Institutional Investor

Asia Real Estate Investment Options Turn Blue-Collar

BY DAVID TURNER

The wave of money into Asian real estate has ramped up prices and ratcheted down yields across much of the region. Good value, let alone bargain prices, has become harder to find. Yet international investors still see opportunities. They're just having to venture farther afield for them, going outside the prime areas of major cities and considering such unglamourous properties as warehouses and parking facilities, rather than trophy office towers.

"We have seen a lot of capital pursuing core property in Asia: high-rise offices and malls that are regional hubs," says Gary Garrabrant, managing partner at Jaguar Growth Partners, a private equity firm based in New York. "Institutional investors, whether Asian or North American, really favor that middle-of-the-fairway style of real estate investment — the sort of buildings for which, if you shut your eyes and opened them again when you reached your destination, you could be anywhere in the world." Garrabrant, who is in the middle of raising $1 billion for a fund at Jaguar, a firm he started after leaving Sam Zell's Equity International as its chief executive in 2012, concludes that "for these assets, it's not obvious that further investment opportunities exist." Many, though not all, investors are also wary of investing in Chinese urban residential property after sharp price rises in recent years.

The most extreme example of the disappearance of value is real estate in Hong Kong's commercial center. There, capitalization rates — net operating income divided by capital value — have fallen to 3.5 to 4 percent, down from the 5 or 6 percent before quantitative easing by the Federal Reserve Board and other major central banks prompted foreign investors to seek profits in Asian property.

To achieve returns beyond these rates, Thomas McDonald, Jaguar's other managing partner, sees potential in parking spaces in the rapidly growing urban centers of emerging Asia, including Jakarta, Manila and cities in China. Urban areas in the world's most populous country need about 50 million more parking spaces than currently exist, McDonald estimates. With car ownership growing at double-digit rates, the parking shortage seems certain to intensify. Jaguar is in discussions with a few existing owners and operators of parking lots about investment to increase capacity nationwide. A key attraction of this market segment is the support from the Chinese central government and local authorities, says McDonald. "They realize that this is basic infrastructure that has to be developed," he says, "so it's unlike other property sectors in China, where there can be a lot of disagreement between government and developers."

Mark Yusko, chief investment officer and CEO of Morgan Creek Capital Management, a $4.5 billion asset management firm based in Chapel Hill, North Carolina, likes a slightly different China infrastructure play: industrial warehouses on the ring roads of China's cities, which are springing up to fulfill the orders generated by the region's e-commerce boom. According to Yusko, private equity investment in Chinese warehouses could generate internal rates of return of "20 percent–plus." In 2013 Morgan Creek coinvested in warehouse construction along with Chinese private equity house Prax Capital, which later that year merged with CDH Investments, another Chinese private equity firm.

Morgan Creek has also invested in the Indonesian property market, both by buying shares in companies that construct and refurbish new apartments and by buying companies that have exposure to the real estate development market. One example of the latter is Ace Hardware Indonesia, the local affiliate of the U.S. retail chain; its stock traded at 925 rupiah (7.9 U.S. cents) on August 22, up 56.8 percent since the start of the year.

Aberdeen Asset Management, a Scotland-based firm with £322.5 billion ($535 billion) in assets, still likes developed markets but is venturing outside prime areas to find attractive properties. "There isn't that much value left in prime assets in capital cities, not just in Asia but globally," says Milan Khatri, head of property research with Aberdeen Asset Management Asia. "We're mostly seeing opportunities in the suburbs of major capital cities or in the next tier down of cities." One such example is retail space in Singapore, but outside the center of the city-state. "The key structural theme is that the government is pushing very hard to decentralize economic activity away from the central business district hub," says Khatri. It is improving transport links and encouraging the growth of business parks in outer areas — measures that should increase the number of shoppers there.

Anton Kwang, senior portfolio manager, Asia-Pacific real estate securities, at Neuberger Berman in Hong Kong, says even prime areas can still offer solid returns to canny investors. "If you invest in less liquid markets or frontier countries, obviously you're going to get much higher returns," he says. "That doesn't mean that core markets are unattractive." He cites offices in the central business district of Singapore, where rents have grown by 8 percent since the beginning of the year. Rents have been boosted by government encouragement of white-collar sectors including commodity trading and legal services. That gives investors the prospect of boosting rental income further through active property management, including refurbishment and extensions, he adds.

Kwang acknowledges, however, that some core Asian markets, such as Hong Kong luxury residential properties, look too expensive for new money at the moment.

Although they differ on the specifics of how to invest in Asian property, investors remain determined to allocate money to it. "There will be huge growth in urbanization and consumption over the next few decades," says Aberdeen's Khatri. "That's what a lot of investors are trying to tap into."