Real estate investment flows – An Asia Pacific Perspective

Asia Pacific Capital Markets Research Report: March 2017

Stronger activity relating to domestic investors; mixed inbound and outbound capital flows

Chart 1: 2016 Asia Pacific capital flows trends: Domestic, inbound and outbound

Transaction Volumes FY2016	Australia	China	Hong Kong	Japan	Singapore	Korea
Domestic Investment	Unchanged	Increase	Increase	Unchanged	Decrease	Increase
Y-O-Y % change	0%	50%	18%	8%	-16%	75%
Inbound Investment	Decrease	Decrease	Decrease	Decrease	Increase	Increase
Y-O-Y % change	-26%	-37%	-47%	-45%	441%	282%
Outbound investment	Decrease	Increase	Decrease	Increase	Increase	Decrease
Y-O-Y % change	-60%	44%	-13%	63%	26%	-21%

Source: JLL, 4Q16

Note: Unchanged denotes it falls within +/- 10% y-o-y % change
For deals over US$5m in commercial, retail and industrial sectors only
"Inbound Investment" refers to cross-border capital flow into the domestic market
"Outbound Investment" refers to country capital source investing overseas globally (including regionally)

Asia Pacific's real estate investment market held up remarkably well in 2016, despite market volatility following Brexit and US election results. Taking a deep dive into looking at investment inflows and outflows by major markets and source of capital yields some interesting insights.

Most core regional markets saw strong activity relating to domestic real estate investors looking at their home markets. Inbound and outbound capital flows were mixed. Inbound investment to Singapore and Korea surged over the year on the back of a handful of mega deals. Outbound investment from China and Japan took off as local investors eye opportunities abroad.

Investment activity in 2017 is likely to remain stable given solid appetite from institutional investors, strong fund raising activity and a low interest rate environment. However, as pricing in major gateway cities are at record levels and given the shortage of investable real estate assets, these factors could play a part in limiting investment activity. As for outbound investment activity from Asia Pacific, tighter government controls over capital outflows may limit Chinese outbound investment in the near term particularly for large sized deals which could take longer to conclude.

Australia

Total transaction volumes declined 13% year-on-year from the record high in 2015. However, lower transaction volumes were not a symptom of diminished investor interest for real assets; rather it was due to a lack of investable stock available for acquisition, particular relative to the amount of investment capital in the market.

Consequently, yields across many markets have compressed to new record lows. This has resulted in domestic investors taking a more cautious approach to investments. Activity from A-REITs has moderated as average market yields continued to compress, potentially making it more challenging to find yield accretive investments.

Inbound investment activity for the year declined. However, offshore investors remained highly active, accounting for 42% of total transactions in 2016. The key sources of cross-border capital were from the US, China, Singapore and Hong Kong, and investment appetite remained focused on prime assets in Sydney and Melbourne. However, selective quality assets in secondary cities such as Brisbane and Perth have also been of interest, as investors execute a counter-cyclical strategy.

Outbound investment was also down year-on-year, as Australian investors remained cautious in their overseas investment approach. A weaker AUD exchange rate has also made foreign acquisitions more expensive for domestic investors. The AUD has declined by about 32% and 14% against the USD and EUR since its last peak in 2011 and 2015 respectively.

China

China's investment market outperformed in 2016 with record transaction volumes, overtaking Japan as the biggest market in Asia Pacific. This is likely to continue into 2017 given the strong purchasing power of domestic investors.

Domestic investment activity increased by 50% y-o-y. Domestic investors, in particular corporates and real estate developers have been active in the market. Chinese insurance companies have also been a strong player as they aim to allocate more funds into the real estate asset class. Acquisitions have been largely concentrated on Tier-1 (Shanghai and Beijing) and selective Tier-1.5 cities (Chengdu and Chongqing).

The increased regulatory scrutiny on capital outflow has led to domestic investors outbidding foreign investors locally, thus keeping the latter relatively quiet in the market. In addition, the slower GDP growth and high pricing level have also led to capital flight from foreign investors.

Inbound investment declined for both Tier-1 and Tier-1.5 cities, given a high base in 2015, which was largely driven by the Corporate Avenue deal, which totaled about US$1.9 billion and was bought by Link REIT and Lee Kum Kee. The Chongbang retail portfolio and Platinum Tower also contributed to the high base.

Inbound investment for 2016 was largely scaled by the Shanghai Century Link deal, which was bought by ARA Asset Management from Hutchison Whampoa and Cheung Kong for about US$2.9 billion. Tier-1.5 cities such as Chengdu and Chongqing also saw some interest from foreign investors. CapitaLand Retail China Trust bought Galleria Chengdu (Chengdu) from BlackRock for US$226 million, while CPPIB purchased Paradise Walk West (Chongqing) from Longfor Properties for US$148 million.

Outbound investment grew to a record level as Chinese investors seek out trophy assets and diversify overseas into other currencies as the RMB depreciates. U.S., Australia and Hong Kong were among the key investment destinations for mainland Chinese groups. Looking ahead, tighter government controls over capital outflows may limit Chinese outbound investment in the near term particularly for large sized deals which could take longer to conclude.

Hong Kong

Investment activity remained robust but was lower compared to 2015 as the comparison base was high. Domestic investors and corporate end users retained a strong appetite for Grade-A offices and strata retail units.

Inbound investment by Chinese investors started the year strongly but moderated after the mainland government implemented capital controls on outbound real estate investments in October; which led to a number of deals being shelved. As a result, investment volume from Chinese investors fell sharply from a year earlier. Still, Chinese investors were involved in several large en-bloc transactions over the course of the year, including Dah Sing Financial Centre and One HarbourGate East Tower.

Although inbound investment for income generating assets was down, mainland Chinese demand for land sites remained strong, and if included this would have driven up total inbound investment into Hong Kong. Notably, HNA Group bought two development sites at Kai Tak Area, Kowloon in 4Q16 at record per square foot pricing levels.

Japan

Investment activity is slowing due to aggressive pricing and a lack of large deals. Investors are now more cautious in their approach given an impending large supply in the office and industrial sectors, which has led to slower rental growth. The low interest rate environment has also provided greater incentive to refinance amid challenges of finding alternative high yielding assets in a competitive environment.

Inbound investment into Japan declined for the year. Domestic investors continue to dominate the market over foreign investors, given their better market knowledge and access to low interest rate financing. J-REITs remain focused on selling non-core assets. Foreign investors retain a strong appetite for the market and continue to eye opportunities in secondary cities such as Osaka, Yokohama, Chiba and Saitama. Among those active in the market were LaSalle Investment Management, Redwood and Mapletree.

Outbound investment was up driven by real estate companies, J-REITs and asset managers. This can be explained partly by the purchasing power of a stronger Yen exchange rate, but also due to a myriad of factors such as expectation that a declining population could lead to less demand for real estate in Japan in the long term, greater need for geographical diversification of assets as well as increased competition in the domestic real estate investment market.

Singapore

Total transaction activity picked up in 2016, supported by a string of mega deals. Domestic investors were quiet in the year as they focus on diversifying exposure overseas. S-REITs were also less active given that they completed many transactions in the previous few years.

Inbound investment quadrupled for the year. Foreign investors' appetite remained robust as the price gap between buyers and sellers narrowed following recent price corrections. Foreign investors were active focusing on counter cyclical play in the office sector, buoyed by the country's long-term stable geo-political fundamentals. They remain upbeat for prime office and sub-urban retail assets, which are closely held and rare to access.

Outbound investment also grew from a year ago, as Singapore investors seek to diversify abroad in terms of geography and sector, given the lack of investable asset locally. Greater real estate capital allocation has also increased the need to seek alternative markets and deploy capital abroad.

Korea

Korea's investment market saw record transaction volumes in 2016. Domestic investors displayed strong investment appetite focusing on core and core plus assets with long WALE. Across sectors, domestic corporate and institutional investors retained a solid interest in buying office assets.

Foreign investors were also active with strong investment appetite focusing on higher risk strategies such as value-added deals. Among those active in the market were Brookfield, Blackstone, CIC and M&G. More opportunities may arise as large Korean conglomerates restructure and offload non-core assets with leasebacks to improve their financial position.

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