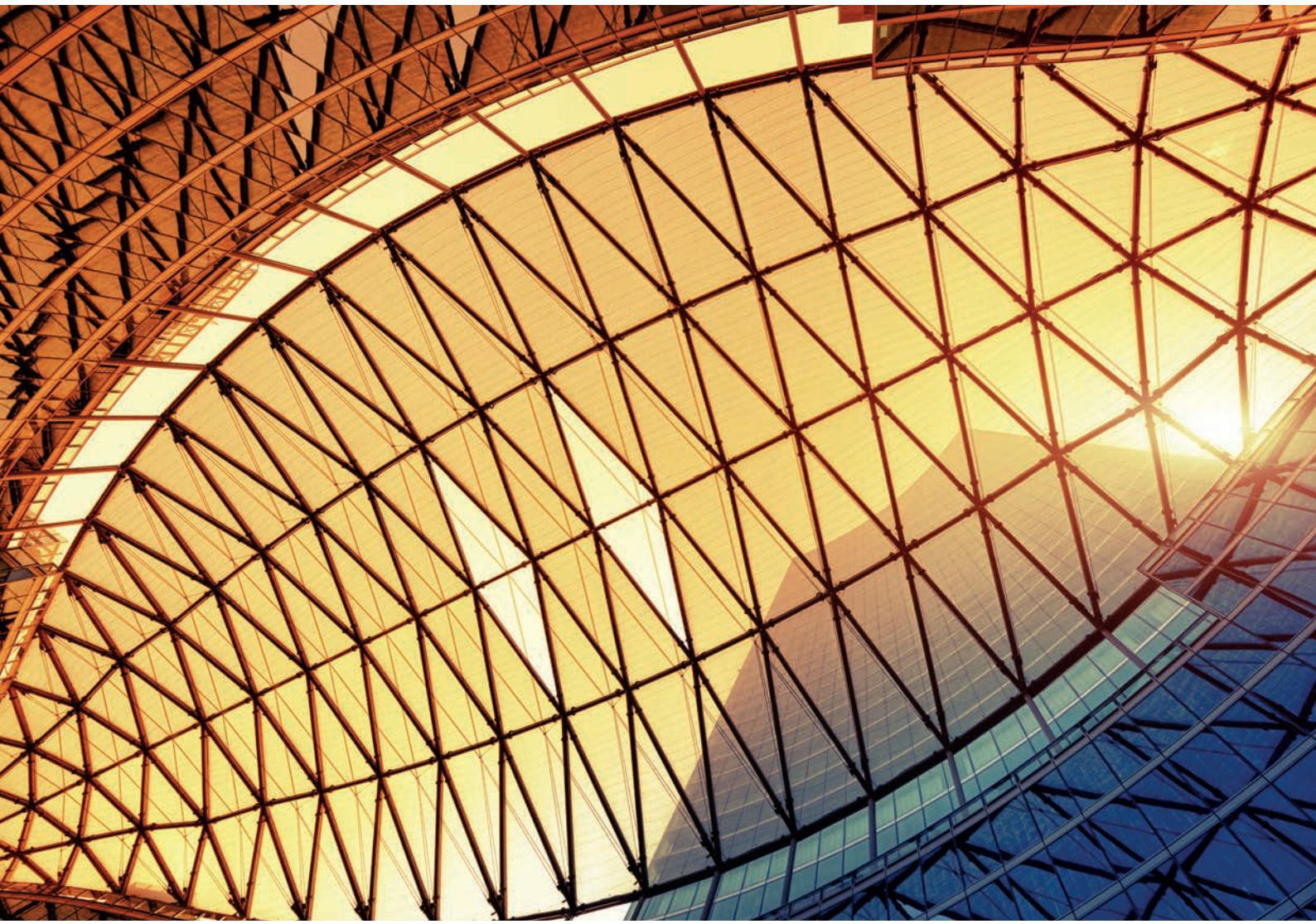


Emerging Trends in Real Estate®

The global outlook for 2015

pwc

ULI Urban Land Institute

Introduction

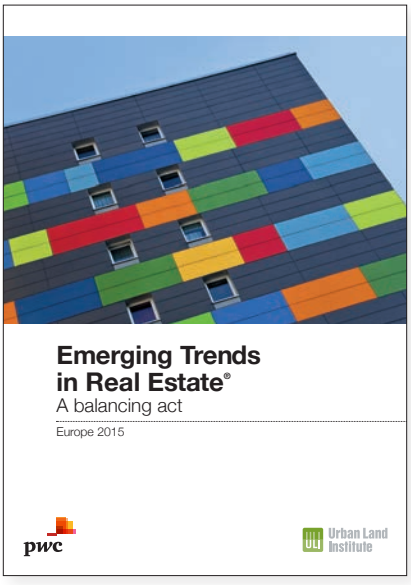
The *Emerging Trends in Real Estate© United States and Canada, Europe* and *Asia Pacific* reports are produced annually by the Urban Land Institute and PwC following extensive surveys and interviews with the most senior property professionals. Over the years, these reports have become key indicators of sentiment in their respective regions.

We have drawn together those regional insights for 2015 in this global report, highlighting the most relevant investment and development trends.

It is evident that there is still a wall of capital targeting real estate in many markets and that it is performing strongly against other asset classes. It is clear too, though, that investors must strike a fine balance between the need to deploy capital and the ability to achieve adequate returns when there is such a wide variance in underlying fundamentals and economic conditions across the globe.

Like last year, the search for yield has taken some investors into development and secondary markets. But for the first time in this global edition we move further up the risk curve and provide a snapshot of an increasingly important emerging market: Africa.

But it is also clear from all three regional reports that many investors are thinking about the future and paying greater heed to such megatrends as urbanisation, demographic change and technology. This global report, therefore, reflects not just the outlook for 2015, but offers a glimpse of just how those megatrends will influence real estate in the long term.



The *Emerging Trends in Real Estate 2015* series of reports are available at: www.pwc.com/emergingtrends

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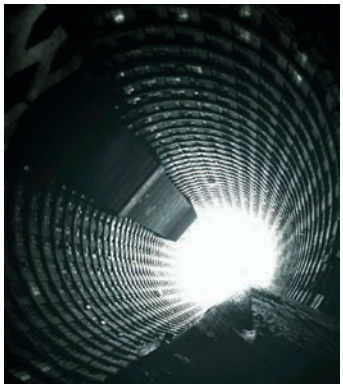


Capital flows

The movement of capital from East to West is likely to remain the major influence on real estate in 2015, according to interviewees and respondents to the surveys conducted for all three *Emerging Trends* reports.

Asia has seen a structural shift in the last couple of years in the role that its institutional capital – from sovereign wealth funds, pension funds and insurance companies – is now playing in the industry, with a big increase in local money being directed into global markets.

For now, much of this new capital is sourced from China and South Korea. In the future, it is likely to be supplemented by substantial amounts of pension fund capital emerging from Japan.

At the moment, this money tends to be targeted at core assets by way of direct investments in gateway cities in the US and the UK. New patterns are evolving, however, according to the three reports. As more capital flows into these cities and as Asian investors become more experienced in operating internationally, new investments are now being directed at assets in Germany and France – primarily Paris – and into US cities such as Atlanta, Chicago and Houston.

Another new trend is an increase in the volume of private capital originating from Asian markets. This has been led by a group of large Chinese developers – although Singaporean and Malaysian players are also prominent – that invest mainly in residential projects both regionally and globally, and whose products are aimed largely at buyers from mainland China.

The conclusions of the three *Emerging Trends* reports follow another strong year for direct investment. According to Real Capital Analytics (RCA), transactions involving income-producing real estate totalled $770.2bn globally in 2014, up 9 percent from 2013. Sales of developable land added another $373.3bn to the total, albeit 29 percent lower than in 2013 due to slowing of activity in China.

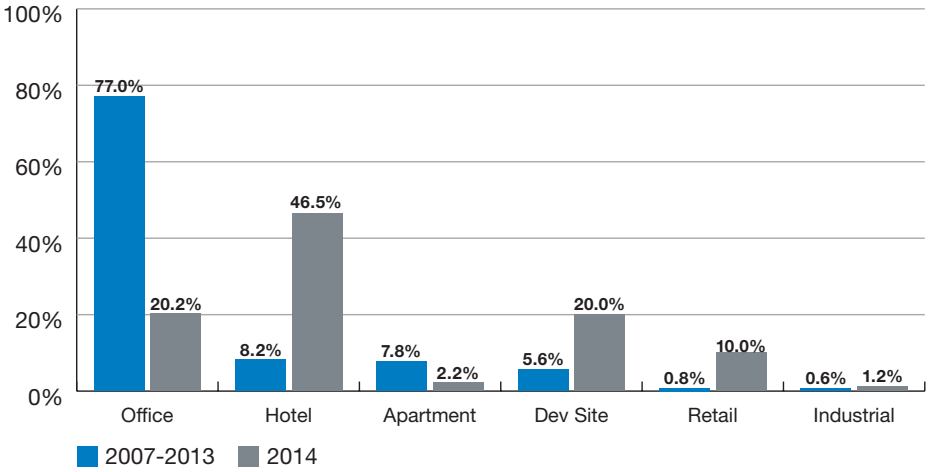
RCA says Europe attracted well over half of all cross-border investment in 2014, indicating that investors still perceive good value in property there despite economic uncertainty across much of the eurozone.

"What's really driving all this activity is the availability of capital rather than the underlying fundamentals. It just comes down to people needing to deploy capital," says one banker interviewed for *Emerging Trends Europe*. Another interviewee claims: "The wall of money is even bigger than before the crisis."

Last year's *Emerging Trends Europe* found cautious optimism over an increased availability of equity and debt, and the need to be the best of the best to win either. This year, it is a given that capital of all kinds will be flowing much more freely in most markets.

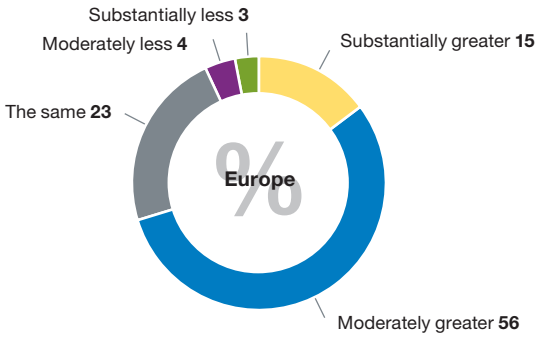
Of those canvassed by *Emerging Trends Europe*, 56 percent expect there to be moderately more equity in the market in 2015, with 15 percent expecting it to be significantly greater. Sovereign wealth, superannuation funds and institutional investors of all stripes are "shifting from fixed-income to real estate". European respondents anticipate that much of the capital will come from the Americas as well as Asia Pacific.

Figure 1 **Chinese investment activity in US commercial real estate by property type**



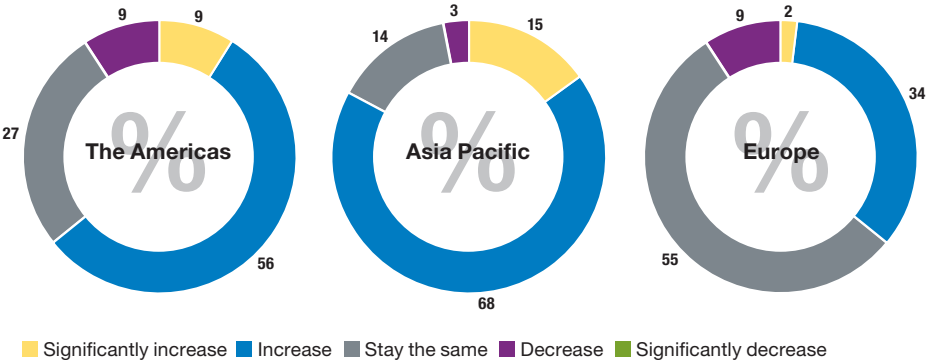
Source: Emerging Trends Asia Pacific survey 2015

Figure 2 **Availability of equity for refinancing or new investment in 2015**



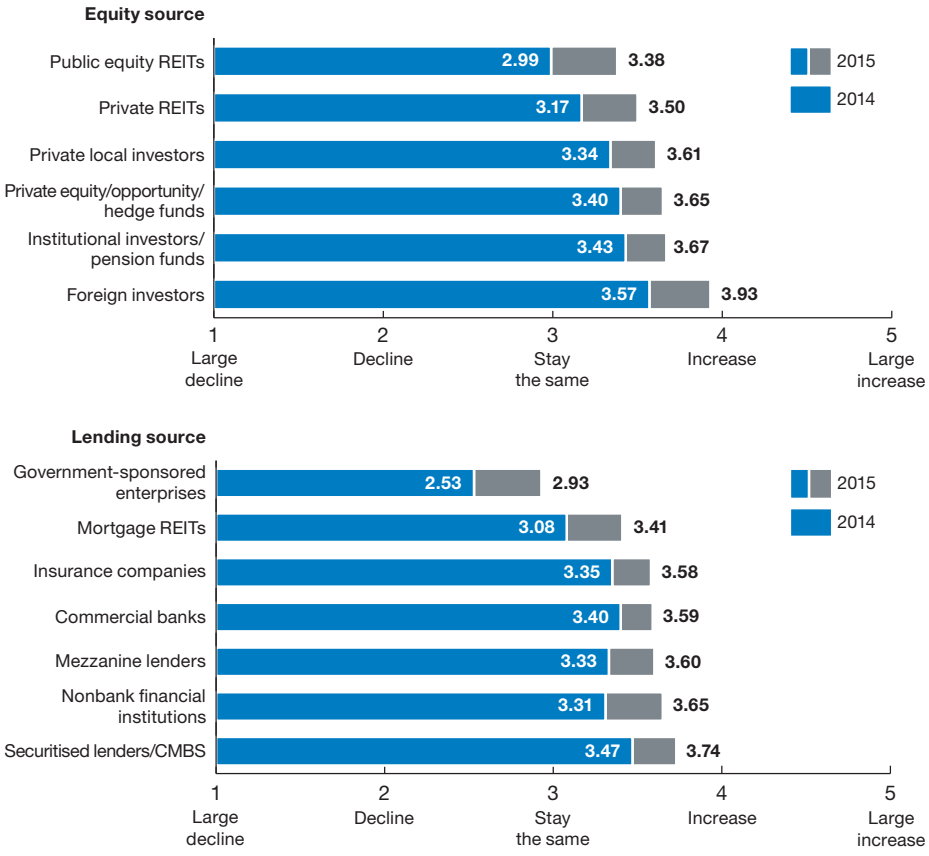
Source: *Emerging Trends Europe* survey 2015

Figure 3 **Cross-border capital into European real estate in 2015**



Source: Emerging Trends Europe survey 2015

Figure 4 **Availability of capital for real estate, 2015 versus 2014**



Note: Based on US respondents only
Source: Emerging Trends United States and Canada survey 2015

> What's really driving all this activity is the availability of capital rather than the underlying fundamentals. It just comes down to people needing to deploy capital.

But as one interviewee observes: "The availability of capital, whether it is equity or debt, is not an issue. The problem is more that there is too much equity and debt and too few investment opportunities."

The corollary of so much capital focusing on limited stock is higher prices. Core property is overpriced in almost all markets, say 61 percent of those surveyed. "If you have the capital, you should have spent it yesterday," says one UK opportunity fund manager.

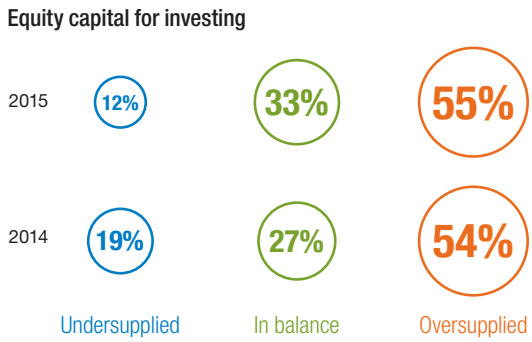
Unsurprisingly, around the same proportion who think core property is overpriced – around three-fifths of *Emerging Trends Europe* respondents – say that finding the required rate of return will involve taking on more risk.

But if spending the money effectively is a challenge, there is no doubt that it wants to go into real estate. The overwhelming majority – 70 percent – of those surveyed by *Emerging Trends Europe* expect more equity and debt to flow into their markets in 2015.

What is more, 83 percent believe capital flows from Asia Pacific into European real estate will increase in 2015.

Much the same sentiment is evident in the US, where international investment has been ramped up over the past year. From coast to coast, Chinese investors, for instance, have been grabbing headlines with deals like the $1bn acquisition by Greenland Holdings of the Metropolis project in Los Angeles from CalSTRS and its 70 percent stake in Brooklyn's 14-building Atlantic Yards development, joining Forest City Ratner. China Vanke, meanwhile, is working with Tishman Speyer in a 655-unit apartment project in the South of Market neighbourhood in San Francisco.

Figure 5 **Real estate capital market balance forecast, 2015 versus 2014**



Note: Based on US respondents only
Source: Emerging Trends United States and Canada survey 2015

Yet China is just one of many sources of inbound investment, albeit perhaps the most visible because of the predilection of the Chinese for eye-popping deals. *Emerging Trends* interviewees know first hand the breadth of the offshore equity capital rushing into the US. A New York-based value-add owner/operator rattles off those buying pieces of his deals in the past year: "Israelis, Koreans, Egyptians, Russians, Mexicans and others have all come to us for a piece of Manhattan."

Gateway cities are still the principal targets for offshore investors, with the list now including Houston and Seattle in addition to the big California markets, Miami, and the Boston-Washington corridor. And according to one investor, "The heartland is now actively considered by Russian, South American, Middle Eastern [and] Asian investors. They like the fundamentals but are really capital [yield] driven."

There is the strong prospect of more capital. According to *Emerging Trends Asia Pacific*, the new institutional players from Asia either have new capital to deploy, want to invest in real estate for the first time or are increasing existing allocations. Right now, Asia-based investors on average currently have allocations to real estate of 6.9 percent. The expectation is that they will increase to thresholds common in the West, such as 10.2 percent in Europe, and some interviewees suggest that 12 percent could be the Asian benchmark.

Longer term, global real estate markets could also benefit from Japanese pension funds. These funds – in particular, the US$1.2 trillion Government Pension Investment Fund (GPIF) – hold some of the largest pools of capital in the world today, mostly in the form of low-yielding Japanese government bonds (JGBs). Changing demographics in Japan mean these funds must now boost income beyond what they earn via JGBs.

But just as the flow of capital from Asia has boosted investment activity in the US and Europe, transaction volumes have fallen in many Asian markets. As *Emerging Trends Asia Pacific* points out, one reason so much new Asian capital is suddenly in international circulation is that some of the institutions have accumulated more capital than can be deployed at home without distorting their local markets.

One interviewee observes, "I think the market in Asia is pretty flat – we've had pretty much a ten-year bull market and rents are softening, so why buy in Shanghai at 4.5 percent net yield when I can buy in London and other markets at 5 percent to 6 percent? I think we're going to see a very slow Asia for the next 12 months."

There is another important consideration for investors across all three regions – "event risk". Geopolitical risks multiplied in number and intensity in 2014 and threaten to escalate in 2015, and that has pushed the notion of "flight to safety" in global capital to the fore. In that context, many real estate markets tend to look safe, at least when compared to equities.

For the time being, there are probably more concerns over pricing than event risks and they are being assuaged by the fact that in a low interest rate environment, the income returns of real estate look good against those of other asset classes.

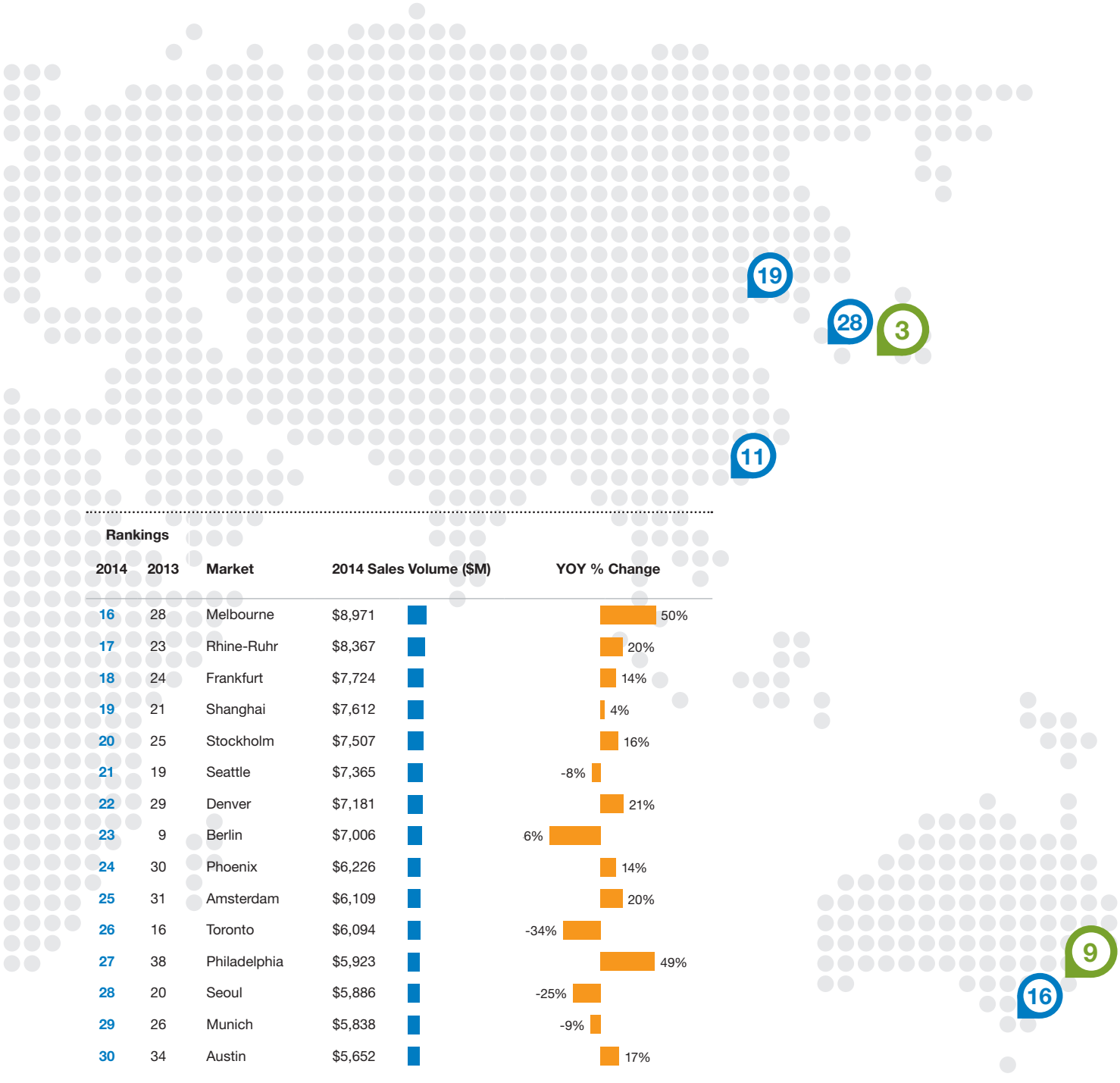
As one European fund manager puts it, "Real estate just looks so attractive to a pension fund. It is one of the highest yielding asset classes on the planet."

The top 30 cities for commercial property investment across the world in 2014

Figure 6 **Top 30 ranking by 2014 Sales Volume ($M)**

Rankings 2014	2013	Market	2014 Sales Volume ($M)	YOY % Change
1	1	New York	$57,012	19%
2	2	London	$42,889	-2%
3	3	Tokyo	$38,894	15%
4	4	Los Angeles	$28,800	5%
5	5	San Francisco	$26,666	51%
6	7	Paris	$24,526	45%
7	6	Washington	$14,275	-19%
8	11	Chicago	$13,565	9%
9	13	Sydney	$13,051	16%
10	12	Dallas	$12,990	5%
11	8	Hong Kong	$12,964	-5%
12	17	Boston	$12,676	37%
13	14	Atlanta	$11,976	22%
14	22	South Florida	$10,714	46%
15	10	Houston	$9,159	-28%

Source: Real Capital Analytics – Global Capital Trends 2014



Rankings 2014	2013	Market	2014 Sales Volume ($M)	YOY % Change
16	28	Melbourne	$8,971	50%
17	23	Rhine-Ruhr	$8,367	20%
18	24	Frankfurt	$7,724	14%
19	21	Shanghai	$7,612	4%
20	25	Stockholm	$7,507	16%
21	19	Seattle	$7,365	-8%
22	29	Denver	$7,181	21%
23	9	Berlin	$7,006	6%
24	30	Phoenix	$6,226	14%
25	31	Amsterdam	$6,109	20%
26	16	Toronto	$6,094	-34%
27	38	Philadelphia	$5,923	49%
28	20	Seoul	$5,886	-25%
29	26	Munich	$5,838	-9%
30	34	Austin	$5,652	17%

Investing in the US

Global and domestic investors continue to be willing to pay what either are or quickly will be record prices for assets in the major US markets.

These assets offer a surety of return of capital that can be reproduced in only a limited number of markets across the globe.

What sets the US apart from other markets are improving fundamentals, which are expected to reinforce the strong, sustained performance of the industry throughout 2015.

And if there is one takeaway from *Emerging Trends in Real Estate*® 2015 it is that the industry still benefits from "once-burned, twice-shy" experience. In most cycles, the US would have seen overbuilding and excess leverage gathering steam by now. That appears not to be happening, and it seems the industry has learned some lessons in self-regulation and self-correction.

As the report reveals, investors are interested in making sure their money – or "flight capital" as one institutional adviser describes it – is placed somewhere that they (or their heirs) can be sure they can recoup at an undetermined point in the future.

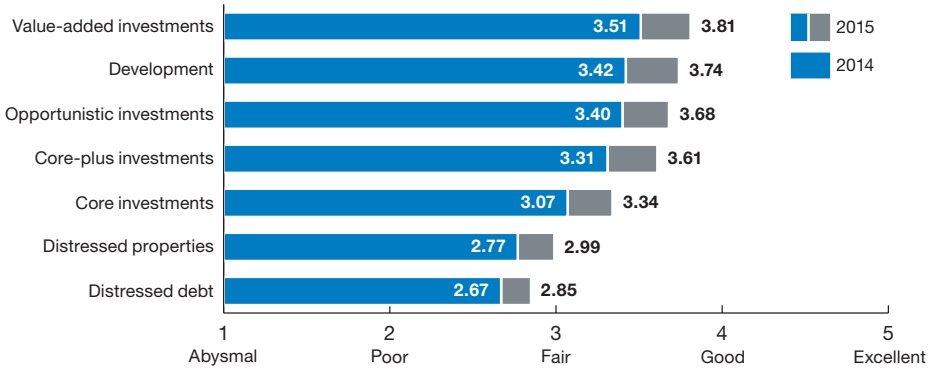
Institutional investors looking at balancing risk and return are quick to admit that "there are a lot of great opportunities for real estate investment outside the major markets, but our ability to pursue those investments is limited by the benchmarks that are used to measure our performance".

This year, though, interviewees and survey participants reflect a desire to take on a measured amount of new risk in search of higher yields. Typical strategies involve moving to more opportunistic-style investments in the major markets or close to a major metropolitan area – such as New York City boroughs – or looking for the best assets in markets outside the core major markets.

This year's rankings reflect the attractiveness of markets for such strategies, although one interviewee sums up the views of many: "It is important to remember that you can find good opportunities in every market, but it really helps to have the right local partner."

> It is not enough to pick the right market any more. We have to pick the right market that is going to be sustainable.

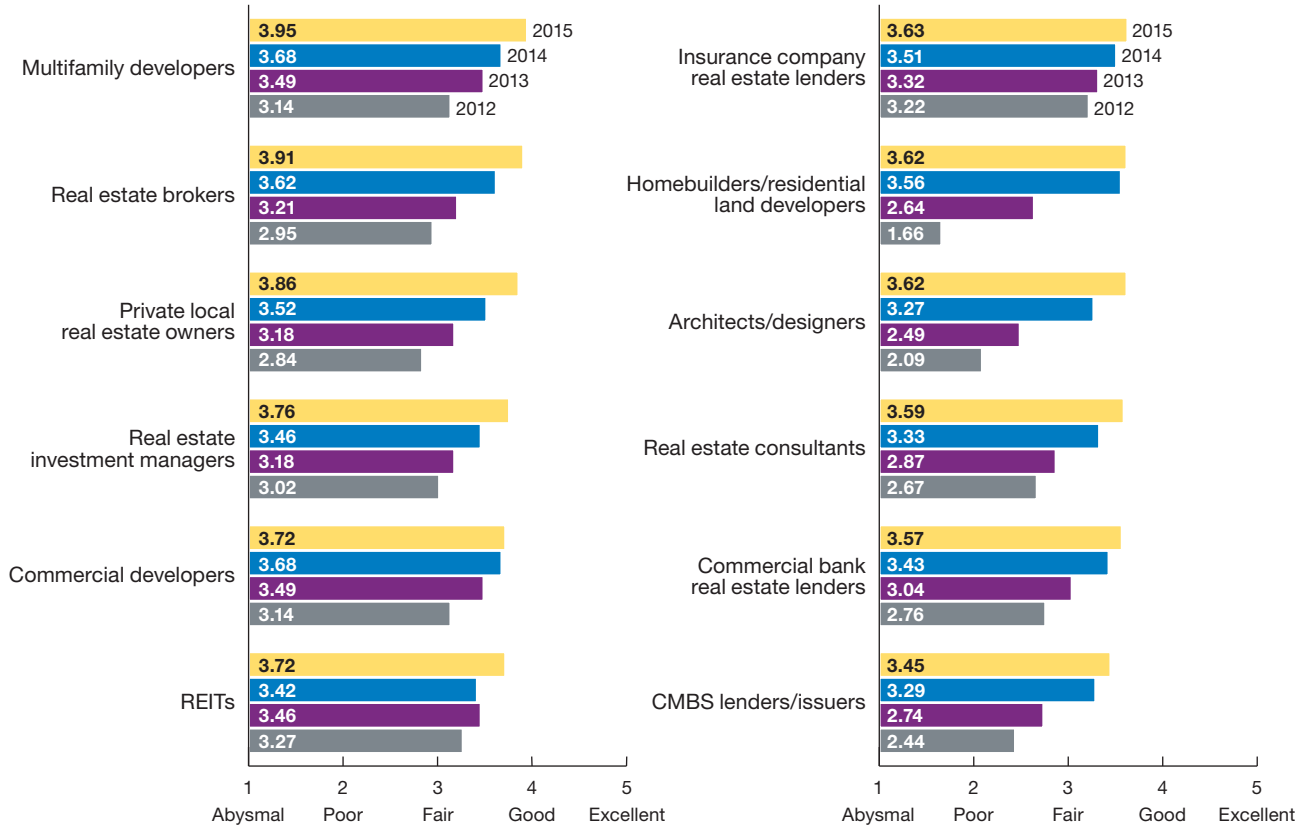
Figure 1 **Prospects by investment category/strategy, 2015 versus 2014**



Note: Based on US respondents only

Source: Emerging Trends United States and Canada survey 2015

Figure 2 **Real estate business prospects**



Notes: Based on US respondents only. Before the 2015 survey, "Commercial developers"' and "Multifamily developers" were combined under the category "Commercial/multifamily developers."
Source: Emerging Trends United States and Canada survey 2015

Another interviewee concludes: "It isn't enough to pick the right market any more. We have to pick the right market that is going to be sustainable."

The survey results are similar to those of previous years and reflect the enduring strength of the Texas economy. Houston completes its ascent up the ranks and claims the Number 1 spot. Austin moves to Number 2, pushing perennial top market San Francisco to Number 3. Denver moves to Number 4 spot, and the Dallas/Fort Worth market completes the Texas markets in the top 20, coming in at Number 5.

However, Charlotte N.C., in seventh place, is rated higher than Seattle and Boston; and Nashville, ranked at 14, tops Manhattan.

As ULI Global Chief Executive Officer Patrick L. Phillips observes, "Investors are looking closely at opportunities beyond the core markets. These cities are positioning themselves as highly competitive, in terms of livability, employment offerings, and recreational and cultural amenities."

Growth in tertiary markets

It is one thing for survey respondents and interviewees to say they are planning to be more aggressive outside the major markets; but when push comes to shove, will risk/return measures and investor expectations allow them to follow through?

Over the past 12 months, the major markets still continue to attract the largest dollar amount of capital, with over $154bn invested there. This brings the major markets back to nearly 70 percent of the historical peak level of activity.

The secondary markets have seen a fairly impressive level of activity as well, totalling $140bn. This represents nearly 72 percent of the previous peak for this group of markets.

Perhaps the most surprising movement – and the one that fits with the markets' desire to look for investments outside the normal locations – is the growth in capital flows to tertiary markets.

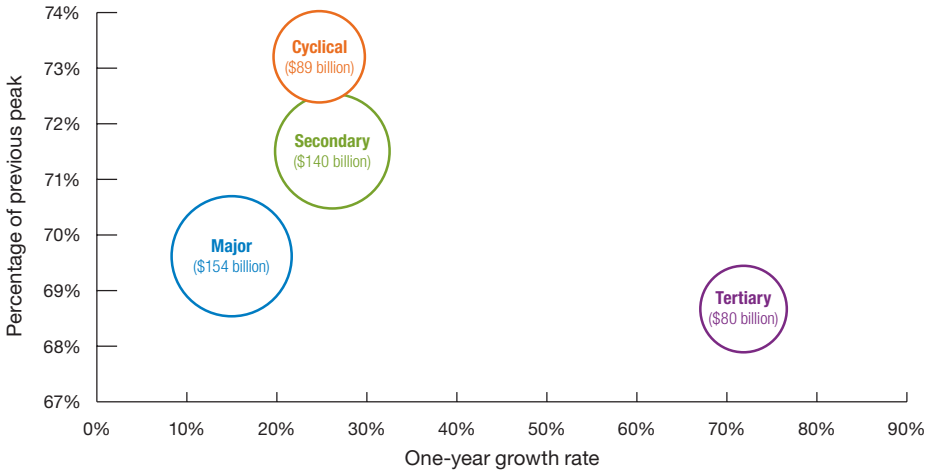
The tertiary markets' share of total dollars invested is still relatively small at $80bn, but it has seen a 72 percent growth in investment over the previous 12-month period. This rate easily outpaces any of the growth witnessed in the other categories. This pace of investment is still only 69 percent of the previous peak for these markets, so there is scope for further investment in 2015.

A number of interviewees offered up explanations for why investment outside the major markets may be up. The first is the belief that the economies of the housing bust markets in the South and West are now recovered to the point where it makes sense to look at investing there. This is leading to an increase in investment in markets such as Florida and Phoenix.

A second driver may be the desire of global capital to move outside its typical comfort zone, which has been confined to the core major markets. One institutional adviser suggests that "global investors are now seriously looking at markets such as Houston and Dallas/Fort Worth for industrial opportunities. These were markets that would have been a difficult sell to institutional investment committees in Europe and Asia just a few years ago."

Finally, investors may well be going where they see the best opportunities. A retail company executive remarks, "If you don't have to worry about what your shareholders think, there are some excellent retail opportunities in tertiary markets. You get the same tenant credit, but the yield on the real estate is significantly higher."

Figure 3 **12-month real estate transaction volume, by market category**



Source: Real Capital Analytics, for period ending June 30, 2014.

Industrial balancing act

The balancing act between the supply and demand for industrial real estate could be getting very tricky very soon.

At more than 12 billion square feet of space, this sector is vast, and since 2010 it has enjoyed a rising demand trend while supply has not kept pace.

Come 2015, however, industrials are entering a period when projected construction is accelerating, but demand is anticipated to decelerate. What's the right price to pay under those circumstances?

Last year, interviewees and survey respondents liked industrials. For many, that has not changed.

As one investment manager suggests, the warehousing sector this year "could be the most sought-after property type in commercial real estate, doing very well and continuing to do so even with some new supply".

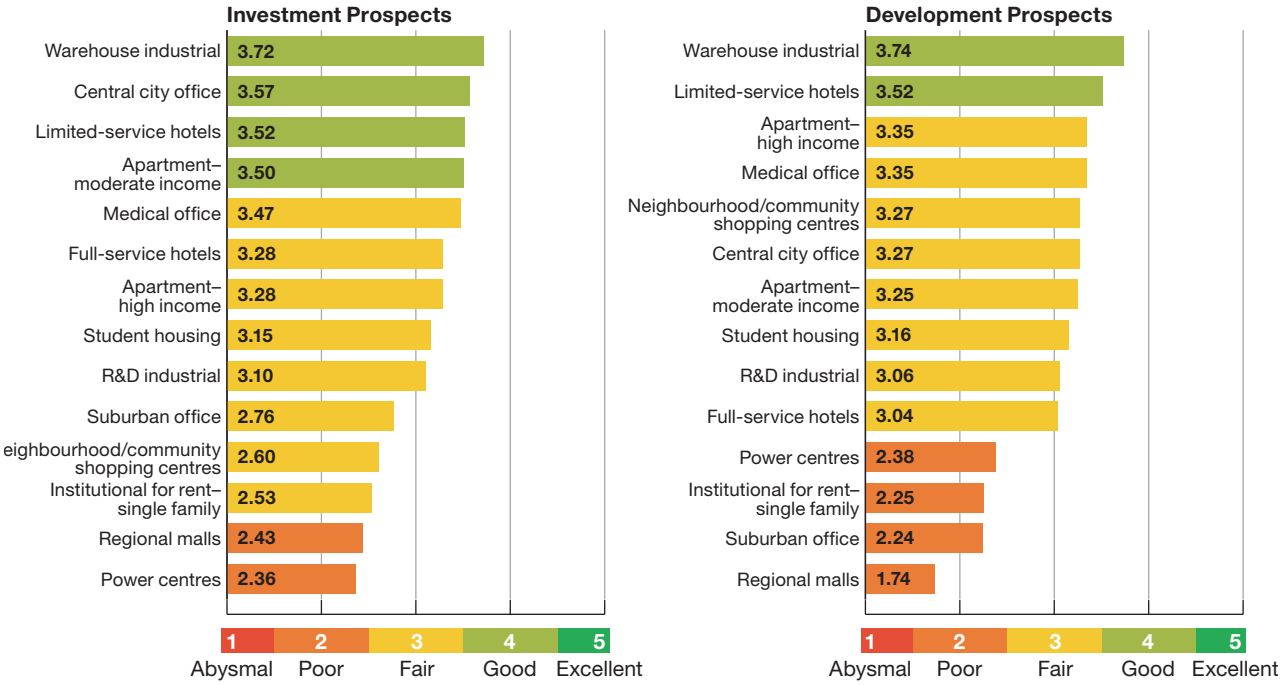
Such views account for the industrial sector once again standing atop the sector rankings for investment. Moreover, in the more granular subsector evaluation, warehouses show an even higher rating for investment and development and, in each case, these results are well ahead of the second-place choices.

One interviewee reinforces the rankings: "Logistic space demand [is] growing steadily. Warehouse cap rates are dropping like a rock. Investors like the stable cash flow, and retailers need the goods."

Some trends highlighted in last year's report remain solidly in place. The return of manufacturing activity to the US with the associated evolution of its economic relationship with China prompted affirmation among this year's interviewees. This trend is positive for several regions, including the Midwest, the Carolinas and Tennessee. Industrial real estate markets are in robust shape.

The sector is far from boring. It is still rated a solid "buy" among *Emerging Trends* survey respondents, and has been sustaining double-digit returns to investors in both the National Council of Real Estate Investment Fiduciaries (NCREIF) and National Association of Real Estate Investment Trusts (NAREIT) indexes. On balance it all looks very good – for now.

Figure 4 **Prospects for commercial/multifamily subsectors in 2015**



Note: Based on US respondents only
Source: Emerging Trends United States and Canada survey 2015

Investing in Europe

Europe's real estate industry expects to be busier and more profitable in 2015. This optimism is clear, despite weak fundamentals and economic conditions as well as an undercurrent of concern about the geopolitical situation in parts of the world.

The confidence comes from the availability of capital. Real estate is awash with equity. Most of *Emerging Trends Europe's* survey respondents and interviewees anticipate an increase in both prime and secondary values as a result of greater liquidity and the need to deploy capital in this asset class.

In many of Europe's main markets, growth in values has far exceeded any rise in occupier activity. Across the eurozone, in particular, rental growth remains elusive. This disconnect between capital flows and fragile occupier demand is expected to be, once again, a feature of the markets in 2015.

Nearly two thirds of those surveyed by *Emerging Trends Europe* believe that core property is overpriced in almost all markets. In this respect, the major influences are the equity-rich sovereign wealth funds and pension funds and insurers from Asia, which have helped drive up the price of core assets in "gateway" cities such as London, Paris, Milan and Berlin. These players are expected to play an even bigger role in European markets in 2015. Private equity firms from North America will also remain a force.

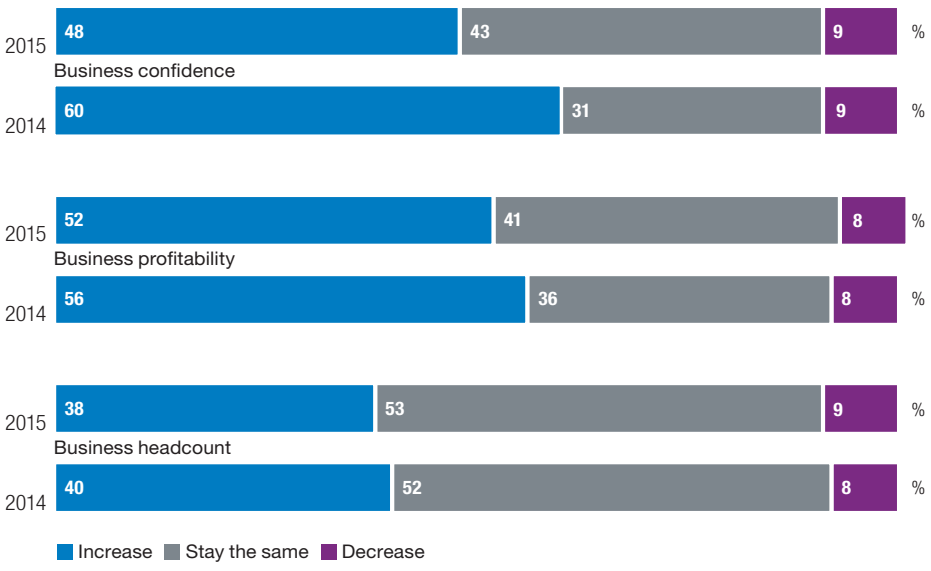
If there is one persistent issue for the industry it is a shortage of acquisition opportunities. This is much more significant to survey respondents and interviewees than regulation or the cost of finance, let alone the relative weakness of the occupational market.

Only 11 percent expect this shortage to ease in 2015. Indeed, 70 percent of investors expect more equity and debt will flow into their markets this year in a quest for the best real estate.

Scarcity and the high prices of these better-quality properties are forcing some to consider taking on more risk, simply to participate in real estate investment. Others are being priced out of the hot markets and are chasing yield.

> The only problem is that we have more money available than product to invest in across Europe.

Figure 1 **Business prospects in 2015**



Note: Percentages may not total 100 due to rounding.
Source: *Emerging Trends Europe* survey 2015

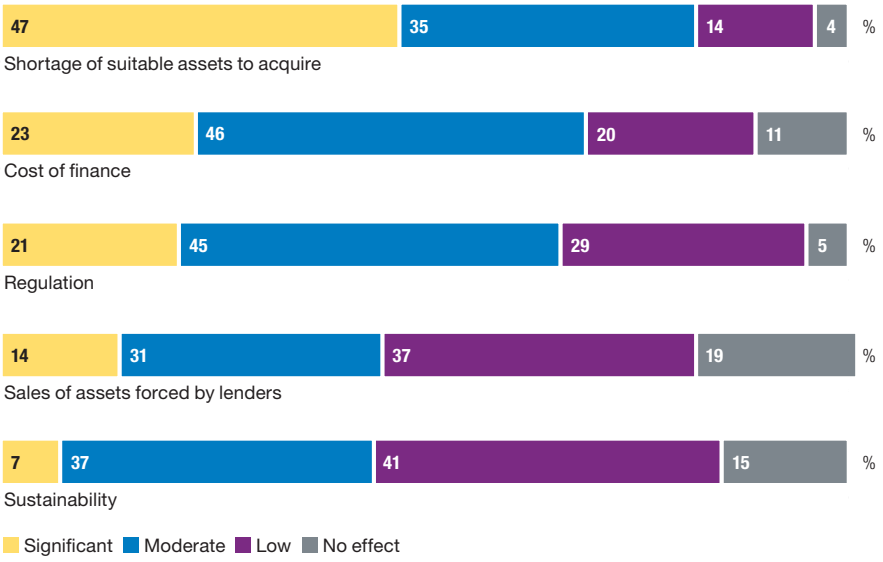
They are moving into less competitive environments, where their local knowledge and asset management skills give them an edge: the fringes of central business districts, regional cities, secondary assets that they can convert to core, development and, in some cases, taking on new asset classes.

Indeed, as many as two-thirds of those canvassed by *Emerging Trends Europe* say there is a need to consider secondary markets or assets. Their willingness to take on more risk is reflected in this year's ranking of city investment prospects: Birmingham in the UK has moved up to 6th place, from 17th last year.

That said, the five cities that *Emerging Trends Europe* respondents rate tops for investment prospects in 2015 are a mix of German "gateway" stalwarts and recovery plays: Berlin is Number 1, followed by Dublin, Madrid, Hamburg and Athens.

As one interviewee concludes: "The only problem is that we have more money available than product to invest in across Europe."

Figure 2 **Issues impacting business in 2015**



Source: *Emerging Trends Europe* survey 2015

Prime assets are over-priced

There is a need to move up the risk curve into secondary markets or assets

Source: *Emerging Trends Europe* survey 2015

Southern Europe rebounds

Southern Europe recovered strongly over the past 12 months, so it is not surprising that Madrid has jumped 16 places to take the bronze at Number 3 in the city rankings.

Last year, *Emerging Trends Europe* identified the surge in capital that was targeting Spain and it continues apace, led by private equity funds. Prices have risen considerably in Madrid, suggesting that investors seeking higher returns are likely to look to secondary markets in Spain for better yields in the coming year.

It is also evident that the spotlight has now widened to include the other distressed markets of Southern Europe, notably Athens, which rebounds to claim the Number 5 spot, moving up 23 places.

With Greece finally pulling out of recession after six years of misery, international money is eyeing the market, and locals are upbeat about an upturn. However, it is early days and there needs to be some caution over Athens' remarkable rise up the rankings. Some of the bigger real estate fish think it too small a pond for them, while others will wait to judge the full market impact following the success of anti-austerity party Syriza in the recent Greek election.

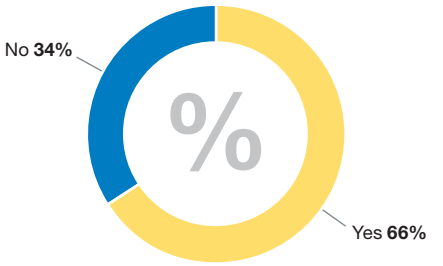
Perhaps more importantly for real estate investors, Italy is very much back on the agenda, with Milan the main focus, shooting up nine places to Number 12.

According to locals, Italy is on "standby where the more speculative investors have shopped already and the other ones should arrive soon".

One interviewee sums up the attractions: "It offers a stronger case for investment than Spain because it was less over-built than Spain and, as an economy, is less dependent on real estate and banking. Italy is much more diversified."

There are still good buying opportunities in Spain

Figure 3 **Housing is in short supply**



Source: *Emerging Trends Europe* survey 2015

Residential on the rise

Residential real estate in Europe is moving out of the public or semi-public sector and specialist investor/developer ambit, and into the mainstream.

Though *Emerging Trends Europe's* constituency is primarily focused on commercial real estate, two thirds are also active in various forms of residential property – mainly building for sale as opposed to holding for long-term investment.

And of those not already in the sector, 15 percent are considering some form of investment, while in some countries, institutional and private equity capital is moving into the sector.

"There is a feeling that it is a very safe and diversified investment and I see a lot of capital trying to enter the sector," says one interviewee.

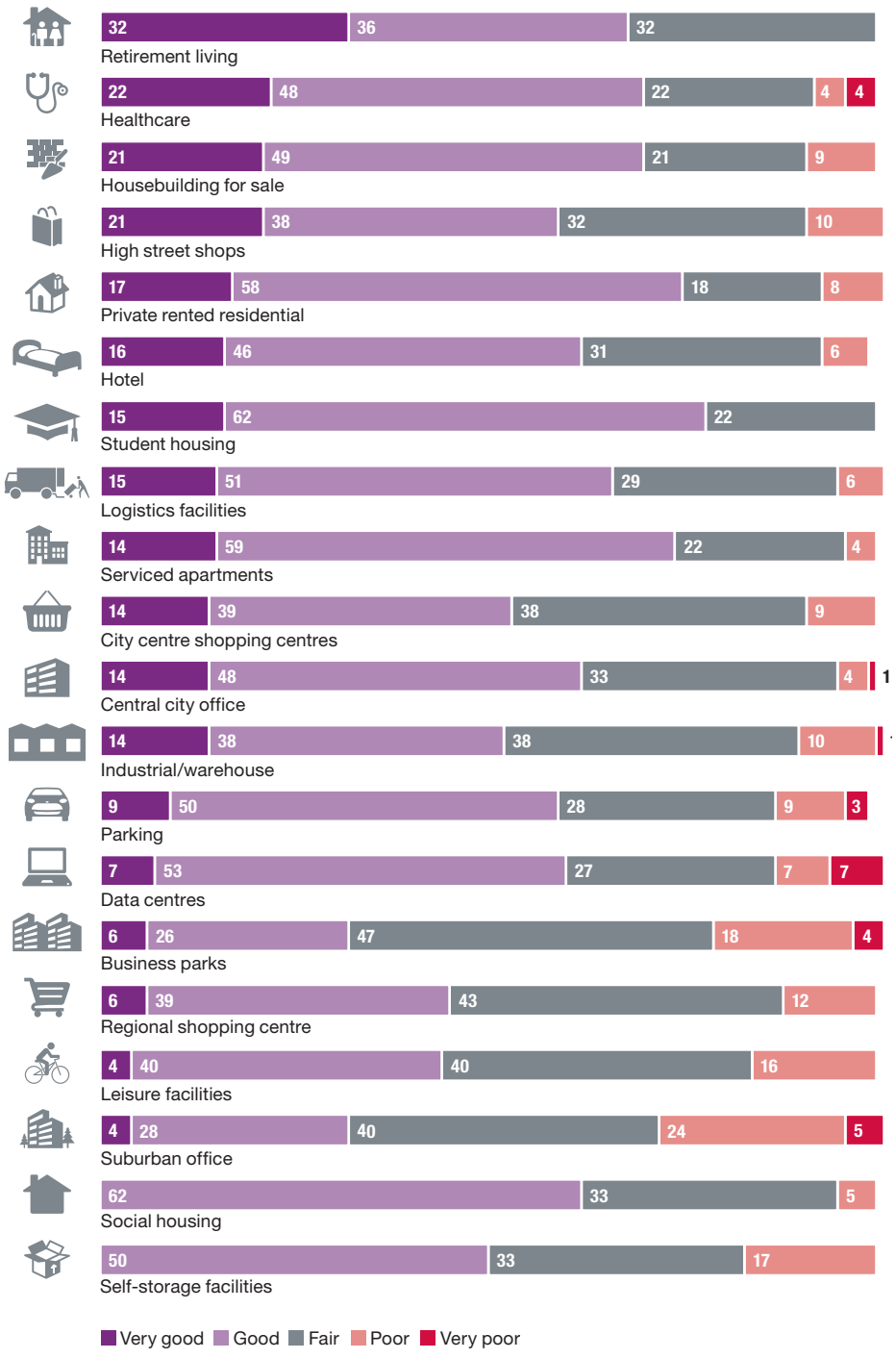
According to survey respondents, the prospects for residential investment in 2015 are stronger than mainstream commercial property asset classes. Four of the top five prospects belong to the sector in one form or another: retirement living, healthcare, housebuilding for sale and private rental housing.

Though some respondents cite lack of expertise as a reason to avoid residential, many more are evangelical in their new-found support for the sector. Where the sceptics see only barriers to entry, the converts see a market of opportunity in 2015 and beyond. Or to be precise, four principal markets: Germany, the UK, the Netherlands and Spain.

Supply shortages are clearly informing the positive sentiment. It is widely acknowledged that there is a serious supply-demand imbalance allied to affordability issues across many European cities. Two thirds of survey respondents report housing shortages in their markets. Taking a longer term view, many interviewees are concerned that the lack of affordable housing "will be a constraint on growth" for Europe's major cities in the context of a wider trend towards urbanisation.

As one interviewee declares: "Private capital follows a path of least resistance, and the residential market has been a one-way bet because it is undersupplied."

Figure 4 **Sector investment prospects 2015**



Source: *Emerging Trends Europe* survey 2015

Investing in Asia Pacific

Real estate markets throughout Asia are expected to remain resilient despite weakening economic fundamentals during 2015, as capital continues to flow into the industry from a variety of investment sources, both domestic and international.

According to *Emerging Trends in Real Estate® Asia Pacific 2015*, Japan remains the favoured country for real estate activity, with Tokyo and Osaka ranked first and third, respectively, in terms of investment and development prospects for the coming year.

"Whether derived from new sources of institutional capital, or from almost six years of global central bank easing, a seemingly endless stream of money is now pointed at real estate assets across virtually all jurisdictions and asset classes. This is pushing up prices and further compressing yields," says John Fitzgerald, Chief Executive, ULI Asia Pacific.

As a result, the region is subject to fewer transactions, a shortage of investment-grade stock, a search for alternatives to core products, and a general pullback from assets in secondary locations.

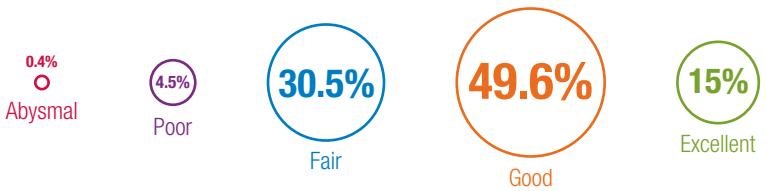
Most investors prefer to remain in gateway cities, where they have more confidence in the resilience of pricing and liquidity. This is especially so in Australia. In China, likewise, many buyers are avoiding secondary locations because of a spate of over-building. Japan is a notable exception, with competition from local REITs forcing investors to branch out beyond Tokyo.

But the one investment category that has undoubtedly enjoyed success throughout Asia is logistics. The sector now represents an estimated 10 percent of total commercial real estate transactions in the region, although the supply of new product in 2014 was down about 30 percent on the previous year.

Logistics yields remain higher than in other sectors but they continue to compress and are now as low as 4.5 percent to 6 percent in Singapore and Japan. The acute shortage of modern distribution facilities will last for years, especially given the rocketing popularity of internet shopping across Asia.

Demand is especially strong in Australia, Japan, Singapore and China. As one fund manager puts it, logistics is "the hottest, most-crowded trade right now in Asia".

Firm profitability forecast 2015



Source: Emerging Trends Asia Pacific survey 2015

Availability of core product falls

Market dynamics have created an intriguing standoff between buyers and sellers across the region. Prospective buyers are reluctant to bid because assets are currently pricing in a recovery that has yet to happen. But at the same time, sellers see few reasons to offer discounts.

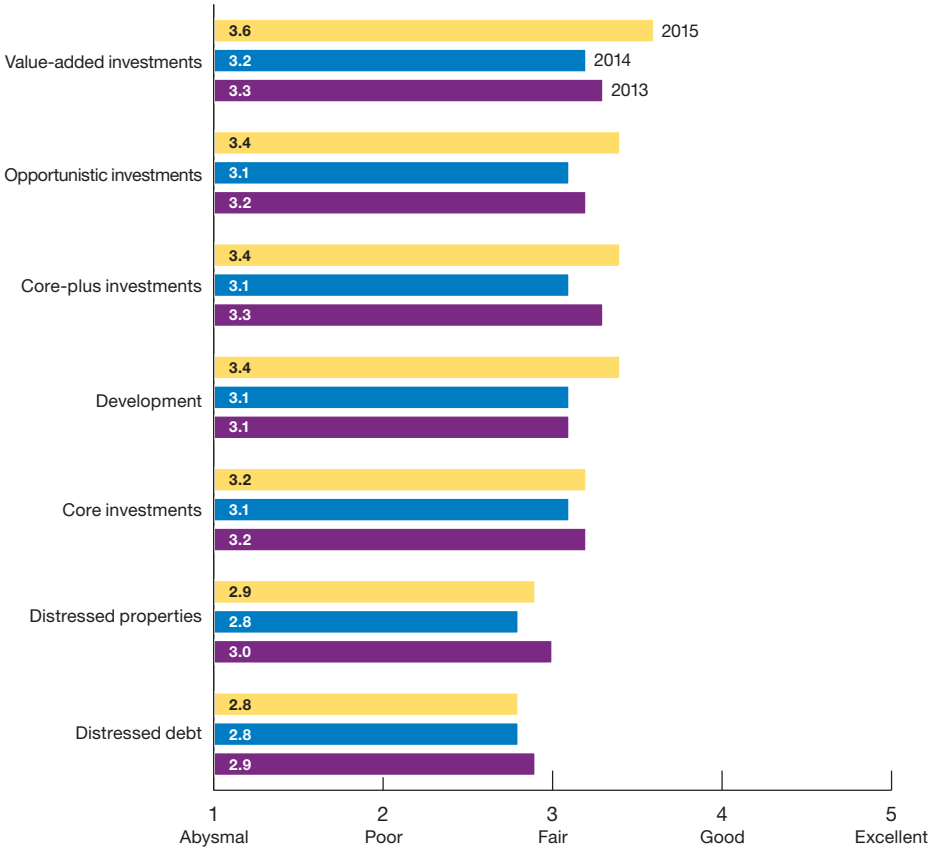
As one interviewee explains, "There's no incentive to part with a good asset for anything other than full price because interest rates haven't gone up, there's no stress, no pressure, and because banks have opened their pocketbooks and put debt out there like it's going out of style."

This standoff is creating a scarcity of suitably priced product – especially in the core space, where Asia's growing club of institutional investors tends to congregate.

The problem is compounded by the fact that the region has always been short of investment-grade stock, both in absolute terms and as a proportion of assets circulating in the market.

In the words of a Hong Kong-based broker: "The theme that underwrites the whole Asian real estate platform is that 98 percent of it is owned by locals, so there is no requirement for turnover because locals will keep it for their grandchildren, whereas in London a lot of it is owned by funds, where it trades every five to seven years. And when it provides such a good return, where they have bought it well and held it for a long time, that's not a big surprise – even if they do sell it, what else will they do with their money?"

Figure 1 **Prospects by investment category/strategy for 2015**



Source: Emerging Trends Asia Pacific survey 2015

The ever-shrinking availability of core product in traditional markets possibly explains the resurgent interest among international buyers in South Korea, which had been something of a backwater for foreigners despite being Asia's fourth-biggest real estate market. Activity in 2014 was led by private equity firms and at least one large sovereign player.

The theme that underwrites the whole Asian real estate platform is that 98 percent of it is owned by locals, so there is no requirement for turnover because locals will keep it for their grandchildren.

> You look for projects that you'd still be happy to hold until markets stabilise if things do turn.

Despite the overall shortage of core product regionally, rising prices and demand in both Japan and Australia mean that some assets are now being recycled onto those markets.

In addition, a sizable number of closed-end funds with fixed life spans that raised capital in Asia between 2005 and 2008 are now approaching their end-of-fund lives and will have to begin selling assets, beginning in 2015. Most of these relate to opportunistic purchases located in Japan, Australia and China. Given the strength of demand in the first two markets, only China-oriented funds are expected to face any problems disposing of assets, and then mainly in secondary and tertiary cities.

Even so, investors are turning increasingly to less conventional strategies, notably more focus on value-add, which features in our survey as the most popular investment category, with sentiment improving significantly over last year's rating. Within that context, however, there are a number of themes, and in particular a greater reliance on defensive plays and income growth. As one analyst concludes, "The guiding principle is that if things might be going to turn in the next 12 to 24 months, you look for projects that you'd still be happy to hold until markets stabilise if things do turn".

Until last year, that included China logistics and Australian residential, but as the supply response has now kicked in for both, "we find we are moving into more complex asset management situations – heavy lifting or re-tenanting/redevelopment – as the only way to make it work".

Japanese consolidation

Transaction volumes in Japan rose 5 percent to $47.9bn in 2014, according to Real Capital Analytics, consolidating its position as the fourth-largest market globally albeit, with some concerns over long-term prospects.

Consensus estimates among interviewees had cap rates for prime commercial and residential properties in Tokyo contracting around 100 basis points in 2014, to around the 3.5 percent mark, and sometimes lower. Grade B assets, which in practice are what foreign investors tend to buy, trade at around 5.5 percent. As one interviewee says, "prices have now gone up so much that we're not wandering around gagging to get into the Japanese market, because it's really expensive".

Investors expect that Tokyo can still deliver compression, "but not to the same degree, unless the cost of debt continues to go down." That seems unlikely given where rates are now.

Indeed most interviewees see potential upside coming in an uptick on the occupancy side rather than through further yield compression. "Cap rates could compress another 25 basis points, but what will probably pick up more is rental growth," says one investor.

For most of the current upswing, the commercial market, especially Grade A offices, has been so dominated by Japanese REITs (JREITs) and local developers that foreign funds have found it hard to get a foot in the door.

Echoing a common theme, one investor comments: "Tokyo is well positioned, but you have to do a lot of work to find product. Big assets are usually traded among Japanese players, and though that may change going forward, putting money to work is not easy."

This means that capital is being pushed into fringe assets or into areas outside Tokyo, where cap rates are higher and still have room to compress. According to one foreign fund manager: "Once the local guys start piling in, the foreigners can't keep up. They buy very quickly, with very short due diligence periods, and they don't have all the structuring that we do, so they're much quicker to act – it can sideline the foreign players quite a lot."

Another big issue concerns the long-term prospects for Japan's huge economic stimulus programme known as Abenomics, which seeks to end years of stagnation by creating an inflationary environment where the value of government debt will be eaten away.

Although Abenomics initially made impressive progress, its impact faded in 2014. Inflation and GDP growth have come up short, and the cheaper yen has failed to make much headway in boosting exports. Meanwhile, the upcoming "third arrow" of the reforms, focusing on structural issues, such as boosting the labour supply, is seen as perhaps its most important component, although for political and cultural reasons probably the hardest to implement.

Most investors are dubious about Abenomics' prospects over the long term but remain confident that the government can keep the balls in the air long enough for them to exit profitably within the time frame of their current investments, especially given a likely boost to construction activity in the lead-up to the Tokyo Olympics in 2020.

One investor concludes: "Long-term growth prospects aren't nearly as attractive as in some other countries, so we see Japan more as a trading market than a long-term hold."

Figure 2 **City investment prospects, 2015**

1	Tokyo	3.50
2	Jakarta	3.44
3	Osaka	3.35
4	Sydney	3.33
5	Melbourne	3.31
6	Shanghai	3.30
7	Seoul	3.30
8	Manila	3.21
9	Singapore	3.16
10	Beijing	3.11
11	Mumbai	3.11
12	Kuala Lumpur	3.09
13	Ho Chi Minh City	3.09
14	New Delhi	3.06
15	Auckland	3.05
16	Bangkok	3.01
17	Bangalore	3.01
18	Taipei	3.01
19	Shenzhen	3.01
20	Guangzhou	3.01
21	Hong Kong	2.97
22	China—secondary cities	2.89

Generally poor | Fair | Generally good

Source: *Emerging Trends in Real Estate Asia Pacific 2015* survey.

Sustained performance across the world

The US and Asia Pacfic are showing signs of improving fundamentals when it comes to real estate, while Europe remains fertile ground for investors despite its economic uncertainties.

Here we interview respected property players from each region to get further insight into their respective territories and a glimpse of their differing approaches to investment.

Sonny Kalsi

Founder and partner of GreenOak Real Estate, the New York-based investment firm with $4.2bn of assets under management globally.

The view from the US

How is GreenOak performing across its various global markets – US, Europe and Japan – and what is the outlook for your business for the rest of the year?

"We are pretty actively investing in the US, Japan and Spain. Those are our primary areas of focus currently on the value add/opportunistic front. We have discretionary fund capital for all of those markets. We are also actively monetising in the US, Japan and the UK. Separately we have launched a few new core-plus mandates with a focus on the US, UK and Japan."

According to *Emerging Trends in Real Estate 2015*, the uncertainty with the US economy has lifted and the industry is benefiting from improving fundamentals. What do you think will drive performance in the US market for the coming year?

"Economic growth which leads to improved real estate market fundamentals. I think we are done with cap rate compression. Now it will be about declining vacancies and increasing rents."

I think we are done with cap rate compression. Now it will be about declining vacancies and increasing rents.

***Emerging Trends* reveals that many investors are looking at opportunities beyond the core US markets. What is the investment rationale behind GreenOak's focus on offices and residential in major cities and are you considering broadening the strategy?**

"We are just not confident that we will see true real estate market growth in secondary markets. Many of those markets have low/no barriers to new entry. In our view the biggest threat to market recovery at this point in the cycle is new supply. And we are therefore avoiding markets with low barriers to entry."

GreenOak has diversified into highly specialised markets overseas – London residential and offices in Japan. Does the firm's approach to investment risk differ at home in the US from these markets?

"We are a local, on-the-ground investor wherever we invest. Our investment team in Japan is Japanese and have been together for a long time. The same is true in Europe where we have a local European team investing in those markets."

One of the big *Emerging Trends* themes is the growing influence of megatrends – urbanisation, demographics and technology – on real estate. How is GreenOak addressing megatrends as part of its investment strategy?

"We are very focused on those key trends and pick our target cities based on those factors. If a millennial wants to be in a certain market we are likely to want to be there as well. NY, Boston, San Francisco and LA are our primary US target cities for those reasons."

Event risk – whether it is geopolitical or global unrest – appears to be an increasingly important factor in the investment mix. How is it influencing GreenOak's investment plans this year, if at all?

"We are defensive in our investment orientation. We do not push the envelope on debt financing, generally choosing lower leverage and term. We focus on investments where we can execute our primary business plan in 12 to 24 months so we can quickly hit the market when we are seeking liquidity, especially if there are larger macro factors or issues at work. We also stay away from trouble spots which have more volatility. To date, no emerging markets, no cyclical energy play locations, we have shorted places like China, Russia, Latin America which we feel have significantly more risk than developed markets."

Dr Marcus Cieleback

Head of Research at Patrizia Immobilien, the German investment group with €14bn of assets under management across 10 European countries and split evenly between residential and commercial.

The view from Europe

How is Patrizia performing across Europe and what is the outlook for your business for the rest of the year?

"The current market environment in Europe is characterised by the absence of the classical real estate cycle in the commercial sector. Consequently an opportunity-driven approach focusing on properties/portfolios requiring asset-management is one of the success factors. As Patrizia has these capabilities we see a strong year ahead for us. In addition, the residential sector offers a variety of opportunities due to structural changes underway, which require a good understanding of residential in general and of the local market circumstances in particular, giving Patrizia a good position going forward."

Patrizia has made a virtue of targeting regional markets, rather than prime, whether at home in Germany or in relatively new areas of expansion for the group, such as the UK. What is the reasoning behind that strategy? Other investors have talked about moving up the risk curve … are you already up the risk curve?

"Given our in-house value chain we do not believe we are actually outside the core or value add segment in any of the markets where we are active. Actually some of our value add activities are not more risky than a classical buy and hold approach due to our in-depth knowledge of the markets we operate in. In general I do not believe that investors are going up the risk curve voluntarily, they simply need the return and a higher return, in most cases, comes with higher risk."

What is driving performance in your chosen sectors and does your approach to investment risk differ from market to market?

"Going forward, the driving factors we are looking at are urbanisation and demographics. Depending on the sector under consideration, office, retail, hotel or residential, we take additional factors into account, especially the institutional framework and the changes underway. As we come from a pure real estate perspective our approach to dealing with risks is more or less similar across the markets we operate, also because we have to fulfil regulatory requirements for our investment vehicles."

Going forward, the driving factors we are looking at are urbanisation and demographics.

Patrizia started out as a residential specialist and is today one of the few pan-European investor/operators to promote residential as part of a broad investment strategy. How do you see that sector developing as an institutional asset class across Europe?

"I think we currently have a situation where institutional investors for the first time can really go European in residential. After decades of increasing ownership rates, rental markets have started to emerge in traditional owner occupier markets like Spain, the UK and Ireland. In addition, regulatory changes, like the changes seen in the Netherlands, further enlarge the investment universe. I therefore strongly believe in a European approach to residential investment in the current environment. But investors have to recognise that the classical buy and hold strategy is not always the best investment solution. We will see many more strategies adding value, like conversions, repositioning or privatisations supplementing the buy and hold approach."

Europe continues to attract a huge amount of capital from global investors despite weak occupier demand, uncertain economic conditions in the eurozone and the threat of geopolitical problems escalating. What's your assessment of the European market as a whole going forward?

In general we still have a divided market going forward with prime properties highly in demand all across Europe as they offer the long-term stability and security sought by many institutional players. In addition, the properties where value can be added become more and more of a focus for institutional investors, but they have to be aware of the fact that local knowledge is a crucial factor of success in this segment, and demands a local partner. And finally, there are still locations investors are not touching, because they simply have demographic and urbanisation risks in the medium term. This location still offers high returns but this return comes with the associated risk. As the quantitative easing measures by the ECB will most likely last (much) longer than currently announced we will see declining prime yields across the eurozone property markets for the coming years. Most likely this will also be the case for the non-eurozone countries UK, Norway and Sweden due to the strong integration of international capital markets. The historical 10-year average might not be the right starting point for assessing the market situation in such an environment.

Richard Price

Hong Kong-based CEO – Asia Pacific, CBRE Global Investors, which has $90.6bn in property assets under management worldwide.

The view from Asia Pacific

How is CBRE Global Investors performing in Asia Pacific and what is the outlook for your business for the rest of the year?

"We have a very solid business in the region, having delivered strong investment performance for our clients over the short, medium and long term. I anticipate increasing transaction activity this year in all of our markets of focus, particularly China, Korea, Japan and Australia. We see increasing appetite for exposure to the region from our global client base and our regional clients remain keen to invest with us around the world."

What is your assessment of the overall strength of demand for the region among sovereign wealth funds and institutional investors?

"In general, appetite for real estate investing remains strong and with bond yields where they are property continues to offer attractive returns in most markets."

There appears to be a disconnect between occupier demand and investment markets, although overall transaction levels fell during 2014. What do you think will drive performance in the main markets in the coming year?

"In many major markets fundamentals are actually improving and as rents rise, pricing today will look more reasonable. I think it is unrealistic to expect cap rates to compress much further, so driving income growth will be the primary source of return in the region's more mature markets."

One reason given for the general fall in transactions recently is that many regional investors are looking to diversify out of Asia. Is that an issue – good or bad – for the region?

"I don't see this as a problem at all. Yes they are looking at global markets but the vast majority of their exposure remains domestic. The important focus for them should be ensuring that they work with experienced local partners as they venture further afield."

The shortage of institutional-grade stock in Asia Pacific has been well documented over the years but arguably more pronounced during 2014. How do you see that demand/supply imbalance playing out among major investors – more of a shift into value-add, development, alternatives?

"I am not sure that it is necessarily a shortage of stock or a shortage of stock at the right price – local investors in almost all markets have an intrinsically lower cost of capital and perception of risk, which makes competition for the best, investment grade assets, very keen. Clearly in the more emerging markets, of which China is the largest, the market for investment grade assets is relatively immature and you often need to take on some development/value add risk to manufacture core assets/exposure."

As a global investor, does your approach to investment risk differ for the various Asia Pacific markets compared with other regions?

"Not really – we apply a consistent approach globally and try our best to mitigate risk with experienced, locally based investment teams across the region."

Any clouds on the horizon for the region?

"While we do not anticipate it, a steep spike in global interest rates would create a significant challenge."

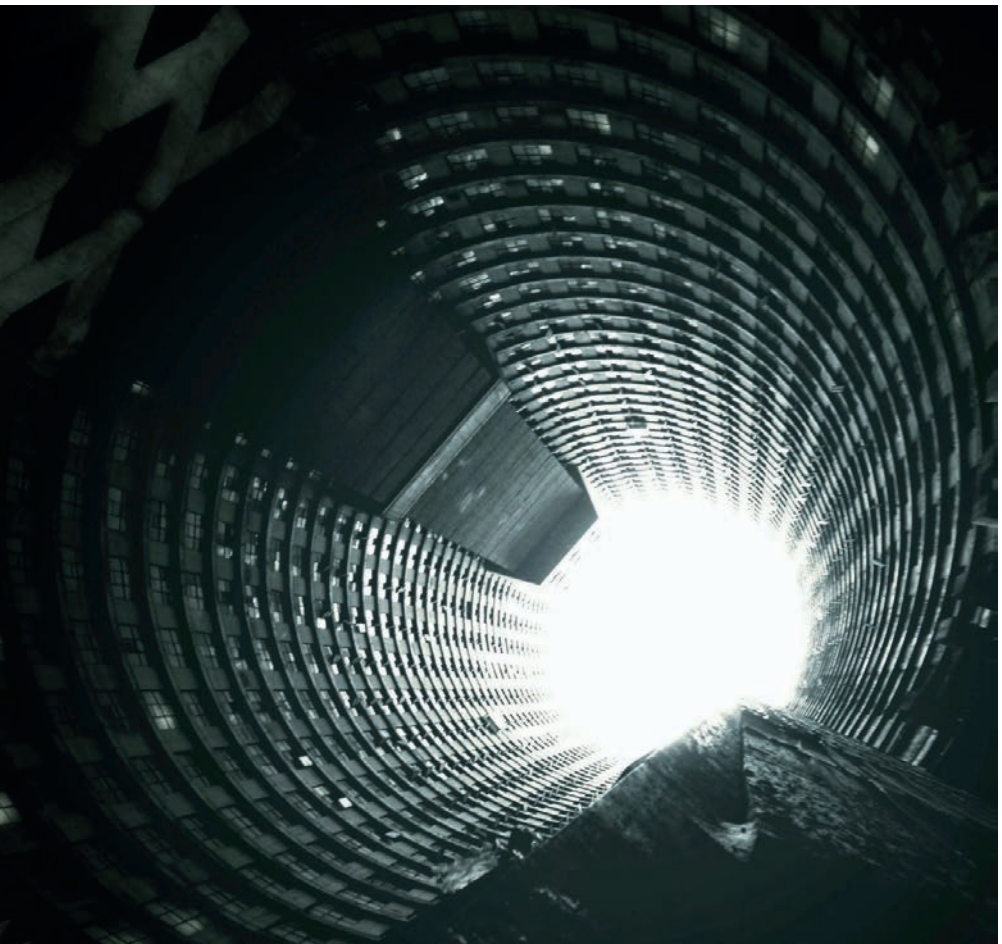
Clearly in the more emerging markets, of which China is the largest, the market for investment grade assets is relatively immature and you often need to take on some development/ value add risk to manufacture core assets/exposure.

Emerging markets – the African opportunity

With global investors starting to look seriously at sub-Saharan Africa, *Emerging Trends in Real Estate*® looks at the key markets and interviews five of the leading players for their views on the investment climate.

Investors and developers are increasingly targeting African real estate as one of the key emerging markets, drawn by the prospect of 20 percent-plus returns across many territories.

In almost all of Africa's markets, demand for high-quality retail, office and industrial accommodation outstrips supply as international and local occupiers respond to the improving economic outlook.



Demographic shifts and changes in consumer behaviour have been the underlying drivers of demand here, encouraging investors from overseas to enter the various markets and participate in what investment manager RMB Westport calls "the African growth story".

"Over the past decade African economic output has more than tripled, which is one of the many reasons why we think that Africa today holds the greatest overall investment potential for all frontier markets globally," says RMB Westport, referring to official IMF data on Africa's GDP growth. RMB Westport has successfully raised US$250 million overseas for its target markets in West Africa.In many respects, however, South Africa continues to dominate activity as the continent's most mature, regulated and transparent real estate market.

According to Real Capital Analytics (RCA), sales of large lot-size property across Africa topped US$2.17bn in 2014, and South Africa accounted for over US$2bn of that total.

In its analysis, Johannesburg is the only non-European city market to make RCA's top 30 EMEA markets – and only just scrapes in at Number 29, ahead of Bremen – with US$1.55bn of transactions, a 13 percent increase in volumes on the previous year.

RCA suggests the low US$173.49m total for the rest of Africa could be attributable to these markets being less transparent than South Africa with their data.
It is also the case that RCA's figures are based on sales of properties and portfolios of at least US$10m, which would exclude a large number of transactions routinely carried out in sub-Saharan Africa as well as the capital deployed for development.

Over the past decade African economic output has more than tripled, which is one of the many reasons why we think that Africa today holds the greatest overall investment potential for all frontier markets globally.

The overall volume of direct property investment across Africa in 2014 was slightly down on the previous year and barely a third of the peak in 2011, although the RCA figures do not cover the flow of capital into South Africa's listed property company sector.

The listed sector has been particularly successful since the introduction of REIT legislation in 2013. For instance, Growthpoint Properties, South Africa's largest listed REIT, has seen its foreign shareholding grow from 16 percent to 21 percent since 2013.

Enlivened by corporate activity, the listed sector delivered impressive 26.6 percent total returns to investors in 2014, according to the South African REIT Association, out-performing all other asset classes for the year as property fundamentals, particularly in retail, showed some resilience to a weaker South African economy.

South Africa is widely regarded as a gateway to other markets, not least because several of the leading listed companies offer some degree of wider African exposure. Indeed the performance of those companies was boosted by their earnings outside South Africa.

One of the clear opportunities opening up for these companies and overseas investors in sub-Saharan Africa is shopping centre development. There are short-term concerns – economies with heavy exposure to the prevailing weak oil price such as Nigeria and Ghana may see a dip in consumer spending this year. Debt finance is also difficult to raise – compared with South Africa – and is usually based on a 50 percent-60 percent loan to value.

The lack of infrastructure, too, is a major consideration, although as one local developer points out: "Infrastructure is catching up with the appetite for retail development albeit not at the speed that the private sector would like it to happen. But you are seeing in markets like Nairobi, Lusaka and Accra that the governments are spending money on building new roads."

Recent PwC research suggests that infrastructure spending in sub-Saharan Africa will exceed US$180bn per annum by 2025. Major infrastructure investment programmes in Nigeria and South Africa have been followed by significant projects in countries such as Ghana, Kenya, Mozambique and Tanzania. However, a huge shortfall in government funding creates opportunities for private investors to support this development need through direct investment and public private partnership agreements.

As Simon Fifield, RMB Westport's CEO, says, all investors must have a "risk-adjusted perspective" when considering African markets. But for those investors with a long-term outlook - and which can accept and manage these risks - the potential rewards are significant.

Stanlib

Stanlib is one of South Africa's leading fund managers with US$2.75bn [R30bn] under management, including the Liberty Property Portfolio. The group is present in 10 countries across Africa. Beattie is also President of SAPOA (the South African Property Owners Association).

Amelia Beattie
Chief Investment Officer
Stanlib Direct Property Investments

South Africa is often depicted as a gateway for other African property markets. What is your assessment?

"South African returns are good but we've got just over 20 counters that are listed entities and probably only the top five are liquid enough for international investors. The unlisted market is in the hands of South African institutions and there are therefore not that many opportunities for international investors. There is also the Rand … the South African market is not [US] dollar denominated whereas beyond South African borders you get investment mostly in dollars, and from a return point of view that makes more sense for international investors."

What is the opportunity for foreign investors to deploy capital in the sub-Saharan markets and who has shown interest?

"The offerings out there are small. For a US pension fund to invest, they need a large cheque size. In many instances what they want to invest and what we can offer as an investable universe are still not matching. But you'll find that family offices from Europe have shown significant interest and they are happy with US$20m or US$30m investments and those are the ones on offer. A lot of sovereign money from the Middle East has already been invested in some of the funds in play and they continue to look for opportunities. Most recently we've seen a lot of interest from Japan."

Is the relative lack of large lot size investments persuading investors to tackle development?

"We do see an appetite for development because some investors realise that unless they do that they may never get a foothold into Africa, and developments eventually become income-producing properties. Someone needs to take the first step and they can then partner with development funds which have a delivery track record. Because there is such a lack of stock in Africa, that development opportunity offers a big upside. With that goes a lot of risk and it's a long time before you can have income from those properties. So those investors need to be long dated."

At the moment, benchmarking of real estate by Investment Property Databank (IPD) is restricted to South Africa and Botswana. What are you doing at Stanlib and in your role as President of SAPOA to promote best practice further afield?

"There is a very strong intention for us to roll out things like IPD so that we can create a transparent African market. We have formed an African sub-committee at SAPOA whose main aim is to raise standards across the continent and we're talking to audit houses about that. I want to ensure that the same valuation methodology gets applied across the continent because a pan-African proposition is problematic if you have different ways of valuing property in the different countries. We are also looking at the measuring of floor space because we want to roll out international best practice. Organisations like RICS (Royal Institution of Chartered Surveyors) are best placed to assist to get this going. IPD links into that because the more information we have the better it is so sell our proposition across the world. And in some cases it is necessary for South African players that operate on the African continent to join forces and sell jointly internationally."

Growthpoint Properties

Growthpoint is the largest property company listed on the Johannesburg Stock Exchange with assets valued at its 30 June 2014 year-end at US$6.55bn [R76.2bn]. At the time the portfolio included 436 properties in South Africa and a 64 percent stake in 51 properties in Australia. Growthpoint has since increased its exposure to the buoyant retail sector through the US$714m [R8.3bn] takeover of Acucap Properties.

Estienne De Klerk
Executive Director
Growthpoint Properties

Foreign investors account for as much as 20 percent of Growthpoint's share register – what's the attraction of the company and South Africa's listed/public real estate sector generally?

"In 2001, Growthpoint owned nine properties and its market cap was US$2.58m [R30m]. Today it is US$5.93bn [R68.99bn]. We've seen the sector as a whole grow quite aggressively. For the last 12 years it is probably the best performing listed/public real estate sector in the world. We've seen a massive flow of capital into the sector and a big contributor has been the new REIT legislation (introduced in April 2013). The total market capitalisation of the South African REIT sector is now over US$27.53bn [R320bn] and if you add other property development counters it rises to US$36.1bn [R420bn], which puts it close to Singapore and Hong Kong. Many of the counters are liquid and tradable and offer a generous yield – the average distribution income yield now is 7-7.5 percent across the sector. If you look around the globe, that's not bad going. Every year we have achieved growth and that's driven continued investment into the country's real estate."

How would you compare the investment climate in South Africa to other markets?

"If you look at Europe you can go and purchase property at 5-7 percent yield and you are funding at 2-3 percent roughly. In South Africa our funding ratio for 5-year debt is coming in at just under 9 percent and you're buying quality property at 7.5-8 percent, so there are not the positive spreads that you have across the globe. Even though the economy and fundamentals aren't that great the amount of investment capital sloshing around the market, as well as the lower interest rate environment, has driven up asset values and we've seen compressed yields for direct property. These factors could create a bubble but the common consensus is that interest rates and with that the yield environment will remain low because of Europe's and America's difficulty in actually achieving growth."

What are the big influences on real estate right now in South Africa?

"Slow economic growth in South Africa, resulting in weaker demand remains the largest challenge.
On the positive side, urbanisation is a continuing trend and as a result you find that the urbanised areas are experiencing growth in demand for retail as those people move into the cities. Johannesburg and Cape Town have been winners but the Northern Cape and the Eastern Cape have been losers in terms of population density. The smaller towns are getting increasingly marginalised – and many are on their knees financially – but the big urbanised areas continue to grow. What we've also seen is an increasing focus by the big metropolitan councils on improving infrastructure, which is having a positive impact on the real estate environment."

Hyprop Investments

Hyprop is one of South Africa's leading listed retail REITs and owns 12 prime shopping centres in major metropolitan areas. The company posted a 17.5 percent increase in the value of the assets to US$2.27bn [R26.4bn] at its 30 June 2014 year-end. Hyprop's expansion into other sub-Saharan markets – through its AttAfrica joint venture with Attacq – is worth US$189m [R2.2bn].

Pieter Prinsloo
CEO
Hyprop Investments

What is the attraction of Africa to global institutional investors?

"Global institutional investors do see growth opportunities in Africa. They should, however, not view Africa as one market. Rather they should seek diversification and look for the best performing investment.

"In terms of South African companies, Hyprop offers healthy capital and income returns translating into long-term sustainability. Over the last ten years, Hyprop's total return on investment has been 32 percent and our distribution yield in Rand terms has been over 11 percent per year. NAV growth per year has been 20 percent. We are competitive and when benchmarked against the rest of the world it is evident that Hyprop follows similar trends to other emerging markets. We are to some extent impacted by similar factors that affect counties like Brazil, China and Russia."

How do you see the growth of retail developing in African markets?

"South Africa has a mature retail market with fewer new opportunities available to investors. Investors therefore choose to focus on existing assets, making them both bigger and better. Retailers also choose to invest more money in their flagships stores, rather than aggressively rolling out new stores in other malls. South Africa has a prominent mall culture, where quality shopping centres perform well and large, quality malls outperform the rest of the market.

"The rest of Africa does not have the same offering despite a strong, growing middle income market. If those people need to shop, they have to travel. Hyprop views this gap as an opportunity to develop shopping centres in large African cities, with high population densities and disposable income. Hyprop is currently focused on Accra in Ghana and Lusaka in Zambia. There are, however, other possible opportunities in African cities, including Nairobi in Kenya and Lagos in Nigeria, where there is a strong base and developed infrastructure that facilitates Hyprop building quality malls that are sustainable. We see opportunity for further development over the next ten years."

Given such development prospects, is there an opportunity for overseas debt providers to enter these markets?

"Funding in South Africa is not a problem, but securing funding in the rest of Africa is very difficult. Roughly three banks offer real estate finance. Funding tends to be expensive and these banks require at least 50 percent equity. Currently the lending margins are profitable and there is fairly strong demand for finance, so I believe there is an opportunity for new debt providers to enter the African funding market."

AttAfrica

Mauritius-based AttAfrica focuses on developing and acquiring A-grade shopping centres in sub-Saharan African markets, excluding South Africa. AttAfrica's shareholders include Hyprop Investments and Attacq, and its key assets include the 20,300 sq m Accra Mall – Ghana's first A-Grade shopping centre.

Kevin Teeroovengadum
CEO
AttAfrica

What are the opportunities in the key sub-Saharan African markets excluding South Africa?

"We're seeing an increase in terms of people moving from low income to middle class, leading to an increase in the consumer class on the back of positive economic growth in Africa. All of this plays in favour of retail development as informal retail starts to formalise itself. If you look at Accra in Ghana as an example, today there are only two malls for a city that's got 4.5 million people. It's a city that could potentially justify 100,000 square metres of malls. We still see this mismatch in various markets. However we have to be careful about the size and number of retail developments that one builds over a short period of time. You should stretch this target over a five-year period."

What is the split between overseas and domestic capital for retail development?

"The development of A Grade malls started around 2007 and had initially been carried out by foreign capital and foreign expertise. Over the last couple of years in markets such as Kenya, Zambia and Nigeria, local developers have recently been able to bring in international expertise and using local capital they've been able to unlock a few schemes. In 2015 it is about 75 percent/25 percent offshore/ onshore capital."

Where is the capital sourced overseas?

"When you look at Europe there's always been an affinity in terms of investment into Africa because of the history and cultural heritage. Initially most of the offshore money was coming from Europe and mainly from London. But over the last three years, global investors are saying they need to be in Africa, whether it's from a private equity or direct investment property point of view. We're seeing more and more non-European investors, including from the US, family offices and pension funds. And over the last year all of a sudden we've seen a resurgence of Asian money – Singaporean, Malaysian and Chinese funding."

What level of returns can these investors expect from retail?

"North of 20 percent IRR, if one is to invest in green-field developments. There is a misnomer in the sense that some global investors think that you come into Africa, it's hard work – it is hard work – and it should justify something north of 30 percent returns. But the reality is that it doesn't. It is difficult to get beyond 30 percent. If you've done 25 percent IRR, you've done extremely well. So investors have to realistic about their return on investments target for Africa."

RMB Westport

RMB Westport was founded in 2008 with backing from Rand Merchant Bank to pursue commercial property development and investment opportunities in Ghana, Nigeria and Angola. The group raised US$250m for its first fund and this year announced plans to raise US$450m for a second fund.

Simon Fifield
CEO
RMB Westport

RMB Westport successfully raised US$250m for its first development fund in 2012 when it was quite tough to source capital for your core West African markets. You have launched a second fund this year and aim to raise US$450m – how is it going?

"It is early days but we are a lot more confident in the Fund 2 fundraising than we were on Fund 1. We have got good relationships with the investors in Fund 1, a lot of whom, I think, were progressive in their thinking and committed relatively early on to the African story. I think it's fair to say that a number of them were 'having a look' then in Fund 1. The feedback we've got from most of them to date has been reasonably positive. For the most part they've expressed a desire to come in and potentially increase their investment size in Fund 2."

Much of your capital in Fund 1 came from the US and Canada, followed by the Middle East and the UK. Do you see that pattern repeating itself in Fund 2?

"I think so. The American market is huge and I'm not sure that if you're raising meaningful levels of capital you can afford to ignore it. Finding an investor whose requirements match with what it is you're offering is just relatively easier in that part of the world."

In your experience, what is attracting overseas investors to real estate development in West Africa?

"The risk-adjusted returns that are on offer, particularly when viewed in the context of what is available globally. These are helped by an extreme demand/supply mismatch in the territories in which we operate, but that mismatch doesn't count for anything unless you can adequately manage the risks that are associated with a difficult development environment. Our track record this time around certainly helps."

First time around you had no track record as RMB Westport, although individually the team had a lot of experience in African real estate. What else convinced investors to support Fund 1 apart from the promise of 25-30 percent IRR?

"Investors are looking at returns from a risk-adjusted perspective. We could point to examples in the market as to where certain assets were trading and then had to ensure that we could deliver similar assets at a certain initial yield. Therefore investors would not be dependent on market forces changing in order to try and extricate value. At the time many potential investors were saying to us they could buy into distressed assets in Europe and get between 15 percent and 20 percent IRR. But a lot of those returns that were being forecast to come out of distressed assets in developed markets made assumptions around those markets recovering. You're relying on something outside your control to get base level returns. But what you're relying on in our business, is our ability to deliver assets at particular initial yields, in jurisdictions where we have meaningful experience in doing so."

Megatrends – the industry responds

"There are big changes occurring and we can't afford to ignore them," says one interviewee in the latest *Emerging Trends in Real Estate® Europe* report.

The interviewee is referring to megatrends, the global evolutionary forces that are creating long-term shifts in demographics, cities, economics and politics and which are impacting the way businesses – across industries – see the competitive landscape.

For real estate, megatrends promise to alter fundamentally the patterns of occupational demand, and create new sources of capital and asset classes – and their influence is altering the industry's strategic outlook. Echoing the findings of PwC's latest global CEO survey, real estate professionals believe megatrends provide new avenues of profitable growth.

When asked about the impact of megatrends on their businesses 78 percent of European respondents cite demographics and social change as having an impact, 63 percent describe urbanisation as influential, and 48 percent believe technological disruption would affect their strategies.

Rapid urbanisation

The rise of cities in the global economy is unprecedented – now half of the world lives in cities, according to PwC.

The opportunities:

Real estate investors are anticipating a race for space in the world's largest cities, creating demand for retail and office – particularly in China where supersonic urbanisation has resulted in over half its population living in cities.

"Within the next five years the global middle class will grow by 75 percent. A lot of that is happening in emerging markets and when combined with urbanisation this will create a huge drive in consumption. Real estate will benefit," says Guggenheim's William Belden.

Best bets:

- Large cities with decent infrastructure and high levels of resilience to climate change.
- As both young and old move to urban centres, opportunities exist across all housing types – retirement homes, student accommodation and high-quality housing close to workplaces.
- Rising wealth and consumerism offer opportunities for the creation of malls that offer luxury brands and unique concepts to accommodate ever-expanding international brands.
- As the densities of mega cities become greater, development that embraces "liveability" – offering access to green space, good public realm and built with high standards of sustainability - will create long-term value. City dwellers will pay premiums for high-quality living and work space.
- Expect warehouses and distribution centres to be located almost exclusively near big cities, as e-commerce firms increase delivery speeds to highly populated areas.
- Exert caution over smaller cities in Europe with downward trends in population growth.

"The great urbanisation wave will inevitably require major private and public sector investment in infrastructure for cities to be successful," adds TIAA-Henderson Real Estate's Alice Breheny.

> Megatrends have been disruptive, changing how occupiers think about the space they need and how they occupy it.

Emerging Trends' US interviewees are similarly aware; 80 percent foresee being impacted by demographics, and 79 percent expect their decisions will be impacted by urbanisation.

Megatrends are nothing new. The recent articulation of ageing populations, the rise of consumerism or the disruptive forces of technology into the term "megatrends" belies the fact that their progressive influence has been underway for decades.

What has changed, however, is that the industry is aligning strategies for them in a way that has rarely been seen before.

How will urbanisation factor in your business decisions in the coming years?

Europe respondents

US respondents

In some cases this is because the opportunities to benefit from some megatrends are more accessible. "If you look at the evolution of the global capital markets you'll see that the opportunities to take advantage of these trends are bigger and more efficient than they have ever been. Markets are opening up for foreign direct investment and provide a whole new avenue for both institutional and retail investors," explains William Belden, managing director for product development at Guggenheim Partners.

In September, Guggenheim launched the first exchange-traded fund to focus exclusively on emerging markets real estate. Guggenheim Emerging Markets Real Estate ETF (EMRE) invests in real estate securities that seek to benefit from the growth of property driven by megatrends such as urbanisation and increasing consumerism.

Emerging markets real estate has expanded from 2 to 11 percent of listed global properties securities in the last 14 years, says Belden, adding: "Many real estate countries want to create vehicles which allow direct investment. So the number of products is growing."

TIAA Henderson Real Estate, which now has a dedicated research effort to monitor megatrends, is currently designing new investment products aligned with longer-term trends like ageing populations and the shifting of economic power from west to east.

Alice Breheny, its global co-head of research, explains that one reason for this strategic shift is partly frustration: "Traditionally forecasting looked at economic recoveries and capital flows. Three years ago we identified Spain as a market that would recover but at the time clients weren't interested.

Demographics and social change

The world's population has increased dramatically, with twice as many people on the planet today as there were in 1970. Most future growth will occur in less developed countries. But declining birth rates and increases in life expectancy are leading to a widespread ageing population.

The opportunities:

Growing consumer power and the innovation potential of a diverse workforce are two core sources of growth and opportunity for businesses, reports PwC.

In Europe investors are focusing on healthcare to cater for the growing numbers of elderly people, as well as retirement housing located near medical care.

"This is a trend very much linked to cities," says L&G's Martin. "The future of age-related housing is more urban than rural because occupants will want to socialise and be close to friends and entertainment."

Best bets:

- As ageing populations form a significant spending group, real estate investors and retailers should take a proactive approach in meeting their needs.
- Convenience stores, chemists, health-related retail and home will benefit from this megatrend, as will retail that is connected by excellent public transport.
- Cities with world-leading universities are also gaining traction, as they attract talented youngsters and offer opportunities for student housing investment. But these "knowledge hubs" do not just appeal to the young: "Cities like Cambridge, Oxford and Edinburgh are where companies want to be. University cities will attract retirees because of their energy and culture," says Zehner. "Institutions are very focused on university cities."
- Go where Millennials go. More than 20 percent of the American Millennial population lives in just 15 different neighbourhoods located in 13 different cities in the US, reports LaSalle Investment Management.
- Millennials will drive demand as they seek dense, diverse mixed-use urban villages with plenty of retail, restaurants and leisure on their doorstep. And don't forget the bike racks for these eco-conscious consumers.

"By the time people recognised Spain as an opportunity it was too late to raise capital to capitalise on it. And we found that was happening over and over again. So we decided to invest our energy in more long-term structural drivers of change."

Legal & General Property, the UK's third largest institutional property fund manager, has also reorientated its research team to analyse how megatrends are impacting the UK. The business believes healthcare, retirement housing and "knowledge hubs" are among the exciting asset classes of the future.

"There's been a conscious effort to be more thoughtful about megatrends, not because the pay off will be immediate but because the pay off could be substantial over time," says Robin Martin, L&G's director of research. "It is now well understood these issues will affect performance. Megatrends have been disruptive, changing how occupiers think about the space they need and how they occupy it."

How will demographic and social change factor in your business decisions in the coming years?

Europe respondents

US respondents

> There's been a conscious effort to be more thoughtful about megatrends, not because the pay off will be immediate but because the pay off could be substantial over time.

Megatrends strategies are also a response to low interest rates. LaSalle Investment Management recently reported that refocusing strategies towards demographics, technology and urbanisation were important for those investing in US property – helping to boost net operating income and counteract the falling returns within a low interest rate landscape.

As rapid price rises have compressed property yields and outpaced rental increases, it argues, investors should look for long-term income growth. "That will be driven by growing age groups – particularly Millennials, the growth of technology and the increasing preference for urban jobs and homes," says Jon Zehner, the firm's head of global capital markets.

Technologicial breakthroughs

Just over four billion people will be online by 2030, according to TIAA Henderson – as e-commerce booms and eats up a 30 percent share of retail sales.

The opportunities:

While demand for bricks and mortar is already decreasing in some sectors, the rise of technology has created new pockets of office and retail demand.

Companies across industries are requiring office concepts that provide multi-functional workspace. The new headquarters of tech giants such as Facebook and Twitter are indicative of the trend; including lavish roof terraces, yoga studios and indoor gardens to foster creativity.

"Office space is becoming less about enabling people to access files and more about enabling interaction," says Nick Axford, global head of research, CBRE.

"It was thought that this would not catch on in Asia but we're seeing that proved wrong. Many companies in Asia are adopting flexible work-based strategies and in sectors people did not expect, like the legal profession."

Best bets:

- Be alert to the young tech firms seeking to transform how small businesses lease and occupy property. WeWork is just four years old but has a market valuation of $5bn and has leased 1.6m square feet in New York since 2012.

  The firm operates by leasing floors and then charging monthly memberships to start-ups and small companies. WeWork aims to triple its "members" from 14,000 to 46,000 over the next year across Austin, Chicago, London and Amsterdam.

- When it comes to retail, shopping centres must focus on placemaking – good green space and public realm that offer shoppers something the internet does not: meeting places and an events programme.

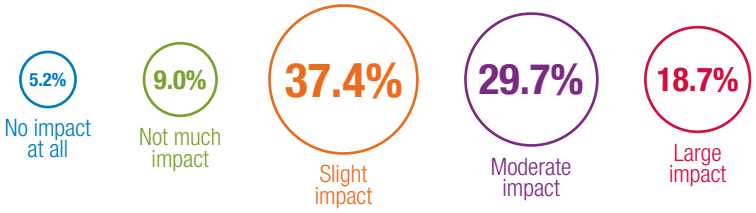
As a consequence LaSalle is now hunting for assets in emerging tech markets such as Minneapolis, Pittsburgh and NOHO in New York City, while medical offices, storage and garages are among its sector picks. In Europe, the firm is focused on cities with major universities – such as Cambridge – where it sees "education and knowledge hubs" anchoring demand for student housing, office and retail space.

That search for yield may lead some investors to latch onto cities which promise the biggest growth from megatrends – like fast-emerging markets in Asia, India or Africa. But the complex interplay between megatrends, and their interdependency, means it is not easy to be sure of outcomes. In that respect, perhaps it is not surprising that the time horizon for investing for most respondents to the *Emerging Trends Asia Pacific* survey is three to 10 years. Only 13.4 percent are looking beyond 10 years.

With successful growth of cities dependent on infrastructure investment and dedicated government efforts to increase the resilience of urban areas from climate change, not all megatrends are positive or easy to predict. As Amlan Roy, managing director and head, global demographics and pensions research for Credit Suisse's banking division, explains:

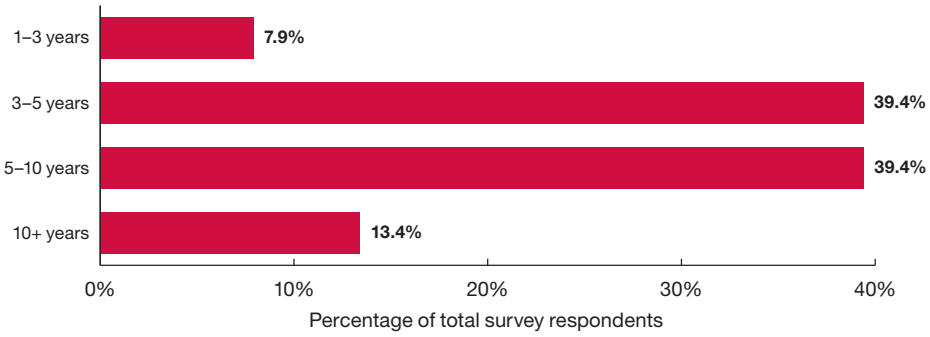
How will technology disruption and change factor in your business decisions in the coming years?

Europe respondents



US respondents

Figure 1 **Time horizon for investing**



Source: Emerging Trends Asia Pacific survey 2015

"Population growth isn't necessarily a good thing, it can be a curse. Demographics are not predictable. So predicting what real estate is needed based on only that is wrong."

For this reason Europe still appeals to global investors despite how exciting megatrends data make Asia's property markets seem. TIAA Henderson reports that by 2030 there'll be 141 cities with 5 million people or more (versus just five in Europe) accounting for half the world's occupied office space. But investors should proceed on the basis of these "headlines" with caution, warns Breheny.

"Yes growth rates in Asia and Africa are exciting but most of the cities there are coming from a low base – only some will get it right. Europe may look uninspiring by comparison but it will still have winning cities, like London, which need to absorb a lot of people," she says.

Nick Axford,global head of research, CBRE, argues that global investors are more likely to increase exposure to different sectors in the region instead: "If you look at aggregate demographics for Europe it looks to be at a turning point as populations get smaller. But the idea that no-one will develop in the region is too simplistic.

> Office space is becoming less about enabling people to access files and more about enabling interaction.

Shift in economic power

By 2030, the purchasing power of the E7 will overtake the G7. Asia Pacific's middle class will be larger than Europe and North America's combined this year, according to PwC.

The opportunities:

Emerging markets and their expanding, highly skilled, educated workforce will become core for global companies.

Office demand will increase in these markets but so will retail, as international brands shift eastwards to take advantage of rising affluence.

CBRE recently reported that China is a top five location for retailers' expansion plans.

Best bets:

- A big effect of this megatrend is the creation of new sources of capital for property, particularly from Asia, where a high savings ratio will result in growing demand for real estate products.
- "Capital looking to invest outside Asia will grow much faster than the capital looking to invest in Asia," says Axford.
- L&G's Robin Martin says this megatrend is in its embryonic stages. "China is an obvious example of that but we'll see capital from India and Indonesia increasingly looking to diversify."

"There will be ebbs and flows of places or cities that will be successful. For Europe to compete with Asia it will have to reinvent itself – education and innovation have always been its strengths. So knowledge hubs, centres of tech entrepreneurship, retirement housing and medical facilities will be opportunities for investors who understand these changes," says Axford.

Another major impact on real estate therefore will be increasing capital allocations to a wider range of asset types. The investment community is likely to accept care homes, medical facilities, student housing, data centres and self-storage as mainstream rather than "alternatives" because of the robust occupational demand they offer. As Martin says, one of the effects of rising technology is the need to focus on areas of "resilient" demand.

"It means thinking about real estate based around people rather than processes. So residential is defensive – beds can't be digitalised," he says. Martin believes that real estate strategies will reflect increased specialisation as fund managers master niche sector opportunities.

Allocations to alternative assets have been a growing trend over the last 10 years, according to the Investment Property Databank, which says the rise of specialist funds, such as healthcare and student accommodation, have changed the make-up of its index – accounting for 15 percent and becoming the UK's third largest sector after office and retail.

Climate change and resource scarcity

Climate change is a fact, as the UN reports huge immediate risks to the planet, its populations and cities rich and poor.

The opportunities:

Heat waves, heavy rains and mega-disasters are on the rise. There were almost $400bn of losses due to extreme weather in 2011, compared to just under $50bn a decade earlier, according to the NatCatSERVICE.

Climate change will affect owners, developers or those running cities. Businesses that adapt to it will remain competitive and resilient. They are also likely to attract increasingly climate-conscious capital.

Best bets:

- "If you're developing today, that building will still be around in 60 years' time when the exposure is very different. It is important to make the right decisions now, so you are not building in the wrong places," says Gregory Lowe, executive director of Willis Group.
- At asset level, sustainable buildings that include solar panels, natural ventilation, water storage and shading technologies will improve a building's resilience. New construction techniques, such as those which use sustainable concrete or timber, are efficient with resources and maximise natural light, minimise energy and water use as well as enable high levels of recycling will create defensive buildings. Meanwhile, investing in cities with proactive resilience strategies and public and private investment in green infrastructure and disaster planning is defensive.
- Grosvenor's recent *Resilient Cities Research Report*, which defined resilience as the least vulnerable and most adaptive cities, found investment hot spot London only ranks 18th due to its increasing social tension and lack of affordable housing. Moscow, Milan and Madrid ranked among the least resilient European cities. Zurich, Amsterdam and Frankfurt are Europe's most resilient.
- The top three most resilient cities, Grosvenor found, are Toronto, Vancouver and Calgary.

Occupiers are expected to focus increasingly on cities rather than countries too, pushing strategies into alignment with "winning cities". It's a trend retailers are embracing; city-specific strategies have led Paris department store Galeries Lafayette to open in Jakarta and London's Harrods in Kuala Lumpur. Apple opened its first store in the former East Germany in Dresden due to its strong university population.

Breheny explains: "The impact of megatrends will be felt at a city not country level. Our analysis shows you only have to invest in one or two cities across a region to benefit from growth. The new products we're working on are focused on that."

While it is clear that very few investors can afford to overlook megatrends, identifying those most relevant to a business is half the battle – requiring research effort that identifies the opportunities and provides information to those managing assets down the production line. As Breheny concludes: "The research needed to understand the competitive landscape is so much more sophisticated than ever before, and so are the forces determining success."

Sponsoring organisations

PwC's real estate practice assists real estate investment advisers, real estate investment trusts, public and private real estate investors, corporations and real estate management funds in developing real estate strategies; evaluating acquisitions and dispositions; and appraising and valuing real estate. Its global network of dedicated real estate professionals enables it to assemble for its clients the most qualified and appropriate team of specialists in the areas of capital markets, systems analysis and implementation, research, accounting, tax and legal.

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Emerging Trends in Real Estate®

The global outlook for 2015

Based on interviews with the most senior property professionals, the *Emerging Trends in Real Estate© United States and Canada, Europe* and *Asia Pacific* reports, produced annually by the Urban Land Institute and PwC, are key indicators of sentiment in global real estate.

We have drawn together those regional insights to focus on the most relevant investment and development trends across the globe, the outlook for real estate finance and capital markets, and the long-term influence of megatrends over the industry.

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