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Asian institutional investors have started to invest in real estate

Nomura Research Institute, Ltd.

Real estate acquisitions by Asian investors have recently been on the rise. This trend reflects that Asian pension funds and other institutional investors are revising their asset allocations and increasing their real estate allocations. We look for continued growth in real estate investment by Asian pension funds with overweight bond allocations and low beneficiary-to-contributor ratios.

Asian investors are making their presence felt in the Japanese real estate market

Until recently, foreign investors in Japanese real estate have mainly been European or American. Before the 2008 financial crisis, Western investors acquired numerous properties priced from ¥10 billion to upwards of ¥100 billion. Their acquisition spree helped to drive cap rates[1] sharply lower[2].

Following the financial crisis, however, property acquisitions by Western investors rapidly abated while cap rates rose. Meanwhile, property acquisitions by Asian investors have been picked up, as shown in the table below. More specifically, acquisitions by investors from relatively advanced Asian countries such as Singapore, South Korea, Hong Kong, and Malaysia have been increasing. These investors are mainly government- or conglomerate-affiliated companies in addition to institutional investors (e.g., pension funds, sovereign wealth funds). As property acquisitions by such Asian investors have increased, cap rates leveled off from their post-crisis rise and stabilized since 2009[3].

To date, Asian investors' Japanese real estate investments have mostly been in the ¥1–10 billion range, amounting to smaller transaction volume than Western investors' pre-crisis volume. Nonetheless, with Western investors' market presence diminishing, it is noteworthy that investors from Asian countries with promising growth prospects have emerged as a key driving force in the Japanese real estate market.

Another distinguishing characteristic of Asian investors is that they invest in a broad range of property types. Properties they have acquired include not only traditional

Exhibit. **Major investments in Japanese real estate by overseas investors**

Major investments by Western investors				Year	Major investments by Asian investors			
Buyer	Home country	Property type	Investment		Buyer	Home country	Property type	Investment
Morgan Stanley	US	Office	¥118bn	2008	GIC	Singapore	Hotel	¥77bn
Morgan Stanley	US	Office	¥48bn		Parkway Life	Singapore	Nursing homes (7)	¥7.8bn
RREEF	Germany	Office	¥19bn		Cykan Holdings	Korea	Hotel	NA
Deka Immobilien	Germany	Retail	¥19bn					
Commerzbank Group	Germany	Office	¥17bn					
Union Investment	Germany	Office	¥15bn					
LaSalle Investment	US	Office	¥12bn					
Deka Immobilien	Germany	Retail	¥10bn					
LaSalle Investment	US	Warehouses (3)	¥5bn					
Secured Capital	US	Office	¥140bn	2009	NPS (with Carlyle Group)	Korea	Office	¥35bn
SEB Asset Management	Germany	Retail	¥12bn		St.Martins Property	Kuwait	Residential	¥13bn
Goldman Sachs	US	Office	¥3.2bn		Parkway Life	Singapore	Nursing homes (8)	¥5bn
LaSalle Investment	US	Warehouses	NA		Mapletree Investment	Singapore	Office	NA
					Alpha Investment	Singapore	Retail	NA
RREEF	Germany	Retail	¥19.5bn	2010	Mapletree Logistics Trust	Singapore	Warehouses (3)	¥13bn
Morgan Stanley	US	Office (3)	¥10bn		NPS	Korea	Office (3)	¥10bn
RREEF	Germany	Office	¥4.7bn		Conglomerate-affiliated company	Hong Kong	Residential	¥7bn
CLSA	France	Office	NA		YTL Corporation	Malaysia	Hotel	¥6bn
LaSalle Investment	US	Retail	NA		Mapletree Logistics Trust	Singapore	Warehouses	¥4.4bn
LaSalle Investment	US	Office	NA		Parkway Life	Singapore	Nursing homes (6)	¥3.9bn
LaSalle Investment	US	Residential	NA		Keck Seng Investments	Hong Kong	Residential(2)	¥3.9bn
AM alpha	Germany	Office	NA		HKR International	Hong Kong	Residential	¥3.5bn
					Parkway Life	Singapore	Nursing homes (5)	¥3.1bn
					Mapletree Investment	Singapore	Office	NA

Source: NRI, based on Nikkei Real Estate Market Report assets such as office buildings, shopping centers, and residential properties but also hotels, distribution facilities, and nursing homes. Asian investors' investments in such illiquid properties imply that they are seeking long-term income streams, not short-term capital gains. The emergence of such Asian investors has increased transaction activity in types of properties not previously regarded as investment properties, liquefying the markets for such properties and enlarging the scope of Japan's real estate investment market.

Previously bond-centric Asian pension funds are diversifying into real estate

The recent pickup in real estate investment by Asian investors reflects that institutional investors, particularly pension funds, are radically revising their asset allocations, as discussed below.

Pension funds that engage in advanced portfolio management practices, such as CalPERS[4)] in the US and Canada's OTPP[5)], diversify their asset allocations to prevent excessive concentration of risk in any given asset class. As one aspect of such diversification, they invest in real estate and infrastructure assets. Indeed, they regard real estate as an important asset class, even going as far as setting up specialized teams focused exclusively on real estate.

Following the example of such developed countries' pension funds, Asian pension funds also have started to diversify their portfolios. Historically, Asian pension funds have always invested conservatively, placing priority on safety. They have consequently been prone to home-country bias, concentrating their portfolios in domestic bonds. Now that they have gained considerable investment experience, however, they have started to invest in real estate and other alternative assets in pursuit of higher returns and risk diversification.

For example, Korea's National Pension Service[6)] (NPS) announced that it will increase its asset allocation to alternative assets, including real estate, to a minimum of 10% by 2015. In 2004, NPS had some 85% of its assets invested in domestic bonds and virtually none invested in real estate or other alternative assets. Over the past year or two, however, NPS has rapidly ramped up investment in real estate. As of 2009, its domestic bond allocation had decreased to around 70%, while its allocation to real estate and other alternative assets had increased to 6%.

NPS is aggressively investing in overseas real estate, partly because Korea's domestic real estate market is relatively small. It is focusing on real estate markets in not only the US and Europe[7)] but also Asia[8)], including Japan, where it has acquired office buildings in Toyosu (Tokyo) and elsewhere. Additionally, NPS plans to invest in Japanese, Australian, and Chinese real estate through a US$1 billion Asian real estate fund.

Asian pension funds, many of which are currently invested predominantly in bonds, are very likely to increasingly revise and diversify their asset allocations like NPS. In fact, many pension funds, including NPS, plan to staff up with real estate investment specialists[9)] and are beginning to branch into real estate investment in earnest.

Asian countries generally have large working-age populations relative to their elderly populations. Their pension funds' maturity level[10)] is therefore still low. Because such "young" pension funds currently have small benefit obligations, they have high risk tolerances, affording them broad latitude in terms of asset allocation. They can even invest in relatively illiquid assets like real estate in the aim of earning liquidity premia.

Moreover, Asian institutional investors, including pension funds, have extremely favorable prospects for growth in assets under management. In light of such, real estate investment by Asian institutional investors should continue to grow.

Note

1) A cap rate measures return on investment in real estate as the ratio of a property's net operating income to its price.

2) The cap rate for office buildings in Tokyo's Marunouchi district, for example, fell as low as 3.5%.

3) The cap rate for office buildings in Tokyo's Marunouchi district has stabilized at 4.2% since 2009.

4) California Public Employees' Retirement System

5) Ontario Teachers Pension Plan

6) With over $200 billion in assets under management, NPS is the world's fourth-largest public pension fund by assets.

7) NPS has acquired major properties in the US and Europe, including HSBC's London headquarters (acquired in 2009 for approx. $1.3 billion) and the Berlin Sony Center (acquired in 2010 for approx. $700 million).

8) NPS's Asian acquisitions include an office building in Sydney, Australia (acquired in 2010 for approx. US$660 million).

9) In a Greenwich Associates survey, roughly half of the institutional investor respondents reported that they plan to expand their real estate investment staffs by a minimum of 1–3 personnel over the next three years. Among these respondents, all of the pension fund respondents reported that they will expand their real estate staffs by 1–3 personnel.

10) Maturity is a measure of pension funds' financial condition. It is generally expressed as a ratio of current beneficiaries to pension plan participants.

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