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China presents the best property prospects in Asia

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The China property market offers the most upside of any country in Asia, according to CB Richard Ellis Investors Executive Managing Director Mark Karlan.

Speaking at a presentation this week, "Taming the Tiger: Opportunities in Asian Real Estate", Mr Karlan said that while Japan and India were attracting significant investor interest, China was the market with the most compelling prospects.

On an economic level, China was projected to leapfrog Japan to become the world's second largest economy within the next decade. Combined with this, the country's property market was robust, with an undersupply of high quality space, improved infrastructure and only limited overbuilding in certain regions.

The market was underpinned by a growing middle class population which already numbered 300 million – a demographic which was helping to drive new development in the region.

Eight of the world's top ten shopping centres were now located in China, including the International Trade City in Yiwu which incorporated 30,000 stores and was close to nine times the size of Australia's Knox City Shopping Centre in Victoria. A second phase of International Trade City is now under development, to capitalise on the centre's strong performance.

These underlying fundamentals have underpinned ongoing investment in China by CB Richard Ellis Investors, a CBRE-owned investment management business with more than \$US42 billion in property funds under management.

Mr Karlan said the business's Strategic Partners II fund was projecting gross IRR's of between 22% and 29% on its recent investments, which included a 25% stake in the new Tianjin Centre – a mixed use development incorporating a 49-storey office tower, retail space, serviced apartments and Raffles Hotel.

The fund also has a 52% joint venture interest in the repositioning of the Guangdong Development Bank Tower in Shanghai. The mixed use project is situated near the 2010 World Expo site.

Strategic Partners has also been targeting Japan – a market which has proved to be relatively immune from the global credit crisis.

Mr Karlan said Japanese banks tended to focus on balance sheet lending rather than debt securitisation – hence the limited fallout from the current credit squeeze.

With interest rates in Japan still very low, there remained a positive arbitrage between the cost of borrowing and property investment yields. As result, there had been limited impact on property values.

While there had been some repricing of secondary assets, there had been little if any impact on institutional grade property in the major city markets and prices were continuing to firm in some instances.

Mr Karlan linked the strong performance of the Japanese property market to the country's continued economic recovery, low office vacancy rates and limited new supply.

This had underpinned strong returns on investments made by Strategic Partners, including its \$US40.7 million acquisition of the FLEG Portfolio in Japan, which includes one residential and three commercial properties in central Tokyo.

While the properties had been bought vacant, all but 2% of the space had been leased in less than 12 months.

The fund had also invested in Ginza 3-Chrome – a boutique retail development in the Ginza shopping district of central Tokyo. Mr Karlan said the Ginza retail vacancy rate was less than 3% and, with strong demand from tenants such as Adidas, Strategic Partners had been able to lease the retail space at rents 9-30% above its preliminary forecasts.

India was another country attracting considerable investor interest, however Mr Karlan warned that there were still considerable hurdles to investing in that market.

While the property fundamentals were strong, there was still limited access for foreign investment and the market was continuing to be constrained by its second-rate infrastructure.

About CB Richard Ellis

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