Asia-Pacific real estate: local approach in a diverse market

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EXECUTIVE SUMMARY

The Asia-Pacific region contributes approximately a third to global gross domestic product ("GDP") and is growing at more than double the pace of the United States ("US") and Europe. However, it has yet to receive its proportional allocation of real estate investments from institutional investors.

Asia-Pacific is an extremely heterogeneous market. Its approximately 50 countries are different from each other in terms of stage of development, governance systems, transparency in real estate markets, tax regimes, and official languages used. In terms of size, the region is vast, covering eight different time zones from India in the west to New Zealand in the east.

Given the diversity in the Asia-Pacific region, Partners Group views the region as a collection of distinct local markets and broadly classifies them into two categories: developed markets and emerging markets. On the following pages, we present our views on the current real estate landscape across Asia-Pacific, with a focus on the markets where we see attractive opportunities in the medium to long term.

Developed Asia-Pacific

- Japan is facing challenging times in the aftermath of the earthquake. While the physical damage to properties held by institutional investors is limited, the impact on the overall business environment is yet to be determined. Economic repercussions could result in lower occupancy for hotel rooms, retail and office space at least in the short term. Nevertheless, yields in Japan show a positive spread relative to interest rates making leverage accretive to investments. Distressed sales due to the financial crisis are expected to create opportunities to buy stable assets at attractive prices.

- Korea’s real estate market is tightly held by domestic institutions with only 13% in the hands of foreigners. Thus, relationships are crucial and investors must have a strong network to access quality deal flow. The secondary market has been an attractive instrument to access commercial properties at discounts to intrinsic value. While supply for those assets is higher compared to historical average, we expect new international grade developments to be positively received by tenants.

- Singapore and Hong Kong are both island economies with limited land. Due to their space-constrained nature and high external dependency, these two property markets tend to be more cyclical than others in Asia-Pacific. While capital values in Singapore and Hong Kong have already recovered from the recent downturn, there are a number of commercial buildings in these markets that are aged and undermanaged by the current landlords and offer potential for value-added strategies.

- Australia faces capital constraints in real estate lending. Foreign banks left with high losses on loan portfolios in the downturn have retreated from the real estate sector. At the same time, domestic lenders have adopted more conservative practices, creating a gap between bank finance and equity. Partners Group sees attractive opportunities in assets that remain capital constrained with a debt recapitalization or mezzanine investment to fill the gap between bank loans and equity.
Emerging Asia-Pacific

- India offers attractive development opportunities in the middle income residential sector backed by strong fundamentals. Foreign direct investments in real estate development is a relatively young industry in India. While there have been successful exits in the India private real estate space, foreign investors have had mixed experiences overall. Partners Group believes risks with investing in India can be substantially mitigated through structured transactions and by partnering with local operators.

- In China, Partners Group sees the most attractive opportunities in residential investments in Tier II cities. We expect volumes and prices for residential properties to fall over the next 12 months as the government is determined to make housing more affordable. Partners Group believes this will present another compelling entry opportunity in a market that has very strong fundamentals over the long term.

- Vietnam’s demand for real estate is underpinned by rapid urbanization and compelling demographics. In terms of economic growth, the country has emerged as one of South East Asia’s strongest performers. While strong growth came at the expense of double-digit inflation, Partners Group still sees compelling opportunities, especially in the residential sector.

Exhibit 1: Asia-Pacific real estate markets

[Map showing Asia-Pacific real estate markets]
DEVELOPED ASIA-PACIFIC

Japan: strong yield play – acquire from distressed sellers

Japan is currently recovering from the aftermath of the earthquake. The natural disaster caused terrible human suffering. In terms of the economic impact, 2011 growth is expected to slow as a result of power outages, damage to factories and infrastructure. Research institutions have taken the disaster into account and revised their GDP forecast downward; however, they have noted that the incident will not stop the economy from its growing trend. By the second half of the year the post-quake reconstruction efforts will likely result in a boost to growth. GDP growth estimates average approximately 0.8% for 2011 with a recovery to 2.6% in 2012.

Exhibit 2: Economic forecasts before and after the earthquake

<table>
<thead>
<tr>
<th>Institution</th>
<th>Pre-Earthquake FY2011</th>
<th>Pre-Earthquake FY2012</th>
<th>Post-Earthquake FY2011</th>
<th>Post-Earthquake FY2012</th>
<th>Change FY2011</th>
<th>Change FY2012</th>
<th>As of</th>
</tr>
</thead>
<tbody>
<tr>
<td>IMF</td>
<td>1.6%</td>
<td>1.8%</td>
<td>1.4%</td>
<td>2.1%</td>
<td>-0.2%</td>
<td>0.3%</td>
<td>3/30/2011</td>
</tr>
<tr>
<td>Goldman Sachs</td>
<td>1.3%</td>
<td>2.1%</td>
<td>0.7%</td>
<td>2.5%</td>
<td>-0.6%</td>
<td>0.4%</td>
<td>3/29/2011</td>
</tr>
<tr>
<td>Nomura Securities</td>
<td>1.5%</td>
<td>2.3%</td>
<td>0.8%</td>
<td>2.9%</td>
<td>-0.7%</td>
<td>0.6%</td>
<td>4/5/2011</td>
</tr>
<tr>
<td>Moody’s</td>
<td>1.4%</td>
<td>1.9%</td>
<td>1.0%</td>
<td>2.3%</td>
<td>-0.4%</td>
<td>0.4%</td>
<td>3/23/2011</td>
</tr>
<tr>
<td>Daiwa Institute of Research</td>
<td>1.4%</td>
<td>2.4%</td>
<td>0.8%</td>
<td>3.6%</td>
<td>-0.6%</td>
<td>1.2%</td>
<td>4/5/2011</td>
</tr>
<tr>
<td>Japan Research Institute</td>
<td>1.1%</td>
<td>2.0%</td>
<td>0.5%</td>
<td>2.2%</td>
<td>-0.6%</td>
<td>0.2%</td>
<td>4/5/2011</td>
</tr>
<tr>
<td>Nissei Research Institute</td>
<td>1.7%</td>
<td>1.7%</td>
<td>0.1%</td>
<td>2.7%</td>
<td>-1.6%</td>
<td>1.0%</td>
<td>3/30/2011</td>
</tr>
<tr>
<td>Average</td>
<td>1.4%</td>
<td>2.0%</td>
<td>0.8%</td>
<td>2.6%</td>
<td>-0.7%</td>
<td>0.6%</td>
<td></td>
</tr>
</tbody>
</table>

Source: Secured Capital Japan (April 2011)

Similarly, the adverse impact on the institutional real estate market could be short-lived as well. The area of northern Japan, hardest hit by the earthquake and tsunami, has minimal institutional real estate ownership. Properties in Greater Tokyo and Osaka have only suffered minor damages. However, the impact on the overall business environment is yet to be determined and economic repercussions could result in lower occupancy for commercial real estate. For example, as fewer tourists and business travellers travel to Japan, demand for hotel rooms is expected to suffer.

GDP in Japan grew 3.9% in 2010, after negative growth of -1.2% and -6.3% in 2008 and 2009, respectively, as a result of the financial crisis.¹ The country faces mounting sovereign debt and lingering deflation. Japan was replaced by China as the second largest economy in the world this year. The generally negative perception of Japan and its lacklustre economic outlook hinder investment capital and, as a result, property values have been largely repriced. At the same time, there are signs of recovery in the underlying property markets. The vacancy rate for class S (premium quality) office building spaces in Tokyo, as a leading indicator for the entire office market, has recovered from 7.8% as of Q4 2009 to 4.1% as of Q4 2010.²

While some of the tenant moves could be held back in the short run, the earthquake could result in a propensity to move into newer and/or larger office premises with higher quake resistance. Additionally, yields in Japan show a positive spread relative to interest rates. Unlike the rest of Asia-Pacific, the potential to achieve positive leverage still exists in Japan in the short term despite leverage below historical levels.

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¹ http://www.stat.go.jp/data/sekai/03.htm, Ministry of Internal Affairs and Communications (2011)
² Office Market Report, CBRE (Q4 2010)
Partners Group believes the most attractive opportunities are in the Tokyo vicinity. Tokyo is the world's largest city economy followed by New York and is supported by modest GDP growth in line with other large city economies as well as favorable demographic developments expected for the next decade. Tokyo accounts for a third of Japan’s GDP, and is supported by solid fundamentals. The current market environment creates opportunities to defensively invest in one of the most transparent and liquid property markets in the world.

Partners Group considers the office and middle income residential sectors to be the most attractive property types in the Tokyo market. The office sector in Tokyo is supported by limited supply over the next five years. On the demand side, 23% of corporate tenants headquartered in Tokyo are reported to be planning new office leases (compared to 24% in 2007).\(^3\) Vacancy rates have already started to recover and Partners Group expects that rental rates for Tokyo offices will follow. The residential sector in Tokyo has historically exhibited very defensive characteristics. Over the past 10 years, the occupancy rate for residential properties in Tokyo has moved in a tight range of between 93% and 96% with very stable rents.\(^4\)

Across the Tokyo market, Partners Group sees attractive deal flow from distressed sellers at fire-sale prices. Such sellers include private funds facing liquidations, corporates looking to offload non-core assets, and financially distressed real estate developers. In addition, over USD 100 billion of loans (bank lending and commercial mortgage-backed securities) will mature over the next three years.\(^5\) As lenders have started to write down their loans, the book value has begun to close in on the market clearing point, suggesting strong selling potential that is expected to be realized in late 2011 or 2012. In the office sector, cautious underwriting is crucial, especially in light of potential for negative rent reversion and tenant defaults. Nevertheless, this sector offers an opportunity to acquire highly leased stable assets with strong cash on cash yield over the investment horizon.

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\(^3\) Survey by Mori Building (December 2010). Includes only office buildings with total floor area of over 10,000 sqm and excludes applications other than office use

\(^4\) J-REIT Property Database, ARES (December 2010)

\(^5\) Moody's, Atlas Partners Japan estimate (March 2010)
Korea: attractive commercial opportunities – access is key

Korea’s economic growth over the past 47 years has been impressive. Per capita GDP was only USD 100 in 1963 and has grown to over USD 20,000 in 2010 (USD 30,000 in purchasing power parity terms). The Korean economy posted its eighth consecutive quarter of GDP growth in Q4 2010 after its economy returned to positive growth rates, supported by the government’s swift and active fiscal spending aimed at bolstering investment and consumption. Due to the recovery of the Korean economy and strong government leadership, the Korean real estate market has attracted strong interest from investors.

The real estate market for foreign investors in Korea opened in 1998, and as a result, is still predominantly held by domestic entities with only 13% in the hands of foreigners. Furthermore, the market is characterized by corporate ownership of property. Relationships in the domestic market, including with Korean conglomerates, are crucial and investors must have a strong network in order to access attractive investment opportunities.

The majority of investment opportunities have been centered on Seoul which generates over 21% of Korea’s GDP. The total Seoul Metropolitan Area represents approximately 48% of Korea’s GDP. Investments in Korea are predominantly in the commercial segment because the leasing system in the residential sector is unique (the tenant pays a lump-sum deposit to the owner for the use of the property with no additional requirement for periodic rent payments).

Seoul’s office rental market has historically been steady in contrast to more volatile rental cycles evident in other markets in the region. Grade A vacancy rates averaged about 3 percent over the past decade and rents held up even through periods of economic downturn.

To date, only a few international investors have entered Korea’s property markets to develop modern, high-quality properties. The city of Seoul is currently revitalizing its business districts with the aim of becoming an Asian business center. As a result, as much as 360,000 sqm of prime office buildings are expected to come online annually from 2011 to 2014, which is equivalent to 5% of total prime office stock in Seoul and over twice as much as its average annual supply for the past six years.

While a number of new office developments will come online over the next three years, there has been a chronic undersupply of international Class A office space in Seoul as local developers have not historically built to an international Class A standard in terms of building efficiency, floor plate sizes, ceiling heights, building infrastructure and technology. As modern demand prefers quality office space, Partners Group believes that new international grade developments will be positively received by tenants.

Through its Seoul office, Partners Group has established strong on-the-ground relationships and is able to access attractive investment opportunities. A recent example is our investment in the International Finance Center Seoul, a Class A mixed use development project in the heart of the increasingly popular Yeouido district. Through the secondary market, Partners Group was able to acquire this opportunity on behalf of its clients at an attractive price from a distressed seller. The project is on schedule and on budget. Further, pre-leasing is far ahead of budget, driven by strong demand for Class A office space from multinational corporations.

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6 http://ecos.bok.or.kr/EIndex_en.jsp, Bank of Korea (2011)
7 Seoul Office Market Report, Savills (February 2011)
8 http://ecos.bok.or.kr/EIndex_en.jsp, Bank of Korea (2011)
Singapore and Hong Kong: focus on real estate fundamentals

Singapore and Hong Kong are among the world's most open and dynamic economies and have both rebounded strongly with robust growth following the downturn in 2009. Singapore and Hong Kong are island cities with limited land. Due to their space-constrained nature and high external dependency, these two property markets tend to be more cyclical than others in Asia-Pacific. The cyclical nature is already evidenced in the rise in property prices since the recent crisis. For example, Hong Kong's residential market has overtaken its 2007 peak and the government is actively trying to counter further price increases by providing more land for sale.

Exhibit 3: Singapore and Hong Kong are extremely cyclical office markets

Partners Group believes the most attractive sectors in Singapore and Hong Kong are office and retail. Undermanaged assets provide opportunities in these markets for value-added strategies.

Singapore has a population of five million people and is the world's fourth leading financial center, playing a key role in international trade and finance. The city's recent growth has been mainly driven by a rapid rebound in manufacturing following a contraction of 1.3% in 2009, and the annual rate of growth will be a moderate 4.5% in 2011. Supply of new office space in Singapore is relatively high and 9.8 million sqft of new office supply is expected to come online through 2013. That said, Singapore had the biggest increase in office rents across the Asia-Pacific region in the third quarter of 2010 and, in USD terms, central business district Class A office rents

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9 Department of Statistics Singapore (2011)
10 Urban Redevelopment Authority, Singapore (2011)
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increased by 15.6%. According to a recent report by Hudson\textsuperscript{11}, employers’ expectations to hire additional staff have risen from 26% in 2009 to 62% in Q4 2010. While the Class B office sector remains vulnerable as there is a “flight to quality” from tenants, Class A office rents rebounded strongly and the outlook remains positive, as market sentiment continues to improve. If demand for space continues to surge, the lack of new office supply beyond 2013 may lead to an increase in Class A rents back to 2007 levels.

Retail sales have been positively impacted by the number of visitors to Singapore, which exceeded ten million last year. Tourist arrivals are expected to further increase to approximately 17 million by 2015\textsuperscript{12}. The retail market is experiencing stable occupancy rates but approximately 4.0 million sqft of new supply is expected through 2012\textsuperscript{13}.

The office sector in Hong Kong shows positive signs as demand and average rentals have both increased after a significant correction in 2008 and 2009. Hong Kong is the world's largest IPO market with a long pipeline of listing candidates. Additionally, multi-national corporations have begun to hire again. During the fourth quarter of 2010, the overall office vacancy rate was down to 5.5% and the net effective rents grew by 5.3%. Jones Lang LaSalle forecasts that office rentals are expected to grow by 13% and 11% in 2011 and 2012, respectively, mainly driven by strong demand from financial institutions and Mainland Chinese companies, coupled with limited available supply\textsuperscript{14}.

In the retail sector, the main driver is the increasing number of visitors from China. According to the Hong Kong Tourism Board, there were approximately 36 million visitors to Hong Kong in 2010, which represents an increase of 22% over 2009.\textsuperscript{15} In 2010, retail sales grew by 18.5% on a nominal basis. With a rise in prime retail rents by 4% quarter-over-quarter, the leasing activity remains strong, especially for prime shops in core locations. New supply is expected to be limited to two-thirds the average historical net absorption since 2001 and should drive the vacancy rate down to 2.9% by 2014.

While capital values in Hong Kong and Singapore have already recovered from the recent downturn, many of the commercial buildings in these markets are aged and undermanaged by the current landlords. Therefore, Partners Group strongly believes that office and retail properties in these markets offer potential for value-added strategies such as repositioning or refurbishment. However, in volatile markets like Hong Kong and Singapore, it is crucial to focus on real estate fundamentals when underwriting deals rather than betting on potential rent increases or future cap rate compression.

Foreign investors with a shorter term (three- to five-year) investment horizon can find it difficult to navigate the cyclical. To help mitigate the risks and identify attractive investments, Partners Group employs local specialists while also working with experienced investment partners, such as Pamfleet, who have been investing in Hong Kong and Singapore over a number of years.

In a recent transaction, Partners Group acquired a portfolio of assets on behalf of its clients at a deep discount to intrinsic value. The portfolio is dominated by Asia Square, an international-quality Class A office development in the heart of Singapore’s central business district. Since acquisition, pre-leasing activities have picked up strongly and the valuation of the property has increased significantly.

\textsuperscript{11} Hudson Survey (2011)
\textsuperscript{12} Singapore Tourism Board (2010)
\textsuperscript{13} Urban Redevelopment Authority Singapore (2011)
\textsuperscript{14} Jones Lang LaSalle (Q4 2010)
\textsuperscript{15} Hong Kong Tourism Board (2010)


**Australia: bridging the gap – issuing junior debt**

Australia has recovered well from the global financial crisis and posted a 2.7% GDP growth in 2010. Part of the strength was directly attributable to policy stimulus that is gradually being removed. However, the strong demand for commodities continues to support Australia’s growth momentum and Australia’s labor market has performed remarkably well.

On the back of these encouraging signs from Australia’s economy, substantial capital previously on the side-lines is now flowing into what is perceived to be the least risky sector of real estate – trophy, core properties. It has resulted in numerous bidders on a small number of transactions causing cap rates to fall below the 7-8% range reflected in older appraisals. Given the cap rate spread over the risk free rate and current difficulty in finding attractive financing, leverage may not be accretive.

The appearance of a recovery in the core property markets may mask real distress that continues to exist in many other segments. Despite a robust banking sector, new credit to real estate continues to be rationed. A significant number of assets are in foreclosure and it is still difficult for property owners with mortgages to refinance assets that are leased and cash flowing. Foreign lenders left with high losses on loan portfolios in the downturn have retreated from the real estate sector. At the same time, domestic banks have adopted more conservative lending practices, creating a gap between bank finance and equity.

Despite the flight to perceived quality, Partners Group maintains that the most attractive opportunities will be in assets that remain capital constrained with a debt recapitalization or mezzanine investment to fill the gap between bank loans and equity. Junior debt offers the opportunity to generate 15%+ returns with quality income producing assets and stable cash flow profiles. Short term mezzanine opportunities are available in the residential sector, higher yielding but with shorter hold periods.

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16 Australian Bureau of Statistics (2011)
EMERGING ASIA-PACIFIC

India: attractive development opportunities backed by strong fundamentals

With a population of over 1.1 billion people, India is the world’s biggest democracy. Driven primarily by domestic demand, the economy has been growing over 8% on average since 2003.\(^{17}\) One of the costs of this fast-paced growth has been a persistently high consumer price inflation, which is probably the biggest macroeconomic risk facing India at this time.

The real estate stock in India’s cities is not sufficient to meet the demand from a strong urbanization trend. The Indian government thus opened the real estate development sector to foreign direct investment (“FDI”) in 2005. Official data shows that foreign investors have been extremely bullish about this sector as FDI in Indian real estate rose from USD 38 million in 2005 to USD 2.8 billion in 2008. Cumulatively, the Indian real estate market has received USD 9.4 billion (as of December 2010) in FDI since 2005.\(^{18}\) Despite the significant FDI, the urbanization trend across India generates further real estate needs.

According to the McKinsey Global Institute, 250 million people will be added to India’s urban areas from 2008 to 2030.\(^{19}\) The requirement to house these people in urban areas raises the need for residential real estate development in the country. While the need for housing is evident, it is critical to select the right development partner and structure a deal that aligns the interest of both parties to the timely and on-budget execution of the project. There have been several instances where local development partner interest was not completely aligned with the investors and projects have had unforeseen delays and cost over-runs.

With 270 million people expected to be added to working-age population by 2030, and 70% of net new employment expected to be generated in cities, the need for commercial space is ever-growing.\(^{20}\) However, it is a difficult territory for FDI investors. The delays in land acquisition and execution have hurt returns for many investors in commercial development in India since 2005. The lack of a Real Estate Investment Trust or institutional real estate investor market creates exit risks for financial investors in the sector.

FDI in real estate development is a young industry in India. While there have been successful exits in the India private real estate space, foreign investors have had mixed experiences overall. This is primarily due to investors’ lack of understanding of real estate related risks in India, which include local partner selection, underwriting of delays in land acquisition and approvals, structuring investments for downside protection, and exit strategy for non-residential assets.

Partners Group has been able to understand and mitigate many of the risks described above by investing with experienced local partners in portfolios that have substantially completed land acquisition, and have visible exit options at project completion. For instance, in late 2010, Partners Group invested on behalf of its clients in a ground-up office construction project being developed by an operator with 15 years of local experience. Partners Group was able to negotiate an attractive downside protection structure whereby Partners Group would receive a 2x cost multiple even if the portfolio was to be sold at 0.74x of cost. In another example, Partners Group invested directly in the second phase of a residential project in the National Capital Region of India in 2011. The first phase is over 90% sold and construction is underway on the second phase.

\(^{17}\) Handbook of Statistics on Indian Economy, Reserve Bank of India (2010)
\(^{18}\) Ministry of Commerce and Industry, India (2010)
\(^{19}\) India’s Urban Awakening, McKinsey Global Institute (2010)
\(^{20}\) India’s Urban Awakening, McKinsey Global Institute (2010)
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China: corrections ahead – selective investment opportunities

China overtook Japan as the world’s second largest economy in 2010 with China’s nominal GDP reaching USD 5.9 trillion compared to Japan’s USD 5.5 trillion. China has also become the world’s largest car market, biggest energy consumer and third largest consumer for luxury goods.

After sharp growth in 2009, China’s residential market started to show signs of slowing in 2010. Over the past few years, land prices for residential real estate have increased by 200-300% and, in 2009, residential properties in Tier I cities experienced price appreciation of 25-30%. In 2010, price appreciation slowed to less than 10% (except Guangzhou). This is primarily due to the efforts of the Chinese government to decelerate the over-heated housing market. Recent policies include the introduction of property taxes in cities such as Shanghai and Chongqing. Despite the lower growth, Partners Group expects these markets to undergo additional, significant pricing level corrections.

Contrary to Tier I city housing policies, China’s government has made it a priority to develop middle class housing in Tier II cities like Chengdu (population 11 million) and Chongqing (population 32 million); regulatory support includes tax incentives to encourage middle-income housing development and greater financing opportunities for middle class consumers purchasing their first home.

On the commercial side, there is a massive amount of new development, especially for Class A space. In Beijing, for example, 18.9% of existing office market stock is projected to come to the market over the next 12 months, and the Shanghai office market is expected to double its existing inventory. Similarly, many Tier II cities have followed and a significant amount of office space will hit the market over the next two years. At the same time, the demand for

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21 The Economist (February 17, 2011)
22 Jones Lang LaSalle (2010)
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Class A space in those cities is low as multinational corporations prefer China’s Tier I cities. The high level of new supply will put pressure on vacancies as well as rents for Class A office space, especially in Tier II cities.

Partners Group sees the most attractive opportunities in residential investments in Tier II cities. We expect volumes and prices for residential properties to fall over the next 12 months as the government is determined to make housing more affordable. Partners Group believes this will present another compelling entry opportunity in a market that has very strong fundamentals over the long term. Partners Group is cautious given government cooling measures but expects to selectively invest in growing Tier II cities.

Partners Group views “build to sell” projects with a two to three year hold as the most attractive investments and expects to capitalize on Tier II city growth as these cities are better positioned with higher owner-occupier ratios than Tier I cities. Tier II cities are characterized by cheaper land and labor costs, less development competition and greater middle-income residential supply/demand imbalances due in part to less speculative build-up in preceding years. Negotiating advantageous terms is less challenging in second tier cities, as local developers are often in need of external capital to fund their projects.

Recently, Partners Group invested on behalf of its clients in a mass market residential development located in Xuzhou, a Tier II city in north east China, with its investment partner Gaw Capital. Average sales prices are significantly exceeding the underwritten sales prices and the project is on-track to deliver returns in excess of five times Partners Group’s cost.
Vietnam: growth wave – middle class demand for housing

In the past decade, Vietnam, the world's 13th largest country by population with nearly 90 million people, has emerged as one of South East Asia’s strongest performers. GDP growth was approximately 6.8% in 2010, which exceeded the official growth target of 6.5%. Strong growth came at the expense of double-digit inflation (12.2%) and a depreciating currency. In February 2011, the USD/VND rate was adjusted by the state bank from 18,932 to 20,693 – a 9.3% devaluation of the official rate. With inflationary pressures, a trade imbalance and currency woes, the government is aware of its need to balance growth with economic stability.

Vietnam’s middle class is rapidly expanding and is expected to grow from 7 million in 2003 to approximately 25 million in 2013. Household incomes have doubled in the last four years and, on the back of increasing disposable income, Vietnam’s retail sales for consumer goods and services grew over 18% in 2010 (excluding the price-rise factor). Official per capita GDP p.a. in major urban areas is far higher than the national average with approximately USD 2,500 in Ho Chi Minh City and USD 1,700 in the capital city of Hanoi. In a global study of urban communities, PricewaterhouseCoopers (“PWC”) projected that Hanoi and Ho Chi Minh City will be the top two fastest growing economies in the world. With anticipated average real GDP growth of 7% per annum from 2008 to 2025, Hanoi and Ho Chi Minh City top PWC’s study of 151 cities around the globe. Compared to other Asian nations, Vietnam has the youngest demographic profile with approximately 80% of the population under the age of 40 and 72% of this majority under the age of 24.

Given the fast growing middle class, there is significant latent residential demand in Ho Chi Minh City and Hanoi. Robust demand and urban migration are far outpacing supply, and have created a severe housing shortage in Vietnam’s urban areas, with a significant portion of the population living in sub-standard accommodations. According to the Ministry of Construction, 28% of the people in Hanoi live in very crowded and very small accommodations with average living space per capita of 7 to 7.5 sqm. As the cities grow, and urban migration and income rise, demand for housing will continue to increase.

While investing in Vietnam is associated with potential risks, including the recent surge in inflation and challenges in fiscal and monetary policies, the fundamentals are compelling over the long term. Overall, demand for real estate in Vietnam is underpinned by rapid urbanization and compelling demographics. Additionally, the country’s emerging middle class is approaching the size necessary to generate self-sustaining internal growth and demand in the property market, particularly the residential sector.

Through a recent acquisition, Partners Group invested on behalf of its clients in two property portfolios in Vietnam at a significant discount with a top quartile real estate manager. The transaction offered an opportunity to secure highly visible residential and hospitality assets in Vietnam. Soon after closing, 162 out of 163 units in a residential property in Ho Chi Minh City were sold on the back of strong demand for housing. Our partner is currently in discussions with a buyer for the remaining unit.

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23 Economic Intelligence Unit (2011)  
24 PricewaterhouseCoopers (2009)  
25 Indochina Land (2010)  
26 Ministry of Construction Vietnam (2010)
CONCLUSION

The Asia-Pacific real estate market offers significant opportunities for investment. While not all countries present attractive market fundamentals, diversity among the region generates distinctive opportunities driven by various macro-economic and fundamental drivers in several locations. Strong relationships, best in class partners, deep regional experience and local offices are critical to successfully take advantage of opportunities over the medium to long term. It is especially important to partner with experienced operators and align interests. Flexible investment structures can be engaged to improve the risk return profile of the investment. Partners Group has completed numerous transactions in the region and is well positioned to continue actively investing in Asia-Pacific through well-vetted, selective transactions.
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