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Asia Pacific

EMERGING TRENDS IN REAL ESTATE®

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Urban Land Institute

Emerging Trends in Real Estate® Asia Pacific 2022

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Asia Pacific 2022

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Executive Summary

As real estate investors plan their 2022 post-pandemic strategies, the road ahead is fraught with uncertainty. Transactions are rebounding after nearly two years of lockdowns and travel embargoes, but the contours of the investment landscape in the Asia Pacific have been reshaped—in some ways profoundly—by pandemic-induced changes to the way we use real estate.

As the new dynamic unfolds, investors are adapting in a number of ways:

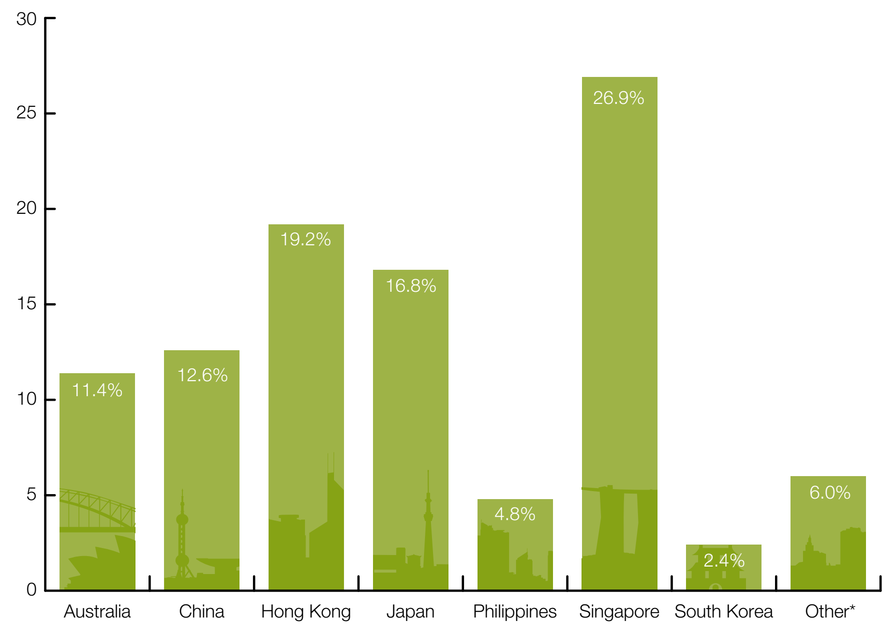
- **Focusing on operations and services.** Today, commercial real estate is no longer regarded as a plain-vanilla investment held over time. With yields continuing to compress and occupiers demanding more, landlords are becoming more proactive in asset management, either by providing new amenities for tenants or by investing in operationally intensive asset classes such as data centres.

- **Pursuing value-add projects.** As markets evolve, many existing buildings are becoming inefficient. Buying to renovate has become one way to arbitrage those inefficiencies, whether through the use of technology, changing building usage, or upgrading to a higher environmental standard.

- **Investing in the theme of decentralisation.** Central business districts (CBDs) have traditionally represented the biggest store of wealth in real estate terms, but the primacy of the CBD is no longer secure. Not only do secondary business hubs offer cheaper rents, but with many employees now working at least part-time from their homes, employers are responding by providing workplaces nearer to where they live.

- **Buying into the new economy.** Companies focused on the growing digitisation of the economy, which are less inclined to locate in CBDs, are also driving this trend. This includes both out-and-out technology companies as well as traditional businesses that are digitally based, be they online education, e-commerce retailing, or even logistics companies that serve demand from internet-based businesses.

Survey Responses by Country/Territory



Source: *Emerging Trends in Real Estate Asia Pacific 2022* survey.

*Includes Indonesia, Malaysia, Taiwan, Thailand, USA, Vietnam.

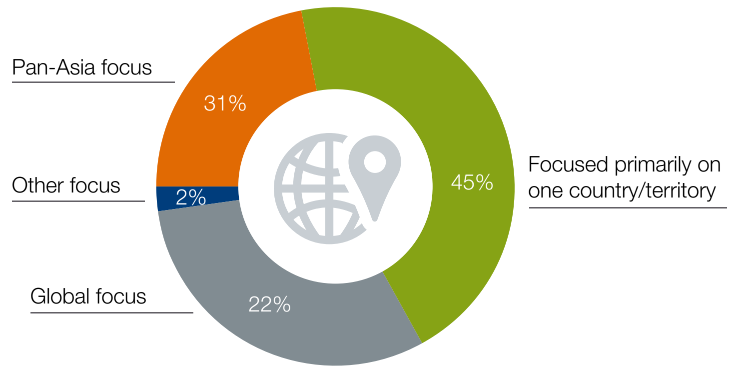
- **Niche asset classes boost yields.** Investors have been buying niche assets for years as a way to eke out higher returns. This trend continues, although it is now also seen as a way to pursue demographic change across society. Retirement living is one example, while work-from-home networking requirements and millennial shopping preferences are driving demand for data centres and cold storage facilities.

Last year, interviewees anticipated a surge in distressed assets in 2021, especially from hard-hit asset classes such as hotels and retail. So far, though, with a few notable exceptions (China, for example, where a financing squeeze has led developers to divest noncore holdings), few forced sellers have appeared. This is partly because banks—with the tacit support of governments—have been reluctant to call underwater loans. Otherwise, the sheer weight of capital seeking to buy real estate assets has ensured that competition is strong and bids remain high.

The push to make buildings environmentally friendly gathered pace in 2021 and promises only to accelerate in future as institutional buyers increasingly adopt mandates requiring compliance with environmental baselines, and more corporate occupiers require their let space to meet higher standards. As a result, landlords are moving to adopt new technology that not only increases efficiency, but also measures and reports in real time everything from electricity and water use, to the flow of people in buildings, to air circulation levels, elevator usage, and maintenance issues.

In terms of capital flows, rising investment volumes have targeted mainly assets in established gateway cities, as investors seek safety in economically stable and liquid markets. Travel embargoes have meant reduced cross-border purchasing, as well as a trend for Asia Pacific capital, when it does venture offshore, to remain within the region rather than migrating to the West. Singapore was the largest exporter of regional capital in 2021, with both sovereign wealth and local real

Survey Responses by Geographic Scope of Firm



Source: *Emerging Trends in Real Estate Asia Pacific 2022* survey.

estate investment trusts (REITs) bidding aggressively for higher-yielding offshore properties.

Tokyo placed top in this year's investment prospect rankings, swapping places with Singapore, which featured first in both the 2020 and 2021 surveys. Tokyo's enduring popularity is down to a variety of factors: a stable economy combined with a deep and liquid market, resilient asset values, and a long track record of better-than-expected returns. While cap rates seem thin, low interest rates generate yield spreads that outperform markets with apparently better fundamentals.

On the development side, Singapore topped the table, boosted by expectations of supply shortages due to a limited pipeline of new development sites and the withdrawal of stock from the market for redevelopment purposes. One fund manager predicted a 30 percent increase in rental growth over the period to 2026. Seoul's ranking of fourth reflected high development yields and soaring transaction volumes due mainly to buying by domestic institutions that culminated in US$10.6 billion worth of deals in the third quarter of 2021—the highest in the entire Asia Pacific region.

Bank finance, meanwhile, remains freely available, with cost of capital either trending down or remaining stable across most markets, apart from China. Availability of nonbank finance has also improved, although with bank capital so plentiful, its use tends to be reserved for deals involving noncore assets or high leverage.

The impact of the COVID-19 pandemic on individual asset classes has been in some cases profound.

Office: Office has been the go-to asset class for many years, but its popularity has suffered lately as investors question its staying power in the age of corporate work-from-home policies. At the same time, many investors are convinced that the impact will be limited in Asia and so are now taking contrarian bets, focusing on well-located, good-quality assets. In order to attract and retain talent, employers are moving to provide workplaces that are both less dense (for health and wellness purposes) and also offer collaborative facilities and experiential spaces. In addition, despite the fact that coworking facilities have seen reduced usage as workers shy away from shared workspaces, flex offices are becoming increasingly popular ways for occupiers to hedge uncertainty about future staffing requirements, as well as to minimise exposure to long-term leases of conventional office space.

Logistics: The surging popularity of logistics as an asset class is due to a combination of factors: structural undersupply of high-quality assets, the evolution of more sophisticated supply chains, and the rapid growth in e-commerce retailing, catalyzed recently by pandemic lockdowns. Transaction volumes have boomed this year, but investor appetite is undiminished despite ongoing yield compression. The extent of the shortfall in modern warehouse stock in the face of rapid demand growth ensures strong ongoing demand for new product. Productivity benefits offered by new types of warehousing technology are another catalyst that is accelerating the obsolescence of aging infrastructure.

Retail: The explosive growth of e-commerce retailing in the wake of widespread lockdowns has created a pervasive sense of negativity towards conventional retail assets, exacerbating a decline that had started even before COVID-19 arrived. At the right price, however, any asset becomes attractive, and the sector seems to have hit that point around the middle of 2021, as third-quarter retail transaction volumes spiked. Values and cap rates have moved to a point where repurposing becomes realistic economically, and a significant minority of investors now see the current downtrend as a rare opportunity to buy and reposition underperforming but well-located facilities. Tenant mixes will change, therefore, but there are still plenty of uses for CBD retail sites, even if not all of them are focused on conventional retail shopping.

Residential: Weak economic fundamentals, combined with rising inflation, make the residential sector appealing to institutional capital, and many funds are now looking to participate in the Asia Pacific region's growing multifamily sector, especially in the leading markets of Japan, Australia, and China. That said, several interviewees questioned the fundamentals of multifamily investing in the Asia Pacific, where high home prices make yields thin and leave little margin for error when underwriting deals.

Hotels: Hard hit by pandemic travel embargoes, the hotel sector has become a target for investors seeking distress deals. They have been mostly disappointed in 2021, however, as banks hold back on foreclosures and owners hold on in the hope of better times ahead as domestic travel picks up and safe travel corridors open. Still, with debt levels sky high, bank patience may dry up in 2022, with the long expected wave of distress deals beginning finally to gain traction.

Notice to Readers

Emerging Trends in Real Estate® Asia Pacific is a trends and forecast publication now in its 16th 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 2022*, 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.

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

Emerging Trends in Real Estate® Asia Pacific 2022 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 101 individuals and survey responses were received from 233 individuals, whose company affiliations are broken down below.

Private property owner or developer	- 24%
Real estate service firm (e.g., consulting, financial, legal, or property advisory)	- 27%
Fund/investment manager	- 25%
Homebuilder or residential developer	- 8 %
Institutional equity investor	- 8 %
Bank lender or securitised lender	- 1 %
Other entities	- 8 %

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.

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: A Brave New World

"This is a fascinating time to enter real estate because the changes over the next 20 years will be dramatic."

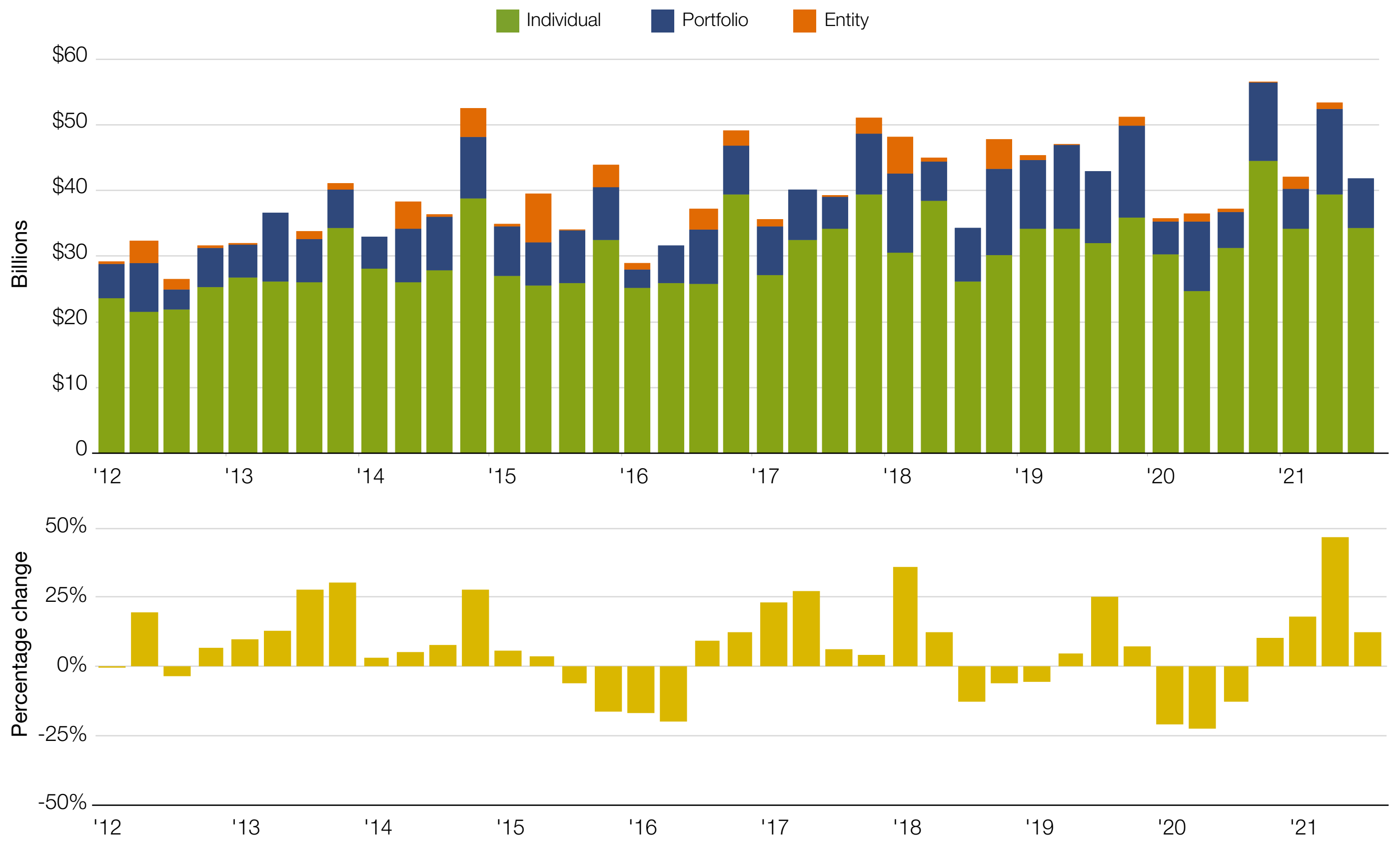
As the outline of real estate's post-COVID landscape begins to take shape, it is clear that in many important ways it differs quite radically from what we knew before. New-normal workplaces, for example, are hybrid constructs of traditional and digital; old-school retail has been hollowed out; warehousing has come from nowhere to be lord of our virtual supply chains; and our homes now function as venues for work, entertainment, and just about everything else.

The question now is: what happens next? While the market's recent excursion into the unknown inevitably tend to revert towards the mean, there is also a sense that many changes are not only here to stay, but are also, in a way, hard won. For years, real estate's notorious resistance to change was based on the inertia of the status quo, but as necessity and technology have pushed past vested interests, it is apparent that the most salient feature of the budding post-pandemic world is how it has evolved to the benefit of the masses, who now enjoy less commuting, better working conditions, more consumer choice, and experiential environments wherever they go. Indeed, it is probably fair to say that the long-overdue shift in the balance of power from the owners of real estate to its users represents the most positive shift for the industry in a generation or more.

In the meantime, the nuts and bolts of the real estate world—wherein buyers invest and owners either sell or evolve—is reaching out towards some semblance of normality. As sentiment has rebounded in the second half of 2021, competition for assets has increased, with investors moving to deploy a wall of dry powder that has grown ever higher since early 2020.

Asia Pacific transactions in the third quarter of the year surpassed US$40 billion for the fourth consecutive quarter, according to analysts Real Capital Analytics (RCA)—up 12 percent on the year and roughly the same as in the third quarter of 2019. The strength of the rebound is perhaps better measured, though, by the US$68 billion pipeline of upcoming deals, which is more than double what it was two years ago.

Exhibit 1-1 **Asia Real Estate Transaction Volumes by Source of Capital (with Year-on-Year Percentage Change)**



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

Unsurprisingly, activity has been led by China, whose zero-tolerance approach to pandemic containment has so far proved effective in insulating it economically from pandemic fallout. South Korean volumes also continue to be remarkably strong. Investment in Australia, meanwhile, has rebounded with a vengeance, up 145 percent year-on-year in the third quarter. Singapore and Hong Kong, meanwhile, are recovering more slowly, while activity in Japan continues to stagnate.

Still, while the bounce in activity is a welcome development for funds' investment committees, finding a home for the growing glut of undeployed capital is causing a fair amount of soul searching. This is not only because pricing—especially for core product—remains prohibitive despite 18 months of elevated risk and deteriorating fundamentals, but also because the industry has in many ways changed drastically in the interim, leaving investors in limbo as they look to sift markets for value and risk. In doing so, feedback from our interviews suggests that hotels and retail are currently a hard sell (unless distressed), office is questionable (though for some a countercyclical buy), value-add and niche (especially for new economy assets) are favoured, and logistics is the sole home run.

Examples of uncertainty abound: how will work-from-home mandates affect demand and fitout for office space? How should malls be reimagined as shoppers migrate to online retailers? How will prolonged travel embargos affect economic growth? What are appropriate risk/return profiles for old and new economy industries? Should underwriting practices reflect environmental, social, and governance (ESG) or net-zero carbon compliance?

In Australia, a Sydney-based developer questioned how anti-pandemic measures would affect local housing markets: "The big issue is: what's going to happen with the population? Whether demand peters out or whether lack of supply creates equilibrium, I don't know. Technical demand—as in births, deaths, and marriages versus new houses—has outstripped supply for the last 15 years, with household makeup taking up the slack. But it's unknown territory for us—we've never seen such low immigration and low population growth since World War II, so we don't know what this means."

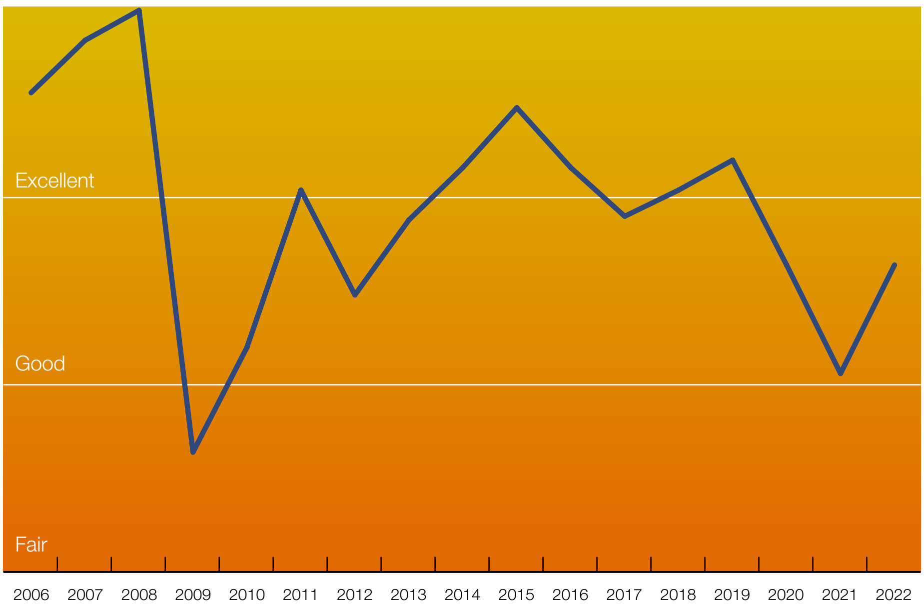
Or, in the words of the global head of one large private-equity group: "We're sitting on this convergence between the post-pandemic world and a number of other influences: technology, ESG, and then the whole question about climate. And when you put those four macro forces together and overlay them onto our industry, I don't know where this goes."

The sense of uncertainty is amplified in Asia Pacific markets because their experience of the pandemic has been quite different from that of the West, both in terms of policy response and also the direction in which individual asset classes were already evolving. According to one fund manager: "Asia is probably the most similar [market] in terms of where it was, pre-pandemic, for some of these trend lines. The office question, for example, is clearly not as big as in the West. The acceleration of e-commerce and industrial [currently underway in the West] is no surprise in Asia. Local retail was having its struggles anyway, so no surprise there either. So Asia is probably less volatile in terms of changing strategy compared to Europe and the U.S."

In practical terms, and while our survey of investor sentiment (see exhibit 1-2) shows a significant rebound compared with last year, fund managers are still getting to grips with what this means for sourcing and underwriting deals. According to one: "Our investment strategies haven't changed, but it has changed questions around risk, which we are evaluating differently. So, for climate change, how do you know if a building is going to be functionally obsolete? Is it even possible from a net-zero carbon perspective? Possibly, but no one knows, so I think there's a chance it will change our strategies globally."

As a result, and as this new dynamic gradually unfolds, investors are adapting their strategies in various ways:

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



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

Services and Operations

In the past, real estate investment was seen as more of a buy-and-hold exercise that functioned much like a long-term bond: a vehicle for yield, in other words, involving an element of asset management. But today, with cap rates continuing to tighten, competition rising, and occupiers increasingly discriminating, a more proactive approach is needed.

As one Shanghai-based investor observed: "Slowing growth rates from a macro perspective and widening variance of returns is forcing owners to derive value from operational performance as opposed to just the beta trade. If everything is growing at 15 percent a year, you don't have to be very active in your day-to-day management to make a lot of money. But now the tide isn't rising as fast, so it's forcing owners to look to add value through operational technology and efficiency."

At the most basic level, this means that landlords are more likely to accommodate occupiers' particular needs by providing relatively straightforward services and amenities to improve the tenant experience. These might include the provision of turnkey space, membership packages, better hardware, and access to flex workspace.

According to a fund manager in Tokyo, "People that can do that are going to be more successful than the old-style landlords who go: 'Here's your vanilla space, now it's all on you, when you leave you're going to have to return [the space] back to the original, and by the way, give me 10 months' deposit and your firstborn.' I think that's a differentiation today that some groups have and others don't, especially compared to the typical old-style developers, who just aren't going to do it."

A Singapore-based investor in the multifamily space commented: "We continue to build personal relationships. You can always hand tasks off to other operators, but nowadays we like to create value beyond just the contraction of cap rates, whether it's sustainability, or tenant surveys, or incentivising [tenants] to stay longer. We currently have assets targeting students in a particular area [in Tokyo]—not student housing as such, but the asset has been modified to attract students because there's a university nearby. And we have other assets, for example, that we would like to master-lease to a co-living operator. So we're trying generally to find alternative ways to use assets."

At the other end of the scale, investors are looking to package deals in ways more akin to direct private-equity investments in operationally intensive enterprises—complex businesses, therefore, that just happen to involve real estate. In this context, returns are driven partly by rent and partly by operations, which means that both revenue streams need to be assessed separately to ensure that one business is not subsidising the other.

What all this means from an operational point of view, according to one interviewee, is that "we are trying to secure more strategic and complex deals rather than compete too much in the market; we're trying to think a bit out of the box, trying to buy operating platforms instead of only buying assets, trying to do more strategic transactions that take a lot of time and energy and are not easy to unlock. But if it's successful, you get access to a very interesting situation that is not only a property but also an operating business."

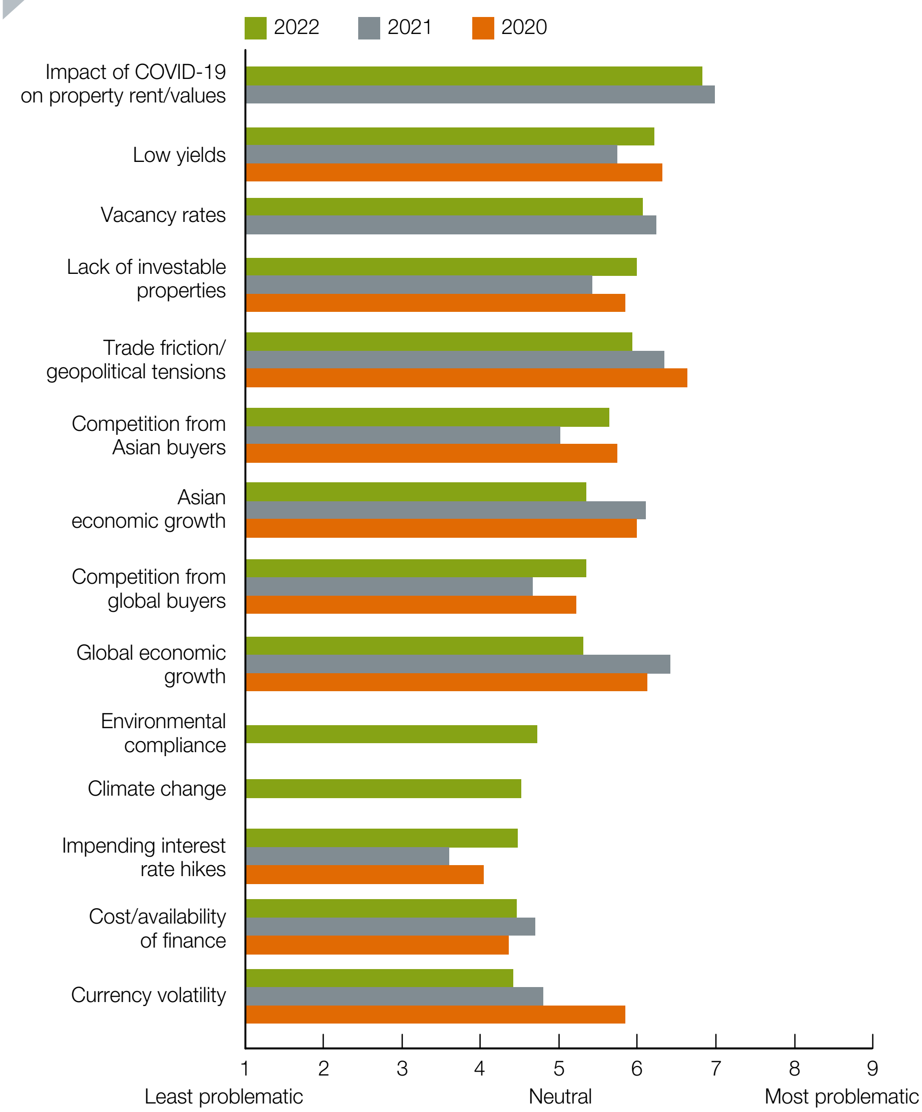
Of course, not all investors are able to run with the ball beyond a certain level of intensity—a reality that favours larger, vertically integrated funds that can afford to employ expertise to manage complex assets such as data centres or cold-storage warehouses. The alternative is to partner with outside experts, although that tends to both reduce margins and increase risk if interests are not properly aligned. However, for funds that lack headcount, or that spread themselves thin across a range of potential markets and asset classes, partnering with specialist teams is probably the only option.

Value-Add Thrives

Given the extent of the changes underway, it is clear that some buildings that may have performed well in the past are likely to be inefficient in the future. These will be added to an already large base of assets that were poorly conceived to start with. According to estimates by JLL, for example, 40 percent of Asia Pacific office space is currently in need of refurbishment, representing some US$400 billion in value-add potential.

Either way, with so much stock in the region in need of repositioning, especially in the office and retail sectors, investors are turning increasingly to value-add strategies when sourcing deals. Not only does this tap a rich vein of potential profit, it also creates a means to bypass the endless grind of cap rate compression that has plagued Asia Pacific markets for years, and that continues to rank as one of the biggest concerns for investors around the region (see exhibit 1-3). Foreign funds also enjoy the additional advantage that they tend to have a well of expertise to help them either reposition or operate value-add projects, often giving them an edge over local capital.

Exhibit 1-3 **Most Problematic Issues for Real Estate Investors**



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

As the scale of the opportunity becomes apparent, it is attracting investors who would normally focus on other strategies. According to a fund manager in Tokyo: "You're seeing more core investors come into the market, and they're willing to pay up a bit. They may be taking a similar viewpoint to the [true] value-add investors in thinking: 'Now's the chance—buy in while the Japan Inc.–type of players are on the sidelines.' They're not getting bargains, but they're definitely pushing into the market, which, when we're selling, is great—they're bidding to a very aggressive number."

Value can be added in many ways, but a few themes are noteworthy:

- Technology provides more bang for the buck. In the past, investors have looked to aircon and lighting systems as easy upgrades, but more recently the trend has turned more towards acquiring and analysing data. As one Australian investor commented: "The value-add is focused around office assets becoming data enabled, as the expectation of corporates that have large office space is for more real-time data [focused] on space utilisation and things like energy usage."

- In China, cash-flow disruptions at some large domestic developers caused by the government's ongoing "common prosperity" initiative is leading them to spin off some underperforming noncore assets at attractive prices. This value-add/stressed-sale situation is now the focus of foreign funds with in-country teams.

- Hotels are often seen as ideal targets for change-of-use strategies, given both the severity of the downturn in the sector and an expectation that the boom in teleconferencing will prevent business travel rebounding to former levels. This applies especially to cities like Hong Kong, where land values are high enough to justify the cost of adapting or redeveloping properties. Japan has also emerged as a target for hotel distress. That said, however, investors active in the hotel sector were ambivalent about the prospects for hotel conversions. According to one: "It's obviously a function of the built form, and whether or not that can be adapted. But most hotels don't lend themselves necessarily to many other uses. Whether it's office, or student accommodation, or multifamily, it's not easy to do, so I think the adaptive reuse can be pretty limited for hotels."

- As both tenants and investors set their sights on either occupying or buying higher-quality buildings, the appeal of grade-B assets, which are less likely to have the modern facilities that occupiers are seeking, has flagged. As prices fall, potential value-add strategies emerge, although location is a key consideration given that some secondary areas may become unfashionable due to lack of access to transportation or other sought-after facilities. Nonetheless, a smart and imaginative approach can reap rewards.

One gauge of how important asset repositioning has become is the extent to which building design is evolving to facilitate future changes of use. According to a consultant based in Hong Kong: "Very often, developers have tended to second-guess what we think the market wants, but it's going to be much more flexible going forward. We will say to architects: 'Build an attractive envelope, make it accessible, but as for what happens within that space, we're going to decide [about] that six months or so from the time we finish the building, because we can't anticipate at this stage how it's going to be used.'" In effect, buildings become blank slates of general-purpose space, similar to a pop-up model, for the market to fill in.

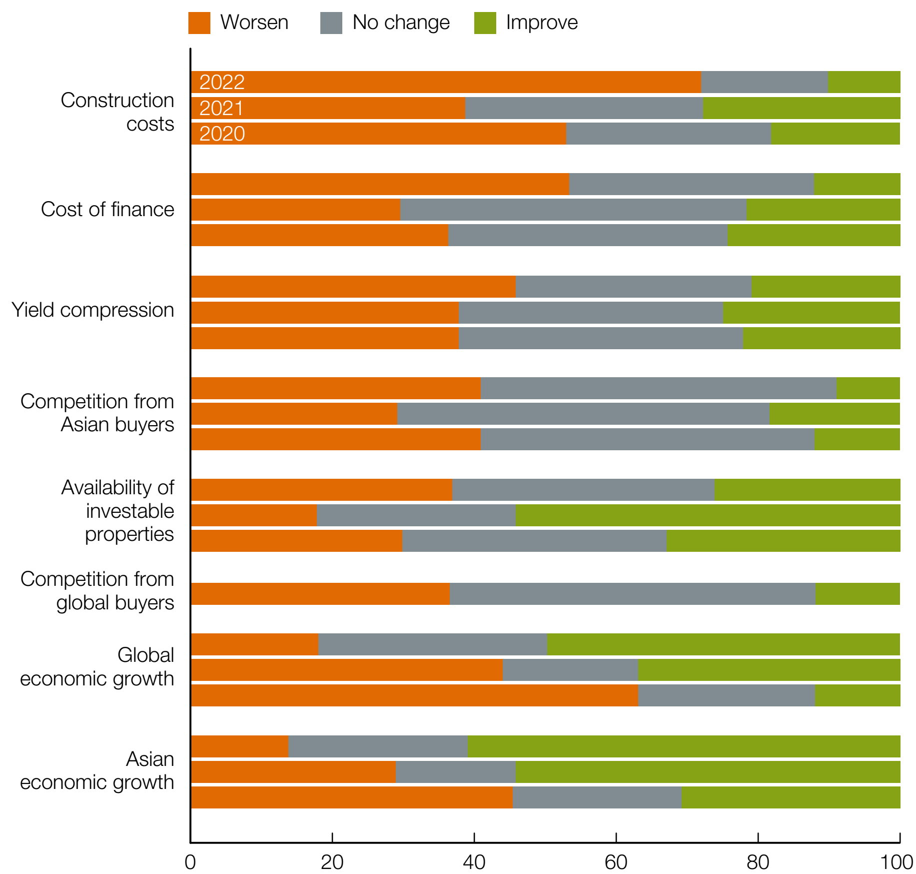
Also, instead of being fitted out, future buildings may be "kitted out" in ways that allow spaces to be re-formed quickly, if not spontaneously. "Beyond that," the consultant continued, "it affects the relationship between landlord and tenant, [creating] a partnership model where the developer shares in the asset value and is also investing in the business indirectly through fitout, or even investing in some of the special features that his partner is installing."

Build-to-Core Still Hot

Another way of approaching value-add strategies is to see them not simply as asset repositioning in the strict sense, as much as a way to create value through disintermediation. In the words of one fund manager, "I do think that the themes we follow, whether it's the densification of wealth in cities, digitisation, or deficient supply—by which I mean not a shortage of stock, but the wrong stock in the wrong place—is a process whereby we disintermediate at the right price point. And for me, the biggest theme is the demand for yield, which is the underpinning of build-to-core."

The reason build-to-core strategies continue to be successful is that vast amounts of core capital, most of it from elsewhere in the Asia Pacific region, are seeking a home in markets that remain structurally undersupplied with core product. Competition for assets is expected to rebound in 2022 after a year of pandemic-related travel restrictions (see exhibit 1-4).

Exhibit 1-4 **Projected Change in Economic Factors, Next Three to Five Years**



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

As one Australian investor commented: "It's a competitive market for assets, and on a risk-adjusted basis, development opportunities look very good, although we usually want to secure tenants before we commit."

One of many regional markets in which build-to-core plays are increasing is India, whose fast-growing real estate investment trust (REIT) sector has cornered much of the market for the country's relatively small number of high-quality income-producing assets due to regulations that allow deferral of capital gains tax on transfer of assets to REITs in some situations. As a result, according to one Delhi-based consultant: "Private funds that have been elbowed out of transactions because of these tax advantages have created a larger pool of capital for forward purchases structured in the millions of square feet, with single transactions of US$500 million, using structured debt."

Until recently, however, investors shied away from build-to-core and forward funding strategies because COVID-19 had made both the demand and rent prospects for new product unclear. In addition, and for the same reasons, banks were not necessarily keen to provide financing. While this continues to be the case in some markets, in particular Japan, rebounding sentiment has seen demand for build-to-core reemerge, including from institutional investors who previously would have avoided development risk. The build-to-rent and logistics sectors are seen as especially suited for this strategy. One logistics operator, for example, reported that sovereign wealth and pension funds that were increasing their allocations to real estate were now looking to take development risk rather than simply buy stabilised core assets as a means to generate higher returns.

Decentralising CBDs

Disintermediation can also be pursued through the theme of location.

Traditionally, the most valuable commercial real estate has always been found in central business districts (CBDs). While this is unlikely to change, especially as core investors continue to seek core product and occupiers opt to upgrade to (now more affordable) CBD office space, in broader terms the primacy of the CBD may not be as absolute as in the past. There are various reasons for this.

First, as much as asset valuations in secondary locations have been victims in 2021 of a pandemic-driven flight to safety, over the long term they offer a price advantage that is hard to ignore. New buildings that are positioned to meet market demand can do well, therefore, especially when they provide facilities not otherwise available on the market.

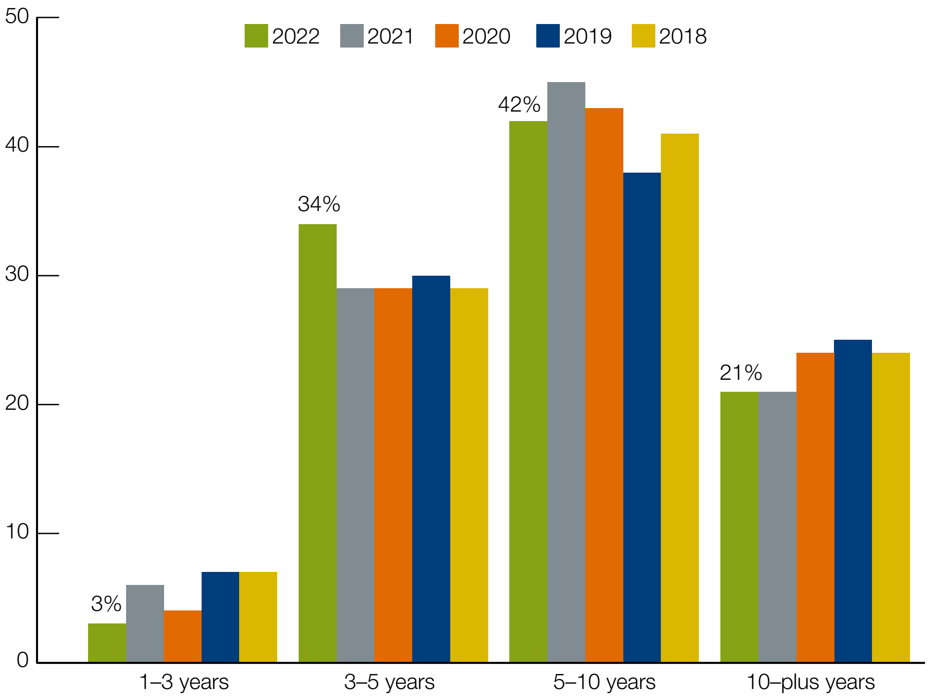
Second, as hybrid working practices create a more decentralised workforce, concern over employee retention is convincing companies to provide workplaces nearer to their homes. As one analyst put it: "People are talking about value add [for grade-B buildings], but the future of offices is no longer people going back to the CBD. So in some mature hubs like Tokyo, Shanghai, even Hong Kong to a certain extent, you don't want to buy grade-B offices in central locations, you should buy decentralised sites that are cheaper—the hub-and-spoke model will prevail."

One opportunistic investor described a successful build-to-core project involving a 1 million-square-foot, large-floor-plate building in a secondary location in Seoul. "We weren't just building new space," he said, "we were building space that we could rent at half grade-A CBD rents and provide an effective grade-A asset in a secondary location that worked for back office. We asked: 'Who are the tenants and where are the employees coming from? What's going to be attractive to them, what subway do they come on?' So it wasn't new demand, it was just being very local on the ground and providing a better value proposition."

This theme will apply in particular to super-metropolises where workers have to endure long commutes. In Manila, for example, one consultant described a global business process outsourcing (BPO) company that had given up 10,000 to 15,000 square metres of city-centre office space in favour of alternative working arrangements, in the form of either work-from-home or flex space. Her client then used what it saved by giving up its office space to invest in better internet connectivity services for its staff. Other Philippines-based interviewees also suggested that local BPO and multinational tenants (MNCs) were surrendering parts of their CBD offices, opting instead for a more distributed model.

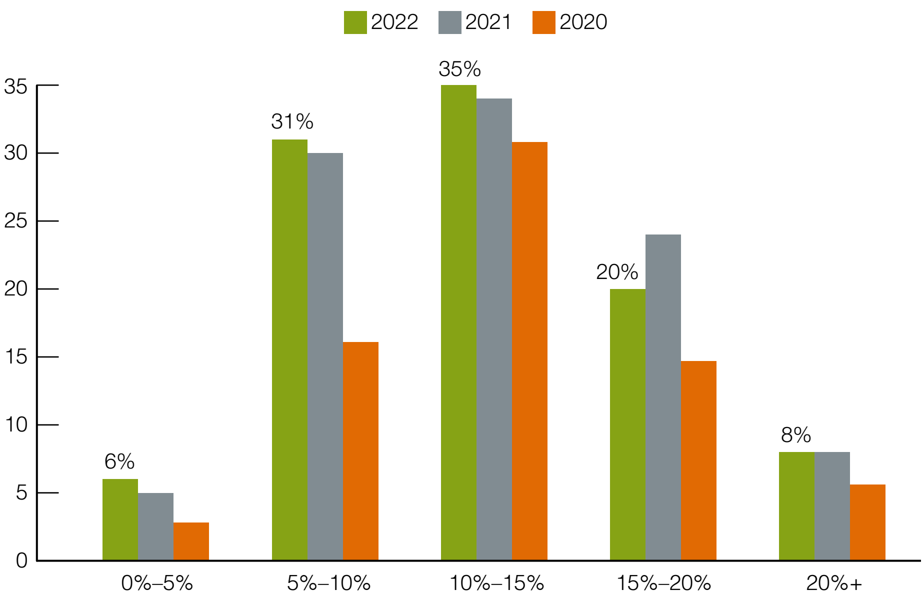
While the consensus among most interviewees was that the shift towards hybrid working (and therefore a degree of decentralisation) in the Asia Pacific was unlikely to reverse, the extent of this change seems unlikely to mirror the experience in the United States, where working from home is now more deeply entrenched, and where an exodus is already underway of companies in locations such as Silicon Valley and Manhattan to cities in states such as Texas or Florida, where taxes are lower, housing is cheaper, and the regulatory environment (pandemic safety protocols, for example) are less restrictive.

Exhibit 1-5 **Time Horizon for Investing**



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

Exhibit 1-6 **Investors' Targeted Returns between Now and the End of 2022**



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

In addition, the approach to decentralisation may vary depending on geography and also employer—with multinational corporations (MNCs) probably more adaptable than local companies. Tokyo's long commutes, for example, don't necessarily overcome engrained cultural norms.

According to one locally based fund manager, "I don't see Japan going through a major decentralisation because, for companies, it's very CBD focused, and anyway people like working in CBDs and offices—it's part of the lifestyle."

At the same time, however, "you're certainly going to see companies, particularly nonfinancial outfits, decentralise to a certain extent and try to put offices close to where people live to make the commute easier. And part of that is trying to get talent, because there's still a very tight labour market."

The suburb of Shinagawa, with its good transportation network and mix of business, retail, and residential properties, was mentioned as one such destination.

Hong Kong, meanwhile, may also prove resistant to distributed working practices, given its compact nature and a skilled, service-oriented workforce. Still, according to one locally based consultant, the very concept of a single CBD has become dated. In the long term, "I think we're looking at business clusters driven largely by public transport. These will contain all conceivable uses: office and residential, and possibly hospitality and retail as well. But it will be driven more by what works from the employee point of view, and what works in terms of the environment—very different considerations to those we've always had in mind."

Australia: Key Themes

Through lockdowns, closed borders, and public protests, Australia's commercial property markets have shown surprising resilience in 2021, with investment volumes rebounding sharply in the first three quarters of the year to some US$24.8 billion—up 106 percent on the year and 21 percent higher than the 2015 to 2019 average. Predictably, competition for assets is high. According to a fund manager at one domestic fund: "CBD is trading at really high prices, purely due to the weight of capital, low interest rates, and prices in Australia compared to other CBD markets—to an extent, these [factors] are masking fundamental drivers."

Cap rates for prime properties have either held firm or continued to compress to sometimes "unheard-of levels" across the spectrum of asset classes. Given this, investors tend to favour stability as much as yield and are therefore seeking (and willing to pay for) long weighted average lease expiries (WALES).

Even with incoming travel for non-residents/citizens at a standstill, activity by global capital is higher than ever. According to one Sydney-based investor: "If anything, there's been an increase in [foreign] capital over the last two years. In part, that's down to stable government and currency, but it's also because, if you look at the cap rates assets are trading at now, local equity can't afford to participate—their cost of capital is too high. So even for the most active local investors, nearly everything they are buying is either through 50 percent of their own equity or, more importantly, through wholesale funds bringing in [sovereign wealth funds]. They then get the fund management fee with a minor equity stake."

As in other markets, the logistics sector has been the standout, led by a single massive deal in the second quarter. Transaction volumes in the logistics sector during the first three quarters of the year were more than double the five-year average, according to RCA. So many investors lining up to buy Australian logistics assets (as much as A$45 billion worth of capital in mid-2021, according to JLL) reflects not just a hunger to place core capital in what is arguably the Asia Pacific's most developed market, but also a structural shortfall of local warehousing capacity in a market where e-commerce—representing some 13 percent of total consumer spending—is still relatively underdeveloped by global standards. According to CBRE, for example, New South Wales needs to boost warehouse supply by some 35 percent to meet demand currently generated by e-commerce sales.

As funds reweight portfolios by reducing retail and office assets, the logistics sector has continued to benefit, with yields sinking to an average 4.8 percent in mid-2021, according to RCA, and sub–4 percent for the most sought-after facilities. At these levels, logistics facilities are trading on a par with prime offices, which have long been the preferred play of foreign investors. "I struggle with [Australian] logistics at the moment," said one investor. "Car rates are so tight and tenants have quite high bargaining power. So, as soon as yields tighten, rents also decrease, which is why rents in logistics have not increased that much over the last 10 years." For this reason, most interviewees doubted that yields would compress much further.

While grade-A office values remain "priced to perfection," net effective rents in Sydney and Melbourne are down by almost 9 percent year-on-year in the third quarter, according to JLL, with vacancies in each pushing 15 percent. Sublease availability also is high, especially in Melbourne.

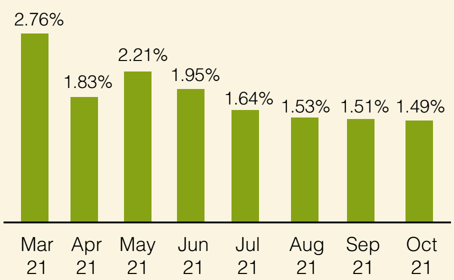
Older buildings in less popular locales have suffered more, and a widening of spreads between rents of city-centre grade-A and grade-B buildings is providing scope for value-add investors in buildings where rents are down and have little prospect of early recovery.

At the same time, investor interest in newer, good-quality CBD offices continues to be strong, driven as in the past by foreign capital. Doubts remain, however, whether historical CBD occupancy rates may be cannibalised by long-term adoption of hybrid working practices. Office utilisation in major east coast cities fell below 10 percent during the September lockdowns—lower than in other Asia Pacific markets and hinting at a future more aligned with Western models that seem (for now, at least) less committed to a return to office-centric practices.

The large corporations that are mainstay tenants for large buildings have yet to make their decisions about their future office strategies, but for midsized companies, as one developer noted, "CBD is not reflective of where some of the opportunities are—decentralisation has become a big theme in Australia for our office markets, and medium-sized firms are now looking for new workplaces, whether because they need less room because of remote working, or they're investing in better spaces, or looking in different areas that may be closer to home."

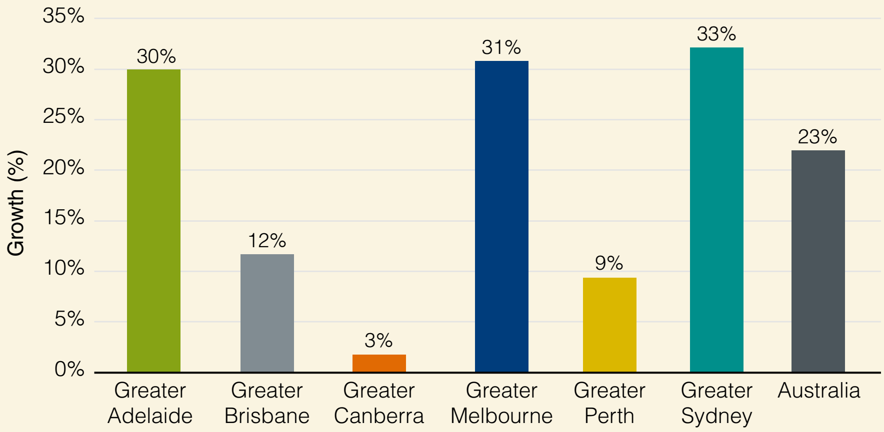
Although COVID-19 has only compounded longstanding dysfunctionality in some parts of Australia's retail sector, 2021 retail sales have been stronger than expected, despite the expiration of the government Jobkeeper programme. Investment volume was also strong. For the most part, this is due to a focus on subregional shopping centres, convenience stores,

Monthly Growth Rate in Australian Dwelling Values, March–October 2021



Source: CoreLogic.

Australian Large-Format Retail: Year-on-Year Capital Value Growth, 3Q 2021



Source: CBRE Research, 3Q 2021.

and large-format retail, all of which have benefitted from lockdowns and work-from-home polices and are priced attractively relative to more popular office and industrial assets. There continue to be wide disparities in performance between different types of retail assets, however.

One analyst predicted "carnage" in the poorly performing non-high-end multilevel shopping centre space, adding: "CBD retail might transform into a two-tier market, with high street retail still in demand but multilevel shopping-centre retail within CBDs more challenged," especially at above ground-floor level. This group was in decline for years and has now also borne the brunt of pandemic lockdown restrictions, with foot traffic for Sydney CBD locations dropping 86 percent month-on-month in September 2021, according to CBRE. Valuations have now been rerated to a point where yields of around 6 percent are attractive for office and industrial assets (i.e., for last-mile fulfilment purposes). In addition, large plots occupied by some suburban retail centres have become candidates for speculative repositioning as mixed-use facilities.

Transactions are expected to remain strong given the number of such multilevel centres in Australian cities, together with an ongoing trend for investment funds looking to divest. Foreign funds (both institutional and private equity) are lining up to take the other side of the trade. This has created the odd situation of previously tight cap rates among city-centre assets softening just as the higher-yielding assets in regional locations tighten.

Finally, the market for residential properties has been on fire in the second half of 2021, as home prices rose steeply despite a hard stop in population growth due to lack of immigration. Inflation is one catalyst, combined with persistently low interest rates and a shortfall in sales listings for the most sought-after markets, according to one locally based developer. (For discussion of the multifamily sector in Australia, see chapter 3.)

Despite current market strength, future prospects for the sector will ultimately hinge on a rebound in immigration. "We can dream about what we can do" he said, "but the reality is that since its founding, Australia has been dependent on two things. One is immigration for population growth and the other is inbound capital—take those two things away and we have nothing to offer, certainly as a growth story."

Although bank finance remains readily available, construction activity has dropped, pointing towards future home supply shortages. According to the developer: "It's a difficult market to find development sites because, in New South Wales especially, the planning process has slowed significantly through the government, which means that the pipeline for new developments looking ahead a few years is limited, on top of which there's increased demand. Which means that if someone has a planning-approved development site, the competition has been extremely tough."

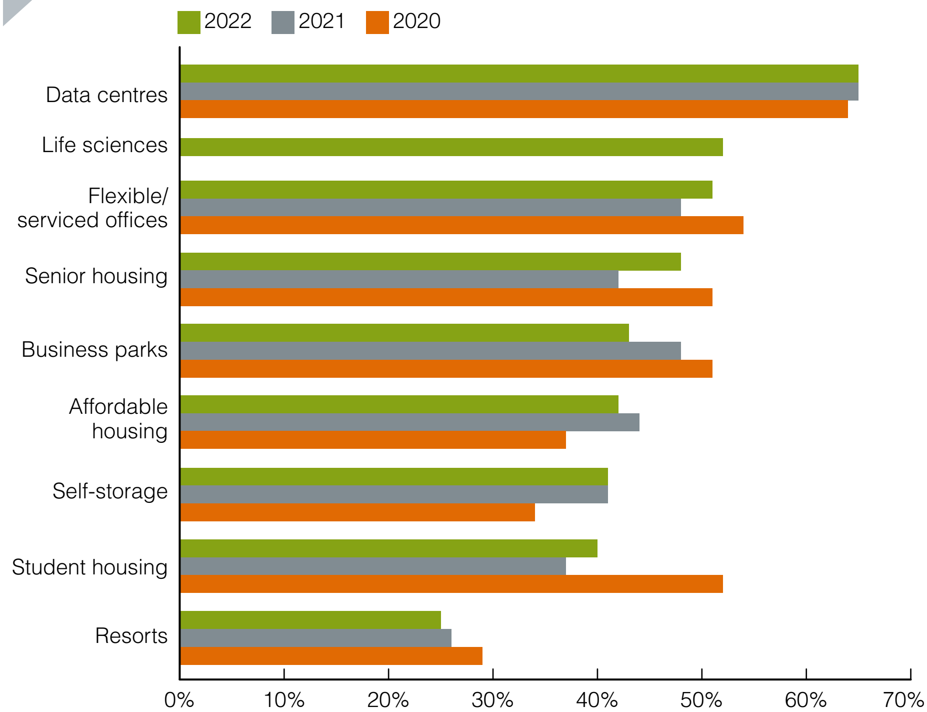
New Economy Drives Demand

A further catalyst for the migration of capital away from CBDs is the overarching shift in the economic centre of gravity in favour of "new economy" industries, which are featuring increasingly today as part of thematically driven investment strategies. In the words of a fund manager based in Hong Kong: "Banks aren't growing, asset managers aren't growing, traditional businesses aren't growing—today, it's about firms that are into digitisation. That may be something as direct as a tech company, but I mean it more broadly. Digitisation could include life science or education, for example. So you need to think about which markets new-generation tenants are migrating to, and what products they're demanding—and that's generally not CBD."

Depending on the market, "not CBD" can mean different things. In China, there is little incentive for companies to create a more distributed workforce when the impact of the pandemic has been relatively minor. However, the government's long-term plan to grow its technology sector has created a large number of new-economy companies with little inclination to be based in city centres. As a result, investment in office and research and development (R&D) space in Chinese technology parks reached a record high of US$2.5 billion in the first quarter of 2021. Collectively, these companies are expected to take up more than 5.5 million square metres of space (i.e., more than 20 percent of total office takeup) by 2025, according to Colliers. Demand from technology companies is also growing in markets throughout the Asia Pacific.

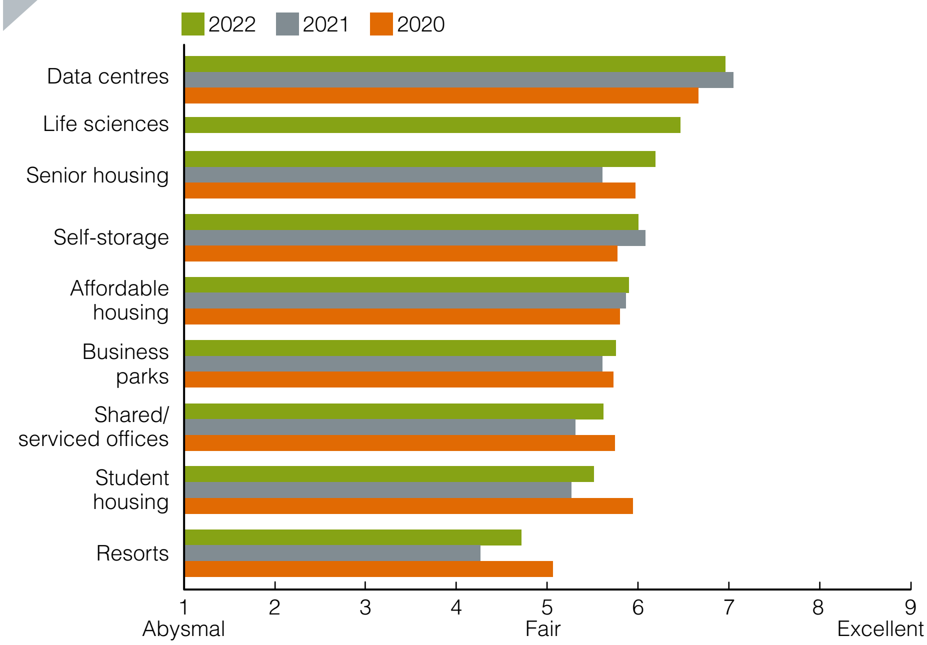
To a great extent, this transition to non-CBD workspaces is happening under the radar. As an example, respondents in our survey indicated they planned to be less active in the business park space over the coming year than they were in either 2021 or 2020. As a Hong Kong–based analyst commented about the market in China: "People are not talking about business parks so much because they are decentralised. In the old days, buildings were low quality, but now parks in upper-tier cities are increasingly mature, rents are cheaper and they are where life science and tech companies are now locating. Beyond that, people are forgetting that the government's new REIT pilots now include business parks [as an eligible asset class]." RCA reported almost US$4 billion in deals of office properties within Chinese business parks in Beijing and Shanghai during the year to October 2021.

Exhibit 1-7 Niche Sectors in Which Investors Are Active or Plan to Be Active in 2022



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

Exhibit 1-8 Prospects for Niche Property Types in 2022



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

In Hong Kong, new-economy companies—including those involved in telecommunications, e-commerce, biotech, new energy, and pharmaceutical industries—have reportedly set up camp in the city's large stock of former industrial and warehouse space that is available for conversion to commercial use under a government incentive policy. Around 50 percent of available space has now been occupied by these companies, according to press reports.

India is another market where the new-economy theme has taken root, with life sciences expected to be a major source of growth, in particular for the offshoring of manufacturing for research carried out by major pharmaceutical companies elsewhere in the world.

According to an opportunistic fund manager active in the space, the Indian life sciences industry is similarly placed to the pre-boom days of the Indian tech office space 15 years ago. "It's not life science in the traditional U.S. context, because it's less venture [capital]; it's a risk-adjusted opportunity, figuring out with the big pharma companies how to reduce costs," he said. "The product itself is somewhere between tech office and logistics/industrial. It isn't the hugely expensive life science space you'd find in the U.S.. It's more around waste disposal, heavier floor loading, more power, better air handling, more infrastructure to handle a heavier level of MEP [mechanical, electrical, and plumbing] that will go into these facilities."

Specific new-economy submarkets identified in interviews included Zhangjiang in Shanghai, Shangdi in Beijing, and Singapore's City Hall. Up-and-coming locations include Sydney's CBD South and Shenzhen's Qianhai New District, which one interviewee suggested may become a new venue for the Chinese life science industry currently centred around Shanghai.

Cash Flow Trumps Yield

While yield has always been a primary focus for investors, the pandemic has led to a shift in priorities. Funds will no doubt continue to engineer higher revenues via value-add or other approaches, but an acceptance that low cap rates are probably a long-term reality, together with an understanding that (sometimes negative) yields on sovereign bonds now make them uncompetitive with real estate, has changed the emphasis.

In particular, higher vacancy rates and tenant churn mean landlords are putting increasing value on retaining their existing tenant base or recruiting new tenants (such as government entities) more likely to have staying power, even at a discounted rent.

According to an office landlord in Tokyo: "We've taken a bit of speed off the fastball in that, in the past, if we had a tenant far below market [rent] and they wouldn't pay up, we'd take the space back and lease it up to market, with a year or two of transition to get it up to full face rent. But we don't want to do that now because tenants aren't making very dramatic decisions, so once you have a relatively large vacancy in your building, it becomes kind of hard to fill it up."

This is one reason why long weighted average lease expiries (WALES) associated with the logistics sector have become so prized. The same applies also to multifamily assets. As one institutional fund manager said: "When you're living in a world of zero percent interest rates, a resilient inflation-linked multifamily asset presents a pretty compelling investment opportunity for a global investor, so that obviously means we have a long runway of investment allocation that will certainly play out into the space over time."

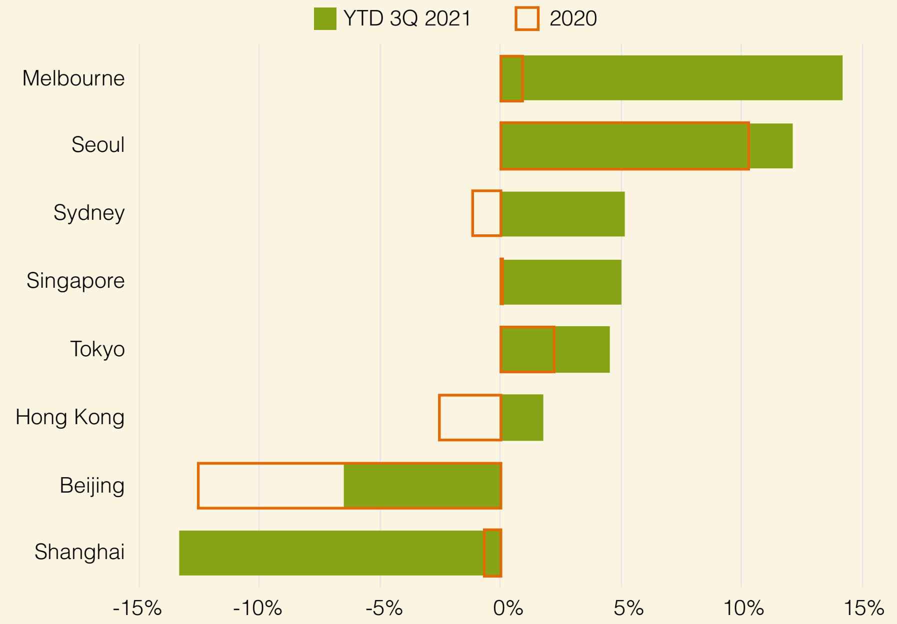
China: Key Themes

China's zero-tolerance approach to COVID containment has successfully insulated its economy from the brunt of pandemic-related shocks, with gross domestic product (GDP) growth reaching a respectable 4.9 percent year-on-year in the third quarter of 2021, according to investment bank Standard Chartered. Real estate investment has also been resilient, rising 15 percent year-on-year in the first three quarters of 2021 to US$35 billion, according to RCA. Driven mainly by domestic investment demand, this makes China easily the strongest market in the Asia Pacific, with economic activity well ahead of pre-pandemic levels in the years 2015 and 2019.

In terms of asset classes, the domestic consumption narrative has become a popular theme. A resilient economy, combined with lack of foreign travel opportunities, has therefore seen retail assets trade strongly. Investors are also pursuing the usual global secular trends, in particular logistics and higher-yielding new-economy subsectors such as cold storage, data centres, and life sciences. The build-to-rent residential sector has also gained traction, backed (among other things) by government policy initiatives for affordable housing opportunities (see more in chapter 3).

Office rents in tier-one cities have declined significantly since the start of the pandemic (less so in 2021), although this reflects excess supply more than weak demand. Capital values have also suffered, with Beijing and Shanghai being the only gateway cities in the Asia Pacific where prices have fallen significantly in 2021. This is partly because of weaker demand from foreign buyers who tend to focus on this space, though it also reflects a shift of focus by domestic institutional investors to suburban business parks.

Change in Asia Pacific Gateway City Office Pricing



Source: Real Capital Analytics.

However, with Chinese domestic capital for the most part still restricted from investing offshore and the residential sector now losing its appeal, local institutions are focusing increasingly on domestic offices. Their lower returns targets and cost of capital create stiff competition for assets, and foreign investors are therefore turning increasingly to value-add strategies, leveraging their operational expertise to upgrade older or mispositioned assets that can be resold (often to those same institutions) as core properties.

June 2021 saw the launch of a domestic Chinese REIT (C-REIT) sector, comprising an initial nine funds with a combined market cap of some US$5 billion, according to JLL. Although the ownership structure, tax breaks, and levels of allowed leverage are less than ideal, they do create an additional institutional exit channel for foreign funds, especially those looking to deploy capital at scale by assembling portfolios. At this point, C-REITs are aimed mainly at the infrastructure sector, although both logistics and industrial properties also qualify for inclusion. As a result, business parks have become a hot sector, especially those focusing on industries favoured by government policy, such as innovation and life sciences.

Despite these positive fundamentals, however, China's real estate industry was blindsided in the second half of 2021 by the introduction of the government's "common prosperity" initiative. Consisting of a broad policy reset with cross-economy effect, sectors targeted varied from technology to gaming to education, with the intent of addressing growing social imbalances and income inequality.

As it affects real estate, the government is focused mainly on the residential sector.

The “Three Red Lines” policy, introduced in August 2020, had already taken aim at high levels of developer borrowing. It was followed in 2021 by a wave of new tightening measures ranging from supply-and-demand issues to leverage, funding, and price controls. Property-sector crackdowns are hardly new in China, but the scope of the current episode has been unprecedented.

Although not aimed specifically at commercial real estate, the impact of the common prosperity drive has spread rapidly across the industry. As financing options quickly dried up, bank lending to developers fell 37 percent in the year to September 2021, according to the China Real Estate Information Corp, while debt sourced from investment and trust funds, as well as both onshore and offshore bond markets, also fell sharply. Meanwhile, year-on-year property sales in the first nine months of 2021 dropped 14 percent (and by a startling 36 percent for home sales), further undermining developer cash flows. Pressure only grew when a number of domestic developers—including one of the country’s biggest—were struck by a liquidity crisis during the third quarter.

Some investors, especially foreign funds, have reacted to the shifting policy landscape by stepping away from the market. For some domestic players, the choice is often compelled by a lack of financing, but uncertainty over the direction of government strategy, together with its potentially negative economic repercussions, have also played a part.

According to one foreign investor: “There’s a lot of ‘risk-off China’ [mentality] in the U.S. right now. The investment view from those already in-country and who understand it well is still positive, but they’re saying: ‘How do I, with my stakeholder base and all the stuff we’re seeing, bring Chinese projects to my investment committee right now?’ So there’s going to be some pullback, though it will probably be temporary.”

Another issue of concern to foreign funds, according to a different interviewee, involves how current or impending policy changes may affect the ability to exit their investments. This applies especially to platform deals, at least partly as a result of the demise of one recent high-profile transaction involving a prominent global private-equity fund.

That said, doomsday scenarios being mooted by some Western analysts are probably overstated—in particular parallels drawn to the origins of the global financial crisis in 2008. As a number of China-facing investors pointed out:

- China’s banking system remains well capitalised, with development loans totalling just 6.9 percent of total loan balances, according to Morgan Stanley.

- The government retains control of the levers of liquidity (ie, via the banking system), which it can reapply at any time.

- The extent of outstanding real estate debt is unlikely to be overwhelming. Although total debt levels across the Chinese economy are hard to pin down, most investment banks consider aggregate leverage in the real estate sector to be manageable. According to Morgan Stanley, total borrowing by domestic developers amounts to around Rmb18.4 trillion, or roughly the same as annual property sales—an amount unlikely to have systemic impact. Leverage in the housing market, meanwhile, stands at a low 40 to 50 percent, according to Goldman Sachs. And while risk of contagion by way of cross guarantees or off-balance sheet lending remains, China has historically fostered an approach to intermediating distress via absorption of debt by state-backed entities that has avoided the type of chaotic unraveling sometimes seen in Western markets.

Going forward, interviewees predicted that property curbs would remain in place until at least the end of 2021. Thereafter, while the pace of new construction may slow, investment activity is expected to rebound quickly, if only because the ongoing squeeze opens as many doors as it closes.

For one, officials have responded to the crisis by lowering prices and relaxing preconditions at local land auctions. In addition, the stress induced in the system has created scope to capitalise on market dislocations.

As one Shanghai-based fund manager said: “The deleveraging campaign has put strains on the balance sheets of some developers, meaning in reality the last opportunity for them to raise capital is to sell noncore assets. So it’s driving a whole host of groups to think about the opportunity costs of some of these commercial assets that they’re not doing a good job of managing and dispose of them, and we’re seeing a lot more flow in that regard.”

As a result, foreign investors are getting better access to closely-held but often underperforming properties of the type that rarely come to market, creating potential to upgrade and reposition them as core properties.

China's Mega-City Clusters

Traditionally, commercial real estate investment in China has focused on its tier-one cities, which have offered the optimal mix of demand growth and wealth to absorb an ongoing stream of high-value development. More recently, however, the focus has shifted—partly due to government policy initiatives—towards creation of larger, megapolis-type areas, often anchored by one or more tier-one cities. The Yangtze River Delta was the first of these to evolve in China, as Shanghai-based businesses grew organically into neighbouring areas, catalysed by development of high-speed transport networks.

More recently, other city clusters have also sprung up, in particular around the Bohai Bay area in the north (otherwise known as the Jing-Jin-Ji) and the Greater Bay Area (GBA) in the south, the latter encompassing a total of nine cities and two special administrative regions, with four at the core: Hong Kong, Guangzhou, Shenzhen, and Macau. The idea is to create a "productivity cluster" featuring hubs specialising in specific disciplines such as financial services, logistics, and technology manufacturing. Each hub helps spur the evolution of the cluster by way of a virtuous feedback loop of mutual economic development.

Lack of clarity as to how currently evolving government policies may reshape the domestic real estate industry has led many developers to refocus strategies in favour of asset classes and geographies they know will continue to enjoy government support. This means less investment in third- and fourth-tier cities, for example, and more in China's evolving city clusters.

It is probably fair to say that the GBA is enjoying particular attention at this time because, despite its nomination by the government to National Strategy status, it remains at a relatively early stage of development as a cluster. This creates some risk, according to one interviewee, that government policy may yet change, but also increases available opportunities for early movers.

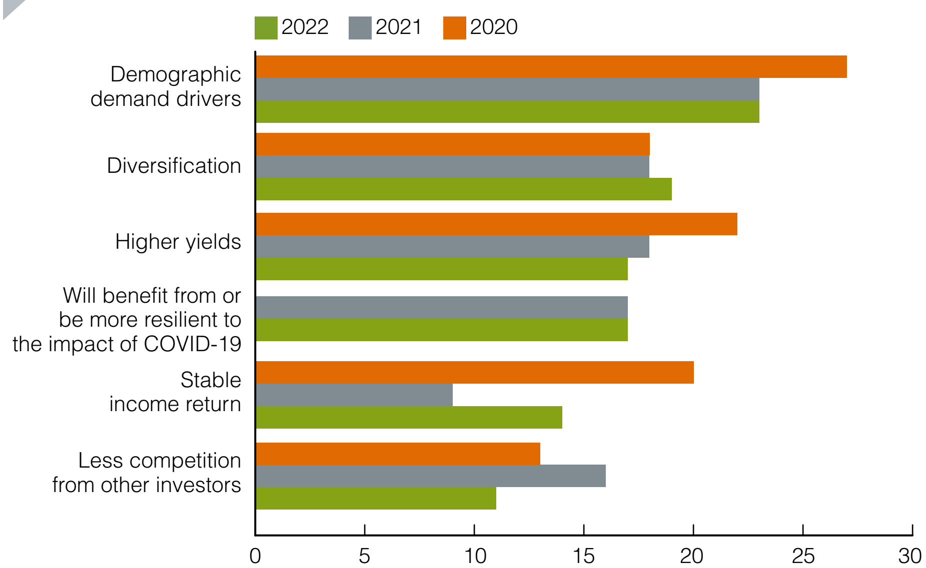
Another catalyst, according to a different foreign fund manager, is the fact that the central government has put increasing emphasis on Hong Kong's integration into the Mainland Chinese economy, thereby incentivising it to spare no effort in ensuring the GBA's success.

A recent poll conducted by investment bank Standard Chartered reflected a consensus among respondents that the GBA had established a clear lead over other economic zones in China in terms of pace of economic reform, market openness, and ease of doing business. Exactly which parts of the cluster will enjoy the greatest success is open to debate, although a representative of one Chinese developer identified Shenzhen and Zhuhai as cities that had become "key development targets in the country."

Demographics Drive Niche Plays

Over the last several years, investors who have been crowded out of traditional asset classes by funds with less demanding performance expectations have turned increasingly to niche assets to meet their targets. Interestingly, although the generally higher yields offered by niche asset classes continue to be a factor, investors today are focused more on demographic demand and diversification as incentives to invest in assets of this type (see exhibit 1-9).

Exhibit 1-9 **Reasons for Investing in Niche Sectors (% of Respondents)**



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

In today's volatile and unpredictable environment, unconventional strategies probably offer more opportunity than ever, although risk is equally elevated. Some of the options mentioned in interviews include the following:

- Defensive asset classes targeting a domestic or local audience are obvious opportunities in a world of seemingly endless lockdowns and travel embargoes. That includes local nondiscretionary retailing, which has been actively targeted by investors across the region.

- For the same reasons, retirement living and care homes were also popular themes, although—with the exception of Australia and Japan—a viable operating model has yet to emerge in the asset class, despite a chronic shortage of supply. Investors are also concerned about residents' potential exposure to COVID-19 outbreaks. Investment volumes in the Asia Pacific have rebounded strongly in 2021, registering US$779 million in the first half of the year, compared to US$689 million for the whole of 2020, according to RCA. In Australia, several interviewees identified facilities for retiring baby boomers as a viable market niche. Many boomers have large discretionary spending capacities and are now looking for space in high-quality gated communities with a focus on health and wellness.

- The pain in the retail sector has been felt most deeply in the upper floors of multilevel retail centres, and as rents continue to fall, there is opportunity to repurpose these spaces in a variety of ways. Suggested uses ranged from studios, workspaces, libraries, schools, clinics, flex workspaces, last-mile logistics, and even retirement facilities, as described above. One interviewee suggested a model where a master landlord controls the whole floor and manages the 20 or 30 revolving tenants on a partnership basis, sharing costs and profits involved in creating different experiences on that floor.

- Data centres and cold storage were also popular themes, especially the former given generally high returns. Both are operationally intensive, however, and have various complexities that make them a minefield for the unwary.

- With lockdowns and high infection rates providing little reason to linger in urban areas, demand for homes in suburban or out-of-town neighbourhoods has shot up. While the motivation for this migration away from densely populated city cores is clear enough, the bigger question is whether the phenomenon has staying power. Opinions on this vary, but for now the trend plays into the decentralisation narrative set out above. In Australia, attention has focused on detached houses in generally pricey beachside suburbs near Sydney and Melbourne. Home values had risen more than 30 percent year-on-year in September 2021, according to CoreLogic. The same applies to Tokyo, where occupancy of rental housing has fallen as residents leave for neighbouring areas such as Yokohama, as well as towns in Saitama and Chiba prefectures. In India, new development has shifted away from high-rises and condos to "plotted developments"—four-floor units situated on 100- to 200-square-metre plots within gated communities. The change has been driven not only by health considerations but also by a desire for freehold properties that provide more space for work-from-home purposes. Prices for plotted developments in northern Indian cities have risen 50 to 60 percent over the last year, according to one locally based interviewee. Finally, the Philippines is seeing a similar phenomenon in the form of "horizontal gated communities."

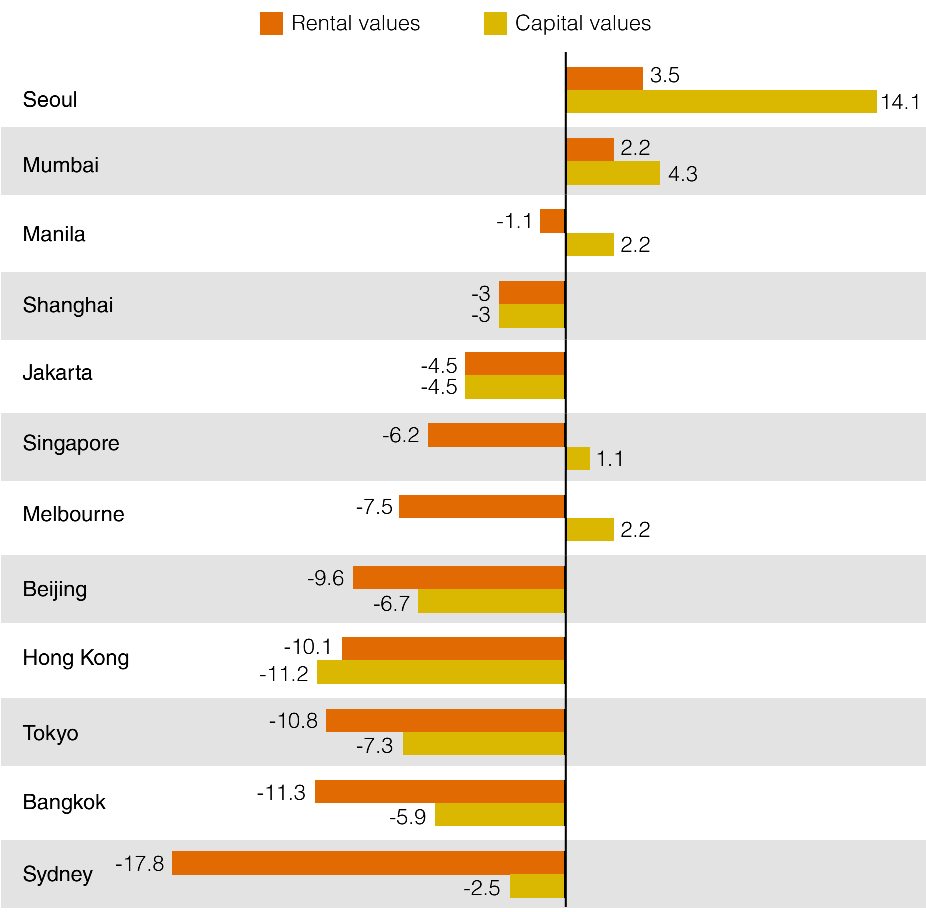
Distress: Still Waiting

Given the extent of the downturn in the global economy, the stability of capital values throughout the Asia Pacific has been remarkable. In last year's report, interviewees expressed widespread conviction that a wave of distressed assets would hit the market in 2021. So far, though, despite often-steep declines in rents (and, apart from Singapore, few expectations of a rebound (see exhibit 1-11)), those fears have not been met, with property values for the most part remaining firm.

Of course, not all markets have avoided the drop. Hong Kong, for instance, has seen steep declines in capital values (apart from residential properties). But the city's longstanding reputation for high rents gives it a unique niche, and local markets were anyway already absorbing the impact of a prolonged period of social unrest immediately before the pandemic appeared. Besides, even as values have declined, the extent of distress in Hong Kong has been limited. Tourist districts in Kowloon may have registered many distressed strata-title sales, but investment-grade assets have been mostly unscathed—a fact that speaks to both the staying power and lack of leverage of local owners.

In terms of asset classes, the retail and hotel sectors are the most exposed to distress, as well as a few of the niche areas. In particular, with some 738,000 degree-level foreign students enrolled in 2019 (more than 200,000 hailing from China), travel restrictions have had a devastating impact on Australia's student housing market. According to one fund manager active in the space, "Student accommodation owners are in real strife, and I don't see how that's going to change for the foreseeable future. So, if you could buy student accommodation in Australia at a deep discount—and I can't help but think there should be some distress there—that would be an asset class that's potentially suitable for conversion. Unfortunately, though, most of the owners are backed by some of the big sovereigns."

Exhibit 1-10 **Office Rental and Capital Value Changes, Year-on-Year Percentage, 2Q 2021**



Source: JLL (Real Estate Intelligence Service), 2Q 2021.

Exhibit 1-11 **Cities Most Likely to See Office Rental Growth in 2021**

Decrease / Increase

1	Singapore	5.34
2	Sydney	4.77
3	Tokyo	4.66
4	Shenzhen	4.61
5	Melbourne	4.58
6	Shanghai	4.58
7	Guangzhou	4.40
8	Osaka	4.39
9	Beijing	4.30
10	Seoul	4.22
11	Hong Kong	4.22
12	Ho Chi Minh City	4.20
13	China—second-tier cities	3.88
14	Taipei	3.72
15	New Delhi	3.52
16	Mumbai	3.50
17	Jakarta	3.47
18	Auckland	3.37
19	Bangkok	3.26
20	Manila	3.24
21	Bangalore	3.19
22	Kuala Lumpur	3.14

Source: *Emerging Trends in Real Estate Asia Pacific 2022* survey.
Note: Data scored on a nine-point scale.

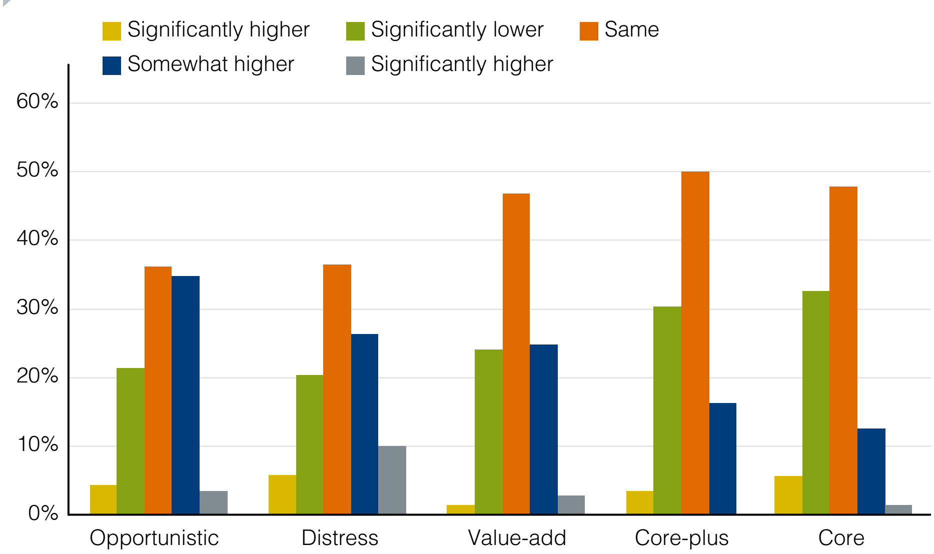
At the same time, student-housing markets in Japan, Singapore, and New Zealand have been less affected because they are aligned closely with domestic market demand. Conceivably, they could benefit from the slack created by the closure of Australian facilities, as Chinese students choose other options.

At the other end of the scale, some Asia Pacific markets have seen commercial property rentals and values increase, despite severe COVID-19 outbreaks. This occurred in India after an unanticipated boom in global demand for tech outsourcing arrived just as the end of tax breaks for the country's special economic zones was driving an exodus of tenants in the direction of crowded IT parks. In Seoul, buyers have flocked to office assets as a result of changes in the domestic tax regime, together with an influx of capital from the country's cash-rich institutional funds, which are having trouble buying assets internationally due to global pandemic control measures.

Meanwhile, expectations for distress going forward seem to have faded, with just 10 percent of this year's survey respondents expecting "significantly higher" returns from distress strategies, compared with 17.7 percent surveyed last year (and just 26.3 percent expecting "somewhat higher" returns, compared with 32.3 percent last year) (see exhibit 1-12).

The unexpected absence of stress has left some investors scratching their heads. One Australia-based fund manager active in the hospitality sector commented: "It surprises me that valuations haven't dipped quite sharply. Certainly, in the big urban city markets, room rates are a function of supply-constrained days in terms of occupancies—so you really need those full-house days to push rates, and that in turn requires the various demand drivers to be firing on all cylinders, whether that's the MICE [meetings, incentives, conference, and exhibition], leisure, or corporate markets. But that tension just is not coming around anytime soon—it still remains to be seen how the big conventions are going to play out, but I think there's a fair runway before we see those returning to full strength."

Exhibit 1-12 **Change in Targeted Returns Compared with 2021**



Source: *Emerging Trends in Real Estate Asia Pacific 2022* survey.

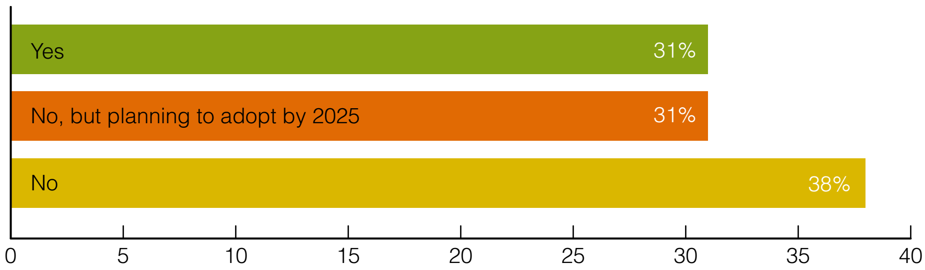
Various factors have been suggested as a cause. First, as the Australian fund manager continued, "It's just weight of capital—investors are taking a view that assets which otherwise wouldn't be up for sale are now available—albeit they're not necessarily getting them at any discount—and then they are also assuming it's a case of when, not if, for a recovery, and probably with some pent-up demand."

Second, banks remain unwilling to pull the plug on underwater loans. Fund managers in both Tokyo and Australia suggested that local banks were complying with an unwritten government mandate to provide forbearance to major borrowers. "There's definitely a public good in keeping the banks liquid, and also the banks keeping the service sector liquid," one manager in Tokyo said. "Also, the better properties are generally owned by the bigger companies, so even though they probably should sell, I don't think anyone's forcing them to do that."

Australia is regarded as having a somewhat less accommodative banking sector, so some see that market as a likely canary in the coal mine. But although a pipeline of potential distressed sellers has emerged in Australia, according to one analyst, owners are still unwilling to provide the 30 percent discount that buyers are asking for. Australian banks have yet to blink, and by now many investors are losing faith they will. As one fund manager observed: "We're more than a year-and-a-half into this now and I think people have just pivoted, adapted, and learned how to live with this stuff. So in most cases I don't think we're going to see distress—we're certainly not banking on that in terms of our strategies."

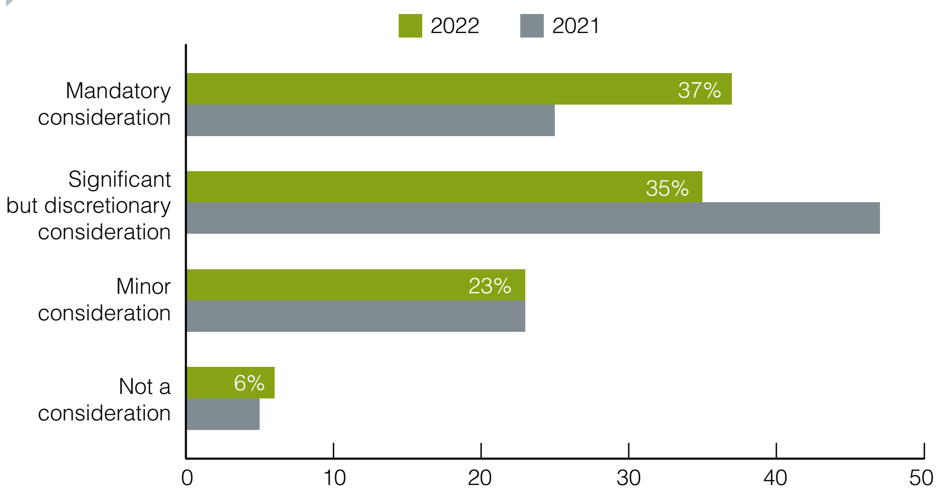
Potential distress is also evident in other markets, though not necessarily linked to the pandemic. China, for one, has seen a surge in divestment of noncore assets by major developers in response to a recent government policy crackdown (see China: Key Themes on page 12). In India, another regulatory crackdown, in combination with the devastating wave of COVID-19 infections in mid-2021, has been a "trial by fire" for local residential developers, bringing many firms to their knees. As a result, the bigger international distress players are now active in Indian tier-1 cities.

Exhibit 1-13 **Company/Organisation Real Estate Strategies with Net-Zero Carbon Emissions Target (by % of Respondents)**



Source: *Emerging Trends in Real Estate Asia Pacific 2022* survey.

Exhibit 1-14 **Role of ESG Factors in Investment Decisions**



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

The Green Premium

Perhaps the most powerful trend to have emerged in the world of commercial real estate over the last decade has been the growing mandate for green buildings, which has now leapfrogged from obscurity to claim top billing on investor and landlord agendas. Apart from Australia, the Asia Pacific region remains behind the West in this area, but is beginning to catch up. And with climate change continuing to dominate the headlines, the pressure to go green will only increase over time.

The shift towards energy efficiency in the region began in Australia as long as 15 years ago, driven first by regulation, then by tenants, and finally by domestic investors, who handed them a 25-basis-point cap rate differential on the basis that higher environmental performance would lead to better building longevity.

Today, the main catalyst for change continues to come from the private sector rather than regulation. Policies embraced originally by European institutional investors required that assets they purchased comply with certain baseline standards focused mainly on energy efficiency. As other major global investors were in turn pressured by their limited partners [LPs] to adopt similar mandates, building owners came under increasing pressure to conform.

More recently, though, the push has come from occupiers. As one Hong Kong–based private-equity investor observed: "Funds are paying more for the green mandate because they can generate more demand from tenants, and therefore higher rentals. That's because big corporate tenants, particularly in markets like Australia, are now adopting policies that they won't take space in buildings below a certain rating." Owners are therefore motivated to upgrade so they can lease out space at higher rents.

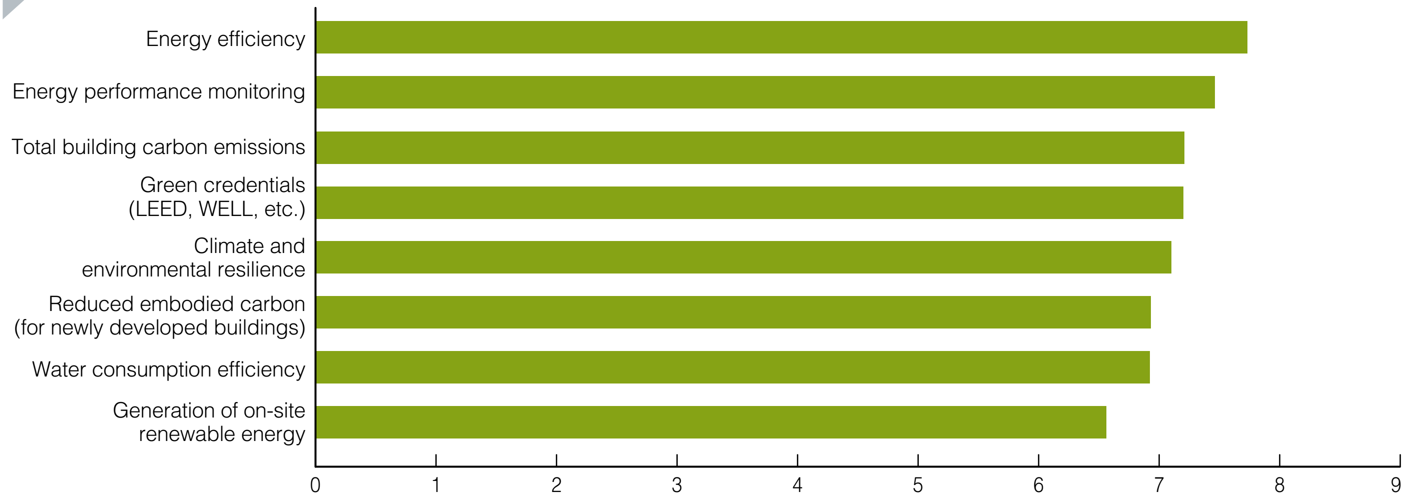
This trend also creates an opportunity for value-add funds to buy well-located noncompliant buildings, upgrade them for ESG purposes, and then either let them to better tenants or sell them to European (or, these days, global) funds looking for future-proofed buildings.

While this so-called green premium is very real, however, putting a dollar value on it is difficult. According to a fund manager at one large private-equity firm: "If we do a WELL rating on an asset, where that really lands is in the productivity of the people who sit in that building. So, when you talk about value accretion, it shows up in places like long WALES and very low vacancies and rent arrears because you get higher-quality tenants—it's not as simple as a 1 percent or 10 percent uptick in building valuation just because it has a Green Star rating."

At the same time, the incentive to comply currently applies mainly to higher-end assets that are the domain of the bigger investment funds and large corporate tenants. For other buildings, the finances of ESG asset enhancement don't necessarily stack up, especially for opportunistic funds with shorter holding periods. For them, there may be plenty of talk about green premiums, but the old discussion over return on investment (ROI) soon rears its head.

According to a value-add investor in Japan: "Frankly, things haven't changed that much for us. We discussed finding buildings where we could materially

Exhibit 1-15 **Investors' Most important ESG Considerations**



Source: *Emerging Trends in Real Estate Asia Pacific 2022* survey.

improve the HVA systems and the ventilation and be able to put in filters and things like that. But there's a relatively big limitation on what you can feasibly do. You can build whatever you want provided money is no object, but it's more a tenant-driven question—it's hard for us as a landlord, unless we have a tenant ready to commit, to reposition in that way."

In other words, for now, values of noncompliant buildings are affected only in terms of opportunity cost, which is always a moving target depending on the asset. According to another value-add investor: "It's a hot topic, but in practice I haven't seen that big of an impact in values to the point where, because a building doesn't comply, we're going to ding it. There's too much money chasing deals for that, so if anybody's [bidding lower] for properties for not being ESG compliant, they're just not going to win the bid."

That said, the writing is on the wall. As tenants and their workforces increasingly require ESG-compliant buildings, the issue will escalate—perhaps within a couple of years—to a point where a "green penalty" will begin to apply.

According to a manager at a U.S. fund group: "I definitely think it's going to evolve. You're going to start seeing people paying more for a building that fits within their ESG parameters and environment requirements versus one that doesn't, simply because the demand is going to be there. [Conversely,] people will not be willing to buy or occupy things that don't fit their parameters. And our retail customers are absolutely driving that—the big multinationals will say: 'I love this space, but I can't possibly get it through because the building doesn't meet the requirements.'"

One interviewee in Hong Kong noted how the pandemic-driven downturn in market fundamentals was also having an impact on ESG upgrading, as landlords who paid little attention to ESG principles in the past because their buildings were always full begin to lose tenants to their more progressive peers. This may help shift slow-to-change markets like Hong Kong in the direction of cities in Australia, for example, where a competitive dynamic is more evident.

Moreover, the same thinking applies to funds. As one institutional fund manager in China pointed out, "It creates an opportunity for managers that are being proactive about ESG to lead the charge, and I think you'll see capital start to congregate around the managers that are taking this seriously."

The recent proliferation of ESG mandates has other consequences, too. First, because newly developed buildings will invariably be built to energy-efficient standards, it generates further demand for build-to-core assets already popular with investors looking to manufacture yield. This idea has particular resonance in Asian markets that remain structurally undersupplied in investment-grade real estate.

Second, it is acting as a catalyst for redevelopment of older buildings. According to a developer in Hong Kong: "You can always retrofit, but you're never going to achieve the same standards as a new-build. So, if you have something that's 40 years old in a key location like Central that might last another five or 10 years if you retrofit, but even then still won't be grade-A compared to a new-build, you have to think about biting the [redevelopment] bullet earlier."

A final point to bear in mind with ESG mandates is that they tend to apply mainly to commercial real estate projects where the investor or developer has both a long-term perspective and an eye to ongoing operating costs. Residential build-to-sell developments, for example, are a quite different prospect. As one Australian residential developer said: "A developer building to sell is going to be very reluctant to incur capital costs and reduce margin for the sake of ongoing operational cost-saving in a building they will have no interest in post-completion."

Japan: Key Themes

Historically, Japan has had strong appeal among foreign real estate investors due to its reputation for stability, liquidity, and cheap debt. Today, with instability of one kind or another increasingly evident in markets across the globe, these qualities are more prized than ever. Japan's stable economy tends to be reflected in a lack of large fluctuations in its real estate transactions, and this has proved to be the case during the pandemic.

Both deal count and volumes have remained within 20 percent of the pre-pandemic average, according to RCA, although the lack of pickup in transactions experienced by other Asia Pacific markets during 2021 is also noteworthy. At US$26.3 billion in the first three quarters of the year, transaction volumes were down 16 percent year-on-year.

In addition, with the exception of the inbound tourism sector, the Japanese economy remains quite self-contained. Domestic demand accounts for 95 percent of the retail market and some 91 percent of the accommodation market, making it less exposed to threats posed by global travel bans, foreign imports, and supply chain constraints. Finally, relative weakness in the yen (down against the U.S. dollar by some 10 percent year-on-year at time of writing) is icing on the cake for foreign funds.

Competition to buy prime assets in Japan has always been tight and remains so today. In particular, the local logistics sector remains both highly sought after and very liquid, with Japan accounting for 39 percent of all Asian logistics deals in 2020, according to Real Capital Analytics. Rents are high and vacancies low. But with yields now among the thinnest in the region, placing capital is hard work. As one Tokyo-based fund manager put it: “Everybody and their brother is trying to buy logistics, so if it's a stabilised asset we typically don't even compete on it because somebody will always pay more than us.”

The office sector has traditionally been the go-to asset class in Japan, but capital values at the top end of the market remain stubbornly high despite rents continuing to slide (class-A rents fell 1.4 percent quarter-on-quarter in the third quarter of 2021, according to CBRE).

In part, this is because large Japanese companies remain fixated on 18- to 24-month planning cycles that cause them to defer making decisions about real estate portfolios. In addition, Tokyo is the focus of a seemingly bottomless well of liquidity from both domestic and foreign institutional buyers who tend to prize stability over returns. In the words of a different locally based fund manager: “Office values continue to be extremely strong in Tokyo in spite of weakness on the rent side—it's being driven by capital looking for a home, very closely correlated with global optimism, global liquidity, and global risk concerns.”

Tightness in class-A offices, however, which currently trade at cap rates in the low 2s, is not necessarily replicated in the class-B market, where rents and capital values have fallen and competition is supposedly less intense due to a widely held perception that long-term demand for space may have been permanently

Data and Verification

As ESG agendas become more prominent, both top-down and bottom-up transparency becomes key. Box-ticking is no longer enough—buildings owned by funds with ESG mandates must now formally verify individual asset performance, firstly at the global investor level, and then also to occupiers, as multinational tenants begin holding landlords to the same high ESG standards. In practical terms, this means adopting technology to measure various aspects of building usage and efficiency, as well as creating a strategic plan outlining a pathway to ESG viability during the hold period.

As a result, real-time data collection and analysis have become the biggest catalysts for promoting green agendas, a process involving the installation of sensor-based technology measuring anything from electricity and water use to the flow of people in buildings, air circulation levels, elevator usage, and maintenance issues. Building management systems can also create digital twins—virtual models of entire smart building environments that draw on real-time data from sensors networked via the internet of things or, in future, 5G technologies.

Just as important, of course, is the analytics used to put that data into context, allowing managers to detect problems, improve efficiency, and, most significantly from an investment point of reduced by corporate work-from-home policies.

A contrarian view, however, is that work-from-home will never gain real traction in Japan given the abundance of smaller homes and a cultural bias in favour of working in the office. Some foreign funds (including a few core players) have therefore adopted value-add strategies for class-B offices, partly with a view to repositioning, and partly to riding out pandemic weakness until an overarching recovery lifts rents and values.

Another popular theme carried over from 2020 has been sale-and-leaseback deals, with established local companies continuing to sell off noncore assets (such as corporate headquarters) to raise cash.

Across the Asia Pacific, arguably the worst-performing sector over the last year has been hotels. The Japanese hospitality sector has been no exception, especially in the context of a hotel construction boom sparked by strong pre-pandemic growth in international tourism (Japan saw almost 32 million visitor arrivals in 2019).

Perhaps surprisingly, however, investors were generally bullish about prospects for Japanese hotel assets, with several fund managers earmarking them as investment targets in the expectation of a rebound in domestic tourism. So far, few assets have traded due a standoff over asset valuations (see chapter 3 for more).

Recently, Japan's build-to-rent residential sector has become a magnet for foreign funds. Once unfashionable, multifamily assets caught the eye of high-profile institutional investors a few years ago as they cast about for long-term, low-risk places to park capital. As the only mature multifamily market in the Asia Pacific, Japan ticks those boxes because it is considered to have low leasing risk as well as potential for rental increases.

Although cap rates for Japanese multifamily assets have steadily compressed over several years (from around 5 percent to current levels of 3 percent or less), competition to buy portfolios is stronger than ever. According to one fund manager, "If you look at European investors, and where residential pricing is in Europe, they still think that even at a 2.5 or 2.75 cap rate, residential looks pretty attractive in Japan, particularly given low borrowing costs." Further compression therefore seems likely.

With many larger multifamily portfolios having already sold, however, assembling a big-enough collection of assets to create a tradeable portfolio has become a problem. Some investors have turned to forward purchases as a way around this, thereby also establishing relationships with developers who can deliver a pipeline of new product over time. Forward commitments are not without controversy, however, given the aggressive underwriting assumptions they often involve (see chapter 3 for more discussion).

view, satisfy the all-important reporting requirements that prove buildings are performing to required standards.

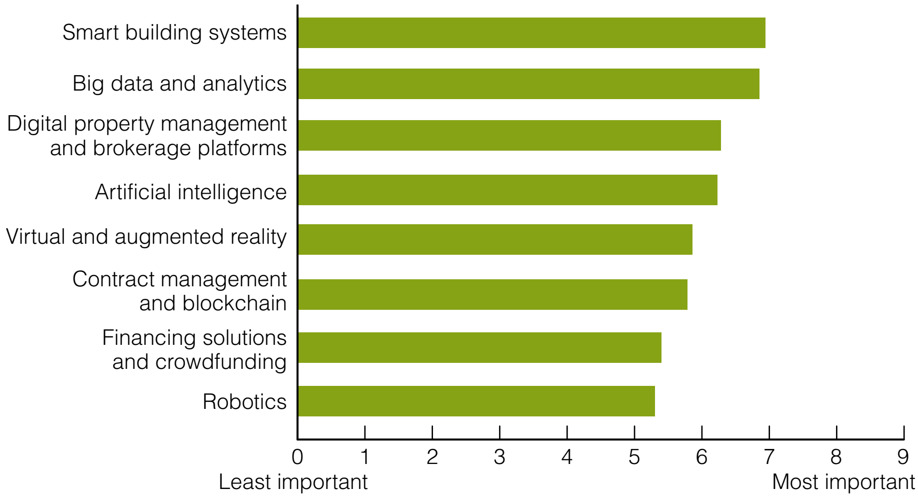
According to one private-equity investor: "Once you have it, it's incredibly powerful because you can get right down to machine-level data, and suddenly you have insights across your portfolio of what buildings are doing well, what buildings need attention, and where you benchmark against the rest of your sector. So in terms of driving capex investments, you can be so much more targeted across your portfolio."

At the same time, the complexity—not to mention the expense—of installing this type of technology is considerable. One large private-equity fund interviewed for this report was in the process of implementing a global data management platform across many thousands of assets in dozens of countries, covering every building they owned.

That kind of endeavour might be a multiyear exercise, however, so in the meantime, investors are resorting to building certification standards such as the Global Real Estate Sustainability Benchmark (GRESB), Leadership in Energy and Environmental Design (LEED), or any of the national equivalents, as proxies to show a minimum baseline has been met.

According to a Singapore-based fund manager, these are "increasingly becoming a necessity because a lot of customers don't want to hire someone to do an audit, but if they can say, 'Look, here's all the documentation certification and analysis,' it quickly allows them to get up to speed. And it's also able to show continuing improvement in the building, not just for the environmental [aspects], but also for social and governance and the interactions with the communities—it's sometimes harder to measure, but people are now always asking about them."

Exhibit 1-16 **Highest-Impact Technologies in the Next Five Years**



Source: *Emerging Trends in Real Estate Asia Pacific 2022* survey.

Chapter 2: Real Estate Capital Flows

"Geopolitical risk has always been an issue in the region. I'm not clear that this time is any different, but the real question for our investors is: Are you getting paid to take that risk?"

The same overarching themes of economic stability, market liquidity, and reliable cash flows once more drove sentiment for the year's *Emerging Trends* survey. In an investment environment characterised by abundant core capital and a flight-to-safety mind-set, the top Investment Prospects rankings were again populated by established gateway cities, more or less mirroring the best performers from last year.

What is perhaps more surprising than the persistence of a safety-first mentality during such stressful times in the market is that the scores in this year's poll came in somewhat weaker, even as interviewees embraced a more positive outlook. Only five cities in the 2022 table, therefore, counted as "generally good" (compared with nine last year), three as "generally poor" (compared with one last year), and the rest as "fair." Whether this implies a more sober assessment of upcoming challenges, or whether last year's scores were just a view-from-the-bottom perspective, is hard to say.

Otherwise, the main difference between this year and last is that sentiment at the bottom end of the table was noticeably weaker, with six cities scoring lower than last year's laggard, Hong Kong.

The fact that most cities received generally positive ratings can probably be attributed to factors noted in the last chapter.

- Regional markets continue to see ever greater volumes of investment capital pointed at regional real estate assets.
- As a result, capital prices remain surprisingly high across most markets, despite mostly weaker rentals.
- Regional economies remain, for the most part, more resilient than expected.
- The light at the end of the tunnel seems brighter.

Exhibit 2-1 City Investment Prospects, 2022

Generally poor | Fair | Generally good

1	Tokyo	6.17
2	Singapore	6.08
3	Sydney	5.95
4	Melbourne	5.74
5	Seoul	5.52
6	Osaka	5.50
7	Shanghai	5.47
8	Ho Chi Minh City	5.44
9	Shenzhen	5.44
10	Guangzhou	5.35
11	Auckland	4.88
12	Beijing	4.83
13	Taipei	4.49
14	Hong Kong	4.44
15	China—second-tier cities	4.38
16	Bangkok	4.18
17	Mumbai	4.16
18	Jakarta	4.09
19	New Delhi	4.06
20	Bangalore	3.87
21	Manila	3.86
22	Kuala Lumpur	3.79

Source: *Emerging Trends in Real Estate Asia Pacific 2022* survey.

The top-ranked investment prospect this year is Tokyo, swapping places with Singapore, which featured first in both the 2020 and 2021 surveys. The city is no stranger to top-of-the-table positions, having placed first or second no fewer than six times over the last 10 years (see exhibit exhibit 2-2 Historical Investment Prospect Rankings).

Tokyo's enduring popularity is down to a variety of factors: a stable economy, combined with a deep and liquid market, resilient asset values, and a long track record of better-than-expected returns.

In addition, while cap rates seem thin, low interest rates (less than 2 percent at 75 percent loan-to-value [LTV] over five years) generate yield spreads that outperform markets with apparently better fundamentals.

Finally, in the current context, the fact that the Japanese economy is fuelled mainly by domestic demand—with the notable exception of the formerly fast-growing international tourism sector—makes it relatively less exposed to outside shocks.

That said, investment in Tokyo does face headwinds. With a core market dominated by a cabal of well-heeled domestic developers, sovereign wealth funds, and global institutional players, returns expectations are low. As a result, yields for high-end properties remain out of reach for most private-equity capital, meaning that foreign investors must generally look elsewhere to meet targeted returns.

While this still leaves plenty of other options—logistics, residential, or non-CBD office strategies, for example—it does render the idea of Japan as a truly core market somewhat illusory for most investors.

In addition, Japan's isolationist COVID-19 policy may count against it as the rest of the global economy begins to open. In the words of one Tokyo-based investor: "The only caveat I would share is that when you look at what's happening in Europe and the U.S., the fact that borders are open and people are starting to travel creates a new dynamic. My concern with Japan is that it could stay as it is today, with no possibility for foreigners to come in without a visa for a long time—that would have an impact at some point on the economy."

To be fair, the same concern applies to other Asia Pacific markets. In particular, Mainland China and Hong Kong share even stricter pandemic policies; these have served them well in terms of containing the number of infections, but may leave them marooned economically as the rest of the world reopens for business.

Although its markets have always been thinly traded, second-ranked Singapore has seen a strong rebound in transactions in 2021 following a lackluster 2020. Office prices have remained strong, reaching record highs for grade-A properties, and a lack of sellers may serve to push up prices over the short term. Meanwhile, the downward trend in rentals reversed in the second quarter of 2021.

Buying sentiment in Singapore has been boosted recently by expectations of supply shortages. This is due to a number of factors: a limited pipeline of new development sites over the near term, the withdrawal of stock from the market for redevelopment purposes, and a belief that Singapore may benefit should foreign companies relocate from Hong Kong, or choose Singapore as a location for their Asia Pacific headquarters.

While this is to some extent offset as the city continues to tighten criteria for incoming foreign workers, one fund manager was pricing in a 30 percent increase in rental growth over the period to 2026. In our survey (see exhibit 1-11 in chapter 1), Singapore emerged as the only Asia Pacific city expected to see higher rents in 2022.

Exhibit 2-2 **Most Active Asia Pacific Metro Areas, Real Estate Transactions 3Q 2021 YTD**

2019	2020	YTD'21	Metro	Cross-border	Domestic	YOY Chg
2	2	1	Seoul	$582,120,241	$18,304,815,161	42%
1	1	2	Tokyo	$2,722,012,046	$11,966,964,138	-8%
6	3	3	Shanghai	$3,004,156,547	$6,455,435,578	1%
5	4	4	Beijing	$609,995,019	$7,626,928,604	3%
4	5	5	Hong Kong	$1,606,776,272	$6,512,818,511	44%
3	6	6	Sydney	$3,236,697,949	$4,285,605,323	57%
8	8	7	Melbourne	$3,700,330,583	$3,081,371,960	87%
7	12	8	Singapore	$2,915,215,924	$2,844,594,628	115%
9	10	9	Shenzhen	$1,366,971,739	$2,731,716,747	53%
11	13	10	Brisbane	$720,886,986	$2,521,918,777	182%
10	9	11	Osaka	$876,135,319	$1,782,063,316	-29%
13	7	12	Guangzhou	$1,157,287,288	$805,783,199	-22%
43	19	13	Pangyo	—	$1,720,113,448	285%
15	35	14	Perth	$662,667,830	$894,399,491	355%
18	15	15	Taipei	$56,498,505	$1,343,243,699	10%
20	20	16	Saitama	$263,657,548	$1,069,795,738	68%
22	17	17	Nagoya	$511,344,194	$719,783,806	8%
19	14	18	Yokohama	$339,704,951	$882,054,204	-33%
17	16	19	Chiba	$333,541,107	$710,799,106	34%
14	18	20	Adelaide	$343,462,085	$658,733,342	27%
67	29	21	Suwon	—	$891,027,828	116%
23	32	22	Hangzhou	—	$871,782,811	97%
25	24	23	Chengdu	—	$869,463,366	102%
31	22	24	Nanjing	$408,748,363	$437,588,600	47%
27	48	25	Suzhou	$172,154,435	$662,737,064	224%

Source: Real Capital Analytics.
Note: YTD 2021 is through third quarter.

Another city whose stock has risen this year is 14th-placed Hong Kong, which had been rooted to the bottom of the table for the two previous years due to twin shocks: a prolonged episode of social instability, followed by pandemic-induced declines in commercial asset values.

However, while the general view may be that the worst has now passed for Hong Kong's markets, investors based there continue to see them as "soft," given a large pipeline of new office supply and ongoing uncertainty over the prospects for net takeup. New occupiers from Mainland China will probably arrive in the city when the border reopens, but sentiment among international companies has been hit by concerns over the political situation and (even more so) by Hong Kong's strict pandemic containment policy, which has severely restricted travel to and from a city long regarded as one of Asia's busiest and most convenient hubs.

The bottom of the table this year features virtually all of the region's developing markets, which continue to suffer from high rates of COVID-19 infection. According to one Manila-based analyst: "The expectation is we're going to get out of this down cycle pretty soon, but from the perspective of foreign investors we're not yet on the radar. If you look at neighbouring countries, a lot of them are already talking about moving into the recovery phase, and their fundamentals are now back in terms of occupier demand. But from where we are at the moment, I don't see a lot of them on the horizon."

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

	2022	2021	2020	2019	2018	2017	2016	2015	2015	2014	2013
Tokyo	1	2	2	4	7	12	1	1	1	13	16
Singapore	2	1	1	2	3	21	11	9	7	3	1
Sydney	3	3	4	3	1	9	2	4	5	4	3
Melbourne	4	6	5	1	2	16	3	5	13	10	7
Seoul	5	4	10	9	19	17	7	7	15	14	19
Osaka	6	8	8	5	10	15	4	3	9	22	21
Shanghai	7	7	7	6	4	6	9	6	2	2	2
Ho Chi Minh City	8	5	3	7	5	4	5	13	19	18	10
Shenzhen	9	9	6	8	6	5	18	19	10	16	—
Guangzhou	10	10	9	10	8	10	20	20	6	15	6
Auckland	11	13	19	20	9	14	10	15	17	17	20
Beijing	12	12	13	12	11	11	14	10	8	7	5
Taipei	13	11	14	21	22	22	17	18	16	9	6
Hong Kong	14	22	22	14	13	18	15	21	18	11	13
China—second-tier cities	15	17	20	18	17	20	22	22	12	8	—
Bangkok	16	14	11	11	16	8	19	16	11	6	14
Mumbai	17	15	12	13	12	2	13	11	22	20	15
Jakarta	18	16	18	15	14	7	6	2	3	1	11
New Delhi	19	18	15	17	20	13	16	14	21	21	12
Bangalore	20	21	16	16	15	1	12	17	20	19	9
Manila	21	19	17	19	18	3	8	8	4	12	18
Kuala Lumpur	22	20	21	22	21	19	21	12	14	5	17

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

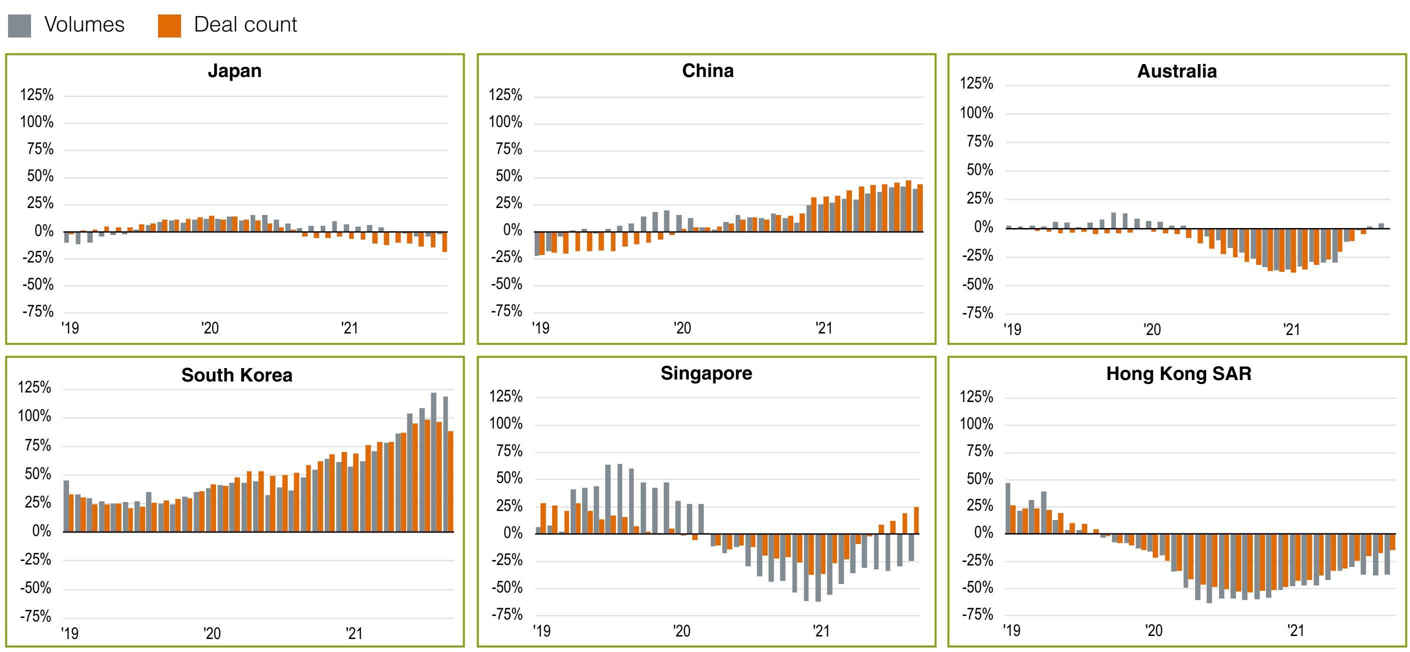
Despite boasting both a young demographic and an economy with positive long-term fundamentals, Manila will struggle to digest a large amount of incoming supply on both the residential and office fronts, even as demand has weakened due to lockdowns and business closures. In particular, the China-dominated online gambling industry, which had been the target of so much of the new supply, is currently in limbo and faces an uncertain future. Business process outsourcing (BPO) facilities, meanwhile, have fallen victim to the work-from-home wave, although over the longer term the industry may benefit from a global trend towards employment decentralisation.

India, finally, is viewed with a similar degree of negativity, probably as a legacy of the devastating wave of COVID-19 infections that hit the country during April and May. In reality, however, Indian markets have rapidly regained momentum in the second half of the year.

In terms of occupancy, the main demand driver is ongoing growth in the Indian technology sector, much of it providing services to global outsourced labour markets. According to one locally based interviewee: "If you look at last year's data on grade-A office, absorption was down 40 to 50 percent across most cities. But this year, tenants are back with a vengeance—they're taking space because even I can see a demand/supply shortfall in the offing."

In addition, Indian transaction volumes recorded their second-highest total ever, according to RCA, with first-half investment of US$2.4 billion. While smaller private-equity funds have continued to avoid India, on-the-ground teams from sovereign, institutional, and large global private-equity funds continue to place substantial sums in multiple asset classes across the country.

Exhibit 2-4 Deal Count, Volume Change, 2019–2021



Source: Real Capital Analytics.

Development Prospect Rankings

Development prospect survey results were marginally weaker this year, although feedback in interviews was more positive given an expected recovery in demand for space in 2022 that should help support underwriting for new development. Build-to-core strategies are also popular given ongoing appetite for core assets in an undersupplied market.

Ranking at number four in the development table (up from seventh last year), Seoul is attracting investors for both office and logistics projects. Transactions have soared in South Korea (mostly in Seoul) since the pandemic began at the beginning of 2020, culminating in US$10.6 billion worth of deals in the third quarter of 2021—the highest in the Asia Pacific region.

Relatively high development yields have drawn investors from other core markets in the region, with several interviewees in Tokyo indicating a preference for deals in Seoul rather than their home market. Investment in Seoul commercial property has also been boosted in 2021 by buying from domestic institutional funds that would normally invest internationally, causing a spike in commercial property values of around 18 percent year-on-year in the third quarter, according to RCA—the highest of any gateway city globally. Rising prices have also convinced investors to gravitate towards forward-funded deals, which represented fully one-third of activity in the third quarter.

At number five, Vietnam has again been singled out as a popular centre for development in the wake of several years of strong foreign investment in local industrial parks. According to one fund manager: "The manufacturing shift is real. Buyers [in our industrial park] are all Asian—[including] Japanese, Korean, a Hong Kong group, and Taiwanese. We like housing, too, but that's an opportunity that will be there for a while—getting in early on industrial and logistics is the here and now."

Exhibit 2-5 City Development Prospects, 2022

Generally poor | Fair | Generally good

1	Singapore	5.80
2	Tokyo	5.65
3	Sydney	5.59
4	Seoul	5.43
5	Ho Chi Minh City	5.41
6	Shanghai	5.31
7	Melbourne	5.31
8	Osaka	5.30
9	Shenzhen	5.26
10	Guangzhou	4.94
11	Taipei	4.72
12	Beijing	4.70
13	Auckland	4.69
14	China—second-tier cities	4.64
15	Hong Kong	4.41
16	Jakarta	4.37
17	Mumbai	4.37
18	Bangkok	4.33
19	Bangalore	4.28
20	New Delhi	4.25
21	Manila	4.09
22	Kuala Lumpur	3.92

Source: *Emerging Trends in Real Estate Asia Pacific 2022* survey.

While Vietnam has many of the right ingredients for export-driven manufacturing, it has been badly affected by COVID-19 lockdowns, with many factories closed and their workforces dispersed. Development and investment work has therefore slowed significantly, especially in the south, where industry is centred more on textiles and light manufacturing. In the north, where worker concentrations are less dense due to a focus on technology, the picture is different. This regional divergence exists also in other markets and reflects how the impact of COVID-19 can vary significantly between different areas of the same country.

As a result, the shutdowns mean that some large manufacturers with factories in Vietnam have either found or are looking for alternate bases, including in China, from where many migrated to Vietnam in the first place. Foreign investment may slow significantly in 2022, therefore, in the absence of a near-term change in government policy that seems unlikely with only 24 percent of the population fully vaccinated against COVID-19 as of the end of October 2021.

Cross-Border Investment Returns

Widespread travel embargoes preventing convenient travel have also limited flows of cross-border capital. This means that the rise in transactions seen in 2021 has come largely at the hands of domestic investors. Still, the dollar value of cross-border deals—at almost US$50 billion, or around 25 percent of this year's total—has not dropped substantially from pre-pandemic years, when it accounted for about 33 percent of buying.

Capital originating from within the region has outstripped purchasing by Europe- and U.S.-based funds for the first time since 2012, according to RCA, another unsurprising side effect of global travel restrictions.

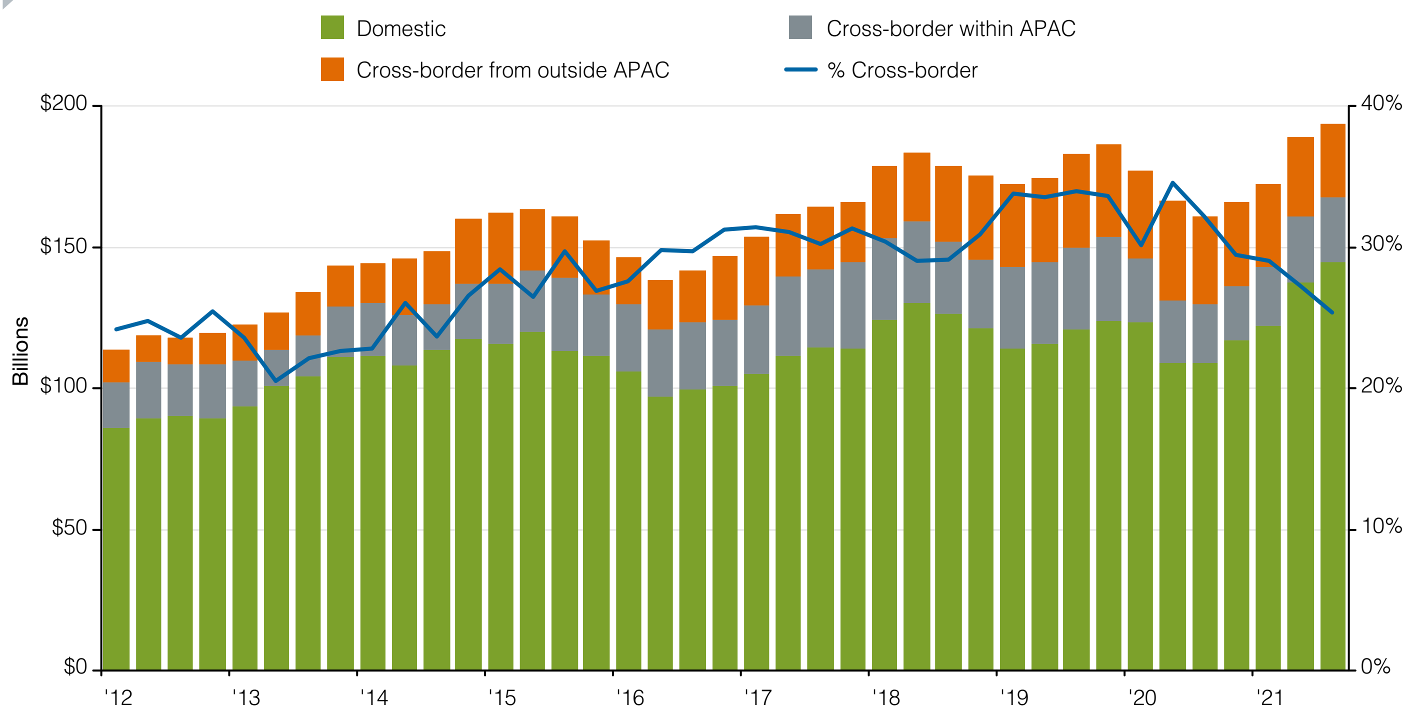
In particular, Singapore was the biggest single source of outward investing into the Asia Pacific, deploying some US$9.3 billion in the first nine months of the year. Sovereign wealth capital was prominent (accounting for half that figure), as was spending by local REITs, who used access to cheap debt to sell assets from their home portfolios and bid aggressively for higher-yielding properties elsewhere, both regionally and globally.

Strong investment flows to Australia have continued in 2021 despite the travel embargo. Again, Singaporean capital was prominent, with one major institution picking up a large Australian logistics portfolio in the year's most prominent deal.

Incoming investment to Japan was down 40 percent in the first nine months compared with the five-year average, due mainly to falling flows from Americas-based funds, which historically have accounted for most foreign-sourced real estate investment in the country.

While overall investment in Mainland Chinese commercial real estate remained at near-record levels, incoming capital flows have been disrupted by questions over the direction of domestic economic policy, falling again by some 40 percent compared with average volumes over the last five years. A fund manager from one large private-equity fund said that

Exhibit 2-6 **Asia Pacific Investment by Source of Capital, 12-Month Rolling Volumes**



Source: Real Capital Analytics.

this created a "whack-a-mole" situation for foreign investors that was harder to navigate than preexisting U.S./China trade tensions because of uncertainty as to which parts of the economy might be affected by current or pending changes.

Meanwhile, outgoing investment from Chinese developers remains subject to tight regulatory control, registering US$1.9 billion in the year to October 2021, according to brokers Knight Frank, down from a peak of US$17.5 billion in 2017. In particular, Chinese and Hong Kong capital has "essentially disappeared" from Australian markets, according to an investor based there.

Global Funds Migrate to Real Estate

In principle, a combination of rising inflation and ultra-low bond yields makes hard assets increasingly attractive to investors. Global allocations to real estate can therefore be expected to increase over the near-to-medium term.

As the head of one diversified private-equity fund said: "Real estate global capital flows are up, broadly speaking, and that makes sense. Our pension people are in a bit of bind in terms of delivering 7 percent returns in a zero interest rate fixed-income market, so where do you go? And the answer every time is real estate or alternatives."

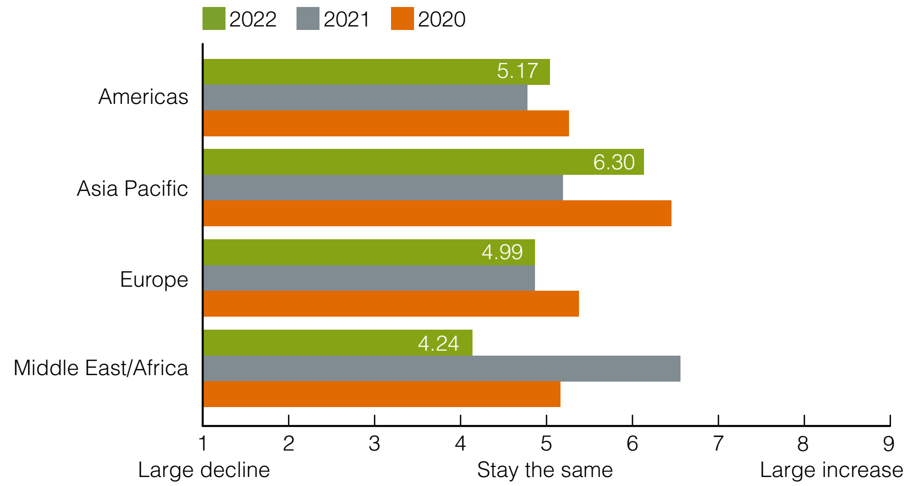
That applies in particular to international capital that remains underinvested in Asia Pacific assets but would like to tap its better prospects for growth. Interest among global funds has therefore rebounded from last year, when a safety-first mind-set prevailed and the likelihood of distress appearing in Western investors' backyards provided plenty of opportunities to profit locally.

As one U.S.-based fund manager said: "Today, Asia represents about 35 to 40 percent of the investable universe in commercial real estate, so global investors have to have an allocation now and that's what has been driving it."

Another reason global capital flows have resumed to Asia Pacific markets is that returns in at least some local asset classes are higher than they are in the West. This applies in particular for logistics and multifamily properties.

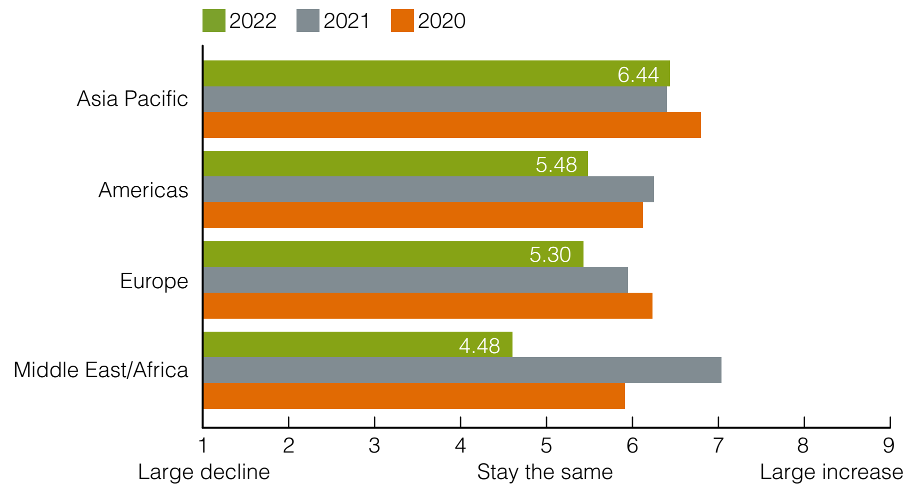
According to a fund manager in Tokyo: "For European investors, they look at where residential pricing is in Europe and think that even at 2.5 or 2.75 cap rates, residential looks pretty attractive in Japan, particularly given borrowing costs."

Exhibit 2-7 **Expected Change in Capital Flows into Asian Markets between Now and the End of 2022**



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

Exhibit 2-8 **Expected Change in Capital Flows into Asian Markets over the Next Five Years**



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

Of course, that begs the question of whether Asia Pacific risk/return profiles match those in the West. As the investor continued: "The problem I have with the whole market is that it's being driven much more by liquidity than by fundamentals. People are looking at all markets as being almost equal, and I feel there's a bifurcation of risk/return expectations—people are just being driven by returns. Whether that will continue long-term or not is a great debate. But we're still buying."

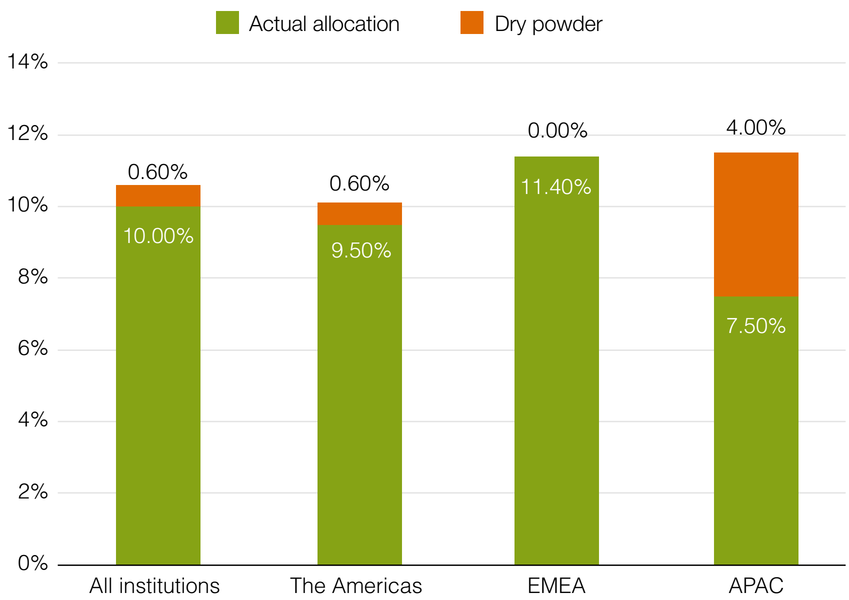
At the same time, competition to place funds—especially into core assets—remains intense. Dry powder has been building for years, reaching a record US$52 billion as of mid-2021, according to Preqin. Compounding that problem, estimated allocations to real estate by Asia Pacific institutions currently stand at just 7.5 percent, well short of a targeted 11.5 percent, according to consultants Hodes Weill (see exhibit 2-9).

Fundraising for new investment funds, meanwhile, has picked up in 2021, with a total of US$8.6 billion in aggregate capital raised just before the end of the first half, according to Preqin, already surpassing the first-half total from the most recent normal year in 2019. Activity has centred mainly on raising capital for core and value-add strategies.

With site visits to many potential deals now impossible due to regional lockdowns, larger investment funds with on-the-ground teams in different markets have benefitted, receiving significant new capital from international funds whose managers are unable to fly internationally.

According to an investor at one large private-equity fund: "Because people can't travel, they've become more comfortable with on-site due diligence through Zoom. But there's still hesitancy, so the big brands are getting bigger a lot faster and the smaller guys are suffering. It's an unfortunate situation; we see this every time we have a crisis." Whether this will slow the preexisting trend in favour of managing investments in-house remains to be seen.

Exhibit 2-9 **Real Estate: Targeted Allocations and Dry Powder by Global Institutional Investors 1H 2021**



Source: Hodes Weill Associates, JLL estimates.

Sovereigns Turn to Asia Pacific Assets

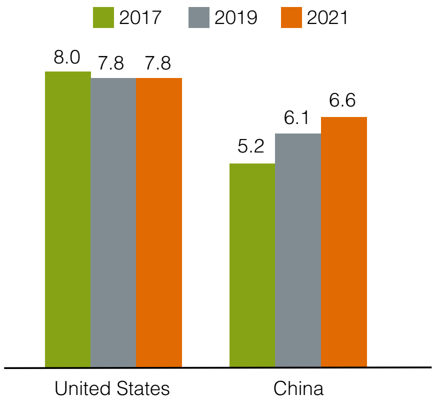
COVID-19 has restricted investment activity among global sovereign wealth funds (SWFs) in the same way it has with private-equity investors. This reduced investment activity in Asia Pacific and other global markets saw them resort to parking capital in U.S. treasury bonds.

However, a survey of global SWFs released in July 2021 found that more than half (53 percent) of those funds intended to increase investment in real estate over the coming year, with 27 percent planning to maintain buying at existing levels. The study also found a preference for investments in emerging Asia Pacific economies, and especially China, based on stronger economic growth, higher asset returns than in the West, and a more effective pandemic containment strategy.

The biggest player (potentially, at least) in the Asia Pacific SWF universe is Japan's Government Pension Investment Fund (GPIF), one of the world's largest, with some US$1.7 trillion in assets. Although GPIF announced several years ago that it would diversify away from Japanese government bonds in a bid to boost returns, its targeted 5 percent allocation to alternatives (including infrastructure and real estate) has so far failed to materialise, with alternative assets representing just 0.7 percent of its portfolio (i.e., some ¥1.3 trillion, or US$11.4 billion) as of March 2021. Of that, real estate assets represented ¥353 billion, or some US$3.1 billion.

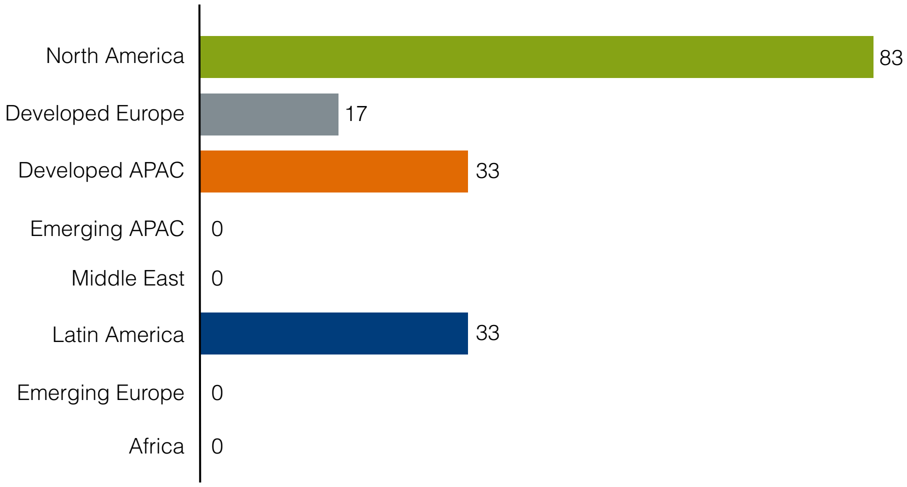
This may change soon, however, following the announcement in July 2021 that holdings of alternatives would more than double to 1.6 percent over the medium term. Given that the fund has seen a huge 25.1 percent increase in net asset value following its rotation to equities in 2020, managers may now have more confidence to take that step.

Exhibit 2-10 **Attractiveness of Economies for SWF Portfolios, Three-Year Prospects**



Source: Invesco.
Note: Average score/10.

Exhibit 2-11 **Preferred Investment Destinations for Asia-Based SWFs**



Source: Invesco.

REITs Consolidate

Low yields offered by global sovereign bonds have helped propel REIT markets throughout the Asia Pacific in 2021, and as share prices rose through the first half of the year, regional REITs were to able raise significant fresh equity, bringing in some US$3.3 billion in the second quarter in the same period of 2020.

REIT spending was commensurately higher, too. Singaporean REIT investments surged some 50 percent year-on-year in the first half to more than US$1.7 billion, Australian REITs doubled investments to $2.9 billion, while REITs from Hong Kong, South Korea, and Taiwan also increased buying.

The large volumes of institutional capital available for real estate purchases in the region has been a catalyst for the creation of bigger investment vehicles via mergers of existing REIT platforms. One large merger took place in Singapore in 2021, and more consolidation is likely, despite relatively high current share prices. Such mergers are likely to include cross-border deals between Japanese and Singaporean REITs, as well as some of Singapore's many smaller, illiquid vehicles, especially those specialising in currently highly prized logistics assets.

Nor is this trend restricted to REITs—other types of asset managers also are looking to merge, both as a means to increase assets under management and because platform deals, by nature, facilitate the placement of large amounts of capital.

Otherwise, the region has continued to see a surge in REIT listings. India created its third REIT during 2021, adding a further US$1.6 billion in capitalisation to the local market. Several REITs were also listed in the Philippines, and in June China launched nine infrastructure REITs (C-REITs), raising a combined total of US$5 billion, according to JLL.

A few peculiarities of C-REITs (some of them shared by REITs in the Philippines) should be noted, however. In particular, they do not directly own their underlying assets (relying instead on securitised income streams), are not allowed to use significant amounts of leverage, and do not enjoy tax breaks. These are all considered crucial components of conventional REIT models in the West, and it is unknown the extent to which this may affect their appeal to investors.

In addition, C-REITs are not yet allowed to buy commercial real estate assets except for industrial and logistics properties (including business parks). Eligible categories are likely to be expanded in the future, however, with the multifamily sector earmarked as a likely beneficiary.

Bank Debt Still Cheap

The shaky fundamentals of different regional economies and asset classes might suggest that banks would tighten lending terms, but in practice interviewees reported that debt remains freely available in all major regional markets (except China) on terms similar to pre-pandemic deals.

According to a developer in Australia: "Not only are banks willing to lend, but pricing is getting very keen for [loans to] residential development. If you want over 50 percent LTV and don't have sufficient presales, then the banks aren't going to be there, or it's going to be a combination of banks and some kind of nonbank mezzanine lender. But even the cost of that is coming down significantly, so both availability and pricing has improved over the past 12 to 18 months."

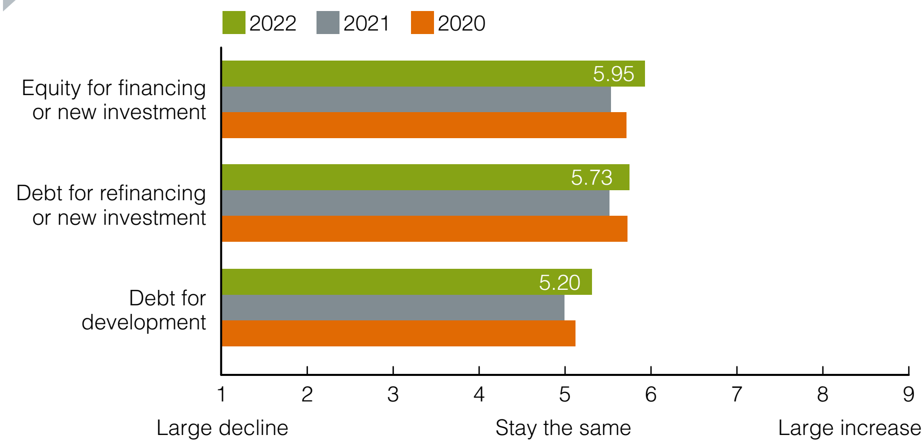
The same applies in Japan, where the cost of capital has historically been low. One locally based investor commented: "I was surprised at how aggressive the banks were for financing a large logistic spec development we're doing—if they like the product type, location, and the sponsor, they're incredibly good terms." Responses to our survey also support the idea that banks have remained accommodative in their lending policies (see exhibit 2-12).

Regional banks' handling of non-performing loans has also proved flexible, and is probably one of the main reasons for the conspicuous absence of distress across the Asia Pacific, despite rising numbers of underwater assets. The extent of bank forbearance was not anticipated last year, but at the end of the day the reality is that foreclosure serves few interests—not only would it mean damaging banks' own balance sheets, but the risk of a chain reaction across the economy is not merely hypothetical.

According to a Hong Kong–based fund manager: "Just because your hotel is running at 20 percent occupancy today, no one is expecting it to be at that level in three years' time. Real estate is a medium-to-long-term investment and I think you have to take the view that, over a five-year investment period, COVID will not have destroyed value; it just means you don't get your expected return. So, if in three years' time you're back to 85 percent of your usual NOI [net operating income], that's not a massive hit in terms of value—ultimately, it's just a question of whether you have the holding power."

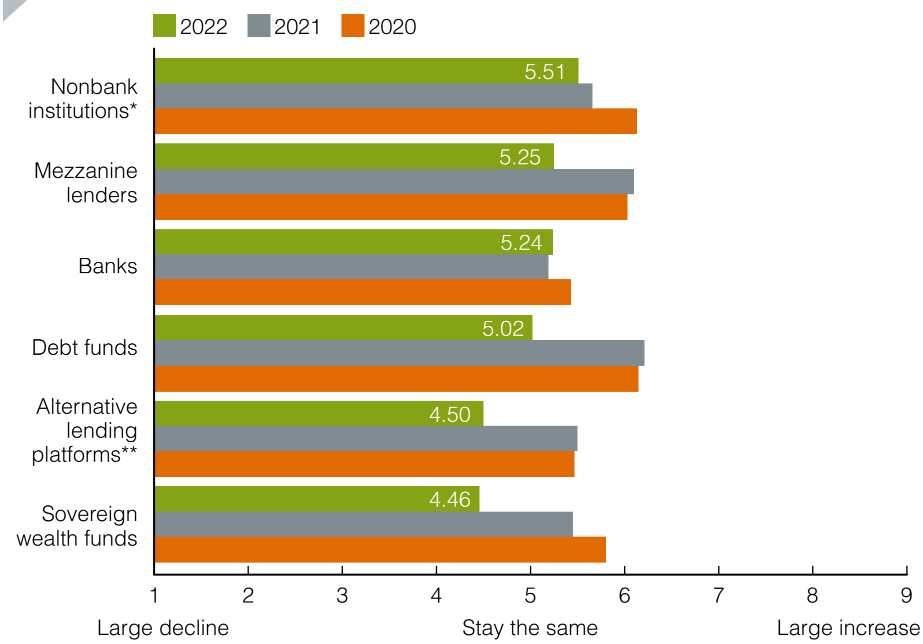
While demand for debt in Asia has always been dominated by banks, nonbank debt is both increasingly available and competitively priced, as more LPs come round to the idea that, in the current environment, debt strategies can be more profitable than equity. Asia-domiciled investors have been active in the space for some time, but a wave of new players has arrived recently, mostly from the United States, ranging from insurance and pension companies to investment funds with special situations, higher-yield, and opportunistic strategies, according to one Sydney-based debt specialist.

Exhibit 2-12 Expected Change in Availability of Debt and Equity Finance



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

Exhibit 2-13 Availability of Debt by Type of Lender



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

Still, appetite remains relatively thin, even in Australia, which is the biggest market for nonbank debt in the Asia Pacific given local regulatory restrictions on the banking sector (see exhibit 2-13). In general, projects with noncore assets, questionable credit profiles, or that require high LTVs or long-tenor loans tend to be those resorting to nonbank money. According to one local developer: "We've had approaches from family offices and Superfunds, but when vanilla bank debt is so easy, cheap, and readily available, and the security and structure is there, why would we change?"

One answer to that question—and a possible opportunity for the nonbank market—is that as social and economic conditions begin to normalise, banks may end their accommodative stance and start calling their nonperforming loans.

At that point, said the debt specialist, "My sense is there's plenty of scope for nonbank [players] to take out banks at higher rates. But because there's more capital than deals, you have to be creative. A lot of those guys end up partnering with lower cost-of-capital lenders and then stratifying the loan in the background. I could see that being a solution, and that's the real benefit of the increased number of lenders in our market—borrowers have more options to raise money. So that's another way of saying I don't see distressed or forced sales arriving in any great volume."

Green Finance Comes of Age

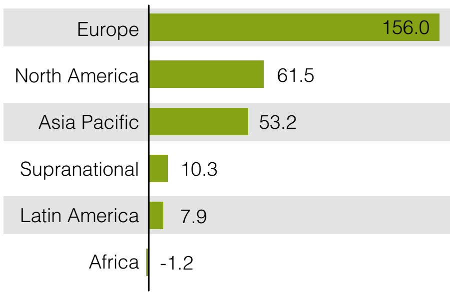
As ESG considerations become ever more important for real estate owners and developers, the same mandate is being applied to the way that projects are financed. Green loans and bonds are therefore increasingly visible in the market as banks and financial organisations take up the environmental mantle.

In 2020, total Asia Pacific green bond issuance (i.e., not related just to real estate) reached US$53.2 billion. That accounted for just 18 percent of the global total, but this figure is increasing rapidly in both absolute and proportional terms.

In particular, the volume of green bonds from China tripled in the first half of 2021 to reach US$26.1 billion, making it the largest issuer in the world, according to data provider Refinitiv. South Korea has recently emerged as another major Asia Pacific issuer, with Japan now ranked third.

Exhibit 2-14 **Green Bond Issuance (in Billions of Dollars)**

By region, in 2020 (billions of dollars)



Source: Climate Bonds Initiative.

Green borrowing can be tied to a variety of issues, ranging from housing affordability to a lack of diversity in corporate boardrooms, but by far the biggest theme relates to the environment, and in particular projects that address climate change.

For borrowers, perhaps counterintuitively, the real benefit of green finance is not necessarily access to lower cost of capital. In fact, green bonds in the Asia Pacific region are currently priced on a par with conventional bonds, while in Europe they trade at a premium of around 9 basis points (bps), according to the Association for Financial Markets in Europe. And although green loans enjoy a discount of up to 30 bps to standard lending costs, very often the real incentive will lie in the fact that capital is available at all, or that it comes with higher leverage, or better access to funding at an earlier stage of the project, where the risk is potentially too high to bring in a major bank.

From the financial institution point of view, the need to grow their portfolio of green loans means that they may be more willing to lend to a project if it qualifies as green than they would if it doesn't. As a developer in Australia put it: "There are buckets of money popping up everywhere that are tied to ESG, all through companies or finance organisations having their own ESG or pooled ESG fund. So, if a superannuation fund has a $200 billion pool, they might allocate $50 million to clean energy or environmental initiatives—in fact, they can't get it out the door quick enough, so it will generally be cheaper or easier to get."

Also, as one analyst put it: "We're building the ship as we're sailing, but I think where it's going to end up is that you'll get price and terms 'A' for green projects, and price and terms 'B' otherwise. Or else they'll say: 'We don't have much headroom for you as a sponsor, but if you do a green loan, we'll find room in a different loan portfolio.' And I think in the syndication space that's going to be important."

Banks are particularly interested in providing green financing to new buildings with strong green credentials. "I think that's going to be priced really aggressively," the analyst continued. "Banks are going to want to bring that onto their book sitting there at high credentials and be able say, 'We've got X percent of the book at six-star Green Star rating, or whatever it is.'"

The incentive is therefore mutual. Banks are motivated to recruit green projects to satisfy internal or shareholder directives, while building owners are motivated to qualify for loans or lending terms they may not otherwise get. In the process, they also obtain cheaper capital, boost building efficiency in ways that will lower their operating costs, and attract more sophisticated tenants that will pay higher rents—a true win/win situation.

Chapter 3: Property Type Outlook

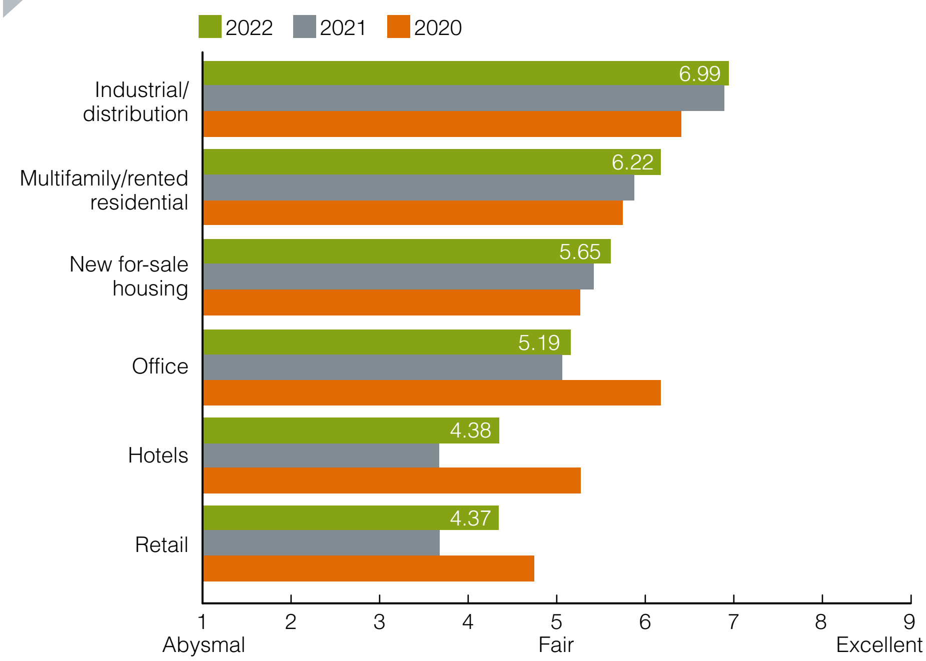
"The office market is quite strong in that you don't see corporates making big decisions at the moment. But for retail, hospitality, and restaurant-type services, it's been horrible; it's been very, very tough."

Historically, the most favoured asset classes in Asia Pacific markets have been the office and retail sectors, which currently represent some 66 percent of investor portfolios in the region, according to JLL, compared with an equivalent 45 to 55 percent in the West. The shine came off in 2020, however, as corporate work-from-home policies and booming e-commerce sales sowed fears of a secular shift away from more conventional real estate uses, tilting the balance towards a reweighting of portfolios into new-economy themes and safe-haven residential assets.

While doubts persist about the prospects for both the office and retail sectors, however, a notable reversal in sentiment occurred during the second half of 2021, as transactions for office properties rebounded sharply (to a record US$22.7 billion in the third quarter, according to RCA) while retail assets recovered to their 2019 levels. Many interviewees saw both the office and retail sectors as currently oversold, with potentially good prospects over the next 24 months as governments move to ease pandemic containment policies.

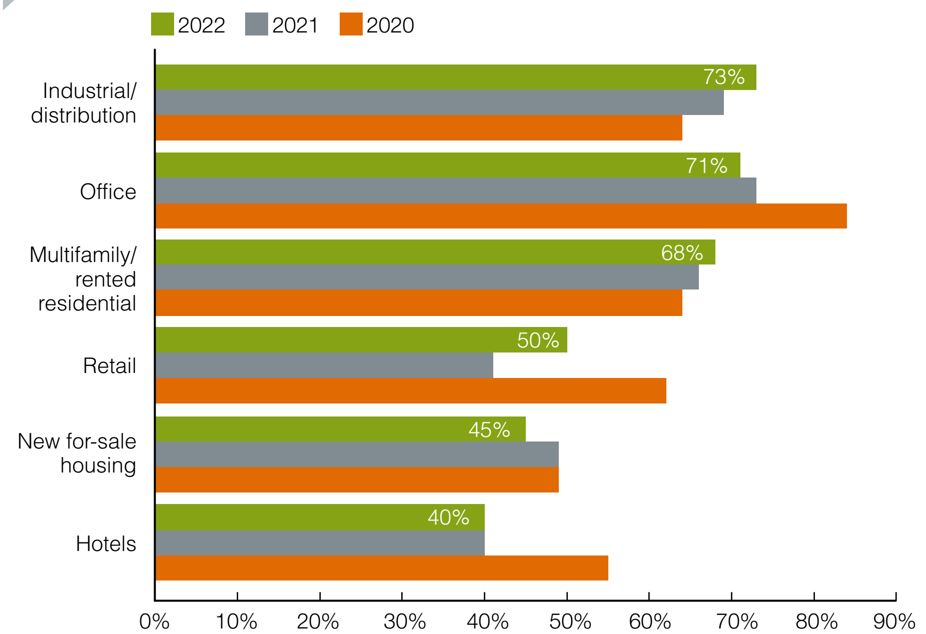
Survey responses (see exhibit 3-1) reflect this turn in sentiment, together with a renewed focus on the hotel sector. Interest in offices remains fairly high, though significantly lower than in our 2020 report. Retail, meanwhile, has rebounded from the severe decline seen in 2020, while both industrial and multifamily sectors continue to gain traction as investors shift focus towards growth and/or safety.

Exhibit 3-1 **Prospects for Commercial Property Types in 2022**



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

Exhibit 3-2 **Broad Sectors in Which Investors Are Active or Plan to Be Active in 2022**



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

Given the overall immaturity of regional build-to-rent residential markets, logistics has become the overwhelming favourite for investors in 2021—a trend that shows no sign of diminishing. Current investor portfolio weighting to logistics properties of around 16 percent is therefore likely to increase to 20 to 23 percent over the next five years, according to JLL projections.

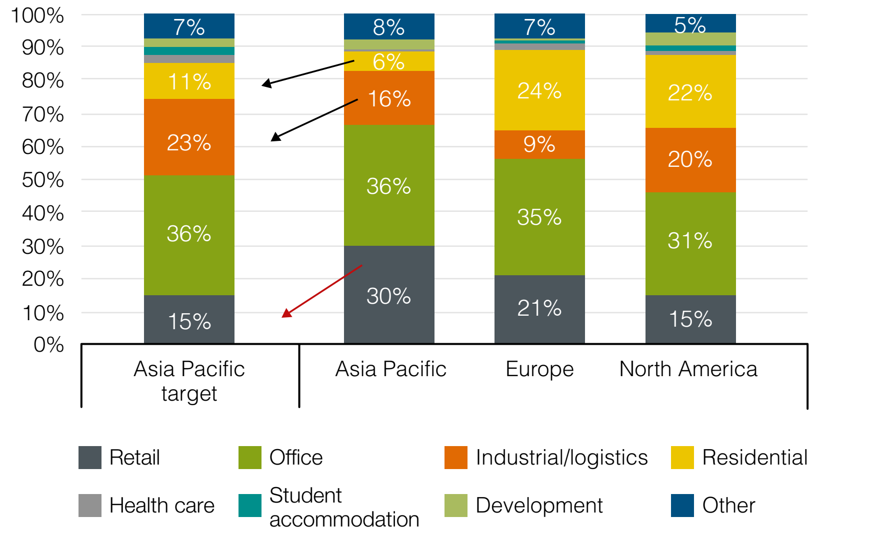
Another factor supporting this migration is the fact that yields for Asia Pacific logistics assets continue to be higher than yields for offices, thereby encouraging continued cap rate compression in the direction of current European levels of around 3.0 to 3.5 percent.

Office

With the exception of China (where vacancies were already high) and South Korea, office occupancy in Asia Pacific gateway cities has weakened significantly in the wake of pandemic lockdowns, partly as businesses have shrunk, and partly as demand for space dried up due to work-from-home policies. As of the third quarter of 2021, however, fundamentals seem increasingly to be turning a corner, with year-on-year demand improving in Sydney, Melbourne, and Shanghai (though remaining weak in Tokyo) and quarter-on-quarter rents rising marginally in Hong Kong, Singapore, Shanghai, and Seoul, according to JLL.

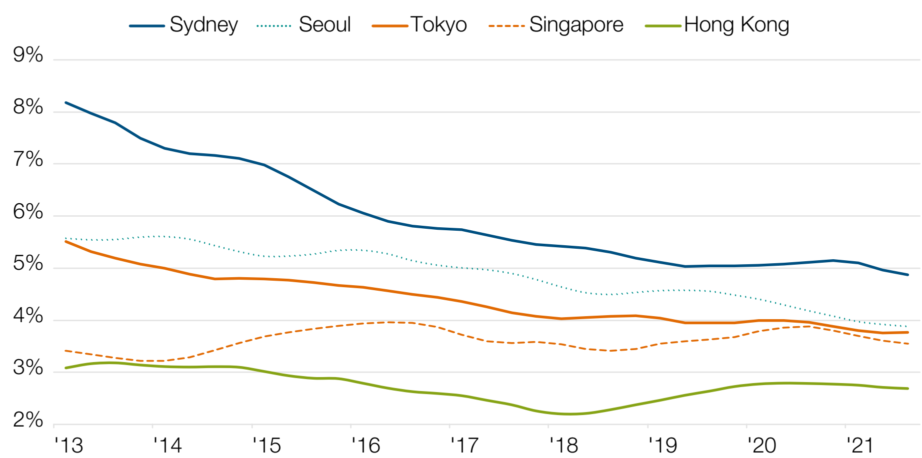
Capital values, meanwhile, continue to be strong no matter what. As one investor said: "There are some places where it's a bloodbath from a fundamentals perspective and we wouldn't want to own office at all—in Shanghai or Beijing, for example—because there's a massive oversupply. So you're seeing a collapse in rents, but you haven't seen a collapse in values. There are just no transactions because there's a Mexican stand-off between buyers and sellers."

Exhibit 3-3 **Current and Targeted Asset Allocation in Real Estate Portfolios**



Sources: ANREV, Preqin, JLL estimates.

Exhibit 3-4 **Selected Asia Pacific Office Transaction Yields**



Source: Real Capital Analytics.

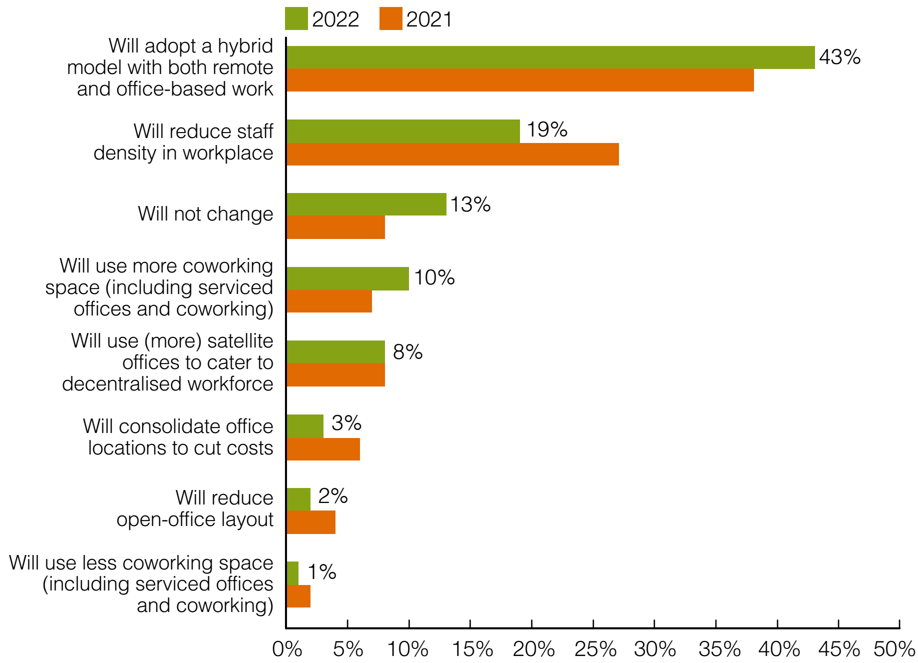
Debate as to how demand for CBD offices might be affected by work-from-home and other secular influences has become polarised. Although many multinational companies are open to embracing working from home as a long-term permanent option for employees, many—if not most—interviewees had strong views that the impact on occupancy rates in the Asia Pacific (with the possible exception of Australia) will be minimal, and that currently soft markets seen in some regional cities reflect oversupply rather than a real lack of demand.

The reasons for the Asia Pacific's resistance to attrition from work-from-home policies are well known—cultural influences, office hierarchies, small homes, and the desire to collaborate all play their parts. In addition, as regional markets continue to grow, service sectors that are currently significantly smaller (at about 50 percent of the whole) than in the West (at 70 to 80 percent) create a secular tailwind of another kind that should act as a catalyst boosting uptake of office space.

That said, there still seems to be an acceptance that, even if regional conditions may not be as favourable to pervasive uptake of home working, a hybrid office/home approach is by now well established and probably here to stay. This idea is supported by our survey responses (see exhibits 3-5 and 3-6).

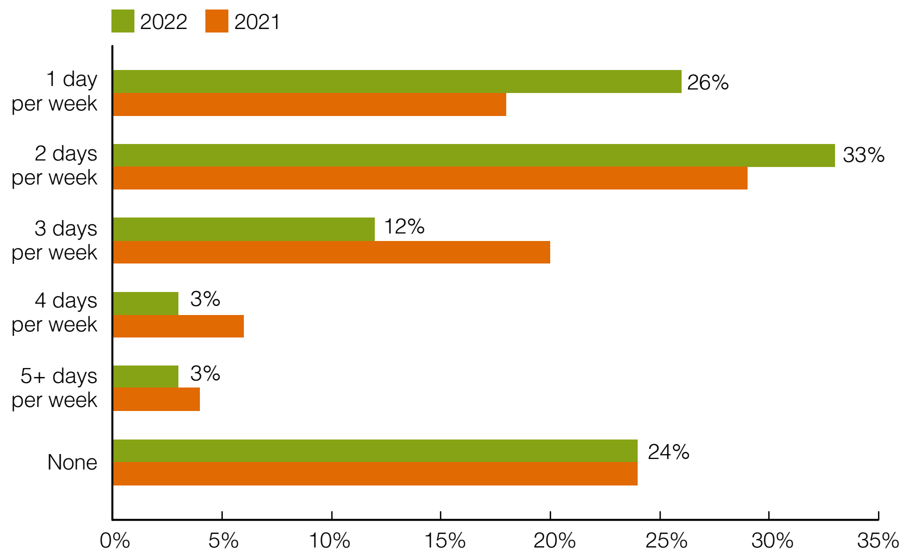
Still, although widespread uptake of hybrid working practices may bring with it long-term implications for a more decentralised approach to workplaces (as discussed in chapter 1), it may not result in an absolute reduction of occupied space. As a fund manager in Sydney said: "We're more interested in [investing in] areas such as Redfern [than we are the CBD], but we're not expecting CBD prices to dramatically decrease, as the shift in demand away from these towers will likely be offset by the space per employee having to increase to accommodate new working styles."

Exhibit 3-5 **How Will Your Organisation's Workplace Model Change as a Result of COVID-19?**



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

Exhibit 3-6 **Average Days per Week Spent Working from Home before and after the Pandemic**



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

What this means is that, to attract and retain talent, employers are moving to provide workplaces that not only are less dense, but also offer better wellness amenities, collaborative facilities, and experiential spaces.

There is a universe of ways to approach this. In terms of wellness amenities, touchless technology was mentioned often in interviews, including installation of no-touch facilities for building access, lifts, and bathrooms. Air-treatment equipment is another important wellness theme, including higher-grade air filters and/or ultraviolet treatments in air-conditioning units and lavatories. Carbon dioxide sensors are also becoming common.

Creating in-office experiences is another focus. These might involve leisure-oriented common lounge spaces, biophilic design, end-of-trip facilities, and landlord loyalty programmes. They also include recreational amenities such as games rooms or even rock climbing walls—all space-intensive uses. As one Hong Kong–based consultant said: "The office has become as much of an experience as has retail, and the old maxim of 100 square feet per person has clearly gone out of the window—most of the schemes I've seen are talking about 200 to 300 square feet per person."

With technology and design evolving so quickly, the challenge for owners is not just keeping up, but also ensuring that features adopted today will not become redundant tomorrow. The ability to ensure integration of different systems platforms is therefore a priority. According to a Hong Kong–based value-add investor: "I think in the next 12 to 18 months, the issue will be: how to pull all this together in the most efficient way from a building management, operations, and user-experience point of view? Does everybody need their own app, or are there opportunities for collaboration across different platforms?"

This drive to upgrade buildings as a means to attract talent and add value has made asset quality an increasingly important theme. Successful CBD office buildings will therefore need to be both well located and high quality (preferably with an ESG angle) or well located and not-so-high quality, but with potential to upgrade.

The rest may have to re-strategise, especially as more companies relocate to suburban locations (cities with large tech sectors in particular). As one Singapore-based fund manager put it: "The good will become better because owners will spend capex on future-proofing aspects, and the bad will become worse or cease to exist."

A World in Flex

Another issue that now tops occupiers' agendas is flexible working. The concept of flex arose originally in connection with coworking spaces, which proliferated around the region over this span of a few years. Today, though, the idea has morphed into a much broader model focused on increasing tenant productivity by leveraging flexibility.

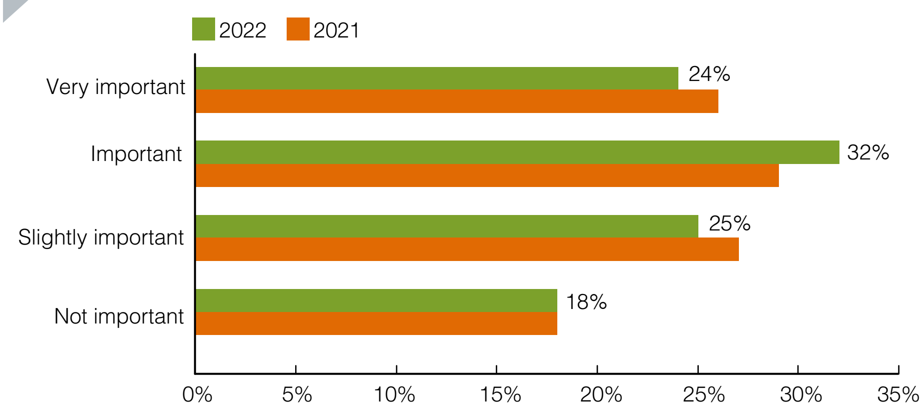
From a workspace point of view, this means providing access to serviced workspaces of various kinds, ranging from traditional coworking facilities, to overflow office space within a single building, to networks of workspaces across portfolios of buildings, or (for large cities) near-to-home drop-in locations scattered around a city. This distributed working concept also plays to the idea of decentralisation, because as a company's allocation to flex goes up, its use of traditional CBD headquarters space tends to stagnate or decline.

Since its inception, the flex workspace business model has been questioned by analysts, especially after the fall from grace of one industry-leading coworking group in 2019. The pandemic has only aggravated those doubts, with usage plunging as workers shy away from use of shared resources. There is little doubt, however, that the dynamics of the current market strongly favour greater use of flex over the medium to long term, as it becomes an increasingly mainstream pathway for large companies to manage their workforce and real estate needs.

In our survey (see exhibit 3-7), some 56 percent of respondents stated that flexible workspace was either important or very important for their organisations. Although that represents a slight decline from last year's figures, this is probably more to do with pandemic-related issues than with any industry retrenchment.

Future growth of the flex industry is also tied to improved business models. Landlords are now more open to the idea of assuming risk, either by forming profit-sharing partnerships with operators or by hiring them to manage in-house resources for a fee.

Exhibit 3-7 **How Important Currently Is Flexible Workspace for Accommodating Employees of Your Organisation?**



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

In addition, management of flex facilities has become streamlined through the evolution of purpose-built software that can handle basic processes such as space booking, access control, tech servicing, and payments, leaving landlords to focus on their own specialty of asset management.

Flex Leases Bypass Risk

Another idea associated with the concept of flex is flexibility in leases. Historically, landlords have favoured long leases because long-term cashflows are important considerations for banks that finance asset purchases. But today's fast-changing business models, together with uncertain headcount projections as employers begin to position for a post-pandemic rebound, often make tenants resistant to agreeing to the type of long lease (such as the nine-year terms common in Australia) that was the norm before the pandemic.

That resistance is fortified by the knowledge that gateway markets today have many big tenants holding large amounts of long-leasehold space they are trying (usually unsuccessfully) to sublet. In such an uncertain environment, risk aversion has contributed to the current stagnancy of occupier markets. As one broker commented about Hong Kong: "Not many occupiers are willing to sign a six-year lease in the CBD, spending $10 million on the fitout, for fear they may not need the office next month, because what if there's a lockdown and everyone's at home? So, most occupiers in Hong Kong have renewed or reduced their existing space; hardly any have taken up new space."

The trend today, therefore, is towards greater contractual flexibility. In practice, this involves an option to decrease or increase space leased by a company on, say, six-months' or one-year's notice. Such flex leasing is growing fast, and as landlords see the tide turning, they have begun to evolve their product offerings, either by deploying prebuilt spaces fitted out for one- to three-year periods or by creating purpose-built spaces they either lease out themselves or via a contract with an operator. At the same time, according to a Singapore-based analyst tracking the flex space: "Allocation of office portfolios from the occupier's side has gone up, probably from 0 percent a few years ago to 5 to 10 percent at the very least—and that was pre-pandemic."

While the upfront operating costs of flex leasing may be higher, optionality brings with it a number of advantages apart from just bypassing risk. For one, companies are able to move faster by using flex-space operators to roll out multiple offices in numerous locations. Fitout costs are effectively eliminated, and flex leases are also more digestible to corporate managers in control of finances. According to the Singapore analyst: "In times like now, when trying to get signoff from CFOs for high capex of millions of dollars on an office that you may not need, it's much easier to do it with a slightly higher opex [operating expenditure] which you can pull the brakes on six months out if you need to."

Logistics

The surging popularity of logistics as an asset class has been caused by a confluence of factors: structural undersupply of high-quality assets, the evolution of more sophisticated supply chains, and the rapid growth in e-commerce retailing that has been recently catalysed by pandemic lockdowns. At the same time, warehouses also tick another box increasingly sought by investors as tenant churn hikes vacancy rates in other asset classes—long-weighted average lease expiries (WALES) that ensure low vacancy rates.

Transaction volumes have boomed this year, with sales of industrial and logistics properties in the first three quarters of 2021 rising 43 percent year-on-year to US$34.8 billion, according to RCA—more than double the level of pre-pandemic years. Regional yields continue to compress, with the spread to office reaching 40 bps in the second quarter, according to JLL, down from 80 bps in the third quarter of 2020 and 120 bps in 2018. In Australia and Seoul, spreads have already reached parity at around 4 percent or even less for the most sought-after assets.

Given ongoing cap rate compression, investors question (as they have for years) whether yields can shrink further. According to a Hong Kong–based fund manager, referring specifically to China: "I get a bit scared when I see US$12 billion being raised for sheds in China when rents haven't moved for a number of years other than in very tight locations around Shanghai. So in China, I'm a bit concerned about logistics as an overall concept. There will be obviously areas where there's a supply shortage and you'll be able to make money, but it's not across the board."

Exhibit 3-8 **Asia Pacific Logistics Yields and Rental Growth, 4Q 2020**

Source: Colliers International, Bloomberg, other.

Demand Still Growing

At the same time, other indicators suggest the sector has yet to peak. First, cap rates in Europe (at around 4 percent in the United Kingdom and 3.5 percent in Germany) are lower than in all but the tightest Asia Pacific markets, implying further scope to compress.

Second, existing warehouse stock in many markets—in particular Japan and Hong Kong—is dated. And as consumer preferences in terms of type of product and speed of delivery evolve rapidly, the rate of obsolescence is only accelerating, thereby generating more demand for new facilities.

Beyond that, demand for last-mile delivery is booming. Although both local zoning rules and residents' objections have sometimes slowed plans to convert space in underused city-centre retail centres into logistics facilities, this is another area set for widespread and long-term growth.

Finally, the productivity benefits from new types of warehousing technology are again acting as a catalyst for the obsolescence of aging infrastructure. Automation and robotics tech is part of that, but the focus is moving increasingly to artificial intelligence (AI) and data analytics. According to a consultant specialising in logistics technology, warehouse operators are rapidly leveraging these themes to maximise operational efficiency via real-time monitoring of warehouse inventory movements.

"You have the picking, the packing, the loading, etc., and you have people and robots moving around, too," he said. "But if you can use analytics to enhance and optimise different parts of that—even the route journeys as to what to pick and pack first—data will help inform how these optimisations can be made. And as you aggregate the numbers of minutes saved across multiple warehouse and regions, you start to come up with savings that can be valued in the tens of millions or more."

For all these reasons, there is still no shortage of demand for new product. In Australia, for example, more than 50 percent of assets scheduled for completion in 2021 were precommitted.

Achieving Scale

Seemingly endless appetite for logistics facilities is having knock-on consequences. For one, competition for assets is such that investors are increasingly straying from gateway markets to deploy capital wherever they can. This often works better in the logistics sector than it does for other asset classes, because, as one fund manager put it, "It's always down to the micro, the specific opportunity."

In addition, as a way for the biggest players to quickly achieve scale (and thereby serve the interests of their large customers), there is increasing focus on platform mergers, portfolio acquisitions, and individual asset purchases rather than simply developing new stock.

Achieving their targeted size is otherwise impossible, said one Shanghai-based investor, so instead "they are diversifying their business model. When they have a completed project, they want to list it [in a REIT] or put it in a core fund and manage it. But then they also have the ability to acquire stabilised projects that other people have built or are building, instead of always developing, which is very hard to do."

Another factor contributing to supply shortages and increased competition is the fact that Asia Pacific markets are dominated by very large developers/operators. According to a Singapore-based executive at one such operator: "A lot of people in the Asia Pacific—just like us—are feeding themselves, so you don't have, as in Europe, the small merchant developers selling a few buildings a year. That means there is less product, percentage-wise, available in the Asian context than in Europe, because we just put it from a development structure into a REIT structure."

Data Centres

Data centres continue to be a popular subsector of the logistics market due to huge bandwidth demand growth in the region, with internet exchange traffic in the Asia Pacific up 40 percent in the first three quarters of 2021 alone, according to data-centre developer Equinix. This is again caused partly by pandemic-related issues such as work-from-home video conferencing and e-commerce shopping. But demand is also boosted by bandwidth requirements for 5G data services, the growing popularity of cloud-based services, and the impact of rapidly evolving data localisation laws.

Data-centre investment in the Asia Pacific reached US$1.8 billion in the first half of 2021, according to CBRE, or about 80 percent of 2020 turnover, most of which was directed to projects in China. Investors tend to develop rather than buy, given the general shortage of stabilised facilities available for purchase.

Competition to place capital in such projects has become intense. According to one experienced data-centre investor, "I suspect in our next fund cycle we will deemphasise [data centres], not just because our programmes will be in place and we'll be working on those, but because a lot of capital is coming in and doing some stupid things, and that will [have to] run its course."

The main reason for the current popularity of data centres among investors is that rents tend to be significantly higher than for vanilla-type real estate investments occupying the same footprint. Stabilised yields are therefore generally much better than yields on cost.

A growing niche within the data-centre space is demand for smaller facilities (a "last-mile" approach, as one investor described it) that cater to discrete areas within a given urban area. According to one investor in Japan: "I think a time is coming when individual floors of office buildings will become data centres—there's a need for [facilities] that don't have huge capacity and just focus on the core area [of a city]."

Investment funds are no longer deterred by the operational intensity of data-centre projects, and many of the larger funds will retain internal specialists (or possibly create an operating team outside the fund) to manage their centres.

At the same time, the reality is that these specialist undertakings are not for the faint of heart. Given the narrow base of potential tenants, data-centre lease-up periods can be multiyear exercises. In addition, regulatory and operational risks are not insignificant. Large projects usually require a partnership with a local telecoms or co-location operator, not simply to operate the facility and ensure that space will be leased, but also because local regulations may require it, and access to the huge amounts of power consumed in such facilities may not be available without it.

Finally, and much more so than price, reliability of power supply can be problematic in Asia Pacific markets, given its critical importance operationally and a general shortage of power utilities that can provide it. This is one reason Japan has become a focal point for data-centre construction despite its high costs.

Key Logistics Markets

- Australia and China were the most active markets in the third quarter of 2021, with significant asset sales by foreign investors.
- Across the Asia Pacific, Australia has the best logistics networks in terms of grade-A per capita space, according to Colliers, and together with East China has the largest base of modern logistics stock in the region.
- Japan is not only short of space in per capita terms, but with just 10 percent of its stock meeting modern standards, most facilities are out of date. At the same time, however, rents and capital values are among the highest in the region. Investors are targeting value-add strategies for older warehouses, looking to demolish and rebuild, often with huge (e.g., 400,000-square-metre) multifloor facilities. Given rising tenant demand and the huge size and cost of such projects, Japan is an ideal market for institutional investors with deep pockets and a long-term perspective. Projects are always tightly bid, despite apparently low yields of 4 percent or less.
- Seoul continues to suffer from supply shortages and has been a magnet for logistics investment (much of it foreign-invested) for several years. Growth is rapid—if all facilities currently planned or underway are completed, the city will see a 26 percent increase in stock from today's levels, reaching 8.6 million square metres of space.
- India has the lowest warehouse rents in the Asia Pacific at under US$3 per square metre per month. Given the acute shortage of modern facilities, the potential is both vast and long lasting, as e-commerce penetration rates (currently at just 5 percent) continue to grow. The big international operators are actively building large, state-of-the-art automated facilities.

Retail

The explosive growth of e-commerce retailing in the wake of widespread pandemic lockdowns has created a pervasive sense of negativity towards conventional retail assets across the region. Footfall was in decline even before COVID-19 arrived, but the ensuing plunge in consumer sales—and, in its wake, retail asset values—convinced many investors that the event marked yet another secular shift, and that the days of shop-based retail were numbered. As a result, with many investors seeking to divest their retail holdings, yield spreads over the cost of debt for regional retail properties has moved out by some 50 bps over equivalent spreads for office assets, according to JLL.

At the right price, however, any asset becomes attractive, and the sector seems to have hit that point around the middle of 2021, with third-quarter retail transaction volumes spiking 36 percent year-on-year to US$7.2 billion, according to RCA, roughly on a par with levels from 2015–2019.

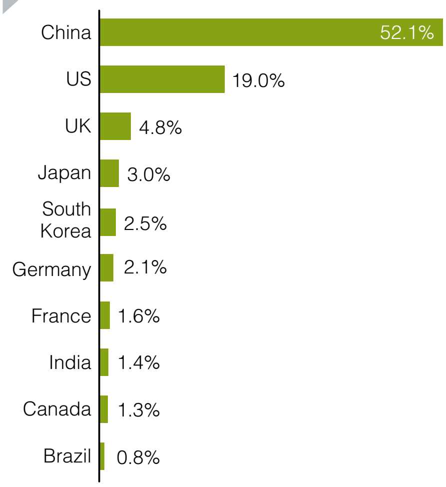
To some extent, this reflects sales of facilities in subsectors that have thrived specifically because of the pandemic. Nondiscretionary retail, convenience stores, and suburban retailers serving areas with large residential catchments—and therefore a captive work-from-home audience—have seen cap rates compress, therefore, as investors pursue revenue growth.

But there is no doubt that the rebound is mostly due to sales of now-cheaper conventional assets. Some markets have been hit harder than others. Hong Kong, for instance, where sky-high rents had been backstopped by a stream of tourists arriving from Mainland China, has seen a massive decline in revenue due to border closures. Overall rents were down 30 to 50 percent in mid-2021, according to Savills, with those in popular shopping areas down even further, to levels last seen in 2003, when the retail sector relied mostly on spending by local consumers.

Australian retailers have also suffered. Its multilevel CBD shopping centres, which had been downtrending for years even before pandemic lockdowns, are one example. Indeed, multilevel shopping centres have been in the eye of the storm across the region, especially on their upper floors, where rents remain too high to justify depleted footfall. Some core CBD retail assets are now changing hands, including one high-profile shopping centre in Sydney that was sold in early November 2021.

At the other end of the scale, consumers in China turned *en masse* to online retailing years ago, forcing physical retailers to adapt to survive. Today, although oversupply remains a problem, the sector has become a bifurcated and increasingly specialist market that now features some of the most sophisticated shopping facilities in the world.

Exhibit 3-9 **Top 10 Countries in Retail E-commerce Sales Share, 2021**



Source: eMarketer.

According to one Shanghai-based investor: "Retail these days has become more concentrated, with just a few good operators. And, especially with new supply coming in all locations, you have to have the expertise, operational know-how, and connections with tenants to make it work. In future, I think the expertise will be concentrated in a handful of good operators, and the others will just die—they'll maybe do conversions, or just lower the rent and accept lower returns."

This comment points to a likely path for the retail sector in other markets, too, and helps explain why, as values and cap rates move out to a point where repurposing becomes realistic economically, a significant minority of investors see the current downward trend as a rare opportunity to buy and reposition underperforming but well-located facilities. Value-add players with the right expertise are therefore jumping on downtrodden retail assets with an eye to reinventing them. Often, too, they are doing so with conviction, as evidenced by the US$1.4 billion purchase by a large North American asset manager of a portfolio of malls in five Chinese cities in mid-2021.

In Hong Kong, according to one former developer, "My sense is that we're going to revert to a ground-floor model because of accessibility and visibility and all the rest. What happens on the first and second floors will be studios, workspaces, salons, clinics, schools, and so. I think we're going to see virtually everything and anything allowed at first- and second-floor level, where a master landlord may take the whole floor and manage the 20 or 30 actors involved in creating experiences there."

In Australia, which even pre-pandemic suffered from an oversupply of out-of-town malls, investors are creating mixed-use communities, building residential towers in formerly sprawling car parks, and transforming the interiors to a wide variety of new uses, often with a community focus.

Follow the Data

Technology, and in particular big data, have become important components of retailing strategies globally. Adoption across Asia Pacific markets varies, however, as does landlords' grasp of functionality.

According to one consultant: "If the tenants succeed, then the real estate company succeeds. So in some ways landlords should subsidise investment needed to create this growth, even if it's as simple as store entrance traffic-counting cameras to help brands measure sales conversion rates—because you can't improve something you don't measure."

In particular, data tracking of consumer spending patterns has become increasingly sophisticated. While the use of anonymised credit card data to analyse spending patterns by location or demographic is not allowed in most Asia Pacific markets (apart from Australia), anonymised mobile phone data has become a commonly used method to track consumer demographics, movements, and visiting times in malls, allowing retailers to compile demographic profiles of their customers in order to target sales discounts at individual types of shoppers.

China's recent regulatory initiatives targeting data privacy (relating especially to technology companies) aim to regulate tracking of individually identifiable consumers, a practice previously widespread in China that was used by brands to create hyper-targeted marketing campaigns. On its face, China's new Personal Information Protection Law (effective in November 2021) specifically states that it has no application to anonymised data, meaning that retailers can continue to use it. However, the ultimate outcome and direction of the government's privacy protection initiative are hard to predict.

Evolving Operating Models

Although online shopping and offline shopping were once seen as very different domains, recognition is growing that they are really two sides of the same coin. Offline retailers are therefore moving to embrace omnichannel strategies more effectively. In China, many shopping centres have already completed this transition, and operate effectively and profitably. Developers elsewhere (Singapore, in particular) have begun experimenting with concept-driven facilities that look to tap the youthful zeitgeist of the modern consumer.

In addition, landlords and retailers are more likely today to work in collaborative ways, opening up opportunities for new business models. According to a prominent retail developer in China, "Do landlords think of themselves as partners of tenants? We certainly do, and that's why we collaborate—so we can mutually serve our customers. I know many other landlords who don't see it that way, whether they admit it or not."

The idea is that each party should be paid according to what they contribute to the partnership. "If you're contributing a square meter of property," said the developer, "you should be paid accordingly; if you're contributing to bringing customers to our tenants, you should also be paid accordingly; and if you're contributing towards sales, you should have a slice of the sales."

One of the consequences of the increasing operational integration of landlords and retailers, who thereby share to a greater degree both the risks and rewards of the retailer's business, is a migration towards a turnover rent model, usually in combination with a minimum base rent. These are already becoming more common in certain retail subsectors, and interviewees in Australia reported that online turnover clauses were also finding their way into retail lease structures.

However, turnover rents become complicated in an omnichannel environment due to difficulties in determining the extent to which an online sale is attributable to an offline store. Sales involving food and beverage or leisure may be easier to assess on a turnover basis, but otherwise—and particularly when it comes to "click and collect" sales—no perfected model exists for evaluating the value provided by any given store in any given location in the context of online transactions.

Residential

Rising inflation is usually bullish for home values, so it comes as little surprise that strong recent increases in consumer prices (and, more so, for base metals and other input costs) have acted as a catalyst for housing prices in many Asia Pacific markets, adding to the appeal of an asset class already favoured by investors as a defensive play.

The extent of some of the increases has raised eyebrows, though. In Australia, residential prices 21.6 in the year to October according to analysts CoreLogic, while condo values in central Tokyo increased 11.4 percent year-on-year as of July, according to the Real Estate Economic Institute.

In India, meanwhile, prices are also on the move, despite a sustained upheaval of the industry that has resulted in many developer bankruptcies. According to one Delhi-based consultant: "Across the board, residential prices have gone up at least 8 to 10 percent throughout the country, regardless if the market has performed or not, driven by developers [trying] to keep pace with increased costs and inputs."

With deal volume of US$8.5 billion in 2020, according to RCA, Japan is the only mature multifamily market in the region. But at a little over 20 percent of overall real estate investment volume, the sector is still small compared with that in the United States (at 36 percent). Still, regional appetite for build-to-rent housing has grown appreciably in 2021, continuing the momentum noted in last year's report.

The perennial problem for regional multifamily markets has been that the Asia Pacific's high home prices make cap rates too low to attract private-equity investors.

Recently, however, the landscape in some markets has begun to shift in ways that have made the build-to-rent thesis more appetizing to institutional funds. In particular, while returns may still be thin, they remain significantly higher than yields for most sovereign bonds. In addition, they offer a measure of cash flow stability that approximates that of a corporate bond, making them especially appealing to managers with long investment horizons.

In Japan, cap rates as low as 3 percent have therefore proved acceptable to institutional buyers, especially when paired with Japan's ultra-low-cost borrowing (i.e., 1 percent or under), levered at 60 percent–plus. Investors also expect to eke out incremental gains in other ways—be it yield compression, rental increases, value-add of various kinds, or even conversion to co-living facilities.

With competition tight and product hard to source, investors have turned to forward purchases as a way to quickly build platforms, increase returns, and address supply shortages. In the process, they are often assuming lease-up risk as a means to boost income.

While this has become a favoured play for foreign funds in Japan, however, the risk/return prospects have been questioned. According to one Tokyo-based fund manager, aggressive underwriting of both pricing and rents leave little margin for error. "One of the big issues for residential is [high] tenant turnover," he said. "We're hearing they're having trouble finding tenants—downtime can be well over a year, and then you have your cost to get tenants in. So if you're buying these forward commitments, and you underwrote this stuff a year and a half ago at, say, 3 to 3.5 [percent cap rate], and your rents are now down 20 percent and you're also having trouble leasing it up, you could easily be in the 2.0, 2.5 percent range very fast, and if you're borrowing at 70 percent [LTV] you'd be in negative net cash flow territory relatively quickly."

One reason for rising leasing risk is that tenant preferences are evolving. With people now more likely to spend time at home, build quality is increasingly important, as is apartment size, with many tenants looking for a bigger footprint or an extra room to use as a home office.

This is probably the main reason behind the reversal last year of the long-established trend of positive net migration into Tokyo—a decades-long process of urbanisation that saw more people moving to the city than leaving it. Lifestyle changes brought about by COVID are now causing an exodus to cheaper suburban areas in neighbouring prefectures such as Kanagawa and Chiba. For the same reason, secondary cities such as Nagoya and Fukuoka are also gaining popularity.

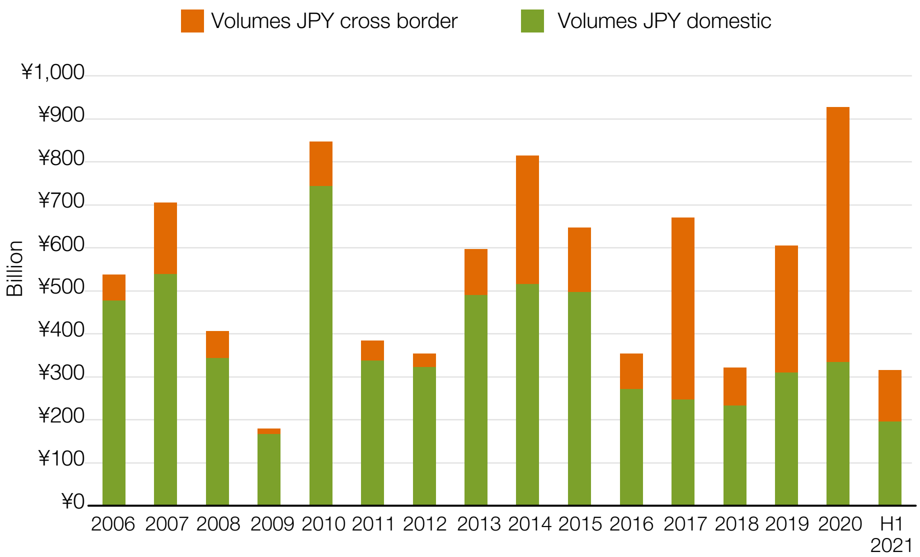
As one local investor observed: "Every quarter, more people are now moving out [of Tokyo], and that to me is a very concerning demographic trend, much more so than ageing populations. People are figuring they don't need to live in Central Tokyo—they can be outside in other suburban areas, live in a larger place, and pay less rent."

For now, the extent of this U-turn in net migration is relatively small, but if it begins to affect the wider supply/demand dynamic for housing, there could be wider repercussions for the profitability of the multifamily sector, which mostly involves properties in central Tokyo. As a side effect, investors are also becoming increasingly willing to consider locations further away from Tokyo's central wards in their search for investable residential projects.

In China, the build-to-rent sector has the tailwind of government support—a significant benefit given the currently fast-changing policy environment. Certainly, an institutional build-to-rent market could never exist in the Mainland in the absence of such support, given high prices, low rents, and an historical (and, for developers, very profitable) preference for private sales.

In recent years, the government became convinced of the need for an institutionalised rental housing market as a means to address widening wealth disparities that are hindering the free flow of labour migrating to the larger cities. Other reasons why China has growing demand for an institutionalised rental housing market include the following:

Exhibit 3-10 **Japan Apartment Investment Volumes, 1H 2021**



Source: Real Capital Analytics.

- A population that is increasingly mobile and more likely to change jobs. Young people are therefore less inclined to buy property.
- At the same time, China's younger demographic is used to a higher standard of living and is more willing and able to pay higher rents than their parents.

As usual in China, little time has been wasted moving from concept to reality. To incentivise developers and make up for the shortfall in yields, authorities offer land at deeply discounted prices (anecdotally, one-third the price of for-sale residential land) and also work behind the scenes to create unofficial quid pro quos for developers. Various business models have sprung up and industry consolidation is ongoing as failed initiatives are weeded out.

The scale of the initiative is massive. In Beijing, according to one locally based interviewee, planning regulations require 33 percent of new supply to be in the form of rental housing; in Shenzhen, the figure is 50 percent. Conversion of older properties for residential rental purposes has been prioritised, and a new planning code introduced in Shanghai (and, soon, Beijing) creates a dedicated zoning regime solely for rental residential properties.

In its 14th Five-Year Plan, issued in 2021, the government set a mandate for 10 percent of new residential land supply nationwide to be reserved for construction of rental homes.

While the vast majority of supply for this new housing class will be met by domestic developers, foreign investors have also been active. Even with land pricing discounts, however, yields are low for a market with China's risk profile. One consultant suggested that potential cap rates for Chinese multifamily assets might be around 3.5 percent, or roughly on a par with Japan. At the same time, however, cost of capital is significantly higher in China, and the government's recent announcement that urban rent increases would be capped at 5 percent annually has torpedoed expectations for rental growth.

As a result, development seems a more likely pathway for foreign investors, with an internal rate of return (IRR) of 8 to 10 percent and a potential exit via China's newly formed REIT industry, which may soon be expanded to allow rental housing REITs. Even at these levels, however, foreign investors may find better opportunities in the co-living sector, which is less focused on the mass market and plays to their strength of operational expertise.

In Australia, meanwhile, the multifamily sector remains in its infancy, but it is drawing increasing attention due to rapidly rising home prices and an expanding demographic of young renters. Currently, billions of dollars in investment capital—mostly foreign sourced—is targeting Australian build-to-rent projects, with JLL projecting it could become the third-biggest asset class in the country within three years.

Again, however, low yields are a problem. One interviewee mentioned "unheard of" cap rates of 2.0 to 2.5 percent, while an unfavourable tax regime further undermines potential profitability.

Upcoming policy changes may help address the tax leakage issue, but structural problems remain. First, according to one analyst, cost of capital is high given that local banks will usually not lend to build-to-rent projects, leaving investors to seek funding via nonbank or offshore lenders.

In addition, according to a locally based residential developer, demand is questionable. "Demand is not from users, it's from capital," he said. "If you look at the build-to-rent that's been delivered today—and there hasn't been much—buildings completed for nearly a year are only 60 to 65 percent occupied. But if I built 200 apartments in an inner-city [area] and sold them to a combination of investors and owner occupiers, 95 percent of them will have an occupant in there within two weeks of completion, maybe a month."

One problem for the institutional market in Australia is that there are so many privately owned properties available for rent whose owners are flexible to changing market conditions, unlike build-to-rent operators who are reluctant to reduce rents significantly because it requires a reset to valuations.

Another problem is that the younger demographic in Australia is not keen on changing location. According to the developer: "I think the mobility of the workforce in Australia is one of the biggest headwinds for the build-to-rent market. If you have a 35-year-old living in Sydney as a middle manager, and you say, 'OK, I have a promotion opportunity, but you have to go to Melbourne and you'll get an extra 20 percent uplift in your wages,' they won't go, because they have a whole social scene around and they won't move. In America, they're off like a shot."

Beyond that, the economics of multifamily investing in Australia just don't stack up. "The capital that's been chasing it is not Australian capital—it can't, because on a weighted-average cost basis it's already too expensive to play. So all the players [in Australia] are bringing foreign capital to invest and just facilitating it, getting development fees and what have you. The other thing is that [domestic capital] cannot compete buying a block of land like-for-like, because if I'm competing to buy 200 apartments build-to-sell and you're competing to buy the same site build-to-rent, then I can outbid you."

In the absence of government concessions, therefore, the developer considered the market unworkable for multifamily investment unless individual investors run out of powder and the number of private properties available for rent on the market begins to fall.

Hotels

Travel bans continue to hit the hotel sector hard across the Asia Pacific. Although Singapore's new Vaccinated Travel Lane scheme offers access to passengers travelling from some countries, most jurisdictions allow little to no unquarantined international travel for nonresidents/noncitizens, with some also enforcing domestic travel restrictions. While many regional governments are making preparations to reopen borders, at least partially, any significant uptick in international passenger movements still seems remote.

The shortfall in tourist and business travel revenues caused by these restrictions has been disastrous for many hotels. As revenues dry up, the pain has become intense for an industry that, in the words of one investor, "is already capex hungry, so you constantly need to reinvest in the building—it's not something you can shut the doors and forget about, you still have costs you're going to incur."

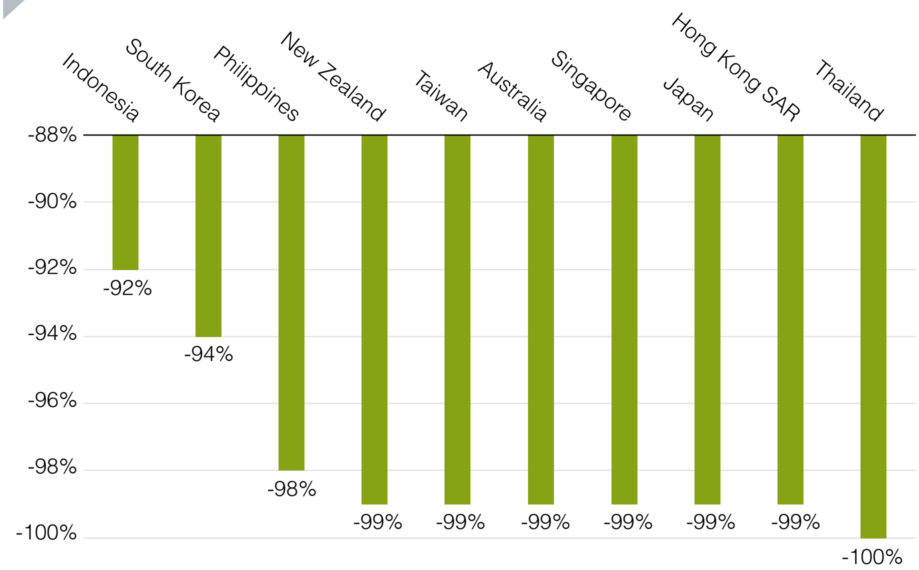
In addition, while many larger hotel chains are owned by deep-pocketed institutions that are better placed to wait out the storm, smaller assets or chains—especially in the resort/tourist subsectors—are often owned by private interests that lack financial staying power.

As a result, interviewees in last year's report had expected the hospitality sector to become a prime candidate for distress sales. In practice, however, and apart from a smattering of forced sales regionally, the distress story in hospitality has yet to materialise. Asia Pacific hotel transactions in the third quarter of 2021 were down 19 percent at US$2 billion, according to RCA, the lowest third-quarter figure in the last decade.

This counterintuitive lack of forced selling is down to several factors. First and foremost, as outlined in chapter 1, banks across the region have shown little inclination to trigger defaults.

At the same time, the weight of capital looking to secure assets that would normally not be for sale in the first place creates competition that has lifted pricing to levels that no longer qualify as distressed. In Australia, for example,

Exhibit 3-11 **Change in International Visitor Arrivals by Region as of August 2021 Compared with 2019**



Source: UNWTO.

which is so far the lone Asia Pacific market to have seen significant hotel transactions, selling prices have been at or above pre-COVID levels.

In Southeast Asia, meanwhile, where assets tend to be owned by high-net-worth families, buyers have underestimated the tenacity of current owners. Transactions in the first half of mid-2021 amounted to about just 1,500 rooms, according to one interviewee, an insignificant number.

As one Australia-based hotel investor said: "We've seen this in previous severe cycles, too, such as the Asian financial crisis or SARS, when everyone thought there was going to be a wave of distress sales. But there's often a lot of faith involved with owning hotels, and they'll cling to them at all costs."

Filling Rooms

In addition, many hotel operators have found a number of ways to fill rooms even in the absence of international travel. First, there has been a pivot to domestic markets, tapping local demand from captive domestic audiences. As one interviewee in Manila observed: "We just went out of town after a long time here, and I was quite surprised that this private resort in Patang was actually at their highest occupancy since the start of this year. So there are some hospitality resorts right now that are performing very well."

Second, at least in international gateway cities, hotels have been able to corner the lucrative market for quarantined travellers. According to a Hong Kong–based private-equity investor: "We're looking to buy a hotel in Sydney that's operating at a much higher margin than it ever has historically because it's currently a COVID hotel, so they're not changing bed sheets or running the spa, all that lower-margin stuff—they're just selling rooms, and the rooms are all full."

A final strategy is simply to lower rates to rock-bottom levels and market rooms as serviced apartments. According to another fund manager in Hong Kong: "If you look at average daily rates for two- or three-star hotels [in Hong Kong], that would be maybe HK$1,000. Those have now plunged to HK$200 or HK$300, which translates to about HK$6,000 to $9,000 [i.e., about US$760 to US$1,160] per month. You don't get much in the private rented residential space for that, so people are renting a nice hotel room for six months and treating themselves. And that's keeping the lights on."

Whether this is enough to keep the wolves from the door, though, remains to be seen. Many investors continue to believe that—once again—secular forces have permanently changed the dynamics of the sector.

According to one: "Bizarrely, the market is on fire. Hotels are trading at pre-COVID levels, with no account of this black hole in revenues and negative NOI. And I don't understand that—what's happening is that yields are actually tightening on hotels relative to real NOI. At the same time, demand levels aren't coming back for quite some time. The MICE [meetings, incentives, conferences, and exhibitions] market isn't coming back soon. And if you have a city-centre business hotel and are looking at local demand, your max occupancy rate is going to be 50 percent, because you've lost half your market."

Bank Forbearance Ending

Otherwise, there are signs that bank patience is wearing thin. According to one regional hotel executive: "Bank forbearance has been a big factor in why we haven't seen many transactions, but now they're running out of patience. Governments have been backstopping banks, but at some point there needs to be a break in the logjam."

Well-capitalised owners will not be affected, but smaller groups, or companies for whom hotels are noncore assets and who may need to raise cash to support core businesses, are likely to be a source of future deals.

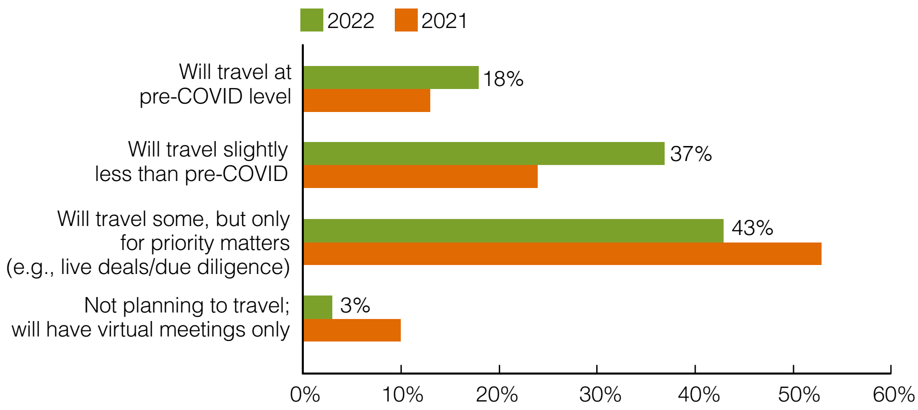
"We believe that early next year the vortex will come together," said the executive. "Lenders and governments will realise that paralysis is not a sustainable economic model. They have to do something, and kicking the can down the road is not an answer, because even when travel restarts, it won't be like flicking a switch—it will take years to recover, years to retrain, and years to pay down the mountain of debt."

One suggested model is a sale-with-buyback option, given that many private-equity players may be interested in cutting deals, but not necessarily in holding assets long-term. And because the resort subsector is likely to be the first to rebound given that urban hotels will be a harder sell for business travel, resort owners may feel that they have more bargaining power to negotiate with private-equity investors to either partner or sell.

The discussions, according to the executive, will revolve around how assets should be valued. "In Asia," he said, "owners often look at land valuations as the main source of [asset] value. But private-equity buyers couldn't care less about that. They're looking purely at buying at a cap rate multiple and then getting out at a different cap rate."

Beyond that, many private-equity investors looking for distress deals have little room for flexibility. According to a regional hotel consultant: "Working on transactions over the past 18 months, what we've seen is that it's difficult for private equity to underwrite deals because their expectation in a crisis is to get 20 to 25 percent IRRs. And there are two moving parts to get that: either the property has to be priced extremely low, or they have to be able to put debt on it, and there's not a wide availability of new debt for these types of transactions. So people that can't put debt on can't get the IRR thresholds. And the owner just says: 'I might give a 20 percent discount but not 50 percent.' So private equity is not getting deals done."

Exhibit 3-12 **What Are Your Business Travel Plans Once Regional Travel Restrictions Are Lifted?**



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

Japan Targeted

In the meantime, growing numbers of investors with less ambitious return expectations are looking to tap domestic travel trends—"revenge travel," as one interviewee put it—in the big three Asia Pacific economies: China, Japan, and Australia. With prices in Australia deemed too high (partly due to high levels of institutional ownership) and the Chinese market already fully supplied, the focus has fallen on Japan, with investors looking to invest at a discount of some kind and then ride the post-recovery wave.

According to a fund manager in Singapore: "Pre-COVID, the Japanese were seeing a very steep curve in visitor arrivals, and what with its infrastructure and other general offerings, we were very bullish long-term on Japan hospitality. It also has the benefit of a big domestic population, so that gives it some level of cushion, but it is missing out on that inbound market. We're launching a new Japan hotel fund, probably a club, that will be targeting hotels in Japan looking for more of that value-add type proposition where owners are maybe a little deprived of capital."

Japan is also interesting for investors who want to arbitrage an imbalance of stock serving different subsectors. According to one local investor, "Performance has been dramatically different between luxury hotels and budget hotels. There's been an alarming increase in [the number of] budget hotels, which will make it nearly impossible for their revenue structures to recover. But we believe this presents a business opportunity in 2022 and later for repositioning assets, for example, as for-sale condominiums. We still expect very favourable financing situations to continue, but we have to analyse assets individually [to assess their merits]."

Interviewees

Actis
Brian Chinappi

Allianz Real Estate
Rushabh Desai

Angelo, Gordon Asia
Zoe Zuo

Aqualand
John Carfi

AR Capital Advisors
Steven Bass

ARCH Capital
Eric Manuel

ArthaLand Corporation
Sheryll Veranno

Asia United Bank
Leonides Intalan

AXA IM Real Assets
Laurent Jacquemin

BentallGreenOak
Dan Klebes

BlackRock
Chris Handte

Blackstone
Nina James
Frank Zhao

Brookfield Asset Management
Stuart Mercier

Capbridge Investors
Ken Fridley

CBRE
Henry Chin
Sid Dhawan
Takashi Tsuji

Centurion Corporation Limited
Kong Chee Min

China Merchants Capital
Vincent Yu

China Oversea Estate
Linlin Wang

Cistri
Peter Holland

Colliers International
Richard Raymundo

CRE REIT Advisers
Tsuyoshi Ito

CSI
Andrew Taylor

Cushman & Wakefield
Claro Cordero Jr.

Daiichi Properties
Charmaine Uy

Daiwa House Industry
Tetsuo Suzuki

Diamond Realty Management Inc.
Ryuta Takeuchi

ESCON Japan
Takatoshi Ito

ESR
Michael De-Jong Douglas

FIT Investment Corporation
Richard Zen

Frabelle Group of Companies
Francesca Tiu-Laurel

GenReal Property Advisers
Anckur Srivasttava

Great Wall Pan Asia Holdings Limited
Serena Zheng

Wellworth Properties
Harly Geraldine Pow

Hines
Jon Tanaka

Hon Kwok Land Investment
James Wong

Huahua
Ken Zheng

Hulic
Yoshito Nishikawa

IDERA Capital Management Ltd.
Harumi Kadono

Invesco Global Real Estate Asia Pacific Inc.
Ryukichi Nakata

Japan Post Bank
Toshiyuki Tanaka

JLL
Janlo de los Reyes
Matt Duncan

KaiLong Group
Ivan Ho

KENEDIX
Keisuke Sato
Takahiro Uchida

KENEDIX Real Estate Fund Management Inc.
Masahiko Tajima

Keppel Land
Kevin Zhou

KKR
Bryan Southergill

Lamudi Philippines
Kenneth Stern

LaSalle Investment Management
Selena Shi

Leechiu Property Consultants
Tam Angel

Lendlease
Andrew Gauci

Link REIT
Chris Brooke

Lobien Realty Group
Sheila Lobien

LOGOS
Mehul Shah

Manulife
Kenny Lam

Menarco Development Corporation
Maria Cristina Samson

Mitsubishi Corp.–UBS Realty Inc.
Katsuji Okamoto

Mitsubishi Jisho Investment Advisors
Toshiyuki Arai
Eriko Kato
Koichi Ueno

Mitsubishi UFJ Trust and Banking Corporation
Hiroyuki Seki

Mitsui Fudosan Investment Advisors
Shuji Tomikawa

Morgan Stanley
Susan Sun

Mori Building
Hiroo Mori

Nomura Real Estate Solutions
Eiji Enomoto

Nuveen
Louise Kavanaugh
Jing Zhou

Ooedo Onsen Reit Investment Corporation
Fuminori Imanishi

Orca Capital
Ariel Shtarkman

Pacifica Capital
Seth Sulkin

PAG Investment Management
Naoya Nakata

PDB Properties Inc.
Steven Tambunting

PGIM
Morgan Laughlin
Benett Theseira

Philippine Constructors Association
Wilfredo Decena

Phoenix Investors
Wilfred Ma

Powerlong Real Estate Holdings Ltd.
Peggy Jin

PRIME Philippines
Jettson Yu

Professional Property Services
Nicholas Brooke

Pronove Tai & Associates
Monique Pronove

Quisumbing Torres
Alain Charles Veloso

Rafi Properties
Baillie Yip

Savills China
James Macdonald

Savills Malaysia
Dougie Chrichton

SC Capital Partners Group
Andrew Heithersay
Michael Lane

Schroder Pamfleet
Andrew Moore

Shenzhen City Investment
Zhiping Li

Shui On Land
David Wong

Starr International Investment Advisors
Alison Cooke

TopChain Group
XueJia Liu

Unionbank
Henry Aguda

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Lingxiao Peng

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