

AEW RESEARCH

ASIA PACIFIC  
MARKET PERSPECTIVE  
Q1 2019

For more information please contact:



**GLYN NELSON**

Director of Research, Asia Pacific  
glyn.nelson@aew.com  
+65.6303.9016



**HANNA SAFDAR**

Research Associate, Asia Pacific  
hanna.safdar@aew.com  
+65.6303.9014

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In office markets like Singapore, Sydney and Melbourne - investors are purchasing to benefit from robust lease reversions and significant increases in NOI

## Investment Strategy

The real estate markets of the Asia Pacific region continue to provide a range of investment opportunities. There are markets where conditions are highly attractive to own real estate, and others where entry opportunities may arise due to pricing adjustments. Recent investor surveys continue to indicate a significant amount of capital is targeting real estate in the region and risk tolerance is moderate, with most investors targeting core through to value-add strategies.

The economic outlook is generally supportive of rental growth but there are pockets of uncertainty. Growth projections were revised up during the first quarter but have been recalibrated after the latest round of trade discussions ended with impasse. Fundamentally, domestic demand is healthy across the region; improvement in some markets is expected in the second half of 2019, supported by increased fiscal spending. In Australia, there is some weakness due to the housing market correction and sluggish wage growth. However, neither of these factors are impacting the commercial sector to-date.

Expectations of higher interest rates have retreated after the Federal Reserve changed its forward guidance to a more accommodative wait-and-see approach, and the interest rate curve remains mostly unchanged in recent months. The cost of debt financing in most markets remains accretive to real estate returns and in some markets, AEW has noticed a slight fall in the cost of debt.

In office markets like Singapore, Sydney and Melbourne, where occupancy conditions are very tight and rents are rising, investors are purchasing in order to benefit from robust lease reversions and significant increases in net operating income (NOI). In markets like Hong Kong, commercial sales activity has slowed amid a quieter leasing market; combined these two conditions may lead to a pricing adjustment in the next two years and a potential entry opportunity.

The retail sector across the region remains very challenging for shopping mall owners due to competition from online sales growth. As such, necessity-based and grocery anchored shopping centers offer a defensive position for this sector. High street retail units provide an opportunity to outperform, especially where these units benefit from increasing tourist spending.

Favorable conditions for investing in the region's key strategic markets remain in place. Looking forward, any growth in value should primarily be driven by NOI growth rather than yield compression. The economic environment and labor markets are supportive of a moderate and sustained level of business expansion and therefore commercial real estate. Combined with tight occupancy conditions, this suggests good NOI growth over the next several years. Additionally, low interest rates, high transaction volumes and a continued investor interest in Asia Pacific exposure all favor support for real estate values.

## Economy

After a 3.8% expansion in 2018, the International Monetary Fund (IMF) forecasts 3.3% global growth in 2019. Asia Pacific is expected to continue to lead the global economic expansion with 6.3% growth in 2019, outpacing the United States (2.3%) and Euro Area (1.8%).

Earlier concerns on tighter financing conditions have receded after the Federal Reserve's March announcement to keep rates on hold in 2019, with several other major banks maintaining an accommodative stance. Instead, the revived uncertainty in U.S.- China trade tensions remains the major downside risk to this years' growth. The latest round of trade discussions in early May ended unfavorably with the U.S. increasing tariffs from 10% to 25% on \$200 billion on Chinese exports. In response, China has announced tariffs on \$60 billion of U.S. exports to take effect by June 2019. Domestically, China has ramped up its fiscal and monetary stimulus to counter the negative effects of trade tariffs, and is still likely to be able to meet its 6.0-6.5% growth target for the year.

Average forecast growth for major Asian gateway markets in 2019 is 2.5%. In Q1, effects of the stimulus in China were evident - China's growth was ahead of expectations, coming in at 6.4% year-on-year with data pointing towards stronger industrial production (up 8.5% year-on-year) and improved consumer demand. Export growth was also up 14.2% year-on-year, in contrast to expectations of a slowdown. Elsewhere in Asia, growth in major developed economies was mixed. Japan and Korea recorded a mild contraction in the quarter due to slower external demand while the economies of Australia, Hong Kong and Singapore expanded slightly. Most governments of these economies are running expansionary fiscal policy, which should help to support growth in H2 2019. South Korea for example announced a \$3.9 billion budget to boost export financing and jobs growth while in Australia, about \$100 billion has been pledged for infrastructure spending over the next 10 years.

CPI growth in Asia's developed economies is generally low. Monetary policy remains accommodative across Asia Pacific, with most of the central banks maintaining status quo on monetary policy. Recent meetings of the Bank of Korea (BoK) and Monetary Authority of Singapore (MAS) indicated that they will be keeping a neutral stance on interest rates in 2019 and in Japan, the Bank of Japan (BoJ) has committed to keeping rates low until H2 2020. In Australia, the Reserve Bank of Australia (RBA) could be making its first rate cut in more than two years in 2019 due to the on-going housing market correction and weaker than-expected inflation data.

Currency movements year-to-date have been mixed. The CNY, AUD, and SGD appreciated slightly against the dollar but post May-5, lost most of gains made in the year. The JPY is flat to-date 2019, after the previous year's 2.7% appreciation. Meanwhile the KRW has been the worst performing currency in the past two-years, down 7.1% in 2019, after 4.1% depreciation in 2018.

### MACROECONOMIC INDICATORS

Countries	GDP (y-o-y)		CPI (y-o-y)		Interbank rate/cash rate		USD exchange rate	
Year	2019	2020	2019	2020	2019	2020	2019	2020
<b>Australia</b>	2.2	2.6	1.49	1.71	1.50	1.75	0.72	0.74
<b>China</b>	6.3	6.0	2.28	2.53	2.80	2.97	6.60	6.45
<b>Hong Kong</b>	1.8	2.1	1.89	2.04	2.75	2.75	7.83	7.77
<b>Japan</b>	0.5	0.4	0.91	1.17	-0.05	-0.05	110.3	109.7
<b>Singapore</b>	2.3	2.6	0.87	1.72	2.11	2.20	1.35	1.33
<b>S. Korea</b>	2.0	2.2	0.95	1.97	1.75	2.00	1,150	1,088

Source: Oxford Economics

# Tokyo

## Favorable fundamentals for multifamily and office investment

### Residential Demand Supported By Migration

Urban population growth in the Tokyo metropolitan region is strong and sustained by steady inter-city migration and immigration. Foreign population growth is concentrated in Tokyo's metropolitan areas and this is expected to grow further as latest relaxation of immigration laws aims to attract more than 345,000 foreign workers over the next five years. At the same time, average incomes are increasing after many years of stagnation. Latest data showed that real wages in December were up 1.4% from the year earlier. These have both had a positive effect on both residential rental and purchasing demand.

### Stable Occupancy and Increasing Rents for Small Units

As young, working adults drive urban migration flows, smaller apartments are more popular and generally command a rental premium. AEW understands that rents for larger units can be volatile, but smaller centrally located units have seen gradual increases over the years. In Q1 2019, the 15 to 30 square meter apartment size band saw average rents increase by 3.9% quarter-on-quarter.

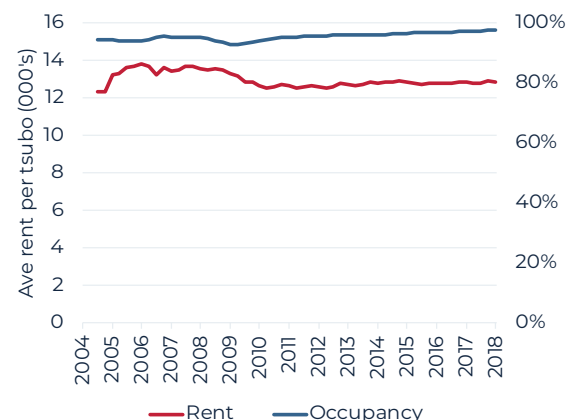
### Limited New Supply of Tokyo Condominiums

Low interest rates and an increasing number of dual income households continue to lend to residential purchasing demand in Tokyo. At the same time, the number of units put up for sale in recent years has slowed, supporting price growth. The average annual number of units supplied from 2014 to 2018 was down about 15% from the previous five-year period while average prices increased by close to 20% over this time. In 2018, the rate of sales slowed from the previous year, but major developers are understood to have strong balance sheets and are thus able to tolerate longer sales periods.

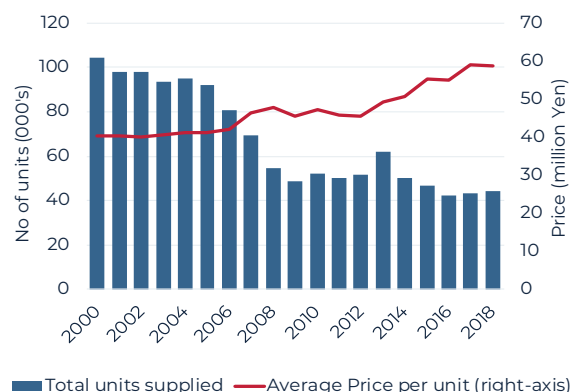
### Strong Demand and Low Vacancy in Grade A Office

Despite substantial construction activity in the office market, favorable conditions hold. Vacancy rates remain low amid an expansionary business environment. A trend observed for large companies is space consolidation, which has increased the demand for large high-specification office space. Due to limited vacancies in existing buildings, preleasing is active with about 81% of 2019 and 2020's supply (up to April 2020) pre-leased. Grade A rents have increased by 5.6% year-on-year in Q1 2019, led by newer buildings, with rents expected to continue to increase in the near term.

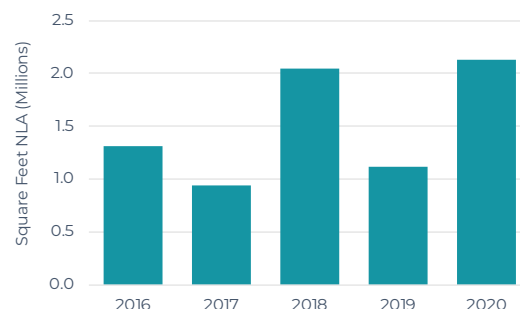
MULTIFAMILY OCCUPANCY AND RENTS  
2004 – 2018



CONDOMINIUM SUPPLY AND PRICES  
2000-2018



TOKYO OFFICE GRADE A SUPPLY  
2016 – 2020F



Sources: ARES, Land Institute of Japan, CBRE, as of March 2019

# Seoul

## Diverging trends between office submarkets

### CBD: Positive Outlook Beyond 2010

In the CBD, vacancy rates are in the midst of stabilizing after a large supply increase in 2018. AEW understands that the bulk of new leases signed in the past year were relocations, resulting in a series of moves among Grade A buildings. Grade A vacancy remained relatively high at 17.6% in Q1 2019, but this is largely due to Centropolis, which completed in Q3 2018 and is still in the lease-up phase. In the near-to-medium term, there will be very limited competitive Grade A supply in the CBD, which will allow vacancy rates to recover and markets to turn landlord-favorable. The five-year (2019-2023) average new supply forecast is 55% below the previous five year's annual average supply and is also 50% lower than annual average demand forecasts. Net effective rents are expected to stabilize in 2019 before increasing in the 2020 to 2023 period.

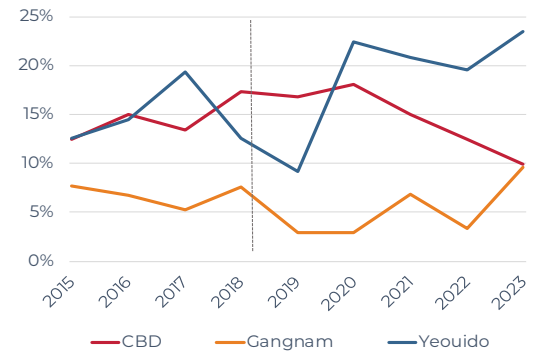
### YBD: Leasing Demand Improves, Large Supply Looms

In Yeouido Business District (YBD), leasing remains robust on the back of attractive incentives and better perception of the submarket. Momentum could be sustained by the lower incidence of relocations outside of core areas and higher incentives (estimated at 5 months) offered by landlords of newer buildings. Effective rents in YBD increased in the past four quarters, bringing year-on-year growth to 5.9% in Q1 2019. In the near term, the pending completion of ParcOne (2.1 million square feet) in 2020 is likely to disrupt further rental increases. The large new completion will increase Grade A stock in YBD by 34% resulting in leasing competition between landlords.

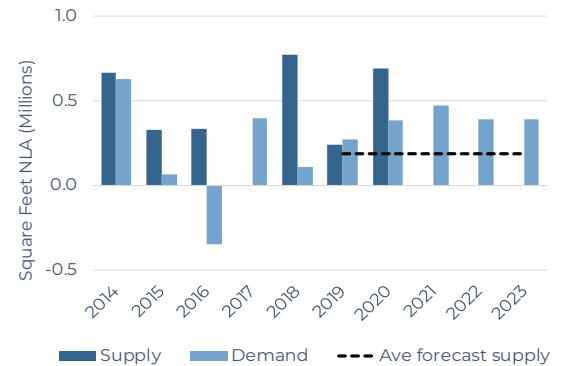
### GBD: Landlord Favorable Conditions

Landlord favorable conditions continue to exist in the Gangnam Business District (GBD) with large-sized leasing transactions absorbing the remaining available space in 2018's new supply (Gangnam N Tower and Luceen Tower). As a result, vacancy rates in GBD decreased by 2.9%-points in the quarter to 4.7%. With no new supply for the next two-year period (2019 to 2020), vacancies are expected to fall to 2.9% by year-end 2020. Constrained by the tight market, net absorption in GBD is likely to slow going forward, but rental growth is expected to continue in the near term, up by 6.0% over 2019 and 2020.

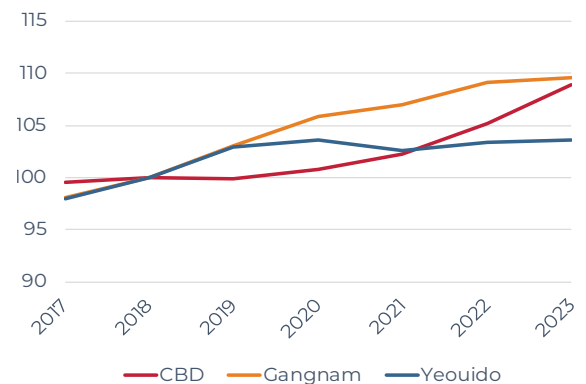
OFFICE VACANCY RATE BY SUBMARKET  
2015-2023F



CDB DEMAND SUPPLY OUTLOOK  
2014-2023F



OFFICE RENTAL OUTLOOK  
Q4 2018 = 100



Sources: JLL, as of March 2019

# China

## Landlord favorable in Shanghai Pudong CBD and further supply delays in Beijing

### SHANGHAI

#### Favorable Outlook in Pudong CBD

Demand-supply fundamentals are expected to turn favorable in the Pudong CBD submarket, where no new completions are projected over the next five-year period (2020-2023), placing upward pressure on rents. Rental growth is expected to accelerate from 0.5% year-on-year in 2020 to 5.8% in 2023.

#### Leasing Competition From Decentralized Markets

In Q1, overall leasing demand cooled, with business plans affected by the ongoing U.S.-China trade tensions. Decentralization remains a dominant theme, with tenants opting to move not only for rental affordability, but also the growing availability of better quality office stock, amenity and infrastructure. While decentralization is impacting take-up in both Pudong and Puxi CBDs, newly completed premium-grade projects continue to outperform. AEW understands that there are several well-performing projects in Lujiazui that have kept high occupancy and rents despite the large supply and vacancy challenges in the surrounding submarket.

### BEIJING

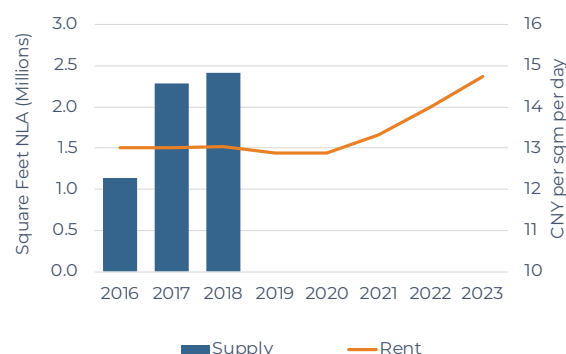
#### Rents Hold Firm in Q1 2019

The uncertain global outlook has resulted in some tenants lowering their rental budgets to maintain operational stability. Few tenants have re-located to more affordable office space in non-core locations, resulting in a slight uptick in vacancy in the five core submarkets. However, in the submarkets of East 2nd Ring Road and Finance Street, vacancies remain below 1%. Landlords have continued to hold firm on rents in the quarter, and AEW understands that some are willing to accept temporarily higher vacancies to hold out for better-quality tenants.

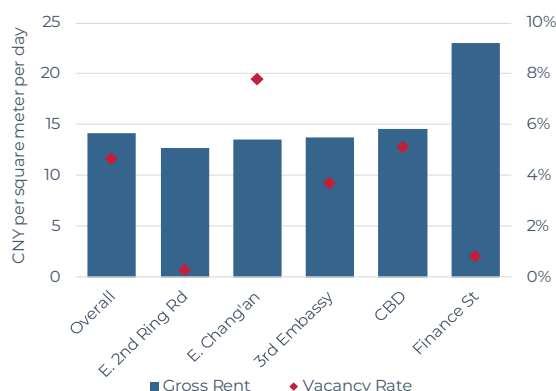
#### Further Delays, Supply to Peak in 2020

New supply in Beijing will be concentrated in the new CBD precinct called Guomao, where about 6.4 million square feet is due to complete between 2019 and 2020. Beyond this, there are no further completions projected over the next five-year term. Due to construction delays, two major projects initially expected to complete in 2019 will be pushed to 2020. The remaining projects completing in 2019 (China Life Insurance Building and China Zun Tower) are expected to be operating at full capacity once completed. The delay in new completions will positively impact landlords in surrounding submarkets, where pent-up demand should result in rental growth.

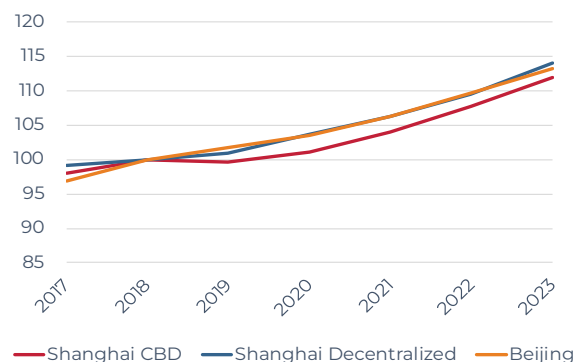
PUDONG CBD SUPPLY & VACANCY  
2016-2023F



BEIJING OFFICE VACANCY & RENT  
Q1 2019



OFFICE RENTAL OUTLOOK  
Q4 2018=100



Sources: JLL, as of March 2019

# Hong Kong

## Office decentralization trends persist and protracted retail recovery

### Office Momentum Slows in Q1 2019

Demand on Hong Kong Island has slowed with a pull back from sectors such as banking and finance, co-working and mainland Chinese firms. Due to tight occupancy conditions, this has had minimal impact on rents to-date, which continued to increase by 1.1% in Q1 on Hong Kong Island. Estimates suggest that leasing demand by Chinese firms were down about 48% quarter-on-quarter. At the same time, news has started to surface of co-working firms pulling out of space it had previously secured due to a lack of funding.

### Decentralization Trends to Persist

Decentralization trends are strong as cost management remains a priority. Kowloon East received the bulk of decentralization demand in Q1 due to higher vacancy while take-up was limited in Hong Kong East where occupancy conditions are tight. With another 1.3 million square feet due to be completed this year in Kowloon East, the submarket is expected to be the main choice for tenants looking to decentralize.

### Downside Pressures Could Build in the Office Sector

Rental pressures from a leasing slowdown and decentralization are not evident yet, but could build in the second half of 2019. The five-year annual average supply outlook on Hong Kong Island is 70% higher than the previous five-year period. However as vacancy rates remain tight and pre-commitment rates remain relatively healthy, it may be some time before landlords are forced to lower rents. Any rental pressures are expected to be most evident in Central, which could be due for a correction after a five-year rally.

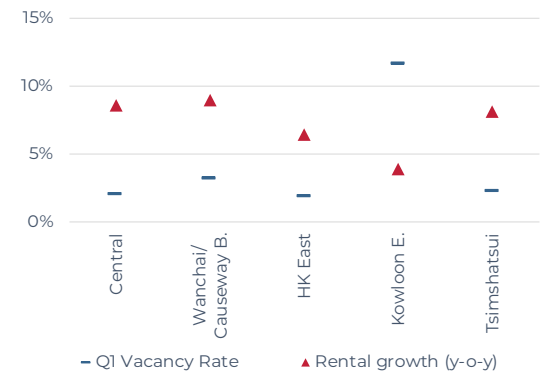
### Improved Consumption Sentiment in Retail

Retail sales in Hong Kong were down 0.2% year-on-year in March. Sales in supermarkets were up 3.3% in the year, but declines in watches and jewelry and apparel segments brought down overall figures. The luxury sector continues to underperform, reflected in the cautious leasing in high-street retail. Vacancies in larger flagship stores have remained for several quarters placing pressure on landlords to reduce rents.

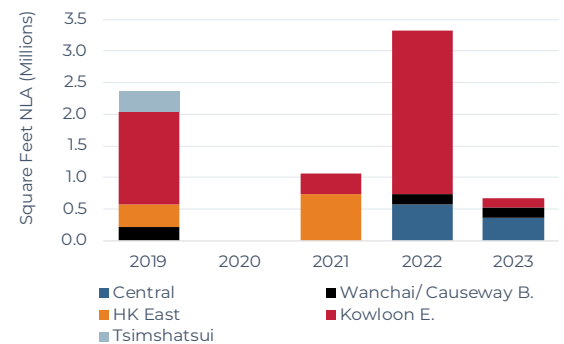
### New Infrastructure Facilitates Tourist Arrivals

Tourist numbers, especially same-day arrivals are expected to continue to increase in 2019 due to new transport links connecting Hong Kong to the Mainland. Day-trippers from China are mostly focused on necessity-based shopping. To-date, retail sites in Kowloon and Hong Kong Island that are in close proximity to border-crossings have seen the largest benefit.

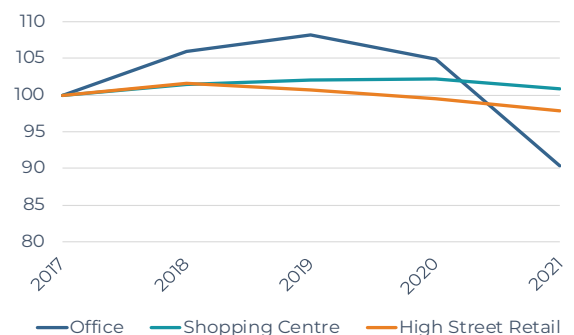
### VACANCY RATE & RENTAL GROWTH Q1 2019



### OFFICE PIPELINE SUPPLY 2019-2023F



### COMMERCIAL RENTAL OUTLOOK Q4 2017= 100



Sources: JLL, as of March 2019



# Singapore

## Office rental growth surprises on the upside, Orchard Rd leads retail recovery

### CBD Office Rents Surpass Previous Peak

Highly landlord-favorable conditions persist — the Singapore office market is now in the eighth quarter of its upward rental cycle. Gross rents continue to accelerate in Q1 2019, increasing by 3.7% quarter-on-quarter and bringing growth from the last trough to about 26%. As of Q1 2019, average gross rents in the CBD have surpassed the previous peak in 2015.

### CBD Vacancy to Remain Low

Vacancy rates fell to 6.0% at the end of Q1 2019, down about 2.1 percentage-points year-on-year and by about 5.8 percentage-points since supply peaked in Q3 2017. In addition to the five-year supply forecast being about 40% below the 10-year historic annual average, a new incentive scheme released by the government to encourage the redevelopment of older assets to mixed-use developments will likely lead to increased withdrawal of office stock between 2020 and 2023. As a result, vacancy rates are expected to remain below the long-term average in the near to medium term.

Separately, based on new planning guidelines, the land-use intensity for some buildings in Raffles Place and Shenton Way have increased by up to 25%, positively impacting valuations.

### Forecasts Revised Upwards, Extended Rental Cycle

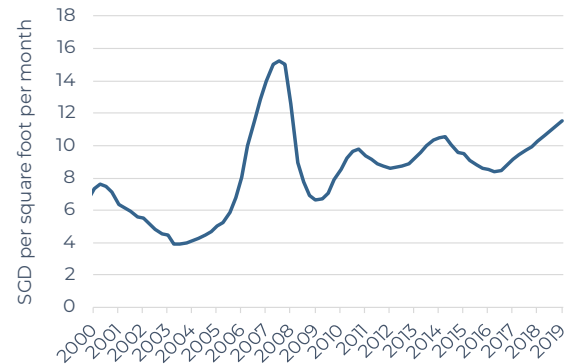
The upward revision in rental forecasts are supported by lower office supply in the CBD going forward. Rental growth is expected to continue to accelerate in 2019, up 13% to 15% year-on-year, before slowing in 2020 to 8% to 9%. Given the longer-term supply constraints in the CBD, rents are now expected to increase beyond 2022.

### Retail Rental Growth Challenged

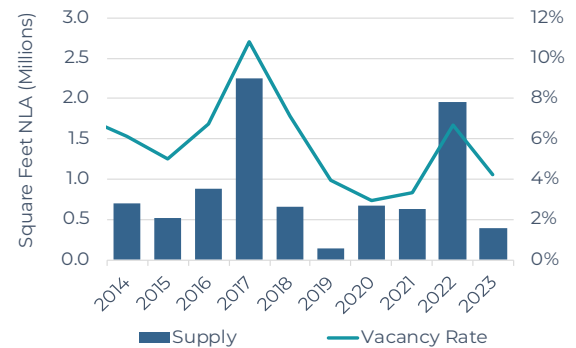
Occupier demand continues to be dominated by food & beverage and activity-based retailers. However, the changing tenant profile to include large-form activity-based retailers, which are usually more rent-sensitive, has generally kept the rental recovery mild.

New supply in the suburban areas will peak in 2019 with the completion of Jewel at Changi Airport. The mall has succeeded in drawing in large crowds in the first few weeks of operation, and could continue to serve as competition to traditional suburban malls in the East and North-East regions. Meanwhile, no new supply in Orchard Road for the next five-year period will support rental growth.

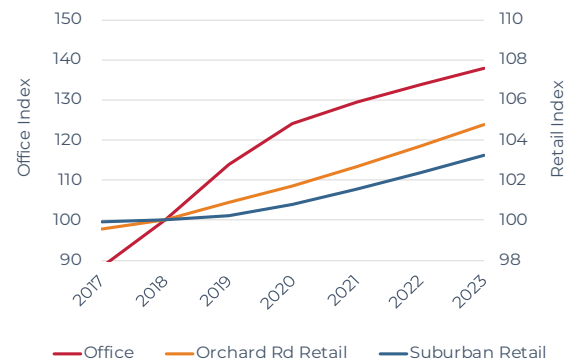
**CBD OFFICE GROSS RENTS  
2000-2019F**



**CBD OFFICE SUPPLY & VACANCY  
2014-2023F**



**COMMERCIAL RENTAL OUTLOOK  
Q4 2018= 100**



Sources: JLL, as of March 2019

# Australia

## Rental growth in North Sydney to outpace Sydney CBD, above-average demand in Melbourne CBD

### SYDNEY

#### CBD to Remain Landlord Favorable in 2019

Stock withdrawals and limited supply in the CBD have resulted in rents increasing by more than 50% between 2016 and 2018. Vacancy rates are low as of Q1 (3.7%), well below historical averages. New supply will only be added from Q4 2019 onwards, ensuring markets remain landlord favorable in 2019. Beyond this, rental growth is expected to slow in tandem with the delivery of new supply.

#### North Sydney Attracts Demand From Larger Occupiers

Larger firms are increasingly looking to North Sydney as a viable and cheaper re-location option, as the current discount to the CBD sits at around 30%. The delivery of new prime grade buildings 100 Mount in (Q2 2019) and 1 Denison (2020) will drive rental growth in the area, forecasted to increase by 8 to 10% in 2019.

Pymont is a developing technology-cluster outside the CBD, where limited supply and low vacancy rates are supporting rents. More activity is being generated in the area due to transport developments and new amenities. A recent building sale in the precinct reflects a new benchmark rate and a positive long-term view for the market.

### MELBOURNE

#### Above-Average Demand Conditions

Employment conditions in Melbourne are robust, driving demand for office space. Total net absorption in the past 12-months was 1.7 million square feet, about double the past 10-year average. Vacancy rates in the CBD are currently at a historical low of 3.65%.

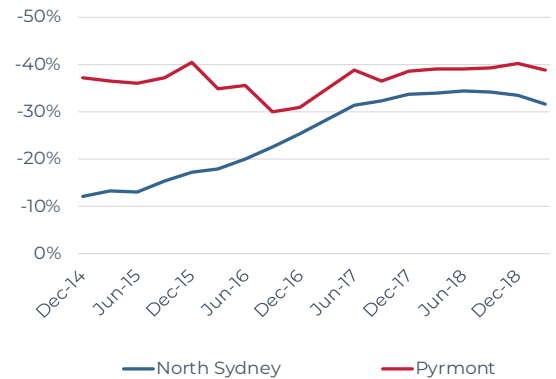
#### Accelerating Supply Cycle, High Pre-Lease Rate

Melbourne is currently in a supply cycle where 8.4 million square feet is due to complete over the next five years. Given the tight occupancy market, new projects are the focal point for tenants seeking large high-quality contiguous spaces. Pre-commitments for supply completing in the next two years increased by 417,000 square feet in Q1. Projects completing in 2019 and 2020 are 97% and 62% pre-leased, respectively.

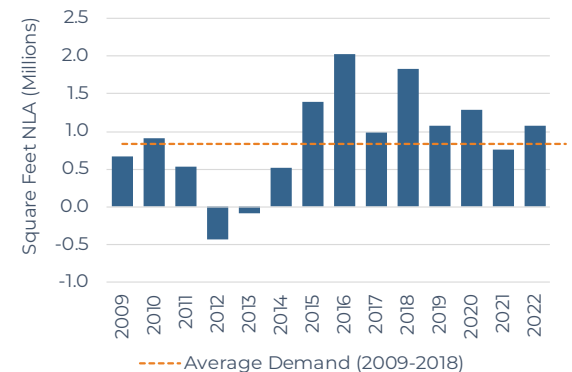
#### Rental Growth to Continue in the Medium Term

Due to robust demand conditions, Melbourne has seen strong rental growth up by 21.4% in the past two years (2017-2018). As a result, rents reverting in 2019 are estimated to be 20 to 25% higher. Rents are expected to continue to grow in the near-to-medium term, up by 8 to 10% over the next two-year period.

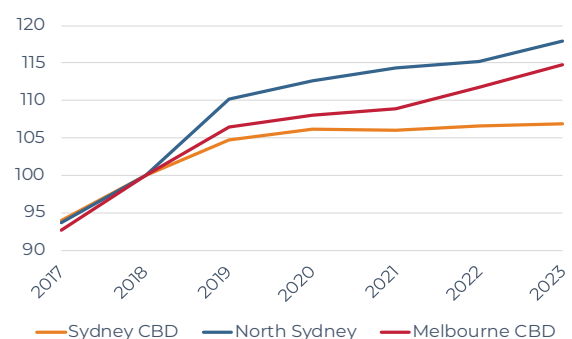
RENTAL DISCOUNT TO CBD  
2014-Q1 2019



MELBOURNE CBD NET ABSORPTION  
2009-2022F



OFFICE RENTAL OUTLOOK  
Q4 2018=100



Sources: JLL, as of March 2019

# Capital Markets

## Transaction Volumes in 2019 Off to Strong Start

After a record year in 2018, transaction markets are off to a strong start. Up to March 2019, there was \$24 billion in income-producing sales across major Asian gateway markets. Including completed and pending deals in April 2019, volumes year-to-date are close to \$48 billion, exceeding 2018's pace. The leading markets (in terms of volume) in 2019 are Hong Kong and Seoul, although momentum in Hong Kong has reduced considerably from the second half of 2018. Of note, volumes in Shanghai and Singapore have increased, attributable to several large or portfolio deals.

## Cross-Border Capital Remains Active

Across the major Asian markets, cross-border capital is active, responsible for about 48% of transactions year-to-date. This number has been pulled up by several megadeals in 2019, and we expect it to normalize later in the year. Hong Kong in particular should see a decline in cross-border activity in 2019, since previously strong mainland Chinese demand has subsided.

From the cross-border buyers, most of the activity this year has been from fund, global pension or insurance capital. Private equity funds have been especially active, buoyed by the positive fundraising environment. Estimates by CBRE suggest that another 62 billion (including leverage) of dry powder will be deployed by regional closed-end funds between 2019 and 2023.

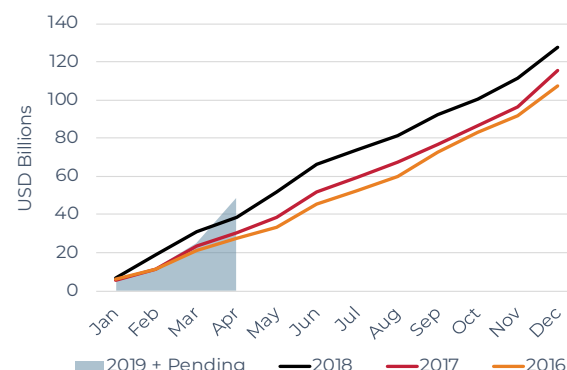
## Several Large Deals Announced Year-To-Date

Following the Fed's announcement to keep interest rates on hold for 2019, financing conditions have stabilized across major Asian markets which has helped support investor sentiment.

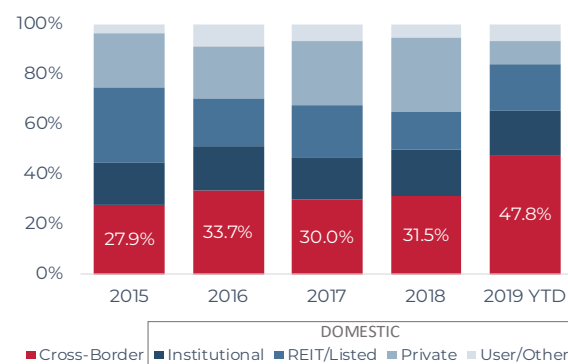
Already year-to-date in 2019, several major deals have been announced, some of which have set new benchmarks in their respective markets. In Melbourne, DEXUS announced it would forward purchase the mixed-use development at 80 Collin's Street from QIC for \$958.8 million and in Shanghai, Brookfield is reported to be buying a mixed-use commercial portfolio for \$1.9 billion ranking as one of the largest property deals in China by a foreign firm in recent times.

Investment appetite is expected to continue to be strong for the year, given the weight of capital looking to be placed and the attractive absolute yield available in the sector.

**CUMULATIVE TRANSACTION ACTIVITY**  
2016-YTD 2019



**BUYER BREAKDOWN**  
2015-YTD 2019



**MAJOR TRANSACTIONS YTD 2019**

PROPERTY	CITY	PRICE (m USD)	DATE	BUYER
Greenland Huang-pu Portfolio	Shanghai	\$1,900	Apr-19	Brookfield
LINK REIT 12 asset portfolio	Hong Kong	\$1,530	Mar-19	Gaw-Blackstone-Goldman Sachs
Shanghai mixed-use Portfolio	Shanghai	\$1,500	Mar-19	Blackstone
Marina Square Shopping Mall	Singapore	\$1,480	Apr-19	UIC
80 Collins Street	Melbourne	\$958	Mar-19	DEXUS

Sources: RCA