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Why Asian outbound investment is here to stay



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CBRE's latest biannual analysis of Asian outbound investment provides some compelling new insights into the deployment of regional capital into offshore real estate.

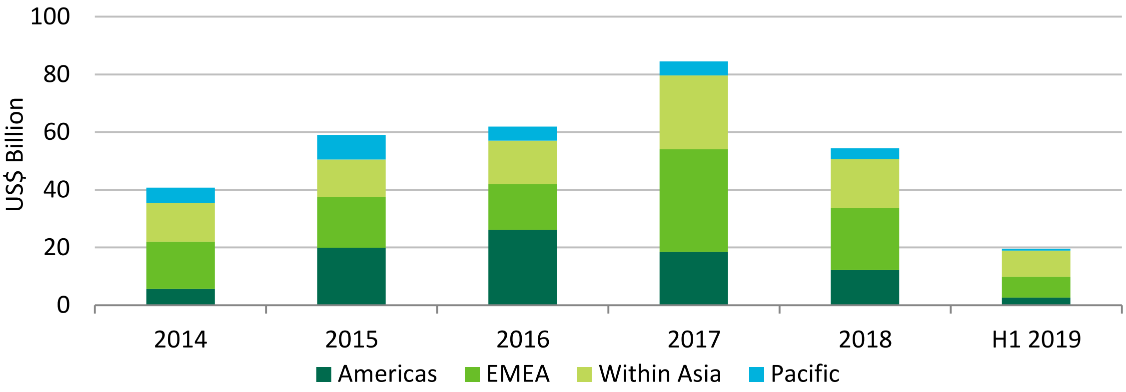
While a cursory glance at capital flows suggests a prolonged slowdown in activity, due mainly to mainland Chinese investors becoming net sellers and rebalancing portfolios, CBRE believes lower interest rates and historically low regional yield means Asian outbound investment is here to stay.

Asian investors are set to further diversify their real estate holdings within the region and globally. CBRE recommends investors adopt a holistic approach; carefully assess portfolio allocations; understand demand and supply dynamics in individual markets (rather than looking at yield compared to their country of origin); and create a fluid combination of different routes into real estate such as investing in foreign real estate funds and partnering with local groups.

A new pecking order takes shape

While headline figures indicate that the overall flow of Asian outbound capital continues to weaken, falling by 25% y-o-y to US 19.6 billion in H1 2019 (Figure 1), a closer examination reveals the emergence of important new sources of capital and an uptick in investment in certain geographies.

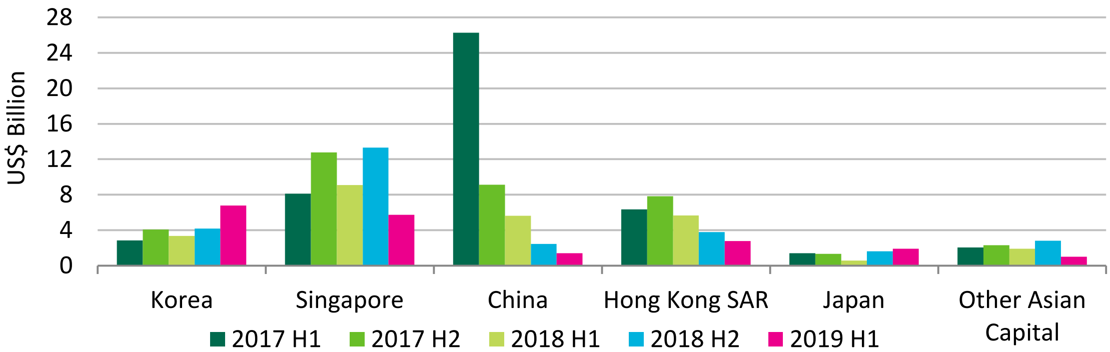
Figure 1: Asian outbound investment by year and destination



Note: Transactions include deals in the Office, Retail, Mixed, Industrial, Hotel, Residential and Other commercial sectors. Development sites are excluded. GLP privatization deal is excluded.
Source: RCA, CBRE Research, August 2019.

In particular, overseas investment by Korean investors strengthened noticeably in the first six months of 2019, somewhat offsetting the continued decline in investment from mainland Chinese investors and Hong Kong-based investors (Figure 2).

Figure 2: Asian outbound investment by source of capital



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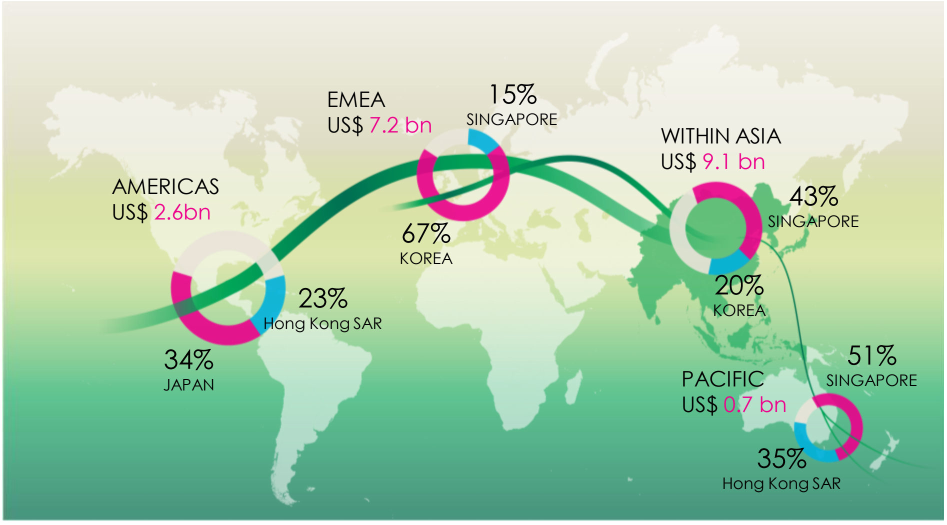
Hong Kong SAR stands for Hong Kong Special Administrative Region
Source: RCA, CBRE Research, August 2019.

Korean investors comprised the largest source of outbound capital in H1 2019, completing US$ 6.8 billion worth of overseas transactions. US$4.8 billion of this total was in Europe, a figure more than double that two years previously.

Outbound investment by Korean groups has risen steadily in recent years, underpinned by purchasing in mature and developed markets by experienced groups, led by major pension funds including the Korea National Pension Service seeking to diversify and hedge the Korean Won, particularly in the Eurozone.

More recently, CBRE has noted a significant uptick in acquisitions by Korean asset management and securities companies purchasing office properties in major gateway cities in Europe such as Paris, Amsterdam and across Germany, a trend that ensured Korean capital accounted for the bulk of Asian outbound investment in EMEA in H1 2019 (Figure 3).

Figure 3: Asian cross-border investment by source of capital in H1 2019



Note: Transactions include deals in the Office, Retail, Mixed, Industrial, Hotel, Residential and Other commercial sectors. Development sites are excluded. GLP privatization deal is excluded.
Hong Kong SAR stands for Hong Kong Special Administrative Region
Source: RCA, CBRE Research, August 2019.

CBRE expects outbound investment by Korean buyers to continue in the coming quarters due to the attractive returns available overseas as a result of higher yield and the positive hedging environment. Selected groups will continue to increase their property holdings in the capital cities of smaller European markets such as Ireland, Poland and Czech Republic in search of even higher cash returns.

Singapore accounted for the second largest source of outbound capital in H1 2019, with buyers from this market completing US$ 5.7 billion worth of transactions, mainly for office and logistics properties. Selected groups are also adding multifamily assets to their portfolios.

While this figure represented a decline of more than 50% from H2 2018, CBRE has observed continued strong demand from Singaporean buyers seeking opportunities in mature economies, particularly cities in the U.S. and Western Europe. As with Korean investors, there is also a growing willingness among Singaporean buyers to pursue opportunities in major cities in smaller European markets, especially in the logistics sector.

Purchasers from Singapore also turned more active within Asia during the first six months of the year, accounting for 43% of transaction volume. This pushed up cross-border investment volume within Asia to US$ 9.1 billion in H1 2019, an increase on the US$ 8.6 billion of deals completed in H1 2018. The percentage of total cross-border investment in Asia rose to 47% in H1 2019 from 33% in the same period last year, indicating that Asian investors are returning to their home region to seek structural opportunities (e.g. logistics and multifamily) as well as defensive assets (e.g. offices). Transaction volume in all other regions declined over the same period.

Although purchasing by Hong Kong-based capital declined for the fourth consecutive half yearly period to US$ 2.6 billion in H1 2019, CBRE continues to observe strong demand from Hong Kong-based investors, particularly for prime assets in Sydney, Melbourne and London.

London has seen substantially weaker interest from Asian investors compared to a year ago when it accounted for 24% of transaction volume, largely due to fears around Brexit and the general trend among Asian investors to consider a broader range of locations (Table 1).

Nevertheless, Hong Kong-based investors retain a keen interest in London, particularly offices in core areas due to solid leasing momentum; the availability of freehold land title; and comparatively low taxes and looser investment regulations compared to other major markets.

The recent weakness in the pound provides an added incentive for Hong Kong capital to seek opportunities in the UK. CBRE expects there to be an uptick in transaction activity post a Brexit resolution.

Key sources of capital from Hong Kong at present include high net worth individuals and family offices seeking portfolio diversification. Corporations have been quiet although some developers are utilising private family vehicles to purchase assets overseas.

Table 1: Top five destination by Asian capital (H1 2018 vs H1 2019)

H1 2018		H1 2019	
City	City share	City	City share
London	24%	Paris	9%
Hong Kong SAR	16%	Tokyo	9%
Singapore	3%	Shanghai	8%
Sydney	3%	Singapore	7%
Shanghai	2%	Seoul	5%

Note: Transactions include deals in the Office, Retail, Mixed, Industrial, Hotel, Residential and Other commercial sectors. Development sites are excluded. GLP privatization deal is excluded.
Hong Kong SAR stands for Hong Kong Special Administrative Region
Source: RCA, CBRE Research, August 2019.

Outbound investment from Japan has been subdued in recent years but CBRE has seen an uptick in activity since the Government Pension Investment Fund (GPIF) awarded its first global real estate mandate in 2018 as part of a wider push into alternative investments. Outbound investment from Japan rose for the third consecutive half yearly period in H1 2019, to US$1.9 billion.

Unlike Korean investors, who prefer direct investment, Japanese institutions continue to opt for indirect channels by investing overseas through funds. Examples include the Local Government Officials Pension Fund Association, which recently appointed Asset Management One to its foreign real estate investment mandate. More Japanese groups, especially banking and financial companies, are also engaging in real estate debt investment. Japanese real estate companies turned more active in the U.S. in H1 2019 and are expected to continue to see direct real estate investment opportunities.

Most Japanese buyers are focusing on mature and transparent markets such as the U.S., UK, Germany, France and Australia. Corporates seeking acquisitions for self-use and investment are concentrating on mixed-use development projects in emerging Southeast Asian markets including Indonesia and Vietnam.

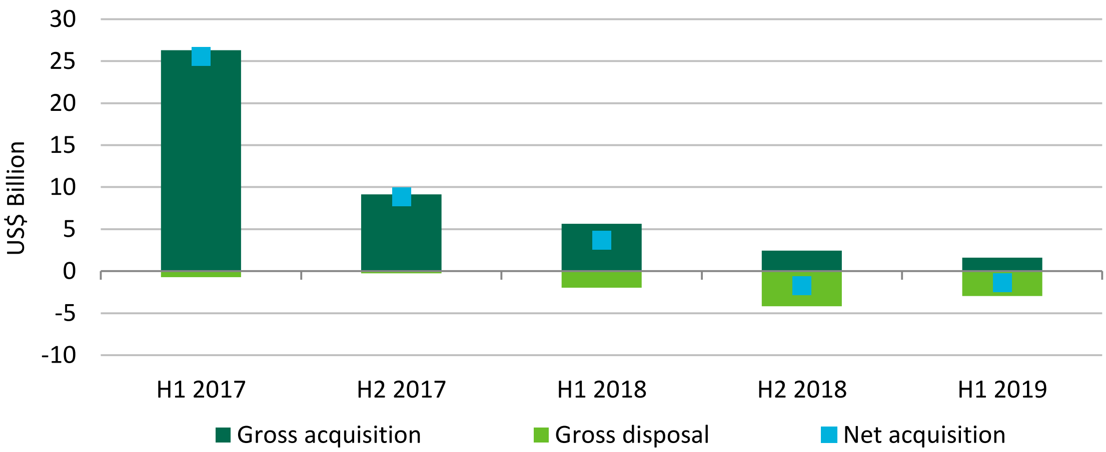
Other key sources of Asian outbound capital at present include Taiwan-based investors, with CBRE recently observing several major institutional buyers deploying capital into co-mingled funds for investment in overseas markets.

Mainland Chinese investors remain net sellers

Purchasing by mainland Chinese buyers continued to weaken in H1 2019, with just US$1.4 billion worth of transactions completed during the period, less than a third of that a year previously and the lowest half yearly total for several years.

The period continued to see large-scale disposals by major mainland Chinese conglomerates and insurance companies offloading assets in major markets including London, New York and Vancouver, ensuring these sources of capital remained net sellers (Figure 4). However, it should be noted that many of these groups made considerable returns on their investments during their holding period.

Figure 4: Gross acquisitions and disposals by mainland Chinese investors



Note: Net acquisition = gross acquisition – gross disposal. Transactions include deals in the Office, Retail, Mixed, Industrial, Hotel, Residential and Other commercial sectors. Development sites are excluded. GLP privatization deal is excluded.
Source: RCA, CBRE Research, August 2019.

With capital controls still in place, CBRE expects mainland Chinese investors to remain net sellers. Purchasing will be led by a limited group of investors including sovereign wealth funds such as China Investment Corporation and the State Administration of Foreign Exchange and corporates acquiring assets overseas for self-use, particularly in markets participating in the Belt & Road initiative. Overseas-listed companies whose primary business is real estate, such as mainland Chinese developers listed in Hong Kong, will also be active in investing capital overseas. Their focus has recently shifted towards smaller-sized stabilised assets and commercial development opportunities with their partners.

Mainland Chinese institutional investors will be restricted from investing directly or indirectly in overseas real estate, while groups whose core business is not real estate will continue to be prohibited from purchasing overseas property for investment.

Conclusion: Embrace holistic investment strategies

CBRE's analysis continues to underscore the fact that capital flows vary considerably from market to market and that investors from Asia possess a broad range of motivations, strategies and options to deploy their resources. While Asian capital appears at first glance to be homogenous, it is in fact very nuanced.

With lower interest rates on the horizon, regional yield at historical lows and the limited availability of core assets in the region providing long-term income streams, CBRE expects Asian investors to continue to look for higher yield spread between real estate and long-term government bonds and rebalance their property holdings across more diverse portfolios in the coming quarters, seeking opportunities beyond their home markets in regional and global locations.

Gateway cities in Europe will remain the major focus due to the current extraordinary low government bond yield environment, with more than half of European government bonds having negative yield. Purchasing will be led by Korean, Japanese and Singaporean buyers. Hong Kong-based investors are shrewd property buyers and were among the first movers into global real estate. Given the current low yield environment in their local market, Hong Kong-based investors will continue to invest overseas, especially in the UK. Mainland Chinese groups will remain net sellers.

In terms of property type, offices will remain keenly sought after, although more investors will be seeking to increase their exposure to assets benefitting from ongoing structural change, such as logistics.

Other emerging areas of interest include multifamily and data centres, although activity thus far has been confined to Singaporean groups. Most interested parties in these sectors lack operational experience and will therefore pursue partnerships or seek platform transactions allowing them to achieve scale and expertise.

Although foreign exchange volatility is a growing concern amid the interest rate downward cycle, CBRE advises Asian investors to focus on underlying market and asset fundamentals. Long-term investors will be less reliant on currency hedging as their returns are largely sourced from rental income streams over time. The mean-reverting nature of exchange rates under the purchasing power parity relationship should ensure the effect of exchange rate fluctuations balances out during the investment period.

Above all, CBRE recommends Asian outbound investors adopt a holistic approach by carefully examining portfolio allocations to create a fluid combination of different direct and indirect channels into real estate.

Investors with direct investments in core properties should also consider going indirect through funds, which can aid the creation of diverse, blended and defensive portfolios capturing alpha returns, or enter partnerships and seek platform deals enabling them to build scale within a relatively short period of time.

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This report was prepared by CBRE APAC/EMEA Research Team, which forms part of CBRE Global Research – a network of preeminent researchers who collaborate to provide real estate market research and econometric forecasting to real estate investors and occupiers around the globe.

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