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Asia Pacific

EMERGING TRENDS IN REAL ESTATE®




Emerging Trends in Real Estate® Asia Pacific 2021

A publication from:



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Executive Summary

Throughout 2020, the success of government efforts across the Asia Pacific to contain the spread of COVID-19 has helped limit its impact on local real estate markets. At the same time, however, there is a sense that asset values have been propped up by a combination of transient factors—government support programmes, bank forbearance policies, healthy corporate balance sheets—that are unlikely to last. As the tank runs dry, there is growing conviction among investors that a market correction is inevitable.

While the downside for regional markets is not expected to be as severe as in the West, investors are anticipating asset prices to fall as we move into 2021. Three markets were identified as offering potential sources of stress:

China—where a government-led liquidity squeeze is depriving smaller developers of bank financing.

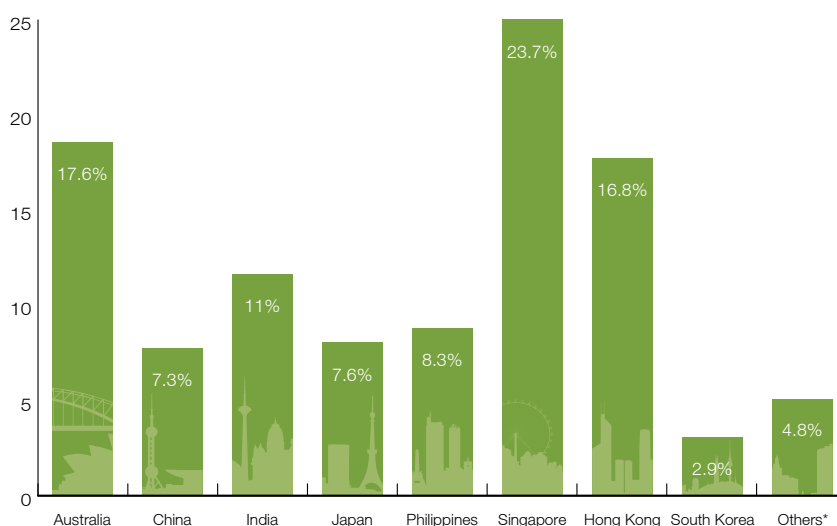
India—where the implosion of local nonbank finance companies again presents opportunities for private-equity funds.

Australia—where the economic impact has been more acute than in other regional economies, and where greater market transparency is likely to offer more buying prospects in the short term.

As recession bites, other opportunities are emerging. In particular, Asian companies that have long held significant amounts of corporate assets in the form of real estate are now looking to tap those holdings to obtain working capital. By divesting them in the form of sale-and-leaseback transactions, the assets can still be used as needed (often as corporate headquarters) while allowing companies to transition to asset-light business models that offer more efficient uses of corporate capital.

Another way in which investors are moving with the times is by rotating capital away from mainstream asset classes that now face cyclical or secular headwinds (such as office, retail, and hotels) and into those that provide reliable income streams in a down-trending market (such as logistics, multifamily residential, and data centres). Logistics, in particular, has become an overwhelming investor favourite given its

Survey Responses by Country/Territory



Source: *Emerging Trends in Real Estate Asia Pacific 2021* survey.

*Includes Germany, Indonesia, Mali, Malaysia, South Korea, Taiwan, Thailand, the United Kingdom, the United Arab Emirates, the United States, and Vietnam.

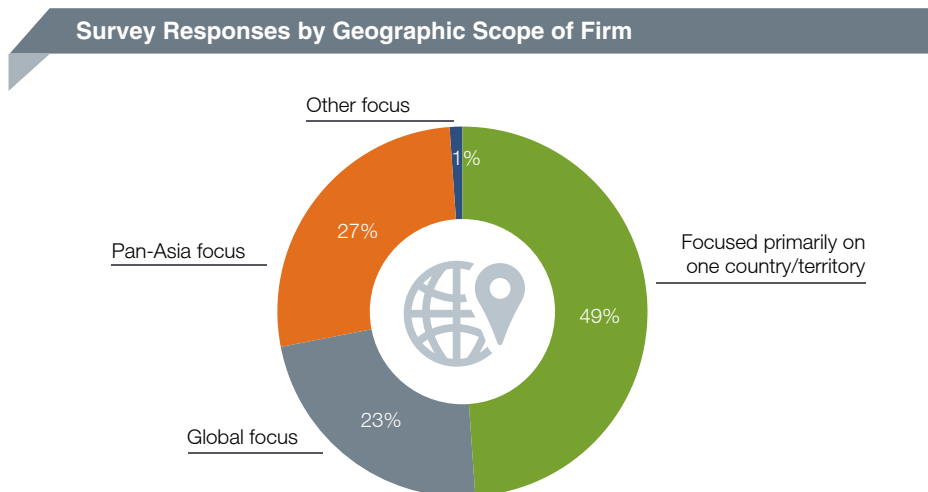
status as the only major asset class whose fundamentals have improved as a result of the pandemic (due, among other things, to surging demand from online retailers). These asset classes are seeing ongoing cap rate compression as investors compete to secure assets.

One common theme seen throughout the region is that the pandemic has acted as a catalyst to accelerate trends already underway before the arrival of COVID-19. Environmental, social, and governance (ESG) themes are one example of this. While ESG tends to be more important for buyers and owners at the top end of the market, there is both a growing awareness of health and environmental issues, as well as an increasing understanding that building efficiency, in particular, is an issue that can translate directly to corporate bottom lines.

Standards such as GRESB are helping create a de facto yardstick of sustainability compliance, while the newer, more exacting CPD standard (which measures buildings' net-zero-carbon strategies) is now emerging. Over time, the CPD is expected to become more important as governments move to comply with carbon emissions obligations delineated by the 2016 Paris Agreement.

A further reflection of today's fast-changing environment is that new-building designs are becoming more flexible, with developers seeking to create general-purpose structures that can be adapted to new types of uses, allowing a variety of purposes over their lifetimes. Approaches to master planning—while slower to gain traction—will probably also be subject to change, especially through the creation of decentralised neighbourhoods and cities offering comprehensive mixes of daily needs within local catchment areas.

In terms of capital flows, 2020 has seen a steep decline in year-on-year transaction volumes. This partly reflects the impact of border closures preventing buyers from travelling, and partly the fact that sellers are refusing to discount asset prices in the hope that markets will quickly rebound once a vaccine is delivered. Cross-border



Source: *Emerging Trends in Real Estate Asia Pacific 2021* survey.

capital flows are also down, although significant activity has been registered in South Korea and Japan as investors adopt a flight-to-safety mentality and seek out markets with deep domestic demand that are less affected by geopolitical risk. China also enjoyed significant cross-border investment for much the same reason, proving that foreign capital still sees it as an important destination despite ongoing trade tensions.

Unsurprisingly, this year's investment prospect rankings showed an ongoing preference for regional gateway cities that offer liquid, stable markets, together with reliable sources of domestic demand. Singapore remains the top investor preference, as in last year's report. Though not regarded as an established gateway in the mould of traditional investor favourites such as Tokyo and Sydney (which featured second and third, respectively), it has successfully cultivated a reputation for neutrality in what has become an increasingly polarised world, drawing significant investment from China in particular during the course of 2020. South Korea investment volumes, meanwhile, rose a remarkable 71 percent year-on-year to a record quarterly high as domestic institutional buyers redirected

capital earmarked for foreign purchasing back to homegrown assets.

Bank finance remains generally available across Asia Pacific markets, even if there is a clear preference for some types of deals (logistics) over others (retail, hotels).

If the impact of the pandemic on the investment environment is likely to be profound, the effect on individual real estate asset classes promises to be just as meaningful.

Office: Investors have long seen office as the go-to asset class, but with future demand for prime office space now thrown into question by a number of competing influences—social distancing requirements, the work-from-home trend, economic retrenchment, and the need for tenants to cut costs—investors have become somewhat gun-shy. The balance of opinion among interviewees across the Asia Pacific was that although employees will work from home more so than in the past (perhaps one day per week), it is unlikely to become a trend to the same extent as is expected in Western markets. Downtown offices will survive, therefore, although workplace layouts and facilities may change significantly.

Logistics: Already a favourite asset class pre-COVID, logistics sector prospects were boosted by the pandemic as online spending soared and manufacturers began creating stockpiles of components they had previously procured on a “just-in-time” basis. Still, while the structural undersupply of logistics facilities means that demand should continue to be strong, investors worry, first, that growth in online sales may peak and, second, that industry pricing dynamics will outrun the market as cap rates become ever more compressed. Cold-storage facilities are now also seeing strong growth, again due to increasing demand caused by rising ecommerce sales.

Retail: The pandemic-induced surge in ecommerce shopping has once again served to accelerate a preexisting trend.

But while the long-term implications for brick-and-mortar retail are undoubtedly negative, there are still positives. First, conventional retail sales remain strong for some segments, such as luxury and nondiscretionary goods. Second, retail operators have stepped up the pace in adapting their assets, either by reimagining them to serve local catchments, or by bringing in other types of commercial as well as residential occupiers.

Residential: As an asset class, residential tends to be favoured by investors during recessionary cycles because—in the Asia Pacific especially—there is usually strong demand, as well as a good track record of mortgage and rent payments. While only Japan has a significant number of institutionally-held, for-rent properties, super-low treasury yields mean that

investors may now be more willing to accept the low yields associated with residential assets.

Hotels: Like retail, the hospitality sector has been hard hit by the pandemic, in this case by lack of tourists. While there may be some hope in reinventing hotels to focus on domestic tourism, it seems likely the sector is now oversupplied, leading to many assets being sold off and converted to other purposes, such as for-rent residential. Hotels are some of the first distressed assets now appearing in the market.

Notice to Readers

Emerging Trends in Real Estate® Asia Pacific is a trends and forecast publication now in its 15th 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 2021*, 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 2021 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 134 individuals and survey responses were received from 391 individuals, whose company affiliations are broken down below.

Private property owner or developer	25%
Real estate service firm (e.g., consulting, financial, legal, or property advisory)	26%
Fund/investment manager	22%
Homebuilder or residential developer	8%
Institutional equity investor	3%
Bank lender or securitised lender	3%
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: On the Brink of a Turn

“This is a demand crisis, so I don’t think the effects have hit yet. But we have a big storm coming—this is going to be a long winter and every asset class is going to suffer, apart from industrial/logistics.”

Ever since real estate markets bottomed in the wake of the 2008 global financial crisis, Asia Pacific investors have been placing capital with an eye over their shoulder and a certain sense of unease as pricing and cap rates have been bid ever higher on a pyramid of liquidity and cheap debt. If the 11-year monster of a rally that has followed was never really convincing because its foundations were, in that sense, built largely on sand, there was also a feeling that whatever came along to displace it would be equally improbable and fantastical.

And so it has proved. Perhaps just as fitting, though, in these most unpredictable of times, is that the consequences of the black-swan event that now has felled the world’s economies—with the apparent exception of China—and seems about to do the same for its real estate markets,

has brought in its own wake a slew of outcomes as unexpected as the pandemic itself.

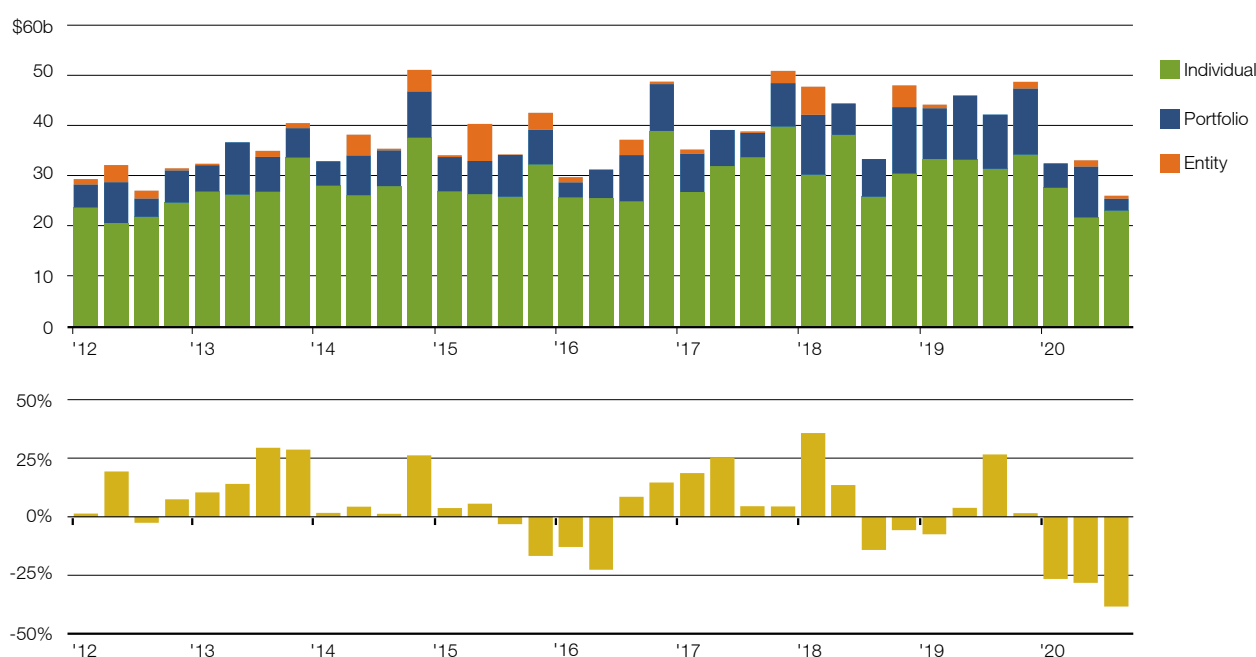
The first is that communities in the Asia Pacific have managed to protect themselves more effectively than developed-market counterparts that far outgun them in both health care and financial resources. The economic fallout for regional markets seems likely to be relatively contained as a result.

The second is that the most significant impact of the coronavirus from a real estate perspective has been to fast-track a number of preexisting secular and cyclical trends in ways that are likely to prove not only transformative but also, in the end, productive. As one Hong Kong-based consultant put it: “We were on course for change before, but what

COVID has done is accelerate everything to an unimaginable degree. Evolving in the normal way, we expected 10 to 20 years to get to the final answer—now we have to get there in a matter of months.”

Finally, and counterintuitively, real estate markets in most destinations have stalled. Investors anticipating a cascade of defaults, therefore, as recession takes hold have largely been disappointed. According to data from analysts Real Capital Analytics (RCA), investment volumes fell by 38 percent year-on-year in the third quarter of 2020, and by around a fifth compared. With the two prior quarters of 2020 prices and cap rates, meanwhile, have remained mostly stable.

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.

Exhibit 1-2 Most Active Asia Pacific Metropolitan Areas by Sector: Third Quarter 2020

2018	2019	YTD 2020	Sector	Metro Areas	Sales Volume (\$m)	YOY Chg	Volume
3	2	1	Office	Seoul	8,992	-3%	\$ 8,991,931,312
2	1	2		Tokyo	7,714	-42%	\$ 7,713,848,772
5	4	3		Shanghai	4,843	-29%	\$ 4,842,824,665
10	6	4		Beijing	4,632	-2%	\$ 4,631,719,475
1	5	5		Hong Kong	2,336	-67%	\$ 2,336,336,167
3	2	1	Industrial	Sydney	2,225	69%	\$ 2,224,605,370
1	1	2		Hong Kong	1,307	-33%	\$ 1,307,490,634
5	3	3		Melbourne	905	-15%	\$ 904,990,554
12	27	4		Beijing	877	1,645%	\$ 876,636,908
10	10	5		Seoul	758	84%	\$ 757,703,236
5	4	1	Retail	Seoul	1,860	-6%	\$ 1,860,011,931
9	31	2		Guangzhou	1,666	2,477%	\$ 1,665,941,231
4	6	3		Tokyo	1,435	-28%	\$ 1,434,629,685
1	1	4		Hong Kong	1,350	-65%	\$ 1,350,189,709
2	5	5		Shanghai	743	-67%	\$ 742,636,817
1	1	1	Apartment	Tokyo	2,021	-18%	\$ 2,020,682,086
4	2	2		Osaka	1,326	218%	\$ 1,326,260,693
20	9	3		Sydney	803	549%	\$ 802,970,663
19	5	4		Nagoya	497	781%	\$ 497,121,390
6	8	5		Fukuoka	282	300%	\$ 281,809,115
1	1	1	Hotel	Tokyo	967	-38%	\$ 966,747,729
25	13	2		Taipei	909	265%	\$ 909,298,603
5	6	3		Shanghai	806	32%	\$ 806,028,821
18	20	4		Kyoto	758	513%	\$ 757,905,895
3	4	5		Hong Kong	332	-69%	\$ 332,414,422

Source: Real Capital Analytics.

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

As one investor said: “What the textbooks tell you doesn’t work anymore. Normally, if economies are down, capital markets fall, corporate earnings decrease, and rents decline—everything is linked. But today, economies are awful, corporate earnings are terrible, governments keep injecting life support, but stock markets are at historical highs and cap rates are still so low.”

There are various reasons why transactions have seized up in this way. First, fear of unknown unknowns. As one Singaporean fund manager said: “We’ve had a very successful fundraising, but there’s no pressure to deploy immediately. Actually, none of the big players like us who have raised capital are actively

deploying right now. It’s a bit of a wait-and-watch. Everybody is doing some deals here and there, but it’s really not full blown.”

Another reason is that travel bans have prevented investors from physically visiting prospective purchases. “Unless you have someone on the ground, none of us would dare to buy anything without seeing it,” said one fund manager. “The industry is very much a touch-and-feel thing, there are so many different moving parts.” Travel bans have had the greatest impact in markets with a high proportion of international investors, such as Australia.

Next, there is a standoff over pricing. Buyers are underwriting lower values and cap rates based on an assumption of lower (or no) growth, together with expectations for declining rents. “The question is how much, how bad, how long,” as one fund manager put it.

“It’s a bit of a wait-and-watch. Everybody is doing some deals here and there, but it’s really not full blown.”

Owners, meanwhile, are generally strong enough financially to avoid forced sales and are holding out in the hope of early turnarounds on both the pandemic and economic fronts. The knowledge that a large amount of unspent capital held by real estate investment funds is waiting in the wings has helped bolster their hopes.

In the words of an institutional fund manager in Singapore: “Valuations have not come down and that’s the biggest challenge we’re seeing. Rents are coming down—people are talking about 10 to 20 percent rental drops—but values are not following, which ultimately goes back to there being just too much holding power.”

Markets Are Levitating . . .

This bunker-down mentality has been encouraged by the huge stimulus and employment support programmes rolled out by governments globally, which have temporarily staved off the impact of deep recessions in most major economies. In the Asia Pacific, governments mostly have held back from writing blank cheques, but banks and landlords have still actively supported cash-strapped customers rather than calling loans or terminating leases. This has served to sustain many essentially insolvent tenants, shoring up occupancy rates and maintaining landlords’ balance sheets at near-pre-COVID levels.

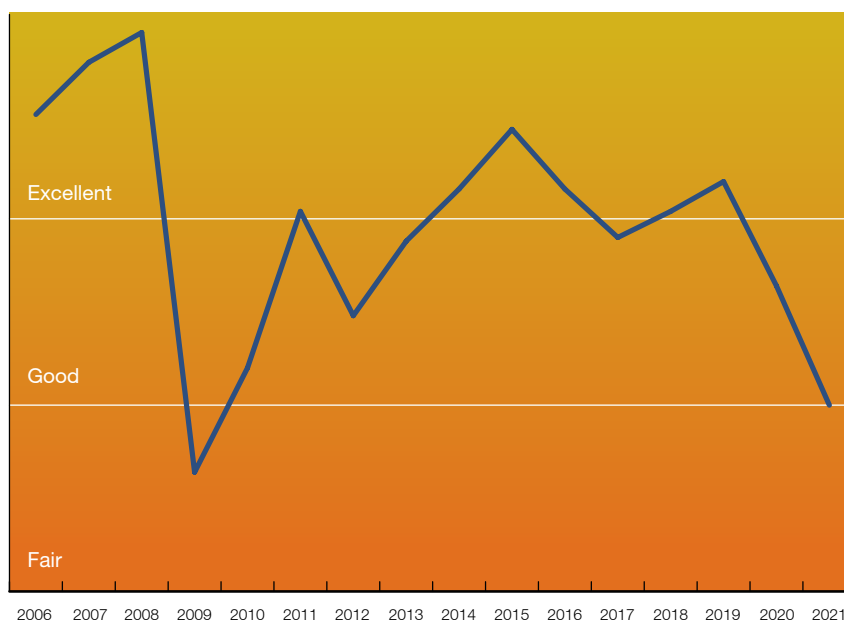
Today, though, with hopes for a V-shaped recovery fading fast, conviction is growing that artificially high asset prices (and, with them, investors’ profits) are due for a fall. According to one analyst: “The impact of government funding on economies has translated into lower [real estate] transaction volumes because businesses have been propped up by government support, which is delaying the appearance of distress in the market. But it will come, for sure, whether it’s corporates selling assets, or investors whose income streams have dried up and are unable to meet interest rate coverage ratios, or banks or receivers themselves stepping in as creditors.” Investor profitability expectations, as reflected in exhibit 1-4, have therefore declined to levels approaching the 2009 lows of the global financial crisis.

Exhibit 1-3 Cities Most Likely to See Rental Growth in 2021

	Generally poor	Fair	Generally good
1 Ho Chi Minh City	5.33		
2 Singapore	5.18		
3 Shenzhen	5.16		
4 Tokyo	5.11		
5 Seoul	5.01		
6 Osaka	4.97		
7 Sydney	4.92		
8 Shanghai	4.89		
9 Guangzhou	4.87		
10 Taipei	4.78		
11 Beijing	4.68		
12 Melbourne	4.67		
13 China—second-tier cities	4.63		
14 Mumbai	4.60		
15 Bangalore	4.59		
16 Auckland	4.58		
17 Hong Kong	4.57		
18 Bangkok	4.55		
19 New Delhi	4.55		
20 Manila	4.42		
21 Jakarta	4.37		
22 Kuala Lumpur	4.32		

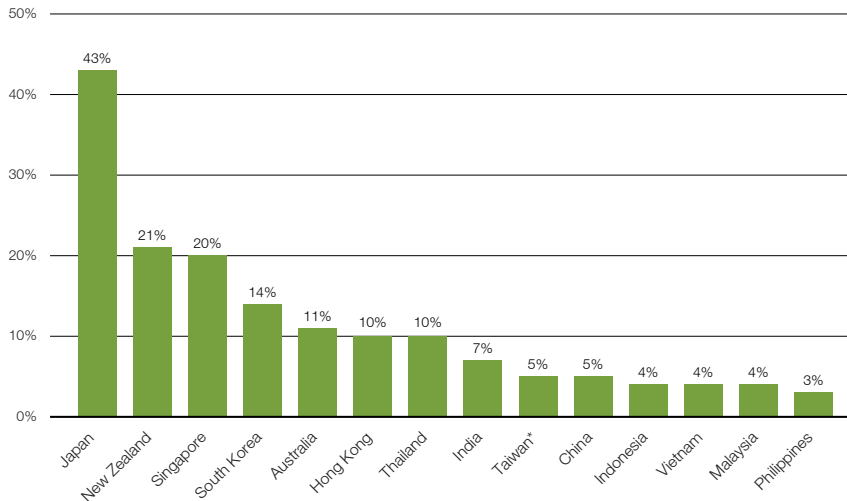
Source: *Emerging Trends in Real Estate Asia Pacific 2021 survey*.

Exhibit 1-4 Real Estate Firm Profitability Trends



Source: *Emerging Trends in Real Estate Asia Pacific 2021 survey*.

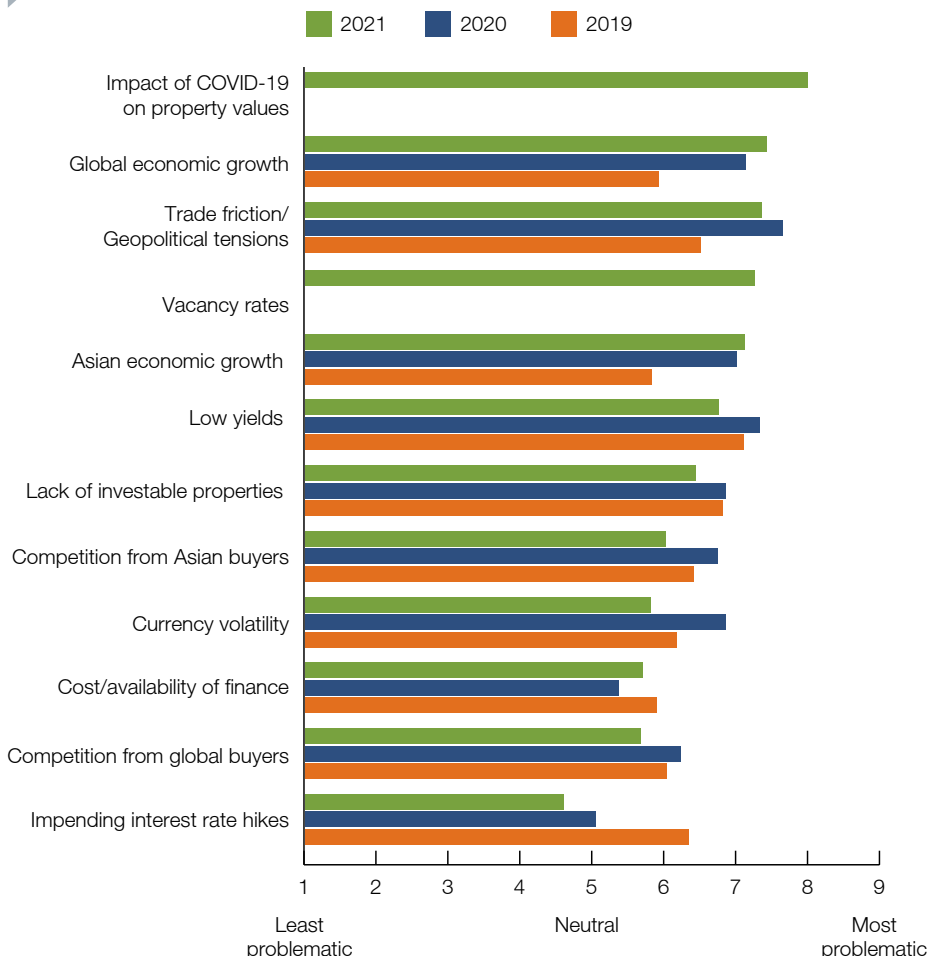
Exhibit 1-5 Fiscal Stimulus Packages as Share of GDP (30 July 2020)



Source: IMF

*Taiwan data are extracted from Taiwanese government press releases.

Exhibit 1-6 Most Problematic Issues for Real Estate Investors

Source: *Emerging Trends in Real Estate Asia Pacific 2021 survey*.

Another reason pricing has remained stubbornly high is that valuers have been reluctant to write down asset values, relying on technical caveats about market uncertainty and hopes for an economic rebound in 2021. In doing so, valuers are following the lead of U.S. equity and debt markets, which as of November 2020 were trading at record highs. As such, institutional asset managers were under no pressure to rebalance real estate portfolios to maintain prescribed asset-allocation levels.

Beyond that, prices have also been supported by the fact that central banks have now set their stalls at a point where interest rates are almost guaranteed to be lower for longer, thereby creating a bigger spread between asset yields and cost of debt that encourages further cap rate compression, which in turn supports higher asset valuations. As one investor said: "Spreads remain elevated across the board because people have been expecting interest rates to push out and eat into them. But if that expectation has now changed, it would certainly justify more cap rate compression."

In any event, realistically, asset prices at current levels are simply too high, a conclusion underlined by bank asset valuations for proposed lending deals, which are currently significantly lower than proposed transaction prices. As one consultant said: "I think the valuation profession is in denial. [Asset] yields have moved perhaps 25 to 50 basis points, but at the end of the day, the test for me is: would someone pay that price to buy it now? I think changes should be 15 to 20 percent more than is being reflected. I also think there will be major differentiation between core and noncore [assets], much more so than in the past—people are just putting off what is going inevitably to be a correction."

... Until the Music Stops

The question now is: when and how will this happen? Although banks “continue to extend and pretend,” some interviewees suggested that the first quarter of 2021, when many government support programmes are set to expire, will mark a transition to a new dynamic.

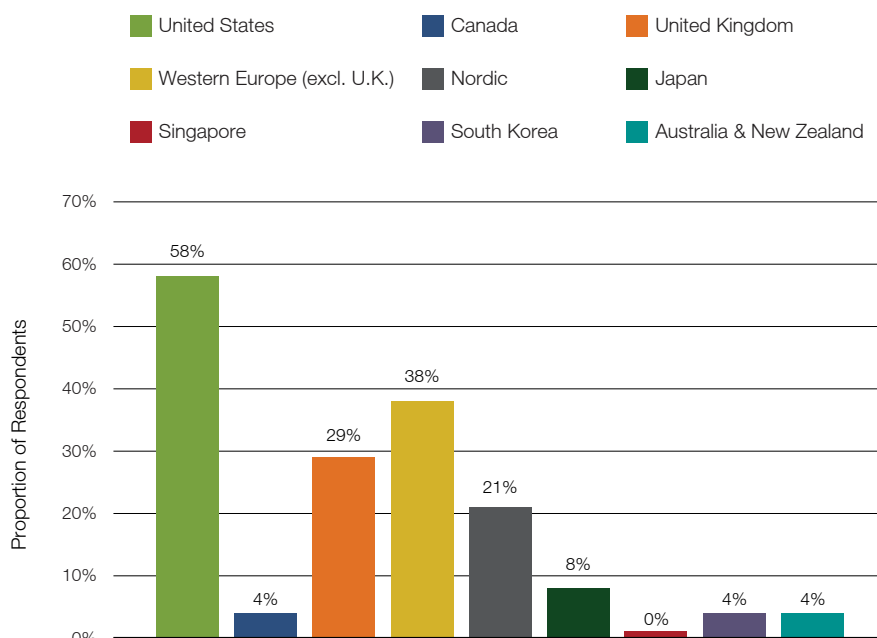
According to one Australia-based interviewee: “Equities are doing well, so real estate assets should retain their values because we haven’t broken the threshold. But that’s why, next year, the first quarter will be important. The job furlough schemes will be removed. You’ll see a rising unemployment rate. You’ll see the other asset classes being repriced. And I think at that time there will be more pressure on landlords to be realistic in valuing their assets.”

And, in the words of one brokerage analyst: “We feel that transaction volumes will come back strongly in 2021, though it might not even be early 2021. These things take a while, so maybe it’s the latter half of 2021 when we really start to see properties being put to market and there’s a price adjustment. It’s actually happening now; we’ve been appointed by a few people who just need to sell. But they are more one-offs than the norm at the moment.”

Projecting the extent of any correction is difficult. However, even though the current downturn is certainly more severe than during the global financial crisis, most investors are expecting fallout to be contained, at least compared to Western markets. As one manager working at a global fund said: “We do not expect as much distress in the Asia Pac compared to the U.S. and Europe, so we’re holding more dry powder available for those two markets.”

There are various reasons for this. First, most regional markets have been relatively successful in containing the coronavirus, thereby reducing the economic impact. Second, “we just don’t have the debt.

Exhibit 1-7 Investor Views on Which Developed Real Estate Markets Present the Best Opportunities



Source: Preqin Investor Interviews, June 2020.

Leverage is what creates distress, and for good or bad we have neither high leverage nor a deep securitisation market.” This is in contrast to the United States, where large amounts of securitised debt have created a structure where special servicers often see more opportunity in calling in loans and taking possession of assets rather than finding a compromise that allows owners to retain them.

In Asia Pacific markets, the prospect of banks resorting to mass defaults simply because borrowers have breached covenants is remote. In addition, and unlike during the global financial crisis, banks today are both well capitalised and better versed on how to manage a systemic threat. They also appear more inclined to work with banking regulators to address economic fallout. Finally, interest rates are ultra-low, and possibly heading lower.

Apart from that, the cost to the banks of calling loans en masse would be both prohibitive and self-defeating. In the words of one debt market specialist: “I don’t think there’s going to be a wave of defaults comparable to the global financial crisis. The way the economy has been managed and how the banks have played their role, it’s not in their interests suddenly to change that situation, because in the end defaults come back to bite them. You triple the cost of underlying risk capital because you have a belligerent and uncooperative borrower, you spend an enormous amount of management time on a deal that can’t get refinanced no matter what, and then there are going to be transaction costs to cover, too.”

Japan: Key Themes

In today's flight-to-safety environment, Japan has become the region's go-to destination. It has depth and liquidity in core assets, cash-rich tenants, and a deep domestic market that is relatively less reliant on external trade—tellingly, the deep decline in transaction volumes seen in most Asia Pacific markets in the first nine months of 2020 was absent in Japan. Sales recorded a relatively modest 22 percent decline, propped up by foreign purchasing and a handful of large deals.

One aspect of the predictability of the Japanese market is its enduringly low interest rates. At less than 1 percent, they offer a decent spread over the cost of debt and reduce the need for leverage to achieve returns. They also explain why cap rates of less than 3 percent still have room to move lower.

Over the next couple of years, Japan (and in particular Tokyo) is expected to continue as a magnet for international investors. According to one locally based fund manager: "I could see in the next couple of years rents coming down in every asset class; but conversely, cap rates could still compress, because I see a lot more international capital coming into Japan as a safe haven. It's one of those countries, like China, where people actually are going back to work, the economy remains kind of positive and fluid, and things are getting created. And unlike China, it has a convertible currency. So if you're not going to invest in downtown New York, you might still invest in downtown Tokyo."

As of October 2020, grade A office rents had dropped slightly but remained fairly stable, vacancies were low, and new supply was limited. However, while that may be enough to draw cash-rich domestic buyers who have long traded Tokyo office assets, some foreign investors are now avoiding the space out of fear that changing workplace practices could create a spike in vacancies. "Next year, I expect more tenants giving back floor space," continued the fund manager.

Volume by Property Type & by Most Active Territories/Markets					
Territory		Third Quarter 2020 Volume		Volume through September 2020	
		US\$ (millions)	YOY	US\$ (millions)	YOY
1	South Korea	6,791.3	22%	15,654.0	0%
2	China	5,164.8	-36%	21,714.5	-25%
3	Japan	4,472.8	-62%	26,352.0	-22%
4	Australia	2,933.8	-61%	11,484.0	-43%
5	Hong Kong	2,633.8	-4%	5,337.9	-62%

Source: Real Capital Analytics.

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

"Japanese companies don't lay off people, but they need to reduce expenses, and the way to do it is to surrender office space and have people continue working part-time at home. So I wouldn't be surprised to see a lot more vacancy in class A office in Tokyo and Osaka."

Logistics and multifamily residential, meanwhile, are now the "major food groups that are going to drive the market." Both have become popular in Japan in recent years, although yields are now ultra-compressed (around 4 percent for logistics and under 3 percent for residential). With demand for logistics still strong, it remains an area where investors are willing to place capital.

Multifamily, on the other hand, may have reached its limit in terms of cap rate compression, although investors are still chasing deals in Tokyo involving larger apartments (i.e., measuring around 35 to 40 square metres) as a way to tap into new demand created by employees working from home, especially in areas like Shinagawa that provide good transportation networks and local amenities.

That decentralisation theme applies equally to another multiyear trend in favour of Japan's secondary cities, whose growing appeal stems from their flourishing economic bases, less densely populated urban cores, and operating and

living costs some 30 percent lower than in Tokyo. According to one fund manager: "I think you need to be looking at locations where not only are you decentralised within Tokyo, but probably also decentralised within Japan. And you can easily be sat in Osaka or Nagoya because you're a quick Shinkansen [high-speed train] ride away. And once that maglev goes in, it's even closer."

As in other markets, Japan should turn up a few prospects for distress, although probably less so than elsewhere and very likely limited to particular situations and assets classes. Sale-and-leaseback deals involving hard-pressed but asset-rich companies are one possibility, as discussed elsewhere in this report.

The hospitality sector is another option. Already saturated pre-COVID by numerous Olympic-related investments, the sector has been hit by the disappearance of the inbound tourist trade. According to one Tokyo-based fund manager: "I think in the rest of Asia travel seems to have come back a little more solidly than it has in Japan, but hotels will be an interesting space in the next couple of years because there are a lot of places that didn't make any sense when they were built even in a good market. So we are aggressively looking just from a real estate perspective—how much is the ground worth if you were to change it to a different use?"

Distress—A Long Wait

Still, while the correction may not prove as severe in the Asia Pacific as elsewhere in the world, most investors are anticipating significant amounts of stressed or distressed assets to surface in 2021 and are preparing to deploy capital accordingly. Even Japan, where transactions and valuations have remained strong, is likely to see some pressured sales. As one local investor said: “I don’t think it’s going to be a river—it might not even be a stream—but I do think the faucet will open.”

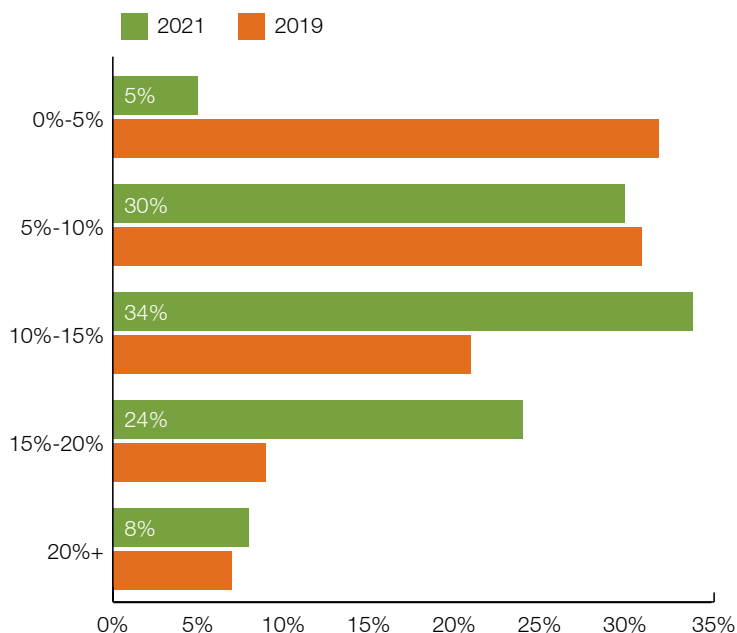
Ironically, this is occurring at a point when opportunistic money is not exactly abundant in the region. Capital raised by Asia Pacific opportunistic funds has been in decline for years and was at its lowest ebb in 10 years in 2019 (i.e., around US\$5 billion, according to JLL). Other types of capital are stepping up though. As one investor said, “It’s not out of the normal realm, but it is something slightly different than four or five years ago, where teams were just geared for more bog-standard types of transactions.” The increase in investors targeting higher returns compared with previous years, in particular in opportunistic and distressed investments, is reflected in exhibits 1-8 and 1-9 of our survey.

Geographically, interviewees identified three markets as likely sources of forced sales.

China—While distressed deals have long been a feature in China (partly because developers tend to be highly geared), such events tend also to be intermediated by associated parties and local governments rather than by the open market. How this plays out on this occasion therefore remains an open question.

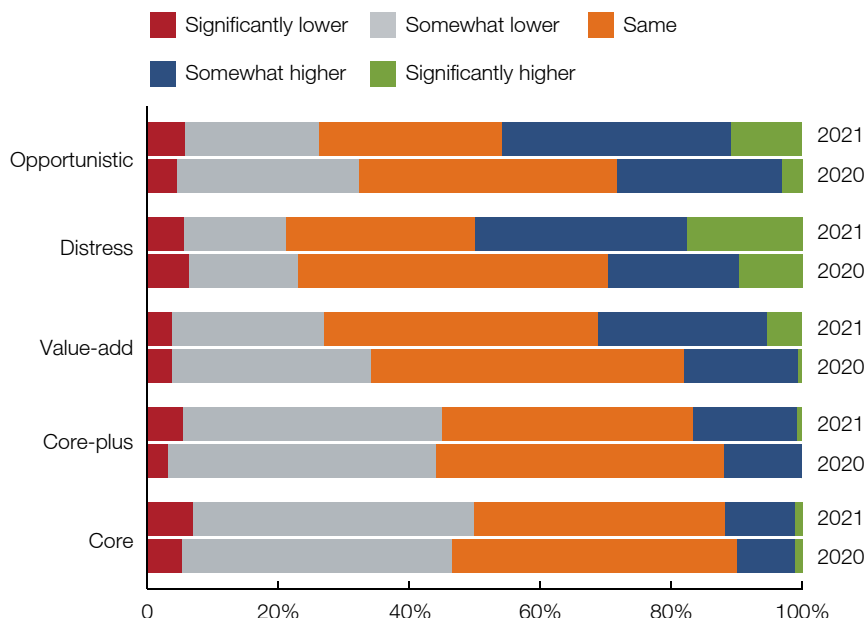
That said, and although the Chinese economy continues to prove resilient, government policy initiatives to tighten bank financing to developers, including the recently publicised (though still unissued) “Three Red Lines” policy, are taking a toll. Bank

Exhibit 1-8 Investors’ Targeted Returns between Now and End of 2021



Source: *Emerging Trends in Real Estate Asia Pacific 2021 survey.*

Exhibit 1-9 Change in Targeted Returns Compared with 2020



Source: *Emerging Trends in Real Estate Asia Pacific 2021 survey.*

funding cuts are aimed at smaller and more leveraged players, who are now looking to sell assets to finance construction and land acquisition costs.

Sales will not be limited to under-pressure small developers, though. According to one Shanghai-based foreign investor, larger players may also be looking to divest assets to “reposition their fire power so they can go on an acquisition spree.”

This is because the steep discounts to market value at which smaller developers are now trading create opportunity for their larger peers to add to land banks at attractive valuations. But with no bank financing to help them, some are now liquidating assets (including commercial properties) to finance those deals. “For them, it might be a question of opportunity cost, whereas for us it’s an opportunity to step into some of these assets at an attractive cost basis—that kind of thing is our bread and butter,” the investor said.

In addition, while China appears to have an endless appetite for new housing, several investors suggested that oversupply may be appearing in some areas. According to one: “I do feel there are signs that the residential market in China is overbuilt. We’ve talked about bubbles there bursting for so long, and while I don’t think they will allow it to happen now, we are going to see more defaults and distress, probably in a controlled manner. Also, because [foreign investors] can’t travel to look at those deals, I think the Chinese government will have the perfect opportunity to sit down with local AMCs [asset-management companies] to handle them.”

Still, China remains by far the most robust economy in the Asia Pacific region (and probably globally too), so these opportunities are more

likely a reflection of cyclical, rather than systemic, weakness. One domestic developer pointed to a strong rebound in consumer demand in the fourth quarter, citing a 30 percent year-on-year increase in his company’s residential sales during China’s annual “Golden Week” October holiday. Chinese developers may therefore still be able to dispose of residential assets fast enough to avoid credit shortages, especially if they are willing to discount prices.

India—Already subject to a 2019 crackdown on developer-finance irregularities, India’s real estate sector was hit by a perfect storm in 2020, as further regulatory tightening was compounded by a severe outbreak of COVID-19. As a result, developer finance is today in shorter supply than ever. “With maybe 95 percent-plus of Indian developers hard pressed for cash and liquidity,” according to one local consultant, “it’s now a process of evolution, where the fit will survive and the rest may not.”

Most international investors continue to focus on tried-and-tested business park assets that have been the focus of both of India’s successful real estate investment trust (REIT) launches to date. Given the country’s large business process outsourcing (BPO) industry, this sector may also benefit from renewed offshoring demand from Western companies dealing with pandemic-related issues.

However, the cathartic process now underway in India is also creating significant industry consolidation, together with demand for distress capital on a massive scale. As a result, many foreign institutional and private-equity funds are looking to India as a source of opportunistic investments.

The main focus of such deals continues to be the residential sector, where last-mile construction funding

on a senior-secured basis for mid-range housing projects offers internal rates of return (IRR) as high as 23 percent.

Australia—The attritional impact of the pandemic on regional economies (especially in Melbourne) has already been reflected in higher vacancies and rental incentives. Further rental declines are expected as unemployment worsens and support provided by government policy measures falls away. However, the main reason investors look to Australia as a source of distress has less to do with current market weakness and more to do with the fact that the economy functions structurally as in the West, with the result that mechanisms to dispose of distressed assets are more front-and-centre. “My gut feel is that Australia is the most transparent [Asia Pacific] market for distress,” said one interviewee. “So if it happens, [investment] funds all have money ready to buy, although at the moment they are having to wait—even core funds are struggling to deploy capital because they can’t travel.”

Clearly, the extent of any correction will vary by market and asset. Still, most investors are not expecting wholesale price cuts. According to a regionally focused analyst: “It’s all about the economy. We don’t want it to collapse, but also we don’t want the property bubbles to continue. I feel like a mini adjustment is good, a 10 to 15 percent adjustment is healthy enough to reset. If we get that, we don’t need it to be 30, 40, 50 percent.”

In some markets, though, the downturn may be deeper than in others. In Hong Kong, one interviewee, speaking of the local market, observed: “If we’re talking about a 15 to 25 percent adjustment, which we might be, then core would be at the 15 end and the second and third tier would be at 25, as would retail.”

Perhaps the main reason declines may be contained in this way is that so much unspent investment capital has accumulated in recent years. According to CBRE, as of the first quarter of 2020, some US\$51 billion was held by Asia Pacific closed-end funds looking to invest in regional real estate. With more money available than assets to purchase, long-term investors may not try to press their advantage, given especially that many properties coming to market will likely be one-off sales.

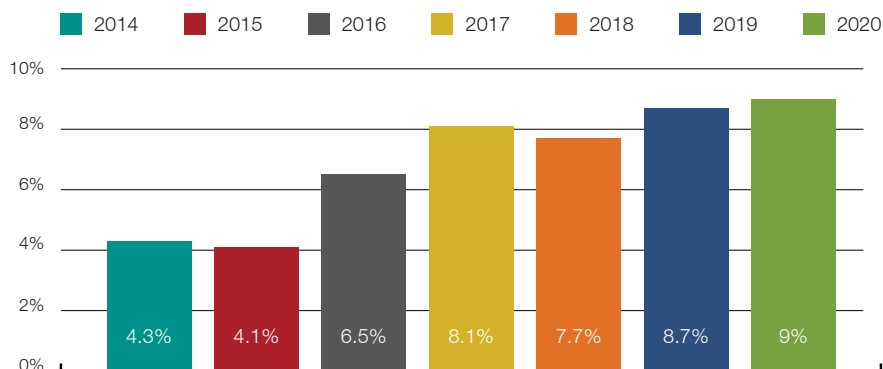
Another secular shift that should continue to support values and cap rates over the medium to long term is the continuing downward trend in interest rates. According to a fund manager in Shanghai: "The reality we now face is that the globe is basically joining the Japan experiment, where we will be at effectively 0 percent interest rates for an extended period. And that makes for an incredibly strong tailwind for high-quality, income-yielding commercial assets, and an acceleration of this secular shift from fixed income into income-bearing brick-and-mortar assets, where the relative yields between a 0 percent bond and a 2 percent, 3 percent,

4 percent commercial property is going to look incredibly attractive. I don't think the market has fully priced in that reality yet, considering the number of folks continuing to sit on the sidelines."

Not only does that spread now look more attractive, it also encourages institutional investors to allocate more capital to their real estate portfolios. According to a

survey of sovereign wealth funds carried out by asset manager Invesco, sovereign investors globally have earmarked an average 9 percent of assets under management (AUM) for real estate purchases in 2020, compared with just 4.1 percent as recently as 2015 (see exhibit 1-10).

Exhibit 1-10 Sovereign Wealth Funds Real Estate Allocation Trends (percentage of Assets Under Management)



Source: Invesco.



Corporates Divest

As economies slow, there are obvious negative implications for corporate balance sheets. At the same time, many Asian companies have large amounts of capital tied up in real estate that can be tapped to provide ready cash. According to one interviewee, “Asian companies, especially big manufacturers, tend to be more asset heavy than those in the U.S., who went with an asset-light approach a lot earlier. Some may now be looking for working capital, and anyway divestment makes sense because the amount of long-term capital coming into the Asian market is encouraging structural change.”

Sometimes, such assets are premium products that rarely trade. An investor in the Philippines, for example, said that prime buildings in Manila’s central business district (CBD) have recently begun appearing on the market. “I’ve been looking at this specific area for the past couple of years, and all of a sudden there are three listings, at pre-COVID prices, owned by high-net-worth families,” he said. “They’re not going to sell at fire-sale rates, but these are people who would normally not be thinking of selling at all.”

Many assets divested in this way feature sale-and-leaseback structures that, with or without COVID-19, represent better uses of corporate capital. As one investor commented: “Why would you hold assets when you can continue to use them through sale and leaseback and then leverage your underlying credit strength? Otherwise, you’re not working your rating or your brand as well as you might. This way, you get a good partner, you get a good diversity of capital, and there might be other things you want to do down the road together in terms of having that kind of capital exposure.”

Sale-and-leaseback deals tend to comprise high-quality assets (including land) located in noncore locations, and are often sold at a discount to equivalent buildings traded in the normal way, at least on a risk-adjusted basis. In addition to corporate offices, investors are looking at potential deals involving logistics

facilities (especially in Singapore) and also universities, which often own large real estate portfolios they can convert to working capital as fee-based revenue dries up.

Some deals have been structured in innovative ways. One New Zealand sale-and-leaseback purchase set up a trust into which a portfolio of petrol station convenience stores was placed. This was then sold to a REIT that funded the purchase (in part) via a private placement to eligible shareholders. Other deals have included buyback clauses allowing sellers to repurchase the asset within a given time frame.

In Japan, sale-and-leaseback deals had already taken hold pre-COVID as a result of a recent trend to improve corporate governance practices, while elsewhere in Asia generational changes in family businesses had also begun pushing management in the same direction.

In India, meanwhile, sale-and-leaseback deals have so far been thin on the ground. According to one local player: “As logical as it is, it hasn’t really taken off. The primary challenge is that a lot of these properties have already been leveraged to the hilt. Beyond that, there aren’t too many buyers in the marketplace—even with a ready seller and a financially viable proposition, the challenge is that I haven’t been able to find any takers.”

Eyeing Development Risk

Reduced consumer demand caused by the global recession inevitably translates to lower demand for space from occupiers. With vacancy rates rising, and investors uncertain as to the depth and length of the slowdown, appetite for new space has weakened.

As a result, and although pricing for core assets has remained steady, development plays across the region are now being postponed or discounted. According to a fund manager in Sydney, “This means people looking for that additional risk return need to look at development sites.

There’s been a shift away from risk in terms of all capital, and development at the riskiest end of the spectrum is where you’re going to see that pricing come into play. So in Melbourne, mainly, there are quite a lot of development opportunities in the market, and I think they’re going to be the assets to keep your eye on because they are the ones that will have the biggest repricing.”

For the right product, however—and in particular for assets with long-term appeal—demand will likely remain strong, especially given the huge amount of institutional capital still on the lookout for core assets in the region.

Opportunistic funds therefore continue to seek out build-to-core options. As one such investor said: “We see an insatiable appetite for income-producing assets built with the goal of creating a very core income stream. This begs the question, though, of how to define what core is? People say it can’t be core if it’s not grade A office, but we don’t consider that to be core, because it’s very hard to create a resilient income stream in a flashy grade A building. For us, core is about figuring out what the demand is, and then creating a durable income stream that we can sell. Within that framework, our goal is to manage the risk, so we always build for domestic demand, which is the most immune to both geopolitical and foreign exchange risk.”

Indeed, this focus on buying assets that tap domestic demand was a theme that cropped up across all asset classes and geographies (but especially China) as investors hedge their bets in an era when export growth has become questionable, partly due to geopolitical concerns and partly because of poor short- to medium-term economic prospects in Western markets.

Flight to Safety Continues

Risk aversion has also been the driving force behind the multiyear trend in favour of investment in regional gateway cities, as investors positioned themselves for an end-of-cycle environment. Now that the long-anticipated black-swan has arrived, the flight-to-safety theme continues. In the words of one brokerage analyst: “If we surveyed the majority of our clients and where they would be buying next, they’re going to be buying firstly in places where they think there’s distress—which there isn’t really at the moment—and otherwise, if you’re looking for safety or security, you’re probably going to Japan and also to some property types in Australia.”

This accounts for the strong showing in this year’s Investment Prospect Rankings of Tokyo and Sydney, both of which have reputations as liquid and transparent safe-havens. Tokyo in particular continues to draw investors. Transaction volumes were the strongest

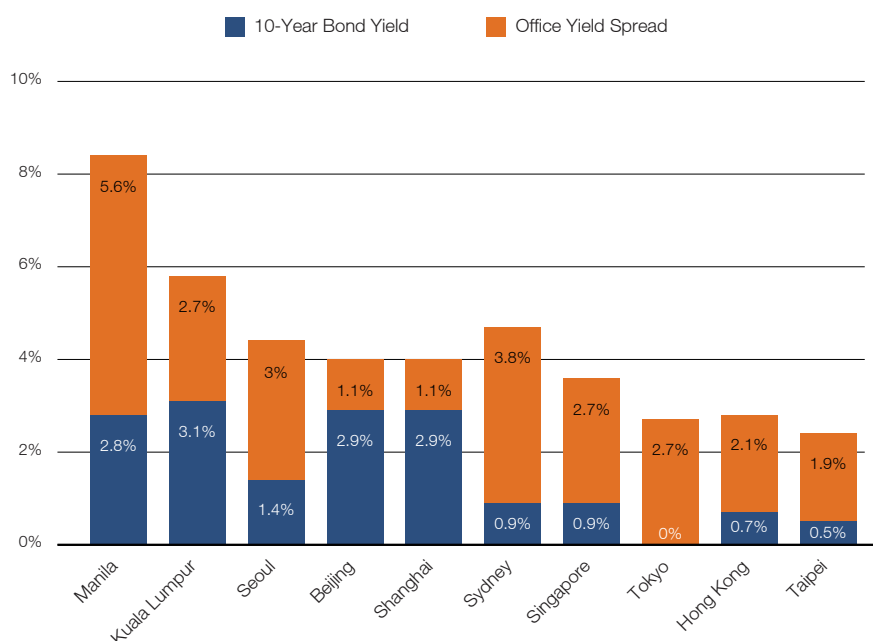
in the Asia Pacific after South Korea in the first nine months of 2020, despite falling by 22 percent, according to RCA. And while the investment market continues to be dominated by local developers and insurance companies, more opportunities of the type sought by foreign investors are expected to open up, especially from large corporates selling noncore assets.

According to one locally based fund manager: “Wealth in Japan is driven by the corporates, and sentiment within the corporates really lags until people see how their overseas business reacts to a crisis. We’re currently in that part of the lag where clearly sentiment is not good, but people are thinking it’s not that bad, which is why I think it will get worse before it gets better in terms of sentiment with respect to real estate. At that point there will be opportunity, because real estate values have risen due to Abenomics, and I think corporate management will want to take those gains before it’s too late.”

Singapore also features in this group (at number one, as in last year’s report). While it lacks the liquidity associated with the other two cities, it boasts plenty of core assets, together with grade A office valuations that are some 30 percent lower than in Hong Kong.

“If you’re looking for safety or security, you’re probably going to Japan and also to some property types in Australia.”

Exhibit 1-11 Prime Office Yield Spreads to Risk-Free Rate



Source: Savills Research and Consultancy.

Out with the Old, in with the New

In general, though, investors are more focused on finding deals among particular asset classes than in particular geographies, with an emphasis on those providing income streams that are resilient in a down-trending market. In the current environment, this translates into a rotation of capital away from mainstay asset classes experiencing cyclical or secular headwinds (such as office, retail, and hotels) and towards those previously regarded as niche (such as logistics, multifamily residential, data centres, and tech-oriented business parks catering to disciplines such as life sciences).

As a result, alternative asset classes are seeing ongoing cap rate compression as investors compete to place capital.

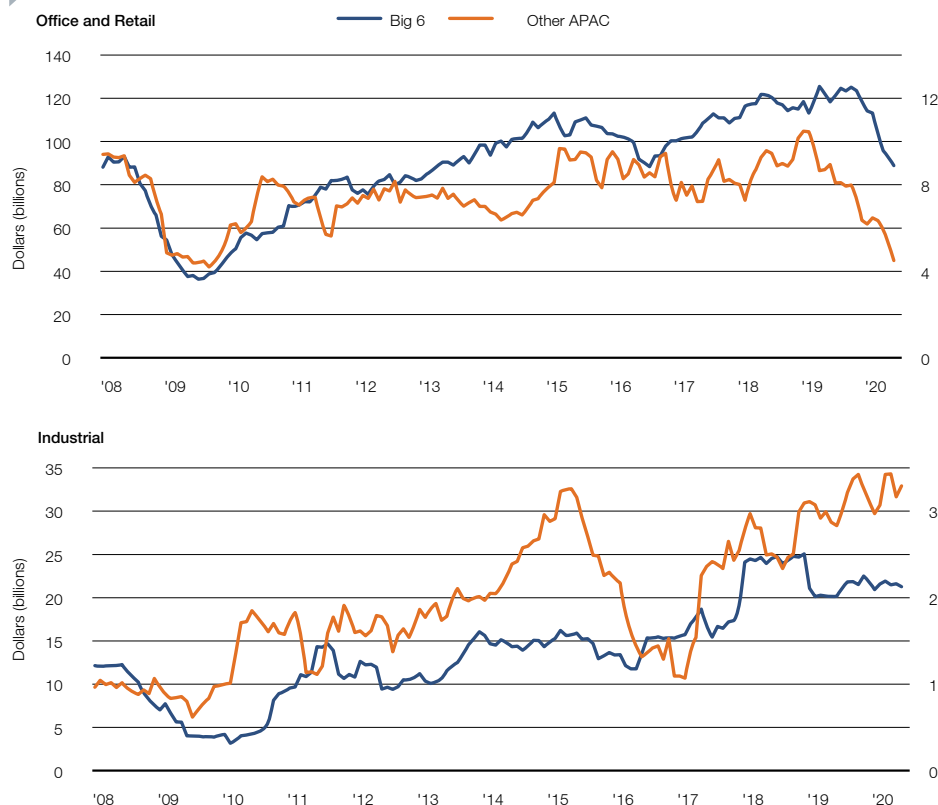
Build-to-Rent Residential

Build-to-rent residential is one area in demand (see chapter 3 for more detail). According to one interviewee: “In the depths of COVID, clients were telling us that retail portfolios were only collecting 25 to 30 percent of rent, and that will still be the case in some markets. For offices, maybe they’re at 70 to 80 percent, and that’s still questionable in some people’s minds. But multifamily is extremely resilient—rent collection in most markets is at 90 percent-plus. So, people like the resilient nature of the income and they’ll try to manufacture yield by doing more development.”

Logistics

Logistics is another sector where investors are chasing strong income streams (see chapter 3 for more detail). Already a favourite asset class pre-COVID, prospects were boosted by the pandemic as online sales soared and manufacturers began creating stockpiles of components they had previously procured on a “just-in-time” basis.

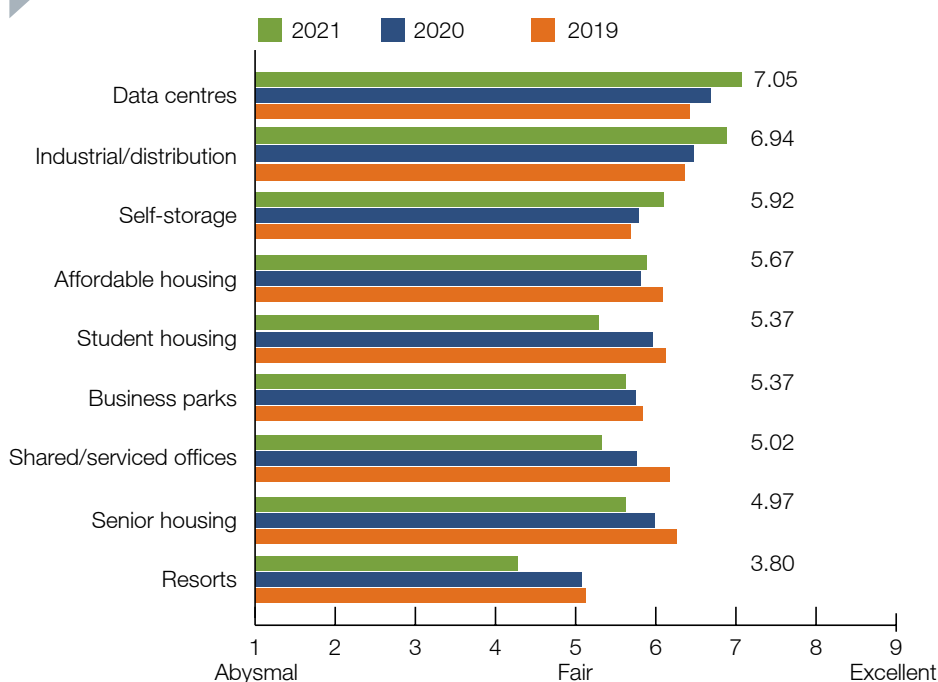
Exhibit 1-12 12-Month Rolling Transaction Volumes for Asia Pacific Big 6 versus Secondary Markets (1H 2020)



Source: Real Capital Analytics.

Note: “Big 6” comprises Australia, China, Hong Kong, Japan, Singapore, and South Korea.

Exhibit 1-13 Prospects for Niche Property Types in 2021



Source: Emerging Trends in Real Estate Asia Pacific 2021 survey.

Still, while the structural undersupply of logistics facilities across the region means that demand should continue for the foreseeable future, investors worry, first, that growth in online sales may peak or even decline and, second, that industry pricing dynamics will outrun the market as cap rates become ever more compressed. As one investor said, “It’s the obvious thing you would want to go into, but the trouble is it’s obvious. So, everyone else is trying to do it, then the prices go up, and then you don’t make the returns because you’ve overpaid for it.”

Data Centres

Meanwhile, data centres have become the other sought-after asset class. Only a few years ago, the sector’s specialist and operationally intensive nature deterred many real estate funds. Today, that thinking has changed. Strong growth in Asia Pacific internet bandwidth capacity (currently 56 percent annually, according to data centre operator Equinix) is creating record flows into development projects, much of it bound for investment-grade assets such as hyperscale data centres. Spending in China has been especially strong, with almost US\$1.5 billion in tech, telecom, and data centre deals recorded in the year to October 2020, according to RCA. Total investment across the Asia Pacific region represented some 2 percent of all regional real estate transactions in the first half of 2020, compared with less than 1 percent for the whole of 2019.

Singapore, Hong Kong, Tokyo, and Sydney are considered the tier-1 data centre markets, while China has seen the fastest growth and India is now about to reach critical mass, with the big operators and investors opening offices in-country.

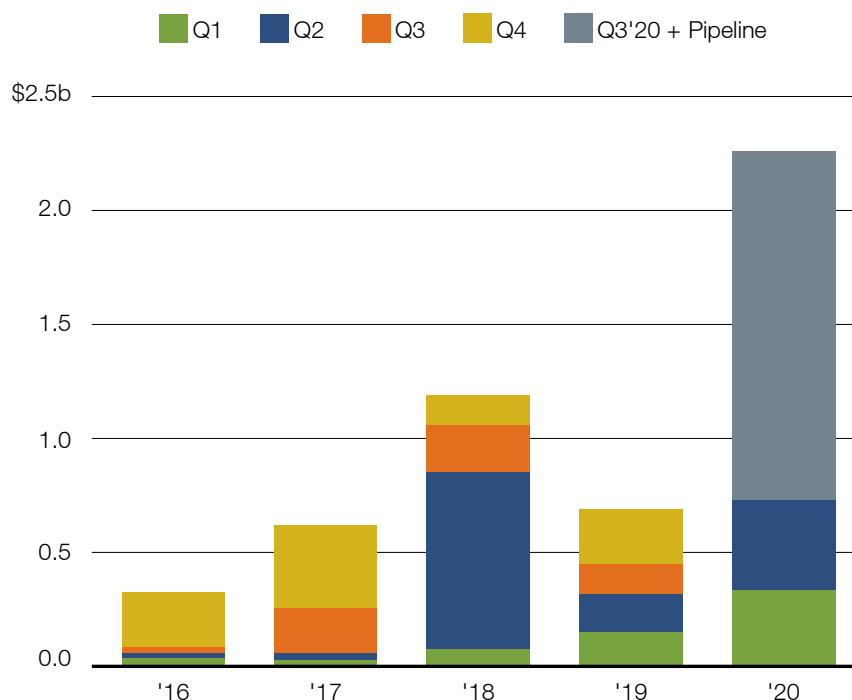
Although growing demand for bandwidth capacity means that data centre construction will continue for the foreseeable future, it remains a challenging sector in which to invest. Revenues tend to be concentrated among a small group of large users, creating both barriers to

entry and inequality of bargaining power. In addition, operational issues have intensified as data centres become bigger and more complicated.

Because quality of service is so critical, both to boosting asset values and securing tenants, investors are now more likely to build data centres as integrated businesses rather than just real estate assets. In the process, they either form partnerships with operators or, increasingly, establish their own in-house expertise, sometimes by buying operators outright. In addition, they are now taking longer-term views, often with the goal of establishing a portfolio of assets that can be sold, either as a platform or via initial public offerings [IPOs].

According to one investor active in the space, “I’m a bigger believer in data centres than I am in logistics, because logistics has fewer barriers to entry and it can get mispriced more easily. Because if you think about what can drive cost for data centres, it’s not land. It may be hard to find both land and also power quotas, but even if land cost doubles, it’s only 10 percent of the build cost. Your MEP [mechanical, electrical, and plumbing] is where all your cost is, and because it’s globally procured, it’s more fixed. That means there’s less of a chance this stuff gets bid up.” The investor cited data centre IRRs in the mid-20s, assuming an 8 percent cap rate on exit, together with unleveraged cash yields-on-cost “in the mid- to low-teens.”

Exhibit 1-14 Asia Pacific Data Centre Investment Volumes



Source: Real Capital Analytics.

Note: Figures include high-spec office and industrial buildings.

Australia: Key Themes

On the face of it, conditions in Australian markets remain fairly benign, with grade A office rents holding steady in the third quarter of 2020 despite worsening conditions on the pandemic front, including a prolonged lockdown in Melbourne. Federal and state stimulus measures have no doubt played a part in keeping property markets afloat.

Scratch the surface, however, and signs of stress become apparent. Purchases by local investors have dried up. “Domestic investors have been pretty cautious,” said a Sydney-based investor. “Aussie pension funds are conservative at the best of times, so they’re not necessarily out there doing deals—the capital markets at the moment are just pretty muted.”

Rent incentives, which had recently been trending down after languishing for years at elevated levels, had rebounded to between 25 and 30 percent as of October 2020. Sublease vacancies were similarly elevated, standing at 2.7 percent, or 135,000 square metres, of office stock in Sydney, as opposed to between 0.3 and 0.4 percent in the 2017–2018 period, according to JLL.

With the government’s main economic support programme, the JobKeeper Payment scheme, set to expire in December 2020 (March 2021 for smaller businesses), the domestic economy can be expected to worsen in early 2021, with tenants relinquishing significant amounts of office space. As one interviewee said: “When these [programmes] end, demand-side economics are going to be very soft and result in a lower-returns environment—you’ll see distressed assets on the market. However, currently no one wants to dispose of assets for lower than book value due to the uncertainty.”

While market fundamentals have weakened, the investment market remained reasonably strong as of the beginning of November 2020. The transparency, stability, and depth of Sydney and Melbourne office assets have long made them favourites of international investors. In the current environment, that appeal is strengthened both by their status as a safe haven and the availability of long leases (i.e., 10 to 15 years) that provide a measure of income security.

According to a local developer, banks have held back from foreclosures in 2020, but for new borrowing “we can see there are more restrictions—lending from Australian banks is getting harder and more expensive, so we continue to favour foreign capital and debt.” At the same time, said one investor, “Interest rates are now lower than pretty much they’ve ever been, and if that’s assumed to continue longer term, which it might well be, then there’s probably even an argument for cap rate compression.”

Despite some softening of prices, investors remained positive. In the words of one Sydney-based fund manager: “If you were to put a well-let office tower on the market today, I think the offshore demand for Aussie office, irrespective that sublease vacancy is going up, will still be pretty strong, so you’re probably looking at a cap rate somewhere between 4.75 and 5 percent. Investors will be comfortable accepting a lower total return by virtue of the fact that rental growth is going to be lower, but I still think they see this market on a relative basis pretty favourably.”

The problem currently is the lack of sales. This is partly to do with the bid/ask spread on pricing, and partly a reflection

of Australia’s very popularity among foreign investors. As a proportion of the whole, international buyers have always been more active in Australia than in other parts of the Asia Pacific, and with travel restrictions now preventing non-Australians from entering the country, their absence has compounded a slowdown in activity by domestic players. Transaction volumes in the first three quarters of 2020 were just A\$15 billion, down 46 percent year-on-year, according to CBRE. As one local fund manager said, “I think border closures will probably be the biggest brake on markets here for the foreseeable future, because we do rely on that offshore capital.”

The retail sector is predictably depressed, with one investor citing a 15 percent reduction in asset valuations. The impact is worst in CBD areas previously seen as “bulletproof.”

On the residential side, meanwhile, the pandemic has sparked a renewed slump that is expected to accelerate as buying from both immigrant and international (especially Chinese) sources grinds to a halt. This will continue to dampen investor activity, especially in inner-city areas. In particular, the student accommodation subsector, which has emerged rapidly as an institutional asset class in Australia, has been hard hit by class suspensions and by the absence of foreign students still unable to enter the country.

Better news was provided by the logistics sector, which saw strong momentum in Australia as it did elsewhere in the Asia Pacific, with transactions in the first nine months of 2020 roughly the same as the same period in 2019 at around A\$4.7 billion.

Going forward, build-to-rent residential promises to become a trending asset class in Australia, driven by changes to planning and taxation rules, more people looking to rent rather than buy, and its popularity among investment funds that see it as a defensive play.

At the same time, regional destinations have seen a surge in both values and

rental activity from residents fleeing to the countryside from major cities. Vacancies in inner-city districts of Sydney and Melbourne more than tripled to 12.9 percent and 11.1 percent respectively between March and October 2020, according to analysts SQM Research, while simultaneously tightening to less than 1 percent in many regional destinations. Although interviewees were

in general sceptical that Asia Pacific cities would embrace the remote-working trend, Australia may yet prove an exception, especially given the high cost of housing in downtown areas of major cities.

Counterintuitive Bets

While a growing sense of pessimism was evident among investors as of early November 2020, opinions on any given geography or asset class often varied widely by location. This points to potential for arbitraging negative sentiment through contrarian bets. In particular:

- Hotel prospects may appear bleak as banks begin flushing thinly capitalised operators onto the market. Increasing demand from domestic travellers, however, has created some light amidst the gloom. Hotels are also being eyed as potential candidates for reuse, in particular in the form of multifamily residences. Underwriting models will have to change, but at a certain pricing level there are plenty of options for repositioning (see chapter 3 for more on the hotel sector).
- Investors remain gun-shy of office as an asset class because the current crisis has thrown into question how demand for conventional space will be affected once the pandemic dust has settled. The majority of interviewees, however, sees both the work-from-home and decentralisation trends as less applicable in Asia than in the West, so to the extent that buyers are now holding back, there may be better prices or at least less competition for assets. In particular, while long office leases are not always common in Asia (with the exception of Australia), offices do generally provide a greater measure

of comfort in that respect than other asset classes.

- Retail assets were generally seen as toxic due to looming oversupply in the wake of the boom in online retailing. As one investor complained, “Retail is a four-letter word.” And another: The minute you mention retail, everyone just turns off and loses interest.” Sentiment is especially negative for bigger malls in core markets. Gross retail sales in Hong Kong, for example, were down around 50 percent on their 2018 peak in October 2020, and with some traditionally high-spending Mainland Chinese customers unlikely to return, consolidation seems imminent.

Retail in Singapore may also be in the firing line. In the words of one regional analyst, “You do feel that Singapore’s suburban shopping centres trading at a cap rate of 5, historically 4, doesn’t make any sense.”

Opinions about retail were far from uniformly negative, though. According to one Chinese-based fund manager: “For us it’s been a contrarian bet, and the reason we continue to be active in this space is that by and large investors are pricing retail like it’s an average asset class, whereas in our experience it really is not, it’s entirely reliant on the specifics of the property. Is it well designed? Do you have good lines of sight? Is there a strong primary community catchment? Does it have good public transit connectivity? So if

we have the opportunity to buy a high-quality or undermanaged property that can be operationally effective at what is a current average price for retail at the moment, that can be a pretty compelling opportunity.”

In Hong Kong, for example, one developer pointed out that performance varied widely according to segment, and with demand for both luxuries and mass-market necessities holding up well, the pain has been felt more in the mid-market space. In general, he said, facilities aimed at locals rather than tourists are more likely to prove resilient.

Another segment experiencing positive fundamentals is the nondiscretionary space. This applies especially to smaller facilities in suburban locations featuring good transport linkages and strong residential catchments. One broker commented: “We’re seeing a lot of liquidity there—supermarket anchored, anything that has liquor stores, chemists, news agents, things people need on a daily basis. People are selling in Australia, but we have plenty of eyes on that stuff and there are no price declines. But as soon as you get into the bigger stuff, B-mall rent collections have been terrible.”

In China, meanwhile, “there’s probably overcapacity, but you can still go and build a big mall and feel confident if you do it correctly, because the consumer base is so high.” Rising incomes and

relatively low penetration of retail facilities suggest there will continue to be scope in that market for well-positioned assets. And with Chinese retail sales rising 3.3 percent year-on-year in September 2020, according to official figures, a rapid economic rebound has cushioned the impact of any pandemic-related falloff in demand.

Picking and choosing between different subsectors and locations is therefore key. Indeed, the very fact that opinions on retail are so bearish has only encouraged a contrarian stance. In the words of one Sydney-based fund manager, “This is probably the biggest opportunity over the next 24 months. Everyone is scared stiff of the sector and has lumped it in as one generic asset class, which is absolutely not the case. It’s been priced to perfection for decades, but I think it’s probably going to deliver some interesting opportunities over the next couple of years.”

Finally, no matter how bleak the outlook, even unviable facilities can be turned around if values drop enough. As an investor in Singapore observed: “Everything is attractive to buy and sell at the right price, so if prices are distressed enough it could be interesting because there’s then a play for repositioning, for adaptive reuse—there’s still a need for physical retail, it’s just how you use the asset.”

Urban Regeneration Booms in China

Strong growth in urban centres across Asia is creating acute shortages of inner-city land as well as large numbers of sites that are either run down or for which current use is no longer appropriate. As a result, city governments are looking increasingly to urban regeneration as a means to create developable inner-city land.

While models used vary widely from market to market, the most active proponent of this approach is undoubtedly China, where urban redevelopment has emerged as a major source of new land supply for domestic developers.

The catalyst for the recent surge in Chinese regeneration projects has been initiatives at the local government level, beginning around 2016, to streamline regulations, approvals, and land conversion processes. Detailed rules have formalised and simplified administrative processes, creating certainty over everything from plot ratios, to land use rights conversion, to land premium calculations. In areas where land shortages are especially severe, authorities continue to streamline and delegate procedures so that new projects can be brought to market faster.

Guangdong Province—and in particular areas around Shenzhen—has seen the most regeneration activity. It has long been the favoured location for national pilot programmes and is anyway so heavily developed that land supply is especially stressed. According to official figures, some 534 million square metres of regenerated land has been created in the province since 2009, amounting to 9 percent of its built area.

With local governments actively driving the process, selected sites tend to fit a particular profile, usually involving either a village or one of the many disused factory sites left over from Shenzhen’s heyday as a manufacturing centre. They are often conceived as transport-oriented developments due to the huge amounts invested in local infrastructure. Affected residents rarely oppose them because of generous compensation packages.

While most sites are developed for residential purposes, they generally also come with a mixed-use component. In addition, planning guidelines invariably set out a baseline level of environmental, social, and governance (ESG) compliance requiring, among other things, that around 8 to 12 percent of gross floor area (GFA)

be built as affordable housing and handed back to the government.

For developers, apart from the better access it provides to land, the main appeal lies in much lower land acquisition costs. According to a local developer active in the sector, land prices for such projects in Shenzhen currently average about Rmb14,000 to Rmb15,000 per square metre, compared with a cost of Rmb40,000 to Rmb50,000 for land bought at conventional land auctions. At that level, developers can generate gross profits of 40 to 50 percent, significantly higher than the 20 to 25 percent available for conventional projects.

At the same time, risks are commensurately higher. Timelines are longer and less certain because negotiations with local residents over relocation and compensation create a potential bottleneck that is hard to quantify given the uncertainty of the bargaining process. Long average development cycles also mean that capital is recycled slowly.

While urban regeneration is now a theme that has been taken up across China, investment prospects vary widely by location. Historically, Shenzhen has been a challenging market for foreign investors to place capital, but it has the advantage of more transparent processes and a wider availability of redevelopment options. In addition, as the fulcrum of the Greater Bay Area Development Plan, Shenzhen now has central government backing, which means that infrastructure investment and a variety of investment incentives will continue to facilitate capital flows.

As the developer said: “Location matters a lot. Guangzhou and Shanghai are quite different from Shenzhen, and the value of projects varies widely according to location. If it’s a place with very limited supply of land, prices will be higher, which means profits are lower.”

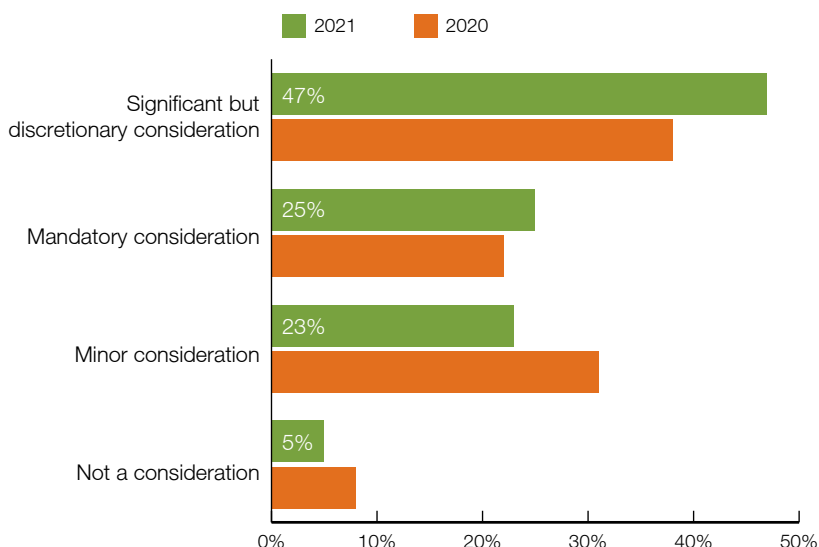
COVID-19 Boosts Environmental Agendas

Even before COVID-19 began boosting the profile of ESG issues, regional real estate industries had already come round to the idea that compliance was more than just a nod to social responsibility. In particular, landlords today increasingly understand that ESG often translates directly to corporate bottom lines because buildings failing to make the grade are likely to be less appealing to investors.

Based on the 2019 Global Real Estate Sustainability Benchmark (GRESB) survey, Australia and New Zealand are market leaders in regional ESG rankings, especially in terms of carbon emission reductions. Certified sustainability initiatives are now the norm in investment-grade office buildings. Large offices in Australia must by law disclose energy efficiency ratings, and over 1,800 buildings had been certified as of 2019. Japan, meanwhile, has almost 1,000 buildings certified under the local benchmark; South Korea has almost 15,000; and Singapore has some 3,000, or about 40 percent of current stock, with the government targeting certification of 80 percent of local buildings by 2030.

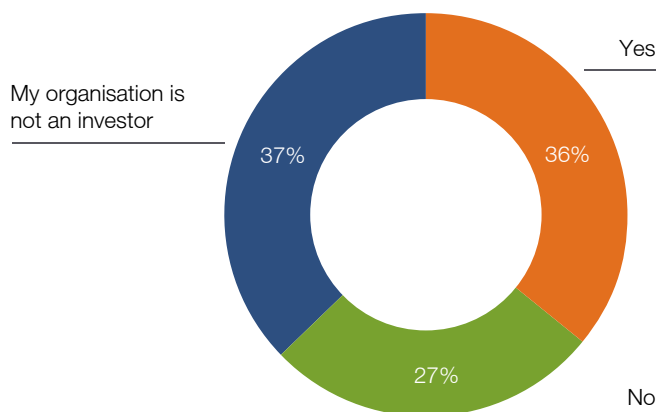
The main driver persuading landlords to adopt ESG features is that institutional funds—particularly those based in Europe—increasingly have mandates only to buy assets (or to place capital with funds that buy assets) that meet certain ESG standards. As one interviewee said: “It’s the same discussion about measuring the uplifts in rent by making buildings green. In the long term we may be able to measure it in terms of the bottom line, but short-to-medium term it’s better to say you can’t afford not to, because if you don’t, these are the potential implications in terms of the value of your property, in terms of reputation, and in terms of the reaction of the market, be it as a tenant or as an investor. Initially, valuers are going to start by making the odd remark in their valuation, but before long I think they’re going to reflect this in the values themselves. And that brings it home in a major way.”

Exhibit 1-15 Role of ESG Factors in Investment Decisions



Source: Emerging Trends in Real Estate Asia Pacific 2021 survey.

Exhibit 1-16 Does Your Organisation Require That Assets in Which It Invests Comply with Certain Baseline ESG Criteria?



Source: Emerging Trends in Real Estate Asia Pacific 2021 survey.

New standards such as the Task Force on Climate-related Financial Disclosures (TCFD) are starting to codify how corporate balance sheets should record the impacts that climate change is likely to have on asset valuations.

That said, ESG tends to affect a small percentage of assets around the top of the market whose owners have expectations of selling to an international investor, or possibly where building tenants are likely to prize ESG features. For the majority of assets, compliance is therefore a luxury

rather than a necessity. As one fund manager said: “We don’t do it on all [our buildings], to be honest. We do bear in mind who the ultimate buyers might be, and if it’s an asset, or a market where we think it’s more likely to be a local buyer than an international buyer, we would be less inclined to spend what is frequently quite a lot more money just to get a LEED Gold [certification]. Because anyway, a lot of the stuff, annoyingly, that you have to do to get a LEED Gold just makes no sense at all—spending, say, half a million extra on really sophisticated ventilation systems when the building windows can open.”

Perhaps in recognition of the sometimes-exclusive nature of the ESG club, there is now a shift towards greater collaboration among owners of buildings located in the same area to pursue ESG upgrades as a group exercise. According to an industry consultant in Hong Kong, “There is a serious discussion now going on across the private sector about how to come together and do something on a neighbourhood basis. So different owners are talking within a neighbourhood about what should happen, and discussions are going on with city planners and leaders about the need for public and private sectors to work together on outcomes. Several clients I’m involved with envisage taking the lead and running pilots to demonstrate the value of what they believe in, and then taking it to the government and suggesting it be done on a bigger scale.”

Because requirements of ESG mandates vary from one limited partner (LP) to another, no single standard exists to use as a yardstick. In general, though, according to one investor who handles ESG matters for a large family of investment funds, GRESB is becoming popular because “it allows [LPs] to evaluate us easily. Generally, a lot of institutional investors want to make sure that what you have in your other funds has good GRESB scores; and if you do, it gives them confidence that they don’t have to necessarily read through all of our details and make a close analysis of every issue, because that would be a lot of work for them.” Probably about 80

percent of LPs with ESG mandates fall into this category, though a minority will have stricter compliance requirements.

While GRESB is arguably the de facto yardstick of ESG compliance, a newer (and more exacting) standard relating to climate change is now appearing. CDP (formerly known as the Carbon Disclosure Project) is a standard relating to companies’ net-zero-carbon strategies. According to the same ESG investor, “Historically, we would get general questions from investors about our climate change programme, but it’s starting to get a bit more detailed, so my prediction is that next year and the year after, the net-zero-carbon type of questions will be more fast and furious and you’ll have to have some kind of long-term programme to reduce carbon, whether it’s net zero or something else. The net-zero-carbon goal of 2050 that everyone is now talking about—how do you fit in that area? Are you committed to that?”

In practical terms, meeting CDP requirements involves creating a pathway to show how a building will get to net-zero carbon emissions. This will usually involve, as a starting point, ensuring that the building skin and internal equipment are energy efficient. After that, “you have to do two things: periodic deep retrofits to give you real energy savings by upgrading major systems in your buildings. And then, over a 10- or 15-year period, you’re going to have to start getting into changing out facades, changing out HVAC [heating, ventilation, and air conditioning] systems, and putting in super-efficient equipment.”

Owners will also probably have to invest in renewable energy resources, either on site if the building structure allows it, or by tapping off-site resources that feed into the building. Finally, the last 10 or 20 percent of savings will probably be realised by buying carbon offsets.

There is still no clarity as to whether meeting CDP’s rigorous net-zero-carbon standards will become mainstream, but given the expense involved, “I think it will be driven by whether regulators start to require it. Most countries have signed

the Paris Agreement, under which many have committed to achieve zero carbon emissions by 2050, and if governments start to factor those commitments into regulations, then yes, net zero will become very real. But if governments are not mandating it—and there will be a lot of people who say it’s all too hard—then people will start to fall away. So, it has to be a combination of government regulations and the market driving this to keep it on track.”

In the meantime, the lower threshold set by ESG investors continues to be the benchmark. While lack of standardisation in ESG reporting and assessments has long been problematic, a new benchmark recently created by the European Union (known as the “Taxonomy Regulation”) was introduced in 2020. It sets out to define what criteria buildings must feature to qualify as “green” for the purposes of assets purchased by European investment funds. Since funds in Europe tend to be at the vanguard of ESG investing, it is likely to become increasingly influential in the Asia Pacific and elsewhere.

“My prediction is that next year and the year after, the net-zero-carbon type of questions will be more fast and furious and you’ll have to have some kind of long-term programme to reduce carbon, whether it’s net zero or something else.”

China: Key Themes

China's economy has seen a remarkable rebound following its successful containment of the coronavirus, with gross domestic product (GDP) growth registering 4.9 percent in the third quarter of 2020, according to official figures. Policy easing measures introduced to offset the impact of the pandemic have now been withdrawn, as rising leverage and a nationwide homebuying rush pushed up average residential prices 4.6 percent year-on-year in September.

A similar story applies in terms of investment. While the dollar value of deals was down some 25 percent in the first nine months of 2020, the drop in other Asia Pacific markets has been steeper. Deal count, meanwhile, has consistently tracked above last year's figures, according to RCA.

Although the strength of the domestic economy means there is little prospect of traditional bank-driven distress in China, there is still the prospect of pressured sales caused by the government's ongoing macro-economic reform initiatives. As one foreign fund manager observed, "It's not true distress, but a reflection of the fact that we're seeing less bank financing and less availability of new opportunities, and as a result developers are turning back to their balance sheets looking to sell assets."

A Shanghai-based developer also noted the opportunity for large developers to profit: "The epidemic and the implementation of new [government] policies have accelerated the marginalisation of small- and medium-sized [developers], so I believe there will be many opportunities for distressed assets next year."

Ongoing trade tensions between China and the United States have raised concerns in some quarters that international investors might shy away from China deals. In reality, however,

there seems to have been little change in foreign investor sentiment. There is a variety of reasons for this, ranging from the need for institutional funds to diversify portfolios, to the appeal of strong ongoing growth in domestic demand, to the fact that the Chinese economy is one of few major markets that continues to function normally, allowing investors with boots on the ground to continue business.

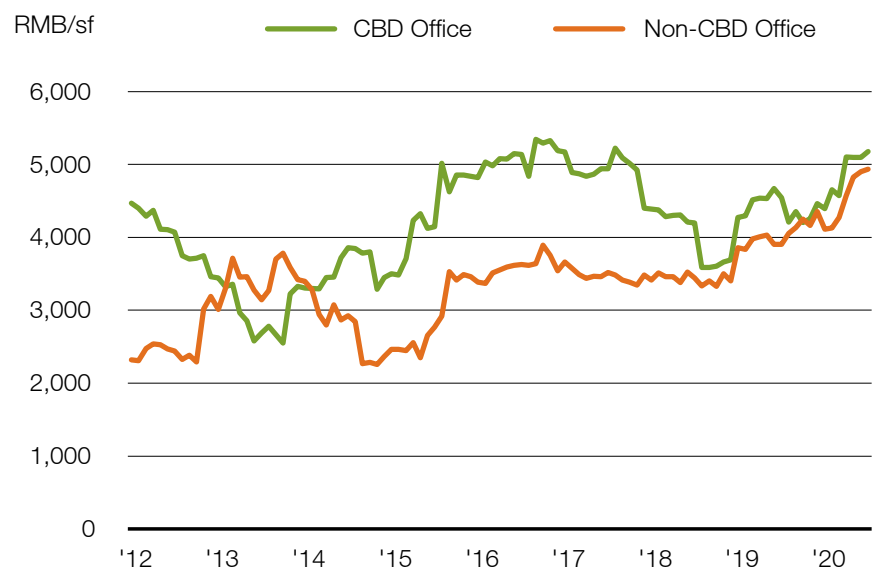
According to one interviewee, "Some of the U.S. funds are more cautious, but what we see is that local investors have taken advantage of the inability of offshore funds to do due diligence, so most of the trade has been domestic, and if you track what's happening you find that [the big domestic players] have been buying assets they would probably have had to compete with the international market for, and probably would not have won the day. Some have local teams that have

managed to stay active, but most foreign investors I talk to are frustrated they cannot get into China to crank up their portfolios."

Prospects differ by asset class. While some interviewees pointed to logistics and data centres in China as areas suffering ongoing structural undersupply, the fundamentals of more traditional plays such as office and retail are less obvious.

Following a surge of new building stock, vacancy rates in CBD offices in Beijing, Shanghai, and Shenzhen stood at 17.7 percent, 20.4 percent, and 20.1 percent respectively at the end of September 2020, according to CBRE. However, while rents have fallen, capital values remain surprisingly strong, with cap rates hovering between 3.5 and 4.5 percent in the Shanghai CBD, according to one locally based fund manager.

Office Pricing for China Tier-1 Cities (RMB/sq ft) (1H 2020)



Source: Real Capital Analytics.

Note: Tier 1 cities comprise Beijing, Shanghai, Shenzhen, and Guangzhou.

“Pricing has remained relatively stable,” he said, “but transactions taking place over the next six to 12 months will reflect the fact that there is a reason for that transaction to take place, so it will be hard to extrapolate a long-term trend because all of them will be situationally dependent. But beyond that, we expect to see pretty strong and steady pricing as economic fundamentals improve.”

The retail sector, meanwhile, has evolved rapidly in China. With online sales

representing a higher proportion (about 24 percent) than in any major economy in the world, the threat to brick-and-mortar outlets might appear existential. Once again, though, on-the-ground experience has proved otherwise. Over the last few years, conventional retail malls have rapidly diversified along omnichannel and experiential lines. Asset values, meanwhile, have remained buoyant post-COVID, especially given the rebound in consumer sales.

As one investor said: “The one thing China has going for it is that integration with the online experience has already been well underway from a retail operations perspective—retailers have seamlessly merged their online to offline activities and found ways to draw online consumers into bricks-and-mortar locations to spend more, creating experiences that cannot be replicated online. It’s one of the things that ensure that the retail market outlook here in China will be vastly different than in some other places around the world.”

Adaptability Now Key

While investors are spending a lot of time thinking about how assets will change from a value perspective, there is also a growing realisation—once again in the context of the pandemic as a catalyst—that the functional characteristics of buildings will have to change, too. This is because buildings that do not move with the rapidly changing times (be it in terms of ESG compliance, health and wellness, or cost-effectiveness) will ultimately lose market value.

According to a consultant advising developers about future uses, “I think a lot of our buildings are no longer fit for our new purposes. In time, you’re probably going to have to gut and then convert them to general-purpose space, with all kinds of uses springing up within a single envelope. We’ve been very strict in our thinking historically about saying, ‘This is residential, this is office, this is retail,’ and we tend to build our buildings in slices or slabs of category. But I think we are going to be looking at a more mixed model in terms of uses going forward; every space will be designed with a general-purpose concept in mind so it can be used as office, retail, or even residential.”

For a start, this will mean a reassessment of planning regimes to address the current prescriptive approach that dictates how

space must be used from a design perspective. In addition, the desire for more flexible use of space within the envelope—allowing parts of the building potentially to be dismantled, recalibrated, or moved to other locations—implies greater use of prefabrication. As a result, “in addition to this general-purpose concept of use within the envelope, more thought is being given to the life you ascribe to a building, including potentially the idea of shifting more value to land, and asking whether we have prescribed too much value to the building on it in the past.”

While this approach remains for now conceptual, owners may be encouraged to be more proactive once they are overtaken by events. As a result, in the words of one interviewee, “I think the catalyst will be the realisation that life has changed from a value perspective. Values are little changed so far, but come December my sense is that any responsible major property company is going to say, ‘Come on, it will be painful, but we need to bite the bullet and accept we can’t sell these assets at levels they’ve been valued at in the past,’ at which point it’s more likely they will be more willing to repurpose. You’re going to say, ‘O.K., it’s now worth 25 percent less, but what can I do to recover 10 percent of that?’”

“We need to bite the bullet and accept we can’t sell these assets at levels they’ve been valued at in the past. You’re going to say, ‘O.K., it’s now worth 25 percent less, but what can I do to recover 10 percent of that?’”

Master Planning Lags

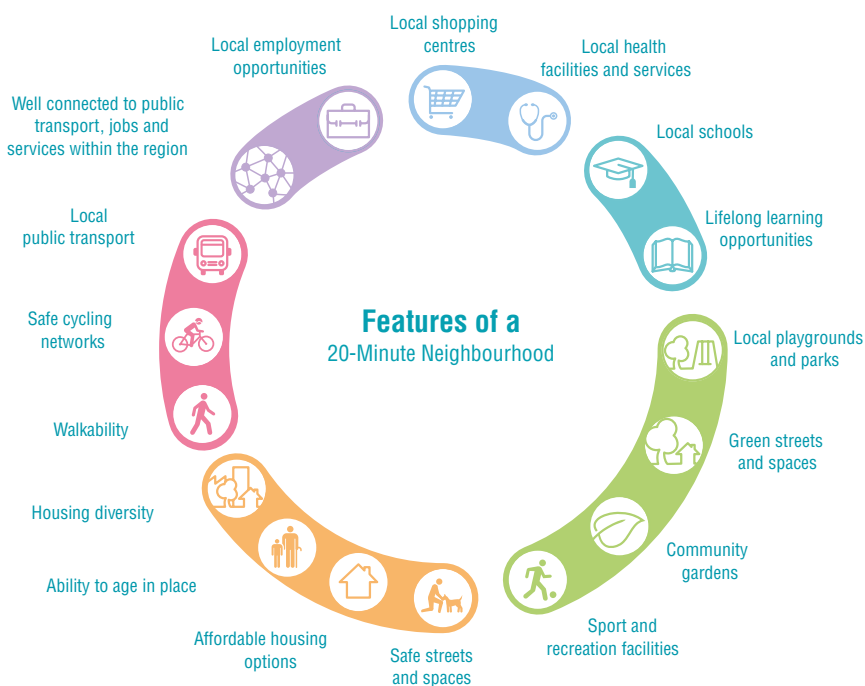
Assuming that the pandemic serves to jump-start a new approach to building design and construction, the same should logically also apply to the process of master planning.

To date, though, there is little sign of Asia Pacific governments moving to embrace the concept of overarching reform to planning guidelines other than through short-term social-distancing or health-protection measures. According to one regionally focused planner, “Cities across Europe and North America have taken 2020 as an opportunity for change, particularly in [terms of] transport and taking streets back from cars, but in Asia [they] have done nothing of the sort. Maybe the conclusion is that COVID isn’t changing anything in places such as China, Hong Kong, Vietnam, and Singapore, simply because they have contained it, and therefore why change?”

That said, recent years have seen incremental changes in the way the built environment is used in the Asia Pacific that may, again, provide a framework within which the pandemic could act as catalyst. Singapore’s recent Land Transport Master Plan 2040, for example, is based on the premise of shaping the city and its transport systems to achieve 20-minute towns within a 45-minute city, providing residents with access to a comprehensive mix of daily-need uses within local catchment areas.

The same concept is being pursued in Australia. According to one locally based planner, the state government of Victoria recently announced a push to establish similar 20-minute neighbourhoods. “It’s not really enshrined in policy or regulation yet,” said the planner, “but there’s certainly a lot of noise, and I think COVID will now provide more ammunition to governments who want to try to bed this down in order to deal with the climate issues and resource management and everything that existed before. Never let a good crisis go to waste—they are going to use this to satisfy a bunch of things that have been building for decades.”

Exhibit 1-17 Features of a 20-Minute Neighbourhood



Source: Victoria State Government.

Apart from that, many cities in Asia had already embarked, pre-COVID, on a process of decentralisation, with business occupiers moving at least some functions out of CBDs and into secondary business districts. While the idea that the post-COVID work-from-home trend would drive demand for these and other satellite business districts proved a polarising topic among interviewees, it seems likely that growth of secondary hubs will continue, if only because business occupiers are increasingly cost conscious.

Another catalyst likely to drive this trend will be growing uptake in Asia Pacific regions of the types of business clusters now commonly found in large urban centres in the West, usually focused on technology companies.

To a certain extent, this shift towards cluster-based decentralisation has already taken root in the Asia Pacific, in particular in cities such as Shenzhen and Bangalore, and more recently in Beijing. But as local tech industries continue to expand, the shift towards industry clusters is likely to expand with them. As one analyst observed: “In the past 10 years, demand [for space] has been driven by financial and tech companies. In the future, while those will still be important, I feel we are going to see more distinct life science clusters forming. And life science is not going to be CBD-based. Even tech isn’t going to be CBD anymore, it will decentralise, too. Once these new clusters are making profits, we will see more service industries moving to where the money is—that’s the direction over the next 10 years.”

A final factor that encourages the breakdown of traditional land use methodology in favour of either satellite-based clusters or multiple city cores is that many cities around the Asia Pacific have become too big to commute. As a result, workers who are needed to staff what are often well-designed new city-centre business districts in cities such as Manila and Jakarta face two- to three-hour each-way commutes.

The response to this problem is coming from the private sector, which increasingly is looking to establish facilities nearer to where workers live. The Philippines is a good example of this, with moves afoot to establish new satellite cities, such as Clark, on the periphery of Manila, as a way to relieve the demographic stress.

In the words of one Manila-based planner, “I don’t think it’s a suburban model; it’s going to be polycentric because of the densities and numbers of people we’re talking about—a small cluster outside the main city of Manila is still 300,000 to 500,000 people, bigger than some downtowns in Australia/New Zealand. So, what we’re talking about is multiple cores instead of trying to drive everyone unsustainably to a single core once you reach 5 or 10 million people in a city. It’s a recognition that there is a human dimension to the ideal density. And it’s because of our unchanging physical size over eons of evolution that walkability defines that bubble.”



Chapter 2: Real Estate Capital Flows

“We are forecasting declines through 2021 and, if I’m honest, 2022—after that it’s a crystal ball, but the short answer is it’s going to get worse before it gets better.”

Beginning in 2018, the *Emerging Trends* survey results reflected a shift in preference among Asia Pacific investors away from high-growth emerging market destinations in favour of regional gateways. This flight-to-safety theme emerged as investors hedged their bets in anticipation of an upcoming cyclical peak. With markets now on the brink of a correction, that theme remains in place. Our 2021 Investment Prospect rankings are dominated by large, defensive markets with stable long-term outlooks: five of last year’s top six cities feature again in 2021’s top six.

While the continuation of a safety-first dynamic is hardly surprising in an economic context likely to involve deep and possibly prolonged recessions around the globe, it is noteworthy that average investment prospect scores earned by the 22 Asia Pacific cities included in our survey did not differ materially from those in last year’s report. As in the 2020 edition, therefore, the scores of eight cities register as “generally good,” one as “generally poor,” and the rest as “fair.” The only real difference in overall sentiment is that most of the last eight cities in the table—located mainly in emerging-market economies—have significantly lower scores than the equivalent group from last year.

These relatively high scores may be difficult to explain in occupational terms for assets likely to deliver lower rents and values. However, they probably result from a combination of factors:

- The effectiveness of regionwide containment measures means that economic downturns are expected to be less severe than they might be.
- The distress likely to emerge as economies slow should provide more profitable investment opportunities, even as existing portfolios decline in value.

- A wave of asset repurposing due to the accelerated rate of secular change noted in the previous chapter will create large numbers and new types of investment opportunities—a phenomenon not seen for five years or more.

Topping the rankings once again is Singapore. On the face of it, in terms of its size, liquidity, and economic maturity, Singapore does not fit easily alongside Tokyo, Sydney, or Melbourne, which are generally regarded as the more established Asia Pacific gateways. But despite weakening rents and a full pipeline of supply for the next two years, Singapore offers qualities the others do not.

Exhibit 2-1 City Investment Prospects, 2021

	<div><div></div> Generally poor</div>	<div><div></div> Fair</div>	<div><div></div> Generally good</div>
1	Singapore		6.24
2	Tokyo		6.04
3	Sydney		6.00
4	Seoul		5.72
5	Ho Chi Minh City		5.66
6	Melbourne		5.58
7	Shanghai		5.55
8	Osaka		5.54
9	Shenzhen		5.51
10	Guangzhou		5.11
11	Taipei		5.06
12	Beijing		4.98
13	Auckland		4.93
14	Bangkok		4.83
15	Mumbai		4.82
16	Jakarta		4.67
17	China—second-tier cities		4.64
18	New Delhi		4.62
19	Manila		4.56
20	Kuala Lumpur		4.48
21	Bangalore		4.37
22	Hong Kong		4.18

Source: *Emerging Trends in Real Estate Asia Pacific 2021* survey.

First, it has cultivated a reputation for neutrality—the “Switzerland of Asia,” as one interviewee put it—that promises safe harbour in an increasingly hostile global environment. This has attracted a steady stream of investors and corporate occupiers. High-profile newcomers include major Chinese tech companies setting up regional headquarters (i.e., outside China). These companies may choose to list in Hong Kong but operate from offices in Southeast Asia, where they expect a majority of their new users to be located.

Less noticeable are various Chinese pension funds and insurance companies now actively scouting the local market with mandates “to buy good assets anywhere they see them,” as one local investor said. “They don’t care so much about the price, and softness in supply and demand doesn’t matter—to them, quality assets here are cheap.”

Otherwise, Singapore is hoping to receive more investment from global financial services and asset management firms that may opt to avoid current uncertainties in Hong Kong.

One city that rose steeply in this year’s investment prospects rankings (to number 4) is Seoul. Like Japan and China, South Korea enjoys the benefit of a deep domestic economy that allows assets to be bought or built with a view to serving domestic, rather than international demand, thereby reducing exposure to outwardly facing geopolitical risk. The strength of that approach is reflected in Seoul’s resilient fundamentals, with third quarter 2020 data showing strong leasing activity and rising rents. In addition, investment volumes rose a remarkable 71 percent year-on-year to a record quarterly high as domestic institutional buyers redirected capital earmarked for foreign purchasing back to homegrown assets. The sheer volume of institutional investment capital available in South Korea suggests there will always be a backstop to pricing in South Korean markets.

Although investors often see South Korea as a destination for core capital, it has long provided opportunities for value-add investors because the existence of various dislocations in the market means that the right types of assets are not always available where they are needed.

Meanwhile, an historic shortage of logistics facilities has made Seoul a fruitful source of deals for foreign investors, although that window may be closing. According to one foreign fund manager active in the city: “We’ve done a couple logistics deals there, but it’s hard to get scale because there’s a lot of stuff that’s been built—anyway we don’t think it’s affordable because the land is too expensive.”

Other notable trends in the survey rankings include the declining popularity of Indian cities. With the local industry subject to an ongoing solvency crisis that has choked off financing options for domestic developers, there is likely to be significant consolidation before the smoke has cleared. Other emerging markets such as Jakarta and the Philippines that featured near the top of the table not so many years ago have since been relegated to the bottom, dragged down by Southeast Asia’s reputation as a high-risk play in times of global retrenchment.

Exhibit 2-2 Historical Investment Prospect Rankings

	2021	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
Singapore	1	1	2	3	21	11	9	7	3	1	1
Tokyo	2	2	4	7	12	1	1	1	13	16	12
Sydney	3	4	3	1	9	2	4	5	4	3	6
Seoul	4	10	9	19	17	7	7	15	14	19	16
Ho Chi Minh City	5	3	7	5	4	5	13	19	18	10	11
Melbourne	6	5	1	2	16	3	5	13	10	7	9
Shanghai	7	7	6	4	6	9	6	2	2	2	2
Osaka	8	8	5	10	15	4	3	9	22	21	19
Shenzhen	9	6	8	6	5	18	19	10	16	—	—
Guangzhou	10	9	10	8	10	20	20	6	15	6	8
Taipei	11	14	21	22	22	17	18	16	9	8	13
Beijing	12	13	12	11	11	14	10	8	7	5	7
Auckland	13	19	20	9	14	10	15	17	17	20	18
Bangkok	14	11	11	16	8	19	16	11	6	14	17
Mumbai	15	12	13	12	2	13	11	22	20	15	3
Jakarta	16	18	15	14	7	6	2	3	1	11	14
China—second-tier cities	17	20	18	17	20	22	22	12	8	—	—
New Delhi	18	15	17	20	13	16	14	21	21	12	5
Manila	19	17	19	18	3	8	8	4	12	18	20
Kuala Lumpur	20	21	22	21	19	21	12	14	5	17	15
Bangalore	21	16	16	15	1	12	17	20	19	9	10
Hong Kong	22	22	14	13	18	15	21	18	11	13	4

Source: *Emerging Trends in Real Estate Asia Pacific 2021* survey.
Note: — = no data.

Hong Kong, meanwhile, remains rooted to the bottom of the table (although with a higher score than last year's 3.93) following two dismal years of social unrest and a COVID-induced recession. However, while foreign investors now consider Hong Kong a risky bet due to its sky-high property prices and globally focused economy, the view among local landlords and investors has recently turned more positive.

There are a number of reasons for this. In terms of business prospects, an expected surge in local stock listings due to a more stringent regulatory environment for Chinese companies in US capital markets should go some way to redress the economic malaise. In addition, there is a growing sense that additional support may be provided from both Mainland government and investor sources. In particular, buyers across the border may again be drawn to Hong Kong assets given increasingly difficult investment environments in the West.

Finally, while various parts of the local economy continue to suffer, the pain is not universal. According to one local developer, "You have to segment out different sectors in Hong Kong. As a hospitality and retail centre, there is certainly big pressure because tourism has fallen off a cliff. But as a commercial centre, I'm still optimistic. We have the highest office rents in the world, and they're holding, they haven't collapsed. Probably they're off 10 to 15 percent from what was a very high base. We also now seem to have an equilibrium domestically. And then the market in China seems to be back to business as usual—I know sales in our own shopping centres in China are booming, so I'm more positive than I've been in a long time."

In our Development Prospects rankings, lower scores all round reflect a more difficult environment for developers due to questionable demand during a nationwide recession. There are bright spots, however. Ho Chi Minh City is once again the sole emerging-market city in the top half of the table. Its prospects have

Exhibit 2-3 City Development Prospects, 2021

	Generally poor	Fair	Generally good
1	Singapore		5.72
2	Sydney		5.70
3	Tokyo		5.68
4	Ho Chi Minh City		5.65
5	Shenzhen		5.43
6	Melbourne		5.32
7	Seoul		5.31
8	Shanghai		5.30
9	Osaka		5.22
10	Guangzhou		5.09
11	Taipei		4.90
12	Beijing		4.75
13	Manila		4.72
14	Auckland		4.71
15	China—second-tier cities		4.71
16	Bangkok		4.69
17	Mumbai		4.64
18	Jakarta		4.61
19	Bangalore		4.57
20	New Delhi		4.51
21	Kuala Lumpur		4.47
22	Hong Kong		3.95

Source: *Emerging Trends in Real Estate Asia Pacific 2021* survey.

been boosted by apparently successful efforts to contain the pandemic, together with a rapidly growing economy that will only grow faster as supply chains seek new options outside China as a safeguard against escalating trade tensions.

Cross-Border Investment Dries Up

Regional deal flow has plunged in 2020, a casualty of ongoing travel bans and a standoff between buyers and sellers over asset pricing. In the third quarter, according to RCA, cross-border investment registered a steep 15.7 percent quarter-on-quarter decline, and was down 23.4 percent year-on-year. One result of wilting sales is that record amounts of dry powder held by Asia Pacific-focused closed-end funds have piled up on the

sidelines. The surplus amounted to about US\$51 billion as of the second quarter of 2020, according to CBRE, and has probably increased since then.

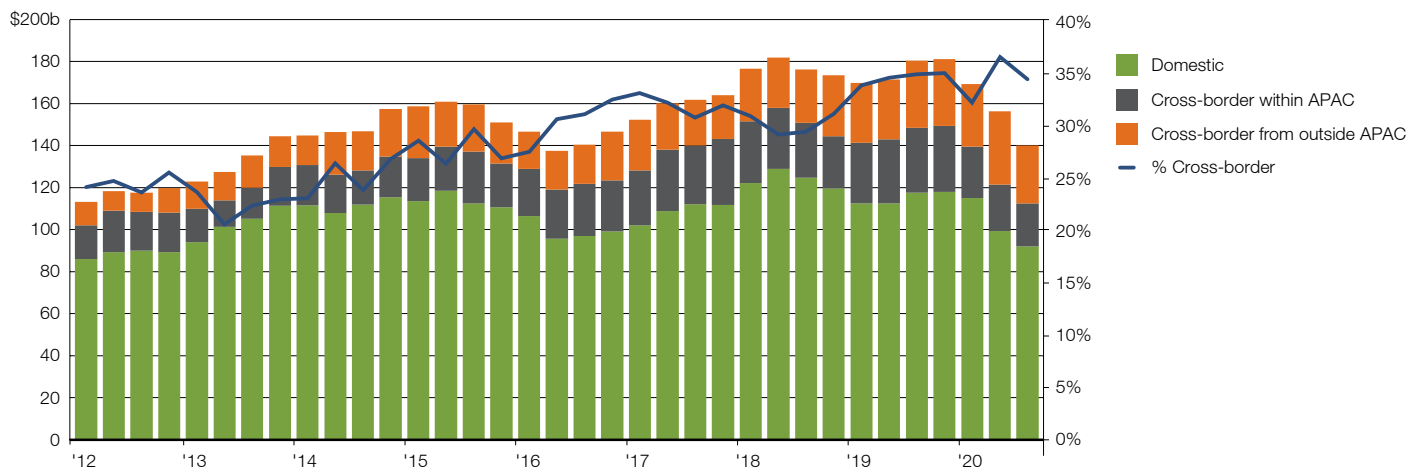
Much of this capital was directed to Japan (especially by U.S. funds), while China has also enjoyed significant inflows from both the United States and Singapore. Although high sales by foreign funds in China have turned cross-border flows negative on a net basis, strong purchasing activity by international capital is ample evidence that trade tensions are not slowing inbound real estate investment. China's robust economy—combined with increased demand for alternative finance resulting from a regulatory squeeze on domestic bank lending—has boosted opportunities for foreign buyers.

Flows to Australia have been limited due to border closures, although interest from international investors remains strong, with the possible exception of Chinese buyers (who spent 80 percent less year-on-year in the third quarter). Some local players suggested Chinese investors may not have the same enthusiasm for Australian assets as before.

Transactions originating from outside the Asia Pacific have so far held up better than cross-border deals from within the region, with the former down 12.5 percent, compared with 34 percent for the latter.

That divergence may not hold up over time, though, with some investors suggesting that certain types of Asian institutional capital that historically would have found their way to markets in the West may now be more likely to stay in the region. According to one Hong Kong-based fund manager: "We're seeing a lot more interest by Asian LPs in Asia. I think part of it pre-COVID was the view that developed markets were expensive. Now, I think they are concerned about pricing—it's going to be a big buying opportunity [in the West], but when? Then they are also saying, 'Hmm, the West doesn't seem to be handling the pandemic very well, so we will wait and see.' But they still have to deploy capital, so generally Asia is faring

Exhibit 2-4 Asia Pacific Investment by Source of Capital: 12-Month Rolling Volumes



Source: Real Capital Analytics.

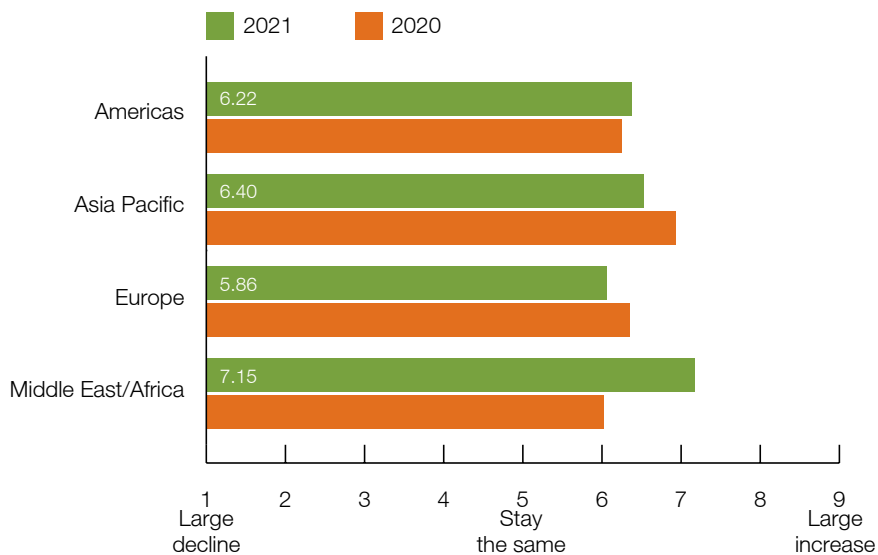
Note: Apartment, hotel, industrial, office, retail, and senior housing transactions included. Entity-level deals included. Development sites excluded.

better. They understand it because it's close to home, and while they can't do things like fly to New York and London, they can meet local teams here and do deals with people they know."

At the same time, the theme of portfolio diversification that has driven Western capital to the Asia Pacific over the last five years or so may slacken in a post-COVID world. According to an Asia-based manager at a global private-equity fund, "Over the last 12 months, there's been probably a divergence in terms of level of interest in Asia [among global investors] to more of a wait-and-see attitude. Because for a North American investor there's an element of risk aversion when things go south, and people just tend to just pull in their horns. Then you can add to that the amount of economic dislocation you now see in U.S. markets—there's going to be some really interesting opportunities emerging in the U.S. over the next six to 12 months, so probably a majority of our investors are now doing less in the Asia Pacific region than before."

Singapore remained the largest exporter of capital, with both government and REITs active. Outbound flows from South

Exhibit 2-5 Expected Change in Capital Flows into Asian Markets Over the Next Five Years



Source: *Emerging Trends in Real Estate Asia Pacific 2021* survey.

Korea, however, have plunged, registering just US\$1.38 billion in September 2020, compared with US\$11.7 billion 12 months before.

Chinese companies, meanwhile, are still exporting very little capital, at least officially, and continue also to liquidate international investments made in previous years, especially in the United States.

Banks Still Lending

In Australia, China, and Hong Kong, some banks have become more circumspect about fronting money for real estate transactions. By and large, however, finance is still freely available, even if banks have clear preferences for lending to some sectors (logistics) instead of others (retail, hotels) and are offering lower rates of leverage (a ceiling of around 60 percent). Otherwise, banks remain well capitalised and have kept interest rates low with the assistance of base rate cuts.

In Japan—the poster child for the Asia Pacific’s super-low bank lending rates—nonrecourse lending for non-Japanese borrowers is available for less than 100 basis points, much the same as last year. Survey responses indicate an expectation that debt across the Asia Pacific will remain freely available, although lending for development projects is likely to tighten.

According to one Singaporean fund manager: “Banks have increased spreads, but it’s counterbalanced by lower base rates, so overall financing costs have come down. For core, income-yielding assets, there’s pretty much no issue, but there’s certainly more caution for anything that is a bit more value-add or development oriented.”

In some cases, lending rules have actually eased. In Hong Kong, for example, authorities relaxed the leverage ceiling for commercial real estate loans to 50 percent from the previous 40 percent, hoping to ease pressure on local markets. According to one local fund manager: “I’m sure the banks have strict underwriting criteria, but we’re still getting offers for new deals and the pricing is reasonable, they haven’t jacked up the margins. But they’ve been through this before with SARS and the global financial crisis, and generally leverage isn’t excessive in Hong Kong anyway. So, on the whole, I’m not hearing of any defaults. I think some people will have seen their equity take a hit, but on the whole the banks are still onside.”

At the same time, with transaction volumes in the doldrums, the line outside lenders’ doors is not very long. According to an analyst in Australia, the federal government made an unwritten agreement with the banking sector to “not put the boot in” on real estate borrowers and to keep the lending wheels in motion until there was more clarity on the outlook. As a result, “banks hit the pause button. Some deals are being done, some developers are getting finance, and some nonbanks are doing loans, but again, in a world where activity generally is down about 30 to 50 percent from last year, a A\$150

million deal sounds like a lot, but in the overall scheme of things and a A\$280 billion [bank sector] book, it’s miniscule.”

Another point made by the analyst was that the willingness of the banking sector—not just in Australia, but also globally—to work with regulators in order to mitigate the economic impact of the crisis is something you “can never un-know,” and will likely change the shape, if not the function, of the banking sector in future: “It’s going to be interesting to see how that relationship goes forward in terms of working together in partnership to continue to create credit for the economy—but it promises to be very different to pre-COVID, when it was much more combative and us-and-them.”

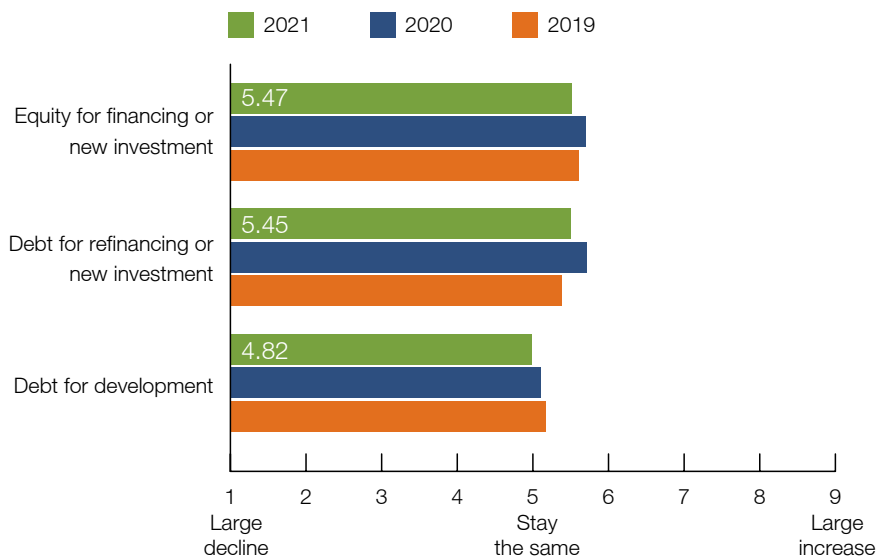
Of course, there is an element of self-preservation in banks opting not to enforce large numbers of loans that borrowers are currently unable to repay. But the implication is that this episode may convince lenders that a more cooperative approach may result in outcomes that are both socially and commercially beneficial.

Exhibit 2-6 Asia Pacific Typical Commercial Lending Terms (Up to 5-Year Swap)

Market	LTV (%)	Base reference rate	Spread (bps)	Financing cost (bps)
Australia	50–55%	5Y swap rate: 0.25%	150–180	200–230
China	50–60%	5Y loan prime rate: 4.65%	100–185	565–650
Japan	50–60%	5Y JPY swap rate + TL spread: 0.2%	60–80	80–100
Singapore	50–60%	3M swap rate: 0.15%	150–210	165–225
South Korea	50–60%	5Y KTB: 1.1%	150–180	260–290

Sources: DWS, Bloomberg. Base reference rates are obtained from Bloomberg.

Exhibit 2-7 Expected Change in Availability of Debt and Equity Finance



Source: *Emerging Trends in Real Estate Asia Pacific 2021 survey*.

Debt Funds Still in the Cold

As the credit environment deteriorates, growing demand for higher-risk capital should logically increase demand for nonbank debt. Indeed, survey results indicate an expectation of increased lending by debt funds. Several interviewees also suggested that their funds were actively considering debt offerings, either in distress situations or as bridging loans where banks are willing to offer sufficient leverage to close a deal.

In practice, however, debt funds in the Asia Pacific have not gained the same traction seen in Western markets. There are various problems, according to a regional debt specialist. The first is that the demand for highly leveraged deals, which were much sought after before the global financial crisis, no longer exists: “As a result of quantitative easing, there is so much money in the system from an equity perspective that you just don’t want 80 percent leverage. And even if you

could get it, because you’re borrowing off someone who looks like you and also has a pot of cash they want to put to work, why wouldn’t you just use your own money instead? So, the opportunity to be a debt fund and to earn comparative returns to your equity buddies becomes quite difficult.”

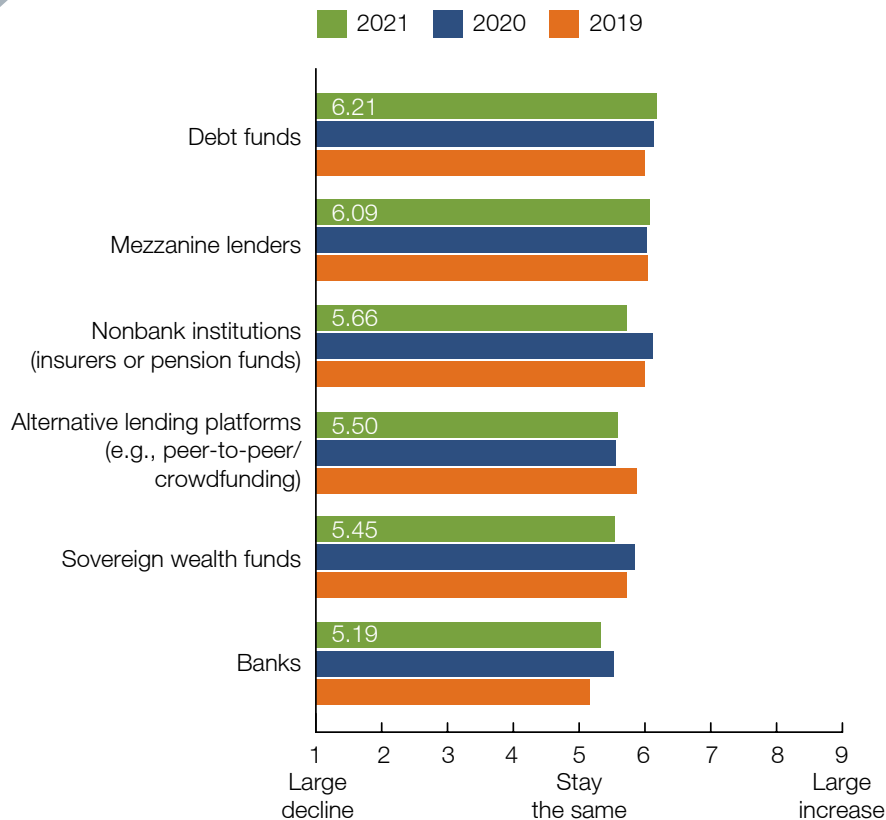
Another problem stems from the fact that the Asia Pacific—unlike the United States and the European Union—has so many different lending environments, monetary policies, and banking systems. “If you’re a nonbank fund coming in to do a really big pan-Asian fund, you have to have some serious backers in order to have—and offset—China exposure, Singapore exposure, and Australia exposure,” said the analyst. “Aside from that, from a regulatory point of view, lending into three different jurisdictions is incredibly problematic, particularly when the regulators in those markets would probably prefer to see some form of

protection for the local bank market, or to regulate banks, rather than nonbanks.”

That still leaves scope for debt funds to provide bridging finance. Again, however, the costs involved means that appetite has been low. “That may change if there’s consolidation,” said the analyst, “because M&A [merger and acquisition] typically throws up a lot more bridging opportunities and gets you across the line.”

One reason M&A deals may occur is in the event of distress—a scenario that may yet create demand for debt at the prices that funds want to charge. In India, for example, which so far has been the only significant market for distress in the Asia Pacific, some foreign funds have established locally based teams with this in mind, seeking opportunities to provide debt to residential projects left stranded by a meltdown in the local nonbank finance sector.

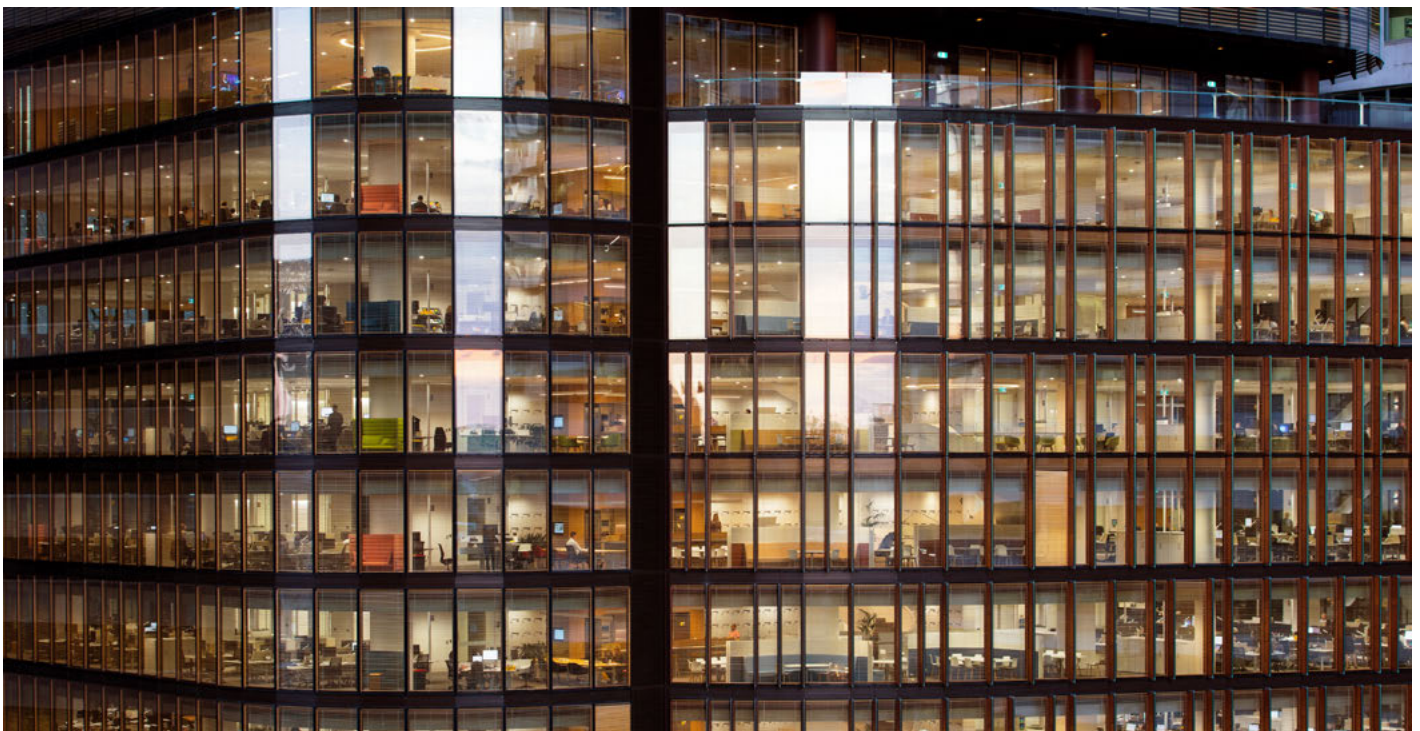
Exhibit 2-8 Availability of Debt by Type of Lender



Source: *Emerging Trends in Real Estate Asia Pacific 2021 survey*.

According to a Delhi-based consultant: “They are looking only at mid-market residential assets. And because no project today in India has enough juice to sustain a distress-debt return for a three-year period, the money these guys are bringing in can only look at the last-mile funding situation, or no more than a 12-month construction completion cycle, and then maybe another six to 12 months for the final sell-out and exit.” On that basis, senior-secured loans are providing lenders with 23 to 24 percent IRRs.

Another way to tap Indian distressed assets is via the portfolios of hard-pressed local housing finance companies, many of which are either insolvent or no longer functioning as going concerns after defaults by local developers. Tens of billions of dollars’ worth of loans are now available to be securitised, with investors buying portfolios at a discount, and receiving repayments and interest on a last-in, first-out basis.



No Roadshows, No Fundraising

Most interviewees suggested that raising capital for new funds currently is difficult, if not impossible, because travel restrictions are preventing investors from holding roadshows aimed at selling products to LPs. In Australia, for example, where foreign investors are particularly prominent and where the predominance of open-end funds means investors will usually want to inspect assets held in funds' portfolios, "unlisted funds—which represent a fair bit of institutional ownership in Australia—won't be active, because obviously if you can't go and do a capital raise, it makes it hard to buy anything unless you have a heap of dry powder on your balance sheet. And because it's really going to be the unlisted funds and the REITs participating until the offshore investors come back in the market, the capital markets are going to stay pretty thin."

Nonetheless, data from Preqin show that some US\$11.6 billion in capital was raised by Asia Pacific-focused closed-end funds in the first half of 2020, an amount comparable to 2019 and 2018 figures. Of this, US\$6.7 billion involved funds raised solely for logistics assets, most of which is targeted at China.

This suggests that capital raising may yet pick up, despite the difficulties with roadshows. According to one regional brokerage analyst: "There's a feeling that maybe the problem is short term and that actually [COVID] will drive investors back into funds because, again, they can't travel and they may also not have a capability on the ground. And that's because the opportunity is now, in the next 18 months, so you want to be putting money with people who can be taking advantage of that. Which means the big fund managers will just continue to grow, that single-sector, single-country funds will be a bit tough, and that first-time fund managers will be extremely tough. But certainly, the big guys will get more money on the basis that they'll be able to allocate it quickly into what are going to be attractive markets."

According to a manager at an opportunistic fund in the process of raising capital: "There are some things

about COVID that have made capital raising difficult, but I think people are going to managers they know well and trust, and doing bigger tickets. So, if we look at our fund composition-wise, we'll have a smaller number of investors than we originally would anticipate in a traditional fund raise, but we will end up with higher concentration. And the other thing we're seeing is massive amounts of co-investments and SMAs [separately managed accounts], in ratios of 2, 3, 4-to-1 stuff. People are saying, 'We'll back the fund, but here's another 400 [million] bucks in co-invest sidecar and SMAs.' So that piece of our business—and I'm not surprised at that—is also accelerating as a result of COVID."

Another factor helping to boost the amount of capital pointed towards real estate assets is that, with base rates set to remain low for an extended period, returns from fixed-income products are also going to remain vanishingly low, forcing investors into alternative asset classes as they seek out yield.

As one interviewee said: "It was already happening previously. Everyone was trying to increase their allocations and this will now give them greater motivation to do so. But at the same time, there's the denominator effect—people are guided by asset allocators and they'll be putting only a certain amount into real estate. And maybe that amount has now gone up, but at the same time they don't want real estate, from a diversification perspective, to be too big a part of their portfolio. So, if their equities portfolio has gone down, that will be an issue."

Investors Turn to Public Markets

With so much dry powder available, and with so many fund managers unable to travel to scope out potential deals, pressure is growing for investors to find other channels in which to deploy capital. The public markets are an obvious alternative, even for investors with no mandate to buy listed assets. During the stock market crash of March 2020,

some investment funds bought shares in prominent listed real estate companies whose share prices had been hammered. And while markets in the United States have since returned to their previous highs due to a tidal wave of quantitative easing, opportunities to buy mispriced equities on a selective basis remain.

According to one interviewee, "If [asset] valuations haven't been written down, why buy physical assets? There are some good REITs now with huge discounts. You could even potentially try to take over some of those with weaker sponsors, in particular in Japan, where there are lots of weaker REITs. I could slowly build my holdings at discounted prices; then, when the market is back to normal, take them private."

Buying either REITs or listed developers will require a hard look at valuations and forward revenues, but there are some huge divergences between net asset values (NAVs) for different types of REITs. "If you look at the NAVs, you can see logistics is trading at a 50 percent premium, which is ridiculous. And if you look at hotels, they are trading at a 60 percent discount. Retail is about the same, and office REITs are trading below NAV, too. So, I think there is value there because they are liquid. I do feel that NAVs are pretty much [elevated] as in the private market, but valuations probably won't make a huge move because so many REITs are sponsored by bigger corporates."

In Japan, according to a Tokyo-based fund manager: "If I had some passive money, I'd be buying office REITs of [the big Japanese developers] because those guys were trading at big discounts to NAV and there's no way the office market has dropped to the level they're trading [at]. They've come back lately, but they're still way down. Part of it is that they are going to lose some tenants, but because you've got a lot of foreign ownership with those large-cap REITs, they're looking at it differently—they [i.e., foreign owners] started to dump them when office markets around the world started to take heat over COVID, so that stuff came off."

Green Bonds and “Greenwashing”

As increasing numbers of institutional investors look to issue both loans and bonds for financing “green” projects, the volume of such green capital in circulation has made it an increasingly mainstream option. In 2019, Asia Pacific markets issued some US\$183.6 billion worth of green bonds (i.e., to all industries, not just real estate), up 29 percent on the year, according to analysts Climate Bond Initiative. While that places the region third behind Europe and North America, it was comfortably largest when measured by number of bond issues, with China and Japan responsible for the lion’s share of the market.

The impact of the pandemic has meant that the volume of green bond issuance in the region during the first half of 2020 dropped to well under half 2019 full-year levels (i.e., US\$12 billion, compared with US\$64 billion, respectively), largely due to the emergence of Chinese “pandemic” bonds in their place. However, there are still positive signs pointing to growing demand for green debt.

Meanwhile, there has been increasing discussion in the industry around the perennial green finance issue of whether projects raising capital are really green or are just “greenwashing,” or “badging” them, enabling undeserving projects to obtain money at preferential rates or terms. Verification systems have historically come up short, but the launch of two major initiatives in 2020 should help define the standards used to measure the extent to which projects have contributed to climate change mitigation or other environmentally worthy objectives.

The first is the E.U. Taxonomy, and the second is the People’s Bank of China’s [PBOC] revised “Green Bonds Endorsed Projects Catalogue” [PBOC Catalogue]. Because these two documents between them apply to markets that account for an estimated 34.7 percent of cumulative greenhouse gas emissions, they provide a critical mass of regulatory heft that will allow other governments to fall in

Exhibit 2-9 Green Bond Issuance by Region as of Year-End 2019

Region	Green bond markets	Issuers	Amount issued (US\$ billion)	Change 2018–19 (amount)
Europe	25	269	307.4	74% +
North America	2	167	190.4	46% +
Asia Pacific	18	345	183.6	29% +
Supranatural	–	11	79.4	9% +
Latin America	11	47	12.9	216% +
Africa	5	16	2.7	485% +

Source: Climate Bonds Initiative.

Exhibit 2-10 Green Bond Top 10 Issuer Domiciles as of Year-End 2019

Country	Issuers	No. of Deals	Amount issued (US\$ billion)	Change 2018–19 (amount)
United States	105	1,128	51.3	44% +
China	79	99	31.3	1% +
France	19	54	30.1	113% +
Germany	–	25	18.7	144% +
Netherlands	15	17	15.1	105% +
Sweden	40	106	10.3	66% +
Japan	47	66	7.2	73% +
Canada	14	17	7.0	63% +
Italy	10	11	6.8	128% +
Spain	11	17	6.5	3% +
Top 10 total	352	1,540	184.3	49% +
Top 10 %	69.6%	85.5%	71.2	-0.9% -

Source: Climate Bonds Initiative.

line along similar lines (especially with the Taxonomy). This should provide a measure of standardisation to how green credentials are assessed.

Specifically, the E.U. Taxonomy and its subsidiary rules, which will come into effect in 2021, establish an updated list of sustainability criteria for 70 different economic activities, as well as “Do No Significant Harm” thresholds relating to each of six environmental objectives set by the European Union:

- Climate change mitigation
- Climate change adaptation
- Water and marine resources
- Circular economy
- Pollution prevention and control
- Biodiversity and ecosystems.

In addition, the taxonomy requires borrowers to disclose the environmental performance of activities in which they invest, providing a framework for investors to assess the environmental impact of their holdings, potentially broken down by activity type.

China's PBOC Catalogue, meanwhile, applies to green bonds only. It updates an earlier catalogue dating from 2015 by tightening eligibility requirements to deny "green" status to some projects with questionable green attributes that has been allowed under the old rules. In addition, the new catalogue (which is still in draft form) takes significant steps to harmonise the Chinese regime with global standards, as well as with domestic standards that sometimes differed when defining the same subject matter. It also has a broader mandate than the E.U. Taxonomy (which focuses mainly on climate change), dealing also with resource efficiency/conservation and environmental improvement.

While different cross-jurisdictional approaches in defining what is green will continue to challenge the evolution of green finance, there is now real momentum in the alignment of standards on a global basis.

Meanwhile, the ever-increasing volume of green financing available on the market today is driving developers to adopt green features in order to obtain finance that would not otherwise be available to them. In China, for instance, developers must navigate a regulatory framework in which liquidity is managed by regulators tightening or loosening bank lending to the industry. With developers now subject to a liquidity squeeze, "we do see more developers coming out with green bonds and financing, targeting in particular international investors," said an executive at one local developer.

Another domestic developer, who issued an overseas green bond in mid-2020, said that pricing costs were 15 to 20 percent lower than for a conventional bond, although the main benefit is that the financing is available at all, rather than the interest payable.

So far, only a handful of green bonds have been issued by Chinese developers. The potential, however, is enormous, especially in view of the volume of green bonds issued in China by other industries, notably

for pollution-mitigation projects. "I've seen maybe four or five [real estate-related] green bonds or sustainable bonds, all issued this year," continued the executive. "But all the developers I know are now working on preparing their frameworks and getting second-party opinions from agencies, so next year there will be more of them. At the same time, the investor base is growing, which should help drive financing costs down."



Chapter 3: Property Type Outlook

“Space in the future will have to fall into the category of ‘general purpose’, which means it offers ultimate flexibility in what you do in them and how you use them.”

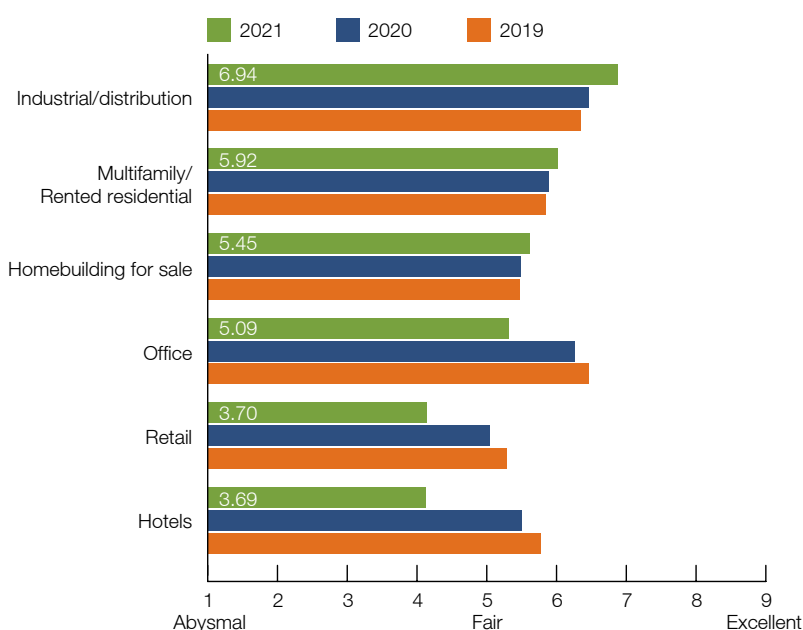
If COVID-19 has brought with it a wave of change in terms of the dynamics of real estate investment, its long-term impact in a more practical sense on the way buildings will be used and how different sectors of the real estate world evolve, will be no less profound.

As pointed out in chapter 1, many, if not most, of those changes were already in progress before COVID-19 arrived, and have now been accelerated, often exponentially, by virus-induced changes in behaviour. In that narrow sense, therefore, the impact of the pandemic has actually been positive. As one investor said: “We are in an industry that does things the old way, so when we were locked down everything stopped. Today, though, we have accelerated things that previously might have taken five years.”

To the extent that investors cannot yet project what changes are going to occur, or how fast the new-normal world will deliver them, the result has been to slow the flow of capital into assets until there is more clarity on likely outcomes. In the office sector, for example, one reason why Asia Pacific investment transactions are down so much (apart from a reluctance to lower prices) is a lack of consensus as to how much CBD space will be needed in a world of competing influences—social distancing requirements, the work-from-home trend, economic retrenchment, and the need for tenants to cut costs, among others.

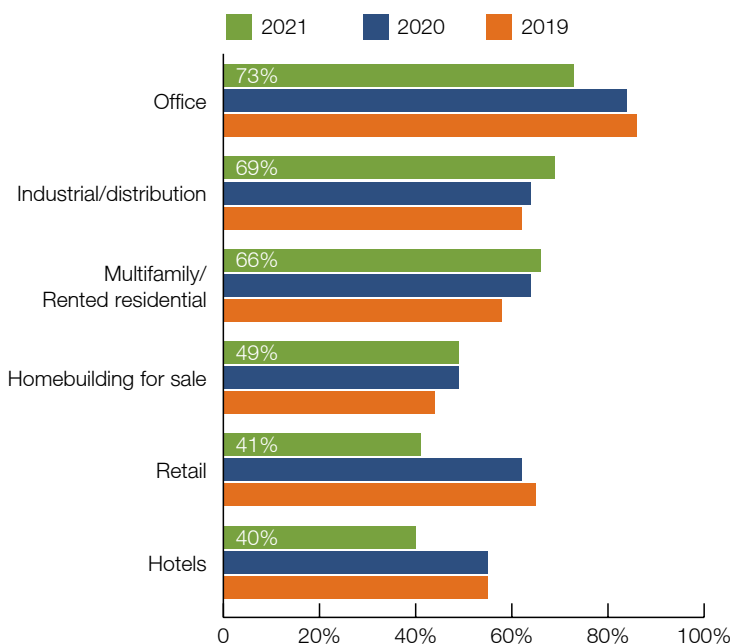
The same applies in principle to the retail and hospitality industries, although there is also a sense in those sectors that the need for change is often so pressing that owners are taking action sooner rather than later.

Exhibit 3-1 Prospects for Commercial Property Types in 2021



Source: *Emerging Trends in Real Estate Asia Pacific 2021 survey*.

Exhibit 3-2 Broad Sectors in Which Investors Are Now Active or Plan to Be Active in 2021



Source: *Emerging Trends in Real Estate Asia Pacific 2021 survey*.

Office

For most investors, office has been the go-to asset class for many years, and our 2021 survey responses (exhibit 3-2) confirm it remains so today, albeit at reduced levels of popularity and expected profitability.

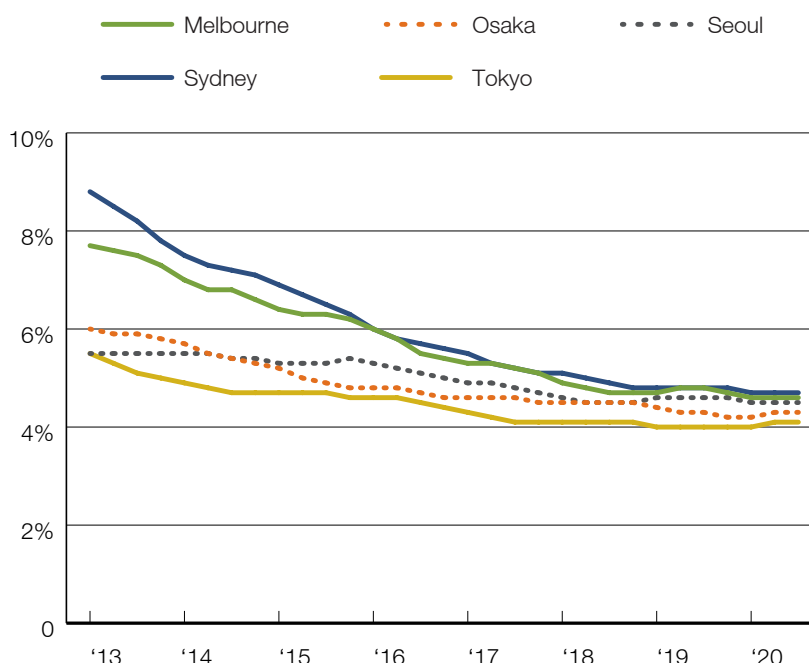
As noted earlier, during the final quarter of 2020, the big debate about the office sector is the extent to which occupier demand may fall in a post-COVID world. Certainly, in a handful of Asia Pacific cities where the impact of COVID-19 is currently minimal, there has been little sign of slowing demand. Taipei is one market where leasing activity remains solid. Chinese cities are also recording strong demand, although vacancy rates there have continued to rise in 2020 due to an overall surplus of supply

But with anecdotal evidence from interviews suggesting that many office tenants across the region are planning to reduce space requirements once their existing leases expire, any significant decline in tenant demand would create a double-whammy for landlords already watching vacant space and uncollected rents tick up.

In Singapore, for instance, an executive for a large design-oriented company said: “What we’ve done is vacate a whole floor—we just don’t need the space, because with people working from home, we’ve adjusted the way we are structuring teams, the way we are bringing people back to work, and how we function generally. So our office is becoming a very different place, and I know a lot of other groups are doing the same. We all have leases that come due next year, and a lot of that space will be given back.”

Japan, meanwhile, has a cultural bias towards collective working and office hierarchies that might suggest a reluctance to embrace a significant shift to working from home. As one foreign fund manager said: “Having lived and worked in Japan for well over 30 years, there is

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



Source: Real Capital Analytics.

certainly a cultural aspect of working within a group, and the ways that big Japanese corporates manage themselves and manage their teams, which I think tends to default to having everybody work in the office most days.”

In practice, however, remote working in Japan has quickly taken root, with many companies apparently planning to adopt it as a permanent strategy, at least partly as a cost-cutting measure. According to one locally based fund manager: “I had a conversation with [a major bank] a couple of weeks ago, and in their opinion, across the board in the service sector, approximately 20 percent of the workforce will be working from home almost 100 percent of the time. Large companies will transfer that 20 percent—whether it be human resources, accounting, general affairs, or whatnot—into a different shell company, turning them into contract employees. The tendency will be that a lot

of service companies may select a portion of their employee force and have them work from home.”

Whether this represents a long-term trend that will survive the release of an effective vaccine, or just a knee-jerk reaction among senior managers who, pre-COVID, were for the most part opposed to remote working, is unknowable. As one interviewee said: “Our company is an example of being an absolute nonadopter of any kind of work-at-home or flexible working arrangement despite my nagging on about it for years. And now suddenly you’ve got a complete U-turn and our chairman wants 80 percent of people working at home all the time.”

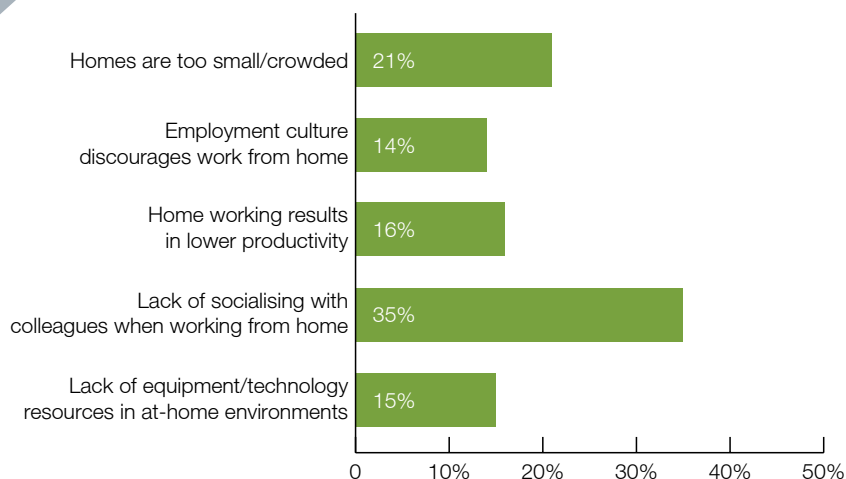
Divided Opinions

In general, the weight of sentiment among interviewees in the Asia Pacific tended to be less in favour of a long-term work-from-home trend than seems to be the case in the West. Survey responses (exhibit 3-4) suggest that the main reasons for this include a lack of opportunity to socialise with colleagues, as well as the small sizes of Asian homes, to which can probably be added that improved containment of the virus has allowed most CBD offices to remain operational, thereby deterring an exodus of residents from core city areas. With few exceptions, the ghost-town feel of New York City and San Francisco is not a factor in the Asia Pacific.

At the same time, however, interviewee opinions about workplace solutions were quite polarised. In particular, those with backgrounds in design or technology were more likely to favour remote working, while those with financially oriented or development backgrounds often preferred to maintain work-from-office regimes, apart perhaps for a day or so per week.

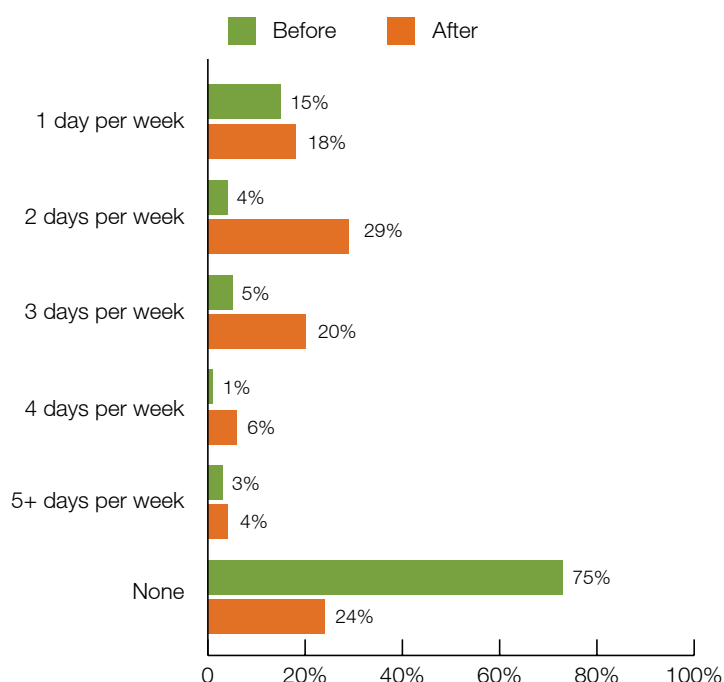
The impact of all these drivers of office demand is hard to game. Currently, most employers appear to be leaning towards a net reduction of daily in-office staff, which would naturally result in reduced demand for space. At the same time, counterbalancing factors, including social distancing requirements, are going to militate towards lower staff densities, whose impact will be to increase demand for space. Which of these competing influences comes out on top remains to be seen.

Exhibit 3-4 What Are the Biggest Obstacles to Implementing a Work-from-Home Policy in Your Location?



Source: *Emerging Trends in Real Estate Asia Pacific 2021 survey.*

Exhibit 3-5 Average Days per Week Spent Working from Home Before and After the Pandemic



Source: *Emerging Trends in Real Estate Asia Pacific 2021 survey.*

Hot-Desking Out, Open Space In

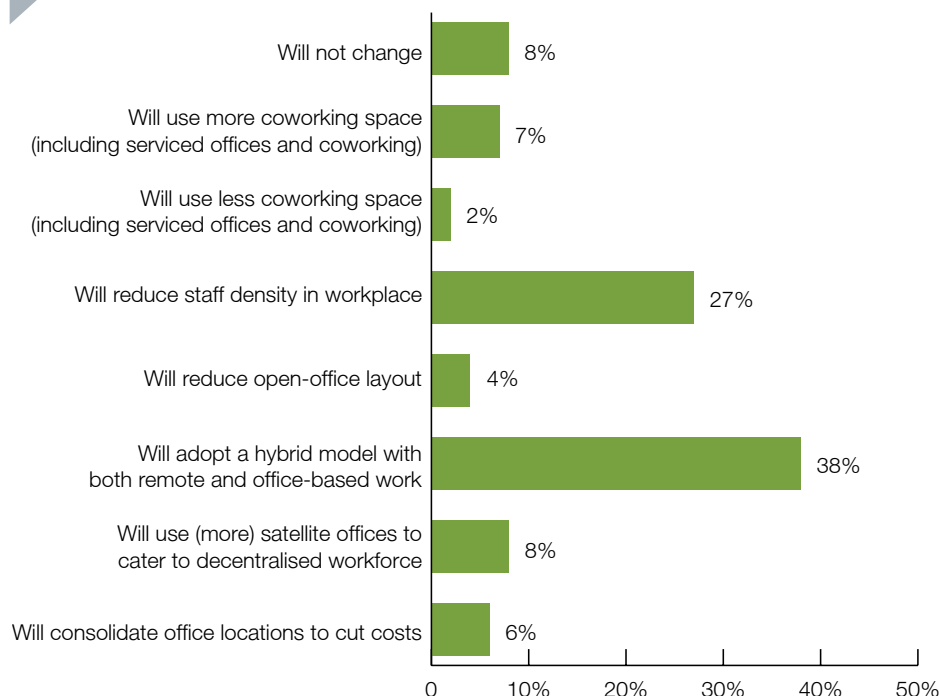
On a global basis, the growing popularity of open floor plan layouts in recent years has seen workplace footprints shrink, as individual offices were eliminated and staff congregated in collaborative groups. Nowhere was this moreso than in the Asia Pacific. According to CBRE, average workplace density in the region currently amounts to about 80 square feet per desk, and sometimes as low as 50 square feet. This compares to an equivalent of 100 to 150 square feet in the United States and Europe and implies—for health care purposes alone—a trend towards decreasing office density going forward.

Office use and layout are poised to change in other ways, too. According to one Hong Kong-based fund manager: “The whole concept of everything being open seating and hot-desking that has been trendy for the last couple of years will have to be reexamined from a health and wellness perspective. If you assume currently that half of your people are out and about dealing with clients and therefore don’t need a full-time office and can share working space going forward, who knows if that will be valid?”

In future, video calls may become the norm for more types of face-to-face meetings, especially after so many interviewees found them more efficient than the old-school alternative. With more employees working from offices, tenant demand for space will increase.

Hot-desking, too, may become a thing of the past. As the fund manager continued: “Does it make sense for everyone, every day, to jockey for a desk, with cross-contamination and everything else? My personal opinion is that it’ll go back towards the older style, where it may still be open-plan but everyone will have their own space. And the amount of floor space they’re going to need is probably going to increase because people won’t be packed in so tightly. So, the office question has a lot of variables floating around it, none of which make me think there will be a crash. I think actually it will be a transformative change happening in how we fit out office buildings and how people use space.”

Exhibit 3-6 How Will Your Organisation’s Workplace Model Change as a Result of COVID-19?



Source: *Emerging Trends in Real Estate Asia Pacific 2021 survey.*

That means, of course, that changes will apply not only to individual offices, but also to entire buildings. Landlords are therefore modernising by installing health and wellness features such as touchless technology and access controls, anti-viral surface coatings, and (especially) building air-conditioning systems. The latter tends to be an expensive upgrade depending on the type of existing system, but will become increasingly important once industry groups like ASHRAE [American Society of Heating, Refrigerating and Air-Conditioning Engineers] begin upgrading building standards specifications.

As one interviewee said: “Modern buildings that can adapt to customer needs with tech and touchless are going to win—older properties are going to become obsolete, and employees won’t want to work there.”

Flex Here to Stay

Part of the calculus as to how much space new-normal occupiers will need involves a verdict on the use of flexible workspace. Coworking operators have been the biggest single adopters of vacant office space globally in recent years, but the sector has become a magnet for controversy over the sustainability of its business model, and problems have been compounded in 2020 as users opt to avoid their crowded open workspaces. Currently, not only have they halted expansion plans, they are actively handing back space.

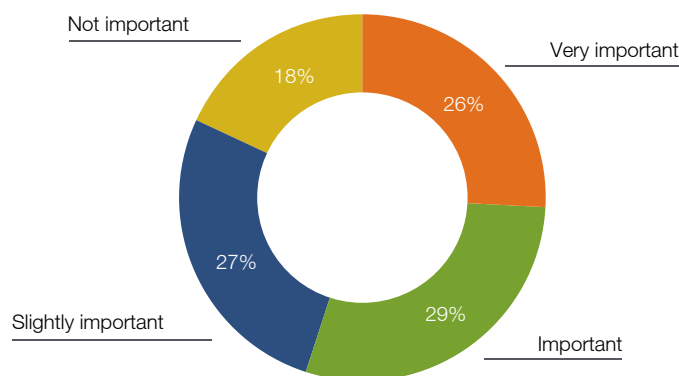
However, although the impact of COVID-19 on demand for flexible workspace has been profoundly negative, the current lack of clarity among occupiers over a slew of issues, ranging from how socially distanced offices should be, to how often employees will work from home, to how staffing demands may change,

amounts to a new driver for flex space demand that will boost its prospects over at least the medium term.

The consensus, therefore, is that flexible space will continue to serve an important role—subject, however, to a couple of caveats. First, companies will prefer to rent serviced offices rather than the classic open-plan coworking space. According to one Manila-based landlord, should vacancies start to rise, “we’re going to start cutting up spaces and offer them as flex serviced offices where, say, 1,000 square metres will be split into ten 100-square-metre floor plates. Because I think it’s only a matter of time, especially for the big office users, to say, ‘I’m not going to need this much space, but I still need half, so will you allow me to refurb half of my available space and turn it into smaller 20-seater offices with walls and workspaces?’ Because those types of space are still doing well, but the [open plan] style is not.”

Second, more landlords are now opting to open their own flex facilities rather than simply lease space to a coworking operator. While many landlords still prefer not to get involved in the complexities of

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



Source: *Emerging Trends in Real Estate Asia Pacific 2021* survey.

designing, fitting out, and operating this type of business, there is an increasing willingness, especially among bigger players, to strike out alone or to adopt a hybrid profit-sharing model.

As one Shanghai-based fund manager put it: “I think that we will naturally evolve towards more of a hotel-like working

relationship between serviced-office operators and landlords, where the economics and the risk/reward will be more equitably balanced between those two parties. And it will come down to the quality of operations and the experience and amenities that the landlord wants to provide to the tenant.”

A Decentralised Future

Another crosscurrent likely to affect future demand for CBD offices relates to affordability. With many occupiers now less profitable than before, there will be increased focus on cutting costs by moving to cheaper locations. According to a Hong Kong-based industry consultant: “What they seem to be looking at is not *if* they should come back [i.e., to their offices], but *where* they should come back. I’m doing a lot of contingency planning at the moment for clients, and there’s a great focus on cost—what COVID has done is to give people the opportunity to step back and ask if they really need to be located in Central [CBD].”

A further factor motivating tenants to look outside CBDs is the need to cater to staff who are now more likely to spend at least some of their time working remotely. As one interviewee said, “I think the dynamics have changed a bit, from being very employer centric to being a bit more employee centric in terms of how they pick offices—so, at least on a satellite basis, they will be relocated to where people live.” Employers able to offer locations convenient to their staff are likely to be more successful in recruiting new talent.

Whether driven by more employees working out of office, or by more companies seeking cheaper space outside the CBD, any large-scale shift

to decentralised workplaces will result in increased demand for satellite office space, or, beyond that, the evolution of greater numbers of secondary CBDs. The implementation promises to be tricky, however, because hub-and-spoke solutions will prove unworkable if they require employees to travel into the city centre and then back out again to get to newly established facilities.

Location will therefore be key, with excellent transport links, reasonable proximity to the CBD, large residential catchment areas, affordable rents, and good local retailing options being the most important attributes. Not many decentralised locations can tick all those

boxes, although some, such as Sydney's Parramatta, Shanghai's Hongqiao, Manila's Clark, New Delhi's Noida, Taipei's Nangang, and a number of distributed noncore locations in Singapore, are emerging.

Even in the absence of such large-scale decentralised locations, which may take years to evolve, one quick-and-easy way to cater to work-from-homers is again to rely on flex space. Coworking operators may therefore opt to adapt strategies that until now have targeted prime downtown locations in order to open smaller-scale facilities in noncore districts where large numbers of CBD commuters are living.

A fund manager in Tokyo spoke of looking to capitalise on such a trend by recruiting more coworking companies as tenants in his fund's buildings: "Personally, I think we're becoming a little more aggressive about doing leasing for creative-office, temporary-office tenants, because we see them doing well within this context. And now my wife has been able to return to Japan from the U.S., I can certainly see the need for someone to have a place to take office calls not in their living room."

Logistics

Of all the main asset classes across the Asia Pacific, logistics will probably be the only one to come out of the pandemic stronger than when it went in. Regional logistics transaction volumes in the first nine months of 2020 were up 15 percent year-on-year, according to RCA, compared with declines of 38 percent in the office sector and 53 percent in retail. Moreover, in the first half of the year, investment funds raised almost US\$7 billion in new capital for deployment in Asia Pacific logistics projects, more than half the total for all asset classes combined—a testament to enduring appetite for warehousing assets.

Demand across the region for logistics facilities was already strong pre-COVID due to longstanding structural

undersupply and a number of cyclical and secular drivers, including in particular growth in e-commerce transactions. In yet another example of COVID-19 acting as a catalyst for preexisting processes, Asia Pacific e-commerce growth that was already faster than that in either the United States or Europe was given an extra push as a result of pandemic social distancing restrictions.

Another factor adding to demand for logistics facilities is that the COVID-19 pandemic has exposed the shortcomings of modern "just-in-time" supply chains. Originally conceived as a way to minimise the number of components held in global manufacturer inventories, the just-in-time mantra was found wanting when components factories and their distribution networks shut down during the pandemic, leading to knock-on slowdowns in entire industries across the world. The back-peddalling now evident by manufacturers to ensure access to larger stockpiles of components, as well as better product-distribution capabilities, has served at least—for the short term—to further increase demand for logistics services.

China remains by far the biggest market for new logistics construction given its huge and rapidly expanding market, together with an acute shortage of up-to-date facilities—currently, just 5 percent of warehousing stock in China can be described as modern, according to JLL.

A Crowded Field

However, despite undeniably strong fundamentals and a market at no imminent risk of oversupply, logistics assets may not be the sure bet they appear. One problem is their very popularity, with almost every interviewee identifying it as a favourite asset class and survey respondents granting it by far the highest investment prospect rating of its peers (exhibit 3-1). As one Singapore-based investor said: "It's going to be a crowded field, and at some point it's going to push prices up to where it doesn't

make sense anymore. We're not there yet, but it could come pretty soon—every logistics deal we are looking at is going at higher pricing than it was a year ago."

And, according to a fund manager in Australia: "The challenge for me comes with actually being able to get your money invested, because it is by far the smallest of the three major sectors of office/retail/industrial; I think it still accounts for only around 10 to 12 percent of the investable universe. Also, I struggle with cap rates being so low—just 4.5 percent for a logistics shed. Historically, what's always happened in Australia is that after the initial lease term and the fixed-rental uplifts that sit in the lease structures, it's cheaper for tenants to just go out and get a new shed built in 10 years' time and pay a lower rent. And I can't see that changing any time soon."

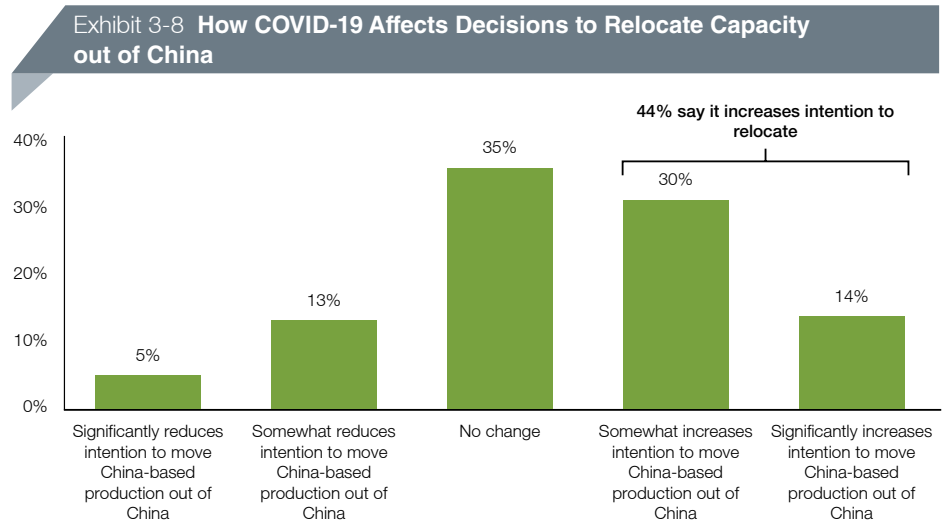
Another potential problem is that, while land can be difficult to secure depending on the market, and tenants tend to favour operators with whom they have existing relationships, the facilities themselves are not generally difficult to build or operate. Barriers to entry are therefore not as high, for example, as they are for data centres. In their favour, warehouses tend to offer long leases, another sought-after attribute in a post-COVID market. By the same token, though, rental growth is usually low, and (unlike office or retail assets) they offer little potential to refurbish or reposition.

That said, not all markets are seeing cap rates compress to levels found in Japan (where yields have dipped below 4 percent) or Australia. In India, for instance, regulatory reform jump-started the birth of a modern logistics industry only a few years ago, so logistics supply remains especially tight. And while market risk is high, development IRRs of 16 to 17 percent, combined with cap rates in the area of 9 to 9.5 percent, provide healthy margins.

China Plus One

Demand for logistics infrastructure in Southeast Asia's emerging markets took off in 2020. This was partly due to domestic economic growth and the pandemic-related online retail theme, but also a consequence of more manufacturers moving production facilities away from China as a safeguard against worsening global trade tensions and supply chain vulnerabilities. In a recent poll by investment bank UBS of executives at 450 U.S. firms with production capacity in China, 44 percent said that COVID-19 increased their intention to relocate.

In an example of how supply chain vulnerability is helping drive this trend, one developer in the Philippines described how Chinese factories traditionally supplied about 90 percent of glass installed in Manila's commercial buildings. When those factories closed in early 2020 because of the COVID-19 lockdown, there were significant delays in local construction activities. As a result, Philippines suppliers began diversifying supply sources in an effort to minimise risk: "The big companies are diversifying supply chains so they can assure me



Source: UBS Evidence Lab, North Asia CFO Survey.

that when the building is finished they're not going to turn around and say, 'Hey, your elevators are here with us [in another country].' Now, whenever we award a big contract, we're asking where it's coming from. And if it's coming from China and then, for this other building, it's also coming from China, then I'd request you get it from Thailand or Taiwan or somewhere else."

This does not imply an overall exodus of manufacturers from the Mainland—"It's a China plus, not a China minus," as one logistics specialist put it—but in absolute terms there are so many factories in China that even a tiny percentage of total capacity is still a huge number in an emerging-market context.

Cold Storage—a Hot Market

Another pandemic-related effect is a huge surge in online grocery shopping, as consumers either elect or are compelled to social-distance. Demand for cold-storage warehousing—which requires complex mechanical infrastructure to ensure constant temperature and humidity—has therefore risen sharply.

Analysts Forrester projects compound annual growth rate (CAGR) for cold-storage demand in the Asia Pacific of 30 percent through 2024, with online penetration doubling from 5.1 percent in 2020 to 10.6 percent by 2024.

Cold-storage uses are not restricted to food; they also include pharmaceutical products, with a potentially huge market for storage of pandemic vaccines expected to roll out in 2021.

As with other types of logistics infrastructure, the Asia Pacific region has deep structural shortages of modern cold-storage assets. In order to create similar volumes of per-capita capacity as the United States, for example, operators would have to build some 411 million cubic metres of new space, according to CBRE estimates—almost doubling the amount of existing stock.

As with data centres, the complexities of cold-storage warehousing mean that investors tend to create partnerships with operating specialists that are rolled into the assets themselves. Not only does this instill a degree of confidence among tenants, it also increases asset values when sold.

One trend beginning to emerge in this area is conventional warehouse space combining with cold-storage space. This has become possible due to the growth in online grocery sales creating demand for more and larger cold-storage facilities than existing assets can provide, especially in markets such as China and South Korea, according to one investor active in this field.

Due to a shortage of facilities in the Asia Pacific region, cold storage trades as an asset class at a premium of as much as 300 to 350 basis points to conventional logistics facilities.

Vietnam is seen as one of the most attractive options. Apart from the strength of its domestic economy, it has a regulatory regime relatively open to foreign logistics companies, with 100 percent wholly foreign-owned entities allowed in warehousing projects. In addition, it has made significant progress in facilitating the creation of a green domestic supply chain, with new legislation allowing warehouses to set up both rooftop solar and off-site direct power purchasing. With many multinational companies now looking to partner with companies that can show a strong track record on environmental issues, Vietnam's measures have proved a smart way to tempt foreign manufacturers to the country.

At the same time, markets across the region are seeing growing competition for land, with the big Chinese e-commerce companies now also creating land banks for their own facilities. "Land is limited across all of Southeast Asia, but it's in the immature markets where land is the biggest challenge," said one investor.

"I think there's going to be a real tussle between occupiers to get land for warehousing."

Indonesia is another market popular among investors, as are Cambodia, Thailand, and Malaysia. All are significantly less sophisticated than Vietnam, however. According to one local logistics investor: "Looking at the emerging markets, Indonesia is big and everyone gets excited, but it's really hard. India is another big market, and it's also really hard, but it's leaps and bounds ahead of Indonesia. The thing people forget about Indonesia is that it's really just Jakarta, so demand is much lower. Whereas in India or China, you have dozens of big or medium-sized cities, which can all be very good markets."

Another problem with Indonesia, according to a different investor, is that it has very concentrated ownership of suitable land: "There's about 10 families that own everything," he said, "so it's difficult to get anything off them at a good price."

A Build-to-Core Play

While demand for logistics properties among investors is booming, acquiring completed assets can be difficult because most buyers prefer to hold for the long term. For this reason, logistics has become a build-to-core play, with investors assuming development risk with the goal of selling finished product to core funds. As one opportunistic investor commented: "If you'd asked me two years ago if we'd be doing logistics in China, I'd have said no way—too much capital has been raised, and pricing doesn't work for us on a risk-adjusted basis. But what we've seen is that there's so much core capital raised in these big platforms that they're happy for inorganic acquisition opportunities. Suddenly we're seeing these opportunities coming because there are fewer people wanting to take development risk, but there's a lot of people that want to buy core."



Retail

As in the West, spending at conventional retail facilities across the Asia Pacific has been losing ground to online retailers for years. Indeed, the shift from offline to online has occurred so quickly that some 62.6 percent of all global online sales in 2020 is expected to take place in the Asia Pacific, according to eMarketer.

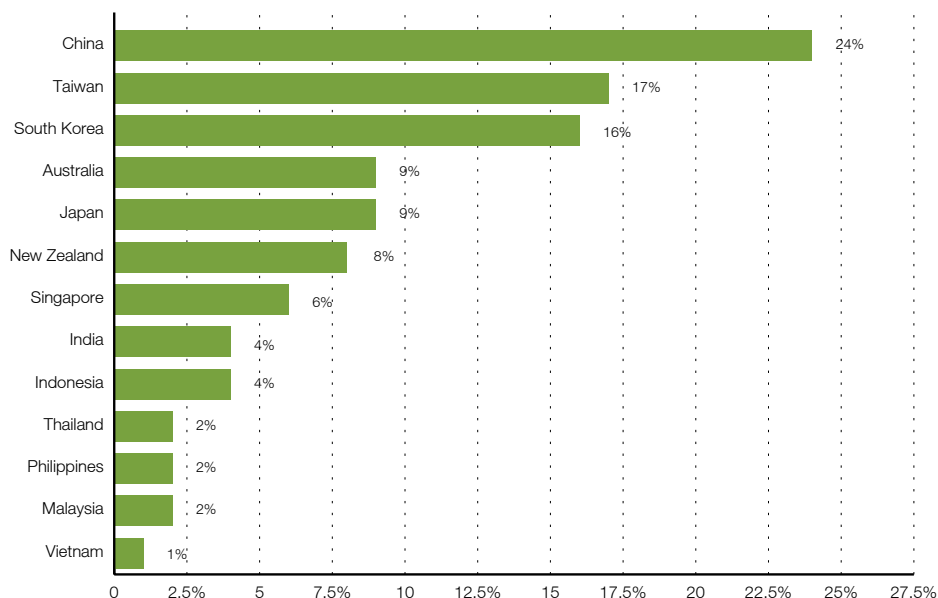
Unsurprisingly, therefore, the impact of the pandemic has once again been to accelerate an already strong inclination to use online platforms, with analysts Forrester projecting an increase from US\$1.5 trillion in online sales for 2019 to US\$2.5 trillion by 2024. At a CAGR of 11.3 percent, that's more than double the rate of uptake in the rest of the world.

In the circumstances, the implications for regional brick-and-mortar stores might appear bleak. But while interviewees acknowledged that attrition in brick-and-mortar facilities is likely, they were not necessarily negative about the prospects for retail generally, or at least only on a selective basis.

There are various reasons for this. First, while online retailer share continues to rise, overall consumer spending across the Asia Pacific is also growing at a rapid clip. Currently, the region accounts for about three quarters of global retail sales growth, according to a recent study by Bain & Company, meaning that conventional retail's shrinking share applies to a rapidly expanding pie, allowing it to adapt as it adjusts to the shifting market.

Second, the impact varies significantly according to retail type. Luxury goods retailers, for instance, proved largely impervious to the downturn. In part, this is because luxury goods buyers tend to favour real-world shopping experiences, but it is also because travel lockdowns have produced a lot of bored rich people. According to one mall operator: "We found that the most high-end shopping malls that sold luxury goods have been among the best performers. Because consumers could no longer travel to overseas markets where they usually shopped, they ended up frequenting domestic high-end shopping malls instead."

Exhibit 3-9 E-Commerce Share of Total Retail in the Asia Pacific 2020



Source: Statista 2020.

By distinguishing between market segments, investors end up looking at different retail assets with a very discriminating eye and judging each on its merits. As one investor said, in relation to suburban retail assets: "More people are now differentiating neighbourhood nondiscretionary, grocery-anchored retail as a completely separate asset class from other types of retail, and we are certainly seeing credit appetite for financing those assets that make that differentiation."

There seems little doubt, however, that the impact of the recent surge by online platforms has finally shown shopping centre owners the writing on the wall, incentivising them to repurpose facilities and/or embrace operational change.

Serving Local Catchments

One result is that mall operators are now more focused on understanding what their customer base wants. In markets or neighbourhoods traditionally reliant on tourist spending, this translates to a greater focus on local catchments. Malls are reducing the number of branded stores, adopting more active and meaningful programming, and embracing shops that target local audiences.

In the words of a Hong Kong-based architect, "I think the focus now is more on frequency of visits—so, people coming in on a regular and ongoing basis, with an emphasis on safety procedures as part of the offering. The sense of localism is now really high." According to a large Shanghai-based retail landlord, the internal travel ban in China imposed during the height of the local COVID-19 outbreak led to a "pivot towards the local catchment and a focus on loyalty and sales promotions. We also did some remerchandising, bringing in very strong first-to-market flagships to get both local people and those from further away to visit. This has been positive—while footfall hasn't increased, sales have."

Promotions, meanwhile, have become “less cynical” than in the past, with greater focus on creating a sense of place rather than serving as a pathway to extract tourist dollars. In the words of one interviewee: “Operationally, retail operators are now thinking more in terms of town centres than malls. They are still called malls, but there’s this idea that you’re an active curator, more like a town mayor, ensuring you get a diversity of audiences coming through on a far greater basis.”

With tourists unlikely to return soon (or at all, in some cases), such strategies serve a dual purpose. Not only do they shore up revenue, they also encourage the creation of facilities that serve the local community—something long forgotten in more internationally oriented cities such as Hong Kong.

Repurposing for Mixed Use

As malls lose parts of their traditional tenant base, vacant space is increasingly being taken up by a variety of new uses, leading to a more complex tenant mix. In part, this is once again an accelerated application of a preexisting trend towards experiential offerings that has seen mall-based entertainment, as well as food and beverage (F&B) offerings, expand rapidly in recent years. Although these new categories have also been hard hit by the pandemic, they are expected to remain a focus for shopping centres once a semblance of normality is restored.

Beyond that, staples like music and F&B are not the only ways for malls to be experiential. Click-and-collect facilities are one option. Space for product trials is another. One investor in Chinese malls, which are established leaders in adapting to the growth of online competition, described how a successful retail centre in Shanghai had prioritised the creation of unique events that shoppers were unlikely to find elsewhere, including a cooperative venture with a popular local comedy theatre and the integration of small botanical gardens into their property.

Green features are seen as important. One Shanghai mall currently under construction is set to include, among other things, 4,000 square metres of multilevel outdoor green terraces featuring waterways, skywalks, and a waterfall; a 5,500-square-metre sky dome; and a large Japanese-style aquarium. According to a China-based investor: “The design was brilliant in that aquariums would be impossible to retrofit into the property due to their electromechanical equipment and structural engineering requirements. It’s increasingly visible as a trend that more projects have anchored recreational or innovative experience in their early-stage design to provide consumers with premium experience.”

An industry consultant, speaking of how even successful retail malls are now looking preemptively to upgrade their properties, said: “They obviously want to position themselves as not just reacting or responding, but also taking the initiative to do something new and different, so there’s a lot of interesting things going on to ensure that whatever is done is seen as exciting, and a positive response to what’s happening. So, a lot of new tech going in—the wow factor is certainly being sought by the client.”

This leads to the question of whether the current stock of retail space is sufficiently sophisticated to cater to the range of new uses. According to one designer: “Architects and retail operators and developers have always structured malls as if they’re a photographic moment, which is strange, because retail is always evolving. But the idea that adaptation will occur faster is now accepted—the mentality that they can make adjustments every 10 years is out the window.” Among other things, this means that designers are looking increasingly to use temporary flooring and lightweight steel systems that are easily demountable, allowing malls to physically adapt to changing demands.

New types of non-experiential occupiers, such as educational or medical services, are also increasingly common, especially in above-ground-floor spaces. According to one interviewee: “They normally don’t pull in a lot of rent, but since operators are

not going to maximise rental yields anyway across large numbers of properties in the tenant mix, they are definitely a lot more open to remixing in order to capture that audience and a greater diversity of audiences.”

Establishing on-site fulfilment centres in malls is another potential use. While they remain largely hypothetical in downtown locations (not least because zoning rules often prohibit them), demand for last-mile fulfilment from omnichannel and online retail is a symbiotic fit that suits both underused suburban malls and overstretched logistics operators. In Australia, several such conversions are currently in the pipeline, and retailers across the region can be expected to embrace similar models, subject to solving sometimes-vexed relations with local residents who may object to increased traffic associated with these facilities.

Ultimately, no matter who takes up newly vacated space, the result is that many retail centres are being reinvented as true mixed-use facilities. According to one architect active in the field, “The fun part for me is that instead of, say, a quarter or less of a project being made up of specialty services or facilities, today some of them might end up having 40 percent. And the reason it’s beginning to make sense to some operators is that it seems you need more of what in the old days you’d call lifestyle centres, although today they are more like neighbourhood centres.”

Smaller Is Better

Another way in which the industry is evolving is that the historical trend favouring ever-larger shopping centre facilities seems now to have been replaced by a theme of greater numbers of smaller, geographically distributed facilities. In the past, such smaller centres (i.e., around 600,000 to 700,000 square feet of GFA) were considered uncompetitive. Today, “the view is that this is perfectly O.K. because we fine-tune each one closer to what the customers need on a location basis. The bigger they get, the more generic they are, and the

required personalisation becomes more difficult. So, this is an opportunity to take advantage of the fact that people want things that are personal to them, including the projects they go to.”

While operational retail space is almost certain to shrink, therefore, the addition of new uses means total per-project space is likely to rise, with retail representing a smaller percentage of a better-integrated overall project. As one industry consultant said, “I can see at least half a mall in the future being devoted to general-purpose space.”

This process is already underway in Australia, where landlords are starting to repurpose underperforming large-format retail centres. An investor/owner of one such project who is currently in the process of adding 300,000 square metres of residential facilities, student housing, and health care uses to the project’s 20-hectare footprint said that while he thought the prospects were good, the new strategy required some explaining to the fund’s LPs. “We’re going to have to take our clients on a bit of a journey,” he said. “Investors originally bought into a shopping centre fund, so we need to show them this is the future of retail. In many ways, it mitigates the risks you currently worry about, because obviously it diversifies cash flows away from just retail tenants. More importantly, though, none of the latent value sits in current asset valuations—I think it’s going to be a huge opportunity.”

New Lease Structures

One byproduct of converting retail space in this way is that rents and values are inevitably affected—usually in a downward direction—because the brand-name stores that are disappearing pay higher rents than the new occupants replacing them. Fulfilment centres, in particular, pay significantly less rent than most retail tenants. This will mean, firstly, that owners of the affected properties will take a hit on valuations, and second, that the ways rents are calculated may be set to change.

According to one large retail landlord: “A lot of the excess space will be repositioned into medical, or perhaps coworking space, or whatever. And/or the capacity could be capped on the basis that base rents are nonexistent and stores will have a turnover rent instead.”

Another large retail landlord in Hong Kong said: “I think both base rents and turnover rents are probably here to stay because they bring certainty for both landlords and occupiers. Whether the proportion of turnover may change for different trades [is possible]. But what we will see for sure is increased flexibility—more pop-up stores in some malls and more short-term tenancies. The typical tenancy in Hong Kong is three years, and this may change to six, 12, 18 months. It’s this sort of flexibility that allows things to be refreshed and new ideas to be tried.”

Also, as omnichannel strategies evolve, landlords will need to find a way to monetise services that are taking place at least partly online. As the landlord continued: “What will happen, and it was happening before, although COVID may accelerate it, is that stores will play a broader role. So, places are showrooming, allowing you to try products, or you can collect or return goods. In that case, how do you measure the actual business at that store? Some landlords are already addressing that with their retailers and are counting the inventory movement in that store as counting towards part of the inventory of the store, whether the purchase is online or physical. There will be a lot of that going on, though maybe on a case-by-case basis.”

Retailers are also looking at charging omnichannel rents that seek to capture a percentage of sales linked partly to the physical retail space (in terms of fulfilment) and partly to an online purchase. These are difficult to implement in densely populated cities because “the devil is in the detail” and defining catchment areas is fraught with difficulty. Models are evolving, however, and this is likely to be an area that becomes increasingly important as the merger between online and offline activities continues.

Residential

Compared with other asset classes, residential sectors across the Asia Pacific have remained surprisingly resilient to the impact of COVID-19, especially bearing in mind the extent to which economic downturns have affected consumer incomes and sentiment. Transaction volumes may be down across the board in most jurisdictions (again, China excepted), but pricing declines have generally been modest in Singapore and Hong Kong, given in particular how much prices have risen in recent years. The reason for this comes down to high savings rates, cultural affinity for home purchases, and longstanding undersupply of mid-range housing.

There are a few outliers to this rule. Australia’s reliance on international buyers is likely to create more softness in an already weak market as border controls prevent students and immigrants from entering the country, with prices likely to weaken again once government economic support programmes end in the early part of 2021. China, meanwhile, has the opposite problem, with home sales posted by leading developers up a remarkable 31 percent year-on-year in August 2020, driven by government financial support being recycled into the market and the release of pent-up demand as positive sentiment returned.

In an environment of uncertainty, this reliably bullish consumer sentiment, together with an equally reliable long-term mortgage repayment track record, earmarks the residential sector as a defensive asset class that investors are now targeting.

Funds Pivot to Multifamily

In particular, build-to-rent (also known as multifamily) assets are in demand. As an asset class, multifamily has been slow to gain traction in the Asia Pacific, with only Japan registering significant numbers of institutionally owned rental properties as a percentage of total housing stock. The problem has always been that residential yields in the region are so low that underwriting a decent return from a multifamily investment is difficult without using high amounts of leverage.

Attitudes have changed, however, for a number of reasons:

- Rental housing is seen as more attractive in a recessionary environment where prospective homebuyers often cannot afford to make downpayments.
- Government moves to create policy incentives in the form of tax breaks and planning concessions have increased potential returns. China introduced such initiatives several years ago, although they are often seen as loss leaders by developers who then rely on the government to make up the shortfall in other ways. Australia is also moving in that direction, and there are rumours of similar policy changes in Hong Kong, too. Still, in higher-priced markets, it will always be difficult for multifamily to make financial sense unless it is built for a middle-income demographic.
- In a world where interest rates will probably be lower for longer, multifamily's skinny yields don't seem so bad after all. According to one consultant: "We seem to be coming around to an acceptance that yields are going to be much lower in future, and if we can do 4 to 4.5 percent net in multifamily, our investors seem to think it's not bad. Very often, too, these residential rents can today be indexed, and you're looking in many cases not just at a two-year let but five years or even longer. So, the characteristics are changing."

- The fact that institutional funds are now looking to buy multifamily assets makes it more likely that developers will build to suit because they have a ready-made exit.
- More progressive asset management is now common. According to one interviewee: "Management and maintenance has always been the roadblock, but we seem now to have a new breed of managers who do things in a more efficient way."

Does It Add Up?

The trending popularity of multifamily as a pandemic byproduct is not universally accepted, however. According to one fund manager: "Outside of Japan there's no depth apart from China, and personally I don't want to be a pioneer in cultural change. If you look at China, there's already been a ton of bankruptcies in the co-living space and you could see that coming."

The two problems identified by the fund manager were, firstly, that unless you buy subsidised land already designated for rental housing, the only way for the math to work is to reposition in an upward direction. "But then the rents are high, so it only works for expats as opposed to locals, and how deep is that market?" he said. The second problem is that investor expectations to eventually sell at a profit seem to conflict with government policy. "They're selling this land cheap to build rental housing because they want it to be affordable," he said. "So, the idea that you're going in and raising rents to make your returns, ultimately, is an absolute conflict. And oh, by the way, you're going to evict tenants when they're not paying?"

Another investor currently managing a multifamily portfolio in Japan voiced similar scepticism about the market there, due mainly to cap rate compression that has squeezed yields to levels of around 3.5 percent. "Part of the issue is that so many people want to go after multifamily

that there's just too much capital, and the sellers know it and so they've not had to adjust their pricing. What you need is to get rent growth to make it work. And to date there has been rent growth and people have got better margins, but it's really a function of the market, not aggressive management."

The presence of large institutional investors in Japan willing to pay premium prices for multifamily assets also makes for stiff competition.

Apart from multifamily, other residential markets mentioned in interviews included mid-range emerging-market projects in Vietnam and India, pitched carefully in terms of unit size and submarket and executed in partnership with brand-name local developers. Distress deals in India are also available, as discussed elsewhere in this report, involving debt rather than equity.

Finally, another option in India lies in huge government-driven low-income housing programmes that aim to create some 11 million units of new accommodation across the country, mostly in tier-2 and tier-3 cities. The availability of government counterparties and numerous financial incentives creates opportunities for impact investing on a scale unprecedented in Asia or even globally.

According to a locally based consultant: "The government has come out with all kinds of support mechanisms, including government subsidies, single-window approvals, interest subsidies, capital subsidies, and stamp duty waivers, together with infrastructure status and priority sector lending status. And the best part is that the sale price is defined by the government. But so far the institutional investor community is not going out of its historic comfort zone in evaluating these opportunities."

Hotels

Together with retail, the hospitality sector has been the worst hit of all asset classes as a result of the current standstill in international tourism. Although United Nations data show a 72 percent reduction in Asia Pacific arrivals in the first six months of 2020, figures from individual markets reflect even steeper declines. Revenue per available room (RevPAR) for hotels across the Asia Pacific has therefore fallen precipitously in 2020 to levels that are financially unsustainable.

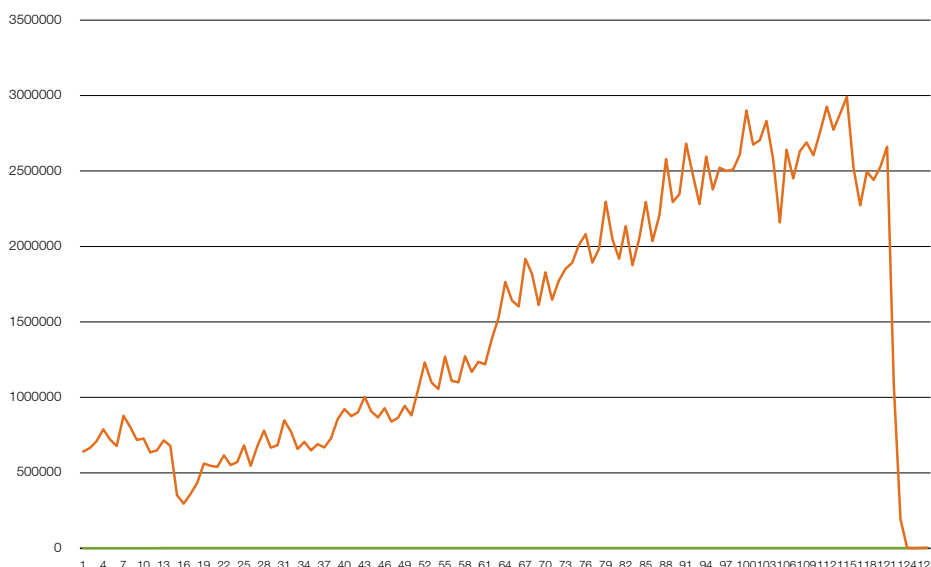
As a result, hotels have been among the first assets to appear on the market in the form of distress sales. According to a Hong Kong fund manager interviewed in early October, "I've had three separate guys come to me this week alone—and we're only Tuesday—wanting to raise money to buy distressed hotels."

While gloomy, however, hotel industry prospects are not hopeless. To start with, prospects can vary significantly by market. Japan, according to one local fund manager, has "a lot of hotels that probably didn't make sense when they were built even in a good market. So I think that could be a place where there will be more activity going forward."

Business at Chinese hotels, on the other hand, has picked up in line with a semi-normalised economy, while Singapore has also managed to maintain first-half occupancy rates as high as 75 percent, according to CBRE, as a result of government quarantine and crisis management programmes.

The capacity of domestic tourism to soak up some of the losses should also not be dismissed, especially in markets that have relatively high numbers of well-off domestic tourists, like China and Japan. Investors in Taiwan also reported that domestic tourism has helped make up for the absence of foreign travellers.

Exhibit 3-10 Visitor Arrivals to Japan January 2010 to July 2020



Source: Japan National Tourism Organization.

Exhibit 3-11 Regional Hotel RevPAR: December 2019 and June 2020

City	RevPAR in USD		
	December 2019	June 2020	Change from December 2019 to June 2020
Singapore	173	51	-70.6%
Incheon & Seoul	109	31	-71.0%
Hong Kong	75	31	-58.8%
Shanghai	58	31	-46.5%
Sydney	135	29	-78.3%
Taipei	155	26	-83.4%
Hanoi	102	25	-75.9%
Beijing	60	22	-64.0%
Metro Manila	80	21	-74.1%
Tokyo	160	18	-88.7%
Mumbai	106	18	-82.9%
Ho Chi Minh City	82	15	-81.5%
Jakarta	44	12	-72.8%
Bangkok	98	12	-88.0%

Source: STR.

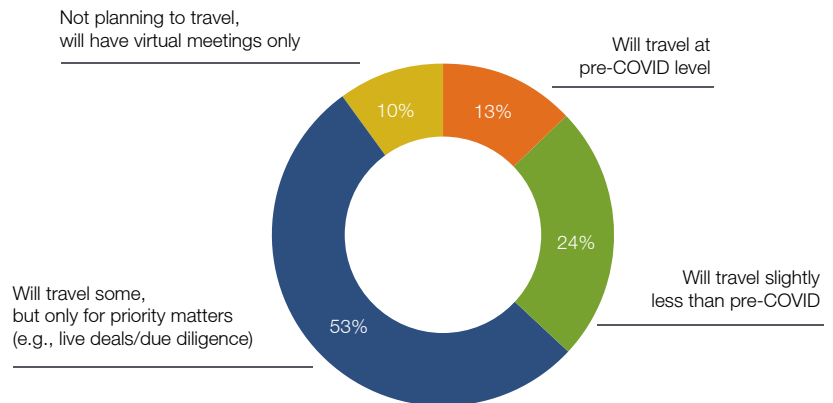
Too Many Rooms

That said, with domestic sales unable to offer sufficient scale to soak up pre-COVID levels of both international tourists and business travellers, the hotel sector is facing an overcapacity problem that will doubtless see large numbers of assets removed from the market.

Emerging-market resorts, therefore, which rely heavily on international travellers, or big corporate hotels offering convention spaces, will be more difficult to turn around. Even if a vaccine were to eliminate the virus tomorrow, regional tourism is unlikely to rebound to previous levels anytime soon, while business travel may well have changed forever, thereby eliminating at a stroke a large number of well-heeled customers who were previously happy to pay sticker price.

As with the retail sector, therefore, investors are looking at ways to repurpose failed hotel assets through either renovation or demolition. One investor in Japan, for example, suggested converting Tokyo city-centre hotels to data centres. “Some of these four-star, nice-scale, distressed hotels might be an interesting play,” he said. “You have to have guts to hold onto them, do it for a couple of years. But business hotels are done, they built too many of them.”

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



Source: *Emerging Trends in Real Estate Asia Pacific 2021* survey.

Another option is to convert to multifamily residential, for which former hotels have appeal because they offer en bloc assets with suitable in-building equipment in terms of plumbing and heating infrastructure. According to one consultant: “I have clients buying hotels already with that in mind—two- and three-star types where they will gut them and turn them into co-living and coworking spaces.”

In Singapore, meanwhile, a fund manager said: “People are waiting for prices to come down. I think if you’re going to buy a hotel now and keep it as a hotel, you have to be thinking of domestic tourism. We’re currently looking at hotels to convert to either senior housing or to residential. And there’s a conversion play, but the prices still don’t add up. All these sellers are still trying to sell based on a hospitality revenue model that just doesn’t apply anymore. International tourism will have a new model, and we just don’t see [the old one] working.”

Interviewees

Actis
Brian Chinappi

AECOM
Scott Dunn
James Kirkpatrick
Vishal Kundra
Tim O'Loan
Sylvester Wong

AEW Asia
Jason Lee

Alpha REIT Managers
Shireen Iqbal Binti Mohamed

AMP Capital
Tim Nation
Kylie O'Connor

Angelo, Gordon Asia
Jon Tanaka
Zoe Zuo

APN Property Group
Joseph De Rango

ARCH Capital Management
Jonathan Umali

Arena REIT Management
Rob De Vos

Arrow Capital Partners
Kurt Wilkinson

ArthaLand Corporation
Leonardo Po

Asia United Bank
Leo Intalan

Atkins
Eli Konvitz

ATR Asset Management
Ronald Benjamin Roa

Australian Unity
James Goodwin

BentallGreenOak
Dan Klebes

Blackstone
Chris Tynan

Brookfield Asset Management
Veronica Huang
Stuart Mercier

Capbridge Investors
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Development Victoria
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Buds Wenceslao

EDMUND TIE
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Japan Post Bank
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Jacob Swan

Jingrui Holdings
Maochun Liu

JP Morgan Asset Management
Tetsuya Karasawa

Kaisa Group
John Fitzgerald
Ken Suen

KENEDIX
Hikaru Teramoto
Takahiro Uchida

KMC Savills
Michael McCullough

KKR
Bryan Southergill

LaSalle Investment Management
Adam Donahue
Tom Miller

Leechiu Property Consultants
Tam Angel

Lendlease
Hsueh Ling Ng

Lobien Realty Group
Sheila Lobien

LOGOS Property
Sandra Fan

M&G Real Estate Asia
Chiang Ling Ng

Macquarie Group
Samuel Green
Andrew Taylor

Metropolitan Real Estate
John So

Mirvac
Stephen Gould
Stuart McLaren

Mitsubishi Corp.-UBS Realty Inc.
Katsuji Okamoto

Mitsubishi Estate
Tetsuji Arimori

Mitsubishi Jisho Investment Advisors
Toshiyuki Arai
Eriko Kato
Naoki Kuwabara

Mitsui Fudosan Investment Advisors
Shuji Tomikawa

Moelis & Company
Ben Boyd

Mori Building
Hiroo Mori

Nuveen
Nick Evans
Louise Kavanagh
Carsten Kebbedies

Ooedo Onsen Reit Investment Corporation
Fuminori Imanishi

PAG Investment Management
Naoya Nakata

Partners Group
Rahul Ghai

PAYCE
Will Morgan

PGIM Real Estate
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Pontiac Land Group
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Savills Malaysia
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