## MIPIM Special

# Opportunities for real estate investors in Asia-Pacific

**Weil Europa und die Vereinigten Staaten mit hohen Staatsschulden und negativen Konjunkturerwartungen zu kämpfen haben, suchen internationale Investoren im asiatisch-pazifischen Raum nach Opportunitäten. Vor allem der australische Immobilienmarkt wird wegen seiner Transparenz geschätzt, doch blieb das Land nicht von der globalen Finanzmarktkrise und einer nationalen Bankenkrise verschont. Dadurch öffnete sich für ausländische Investoren ein Fenster in dem sonst weitgehend reifen Markt, erklären die Autoren. Anders als von vielen erwartet platzte in China keine Immobilienblase, weil die Regierung massiv in den Markt eingegriffen hat. (Red.)**

There is much speculation that the China real estate bubble has begun to burst or at least deflate. The recent real estate bubble began in the 2008 to 2009 worldwide financial crisis. The Chinese government released trillions of yuan of cheap credit in an attempt to maintain strong growth (or at least a perception of it) and to control social unrest due to loss of jobs in the export industries. This resulted in a borrowing spree by local governments, developers and industrial companies speculating in the real estate market. The Chinese real estate sector therefore performed strongly in the last few years, for the reasons above as well as the insulation provided by China's continued strong economic growth and urbanisation. This led to the explosion of the real estate market in China and Chinese citizens found it harder and harder to purchase affordable housing.

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Although accurate data is hard to find, it is believed that there are 65 million idle homes, purchased on speculation and cheap borrowing. In 2010, Beijing instigated a series of measures to control soaring prices, mainly by imposing restrictions on bank lending and ownership. The government policies have worked and we are experiencing their effects – very simply, residential property prices have declined in recent months. In December, average prices were down 0.3 percent from the previous month. China's National Bureau of Statistics recorded price declines in 53 of China's 70 biggest cities. Real estate investment grew around 28 percent year-on-year in 2011. But this has been decelerating. The year on year pace was 25 percent on October, 20 percent in November and twelve percent in December.

In contrast to the West, this cooling of the Chinese real estate market has occurred in the context of a proactive approach by the Chinese government to curb the risk of a property bubble. In the past year, the Chinese government has strengthened its efforts to stabilise property prices through three main initiatives.

- The first initiative has been a massive increase in the construction of affordable housing to bring prices down. Beijing is pinning its hopes on building 36 Million subsided flats by 2015. This "one stone two birds" strategy seeks to provide affordable housing for low income earners while maintaining investment led growth. The issue China faces in this initiative is that developers have no incentive to build housing that will drive prices down.

- Second, China has been trialing taxes on new properties in Shanghai and Chongqing. In January, Vice Premier Li Keqiang announced plans to gradually expand this tax further.

- Third has been the introduction of further restrictions on residential real estate acquisitions by foreign individuals. To purchase property, foreigners have had to prove that they have worked in Mainland China for at least a year and that they do not own any other property in China. Likewise, foreign institutions that have a representative office or branch in China may only purchase non-residential property for office use and only in the city where the institution is registered.

All these measures will stabilize the property market as opposed to creating a free fall in the property market. The facts are as follows: the government policies have worked, inflation is under control and the steam has been taken out of spiraling property prices. There is expectation that credit will loosen and borrowing and purchasing restrictions lifted this year.

## The revaluation of the renminbi

In response to pressure from the US, Europe and Brazil over trade imbalances and in an effort to tame inflation, the renminbi has been revalued, up 8.5 percent against the US dollar since June 2010, with the pace having slowed in the last six months. Taking into account the different inflation rates in the two counties, the effective increase is closer to twelve percent. However, the currency remains undervalued, relative to all other currencies, by an estimated five to 20 percent and is expected to further appreciate in value.

The potential for investment gains through such an appreciation is enormous. Accordingly, in anticipation of such appreciation, foreign investors have shown great interest in investing in the renminbi. As there are restrictions on the trade of the renminbi, investors have instead invested in real estate and equities as proxies to the renminbi. This influx of speculative capital in the Chinese real estate market has further contributed to an upward pressure in property

prices. In addition, the appreciation of the renminbi has had the effect of driving down the cost of imported construction materials, which in turn has the potential of increasing the profit margins of real estate developers.

For all these reasons, the outlook for the China real estate market is good. The bubble has not imploded or burst but has assumed a much more stable and organic form.

## Australia – a land of opportunity?

The Property Council of Australia's quarterly survey of Property Industry confidence released in January demonstrated that within the Australian property industry, the two speed economy is well and truly alive. The resource rich states of Western Australia and Queensland saw significant uplifts in industry confidence from already strong levels whilst the big states, New South Wales and Victoria both showed falls in confidence. Victoria dipped into negative territory as did the Australian Capital Territory.

At the extremes were the Northern Territory with booming confidence and Tasmania in the doldrums. This demonstrates the difference that significant projects can have with the Northern Territory being the beneficiary of the 30 billion Australien dollars IMPEX Ichthys Gasfield project and the resources boom in Western Australia, South Australia and Queensland leading to over 140 billion Australian dollars of committed investments to iron ore, coal, gas and associated infrastructure projects. These states will have their economies underwritten for the foreseeable future by the almost insatiable demand for iron ore and energy coming from China and India as the largest economies in Asia.

Victoria, which has consistently shown strong growth over the last ten years has finally started to lose its gloss. A change of government has led to something of a policy vacuum and the rate of population increase, which was 80,000 to 100,000 people per year over the last seven years, has slowed and economic growth has slowed with it.

One of the key negatives is the continuing credit squeeze which is anticipated to worsen rather than improve in coming months. Since the Global Financial Crisis, Australia has largely been beholden to the four major banks, who have found themselves overweight in property debt. When combined with the requirement to hold more tier one capital to support property debt, they are unable to cost effectively lend to the sector. Add to this economic uncertainty from the issues in Europe and it is easy for the banks to sit back and selectively allocate the available credit to only the best.

Traditionally when the big banks have stepped back from the property sector, the second tier and alternative market has stepped in to fill the void. With the GFC bringing an end to this secondary market, there is a significant gap which is now being filled by foreign investors. Offshore private equity funds, sovereign wealth funds, pension funds, opportunistic funds and large private investors are all eyeing Australia as providing great opportunities for opportunistic style development returns in a relatively safe, transparent and sophisticated market. Initially, this money was coming in to satisfy mezzanine debt requirements of property developers, particularly in the residential market.

However, the big four banks with their monopoly on senior debt have almost closed the door on mezzanine lenders by refusing to accept inter-creditor agreements or second ranking securities behind their senior positions. This is leading to a new breed of investor, which is prepared to co-invest through joint venture agreements, development agreements or even unsecured junior debt positions and more often than not, a combination of all of the above. This is lifting the risk profile of investment, but also enhancing returns for those prepared to enter the market.

## Developments and the new credit environment

With traditional Australian property developers being highly geared, the new credit environment means that there is ample opportunity for quality offshore investors. Generally, investors are coming in late in the development cycle, after planning approvals have been obtained, the project has been substantially or wholly pre-sold, the construction contract is in place and the senior debt arranged. An investor undertaking a thorough due diligence is therefore able to fully analyse the risks from the project and the likely returns.

As most investors are effectively acting in the role of junior lender, the bulk of the returns are usually able to be repatriated subject only to the ten percent withholding tax rate applicable to interest income. This ensures that the effective Australian tax rate on the investment is suitably low.

Recent volatility in exchange rates has impacted swap rate margins, however, with the United States indicating it will be maintaining its low interest rate policies until 2014 and the extent of the resources boom in Australia, it would seem that Australia's exchange rate is likely to remain high for the medium term, so many investors can factor that risk into their overall returns.

Residential development is not the only sector which is seeing offshore investment. The January Office Market Report indicated that sales of commercial property assets over ten million dollars were 5.6 billion dollars in 2011 exceeding the pre-GFC total of 5.5 billion dollars in 2007. Of these, 36 percent, or just over two billion dollars, of all CBD deals and 50 percent of all deals in Sydney and Melbourne combined were to offshore buyers (Knight Frank Office Market Report January 2012).

This investment is being driven by strong office market fundamentals. While Sydney's vacancy rate at the end of 2011 remained at 9.6 percent, Melbourne's is a low 5.3 percent, Brisbane 6.2 percent and Perth only 3.3 percent. The net absorption in Brisbane and Perth of approximately 50,000 square metres each for the second half of 2011, being well above the long term average and demonstrating the impact of continual growth by the resources sector and their suppliers in those markets.

Whilst a significant 800,000 square metres of new stock has to be added in 2012 which is higher than the historic average, only 400,000 square metres will come on line in 2013 so that the two year figure is in line with the long term average. Very little of this supply is in the core Sydney market, with no significant new buildings to be completed over those years (Property Council of Australia's Office Market Report, January 2012).

With the scarcity of bank debt and the ongoing credit squeeze, the field is ripe for well funded offshore players in the Australian market.