Global Property Insight

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Investors stride the world stage

Ownership is now an international affair as overseas funds pour into traditional markets **Page 2**

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Global Property Insight

Era of global ownership dawns

A new financial sobriety has put an end to the decade of the quick buck, writes *Ed Hammond*

As the financial crisis rumbles its way into a fifth year, the global property industry has found itself facing a crisis of shared difficulties.

On both sides of the Atlantic, funding has ebbed away from fixed assets. The free-wheeling 'develop first, ask questions later' years that defined the past decade are long gone, replaced by a new financial sobriety. The global banking system, having lent so freely, is awash with trillions of dollars of real estate debt; much of which it will have to sell. New lending to the property sector is off the agenda. Meanwhile, the value gap between desirable and undesirable buildings has never been wider.

Property markets the world over are fighting the same fight to return to some sort of equilibrium. This sharp narrowing of the factors that determine the success or failure of a particular market or asset class, has suffocated thousands of property companies. Unable to secure new finance, many more are gradually winding down into corporate obscurity.

But, just as the struggle has wiped out swathes of traditional participants, it has created opportunities for a new breed of property investor.

Simon Hope, head of capital markets at Savills, the property services group, says that two distinct categories of investor have emerged as the new front runners in global property. "There are those who are relatively risk-averse – these would be sovereign wealth funds, pension funds and private investors; and those who embrace risk – US opportunity funds, local property companies, and private trader/developers."

The long-term, risk-averse investors are attracted to the perceived safety of London, New York, Hong Kong and Paris, says Mr Hope. Property values in the large, world cities typically operate in vacuums, unencumbered by the difficulties of their respective domestic markets. "Those that are risk embracing, meanwhile, are looking to buy at the bottom; they are interested in buying distressed properties that will provide capital growth."

Whether risk on or off, success in property, as with most other business sectors, has always been determined by access to finance. The dearth of bank lending in the past five years has laid low large parts of the real estate industry. The business model of borrowing cheaply, buying an office block, polishing it up and waiting for values to rise before paying off the loan and starting again, is gone. In the UK – once the centre of Europe's property boom – gross lending, comprising new loans and refinancings, was estimated at £37.7bn last year. The figure is less than half the £80bn issued by banks in 2007, according to research from De Montfort University.

Less popular still is development. Banks, once besotted with sharing in some of the upside of development risk, are averse to anything remotely speculative. That general disenchantment is likely to get worse.

Sweeping changes to banking being ushered in next year under Basel III – the third accord in a sequential improving of global bank regulation – will raise the amount of capital lenders need to hold against loans secured on commercial property.

The upshot of this retrenchment has been twofold. On the one hand, cash-rich entrants to the property market have started to self-finance development in the hope of taking advantage of the lack of new supply. On the other, a new breed of financial institution has begun making tentative forays into real estate lending.

Illustration: James Ferguson

Global insurance groups Axa, Met Life, Aviva and Legal & General have launched programmes for providing debt finance to property companies. And specialist mezzanine and stretched senior debt funds have sprung up to try to cash in on the gap created by the shortfall in bank lending.

Even in the residential property market – long the territory of traditional lenders – new sources of capital are appearing.

Robert Hodges, managing director at Carlyle, the US private equity group. says: "The reason the market for residential looks interesting at the moment is that there is a gap in the capital structure that has been left by the banks withdrawing finance. That has created an opportunity for new types of investors, such as private equity funds.

"The demand profile is looking very good and, even though there are a lot more players coming to market, supply is still constrained," he adds.

Other finance coming into the market has targeted only those investments perceived as capable of producing steady income. Pension funds and other long-term investors have looked to specialist property areas, such as student housing and, often government-backed, infrastructure assets as the right investment.

> 'Many have held on in the hope that economic recovery lies over the next hill'

Hans Meissner, managing partner at EISER Infrastructure, says: "With uncertainty swirling around the global economy, investors are increasingly looking for defensive assets that provide diversification and yield – a combination that infrastructure produces".

Annabel Wiscarson, a director of business development for Industry Funds Management in Europe, says: "Government counterparties and regulation provides long-term certainty to investors, as they make cash flow more predictable. Even during the financial crisis, infrastructure such as utility companies had stable cash flows."

However, Ms Wiscarson suggests that investors are not migrating to infrastructure from traditional real estate. "More commonly, they are reallocating parts of their portfolio away from bonds and equities into infrastructure to access its less volatile, but equity-like returns," she says.

One feature of the property market during the global financial crisis that has been universal is the increased internationalisation of ownership.

Vast quantities of capital from Asia, the Middle East and Latin America have poured into the traditional boom markets of Europe and the US. Meanwhile, investors have shunted billions of euros between the struggling economies of Spain, Italy, Greece and Portugal towards the safety of London, Paris and Germany.

The shift in ownership towards large, international investors will undoubtedly alter the complexion of global real estate.

Longer term holders will drive liquidity down in some of the more febrile markets. Those cash-rich investors willing to take a risk on buying non-performing bank loans, offices in secondary locations or residential development, should see many more opportunities arise, as the banks and other motivated sellers continue to offload the legacy of zealously backing the market last time round.

In spite of the opportunities, there are likely to be many more bumps in the road before the property world rediscovers the ingredients needed for it to boom.

"Many have held on in the hope that economic recovery lies over the next hill," says Marc Mogull, managing partner at Benson Elliot, the real estate private equity group.

"However, the most recent flare-up in the eurozone has doused that hope. Second-quarter GDP figures paint a picture of a European economy that has ground to a halt. Put simply, the costs to economic growth of solving the eurozone crisis are proving higher than anyone expected."

Until the global real estate sector overcomes the problems it collectively faces, it is unlikely that individual markets will be able to fulfil their promise.

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Mexico's National Trust Fund for Tourism Development

Investment Opportunities

FONATUR is a sound institution backed with a vast experience in developing Integrally Planned Resorts, providing timely and accurate information to the investors once they decide to invest in the tourism industry. It features the largest list of options in tourist urbanizations in Mexico, thus making it one of the most important organizations promoting tourist investment worldwide.

In the early 70's, when the tourist industry was just starting to develop in Mexico, the Federal Government developed a long-term plan for this new sector nationwide. It started out by creating FONATUR —Mexico's Trust Fund for Tourism Development — charged with the mission to carry out a variety of objectives including the planning and development of sustainable tourism projects on a large scale and promoting national and international investment in the Mexican tourist industry.

FONATUR thus focused on developing six Integrally Planned Resort in Cancun and Ixtapa in 1974, Los Cabos and Loreto in 1976, Huatulco in 1984 and the latest development in Litibú in 2006 on the coast of Nayarit, just a few miles north of Puerto Vallarta.

The Fund has made a name for itself during its 38-year history by implementing several FONATUR projects including its most successful development in Cancun, a tourist destination it planned and developed as an Integrally Planned Resort (IPR) from its early beginnings. IPRs are conceived as a mix of tourism and urban development with a strong emphasis on preserving and improving the natural surroundings while ensuring social equity and competitiveness in tourism sector. The Cancun IPR model was repeated throughout Mexico, with the construction of five additional Integrally Planned Resorts.

FONATUR is responsible for overseeing the Master Plan, Infrastructure Development, Urban Services and quality maintenance programs in all IPR projects.

The Fund works in a coordinated effort with the Mexican Ministry of Tourism to select the most promising locations for tourist developments, running feasibility studies to assure all aspects of the project, such as environmental sustainability and the stimulation of local economic growth.

FONATUR has pioneered the Integrally Planned Resorts concept for nearly four decades, bringing the tourist industry in Mexico to a whole new level under current macroeconomic conditions and raising Mexico to a competitive position as a major player in the tourist arena and one of the most important tourist destinations worldwide. Mexico offers a wide variety of opportunities for international investment through FONATUR.

FONATUR's success is grounded on a bottom-up development strategy that guarantees ecological sustainability. This multidisciplinary approach helps small and medium-size businesses and international corporations build on their strengths, uniting to raise the Mexican tourist offering to a world-class status.

Recent attention has focused on three of FONATUR's major development projects in Cancun, Huatulco and Loreto, each offering a unique regional experience with the same type of luxury and natural beauty everyone has come to expect from Mexico.

The Fund´s success can be seen all along the country´s coastline in: 6 Integrally Planned Resorts - Cancun, Los Cabos, Ixtapa, Huatulco, Loreto and Litibu - 3 Port Administrations (Ixtapa, Huatulco and Los Cabos), 12 Marinas in the Sea of Cortes region, 3 Golf Courses (Ixtapa, Huatulco and Litibu). One eco-archeological park in Huatulco and several small hotel chains.

Tajamar Cancún will feature;
Seafront promenade
Housing units: 5,214
Residential units: 2,500
Total surface: 193.75 acres
Hotel & Entertainment lots
Condominium lots (Exclusively residential)

FONATUR is reinforcing Cancun´s global position as a world-class tourist destination by developing Tajamar.

Cancun, the flagship of FONATUR´s success as a development institution has become a household name as one of the major tourist centers in the world. Investment opportunities in this Integrally Planned Resort are far from maxing out at capacity. We have already developed a new commercial and residential zone that will strengthen its great international position as top tourist destination.

This new Tajamar development will further enhance the quality of its recognized destination, strengthen the city´s international position and attract desired tourist markets for their high spending levels.

Tajamar is designed to become an urban-tourist centre with first-class housing, services and trade facilities, thus continuing to maintain its position as the city´s touristic district an the water front of Nichupté Lagoon shores. It will feature a tourist pier and it is designed to hold up to 2,500 new homes and 5,000 hotel rooms; that is to say 9,000 permanent residents who will have their needs for leisure, recreation and cultural activities met, substantially improving their living conditions, contributing to its social, economic and regional development policies, based on urban trends.

Cancun features a total installed capacity of nearly 30,000 hotel rooms, receiving more than 3.5 million tourists last year.

Cancun´s International Airport held more than 45,000 flight operations during 2011, 65% of which were international flights.

HUATULCO

Located on the coast of Oaxaca, Huatulco is the first community awarded with the EarthCheck Gold certification in the world, it is situated across 51,830 acres that include 9 bays, 36 beaches, mountains and valleys, irrigated by the Copalita, San Agustin and Coyula rivers, a national park with a protected natural reserve, an the eco-archeological park and museum Copalita.

In 2010 Huatulco teamed up with EarthCheck to become the first community in the world to receive EarthCheck Gold certification, previously known as Green Globe award. This is quite an accomplishment considering its rigorous judgment and certification process based on seven international recognized standards, environmental legislation, energy efficient, clean and residual water, treatment of solid and hazardous waste, diffusion of an environmental culture and community training programs.

These high ecological standards have made Huatulco have it all, a successful tourist industry and a bright and clean future.

FONATUR, Mexico´s leader in developing integral tourist projects, undertook an effort to condition the community of Huatulco to become a fully sustainable tourist destination in the Pacific Coast of Mexico ideal for investors and tourists.

Huatulco offers you a wide variety of investment options in tourist developments, with different opportunities based on each development´s unique characteristics.

With a capacity of 3,500 hotel rooms Huatulco received more than 350,000 guests during 2011, while its international airport held more than 2,600 flight operations.

The flow of domestic and international investment to Huatulco show that FONATUR´s expectations have been met, working with the community, the municipality and the private sector, which collectively represent a true engine that drives development in the region.

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MAJOR PROJECTS AVAILABLE:
Mirador Chahué: Residential tourist lots
The Conejos Hotel Complex: hotel lots
The Conejos Residential Development: tourist residential lots
The "O" Sector: single family lots
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where luxury is not purchased, it is found

MAJOR PROJECTS AVAILABLE:
Puerto Escondido: downtown urban lots
Loreto: single family lots featuring 1,850 sq ft

Investors in Baja California Sur will find the perfect match between world-class natural beauty and luxury.

Loreto is part of a three-phased Integrally Planned Resort encompassing 25,200 acres of land: The traditional town of Loreto, the tourist zone of Nopoló and the marina in Puerto Escondido form this popular corridor. Located in the center of the Baja California peninsula, it is watered by the Mar de Cortés, called the aquarium of the world by Jacques Cousteau. Its natural scenery has no comparison, mixing the ocean, desert and mountains to create a natural wall formed by the Sierra de la Giganta which borders Isla del Carmen, the country´s largest marine ecological reserve.

Since FONATUR set sight in one of the oldest settlements in Baja California Sur, it has remained a well kept secret that carries us away into a Mexico of colonies and legends, where visitors may wander through its streets or explore outlying areas and visit caves adorned with prehistoric cave paintings. More than 300 years of history make up the legend of the oldest settlement on the Baja California peninsula, and today savvy tourists will delight in the colorful contrast between the deep indigo hued sea against the green-ocher of the closer islands.

Those on a winter getaway won't want to miss the opportunity to take a whale watching tour; gray whales can be sighted only minutes away from Loreto or enjoy world-class sport fishing and play golf and tennis at the Nopoló recreational sports complex.

Loreto offers some very unique opportunities to investors and tourists; it has been developed as a world-class destination without the world-class price tag, its low profile has kept real estate prices extremely low.

Loreto features a total installed capacity of 1,000 hotel rooms, receiving more than 80,000 visitors in 2011.

For further information about any of these projects:
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Investors face very long drama

Funds Distressed assets still offer little value, writes *Ed Hammond*

Sale saga: falling values and oversupply has the market on edge Getty

Four years ago, with the wheels spinning off the property markets on both sides of the Atlantic, investors specialising in distressed real estate started to brace for opportunistic purchases.

They are still waiting.

Far from rushing headlong into fire-sales, banks have been unexpectedly slow in disentangling the legacy of profligate lending to real estate companies during the 2000s. Sales of buildings have been eschewed in favour of shedding portfolios of underperforming property-backed loans. Those few that have gone ahead have been dripped into an expectant and cash-heavy market.

"The degree of support that has been offered to the banks by government and central banks has limited the extent to which they have needed to liquidate distressed positions in the real estate sector," says Michael Haddock, senior director of research at CBRE, the property consultants.

Simon Hope, head of capital markets at Savills, says: "Opportunity buyers have been hugely disappointed by the low volume of stock and have been forced to buy debt portfolios as opposed to assets."

The slower than expected pace of disposals has created problems for private equity firms and so-called vulture funds, which raised billions of dollars during the past few years. This mismatch of fire-power and opportunities has led to greater competition, with many funds having to wait, and financial muscles atrophying, until the banks step things up.

> 'Property lenders are taking a rational, long-term view when restructuring'

The banks have also, for the most part, avoided what many had hoped for and held onto their best performing assets. While keen to cut their exposure to the real estate sector, lenders are in no rush to rid themselves of income-producing assets. The prevailing attitude has been to hold on to loans where the borrower has a chance of paying back, rather than cutting loose the problem and crystalising a loss.

Even in the case of Ireland's National Asset Management Agency, the government-established bank – set up for the purpose of disposing of €74bn of toxic loans – the sell-off hasn't lived up to expectations.

Ric Clark, Brookfield Property Partners chief executive, says the predictions of panic property sales, including dire forecasts of a collapse in real estate due to commercial mortgage-backed security woes, have not come to fruition.

"Property lenders are taking a rational, long-term view when restructuring, particularly when dealing with ownership of iconic, high quality properties."

Mr Clark adds, however, that there are likely to be more opportunities as banks sell off property outside their domestic markets. "Purchasing distressed properties in secondary or tertiary markets requires sophisticated turnaround skills in areas such as financing, property management and leasing."

One of the difficulties for buyers looking for distressed opportunities is correctly assessing the risk of a particular asset or loan. No more is this problem apparent than for the handful of funds looking to make acquisitions in the peripheral eurozone economies of Spain, Italy, Portugal and Greece.

The toxic trinity of falling values, oversupply, and uncertainty over the future of the single currency has caused a cessation of transactions. Even investors prepared to trade high risk for returns are steering clear.

Eric Adler, chief executive of Pramerica Europe, the property investment group, says that in southern Europe – the most obvious target for distress investors – nothing much has happened, and is less likely to happen now there are real existential doubts about some of those economies. "The prices you'd have to pay for those assets are so low that the governments can't allow the banks to sell at those numbers. It's really shutting down the traditional distress route in Europe," he says.

"The real distress story is going to play out not months from now, but years from now," he adds.

A costly continental shift in confidence

Europe

A sharp drop in lending has left some eurozone countries reeling, reports *Ed Hammond*

There can have been few places in the world less favourable to holding large fixed assets than Europe has been during the past two years.

Already swaying from the global economic downturn and the value-stifling effect of overdevelopment, the continent's property market has been hard hit by the eurozone crisis.

Confidence has drained out of all but the safest real estate sub-sectors and many assets – from Spanish shopping centres to Irish hotels – have become virtually impossible to trade.

House prices have declined across most markets outside the big capital cities. In the worst affected countries, concern over the future shape of the European economy has caused a near cessation of transactions.

The Spanish and Italian commercial property markets have seen the number of transactions falling more than 90 per cent in the three months to July, as investors worry about the future of the eurozone.

Only three large commercial property transactions were registered in Spain during the second quarter, down from 58 deals in the previous quarter.

In Italy, just two buildings were traded, down from 56, Real Capital Analytics data shows.

Christian Ulbrich, chief executive of Jones Lang LaSalle in Europe, says that the continent's deeply polarised property markets are likely to pull further apart.

"There is strong demand for trophy assets in London, Paris, Germany and Poland on the one hand, whereas transactions [are] drying up across southern Europe and in some of the less prominent cities.

"The Nordic markets are also high on the list, but are very competitive because of strong domestic investor interest," he adds.

Mr Ulbrich says investors need to be cautious and consider the risks of each market.

The flight to high quality property assets has already sucked billions from the continent's second tier markets and into pockets of economic resilience, such as Paris retail property and central London offices.

Europe's banks are one of the key drivers for the refined approach to property investment.

Already heavily exposed to billions of euros worth of distressed real estate – a legacy from years of profligate lending during the past decade – the continent's banks are facing a new pressure.

Sweeping changes to global banking regulation, due to be introduced next year, will increase the amount capital lenders are required to hold against loans secured on commercial property.

The combined pressure has led to a sharp drop in lending for property companies. Some of Europe's largest banks, including Eurohypo of Germany and France's Société Générale have even imposed moratoriums on writing new loans in certain countries, including the UK.

> 'We can now get on the front foot and actively look for opportunities in the eurozone'

As well as inner-European cross-border capital flows, investment in the continent's property market from Middle Eastern and Asian institutions has become more targeted.

The result of such narrow investment focus has been to create an ever-widening gap within Europe's once homogenous real estate markets.

Even within the strong economies of France, Germany and the UK, the division between the prime city markets and those in the regions has created two very distinct tiers.

Neil Turner, head of property fund management at Schroders, says: "While the focus on prime assets in northern Europe may be understandable, we believe that it could be storing up trouble for the future."

He says there can only ever be about 10-15 per cent of properties in the market that are genuinely prime.

Yet, and in spite of the difficulties stalking large swathes of Europe's property landscape, the world's largest investment funds think the worst case scenario has been avoided.

Sabina Kalyan, chief economist at CBRE Global Investors, says the concerted action of European governments and the continent's central bank have helped quell the doubts that have plagued property markets for the past two years.

"No longer do we have to do downsize scenarios about a Greek exit. We can now get on the front foot and actively look for opportunities in the eurozone and enter this arena for the first time in a year without macro risks hanging over our head," she says.

Global Property Insight

London swings to the beat of foreign drums

Residential

Overseas buyers are boosting the price of trophy assets, says *Ed Hammond*

Heading westward along the busy road from Buckingham Palace to Knightsbridge, drivers could be forgiven for failing to realise they are passing through the world's most hyperactive property market.

The imposing houses overlooking Hyde Park's southern fringe are impressive, but not noticeably different from thousands of similar sugar-white homes scattered across central London. However, one of the larger houses on the street has just gone on sale for £300m – more than double the previous record for the UK's most expensive residential property.

The property is unusual – the asking price demonstrates that. The 45 bedrooms, swimming pool, 10-car underground garage, three elevators, bullet-proofed windows and gold-leaf walls add to the notion of it being a bit more than a better-than-average family home.

But, perhaps the strangest thing of all, is that the price is not unrealistic.

At just over £4,200 a square foot, the 70,000 sq ft house is pretty much bang in line with the rest of the neighbourhood. Indeed, it looks reasonably cheap compared with the apartments at nearby One Hyde Park, which have fetched £6,500 per sq ft.

Knightsbridge is one of a handful of London districts where, during the financial crisis, house prices have decoupled entirely from the economic logic of the UK's real estate market. The soaring prices in London's prime property – the top 5 per cent of the market by value – have been driven by a single factor: foreign buyers.

Cash-rich housebuyers from around the globe have poured billions into the UK capital as they look for safe investments to protect their wealth. From Greek buyers trying to get money out of euro-denominated assets to Egyptian investors worried about how the future political topography of the Middle East might impact their wealth, London has become the destination of choice for wealth preservation.

Foreign purchasers spent £5.2bn on central London houses last year, £1.5bn more than in 2010, according to the think-tank IPPR.

Prime postcode property

During 2011 and the first half of 2012, 60 per cent of buyers in the prime central London market were overseas buyers, research from BNP Paribas shows.

Jon Neale, director of residential research at Jones Lang LaSalle, the property consultancy, says: "The market for individual second-hand sales is increasingly dominated by wealthy overseas investors who see a property in the city as a status symbol or long-term wealth preservation play, rather than an income-drive investment or shorter term hold. This makes it hard for more conventional investors to gain a foothold."

In an attempt to capture this torrent of money coming into the city's residential property market, developers are battling to add to the housing stock in the most coveted postcodes.

In the past year, a rash of large-scale housing projects has got under way, including the multimillion-pound redevelopment of Hyde Park Barracks. At the smaller end of the market, investors are converting commercial property into luxury apartment blocks.

EC Harris, the built asset consultancy, says there is £38bn of housing under construction or in planning in central London – all to be finished before 2021.

But, there are many who suspect the market is building into a bubble.

Edouard Fernandez, a principal at Wainbridge, the property investment firm, says many of the new developers coming to market have little or no experience of acquiring sites and creating property that can command up to £5,000 a sq ft.

"Although a handful of projects in the best locations of central London will be able to achieve these prices, it is our opinion that many of these developers will find their projects are not accepted by the continually more demanding ultimate buyers," he says.

> There is £38bn of new housing under construction or in planning in central London

London is also undergoing a revolution at the opposite end of the residential property spectrum.

A few miles east of the opulence of Hyde Park lie the ramshackle docks at Silvertown.

The 50-acre stretch of scrub that runs away from City Airport is set to be ploughed up and used as the foundation for 4,000 homes.

The scheme, to include a large slug of affordable housing, is one of a number of new-build projects close to the Olympic Park.

But, rather than just attracting interest from would-be homeowners, the residential property boom is luring institutional investors who believe a model that has been successful in continental Europe and the US for decades could finally find traction in the UK.

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Solace sought in bricks and mortar

Gulf investors Prime western real estate is seen as a low-risk investment, explains *Camilla Hall*

After the sting of the global financial crisis, the Gulf's sovereign wealth funds are finding a comfortable haven in developed market real estate, in the hope of earning both yield and security.

Qatar has emerged as the most public Gulf investor, snapping up Europe's headline-grabbing property assets. But other regional funds, such as those of Kuwait and Abu Dhabi, have remained active, albeit harder to detect.

After seeing tumbling stock market indices throughout the depths of the economic crisis, Gulf investors see prime western real estate as a low-risk investment that offers regular returns. In a move away from more complex financial instruments, the tangible nature of real estate is helping attract the region's biggest investors.

Qatar's purchases in the United Kingdom have ranged from Harrods, the London department store, to Credit Suisse's London office and the city's Shell centre. The gas-rich Gulf emirate has also spread its wings to Paris, the south of France and Sardinia, with further real estate acquisitions through its sovereign investment arms.

But the region's oldest sovereign funds, such as the Kuwait Investment Authority (KIA) and the Abu Dhabi Investment Authority, are not new to investing in property. Unlike the public purchases of Qatar, much of their assets have stayed under the radar in recent years, investing through consortiums or special purpose vehicles, into large-scale commercial real estate.

Some of their investments have been made public, such as Kuwait's recent acquisition of 1 Bunhill Row in the City of London, through its state-funded property investment vehicle St Martin's. The same Kuwait-backed fund also bought 60 Threadneedle Street, another central London property, in December.

Victoria Barbary, senior researcher at the Sovereign Investment Lab of Bocconi University in Milan says that, in the lead-up to the financial crisis, the sovereign investment arms of the Gulf started to stray from their original model of direct real estate investing by taking riskier bets on Reits and more complex real estate instruments.

Now, they are reverting to their original modus operandi after the losses they incurred on more complex instruments. "They're back to bricks and mortar."

Of course, the region's investment arms do still invest some of their real estate allocation into funds, particularly those aimed at emerging markets and Asian real estate where not all SWFs have the capacity to invest easily. Some of the more mature funds, such as the KIA, have stepped into emerging markets and are currently thought to be eyeing investment in China's real estate sector.

While the Abu Dhabi Investment Authority does not usually announce its real estate investments, the fund typically holds a minimum of 5-10 per cent of its portfolio in real estate at any time.

As a result of their age and development, the Gulf's sovereign wealth funds have different levels of expertise when it comes to buying real estate. But, in recent years, many have focused on boosting in-house real estate teams to improve investment capacity and become less reliant on external managers.

"Many funds have had a less than satisfactory experience with their investments and now there's certainly a drive to quality," says Nick Tolchard, head of the Middle East region for Invesco, the asset manager. "There's a lot more security in some of the prime real estate areas in the west."

In a move away from the typical hands-off investment approach of the Gulf sovereign funds, Qatar is now attempting to monetise its real estate purchases, with plans to turn some into hotels. It is capitalising on the Harrods brand to build a chain of international hotels. Although in other investment sectors the sovereign wealth funds remain more constrained, real estate has offered the freedom to seize opportunities as they arise.

That flexibility has also created competition. There are not that many trophy assets to buy in western Europe, so Gulf funds have to compete with other investors such as pensions funds and Asian sovereign wealth funds to winkle out long-term property owners.

Current owners have limited options to park their own funds, so can be reluctant to sell, developers say.

Ms Barbary says: "They're going to have to think about it a bit more out of the box. There's only so much space in central London." With so much interest in trophy property from overseas, funds risk driving prices up.

Despite that, they continue to vie for western commercial real estate because of the demand for both yield and security.

Mr Tolchard says: "What we're seeing is less investing into securitised assets, but a desire to invest in real assets and real estate is an example of that."

Centre stage: Qatar has purchased the Shell building on London's South Bank

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Sector still a good bet for those in the know

China

Foreign developers seek greater access to a still strong commercial sector, says *Paul J Davies*

Plans by Zhang Yue, the inventive and ambitious air-conditioner entrepreneur, to build the world's tallest skyscraper in record time out of prefabricated blocks seems to many like just one more sign of madness in China's property bubble.

The real estate sector has been seen widely as the monster created by Beijing's huge financial stimulus package in the wake of the western financial crisis of 2008. The residential sector especially saw fierce speculation drive prices rapidly higher and led the government to clamp down hard on lending.

But predictions of a greater bust are becoming rarer.

For all the concern about the direction of the Chinese economy, overall, growth of 7 to 8 per cent still offers better reasons to invest than in most other countries, in commercial property at least.

David Hand of Jones Lang LaSalle in Beijing says: "The commercial sector, broadly speaking, is still very strong. We have seen good rental gains and capital gains across tier one cities such as Beijing, Shanghai and Guangzhou."

New office blocks are an attractive bet in many cities, say some analysts, while retail space especially should be a very strong area, given the Chinese government's determination to promote consumer spending to rebalance the economy and with the growth in retail sales overall still running at 13-14 per cent.

For foreign developers, however, there remain multiple difficulties to becoming involved in building and owning new projects.

Mr Hand, for example, says it has become much more difficult in recent years and, while the government is not actively discouraging foreign investment in developing property, it is certainly not encouraging it either.

"Five or 10 years ago, the government was really encouraging foreign involvement," Mr Hand says.

Constructing profit: China's economy still growing Bloomberg

"In both residential and commercial property, foreigners were bringing in capital and knowhow – in terms of planning, what to build and how to build it, how to get the highest and best use of a site, and management of the project once it was under way.

"The local developers have absorbed all that very quickly."

That kind of "technology transfer" has, of course, been happening in all industries. But others disagree that it is finished yet in property. Simon Baxter of consultants EC Harris, which has offices in Beijing, Shanghai and Guangzhou, says local developers still need help with assessing and planning projects.

> It is still difficult for outsiders to move quickly enough in many cases

He says that in some cities – particularly those that have districts in competition with each other – retail space can end up being overbuilt, with the same seven-storey "podiums" ending up only half full.

"If developers start using international methods for calculating commercial demand they could see quickly that they don't always need floors four to seven. So there is still a need for that 'software'."

Michael Tam, a Hong Kong-based lawyer for Berwin Leighton Paisner, agrees up to a point, saying that, while the local developers need no help in construction methods or project management, they can still fall short on commercial planning and viability. This is especially true of those who have done well in residential and then tried to expand into commercial.

"For example, you get a 50-storey office block that only has four elevator shafts," he says. "That is never going to work and it risks becoming a white elephant."

But, even where there is a need for foreign input, it is still difficult for outsiders to move quickly enough in many cases. They often take longer to do due diligence on a project and this means they will lose out to locals who are more familiar with the market and, at times, less concerned about the same issues.

Mr Tam says that the first few projects a foreign developer looks at, they will almost certainly fail to get into because of this – "unless they are exceptionally brave".

But, while the bureaucratic processes can be painful, Mr Hand says that this can be quicker and easier in second or third tier cities, which do not have so much development work completed or under way.

Funds look to the longer term

Investment

Prime assets offer global benefits, writes *Alistair Gray*

From social housing to shopping centres, property developments across the globe have benefited from increasing interest from insurance companies and pension funds.

Spurred by macroeconomic and regulatory forces, these sources of long-term funding have become a more important source of investment for the real estate sector.

They are looking for ways to boost investment returns in the low-interest rate environment and are supplying capital in various ways, says Jörg Schürmann, corporate finance managing director at Jones Lang LaSalle. These include: as direct investors into property assets; as equity investors in funds or joint ventures; or as debt providers.

A survey this year by Goldman Sachs Asset Management shows more than a third of insurers globally are planning to increase their allocations to property over the next 12 months.

The survey covered 152 of the world's largest insurers, which control almost $4tn of assets.

Property "can provide portfolio diversification away from volatile public credit and equity, and the longer-term nature of the cash flow profile may also appeal", the survey noted.

Recent examples include funding that Allianz provided for the refurbishment of Deutsche Bank's headquarters in Frankfurt to a loan that Legal & General made to Unite, the UK's largest developer and manager of student housing.

This new interest comes amid a retrenchment by banks. They have been left overexposed to the sector and the new global Basel III regulatory standards are set to force them to allocate more capital to loans secured against real estate.

Richard Merryweather, the head of UK investment at Savills, says: "In a market where there is considerably less debt than we have seen for several decades, equity-rich investors – such as pension funds – have become substantially more important.

"Their relative importance in the current market is increasingly due to their consistent activity in the absence of private, highly-geared investors that were substantially more prominent in the boom times."

> The increased interest in the sector comes from a low base

All of which raises the question of how they will affect the industry differently from banks and traditional short-term investors.

Property experts caution that the interest of long-term sources of capital is not necessarily across-the-board and they are keen on lending to certain property types – those that yield steady, long-term returns to match their liabilities.

Mr Schürmann says: "Segments fulfilling these criteria are likely to become less volatile, because of the buy and hold strategy of insurers and pension funds. But don't expect insurers and pension funds to invest other than in prime assets in core and developed markets".

Referring to recent property deals by pension funds and insurers in the UK, Jane Hollinshead, head of property at Addleshaw Goddard, a law firm, says: "It is no coincidence that the L&G deal was in the student accommodation sector."

Moreover, the increased interest in the sector comes from a low base. Property accounts for only about 4 per cent of insurers' total investment portfolios, a survey by BlackRock this year found.

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Investors buy into landmark buildings' brands

Trophy assets

Middle East interest is just the tip of the sand dune, writes *Ed Hammond*

In July this year, a small group of Italian businessmen gathered in a private boardroom at the Ritz Hotel in London. Over two days of back-to-back meetings, they tried to persuade London's hard-nosed investors to buy into a fund that was concerned only with a very particular type of property: trophy buildings.

The proposition by Sorgente, the Italian real estate company, is a simple one: if a building has a strong enough brand, it will hold value better than lesser known properties around it.

Although it sounds like a marketing gimmick, the family-controlled company has turned the hunt for trophy buildings into a multi-billion-euro business.

Stefano Cervone, director-general of Sorgente, explains: "These assets are more liquid than a lot of others on the market, as they attract a global investor and will always command a premium to other top grade property." Sorgente owns some of the world's best known properties, including the Flatiron building in New York.

The company is keen to replicate its success at home and in the US, by launching a £1.6bn fund for buying up some of the standout buildings on skylines across Europe. "Tenants also want to remain in these type of buildings, as they become attached to the property and want their company to be associated with it," adds Mr Cervone.

The value-retaining qualities of trophy buildings have positioned them among a small number of haven investments within the property sector. In London, Paris, Hong Kong, New York and Rome, real estate investors are willing to pay a premium for those rare buildings that are likely to float above the economic maelstrom that is draining value from the mainstream property market.

However, while European and US investors are attracted to trophy assets for their stability, it is the large Middle Eastern and Asian sovereign wealth and family investment funds that have started to corner the market.

There is no better example of this trend than the Shard skyscraper in London. The 310m glass spire rises above London like a symbol of defiance at the economic turmoil beneath.

However, the project, now the tallest building in the EU, very nearly came unstuck. At the start of 2008, when construction finance dried up, it took a last-minute deal with a consortium of Qatari investors to swap an 80 per cent stake of the Shard for £150m to keep it going.

> 'Trophy assets are tangible assets with fixed returns and a good hedge against inflation'

In every big city in the world, there are examples of large, often government-backed funds, buying up buildings that have become brands in their own right.

"Sovereign funds from the Middle East are, of course, driven commercially – but also politically," says Nick Maclean, managing director for CBRE, the property consultancy, in the Middle East.

"The opportunity to gain influence or a higher national profile, while enjoying capital appreciation and income flows, makes real estate investment – not just in trophy assets – compelling," he adds.

But Yahya Abdulla, head of capital markets for Cushman & Wakefield in the Middle East, says that there is much more to come from the region in terms of cross-border property investment.

"Without having the same returns criteria, lifespan or cost of capital of large real estate funds, these organisations will seek to increase their portfolio, only making an exit once a compelling and perhaps strategic opportunity arises. We have perhaps only seen 'the tip of the sand dune'," he says

In many ways, the flight to trophy buildings is no different from investors turning to other secure real estate assets, such as student housing and government offices.

However, those companies specialising in trading the most distinctive buildings in the world argue that these hold their value through downturns and, crucially, outperform during the boom years.

But there is a limited supply, and industry observers are warning that this thin slice of the market might already be overpriced.

Mike Pope, senior city investment director at BNP Paribas Real Estate, comments: "Trophy assets are tangible assets with fixed returns and act as a good hedge against inflation.

"The real money, however," he adds, "is potentially in the less glamorous buildings.

"These, in due course, could become a focus for UK institutions as well as traditional buyers as opportunities start to open up."

London's Shard was made possible by Qatari finance Getty

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