



abrdn Asia-Pacific real estate market outlook

Q2 2024

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Executive summary

- Inflation's gradual decline towards central bank targets should allow an increasing number of central banks to begin rate cuts in 2024. This includes the Bank of Korea (BOK), given the continued easing in demand-side price pressures. Additional easing is also expected in China, although its target growth rate of 5% in 2024 remains optimistic in our view. India's outlook is more constructive, and we expect further upside risks to growth despite a recent upgrade. While there was a dovish shift in the Reserve Bank of Australia's (RBA) recent statement, the labour market is still too tight for comfort.
- Market expectations for rate cuts in the US have been pushed back. A lack of clear signs of economic stress has encouraged the Federal Reserve (Fed) to exercise more caution, but it seems clear that US rates have peaked. Peak US rates have historically been a near-term positive for Asia-Pacific (APAC) markets. Capital values for commercial properties tend to benefit, although occupier fundamentals are still key. Our base case expects more downside risks to the region's capital values in the near term. This is especially the case for most sectors in Hong Kong, grade-A offices in Tokyo's central business district (CBD), and logistics properties in Greater Seoul.
- Korea remains a high-conviction market for abrdn. We expect the bulk of debt funding for 2021's record transaction volumes in Korea to be due for refinancing in 2024. Retail and logistics properties are likely to face funding gaps. While the BOK's policy easing could provide some relief, it's unlikely to close these gaps. This should translate into capital deployment opportunities for private-credit investors, especially as traditional lenders pull back.
- We expect near-term capital returns to remain under pressure, despite the prospect of rate cuts in 2024. But over the longer term, our base case is for interest rates to retreat to lower levels. We expect the net effect of demographic change on interest rates to be negative up to 2030. Lower interest rates should support better capital returns beyond the immediate 12-24 months. Higher property yields in the near term are therefore likely to be good opportunities for investors to pick up grade-A assets in core locations.

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- Inflation's gradual decline towards central-bank targets should pave the way for rate cuts in 2024.
- Peak US rates are historically a near-term positive for property values, but occupier fundamentals are still key.
- Our base case is for more downside risks to the region's capital values in the near term.

APAC economic outlook

Our economic base case is for a US soft landing with slowing growth. While there are risks, inflation should decline gradually towards central-bank targets. This should allow an increasing number of central banks to begin cutting rates in 2024. Recent central-bank communication supports this expectation.

Among the central banks in key APAC markets, the BOK is expected to be one of the first to begin rate cuts. The easing in demand-side price pressures is increasingly shifting the focus towards shoring-up sluggish domestic demand and economic sentiment.

Additional policy easing is also expected in China, given the challenges facing the economy. While the Chinese economy gained further momentum at the start of 2024, indicators in the property sector paint a mixed picture. The desire from authorities to hold the line on de-risking, and the increased focus on national security and resilience, suggests the target growth rate of 5% in 2024 could be optimistic.

The outlook for India is more constructive and we expect further upside risks to growth. Consequently, we think the Reserve Bank of India will remain on hold during the first half of the year. We have pushed back our expectations for the timing of its first rate cut.

While there was a dovish shift in the RBA's March policy statement, the labour market in Australia is still easing too gradually for the RBA's comfort. February's unemployment rate fell to 3.7%, which was below the RBA's forecast of 4.2% by June.

The Bank of Japan (BOJ) finally exited its era of ultra-easy monetary policy in March. But we expect limited additional tightening, as domestic inflation pressures are likely to continue easing over the coming months.



APAC economic outlook

	2023	2024	2025	2026
Real GDP growth (%)				
- China	5.2	4.6	4.3	4.2
- Japan	1.9	0.7	1.0	1.1
- India	7.7	6.2	5.7	5.4
CPI (average; %)				
- China	0.3	0.7	2.1	2.2
- Japan	3.3	2.0	1.6	1.6
- India	5.7	4.4	5.1	5.5
Policy rate (YE; %)				
- China	1.8	1.6	1.5	1.6
- Japan	-0.1	0.3	0.5	1.0
- India	6.5	6.0	5.8	6.0

Source: abrdrn Global Macro Research; March 2024
Forecasts are a guide only and actual outcomes could be significantly different.

APAC real estate market overview

Market expectations for rate cuts in the US have been pushed back. A lack of clear signs of economic stress has encouraged the Fed to exercise more caution, although it seems clear that US rates have peaked.

Peak US rates have historically been a near-term positive for APAC markets. Capital values for commercial real estate tend to benefit, but occupier fundamentals are still key. Our base case is for more downside risks to the region's capital values in the near term. This is especially the case for most sectors in Hong Kong, grade-A offices in Tokyo's CBD, and logistics properties in Greater Seoul.

In the case of Greater Seoul's logistics properties, the faster tapering of new supply could bring forward the trough in occupancy. The near-term pricing adjustment could therefore provide an attractive entry point for investors to tap the sector's longer-term growth potential. Meanwhile, there are near-term opportunities for private-credit investors to plug funding gaps, as loans from 2021-22 are refinanced in 2024-25.

We remain positive about grade-A offices in the major business districts of Seoul. Fundamentals in the occupier market remain solid. Vacancy rates are low amid limited near-term supply and healthy leasing demand from domestic firms. Large-scale office developments are scheduled for completion from 2026 in the CBD sub-market, which should raise its vacancy rate from the current low. That said, the upcoming GTX-A rail line is expected to enhance this sub-market's locational appeal. This opens in phases from April 2024 and will substantially reduce the commuting time to Seoul's CBD.

We like Japanese multifamily properties, particularly those within Tokyo's 23 wards. The solid rebound into Tokyo post-Covid is likely to continue, which should keep vacancy rates tight and support further rental growth. Importantly, the widening rental premium based on building age supports a value-added investment strategy. A faster pace of urbanisation, coupled with below-average homeownership and housing stock-to-household ratios, will further strengthen the sector's longer-term occupier fundamentals.

APAC real estate market trends

Offices

The rental decline for APAC's offices (year on year (y-o-y)) accelerated in the fourth quarter of 2023, with the average vacancy rate still trending higher. Chinese tier-1 cities and Melbourne's CBD contributed to the faster fall in office rents during the quarter. Meanwhile, Singapore registered its first net-effective rental y-o-y decline in over two years. On a more constructive note, shadow stock in Singapore appears to have moderated. JLL expects pent-up demand to drive a recovery in both the leasing and capital markets by the second half of 2024.

Melbourne's CBD office rents struggled in the fourth quarter of 2023. But occupier performance for offices in Sydney's core CBD, Brisbane, and Perth was much better. In the case of Sydney's CBD, sub-leases have been on a decline. Rightsizing by larger corporate occupiers also appears to be slowing, according to CBRE. While investment sentiment remains soft, it appears investors are selectively picking up prime assets that could be on the right side of the growing bifurcation in the Australian office market.

In Japan, the net effective rental y-o-y decline for Tokyo's CBD grade-A offices narrowed in the fourth quarter of 2023. Overall, it appears the market remains on track to bottom-out in the near term.

Logistics

Rental growth (y-o-y) for logistics and industrial properties in APAC slowed in the fourth quarter of 2023, even though it remained the sector with the best occupier performance. The average vacancy rate across the region held steady during the quarter, although Tokyo and Beijing were higher. Leasing pressure continued in China's premium logistics market in the fourth quarter of 2023. The new supply scheduled for completion in 2024-25 will keep the occupier market under pressure.

While investors' interest in Tokyo's logistics properties has clearly strengthened, the market's occupier fundamentals appear far from inspiring. Scheduled completions are expected to be lower in 2024, but the total stock is still projected to expand by 10%. Investors may be finding comfort in higher construction costs, which could mean a faster-than-expected tapering of new supply. Higher ecommerce penetration could also translate into additional leasing demand.

The occupier fundamentals of warehouses in Australia's key capital cities are in better shape, although we expect rental growth to slow from the heady levels in recent years. Over the longer term, Australia's supply of serviced industrial-zoned land will remain constrained, which will limit the development pipeline.

Retail

The post-Covid recovery in APAC's prime retail occupier performance slowed in the fourth quarter of 2023, with the average y-o-y growth in rents decelerating to 4.9% (from 5.9% in the third quarter). This was principally led by Singapore, where prime rental y-o-y growth slowed to 2.9%



(from 8.3%) during the quarter, according to JLL's data. The y-o-y rental decline for Australian regional centres decelerated further, and the near-term outlook has turned for the better after five challenging years.

Despite slower rental growth, the robust investment demand for Singapore's retail assets in 2023 has carried over into 2024. In March, Allgreen Properties announced the acquisition of Seletar Mall, a suburban mall in north-east Singapore, for SGD550 million (USD409 million), which reportedly translated into a yield of just 3.9%.

Besides Singapore, India also had slower retail rental y-o-y growth in the fourth quarter of 2023. This was led by Delhi NCR, where the average rent decline widened to -4.8% (from -4.2%). JLL expects another 41 million square feet of retail space to be added across India's seven key cities between 2024 and 2028. Delhi NCR represents the largest share of this (34%). Importantly, 24% of this pipeline is greenfield/brownfield developments, backed by foreign institutional capital. This shows the growing investment interest in this market/sector from international institutions.

Living

The investment case for Japanese multifamily properties is supported by solid occupier fundamentals, which are underpinned by faster urbanisation across major Japanese cities. In December, Japan's National Institute of Population and Social Security Research released its new regional population projections, which forecast the concentration of working-age population across Japan's 21 major cities to exceed 36% in 2050 (from 32% in 2020). This represents a faster pace of urbanisation, compared with the previous projections published in 2018. Importantly, the population of Tokyo's 23 wards is now projected to be over 5% more in 2050 than in 2020 - even as Japan's population is expected to shrink by 17% over the same period.

The investment sentiment in Greater China is likely to remain cautious. But investment strategies targeting well-located hotels with conversion potential remain active. These assets could be converted into rental apartments and operated as co-living and/or multifamily properties. In the first quarter of 2024, a Tishman Speyer-managed fund announced the acquisition of a 75% stake in Holiday Inn Express in Shanghai's Yangpu District for CNY360 million (USD51 million). This represented a discount of about 20% to the vendor's entry price in 2014. The asset will be refurbished and converted into serviced apartments to be operated by Frasers Hospitality.

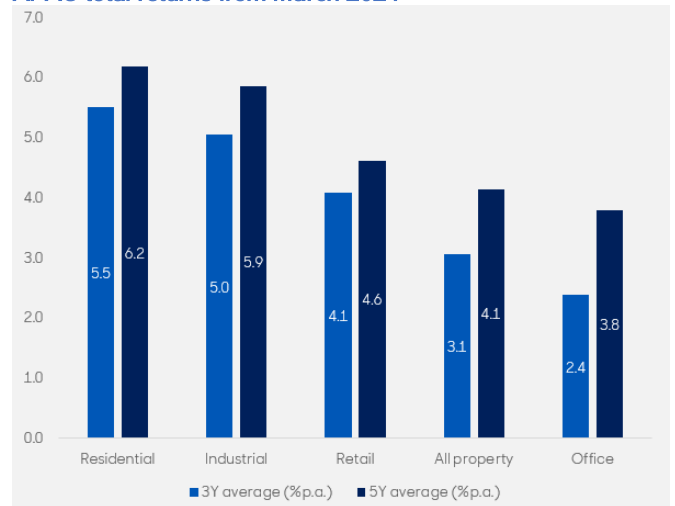
Outlook for risk and performance

We expect near-term capital returns to remain under pressure, despite the prospect of rate cuts in 2024. Over the longer term, our base case anticipates rates to retreat to lower levels. In fact, we expect the net effect of demographic change on interest rates to be negative up to 2030. A falling labour contribution to potential growth more than offsets upward pressure from ageing populations. Moreover, downward pressure on rates across the largest economies

means the global financial system provides another check against upward pressure. We expect lower interest rates to therefore support better capital returns beyond the immediate 12-24 months. Higher property yields in the near term are therefore likely to be good opportunities for investors to pick up grade-A assets in core locations.

Macroeconomic drivers and geopolitical developments will have a bigger impact on real estate's near-term performance. While US rates may have peaked, geopolitical developments and their impact on supply chains remain highly fluid. These developments could affect inflation and interest rates in unexpected ways. Within APAC, Australia's job market appears to be easing too gradually for the RBA's comfort. There was a dovish shift in the recent statement and the historical correlation in long-term yields between the US and Australia is high. But the risk is that Australia's rate-cutting cycle may lag that of the US, with potential implications for Australian real estate yields and capital values.

APAC total returns from March 2024



Source: abrdn; March 2024

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