

AEW RESEARCH

Asia Pacific Market Perspective

Q2 2022

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Moving into a New Investment Environment

ECONOMIC RECOVERY CONTINUES INTO H2

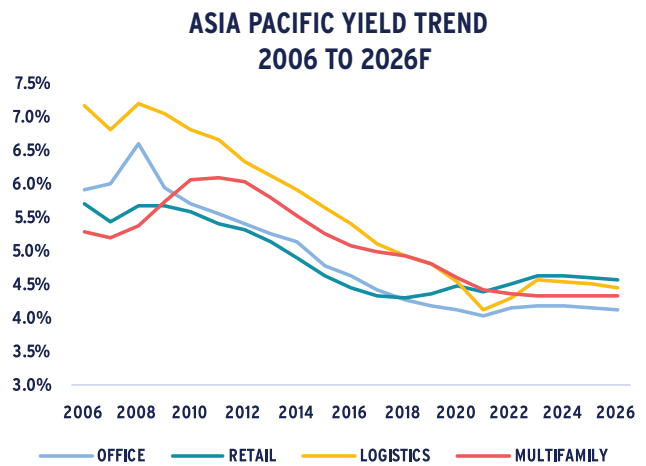
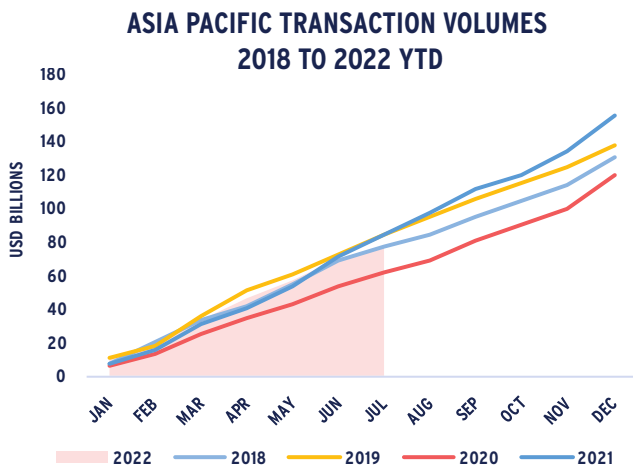
- Most of our monitored markets in the region will continue to see GDP growth this year. Positive factors include a modest recovery for China in Q3 (after a weak Q2), easing supply chain disruptions, and positive labor market signals.
- Still, it appears that the Fed is pushing ahead with raising rates, with new guidance that the Fed Funds Rate will peak at 3.75 or 4%. Consequently, more front-loaded policy tightening is expected for the major Asia Pacific economies.
- With higher interest rates in some of the key Asia Pacific markets, transaction volumes were noticeably slower over the quarter as investors relooked their investment strategy and allocations.

INVESTMENT ACTIVITY STARTS TO SLOW, LIQUIDITY FOR 2022 REVISED

- Financial asset prices have been volatile and short-term allocations across assets classes are shifting - but these have not had a material impact on real estate allocations to-date.
- Fundraising environment in H1 2022 was healthy with \$20.4 billion raised for Asia Pacific strategies. Interestingly, industrial-focused funds still garnered the strongest support.
- In transaction markets, themes of risk aversion are starting to become apparent with a pull-back in transaction volumes. Major gateway cities in the region tracking USD74 billion as of year-to-July 2022, down 12% compared to the same period last year.
- Singapore and Seoul have continued to show strong investment activity compared to last year, while steep drops have been noted in China T1 and Japan. Across sectors, industrial/logistics volumes had the largest contraction, especially after strong re-pricing and record investment volumes in 2020 and 2021.
- Reflecting the changing investment environment, liquidity forecasts for the region have been revised down. Investment volumes are likely to contract between 5% to 10% year-on-year in 2022 and come in line with what was observed in 2018.

WHAT COMES NEXT?

- Investment strategies will need to adjust to a period of slower growth and more expensive debt over the next 12 months. This could involve a material shift in country and sector allocations.
- In markets where NOI growth is challenged, we expect to see pricing adjust downwards - while we will need to protect existing assets from value erosion, good buying opportunities could arise.
- Capital with flexibility on LTV terms today may have an upper hand acquiring assets.
- For risk-taking capital, look for leasing opportunities in markets with solid occupier fundamentals (that will provide NOI growth) and look to enhance green rating status of buildings which can provide significant value uplift at sale.



Source: AEW Research, JLL, PMA, Real Capital Analytics
 Note: Transaction volumes measure income producing investments across AEW's target markets

Growth Maintained but Pressure Points Rise

INFLATION AND EXTERNAL RISKS BITE INTO GROWTH FORECASTS

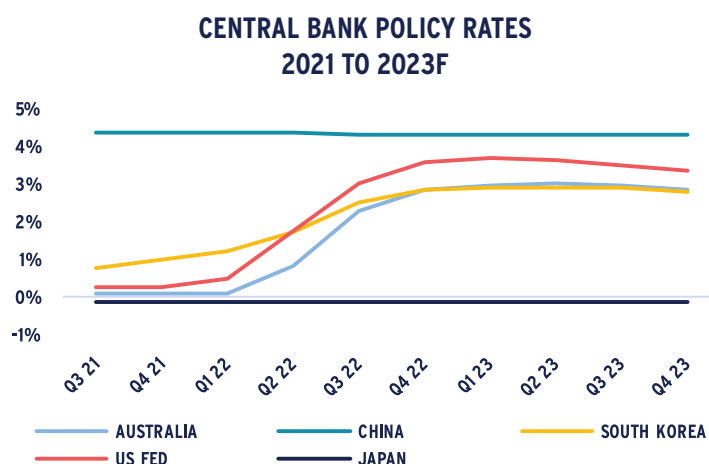
- Global growth prospects worsened over Q2 and further into July – a key factor behind this remains inflation which is impacting real incomes and raising business costs.
- While inflation risks have risen in Asia Pacific, they are still manageable. In fact, June’s core inflation (excluding volatile items like fuel and food) across the major economies was just 2.85% compared to the 5.9% core inflation print in the U.S.
- Based on revised forecasts, annual GDP growth across the major markets in Asia Pacific is expected to average 2.4% in 2022 (down 0.6% from last quarter’s report). For China, growth in H2 is expected to be stronger than H1, especially on the back of government policy support and infrastructure spending. Still growth prospects beyond 2022 have turned more cautious, especially due to weakness in the domestic housing market.

LABOR MARKET AND CONSUMPTION STRENGTH MAY START TO TURN IN H2 2022

- In Q2, retail sales continued to expand, with year-on-year growth seen in Australia, Singapore, Japan, and South Korea.
- Because of rising inflation, retail sales momentum is expected to slow in H2 as real incomes get reduced. Latest consumption sentiment indices, an often-used precursor of spending momentum, has also turned negative as of July 2022.
- Similarly, labor markets held up well in Q2 with unemployment at new lows in Singapore and Australia, however this may be temporary. Hiring freezes and planned layoffs (especially across technology sectors) might start to filter through in coming month which will put stress on office demand.
- Labor market concerns are currently the strongest in China, where the youth unemployment rate is estimated to be close to 20% as of the end of Q2. However, prospects for improvement in the following quarters are strong. In China, government departments have been instructed to provide aid to help manage unemployment – these include cash handouts to individuals and businesses.

EXPECT FURTHER RATE HIKES IN H2, CHINA AND JAPAN REMAIN ACCOMODATIVE

- Accelerated rate hikes by the Fed have resulted in a stronger reaction from Asian central banks
- In Australia, the previously dovish tone took a turn in May and rates were raised for four consecutive months to 1.85%. In South Korea, the cash rate is now 2.25%, up 175 bps from the same period last year, while in Singapore there was a surprise off-cycle tightening in July.
- Meanwhile, Japan’s and China’s central banks have reinforced the need to support business activity to shore up growth and will maintain loose monetary policy in the near-term.
- Alongside front-loaded Fed tightening and weakening trade terms, local FX depreciation to the USD might persist till year-end.



Source: Oxford Economics, Bloomberg, as of 15 August 2022

Note: China 1-year Loan Prime Rate is used a proxy for PBOC policy changes. Singapore is not included in the above graphic as the Monetary Authority of Singapore (MAS) has adopted the use of the exchange rate rather than the interest rate as the instrument of monetary policy.

Varied Occupier Cycles Across Markets and Sectors

Office

MORE LEASING IN Q2, BUT DOWNSIZING STILL COMMON

Leasing enquiries have increased since the start of the year, however a number of these involved down-sizing or contractions ranging from 10% to 20%. As a result, net absorption across our monitored markets in Q2 was just slightly over 1.0 million sqft, about 70% lower than the level of take up in the previous quarter. Markets that contributed positively were Singapore, Seoul and Beijing. Conversely, occupied space contracted the most in Tokyo (-350,000 sq ft); Shanghai (-140,000 sq ft); and Melbourne (-115,000 sq ft). Each hit peak vacancy in the quarter. For Tokyo in particular, a substantial chunk of the contraction in occupied space was due to cancellations of space, especially in newly completed projects where pre-leases were signed.

TECHNOLOGY DEMAND IS WANING

Take-up by technology firms typically makes up a third of new demand in each market. In the months ahead, we expect demand from technology firms to pull-back, in sync with multiple reports on hiring freezes or layoffs. There were several active leasing briefs by technology companies in Q2, but three out of four of these have gone silent or have indicated that they will cut their space needs by 50%.

MARKETS AT DIFFERENT POSITIONS IN THE CYCLE

Each of our monitored markets is at a different position in the occupier cycle, and the varied recovery profile provides a guide to investment timing to maximize NOI growth. Seoul and Singapore office are both several quarters into a multi-year rent cycle, with vacancy on the down trend and future supply below the historical average. CBD markets in Sydney and Melbourne are rebalancing slowly, but we expect rental growth to accelerate only in 2023. Across China T1 and Tokyo, excess supply amid already high vacancy rates means that submarket selection will be the key to outperformance.

Logistics

LANDLORD FAVORABLE CONDITIONS EXTENDED

Increase in construction and labor costs are reducing supply risks in the region. In South Korea for example, substantial delays or cancellations in the last six months have resulted in about 14 logistics projects being postponed by six months to one year. As of end Q2, demand-supply conditions are better balanced than previously forecasted. Landlord favorable conditions have been extended, and as a result, rent growth forecasts have been further revised up. In Australia rents today are 10% to 20% higher than they were three years ago. In some submarkets, rents are reverting at 40% to 50% higher with tenants still willing to pay.

INVESTMENT ACTIVITY RETREATING, LONG-WALE ASSETS ARE REPRICING LOWER

After two-years of record activity in 2020 and 2021, investment volumes into the logistics sector for 2022 is retreating. Investment volumes have fallen the most in Australia down 30% compared to the same period last year. The yield decompression cycle for logistics has started, impacting mostly long WALE assets to-date where yields have softened circa 15 to 25 bps from six months ago.

Multifamily - Japan

LEASING ENVIRONMENT EXPECTED TO IMPROVE

Leading business indicators like the Tankan Business Survey and hiring conditions by medium and large enterprises have started to strengthen in Q2. These typically have a strong correlation to net migration trends (as more job seekers move into the city) and we expect this trend to follow in the coming months, benefiting the residential leasing markets.

On the investment side, transaction volumes continue to be healthy with USD4 billion in transactions up to July 2022. We expect another year of strong cross-border investor activity, especially as fundamentals remain solid, the cost of debt stays low, and currency (USDJPY) continues at a favorable entry point.

Retail

IMPROVED RETAIL SALES IN SOME MARKETS, BUT CONCERNS ON CONSUMER SENTIMENT REDUCING

Although some fundamentals have improved in Q1 and Q2 2022, there are risks that consumption activity might be curbed from inflation and rising interest rates in H2. Investors that were previously active in the space have reduced exposure and from those that are still interested, they are targeting fewer markets. In the last six months, there have been 40 transactions greater than USD 50 million. Buyers have been a mix of institutional investors and private capital sources.

Office

AUSTRALIA: OCCUPIER MARKETS IMPROVING BUT INVESTMENT DEMAND SLOWS

- Leasing picked-up in Q2 but was mostly concentrated in spaces that were less than 500 sqm.
- Rental recovery is expected to gain pace in late 2023 led by Prime grade stock. The Melbourne market is expected to lag Sydney by three to four months.
- Investment activity has held up year-to-date but is expected to fall in H2. Deals are taking longer to transact as the buyer-seller bid-ask spread has widened to around 15%.

SINGAPORE: A RECORD YEAR FOR OFFICE PURCHASES ON THE BACK OF RENTAL OUTLOOK

- Demand momentum is modest, but limited supply (due to stock withdrawals) will support 6% to 8% rental growth p.a. in the next three years. This represents one of the strongest outlooks in the region.
- With close to 15 deals closed in H1, a new transaction record may be set in 2022. Pricing continues to climb despite higher interest rates due to strong rent growth prospects. A recent all-cash transaction in Q2 set a record-breaking record of SGD 3,617 psf.

HONG KONG: MARKET REMAINS TENANT FAVORABLE

- Aggregate demand in H1 continues to shrink and as a result rental markets remain weak. Rents in Central and Kowloon are 28% and 19% below its peak in 2019. This rental weakness is likely to persist in the near-term, with strong supply in 2022 and 2023 (with limited precommitments).
- Investors have generally eschewed the office market, with only one medical office enbloc transactions since the start of 2022. As a result, price discovery has been limited.

CHINA: LEASING WEAKNESS IN H1 MORE APPARENT IN SHANGHAI

- Amid extended lockdowns in Q2, take-up in Shanghai hit a quarterly low in Q2. In Beijing, where conditions are slightly better, only select submarkets like Lize, Guomao and Finance Street saw steady take-up in Q2.
- For both markets, investor interest has dampened. Major transactions were mostly by domestic investors and for self-use. To-date, AEW Research understands distress in T1 markets are greater in Shanghai vs Beijing.

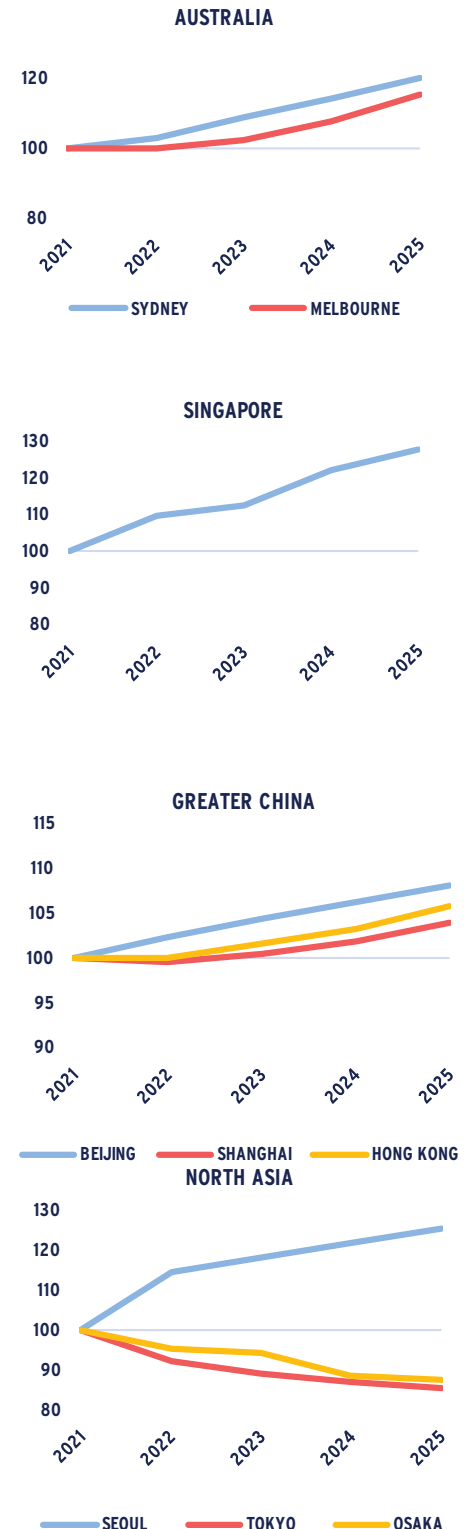
SOUTH KOREA: FAVORABLE FUNDAMENTALS SUPPORT DOMESTIC INVESTMENT

- Expansion in occupier demand is seen across a broad range of industries. Rents are typically indexed to inflation and in the current environment, yearly escalations and highly positive rent renewals are helping manage the increased cost of debt.
- Investment markets continue to be active with USD13.7 billion in transactions year-to-date. AEW understands that valuers are already reflecting higher interest costs into today's valuations, but to-date, there is limited transactional evidence of price correction.

JAPAN: SUPPLY RISKS WILL DELAY RENTAL RECOVERY

- Tokyo: While there is evidence of demand supply rebalancing, this is expected to be short-lived. Demand is still soft as several firms are downsizing or canceling space. Meanwhile the availability rate (which includes current and future space available for lease today) is at 9% and landlords remain very accommodative on terms.
- With more vacancy expected in H2 and strong supply levels from 2023 to 2025 prospects for a rental recovery are weak.

OFFICE RENT INDEX (2021 - 2025F)
2021 = 100



Source: AEW Research, JLL, Q2 2022

Logistics

AUSTRALIA: OCCUPIER MARKET STRENGTH, BUT PRICING STARTING TO COME OFF

- Occupier conditions are still healthy with vacancy rates continuing to fall and pent-up demand supporting pre-leasing in new construction. Rental growth outlook for 2022 was revised upwards again, with 10 to 15% rental growth expected in 2022.
- After strong re-pricing in recent years and with increased financing costs, investors have pulled back on buying activity. Cap rates for long WALE assets have already started to expand (15 to 25 bps from six months ago), as there is limited ability to grow income.

SINGAPORE: HEALTHY DEMAND FOR PRIME ASSETS

- Business Parks Demand for well-located and newer spaces continue to be sought by growing industries, widening the vacancy and rental gap between prime and sub-prime buildings.
- Logistics Demand for warehouses remained healthy in H1 as food, pharma and semiconductor firms increased their storage requirements. Near-term supply is low, and demand is expected to remain strong, causing upward rental pressure.

HONG KONG: LOGISTICS REMAINS THE PREFERRED SECTOR BY INVESTORS

- Rents are still growing as demand remains healthy and supply is limited. Besides traditional occupiers such as manufacturing and 3PLs, there is increasing demand from the tech sector (for data center conversion) or pharmaceutical occupiers for laboratory space. In H1 there was also strong demand by cold-storage operators, but this is expected to be temporary.
- As the only sector in Hong Kong where occupier fundamentals are positive, investment activity has been healthy with volumes in H1 2022 up 15% compared to H2 2021. Still, it is worth noting that the number of deals transacted halved in Q2 vs. Q1 after interest rate increases.

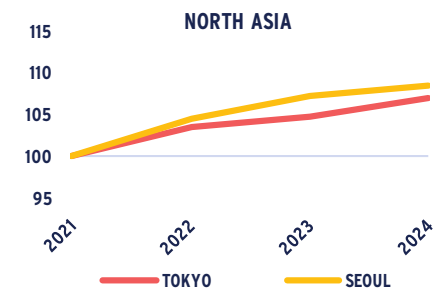
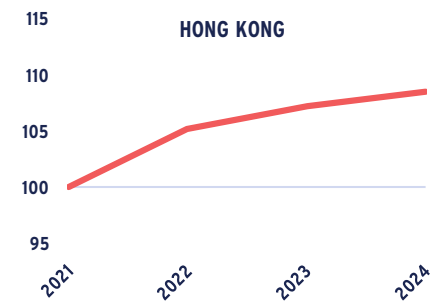
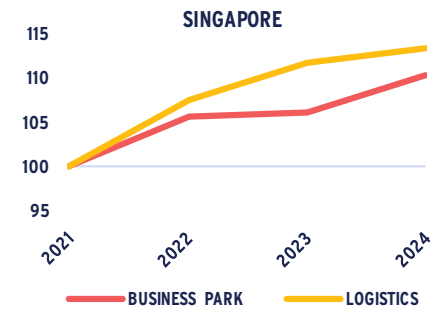
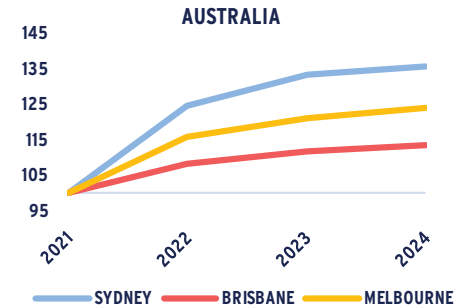
SOUTH KOREA: LANDLORD FAVORABLE ENVIRONMENT EXTENDED, DRY OUTPERFORMS COLD

- New completions in 2022 are now expected to be about just 31 million sq ft, about 45% lower than initially forecasted, extending favorable conditions for landlords.
- Occupier conditions in dry vs. cold space opportunities are currently mixed. While there is pent-up demand for dry space, cold-chain facilities are taking longer to lease up (due to a surge in supply in recent months). Current vacancy in dry space is around 2% while cold chain facilities are estimated to be closer to 7%.
- Due to an active domestic investor base, investment volumes in Greater Seoul logistics have continued to climb in 2022 (up 15% year-to-date) despite the increased cost of debt. In general cross-border capital is keeping at bay as they wait for construction costs and interest rates to settle.

JAPAN: DEMAND PRESSURES EASE AND RENTAL OUTLOOK LOWERED

- Rental outlook for Tokyo logistics was slightly lowered over the quarter. While demand is still healthy, tenants are less pressured to sign new contracts under the pretense that more supply is expected. Current pre-leasing for the next 12 months is just 27% compared to 50% just six months ago.

LOGISTICS RENT INDEX (2021- 2024F)
2021 =100



Source: JLL, as of Q2 2022

Retail

AUSTRALIA: INVESTMENT ACTIVITY RESPONDS TO RBA ACTION

- Growing retail sales up to June 2022 set a positive picture year-to-date. Spending has been driven by discretionary categories such as clothing and footwear, café and restaurants, as well as department stores. Reflecting this, vacancy rates for shopping centers (excluding Prime CBD retail) remained resilient and stable in H1.
- Latest moves by the RBA to curb inflation is expected to have an impact on spending in the second half of 2022, and the positive trend seen year-to-date could reverse.
- H1 2022 investment activity has already dropped by a significant margin vs. the record high in Q4 2021. Most transacted assets were either non-discretionary or with development potential. Retail yields which were previously expected to stay stable in 2022 and 2023 are now expected to soften between 25 to 50 bps in the next 12 to 18 months.

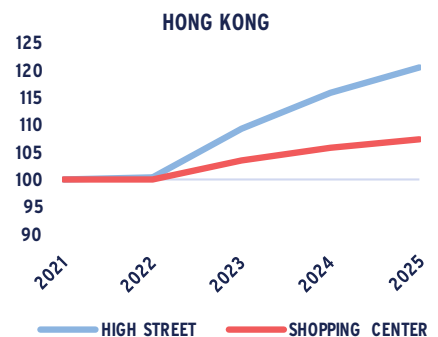
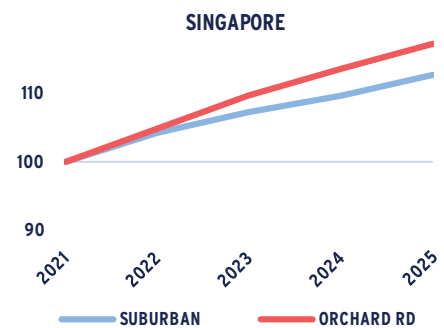
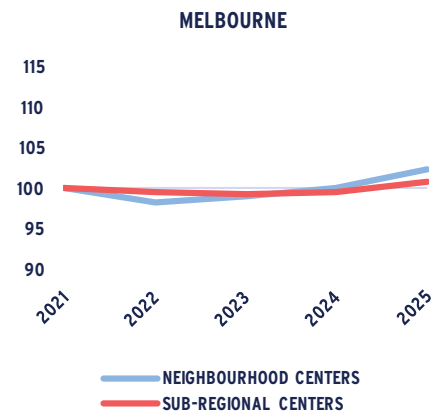
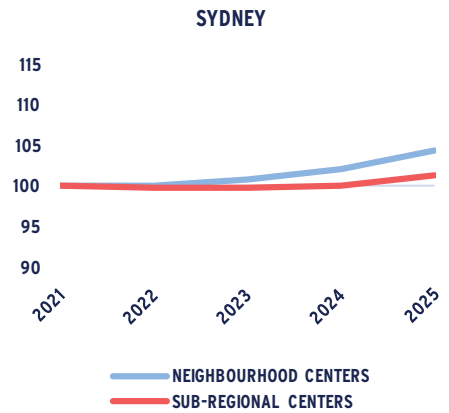
SINGAPORE: LEASING IMPROVING BUT REVERSIONS STILL NEGATIVE

- Leasing activity continued to gain momentum supported by improvement in retail sales and business expansion. Vacancy rates across prime and suburban areas fell in Q2.
- Most landlords today have adopted the fair tenancy agreement (a recently instituted code of conduct) which means that most rental agreements no longer capture a gross turnover component (or the recent improvement in retail sales). As a result, rents are still 10% to 15% below pre-Covid levels and reversions are expected to continue to be negative in the near-term.

HONG KONG: REOPENING WITH MAINLAND IS CRUCIAL TO RECOVERY

- The government-issued consumption vouchers to all residents supported a slight improvement in retail sales in Q2. Retail sales volumes as of end June were HKD 28 billion vs HKD 43 billion in March 2022.
- With inbound tourism expected to stay low, retail sales will continue to be domestic led. We expect demand and occupancy to continue on a downtrend and expected to improve once travel restriction and borders with the mainland are reopened.

RETAIL RENT INDEX (2021 - 2025F)
2021 = 100



Source: JLL, as of Q2 2022

Multifamily

JAPAN: MIGRATION TRENDS START TO NORMALIZE IN 2022

- Several J-REITs reported a slowdown in leasing activity compared to the same period last year, however we expect this to be a Covid-related disruption and temporary.
- Leading business indicators like the Tankan Business Survey and hiring conditions by medium and large enterprises have started to strengthen in Q2. These typically have a strong correlation to net migration trends (as more job seekers move into the city) and we expect this to follow in the coming months, benefiting the residential leasing markets.
- The Investment market continues to be active as interest rates remain stable and the USDJPY represent a favorable entry for cross border investors.

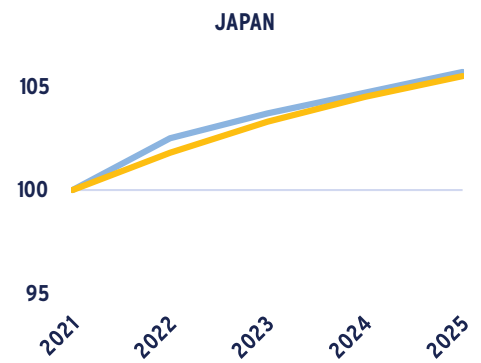
AUSTRALIA: POSITIVE TAILWINDS, IMPROVEMENT ON TAX LEGISLATION NEEDED

- BTR in Australia will cater to an emerging pool of renters (both domestic and migrants) that have been priced out of homeownership.
- There is currently a strong mismatch between demand and supply, which has driven apartment rents to record levels in June 2022. In the last 12 months, rents have risen by 15% to 20% within high density areas in capital cities.
- The build-to-rent sector’s development pipeline is expanding quickly with investors generally looking past some of the immediate disadvantages around interest rates, construction costs and tax legislation. With several projects completing this year, the BTR concept and performance will be tested. Recent studies based on completed BTR projects have shown that they command a 20% rental premium to traditional rental projects.

CHINA (TIER 1): DEMAND AND INVESTOR INTEREST DISRUPTED

- Leasing demand for the multifamily sector in Shanghai and Beijing has slowed in H1. While some of the affects are seasonal, Covid outbreaks and strict lockdowns have dominated the disruption.
- Investor interest in the sector has also waivered under the current conditions, with only one multifamily deal concluding in Q1 in Beijing.

MULTIFAMILY RENT INDEX (2021 - 2025F)
2021 =100



Source: AEW Research, as of Q2 2022