Summer 2008

Citi Alternative Investments Journal

Citi Alternative Investments

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Real Estate Investments: The Case for Asia

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This article makes a case for investing in Asia. In so doing, it focuses on the drivers of commercial real estate ("CRE") demand as well as the risks associated with such investments.

Being rooted and immobile, a CRE property's financial performance will be dictated by, among other things, its "nature of permanence" in a geographical market and the specific sub-segment of the market in which it is located. Identical office buildings in, say, Hong Kong, Manila, Beijing, Delhi or Tokyo may provide significantly differing investment return profiles. Capital intensity and the time lapse between conceptualizing, permitting and construction provides an existing CRE asset time to appropriate above market returns before new supply comes to market and competitive equilibrium reasserts. Few investment vehicles display this defensive characteristic making CRE an attractive asset class for many investors.

Structural and cyclical drivers influence CRE demand and investor returns. Structural drivers include factors such as a change in demographics, fundamental product innovation (i.e., sales and leaseback activity), as well as changes in the type of economic activity in a region. Cyclical drivers include factors such as the rate of GDP growth, changes in interest rates that influence financing costs, new supply, and the indirect effects of consumer and business spending.

That said, CRE has its share of risks and drawbacks. Immobility precludes the possibility of moving a CRE asset in an economically depressed region to a booming region when economic conditions warrant. So, while manufacturing or service entities can change their products and services relatively quickly to respond to changing market and economic conditions, the option to physically relocate is not available to a CRE asset. Given the "static" nature of CRE assets, it is particularly important to choose the right geographic markets and asset sub-type in which to invest. On the market risk front, investors have to contend with excess supply shocks, changes in cap rates and rental/income growth slowdowns. Institutional risks include a lack of transparency, low liquidity as well as economic and political risk. In addition, the typical five to seven year business cycle risks of CRE assets persist.

Asia's attractive demographics and rapidly rising GDP per capita will be a key factor driving its real estate markets growth

Asian Economic Backdrop

The region's economic fundamentals are in place to enable it to achieve significant economic growth well into the future. These include healthy foreign reserves, strong export growth and robust domestic consumption. Foreign Direct Investment ("FDI"), including a substantial amount allocated for real estate, continues to flow into Asia. There are around 61 real estate funds targeting to raise $28 billion in capital, with an average size of around $459 million, in the market these days.[1] This is a significantly higher number than the 32 funds that raised an aggregate $21.8 billion in 2007.[2] In addition, there are many, Asia focused, private equity real estate fund of funds being formed as well as an increase in global funds that earmark sometimes 10% to 15%[3] of their allocations, for Asian property on an opportunistic basis.

Asia's attractive demographics and rapidly rising GDP per capita will be a key factor driving its real estate markets growth. Its relatively young, large and growing population, its sophisticated and cost-competitive services, and its production base underpin Asia's long-term growth prospects. While the savings rate in the region continues to lead the world, the trend towards higher consumption spending and investment in real assets is expected to continue in the years ahead. This, together with a move from an agricultural-

1 *Private Equity Intelligence, Spotlight 02/2008.*
2 *Private Equity Intelligence, Spotlight 02/2008.*
3 *CAI Research.*

based economy towards an industrialized economy, has led to the emergence of many large urban centers and has driven demand for property up in the newly industrializing Asian countries.

Overall investment conditions have improved in the wake of the Asian financial crisis through re-capitalized banking systems, increased national reserves and a proactive regulatory environment. This has resulted in strengthened capital markets. Regulators have imposed well received credit restrictions and debt requirements on the banking and lending sector, severing somewhat the link between government and large real estate firms that contributed to the large misallocations of capital pre-1997. Corporate governance continues to improve dramatically with many of the OECD suggested reforms now being adopted across the region.

In Asia, wide variations exist between countries and within countries with respect to real estate opportunities

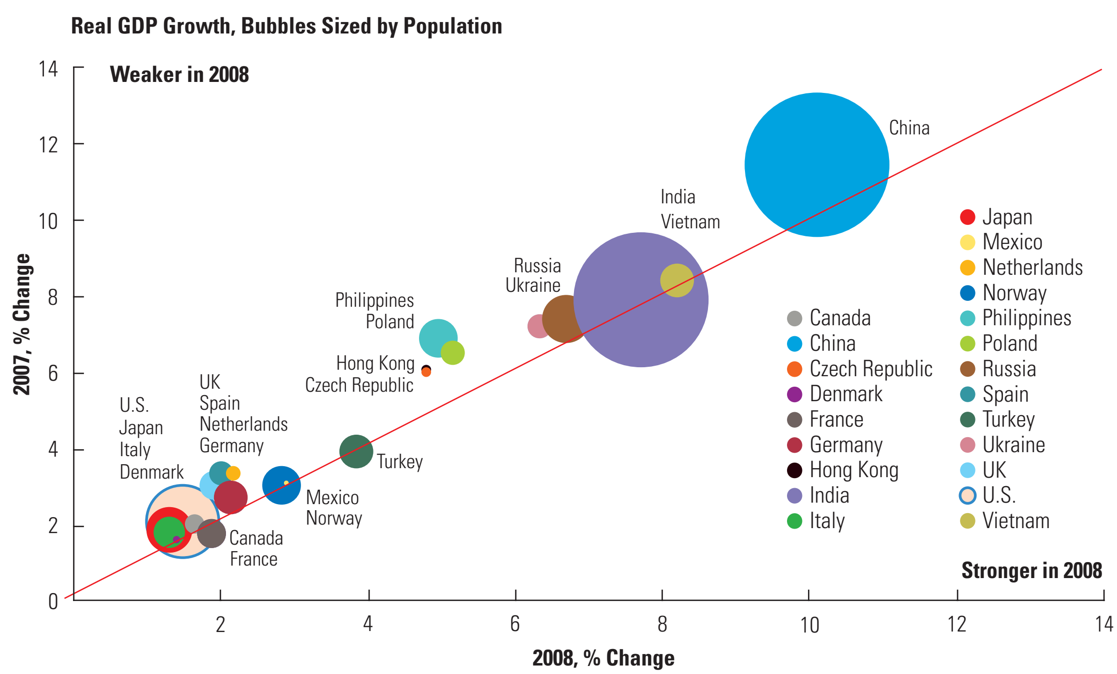
Asia is, of course, a heterogeneous continent with widely different real estate markets. Some segments of the real estate markets in Asia offer parallels to the state of the U.S. markets in the early 1990s (i.e., severe overbuilding, relative scarcity of equity and debt capital, and significant inventories of assets). Despite this, many excellent opportunities can still be found in other markets. Asian regional investors recognize these opportunities, as evidenced by the recent flow of regional investment from Hong Kong, Singapore and Japan.

State of Asian Commercial Real Estate Markets

The differential global economic expansion and opportunity can be sensed from Figure 1 which depicts GDP growth in 2007 and its projections for 2008 for North America, Europe and a few countries in Asia; the size of the bubbles reflect population. The wide range of economic conditions across the world and the bias toward very swift growth in developing Asia is immediately apparent. In particular, within Asia, China and India's economic growth and demographics stand out.

India and China are poised to continue as major growth engines

Figure 1: Projected GDP Growth



Source: Economic Intelligence Unit.

With respect to investment atmosphere, prior to 1997, foreign private investment in real estate was practically non-existent in all but a few segments of the market. The region's dramatic improvement for attractive real estate investments in hotels, warehouses and residential units can, in part, be attributed to: (i) an improvement in the availability of suitable deal opportunities often on account of restructuring and divestment of commercial property assets to streamline balance sheets; (ii) structural and regulatory reform; (iii) improved economic climate and strong fundamentals; (iv) strong management teams that are increasingly adopting developed market construction and property management practices; (v) attractive demographics; (vi) attractive exit opportunities; and (vii) the establishment of pension plans that seek to invest in long-life assets to meet future liabilities.

Positive economic factors are contributing to real estate investment opportunities in the region

Table 1 provides a qualitative assessment of the factors impacting demand, pricing and risks in the Asian real estate sectors.

Table 1: State of Asian Real Estate Sectors

		Asia			
		Retail	Office	Industrial	Multi-family
Structural Drivers	Demographics	+++	+++	+++	+++
	Sales and leasebacks	+++	+++	+++	+++
	Innovation/emerging products	+++	+++	+++	+++
Cyclical Drivers	Economic growth	+++	+++	+++	+++
	Supply/demand	+++	+++	+++	+++
	Interest rate environment	+	+	+	+
	Consumer and business spending	+++	+++	+++	+++
Market Risks	Supply risks	++	++	+++	++
	Cap rates	++	++	++	++
	Vacancy rates	+++	+++	+++	+++
	Income/rents	++	++	+++	+++
	Cost/financing	++	++	++	++
Institutional Risks	Country/political	Moderate to high	Moderate to high	Moderate to high	Moderate to high
	Transparency	Moderate to high	Moderate to high	Moderate to high	Moderate to high
	Liquidity	Moderate	Moderate	Moderate	Moderate

Favorable or positive	+++
Favorable but slowing	++
Somewhat favorable	+
Out of favor	-

Source: Qualitative insights from Citi.

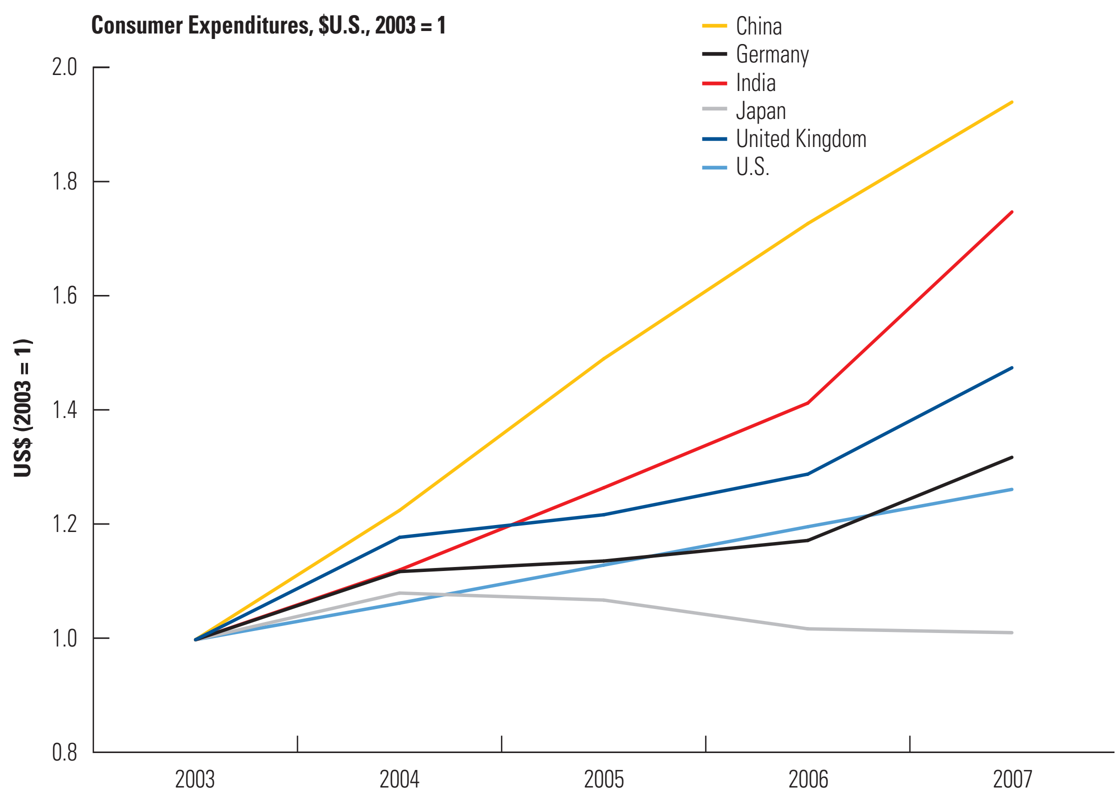
Economic significance of China and India in a global economy warrant their consideration in CRE portfolios

Focus: China and India

China and India were largely isolated from the global economy until just a few decades ago. Democratic India began market-based economic reforms after substantially moving away from a centrally planned economy in the early 1990s and joined the World Trade Organization ("WTO") in 1995. This liberalization trend, including easing restrictions on FDI in real estate, has built momentum and continues today. Meanwhile, communist China entered the global economy with a program of broad economic reforms in 1979 and joined the WTO in 2001. Rapid productivity and income gains, expansion of consumer spending, as well as the growth and new formation of a middle economic class have also been experienced in these countries.

Figure 2 depicts consumption trends across select major economies, indexing 2003 to 1. The steep upward slopes of consumption trends in China and India, in turn, have spurred demand for retail and residential structures.

Figure 2: Consumption Trends Across Economies

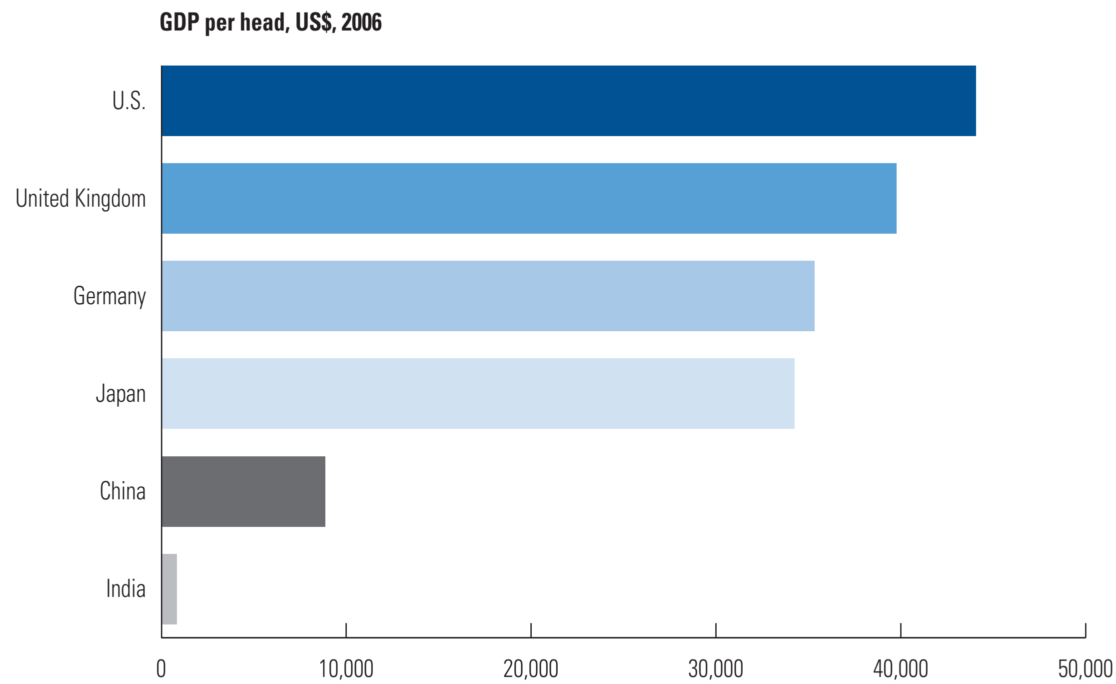


Source: Economic Intelligence Unit.

Despite the high growth rates of these two economies over the last few years, they do significantly lag, on a per capita basis, the wealth levels of leading developed economies (Figure 3). As they develop further and acquire more wealth, it is reasonable to expect that they will require better infrastructure and make increased investments in real property.[4]

4 *On the topic of infrastructure, as an aside, Chinese central government directives have been credited with significant progress and spending; more than has been achieved in India. This, in itself, has been identified as a key factor in the growth rate difference of the Chinese economy over that of India.*

Figure 3: Comparison of Per Capita GDP



Source: Economic Intelligence Unit.

Commercial and residential structures, such as modern office space, middle-class residential, luxury residential for the rising number of affluent residents, and modern logistics facilities to serve China's key manufacturing exporters are in demand

China Opportunity

The restructuring and liberalization of the Chinese economy has contributed to its dynamic growth of the past 15 years, with China emerging as one of the primary engines of the global economy. This economic expansion is expected to persist due to, among other reasons, competitive cost structure, high savings rates, broad pent-up domestic consumer demand and large foreign currency reserves. Its evolution toward a market-oriented economy has led to an influx of multinational corporations seeking to establish or expand their presence in the country. They are drawn by the prospects of substantial production and labor-cost savings, a huge domestic market, an accelerating level of middle-class consumerism and an emerging world-class quality infrastructure.

China's rapid urbanization is expected to heighten the opportunities for profitable real estate investment. A significant proportion of existing housing stock in China's urban areas is of inferior initial quality and is poorly managed resulting in rapidly deteriorating conditions. They are unsuited to meet the needs of both China's increasingly wealthy domestic middle class and the rising numbers of expatriates transferred to China by multinational employers. This supply/demand imbalance creates opportunities for high-quality housing for both the rental and for-sale property market segments.

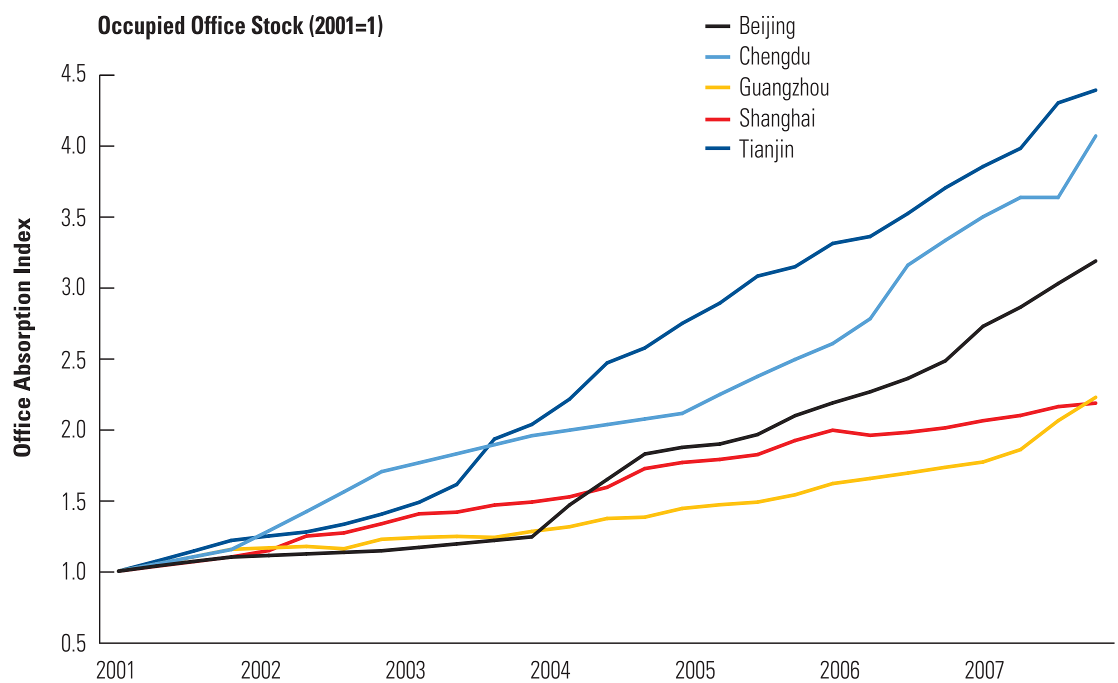
Further, China's major cities are in the process of substantial redevelopment. In an effort to expand office clusters, establish central business districts and modernize infrastructure, national and local government agencies are relocating existing factories and replacing antiquated housing with new structures. These structures reflect the highest and best use of scarce, center-city land. Many of these urban redevelopment projects are large, complex and capital-intensive, limiting the ability of local developers to participate.

We briefly discuss next the burgeoning office, residential and urban center sector opportunities in China.

Office

With the Chinese economy diversifying away from basic manufacturing, absorption of office space across the country's major cities has spiraled. Beijing's office market is over three times the size that it was in 2001, Chengdu is over four times its size in 2001 and Tianjin is almost 4.5 times its size over that same period, as illustrated in Figure 4.

Figure 4: Office Space Absorption



Source: DTZ, CPI Research.

Multinational firms seeking to establish or expand their operations in China, are relocating their Asia-Pacific headquarters from other areas (such as Hong Kong, Singapore or Tokyo) to Shanghai or Beijing. In doing so they face limited availability of international-quality Class A space to meet this demand. More broadly, major market properties are often found wanting in the quality of design, construction, mechanical systems, efficient floor plans and world-class property management demanded by top tenants. Recently, there has been a significant boom in office space construction in the Tier I cities while opportunities still exist in the Tier II and III, as discussed later.

Residential

Residential demand is boosted by: (i) rising levels of home ownership; (ii) increased prosperity that accompanies rising wages; and (iii) strong migration to key employment centers

Historically, China's urban population has resided in state-owned housing and, though growing, still considerably lags developed market benchmarks in living space per capita.

However, there have been recent gains. The focus on per-unit expansion, combined with higher levels of domestic wealth, accelerating urbanization and the tide of expatriate workers flowing into China's major markets, will continue to drive strong demand for residential housing for the foreseeable future. As construction of new residential projects has been accelerating rapidly in response to surging demand, the inventory of unsold, available units has been steadily declining. In order to facilitate the expansion of the residential sector, China's financial institutions have begun to promote the development of a domestic mortgage market.

Recently, the government made a number of policy adjustments to help ensure sustainability and transparency in residential development in China's major cities. These measures are designed to curb short-term residential speculation and address inefficient and opaque mechanisms for selling available developable land. Specific policy changes include: (i) requiring that all government land-use rights be tendered publicly or sold through an open auction process; (ii) increasing the minimum equity required for home purchases; (iii) imposing a "flip-tax" on the transfer of residential properties owned for less than two years; (iv) charging an "idling" fee for holding land without starting development; and (v) increasing interest rates.

These policy adjustments will increase transparency in the acquisition of land-use rights and make it more difficult for many property developers to retain undeveloped land parcels. It is expected to lead to consolidation among local developers and release, to the market, undeveloped land hitherto under tenuous ownership. The standardization and increased transparency in land acquisition favors companies with strong financial capabilities and proven real estate development qualifications. Additionally, many project developers are also facing considerable government and civic pressure to complete construction in advance of the Beijing Olympics this year and the World Expo in Shanghai scheduled for 2010. These pressures may lead to financial distress for inexperienced or under-capitalized developers, creating significant opportunities for investors with strong balance sheets to gain control of well-located, high-quality projects at attractive prices.

Urban centers are poised for continued expansion

Urban Centers

Investment into the Asian CRE market has largely been an urban strategy driven by agrarian transition to non-agricultural occupations that have developed in fast expanding urban centers. Urban centers are efficient aggregation points for financial capital, human capital and physical capital housed in commercial and residential structures. It is not surprising, therefore, to find rapidly expanding urban centers outpacing the overall national rates of economic expansion.

Developing urban China is most often associated with mainland cities such as Beijing, Guangzhou, Shenzhen and Shanghai. These "Tier I" cities lead the way in rapid development and have a high presence of multinational firms. CRE investments of $10.20, $8.56 and $4.37 billion in Shanghai, Beijing and Guangzhou, respectively, in 2007, provide a perspective of the pace of development.[5] It is also true, however, that given the high volume of investment and development activity in these well known cities, many first-mover advantages have dissipated. Beyond these familiar core cities, though, there are a number of "Tier II" and "Tier III" cities with populations well above five million where opportunities and pricing remain favorable. These include Chengdu, Chongqing, Kunming, Tianjin, Wuxi, Shenyang, Dalian and Xian. They currently lag Tier I cities on virtually all dimensions, notably size, wealth and the presence of multi-national companies. At the same time, per unit city-center land prices are more affordable.

The structural and cyclical drivers are the same as those in the Tier I cities. Additionally, a key element contributing to the spread of economic opportunities across the 20 to 30 major Chinese urban markets is the central government's commitment to develop transportation infrastructure. The central government has also enacted its 40 to 50 year "Go West" initiative to encourage growth in its western provinces in hopes of reducing the income gap between the relatively affluent eastern coast and the less affluent inland western provinces. Experience gained in understanding past patterns of growth and development in Tier I markets is applicable to newer opportunities in lesser-developed lower tier markets. It is highly likely that the Tier II and Tier III cities will reap the economic benefits as they mature rather rapidly.

A case in point is Shenzhen and its neighbor Guangzhou. As China's first special economic zone ("SEZ"), Shenzhen has since reaped benefits, becoming a primary manufacturing center in China, providing goods for the world, and now the key economic engine in the Pearl River Delta ("PRD"). Shenzhen has maintained above average job and population gains ever since its special designation. Per capita income increased by over 13% in U.S. dollars. In fact, Shenzhen's manufacturing expansion has not only allowed

5 *Real Capital Analytics, Global Capital Trends—2007 Year in Review, Jan–Feb, 2008.*

Shenzhen's property markets to thrive but has also invigorated nearby Guangzhou. Growth in the PRD and a thriving manufacturing economy resulted in the emergence of a services center, which has found a home in Guangzhou. Guangzhou's emergence has come to rival, if not overshadow, Shenzhen in its importance to South China's economy. Job growth in Guangzhou was just below 5% in 2007 and per capita income grew by almost 18%. Also, the metro area added 167,000 new residents.[6] Guangzhou has developed an office market of almost 2 million square meters—double the size that it was just three years ago and a projected 500,000 square meters of net absorption each year over the next three years.[7] Parallel opportunities in retail and residential sectors are not to be overlooked.

Tier II city Xian, for instance, a market of 7.4 million residents, is enjoying a rapid rise in output, income and a burgeoning middle class. Bolstered by its important tourism industry—it is the home of the terracotta warriors and the oldest walled city in China—and modern, expanding technology, manufacturing and aerospace industry, the city is absorbing increasingly upscale residential development and retail centers. Another example of a similar transformation is Kunming, the capital of Yunnan Province. It has traditionally been another tourism spot, known as the "Spring City." More important from the current CRE investor perspective, however, is the city's location—it is particularly accessible to India and South East Asia, making it a hub for intra-regional trade and travel. Airport and road infrastructure expansions are currently underway, which will further support the construction of new residential, retail and logistics structures.

Investment opportunities abound in office and technology park developments as well as residential and lodging (luxury hotels, business hotels and serviced apartments)

India Opportunity

India is rapidly emerging as one of the most promising real estate investment markets in the world. Private Equity Intelligence estimates $4–$6 billion to be raised for India centric property funds in 2008. The market is characterized by disparate local developers and properties of widely varying quality. Over the past years, the technology and services outsourcing boom has resulted in rapid economic growth and spawned an expanding and increasingly affluent domestic middle class. These trends have led to soaring demand for modern, high-quality office and residential real estate, far in excess of the availability of such properties.

India's economic growth has been accelerated by a concerted effort on the part of the Indian government to embrace the benefits of globalization and a free market economy. Previously, foreign investment had been permitted only in large-scale property projects in a handful of real estate sectors and was tightly regulated. Supportive government initiatives include: (i) permitting FDI in real estate projects; (ii) property taxes rationalization; (iii) abolishing the "Urban Land Ceiling Act" in many states; (iv) moving to formulate real estate mutual funds (and perhaps REITS in the future); (v) reducing transaction costs through lower "stamp duty"; and (vi) permitting foreign currency and external borrowings for real estate investments.

Perhaps the most significant of these initiatives is the first one—the relaxation of restrictions on FDI in real estate. This easing opened a wide variety of property investment opportunities to foreign investors for the first time. In stages, this included the 2004 permission opening international and domestic companies to establish real estate private equity funds, and the 2005 clearance by the Central Government's Cabinet Committee on Economic Affairs of a proposal allowing for 100% FDI in construction and development projects that met certain FDI requirements. This critical policy change eliminated the need for cumbersome approval of development projects by the Foreign Investment Promotion Board. Foreign investors can now more freely invest in a number of different real estate opportunities throughout India.

The Indian real estate industry is still fragmented and the quality of construction, although improving, remains in large part inconsistent. Currently, the market is comprised largely of local investors and developers focusing on small markets. These conditions present the opportunity for investors to focus on major markets across the country and to develop properties nationally recognized for their quality,

6 *Experian Group, Ltd.*
7 *Jones Lang LaSalle.*

Satellite suburban markets surrounding major cities offer excellent opportunities to invest in office property, residences and retail shopping malls

There exists significant demand for office parks, hospitality and residential structures in cities throughout India

reliability and international standards. Significant demand is expected to continue to take place in cities that have proven attractive to multinational companies. These cities include Mumbai (Bombay), Delhi, Bangalore, Hyderabad, Chennai (Madras) and Pune (Poona). Within these cities, the greatest absorption has typically occurred in areas outside the Central Business District ("CBD"), where land has been available for new office developments better suited to meet the needs of multinational corporations.

These metropolitan areas are the most developed and should provide the greatest opportunities for investment. Each market has experienced significant growth in the demand for modern office space, specifically from multinational corporations. Although each market has its own unique characteristics, they all share certain traits that reflect the broad economic forces shaping India. Due to land constraints and the poor quality of existing stock in CBD areas, the peripheral and suburban submarkets of these cities have attracted the majority of recent growth and activity in the office and residential sectors. The increased affluence of India's middle-class population has had a tremendous impact on real estate markets within these cities. Upward trends in employment and growth in real wages have fueled demand for modern residential dwellings and consumer products. Much of the new residential supply has been delivered in peripheral submarkets proximate to most of the new office stock. Complementary retail space has also been created to meet the demands of new residential communities. Economic growth and the associated demand for modern, first-class real estate are expected to continue in each of these markets.

As India property markets continue to evolve, even more investment options are likely to arise across various other property types including retail assets and hotels. As a general rule, though, Indian Tier I cities still afford opportunity to CRE investors and are not as saturated as may be the case in China.

Local Participants

Local and state governments: As part of their economic development strategies, government entities in many parts of India have established partnerships with developers to create office and residential properties, as well as larger integrated townships. In many cases, the government contributes land for the proposed project while the joint venture partner offers capital and development capabilities.

Large Corporations: Faced with an increasingly competitive global market, corporate property owners are often under pressure to divest themselves of real estate assets or to identify an experienced real estate partner to assist in maximizing the potential of their underutilized assets. Corporations will be an important source of potential build-to-suit opportunities.

Local Developers and Real Estate Investors: Many local real estate developers and investors throughout India lack the capital or other resources necessary to develop large-scale projects. They are often prepared to become a minority partner in order to participate in real estate investment opportunities.

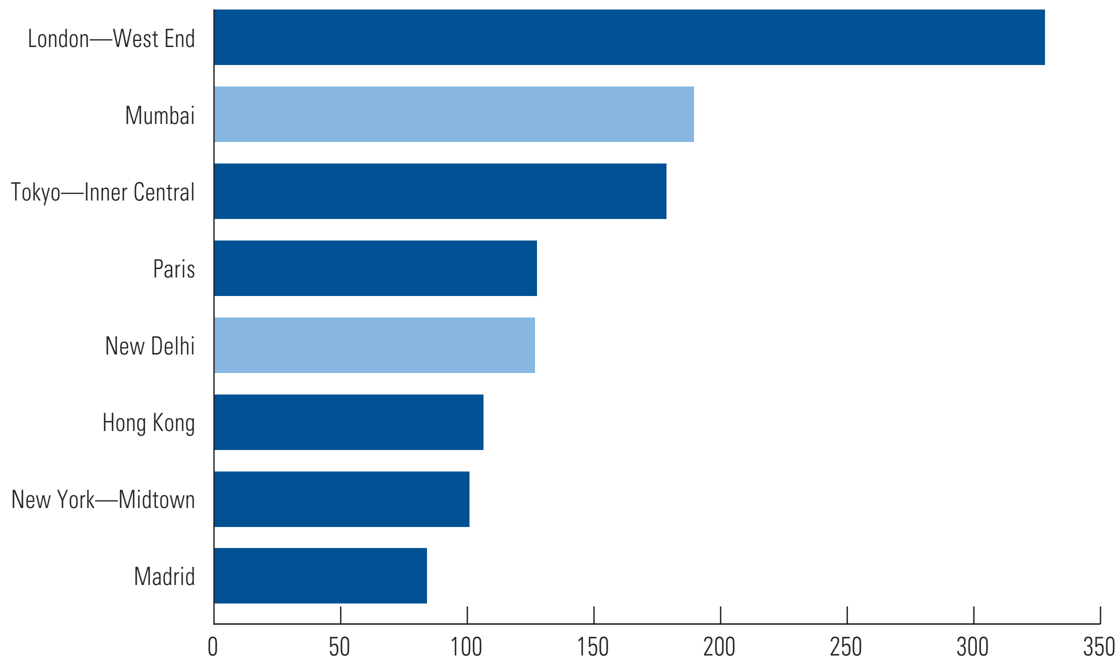
Moving to the market sub-sectors, we briefly touch upon the office, residential and integrated township sectors in India.

Office

Rapid economic growth and the influx of multinational companies has generated increasing levels of demand for high quality office space throughout India, particularly from the information technology, business process outsourcing and financial services sectors. As these companies continue their expansion into multiple domestic cities, they require a consistent quality level in the buildings they occupy, including attractive design and finishes, high-quality construction, state-of-the-art technology and telecommunications capabilities as well as superior standards of building services and amenities. India's older office buildings, most often located in CBD locations, are typically aging, functionally obsolete and often largely unsuited to the requirements of new discriminating tenants. Consequently, tenants increasingly are turning to new developments in peripheral areas outside the CBD where larger parcels of land are more readily available.

The resulting scarcity of modern office space in India is evidenced by the fact that the cost of office space in India's major markets has now reached the highs seen in the developed world. Figure 5 depicts occupancy costs for office space in some major markets around the world. Rents in Mumbai and New Delhi are now priced at parity with markets such as London, Paris and Tokyo. India simply needs more Class A office space.

Figure 5: Comparison of Office Space Rental Cost, U.S.$ per Square Foot, per Annum



Source: CBRE Research, data as of November 2007.

Residential market demand is expected to remain robust due to strong job growth and income increases

Residential

As a consequence of increased employment levels, particularly services employment, there has been a substantial increase in personal incomes and a growth of the middle class. Coupled with an increased availability of mortgage financing, this income growth has led to a significant increase in home ownership. Indicative of these trends is the dramatic drop in the age of the average homeowner from 45 to 32 years old over the past 17 years. These conditions, among others, have created a nationwide shortfall of residential space estimated to be approximately 50 million square feet.

Most residential projects are developed on a presale basis with buyers committing to purchase units prior to the commencement of construction. Reflecting the strength of current demand, Class A residential developments recently have been 100% pre-sold before the completion of construction. Savvy investors see opportunities in the development of premium, for-sale residential units in desirable submarkets. Key considerations in choosing potential development sites include the usual ones: location and adequacy of local transportation infrastructure, proximity to employment opportunities (particularly new office developments), and ease of access to schools, shopping and recreational amenities.

Successful investing involves addressing legal and regulatory issues, bringing operational and technical expertise to projects and aligning with reputable partners in the given arena

Integrated Townships

Prior to the regulatory changes governing FDI that were announced in early 2005, the primary vehicles for foreign investment in India's property markets were integrated townships. These large-scale projects, over 100 acres, encompass all of the primary features of fully developed communities: residential units, office buildings and retail, as well as roads, schools, parks and similar amenities. While other forms of FDI are now permitted in India, integrated townships remain an attractive investment option. Local governments have begun to actively seek to establish partnerships with national and international developers to transform agricultural land into world-class communities as a means to attract investment, new jobs and new residents. Often, the government will contribute land to the development partnership in exchange for a participation interest in the project. In addition, having the government as a partner substantially reduces any potential title issues and helps facilitate the approval process.

Risks

As in most of developing Asia, the real estate industry in India is dominated by local developers and property operators who offer disparate levels of quality, reliability and customer satisfaction. There is little transparency, and accurate market information is sometimes difficult to access. Although the industry has matured over the past few years, firms that provide consistent high-quality products, absolute integrity in business dealings and strong customer service remain scarce.

Key challenges

Few professional players in the market: Real estate markets in India are presently highly fragmented and localized. Finding professional developers with national reach and presence still remains a difficult task.

Developers have low skills for large developments: So far Indian developers have been developing projects on a smaller scale—average cumulative experience for the large developers ranges from 2 million to 3 million square feet of projects completed. Further, many of these developers operate as family owned businesses, sometimes with little professional involvement. With the expected rise in demand from commercial, housing and retail sectors, developers are now taking large projects ranging from 2 million to 10 million square feet.

Procedural and legal vulnerability: Development projects entail clearances and permissions from various government departments. It is estimated that about 60 permissions are required for developing raw land and starting construction. These delays are tedious and time consuming and they vary from state to state (local laws) making scalability for a national developer rather difficult. This adds to overall transaction complexities and increases the need for local expertise in each regional market.

Title clearances: Title clearance in India is a complicated process in the absence of a central database of properties. This adds to cost and often results in project delays.

Infrastructure bottlenecks: Infrastructure is still a cause of concern in the majority of cities across the country. Recent infrastructure developments have been slow and have not kept pace with economic activity. Inadequate power, absence of drinking water, electricity failure, traffic congestion and pollution have become a common feature of the larger cities in India.

Steep rise in property prices: In the last three years, property prices have increased remarkably creating skepticism about future sustainability of price rise. This price rally has been broad based, covering all major cities and most property types.

Transparency: Absence of an organized database of property ownership has resulted in a premium pricing for information, raising cost of transaction.

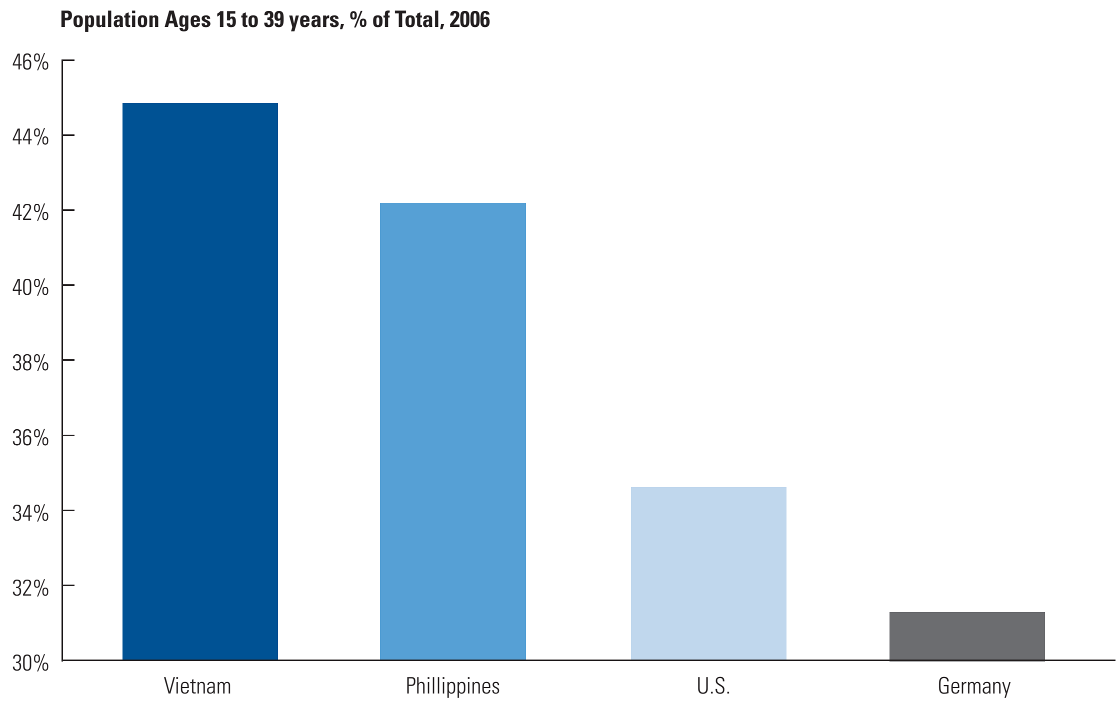
Other Asian Countries: Fast Developing Asia

Asia is not just China and India, though these nations do make up the lion's share of investable developing markets in the region. There are opportunities for savvy investors in practically every Asian market. One just needs to be extremely selective. In that regard, fast growing as well as demographically compelling Philippines and Vietnam are particularly interesting. According to Real Capital Analytics,[8] the Philippines accounted for $324 million in commercial real estate transactions in 2007. Vietnam fared even better with $429 million.

While these are quite small markets, their youthful demographics and business-friendly stance imply that their labor force growth and propensity to consume are moving decidedly in the right direction for investors. Figure 6 illustrates the disparity in the age composition between these two developing nations and the more familiar markets in the West.

Foreign investors have been bullish on Vietnam and Philippines. Their real estate markets continue to present many new opportunities

Figure 6: Demographics



Source: Economic Intelligence Unit.

Considerably smaller than China and India, the relationship between their emerging economies and their need for commercial real estate assets is much the same as the two giants. Manila, for instance, is quickly becoming a significant location for off-shore business services, particularly as its costs of doing business remains favorable relative to India and China, according to McKinsey Global Institute.[9]

8 Real Capital Analytics, Global Capital Trends—2007 Year in Review, Jan–Feb, 2008.
9 McKinsey Global Institute, The McKinsey Quarterly, Nov., 2005, Attracting More Offshoring to the Philippines.

Opportunistic real estate funds are uniquely poised to participate in and shape the evolution of Asian real estate investing

Future Prospects

As Asian markets mature there will be new opportunities to make investments in one or more of the following categories: (i) undervalued assets; (ii) assets requiring substantial repositioning and/or re-leasing; (iii) strategic development and redevelopment; (iv) properties with definable legal risks; and (v) transactions requiring certainty of closing, reliability of buyer and/or rapid execution.

In the years ahead, investors should expect to see further opportunities to implement value enhancement plans including, redevelopment, repositioning and releasing, improving property aesthetics, correcting deferred maintenance items, financial restructuring and more selective opportunistic development.

Conclusion

Asian real estate markets have experienced increased capital flows over the past few years. These flows have originated from regional and international investors. Transparency and contracting frictions remain major issues for many Asian property markets. These are being resolved thanks to progressive government initiatives. Office and residential sector investments represent by far the largest opportunity set in India and China—countries that are leading the Asian property market growth. Strong demand and limited supply have kept vacancy rates down. With attractive structural and cyclical drivers, Asian real estate should continue to find favor with investors.

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353103 AI04208 Publication Date July 2008