# AN EXPANDING HORIZON

## Chinese Capital Tapping into Overseas Real Estate Markets

**2013**

**GLOBAL RESEARCH & CONSULTING**

CBRE

# EXECUTIVE SUMMARY

- In recent years, Chinese individual investors, property developers and institutional investors have increased investment in overseas real estate markets. This trend has been driven, in our view, by several factors including limited investment channels in China, abundant liquidity, RMB appreciation and the relatively lower valuation of overseas assets in the years following the 2008 financial crisis.

- Individual investors from China have been particularly active in overseas real estate markets in recent years, extending their primary objectives from immigration and the education of their children to wealth preservation and creation. By contrast, the involvement of Chinese real estate enterprises in overseas real estate markets is still in its preliminary stage, with most looking to broaden their financing channels, to gain knowledge, experience and know-how from their overseas counterparts. Well-capitalized Chinese Sovereign Wealth Funds (SWFs) have initiated capital allocation to real estate investment in their attempt to generate both capital gains and long-term stable rental income from undervalued core property assets overseas.

- Domestic insurance institutions possess abundant and long-term capital with relatively lower return expectation and have been permitted to invest overseas as well as conduct direct real estate investments since late 2012. We therefore expect Chinese insurance companies to emerge as a major new buying force in overseas real estate markets in the near term.

- Yet there are still a number of risks related to overseas investment allocation of Chinese capital. These include unfamiliarity with overseas markets, lack of experience in overseas property investment and asset management, fluctuating exchange rates and possible policy changes. Other challenges include how to time the closure of deals in the current competitive market, how to determine investment horizons, how to optimize transaction structures and identify appropriate financing arrangements.

# INTRODUCTION

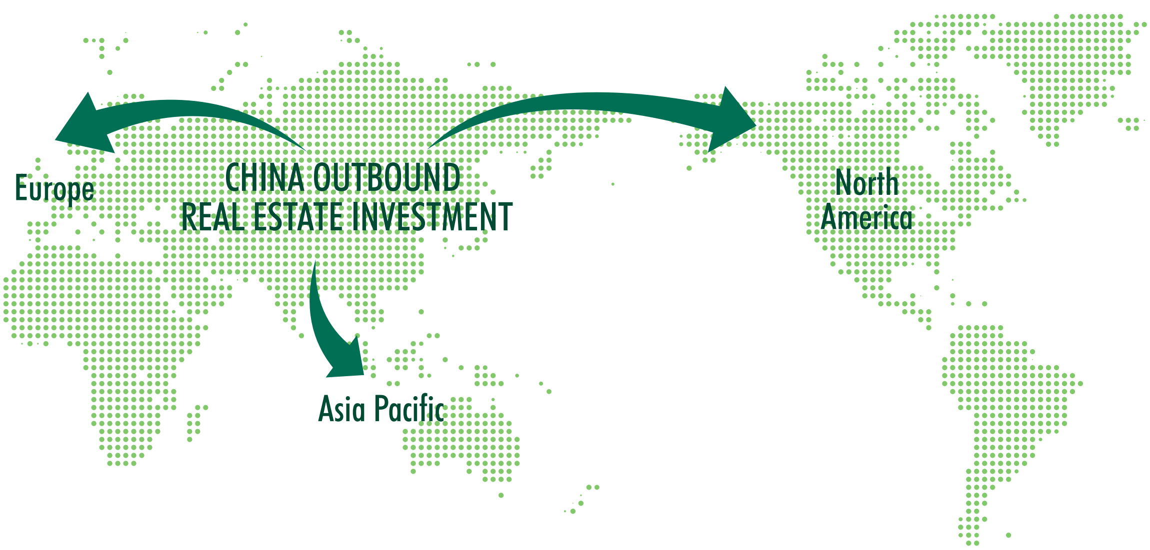
The Chinese economy enjoyed remarkable CAGR growth of 9.8% between 1978 and 2012, a figure 6 percentage points higher than the average global growth rate during the same period. China's GDP stood at USD8.2 trillion in 2012, making it the world's second largest economy after the United States. This strong economic growth has driven an increase in the size of the real estate market and the volume of investable assets for institutional investors. Such conditions have promoted direct investment in the real estate sector and the development of other real estate investment channels.

China's rapid urbanization and its government-led large-scale investment plan launched in 2008 have resulted in an upsurge in real estate investment and development. The large increase in the price of land and expanding demand for property consumption and investment has led to soaring property prices. As a result, the government has launched a series of measures to curb domestic real estate speculation, especially in the residential sector.

Whilst tighter credit conditions, strict regulations and pressure from short term oversupply have increased the investment risk in the domestic real estate market, sentiment towards outbound real estate investment has risen steadily encouraged by the gradual easing of global credit conditions, RMB appreciation, rising demand from wealthy Chinese - particularly High-Net-Worth Individuals (HNWIs) - looking for immigration and wealth preservation, and the increasing volume of investable capital in China. Investing in real estate assets overseas has therefore emerged as a preferred strategy among Chinese individuals and institutional investors. At the same time, a number of domestic real estate enterprises have begun to enter foreign markets seeking broader investment channels and other strategic alternatives to the Chinese market.

This report was compiled via research into Chinese individuals, enterprises (mainly real estate development enterprises) and institutional investors with the aims of:

- Ascertaining and measuring the extent of Chinese capital investment in overseas real estate markets;
- Analyzing the motivations behind these groups' decisions to invest in overseas real estate markets and their investment considerations;
- Providing suggestions and advice on risks, opportunities and challenges that Chinese outbound investors are likely to face in overseas real estate markets.



# THE OUTFLOW OF CHINESE CAPITAL

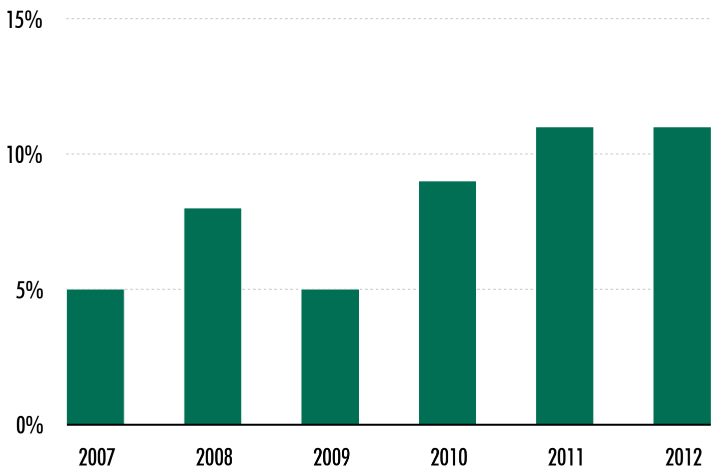
Chinese capital is an increasingly visible presence in overseas property markets. However, the precise volume of invested and incoming Chinese investable capital in overseas real estate markets remains difficult to ascertain.

## Individual Investors

The 2013 China Private Wealth Report released by China Merchants Bank and Bain & Company reports that the total investable assets held by Chinese individuals amounted to RMB 80 trillion in 2012, twice as high as 2008's figure. Investable assets of Chinese individuals witnessed particularly rapid growth from 2008 to 2010 with CAGR growth of 28%. Although growth slowed to 14% between 2010 and 2012, it still remained in double-digit. By 2012 there were over 700,000 HNWIs in China with investable assets of over RMB 10 million. Their investable assets per capita were approximately RMB 31 million and they held investable assets worth a total of RMB 22 trillion. Given the current asset scale, investment preferences and tendencies of HNWIs, CBRE Research estimates that approximately 5% of their investable assets are to be allocated to overseas real estate markets.

Although China has not yet begun to track specific transaction information regarding individual investors in overseas property markets, the size of this group of investors is growing rapidly. According to National Association of REALTORS statistics published in 2012, 11% (rising from 5% in 2007) of overseas buyers purchasing private houses in the United States that year were Chinese individual investors[1]. Investors from China spent a total of USD 9.08 billion in 2012 and were the second largest group of investors after Canadians (Exhibit 1). According to Hong Kong Centaline Property statistics[2], individual investors from China accounted for 51% of transactions in the Hong Kong primary residential market in Q3 2011, a proportion that later declined and stabilized at around 35% in subsequent quarters. Since the second half of 2012, when the Hong Kong government introduced an additional stamp duty and implemented a buyers stamp duty on purchases by non-permanent residents, the number of investors from China began to decline significantly. Even so, buyers from China still accounted for 17% of overall private residential transactions (including in both the primary and secondary market) in 2012.

**Exhibit 1: Chinese as A Percentage of Foreign Home Buyers in the US**



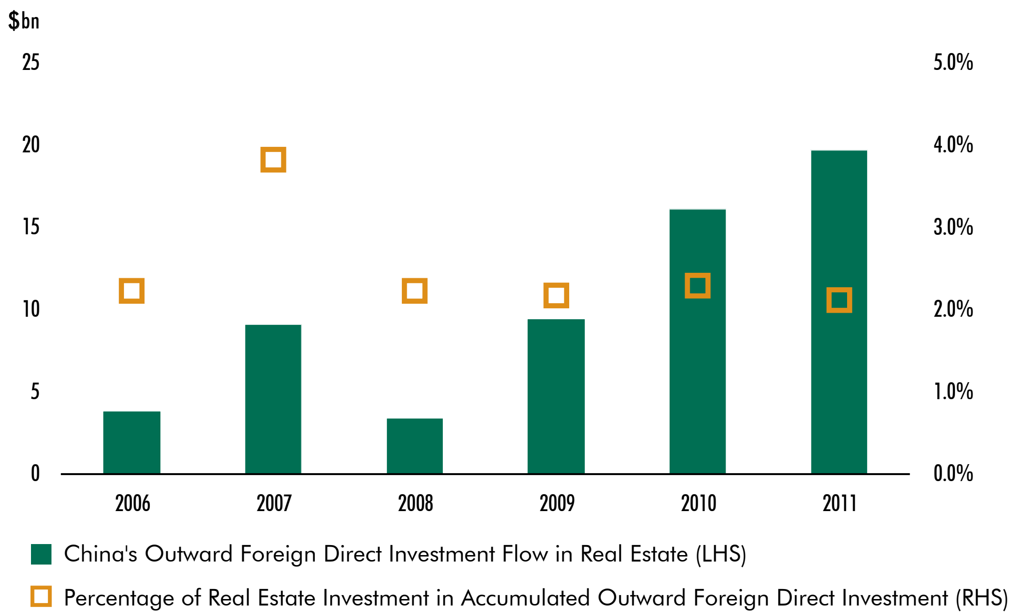

Source: National Association of REALTORS

1. The 2012 NAR Profile of International Home Buying Activity
2. http://hk.centanet.com/home/ArticleTemplate4.aspx?id=47481

## Corporate Investors

According to official statistics, Chinese direct investment in overseas real estate markets remains at a low level (Exhibit 2). In 2011 the total capital outflow from China to overseas real estate markets hit a historic peak of USD 1.97 billion, just 2.6% of Chinese total direct outbound investment that year[3]. In comparison, Chinese domestic investment in real estate development that year totaled RMB 6.18 trillion (USD 1.0 trillion). By 2011, Chinese total outward investment stock (OIS) in real estate amounted to USD 8.99 billion, accounting for 2.1% of the national total stock. However, in view of the untraceable original source of outbound investment funding[4], it is unlikely that this figure reflects the full scale of corporate investors' involvement in overseas real estate investment.

**Exhibit 2: China's Direct Overseas Investment in Real Estate (2006-2011)**




Source: Statistical Bulletin of China's Outward Foreign Direct Investment

3. China's Ministry of Commerce released "The Bulletin of Chinese Direct Outbound Investment in 2003 (Non-financial section)" (hereinafter referred to as "The Bulletin of Direct Outbound Investment") to the public for the first time in 2004, but the real estate industry has not been covered in the analysis category of industrial distribution of direct outbound investment flows/stock until 2006 together with the financial industry for the first time.
4. In recent years, the direct outbound investment of Chinese enterprises mainly flows to traditional tax havens, such as Hong Kong SAR, British Virgin Islands, Cayman Islands, Luxembourg and Australia. In 2011, Chinese investment stock for Hong Kong SAR, British Virgin Islands and Cayman Islands were USD261.519 billion, USD29.261 billion, and USD21.692 billion respectively, accounting for 73.6% of its total stock of outbound investment.

# Institutional Investors

Corporate pension funds, insurance funds and SWFs differ in terms of their investment decision making and considerations.

In China, supplementary pension funds, the counterparts of foreign employer pension funds, are referred to corporate annuity funds or corporate pension funds. At present, Chinese corporate annuity funds are limited to investing in the domestic market and are not permitted to directly invest in the real estate sector[5].

Insurance funds in China were only permitted to invest in the form of currency until the policy being extended to cover the category of real estate investment in 2009 after the National People's Congress passed the revised "Insurance Law of the People's Republic of China". In 2010, the China Insurance Regulatory Commission (CIRC) issued the "Interim Regulations of CIRC on Insurance Fund Investment in Stock Equity and Real Estate[6]", which permitted insurance funds to invest in categories such as currency, fixed income, equity and alternatives, thereby officially adding equity, real estate and unsecured corporate bonds and other investment vehicles. In July and October 2012 the CIRC issued the "Detailed Implementation Regulations on the Investment of Insurance Funds in Stock Equity and Real Estate " and the "Detailed Management Regulations on the Overseas Investment of Insurance Funds[7]". The new regulations permitted insurance companies to invest a maximum of 15% of their total assets as of the end of the last quarter in non-self-use real estate (applicable to both domestic and overseas investment). At the same time, the new regulations included a number of other provisions relating to real estate and related investments opportunities. They included limiting insurance companies to investing in "mature retail and office properties with stable income, located at the central areas of the major cities in 25 developed markets", including but not limited to the United States, UK, Hong Kong, and Australia, along with the listed real estate investment trust funds (REITs) in these 25 countries or regions. The investment total is limited to a maximum of 15% of the insurance institution's total assets at the end of its previous fiscal year.

In 2012, the total assets of national insurance institutions stood at RMB 7.4 trillion (USD 1.2 trillion). Based on this, it is estimated that, in theory, there could be as much as USD 180 billion in Chinese insurance funds available for domestic and overseas real estate investment. Based on patterns of insurance fund allocations witnessed in developed countries in recent years, most insurance funds typically allocate less than 6% of their assets to direct property investment, except for life insurers in countries such as Norway and Switzerland which allocated more than 10% of their assets in direct property investment in 2011[8]. Among domestic insurance groups, real estate investment is still a relatively new asset allocation category. Therefore, it is anticipated that Chinese insurance funds investment in real estate will likely be no more than 6% of their total assets, or about USD 72 billion. In addition, as the CIRC only recently permitted Chinese insurance institutions to invest in overseas real estate, insurance institution investment in overseas real estate will not exceed 20% of their total investment in real estate, which would equate to around USD 14.4 billion. Despite the quota approval procedure of China's State Administration of

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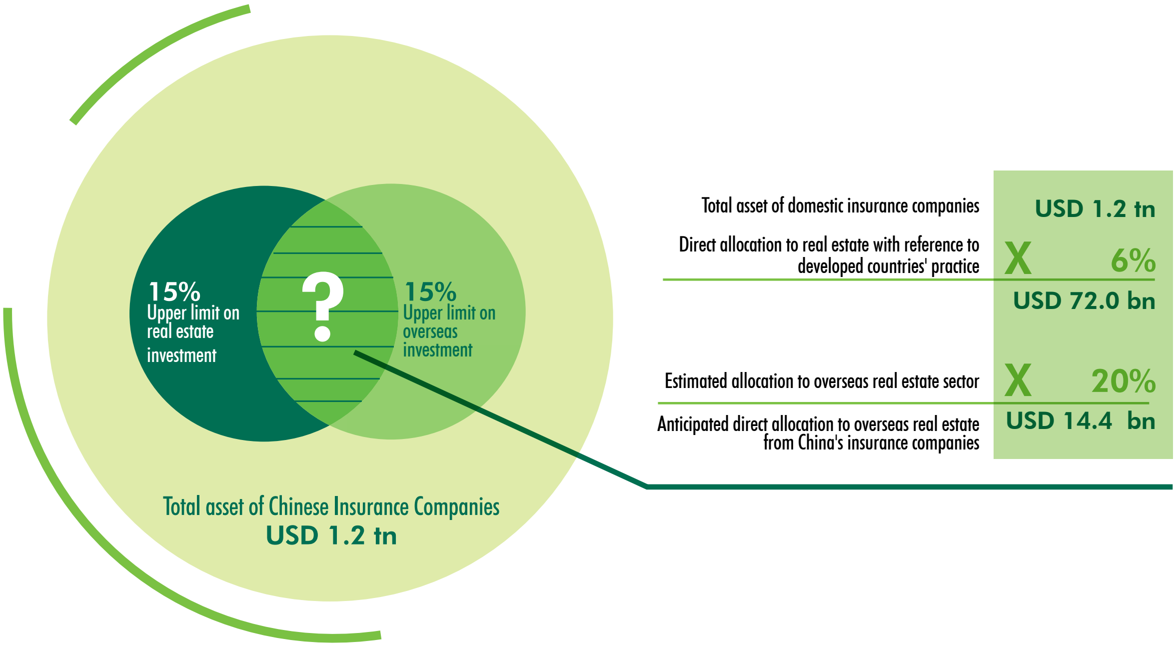
5. The Ministry of Human Resources and Social Security (MHRSS), China Banking Regulatory Commission (CBRC), China Securities Regulatory Commission(CSRC) and China Insurance Regulatory Commission (CIRC) jointly issued the No. 23 paper [2013] of MHRSS – Notice on Widening the Investment Scope of Corporate Annuities on March 19, 2013, expressly extending the investment scope of corporate annuities to commercial bank wealth management products, trust products, infrastructure bond investment plans, specific asset management plans and stock index futures, etc.
6. On July 25th, 2012, No. 59 paper [2012] of CIRC - Notice on Issues Concerning Insurance Funds Being Invested in Stock Equity and Real Estate was issued.
7. On October 22nd, 2012, No.93 paper [2012] CIRC - Notice on the Detailed Implementation of the Interim Management Regulations on the Oversea Investment of Insurance Fund was issued.
8. OECD Global Insurance Market Trends - 2012

Foreign Exchange (SAFE) for qualified domestic institutional investors (QDII)[9], insurance institutions are, in practice, able to invest in real estate overseas via a “domestic guarantee for overseas credit”.




Source: SWF Institution, TheCityUK estimates

There have not yet been any confirmed overseas direct real estate transactions by Chinese insurance institutions. However, given the experience they have accumulated in the domestic real estate market and their active pursuit of non-capital investment opportunities after a series of policies issued by the CIRC[10], their entry to overseas markets is thought to be imminent.

Compared with developed countries, the penetration of the insurance sector in China is still relatively low[11], with ample room for growth in the coming years[12]. Once there is a success story in overseas real estate direct investment, other Chinese insurance funds will follow and this group of buyers will likely emerge as the main driver of Chinese capital investing in overseas real estate.

As of 2013 Chinese sovereign wealth funds held assets of approximately USD1.49 trillion, ranking No.1 in the world by scale, and accounting for 29% of the value of total global SWFs (Exhibit 3). China SAFE Investments Limited (SAFE), China Investment Co., Ltd. (CIC) and the National Social Security Fund (NSSF) ranked as the world's third, fifth and eleventh largest SWFs, respectively.

9. The Investment Quota Approval of Qualified Domestic Institutional Investors (QDII) from SAFE shows that as of March 31, 2013, a total of USD23.967 billion was approved for 28 insurance institutions nationwide.
10. Securities Times, Ongoing Search for Non-funding Investment Opportunities, by Ren Huichuan, General Man ager of Ping An Insurance. Source: http://epaper.stcn.com/paper/zqsb/html/2012-06/28/content_381535.htm
11. Insurance penetration refers to the ratio of insurance premium to the country's GDP, an important indicator that measures the level of insurance industry growth in a country. Swiss Sigma report shows that China's insurance penetration only reached 3.0% in 2011, ranking 45th in the world. Taiwan has topped the world’s highest insurance penetration with a 17% ratio. In developed countries, the insurance penetration of the United Kingdom, Japan, France, and the United States were 11.8%, 11.0%, 9.5% and 8.1% respectively, in the 4th, 7th, 9th and 13th places in the world. The world’s insurance penetration averaged 6.6% in 2011.
12. The annual compound growth rate of national premium income from 2000 to 2011 reached a level of 22%.

Current regulations stipulate that 20% of the NSSF may be invested in overseas markets (in practice around 7% of total funds are invested overseas). However, only equity and creditor rights are permitted for overseas investment while real estate related investment is excluded[13]. The other two Chinese SWFs have been more active overseas. Since May 2012 Gingko Tree Investment Ltd, a wholly owned subsidiary of SAFE registered in the UK, has made at least four investments totalling approximately USD 1.6 billion, inclusive of student apartments and office buildings. At the same time, CIC has also stepped up its investment in real estate and infrastructure. In November 2012 CIC acquired Winchester House – the London headquarters of Deutsche Bank – for approximately USD 400 million in the form of a joint venture. Looking ahead, CIC and SAFE are both likely to increase their direct and indirect allocation to real estate and other alternative asset classes in the coming years.

**Exhibit 3: SWFs Market Share by Country and Region – 2012 YE**

| BY COUNTRY | $ BN | % SHARE |
|---|---|---|
| China | 1,490 | 29 |
| United Arab Emirates | 816 | 16 |
| Norway | 664 | 13 |
| Saudi Arabia | 538 | 10 |
| Singapore | 406 | 8 |
| Kuwait | 296 | 6 |
| Russia | 150 | 3 |
| Others | 840 | 16 |
| **BY REGION** | **$ BN** | **% SHARE** |
| Asia | 2,003 | 39 |
| Middle East | 1,797 | 35 |
| Europe | 955 | 18 |
| Africa | 197 | 4 |
| Americas | 157 | 3 |
| Others | 91 | 2 |
| Total | 5,200 | 100 |

Source: SWF Institution, TheCityUK estimates

13. According to the China Pension Report 2010 released by the Center for International Social Security Studies, Chinese Academy of Social Sciences, the National Council for Social Security Fund has applied to expand the outbound investment scope of social security from equity and creditor rights to the equity investment and equity investment fund of the unlisted companies and it is expecting to strengthen the cooperation with organizations for outbound pension investment

# KEY DRIVERS AND INVESTMENT CONSIDERATIONS

## Individual Investors

In China, real estate has always been a traditional investment channel and an important source of wealth formation for individual investors. According to a report released by China Construction Bank and Boston Consulting Group, 14% of surveyed HNWIs in 2011 accumulated their wealth via real estate investment, a figure which fell to 9% in 2012. Although the Chinese government has in recent years introduced a number of austerity measures to dampen its residential property market, 24% of HNWI respondents in the same report still ranked real estate as one of their preferred investment products.

CBRE research has found a large overlap in the Chinese HNWIs ranking of preferred destinations for overseas real estate investment, their ranking of preferred destination for overseas study and their ranking of preferred destination for immigration. On the one hand, the finding supports the conclusion that immigration, opportunities for their children to study abroad plus asset value preservation and accumulation are the main priorities for Chinese HNWIs, a claim supported by numerous studies released by private banks based on interviews and surveys of their clients. On the other hand, it also reveals the motivation of Chinese HNWIs who purchase overseas properties either for self-use or for investment. According to the "Annual Report on Chinese International Migration (2012)", over 150,000 Chinese citizens permanently emigrated to major developed countries in 2011. These included 87,017 Chinese who obtained permanent residency in the United States, representing the largest number of emigrants that year, followed by Canada, Australia and New Zealand. According to the "Education at a Glance 2012" report released by the Organization for Economic Cooperation and Development (OECD) in 2010, students from China accounted for the highest portion of foreign students located in Australia, Canada, New Zealand and the United States in 2013, accounting for 32.3%, 24.7%, 23.9% and 18.5% of the total respectively.


Source: Education at a glance 2012 – OECD indicator

China's overall economy slowed in 2012, with the Shanghai composite index falling below 2,000 and domestic stock markets remaining subdued. With austerity measures remaining imposed on the residential market, HNWIs have been left with fewer investment options, a situation which has compelled many buyers to look overseas. This trend has been further supported by the continued appreciation of the RMB.

# Corporate Investors

There are several precedents of Chinese companies tapping into overseas real estate markets. For example, a subsidiary of China Metallurgical Group Corporation (MCC), successfully undertook the construction of Universal Studios Singapore and has since begun to develop residential projects in the same market. Elsewhere, financial firms represented by the Industrial and Commercial Bank of China (ICBC) and China Construction Bank (CCB) , along with China Southern Airlines and Hainan Airlines, have purchased office properties overseas for self-use to meet their business expansion needs. At the same time, several Chinese real estate enterprises have pioneered overseas real estate investment.

Chinese real estate enterprises have entered overseas markets primarily for the following reasons:

**1. To capitalize on opportunities arising from the purchase of overseas property by Chinese HNWIs.**

In recent years, Chinese HNWIs have begun to acquire residential properties overseas and have become a focus for both domestic and foreign real estate developers. This trend has prompted a number of major Chinese real estate companies including China Vanke Co., Ltd., Country Garden Group and Xinyuan Real Estate Co., Ltd. to enter overseas housing markets via joint ventures or the purchase of land.

**2. To broaden financing channels.**

Generally speaking, property development in China is funded by the proceeds of pre-sales (40%), bank loans (30%) and developers' equity (30%). However, in recent years, the domestic real estate industry has been confronted with tightening policy, slowing pre-sales and a tighter credit environment. This has presented most real estate enterprises - particularly small- and medium-size ones – with capital constraints. Under these conditions many enterprises have sought to broaden their financing channels and reduce the cost of financing. Several large real estate enterprises listed in the A-share markets have recently conducted backdoor listings in overseas markets. Examples include recent acquisitions by real estate companies such as Vanke, Gemdale Group and China Merchants Property Development Co., Ltd. In July 2012, Vanke acquired Winsor Properties Holdings Limited (later renamed Vanke Property (Hong Kong) Company Limited). In March 2013, it issued US$800 million in US$-denominated bonds with a 5-year maturity through its wholly-owned subsidiary, Bestgain Real Estate Limited. The interest rate for the 5-year bond was as low as 2.755%. The cost was significant lower than financing through domestic bank loans (normally in the range of 7% to 8%) or issuing trust products (about 10%). The deal did not take into account the expected RMB appreciation, which will further lower the effective interest rate for this type of US$-denominated bond. Additionally, borrowing period for domestic loans is usually shorter, namely, two to three years, whereas the period of these bonds in USD can be as long as years. This will effectively ease the refinancing pressure of enterprises, thus greatly advancing the flexibility of their operations.

**3. To learn from international experience.**

The Chinese real estate market enjoyed particularly rapid growth in the first ten years of the 21st century and has since settled on a slower but more sustainable growth trajectory. In terms of strategy and operations management, real estate enterprises are being confronted with challenges due to increasing difficulties in acquiring land, rising costs and mounting market competition. Ultra-large real estate enterprises such as Vanke and Wanda Group have opted to cooperate on some projects with experienced foreign partners by establishing joint ventures or mergers and acquisitions. Utilizing this strategy, they can quicken their learning process in overseas markets and use advanced overseas experience to support their domestic operations. In addition, the undervalued overseas real estate markets that were hit by the financial crisis will create opportunities for them to gain a better return on investment. Real estate enterprises such as Vanke, Wanda, Greenland Group and China Overseas Holdings Limited have all embraced the slogan of "go international". At the same time, smaller local real estate development enterprises and some newly formed real estate enterprises have also been actively engaged in overseas expansion since 2012, investing and developing office buildings, retail, stand-alone homes, apartments, hotels, industrial buildings, tourist attractions as well as science and technology parks.

That said, the larger Chinese real estate enterprises are still in the very early stages of investing overseas. Therefore it is too early to conclude that "going global" represents a general trend among Chinese real estate enterprises and that investing in overseas property markets has a bright future.

Overall, we consider that overseas investment made by China's real estate enterprises still remains at a trial stage and overseas property purchasing demand from HNWIs still serves as the main driver of the overseas expansion of real estate companies. Relatively low cost of overseas financing and more mature real estate development and valuable operation experience are two other major incentives for real estate enterprises to enthusiastically set foot in the overseas markets. At present, however, the number of companies investing in overseas real estate markets is still small from an overall strategic perspective.


Source: CBRE Research

# Institutional Investors

In developed countries, pension funds, insurance fund and SWFs are all enthusiastic investors in real estate investment. However, due to the strict policy regulations and a short history of property market growth, Chinese institutional investors are still lingering at a preliminary level of overseas real estate investments, despite the fact that they have exuberantly invested in the domestic property market for ten years.

## Pension Funds

Although alternative investment, the category real estate investment falls into, has been gaining ground year by year in the asset allocation of global pension funds, with its asset share climbing from 5% in 1995 to 20% in 2011[14], direct investments in real estate only account for a comparatively small proportion in the portfolio of global pension funds except those in Switzerland, Portugal, Finland, Canada and Australia (which have directly allocated 5% to 10% of their funding to real estate investment)[15]. The data released by TheCityUK shows that OECD countries own 97.3% of the $ 31.4 trillion of global pension funds in 2011, while the pension funds in the 34 member countries have merely 1.48% of their assets allocated in direct real estate investments, according to an OECD's survey.

Real estate investments usually make up less than 4% in the portfolios of pension funds in Asian-Pacific countries. Ranked by country, South Korea takes the lead in Asia, with three pension funds investing a total of USD9.4 billion in real estate. Malaysia ranks second, investing USD1.7 billion in 2012.

**Exhibit 4: Major Pension Funds in Asia**

| INVESTOR | COUNTRY | FUNDS UNDER MANAGEMENT ($MN) | CURRENT ALLOCATION TO REAL ESTATE (%)* | TOTAL AMOUNT INVESTED IN REAL ESTATE ($MN) |
|---|---|---|---|---|
| National Pension Service | South Korea | 330,719 | 2.5 | 8,268 |
| Employees' Provident Fund | Malaysia | 158,508 | 0.4 | 602 |
| Kumpulan Wang Persaraan | Malaysia | 27,220 | 4.0 | 1,089 |
| Social Security Office | Thailand | 27,000 | 2.0 | 540 |
| Thailand Government Pension Fund | Thailand | 18,759 | 3.6 | 668 |
| Korean Teachers' Credit Union | South Korea | 18,000 | 3.8 | 684 |
| Korea Teachers Pension | South Korea | 13,069 | 3.4 | 444 |
| Toshiba Employees' Pension Fund | Japan | 10,105 | 3.0 | 303 |

*Includes direct and indirect real estate assets
Source: Preqin

14 China Pension Report 2012
15 OECD: Pensions at A Glance 2011

The Corporate annuity is the Chinese counterpart to a foreign employer retirement plan. The Notice Regarding Expansion of Investment Range of Corporate Annuity Pensions, jointly released in 2013 by the Ministry of Human Resources and Social Security (HRSS), the China Banking Regulatory Commission (CBRC), the China Securities Regulatory Commission (CSRC), and the CIRC, have specifically expanded the investment scope of corporate annuities to wealth management products, trust products, investment plans on infrastructure bonds, asset management - specific plans, and stock index futures. Thus, real estate investment can be made indirectly via trusts or specific investment plans.

## Insurance Funds

The main investment vehicles for insurance funds include corporate bonds, corporate stock, real estate, and private equity funds. Influenced by asset securitization, insurance companies in various developed countries have begun to taper off the proportion of direct investment in real estate and turned their focus to indirect real estate investment since the 1990s. The proportion of insurance funds invested in real estate reveals a declining trend[16] since the financial crisis in 2010. However, real estate investment remains an indispensable option for the investment portfolio of insurance funds in light of its liquidity, employment risk premium and the expected return of financial leverage beyond the risk-free interest rate. The maximum proportion of direct allocation to real estate investment from insurance funds is theoretically set between 15% to 20% in the Asia-Pacific market, but actual investments are generally undertaken prudently (Exhibit 5)[17].

**Exhibit 5: Real Estate Investment by Insurance Funds in the Asia-Pacific Market**

| $BN (2011) | AUM BY LIFE INSURANCE COMPANIES | ALLOCATION TO REAL ESTATE (LIFE INSURANCE) | UPPER LIMIT OF DIRECT ALLOCATION TO REAL ESTATE | MAJOR REAL ESTATE INVESTMENT PLAYERS |
|---|---|---|---|---|
| Japan | 3,257.5 | 2.0%* | 20.0% | Nissay Life Insurance Company, Meiji Yasuda Life, Dai-Ichi Life |
| South Korea | 438.7 | 2.8% | 15.0% | Samsung Life Insurance, Korea Life Insurance |
| Taiwan | 381.5 | 4.7% | 19.0% | Cathay Life Insurance, China Life Insurance, Fubon Life Insurance, Nan Shan Life Insurance, Shin Kong Life Insurance |
| Singapore | 106.5 | 3.8% | 20.0% | NTUC Income Life Insurance, Greater Eastern Life Insurance |

*Fiscal 2011, from 1st April, 2011 to the end of March, 2012
Source: The Life Insurance Association of Japan, China Insurance Regulatory Commission, Taiwan Insurance Institute, Korea Life Insurance Association and OECD

16 There are several vehicles for insurance funds to be indirectly invested in real estate, including real estate equity, REITs, CMBS and RMBS, whose risks can be controlled within a certain scope. In the US, there is collateralized debt obligation and other investment vehicles based on subprime mortgage which have increased the risks of indirect investment in real estate, thus causing mainstream insurance companies to suffer heavy losses in the subordinated debt crisis.

17 According to "A model of Real Estate Investment of Insurance Funds" carried in "Insurance Studies" No 10, 2009, the insurance funds. Direct real estate investments were capped at a maximum 20%, 19%, 15 % and 20% of their insurance funds in Japan, Taiwan, Korea and Singapore.

The history of real estate investment by Chinese insurance institutions shows that each large insurance company has during recent years built up remarkable experience in this field by purchase for self-use and for rent, self-construction for self-use, partnerships in projects or co-establishment of companies, real estate investment advisory services in strategic cooperation and direct purchase, though insurance funding were approved to invest directly in real estate market not long ago.

There are no cases of outbound real estate investment proven to be successful so far for Chinese insurance funds, but we believe they are already on the horizon. For one thing, the ever-increasing funds of the thriving insurance industry are eager to find new channels when investment products are at a low level of securitization. For another, insurance funds, life insurers in particular, in large amounts, at low cost and enjoying longer payment period liability, will perfectly match retail and office properties investments featuring low liquidity, good value-added potential, and stable cash flow. Given the present scarcity of investable prime properties in first-tier domestic cities and the short-term risk from the oversupply in second- and third-tier cities, we conclude that office properties in core overseas cities may become a future option for the portfolio of insurance funds in China, considering the attractive valuation of overseas real estate markets after the financial crisis, particularly that of prime location high-end offices, and the stable rental income they can produce.

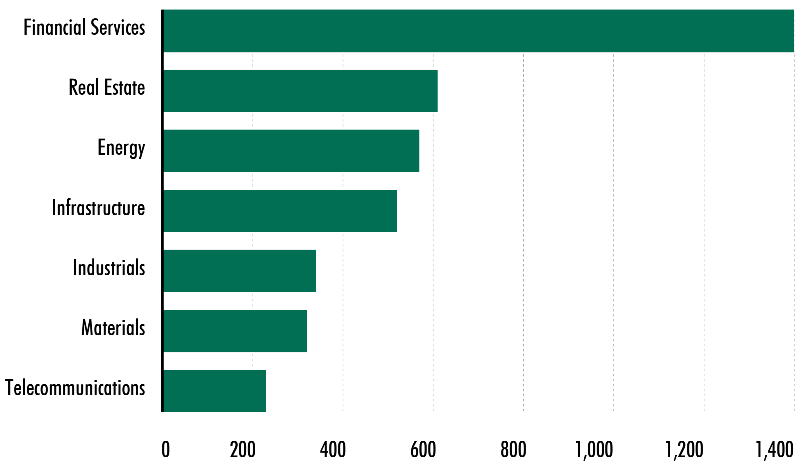
## Sovereign Wealth Funds

Sovereign Wealth Funds (SWFs), as investment funds or as arrangements owned by generalized governments for special purposes, differ in their investing strategies. It features massive funding, higher risk tolerance and longer investment cycles compared to other institutional investors.

The primary portfolios of SWFs across all countries are comprised of financial service, real estate, energy and infrastructure (Exhibit 6). Real estate investment, with direct property ownership and stable rental yields jointly linked to inflation, is one option for SWFs to defend against inflation.

**Exhibit 6: The Portfolios of SWFs**

**$bn invested between 2005 and 2012**




Source: SWF Institute – Sovereign Wealth Fund Transaction Database

It is widely believed that SAFE Investment Company Limited, CIC and the China National Social Security Fund that are under the management of the State Administration of Foreign Exchange are regarded as three Chinese SWFs. As deep-pocket latecomers to the market, Chinese SWFs have shorter histories and less experience (Exhibit 7) than their counterparts in developed countries.

**Exhibit 7: World Major SWFs**

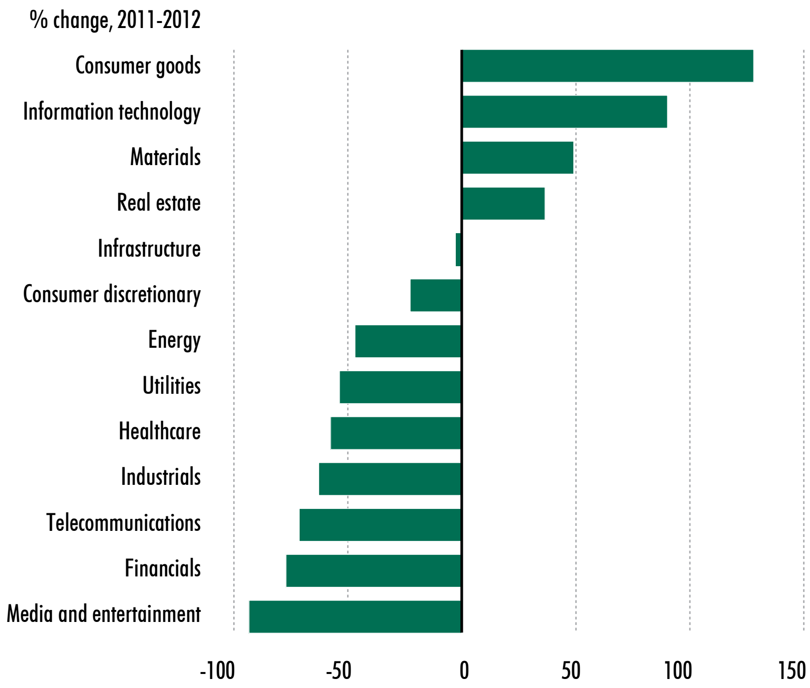
| INSTITUTION | AUM IN 2012* ($BN) | COUNTRY | INCEPTION YEAR | ALLOCATION TO REAL ESTATE** |
|---|---|---|---|---|
| Government Pension Fund - Global | 664 | Norway | 1990 | 1.0% |
| Abu Dhabi Investment Authority | 627 | UAE-Abu Dhabi | 1976 | 7.5% |
| SAFE Investment Company | 568 | China | 1997 | 5% allocation to alternatives |
| SAMA Foreign Holdings | 533 | Saudi Arabia | N/A | N/A |
| China Investment Corporation | 482 | China | 2007 | 5.0% |
| Hong Kong Monetary Authority Investment Portfolio | 299 | China (HK) | 1993 | 0.5% |
| Kuwait Investment Authority | 296 | Kuwait | 1953 | 3.3% |
| Government of Singapore Investment Corporation | 248 | Singapore | 1981 | 10.0% |
| Temasek Holdings | 158 | Singapore | 1974 | 6.2% |
| National Welfare Fund | 150 | Russia | 2008 | N/A |
| National Social Security Fund (NSSF) | 135 | China | 2000 | N/A |

*Source: SWF Institute and TheCityUK estimates
**Source: Preqin

Influenced by low bond yields and volatile stock markets in developed countries, SWFs have geared up their shares of investments in the real estate sector (Exhibit 8), mainly in major cities of mature European and American markets. London, New York, San Francisco and the like are the hotspots[18]. One large scale example of real estate investment from SWFs in 2012 is CIC's purchase of Winchester House, the home to Deutsche Bank's London headquarters.

Relative to those on other continents, the Asia-Pacific SWFs, especially Singapore's Government Investment Corporation and Temasek Holdings, have long been active real estate investors. Judging from their past performance, Chinese SWFs may well follow their counterparts in Singapore to become another heavyweight player in the real estate market.

**Exhibit 8: Direct SWF Investment Activity (2011-2012)**




Source: SWF Institute - Sovereign Wealth Fund Transaction Database

# OPPORTUNITIES AND CHALLENGES

Most of the Chinese investors with sufficient capital are now facing limited domestic investment channels. While regulation on the domestic real estate market is increasingly tight, some of the major oversea property markets are now experiencing a gradual pick up of investment momentum, given the depressed value of higher-yielding assets after the great financial crisis. Factor in the escalating purchasing power enabled by the continuous appreciation of RMB, it is now a considerable timing for Chinese capital from various investment categories to enter the overseas real estate investment market – not only individuals who are looking for opportunities to preserve and create wealth as well as to immigrate/gain better education; also companies which are initiating new growth points, seeking more economic/diversified investment channels and expecting to learn from the best international practices; finally, institutional investors targeting long-term gain and stable income flow with moderate long-term risk. Regardless of the aforementioned opportunities, Chinese capital will surely confront many challenges due to the unfamiliarity of overseas property markets and investment environment, along with the divergent regulations and property market practices across the globe.

## Individuals

So far, the sources to gain information on overseas real estate markets for Chinese individual buyers are still being limited to the domestic immigration advisers who at the same time run real estate agencies and overseas property exhibitions. Although some foreign real estate agencies have begun to directly contact the potential clients with the help of the advanced network and other high technology resources, individual clients still find it difficult in identifying the qualifications of these agencies, un-integrated information and the consequent information asymmetry.

| S | W |
| --- | --- |
| • Adequate liquidity<br>• Familiarity with real property investment | • Lack of in-depth understanding of overseas property market<br>• Significant divergence across different markets and segments, lower integrated and asymmetric information<br>• Lack of the experience in investment property management |
| **O** | **T** |
| • Lower overseas property prices<br>• Continuous RMB appreciation<br>• Higher return compared to domestic residential investment market | • Exchange rate volatility<br>• Possibly loss due to poor professionalism of agents and their after sales services<br>• Possible regulatory on overseas buyers |

S-Strengths, O-Opportunities, W-Weaknesses, T-Threats
Source: CBRE Research

## Corporate Investors

Most of the Chinese real estate companies entering the overseas markets have accumulated rich experience in China and have been targeting the wealthy, so they have gained some brand advantages and well understood customer's behavior in the domestic setting. But they still face a number of problems, such as weakened negotiating capacity and a relatively long learning curve due to little knowledge about foreign local laws, market rules and regulations, lack of strong track records in foreign markets and absence of the scale effect they had at home. In addition, as the real estate development, operations and markets vary greatly in different countries, and the potential investment return is closely associated with the currency performance in each country, the Chinese real estate developers may face many challenges in terms of land acquisition, sales, team building and management of foreign exchange rates if they intend to enter the real estate markets in several countries at the same time - one highly possible case could be that a successful model in one country may not be able to be duplicated in other countries.

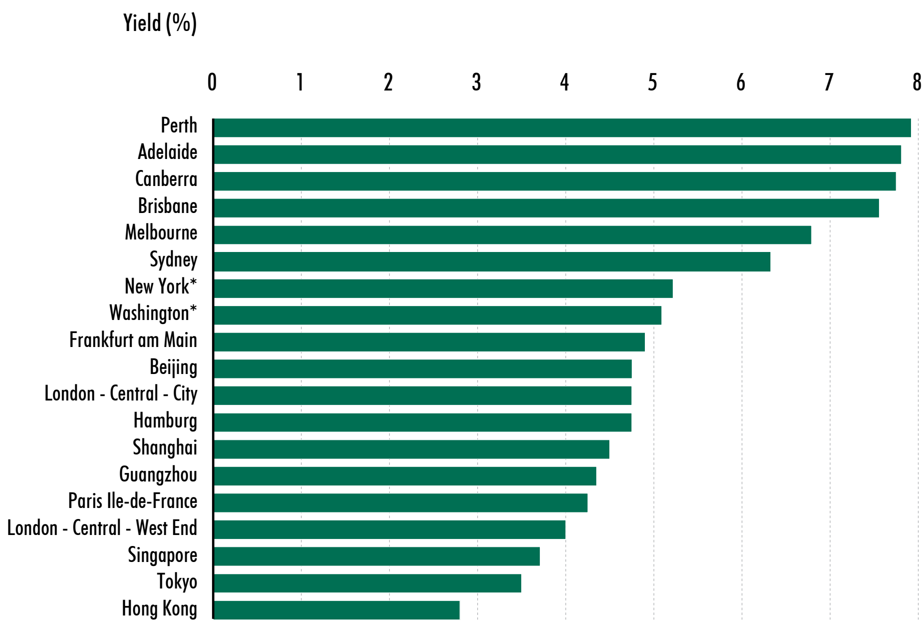
| S | W |
|---|---|
| • Understanding of Chinese consumers' preferences<br>• Stable potential customer base<br>• Increasing potential customer demands<br>• Short cycle of real estate property development and investment | • Lack of appreciation of overseas property markets<br>• Without the scale effect the investors had at home<br>• Longer learning curve |
| **O** | **T** |
| • Increasing potential customer demands<br>• Short cycle of real estate property development and investment | • Competition from local market<br>• Without cash-in during development<br>• Exchange rate volatility |

Source: CBRE Research

# Institutional Investors

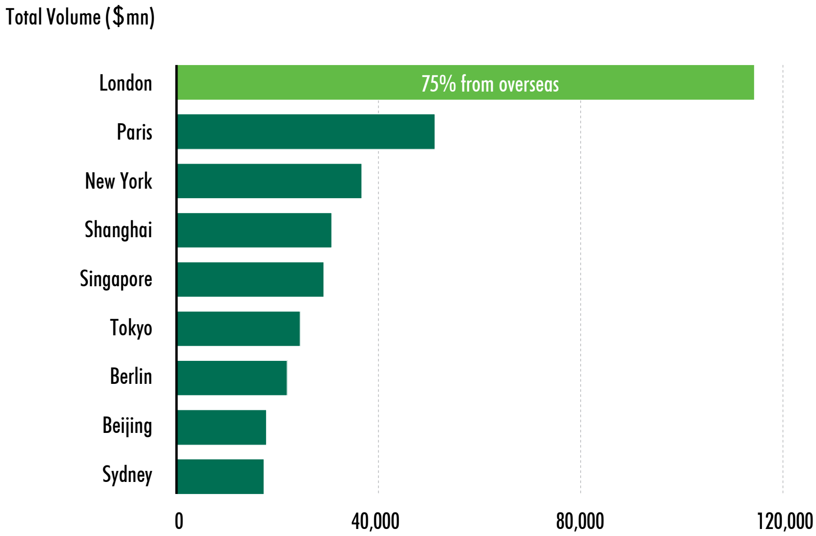
The institutional investors focus their investment on office and retail properties. However, retail asset management, an essential requirement for retail property acquisition is the expertise absence for many Chinese developers. We therefore anticipate that they will still mainly focus their investment on offices in near term. Thus far, the office properties with higher ROI worldwide are mainly concentrated in the international gateway cities in Australia, US and UK (Exhibit 9). While the institutional investors in other areas are actively seeking interest-bearing assets, these gateway cities have attracted the attention of global institutional investors (Exhibit10). In this sense, the Chinese institutional investors will face the competition from their experienced international counterparts.

**Exhibit 9: Yield of Global Prime Office Market (Q1 2013)**




* As of Q4 12
Source: CBRE Research

**Exhibit 10: Top Cross-border Investment Destinations (2007-2013 Q1)**




Source: RCA

The Chinese institutional investors will be confronted with a number of challenges, including 1) how to make choices on different investment areas/destinations; 2) how to close a deal as quickly as possible amid keen competition; 3) how to determine the right investment horizon, optimize the transaction structure and identify the best financing arrangement to maximize the ROI; and 4) how to manage and operate the acquired assets effectively.

| S | W |
|---|---|
| • Adequate liquidity and lower financing cost<br>• High-growth industry<br>• Having existing property investment teams | • Lack of experience in outbound property investment<br>• Lack of investment management teams with local market knowledge |
| **O** | **T** |
| • Controllable risk as a long-term investment<br>• Long-term liability vs. comparatively long investment horizon*<br>• Lower property prices | • Competitive market<br>• Lower liquidity compared to financial products<br>• Subject to policy influence** |

Source: CBRE Research
* Refer to insurance company
** Insurance companies may face policy constraints from China Insurance Regulatory Commission; SWFs may fall under the policies protecting from destination countries.

# SUGGESTIONS

In summary, CBRE suggests Chinese investors focus on the following issues when entering overseas real estate markets:

1) Select a suitable positioning strategy before investing in overseas real estate market. This is particularly important for individual investors and developers which should avoid blindly following other groups in terms of investment destination and timing.

2) Select the right local partners, recruit experienced local employees and utilize professional real estate advisors with extensive networks to fully capitalize on local market intelligence and shorten their learning curves.

3) Consolidate resources and fully utilize the real estate related investment experience accumulated by their domestic asset investment team to create an appropriate portfolio and select the best investment management model.

4) Implement risk management, fully consider the strengths and weaknesses of direct and indirect real estate investments to create an optimal investment portfolio.

# OUTLOOK

To curb rising price of housing, the Chinese government is obviously aiming at limiting the demand for individual real estate investment and speculation through administrative, loan, taxation and other restrictions. However, we still believe that real estate, as a long-standing investment option and a key source for wealth generation, will continue to serve as an important investment channel for Chinese individual investors. In particular, wealthy Chinese will continue to pay attention to real estate investment. The overseas real estate investment market might become a hotspot for Chinese HNWIs as it can also satisfy their needs for immigration, children's education, wealth preservation and accumulation, within the context of rising individual wealth, diversified needs for wealth management, and the rather limited investment channels available in China.

Hong Kong and Singapore have always been among the most favorable residential investment destinations of Chinese individual investors, and some of them have actually gained substantial profit from the two destinations over the past few years. However, as Hong Kong and Singapore local governments recently began stringent measures to control outbound buyers, the number of transactions concluded by outbound investors in these two places has significantly declined. In contrast, the preferred traditional destinations for immigration and overseas study, represented by the US, Canada and Australia, are expected to continue to as primary choices for Chinese individual investors to enter the overseas real estate markets over a certain period of time, thanks to their large market capacity, lower property prices, promising ROI and lower likelihood of policy regulation on inbound investment in local properties. In terms of corporate investors, we expect that there will be more and more developers attempting to enter the overseas real estate markets, in particular those with large investment size in China who will follow the HNWIs looking to buy overseas properties. Geographically speaking, we believe that the advanced markets marked by high transparency, such as US, Canada, and Australia, as well as some Asian markets which are adjacent to the Chinese mainland with similar cultural backgrounds, such as Hong Kong, Singapore, Malaysia and Thailand, will be the major destinations for Chinese real estate developers to tap into in the future.

As for institutional investors, although the number of investable properties in developing regions has increased sharply in recent years, those of high quality properties in Asia Pacific region are still limited in investment scale, compared with those in North America and Europe. In this sense, we expect that Chinese institutional investors will focus on the core investable properties capable of generating stable ROI in the short term, such as the premier offices in international gateway cities.

# DEFINITIONS

## High-Net-Worth Individuals (HNWIs)

Defined by the China Banking Regulatory Commission (CBRC) as private clients of commercial banks (the HNWIs of private banks) having net financial assets in excess of RMB 6 million. However, in practice, the asset thresholds for HNWIs classifications differ by private banks. In this paper, unless otherwise specified, the CBRC definition is applied.

## Investment in Real Estate Development

Refers to the investment by the real estate development companies, commercial builders, construction companies and other real estate development units of various types of ownership in the construction of residential buildings, factory buildings, warehouses, hotels, guesthouses, holiday villages, office buildings, and the complementary service facilities and land development projects, such as roads, water supply, water drainage, power supply, heating, telecommunications, land leveling and other projects of infrastructure. It excludes the activities of pure land transactions.

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

## Disclaimer