ASIA-PACIFIC
HORIZON

Knight Frank

Look Beyond the Norm

Part 3

The report expands on our Active Capital research, where we examine the cross-border capital trends impacting commercial real estate in Asia-Pacific and how key markets in the region offer diverse investment opportunities.

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Contents

Foreword

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Global commercial real estate investors continue to face ongoing complexity, despite some signs of economic improvement. Several countries, including the United States (US), are experiencing upward revisions to GDP growth forecasts for this year. Although financing costs remain significantly higher in many locations, there are indications of moderation, supported by a more dovish stance from several central banks. This occurs against a backdrop of evolving geopolitics, with about half of the world's population heading to the polls.

Following soft global investment volumes last year, early signs of momentum are emerging. Private capital is forecast to remain a significant contributor to global investment in the coming months as debt markets continue to shape market dynamics. We predict a six-to-nine-month window for global capital to capitalise on current pricing and reduced competition before the anticipated recovery becomes widely recognised. Our Active Capital research forecasts investors from Singapore and Japan to be among the top five global sources of real estate capital for the year. Most investor interest is expected to target sectors with structural tailwinds, such as the living sectors, logistics, private credit, and where occupier markets show strength. Australia and Japan are projected to be among the top ten destinations for global investment, reflecting the ongoing appeal of these markets in the current economic climate.

Asia-Pacific embracing a notable pick-up in investment transactions in H2 2024

Where at least six rate cuts were anticipated at the beginning of the year, a recent wave of strong economic data suggests that the market is straying away from imminent policy easing measures. As inflationary pressures in the US persist, the Federal Reserve (Fed) has pushed back the rate cuts, with two 25bps cuts in September and December expected. This has prompted many central banks in Asia-Pacific to hold interest rates steady in the near term and gradually ease in 2025.

The Asia-Pacific landscape is unique. Unlike the more homogenous North American and European markets, Asia-Pacific presents a complex tapestry of economic environments and policy approaches. This makes it difficult to identify consistent market trends and rendering broad investment strategies ineffective. Variations in interest rates across the region, ranging from marginal increases in Japan to steep hikes in markets like Australia, Hong Kong SAR, Singapore and South Korea, impact real estate values. However, this diversity presents numerous opportunities for investors looking to maximise returns.

The road to market recovery in the coming year promises to be uneven, reflecting the diverse market fundamentals. This inconsistency is particularly evident in the office sector, where a clear bifurcation is emerging. Return-to-office trends differ markedly between countries and even cities, influenced by local work cultures and government policies. Simultaneously, a flight to quality and increasing emphasis on green buildings are reshaping demand, with premium, sustainable office spaces outperforming their older counterparts.

However, we expect a return to normalcy as we progress through the second half of 2024. Expanding from our flagship Active Capital research, we examine the cross-border capital trends that are impacting commercial real estate in the Asia-Pacific region and search for investment opportunities. We expect the rate cuts to pave the way for cross border investments in Asia-Pacific to rise by more than a third in H2 2024 over H2 2023. Amongst the key gateway markets, Knight Frank estimates Australia to receive the highest cross-border investment volumes in the second half of 2024, representing a 129% pick-up from the same period a year ago. For the full year 2024, Australia, Japan and Singapore would clinch the top three investment destination for cross-border capital, with approximately 36%, 23% and 11% share, respectively.

Our Capital Gravity model forms one of the cornerstones of our Active Capital research, which offers a unique perspective on the global real estate investment outlook, from our forecasts of capital flows to our analysis of the most pressing strategic considerations.

Active Capital Asia-Pacific 2024

Source: Capital Gravity Model 2024, Knight Frank Active Capital Research

Highlight from this year's research

CROSS BORDER VOLUMES TO RECOVER BUT ONLY TO C. 60% OF 2021 PEAK LEVELS

With significantly lower office and higher logistics activity

THE OFFICE SECTOR IS EXPECTED TO ATTRACT

30%

OF CROSS-BORDER INVESTMENT VOLUMES

FOLLOWED BY THE LOGISTICS SECTOR 29%

TOP

DESTINATION FOR CROSS-BORDER CAPITAL

1	Australia	36%
2	Japan	23%
3	Singapore	11%
4	Greater China	10%
5	India	9%

Investment volume by property type

#1 Office

30% of all transaction volumes

- Second lowest since 2013 (2019 being the highest); only slight recovery from 2023
- Australia and Japan are forecast to experience a rebound with full year volumes almost doubling from 2023
- Singapore should also receive around 15% more volume this year than 2023
- Greater China could see significantly lower volumes in 2024 than previous years
- India could also see a softer 2024

#2 Industrial

29% of all transaction volumes

- Recover to 20% below 5-year average (2018-2022)
- Greater China volumes to fall over a third year-on-year in 2024 to its lowest since 2018
- India could see second best year on record
- Japan inbound on par with the last two years
- Activity in Singapore to pick up above long-term average, similar to 2017/2018 peaks
- South Korea activities to return but not to long term levels

#3 Living

18% of all transaction volumes

- Recovery to above 5-year average (2018-2022)
- Top locations are Japan, Australia and Greater China respectively
- Australia could see second best year on record
- India to record smaller ticket sized deals but could be best on record

#4 Retail

13% of all transaction volumes

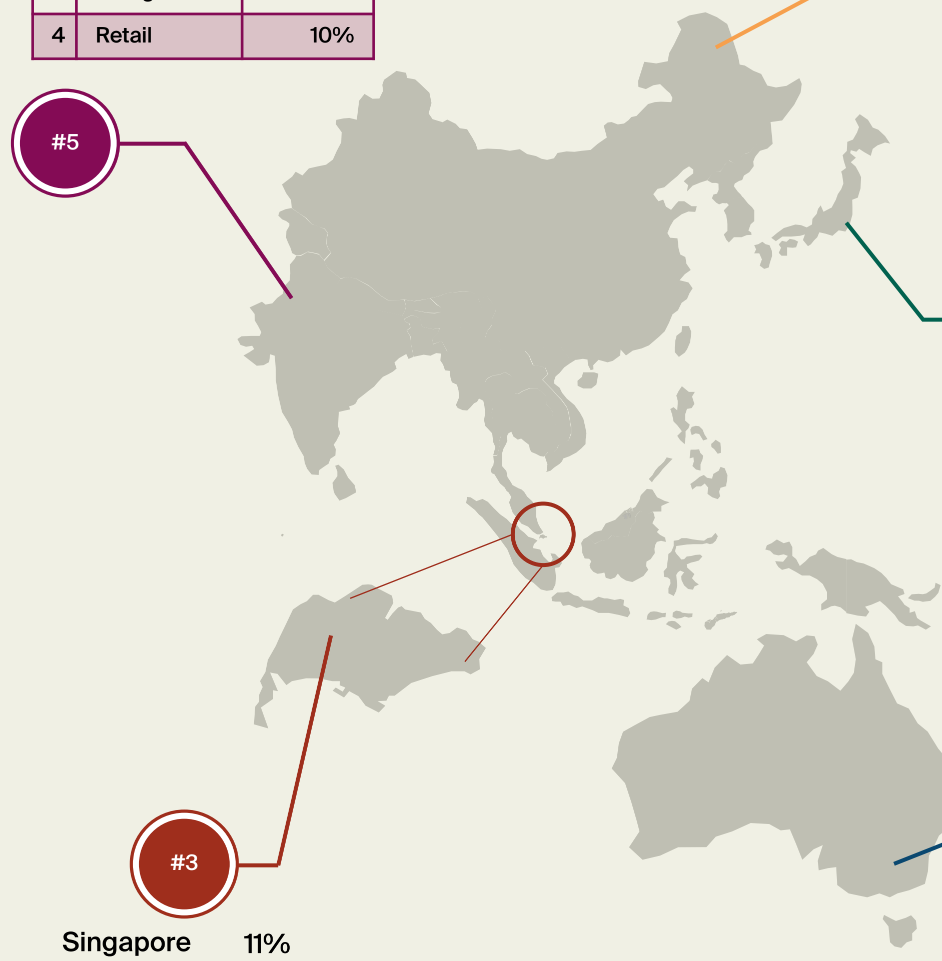
- Second best post-2020
- Capital flowing to Australia, Japan & Singapore
- Australia should see volume above the long-term average (best since 2018)

#5 Hotel

10% of all transaction volumes

- Best year since 2019
- Capital flowing to Australia, Japan, Greater China, South Korea and India

Top five markets



India 9%

1	Office	36%
2	Industrial	30%
3	Living	15%
4	Retail	10%

Greater China 10%

1	Industrial	31%
2	Office	26%
3	Hotel	16%
4	Living	13%

Japan 23%

1	Living	29%
2	Industrial	24%
3	Office	20%
4	Hotel	12%

Singapore 11%

1	Office	48%
2	Industrial	31%
3	Retail	19%
4	Hotel	2%

Australia 36%

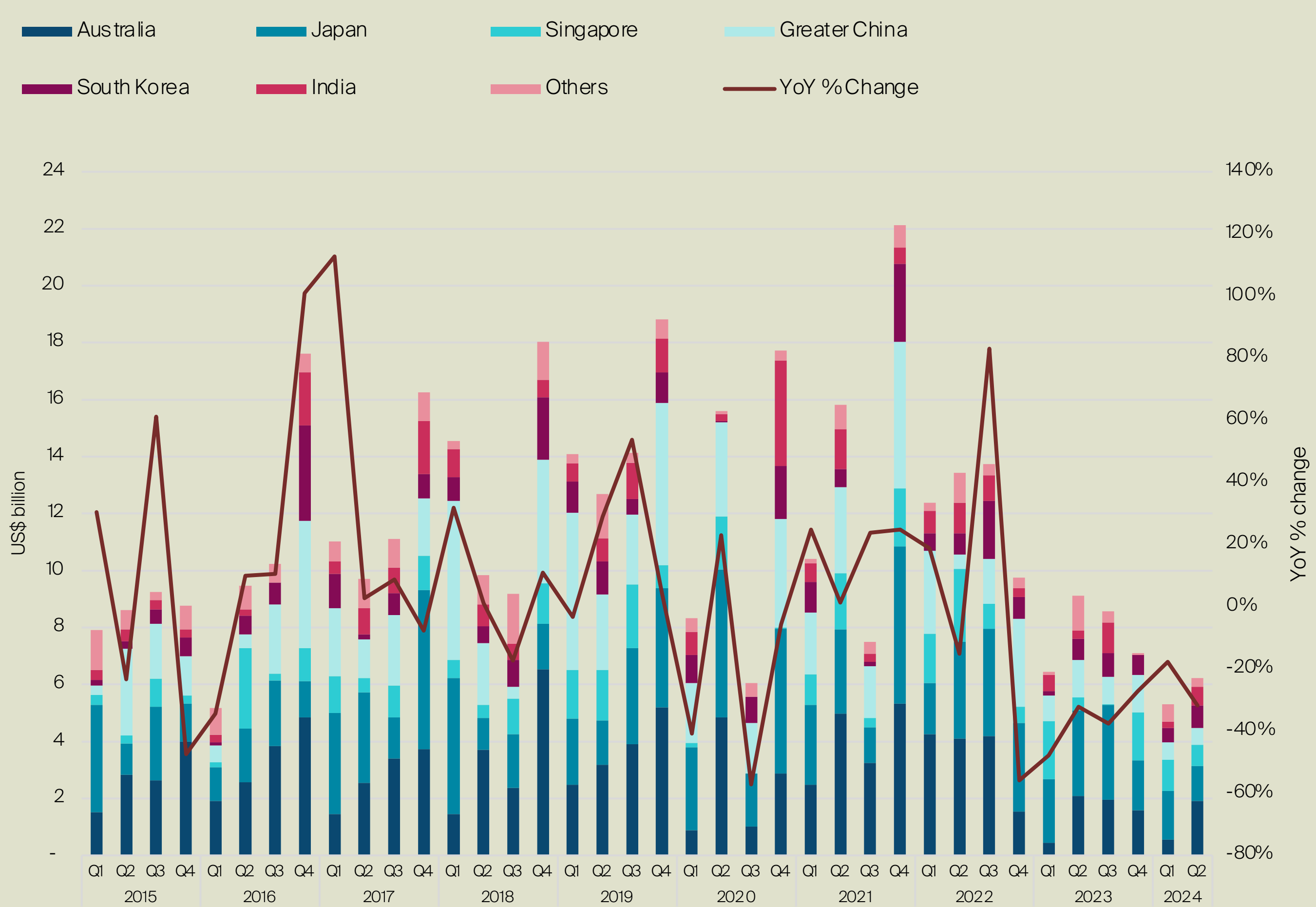
1	Office	27%
2	Industrial	27%
3	Living	20%
4	Retail	16%

Asia-Pacific top destinations

Cross-border investments have experienced a harsh retreat since interest rates started to hike aggressively in the second half of 2022. With yields not expanding fast enough, and assets still being repriced, investors exercised caution and adopted a circumspect approach by focusing on opportunities within their national boundaries rather than pursuing ventures in foreign markets.

Cross-border transactions in Asia-Pacific recorded US$6.2 billion in Q2 2024, an encouraging 17.4% increment compared to the quarter prior, according to data from MSCI Real Assets. Although it is still nearly one-third lower than the same period in 2023 (see Figure 1), the rate of decline is slowing down, which is an early sign that we are approaching the bottom.

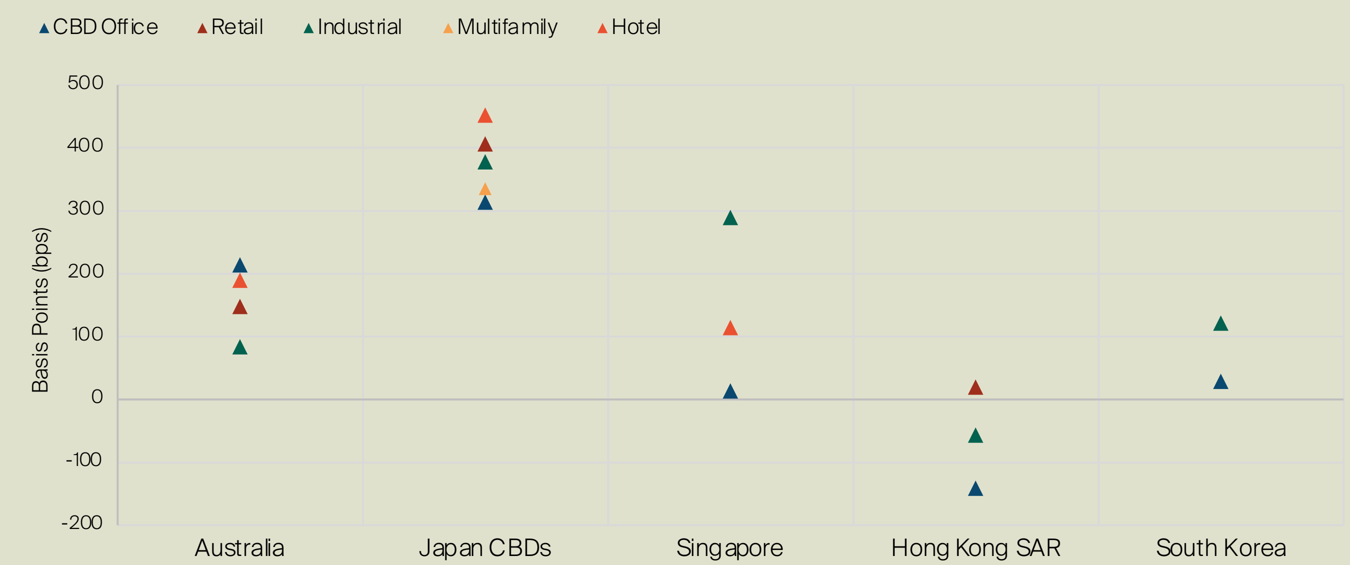
Figure 1: Cross-border volume



Source: MSCI Real Assets, Knight Frank Research

Data download as at: 15 July 2024; Inclusive of pending deals/excludes land

Figure 2: Yield spreads of key markets in Asia-Pacific



Source: MSCI Real Assets, Knight Frank Research

Data as at 15 July 2024

Asia-Pacific top destination: #1 Australia

Quiet market poised for swift rebound?

Deal flow remains generally constrained due to postponed rate cuts and a persistent price disparity. However, the withdrawal of overseas investors is most apparent in Australia compared to other key markets in the region. Throughout 2023, cross-border volume more than halved (56.8%) that of 2022, suggesting much resistance to deploying capital into the fastest repriced market in Asia-Pacific. However, since Q2 2024, cross-border capital has returned, with deal momentum gaining traction, supported by several high-profile transactions.

Q2 2024 clocked US$1.9 billion worth of international capital, 2.5 times that of Q1 2024 volume but still 8.5% lower than Q2 2023. Of this, 63% of total transactions can be attributed to the office sector. In June, Mitsui Fudosan acquired a 66% stake in 55 Pitt Street for US$879.4 million, continuing a trend that has made Australian commercial property assets the top target for Japanese investors. Japanese firms, well-capitalised after earning record profits due to the weak yen and low borrowing cost, remain eager to find higher-yielding assets overseas. This trend hit a record US$1.9 billion in 2023.

Although progress is being made on narrowing the price gap, it is still insufficient to encourage more deal completions. Factors such as uncertainty over rate cuts, slow adaptation to current pricing, and a lack of indicative deals reflecting present values impede deal completions. However, relatively speaking, the assets in Australia appear more attractive due to higher-than-average re-pricing compared to the rest of the region.

Asset class trends

- Industrial sector continues to be Australia's most favoured stabilised asset class, due to its relatively low risk with long term growth potential. Yields appear to have stabilised, averaging 5.5% to 6.4%, suggesting that pricing adjustment is probably completed. Institutional investors are likely to return to the market to capitalise on this stability. Based on Knight Frank's estimates, we expect the annual industrial transaction volume to be on par with office volume.

- Office sector is anticipated to see stabilisation in yield in H2 2024 after substantial repricing and two years of yield softening. As transactional evidence accumulates and heightened investor confidence spurs increased market participation, liquidity in the office market is gradually improving, with more office transaction volumes expected over the coming months.

- Living sectors retain substantial interest, but attention shifts towards co-living and purpose-built student accommodations (PBSA) due to rising construction costs, and a lack of clarity of proposed tax reform, rendering build-to-rent (BTR) less appealing. Find the complete analysis of the Australian living sectors on page 22.

- Retail sector attracts renewed institutional interest due to adjusted pricing, positive spreads, and limited core supply.

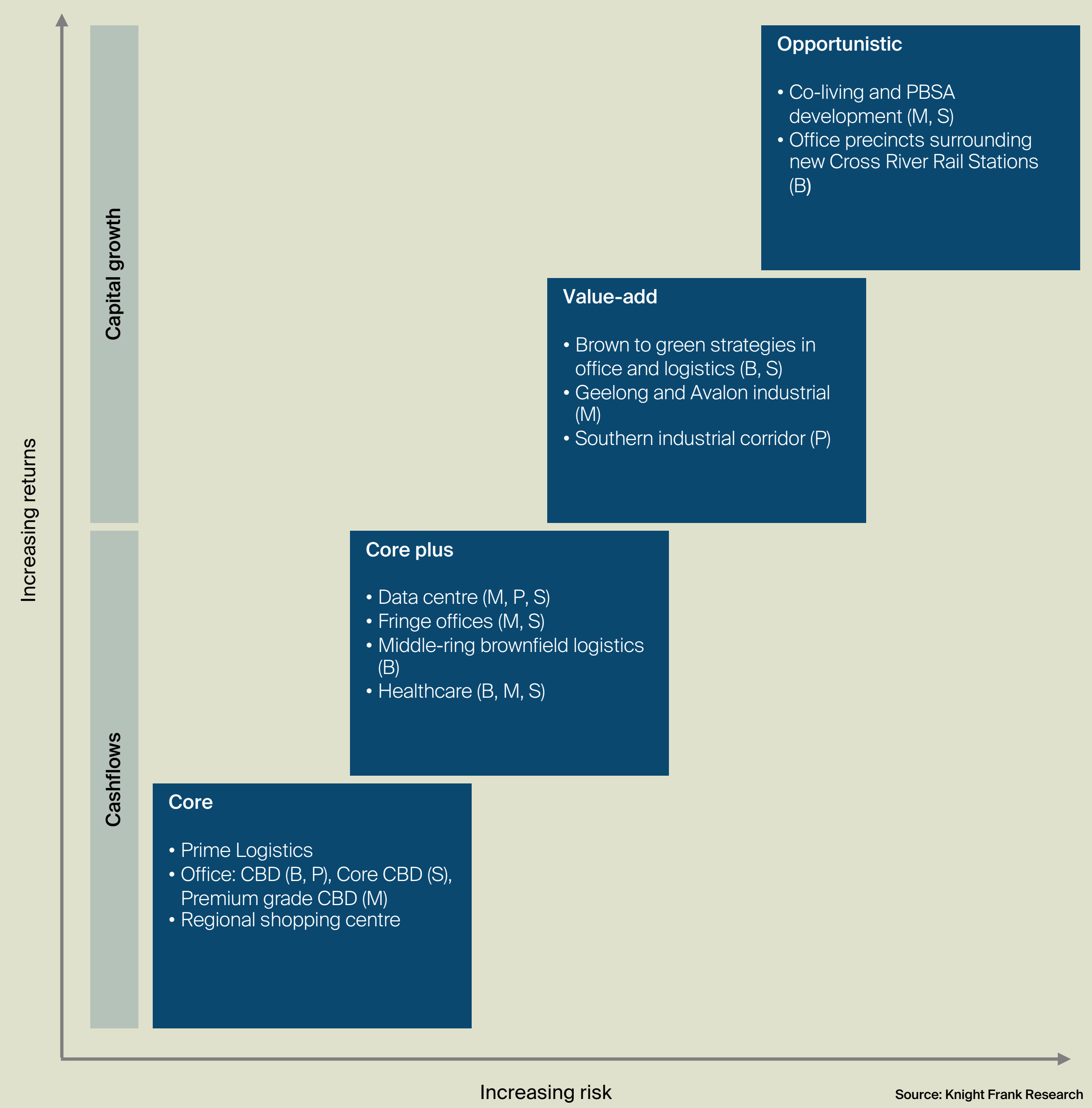
Outlook

Knight Frank's research predicts that 36% of the cross-border capital targeting Australia will make it the top cross-border destination in 2024 among APAC markets. Despite muted sentiments in the first half, the second half will likely witness a narrowing bid-ask spread, which would encourage dealmaking. A higher number of assets in the pipeline have been actively marketed, exceeding expectations. For instance, Woolworths Distribution Facility (Mulgrave), 40 Miller Street, 383 La Trobe Street and 367 Collins Street are expected to close in the coming quarters.

Sydney's well-established CBD office precincts have yielded several core opportunities with its high-quality prime assets. This has made the city's offices the top targeted asset type by cross-border capital year-to-date in 2024. Australian offices, which have been the quickest to adjust prices in the region, have appealed to investors looking for yield-accretive acquisitions. Australia's transparent property markets and robust economic fundamentals will remain a draw for international capital.

The following six to nine months offer a prime investment window for undervalued assets; cautious buyers should note that owners' price recovery optimism may limit future acquisition opportunities as the latter holds onto their assets in anticipation of a turnaround.

Investment strategy for Australia – Brisbane (B), Melbourne (M), Perth (P), Sydney (S)



Source: Knight Frank Research

Asia-Pacific top destination: #2 Japan

A bright spot among key markets

Japan has consistently been a strong performer globally despite a challenging investment landscape ever since interest rates rose aggressively. The proportion of Japanese transactions in region rose steadily from 18.9% in 2021 to 25.4% in 2023. Even after the marginal rise in short-term interest rates in March 2024, it had little to no effect on dampening market sentiments, particularly amongst domestic investors. However, cross-border activity has been restrained due to reduced confidence within this group and elevated global interest rates. Against a high base in Q2 2023, which was bolstered by several high-profile portfolio deals and large ticket assets, investment volume recorded by overseas buyers contracted almost 60% in Q2 2024 to US$1.2 billion.

Nevertheless, international investors are gradually re-entering the Japanese market, capitalising on favourable long-term prospects. This is most evident in established players seeking opportunities in prime locations and high-quality assets where they offer a stable yield spread. For instance, BentallGreenOak acquired Honmachi Garden City in Osaka, a mixed-use building, from Sekisui House REIT for US$422.9 million in May 2024, representing a 3.0% cap rate for the hotel component and a 3.4% cap rate for the office component.

We expect 23% of the total cross-border flows to target Japan in 2024.

Asset class trends

Living sectors remain of interest to investors, but cap rate compression has led to investors being highly selective in multifamily asset acquisitions. Some investors have also started to explore opportunities in the senior living sector, capitalising on the country's demographic shift.

- Office sector is seeing a recovery with fundamentals strengthening, driven by positive shifts in demand and the resurgence of expansion efforts among domestic companies. This confluence of factors creates optimal acquisition opportunities for investors.

- Industrial sector is being reshaped by the upcoming labour law changes aim at improving truck driver welfare, potentially leading to increased demand for modern, quality logistics facilities in prime locations. On the other hand, facilities with poor specifications that are struggling to secure tenants provide some value-add opportunities.

- Hotel sector is experiencing positive momentum due to strong inbound tourism numbers and the yen's continued weakness, generating increased interest from institutional investors. Some investors adopting value-add or opportunistic strategies also convert hotels to multifamily to gain exposure to the niche sector.

Outlook

Japan remains a safe spot for global capital due to the Bank of Japan's cautious approach. The Central Bank monitors market conditions, prioritising sustainable wage growth and moderate inflation before significant rate hikes. A short-term 10-30 basis point rise is possible with minimal impact on value-add players. However, should long-term interest rates hike further, investors may demand higher cap rates, leading to more pronounced discrepancies in bid-ask spread and reduced liquidity.

Asia-Pacific top destination: #3 Singapore

Magnet for private capital

Impeded by weak market momentum, investment activity in the city-state continues to record lacklustre performance. Although both domestic and international investors retreated, the proportion of cross-border capital remains substantial at 48% in H1 2024, higher than the 10-year average of 43%, suggesting that Singapore continues to attract significant cross-border.

Total cross-border volume captured amounted to US$756.8 million in Q2 2024, largely supported by PAG's acquisition of Mapletree Anson, an office building, from Mapletree Pan Asia Commercial Trust at US$567.5 million. While this marked a quarterly decline of 29.7% investment activity vastly increased by 63.8% against the same period a year ago.

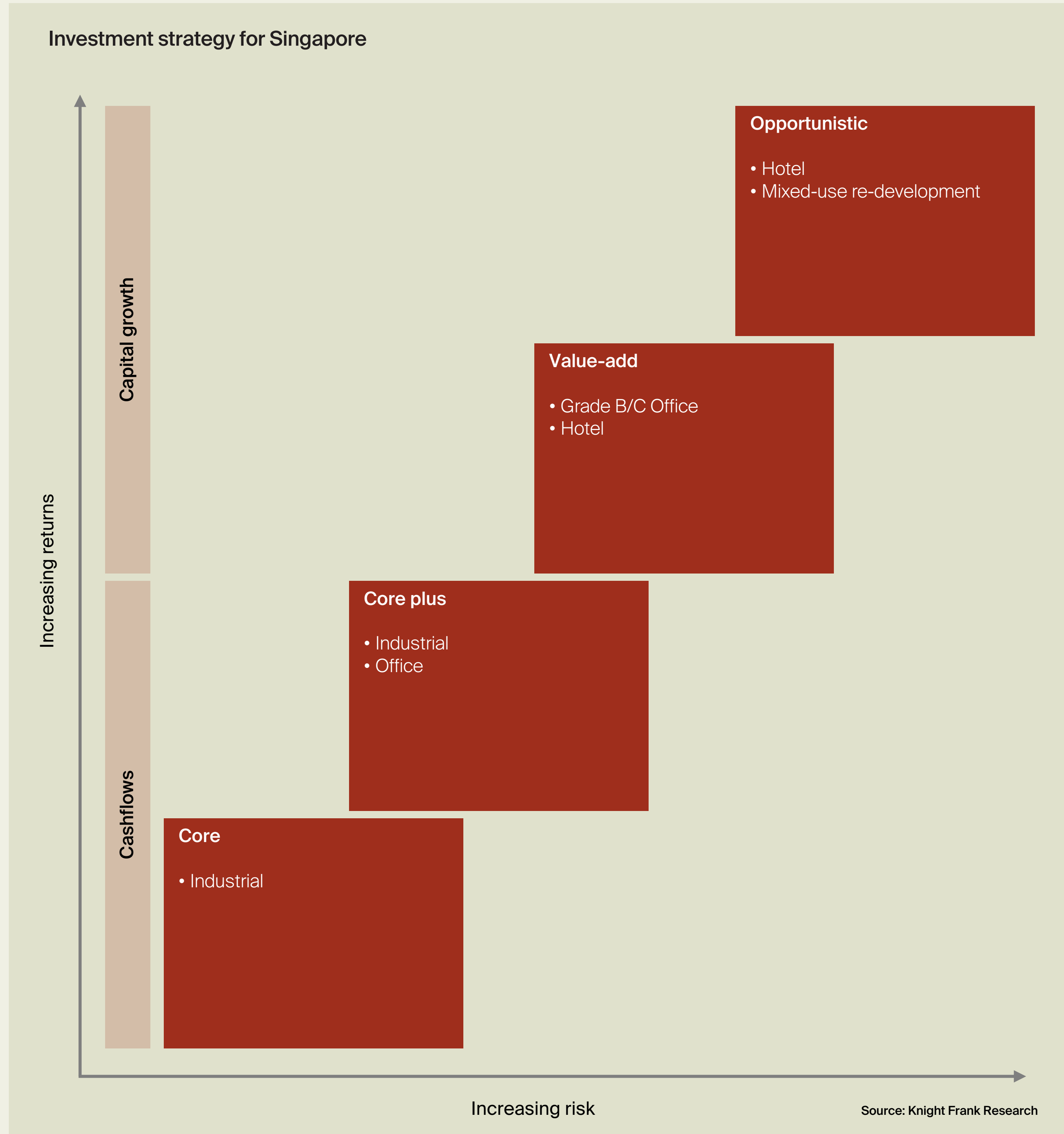
Interest in the country's real estate assets can be attributed to its macroeconomic stability, business-friendly environment, and politically neutral stance, which persistently instil confidence in investors to achieve portfolio diversification and wealth preservation. This puts Singapore at third place in capital flow predictions for the Asia-Pacific region in 2024, attracting about 11% of the cross-border capital.

Asset class trends

- Office sector will benefit from gradually improving financing conditions and easing constraints on occupier Capex. The previously restrained demand for occupying space may steadily return to the market, presenting an attractive investment opportunity with the potential for consistent rental income and stable occupancy rates for investors.
- Industrial sector remains a focal point for investors due to its relatively higher yields and positive long-term outlook. Assets with value-add potential are particularly enticing, especially those that cater to emerging industries like self-storage, cold chain, and data centres.
- Retail sector, especially suburban malls in prime locations, maintains its appeal due to stable rents, steady foot traffic, and sustained demand from retailers seeking to capitalise on these factors to carry out expansion plans.
- Hotel sector presents value-add opportunities through strategic partnerships between investors and developers to improve or redevelop assets for higher yields and capital appreciation. The government's ongoing dedication to realise the Tourism 2040 vision is boosting hotel demand.

Outlook

Despite tight yield spreads and high borrowing costs, Singapore's real estate market continues to attract investors due to the nation's reputation as a safe haven, robust fundamentals, and sustained rental growth in a slowing economy. Given the timing of the Fed's potential rate cut in the second half of 2024, we expect a resurgence of investor interest, further strengthening the market's appeal, especially for private capital.



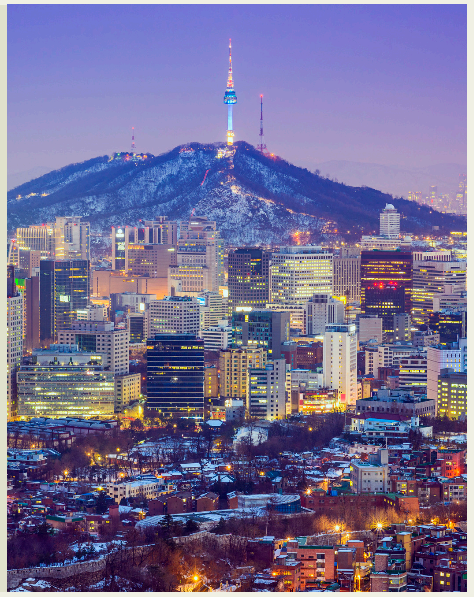
Other bright spots in Asia-Pacific: South Korea and Hong Kong SAR

South Korea's appeal

Undeterred by the higher cost of capital, overseas investors are actively acquiring office assets, leveraging on the sector's solid fundamentals in the occupying space. Similarly, the hospitality and industrial sectors are experiencing increased activity as yield expansion starts to moderate.

As the Bank of Korea starts reducing interest rates in H2 2024, bid-ask spread, and liquidity should improve. With more assets expected on the market, coupled with the favourable environment, transaction volume should see a boost throughout 2024.

On the other hand, the sharp repricing of office assets in the USA and Europe has prompted Korean asset owners to assess various exit strategies, with a stronger preference for refinancing over divesting. This then presents opportunities in the debt market. Uncover more insights on page 21.



Pockets of opportunities in Hong Kong SAR

Challenges lingered in the Hong Kong SAR commercial real estate market as sluggish leasing activities persisted. The office sector is particularly concerning, with rising cap rates and an increasing pipeline leading to oversupply.

However, prime office assets with cutting-edge facilities and green credentials aligning with the 'flight to quality' trend still appeal to investors, especially with valuations declining up to 35% from their peak.

As investment sentiment improves due to a potential US interest rate cut and stock market recovery, it is likely to stimulate a surge in demand for distressed assets as investors seek undervalued opportunities to capitalise on market improvements. Access additional insights on page 25.

Shifting landscapes: unfolding trends

Real estate: a safe bet for private wealth in uncertain times

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The current financial market is facing increased volatility due to sticky inflation, elevated rates, and geopolitical uncertainties. Although the 60-40 strategy has historically provided an 8% return for private wealth investors, generating similar returns in the coming years might require diversifying into alternative asset classes with a low correlation with equity and bonds. We saw that growing private wealth investors are reassessing their portfolios in this new regime, and many are considering real estate to be a compelling source of risk-adjusted returns, income, and diversification.

Over the past 24 months, private capital has become a major driving force behind real estate investment. High-Net-Worth-Individuals (HNWIs) in the region significantly increased their investment in commercial real estate in 2023, reaching US$4.4 billion, up from US$2.2 billion in 2022, in contrast to the global investment volume decline to almost a 10-year low. However, with headwinds continuing to brew, investments by HNWIs only recorded approximately US$460 million in the first six months to June 2024, plunging almost 60% from the same period prior.

Capital preservation still key

As reported by **Capgemini**, HNWIs have increased their cash holdings to a multi-decade high of 34% in 2023, significantly above the long-term average of around 25%. This trend suggests a shift in investment focus among private wealth investors toward capital preservation rather than the aggressive pursuit of high yields. Although wealthy investors and family offices, with ample capital and low reliance on debt financing, have benefited from reduced competition in the last 24 months as institutional investors retreated, they remain cautious in the face of volatility. Despite their competitive advantages, private wealth investors prefer to adopt a wait-and-see approach during periods of market uncertainty.

Most cross-border investments executed by Asia-Pacific HNWIs have predominantly remained within the region. From 2022 to 2023, Singapore outshined the rest of the region with over 50% of total intra-regional capital allocated, followed by Hong Kong SAR at 28.5%. Regarding investment allocations, the conventional offices remain the majority. However, opportunistic investments in the living and hospitality sector are riding on the structural undersupply amid construction delays and revenge travel. In Singapore, we also saw the rise of shophouse transactions, an asset class unique to HNWIs for wealth preservation.

There are also allocations to the UK and Switzerland, favoured by HNWIs due to their safe haven status and a good window of opportunity to secure some assets at attractive valuations. Below are the latest trends in the private wealth space that have emerged:

Student accommodation sector

This sector is particularly appealing due to its reliable cash flow, primarily driven by upfront student payments for almost the entire academic year. For Hong Kong SAR, the doubling of quota from 20% to 40% for non-local students at universities for this coming academic year further enhances its lure.

Cross-border investments

There is a strong interest in diversifying portfolios internationally, with Hong Kong-based family offices exploring opportunities in London's residential market despite current yields being outweighed by interest rates.

Interest in Japan

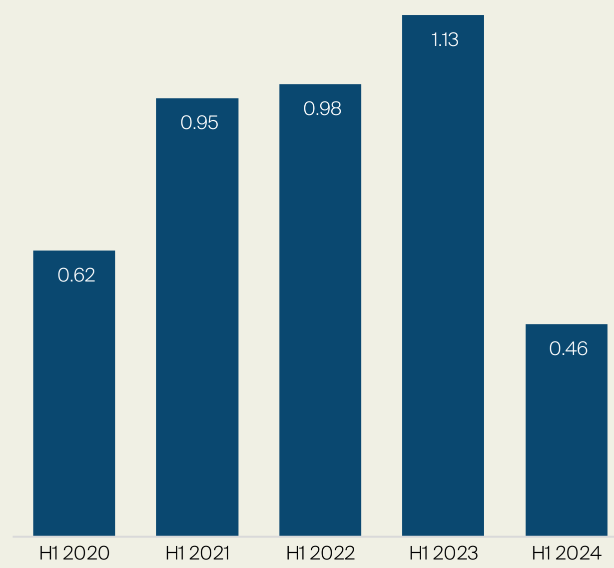
Japan, especially in areas like Niseko and Tokyo, is a popular investment target. Investors are interested in residential properties and land, with Tokyo's prime residential prices being driven by high demand from cross-border investors from Greater China and Singapore.

Australia and New Zealand

There is growing interest in these markets, particularly in Sydney and Brisbane, focusing on the living sector and BTR properties. Farmlands are also being explored, though these are often more personal than investment-driven. Many of the products from crop land, such as food, are also tied to inflation, which could outperform the broader market if inflation rates remain stubborn.

Given the USA's mixed signals regarding the rate cut timeline and evolving geopolitical instabilities, private wealth investors are seen as more risk-averse. They are leaning towards regarding the rate cut timeline and evolving geopolitical instabilities, private wealth investors are seen as more risk-averse. They are leaning towards secure, long-term investments that emphasise cash flow and downside resilience for wealth preservation. While real estate investments continue to appeal to private wealth investors, asset owners may need to offer deep discounts to attract private capital.

Figure 3: Asia-Pacific HNWIs total investment in H1 2024 (US$bn)

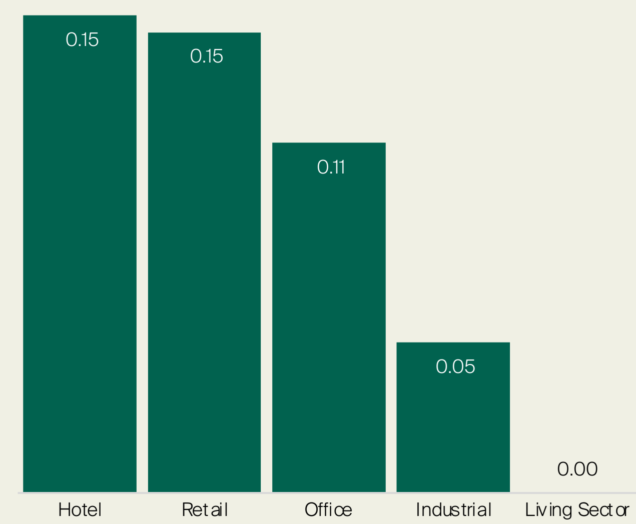


Source: MSCI Real Assets, Knight Frank Research | Data as at 15 July 2024

% change vs H1 2023

▼ 59.3%

Figure 4: Asia-Pacific HNWIs investment by sector in H1 2024 (US$bn)



Source: MSCI Real Assets, Knight Frank Research | Data as at 15 July 2024

% change vs H1 2023

▲ 43.6%	▼ 27.3%	▼ 43.9%	▲ 126.1%	-

Case Study (Inbound Capital)

70,71 and 72 Duxton Road

Type	Shophouse
Market	Singapore
Date Completed	February 2024
Previous Transacted Price	SG$22.2 million (US$16.4 million)
Current Transacted Price	SG$45 – 50 million (US$33 – 37 million)
Cap Rate	NA
Buyer	Zhang Ying
Seller	An entity linked to a Singapore-based property investment group

Acquisition/ Divestment Motivator

Zhang Ying, a Singapore citizen, and the wife of Alibaba Group co-founder Jack Ma was reported to have bought three adjoining shophouses on Duxton Road in the Tanjong Pagar area, in Q1 2024. She paid about SG$45 – 50 million (US$33 – 37 million) for 70, 71 and 72 Duxton Road. This translates to around SG$4,200 – 4,600 (US$3,100 – 3,400) per sqft on the estimated built-up area. The properties are on commercial-zoned sites with 99-year leasehold tenures that started from September 1988, leaving a balance term of about 63 years.

Located in the Tanjong Pagar Conservation Area, the three shophouses have three floors and an attic each and are sited on a total land area of 3,239 sqft. The total built-up area of the shophouses are estimated to be 10,700 sqft.

Prices of shophouses in Singapore have risen significantly since the pandemic in 2020, and buyers are beginning to resist improbable price premiums within the wider context of the elevated borrowing environment and business uncertainty in 2024, despite demand being intact.

Nevertheless, shophouses are a limited historical asset without any new supply. This typically leads to capital appreciation over a medium- to long-term investment horizon. The combination of shophouse areas that have been gentrified and those that are in the process of being gentrified alongside modern buildings in Singapore's urban landscape will continue to churn the diverse mix of human and business activity that support demand for shophouses.

Rising rates impact Asia-Pacific real estate lending

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The real estate debt market has significantly changed in recent years as domestic banks across the region review their exposure in the sector alongside the growth of private credit funds seeking equity-like returns in the current high interest rate environment. Australia is demonstrating potential as one of the most promising markets in the region, with non-bank lenders representing approximately 16% of the real estate lending market. This market share is projected to increase by up to 25% in the next 10 years as the Australian funding market begins to resemble that of the US and Europe, where non-bank lenders play a much more significant role.

Recent market themes, most notably a significant rise in interest rates and a gradual return to office work after the post-pandemic, have resulted in real estate assets globally experiencing adjustments in pricing. These same factors have also affected how lenders evaluate new opportunities and review existing loans. In the current market, lenders are taking a more cautious approach, mainly focusing on interest coverage and carefully examining business plans to ensure that value is either protected or enhanced over a loan term.

Minding the gap

Since interest rates began rising globally in 2022, the funding gap has been a major topic in every real estate market. This is caused by decreasing property values and lower loan amounts available for refinancing due to restrictions on debt serviceability. The impact in the Asia-Pacific region is anticipated to be less drastic than the effects felt in the USA and Europe.

In the past 12 months, capital raising for non-bank lenders has remained strong globally, outperforming traditional direct real estate strategies as investors seek protection further down the risk curve while still achieving attractive returns.

Strong buying opportunities

Looking ahead, the forward projections for interest rates across Asia-Pacific, while starting from different points, show a relatively uniform projection. The 3-and 5-year swap rates (typical tenors for real estate investment loans) in key markets show only a modest reduction in rates and support the narrative of higher for longer interest rates. As we have seen in 2024, decision-making and the consideration of rate cuts can change quickly based on key economic data. If inflation figures continue to improve, the timing of future cuts will change again.

The current market arguably presents a strong buying opportunity. This is especially true when asset pricing accurately reflects swap rates and forward projections, resulting in investor returns that outperform those of lenders. There is also potential for significant value creation once the cycle of rate cuts begins.

As for the non-bank lending space, we anticipate more lenders will secure sources of capital seeking core returns and be able to provide senior lending facilities capable of competing with domestic and international banks. This theme has been seen in Europe and the USA. This will increase the depth of the lender pool across Asia-Pacific and provide greater choice to borrowers seeking loans with greater flexibility alongside competitive pricing.

Australian living sectors hold promise for patient investors

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With living sectors emerging quickly in Australia and encompassing several distinct asset types, the challenge has shifted to execution. Severe undersupply in residential markets and a thin apartment development pipeline provide fertile ground for the expansion of living sectors through a sustained supply-demand imbalance driving rental growth. Still, myriad cost pressures on developers are slowing the pace of delivery.

Build-to-rent (BTR) has led the way and has the greatest potential to scale up over the long term, but high funding costs, the rapid escalation of construction costs and a lack of clarity over the implementation of long-awaited managed investment trust (MIT) reform are all making it difficult to underwrite new developments.

These factors are slowing the pace of BTR expansion, which will lead to greater segmentation in investment strategies. While larger global investors with a relatively low return hurdle will continue to prioritise BTR, investors seeking higher returns will gravitate to other asset types, including co-living and student accommodation.

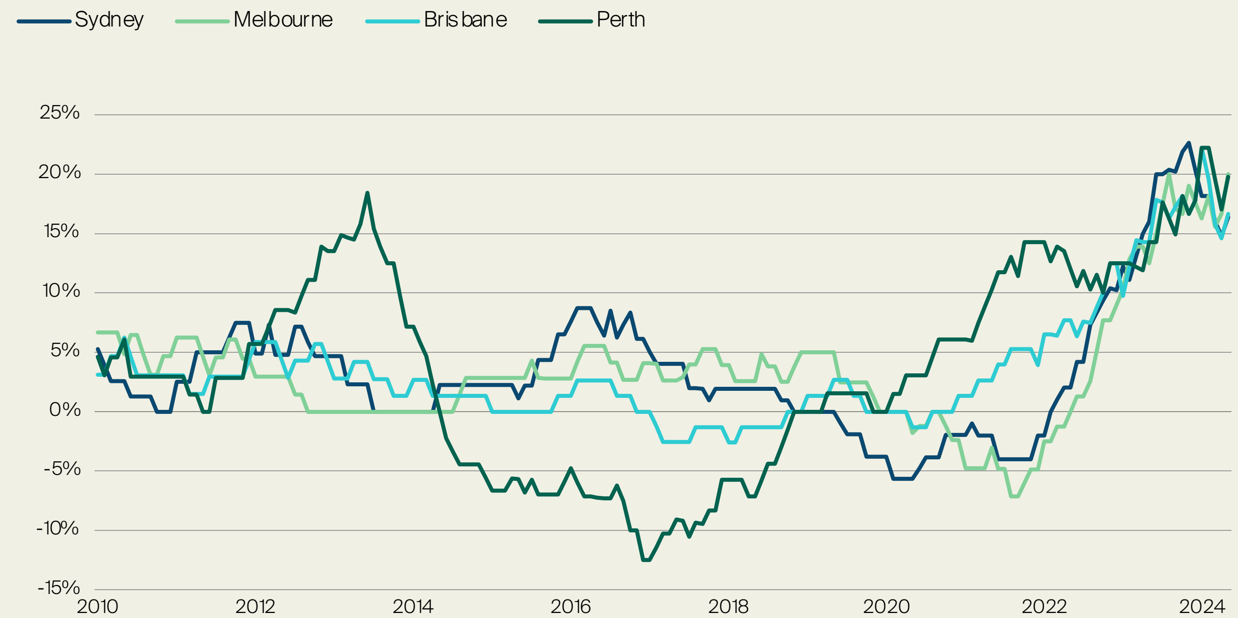
Co-living/PBSA offers better traction

Co-living development sites need not be as large as sites for BTR, and the current market is small and fragmented, offering significant opportunity to capture latent demand for a new product type geared towards shorter stay rental accommodation. Investors can leverage off the same demand and supply thematic driving BTR, but in an alternative form that offers greater flexibility, the ability to invest at smaller scale and within the commercial residential planning framework that avoids the GST and MIT complications that can impact the feasibility of BTR.

The student accommodation sector is also in focus, prompted by the rapid expansion in international student numbers. Higher education commencements rose to record levels amidst a wider surge in migration post-pandemic. This has sharpened the focus on students' contribution to high overall migration levels, and the government recently flagged the introduction of caps on student numbers.

While at face value, this appears to reduce demand; the cap is intended to be implemented flexibly alongside a requirement for universities to develop new student accommodation should they wish to increase enrolment above a given allocation. Given the prospect of an explicit link between demand and supply, this is likely to add impetus to the sector and generate significant opportunity for investors in years to come.

Figure 5: Annual growth in median asking apartment rents per week



Source: Knight Frank Research, CoreLogic

Case Study

Type	Build-to-Rent (BTR)
Market	Australia
Date completed	May 2024
Capital partnership	Up to AUD$1,500 million
Parties	apt. Residential & PGGM

Acquisition/ Divestment Motivator

Sydney-based investment manager apt.Residential has formed a long-term partnership with PGGM Private Real Estate Fund, managed by the Dutch pension investor PGGM, for a programmatic roll out of Build-to-Rent developments in Australia. With an initial focus in Sydney, the objective of the partnership is to develop and invest up to $1.5bn in a large-scale portfolio of institutional rental properties.

Phase one of the partnership will aim to develop over 2,500 BTR apartments, bringing forward much-needed new supply in employment and education hubs, developing convenient community amenity, and providing turnkey solutions that serve those with more transient housing needs.

The partnership will prioritise sustainability in the design, delivery and operation of the new communities and is targeting 5-Star Green Star performance, 7+ star NatHERS, 100% electric residences as well as Net Zero in operations, powered by 100% renewable energy.

The first project has now been launched – a $280m mixed-use BTR precinct in Sydney's Meadowbank. With a pre-approved development application, the apt.Meadowbank scheme will deliver a range of 291 studio, one-, two-, and three-bedroom fully furnished and unfurnished apartments for long-term renters across four low-rise buildings.

Rising from the trough: value office is emerging

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Over the past two years, office markets globally and in Asia-Pacific, particularly Australia and Hong Kong SAR, have been exposed to the combination of higher interest rates and uncertainty over the long-term impact of changing workplace strategies. Pricing has had to adjust, and liquidity has been restricted, with the market characterised by a prolonged impasse between purchaser and vendor expectations.

Finally, however, some of the key pressures impacting the market are showing signs of easing. Firstly, the global interest rate cycle is starting to turn. Europe and Canada have already started the path down, and the USA is expected to follow later in the year. In Australia, since the cash rate was not raised as high as in many comparable economies, the Reserve Bank of Australia (RBA) is likely to wait longer, but the consensus outlook is for significant rate cuts by the end of 2025.

Hong Kong SAR's office market: discount deals spark investor interest

In the Hong Kong SAR office market, muted occupier demand, coupled with record supply that could take years to absorb, is hitting a market that is barely recovering from the pandemic's onslaught. The prolonged elevated interest rates as been the last straw that broke the camel's back. The office market has been hammered and will continue to be heavily discounted in the foreseeable future.

Significant 'peak-to-trough' discount deals have been recorded. For instance, the entire 29th floor of 9 Queen's Road Central, with 13,769 square feet (sqft), was sold for approximately HK$310 million (US$39.6 million), or HK$22,514 (US$3,812) per sqft, in May 2024. This marked a 63% discount compared to the peak unit price of HK$60,000 (US$10,159) per sqft back in 2018. These discounts have incentivised investors to explore office market deals. Consequently, the market has seen a surge in distressed sales, especially of en-bloc office buildings.

Besides Hong Kong SAR, the Australian office markets have also seen office values decline.

Australia's office sector: adjusting pricing and improving outlook

By the end of Q1 2024, reported book valuations in Australia have fallen by an average of 14% since their peak. While recent market evidence suggests that the adjustment still has further to go, the gap between valuations and buyer sentiment has narrowed.

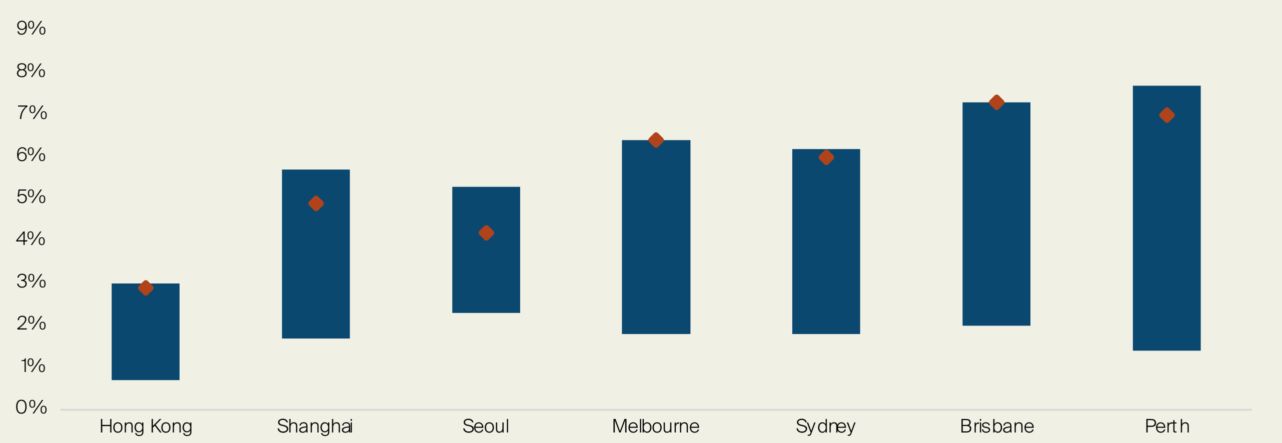
The outlook for relative returns across asset classes is also shifting back in favour of offices. During 2023, few were willing to deploy additional capital to the sector, but as pricing adjusts, the outlook is starting to look much more favourable on both an absolute and relative basis. Substantially higher cap rates now, in evidence, mitigate against near-term risks and pave the way for strong risk-adjusted returns over the long term.

All of this will start to entice investors back. After an extended period of inactivity, major domestic institutions and cross-border investors will be reappraising the outlook, and some will choose to flick the switch back to acquisition mode. In addition, pent-up demand from both investors and vendors to trade and reposition their portfolios continues to build, and as the level of uncertainty around the outlook eases and downside risks dissipate, a deeper pool of assets will come to market.

History suggests that office markets can move quickly and that the best buying often comes hot on the heels of a downturn, as evidenced by the returns generated by the early movers who shifted into acquisition mode immediately post-GFC in late 2009.

The storm has not yet passed, but the worst is over, and investors should be gearing up for the next chapter.

Figure 6: Selected Asia-Pacific prime office yields



*10-year historical
Source: Knight Frank Research

◆ 2Q24 ▬ Min-Max Range*

Note: as of 15 Jul 2024

Case Study

Bank of America Tower

Type	Office
Market	Hong Kong SAR
Date Completed	April 2024
Previous Transacted Price	US$90 million in 2018
Current Transacted Price	US$32 million
Cap Rate	2.5% to 3%)
Buyer	Sino Land related
Seller	Shandong Ruyi Group

Acquisition/ Divestment Motivator

An entire 23rd floor of Bank of America Tower, a prime Grade A office building in Admiralty, Hong Kong Island, has been on the market for over a year. The property enjoys easy access to both Admiralty or Central Station in Central's financial business district. In April 2024, it was sold for HK$250 million (US$32 million) to Sino Land's family, with an extremely attractive unit price of HK$18,000 (US$2,368) per sqft. This was the lowest price per sqft for the building in nearly 14 years, a significant depreciation of about 64% compared to the owner's original purchase price six years ago.

The transaction, which included three parking spaces, offered a gross area of approximately 13,880 sqft. After becoming a distressed property in October 2022, it was put on the market with an asking price of HK$500 million (US$64.1 million), or HK$36,000 (US$4,615) per sqft, for vacant possession. Yet, it did not receive any offers from buyers until recently.

Market information shows that Forever Winner International Development Limited was the original registered buyer. The company's directors include Qiu Yafu and Qiu Chenran. Qiu Yafu is a Chinese textile tycoon and the Chairman of Shandong Ruyi Group, and Qiu Chenran is his daughter. He has been facing financial difficulties in recent years, and Trinity Limited, a listed organisation under him, has also been suspended from the Hong Kong Stock Exchange in October 2022.

Macro shift sets tone for Japanese activity

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By raising borrowing rates in March 2024, the Bank of Japan simultaneously unwound its negative interest rate policy and hiked for the first time in 17 years, ending a legacy that stretched back to the Lehman fallout in 2008.

Japan's annual spring wage talks in 2024 also concluded with its top companies agreeing to pay rises averaging 5.6%, according to preliminary data released by Keidanren – the country's business lobby group. The result exceeded last year's increase of 3.9% and topped 4% for the first time since 1992.

Japan's renaissance

The shift in the macro landscape heralds a new era for Japan, marking significant progress after enduring a prolonged period of economic stagnation and deflation. The economy, moving to a situation where inflation, interest rates and wage growth are all rising, will catalyse substantial investment opportunities.

Free of the deflation that has held the country back since the turn of the century, household and institutional investors will feel compelled to build themselves a hedge against rising price levels. And the outlook has never been firmer. With a deepening labour crunch, the largest wage increases in over 30 years could still go higher, which burnishes the odds of another rate hike by October.

For several reasons, the Japanese story will be one of unlocking value and awakening new dynamics in Japan's economic transition. It helps unleash the estimated JP¥2,000 trillion (US$13 trillion) in household savings, now mostly tied up in bank deposits and cash, towards corporate Japan and economically significant projects, which will have positive ramifications on commercial real estate.

Rising divestments

With debt cost a positive debit on the balance sheet, companies are compelled to re-evaluate their capital structures to optimise capital. Reforms in the country's Stewardship and Corporate Governance codes, which sought to encourage alignment between shareholders' and corporate interests, will lead to more motivated sellers as Japanese companies accelerate the shedding of property assets, unlocking extensive property holdings in the country.

Recent market activity has included sales of former factory sites and corporate headquarters. Auto-supplier Bridgestone sold a company housing compound in the upscale Roppongi area it has owned since 1897 for JP¥63.4 billion (US$405.8 billion) in early 2024. Seibu Holdings is also contemplating the sale of Tokyo Garden Terrace Kioicho, a high-end office-hotel development in central Tokyo, which could become one of the largest property deals in Japan's history.

As of the second quarter of 2024, Japan has asserted its claim as Asia-Pacific's largest real estate investment market. While the central bank's decision to maintain its accommodative stance just as most of the world was hiking raised allocations to Japanese real estate, moves to normalise monetary policy will continue to fuel investors' appetite, now motivated more by property fundamentals.

Outbound volumes slump after record 2023

Japan's outbound investments, which ran to a record of over US$5.2 billion in H1 2023, have since fallen back to just under US$2.4 billion in H1 2024. The current slump in deals year-to-date in 2024 can be attributed to a confluence of factors, not least the weakened purchasing power due to the yen's three-decade low against the greenback as well as undelivered expectations of a Fed rate cut, all of which have curtailed investment volumes in a protracted standoff between buyers and sellers.

Investments by Japanese groups in 2023 had displayed an opportunistic streak, headlined by several office acquisitions by Mori Trust in the USA, a sector embattled by the work-from-home trend and the steepest hikes in borrowing costs in over 40 years. Japanese companies, from its developers to exporters, are sitting on record earnings after years of low interest rates and a weak yen, armed with ample firepower to invest in other countries.

Going higher on the risk curve

Aside from the USA, the UK and Australia are expected to remain the top destinations for Japanese investors, while development-led opportunities in India have sparked interest.

Sumitomo Realty, in 2023, acquired a site in Worli, Mumbai – which recently completed a northbound coastal highway – for US$561 million. The developer expects to spend over US$3 billion developing the site into an integrated project with offices, a hotel, and commercial components, underscoring a shift up the risk curve.

While deal flow will ebb and wane with market conditions, Japanese overseas investment forays will likely be sustained as domestic firms view diversification as inevitable, as long-term growth is constrained by the country's declining population.

Figure 7: Net acquisitions in Japan by investor type

Note: YTD 2024
Source: MSCI Real Assets, Knight Frank Research
Updated: 15 Jul 2024

Chain reaction

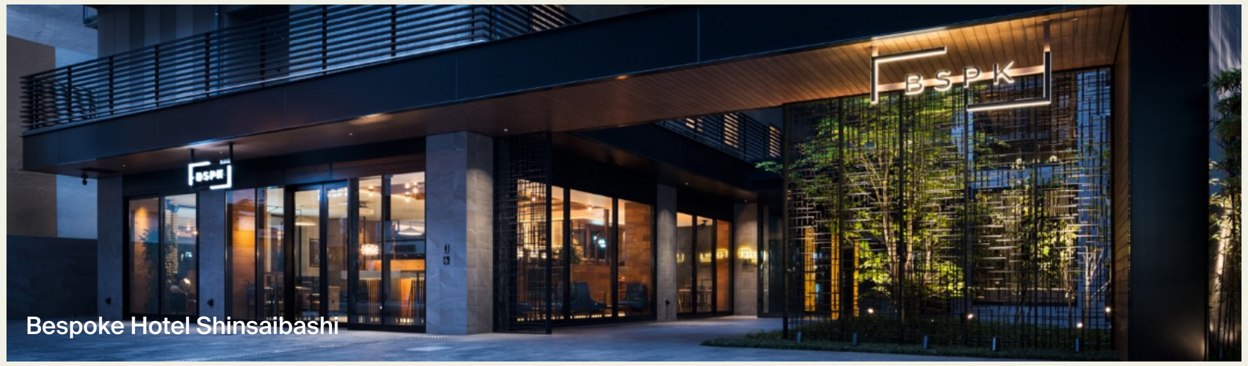
Policies

- CORPORATE GOVERNANCE REFORMS
- RETURN TO INFLATION
- NORMALISATION OF MONETARY POLICIES

Opportunities

- INCREASED DIVESTITURES
- PORTFOLIO RECONSTRUCTION
- MORE ACTIVE CAPITAL MANAGEMENT

Case Study (Inbound Capital)



Bespoke Hotel Shinsaibashi

Type	Hotel
Market	Japan
Date Completed	August 2023
Previous Transacted Price	NA
Current Transacted Price	JPY8.5 billion (US$59.6 million)
Cap Rate	4.1% (estimated)
Buyer	City Developments Limited (CDL)
Seller	Undisclosed

Acquisition/ Divestment Motivator

The 256-room hotel, which opened in 2019, enjoys a prime location in Osaka's Shinsaibashi commercial district, a major shopping and entertainment centre and one of the city's top tourist attractions.

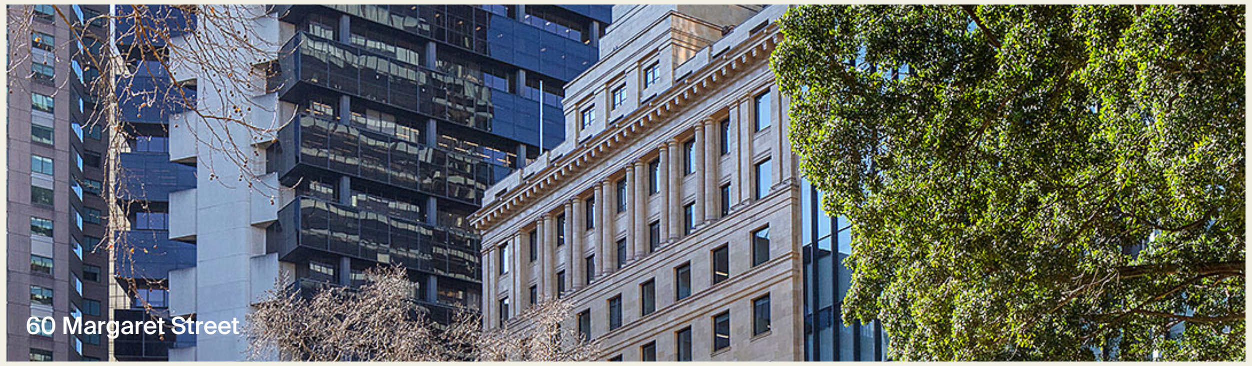
CDL acquired the property in August 2023, a second hotel asset in Japan in addition to the 329-room Mitsui Garden Hotel in Ginza, Tokyo. Although CDL owns an extensive multifamily portfolio in Japan, the company is looking to expand its hotel portfolio, with Japan a key market.

Osaka have attracted the bulk of investments into hotels year-to-date in 2024, accounting for close to 50% of capital spent. Osaka is already one of the most popular destinations among both domestic and international tourists that is recovering rapidly post-pandemic, which is likely to accelerate in the coming years.

The US$10 billion MGM Integrated Resort with casino, entertainment, shopping, hotel, and MICE facilities is scheduled to open in 2030. The city is also set to host the six-month-long World Expo in 2025. In the short term, the Chinese mainland's recent lifting of restrictions on group tours to Japan is another positive boost for the hotel industry. The weaker yen, which fueled a surge in inbound visitor arrivals, has lifted demand of hotel accommodation and boosted average daily rates across the country by up to 30% compared to pre-pandemic, according to STR.

With new hotel supply likely to be restrained by rising construction cost, this acquisition represents an opportunity to gain exposure to a promising market. Given the strong fundamentals as well as the compelling gap between the real estate cap rate and financial cost, overseas investors' appetite is expected to remain sustained.

Case Study (Outbound Capital)


60 Margaret Street

Type	Office (with Retail)
Market	Sydney
Date Completed	October 2023
Previous Transacted Price	AU$800 million (US$599 million)
Current Transacted Price	AU$777 million (US$512.1 million)
Cap Rate	5.3%
Buyer	Ashe Morgan/MEC Global Partners Asia
Seller	Mirvac/Blackstone

Acquisition/ Divestment Motivator

Located in the prime City Core submarket in the CBD, the property is a 39-floor Grade A office tower with over 40,000 sqm of net lettable area and a 6,400 sqm retail component – the MetCentre – which boasts frontages along George Street and connects the complex to Wynyard Station.

The property was acquired through a value-add fund which is reportedly the first to be established by a Japanese real estate company in Australia. Japanese companies form the bulk of the fund's LPs.

According to Mitsubishi Estate, which co-founded the fund, a major revamp of the property is being planned, which will seek to reposition the retail podium, expand lettable space as well as upgrade the office lobby and other tenant exclusive areas.

The acquisition capitalizes on the rejuvenation dynamics in the locality. The precinct around Wynyard Station has been lifted since the completion of the CBD and Southeast Light Rail and the redevelopment of Wynyard Place into Brookfield Place Sydney, which is just across 60 Margaret Street. A flight-to-quality trend in the office sector has also driven new and existing owners to give their assets a makeover.

The deal marks Blackstone's first major Australian office divestment as it reduces its holdings in the sector globally, underlining the company's shift away from being an office landlord. Mirvac, which has held a stake in the property for 25 years, has also sold down its office portfolio to diversify into the living and industrial sectors.

We like questions. If you’ve got one about our research, or would like some property advice, we would love to hear from you.

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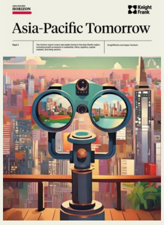
Recent research

Knight Frank Asia-Pacific Horizon Part 2



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