

Real Estate Outlook

Asia Pacific – Edition 3, 2021



Navigating rough waters.



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APAC outlook

Big ripples, or **small waves?**



While the stuttering pandemic situation will weigh on near-term growth, the outlook for real estate in APAC is more sanguine. Demand for commercial real estate is expected to reverse into positive territory across most markets by the end of 2021. Investment activity in the logistics segment will be partly driven by the availability of quality stock. Investors could benefit from increased exposure to emerging segments.

Market overview and outlook

A matter of perspective.

We cannot stop the waves...

The stuttering pandemic situation will continue to weigh on growth in the near-term, especially as vaccination rates remain low in most of APAC. The latter partly explains the harsh and sharp responses towards virus outbreaks. Minor clusters of infections have led to entire economies being shut down. Unlike in many other western countries, governments have shown limited to zero tolerance towards COVID-19. To be fair, the headlines do not paint the entire picture. It is a matter of perspective. In developed APAC, the recent spike in new infections looks relatively manageable, at least on paper. As of 26 July 2021, there were only 5.7, 30.9, 30.6 and 27.0 new confirmed COVID-19 cases per million people¹ in Australia, Japan, South Korea and Singapore, respectively. To put it into context, these figures are significantly lower than the 564.2 and 157.1 in the UK and US, respectively.

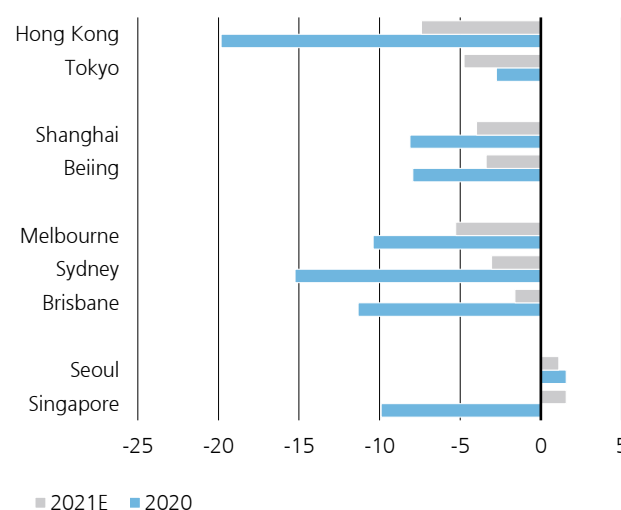
...but we can learn to surf

One saving grace is that most APAC governments have generally learned from lockdown experiences in 2020, evidenced by the muted ripple effects of more recent lockdowns. Furthermore, global demand has been improving over the past few quarters and that bodes well for the APAC economy, which is predominantly trade driven. Supported by the economic behemoth in China, regional economic performance was largely ringfenced and we saw APAC's aggregate GDP fall by only 4.0% YoY in 2Q20, improving to 9.4% YoY growth as at 2Q21.

Most APAC office markets continued to see weak performance in 2Q21. Despite that, demand for office space is expected to reverse into positive territory across most markets by the end of 2021. A year of turmoil has led to some increase in secondary and shadow office space, and office tenants are now more cost conscious. These will still be key drags on overall rent performance (see Figure 1). The markets where we saw the biggest rent corrections are markets in which prime rents have had a huge run-up over the past few years, such as Sydney. With limited supply expected in 2021 and 2022, the Tokyo office market will have the breathing space to cope with the emerging secondary vacancy later this year.

New-economy occupiers, such as those in the technology and media sectors, will continue to satisfy their deep appetite for office space in China and Singapore. Across APAC, high quality office assets have maintained tight vacancy rates and have proved to be more resilient. Looking forward, aging office buildings with less sought-after locations may suffer more in the medium-term, especially as occupiers put an added focus on the wellness of their employees.

Figure 1: Prime office rent growth (%)



Source: PMA; UBS Asset Management, Real Estate & Private Markets (REPM), June 2021

We think the glass is half full in the much-maligned retail sector. The pandemic has separated the wheat from the chaff in the retail space. There is still significant headroom for e-commerce penetration in APAC, which is not supportive of retail. However, the prospects for retailing lie in the two extreme ends of the spectrum, namely essential retail and prime retail. Every other retail format in the middle of the spectrum has and will be disrupted by the growth in online share of spending. Disclosure by public REITs across the region tells us that non-discretionary retail performed relatively well before and during the pandemic. This will still be the case after the pandemic.

On the other end of the spectrum, the outlook for prime retail is likely to improve once borders are re-opened. The downside risk is the uncertainty around that timeframe. However, astute investors can start to identify assets which have seen significant re-pricing and embark on value-adding strategies to adapt to the evolving retail formats and habits.

¹ Source: Our World in Data (7-day rolling average), as at 26 July 2021. (<https://ourworldindata.org/covid-cases>)

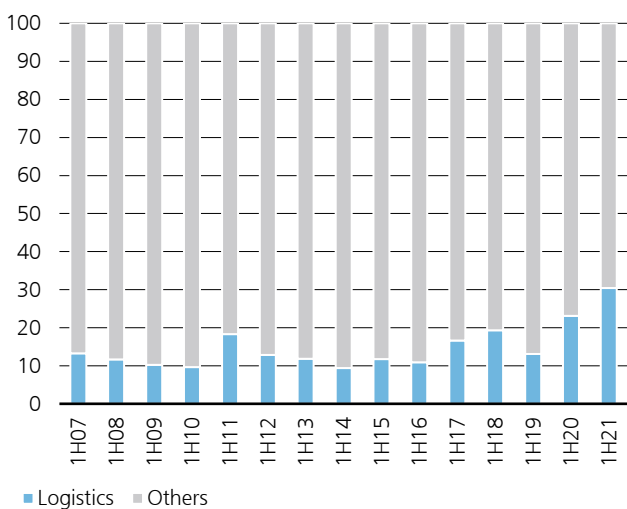
Strategy viewpoint

Riding the logistics wave.

According to preliminary data from Real Capital Analytics, total commercial real estate transaction volumes in APAC amounted to almost USD 66.7 billion in the first half of 2021, up by around 14.9% YoY from the same period last year. Total logistics property transaction volumes were up by a solid 51.4% YoY in 1H21, building on a strong 26.4% YoY growth in 1H20. As cyclical demand for the office and retail sectors toned down, logistics made up more than 30.0% of total investment activity in 1H21, up from the 23.1% we saw in 1H20 (see Figure 2).

As much as margins are low in the e-commerce space, logistics rent growth is still possible, albeit marginal. Lastly, we are seeing a cut-back in the supply of industrial land across APAC, and that has really pushed up the rents and capital values of logistics assets, especially the well-located ones. Japan, South Korea, China, and Australia are the few markets that will see better availability of modern logistics assets. Investment activity will likely be centered around these markets in the next few years.

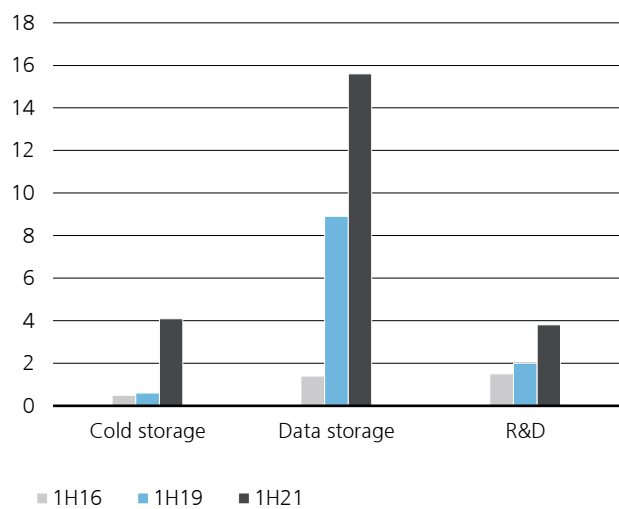
Figure 2: APAC transaction volumes (% by proportion)



Source: RCA, as of 29 July 2021

The surge in warehousing needs is underpinned by a few factors. First, countries and companies are increasingly safeguarding the integrity of their supply chains by engaging in near-shoring and on-shoring. This has led to greater demand for storage space domestically and regionally. Second, the exponential growth in e-commerce and the drive for efficiency have resulted in end-users struggling to keep pace with the parallel rise in warehousing requirements. Third, warehousing costs typically make up less than a third of total logistics costs for operators, with transportation costs driving another 50%. This means that it is cost-effective for end-users to pay more for higher quality and better located logistics space, and achieve costs saving on transportation.

Figure 3: Share of total logistics transaction volumes (%)



Source: RCA, as of 29 July 2021

The low cost of capital in the region should support pricing in the logistics sector over the next few years. Notably, we have also seen increased activity in the niche sub-segments of the logistics sector, due to the chase for returns as well as structural changes in occupier demand. The share of total logistics investment volumes of cold storage warehouses, data centers and R&D facilities have grown exponentially in recent years, although they still make up just a small proportion of overall transaction volumes (see Figure 3). The runway for growth is long, and investors could benefit from increased exposure to these emerging segments to ride on fundamental shifts in long-term trends.

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