DECEMBER 2022

# 2023: Pivoting Towards Opportunities

## Asia-Pacific Outlook

# Asia-Pacific Outlook

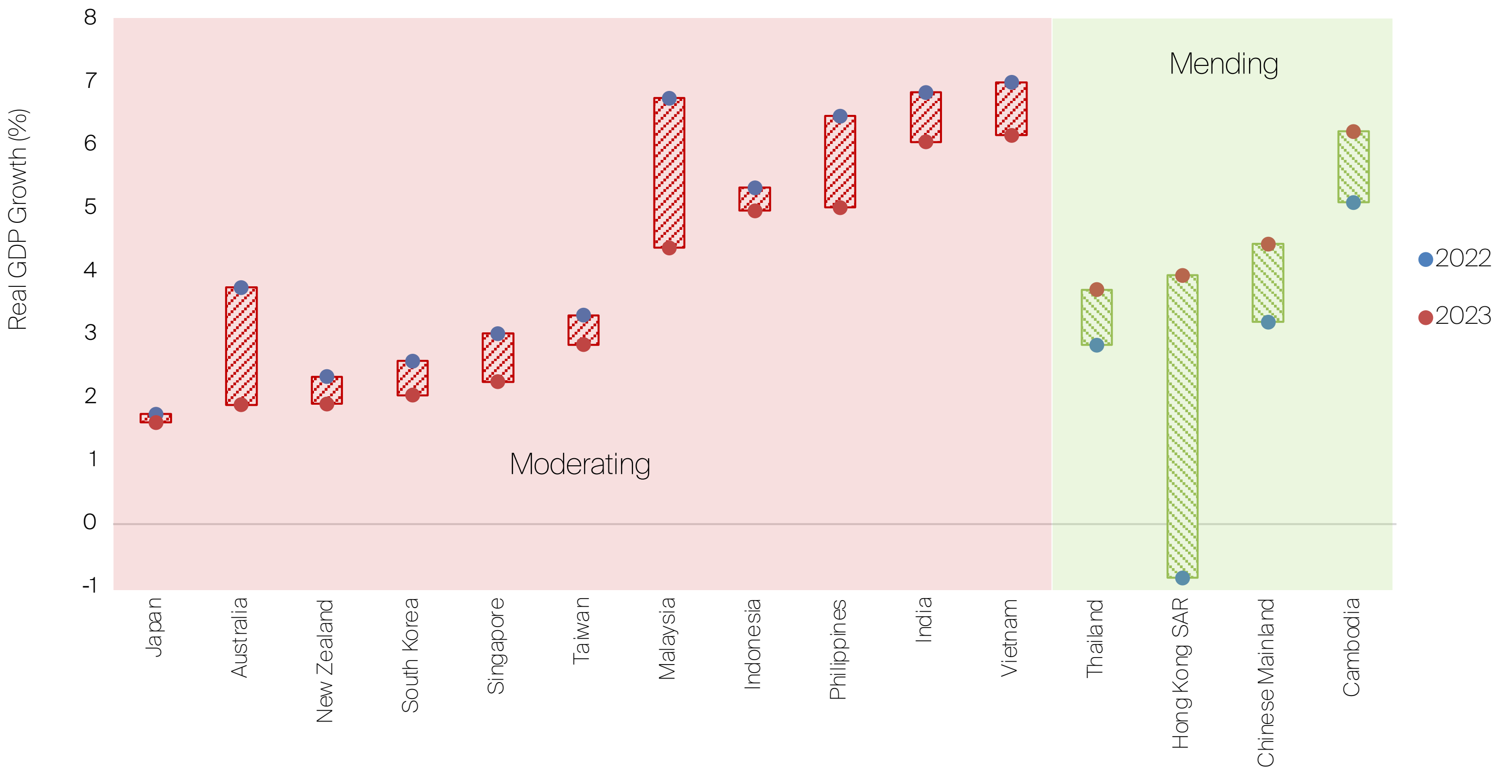
Even as the economic rebound strengthens in the post-pandemic recovery, the surging inflation that accompanied it has complicated the outlook. Exacerbated by the conflict in Ukraine, global inflation in 2022, expected at over 8%, is at its highest since 1996. As most central banks in Asia-Pacific (APAC) turn the screws on monetary policies to stave off inflation, growth will inevitably slow.

Across much of the region, growth momentum will continue to normalise, although some economies will still play catch up. While China's economy will lag potential output, growth could outperform expectations as pandemic restrictions were somewhat eased towards the end of 2022, which could signal an evolving zero-tolerance stand. Still, recovering demand in domestic-oriented economies, particularly emerging Southeast Asia and India, should broadly support growth; Asia-Pacific will remain the world's fastest-growing region.

There were also positive developments on the geopolitical front. The first face-to-face meeting in Bali between the presidents of the world's largest economies during the G20 meeting in November 2022 could signal thawing US-China Relations. While it is unlikely to resolve all differences, a more consultative approach will revitalise global trade flows – a crucial cog in the region's export dependent economies.

**Figure 1: APAC growth momentum to normalise**

Projected GDP growth of APAC markets




*Source: IMF WEO, Macrobond*

# Asia-Pacific Outlook

## All Eyes on Terminal Rates

With much of the interest rate hikes likely frontloaded, the pace of increase is expected to slow in 2023. Much will depend on the Federal Reserve's (Fed) reaction function. While inflation is not likely to reach the levels seen in the US and Europe, the region remains vulnerable to capital outflows which an excessively strong greenback can induce. Monetary authorities will be compelled to keep pace with the Fed's hiking cycle, in addition to walking the tightrope between growth and inflation.

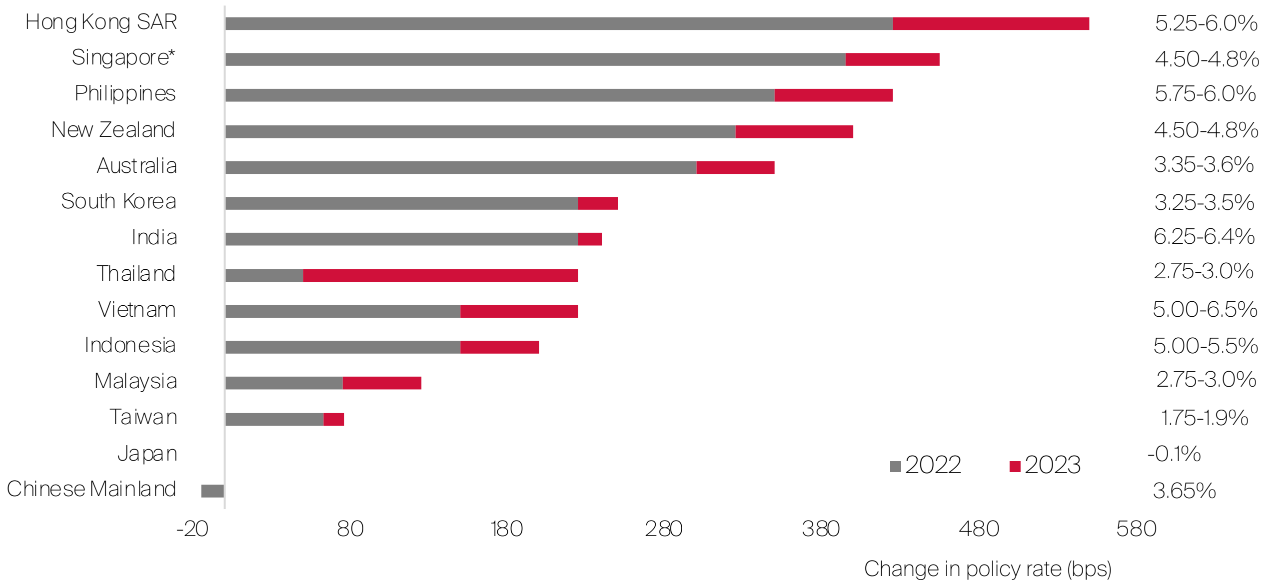
Inevitably, the region's interest rates in 2023 will approach multi-year highs. Real estate markets in the region will weather a period of transition, as occupiers and investors review their strategies in a rapidly evolving environment.

**To watch Christine Li's full interview**

Click Here

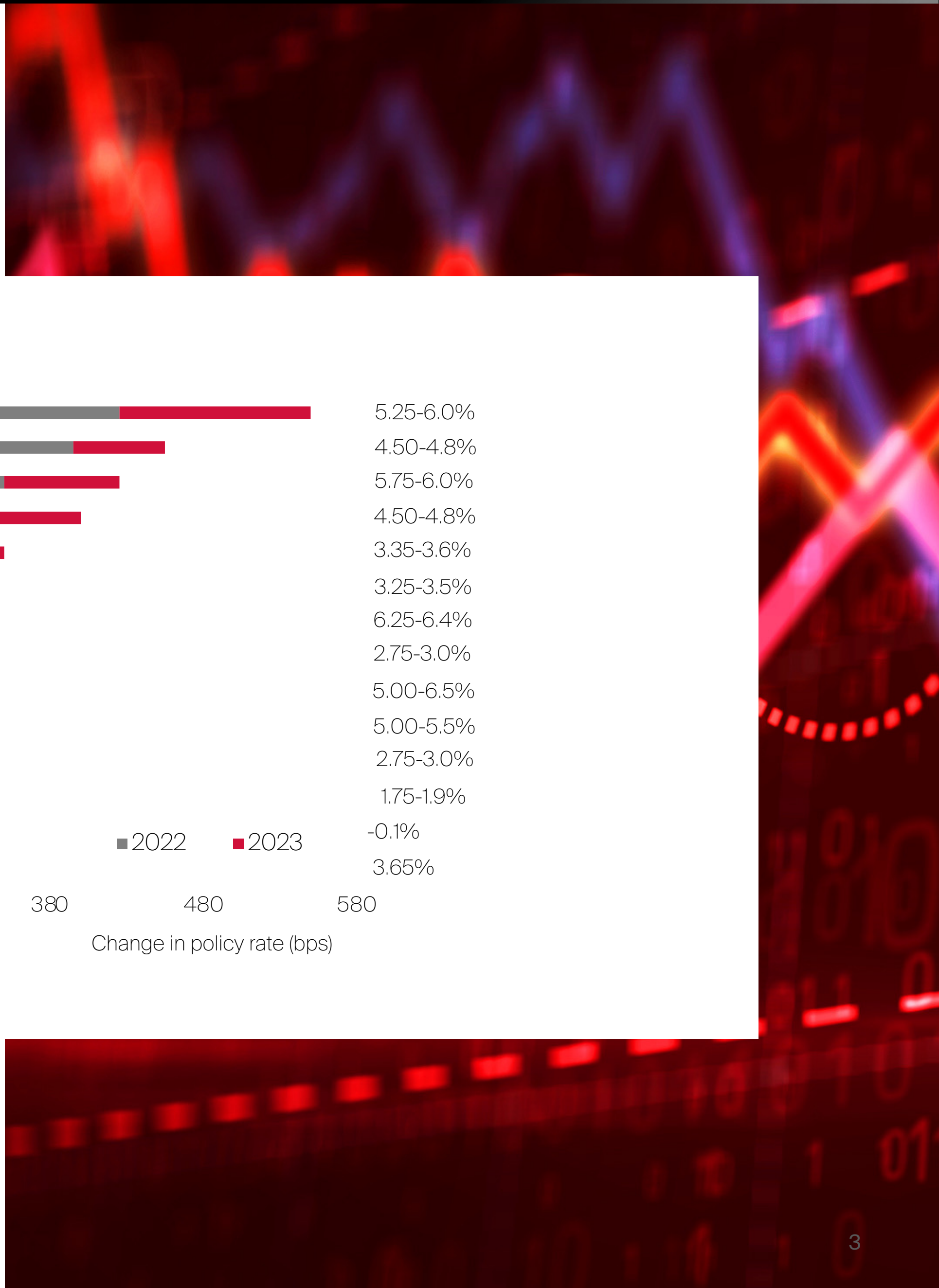
**Figure 2: Rates at a high although pace of hikes slows**

APAC markets expected terminal rates in current hiking cycle




*proxied by Singapore Overnight Rate Average

*Source: Macrobond, Knight Frank Research*



# Key Risks to Growth

**1**

Escalation of conflict in Ukraine

**2**

Worse-than-anticipated deterioration of economic conditions in Europe

**3**

Hard landing in the US

**4**

China remains mired in economic doldrums

**5**

Capital outflows turn disruptive

**6**

Heightened currency volatility

Source: Macrobond, Knight Frank Research

*"While the Asia-Pacific economy will face significant headwinds in 2023, it will remain a bright spot amid the shadows cast by the slowing global economy. Economies in the region will once again dominate growth worldwide, which will have implications for its real estate markets. That underlying growth will continue to underpin its attraction to occupiers, while its economic diversity offers ample opportunities for investors to target a range of asset classes to position their portfolios for the post-pandemic landscape."*

To watch Kevin Coppel's full interview

Click Here

*Kevin Coppel, Managing Director, Asia-Pacific*

# 2023 Asia-Pacific Real Estate Market Outlook


## CHALLENGES

### ECONOMY
- Interest rates/inflations stay **elevated for longer**
- Currency volatility
- Geopolitical tensions

### RESIDENTIAL
- Rising mortgage rates and high inflation **dampening demand**
- Standoff between buyers and sellers – **lower transaction volumes**

### OFFICE
- Businesses keeping cost in check and **CAPEX growth moderates**
- Shadow space emerges
- Potential headcount reduction puts **downward pressure** on rents and vacancies

### LOGISTICS
- **Recessionary fear, normalisation of e-commerce boom**
- Structural **undersupply** of high-quality assets

### CAPITAL MARKETS
- **Lower** returns due to high cost of borrowing and weaker fundamentals
- **Widening price gap** between buyers and sellers
- Yields to **move out**

## OPPORTUNITIES

### ECONOMY
- Potential for interest rate cycle to peak
- **Stimulus to boost GDP growth**

### RESIDENTIAL
- Outbound opportunities from Asian buyers into global markets
- **Flight to safe haven markets**, with transparent ownership and price growth

### OFFICE
- **Better space utilisation** due to cloudy economic outlook
- **Flight to quality** and agility/flexibility
- **Enhanced amenities** and workplace experience

### LOGISTICS
- Consolidations and cost savings
- **New demand drivers** emerged from healthcare and life science related sectors

### CAPITAL MARKETS
- **Flight to quality** and **inflation hedge** assets
- Redevelopment of aged asset to be ESG-compliant

# Residential Sector

## *Resilience amid Caution*

# Resilience amid Caution

A year into post-COVID, the residential sector is feeling the pinch of rising mortgage rates. While the market has not experienced any notable correction yet, homebuyers are finally taking a breather by adopting a wait-and-see attitude amid rising mortgage rates and an elevated inflationary environment. The rise in near-term interest rate expectations means a price reversal will be widespread across several regional key markets. The correction in home prices is reflected by slower sales volumes, given markets such as Hong Kong SAR and some Australian cities have fallen by about 22% and 16%, respectively, quarter-on-quarter (QoQ).

**Table 1: Sales are slowing down**
Residential sales volume by market (as of Q3 2022)

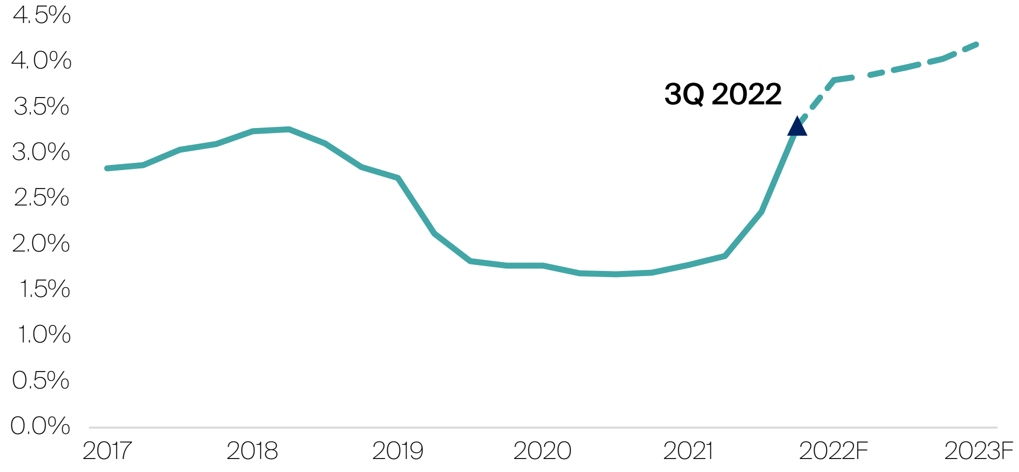
| Market | YoY Change | QoQ Change |
|---|---|---|
| Australia | -1.5% | -15.7% |
| Auckland | 15.8% | -4.4% |
| Singapore | -32.3% | -9.7% |
| Kuala Lumpur^ | 71.9% | 3.6% |
| Shanghai | 11.1% | 218.5% |
| Beijing | -27.0% | -7.7% |
| Shenzhen | -20.0% | 20.6% |
| Guangzhou | -11.2% | -23.5% |
| Hong Kong SAR | -38.4% | -21.7% |
| Seoul^ | 2.6% | 0.3% |
| Tokyo | 14.3% | 13.9% |

^Data as of June 2022

*Source: Macrobond, Knight Frank Research*

According to the Knight Frank Asia-Pacific Residential Review, 17 out of 24 cities tracked by Knight Frank registered positive annual price growth in the third quarter of 2022. This is down from 19 cities in Q2 2022. Average price growth for the region also slowed from 5.7% to 2.8% year-on-year (YoY), which confirms the housing market in the region has started to cool after the pandemic boom.

**Figure 3: Average interest rate in APAC will rise further**
APAC average interest rate 5-year historical and forecast




*Source: Macrobond, Knight Frank Research*

**To download the Asia-Pacific Residential Review Report**

Click Here

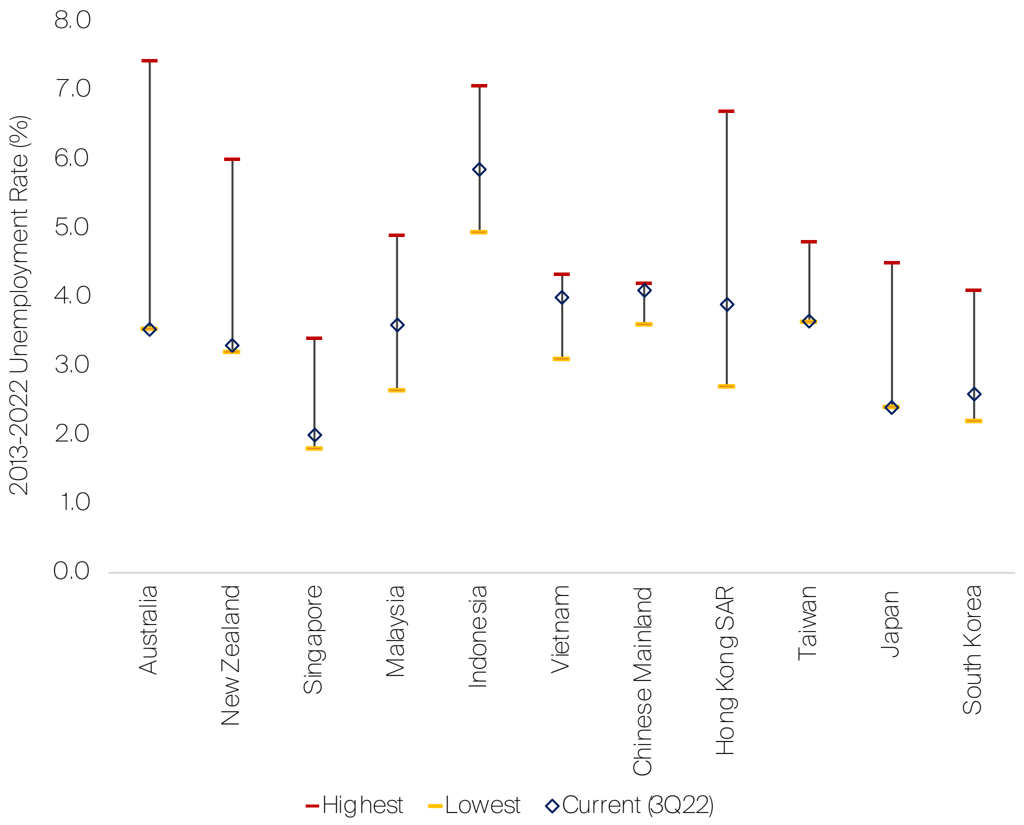
Life is finally returning to relative normalcy in large parts of the region, except for the Chinese Mainland, which is still affected by the ongoing zero-COVID strategy, and Hong Kong to a lesser extent due to the relaxation of quarantine rules for arrivals in the later part of 2022. Given the uncertainty around ease of travel, the Chinese Mainland and Hong Kong SAR property markets will still face headwinds as demand stays muted. In Southeast Asia, where economic recovery is modest post-COVID, price stability has been challenging, although declines have also moderated. Malaysia, the laggard in 2022, is seeing more optimism in the year ahead, as developers are expecting prices to pick up, hence withholding inventory pending price increases.

With rates not expected to come down any time soon, coupled with recessionary fear and the rising cost of living, markets are entering a standoff phase between buyers and sellers, the extent of which will vary significantly across the region. Much is dependent on where in their property cycle each market currently sits. Key markets leading the price reversal include New Zealand and Australian cities, given the strong price run-up during the pandemic. However, the pull-back was still moderate even after the recent double-digit correction, New Zealand and Australia's overall residential prices are still 20.0% and 25.5% above pre-pandemic levels.

Despite rising mortgage rates, the price correction is unlikely to be of the same magnitude as previous downturns due to two key reasons. Firstly, throughout the pandemic, supply chain disruptions, weather events, as well as labour crunch have given rise to significantly higher construction costs which would likely be passed on to end-users. Buyers will have to fork out more for these new purchases unless developers face financial difficulties by absorbing the unexpected costs. Secondly, labour markets have been tight across the region, and unemployment rates are now significantly below the historical average. The low unemployment rate is an indicator that potential sellers have holding powers even amid economic headwinds. This will provide a cushion to prevent a steep fall in housing prices should the economic outlook deteriorate further.

**Figure 4: Tight labour market across most APAC economies**

Unemployment rates below long-term averages




*Source: Macrobond, SingStat, Knight Frank Research*

While higher mortgage rates are impacting buying sentiments across the board from gateway to emerging markets, rental markets are at the other end of the spectrum. Post-COVID, the demand-supply imbalance is still elevated in several key gateway urban centres, as expatriates relocate and international students return to campus to pursue higher education. In addition, due to uncertain economic conditions and recessionary fear, buyers have been pushed to rent instead. In previous cycles, residential rents have proven resilient as an inflation hedge, especially when supply is tight. For example, rents increased by 7 to 12% annually between 1974 and 1985, a period of high inflation.

Despite rising demand, the current squeeze in the development pipeline is still felt by a lack of supply. In most markets across Asia-Pacific, pipeline supply is still playing catch up with rising demand. One exception is Auckland, it's a tenant's market as supply is estimated to have increased 16% YoY pushing rents lower.

## Asian Buyers on the Lookout for International Trophy Homes

Rising mortgage rates and the high inflationary environment impact housing affordability, particularly the mid to lower end of the housing spectrum. The prime segment where buyers are less sensitive to rate hikes and rising borrowing costs is still thriving, attributing to wealth preservation by high-net-worth individuals (HNWIs). Safe haven's requirements will support HNWIs' demand for prime properties in gateway markets such as the US, the UK, Monaco, Switzerland, etc. Singapore is also highly sought after by Greater China buyers due to its reputation as a safe haven and a growing APAC hub for business and finance. The resumption of travel brings back Asian buyers and investors, who continue to show strong interest in these international gateway markets. Despite a tightening of lending regulations around home loans and an increase in foreign investment taxes and stamp duty, international investors still find them relatively reliable and resilient in times of uncertainty.

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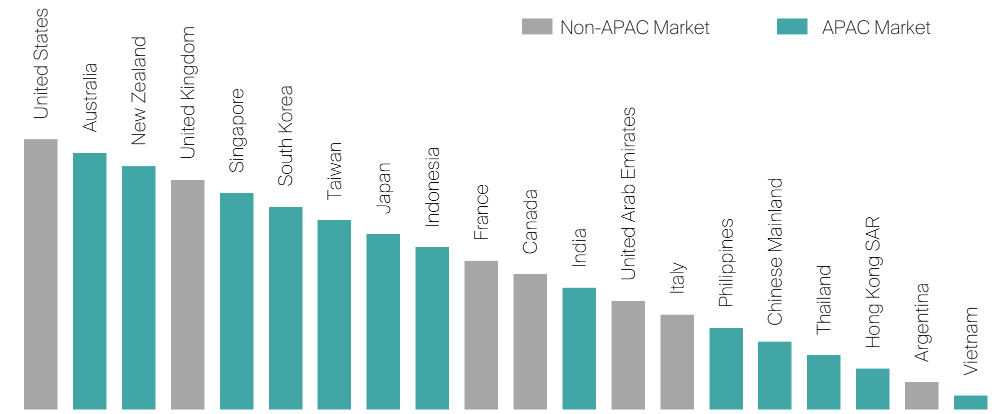
**Figure 5: Safe haven markets attract the likes of HNWIs**

Asian buyer's top 20 preference in destinations for a second residence (descending order)




*Source: Knight Frank Wealth Report 2022*

### Markets to Watch

**SINGAPORE**

1

Better economic prospect and steady inflow of talent

**BENGALURU**

2

Consistent growth of start-ups and unicorns coupled with rising income levels

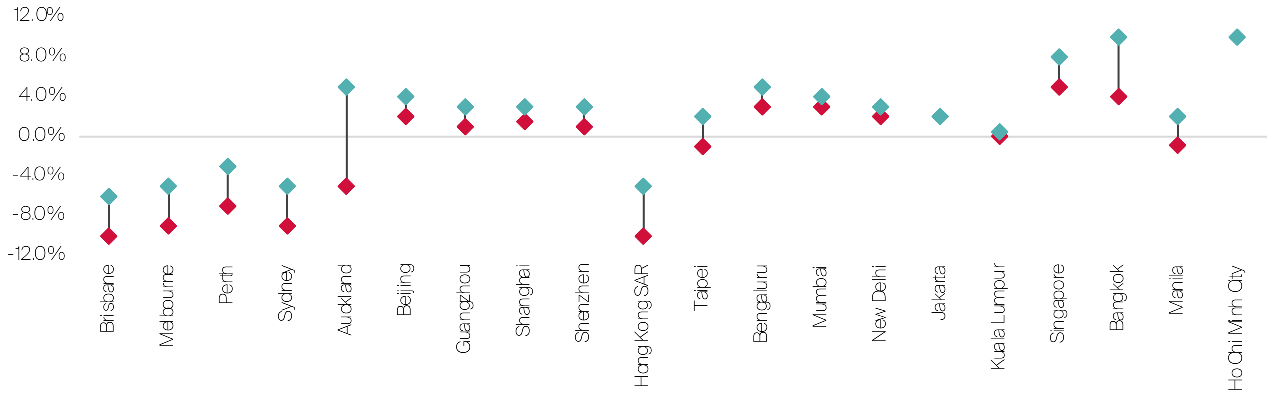
**TOKYO**

3

Remains popular due to its defensive nature

## OUTLOOK

Figure 6: 2023 residential price forecast range




*Source: Knight Frank Research*

Prior to the acceleration of mortgage rate hikes, many authorities in the region have been implementing macro-prudential policies to rein in housing prices. The current deceleration reflects the success of some of the early policy measures, rather than a sign that demand is waning. Asia-Pacific has been and will continue to be a global engine of growth in this decade and, possibly, beyond. The long-term structural tailwinds are attractive to long-term investors. Multi-national companies are setting up bases in emerging markets, attracted by its favourable demographics and growing middle class. This bodes well for the residential segment, which will continue to remain broadly characterised by strong latent demand, underpinned by robust home ownership aspirations, and constrained supply. In the next 12 to 18 months, households will need to dig a little deeper to get around their finances amid higher mortgage rates and elevated inflation. However, the depth of a correction, if any, will remain manageable. Demand for residential investments in key safe haven markets will remain supportive of prices. Labour markets remain resilient with little evidence of forced sellers.

Second, or holiday homes and investment properties, on the other hand, could be more vulnerable to rising mortgage rates and recession given the discretionary nature of such purchases. Higher mortgage rates could also erode rental returns, putting pressure on investors with limited holding power.

We also expect cross-border residential demand to climb throughout 2023. Although it is unlikely to reach the level seen pre-COVID, demand will still be significantly higher than that during the pandemic between 2020 and 2022. A recovery in market conditions is also on the cards once inflation is under control and rates can fall potentially around late 2023.

***"We believe the region's property market is better anchored to its economic fundamentals, which will also continually revive from reopening dynamics. The region's economic growth story will remain urban-centric, and its residential investment landscape will continue to be defined by its prime urban cores. Underpinned by its high rates of urbanisation, investors can look forward to a more sustainable growth trajectory and wealth preservation profile."***

To watch Victoria Garrett's full interview

Click Here

***Victoria Garrett,***
***Head of Residential, Asia-Pacific***

# Office Sector

## *Ongoing Workplace Experiment*

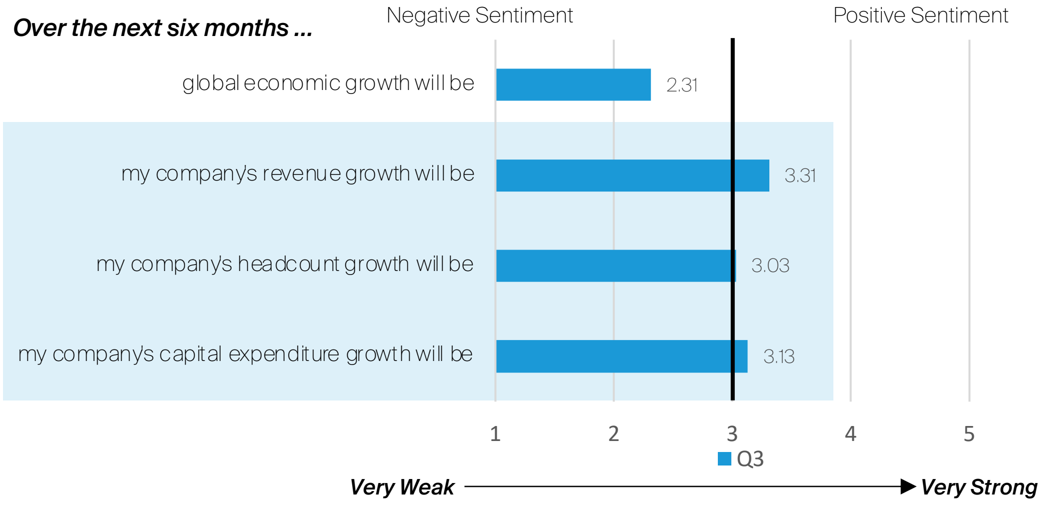
# Ongoing Workplace Experiment

The past three years of COVID restrictions have provoked the world to reflect on our work behaviours, which then set off a series of discussions on the future of the office. Our workplace environment has already started to change as we put more emphasis on people and how better to foster culture, learning and productivity. The following three observations are expected to shape the ongoing Asia-Pacific workplace experiment.

## Talent vs Real Estate

Up till early 2020, employees had to get accustomed to their offices. The way forward, however, is that offices must be reconfigured to better accommodate employees as the world slips into a new normal while businesses balance the impact of economic challenges.

**Figure 7: Q3 2022 Knight Frank Cresa Corporate Real Estate Sentiment Index Survey result comparing quarterly growth dynamics**




*Source: Knight Frank Cresa*

According to the Q3 2022 Knight Frank Cresa Corporate Real Estate Sentiment Index (Figure 7) - a unique index assessing the outlook of the global corporate real estate community - respondents continue to be upbeat about the growth prospects for their company, albeit tamed compared to the prior quarters. Companies are generally still recording growth despite deepening turmoil in the economy. However, office expansion is not in the books as they take on a cautionary stance.

On the other hand, the labour market is rapidly tightening (Figure 4), contrasting to the downbeat sentiments. As a result, the war for talent in the post-pandemic world will stretch into 2023, compelling employers to propose more accommodative working arrangements to retain talents. Possessing the most skilled employees is a critical strategy to protect their bottom line, especially in our current climate.

Sparked by the global pandemic, talents have changed the way they view work and the role they want it to play in their life. They also want their jobs to better reflect their new priorities derived from extended lockdown periods.

Therefore, one challenge company leaders have to tackle is how best to configure the occupying space for employees since working in the office now holds a brand-new meaning. While there is no one-size-fits-all approach, more fluidity is needed in office requirements, with increased user-centric workplace design. The social value of the office space should also be leveraged on, and businesses need to be concerned about their employees' social, physical, and psychological welfare.

In the upcoming years, it will be vital for companies to create working environments that support a variety of work styles for their workers and enable them to do so comfortably and productively. As such, businesses are now at an optimal point in time to find out how they can best provide for their employees and take steps to curate the most desirable workplace for them.

**To download the CRE Sentiment Index Report**

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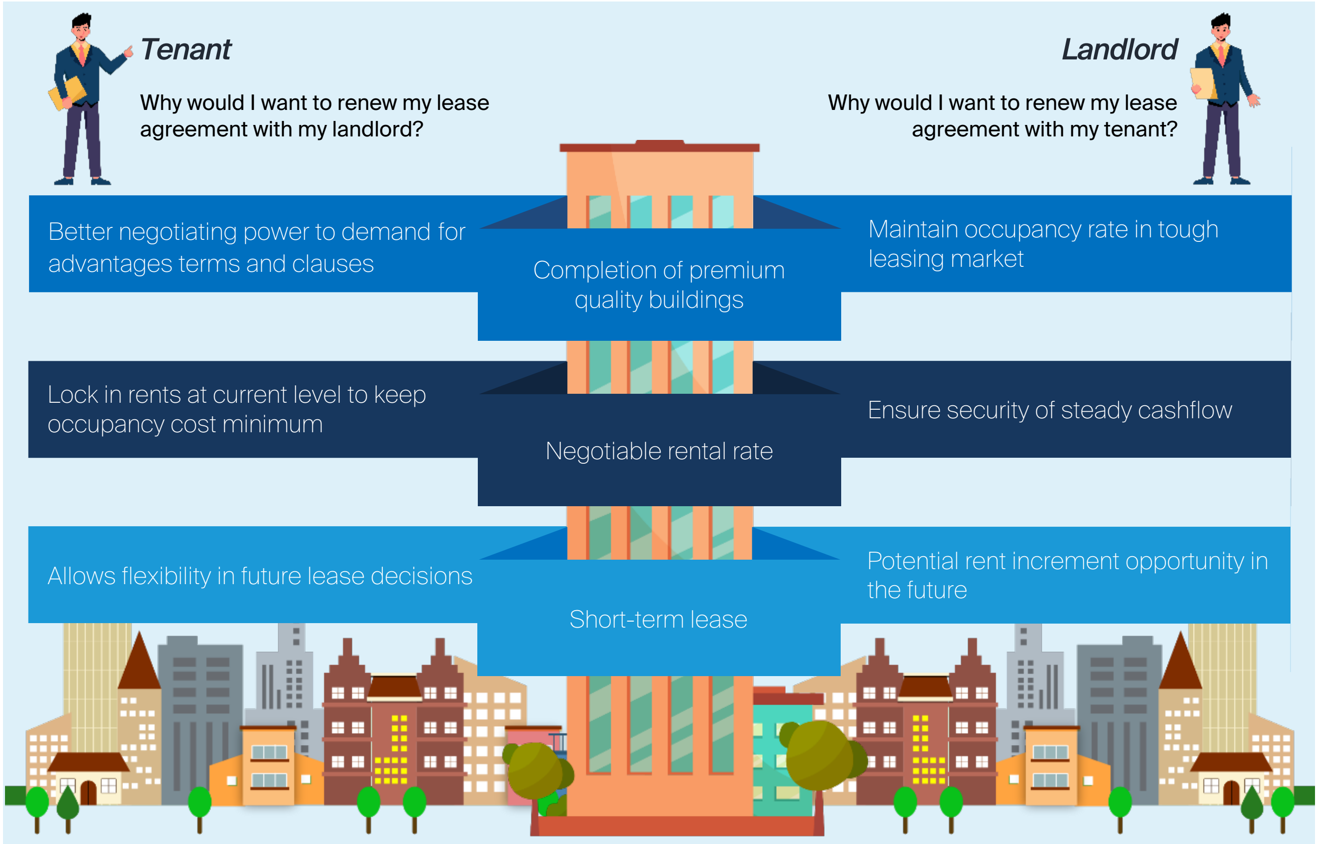
## Reshuffling of Occupancy Costs

A study conducted by International Data Corporation (IDC) in September 2022 revealed that 59% of senior company leaders from around the world predicted a recession for the upcoming year, with a vast majority of Asia-Pacific executives anticipating the recession to last one year or longer. Such market volatility will naturally prompt businesses to keep operating expenses (OPEX) in check and tighten their capital expenditures (CAPEX).

From the same Q3 2022 Knight Frank Cresa Corporate Real Estate Sentiment Index (Figure 7), although expectations around revenue, headcount and CAPEX growth over the next six months all remain positive, there is a fall in respondent sentiments as companies adopt a more defensive stance. Real estate space, being the second largest OPEX after payroll, would be an area where occupiers can be more prudent without adversely affecting business operations.

First, catalysed by the weakening economic and operating environment, tenants tend to be more cautious in making lease decisions, while landlords will prioritise safeguarding their cash flow. Occupiers facing incoming lease expiries and have yet to secure a new agreement are more inclined to renew their leases, and for a shorter term. Renewal cases are currently dominating some Asia-Pacific markets, and we will likely see more of this phenomenon playing out in the coming year. Figure 8 on the right summarises some of the motivations behind pursuing a lease renewal for both tenants and landlords.

**Figure 8: Benefits of lease renewal to tenants and landlords in current economic environment**




*Source: Knight Frank Research*

Second, occupants will be forced to review the quantum of space they hold, resulting in the emergence of shadow space (or phantom space), especially from tech firms. Many of them had committed to long-term leases during exponential growth years, but with funding becoming limited, there is a pressing obligation to reduce their cash outflow. Moreover, with the adaptation to hybrid working, companies are able to shed supplementary spaces that are underutilised.

## What is 'Shadow Space?'

*A term used to describe idle space on a current lease that a tenant would prefer to retire by finding the landlord a new tenant.*

The frequency of news reporting about major companies reducing office footprints has increased over the past few months, with Meta (the parent company of Facebook) being the latest to announce plans to reassess their real estate requirements in October. Their goal is to make the office more dynamic by recalibrating their space and revitalise the in-person work experience. Existing leases for their idle spaces could be left to expire, or they may decide to combine floors from different buildings into one.

Shadow space can also emerge from large-scale layoffs, such as the ones we have seen from Twitter, and Meta, as these corporates are on edge and insecure about business prospects. The latter has already dismissed 11,000 employees out of its 87,000-strong global workforce in November, which will inadvertently further shrink the amount of corporate space Meta requires.

While we foresee shadow space, significant space reductions from occupiers across Asia-Pacific should be few and far between, underpinned by a stronger preference for office-based working compared to the US and Europe, such as the situation in Tokyo and Seoul. Even with hybrid plans implemented, the majority of the work week will still be spent in the office. Mass dismissal of workers in Asia-Pacific is also not anticipated given the more optimistic outlook compared to other regions.

### Productivity Paranoia

As the world gets accustomed to the pandemic and work routine resumed, numerous studies and surveys illustrated how employees prefer to have some flexibility with regards to the return to office, often citing improved mental health and autonomy as some of the benefits. However, in spite of the structural shift towards more hybrid working, some employers are issuing stronger mandates around return-to-office as they believe most tasks should continue to be completed in the office.

A majority of the employees are obligated to return to the office full-time due to heightened concerns for job security and opportunities for promotion, particularly at this juncture with the imminent possibility of retrenchment. A recent poll by OSlash, a productivity software company, corroborated this. Their results showed that over 80% of remote employees worldwide worry that their employers would dismiss them if they refused to return to the office. At the same time, almost one-fifth of employers affirmed that they would terminate staff who refused to go back to their desks, with more than half of these executives acknowledging that they fired workers without having to lay them off by mandating return-to-work policies. Such an alarming position would naturally push workers back into offices, leading to higher space utilisation for some firms.

## Markets to Watch

### SINGAPORE

1

Limited supply and a flight to safety from around the region to support office demand in 2023

### SEOUL

2

Strong office demand and a lack of leasable space will continue into 2023, sustaining growth in the sector

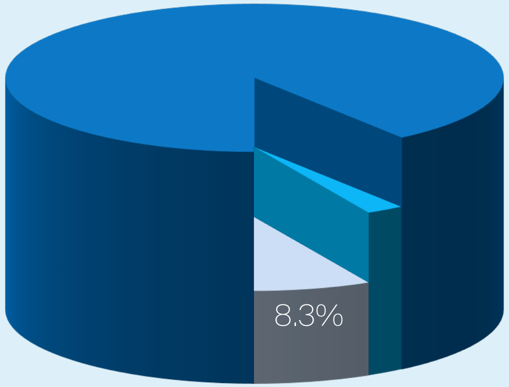
### INDIA

3

Recessionary forces in the west potentially outsourcing more roles to India, increased hiring in the IT sector, and an overall stable economic outlook should support the market in 2023

## OFFICE MARKET OUTLOOK

**Figure 9: 2023 residential price forecast**
Existing stock vs new stock




***148 million sqm* as at end of 2021**

***4 million sqm* of office space completed in 2022**

***12.5 million sqm* of office space expected in 2023**

*Source: Knight Frank Research*

2022 saw the completion of some office supplies delayed due to various COVID restrictions and supply chain disruption of construction materials. As a result, the average vacancy edged up slightly by 0.6%, which was less than the 2% we forecasted. This is probably cushioned by sustained leasing activities recorded in markets such as some cities in India, Singapore and Seoul. However, with roughly 12.5 million sqm of office space expected, we foresee vacancy to rise from the current 14.6% to 16%.

While the office sector has generally rebounded, a gloomy outlook lingers against the backdrop of economic headwinds. As businesses reassess expansion plans, leasing volumes should remain muted in the face of an increasingly inflationary scenario.

Growth in office rent should also moderate, as occupiers seek to add some flexibility to their portfolios to generate savings.

Key drivers of leasing demand will continue to stem from professional services, finance and co-working sectors, with the inclusion of flight-to-quality requirements. We have seen rapid expansion of co-working footprint in CBDs in line with the shift in preference for flexibility by space users.

Market conditions in 2023 will continue to favour tenants as highly amenitised buildings with sustainability credits are being completed and ready for occupancy. Considerations for ESG will take on a more prominent role in the office market as companies inch a year closer to their 2030 sustainability targets, which might spur relocation to buildings with high ESG credentials within their budgets.

## Green Buildings

*Based on Knight Frank's preliminary study,*

**22 %**
*Growth in number of green buildings from 2022 to 2030*

**42 %**
*Of entire office inventory will be greened by 2030*

# Strategies to Adopt

| Occupiers | Landlords |
|---|---|
| • Capitalise on the widening window of opportunity for rental negotiation | • Prioritise occupancy over rents in current market downturn |
| • Analyse workplace utilisation and redesign the space according to the type of work arrangement endorsed and employees' behaviours | • Cater to occupiers' requirements if they are reasonable and feasible to retain tenancy |
| • Focus on assets of higher calibre that can support flexible workspace design with quality amenities and services | • Sustainably retrofit older buildings to be in line with ESG requirements in preparation of economic recovery |
| • Implement ESG agenda, especially on the 'S' and 'G' aspects | • Include flexible space in office portfolio |

To download Why ESG Matters: A Guide for Occupiers (October 2022) Click Here

**Figure 10: The office sector to remain largely tenant favourable in 2023**

The Asia-Pacific office occupier overview

## 12-Month Rental Outlook

### Decreasing

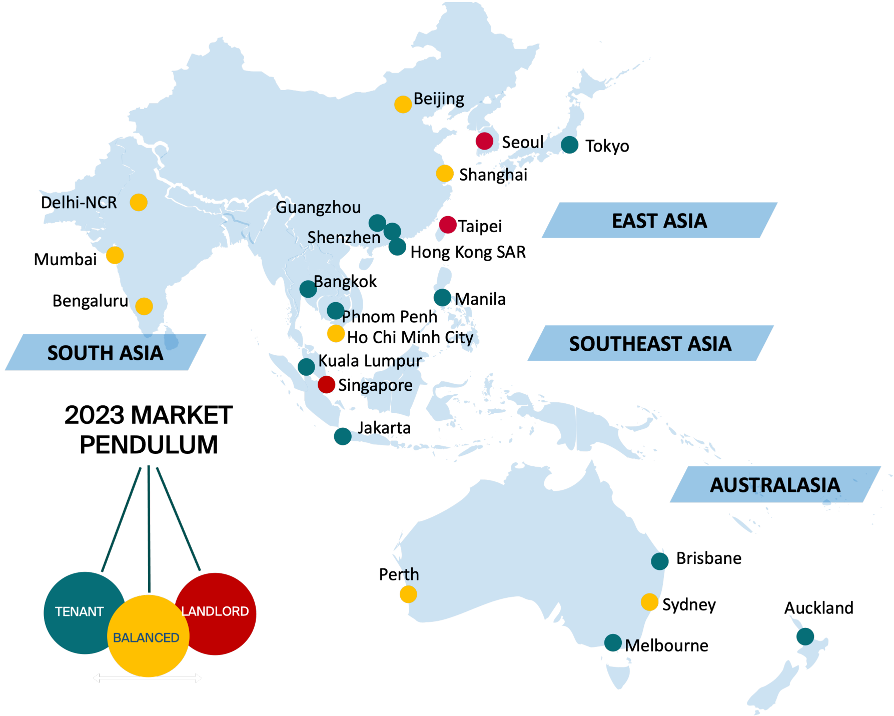
- Tokyo
- Guangzhou
- Kuala Lumpur
- Bangkok
- Manila
- Ho Chi Minh City

### Unchanged

- Auckland
- Beijing
- Shenzhen
- Bengaluru
- Mumbai
- Delhi-NCR
- Phnom Penh
- Jakarta

### Increasing

- Brisbane
- Melbourne
- Perth
- Sydney
- Shanghai
- Hong Kong SAR
- Taipei
- Singapore




***Bengaluru***
Highest Rent Growth
7.0%

***Seoul***
Tightest Vacancy
1.5%

***Shenzhen***
Highest Supply Growth
3.4 million sqm

*"The increasing integration of hybrid working as a new norm in workplace culture will continue to feed a flight-to-quality trend in the region's office markets. Occupiers will continue to gravitate towards spaces that are best placed to bridge the gap between remote working, which are also well-amenitised to provide a strong return-to-office narrative. Despite a challenging economic outlook, rental and occupancy levels remain well supported by sustained demand and limited supply. There is an emerging window of opportunity to look at prime options, but it will be bifurcated along supply pipelines, with those in the tightly supplied Singapore, Seoul and Australian markets likely to narrow rapidly. "*

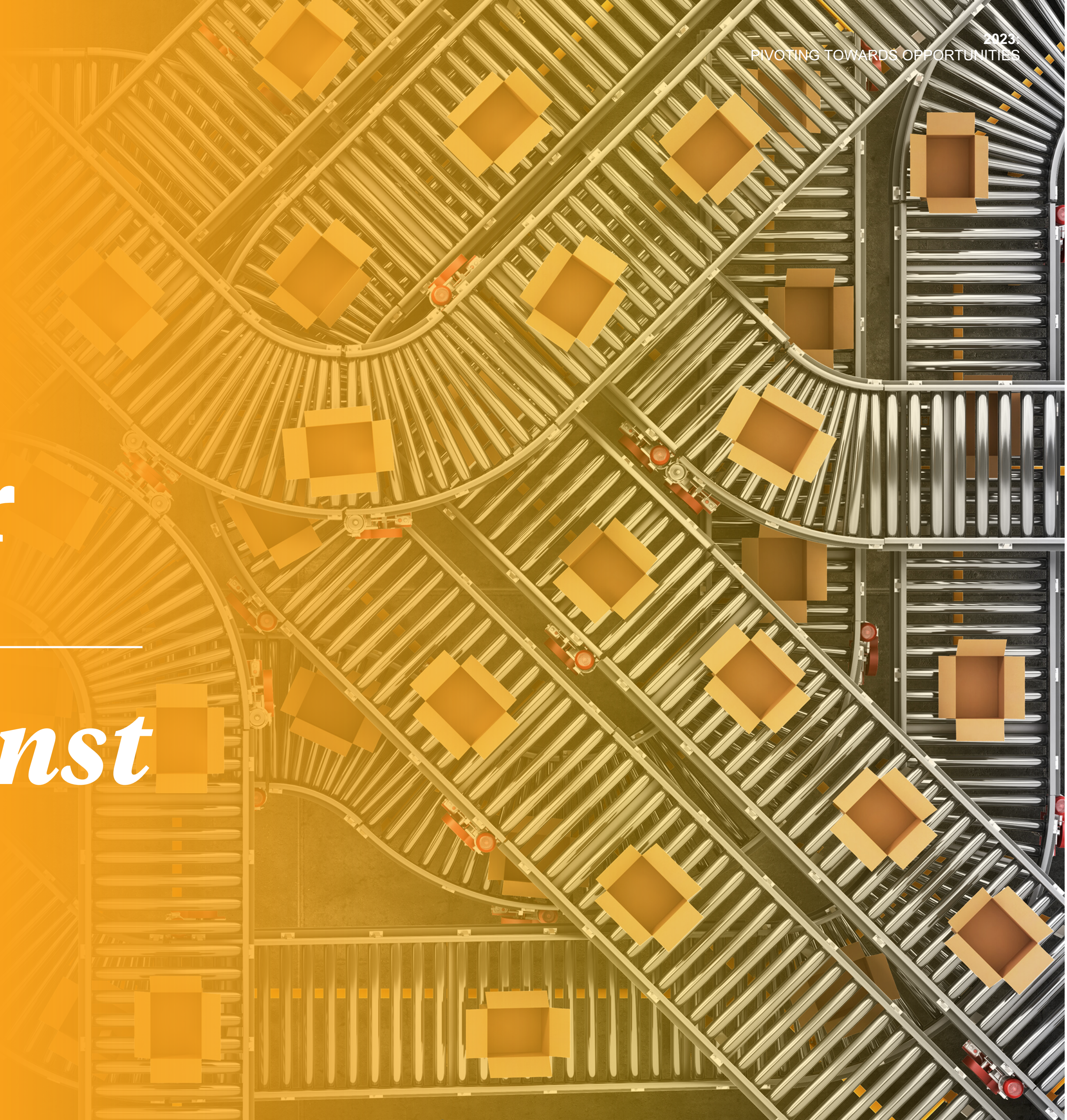
To watch Tim Armstrong's full interview

Click Here

***Tim Armstrong,***
***Global Head of Occupier Strategy and Solutions***

# Logistics Sector

## *Tenacious against Headwinds*



# Tenacious against Headwinds

Exponential growth was recorded over the pandemic years, underpinned by heavy demand from third-party logistics (3PL) players, e-commerce companies, and pharmaceutical firms. The disruptions in global supply chain also brought about a shift from just-in-time to just-in-case management, where holding more inventory is emphasised. Just as we see a silver lining amid the grey cloud of the health crisis, the sector is being challenged yet again by the following issues.

## Normalisation of Demand for Logistics

Since 2020, Asia-Pacific's household spending has been on the upwards trajectory as real income rose. This was a boon for the logistics sector as the vacancy rate tightened to a record low and rents surged.

Fast forward to end 2022, consumers have re-evaluated their spending in light of moderation in real income growth, and deteriorating sentiments. The pace of private consumption is thus anticipated to lose steam but remain resilient in 2023 (Figure 11).

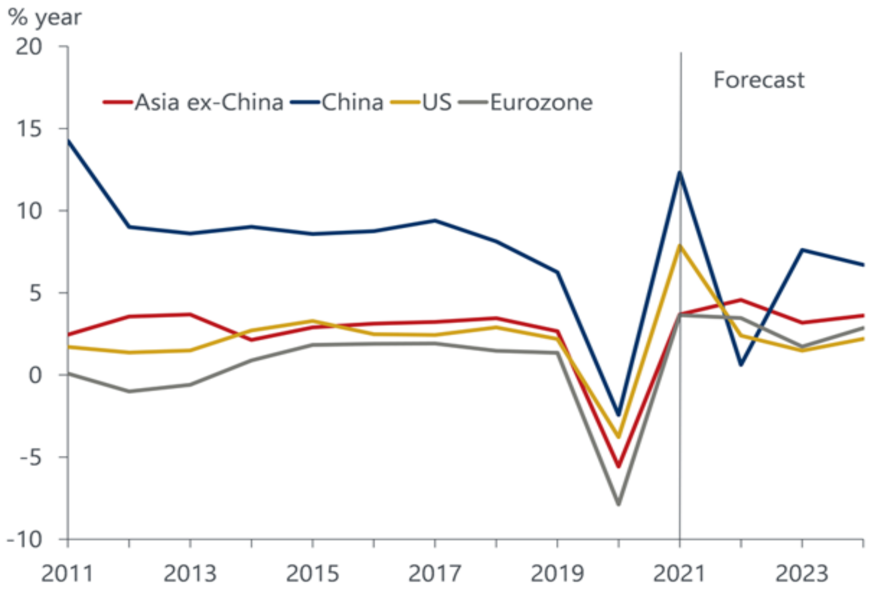
As consumers scale back on their purchases and consume more services instead of goods, companies are also bracing for slower sales. For instance, e-commerce giant, Amazon, anticipates sluggish sales during the festive season, indicating that individuals and companies were less willing to spend due to concerns about inflation.

Correspondingly, companies in Asia-Pacific are reassessing their requirements for logistics spaces and revising plans to concentrate on nearshoring, given the prolonged supply-chain issues and decoupling from the Chinese Mainland.

Much of the recovery in this sector depends on Chinese Mainland's capability to reign as a trade powerhouse and maintain continuous activity in its factories and ports on top of stringent COVID policies. To avoid further complications in supply chains, businesses are continuing to leverage on the "China Plus One" strategy and diversify production into other markets.

Demand, albeit declining, is being diverted to India and some Southeast Asian countries, such as Indonesia, Vietnam, and Thailand, enticed by the lower costs, ease of trade and growing manufacturing base. In addition, the rising middle-class population is driving the growth of these economies, rendering the Asia-Pacific logistics sector to display resiliency as it navigates through uncertainties.

**Figure 11: Slowing consumption in APAC**
World: private consumption




*Source: Oxford Economics*

## BRIGHT SPOT EMERGING – LIFE SCIENCE

Investment into healthcare has risen due to post-pandemic behavioural changes, leading to much potential yet to be unleashed for the nascent life science sector in Asia-Pacific. From research and development (R&D), manufacturing facilities to pharmaceutical logistics, every aspect of this sector requires more space.

### *RESEARCH & DEVELOPMENT*

- R&D lab facilities are expanding their footprints in science parks across Asia-Pacific

### *MANUFACTURING FACILITIES*

- Domestic demand spurring the need for more facilities that are closer to consumers

### *PHARMACEUTICAL LOGISTICS*

- Increasing demand for high specification facilities that improve distribution networks and last mile efficiency

## Structural Undersupply of High-quality Assets

The imbalance in supply-demand dynamics, which became apparent during the global health crisis, was made worse by the delay in the completion of institutional-grade assets in Asia-Pacific. This then drove rental growth upward by double digits in many markets due to the scarcity of premium spaces.

Fundamentals for the logistics sector in Asia-Pacific have yet to be as well-established as the US or Europe, leading to an acute shortage of modern facilities and fierce competition.

First, it did not help that most facilities, especially those in Japan and Hong Kong SAR, are out-of-date. Additionally, more advanced warehousing technology that leverages on artificial intelligence (AI) and data analytics further accentuate these ageing premises. As consumer preferences for product type and delivery speed vary considerably, the rate of obsolescence only accelerates, increasing the need for new facilities.

Second, many facilities are built to suit, which cater to the specific requirements of clients, or increasingly have a large proportion of the precinct being pre-committed due to the intense competition for prime assets. This puts smaller businesses with limited budgets at a disadvantage since they would not have the financial means to compete with large corporates for the already inadequate supply pool.

## INDUSTRIAL INTENSIFICATION – VERTICAL WAREHOUSES

With customers' expectations and demands for same-day or next-day delivery, the issue of 'last mile' has been in the spotlight for the past couple of years. Logistics operators are constantly looking for facilities that are in close proximity to urban areas to add into their portfolios. However, given the higher cost of land for such locales, which translates to higher rents, it might not be financially viable for companies to undertake the space.

As such, in order to intensify land productivity and keep rent affordable, developers have started to build vertically instead of laterally. Traditionally, multi-level industrial facilities are more common in land-constrained cities such as Singapore and Hong Kong, but as location has become an influential aspect, demand is gaining traction especially in Australia.

Many opportunities remain in this particular segment of the market to alleviate some demand pressure and allow operators to stay relevant.

***Goodman Interlink, Hong Kong***

A 24-level logistics industrial warehouse

All in all, supply chain bottlenecks have made people realise the importance of supply chain diversification, propelling regionalisation of trade within Asia-Pacific via nearshoring, reshoring and devising more sophisticated supply networks. Asia-Pacific CEOs echoed this view as shown by PwC's 25th Annual Global CEO Survey, where they rebalanced their focus within Asia-Pacific to drive revenue growth. Although the US and Chinese Mainland (44% and 36% respectively) are still the most favoured markets, Australia has leapt from eighth to third place, gaining from 10% to 18%. This demonstrates the advantages and viability of intra-regional commerce. Opportunities in the region will grow gradually as businesses slowly reduce their reliance on Chinese Mainland but not completely detach from it.

### Logistics Market Outlook

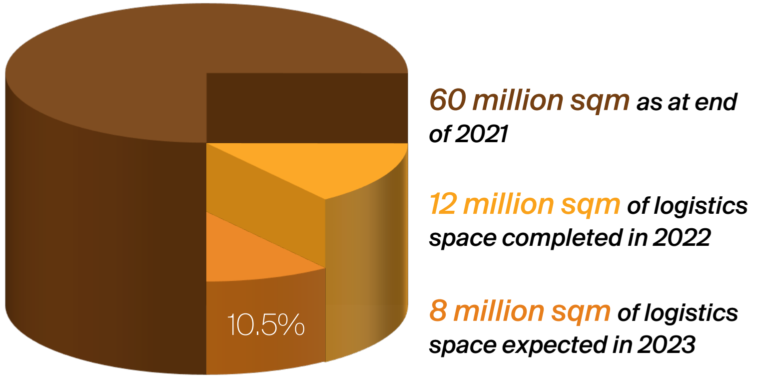
With slightly over 8 million sqm of incoming supply, coupled with weakening expansionary demand, vacancies in the region will likely increase marginally. However, pipeline supply constraints in markets like Sydney, Hong Kong, and Ho Chi Minh City might cushion the drop in vacancies.

On the other hand, recent shipping patterns imply that supply chains are beginning to normalise, alleviating some pressure on demand and rent. Nevertheless, higher borrowing costs accompanied with looming recession fears due to the aggressive interest rate hikes could result in a more cost-conscious business environment. Occupiers who adopted the 'just-in-case' approach will possibly reassess their portfolio to consolidate the amount of space they require to minimise CAPEX.

As headwinds brew into 2023, market fundamentals will render a general balanced logistics market in Asia-Pacific, with rental growth set to moderate compared to the past two years. Logistics occupiers will continue to commit to build-to-suit solutions and gravitate towards institutional-grade assets. Structural factors will still bode well for the sector in the long run.

**Figure 12: Regional stock to rise by 10.5% in 2023**

Existing stock vs new stock




*Source: Knight Frank Research*

# Strategies to Adopt

| Occupiers | Landlords |
| --- | --- |
| • Plan in advance to relocate/expand footprint in areas with growth potential while minimising spatial needs in cost-inefficient locales | • Expand footprint into emerging logistics hubs by developing land banks in places close to new infrastructure or next to rapidly expanding neighbourhoods |
| • Engage landlords proactively to get custom-built features according to company's operational needs | • Modify property features to meet the requirements of occupants, which helps to secure large tenants, particularly in markets with sizeable incoming supply |
| • Invest in sustainable technology innovation, and enhance portfolios to reflect more assets with these two attributes | • Modernise ageing logistics facilities in strategic locations to meet occupant demand for advanced amenities and ESG |

Figure 13: Optimism remains in the APAC logistics sector

The Asia-Pacific logistics overview

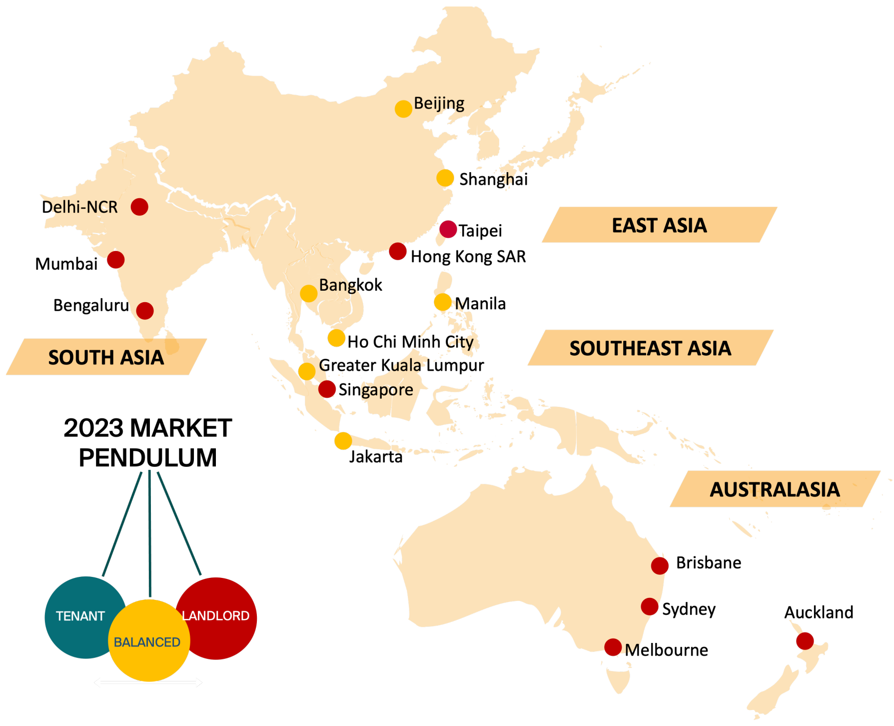
## 12-Month Rental Outlook

### Unchanged

- Beijing
- Shanghai
- Greater Kuala Lumpur
- Manila
- Jakarta

### Increasing

- Auckland
- Brisbane
- Sydney
- Melbourne
- Hong Kong SAR
- Bengaluru
- Mumbai
- Delhi-NCR
- Singapore
- Taipei
- Ho Chi Minh City
- Bangkok




***Australia***
Highest Rent Growth
12.0%

***Ho Chi Minh City***
Tightest Vacancy
1.0%

***India***
Highest Supply Growth
2.8 million sqm

*Source: Knight Frank Research*

*"Although e-commerce demand is normalising, the outlook for Asia-Pacific's logistics markets remain upbeat, with sustained leasing demand to support occupancy levels and milder rent growth. We see the more moderate rental increase in a positive light, which is more aligned to fundamentals in a post-COVID landscape. We expect dynamics to remain compelling, as demand will remain robust in the manufacturing hubs, supported by "China Plus One" strategies as well as the continued structural shortage of prime logistic assets in the region. While just-in-case strategies could wind down as supply chains disruptions ease, the development of resilience and diversification in supply chains is also unlikely to be fully reversed."*

To watch Tim Armstrong's full interview

Click Here

***Tim Armstrong,***
***Global Head of Occupier Strategy and Solutions***

# Capital Markets

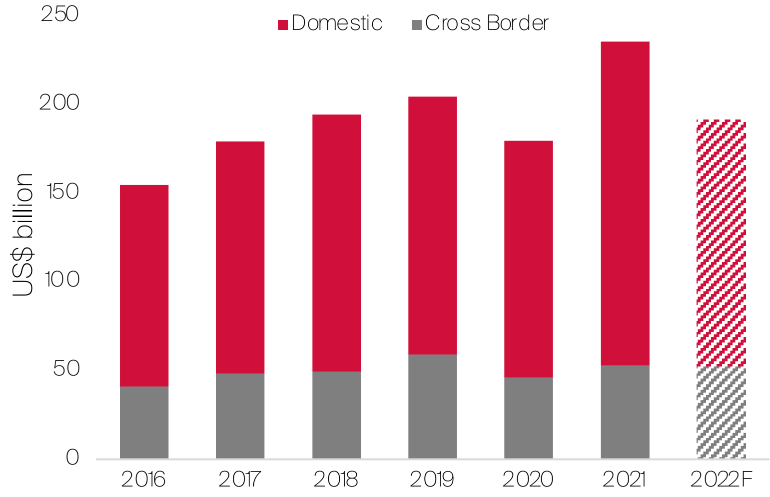
## *Strategising the New Landscape*

# Strategising the New Landscape

Interest rate hikes have weighed on sentiment across Asia-Pacific. Overall transaction volumes through the first three quarters of 2022 have contracted by 13.4%. With macroeconomic headwinds remaining significant, total volumes for the whole of 2022 are likely to dip. Much of the pullback was driven by the drop-in domestic activity that is coming off from the high base in 2021; the unwinding of pandemic travelling restrictions has also diverted capital to foreign opportunities. However, cross-border volumes are on track for a decent increase in 2022. Despite the challenging climate, cross-border investments have remained remarkably resilient, gaining 11.8% in the first nine months of 2022.

**Figure 14: APAC volumes to decline**

Transaction volumes in APAC




*Source: MSCI Real Assets, Knight Frank Research*

## Altered States

After over a decade of abundantly available capital, the rapid reversal in macroeconomic fundamentals is changing the playbook for real estate investment globally as well as in the region. Listed real estate has corrected in tandem with the heightened uncertainty and transaction activity in private markets is set for a pause in the transition. With the rising tide of low-interest rates on an ebb, the search for a new equilibrium will bring about a period of dispersion as asset managers, investors, and developers appraise the new valuation landscape. On the cusp of a new era, a number of major themes will underpin the new investment landscape.

*1. Inflation-hedges*

Commercial real estate which exhibits income growth potential, diversification benefits and relative stability will see strengthened interest. Countercyclical as well as those which capture structural changes, from continued digitalisation trends to the region's wider demographic changes, can also offer opportunities. With elevated building costs, we might see increased refurbishments and repurposing of assets to capture alpha-based returns.

*2. Flight-to-quality*

For commercial real estate to serve as an effective inflation hedge would require to some extent, for landlords to successfully push through positive rental reversions. These conditions are particularly conducive to well-leased, quality assets located in gateway markets. We expect investors to focus particularly on core, liquid assets in prime locations with attractive yields relative to the cost of debt. There will be an increased differential between core, well-located prime assets with good ESG credentials and more secondary assets with low sustainability credentials.

*3. Rise of Dollar Investors*

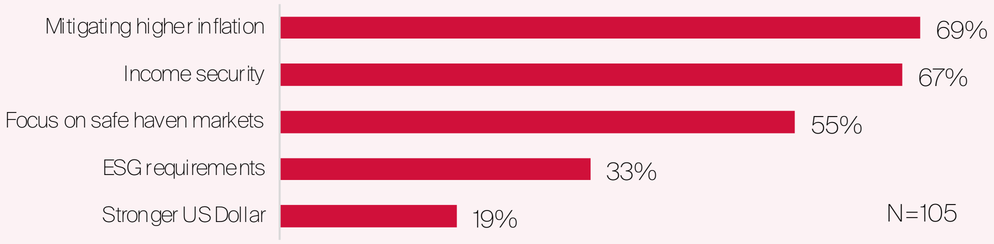
We expect increased demand from dollar-denominated investors from North America, the Middle-East, and parts of Asia, looking to take advantage of the strong currency and diversify their portfolios into the core markets of the region. These investors are watching the re-pricing of markets closely and are ready to move quickly when conditions are stabilising.

*4. Dominance of Private and Sovereign Investors*

The final key theme in the short term will be the increased dominance of private and sovereign investors. With longer horizons and deep pockets, such investors are prepared to move quickly to secure prime assets while there is limited competition. Singapore has seen a huge influx of family offices from the US, Europe and China over the last two years and we see these private investors being the most aggressive buyers for trophy office assets in the region's safe-haven markets.

**Figure 15: Poll result about investment strategy**

Which are the top 3 themes influencing your investment strategy?



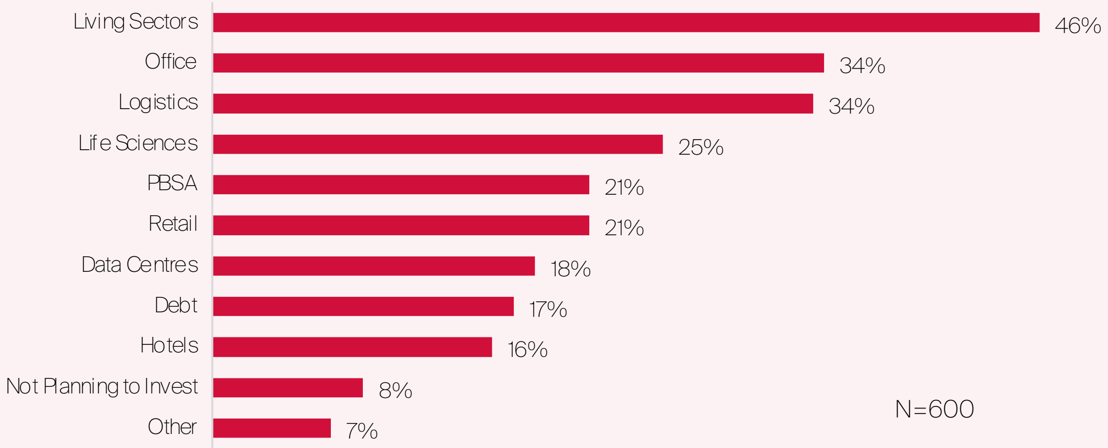

*Source: Knight Frank Research, Active Capital: Rising Capital in Uncertain Times Webinar (June 2022)*

## Outlook

The sharp increase in the cost of debt has repriced risk assets. Volatility will hold up transactions in the short term as investors seek price discovery in the various markets. With central banks still on a hiking cycle, investors preferring to remain side-lined will constrain deals. While investment volumes in 2022 are normalising from the high base set in 2021, the market has evidently slowed in the latter part of 2022 as deals take longer to complete.

**Figure 16: Investor preference for type of real estate**

Which top 3 sectors are you targeting over the next 18 months?




*Source: Knight Frank Research, Active Capital: Real Estate Strategies for Volatile Times Webinar (October 2022)*

However, real estate is cyclical, and activity can be expected to pick up in the latter part of 2023 as the macroeconomic picture stabilises. We expect sectorial strategies to dominate as investors will turn more selective on capital deployment. Overall, real estate offers good diversification benefits with a relatively low correlation to equities and bonds. Therefore, risk-adjusted returns for direct real estate are unlikely to re-price to the same extent as indirect. There remains a large pool of capital waiting to be deployed into direct real estate once bid-ask spreads narrow.

## Upsides on the Horizon

With much of the known risks largely priced in and likely to have overshot on current negativity, there remains potential for these to surprise on the upside, and rapidly shore up sentiment. As much of the current volatility is largely policy induced, the possibility exists for these to be rolled back.

**China's COVID-Zero Pivot:** China's zero-tolerance stance has been one of the main drags on global and regional economic growth. However, these were eased in late 2022, as authorities reduced the duration of quarantine for inbound travellers from seven days to five. While the changes are still incremental, it is a positive development that could set the tone for more calibration and an eventual exit in 2023, paving the way for higher inbound and outbound cross-border capital flows.

**Peak Inflation:** While a victory against inflation has not been declared, the Fed has recognised the lagged effects of its cumulative rate hikes, which could hint at a slower pace of increase going into 2023. Nascent signs of slowing inflation have also crept into the Fed's data in the last quarter of 2022, indicating peaking pressures. While it remains to be seen if this can be sustained, a more visible macroeconomic outlook will be crucial for a narrowing of bid-ask gaps while lower-than-expected terminal rates can no doubt be a shot in the arm for deal activity.

**To download the Active Capital Report**

Click Here

# Sectorial Strategies to Consider

| Sector | Investment Thesis | Market |
|---|---|---|
| **Office** | • Offices remained the main target for investors, as the region led the return to work – mainly focused on newly built offices in safe-haven markets. There remains a good base of all-cash buyers or lowly geared regional core funds keen to buy prime offices with inflation-hedging characteristics when pricing has adjusted. | • Singapore |
| **Data Centres** | • Data centre transactions have increased sharply in Asia-Pacific. Driven by tenant demand from cloud service providers moving into Southeast Asia, Australia, and Japan, there is strong demand from global investors to fund developments in these locations. | • Australia<br>• Japan<br>• Southeast Asia |
| **Living Sectors** | • Living sectors tend to perform well in a downturn and possess strong structural fundamentals with good inflation-linked rental growth prospects. Demand will likely increase from offshore investors due to the low borrowing costs and sought after for its resilient income profile. The build-to-rent sector in Australia is poised for growth as major cornerstone investors enter the market, attracted by the solid immigration levels and softer house prices. | • Australia<br>• Japan |

To learn more about Living Sectors

Click Here

To download the Global Data Centres Report

Click Here

*"With the global economy going through a fundamental reset, the lower-for-longer rate environment is rapidly shifting into one that will be defined by higher interest rates and inflation. By tapping into the shifting demographic and digitalisation trends and staying on the right side of sustainability megatrends, we believe real estate markets in Asia-Pacific, with its diverse economic and urbanisation structures, can be critical in the construction of defensive and inflation-hedged portfolios. While differing opinions on valuations are tempering current market activity, opportunities will likely materialise into the latter part of 2023, when markets trace a new equilibrium and more motivated sellers emerge in the higher-rate environment.*

To watch Neil Brookes' full interview

Click Here

***Neil Brookes,***
***Global Head of Capital Markets***

# We would love to help you with your real estate strategies, contact us to get the conversation started!

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