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Emerging International Real Estate Markets

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Emerging International Real Estate Markets

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CONTENTS

Emerging International Real Estate Markets

1. EXECUTIVE SUMMARY

- The term 'emerging markets' derived from the economic development debates of the 1970s and 1980s. The world has changed much since then and perceptions of emerging markets have evolved too. This paper explores the real estate context of this debate, assessing progress over the last decade against developed world benchmarks to highlight key themes, notably:
    - What is the scale and balance of investment between established and emerging markets?
    - Are emerging markets now considered more 'investable'[1] than a decade ago?
    - What are the main factors that determine the developmental status of markets?
- Capital flows data indicate that the concentration of property investment in emerging markets remains much lower than their (rapidly growing) economic size and importance. While the imbalance is striking, it is shifting and evidence suggests that it is probably not mis-aligned when compared with other financial assets.
- The growth of investment inflows to frontier and emerging markets has comfortably exceeded developed world benchmarks over the last decade. Although not maintaining the peaks of the immediate post-GFC period, the share of emerging market investment is much higher than in the mid-2000s.
- Evidence is mixed for 'investable' markets. At a national level, the metrics show that developed markets have seen a larger rise in real estate inflows relative to their market size, though there is much stronger evidence of increased intensity[2] in the emerging world's major cities.
- Other evidence from national investment flows suggests that neither the more open nor the domestic-orientated approach have resulted in stronger inflows in the longer term. Sectoral development also does not seem to follow a set pattern in the emerging world.
- In looking for factors that drive development, economic influences were by far the most significant. Correlations of GDP and population growth are high, explaining 90% of the movement in emerging market inflows at both city and national level – much higher than for mature markets. This suggests that, with economic and demographic growth continuing to outstrip the mature markets, investment will continue to thrive in the emerging world.
- Results from the non-economic indicators were generally inconclusive; notably, political and credit risk showed limited statistical relationships. While this may reflect data limitations, it is a key area for further exploration before development patterns can be assessed, as these 'softer' influences are seen as important moderators in any discussion of immature real estate markets.
- Narrowing the focus to major cities provided some counter-intuitive results: while inflows were more concentrated in the major centres of each emerging country, these cities tended to show slightly lower growth rates than their outlying economy. The trend in the developed world is the opposite, with the top cities on average more dynamic. In both emerging and developed markets, the pattern reflects economic trends.
- In addition, emerging markets did not seem to provide significantly greater returns for investors to compensate for the greater risk and volatility encountered there. Data quality is an issue at this level, but these results suggest that, while cities are clearly central to real estate development, patterns may be more nuanced than might have been expected.

[1] By 'investable'/'investability', it is meant how institutional investors view the suitability of a market for investment purposes.
[2] A market's 'investability' may be measured by the level of investment activity, known as investment intensity. This is calculated by dividing the three-year average of investment inflows into a country by its current real GDP.

2. EMERGING MARKETS IN REAL ESTATE

The term 'emerging market' derives from economic policy debate of the 1970s and 1980s. These markets were generally defined as nations with low to middle per capita income (1981, World Bank). This worked well for economic analysis, though the world has changed significantly over the last 35 years and perceptions of emerging markets have shifted markedly[3]. In addition, the focus of this research is real estate investment, which, although linked, may occur at a very different pace to economic development. A more appropriate description for the purposes of this paper is from the FT[4]:

> Emerging market is a term that investors use to describe a developing country, in which investment would be expected to achieve higher returns but be accompanied by greater risk. Global index providers sometimes include in this category relatively wealthy countries whose economies are still considered under-developed from a regulatory point of view.

A wealth of economic research on emerging markets has helped established benchmarks and development models, but the literature is thinner for real estate. One important paper in the Journal of Property Research (1994) by Keogh and D'Arcy[5] looked at market maturity by a comparison of London with the then emerging markets of Madrid and Milan. They highlighted the importance of institutions, professional standards, information and transparency in determining potential, as well as traditional drivers such as economic and political stability. Interestingly, they concluded that there is no clear evolutionary path for emerging markets to follow and noted that the mature centres were not necessarily a model to be copied. This work highlights the complexity of the development process and the importance of historic, culturally-specific processes.

This short paper, rather than using specific case studies or detailed micro-level analysis, takes a broader approach, looking for trends across a range of markets to identify underlying drivers of real estate capital flows. The results are used to assess which of the emerging markets may be best placed to progress over the next decade. Key themes addressed by the research comprise:

- The scale of international investment and balance between established and emerging markets;
- Whether emerging markets are now considered more investable compared with a decade ago; and
- The factors that determine the developmental status of markets.

If national income per head is not the sole differentiator of market maturity, this makes categorisation harder, so it is important to be clear about terms of reference. Past property and equity classification surveys were used as the starting point in this research. Around fifty global markets were then divided into developed, emerging and frontier groups on the basis of an assessment of investment flows, market transparency and GDP per head. For tractability, the smallest markets were excluded, but the final survey sample accounted for 99% of the investment universe according to JLL's 2014 Global Capital Flows (GCF) data[6].

[3] See Financial Times survey, Redefining EM: Choosing the best matrix, James Kynge, FT, 18 August 2015 http://www.ft.com/indepth/redefining-emerging-markets

[4] http://lexicon.ft.com/Term?term=emerging-markets) (http://lexicon.ft.com/THYPERLINK http://lexicon.ft.com/Term?term=emerging-markets) erm?term=emerging-markets)

[5] "Market maturity and property market behaviour: A European comparison of mature and emergent markets"

[6] Redefining Retail Investment (2012) for example; https://www.joneslanglasalle.com/ResearchLevel1/JLL_Redefining_Retail_Investment.pdf

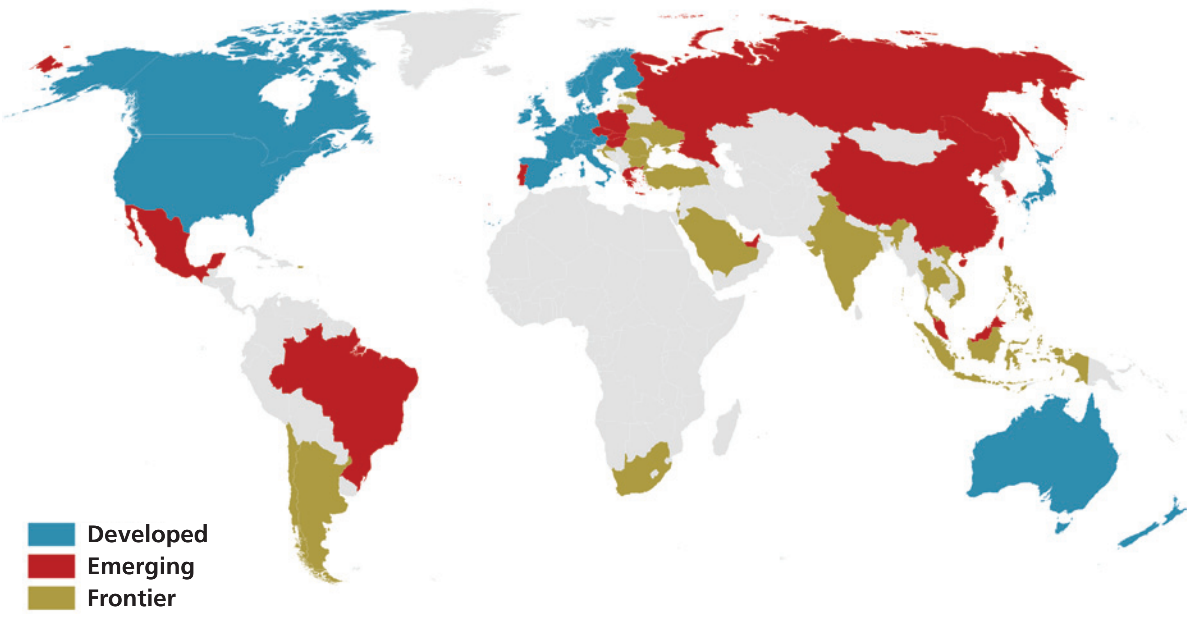
2. EMERGING MARKETS IN REAL ESTATE

Table 2.1: Classification of real estate market types

Market type	Markets
Developed (mature, advanced) High levels of per capita income, investment activity and transparency	US, Australia, Netherlands, UK, Singapore, Sweden, Hong Kong, Canada, Germany, France, Norway, Switzerland, Finland, Ireland, Denmark, Japan, Belgium, Italy, Spain, Austria, New Zealand
Emerging (growth, transitional) Medium levels of per capita income, property investment and market transparency	Taiwan, South Korea, Poland, Czech Republic, Russia, Malaysia, Portugal, Brazil, Greece, Hungary, China, UAE, Slovakia, Mexico
Frontier Low levels of per capita income, property investment and market transparency	Saudi Arabia, Israel, Thailand, South Africa, Croatia, Turkey, Romania, India, Chile, Bulgaria, Lithuania, Estonia, Indonesia, Ukraine, Argentina, Vietnam, Philippines

Source: JLL

Figure 2.1: Map of key market groupings



3. ARE EMERGING MARKETS BECOMING MORE IMPORTANT?

This section focuses on national and regional trends in emerging markets and how these compare with developed world benchmarks. This analysis is based primarily on aggregates from JLL's Global Capital Flows database, based on commercial property transactions and providing aggregate investment volumes over the period since 2003. This covers roughly a single market cycle and is believed to be the longest consistent historic series available globally. Data include commercial property deals, but exclude residential and land sales.

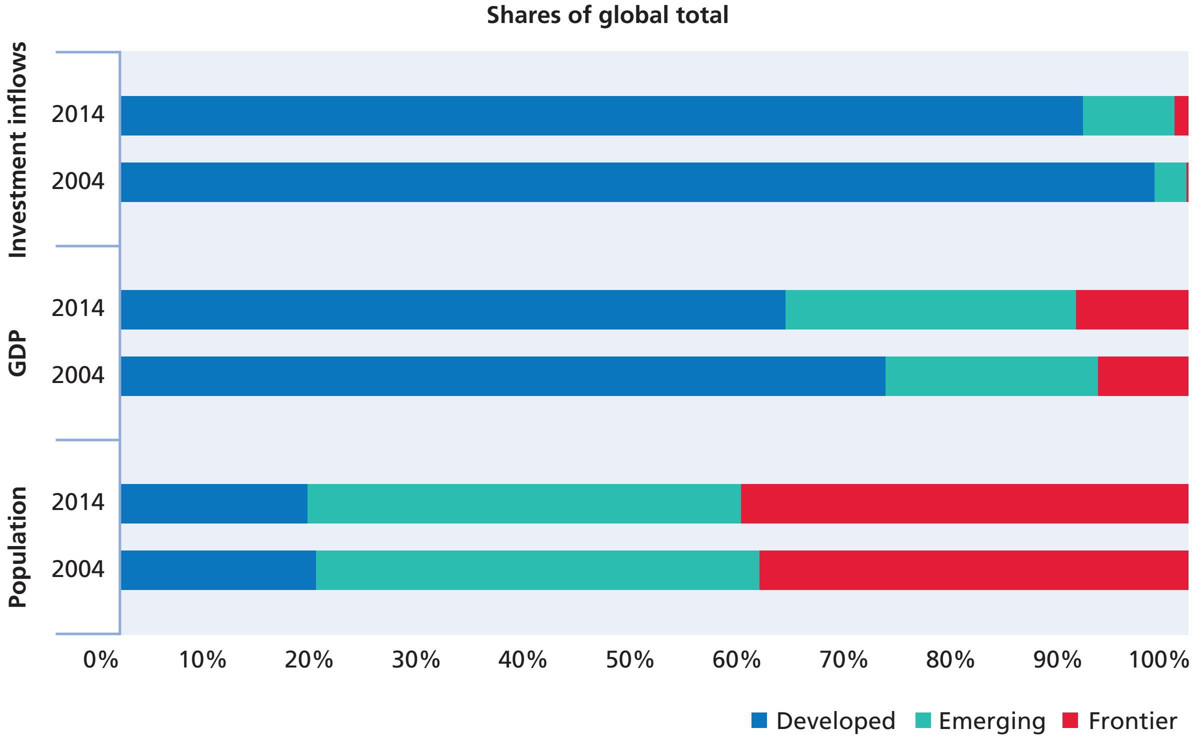
Ideally, in a quantitative survey, any analysis would be supported by other indicators, such as rents, yields and returns. Unfortunately, the most comprehensive consistent global sources, such as the IPD multinational index, covers only four of the 14 emerging markets identified by the research and only South Africa in the frontier grouping. Combining JLL's city-based data into meaningful national aggregates across a wide range of markets is problematic, even without the challenges of quality, coverage and consistency in less mature economies. For these reasons, the research concentrates initially on the capital inflows for each country, with other metrics revisited in the city-level analysis.

Comparing aggregates for groupings provides a clear indication that the concentration of investment in developed markets is much higher than implied by their economic size and importance. Financial development tends to lag behind economic advancement, though the imbalance in investment flows is particularly striking. However, data from MSCI suggest that this gap is wide for equities as well, with the market capitalisation in their definition of emerging markets estimated at just 13% of the global total (up from a mere 1% in the late 1980s). Although this comparison is not on a like-for-like basis with the real estate capital flows, it highlights how far financial development lags economic and suggests that the property share is not necessarily out of line with other asset classes.

Whereas advanced markets identified in this study account for about 20% of global population and some 60% of GDP, they still received around 90% of all real estate investment flows in 2014 (see Figure 3.1). For emerging markets, the balance is about 30% of world economic production and 40% of the people and just under 10% of real estate investment on average over the last decade.

3. ARE EMERGING MARKETS BECOMING MORE IMPORTANT?

Figure 3.1: Contributions by grouping - real GDP, population and real estate investment



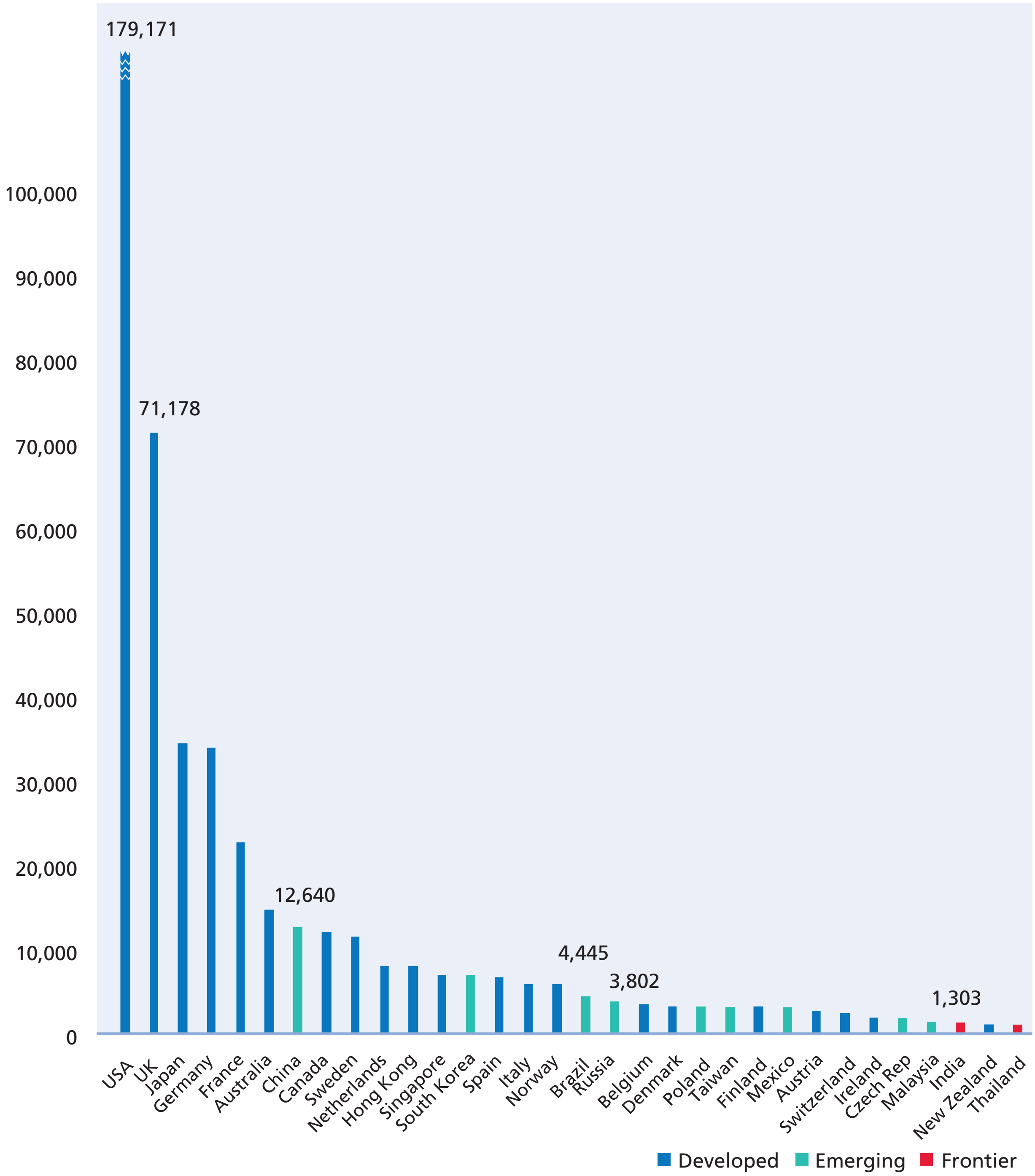
Source: JLL, Oxford Economics

Concentration is a feature even in the developing world, with the five largest markets alone accounting for 70% of inflows. It is also clear that the biggest emerging markets are starting to move up the global investment rankings previously dominated by mature economies. Figure 3.2 confirms China as a top-10 destination over the last decade, while a handful of other 'emergers' and even one frontier market (India) appear in the locations that have seen over $1bn a year inflows on average. While still accounting for a small market share, the scale of these markets is becoming too important to ignore.

Comparison over a decade also provides evidence that the balance is shifting towards emerging markets over time. In terms of economic contribution, the change is consistently upwards. A decade ago, the advanced markets accounted for over 70% of global output, with emerging markets under one fifth. Since then, the latter group have increased their share of total GDP by 8 percentage points (to a 27% share), with frontier markets up by 2% (to 11%). This drop in the relative contribution of the developed world marks a significant change in the balance of economic power, related to the rise of the BRICs (Brazil, Russia, India and China) and reinforced by the global financial crisis (GFC).

3. ARE EMERGING MARKETS BECOMING MORE IMPORTANT?

Figure 3.2: Capital inflows annual average 2004-2014 by country, $USm



Source: JLL

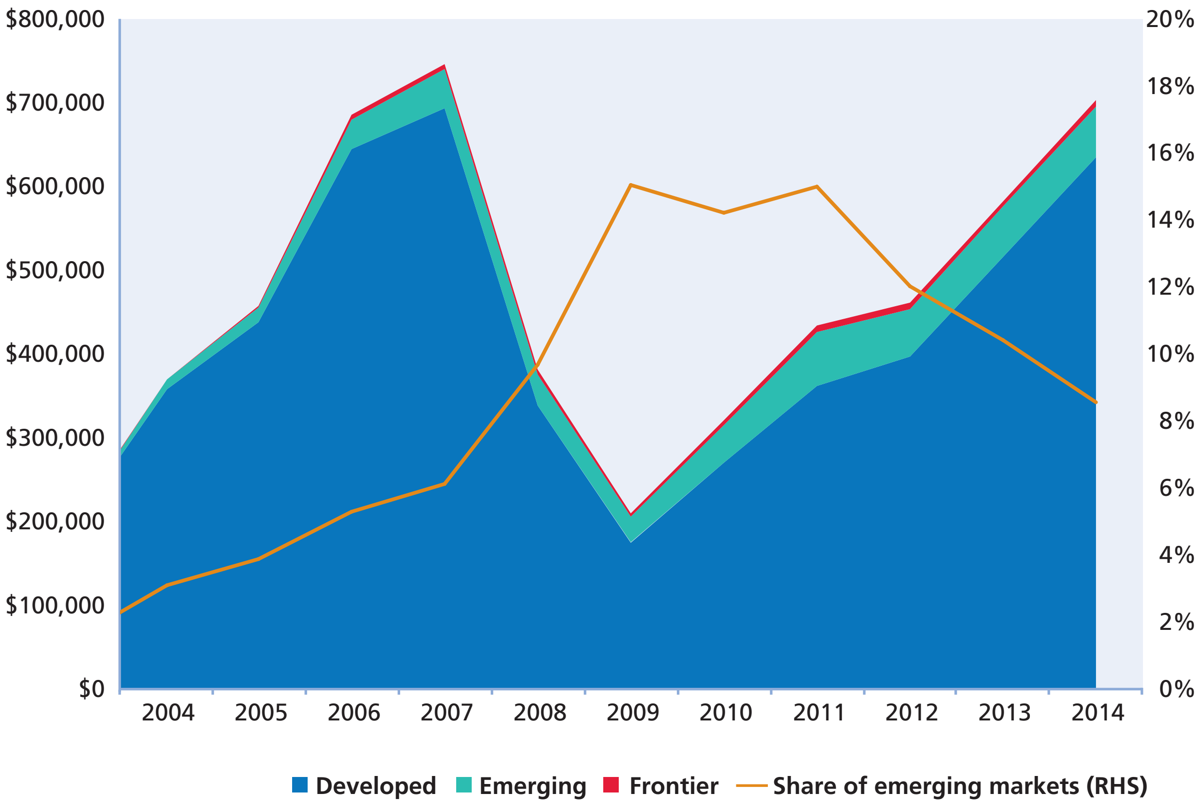
3. ARE EMERGING MARKETS BECOMING MORE IMPORTANT?

For real estate investment, the cyclicality of the data requires greater caution in its interpretation (see Figure 3.3). However, there has been a net increase in the importance of emerging markets, with the developed world share declining about 7 percentage points since 2004. The emergers' contribution rose steadily, to a peak of 15% in 2011, during the weak revival following the financial crisis in the West. The subsequent reversal largely reflects a recent US-led economic recovery and there has been a slight relative decline in emerging market share.

While the trend has not been consistent over time or across economies, it suggests that real estate inflows are following where economic development leads. Global investment levels reached over US$700bn in 2014, with emerging and frontier markets contributing a record $70bn (see Figure 3.3). Unlike developed markets, this is above the 2006-2007 recorded peaks.

In moving to a national focus, there are greater challenges in dealing with capital flows data, which even in the most liquid markets can vary widely from year to year. To reduce this volatility, rather than standard growth rates, the most recent three-year average for inflows is compared with the 10-year mean to provide a growth benchmark. This shows emerging and frontier market investment was 40% higher during 2012-2014 than on average over the last decade, compared with an 18% rise in developed markets.

Figure 3.3: Capital inflows annual average 2004-2014, $USm



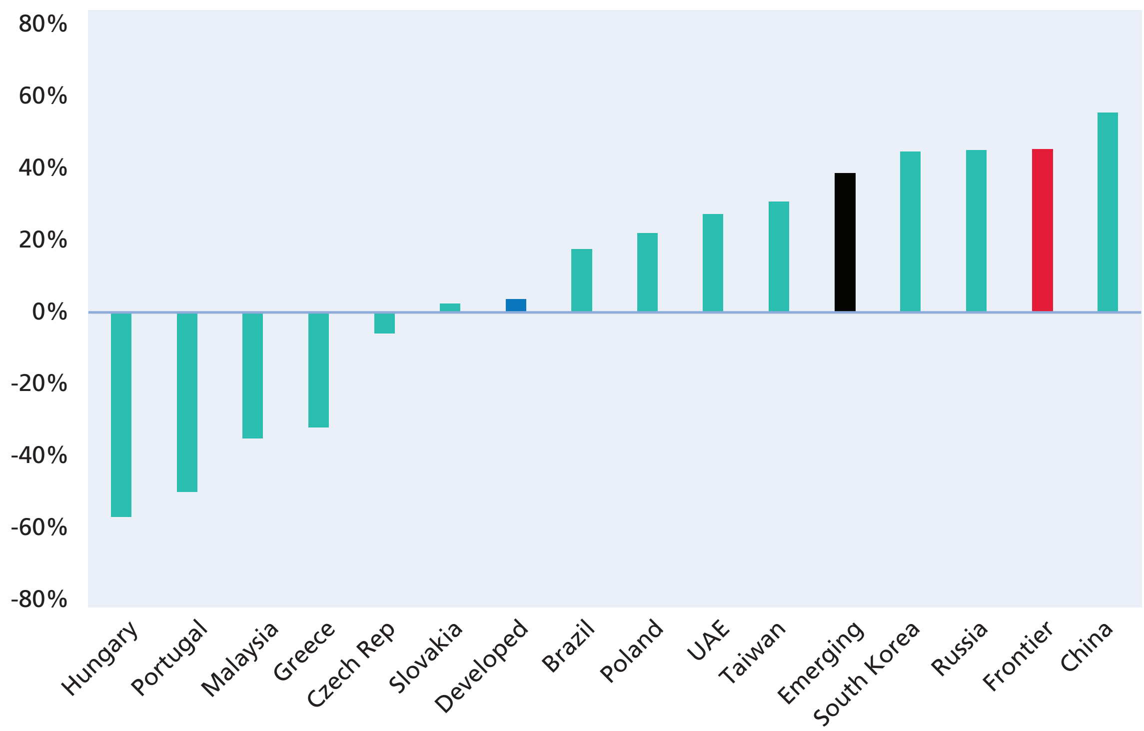
Source: JLL

3. ARE EMERGING MARKETS BECOMING MORE IMPORTANT?

The growth in emerging (and frontier) market flows has been significantly stronger proportionately than in the developed group. Nonetheless, this picture is not homogeneous. Of the outperformers, Mexico is an outlier, with a notably sharp acceleration in inflows over the last three years relative to the past. China too is a major contributor, while South Korea and UAE also rate strongly. A casual observation from the data is that the investment growth trend appears stronger in the 'larger' markets (in terms of economic importance, population and investment share), although this is not a hard rule with Brazil as a counter-example.

In contrast, there are a number of countries where recent inflows are below their historic averages. These are largely in Europe and the trend, in part, appears to relate to specific economic difficulties in the Eurozone fringe or CEE. Greece and Portugal are markets that were seen as close to mature in the mid-2000s, but experienced regression post-GFC, while several eastern European markets also struggled, most notably Hungary. Contraction is not confined to one continent, however, with Malaysian inflows also slipping over recent years compared with past performance, despite a solid economic backdrop[7].

Figure 3.4: Emerging market capital flows, underlying growth 2004-2014 against historical mean



Source: JLL

Of the aims of this study is to establish whether emerging markets have become more investable over time. This is not a straight-forward question, as there is no agreed definition or measure for what investable means. As previously noted, investment activity has been stronger across the emerging world, but is this also true in relative terms? To understand this, a comparison with a standard of the potential for this growth is required.

[7] For Hungary, the weakness appears to reflect a combination of more disappointing economic performance than its neighbours, reinforced by political concerns and property market factors. In the case of Malaysia, by contrast, the cause seems to be regulatory changes, which have relaxed the rules on foreign ownership and diverted funds away from the domestic market.

[8] See http://www.jll.co.uk/united-kingdom/en-gb/Documents/Investment_Intensity_Infographic%20Q2%202014.pdf. Investment intensity is calculated by dividing the three-year average of investment inflows into a country by its current real GDP (expressed in US$). Figures are indexed, using US/New York 10-year average = 1.00 for comparison.

3. ARE EMERGING MARKETS BECOMING MORE IMPORTANT?

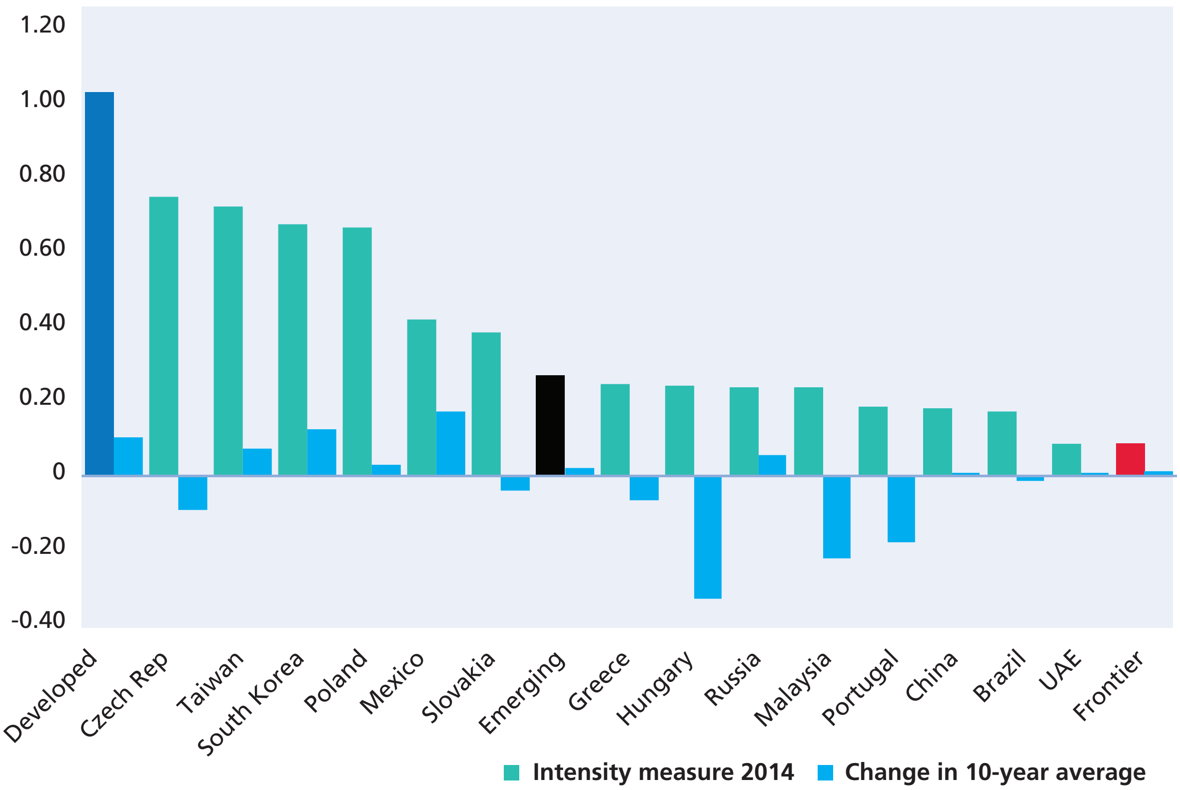
Have emerging markets become more investable?

JLL Global Research calculates an investment intensity measure that compares the last three years' average capital inflows to current GDP levels[8]. This provides a gauge of how well markets capture inflows relative to their size, with GDP a proxy for the property stock in each market and investment volumes smoothed to provide a balanced comparison. This analysis is perhaps less appropriate as a national measure than for cities, given disparities in national urbanisation rates, but it is a useful benchmark and proves more satisfactory than other alternatives (for instance per head measures).

Even in the developed world, however, there is a wide disparity across countries on applying this measure and there are no clear ranges that differentiate groupings. There is a wide contrast, for instance, between the high intensity of the Anglophones and the Nordics and the much lower figures of some Eurozone markets, notably Italy and Spain, where levels are not dissimilar to many emerging markets. On average, though, there is a substantial gap between emerging and established markets.

For comparability, the figures are expressed relative to the US historic mean. In 2014, emerging market intensity averaged only about one third of US levels. The measure varied widely from China and Brazil at one end of the spectrum (close to frontier averages) to Taiwan and the Czech Republic at the other with intensity approaching developed norms; see Figure 3.5. However, there appears to be a limited relationship between intensity and investment performance, with strong inflows seen in both under-developed (China) and established markets (South Korea) over the last decade.

Figure 3.5: Investment intensity 2014 and change versus historic 10-year average since 2004



Source: JLL, Oxford Economics

3. ARE EMERGING MARKETS BECOMING MORE IMPORTANT?

The results for 2014 were also compared against historic averages over the whole period to assess changes. These figures suggest that intensity is generally higher on average globally over the last 10 years, though with more modest gains in emerging markets (at about 9%) than in developed (11%), while the frontier grouping outstripped both (17%). There were gains for Mexico, Taiwan, Russia and Korea, but these were offset by weakness elsewhere. Intensity fell in many European markets, which is not unexpected given the pronounced investment cycle, but results for Brazil and China were also subdued.

Any conclusions can only be tentative, given the relatively short horizon and the limitations of the approach. The fact that many of these less mature markets experienced exceptional GDP growth over the period is also clearly significant. It is interesting, however, that the intensity measure suggests that emerging markets, while seeing volumes rise strongly, may not have become more investable relative to their economic scale, suggesting that their real estate development may lag their economic progress. The research returns to this issue in its city analysis in Section 5.

The investment data also allow an examination of shares of cross-border flows, based on office and retail investment within emerging markets at the national level. Cross-border shares, on average, are significantly higher in the emerging and frontier economies than in mature markets (at around 40% compared with 30% for the latter), which may appear surprising, given their risk and relative illiquidity, although this picture varies widely.

Some markets, for example Korea and Taiwan, have developed their real estate using domestic savings rather than foreign capital, although this has not been typical. Elsewhere, openness to foreign capital has allowed inflows to flourish, most obviously in Poland, where cross-border is the majority of all investment. The precise development model may be more by necessity than choice, depending on the strength of domestic institutions, and both models have strengths and weaknesses. Overall, there is no compelling evidence that either the more open or domestic approach has resulted in stronger inflows or that either acts as a barrier to or promotes development.

In sector terms, retail and office investment are the predominant asset types for investment transactions, accounting for 75% of the measured global universe in this database. There appears to be no consistent pattern of development, however. Differences between the developed and the emerging markets are modest, with slightly higher concentration of office investment in the latter. More interesting, totals for other types of asset in the frontier markets indicate a significantly higher proportion of deals outside traditional office and retail, although data quality may be an issue here.

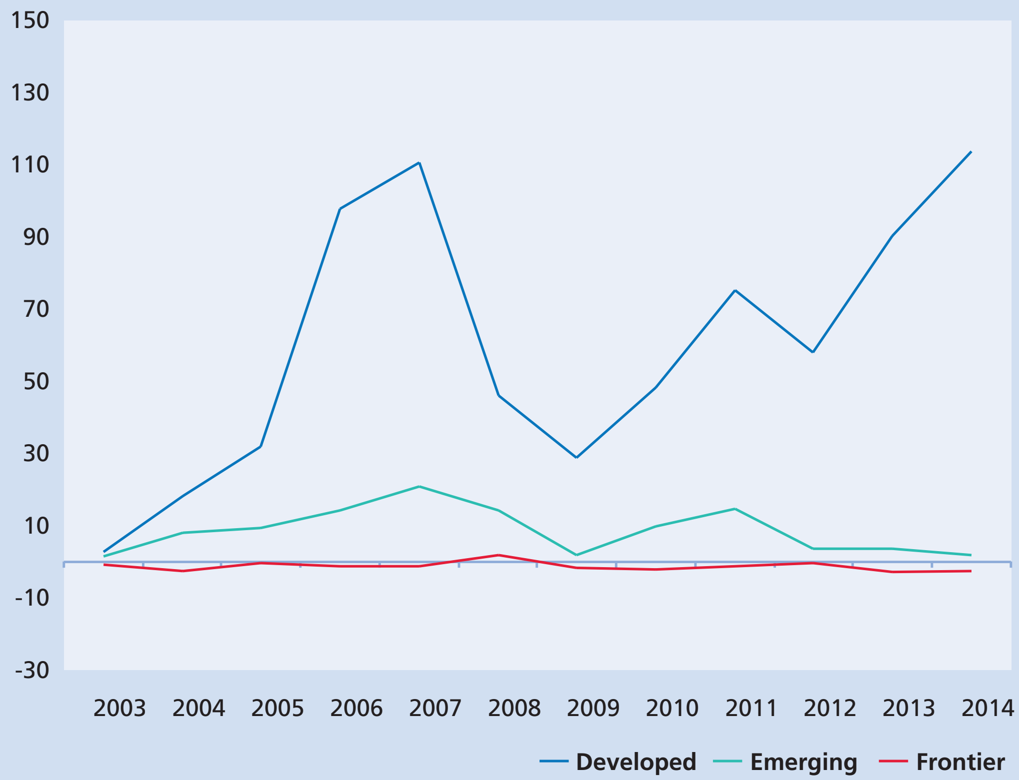
3. ARE EMERGING MARKETS BECOMING MORE IMPORTANT?

Are net inflows the real issue for the next decade?

The focus of this study has been chiefly on capital inflows for real estate, but these represent only part of the story. In particular, there is evidence of rising outflows from liberalising emerging Asian markets, such as China and Korea, over recent years. These countries have reached a stage of maturity where domestic institutions are looking to diversify and this capital is flowing out, usually to the developed markets (see Figure 3.6). Outflows from emerging markets have grown steadily over the survey period to the extent that they have almost matched inflows in 2014; hence, net figures in recent years have declined to the most modest levels since 2009.

While emerging markets will continue to require capital imports to develop their real estate markets, this is a healthy trend, indicating a two-way flow with advanced economies, which will result in increasing interdependence in future. In trying to assess emerging markets' progress, the focus has been on emerging markets as a destination for investment. It should also be recognised, however, that these economies are increasingly a source of capital for western investment, so that inflows are only part of the globalisation story.

Figure 3.6: Net global capital flows by market type (US$bn)



Source: JLL, Oxford Economics

3. ARE EMERGING MARKETS BECOMING MORE IMPORTANT?

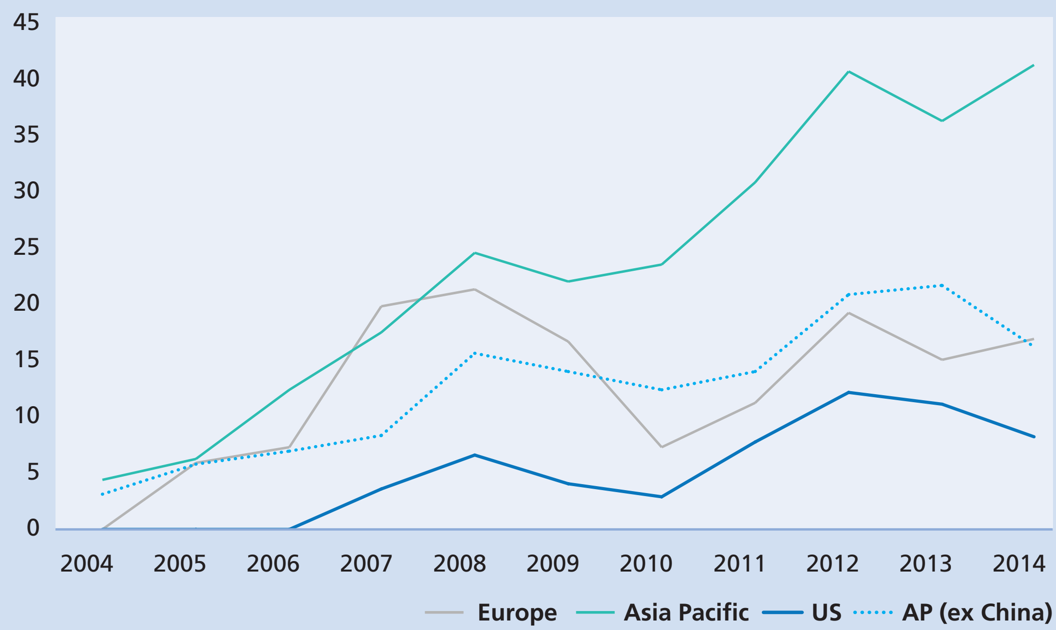
Is there a regional dimension to emerging market development?

After looking at the investment data in detail, one question that emerged was the impact of regional trends within a market category. One concern is that an emerging market story may be confused with, say, an emerging Asia one. By looking at the regional breakdowns, the effect of desynchronised local investment cycles can be isolated and it can be determined whether they are distorting the underlying global aggregates assessed (see Figure 4.1).

Asia is certainly the most significant region in terms of the emerging market definition. This is largely a consequence of the disproportionate importance of China (the world's second largest economy); when excluding China, this changes Asia totals to levels not dissimilar to emerging EMEA and Americas. The more pronounced cyclicality is in the European component, however. While flows into other regions show minor fluctuations, these are small deviations from a general upward trend. By contrast, European inflows took the regional lead in 2006-2007, after which there was a prolonged slump, from which levels only fully recovered during 2014.

In fact, the pattern in emerging Europe is significantly more correlated to developed world flows than in other regions. This suggests that in the 2000s, inflows to these emerging markets were more influenced by the credit boom that prefigured the GFC and that these markets were more influenced by the prolonged hangover that followed. This greater interdependence may be explained by the proximity to a large cluster of developed economies and reinforced by the perception that some markets now seen as emerging have regressed since the crisis (notably Eurozone members Greece and Portugal). This pattern is not pronounced in the other regions.

Figure 3.7: Emerging and global capital inflows by region (US$bn)



Source: JLL, Oxford Economics

4. WHAT FACTORS DRIVE EMERGING MARKET DEVELOPMENT?

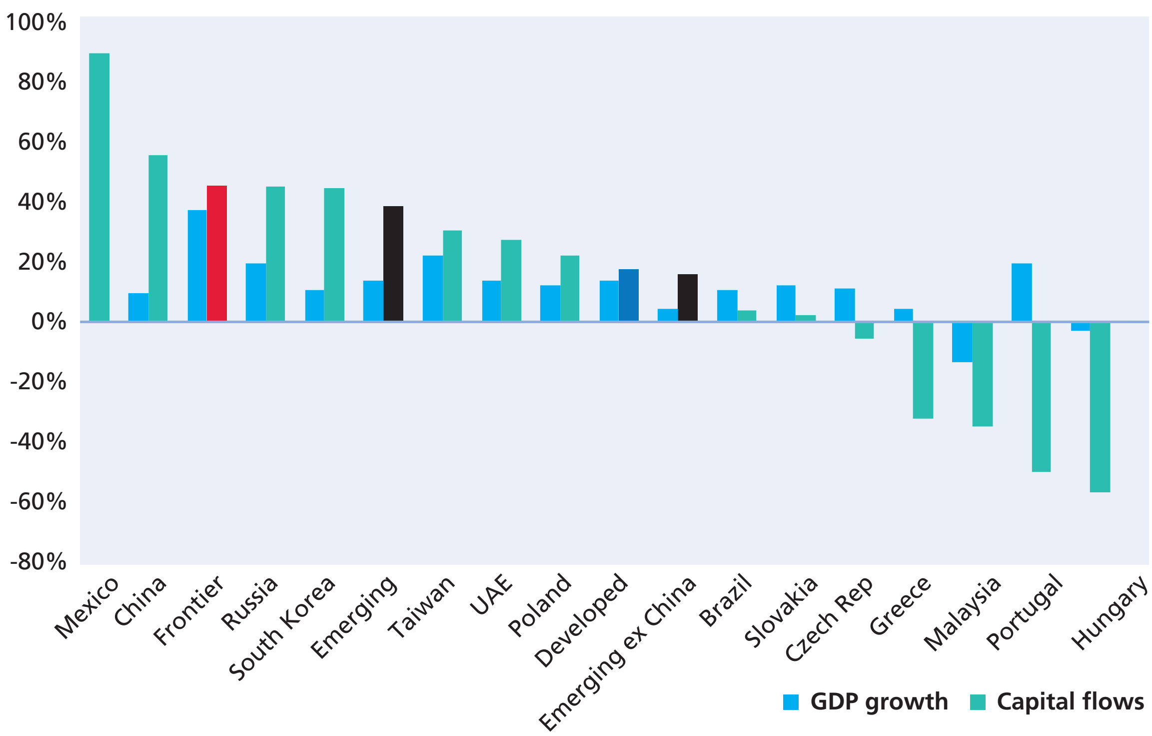
In this section, the research considers the macro factors that may underpin investment trends by examining the strength of relationships with other indicators. As national level drivers remain the benchmark, the analysis focuses primarily on capital flows.

Economic performance is the obvious starting point. Although economics is not the only aspect of development, it is widely regarded as the most important influence and is a key driver for real estate. There are many dimensions to economic statistics and an enormous range of possible options to test, only constrained by the need for comparable figures across the 50 or more economies that were considered. Generally, it was found that the results for high-level macro measures were as good as more granular alternatives and analysis is limited to these for the purpose of this paper.

Real GDP measures provided the strongest correlation with investment volumes in the survey, but there were marked difference between market groupings. This is not surprising perhaps when the varying economic fortunes over the period are considered. On an underlying basis, the emerging group experienced a 22% uplift in real output compared with a 4% rise in the developed world, which was impacted by the financial crisis, and a 19% increase in the frontier markets (see Figure 4.1).

Real GDP changes explain over 90% of movement in emerging market inflows and 79% in frontier, although this correlation declines to 39% in the developed economies (see Table 4.1). China accounts for over half of the growth in emerging market GDP, but even excluding this only reduces the correlation with capital inflows to 87%. A scatterplot and basic regression analysis on the changes are shown in Figure 4.2, indicating that for each additional 1% in output growth real estate investment rises by about 2%.

Figure 4.1: Emerging market capital flows compared against GDP growth, 2012-2014 mean versus historic average (%)

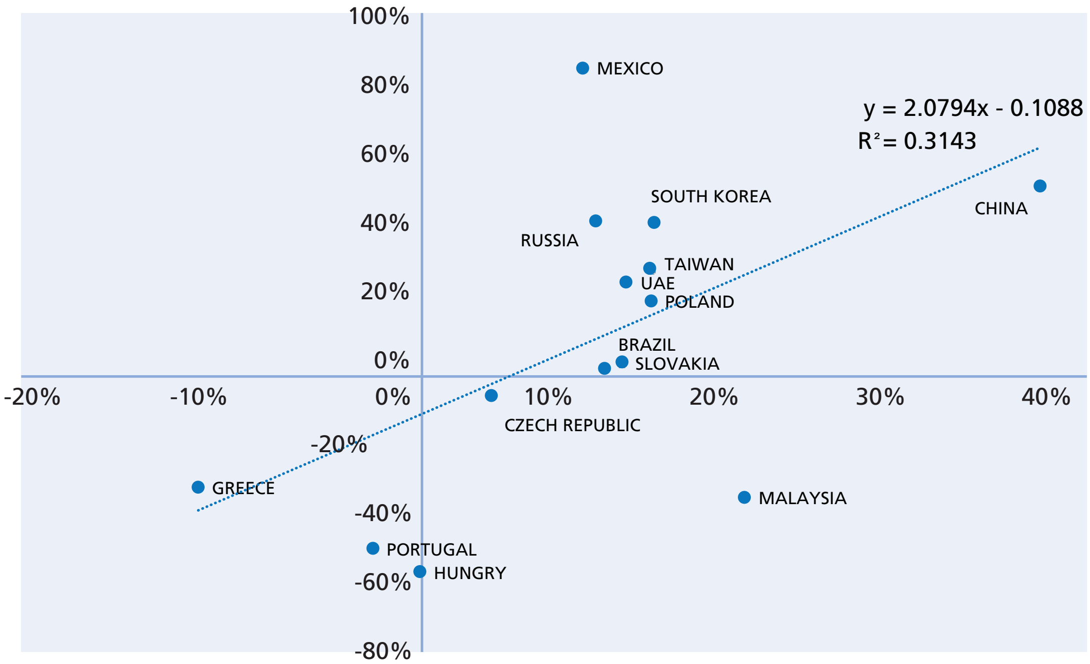


Sources: JLL, Oxford Economics

4. WHAT FACTORS DRIVE EMERGING MARKET DEVELOPMENT?

GDP growth trends also provide support for national level performance in emerging markets, with a few exceptions, such Malaysia, where the correlation is negative. Although the relationships are slightly weaker on average in Europe, economic difficulties clearly explain why Greece and Portugal have regressed as investment destinations and why Poland has held up well in contrast. The strength of market performance in China, South Korea and Taiwan is also supported by above-average economic growth rates.

Figure 4.2: Emerging market capital flows compared against GDP growth, 2012-2014 mean against history (%)



Sources: JLL, Oxford Economics

Demographic change is part of the economic growth story in the emerging markets. On average, results for population are slightly less satisfactory than for GDP in emerging and frontier markets and show almost no relationship in the developed world (see Table 4.1). There is a preponderance of more populous emerging markets at the top of the investment growth rankings, including Russia, China and Mexico. While this scale may be an important influence, it appears not to be a barrier to relative success in smaller emerging real estate markets, such as Macao, neither is it a guarantee, as shown in Brazil for instance.

Table 4.1: Correlations with capital inflows by market type, 2004-2014

	Real GDP, US $	Population	Political Risk	Credit Rating
All	27%	13%	-20%	13%
Developed	39%	1%	-1%	-14%
Emerging	91%	89%	-6%	10%
Frontier	79%	75%	-3%	76%
Emerging (ex. China)	87%	89%	-6%	10%

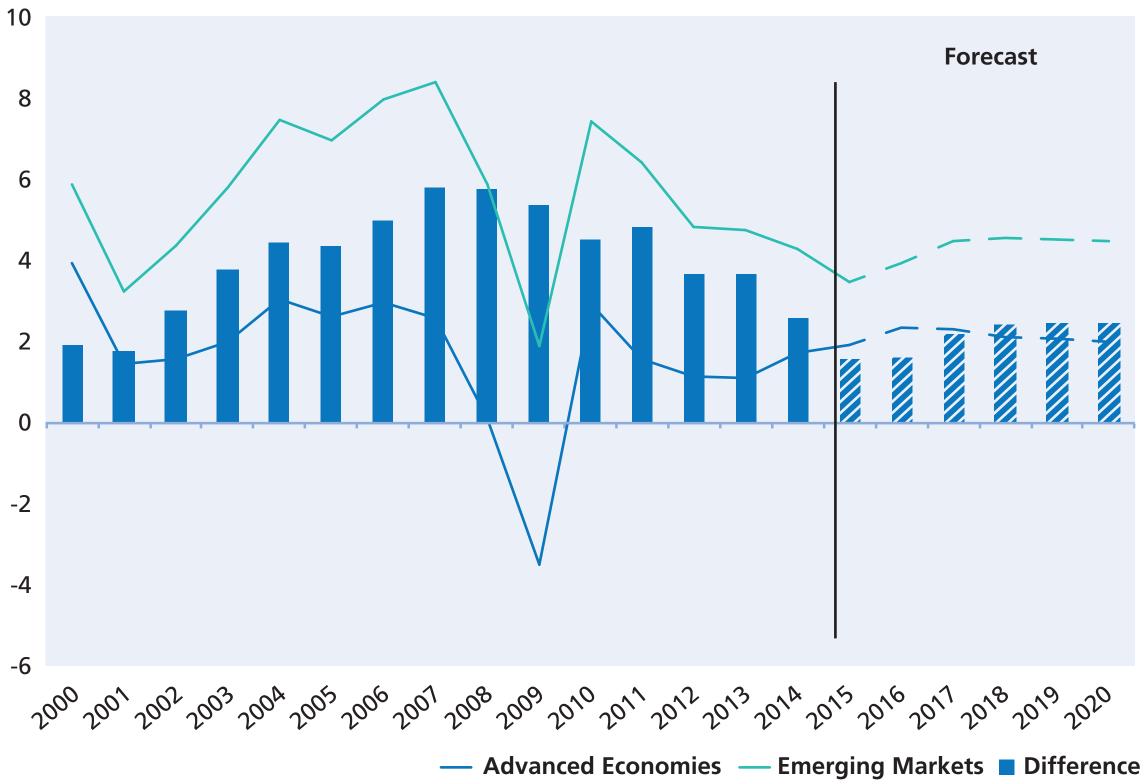
Sources: Oxford Economics, World Bank

4. WHAT FACTORS DRIVE EMERGING MARKET DEVELOPMENT?

One advantage quantitative macroeconomic variables gives is a forward-looking perspective, with forecasts widely available. Over the next five years, Oxford Economics forecast underlying global GDP will be slightly stronger than over the last decade, with emerging markets gaining a fifth and developed rates recovering too (Figure 4.3). Of the emerging and frontier markets considered in this research, China remains the front-runner, followed by Malaysia, with notable expansion in India, Vietnam, Indonesia, Lithuania and Chile also.

Conclusions about potential winners and losers in real estate investment using these forecasts must necessarily be highly cautious, especially at the national level but, in general, it appears likely that the strong growth in overall inflows will continue against this strong economic background. In addition, while the relativities between developed and emerging markets may narrow on the recent past (in line with GDP trends), estimates from this research suggest that the latter will continue to see significantly faster growth of capital inflows.

Figure 4.3: Emerging market capital flows versus GDP growth, 2012-2014 mean versus historic average (%)



Source: Oxford Economics

Aside from macroeconomic fundamentals, relationships with a number of other indicators were also investigated. After economic performance, other evidence was sought chiefly in qualitative measures derived from the extensive range of global surveys and benchmarks, notably the World Bank's development Indicators. The advantage of these is that they can quantify the greater risks that investors face in emerging markets. These measures also allow testing of the factors that influence market evolution by quantifying the effect of such factors as political environment, legal system, infrastructure, taxation, financial development and urbanisation.

4. WHAT FACTORS DRIVE EMERGING MARKET DEVELOPMENT?

For this analysis, a wide range of options were reviewed but, as results were generally inconclusive, only two areas are highlighted: political risk and credit rating. Emerging markets have, in general, medium levels of political stability according to World Bank governance indicators[7]. The study group of ‘emergers', as expected, show significantly lower ratings on this composite metric, averaging a score of 4.8 against ratings averaging around 6.0 for developed markets, out of a maximum of 7.0. The range of governance scores in the emerging category is wide with some approaching developing levels, such as South Korea, Malaysia, Czech Republic and Portugal, while others see much lower levels, notably China, Russia and Brazil (all below 4.0, which is less than the frontier markets average).

For the purpose of this research, the impact of the change in political risk is perceived to be of the greatest important. Net changes in this index are small for the emerging group (unlike frontier, where there was a strong rise), but there are big differences nationally. Overall, there is no strong tendency for improvement in political risk in stronger markets and vice versa. Several countries where capital flows have grown and economic performance has been strong, for instance, saw a reversal in politics, including high-flyers China, Russia and South Korea. Correlations for this index were poor, so it is difficult to recognise this as a driver of performance over the last decade at least (see Table 4.1).

The political risk measure covers a broad range of aspects, including corruption, regulation, rule of law and accountability. Of these, legal systems gave the best correlation, which is encouraging as anecdotal comments from investors highlighted this as important, but even these results were not especially strong statistically. Finding any relationship of slowly-evolving structural factors with volatile investment data over a relatively short time series will be challenging, so inconclusive results were not unexpected.

This evidence alone is not enough, however, to rule out political factors as an important moderator of investor behaviour. In particular, while not determining growth, they could prevent market evolution beyond a certain point to, say, achieving developed status. Four of the emerging markets identified have governments that are categorised as authoritarian on the EIU's democracy index for example[8]. Given that all developed markets are democratic, it may be that these ‘emergers' will never be regarded as ‘developed' by investors, no matter how strong their economic performance.

One other qualitative measure examined was credit rating, which relates directly to investor perceptions, albeit on a wider spectrum of assets than property. This measure is derived as a composite from Fitch, Moody's and S&P ratings, with AAA credit scoring 20. On average, the emerging group scores between 13 and 14 on this metric, compared with 18 to 19 for the advanced economies, although there have been some important shifts in some markets over recent years and dispersions have widened markedly.

Overall, credit ratings have declined, which is not surprising given the upheavals of the period surveyed. More unexpected is that trends in the emerging grouping are not significantly stronger than economies in the developed world on average. Otherwise, the credit rating indicator provides some link with the investment data, albeit far less robust than for economic output measures (see Table 4.1). Changes were dominated by a slump in the ratings of three particular European emergers: Hungary, Greece and Portugal. These all lie at the bottom of the investment volume growth ranking. Rises in credit ratings were seen in some of the stronger nations for capital inflows, notably China and Russia.

[7] http://info.worldbank.org/governance/wgi/index.aspx#doc

[8] The Economist Intelligence Unit provides country, risk and industry analysis across 200 countries worldwide.

4. WHAT FACTORS DRIVE EMERGING MARKET DEVELOPMENT?

Results from non-economic measures were generally disappointing. This is a key area for further research as these influences are repeatedly raised in the discussion of immature real estate markets. Identifying the key non-economic drivers of development will be essential to establish the evolutionary path for markets, even if the statistical evidence is likely to remain patchy until a much longer historical base is established.

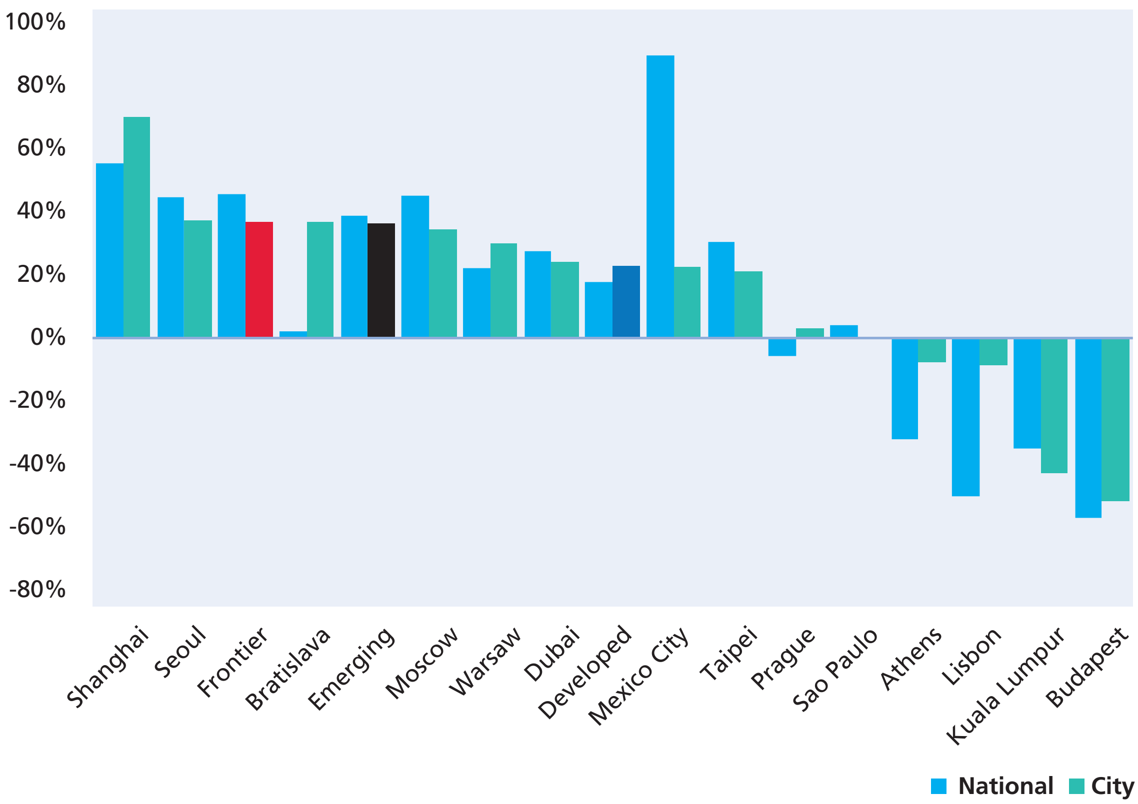
5. ARE MAJOR CITIES DRIVING EMERGING MARKET CAPITAL FLOWS?

In economic development there is an increasing focus on urbanisation in debates on the evolution of emerging markets. The drift from rural to city living is creating new conurbations and there is evidence that economic growth is becoming ever-more concentrated in urban clusters of high-value service industries. As the developed world is relatively mature in this regard, the bulk of this change is occurring in emerging markets.

Even without these urbanisation trends, cities are fundamental to commercial real estate. Retail and office property is integral to urban areas and there is also a concentration of other property types within cities, including hotels and apartments. Outside the developed world, major cities are seen as key to opening up less transparent markets, with evidence that investors will seek a foothold in these centres before considering other opportunities.

Given the perception that major cities play a special role as gateways for investors, in this section the most important centre for each country was selected and analysed on this basis. This was generally the capital city, but in some cases a centre was substituted due to its greater importance in commercial real estate terms (for instance Shanghai in China or New York in the US).

Figure 5.1: Emerging market city capital flows, underlying growth national versus major city trend



Source: JLL

5. ARE MAJOR CITIES DRIVING EMERGING MARKET CAPITAL FLOWS?

In terms of shares of capital flows, major cities surveyed contributed about one third to the overall developed markets totals, but more than a half to the emerging and frontier markets. This concentration fits well with the view that gateway cities are more important in these new investment destinations than in traditional markets. But this alone does not guarantee these cities will grow faster. In fact, city investment growth slightly lagged national trends in emerging and frontier markets over the period surveyed. This was a slight surprise with about half the centres seeing slower growth than at the country level, albeit that the aggregate difference is not wide (2 percentage points) and there is stronger growth in a number of major cities (including Shanghai and Warsaw).

The trend in the developed world is the opposite, with major cities on average more dynamic. This is consistent with a view that city economies will tend to be faster-growing because of their concentrations of high-value-add service sectors. Conclusions must be tentative, however, given data quality issues at the city level. There are also alternative investment destinations in certain markets that have outperformed the major city, notably Mexico and Russia.

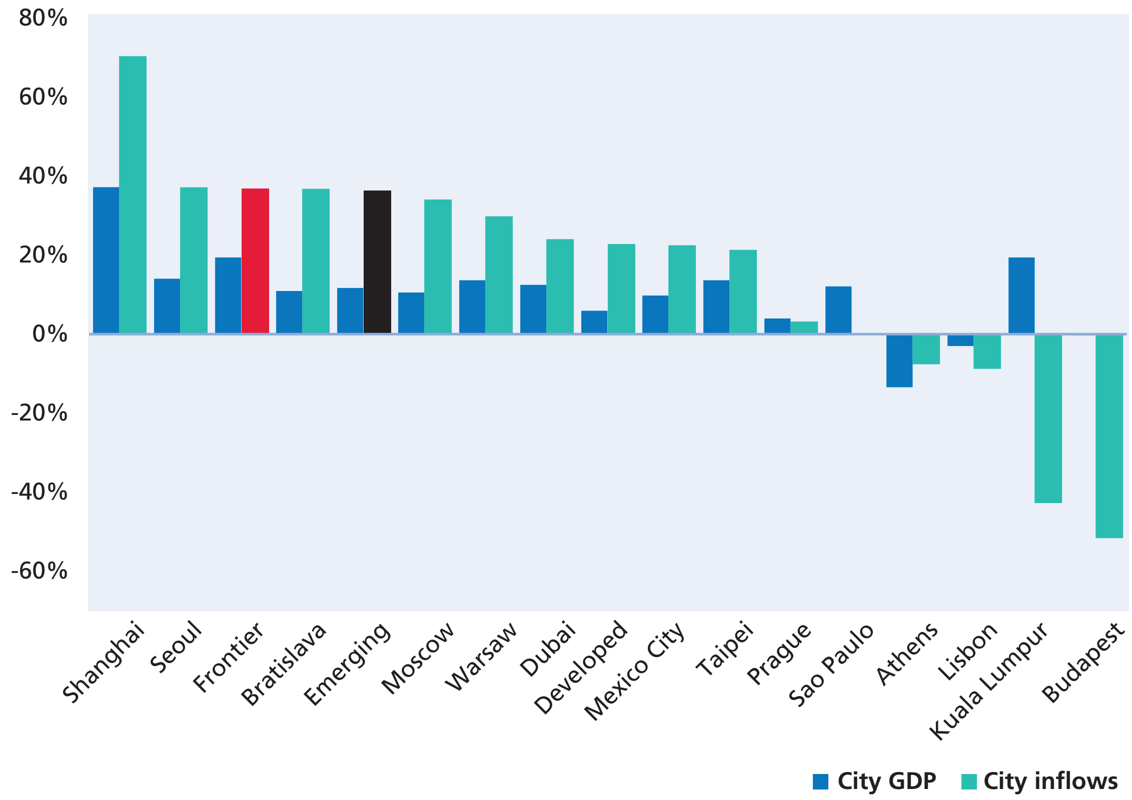
But these differences are also, in part, a reflection of the economic fundamentals. According to Oxford Economics Global City database, the real GDP figures show that emerging market major cities expanded by 12% over the last decade (+9% excluding China). This is a more rapid increase than for the developed group, which increased by 6% on an underlying basis. The key difference, however, is relative to national performance, with emerging markets lagging the wider economy (at +22%) and developed world cities holding up better (+4% nationwide).

It would be expected that urban markets grow much faster than their outlying national economies, thanks to population migration and the contribution of dynamic sectors. The emerging group includes several European cities that have suffered particularly badly since the GFC, including Athens and Lisbon (see Figure 5.1).

Patterns of strong GDP growth are generally consistent with buoyant city investment inflows and vice versa (with odd exceptions like Kuala Lumpur and Budapest).On average, correlations of city economic performance with investment inflows were similar to the national results (at just over 90%), as were the regression statistics. As with the national trends, forecasts suggest that growth will be sustained at the city level.

5. ARE MAJOR CITIES DRIVING EMERGING MARKET CAPITAL FLOWS?

Figure 5.2: Emerging market city capital flows and real GDP growth, underlying change



Source: JLL, Oxford Economics

One advantage with the urban focus is that it allows the analysis of new data series, notably returns. Conclusions must be cautious as the figures are only available for prime offices on a gross basis and are not for all the locations covered in this research. After concentrating on investment, it is interesting to look at how returns vary between market groupings. Emerging markets should provide greater returns to investors to compensate for the greater risks compared with developed economies (and even more so for frontier markets).

Returns are higher in emerging markets, but the spread above developed markets is low, at less than 1 percentage point on average over the last 10 years. The premium also seems to be declining over time. Moreover, office returns in emerging and developed markets move closely in line. This suggests that there is limited diversification benefit from these immature markets as they follow a similar cycle. Data caveats notwithstanding, this may explain why property investment has remained concentrated in the advanced economies and development elsewhere has been relatively slow.

5. ARE MAJOR CITIES DRIVING EMERGING MARKET CAPITAL FLOWS?

Figure 5.3: Average gross office returns by market grouping

Source: JLL

As a final step, the research repeated the investment intensity metrics for the emerging cities and compared these with the other groupings. New York's historic average is used as a comparison for the sample of gateway centres, so that results are not directly comparable with the previous analysis. By city, results are more widely dispersed than in the national analysis, but there has been a general increase in the aggregate intensity. Some centres also show a higher intensity than the developed city average, including Shanghai and Seoul.

Conclusions must be cautious, given the relatively short horizon and data quality, but the rise in intensity on aggregate is higher than for the developed city grouping (at 19% compared with 14%). This provides evidence that, for major cities at least, these markets are becoming more attractive to investors: a stronger conclusion than for the national level data.

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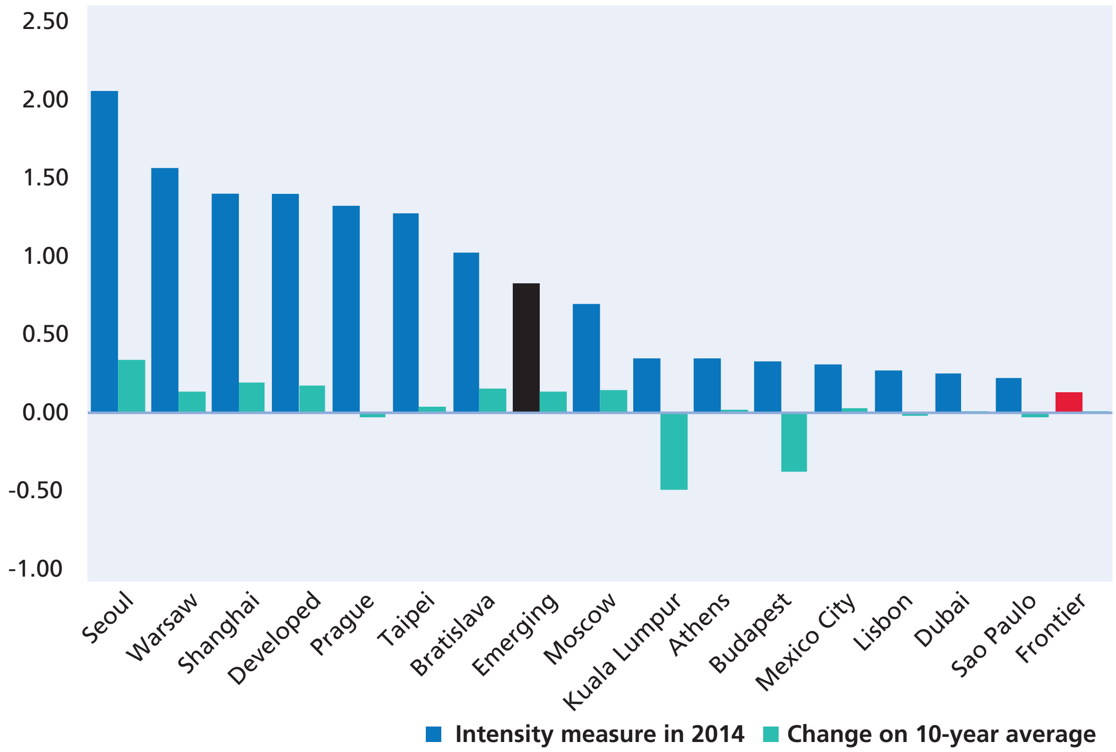
Figure 5.4: City investment intensity 2014 and change on historic average



New York = 1.0 intensity

Overall, results from the city analysis are less decisive than expected. Although few would doubt the importance of cities in market development, this high-level analysis of major city trends in emerging markets adds only limited insight to the previous analysis. This is perhaps a result of the data quality at this more granular level or because cities may present a degree of complexity missed at the macro-level. Nonetheless, the analysis of city-level intensity provides more satisfactory results than at the national level, while the returns perspective also adds to the picture.

6. CONCLUSIONS

In the last decade, growth in capital inflows to emerging and frontier economies have far outstripped those to the developed world. This difference was most apparent during the severe post-GFC recession in the advanced economies in the late 2000s, but the trend has continued since. Activity has been most marked in the BRICs and Asian Tigers, while, in contrast, investment in some European emerging markets has declined.

A comparison of global capital flows indicates that property investment activity remains highly concentrated, with the emerging world accounting for only around one tenth of the total. However, evidence suggests that this is broadly in line with other assets.

The assessment of emerging market investability is not helped by a lack of standard terms of reference, but measures adopted in this research indicate a gradual improvement over the last decade or so. National results were inconclusive, but investment intensity in the major cities within emerging markets showed a clear increase relative to movements in developed markets.

Economic drivers provide the clearest explanation for the development of emerging markets in real estate over the last decade. Correlations with output are high at both national and city levels and significantly stronger than seen in developed markets. With forecasters pointing to continued strong GDP growth in the emerging world, this suggests that these markets will continue to increase their share of global activity.

Many other factors have been suggested for the development of emerging investment markets, including rule of law, taxation, political freedom and infrastructure. Even where these influences could be quantified, however, the relationships with property investment were much weaker than with economics. As these factors may be important modifiers of development, this is an important area for further study.

Given that gateway cities are regarded as key channels of development in the emerging world, results from the urban analysis were more mixed than expected. Economic growth was, again, a strong driver, but major city growth did not always keep pace with national trends, while the pattern of returns in emerging markets was surprisingly similar to the developed world.

A number of challenges arose in undertaking this research. While less transparent markets are expected to be less 'measureable', data issues often limited the analysis, particularly working with a historic perspective of less than one complete cycle. This aspect, at least, will improve over time.

A stronger framework for assessing the development of real estate markets would complement this quantitative analysis - in particular, further work to identify which structures and institutions have been most successful in promoting emerging market real estate development. Given the data issues highlighted, this is likely to require further detailed case studies and international comparison.

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