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Fundraising challenges ease in Asia-Pacific

Real estate investment activity in the region is ramping up, but China remains off the radar for investors. By Mark Cooper

Private equity real estate firms are becoming more active in Asia-Pacific as markets adjust to higher interest rates.

The region saw an upturn in investment activity in the third quarter of 2024, according to data from JLL. The broker reported transaction volumes for the first nine months of the year hitting $96.3 billion, up 28 percent on the same period in 2023. Transaction volumes in Japan and Korea have been relatively resilient since interest rates started to rise, due to liquidity from domestic investors, while MSCI reported improved liquidity in Australia in 2024.

Nonetheless, the managers taking part in *PERE*'s Asia roundtable say they will be proceeding carefully and sticking to their preferred sectors and markets. Capital raising has become easier as the year has progressed, but investing in China remains out of the question for many US and European investors.

Tim Jowett, managing director and head of Asia research at manager Hines, says: "We are definitely having a better time fundraising in 2024 than we were in 2023; there's definitely more appetite. And I think that trajectory will continue forward. I do expect liquidity to pick up and fundraising to improve in line with that."

Investors have tended to favor a limited number of sectors, says Louise Kavanagh, chief investment officer and head of Asia real estate at manager Nuveen. "We have been able to raise capital in some of the sectors that have been in favor, such as beds and sheds, and real estate debt. However, when we come back to core or the more traditional sectors and markets, it will be 2025 to 2026 before we see a more normalized capital-raising environment."

Some market observers have suggested Asia-Pacific's resilience may be to its detriment when it comes to attracting investment, perceiving more stressed situations and potentially better returns in the US and Europe where market dislocation has been greater. However, the panel insists Asia-Pacific's long-term returns and growth drivers mean it remains attractive.

Jowett explains: "The US and Europe have repriced more than Asia-Pacific, so if you're looking at capital values, peak to trough, US and Europe have moved more. However, I don't think investors look solely at that pretty narrow data point. There's a much more nuanced story across the region.

"Asia-Pacific prices are about 11 percent below their long-term trend. They were last at this number in the aftermath of the GFC. I am not making a call on whether this is attractive relative to other regions, but this is attractive relative to this region's history and therefore a good window in which to deploy capital.

"Hines' global rental growth forecasts, produced by our quant team, show rental growth in Asia-Pacific about double that of Europe or the US.

Tim Jowett
Managing director and head of Asia research, Hines

Jowett has more than 20 years of industry experience, 15 of which have been in Asia. In 2023 he joined global real estate investment manager Hines, which has $8.1 billion of AUM in Asia and $93 billion worldwide, from Grosvenor Asia Pacific.

Marcus Merner
Managing partner, head of Asian investments & portfolio manager, Asia value-add, BGO

Responsible for overseeing all acquisitions and asset management functions within Asia, Merner joined BGO (formerly BentallGreenOak) in 2010 from Morgan Stanley, having spent approximately 16 years with the firm, and is primarily based in Tokyo. BGO has $83 billion of AUM worldwide and $7 billion in Asia-Pacific.

Joel Rothstein
Shareholder, chair of Asia-Pacific real estate practice, Greenberg Traurig

Rothstein leads the Asia real estate practice for international law firm Greenberg Traurig. Based in Tokyo, he is coming up on 27 years in Asia, having initially moved to Japan to work on the first non-recourse real estate loans and real estate securitizations completed in North Asia.

Louise Kavanagh
Chief investment officer and head of Asia-Pacific real estate, Nuveen

Kavanagh joined global investment manager Nuveen, which has global real estate AUM of $143 billion and Asia-Pacific real estate AUM of $6.2 billion, from Invesco Real Estate in 2017. She is a board director of ANREV and an appointed global governing trustee for the Urban Land Institute.

I think in most sectors, looking forward, the rental growth story is quite compelling."

Meanwhile, Kavanagh points to data from Asian real estate investor association ANREV showing Asia-Pacific core returns in local currency to be higher and less volatile than their equivalents in the US and Europe. She adds: "The region continues to benefit [from] those tailwinds which we all know about: the rising middle class, growing manufacturing and technology hubs, and demographic changes which are positive for real estate."

However, relative performance cannot be ignored. Marcus Merner, managing partner, head of Asian investments and portfolio manager, Asia value-add at manager BGO, says: "For many investors, it is all about the returns. Diversification is important and people may be looking for Asian exposure, but what trumps all of that is, am I going to get paid for going to Asia?"

China turn-off

Prior to the covid pandemic, China had become one of the biggest real estate markets in the world and was a popular destination for overseas real estate investors. However, the prolonged lockdown, sluggish recovery and continued geopolitical tensions between China and the US have dampened appetites.

Merner says: "Larger US investors may already have exposure to China, but the vast majority of those investors will want to invest any new dollars allocated to the region outside China. There is probably a number of folks who are going to sit this one out for a few years to see how China plays out."

While US and European investors are reluctant to engage with China, there are some investors, such as those from the Middle East, which are prepared to allocate capital. This means managers need to structure vehicles to account for the diverging views.

Joel Rothstein, shareholder and chair of the Asia-Pacific real estate practice at law firm Greenberg Traurig, says: "I'm currently working on a fund formation project, which is a debt/special situations fund. We have had to create a parallel fund to carve out China for investors that don't want exposure to China."

Even with the current depressed China real estate market, which has seen a number of developer bankruptcies, Rothstein believes there would be more appetite if the government allowed foreign capital to take on opportunistic or special situations plays. He says: "The issue in China is whether the government will allow and facilitate access to special situations where foreign players could be involved in

> *"The risk-adjusted returns in India stack up pretty well, and it is a market where development stacks up attractively for us"*
>
> **TIM JOWETT**
> **Hines**

Mega-mergers add value for both managers and clients

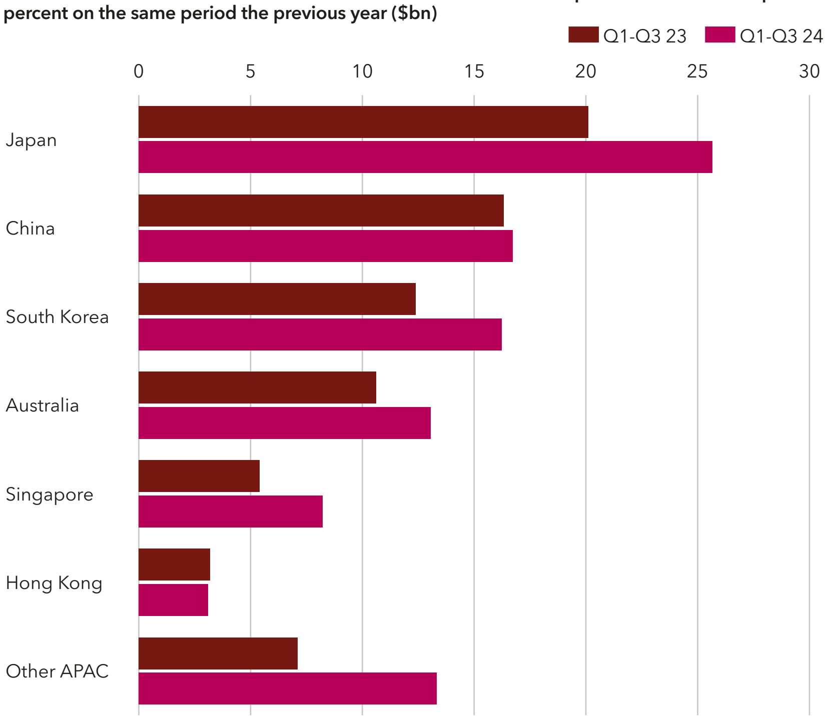
2024 saw some significant merger activity in Asia-Pacific private real estate

In May, Hong Kong-listed manager ESR announced that it had received a buyout proposal from a consortium led by Starwood Capital, while in October US manager Ares Management announced it had agreed to buy GLP's fund management business outside of China for $3.7 billion. These two deals involve combined assets under management of $200 billion, most of which are in the Asia-Pacific region.

Adding scale in this fashion circumvents two of the main problems for managers seeking to expand in Asia-Pacific, says Greenberg Traurig's Joel Rothstein. "The two biggest challenges international private equity funds and asset managers have in Asia, is firstly acquiring assets and building a large portfolio. The second is finding good staff and creating an integrated team. Acquiring a company provides an elegant solution that enables you to solve both complex problems in one transaction."

The move toward larger managers with a broader range of fund products on offer also benefits private real estate investors in the region, says BGO's Marcus Merner. "Investors tend to be shrinking the number of managers they invest with, so being, as much as possible, a one-stop shop is advantageous."

Commercial real estate deal volume in Asia-Pacific in the first three quarters of 2024 was up 28 percent on the same period the previous year ($bn)



Source: JLL

workouts and restructures. So far, China has not opened the door to these opportunities."

Under the circumstances in Asia-Pacific and elsewhere, investors are moving forward with care. Merner says: "We are being cautious and we are picking our spots. We are looking to pursue opportunities or deals where we have high conviction. Our focus is developed Asia: Japan, Australia and Korea."

These three developed markets together accounted for 55 percent of real estate transactions in the region in the first three quarters of 2024, according to MSCI. Of the other developed markets in the region, panelists said Singapore still attracts interest but is comparatively small, whereas Hong Kong is battling significant oversupply in its office and retail markets and subdued liquidity. Merner says: "Sentiment in Hong Kong is dampened as it has been a very difficult market to invest in due to limited options for exits."

Japan, the largest market in the region outside China, remains central to the investment strategies of global real estate managers investing in Asia-Pacific. Rothstein says: "For the traditional international private equity fund asset manager, Japan is the perennial favorite, in my view, simply because it's a very investable, transparent market, without the foreign investment restrictions that you have in other jurisdictions. And I think in many respects, Japan is benefiting from the reallocation of Asia-dedicated investment capital away from China."

Although the logistics sector has become oversupplied in some areas, which has subdued rental growth, investors in Japanese real estate are typically looking at a range of sectors in which to invest. Merner says: "In Japan, we have historically been long [on] office while pursuing hospitality opportunistically, as well as investing core-plus capital in Tokyo multifamily residential properties."

Multifamily and the broader

"living" sectors in Japan continue to attract substantial investor interest. Nuveen is targeting the multifamily and senior living sectors in Japan, says Kavanagh. "There is strong net migration into Tokyo, which supports multifamily, a sector which offers highly defensive income. For senior living, Japan has the biggest senior citizen cohort in the world. The lot sizes are small – $5 million to $20 million – so there is an amalgamation play."

Markets in focus

A key attraction of Japan is that it has consistently offered a positive gap between real estate yields and the cost of debt. However, Japan has begun to raise interest rates from rock-bottom levels and is set for further interest rate rises.

Merner says: "Over the past six to nine months, Japan debt costs have risen 30 to 40 basis points but there has been no change to cap rates so far. In future we'd expect some modest cap rate expansion, but do not anticipate material cap rate expansion as we've seen in the US and Europe over the past several years."

Rothstein adds: "I don't think the interest rate issue is one that, so far in Japan, has had any major impact on the market. Rising interest rates are somewhat balanced off against the depressed value of the yen. In addition, interest rates in Japan remain very low in comparison to other major markets around the world."

Jowett notes that "Japan looks expensive from a cyclical point of view," but adds that the future may bring different dynamics in terms of inflation and rental growth as the country shakes off its long stagnation.

According to MSCI Real Assets data, liquidity in the Australian real estate market improved in the third quarter. Transaction volumes for 2024 are on track to exceed 2023 levels, with a notable increase in activity in the office, retail and industrial sectors.

Jowett says: "Australia has seen reasonably significant repricing, depending on asset class. Office sector prices are back to 2018 levels and yields are back to where they were in 2015."

Since Australia's post-pandemic reopening, the nation has seen rising immigration, much of which comes from international students. This has prompted investor interest in purpose-built student accommodation. Kavanagh says: "Education is Australia's second largest export sector after mining, worth almost A$50 billion ($33 billion; €30 billion) to the economy in 2023 (equivalent to 2.8 percent of GDP) and supporting around 250,000 jobs. Overseas students are also important consumers, with 60 percent of their expenditure spent on purchasing goods and services and the remainder on tuition."

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> **LOUISE KAVANAGH**
> **Nuveen**

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> **MARCUS MERNER**
> **BGO**

Korea remains a target for overseas investors, particularly the office and industrial sectors. In October, Nuveen announced the acquisition of a $253 million office building in Seoul, a city which has comprehensively bunked the global trend with a 30 percent hike in office rents in 2022-23.

Rothstein says the preponderance of office deals in Asia-Pacific, especially in Japan and Korea, is "something of a surprise to my colleagues in the US." While Seoul's office boom might be an outlier, other Asia-Pacific office locations have been surprisingly resilient. Japan has seen rising office rents across Tokyo, where the vacancy rate is under 3 percent according to Savills data, and provincial cities. Even in Australia, where home or hybrid working has been a more pronounced trend than elsewhere in the region, occupier demand for the best and most sustainable offices has been strong.

Across the region, Jowett is seeing tenants gravitating toward high-quality, sustainable office properties adjacent to amenities in core central locations. "The overall office experience is more and more important, with occupiers viewing their office spaces as more than just physical workspaces," he adds.

The data center is perhaps the hottest asset in real estate today, and this extends to Asia-Pacific. There are opportunities in both developed and emerging markets, but the niche property type – which some investors consider infrastructure rather than real estate – is not an easy one to enter, Kavanagh says: "Where we struggle with APAC data centers is the size of the transaction and the capital deployment required, combined with low liquidity. Execution risks, such as construction cost and delays or power supply, also make it a tough sector."

Rothstein adds: "We see quite a bit of activity right now in data centers and digital infrastructure. However, there's not as many deals as people would like. The issue with the sector is that data centers have somewhat specialized requirements and features, so activity will increasingly lean towards specialist players."

India rising

Although transaction volumes are low, they have been rising in India over recent years as the country has become more attractive to foreign investors. The number of overseas real estate investors in India is small, but each tends to have made a substantial commitment. Managers such as Brookfield and Blackstone have assembled significant portfolios.

Since 2016, the government has introduced a number of regulatory reforms, some specifically targeting real estate. It has also invested billions in infrastructure improvements across the country, building new roads, railways and airports.

Jowett says: "India is a market for which we have seen more and more

Limited opportunities for real estate debt investment

Australia is the region's only market registering significant activity in the space

Private debt makes up around 40 percent of all commercial real estate lending in the US and 10 percent in Europe, per 2023 research from manager Schroders. Yet in Asia the figure is so low and the market so opaque that comparable figures are not readily available.

The only market with significant private real estate debt activity is Australia. Here, debt funds have moved into the space vacated by the nation's large banks, which have been moving away from real estate debt, especially more complex lending.

Nuveen's Louise Kavanagh says: "In Australia, domestic banks can't compete against non-bank lenders like ourselves, who offer bespoke solutions, higher execution speed and higher leverage."

While there is a small number of private debt companies operating around the region, the bulk of real estate finance comes from banks. Asian banks remain willing to support real estate, while a less complex capital stack is also a factor.

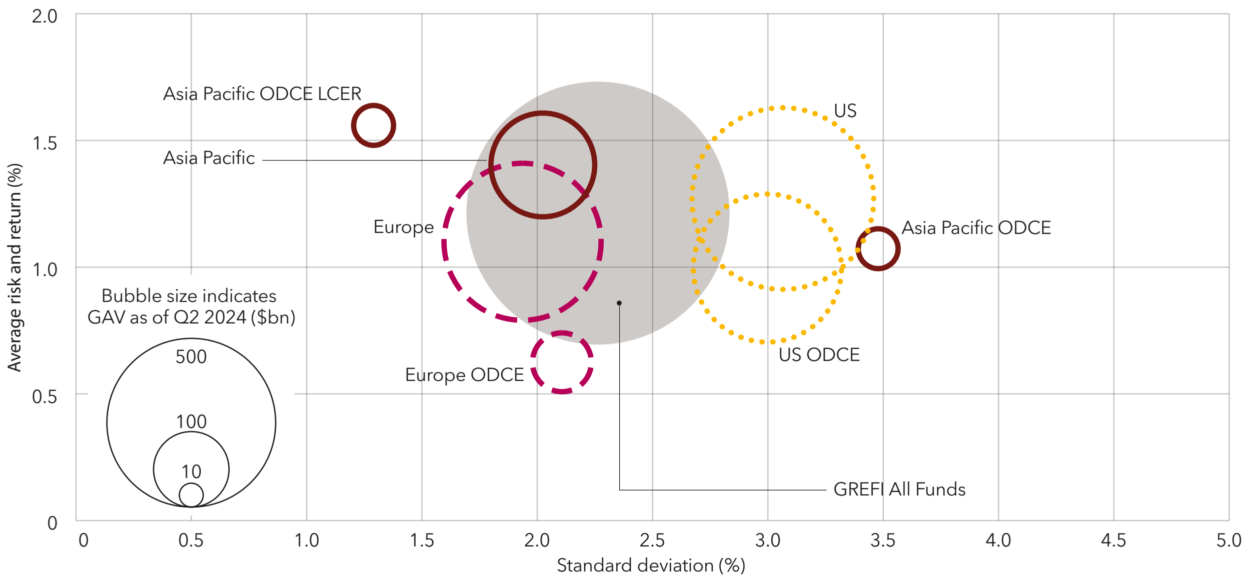
Greenberg Traurig's Joel Rothstein says: "In the US, in a typical deal, there might be senior mortgage debt, two levels of mezzanine debt and preferred equity, whereas in Asia deals are more likely to be financed with bank debt alone. When there is a multilayered capital stack there are more potential points of entry into a deal for debt investors."

A number of private debt firms lend to real estate in India, although the market is small and BGO has a lending platform there. Marcus Merner says: "India credit is a good opportunity, especially for rupee-based investors."

"In many respects, Japan is benefiting from the reallocation of Asia-dedicated investment capital away from China"

JOEL ROTHSTEIN
Greenberg Traurig

Looking at core real estate returns in local currency shows Asia-Pacific returns are higher and less volatile than other regions, Q3 2016-Q2 2024



The Asia Pacific ODCE Local Currency Equivalent Net Total Return removes the currency fluctuation impact over the quarter (history starts from Q3 2016)

Source: ANREV

attention from our investor base over the past 12 months, and particularly more investment attention from investors within this region. I think the risk-adjusted returns in India stack up pretty well, and it is a market where development stacks up attractively for us.

"After multiple cycles of investors having challenges in India, reform in broader financial markets and specific real estate sectors has created an environment where investors have greater confidence. Alongside the infrastructure improvements which had long been a challenge, there is a better environment and a stronger fundamental story in India."

The difficulty of investing in China has put a greater focus on India, as it is the only market which offers similar scale. But Kavanagh says the two are not interchangeable: "Sometimes talking to investors or overseas colleagues, they ask: 'What about India? If China doesn't work what about India instead?' There is a perception that India will deliver what China did 10 years ago, but the two nations have very different political systems and economies. You can't just swap one for the other."

Negotiating geopolitics

The roundtable discussion took place in October, prior to the US election. Looking ahead, the panel was relatively sanguine about the result, on the grounds that protectionism and tariffs would continue regardless of which party was victorious.

Kavanagh also suggests some markets many benefit from continued frosty relations between the US and China. "Developed Asia-Pacific markets such as South Korea, Japan and Australia have strong ties and allegiances with the US. We could see a situation where the US and other countries buy cars and technology from South Korea, for example, rather than China."

Nonetheless, geopolitical tensions are a risk for real estate investors to negotiate. Merner says: "In this geopolitical environment you need to understand how defensive your investments are. There is no perfect hedge for geopolitics and the perceived volatility that it may bring. But you need the benefit of time – in the event the unexpected occurs.

"For asset owners, real estate events tend to be triggered by debt terms, ie maturity dates, so we are always looking for ways to extend and have options on debt. For example, Japan is a five-year debt market so we try to structure six, seven-year loans, including optionality."

Despite their caution about the short term, the panel remains confident about Asia's prospects in the long term, thanks to its size and demographics. It is not just a market for the future, either: the region is already home to more than a third of the world's billionaires and is a manufacturing hub for a range of technology products, from semiconductors to consumer electronics.

Rothstein says: "Asia-Pacific is still the market of the 21st century in terms of the demographic changes which support investment in real estate, and it is attractive from both the inbound and the outbound perspective." ■