Real Estate Outlook

Asia Pacific – Edition 1, 2022

Investment reaches new peak.

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APAC outlook

The hardest climbs look challenging until conquered.

The economic recovery has been choppy, while inflation has risen across the region. Central banks have moved to tighten policy, but we don’t think this will significantly impair real estate performance. APAC investment activity hit a new record in 2021 and cap rates were flat or fell in the last quarter. Occupier markets were generally healthy and should be buoyed by economic growth in 2022.

Market overview and outlook

APAC investment activity reaches new peak.

APAC economies continue to experience a choppy recovery from the pandemic. Just as the impact of the Delta variant of COVID-19 was subsiding, the Omicron variant emerged to hit activity in the run-up to year-end. Growth is expected to have been curbed in 1Q22 as well, before resuming the recovery phase. Despite Omicron, the main APAC economies are thought to have regained their pre-pandemic levels of output during 2021. The only exception is Japan, where Oxford Economics thinks GDP remained slightly below its pre-pandemic level in 4Q21 and is not expected to recover it until 2Q22.

Mirroring the global trend, inflation has accelerated across the region, although not to the same extent as in the US. New Zealand has the highest inflation rate of the main APAC economies, at 5.9% in December. The policy picture is varied. The People's Bank of China has cut some interest rates and reduced bank reserve requirements to cushion the economy from the housing market downturn. While the Chinese government is expected to provide support by increasing infrastructure spending as it focuses on the quality of growth.

In Australia, the central bank moved to tighten policy by ending its asset purchase program, but interest rate rises are not expected until towards the end of 2022. The Monetary Authority of Singapore has also tightened policy while interest rates in Hong Kong are dependent on the US given its currency peg, and thus expected to rise over the course of 2022. Meanwhile, South Korea led global policy tightening, with two rate hikes in 2021, and more expected in 2022. We do not think that higher rates will be significantly detrimental to real estate performance provided economies keep growing.

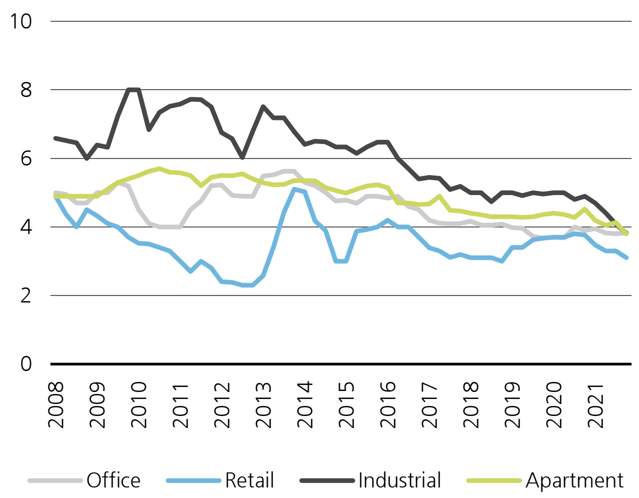
In the office sector, occupiers are looking to position their estates for the new and emerging hybrid working environment. Office net absorption across APAC recovered strongly in 2021, up 40% YoY according to CBRE, but remained slightly below 2019 levels. In addition, grade A office rents were mixed in 2021. In 2022, any rental declines are expected to be limited, like in Tokyo, while office rents are forecast to rise in some markets, including Singapore, Auckland, Melbourne and Sydney. The facilities and locations of offices will be of particular importance in driving rental growth and for occupiers in their quest to attract talent.

The retail market continues to be affected by COVID-19 restrictions as well as restricted or banned international travel. China and Hong Kong stand apart as keeping strict zero-COVID-19 polices. Some retail markets are turning the corner though. According to CBRE, Hong Kong prime high street retail rents showed modest growth of 4% in 2021. While in Australia prime shopping center rents were flat. The emphasis is on experience, brands and blending online and physical channels.

The industrial and logistics sector continued to perform strongly. According to CBRE data, rents rose across most APAC markets in 2021 and are expected to show further growth in 2022. However, rental growth is expected to slow in some markets, such as Greater Seoul as more new supply comes online. Prime assets near major consumer markets or transportation hubs are expected to perform best.

Yields and cap rates were typically flat or fell in 4Q21, with further sharp declines reported in the industrial and logistics sector where cap rates fell to record lows (see Figure 1). Real Capital Analytics reported that APAC investment volumes topped USD 200 billion for the first time in 2021, up 22% on 2020 and 10% from the previous record set in 2019. The industrial and retail sectors saw the strongest rises in activity compared to 2020, of 48% and 41% respectively.

Figure 1: Asia Pacific top quartile cap rates
(12-month average, %)



Source: Real Capital Analytics, February 2022

Strategy viewpoint

Investors target industrial for 2022.

At the start of the new year, investors often re-evaluate their portfolios and positioning for both the short and long-term. The new year also brings investor surveys which give insights into investor thinking and strategy. 2021 saw a strong but polarized performance in APAC real estate markets as investors had to navigate through the ongoing pandemic, with uncertainty prevailing over the mainstream office and retail markets. This made for a crowded logistics market and investors increasingly looked to residential, specialist and niche sectors. Moving into 2022, portfolio positioning will increase in importance, as investors grapple with the outlook for interest rates and inflation.

Encouragingly, this year's surveys show that investors are placing increased importance on ESG matters. ANREV's *Investment Intentions Survey 2022* reported that prior to investing in non-listed funds, 100% of APAC institutional investors considered whether the fund promotes ESG investments. 88% of respondents considered whether the fund has a commitment to net zero carbon, and 81% considered whether the fund had an established diversity, equity and inclusion (DEI) program. Indeed, from all the global investors surveyed and averaging across the three areas, those based in APAC placed the highest importance on ESG matters. This was boosted by the dominance of Australian investors in the survey and their long experience of focusing on ESG factors.

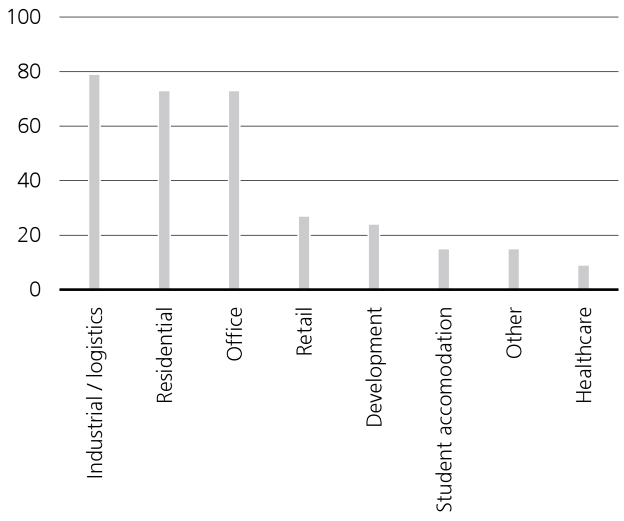
CBRE's *2022 Asia Pacific Investor Intentions Survey* also reported that investors are increasing their emphasis on ESG. More than 40% have already adopted ESG criteria, just above 10% said they will adopt ESG criteria over the next three to five years and just over 30% are considering adopting ESG criteria within an unspecified time frame. This leaves just over 10% of investors saying that they are unlikely to adopt ESG criteria. However, with ESG credentials becoming ever more important, it seems likely that these holdouts will also eventually embrace ESG.

Investors can target sustainability credentials by purchasing green buildings or retrofitting old buildings to enhance energy efficiency, water usage and wellness. The retrofitting of older buildings is particularly important for improving sustainability and reducing the carbon footprint of real estate, but also a big challenge. The CBRE survey reported that the three main priorities of APAC companies' ESG strategies are enhancing brand image and gaining certifications (such as GRESB), protecting the future value of real estate assets and the environment.

As well as highlighting the growing importance of ESG for investors, the investment intentions surveys also provide an insight into investors' views on the market. The ANREV survey reported that APAC was the favored region for investors from around the world, with 70% expecting to increase their allocations to the region and core being the preferred investment style. By contrast, CBRE reported value-added as being slightly preferred to core. The ANREV survey cited the top three cities for investment into APAC remaining as Tokyo, Sydney and Melbourne, while CBRE reported the top three as Tokyo, Shanghai and Singapore. Hence, Tokyo stands out as featuring in the top three of both surveys.

In terms of sector allocation, both surveys reported industrial and logistics as the preferred sector for investors, who are expecting that the sector's strong performance in 2021 has further to run (see Figure 2). Offices and residential were in the second and third spots. In the alternatives space, CBRE reported that data centers, cold storage and healthcare were investors' preferred sectors. A smaller share of investors were interested in real estate debt, which was lower than in 2021. Though, sentiment is likely cooling due to debt defaults in the Chinese residential sector. Overall, the appetite for real estate looks set to remain strong, with investors globally currently being a percentage point below their 10% allocation target.

Figure 2: Preferred sectors for 2022 investments in APAC
(% of respondents)



Source: ANREV, January 2022

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