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A fresh look at Asia real estate

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Resilient structural trends defy challenging macro backdrop

October 2019

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- Real estate investors in the Asia Pacific region are continuing to enjoy steady returns despite an increasingly challenging macroeconomic climate in many of the world's economies
- We forecast a total return of 8.7% in 2019, supported by stable growth of developed markets
- Despite an overall resilient outlook for real estate owing to longer term structural trends, a number of sector risks remain for investors to stay alert to

Long-term structural trends help to sustain growth

The Asia Pacific economies are currently challenged by less global growth, increased geopolitical tensions and a slowing Information Communications Technology (ICT) cycle, leading to looser monetary policies in countries such as Australia and South Korea.

As such, interest rates and long-term government bond yields are expected to remain low in the near term, thus maintaining an attractive real estate yield spread versus 10-year government bonds.

External headwinds aside, the relative strengths of the labour market and the advancement of digital- and knowledge-based economies should help to sustain the stable growth of the developed APAC markets.

Over a longer term, the ICT sector is expected to benefit from the gradual global introduction of 5G telecommunication networks, which is particularly good news for Japan, South Korea and Singapore.

Structural trends such as these should bode well for APAC real estate. Investors, however, should note some of the possible challenges that each sector faces alongside its opportunities.

Growing e-commerce to support higher-returns for logistics

The growth of e-commerce in the region should drive demand for logistics space, particularly in Australia, Japan and South Korea. It is estimated that 14 million square meters of additional warehouse space is required to support a forecast US$ 120 billion worth of e-commerce sales in the developed APAC markets by 2023. Increasingly, logistics occupiers catering to private consumption seek better quality space to support increased automation and higher volume of goods. Niche segments such as cold-store units for online grocery shopping and healthcare logistics are also earmarked as areas of growth.

The lack of high quality and well located warehouse space in the region, however, is inhibiting the growth and scale of occupiers. Location remains a key requirement, as transportation typically accounts for at least half of logistics providers' total costs. Yet new supply is curbed by the lack of suitably-sized land plots as well as government restrictions in areas close to residential neighbourhoods.

Developed APAC logistics real estate could deliver relatively higher returns over the next three years with a total return forecast at around 7 per cent annually. This is mainly driven by further yield compression as the sector continues to mature and attract more investment interest.

Shift towards more knowledge-based economies to grow demand for prime offices

A more digital- and knowledge-driven economy is expected to bolster office-based employment in the region. With employees' wellbeing increasingly important among corporates, there is a growing preference for prime office developments that provide high quality space and amenities. Such space would also give corporates an edge as the competition for global talent in emerging sectors intensifies. For investors focused on core real estate, new prime office assets should provide relative income stability and resilience.

Office real estate rental growth looks to outperform other sectors due to low vacancies and the good management of supply in most markets. An area to watch out for are sub-markets that are heavily dependent on the technology and/or emerging sectors, particularly co-working. Should potential tech sector liquidations or consolidation activities take place, these would be hotspots for sudden increases in office vacancies, thus negatively impacting rental income.

Population growth in gateway cities to benefit multi-family residential

Multi-family residential in gateway cities such as Tokyo is expected to see sustained demand due to population growth and an increase in white-collar employment. A tight labour market has led to the relaxation of hiring policies for foreigners and the rise of dual income households as more women re-enter the workforce. Positive fundamentals for this sector is expected to draw more interest from foreign institutional investors, potentially leading yields to compress further. Japan's residential sector is thus forecast to deliver a total return of 11.5% in 2019.

Inner-city residential districts should record relatively more defensible and higher income returns as they appeal to millennials who have a strong preference for areas with convenient access to public transport and attractive amenities.

More prevalent omni-channel retailing to keep prime retail space relevant

Retail real estate continues to be impacted strongly by the expansion of e-commerce with more companies implementing omni-channel retail strategies to expand their customer base and remain relevant.

As such, prime retail locations in gateway cities will serve as essential branding and marketing touchpoints going forward. In addition, it will also be necessary for landlords to maintain well-managed suburban shopping centers in densely populated areas to develop strong community hubs.

In an increasingly digital age, retail property will require more intense asset management and place-making initiatives to attract visitors and increase dwell time. As the point of sales in a store becomes more difficult to establish, footfall and marketing success of an asset may gradually become part the variable component for retail rents.

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