	3Q2007	16%	3Q2007	22%
Sydney	2Q2008	14%	4Q2007	10%

Source: JLL REIS, Miki Shoji, RREEF Research

With rents in the Hong Kong and Singapore office markets are now experiencing negative quarter-on-quarter growth, the Seoul and Kuala Lumpur office markets remain the exceptions in the Asia Pacific region, having yet to enter their contraction cycles. Rents in the contracting office markets have so far corrected by a range of 3% to 20% from their respective peaks. At the same time, capital values have fallen by 2% to 22%, generally implying that cap rates have moved out by 40 to 140bp. This reflects investors' continuous risk aversion despite consecutive cuts in interest rates.

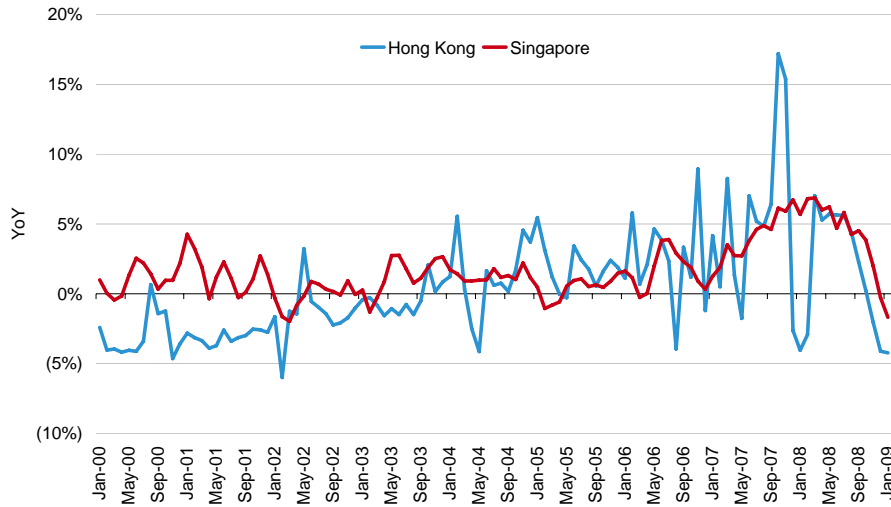
The office market should remain weak in early 2009, as suggested by frequently released economic statistics, including loan growth, employment, and business confidence. Total outstanding loans continued their quarter-on-quarter declines in January in Hong Kong and Singapore by 4.2% and 1.7% respectively. This highlights how the lack of capital – or diminishing demand for capital – has started to filter through the real economy. In Japan, the job-to-applicant ratio continues to drop, most recently to 0.67. This was the lowest level since September 2003, suggesting a resistance to hiring among Japanese corporations. In South Korea, business confidence in January touched the lowest point since the Asian financial crisis and is expected to hover at a low level in the first quarter of 2009.

Figure 7: Office rental growth in Tokyo and job-to-applicant ratio in Japan



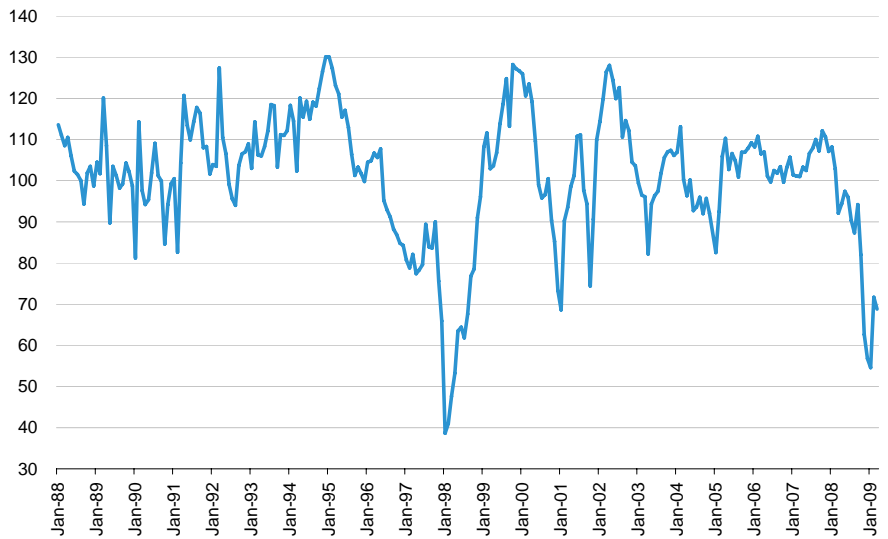
Source: Bloomberg, 3 March 2009; JLL REIS; RREEF Research

Figure 8: Outstanding loan growth in Hong Kong and Singapore



Source: Bloomberg, 3 March 2009

Figure 9: The Federation of Korean Industries Business Sentiment Index

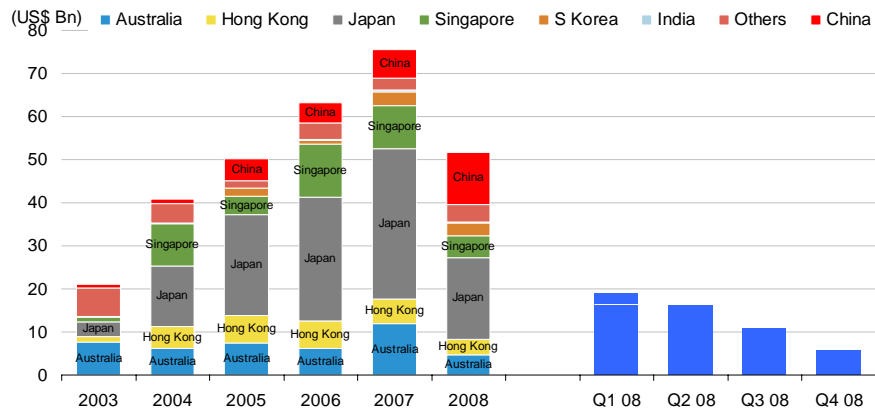


Source: Bloomberg, 3 March 2009

Real Estate Investment Capital Flow

The investment market remained subdued in 4Q2008, with investor confidence weak, the economic outlook bleak and financing scarce. Investment volumes plummeted by 56% quarter-on-quarter to only USD\$4.2 billion in 4Q2008, following a 25% quarter-on-quarter decline in 3Q2008. The total value of investments in 2008 was recorded at USD 45.4 billion, a 40% decline over 2007.

Figure 10: Real estate investment activities in Asia by investment destination



Source: RREEF Research, JLL, Nikkei Real Estate, January 2009

In 4Q2008, Japan continued to be the most active market in Asia, with transactions amounting to USD\$1.8 billion. Notable transactions included the purchase of a land plot located in Tokyo Waterfront City by the consortium of Mori Building and Toyota Motor Corporation from the Tokyo Metropolitan government at JPY 81.4 billion. Despite recording a year-on-year decline of 45.6%, total deal volume in Japan, which totalled USD\$18.9 billion for the year, continued to top the rest of the Asia Pacific region with a market share of 41.6%.

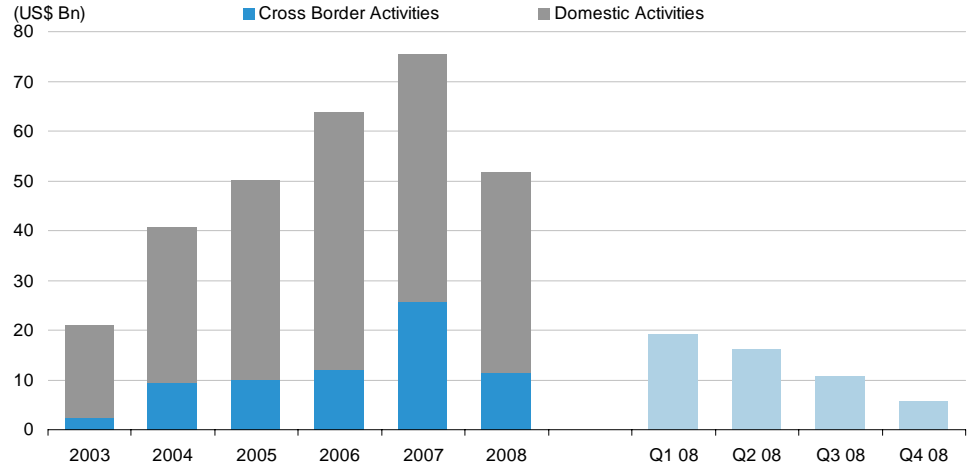
Market activities in China and Singapore in 4Q2008, however, declined sharply. China was down by 66% from the previous quarter to USD\$371.4, while Singapore fell 89% to USD\$159.0 million. The purchase of Maxon Plaza in Beijing by Financial Street Holdings at a price of USD\$235.2 million was the major transaction in China during the quarter. In Singapore, investors remained on the sidelines of this once popular Asian market. Total domestic transactions in Singapore were valued at USD \$116.6 million in 4Q2008, compared with USD\$1.4 billion in 3Q2008. The aggregate value of all deal transactions completed in China and Singapore in 2008 dropped by 12.1% and 48.6%, respectively, over 2007.

Low levels of investment were due mainly to a constrained credit environment where banks were conserving capital and were reluctant to lend in light of market uncertainty. The severe difficulties of financial institutions in the developed economies also indirectly affected the supply of capital in the region, as foreign banks scaled back their overseas operations, including Asia.

A heightened level of risk aversion and a lack of financing together restrained cross-border investments which carry the added weight of currency risk. Cross border investment activities declined to only USD\$0.4 billion in 4Q2008 from USD\$6.0 billion in 1Q2008, with the year 2008 totalling USD\$11.2 billion. Bid-ask spreads remained large as potential property investors required lower prices to compensate for higher costs of funding. Meanwhile, property sellers were reluctant to liquidate their portfolios as they generally maintained a healthy gearing ratio following the Asian financial crisis. Forced sales, however, may become more frequent in Australia if REITs cannot raise new equity to lower their increased debt ratios arising from declining asset valuations.

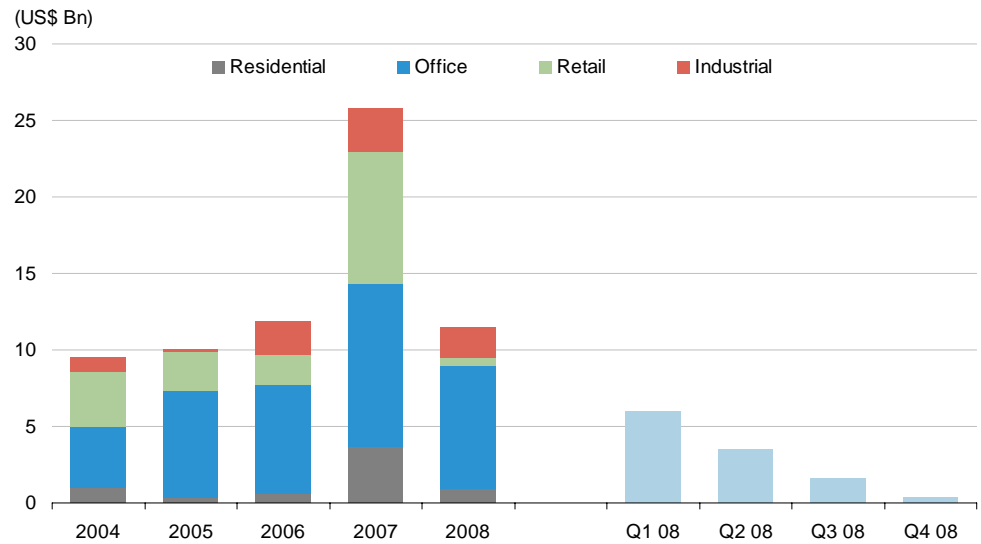
In the light of economic uncertainty, some institutional investors have started to unload their properties. Notable transactions include Morgan Stanley's sale of the DBS Building in Hong Kong at HKD 698 million and the Glass City Harumi office building in Tokyo at JPY 16 billion. LaSalle Investment Management also disposed of the Akihabara Center Place Building, an office building in Tokyo, at an undisclosed price. In Australia, GE Real Estate sold the Beldon shopping centre at AUD 8.4 million.

Figure 11: Investment activities in Asia by nature of capital flow



Source: RREEF Research, JLL, Nikkei Real Estate, January 2009

Figure 12: Cross-border investment activities in Asia by sector

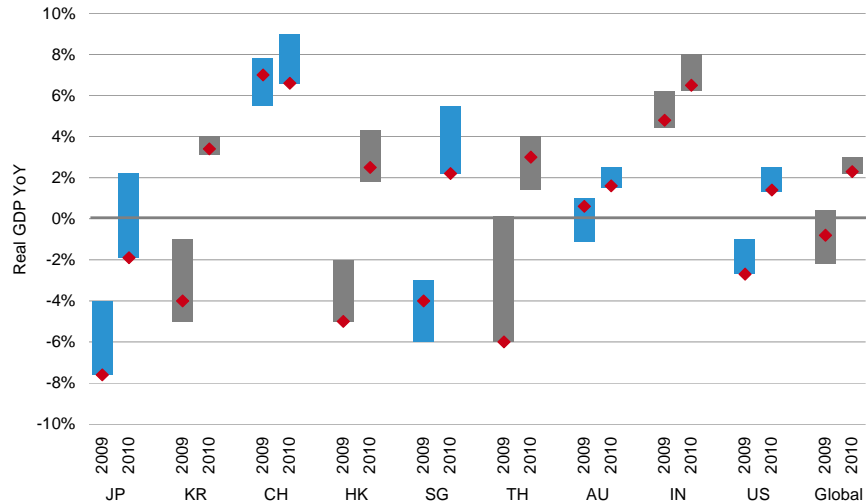


Source: RREEF Research, JLL, Nikkei Real Estate, January 2009

Market Outlook

Most of the economists now expect an outright recession for the global economy in 2009, due mainly to the recession in the US and in Europe, as well as a severe recession in Japan, the second largest economy in the world. The Asian economies, the growth of which has been export-driven, will not “decouple” from the global economies. Economists expect many of the Asian economies to experience a recession sharper than the developed countries in 2009 before rebounding strongly in 2010, based on a forecast resumption of growth in the developed markets.

Figure 13: GDP forecast of Asian economies



Note: Red dots denote latest forecasts by Deutsche Bank; bars represent range of forecast made by six investment houses – Deutsche Bank, Goldman Sachs, Morgan Stanley, JP Morgan, UBS and HSBC.

Source: Deutsche Bank, Goldman Sachs, Morgan Stanley, JP Morgan, UBS and HSBC

The weak economic outlook and the restricted availability of financing will add further weight to the real estate market. Potential forced sales from the highly indebted property owners, particularly the Australian REITs, would also hurt market sentiment and send property prices down further. Cross border investment activities will remain muted unless credit expansion resumes, which is unlikely in the near future. However, in the long run, property prices in Asia are well supported by continuing urbanisation and increased productivity. The process of “institutionalisation” of the property market is also expected to render support.

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Main Offices

Frankfurt

Mergenthalerallee 73-75
65760 Eschborn
Germany
Tel: +49 69 71704 906

Hong Kong

48/F Cheung Kong Centre
2 Queen's Road Central
Hong Kong
Tel: +852 2203 8888

London

1 Appold Street
Broadgate
London
EC2A 2UU
United Kingdom
Tel: +44 20 7545 8000

New York

280 Park Avenue
23W Floor
New York
NY10017-1270
United States
Tel: +1 212 454 3900

San Francisco

101 California Street
26th Floor
San Francisco
CA 94111
United States
Tel: +1 415 781 3300

Tokyo

Floor 17
Sanno Park Tower
2-11-1 Nagata-cho
Chiyoda-Ku
Japan
Tel: +81 3 5156 6000

RREEF Research

Peter Hobbs

Head, Global Real Estate Research
+44 20 7547 4855

Asieh Mansour

Chief Economist and Strategist
+1 415 262 2044

Europe

Brenna O'Roarty

Director
+44 20 7545 6099

Lonneke Löwik

Vice President
+44 20 7545 6328

Maren Våth

Vice President
+49 69 717 04 466

Ermina Topintzi

Vice President
+30 210 7256 153

Justin Curlow

Assistant Vice President
+44 20 7545 9682

Jarek Morawski

Assistant Vice President
+49 69 717 04 204

Asia Pacific

Tan Yen Keng

Vice President
+852 2203 8062

Koichiro Obu

Vice President
+81 3 5156 6522

Henry (Wei) Chin

Vice President
+852 2203 7908

North America

Alan Billingsley

Director
+1 415 262 2017

Brooks Wells

Director
+1 212 454 6437

Hope Nadji

Director
+1 415 262 2022

Andrew J. Nelson

Vice President
+1 415 262 7735

Bill Hersler

Vice President
+1 415 262 2075

Ross Adams

Vice President
+1 415 262 2097

Jaimala Patel

Vice President
+1 212 454 1752

Stella Xu

Assistant Vice President
+1 415 262 7715

Publication Address:

RREEF
1 Appold Street
Broadgate
London EC2A2UU
United Kingdom

Website:

www.rreef.com

Additional information is
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