The Rise of Alternative Real Estate in Asia Pacific

Private Education Gets Top Marks From Investors

A brief introduction

The private education market in Asia Pacific is estimated to be worth USD 1.2 trillion, and the industry is continuing to grow, driven by shifting macroeconomic and demographic trends such as rising wealth and population growth.

In Asia Pacific, the K-12 and Tertiary education sectors are the largest and most developed. English Language Teaching (ELT), Early Years and Educational Technology (EdTech) are also increasingly big growth areas.

The education sector has seen active investment from private equity, pension and sovereign wealth fund investors looking to capitalize upon high-growth, recession-resistant opportunities, featuring long-dated leases and positive cash flows.

This report highlights some of the key growth areas, potential investment routes as well as opportunities.

“The education market in Asia Pacific is a bright spot for investment supported by favourable demographics and macro-economic trends. This sector offers great opportunity whatever your investment strategy: from different market segments and geographies to OpCo/ PropCo investment structures.”

Noeleen Goh
Director of Alternatives
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The Key Growth Sectors

K-12

International schools were once a luxury service targeting expat families on company packages. Today, the demand is coming mainly from affluent Asian families. These parents believe that a high-quality, English-medium, international curriculum will give their children an edge in enrolling in the top universities. International schools typically also feature smaller class sizes and students of different nationalities. Such classrooms offer a more customized approach to learning and a greater understanding and acceptance of different cultures and worldviews—skills that are increasingly seen as important to succeed in today's globalized world.

Tertiary

In the past, high quality internationally recognized education has driven many Asian students to study abroad. This has changed. An increasing number of students are now pursuing degrees from foreign institutions in their home or neighboring countries to reduce cost. Higher education delivered in a country other than a country in which the awarding institution is based is known as Transnational Education (TNE). Degrees from U.S., British and Australian institutions are particularly popular in Asia, with delivery methods ranging from franchise, joint programs, international campus and online learning. As Asia sees growth in its higher education sector, local universities are also muscling up as worthy competitors to Western institutions.

English Language Teaching (ELT)

As English Language is a universal language for academic and professional communication, ELT has moved from being aspirational to essential. Learning English is now seen as an important step to better career prospects and job success. In countries such as Vietnam, Thailand, Japan and China, where the national curriculum does not provide adequate opportunity to become proficient in English, ELT has become a growth market.

Early Years

Early Years is usually defined as the period from birth until the age of eight or nine. Many believe that the first five years of a child's development are the most important. As the Early Years' segment is less restricted in most countries, the private market has flourished, offering parents a myriad of options such as Montessori, Reggio Emilia and play-based learning.

What is Driving Demand?

Key Trends

Asia Pacific is the fastest growing economic region in the world. Its combined nominal GDP is already larger in terms of output than the U.S. or the Eurozone. If it continues on its current growth trajectory, it will surpass the combined GDP of the U.S. and the Eurozone within the next decade.

Rising Wealth

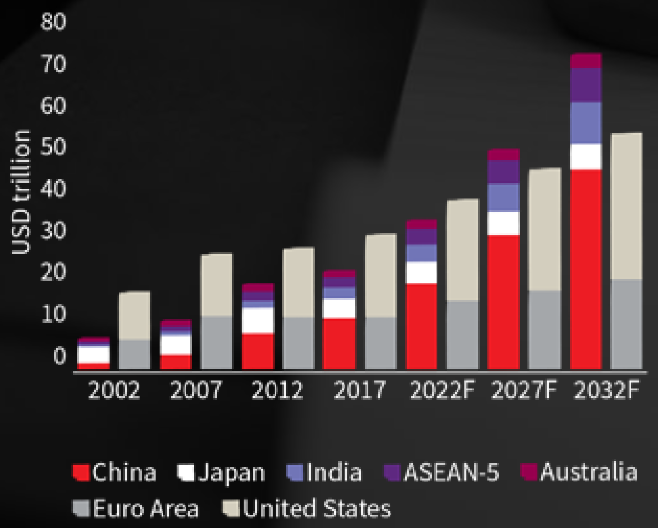
At present, just over 48 million households are earning more than USD 100,000 annually. This number is expected to increase by 217% over the next 15 years. Much of the growth is concentrated in China, India and South East Asia.

Urbanization

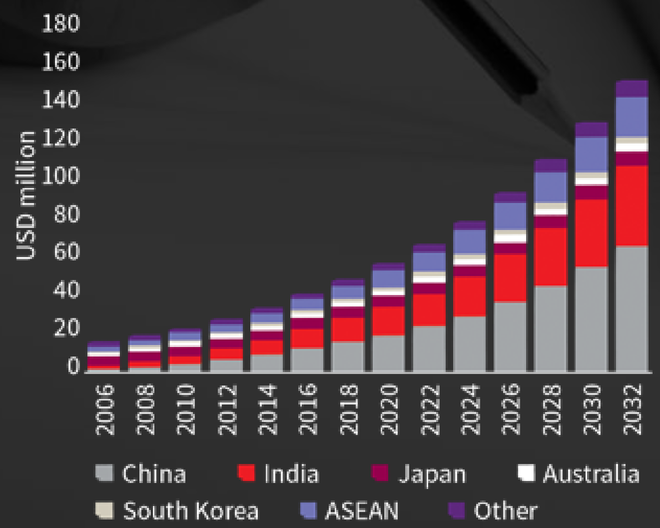
The Asia Pacific region will account for more than half of global urbanization growth over the next 15 years. In the region, there will be an additional 560 million people living in cities.

The increase in wealth and dramatic spike in urbanization means that the demand for places in international schools will only continue to grow. In the K-12 sector, the international school count has already risen by 38% since 2012 and student enrolment has grown by 47%.

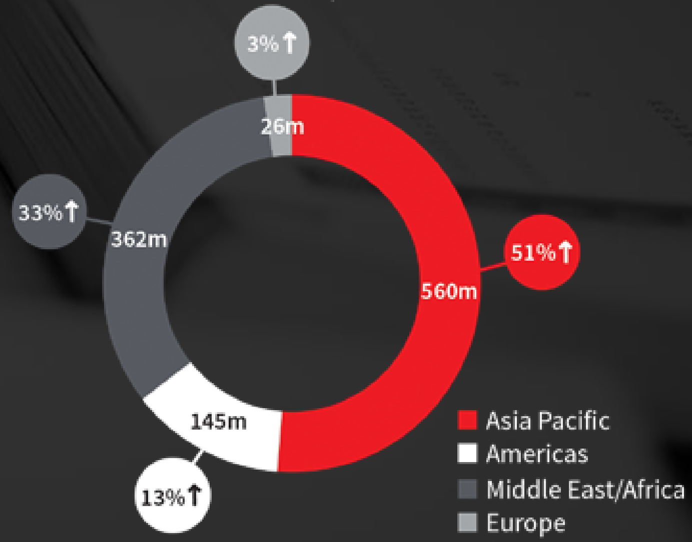
Nominal GDP



Households with Earnings over USD 100,000



Forecast Growth of Urban Population from 2018 to 2032



Six Major Trends

1. Shift from Premium to Mid-Price Education Options

A burgeoning local middle class, shrinking family sizes and more households with a double-income have led to a surge in demand for international schools at the mid-price level.

80% of students attending international schools in Asia are now the children of local parents (ISC Research, 2018). Countries such as Malaysia, Thailand and China have relaxed restrictions for international school enrolment and are set to show strong and sustainable demand. At the same time, expat packages are not as generous as they used to be, which means enrolment at the premium end of the market has not risen at the same rate as the more affordable mid-price schools.

Mid-price schools differ from the premium segment in that they typically have larger class sizes, less facilities, a narrower curriculum and occasionally teacher qualification requirements.

2. Focus on English Language Education

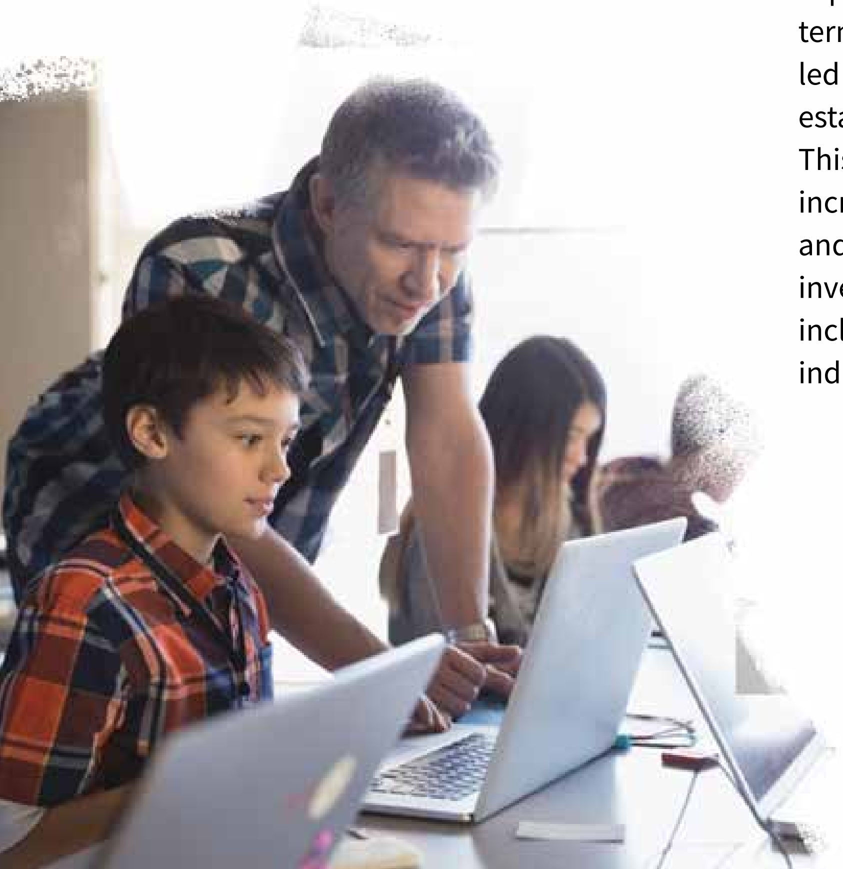
Parents and professionals are willing to pay a premium for first-rate academic and business-orientated ELT options not only in K-12 classrooms, but also at tertiary level and for English tutoring, admissions test preparations and specialized language training. The consequence of this development is striking: students from Asian countries are excelling abroad and now make up 64% of the total international student body in the U.S. (Open Doors, 2014).

3. Attention to Quality

The proliferation of international schools across Asia Pacific means that the competition for students is fierce and the quality of education is arguably higher than it has ever been. When choosing where to spend their tuition money, parents place a great deal of weight on an institution's overall academic reputation, curriculum, teaching quality, as well as university acceptance. The school's ability to impart communication skills, promote collaboration and decisive thinking, as well as to provide international exposure, is also high on parents' wish lists.

4. Teacher Shortage

The booming demand for international schools has created a shortage of qualified teachers. An additional 200,000 full-time teachers will be needed at international schools around the globe in the next five years to keep pace with market growth (ISC Research, 2018).



5. Rise in Investor-Backed Companies

Private education investment is a high-growth sector that is fairly recession-resistant due to its long-dated leases and demographic demand drivers. In recent years, there has been a rise in both international school operating companies including Nord Anglia, International School Partnership, GEMS Education and Cognita – all of which are backed by institutional investors. Expanding K-12 operations is capital intensive in terms of both land and infrastructure, which has led to the formation of education-focused real estate players such as Alpha REIT in Malaysia. This fast-expanding private school market is increasingly attracting real estate developers and investors who are seeking alternative investments away from core assets, which include commercial, residential, retail and industrial real estate.

6. Educational Technology (EdTech)

Technological innovation is changing how students learn. Digital platforms that allow a student to practice, upload homework and learn through 3D immersion are catching on fast. The level of investment in EdTech is ten times the level it was a decade ago and in 2016, global investments in Chinese EdTech companies rose to USD 1.2 billion, according to Goldman Sachs. Going forward, the EdTech industry in China is expected to grow 20% annually, and the Asia Pacific region is projected to account for 54% of the global Edtech market by 2020. Recently, China’s VIPKid, which links mainly North American tutors with Chinese children, raised about USD 500 million at a valuation of more than USD 3 billion, making it the largest online education start-up.

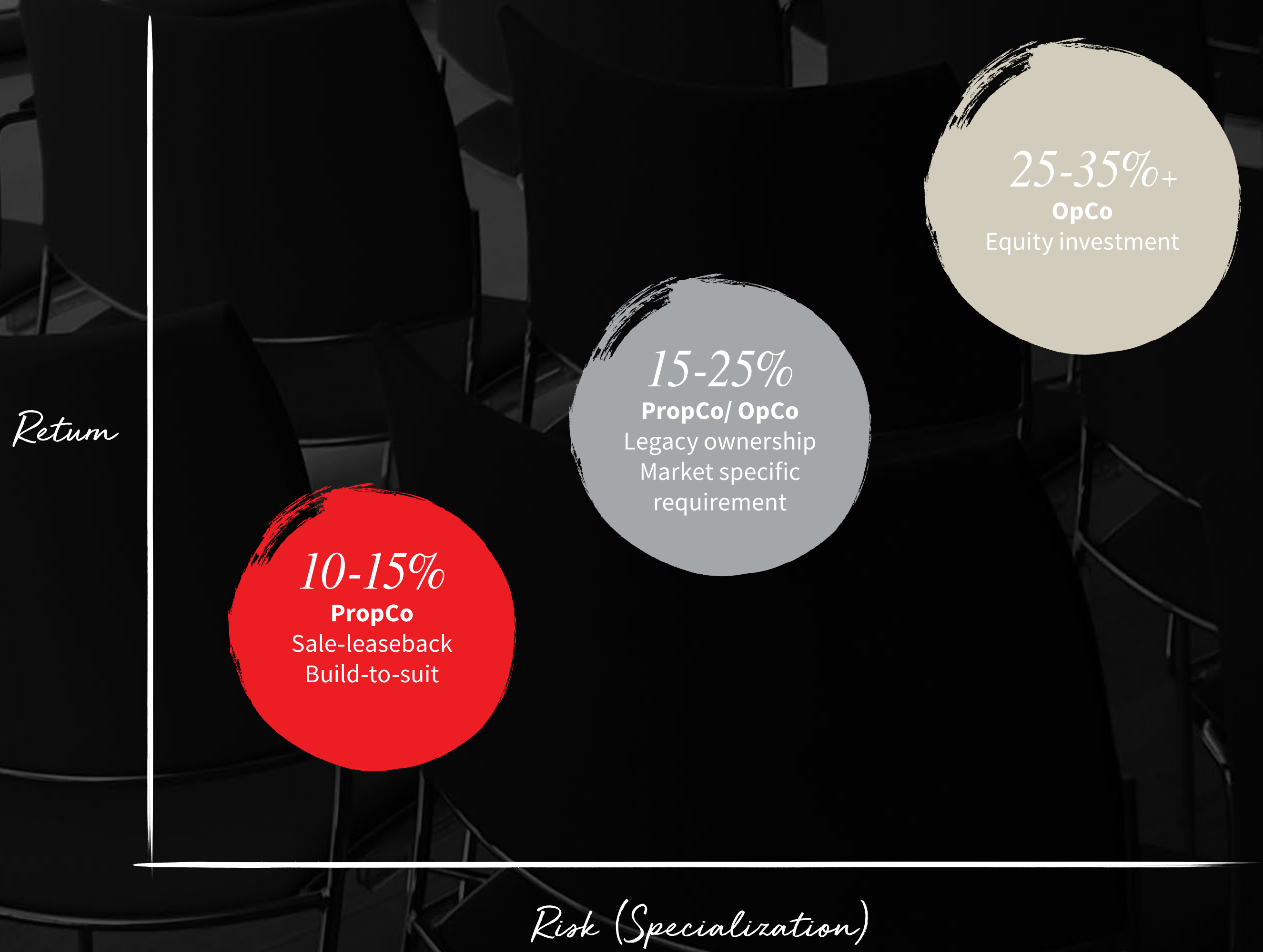
Investor Approach

Choosing the right investment route into this sector depends on an investor's appetite for risk and return criteria. Especially in the K-12 and Tertiary sectors, real estate is a significant factor in the business plan and if owned, represents a large proportion of the capital invested.

It is common to separate the real estate from the operating company (OpCo) and hold it in a property company (PropCo). This gives investors the option to either invest in education operations or the real estate.

For OpCo investors, not owning the real estate means they can focus their efforts on operations and channel the funds to invest in the core business of educational services rather than having to deal with the risks and obligations associated with real estate ownership. For PropCo investors, they can do what they do best: maximizing the asset value by improving and maintaining the property.

Illustrative Risk/ Return Spectrum in the Education Sector in Asia Pacific



Source: JLL

PropCo Investment

There are two common modes of PropCo investment:

1. Sale and Leaseback: under this arrangement, the school will sell the campus to a PropCo investor and lease it back on a long-term agreement. Typically, the school would have already been in operation with a stabilized structure, thereby providing a strong tenant covenant from a profitable cash business.
2. Build-to-Suit: under this arrangement, the PropCo investor develops a bespoke campus for the school, who is contractually bound to either buy or lease the property upon completion. The school gets the benefit of a custom-designed campus with minimal capital outlay and limited development risk. The PropCo investor will benefit from the premium rent for taking on development and tenant risk, especially if the school is new.

In both cases, the PropCo Investor could also include features such as inflationary increments and periodic rent reviews to hedge against inflation. The PropCo could also charge rent as a percentage of revenue to participate in the upside of the school business. In most markets, yield compression over time is also expected.

OpCo Investment

OpCo investments may be made through debt or equity into a single school operator or via a platform that operates multiple schools. Investment into OpCos alone tends to yield higher returns and is often more liquid than investment into PropCos alone or combined. Another benefit is that more capital can be freed up to invest in the company or to fund expansion. As opposed to PropCo investment where there is real estate collateral to protect the investment, the cost of capital and risk-return of OpCos are expected to be higher. Recent OpCo transactions have been concluded at EBITDA multiples of above 13x. Needless to say, established brands, operating platforms and companies with growth potential will command higher premiums.

Investor Profile

Private equity investors have been particularly active in the sector – investing both in single assets and platforms. The preference has been to invest in platforms due to the ability to deploy large amounts of capital in a single transaction. This approach also allows investors to scale up quickly and benefit from future growth. There are many examples of large international school operating platforms that are backed by private equity houses. For instance, Blackstone, Fajr Capital, Mumtalakat and Khazanah's investment in GEMS Education, Bregal and KKR's investment in Cognita and Partners Group's investment in International Schools Partnership. Investments like these can be active or passive, depending on whether the investor has operational expertise and could help the school operator improve their existing operations or expand.

Investment by sovereign wealth and pension funds has also become increasingly common. In 2017, Baring Private Equity Asia and Canadian Pension Plan Investment Board announced their acquisition and privatization of Nord Anglia. More recently, Palace Investments, a unit of Temasek Holdings, announced it would take a 30% stake in MindChamps PreSchool Global Fund, which will invest directly or indirectly in local funds to buy and set up schools under the MindChamps brand.

From an operator's perspective, sovereign wealth and pension funds offer competitive, long-term capital. From a PropCo investor's perspective, acquiring an education property is a means of diversifying away from traditional asset classes and moving up the risk curve to achieve higher returns. Alpha REIT, for example, is a Malaysia-based unlisted REIT that focuses on long-term sale-and-leaseback and build-to-suit solutions for education assets. In 2017, they entered into a sale-and-leaseback arrangement with Paramount Corp Bhd, the operator of Sekolah Sri KDU and Sri KDU International School, acquiring the PropCo for USD 38.5 million, with a 7% net initial yield. Most recently, Equitava, the fund manager for Emirates REIT, announced that it would set up a new REIT to buy education assets in India. Of course, PropCo investment is not limited to PropCo investors, school operating companies often buy rather than lease their own property. This means that their capital is tied-up in the real estate, but such an arrangement can provide security and flexibility, and in some countries is a necessary means of entry due to local regulation.

Want to be top of the class?

Our guide to the best investment opportunities across Asia Pacific.

China

Fast growth despite regulatory restrictions

In the K-12 sector, the focus has shifted from expatriates to the affluent local market. As the number of expatriate families declines, the number of wealthy local Chinese parents who are willing to spend a significant portion of the household income on education has increased. With the end of China's one-child policy, the subsequent surge in demand for high-quality education options becomes inevitable. The Early Years sector was the first to benefit when China's one-child policy was abolished and has seen a spike in interest from investors especially since the restrictions surrounding foreign ownerships are much less stringent than in the K-12 sector. In 2015, the total number of kindergarten students in China was 43.6 million. By 2025, this figure is estimated to rise to 65 million (8.3% CAGR). Experts predict that the total market value for education and training will reach RMB 3 trillion (USD 480 billion) by 2025, with RMB 2.7 trillion coming from the K-12 student market (DBS Vickers, 2017).

However, entering the market in China and targeting local students is not straightforward. Foreign ownership is restricted and Chinese students must complete the Grade 1 to 9 compulsory national curriculum. There are two potential routes of entry for foreign investors. Investors can form a business relationship with a Chinese entity or form a joint venture between a foreign education provider and a Chinese entity. Locally owned international schools and co-operative structures that deliver G1-9 compulsory education must be established as not-for-profit entities and hence investors would need to find alternative routes to generate income from the JV. Despite these hurdles, the Chinese market is still very attractive and poised for exponential growth.

Hong Kong

Scarcity of sites

The number of English-medium international schools in Hong Kong increased from 92 in 2000 to 177 in 2017. However, the number of students more than doubled in this period, from 34,200 to 81,000 (ISC Research, 2017). The scarcity of suitable sites, combined with increasing demand for international school places from local wealthy families and already-high demand from expatriate families, means that most schools in Hong Kong are operating at, or close to, full capacity, and there are long waiting lists at virtually all of the leading schools. The English Schools Foundation (ESF) which operates 22 international schools in Hong Kong, is particularly popular as it offers subsidized tuition fees. However, it will be phasing out this subsidy by end of 2018, which may lead to higher demand for places at other top-tier schools.

Malaysia

Saturated premium market, shift to domestic mid-market

Malaysia's private education market doesn't restrict locals from attending international schools. Since 2012, the number of such schools has risen from 108 to 170, and student enrolment has climbed from 29,000 to 71,500 (ISC Research, 2017). A downturn in the oil and gas sector has slowed growth, and with expatriates leaving the country, there was a significant drop in enrolment numbers at the high-end premium schools. The growth opportunity in the K-12 international school segment is now focused on mid-price, good-quality offerings targeted at aspiring middle-income families. With the perceived weakness of the national education, these parents want to give their children a good foundation and greater opportunities for success.

In the tertiary education sector, Malaysia was ranked, alongside Singapore, as one of the top host countries for UK Transnational Education in 2017 (Times Higher Education, 2017).

Singapore

Demand for mid-price offering for expats

The K-12 international school market in Singapore is one of Asia's most developed and is driven mainly by the city's role as a regional economic and financial powerhouse. Singaporean citizens are not allowed to attend international schools past the pre-kindergarten level except when approved under special circumstances, so demand is driven by the expatriate population, unlike many other countries in the Asia Pacific region. With the decline in expat packages, demand has shifted from premium to mid-priced international schools. The international school network in Singapore is regulated by the Economic Development Board (EDB), which releases land for development only when it wishes to expand the network. EDB aims to match capacity with anticipated demand for places. As such, Singapore enjoyed an increase of 72% enrolment from 2012-2017 equivalent to an average annual growth rate of more than 11%, despite the downturn in the oil and gas sector which affected many expatriates' employment.

Investors still find Singapore an attractive market especially for mid-price high quality offerings but the challenge is the availability of suitable sites on a long-term basis and the requirement for schools to own their land and buildings in the event land has been allocated by the government; which makes it capital intensive.

Vietnam

Relaxation of Decree 73 will grow domestic demand

Until recently, Decree 73 limited the enrolment of Vietnamese students at foreign-owned schools to 0% at pre-primary level, 10% at primary level and 20% at secondary level. Decree 86, which takes effect from 1st August 2018 relaxes these limits on enrolment, allowing a significantly higher proportion of local students to attend international schools: 10% at pre-primary level, 20% at primary level and 50% at secondary level. Although foreign-owned schools that have reached their fill quota of local students will still have to operate waiting lists for

> *"Successful investment strategies need a local approach. Understanding the domestic demand drivers, competitive and regulatory landscapes across the region is key."*
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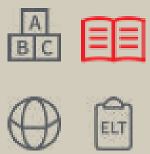
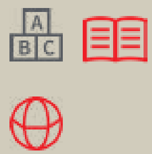
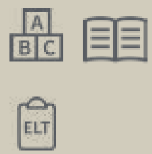
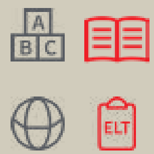
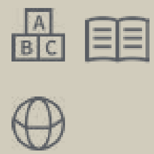
these students even if they have spare capacity, it is anticipated that this change in legislation will lead to a significant increase in local student enrolment. Research suggests that the level of unsatisfied demand from local families for places at foreign-owned schools would support the development of several new schools in this sector of the market. School operators and investors see Vietnam as the rising star of South East Asia with its expected GDP growth, young population and untapped market.

Thailand

Local partnership is key to accessing opportunity

Thailand has no restrictions on the enrolment of local students at international schools, however, well-established schools have self-imposed caps to maintain a multi-nationality environment. However, this is starting to change as high-quality brands look to enter the market targeting mostly affluent locals. Since 2012, Thailand's K-12 international school enrolment has grown by more than 20%. While local students account for just over 50% of enrolments, there is a growing expatriate population. At the same time, the number of affluent local families seeking international schools as a pathway to good overseas universities is likely to continue to increase, driving sustained demand in the sector (ISC Research, 2017). Foreign investors looking to enter the market must find the right local partner as the school license holder must be a Thai citizen. Investors should also be aware of the requirements surrounding teaching staff and property ownership. The process for foreign teachers obtaining teacher license is becoming more rigorous and there are restrictions to foreign land ownerships.

Investor Playbook: Your guide to investing in the Education sector

	China	Hong Kong	Malaysia	Thailand	Vietnam	Singapore
Top Pick Sectors	 [1]		 [2]			 [2]
Key Drivers	• Population growth • Rising local affluence • English language learning • Pathway to overseas universities • End of one child policy/ young population	• Scarcity of schools/ land for development • Large population of expatriates and affluent locals • No restrictions on enrolment of local students	• Friendly regulatory environment for investors • Growth of middle income families • Perceived weakness of national education • No restrictions on enrolment of local students	• Rising local affluence • Growth in expatriate population • Pathway to overseas universities • English language learning • No restrictions on enrolment of local students	• English language learning • Perceived weakness of national education • Rising local affluence • Young population	• Economic/ financial powerhouse • Large population of expatriates • Decline in expatriate packages
Key Considerations	• Compulsory national education G1-9 for locals • Foreign ownership restrictions	• Restricted real estate availability	• Market positioning and location of school critical to success	• Foreign ownership restrictions • Local business partner required • Stringent teaching licence requirements	• Caps on enrolment of local students • Stringent teaching licence requirements	• Restricted real estate availability • School licences tightly controlled • OpCo/ PropCo structures restricted

 Early Years
 K-12 International
 Transnational Education
 English Language Teaching
 Higher growth potential

[1] Bilingual International Schools
[2] Mid-priced high quality offering

Achieving your ambitions with Alternatives

Despite the growing demand across the region, **there remains a disconnect between investors, operators and developers** which has **opened up an opportunity for first movers** across a number of markets and sectors.

- **Investors** want to **diversify** their portfolios. They want **access** to Alternatives **products** where demand outstrips supply, and to the **operational expertise** these assets require.
- **Operators** want **scale** and **operational efficiency**. They need **access to capital** and **development expertise** to enter new markets and navigate the regulatory environment.

That's where we come in.

We combine access to capital, financial and operational expertise and real estate insights to build the strategic partnerships that will help you achieve your ambitions.

Our service offering includes:

- Market entry strategy
- Corporate M&A and structured transactions
- Joint Venture partner mapping and selection
- Capital raising
- Investment sales & purchases
- Sale & leaseback transactions
- Build-to-suit structuring
- Leasing transactions and audits
- Research and advisory
- Due diligence services
- Project and facilities management

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