WHY INVEST IN ASIAN REAL ESTATE?

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A communication to investors

Asian countries are fostering stronger regional integration as well as trade ties at a time when Europe is dealing with uncertainties surrounding the EU and the breakaway of one of its key trading partners, the UK. As Asia braces for further economic progress, with China at the helm, Asian countries are set to benefit from these strengthened partnerships, making it an appropriate time to consider investing in the Asia-Pacific region.

It is difficult to think of another part of the world that provides the diversity of investment opportunities available in the Asia-Pacific region. The continent consists of many different countries, from developed nations such as Australia, Hong Kong, Japan, South Korea and Singapore, to emerging markets such as China, the world's second-largest economy (thrice the size of the German economy and four times that of UK). It can also offer exposure to frontier markets such as Indonesia and the Philippines, with a population of 261 million and 103 million, respectively - a combination that is greater than the populations of either Western Europe or the US.

Economic power is shifting from the West to the East

Asia - home to two-thirds of the world's population - is one of the fastest growing regions.

Supported by robust economic growth prospects in the area, the Asian economy is widely expected overtake both the US and Europe within the next 20 years. [1]

1 Oxford Economics

As of 2017, the Asia-Pacific region accounted for about

40%

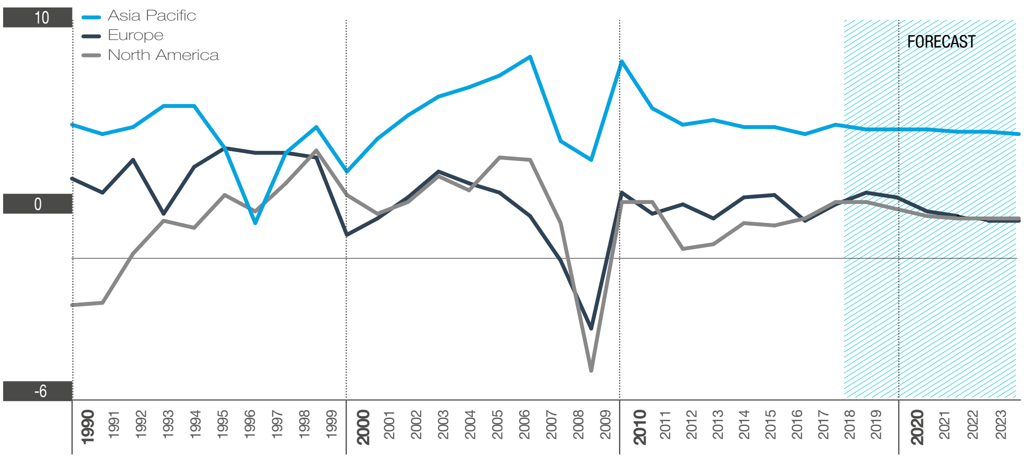
of global nominal GDP

Since the 1997-98 Asian financial crisis, the region has gone through a radical transformation. The crisis forced countries to strengthen their economic framework, address structural weaknesses, implement market reforms and promote the private sector. Since then, both corporate and government balance sheets in Asia have been solid.

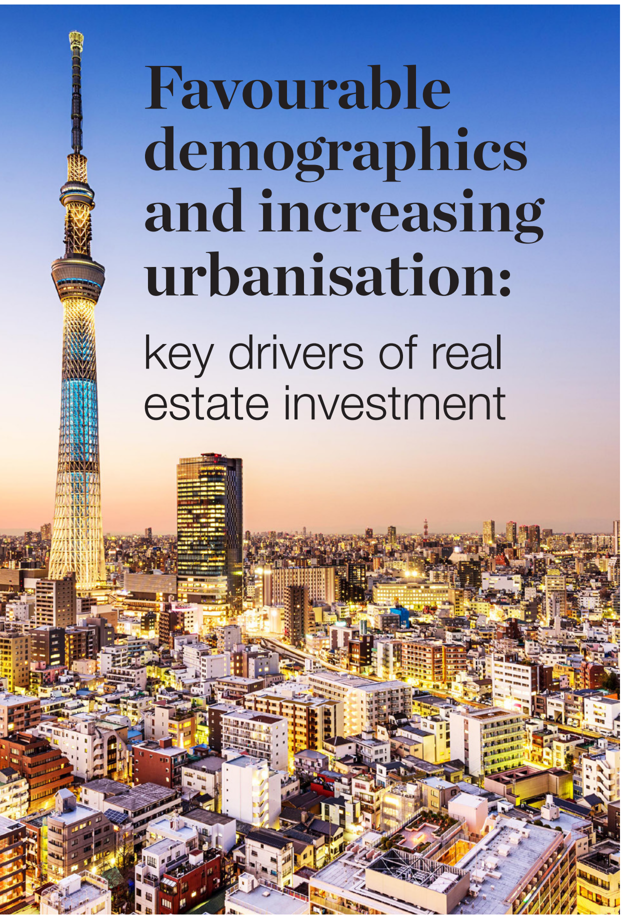
Financial oversight, macroeconomic frameworks, and domestic competitiveness have been greatly strengthened. As a result, the region has experienced solid growth and proved resilient during the global financial crisis, when other economic regions were collapsing, proving to be the most dynamic economic region in the world (figure 1). This is forecast to continue.

FIG. 1:

GDP economic growth and forecast (%)



Sources: IMF, Savills Investment Management



Favourable demographics and increasing urbanisation:

key drivers of real estate investment

The rapid growth story in the Asia-Pacific region is linked to strong economic fundamentals such as ongoing strong urbanisation, outstripping the pace in the US and Europe (figure 2).

Asia is moving into an era of unprecedented urbanisation. For instance, in just 30 years, nearly 500 million people will have moved from rural areas into China's 622 main cities, and a predominantly rural country will have become nearly 60% urbanised. McKinsey & Company and Meinhardt Group expect that 58% of the world's population, or 4.6 billion people, will live in urban areas by 2025, up from 3.9 billion currently.

Cities will hold the future of economic growth. For instance, even though Japan's population has been declining since 2012, Tokyo continues to record strong population growth thanks to internal migration.[2] With more than 80% of global GDP generated in cities, urbanisation can contribute to sustainable growth if managed well by increasing productivity, allowing innovation and new ideas to emerge.

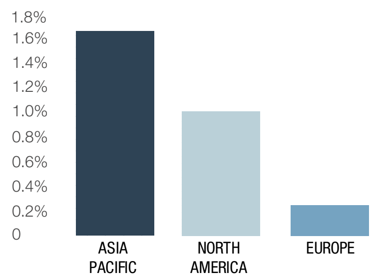
2 Oxford Economics

In many places, cities will merge together to create urban settlements on a scale never seen before. These new configurations will take the form of mega-regions, urban corridors and city-regions. For example, Oxford Economics estimates that Japan's Tokyo Nagoya-Osaka-Kyoto-Kobe mega-region will have a population of 60 million by 2025.

THE PROSPERITY OF NATIONS IS CLOSELY LINKED TO THE PROSPERITY OF THEIR CITIES

FIG. 2:

Urban population growth (%) (2015-2035)



Sources: United Nations Department of Economics and Social Affairs, Brookings Institution, Savills Investment Management

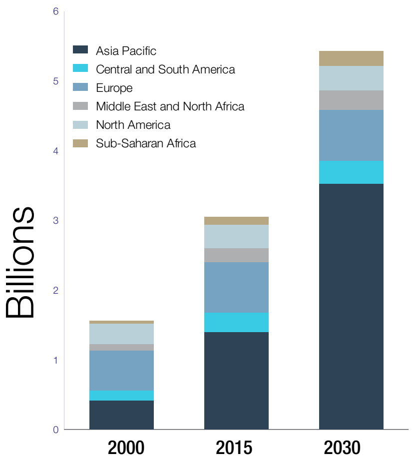
Compared to the more developed economies in Asia, developing economies such as Indonesia, Malaysia, the Philippines and Vietnam boast robust young populations that drive the economy as they join the workforce each year. Economic growth and structural shifts towards higher-productivity sectors are boosting household income across Asia. By 2030, an estimated 1.8 billion people are expected to move into the middle-class bracket (figure 3), while Asia alone could have at least 28 new megacities (defined as cities with a population greater than 10 million) compared to its current 34. Asian countries will benefit from a growing middle class with domestic spending power fuelling domestic consumption trends and driving consumption growth in the next decade.

Populations are not only increasing rapidly but are also often better educated and increasingly mobile, which puts additional pressure on towns, cities and transport networks. This increases the demand for infrastructure, which is associated with real estate. Major infrastructure projects ranging from China's ambitious Belt and Road initiative on a global level, to infrastructure development in the Association of Southeast Asian Nations (ASEAN) (such as Thailand, Malaysia, Indonesia and Singapore), are also expected to support further economic growth as the population grows, supporting demand for real estate.

The megatrends also benefit the region through increased intra-regional business activity. The presence of Global Fortune 500 companies in Asia has been growing significantly, surpassing growth in North America and Europe.[3] Based on the updated Fortune Global 500 list, Asia is home to 197 listed companies, followed by North America (145 companies) and Europe (143 companies).

The shift towards integrating technology to boost productivity because of an ageing society in the developed markets combined with a burgeoning growth of a more educated workforce also indicate growing demand for high quality real estate.

FIG. 3:
Size of the global middle class (billions people)



Sources: United Nations Department of Economics and Social Affairs, Brookings Institution, Savills Investment Management

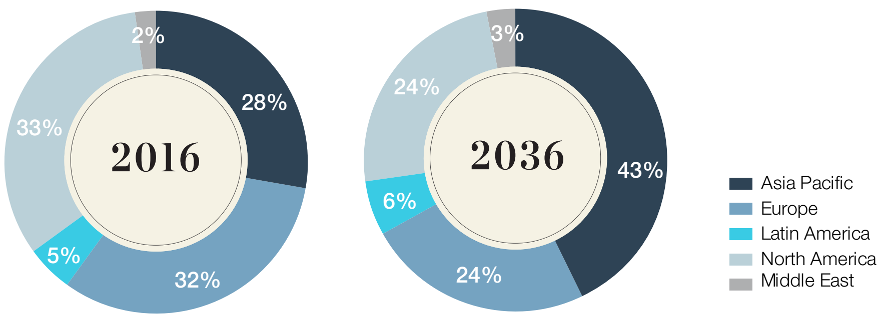
Diversification and size benefits

Besides the potential of investing in a region that offers faster economic growth compared to the US and Europe, an allocation to Asia in a global portfolio helps with diversification. Even within the Asia-Pacific region, the real estate markets are at different points in the pricing/rental cycle as well as the economic cycle. Moreover, (like in Europe) there are a variety of different property sensitivities and tenancy regimes across Asia.

As the market matures, so does transparency alongside the growing institutionalisation of the Asian real estate universe.

By 2036, the Asia-Pacific's investable universe is expected to grow exponentially and set to overtake the US and Europe (figure 4).

FIG. 4:
Investment set in the Asia-Pacific region (USD trillion)



Sources: Bird's Eye View Update, Savills Investment Management

To put things into perspective, and as an example, the investable stock in China alone was equivalent to that in the UK and France as of 2016. However, China's investable universe is expected to be as large as the entire European investable universe by 2036 as the market matures.[4]

While Asian asset markets should not be considered a safe haven during periods of global market volatility and are not entirely immune from the economic woes that are troubling the West, opportunities exist for long-term investors who are underweight to the Asian region. We believe the long-term upside remains attractive for those investors looking for favourable risk- adjusted returns.

A real strategy for 2018

There is a cocktail of factors to note when considering the make-up of a diversified pan-Asian real estate portfolio

The attractive volatility mix that is commensurate for a certain level of return needs to take on board the various nuances that influence stock selection criteria. These can include indicators such as the nature of the country being targeted (developed or emerging), the obligations/rules of engagement between landlord and customer (lease, costs and tax structures), the size of the real estate market at the city level, its liquidity, its transparency and the point at which you are in the cycle based on fundamentals of supply, demand and pricing. Our recommendation for a net return to investors in the range of 8-10% per annum would be to have a bias towards income-orientated stock with some income growth potential in major Japanese and Australian cities (circa two-thirds of the portfolio). The remainder would target emerging countries, but major cities that are benefiting from strong population/urbanisation dynamics where occupiers want to build long-term businesses. Asset classes such as offices, residential and logistics would be our favoured targets.

The key to success

Whatever the market conditions, stock selection and understanding market dynamics is key. Investors will benefit from partnering with managers that can draw from the benefits of a broad network of offices and local market understanding to source and add value to assets.

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