

## Rush for property in emerging countries

By Laura Cohn

Published: July 15 2008 03:08 | Last updated: July 15 2008 03:08

The story is the same in almost every developed country: the bursting of the real estate bubble has caused property values to plummet, credit markets to seize up and the flow of deals to grind to a halt.

According to Real Capital Analytics, a research and consulting firm, the volume of deals in the industrialised world fell 54 per cent in the first quarter of 2008 compared with a year ago.

What is a restive real estate investor to do? How about an office block in China? Or an apartment development in India? Or an industrial park in suburban Moscow?

**Due to urbanisation, a growing middle-class and the opening of local mortgage markets, property in developing economies is on a tear as the rest of the world stagnates.** RCA said the number of transactions in emerging markets rose 43 per cent in the first quarter.

And the big boys are jumping in. A Citigroup survey of 50 leading pension funds in the US and Europe found that portfolio managers want to commit some \$370bn to real estate during the next three years, in spite of the slowdown in their domestic markets. That would bring property holdings up to 6 per cent of their portfolios, from an estimated 4.5 per cent.

Big chunks of that money are beginning to flow into countries such as China, India, Russia and the **emerging economies of eastern Europe**. Charles Schwab's \$228m Global Real Estate Fund made its first foray into emerging markets in March. Its fund managers have holdings in India, Brazil, Mexico and the Middle East – and insist they have just begun.

### Brazil sets the scene for a hot real estate market

One emerging market attracting a flood of investment capital is Brazil. With more than \$1bn in commercial real estate deals signed each quarter, the country has raced ahead of other regional rivals such as Argentina, Mexico and Chile.

Rising wages, low inflation, and a stable currency have spurred construction activity – and bullish sentiment. Sam Lieber, president of Alpine Funds and portfolio manager of the Alpine International Real Estate Equity Fund since 1989, says Brazil is a good place to be at present.

"Previous booms have been derailed by external and internal problems," he notes. "But now, there is much greater potential and opportunity."

Together with strong economic growth, favourable financing conditions make the country an alluring place, in his view. "Four years ago, there was hardly any financing available of any kind," Mr Lieber says. "Now, there's more bank financing." Even better, in contrast to banks in the US, he says, banks in Brazil are flush with cash.

Another advantage is that, unlike the US which has a mortgage-penetration rate of 80 per cent, Brazil's is well under 10 per cent, according to Fitch Ratings. That suggests the market has considerable promise.

"This is a market where the high end is under-served, as are the other strata," Mr Lieber says.

"A lot of the real estate we want to invest in doesn't exist right now," says Dionisio Meneses, a portfolio manager at the fund, referring to the huge amount of money chasing relatively few properties. "The opportunity will only increase."

The rush is coming from outside the west, too. Asian pension funds and sovereign wealth funds have begun to search for their own ways to get into real estate in the developing world, according to an analysis by the Urban Land Institute and PwC.

The Kuwait Investment Authority has invested \$750m in the Cevahir shopping mall in Istanbul. Separately, the Mapletree India-China Fund, a unit of Singapore's Temasek Holdings, has made a series of investments in China, including a \$320m residential and retail development in the southern Guangdong Province and a \$121m office block in Beijing.

"Investors believe emerging economies offer a great opportunity to grow capital," says Dan Fasulo, managing director at RCA. "The opportunities are overwhelming." So overwhelming that he expects the flows to keep rising. "All signs are, in the second quarter, it will be the same story," Mr Fasulo says.

But do not confuse this boom in developing country real estate to the investment bubbles that hit Asia, Latin America and the rest of the emerging economies in the late 1990s. Unlike the hot money that chased – and then fled – emerging markets, much of the investment this time is coming from within the individual economies. Less reliance on foreign financing means the rash of cash will last longer than it did a decade ago.

**Analysts at Morgan Stanley are so upbeat that they expect a boom in emerging market property over the next 10 years.** They think developing nations will spend \$22,000bn on core infrastructure projects during the period. About half of that will go towards construction.

The US credit crunch has quickened the process, as US investors pulling out of the domestic market look for other places to find returns on real estate.

The fast growth in deals in developing economies is due, in part, to a relatively low base – big-league real estate deals in some of the countries barely existed a decade ago. Even as growth slows in industrialised countries, deal volume still outstrips the number of transactions in emerging markets. The developing world is catching up, though. And one reason for the speed of growth is tied to the rise of China.

In the 12 months through the first quarter, China received \$102bn, or nearly two-thirds of the total flow to developing nations, RCA reports. That is serious volume no matter how it's measured: over the same 12 months, China was home to almost half of all land sales in the world, whether measured by their value or the number of parcels sold.

Much of the money going into Chinese real estate is domestic. A full 69 per cent of the real estate investment China saw over the past year came from home sources. One advantage domestic players have in China is the difficulty foreigners have investing without forming a partnership or a joint venture with a local company.

In a sign of how desirable Chinese property is, investment has spread well beyond leading cities. Of the five development deals that were valued at more than \$1bn, four were in lesser-known municipalities. Last year, property developer [Beijing North Star](#), along with partner Beijing Urban Development Group, paid \$1.2bn for development rights in Changsha, the capital of China's Hunan province.

Although China is the emerging real estate giant, it is hardly alone. India saw property sales volume jump 210 per cent in the first quarter over the first three months of last year, making it the world's fastest-growing real estate market, by RCA's count.

And like China, local investors dominate the market, with 59 per cent of the transactions. But unlike China, India has been helped by a government push since 2005 to loosen regulations that prevented foreigners from investing

in property, which has helped draw overseas capital.

"In India, they're just beginning the urbanisation process," notes Jonathan Garner, head of global emerging markets strategy at Morgan Stanley. "This is a long-waved theme."

India's burgeoning middle-class is driving the boom as a cadre of wealthy young people look for western-style housing. India had \$6.7bn in real estate transactions in the year through the first quarter, but the number of people trying to buy homes has created a shortfall of some 20m housing units, making it a market set to appreciate even further.

A big driver of the surge in demand for real estate in both India and China is population growth. The United Nations forecasts the two nations will become population powerhouses by 2050. By then, the UN expects each country – on its own – to have more people than the entire developed world.

During the next four decades, the UN expects the population of developing nations to make up 63 per cent of all the people on the planet. That would be a jump from the present figure of 56 per cent – and makes demographics a powerful justification for investors to put money into such markets now.

But it's not just the countries with fast-growing populations that have become investment magnets. Russia's oil wealth has spurred strong economic growth, and the real estate money has followed. As is the case in parts of Asia, foreign companies looking to invest in Russian property must enter into a joint venture with a domestic company. But unlike the investment in the Asian nations, the Russian deals have involved existing properties for the most part.

Elsewhere in Europe, Poland, Romania, and the Czech Republic have drawn investment flows. In addition, Turkey has caught the eye of investors. Foreigners sank some \$3.5bn into Turkish property last year, up from \$2.9bn in 2006, Morgan Stanley reports.

The rationale for the flows is that prosperity in emerging markets will create a need for residential and commercial development alike.

"These economies, which are growing faster than those in the developed world, are dragging people into the middle-class," says Stephen Blank, senior fellow, finance, at the Urban Land Institute. "And the middle-class needs office buildings."

[Copyright](#) The Financial Times Limited 2008

"FT" and "Financial Times" are trademarks of the Financial Times. [Privacy policy](#) | [Terms](#)  
© Copyright [The Financial Times](#) Ltd 2008.

---

[Go to source web page>>](#)