

MarketScore: Assessing Risk and Return in Asian Office Investment Markets

Andrew Ness and Ada Choi

CBRE Research, Asia

23 March 2006

EXECUTIVE SUMMARY

Attracted by the strong economic fundamentals and broad appreciation of office rental levels, the past several years have witnessed a rising level of institutional interest in Asian office property investment markets. With an aim to help investors fully evaluate risk and return potential in investing in this asset class, the current exercise assessed the investment case in Asia quality office property markets by scoring the levels of risk and return of each city (both having 10 as full mark, summing to a maximum overall score of 20) based on various aspects ranging from structural issues to historical market performances and market forecasts. Twelve cities were included in the survey, namely Tokyo, Seoul, Hong Kong, Singapore, Beijing, Shanghai, Guangzhou, Taipei, Manila, Jakarta, Bangkok and New Delhi.

As office rentals of most cities under review are on a rise and some offer lucrative yields, their scores in return are satisfactory, with the scores awarded ranging from 5.4 to 7.2 out of 10. However, their performances in risk score are relatively diverse, around 3.7 to 7.8, reflecting the fact that the markets are subject to different levels of risk. In particular, investors in Asia's emerging markets should take into account the higher risks associated with different levels of market liquidity, regulatory and political stability, restrictions on foreign investors and currency control.

For investors wanting to limit their risk exposure, Hong Kong (14.7 out of 20 marks), Singapore (14.6), Tokyo (13.1) and Seoul (12.9) are the desired destinations, and are also markets where institutional investors have been unusually active in recent years in engaging in major real estate investments. These cities also scored at the top of the MarketScore exercise, occupying four places amongst the top five. Prime office rentals in Hong Kong and Singapore are forecast to increase by 20% or above in 2006. However, in Hong Kong, a correction in office capital value is currently observed as the sales market has come under some downward pressure due to the interest rate rise. Tokyo is forecast to have a continued upward swing in rentals, rise around 10%-15% in 2006, but office investment capitalisation rates are currently under considerable pressure due to excessive liquidity, as the Central Five Wards is evolving into a "lower risk, lower return market". Although rental growth potential for Grade A office in Seoul is relatively mild, at about 3%-4%, office investment carries around 7.0%-7.5% yield, a level significantly higher than those in other mature cities.

Mainland cities are witnessing increasing interest from international institutional investors. Offering solid prospects of continued rental growth over the short term and initial yield around 6.8%, Shanghai (13.2) obtains the highest score among Mainland cities covered in the survey while Beijing (12.1) and Guangzhou (12.1) are under pressure of supply peak during 2005 and 2007. Extra potential returns to foreign investors are possible due to pressure on the Renminbi to further appreciate following the shift of exchange rate to a managed float regime in July 2005, since which time, the RMB has appreciated by about 2.9% against the US dollar.

Within the Greater China region, the Taipei office market (11.4) also witnesses increasing overseas interest while the market has relatively acceptable risk level and stable rental growth.

Investments in other emerging office markets are associated with higher levels of risk in regulatory or political uncertainty and restrictions on foreign ownership, although some cities, including Bangkok (12.3), Manila (11.7) and New Delhi (11.4), are providing attractive rental growth and potentially high yields.

INTRODUCTION

The Asia property markets have been in recent years the focus of a heightened level of interest from international investors, as the region is benefiting from the acceleration of growth by giants such as China and India and recovery on the part of economies which have traditionally driven growth in the region, namely Japan, Singapore and Hong Kong. As a result of the broad appreciation of rental levels in most of Asia's leading office markets over the past two years, office buildings are one of the most desired asset classes for real estate investment. However, in making investment in different office markets in Asia, investors will have to accept different levels of risk associated with various factors such as market liquidity, regulatory and political stability, restrictions on foreign investors and currency control. When considering building a region-wide portfolio in Asia, it is important to take into account the different levels of risk and return associated with each city through the use of a structured evaluation system — a framework that quantifies the risks and profit opportunities in each jurisdiction.

This paper pools insights and expertise of CBRE research teams in cities around Asia to provide an overall big picture of the investment case in Asia quality office properties by scoring the level of risks and returns of each city under different aspects. The discussion is then extended to each city to cover the current market conditions and issues that would impact on office property investment.

Cities under study include those with considerable institutional investments as well as emerging investment markets. Twelve cities were covered, namely Tokyo, Seoul, Hong Kong, Singapore, Beijing, Shanghai, Guangzhou, Taipei, Manila, Jakarta, Bangkok and New Delhi.

Content

Executive summary	2
Introduction	4
Scoring on risk.....	6
Scoring on return.....	8
Overall scores	9
Hong Kong	12
Singapore	13
Tokyo	15
Seoul.....	17
Cities in Mainland China.....	19
Shanghai.....	19
Beijing	19
Guangzhou.....	20
Bangkok.....	21
Manila	22
Taipei.....	23
New Delhi	24

Jakarta..... 25

SCORING ON RISK

From an international institutional investor's perspective, their major sources of risk lie in the volatility of rental income, stability of business environment and availability of exit channels for their investments. With respect to the above attributes, a comprehensive framework on risk scoring was developed.

The volatility of rental income is assessed by the standard deviation of Grade A office rental growth rate in the past 10 years. As the rental income is highly influenced by market supply and demand, fluctuation in supply, as measured by the range of vacancy rate, and demand, for which the economic growth is regarded as a proxy, are also taken into account in the scoring schedule.

While the rent, supply and demand can be assessed numerically in a quantitative fashion, other market attributes are more related to market structure. Taking a micro prospective on an investment project, an investor should consider the liquidity of the local office leasing and sales markets. For a market with high liquidity, it is easier for a landlord to secure tenants or obtain buyers at a fair market price level. Another factor taken into consideration is the length of typical lease structure. Institutional investors prefer a longer lease period so as to reduce the uncertainty posted by leasing risk.

As a higher level of cross-border investment activity is seen, it is also important to consider the risks associated with undertaking overseas investment itself. In Asia where many markets are still relatively immature, many countries impose restrictions in property ownership by foreign entities and in repatriation of domestic currency. The volatility of the target market's currency also creates additional uncertainty for foreign investors. Also under consideration is government policies and incentives provided to them.

On a macro level, regulatory environment and economic stability are also factors which bear close scrutiny by real estate investors, especially those putting money in emerging markets. Jurisdictions which permit a high level of information flow with respect to transactions in their local real estate markets and which maintain good land registration system are rewarded with higher score as this greater degree of market transparency enables investors to make better informed investment decisions.

Table 1. Scoring on risks

Rent	Standard deviation of Grade A office rental growth rate in the past 10 years
Supply	Range of vacancy rate in the past 10 years
Demand	Standard deviation of the GDP growth rate in the past 10 years
Structure	Project risks Investment liquidity Leasing liquidity Length of typical lease structure Risks on foreign investors Incidence of foreign ownership restrictions Government policies/incentives for foreign investors Currency stability Foreign exchange control Regulatory/environment risks Market transparency Regulatory environment Economic stability

Rent, supply and demand are scored on a 10-point scale, based on the quantitative measures stated above. Scores for structural issues are based on a 5-point scale and are assigned with reference to the market's local practice and relevant market framework. *(Please see Appendix 1 for detail)*

SCORING ON RETURN

Compared with scoring investment risk, assigning scores on investment return is somewhat less complicated. The most important factors in assessing return potential are the forecast rental growth rate of Grade A office buildings and the average initial yields on offer in the market.

The chief factors determining rental growth are market supply and demand. Vacancy and future supply within one year's time frame, taking into account the size of the market, provide the scoring figure for supply. For demand, on the other hand, a macro approach is adopted by assuming office demand is growing more or less in line with economic growth.

The above factors determine the gross return on office investments, but in considering the return in net terms, tax expenses and transaction costs must also be included in the evaluation system. Also, market practices with respect to rent indexation and review are also useful in assessing the likelihood of stable rental growth in an objective and systematic way. However, such practice in Asia cities is generally not witnessed. On renewal, rentals are generally determined by negotiation between landlord and tenant, on the basis of prevailing market conditions.

Table 2. Scoring on return

Rent	Forecast rental growth rate in 2006 Initial yield on offer
Supply	Vacancy rate plus forecast one year development pipeline as a percentage of stock as at the end of 2005
Demand	Forecast GDP growth in 2006
Structure	Tax on transaction Transaction cost Rent indexation and review basis

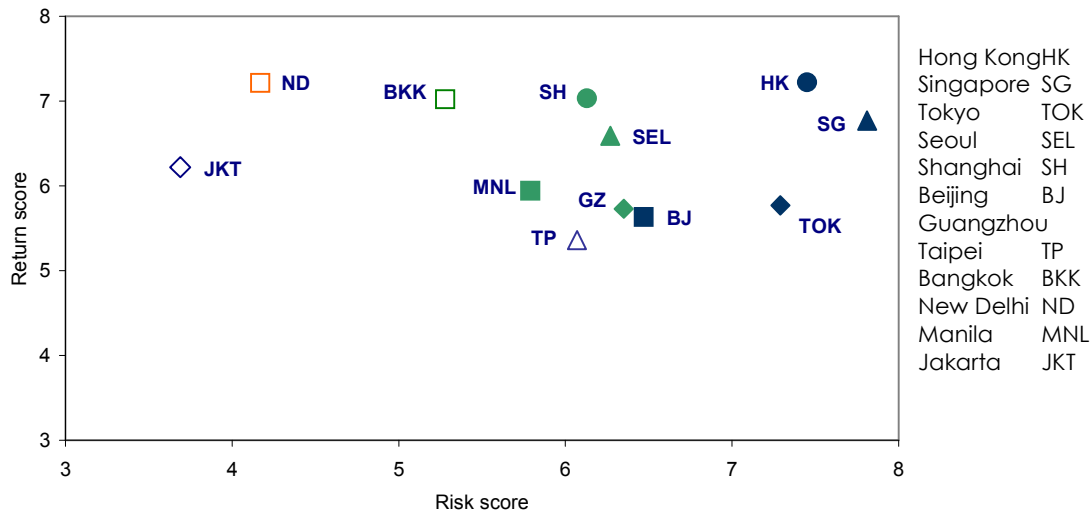
Similar to the scoring of risk, rent, supply and demand scores on return are based on a 10-point scale based on numbers and forecasts by CBRE Research while structural issues are based on a 5-point scale which is geared toward assessing market conditions.

After assigning scores on different aspects of risk and return, weighting on these aspects are assigned to each aspects according to the importance in property investment. The overall risk and return scores, each with 10 points as full mark, were then determined, summing to 20 marks as the overall score for each city.

OVERALL SCORES

Considering risk and return in two dimensions, all cities obtained satisfactory scores in return (5.4 to 7.2 out of 10) but their risk scores are relatively diverse, ranged around 3.7 to 7.8 (see Figure 1). This result reflects the fact that Asian property markets are generally on an upswing to provide viable returns to investors while are subject to different levels of risk. In fact, prime office rentals in all Asia cities experienced growth in 2005, with some surged over 40% (Hong Kong, New Delhi¹ and Manila) and some had mild increase less than 5% (Taipei, Seoul, Guangzhou and Beijing) (see Figure 2). However, at the same time, as some markets are still not very mature, investors have to face varied sources of risks and more complex issues. In particular, Jakarta, New Delhi are considered high-risk markets, rewarded a risk score below 5.0.

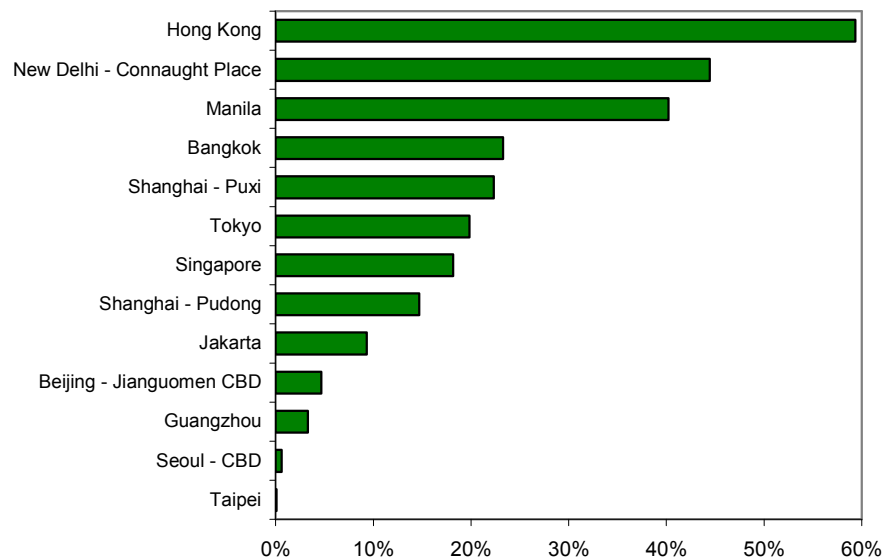
Figure 1. Risk and return scores



Note: A higher risk score represent a lower risk level.

Figure 2. Comparison of prime office rental growth in 2005

¹ Prime offices in Connaught Place

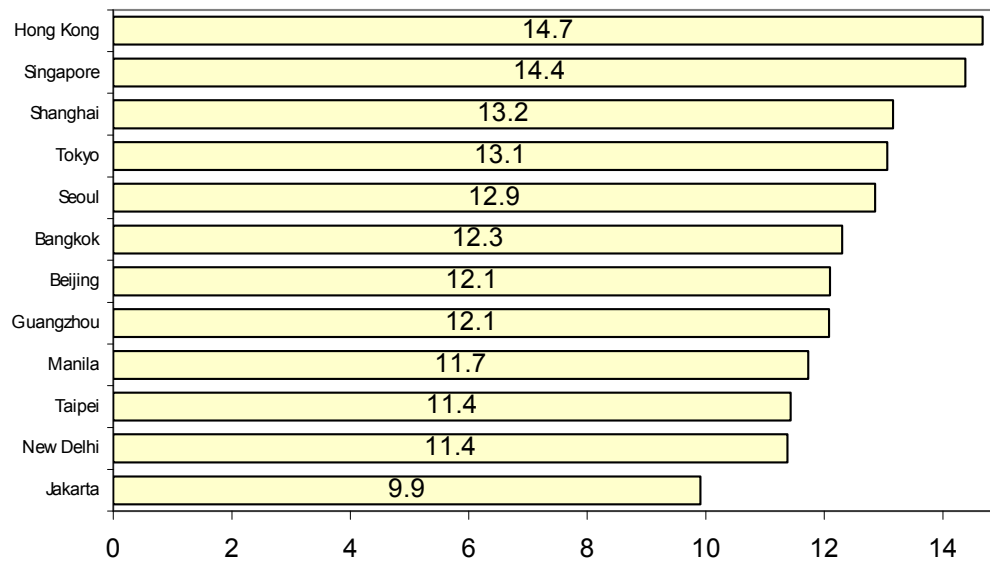


Overall, of the 12 cities under review, Hong Kong and Singapore obtained the highest overall score in their Grade A office market (14.7 and 14.6 respectively), followed by Shanghai, Tokyo and Seoul (13.2, 13.1 and 12.9 respectively). Hong Kong, Singapore, Tokyo and Seoul are currently the only Asia cities in which a broad range of institutional investors are active in engaging in major real estate investments, due to a constellation of factors which collectively create an acceptable environment.

Mainland China Cities are also witnessing higher level of institutional investments. Shanghai (13.2) has the highest score among Mainland cities, above Beijing (12.1) and Guangzhou (12.1), as the two cities will have high level of supply slated for completion in 2006, exerting pressure on rental growth. However, such situation may change during 2007 and 2008 as a number of office buildings will be completed in Shanghai, including the 101-storey World Financial Centre.

As the focus of increasing overseas institutional interest, Taipei (scored 11.4) market has relatively acceptable risk but rental growth is somewhat less exciting. Other cities are only suitable for consideration by overseas investors who are willing to accept the higher level of risks associated with regulatory or political uncertainty, in markets which may appear opaque. Meanwhile, some cities, namely New Delhi, Manila and Bangkok, are providing attractive rental growth and potentially high yields.

Figure 3. Overall score of the 12 cities



HONG KONG

	Score
Risk	7.5
Return	7.2
Overall	14.7
Overall rank	1

After moving away from the bottom of economic trough in 2003 after the SARS outbreak, the price and rental level of Grade A properties have experienced strong growth, with both having more than doubled within the past two years, attracting a level of interest from investors who believe that valuations are still low, indicating that office properties are still capable of providing lucrative return.

Return potential

Looking forward, it is expected that office rents will continue to head upward in 2006 in conjunction with the expected continued strength in the economy and no new supply. CBRE forecasts rentals to increase by 20% in 2006. This supports a high score on return. However, office capital values in Hong Kong have recently experienced a correction, due to the market's having been spocked by the interest rate cycle, leading to a rebound in yields offered in office investments to the level of about 3.8%.

Risk considerations

Hong Kong is regarded as a model of economic freedom with stable political and economic environment and no restriction on foreign exchange conversion and foreign investor ownership. The government adopts an open door policy and welcomes all kinds of investments although incentives, such as tax breaks, are not given. This structure has created a favourable atmosphere for real estate investment. However, one note that should be brought to institutions is that the Hong Kong economy is highly dependent on the external environment with high volatility in office demand as was evidenced by the severe impact which the Asian financial crisis in 1997 and the 2003 SARS outbreak had on the Hong Kong's economic performance.

SINGAPORE

	Score
Risk	7.8
Return	6.8
Overall	14.6
Overall rank	2

Historically, there has been substantial interest in acquiring Singaporean prime investment property on the part of overseas institutional investors. The launch of REIT market in July 2002 has also fueled institutional interests in Singapore. 2005 was a very active year for Singapore's property investment market, having been characterised by a high volume of transactions with S\$5.85 billion worth of deals in the latter half of 2005 alone.

Return potential

On the back of increasing space requirements from private wealth management companies, global offshoring operations, financial services players and IT firms as well as a steady pace of broad-based growth in economy, CBRE is projecting a rental increase of approximately 25% in 2006 for prime office properties. Investment in office properties is now providing a gross yield of 4.5%. Pipeline supply in 2006 will reach 2.02 million sf. Such large new short-term supply was the only demerit in determining Singapore's return score. However, the bulk of the supply, 1.3 million sf, from One Raffles Quay, has already secured pre-commitment of over 65%. Thus, such increase in supply is not expected to exert pressure on the rental levels.

Risk considerations

A high level liquidity is generally a characteristic of Singapore's office leasing and sales markets, as leasing transactions and sales transactions are frequent. The Singapore government has been proactive in attracting foreign investment and gives wide range of tax incentives and loan schemes to foreign investors, supporting the stream of office space demand from foreign companies. Foreign participation in property development and ownership is allowed with no restrictions. The rights of overseas investors are also well protected by the healthy judicial system and clear and fair investment laws. There are also no controls on currency exchange and offshore remittance of capital and income. High market transparency is maintained as disclosure of property transaction details are mandatory and must be lodged with the Singapore Land Authority and can be assessed on the authority's website with a fee. The economic uncertainty which should be considered by institutions investing in Singapore is mainly the country's extensive exposure to the Asian regional economies and the US economy due to the strongly external orientation of the Singaporean economy. After considering the above

attributes, the risk level of Singapore is considered low among the Asia cities under study.

TOKYO

	Score
Risk	7.3
Return	5.8
Overall	13.1
Overall rank	4

As one of the most mature market in Asia with significant market width and depth, Japan property investment market offers a large pool of investment objects for institutional investors, both local and overseas. In recent years, along with the convincing rebound of Asia's largest economy, Tokyo Grade A office appeared as a viable choice for international investors in 2002-2005, but as the recent severe compression in office investment capitalisation rates, Tokyo is evolving into "lower risk, lower return market", which is being increasingly dominated by domestic investors in the form of J-REITs and private funds.

Return potential

The potential of real estate investment in Tokyo lies in Japan's strong rental growth coupled with the fact that demand continues to outpace supply as medium-size corporations in the city are currently in a phase of massive expansion. CBRE forecasts the rentals of Grade A office will grow at 10%-15% in the year 2006, after a 20% spike in 2005, as a larger volume of Grade A office space will be slated to the market compared with 2005. About 6.63 million sf of space will be delivered in 2006, 84% more than the amount in 2005. The investment market of prime offices remains buoyant, with funds from overseas and local institutions both seeking suitable investment properties. However, competition for real estate assets continued to drive down NOI capitalisation rates for prime office buildings to approximately 3.0%-3.5%, effectively lowering the overall score on return.

Risk considerations

The risk level of Tokyo real estate investment is considered low as the market is mature and well regulated. Comparing the performance in the past 10 years with other cities in Asia, demand and supply of prime office space in Tokyo have relatively low volatility. For foreign investors, Japan imposes no restriction on foreign ownership and currency exchange though individual investors may have difficulties in obtaining mortgage financing from domestic banks. However, the Japanese market presents a high degree of complexity to foreign institutions due to the low degree of market transparency. Currently, only information such as name of purchaser and location of the property sold are available from the Civil Affairs Bureau's real estate registry; critical figures such as purchase prices and exact floor area are omitted from the registry's public records. Only transactions by J-REIT companies are required to be disclosed as part of the requirements for listing.

SEOUL

	Score
Risk	6.3
Return	6.6
Overall	12.9
Overall rank	5

In recent years, higher level of institutional buying into office properties in Seoul is witnessed as a sizeable group of real estate funds has emerged. These funds, backed by major investment management companies, have raised at least KRW 1.6 trillion (US\$1.6 billion) of capital in total. Overseas institutions, such as ING, DEKA and GIC, are seen to interested in acquiring office buildings, aiming at achieving high yield and stable cash flow.

Return potential

Office property investment in Seoul suits institutions targeting high-yield stable rental income stream. Yields offered by these buildings are around 7.0%-7.5%, a level which is generally not attainable in Asia's other mature office investment markets, including Hong Kong, Singapore and Tokyo. Consistently strong leasing demand is observed year on year, thereby lowering the chance of space being left vacant. The average vacancy rates of prime office buildings in major business areas, including the CBD, Gangnam and Yeouido, have remained at a level as low as 5% or below since Q2 2002. Such condition should prevail in 2006 as new supply will be very limited and fairly robust economic growth continues to support high demand for office space. In view of the above factors, return scores for Seoul of the corresponding aspects are high. Nonetheless, relatively mild rental growth potential for Grade A office is expected, at annual rate of 3%-4%. This results in a medium overall return score.

Risk considerations

Currently, the typical lease length is about two years, which is relatively short and may not be preferred by investors seeking long-term stabilised rental income. The real estate market has been fully opened to foreign investors since 1998, following South Korea's entry into WTO as a regular member, while investors wanting to remit funds offshore from the sale of properties which were acquired using capital generated in South Korea must first notify the Governor of the Bank of Korea. The market transparency is improving in South Korea as a new system of real estate transaction records was introduced in January 2006. Now, land or property purchaser or the broker must notify and register the actual transaction price to the government office in the city or district concerned within 30 days from the agreement date of the contract. While, such records are currently not publicly available, the Ministry of Construction & Transportation has a plan to permit their disclosure. Taking into account the above points and a stable rental growth as suggested from past

records as well as having a liquid market, the risk score of Seoul remains in the higher end of the spectrum.

CITIES IN MAINLAND CHINA

	Shanghai	Beijing	Guangzhou
Risk	6.1	6.5	6.4
Return	7.0	5.6	5.7
Overall	13.2	12.1	12.1
Overall rank	3	7	8

SHANGHAI

Despite the implementation of a series of macroeconomic control measures since second half of 2004, Shanghai office investment market remains active and is characterised by a rising level of interest from overseas investors. The city's strong economic growth also supports buoyant demand for office space from both corporate expansion and new corporate formation.

Return potential

The city is experiencing high rental growth although the momentum is expected to diminish in 2006 to increase at a rate about 8%-10%, significantly lower than the 21% rate recorded in 2005. The lucrative level of office investment yields, at around 6.8%, is another attraction of undertaking investment in the Shanghai office sector. In line with China's fulfillment of its WTO commitments coupled with rapid growth in overseas participation in domestic financial industry, strong demand for office space has been observed during the past five years. Looking forward, about 4.3 million sf of supply is expected in 2006, a lower amount compared to 6.6 million sf in 2005, and current vacancy rate is low at around 5%. Given the recent pattern of strong annual absorption of prime space, the supply factor should not exert negative impact on investment return potential.

BEIJING

Beijing is another one of the hottest spots for overseas institutional real estate investment in Mainland China, outside Shanghai. As the capital of the PRC, the office market in Beijing is a direct beneficiary of the country's rapid economic growth and increase influx of international business.

Return potential

New supply in Beijing prime office market is expected to reach its peak in 2006/2007. Rental levels of prime office in Beijing are expected to experience some downward adjustments in the next two years, as growth in demand may trail slightly behind the significant growth in new supply. Meanwhile, investors are still attracted by reasonably high yields of around 6%-7%. The Beijing Chaoyang District Government started offering subsidies to financial institutions setting up operations in Beijing's CBD via the lease or purchase of office space commencing from March 2006.

Such incentives should act as a stimulus, creating further demand for office space in the central city area.

GUANGZHOU

Compared with Beijing and Shanghai, institutional real estate investment in Guangzhou is less active. Primary land sales by the municipal government are still the focus of investment activity. As one of southern China's foremost business hubs, it is expected that Guangzhou will be a major recipient of new investment in the coming years, given the city's very strong existing manufacturing base and the further opening of China's banking and insurance industries, in line with its 2005 WTO commitments.

Return potential

With the continuing rapid completion of a succession of new office properties in Guangzhou, it is anticipated that rentals in the city will remain generally stable at the start of 2006 but begin to come under downward pressure as the year progresses. However, the relatively high level of Guangzhou investment yields, at around 7%-9%, coupled with Renminbi's appreciation potential, have recently made the city more attractive to overseas institutions.

Risk considerations in investing in Mainland China cities

As China's major urban centres have all undergone massive urban redevelopment over the past 10 years, Mainland cities which were covered in the MarketScore exercise, namely Beijing, Shanghai and Guangzhou, had all experienced problems of over-supply during 1998 and 1999, with Shanghai having experienced the highest vacancy rate, which was recorded at one point as 61.8%. However, as the urban regeneration process is still on a fast track, supply uncertainty still exists. As the cities have all benefited from the rapid economic growth during the past decade, the demand for prime office space is highly promising. For foreign investors, the limited convertibility of Renminbi and controls on outward remittances add a layer of risk with respect to realising the returns in their original currency, although the opening of China's capital account and the free convertibility is expected over the medium term. In July 2005, China reformed its exchange rate regime by moving to a managed float mechanism. Since then, the RMB has appreciated by about 2.9% against the US dollar and pressure for further appreciation has not significantly diminished. This creates extra return potential to foreign investors in Mainland properties.

China's imperfect level of market transparency is yet another factor that increases risk in making real estate investment in the country but the situation is improving. Associated with market stabilisation measures

which have been brought about by the imposition of macro economic control policies is better administration of the property market. All primary land sales in Beijing, Shanghai and Guangzhou are now carried out by the city government under public and competitive circumstances, whereas in the past such authority was decentralised to rural government agencies or state-owned units. Such land transaction records can be accessed through the government website. However, transaction details for properties are still not available.

Also of concern is the fact that the judicial system still requires further improvement. The low level of consistency in enforcement of laws and regulations and in implementation of court rulings tends to lower the confidence of potential investors in the Mainland China property market.

BANGKOK

	Score
Risk	5.3
Return	7.0
Overall	12.3
Overall rank	6

The Bangkok real estate market is only semi-open to overseas players as the government still imposes restrictions on foreign ownership of freehold land. However, the potential rental appreciation and high yield offered by office properties are attractive to investors.

Return potential

After experiencing double-digit growth in rentals of Grade A office in the past two years, the rental growth is expected to slow, due to the release of 1.36 million sf of new spaces to the market in 2006. However, office rental should still manage to gain 10% as the Thai economic outlook remains positive, subject to the outcome of the current political crisis surrounding the Prime Minister Thaksin and severity of the impact of avian flu epidemic. Investors in Bangkok office buildings can also enjoy a high yield of about 7.8% but tax burden may be high, including ownership transfer fee (at 2% of assessed value), special business tax (3.3% of declared amount²), withholding tax and stamp duty (respectively 1% and 0.5% of the higher of declared amount or assessed value).

Risk considerations

Currently, the investment liquidity of office property is quite low as the quantum of properties offered for sale is limited and local property investor base is still small. Activity level in the office leasing market is higher, supported by the space requirements from both local and international companies. Uncertainty of property investment in Bangkok also includes low market transparency and less mature regulatory

² This includes municipal tax which is charged at 10% of specific business tax.

environment. Details concerning property transactions are currently not required to be filed with any government body and thus private property transaction records are not publicly accessible. While private property rights are generally protected, more consistency in enforcement of regulations is still needed to attract overseas investment.

Foreign real estate investment in Bangkok is limited as overseas entities are generally not permitted to acquire freehold land. Currently, overseas investors can purchase leasehold properties³ through a variety of ownership structures⁴. Foreign investment capital can be freely remitted into the country. Investment funds in foreign currency can be remitted outwards freely upon submission of supporting evidences that all required tax payments have duly been made. But investors should aware of the volatility of Baht, which has moved within 9% range against US dollar in 2005.

MANILA

	Score
Risk	5.8
Return	5.9
Overall	11.7
Overall rank	9

Manila market is still a relatively closed market for foreigners and has limited supply of investment-grade office properties. Although rental growth and gross yield appear attractive, high transaction costs and taxation tend to erode a large portion of profit.

Return potential

Manila registered a high score in respect of its gross yield, at 6.5%-9%, and also with respect to its steady upward trend in rental level, which is expected to grow 8% in 2006 as supply of prime office space in the Makati CBD is still limited, keeping vacancy rate in single digit over the near to medium term. Over the past few years, sales transactions in prime office properties have been limited with the most active sales market being that of properties which have been pledged as banks' collateral for non-performing loans. Some foreign involvement in acquisition of non-performing asset has observed.

Transaction costs are high, agency fees and legal cost can be as high as 15-16% of the transacted price. The structure of taxation which applies to the sale of office properties is quite complicated. Tax schedule vary among real estate companies and between other types of companies as well as between local and overseas entities. Taxes on acquisition and

³ The duration of the lease should exceed 30 years but less than 50 years, according to the Lease of Immovable Property for Commerce and Industry Act 1999.

⁴ One possible structure is setting up a holding company in which majority ownership is held by a local entity while the foreign entity has controlling power on the board of directors.

transfer of properties include stamp duty, transfer tax and creditable withholding tax (at 7.5% paid by buyers), capital gains tax (at 6% paid by sellers). Rental income is also subject to 12% value added tax and, for corporations, payment of corporate tax.

Risk considerations

Investors in Manila properties also have to accept a higher risk associated with the regulatory environment and the political and economic stability of the Philippines. As a developing country, the Philippine government's regulations in general still lack transparency and are sometimes enforced in a haphazard manner. The banking sector is also prone to money laundering problems, and this hurts the overall healthiness and financial stability in the Philippines.

Foreign entities are currently prohibited from engaging in private land ownership but can lease land for 50 years with option to renew the lease for another 25 years and own properties on leasehold land. Alternatively, foreign entities which form joint venture with local corporations, such that at least 60% of the equity is held by the local counterpart, can purchase land. Funds invested in Philippine can be freely remitted aboard but are subject to currency risk as Peso is quite volatile against the US dollar. Market transparency is another area in which substantial improvement is still required. Currently, sales transactions tend not to be publicised. However market comparables such as tenants, floor area and rents are generally available for recent transactions in Metro-Manila.

TAIPEI

	Score
Risk	6.1
Return	5.4
Overall	11.4
Overall rank	10

The Taipei real estate investment market is attracting attention from both foreign and local investors. The launch of the REIT market supports the growth of domestic institutional investment in office properties while overseas investors also account for a significant amount of transaction activity in the Taipei office market.

Return potential

The Taiwan economy is forecast to witness a mild expansion in 2006 and will lend support to the level of leasing demand for prime office space in Taipei. A slight growth in rental level is expected in 2006, after a 0.15% increase in 2005, due to the limited supply of prime office space in major business districts and lack of new prime office space being released to the leasing market. Investors in office buildings can receive initial yield of 5.0%-6.0% from rental income.

Both property buyers and sellers are subject to the taxes payable on property transactions. Property sellers of local entities and foreign entities that have offices in Taiwan are subject to corporate income tax or Land Value Increment Tax⁵. Sellers of foreign entities owning properties in Taiwan without fixed business office are subject to a withholding tax, at 20% of gross income generated in the market, on top of paying Land Value Increment Tax. Buyers are responsible for paying deed tax (6% of price for property acquisition) and stamp duty (0.1% of contract price). Hence, when taken together, these overall tax expenses can be quite high.

Risk considerations

Liquidity risk is not a problem in the Taipei office sales and leasing markets. Sufficient amount of institutional investors, both local and foreign, were witnessed to be actively in search of investment-grade office buildings, demonstrating that persistent demand for quality office space exists.

The Taiwan government welcomes foreign investment and does not impose any limitation on foreign investment amount. Favourable incentives, including lower land price or looser land use in industrial zones, are offered to foreign companies who wish establish their regional headquarters in Taiwan. Foreign investors are allowed, in general terms, to purchase and own premises. Investment in ownership of land or buildings for the purpose of generating an income return has been permitted since 1997. However, companies wishing to exchange currency worth over US\$50 million for the purpose of making overseas remittance must apply for permission from the Central Bank.

Taiwan's business regulations can be burdensome and corruption is still a problem, though not very serious. The changing status of cross-strait relations between Taipei and the Chinese Central Government is also a politically and potentially socially destabilising factor in Taiwan. Taipei city enjoys a better market transparency, among other cities in Taiwan, as the Department of Land of the city maintains a comprehensive land registration system and information on real estate transaction is accessible via public channels.

NEW DELHI

	Score
Risk	4.2
Return	7.2
Overall	11.4
Overall rank	11

⁵ 20%-40% of the increase in the government-assessed value of the land component of the property during the ownership period.

With the encouraging performance of the Indian economy, growing at a rate about 7%-8%, the outlook for the real estate market remains optimistic. However, foreign property participation is still largely restricted and the number of investment-grade office buildings on offer for sale to domestic institutions is limited. The involvement of overseas institutional fund is still at a very nascent stage with only a handful of deals having been executed to date.

Return potential

Increase in rental level in prime offices in the CBD area accelerated during 2005 as the quantum of ready-to-lease office space is limited. Looking forward, rental growth in 2006 is forecast to be around 8-12% after accounting for the diluting effect of a sizable quantum of supply to be released to the market in mid-2006. Gross yields for prime office properties can be as high as 9% and hence they remain lucrative. However, property investors should also be aware of the high transaction costs such that sale of a property is subject to stamp duty (up to 8% of transacted value) and agency fee (about 2% of transacted value), among other costs.

Risk considerations

At present, foreign entities are allowed to invest only in development projects and not in tenanted properties for a cash-on-cash yield. Although it has been four years since India opened the real estate sector for foreign direct investment in property development since 2002, only nine approved FDI projects have been recorded within the period, as suitable large-size development parcels are in short supply, especially major metropolitan areas like New Delhi. Foreign investors engaging in development are also restricted from repatriating capital for a period of three years before the completion of the properties, except as approved by the government, but can remit abroad the profits generated from the project.

Investment in completed office properties by local investors is also inactive as investment-grade properties are scarce in New Delhi though significant interest in such projects is observed.

At present, the New Delhi real estate market remains largely opaque such that information on property transactions is limited. Property transactions are typically structured to include an undisclosed cash component and evasion of tax and registration duties are not uncommon. Nonetheless, there has been an on-going drive to rationalize and improve the property transaction registration system.

JAKARTA

Score

Risk	3.7
Return	6.2
Overall	9.9
Overall rank	12

As the economic growth of Indonesia remains subject to some uncertainty, a number of international institutions have revised down their GDP growth forecast of the country. Companies have adopted a wait-and-see attitude with regard to their expansion or relocation requirements.

Return potential

The hike in fuel costs resulted from the cuts of fuel subsidies of the government and fluctuation in Rupiah against US dollar have increased level of economic uncertainty in Indonesia. Under the high inflation environment (17% in December 2005), the rental level of prime office space in Jakarta is expected to increase by about 5% in 2006 but is subject to the impact of approximately 1.7 million sf of new space to be added to the market within the year, with about 4.4 million sf space still standing vacant as at December 2005. The gross yield remains high at about 10.7%, however, tax burdens are high. Investments by companies in properties or lands priced or assessed, whichever higher, at over Rp 60 million are subject to a Land and Building Transfer Duty of 5% as well as capital gains tax at 5% and value added tax of 10%.

Risk considerations

The liquidity of Jakarta's office sales market remains low with less than five large-lot transactions in the past two years. Foreign entities have no freehold right to own land in Indonesia but can obtain land through long-term lease agreements (around 25 years) or can set up a company in Indonesia to legally obtain rights on land. The quality of the regulatory environment and the government is also under concern as corruption is generally endemic and laws and regulations are often vague and enforcement is inconsistent.

The overall transparency of the Jakarta real estate market still remains low. Although the government keeps records on property transactions, since all transactions are subject to the object transaction Tax, transaction records are not publicly available.

References

1. *"Leasing and Investment Guidelines"* by CBRE Research, Asia
2. *Asia Pacific Office Market Review* by CBRE Research, Asia
3. *Asia Pacific Investment Review* by CBRE Research, Asia
4. *"The case for a strategic allocation to global real estate securities"* by Morgan Stanley Investment Management
5. *"Communicating Investment Risk to Clients: Property Risk Scoring"*, *Journal of Property Research*, June-September 2005, by Normal E. Hutchison, Alastair S. Adair and Iain Leheny
6. *"The Quantification of Corporate Real Estate Risk"*, Summer 2004, *Real Estate Issues*, by Forrest Huffman
7. *"Asia Pacific Executive Brief"*, February 2006, by International Market Assessment Asia
8. *Websites of relevant government agencies*

Appendix 1. Structural risks of Asia cities under review

	Project risk		Risk on foreign investor		Regulatory/environmental risk					
	Investment liquidity	Leasing liquidity	Typical lease length	Restriction on foreign ownership	Government policy/incentives for foreign investors	Currency stability	Foreign exchange control	Market transparency	Regulatory environment	Economic stability
Hong Kong	High	High	Medium	Favourable	Neutral	High	Favourable	High	Favourable	High
	High level of economic activities supporting continuous demand	High level of leasing activity, supported by the expansion of banking and financial companies	3 years	None	No specific incentives; the government adopts door-open policy to attract overseas investors	Hong Kong dollar pegs to US dollar at a rate between 7.75 and 7.85	None	Comprehensive transaction records can be accessed through online database; free flow of information through mass media	Transparent common-law system; low level of government intervention in the economy	Positive economic condition; international financial centre; healthy banking system
Singapore	High	High	Medium	Favourable	Favourable	High	Favourable	High	Favourable	High
	High transaction volume, about S\$5.85 billion worth office transaction in 2H 2005	Economic growth especially in the business and financial sectors underpinned demand	3 years	None	Adopts door-open policy; various incentive schemes to attract foreign investors	Exchange rate against US dollar around 1.62 and 1.85 in the past five year	None	Mandatory for property transaction with the Singapore Land Authority; records publicly accessible	High protection on private property; transparent common-law system	The most advanced economy in South East Asia; international financial centre with robust banking system; consistently receives high credit rating
Tokyo	High	High	Short	Favourable	Neutral	High	Favourable	Medium	Favourable	High
	High transaction volume; strong buying power from J-REITs	Strong demand from occupiers for office upgrade	2 years	No restriction on ownership	No specific incentives	One of the world's major currency; exchange rate against US dollar is quite volatile	None	Apart from J-REIT companies, property transactions are not required to publicise	Secure property rights	Slow but robust economic growth; competitive financial system
Seoul	High	High	Short	Favourable	Favourable	Low	Neutral	Medium	Neutral	Medium
	Sufficient buy-side capital (such as ING, GIC, Mirae and DEKA)	Consistent demand is expected along with stronger economy	2 years	None	Tax exemption or reduction in accordance with Foreign Investment Promotion Act	Exchange rate against US dollar around 1350 and 950 in the past five year	Neutral	A new registration system on real estate transaction has been introduced since 1 Jan 2006	Private property is secure; justice system is not very efficient; regulatory process may not be very transparent	Key industries post strong performances; North Korea's nuclear weapons programme posts uncertainty to the country
Mainland China	Medium	High	Medium	Favourable	Favourable	High	Not favourable	Medium	Not favourable	Medium
	Foreign investors have started seeking investment opportunities in office sector	Robust demand supported by new set-ups and expansion of large MNCs	2-3 years	Foreign investors can buy properties in Mainland China.	A wide range of incentives on industries and locations, including Special Economic Zones and coastal cities	In July 2005, China reformed the exchange rate regime by moving into a managed float regime.	Renminbi is not freely convertible	Land transaction records can be obtained through respective cities' government agencies	Weak judicial system; macro-economic control in place to cool down property investment	The economy is undergoing rapid growth; some uncertainty of overheating; the financial sector is still under-developed

	Investment liquidity		Project risk		Length of typical lease structure		Incidence of foreign ownership restrictions		Risk on foreign investor		Market transparency		Regulatory/environmental risk		Economic stability	
	Leasing liquidity		Leasing liquidity		typical lease structure		ownership restrictions		Government incentives for foreign investors		Currency stability		Regulatory environment		Economic stability	
Taipei	Medium	Instifutional investors have started aggressively searching for investment-grade office buildings	Medium	Persistent demand for quality stock; certain amount of "flight-to-quality"	Medium	3-5 years	Favourable	No restriction on commercial buildings	Neutral	Tax holidays and incentives on preferred investment and in the past five year over US\$50 million must apply for the Central Bank	Medium	Exchange rate against US dollar around 31 and 35	Medium	Outward remittance of currency worth US\$50 million	Neutral	
Bangkok	Low	A few property offered for sale as well as a small number of local property investors	Medium	Continuous office space demand from local and international companies	Medium	3 years	Not favourable	Foreign investors are generally not permitted to hold title to land but can purchase leasehold properties	Favourable	Offers various incentives and special benefits to attract foreign investments.	Low	Exchange rate against US dollar around 38 and 46	Favourable	Investment funds can be remitted freely upon filing with the Bank of Thailand	Favourable	
Manila	Low	Sales transactions have been drive the market limited over the past few years	Medium	Call centres/BPOs drive the market demand	Medium	3-5 years	Neutral	Foreign investors are generally not permitted to hold land but are allowed to lease private land	Neutral	Firms registered with Board of Investment or Philippine in the past five year Economic Zone Authority can enjoy tax incentives and other privileges	Low	Exchange rate against US dollar around 48 and 57	Favourable	None	Favourable	
New Delhi	Low	Investment-grade space is "ready-to-move-in" but attracts significant investor interest	Low	Very limited "move-in" supply	Medium	33 months	Not favourable	At present, foreign entities are allowed to invest only in development projects but are not allowed in tenanted properties.	Favourable	Special tax incentives in special economic zones from time to time to stabilise the exchange rate	Medium	The Reserve Bank of India carries out market operations from time to time to stabilise the exchange rate	Not favourable	Repatriation of capital investment in real estate development is not allowed for a period of three years generally	Not favourable	
Jakarta	Low	Less than 5 major transactions in the last 2 years	Low	Many companies adopt a wait-and-see attitude in office expansion	Medium	3 years	Not favourable	Foreign entities have no freehold rights to land ownership in Indonesia	Neutral	Some incentives for the import of capital goods and investment in remote area	Low	Have wide fluctuations against US dollar after adopting free-float exchange rate regime since 1997	Neutral	Foreign remittance worth over US\$10,000 must be reported to the Central Bank of Indonesia	Neutral	