DTZ Research

DTZ Insight

The Great Wall of Money

New capital increases most for Asia Pacific

10 March 2011

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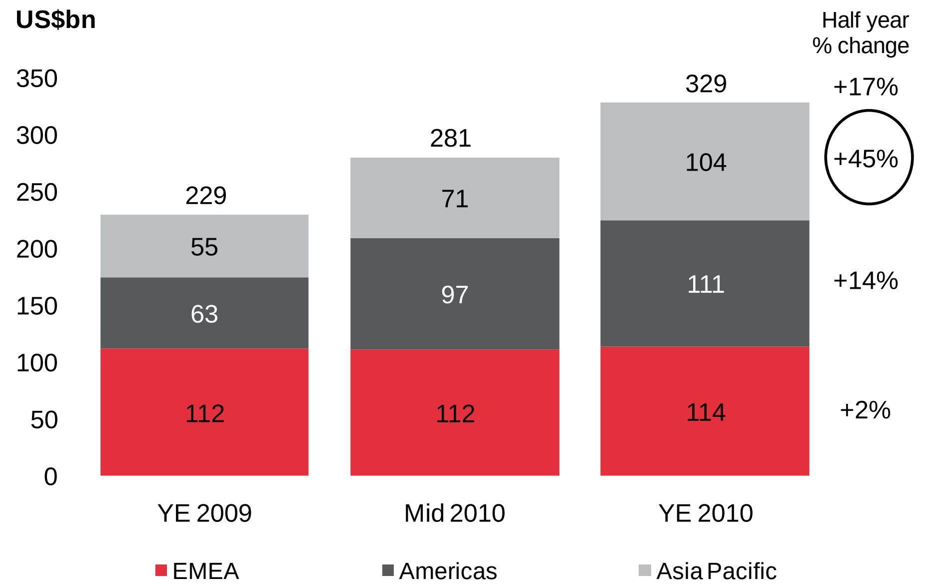
- US$329bn of capital is available for investment in the direct real estate markets in 2011. This is a 17% increase on the US$281bn reported mid-2010. Much of the growth reflects an increase in funds targeting Asia Pacific, up 45% to US$104bn (Figure 1).
- The growth in newly available capital has been driven by third party fund managers and publicly listed companies. Also, the majority of funds continue to target multiple property types.
- The target geography is now evenly split between single country and multi country funds. Asian and European investors have a preference towards investing in their home region.

Based on these findings we come to the following outlook:

- With more capital targeting Asia Pacific markets, we highlight the risk that some of these markets may re-price more quickly than suggested by our fundamental analysis.
- If the attractiveness of global property continues its decline of the last four quarters, we project a stabilisation in the amount of new capital available in the next few years.
- A raft of new regulatory initiatives could limit the availability of both new equity and debt capital in the longer term. Investors are already expecting these regulations to have a negative impact.

Figure 1

Available capital by region 2011



Source: DTZ Research

Introduction

This is the third edition of our "Great Wall of Money" report[1]. The report tracks new capital targeting direct real estate and the opportunities this capital is targeting. This report is divided into five key sections.

In the first section we outline the amount of new capital available for investment in 2011 and compare with our previous studies. Second we consider the amount of capital available by investor type. Third we look at the property types the capital is targeting before looking at the geographic distribution in section 4. Finally, in our outlook we consider the impact this capital has on the wider transactional market.

In the appendix we outline our bottom-up data collection process and methodology and how we reached the amount of capital available in 2011.

New capital available in 2010

Significant increase in capital targeting Asia Pacific

Based on our updated analysis we estimate there to be US$329bn of capital available for investment in the direct real estate markets in 2011. This represents a 17% increase on the US$281bn we estimated to be available in mid-2010 and 44% greater than the US$229bn at year-end 2009 (Figure 2). See Box 1 for more detail on the drivers of this growth.

Much of the growth in available capital reflects a growing number of funds targeting the Asia Pacific region. In total we estimate this to represent US$104bn, a 45% increase on the $71bn available at mid-2010.

We have also seen a further increase in the amount of capital targeting the Americas, which rose 14% to US$111bn. In contrast the amount of available capital targeting the EMEA region rose just 2% to US$114bn. Since the end of 2009, the amount of available capital targeting EMEA has remained virtually unchanged.

Box 1: Driving the growth in capital

Since we first began our analysis, the amount of new capital available has grown by over 40% (or US$100bn). But what is driving this?

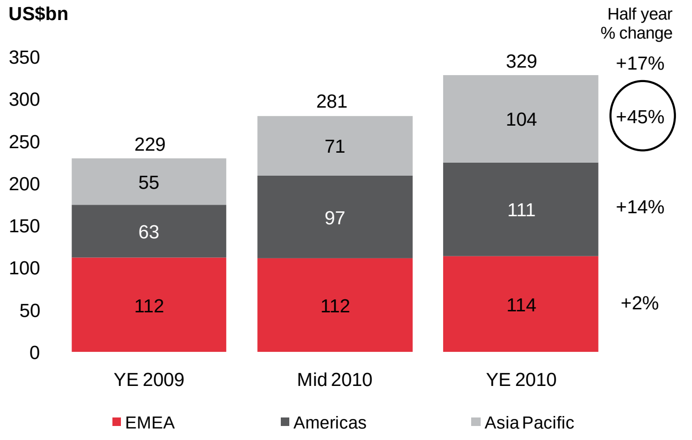
Some of the growth can be attributed to an increase in the number of funds seeking to raise or deploy capital in the market. At year-end 2009 we recorded data for just 1,600 funds. That fell to 1,535 funds at mid-year 2010. In this updated analysis we have tracked details from 1,726 funds.

New equity has been raised from IPOs or rights issues. Since our last update we have recorded $34bn of new equity raised this way to target real estate.

A number of funds have also announced their intention to raise funds. Over the last six months we captured $25bn in equity that funds are intending to raise to target direct real estate.

Figure 2

Available capital by region, 2011



Source: DTZ Research

[1] See The Great Wall of Money – Volumes to double in 2010, December 2009 and The Great Wall of Money – Capital shifts to attractive markets, October 2010.

Investor type analysis

Third party funds and publicly listed companies increase market share

As with our previous reports, third party fund managers remain the most dominant players in the market with equity to deploy. Over the past six months, they have grown their share of activity from 49% to 56% (Figure 3).

In total, third party managed funds have already raised over US$131bn of capital to deploy compared to the US$114bn we captured six months ago. This implies that recent capital raisings are starting to have a positive impact.

The amount of capital publicly listed companies have ready to deploy this year has more than doubled to US$71bn. This follows the successful completion of IPOs and rights issues over the past six months and increases the listed sectors share of available capital to 20%.

The nominal amount of capital available from institutions has remained stable, however, their share of the total has slipped from 16% to 13%. German open ended funds have seen their share of capital fall below 1%. In addition, as uncertainty over planned changes to regulations continues to impact funds, with some now liquidating assets, we would expect activity to remain relatively subdued at a time when inflows currently remain low.

Property type analysis

Diversity across property types remains

As with our previous analysis the majority of investors still favour multiple property types. Over three quarters of investors (78%) are targeting more than one property type (Figure 4). Whilst down on the 81% seen in our previous two reports, it still highlights the overwhelming preference of investors to have flexibility in how they deploy capital across property types.

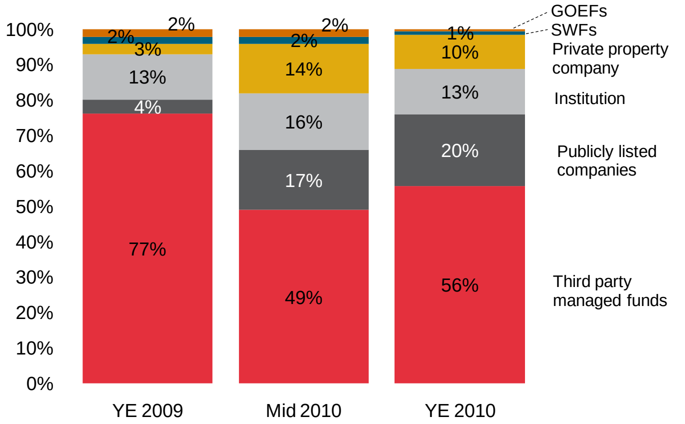
Of those funds targeting a single property type (indicated by the three bars to the right in Figure 4), we do see some changes in the targets of these funds. Retail continues to dominate, increasing its overall share to 31% of single property type funds. Its attractiveness is matched by our fair value analysis, in which retail is considered the most attractive property type.

Despite having the weakest fair value score of the three property types we track, offices have moved into second spot, compared to fourth place last time.

Hotels have grown in popularity and are now the third most targeted property type ahead of both industrial and residential, which have slipped back. Other alternative property types, notably including healthcare and leisure, have also grown their share.

Figure 3

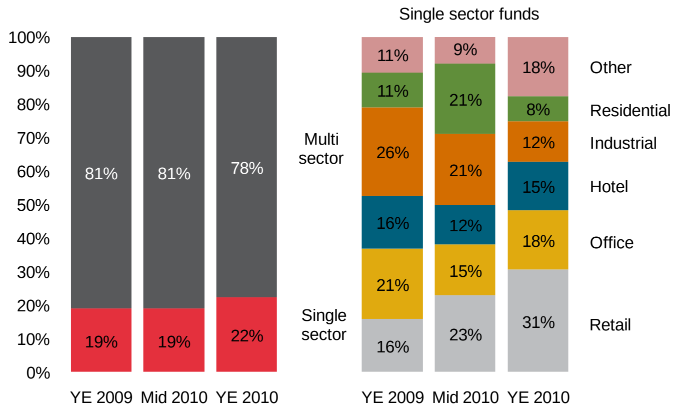
Available capital by investor type 2011



Source: DTZ Research

Figure 4

Target property type 2011



Source: DTZ Research

Geographic analysis

Single country funds grow in importance

Diversification by target geography is no longer clear cut. Half of the funds raised are now targeting a single country. This compares to 44% at mid-2010 and 30% at year-end 2009 (Figure 5).

With many of the funds set up prior to the market crash now nearing the end of the commitment period to spend, the growth in single country funds could reflect a retrenchment of new funds focusing on the recovery in home markets.

Of the capital targeting single countries (shown by the three bars to the right in Figure 5) we note the US continues to dominate, attracting over half the available capital. This is not surprising given the US is one of the most attractive markets globally according to the DTZ Fair Value Index™.

The UK remains the second most popular target, albeit attracting a smaller 10% of the total. This reduction is no coincidence. In mid-2009 the UK was considered the most attractive market according to the DTZ Fair Value Index™. The weight of capital targeting the UK back in 2009 and increased transactional activity left many markets overpriced during 2010. The reduction in capital targeting the UK reflects its lower relative attractiveness in our fair value index.

China and Australia remain the most popular targets in Asia Pacific. Both countries have a majority of markets rated as WARM or HOT. In Europe, Germany has increased in popularity. All its markets rated as WARM or HOT, making it an attractive proposition to investors.

Other European markets have also seen their share increase, including France, Italy, the Netherlands and Sweden. In contrast we see little change in capital targeting other markets in the Americas.

Respondents to our survey were asked to note their top five buying countries for 2011. Of those responding the US, Germany, UK, France and Japan topped the investors' list of target markets. Also high up the list were Australia, Canada, China and Poland. These rankings broadly align with those markets specifically targeted by investors.

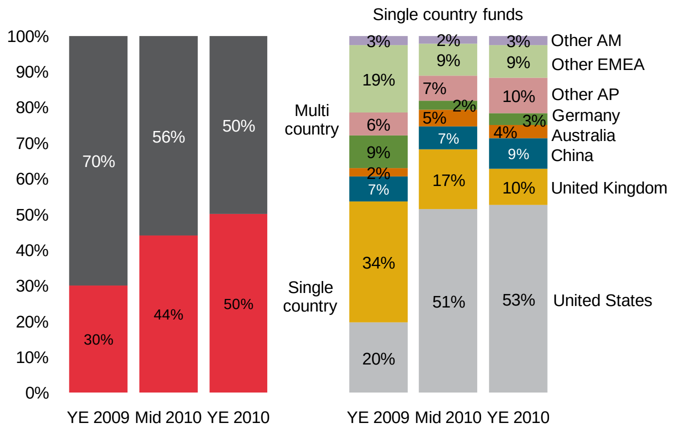
Intra-regional investment dominates

Whilst both the Americas and Asia Pacific are winners in terms of an increase in the level of capital targeting their regions relative to Europe, it is also important to explore the expected trends in capital flows. On this basis we see a slightly different picture.

By looking at the regional domicile of each investor, we can see that the majority of capital is targeted on their home region (Figure 6). This is most evident in Asia Pacific and EMEA where 92% and 81% of capital respectively is being targeted on their home region. Only in the Americas do we observe a different picture where we see a greater proportion of funds directed towards EMEA and globally. Of course, many funds domiciled in the US have a global reach. Therefore the higher proportion of capital targeted globally is of little surprise.

Figure 5

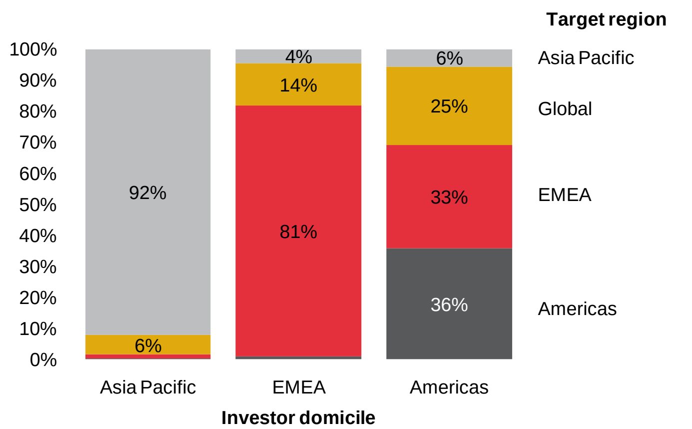
Target geography, 2011



Source: DTZ Research

Figure 6

Investor domicile and target region



Source: DTZ Research

This suggests that many investors are focussed on their home markets, which they know better. This is in line with responses from our investors' survey (see Box 2).

New capital targets most attractive regions

The impact of increased capital targeting Asia Pacific and the Americas now means the volume of capital targeting the three core regions globally is now virtually equally distributed (Figure 7). EMEA still attracts the largest share of capital (35%), only marginally ahead of the Americas (34%) and Asia Pacific (32%). This compares with our first report, when close to half the capital targeted EMEA.

The increase in capital targeting Asia Pacific and the Americas is consistent with the latest DTZ Fair Value Index™. This reflects the focus of investment on more attractive markets. Europe's index score has remained below 50 in the past two quarters, indicating that a higher proportion of markets are COLD. In contrast the index scores for Asia Pacific and the US have been above 50 indicating a higher proportion of HOT markets (Figure 8).

With more capital now targeting Asia Pacific markets we would expect some of these markets to re-price more quickly than suggested by our fundamental analysis. We have already seen this in the UK and it is also starting to happen in continental Europe.

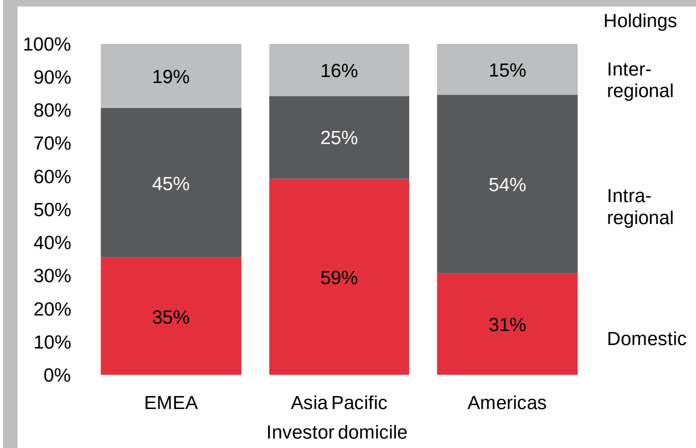
We have also observed a reduction in the amount of new capital funds propose to raise since the end of 2009. At the same time we have also seen a reduction in the global fair value score. As the attractiveness of markets reduces we foresee a stabilisation in the amount of new capital being raised in the future.

Box 2: Current and future allocations by region

We are currently surveying investors globally on their current holdings and how they expect these to change in the next two years. The results draw on a sample of 82 investors with assets under management in excess of US$500bn. In terms of current allocations by region, fewer than 20% of investors focus their activities outside their home region. In Asia Pacific the majority of investors (59%) are focussed domestically (Figure 9).

Figure 9

Investors' survey: investor domicile and target region

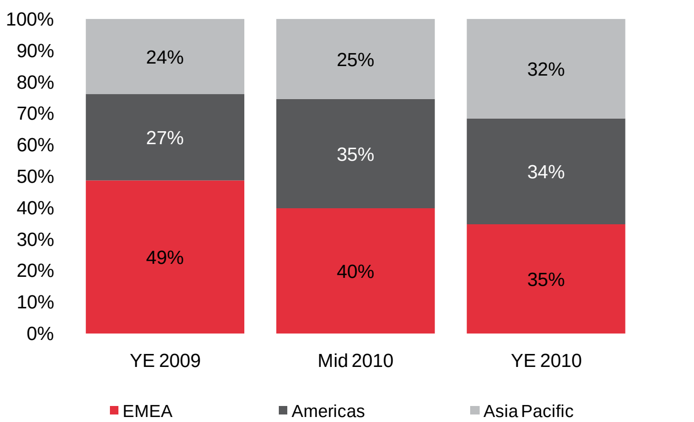


Source: DTZ Research

In contrast to our analysis, the survey suggests investors from the Americas are less inclined to invest inter-regionally. The discrepancy reflects differences in the survey sample that is reflective of the wider investor base in the Americas.

Figure 7

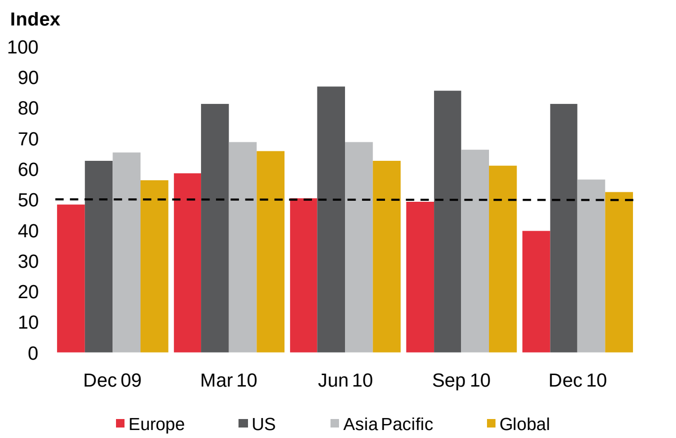
Target region, 2011



Source: DTZ Research

Figure 8

DTZ Fair Value Index™ regional scores



Source: DTZ Research

Outlook

Transaction volumes to increase

In 2010 global investment transaction volumes totalled US$325bn, a 64% increase on 2009. The growth in available capital in 2011 implies increased transactional activity, assuming all capital is deployed (Figure 10). Although this represents a marginal increase on 2010 volumes, we should remember that activity is not solely generated by new capital. We will see increases in activity arising from changes in capital values and natural churn in the market.

More Asian markets to re-price sooner

With Asia Pacific now benefiting from a greater increase in capital targeting the region, we would expect to see growing demand and competition for the better quality stock. As a result, we highlight the risk that some of these markets might re-price more quickly than suggested by our fundamental analysis. This follows the trend that we have already seen in the UK where high levels of demand placed downward pressure on yields, leaving a growing number of markets over priced during 2010 according to our fair value analysis.

Less new capital expected, if decline in attractiveness continues

The attractiveness of property has declined over the last four quarters (Figure 8). If this trend continues, we project a stabilisation in the amount of new capital available in the next few years. Investors can avoid the repercussions of this trend by stepping up their due diligence at both market and asset levels.

Whilst the amount of newly available capital remains strong, the amount of capital expected to come through in the future from new raisings has shown a modest decrease over the past six months from an estimated US$130bn to US$126bn.

It is significantly lower than the US$228bn we estimated at year-end 2009, albeit at a time of significant planned raisings to exploit the expected distressed opportunities available – much of which failed to materialise.

Regulatory reforms to impact future capital

Looking forward we see a raft of new regulatory initiatives in response to the financial crisis of 2008. Whilst some are specifically aimed towards the banking sector, a number are set to impact investors. These include: EU Solvency II rules for insurance companies and pension funds, the Alternative Investment Fund Managers Directive and the Dodd Frank Reform in the US.

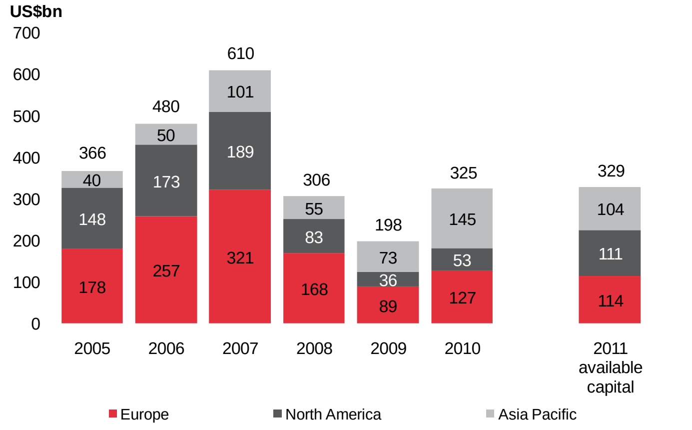
As investors digest the likely impact of reforms we can expect some to delay decisions potentially impacting the deployment of capital. We also expect enhanced regulations to impact the level of compliance placed on funds. This will likely impact new start-ups and more niche investors, reducing potential competition and the level of activity from these investors. Of course, the regulations may play more into the hands of larger investment houses and the potential for more multi-billion dollar funds.

Balance of investors hold negative views on new regulations

From our investor survey, a majority of respondents have a neutral stance towards regulatory reforms (Figure 11).

Figure 10

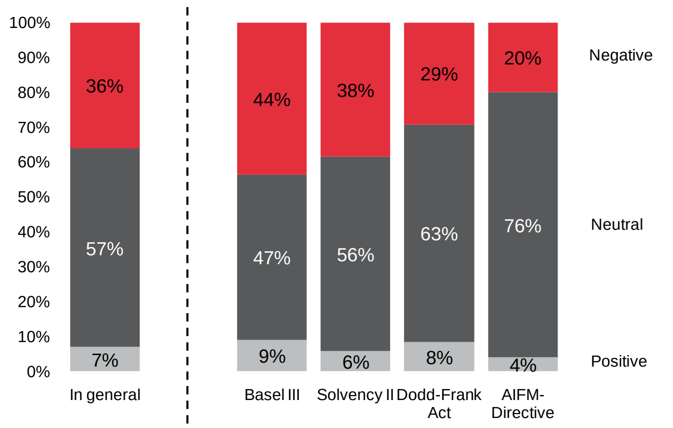
Global transaction volumes and available capital



Source: DTZ Research

Figure 11

Investors' survey: impact of regulatory reforms



Source: DTZ Research

However, we believe that this reflects the fact that many are still interpreting the impact of these new regulations for themselves and their clients. The net balance of respondents is still very negative. This is particularly the case for Basel III and Solvency II which are at the forefront of many investors' minds.

Overall it is too early to determine their impact as markets normalise, as final regulations might have less of an impact than originally expected.

With the upcoming regulations expected to limit the availability of new equity and debt capital, we would expect the wall of money targeting real estate to stabilise in the longer term.

Appendix 1: Methodology

Our approach to calculating the amount of capital available remains in line with the five step approach developed in our previous paper. As a recap we have summarised this approach based on the new numbers in Figure 12 below.

Step 1. US$425bn of equity raised

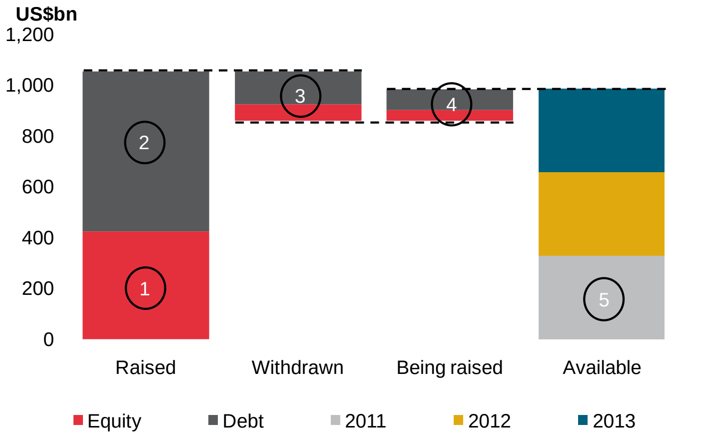
Our starting point for this research has been to update our previous database through amending existing records, adding in details on new or existing funds from existing and new sources and removing records where capital has been spent or the record has become historic for the purposes of this research. In total we have records on over 1,700 individual funds. Additionally we have utilised our Money into Property database. On the basis of this bottom-up data gathering exercise, we have identified US$425bn of raised equity.

Step 2. US$1,057bn in total raised capital

Assuming an overall LTV ratio of 60% we have estimated there to be US$1,057bn in total capital raised. Our overall LTV assumption of 60% is based on a combination of stated LTVs from the research we have undertaken and data from our Money into Property database for Institutions. We have assumed no gearing for Sovereign Wealth Funds. For funds with no stated gearing we have assumed these to have similar gearing to those funds where we have a stated LTV. Our assumptions are summarised in Table 1.

Figure 12

Available capital – step-by-step



Source: DTZ Research

Step 3. US$197bn of capital to be withdrawn

We expect US$197bn of capital will be withdrawn by third party funds reflecting the fact that some fund managers have not been able to invest all committed funds. With over 60% of capital available today having been raised in the last three years it is likely that some funds will not be able to deploy all the capital investors have agreed to provide.

Step 4. US$126bn capital being raised

A further US$90bn of capital is expected to be available for investment in the next few years. Assuming an overall LTV of 64%, this would equate to US$252bn in total capital. However, we expect that many of these plans will not be realised. Therefore, we assume only half of this capital (US$126bn) to be available for investment over the commitment period.

Step 5. US$329bn of capital available

DTZ Research estimates that US$329bn of capital will be available for investment in commercial property globally in 2011.

After taking into account the previous steps, we have a total amount of capital available for investment in the next three calendar years of approximately US$986bn. Just to recap, this consists of:

- US$1,057bn in raised capital
- Minus US$197bn of capital to be withdrawn
- Plus US$126bn of additional capital being raised

But this capital is expected to be available for investment over a three year period. Therefore, we estimate that a third will be invested in 2011.

Table 1

Average LTV by investor type

	Equity	Debt	Total	LTV
Funds: Stated LTV	63	123	187	66%
Institutions	105	30	135	22%
SWFs	10	0	10	0%
German OE Funds	2	2	5	49%
Funds: Unstated LTV	245	476	721	66%
Total (US$bn)	**425**	**631**	**1,057**	**60%**

Source: DTZ Research

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