



Trends

HOME AND AWAY

How to navigate unfamiliar markets for global real estate investments

BY MELISSA REAGEN

Investing globally provides diversification, a broader opportunity set and potentially higher risk-adjusted returns. For pension plan investors who are considering a global allocation to real estate, conducting an analysis of foreign markets in order to develop a deeper understanding of how they compare to domestic markets is an important first step.

This process of analysis might seem unwieldy, given the array of property types and countries available. However, comparing a few of the aspects of retail properties located in mature Asia-Pacific countries (Japan, Hong Kong, Singapore, Australia and New Zealand) to those in Canada will highlight some of the key issues and risks that investors should be aware of when investing in a foreign market and building a global core property portfolio.

Understanding the different local market drivers and nuances of retail in each of these areas is an essential starting point. Retailers in Asia, for example—particularly those located in highly visible locations—will pay very high rents for “high street” retail locations on the main street of a town clustered near other businesses because they believe such exposure is critical from a marketing and promotional standpoint, even if store profitability is low. Although location is important to retailers located on the main streets of Canada, rarely does it trump profitability.

On the demand side, according to the *Luxury Goods Worldwide Market Study, 10th Edition*, Chinese consumers spend €12 billion to €15 billion on luxury goods outside of China to avoid the high tariffs imposed on such items in China. Many of these consumers shop in the mature Asian economies, boosting retail sales in high street locations and making it easier for retail tenants to swallow high rental rates. Given this, investors should be cautious with high or main street retail properties that house luxury brands, as they are more likely to be overpriced. Better investment value may be found in shopping centre space across mature Asian economies and in Canada.

In terms of ownership and lease structures, *strata title*—also known as fractured ownership of a property—exists in Asia but not in Canada. Having multiple owners in a building, rather than a single building management team, incents each owner to take care of only his or her individual portion. The overall building, therefore, doesn’t receive as many capital expenditures as it would under a single owner and management team. Foreign investors should understand the implications of this structure. Retail centres with strata title often lose competitiveness because of the lack of appropriate

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capital expenditures, resulting in lower achievable rental rates and potentially lower terminal value.

Lease lengths for non-anchor retail space (businesses that are not major chains) in mature Asian markets tend to be three to five years, versus five years for similar space in Canada. Anchor leases average 10 years in Asia, versus 10 to 15 years in Canada. And the fractured ownership and shorter lease terms of core retail properties in mature Asia-Pacific

markets tend to produce more volatility than core retail properties in Canada.

However, these characteristics can provide even core investors with opportunities. In higher growth markets, such as the mature Asia-Pacific markets, shorter leases actually provide significant upside potential as leases roll to potentially higher market rates.

These are just a few examples of the key considerations that pension investors should fully analyze and explore before shopping for real estate assets in foreign markets. Comparing domestic and foreign markets is critical to making prudent investment decisions. 

Fact File

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