INTERNATIONAL REAL ESTATE MARKET STUDY: A FRAMEWORK FOR WORLD CLASS OFFICE DEVELOPMENT

Professor Sr Ts Dr. Ting Kien Hwa
Professor of Property Investment
Universiti Teknologi MARA,
40450 Shah Alam, Selangor, Malaysia
tingkien@salam.uitm.edu.my tingkienhwa@yahoo.com

ABSTRACT

The 1997–98 Asian Financial Crisis provided the catalyst for many Asian countries to improve and strengthen their domestic financial sector and recognized the urgency to restructure its economy into a high value-added, knowledge-based service economy. Developing countries such as Cambodia, Thailand and Vietnam have turned to the development of international financial centers owing to the perceived various economic, financial and other benefits of hosting an international financial center. These centers are dominated by iconic tall office buildings often with world's tallest building ranking and are supported by other related uses e.g. retail centers, hotels, service apartments, recreational spaces etc.

Success of such centers depends on the findings of a comprehensive real estate market studies that support its feasibility. However existing traditional real estate market studies are able to identify suitable property development and investment opportunities at the local, regional and national level only. Existing methodology is not able to cater for international commercial development such as those of an international financial center.

This paper propounds a methodology for international real estate market study to identify the development potential of an international financial center.

The new methodology covers an evaluation of a nation's competitiveness, global city competitiveness, property market transparency, property market momentum, property investment intensity, SWOT analysis and positioning.

1. INTRODUCTION

The Asian Financial Crisis of 1997–98 provided momentum for many Asian countries to improve and strengthen their domestic financial sector and recognized the urgency to restructure its economy into a high value-added, knowledge-based service economy. Several countries have turned to the development of international financial centers to anchor this change owing to various economic, financial and other benefits of hosting an international financial center. Such centers are dominated by iconic tall office buildings often with world's tallest building ranking and are supported by other mixed uses e.g. retail centers, hotels, service apartments, recreational spaces etc.

The financial industry is a high value-added sector that has positive spillover effects on the overall economy. A dynamic international financial center creates a virtuous cycle through the combination of economic and financial globalization and the development of modern financial infrastructure and supporting industries integral to it.

International financial centers (IFC) are active in international loan syndications, asset management, trade financing, mergers and acquisitions, initial public offerings, and other activities. In addition, such centers attract many non-bank financial institutions such as insurance companies, finance holding companies, and international investment and hedge funds. Multinational companies also prefer to locate their regional headquarters in such centers because of their proximity to major financial institutions and excellent telecommunication and transportation infrastructure.

Many developing countries in Asia have embarked on large scale high-end commercial property development that are built and targeted for the international market. Such projects are characterized by landmark and signature office buildings complemented by large modern shopping centers, 6-star hotels and supporting luxurious service apartments and condominiums.

These commercial spaces are often targeted to be leased and sold at a premium rental and capital values relative to the existing property market spaces. However for these property development projects to succeed, it requires a strategic development concept and implementation that could provide the much needed fundamental support for these up- market commercial spaces.

The current framework of real estate market studies is able to identify suitable property development to meet local, regional and national demands. Demand and supply analyses are carried out in market studies to identify a development potential gap. However current real estate market study methodology is not capable of identifying the types of international property development and investment projects to be carried out. This paper explore this gap in the real estate market study literature and propound a framework for international real estate market studies that identify the right development concept that could meet the demand and supply for world class property development in a IFC.

2. REAL ESTATE MARKET STUDY FRAMEWORK

A market study is concerned with the determinants of development/investment profitability and its sustainability e.g. population, households, employment and income etc. Market study is the identification and study of the property market for a particular development/investment. The market study specifically relates market conditions to the property under evaluation. It must show how the interaction of supply and demand affects the feasibility or attractiveness of the development/ investment. The study is used to determine whether there is market support for new property development or an existing property in the foreseeable future (Geltner et al. 2013).

2.1 Limitations of existing market study framework

A survey of past literature on market studies indicate that existing market studies are focused on localized property development and investment situations (Brett and Schmitz, 2009; Fanning, 2005; Myers and Beck, 1994 and Wincott and Mueller, 1995). Malizia (1992) shows that market studies are conducted to cover the following property development and investment situations:

(a) A use in search of a site (use given, site unknown)
The market study attempts to identify and select the best site for the identified use for maximum profit and growth.

(b) A site in search of a use (use unknown, site given)
The study attempts to determine the most fitting and probable use by studying and comparing legal, physical, market and financial aspects of alternative uses.

(c) Market and financial feasibility are carried for an identified scheme (use given, site given)
The study determines the market and financial feasibility of the proposed project.

(d) Capital in search of investment (use known, site unknown).

Myers and Beck (1994) has proposed a 'four-square design' approach to take into account of the present-future and macro-micro dimensions to conduct a comprehensive market study. A good market study should take into account of present and future market conditions and also the macro and micro aspects of the property market. Real estate professional associations that issue guidance on the preparation of market studies have also focus on the development potential of localized property development. In US, a position paper on market analysis was adopted by the Joint Valuation/Research Subcommittees of the National Council of Real Estate Investment Fiduciaries (NCREIF) in 1995. This was released in an article by Wincott and Mueller (1995) in *The Appraisal Journal*. An update of the position paper was released by NCREIF Valuation Committee on 21 May 2012 (NCREIF, 2012). Again the scope of market studies has not extend beyond demand and supply in local property markets.

In Malaysia, upon the aftermath of the Asian Financial Crisis, the Bank Negara has recommended that banks should request for property market studies to support lending to the property sector. In response to Bank Negara's requirements, a guideline known as "*Market and Feasibility Study Guidelines for Property Projects or Property Investments*" is prepared by The Association of Valuers and Property Consultants in Private Practice Malaysia (PEPS) in 2001. However, there is no guidance on property development that could meet the demands from the international property market.

Traditional market studies are generally conducted in relation to national, regional, state or metropolitan or city level. Many of the market analytical techniques used in real estate market studies are similarly defined by national, regional, states or city boundaries. In the globalization era and the more open economies, rapid flow of capital and goods, global telecommunication networks, analyses within national, state and local levels are not adequate to cater for the analysis of demand and supply for cross border development and investment.

The generally lack of property development targeted at the international level in the past has not spurred the need or urgency to develop frameworks or methodologies to conduct international real estate market studies.

2.2 Rationale for international real estate market analysis

With globalization, there are increasing international development projects, cross-border investments in real estate, multinational real estate ventures and integrated urban centers, not just in developed markets such as Europe and North America, but increasingly in the real estate markets of the developing countries.Property development of high grade commercial properties do not exist in a vacuum. World- class office property development relies on an international network of activities to make it viable. A single landmark office building in the form of being one of the tallest building in the world does not make the development world class nor the catalyst to form an IFC. Yet this approach have been adopted by many countries.

A multitude of factors needs to be considered before the appropriate type of world class property development in an IFC can be proposed. The following section discuss some of these key factors.

3. FRAMEWORK FOR INTERNATIONAL REAL ESTATE MARKET STUDY

In view of the literature gap on the scope of real estate market studies, this section will propound a framework for international real estate market studies. This proposed framework will focus on office development particularly in the context of the demand and supply of office spaces in IFCs. The various stages to carry out the study are shown in Figure 1 and discuss in the following sections.

Stage 1: Global competitiveness of the country

Competitiveness is define by World Economic Forum as the set of institutions, policies, and factors that determine the level of productivity of an economy, which in turn sets the level of prosperity that the economy can achieve. The Global Competitiveness Report published by the World Economic Forum has monitored and benchmarked the factors and institutions that determine productivity in close to 140 countries for the past 40 years. The Global Competitiveness Index (GCI) of the report ranks countries based on its economic competitiveness based on twelve elements. The GCI will help to establish the ranking and competitiveness of a national economy in terms of factor-driven economies, efficiency driven economies and innovation driven economies (refer Figure 2).

Different nations exhibit different features in different stages of economic development. These stages and features have been identified by Rostow (1964) and Porter (1990) which helps in understanding the development status of a country. An assessment of the competitiveness of a nation is necessary to establish it’s comparative advantage relative to other countries.

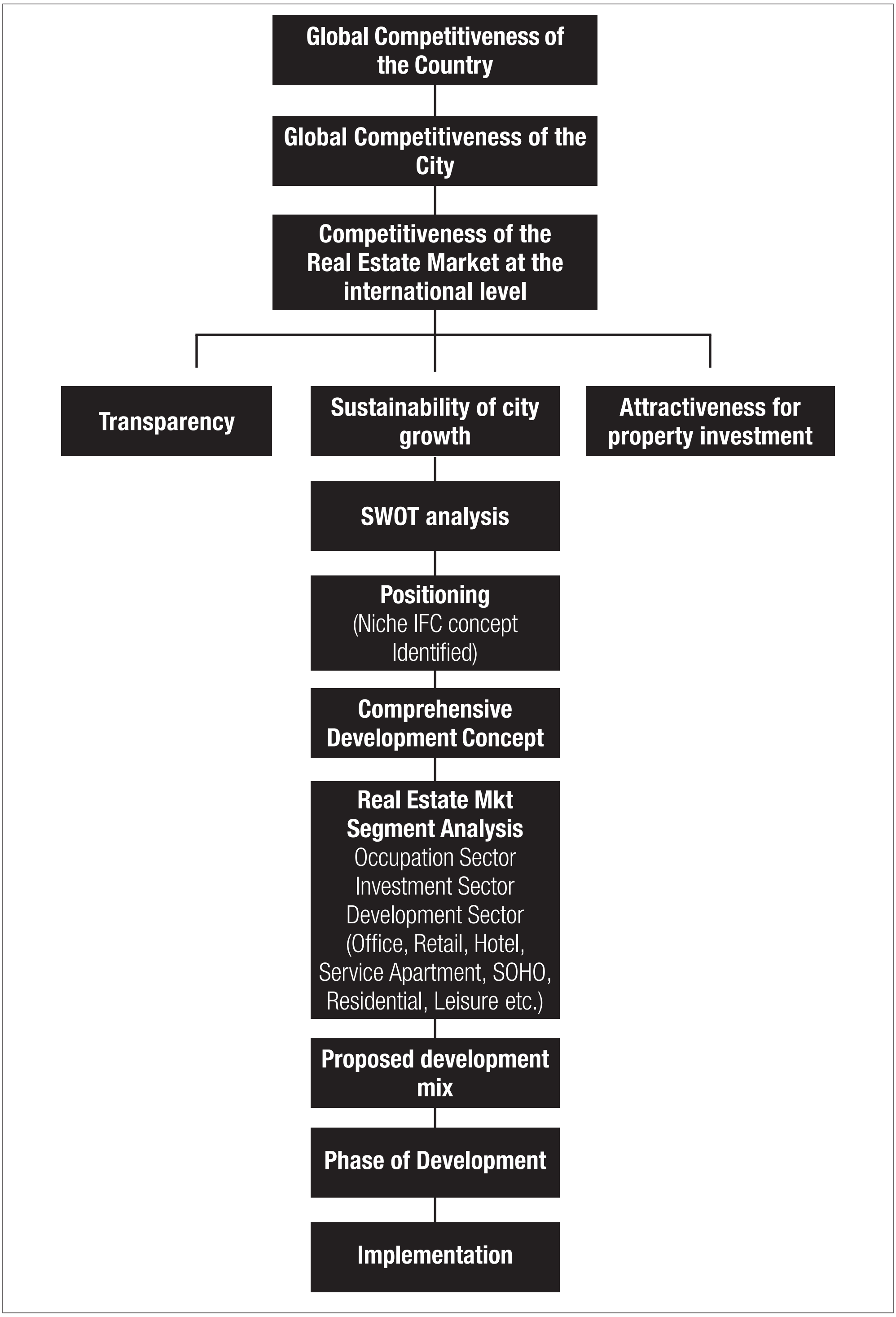

Figure 1: International Real Estate Market Study Process
Source: Author, 2018

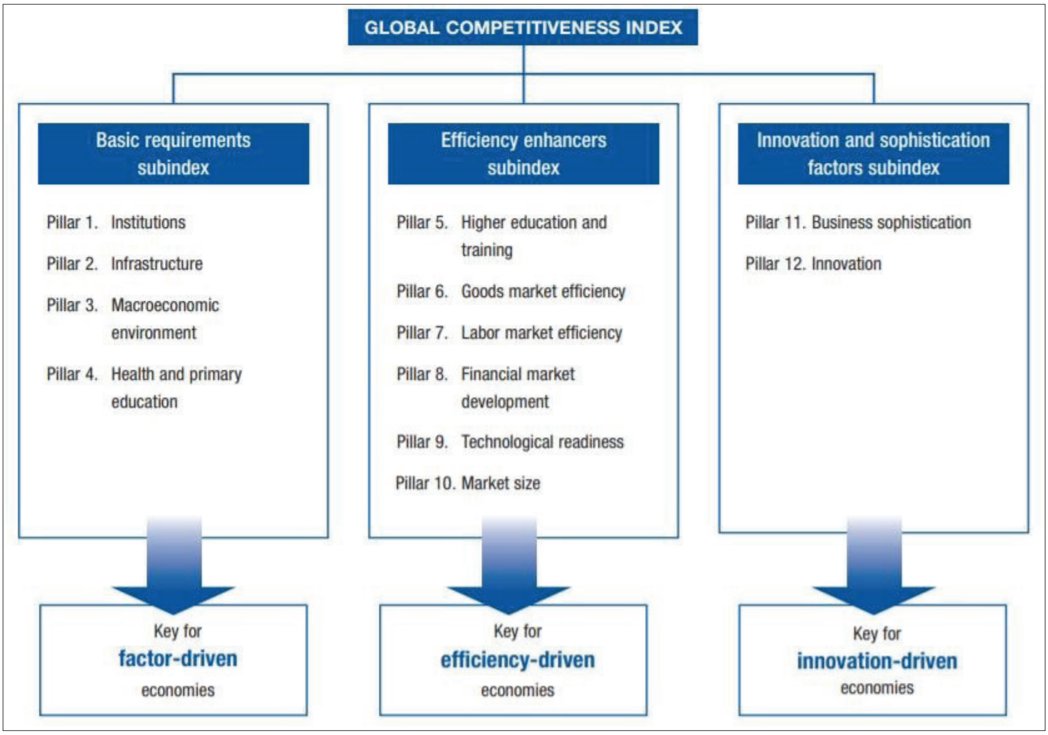

Figure 2: WEF Global Competitiveness Index 2017-2018
Source: World Economic Forum (2017)

Stage 2: Global competitiveness of the city

The world city/global city literature have established the existence of world city hierarchy (Friedman, 1986), a global network of cities (King, 1990) and global cities (Sassen, 2002). The essential idea is that cities or urban regions form part of a global hierarchy determined by the global system of capital, trade and business flows.

The economic globalization forces which drive globalization are noted to be centered in cities and have a spatial impact on cities differently. The role of cities is central to globalization process (Sassen, 2002). Intensifying economic globalization has resulted in competition among cities.

Urban competitiveness is taken to mean the ability of a city to exploit or create comparative advantage and thereby to generate high and sustainable economic growth relative to its competitors (D'Arcy and Keogh 1999). The factors affecting urban competitiveness according to Kresl (1995) are economic determinants (e.g. factors of production, infrastructure, location, economic structure and urban amenities) and strategic determinants (e.g. governmental effectiveness, urban strategy, public-private partnership and institutional factors). Keum (2000) asserts that urban competitiveness is not merely an economic issue but also a multifaceted issue comprised of environment, social, ecological infrastructure and human development. Kresl and Singh (1999) have developed measures of urban competitiveness that is both quantitative and comparative in terms of competitive strengths and weaknesses.

Several global city indices are available to make the assessment on the global competitiveness of a city.

Stage 3: Competitiveness of the real estate market at the international level

Stage 3a: Transparency of the national real estate market

Different international property markets are at different levels of development and maturity. The attractiveness of a property market depends on its market transparency. The relative transparency of property markets among different countries can be examined using JLL Global Real Estate Transparency Index (GRETI). This index categorises the level of property market transparency of 109 countries into five categories: high, transparent, semi, low and opaque transparencies. It applies 139 individual transparency measures that cover the following aspects:

Performance Measurement	- 25%
Market Fundamentals	- 20%
Governance of Listed Vehicles	- 10%
Regulatory and Legal	- 30%
Transaction Process	- 15%

Figure 3 shows in detail the criteria in determining the levels of market transparency. Figure 4 shows the transparency of international property markets using GRETI.

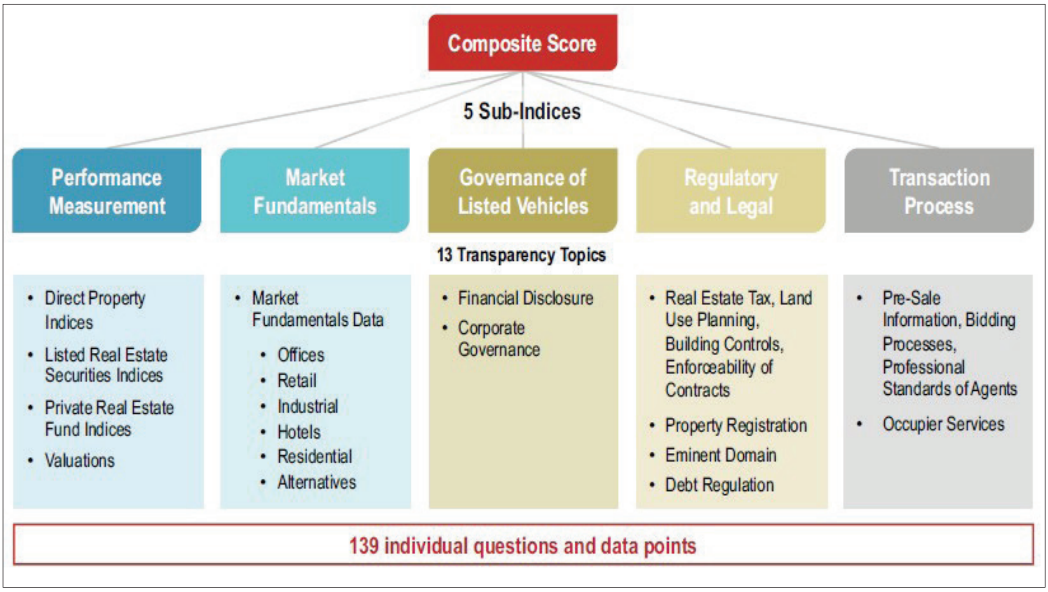

Figure 3: Assessment criteria of GRETI 2016
Source: JLL, LaSalle Investment Management

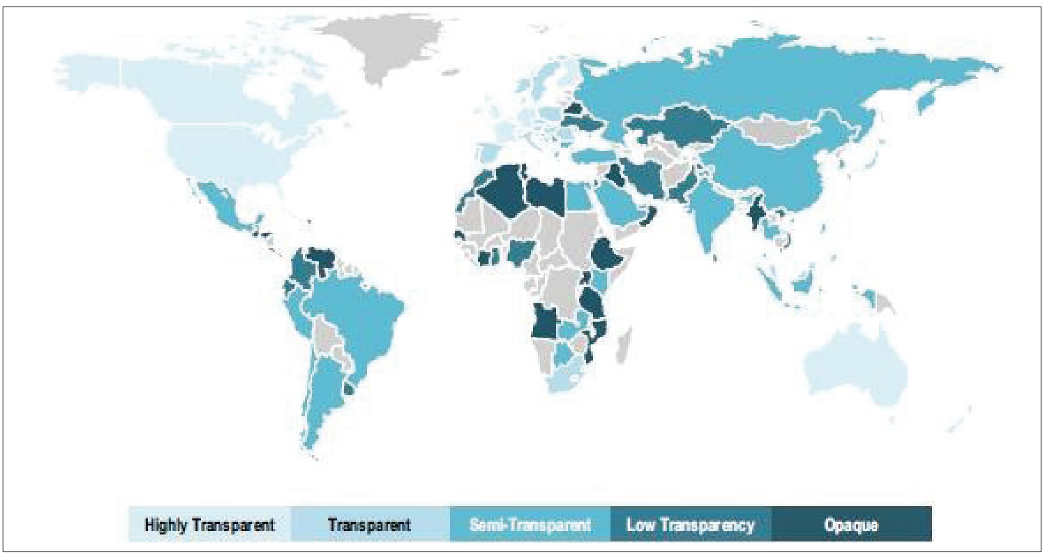

Figure 4: International real estate market transparency 2016
Source: JLL, LaSalle Investment Management

Property markets that are less transparent, opaque, corrupt practices, poor corporate governance and failures in regulatory enforcement will fail to attract businesses, corporate activities and investment flows. International investors and occupiers will focus more on transparent markets. A transparent real estate market not only act as a facilitator of new development, investment and business activities but also community well-being and inclusiveness. Figure 5 shows the importance of real estate market transparency.

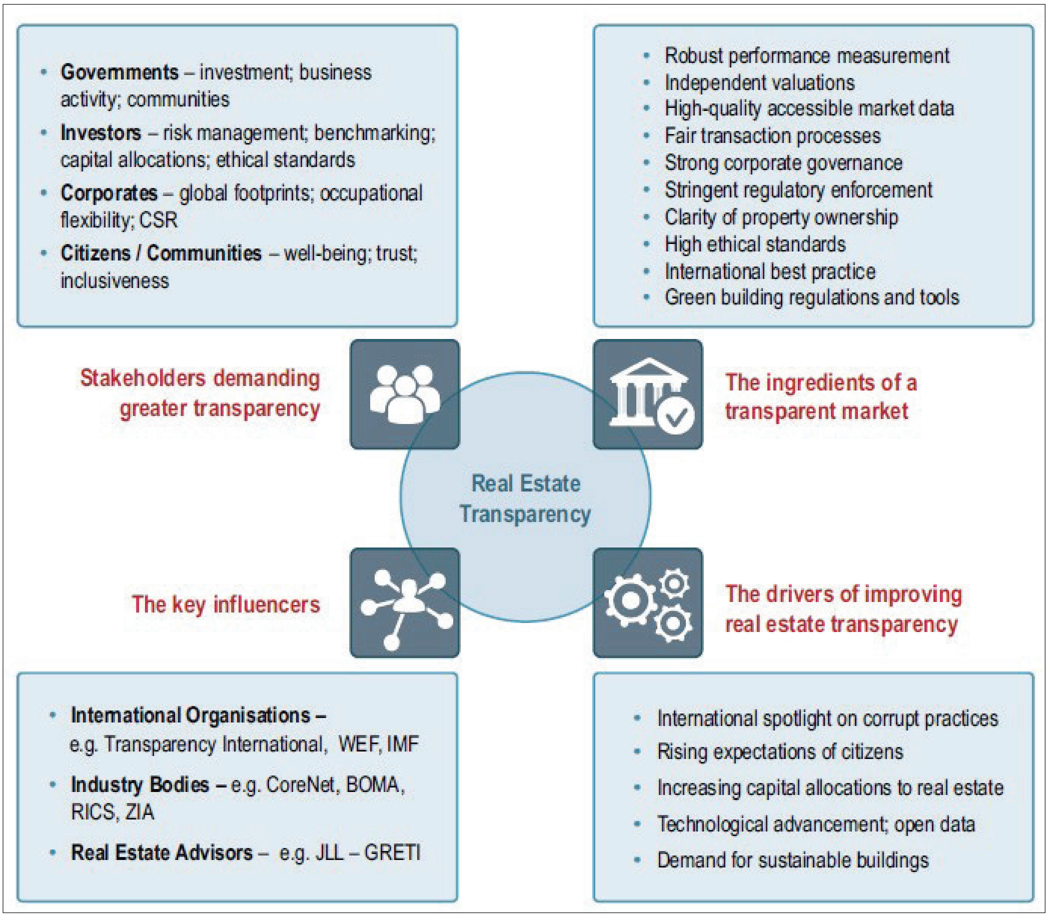

Figure 5: Importance of real estate market transparency
Source: JLL, LaSalle Investment Management

Stage 3b: Sustainability of City Growth

Sustainability of city growth can be termed as “city momentum” which refers to the performance of a city in the short term and its potential to continue to perform in the longer term. The JLL City Momentum Index provides information on this aspect (refer Figure 6). The components of the City Momentum Index enable cities to be clustered according to levels of short term economic and real estate momentum:

(a) Socio-economic momentum relating to changes in city GDP, population, air passengers, corporate headquarters and foreign direct investment (FDI).

(b) Commercial real estate momentum relating to changes in absorption, construction, rents, investment volumes and real estate transparency covering the office, retail and hotel sectors.

(c) High-value incubators relating to the ability of the underlying attributes of a city to maintain momentum over the longer term (i.e. its future-proofing capacity) in terms of higher education infrastructure, robust innovation economy, high levels of technology business start-ups and patent applications, and high air quality and environment.

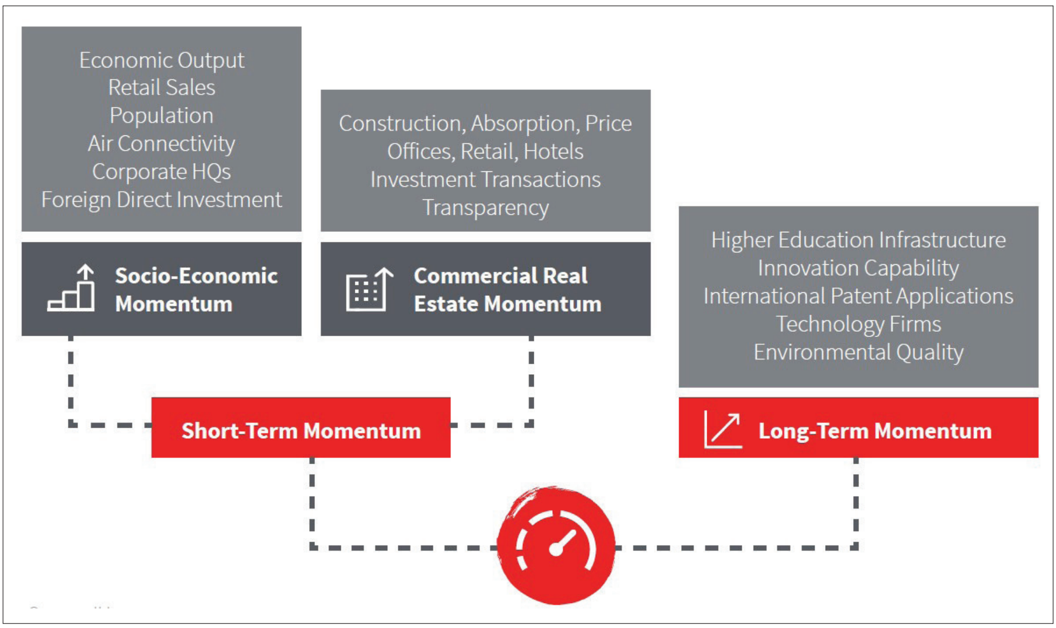

Figure 6: JLL City Momentum Index
Source: JLL, LaSalle Investment Management

Stage 3c: Attractiveness for property investment

Growing real estate allocations from institutional investors and new sources of capital targeting the direct property sector will expand the competition for direct property investment. Investors will look increasingly to 'Emerging World Cities' to satisfy their requirements, since an estimated 60% of the global office development pipeline up to year 2020 are in emerging markets. A measure on the level of attractiveness among cities will be useful to evaluate the relative attractiveness of cities as a destination for property investment.

JLL's Investment Intensity Index compares the volume of direct commercial real estate investment in a city over a three-year period relative to the city's current economic size. The Index provides a measure of real estate market liquidity, as well as a useful barometer of a city's overall health, highlighting cities that are performing well in attracting real estate investment.

The index is able to indicate the top cities for cross-border investment intensity, identify the leading 'Emerging World Cities' and provide a breakdown of which cities are attracting the most intensive investment activities into the office, retail, hospitality and leisure sectors.

Stage 4: SWOT analysis

A SWOT analysis will examine the macro perspective at a country level, the suitability to develop an international financial center. The analysis involves (a) identifying and assessing strengths and weaknesses of a country and (b) identifying and assessing external opportunities and threats at the regional and global level in developing an IFC.

Stage 5: Positioning

An understanding of the institutions and strategic characteristics of the nation and city, together with SWOT analysis will reveal the potential for the development of an international financial center. A further analysis on the existing and proposed competitive IFCs in the region will narrow down the possible type of IFC to be proposed and to find a niche in the international finance marketplace.

Table 1 shows the types of IFC classified by various criteria. The competitiveness of a new IFC can be evaluated by examining the business environment, human capital, infrastructure, financial sector development and reputation (refer Figure 7).

Table 1: Classifications of international financial centers

	Criteria	**Types of IFC**	**Characteristics of IFC**
IMF (2000)	Scope and level of financial services	1. International financial center	Large full service IFC providing global services (London, New York, Tokyo)
		2. Regional financial center	Intermediate service IFC servicing surrounding regions (Hong Kong, Singapore, Luxembourg)
		3. Offshore financial center	Smaller limited specialist services (Bahamas, Cayman Islands)
Park (2011)	Sources and uses of funds	1. Primary center	Serves worldwide clients (London, New York, Tokyo)
		2. Booking center	A financial entrepot where the sources and uses of funds are oriented toward the outside regions (Nassau, Cayman Islands)
		3. Funding center	Channels offshore funds from outside their market areas toward local uses (Singapore, Panama)
		4. Collection center	Primarily in outward financial intermediation (Bahrain, Dubai)
Seoul Financial Forum (2003)	Operational and geographical reach	1. Global financial center	Broadest range of financial services, new financial products and new risk management techniques (London, New York, Tokyo)
		2. Regional financial center	Cater to regional market clients (Frankfurt, Tokyo, Shanghai, HK, Singapore)
		3. Niche financial center	Specialize in certain financial service sectors for having developed special expertise and reputation. (Sydney, Zurich, Edinburgh)

Johns (1994)	Clusters based on linkages to a major onshore center and its time zone	Cluster 1 Caribbean – Central America Cluster 2 Europe Cluster 3 Middle East Cluster 4 Asia-Pacific	Time zone – New York Time zone – London Time zone – Dubai Time zone –Tokyo

Source : Author's Complilation

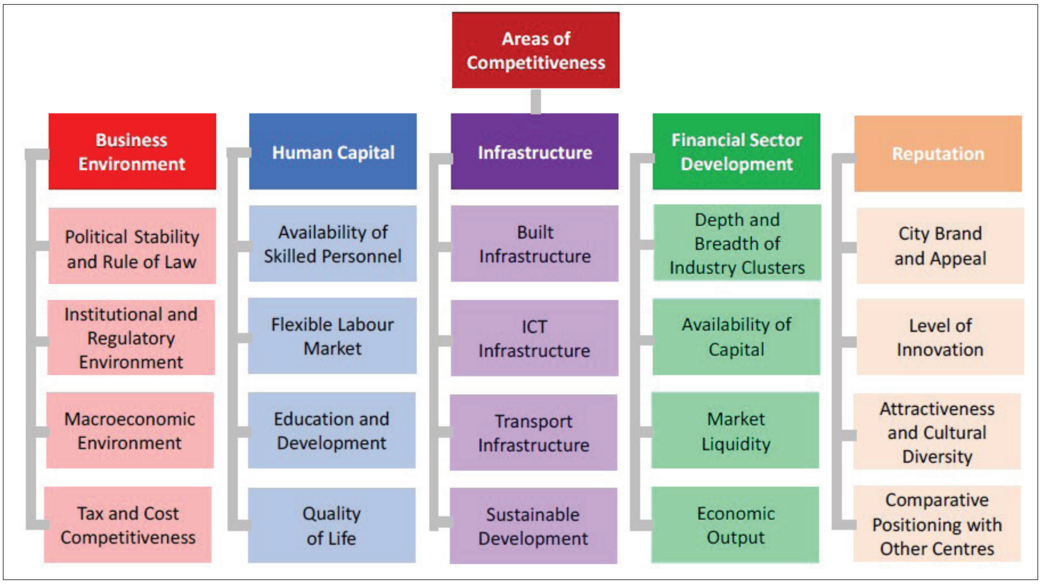

Figure 7: Assessment criteria for IFC
Source: The Global Financial Centers Index (Sept 2017)

Stage 6: Comprehensive development concept

Based on the niche IFC identified, a comprehensive development concept will be developed comprising mixed land uses that support the proposed IFC such as retail, hospitality, cultural, leisure, MICE and luxurious residential uses to make the IFC an integrated development. The concept will take into account existing and future accessibility, access connections and linkages, mass transit modes, visibility and other site characteristics and conditions to enhance the attractiveness of the new development,

A successful IFC is not merely a mixed commercial development but need to be supported by residential, cultural, institutional and entertainment/leisure uses, where these supporting activities are physically and functionally integrated to the IFC.

The real estate market segment analysis in the following stage will analyse existing and future property market conditions to identify the suitable types of development that may meet the future demand of space from the IFC and the necessary supporting amenities and facilities.

Stage 7: Real estate market segment analysis: Occupation, Investment and Development sectors

The analysis of the real estate market segment will be based on the occupation, investment and development sectors for each of the office, retail, hotel and residential sub-sectors. The drivers of the components of the real estate markets i.e. occupier market, investment market and the development market will also be analysed. Specifically the demand and supply of office spaces to meet the office demand and requirements by the IFC will be carried out.

For each property sub-sector, existing and future demand and supply situations will examined. Existing and future rental and capital values will be analysed in the context of vacancy rate, yield, future supply and demand, investors preference etc. Analyses based on building grade and green buildings according to geographical locations and distributions will provide insight into future demand on office spaces. Projections and analysis on new job opportunities in IFC will indicate the types of spaces and supporting amenities to be provided to meet the demand and requirements of the occupiers of the IFC.

Stage 8: Proposed development mix

The findings in Stage 7 will be able to establish the detail development components of the IFC. Guidelines and development criteria such as land use, plot size, plot ratio, density, height etc. will be detailed. The indicative building size, floor size, building specification, targeted tenants, indicative rentals and capital values by property types will be proposed.

Mixed-use developments combine living, shopping and working space into one location. Traditionally, mixed-use developments involve office, retail, residential units and some elements of leisure and entertainment. There are elements of pedestrian-oriented communities and often have park settings with fountains, gardens and children's play areas.

Tourism and leisure also play a critical role in mixed-use developments. Tourists add to the demand for hotels, restaurants, shops and entertainment. Green design elements will make the high density, condensed land use features of mixed-use developments a conducive commercial built environment.

Stage 9: Development Phasing

Appropriate development phasing of the whole IFC development will be determined based on the infrastructure, capital availability, the state of the real estate market, economic conditions etc.

To unlock the growth and development potential of the proposed IFC requires a phased approach to aid viability and deliverability. Utilities infrastructure requirements and highways capacity are the key drivers behind the phased approach to the delivery of the IFC masterplan. Each phase of development should leverage on any new and existing access linkages (e.g. monorail, LRT, MRT, highways etc.) and infrastructural capacity to unlock the next development precinct until total build out is achieved. This is an important function of the phased approach and any development that is brought forward out of sequence will need to be considered carefully to ensure that it does not impact upon the viability of subsequent growth.

4. CONCLUSION

Existing real estate market studies are catered to development at the national regional, metropolitan and city level. The methodology of these studies do not cater to property developments that are targeted at international real estate markets.

This paper introduced the conceptual and methodological underpinnings of international real estate market study for the proposal of an IFC. The framework may be improved to take into consideration other evolving factors in the future. New real estate drivers and trends in the sharing economy such as FinTech, co-working, PropTech etc. will need to be examine in terms of their impacts on future office space demand. In particular, it is pertinent to consider how the growth of the disruptive technologies, automation and digitization of work processes will affect future office demand.

Other components of an IFC are also affected by emerging trends such as e-commerce affects the retail spaces, shared accommodation services affects the hospitality sector and co-living may affect residential properties.

REFERENCES

Association of Valuers and Property Consultants in Private Practice Malaysia. 2001. *Market and Feasibility Study Guidelines for Property Projects or Property Investments* PEPS

Barrett, G. V. and Blair, John P. (1982) *How to conduct and Analyse Real Estate Market and Feasibility Studies* Van Nostrand Reinhold

Brett, D. L. and Schmitz, A. 2009. *Real estate market analysis: methods and case studies.* 2ed. Urban Land Institute, Washington, D. C.

Carn, Rabianski, Racster and Seldin (1988**)** *Real Estate Market Analysis - Techniques and Applications* Prentice Hall

Clapp, John M. (1987) *Handbook for Real Estate Market Analysis* Eaglewood Cliffs, Prentice Hall

D'Arcy, E. and Keogh, G. (1999) The property market and urban competitiveness: A review. *Urban Studies*, 36, 5/6, 917-928.

Fanning, S. F. 2005. *Market analysis for real estate: concepts and applications in valuation and highest and best use*, Appraisal Institute, Chicago

Fanning, Stephen F. & Winslow, Jody (1988) Guidelines for Defining the Scope of Market Analysis in Appraisal Assignments, *The Appraisal Journal,* October

Featherstone, J. B. (1986) Approaching Market Analysis in a New Economic Environment, *Journal of Real Estate Development,* 1(4) Spring, 5 - 10

Friedman, J. (1986) The world city hypothesis, *Growth and Change*, 17, 69-83.

Geltner, D. M., Miller, N., Clayton, J. and Eichholtz, P. (2013) *Commercial real estate*, South Western Educational Publishing

Global Financial Centers Index 22edition, September 2017

International Monetary Fund (2000) *Offshore Financial Centers—IMF Background Paper*, Monetary and Exchange Affairs Department, Washington, D.C.

Johns, Anthony (1994) Not Tax Havens, Havens for Transnational Invisible Trade Enterprise, *Intereconomics*, 29

Jones Lang Lasalle (2016) *Global Real Estate Transparency Index 2016,* JLL Jones Lang Lasalle (2017) *City Momentum Index 2017,* JLL Jones Lang Lasalle (2017) *Investment Intensity Index 2017,* JLL

King, A. (1990) *Global cities: Post-imperialism and the internationalism of London*, London, Routledge.

Kresl, P. K. (1995) The determinants of urban competitions: A survey in: Kresl, P. and Gappert, G. (eds) *North American Cities and The Global Economy*. Sage, Thousand Oaks

Kresl, P. K. and Singh, B. (1999) Competitiveness of the urban economy: Twenty-four large US metropolitan areas, *Urban Studies*, 36, 5/6 May, 1017-1028

Keun, H. (2000) Globalisation and inter-city cooperation in Northeast Asia, *East Asia: An International Quarterly*, Summer, 18:2, 9 114

Malizia, Emil (1992) A Framework for Real Estate Feasibility Research, *Journal of Property Valuation & Investment,* 10(3), 640 – 645

Myers, Dowell and Beck, Kenneth (1994) A Four-square Design for Relating the Two Essential Dimensions of Real Estate Market Studies in DeLislie, J R & Sa-Aadu J ed. *Appraisal, Market Analysis & Public Policy in Real Estate* Real Estate Research Issues Vol.1 Kluwer Academic Publishers

NCREIF (2012) *Market analysis in the appraisal process,* Valuation Committee Position Paper

Park, Yoon-shik and Musa, Essayyad (1989) *International Banking and Financial Centers*, Boston: Kluwer Academic Publishers

Porter, M. E. (1990) *The Competitive Advantage of Nations*. New York: Free Press

Rostow, W. (1964) *The stages of economic growth: a non-communist manifesto* Cambridge UK

Sassen, S. (1991) *The Global City*, Princeton, Princeton University Press.

Sassen, S. (2002) Locating cities on global circuits, *Environment and Urbanisation*, 14, 1, 13-30

Seoul Financial Forum (2003) *Korea as an International Financial Center: Vision and Strategy*, Seoul Financial Forum, January, 38.

Wincott, D. R. and Mueller, G. R. 1995. Market analysis in the appraisal Process *The Appraisal Journal,* January, 27 - 32

World Economic Forum (2017) *The Global Competitiveness Report 2017-2018*