# Asia

## *Land of rising real estate opportunities*

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Where is the biggest real estate market in the world? Which market is expected to beat the U.S. in terms of total returns on prime property over the next five years? Where boasts a rapidly growing pool of core investment opportunities thanks to improving market transparency and liquidity?

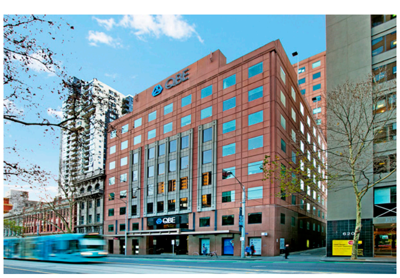
The answer to all those questions is Asia Pacific. From bustling shopping malls in Hong Kong to high-rise residential towers in Japan and state-of-the-art offices in Australia, real estate investment in the region has more than doubled in the past decade and is now the largest market in the world with total commercial stock estimated at $4.6 trillion.[1]

Capital allocation to Asian real estate is on an upward trend. In addition to the rise of interest from domestic institutions, major investors from Europe and North America now clearly consider developed Asian countries as strategic markets, and expect to increase their allocation to the region in the coming years.[2]

So, what is the attraction of Asia real estate?

### Global growth engine

Firstly, the dynamic economic conditions. Over the past decade, Asia's gross domestic product (GDP) per capita has grown on average by 7.4 percent per annum, more than double the rate seen in both the U.S. and the European Union.[3] Such outperformance is expected to continue in the medium term, driven by the emerging markets of Southeast Asia and the maturing of the Chinese economy, as well as by the structural transition from manufacturing to services and from exports to consumption. These trends in turn benefit the region's developed economies through increased intraregional business.



*One of M&G Real Estate's 2014 acquisitions in Asia Pacific, 628 Bourke Street, Melbourne — a high-quality office building in the central business district, let to tenants including multi-national companies.*

> **Top opportunities for 2015**
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> **Strongest short-term rental growth prospects: Tokyo and Singapore offices**
>
> **Short-term investment opportunity: secondary assets in top locations in Japan and Australia**
>
> **Long-term investment opportunity: Korea's maturing logistics sector**

The rapid expansion has made Asia Pacific the largest economic region in the world, accounting for some 30 percent of global GDP. Its resilience to Western economic downturns, as shown in the 2008/2009 financial crisis, underscores the robust nature of the economy and the diversification benefits for North American and European investors.

Our research shows a strong positive relationship between real estate returns and GDP growth. Indeed, the correlation coefficient between GDP growth and real estate returns based on cross-country data (2000–2014) is significant and positive at 0.6. The regression of real estate return on GDP growth has a beta of 1.65 — implying that a 1 percentage point increase in GDP growth could lead to a 1.65 percentage point increase in real estate returns.

Correlation analysis also provides consistent evidence that, within a country, positive economic cycles are likely to lead to stronger real estate performance. For real estate investors this has a critical implication: allocations to high growth markets — such as Asia Pacific — are likely to outperform over the medium to long term.

### A maturing real estate market

Secondly, the region — once largely dominated by risk-taking opportunistic investors — has seen a marked shift in market conditions with noticeable improvements in quality of stock, liquidity, transparency and lease covenants.

Leasing practices in developed Asian markets have become similar to those of the U.S., thanks in part to growing transparency and standardization. This evolution has been supported by increased lease duration and enhanced security of the income returns which underpin long-term investment performance.

In addition to Australia (often ranked as the most transparent market in the world), other real estate markets in the region — such as Hong Kong, Singapore and Japan — now rival those of North America and Western Europe in terms of transparency and maturity, as defined by the proportion of institutional ownership. These structural developments have led to a significant compression of risk premium over the last decade.

### Robust occupier demand

Thirdly, return prospects in Asia's real estate market are underpinned by growing occupier demand for modern and high-quality commercial real estate across the sectors.

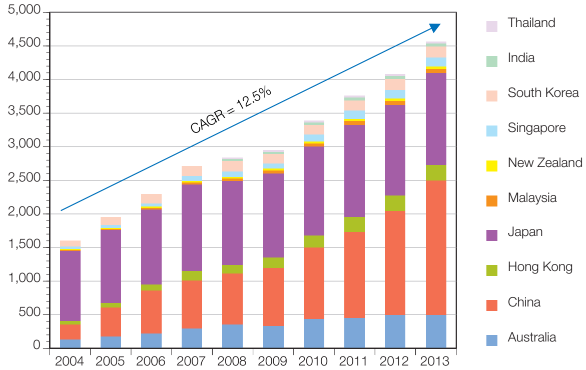

*Merado Daikai — a retail property in an established urban residential neighborhood of central Kobe, Japan.*

Long-term demand for offices is fueled by the secular shift of employment toward the service sector. This is backed by the rise of Asian corporates, which increasingly need office space to support their global expansion, as well as by the growth of industries such as finance, healthcare and technology in developed Asia. For example, Singapore and Hong Kong have emerged as key global hubs of private banking and consumer financial services.

Appetite for quality retail shopping space, meanwhile, comes from the rapid growth of the middle-income class. By 2030, two-thirds of the global middle-class will be living in Asia Pacific.[4] Already the region's retail market is the world's largest and is forecast to account for over 40 percent of global retail sales by 2017.[5]

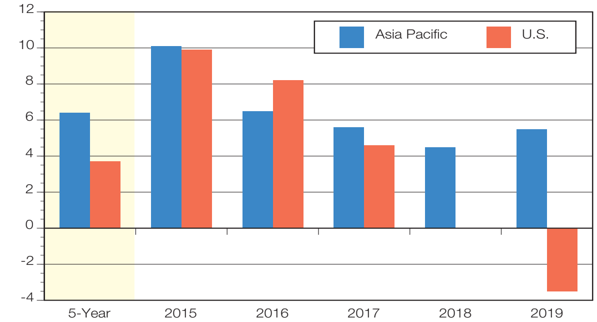
The growth in trade volumes is also driving the demand for third-party logistics

**Asia's growing real estate universe**




*Source: DTZ, "Money into property 2014"*

**Total returns outlook: Asia vs. U.S.**




*Note: Returns are unleveraged in local currency. Asia Pacific returns comprise Australia, Japan, Hong Kong, Singapore and South Korea, weighted by market capitalization.*
*Source: M&G Real Estate, Q4 2014*

services and distribution networks. This is further accentuated by the structural undersupply of modern logistics in Japan, Hong Kong, China and South Korea, as well as by the growth in online retail across the region.

Together, Asia's structural and economic shifts create an environment for continued strong occupier demand, reducing the risk of vacancies and boosting the prospects for rental growth.

## Strong returns and diversification

For international investors, the region offers the additional benefits stemming from portfolio diversification. Over the next five years (2015–2019), we expect that the Asia Pacific prime returns will outstrip those of the United States.

The picture is equally compelling when looking back on the historic performance and adjusting the returns for risk taken. Over the decade to 2013, Asia Pacific real estate delivered an average annual return of 7.9 percent with an average volatility of 13.0 percent.[6] Our analysis of global allocations for a selection of U.S., U.K. and euro zone institutional investors shows that an investment allocation to Asia Pacific results in an improved risk/return trade-off.

For U.S. investors in particular, a global portfolio clearly helps to reduce overall risk and, within that, exposure to Asia makes the most significant impact on lowering the volatility of returns. Those seeking to diversify through exposure to Europe alone are generally subject to weaker returns than those who also invest in Asia.

The dynamism of Asia also allows for intraregional diversification without straying from core. Opportunities include the higher growth prospects in Singapore and Hong Kong, the strong economies of Australia and Korea, together with the stable income-driven returns of Japan. As China's Tier One cities (Shanghai, Beijing, Shenzhen, and Guangzhou), Indian cities, Kuala Lumpur, Jakarta and others reach maturity, the opportunity set for core investors will widen further.

**How Asia exposure impacts returns**

| Investor | Return (pa) | Volatility of return |
|---|---|---|
| U.S. investor with 100% domestic portfolio | 8.5% | 10.6% |
| U.S. investor with 20%–30% Asia Pacific investment | 8.8%–9.0% | 9.1%–8.6% |

*Source: M&G Real Estate, based on 2000–2012 data*

## Benefits of investing in unlisted funds vs listed REITs

Investors looking at Asian real estate have a growing universe of potential investment vehicles, including specialist funds and listed REITs. REITs benefit from better liquidity, but investing in Asia directly through an unlisted fund offers a number of other advantages, including:

- Lower volatility;
- Broader geographic reach across the region, given that currently only Australia, Japan and Singapore offer well-developed REIT markets;
- Returns closely linked to property market performance; REITs, in contrast, behave more like equities;
- Asset-level diversification through fund portfolios of a significant scale, which can efficiently diversify structural risk; in comparison, individual REITs can be highly correlated.

## Conclusion

As Asia's real estate market comes of age, it is no longer an investment greenfield for the opportunistic — it has all the characteristics to earn a key place in a diversified global core real estate portfolio. Early investors are benefiting from the structural advancement in the region's real estate markets, with the strong improvements in both market size and quality.

Our research shows that investment in core Asia Pacific real estate has the potential to provide strong diversification benefits and the potential for long-term, sustainable income-driven returns, backed by economic growth.

These benefits can be maximized by investing in Asian real estate through a specialist fund, which offers local expertise and active asset management, as well as greater control and lower volatility compared to indirect investments through REITs. ■

1 DTZ, "Money into property 2014"
2 ANREV, Investment Intentions Asia Pacific Survey 2015
3 International Monetary Fund
4 Ernst & Young, "Hitting the sweet spot" report, 2013
5 Canadean Ltd, "The future of global retailing to 2017", October 2013
6 Performance data from IPD and PMA; regional statistics weighted by DTZ's market capitalisation

## COMPANY OVERVIEW

M&G Real Estate is the real estate fund management arm of M&G, and one of the top 25 real estate fund managers in the world by assets under management. It has over £20 billion ($33 billion) invested in a broad spread of properties across Europe, North America and the Asia Pacific region (as of September 30, 2014). M&G Real Estate offers institutional investors a range of commingled strategies, as well as segregated mandate and joint venture opportunities with a focus on generating long-term income driven returns through prudent asset selection and active management.

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