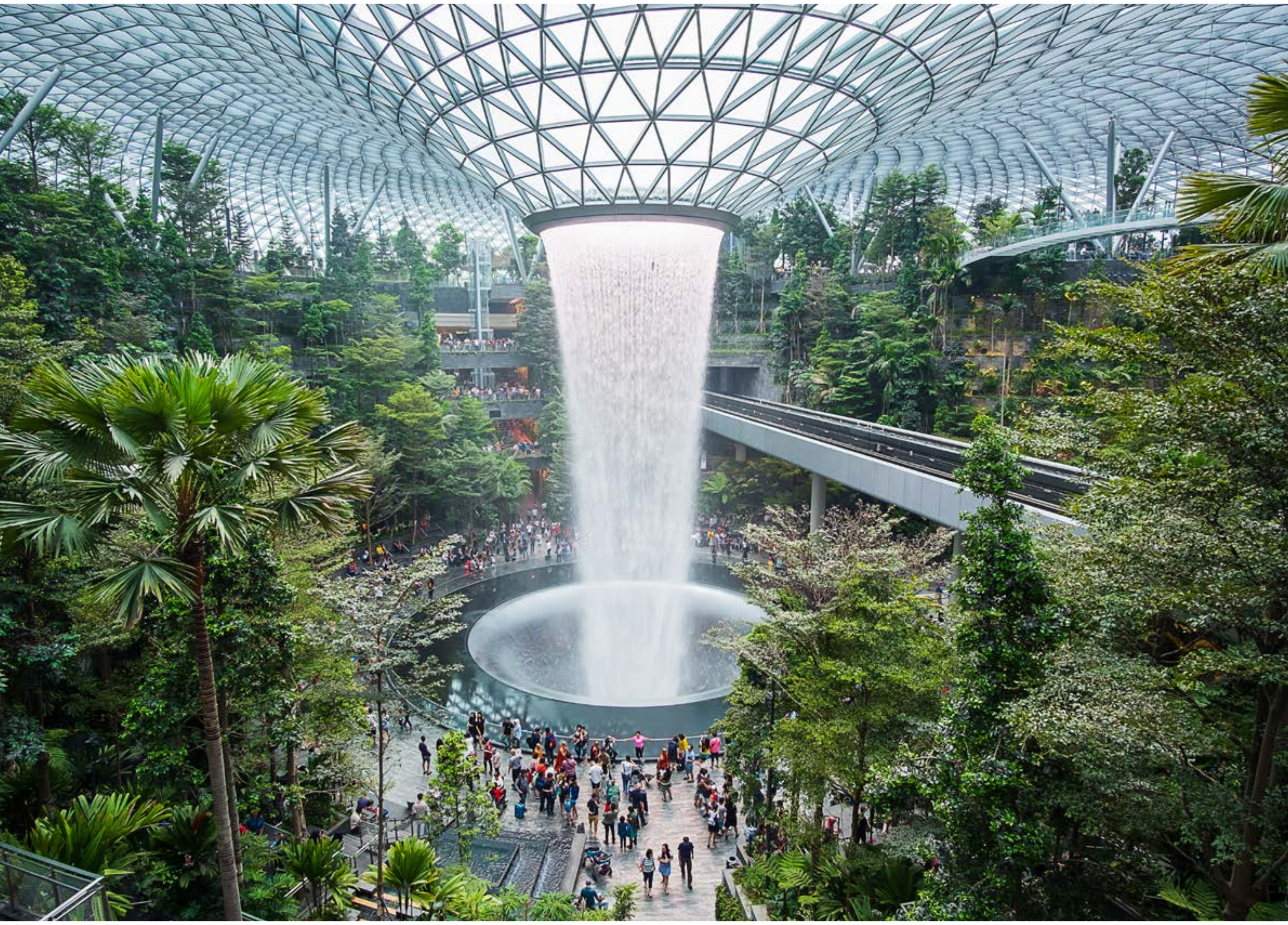


Emerging Trends in Real Estate®

Asia Pacific 2020

Emerging Trends in Real Estate®
Asia Pacific 2020

A publication from:

Contents

Editorial Leadership Team

***Emerging Trends in Real Estate*® Asia Pacific 2020 Chairs**

K.K. So, PwC

John Fitzgerald, Urban Land Institute

Principal Authors

Mark Cooper, Urban Land Institute Consultant

Alex Frew McMillan, Urban Land Institute Consultant

Contributing Editor

Colin Galloway, Urban Land Institute

Contributing Researchers

Michael Owen, Urban Land Institute

Pauline Oh, Urban Land Institute

Yusnita Baharuddin, Urban Land Institute

ULI Editorial and Production Staff

James A. Mulligan, Senior Editor

David James Rose, Managing Editor/Manuscript Editor

May Chow, Senior Vice President, Marketing and Communications, Asia Pacific

Lawreane Jamie de los Santos, Designer

PwC Advisers and Researchers by Territories

Australia
Andrew Cloke
Bianca Buckman
Chelsea Hancock
Christian Holle
David McDougall
James Dunning
James McKenzie
Jane Reilly
Josh Cardwell
Liz Stesel
Morgan Hart
Nick Antonopoulos
Nita Prekazi
Rachel Smith
Ross Hamilton
Scott Hadfield
Shannon Davis
Sue Horlin
Tony Massaro

Mainland China
Gang Chen
G. Bin Zhao

Hong Kong SAR
K.K. So
Paul Walters
David Kan

Taiwan
Jason Liu
David Tien
Bonnie Ho

India
Anish Sanghvi
Bhairav Dalal
Dhiren Thakkar
Tanya Tandon

Indonesia
Brian Arnold
David Wake
Margie Margaret

Japan
Akemi Kitou
Eishin Funahashi
Hideo Ohta
Hiroshi Takagi
Koichiro Hirayama
Raymond Kahn
Soichiro Seriguchi
Takashi Yabutani
Takehisa Hidai
Takeshi Nagashima
Takeshi Yamaguchi

Luxembourg
Kees Hage
Robert Castelein

Philippines
Malou Lim

Singapore
Chee Keong Yeow
Magdelene Chua
Maan Huey Lim

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 157 countries with over 276,000 people who are committed to delivering quality in assurance, advisory, and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com.

Recommended bibliographic listing:

PwC and the Urban Land Institute: *Emerging Trends in Real Estate*® *Asia Pacific 2020*. Washington, D.C.: PwC and the Urban Land Institute, 2019.

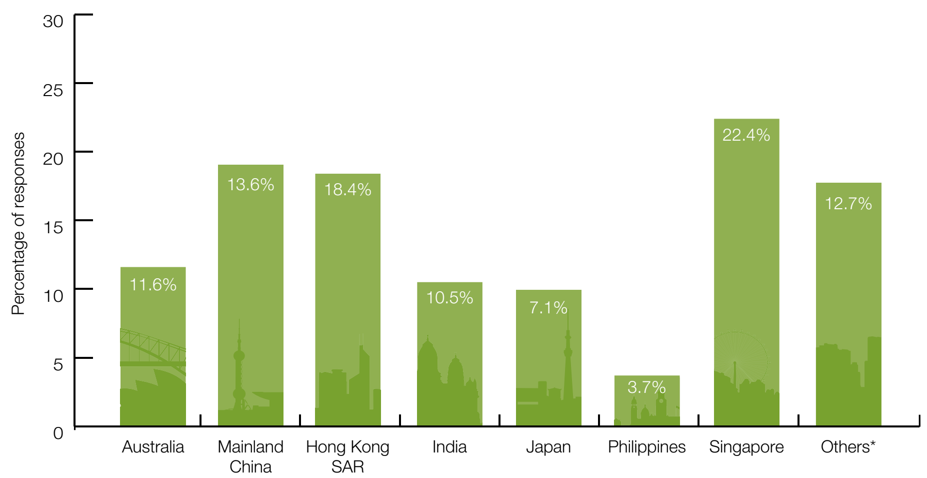
ISBN: 978-0-87420-442-1

Executive Summary

More than a decade since the global financial crisis, Asia Pacific real estate continues to produce strong returns. But as the clock ticks down towards the end of the current cycle, caution is increasingly embedded into investor strategies.

This despite the fact that there is no clear consensus as to whether the market is near, at, or beyond its peak. In part, this is because of the heterogeneous nature of local markets. As one Singaporean developer observed: “The risk of a market downturn has increased significantly, but it’s market specific.” In addition, markets and sectors across the Asia Pacific are often at different stages of their own cycles. Singapore, for example, has only now rebounded from a slump that bottomed around three years ago, while other markets have been riding the same wave after six years or more. Finally, with economic growth continuing at a reasonable clip, interest rates remaining at near-record lows, and with ever-increasing amounts of capital circulating around the region looking for an investment home, it is hard to see where the catalyst for the next recession is going to come from. In the words of one private-equity investor: “If you compare where Asia is today versus where the developed markets are, cyclically we feel like we’re in a better position.”

Survey Responses by Country/Territory



Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

*Includes New Zealand, Thailand, Malaysia, South Korea, United Kingdom, Germany, Belgium, Taiwan, Burma, United States, Russia, Indonesia, Vietnam, and Netherlands.

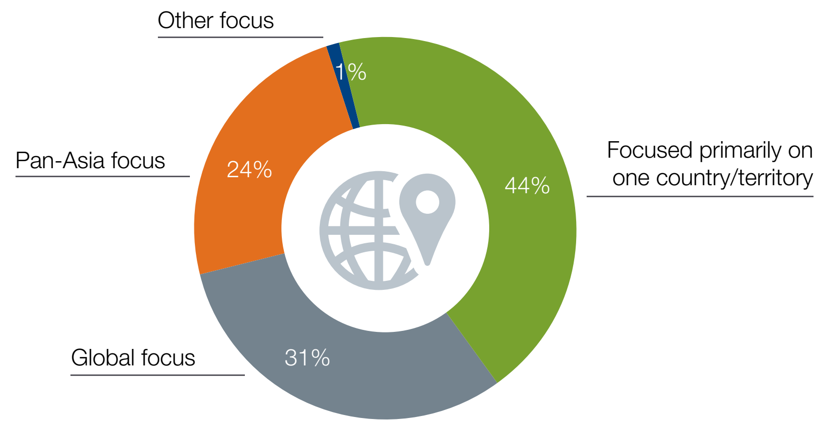
Nonetheless, caution is widespread, especially as yields begin to rise in some markets. Unusually, geopolitics has become the new wildcard, with China-U.S. trade friction, protests in Hong Kong, and the spat between Japan and South Korea causing the most concern. Interviewees highlighted a handful of markets or sectors that look most vulnerable to localised downturns—mainland China, Hong Kong SAR, and India—and these may offer buying opportunities in the longer term.

Nevertheless, sourcing deals remains as hard as ever, forcing investors to find other ways to get capital into the market. Some, for example, are turning to joint ventures, buying slices of larger assets that also allow them to spread their risk. Larger investors, meanwhile, are boosting their commitment to core markets and, where possible, core assets, with Australia, Japan, and Singapore the most popular. An outlier, but a very popular one, is Ho Chi Minh City—an emerging-market growth hedge against more muted core market performance.

The office sector remains the most popular asset class, although business models in the fastest-growing component of that sector—flexible workspace—are increasingly being called into question. The industrial and logistics space, meanwhile, is still the sector most often tipped for outperformance. While the Asia Pacific region is still undersupplied with modern logistics space, more investors are now seeking excess returns in subsectors of that market, such as cold storage or last-mile warehouses.

There is a growing perception that the retail sector in Asia has been oversold, with too many good assets penalised due to problems surfacing elsewhere in the world. Selective but sometimes large-scale buying has been seen in several markets, with investors now increasingly focused on adapting existing assets to meet the changing demands of modern consumers.

Survey Responses by Geographic Scope of Firm



Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

After years in the shadows, sustainability is now finally becoming a priority for the region’s largest investors, and also many smaller ones. Landlords have come around to the view that incorporating sustainable features into their buildings will allow them both to cut running costs and increase rents as tenants become more willing to pay for space that acts as a magnet for talented staff.

In terms of capital flows, cross-border investment patterns into the Asia Pacific are being affected this year by the rising tide of antiglobalism in markets worldwide, with incoming capital from the United States and Europe down 28 per cent year-on-year in the second quarter of 2019 to just US$2.54 billion—the lowest figure since 2012. At the same time, however, the value of cross-border deals involving money from within the Asia Pacific was up 23 per cent year-on-year to US$7.76 billion. This reflects the huge volume of capital held by regional institutions and sovereign funds that is outgrowing the capacity of domestic markets to absorb.

In China, local regulations have drastically restricted outflows in 2019, but the slack has been taken up by others, in particular Singapore and South Korea, while outflows from Japan are also picking up and can be expected to grow rapidly in coming years.

The sheer weight of capital now in circulation means that competition to place it in regional markets continues unabated. One result of this is that investment funds are holding increasing amounts of capital they are unable to spend. When they do spend it, however, financing for deals is for the most part readily available (apart from in China and India, where the dynamics of domestic markets have seen banks retrench). Lending practices have been tightened to an extent, but for creditworthy investors there is no problem. As one Hong Kong–based advisor put it: “There’s no change at the top. We see easy access for low-leveraged deals from good-quality sponsors.” With interest rates in the second half of 2019 reversing course to the downside, the overarching trend in terms of access to bank finance will probably continue to be accommodative.

Asian REIT markets have rebounded in 2019, as interest rates in the United States began to decline. Many REITs in the region, and especially in Singapore, are now on acquisition sprees to take advantage of the lower cost of capital for new purchases, as well as an anticipated upswing in investor interest in yield-bearing stocks, including in particular from investment funds, which have become more willing to buy into REITs as opposed to fixed assets.

The first domestic Indian REIT listed in 2019. Its shares were rapidly bid up in value until by the end of 2019 its implied yield had compressed to under 6 per cent—a remarkably low level for a market where risk is perceived to be high.

This year's investment prospect rankings again reflect investor preference for regional markets that are large, liquid, and defensive—Singapore, Tokyo, Sydney, and Melbourne therefore figure strongly. This is partly a reflection of a flight-to-safety mentality resulting from growing concerns about a global economic downturn. In addition, though, these are all markets offering significant numbers of core assets that are the preferred targets of regional institutional investors that today constitute the biggest driver of new demand for assets.

While investor sentiment towards local emerging markets is now on the wane due to global economic concerns, Ho Chi Minh City received consistently strong feedback in all areas. While placing significant amounts of capital in Vietnam remains problematic given the relatively small size of local markets and a general shortage of investment-grade assets, it is receiving strong inflows of capital as a result of incremental shifts of manufacturing capacity away from China. Remarkably, Ho Chi Minh City this year, also ranked as the top city for all asset classes in this year's buy/hold/sell tables.

Notice to Readers

Emerging Trends in Real Estate® Asia Pacific is a trends and forecast publication now in its 14th 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 2020*, undertaken jointly by PwC and the Urban Land Institute, provides an outlook on real estate investment and development trends, real estate finance and capital markets, property sectors, metropolitan areas, and other real estate issues throughout the Asia Pacific region.

Emerging Trends in Real Estate® Asia Pacific 2020 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 94 individuals and survey responses were received from 463 individuals, whose company affiliations are broken down below.

Private property owner or developer	26%
Real estate service firm (e.g., consulting, financial, legal, or property advisory)	23%
Fund/investment manager	21%
Homebuilder or residential developer	10%
Institutional equity investor	3%
Bank lender or securitised lender	1%
Other entities	15%

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: Defying Gravity?

"We need to be a little bit more cautious in investing in APAC, particularly in areas of the economy that are going to be impacted by U.S.-China trade relations."

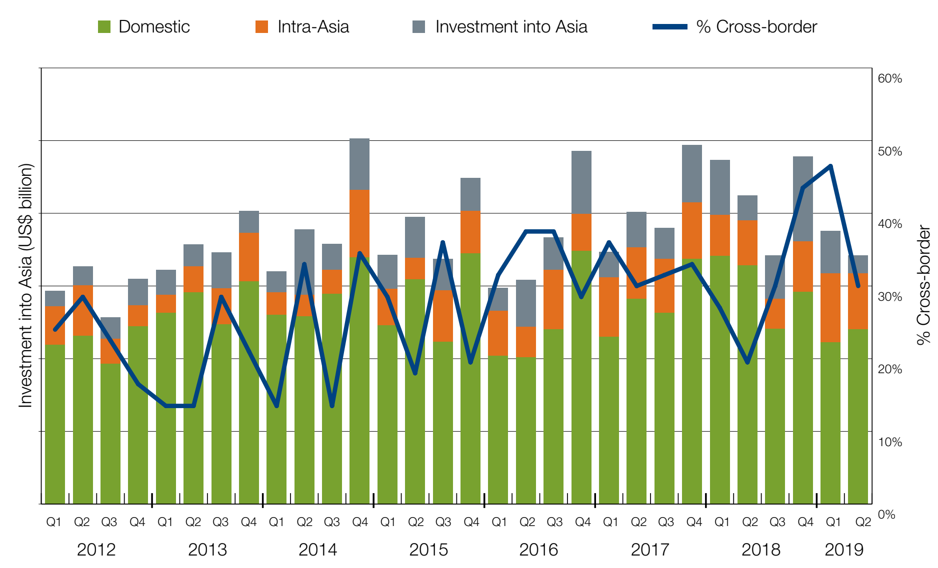
While investors across the Asia Pacific region are notably more cautious about market prospects than in previous years, the jury remains out on whether the top has been reached or breached. What's certain, though, is that concerns today are greater than ever. As one interviewee commented: "I have been cautiously optimistic for years—now I'm just cautious." And as an investment manager in Australia noted: "For the past five or six years I've probably sounded like a broken record, but it is a little bit different this year."

The biggest single factor, as cited by respondents to our Asia Pacific survey, is the impact of the ongoing U.S.-China trade friction, which is being felt across the region as the Mainland economy slows.

Emerging signs of a potential recession in the U.S. economy have only added to concerns. In a September 2019 report, analysts Oxford Economics stated: "Of seven indicators that have been strongly associated with global recessions over the last 45 years, only two are currently sending recession signals. However, one of these two—the U.S. yield curve—has the best predictive record and tends to send the earliest warning."

Recent statistics add to the sense of unease. Respondents' expectations of profitability declined in this year's survey to an eight-year low, while data from analysts Real Capital Analytics (RCA) show a 20 per cent decline in year-on-year transaction volumes through the first half of 2019, together with a fall in rolling

Exhibit 1-1 **Asia Real Estate Transaction Volumes by Source of Capital**



Source: Real Capital Analytics.

12-month volumes from the record levels seen in mid-2018. In both China and Japan, quarterly volumes fell to the lowest levels in a decade, as both domestic and cross-border investment slumped.

Not all indicators are negative, however. Indeed, there seem to be few signs of regional economic instability that might trigger a widespread downturn. Inflation is in check, financial systems appear well capitalised, and global interest rates remain at or near all-time lows.

According to one fund manager: "In most asset classes, you have reasonably decent operating fundamentals in terms of occupancy levels and demand. There is a limited amount of new supply, credit growth to the sector has been reasonable, [and] lending standards for new construction have been responsible. Those are all typically the areas that would precipitate some sort of cyclical downturn."

Other indicators are also supportive. As one investor pointed out: "Real estate still feels like an attractive asset class vis-à-vis bond yields and where interest rates are." According to another, liquidity is also a factor: "We've been at the top now in Asia for about five years, and every year we sit down and say, 'Well is this it, are we now ready for a correction?' And then all these people rock up with billions of dollars to spend on Asian property and of course they support values."

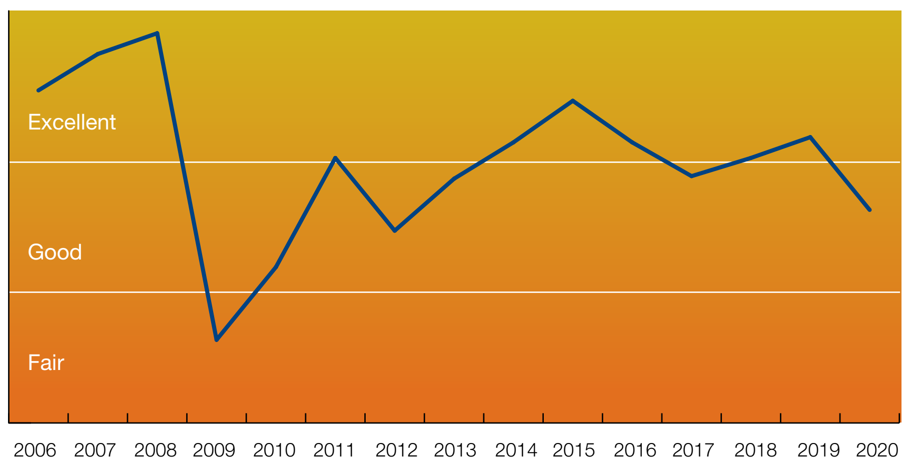
Meanwhile, DWS research projects unlevered aggregate total returns for core Asia Pacific real estate to range between 5.5 per cent and 7.6 per cent annually from 2019 to 2023, well below the 2018 figure of 10 per cent.

Exhibit 1-2 **Most Active Asia Pacific Metros H1'19**

2018	H1 '19	Metro	Grand Total ($m)	% YOY
1	1	Hong Kong SAR	$10,637	–46%
2	2	Tokyo	$9,719	–19%
3	3	Seoul	$8,357	–2%
6	4	Beijing	$5,839	138%
4	5	Sydney	$5,763	17%
7	6	Singapore	$4,884	73%
5	7	Shanghai	$4,572	–2%
8	8	Melbourne	$2,821	–14%
10	9	Osaka	$2,007	165%
21	10	Shenzhen	$1,257	1,233%
26	11	Tianjin	$1,237	295%
9	12	Brisbane	$1,217	–21%
15	13	Mumbai	$1,074	–23%
11	14	Taipei	$679	–33%
13	15	Yokohama	$503	–56%

Source: Real Capital Analytics.

Exhibit 1-3 **Real Estate Firm Profitability Trends**



Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

Geopolitics: the Good, the Bad, and the Ugly

Historically, real estate investors prefer to focus on bottom-up rather than top-down macroeconomic factors. Hence: "location, location, location" trumps "events, my dear boy, events."

Nonetheless, political upheaval has become a common theme across the world in 2019. U.S.-China trade friction may be the obvious harbinger of doom, but it is hardly the lone red flag. Japan and South Korea are also engaged in a renewed political spat, while a series of street protests over a number of months have also flared up in Hong Kong, wreaking havoc on the city's retail and hotel sectors.

What are the consequences from a real estate point of view? While undoubtedly negative for the markets, the current dislocations are also creating opportunities. In China, for example, the trade friction has followed hard on the heels of an ongoing regulatory crackdown on alternative finance products as well as a general tightening of credit imposed by the central bank. Interviewees based in China warned that the malaise was starting to gain traction. In the words of one private-equity investor, the economy "is getting hit harder than people outside China realise."

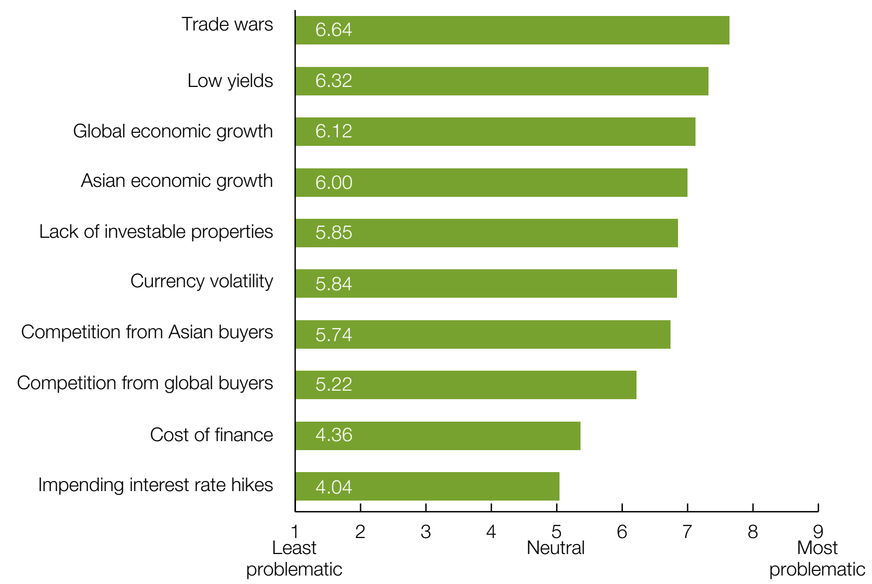
As a result, for many multinational corporations (MNCs), expansion plans are now on hold. "They're more treading water than anything else, which certainly impacts commercial office leasing," one China investor said. However, "If you look at the market as a whole, the growth story is still very much about the tech sector, and Chinese tech firms are doing very well. They are absorbing a lot of space.

According to a different fund manager, "There is clearly an impact in the Shanghai and Beijing markets. Shanghai, in particular, has recently had quite a bit of office development – so you have shrinking demand from MNCs nervous about the trade friction at the same time as a spike in supply. Having said that, the biggest occupiers in Shanghai are domestic companies, and the refocusing of the economy from exports to domestic demand–driven activities will mop up that supply relatively quickly. So, there could be a short window to buy." RCA data show Chinese transaction volumes falling by 19 per cent year-on-year to $15 billion in the first half of 2019, with a more dramatic 39 per cent fall in the second quarter. Given that domestic players have been handicapped by restricted access to capital, foreign buyers are now especially active in the market.

In Hong Kong, meanwhile, the impact of street protests has begun to be felt in earnest. Tourist arrivals were down 40 per cent year-on-year in August, hotels were on average only half full and, in the retail sector, one major landlord reported same-store sales down 50 to 90 per cent over the same period. That said, the office sector has emerged largely unscathed. Although central business district (CBD) vacancies were up and rents were down marginally, there has been little effect on investment values. According to a locally based investor who acts for a number of large institutions and sovereign wealth funds, "A couple of the big sovereign funds called to ask if this is an opportunity, but I had to tell them, essentially, that no one is selling. Apartment owners may panic-sell, but you're not going to see anything on the commercial side. The sentiment is wait and see—if they don't have to close a deal, they're not going to close, but basically, the Singaporeans and Koreans see it as just a blip—no one is expecting carnage."

Going forward, there was also a consensus that Hong Kong is unlikely to suffer an exodus of businesses to other destinations. In particular, the prospect of Hong Kong's financial industry migrating to locations such as Singapore or Shanghai is seen as unlikely due to the continuing advantages offered by Hong Kong's reliable legal system, its low tax rate, and its proximity to mainland China. Given that the Mainland's capital account is unlikely to open up, Shanghai will remain unable to compete as a major finance hub.

Exhibit 1-4 **Most Problematic Issues for Real Estate Investors**



Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

Singapore, meanwhile, is too far away to be a major player, offers minimal cost savings compared with Hong Kong, and struggles with a number of challenges of its own, including difficulties obtaining working visas for staff.

Still, with so much capital circulating in the region, certain markets probably stand to benefit. Little new capital is finding its way to China, for example, which must therefore be heading elsewhere. As one fund manager said: "I think at the margins, people hesitant to put money to work in mainland China and Hong Kong SAR will perhaps be even more focused on Tokyo and Australia. And maybe Singapore is also a net beneficiary of what's going on in China."

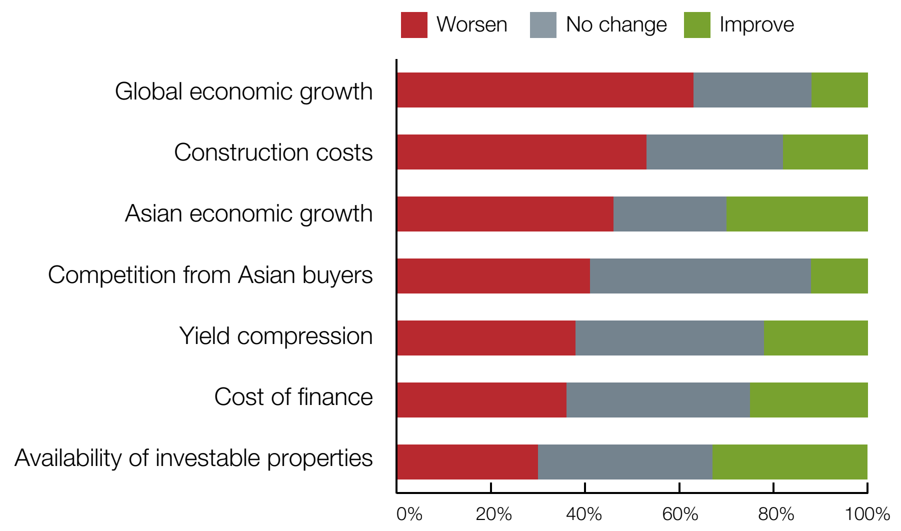
Trade Friction: Winners and Losers

Another way that trade friction is altering regional investment patterns relates to the migration of manufacturing capacity out of China. This shift had been underway for several years, but tariff hikes have now accelerated the process. While the amount of capacity leaving China is still small relative to the total, even a minor shift in a market as big as China can have a major impact on the emerging-market economies where most of the outgoing capacity is now heading. So far, the prime beneficiaries have been South East Asian economies, although some countries have benefitted more than others. According to one interviewee: "Over the past year, of the 25 major industrial refugees that have left China, most have gone to Vietnam, Thailand, or Myanmar." Indonesia has so far seen little activity, and the same applies to the Philippines. This is because, although "they've been poking around, they're very used to competing on tax incentives, and that's where Vietnam trumps the Philippines, despite having a more opaque legal contract system."

One result of this migration is that space in emerging-market logistics and business parks "has been selling like hot cakes", as investors scramble to find a home for new factories. Industrial real estate rents rose by double digits year-on-year in the first half of 2019 in several Vietnamese provinces, according to Savills research, including 54.6 per cent in Binh Duong and 31.1 per cent in Tay Ninh, northwest of Ho Chi Minh City. With incoming foreign investment, meanwhile, rising 69.1 per cent to US$16.74 billion in the first five months of the year, Vietnam is now well-entrenched as the favoured China-plus-one model.

Another result is that Bangkok is now figuring increasingly as a candidate for multinationals' regional headquarters. According to one executive active throughout South East Asia, "Thailand is featuring more and more in people's minds just because executives like being in Bangkok. The quality of lifestyle products for their families is abundant, people have gotten used to commuting by the Skytrain and metro, so the traffic is surmountable, and of course liquidity in Bangkok is the best, in terms of buying and selling real estate generally. As companies become more fly-in fly-out, and as there's a lot more regionalism, a high-cost base like Singapore, especially with its tightening visa requirements and high home prices, make places like Bangkok an interesting option as a base."

Exhibit 1-5 **Projected Change in Economic Factors, Next Three to Five Years**



Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

China: Key Themes

Despite a slowing economy, concerns over ongoing trade friction, and a tighter regulatory environment, more and more overseas investors are beating a path to Chinese real estate markets. First-tier cities, and especially Shanghai, are today regarded as gateway destinations where the largest global institutions feel they must have a presence as they diversify their portfolios.

Commercial real estate transaction volumes in China hit a record high US$25 billion in the first half of 2019, according to JLL. The results were driven by a bumper first quarter, with investment volumes rising 174 per cent year-on-year to some US$17 billion. As usual, most activity was focused on Shanghai, which saw US$10.9 billion of transactions, making it the fourth-most-liquid city in the world, behind only New York, Tokyo, and Paris.

A few years ago, foreign investors often had trouble landing deals in China's primary cities. Today, however, the number and size of such transactions have increased significantly. "I think there's been a dramatic shift over the last few years," one investor said. "Historically, the Chinese [imposed] tight controls over foreign capital entering the market, and it was very difficult to compete against the locals. Clearly, as the economy has started to slow, you have less aggressive domestic capital and a weaker Chinese currency, but there is also a desire from Beijing to see more foreign capital come into China."

A further boost for foreign investors has been Beijing's reluctance to slacken lending restrictions for domestic real estate buyers, even though some loosening has been allowed for small and medium-sized companies. "We're still seeing a very tight lending market towards real estate, [and] as of right now, I don't see that changing," one developer said.

The Chinese office sector has been the asset class hit hardest by the trade friction, although investors continue to selectively target assets in the biggest destinations. According to one fund manager, "We prefer to invest in the first-tier cities, where we tend to see higher levels of growth, greater levels of liquidity, and larger opportunities. Cities that have the most innovative companies, particularly oriented towards the technology sector, are where you have the highest growth.

The current regulatory environment, which has tightened access to capital for developers, investors, and consumer buyers and introduced price controls for residential properties in some cities, has led some investors to take a cooler view of China. However, the logistics sector continues to be a favourite. According to one overseas investor: "We are looking at some logistics deals in China. There's still a massive undersupply of good-quality stock, and it's hard to get the land. It takes years to line those deals up, but they certainly seem to lease well and quickly once they're built. There is massive domestic growth in consumption, which is supporting logistics, the trade war notwithstanding."

A notable change in markets in first-tier cities has been requirements in public land auctions insisting that buyers agree to long-term ownership. For example, the buyer of a mixed-use development site will be able to sell the residential element as usual, but must continue to hold the commercial part of the development for 10 years or more after construction is complete. This naturally makes life difficult for fund managers, unless they are investing in conjunction with a source of long-term capital. As a result, "we've been moving to more brownfield, value-add projects," one fund manager said. "The requirements on greenfield development are becoming onerous for anyone investing via a fund."

Finally, a number of interviewees predicted that the days of "easy growth" have already ended in China. According to one investor: "We still want to invest; however, we do have to be cognizant of the fact that growth is slowing. China has fantastic growth prospects, but it is not likely to achieve the growth levels it has been historically achieving. We are probably more enthusiastic about areas or assets within the Chinese economy that face domestic consumption."

More Caution, More Core

The reluctance to declare a downturn does not mean that Asia Pacific real estate investors have their heads in the sand. More and more, they are turning to defensive strategies in order to hedge against a potential reversal.

One way of doing this is to hold onto investments longer. Our 2020 survey confirms a steady decrease in shorter-term plays over the last five years and a corresponding increase in longer-term investment horizons, with more than twice as many respondents (i.e., 24 per cent) indicating an intention to hold for 10 or more years compared with 2016 data. To an extent, this phenomenon also reflects the increasing volumes of institutional money now looking for an investment home.

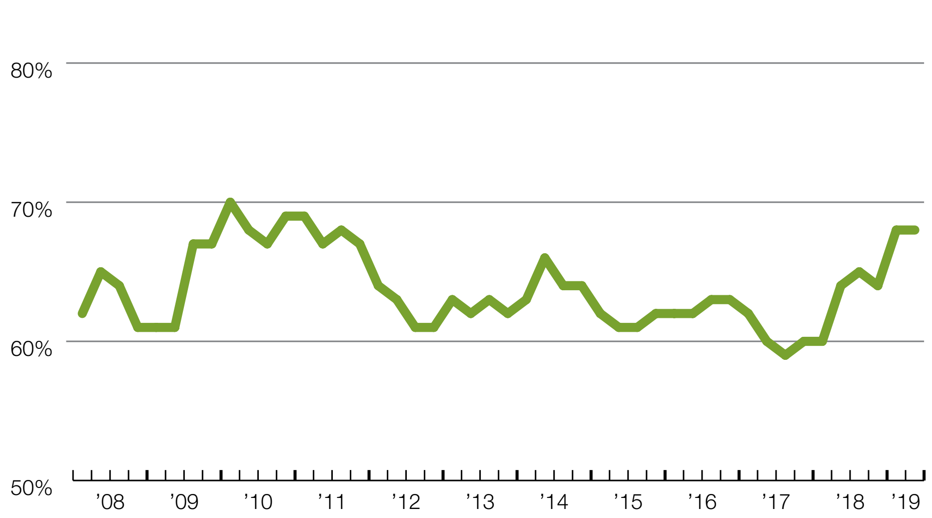
According to one fund manager, “Over the next 12 to 24 months, we would like to rebalance a little bit by doing more core investments, buying a steady stream of cash flows with a long weighted-average lease length and downside protection. So, even if there is a correction, we still have those cash flows coming in and are not dependent on capital gains.”

There is also a flight to quality in terms of location. RCA data show that since the third quarter of 2017, investors’ caution, expressed by their preference for core markets, has been rising (see Exhibit 1-6). “Investors generally are probably a little bit more cautious on opportunistic [investing] and leaning a little bit more towards core strategies because of their concerns around valuation and risk. So they are orienting a little bit more towards lower-risk strategies and probably a little bit away from more cyclical asset classes, like hotels, and more towards less risky assets,” one investment manager said.

This assertion is also backed by the data. RCA statistics for the first half of 2019 show a 39 per cent fall in hotel investment volumes. The top metropolitan areas for real estate transactions in the first half of 2019 were Hong Kong, Tokyo, Seoul, Beijing, and Sydney—all large markets with core assets. According to one investor, “We’ve been super defensive for the past three years, just looking at things where there is really strong local demand and that are very, very affordable.”

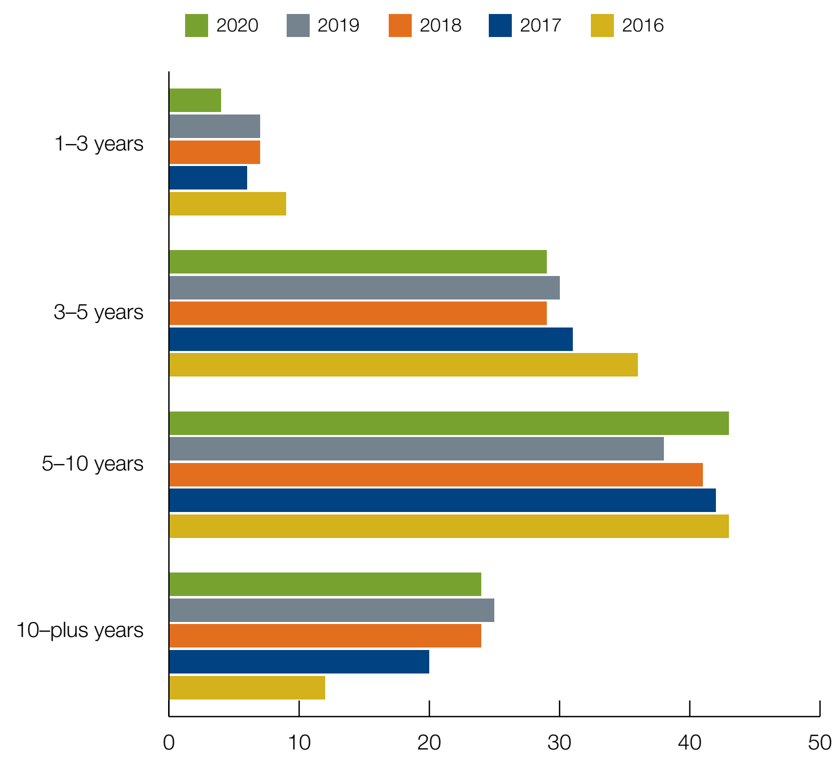
Another said, “We have become extremely disciplined in terms of underwriting and making sure the rental growth profile is something that we validate extensively. We also need to be focused on costs such as tenant incentives, capex [capital expenditures], and maintenance.”

Exhibit 1-6 **Top Eight Metros Areas Share of APAC Volume**



Source: Real Capital Analytics.

Exhibit 1-7 **Time Horizon for Investing**



Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

Spreading the Load

Another way to reduce risk is to share it with others. Larger players are therefore increasingly willing to structure deals as partnerships, and are even turning to funding investments as a way to diversify. JLL reported that Asia Pacific investors racked up some $13 billion of joint venture transactions in the first half of 2019, after an equally busy 2018. “These deals help investors access prime assets with large lot sizes and also reduce concentration risk,” according to one investment adviser.

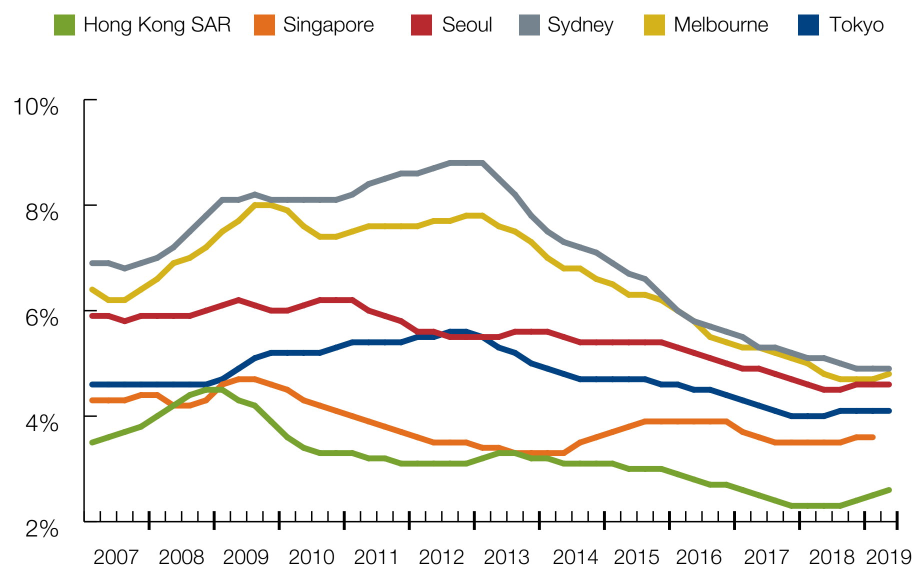
Joint ventures and club deals are particularly favoured in China, where a number of recent deals have resulted in partnerships between domestic and international investors, often involving multiple partners. Anecdotal evidence, however, also suggests that some larger investors, who in the past have been more inclined to target joint ventures or club deals, are beginning to invest in funds once more. According to one fund manager, “We hear that some investors that you don’t think of as fund investors are going into multiple funds. We understand this is partially to reduce risk but also a way to gather information—if you are investing with five fund managers, you have five research departments and acquisitions teams to tap into.”

Yields Begin to Rise . . .

For the past four or five years, real estate professionals across many markets have been wearily sucking their teeth and declaring that cap rate compression cannot go on. So far, however, they have been wrong, with transaction yields continuing to drop incrementally or at least remain compressed.

More recently, however, office yields in some markets have begun to turn. In Hong Kong, where cap rates moved out 35 basis points from their 2018 lows to reach 2.6 per cent as of June 2019, the outward move may be attributed to social tensions. But yields have also begun to expand in major markets such as Melbourne and Tokyo. Whether this turns into a trend remains to be seen, but as one interviewee noted: “I can’t see cap rates getting lower. I know the U.S. has cut interest rates, but I really cannot see any sensible opportunities for cap rates to [continue to] come down.”

Exhibit 1-8 **Asia Office Yields**



Source: Real Capital Analytics.

. . . But Not Everywhere

This reversal in cap rates is hardly universal, however, and in some locations, yields have continued to compress.

In India, for example, some observers see substantial compression of high-end office yields as the economy continues to mature. "I think India is the next big growth story—in the same way we saw one-off yield compression in China over the last 15 years, we'll [also] see one-off yield compression in India." This is the major reason India is so popular amongst those deploying patient long-term capital. Income-producing Indian properties are now in huge demand—so much so that investors are sometimes willing to enter into forward purchases of Indian assets with strong developers in popular locations such as Hyderabad and Bangalore.

According to one locally based consultant, eight to 10 (mainly foreign) investors are now competing for each income-producing asset brought to market. "Bidding wars normally start at around 8.5 to 9 per cent and we've seen numbers go even tighter to 7.5 per cent. From a global investor's perspective, this may not seem too bad, but given the risks Indian markets have, I think people are overexcited."

Meanwhile in Australia, recent interest rate cuts, combined with continued rental growth in the Sydney office market, have led some to suggest that further cap rate compression is on the cards. The reason, according to a Sydney-based fund manager, "is historically strong occupational markets with a macro overlay of interest rates being lower for longer—the 10-year bond rate is below 1 per cent now."

In any event, the mild unwinding of cap rates seen in some locations still leaves prices very much on the risk side of the risk/return spectrum as too much capital continues to chase too few assets. "The weight of capital has readjusted all the returns," as one Singapore-based fund manager said. "It has mispriced risk because no one can find a home for the capital, so you're finding extraordinarily low cap rates for assets that are, frankly, an opportunistic play. And that's the funny thing about it. In a lot of cases, you should be saying, "Time to hit the door."

Exhibit 1-9 Office Sector Cap Rates, Core Locations H1 2019

Country	City	Range	Outlook
Australia	Sydney	4.00–5.00	▼
	Melbourne	4.25–5.00	▼
	Brisbane	4.75–5.75	▼
	Perth	4.75–6.50	▼
New Zealand	Auckland	5.00–6.50	▼
	Wellington	5.50–7.50	▼
China	Beijing	3.00–4.50	◀▶
	Shanghai	3.00–4.25	▲
	Guangzhou	3.75–4.75	◀▶
	Shenzhen	3.50–4.50	◀▶
	Hong Kong	1.50–2.80	◀▶
Japan	Tokyo	2.20–3.50	◀▶
	Osaka	2.80–4.00	▼
South Korea	Seoul	4.00–5.00	◀▶
Singapore	Singapore	3.00–3.75	◀▶
India	Gurgaon	8.00–8.75	◀▶
	Mumbai	8.00–8.75	◀▶
	Bangalore	8.00–8.75	◀▶

Source: CBRE.

Focus on FX

Instability in global currency markets means that exchange rates and foreign exchange (FX) hedging strategies are becoming increasingly important for returns.

According to one European investor, currency is "an important factor in every transaction, [but] now the impact can vary. It is huge in certain places like India, [while] there is a lower impact in places like Japan and Singapore."

Approaches to currency hedging vary widely. Broadly speaking, European, South Korean, and Japanese investors are more inclined to hedge, while very large global investors tend to adopt diversification as a natural alternative to conventional hedging strategies. Overseas investors also tend to borrow in local currencies in order to gain a partial hedge.

In some cases, FX hedging can have a significant positive effect on returns, depending on the currency pairing. For example, as of mid-2019, Singaporean capital received much stronger currency returns in Europe or Japan than it did in Australia. As one adviser commented: "There is a strong FX arbitrage for Asian investors into Europe at the moment and [also] from the U.S. into anywhere else."

Nonetheless, currency movements can make life difficult. According to one investor, "Currency is becoming more of a factor because we have had some dramatic movements. You can do well at the property level and then lose it on the currency. Generally speaking, it is so expensive to hedge that it takes a massive knock off your returns and, until you have some certainty about when your money is coming out, it is difficult to actually hedge it effectively."

The most notable trend in the past 12 months has been the strength of the U.S. dollar, particularly compared with the Indian rupee, the Australian dollar, and the Chinese yuan.

Exhibit 1-10 Internal Rate of Return Impact to Investor Returns Using Cross–Currency Swaps

Home currency (investor capital from…)

Property currency (investing into…)	Hong Kong SAR (HKD)	Japan (JPY)	Mainland China (CNH)	Singapore (SGD)	South Korea (KRW)	Europe (EUR)	Australia (AUD)	U.K. (GBP)	U.S.A. (USD)
Hong Kong SAR (HKD)	N/A	–2.06%	0.91%	0.01%	–1.14%	–2.02%	–0.43%	–0.81%	–0.03%
Japan (JPY)	1.99%	N/A	2.91%	2.01%	0.87%	–0.02%	1.58%	1.19%	1.97%
Mainland China (CNH)	–0.92%	–2.96%	N/A	–0.90%	–2.04%	–2.93%	–1.33%	–1.72%	–0.94%
Singapore (SGD)	–0.03%	–2.07%	0.90%	N/A	–1.14%	–2.03%	–0.43%	–0.82%	–0.04%
South Korea (KRW)	0.88%	–1.16%	1.81%	0.91%	N/A	–1.12%	0.48%	0.09%	0.87%
Europe (EUR)	1.96%	–0.08%	2.88%	1.98%	0.84%	N/A	1.55%	1.17%	1.94%
Australia (AUD)	0.39%	–1.65%	1.31%	0.41%	–0.73%	–1.62%	N/A	–0.41%	0.37%
U.K. (GBP)	0.75%	–1.29%	1.67%	0.77%	–0.37%	–1.26%	0.34%	N/A	0.73%
U.S.A. (USD)	0.02%	–2.02%	0.94%	0.04%	–1.10%	–1.99%	–0.39%	–0.78%	N/A

Source: JLL.

Japan: Key Themes

In developing Asian nations, the fundamentals of demographics and economic growth underpin real estate investment and—for investors active in those markets—outweigh short-term difficulties and barriers to entry. In Japan, the situation is precisely the opposite: gross domestic product (GDP) growth has rarely reached 2 per cent in the past five years, and the country has probably the worst demographic outlook of any nation in the world. Nonetheless, Japan continues to be a popular destination among large investment funds. It offers liquidity, a large base of investable assets, and easy access to nonrecourse bank finance at rates that still come in at less than 100 basis points, despite moderate tightening over the last couple of years.

Overall investment volumes have been slowing for the past 12 months, but asset performance remains strong. Both the office and residential sectors continue to see yield compression.

Interest in office assets is buoyed by “super-strong fundamentals,” according to one private-equity investor. “It’s been impressive to see the steady demand for office—I think that’s surprised most people because there’s been substantial supply in 2018 and 2019. But that’s pretty much been spoken for, so the office market in Tokyo is still very promising.”

However, strong activity by Japanese REITs and the continuing dominance of large domestic developers over high-end office space mean that pickings are slim for all but the best-established foreign players. “We are trying to find stuff in the market, but we just cannot find enough to buy,” said one fund manager. “The [foreign] guys who bought office have sold most of it, so the sellers are domestics and they’re selling to other domestics.”

High prices in the office sector have seen many investors turn to the multifamily residential space over the last few years, but competition for assets has driven cap rates to levels that some see as prohibitive. According to one Tokyo-based investor, “The pricing is so tight we’ve stopped looking at residential. We still see it coming across, but Tokyo is trading in the low 3s [i.e., 3 per cent].” With some properties selling at a higher per-square-metre price than brand-new condos in the same submarket, operating incomes are further reduced once leasing, renovation, and turnover costs are factored in. “So, if you’re buying a 3-cap [rate], you’re probably looking at a 2.5 on a net cash flow basis.”

Despite rising tourist numbers, the outlook for Japanese retail property is somewhat flat: average prime retail rents in Tokyo, Osaka, and Nagoya have been unchanged for 16, 12, and six quarters respectively, according to CBRE research. However, there are pockets of growth: Ginza, Tokyo’s prime shopping district, is seeing rising rents and interest from investors.

According to one investment manager, “People are looking for high street retail, but it is not really available. Domestic [players], especially the trading companies, continue to be the most aggressive buyers, picking up whatever they can. But there’s also concern over the consumption tax going up and whether that will be sustainable, particularly if tourism tails off because of the [problems] with South Korea and China.”

Although Japanese shoppers remain seemingly immune to the appeal of e-commerce, the structural shortage of modern warehousing stock has provided bumper opportunities for developers and investors. Nor is there any sign of the logistics boom ending—vacancy rates in the core markets of Greater Tokyo, Osaka, and Nagoya have been declining, according to CBRE, with vacancies in the Tokyo Bay Area falling to zero in 2019 for the first time since 2008.

“Whether you are looking at assets focused on e-commerce, or just general logistics, there is a lot of life in the sector and the price is still making sense when you can buy in the mid-4s as opposed to the low 3s,” according to one interviewee.

Difficulty placing capital in Tokyo is leading growing numbers of investors to look to other domestic markets as sources of more affordable deals. “The liquidity has improved,” said one fund manager. “Fifteen years ago, these were secondary cities where you could chase yield, but there was always an underlying problem of liquidity. However, Osaka, Nagoya, and Fukuoka repositioned themselves after the financial crisis and expanded their economic base. I don’t think these cities are secondary anymore—they’re just not Tokyo.”

Major provincial cities still offer higher yields than Tokyo; while office cap rates in the capital are now between 3 per cent and 3.5 per cent, the equivalent in Osaka and Nagoya might offer 50 to 75 basis points in additional yield.

Pockets of Distress

Although in general, high prices and compressed yields remain the norm, signs of stress have emerged in a few markets, caused in particular by a lack of access to capital. In India, for example, while the office sector is a runaway success, residential developers are in a downward spiral. A government crackdown on banking-sector malpractice, combined with growing credit risk among developers, has seen banks pull the plug on real estate lending. With the nonbank financial sector in similarly dire straits, developers now have nowhere to turn for finance.

In July 2019, a report by investment bank Goldman Sachs predicted that 70 per cent of Indian developers could go out of business within the next two years. “These are painful times,” one Delhi-based consultant said. “The whole game is going to become redefined; only people with access to a credible capital partner will survive. Developers are struggling for survival.” As a result, distress plays are becoming a major opportunity. A newly introduced bankruptcy code means that more assets are being auctioned off by banks at a discount.

Still, the prospects of structuring such investments using debt may be even more appealing. “Anyone coming to India saying, ‘I have capital to deploy for distress’ should be able to make equity-like returns doing senior structured last-in, first-out senior debt, with potential for IRRs [internal rates of return] in the region of 22 to 24 per cent”, continued the consultant. “So far, few people have woken to that opportunity and just a handful of funds have entered the market.”

In China, meanwhile, a government crackdown on nonbank lending, together with new central bank rules tightening access to real estate borrowing, means that all but the largest players are having problems accessing capital. Particularly at risk are overstretched operators in the residential leasing and coworking sectors, both of which have already seen business failures.

While some see a major opportunity, predicting “massive failures,” others are more sanguine. According to one Shanghai-based fund manager, “I see a lot of people talking about it, but I hardly see any deals, for a couple of reasons. First, these kinds of opportunities are complicated. If it’s really distress, it involves lawsuits, foreclosure arrangements, and negotiations, so it’s hard to close. And the other reason is that people are still not desperate enough. With the Chinese government already talking about relaxing money supply by cutting bank reserve ratios and other measures, it’s hard to see it getting worse.”

Other opportunities for distress relate to overcapacity. In Japan, for example, the tourism sector has been a huge success story over the last few years. That may have been too much of a good thing, however—overbuilding in the hotel sector is already creating distress situations.

If Japan’s current diplomatic quarrel with South Korea is not resolved, distress may become worse, given that nearly a quarter of Japan’s 2018 tourists came from that country. According to one Tokyo-based fund manager, “You have a lot of construction, and a lot of these hotels have unsophisticated owners and small, undercapitalised management companies that are in on either a lease or an operating agreement, but they will not have the ability to perform. These guys have been backed but can’t service the debt. So, I think going forward there’s going to be opportunity once there’s a bit of distress in tourism.” While the problem is likely to worsen after the Olympics, less savvy owners and operators could run into trouble before that.

Further opportunities exist in Vietnam, which suffers a perennial problem from overbuilding in the condo sector, and also in Australia, where Chinese buyers of residential development sites in recent years bid heavily to buy land but today are sometimes unable to source capital to complete their projects. One local private equity investor said that his company had been active in the “for-sale condominium market, where there’s been a lot of overbuilding, the capital market flow is disrupted, and the financing market is disrupted. That’s creating an opportunity we’re taking advantage of.”

Sustainability: Coming of Age

Over the last decade or so, interviewees in the Asia Pacific region have spoken wistfully about efforts to improve the efficiency of their buildings: green was good, but all too often they were deterred by the perceived costs of upgrading. Today, though, a threshold of sorts appears to have been crossed. For developers, owners, and occupiers of prime real estate, sustainability is now intrinsically linked with quality; it is hard to imagine a worthy grade A office building not rated under the Leadership in Energy and Environmental Design (LEED) or some other local certification scheme.

According to one global investor, "For all our office investments, we are now required to have some sort of green certification, and we are happy to spend the money required to achieve it because we consider it [both] a differentiator and downside protection."

The drivers for this are twofold: capital and regulatory. On the one hand, there is growing awareness that upgrades to building infrastructure can create real financial value—either through reduced costs such as electricity, or through higher rents. According to one investor involved in fitting out a building in Kuala Lumpur, "You're looking at cloud management and very sophisticated artificial intelligence that can optimise the running of the building in terms of things like predictive maintenance, occupancy usage patterns, and optimisation of temperatures using a number of different data points, including satellite weather forecasting."

In addition, private-equity investors, large real estate investment trusts (REITs), and most major developers almost inevitably have to cater to the requirements of institutional investors from Europe and North America, who by and large require entities in which they invest to meet a minimum standard in terms of sustainability. Larger European pension funds, for example, will not give capital to managers who cannot demonstrate environment credentials.

According to one fund manager, "To get investor funds, you need to have a real ESG [environmental, social, and corporate governance] programme and platform. When we see RFPs [requests for proposals] come in, there's a huge ESG section. From our perspective, you need energy efficiency as one of the key requirements of any asset, simply because the capital markets are going to start discounting it if that stuff is absent."

The other catalyst is the need for regulatory compliance. Requirements vary from government to government around the region, with Australia and Singapore seen as the strongest promoters of environmental sustainability, and smaller developing markets having less imposing rulebooks. That said, buildings in emerging markets are often some of the least efficient, meaning they have more to gain by introducing efficiency measures, even without mandatory measures.

In any event, larger real estate players expect more regulatory control in this area as governments fall increasingly in line with the Paris Accord, which aims towards net-carbon-neutral economies. "The big risk," said one investment manager, "is that you buy something now that will fail the regulations or the requirements of investors some way down the line. In three or four years' time, you might find that you can't lease it or sell it because it doesn't have the environmental credentials."

There is also growing pressure on this front from multinational occupiers, although the environment in the Asia Pacific is not currently as demanding as in the West. According to one adviser: "Elsewhere in the world, we are starting to see major corporates requiring LEED Gold certification as a condition of tenancy. "We have not seen that yet here, but I think that will eventually be the direction of travel."

Meanwhile, more and more Asia Pacific real estate players are signing up to the Global Real Estate Sustainability Benchmark (GRESB), which requires managers of assets to report environmental policies and performance, with data then made available for use by investors to support their allocations of capital.

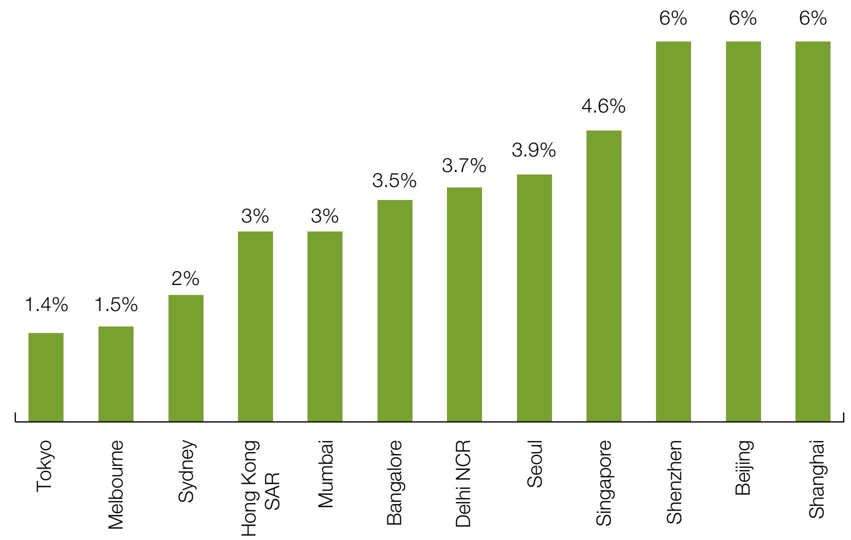
"GRESB gives investors a number," said one subscriber to the programme. "They can see that firm X scores 86 and firm Y scores 50 and they can point to firm X being better. They don't even need to know how. And, of course, it makes you look worse if you're not in GRESB."

One frustration for ESG advocates is the difficulty in demonstrating a causal link between ESG initiatives and improved asset performance. However, according to one interviewee, "If you look at the investor-led indices and benchmarks, better risk-adjusted returns are linked to a broader management of ESG issues."

Coworking: Does It Work?

The failed initial public offering (IPO) of the world's largest coworking company in September 2019 has forced investors globally to reconsider the risks relating to the structuring of the industry's lease agreements. Usually, operators obtain space from landlords on long-term leases (often including long rent-free periods, nonrecourse terms, and commitments from landlords to undertake costly fitouts) that is then sub-let to their own end users on a short-term basis. This mismatch means that operators at risk of losing tenants in the event of a downturn will still be bound by the terms of their own (longer) leases with building owners (who are in turn exposed if an operator goes out of business). In addition, the extent of the losses disclosed in the abortive IPO now raises further questions. In particular, is the industry's business model sustainable over the long term? And, more important in the short term, will operators still be able to raise equity and debt in an environment where so few operators are currently profitable and competition is only increasing?

Exhibit 1-11 **Penetration of Coworking Operators in Asia Pacific Cities**



Source: CBRE Research, May 2019.

Given the sheer volume of coworking space now on the market, these risks apply not only to coworking operators, but also to building owners and potentially also banks that have financed the purchases of buildings in which there are large concentrations of coworking facilities. According to CBRE, the total office footprint of coworking operators in the Asia Pacific region has risen more than 300 per cent since 2016, reaching some 54 million square feet as of March 2019. The industry now occupies more than 3 per cent of office supply in the Asia Pacific region, compared with 2 per cent in the United States.

According to one Shanghai-based fund manager, "Lots of smaller coworking companies in China are now having trouble servicing [debt]. There is definitely demand, but the dilemma for investors is the need to consider whether there will be a negative impact on exit in terms of pricing because the credit standing of the industry is deteriorating."

As a result, landlords are now changing the way they contract with coworking occupiers as they seek to reduce their risk. "We are shying away from leasing out the whole building [to operators]," continued the fund manager. Instead, "we may give a third or a quarter of our space to them, and then try to include more covenants, requiring a big deposit or guarantee."

Another way the flexible space dynamic is changing is through the emergence of landlord/operator partnerships, with operators looking to secure management contracts to create flexible workspaces, either within individual buildings or across an entire portfolio of assets. Coworking companies thereby gain access to a large client base of established corporate tenants while simultaneously slashing both rental overheads and the large capex commitments needed to set up new coworking centres. Landlords, meanwhile, can upgrade amenities for existing tenants and are spared from having to compete with the operators by creating standalone platforms.

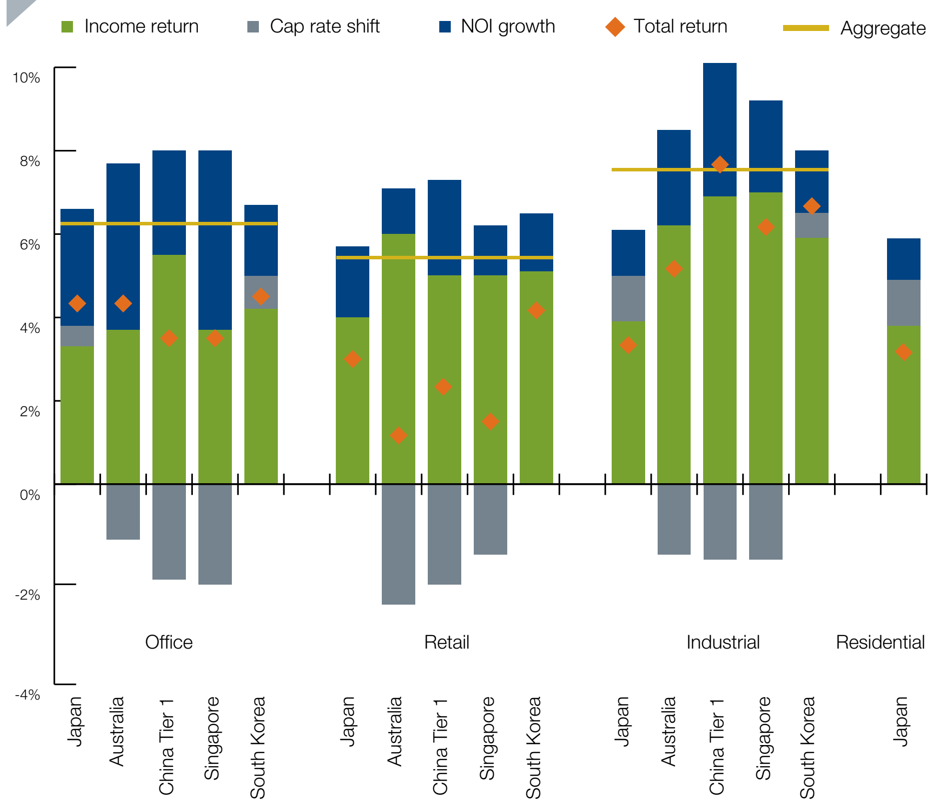
This type of relationship is becoming increasingly common in the United States. According to an executive of one U.S.-based coworking operator who has negotiated numerous such deals, "The landlord is now our client, so we're structuring these top-line revenue-share structures or profit-share structures where landlords put up the majority of capital, but get a premium to the market rent. For example, in New York our rent is $64 per square foot, but we're rerenting that space for $380 per square foot. So, we say to the landlord, "You're missing out on that opportunity—you could be making a 40 per cent to 50 per cent premium on a traditional rent." Although so far this model is relatively rare in the Asia Pacific, landlord/operator partnerships can be expected to evolve quickly over the medium term.

Retail: Is Asia Different?

On a global basis, the retail sector has become real estate's whipping boy, unloved by investors and attracting dour headlines as it struggles to fend off the threat from online competition. The story is similar in the Asia Pacific, although somewhat less dire. RCA data show a decline in regional retail investment volumes of 7 per cent to $16.5 billion in the first half of 2019, a slower rate of decline than seen globally, while survey respondents ranked the sector the one with the weakest prospects, rating it less highly than in our 2019 report.

However, a number of large investors continue to participate enthusiastically in the sector and have made substantial commitments in several regional markets, in particular mainland China, South Korea, and Hong Kong SAR.

Exhibit 1-12 **Projected Annual Total Return by Sector and Country in Asia Pacific, 2019–2023F**



Source: DWS, as of June 2019.

Various reasons have been cited for this, one being that most locations in Asia are structurally undersupplied compared with developed markets. Only in Australia is there substantial per capita retail supply. While there has been localised overbuilding in China and India, these markets still lag Europe and North America in total supply.

More important, the fact that Asian consumers are the most online savvy in the world creates potential to incorporate digital technologies within new retail developments. Nowhere is this clearer than in China, where malls now serve both online and offline shopping as well as providing a higher proportion of entertainment, education, services, and food and beverage (F&B) space. "China will come out of the retail slump before others because they're further along in this amalgamation of online and offline, of logistics, of the next iteration of what retail space is really about," said one developer. "But to get there, retail has had to go through a revaluation, [because] if you have a lot more retail space devoted to entertainment or F&B, that traditionally won't pay as high a rent as fashion."

Meanwhile, non-discretionary retail continues to find favour as a defensive asset because shoppers will always need neighbourhood retailing. In China, "nondiscretionary expenditures in retail, food and beverage, and some mall properties are still doing pretty well," one investment manager argued. A number of interviewees also commented that retail assets are the least homogeneous in real estate, making generalisations difficult. The best mall in a city can therefore thrive, while all those around it are struggling.

Retail has always been the most actively managed of the core property sectors, and that has intensified as landlords try to create spaces that will attract footfall. According to one interviewee: "Landlords are starting to look at providing a more immersive experience and a more personalised offer in their malls, which technology—the ability to collect and analyse data—is enabling them to do."

The other crucial factor in shopping centre management is positioning the mall in its community. "The Asian shopping centre has always been closer to the heart of the community than elsewhere," one developer said. "And I think that goes to the oldest paradigm of what a shopping mall actually is, which is a town centre. The innovation is a really simple one, which is just to look at any neighbourhood and what makes it thrive and provide all that front and centre."

Often, the most innovative malls are those in a niche location, or where space is constrained. "If you go to a place like Shibuya in Tokyo, you can see malls which are constantly remixing themselves organically. They don't have long-term leases or anchor tenants, or if they do, it will be retailers who turn their stock over really quickly."

Some interviewees also see an opportunity in secondary malls, which can be bought cheaply and refurbished to provide more up-to-date offerings, which might include coworking and other service

Australia: Key Themes

"If I was putting my money anywhere in the Asia Pacific in the long term, I would continue to put it in Australia." With both Sydney and Melbourne continuing to rank near the top of this year's investor ranking survey, this fund manager's opinion clearly has widespread support. Australian markets offer good (for Asia) yields, reasonable liquidity, ongoing rental growth, a reliably strong economy, and even a weak currency to boost the appeal for offshore investors. RCA data show that Australian investment volumes rose 3 per cent year-on-year in the first half of 2019, making it the only one of the five busiest markets in the Asia Pacific region to record an increase in transactions.

According to one private-equity investor: "Australia is pretty fully priced, but I think maybe late-cycle people gravitate towards the most efficient markets, and I would put Australia on the list of very efficient markets."

Investor enthusiasm is supported by continued strong performance across the office and logistics sectors. Savills research for the second quarter of 2019 showed continuing rental growth in Australia as well as ongoing yield compression, even in Sydney, where average prime office yields are now less than 5 per cent.

As one Australian fund manager said: "The office markets just continue to go from strength to strength, particularly in Sydney and Melbourne, based on historically strong occupational markets. Vacancy rates in Sydney and Melbourne are at historic lows."

Australia's residential sector has been one of the few in the Asia Pacific region to suffer a downturn over the last couple of years. Prices may now be stabilising, however, following two interest rate cuts, tax breaks, and the easing of mortgage borrowing requirements. In Sydney and Melbourne, markets have also been boosted by a spike in purchases by Hong Kong investors looking for a safe haven as the city's street protests continue. One developer cited how the influx of new capital has resulted in a resurgence of sales at some inner-city projects that had previously been lagging.

Despite a significant pullback from Chinese investors due to restrictions on outbound capital, Australia continues to attract global players. According to one fund manager: "A lot of the guys we are talking to are new guys, and mainly Asian groups—a lot of pension funds, insurers, or sovereign wealth funds."

Going forward, there is a general expectation that Japanese institutional investors also will soon become major investors in Australian markets, since they offer the type of transparency and liquidity that Japanese capital is seeking as it begins to diversify outside of Japan.

Nonbank debt is featuring more and more as a means to finance real estate deals in Australia, thanks to a partial withdrawal from the market by the large domestic banks, whose lending is hobbled by increased regulatory pressures and higher capital requirements. The funding opportunity is expected to grow to some A$50 billion by 2023, according to Maxcap Group, an Australia and New Zealand commercial real estate debt specialist. As one investor said, "With [domestic] banks unable to participate at the same level, or in some cases not able to participate in some of the foreign deals, it has opened up this opportunity to nonbank lenders. And it's a pretty exciting opportunity, particularly at this point in the cycle where for some investments you would much rather have debt than equity exposure."

Some investors strike less positive notes, however. Many of Australia's prime properties are tightly held by local REITs, and the huge volumes of cash held by Australian pension funds mean that competition for assets in that market will always be tough. In addition, there is little incentive for building owners to sell because they may not be able to get back into the market if they do.

Also, as cap rates continue to compress across the board, some asset classes are losing their appeal. For the past few years, for example, Australian logistics has been a go-to sector for investors. Today, this is changing. According to one fund manager, "Industrial is so ridiculously priced at the moment—I think you would be mad buying it at a 4.5 per cent yield when you can buy prime offices in Sydney and Melbourne off similar cap rates. Australia's a big place with a lot of land. Industrial has never really generated rental growth above inflation, and with the land supply available, I don't think 40-odd years of history is going to change too much. There's also an obsolescence risk with industrial and logistics."

Overall, though, prospects remain positive; 2019 marks the 27th year since the last Australian recession.

industries, as well as a contemporary retail mix. According to one architect, "Repositioning is not so glamorous, but I think that is where a lot more experimentation will actually occur."

In China, one foreign opportunistic investor spoke of repurposing upscale malls to appeal to an edgier demographic: "We're looking at a strategy to reposition [assets] that were built on the basis of being filled with [stores like] Gucci. We're going in and buying at discounted prices with the idea of re-tenanting it with entertainment, retail services, doctors' offices, better clinics–the kind of stuff that pays a very different rent, but if you buy at the right rent point in a very good urban location, you've got a good asset. It's a pretty interesting opportunity."

For some, the current negativity towards retailing is welcome. According to one Australian investment manager, "I think this is going to present opportunities, because the fact that there is such a negative attitude towards retail is going to lead to mispricing. With all the noise around the sector, there is going to be an opportunity for the next 12 months or so, and what we're starting to hear from the bigger global investors [is] that they're recognising it as well. They are actually seeking out a potential buying opportunity for assets that very rarely, if ever, trade."

Focus on the End User

Today, real estate investors across the Asia Pacific are taking an increasing interest in their end users—the shoppers and office workers in their buildings—as opposed to the companies that sign the tenancy agreements.

In the office sector, this manifests as an increased focus on health and well-being, whether this means providing end-of-trip facilities for cyclists, health programmes, or clean air for tenants. "In China, there is a very strong focus on indoor air quality, and this is a focus for workers and thus also for HR [human resources] departments. That translates into tenant stickiness," said one investor.

The concept of "space as a service" has until now been popularised mainly by coworking companies, but real estate investors—even if they have conventional leases in place—are starting to see opportunities in providing more services for end users, including retail space within offices, for example.

The service component is increasingly important in retail spaces too, as omni-channel retailing begins to challenge the traditional landlord/tenant dynamic. Whereas previously, retail landlords simply provided space for tenants and let them focus on customers, they now have more direct involvement, with an increasing focus on "programming," i.e., the software of their spaces. According to one developer, "I think the general investment into programming has had to increase significantly to keep people there. And then working with some of the tech-related companies as they roll out new products and showrooms and display their products in a different way. It's all about trying to create a more unique experience."

Some observers take a more philosophical approach to this phenomenon. According to one adviser, "There is no return on capital anymore, so you look to make money on the service component—you want a bit of real estate in the densest location you can [find] where you can get the greatest number of people using your real estate and then make money through services to them. It is all about owning assets in dense urban locations."

Nervous about Niche?

For several years, higher returns offered by alternate sectors created a favoured refuge for regional investors seeking to hit targeted returns. These remain popular today, although concerns are emerging about niches that feature a heavy operating element. Sectors such as student housing, data centres, self-storage, and senior housing are high-maintenance plays, where investments are often structured using separate operating companies. As one investor noted, "There are a lot of moving pieces that real estate investors do not understand—it's a different way of investing, where you're trying to capture more of the operating profit and move up the value chain. It is a lot more complicated, and running a business is very, very different from collecting rent. It is part of that continuum between being a landlord and being an owner-occupier." As a result, some investors are beginning to question whether the investment required in an operating company is actually diluting real estate returns.

The industrial and logistics sector has proved one of the most popular with global real estate investors over the past decade, with the bulk of investment dollars going to create modern logistics facilities. But with logistics now firmly established as a core asset class, a range of subsectors within the industry is drawing investor attention.

LAST-MILE FULFILMENT is one emerging subcategory. According to one Singapore-based adviser, "There is clearly a need for urban logistics now, because if you are going to order online and expect a man on a bike to arrive in 30 minutes, the centre must be within 30 minutes' ride of where you are sitting."

Enabling last-mile delivery is tricky, though, because city-centre land is expensive and logistics warehouses are rarely small. Investors are therefore thinking creatively about using space. For example, as shopping centres lose business to e-commerce retailers, vacated capacity can be leveraged as a fulfilment facility, as can older, lower-grade industrial buildings, as long as they are accessible. Vacant floors in fringe office locations could also be adapted as logistics space.

COLD-STORAGE FACILITIES are another logistics spinoff, driven in this case by evolution of the online grocery sector. Aggregate online sales of groceries in the Asia Pacific are forecast to surge from US$80.7 billion in 2018 to US$260 billion in 2023, according to researchers Forrester.

"Cold storage is interesting, just because of the rise of the middle class, and the consumption trends around frozen-food," a private-equity investor commented. "And not just in China, but places like Australia [also] have pretty significant food exports, so frozen-food growth is driving demand for cold storage above and beyond what you would expect in a developed market."

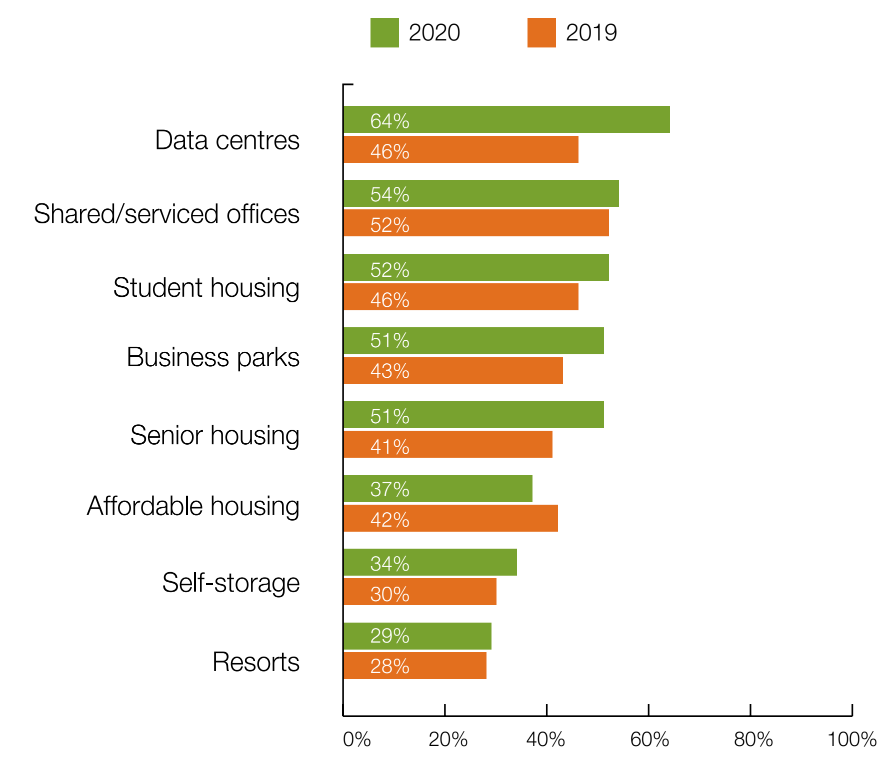
CBRE research suggests that for the Asia Pacific to build the same per capita cold-storage capacity as the United States would require 411 million cubic metres of new supply. It also said that yields for cold-storage facilities are 50 to 150 basis points higher than for warehouses, with tenants generally also taking longer leases of 10 to 25 years.

DATA CENTRES are the favoured niche sector in this year's *Emerging Trends* survey, driven by growing appetite for data by cloud computing providers and the impending advent of 5G mobile technology. "There is huge demand for data centres," according to one adviser. "It's probably up with logistics as the sector everybody wants to get into. The problem for the big investors is scalability, because data centres are generally not very big physically or even in value. So, if you're going to invest, you need a lot of them, and I think some of the big investors will find that a little bit fiddly."

South Korea, Japan, and Australia are the first Asia Pacific nations to begin the rollout of 5G services and, alongside Singapore, are the prime targets for investors in the sector. But emerging markets also are consuming ever-growing volumes of data, and investors from Jakarta to Manila mentioned the sector as one with a high local growth trajectory.

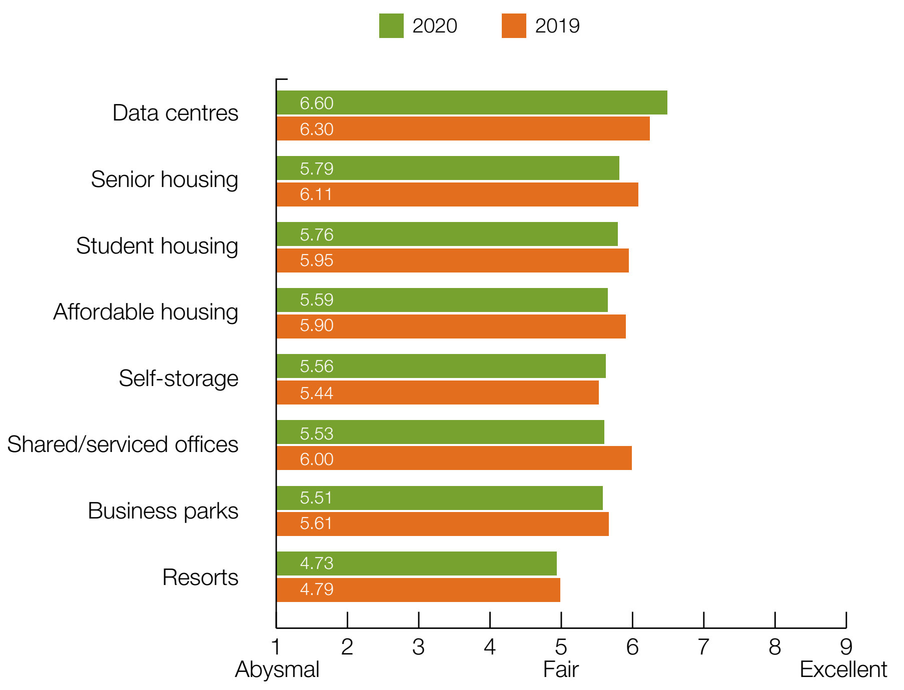
China is an entirely separate market, and many investors prefer to stay away because of regulatory barriers and concerns over data security. However, it has huge potential and notable undersupply. A recent report from DBS Bank found a huge mismatch in supply and demand in markets across the Mainland, with all the primary cities lacking sufficient capacity. The prime challenges for China data centres lie in finding land in cities where demand exists and in securing required supplies of power.

Exhibit 1-13 **Niche Sectors in Which Investors Are Now Active or Plan to Be Active in 2020**



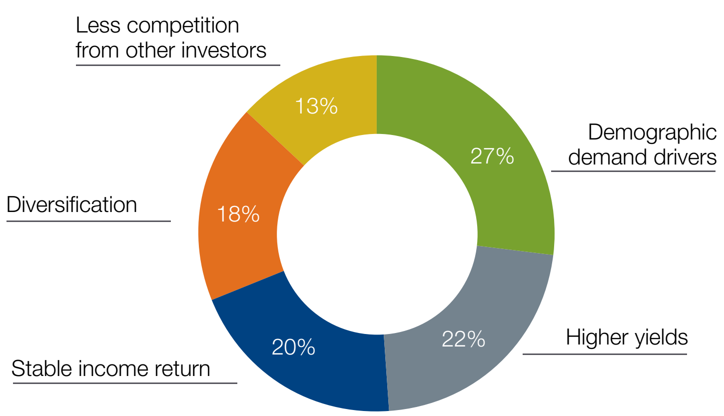
Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

Exhibit 1-14 **Prospects for Niche Property Types in 2020**



Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

Exhibit 1-15 **Reasons for Investing in Niche Sectors**



Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

Accounting for Climate Change

A relatively new concept for real estate investors is that of climate risk and resilience—how exposed an asset or a portfolio is to the various impacts of climate change, including warmer temperatures, higher sea levels, and the increased risk of extreme weather events.

As extreme weather events increase in frequency, awareness of potential negative impacts on long-term asset values is forcing owners and investors to change the way they underwrite investments. According to one fund manager, "Most commercial properties tend to be around water—close to either an ocean or a river, because that's where everybody is. So, if we have more severe weather events, there is potential for flooding, for example. I think the industry will move quickly on this, even more quickly than with regard to carbon reduction."

"There's a huge amount of climate risk in sea-level rise in Greater China, and [particularly] in the Greater Bay Area there's lots of risk exposure," one interviewee stated. "For areas such as Miami, there is an emerging ecosystem around climate resilience, but I am not sure that is the case in China."

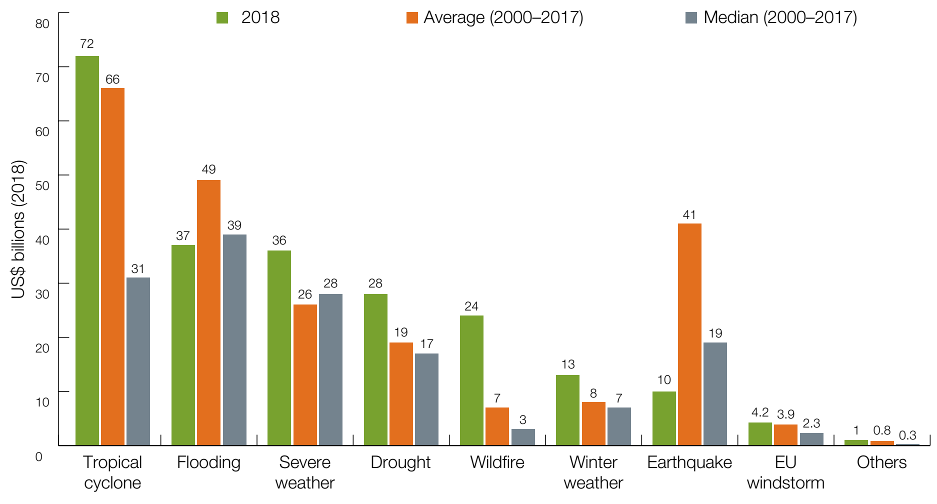
The real estate industry as a whole has begun to develop more advanced strategies to recognise, understand, and manage risks, but still mainly relies on insurance to cover the majority of the shorter-term climate change risk. However, while insurance has remained generally attainable in risk-prone areas, being insured does not protect investors from a reduction in asset liquidity.

In the words of one fund manager, "Pretty soon, the insurance industry is going to reach a tipping point, where they don't just look at historical events to try to determine the premium for a property, they are going to use modelling to see what potential future events might happen. So, they will model the risks for a building and charge accordingly. If a buyer gets a report that says the chances are that over the next 10 years the asset may be knocked offline six times by flooding and there are no protections in place, well, nobody is going to pay you for that building."

Owners and investors are seeking to harden assets against the risk of extreme weather events. They are also using energy efficiency and other mitigation measures to reduce their risk and improve asset efficiency. For example, firms in Australia are using native landscaping to absorb heat and reduce air-conditioning costs.

"We have to worry about what those models are going to say and make sure we have a mitigation plan in place," the fund manager continued. "In most cities, we as individual asset owners should not assume the government will take care of this for us."

Exhibit 1-16 **Global Economic Losses by Peril**



Source: *Aon.*

Embracing Technology

While the real estate industry has been a notoriously slow adopter of new technology, both awareness of and investment in property technology (proptech) strategies are growing rapidly. Several developers have launched their own funds or incubators to gain exposure to potentially game-changing applications. This has become necessary because most innovation in proptech now comes from the technology industry rather than from real estate.

Perhaps the simplest (and often the cheapest) way for landlords to use technology is via software: retail landlords use customer loyalty apps, which can also be used for parking or food ordering, while larger office investors in the region are trialling apps allowing tenants to book facilities and services. Apps can also be used, in tandem with sensors, to control or monitor different aspects of building functionality, including in particular air-conditioning and lighting systems. Creating "smart" buildings reduces costs and can provide crucial occupancy-related data that help boost efficiency.

One upcoming technological development that will have a significant effect on real estate in the near future is 5G mobile networks, which are already being rolled out in South Korea, Japan, and Australia. According to one property advisor, "5G will offer richer and more immediate data, which can be used to adjust heating and cooling, automate security, and improve the performance of a building."

As dozens of cities in China, India, South Korea, and Japan undertake smart-city initiatives, 5G devices will be crucial to transmitting the big data required for efficient processing of traffic, waste, water, and power.

Technology is not without controversy, however. Some observers believe that data security will become a major governance issue for landlords as they deal with the thorny issue of data collection and use. According to one advisor, "Data privacy is going to become a C-suite issue for real estate companies. With smart cities, increasingly digitised operations, and tenant data, it is on the horizon."

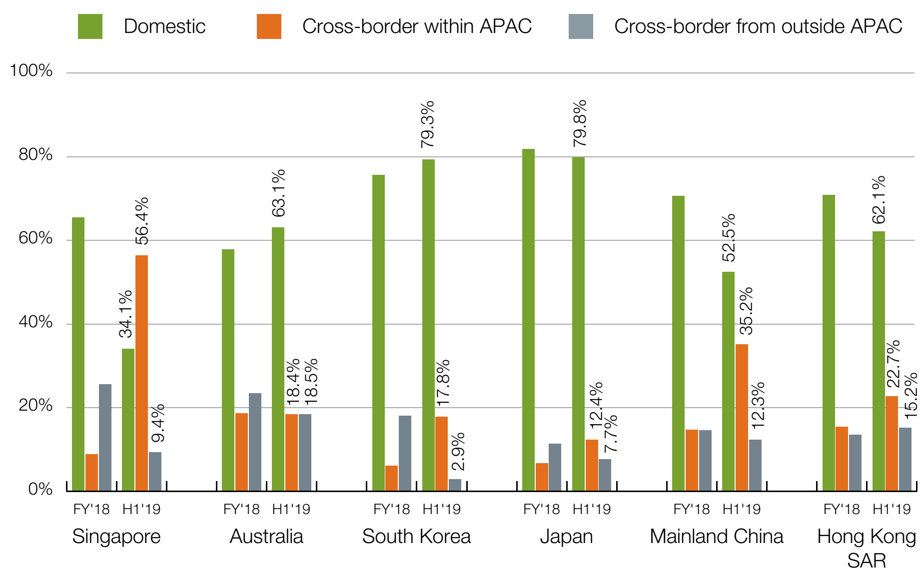
Chapter 2: Real Estate Capital Flows

"The appetite for real estate inflows into Asia has tightened the last six to nine months. Has it gone to zero? Certainly not. But a lot of investors have been looking to take risk off the table, so their propensity to invest into Asian real estate has diminished."

In the face of dwindling global trade and growing geopolitical headwinds, cross-border investors turned decidedly cautious in 2019. And with antiglobalist agendas now increasingly prominent in global politics, cross-border investment in the Asia Pacific declined in the second quarter of 2019 to some 30 per cent of total transactions, according to analysts Real Capital Analytics (RCA), down from a record 41 per cent in the first quarter.

Unsurprisingly, this drop was due mainly to declining activity by American and European investors, with such deals falling a substantial 28 per cent year-on-year in the second quarter to just US$2.54 billion—the lowest figure since the start of 2012. At the same time, though, the value of cross-border deals involving capital sourced from within the Asia Pacific region saw a substantial increase (i.e., up 23 per cent year-on-year) to some US$7.76 billion. This suggests two things: first, antiglobalism is not as big an issue in the Asia Pacific as it is in the West, and second, the relentless exodus of Asian capital into cross-border investments seen over the last five years shows no sign of abating. In fact, with intra-Asian deals hitting record levels in the first half of 2019, at just under US$17.3 billion, another new high-water mark is likely to be set for full-year transactions.

Exhibit 2-1 **Capital Flows, Share of Capital Source by Country/Territory, FY'18/H1'19**



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

Source: Real Capital Analytics.

The main driver of Asian cross-border outflows remains the same: a huge surplus of investment capital held by regional institutions and sovereign wealth funds that cannot be reinvested domestically without creating asset price distortions. Increasingly, too, investors are recognising the value of diversification of asset bases as a hedge against home-market risks.

In 2019, the biggest exporter of capital regionally was Singapore, which was also biggest last year. Although the current dominance of Singaporean capital is due partly to slowing outflows from China, Singapore's outbound cross-border investment has been growing at a consistent 12 per cent annual rate for the last five years. Often involving portfolio purchases, Singaporean outflows comprise a mix of sovereign wealth fund money, investments by the city-state's various integrated developers, and also capital from Singapore's large (and for the most part very liquid) REIT sector, which is forced to look overseas given the relative shortage of suitable investment opportunities remaining in the domestic market. In addition, Singapore acts as an aggregator of capital from around South East Asia, packaging money into locally based investment funds that is then deployed internationally.

China, meanwhile, continues to restrict capital outflows on policy grounds. This looks unlikely to change soon, but while Chinese flows to Western markets (in particular the United States) have therefore ground to a halt, Chinese investments within Asia have remained stable, with capital directed mainly to Hong Kong and Singapore. This is because significant amounts of Chinese capital are still in circulation that are beyond the reach of domestic export controls. According to one institutional fund manager based in Singapore, "You can definitely see there still is Chinese capital, particularly from the large and well-funded [players]. It's capital that's already overseas—and even if you are just looking to rotate [that], you're still talking about massive amounts [invested] in real estate."

South Korea is another market exporting large amounts of money offshore, and was the only major market in Asia where year-on-year outflows increased in the first half of 2019. Most South Korean money is heading out of the region, though, due to the dynamics of currency hedging, with the focus switching from the United States to Europe. According to one Seoul-based consultant, "Nowadays, FX [foreign exchange] hedging gives you a premium for investments in Europe. So if we get a 6 per cent yield in, say, Paris, then after FX hedging, we get an extra 1.5 per cent. In the U.S. market, though, it's the opposite—we lose 100 to 150 basis points [bps]." Because South Korean investors tend to focus on cash-on-cash returns, hedging costs have become a major differentiator for investors, as are lower interest rates available in the Eurozone.

South Korean investors are targeting assets mainly in Paris, Amsterdam, and Frankfurt. In addition, interest is growing in further-flung destinations in Eastern Europe. In part, this is because London, long a favourite of international capital, has somewhat lost its shine due to the uncertainties created by Brexit. Beyond that, though, markets such as Poland, the Czech Republic, and Slovakia are now drawing more attention from international investors due to tightening yields across Europe. One South Korean consortium, for example, recently purchased an office building in Slovakia's capital, Bratislava at an acquisition yield of 5.75 per cent. This migration of capital towards emerging European markets is likely to continue.

In terms of the biggest regional recipients of cross-border flows, Australia and Singapore were the major winners in 2019. Perhaps surprisingly, given current trade tensions, China also featured strongly. This is because, although many foreign funds have put China strategies on hold due to uncertainties caused by U.S.-China trade friction, substantial volumes of capital that were already committed to China-facing funds are now being actively deployed.

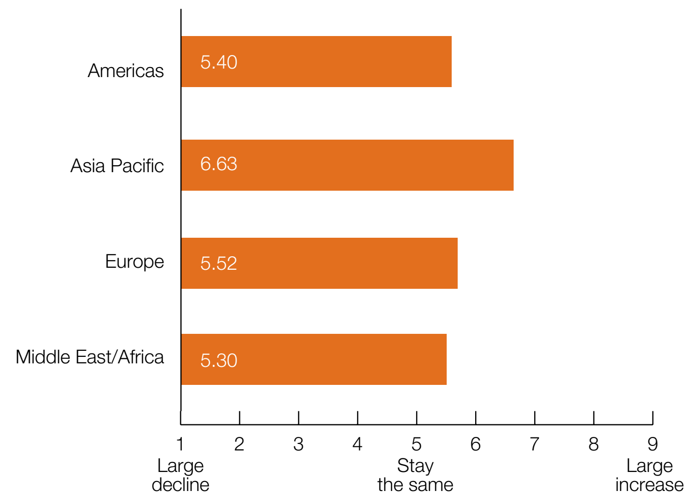
Global Funds Under-Allocated

While for the time being many real estate investors in the West are adopting a wait-and-see attitude, the last several years have seen strong increases in global allocations to Asia Pacific markets. This is mainly an exercise in diversification, as fund managers seek to plug an Asia-shaped gap in their portfolios. In principle, therefore, although some may question whether risk-adjusted returns are adequate, international investors need little convincing of the merits of an Asia Pacific strategy. According to a fund manager at the investment arm of a large global insurer, "Both the demographics and the urbanisation in Asia are strong trends relative to the other continents. So, although historically a lot of our allocation was back in Europe, with more transparency, a lot more information, and people travelling a lot more, there is clearly more confidence that real returns can be found [there]."

One issue that has historically been a stumbling block for global investors has been in finding suitable assets. "If you asked most of the large global investors, they would like to invest more in Asia," one local broker said. "It's largely been lack of opportunity. They don't have teams, they don't have the opportunities, they don't have the approval." Since the global financial crisis, they have gravitated to safer core plays, but prefer direct investing to investments via funds, partly because they prefer to retain control of investment allocations, partly to save fees, and partly hoping to gain a better understanding of the component parts of their portfolios.

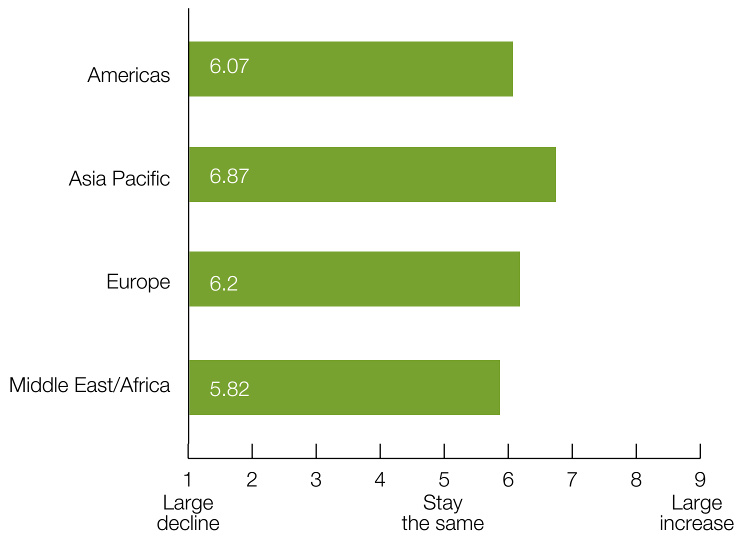
However, direct investments present challenges in Asia because the stock of big-ticket properties capable of moving the meter is not extensive. In the words of one institutional fund manager, "Any analysis of transaction volumes shows pretty starkly how illiquid Asian markets are, relative to the U.S. and certainly the U.K. If you look at London, which has one-third the population of Shanghai, it's a very liquid market, turning over in its entirety every five years. So even including Japan and Australia, which are more liquid markets, [Asia Pacific] transaction volumes are remarkably low, which means that—especially in relation to core-type assets—you're aiming at quite a small opportunity set." This is one reason why build-to-core has become such a popular investment strategy among institutional investors across the region.

Exhibit 2-2 **Expected Change in Capital Flows into Asian Markets between Now and the End of 2020**



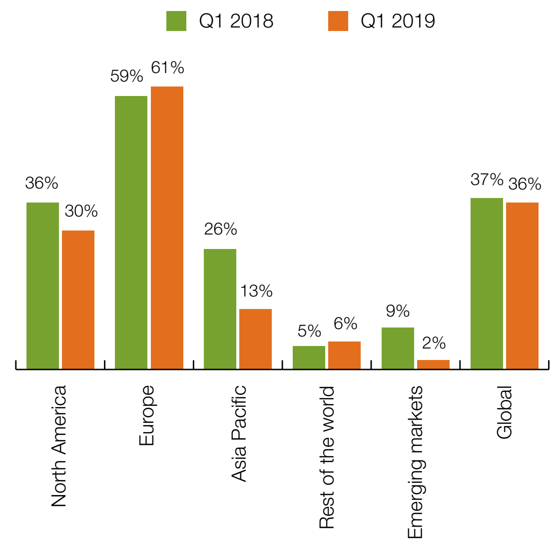
Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

Exhibit 2-3 **Expected Change in Capital Flows into Asian Markets Over the Next Five Years**



Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

Exhibit 2-4 **Regions Targeted by Private Real Estate Investors over the Next 12 Months, Q1 2018 vs. Q1 2019**



Source: Preqin Pro.

Japan's Slow-Motion Exodus

Japanese institutional funds, such as the US$1.4 trillion Government Pension Investment Fund, have been preparing to move a portion of their assets offshore for several years, driven by shrinking investment returns at home as well as the dwindling stock of Japanese 10-year government bonds (JGBs) left to buy after authorities bought up most JGB supply as part of the government's quantitative easing strategy.

So far, though, the migration out of Japan has been a slow and spotty process, although progress can be hard to gauge because Japanese allocations are often heading to funds of funds and pools, rather than into direct purchases.

"Japanese capital is active, but very focused on mature core markets—the United States, and to a much lesser extent the U.K. and Australia," an investment adviser said. As a result, according to one Tokyo-based fund manager, "You're starting to see a pickup in terms of institutions getting asset managers and gatekeepers in place who can understand these markets and put more capital into play. We've been dealing with a couple different companies, and I've been relatively impressed by the fact that they are spending a lot of time trying to understand the markets and see what fits and what's strategically the best bet long term."

Until now, relatively little Japanese capital has been directed to Asia Pacific assets, although Japanese banks are moving offshore and are active in a number of markets across the region, again seeking out higher returns than can be found in Japan, where borrowing costs are generally well under 100 basis points. In particular, Japanese developers are actively investing in South East Asia, often in support of Japanese manufacturers as they set up new production facilities.

Infrastructure is another focus. According to one Manila-based developer, "You do have some [Japanese] state-backed industrial investment that's poking around the edges trying to find the right thing. They've been very active in encouraging [Japanese outsourcing businesses] and with financing the big industrial players to strike deals with the Philippine government, especially around health care/medical and smart city tech."

Fundraising Slows

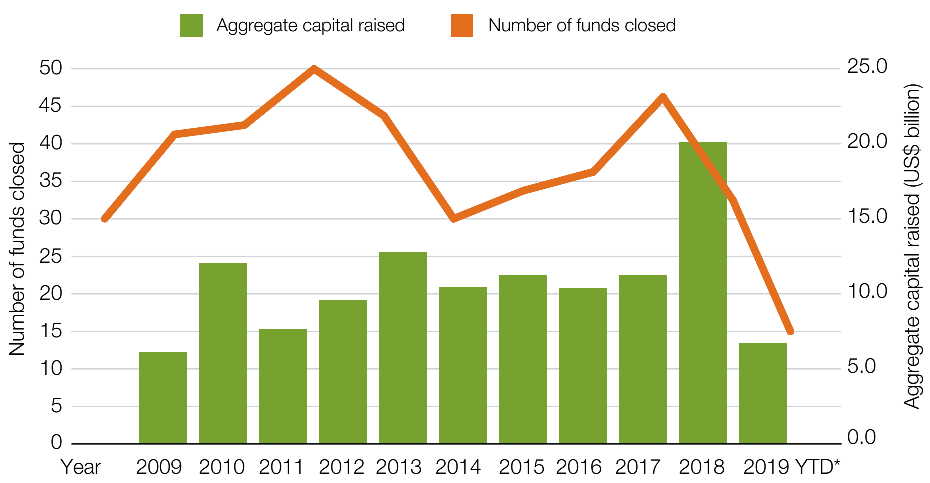
After a record haul in 2018, when Asia Pacific investment funds raised a record US$20.2 billion in real estate–related capital, fundraising has fallen precipitously in 2019. According to analysts Preqin, only US$6.7 billion was brought in during the first nine months of the year, implying a full-year figure of just US$9 billion—on pace for the slowest total since 2011.

The speed of the dropoff comes as a surprise and does not bode well for funds holding roadshows in 2020. Fund managers have grown accustomed to setting their sights on a target of, say, US$500 million in assets, only to raise US$250 million or less.

The rate at which funds have been deploying capital has also fallen. Following a record number of deals completed in the fourth quarter of 2017, when US$49.6 billion in assets changed hands, according to RCA, the market has faded, with four straight quarters of decline (on a rolling 12-month basis) experienced in the year to June 2019, the most recent figures available at the time of writing. The pace of deals seems set to slow further in 2020.

A lack of deals does not imply lack of liquidity, however, nor does it mean that investors have lost their appetite for placing capital. The likely explanation is that funds have been unable to source sufficient assets that meet their risk/return profiles.

Exhibit 2-5 Asia-Focused Real Estate Fundraising, 2009–2019 YTD



Source: Preqin Global Real Estate Report.

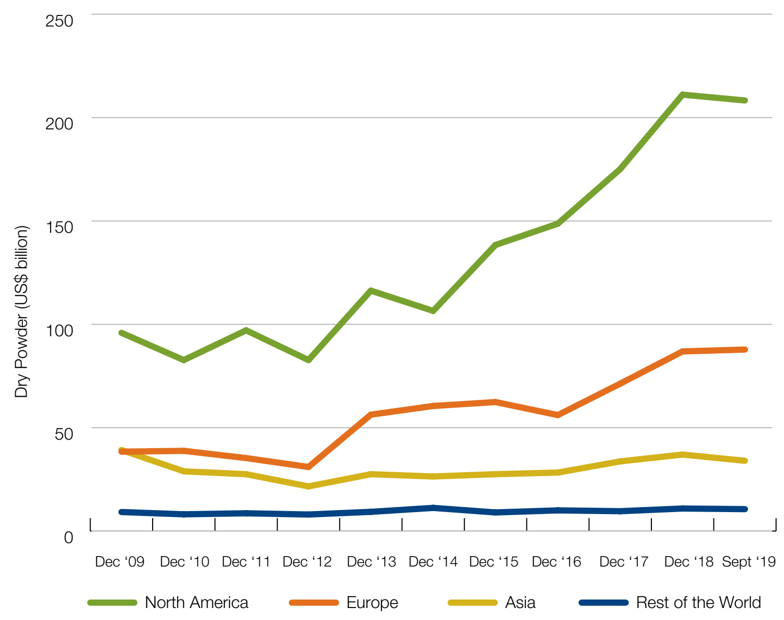
* Through September 4.

Dry Powder Builds

Although fundraising slowed dramatically in 2019, considerable amounts of raised capital are still looking for an investment home across the region. According to Preqin, the US$34 billion in Asia-specific mandates awaiting deployment as of September 2019 is down only modestly from the US$37 billion on hand at the end of last year, which was the highest level since 2009.

These large reserves of dry powder only reinforce the difficulty that global investors have in getting money into the market. They also underline how hard it will be to remedy their historical under-allocation to the region. As one Hong Kong–based fund manager said, "European and American investors are still very underweight in Asia—at the end of the day, there is potentially way more capital than there are suitable deals."

Exhibit 2-6 Real Estate Dry Powder by Region, 2009–2019



Source: Preqin.

Still, the unused capital held by Asia Pacific funds is a far cry from what is currently piled up on the sidelines in the West, with US$208 billion in dry powder waiting for deployment in North America, as of September 2019, and some US$88 billion held by European funds. European allocations have risen rapidly since 2012, when they were roughly at the same levels Asia-focused money is now.

Tighter Bank Lending

Raising finance from banks is certainly tougher in 2019. Slowing global trade and economic growth have led to tighter loan underwriting standards. As a result, a flight-to-quality mentality has emerged among lenders, with rates drifting up and loan tenures falling. "If you are a credit provider, trade disputes do not give you a large appetite to advance riskier credit," one debt specialist said. "Do you want to lend into a recession? Or wait for a recession and then, when there is blood in the street, buy real estate, as they say?"

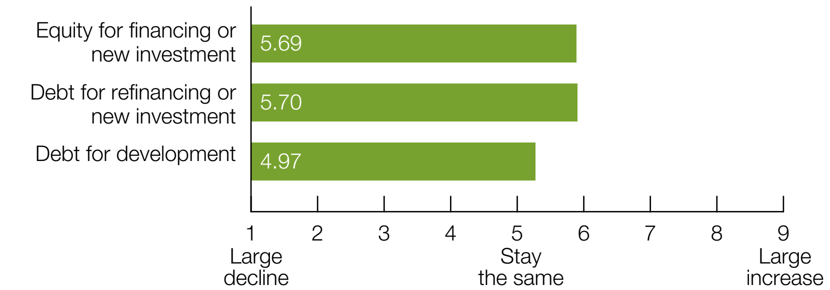
That said, banks remain by far the largest provider of capital for Asian public and private deals, simply because they have such vast amounts to deploy. As a result, in most markets, financing is not hard to find for high-quality assets. In the words of one Hong Kong–based broker: "There's no change at the top. We see easy access for low-leveraged deals from good-quality sponsors—they have no problem raising money because their track record is so good."

In addition, even as banks become more wary of overall macroeconomic risk, interest rates are again starting to sink, removing some of the stress in the system. In the second half of 2019, most major Asian markets have seen the cost of debt charged by banks decline by something approaching 100 basis points for five-year loans, in line with ongoing rate cuts introduced by the U.S. Federal Reserve. As interest rates fall, banks also have the opportunity to widen spreads to address the perception of extra risk without increasing the real cost of capital.

Beyond that, other secular drivers also militate towards an environment of lower-for-longer interest rates. First, vastly increased levels of liquidity are now the norm for both real estate markets and the global economy generally, meaning that conventional laws of supply and demand will tend to suppress borrowing costs. Other factors are also in play. As a recent paper published by fixed-income investment manager Pimco argues: "The two most important secular drivers are demographics and technology. Rising life expectancy increases desired saving, while new technologies are capital saving and are becoming cheaper—and thus reduce ex-ante demand for investment. The resulting savings glut tends to push the 'natural' rate of interest lower and lower."

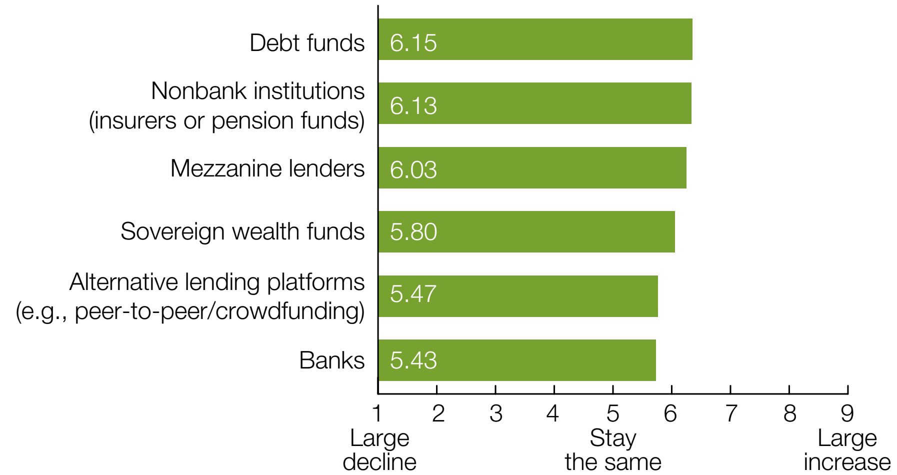
Japan is probably the poster child for the long-term, low-rate scenario. The government is continuing its accommodative policy, though this has not prevented Japanese interest rates drifting up marginally over the last year. According to one Japanese-based investor: "There still continues to be a bit of tightening, and banks are much more selective on what they'll lend on. So, for true nonrecourse [debt] with non-Japanese sponsorship, you're still in the 80 to 90 bps area, and between 55 and 60 per cent LTVs [loan-to-values]." At these levels, interest rates have become one of the major draws for investors in Japan. Cap rates may be low, but the spread over the cost of borrowing means that returns are comparable to markets offering significantly higher yields.

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



Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

Exhibit 2-8 Availability of Debt by Type of Lender



Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

Exhibit 2-9 **Typical Commercial Lending Terms (Up to Five–Year Swap)**

Market	LTV (%)	Base reference rate	Spread (bps)	Financing cost (bps)
Australia	50–50%	5-year swap Rate: 1.40%	140–190	280–330
China	50–60%	1– to 5–year base lending: 4.75%	200–500	675–975
Japan	50–60%	JPY swap rate + TL spread: 0.2%	40–60	60–80
South Korea	50–60%	4–year swap rate: 2%	120–180	320–380
Singapore	50–60%	5–year KTB: 1.6%	150–200	310–360

Source: DWS, Bloomberg, as at June 2019.

Nonbank Lending Picks Up . . .

In some markets, however, regulatory pressure is cutting—sometimes drastically—the availability of bank finance. At the same time, there are growing numbers of investors who are either seeking out better returns than can be found in the bond markets or who prefer collateralised deals that will offer better protection should the real estate cycle turn.

As a result, there is a market on both the demand and supply sides for nonbank lenders such as offshore banks, private-equity players, and debt funds to step in, providing anything from distress debt to mezzanine funding (with the latter "probably generating the best [debt] returns," according to one investor).

In Australia, regulators are compelling domestic banks to adopt more rigorous underwriting standards for both commercial and consumer borrowers. Capitalisation requirements were hiked further in July 2019. As a result, the Big Four domestic banks are unable to satisfy demand via the usual combination of bilateral or club loans. Nonbank financing therefore is increasingly filling the gap for construction and land-acquisition deals, and occasionally for core investment loans, too. Although domestic banks rarely provide loan tenures lasting more than five years, institutional funds are more willing to offer longer-tenure loans.

A variety of new players are participating. In general, Australian superannuation funds have been slow to react, leaving more opportunities for foreign banks to pick up business. However, as rates fall, superannuation players are being pushed to look for higher-yielding investments, often using managers to provide a lending vehicle.

In July 2019, for example, one major domestic developer obtained finance from an Australian superannuation fund for A$360 million in senior debt for redevelopment of a large office building in Brisbane anchored by a blue-chip tenant. The transaction was described at the time as Australia's single largest nonbank senior debt facility. Banks would normally have structured it as a club deal, but the borrower wanted a single financier, according to a consultant specialising in the field: "The reason it got done is that transaction risk was low because there was a single lender. That tells you there is nonbank capital [available] at a price for institutional assets."

More (and bigger) deals are now in the pipeline, with expected demand from Australian real estate borrowers for nonbank debt rising to an estimated A$50 billion by the end of 2023, according to an estimate from one such lender.

While large and creditworthy Australian developers will have no trouble sourcing nonbank debt, there is a long-term trend militating against lending for riskier deals, such as with tier-2 developers, high-leverage plays, or transitional product with short weighted average lease expiries (WALEs), which continue to be affected by government guidelines. For example, nowadays "there's almost no credit available for retail [assets]," according to one Asia debt specialist.

China is another market where the central bank has curtailed domestic bank lending to the property sector, which has therefore been deprived of funding to buy and/or develop real estate and land. This is providing opportunities for offshore platforms offering mezzanine lending by well-capitalised institutional clients. According to one investor: "There is nonbank capital available for this type of sponsor in markets like China, where banks might struggle to do five years or seven years, or struggle to do 60 per cent loan-to-value, or struggle to do the offshore component with an onshore bank that's not them." In addition, by some estimates, approximately US$70 billion worth of commercial real estate loans is due to be refinanced over the next five years. Lending to distress situations in China is also a possibility, as discussed in Chapter One, although this type of opportunity has not historically proven fruitful for foreign investors in that market.

Indian banks, meanwhile, have flatlined their exposure to commercial real estate over the last two years, due partly to regulatory tightening and partly the need to minimise their exposure to a sizeable portfolio of nonperforming loans issued to local developers. Indian nonbank financial companies (NBFCs) originally stepped into this void, but have since run into financial problems themselves and are therefore no longer in the mix. Opportunities for foreign funds to offer senior debt to stressed developers are therefore very much in the frame.

. . . But Appetite Remains Low

Despite the opportunities surfacing in Australia, China, and India, however, demand for nonbank debt remains low in most Asian markets. With interest rates now again in decline, and banks opting to absorb some of the impact (i.e., by tightening spreads) even when they were rising, the amount of nonbank finance issued has not been as high as expected. As one investor said: "There is nonbank money [available], but I'm not sure there's a lot of appetite for the price. There's just not enough nonbank money out there that is realistic compared to where rates are."

One type of nonbank finance that has risen in popularity in the West over the last few years is that offered by debt funds, which create pools of private equity capital that are then provided to borrowers as senior or mezzanine debt. However, while there is no shortage of new debt funds being set up, the popularity of this type of finance may already have peaked. Globally, the level of dry powder held by real estate debt funds increased to US$61 billion as of March 2019, according to Preqin, from a low of $12 billion in 2012. Fundraising for debt funds has also dropped sharply in both 2018 and 2019.

In Asia, debt funds have for several years been touted as an emerging investment sector that would soon find a niche. In reality, however, managers have struggled to deploy capital when the market is already flush with liquidity. Banks enjoy deeper lending relationships and lower capital costs—key differentiators when lending margins are already so thin. According to one specialist in Asian debt capital: "The number of [Asian] debt funds in the last 12 months has not increased significantly—I hear about lots of people wanting to do it, but I don't see people actually doing it."

One reason for this is that margins are generally low, apart arguably for mezzanine debt. "The appetite from banks [to lend] may not be there [today], but that doesn't translate into a huge dislocation in price," continued the debt specialist. "Just because a bank won't go to 65 per cent LTV on senior debt doesn't mean a nonbank can come in and charge 2 per cent more than normal on that type of asset."

In addition, both debt funds' and nonbank lenders' lack of expertise in assessing credit risk has created problems. "Some got their fingers burned," one Singapore-based investor said. "Assets were overcapitalised, or revenue streams weren't there, or there were systemic problems with the borrower, or the 'KYC' [know your customer] may not have been done quite as well." A handful of established nonbank players now have a better track record in this respect and will probably continue to dominate the market for this type of finance.

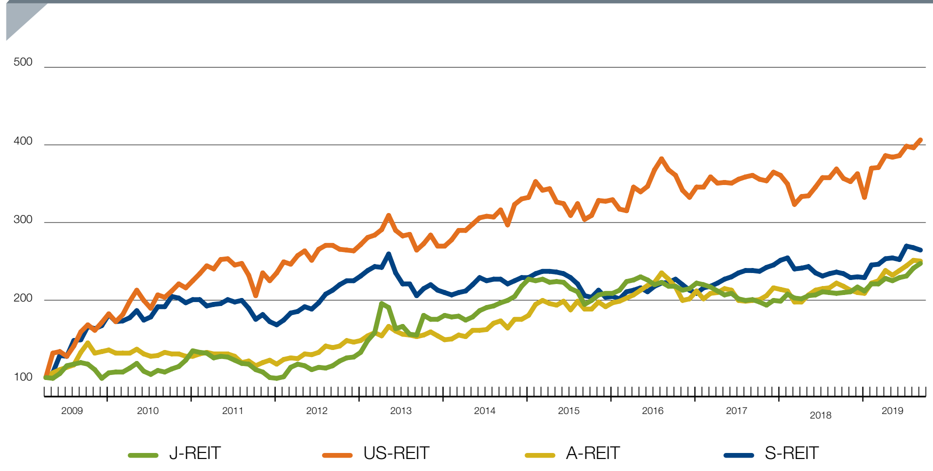
Another problem in setting up Asia-based debt funds is that setting up a debt team is quite difficult. Usually, debt funds are set up by carving them out of existing equity fund teams, but the equity side will usually still be favoured because of the relative lack of return. According to one adviser: "There's no upside in debt—if you have 6 per cent IRR from a debt deal, but get 12 per cent from an equity deal, your resources are going to be focused on the 12 per cent IRR trades. It's not fair to say you can have people toggle between debt and equity in the same teams."

Debt's lack of upside vis-à-vis equity deals is only worsening as interest rates begin to retrench. So, while cap rates in Asia are certainly low, they can still provide a good spread for private equity players over the cost of bank lending. In Australia, for example, debt funds will make a 3 per cent return on three-to-five-year loans. But "why would an equity fund pivot out of equity to a 3 per cent yield with no upside? They can get that through rental growth and yield compression. My prediction is that the next wave of debt funds will look for lower coupon where they can genuinely compete with the banks for the deals the banks don't want to do."

REITs on the Rise

Share prices in Asia Pacific REITs strengthened in 2019 as interest rates in the United States began to decline. Many REITs in the region, and especially in Singapore, are now on acquisition sprees to take advantage of the lower cost of capital for new purchases, as well as an anticipated upswing in investor interest in yield-bearing stocks. In particular, institutional investors are rumoured this year to be more interested in investing in regional REITs as opposed to direct asset purchases, because both REITs are by nature more liquid, and because high-quality standalone properties are increasingly thin on the ground. Nikko Asset Management's Singapore-listed exchange-traded fund tracking Asia ex-Japan REITs—basically a fund of funds for REITs outside Japan—was looking at a 14.6 per cent equity return for the first nine months of 2019, with an average 3.7 per cent dividend yield.

Exhibit 2-11 **Index Performance of REITs by Country**



Source: DWS, Bloomberg, as of August 2019.

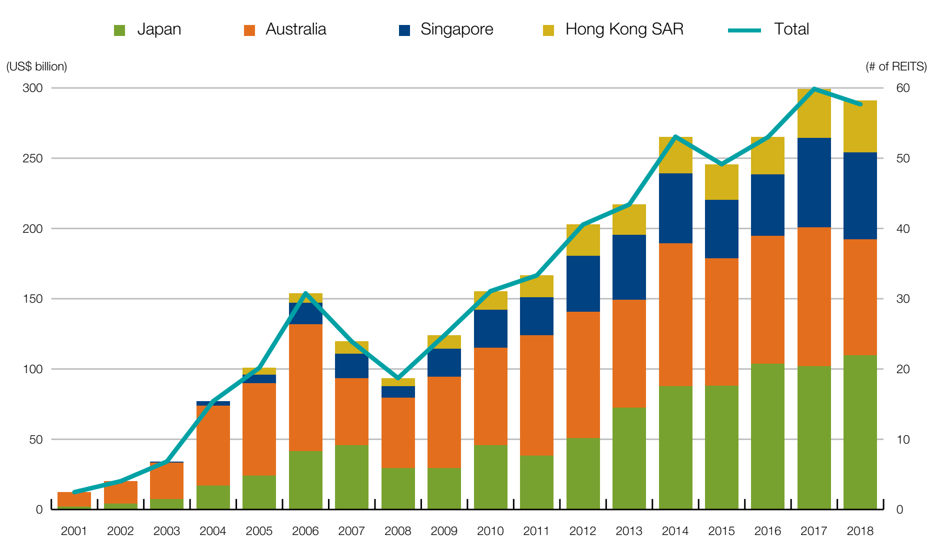
Japan REITs (J-REITs) also performed well, with the Tokyo Stock Exchange REIT index up 22.8 per cent for the first nine months of 2019. That brought J-REIT shares to their highest point since the 2007 crisis. An average yield of 3.8 per cent may not rival the roughly 5 to 6 per cent return offered by Singapore REITs, but negative yields of Japanese 10-year government bonds still provide a spread of 400 bps, a figure comparable with that in Singapore.

Singapore

The very success of the Singapore REIT industry has to a great extent defined its path going forward. With some 38 REITs and property trusts now listed in a city with such a relatively small stock of investable assets, competition between REITs is driving two major trends. First, consolidation among the smaller players becomes inevitable; larger REITs trade more often because they have a higher free float, attract more analyst coverage, and are more likely to be included in major indices. In addition, a merged REIT will be able to obtain more funding because it has a bigger asset base and will usually be seen by lenders as a better credit risk.

Second, REITs must move offshore in order to find assets to buy. Currently, about 40 per cent of all S-REITs' holdings are located outside Singapore, a figure that can be expected to rise in the future. Buying offshore can be problematic, however, because REITs must generally buy assets that are accretive to their yields, and cap rates for investable assets in many Asia Pacific markets have compressed below the distribution yield currently payable by Singapore REITs. This is why Australia, with its relatively high cap rates, has become a favoured destination. As one S-REIT manager commented, "Singapore REITs are making a bigger foray into Australia than Australian long-term funds are."

Exhibit 2-12 **Major Asia Pacific REIT Market Capitalisation by Country/Territory**



Source: DWS Investments.

Japan is another option for S-REITs, although yields there are usually tight. As one fund manager observed, "I like the story because it allows them to diversify some of their capital, but when you're looking at the disparity between the dividend yields between the two markets, I'm not sure how it works. You're talking of going from 3.5 per cent [in Japan] to almost 6 per cent [in Singapore]. [But] you might see some of the Singapore REITs coming up here to try to merge—that might work, especially if you look at some of the larger sponsors in Singapore that do have some credibility here."

Japan

J-REITs continue to dominate transactions in Japan's commercial property markets, accounting for about 38 per cent of all commercial real estate transactions in Tokyo for the year ending March 2019. J-REIT dominance is one reason that foreign buyers represented just 13 per cent of this year's total transactions, according to Deutsche Bank, the lowest level of foreign participation of any Asia Pacific country apart from Hong Kong SAR and mainland China.

While the US$110 billion J-REIT market is huge, however, it is often equally inefficient, featuring numerous entities that are small, poorly managed, and trade well below net asset value. In principle, these REITs would make attractive takeover targets for larger investors looking to invest at the portfolio level, especially when the number of assets available to purchase on the Tokyo market is currently at a low ebb. However, while the market is badly in need of consolidation, until recently, such thinking was nothing but a pipe dream because unsolicited takeovers in Japan have rarely been successful.

The landscape may slowly be changing, however, following the hostile takeover in September 2019 of a US$570 million J-REIT with assets located mainly in and around Tokyo. According to one Tokyo-based fund manager, "It's long overdue for someone to do an unsolicited takeover of a REIT that was basically going nowhere. I think we will start to see more of this now, so that these REITs that have no reason to live are going to be taken over, and they know they can't sit there and say, 'Sorry, we're not interested.' Hopefully, it will start to change the REIT market and start to change perspectives, so that they are managed for the unit holders and will start to pay out dividends."

Consolidation of the J-REIT market, whether by hostile takeovers or otherwise, would be healthy not just from a corporate governance perspective, but also because it will create a bigger group of REITs that qualify to join the government's asset-purchasing scheme. As part of its quantitative easing policy, the Japanese central bank pledged to buy as much as 90 billion yen (US$840 million) worth of J-REIT shares annually, depending on market conditions. But because of minimum capitalisation and liquidity requirements, less than half of Japan's 60-odd REITs qualify to join the programme, meaning that the buying is concentrated in a limited number of REITs. As a result, since the programme began in 2010, persistent buying has left the Bank of Japan holding more than 5 per cent of a dozen large J-REITs, creating a self-fulfilling prophecy of upwardly mobile share prices. Consolidation of the market would potentially expand the number of qualifying REITs significantly and therefore reduce the distorting effect of the government's asset purchase programme.

Australia

The Australia listed property universe is the Asia Pacific region's oldest. It used also to be the largest, by some distance. After consolidation whittled the number of listings from 49 down to 40 in the last five years, Australia has almost the same number (38) of listed A-REITs as Singapore. The REIT sector is significantly larger in Australia, however, with a combined market capitalisation of US$61.9 billion in Singapore versus the US$82.3 billion down under.

Given the scarcity of investable assets on Australian markets, buying an A-REIT is an appealing way for international investors to get instant exposure to Australian property. One large office REIT was purchased by a Canadian investor in 2018, and more merger activity involving both foreign and Australian buyers seems likely.

Although the sector has been dwindling in size, Australia's REITs should be particularly attractive to investors looking for exposure to niche segments of the real estate market. At a time when investors are looking for specialty-sector exposure, listed funds make a lot of sense as vehicles that can offer a broad portfolio managed by experts in any given niche asset class.

India

It took five years to make it to market, amid many a false start, but India has finally introduced its first REIT. Comprising a portfolio featuring seven office parks and four office buildings, and offering an initial distribution yield of around 8.25 per cent, the Embassy Office Park REIT's share price shot up some 34 per cent in its first six months, shrinking the implied yield to less than 6 per cent—a remarkably low level for a market where risk is perceived to be high. One interviewee suggested that, given higher taxes and currency volatility, Indian REITs ought to trade at a yield of some 12 per cent to 13 per cent to be comparable on a risk/return basis to the region's major REIT markets.

"Logically, it shouldn't be priced there," observed one locally based consultant, who offered two reasons why the shares had been bid up. First, the REIT passed an initial hurdle when it was able to provide investors a first-quarter dividend, providing confidence to a sceptical market that the story was actually solid. In addition, ongoing capital appreciation in the Indian office sector (partly, it has to be said, caused by the Embassy listing in itself) has further boosted sentiment.

"The analyst community is what's driving the share price, not the retail buyer," continued the adviser. "The general view is that if you start discounting the value of this portfolio using cap rates at the same levels of other recent transactions, then clearly the market deserves to give these guys a higher price. Whether you think those cap rates are justifiable is another matter."

At the end of the day, therefore, and unlike REITs in most other markets, "it's really not a yield story, because the larger IT occupier community in India wants to stick to a US$1 per square foot per month rent, and the weighted average rentals for the Embassy portfolio are not too far from that. So it's not about rent appreciation, it's the cap rate compression story that's driving the value appreciation."

Unsurprisingly, the Embassy REIT experience is seen as a positive omen for future Indian REIT listings. Other domestic developers, including several in South India and in Mumbai, are now looking at listing portfolios of their own, with two or three new REITs likely to come to the market in 2020.

Chapter 3: Markets and Sectors to Watch

"I tell investors, you should come to Asia for medium- to long-term growth and diversification, not for a premium to your home market; it is not sustainable to expect that through the cycle."

As the end of the current real estate cycle approaches, investors in Asia Pacific real estate are doubling down on large, liquid, defensive markets. Emerging economies—with one notable exception—are on the wane.

This year, Singapore, Tokyo, Sydney, and Melbourne—all liquid and transparent markets—are four of the top five cities ranked by investment prospects. All also appeared among the top five cities in our 2019 report, when concerns about an approaching downturn were first aired. The rest of the top 10 cities for investment are similarly large and liquid.

The outlier among 2020's favoured markets is Ho Chi Minh City. A destination that has been rising up the investment rankings for the past five years, it is now rated the region's top city for development and third for investment. Remarkably, it is also ranked as top in our buy/hold/sell tables for all asset classes.

Vietnam offers strong economic growth, a positive demographic profile, and,—perhaps most important—is seen as the biggest beneficiary of the slow migration of manufacturing capacity away from China. Transparency remains a weak point, although it is improving.

Nonetheless, the problem for real estate investors is that Ho Chi Minh City remains a market with relatively few investable assets and where risks are high. Indeed, a number of interviewees commented that too much capital was already being funnelled into the wrong places. As one investment manager said: "Vietnam needs truly affordable middle-income housing, but people are building too high-end."

Investor interest in Asia's other growth markets is muted: Jakarta and Manila remain marooned in the bottom quarter of the investment table, while—aside from Ho Chi Minh City—only Mumbai and Bangkok among emerging–market cities make it into the top 10 for development. With fears of recession looming in the United States, investors will always be wary of emerging markets—experience proves that when economic strife arrives, their illiquidity and currency volatility make them especially unsafe.

That said, investors continue to warm towards India as a long-term investment destination. "It is moving from, 'I'll never do it again,' towards, 'I have to be there'," as one investor put it. Although positive sentiment is not reflected in the city rankings, this is probably because India is heavily favoured by a few larger players rather than a large cross-section of the investment community.

China's second-tier cities continue to be unpopular, as does Beijing, despite its being a larger and more liquid market than both Shenzhen and Guangzhou, which ranked well ahead of the Chinese capital for investment and development. Both southern cities may be benefitting from the integration of the Greater Bay Area, which has seen massive infrastructure investment that is improving connectivity across the Pearl River Delta. Beijing, meanwhile, tends to be a difficult place for foreign funds to place capital given it remains dominated by well-heeled state-owned enterprises that buy at a premium and then hold indefinitely.

Hong Kong, meanwhile, has plunged to the bottom of both the investment and development rankings. Months of street protests in the city have been a huge drag on tourist arrivals, with serious knock-on consequences for local retail and hotel sectors. At the same time, however, brokers say that while office vacancies are slightly up from historical levels, so few transactions have taken place in recent months that pricing on CBD properties has seen little to no movement.

Exhibit 3-1 City Investment Prospects, 2020

Generally poor | Fair | Generally good

1	Singapore	6.31
2	Tokyo	6.11
3	Ho Chi Minh City	6.06
4	Sydney	5.99
5	Melbourne	5.95
6	Shenzhen	5.86
7	Shanghai	5.73
8	Osaka	5.69
9	Guangzhou	5.36
10	Seoul	5.29
11	Bangkok	5.11
12	Mumbai	5.07
13	Beijing	4.97
14	Taipei	4.95
15	New Delhi	4.93
16	Bangalore	4.90
17	Manila	4.87
18	Jakarta	4.86
19	Auckland	4.83
20	China–second-tier cities	4.77
21	Kuala Lumpur	4.73
22	Hong Kong SAR	3.93

Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

Exhibit 3-2 City Development Prospects, 2020

Generally poor | Fair | Generally good

1	Ho Chi Minh City	5.96
2	Singapore	5.77
3	Sydney	5.71
4	Tokyo	5.64
5	Melbourne	5.56
6	Shenzhen	5.35
7	Shanghai	5.32
8	Osaka	5.28
9	Mumbai	5.21
10	Bangkok	5.10
11	Manila	5.08
12	Seoul	5.07
13	Guangzhou	5.06
14	Bangalore	5.04
15	New Delhi	5.03
16	China–second-tier cities	4.91
17	Jakarta	4.86
18	Auckland	4.82
19	Taipei	4.76
20	Kuala Lumpur	4.71
21	Beijing	4.63
22	Hong Kong SAR	3.96

Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

These are the leading buy/hold/sell recommendations for the various asset classes:

Office

Buy Ho Chi Minh City and Singapore

Sell Kuala Lumpur and Hong Kong

Retail

Buy Ho Chi Minh City and Manila

Sell Taipei and Auckland

Residential

Buy Ho Chi Minh City and Bangkok

Sell Kuala Lumpur and Hong Kong

Industrial/distribution

Buy Ho Chi Minh and Guangzhou

Sell Hong Kong and Taipei

Hotels

Buy Ho Chi Minh City and Tokyo

Sell Mumbai and Manila

Exhibit 3-3 Historical Investment Prospect Rankings

	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011	2010
Singapore	1	2	3	21	11	9	7	3	1	1	5
Tokyo	2	4	7	12	1	1	1	13	16	12	7
Ho Chi Minh City	3	7	5	4	5	13	19	18	10	11	13
Sydney	4	3	1	9	2	4	5	4	3	6	6
Melbourne	5	1	2	16	3	5	13	10	7	9	9
Shenzhen	6	8	6	5	18	19	10	16	–	–	–
Shanghai	7	6	4	6	9	6	2	2	2	2	1
Osaka	8	5	10	15	4	3	9	22	21	19	18
Guangzhou	9	10	8	10	20	20	6	15	6	8	12
Seoul	10	9	19	17	7	7	15	14	19	16	4
Bangkok	11	11	16	8	19	16	11	6	14	17	19
Mumbai	12	13	12	2	13	11	22	20	15	3	8
Beijing	13	12	11	11	14	10	8	7	5	7	3
Taipei	14	21	22	22	17	18	16	9	8	13	11
New Delhi	15	17	20	13	16	14	21	21	12	5	10
Bangalore	16	16	15	1	12	17	20	19	9	10	14
Manila	17	19	18	3	8	8	4	12	18	20	20
Jakarta	18	15	14	7	6	2	3	1	11	14	17
Auckland	19	20	9	14	10	15	17	17	20	18	16
China–second-tier cities	20	18	17	20	22	22	12	8	–	–	–
Kuala Lumpur	21	22	21	19	21	12	14	5	17	15	15
Hong Kong SAR	22	14	13	18	15	21	18	11	13	4	2

Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.
Note: – = no data.

Top Investment Cities

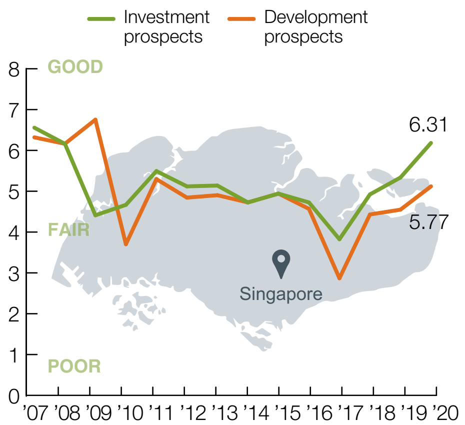
Singapore (first in investment, second in development). Until recently, the Lion City had experienced several subpar years across all property sectors in a slowdown that was out of kilter with the upward trajectory of the rest of the region, as economic woes and a glut of high-end supply saw vacancies surge and capital values and rents decline. As recently as our 2017 report, Singapore placed just 21st in our investment rankings, underlining how quickly the tides can shift. Today, the office sector has largely absorbed the oversupply, and with vacancies at an all-time low and limited supply in the pipeline, confidence in medium-term prospects has returned.

Singapore was one of the few markets regionally to see a surge in transactions in the first half of 2019, with most activity driven by cross-border capital. The US$4.9 billion in deals was an increase of 73 per cent year-on-year, according to Real Capital Analytics (RCA), although growth came from a low base. The only other country even close to being positive was Australia, where volume rose 3 per cent to US$11.9 billion. In particular, Singapore has benefitted from an uptick in interest from investors who are currently avoiding mainland China and Hong Kong SAR, both of which are seen as geopolitical flashpoints. Transaction volumes in the second half of the year are also expected to be strong.

Many of this year's investments were big-ticket deals, with six acquisitions worth US$300 million or more in the first half of the year. Landlord willingness to sell into the stronger market also has helped liquidity. Office yields, at 3.6 per cent, are some of the lowest in the region, and prices remain high by global standards. Rentals, meanwhile, driven by takeup from coworking operators, have been strong.

Although most analysts see little prospect of Hong Kong suffering a large exodus of businesses as a result of recent street protests in the city, there has been a steady flow of Hong Kong capital migrating to Singapore in 2019 in search of a safe haven. This has benefitted the luxury housing market, and to a degree has also boosted office occupancy. "Private banking is a source of demand here in Singapore," said one locally based fund manager. "Landlords and agents are looking like crazy for space as private banking accounts [in Singapore] have swollen."

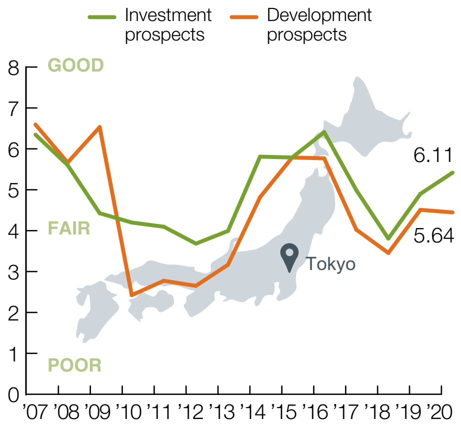
The city has always been the first choice as an offshore destination for capital from South East Asia. Investors from Thailand have recently joined Indonesians as active players, with Thai asset-management companies recently greenlighted to invest overseas.



Tokyo (second in investment, fourth in development). The Japanese capital remains dominated by local players, who accounted for 80 per cent of deals in the first half of 2019. Foreign money still has opportunity in one of Asia's most liquid markets, though. Both Hong Kong and South Korean capital has become more active in 2019, while U.S. purchases have sunk to their lowest level since the post–Lehman Brothers days in 2009.

Record-low Japanese bond rates mean that borrowing costs remain the lowest in the Asia Pacific region, creating a good spread over the cost of debt despite Tokyo's compressed cap rates. Leverage is also easily available, although loan-to-value (LTV) ratios these days tend to peak at the 60 per cent range rather than the lofty (and frankly nonsensical) rates of 90 per cent–plus seen some years ago. In addition, the city is an easy sell to investment committees—no one loses their job allocating to Tokyo.

"From a macro standpoint, economists have loved to hate Japan for decades, but over the last 10 years it's been one of the best markets for returns," the Asia head of real estate for a private-equity house said. "Absolute returns are fantastic, and the risk-adjusted returns are even better, if not the best in the world."



However, with office yields standing at between 3 and 3.5 per cent, pricing remains rich. According to one locally based fund manager, "People are hesitant to sell because there's still a lot of capital in the market. There's certainly no shortage of buyers and when stuff does go out to bid, it's really competitive." At these levels, though, many investors are baulking. Tokyo saw a 19 per cent decline in transaction volume for the first half of 2019, according to RCA.

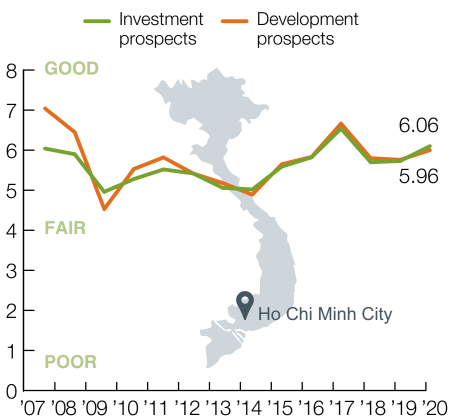
With the office sector languishing and cap rates in multifamily residential now compressed to unattractive levels (i.e., a little over 3 per cent), many investors are looking to other sectors. Retail is seen as problematic at the moment given a recent increase in the consumption tax, and declining visitor arrival numbers caused by bilateral tensions with South Korea and (potentially) with China too. As usual, the logistics sector is seen as a go-to option.

With the Olympics due to take place next summer, many investors are forecasting the usual hangover effect once the Games are over, especially in the hospitality industry, where oversupply and poor management of newly opened facilities is already creating problems. Opportunities for distressed investing may therefore become more common.

Ho Chi Minh City (third in investment, first in development). Vietnam's financial capital has seen a surge of popularity in the past five years, featuring close to the top for both investment and development rankings.

"Ho Chi Minh is not institutionalised, but hopefully it will go down the path of a Tier 1 Chinese city—the demographics look good," one Hong Kong–based head of Asia real estate for a major private-equity house said. "There are enough investors who have invested in it for more than a decade that have more experience, so you have local operators who are more experienced not just with real estate, but also with institutional investors and the governance they need," he continued. "I do feel Ho Chi Minh has a better chance than some of the other emerging markets."

However, confidence about the city's prospects has not been matched by the scale of foreign investment, mainly because the small size of the market means that investable assets are hard to find. As one investment manager said: "If a billion-dollar fund decides to allocate 10 per cent or 20 per cent to Vietnam—a meaningful allocation—that is a pretty significant percentage of the annual international real estate volume in that market."



Top Five Markets

TOKYO

For years, Tokyo markets have offered some of the best returns in the region. With domestic interest rates remaining at rock-bottom levels, investors continue to flock there, although competition from local buyers means the market is tight.

HO CHI MINH CITY

Vietnam is now the preferred emerging market destination in Asia, with manufacturers migrating to set up factories as an alternative to China. Risk is high, however, and good investment opportunities can be hard to pin down.

SINGAPORE

Having absorbed a glut in office supply, sentiment for Singaporean assets has now rebounded from the lows of 2017. With vacancies now minimal, confidence has returned. Foreign investors are leading the charge as buying activity surges.

SYDNEY

A long-time favourite that continues to deliver. Sydney offers a liquid, stable, high-return market with low vacancies and good prospects for growth going forward. Depressed valuation of the Australian dollar only adds to the appeal.

MELBOURNE

Melbourne continues to be popular with investors for the same reasons as Sydney. Office assets are a little more than half the price, though, giving the city particular appeal for Asian buyers with an eye for long-term capital appreciation.

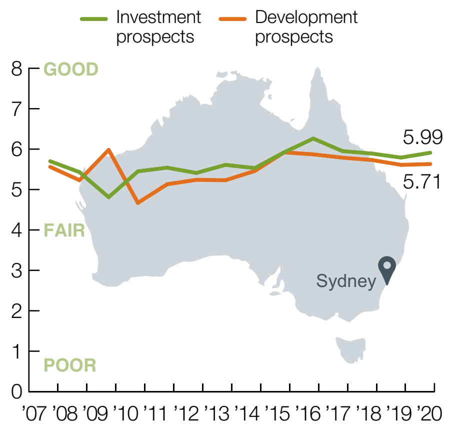
A limited number of private-equity players have made platform investments in Vietnam, but most of the real estate capital going into Ho Chi Minh City has been on the development side, targeted especially at the residential sector. This has led to problems with overbuilding. Land values and rents have also risen sharply across the board. According to one interviewee, "Retail space in Ho Chi Minh City is now three times or more the rent of similarly located retail space in Manila."

Still, the government has taken steps to try to address some of the ongoing problems. An anticorruption campaign is underway, targeted in particular at property developers. In addition, after the latest oversupply problems arose in the residential sector, authorities intervened. According to one opportunistic investor active in Vietnam: "There have been no approvals out of Ho Chi Min for, I think, at least 18 months, so the demand is just backing up and there's no supply. We have a project that just launched, and they sold 200 units in one afternoon." In general, demand is higher for affordable and mid-market housing than for high-end units where oversupply problems are worst.

South Korean and Japanese companies are especially active in Vietnam, mainly in support of manufacturing businesses from their home countries, and buildout of local industrial capacity is proceeding quickly, as more factories opt to move their operations outside China. Good logistics facilities, however, remain in short supply

Sydney (fourth in investment, third in development). Australia's longstanding appeal as a focus for both domestic and international capital continues for all the usual reasons: a relatively liquid and mature market featuring numerous high-quality assets, a stable economy, and higher cap rates than can be found elsewhere in the Asia Pacific. At some 50 per cent of total transactions, the number of cross-border deals in Australia is rivalled only in Singapore (55 per cent). However, reluctance of owners to sell their properties remains a problem.

Sydney's historically high office yields continue to compress, reaching 4.9 per cent in mid-2019, down from north of 8.0 per cent five years ago. For the best properties, yields have fallen to as low as 4.5 per cent. Rentals continue to be strong, and with vacancies remaining low, rents promise to continue rising (albeit at a more measured pace) for the foreseeable future. Falling domestic bond yields also suggest that cap rates will continue to track lower.



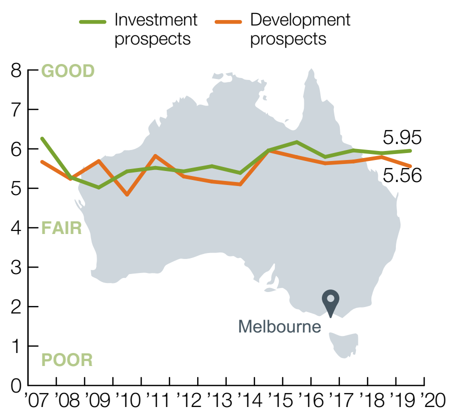
More than 25 per cent of Australian residential development sites were bought by Chinese developers in each of the last five years up to the end of 2018, according to brokers Knight Frank, and while Chinese capital is now less evident due to the impact of Chinese export controls, Sydney has been the subject of many deals in recent years involving conversion of downtown grade B office assets to luxury residential facilities. The fall in residential prices over the last two years means that some of these developers may be forced to offload their sites at a loss, especially if they face difficulties in securing funding to complete their projects. Meanwhile, Chinese developers are beginning to diversify their investments to include office and lower-density residential projects—an indication they are there for the long haul.

Demand for all asset classes in Sydney is strong, with a little more than one-third of those surveyed on the hunt for buying opportunities in office, residential, industrial, and hotels. The exception is retail, where there would be more sellers than buyers at the moment.

For the last two years, residential prices in Sydney have been falling. While signs of a bottom were emerging in late 2019, home prices remain high by any standards, with the city now third behind Vancouver and perennial first-place Hong Kong in the least affordable cities rankings, according to Demographia.

Melbourne (fifth in investment, fifth in development). Melbourne's moment of outpacing rival Sydney in terms of potential, as it did in our rankings last year, was short-lived. However, the capital of the state of Victoria remains one of the first names on the list of the region's institutional investors when they are looking to place capital.

Cap rates continue to compress. They remain slightly behind Sydney, but not by much. Melbourne office vacancies are the lowest in Australia, although they are set to trend upwards over the next year as new supply comes onto the market. Capital values, meanwhile, are slightly more than half those in Sydney's, making them especially appealing to Asian buyers who are generally more focused on price per square foot than on yield.



With favourable demographics and a diverse local economy, office rents should continue to trend upwards over the next five years, according to investment bank Credit Suisse, providing scope to reposition some of the city's older building stock. Construction of the Melbourne Airport rail link, which is set to begin in 2022, should also serve to open up new areas for both commercial and residential development.

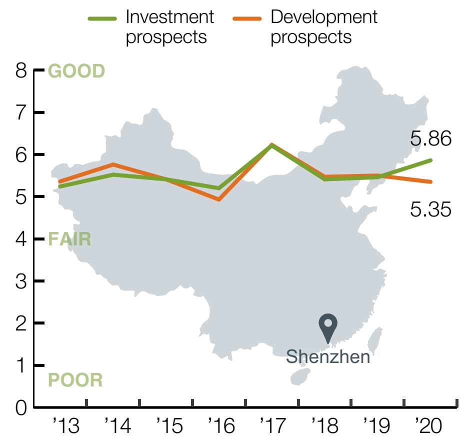
Logistics space is in high demand in and around Melbourne. Build-to-core and build-to-let development also is attracting interest, and with vacancies remaining so low these seem relatively low-risk strategies. By and large, Australian retailers have been slow to adapt to changes being forced on the industry by the evolution of online retailing, so investors are assessing the viability of retail assets carefully, favouring either large, dominant regional malls or very specific high street locations, and avoiding suburban malls.

Melbourne residential real estate is also at unaffordable levels, featuring fourth globally behind Sydney in the Demographia ratings. It currently costs 11.7 times median income to buy a Sydney home; the figure is 9.7 times in Melbourne. Still, two years of falling residential prices in both Melbourne and Sydney have removed some heat from the market.

Shenzhen (sixth in investment, sixth in development). One of the most dynamic cities in the world, Shenzhen is constantly reinventing itself, having morphed from its historic role as a textile manufacturing centre into hardware and now to software and finance. With improved transport links to other cities in the area, Shenzhen continues to be the preferred headquarters location for Fortune 500 companies in southern China.

While Shanghai remains the most important Mainland investment destination, Shenzhen ranks above it in this year's survey. This is most likely a reflection of the city's importance within the Greater Bay Area (GBA), a megalopolis consisting of 11 cities in China's southern Pearl River Delta area, including Hong Kong and Guangzhou, that has been earmarked by the central government as an area for accelerated economic growth.

According to one Shanghai-based fund manager: "[The GBA] is now more popular because of the government policy and all the improvements in infrastructure. And for Shenzhen, because its GDP is now bigger than Hong Kong's, people are more and more positive. But closing deals there is not easy. Prices are not cheap, and there is also an oversupply issue, especially as far as office is concerned, so if you're going to do a deal, you need to take a medium- to long-term view, rather than a three- to five-year view." Another factor in Shenzhen is that many large office buildings in the city have been sold off piecemeal and are now held on a strata-title basis, leaving relatively few *en bloc* assets available for purchase.



In 2019, the office sector continues to see significant amounts of new supply, with 15 new grade A office towers scheduled for delivery in 2019. This has driven vacancies to a record high of 16.6 per cent, according to CBRE, equivalent to some two years of new demand. The problem has been aggravated by the U.S.-China trade friction, which has hit businesses in the tech-focused city especially hard. Many have moved out of rented offices and into coworking facilities to cut costs. Half of the vacant space is located in the Nanshan district, home to tech heavyweights such as ZTE, Tencent, and drone makers DJI.

Shenzhen also features some of China's priciest residential property. Its enormously volatile market is now amongst the five most expensive in the world, according to recent study by CBRE.

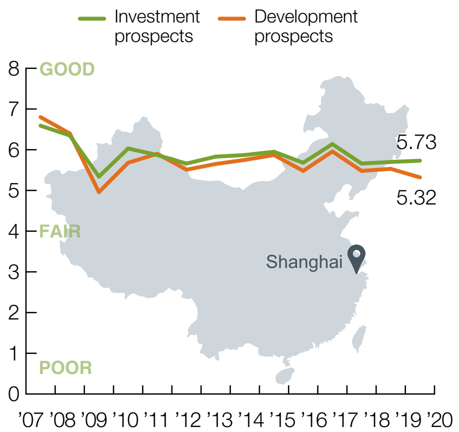
Shanghai (seventh in investment, seventh in development). China's financial capital remains the favoured destination for foreign investors and accounts for the majority of cross-border deals in the Mainland. This year, in a context of slowing economic growth caused by the U.S.-China trade friction, together with an ongoing regulatory crackdown on domestic bank and nonbank lending that has suppressed buying sentiment from local purchasers, foreign funds are finding that prices are lower and assets more available.

This is a sharp reversal from the situation in place until only a few years ago, when foreign funds could not compete with domestic capital that viewed the local market through a different prism from a risk/reward perspective. In both 2018 and 2019, however, the majority of prime commercial property deals in the city have involved a foreign buyer.

Although Asia Pacific investors who are not already active in China may be shying away from entering into Mainland deals for the time being, money that is already committed to China-facing funds is being actively deployed. Given that Shanghai is now regarded as a gateway city by international investors, a significant amount of capital has recently been lined up for deployment. Transaction volumes in the first half of 2019 were therefore almost unchanged on a year-on-year basis, with a good pipeline of deals expected in the second half of the year, according to RCA.

Lower prices for Shanghai offices are largely the result of uncertainty caused by the trade friction, which has caused many firms—both domestic and international—to put expansion plans on hold. This has coincided with a glut of new supply coming to market over the past two years. As a result, rents have fallen and vacancies have shot up, jumping 4.4 percentage points to a decade-high 18 per cent in the middle of 2019, according to CBRE. Just 140,000 square metres of new office space was taken up, just 20 per cent of the amount absorbed in the same period in 2018.

The shortage of available land in or near Shanghai's city centre has created obstacles for new development. Regeneration—either of individual assets or on a neighbourhood level—has therefore become the name of the game. In addition, investors are increasingly willing to look to suburban parts of the city, where most new development projects are taking place.

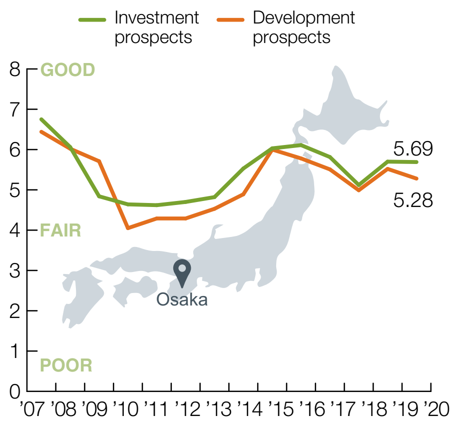


Osaka (eighth in investment, eighth in development). Japan's second city outshines Tokyo at the moment in terms of the appeal of its office market. In all, 39 per cent of respondents indicated a buy signal for Osaka office, a level of popularity outdone only by Ho Chi Minh City and Singapore.

Hotel space is also a buy for 36 per cent of respondents, which makes it the fifth-hottest city in Asia behind Ho Chi Minh City, Tokyo, Singapore, and Bangkok. The rise in tourism from both China and South Korea, together with an increasingly wealthy South East Asia, is likely to sustain strong interest in the city from international tourists well past the 2020 Tokyo Olympic Games. However, signs of oversupply in the hotel sector have left some investors scouting for potentially distressed assets in the Osaka area, an opportunity that will probably last for at least the next two years.

The Osaka office market is viewed as more amenable to deals by overseas buyers, with a little less off-market dealing between insiders. At under 3 per cent, office vacancies in Osaka are the lowest in Asia, along with prefectural capitals Sapporo, Fukuoka, and Nagoya.

According to one Tokyo-based investor, "All the secondary cities—Osaka and Nagoya and Fukuoka—have gone out and repositioned themselves after the financial crisis to expand their economic bases, so they actually now have their own independent liquidity. It's not just a matter of saying, 'O.K., I want higher yields, so I'll go to Osaka'—it's, 'I'm going to Osaka because I like what's going on there. I like the office space, I like tourism there, it has a 24-hour airport, the cost of doing business is substantially cheaper.' And when you look at transitioning to a service-based economy, Osaka is really well positioned, because the cost of living is so much cheaper—people can buy a condo down there, whereas in Tokyo they can't afford it."



Still, the growing popularity of Japanese cities such as Osaka has also meant that investors are more willing to chase yields, so while they remain less expensive than Tokyo, the differential has narrowed. According to the same fund manager, "Osaka now is 3.5 per cent for both office and retail, sub–4 per cent for sure. Nagoya is probably around 4 per cent for both. Fukuoka is the same, probably 4 per cent for office, sub–4 per cent for residential. So, if you're thinking Tokyo is a 3 per cent, 3.5 per cent for office, you still end up with a 50 to 75 bps and potentially a 100-bps differential, depending on the asset. So, cap rates have come down a bit from where [they] used to be, but the difference is still there."

Whereas retail space is popular in Tokyo's central wards, several interviewees expressed concern over retail assets outside the Japanese capital. On this front, Japanese demographics are unfavourable. Since one major department store normally anchors mall space in smaller cities, there is a risk of nonrenewal of leases; also, exit strategies for retail assets aren't obvious.

Guangzhou (ninth in investment, 13th in development). With integration helped by new high-speed rail links to Hong Kong to the south and to Beijing and Shanghai to the north, Guangzhou is expected to be a major beneficiary of the buildout of the Greater Bay Area. "The improved connectivity within the GBA has already made a difference, so we are seeing the benefits of all that infrastructure investment," one investment advisor said.

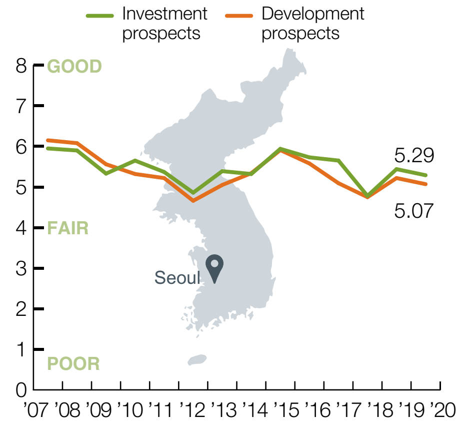
Concerns over U.S.-China trade friction seem to have hit Guangzhou real estate more quickly than other Chinese cities. However, new office supply was limited in 2019 and is expected to remain muted through 2023, which should be positive for income-producing assets. Meanwhile, both domestic and international investors are actively looking for properties with scope for value-add opportunities, seeking to leverage the city's copious supply of older office space. In the words of another investor: "We closed a deal in Guangzhou recently and are looking at another couple of deals, too. Guangzhou is actually quite positive because vacancy rates are quite tight relative to Shenzhen."

The key submarket over the next few years will be Pazhou, a new office district that offers more development opportunities for developers and lower rents for occupiers. The technology, media, and telecoms sector continues to be the major driver of the office market.

Seoul (10th in investment, 12th in development). Until 2015, transaction volumes in Seoul were less than US$5 billion annually, but have since doubled after a number of sizeable new buildings came onto the market. The South Korean capital was the third-most-active city for deal volume in the first half of 2019, behind Hong Kong and Tokyo. Deals worth US$12 billion are expected to have been completed for the whole of the year, according to Colliers.

Historically, the investment market has been dominated by large domestic corporate players, but foreign investor participation has been increasing steadily in recent years. In the first half of 2019, cross-border acquisitions accounted for 33 per cent of the dollar value of deals, double the rate of international participation in Tokyo and triple that of Hong Kong.

Office sector cap rates for grade A properties have been slowly compressing in line with falling interest rates and growing liquidity in the market. They stood at slightly over 4 per cent in the third quarter of 2019. For years, vacancy rates have ranged between 10 and 15 per cent, but they declined rapidly in 2019 to some 6.7 per cent. Even at that level, though, both rents and capital values remain significantly lower than in other gateway cities in the region.



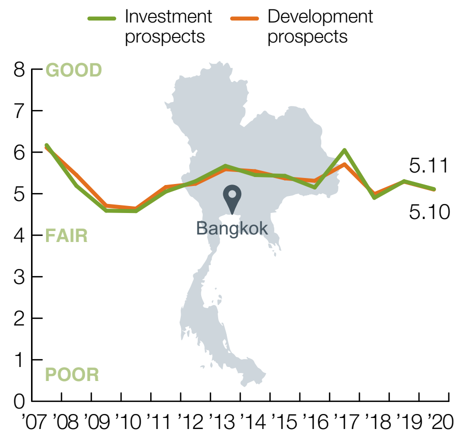
Until recently, most foreigners active in the Seoul market were opportunistic players, but there are now increasing numbers of core-plus and value-add investors, too. Recent missile testing in North Korea has deterred some funds from entering the market. According to one Seoul-based advisor: "They are having a hard time getting their investment committees to approve Korean acquisitions. But other investors come in because they are sitting on money and they have no options other than Japan or Australia. In China, you have different dynamics, it is a very speculative market, while Singapore is very pricey these days, and Hong Kong, too. So, they look to get some exposure in Korea—not too much, but just an acceptable limit."

Value-add options are also available in a market that suffers generally from a lack of diversity. One typical play has been to convert small or medium-sized offices in areas with strong retail demand into mixed-use facilities that bring higher-paying retail tenants into lower floors of buildings.

Another option, according to one foreign opportunistic investor, is to convert "really crummy, strata-titled, old office stock to efficient, large-floor-plate, high-lift capacity for back office [uses]. Everywhere else around the world has that option, but Seoul didn't, so we delivered a million square feet at a basis that allows us to undercut CBD rents by 50 per cent, providing grade A space as we spec'ed the building up."

Bangkok (11th in investment, 10th in development). The Thai capital is one of the region's most dynamic cities and a popular tourist destination. It is currently also one of its better-performing real estate markets, with steady office rental growth and capital price appreciation over the past five years. The residential market has also seen healthy growth. Bangkok continues to add substantial public transport infrastructure, which is expected to open up new areas of the city for investment.

Political instability—despite its demonstrable failure to affect day-to-day living conditions—continues to put off some international investors, especially those reliant on the approval of investment committees in the United States or Europe. For real estate players based in the Asia Pacific, a lack of transparency and the difficulty of doing business in Thailand are more serious impediments to investing in Bangkok. According to one investor, "Thailand is a tricky place to do business. A lot of shifting sands, a lot of uncertainties— and we have ended up spending a huge amount on legal fees."

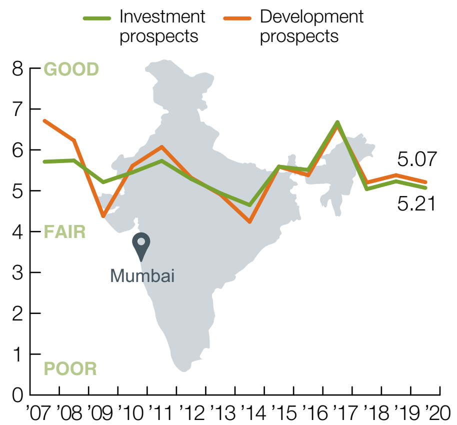


But the overall improvement in office and residential stock has now crossed a threshold, with more businesses now willing to consider it as a candidate for regional headquarters. Office vacancy rates have recently hit a low of 5.7 per cent, according to JLL, while rents rose 7.9 per cent year-on-year in mid-2019. Both rents and values are expected to continue to rise.

Bangkok suffers from a lack of affordable housing, poor construction quality, and inadequate management of its existing stock. This should provide an opportunity for overseas investors; however, market opacity and difficulties in gaining construction finance both act as barriers to entry for foreign players.

Mumbai (12th in investment, ninth in development). The commercial real estate story continues to go from strength to strength in Mumbai. Demand for office space continues to be very strong. In 2019, one foreign investor paid US$100 million per acre for a prime three-acre site in the Bandra-Kurla Complex, a planned business district in the north of Mumbai that is today the city's prime financial district. This was an all-time high price for any land parcel in India and underscores confidence in market conditions.

According to one local consultant, "Real estate and large developers who have the backing of big foreign investors are continuing to go long and pick up aggressively priced assets where they feel there is active market demand and they can go into a redevelopment story."



Authorities continue to build out transport infrastructure, improving connectivity to new areas such as Navi Mumbai, which houses many new IT parks. While a potential oversupply situation may be brewing over the coming three-year period, these new facilities have better access to manpower as well as a lower cost of living. They are therefore well placed to pick up the slack as more traditional areas of the city run out of room to absorb new capacity.

Capital values continue to trend upwards, driven by rising rents, and both foreign and domestic players are actively bidding for good assets whenever they come to market. While cap rates are already at questionable levels, the current strength in the commercial markets suggests that they may still have room to run.

The residential sector, however, is as weak as the commercial side is strong, especially among the mid-tier development community, which is desperately short on capital. Further consolidation among developers therefore seems likely.

Beijing (13th in investment, 21st in development). A shortage of land, combined with a slowing economy and growing concern over the U.S.-China trade friction, has seen Beijing slide down the survey rankings for development prospects this year. For investment purposes it still places in mid-table, but the city remains the least favoured of China's first-tier cities. Both rents and capital values have been in decline in 2019.

Although foreign investors completed a number of office acquisitions in the first half of 2019, the Beijing market has traditionally been dominated by domestic purchasers able to outbid foreign players, and the status quo seems unlikely to change.

According to one investor, "There isn't a lot of supply within the 5th Ring Road, so if you can find an asset at the right pricing in Beijing within that 5th Ring Road, it's fantastic. If you can find an asset in one of the business parks which are dominated by local technology companies, that's O.K., too."

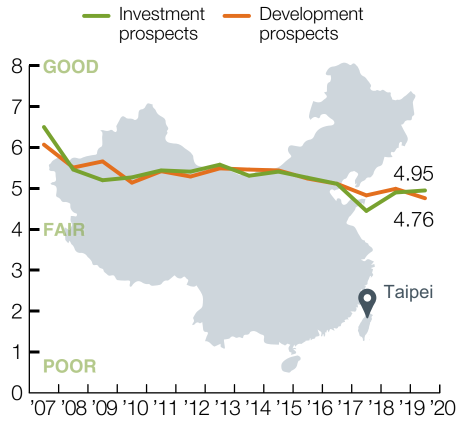
Concerns have surfaced over an incoming glut of office supply just as demand from tech companies, which have been the biggest marginal source of demand over the last few years, is cooling. As of mid-2019, vacancies had risen to an eight-year high of 11.5 per cent (expected to

rise to 15.1 per cent by the end of 2019), according to brokers Colliers. Admittedly, Beijing has in the past been able to ride out similar supply surges without much difficulty, as supply has been soaked up by state-owned enterprises and regional government offices that continue to migrate to the capital to open offices.

The municipal government has released a planning draft intended to reshape the Beijing retail sector, which should favour retail projects in the Wangfujing and Tongzhu areas over the long term.

Taipei (14th in investment, 19th in development). Taipei is probably the least liquid of the Asia Pacific's major markets, mainly because a high proportion of investable assets are held in the portfolios of local institutions and insurance companies and therefore do not trade. That said, there has been reasonable rental growth in 2019, which has resulted in cap rates widening at the midpoint of the year.

Takeup was triggered mainly by a wave of office relocation from aging buildings to Shinyi District, Taipei's CBD. Meanwhile, international coworking space operators have also aggressively occupied new space.



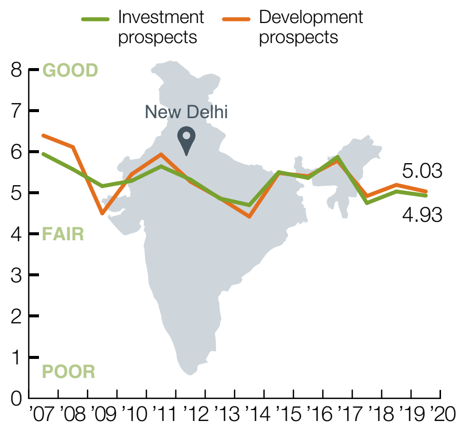
In part, this new demand for space is due to the fact that Taiwan has been luring "reshoring" business back to the island and away from mainland China. The reshoring tends to be in capital-intensive, high-value, robotized manufacturing, and has already added 0.4 per cent to the island's GDP. South East Asia is the top destination for Taiwanese companies expanding away from mainland China, but moving back home is the second choice. The Taiwanese government has initiated a three-year action plan to welcome returning businesses, and help them find land at concessionary rates. This has benefitted not only the industrial market, but also the high-end residential sector as reshoring business owners return to Taiwan.

As usual, domestic capital held by local institutions continues to dominate the market in Taiwan. Since it is not as price sensitive as foreign capital, the prospects for international investors are expected to remain limited.

New Delhi (15th in investment, 15th in development). New Delhi has traditionally been focused more on residential development, so the downturn in the residential market nationally is probably felt more keenly here than in other parts of the country. Oversupply in the sector has been growing since 2013, and conditions worsened following the government's 2016 demonetisation campaign, together with tighter regulation of the industry. Now that both the banking and the nonbank finance sectors in India have dried up as a source of capital, many developers—especially in the mid-tier—are starving for cash. Defaults have become commonplace and many more developers are likely to fail over the next 12 months, according to one interviewee.

At the same time, on the commercial side, the market can do no wrong. Takeup of new office space is rising by around 30 per cent annually, according to one Delhi-based advisor, and is especially strong in Noida, a satellite city to Delhi's south east, where absorption of grade A office space shot up to some 3.5 million square feet in 2018 from a historical average of 1 million to 1.2 million square feet annually. Noida offers cheaper office facilities and has benefitted as rental costs elsewhere in Delhi have risen. "The primary driver was that in Gurgaon [another subdistrict of Delhi], office rental prices have gone up to as much as $1.50 or even $2 per square foot per month, which no longer makes sense for IT occupiers."

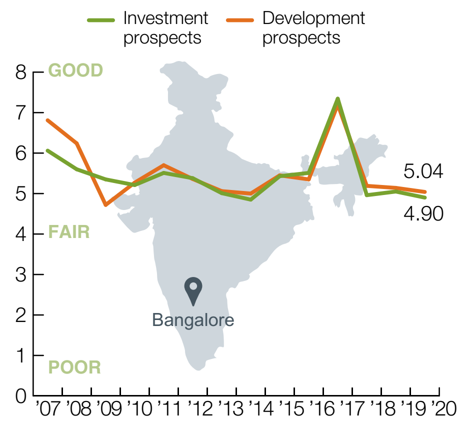
Another sector that is booming in Delhi is logistics. According to one interviewee, "You've seen properties that are 100 acres in size being committed to the extent of 60 per cent even before the properties are ready for occupation—that's how strong the underlying demand in north India is." While finding a good development partner in northern India remains a challenge, the demand for logistics and warehousing facilities appears "endless" and buying land at reasonable prices is not generally a problem.



Bangalore (16th in investment, 14th in development). While Bangalore has been undeniably the big success story of India's IT park and business process outsourcing (BPO) sector, growth in the city has been so strong for so long that many are wondering whether the peak has been reached. Surprisingly, however, the city's commercial office sector continues to expand at a breakneck pace. Absorption grew some 30 to 35 per cent year-on-year in the first half of 2019, rentals have continued to rise, and large pools of capital are available for further investment. According to one consultant, "Bangalore will this year again be one of the world's largest commercial office and IT space markets."

Doubts as to the sustainability of this growth probably explain why it ranks lowest of the Indian cities in this year's survey, despite there being little sign of a slowdown.

One consequence of the rapid expansion of Bangalore's multitude of IT parks, which now employ more than 2 million IT workers, is that the city has outgrown available infrastructure. Traffic is even more chaotic than usual in India. Meanwhile, the metro is poorly planned, although in certain pockets where metro connectivity is available, things are not as bad as they once were. Provision of basic utilities, from internet to electricity to water, is also patchy, while pollution is a growing problem.

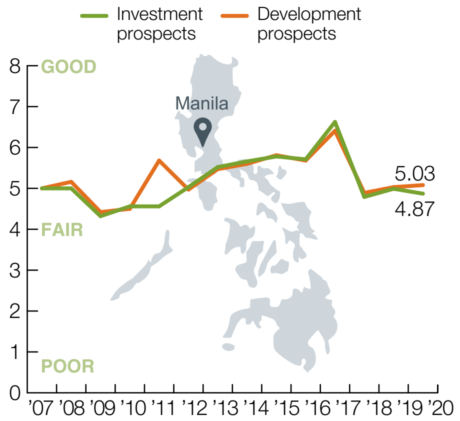


Manila (17th in investment, 11th in development). Despite apparently healthy real estate markets, Manila continues to languish near the foot of the investment sentiment tables this year, far removed from the third-place ranking in our 2017 survey. Ongoing restrictions on foreign majority ownership of domestic real estate assets probably play a role in this, given that office-sector vacancies remain low, rents are rising, and capital values continue to grind upwards (climbing 1.8 per cent quarter-on-quarter alone in the second quarter of the 2019, according to JLL).

Over the last several years, the main catalyst for Manila's office sector has been demand from Philippine offshore gaming operators (POGOs), an industry providing online gambling services, mainly to gamblers in Mainland China. Demand from POGOs represents almost 40 per cent of new office takeup in the city. There have been complaints, both domestically and from the Chinese government, that the industry has come too far too fast, but it remains too important to cut loose at this point. According to one locally based interviewee, "There are a lot of local people who are entrenched in both the real estate and the construction industries that don't want to lose those big Chinese players—as long as that's the case, at least for the next year or so, I don't see a significant change."

The BPO sector remains the largest office sector tenant. It continues to grow, although at a slower pace. So far, it has been able to fend off the threat posed by the evolution of artificial intelligence–based solutions, and has recently received a boost from growing interest in "captive centres," involving the offshoring of corporate in-house services such as human resources, finance, and IT.

Meanwhile, survey sentiment towards development plays was significantly stronger this year than that for investment. To some extent, this reflects the reality across most emerging markets, where stabilised assets are generally in short supply. Another reason is that Manila



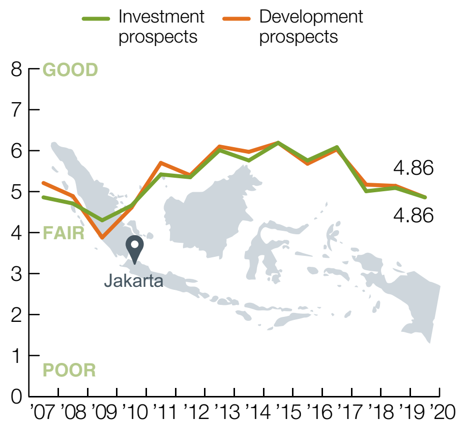
offices trade at cap rates (i.e., some 5.9 per cent, according to Knight Frank) that are probably hard for international investors to justify on a risk/return basis.

The appeal of development plays has also been boosted by the government's "Build Build Build" infrastructure construction programme, now in its third year. This is focused, amongst other things, on opening up satellite locations outside Manila as a way to relieve stress on a chronically overpopulated city centre. Government projects dominate to the north, while to the south, according to one locally based planner, "a lot of private-sector players are quietly developing massive land banks, maybe 500 to 2,000 hectares in size, to build quasi-cities based on horizontal infrastructure and the creation of new broadband connections. You do see the private toll operators connecting roadways down south, and that's going to open up a lot of new communities." New tax policies may also encourage the translocation of BPO providers to these satellite locations.

Jakarta (18th in investment, 17th in development). Economic growth in Indonesia continued at a robust pace of 5.2 per cent in the first half of 2019. The recent reelection of President Joko Widodo has also created confidence that the overall environment will remain stable and that government infrastructure investment programmes will continue.

That said, the Jakarta office market continues to be plagued by oversupply. With little relief in sight, rents look set to continue on a downward track as vacancy rates touch some 35 per cent in 2019. On the residential side, Jakarta continues to see too much supply aimed at the top end of the market, especially given the relatively small number of expat workers living in the country.

The recent announcement that the government intends to move its capital (together with some 180,000 civil servants and their families) away from Jakarta to a new base in Kalimantan has raised concerns that vacancy rates in the city may worsen. However, if authorities proceed with plans to demolish newly vacated government buildings and turn them into green spaces, the move may lead to interesting opportunities to regenerate parts of Jakarta's chronically congested inner city.



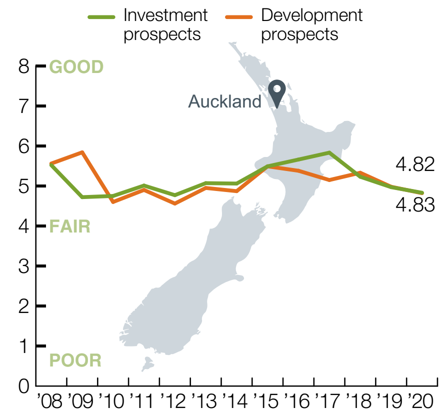
To a certain extent, this has already happened in some areas, thanks in particular to the ongoing buildout of the city's Light Rail Transit (LRT) system. In particular, buildings on main roads with good LRT access enjoy strong occupancy. According to one interviewee, "The tactical urban renewal around the stations has taken a lot of people by surprise; they come back to a Jakarta they don't recognise. Parts of it are walkable, and there are new downtown districts that are gleaming. Jakarta had always sat between Kuala Lumpur and Manila, maybe a little behind Bangkok, in people's minds in terms of development quality. But maybe in these pockets, some industry watchers are saying it now exceeds Bangkok in certain quarters, though as a city it still struggles."

Otherwise, opportunities exist for private-equity investors to exploit a multitude of localised inefficiencies. Value-add plays are a definite prospect, with some local developers now prioritising introduction of smart building technologies as a way to cut running expenses. Beyond that, the many office buildings suffering chronically high vacancy rates, as well as some residential complexes, have become potential targets for conversion to hotels or co-living facilities.

In addition, several large private-equity investors have considered investing in outlying transit-oriented developments (TODs) that have been earmarked for construction along the new LRT lines, though so far none has taken the plunge. Finally, the logistics sector continues to draw attention, although in practice investing remains problematic given the high cost of land and the profusion of mom-and-pop operators who are unlikely to lease expensive new high-tech facilities.

Auckland (19th in investment, 18th in development). Offshore investors on the hunt for higher yields discovered Auckland several years ago, their arrival triggering a bidding war for commercial assets that saw values rise steeply and cap rates rapidly compress. Prime yields currently stand at some 5.6 per cent, with turnover reaching almost US$2 billion in 2018, according to CBRE.

While the low-hanging fruit has now been digested, transactions remained at a healthy level in 2019, with offshore institutional investors (especially from Australia, the United States, Singapore, and China) continuing to be a major influence. However, significant levels of incoming supply have seen rental growth plateau, and with a modest 2.1 per cent annual growth expected until 2023, according to Deutsche Bank, cap rate compression can be expected to stabilise going forward.



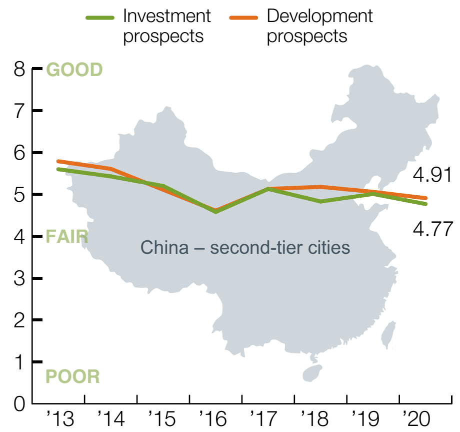
As in other markets, the logistics sector is booming in Auckland. Industrial land values have risen an average 10 per cent annually over the last five years, and with most industrial sites fully occupied, rents are expected to continue to rise going forward.

New Zealand's housing market has seen demand outstrip supply for at least the last 10 years, and with additional pressure also coming from foreign buyers, home prices reached the point where the government felt compelled to introduce restrictions on international purchasers in 2018. The house market softened in 2019, following Australia's example, but appears to have rebounded towards the end of the year.

China's second-tier cities (20th in investment, 16th in development). Overseas investors have largely withdrawn from China's second-tier cities in favour of more mature markets, in particular Shanghai and Beijing. With China's economy slowing, investors are concerned about liquidity in less developed cities. Furthermore, China's secondary cities tend to be plagued by oversupply, especially in the office sector.

"A lot of foreign capital has been burned in the Tier 2, Tier 3 cities," one fund manager said. "Outside of the residential sector, there has been no real rent growth in either office or retail because supply has been enormous. And there's a lack of liquidity for takeout capital at the end of a project."

Some opportunities may still be available for adventurous investors, however. According to one locally based fund manager, "Shopping malls may be O.K.—if the demographics are positive, they may survive in Tier 2 destinations. Then, logistics is everywhere, and in terms of residential, some of the Tier 2 cities are still positive and selling well. Although the market is slowing, you can still sell. The volume is still there, although the latest statistics show that prices in the top 30 cities have recently come down by 2 to 3 per cent."



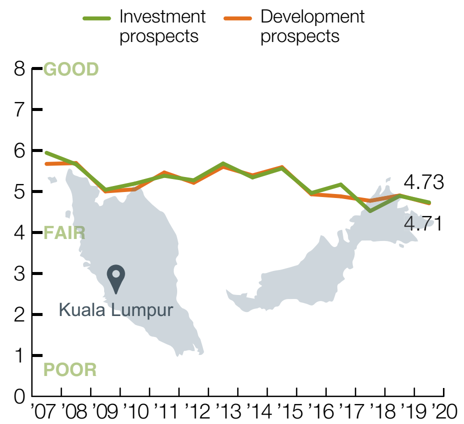
Hangzhou, Chengdu, and Suzhou are the most popular secondary cities with investors due to their strong technology and education sectors. Meanwhile, smaller cities west of the Greater Bay Area are expected to see relatively greater benefits from the integration of that area.

According to one investment manager, the GBA story is "all about the 'West Bank,' not about Shenzhen and Guangzhou—they are already big enough and there's a lot of supply and activity. They don't need help. But the smaller cities could see a lot of change. We are looking at residential and development that supports residential, such as education and health care."

Kuala Lumpur (21st in investment, 20th in development). On the face of it, serially unloved Kuala Lumpur should be more attractive to international real estate investors. Malaysia's GDP per capita is the second highest in South East Asia—four times higher than investors' favourite, Vietnam—and its developed financial markets, including real estate investment trusts should provide appeal to institutional investors. In addition, Malaysia is seeing the arrival of significant amounts of investment from Chinese tech manufacturers as they move some operations offshore.

However, significant oversupply in the office and retail sectors has again cast a cloud over local markets. Office vacancy rates exceeded 18 per cent in mid-2019, according to JLL, and with more than 3 million square feet of new supply arriving in 2019, vacancies are expected to ex-ceed 25 per cent by the end of the year. Unsurprisingly, capital values and rents are in retreat. The retail sector has seen the greatest involvement by foreign developers, and some have also been involved in residential-led mixed-use projects in Kuala Lumpur.

In recent years, foreign investment—mainly Chinese—has been focused on building residential projects in the Iskandar region of southern Malaysia, although this has now dried up to a great extent due to Chinese capital export restrictions.



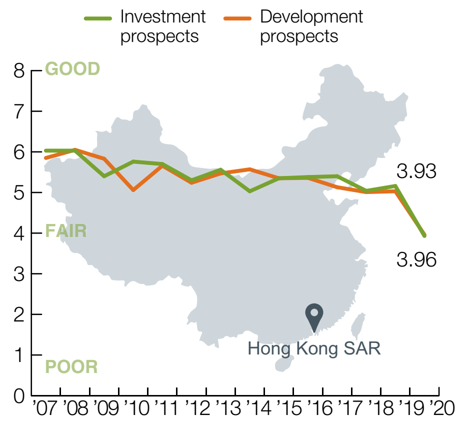
Hong Kong SAR (22nd in investment, 22nd in development). Its reputation as the priciest real estate market in the world has guaranteed Hong Kong a place in the lower half of our investment rankings survey almost every year since its inception—not only do grade A assets rarely trade, but capital values are so high and cap rates so low that many foreign investors see little prospect of further incremental gains. This year, however, the city has woes of a different kind to contend with. Months of street protests have seriously damaged the tourism and retail sectors and raised doubts about the city's long-term investment prospects. As a result, the city finished dead last in our investment prospects survey, with the lowest score seen in years.

That said, much of the damage is more apparent than real. Although retail sales fell 23 per cent year-on-year in August 2019 (with same-store sales in some locations declining over 50 per cent) and hotel occupancy dropped to just half after tourist arrivals fell 40 per cent in August compared to the previous year, there has so far been little impact on property values—investors scouting for deals on a distress basis have been disappointed as owners opt to sit tight and wait out the storm. This is perhaps unsurprising given that Hong Kong has always been a tightly held market, and owners are generally not highly leveraged or short of capital.

In particular, the city's CBD, which is located in a confined geographical area that guarantees prime space will always be in short supply, has seen relatively little negative impact. Rents fell 2.2 per cent quarter-on-quarter in the third quarter of 2019 since peaking in June, according to JLL, and while new lettings fell by 72 per cent month-on-month during August, CBD grade A vacancies stood at a mere 5.5 per cent—high for Hong Kong, but hardly exceptional by international standards. At the same time, however, few tenants signed CBD leases in October 2019, and those that did often benefitted from significant rent-free periods that mask the true level of rental declines.

While the retail sector—especially at the high end—may be subject to longer-term negative repercussions, it has always been a volatile sector and seems likely to recover much of the ground it has lost once the situation stabilises. Most local investors see the threat from the U.S.-China trade friction to be a much more serious potential drag on the economy.

Residential values, meanwhile, have also started to experience declines, though prices at the end of October 2019 were still higher than they were at the beginning of the year. Given the extent of home price increases experienced in recent years, few owners are currently in negative equity and the supply/demand equation still militates in favour of sustained upward pressure on private home values.



Property Types in Perspective

OFFICE

The office sector continues to be the most popular amongst investors in the Asia Pacific region, and in most markets has continued to perform. Despite widespread concerns about pricing and a general consensus that yields may have bottomed, a number of markets continue to see yield compression.

Overall, however, the office sector has become marginally less popular with investors: 84 per cent are or plan to be invested in it, compared with 86 per cent in 2019. Investors rate its prospects marginally lower than in our 2019 report, and now expect the industrial/logistics sector to be the best-performing asset class.

The huge lot sizes in Asia Pacific markets mean that more properties are being sold to joint ventures or investment clubs. The abundance of institutional capital that continues to find its way into regional markets looking to buy core properties guarantees that office assets will remain in demand.

Demand for coworking space continues to be very strong in most Asia Pacific markets (in particular in China), and while developers and landlords are often sceptical about the sustainability of the conventional coworking business model, the industry has become entrenched so quickly that there is no question that flexible space will remain in growth mode for the foreseeable future.

Expected best bets: Most city office markets are regarded in much the same light as they were a year ago, which is broadly positive; observers would usually buy or hold in most markets. However, a small number of them have seen dramatic changes in popularity, either upwards or downwards.

For example, Ho Chi Minh City and Singapore have seen their buy rating increase by more than 10 percentage points, while Osaka has seen its grow by five percentage points.

Singapore's office market was one of the last in the region to recover from the global financial crisis, and prime rents there are still well below their 2008 peak. Since then, the city has expanded and upgraded its CBD office stock, as well as opening up a number of decentralised office districts. Rents are rising sharply.

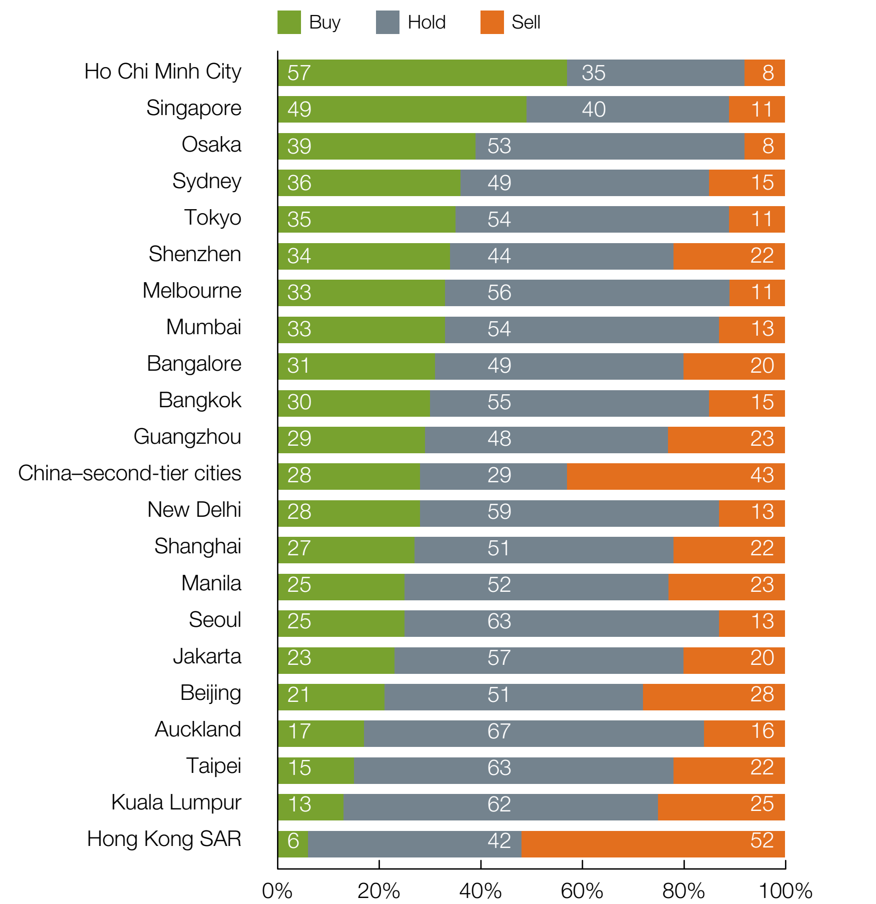
Ho Chi Minh City continues to be extremely popular from a top-down perspective due to Vietnam's excellent demographic and growth prospects and also because it has seen strong rental growth. However, overseas investment in the city's office sector is minimal.

The resurgence of Osaka, boosted by almost a decade without significant office supply, is part of a wider refocusing of investor interest to Japanese provincial cities. Tokyo's ranking has slipped a little, but it is clearly still seen as a defensive play by investors: its sell rating dropped to 11 per cent from 14 per cent.

Only two cities or city groups saw a dramatic rise in their sell ratings, and for rather different reasons. China's second-tier cities saw their sell rating rise to 43 per cent, from 32 per cent. These locations tend to be oversupplied with office space, something that will hit returns as China's economy slows.

Hong Kong saw the sharpest rise in the percentage of investors who would be sellers of its office market. More than half (52 per cent) are now sellers, spooked by ongoing political protests.

Exhibit 3-4 **Office Assets Buy–Hold–Sell Recommendations for 2020–by City**



Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

RETAIL

The retail sector continues to be out of favour with investors in the Asia Pacific, largely due to the growing threat from e-commerce sales. It was the only property type to see a fall in the percentage of investors who plan to invest in the sector.

That said, retail remains a core real estate asset class, and there is a growing conviction among investors that if existing facilities are well located and can be adapted in ways that satisfy consumer expectations in terms of 'experiential' services, they will continue to thrive, albeit possibly at lower profit levels than in previous years. Investors rate its prospects lower than other core sectors, however, and worse than in 2019.

However, the retail sector seems to be relatively more popular in the Asia Pacific region than elsewhere in the world. According to RCA, global retail transactions in the first half of 2019 were only slightly higher than in the industrial and logistics sector, while in the Asia Pacific, retail sales volumes were more than twice those of industrial and logistics assets. While retail property sales in the Asia Pacific fell 7 per cent year-on-year in the first half of 2019, globally they fell 35 per cent. This gives some support to the thesis that Asia Pacific retail is adapting better to the growth of e-commerce, or anyway that it is suffering less due to lower per capita retail space in most cities.

In 2018 and the first half of 2019, a number of global investors allocated substantial capital to retail in Vietnam, India, and Greater China, suggesting at least localised faith in the sector.

Overall, in the Asia Pacific region, the retail sector attracts more sell ratings from investors than any other asset class, with 13 cities having a higher percentage of investors saying they would sell retail rather than buy it.

Expected best bets: There are only eight cities where investors would rather buy retail than sell it, and the only city with a clear majority in favour of buying retail is Ho Chi Minh City, where the sector is relatively undeveloped, although undermanaged retail podiums in residential developments have been tipped as a value-add proposition.

According to CBRE, the supply outlook for Ho Chi Minh City is better than expected after a number of projects were delayed.

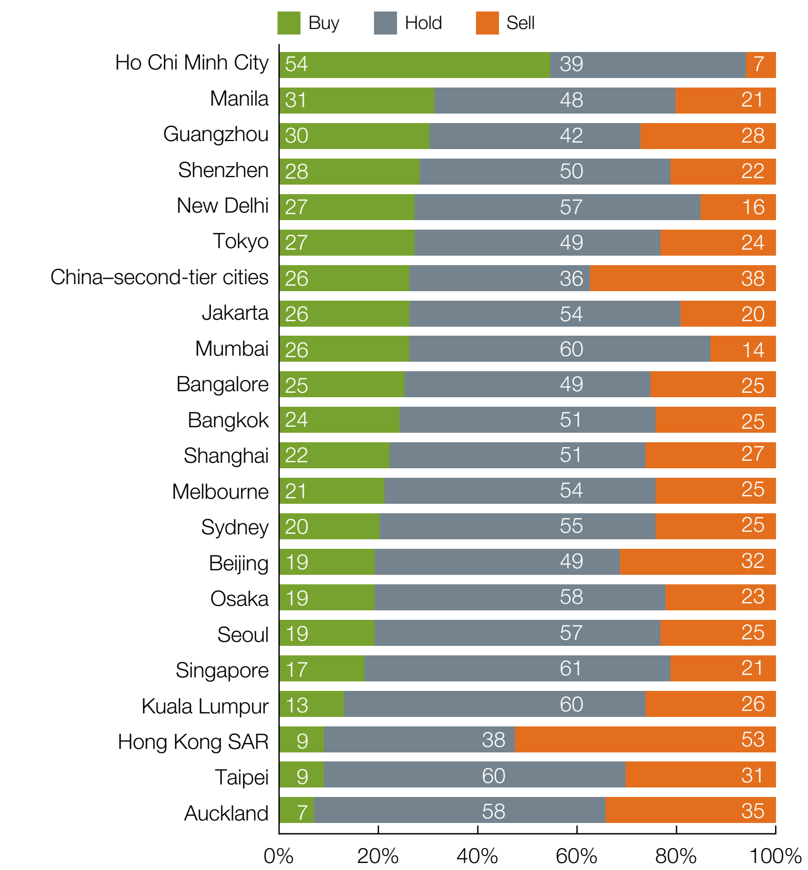
There is also optimism about retail in fast-growing emerging markets such as India and Manila. Opinion about the prospects for retail in China's second-tier cities is sharply divided, possibly a reflection of how different each city's prospects are, which is down to supply factors.

While some second-tier cities in China are relatively undersupplied with modern shopping centres, others have seen a huge wave of supply, often ill-conceived and rarely well managed.

Thanks to the attractiveness of the Ginza shopping district in Tokyo, the Japanese capital's retail property sector remains relatively popular with investors. However, Osaka retail has not gained the same popularity with investors as its office sector has. Retail sales in Japan are under threat, however, from the prospect of declining tourist arrivals from South Korea and China in the wake of existing or potential disputes with those countries.

Sentiment towards retail in Hong Kong retail, meanwhile, has been hit by the wave of protests in the second half of 2019 that has seen tourist arrivals drop precipitously.

Exhibit 3-5 **Retail Assets Buy–Hold–Sell Recommendations for 2020–by City**



Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

RESIDENTIAL

The residential sector remains broadly popular with investors in the Asia Pacific, with both multifamily residential and for-sale residential being higher rated this year than in our 2019 report.

However, there are clearly a few dissenting voices, with residential assets in some cities attracting relatively high sell ratings from investors due to historically high prices and the risk of government intervention. According to one investor, "I do think residential for sale is teetering on the brink at the moment."

In Hong Kong SAR and Australia in particular, house price growth has leaped ahead of income growth, which is not the case for mainland China and Singapore, even though prices have risen in all these markets.

A number of interviewees expressed an interest in the multifamily residential sector across the Asia Pacific, but also said that opportunities are limited since the sector is underdeveloped compared with the United States and Europe. Japan remains the only market with a large proportion of multifamily residential property, although the sector is growing in both Australia and China, with the latter expected to evolve into a major component of total residential assets.

Expected best bets: Ho Chi Minh City tops the table again. In this case, however, there has been a reasonable amount of overseas investment in local residential assets. Foreign developers and private-equity players have both invested in condominium developments and developed a number of new luxury apartment blocks.

However, anecdotal evidence suggests that concern is growing about Vietnam's land prices and about how many luxury apartments can be absorbed. Tellingly, many of the new blocks have been heavily marketed in Hong Kong and Singapore, where they have proved popular with investors priced out of their home markets.

Singapore residential assets have also increased in popularity; however, the prospects for investors and developers are constrained by the city's residential cooling measures, which impose onerous stamp duty on non-Singaporean buyers. Furthermore, the city's anti-immigration stance is also working to constrain demand for new apartments.

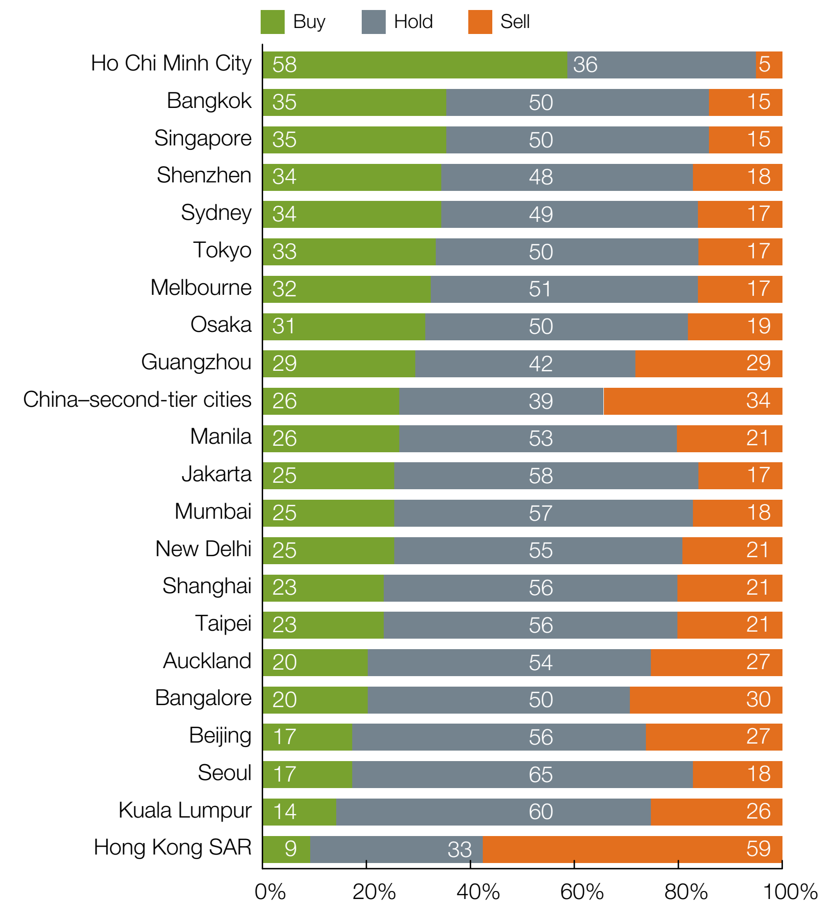
Sydney remains popular. The city now looks more attractive after two years of falling prices and also interest rate cuts that look set to send the market on an upswing. Australia continues to see high rates of immigration, which are boosting demand for new homes.

There also is interest in Tokyo, which is still growing due to migration from the rest of Japan. The stable income prospects of multifamily there remain attractive, but pricing is tight.

Again, investors have very mixed feelings about second-tier cities in China, many of which have strong growth prospects but also a big pipeline of new supply and localised cooling measures that reduce profitability. As China growth slows, overseas investors are increasingly focused on first-tier cities.

Hong Kong again props up the bottom of the table. More investors (59 per cent) rate Hong Kong residential as a sell than any other city/sector combination. Several months of street protests have damaged sentiment in the city. However, price declines have been minimal as of the end of October, and the fundamental lack of supply in the city will probably be sufficient to prop prices up going forward.

Exhibit 3-6 **Residential Assets Buy–Hold–Sell Recommendations for 2020–by City**



Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

INDUSTRIAL/LOGISTICS

Although industrial, warehouse, and logistics space would logically be the sector hardest hit by the slowdown in trade due to higher tariffs and slowing economic growth, the asset class remains a favourite play amongst institutional investors, who rate it the top sector for investment prospects in this year's report.

Rising consumer spending and the growth of e-commerce across Asia are driving the need for high-spec, tech-driven warehouse space, an asset class that is hugely undersupplied across the region, with the arguable exception of Australia. E-commerce also intensifies the need for well-located facilities that are far more than "sheds," able to distribute goods at the lightning speeds now required. That dynamic is still very favourable in most developing Asian markets, where the size of the middle class is rapidly rising.

"Industrial warehouses at the low end have been affected by the trade war. But they haven't been the major assets favoured by institutional investors," the head of Asia research at a commercial brokerage said. If anything, tariffs and economic pressure may push the adoption of higher-end warehousing that can offset any higher trading costs through greater efficiency.

Emerging Asia tends to set pulses racing most when it comes to logistics. The top cities for buy interest are all in Vietnam, China, or India, all of which are chronically undersupplied, or benefit from government policies that boost buildout of logistics infrastructure, or both. Tokyo is the only developed market that features among the top 10 target cities.

Expected best bets: Ho Chi Minh City (number 1 for buy interest) is the most attractive target destination for industrial, followed by Malaysia and then the rest of South East Asia. All of these areas benefit from a gradual migration of manufacturing capacity away from China. In particular, the pro-business administration in Vietnam is very accommodating to foreign investors and manufacturers looking to increase their presence.

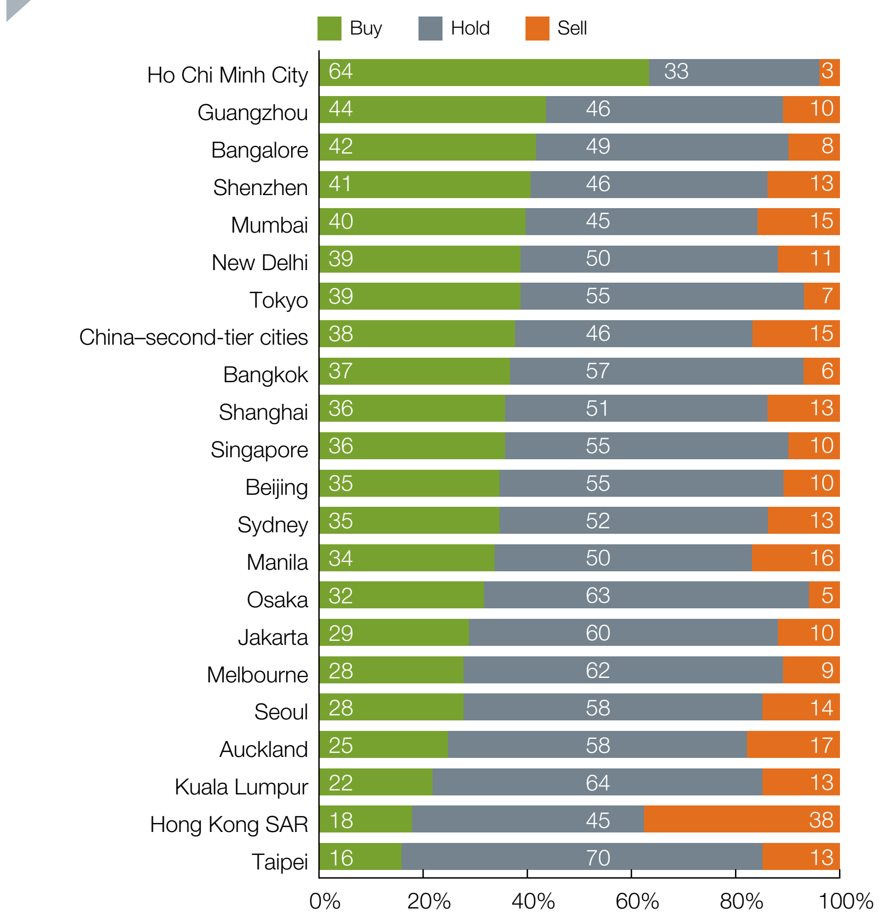
Then there is the domestic attraction. "Putting aside the trade war, Vietnam is early on in its evolution, so it's a great opportunity for serious global developers in retail logistics. It's got a huge and growing middle class," one fund manager noted.

There is one major problem for institutional investors looking to buy existing logistics space that meets international standards in Vietnam, and that is the almost complete absence of available assets. So Ho Chi Minh City, together with cities in India (in particular Mumbai (number 5), and New Delhi (number 6)) score high in our survey and have now become developing markets for warehouse specialists.

In China, there is an increasing stock of high-end space that may ultimately be sold by developers into the secondary market. Guangzhou (number 2) and Shenzhen (number 4) rate particularly highly in terms of buy interest in our survey, ahead of Tier 2 Chinese cities (number 8) as well as China's biggest commercial markets, Shanghai (number 10) and Beijing (number 12).

When emerging market and frontier cities top the survey responses in terms of interest, it is often the case that the markets that appear attractive at a macro level and in terms of demographics offer little opportunity for actual investment. It requires a strong local partner to penetrate those markets, mainly for investors willing to pony up long-term capital for years of development.

Exhibit 3-7 **Industrial–Distribution Assets Buy–Hold–Sell Recommendations for 2020–by City**



Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

One asset manager said that he is seeing huge interest from clients in logistics space in South Korea. This is not reflected in the survey results, where Seoul ranks in the bottom five least attractive markets for a buy on distribution assets. Korean exports of cars and computer chips have been hurt by global trade tensions and also a spat with Japan over wartime reparations.

Yet even though South Korea is one of Asia's most export-oriented nations, it still lacks high-grade logistics space to serve both exporters and the local market. That may justify greater attention to the market.

"I've got great hopes for South Korea," the asset manager said. "They've got a much bigger population than, say, Australia, and you've got freehold assets, which is our ambition, to wean ourselves off leasehold properties. They really haven't had that much institutional trade of assets."

The same manager said that you "can't take your eyes off" logistics in China. Major overseas players continue to build huge amounts of new space. They will ultimately need to monetize those assets, either through portfolio sales or securitisation.

The industrial sector is a favourite target for investors in Japan. But it is not always easy for international investors to identify good deals. For the most part, Japan remains a developer play for modern warehouse space, rather than an asset class where a large fund or institution can buy stabilised properties.

Investing in industrial J-REITs is a way for investors to find easy liquidity and an entry to the industry. They trade at a 24 per cent premium to net asset value (NAV), demonstrating there is more money keen to get into the industry than there is free float of J-REIT shares. Likewise, the premium to NAV on office J-REITs is 29 per cent.

HOTEL

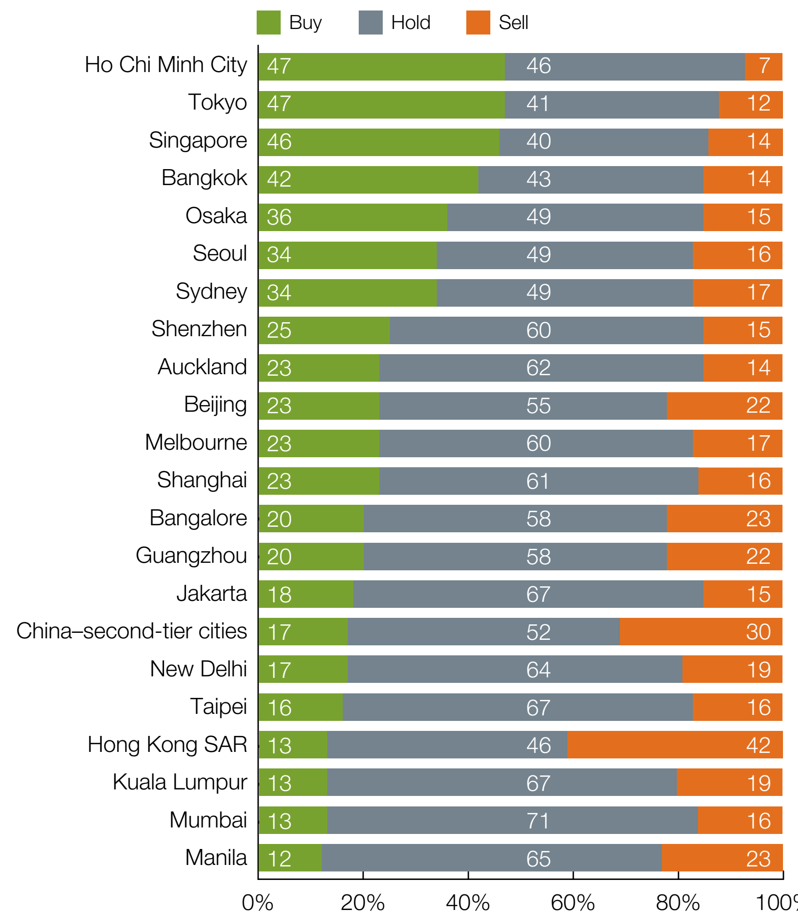
As they do with office space, investors favour Asia's most developed markets for hospitality plays. As an asset class, hotels are of middling interest overall when our survey respondents identify sectors for growth in 2020. But hospitality tends to be a specialist sector, of great interest only to those with expertise and a track record in the field in Asia.

Bangkok (number 4 for buy interest in hotels) is the world's most visited tourist destination. It has been the top city globally for international visitors for six of the last seven years, according to Mastercard's Global Destination Cities Index.

Bangkok drew 22.8 million overnight international visitors in 2018, 19.3 per cent more than second-place Paris. In particular, it is the destination of choice for travellers from mainland China, who are now outdone globally only by Americans in terms of international-traveller volume. Chinese tourists, who make up 37.3 per cent of overseas arrivals in Bangkok, also target Seoul and Tokyo, in that order.

Expected best bets: Singapore (number 3) also scores high in our survey as a market for hotel buys. It is the second-busiest city in Asia for international tourists, according to Mastercard, just ahead of Kuala Lumpur. Both Singapore and Kuala Lumpur drew more overseas visitors last year, at around 14 million, than

Exhibit 3-8 **Hotel Assets Buy–Hold–Sell Recommendations for 2020–by City**



Source: *Emerging Trends in Real Estate Asia Pacific 2020* survey.

New York City. Singapore draws sizeable visitation not only from China but also from India, putting its hotel industry in a particularly sweet spot.

Kuala Lumpur's low ranking in our survey (number 20, third from the bottom for hotel buy rating) is therefore shockingly low. Only 13 per cent of investors would be looking to buy Kuala Lumpur hotels, suggesting that bargain hunters may be able to find deals. Malaysia, like Vietnam, also is a beneficiary of trade tensions, which should boost the domestic economy. Kuala Lumpur gains from an increase in Chinese travellers, now a top source at 20.6 per cent of arrivals, and also from the significant growth in tourism out of South East Asia. Thais and Indonesians each account for just under 12 per cent of overseas arrivals in Kuala Lumpur.

Mastercard also projects particularly strong 9.9 per cent growth in tourist arrivals in the Malaysian capital. That is outstripped only by the 10.0 per cent advance in visitors to Tokyo.

The growth in Tokyo will boost the ranks of the 12.9 million visitors who came calling on the Japanese capital in the last full year's figures. Japan has been a prime target for hotel investors, buoyed by the short-term benefit from the Rugby World Cup, and the 2020 Olympic Games in Tokyo. But the greater driver has been a rapid increase in tourist arrivals in recent years. The fast growth of the Japanese hotel sector may come back to haunt it, though. Signs of overbuilding have already emerged, while there is also a threat to tourist arrivals arising out of actual or potential bilateral tensions involving South Korea and China. Once the Olympics are over, many analysts are expecting the sector may retrench.

Tokyo (number 2) and Osaka (number 5) both feature near the top of our survey in terms of buy interest on hospitality assets.

However, hospitality J-REITs show a minimal premium over their net asset value, suggesting that concerns over pricing are mounting. Unlike industrial and office J-REITs, which trade at significant premiums, there is a minimal 2 per cent premium on hotel REITs, and a –0.6 per cent discount on retail J-REITs.

"It's quite a clear indication of investors' preference," the Tokyo-based head of research for an investment-bank asset manager said. "I don't know if they are right, but this is a reflection of the market response."

Once again, Ho Chi Minh City tops the list, as it does with every other asset class, the issue being whether investors can find hotel stock that trades.

Interviewees

Dougie Chrichton

151 Property
Chris Chapple

Accord Group Holdings
Richard Price

Actis
Brian Chinappi

AECOM
Sylvester Wong

ALE Property Group
Andrew Wilkinson

Allianz Real Estate
Rushabh Desai

AMP Capital
Tim Nation

Angelo, Gordon International
Jon Tanaka

ANZ
John Hudson

Aoyama Realty Advisors
Haruyuki Shinya

Arrow Capital Partners
Kurt Wilkinson

Australian Unity
Mark Pratt

AXA Real Estate Investment Managers Japan
Yoshihiko Hayafuji

Blackstone Group
Christopher Heady
Kimmo Tammela

Brookfield Asset Management
Niel Thassim

Cache Logistics Trust
Daniel Cerf

Capbridge Investors
Ken Fridley

CapitaLand Limited
Andrew Lim

CBRE
Henry Chin

CBRE Global Investors
Tetsuya Fujita

Centuria Capital
John McBain

Charter Hall
David Harrison

Colliers International
David Faulkner
John Kenny
Kichoon Jung

CRE REIT Advisers
Tsuyoshi Ito

Daiwa House Industry Co., Ltd.
Tetsuo Suzuki

Deutsche Bank
Hugh McDonald

Dexus
Darren Steinberg

DWS Investments Japan
Koichiro (Ko) Obu

ESR
Stuart Dawes

Fife Capital
Allan Fife

Frasers
Rod Fehring

Frasers Property Australia
Chamoun Malki

GenReal Property Advisers
Anckur Srivasttava

GPT Group
Bob Johnston
Nick Harris
Chris Barnett

Grosvenor Asia Pacific
Benjamin Cha

ISPT Super Property
Darryl Browning

Hulic Co. Ltd.
Yoshito Nishikawa

ITOCHU REIT Management
Junichi Shoji

Japan Post Bank Co., Ltd.
Hiroyuki Tanaka
Yuki Ogawa

Jerde Partnership
Tetsuya Karasawa

JLL
Stuart Crow
Tim Graham
Fergal Harris
Megan Walters

JPMorgan Asset Management (Japan) Ltd.
Tetsuya Karasawa

KaiLong
Hei Ming Cheng

Keppel Land Limited
Tan Swee Yiow

Kenedix
Takahiro Uchida
Hikaru Teramoto

LaSalle Investment Management
Simon Howard
Tom Miller

Mapletree Investments Pte Ltd
Hiew Yoon Khong
Norihiro Matsushita

Metropolitan Real Estate
John So

Mitsubishi Corp.-UBS Realty
Katsuji Okamoto

Mitsubishi Jisho Investment Advisors
Naoki Kuwabara
Toshiyuki Arai
Eriko Kato

Mitsui Fudoson Investment Advisors
Shuji Tomikawa

Moelis Australia
Ben Boyd

Mori Building
Hiroo Mori

NAB Healthcare
Georgina Switkowski

Nuveen
Nick Evans

Ooedo Onsen Reit Investment Corporation
Fuminori Imanishi

PAG Investment Management
Naoya Nakata

Pamfleet
Andrew Moore

PAYCE
Will Morgan

PGIM Real Estate
Benett Theseira

PGIM Real Estate (Australia)
Steve Bulloch

Portwood Capital
Peter Churchouse

Professional Property Services
Nicholas Brooke

Property Council of Australia
Ken Morrison

Samurai Capital
Ken Aoyama

Savills
Christopher Marriott

SCA Property Group
Anthony Mellowes

Starr International Investment Advisors (Asia)
Alison Cooke

Stockland
Mike Davis

Swire Properties
Ashley Hegland

Telstra Super
Andrew Bambrook

Tishman Speyer
Ryan Botjer

Tokyu Land Capital Management
Yutaro Tanaka

Touchstone Capital Management
Fred Uruma

UBS
Grant McCasker

Vicinity Centres
Justin Mills
Carolyn Viney

Wing Tai Holdings Limited
Cheng Wai Keung

Sponsoring Organisations

PwC's real estate practice assists real estate investment advisers, real estate investment trusts, public and private real estate investors, corporations, and real estate management funds in developing real estate strategies; evaluating acquisitions and dispositions; and appraising and valuing real estate. Its global network of dedicated real estate professionals enables it to assemble for its clients the most qualified and appropriate team of specialists in the areas of capital markets, systems analysis and implementation, research, accounting, and tax.

Global Real Estate Leadership Team

Craig Hughes
Global Real Estate Leader
London, United Kingdom

K.K. So
Asia Pacific Real Estate Tax Leader
Hong Kong SAR, China

Paul Walters
Asia Pacific Real Estate Assurance Leader
Hong Kong SAR, China

Jim Chen
China Real Estate Leader
China

Alan Ho
South China Real Estate Leader
Hong Kong SAR, China

Gang Chen
China Real Estate Tax Partner
China

David Kan
Hong Kong Real Estate Tax Leader
Hong Kong SAR, China

Jane Reilly and **Josh Cardwell**
Australia Real Estate Leaders
Sydney, Australia

Bhairav Dalal
India Real Estate Tax Leader
Mumbai, India

Brian Arnold
Indonesia Real Estate Leader
Jakarta, Indonesia

Jennifer Chang
Malaysia Real Estate Leader
Kuala Lumpur, Malaysia

Hiroshi Takagi and **Hideo Ohta**
Japan Real Estate Leaders
Tokyo, Japan

Taejin Park
Korea Real Estate Leader
Seoul, Korea

Chee Keong Yeow
Singapore Real Estate & Hospitality Leader
Singapore

Nguyen Thanh Trung
Vietnam Real Estate Leader
Ho Chi Minh City, Vietnam

Jason Liu
Taiwan Real Estate Leader
Taipei, Taiwan

www.pwc.com

The Urban Land Institute is a global, member-driven organisation comprising more than 45,000 real estate and urban development professionals dedicated to advancing the Institute's mission of providing leadership in the responsible use of land and creating and sustaining thriving communities worldwide.

ULI's interdisciplinary membership represents all aspects of the industry, including developers, property owners, investors, architects, urban planners, public officials, real estate brokers, appraisers, attorneys, engineers, financiers, and academics. Established in 1936, the Institute has a presence in the Americas, Europe, and Asia Pacific regions, with members in 80 countries.

The extraordinary impact that ULI makes on land use decision making is based on its members sharing expertise on a variety of factors affecting the built environment, including urbanisation, demographic and population changes, new economic drivers, technology advancements, and environmental concerns.

Peer-to-peer learning is achieved through the knowledge shared by members at thousands of convenings each year that reinforce ULI's position as a global authority on land use and real estate. In 2018 alone, more than 2,200 events were held in 330 cities around the world.

Drawing on the work of its members, the Institute recognises and shares best practices in urban design and development for the benefit of communities around the globe.

More information is available at uli.org. Follow ULI on Twitter, Facebook, LinkedIn, and Instagram

W. Edward Walter
Global Chief Executive Officer
Urban Land Institute
https://uli.org

John Fitzgerald
Chief Executive Officer, Asia Pacific
Urban Land Institute
https://asia.uli.org

ULI Center for Capital Markets and Real Estate
Anita Kramer
Senior Vice President
www.uli.org/capitalmarketscenter

Urban Land Institute
2001 L Street, NW
Suite 200
Washington, DC 20036-4948
United States

202-624-7000

www.uli.org

Front cover photo: Rain Vortex at Jewel Changi Airport, Singapore.
Image courtesy of iStock by: Panuwat Dangsungnoen.

iii image: COFCO Landmark, Beijing, by SOM.
Photo by: ArchExist.

Page 20-21 image: Tokyo Station.
Image courtesy of iStock by: Easyturn.

Page 33 image: Bui Vien Street, Ho Chi Minh City.
Image courtesy of iStock by: Kevin Miller.

Emerging Trends in Real Estate® Asia Pacific 2020

What are the best bets for investment and development in 2020? Based on personal interviews with and surveys from 463 of the most influential leaders in the real estate industry, this forecast will give you a heads-up on where to invest, which sectors and markets offer the best prospects, and trends in the capital markets that will affect real estate. A joint undertaking between PwC and the Urban Land Institute, this 14th edition of *Emerging Trends Asia Pacific* is the forecast you can count on for no-nonsense, expert insight.

ULI is the largest network of cross-disciplinary real estate and land use experts who lead the future of urban development and create thriving communities around the globe. Visit uli.org/join to learn more about member benefits. Become part of the ULI network where you can connect to other members via the Member Directory (members.uli.org), engage in member-only opportunities via Navigator (navigator.uli.org), and access an expanding library of high-quality content via Knowledge Finder (knowledge.uli.org), including all the *Emerging Trends in Real Estate®* reports published since 2003.

Highlights

- Tells you what to expect and where the best opportunities are.
- Elaborates on trends in the capital markets, including sources and flows of equity and debt capital.
- Indicates which property sectors offer opportunities and which ones to avoid.
- Reports on how the economy and concerns about credit issues are affecting real estate.
- Discusses which metropolitan areas offer the most and least potential.
- Describes the impact of social and geopolitical trends on real estate.
- Explains how geographical and sectoral preferences are changing.

Urban Land Institute
www.uli.org

pwc
www.pwc.com