2025 Asia Pacific

EMERGING TRENDS IN REAL ESTATE®

Emerging Trends in Real Estate® Asia Pacific 2025

A publication from:

Emerging Trends in Real Estate®

Asia Pacific 2025

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UPPER

Executive Summary

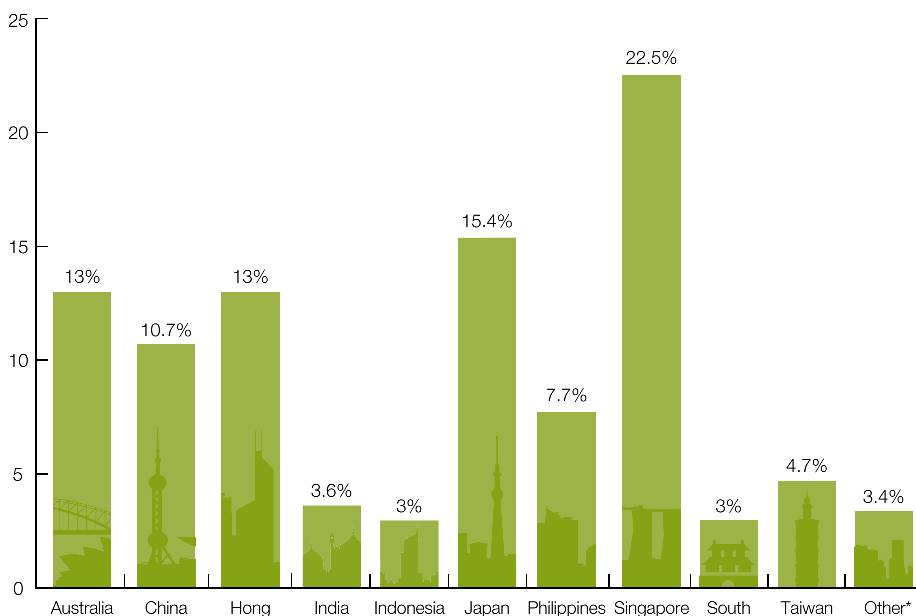
A quick glance at industry data in late 2024 might suggest Asia Pacific markets are little changed from last year, with deal flow, cap rate, and asset price indicators still in limbo across most of the region. Under the surface, though, hints of an impending revival – both in transactions and sentiment – are emerging.

The main catalyst for change was the September decision by the US Federal Reserve to loosen monetary policy, ending a more than two-year period of rapidly rising interest rates that has caused persistent bid/ask pricing standoffs across the region. Interviewees reported that the prospect of lower-cost leverage is now boosting deal pipelines, with significantly higher transaction volumes expected for the last quarter of 2024.

That said, conditions vary widely by location. Of the big regional markets, China remains in a multi-year downtrend that has created its own property microclimate, while Japan's ultra-low interest rates have also insulated it from outside economic forces. Australia, therefore, provides the best example of how markets are starting to adapt. On the one hand, local institutional funds have cut asking prices as they move to recycle assets or satisfy redemption pressure. On the other, buyers anticipating cheaper cost of debt have sharpened their pencils to underwrite potential deals. The recent 20 to 25 percent fall in book values has piqued the interest of global funds that have been largely absent from local core markets for the last two years, with prices expected to see further downward pressure over the near term.

Another factor pushing markets to accept pricing adjustments is growing pressure from banks (or bank regulators) as they finally move to address underwater loans. As they do so, borrowers are being forced to revalue assets and/or top up equity contributions. Hong Kong, which has seen the biggest drop in asset values, is seeing growing numbers of foreclosures, while Australian and South Korean markets are also "starting to have cracks", as one investor put it.

Survey Responses by Country/Territory



Source: *Emerging Trends in Real Estate Asia Pacific 2025* survey.
*Includes Cambodia, Malaysia, Taiwan, Thailand, United States, Vietnam.

However, while investors expect regional repricing trends to accelerate, values are not expected to decline to the same extent as in some Western markets, given generally higher Asia Pacific occupancy rates, lower use of non-recourse lending, and a long-standing reliance on relationship banking, as opposed to the securitised vehicles commonly seen in the United States.

As pricing resets gather pace, distress will inevitably rise. This does not mean, though, that a wave of regional foreclosures is imminent. In part, this is because the current downtrend has been a slow-motion phenomenon rather than a convulsive market crash, meaning that lenders are incentivised to string out the pain rather than spark a rush of forced sales and, potentially, a systemic crisis. As a result, in the words of one investor, where distress does appear, it is likely "to involve much smaller lot, non-performing loans, which I view as a flow trade, just buying debt off banks".

That said, in some markets or sub-markets, the extent of price corrections are such that significant levels of real distress are unavoidable. Hong Kong is one such market. Melbourne – which never truly recovered after COVID lockdowns – is another. And China, where distress is abundant on both the asset and entity levels, is another target rich environment, although local banks' reluctance to act on delinquent loans has meant that distress tends to be intermediated via unofficial, often related-party, channels.

Meanwhile, elevated bid/ask spreads have encouraged investors to pivot away from conventional strategies in favour of assets more likely to meet return thresholds. Core properties have therefore fallen from favour, apart from niche asset classes such as data centres, or development projects that can be used to manufacture new capacity. Opportunistic and value-add investments are also in play, together with private credit, which is increasingly sought after as a route to higher risk-adjusted returns.

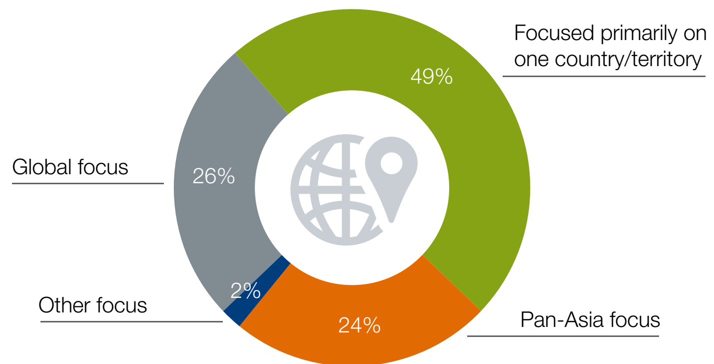
Finally, alternative assets – which include new-economy themes offering superior growth prospects due to reliance on emerging technological, demographic, or social trends – continue to draw interest. In absolute terms, they may remain a small part of the investment pie, but alternatives represent a new departure for the industry, as funds become increasingly willing to migrate away from 'sit-and-wait' real estate towards private equity–type strategies featuring non-real estate operational components.

An environment of rapidly rising construction costs, higher interest rates, and uncertain demand from occupiers has led many investors to shy away from development plays, although new-economy assets – including, for these purposes, data centres – are an exception given they are almost by definition in short supply. Over the long-term, however, today's constrained development pipeline should prove beneficial for asset classes now suffering from excess capacity.

Sustainability, and in particular carbon efficiency, remains an important part of investor agendas. At the same time, however, the often high costs of implementing low-carbon operational strategies means many investors/owners have put off asset upgrades as they concentrate on other priorities. Another trend in this area is an increasing focus on embodied carbon, which refers to emissions associated with a building's entire life cycle, including in particular its steel and concrete components. While the cost of lowering these inputs is not high, low-carbon versions of both commodities (and especially steel) require technical upgrades to manufacturing processes that may be expensive and politically complex to implement.

Turning to this year's *Emerging Trends* investment prospect rankings, Japan's enduringly low interest rates continue to make it a favourite among cross-border investors, with Tokyo and Osaka ranking as the top two picks. At the same time, investor attention is switching increasingly to Sydney and Melbourne (at number three and six, respectively) as those markets start to re-price assets lower. At the other end of the rankings, Chinese properties remain off the table for most foreign funds, although there has been activity by established foreign players, especially large integrated developers from Hong Kong and Singapore. Finally, there is increasing interest in emerging market assets. Vietnam remains the obvious candidate, as China-based manufacturers push capacity offshore. India is now also on investor agendas, although there remain few stabilised investment-grade assets available for purchase.

What is the geographic focus of your business's activities?



Source: *Emerging Trends in Real Estate Asia Pacific 2024* survey.

Individual asset classes, meanwhile, are still in the throes of change.

Office: Investor interest in office assets has fallen off in the wake of steep losses incurred in US and European markets. While occupancy levels and net operating income in the Asia Pacific (with the exception of Australia) are significantly higher than in the West, questions over secular demand remain, while underwriting returns for core office assets is difficult in the context of ongoing bid/ask standoffs. Seoul, which enjoys anomalously high occupancy rates, is a notable exception, boasting good (although possibly peaking) rental growth, as well as strong buying interest among global funds.

Logistics: On paper, regional undersupply of modern warehousing makes for a bullish investment thesis. At the same time, and adding to similar concerns from last year, there is a nagging anxiety among investors that the sector may be close to an inflection point after years of headlong growth. Interviewees spoke of pockets of oversupply, high rents, and concerns over softening retail and e-commerce sales. There is also concern that, fundamentally, cap rates for logistics assets have been compressed to levels that are irrationally low for an asset class where barriers to entry are low. There have been signs of cyclical softness in some markets, in particular South Korea and Japan, as well as oversupply in China. Partly as a result of overcapacity concerns, some investors are looking to develop last-mile logistics assets in locations closer to the urban core. Data centres, meanwhile, although not a true logistics play, go from strength to strength, in line with booming global demand for artificial intelligence (AI).

Retail: After years of price declines, there is today a growing sense, at least for some markets and typologies, that the retail sector may finally have bottomed, with significant numbers of interviewees expressing a willingness to buy. One reason for this is a growing acceptance among both the industry and the public

that online retailing has not been the death knell of conventional shopping. Retailers in some markets are now returning to prime city-centre shopping districts, taking advantage of sometimes steep reductions in rents.

Living Assets: Along with data centres, multifamily projects are probably the single most sought-after asset class in the Asia Pacific, as weak economies and high home prices increase incentives to rent rather than buy. The sector offers investors reliable income streams and short-term lease structures that reset easily to counter inflationary pressures. At the same time, the market in Japan – by far the largest in the region – has slowed as investors eye upcoming domestic rate hikes. Questions also persist over how thin yields offered by multifamily assets can stack up in the absence of direct or indirect government subsidies. Meanwhile, interest has also grown for related asset classes such as student and (especially) senior housing, as regional demographic trends boost demand.

Hotels: For an industry hit so hard by pandemic travel restrictions, the rebound of Asia Pacific hospitality has been impressive. After an initial wave of post-pandemic revenge travel – accompanied by a parallel wave of hotel buying – peaked in 2023, the market seems finally to have achieved equilibrium. The Japanese market is seeing by far the strongest institutional deal flow, driven as usual by accretive yields. In addition, resurgent international tourism, a weak yen, and a minimal pipeline of supply have boosted interest from foreign capital. That said, the wide gap between buyer/seller pricing expectations has depressed buying activity and left private investors, family offices, and high-net-worth buyers as the main players. Probably the main problem for the industry regionally is a chronic shortage of labour that prevents many hotels from operating at full occupancy.

Notice to Readers

Emerging Trends in Real Estate® Asia Pacific is a trends and forecast publication now in its 19th edition, and is one of the most highly regarded and widely read forecast reports in the real estate industry. *Emerging Trends in Real Estate® Asia Pacific 2025*, undertaken jointly by PwC and the Urban Land Institute, provides an outlook on real estate investment and development trends, real estate finance and capital markets, property sectors, metropolitan areas, and other real estate issues throughout the Asia Pacific region.

Emerging Trends in Real Estate® Asia Pacific 2025 reflects the views of individuals who completed surveys or were interviewed as a part of the research process for this report. The views expressed herein, including all comments appearing in quotes, are obtained exclusively from these surveys and interviews and do not express the opinions of either PwC or ULI. Interviewees and survey participants represent a wide range of industry experts, including investors, fund managers, developers, property companies, lenders, brokers, advisers, and consultants. ULI and PwC researchers personally interviewed 67 individuals and survey responses were received from 137 individuals, whose company affiliations are broken down below.

Private property owner or developer	16%
Real estate service firm (e.g., consulting, financial, legal, or property advisory)	30%
Fund/investment manager	26%
Homebuilder or residential developer	2%
Institutional equity investor	3%
Bank lender or securitised lender	1%
Other entities	21%

Throughout the publication, the views of interviewees and/or survey respondents have been presented as direct quotations from the participant without attribution to any particular participant. A list of the interview participants in this year's study who chose to be identified appears at the end of this report, but it should be noted that all interviewees are given the option to remain anonymous regarding their participation. In several cases, quotes contained herein were obtained from interviewees who are not listed. Readers are cautioned not to attempt to attribute any quote to a specific individual or company.

Please note that in the text "China" refers to "Chinese mainland", and "Hong Kong" refers to "Hong Kong SAR".

To all who helped, the Urban Land Institute and PwC extend sincere thanks for sharing valuable time and expertise. Without the involvement of these many individuals, this report would not have been possible.

Chapter 1: Sounding out the Bottom

"Sentiment has changed – last year, people didn't even do the underwriting. Now they're running the numbers, sitting on the sidelines, and looking at deals to see what works."

Speaking to investors when researching last year's edition of this report, sentiment among interviewees ran the gamut from gloom to anticipation; on the one hand, many saw little relief from the funk into which markets had fallen since US rates began rising in 2022. On the other, some pointed to subsiding inflationary pressures as a precursor for an imminent turn in both rate and real estate cycles.

Twelve months later, the market seems little changed. Cap rates are too low, asset revaluations remain a work in progress, and deal flow is at best lacklustre, with buyers congregating around a handful of strategies able to eke out accretive returns.

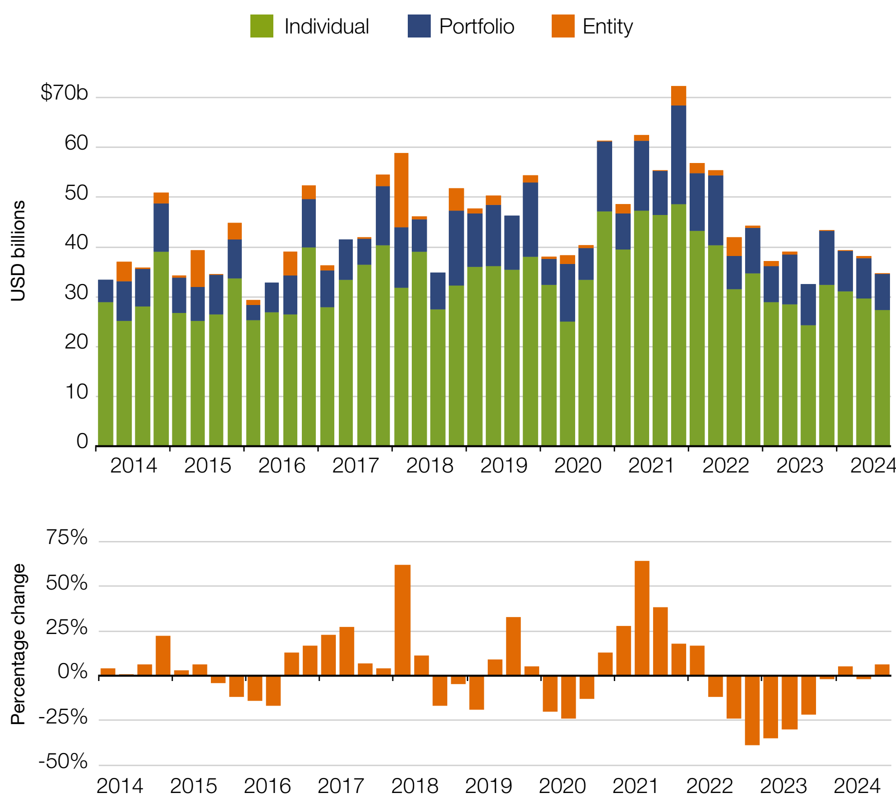
This apparent inertia is illusory, however, because in the interim, sentiment made a round trip and arrived back where it started. After data in early 2024 suggested US inflation was indeed cooling, the industry celebrated an imminent reversal in rates and a back-to-the-races market revival. While that enthusiasm quickly faded when data turned south – alongside hopes for as many as six cuts in the year – the episode demonstrates how markets across the region remain hostage to monetary policy expectations and the sugar rush of cheap debt.

With that in mind, and a changing of the guard in the White House now boosting the odds of higher-for-longer inflation, the final quarter of 2024 seems to have left Asia Pacific asset owners marooned in the past. Unlike Europe and the United States, where investors have embraced higher interest rates as a new normal, local markets too often rely on outdated valuation models based on cap rates set below the cost of borrowing. As a result, buyers refuse to meet the ask, deal flow has slowed to a crawl, and markets are left in limbo.

Still, even as investor dry powder piles up, changes around the margins suggest the gridlock may soon be broken. For one, the interest rate bandwagon seems finally to be moving. While the 75 basis-point (bp) rate cut in the United States has no direct influence on monetary policies in the Asia Pacific (apart from Hong Kong), it does create an example for others to follow. South Korea, therefore, reduced its benchmark rate in October, following a similar move by New Zealand, and both India and Vietnam have expressed intention to do the same. China also continues to cut rates, although admittedly in a different context.

Second, although transactions data for the first nine months of 2024 provide little hint of an impending rebound (see Exhibit 1-1), recent data, together with anecdotal reports from brokerage sources, suggest deal pipelines going into the final quarter of 2024 have seen a significant upswing to levels near their 2021 peak (see exhibit 1-3). Improvements in investor sentiment are also evident in our survey results, with profitability projections for 2025 registering their highest score since 2019 (see exhibit 1-2). Although another false dawn is always possible, prospects this time seem stronger than last.

Exhibit 1-1 **Asia Pacific Real Estate Transaction Volumes by Source of Capital, and Year-on-Year Percentage Change, 3Q 2024**



Source: MSCI Real Capital Analytics.
Note: Apartment, hotel, industrial, office, retail, and senior housing transactions included. Entity-level deals included. Development sites excluded.

Exhibit 1-2 **Real Estate Firm Profitability Trends**

Source: *Emerging Trends in Real Estate Asia Pacific* surveys.

While increased activity seems for now to be mostly at the hands of domestic, rather than cross-border capital, recent US base rate cuts also appear to have re-energised global funds (largely absent since 2022) to return to the fray. While these funds represent a far smaller capital base than their intra-regional counterparts, for a variety of reasons their participation is necessary for markets to function efficiently, especially for deals of big-ticket, core assets they traditionally target.

As a fund manager at one global fund commented: "A key component for cap rates normalising is global investor demand coming back to the region, especially in markets that don't have a lot of strong domestic buyers. If that capital doesn't come back, then, even if rates come down, you may not see the cap rate compression outcome you're hoping for."

Mind the Gap

The most important pre-condition for jump-starting regional transactions is an end to the pricing standoffs that have hamstrung the market since 2022. This is something already implied by the fact that deal flow is accelerating, and was further confirmed by feedback from interviewees that cap rates currently under negotiation are starting to move out.

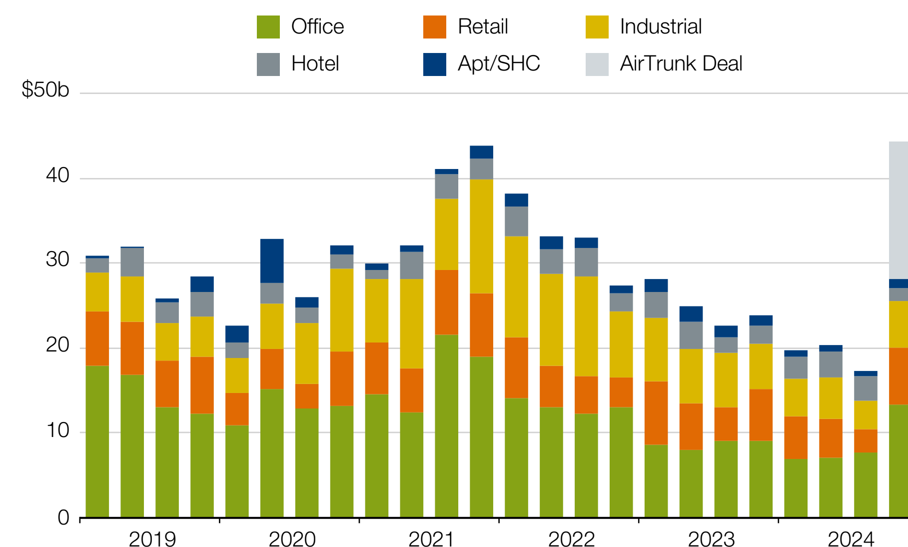
At the same time, conditions vary significantly by market. China, for example, remains mired in a property sector downturn that creates its own pricing microclimate. Japan, meanwhile, continues to feature a combination of ultra-low interest rates and widely available leverage that create little pressure to change, although Tokyo-based interviewees reported that prices are inching lower anyway.

A better litmus test of market moods, therefore, is probably Australia, where, according to one interviewee: "Office valuations are starting to truly reflect where they should sit, and we are starting to see increasing movement towards transactions. Not a huge volume yet, but you get the sense you're going to see more over the next 12 months, just because it'll be easier to bridge that gap between buy and sell."

Although Australian markets are more Western-oriented in terms of structure and transparency, the forces that have instigated local price discovery trends are instructive, and may have general application across Asia. First, activity is being led by local institutions such as domestic real estate investment trusts (REITs) and wholesale funds, which have emerged as net sellers as they move to recycle assets or satisfy redemption pressure. As a result, book values for core assets have declined by some 20 to 25 percent, setting new cap rate benchmarks that are being used to price sales of other central business district (CBD) office assets. As discussed in the "Australia: Key Themes" section (see page 8), two premium-grade Sydney CBD office transactions in the second quarter of 2024 implied an outward cap rate movement of some 150 bps, to levels last seen in 2014 (i.e., around 5.5 to 6.0 percent). The local retail sector has also seen a similar bout of cap rate expansion.

Another reason for thinking an end to the logjam may be in sight is that local banks (or sometimes their national regulators) have become less willing to turn a blind eye to underwater loans, or are at least requiring borrowers to revalue assets and inject more equity to provide a bigger cushion of collateral. This is hardly surprising given how long regional banks have sat tight over this issue since interest rates began rising in 2022.

Exhibit 1-3 **Deal Pipeline at the Start of 4Q 2024**



Source: MSCI Real Capital Analytics.

Exhibit 1-4 **Key Asia Pacific Interest Rates**

Market	Rate	Rate (as of 24Oct 2024)	YTD October 2024	Change in 2023
Japan	Key Policy Rate	0.25	Up 35 bps	Flat
Taiwan	Discount Rate	2.00	Up 13 bps	Up 13 bps
India	Policy Repo Rate	6.50	Flat	Up 25 bps
Australia	Cash Rate	4.35	Flat	Up 125 bps
South Korea	Base Rate	3.25	Down 25 bps	Up 25 bps
Vietnam	Discount Rate	3.00	Flat	Down 150 bps
Singapore	3M SORA	3.49	Down 21 bps	Up 68 bps
Mainland China	1Y Loan Prime Rate	3:10	Down 35bps	Down 20 bps
Hong Kong SAR	3m HIBOR	4.33	Down 82 bps	Up 16 bps

Source: Various.

As a result, according to one fund manager: "I think it's coming, though it varies country by country. If you look at Hong Kong, which is direct delta to rates, and then Australia and Korea, all three are starting to have cracks, and all three I expect to see more pressure to drive outcomes. Banks in Hong Kong have already started to foreclose on assets and push sales and valuation tests, and we're starting to see the same in Australia, and to some extent Korea."

The pain threshold for banks is likely to depend on when rates locally began to rise, as well as the average duration of debt in individual markets. In Hong Kong, for example, where debt is typically for three-year terms, loans coming up for refinancing today are not only more expensive in absolute terms, but probably also non-compliant with debt service coverage (DSC) covenants. In addition to increasing the cost of capital, banks may also ask owners to reduce loan-to-value (LTV) ratios, thereby necessitating even more top-up equity – an increasingly common scenario given that, as of September 2024, LTVs for new loans across the Asia Pacific averaged some 10 percentage points lower than before rate hikes began in 2022, according to JLL.

As the fund manager continued: "If you've got an aggressive bank, and they're pushing an LTV test, are you going to top up your LTV requirements? That forces the conversation. Banks are sitting on a lot of debt, and they now have to make provisions for some of it, or start to enforce. So they're getting tighter on their capital available for new loans, [thereby] creating more scrutiny on other loans."

The Reappraisal Rabbit Hole

Estimating the eventual extent of asset repricing across Asia Pacific markets is difficult because different markets are subject to different cross currents. The consensus among interviewees, however, was that values (using office as a proxy) still have room to fall – a predictable conclusion given that the rebound is still in its infancy and yield spreads remain well below pre-2021 levels. According to JLL, spreads for Asia Pacific prime offices stood at 163 bps in Sydney, 124 bps in Seoul, and 114 bps in Tokyo as of mid-2024 – levels significantly lower than average equivalent spreads of 292 bps, 227 bps, and 280 bps respectively for the 10 years to 2021.

As one Sydney-based fund manager said: "There's a lot of interest from offshore capital in coming to Australia, but the sell is not quite where buyers want it to be. It's narrowing for sure, but we're only seeing a handful of trades at the moment, so that's why I think the values will continue to come down into Q4."

Other insights from interviews include the following:

- Differing valuation techniques make tracking the trajectory of asset values more difficult in the Asia Pacific (where appraisers assess them by reference to recently transacted deals) than in the West, where more flexible approaches, such as market sentiment or discounted cashflow analysis, are commonly used. This can expose local valuation ecosystems to goal seeking by those with vested interests. According to one consultant: "The unfortunate fact is that the sell-side lived in a dream world in terms of what their assets were worth, because the valuations community is complicit, effectively, in maintaining artificially high valuations. So that gap between what buyers thought had become reasonable, and where sellers thought true value lay, having not adjusted their valuations after interest rates had risen, was mythical."

- Notwithstanding this, pricing declines in Asia Pacific markets are unlikely to be as deep as in the United States and Europe. In fact, data from US-based analysts Green Street (see exhibit 1-5) suggests valuations in both those regions may already have bottomed, although some investors have also described it as a lumpy process that may not occur in some major cities until well into 2025.

  Based on that research, however, peak-to-trough pricing declines in the United States as of October 2024 stood at 37 percent for offices and 22 percent for commercial real estate generally. Equivalent figures for Europe, meanwhile, were 37.7 percent and 23.4 percent, respectively. Unfortunately, there

are no equivalent datasets that attempt to track revaluations in the Asia Pacific, probably because of the market-by-market nature of the region, and the challenges in determining where values stand in the absence of more widespread price discovery. In any event, the fact that asset depreciations promise to be relatively shallow is a positive given that much deeper portfolio writedowns in Western markets bring with them potential for systemic risk.

- The limited extent of pricing declines in the Asia Pacific compared to markets in the West makes sense given that local occupancy levels are by and large quite healthy, and that the focus on old-fashioned relationship banking for deal financing – as opposed to the securitised loan vehicles so common in the United States – tends to produce lower leverage and less-convulsive corrections.

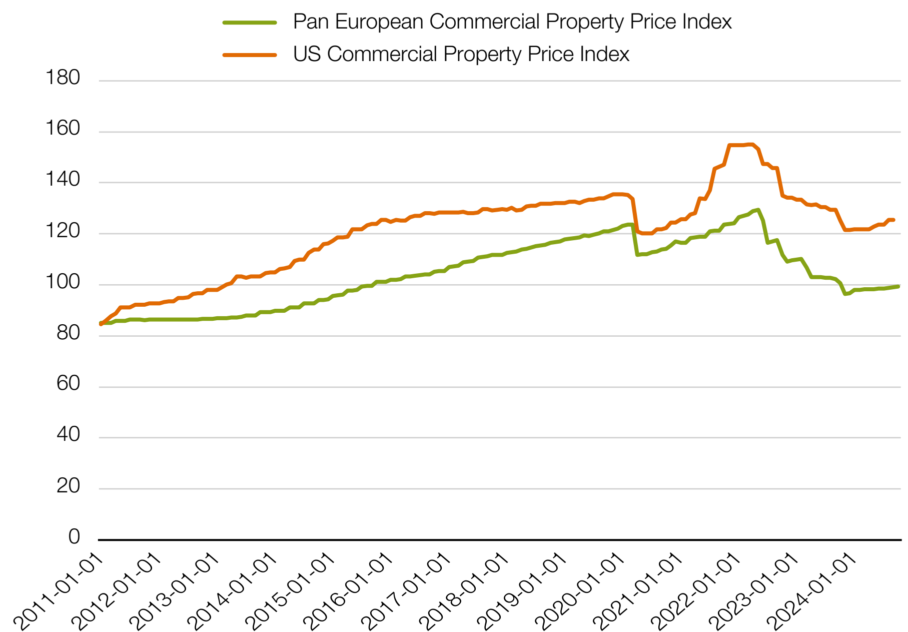
  At the same time, regional office values may still be subject to outsized corrections because the global funds that were the default buyers in the past have been burnt by their experiences in home markets and may therefore not be willing to allocate capital or otherwise compete to secure deals, as recent experience in Australia has proven. As one Sydney-based fund manager commented: "More capital is required by the system [to deal with upcoming redemptions and refinancings], but there's actually less capital coming into it. And what we think that means is that you're going to be able to buy better because it's less competitive."

- Although survey responses (see exhibit 1-6) do not suggest elevated investor concern over financing issues compared to previous years, asset classes that have experienced higher capital value growth and/or cap rate compression (such as alternatives) will be less exposed to bank refinancing (and hence re-pricing) pressure because LTVs and DSCs will not be as stressed as, for example, retail and office assets, where values have in some cases retrenched steeply. The same applies by geography.

- Equally, asset values will be subject to downward or upward pricing pressure depending on secular changes that have altered user demand for different types of properties. In Australia, therefore, requirements for office space have been eroded by the resilience of work-from-home practices, even as employees in other regional markets increasingly revert to office-based working patterns. The retail sector, meanwhile, has been hard hit by the growth of ecommerce competition, though there are indications that cannibalisation of physical retail may have run its course. Demand has also been affected by migration trends, as evidenced by Singapore (due to inbound companies setting up regional headquarters), Hong Kong (as outbound companies leave and fewer Mainland counterparts arrive), and Tokyo (where residential demand has been fueled by the arrival of foreign workers).

- Finally, both buyers and sellers will be motivated to make concessions from their own side of the bid/ask spread. This is partly because funds that have been inactive for the last couple of years have an abundance of dry powder to invest, and partly because they are aware that the rate-cut cycle has begun, providing room for the yield spread to widen naturally over time. In addition, investment managers, especially those with time-limited funds, are under pressure to liquidate assets so they can return capital to their investors. That can only happen once markets begin to function with a degree of normality and liquidity.

Exhibit 1-5 **US, European Commercial Property Price Indices, 2011–2024**



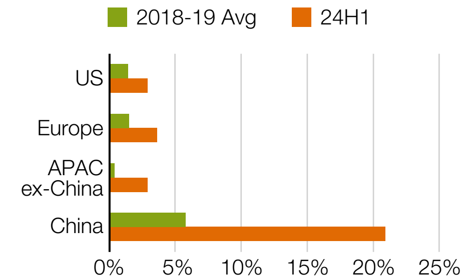
Source: Green Street.

Distress – Don't Give Up

If bank forbearance in recognising depreciating asset values has been the biggest single cause of shrinking transaction volumes, an increase in forced sales should be the first sign that loan portfolios are being appraised more critically.

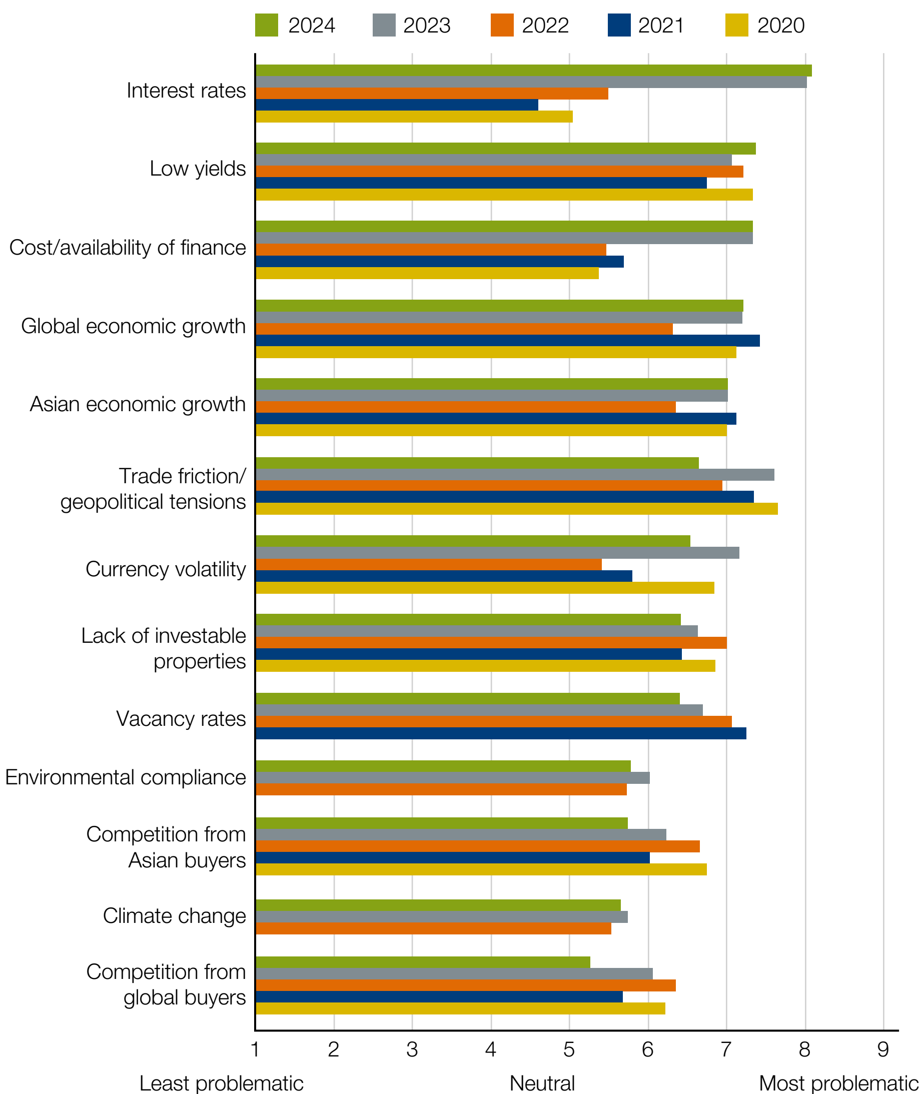
Although banks have no desire to be left holding large portfolios of defaulted, underperforming, and often unoccupied buildings, recent data suggests that distress is now on the rise. In the first half of 2024, according to MSCI, the proportion of distressed sales relative to all Asia Pacific transactions rose appreciably compared to a benchmark drawn from 2018–2019. The fact that most of these sales occurred in China is unsurprising in light of the extent of the downturn in Mainland markets, but the increase has also been visible elsewhere in the Asia Pacific. MSCI commented that the belated surge of distressed deals is significant in terms of identifying a prospective bottoming process, given that similar patterns during the global financial crisis marked a turning point for other market indicators.

Exhibit 1-7 **Share of Deal Volume Resolving Distress Situation, 1H 2024**



Source: MSCI Real Capital Analytics.

Exhibit 1-6 **Most Problematic Issues for Real Estate Investors**



Source: *Emerging Trends in Real Estate Asia Pacific* surveys.

The narrative around distress is a nuanced one, however, and subject to various caveats. First, the types and extent of distress that have emerged have done so in a slow-motion manner that is atypical of conventional distress scenarios involving a market crash, which is why many investors hesitate to label it as distress at all. As one fund manager observed: "There are probably pockets of distressed players, and there are pockets of opportunities. But it's not your traditional commercial real estate [situation]. It's probably going to involve smaller lot, non-performing loans, which I view as a flow trade, just buying debt off banks who are saying: 'we're not going to be able to solve this, so we'll just sell it on to a distress operator'." The cold storage logistics sector in South Korea is one example of this.

Second, even where distressed assets have appeared, they may not be available to transact in the normal way, meaning that dispositions commonly occur via associated parties or as backroom deals.

Third, as noted above, the incidence of distress varies widely by market. For example, Japan's low interest rates and covenant-lite lending terms have fostered an "avoid-at-all-costs" mentality to asset foreclosure, although defaults have occurred among construction companies due to rapidly rising costs of labour and materials. Singapore's stable

fundamentals and cap rates (see exhibit 1-8) have also generated very few foreclosures.

At the other end of the scale, the situation is different. While classic foreclosure sales have been, as usual, rare in China, distress is abundant at both the asset and entity levels, with numerous stressed sales taking place, often on a related-party basis, that are not precipitated by direct bank action (for further discussion, see “China: Key Themes” on page 12). With few foreign funds currently active in China, this means that opportunities to exploit distress are available mainly to local players, although a few foreign funds with feet on the ground and experience in the market have been active.

In the words of one such investor: “There’s been a lot distress in Chinese real estate, and a lot of the big developers and major shareholders are no longer able to get loans from banks, even when they have clean assets in Hong Kong. Those are good targets for private credit deals if Hong Kong assets are used as collateral, or even when you have China assets but with a Hong Kong ownership structure as collateral.” In addition, low cost of debt is available in China for investors looking to leverage distress deals.

Finally, Hong Kong, and perhaps also Melbourne, are the only markets regionally where significant volumes of true distress are appearing – a result of dramatic declines in asset values that have left large numbers of loans underwater (for Hong Kong, see exhibit 1-8). In the former, pressure from the Hong Kong Monetary Authority is pushing banks to clear their real estate loan books, resulting in significant numbers of foreclosures on high-end residential and commercial assets.

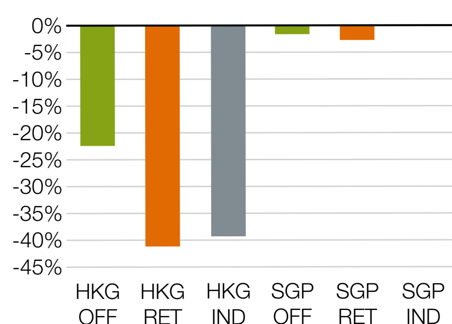
According to a Hong Kong–based fund manager: “To the extent that there are distressed sellers and not that many buyers, prices will continue to drop, and one of the reasons for that is lack of available debt for financing. Banks are really cautious because they have problems within their own loan books, and are therefore unwilling to take on new business. But it’s difficult to buy if you can’t borrow, because very few buyers have 100 percent equity, and there’s not much here in the way of non-bank lending.”

This has motivated buyers to be more aggressive with bids, making Hong Kong the only market in the Asia Pacific where distress selling has created a self-reinforcing spiral of downward pressure on asset prices.

Falling-knife scenarios of this type are notoriously difficult to assess, although they also offer high upside. According to a manager at a global fund: “No one wants to buy a building in Melbourne right now because it’s a terrible market, you’ve got tons of supply, and you’ve got lots of incentives that you take on as an owner. Prices may be off 30–40 percent right now, but how long do you need to hold that for before you see a recovery? How much negative cash flow would you have to sit on until that happens? And what is the return profile, or was it just 40 percent overpriced because of the last cycle? Those are all decisions people need to make.”

While the frequency of distress sales in Asia Pacific markets is likely to increase as banks come under pressure to clean up balance sheets, overall losses have yet to approach global financial crisis levels, and seem unlikely to do so in the absence of a worldwide recession. There are a variety of reasons for this, all of which revolve around structural changes implemented after the 2009 crash; today, Asia Pacific and Western banks are better capitalised, real estate risk is less concentrated, and deals are less levered. Moreover, the ongoing downturn in real estate markets is not, as in previous episodes, a single, concentrated event, and the fallout can therefore be mitigated over time rather than in a cathartic way. Indeed, given the opaque and generally illiquid nature of real assets, it will probably take years for the slow-motion reset in real estate pricing to be seen in its entirety.

Exhibit 1-8 **Singapore and Hong Kong Price Change, Q2'24 vs Recent Peak**



Source: MSCI Real Capital Analytics.

Engineering Higher Returns

The persistence of buyer/seller pricing standoffs is leading investors to pivot away from conventional cap rate compression-related investing in favour of other strategies more likely to meet designated underwriting thresholds, and in particular those focused on cash flow and income growth to drive returns.

As a result, core funds are struggling both to raise capital and deploy it. With few foreign funds now active in China, and the limited number of core transactions in Japan currently dominated by domestic institutions, only Seoul has seen significant recent activity in core offices, although the Australian market may be on the verge of a revival, as noted above. Apart from a longstanding focus on logistics facilities, therefore, core capital has gravitated towards niche asset classes, including data centres.

These are not without problems of their own, however. According to a regional analyst: “It’s the only way for the core money to generate a better return, but at the same, those niche assets come with liquidity risk, and you may also have asset depreciation issues when you want to dispose.” Such investments are therefore usually restricted to first-tier markets.

The decline of core strategies means that opportunistic and value-add plays have become go-to alternatives. Opportunistic investors seek out investments wherever they can, in the usual way. Distress is

firmly on their radar, although as already discussed, it has yet to surface in significant volume on a regional basis, and may never become abundant in the current cycle.

Value-add has also grown in popularity, partly because the move up the risk curve is an inevitable consequence of tighter yield spreads, but also because there has been significant underinvestment in new assets for several years, just as occupiers are actively seeking to upgrade to better-quality, more-sustainable spaces in an effort to attract employees or customers. Some core funds have therefore morphed into shadow value-add plays, buying core assets that are older, or in some way under-managed, in markets with strong fundamentals.

According to a Tokyo-based value-add investor: "Unfortunately, the whole discussion around sustainability has lost a little bit of support, but in markets where there is still sensitivity around that, I do think tenants value the fact that you've taken an older building and upgraded it, which creates much less in the way of CO_2 emissions, versus a brand new building. I don't think that story would fly with most tenants and investors here in Japan, and I don't think in Korea anyone cares enough. But I do think – and I'm generalizing, but it's pretty obvious there is a difference between countries in the region – that it can work in Australia."

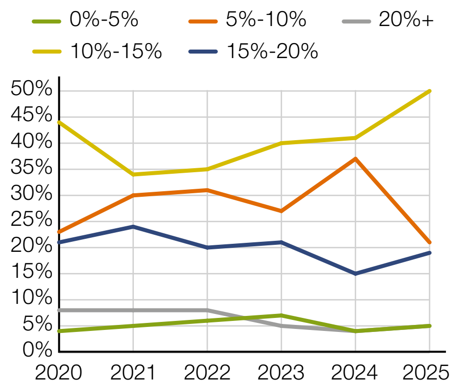
Private credit plays (see page 14) have recently emerged as a prominent strategy in Asia Pacific markets, providing often superior risk-adjusted returns compared to equity investments in the same space. Private equity funds have therefore moved quickly to fill the void left by regional banks as they reduce exposure to real estate lending, although there are questions as to whether private debt strategies will continue to appeal as interest rates decline.

Otherwise, there are strong opinions about the prospects for different geographic markets. Last year, for example, Japan was by far the most popular Asia Pacific destination for cross-border investors, to the extent that it was often the only market in which they were willing to deploy capital. That popularity persists today, although institutional buying in Japan fell in 2024 as concerns grow over prospects for domestic rate hikes (see exhibit 1-11).

Of the other markets, South Korea is viewed positively by investors; Australia is also seen to have good prospects as assets begin to re-price; and while China and Hong Kong remain difficult, there is future potential for buying stressed or distressed prime assets that would otherwise rarely come to market. Lastly, emerging markets are also viewed favourably, with a risk profile that has steadily diminished over time. India, in particular, offers investors opportunities to deploy capital at scale, although it continues to be seen, rightly or wrongly, as a market with significant barriers to entry (see the discussion on emerging markets in chapter 2).

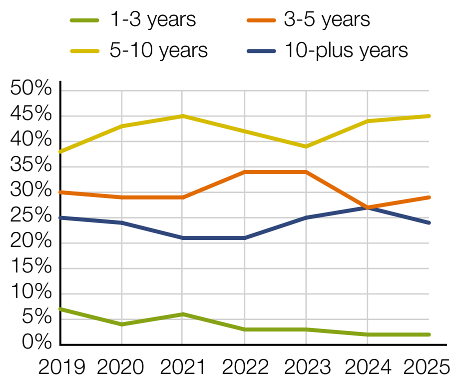
Finally, probably the biggest recent strategic shift for investors as they focus on engineering yield is the migration of capital towards alternative, or "new economy" assets, an issue analysed in the last year's *Emerging Trends* report.

Exhibit 1-9 **Investors' Targeted Returns between Survey and End of 2025**



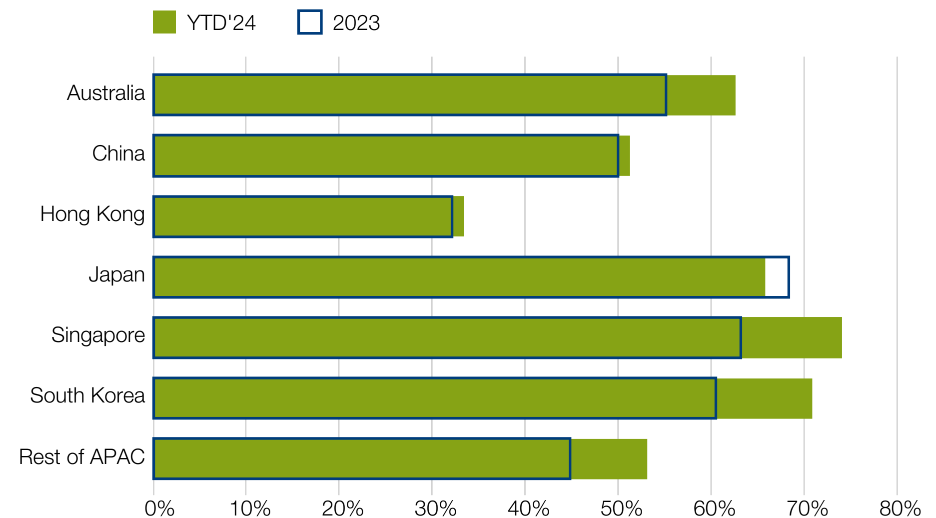
Source: *Emerging Trends in Real Estate Asia Pacific* surveys.

Exhibit 1-10 **Time Horizon for Investing**



Source: *Emerging Trends in Real Estate Asia Pacific* surveys.

Exhibit 1-11 **Institutional Share of Investment, YTD 2024 vs FY 2023**



Source: MSCI Real Capital Analytics.

Australia: Key Themes

Before the pandemic, limited supplies of CBD office stock in Sydney and Melbourne were often subject to bidding wars by foreign buyers who coveted their higher yields compared to equivalent properties in Tokyo, Singapore, or Hong Kong. But the sector stagnated when international investors disappeared in 2021, and transaction volumes have remained muted ever since, with buyers reluctant to pay asking prices based on historical valuations.

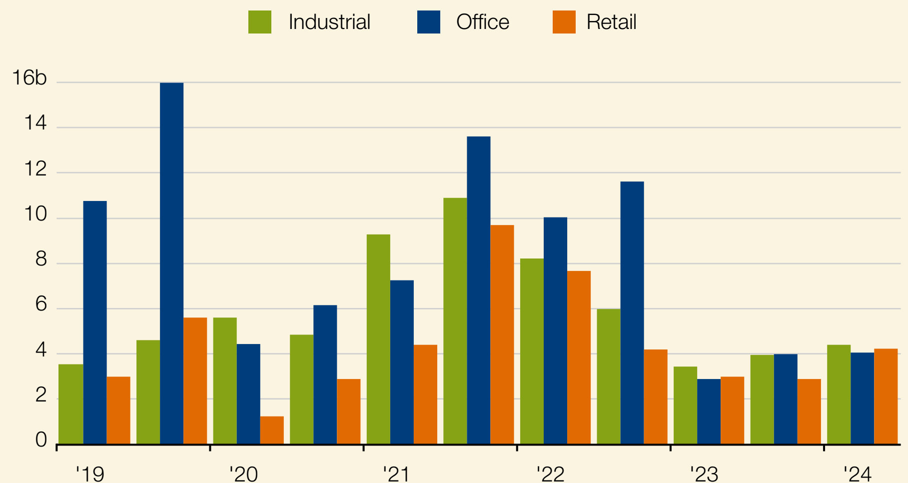
Sentiment changed significantly in the second quarter of 2024, however, after seller pricing concessions led to the first premium-grade office transactions in more than two years, with office cap rates moving out some 150 bps from the peak of the market in 2022 to levels last seen in 2014, or around 5.5 to 6.0 percent.

With values of other asset types also declining, investor activity in Australia (including by foreign funds) increased in the first half of 2024 (see graphic: Australian 1H 2024 Commercial Property Transactions by Sector).

Still, while 20 to 25 percent price declines seem to have ended the buyer/seller standoff, most investors remain on the sidelines in anticipation of further cap rate movement. One reason for this is that falling prices have been partially offset by an increase in incentives, which as of October 2024 had risen to some 30 to 40 percent. In addition, many buildings will require upgrades to bring them up to speed at a time when construction costs are soaring.

According to a Sydney-based fund manager: "Deals are happening, but they are far fewer, and from a very different capital base than we've seen previously. The Aussie domestic institutions are net sellers, and offshore investors are still paralysed by exposure in the US or Europe, so there's no way anyone would be brave enough to put it to a global investment committee. That means the transactions that have happened,

Australian Commercial Property Transactions by Sector, 1H 2024



Source: MSCI Real Capital Analytics.

particularly in Sydney, have mostly been syndicated down to high-net-worth family-office capital."

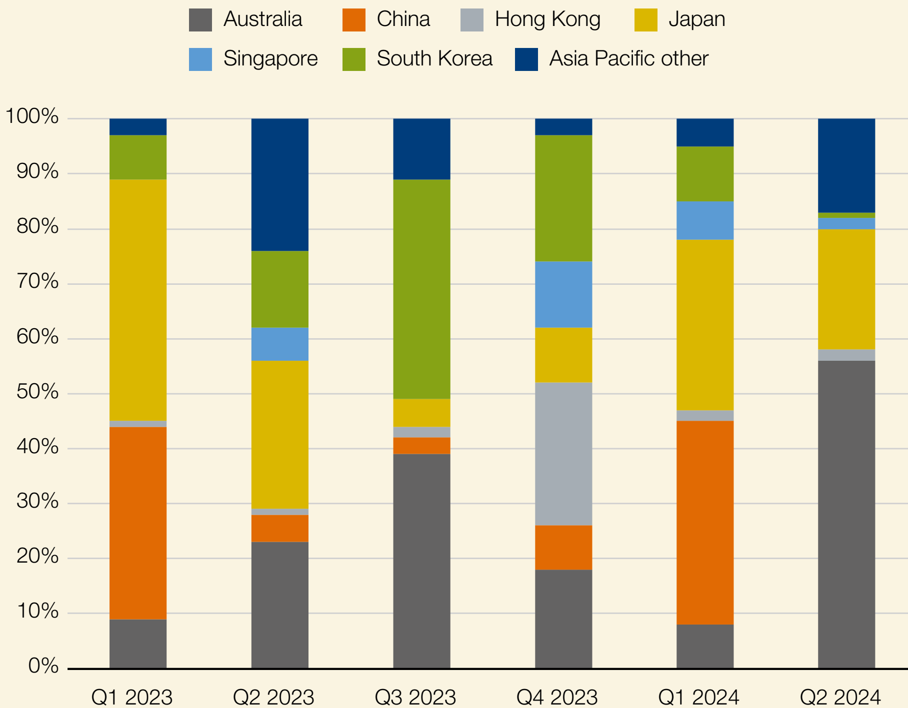
In addition, although Japanese and Singaporean capital has participated in a couple of recent deals, the traditional core assets buyers – REITs, wholesale funds, and offshore institutions – remain net sellers. As a result of the buy-side vacuum, one local opportunistic fund manager said he was able to underwrite "up to mid-teen IRRs on what will be really strong defensive assets for the next 25 years. There's going to be a first-mover advantage, with the best deals getting done over the next 12 months. So there's good money to be made for the brave, because when capital does come back, cap rates will compress again in a heartbeat."

More activity, meanwhile, has been seen in other asset classes. In particular, the retail sector has shown signs of bottoming after an even longer period of decline. One analyst noted that shopping centers in some markets have re-priced to an entry yield of 7 or 8 percent. "It may not be for everyone," he noted, "but I think value-add is a winning formula. Australian retail is very uninspiring, but if someone can bring in that Asian flavor, perhaps using the immigrant students to underpin demand, then at [current] pricing, I think suburban shopping malls will work."

Another strategy that has grown in popularity is private credit, usually in the form of bridge loans and development finance. With authorities unlikely to lower the cash rate soon (from a level of 4.35 percent as of early November), and regulatory constraints continuing to limit leverage provided by big domestic banks, a hole has appeared in the capital stack that non-bank groups have moved to fill. As a result, Australia is thought to account for some 60 percent of the Asia Pacific market for non-bank lending (i.e., both real estate and non-real estate debt), according to estimates by KKR. Mezzanine lending is available at up to 1,000 bps above the cash rate.

As one fund manager commented: "There's been a lot of activity by private credit to support construction of for-sale residential [properties], partly because mainstream banks have pulled back on supplying into that subsector, but also because

Share of APAC Cross-Border Investment Volumes by Market



Source: JLL.

construction companies themselves are in a lot of trouble, with record insolvencies across the industry."

Offices are also proving fertile ground for debt strategies, as ongoing asset revaluations create pressure on borrowers to recapitalise properties, especially for loans collateralised on secondary assets. Although this is a strategy on the radar of many regional investors, Japanese players were identified in interviews as being especially active.

Finally, the living sector is also a focus of attention, just as in other Asia Pacific markets. In particular, the Australian build-to-rent sector, which was the subject of considerable investor interest in 2023, has been tripped up this year by a combination of factors; low entry yields, rampant construction-cost inflation, tax and regulatory issues, and overall business risk in a market for which the model is still very new.

For this reason, the focus has moved away from build-to-rent in 2024, turning instead towards other residential concepts such as student housing and, especially, the land lease market – a senior housing concept where retirees rent land on which they can build and own their homes. Land lease deals registered a record US$1.1 billion in transactions in the first half of 2024, with cap rates for platform acquisitions reaching a "pretty aggressive" 4 percent, and development yields standing at about 5.25 percent. According to one investor active in the sector: "You've got that arbitrage between build-to-core versus buying-core, which is what we see as attractive. Our strategy is around building scale, and then getting re-rated, but the challenge will be continuing to find sites, because it's getting more competitive as more players enter the space."

Briefly put, new economy assets are emerging real estate typologies that aim to ride tailwinds generated by new technological, demographic, or social trends that are uncorrelated to macroeconomic fluctuations. Key to this is the prospect of early entry to emerging industries where competition is less intense (though this can change quickly), growth prospects are potentially explosive, and businesses include an operational component that offers value quite separate from associated real estate assets.

Arguably the most prominent alternative asset class has been the living sector, an umbrella name for a range of short- or long-term accommodation types, ranging from standard multifamily, to senior housing, to student accommodation, to co-living properties.

Living sector narratives resonate with institutional buyers because they dovetail with today's socially oriented institutional mandates. In addition, though, deep structural undersupply across Asia Pacific markets (in many of which they are functionally non-existent) offers deep-pocketed buyers an opportunity to deploy capital at scale, just as the same sectors in Western markets have now become mature. Living assets are discussed in more detail in chapter 3.

The Quest for Structural Alpha

The explosion of investment in data centres beginning around 2018 – with its parallel themes of digitalisation, exponential growth, and demographic-driven demand – represented the dawn of new-economy investing, and came at

a time when many real estate investors questioned whether data centres were actually real estate at all, or just an exotic form of infrastructure housed in high-tech warehouses.

Indeed, even as real estate funds today accumulate ever-larger portfolios of new economy assets, that question remains as relevant as ever, creating something of an existential crisis for an industry that is in the process of re-inventing itself from an "invest-and-sit" exercise in capital placement into private equity-like formats that require varying degrees of operational expertise.

This dichotomy is underlined by the fact that many long-established real estate funds are unable – at least as currently structured – to engage in operationally oriented investing. According to one fund manager: "The challenge with us investing in data centres is the differentiation between real estate and infrastructure, and do we have the right capital to invest in the sector?"

The same problem applies to other asset classes. According to a fund manager investing in residential alternative assets: "The fund I run can only do real estate, so if I found an operator, say an asset manager, that also owned assets, I couldn't buy it with the fund – I'd either have to buy it through some other bucket of money in the company, or work really hard to structure it, and find a partner who will take it on."

That kind of partnership can create a multitude of complications, however. One is how to value assets post-acquisition. Another is how to split profits.

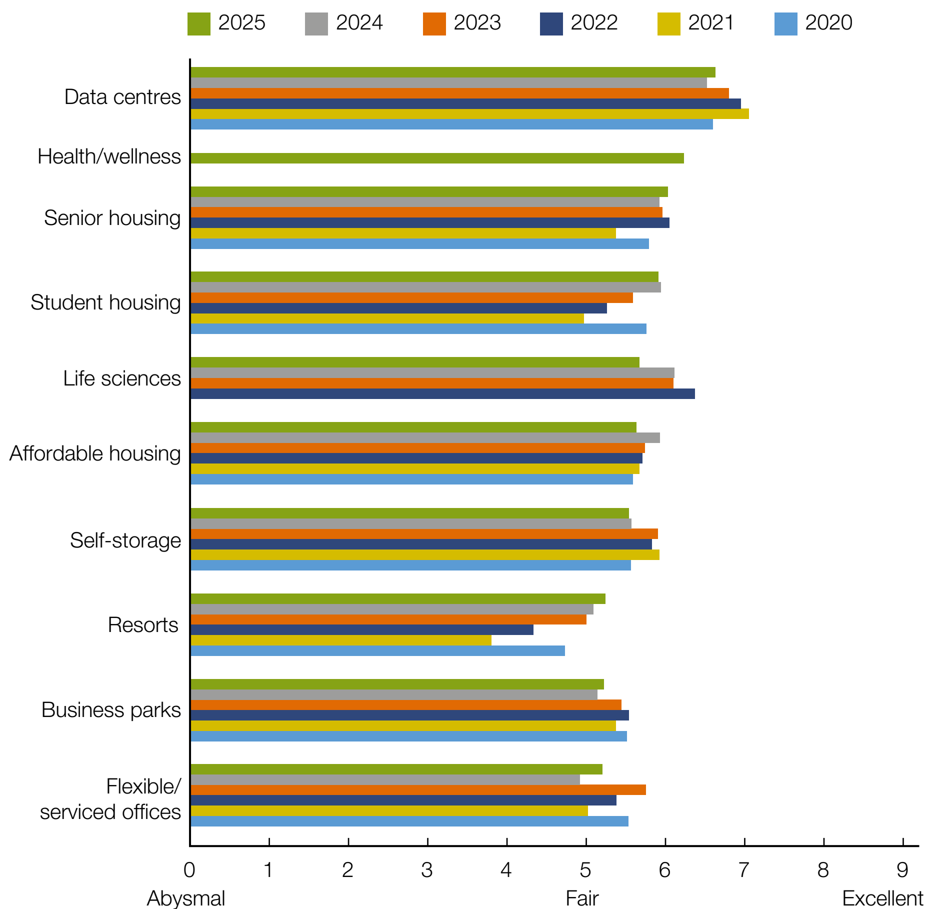
Traditionally, in such arrangements, real estate funds earn rent under sale and leaseback agreements, while the operator pursues its business and retains the income from it. This can be a great proposition for specialist, high-margin operators who want to run capital-lite businesses, and it may also be appealing to funds that thereby gain access to a pipeline of potential deals, especially in an environment where there is more capital than investable assets. Apart from data centres, notable examples of this type of structure can be found in the student housing, co-living, and senior living arenas.

That said, retaining an exclusive focus on real estate can be a real problem for funds given that elevated interest rates, combined with enduringly low cap rates, make it ever harder to achieve targeted returns. As one investor said: "I've been telling my team, look, just do simple math. Don't bring me any deals that are negative carry. But then [doing] that means you're pretty much stuck with either Japan or private credit [as investable deals]."

Nor is this scenario likely to change. Notwithstanding that sellers are beginning to relent on asking prices, the growing sophistication of regional real estate markets has made the industry increasingly competitive. In the words of a Tokyo-based fund manager: "When I showed up 20 years ago and started doing transactions in Japan, yields were much wider – for multifamily, cap rates were 6 percent. Spreads were wider, and there was less transparency and more risk. Today, the market is much more mature, you have a lot more information, it's a lot more efficient. What that means is that all the fat in the market has gone, cap rates are really tight, there's competition for everything, and the pricing is tighter and more transparent."

This new-normal investing environment, together with the fact that funds partnering with alternative asset operators tend to be left with the less-lucrative parts of deals,

Exhibit 1-12 **Prospects for Niche Property Types**



Source: *Emerging Trends in Real Estate Asia Pacific* surveys.

is leading fund managers increasingly to adopt private equity–type mentalities and skillsets, while also bringing operational expertise in-house. Funds can then obtain recurring income in the form of fees, as well as "promotes" or "'kickers" – basically, profit-sharing formats based on operational performance.

According to the alternative assets fund manager: "There's a lot of talk now about 'verticals', where the fund provides the capital and also the operational team that can execute investments in a given specialist space. The capital partners then have control, they have what they call 'structural alpha', which just means you have a team with specialist knowledge and execution ability in a certain sector and geography that can outperform the typical capital provider who's just throwing money out to different managers."

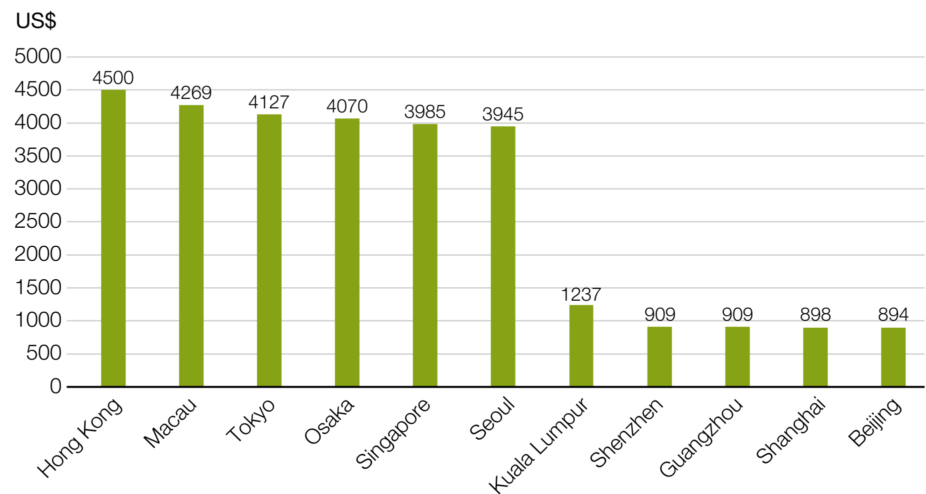
One consequence of this shift towards verticals is a growing tendency for funds simply to buy out operators, providing instant heft in the market, and short-circuiting the need to recruit teams or to master obscure operational disciplines. Platform deals are therefore on the rise, creating a premium for eligible assets, especially in the data centre and senior housing sectors.

Supply Pipelines Shrink

Given the lack of existing stock, growing investor focus on new economy assets comes almost by definition with the need to develop. Build-to-core plays are especially notable among investors targeting data centres, as well as living assets such as multifamily and senior housing projects.

Nonetheless, perceived wisdom among investors in most Asia Pacific markets is that development risk in many cases has become prohibitive. As one fund manager said: "The problem everywhere is that construction costs, and the ability to secure contractors is a nightmare. In Australia, deals aren't even getting to a contractor because costs are just too high for them to stack up, whereas in Japan,

Exhibit 1-13 **Asia's Most Expensive Construction Markets in 2024**



Source: Turner & Townsend.

they kind of stack up, but the contractor tells us we have to wait three years before we develop. So in that sense, it still doesn't [work] because prices are being pushed up over time."

Other concerns about development include ongoing questions over long-term tenant demand, together with lack of appetite for new lending from banks already struggling with growing numbers of underwater loans.

While sentiment towards new construction is therefore poor, some investors are willing to accept development risk for the right projects. According to an opportunistic investor with long experience in build-to-core development, especially in higher-risk emerging market projects: "We're serving needs that aren't being served, and making sure there's value in the buy. So we create that spread, as opposed to just hoping we buy low and sell high, and make sure we deliver at a basis that's low enough where we can make money through cycle. In a way, that's much more controllable than buying a completed asset, as long as you can manage the risks in the delivery process."

In circumstances where underwriting rental growth isn't feasible, he continued, or when cap rates are expanding, or when project economics are changing, the key variable becomes land cost. "In our development deals, because we know construction costs aren't ever going down, land is the adjustable factor," he said. "Previously, everyone said [the price of] logistics land in Japan would never come down – it has, though, and we've seen it adjust in other markets too. But that's where you have to bring something, so it means you're probably making the landowner a partner in some minority way, anything to give them some taste of upside if you get over certain hurdles."

In some cases, risk is contained by the nature of the asset. Land lease projects, for example (and probably senior housing projects generally), are lower risk than high-rise commercial buildings because they have shorter development cycles. In addition, they lend themselves to a phased construction approach that allows postponement of subsequent phases as circumstances require, with initial batches of completed assets generating cash flow that can be redirected to development of later phases.

Still, high levels of construction cost inflation continue to weigh on the industry. Builders are therefore reluctant to commit to fixed-price contracts without padding their quotes for contingent cost increases, which only pushes up costs further. And with investors equally unwilling to

China: Key Themes

Four years after a crackdown on real estate leverage served as the catalyst for what is today an ongoing property sector downturn, Beijing in September 2024 introduced a long-anticipated package of fiscal stimulus, aiming simultaneously to shore up real estate values, revitalise a flagging economy, and end a growing crisis of confidence among Chinese consumers.

Although the government had previously delivered piecemeal bouts of property market stimulus, this "Big Bang" policy change signals a shift by authorities to a more uncompromising stance.

The package has been broadly tailored along similar lines to policies rolled out in the United States, involving massive liquidity injections into the stock market. It contains lower rates, reductions in bank capital requirements, a facility similar to a "repo line" to encourage financial institutions to buy stocks, and specific – though still limited – support targeted directly at the property sector.

There is no question that the September policy initiative marks an important changing of the guard in terms of economic strategy, given the pivot to a fiscal toolset more relevant to China's larger, but slower-growing, economy. However, despite an initially positive response, analysts have continued to call for more pro-growth stimulus, in particular in the form of additional easing, more and better-implemented housing reform initiatives, and – above all – a commitment to a structural shift in the economy that stimulates long-term demand from consumers and the private sector.

While meaningful additional stimulus has been slow to arrive, the government's measured approach is in line with historical practice, with policymakers signalling more stimulus is in the pipeline. This cannot come too soon given both the ongoing decline in home prices (residential values have fallen more than 20 percent from their mid-2021 peak as of the end of September 2024), and the increasing likelihood that the incoming US administration will raise tariffs on Chinese exports.

Prospects for commercial real estate are also depressed. Developer liquidity is still tight, with banks reluctant to offer further financing when so many projects remain at risk, and with many local builders anyway reluctant to deploy capital into a market where demand is weak and valuations continue to fall.

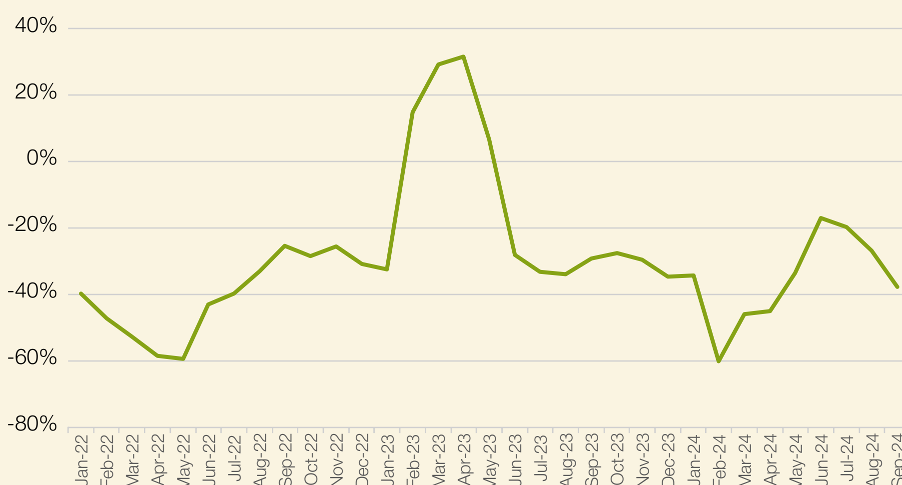
Apart from a few large Hong Kong and Singaporean investors, interest from cross-border capital remains anemic. This is due, first, to a weak economy and elevated geopolitical risk. Beyond that, even funds with in-country teams that can quickly assess potential opportunities have been held back by existing portfolios that are in many cases underwater, as well as by a lack of buyers preventing them from easily disposing of assets.

As one fund manager put it: "Investors already have a lot of China risk in hand, so when they go to their IC [investment committee] and say they want to put on more risk in China, the IC comes back and says, 'go deal with your existing positions first.' So obviously, liquidity has dried up because it's very hard for them to exit." Lack of exit options means that many limited partners (LPs) have capital that remains tied up in China investments, forcing managers to extend fund lives.

In an attempt to address this, some foreign funds have turned to local markets as a source of new capital, creating domestically licensed entities in partnership with local institutions, often with the intention of buying out the interests of foreign LPs looking to exit.

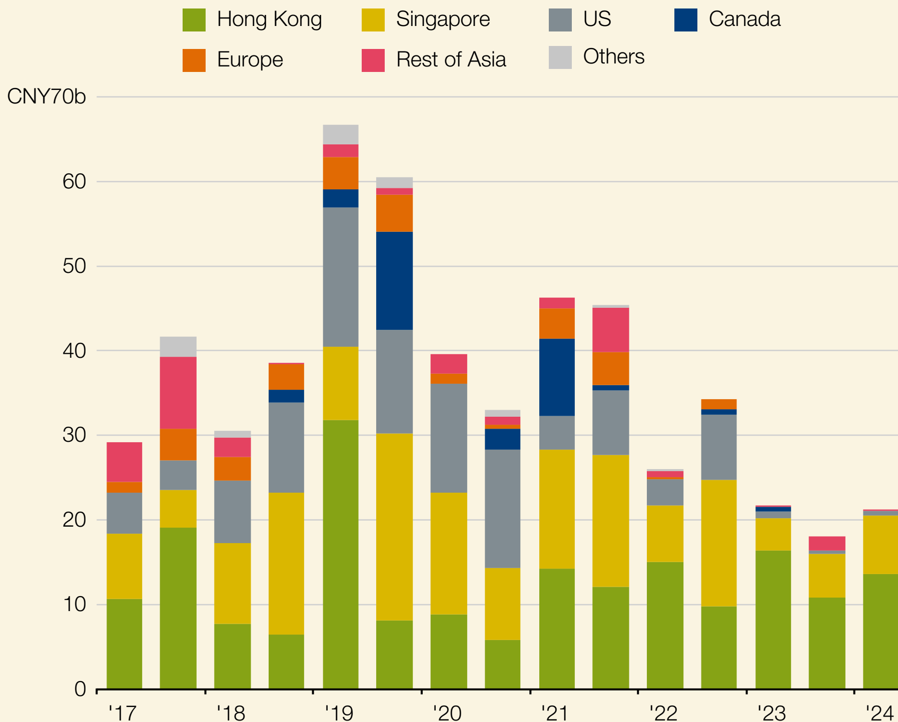
According to one foreign investor: "If you have a team here, it's a natural way to think about it. Even three years ago, foreign funds were the mainstay of institutional real estate investing in China, but never considered [tapping] local investors because they asked the same type of returns, weren't as experienced as the foreigners, and weren't willing to provide blind-pool capital. Now that foreign capital has basically disappeared, local capital becomes the only option."

Monthly Sales by Top 100 Developers Compared With Year Earlier



Source: China Real Estate Information Corp.

Sources of Cross-Border Capital in China



Source: MSCI Real Capital Analytics.

However, while a few international funds have successfully raised domestic capital in this way (in particular for the logistics sector), it remains a challenging exercise given the immaturity of the local market, lack of risk appetite among Chinese investors, and competition from local state-owned players and insurance companies who enjoy in-built advantages in their home market.

Despite current reluctance of foreign investors to accept China risk, the depressed state of domestic real estate markets presents a target-rich environment for those with a longer-term view. Options mentioned by interviewees include:

- **Land banking or acquisition opportunities,** especially for large integrated developers with on-the-ground operations in China. According to one Hong Kong–based consultant: "They are negotiating with local authorities to acquire sites that were never before considered feasible because of cost, but which local authorities are now quoting at prices just a third of what they were [in the past] for mixed-use, CBD, quality locations. So you have to be there, but there is opportunity to take advantage of weakness."

- **Distress.** Ongoing liquidity shortages have led to widespread distress among Chinese developers and commercial asset owners that should logically translate to opportunistic deals. However, while MSCI has reported that more than 15 percent of Chinese transactions (excluding development sites) in the first half of 2024 involved distress (up from an historical norm of 5 percent), the number of transactions has been small relative to the actual number of distressed assets. On the one hand, according to an investor active in the market, asset owners are not incentivised to sell when values have dropped to a point where their equity (commonly 30 to 40 percent of the purchase price) has been extinguished. On the other, banks are not incentivised to foreclose either. As the fund manager observed: "It depends on whether the lender is willing to take a haircut. Foreign lenders might have a more commercial perspective, just to clean up their book. But for local lenders it's a long process, and they don't necessarily want to realize the loss because then it's in a distress bucket, and you have to justify taking [it]. That's why prices are still at the level of the loan values, and these just aren't discounted enough from an institutional investor perspective."

- **Multifamily.** The appeal of multifamily assets in China is largely the result of favourable government policies that provide access to cheap land (anecdotally, 20 percent of the price of comparable for-sale residential land), reduced property tax rates (i.e., 4 percent, compared to the usual 12 percent), and lower interest charges for development loans (i.e., 3 percent, compared to the norm of 4 and 5 percent). In addition, strong local institutional appetite to create portfolios of stabilised residential products offers a viable exit strategy for multifamily assets at a time when transactional activity in other asset classes has slowed. The sector has seen significant activity by foreign private equity investors over the past three years, especially involving platforms of multifamily assets (see page 41 for more).

underwrite the resulting rent increases, there is little question that appetite for building new stock, especially for conventional asset types, will continue to be weak, resulting in postponement or cancellation of many planned projects.

This is not to say the implications are necessarily negative, however, because over the long term, shrinking supply leads to shortages of new stock that may last for years. Especially with so many existing buildings nearing obsolescence, tomorrow's shortages will serve to underpin today's pricing for good-quality existing buildings (including those with value-add potential), making buyers think twice about where asset values should really lie.

As one developer observed: "Inflation in construction means replacement cost of existing assets has increased, so when you look at today's purchase price versus replacement cost, then you're buying an existing asset for 10 percent below that, or whatever it is. That certainly does refocus investor attention on acquisitions versus development."

Debt Trumps Equity

As thinner returns and higher risk make equity investing less appealing, many regional funds have begun deploying capital in the form of debt – a strategy whose appeal has been boosted by the emergence of a funding gap created as regional banks, especially in large markets such as Australia and South Korea, pull back on new lending (see 'Banks Turning the Screws', chapter 2).

According to CBRE, the funding gap between bank lending quotas and market demand for commercial real estate debt will be some US$8.4 billion between 2024–2026, and is especially prominent in markets and asset classes where fundamentals are weak, such as the office sector in Hong Kong. As one locally based fund manager said: "Banks have definitely paused on office lending, and where it's B-grade, or otherwise unable to create yield, that's probably where non-bank providers like ourselves are able to say: 'We can provide leverage – it's going to cost, but we can provide it.'"

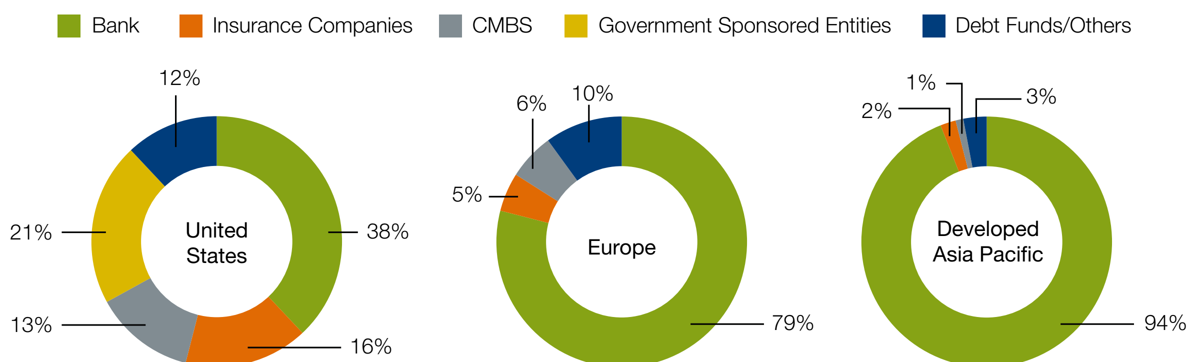
From a capital provider's perspective, the appeal of credit strategies is obvious: they offer both lower risk (including duration risk) than equity-based structures, together with generally superior returns that average between 12 and 15 percent on a senior lending basis, according to one interviewee. That's about 50 to 100 bps higher than in the United States and Europe.

Nonetheless, activity remains marginal. Asia Pacific real estate deals financed by private credit amounted to just 6 percent of the lending market as a whole, as of mid-2024 – a far smaller share than in mature debt markets such as the United States or even Europe (see exhibit 1-14). Even then, most private credit deals in the region have historically targeted special situations such as distressed debt rather than performing credit plays.

Opportunities for non-bank lending vary by market, but those most commonly mentioned by interviewees were:

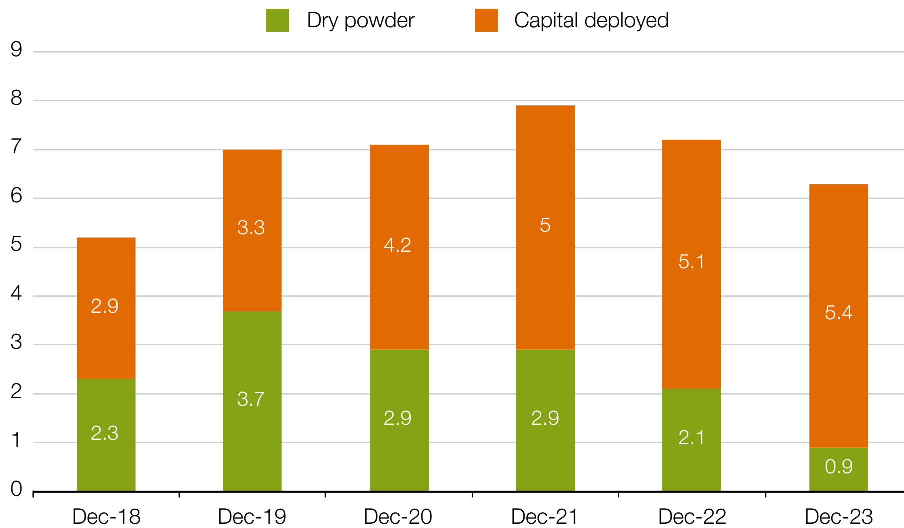
- **Australia** – Regulatory constraints have prevented large domestic banks from completely satisfying demand from real estate borrowers for several years, leaving a hole in the market that investment funds have moved to fill. Some of this relates to asset owners looking for gap financing (in the form of stretch senior or mezzanine debt) as part of an asset recapitalisation. Otherwise, demand may arise from new types of living sector assets. According to one locally based investor: "Given the higher interest rates in Australia, risk-adjusted returns for living sectors with structural growth drivers, and also development loans for brand new

Exhibit 1-14 **Commercial Real Estate Debt Market Composition**



Sources: Mortgage Bankers Association, AFME, ECB, Cushman & Wakefield, MSCI, PGIM.
Note: Developed Asia refers to Australia, Hong Kong, Japan, South Korea, New Zealand, and Singapore.

Exhibit 1-15 **APAC-Focused Real Estate Credit AUM ($bn), 2019–2023**



Source: Preqin Pro.

assets, are quite attractive, which is why we have Korean and Japanese investors looking to Australia for lower risk and higher returns." For these purposes, lending is generally senior-secured, first mortgage.

- **South Korea** – While South Korea is a capital-surplus country, it also offers pockets of distress that private credit is targeting, most recently in relation to overbuilding of logistics assets (in particular cold storage), but also generally for asset recapitalisations. One factor contributing to this is that rents in South Korea are notoriously difficult to increase. Another is that it is such a highly levered market.

A further source of distress is the unusual relationship between construction companies and banks. According to one fund manager: "The dynamic in South Korea is for construction companies to provide guarantees to banks, and we're finding that where they have gotten themselves into trouble, there's often a lot of leverage and a very small amount of equity. So if that's been wiped out, we're able to come in and take out the loan to help finish off the project."

- **Hong Kong and China** – With Hong Kong experiencing probably the deepest pricing corrections in the region, and China not far behind, banks with loan portfolios already deep underwater are reluctant to provide further leverage. This has created scope in both markets for private credit to pick up the slack, especially with so many high-quality assets in Hong Kong available as collateral.

In practice, however, many investors have been reluctant to take the plunge because both Hong Kong- and China-related risk tend to be so opaque. According to one locally based consultant: "I wave a flag of caution, because the opportunity comes with risk. People are in this situation for a reason, and if they're willing to pay 30 to 40 percent [interest], it means they're in some strife. A lot of our clients are doing one-year loans and getting 18-, 20-, 25-percent [terms]. If you can do it for that duration, and you've got someone of reasonable calibre, and if you can get some extra collateral, then you're OK. But very often you can't, so you're lending against the creditworthiness of the individual."

- **India** – Although it tends to be a small market in terms of the dollar value of individual deals, non-bank lending has long played a significant role in India, with demand running the gamut from non-performing loan portfolios to development financing.

While demand for private credit across Asia Pacific markets is therefore rising, fundraising for debt strategies has failed to keep pace, meaning that dry powder is diminishing even as managers deploy their capital. Assets under management (AUM) at Asia Pacific-focused real estate credit managers stood at just $6.3 billion at the end of 2023, according to data from Preqin, with the proportion of dry powder to AUM dropping from 52 percent in 2019 to just 14 percent (see exhibit 1-15).

Despite rapid growth, how long the window for private credit will remain open is uncertain given that, once the easing cycle is in place, most investors will revert to equity strategies as cheaper bank lending again becomes the norm. However, although interviewees noted that demand for non-bank debt is already shrinking in the West, prospects in the Asia Pacific are thought to be more enduring, as financial markets continue to evolve in tandem with local economies.

In the words of one fund manager: "On a global basis, I'd say there are probably too many groups trying to start debt funds, and definitely in markets like the US you have to ask how big is the market opportunity going to be? But Asian real estate is starting from such a very low base – probably less than 5 percent of the [global] market – because the market is still dominated by relationship banking. So I think that five percent could easily become 10 or 15 percent – even that small shift opens a lot of opportunities."

Japan: Key Themes

Japan's low borrowing costs have long served as a magnet for global investors, and with floating-rate debt still available from local banks at sub-100 bps pricing (fixed-rate is slightly more), Japanese markets continue to offer the accretive terms that are the number-one priority for most investors.

Beyond that, Japan's long-term corporate reform story continues (quite literally) to pay dividends. Divestment of non-core assets and other productivity- boosting measures are generating higher profits and greater efficiency, creating a virtuous cycle that has rejuvenated economic fundamentals after decades of deflationary pressure. Nominal wages rose 4.5 percent year-on-year in June – a level that makes rising rents and consumer spending meaningful contributors to economic growth.

Another factor that favours Japan is that,in the absence of investor appetite for China deals, it is currently the only regional market (including Australia) able to offer a critical mass of investment-grade assets.

Nonetheless, as much as global fund managers have continued to beat a path to Tokyo, some interviewees see Japan as a late-cycle play increasingly vulnerable to rising interest rates (even as governments elsewhere begin to ease), as well as to exogenous shocks of the type seen in August 2024, when an ill-timed 25-bp rate rise by the Bank of Japan (BOJ) sparked a carry-trade exodus that led to an instant 10 percent depreciation of the yen, and the biggest points crash in the Nikkei's history.

According to a manager at a global fund: "Spreads and margins [in Japan] aren't as attractive as they were even 12 or 18 months ago, so on a risk-adjusted basis, it's already less attractive. But if you add to that the concern that rates go up 25 or 50 bps, then, you can hope that cap rates will stay flat, but if it's worse [than that], you've got more downside. So we're not as focused on Japan as we were a year ago, and certainly not as much as we were two, three, or four years ago in our high-return strategies, because on a relative basis it's not presenting the same type of opportunity."

This ambivalence towards potential rate increases was reflected in a 46 percent year-on-year decline in commercial real estate transactions during the third quarter of 2024, according to MSCI figures.

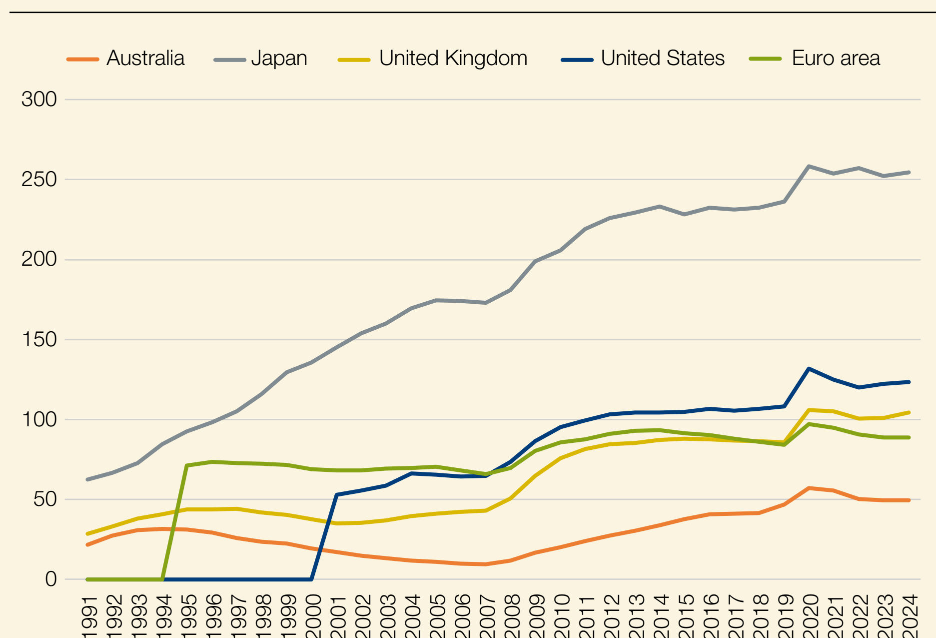
While there is little consensus around how high Japanese interest rates might rise, authorities are constrained by public sector debt that currently stands at more than 250 percent of gross domestic product (GDP), a level far higher than in other advanced economies (see graphic: Japan Government Gross Debt). With the government already spending around 23 percent of its annual budget on debt redemption (i.e., as of 2023, when policy rates were negative and the 10-year government bond yielded an average 0.62 percent), the BOJ will struggle to repay interest on its own borrowing should rates rise significantly above current levels – a factor likely to discourage meaningful rate increases.

According to a Tokyo-based foreign investor: "Most people outside Japan take the view that Japan has no choice but to raise interest rates, without understanding the underlying issues with government debt. Inside Japan, the view is they're not going to raise interest rates because they can't. Japan doesn't care what other people think, they're going to do what they think is in the best interest of the economy – and low interest rates are what keep it going."

The wildcard, therefore, shifts in the direction of currency volatility of the type seen in 2024. Currency hedging for incoming capital is currently both accretive to returns and readily available, meaning that foreign funds can (and generally do) opt for easy protection against future black-swan events. Still, currency instability remains a known unknown that has contributed to the market pause.

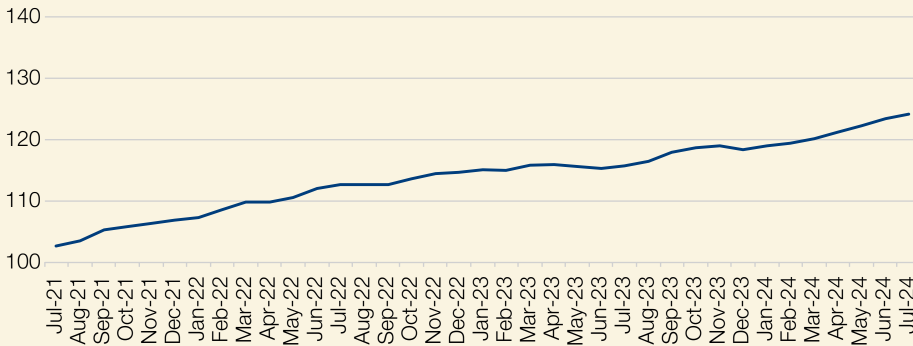
Apart from the interest rate question, another issue concerning investors is that so much foreign capital is competing for a shrinking number of available deals. According to one Tokyo-based fund

Japan Government Gross Debt (Percent of GDP)



Source: IMF.

Japan Residential Property Price Index July 2021–July 2024



Source: Trading Economics.

manager: "Japan has become a very challenging market across the board because of the sheer weight of capital. Everybody we talk to has been either adding resources, or building out new offices, or hiring new teams for Japan, and that's just put more capital in an already crowded space. And so a lot of global capital has been trapped, particularly with the weak yen."

Finally, rapidly rising construction costs are holding back new development. According to a Tokyo-based developer: "If you haven't already secured the general contractor and negotiated your price, you need to pause, in many cases. There's just huge demand and very little capacity among the major general contractors, so they're turning down work left and right, and they're pricing new jobs at record levels. There's now 40 to 50 percent inflation on construction costs in Japan – something unheard of in anyone's career."

The net impact of these various influences is that trading in traditional large assets, such as core office – a sector where foreign capital has anyway rarely been able to compete with domestic institutions – has declined as investors shy away from risk associated with low cap rate deals (in this a case, often less than 3 percent).

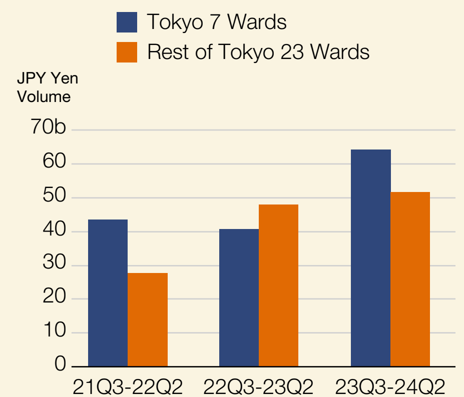
Instead, investors have become increasingly focused on thematic pockets where they can leverage higher returns through asset management. One way to do this is through value-add office, for which there is a ready tenant base given Tokyo's sub-4 percent vacancy rate. Many foreign funds are pursuing this option given the city's large number of older office buildings, and a preference among local owners to redevelop rather than refurb.

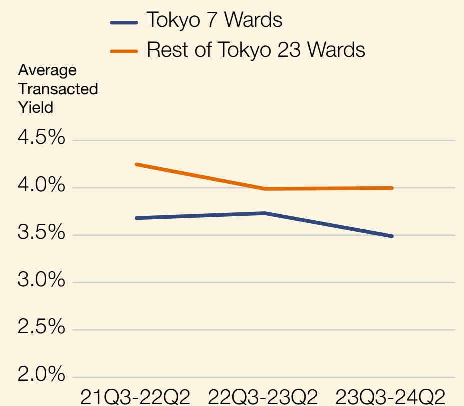
The hotel sector was an especially popular asset class beginning in 2023, as investors looked to buy properties that had become casualties of pandemic-era shutdowns. While distress was plentiful, however, banks proved reluctant to foreclose, and with so many buyers in the market, prices quickly rebounded to prohibitive levels. While interest in hotels remains generally strong, therefore, buying has migrated in the direction of niche facilities with a specific audience such as 'business hotels', rather than in traditional luxury facilities that often struggle to find enough staff to run at full capacity.

Meanwhile, multifamily continues to be the preferred asset class for many foreign buyers. Cap rates remain tight at around 3.5 percent for larger portfolios, and with equally narrow vacancy rates of just 3 to 4 percent, investors are counting on wage growth to drive up rents at a pace that can match or exceed interest rate increases. In addition, population migration into central Tokyo, partly as a result of increasing numbers of foreign residents, has increased demand for rentals, as have all-time-high residential property values (up more than 30 percent in inflation-adjusted terms over the past five years, according to UBS) that have made home ownership unaffordable for many.

In pre-COVID days, many investors looked to buy or aggregate large portfolios of multifamily assets valued at a billion dollars or more, before flipping at a premium to the next institutional fund. Today, investors are more choosy, with buyers – including growing numbers of domestic funds – looking to cherry-pick projects they can operate and manage more efficiently, thereby squeezing out a few more basis points of yield. As a result, large multifamily portfolios are commonly trading at a discount, and smaller assets at a premium, compressing cap rates to as low as 3 percent, according to one local multifamily investor.

Tokyo Multifamily Deal Volume, Yields by Submarket





Source: MSCI Real Capital Analytics.

Sustainability on Hold

The most important sustainability-related issue for Asia Pacific asset managers and investors continues to be the drive for carbon efficiency, a cause that until now has been led by the low-carbon mandates of global (and especially European) institutional investors, as well as the requirements of multinational tenants who increasingly require buildings they occupy comply with baseline sustainability requirements.

It is probably fair to say, however, that with the commercial real estate sector currently under mounting financial pressure from low occupancy rates and falling asset values, the cost of implementing often expensive carbon-efficiency strategies has led many investors/owners to put off asset upgrades as they focus on other priorities. In the words of a Tokyo based investor "In an operationally challenging environment, owners are choosy on where to spend capex and unlikely to prioritise spending on older buildings in the short term."

Also, according to a fund manager raising capital for an Asia Pacific brown-to-green retrofit strategy: "We do have a good pipeline [of assets] globally, but capital has been slow to respond. People understand intuitively that it makes sense, but they want to know details of the financial performance, which leads to a chicken-or-egg situation. So I'm very focused on financial returns, trying to pick examples from our own portfolio as case studies to show that it's financially accretive – that has to be the crucial part of the story."

Another factor hindering the progress of carbon mitigation efforts is that, despite the efforts of a select and vocal group of big developers and institutional investors at the top end of the market, the level of institutional ownership of commercial real estate remains much lower in the Asia Pacific than in the West, meaning that both visibility and knowledge of energy efficiency issues tend to be diluted among a sea of smaller players.

Other obstacles to widespread adoption of sustainability initiatives are lack of consistency of decarbonisation pathways in different markets, the complexity of associated technologies, and an often-impenetrable industry jargon that is sometimes lost in translation across Asian language barriers.

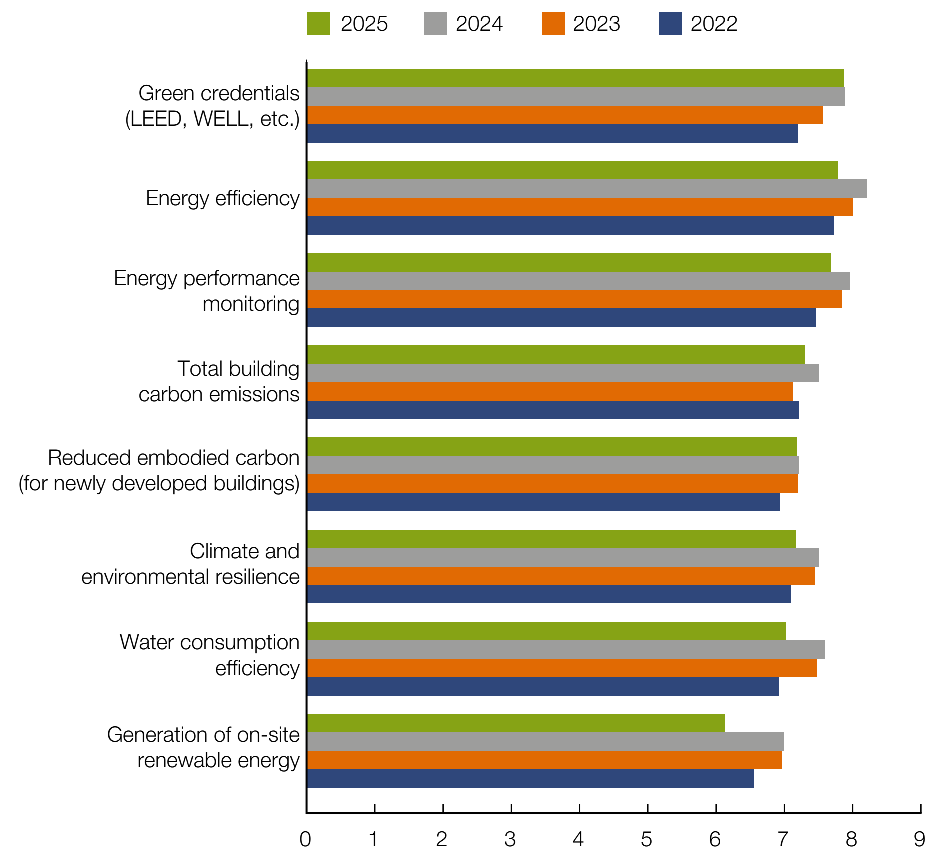
Progress is being made, however. In particular, more effort is being directed to demystify carbon-mitigation agendas, often led by different regional green-building organisations responsible for local certification standards, such as BREEAM, LEED, Green Star, Green Mark, and HQE.

The world of green finance is one example. While green loan and bond offerings are now widely available for deal financing, uptake in Asia Pacific markets has been hindered by the large number of different of taxonomies (i.e., classification systems published by regulators to help asset owners assess the sustainability of their projects), as well as by differing methodologies adopted by the regional green-building ratings tools (such as those listed above) that are commonly used by banks when assessing eligibility.

A recently-published guide compiled by five major global green building councils has sought to cut through the maze of regulation and standardisation by comparing and cross-referencing the different ratings tools, taxonomies, and green finance principles.

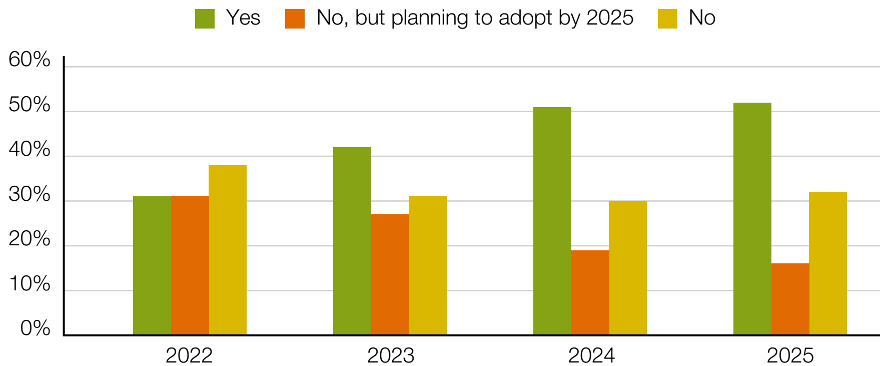
Impending regulatory changes are another factor militating towards further change. Recent reforms, in particular

Exhibit 1-16 **Which are your organisation's most important green building criteria?**



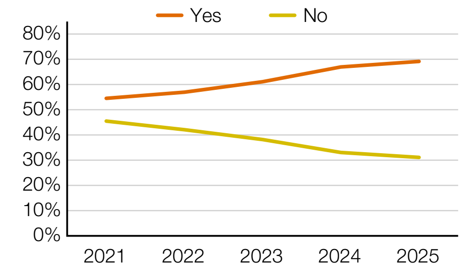
Source: *Emerging Trends in Real Estate Asia Pacific* surveys.

Exhibit 1-17 **Does your organisation's real estate strategy include a net-zero carbon emissions target?**



Source: *Emerging Trends in Real Estate Asia Pacific* surveys.

Exhibit 1-18 **Does your organisation require that assets in which it invests comply with certain baseline ESG criteria?**



Source: *Emerging Trends in Real Estate Asia Pacific* surveys.

in Australia and Singapore, include mandatory disclosure of energy consumption data for large buildings, the development of new taxonomies, and the integration of the International Sustainability Standards Board's (ISSB's) sustainability reporting standards for listed companies in various local jurisdictions. Taken together, these developments suggest that regulatory frameworks are rapidly evolving in a direction that will ultimately align regional rulebooks with more stringent regimes already in place in the United States and (especially) Europe.

Embodied carbon

Another sustainability-related issue that has recently risen to prominence in Asia Pacific markets relates to embodied carbon. As opposed to operational carbon – which involves greenhouse gas emissions generated during use of a building – embodied carbon refers to emissions associated with a building's entire life cycle, including extraction, transportation, and manufacturing of construction materials, as well as in the construction process and the building's ultimate demolition and disposal.

Embodied carbon represents some 15 percent of building sector emissions in the United States, according to the US Energy Information Administration, but the figure can be much higher in developing countries (such as China, where it represents as much as 55 percent).

Addressing embodied carbon in individual buildings is a complex exercise, partly because of inconsistent or inadequate standards used in different jurisdictions, partly because of a lack of tools able to calculate the embodied carbon contained in any given unit of locally sourced construction material, and partly because local building industries (in particular construction companies) remain largely ignorant about the issue and how to address it.

In practice, however, the intricacies of calculating and reducing embodied carbon loads is simplified by the fact that somewhere between 70 and 90 percent of most buildings' embodied carbon emissions is contained in two basic construction materials: steel and concrete. Using low-carbon versions of those commodities carries a negligible premium in terms of the finished cost of a standard commercial building, and is therefore an efficient way to achieve substantial reductions in embodied carbon emissions.

The harder part, however, lies in identifying reliable sources of supply. Low-carbon steel, in particular, is scarce in Asia, especially when developers have to compete with automakers to secure it.

China, which is by far the largest global steel producer and is likely to be the main source of low-carbon supply in the Asia Pacific, has a comparatively young blast furnace fleet that is mostly incapable of delivering low-carbon product. Indeed, current steel production using the latest H2-DRI processes in China is miniscule, and any attempts to increase it significantly would be both expensive and subject to government approval that may be hard to obtain in the current economic climate.

Nonetheless, the industry pathway in China has been defined, and with the government continuing to actively regulate carbon emission issues, there is a reasonable chance that policy changes may be in the pipeline that would bring substantive change to the Chinese steel industry's production profile in favour of low-carbon product.

Chapter 2: Real Estate Capital Flows

"Even if interest rates go down, I think prices still have some way to fall. But there's now a better balance between the fear and greed sides of the equation, so if you're cashed up to buy then you can make an offer and wake up the following day thinking: we should be okay with this one."

With regional transaction volumes, yields, and interest rates percolating at around last year's levels, there's little surprise that the 2025 *Emerging Trends* investment prospect rankings also show little change. Six cities, therefore, scored in the "generally good" category (the same as last year), three fell into the "poor" category (again, the same), and sentiment overall registered slightly lower levels than those in 2023, but roughly on a par with surveys in the two prior years.

While 2021 and 2022 responses might be seen in retrospect as overly positive at a time when rate hikes were impending, this year's relatively upbeat outlook – coming just as a global easing cycle kicks in – is easier to understand, especially as signs emerge of a middle ground in the long standoff over bid/ask pricing. Beyond that, it also corresponds with our survey's relatively positive view on profitability noted in chapter 1 (see exhibit 1-2).

Exhibit 2-1 **City Investment Prospects, 2025**

Generally poor / Fair / Generally good

Rank	City	Score
1	Tokyo	6.78
2	Osaka	6.07
3	Sydney	6.01
4	Singapore	5.83
5	Seoul	5.70
6	Melbourne	5.60
7	Bangkok	5.10
8	Ho Chi Minh City	4.95
9	Mumbai	4.93
10	Taipei	4.89
11	New Delhi	4.85
12	Bangalore	4.75
13	Auckland	4.69
14	Kuala Lumpur	4.66
15	Manila	4.55
16	Shenzhen	4.51
17	Jakarta	4.42
18	Shanghai	4.39
19	Hong Kong	4.33
20	Guangzhou	3.69
21	Beijing	3.65
22	China - second-tier cities	3.09

Source: *Emerging Trends in Real Estate Asia Pacific 2024* survey.
Note: Cities are scored on a nine-point scale.

In terms of individual city rankings, responses are heavily skewed in favour of distinct geographical groups, again mirroring the 2024 survey. Japan, therefore, remains the favourite, followed by Osaka in second place. Both cities scored slightly higher than last year, even though sentiment among interviewees seemed somewhat weaker. While Japanese assets are still prized for their accretive yields, therefore, and have become the natural alternative for capital that might previously have been directed to China, the large numbers of foreign buyers currently competing for deals in Japan are seen by some as signalling a potential market peak, especially with rates hikes looming in 2025.

According to a fund manager at a global fund: "Japan feels a lot like the rest of the world two years ago and before, where it's very tight, you're having to get really aggressive on rental assumptions, or you're going to have to underwrite cap rate compression that in today's world feels pretty tough. That's why for most of foreign investors, it's gotten harder to find transactions that really hunt."

Strong results for Sydney are also consistent with sentiment from interviewees, whose views on Australia were arguably more bullish than for Japan. With Australian owners now beginning to re-price assets on a basis that better reflects cost of debt, investors are more positively inclined towards Sydney core properties that have sat unsold for several years. Although most interviewees continue to wait for further outward movement in cap rates, global funds have begun to circle, suggesting further transactions and a healthy move towards normalisation in 2025.

Exhibit 2-2 **Cities Most Likely to See Office Rental Growth in 2025**

Decline / Increase

Rank	City	2025	2024	2023
1	Tokyo	6.23	5.96	5.12
2	Sydney	5.88	6.09	5.03
3	Osaka	5.85	5.73	4.58
4	Seoul	5.81	5.98	4.49
5	Bangalore	5.73	5.58	3.40
6	Shanghai	5.73	4.86	4.55
7	New Delhi	5.72	5.41	4.16
8	Mumbai	5.67	5.55	3.90
9	Taipei	5.50	5.16	3.90
10	Ho Chi Minh City	5.33	5.33	4.94
11	Kuala Lumpur	5.15	5.33	3.98
12	Melbourne	5.14	5.70	4.58
13	Bangkok	5.08	5.44	3.91
14	Jakarta	5.08	5.17	4.40
15	Manila	5.05	5.42	3.98
16	Auckland	4.51	5.02	3.68
17	Singapore	4.29	6.24	5.81
18	Shenzhen	3.98	5.05	4.35
19	Hong Kong	3.88	4.81	4.45
20	Beijing	3.70	4.63	4.15
21	Guangzhou	3.52	4.52	4.06
22	China - second-tier cities	3.03	3.91	3.55

Source: *Emerging Trends in Real Estate Asia Pacific* surveys.
Note: Cities are scored on a nine-point scale.

The market in Melbourne, meanwhile, continues to suffer from a COVID hangover, with high vacancies and sizable leasing incentives still the norm. Rent growth prospects remain relatively weak (see exhibit 2-2), and even with prices discounted 30–40 percent, buyers remain thin on the ground. According to more than one interviewee, there may be opportunities for distress purchases once investors begin to see clearer signs of a bottom.

Of the other two top-ranked cities, Singapore remains evergreen. Office pricing has remained remarkably stable through the downturn, supported by tight supply and strong demand from inbound corporate occupiers. Equally, though, most investors see local cap rates as too tight to be buyable. While it continues to "bubble along", therefore, transaction volumes have been anaemic, although a couple of large deals in the third quarter of 2024 bumped up annual transactions to near-2023 levels.

One interesting detail coming out of our survey results is Singapore's relatively poor office rental growth prospects (see Exhibit 2-2). Considering the city's office rents have risen strongly for several years, this is probably indicative of concerns over incoming supply, as well as long-compressed cap rates (around 3.4 percent), which stand well below cost of debt at 3.94 percent as of the third quarter of 2024, according to JLL.

Rounding out the top-ranking cities is Seoul, whose counter-cyclical outperformance is drawing "phenomenal" numbers of inquiries, according to one brokerage analyst. The Seoul office market, in particular, boasts some of the tightest occupancy in the world, making it a magnet for buyers in 2023 and most of 2024. However, strong recent rental growth makes further increases difficult to underwrite, and some investors think the sector may have reached a cyclical peak, especially with new supply arriving in 2027.

Seoul logistics assets have therefore become the new investor favourite, following an episode of overbuilding that has created a wave of distress opportunities (including private credit recapitalisations), particularly in the coldstorage area. According to a fund manager active in the Seoul market: "First, it was overbuilt. Then, to make the returns work, people took on more leverage – [Korea] is our most highly levered market outside of Japan, the only place we'd go up into the high 70s, for example, on debt. And then you had an economic slowdown and interest rates went up. It's just a classic real estate cycle."

Meanwhile, the bottom of the table is again dominated by cities in China, reflecting a wariness of Chinese assets that is perhaps not always justified given opportunities on offer for long-term investors. Apart from predictable concerns over the domestic economy and a huge overhang of office supply, another overarching issue is the need for governance-type reforms. According to one fund manager: "There are a lot of granular things they need to do to improve the transparency of owning real estate – everything from renewing land title, bringing capital into China and then remitting it, and domestic issues relating to the housing market and banks. They just need to level the playing field for institutional investors, and until they do I don't see foreign investors are going to come."

Development Prospect Rankings

Survey responses showed positive sentiment for cities at the top of this year's development prospects rankings, where results were again comparable to those from 2024. At the same time, cities ranked mid-table and below recorded scores that were noticeably weaker than last year.

Exhibit 2-3 **Historical Investment Prospect Rankings**

	2025	2024	2023	2022	2021	2020	2019	2018	2017	2016
Tokyo	1	1	2	1	2	2	4	7	12	1
Osaka	2	3	4	6	8	8	5	10	15	4
Sydney	3	2	3	3	3	4	3	1	9	2
Singapore	4	4	1	2	1	1	2	3	21	11
Seoul	5	6	5	5	4	10	9	19	17	7
Melbourne	6	5	6	4	6	5	1	2	16	3
Bangkok	7	10	11	16	14	11	11	16	8	19
Ho Chi Minh City	8	8	7	8	5	3	7	5	4	5
Mumbai	9	9	12	17	15	12	13	12	2	13
Taipei	10	19	17	13	11	14	21	22	22	17
New Delhi	11	7	13	19	18	15	17	20	13	16
Bangalore	12	15	21	20	21	16	16	15	1	12
Auckland	13	14	15	11	13	19	20	9	14	10
Kuala Lumpur	14	13	14	22	20	21	22	21	19	21
Manila	15	17	16	21	19	17	19	18	3	8
Shenzhen	16	11	8	9	9	6	8	6	5	18
Jakarta	17	18	9	18	16	18	15	14	7	6
Shanghai	18	12	10	7	7	7	6	4	6	9
Hong Kong	19	16	18	14	22	22	14	13	18	15
Guangzhou	20	21	20	10	10	9	10	8	10	20
Beijing	21	20	19	12	12	13	12	11	11	14
China – second-tier cities	22	22	22	15	17	20	18	17	20	22

Source: *Emerging Trends in Real Estate Asia Pacific* surveys.

The handful of higher scores may seem counter-intuitive given negative feedback about development risk expressed by interviewees, who cited rapidly rising construction costs as an acute problem. In addition, new development projects have to contend with limited availability of construction finance, potentially secular declines in demand for some asset classes (i.e., office and retail), and ongoing uncertainty over occupancy and cap rate trends.

In most markets, therefore, development activity has declined. As a Tokyo-based developer observed: "For industrial, we're definitely seeing a lot of projects on hold, and for major office projects in Japan, I've heard some projects have come to a halt or are doing redesign – value engineering – to adjust to the new reality of higher costs." Ultimately, however, the depleted pipeline of new building stock will function to support the market, allowing existing oversupply to be absorbed more quickly.

Problems with new development projects are especially apparent in Australia, and are one reason the domestic build-to-rent industry has recently lost momentum. Not only are there acute shortages of labour given the availability of other work on multiple large infrastructure projects around the country, but rapidly rising costs continue to take their toll on local builders. According to one locally based fund manager: "There are so many insolvencies that they're getting stuck, and then they have to figure out what to do with a half-built product."

In some circumstances, however, build-to-core projects remain the only option to manufacture new stock, especially in alternative asset sectors where demand is strong and existing supply is low or non-existent. One obvious focus for new development is data centres, with exponentially growing demand generating a substantial pipeline of new supply, particularly in emerging economy locations where both land and grid connections are easier to secure. Malaysia's Johor is one example.

Exhibit 2-4 **City Development Prospects, 2025**

Generally poor | Fair | Generally good

Rank	City	Score
1	Tokyo	6.20
2	Osaka	5.83
3	Sydney	5.73
4	Singapore	5.57
5	Seoul	5.51
6	Melbourne	5.49
7	Ho Chi Minh City	5.05
8	Bangkok	5.05
9	Mumbai	5.01
10	New Delhi	4.93
11	Taipei	4.90
12	Bangalore	4.84
13	Manila	4.83
14	Kuala Lumpur	4.78
15	Jakarta	4.70
16	Auckland	4.67
17	Shenzhen	4.11
18	Shanghai	4.08
19	Hong Kong	3.98
20	Beijing	3.45
21	Guangzhou	3.34
22	China - second-tier cities	3.07

Source: *Emerging Trends in Real Estate Asia Pacific 2024* survey.
Note: Cities are scored on a nine-point scale.

Senior housing is another asset class seeing significant forward-purchase activity, with many build-to-rent developments underway in markets such as Australia, South Korea, and Japan, among others.

Investors Flock to Emerging Markets

A final noteworthy feature of this year's city prospects tables is the relatively favourable assessment for emerging market economies, especially Vietnam, Thailand, and India, which continue to benefit from an exodus of manufacturing capacity from China. While "China plus one" outflow has been a gradual migration many years in the making, momentum picked up recently due to rising geopolitical tensions and the often non-negotiable directives of multinational buyers over the location of manufacturing facilities.

Vietnam was the original beneficiary of the out-of-China movement, and its industrial park/logistics sector continues to power ahead as the region's most prominent emerging market investment thesis. While the local supply pipeline is delivering worryingly large amounts of ready-built factory and 3PL space, strong Vietnamese export growth (up 15.4 percent year-on-year in the first nine months of 2024) means it is quickly absorbed. According to one foreign investor involved in industrial park development in Vietnam: "There's currently a slowdown because of uncertainty over the US election, but while some of our tenants are saying they're 'waiting and seeing', they're not waiting and seeing on tariffs, because if more tariffs are put on Vietnam, they're still going to be lower than in China."

Most of Vietnam's new industrial capacity is being developed in its northern provinces, which have better infrastructure and lower land prices than in the south, and are within easy reach of factories in China. Top industries include electronics, renewables, and auto-related products. According to the same investor: "Our Vietnam program is all northern Vietnam, and 80 percent of the tenant base is Mandarin speaking. So it's largely a Chinese diaspora that's coming out. It's not going to India because India won't allow it, so Vietnam gets some protection that way. But we prefer the north to the south because it's a 12-hour truck drive from Dongguan [i.e., near Shenzhen, in China's Guangdong province]. We've had Chinese tenants say to us, 'we just view Haiphong [i.e., Vietnam's major port in the north] as the southern-most province of China'."

Perhaps the most challenging problem with emerging markets, apart from elevated overall risk, is that they lack scale – individual projects are usually too small to absorb capital at the rate most investment funds want to deploy it.

India in Demand

The one exception to this is India, whose vast population includes a young and increasingly educated demographic that is pushing the country by increments up the economic value chain. Given that the Indian economy is currently just 12 percent the size of China's, there is obvious blue-sky potential to scale up over time. A recent projection by private equity firm KKR estimated that India could represent 20 percent or more of total global growth over the next five to seven years.

Deal volumes in India increased 29 percent year-on-year to $4.5 billion in the first nine months of 2024, according to MSCI. While still small compared to the $27 billion recorded in the same period by China, both rapid institutionalisation and the evolution of a domestic asset management industry are acting as catalysts for growth.

In the past, most foreign investors in India focused on developing large campus-style office complexes housing tech and international outsourcing operations. Office take-up continues to grow, fed by rising demand from the Indian domestic market, outsourcing companies, and tech multinationals who are building their own global capability centres that cater to both Indian and global demand. As one investor observed: "It's probably the only place in the world where you're seeing this type of scale of office development at the moment."

In addition, global capital is increasingly investing across the spectrum of asset classes, including retail, logistics, core CBD office, life sciences, data centres, and for-sale residential.

The problem for most foreign investors, though, is that cross-border flows remain mainly the preserve of a cabal of global funds, almost always with a presence on the ground, and usually in partnership with a prominent local player. Given the small base of stabilised institutional-grade assets, their focus tends to be on development, which also delivers the level of risk-adjusted returns they seek.

There are also many smaller foreign funds that would like to invest in Indian income-producing assets, but have so far made little headway given the lack of stabilised properties, and the small deal sizes available. As one foreign fund manager active in India said: "If you're an income buyer trying to get in, then it's pretty tightly held – the big guys are controlling a big chunk of the market. On the development side, there's a lot more opportunity, but people are more nervous about that. There are really strong development spreads in India, and you can deliver on the ground if you can, but you have to know how it works and underwrite for it."

Another area where the Indian market offers good prospects is in the area of private credit. The collapse of the Indian non-bank finance sector in 2019 resulted in a slew of non-performing loans that continue to trickle onto the market, according to one foreign investor. In addition, regulatory restrictions that limit access to bank-supplied lending for real estate development are also creating opportunities for foreign investors to provide private debt, especially for development finance.

Returns for senior secure debt are high. According to one Singapore-based fund manager: "Typically, if I'm in the 16 to 20 handle of return, I need to be subordinate. But that's not the case here – we've had transactions as high as 20 to 22 percent [for senior secure]. There is then some friction due to taxes and being a foreign investor, so by the time you net to the dollar, you're at 14, 15-ish."

Exit options are another challenge for equity investors. The rapid evolution of an Indian REIT market has now created opportunities to exit for those big enough to sponsor their own vehicles, but Indian REITs have yet to buy assets from non-sponsors (although one such deal was under contract at time of writing), so this route is applicable mainly for those with platforms big enough to be packaged and sold. As a result, in the words of the Singapore-based manager, "we've used every avenue we think makes sense in

Exhibit 2-5 **Most Active Asia Pacific Real Estate Markets 3Q 2024**

		Q3'24 Volume		YTD'24 Volume	
		$bn	YOY	$bn	YOY
1	China	9.3	15%	27.0	-5%
2	South Korea	6.3	24%	17.6	25%
3	Japan	5.8	-46%	29.7	-9%
4	Australia	5.1	20%	14.6	14%
5	Singapore	3.0	520%	5.7	-8%
6	Taiwan	2.0	312%	4.9	68%
7	Hong Kong, SAR, China	1.9	97%	5.0	0%
8	India	0.9	-42%	4.5	29%
9	Malaysia	0.2	68%	1.7	93%
10	New Zealand	0.2	-70%	0.5	-47%
	Other Asia Pacific	0.0	-96%	0.9	-27%
	Grand Total	34.6	6%	112.1	3%

Source: MSCI Real Capital Analytics.

the cycle: domestic capital, private sales, portfolio sales, sponsor-led recaps, all sorts of things. But yes, exit is always an issue."

Global Funds Returning?

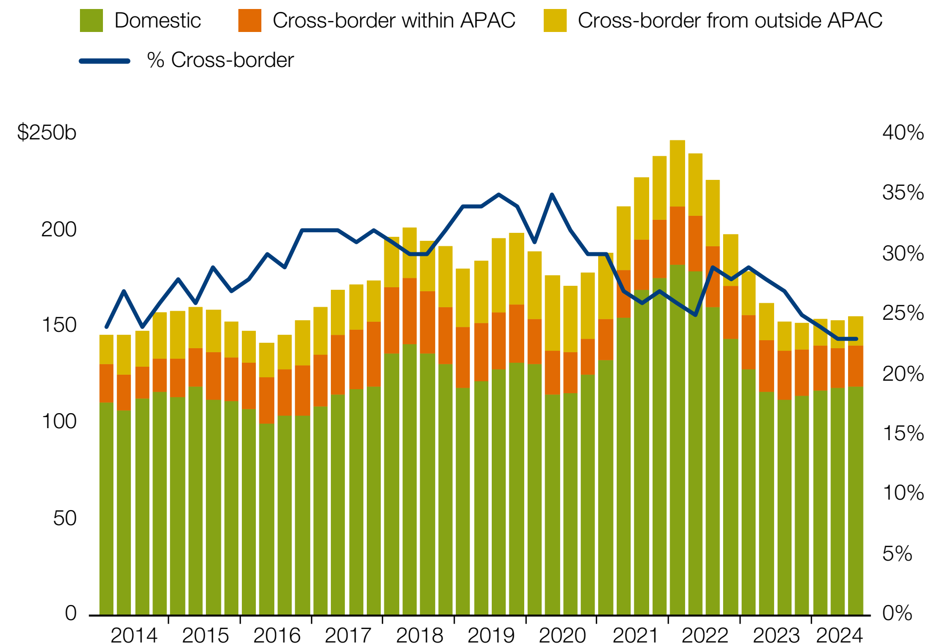
Stubbornly high asset prices have led global funds to reduce capital deployment, with their purchases in the region falling by around a third in the second quarter of 2024 compared to the previous year, according to MSCI. Lower Asia Pacific spending is also a consequence of the emergence of cut-priced assets in their home markets, as well as a natural tendency for funds to withdraw to familiar territory in times of economic stress. To a lesser extent, the same applies to cross-border investment originating from other countries within the Asia Pacific.

As a result, as of the third quarter of 2024, cross-border investment in the Asia Pacific had shrunk to just 23 percent of total buying – the lowest level since at least 2014. Global funds have congregated mainly in Japan, while Asia Pacific cross-border players have favoured Australia.

The capital flows landscape changed overnight in September, however, when a 50-bp interest rate cut in the US (followed by a further 25 bp cut in November) kicked off what is likely the beginning of a long-term easing cycle. Buying interest from global investors jumped dramatically as a result, with regional purchases almost doubling in the third quarter on a quarter-on-quarter basis, according to JLL figures.

An additional reason for increased buying by global funds may stem from a reversal of the "denominator effect", which requires them to maintain a pre-determined balance of allocations between different types of assets (e.g., bonds, equities, and real estate). Fund managers reduced their real estate investments in 2023 in order to prevent portfolio allocations rising relative to sinking values of equities and bond holdings, but with values of those asset types now higher, real estate has in turn become underweight, requiring a corresponding increase in new investment.

Exhibit 2-6 **APAC Investment by Source of Capital Q3 2024**



Source: MSCI Real Capital Analytics.

A notable component of global funds' third-quarter activity was increased flows to Australia, in line with ongoing cap rate expansion as assets there are re-priced (see the "Australia: Key Themes" section on page 8). Given limited supply of core assets in Australia, an influx of foreign capital (which accounted for 27 percent of total deal flow in the first half of the year, according to CBRE) could quickly have a meaningful impact on local pricing dynamics. As one investor said: "There's a real push in the industry to find assets in Australia. Obviously, though, the problem is that the population is only 25 million, so it's not like chasing assets in China. It's a small market, so I suspect the run doesn't last long."

Apart from global funds, significant numbers of Asian investors have also targeted Australia, in particular from Singapore (a common source of outbound regional capital) and also Japan, which has deployed capital into Australian assets ranging from CBD office, to private debt, to living sector development projects. One factor behind increased Japanese interest is that buying US assets with yen-denominated capital is subject to prohibitive hedging costs (of some 400 bps), compared to equivalent costs to hedge Australian-dollar investments that are more or less flat. Japanese buying is also facilitated by access to low-cost leverage sourced from Japanese banks that provides a competitive advantage over rival bidders.

Flows out of Japan are a significant factor in regional cross-border buying because Japanese financial institutions hold enormous reserves of capital that until recently they had been reluctant to deploy internationally. That restraint seems to have ended, however, due partly to rising domestic interest rates and partly to the increasing divergence between local and international yield spreads. In 2023, Japanese capital bought more than $2.3 billion in Asia Pacific real estate assets, according to MSCI, more than twice the figure from the previous year. Of that, some $1.8 billion

was invested in Australia. While the value of flows dipped in 2024, the Japanese focus on Australia continues.

The trend for outward flows of capital to stay within the region rather than – as in the past – migrate to Western markets seems to be widespread, however, with a poll published in November 2024 by advisory firm Hodes Weill finding that just 65 percent of institutions polled from within the region planned to invest in North American real estate in 2025 (down from 91 percent in 2024), while 70 percent said they would invest their capital regionally (up from 55 percent in 2024).

Fundraising Sinks as Dry Powder Builds

Although transactions regionally began picking up in the second half of 2024, the falloff in deals over the previous two years has left funds holding a mountain of dry powder they have been unable to deploy. This has not helped their efforts to raise capital for new vehicles, given especially that LPs are well aware of sometimes large losses suffered by commercial real estate portfolios in Western markets.

Fundraising in the Asia Pacific through the first half of 2024 was therefore at its lowest level since the global financial crisis (see exhibit 2-7). Where capital has been raised, it has often ended up at funds with existing track records, leaving the big to get bigger as average fund sizes increase.

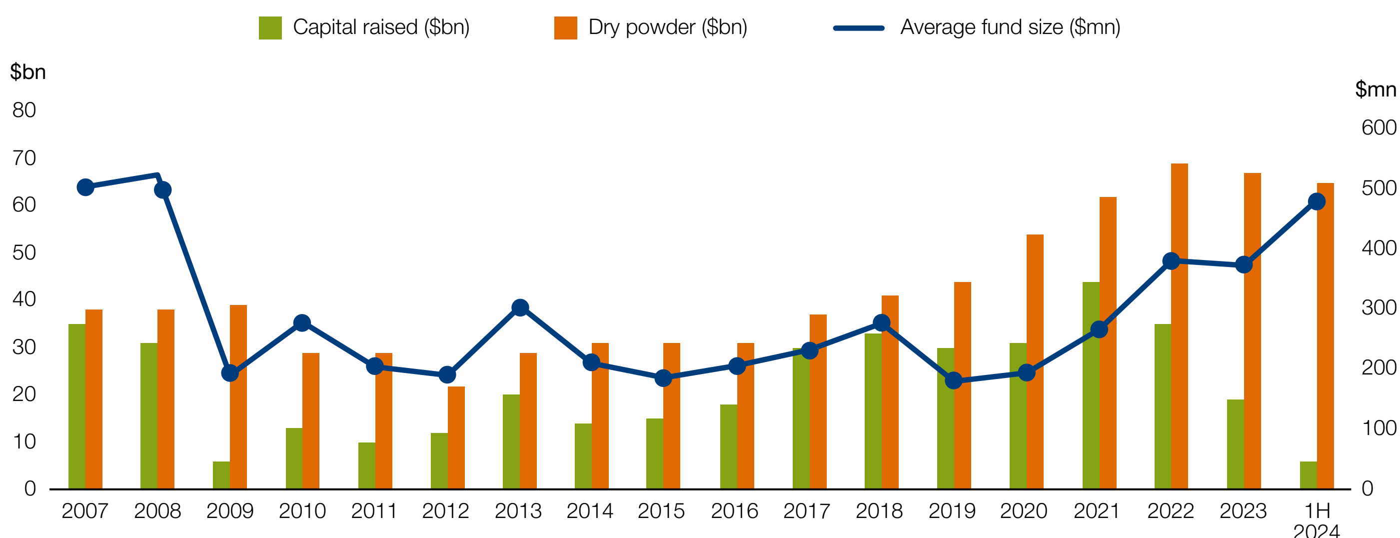
In general, there is a strong preference for fundraising for value add and opportunistic strategies, as opposed to core plays, where capital raised has dwindled to almost nothing. This of course reflects the situation on the ground. As one Sydney-based investor observed: "Deals are happening, I'd just say they are far fewer, and from a very different capital base than we've seen traditionally. Pre-global financial crisis, there were massive queues to get access to some of these core funds. I remember at [my last fund], we had a queue at one stage of about $800 million trying to get in – it's amazing how quickly things get turned around."

In terms of fund structure, LPs are continuing to migrate away from the blind pool model in favour of more targeted approaches. According to a manager at a global fund: "I think ultimately we'll be a victim of this, but I definitely feel investors want more sharpshooter strategies, partly because larger institutional investors are now better staffed, so they can be less dependent on a much larger fund to underwrite a one-off opportunity. And then on the other hand, some sectors and geographies have been fairly or unfairly highlighted over the past couple of years, and investors don't want that, or they want something else that aligns with their own portfolio construction."

This has meant that funds targeting specific new economy-type assets such as data centres and specialist living sector assets tend to have a "less difficult path to fundraising", as one fund manager put it.

Another factor that has contributed towards the recent fundraising malaise is that funds have been unable or unwilling to sell assets due to current market conditions (including in particular in China), leaving LPs reluctant to contribute new capital until they recover their original investments. This may prove impossible in China over the short term given the general lack of foreign buyers. Elsewhere, however, funds are facing increasing requests for redemption

Exhibit 2-7 **Asia Pacific Funds Dry Powder, 2007–1H 2024 ($bn)**

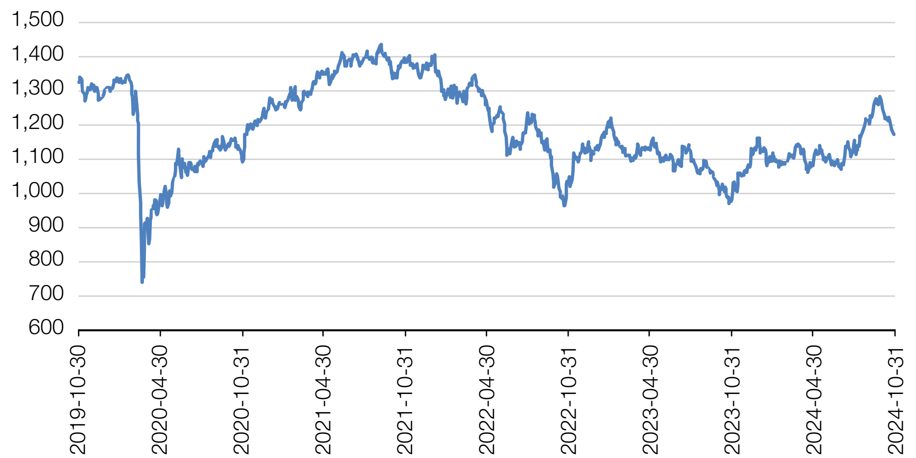


Source: Preqin.

and need to sell assets to meet them. According to a Sydney-based investor, for example: "A lot of the core funds [in Australia] at the moment have some huge redemptions, and there are some pretty interesting liquidity events coming up over the next few years that could have a significant impact on the market." The impact will be felt not only on the sell-side however, because, having withdrawn their capital, LPs will be more likely to redeploy it into new fund vehicles.

In any event, as interest rates retreat, asset re-pricing begins to gain traction, and fund allocations revert towards the mean, the fundraising tide may finally be turning, providing LPs increasing incentive to again place capital with global funds.

Exhibit 2-8 **Asia Pacific REITs Five-Year Index**



Source: S&P Dow Jones Indices.

REITs in the Crosshairs

Regional REIT markets have underperformed in recent years, as higher interest rates ate into net income and reduced their chances of finding accretive investments. In addition, shareholders have sold down holdings of REITs that own traditional (and now unfashionable) core assets such as office and retail properties.

In principle, as the easing cycle kicks in and markets anticipate the arrival of lower interest rates and higher distribution yields, REIT shares should benefit. That has not so far been the case, however, with the S&P Asia Pacific REIT index slow to respond to the September 2024 cut in US base rates, trading roughly in line with September levels as of the beginning of November (see exhibit 2-8).

This lag in REIT share prices is partly a result of asset valuation markdowns taken by REIT managers, who have been quicker to re-appraise to the downside than their private-sector peers. In addition, it disguises variable performance, both geographically and by REIT type. Finally, REITs cannot immediately refinance maturing debt at lower rates (and thereby cut their costs) given that today's spot rates have yet to fall to the cost of debt they obtained in previous years.

In the current environment, therefore, REITs in most jurisdictions still trade at sometimes significant discounts to net asset value (with the exception of Australia, though this is only due to a number of data centres held in local trusts), making them attractive buyout candidates for large private equity players. Australian trusts featuring less-popular office and retail assets are seen as especially vulnerable to takeovers, although Australia also has relatively few smaller REITs of the type usually sought by investors, given that most have already been taken over in previous episodes of consolidation.

Finally, any discussion about REIT consolidation needs to be qualified by an understanding that Asia Pacific REITs have for years been touted as takeover targets without any significant number of deals – hostile or otherwise – actually taking place. This is due to a range of factors specific to individual markets; conservative mindsets and complex shareholding structures (as in Japan), heavy government regulation (as in Singapore), and questions over the quality of REIT assets (as in Hong Kong).

Banks Turning the Screws

While banks in some Asia Pacific markets now hold sizeable amounts of real estate-related non-performing loans (NPLs), systemic risk remains far lower than in the United States, where the government was forced to introduce the (now-defunct) Bank Term Funding Program in March 2023 to address regional bank solvency concerns caused by defaulted commercial real estate loans.

There are various reason for this. First, Asia Pacific banks have more conservative lending practices, with the majority of loans made on a recourse, rather than a non-recourse basis, as is common in the United States. In addition, higher building occupancy rates mean that asset values in the Asia Pacific have not depreciated to the same extent as half-empty office buildings in, say, Manhattan, while also generating significant income that can partially offset the equity top-up requirements caused by downward valuation adjustments.

Until now, regional banks have favoured a kick-the-can approach to recognising asset re-pricing, even in markets such as Hong Kong, where values have plunged. In part, this reluctance arises from fear of capsizing the boat by sparking a wave of foreclosures or recapitalisations. In addition, according to a Hong Kong-based consultant: "Banks will do almost anything, at the moment anyway, to avoid having to foreclose and become the owner of a property they may not be able to sell, or if they can sell, at probably well below the amount they've previously lent at. So in every case I can think of, there's been some sort of understanding reached between bank and borrower. Very often, the term gets extended, but there may also be a fight about payment terms and getting some holiday."

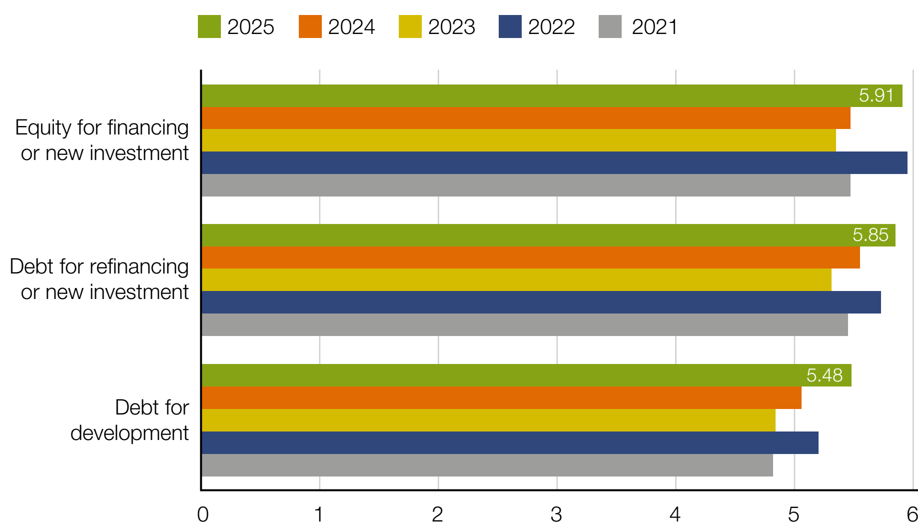
This has led both banks and borrowers to attempt to outwait the downturn in the hope that prices will rebound when the interest rates cycle reverses. That tactic was probably never realistic given that the trajectory of the current interest rate environment has been quite different from that which followed the global financial crisis, when banks were prepared to "extend and pretend" while rates were falling. Today, as more low-interest pre-2022 loans come up for refinancing at substantially higher interest rates, the issue has become increasingly harder to ignore.

In the words of one fund manager: "We're getting to the point where owners hoping for a sunnier day won't have that opportunity because lenders have forced their hand. So they're looking at refinancing at lower LTVs, when either the V [i.e., value] goes down, or the L [i.e., loan amount] goes down, or both, which means you have an equity requirement. A lot of owners are not in a position to top up equity, or increase debt service coverage, so that's going to force the issue. And we're getting closer to that across the region; it's not just Hong Kong."

The total dollar value of required top-up equity (otherwise known as the "funding gap") that owners in Asia Pacific markets will have to pay has been calculated by CBRE at some $8.4 billion between 2024 and 2026. While far from trivial, the Asia Pacific funding gap pales in comparison to equivalent shortfalls in the commercial real estate markets in the United States ($157.3 billion) and Europe ($191.4 billion).

This implies a pain threshold for Asia Pacific markets an order of magnitude lower than in other parts of the world. Even at that reduced level, however, it promises to create opportunities for investors ranging from distressed or stressed sales, to provision of private debt (see discussion in chapter 1), to purchasing non-performing loans directly from banks. CBRE cited Australia and China as markets where debt funding gaps are largest, although Hong Kong (which has less outstanding lending in absolute terms) must fall into the same bracket in terms of the acute need for top-up equity. Indeed, major Hong Kong banks have already begun to move, in some cases aggressively, in foreclosing on defaulted loans.

Exhibit 2-9 **Expected Change in Availability of Debt and Equity Finance ('higher score = more availability')**



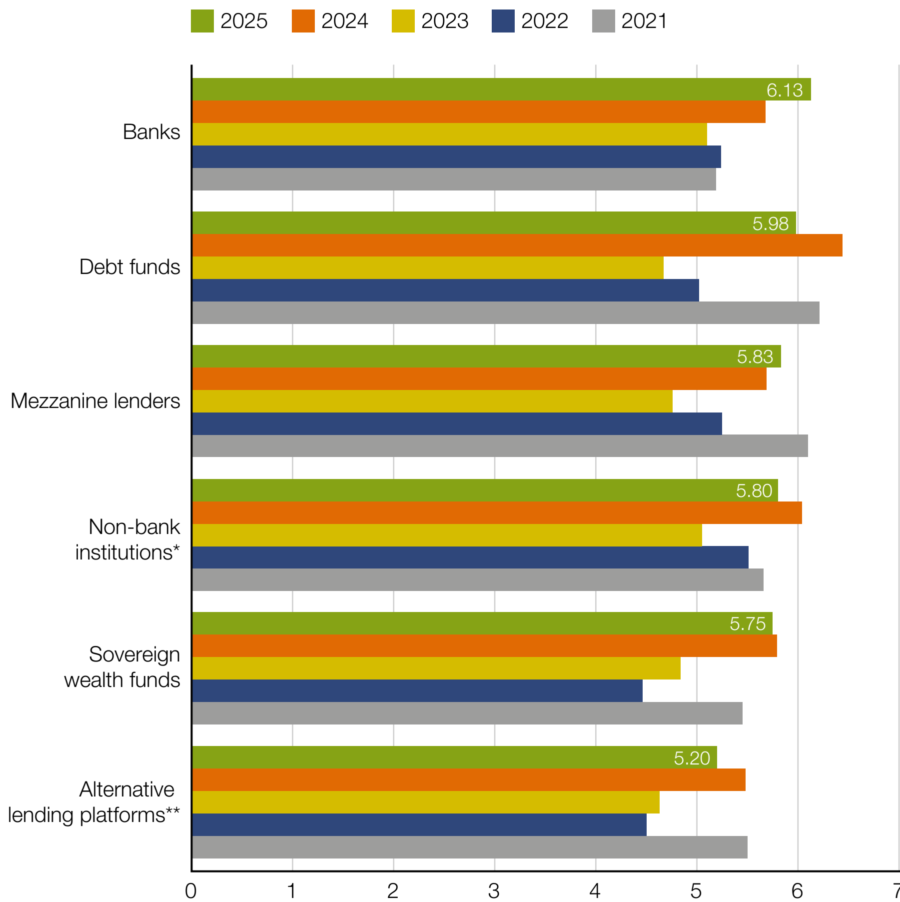
Source: *Emerging Trends in Real Estate Asia Pacific* surveys.

Tighter lending policies will also have consequences for investors looking to leverage new deals. In Hong Kong, for example, where many bank loan books are already well underwater, banks have limited appetite for lending. This is one reason transaction volumes in Hong Kong have been so weak, and implies additional scope for lower prices and further distress.

That said, in other Asia Pacific markets, investors with deep pockets and good track records report little change in loan availability, although some also say banks have become more discriminating, both as to their choice of borrower and the extent of leverage. Construction loans, for example, are assessed much more critically, with banks often asking for pre-commitments before providing loans.

According to an opportunistic fund manager in Sydney: "Banks have become very selective for the office sector, but there's still heaps of demand for industrial, huge appetite for land lease [i.e., senior housing], and as for retail, I suspect banks would be more

Exhibit 2-10 **Availability of Debt by Type of Lender (‘higher score = more availability’)**



Source: *Emerging Trends in Real Estate Asia Pacific* surveys.
* Examples include insurers or pension funds. ** Examples include peer-to-peer lending and crowdfunding.

comfortable now, bearing in mind the acquisition metrics on some of these recent deals, and the very attractive income profiles that high-quality assets are throwing up.”

In Japan, investors report much the same dynamic, although interest rates there have moved marginally to the upside. “Banks are selective,” said a fund manager in Tokyo. “If they like the asset and the asset class, they’ll be aggressive. If not, they’re pulling back. We’re working on a deal for a residential-to-hotel conversion, and the mega banks said no, they don’t like the business model. So there’s discipline in place. In the past, they were just looking to get money out; it was very much sponsor driven. Now, they’re looking at the underlying assets and being much more judicious.”

Chapter 3: Property Type Outlook

"All the free lunches, the fat in the market, has gone, and there's competition for everything. So how do you generate returns in alpha? It's through creating specialised knowledge and execution capabilities."

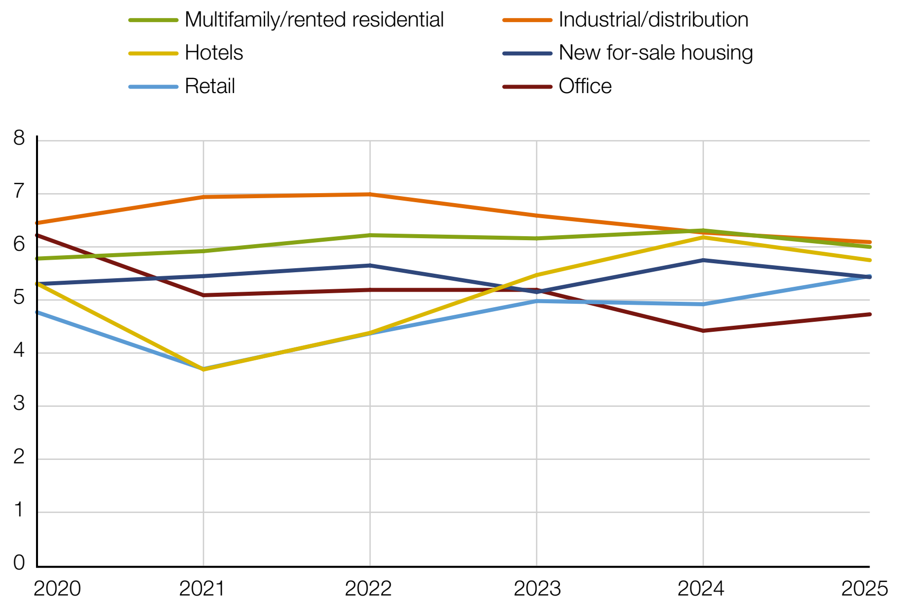
Over the past 15 or so years, the most important single factor shaping the direction of travel for the commercial real estate sector – from underwriting to operations – has been the changing tide of the interest rate cycle.

The long period of low rates following the global financial crisis drove an inflow of capital into hard assets that made for relatively straightforward strategies based on leverage and cap rate compression. From early 2022, however, rising inflation prompted a cycle shift to an environment of rapidly rising rates, leading to a period of stagnation in which investors in Asia Pacific markets have been forced to shift their focus towards asset types where value is driven less by the sheer weight of incoming capital and more by real value-adds, ranging from simple qualitative upgrades to technological innovation, long-term social trends, or operational characteristics that generate returns independently of real estate inputs.

The question now, as interest rates move again into an easing phase, is what this implies for the current status quo. If rising rates, for example, were instrumental in sweeping away long-outdated asset management approaches, might a downtrend imply a reversion to the mean? This issue is especially relevant given that the enormous public debt generated by years of quantitative easing may deter governments from imposing long periods of tight fiscal policies because the resulting debt repayment burdens would soon become untenable. In this context, low interest-rate regimes would become a fixture in the West as they are already in Japan.

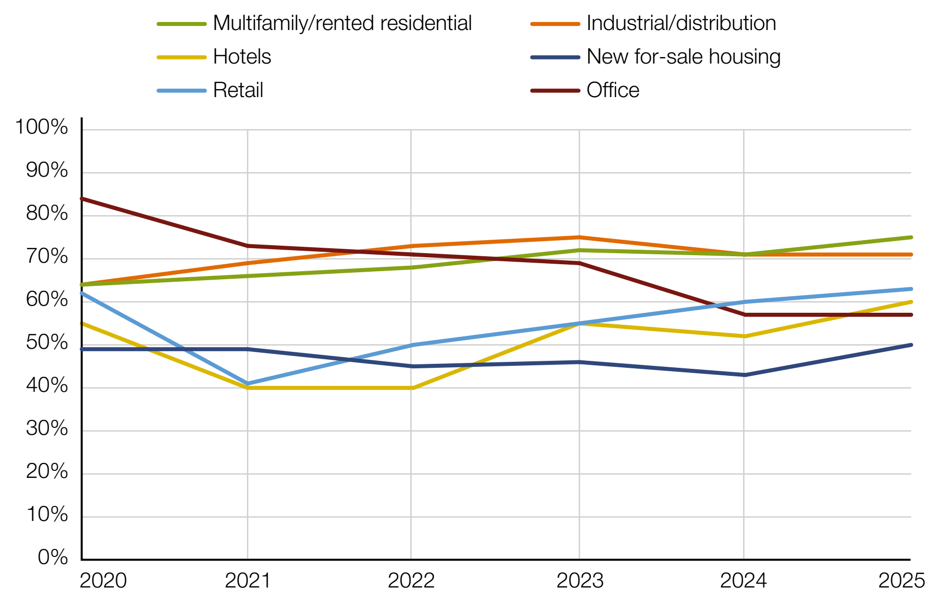
While this is a plausible scenario, however, it is likely to prove academic over the near term because, by now, the genie is out. Use cases for CBD offices have been forever changed because buildings that fail to evolve in user-friendly

Exhibit 3-1 **Prospects for Commercial Property Types**



Source: *Emerging Trends in Real Estate Asia Pacific* surveys.

Exhibit 3-2 **Sectors in Which Investors Are Active or Plan to Be Active**



Source: *Emerging Trends in Real Estate Asia Pacific* surveys.

directions will soon be marginalised, as occupiers vote with their feet in what is already a tenant's market. The same applies to obsolete retailer formats, which will continue to be cannibalised by e-commerce competitors, even as more experiential facilities evolve and thrive.

Equally, the recent shift in favour of alternative asset classes is also likely to prove enduring, as investors turn their attention to operational, higher-growth investment typologies such as the living sector and data centres.

Office

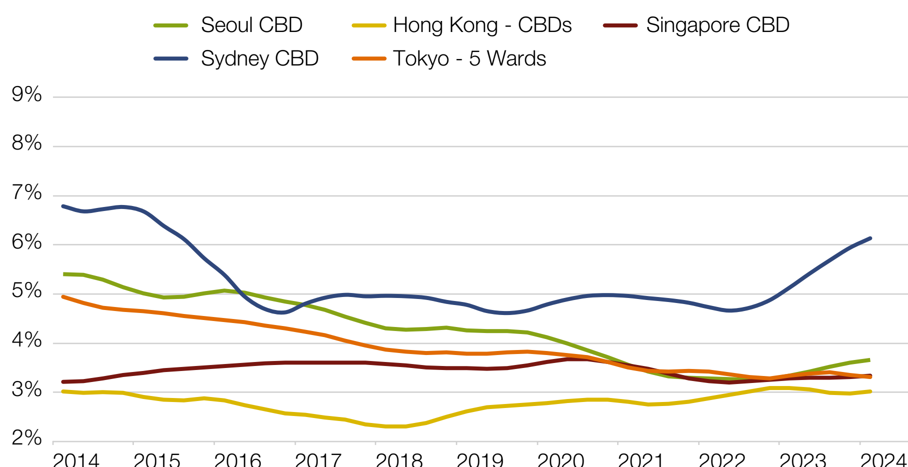
Investor sentiment towards Asia Pacific offices remains generally poor, in part because core product is priced too high to attract buyers at current interest rates, and also because global funds that have historically been major buyers have little appetite for sector risk following deep office sector downturns in the West. However, MSCI recorded an increase of 19 percent in regional office transactions in the third quarter of 2024, reversing a string of eight consecutive quarters of declines, and suggesting a bottom may finally have been reached – a finding that also chimes with the declining interest rate theme.

This initial wave of transactions is unlikely to mark the start of a V-shaped recovery, however. Investor aversion to core office remains entrenched, even though Asia Pacific utilisation rates (averaging 79 percent as of July 2024, according to CBRE) are far higher than in major cities in the United States, which registered an equivalent 61 percent in October 2024, according to data from Kastle Systems, or in the United Kingdom, where they averaged just 35.9 percent in the first quarter of the year, according to Remit Consulting.

That said, data based on regional averages can be misleading in an Asia Pacific context because it disguises a wide variety of on-the-ground conditions. Hong Kong, therefore, has so far shown few signs of an office sector revival. In Australia, though, the story is different, with cap rates for premium assets beginning to expand in mid-2024 after domestic institutions dropped asking prices amid growing interest – though as yet few purchases – from global funds. Expectations are now rising that office cap rates for both Australia and markets regionally will continue to creep outwards, finally breaking the transaction logjam sometime in 2025.

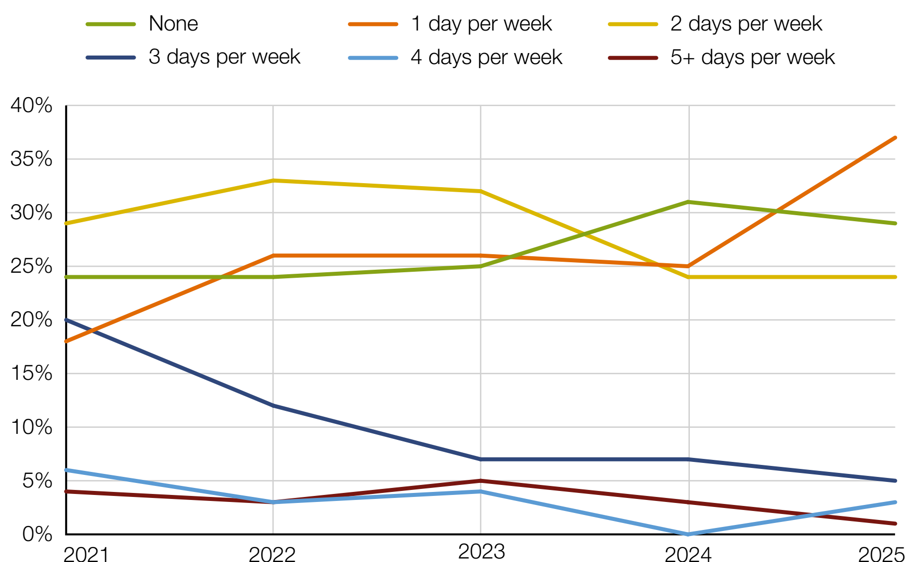
The catalyst for the recent office pricing downturn in Australia has not been any significant increase in distress, despite scattered reports of forced sales among high-vacancy secondary office buildings. At the higher end of the market, where

Exhibit 3-3 **Asia Pacific CBD Office Yields, 1H 2024**



Source: MSCI Real Capital Analytics.

Exhibit 3-4 **Average Days per Week Spent Working from Home**



Source: *Emerging Trends in Real Estate Asia Pacific* surveys.

banks are anyway more inclined to work with institutional owners irrespective of declining asset values, the incentive has been fatigue among local REITs and wholesale funds that can no longer wait to circulate capital. According to a Sydney-based fund manager: "There's not been a lot of pressure to sell, so it's not so much liquidity pressure as it is managers recycling because they've completed a business plan and just have better uses for the capital."

Seoul, meanwhile, continues to forge its own path. Local markets were described as a "parallel universe" by one interviewee because, in contrast to booming regional logistics sectors, the Seoul logistics market has become mired in oversupply just as its offices feature some of the tightest occupancy in the world (with vacancies of 1.6 percent as of mid-2024, according to CBRE). Still, while office rental growth of almost 20 percent in 2022 has made Seoul a magnet for core investors, enthusiasm is now waning as rental growth slows to single digits and deals become increasingly difficult to underwrite.

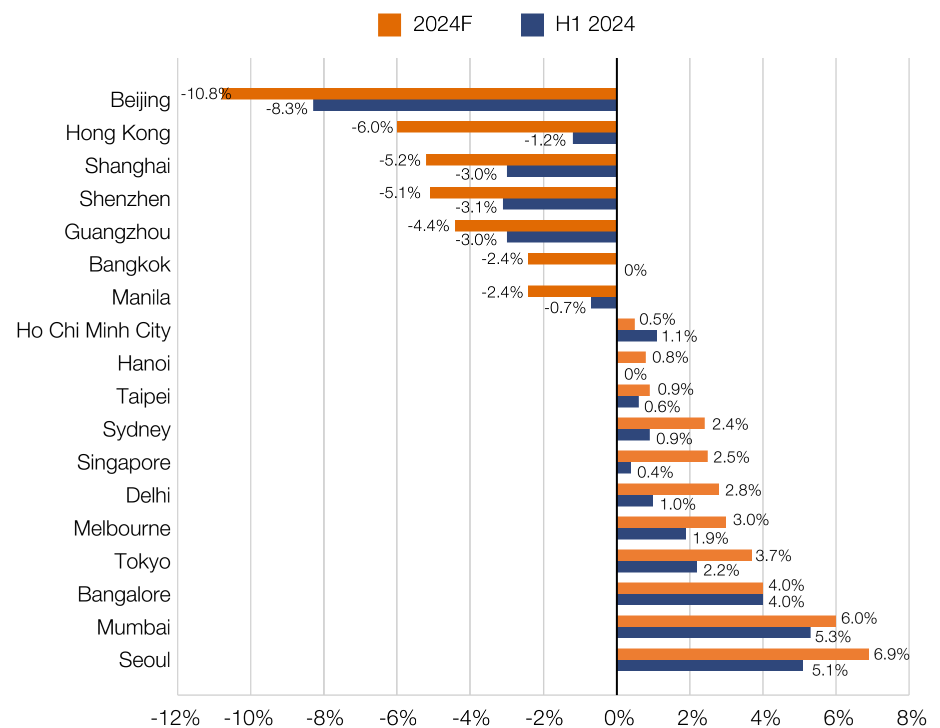
Tokyo also features low grade-A vacancies (of around 4 percent), but the core office market as usual has seen few transactions, and with cap rates often under 3 percent it tends anyway to be the preserve of domestic institutions. Most foreigners therefore pursue other opportunities, although there has been significant activity among global funds in value-add office refurbishment plays.

Singapore's offices remain a solidly boring asset class in the sense that fundamentals have remained unremittingly firm, featuring few vacancies and low cap rates that until recently have shown little hint of softening. This has made the city a difficult sell for investors who see better returns potential elsewhere. Strata-title purchases are one alternative option. Value add is another, although most recent deals have gravitated towards the lower end of the pricing range. Moreover, for a city where sustainability upgrades have become a major focus, value-add is not an obvious strategy. According to a Singapore-based investor: "There will always be value-add investors who feel they can buy something and fix it. But the model does have challenges in the Singapore context, because there may be quite a few value-add investors, but there aren't many core investors, so once you have done the value add I am not sure who you sell it to."

Hong Kong offices have recently endured a long list of headwinds that include the region's highest interest rates (now in decline), its lowest cap rates, weak occupier demand, an enormous pipeline of new supply, and geopolitical complications that have kept foreign buyers well offshore. Unsurprisingly, according to one locally based fund manager: "Asset values have corrected very significantly across all the major food groups, with office down 40 to 50 percent in some cases."

Nonetheless, distress transactions in Hong Kong have not been as frequent as expected, largely because local banks remain reluctant to pull the plug. "We've seen a bunch of receivership auctions in Hong Kong just get stuck," continued the fund manager, "because it goes through a receivership process, and the brokerage then takes the best bid back to the bank, who says: 'I'm not willing to take that kind of haircut yet.' So they just let it sit there. But the longer that goes on, value just erodes because no new tenant is going to sign up for a lease at a building under receivership. So Hong Kong right now is in a tough spot, and that's creating some opportunities."

Exhibit 3-5 **Asia Pacific Office Rental Growth 2024**



Source: CBRE.

Shanghai offices, finally, are weighed down by weak demand and an overhang of supply. With the vast majority of the city's super core assets locked up in the hands of state-owned companies or a handful of foreign developers, bidding on other properties tends to be based strictly on price. According to one fund manager: "If you are better-located, let's say you have a Bund view, there are certain trades that some buyers might be willing to take for self-use, or else to strata sell. But it's still a no-go unless the price drops significantly, because you almost have to assume rents will fall, and then you still have the uncertainty of exit because nobody likes the asset class. So the price has to be really attractive, and that then goes back to the lenders, [who don't want to take a haircut on their loan]."

Flight to Quality

Although the trajectory of office pricing across different Asia Pacific markets is highly variable, one issue that remains consistent is weak leasing demand (apart from India, where it has gone from strength to strength). Poor takeup is partly caused by economic conditions, but is also the result of ongoing uncertainty that is leading occupiers to renew existing leases rather than incur moving expenses.

One exception to this is the ongoing flight-to-quality trend, where companies migrate to high-quality, better-amenitised offices as a way to attract or retain staff. In the process, they often swap larger, less well-appointed offices, for smaller premises better suited to hybrid working schedules.

The result is that demand for high-end buildings in good locations remains strong, which in turn creates potential (especially in Australia and Tokyo) for value-add investors looking to buy buildings to upgrade. This occupier-upgrade theme has been in place for several years, in the process creating an increasingly two-tiered market where older buildings further away from transportation and other CBD facilities are being marginalised, especially in cities with high vacancy rates such as Hong Kong, Melbourne, and in China.

This is turn raises the issue of how cities should address the newly created surplus of office capacity. In the past, ideas were floated to convert unwanted CBD buildings, or even entire land packages, to alternative uses such as housing, or otherwise into different types of publicly usable space. While superficially appealing, however, this brings with it a number of problems. While it is true that Asian CBDs often lack balance between different use typologies, including especially shortages of city-centre homes, the reality is that most local office buildings are even less suited for residential conversions than they are in the United States, where the same issue arises – a result of small floor plates, high ceilings, and generally inadequate internal infrastructure. Beyond that, CBD land plots tend to be too small to be easily redeveloped, while fragmented ownership makes them difficult to aggregate, thereby frustrating plans for large development projects.

Moreover, with office utilisation rates in Asia (Australia aside) recovering at a faster pace than in the West, concern that regional CBDs will be left with significant amounts of unused space may be misconceived. According to a Singapore-based consultant, constrained pipelines of new office stock mean that organic demand will eventually soak up excess supply. "I'd be really wary, from a planning perspective, of handing it all over to what is effectively a strata-title asset class [i.e., residential]," he said, "because once you do that, it's impossible to get it back. And you need to retain a big chunk of CBD [space] for non-strata title, single-ownership land so that landlords have the freedom to do what is necessary in response to market conditions."

This is not to say, however, that CBDs of the future will be unchanged from previous incarnations, because as markets digest currently unwanted space, older and underused buildings will be either refurbished or redeveloped in specific ways that will serve new uses and (hopefully) higher purposes. One example will be creation of purpose-built facilities catering to specialist industries such as health care. Another will be that spaces are developed in ways that make them easy to convert. According to one developer: "The coming trend will not be for just traditional grade-A office, it will be for flexible use. So when you redevelop or convert or construct a building, during the construction stage, designers will ensure an outcome that will accommodate a number of different uses. That's because in the coming era you won't be able to anticipate which industry will be king of the world."

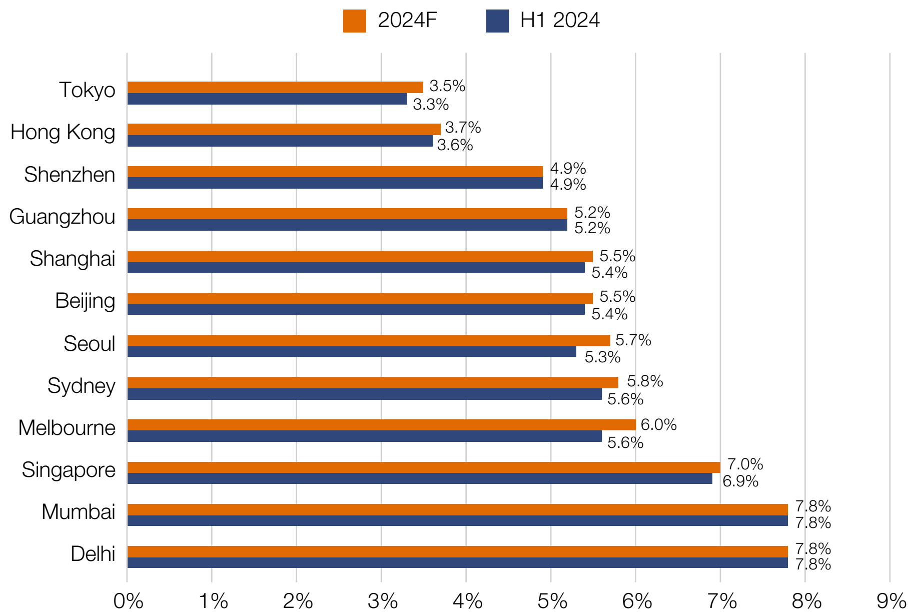
Logistics

As investors in the last couple of years have moved away from traditional thematic strongholds in the office and retail sectors, logistics assets have picked up much of that slack. The aim originally was to leverage huge structural undersupply across the region, but the sector has also successfully ridden the wave of an e-commerce boom during the pandemic years. Looking at the most recent data, the undersupply story seems intact. Supply pipelines in some markets are facing delays due to higher construction costs, while vacancies (with notable exceptions) remain tight, with occupiers continuing to chase improved efficiency standards offered by newly constructed facilities.

At the same time, and adding to similar concerns last year, there is a nagging anxiety among investors that the sector may be close to an inflection point after so many years of headlong growth. Interviewees spoke of pockets of oversupply, high rents, and concerns over softening retail and e-commerce sales. There is also concern that, fundamentally, cap rates for logistics assets have been compressed to levels that have become irrationally low for an asset class where barriers to entry are not as high as, say, the retail sector, where properties trade at higher yields.

According to an interviewee in Australia: "Rents skyrocketed 18 months ago, and

Exhibit 3-6 **Asia Pacific Logistics Prime Yield, 1H 2024**



Source: CBRE.

then, when they had nowhere else to go, that's when yields went really firm. But now, the rising cost of living is having an obvious impact on retail, so tenants at distribution warehouses are taking a step back. They're just not needing these big warehouses anymore, which means rents are remaining flat. And because everything else is getting more expensive, yields have softened, typically by 75 to 100 bps across the market."

At the same time, incentives have risen to some 15–20 percent, according to a different interviewee, while demand for longer leases has also declined, reflecting occupier concerns about upcoming demand for space should retail sales weaken.

There have also been signs of softness in the sector elsewhere in the region. Seoul has recently seen a wave of logistics-sector distress following introduction of a glut of highly levered new stock, just as interest rates rose. Rents have fallen as the market struggles to absorb the new supply, and investors are now able to buy properties at below replacement cost. According to a regional analyst: "After Sydney office, my number two pick is probably Korea logistics. It's right at the bottom of the current cycle, so re-pricing has now come through, they will cut interest rates before year end, and the oversupply situation will ease."

Japan, meanwhile, continues to experience chronic shortages of modern warehouse capacity. However, the process of consolidating outdated stock into sometimes giant new facilities has led to an oversupply of new capacity in the greater Tokyo area. This is likely to be a temporary phenomenon, given that demand remains strong (especially as occupiers migrate from self-use to 3PL warehouses) and that, as one fund manager observed, "logistics development has ground to a near halt" due to high construction costs.

Still, the path forward in Japan is not without obstacles. One problem is that rents have run up significantly. According to a Tokyo-based investor: "Tenants' labour and transportation costs have gone up, so they can't afford to pay the higher rents. [That's led to] a pretty good bid/ask gap between buyer and seller right now – sellers still think people should underwrite growing rents, but buyers are saying at best they're going to keep rents flat for the near term. So we know a couple logistics deals that have had difficulty getting done."

Finally, the Chinese logistics sector has also experienced oversupply issues that have been exacerbated by falling consumer demand in a weaker economy. Deal volumes for Mainland logistics and light industrial properties collapsed in 2024, according to MSCI, with second quarter purchases falling to $1.6 billion, the lowest quarterly level since 2019. The hiatus in deals has trapped significant numbers of foreign investors who invested in new logistics projects and are now unable to exit.

One reason for oversupply is that cash-strapped local governments sold large amounts of land during COVID for logistics development, creating huge amounts of new supply that are now pressuring rents. At the same time, users are rationalising their operations, including sometimes by building infrastructure for self-use. According to one China-based investor: "The 3PLs and end users are trying to make their space as efficient as possible. Before, they might just lease facilities without an end user, and distribute goods without really thinking about how they can better utilise it. But now they are looking at finding an end user before they rent, and at figuring out how to maximize use of space to squeeze every dollar. Because from the top down, profit margins have been shrinking."

Oversupply is significantly worse in northern China, which has approximately 50 million square metres of stock, according to one interviewee. Investors are therefore likely to find better opportunities in southern provinces, where supply stands at only half that level, and demand is currently stronger due to growth of new, cross-border e-commerce companies.

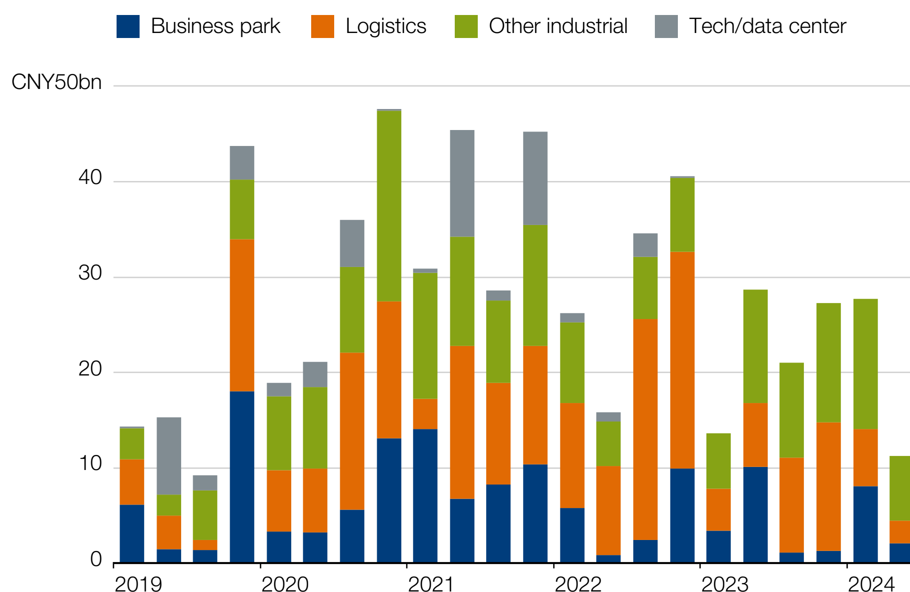
The general wariness about potential excess capacity in conventional logistics assets is leading investors increasingly in the direction of more specialist facilities, both in Australia and elsewhere.

According to a regional analyst: "If you want to just trade in the wider asset class in order to generate a return, I'm skeptical. Locals will tell you vacancy rates are very low, and I get that, but that's from an investor's point of view. From an occupier's point of view, costs have increased quite substantially, so I need to optimise my portfolio, and that means I need to be in a good location with modern facilities because those are the assets that outperform. All the average, grade-B stock, they can't ride the wave anymore."

Otherwise, there is increasing interest in developing last-mile logistics assets in infill locations. According to a Singapore-based logistics specialist: "There are a lot of inner-city locations that they should be looking to redevelop, not necessarily with big boxes, but with a new generation of industrial to serve communities. Everyone thinks that if [the inner city] has become so prolific and gentrified, then the highest and best use is not industrial, but it's very much a value creator for the whole district, so it's a bit of a necessary evil." Obtaining land and approvals for these types of facilities is predictably difficult, although there are some existing, privately owned, and generally underperforming industrial properties in infill locations that can be targeted for takeover.

The same infill strategy was also mentioned by an opportunistic fund manager in Sydney, who said: "Our view is that it's far more sustainable for a longer period than in that shiny big-box logistics space, because there's so much land in those outer logistics locations, whereas in the pockets we're buying, there's no land and there's zero vacancy, which is supporting continued rental growth. It's not going to be the 20 percent we've seen for a few years, but it's certainly going to be high-single, low-double digits for the foreseeable future. And tenants can afford to pay that because their biggest cost are transportation, and building a more efficient distribution model means they're spending less on that."

Exhibit 3-7 **China Industrial Volume by Subsector, 1H 2024**



Source: MSCI Real Capital Analytics.

Data Centres

Booming growth in Asia Pacific data centre capacity saw no signs of softening in 2024, with total operational capacity increasing to nearly 12 gigawatts in the first half of the year, according to Cushman & Wakefield, of which some 1.3 gigawatts were added in the first six months alone. By 2030, according to projections by industry analysts Structure Research, new regional supply of an additional 13 gigawatts is set to arrive – a massive amount by any standards.

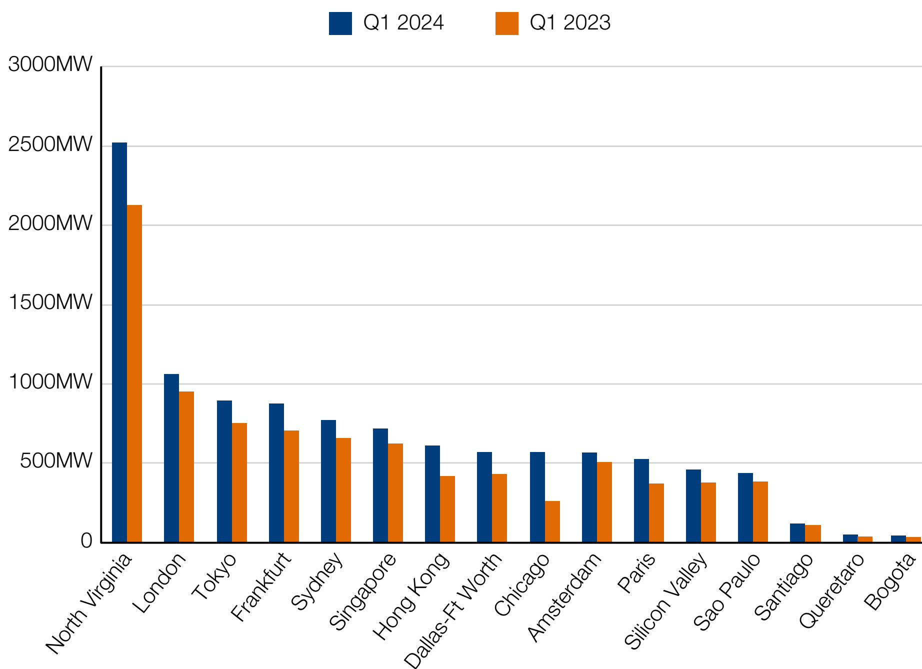
While ballooning growth is based in part on increasing demand from conventional colocation, edge, and cloud facilities, the real game-changer has been demand for huge hyperscale facilities hosting specialised chips and servers needed to execute applications driven by artificial intelligence (AI). The design parameters of AI machine learning processes hosted at these hyperscale facilities has led to a seemingly limitless appetite for power and bandwidth that are fundamentally changing the design, location, and financing of new data centre infrastructure.

By way of illustration, AI data centres consume on average between two to five times more electricity than comparable cloud facilities, feature levels of power density that cannot be supported by the vast majority of existing collocation sites, and generate heat loads necessitating use of expensive and resource intensive direct-to-chip liquid cooling systems.

What's more, demand for new AI infrastructure is growing exponentially. In 2023, NVIDIA shipped 100,000 AI servers globally, collectively consuming an average of 7.3 terawatt hours of electricity per year. According to International Energy Agency estimates, this number will rise to some 90 terawatt hours by 2026, an amount equivalent to the annual electricity consumption of the city of Tokyo.

The huge size and technological demands of incoming data centre supply pipelines has a number of implications. The most important relates to demand for power, which has grown to a point that it is now outstripping available capacity in many developed markets, leading to increasing competition for resources.

Exhibit 3-8 **Data Center Inventory by Market (in Megawatts)**



Source: CBRE Research.

As a result, construction moratoriums have sprung up in some markets. Following a ban on new construction in Singapore in 2019 (now partially lifted), both South Korea and Taiwan recently issued their own suspensions, while competition with either businesses or residents for land and energy have led to similar shadow bans at a local level. In Japan, (the Asia Pacific's largest data centre market outside of China), grid connections typically involve delays of between four and eight years, according to one interviewee, which is "far too late for some of these hyperscalers, who need capacity now – in fact by yesterday".

This means that data centre developers are increasingly building new hyperscale facilities in locations far removed from sources of demand – a solution made possible by the low latency nature of most AI-related tasks. A number of previously obscure emerging market destinations have therefore quickly picked up the slack, with more than half of all APAC data centre transaction volumes in the first half of 2024 being recorded in Southeast Asian countries, according to JLL.

Malaysia, and in particular Johor Bahru, which sits adjacent to Singapore and thereby profits from the city's restrictions on new data centre construction, has been the main beneficiary to date, with local operational capacity growing by 80 percent year-on-year as of mid-2024, according to Cushman & Wakefield. Johor now has a pipeline of nearly 2 gigawatts of new capacity, which, when completed, will put it on a par with existing heavyweights such as Sydney and Shanghai. India, meanwhile, is currently "a bit land-grabby", in the words of one data centre investor, but is likely eventually to emerge as one of three regional AI/ machine learning hubs, together with Malaysia and some parts of Japan.

The reason for surging interest in emerging market locations is a combination of ready access to land and power supplies, together with tax incentives aimed at attracting new investment. Growth has been frothy, however, and given the finite nature of local supplies of energy and water, current deal flows may already be bumping up against a hard ceiling of capacity. According to one investor: "At the end of the day, it's not going to be a long-term solution, and if you look at Malaysia now, they've been overwhelmed by the demand and are trying to put in place regulations to have more structure around growth and get a better handle on what's coming through. To me, it's just a matter of time that every market will have regulations in place that will complicate the expansion of the industry."

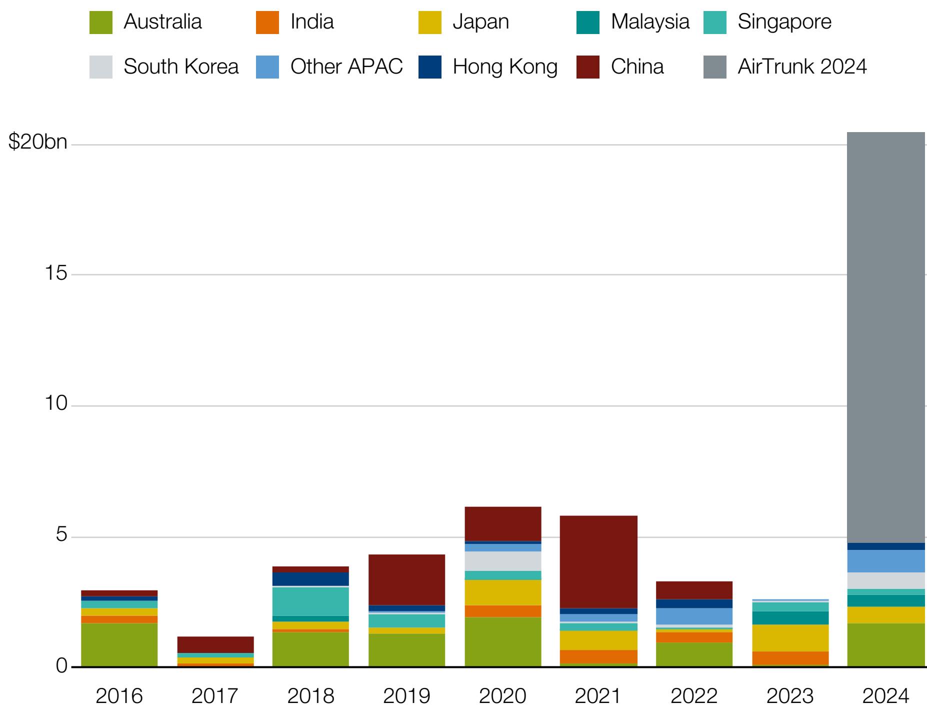
Complex Structuring

The other way in which exponential growth in data centre construction is affecting the status quo is in the realm of finance and deal structuring. To begin with, investor demand for data centre exposure has made fundraising at least "less difficult" than it would otherwise be. It has also led to some enormous capital raises, as well as tight cap rates for completed transactions (i.e., in the range of 3–5 percent in 2024, according to MSCI). At the same time, the evolution of data centre technology, the inexperience (in general) of the investor base, and the sheer size of the assets and associated capital commitments mean that data centre deals are often an order of magnitude bigger and more complex than the norm.

This is reflected in surging transaction volumes, with US$4.8bn in acquisitions of completed facilities in the first nine months of 2024 (excluding one large platform deal), almost double the volume for the whole of 2023, according to MSCI.

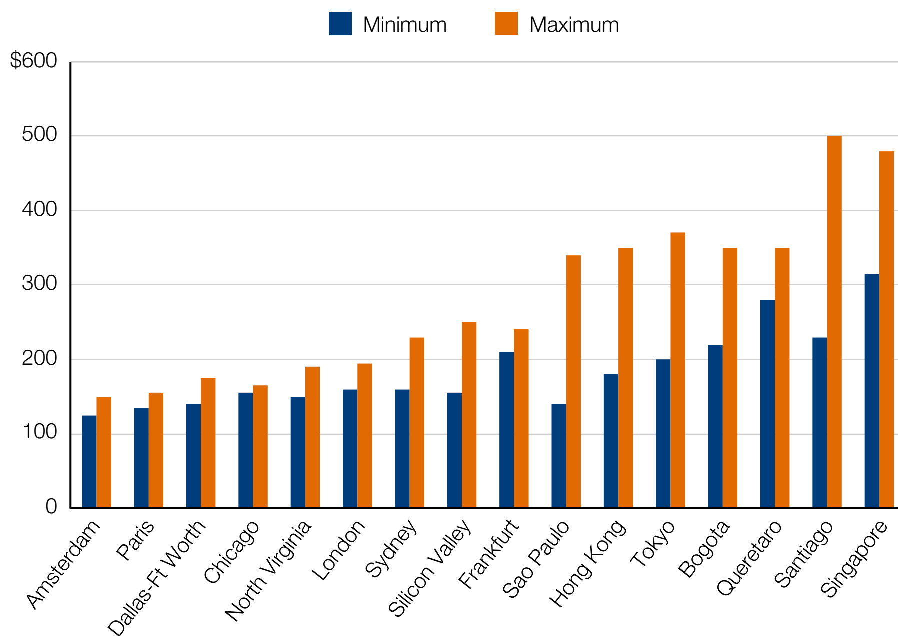
The scale of the ticket size implied by modern-day data centre investing is reflected in the US$16 billion deal for an Australian-based operator in the third quarter of 2024, involving a combination of syndicated staple financing, bank loans, and private credit. As chunky as that was, however, deals are likely only to get bigger given the projected quantum of future infrastructure buildout (i.e., some 40 gigawatts globally by 2030, according to Structure Research). As one investor observed: "Let's say it's US$10 million to US$12 million per megawatt to build up this capacity, then at 40 gigawatts, that's US$400 billion in capital we're going to need to even be relevant."

Exhibit 3-9 **Asia Pacific Data Center Volumes, Q1-Q3 2024**



Source: MSCI Real Capital Analytics.

Exhibit 3-10 **Monthly Pricing Range for 250-500kW Data Centres (Min-Max per kW) Without Electricity Cost Q1 2024**



Source: CBRE Research.

On top of this, the size of individual facilities has mushroomed. “If you go back to the cloud days in 2015 when [the industry] was taking off”, continued the investor, “then probably with US$100 million to US$250 million in equity, you could build a 20-or-above megawatt IT load. Today, most AI facilities have become campus-style developments. Each campus consists of two or three or four facilities, and can easily house up to 200- or 300-megawatt IT load, which means that for each campus development, we’re looking at up to US$1 billion to US$2 billion in equity alone, coming into one single campus in a single location.”

Another part of the puzzle is how deals are put together. This is a complex subject that is beyond the scope of this report. However (and apart from just buying a stabilised platform), investor options include the following:

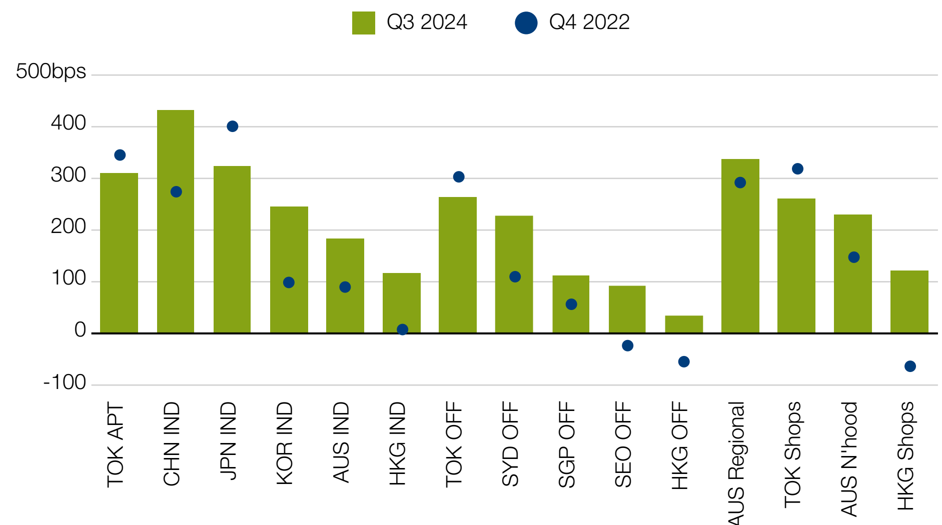
- Developing and operating their own facilities, often as co-investments with their LPs. This is a more complex route, and is increasingly more difficult for investors lacking experience in the asset class. As one investor said: “There’s only a handful of customers out there, and they’re only going to deal with the top operators in each region, not some tier-two operator who has [access to] power and can give them the cheapest rate. The reality is that the criticality of delivering an operating environment on time is just huge for these guys.”

- Creating joint ventures with established operators and acting solely as a capital provider. Again, this is likely to involve a co-investment component. According to a fund manager adopting this approach: “I don’t want to go out and build my own business and compete with [incumbent operators], who are well established and have teams in place. I don’t want to go into new markets and try to hire people away from them to run my business. I’d rather just partner with them, and leverage off their [technical]

and origination capabilities." This approach removes a significant degree of complexity on the operational side, though it also negates potential upside for investors to leverage the value of the operational platform managing the assets.

Today's large deal sizes necessitate a sophisticated approach to financing that often leverages different types of capital at different stages of the project. For example, opportunistic capital may feature at the construction phase, after which stabilised assets might be sold to a different vehicle with a core strategy, or possibly (following the US model) as asset-backed securities.

Exhibit 3-11 **Yield Spreads to Government Bonds**



Source: MSCI Real Capital Analytics.

Retail

The long decline of the Asia Pacific retail sector has made it in some ways a forgotten asset class. All cycles must turn eventually, however, and there is a growing sense, at least in some markets, that retail may finally have bottomed, with significant numbers of interviewees expressing a willingness to buy.

According to a Singapore-based consultant: "Retail isn't the ugly duck it was two or three years ago that no one would touch. People are now starting to think there's a bit of logic in some of these assets, particularly in markets like Australia and Singapore, where they are a protected species from a planning perspective."

One reason for this is a growing acceptance among both the industry and the public that online retailing is not, after all, the death knell of conventional shopping, and that brick-and-mortar stores have a real social function to play. As one interviewee remarked: "Funnily enough, it took COVID to convince everyone that online wasn't the destroyer of retail, it was the refresher, the catalyst that was going to come in and make landlords stand up and be noticed. So when you talk to retailers now, they say: 'Yes, we went bananas online over COVID, but now people are coming back to the shops.'"

This revivalist mentality corresponds with recent research from CBRE showing that retailers in some markets are aggressively seeking to expand space, especially in prime shopping districts, at a time when new supply has fallen away. In part, this reflects sometimes steep reductions in rents, although conditions vary significantly by location. In Hong Kong, for example, prime retail rents are now anywhere between 50 and 90 percent below previous peaks. In Tokyo, meanwhile, rents in the second half of 2024 remain at around 2019 levels.

In part, too, the renaissance of prime retail is due to a migration of retailers back to core locations in a reversal of defensive postures adopted several years ago, when many sought shelter in community or non-discretionary subsectors. As a result, demand for space in secondary locations is today relatively soft.

The retail sector recovery also jibes with an expansion of retail yield spreads in many markets (see exhibit 3-11), together with a rebound in transactions. In Australia, for example, pricing corrections began as long ago as 2021, and investors are now belatedly responding, with deal volumes up 23 percent year-on-year in the third quarter.

In particular, some investors spoke about buying regional centres in Australia as value-add plays, with the intention of upgrading them to more modern formats. According to a Sydney-based investor: "Fundamentals look a whole lot better – yields and rents have re-based to cyclical lows, so there's room for growth; development is non-existent, assets have been trading below replacement cost, and the consumer may be hurting with the cost of living pressure, but that isn't coming through in the retail numbers."

Japanese retail is another market that has been resurgent in 2024, with rents up some 15 percent year-on-year in the third quarter, according to JLL. This is in part due to higher inflation, but even moreso a reflection of rebounding tourism, which in turn is a factor of Japan's weak currency. As a result, transaction volumes in Japanese retail assets almost doubled in the 12 months to October 2024 on a year-on-year basis, according to MSCI.

Reinventing the Wheel

If retail is now reborn, however, its reincarnation is significantly different from pre-pandemic formats, following a decade-long process of rebalancing and winnowing out of uncompetitive inventory. For example, use of omnichannel strategies that integrate physical and online stores have become common. Under this model, a retail chain may have an online presence, a small number of large stores, and a large number of widely distributed small stores that function also as fulfilment centres, delivering to walk-in customers from stock sent to them from larger counterparts. Experiential and F&B strategies are also now par for the course. In addition, widespread adoption of data analytics (such as footfall monitoring) has helped create better understanding of customer behaviour across channels, allowing retailers to optimise layouts and create more targeted offerings.

Unsurprisingly, retailers are today focused on optimising their use of space. This applies not only to smaller retailers who have been forced to downsize to survive, but also larger businesses that have historically used space inefficiently. In Australia, which suffered oversupply of out-of-town malls even before the pandemic, landlords have created mixed-use communities, building residential towers in former car parks and transforming interiors to a wide variety of new uses. According to one investor: "They're up to their eyeballs in: 'how do we get BTR onto our mall site? We'll give up the car parking and we'll put some resi in there', because they've worked out it's worth it. So there's a lot of activity in that space."

The same is happening in Singapore. According to a locally based interviewee: "Landlords are trying to work out how to use their excess car parking for logistics facilities. They have great locations, because they're at the heart of every single township, and they're all owned by [big developers], which means they're great locations for last mile logistics. So they're all going through that process now, where they've started thinking more about town-centre services being more than just flogging T-shirts."

Living Assets

Growing investor demand for what are known as "living assets" – a collection of residentially oriented typologies also known as the "beds" sector – has transformed what was previously an investment backwater into an increasingly sought-after asset class.

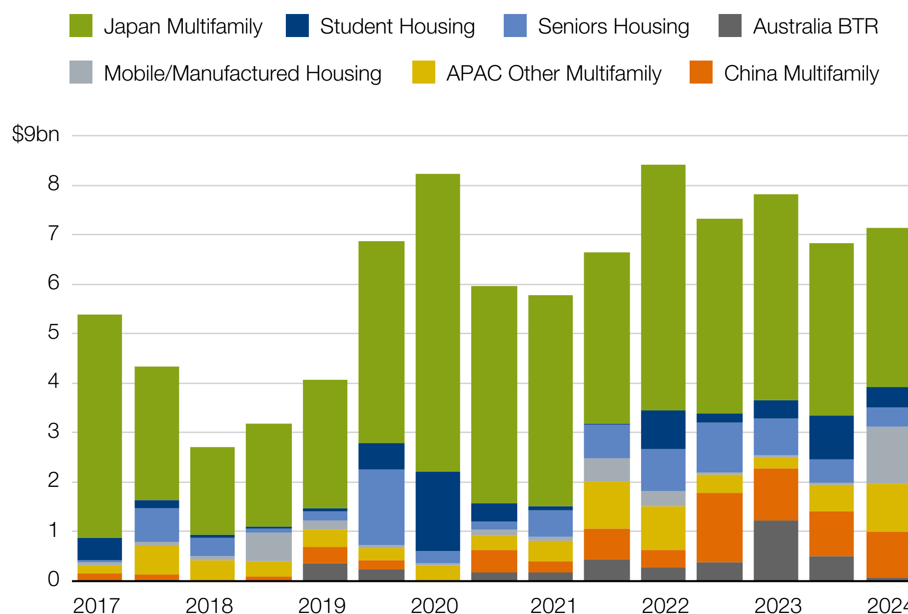
Apart from the fact that it is a natural destination for capital previously invested in the office and retail sectors, the asset class has appeal for various reasons. First, residential-type facilities tend by nature to be conservative investments that tap a reliable source of consumer demand, even in times of economic weakness. In addition, they leverage evolving social and demographic trends that ride the tailwinds of future growth opportunities.

According to a Tokyo-based fund manager: "If you're [strategically] focused on growth, the question becomes: where can you achieve rental growth and what structural trends are the ones that could potentially support that? The residential living sector is a good example, where a combination of affordability issues, the growth in the number of households, the absence of institutionally owned residential product, changes in what people want, social mobility, etc., are all drivers for growing demand for renting in one form or another. And it's not just a story about a product that resonates well with the occupants, it's also a story that resonates well with buyers."

The fact, therefore, that low penetration rates mean that living assets still barely exist as an asset class in almost every Asia Pacific market (at a time when markets in the West are often saturated with the same asset types) bestows on them instant appeal to institutional investors with large amounts of capital to deploy and few alternative thematic strategies in which they can invest.

Deal flows for living assets in the first half of 2024 have been relatively robust

Exhibit 3-12 **Asia Pacific Living Sector Transaction Volumes 1H 2024**



Source: MSCI Real Capital Analytics.

compared to other asset classes, with transactions down 8 percent year-on-year, compared to a 31 percent decline seen in traditional sectors, according to MSCI.

The best-known, and by far the biggest, component of the living assets group is the multifamily sector, which until fairly recently was confined almost exclusively to Japan, although the recent emergence of multifamily sectors in other markets (in particular China and Australia), has now diluted the Japanese monopoly (see exhibit 3-12).

Japan

Having peaked in 2022, multifamily activity in Japan has slowed as cap rates compress to a point (as low as 3 percent), that makes further declines unlikely. While investors remain positive about rents rising due to a combination of inflation, higher wages, and increased migration to urban areas, the potential for domestic interest rate hikes in 2025 implies significant downside for returns – a prospect that resonates with investors who have already ridden years of outsized profits.

The sentiment was summed up by a manager at a global fund, who said: “It’s very late cycle for multifamily, so I don’t think you’ll see much more compression. Japan is still an interesting and deep market, so you always find some opaqueness and mispricing, but I think the easy money has been made.”

Investors are therefore prioritising asset management as a way to push rents higher. As discussed in the “Japan: Key Themes” section in chapter 1, this means pivoting away from strategies that aim to accumulate large portfolios of properties in favour of adding to existing platforms by cherry-picking smaller assets or targeting individual sub-markets. Either way, the goal is to introduce specific operational improvements that enable managers to eke out incremental gains in efficiency.

As one locally based multifamily investor observed: “Several years ago, there were a lot of forward commitments, and a lot of portfolios bought purely on a yield basis – but they weren’t selecting assets so much as just trying to get scale. That’s definitely changed, with more focus on creating value-add strategies through the nitty gritty of asset management – today, you just can’t get around value creation at the fundamental asset management level.”

China

China’s stock of multifamily assets has grown rapidly in recent years, supported by government policy incentives, changing preferences among China’s younger demographic, and economic factors that make home ownership either unaffordable or unappealing as housing prices continue to trend down. With just 5 percent of households in Shanghai currently renting homes (compared to some 60 percent in Tokyo), the industry has enormous blue-sky potential that is further boosted by falling interest rates (as low as 3 percent for development loans) and declining construction costs.

By far the most important catalyst for the sector is a government policy initiative that offers investors both low taxes and affordable land, allowing them to underwrite acceptable returns in markets where rental yields would otherwise be unappealing. What is known as “R4” land is specifically zoned for rental housing and sold at a fraction of the usual land price (i.e., in Shanghai, around 20 percent, according to one investor). Much of it consists of plots located outside the city core that was zoned for industrial use. Substantial amounts of R4 land have been tendered in Shanghai on this basis.

Two different investment models are in use. The first is an asset-light, private equity–type approach, where operators raise third-party capital (a propco/opco strategy) to build and manage scalable platforms. This was the preferred method in the days before the government offered access to low-cost land. According to a Shanghai-based investor: “The strategy is to capitalise on as many investment opportunities as possible to grow their AUM. They don’t necessarily need to own a big chunk of those investments, and they serve as the asset manager or developer. The idea is to one day list as an asset manager.”

At the moment, finding local capital willing to invest in projects at targeted valuation levels is challenging due to the weak economy, although at least two large foreign investors have recently made substantial commitments to local co-living-type rental platforms aimed at young professionals based on this model.

The other approach is a more conventional asset-heavy strategy, where an underused building, such as an office block in or near the CBD, is converted to high-end rented residential use on an opportunistic basis.

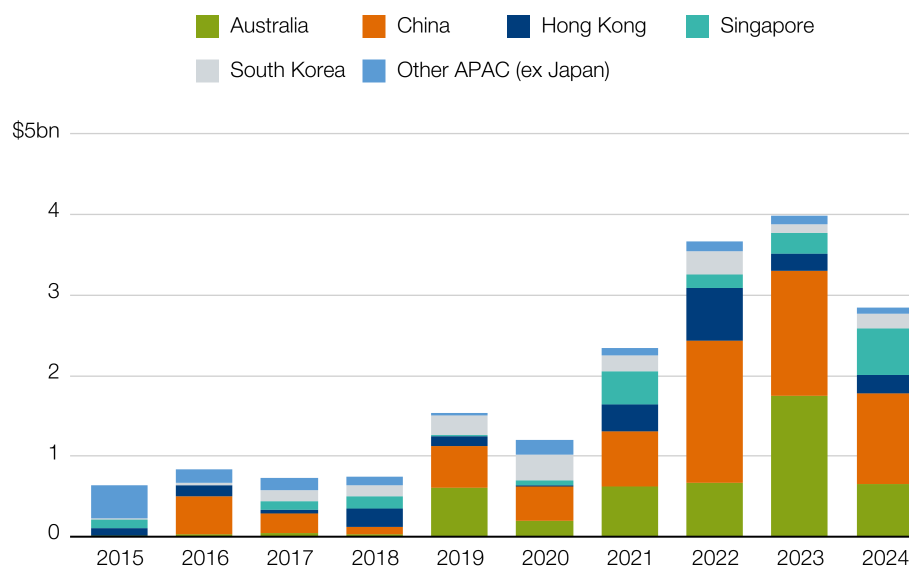
Another factor supporting capital flows to the Chinese multifamily sector is an influx of domestic institutions looking to build large housing portfolios. These offer a natural exit for funds holding smaller portfolios of aggregated assets, and have become especially important in an environment where foreign funds are no longer active buyers. According to a locally based fund manager: “The biggest trend today for institutional rental housing is that Chinese institutions are now looking to own more core and stabilised rental housing products – something not even on their radars five to six years ago. The fact that there’s such huge appetite from domestic institutions creates opportunities for guys like me to look at value-add development or opportunities to build good rental housing stock and then exit to them.”

China’s new CREIT regime is now also eligible to cater to rental housing assets, creating another potential exit option over the longer term. However, the CREIT framework is not yet fully open to foreigners. According to one fund manager: “There are still a lot of constraints with CREITs from an international investor’s perspective, so

when we look at potential deals in China rental housing – although it does give you some hope – we're not counting on them for an exit."

Despite these various tailwinds, there are also challenges for foreign investors. In particular, competition to place capital is tight. Local state-owned enterprises see rental housing investments as much in terms of their social benefits as an opportunity to generate returns, and are able to outgun foreign buyers in terms of cost of capital, cost of construction, and lower return thresholds. Funds therefore need to purchase assets on a very low cost basis, and even then margins remain thin, with one large foreign fund citing targeted returns of sub-10 percent for core-plus, and 11 percent for value-add strategies.

Exhibit 3-13 **Asia Pacific Multifamily Markets Outside Japan, 3Q 2024**



Source: MSCI Real Capital Analytics.

Australia

The market for institutionally owned rental housing in Australia (known locally as "build-to-rent") has emerged out of nowhere in recent years. As in China, it has been the beneficiary of favourable government policies aiming to increase the nation's stock of housing at a time when home prices are soaring, immigration is accelerating, and new home construction has stalled.

Global institutional funds have recently made significant commitments to Australian multifamily projects in collaboration with local developers. In doing so, they often act in pursuit of a worldwide mandate to allocate capital to living assets (in general) and multifamily projects (in particular). In the case of Australia, they are also often willing to overlook short-term underperformance in targeted returns on the basis that secular change in the local market will ultimately drive future uptake and rental growth. Whether their bet will be successful has been the subject of much debate among the local investment community.

The most problematic issue concerns yields, which at around 4 percent remain below the government's 10-year bond benchmark. As one interviewee observed: "I struggle to see the value because you still have the development risk, the vacancy risk, the operational risk, that aren't priced into that." To make matters worse, the introduction of draft regulations aimed at reducing withholding tax and boosting the affordable housing component of new multifamily projects have done little to convince investors they offer real benefits, leading one Sydney-based fund manager to describe the model as "fundamentally flawed".

In addition, questions have long been raised about organic demand for rental housing in Australia given a cultural preference for home ownership and the fact that most build-to-rent development is aimed at the high end of the market, which is not the main source of housing demand.

Beyond that, a catalogue of negative influences have conspired against ongoing projects. First, any type of development in Australia has become a high-risk exercise as a result of steep increases in construction costs and acute shortages of labour that have generated a wave of bankruptcies among local builders. The increased risk has made banks less inclined to fund residential development, and more likely to charge higher spreads if they do. This in turn has made investors more reliant on capital sourced from private debt providers at significantly higher cost (say, 1,000 bps above the cash rate, compared to 400–500 bps if sourced from banks) – a burden they are not positioned to absorb given already tight cap rates.

According to another Sydney-based investor: "The problem with build-to-rent is that everything's hard at the moment because the tax settings aren't in favour of institutional investors. Fundamentals are so strong, but there's a lot of complexity around the zoning, construction costs are high, and it's problematic to actually deliver the product. And then, in terms of general business risk, because the operating model is still new to Australia, I expect we'll just take some time to work through and become efficient at it, because nobody has scale and actually nobody's done it here before, so it's going to be a bit lumpy."

Perhaps unsurprisingly, new investment in build-to-rent assets slowed substantially in 2024, (see exhibit 3-13) with the market turning instead to other living sector themes, including student housing and the land lease sector. That said, and

despite recent missteps on the policy front, government support for creation of a domestic multifamily market, with particular emphasis on affordable housing, virtually guarantees a degree of preferential treatment for the rental market and implies authorities will engineer a positive outcome for the sector one way or another.

Senior Housing

Asia's rapidly aging demographic profile means that increased demand for senior care residences – running the gamut from nursing homes to independent living communities – is statistically inevitable. Demand among investors for senior living assets rose significantly in 2021–2022 as fund managers picked off available assets, but the fragmented nature of the industry (apart from in Australia) has meant that activity has tailed off now that the bulk of available institutional-grade assets have already been bought.

Nonetheless, investor interest in the space remains strong, and with demographic tailwinds in its favour, the focus has moved to development as a way to manufacture new assets. Japan is a major regional market. According to a Tokyo-based fund manager, his fund adopts three different strategies. The first involves development via forward purchase. "On the occupier side, there are waiting lists for senior housing that are off the charts," he said, "and we can't build enough to supply it. Structurally, it's just not possible." The problem lies in local labour shortages and fast-rising construction costs that have made builders unwilling to commit to deals at current rates due to the risk of further cost increases.

Where new assets have been built, however, investors master-lease the facility to an existing operator, who provides medical-related services. While there are literally thousands of operators in Japan, the vast majority are single-asset operations, with perhaps 50 that have enough scale for investment funds to work with, the investor said.

Otherwise, funds can acquire existing assets on a sale and leaseback basis, or work to aggregate small operators until they assemble a portfolio that can be sold.

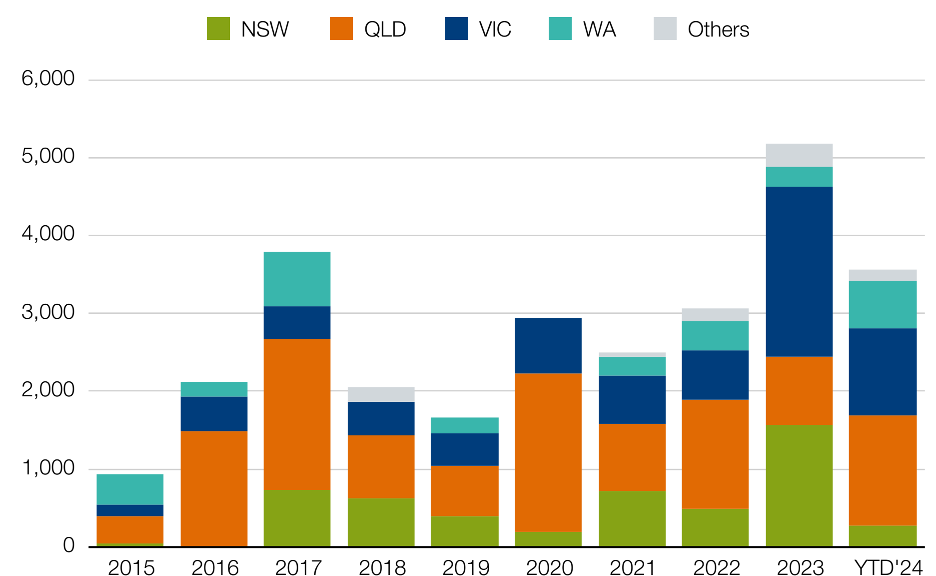
While investment funds can draft master leases in ways that allow them to replace operators should they underperform, senior housing businesses in Japan must be structured into both a non-profit component and also a for-profit medical services component in order to qualify for government insurance payments. This convoluted operating format makes the business opaque and has in the past led to operating partners syphoning off profits.

The regulatory complexities of operating senior housing facilities that include medical service components have led many investors to gravitate instead towards models that are "assisted living and below", as one investor described it. "It's a hybrid between residential real estate, hospitality, and a service department," he continued, "basically a service department on steroids relative to concierge side."

This type of offering involves product formats that differ significantly from country to country. They are currently being rolled out in a number of jurisdictions, from South Korea to Vietnam to Thailand. One investor described a project in Bangkok involving a retrofit of an existing apartment block into one- or two-bedroom units, reinventing it for senior living purposes, then leasing it out on a multi-year basis. "There are so many different ways to cut it up and so many different ways where people fit and so many different ways in which it's defined," the investor continued. "Is it wellness? Is it active? Is it age restrictive? Are you intergenerational? Are you a grandma? Are you sales? Are you rentals? It's just a mixed bag of everything."

A final approach to senior housing is the independent living segment, where minimal assistance or care elements are necessary. This model has recently gained momentum in Australia, where the senior housing sector in general is seen as more mature (and therefore more investable) than in Asia. Investment in the land lease model, whereby retirees rent land on which they then build and own

Exhibit 3-14 **Construction Starts of Australia Land Lease Villages, 3Q 2024**



Source: MSCI Real Capital Analytics.

their homes, has seen explosive growth in 2024 (see the "Australia: Key Themes" section in chapter 1).

Hospitality

For an industry hit so badly by pandemic travel restrictions, the rebound of the Asia Pacific hospitality sector has been impressive. After an initial wave of post-pandemic revenge travel – accompanied by a parallel wave of hotel buying – peaked in 2023, the market has now achieved an equilibrium of sorts.

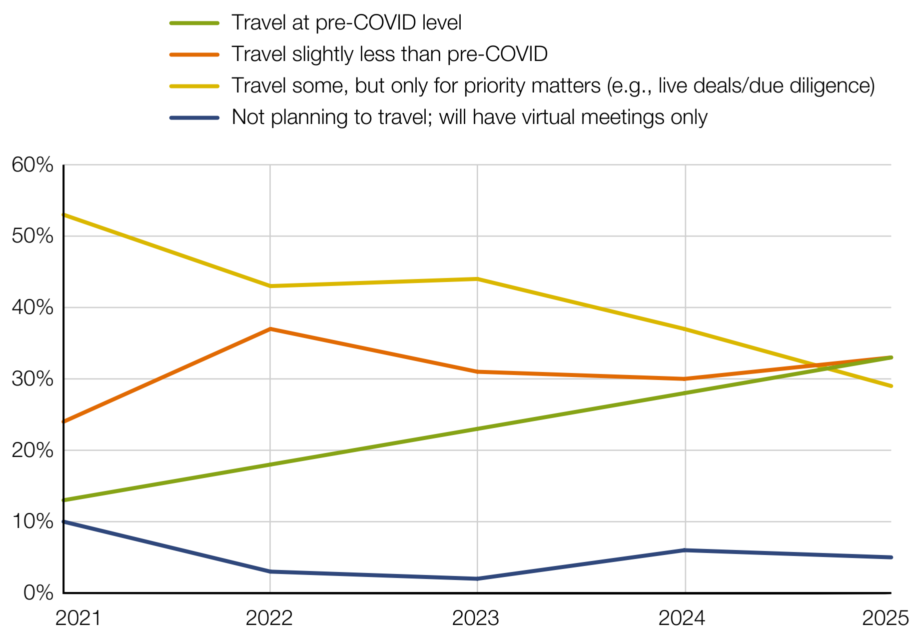
Buying interest across the Asia Pacific is currently focused on Japan, Singapore, and possibly Thailand, although the latter two have seen relatively little activity due to unrealistic bid/ask spreads.

China has also seen significant numbers of transactions, although these mainly involve local capital targeted at distress deals. According to a Hong Kong–based consultant: "There's plenty of assets changing hands [in China] where wealthy individuals have cash and they want to pick something up. But they don't look at yields, and I've yet to fully understand their rationale. So there is liquidity there, it's just not measuring with the same tape as other people."

Japan, therefore, remains the market with by far the strongest institutional deal flow, driven as usual by positive carry resulting from Japan's cheap financing, together with resurgent tourism, a weak yen, and a minimal pipeline of supply. However, while investor interest and deal flow are strong, the local industry is not without problems.

First, asset prices in Japan rebounded very quickly post-COVID, wrongfooting many investors who made pitches for apparently distressed Japanese assets at low price levels, then missed out when the market moved on without them. This echoes the experience elsewhere in the region, where a multitude of distressed hotel assets had emerged, but relatively few were sold at distressed prices. As one interviewee commented: "We did see some transactions coming out of

Exhibit 3-15 **How have your business travel plans changed post-COVID?**



Source: *Emerging Trends in Real Estate Asia Pacific* surveys.

COVID, but that window where stuff was affordable, or where you could be really opportunistic was only a year, or half a year across the region. Those who bought something may have gotten a good deal, but usually quality assets in Asia are with very resilient owners, and so we just didn't see that much forced selling."

Another problem is that the industry's high average daily rates (ADRs) disguise chronic labour shortages that prevent them from operating at full occupancy. Again, this issue has application across the region and is not restricted to Japan. Staff laid off or furloughed when hotels closed during the pandemic have opted not to return once they re-opened, citing difficult working conditions and poor pay.

According to a Tokyo-based fund manager: "ADRs may be high, but RevPAR [revenue per available room] is not as high, because occupancy is not the same as 2019. So all these labour shortages mean that a number of luxury hotels in Tokyo aren't running all their rooms because they don't have staff. They might be highlighting these ridiculous ADRs, but they're only filling 65 or 70 percent of their rooms. Overall, they're still highly profitable, probably higher than 2019, but if you could solve that problem, you would be on an even better trajectory."

One way to address this is simply to structure facilities to operate with fewer staff. This is hard to do with luxury or resort hotels, which require higher staffing thresholds to maintain service standards. Many investors have therefore switched their attention to so-called "limited service hotels" that, in the words of one investor, "need only seven to nine people to run the entire hotel, as well as outsourcing the cleaning."

Another option is the "business hotel" model. This again offers limited services and is conceived around small room sizes of around 15 square metres aimed at local businessmen making short-stay domestic trips.

A third model, which has gained some traction in Europe and is being considered by operators in Asia, lies in tech-enabled hotels that automate check-

in and other functional processes using smartphone apps, while also eliminating onsite dining, minimising room service, and generally provide a minimum of human interaction.

Yet another approach, this time mentioned by a fund manager in Australia, involves “lifestyle hotels”, which he cited as “the fastest growing hotel sector globally”. These again involve smaller room sizes, in this case fitted out in a contemporary and efficient way. “They look funky,” said the fund manager, “but people who stay there tend to spend more time downstairs in the bar. So you're generally checking in at the bar, there are pool tables, they often have DJs, and you can have a meal down there. It's more of an experiential type of accommodation than for people staying in their room and ordering room service.”

A final problem for hotel investors looking to buy in Japan is that increasing flows of incoming investment capital looking to buy local hospitality assets has led owners to raise their asking prices, creating a new bid/ask gap that has left many prospective deals in limbo.

According to the Hong Kong–based consultant: “There just aren’t enough opportunities for everyone. If you look at the big private equity guys, they can pick up half-a-billion dollar assets, but you can probably count that type of buyer on one hand. And then anything in the under-US$100 million range will have so many buyers that it’s very difficult to make the pricing work. Your entry is basically restricted to the three main markets of Osaka, Tokyo, and Kyoto, and to make the numbers stack in those key areas is very tough right now.”

Interviewees

151 Property
Sachin Dave

Abacus
Gavin Lechem

Actis
Brian Chinappi

Acacia Capital Partners
Kumar Kalyanakumar

Aliro Group
Andreas Hacker

Alyssa Partners Japan
Ken Fridley

AP Hospitality Advisors
Dan Voellm

Barings
Alastair Wright

Brookfield Asset Management
Scott Mugglestone
Leonie Wilkinson

CBRE
Henry Chin

CBRE K.K. Japan
Takashi Tsuji

Cistri
Jack Backen

Colliers
Mike Davis
Simon Hunt
Lachlan McGillivray
Christopher Pilgrim

CRE Logistics REIT
Tsuyoshi Ito

Daiwa House Asset Management Co., Ltd
Koichi Tsuchida

Denison Partners
Ian Holmes

DevinQi Advisors, Thrive Senior Living
Dan Cerf

Diamond Realty Management
Hisashi Ishiwata

ExtraM Partners
Ryota Morioka

EQT
Paul Gately

ESR Group
Ivan Lim

Fraser Property Limited
Adrian Choo
Wanshi Zheng

Highbury Partners
Ben Roberts

Hines
Jon Tanaka

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Yoshito Nishikawa

ICG APAC Infrastructure
David Richardson

ICG APAC Real Estate
David Kim
Stephen Tang
Isaac Leo

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Calvin Chou

Invesco Global Real Estate Asia Pacific, Inc.
Ryukichi Nakata

ISPT
David Rogers

Japan Hotel REIT Advisors Co., Ltd.
Shigeo Nakazato

JAPAN POST BANK Co., Ltd.
Hiroyuki Tanaka

JGS Property
Russell Meacham

JLL Japan
Ryuta Takeuchi

JPMorgan Asset Management
Tetsuya Karasawa

KENEDIX, Inc.
Keisuke Sato

KJR Management
Naoki Suzuki

Knight Frank
Christine Li

LaSalle Investment Management
Joelle Chen
Adam Donahue
Kunihiko Okumura

LendLease Japan
Andrew Gauci

Mirvac
Scott Mosely

Mitsubishi HC Capital Realty Advisers Inc.
Itsuo Wakao

Moelis Australia
Ben Boyd

Morgan Stanley
Susan Sun

MU Real Estate Asset Management / Mitsubishi UFJ Trust and Banking Corporation
Naokatsu Uchida

Nuveen
Steven Bass
Louise Kavanagh

PAG Investment Management Limited
Naoya Nakata

PGIM Real Estate
David Fassbender
Morgan Laughlin

Professional Property Services
Nick Brooke

RF Corval
Tim Nation

Schroders
Andrew Moore

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- Which metropolitan areas offer the most and least potential
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