Asia Pacific Real Estate Strategic Outlook

December 2024

IN A NUTSHELL

- Following a multi-year asset repricing, we see a potential upward cycle within the next 12 months with real estate valuations in Asia Pacific approaching attractive levels, driven by healthy fundamentals and easing monetary conditions.
- With occupier demand expected to remain resilient, the spotlight could shift to supply constraints arising from surging construction costs, particularly in the cost sensitive logistics sector.
- Prime Logistics in locations facing future supply constraints such as Greater Tokyo, Seoul and Australia, Living assets in Australia and Japan, and repriced Next-Generation Offices in Sydney and Seoul form our top picks for the core investment opportunities across the region.

1 / Economic Update

The year 2024 saw economies in Asia Pacific navigate through inflationary pressures, moderating domestic demand post pandemic and an export rebound driven by the global technology upturn. The IMF titled its November economic report for Asia Pacific as “Resilient Growth but Higher Risks”, which summarizes well the outlook and challenges ahead. While China GDP growth is expected to slow further to 4.4% in 2025, developed Asia Pacific GDP growth averaging 2% is expected to outperform the U.S. and Europe over the next five years[1] supported by rising intra-regional trade and the continued emergence of Southeast Asia and India.

Central banks across many parts of Asia Pacific are expected to cut interest rates through 2025. Current analyst expectations are for key policy rates in Australia and South Korea to fall around 100 basis points by end-2025[2], helping drive real estate liquidity and valuations. Japan is the notable exception. The Bank of Japan is expected to continue tightening monetary policy and raise policy rates, although only at a gradual pace. And while real estate financing costs remain high compared to the

[1] DWS CIO forecasts, as of November 2024
[2] Retrieved from Bloomberg, as of 18 November 2024

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pre-pandemic low-interest rate environment, senior loan rates in Australia, South Korea and Singapore have already fallen by an estimated 80 to 100 basis points compared to a year ago.

Our central case economic scenario assumes the normalization of regional economic growth coupled with reduced inflation. Nonetheless, rising geopolitical tensions, declining global trade flows and a prolonged slowdown in China are major risk factors that could potentially impact regional growth. Major changes in U.S. foreign trade policies such as the reenactment of trade tariffs, could potentially lead to increased de-globalization and revive global inflationary pressures including that in Asia Pacific, a potential dampener to occupier demand especially across export-oriented countries such as South Korea.

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2 / Real Estate Outlook

Office: Office performance in Asia Pacific continued to diverge for most of 2024, with rental growth slowing in most markets compared to the previous year. Rents in Singapore hit their highest levels in 15 years, driven by strong leasing enquiries for newer high-quality space, though some tenants have been reducing their office footprint in older buildings. In Tokyo, leasing demand remains healthy, driven by the manufacturing and services industries, while Seoul continued to see strong leasing demand from the vibrant technology industry which underpinned rental growth amid vacancy levels below 4%.

On the other side, overall office vacancy levels in Australia remained at elevated levels near 12% in Sydney and 18% in Melbourne, while net absorption remained negative particularly for lower grade buildings. Leasing activity remains concentrated in premium grade assets, where net absorption and vacancy levels have outperformed other assets. Elsewhere, the leasing and rental markets in China and Hong Kong continue to face strong headwinds due to a combination of lackluster demand from macroeconomic pressures and high pipeline supply pressures.

Occupiers continue to gravitate towards higher specification buildings in core locations, as employers focus on productivity and sustainability. Over the next few years, new office supply levels are likely to fall below historical averages, partly constrained by rising construction costs, though the impact varies by location and will likely be of a lower magnitude compared to the logistics sector where construction costs constitute a higher proportion of overall development costs. The trimmed supply pipeline should help support rental growth and occupancy levels, particularly for higher quality developments.

Industrial: Logistics leasing demand in Asia Pacific generally remained resilient, although net absorption levels have moderated from the post-COVID peak experienced in 2022 and 2023 amid inflationary pressures and slowing domestic consumption. This has led to vacancy levels climbing across some locations, such as Australia where the national vacancy rate climbed from historic lows a year ago to 2.9%[3] in the third quarter of 2024 – although still an exceptionally low level. Meanwhile, vacancy levels across Greater Tokyo and Soul remains high with landlords offering higher incentives as record new supply levels weigh on rental growth.

Looking past the current headwinds, we expect future supply levels to drop significantly as rising construction costs pressure project feasibility and lead to supply cancellations. While rental growth in 2025 is likely to remain relatively subdued, we expect rents to pick up strongly across most markets from 2026 onwards, particularly in incoming supply-constrained markets such as Japan and South Korea where high construction costs and breakeven rents for new developments could exert strong upward pressures on logistics market rents (See Section 5).

Retail: The APAC retail sector continued to benefit from the recovery in international tourism. High-street retail locations across Tokyo, Seoul, and Singapore with significant exposure to inbound tourism continue to experience rental growth as leasing sentiment remained firm. On the other hand, domestic consumption has been relatively muted across some markets such as Australia and China where retail sales growth and discretionary spending continued to slow, limiting rental growth.

We believe the retail sector could offer selective tenant repositioning or asset conversion value-add opportunities, but a strong turnaround remains unlikely considering structural and cyclical headwinds such as rising ecommerce sales, higher cost-of-living and operational costs for retailers, which could constraint rental growth prospects over the medium-term.

Residential: Positive demographic factors such as continued population growth, relative economics of renting over stretched home ownership affordability and housing supply shortages continue to underpin residential rental growth in parts of the region. In Australia, where the vacancy rate sits just above 1%, nationwide housing rents registered a 6% y-o-y increase in October 2024[4], albeit moderating from the double-digit growth experienced over the past couple of years. Investors continued to participate actively into Build-to-Rent (BTR) developments across the region as rental demand remains driven

[3] Colliers Research, as of October 2024.
[4] SQM Research, as of October 2024

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by elevated housing prices and low mortgage affordability, while limited new housing supply has been hampered further by rising construction costs and high interest rates.

Japan's residential market remained buoyant, driven by ongoing urbanization, positive domestic net migration, healthy wage growth as well as rising household formation around major city centres. Residential rents in Tokyo and Osaka have benefited from strong rental growth since 2023, averaging 5.5%-6% annually. The rental growth outlook has been further boosted by low vacancy levels and constrained condominium supply arising from elevated construction costs, although we expect growth in the medium term to settle at a more sustainable pace of around 3% per annum.

Hotels: The tourism industry in Asia Pacific continued to benefit from rising passenger flows, as international arrivals grew 33% y-o-y during the first 8 months of 2024[5], outpacing all other global regions. During the same period, Japan's hotel performance remained one of the strongest in the region, with increases in occupancy rates and hotel room rates driving RevPAR increases of 28% and 16%[6] respectively for Tokyo and Osaka. Other hotel markets in Australia, South Korea and Singapore also benefited from positive occupancy and ADR growth, albeit at a slower pace. With outbound travel from China yet to recover to pre-COVID levels, this growth momentum could be sustained as international travel continues to rise.

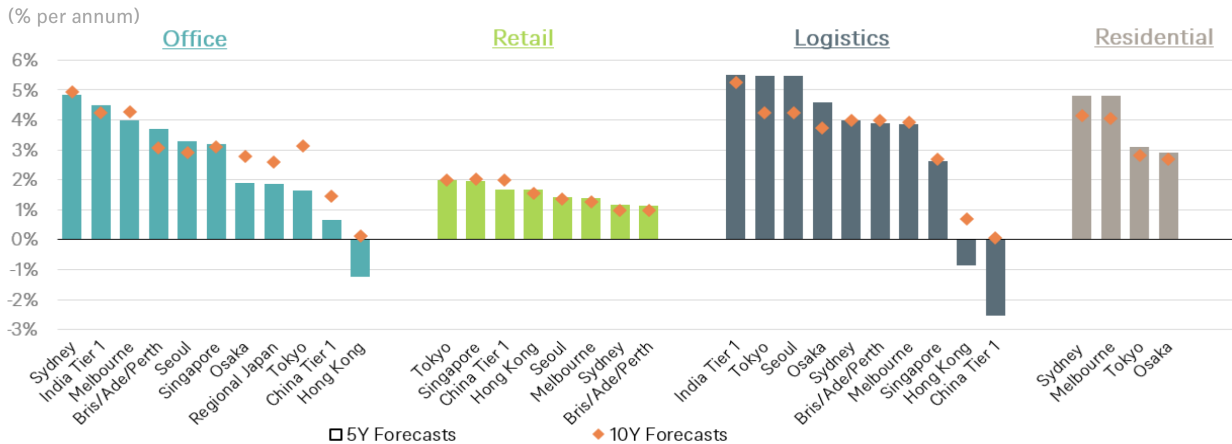
Rental Outlook

Though short-term rental headwinds could persist in 2025, we believe logistics rents could see a strong turnaround from 2026 onwards as demand-supply fundamentals turn more landlord favourable, particularly across Greater Tokyo and Seoul where we see elevated construction costs and new project cancellations forcing vacancy down from current levels exceeding 9% to sub 3% levels by 2027, driving strong rental growth of over 5% per annum over the next five years. Overall, logistics assets could benefit from some of the strongest rental upside in Asia Pacific outside Greater China, with annual rental growth averaging over 4% over the next five years.

Rental growth prospects in the residential markets in Australia and Japan (multi-family, build-to-rent) look favourable as well while select office markets across Australia should also perform well over the next five years, on the back of rising face rentals and falling incentives. We have also initiated our Houseview forecasts for major Tier 1 cities in India, where we see strong rental growth prospects underpinned by rapidly growing services and consumption growth.

Exhibit 1: Net Effective Rental Growth Forecasts (2025-2034F)

(% per annum)



Note: Figures shown are on net effective basis after factoring incentives. China Tier 1: Beijing/Shanghai/Guangzhou; Regional Japan: Nagoya/Yokohama/Fukuoka; India Tier 1: Mumbai/Bangalore/Delhi. There is no guarantee the forecasts shown will materialize.
Source: DWS. As of December 2024.

[5] ForwardKeys presention, as of October 2024
[6] HVS, Market Snapshot: Asia Pacific 2024, October 2024

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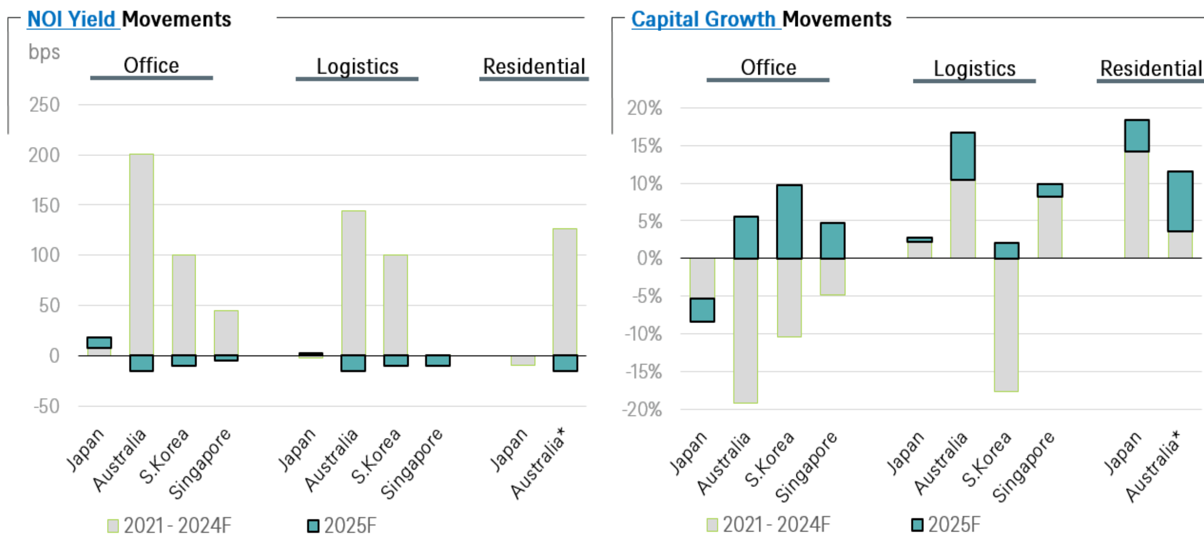
3 / Investment Trends

Based on data from MSCI, income-producing real estate transaction volumes in Asia Pacific appear to be stabilising, with volumes hovering above the US$35 billion level[7] in recent quarters. Rising participation from institutional investors point to positive signals of a market recovery ahead, being notably more active during the first ten months of 2024, accounting for 60%-70% of total investments across Japan, Australia, South Korea and Singapore, around 10 percentage points higher compared to the preceding year. This is further reinforced by strong ongoing deal pipelines across all major sectors, at the highest level since the start of 2023.

Until recently, asset repricing in Asia Pacific had lagged considerably behind the steeper price correction trends observed in Europe and the U.S. Over the past 12 months however, significant pricing adjustments have occurred in several markets, particularly across Greater China, Australia and South Korea. This is evidenced by the sharp decompression in market yields, led by Australia where prime office and logistics yields have expanded between 150 to 200 bps since the end of 2021. Grade A office yields in Sydney and Melbourne currently stand at 6.8%-7.0%[8], the highest levels in a decade, drawing the attention of investors, acquiring CBD assets at prices up to 25% below their peak value.

Similarly in Seoul, market yields for prime office and logistics have increased by 100 bps during the same period, reflecting price corrections of 10%-20% from the peak. Japan has so far been the outlier, but we believe office prices have corrected by around 5% in 2024. Asset repricing in Singapore has also been more limited due to the low market leverage, strong landlord balance sheets, as well as an active presence of both domestic and foreign investors, including new sources of private wealth.

Exhibit 2: NOI Yield and Capital Value Changes since Q4 2021



*2021-2023 figures for Private Rented Market / Build-to-sell market. F=Forecast. There is no guarantee the forecasts shown will materialize.
Source: DWS, JLL, Colliers, CBRE, Miki Shoji, WeFunding, SQM Research. As of December 2024.

[7] MSCI-RCA data, as of November 2024
[8] Colliers data, as of May 2024

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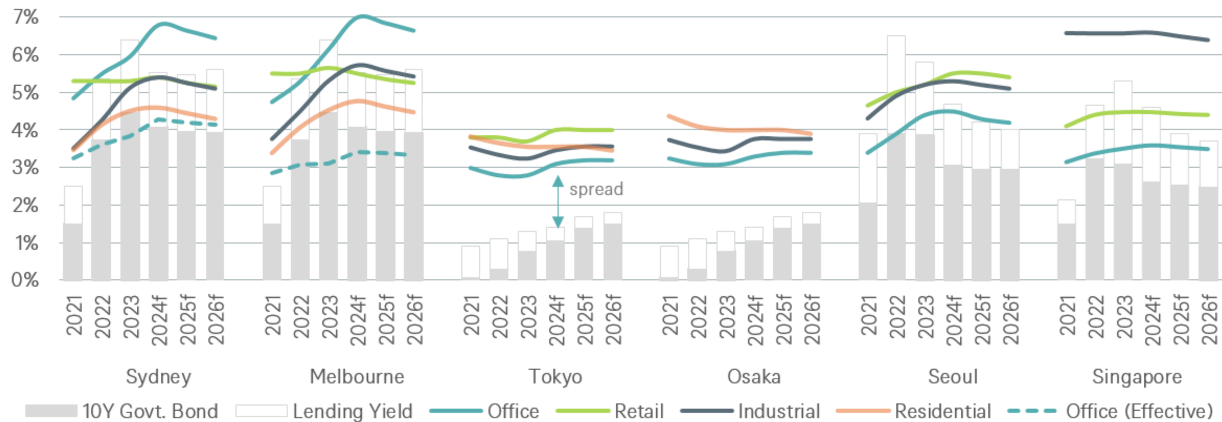
Following a correction cycle lasting 2-3 years, we believe that yield decompression and real estate prices in Asia Pacific (excluding Japan and China) are near a turning point, with prime capital values recovering from 2025 onwards. Potential tailwinds include more attractive valuations on core assets where fundamentals remain healthy, softening financing costs as well as investors deploying capital back into real estate after sitting on the sidelines over the last few years.

With market expectations for Japan's ultra-low interest rates to normalize at a gradual pace, significant asset repricing is unlikely to occur although we believe this to be sector specific. The weaker outlook for office assets pressured by rising supply pressures and subdued rental growth should lead to a further price correction in 2025, while positive demand-supply fundamentals in the residential sector should see assets maintain growth in capital values.

The caveat is that while yields could have potentially peaked, we are of the view that central bankers are likely keen to avoid a repeat of the recent high inflationary challenges, hence policy rates and long-term bond yields are unlikely to decline to the previous COVID pandemic lows. Given the elevated volatility in financial markets and distortions arising from rising geopolitics and policy uncertainties particularly from the U.S, arriving at the appropriate long-term risk-free rates with high confidence levels is a challenging task. Nonetheless, we think a sensible projection for cap rates going forward would be a moderate, but not overly strong yield compression over the coming years.

At the same time, with global investors' focus increasingly shifting towards high quality, ESG compliant assets, we believe owners of non-prime stock with high capital expenditure requirements could increasingly look towards divestment and recycle capital into the prime space. This could enhance the pricing gap between older lower quality buildings compared to prime assets with high ESG credentials.

Exhibit 3: NOI Yields vs Bond Yields



f=forecast. There is no guarantee the forecasts shown will materialize
Source: DWS, Colliers, Miki Shoji, Oxford Economics. As of December 2024.

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4 / Returns Outlook

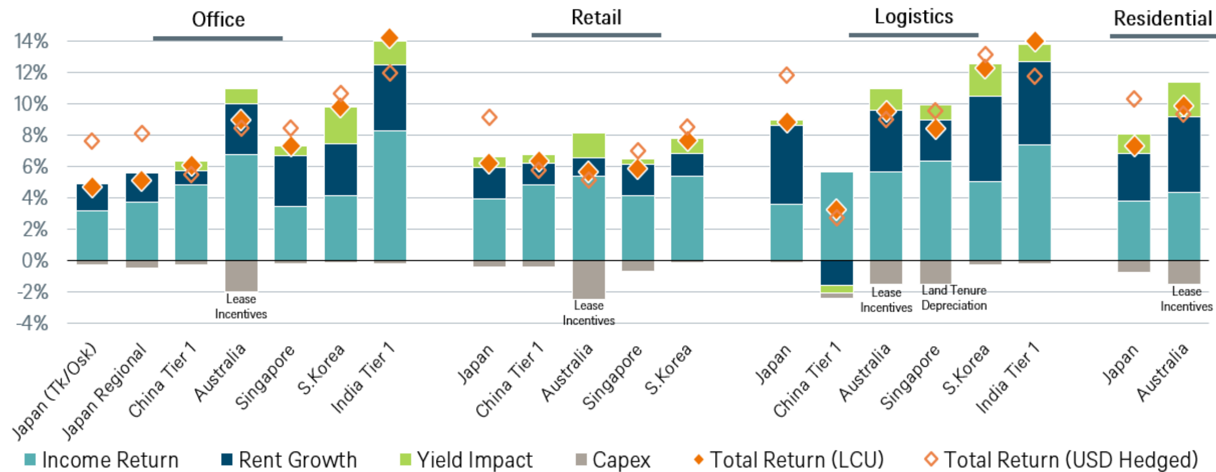
Combining our house view rental growth and yield forecasts over the next five years, we believe the logistics sector in Asia Pacific outside China could outperform with annual unlevered total returns ranging from 8%-14%, driven mainly by attractive income yields and rental growth expectations. We also believe institutional residential assets could perform strongly in Australia (BTR) and Japan (on a USD hedged basis, especially with leverage).

The office sector should see a wider divergence in returns performance across major APAC cities. Behind India, we think Australia and South Korea could do well, led by Sydney and Seoul where returns look more attractive following a period of repricing with a potential recovery in asset values over the next 1-2 years.

Critically, our current expectations are for real estate returns to be predominantly driven by income yields and rental growth rather than aggressive cap rate compression. Monetary policies in the APAC region are likely to ease from current restrictive levels, but we believe long-run neutral interest rates could remain higher than pre-pandemic levels.

Exhibit 4: APAC Total Return Forecasts, (2025-2029F, Unlevered)

(% per annum)



F = Forecast. LCU refers to local currency returns. Country returns refer to projected market returns calculated on unlevered property-level basis and are stock-weighted based on the following city-level data: Japan – Tokyo (All sectors), Osaka/Yokohama/Nagoya/Fukuoka (Office); Australia – Sydney/Melbourne/Brisbane/Perth/Adelaide; China T1 – Beijing/Shanghai; South Korea – Seoul. USD Hedged Returns are calculated based on 5-year interest rate swaps There is no guarantee the forecasts shown will materialize.
Source: DWS. As of December 2024.

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5 / Investment Strategy

APAC Logistics

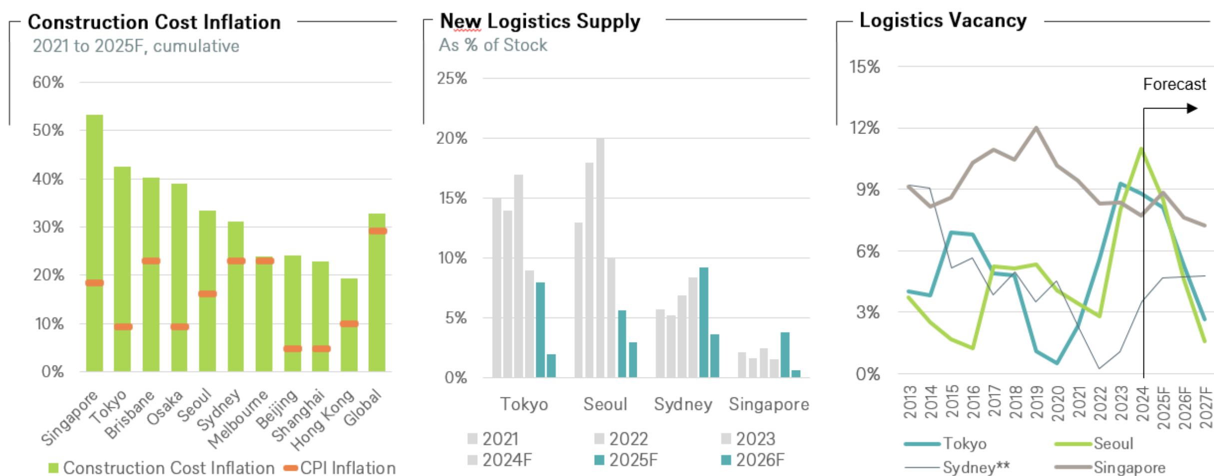
The logistics sector remains among our preferred investment picks in the region. Though recent trends indicate logistics demand has moderated from post-pandemic highs, structural drivers for modern warehousing needs across Asia Pacific remain intact – underpinned by unabated e-commerce growth, upgrading demand from older obsolete warehouses and increased nearshoring practices as diversification of supply chains takes place.

A major tailwind we anticipate for the sector in the years ahead is supply. By the end of 2025, general construction costs are projected to have risen by 30%-40%[9] across Japan, South Korea and Australia in the five-year period since 2020. As construction costs constitute a significant 60%-70% of total development costs, this creates significant pressures on the economic feasibility of new developments – for example, we estimate breakeven rents for new logistics developments in Tokyo will be 35% higher compared to that in 2020. As a result, new project cancellations have been gaining momentum – incoming supply across Greater Tokyo and Seoul is expected to plunge from near 20% of total stock in 2022-2023 to low single digit figures by 2026, creating a supply shortfall over the next few years, supporting occupancy levels and rental growth.

We expect modern logistics assets located in regional transport hubs or infill markets close to population catchment to fare better. Warehouses with cold storage capabilities (except in South Korea facing excess speculative supply) underpinned by growing fresh food consumption may also present selective investment opportunities. With cap rate decompression which occurred since 2021 lifting logistics income yields in South Korea and Australia back to current attractive levels of around 5.5%- 6.0%, we see good entry opportunities in the Greater Seoul and major Australian cities (Sydney, Melbourne, Brisbane) within the next 6 months with the potential for future cap rate compression as monetary conditions ease.

Meanwhile, while logistics yields in Japan and Singapore have been relatively stable, the rental outlook and good yield spreads should continue to attract income-oriented investors. With further interest rate hikes anticipated, the second half of 2025 may present better entry opportunities for logistics assets in Greater Tokyo once pricing pressures stabilises.

Exhibit 5: APAC Logistics – Incoming Supply Shortage



F = forecast. Projected returns are based on compounded basis There is no guarantee the forecasts shown will materialize.
Source: DWS, Turner & Townsend, Colliers, JLL, CBRE, R Square. As of December 2024.

[9] Turner & Townsend Construction Market Surveys 2021-2024, as of June 2024

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APAC Living Sector

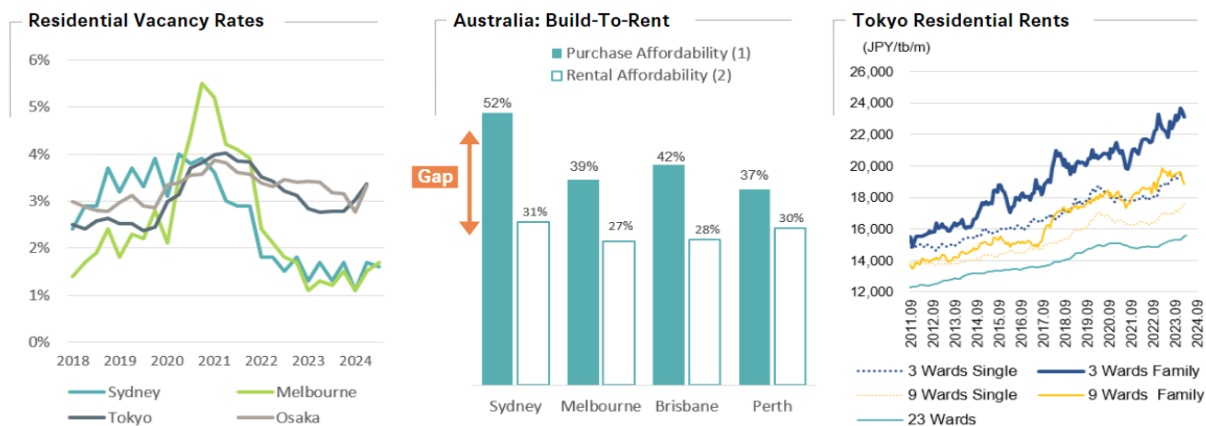
While still at a nascent stage compared to the U.S. and Europe, the living sector in Asia Pacific continues to gather momentum among investors looking for increased diversification from the office and industrial sectors, owing to positive structural demographic trends such as net migration inflows and evolving lifestyle preferences particularly among younger renters, as well as defensive aspects such as its perceived rental stability and lower volatility. Investment volumes in the APAC living sector reached a near record high of over US$12 billion in 2023, compared to the average US$9 billion recorded in the preceding 5-year period, while year-to-date volumes in 2024 remained strong.

Japan's mature multifamily segment continues to attract the bulk of investments underpinned by its high market liquidity, scalability and rental stability. We see potential investment opportunities in larger family-type apartments in Tokyo and Osaka anchored by strong leasing demand from working couples and professionals priced out by elevated for-sale condominium prices. Positive net migration flows from both overseas and domestic sources should underpin annual rental growth of around 3% over the next few years, while cap rates of 3.8%-4% are sufficient to generate positive yield spreads of 2%-2.5% over borrowing costs which remain appealing for income-oriented investors particularly on a high levered basis.

In Australia, notwithstanding the surge in residential rents driven by strong demand, our recent Housing Affordability Review publication[10] shows that major cities including Sydney and Melbourne remain among the most affordable locations globally for renters. Strong population growth underpinned by continued net overseas migration in major Australian cities, combined with an ongoing housing shortage exacerbated by tight vacancy rates of less than 2% and poor mortgage affordability due to elevated housing prices, is expected to underpin demand for the emerging Build-to-Rent sector which constitutes only a small portion of overall housing supply. Another tailwind is the proposed legislation introducing tax concessions for new residential BTR projects which is expected to open the sector for foreign investors.

While apartment rents in Sydney and Melbourne are unlikely to match the immense double-digit growth experienced over the past 2-3 years, we still believe that fundamentals for the sector remain strong enough to support annual rental growth of close to 5% over the next few years. We favour immediate investment opportunities involving well located BTR apartment projects in city fringe locations near transport hubs, particularly districts where a larger proportion of higher income renters reside, to capitalise on the strong front-loaded rental growth prospects.

Exhibit 6: APAC Living – Fundamentals remain strong



(1) Based on % of gross household income required to service an 90% LVR mortgage for a term of 30 years. Prices are based on apartment prices as of November 2024.
(2) Rental affordability = Median weekly asking rents for units / Median gross household income (2021 Census figures have been adjusted by state WPI to June 24).
Source: DWS, CBRE, SQM Research, ARES, Australia Bureau of Statistics, LMC, ARES. As of December 2024

[10] DWS Real Estate Research: Housing Affordability Review – 2024, Published in November 2024

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APAC Office Sector

The office sector in Asia Pacific have held up relatively well, with higher utilisation rates and occupancy levels compared to the U.S and Europe, particularly in South Korea and Japan. Increasingly we see more companies requesting employees to return to the office more frequently. A recent survey by CBRE[11] backs this observation with its findings that over 60% of occupiers in Asia Pacific have seen their office attendance levels stabilise while another 32% expect their office usage to increase over time. This reinforces our belief that offices remain relevant in the longer term.

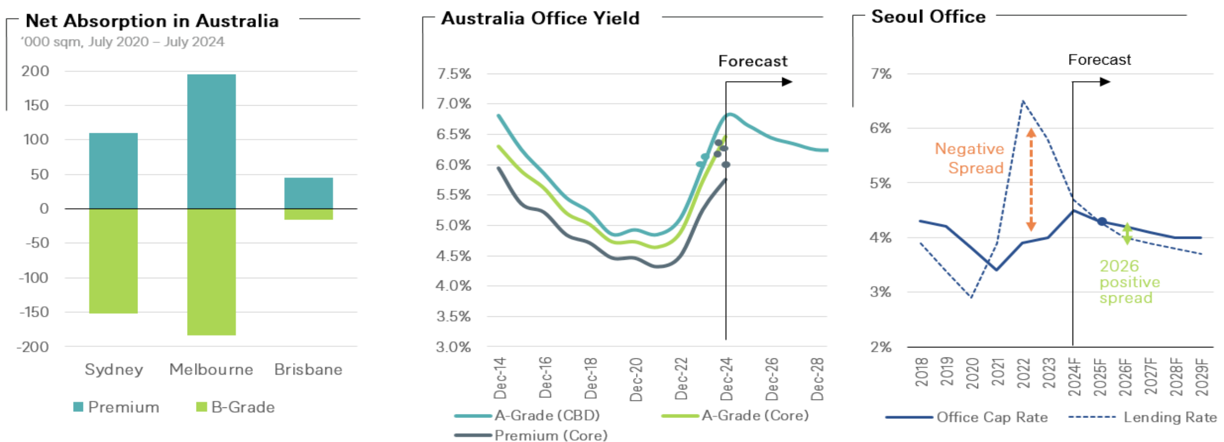
The majority of the asset repricing in Asia Pacific occurred in the office sector (see Exhibit 2), particularly in Australia. We think a pricing trough is likely to materialise over the next 6 months in most markets, aided by easing financing costs which presents a cyclical opportunity to acquire core assets discounted from peak valuations.

Sydney and Seoul's office markets stand out due to the relatively sharper pricing correction that have occurred (10-20%), as well as positive market outlook ahead. While Sydney's office market faced rising vacancies over the past few years, there are signs of recovery with increased leasing activity supported by a limited supply pipeline. Meanwhile, net absorption for premium grade assets has been steadily positive while demand for secondary grade buildings continued to contract. With A-Grade CBD office yields approaching more attractive levels of 6.8% (a full expansion of 200 bps from trough levels), and prices potentially bottoming out, this could present tactical buying opportunities for investors.

Seoul's office market fundamentals remained strong with its sub 4% vacancy rate among the tightest globally, driven by limited supply and strong leasing demand from the buoyant technology industries. The negative yield spread situation in recent few years has started to normalize as office yields rose while financing costs have fallen significantly from the peak of over 6% to sub 5% levels, with the trend expected to continue. Given challenges in sourcing standard equity deals as sellers remain firm on their asking prices, investors could explore alternative deal structures such as preferred equity investments to potentially gain access to prime office stock; and to benefit from higher cash-on-cash yields (currently 6%-7%[12]) with target IRRs of 8%-10%.

We prefer next generation office assets in core locations with good transportation links, particularly developments with ESG credentials and amenities which appeal to the younger Millennial and Gen Z employees.

Exhibit 7: Repriced Offices present buying opportunities



F = Forecast. There is no guarantee the forecasts shown will materialize
Source: DWS, Colliers, JLL. As of December 2024

[11] CBRE, 2024 Asia Pacific Office Occupier Survey, as of September 2024
[12] DWS analysis of market transactions sourced from CBRE, Deloitte, Savills, JLL as of November 2024

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India

While the majority of core investors continue to focus on the developed Asia Pacific countries, the emerging economies of China, India and ASEAN with large population bases offer operational scalability and growth potential for new investment frontiers including real estate.

India stands out owing to its huge economic size and growth potential, exceptional demographics, ongoing market reforms and increasing transparency to investors. Moreover, India looks to be a key beneficiary of rising geopolitical tensions and potential tariff wars between the U.S and China which could accelerate the 'China Plus One' strategy and speed up supply chain diversification through increased manufacturing activities outside China. Our recently published Indian Real Estate Outlook Report[13] highlights our total return forecasts of 13%-15% per annum across the office and logistics sectors over the next 5 years, supported by high income yields, yield compression and rental growth.

We believe initial investment into India can be considered on the largest and fasting growing markets such as Bangalore and Mumbai, with market entry through development of high specification logistics, data centres and investments into core office.

While Indian real estate may offer the potential of higher returns, investors should pay attention to avoid any potential pitfalls. The selection process of the appropriate local partner, due diligence checks, submarket location and asset assessment analysis will be highly critical given the significant divergence in asset performance commonly experienced in emerging markets.

[13] DWS Indian Real Estate Outlook, September 2024

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