The financialization of real estate in megacities and its variegated trajectories in East Asia

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Natacha Aveline-Dubach[1]

Abstract

This chapter sheds light on the forces that drive global financial investment into the real estate markets of megacity regions across the world. Although financial approaches and metrics of valuation stem from the Anglo-American investment culture, their rooting in different institutional contexts produces varied trajectories of financialization. Hybridization dynamics are seen especially in East Asia, where local cultures and institutional arrangements were not initially fit to integrate Western investment concepts. This chapter highlights the diverging patterns of real estate financialization in three East Asian countries /regions: Japan, Hong Kong, and Mainland China. It is based on a framework that combines three key elements: i) the representations of 'investable' markets by the global financial industry; ii) the initiatives taken by state agencies to provide a supportive environment for financial investment; and iii) the response by property developers to the supply of market capital in the built environment.

Key words

Real estate, financialization, East Asia, REITs, property, urban policy

Introduction

The three past decades have seen the rise in power of market finance, resulting in dramatic changes of the way the built environment is (re)produced. As revealed by the 2008 global financial crisis (GFC), capital markets and real estate have become deeply intertwined through a process of financialization that has a strong metropolitan dimension (Aalbers, 2012). Indeed, far from spreading homogeneously in space, financialization proceeds with a marked selectivity regarding both urban objects and places, while extending its grip on a growing number of regions and sectors (Halbert, Henneberry, & Mouzakis, 2014). Megacities and megacity regions are at the forefront of these dynamics. As the financial community seeks to maximize returns, minimize risk and recoup its investments easily, major metropolitan cities stand as primary targets for capital investment in real estate. Although the process of financialization covers only a small portion of the built environment of these cities, it contributes significantly to altering their socio-spatial arrangements and to strengthening their position as major economic nodes. The mainstreaming of financialized standards and tools transforms the operating modes of local real estate industries, affecting their structures, representations, routines and practices. Yet the magnitude of these changes significantly varies across countries. Far from entailing a convergence towards a unique model,

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the ingraining of Anglo-American valuation logics and metrics in different institutional contexts produces varied trajectories of financialization. Hybridization dynamics are seen especially in East Asia, where local cultures and institutional arrangements were not initially fit to integrate Western investment concepts. This chapter examines the cases of three East Asian countries/regions that are among the world's largest urban economies, e.g. Japan, Hong Kong, and China. They exemplify the highly diversified patterns of finance capital embedment into built space. The focus is put on the financialization of *real estate*, leaving aside urban infrastructure.

The chapter divides into two major sections. The first sheds light on the underlying forces that have driven finance capital towards major city regions. It points to the processes at work in the anchoring of capital into built space, and draws out a conceptual framework that analyses the combined actions of three major actors: financial investors, public authorities and developers. Based on this framework, the second part compares the characteristics of financial investment in real estate in the three selected countries/regions.

1. Real estate financialization and polarization of capital in megacity regions

Transforming real estate as an asset class for global financial investment

The deregulation of financial markets, launched in the mid-1980s in the United States and expanded eastwards since, has resulted in the development of a massive financial industry that has autonomized itself from other value-producing activities, pursuing its own logic. A major objective of the financial community is to increase the *liquidity* of capital (i.e., the ability of an investor to trade assets into a cash form or vice versa) so as to optimize the performance of asset portfolios by a flexible and smooth management. The quest for liquidity implies expanding the scope of investable commodities, not only to allow financial investors to shift capital allocation towards higher-yielding assets, but also to hedge against the systemic risks that liquidity itself generates in part. This is how an intrinsically immobile and illiquid commodity such as real estate has been converted into a financial asset class (Coakley, 1994). Such a process has involved financial engineering to unbundle capital ownership rights from the underlying property assets, as well as territorially-based institutional reforms organizing the circulation and accumulation of capital in the built environment (Corpataux & Crevoisier, 2005). The tradability of assets has been further enhanced by the rapid development of information and communication technologies (Lizieri & Finlay, 1995). By creating "liquidity out of spatial fixity" (Gotham, 2009:355), the financialization of real estate has enabled financial actors to extract value generated by urban societies (Weber, 2002). This process operates through investment vehicles that offer a range of risk-adjusted returns and whose performance is constantly compared and contrasted to that of other investment products.

To enhance the volume of capital available for investment, the financial industry has created an array of instruments aimed at capturing the savings of major economic agents, i.e. households (non-consumed incomes), companies (non-reinvested profits), and even States (trade balance surpluses collected by sovereign wealth funds). Demographic aging in the developed world has significantly increased households' retirement saving needs, more particularly in countries with funded pension systems (Clark, 2000).

While the capture of savings is relatively homogeneous spatially, the collected capital gets centralized in the hands of institutional investors such as pension funds, banks, insurance companies and mutual funds. Due the dramatic growth of the pooled money circulating under their control, institutional investors have become tremendously powerful. As highly skilled and knowledgeable investors, they act on behalf of their customers to place capital in various assets and manage them in an expected and efficient way. They are subject to fewer protective regulations than other investors as they are considered better-equipped to protect their interests. Beyond their specialized skills, owing to their large size, institutional investors are committed to providing economies of scale, and so increased returns. Although they typically favor investment in stocks and bonds, they tend to allocate a growing share of capital to real estate as financialized channels have developed in this sector. Globally interconnected property markets provide them the benefit of cross-border, cross-sector and cross-cycle diversification. Therefore, today only a small share of brick-and-mortar properties are managed directly by institutional investors; the vast majority is detained in the form of securities ('paper' assets) underpinned by commercial property ownership (Falzon, Halle, & McLemore, 2003).

Developing global channels to extract value from emerging and distressed property markets

The most frequently used securities dedicated to real estate investment are held as equity in private (unlisted) funds. Accounting for over half the capital invested by global players in real estate markets,[2] these investment vehicles offer the broadest suit of options across the risk-return spectrum, ranging from "core"/core+ (low risk, low returns), to "added value" and "opportunistic" (high risk, high returns), yet with a bias towards the latter.

Core investment typically targets significant barriers to entry that provide long-term, stable cash flows, and resilient asset value. It includes fully leased, quality grade properties (class A buildings, mostly in the office and retail sectors) with creditworthy tenants, located in prime urban areas (Boisnier, 2015). This translates into very selective geographies such as central locations or well-served subcenters of major cities in advanced countries. German open-ended funds in the office sector stand out in this category (Wijburg & Aalbers, 2017b). At the other end of the risk-return spectrum, opportunistic strategies involve highly leveraged investment purposes. These include (joint) property development in emerging economies or higher-risk markets, and the improvement of underperforming and distressed properties. Both development and management activities operate generally on a short-term basis (but not exclusively, see Waldron, 1995) so as to exit the market quickly by selling assets at a high profit. While this type of investment is much less selective concerning the spatial attributes of properties, it often takes place in major cities because this is where the highest potential appreciation in capital value lies.

Investment in unlisted funds is dominated by multi-billion dollar Private Equity Real Estate firms (PEREs). Operating globally, these firms typically focus on 'opportunistic' and 'value added' investment in real estate and property-related debts, although they have recently developed an appetite for less risky core property and urban infrastructure. In 2017, the 50 world's largest PERE firms raised a total of USD 333.75 billion, an amount equivalent to the Denmarks's GDP. Most PERE firms are headquartered in the US (37 out of 50) and have developed extensive international networks of offices. At the top of all rankings, the Blackstone group, funded in 1985, currently manages some USD250 billion real estate-related assets worldwide, through its 23 offices across the globe. All this makes the United States by far the world's largest recipient of private equity financing in real estate. However, the last decade has witnessed a dramatic increase of property investment by unlisted funds in East Asia, originating from both cross-border and domestic capital. The latter is expanding rapidly, driven by the growth of institutional funds (pension funds, sovereign wealth funds) and the dramatic rise of high-net-worth individuals. This is evidenced by the fast-paced growth of the private equity firm ARA Asset management (headquartered in the US) funded by the powerful Hong Kong tycoon Li Ka-shing, now in 14th position in the PERE world ranking.

Securitizing real estate to ensure regular revenue streams from major financial centers

The second major type of securities dedicated to property investment are the shares issued by the Real Estate Investment Trusts (REITs), which are often used as an 'exit' instrument for private funds holding assets for 4 to 6 years. REITs are listed entities that pool capital from small and large investors to acquire and manage portfolios of a variety of income-producing properties on a long-term basis.[3] In most cases, if the major part of their earnings is paid out to the unit-holders, they can deduct these dividends, which in turn increases their yields. REITs account for a smaller share than private funds of global institutional investment (6%), but the establishment of REIT regimes requires the adoption of dedicated legal and regulatory frameworks which impose financial metrics for property valuation and asset management performance. While REITs may hold various types of properties, they tend to specialize in a single real estate sector, targeting primarily office and retail assets but

[2] According to "The Great Wall of Money 2017" by Cushman&Wakefield, http://www.cushmanwakefield.co.uk/en-gb/research-and-insight/2017/great-wall-of-money-2017, checked on December 15, 2018.

[3] Open-ended private funds known as 'non-listed REITs' or 'quasi-REITs' do not belong to this category. Although REIT regulations have many common characteristics around the world, there are significant differences between those that are entitled to operate development activities, and those that are not (known as "passive structures"). In the US, REITs are also engaged in equity and mortgage businesses (equity and mortgage REITs in the US).

also apartment complexes, hotel, healthcare facilities, data centers, etc. Currently, there are 849 listed REITs in 37 countries/regions (ARES, 2017: 156). The US accounts for 64% of the REIT market capitalization globally (US$1,069 billion in 2017) with 224 publicly-traded structures. Yet here again, East Asia has recorded a marked growth of REIT capitalization in the past decade, with Japan becoming the second REIT market worldwide, though far behind the United States (US$107 billion according to ARES).

REIT asset managers must ensure the generation of stable cash flows while being subject to a permanent risk of exit by unit-holders. Therefore, they are expected to prioritize long-term incomes over short-term capital appreciation. This places REIT securities in the lower end of the risk-adjusted spectrum —in the core+ category, as they bear greater risk than core unlisted funds due to their exposure to stock market volatility. REITs' lobbyists claim that the establishment of securitized real estate channels contribute to providing cities with quality properties run by skilled real estate professional managers. In fact, the urban outcomes of REIT investment critically depend on the national regulatory frameworks, in particular, the degree of engagement in property development. They also differ considerably depending on the corporate environment and asset management objectives of the trusts. When the opportunity allows, some trusts do not recoil from venturing into more speculative "value added" approaches. For example, Richard Waldron (2018) documented how Irish REITs offered hedge funds investment opportunities in Dublin by seeking housing capital appreciation from the expected recovery of housing markets which were distressed following the global financial crisis (GFC).

As publicly traded entities, REITs generally locate in the major financial center of each national jurisdiction. This is because an initial public offering (IPO) is a complicated process that requires the assistance of highly skilled operators and the proximity of securities firms, issuers and investors (Wójcik, 2011). Most regulations allow cross-border investment, but REIT portfolios generally comprise a majority of properties in the national territory, with an overwhelming share in the city where the asset management is located. Such patterns reflect a bias in decision-making processes by financial managers whose investment strategy is influenced by market familiarity (Henneberry & Mouzakis, 2014) and portfolio benchmarking practices (Henneberry & Roberts, 2008).

Urban development outcomes and socio-economic effects of increasingly synchronized property markets

The rise in power by institutional investors and real estate investment funds operating globally has far-reaching implications for cities, especially for major city-regions where most of the accumulation of capital takes place. The quest for income-yielding real estate assets conveys an abstract and fragmented vision of urban space: "the city is compartmentalized and grouped into homogeneous and standardized categories (residential, offices, infrastructure, etc.), which are characterized by two numbers: risk and expected yield" (Theurillat, Vera-Büchel, & Crevoisier, 2016:3). In this way, large volumes of capital can be provided to fund the construction of urban projects, but these are negotiated at great cost to local communities through significant concessions to financial investors (Guironnet, Attuyer, & Halbert, 2012).

On a broader scale, the dramatic increase of cross-border real estate investment contributes to increasing the synchronization of property market dynamics across major cities around the world. This has been evidenced by recent empirical analysis addressing both office and housing markets. Stevenson, Akimov, Hutson, & Krystalogianni (2014) compared the property cycles across twenty of the world's largest office markets (in the US, Europe and Pacific Asia) and found a significant concordance across a large number of cities. Likewise, a study by the IMF comparing residential markets across 44 major cities in 40 countries revealed an increase in the synchronization of house prices over the few past decades. This co-movement is characterized by the simultaneous growth of prices in major cities of both advanced and emerging countries. Thus, the influence of global financial investment is clearly acknowledged by the IMF: "[…] the motives of global and institutional investors searching for yield in a low-interest-rate environment have emerged as a potential explanation for the brisk and synchronized increases in house prices"(IMF :94). This growing concordance in real estate market dynamics has become a threat to global financial and macro-economic stability. The vast majority of the past systemic crises have been triggered by boom-bust episodes in residential property markets (35 out of 51 examined by Crowe, Dell'Ariccia, Igan, & Rabanal, 2013).

Needless to say, these property-related systemic crises have disastrous socio-economic effects. Not only do households suffer from a contraction in jobs when a financial crisis affects the entire economy, but their homes become the target of opportunistic investment if unemployment prevents them repaying their mortgages. A nascent body of work has documented the predatory strategies of so-called "corporate vultures" which target post-GFC distressed residential property markets (in the USA, Spain, Ireland and Greece) to accumulate wealth by the dispossession of impoverished households' homes (Beswick et al., 2016; Wijburg & Aalbers, 2017a; Waldron, 2018). Indeed, the financial community has managed effectively to take advantage of both upward and downward phases of property cycles: price-swings to which it significantly contributes.

Anchoring finance capital in targeted property markets

Despite the extraordinary progress of market finance in controlling real estate, the construction of a global "investable universe" in which property assets can be smoothly transacted around the world remains a project in permanent progress. The investable universe is itself constantly on the move as a growing number of cities become eligible for institutional investment — especially with regard to market size, political stability and the protection of property rights. In this area, international property consultancy firms, such as JLL or CBRE, play an instrumental role by bringing into light new potential property markets for the financial community (Guironnet & Halbert, 2014). Owing to the valuation and brokerage businesses operated by their extensive global network of offices, they have the capacity to compile in-house real estate databases and to develop their thorough knowledge in local property markets. Their reports and market analyses establish orders of priority in terms of property sectors and geographies of investment, framing them in financial terms that help global investors to rationalize their choice between financial assets.

A second imperative is to ensure the provision of a supportive environment for foreign and domestic investment in the targeted markets, and establish financial channels for real estate investment. To this end, significant State action is required. The securitization of property through REIT channels, in particular, implies a whole package of measures. This includes the imposition of the aforementioned performance assessment and disclosure policies, along with a reform of the tax system to grant tax exemption to REIT structures. Despite the cost and effort involved, quite a few national states see here an appropriate opportunity to develop their domestic financial markets (Wijburg & Aalbers, 2017b) and to enhance the position of "national champion cities" (Crouch & Le Galès, 2012). State agencies are also encouraged to privatize public properties under the auspices of New Public Management, thus providing market capital further investment opportunities.

At subnational level, local governements struggling with shrinking public finance most often welcome the large amount of capital ready to be mobilized by financial investors. Fund managers usually target large-scale (re)development projects where considerable value can be created through a major reconfiguration of the urban and social landscape. However, they may meet strong opposition from local residents, or encounter tough trading conditions with some local governments (Guironnet & Halbert, 2014).

To tilt the balance of power in their favor, and maximize investment performance while limiting risks, financial investors need the mediation of local players having situated knowledge and political influence. Property development firms play a central role in this regard. As locally embedded actors involved in the coordination of all stages of development projects, they act as a crucial interface to defend the interests of financial investors, to which they in turn transfer the financial risk of the development projects. Developers negotiate with local governments the design and construction rules of urban development projects, translating the various elements into standardized categories of risks and returns while seeking acceptance of these decisions by urban stakeholders (Theurillat & Crevoisier, 2013). Property development firms of advanced countries have themselves undergone significant changes in the course of financial globalization. Successive episodes of boom-bust cycles in property markets have entailed movements of mergers and acquisitions that have resulted in the affiliation of several development firms with major international banking or financial groups (Pollard, 2018). The situation is quite different in emerging countries where developers have more traditional structures and a smaller scope of action. In some instances, being an entry point for the entrenchment of finance capital can be a privileged way for them to become prominent city-builders, such as evidenced in the case of Bangalore (Rouanet & Halbert, 2016). Yet in other cities, like Mexico, local developers may coalesce against the influx of finance capital if they have a greater interest to keep their existing financing modes (David & Halbert, 2014).

From this it is clear that the anchoring of capital markets into the built environment is fundamentally a *situated process* whose outcomes crucially depends on how it is mediated by the actors of the targeted markets, at various scales. More precisely, it follows from the above description that the varied forms of real estate financialization can be analyzed through three key elements: i) the representations of 'investable' markets by the global financial industry; ii) the initiatives taken by state agencies to provide a supportive environment for financial investment; iii) the response by property developers to the supply of market capital in the built environement. This framework will be applied in the next sections to grasp the differentiated dynamics of real estate financialization in the three selected East Asian countries/regions.

2. Connecting East Asian real estate to global capital markets

Financial channels for real estate investment appeared relatively late at East Asia, in the end of the 1990s, to fuel Japan's distressed property markets with fresh capital after the bust of the dramatic 'financial bubble' (1985-1991). This major crisis weakened Japan's competitiveness and prompted the emergence of Hong Kong as Asia's top financial center — marginally ahead of Singapore according to the Global Financial Center index— and which provided promising new avenues for global property investment in Greater China. However, the development of financial channels in the latter region turned out to deviate significantly from international standards, with much fewer rewarding opportunities than expected for global investors. Hence it is possible to rank the three countries/regions in accordance with their compliance to Anglo-American financial standards.

Japan, a good performer of real estate financialization

Within the group, Japan is the country where the mainstream real estate financial channels have experienced the broadest expansion. Yet this is not the result of a smooth process whereby Japanese policy-makers and real estate players enthusiastically adopted the Anglo-American mode of financialization. As a developmental state, Japan had based its growth on a highly regulated, state-led financial industry. Given its political stability and well-maintained rule of law, its strong economic performance and vast quantities of financial resources, Japan stood as an ideal playground for the expansion of the US financial industry. In the late 1970, US authorities began putting pressure for the deregulation of Japan's financial system. Japanese policy makers responded by a gradual liberalization of the domestic financial industry starting from 1981. The financial bubble that grew during the second half of the 1980s was an outcome of this policy (Fujita, 2011). It resulted from intricate speculative mechanisms in both stock and land markets, fed by a deregulated banking sector.

The boom and bust in land markets were particularly violent in Japan's two largest city-regions, Tokyo and Osaka. Financial investment was not directly involved: the speculative mechanism was fueled by domestic banking credit and the reinvestment of profits from skyrocketing stock markets (Dehesh & Pugh, 1999). Only after the bubble bust did Japanese policy-makers resort to financialize the domestic real estate markets. It was regarded as a necessary condition to avoid the deepening of the financial crisis, given that an overwhelming share of the outstanding credit was collateralized by land assets. In 1997, the establishment of special purpose vehicles in real estate was approved. Opportunistic equity funds backed by US investment banks (Merrill Lynch and Morgan Stanley) started to invest in Tokyo's distressed markets, purchasing office properties at 30% of their peak values. In 2001, REIT channels (hereafter 'J-REITs') were introduced on the Tokyo Stock Exchange. Owing to the slump in land prices, real estate yields had turned attractive, and J-REITs rapidly expanded and diversified. By providing alternative capital resources to real estate, the new financial channels played a crucial role in the recovery of Japanese property markets. They also contributed to substantial improvement in corporate balance-sheets. Japanese companies had heavily invested in land during the bubble period, and were burdened with significantly devalued and most-often unused land assets. By transferring these properties to private funds and REITs, they could move them off their balance sheets and improve their financial standing.

National State agencies were particularly pro-active in supporting the development of financial channels in real estate. Given the centrality of land in the bubble mechanism (Kerr, 2002) most measures taken to reshuffle the economy were to some degree beneficial to the development of market finance in the built-up environment. The disposal of non-performing loans, mostly collateralized by land assets, was addressed by ultra-low interest rates that stimulated highly-leveraged property investment. Corporate restructuring was supported by tax and accounting measures encouraging Japanese companies to transfer their considerable land holdings to investment funds. The State also undertook drastic reforms in the field of urban planning. Urban shrinkage due to population aging had emerged in suburbs, and it was considered paramount to concentrate public effort on central areas. Hence State action mainly consisted in drastically increasing building density in city cores. Tokyo received special treatment under the re-centering of the national economy towards the capital city. From 2002 onwards, a growing number of core urban areas were designed as ‘special districts’ with deregulated rules to accommodate high-rise projects (Machimura, 1992), especially close to railway stations. Building regulations were even re-centralized under the authority of the Ministry of Construction to ensure smooth implementation of the reforms (Sorensen, Okata, & Fujii, 2010). Local governments responded differently to these measures: while wards and municipal authorities tended to partner with local residents and environmental activists against severe building intensification (Sorensen, 2011), the regional authority – the Tokyo Metropolitan Government (TMG) – showed continuous support for big financial and property conglomerates. Today, the TMG’s major concern is to enhance Tokyo’s positioning in the global financial industry by promoting the vision of a “Global Financial City: Tokyo”, together with the central government and the private sector.

The dramatic rescaling of building density obviously benefits financial investment, which is now fully endorsed by the domestic property industry. And yet, Japanese real estate professionals have come a long way since their first encounter with global market finance. When US vulture funds started to purchase distressed properties at drastically discounted prices based on the rental incomes of buildings, it came as a shock to Japanese real estate players. They were used to looking exclusively at the land component of properties, after a virtually uninterrupted ascension of urban land prices for almost half a century, and they disregarded built properties due to Japan’s traditionally fast construction-destruction cycles (20 years for a residential building, and 30 years for office buildings on average).[4] However, the establishment of REITs accelerated the pressure on moving towards a financial paradigm in the property industry, and eventually entailed a shift from the exclusive focus on land to a more ‘standard’ conception of real estate (Aveline-Dubach, 2014).

Major Japanese property developers were quick to integrate the new financial channels into their business models, acquiring skills in asset management through partnerships with foreign firms. As ‘sponsors’ of J-REITs, they own the asset management structures and thus keep control over the investment strategy of the trusts. Like many of their Asian counterparts, J-REITs are not permitted to engage in property development. The properties composing a trust’s portfolio at the time of its IPO are directly divested by the sponsor group; this allows capital to be unlocked and redeployed into (re)development activities, while receiving fee-based income from the securitized assets. The other properties of the portfolio are often developed by the sponsor group, drawing on capital from in-house unlisted funds. By so doing, the sponsor groups can mobilize finance capital across the whole real estate value chain: from construction, development and short-term management through private funds (6 years on average), to long-term management through REITs.

Today, Japan hosts 56 J-REIT structures managing a total of 3,487 properties with an estimated value of JPY17.3 trillion, exceeding that of private funds (JNY6.2 trillion).[5] While financial groups and industrial firms run some of these funds, the domestic property conglomerates are predominant sponsor groups, with Mitsui Fudosan and Mitsubishi Jisho being major players. Foreign investment is quite active, contributing to one fourth of HK-REIT’s aggregated capital. Finance capital also circulates across various sectors, primarily in office but also in retail, housing, and logistics properties. In the residential sector, financial channels have led to an institutional supply of good-quality, centrally-located rental condominiums for young employees of big firms in Tokyo (Aveline-Dubach, 2020a).

Behind this bright picture lies a much less rosy reality. The dramatic densification of the built environment aimed at luring financial investment in city centers has considerably accelerated the urban shrinkage. In the peripheries of major cities including Tokyo and Osaka, severe economic decline is unfolding (Phelps & Ohashi, 2018) and housing vacancy has become a major issue. It is estimated that 8.2 million homes are unoccupied, mainly with zero or negative value. Local governments are left to deal with this situation, while the national authorities continue to favor “compact cities” and to put emphasis on the capital region (Buhnik, 2017). The very uneven spatial allocation of finance capital reflects this situation: the Tokyo region (Kanto) accounts for more than two-third of the total asset value held by REITs and private funds, while the Osaka region (Kinki), with a GDP greater than nation states like Switzerland or Sweden, accounts only for 10-15% of asset values.

[4] This practice of rebuilding was the result of old *shinto* practices (rites for the reconstruction of the Ise shrines) and of recurring natural disasters. But it was also driven by continuous relaxation of floor-area-ratio regulations.

[5] For REITs : https://j-reit.jp/en/market/ (checked on December 21, 2018); for private funds: Sumitomo Mitsui Trust Research Institute, “Survey on Private Real Estate Trusts in Japan”, July 2018. https://www.smtri.jp/en/releases/pdf/20170327_e.pdf (checked on December 21, 2018).

Hong Kong, a paradoxical paradise of securitization

Unlike the case of Japan, Hong Kong developed an investment-friendly regulatory framework and finance-related skills at an early stage of its development, as a legacy of the British rule. Drawing on these assets, the Hong Kong Special Administrative Region (thereafter, HKSAR) established a finance- and real estate-based mode of growth (Smart & Lee, 2003; Haila, 2000). Although the public ownership of land greatly facilitated this outcome — with a significant portion of public revenues relying on land leases — it did not result from a straightforward process. Back in the early 1980s, when the opening of China prompted the relocation of labor-intensive manufacturing activities from Hong Kong to the Pearl River Delta, the ruling elites were divided on a relevant strategy to redeploy the local economy, by moving up the value chain to high-tech manufacturing or by engaging in financial and real estate services (Jessop and Sum, 2000). The parties promoting the latter view prevailed during the transitional process of Hong Kong's handover to China (1984-1997). A handful of powerful Hong Kong family-based property groups took over former British businesses and large-scale industrial sites. They further extended their land banks along newly-built transit corridors across Hong Kong's territory (McCarthy, 1996) but also in major cities of the Mainland (Poon, 2011). In the 1990s, these groups benefitted from the deregulation of a number of sectors (telecommunications, energy, maritime and bus transport) and became highly diversified conglomerates (Chiu & Lui, 2009), controlling virtually all aspects of Hong Kong residents' everyday life.

Under this property-led regime of capital accumulation, real estate prices have undergone a sharp increase since the early 2000s, becoming amongst the highest in the world. Such conditions have been most appealing for global financial investors. As publicly-listed structures, Hong Kong property conglomerates are well known for providing a particularly broad access to global investment: in 2010, before the surge of the Chinese listed firms, they accounted for 23% of the capitalization of listed property groups worldwide (Newell, Yue, Kwong Wing, & Siu Kei, 2010). However, in fact, truly profit-generating businesses are not incorporated in these securities. They are kept in the hands of the families controlling the groups, through a myriad of non-listed profitable companies, while "outsiders are left with the rest" (Studwell, 2008: 119).

To enhance the attractiveness of the HKSAR as a global financial center, the Hong Kong government decided in 2004 to establish REIT channels. The purpose was not only to offer the financial community access to more focused and rewarding investment vehicles in real estate (in both Hong Kong and Mainland China), but also to boost investor's confidence by showing the government's commitment to limiting public expenditure. Therefore, unlike the case of many other Asian countries, the securitization of real estate in Hong Kong was not initiated by a sponsor group that divested part of its properties, but by the State, through the privatization of social assets owned by the Hong Kong Housing Authority (HKHA). More precisely, securitization involved all HKHA's shopping facilities and parking spaces in 175 social housing estates scattered across Hong Kong territory. The IPO was launched in 2005 by three global financial investors, including the local bank HSBC, historically a vital capital provider to Hong Kong's real estate. The securities of this first REIT, named The Link, met massive demand from small Hong Kong savers but the government managed to funnel the lion's share to global institutional investors (Aveline-Dubach, 2016). Soon afterwards, four property conglomerates established REIT structures at the Hong Kong Stock Exchange, followed by regional firms operating in the Mainland. However, considering the attractive features of the HKSAR's built environment from an investment perspective, and the status of Hong Kong as a gateway for Mainland China, the REIT market (HK-REIT) has fallen short of expectations.

Currently, there are 9 HK-REIT structures with a total capitalization of US$26 billion, a far cry from the US$51 billion managed by the 38 Singaporean REITs (ARES, 2018: 158). The Link dominates the market with more than half HK-REITs' capitalization. Although the Hong Kong property conglomerates hold a vast number of high-quality office buildings and shopping malls in the HKSAR and on the Mainland, Cheung Kong Holdings has been the only group to securitize its properties on a significant scale. Funded by the tycoon Li Ka-shing, the Cheung Chong Holding group divested assets into two REIT structures, in addition to a trust in the Mainland (all now run by the PERE ARA Asset Management). This is not to say that Li Ka-shing's group has fully played the 'REIT game'. Looking at its 23 Hong Kong-based REIT assets (mostly neighborhood shopping arcades and B-grade office buildings in non-core areas), it is clear that securitized channels have been primarily used to outsource lower-grade properties (Aveline-Dubach, 2016).

In contrast with the passive stance of REIT management by family-based groups, The Link has developed a most pro-active strategy to enhance shareholder value, shifting from 'core' to 'value-added' investments. Having acquired the HKHA's welfare retail and car park facilities at a discounted price trough an *en bloc* sale (US$2.86 billion), The Link has easily managed to raise income by increasing the rents and launching 'asset enhancement initiatives' (AEI) on selected assets. The objective of the AEIs is to increase the catchment area of the retail properties by achieving a complete refurbishing of premises, and transforming the tenant-mix with big retail chains. Such projects have entailed a mismatch in the customer base of the retail facilities: young middle-income households of neighboring areas have become the main customers, whereas the needy older residents of the social housing estates have to carry their heavy shopping from remote markets, as local food prices are now beyond their reach. The Link has further enhanced shareholder value by selling-off some thirty properties at high bidding prices to various equity funds – including Blackstone – in violation of its commitment to maintain the unity of the HKHA's asset portfolio. As a result of this aggressive value-added management strategy, The Link's shares have significantly outperformed the industry, recording more than a fourfold surge in value since the IPO. This has caused irreversible damage to local residents and small shopkeepers. The Link has been nicknamed 'bloodsucker', and is being subject to increasing challenges by urban stakeholders who are urging the government to buy back the HKHA's assets. Given the centrality of the Link in Hong Kong as major retail landowner, the socio-economic impact of its strategy has become a major challenge for the current chief executive.

China's rejection of the mainstream model of financialization

While Japan and Hong Kong have engaged in real estate securitization, China has strongly contained the development of foreign REITs on its territory and avoided establishing such channels on its domestic stock exchanges. Commentators often explain this by a "lack maturity" of Chinese property markets. Admittedly, these markets are very young: the first legislation relating to real estate ownership were passed in 1998, and it was not until 2004 that the right to private property was written in the Constitution. However, another interpretation may be considered. It will be argued below that the Chinese state has deliberately stayed away from mainstream global financial channels, and chosen instead to allow the development of an indigenous financialization of the built environment.

During China's transition from a command to market economy, the Hong Kong family-based property groups were the first foreign players to venture in this country in 1998, after receiving incentives from President Deng Xiao Ping. They invested in extensive land banks at low prices, specializing in high-end markets of major city-regions and regional cities (Amy & Zweig, 2011). As decentralization proceeded in China, local governments encouraged other regional groups, from Singapore and Japan, to engage in the construction and management of sophisticated commercial buildings. Yet these investments were predominantly funded by developers' capital. Financial channels for foreign property investment were opened up in the late 2000s, prompting North American investment funds and PERE firms such as Blackstone, Tishman Speyer, CBRE, or Angelo Gordon, to step in. For these Western financial players, the conditions of investment in China were particularly difficult. They were subject to stringent control by State authorities, and forced to partner with Chinese developers, either by becoming shareholders of these companies or by being a limited partner in joint-ventures. In addition, they viewed Chinese real estate markets as 'inefficient', mainly due to the weak rule of law, significant State interference and ambiguous property rights. China has adopted a tenure system inspired by Hong Kong's whereby urban land is State-owned and land-use rights are transacted by local governments at market-determined prices (Li, 1997). The user pays the local government a land grant premium for the right to use the land for a fixed term from 20 to 70 years (typically 50 and 70 years for office buildings and housing, respectively), but there is strong uncertainty as for regards the conditions of renewal at the expiration of leases. Despite the administrative hurdle and risks involved in China's real estate investment, the huge profits made and the fast pace of urbanization have been sufficient enough to encourage foreign investors to increase their market shares.

Western consultancy firms did not lose time to train Chinese real estate professionals (in both knowledge and "good practices") and to help financial investors find their way in China's Eldorado. In 2007, JLL designated 30 cities as "rising urban stars", based on a statistical analysis of demographic, economic and political factors.[6] In 2012, the study was updated with 20 newly emerged urban stars.[7] The 50 'investable' cities were classified into

[6] Jones Lang LaSalle, "China 30, China Rising Urban Stars," 2007.

[7] JLL, "China 50, China Rising Urban Stars, Fifty Real Estate Markets that Matter," 2012.

four main categories, echoing the four investment risk-returns profiles (tier 1-'core and transitional', tier 2 'growth', tier-3 'emerging', tier-4 'early adopter'). The map featured a large number of cities along or nearby the coast, particularly clustering around the regions of Shanghai and Guangzhou-Shenzhen. However, the allocation of market capital in Chinese cities was not dependent on the free-choice of foreign investors. It was critically connected with windows of opportunity opened by local governments, and on Chinese developers' interests in pursuing partnerships with foreign players. These two conditions were no longer met in the early 2010s.

The 2008 GFC hit the Chinese economy through the trade channel, revealing the danger of export dependence on North America and Europe. The government adopted a CNY4 trillion (USD486 billion) stimulus package, aimed at supporting a more domestic-led growth model, *inter allia* through infrastructure and housing construction, with preferential treatment for domestic firms (Schüller & Schüler-Zhou, 2009). Local governments responded by reducing opportunities for foreign property investment further, though to varied degrees across cities and with privileged conditions for groups from Hong Kong and Singapore. Municipal finance had become heavily dependent on local governments' revenues from land, through sales of land-use rights and investment platforms collateralized by land banks. This had led to a so-called 'land-based' mode of urbanization (Hsing, 2010; Lin, 2014) supported at the end of the chain by urban dwellers' housing demand for both occupation and investment (Wu, 2015; Theurillat, Lenzer, & Zhan, s. d.). It was thus considered dangerous to expose booming Chinese markets to the vagaries of US-dominated market finance, and it was conversely viewed as beneficial to award the full benefits of the urban rent extraction to domestic market players.

Indeed, top Chinese developers, who had been the only suitable partners for foreign investors, were ready to fly with their own wings. They had moved up the value chain owing to the transfer of technological and commercial skills from their collaboration with world-class regional property groups and PERE firms. Having reached a large size, they could be granted lines of credit at prime rates from banks, though with much better conditions for state-owned developers than private ones, while those listed in Hong Kong had access to international bond markets (Theurillat & O'Neill, 2017). Yet, within a highly-regulated, state-led banking system, developers still had to self-finance a significant share of the cost of their development projects. To raise capital, they established investment platforms to draw funds from domestic corporate and small savers, rather than being forced to share profits with foreign investors. Collaboration with the latter was then mainly restricted to large-scale projects or niche markets where further knowledge could be gained.

The State turned a blind eye to the wide use of informal credit in infrastructure and real estate construction, allowing a dangerous accumulation of "grey debt". While land-based finance and abundant bank credit to state-owned enterprises have operated a rather balanced spatial distribution of capital for urban development across the national territory, they have led to skyrocketing prices in the biggest cities, and have entailed an over-production of housing that is unparalleled in history. Because investment in real estate, especially in housing, has been a quasi-exclusive saving channel in the past decades (both through platforms or by direct acquisition of housing units) (Wu et al. 2020), Chinese households and firms have come to hold some 50 million unoccupied homes, or approximately 22% of the total housing stock.[8] One can only be glad that China's speculative mechanism supported by small investors' distorted apprehension of risk (Aveline-Dubach, 2020b) is poorly interconnected with global financial channels.

Conclusion

This chapter gives evidence of contrasted trajectories in the financialization of real estate in East Asia. Global investors operate in the three countries/regions, but their action significantly differs in scope, and combines in a unique way with the idiosyncrasies of public policies and real estate industries. In Japan and China, State-led development strategies initially brought about highly regulated financial systems. But the two countries moved in opposite directions when global investors "knocked at the door". Japan embraced the deregulation of its financial industry and responded to the subsequent bubble mechanism by expanding the financialization process to real estate. By contrast, China severely restricted foreign financial practices to fund its urbanization and developed an indigenous informal type of financialization. In both cases, the State's strategy was fully followed by the big development groups, which efficiently managed to align their own interests with public policies.

[8] CHFS Data Talks (2004) "Trend in the housing market and Housing vacancy rate in urban China".

Despite the demographic transition in Japan, domestic and foreign investors find real estate targets for core/core+ allocation attractive, especially in the Tokyo region. But this comes at the cost of strong building intensification to sustain land values and attract population, which in turn reinforces urban shrinkage in other areas. In China, locally-based informal channels provide a more homogeneous distribution of capital in the built environment across cities and within cities, though this has not prevented the emergence of a dangerous accumulation of unoccupied built space and related grey debt. Hong Kong stands out with a tradition of economic freedom engrained by British colonizers. Yet that did not bring more openness to financial investment in real estate, as powerful Hong Kong property conglomerates tend to keep development profits and commercial properties under family control. The securitization of Hong Kong's real estate markets has nonetheless contributed to enhancing the status of Hong Kong as a regional hub by offering The Link's foreign investors handsome yields at the expense of local welfare beneficiaries. Obviously, this ties in with the emerging literature on "corporate vultures".

This chapter has addressed the financialization of real estate from the perspective of interconnections with financial global channels and the standardization of Anglo-American approaches in East Asia. It was not within its scope to examine purely domestic financialized instruments. China has proved particularly inventive in this regard, and its informal experiments deserve more attention, drawing on previous work (Zhang, 2018; Theurillat, Lenzer, & Zhan). More importantly, China's financialization trajectory may have preserved the world economy from the impact of its large-scale property cycle. China's path also challenges the teleological assumption that all countries will converge on mainstream financial instruments.

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