Growing up fast

Emerging Asian markets are flexing their muscles and attracting increased investor interest

by Mard Naman

The pandemic's effects on global supply chains boosted the profile of several emerging Asian nations as businesses worked to become less reliant on China. China's faltering real estate sector, sputtering economy and increasing geopolitical risk have helped accelerate this trend.

Indeed, foreign direct investment in China dropped by more than 5 percent in the first eight months of 2023, according to China's official Ministry of Commerce. Even as there are signs of stabilisation in China's economy, the International Monetary Fund sees China's GDP growth slowing to about 3.5 percent over the medium term.

US firms in China are the least optimistic they have been in a quarter century about China's five-year outlook, according to a September article in the *South China Morning Post*. In a recent survey by the American Chamber of Commerce in Shanghai, 40 percent of US firms said they were shifting their supply chains and investments elsewhere, 6 percent more than in 2022.

But this trend does not mean investors are fleeing China. "The investment activities in China from cross-border capital may have slowed down, but many are adopting a wait-and-see approach," says Pamela Ambler, head of investor intelligence, Asia Pacific, for JLL.

"Our experience indicates an expansion rather than a movement of manufacturing out of China — largely for diversification and resilience," adds

Brian Chinappi, partner and head of real estate for Actis. India and Vietnam have been large beneficiaries of this ongoing shift, Chinappi notes.

India presents strong GDP growth, urbanisation and a well-developed tech sector with talent, Ambler explains. REIT listing as an exit option increases liquidity. Vietnam enjoys favourable economic and demographic tailwinds, and has robust manufacturing capabilities and export sectors.

"Both markets are expected to deepen their liquidity as they attract more foreign investment and develop their financial infrastructure," says Ambler. In addition to India and Vietnam, Ambler believes Thailand and the Philippines can be potential beneficiaries of the trend of de-risking and diversifying manufacturing supply chains from China, as they both have industrial capabilities and relatively lower cost. Markets less appealing to investors are those with political instability, low business transparency and regulatory challenges.

Actis has been focused on high-growth markets such as South Korea, China, India and Southeast Asia as a region. This is where Chinappi sees a strong convergence between durable global themes (such as digitalisation, supply-chain transformation, climate transition, health and wellness) and strong secular demand trends (such as densification of wealth in cities, limited suitable existing stock and significant local institutional demand for new core assets).

"There is a gradual production shift out of China due to the diminishing cost advantage," notes Dr Henry Chin, global head of investor thought leadership and head of research, Asia Pacific, for CBRE. However, Chin notes China's strong supply chain and production expertise will enable the country to act as a major value-added contributor to regional partners.

"Meanwhile, India and ASEAN countries are competing to become the world's next factory," says Chin. Several of these countries have introduced generous incentives to lure foreign investment and encourage new factories and job creation in strategic industries such as electric vehicles and semiconductors.

Manufacturing hubs of key industries — including electric vehicles, semiconductors, electronics, fast-moving consumer goods, life sciences, and textile and chemical — are expanding in emerging Asian countries, Chin notes. This includes India, Indonesia, Malaysia, Thailand and Vietnam. And

this, of course, has positive implications for commercial real estate in those nations.

For India, Vietnam and other select ASEAN countries, Ambler sees an investor focus on industrial and logistics assets, given increased demand for warehousing and manufacturing facilities. "Data centres also have a long runway for expansion," adds Ambler. The logistics and office sectors will benefit from more foreign companies entering the market and are expected to have better liquidity than other sectors.

India is a big winner in the shift

Apple Inc's move to diversify iPhone production from China to India is one example of the supply shift, and investors are pursuing data centre and several alternative-sector strategies in India. For example, investor interest in the Indian life sciences sector will keep growing as India continues to produce a large percentage of vaccines and prescription medications for the United States and the world, Chinappi suggests.

There are also opportunities in India's industrial and warehouse sectors. About 60 percent of India's GDP comes from consumption, and both sectors are directly related to the growing manufacturing and consumption, as well as the supply-line realignment that is benefitting India.

India's GDP growth in the past fiscal year was about 7 percent, and growth expectations for 2023 are between 6.0 percent and 6.5 percent. This growth is expected to continue, with economic experts predicting India will become the world's third-largest economy by 2030, after the United States and China. And a recent DBRS Morningstar study found rapid digitisation is transforming India into a more electronic, efficient and formal economy.

India's younger demographics, population growth, ongoing urbanisation and the government's push for more foreign direct investment are appealing to investors. Still, India's unwieldy bureaucracy, burdensome regulations and sometimes chaotic democracy have also made some investors cautious.

But India is becoming more appealing to foreign real estate investors. "The Indian real estate sector has undergone a major transformation toward institutionalisation over the last decade," notes Chinappi. "As a result, transaction activity has multiplied, adding exit depth for investors and reducing exit risk."

Supportive and progressive government policies are also helping put India in the spotlight for institutional real estate capital. "We can see this in the number of global investors actively investing in the sector in India," says Chinappi.

Going beyond traditional property types

So far, most global institutional capital has invested in traditional property types — mainly office, residential and retail — where there are longer-term sector track records. But that focus is starting to change. "As these mainstream property types have become more mature, underwriting has become tougher and potential returns lower," explains Chinappi.

Compelling opportunities exist outside the mainstream in alternative real estate property types. "Some of these property types offer a promising early-mover opportunity, akin to investing in the Indian office sector in the early years of its evolution, which went on to see significant value creation and create many winners," says Chinappi.

While traditional real estate in Asia has generally been less negatively affected since the pandemic than in the West, that is not Actis' focus. "We see huge potential and relative value in what we refer to as 'new economy real estate'," notes Chinappi. He defines this as real estate where end-user demand is driven by current growth industries and global thematics.

This has led Actis to focus on industrial/logistics, data centres and life sciences. Life sciences real estate stands out among these alternative property types, as does manufacturing-focused industrial. Chinappi also sees growing selective opportunities in urban repurposing because many emerging Asian markets are home to several very mature, developed cities where some repurposing is required and often overlooked by larger local players.

Investing in growth markets in Asia provides significant investment opportunities, but they are not slam dunks. Experience, on-the-ground presence, local relationships and an intensively operational mindset are important ingredients to achieving strong investment outcomes in emerging

Indonesia's opportunities and challenges

Indonesia, the world's fourth most populous country, has a median age of only 29, younger than China and India. It has a growing middle class, and the current government strongly supports economic growth and infrastructure investment. Indonesia is also the world's largest producer of nickel, a key component in electric vehicle batteries.

Currently, Indonesia is attractive to investors interested in logistics/warehouses, landed housing, land development and serviced apartments, according to Pamela Ambler, head of investor intelligence, Asia Pacific, for JLL. Indonesia can also provide diversification benefits for investors interested in new economy sectors. But there are challenges. "Bureaucratic complexities, insufficient infrastructure and the risk of natural disaster are key considerations for investing in Indonesia," cautions Ambler.

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Asia, Chinappi emphasises. "Unfortunately, there are no shortcuts to getting this right," he adds.

Also, the amount of existing investable stock is not comparable with mature markets, so many investors may prefer more-developed nations, such as Japan and Australia, Ambler notes. "Emerging Asian markets have relatively limited investable stocks, and there are also limitations on foreign ownership, making it harder for international investors to penetrate," Chin adds.

Very lively life sciences sector in India

The Indian life sciences sector has momentum behind it: It is expected to grow at a compound annual growth rate of 13 percent, reaching US$427 billion by 2030, according to Chinappi. Life sciences in India has a long track record and global importance, even though less well known than most other sectors. For example, India accounts for 60 percent of global vaccine production and supplies nearly 40 percent of generic medicines consumed in the United States. It supplies about 25 percent of all medicines consumed in the United Kingdom. And, outside the United States, India has the largest number of FDA-approved plants globally.

"The sector is poised for growth and acceleration," Chinappi predicts. Global factors include the realignment of supply chains and an ongoing "patent cliff" that will unlock a generic market worth up to US$250 billion globally.

India also has one of the largest talent pools of chemistry, biology and biotechnology graduates available at very competitive costs. "Research and development in India costs around one-third of that in the US and Europe, giving rise to a huge and growing potential for R&D outsourcing," Chinappi advises.

Local factors also support growth. This includes rising incomes, increasing insurance penetration and coverage, more focus on healthcare by the Indian government, and a new government policy providing research-linked incentives to the life sciences industry. But an absence of mainstream developers in the life sciences sector means a shortage of appropriate stock in the market, creating a meaningful opportunity.

Notably, the life sciences sector in India is markedly different than in developed markets. "In India, the most scalable part of the industry is effectively the outsourcing and offshoring of science," observes Chinappi. This means tenants require larger spaces, longer leases and have more stable credit. "The tenants are also required to fund their own fit-out, making them very sticky," he adds.

India's huge demand and development opportunities for logistics/warehouses

Consumption accounts for about 60 percent of India's GDP, so the economy relies heavily on local demand. S&P has forecast the Indian consumer market will almost double from US$2.3 trillion in 2022 to US$5.2 trillion by 2031, reflecting a growing population and rising household incomes. "Clearly, such an expansion alone will create huge demand for logistics infrastructure, including warehousing," says Chinappi. And the current single-digit penetration of ecommerce in India means there is plenty of headroom for ecommerce growth going forwards.

Also, a lot of lower-quality legacy warehouse stock is not suitable for today's and future use. The potential obsolescence of some existing stock can increase the demand even further.

The supply side of Indian warehousing was reborn in 2017, when the government introduced a unified goods and services tax, removing numerous state tax boundaries. "This has created an unprecedented opportunity for manufacturers and sellers to improve efficiencies in production and distribution," notes Chinappi.

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Industrial property is benefitting from three major demand-related tailwinds, making it well positioned for future growth, Chinappi suggests. First is the global realignment of supply chains to reduce concentration risk, which benefits India. Secondly, India is in the initial recovery period of the private capex cycle. This is well supported by a deleveraged private sector and healthy levels of private-sector capacity utilisation, which will increase demand for industrial property as it picks up steam. And third is a strong policy push from the Indian government to accelerate the setup of large-scale manufacturing capacities.

Since much needs to be done to create the warehousing stock necessary to support India's expected GDP growth, the sector holds great promise for industrial and warehousing property developers. And there are not enough institutional players currently in the sector, creating attractive room for new entrants. "With the tailwinds in the sails, the sector may even deliver above-inflation rent growth in the years to come, as demand potentially exceeds supply, a phenomenon we have witnessed in many other markets in a demand-supply imbalance," states Chinappi.

Good morning, Vietnam

It is a new day for US-Vietnam relations, as US companies and other global investors increasingly do business in Vietnam. US President Joe Biden visited Vietnam in September, and the United States recently announced a strategic partnership that significantly enhances economic and technological ties between the United States and Vietnam.

Malaysia ranks high for data centre growth

Malaysia topped Knight Franks' newly launched SEA-5 Data Centre Opportunity Index in April 2023. The proprietary tool assesses the data centre ranking of five Southeast Asian markets — Malaysia, Indonesia, Thailand, Philippines and Vietnam — based on factors such as recent take-up and supply figures, existing and future cloud availability zones, subsea fibre connectivity, population sizes, GDP growth, and ease of doing business for foreign investors.

According to *The Knight Frank Report* from the first quarter of 2023, the data centre markets of Mumbai, Seoul, Kuala Lumpur and Bangkok are growing rapidly. The majority of overall growth in Asia Pacific supply was fuelled by market expansions recorded in Mumbai, as well as new capacity announcements from Bangkok, Kuala Lumpur and Tokyo.

Malaysia is currently the third-largest data centre colocation market in the ASEAN region, according to Synergy Research, and is forecast to have a compound annual growth rate of 11 percent until 2027.

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According to CBRE's *2023 Asia Pacific Investor Intentions Survey,* Tokyo retained its status as the top city for cross-border investment for the fourth consecutive year, and it was followed by Singapore and Ho Chi Minh City in second and third place, respectively.

"Ho Chi Minh City ranked in the top three for the first time since the surveys began, while Hanoi was also named in the top 10 as Vietnam continued to benefit from its status as a China plus-one destination," notes CBRE's Chin. "End-users, developers and opportunistic investors are all eyeing opportunities in this market."

Singapore-based Keppel Corp is one such investor. The Keppel Vietnam Fund (KVC), an opportunistic fund launched in 2020, invests in residential developments, commercial properties and mixed-use projects, primarily in Ho Chi Minh City and Hanoi. In May 2023, KVC entered into an agreement with a leading Vietnamese property developer to jointly develop more than 200 homes and 600 high-rise apartments in Ho Chi Minh City.

Vietnam has one of the fastest-growing economies in Southeast Asia, and its 8.02 percent GDP growth in 2022 was Asia's fastest, according to Bloomberg. Vietnam's GDP growth rate slowed in 2023 but improved to 5.3 percent year-over-year in the third quarter of 2023, compared with 4.1 percent in the second quarter, according to an October S&P *Global Market Intelligence* report.

Despite a downturn in exports during 2023, Vietnam is expected to resume rapid economic growth over the medium term, as exports rebound. "Vietnam is expected to continue to be a key beneficiary of the shift in global manufacturing supply chains towards competitive Southeast Asian manufacturing hubs," the report predicts.

Limited fallout from China's property woes

China's property sector is undergoing its toughest times in decades. More than 50 Chinese property developers defaulted or failed to make debt payments in the past three years. In August, giant developer China Evergrande Group filed for bankruptcy in the United States. Another giant developer, Country Garden, is facing a loss of more than US$7.5 billion. Home sales have plummeted, and consumers are losing confidence and holding back. Many see a chain reaction threatening the broader economy, and there do not appear to be any quick fixes the government can make.

"China's residential property market faces a crisis of debt deflation, where the asset pricing is dropping while debt keeps piling up," notes Ambler. The government has been trying to beef up consumer confidence by ensuring the delivery of new homes. So far, not much is working. "Whether this will spiral and affect the wider economy is yet to be seen," says Ambler.

Asia Pacific's emerging markets have historically been correlated with China's fortunes, so investors are naturally concerned about negative spillover from China's woes into the rest of the region. But the old adage, "When China sneezes, Asia catches a cold", is no longer uniformly applicable, notes Sue Trinh, managing director, global macro strategy, for Manulife Investment Management.

In a recent webcast, she said fallout will be uneven, and Hong Kong and Singapore may be most exposed. "Asian economies with much smaller manufacturing sectors like India, Indonesia and the Philippines, should be far less impacted by mainland China's slowdown," predicted Trinh. As supply chains continue to diversify, and more investors engage in China-plus-one strategies, what is China's loss can be emerging Asia's gain, as it enjoys increased foreign direct investment.

Ambler also does not believe China's woes will drag down the entire region. "So long as a high portion of global manufacturing activity remains in Asia Pacific, the impact of China's economic slowdown can be offset by the growth in emerging markets," she attests. And astute investors and developers will capitalise on this continuing growth. ❖

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