Asia’s commercial real estate markets had become increasingly volatile long before China’s equity markets wobbled in late summer 2015. Indeed, deal flow in 2014 was down 24 percent compared to a year earlier, while in the first half of 2015, transaction volume fell $159B, or 41 percent, according to data provider Real Capital Analytics, the latter driven by a two-thirds fall in development site acquisitions as well as 30-percent-plus declines in office, industrial, and hotel deals.
As value recovery took hold in the U.S. and Europe, it seemed many investors turned their attention away from Asia.

Yet in the wake of rising volatility and falling transaction volume, managers and institutional investors are beginning to refocus their attention on Asia as short-term opportunities re-emerge alongside the longer-term growth stories of the region.

“Asia is going through a transitional process,” says Prudential Real Estate Investors’ head of Asia Pacific, Benett Theseira. “It’s had many years of strong growth, [but] it’s actually good that there is some element of correction or headwind in the markets, because it creates opportunities. It brings values to a much more rational level.”

And those opportunities are coming across the risk spectrum, he adds, as well as across different countries.

“Asia offers both long-term and short-term opportunities,” says Theseira, who leads PREI’s $4.7B Asia portfolio, which is invested in six countries, predominantly in the core and value-added space and across all the property food groups.

“In general, based on the long-term fundamentals of the region, we advocate a long-term hold—particularly for core assets. But apart from that, because of the growth of the markets, which creates some volatility, there are great opportunities for short-term [investments].”

Seeing a plethora of opportunities is a view shared, in part, by Townsend Group principal Prashant Tewari, who leads global investment strategy for the Cleveland, Ohio-based investment manager.

“There is growing interest in our client base in Asia real estate,” says Tewari, who believes that in “years to come, Asian real estate is going to gain increasing prominence in our client portfolio.”

Townsend is focused on value-added, repositioning opportunities in the region, not least in India, where the firm—alongside a sovereign wealth fund—recently invested in a senior-secured lending platform for condo developments. However, Tewari thinks it’s important to understand the unique elements of each country’s economy and how uncorrelated the Asia region is as a whole before investing.

“In the developed markets of Japan and Australia, Japan has a stagnant growth outlook, while Australia has a healthy growth outlook,” says Tewari. “On the contrary, when you look at the emerging economies of China and India, in India you have a high growth rate that is accelerating, and China, up until now, had an even higher growth rate. This lack of correlation among the economies in one given region is a little unprecedented.”

For Theseira, such a lack of correlation among Asian economies and real estate markets means execution is key to the success of any investment strategy.

“Asia is a complex market,” says Theseira, who argues that boots on the ground is part of any successful deal execution. “There are different markets and different cultures, and relationships are important. In order to be successful you need to have a local presence, you need to have people that are either local or have a great understanding of the local culture.”

But just being able to read a market or pick a good asset isn’t enough, Theseira continues.

“Execution is key. In many cases, the level of asset management execution in the Asian markets is fairly weak, and so our ability to work with development partners or joint venture partners, bring in quality standards, or a much more developed approach to real estate asset management – I think that adds a lot of value.”

Tewari agrees, saying that it’s not just boots on the ground that ensures success, but also a robust investment strategy and asset selection.

“I wouldn’t want to say one is more important than the other, but if you have a stack of cards and you pull one out, the rest of the tower...
“Asia is going through a transitional process. It’s had many years of strong growth, [but] it’s actually good that there is some element of correction or headwind in the markets, because it creates opportunities.”

Benett Theseira, Prudential Real Estate Investors

falls down,” Tewari says. “So each one is really important, especially in a region like Asia. It’s very important to have the right asset, it’s very important to have that asset located in the right location, and it’s also very important to have the right partner that you want to work with.”

And when it comes to location and assets, both Theseira and Tewari agree there are plenty to choose from in Asia, depending on the investor’s risk appetite.

On a short-term basis, Theseira says the next six to 12 months will generate good buying opportunities in China, thanks to the recent equity market volatility and government attempts to cool down property markets—particularly when set against the country’s long-term growth story.

“We see a lot of supply issues in various cities, including in the second- and third-tier cities that have caused a lot of headwinds in the market,” Theseira explains.

Theseira also sees retail as one of the most attractive food groups across Asia today, fueled by strong consumption and demographic trends. “With the suburban malls, you find these assets are very resilient, because they are based on necessity shopping, targeted local consumers, and they’re able to ride through different economic cycles, owing to the nature of the consumer and the product [the malls] cater to,” he says.

Australia is on the radar of both Theseira and Tewari, with the Townsend principal saying people often lose sight of the country’s high population growth. “If you look back, Australian real estate has outperformed most of the other regions, and there’s no reason to believe that a lot of that wouldn’t continue in the future.”

But even countries with slower population growth, such as Japan, offer opportunities for investors.

“Even in these developed parts of Asia, there are real estate sectors that are emerging,” Tewari notes. “We’re doing a lot of work in senior housing in Japan. We’re looking at student housing in Australia. We’ve made a recent investment in self-storage in Singapore. So even within developed Asia, there are emerging [property sectors] that provide outsized returns to investors.”

A build-to-core strategy is another part of the equation in developed countries, with Tewari saying that while Townsend currently doesn’t like core income properties, “we like to build to core in these [developed] markets... Because core is in such short supply in these markets, you have a very healthy demand for core assets, primarily from local investors.”

Theseira echoes Tewari’s comments: “The reason for going to development is all about the long-term opportunity in Asia and the growth of core real estate... And over time, we do see a lot of potential in the region’s markets, thanks to their long term growth.”
Disclaimer

IMPORTANT INFORMATION — Prudential Real Estate Investors
Prudential Investment Management is the primary asset management business of Prudential Financial, Inc. Prudential Real Estate Investors is Prudential Investment Management’s real estate investment advisory business and operates through Prudential Investment Management, Inc. (PIM), a registered investment advisor. Prudential, the Prudential logo and the Rock symbol are service marks of Prudential Financial, Inc. and its related entities, registered in many jurisdictions worldwide.

These materials represent the views, opinions and recommendations of the author(s) regarding the economic conditions, asset classes, securities, issuers or financial instruments referenced herein. Distribution of this information to any person other than the person to whom it was originally delivered and to such person’s advisers is unauthorized, and any reproduction of these materials, in whole or in part, or the divulgence of any of the contents hereof, without prior consent of Prudential Real Estate Investors is prohibited. Certain information contained herein has been obtained from sources that PREI believes to be reliable as of the date presented; however, PREI cannot guarantee the accuracy of such information, assure its completeness, or warrant such information will not be changed. The information contained herein is current as of the date of issuance (or such earlier date as referenced herein) and is subject to change without notice. PREI has no obligation to update any or all of such information; nor do we make any express or implied warranties or representations as to the completeness or accuracy or accept responsibility for errors. These materials are not intended as an offer or solicitation with respect to the purchase or sale of any security or other financial instrument or any investment management services and should not be used as the basis for any investment decision. Past performance is no guarantee or reliable indicator of future results. No liability whatsoever is accepted for any loss (whether direct, indirect, or consequential) that may arise from any use of the information contained in or derived from this report. PREI and its affiliates may make investment decisions that are inconsistent with the recommendations or views expressed herein, including for proprietary accounts of PREI or its affiliates.

The opinions and recommendations herein do not take into account individual client circumstances, objectives, or needs and are not intended as recommendations of particular securities, financial instruments or strategies to particular clients or prospects. No determination has been made regarding the suitability of any securities, financial instruments or strategies for particular clients or prospects. For any securities or financial instruments mentioned herein, the recipient(s) of this report must make its own independent decisions.

Conflicts of Interest: Key research team staff may be participating voting members of certain PREI fund and/or product investment committees with respect to decisions made on underlying investments or transactions. In addition, research personnel may receive incentive compensation based upon the overall performance of the organization itself and certain investment funds or products. At the date of issue, PREI and/or affiliates may be buying, selling, or holding significant positions in real estate, including publicly traded real estate securities. PREI affiliates may develop and publish research that is independent of, and different than, the recommendations contained herein. PREI personnel other than the author(s), such as sales, marketing and trading personnel, may provide oral or written market commentary or ideas to PREI’s clients or prospects or proprietary investment ideas that differ from the views expressed herein. Additional information regarding actual and potential conflicts of interest is available in Part II of PIM’s Form ADV.

Townsend Group
The views of Townsend Holdings LLC are as of the date of this publication and may be changed or modified at any time and without notice and should not be construed as investment advice or an offer or solicitation for the purchase or sale of any financial instrument. This document may contain statements that constitute “forward looking statements.” While these statements may represent the judgment and future expectations of Townsend, a number of uncertainties and other important factors could cause actual developments and results to differ materially from the expectations of Townsend.