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Paving the Way: Trends and Investment Opportunities in Asian Industrial, Warehousing and Logistics Property

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Most of the macroeconomic trends playing out in the ongoing story of Asia’s development point to ever-greater industrialization and growth of domestic markets and thus support an investment hypothesis focusing on industrial, warehousing and logistics (IWL) properties in the region. These facilities may be urban, suburban or rural, but do not include office parks, R&D parks, high-tech parks or cyber parks, which share more features with regular commercial property than with industrial assets.

Asian markets are maturing and deepening. Domestic consumer spending increases with GDP growth and shifts to more locally manufactured goods; families in Chongqing and Jakarta are now buying the washing machines, scooters, blenders and televisions formerly exported to the United States.

As incomes and purchasing power expand, middle classes grow, and regional consumer demand increases to fill in for shrunken U.S. import demand. New shipping routes and transport infrastructure are being built to connect producers with these new consumers. As the renminbi appreciates versus the U.S. dollar and wages and other costs rise in southern China’s manufacturing belt, production is moving inland to the West, to Anhui, Chongqing and even Urumchi – the center of a 150 million-person market in Western China. Again, new shipping routes and transport infrastructure are being built to connect consumers with these new producers.

This article looks at these issues from the investor’s perspective but with an eye toward the underlying economic development and infrastructure – what’s happening on the ground – to identify attractive investment areas. It also will outline practical ways an institutional investor can put together a sound sectoral IWL investment portfolio that is still well positioned and diversified in terms of both sector and location. The objective is to benefit over the long term from exposure to those markets which, in turn, will benefit the most from the shifting trade and financial flows and new routes to market for Asia-manufactured and -grown goods.

TRANSPORT TRAFFIC

A transport corridor now connects these emerging low-cost manufacturing and industrial centers in Western China and the rich agricultural heartland areas of Central Asia (Uzbekistan produces some of the best fruits and vegetables this author has ever tasted) to consumers in Russia and Western Europe (see “Western Europe – Western China Transport Corridor,” page 23).

This multibillion-dollar "New Silk Road" undertaking, financed by multilateral organizations including Central Asia Regional Economic Cooperation, the World Bank, Asian Development Bank and European Bank for Reconstruction and Development, as well as national governments and private developers, is progressing steadily to reduce shipment costs, streamline customs and generally facilitate trade along a network of routes in a wide swath running from France and Germany through Russia and Kazakhstan to China, reducing transit time by weeks and increasing the flow of Europe-Asia trade overland.

A further indicator of massive international investment in regional transportation corridors that will require additional IWL facilities is the European Union's Transport Corridor Europe-Caucasus-Asia (TRACECA) project to improve road and rail transport corridors linking Central Asia and Southern Caucasus with Turkey, Ukraine, Romania and Bulgaria. The TRACECA master plan also proposes a number of new IWL facilities along these routes, structured as public-private partnerships.

A simple indicator of the increasing traffic on these routes is the number of freight containers passing each year through Western China's "backdoor to Europe" – the land-port at Dostyk, Kazakhstan, the primary land-port for westbound-containerized freight from China. The transshipment of containers at Dostyk, which stood at nearly 200,000 TEUs (twenty-foot equivalent units) in 2008, is projected to top 700,000 TEUs in 2015, according to the Eurasian Development Bank.

Further market confirmation of these trends may be seen in the "Agility Emerging Markets Logistics Index 2011" map on page 23, prepared by Agility Logistics and Transport Intelligence for its recently released Agility Emerging Markets Logistics Index. Survey data from international shipping companies was used to rank countries in terms of their attractiveness as markets for logistics services in 2011 compared with a similar survey taken in 2010. The results show a clear consensus that Russia, the Commonwealth of Independent States and Central Asia are becoming a more attractive market for logistics providers.

CONVERGING TRENDS

Simply put, as goods and produce begin to flow in these new channels, new IWL facilities and properties must be built at each key node in the transport network to collect, sort, pack, store, ship and distribute them. And as trade flows increase, the rental income generated by, and the asset value of, these IWL properties will increase.

At the same time, emerging markets and industrial property assets are moving, post-crisis, into core positions in leading institutional portfolios. Clearly, then, these two trends converge on the need to identify and structure assets and opportunities to serve both institutions' need to invest and developers' need to build.

Let us briefly review the arguments for including IWL as a core part of a diversified international property portfolio:

- The economic performance of industrial property tracks general economic conditions more accurately than other property assets as industrial assets are directly related to space requirements for production and distribution, and storage of goods. The economic recovery now under way, especially in Asia, shows good macro drivers (e.g., GDP growth and growth in domestic markets, inventories, employment and manufacturing).

- Ease of achieving diversification for a given portfolio allocation – industrial properties can be significantly less expensive to acquire than typical core office or commercial buildings.

- Development time to market is shorter for industrial property than for office and general commercial buildings, so the sector can respond more flexibly to changes in demand.

- Industrial property capital expenditure and investment requirements are generally lower than for office or commercial property.

- Industrial rents and vacancy rates are less variable than for office and commercial properties.

A recent RREEF study concluded, “Investors can continue to achieve favorable returns by including industrial properties as a key component in their long-term investment strategies.”

Overall, then, there are many arguments supporting the premise that carefully selected IWL properties can offer attractive risk-adjusted returns with less volatility than other property sectors.

It also seems there is a strong case to be made that Asia, with its more resilient economies, explosive growth in the number of middle-class consumers and new trade routes, may present an especially attractive place in which to invest in IWL.

But, assuming this is the case, how would one design and implement an IWL investment strategy in Asia – creating exposure to both its core and its emerging areas?

On one hand, some U.S. and E.U. institutional investors now, after the global financial crisis, are apparently shying away from private equity–type real estate funds, with their relatively short time horizons and high fees, in favor of more separate accounts and direct investments. A California Public Employees’ Retirement System official was quoted recently as saying that the pension fund is planning to avoid new investment in pooled vehicles such as private equity–type closed-end property funds and REITs, but to use their market behavior solely for benchmarking the performance of direct investments.

On the other hand, not all investors can afford to take this “wholesale” approach. Many, for reasons of size or policy, need the convenience and efficiency of investing through managed pooled or listed real estate portfolios and investment products, especially in markets with which they are only becoming familiar, and many of these will no doubt show good portfolio returns from continuing to do so.

So, how to create the desired exposure to the core IWL sector using an approach suitable for a particular institutional investor? Given the specific functions and business uses of IWL assets, and the fact that many are owned by their operators, some strategists might argue for investing through a portfolio of large publicly listed logistics and transportation companies that own and manage portfolios of such properties as part of their regular business. We will look first at some available IWL-oriented REITs and then at some strategies for direct investments, including in partnership with operating companies.

REIT INVESTMENT

REITs and similar vehicles allow an investor to gain quick exposure to entire portfolios of IWL assets with a single trade. The category of IWL property REITs is seeing new favor, with several listed on regional exchanges and more in the pipeline. Even if an institution prefers direct investments, these REITs offer an interesting view of how industrial property portfolios can be assembled, as well as some measurable proxy for the overall market.

A good current proxy or benchmark for the Southeast and East Asian IWL market is Sing-apore’s Ascendas

REIT. Ascendas REIT has grown, through both internally generated developments and acquisitions, from a core portfolio of Sing-apore IWL-type properties at the time of its five times oversubscribed initial public offering in November 2002 to current assets of approximately S$4.9 billion (US$3.9 billion) and portfolio gross floor area of 2.4 million square meters that is 95.6 percent occupied. Properties range from airfreight logistics facilities to a specialty vertical IWL hub for the food and beverage industry, and several were developed jointly with and for leading logistics operators/tenants, including CWT, Schenker and Zuellig. In terms of international diversification, Ascendas REIT still comprises only Sing-apore assets but has announced plans to invest in China. Ascendas REIT's unlisted sponsor/manager, Ascendas Pte. Ltd., has a separate portfolio of IWL and commercial properties in Singapore, the Philippines, Malaysia, China, India, South Korea and Vietnam.

Other Singapore-listed REITs with IWL assets include:

- Mapletree Industrial Trust (IPO in October 2010): The trust is also 100 percent Singapore properties, but the manager also runs an unlisted vehicle (Mapletree Industrial Fund) targeting investments in IWL properties in China, Singapore, Malaysia, Vietnam, Thailand, India, the Philippines, South Korea and Japan.

- Cache Logistics Trust (IPO in April 2010): The REIT currently holds a portfolio of six IWL properties, all in Sing-apore, valued at S$744 million (US$584 million) as of the end of 2010. Cache is affiliated with Sing-apore commodities-focused logistics operator CWT, which is a partner in the manager.

Although not within the scope of this discussion, comparable Australia-listed industrial REITs include:

- Australand Property Group (current portfolio comprises only Australian assets)

- Bunnings Warehouse Property Trust (current portfolio comprises only Australian assets)

- Mirvac Industrial Trust (current portfolio comprises assets in Australia and Chicago)

- ING Industrial Fund (current portfolio comprises assets in Australia, Germany, Spain)

BROADER REGIONAL DIVERSIFICATION

For investors seeking broader regional diversification than offered by listed REITs, the question arises how best to construct a balanced high-quality portfolio of individually invested IWL properties, given the inefficiencies and opacity of Asian property and direct investment markets.

Ideally, such a portfolio would be anchored in core relatively developed markets such as Sing-apore, Hong Kong or China's Pearl River Delta area (e.g., Guangzhou, Shenzhen or Zhuhai), but would provide meaningful exposure at the margins to those potentially high-growth centers (e.g., in Indonesia, India or along the Western Europe to Western China corridors), which are expected to develop as the shifts in trade and economic flows discussed above play out.

Cost-effective strategies for a large pension fund or other institutional investor with a long-term investment horizon looking to identify, develop and manage IWL properties across the region might include partnering with one or more large regional or global logistics companies. Such a strategy might include acquisitions and leasebacks of existing assets as well as joint investment in greenfield IWL projects to be developed along new trade routes. In such an arrangement, the institutional investor could be the dominant owner of substantial assets with the protection of professional asset management and part (or 100 percent) tenancy by a major reputable operator (similar to an operations and maintenance provider in an infrastructure asset such as a wastewater treatment plant or an airport).

The scale of IWL opportunities of all sizes in the region means that this approach is not only for mega-funds but for any institution looking to be positioned well on a 20- to 30-year time horizon. By 2040, the goods traffic on the “New Silk Road” may well have eclipsed that on the United States’ Interstate 80 or the M4 motorway in the United Kingdom.

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