

THE SIGNIFICANCE OF REAL ESTATE IN SOVEREIGN WEALTH FUNDS IN ASIA

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Abstract

Sovereign wealth funds have taken on increased importance in global investment markets in recent years. Real estate has recently taken on increased importance as an asset class for many sovereign wealth funds, with several sovereign wealth funds having significant global real estate portfolios. This paper assesses the stature of sovereign wealth funds and highlights the significance of real estate in sovereign wealth funds. It particularly highlights the significance of real estate in sovereign wealth funds in Asia and the real estate investment strategies used by sovereign wealth funds in the current global financial crisis.

Keywords: *Sovereign wealth funds, real estate, Asia, disclosure, transparency, real estate activity.*

INTRODUCTION

Sovereign wealth funds (SWFs) are government investment vehicles funded from government reserves, which are managed separately to the country's central bank. They operate as long-term investors. The funding sources for these government reserves come from either natural resource reserves (eg: oil, gas), goods and services foreign exchange reserves or pension fund reserves where there is no explicit liability. The strategic objectives of these SWFs include the management of government holdings, wealth optimisation of risk-adjusted returns, diversification and offsetting of future declines in the country's natural resources and supporting the development of the local economy. This sees SWFs behaving in a similar manner to either endowment funds or economic development funds. Examples of these SWFs include Abu Dhabi Investment Authority (ADIA), Singapore's Government

Investment Corporation (GIC), Norway's Government Pension Fund (GPF), China Investment Corporation (CIC), Singapore's Temasek Holdings and Malaysia's Khazanah Nasional.

SWFs have operated for over 50 years, with the Kuwait Investment Authority (KIA) established in 1953. The 1970s/1980s, with the increase in oil prices and the growth in the Asian economies saw further SWFs established (eg: ADIA, GIC), with the 1990s seeing smaller SWFs established in Asia (eg: Khazanah Nasional). Since 2000, with the increasing oil prices and significant trade surpluses, a large number of SWFs were also established (eg: CIC, Qatar Investment Authority (QIA) and Korea Investment Corporation (KIC)). Over 50% of SWFs have been established since 2000. The Middle East and Asia dominate the SWF market, with several countries having more than one SWF (eg: Singapore, Abu Dhabi).

SWF GROWTH

Figure 1 shows the growth in SWFs since 1999, with current estimates seeing total SWF assets of \$3.8 trillion. A lack of transparency for SWFs sees only estimates of SWF total assets being available. Figure 1 shows the significant growth over 2006-2008 and the impact of the global financial crisis (GFC). Commodities-based SWFs account for 60% of SWF assets, while non-commodities-based SWFs account for 40%. The contribution by non-commodities-based SWFs has increased significantly in recent years, reflecting significant transfers from foreign exchange reserves. Global foreign exchange reserves are currently \$7.5 trillion; for example, China has \$2.1 trillion in foreign exchange reserves.

Figures 2 and 3 show the leading SWFs, including assets under management and year of establishment. These SWFs reflect a diverse range of economies, with the top 2 SWFs having over \$1 trillion in assets in total, while 11% of SWFs have less than \$1 billion in assets. The SWFs in Asia include CIC, GIC, Temasek, KIC, Khazanah Nasional and Brunei Investment Agency. The SWFs in Malaysia are Khazanah Nasional and 1Malaysia Development. Japan and India do not have a SWF. Figures 4-6 show the regional diversity of SWFs, with the Middle East and Asia accounting for 75% of SWF total assets.

Figure 7 shows the year of establishment of the SWFs. While 27% are well-established with over 20 years of activity (eg: ADIA, GIC), 56% of SWFs have been established for less than 10 years. In particular, 50% of SWFs in Asia have been established for less than 5 years. This clearly presented operational and risk management issues during the GFC. Typically, the older SWFs were cautious, discreet and conservative investors, while the newer SWFs were less cautious, confident in an environment of increasing oil reserves and economic

growth, adopted active management approaches similar to private equity funds and often used gearing. Figure 8 puts SWFs in the perspective of global assets under management. This sees SWFs accounting for \$3.8 trillion; only 5% of global assets under management and only 12% of the asset value of pension funds globally.

SWF FEATURES

The management of SWFs sees them as independent operational entities, long-term investors and users of external managers (45% of assets). SWFs have increasingly adopted an active management strategy, which sees them including property and private equity amongst their mandated asset classes.

Transparency and disclosure remain as key concerns for SWFs. This has improved recently following the Santiago Principles in 2008, which has resulted in a code of conduct/regulations and the establishment of the International Forum of SWFs. This has resulted in many SWFs now producing an annual report and having an informative website. However, full details are often not provided regarding their total assets, asset allocation and detailed investment strategy. This lack of transparency, as well as the size and potential geopolitical conflict issues has previously raised concerns over SWF activities. However, the SWFs were seen to play a major positive role during the GFC in terms of the survival of the financial services sector in several Western economies (eg: US).

Importantly, there are major differences between the various SWFs, including size, objectives, motivation, investment horizon, organisational structure, risk appetite, asset allocation, experience and transparency. This sees the more established SWFs such as ADIA and GIC as being experienced

and sophisticated investors, with institutional maturity, performance-focused, professional investment standards and extensive risk management procedures.

Figure 9 highlights the different levels of transparency for the SWFs using the Linaburg-Maduell SWF transparency index. Typically, the SWFs in Asia are more transparent than the Middle East SWFs. Temasek is the most transparent of the SWFs in Asia, with CIC and GIC being mid-range in transparency. While some SWFs have only recently produced annual reports (eg: ADIA), Khazanah Nasional has produced an annual report for the last six years; see Figure 10.

Figures 11 and 12 provide further evidence of the significant differences in SWFs regarding their financial risk (regarding their asset allocation) versus sovereign ownership risk, as well as their level of transparency versus investment approach (conventional through to strategic). This clearly positions the SWFs in Asia relative to the Middle East SWFs.

SWF ACTIVITY AND TRENDS

To assess SWF activity over the last 10 years, a range of excellent SWF information sources were used; namely from the Sovereign Wealth Fund Institute, Monitor and Preqin; see references. In particular, Monitor records the public transactions by SWFs, resulting in a database of over 1,200 SWF transactions worth \$285 billion over 2000-2009. Real Capital Analytics was also used to source 68,000 global property transactions worth \$2.1 trillion over 2007-2009 to strip out SWF property transactions activity. SWF websites were also used to identify specific SWF activity.

Figure 13 details SWF activity (by number and value of transactions) over 2000-2009. The earlier years saw a large number of

small \$ value transactions, with 2007-2008 seeing a significant increase in the value of the SWF transactions. 2009 clearly sees the impact of the GFC, with transaction value reducing from 175 transactions at \$128 billion in 2008 to only 63 transactions at \$36 billion in 2009(Q1-Q3).

To highlight the impact of the GFC, Figure 14 breaks this transaction activity into quarters for 2008-2009 to highlight the impact of Q1 on 2008 activity. Caution should be taken regarding the potential upturn at Q3:2009; particularly given recent events in Dubai regarding debt deferral.

Importantly, Figures 15-16 show the significant activity by SWFs in Asia in recent years (to 2008) and the significant contribution that property makes to SWF activity; accounting for approximately 20% by both number and value of transactions. This sees property as the #2 transaction sector, only exceeded by financials. Figure 16 also highlights the role of SWFs in the traditional energy, financial services, property and industrial sectors, as well as the emerging sectors of IT, telecommunications and healthcare. The emerging sectors clearly reflect the strong economic developmental role by SWFs in recent years, reflecting a search for comparative advantage in key areas of advanced technology. Figures 17-19 further reinforce the significant and consistent contribution by property to SWF activity over 2000-2009.

The recent investment flows from the Middle East SWFs and Asia SWFs are given in Figures 20-21; highlighting the OECD focus for Middle East SWFs and the increasing OECD focus by SWFs in Asia over 2000-2008. However, the dynamic of the OECD focus has changed with the impact of the GFC; as seen in Figures 22-23. This saw a

major retreat from the OECD markets to the emerging markets focus in 2008; reflected in OECD investment reducing from 94% in Q1:2008 to only 27% in Q4:2008. A major return to the OECD markets was evident in 2009, increasing from 27% in Q4:2008 to 88% in Q3:2009; reflecting some degree of investment confidence by SWFs and distressed sale opportunities (including property).

Figure 24 also highlights this shift between a domestic market focus in 2008 and a return to a foreign market focus in 2009; increasing from 31% international in Q4:2008 to 92% in Q3:2009. This clearly illustrates the three operational phases for SWFs regarding the GFC as supporting the Western financial institutions in 2007-2008, stabilising of domestic markets in the 2nd half of 2008, and increasing international appetite in 2009.

Figure 25 shows the acquired stakes in investments over 1995-2008. Importantly, 39% were majority stakes of at least 50%. These controlling interests were often in emerging markets (eg: Temasek), with controlling interests in OECD countries typically in non-sensitive areas such as healthcare or retail. JVs were often used to avoid political concerns, as well as a non-board of directors role being typical.

In summary, Figures 26-28 highlight the dynamics of SWF activity over 2000-2009. This clearly highlights the impact of the GFC and falling commodity prices, as well as the significant investment by SWFs such as GIC, CIC, ADIA, KIA, QIA and Temasek into the financial services sector (eg: Citibank, UBS, Merrill Lynch, Carlyle and Blackstone). Often, this resulted in significant paper losses by the SWFs. Figures 27-28 clearly highlight the significant role of property in SWFs over these timeframes.

SWF PROPERTY ACTIVITY

While 51% of SWFs invest in property, this is dominated by the larger SWFs (80% of those SWFs with > \$100 billion) compared to the smaller SWFs (30% of those SWFs with < \$10 billion). Of those not investing in property, they tend to be the more recent SWFs which are still formulating their investment strategy for alternate assets, as well as conservative SWFs focused on stocks and bonds only.

Importantly, Figure 16 shows property accounting for approximately 20% of SWF transactions in recent years. SWFs with significant property portfolios (both \$ and %) include GIC (12%), ADIA (10%), Temasek (7%) and Mubadala (13%). This property focus in a SWF is often achieved by using sovereign wealth enterprises (SWEs) or holding companies within the SWF, with 40% of SWFs having separate property arms. In several cases (eg: ADIA, KIA, QIA), several SWEs are used to achieve this property exposure both locally and internationally. Strategies for property investment are sophisticated, covering all aspects of the property space. This includes direct property, separate accounts, REITs, JVs, co-investment with other SWFs or pension funds, private equity funds, equity stakes in property companies/REITs, debt financing and capital commitments for property development.

In particular, 2007-2009 have seen SWFs as amongst the major property investors globally. For example, 2007 saw Dubai World (#14), GIC (#21) and Istithmar World (#44) amongst the top 50 property investors globally, as well as Dubai World (#1) and GIC (#18, #21, #34) involved in several of the top 50 global property transactions. Whilst 2008 saw less activity, Dubai World (#26), QIC (#31), GIC (#39), Temasek (#41), ADIA (#74) and KIA (#98) were in the top 100 global property investors, with KIA/QIA (#1), QIA (#4),

KIA (#26), ADIA (#28), Dubai World (#34, #48) and GIC (#35) involved in several of the top 50 global property transactions. 2009 has seen less property activity, with ADIA participating in the 2nd largest global property transaction (via JV).

The significance of property amongst SWFs in Asia over 2000-2008 is shown in Figure 29. Property was the second largest sector by \$ value and the third largest sector by number of transactions. The following sections will highlight the significance of property in a number of the SWFs in Asia; including the SWFs in Malaysia.

PROPERTY IN SWFs IN ASIA GIC

GIC was established in 1981, with a global mandate (ex-Singapore), with the property section established in 1982 as a long-term property investor. This sees GIC Real Estate as one of the three asset management companies within GIC. Within the overall GIC asset allocation of stocks (38%), fixed income (24%), alternates (30%) and cash (8%), property accounts for 12% of the GIC portfolio and resides in the alternate asset allocation. The total GIC portfolio is estimated to be \$248 billion. GIC produces an annual report, with an informative website.

GIC is a sophisticated property investor, being in the top 10 property investors globally. The property portfolio comprises over 200 major properties in over 30 countries, with over 150 property staff in seven offices globally. Figure 30 shows some of the major commercial properties in GIC's international property portfolio.

GIC's property investments have covered all aspects of the property space, including direct property, indirect property, JVs, debt financing and private equity. GIC has significant stakes in leading property companies/REITs globally, including British

Land, Brixton, Great Portland, GPT and Liberty International. Recent activities have included acquiring the Prologis Japan/China industrial property platform (\$1.3 billion), as well as significant property acquisitions recently in Tokyo, Stockholm, London, Finland and Italy. Often these acquisitions are via JVs with local players or pension funds (eg: Canada PPIB).

TEMASEK

Temasek was established in 1974 with a focus on Singapore and Asia; particularly the emerging economies. With assets of \$120 billion, Temasek is a long-term investor, largely operating as an economic development fund. Its four investment "themes" are transforming economies, growing middle income populations, deepening comparative advantage and emerging champions. Assets comprise listed entities (79%) and unlisted entities (21%). Temasek is one of the most transparent SWFs, producing an informative annual report.

Property accounts for 7% of the Temasek portfolio; being the 4th largest sector in the Temasek portfolio. In comparison, financial services accounts for 40% and telecommunications accounts for 24% of the Temasek portfolio. Via indirect property, Temasek has major stakes in CapitaLand (40%) and Mapletree (100%).

CHINA INVESTMENT CORPORATION (CIC)

CIC was established in September 2007 with \$200 billion from China's foreign exchange reserves, with the objective to maximise risk-adjusted returns and to diversify China's foreign exchange holdings. CIC comprises CIC with a global mandate and Central Huijin Investment for the local RMB investments. To provide diversification, CIC reorganised their investment departments in April 2009 into four markets; namely

public markets, tactical investments, private markets and special investments. Property is included in the private markets mandate. CIC is expected to receive an additional \$200 billion in 2010 to further enhance its portfolio. CIC is a member of the International Forum of SWFs and has an informative website.

Property activities have accounted for 10% of recent CIC activities, comprising direct property (85%) and listed property (15%). A mixed investment strategy is used for property investment comprising direct, separate accounts, funds and debt financing; with an opportunistic distressed property focus. Specific property investments (7 at \$3.6 billion) have included Morgan Stanley REF VII (\$800 million), separate accounts (4 at \$1.2 billion) and debt finance for Goodman and Songbird (\$1.6 billion).

KOREA INVESTMENT CORPORATION (KIC)

KIC was established in July 2005. The current portfolio comprises stocks (28%) and bonds (72%). Plans to extend into property were to be developed in 2009. KIC has recently established MOUs with other SWFs including KIA, ADIA and Khazanah Nasional.

KHAZANAH NASIONAL

Khazanah Nasional (KN) was established in Malaysia in 1993 as an economic development fund for the strategic investment in new industries and markets and to promote economic growth via strategic industries. Its investment strategy involves the three “themes” of creating sustainable value, raising national competitiveness and creating a culture of high performance. KN has produced an annual report for the last six years.

With assets of \$25 billion, KN invests in 50 companies largely in Malaysia across 15 sectors. This includes Telekom Malaysia, CIMB, MAS and PLUS Expressways. Property activities have included investments in Iskandar, Putrajaya and STLR; as well as investments in companies in infrastructure, logistics and utilities.

Recent developments include an MOU with KIC in June 2009, as well as establishing a Beijing office in October 2008.

1 MALAYSIA DEVELOPMENT(1MD)

1Malaysia Development was established in early 2009; previously being the Terengganu Investment Authority. Its activities are the long-term sustainable development of Malaysia in the energy, property, tourism and agribusiness sectors. Limited specific details are available on the 1MD website concerning its activities in these sectors.

Recent developments include MOUs with QIA and KIA, as well as a joint venture with Mubadala (Abu Dhabi SWF) in January 2010 for joint clean technology projects, with possibilities of establishing a carbon-neutral city in Malaysia.

FUTURE DEVELOPMENT OF SWFs

SWFs are an important part of the global financial and investment markets, using a range of sophisticated investment strategies in developing their portfolios. This includes property investment in its various forms across the property space. Whilst SWFs were impacted by the GFC, it has provided the opportunity for SWFs to reflect on their operations and undergo reorganisation and realignment in moving forward. This has been particularly true for the newer SWFs with regard to their ongoing risk management strategies.

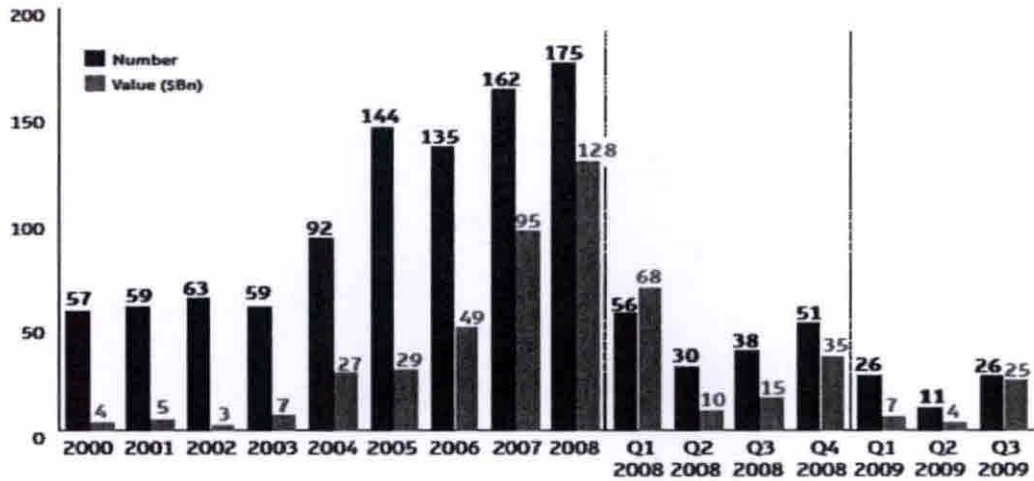
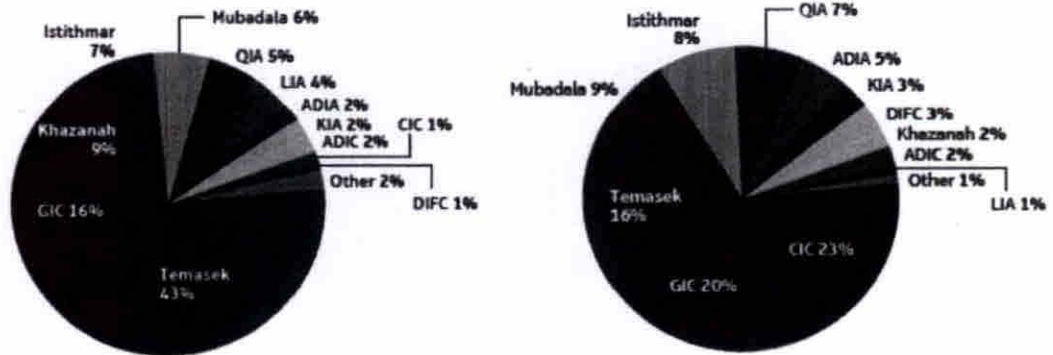


Figure 14: SWF Investment Trends: 2009
Source: Monitor (2009b)

value of \$73 billion and Temasek has \$56 billion. Among the MENA-based funds, Istithmar, Mubadala, and QIA are the leading investors by number and value.

Number of Deals by Fund

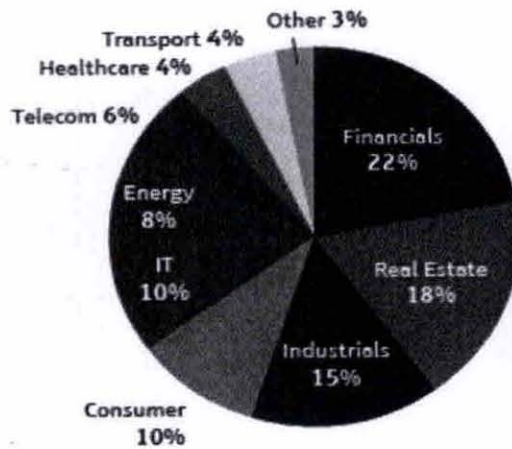
Value of Deals by Fund (USD MM)



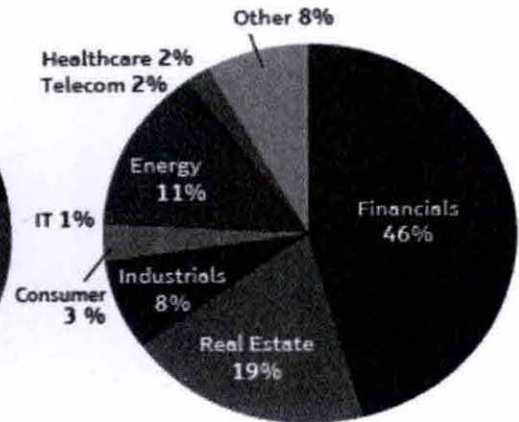
Note: Publicly available data for SWF equity, real estate, and joint venture deals
Source: Monitor-FEEM SWF Transaction Database

Figure 15: SWF Transaction Leaders
Source: Monitor (2009a)

NUMBER OF DEALS BY SECTOR (785 DEALS)



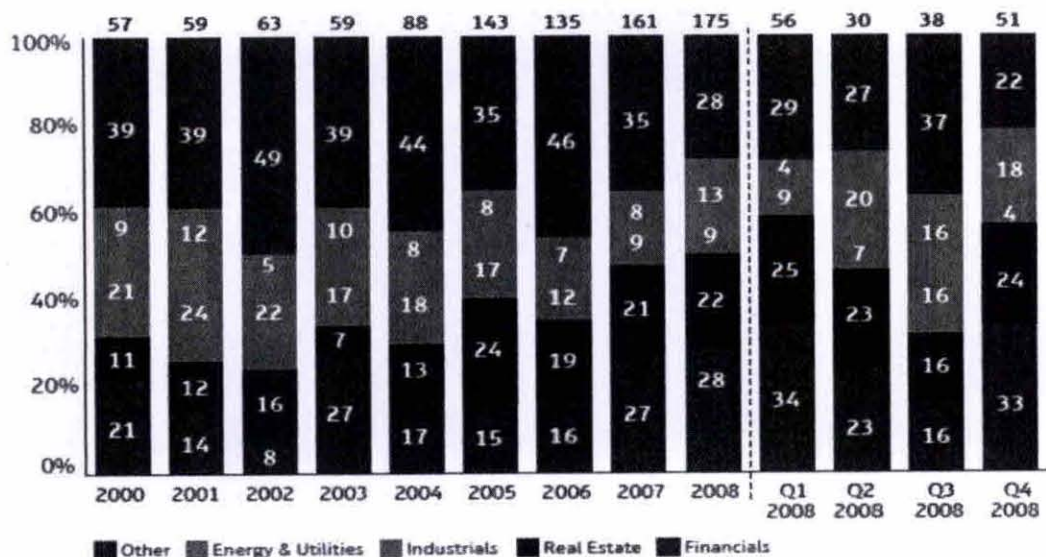
VALUE OF DEALS BY SECTOR (\$250 BN)



Source: Monitor SWF Transaction Database

Figure 16: SWF Transaction By Sector

Source: IFSL (2009a)



Note: Publicly available data for SWF equity, real estate, and joint venture deals
Source: Monitor-FEEM SWF Transaction Database

Figure 17: SWF Transaction By Sector: Annual

Source: IFSL (2009a)

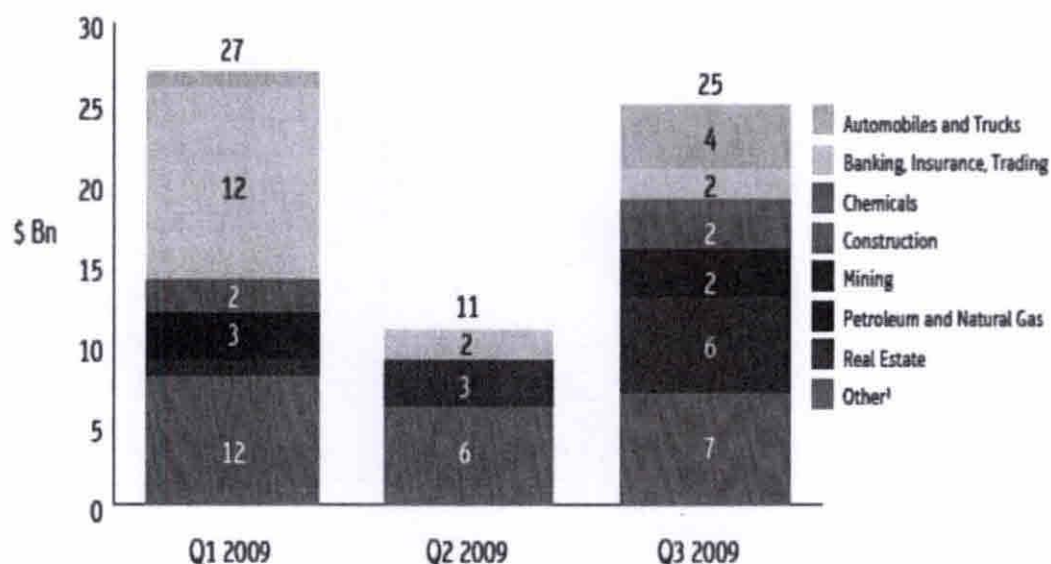


Figure 18: Number of SWF Transaction By Sector: 2009

Source: Monitor (2009b)

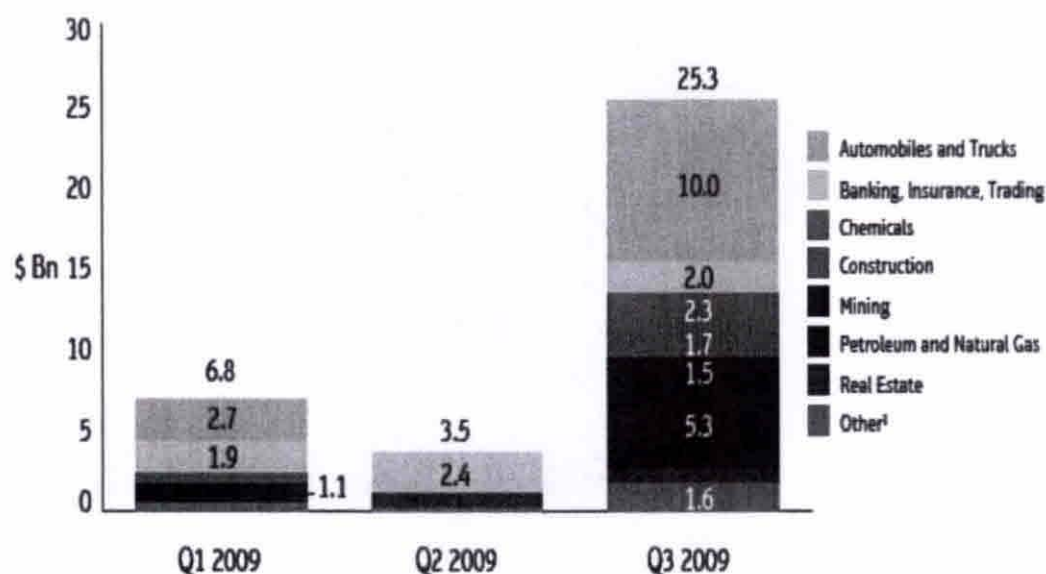
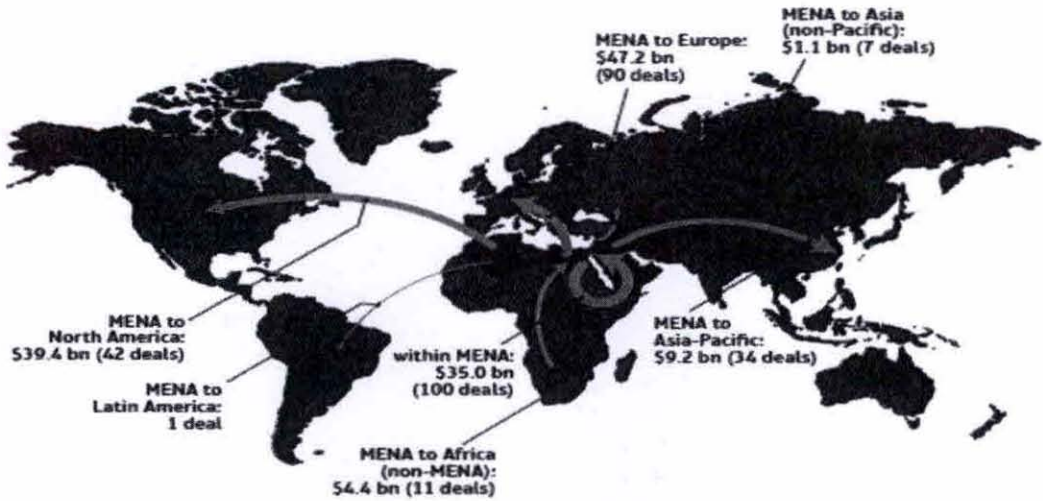


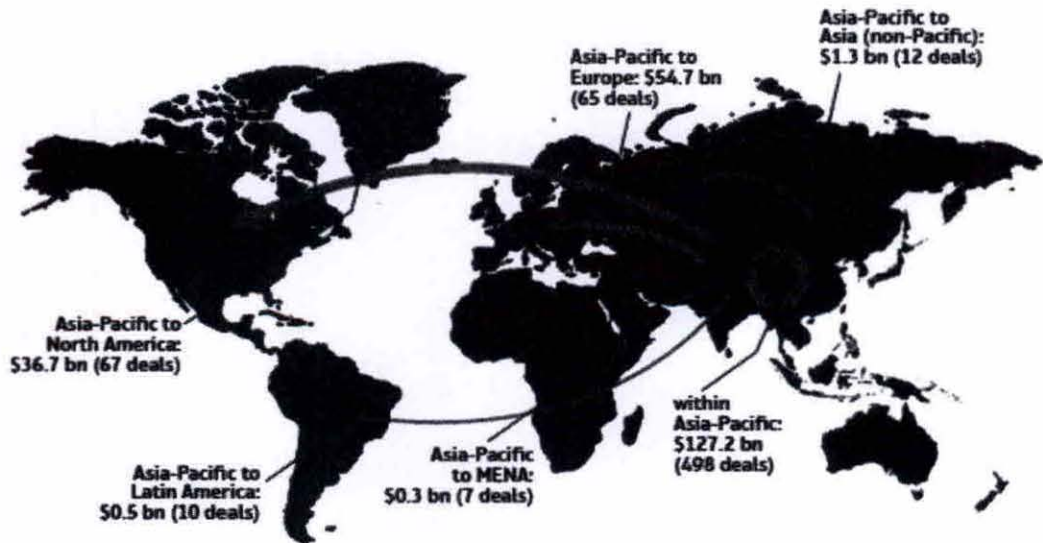
Figure 19: Value of SWF Transaction By Sector: 2009

Source: Monitor (2009b)



Note: Publicly available data for SWF equity, real estate, and joint venture deals
Source: Monitor-FEEM SWF Transaction Database

Figure 20: Investment Flows: MENA Swfs
Source: Monitor (2009a)



Note: Publicly available data for SWF equity, real estate, and joint venture deals
Source: Monitor-FEEM SWF Transaction Database

Figure 21: Investment Flows: Asia Swfs
Source: Monitor (2009a)

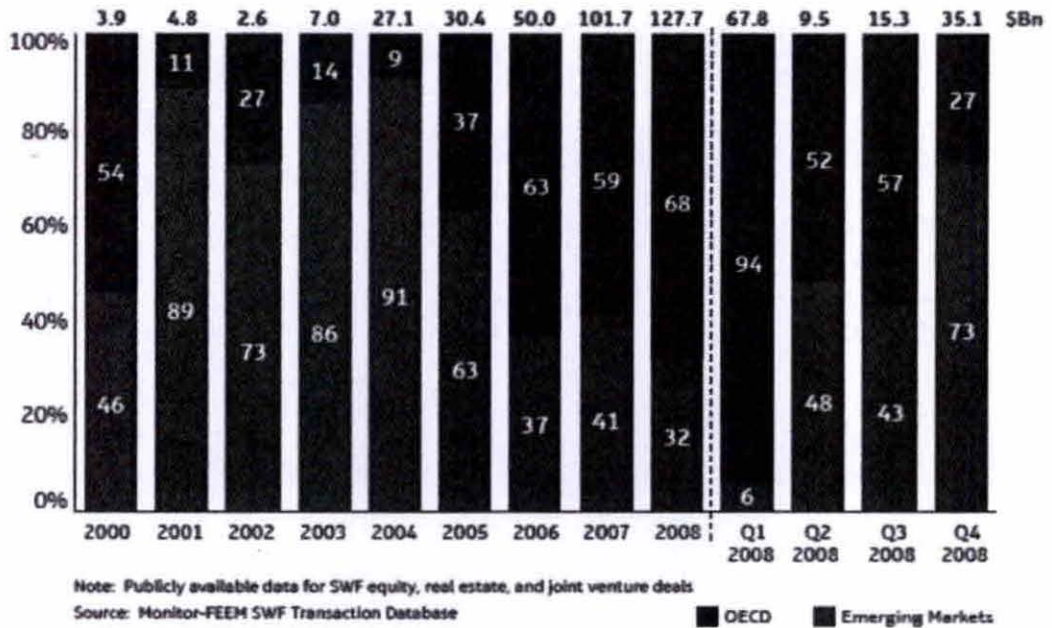


Figure 22: SWF Transaction: OECD vs. Emerging: 2000 - 2008
Source: Monitor (2009a)

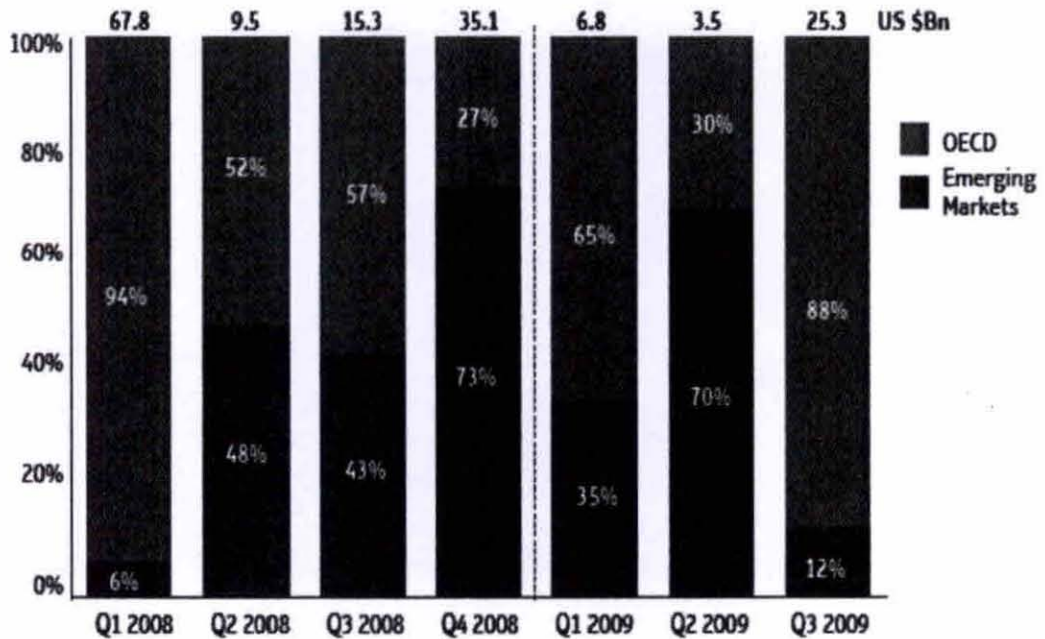


Figure 23: SWF Transaction: OECD vs. Emerging: 2009
Source: Monitor (2009b)

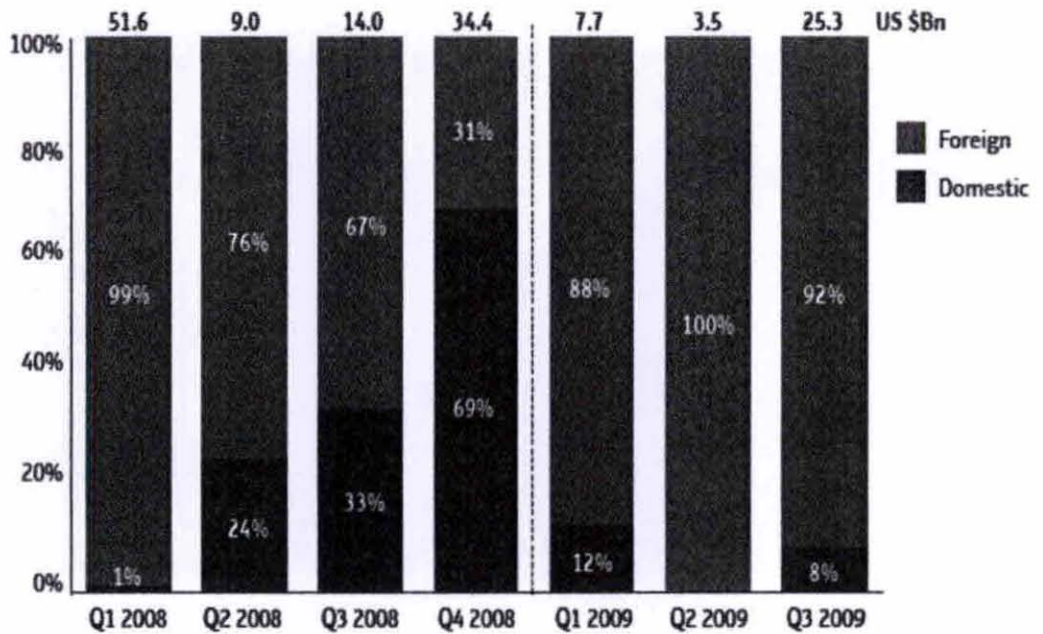
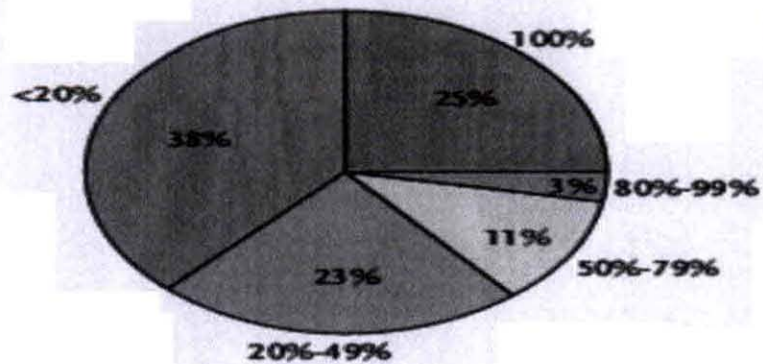


Figure 24: SWF Transaction: Domestic Vs. Foreign: 2009
Source: Monitor (2009b)

Chart 12 SWF investments by size of acquired stakes

% share, completed investment transactions by SWFs, 1995 - June 2009, total \$187bn



Source: Deutsche Bank Research, Dealogic

Figure 25: SWF Stakes
Source: IFSL (2010)

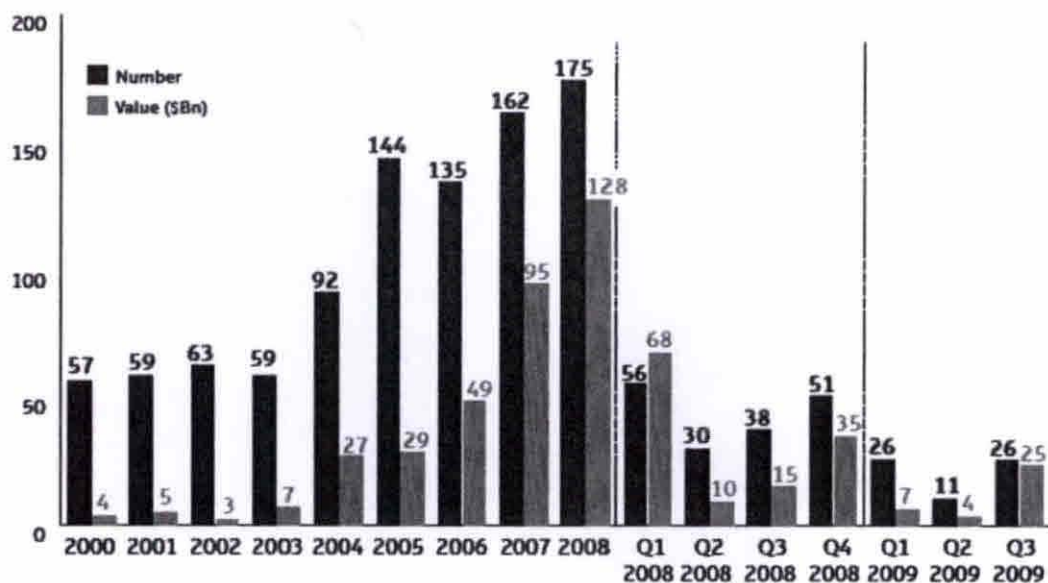
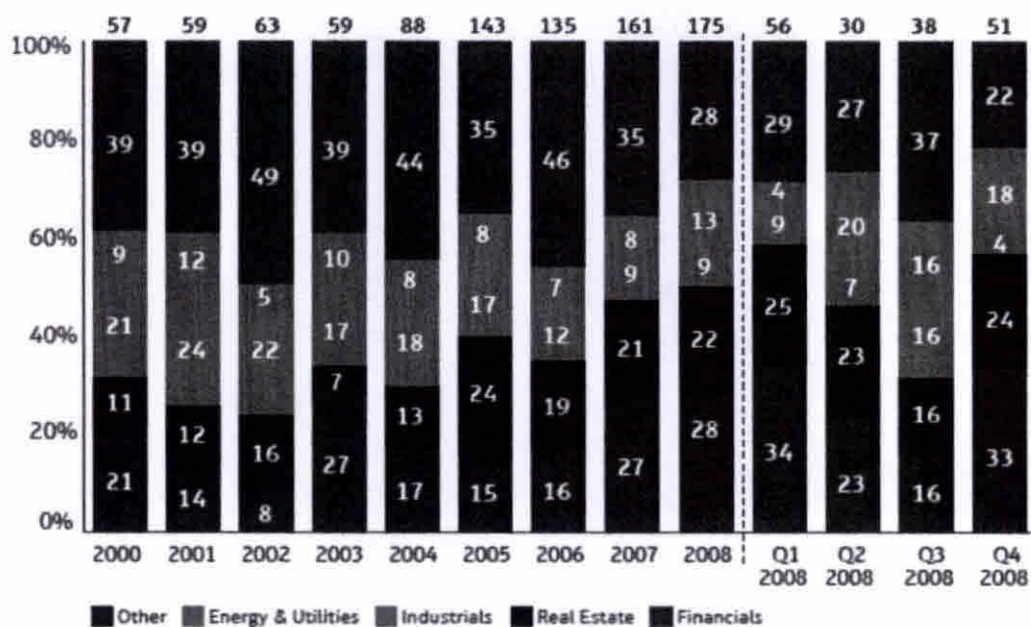


Figure 26: SWF Transaction: 2008 - 2009

Source: Monitor (2009b)



Note: Publicly available data for SWF equity, real estate, and joint venture deals

Source: Monitor-FEEM SWF Transaction Database

Figure 27: SWF Transactions By Sector: 2000 - 2008

Source: Monitor (2009c)

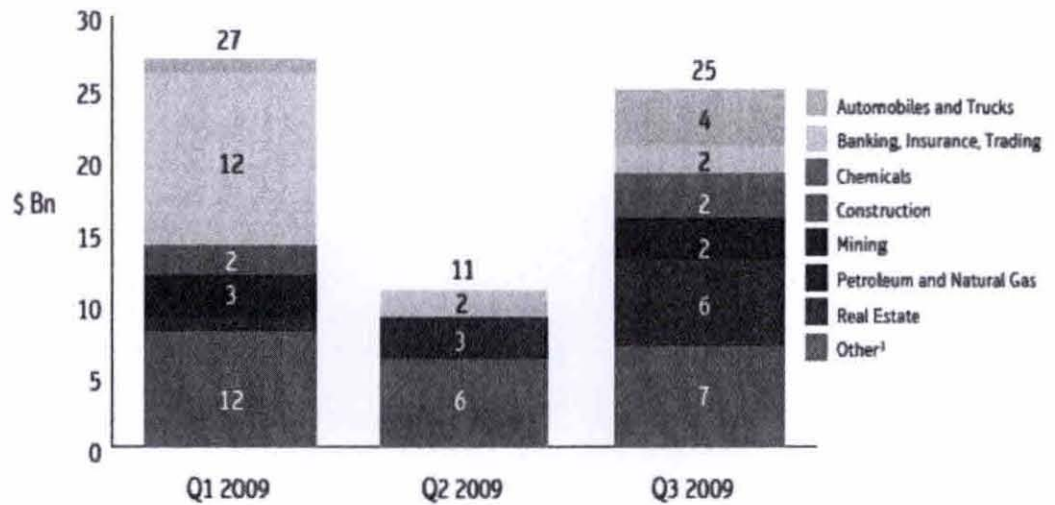
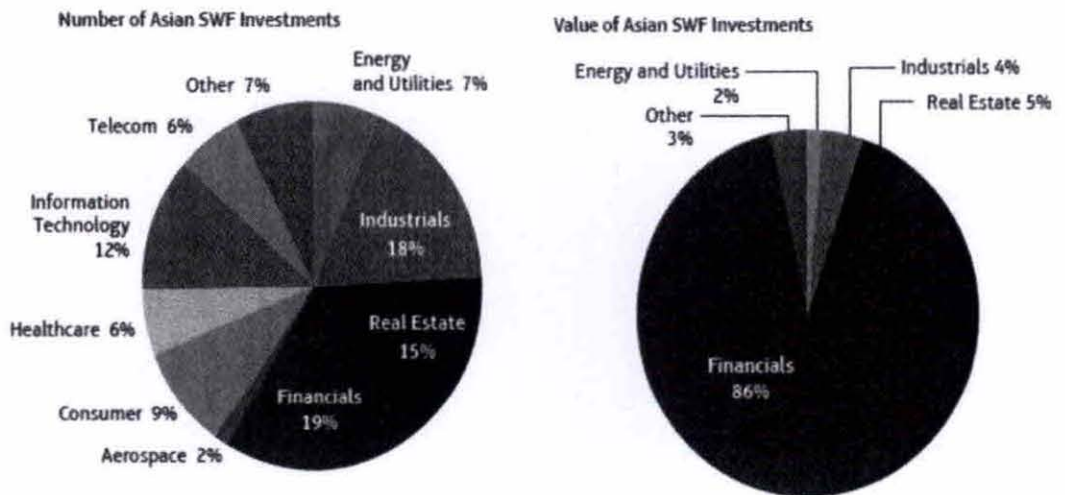


Figure 28: SWF Transactions By Sector: 2009

Source: Monitor (2009b)



Note: Publicly available data for SWF equity and real estate deals, joint ventures and capital injections

Source: Monitor-FEEM SWF Transaction Database

Figure 29: Asia SWF Transactions By Sector

Source: Monitor (2009c)



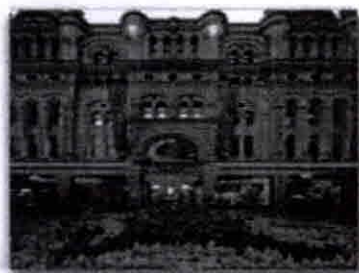
- Azia Centre, Shanghai, China



- Shiodome City Centre, Tokyo, Japan



- Seoul Finance Centre, Seoul, South Korea



- Queen Victoria Building, Sydney, Australia



- Bluewater Shopping Centre, Kent, UK



- Uptown Munich Tower, Munich, Germany



- Westin Paris, Paris, France



- Franklin Centre, Chicago, US

Figure 30: GIC Properties

Source: GIC website

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