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FEATURES

Explosive Growth

Extreme population growth carries a downside.

By Alex Eidlin 3

India Revisited

Has the time come for property investors to consider India again?

By Anna Pandey 13

The Lure of Oz

Foreign investors seek to access Australia's historically tightly held real estate market.

By Stephen Day 25

Window on Vietnam

Vietnam's domestic real estate developers are looking for help to overcome high interest rates.

By David Blackhall 29

Investment Manager

Rankings

An updated list of the top investment managers ranked by global real estate AUM.

By Larry Gray 35

DEPARTMENTS

People 17

Investment News 18

Fund Activity Table 20

Calendar of Events 22

Market Focus:

Melbourne 36

Transaction Analysis:

May and June deals 37

Asia Pacific Transactions 38

REIT Markets Snapshot 40

Market Pulse 42

Clear and Simple

Greater Standardization and Transparency

Measures for Asian Real Estate Markets

Would Make Portfolio Management Easier

by Alex Frew McMillan

The global financial crisis showed that many investors were operating in the dark in terms of the information they received about their real estate investments. Now they're seeing the light. The calls are getting louder for the real estate industry in Asia to be more transparent, more standardized and more consistent in the way it reports information. Achieving those goals will require a lot of hard work. But a sea change may be inevitable.

If you can't measure it, you can't manage it — so the saying goes. The financial crisis laid bare numerous problems with tracking property fund performance in institutional portfolios, with investors feeling they were shut out by the people managing their money. Risk exposures, comparable returns and even just basic information on how individual properties performed suddenly proved highly relevant — and shockingly hard to come by.

The issue is particularly troublesome in Asia, where markets are fragmented, different currencies come into play, and even the basic unit of area measurement — square foot, square meter, tsubo, rai, ping — requires plenty of translation.

At a time when capital is tough to access, a lack of properly comparable measures on how to track properties' performance at a building, fund or portfolio level

is holding back the development of the industry. That's particularly true in Asia, where the industry is much less mature, basic data on performance aren't always available, and the first instinct when people are asked to share data may be to clam up.

"It's increasingly an issue," says Richard Price, CEO of ING Real Estate Investment Management (REIM) for Asia. "It's fair to say there is in general a lack of good data to benchmark and track. Asia is not one market, and that exacerbates things."

Initially when international institutions were looking at Asia, they were looking at it much more as a total return, opportunistic play. When considering development opportunities, turnarounds or other riskier initiatives, benchmarking relative to performance is much less critical, and investors look only at the end result. An investor may simply decide to look at residential development in China and want to generate returns in excess of 20 percent.

But as institutional investors look to Asia as a more mature market, and seek core and core-plus holdings in the region, getting good data on comparable performance is vital. Knowing how those holdings are doing compared with the broader market and other asset classes becomes much more relevant.

Continued on page 4

Clear and Simple

Continued from page 1

The financial crisis also drilled home the importance of measuring how property-fund managers were performing compared with each other, how they were faring compared to other types of investment, and what kinds of risks they had to various counterparties, tenants and the like.

“It becomes much more relevant — how are you performing compared to the ‘market,’ whatever that market might be,” Price says. “Many investment boards and committees and institutions will have policies that say, ‘If you can’t measure it, we shouldn’t be investing in it.’”

FRESH START FOR A NEW CYCLE

Price also chairs the membership committee at the Asian Association for Investors in Non-listed Real Estate Vehicles, or ANREV, which has 118 members across 14 countries. The group is building on the progress made and lessons learned by its European counterpart, INREV.

ANREV aims to introduce standards to Asia on how non-listed funds are set up and run. It is promulgating guidelines on the appropriate way to set up and operate private property funds, and how performance metrics should be provided.

Difficulties involved in sharing data and understanding performance across economies at different stages of development, regulatory regimes, currencies and the like “are of course subsumed in times of rapid economic development,” ANREV executive director Jeremy Stewardson states.

But the global financial crisis revealed plenty of warts in the property industry — poor alignment of interest between investors and managers, little accountability to investors, and a lack of transparency across the board. Now the industry is homing in on resolving those issues as it consolidates and struggles to raise capital for the next upswing.

“This has created an appetite, we believe, amongst institutional investors in unlisted property funds and their managers for an

understanding as to how the appropriate fund framework should be constructed and run, as the new cycle progresses,” Stewardson notes. “The urgency for some of these investors is growing as they are forced, by ever-swelling coffers and by the need for diversification and improved returns, to look away from their own saturated property markets to property markets overseas,” he adds.

LACK OF COMPARISON ON FEES

ANREV’s whole agenda is to push for greater transparency and comparability. In June, it released the first study on non-listed property-fund fees in Asia, showing that investors are demanding much greater transparency on fees. That will be vital if non-listed funds are to attract and secure capital, the report concludes.

Up-front fees, management fees, performance fees, fund expenses and property-specific costs are all charged in different ways, on different sums and at different times, depending on the fund.

“The results show that while some patterns in fee structures exist by style and structure, overall fees in the region lack any real comparability, which would support transparency for investors,” the ANREV report stated.

ING REIM — due to complete its sale to CB Richard Ellis in the second half of this year — uses ANREV’s guidelines in developing the offering materials for any non-listed funds it rolls out.

“The majority of the investor questions and more commonly asked things are prepared before we hit the road,” Price says. “So you have really broken the back of 80 percent of people’s due diligence. That’s a very useful piece of work.”

The Asia Pacific Real Estate Association (APREA) also is pushing for greater transparency. The organization started out representing the listed real estate segment only. But its members have developed a much broader agenda that relates to the industry as a whole. APREA currently has 165 members globally.

APREA and ANREV essentially share the same positive goals.



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“There are variable standards and variable approaches to measurements from country to country,” says Peter Mitchell, APREA’s CEO. “Some investors have worked out ways to deal with those issues. But certainly Asia would benefit from more consistent standards in reporting valuation, corporate governance and so on.”

LOBBYING PUSH

APREA is working on the second edition of its best-practices handbook for listed real estate entities in Asia, with recommendations in the areas of valuations, reporting standards, corporate governance, market conduct and portfolio performance. The group says the handbook is catching on in the region and says it was pleasantly surprised with the high participation rate from listed Asia Pacific companies and funds in the first APREA annual awards, based on these recommendations in 2010.

APREA also has developed an industry training program to teach best practice approaches on an

applied basis that is now delivered in six countries in the region.

It’s key if direct property assets and property funds alike are to command the size of the institutional-investor pie that they deserve. And the pie will soon need a new oven — the Asian pension fund industry is predicted to double its assets in the decade through 2015 and reach US\$4.3 trillion by 2020.

APREA also is pushing for the standards laid out by the International Valuation Standards Council to be adopted throughout Asia. Getting those kinds of standards accepted by the industry could happen with the development of public property markets, as has happened in Singapore with the boom in the REIT industry.

New protocols also can be achieved through legislation — APREA is lobbying for emerging markets such as India and the Philippines, where there aren’t standards, to adopt standards by law. That often can happen through the development of rules that allow the REIT market to

develop — the Philippines has a REIT Act in the works that has yet to kick in.

There are successes — Malaysia has a small REIT market that’s growing and maturing. But it doesn’t always work — Thailand is working on a new REIT law that would expand what’s so far a set of rules based on mutual funds that has not worked well to develop the listed real estate funds market. China has long been rumored to be working on REIT rules, but property watchers aren’t holding their breath that REIT standards will come any time soon.

DOWN TO THE NITTY GRITTY

In addition to a macro-level, government-led push, there also needs to be micro-level change within companies. That extends down to the way firms interact with their service providers and manage volumes of investment data.

David Stanford, the founder of the global property consulting company RealFoundations, says simple measurement of performance also is incredibly difficult

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for investors to track. His company has been working on the issue for several years with large institutional investors.

RealFoundations has worked with one large sovereign wealth fund in Asia, for instance, that has a network of service providers that runs in the hundreds, each company providing data in different ways across different geographies.

“There’s usually between four and six hops from the actual true performance of that asset all the way up to the actual economic holder,” Stanford says. “Real estate is an opaque and fragmented asset class, and each asset doesn’t have a CUSIP number,” as stocks and bonds do.

The proliferation of service providers makes it “excruciatingly difficult,” Stanford adds, to get a handle on a portfolio level of what comparable actual asset numbers are.

To borrow a concept from the retail industry, global retailers such as Walmart, with thousands of suppliers, would spend endless effort making sure they generated and tracked information that shows what’s going on throughout the supply chain, and how the products it provides are faring. But many institutional investors in property dabbled a little bit with investment in the asset class at first and then have slowly expanded

their portfolios without recognizing the need to treat the companies that serve them as part of a formal supply chain.

“You have to recognize you have hundreds of suppliers, need

“If you want to be in the real estate investment space and source capital from the top pension funds, the process you go through to steward and protect their data is really starting to matter a lot more in the due diligence process.”

— David Stanford,
founder,
RealFoundations

to put the data governance people in place to create your own standards, and then have the discipline to manage that from a day-to-day process,” Stanford explains. “Work with the investment managers that you place money with to help them over

time to become better stewards of the data. That doesn’t just happen by yelling at them,” he adds.

Cooperation works much better. The data suppliers may not appreciate the scope of the problem or how failing to provide useful, full information to the money men and women is restricting the flow of funds into property.

The problem needs to be addressed at a corporate level, with companies coming to an understanding of their data collection, data management and data suppliers.

“No standards-setting organization is going to do that,” Stanford says. But both property investors and property fund managers have strong interest in making it work.

“If you want to be in the real estate investment space and source capital from the top pension funds, the process you go through to steward and protect their data is really starting to matter a lot more in the due diligence process,” Stanford notes. “We see small private equity operators raising money [who are] saying they are getting a lot more questions about what their information collection and automation looks like. It’s an evolving process.”

CULTURE OF SECRECY

In Asia, one problem facing organizations looking to set standards,

Shaping Your Spreadsheet

One major initiative looking to address the management of raw data is the Open Standards Consortium for Real Estate (OSCRE). It’s a nonprofit organization that is striving to develop standards that will set how data is delivered, so information is shared more efficiently and effectively.

Ed Lubieniecki, who works with David Stanford, the founder of RealFoundations, is also chairman of OSCRE. The group has developed a guideline format for submitting data called the Investment Performance Reporting project that is now open to review by its members and due for publication this fall.

The initiative aims to develop standards to guide the way property data is delivered, virtually down to the Excel field it should appear in. Many of the issues are highly technical, but any participant in the property investment industry should have a vested interest in seeing them resolved.

“Whether you are contributing or assembling cash, an asset or an investment manager, a portfolio manager, an appraiser, or a property manager, you are dealing with information that others have and you want,” Lubieniecki says. Efficiently sharing this data is the hard part.

“All of the investment stakeholders want more information, quicker,” Lubieniecki says. “But moving information up and down the food chain is really hard. OSCRE exists to make the information flow smoother.”

The idea is to build data and technical standards that software vendors such as MRI, Yardi, Argus or Trace Solutions can incorporate into their property-performance analysis software. Big investors such as ING Real Estate, Schroder Property Investment Management and State Street Bank along with others also are participating to represent the investor perspective.

— Alex Frew McMillan

and managers looking to obtain streamlined data, is that there's more of a culture of secrecy surrounding property investing in the region. The initial reaction of many property managers when asked to share performance numbers is that they don't want to do so.

Benchmark provider IPD, the Investment Property Databank, has confronted that obstacle in compiling its benchmarks of how institutional property portfolios are performing in Asia. The company now tracks performance in nine nations, having started with Japan and South Korea nine years ago and now also tracking China, Hong Kong, Indonesia, Malaysia, Singapore, Taiwan and Thailand.

In 2010, IPD also introduced its first-ever measurement across Asia, the Pan-Asia Returns Research. Figures released in June showed the total local-currency return for commercial property across Asia was 6.4 percent for 2010. Performance was as high as 21.6 percent in Hong Kong, while Japan, the biggest market by far, had the worst performance with a total return of 0.2 percent.

Though such performance figures enhance the ability to invest in and across Asian markets, fewer Asian investors have yet been persuaded to participate in IPD's research in Asia than in Europe. Around 25 percent of the data the company uses in Asia comes from public filings, such as from listed property companies, whereas in Europe all the data used to compile IPD's performance figures come straight from the property managers themselves. Perhaps because they don't want to pay fees, or they don't see the reward for revealing performance information, IPD has to work with public data — and assume its analysis of it is correct — rather than getting the sign-off from the companies themselves as IPD would prefer.

"There is sometimes a difference between the outlook of domestic managers in Asia and the accepted Western approach, which has for a long time had the notion of fiduciary duties and performance monitoring, showing your investor and your trustees that you're getting not just a good return but you're doing a good job against a peer group

or against the wider market," say Kevin Swaddle, IPD's managing director for Asia.

The situation is worst on the non-listed side. But even many REITs are "as transparent as they need to be but not much more than that," Swaddle adds.

As a result, Asia lacks some of the most basic information on property performance in the region, information that's readily available for other asset classes.

"When you talk about real estate in Asia, individual investors have a vague feeling that they

"[Many REITs are] as transparent as they need to be but not much more than that."

*— Kevin Swaddle,
managing director for
Asia, IPD*

have done well in a particular period or have done badly in a particular period," Swaddle mentions. But they can't quantify it against the rest of the market or the performance of other assets.

HOLDING BACK THE INDUSTRY

The lack of that information is holding back the region's development. Asian developers and fund managers may feel they can always find opportunistic investors, particularly domestic institutions that take on more risk. But the industry is missing out on longer-term institutional investors that are the most research driven in their investment, needing to extract historic data to drive their models and decision making.

Those investors "have what I call the more sticky money to stick around during the up and down cycles," Swaddle notes. "The more opportunistic money will generally take flight at the first sign of any problem. If that's all you have coming into the market, that is introducing an element of structural volatility because of the nature of those investors."

It's also holding back the development of Asia's capital markets. Investment banks also use indices such as IPD's benchmarks to construct property derivatives and make a market in futures, something that's done quite extensively in Europe. There was a lot of interest in developing derivatives in Asia a year or two ago, but that seems to have waned once the difficulties became clear.

"It's a bit of a red herring in Asia," Swaddle says. "Although there are people that would like to do property derivatives, it's not something that is just around the corner. But the existence of an index does mean it is now theoretically possible for the property derivatives to be developed."

For real estate investment standards, money is eventually likely to talk, of course, as it has done in the United States and Europe. The wall of money pushing into property from capital markets, pension funds and sovereign wealth funds likely will be too hard to resist.

"You don't have to be rocket scientists," Price says. "As investors increasingly demand that things be measurable and more transparent, then you're going to have less and less choice" but to provide measurements and transparency.

Institutional allocations to property are much lower in Asia than in Europe or the United States, with only 35 percent of pension funds in Japan, the largest pension fund market in Asia, allocating to the sector at all, according to APREA. Throughout Asia, the lack of real estate market information and transparency is the second-most-important reason holding back greater allocations — immediately behind the need for better alignment of interest with the property fund manager.

Investors will want to see that change, and — if Asia's development is anything to go by — fast.

"To my mind it is inevitable. Is it hard work? Yes, of course. But 10 or 15 years ago it was not that easy in Europe," Price says. "We are much closer to the beginning of a journey here, but there is a lot of international experience on which we can draw." ♦

Alex Frew McMillan is a freelance writer based in Hong Kong.
