

2008

PRICEWATERHOUSE COPERS (2)

Emerging Trends in Real Estate® Asia Pacific 2008

A publication of:





Emerging Trends Real Estate Asia Pacific

2008

Contents

1 Executive Summary and Preface

2 Chapter 1 Party Set to Continue

- 4 Red-Hot Markets
- 5 Yield Compression Near Bottom
- 6 The Road Less Traveled
- 7 Retail and Residential Find Favor
- 7 Emerging Markets a New Magnet
- 9 Investors Eye Development Opportunities
- 10 Niche Sectors Break Out
- 11 Investors Bullish, but Risks Lurk
- 12 Governments Meddle as Markets Take Off

14 Chapter 2 Real Estate Capital Flows

- 15 Party Looks Set to Continue
- 16 Private Equity Is King
- 18 Down-Under Funds Head North
- 19 Petrodollars Seek a Home
- 20 Asia's Sovereign Wealth Hits the Streets
- 20 Overseas Chinese Take Emerging Markets by Storm
- 21 REITs Are Here to Stay
- 24 No Abuse of Debt
- 26 In the Crystal Ball

28 Chapter 3 Markets and Sectors to Watch

- 30 Enigmas Abound
- 31 Finding Equilibrium
- 32 Property Sectors in Perspective
- 36 Top Investment Cities
- 42 Second-Tier Investment Cities

46 Interviewees

Editorial Leadership Team

Emerging Trends in Real Estate® Asia Pacific 2008 Chairs

Richard M. Rosan, Urban Land Institute Patrick R. Leardo, PricewaterhouseCoopers

Principal Authors and Senior Advisers

Steven Laposa, PricewaterhouseCoopers Colin Galloway, Urban Land Institute Consultant

Senior Advisers and Contributing Researchers

Stephen Blank, Urban Land Institute Chuck DiRocco, Urban Land Institute Dean Schwanke, Urban Land Institute

Senior Adviser and Publisher

Rachelle L. Levitt, Urban Land Institute

PricewaterhouseCoopers Global Real Estate Leadership Team

Marc Saluzzi, Global Investment Management & Real Estate
Group Leader, Luxembourg, Luxembourg
Patrick Leardo, Global Real Estate Advisory Leader
New York, New York, United States of America
Uwe Stoschek, Global Real Estate Tax Leader, Berlin, Germany
William Croteau, Global Real Estate Assurance Leader,
San Francisco, California, United States of America
KK So, Asia Pacific Real Estate Tax Leader, Hong Kong, China
James Dunning, Asia Pacific Real Estate Assurance Leader,
Sydney, Australia

Henrik Steinbrecher, European Real Estate Leader, Stockholm, Sweden

Timothy Conlon, United States Real Estate Leader, New York, New York, United States of America John Forbes, United Kingdom Real Estate Leader, London, England, United Kingdom

Robert Grome, Asia Pacific Investment Management and Real Estate Leader, Hong Kong

Advisers and Contributing Researchers

Australia Brian Lawrence

Hong Kong KK So Alan Ho

Jacqueline S.Y. Wong

India Gautam Mehra

Radhakishan Rawal

Jesal Gandhi

Japan Raymond A. Kahn Korea Jin-Young Lee

Taejin Park
Jae-Dok Lee
YongJoon Yoon
Hyung-Ju Choi
Malou P. Lim

Philippines Malou P. Lim Singapore David Sandison

Wee Hwee Teo

ULI Editorial and Production Staff

Nancy H. Stewart, Managing Editor David James Rose, Manuscript Editor Byron Holly, Senior Graphic Designer

Craig Chapman, Director of Publishing Operations

Karrie Underwood, Administrative Assistant

Emerging Trends in Real Estate® is a registered U.S. trademark of PricewaterhouseCoopers LLP.

Copyright September 2007 by ULI-the Urban Land Institute and Pricewaterhouse Coopers LLP.

Printed in the United States of America. 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: ULI-the Urban Land Institute and PricewaterhouseCoopers LLP. Emerging Trends in Real Estate® Asia Pacific 2008. Washington,

D.C.: ULI-the Urban Land Institute.

ULI Catalog Number: E31 ISBN: 978-0-87420-994-5

Executive Summary

- The growing Asia Pacific real estate market still offers opportunities for investors and developers in 2008. However, stiffening competition continues to compress yields to their lowest points. Therefore, a new flow of investments is heading into less mainstream markets for the possibility of producing higher returns.
- Asia Pacific real estate executives' responses remain strong on overall economic and market fundamentals, regardless of interest rate increases. However, an added degree of risk is being introduced as real estate is offering lower returns at higher leverage. In 2008, participants will still have higher—albeit slightly diminished—real estate firm profitability when compared with 2007.
- Topics of discussion that investors will be keeping abreast of are an oversupply of foreign exchange reserves, rising occupancy and staffing costs, market transparency, and interventionism of regional governments. Each of these areas is of concern and may possibly affect investment and development opportunities as the year progresses.
- High levels of equity capital continue to pour into the Asia Pacific property pool. Most executives believe that these markets are attracting even more capital than in 2007. The majority of real estate capital in Asia is private equity, which has kept the markets moderately oversupplied. Investment capital flows across all continents, but with strongest growth in flows coming from the Middle East, China, and other Asia Pacific countries. Opportunity funds, institutional investors, and publicly listed companies will lead the growth in real estate investing in 2008.

- Due to relatively low-cost debt, an increase in leverage continues to be popular among Asian property investors. However, little interest remains for securitized financing deals such as CMBS or CDO deals. Therefore, most Asian markets don't risk having too much exposure to credit meltdowns similar to those witnessed in the United States in 2007.
- The boom of REIT growth in 2007 looks to slow slightly as 2008 approaches. Australia continues to be the dominant player within the Asia Pacific region, followed by Japan with over 40 publicly listed property companies. Yield compression seems to have taken its toll on the REIT industry, as private equity isn't attracted to only capital growth investments. Regardless, executives continue to be confident that the industry will emerge as a major force in Asia.
- Based on investment prospect ratings, the top five markets are Shanghai, Singapore, Tokyo, Osaka, and Hong Kong. Compared with last year, four of the five cities remain in the top five, with the only addition being Hong Kong. Other notable increases in rank are Seoul, Ho Chi Minh City, and Mumbai moving into the top ten.
- For 2008, the hotel sector tops the list of real estate performance prospects, followed by the office sector, which led all others in 2007. Hotel growth looks strong as there continues to be demand for rooms in most of the major cities. On the development front, residential (for-sale) properties comes out on top. Not all cities would agree, but an increase in urbanization, second-home markets, and household income supports this sector's strong growth.

Preface

A joint undertaking of the Urban Land Institute (ULI) and PricewaterhouseCoopers, *Emerging Trends in Real Estate® Asia Pacific* is a trends and forecast publication now in its second year. The report provides an outlook on Asia Pacific real estate investment and development trends, real estate finance and capital markets, property sectors, metropolitan areas, and other real estate issues.

Emerging Trends in Real Estate® Asia Pacific 2008 represents a consensus outlook for the future and reflects the views of more than 200 individuals who completed surveys and/or were interviewed as a part of the research process for this report. Interviewees and survey participants represent a wide range of industry experts—investors, developers, property companies, lenders, brokers, and consultants. ULI and PricewaterhouseCoopers researchers personally interviewed 46 individuals, and survey responses were received from 155 individuals whose company affiliations are broken down as follows:

Private Property Company or Developer	27.7%
Institutional/Equity Investor or Investment Manager	17.6%
Real Estate Services Firm	15.5%
Publicly Listed Property Company or REIT	14.2%
Other Entity	14.2%
Bank, Lender, or Securitized Lender	7.4%
Homebuilder or Residential Land Developer	3.4%

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 PricewaterhouseCoopers extend sincere thanks for sharing valuable time and expertise. Without the involvement of these many individuals, this report would not have been possible.



This year, even greater volumes of cash have descended into these markets as institutional funds follow the trail blazed by their more opportunistic cousins.

Set to Continue

estate markets in 2005 and 2006 was remarkable for the fact that it marked the start of a wave of foreign interest in regional property assets, the follow-up in 2007 has been no less extraordinary. This year, even greater volumes of cash have descended into these markets as institutional funds follow the trail blazed by their more opportunistic cousins, besieging limited supplies of investable stock, forcing up prices, and sparking a migration of capital to the far corners of the region as investors fight to place funds from Tokyo to Hanoi.

But as growing competition compresses yields ever further, investors have reached a point where they have little more room in which to maneuver. With capitalization rates at rock bottom, the only way for many fund managers to deploy their cash is to move into less mainstream areas, either by morphing into developers or by moving from established markets and opting instead for more chancy secondary destinations. As global interest rates continue to creep upward, the combination of lower overall returns and generally high levels of leverage brings an added degree of risk to an already uncertain horizon. But economic and market fundamentals—for now—remain robust (see Exhibit 1-1), meaning that 2008 returns, albeit diminished, should remain adequate to keep most investors happy.

Exhibit 1-1	Asia Pacific Economic Growth:
LAINDIL I-I	Consensus Forecasts

		Real GDP Growth Rate (%)			
	2008*	2007*	2006	2005	2004
China	9.58	11.38	11.08	9.90	10.10
India	7.70	8.11	9.46	7.90	7.50
Singapore	6.17	6.09	7.88	6.40	8.70
Indonesia	5.92	6.24	5.48	5.60	5.10
Thailand	5.72	4.58	5.02	4.40	6.20
Malaysia	5.52	5.74	5.93	5.20	7.10
South Korea	5.29	4.46	4.99	4.00	4.70
Taiwan	4.60	4.02	4.62	4.10	6.10
Philippines	4.52	5.11	5.45	5.10	6.00
Hong Kong	4.29	4.57	6.92	7.30	8.60
Asia	3.80	4.00	4.20	3.70	4.40
Australia	3.38	3.18	2.66	2.60	3.50
Oceania	3.30	3.10	2.60	2.70	3.70
New Zealand	2.81	2.42	2.09	2.00	4.30
Japan	2.17	2.09	1.82	2.60	2.30

Sources: World Bank, Moody's (www.economy.com).

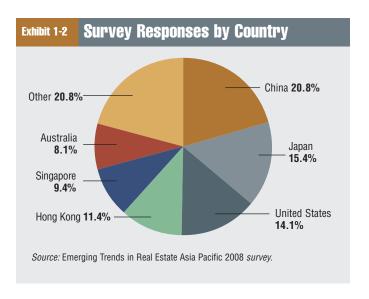
*Projections

Red-Hot Markets

In terms of property investment flows, the two big stories this year are Japan and China. Despite the fact that Japan is already Asia's biggest real estate market by far, accounting for 55 percent of total deals by value, real estate investment growth in 2006 was the strongest in Asia by a mile, with commercial property transaction volumes soaring 128 percent to \$52 billion, according to Jones Lang LaSalle. Of this, cross-border investment totaled \$13 billion, up 43 percent for the year. Why the surge? For one, Japan's economy is emerging from a multiyear period of stagnation and is seen by investors as a good bet for a cyclical recovery. Second, while deals there are hard to execute technically, nowhere else in Asia has a market with the same depth. As one investor says, "It has the stock and there is an active market that is not reliant on foreign investors for transfer of completed buildings." Third, it offers a level of maturity that can only be rivaled elsewhere in the region by markets in Australia, Hong Kong, and Singapore, which makes it attractive to a lot of the new money arriving in Asia.

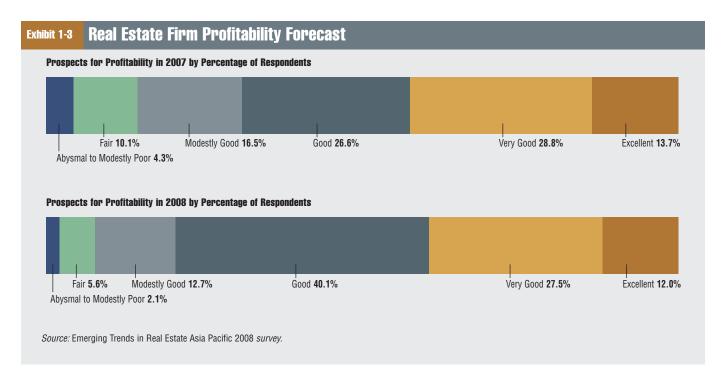
According to one consultant, "There's generally an increased allocation to Asia Pacific property and a lot of it is coming for the more institutional rather than opportunistic funds. When they've done their homework, they do like Japan—the more risk averse they are, the more attractive it is." Another executive stated: "China has growth that Japan doesn't have, but China has risk attached to it and the price is very competitive now. So, if you do a risk-adjusted return calculation, Japan is a better market. A lot of investors are saying this and I agree with them." Finally, while yields are nothing to write home about, interest rates are even lower. As one consultant says, "The average yield would be in the threes for A-grade, but the borrowing rate is still in the twos, so you're getting a positive yield spread." That makes it unique in Asia, with the possible exception of Taiwan. As a result, "you can sit there, get no growth, pay your debt, collect your money, and as long as you're not getting vacancies unexpectedly, it's like falling off a log."

That doesn't mean that the appeal of China's market—last year's star—has waned. In fact, in terms of the oversubscription of capital chasing investable opportunities, the mainland is at least as popular as before and probably more crowded



than any other Asian destination, according to executives interviewed for this report. Last year, direct commercial real estate deals amounted to some \$9.2 billion according to Jones Lang LaSalle, up 70 percent for the year. Of this, cross-border capital amounted to \$6 billion, an 18 percent rise over 2005. That now ranks the China market as Asia's third biggest behind Japan and Australia, with about 10 percent of the Asian total (and just over 1 percent of the global total).

The problem with investing in China is that its cities have very little investable stock. And with a bevy of new regulations restricting market access, and plenty of other pitfalls lurking in the shadows, it remains a very tough place in which to invest. "China is about as speculative as you can get," one consultant says. "The further you are away, the more interesting it looks, but when you're actually there, you figure out how difficult it is to get something to perform. Deals are getting done, but they're taking a long time. When you agree to a deal in Singapore or Hong Kong or Tokyo, you can have it closed in a month—it's at least six months in China. With the red tape and lack of transparency, you don't know what you've bought until you're way down the line—then you suddenly find out and the deal falls out of bed." As a result, some players have adopted a strategy of splitting funds between the two markets. Says a developer active in both: "I think a combination of the two is quite a good blend, because you have high growth and somewhat higher-risk elements in China against a more stable, predictable market in Japan."



Yield Compression Near Bottom

As newly minted investments begin to register on balance sheets and investors bask in better-than-expected performance on both the capital appreciation and rental return fronts, investor confidence in 2008 profits remains strong (see Exhibit 1-3). That said, with competition to buy properties so strong in markets across Asia, prices for prime real estate are spiraling higher, and cap rates continue to head south for newly placed money. Across the continent, according to DTZ, yield compression amounted to an average of 100 basis points in 2006, about twice that seen in the United States. Although one reason for this is that yields were higher in Asia to begin with, there is now a growing consensus that cap rates in many Asian countries—which now commonly match those in other major global markets—have reached a point where they can be squeezed no more. Interviewees report that investors are becoming unwilling to accept Asian levels of risk for returns that can often be had in more familiar Western territory. For example, from Japan: "I can't see much more yield compression in Tokyo Grade A offices." From Singapore: "The market just won't take it anymore." And from China: "Those who have promised investors high returns are simply not buying" and "yields are as low as they're going to get—they've been lower than they should be anyway."

While yield compression is clearly a negative for buyers, it is not a deal breaker if future rent increases are enough to boost project cash flow significantly—and that's what's happening in many markets. In Japan, "there wasn't much growth in office rents for about 20 years; it was reliant on yield compression as greater appetite affected pricing. Now you have to rely on rental growth—but it's still a good story," says one observer. Indeed, the last 18 months have witnessed spectacular rent increases for some Asian office markets. In Tokyo, interviewees report that rents for prime office properties in the central business district (CBD) have risen 50 percent or more since the beginning of 2006 alone. Hong Kong office rents rose 31 percent year over year in April. Singapore is another market that's "on fire," with Grade A rents registering an extraordinary 106 percent yearover-year increase over the same period, according to Jones Lang LaSalle. This type of performance has encouraged investors to keep buying in the expectation that rents will outrun currently tight yields. As one consultant, referring to the equally hot Vietnamese market, points out, "Yield compression is not an issue when rents are doubling every 18 months."

With rental returns booming, the question is, "When will the music stop?" No time soon in markets where vacancy rates are

Average Real Estate Yields in Average Markets

	Grade A Office	Prime Retail	Luxury Residential	Logistics
Bangkok	7.6	10.9-12.9	4.3-5.3	NA
Beijing	8.9	7.8	8.4	NA
Chengdu	10.9-13.1	NA	NA	NA
Delhi	11.0	10.5	3.0	NA
Hanoi	NA	13.5	13.0	NA
Ho Chi Minh City	10.0	14.8	12.8	NA
Hong Kong	4.5-6.5	3.9	3.2	6.7-7.0
Jakarta	7.9	15.0	10.7	NA
Kuala Lumpur	7.7	8.5-12.0	7.1	NA
Makati (Philippines)	9.9	11.5	7.4	NA
Macau	NA	6.1	3.6	NA
Mumbai	11.1	10.5	3.5	NA
Seoul	6.3	7.0	4.5	NA
Singapore	5.2-5.7	5.8	2.8	NA
Shanghai	8.2	11.3	5.5-8.0	10.2
Sydney	5.5-6.25	5.8	NA	7.1
Taipei	4.9-5.9	NA	NA	NA
Tokyo	3.2	3.6	5.1	4.5-5.5

Sources: Jones Lang LaSalle, CB Richard Ellis, Prologis.



currently 3 to 4 percent or less, such as Singapore, Japan, and Hong Kong. According to a fund manager based in Singapore, "For the next 18 to 24 months, rents will continue to rise simply because there's no supply coming. The [government] is only now starting to auction off land [for new development], and some of the buildings that haven't even started yet are already precommitted, which gives you an indication of how desperate people are."

The Road Less Traveled

The flip side to yield compression, however, is that in markets where rent increases are not so dramatic, investors are hard pressed to find assets that can satisfy bottom-line requirements. In China, for example, most Western investors prefer to operate in first-tier cities such as Shanghai or Beijing. Foreign investment in Shanghai property has soared, rising from \$400 million in 2005 to some \$840 million in 2006, according to CB Richard Ellis (CBRE). However, the sheer weight of money in the market—\$15 of capital chasing every dollar of available product—means that finding property has become increasingly difficult, while ongoing price hikes often leave returns inadequate to justify the extra risk of buying in China.

As an example, a residential site in Shanghai's Yangpu district was sold to local developer Greentown China Holdings in June this year for a price averaging \$154 per square foot (\$1,655 per square meter [psm])—a 90 percent premium to the price paid for a similar nearby site sold just seven months earlier. According to one observer, "In Beijing and Shanghai today, you would be looking at a yield of between 7 and 8 percent, whereas a year ago that could well have been in the double digits. IRRs [internal rates of return] would be in the low teens, and with combined rental plus capital growth you are probably looking at between 12 and 15 percent. That's still not bad, but obviously a good deal less than you were getting a year ago."

As a result, many real estate investors from the West are now voting with their feet and decamping to secondary markets in search of better pickings. In China, these include places that many in the West have never heard of—cities such as Changsha, Hangzhou, or Chongqing. There they often find themselves rubbing shoulders with overseas Chinese investors, in particular from Hong Kong and Singapore, who are well versed in the China real estate game and have been operating with some success for a number of years.

China is not the only market where this is happening. In Japan, too, foreign investors are looking increasingly to provincial locations. And not just to popular large cities such as Osaka, Nagoya, and Fukuoka, but also to more obscure provincial destinations. According to one executive, "A lot of opportunistic money has been ploughed into Tokyo over the last five years, and those people are now finding it tough to invest anew in the sectors they've been used to—in other words, the Tokyo office sector. They are the ones who are generally spreading outside because that's where they see future yield compression."

Retail and Residential Find Favor

One byproduct of this gradual migration into Chinese and Japanese secondary markets has been increasing investment volume in retail and residential projects. To some extent, this trend is dictated by the lack of investment-grade office stock outside major cities. As a consultant based in one up-and-coming Chinese city says, "In Shanghai you have, say, 60 Grade A office buildings; in Tianjin, you have three." In addition, no one knows where the CBDs in undeveloped locations might eventually be established, making office development a risky prospect. Residential projects, however, are seen as a safer bet. "You sell it unit by unit and if you have to get out, you can always do it—you just have to lower the price, whereas if you have a whole asset it's much harder," says one investor.

The drift to mass residential development is especially strong in China, where Beijing has tired of an obsessive interest in building high-end accommodation in pursuit of apparently higher margins—a development strategy that has distorted the market by failing to meet the needs of most consumers, caused land and property prices nationwide to bid up in a speculative frenzy, and left a vast pool of completed housing stock standing empty because so few can afford to buy it.

As a result, government policy is now focused on developing large tracts of low- and medium-priced housing. According to official figures, new land supply during the first five months of 2007 for all mainland residential developments grew 35.5 percent year over year, while supply for apartment buildings grew 76.3 percent, and that for low-cost homes a remarkable 166 percent. As one executive says, "The big real estate play [in China], which all the Hong Kong and Singapore developers are pushing, is to develop middle- and bottom-end residential. This is a no-brainer in the second-tier cities at the moment." It can also be quite lucrative. According to an analyst at one Western development firm active for a number of years in China's mass-market residential sector, "We can deliver 20 to 25 percent returns on the project level, depending on what we're doing and where we are."

Retail is an equally attractive product for secondary market players. "Any place you have enough people you have good retail opportunities, and if there's one thing China has plenty of, it's people. So second- and third-tier city retail opportunities are definitely going to be one of the prime targets moving forward," says a Shanghai-based consultant. Japanese provincial destinations are also touted as good retail destinations.

Risks in these secondary locations will invariably be higher than in first-tier cities, especially in developing markets. "A lot of the assets have the same challenges as in Shanghai or Beijing ten years ago—maybe the title is not clear, or the buildings being built won't be commercially relevant in 20 years," says the Tianjin-based consultant. "There's one challenge that everyone here faces and that's transparency," says another second-tier investor. "If you don't have local partners and don't have a lot of local experience, transparency will be a huge hurdle." At the same time, though, conditions are improving as more foreign developers move into these cities and create a paper trail that sets benchmarks and transaction precedents for future investors.

While risks can be high, rewards can also be significantly greater than those obtained in mainstream cities. According to one observer, "In some of these second-tier cities, you can see that rents can triple in three to five years. So initial yields can be very low, but overall returns are going to be higher. IRRs in the mid-20s are quite easy to achieve in these second-tier cities, and way above that as well."

Emerging Markets a New Magnet

The trend toward building in secondary locations is also provoking a wave of investment into emerging Asian economies, the standouts being Vietnam and India.

Vietnam is seen as a compelling destination largely because of similarities to its northern neighbor. Several interviewees described it as "like China ten years ago," noting also it was a "nation of entrepreneurs," "hugely ambitious," and "well on its way to being a major force in the region." While still a market for opportunistic investors, Vietnam is now drawing interest from Asian developers—particularly from Hong Kong, Singapore, Taiwan, and Korea—as well as international private equity players. Most deals are done with a local company as joint venture partner.

With so little existing stock to buy, the game remains "either greenfield development, or doing a deal with authorities to

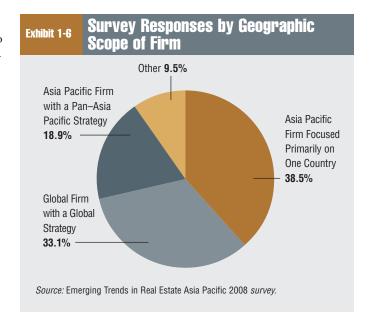
acquire a large plot in the urban area: they clear it for you and the price you pay is land value plus clearance cost." According to one consultant advising a private equity fund active in the country, "Costs are about a third the costs in China." In addition, "You're looking at about 25 percent IRRs still—but weight of capital means that they are going to come down very rapidly. I think in a year's time, IRRs will be halved."

Market or political risk in Vietnam, according to one Ho Chi Minh City—based executive, is not the biggest issue. The local court system may be difficult to negotiate, but it is not as problematic as quality control and construction delays. Transparency is another perennial problem: the nation ranks dead last in Jones Lang LaSalle's global real estate transparency index. According to one executive, "It's a very opaque market, there's not even a public register of land. So you can buy land from the government, but [the purchase] isn't recorded anywhere."

Moreover, while potential returns may be high, the small size of the market guarantees that it will remain a fringe player for the foreseeable future. Vietnam's biggest market, Ho Chi Minh City, currently has just 4.3 million square feet (400,000 square meters) in office stock of all grades, according to CBRE, with another 2.69 million square feet (250,000 square meters) under development. Individual developments are also small scale: "If you want to deploy a billion dollars, that's probably 40 to 50 projects," says one investor.

While Vietnam may be the new kid on the block, another favored kid has actually been around for a while. India has been on investors' radars for several years, but has hitherto proven inaccessible due to government restrictions. That changed in 2005, when some foreign investment restraints were eased. Southeast Asian developers were the first to appear on the scene, but today India is attracting huge amounts of global capital—mostly opportunistic money from the United States, Europe, and the Middle East—chasing deals across the board. Foreign investment has ballooned from 4 percent of all Indian real estate deals in 2004 to an expected 26 percent this year, according to a recent analysis by the Associated Chambers of Commerce and Industry of India, which also projected that the total size of the domestic real estate market would rise from a current \$16 billion to \$60 billion by 2010.

While that's a big jump, it still pales in comparison to investment flows currently targeting the country. At this year's



REIW conference in Singapore, for example, five panelists took to the stage and announced that they had collectively raised some \$20 billion to invest in Indian real estate over the next two years. Spending on this level seems a tall order given that regulations still bar foreigners from buying freestanding investments, forcing them to take the development route. Then there's the need to negotiate a minefield of potential obstacles. How to exit a relatively illiquid market when foreign investors can't buy finished product is one looming issue. Furthermore, the land registration system is weak and transparency remains poor. According to one consultant, "About 70 percent of all the cases in court in India are land related, and 25 percent of all land transactions [involve] corruption."

In addition, "You've got a lot of unregistered transactions because people are dealing on the black market to avoid paying stamp duty, which is up to 10 to 12 percent in places." However, transparency is improving rapidly as private equity players bring in stricter management practices, longer-term perspectives, and more focus on improving building quality.

While the sheer volume of new cash piling into India has elicited a cautious tone from interviewees, the overall response is bullish. According to one India-based consultant, "I'm sure that some people are going to burn their fingers, but that's alright. If you are chasing 25 percent IRRs, you have to be ready to take on risk. I think people who go wrong, even on

20 percent of their projects, might still get 25 percent IRRs because I know of projects where investors are sitting on 60 to 70 percent IRRs. There is no dearth of demand in India." High returns are especially visible in CBD office sectors, where supply shortages have resulted in Grade A rental increases of 60 to 70 percent in the Delhi and Mumbai CBDs for the year to March 2007, according to Jones Lang LaSalle.

While these are unlikely to be sustainable, say interviewees, the market abounds with opportunity. Another interviewee adds, "India is behind China, but it's going to happen because these guys are going to force it to happen. The Indian government seems much more open to it, and the country has a transferable currency, which helps. The problem is, what are you going to do about the infrastructure? China is manic about it, whereas in India they're slow and it's not really there—I think that's really going to hold it back."

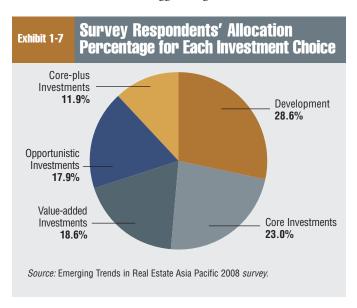
Investors Eye Development Opportunities

Another consequence of Asia's overcrowded markets and evertightening yields is that organizations that would usually operate as pure investors are now being forced further down the real estate food chain (see Exhibit 1-7). In a "major shift," according to one executive, "many of the traditional pension funds and insurance companies that had hoped to buy standard investment and hold it for a combination of income plus capital growth are now having to take development risk. Initially, they tried to buy into half-completed schemes, where the land conversion risk and the planning risk have been removed and all you really face is construction and market risk. Now, people are being forced further down to the start of the project, so people are coming in almost at entry, taking land conversion risk, planning risk, total construction risk, and total market risk."

This shift is not simply a consequence of the need to find a way to place funds. "The other reason you migrate up that risk curve is very much about creating your own product that becomes core real estate. If the developers in Asia are not creating things that are of institutional quality, the solution is to take something that is substandard, add value to it, and turn it into an institutional-quality product," says one analyst.

Usually, entering the development game in less developed markets involves partnering with a local player who can help navigate the local bureaucracy and other on-the-ground issues. This is particularly so in China. "For development you have to partner, you can't do it on your own—even the Hong Kong and Singapore players tend to take partners; it spreads your risk," says one observer. Fortunately, the partnership game in most developing and emerging Asian markets is symbiotic. Local developers are historically cash poor and face an expanding body of new regulations that makes their traditional approach to development—debt financing—harder to obtain and increasingly expensive. Finding someone good to work with is always a challenge, but there are plenty of fish in the ocean.

India is also a location where investors have assumed high levels of development risk, although this is directly related to the fact that government regulations basically restrict foreigners to investing only in development projects. One India-based consultant saw this as the biggest single risk factor in the local



market. "All these guys are investment bankers, and they haven't done many deals in India. The challenge they face is in having the ability to deliver—not just on their own behalf, but [also] from joint venture partners. We did an analysis of the top Indian developer groups, calculating how much space they have developed in their entire existence compared to how much they are proposing over the next five to seven years. We [found] that the relationship between what they have done to date and what they are proposing is on average between ten and 40 times. Those are scary numbers."

The shift toward assuming development risk is proving controversial, with many seasoned observers questioning whether inexperienced players are safe swimming in such shark-infested waters. "I've always thought development was a difficult game," says one observer. "All of a sudden, all these people who have never developed anything in their lives are becoming developers. I have to question that. They think they can hire in the expertise—but development is a high-risk skill." According to another, "The funds that are investing in development are being very complacent. They've stress tested their IRRs and are feeling comfortable, but most of these guys don't have enough people to even check up on the checkers. And I don't think that just because you have a good development partner you're going to insulate yourself from a downturn."

Niche Sectors Break Out

Buoyed by investor overflow from overcrowded mainstream sectors, investment in less visited niche sectors has boomed since the beginning of 2006. As a result, money is flowing increasingly into a variety of specialist folds, from retirement homes in Australia to health tourism in Thailand. Interviewees suggest that niche markets will be a continuing draw over the medium term.

Hotel transactions across the Asia Pacific area ballooned to \$5.25 billion last year, double the amount transacted in 2005, according to Jones Lang LaSalle. Almost half of this (\$2.3 billion) was included in Morgan Stanley's purchase of 13 Japanese hotels as part of the country's largest real estate purchase by a foreign investor. Turnover in 2007 is expected to exceed \$7 billion. Unsurprisingly, rising prices have seen yields compress, with the average price per key rising from \$138,000 to \$204,000 for the year. Public companies and operators have been the main sellers, with Asian institutional funds and real estate investment trusts (REITs) the most prominent buyers.

One prominent driver in the hospitality market has been the upsurge in Asian gambling and resort destinations. The former Portuguese colony of Macau has seen hotel capacity skyrocket in line with development of local gambling facilities, which now have a higher turnover than Las Vegas. Las Vegas Sands has opened the 3,000-room Venetian Macau casino resort in August. Squeaky-clean Singapore also has decided to target this market in an effort to rebrand itself as a more tourist-friendly destination and to become a draw in the conventions business. The development of two casino-centered integrated resorts at Marina Bay and Sentosa Island have jump-started activity in the local hotel sector, which saw some \$1.2 billion in transactions during 2006.

Skeptics question whether there is enough demand in Asia to soak up this glut of new hotel capacity. But according to one Macau-based gaming analyst, "I was probably cynical about this several years ago, but I'm not as skeptical now. If you look at the sort of offering that particularly the new [3,000-room] Venetian Hotel [in Macau] will make, it's essentially oriented toward the convention and expo business. If they're able to get that off the ground, as I think they will, it's really going to suck in a lot of demand for accommodation, entertainment, dining options—things that haven't really figured large until now."

Otherwise, investment in logistics facilities has also soared, partly as a result of the need to supply growing retailing activity around the continent. This, despite the fact that for some, "rent fundamentals are weak." Japan, whose aging stock of unsophisticated warehouse space needs extensive upgrading, remains the biggest market in absolute terms, with some 30.1 million square feet (2.8 million square meters) of modern logistics facilities built since 2002, mostly in Tokyo and Osaka, according to Prologis. Cap rates have fallen to a current level of 4.5 to 5.5 percent.

In China too, demand for logistics facilities is booming, fed by an explosion of new retailers, many of them multinationals, in secondary and tertiary cities. "Last year, there were just five or six players," according to one consultant active in the sector, "but now there must be at least 20 looking to place funds." Yields are lower than in other sectors: "Gross yields now are about 9 percent, but there are taxes, so net is only about 7 percent—but that's still higher than in other countries." And the wave seems set to continue: "I struggle to see how you can go wrong with logistics in China—there's going to be a real boom in the sector over the next few years." To give an idea of the current market, the total volume of modern logistics facilities in Shanghai is expected to rise to some 22.17 million square feet (2.06 million square meters) by the end of this year, up from just 14.53 million square feet (1.35 million square meters) at the end of 2006, according to Jones Lang LaSalle.

Investors Bullish, but Risks Lurk

Most interviewees remain bullish about market prospects. "As I look at the risk on the fundamental side, I'm really very optimistic," says one. "If you look at office vacancy rates and economic growth, I can see the market charging on. Our leasing people in every office are going flat out—and if the office market is going well, everything is going well," says another. "Fundamentally, I don't have too much concern about it—if you take out external shocks, markets in Asia are not fundamentally oversupplied, there is very good end-user demand, vacancy rates are down, rents are going up, and that alone is supporting capital value rises," according to a third.

In the current environment, the most likely adverse event is likely to be exogenous. In particular, one common (and predictable) refrain voiced was unease over the return of inflation and rising global interest rates, especially when so many deals in Asia are employing leverage. "What concerns me is what happens to real estate market cap rates as alternative benchmark rates—the bond rates in these countries—are rising," says one analyst. He continues: "In that context, I worry about ultra-low yields that we see at present due to the weight of capital in the direct markets. The risk is that Asia gets caught by a developed-world squeeze in which capital markets in North America or Europe move against real estate. A withdrawal in capital from emerging markets is typically more volatile than in the developed world."

Another interviewee echoed concerns over capital flight: "As we saw in 1997, what comes in can go out, and if things go pear shaped and people become jittery I could see quite a lot of the capital run for cover. They all say they're long term, but that's something the more serious of us ponder." If that happens, says another executive, "there's going to be blood on the streets and people will automatically stop purchasing because they'll wait for values to realign. So you'll get a stumble in the market and that may or may not precipitate the next crash."

Beyond this, many players express a nagging sense of worry. While supply/demand analyses do little to suggest that a turn in the market is imminent, "everything is cyclical and there will be something that will tip it off," says one interviewee. "There always is, and everyone always acts surprised when it happens—we're well, well into the cycle now." An example of how quickly things can turn is Thailand. A hot destination in 2006, the local

market is now in limbo as a result of political upheavals caused by the ouster of the government in a military coup.

In terms of economic pitfalls within Asia, the most likely source of trouble may well be the sheer volume of foreign exchange reserves accumulated by Asian governments. According to the International Monetary Fund (IMF), these will probably exceed \$1.8 trillion this year, or about six times the level in 1999. The problem is that few Asian countries have capital markets sufficiently well developed to deal with the excess liquidity. In particular China, which as of June this year held some \$1.3 trillion in foreign exchange reserves, has had trouble sterilizing (usually by issuing domestic bonds) the huge purchases of foreign currency assets needed to mop up the flood of cash entering the country as foreigners buy Chinese exports. According to a recent note authored by Morgan Stanley economist Stephen Roach, the excess liquidity created by this phenomenon pushed up broad money supply in the region by some 17 percent in 2006, or nearly three times the rate of growth in developed economies.

The risk is twofold. First, the extra cash floating around Asian economies increases the prospect of the formation of asset bubbles, such as the inflated equity prices seen this year in several Asian equity markets, including China's. Second, because regional (and especially Chinese) capital markets remain woefully immature, local banks are left to pick up the slack in trying to intermediate the extra cash. China's banks, for example, are responsible for some 85 percent of all lending to the nation's nonfinancial sector, and with lending surging 16.5 percent year over year through April, it has become directly exposed to the consequences of any asset bubble collapse. In other words, should China's stock (or for that matter, property) boom suffer an inglorious end, the nation's banking system, which remains for the most part government-owned, will end up holding the bag, creating a world of economic pain in China and beyond.

Away from a macroeconomic viewpoint, interviewees mentioned several other specific issues that raise warning flags. Rising occupancy costs and (especially) staffing costs are now causing increasing pain. "In my opinion, the salary spiral is probably the biggest single threat because it takes profit off everybody, and yet you can't operate without your staff," says one consultant.

Market transparency is another perennial problem, although in some countries it is improving rapidly. In part, this is a consequence of increased activity by foreign investors. As one fund manager says, "The fact that you are able to transact now is a strong point—you get to see information on deals collected by brokers and transaction evidence, which is something quite new in Asian markets. Until a couple of years ago, the only information on pricing would be based on valuation. That's a very positive thing that's happening not just in China, but other parts of Asia, too." Increased activity by REIT investors has also boosted transparency, in particular in Japan, according to interviewees.

Governments Meddle as Markets Take Off

Another recently emerging trend that has ruffled feathers in Asian property markets is creeping interventionism by regional governments. In July, former Singaporean Prime Minister Lee Kuan Yew announced that "Singapore must not allow its rising property prices to be as high as those in Hong Kong," a pronouncement that presaged an increase in the local land development tax from 50 to 70 percent. The tax is levied on developers where land values are increased as a result of government rezoning. In addition, the government has boosted the amount of land released onto the market in an effort to reduce perceived shortages that have contributed to large capital and rental price hikes over the last 12 months.

In Korea, a government backlash against foreign real estate investors has now made deals difficult to come by. According to one consultant, "Until about two to three years ago, [the market] was entirely foreign investors. There were about 70 to 80 deals that had been done entirely by foreigners. To my mind, the Koreans got jealous and realized that people had been buying at 11 and the market had moved to 8, so there was a backlash from government and tax authorities."

While other instances of official intervention have been reported in Japan and Malaysia, it is in China where the government's hand has had the biggest impact. The process began in July 2006 with the introduction of a new rule (known as circular 171), requiring foreign real estate investors to conduct business through a locally established entity (with a local office), and

to have registered capital of at least 50 percent of the total to be invested if it exceeds \$10 million. In addition, rules introduced last May now require all new foreign-invested real estate enterprises to be vetted by Beijing.

As one consultant pointed out, this last requirement, while apparently innocuous, creates something of a safety valve for the central government to control foreign-invested projects as it sees fit. "It's an open book to do it as quickly or slowly as they want," he says. Meanwhile, the implementation of a local capital gains tax (known as land value-added tax [LVAT]) has boosted tax liabilities for both foreign and domestic investors significantly. According to projections by the Bank of China International, 2007/2008 earnings at major developers in China are expected to fall by as much as 10 to 15 percent as a result of the change. As one investor commented, "The LVAT is the one that's really been causing the issues—that by itself is going to stop yields going further."

Finally, rules introduced in July now ban foreign players from using foreign debt to finance Chinese real estate investments. This is more than a mere inconvenience. By raising capital offshore, foreign investors could make a play on the nearcertain appreciation of China's currency, the renminbi (Rmb) (see next chapter). If their cost of debt is matched by a rising Rmb, they could in effect leverage their investment for free. That option now appears to have been removed.

Beijing's efforts to target property investments by foreigners have proven controversial, with some questioning whether circular 171 and other recently introduced measures comply with World Trade Organization (WTO) rules. The real problem, however, is one of perception. While foreign capital currently represents just 5 percent of investment in Chinese real estate, foreign buyers are very visible players. According to one consultant, "At the end of the day, [the government] is interested in the mass market, but they know that the upper end of the market where the foreigners operate is dragging up the whole thing."

The more important point for investors is perhaps that Beijing now seems committed in the future to exercising far greater control over the property sector generally. "This year, I've felt things have gotten a lot tougher," says one investor. The change arises not only out of concern that local markets may be overheating. It also reflects a determination to crack down on years of systemic abuses in local property markets by domestic developers and often corrupt local government officials that have resulted in an unrestrained charge of development across the country, consumed vast areas of arable land, witnessed the summary eviction of hundreds

of thousands of farmers from their villages and fields, distorted local property markets, and fomented speculative investment bubbles, corruption, and political resentment throughout China.

In this context, the wave of new regulations introduced over the last 18 months or so can be seen as part of a plan to exert more centralized control over property development policy. In practice, this will be done via the establishment of new land superintendencies that are now being set up in provincial centers nationwide. These bodies are answerable only to Beijing and have a mandate to step up supervision and investigation of land-related local government decisions.

While Beijing's previous attempts to exert control over the sector have featured similar language and posturing (with little, if any, impact), there are reasons to suppose that this time, the central government is serious and that increased regulation of property deals generally is likely to be in the pipeline. Rumors now circulating suggest that a further crackdown may be in the works, targeting use of overseas investment vehicles to structure local deals in order to escape taxation, provide finance, and ease the passage of the sale of a property to a foreign buyer.

While such a measure would be certain to provoke further consternation among many foreign investors, not all of them are dismayed by the current crackdown. According to one consultant based in Shanghai, the new regulations have a Darwinian impact: "The more comfortable you are with the market, each new regulation gives you an advantage over everyone else, while the people who are not comfortable get less comfortable." In fact, the impact of recently introduced rules that boost transparency by requiring government-owned land to be sold only by way of auction instead of according to the old glad-handing ways has boosted prospects for foreign players. This is partly because it means they have access to more deals, and partly because the new rules also require upfront payment, an issue that is far more onerous for cash-poor local developers than it is for foreign funds loaded to the gills with capital.



There is concern in some quarters as debt markets begin to tighten, and some are changing the pattern of their investing.

Capital Flows

s the proverbial rising tide lifts all boats, real estate markets across the Asia Pacific region continue to be buoyed by an influx of newly arriving capital. From the supertanker of Japan—which, on its own, accounts for more than half of total Asian property investment—to the tugboat of Vietnam, property markets across the region are riding high on a wave of new capital. Most executives interviewed for this report reckon that Asia Pacific's markets are attracting even more capital today than they did a year ago, a period that was seen as a high watermark in its own right.

Which naturally leads to a question on many minds: Has the market peaked? Yield compression has reached a point where investors are unlikely to relent, tenants are "howling" at recent rent hikes, and further capital appreciation seems a tall order given the bull run in Asian markets over the last few years. Most interviewees see no letup in new capital coming into the market, but with so many deals highly leveraged, there is concern in some quarters as debt markets begin to tighten, and some are changing the pattern of their investing.

According to an analyst at a large fund group active in Asia, "We are seeing a bit of a shift away from investing in standing, completed real estate and adopting higher degrees of leverage, and more of an emphasis on value-added activities and even development activities at the margin, moving up the risk spectrum." In the current environment, "you have to ask if this is a good time to sit on your hands rather than continue to put money into completed real estate."

Party Looks Set to Continue

According to a director at one firm specializing in tracking property investment flows, overall transaction volumes for commercial real estate in Asia reached \$94 billion in 2006, up 42 percent on the year, with at least \$5 of capital chasing every dollar of available product. In some countries, that ratio is even higher, "probably \$10 or more," according to one investor. Interviewees talk of a "wall of money," the "perfect storm," "an absolute wave of money."

What's more, the flood shows no sign of abating. According to estimates by property consultants Jones Lang LaSalle, Asia Pacific property investment rose 12 percent year over year in the first six months of 2007 to some \$55 billion, mainly a result of increased cross-border flows. With this weight of capital in



the market, "the reality, of course, is that much of it isn't finding a home—it's sloshing around the region, forcing up prices, compressing yields."

One reason why transaction volumes have risen so strongly is, quite simply, that rising property prices make individual deals more expensive. As one consultant says, "About 50 percent of the increased transaction volume [in Asia] in the last year is yield compression as capital values have gone up." In addition, the amount of cross-border capital circulating in Asia has continued to rise (to 32 percent of the total in 2006, up from 29 percent the previous year, according to Jones Lang LaSalle). As one interviewee put it, "They are either being

pulled here by prospects or they are being pushed here by the lack of prospects in their own regions."

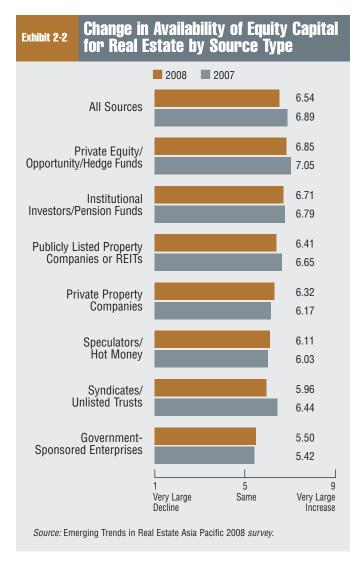
Overall, the drivers remain much the same as last year:

- Unparalleled volumes of global liquidity.
- Relatively cheap debt.
- Ongoing rerating of real estate as an asset class.
- Increased allocation to Asia Pacific property by Western institutional funds looking for diversification and for exposure to booming Asian economies.
- Pension funds seeking higher returns for growing numbers of retirees in Western countries.
- Low levels of institutional ownership of Asian real estate (ranging from 10 percent in China and India to under 30 percent in Taiwan and South Korea, according to RREEF). This compares to 60 to 70 percent in the United States and the U.K.
- Continuing yield compression in worldwide property markets.
- In relation to China, the likelihood of continuing appreciation of the local currency against the dollar promises windfall profits for China-bound investments. Whatever the merits of Washington's campaign to press China over currency revaluation, the political pressure on Beijing appears irresistible as China's trade deficit with the United States continues to mushroom. Although the Chinese government has already allowed the Rmb to gain some 9.5 percent against the dollar since China ended its fixed exchange-rate policy in mid-2005, the rate of change recently accelerated to an annualized pace of about 6 percent. Projections call for further strengthening of the Rmb to 6.93 to the dollar by mid-2008, up from a current level of 7.55, according to investment bank Goldman Sachs.

Private Equity Is King

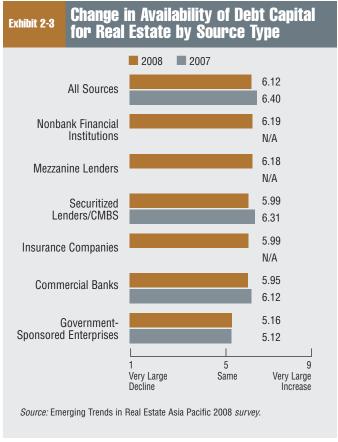
By far, the majority of real estate capital in Asia is private equity—be it Asian developers who may finance projects via syndicated loans or cash-rich foreign funds that use leverage to extend their reach. This seems set to continue in 2008, according to survey responses (see Exhibits 2-2 and 2-3).

The amount of public equity active in regional real estate transactions remains relatively small by comparison, though it is growing steadily, pulled along by increased liquidity and demand for alternative financing options. More developers have taken the chance to list shares in 2007 as local stock markets have boomed and as government regulations continue to tighten access to debt.



This provides an indirect public equity investment channel, but for many players it remains a second choice.

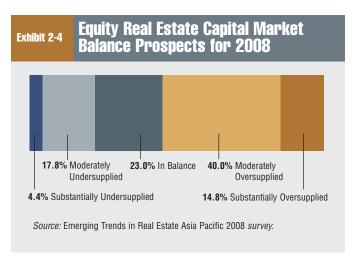
"There's an attraction to head the IPO [initial public offering] route in terms of pricing," says one observer, "but obviously going public brings all the other implications—governance, transparency, and a degree of inflexibility you don't have if you remain private. Some of the mainland [Chinese] companies are interested, though. Initially, they came to Hong Kong [to list] and more recently they've been going to Shanghai. But the parallel to that is that they are setting up initiatives with some of the major institutions and the major funds—often foreign players—whereby they get access to a pool of capital,



either equity or loan capital, and they use that to invest. Much the same as last year, except more so."

Meanwhile, Asia's nascent REIT market has had a tough year in 2007 and will likely continue to labor against private equity while interest rates remain low. The region's tiny market for public debt continues to find little interest.

Geographically, money is coming from all major financial centers in large quantities. Global funds, whose \$6 billion of capital invested in Asia in 2006 hails from indeterminate origins around the world, are reckoned to be the biggest cross-border players, as they are these days in most markets. They are rubbing shoulders with Australian (\$3 billion), American (\$3 billion), and a range of overseas Chinese investors, in particular the Singaporeans (\$2 billion).



20.6% Moderately 27.9% In Balance 33.8% Moderately Oversupplied 12.5% Substantially Undersupplied 12.5% Substantially Oversupplied Source: Emerging Trends in Real Estate Asia Pacific 2008 survey.

In terms of investor types, participants again run the gamut. However, in the current low interest rate environment, private equity investment in Asia is seen by interviewees as having a distinct advantage, not only over other asset classes regionally, but also worldwide.

Historically, most of the action by Western funds in Asia has been driven by opportunity investors whose mandate was to treat Asian assets as relatively high-risk investments in the pursuit of high-octane returns. "I think that has changed over time," says one analyst. "And I think we are on the cusp of a further change in the direction of Asia being accepted by global, regional, and local investors as a legitimate place to invest with core strategies." According to one executive, "There's generally more money around and a lot of it is coming from the more institutional rather than opportunistic funds. They like Japan, Singapore, Hong Kong, [and] Sydney because the risk factors are lower."

The growing maturity of Asian real estate markets is therefore reflected by the growing number of core investors now looking to place funds around the region. This changing dynamic has had a number of repercussions. For one, there are greater numbers of investors with more structured and conservative investment strategies, who allocate funds rather than just deploying it wherever they see good prospects. In addition, the competition has stoked what was already a red-hot investment market with substantial amounts of new capital, boosting stiff competition to buy assets. One investment bank fund manager noted "a unique

situation in Singapore at the moment, where European core investors are bidding for similar products against Anglo-Saxon investment banks with substantially higher-return profiles."

Despite this weight of capital, there is a strong tendency for Asian real estate deals to be highly leveraged. According to one analyst, "It's long been the case that relatively modest proportions of total returns [in Asia] are coming from income. Much of it [has] to do with growth, and it's still possible, even in rising interest rate environments, to achieve quite high returns by leveraging the growth part of the return so that you may barely wash your face with the income return covering your debt costs. So, of all the regions in the world, the place where you might see leverage employed longest is Asia because of that growth orientation. The fact that we still have so many opportunity funds active in the market will help that debt side remain more significant longer here than in other parts of the world."

Down-Under Funds Head North

Historically, most real estate capital flows in the Asia Pacific region have been incoming. The notable exception to this rule has been Australia, whose compulsory superannuation pension schemes held a huge US\$959 billion in assets as of March 2007, up 17.1 percent year over year. Of this, some 8 percent was allocated to property investments, a phenomenon that explains why Australia's REIT industry is today worth some \$110 billion.

Australia has more managed funds per head of population than any country in the world. With over \$4 billion in new funds flowing annually to Australian listed property trusts (LPTs), the Australian equivalent of REITs, and most suitable commercial property in Australia already tightly held, continuing large outflows of capital to international markets are virtually guaranteed.

In 2006, according to Jones Lang LaSalle estimates, Australian property funds purchased some \$12 billion in new assets outside Australia. In the past, the majority of outgoing capital was placed in U.S. property, but the emphasis has since shifted to Europe. While Australian investment in the United States sank a hefty 67 percent to \$3 billion in 2006, European property markets last year absorbed some \$6 billion of funds from down under. In addition, a substantial amount of Australian money has now been placed in Hong Kong, Singapore, China, and (especially) Japan, where three Australian LPTs have bought assets and listed them in Australia.

Petrodollars Seek a Home

Survey responses noted large quantities of capital arriving from the Middle East (see Exhibit 2-6). "They're trampling all over the patch," as one observer put it. Windfall profits from continuing high oil prices have left Middle Eastern wallets bulging, with the combined external surplus of the six Gulf Cooperation Council states alone (i.e., Saudi Arabia, Kuwait, the United Arab Emirates, Bahrain, Qatar, and Oman) totaling some \$200 billion in 2006. Given their limited capacity to absorb this kind of cash internally—especially after the crash of regional stock markets in 2006—much of it must necessarily be recycled abroad.

According to investment bank Morgan Stanley, net foreign assets owned by oil-exporting countries ballooned from 1.5 percent of global gross domestic product (GDP) in the first half of the decade to 2.5 percent in 2005 and approximately 3.8 percent last year. In the past, much of the Middle East's spare cash was channeled into American assets. But with the Patriot Act and the post-9/11 climate in the United States stymicing the flow of Middle Eastern money into the country, there has been a recent shift in emphasis toward assets in Europe and Asia. And real estate is right on their radars, with investors such as Istithmar, Emaar, and Nakheel becoming increasingly active in the region. Hotels seem to be an early favorite for petrodollar spenders, but no one expects them to be restricted to this niche for long.



Although many interviewees note that until now Middle Eastern money has stayed very much below the radar, that now seems to be changing as Arab investment houses set up regional teams rather than operate through proxies such as global funds. According to a director at one consultancy, "The direct [Middle East money] is going to come. We're bidding on some office buildings now and we see them there. They're not bidding aggressively enough yet, but we see them bidding, and they have a lot of money. Now it's tailed off in the U.S. a bit, there's still a lot of interest in Europe, but you can just feel the focus is now here."

Asia's Sovereign Wealth Hits the Streets

While most Asian countries have historically been inward looking, the idea of exporting capital to external markets has begun to catch on across the region, driven by increasingly wealthy populations and by economic pressures created by the accumulation of substantial reserves of foreign currency. Sovereign investment funds, in particular, are becoming increasingly active.

Singapore, whose Government Investment Corporation (GIC) manages some \$200 billion worth of assets accumulated internationally according to ING, is seen as a model. GIC has bought into a number of developed and emerging real estate markets across Asia and in particular in China, where it has entered a string of property development investments. Korea has now placed \$20 billion of its foreign reserves into a similar organization, the Korea Investment Corporation (KIC), while Japan's Government Pension Investment Fund had boosted the value of its foreign assets to some \$150 billion by the end of 2005, from virtually nothing in 2001.

According to an analyst at one sovereign fund, these bodies are "looking to adopt an investment structure similar to a pension fund, in particular a much broader asset allocation away from short-term cashlike instruments, possibly into equities and private equities, which can be anything from real estate to investment in infrastructure or private ventures."

The region's 800-pound gorilla in the sovereign fund stakes is undoubtedly China, whose vast pile of foreign cash from its export-driven economy grew by some \$250 billion in 2006 and as of last June was burning a \$1.3 trillion hole in the government's pocket. Aiming to siphon off some of this cash, Beijing set up the State Foreign Exchange Investment Company (SFEIC) in early 2007 and later unveiled a plan to provide it with capital by issuing \$200 billion in ten-year bonds. Most, if not all, of this is earmarked for investment abroad.

Beijing has yet to say just how the SFEIC (which at a stroke becomes one of the world's biggest investment funds) will deploy this money, but a recent Morgan Stanley note observed that if authorities were to decide to maintain their existing mountain of foreign reserves at current levels (a not-implausible scenario given the torrent of criticism the size of the reserves has drawn), the resulting flood of outgoing capital "would significantly affect the global financial markets." The investment bank also speculates that the SFEIC would need to "seek high returns from its investment in order to make reasonable gains after adjusting for potential losses from renminbi appreciation." This would presumably include buying higher-returning assets such as real estate instead of low-yielding treasuries.

While the first major flows of outgoing Chinese money will probably belong to the government, there also are huge reserves of private capital that will eventually follow as Beijing eases foreign investment restrictions. For example, the government recently raised the limit for overseas investment by mainland insurers from 5 to 15 percent of investable assets. Large amounts of outgoing Chinese funds will probably have to wait until China opens its capital account, an event unlikely to materialize for at least another couple of years.

Interviewees agree that outgoing Chinese money is set to have a big impact, "probably sooner than we think." Says one: "The story of the next five or ten years is the money that's going to come out of China. I think it will seek a direct home—projects, if you like, or buildings. We have involvement with several initiatives where we have Chinese developers looking very seriously at investing in places like Vietnam, Singapore, and Malaysia and wanting to form alliances with the big players there, so they gain immediate access to scale, product, and expertise."

Overseas Chinese Take Emerging Markets by Storm

Not so many years ago, the tribulations of Hong Kong developers trying to make a buck in Chinese real estate was something of a standing joke among market watchers in China. Before the turn of the century, companies such as New World Development and Henderson Land Development took beatings when the Chinese property market collapsed and contracts with government agencies turned sour.

How times have changed. Today, profits from the mainland operations of Hong Kong property developers are soaring as they turn increasingly away from Hong Kong's mature market to harvest rich pickings the length and breadth of China. Big players are raking in the profits and have accumulated vast land banks for future development (in March, for example,



Henderson Land Development announced plans to double its China land bank at a cost of more than \$1.3 billion).

According to a report jointly published earlier this year by the Chinese State Council's Enterprise Research Institute and Beijing's Tsinghua University, seven of the ten biggest overseas developers active in China today are from Hong Kong, while the remaining three are from Singapore. Equally at home in big cities or in far-flung locations, they are opportunity driven and have developed a reputation as shrewd and efficient operators: "These guys have got it down to an art form." While they often work in partnership with local developers, they are equally ready to go it alone—a prospect that would be viewed as suicidal by most other foreign investors. The reason they can get away with this, according to one analyst, is that their China operations have become

sufficiently sophisticated that they have often become, in effect, home players. "They have invested very heavily in being successful, establishing Chinese development operations within their companies. It's the same with the Singaporeans, they are all doing it that way. So it's really a bit of a myth that these people are outside developers."

Nor are they restricted to China. Hong Kong and Singaporean developers are now big investors in markets throughout the region, from Vietnam to Singapore.

One reason why the Hong Kong and Singaporean money has been channeled into so many cross-border deals is that prospects in their own backyards are so limited. Singapore is a relatively small market to begin with, and while Hong Kong is larger, local developers are fish that have outgrown their pond, forcing them to move elsewhere in order to maintain income growth. Besides, commercial property prices and rentals in these cities are now at nosebleed levels, which erodes the prospects for future capital appreciation.

The reason for this is tightening supply caused by an influx of deep-pocketed tenants from abroad—mainly from the finance, insurance, real estate, and business support services—competing for a shrinking resource. According to one fund manager, the phenomenon has been "heavily driven by the financial sector, where all the big banks are relocating their private banking and other divisions. At our bank, we're closing down operations in other markets and basically relocating jobs into Asia and away from places like New York and London that have become extremely expensive." Given the very limited supplies of new office space in Hong Kong and Singapore, this trend is set to continue for at least another couple of years, say interviewees.

REITs Are Here to Stay

This time last year, REITs were seen as the golden child of Asian real estate, offering opportunity for smaller foreign funds and retail investors to access assets in what was hitherto mostly a developers' playground, and bringing newfound discipline to previously opaque markets. What a difference a year makes. Apart from Australia, which is in a unique position because of the weight of money held in government-mandated superannuation schemes, investor interest in Asian REIT products has waned substantially over the last year. As of July 2007, 105

Exhibit 2-7 Listed Property and REIT Market Capitalization

	S&P/Citigroup	
	Global Property Index (MM US\$)	Global REIT Index (MM US\$)
Global	1,352,528	655,082
North America	359,556	333,481
Asia Pacific	711,221	185,623
Europe	266,862	132,828
Hong Kong	191,687	8,327
Japan	163,956	46,565
Australia	121,941	110,137
China	119,267	0
Singapore	64,671	16,493
India	15,968	0
Philippines	10,808	0
Taiwan	8,126	790
Malaysia	5,982	358
Thailand	3,813	0
New Zealand	2,952	2,952
Indonesia	2,049	0

Source: S&P/Citigroup Global Equity Indices. All data as of July 31, 2007.

REITs were listed in seven countries across the continent with a combined value of \$185.6 billion (see Exhibit 2-7).

The main reason for this is that REITs have fallen victim to yield compression. As one consultant points out, "With the weight of money that has come into the region, we are now seeing office yields in Hong Kong of between 2 and 3 percent. Even if you think there will be attractive capital growth, that's not going to attract an awful lot of customers." Although future rent increases may ultimately provide REITs with earnings similar to those of private equity players, leases typically revert to market only every three years, and lumpy income streams are not what REIT investors are looking for.

The biggest REIT market in Asia—Australia aside—is in Japan, where 41 JREITs are listed with a value of some \$46.6 billion. Despite the fact that average weighted yields for the JREITs were just 2.94 percent in June this year (down from 3.5

percent a year previously), they remain a popular option with investors, partly because the market is used to low yields anyway (ten-year government bonds in Japan yield about 1.9 percent), and partly because Japan's low interest rate ensures buyers a positive spread. As one investor says, "We still have this healthy spread between the cost of borrowing—which is still under 1 percent—and property yields, which are around 4 percent, so JREITs still have a place. We don't have that spread in other markets. In fact, interest rates in most markets are well in excess of yields." Even so, JREITs are not the hot players they were a year or two ago. According to one investor in Japan, "Right now debt is cheap, globally and in Japan, but you can't take advantage of that. If you're a REIT, you can only leverage up to 50 percent in most cases, so private equity has a big advantage."

In Singapore, which so far has listed 16 REITs with a combined market value of some \$16.5 billion, the average yield was down to 3.9 percent in July, compared with 2.9 percent on the local ten-year bond and a yield of 5.9 percent a year previously. The number of REITs is projected to swell to 30 by mid-2008, according to investment bank estimates. While that might seem like healthy growth, the value of recent listings remains relatively small, and most have not involved core assets.

According to one local REIT manager, "We're heavily—in fact, almost exclusively—yield driven, so when you get private equity coming in and buying at sub-three, we can't compete. It's very sector led, and each sector is very different for each REIT—industrial will be different from hospitality, which is different from office, and so on. It's one of those things where it's difficult to play in certain markets where there's a lot of private equity that's attacking."

That said, the market is hardly stagnant. For one thing, he says, "these are long-term funds—you have to know the nature of the animal." What's more, "everyone has an allocation, so there will always be plenty of funds for this type of product." In addition, much of the demand for Singapore REITs will inevitably be foreign assets, often located in developing jurisdictions such as China, India, and Indonesia, where yield compression is unlikely to be such a problem. Finally, REIT players are already eyeing the end game: "Once yield compression dampens, these guys will all have to bail out," he says, "so there will be a lot on the market in the next couple years."

The Hong Kong REIT market (comprising seven trusts valued at some \$8.3 billion at present) has probably been the most disappointing. Currently yielding an average of about 5 percent,

compared with 4.8 percent for the government ten-year bond yields. Hong Kong's REIT industry also suffers from an image problem created by questionable accounting exercises as REITs stretched valuations in an effort to get product out the door. As one investor put it, local REITs were "very creative in terms of financial engineering, topping up in all kinds of creative ways, and the market quite frankly has gotten wise to that—it's really only interested in the underlying yield on the asset."

In addition, some interviewees have been critical of the quality of assets brought to market. As one interviewee summed it up, "Hong Kong is as predicted—a few developers chucked their rubbish in there and overleveraged it and people have lost faith as a result."

Indeed, the problems in Hong Kong reflect a broader issue affecting the investment public throughout Asia. According to one consultant, "For me, one of the big benefits of REITs has been the widening of real estate categories that could be taken to the investor—any real estate that has income-producing capabilities can be 'REITed.' That's why in other places you have self-storage, nursing homes, medical centers, and even prisons that have been REITed." But in Hong Kong, for example, "people think you buy REITs in the morning and sell them in the afternoon. That's not what REITs are all about. REITs are something you buy for five years and forget about it—the sort of thing your granny puts her pension in."

In developing markets, REITs have for the most part failed to get out of the starting gate. India is now talking about introducing REITs next year and is meanwhile beginning to list property assets in Singapore and Dubai. In China, where some 80 percent of property development is still financed by bank lending, REITs might seem the ideal means for shifting the burden of property development funding away from an already fragile domestic financial sector and into the capital markets.

But the volume of investable property in China remains low. And while the Shanghai Stock Exchange has begun to study the possible launch of a homegrown REIT industry, and a handful of foreign-listed REITs have managed to bring Chinese assets to market (in Hong Kong and Singapore), most interviewees remain pessimistic about the short-term prospects for a Chinese REIT industry. "As far as I know, there's no chance of it happening anytime soon," says one. "It needs State Council approval and I don't think it's something they will countenance

as long as there's so much political risk attached to anything to do with real estate."

What's more, there is a concern that China has yet to develop the financial sophistication to administer this type of product properly. "It's like China turning around and saying, 'We're going to build commercial jets'—it's all very well if you have the engineers, but if you don't, how on Earth are you going to do it!"

Another issue currently catching investors' attention is the possibility of Asia's REITs being taken private, a trend that has gained traction in the United States this year as REIT share prices dropped significantly below the underlying value of their assets. Indeed, privatizations have already occurred in Australia, where some REIT assets have recently been sold off. In this case, however, privatization of assets does not reflect weakness in the local LPT market as much as it does strength, with private equity looking at "what are essentially very high-dividend and real estate yields in Australia and thinking, given the low-risk environment of Australia, that they're perhaps one of the more attractive [destinations] around the world."

At first blush, the prospect of REITs being taken private in other Asian jurisdictions may seem remote given that, in Hong Kong, REITs currently trade at about 1.3 times net asset value (NAV), and in Singapore at between 1.1 and three times NAV. But it is still plausible. According to one analyst, "Could you see someone privatizing a REIT at a premium to NAV? Absolutely. At the moment, private equity is very competitive and as long as there's opportunity in markets around the region, even though it's less effective than it was, private equity can use leverage to bid out public equity."

But that still leaves other problems. The analyst continues: "Personally, I think it's going to be quite hard to do because of the REIT structures adopted in Asia—the limited shareholdings that are available to the public, the degree to which they've been held by the sponsors, the fact that free floats are relatively restricted. But it's out there as something that may happen. You could see big REITs swallowing small REITs and growth coming from M&A rather than from organic growth."

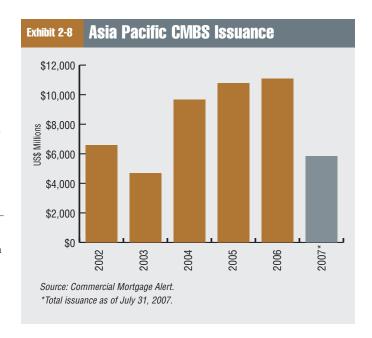
Over the long run, though, most interviewees have confidence that REITs will emerge as a major force in Asian real estate. For one thing, markets will mature. In addition, investable supply will increase, both generally and because, according to one interviewee, "We're looking at four- to six-year closed-end funds that all these institutions are spending their money on—they're going to have to have exit strategies to get them out quickly at the end of the fund period."

No Abuse of Debt

Leverage continues to be popular with Asian property investors, but most debt is raised from banks and there remains little traction for securitized financing such as commercial mortgage—backed securities (CMBS) (see Exhibit 2-8), and even less for the more risky collateralized debt obligations (CDOs, in this case, bundles of CMBS), which have yet to appear at all on Asian horizons.

This lack of appetite for structured finance or in general for highly leveraged investing means that most Asian markets have little direct exposure to the type of meltdown experienced in U.S. credit markets in mid-2007. There is limited—though at this point unquantified—risk for Asian banks that have invested in subprime assets bought in the United States, but this does not appear to be a systemic problem. State-owned banks and sovereign funds (in particular in China) are also known to have invested some of their considerable assets in U.S.-packaged loans, but these are thought to comprise mainly higher-grade paper. While this does not leave them free and clear of the crisis given that prices are now heading south for the whole universe of asset-backed products, the exposure is again relatively small, and as long-term holders they have more leeway to outlast the worst of the rout.

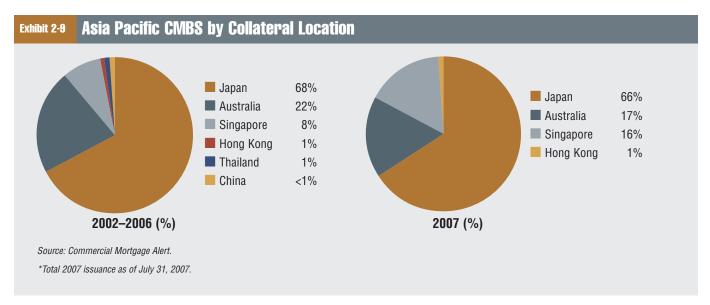
Just how Asian markets will be affected by the indirect fallout from the global credit-market contagion is another matter. In late August, the value of the Japanese yen ballooned as U.S. institutions unwound cheap loans taken out in the local currency in order to invest in higher-yielding assets elsewhere (the so-called carry trade). This may presage a reduction in foreign capital circulating in Asian real estate markets as funds scramble

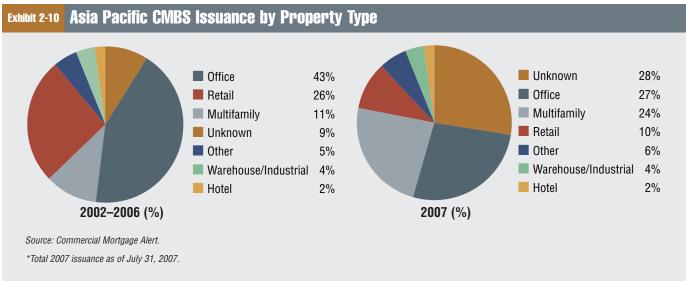


to meet cash calls elsewhere in the world, but that may not be a bad thing given the current oversubscription of liquidity in the region. However, if the crisis spreads to hit U.S. retail markets, this could severely affect Asian economies that are heavily reliant on the U.S. consumer to buy their exports. At this point, this risk of such a scenario is hard to quantify.

To the limited extent that mortgage-backed products have appeared in Asian markets, the major players are Australia, which tends to follow Western financing models anyway, and Japan. In Australia, the CMBS market has become a major financing option for real estate investors, driven largely by the LPTs (i.e., the local REIT market), with issues exceeding \$972 million in 2007, according to Commercial Mortgage Alert. However, Japan continues to be the largest in the CMBS market, representing over 65 percent of all transactions in 2007 for a total of \$3.86 billion (see Exhibits 2-9 and 2-10).

Otherwise, the biggest regional player is Singapore, which has produced 15 CMBS transactions since 2002. Even there, though, issues peaked in 2005 and have fallen off dramatically this year. A few CMBS issues have also been seen in Hong Kong, Taiwan, and Malaysia. China launched its first two CMBS notes last year.





Why the lethargic performance? Partly, it reflects a cultural reluctance to borrow that has seeped into financing practices: "Traditionally, they're not led by the debt market so much," observed one fund manager. But it's also a sign of the times. According to one analyst, "In Asia, the growth of this product has been linked to the development of the REIT markets—they seem to fit better with the underlying vehicle that is taking the debt. But in a time of great liquidity, it's far more straightforward and cheaper to get a syndicated loan to finance real estate than to go through the elaborate and costly processes of setting

up a mortgage-backed security." A local REIT manager described CMBS as "a very cookie-cutter type of debt—it's just a question of how competitive it is. We have a trading price now where the yield is quite low, so we'd be better going off and raising equity, and in some cases that's basically what people do. But it will—mark my words—have an effect at some point, because this is going to reverse and the fact that the cost of equity is lower than the cost of debt is truly a unique market condition."

"Derivatives are going to absolutely take off in this part of the world."

Exhibit 2-11 Su	Survey Respondents' Global Real Estate Portfolio
by	y World Region

		Portfolio Allocation		
	Small Part (<25%)	Substantial Part (25-75%)	Large Part (>75%)	
2008				
Asia Pacific	28.1%	21.3%	50.6%	
United States/Canada	64.0%	18.0%	18.0%	
Europe	76.4%	23.6%	0.0%	
In Five Years				
Asia Pacific	17.9%	38.1%	44.0%	
United States/Canada	64.3%	23.8%	11.9%	
Europe	76.2%	23.8%	0.0%	

their desks and trade online than actually go out and hunt around."

According to another Hong Kongbased executive, "Derivatives are going to absolutely take off in this part of the world. The growth in London is absolutely huge from a standing start, and they're going to appeal to the Chinese investor." Trading of residential derivatives was launched in Hong Kong in February this year, followed by tests of commercial property derivatives (based on indices compiled by Investment Property Databank [IPD]) in Australia and Japan.

Mezzanine debt, however, has proven more popular. According to one investor in Japan, "There are a lot more mezzanine lenders in the market today—there's a lot of capital that's been raised, and a larger diversity of capital, and a lot of it is specifically focused on that risk piece in real estate deals. They don't want to take the riskier equity price, but they want a higher return than the senior price. I think that for the risk they're taking, they're getting good returns."

Mezzanine deals have also been popular as part of offshore financing packages in China, which provide investors with tax breaks, access to cheaper capital, and a free ride on China's slowly appreciating currency. Recently, however, Beijing has introduced new regulations (following similar moves by Indian authorities), which seek to end financing mainland property investments with offshore loans. Whether these regulations can be enforced, however, remains to be seen.

Finally, while these more exotic forms of debt finance are clearly still in the embryonic stage of development in most Asian markets, a new type of derivative trade seems set to become wildly popular in the region. Born in the U.K. at the end of 2005, index-linked property derivatives allow investors (and speculators) to make over-the-counter bets against movements of a benchmark index over a set time frame. "It's virtual trading in real estate," as one observer put it. "The benefits are that you don't pay trading costs and don't have the illiquidity of single units. In a speculative market like Hong Kong, I think people would much rather sit at

In the Crystal Ball

"More allocation to Asia, even more capital looking to be placed in real estate" is a sentiment shared by most interviewees and survey respondents (see Exhibit 2-11), with some qualifications. Certainly, the weight of money targeting the Asian region shows no sign of slowing. Morgan Stanley, for example, announced in June that it had raised \$8 billion in new capital that will be leveraged to provide some \$30 billion in spending power in what will be the world's biggest property investment fund. About 60 percent of this is targeted at Asia, and in particular at Japan, China, and India.

Interviewees offered a variety of opinions about future trends in Asian real estate markets over the next five years: "Energy conservation and sustainability will be major criteria for marketing new developments to prospective tenants, as will new codes and standards through regulatory/governmental authorities," says one. "We are focusing on understanding trends in the housing market and targeting our products to meet these," offers another. "Becoming more and more specialized," says yet another. "Upgrades in all product types toward more international standard." And finally: "Investors will need to actively manage the assets in order to generate returns—the days of [purely] financially generated transactions are winding down."

Despite solid fundamentals, the extent of price increases and yield compression over the last 18 months has left many wondering how much fuel can be left in the tank. "I suspect that pricing issues in mature markets are probably reaching their

peak," comments one fund manager. "You have to question whether with the development charge they've brought in here [i.e., Singapore] recently whether sentiment may be slowly topping out," says another.

Whether that pans out or not, the dearth of opportunity in major Asia Pacific markets promises to add juice to the growing migration toward secondary markets. As one consultant says, "There will be a greater spread of investments, so that other markets such as Vietnam and Japanese provincial markets, and second-tier cities in both India and China, will find greater attraction."

At present, the prospect of rising interest rates seems to be the major potential spoiler. Even then, however, the consensus is that markets are more likely to slow than to reverse. According to one analyst, "If the underlying fundamentals hold up as well as projections say they should, the question becomes: Will the growth in income streams from real estate be enough to offset any adverse movements in cap rates in a global context of rising interest rates? At the moment, the base case suggests that in Asia they will. That doesn't mean there will be spectacular returns. But it will mean that growth in value stemming from growth in income offsets a potential decline in value from an adverse cap rate shift. That means much more modest returns going forward."



"There is a clear sense that most of the

Asia Pacific property markets

have moved toward maturity."

and Sectors to Watch

ast year, survey respondents anticipated positive movements for Asia Pacific property markets in 2007. They envisioned Asia Pacific property markets progressing along a continuum, from a noninstitutional emerging phase to a mature, internationally integrated status. There was a consensus that if Asia Pacific property markets continued to mature, then 1) transparency across property markets would increase, 2) the quality of information would improve, 3) government policies and regulations would stabilize for domestic and foreign investors, and, overall, 4) there would be better real estate intelligence to support property investment and development strategies in the Asia Pacific region.

So what happened in the interim, between last year's survey and this year's survey? Did Asia Pacific property markets continue their evolution? Have they become competitive in performance, maturity, and opportunities with other global property markets in Europe, Latin America, the Middle East, Africa, and North America?

The evidence of Asia Pacific property market growth is mixed since last year's inaugural *Emerging Trends in Real Estate® Asia Pacific* publication. Over the last year, there has been exponential growth of new property developments throughout the region. But more construction is not necessarily a sign of maturity as experienced in most international property markets during the 1980s. In fact, several interviewees express concerns about an "oversupply of hotels in Beijing" and "oversupply risks in the India business process outsourcing [BPO] segment." The quality of property research in the private and public property sectors has improved. And there are new global and regional real estate funds, initial public offerings of real estate operating companies, and new participants in the Asia Pacific region—all positive signs of maturity.

According to this year's survey respondents and interviewees, there is a clear sense that most of the Asia Pacific property markets have moved toward maturity, although there is still a sense of bewilderment and "continued skepticism" regarding government regulations and the mechanics of how Asia Pacific property markets function. Is it that the maturation of some property markets in the Asia Pacific region has in fact highlighted the less-than-mature nature of other Asia Pacific cities? Is there now a widening gap of maturity between property markets such as Tokyo and Ho Chi Minh City?

One significant change in survey responses from last year to this year is the increasing number of respondents and interviewees who discuss more than one property market or country. Pan-Asia Pacific investment and development strategies are clearly apparent in numerous responses. Indirectly, the 2008 results indicate a maturity of individuals and firms active in the Asia Pacific property markets. One interviewee, representative of many others, easily referenced several countries and markets within sentences with statements such as "India is too speculative in all niches, especially commercial, mixed-use, and hospitality developments." Statements such as this often were quickly followed by "Singapore and China are the strongest areas for development activity based on strong demand. Japan is priced extremely high. China has a growing appetite in secondary and tertiary cities. Primary markets may slow down." Understanding and recognizing the diversity and variations between Asia Pacific property markets is undeniably another step toward maturity.

The Asia Pacific property market is not one market, but many; in terms of opportunities, risks, capital markets, economic and demographic demand factors, and business cycles, it

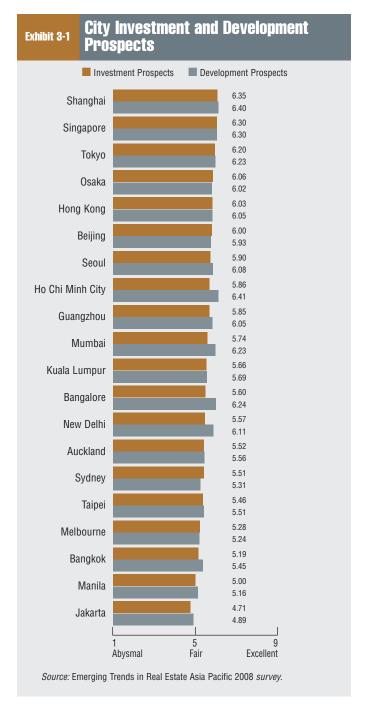
"Investors will try **new markets** to improve returns."

is as diverse today as it was a year ago. We did not hear responses that inferred a "herd mentality" this year. Last year, several respondents simply stated that they were investing in the Asia Pacific property markets because their competitors were investing in them. Where to invest in such a large geographic expanse, and which cities to invest in and develop? "All of the above," replied one institutional investor.

Enigmas Abound

Enigmas exist, however, in the minds of many interviewees and survey respondents as evidenced by interview notes, surveys, and overall results. Consider the following:

- Development outranks investment ratings in 15 of 20 Asia Pacific property markets. Last year's top development market continues to be the top development market this year (Ho Chi Minh City) and now joins the top ten investment markets. One interviewee expressed the notion that the "lack of investment-grade stock will lead to new development, except in the potentially oversupplied markets. Investors will try new markets to improve returns." Another respondent forecasted that "2008 will be a bellwether year in development throughout Asia, because so much development is occurring throughout the region, with much of it being delivered through 2010." Does that sentiment explain Ho Chi Minh City's number-one ranking for development and its rise from a 12th-place ranking in 2007 to eighth in 2008 for investment, or the number of other respondents who identify secondary cities as potential investment and development targets?
- There is little correlation between investment rankings to city risk rankings. Several of the top ten investment markets such as Shanghai, Beijing, Ho Chi Minh City, Guangzhou, and Mumbai are respectively ranked 11th, 13th, 18th, 12th, and 14th in the city risk categories. However, cities such as Auckland, Sydney, Taipei, and Melbourne—ranked in the bottom ten investment markets—are in the top ten city risk ratings. Are investors compensated for city risks in the top ten investment markets?
- Foreign investors welcomed, foreign investors regulated. While countries such as China and India are proposing, changing, or implementing government regulations restricting foreign real estate investments in domestic property markets, other countries such as Cambodia, Thailand, and Vietnam are encouraging foreign real estate investments and developments. One



interviewee questioned, "Will government restrictions on [the] residential market have an impact on other real estate sectors in China?" Another mentioned "uncertainty in policy changes in China" as a future investment risk. Finally, one respondent mentioned "regulatory restrictions on foreign investment and changes in local property legislations" as factors affecting all

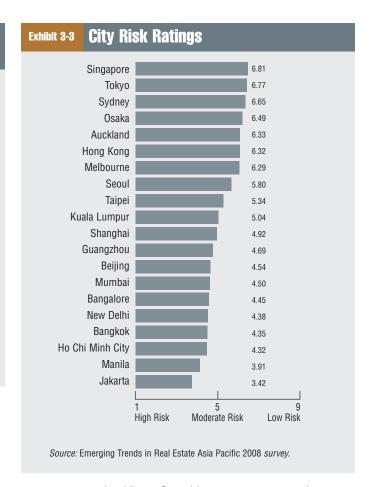
2008 vs. 2007 Investment Prospect Ranking		
City	2008	2007
Shanghai	1	2
Singapore	2	4
Tokyo	3	3
Osaka	4	1
Hong Kong	5	11
Beijing	6	9
Seoul	7	13
Ho Chi Minh City	8	12
Guangzhou	9	7
Mumbai	10	17
Kuala Lumpur	11	15
Bangalore	12	10
New Delhi	13	14
Auckland	14	_
Sydney	15	16
Taipei	16	5
Melbourne	17	6
Bangkok	18	8
Manila	19	18
Jakarta	20	19

countries and markets. Restrictions may affect a country's international competitiveness, as explained by one respondent: "Due to restrictions on leverage, China's leveraged IRRs are on the lower end of the global scale and not expected to improve."

Finding Equilibrium

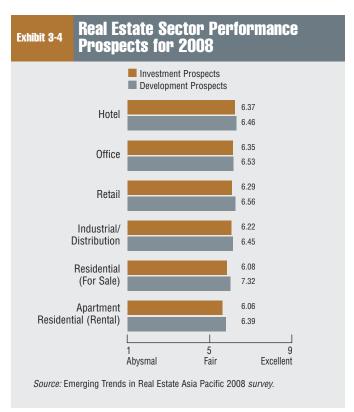
It is not surprising that four cities are new to the top ten investment rankings in 2008, and four others have dropped out. *Emerging Trends in Real Estate® Asia Pacific* is relatively new compared with the Europe and U.S. editions. As such, there is a natural and slight disequilibrium of city ratings and rankings during the early editions as survey respondents acquaint themselves with the unique process of *Emerging Trends* and potential sample biases are filtered. As industry acceptance and awareness of the Asia Pacific survey evolves over time, a general consistency of city assessments may occur similar to that seen in the U.S. and Europe editions.

Hong Kong, Seoul, Ho Chi Minh City, and Mumbai are the four new cities in the top ten investment rankings, while Bangalore, Taipei, Melbourne, and Bangkok have dropped in rankings. Top investment rankings, however, do not necessarily correlate with interviewees' assessment of future real estate performance. Last year's theme of "deluge of money chasing



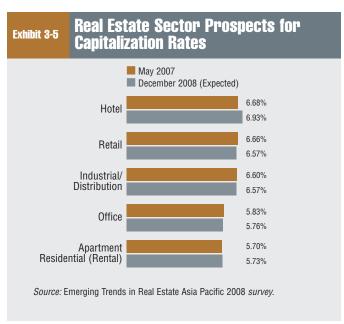
opportunity and risk" is reflected by one interviewee who is "looking at correction in high-priced cities such as Hong Kong, Shanghai, Singapore, and Ho Chi Minh [City] to create new buying opportunities." Whereas one interviewee "had a good experience in India in 2006," the interviewee's firm is "now looking at secondary cities in China."

Exhibit 3-1 ranks our survey of 20 Asia Pacific property markets by investment prospect ratings. The top five property markets are Shanghai, Singapore, Tokyo, Osaka, and Hong Kong, with Beijing, Seoul, Ho Chi Minh City, Guangzhou, and Mumbai rounding out rankings six through ten. The top five property markets ranked by development prospects are Ho Chi Minh City, Shanghai, Singapore, Bangalore, and Mumbai. Exhibit 3-2 compares investment prospect rankings for 2008 and 2007. The largest ranking increases were Mumbai (+7), Hong Kong (+6), Seoul (+6), and Ho Chi Minh City (+4), while the largest decreases were Melbourne (-11), Bangkok (-10), and Kuala Lumpur (-4).



Unlike last year, the relationship between an Asia Pacific property market's investment prospects and development prospects is more correlated. Numerous interviewees mentioned the deteriorating imbalances between the supply of, and demand for, investment properties. Thus, more respondents are investigating development opportunities in top-ranked investment markets. "Due to the limited [number of] investment properties available, riskier development projects will continue to be popular," claimed one respondent. Another stated, "Development will be of huge importance for the next couple of years. As cap rates on existing buildings have tightened greatly, speculators and developers have come back to the market. Lenders also are becoming more bullish and capital is being set aside for development." The survey results basically imply that respondents and interviewees believe that if a property market ranks high for investment, why not development, too?

Other cities mentioned as potential investment and development targets include Brisbane, Macau (gaming sector), Sapporo, Fukuoka, Nagoya, Hangzhou, Dalian, Xi'an, Chengu, Chongqing, Suzhou, Nanjing, Chennai, Pune, and coastal cities in Vietnam. Inland second-tier cities in China, characterized as offering



"higher yields and less downside risk," are frequently mentioned by numerous interviewees and respondents.

Property Sectors in Perspective

Hotel investment moved slightly ahead of office, last year's top property sector investment ranking, whereas residential for-sale's development rating far surpasses other property sectors (see Exhibit 3-4). Hotels, including luxury resorts, are frequently mentioned as important sectors in the short- and long-term development of Asia Pacific property markets. One respondent stated that "hotel investment and development will be very active in 2008," while another developer noted a focus "on luxury resorts, hotels, residential, and service outlets" over the next five years. An interviewee from India stated, "I see big demand for hotel rooms in major cities like Delhi, Mumbai, and Bangalore."

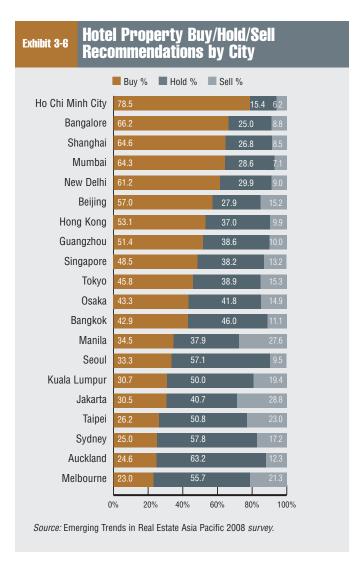
The residential (for-sale) property sector has a strong development prospect rating at 7.32. Unlike other regions of the world mired in issues such as subprime lending and significant contractions in the homebuilding market, there is a different story to tell regarding residential development in the Asia Pacific region. Trends in urbanization, second-home markets, and increasing household incomes support growth in this property sector. Not all property markets are expected to participate in residential development such as Bangalore, where one respon-

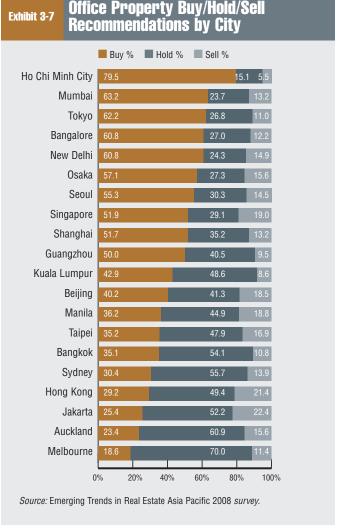
dent stated, "Even prime residential is now twice its all-time earlier peak. The sustainability of these prices is questionable." Another claimed, "Residential development opportunities will be scarce in Sydney and Brisbane."

Hotel Sector: Rising Demand. As previously mentioned, the hotel sector ranks highest this year for investment and fourth for development. Many comments were favorable: "hotel investment and development will be very active in 2008" and "more funds will be investing into hotel developments in 2008." Business travel and tourism growth are driving demand in many property markets. Some of the same cities rank highest with buy recommendations as with office such as Ho Chi Minh City, Bangalore, Mumbai, and New Delhi. High buy ratings may not

necessarily reflect future growth, but rather opportunities based on cyclical and new demand factors. One respondent stated that "there will be an oversupply of hotels in Beijing after the Olympics, so we can expect to see some of them trade in 2008. Singapore and Macau will benefit from the gaming industry, so major hotels with casinos will be attractive to both investors and developers." Several interviewees also believed that there would be growth in "boutique hotels, or resort residential for holiday use" as well as "budget business hotels . . . where hotel rates are high and business travelers have little time to enjoy hotel facilities."

Office Sector: Fierce Competition. One respondent succinctly summed up the office sector market in Asia Pacific property markets: "fierce competition for all sectors, especially





	Foreca	ıst (%)
City	2007	2008
Beijing	26.0	23.0
hanghai (Pudong)	4.0	9.0
lew Delhi	0.5	0.5
angalore	3.0	1.0
/lumbai	10.7	10.8
uala Lumpur	9.0	9.0
angkok	15.0	14.0
aipei	13.5	12.5
long Kong	4.1	4.2
eoul	1.8	1.8
okyo	3.5	3.2
)saka	6.9	6.7
Singapore	1.5	1.2
ydney	6.9	5.9
/lelbourne	6.3	6.4

office properties." The highly competitive nature of buying office properties in major cities has created alternative strategies to develop office properties, especially in growing cities such as Ho Chi Minh City, Mumbai, Bangalore, and New Delhi, or redevelop existing properties. One respondent noted an opportunity to invest in "Grade B office buildings that can be easily refurbished and then sold after increasing the rent. This will be the focus for funds in Japan and China." Another respondent cautioned, "As India and China labor and occupancy costs increase, jobs and office development opportunities will migrate to the Philippines and Vietnam." Jakarta and Hong Kong lead in sell percentages for all office markets, but all markets are still below a 25 percent threshold.

Office demand in major international property markets is relatively strong. "Office—continued heavy demand for key cities—Singapore, Hong Kong, Shanghai, and Tokyo," said one respondent. Continued office demand in key cities will increase occupancy and decrease vacancy rates, thus creating an environment where "the lack of prime office space in Tokyo, Seoul, Hong Kong, Singapore, and Hong Kong will drive up rents, which will cause more office buildings to be acquired by REITs and private funds. Developers will start more projects, but most will be too late to take advantage of the current market conditions." According to RREEF Real Estate Research, most office

vacancy rates are expected to remain stable through 2008 with the exception of Shanghai (Pudong). Exhibit 3-8 presents yearend 2007 and 2008 office vacancy rate forecasts.

Retail Sector: Dynamic Changes. The retail sector in Asia Pacific property markets is very dynamic. "Everywhere there is a drive for diversification of retail concepts—big box, factory outlets, and specialty retailing," said one respondent. "Retail is hot as Hell right now in China . . . especially entertainment," countered another respondent. Per-capita income growth is rising faster than inflation in many Asia Pacific countries. In countries such as India, retail growth is partially fueled by multinational retailers eager to enter new markets. According to one respondent, "Assuming foreign direct investment in multibrand retail



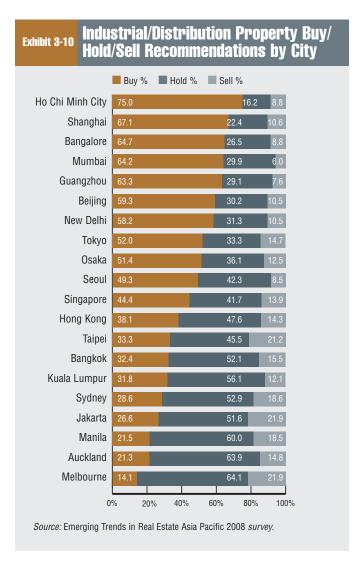
opportunities will migrate to the Philippines and Vietnam."

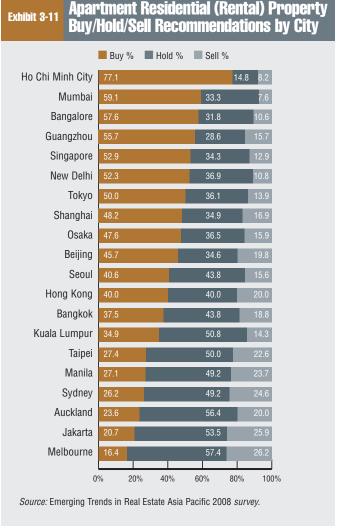
being allowed, foreign retailers will enter India. As a result, the demand for quality retail real estate will increase." Top-quality management of retail properties is also noted by several respondents: "Better returns may be limited to properly managed retail centers with the right mix of tenants," affirmed one respondent.

Industrial Sector: Modernization. A consistent theme among many respondents is the need for sophisticated and modern industrial properties. As one respondent said, "Industrial facilities will be upgraded in many markets and there is big potential in China." Another believed that "the distribution sector will see more development activity due to functionally obsolete existing stock as well as increased capital expenditures into plant and

equipment by occupiers." Though not as glamorous as Class A office buildings and high-end retail, the industrial sector is gaining respect with investors and "will be recognized as a major property type in 2008," claimed one respondent.

Apartment Sector: New Definitions. Urbanization in Asia Pacific property markets is a self-fulfilling economic factor for the supply and demand for residential space. As the percentage of the population moving to cities increases, demand for residential property grows. Interviewees and respondents in this year's survey address the variances of residential investment and development across Asia Pacific property markets. In some mature markets, "the residential apartment market will continue to be depressed,





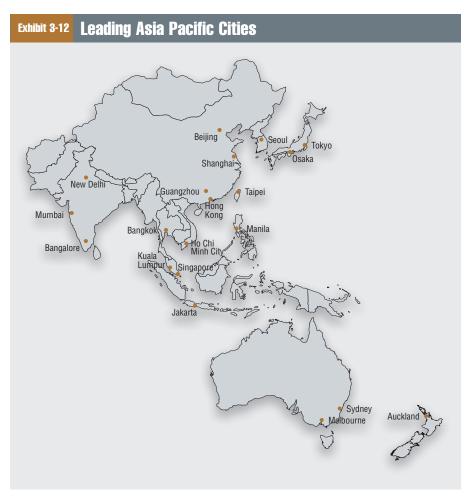
except at the top end in prime locations. Development opportunities will be scarce in Sydney and Brisbane, unprofitable in Melbourne but growing in Adelaide, Perth, Darwin, and some other regional centers."

There is a clear message that understanding the current and future trends of apartment or residential segmentation, such as low-income, middle-income, or luxury residential, is critical in sustaining the apartment sector. In some cases, "midmarket residential properties, which are encouraged by the central government under the 11th five-year plan," are just as important "as the current drive to cool down the housing market, by increasing the supply at the lower-end segment," one respondent noted. "Development of residential property in China's second- and third-tier cities will be the most lucrative market in 2008," claimed another.

The new definitions of the apartment sector also include new property types. These new property types comprise a variety of housing—"medical tourism—type facilities, [including] resorts and retirement villages, which will mature attracting more capital for development"—as well as "waterfront mixed-use developments, espe-

cially residential properties mainly because of lifestyle demands."

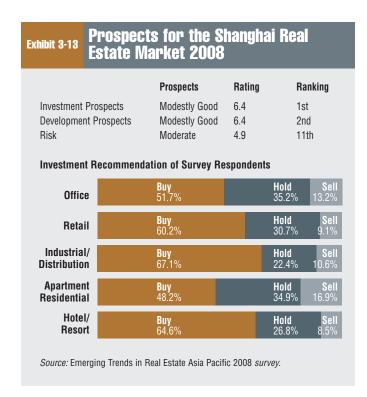
The enigmas of Asia Pacific property markets will eventually subside. As the years go by, Asia Pacific property markets will integrate more fully with the global economy and, just as important, the global property capital markets. If the quality and quantity of research, business intelligence, and transparency improve in Asia Pacific property markets, then the atypical puzzles and learning curves of the marketplace will be replaced with diversity and maturity.



Top Investment Cities

Shanghai

Shanghai reaches the pinnacle of Asia Pacific property markets in 2008 as ranked by investment prospect ratings. According to one respondent, Shanghai belongs to an elite group of cities. "The real estate investment market will continue to focus on the main gateway cities in Asia Pacific of Tokyo, Hong Kong, Singapore, Shanghai, Beijing, and Seoul." Another observer states, "Expect continued heavy demand for key cities—Singapore, Hong Kong, Shanghai, and Tokyo."



Oversupply is a concern among respondents and interviewees this year, which probably explains the increase of sell recommendations of office (8 percent in 2007 to 13 percent in 2008) and retail (3 percent in 2007 to 9 percent in 2008). One interviewee expressed an apprehension of "potential overheating in some stock markets, especially Shanghai, which could have a knock-on effect on real estate."

Singapore

Singapore, another Asia Pacific gateway city, climbs in all categories from 2007 to 2008. The city jumps from fourth to second for investment rankings, goes from ninth to third for development rankings, and ranks first for city risk rankings in 2008. According to Jones Lang LaSalle, Singapore is one of the world's "hottest" markets and is frequently mentioned with Hong Kong as a significant real estate capital market center in the region. As one respondent mentioned, government regulations "will likely continue to be relaxed to help Singapore secure its position as a



hub for regional Asian REITs. The new offerings in 2008 will likely have some cross-border elements." Singapore is "certainly one of the markets in the area that provides a very stable legal and tax environment and property rights that are beyond question. And it therefore is certainly one of the markets where many, especially Westerners, are very comfortable," said one respondent.

One significant difference from last year is the change in sell recommendations for several property types. Sell recommendations increased for office, retail, and hotel/resort from 0 percent in 2007 for all three property sectors, to 19 percent, 13 percent, and 13 percent, respectively. Industrial/distribution buy recommendations increased from 35 percent to 44 percent from 2007 to 2008.

Tokyo is a city where "supply is still very tight and vacancy rates low."

Tokyo

Tokyo maintains its third-place ranking for the second year in a row. Tokyo is a city where "supply is still very tight and vacancy rates low," respondents say. Also, "there's more institutional money looking at Tokyo, but there's been a lot of opportunistic money that has been ploughed into Tokyo over the last five years," according to respondents. According to the Japan National Tax Agency, Japan land prices increased at the highest rate in 15 years, confirming a recovery in the land market. One interviewee expects "recovery to continue in the next five years; the current

Prospects for the Tokyo Real Estate Exhibit 3-15 Market 2008 **Prospects** Rating Ranking 3rd **Investment Prospects** Modestly Good 6.3 **Development Prospects** 6th Modestly Good 6.3 Low 6.8 2nd **Investment Recommendation of Survey Respondents** Office Hold Retail 40.0% Industrial/ Distribution **Apartment** Residential Hotel/ Resort Source: Emerging Trends in Real Estate Asia Pacific 2008 survey.

strategy is to buy and hold We also expect continued flow of capital, more REITs with Japan assets in both the Japan stock market and other markets such as Singapore and Australia."

Sell recommendations have increased over last year's percentages for office (9 percent to 11 percent), retail (6 percent to 10 percent), industrial/distribution (7 percent to 14 percent), and hotel/resort (6 percent to 15 percent), while buy recom-

mendations for retail decreased (72 percent to 50 percent). The change in sell recommendations potentially reflects a cyclical peak in the market partially due to high levels of foreign and domestic property capital flows.

Osaka

Osaka dropped its top investment ranking in 2007 to fourth in 2008. Some investors "constantly look at Osaka as a market to expand," and investors continue to enter the market. One interviewee stated that investors "are prepared to look and buy outside of Tokyo, particularly in the nonoffice sectors. Shopping centers, retail in general, and then logistics. The preferred area is Osaka "Another cautioned that "Japan will emerge from its long period of stagnation to boom such that its real estate market in Tokyo and Osaka will become numbers one and two in pricing and occupational costs."

Similar to other top investment ranked cities, all the sell recommendations have increased over 2007 levels. Sell recommendation percentage changes from 2007 to 2008 include office from 4 percent to 15 percent, retail from 4 percent to 10 per-

Prospects for the Osaka Real Estate Market 2008				
		Prospects	Rating	Ranking
Investment Pro	spects	Modestly Good	6.1	4th
Development P	rospects	Modestly Good	6.0	11th
Risk		Low	6.5	4th
Investment Recommendation of Survey Respondents				
Office	B 5	Buy 57.1%	Hold 27.3%	Sell 15.6%
Retail		Buy 51.3%	Hold 38.2%	Sell 10.5%
Industrial/ Distribution		Buy 1.4%	Hold 36.1%	Sell 12.5%
Apartment Residential		Buy 17.6%	Hold 36.5%	Sell 15.9%
Hotel/ Resort		Buy 13.3%	Hold 41.8%	Sell 14.9%
Source: Emerging Trends in Real Estate Asia Pacific 2008 survey.				

cent, industrial/distribution from 4 percent to 12 percent, apartment from 8 percent to 16 percent, and hotel/resort from 9 percent to 14 percent.

Hong Kong

Hong Kong joins the top ten investment cities. Those who were surprised by the city's 11th-place ranking last year no doubt are pleased with a fifth-place ranking for 2008. Hong Kong is consistently mentioned as one of Asia Pacific's gateway cities, a municipality that is internationally competitive. As one respondent exclaimed, "Hong Kong is reflecting the glory of China." Another interviewee mentioned that Hong Kong is a "key location for financial services, insurance; strong rental growth with little supply." In spite of Hong Kong's significant jump in the rankings this year, "the environmental issues in Hong Kong are very substantial," said an interviewee. Another interviewee echoed, "If Asian corporate headquarters move from Hong Kong to other Asian cities, the market will have a serious hole in it."

Our survey respondents altered their buy/hold/sell recommendations from 2007. Office buy recommendations decreased from 40 percent in 2007 to 29 percent in 2008, apartment/residential buy recommendations increased from 26 percent to 40

percent, and hotel/resort buy recommendations also rose from 43 percent to 53 percent. The hold recommendations for all property sectors increased—for office from 37 percent in 2007 to 49 percent in 2008, and retail from 46 percent in 2007 to 58 percent in 2008. The sell recommendations for apartment/residential decreased from 35 percent in 2007 to 20 percent in 2008.

Beijing

The cautionary note signaled by last year's survey respondents continues this year. "Beijing is oversupplied," stated one interviewee. It is a consistent theme with many interviewees, particularly after the completion of the 2008 Olympics. Even though Beijing ranks sixth in investment rankings, and its risk ranking is 13th out of 20 Asia Pacific cities, partially reflecting survey respondents' view of supply, political, and regulatory risk factors.

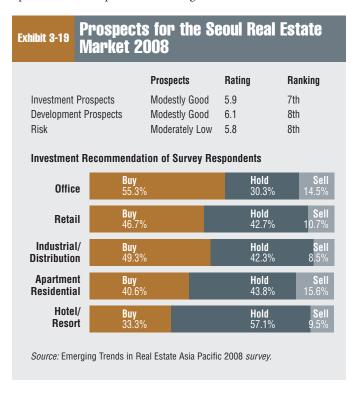
Is now the time to start thinking of selling properties in Beijing? Most of the sell recommendations for each property sector increased over last year's levels. Office sell recommendations increased from 9 percent in 2007 to 18 percent in 2008, retail increased from 7 percent to 13 percent, apartment/residential rose from 11 percent to 19 percent, and hotel/resort increased from 4 percent to 15 percent. Yet, buy recommendations are still greater than 50 percent for hotel/resort, industrial, and retail.

Prospects for the Hong Kong Real Estate Market 2008						
Investment R	Investment Recommendation of Survey Respondents					
Office	Buy 29.2%		Hold 49.4%	Sell 21.4%		
Retail	Buy 28.2%		Hold 57.7%	Sell 14.1%		
Industrial/ Distribution	Buy 38.1%		Hold 47.6%	Sell 14.3%		
Apartment Residential	Buy 40.0%		Hold 40.0%	Sell 20.0%		
Hotel/ Resort	Buy 53.1%		Hold 37.0%	Sell 9.9%		
Source: Emergii	Source: Emerging Trends in Real Estate Asia Pacific 2008 survey.					

Investment Prospects Modestly Good 6.0 6th Development Prospects Modestly Good 5.9 12th Risk Moderate 4.5 13th Investment Recommendation of Survey Respondents Office Buy 40.2% Hold 30.0% Sell 30.0% 13.3% Retail Buy Hold 30.0% Sell 30.0% 10.5% Apartment Residential Buy Hold 30.2% Hold 30.2% 10.5% Apartment Residential 45.7% Hold 34.6% 19.8% Hotel/ Resort 57.0% Line Buy Hold 34.6% 19.8%	Exhibit 3-18 N	rospects larket 20	s for the B DO8	eijing Rea	l Estate
Development Prospects Modestly Good 5.9 12th			Prospects	Rating	Ranking
Risk Moderate 4.5 13th Investment Recommendation of Survey Respondents Office Buy Hold Sell 41.3% 18.5% Retail Buy Hold Sell 30.0% 13.3% Industrial/ Distribution 59.3% Hold Sell 10.5% Apartment Residential 45.7% Hold Sell 19.8% Hotel/ Buy Hold Sell 19.8%		•	,	0.0	• • • • • • • • • • • • • • • • • • • •
Investment Recommendation of Survey Respondents Office Buy Hold Sell 41.3% 18.5% Retail Buy Hold Sell 30.0% 13.3% Industrial/ Buy Hold Sell 10.5% Apartment Buy Hold Sell 10.5% Apartment Residential 45.7% 34.6% 19.8% Hotel/ Buy Hold Sell	•	rospects	•		
Office Buy 40.2% Hold 41.3% Sell 18.5% Retail Buy 56.7% Hold 30.0% 13.3% Industrial/ Distribution Buy 59.3% Hold 30.2% 10.5% Apartment Residential Buy 45.7% Hold 34.6% 19.8% Hotel/ Buy Hold Sell Hotel/ Buy Hold Sell Sell	Risk		Moderate	4.5	13th
Retail Buy Hold Sell	Investment Recommendation of Survey Respondents				
The color	Office		%		
Distribution 59.3% 30.2% 10.5%	Retail		%		Sell 13.3%
Apartment Residential 45.7% Hold Sell 19.8% Hotel/ Buy Hold Sell					
Residential 45.7% 34.6% 19.8% Hotel/ Buy Hold Sell	Distribution	59.3°	%	30.2%	10.5%
Hotel/ Buy Hold Sell			2/		
Duy Hold Sell		45.7	70	34.0%	19.8%
1163011 57.0% 27.9% 15.2%	,				
	7103011	37.0	70	21.376	13.2/0
Source: Emerging Trends in Real Estate Asia Pacific 2008 survey.	222.237 2019.				

Seoul

Seoul leaps into the top ten investment property markets, moving from 13th in 2007 to a seventh-place ranking in 2008. Several respondents mentioned Seoul with other Asia Pacific gateway cities. "Core-location office assets in Tokyo, Singapore, Seoul, and Hong Kong are the most sought-after products in the region as rental and capital values continue to follow their upward trajectories on the back of strong rental growth potential, extremely low vacancy due to scarcity in supply, and strong demand, particularly from the expansion of the financial services sector," according to one respondent. The National Assembly has enacted laws to attempt to cool off the heated property market, with developers rushing to obtain permits, especially in the apartment sector, prior to the inauguration of the new laws.



There are two significant differences in the buy/hold/sell recommendations from last year's survey results. First, all of the sell recommendation percentages are down for all property sectors, with the exception of the apartment/residential sector.

Office is down from 24 percent to 15 percent, retail is down from 13 percent to 10 percent, industrial/distribution is down from 13 percent to 8 percent, and hotel/resort is down from 21 percent to 9 percent. The second major change is the buy recommendation for apartment/residential, increasing from 20 percent in 2007 to 40 percent in 2008.

Ho Chi Minh City

Ho Chi Minh City, one of the highest-risk cities in the Asia Pacific region, has joined the top ten investment prospect rankings. While most interviewees mention "expected growth . . . long-term growth . . . low labor costs" to explain interest or activities in Ho Chi Minh City, other respondents remain cautious, expressing a "too hot, too quick" perspective or expectations of "price corrections in cities such as Ho Chi Minh City."

Although all buy recommendations are close to or above 75 percent for all property sectors (generally the highest buy ratings of any city in the survey), one interviewee maintained that "the only standing product that you would want to buy is hotels. Otherwise, you're buying paddy fields. And the game is to convert paddy fields into finished product. So it's all linked to land conversion. It's either greenfield development or doing a deal with the city or central authorities "

		e Market 2			
		Prospects	Rating	Ran	king
Investment Pros	pects	Modestly Good	5.9	8th	
Development Pro	spects	Modestly Good	6.4	1st	
Risk		Moderately High	4.3	18th	1
Investment Recommendation of Survey Respondents					
Office	Buy 79.5%)		Hold 15.1%	Sell 5.5%
Retail	Buy 73.2%)		Hold 19.7%	Sell 7.0%
Industrial/ Distribution	Buy 75.0%)		Hold 16.2%	Sell 8.8%
Apartment Residential	Buy 77.1%)		Hold 14.8%	Sell 8.2%
Hotel/ Resort	Buy 78.5%)		Hold 15.4%	Sell 6.2%

Guangzhou

Guangzhou remains in the top ten investment prospect rankings, dropping slightly from seventh in 2007 to ninth in 2008. Investment and development prospect rankings also declined from last year's results. Interviewees and survey respondents rarely refer to Guangzhou separately, generally including the city in a discussion with Beijing, Shanghai, or Hong Kong. For example, one interviewee stated that "Beijing, Shanghai, and Guangzhou have significant service sector elements, whereas a place like Tianjin is making the leap from manufacturing to service." Another noted "a lot of movement up toward the Bohai Bay area, away from the greater Shanghai area and the Guangzhou area."

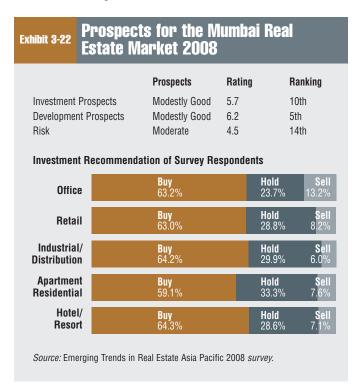
In spite of the minor drop in rankings and ratings, buy recommendations for all property sectors have increased over last year's percentages, with the largest gain for industrial/distribution (46 percent buy in 2007 and 63 percent buy in 2008).

Prospects for the Guangzhou Real Exhibit 3-21 Estate Market 2008 **Prospects** Rating Ranking 9th **Investment Prospects** Modestly Good 5.8 **Development Prospects** Modestly Good 9th 6.1 Moderate 4.7 12th **Investment Recommendation of Survey Respondents Hold** 40.5% Office Retail Industrial/ Distribution **Apartment** Residential Hotel/ **Buy** 51.4% Hold 38.6% Resort Source: Emerging Trends in Real Estate Asia Pacific 2008 survey.

Mumbai

Mumbai rounds out the top ten in investment prospect rankings. "Booming commercial activities" in Mumbai, noted one survey respondent. Another interviewee mentioned "big demand for hotel rooms in major cities like New Delhi, Mumbai, and Bangalore." Investors in Mumbai, as in other cities in India, face various hurdles. Such hurdles include "...a market that has just recently opened and is moving very rapidly. It's difficult to do effective due diligence. There is little history," according to one interviewee. In addition, "one of the problems in India is that transparency is an issue."

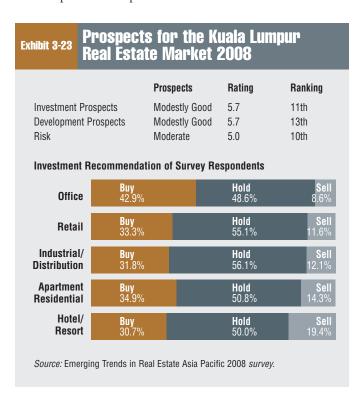
Significant changes from last year's buy/hold/sell recommendations include higher buy percentages for industrial (57 percent in 2007 and 64 percent in 2008), lower buy percentages for retail (79 percent down to 63 percent), apartment/residential (67 percent down to 59 percent), and hotel/resort (75 percent down to 64 percent).



Second-Tier Investment Cities

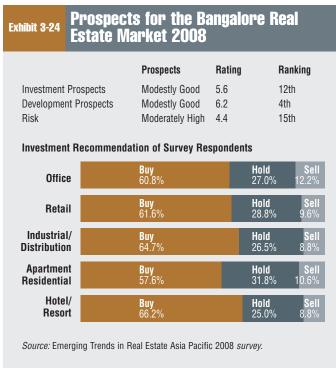
Kuala Lumpur

Kuala Lumpur jumps from its 15th-place ranking in 2007 to an 11th-place investment prospect ranking in 2008. "Strong for development," said one respondent regarding the Malaysian city. Several interviewees characterized Kuala Lumpur as a buy market "if you can find properties." Perhaps the struggle to find properties in Kuala Lumpur is reflected in the change of buy/hold/sell recommendation results for 2008. Hold recommendations increased over 2007 levels for all property sectors except retail. Office increased from 33 percent in 2007 to 48 percent in 2008, industrial/distribution rose from 43 percent to 56 percent, apartment/residential increased from 27 percent to 50 percent, and hotel/resort increased from 40 percent to 50 percent.



Bangalore

Several respondents specifically mentioned Bangalore on survey questions regarding highest potential for development in Asia Pacific property markets. Bangalore's fourth-place development



ranking stands in contrast to the city's 12th-place investment ranking. One respondent, however, cautioned that "Bangalore looks like a risky market to be in, particularly for larger non-prime township developments, simply because the expected supply is massive. Even prime residential is now twice its all-time earlier peak. The sustainability of these prices is questionable." Buy recommendations have increased over 2007 levels for office, retail, and industrial/distribution.

New Delhi

New Delhi's investment prospect ranking moves up slightly to 13th in 2008 from 14th in 2007. Similar to Bangalore, the city's seventh-place development prospect ranking is significantly higher than its investment ranking. Respondents frequently mention the need to develop hotel rooms in New Delhi, yet the buy recommendations for hotels/resorts decreased from 77 percent in 2007 to 61 percent in 2008. Industrial/distribution buy recommendations increased from 43 percent in 2007 to 58 percent in 2008.

Prospects for the New Delhi Real Estate Market 2008

	Prospects	Rating	Rankin
Investment Prospects	Modestly Good	5.6	13th
Development Prospects	Modestly Good	6.1	7th
Risk	Moderately High	4.4	16th

Investment Recommendation of Survey Respondents



Source: Emerging Trends in Real Estate Asia Pacific 2008 survey.

Prospects for the Auckland Real Estate Market 2008

	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	5.5	14th
Development Prospects	Modestly Good	5.6	14th
Risk	Moderately Low	6.3	5th

Investment Recommendation of Survey Respondents



Source: Emerging Trends in Real Estate Asia Pacific 2008 survey.

Auckland

Auckland joins our survey this year with a 14th-place ranking for investment prospects and development prospects. The city's low risk is reflected in its fifth-place ranking. "Auckland is undervalued and has huge potential," said one interviewee. "Local government officials are increasing controls and restrictions on greenfield developments, and encouraging infill development," speculated another respondent. Based on survey results, investors and owners are likely to hold all property sectors in 2008.

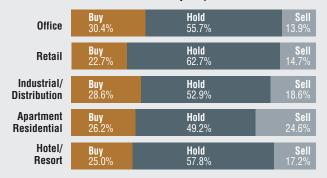
Sydney

According to one interviewee, "Conservative investors like Sydney . . . because the risk factors are low." Sydney is a city "that has taken off well," said another interviewee. Survey respondents confirm Sydney's low risk factors with a third-place ranking for city risk. "Development opportunities will be scarce in Sydney," stated one respondent. Noted changes between 2007 and 2008 include the increase in the buy recommendations for the apartment/residential sector (14 percent in 2007 to 26 percent in 2008) and hold recommendations for the office sector (39 percent in 2007 to 56 percent in 2008).

Exhibit 3-27 Prospects for the Sydney Real Estate Market 2008

	Prospects	Rating	Ranking
Investment Prospects	Modestly Good	5.5	15th
Development Prospects	Fair	5.3	17th
Risk	Low	6.7	3rd

Investment Recommendation of Survey Respondents

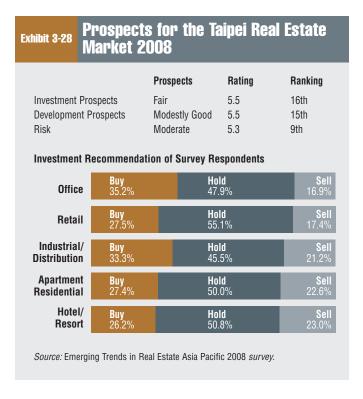


Source: Emerging Trends in Real Estate Asia Pacific 2008 survey.

Jakarta ranks last in all categories for 2008.

Taipei

Presidential elections and the potential for political change at the end of 2007 appear to cloud several survey respondents' perceptions and may explain the drop from the city's fifth-place investment prospect ranking in 2007 to 16th in 2008. Comparisons of 2007 versus 2008 buy/hold/sell recommendations also indicate an uneasiness in the market as office, retail, apartment/residential, and hotel/resort had significant decreases in buy percentages and increases in sell percentages. There are positive sentiments as well, however. According to one interviewee, Taipei is a city "that didn't really feature as an investment market a year ago and does now—mainly because of the insurance groups that need to invest their real estate funds into countries where their mother company is already exposed."



Prospects for the Melbourne Real Estate Market 2008						
	Investment Prospects Fair 5.3 17th Development Prospects Fair 5.2 18th Risk Moderately Low 6.3 7th Investment Recommendation of Survey Respondents					
Investment R	Investment Recommendation of Survey Respondents					
Office	Buy 18.6%	Hol 70.0		Sell 11.4%		
Retail	Buy 17.9%	Hol 67.2		Sell 14.9%		
Industrial/ Distribution	Buy 14.1%	Hol 64.		Sell 21.9%		
Apartment Residential	Buy 16.4%	Hol 57.4		Sell 26.2%		
Hotel/ Resort	Buy 23.0%	Hol 55.7		Sell 21.3%		
Source: Emergi	ng Trends in F	Real Estate Asia Pacifi	c 2008 <i>survey.</i>			

Melbourne

Melbourne dropped out of the top ten investment prospect rankings, falling from sixth in 2007 to 17th in 2008. One respondent believes there is a "threat of oversupply" in Melbourne, while another has "positive feelings about Melbourne industrial." Hold recommendations increased over 2007 levels for all property sectors, with the exception of hotel/resort. The hotel/resort sector shows increases in the buy recommendations (13 percent in 2007 to 23 percent in 2008) and sell (6 percent in 2007 to 21 percent in 2008) recommendations.

Bangkok

One interviewee directly addressed the investment climate in Thailand and indirectly Bangkok: "It's a lot of investigation, a little bit of wait and see. Waiting for more clarity and seeing what's going to happen." Another respondent stated, "Waiting on sidelines for now," which partially explains why Bangkok dropped from its eighth-place investment prospect ranking in 2007 to 18th in 2008. According to our survey buy/hold/sell recommendations, Bangkok is more of a sell market in 2008 and less of a buy market as it was in 2007 for all property sectors.

Exhibit 3-30 Prospects for the Bangkok Real Estate Market 2008

	Prospects	Rating	Ranking
Investment Prospects	Fair	5.2	18th
Development Prospects	Fair	5.5	16th
Risk	Moderately High	4.3	17th

Investment Recommendation of Survey Respondents

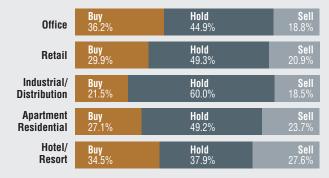


Source: Emerging Trends in Real Estate Asia Pacific 2008 survey.

Prospects for the Manila Real Estate Market 2008

	Prospects	Rating	Ranking
Investment Prospects	Fair	5.0	19th
Development Prospects	Fair	5.2	19th
Risk	Moderately High	3.9	19th

Investment Recommendation of Survey Respondents



Source: Emerging Trends in Real Estate Asia Pacific 2008 survey.

Manila

Manila may be ranked 19th in investment prospect rankings, but according to one survey respondent, for office investment, the "best investment prospects are in Manila." Another interviewee claimed that "the opportunity lies in the construction of buildings for the BPO industry, low-cost and medium-cost housing, and the development of tourist-related facilities" in Manila and in general for the Philippines. The sell recommendations for all property sectors decreased from 2007 levels, and the buy recommendation levels for office, retail, and industrial/distribution increased.

Jakarta

Jakarta ranks last in all categories for 2008. Whereas most interviewees and respondents use terms such as "caution" and "avoidance" when discussing Jakarta and Indonesia, a small segment of interviewees places this city (and country) in the same category of emerging markets such as Cambodia and Laos. There are, however, changes from last year's buy/hold/sell recommendations. For example, sell recommendation levels increased for the hotel/resort sector (18 percent in 2007 to 29 percent in 2008), and buy recommendations increased for the retail (8 percent in 2007 to 32 percent in 2008), industrial/distribution (17 percent in 2007 to 27 percent in 2008), and apartment/residential (9 percent in 2007 to 21 percent in 2008) sectors.

Prospects for the Jakarta Real Estate Market 2008

		Prospects	Rating	Ranking
Investment Pros	spects	Fair	4.7	20th
Development Pr	ospects	Fair	4.9	20th
Risk		High	3.4	20th
Investment Re	commendat	ion of Survey	Respondents	
Office	Buy 25.4%		Hold 52.2%	Sell 22.4%
Retail	Buy 31.8%		Hold 50.0%	Sell 18.2%
Industrial/ Distribution	Buy 26.6%		Hold 51.6%	Sell 21.9%
Apartment Residential	Buy 20.7%		Hold 53.5%	Sell 25.9%
Hotel/ Resort	Buy 30.5%		Hold 40.7%	Sell 28.8%

Interviewees

Angelo Gordon Asia Limited

Chris Kim

ARCH Capital Management Co Limited

Richard Yue

Asian Public Real Estate Association

Peter Mitchell

CB Richard Ellis

Marc Townsend

CB Richard Ellis Investors

Steve Bass

Citigroup Property Investors

Pius Ho

David H. Schaefer

Colliers International

David Faulkner

Crispin Property Services

Sam Crispin

CTG Property Holdings Limited

Tyler E. Goodwin

DTZ

David Watt

Electra Real Estate Ltd

Ivan YT Chan

First American Title Insurance Company

Alison Cooke

Forum Partners

Russell Platt

GE Real Estate Asia-Pacific

Mark Hutchinson

Genkai Capital Management

Masatoshi Matsuo

Grosvenor Properties

Nick Loup

Hopson Development

Holdings Limited

L L Tam

ING Real Estate

Timothy Bellman

ING Real Estate Investment

Management

Richard T.G. Price

Japan REIT Advisors

Hisamitsu Abe

Jones Lang LaSalle International

Capital GroupGuy Hollis

Jones Lang LaSalle, Shanghai

Trent Illiffe

Jones Lang LaSalle Tianjin

Michael Hart

Keppel Land

Dan Cerf

LaSalle Investment Management

David Edwards

Macquarie Global Property Advisors

James E. Quille

Mapletree Investments Pte Ltd

Wong Mun Hoong

Mitsubishi Estate

Toshio Nagashima

Mitsui Fudosan

Takayuki Namae

New City Corporation

Christopher E. O'Brien

Orchard Funds Management

Mark Vonic

ORIX Real Estate Corporation

Hiroaki Nishina

Pacific Management Corporation

Yasushi Iwasa

Premier REIT Investment Advisors

Fumihiro Yasutake

Professional Property Services Limited

Nicholas Brooke

Property Council of Australia

Peter Verwer

Prudential Real Estate Investors

Charles Lowrey

Reitaku University

Chihiro Shimizu

RREEF

Henry (Wei) Chin

Peter Hobbs

RREEF Asia Pacific

Brian Chinappi

Tan Yen Keng

Kurt W. Roeloffs

The Royal Bank of Scotland, Hong Kong Branch

Morgan A. Laughlin

Savills Property Services

Matthew Brailsford

Sponsoring Organizations



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.

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. Established in 1936, the Institute today has almost 38,000 members from 90 countries, representing the entire spectrum of the land use and development disciplines.

Senior Executives

Richard M. Rosan President, ULI Worldwide

Cheryl CumminsPresident, ULI Americas

William P. Kistler President, ULI EMEA/India

Rachelle L. Levitt

Executive Vice President, Global Information Group

ULI-the Urban Land Institute 1025 Thomas Jefferson Street, N.W. Suite 500 West Washington, D.C. 20007 202-624-7000 www.uli.org

PRICEWATERHOUSE COPERS @

PricewaterhouseCoopers real estate group 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.

Real Estate Leadership Team

Marc Saluzzi, Global Investment Management & Real Estate Group Leader, Luxembourg, Luxembourg

Patrick Leardo, Global Real Estate Advisory Leader, New York, New York, United States of America

Uwe Stoschek, Global Real Estate Tax Leader, Berlin, Germany

William Croteau, Global Real Estate Assurance Leader, San Francisco, California, United States of America

KK So, Asia Pacific Real Estate Tax Leader, Hong Kong, China

James Dunning, Asia Pacific Real Estate Assurance Leader, Sydney, Australia

Henrik Steinbrecher, European Real Estate Leader, Stockholm, Sweden

Timothy Conlon, United States Real Estate Leader, New York, New York, United States of America

John Forbes, United Kingdom Real Estate Leader, London, England, United Kingdom

Robert Grome, Asia Pacific Investment Management and Real Estate Leader, Hong Kong, China

www.pwc.com

Production support provided by:





Emerging Trends in Real Estate® Asia Pacific 2008

What are the prospects for real estate investment and development in 2008 across the Asia Pacific region? Based on personal interviews with and surveys from nearly 200 of the most influential leaders in the Asia Pacific real estate industry, this forecast will give you the heads-up on where to invest, what to develop, which markets are hot, and how Asia Pacific economic trends and capital flows will affect real estate. A joint undertaking of PricewaterhouseCoopers and the Urban Land Institute, this second edition of *Emerging Trends in Real Estate® Asia Pacific* is the forecast you can count on for no-nonsense, expert advice.

Highlights

- Reports on how Asia Pacific economic trends and issues are affecting real estate.
- Describes trends in the capital markets, including sources and flows of equity and debt capital.
- Tells you what to expect and where the best opportunities are for both investment and development.
- Assesses real estate prospects and opportunities in 20 Asia Pacific cities.
- Discusses which metropolitan areas offer the most and least potential.
- Features detailed analysis and prospects for office, retail, industrial/distribution, hotel/resort, and apartment residential property sectors.
- Explains which property sectors offer opportunities and which to avoid.



www.uli.org

ULI Order Number: E31 ISBN: 978-0-87420-994-5



www.pwc.com